THE CURRENT STATE OF THE UK PIG MARKET

Briefing Document

Overview

The UK pig market has been going through tough times lately, with producers feeling the strain of low pig prices and lack of demand. This document aims to provide an overview of what is currently happening within the industry to cause these downward pressures.

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Executive Summary

The UK pig industry is facing tough times. The average pig price has fallen steadily since late 2013, with pigs losing a third of their value in that time. Price falls have accelerated in the past 12 weeks, losing 13p/kg (around £11 per head) in that time. As a result, many pig producers are now losing money and there is an increasing risk that some will decide to leave the industry, affecting the level of UK pork available to the market.

This comes in a climate where production continues to rise as efficiency and productivity improve and record weights are being seen, all leading to more pig meat on the market. At the same time, demand for pork has dropped, even though the price is falling. UK pork is having to battle hard against cheaper EU imports, exacerbated by the weakness of the euro against sterling and a supply glut on the continent due to increased production and closure of trading routes to major export partners.

This document aims to provide an overview of the pig industry in the UK and a round-up of the state of the market.

Summary Points:

- UK pig production has been consistently higher in 2015 and 2016 to date – with more, heavier pigs
- Retail purchases of pork have been decreasing, despite falling prices. Consumers are increasingly switching to more convenience based foods, where pork does not feature strongly, as well as to chicken, and the image of fresh pork is becoming dated and jaded, a trend which the current Pulled Pork advertising campaign is aiming to reverse
- These factors have contributed to the downwards pressures on pig prices – currently at a near eight-year low; in real terms prices are the lowest since 2000
- UK pork has had to compete with cheap European imports, with a continental supply glut, accompanied by a weak euro
- This has further driven down the value of UK pork – although export volumes have grown slightly, especially with global export partners such as China
- There is little sign as yet of any herd rationalisation in the UK, as the falling cost of production helped to cushion some of the price falls in 2015
- However, pig prices are now at a level which is lower than average producer cash costs, so we are likely to start to see producers leaving the market and breeding herds becoming rationalised
- This activity has already been seen in some EU member states.

The Current Structure of the Pig Market

Pig farming is most concentrated in the east of the country – East Anglia and Yorkshire. This is where the feed is produced, so sensibly pig production lies close to this. Over the past years, the pig production industry has become more concentrated. Nearly 90% of sows reside on less than 1,000 farms, which each house more than 100 sows.

Uniquely, 40% of the British pig herd is outdoor bred, which is a major factor of differentiation when compared to the global pig production methods. As well as this, other animal welfare standards in the UK are higher than in most other countries. For example, the use of sow stalls is completely banned in the UK, while sows in the rest of the EU can still be kept in stalls for up to four weeks after service.

The supply chain is dominated by a few large processors and has become increasingly vertically integrated over the past decade. Most pork is bought by consumers from multiple retailers, who make up nearly 80% of the food retail market.

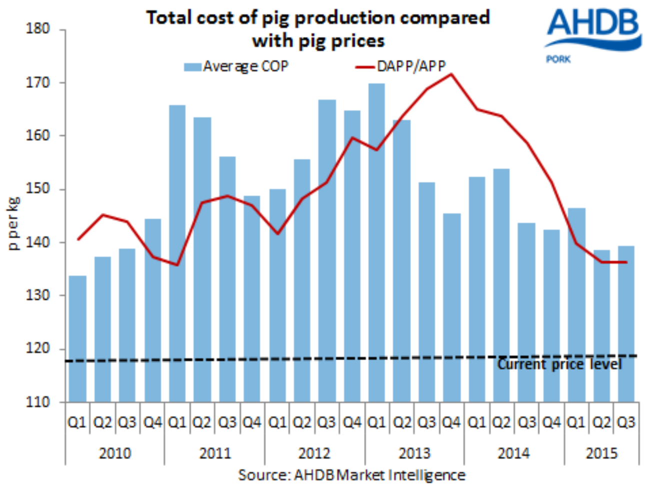
Only around 40% of pig meat consumed in the UK comes from British pigs and the country's demand relies heavily on imported products. Around a quarter of home-produced pork is exported, mainly made up of cuts which are less popular with UK consumers. The most popular cuts (eg back bacon, chops/steaks, gammon and ham) are under-produced domestically, while the less popular cuts (eg shoulder, belly and offal) are over-produced. The majority of British pork imports come from four main countries: Denmark, the Netherlands, Germany and Ireland.

The Current State of the UK Market

Each quarter, AHDB estimates the cost of pig production during that period, based on spot prices for feed and other input costs. This allows the net margin to be calculated, comparing the cost of inputs with the income received for the pigs sold over the same period.

When comparing the cost of production (COP) against the all pig price (APP), we can see that producers' margins were largely positive during 2014. That started to shift in 2015, with a fall in pig prices. As the COP also fell in the same period, the impact of the falling pig price was softened for producers through much of 2015.

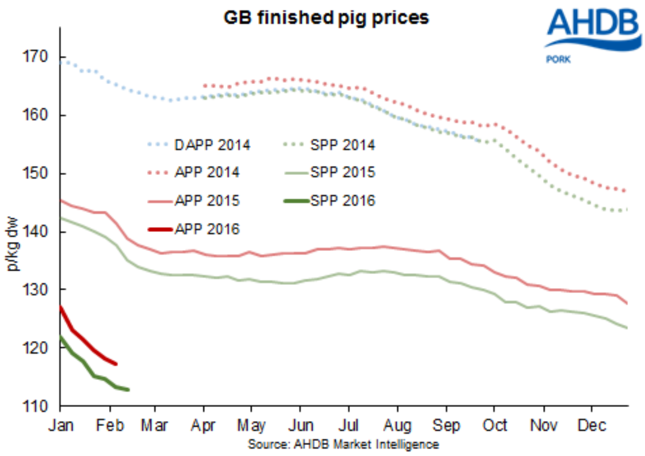
However, the current pig price is now well below the COP (which is unlikely to have changed much since the autumn, when the latest estimates were published). The price is now at levels that will be starting to hurt producers on a cash basis, as well as a full economic basis (where "hidden" costs are factored in, such as depreciation of fixed assets and family labour costs). As a result, we may well start seeing producers leaving the industry and there have been signs of this already.



Relationship with Pig Prices

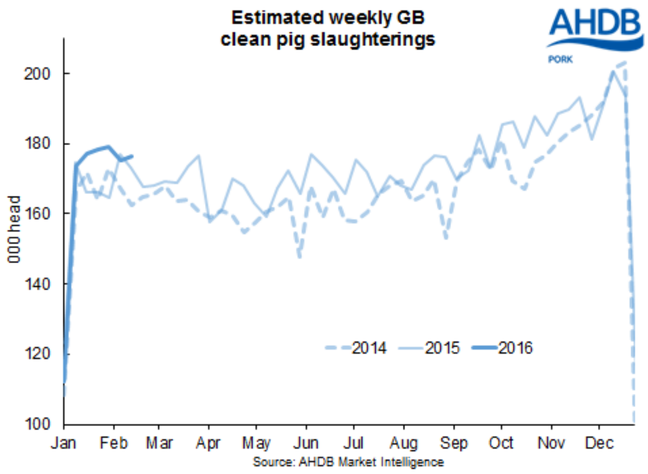
GB finished pig prices[i] have been on a downward trend for over two years, from a record high in late 2013, to a near eight-year low in February 2016. Over that time the value of pigs has fallen by a third. In real terms, pig prices are now at their lowest level since 2000. That was a period when the UK pig herd was shrinking significantly due to poor profitability, leading to a sharp rise in imports of pig meat.

The drop in pig prices has accelerated of late, with falls in the last 12 weeks (up to 13 February 2016). During this time, the price has dropped by 14p/kg (equivalent to around £11 per pig).

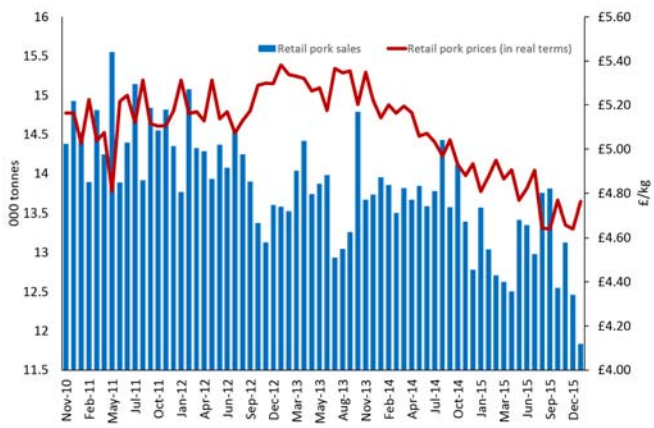


Pig prices, like most market prices, are largely a result of supply and demand forces. Expectations about levels of future supplies may affect the price to some extent but due to the perishable nature of the product, this is likely to be limited.

Over the same period, production levels have been increasing, with more, heavier pigs being produced. Pig meat production has been rising for over a decade and last year it overtook beef production for the first time since 2003. There are several factors behind this, including increased efficiencies, better genetics and greater integration within the industry.



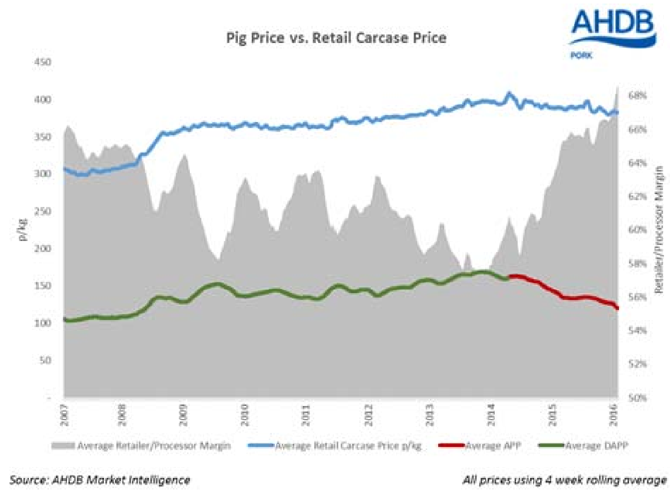
However, this rise in production levels has continued even though demand has been decreasing since 2014.. Despite the lower prices for pork products, retail sales have not increased. This has led to an oversupply of pork and farmgate prices have fallen as a result. As a rule of thumb, if retail prices decrease for a product then consumption will increase, as the product becomes more price attractive. However, this has not been the case recently for pork.



AHDB Pork is currently undertaking work to better understand the reasons behind the fall in demand for pork, which is also starting to affect other pig meat categories such as sausages and bacon. Existing research has shown that younger consumers do not identify with pork, and it would not be their meat of choice. Furthermore, there is an increasing demand for more convenient offerings, such as ready meals and chilled main meal accompaniments, and pork does not feature strongly in these categories. However, pork has seen a slight resurgence in demand in the food service sector, with the pulled pork and barbecuing/Americanisation trend growing from strength to strength.

Supply Chain Margins

The decrease in the pig price is providing a lot of pressure for producers in the market currently, while processors and retailers are feeling the pressure from the lack of consumer demand, subduing the price consumers are willing to pay for the product. The reduced retail price has not stimulated consumer demand for the product though, leading to further price reductions, which put more pressures on margins.



Pig prices increased until the end of 2013 and retail pork prices increased by a smaller amount (when averaged over the whole carcase), resulting in producers receiving a rising proportion of the retail price. This topped out at around 43%, which was the highest share seen since the mid-1990s.

However, since pig prices peaked at the end of 2013, they have been on a downwards trend ever since. The speed of this decline has not been matched by the retail carcase price, which has fallen at a much steadier pace. This has reduced the producers' proportion of the retail price to around 32% in the first month of 2016, the lowest level for well over a decade.

Pig producers receive a lower share of the retail price than other livestock farmers, with beef producers averaging 47% in January 2016 and lamb producers 49% in the same month.

Based on the cost of production for Q3 2015 (which is forecast to be similar to Q1 2016 based on a relatively stable feed price) and the current APP, producers are currently facing a loss of 20p/kg. If this level of loss is sustained throughout 2016, then total GB producer losses could amount to just under £150 million.

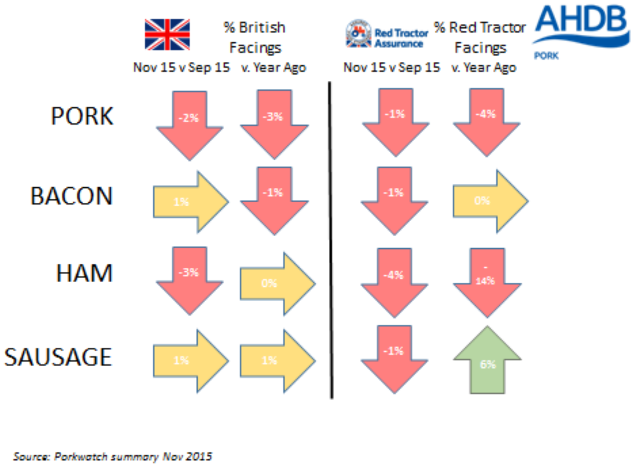
If processors and retailers passed back an additional 5% of the retail price to producers, this would allow the latter to operate at their breakeven point, unless there were any increases in the cost of production.

Even if this were done without increasing the retail price paid by consumers, the rest of the supply chain would still have margins similar to those at the start of 2015 and higher than those in 2013 and 2014.

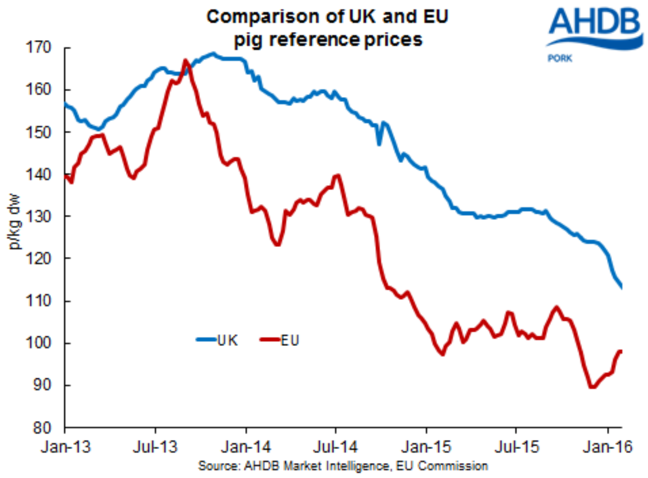
Imports and Exports

Following the “Horsegate” scandal in 2013, several of the major multiple food retailers switched to 100% British pork as customers were becoming increasingly concerned with the provenance of the food on their plate. Even though foreign cuts have been cheaper this year, those supermarkets which pledged to stock 100% British fresh pork have continued to do so.

However, those retailers which do not source all of their fresh pork from the UK have decreased the percentage of their facings devoted to British pork in the year to November 2015, when compared with the same period a year before. In addition, the share of bacon facings allocated to British bacon has fallen over the last year, while the share for ham and sausages is unchanged. This comes despite plentiful supplies of British pork being available, suggesting that decisions are price-driven.

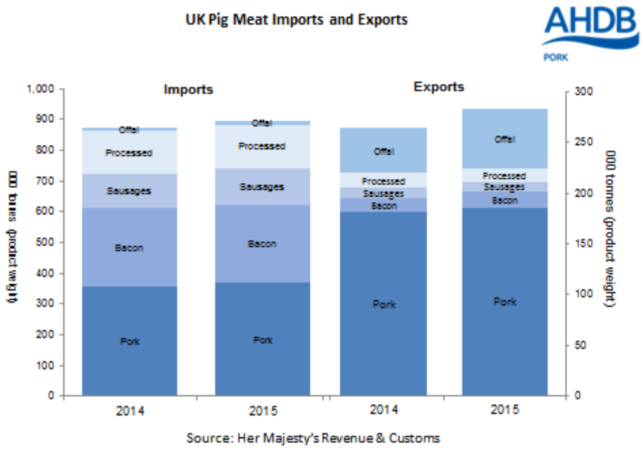


Import levels of (predominantly) EU pork only increased slightly in 2015, when compared with the previous year. However, lower import prices have meant that domestic prices have had to decrease to be able to stay competitive. This has caused downwards pressure on the UK price, although the premium over EU prices is still high by historic standards. On a more positive note, the euro has started to strengthen against sterling in 2016, which will make UK product more competitive against its European counterparts.



Some of the oversupply on the domestic pork market has resulted in greater volumes of exports. This is particularly prevalent for the Chinese market, where we saw exports increase by 10% in 2015, when compared with the previous year. There was also a growth in exports to Ireland (+11%) and the United States (+84%), but these were somewhat offset with decreases to the Netherlands (-8%) and Belgium (-20%).

Exports were most increased for offal, which was driven by the Chinese market. However, while the export opportunities to China are welcome at a time when there is a supply glut in the UK, the economic slowdown in China and recovery of its own pig production could make this market more challenging in 2016.

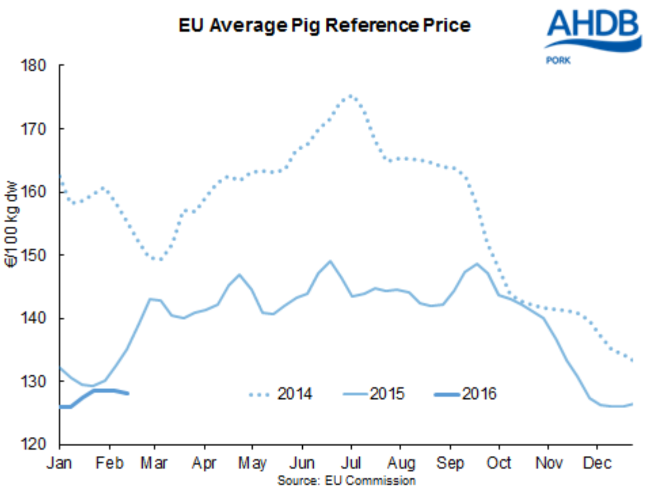


The European Situation

UK pig prices have historically commanded a premium over their European counterparts, driven by consumer preferences and the higher standards of welfare by which pigs are produced here. EU regulations came into effect in January 2013 to raise pig welfare standards across all member states, including the partial banning of sow stalls. Since the EU-wide ruling, there have been certain member states which have had complaints filed against them for non-compliance.

The UK has legally enforced these welfare standards since the late 1990's and indeed, UK standards remain higher than those applied elsewhere. This impacted on the efficiencies in number of pigs produced but demonstrated the UK's commitment to produce a high welfare product as a point of differentiation. Sweden operates to a similar voluntary level of welfare illustrated by the UK but according to a recent Business Benchmark on Farm Animal Welfare (BBFAW) report, the UK scores highest for animal welfare levers amongst all livestock production.

Production levels in the EU have increased strongly in 2015, putting further pressure on prices. With consumer demand on the continent remaining subdued, this has resulted in the EU average pig price at the turn of the year being at its lowest level since the end of 2010.



While the UK did not trade directly with Russia, other EU member states had strong trade links with it. Therefore, the ban on EU food imports imposed by Russia caused a flood of European pork and other pig meat products to become available. As the EU is a net exporter of pork, this meant exporters had to seek alternative trading partners. Whilst most of the volumes have been able to be shifted elsewhere (especially China), this has been at the expense of value, and UK pork has had to compete on this stage.

With EU pig prices substantially lower than those in the UK over the last two years, while input costs were only slightly lower, European producers have been in a worse financial position than their UK counterparts. This is likely to mean that some member states are starting to rationalise their herds, potentially leading to a tightening of pig supplies later in 2016. Results from the December census confirm this, with the EU pig breeding herd declining by 2% during the year.

Moving into 2016, European prices have started to firm up, at a time where the UK price is still falling. As well as some early signs of tightening supplies, this can also be partly attributed to the launch of the Private Storage Aid scheme (PSA) on the 4 January. This has since been suspended (27 January) with the intention to close, after temporarily removing almost 90,000 tonnes of pig meat from the market. However, EU prices have remained largely stable in the wake of the PSA scheme closure. Nevertheless, there are already cries from industry leaders that it is paramount that the scheme is opened again or other steps are taken to avoid further price falls.

The current weakening of sterling against the euro will also start to make UK pork more competitive against its European counterparts, although the volatility in the exchange rate and the impending Brexit referendum will have an uncertain impact on the direction of movement going forwards.

In Conclusion…

Pig meat supply has increased over the past three years with more, heavier pigs coming to market at a time when demand for them has been subdued. This has led to a dramatic decrease in the pig price from a record high in 2013 to a near eight-year low moving into 2016. Coupled with this, a ready supply of cheap European pork has put further downwards pressure on UK prices, both on a domestic market and the global export stage.

Currently, it is too early to state whether the pig prices will force many producers to rationalise their herds or leave the market. We have seen little evidence of this to date, but margins are now such that this could become a reality – especially if pig prices were to reduce much further or production costs increase. Glimmers of light on the horizon are the first signs that the European supply of pork may tighten in the second half of 2016 and the fact that sterling is beginning to weaken against the euro, making UK pork more competitive on the global stage.

[i] In October 2014, the DAPP (Deadweight Average Pig Price) was replaced with the GB SPP (Standard Pig Price) and the GB APP (All Pig Price) in response to changing industry needs for pig price reporting. The GB SPP is made up of only "standard" pigs ie these are pigs where no premium is paid for a specific attribute other than weight or grade. Pigs on which premiums exist for certain production systems, feed regimes or breeds, including schemes such as Freedom Foods are not included. The GB APP is made up of standard and non-standard pigs.