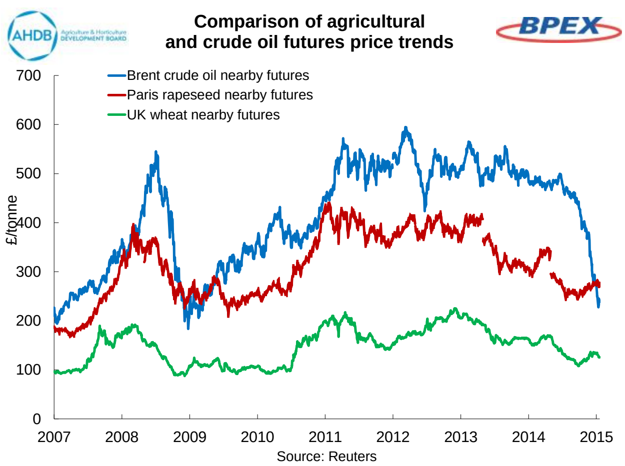
The far-reaching effects of low oil prices on agriculture

The fall in nearby Brent crude oil futures to under $50/barrel, from over $115/barrel in mid-June, is likely to have far reaching effects on agriculture both in the UK and worldwide. Despite currency movements, crude oil prices in sterling terms have also lost over half their value since June. This has come on the back of strong increases in world oil production. Oil's interaction with grain and oilseed prices will have a larger impact on agricultural margins for both arable and livestock farmers than lower oil costs directly.

For livestock sectors, the effects of lower oil prices on grain and oilseed prices will have a significant influence on feed costs. For pig production especially, feed costs represent over half the cost of production, so it is through this channel that lower oil prices will have a greater impact on margins than through lower energy costs.

However, while it is straightforward to assume that oil-induced movements in grain prices will reflect in lower feed prices, the impact from oilseeds is more complex. If rising liquid fuel consumption supports demand for vegetable oil due to biofuel mandates, demand for oilseeds to crush would be supported. All other things being equal, however, this would increase oilmeal supply, putting downward pressure on the price of these key feed ingredients.

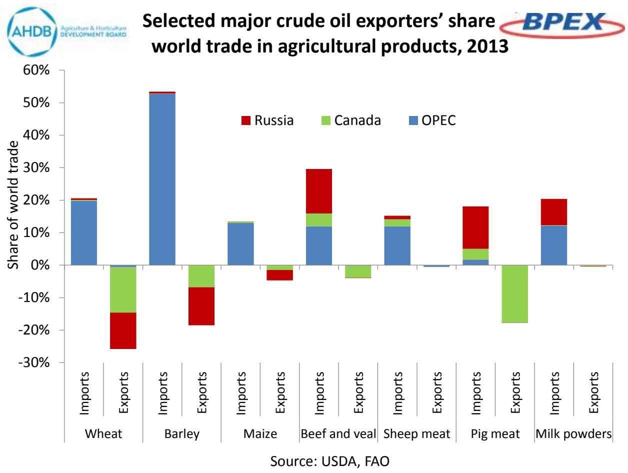


Lower oil prices also play a role in lowering fuel and energy prices. If lower fuel prices prevail, it should take some pressure off farm cash flows due to lower costs for running machinery and for heating, lighting and drying crops. The costs of product transport can also have an impact on margins, both directly and indirectly. Directly, it can help reduce the disparity between the price a purchaser pays and that which a farmer receives (both for inputs and outputs).

Fuel costs are also the largest cost item of the highly competitive global shipping industry, suggesting that fuel savings will likely result in lower international freight rates. By increasing the distance a product can be moved at a set cost, this exposes all farmers to greater competition – essentially making the world feel smaller. Depending on costs of production relative to elsewhere in the world, this can present both an opportunity and a challenge.

Oil prices are largely influenced by supply. The increases in production in 2014 came predominantly from North America (driven by fracking) and are forecast to continue. Thus, it is other oil producing areas that will be expected to suffer the largest reductions in oil revenues, which will put pressure on those economies that particularly rely on oil exports.

For oil exporters which are also exporters of certain agricultural products, such as Russia for feed grains, the effects are arguably already being seen, with grain export tariffs, for example, helping support diminishing state revenues. For agricultural importers in the category, especially OPEC members (which account for half of global barley imports, for example), reduced funds to pay for imports could lower some demand for agricultural products, although imports of higher-end products will likely feel the worst effects from this.



On average, however, and for the UK and Europe in particular, lower oil prices are expected to benefit economic growth. Estimates by the IMF suggest a 0.3-0.7% addition to global GDP in 2015 from the existing fall in the oil price. The flipside of many agricultural products being 'necessities' for consumers, however, is that any upside effects to demand felt by agriculture may be limited.

It's clear that falling oil prices are likely to have far-reaching effects across the global agricultural markets. For UK pig produces, the impacts are likely to be largely beneficial. Direct cost of production gains from fuel costs may be limited but the interaction of crude oil prices with feed grain and oilseed prices may mean a noticeable reduction in costs. Furthermore, the wider economic impacts will, if anything, mean improved global demand for pig meat and, through reduced freight costs, greater competitiveness of UK (and EU) product on key export markets, such as China.