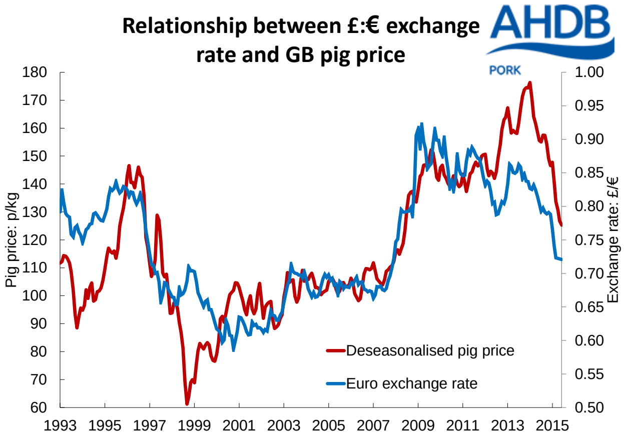
How does the exchange rate affect the GB pig price?

One of the main developments affecting UK agriculture recently has been the strengthening of the pound against the euro. The recent highpoint for the value of the euro was in July 2013, when it was worth 87p. Between then and the end of 2014, the euro gradually reduced in value, reaching the end of last year worth about 78p. Then in January and February the euro devalued significantly. Since then the exchange rate has fluctuated but overall the euro has weakened still further and has recently been worth only 70p.

These movements are important for the pig industry. Historical trends confirm that there is a close relationship between pig prices and the exchange rate. Analysis shows that over 60% of the variation in pig prices can be explained by the exchange rate alone. There are times when supply and demand factors outweigh the exchange rate, such as in 2012 and 2013, when prices were higher despite the euro being somewhat weaker than in 2009-11. However, the long-term relationship is normally re-established fairly quickly.



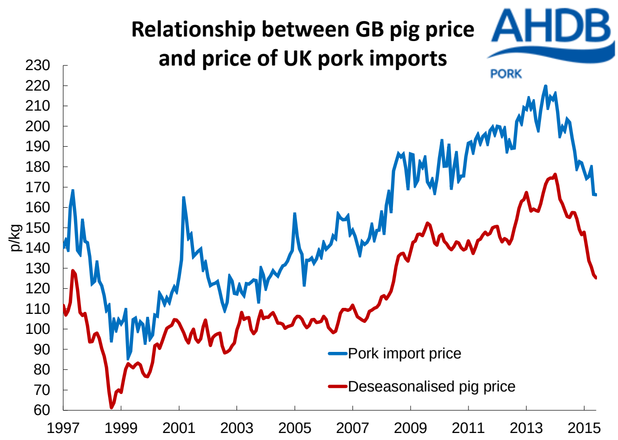
Source: AHDB, European Central Bank

On average, for every 1p decrease in the value of the euro, the pig price falls between 2p and 3p. Therefore, a fall of 17p, such as the one seen over the last two years, might be expected to coincide with a fall of around 40p in the pig price. The actual fall over that period has been of about that size, confirming that the exchange rate probably had a significant influence on the price drop.

The close link between the exchange rate and the GB pig price is mainly because of its impact on the UK's pork trade. With more than half of the pig meat consumed in the UK imported from the rest of the EU, the price of imports is particularly influential on the domestic market.

Normally, when considering the impact of imports on the domestic market, we compare UK and EU pig reference prices. These have the advantage of being available on a weekly basis and within a few days of the pigs being sold. However, EU farmgate prices don't necessarily follow the same trend as the price of UK pork imports. It is the latter which will have the biggest influence on the UK market.

Prices of imports are higher than GB farmgate prices because they are mainly made up of cuts, so include the costs associated with initial processing. The gap between the two has been fairly consistent over time, with import prices around 30% higher, albeit with some short-term fluctuations.



Source: AHDB, European Central Bank

The price of pork imports will be affected by a number of different factors. As well as prices on both sides of the channel, the exchange rate is obviously important. In sterling terms, import prices in the first five months of 2015 were 16% lower than two years earlier and GB pig prices fell at about the same rate. The importance of the exchange rate, though, is emphasised by the fact that the import price in euro terms was only 4% down over the same period.

One interesting feature is that the import price has steadily diverged from the EU pig price in sterling terms. In the late 1990s, import prices were around 30p/kg higher than the EU pig price; the gap is now closer to 70p/kg. This is partly because the mix of products has changed. In particular, fresh boneless cuts (which have a high unit price) now make up around 30% of imports; in the late-1990s they accounted for less than 10%.

Based on this analysis, it is possible to estimate what the GB pig price might have been had the exchange rate not moved. The increased supply in both the EU and UK would have meant that it still moved down. However, the fall would have been smaller and GB prices in recent months might have been around 15-20p higher than they are. This does suggest that, with the euro apparently unlikely to strengthen against the pound in the near future, it will be difficult for GB prices to regain lost ground, especially if EU pig prices stay low.

This analysis shows that the exchange rate has a clear link with GB pig prices via imports. However, this is not the only way in which the exchange rate affects the pig market. Other aspects will be examined in an upcoming article.