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Prospects/Outlook

The strong improvement in aggregate farm income levels in 2008 has been largely resilient through 2009, although a small reduction is anticipated in 2010. Across individual sectors, performance is expected to be mixed. Cereals and dairy incomes are likely to remain under some pressure (high global stocks putting downward pressure on commodity prices), but the livestock sector continues to be characterised by strong prices, underpinned by the weak exchange rate. Indeed, agriculture tends to be countercyclical to the wider economy, with a weaker £ helping support farm incomes (higher price for imported foods; stimulate demand for exports).

Domestic demand for foodstuffs and agricultural products has remained relatively constant through the recession, whilst the recovery of global demand is also driving increases in world market prices (e.g. have seen some recovery in global dairy product prices in second half of 2009). UK shoppers have trialled other stores and downgraded some of their purchases, but premium foods have also been viewed as an affordable luxury. Although some product sectors (most notably organics) have seen a significant drop in demand, consumers have not readily traded off their values for value which has benefitted locally produced foods and items of similar provenance.

According to Bank of England statistics outstanding lending to agriculture increased by 5.7% between Q3 2008 and Q3 2009 credit facilities grew by 2% meaning credit facilities remaining shrank by 13%. Agriculture is now using 83% of its available credit compared with 80% in 2008. Lending to agriculture clearly remains strong, with the major lenders all committed to supporting their farming clients. With more preferential rates, banks have encouraged farmers to restructure their lending, although arrangement fees and terms are reported to have increased significantly. Anecdotally, we are hearing that access to funding for farm diversification projects is harder to come by, with lenders favouring core farming activities.

Weather created some challenges for agriculture. Vegetable harvesting, milk collection, and obtaining feed for stock were the major issues, which will have had some impact on both revenues and input costs depending on the type of farming sector. It is difficult to look at the longer term impact of the 'cold spell' on lambing percentages, in the ground crops, etc. but we do not anticipate that it has impacted significantly on farming fortunes for the year ahead overall.

Business Investment

Heavy investment in tractors and machinery was seen during 2007/08 but has fallen through 2009, with the trend likely to continue. Better prices in livestock may result in some investment by this sector, although it would still take a continued stabilisation of prices to encourage a reversal of the decline livestock numbers that has characterised UK livestock production. Poultry farmers are likely to need to step up investment in production systems to comply with EU regulations in the next year. The recession is likely to mean farmers will be reluctant to risk investing in retail and tourism in the near future.

The majority of farm assets are comprised of land and buildings. Although it is unlikely that lifestyle buyers will return to the market anytime soon, farmland values remain high and these are assets provide owner occupiers against which to borrow. Tenant famers do not have such security for their loans, instead borrowing against existing capital (in the form of machinery and livestock). At present,

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access to finance remains relatively favourable as indicated previously. Although businesses will have money to re-invest into their businesses in 2010 it is not likely to be at the same levels as in the recent past, particularly in cereals and dairy which are typically the sectors where most agricultural investment occurs. As farm businesses are small enterprises profits tend to be used for family income and any surplus is used for investment. A small change may lead to vastly reduced profit used for investment.

The rise in lending indicated earlier demonstrates that finance is available to most businesses however as agriculture utilises more of its credit facilities some investment inevitably will not take place.

Labour Market

Employment numbers in 2008 increased, partly due to a big increase in planted crop area and a need for labour requirements, and provisional 2009 data shows a small increase in the total agricultural labour force. Employment in the sector is anticipated to remain at similar levels.

The Agricultural Wages Order settlement for Grade 1 workers was 1p above the minimum wage and 2.2% increase for all other grades. This will impact on wages paid to farm workers for the majority of 2010. Labour is a key issue for horticulture above all other sectors, with large numbers of low-skilled, seasonal staff required to harvest crops. Within horticulture, there are concerns that the competitiveness of the sector will be impacted by these wage increases as well as NICs changes.

Costs/Prices

Collectively, input costs to farming fell in 2009 compared to 2008. Key inputs to farming are fertiliser, fuel and feed. Prices of all of these are at lower levels than they were 12 months ago (significantly so for fertiliser) and this is helping to offset price rises seen in other inputs. Based on NFU estimates, farming's spend on inputs like seeds, electricity, contractors charges, materials & buildings, and vets charges are all on an upwards trend. Of particular interest at present is the upwards trend in energy prices, which will in turn influence the fertiliser price. A continuation of these trends will have a significant impact on margins for farm products in 2010.

Farming finds it notoriously difficult to pass on shifting prices in costs to their customers. Some sectors and buyers are more responsive than others (e.g. McCains and potatoes; liquid milk and dedicated retail supply pools), but overall increasing production costs are seldom reflected by higher prices. Instead, it has been the exchange rate that has effectively pushed up the cost of imports to food buyers, allowing UK prices to increase accordingly. The £ is widely expected to strengthen which will impact price levels achievable by farmers. However, we will be playing close attention to the development of a supermarket ombudsman which we envisage will play a key role in improving the ability of farm businesses to pass on cost increases to customers.