Economic News and Views

AEA looking forward turning opinion

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[UK regs delayed](#)
[New Year reflections](#)
[Farmers confident of short-term but not further ahead](#)
[New EU farm rules enter force](#)
[Milk matters](#)
[New report aims to drive productivity growth](#)
[UK wheat market least volatile in a decade](#)
[South American rains ease soya concerns](#)
[Consumers hit by food price rises](#)
[Manufacturing outlook remains solid](#)


***Key data at a glance** (last full week/month unless stated)*

| | Latest | Change on week/month | Change on year |
|---|---|---|---|
| **Agricultural Equipment, November** | | | |
| UK tractor regs (>50hp) – monthly | 769 | n/a | +28.8% |
| UK tractor regs (>50hp) – MAT | 11,188 | +1.6% | +4.7% |
| **Farm outputs** | | | |
| UK feed wheat (£/tonne) | n/a | n/a | n/a |
| UK feed barley (£/tonne) | n/a | n/a | n/a |
| UK rapeseed (£/tonne), w/e 22/12 | 311.0 | -3.0 | -48.0 |
| GB potatoes (£/tonne) | n/a | n/a | n/a |
| UK milk – monthly, Oct (p/litre) | 31.88 | +0.09 | +6.34 |
| GB prime cattle (p/kg) | 363.9 | +1.2 | +10.1 |
| GB lambs (p/kg liveweight) | 189.6 | +11.6 | +21.1 |
| GB pigs (p/kg) | 149.78 | -0.62 | -2.12 |
| **Farm inputs – monthly figures, November (£/tonne)** | | | |
| Big bale hay | 65 | +9 | +14 |
| Big square bale barley straw | 72 | +14 | +29 |
| Big square bale wheat straw | 66 | +14 | +28 |
| Red diesel (p/litre) | 55.4 | +2.0 | +3.6 |
| **Economic indicators, Wed close** | | | |
| Exchange rate £ v € | 1.125 | -0.002 | -0.049 |
| Exchange rate £ v US$ | 1.353 | +0.012 | +0.123 |
| Aluminium ($/tonne) | 2240.0 | +41.0 | +540.0 |
| Brent crude oil ($/barrel) | 67.84 | +1.40 | +11.38 |

## UK regs delayed

Publication of December's UK tractor registrations has been delayed by a few days. This is because, in the run-up to the end of the year, DVLA rejected a significant number of applications because they were being registered for agricultural use (which would mean that they are tax exempt) but there was insufficient evidence provided to support this.

DVLA have now advised us that the applications for December that were rejected can still be processed as December registrations provided they're received in the near future. The application will either have to be provided with the correct evidence to support agricultural use or they will have to be registered with payment of the appropriate fee for vehicle tax.

In order to ensure that the figures we publish accurately reflect the number of tractors registered in December (and, hence, for the year as a whole), we have taken the decision to delay publication until we receive any registrations affected.

## New Year reflections

As one year ends and another one begins, it is traditional to reflect on the previous 12 months and look ahead to what the next 12 months might bring. With 2017 being my first year with AEA, I haven't got any previous experience to compare it against but I'm sure you'll indulge me if I give you my reflections (you can always skip to the next article, though).

Although not without its challenges, 2017 will go down as a good year for the UK's agricultural machinery sector, at least by recent standards. Responses to AEA's monthly barometer have consistently shown that most members regarded the business environment as satisfactory, with orders above 2016's level, with our statistics generally backing that up. It was also a better year for the industry globally, with sentiment improving virtually everywhere.

As an example of the improvement, registrations of new agricultural tractors had already passed last year's total by the end of November. With December's figure likely to be inflated (see above), the final tally will probably be up by

over 1,000 on 2016. That will be only the second year-on-year rise in nine years and the first since 2011. Most other types of machinery have also seen improved sales, although there have been some exceptions, such as drills, forage harvesters and sprayers. As those are towards the more expensive end of the machinery range, they will have held back value growth to some extent. However, with much of the machinery sold in the UK being imported, prices will have gone up, so the turnover of the farm equipment sector should have increased when the final sums are done later in the year.

Adding to turnover growth, our UK-based manufacturers have benefitted from the weaker pound, allowing them to increase their export sales. The value of machinery exports was up 14% in the first ten months of the year. Many exporters are working to build markets outside the EU, in case of any Brexit-related disruptions ahead, although the EU share of exports in the year to date was the same as in 2016.

The exchange rate has also had a favourable impact on the fortunes of British farmers. Although it has pushed up some input costs, this has been more than offset by higher prices for the majority of farm produce during 2017. Most UK products are competing with the EU or global market and a weak pound makes imports more expensive and exports more competitive. That increases demand for UK-produced food, at home and abroad, and pushes prices up. Most global prices have been rising anyway, particularly for dairy products, strengthening the UK market further. The exchange rate also means higher CAP payments for farmers, as they are set in euros. On top of that, a better growing season this year has increased output across most types of produce, particularly crops, boosting farm incomes further. This is the main reason for the machinery sector having a better year, after all our sales depend more than anything on our customers' ability to pay.

But could last year have been even better? Taking into account farm finances and other factors such as the weather, arguably machinery sales might have been higher still. Certainly, AEA's forecasting model suggests that should have been the case. As further evidence, respected farm consultants Andersons have estimated that Total Income from Farming (effectively net farm profits) in 2017 will have been around £4.7 billion. The last time it was that high was in 2012, when tractor registrations were almost 14,000 units. In 2017, they will probably have been around 12,000, even with the inflated numbers registered at the end of the year. That difference is too big to be explained by increases in power alone. With sales of other big-ticket items, such as sprayers and harvesters, also subdued, there is perhaps a suggestion that farmers (and contractors) are being cautious about making big investments while uncertainty about what the post-Brexit future will look like remains.

Brexit is, of course, the biggest issue on the horizon for the industry. Any direct effect so far has been limited and that may continue to be the case in 2018. Over the course of the next year, though, we should get more clarity about what life will be like after 29 March 2019. Firstly, by March we should have an idea about whether there will be a transitional period and how long that might last. Later, we will start to find out more about the long-term trading relationship, even if the fine details aren't ironed out until next year and beyond. Of course, we might not get a deal at all, in which case we will be preparing for trading with the EU on WTO terms.

During the course of the year, we should also get an indication of what future UK agricultural policy will look like. Ultimately, the most important factor for our industry will be the level of funding available to farmers over the longer term, which probably won't be clear until we get closer to the next General Election. However, any support for investment in technology to improve productivity or protect the environment could be beneficial to AEA members, regardless of the total amount of support. If policy is better suited to the needs of UK agriculture, rather than the diverse mix across the EU, there is no reason why British farms couldn't thrive with less support anyway, even if there are some casualties along the way.

All of that makes it hard to predict what 2018 will bring. Early expectations are that the machinery market will be similar to 2017, with forecasts suggesting stability or slight growth for most types of machinery. Farmers look set to remain in a pretty good position financially, assuming the pound remains at a similar level against other currencies, although rising costs may take the edge off their incomes. Whether a second year of good profitability will loosen the purse strings remains to be seen. Uncertainty could work both ways – some may decide to invest in improving efficiency while they can, rather than risk being left with ageing machinery and no money to replace it; others may decide to hold on to their cash until they know what the future holds. Whatever happens, it looks certain to be another interesting year ahead, so we should have no shortage of things to write about. Hopefully, that will give you plenty of reasons to keep reading this newsletter as we try to make sense of it all.

### *Farmers confident of short-term but not further ahead*

Results from NFU's biannual Farmer Confidence Survey shows that the majority are feeling positive about short-term prospects (for the next year) but are much less confident about the medium-term (three year) outlook. All sectors were optimistic about the coming year, with dairy farms the most buoyant, although overall the confidence index eased back slightly from April's four-year high. Improved prices and larger subsidy cheques are no doubt among the main contributory factors. However, inflationary pressure on costs, along with the uncertainty associated with Brexit has knocked confidence in the medium-term, which was at the lowest level recorded in the history of NFU's survey. The most gloomy sector is arable but mixed and grazing livestock farms are also pessimistic. The view among dairy farms is balanced between those who are positive and negative.

NFU supported by
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When asked about the main influences in 2018, the biggest negative effect was considered to come from input prices, with regulation, Brexit and economic conditions also cited as negatives by over half of NFU members. Views on output prices and supply chain issues were more balanced, while the biggest positive influence was an expectation that consumers would be more inclined to buy British.

The survey also showed that twice as many farmers are planning to reduce investment (20%) than increase investment (10%) because of uncertainty associated with Brexit.

### *New EU farm rules enter force*

A raft of changes to EU farm rules came into force on 1 January 2018, aimed at simplifying and modernising the CAP. These form part of the so-called 'Omnibus regulations' and are effectively the mid-term review of the current CAP (2013-2020). The Omnibus regulations also cover other changes to the EU's Financial Regulations but the agricultural elements were agreed ahead of the rest, enabling them to come into force at the start of this year.

Among the key improvements included in the Omnibus are:

- Stronger support for farmers' position in the food supply chain. The new rules will include value-sharing clauses to be negotiated by every product sector and will give farmers the right to ask for a written contract for the first time (unless trading with SMEs);
- Simpler risk management tools to help farmers, including a sector-specific income stabilisation tool and improvements to insurance schemes that will allow compensation of up to 70% for farmers whose production or income is cut by at least 20%;
- Clearer rules governing intervention in markets, allowing the Commission to act rapidly to address market failures without having to use public intervention or private storage measures;
- Greater flexibility for Member States to support specific sectors of economic, social or environmental importance through voluntary coupled support, even when these sectors are not in crisis;
- Clearer rules on support for farmers, notably through more flexibility on the definition of active farmers and stronger incentives for young farmers, with an increase in additional payments from 25% to 50% and guaranteeing all young farmers the right to the full five-year allowance for these payments, regardless of when they apply for them within their first five years of their setting-up;
- Improved environmental measures, including simpler rules on crop diversification and the addition of three new types of ecological focus area focused on nitrogen-fixing crops, giving farmers and national authorities more options to suit their particular circumstances.

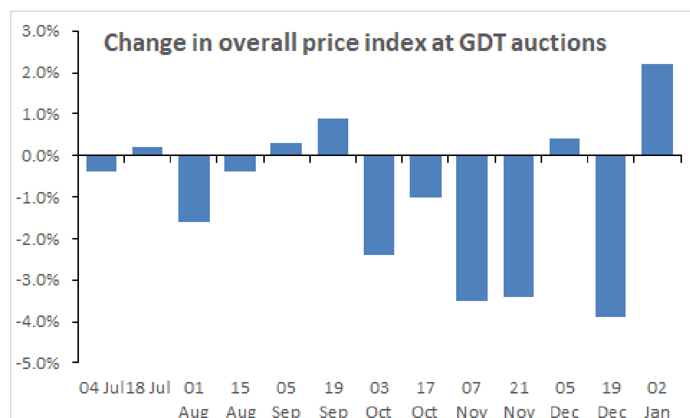
### *Milk matters*

There was little Christmas cheer in the dairy market, with UK wholesale prices slipping back further in December as plentiful supplies and thin demand took their toll. Although prices reported to AHDB were quite varied, the average butter price fell by another 11%, to just £4,000/tonne, which is only £300 higher than at the end of last year and well below the heights of the summer. Prices for cream, cheese and skimmed milk powder also dropped back and SMP was a third cheaper than in December 2016, while cream and cheddar prices were in line with 12 months ago.

Muller has confirmed that, following its 1.5ppl reduction on 1st January, it will now hold its farm-gate milk price until 1st March. Arla announced in late December that it would cut its price by 1.3ppl this month.

Defra has released revisions to milk volumes in England and Wales from January 2017 to October 2017 and this has had a minor effect on UK milk prices. This means that the average farm-gate milk price for November 2017, at 31.88p/litre, represents only a 0.3% (0.09 ppl) increase on October 2017 although it is still 25% up year-on-year. November milk volumes followed seasonal trends by decreasing 2.3% on the previous month to 1,164 million litres. Butterfat content levels increased 0.2% on October at 4.18% and were 1.7% down on November 2016.

The final Global Dairy Trade auction of 2017 recorded another decline in prices across the board, with the overall index dropping by 3.9% and cheddar by as much as 7.9%. However, the first event of the new year, held on Tuesday, saw the overall index bounce back by 2.2%, the biggest rise since May. This was mainly due to higher powder prices, although the steep decline in butter prices was halted by a small rise. This followed Fonterra, New Zealand's largest milk company, reducing its production forecast for the current season, due to adverse weather conditions (a wet start has been followed by dry conditions recently).

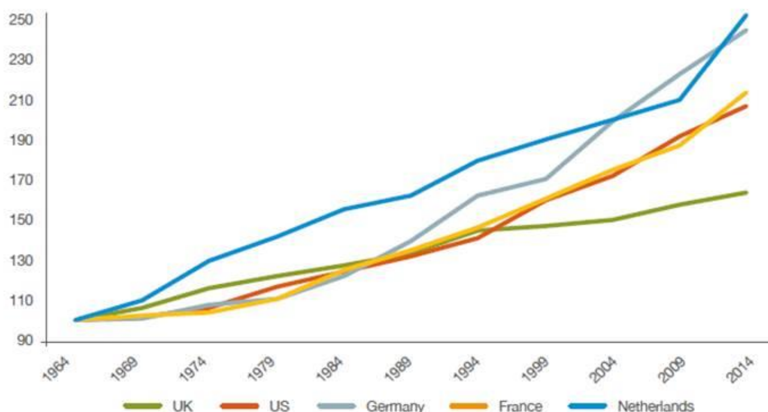



The EU Commission has outlined two working scenarios for the future of Skimmed Milk Powder (SMP) in intervention. Under both scenarios, the EU Commission is expecting to continue to hold significant intervention stocks of SMP for the foreseeable future, with a knock-on impact on SMP market prices. There are currently 375,000 tonnes of SMP in intervention, built up during the market downturn in 2016, with only very small volumes sold subsequently.

The first working scenario assumes SMP is released from intervention over the next three years with no additional purchases being made, assuming milk prices remain relatively high thanks to sustained butter prices. Under this scenario, 140,000 tonnes of intervention stocks will be released onto the market but this would still leave over 200,000 tonnes and SMP prices would remain low over the next 2-3 years. The second working scenario is that no SMP is released from intervention in 2018. Assuming higher milk production than in Scenario 1, more fresh SMP will be produced, reducing the need to buy from intervention stocks. Under this scenario, the Commission see the lack of sales from intervention putting upward pressure on SMP prices later in the year.

### *New report aims to drive productivity growth*

At this week's Oxford Farming Conference, the Agriculture & Horticulture Development Board (AHDB) launched a new report looking at how the productivity of UK agriculture can be improved. The report highlights how Total Factor Productivity (TFP) in UK farming has grown more slowly than in many other countries since the mid-1990s. It estimates that, had UK TFP grown at the same rate as in the US since 2000, UK farming's contribution to the rural economy would have been £4.3 billion higher by 2013. The report says that productivity is often misunderstood; it is not about how much we produce but how efficiently we produce it. Higher levels of productivity are a result of producing the same or greater output from fewer inputs.




Total factor productivity (TFP) annual growth 1964–2014

Improving productivity matters for two main reasons. It affects our ability to compete in increasingly competitive markets, whether that's at home or overseas, and it benefits our natural environment. The report identifies six major drivers of agricultural productivity growth: the business environment, natural capital, competitive pressures, policy, ideas and people. It concludes that the last two of these are what is holding the UK back relative to our competitors.

On ideas, agricultural R&D funding in the UK is reasonably strong, although behind some other countries, but is still skewed towards blue-sky, academic research rather than near market applications. Furthermore, innovation systems in the UK are fragmented, with no 'one-stop shop' of industry knowledge, making it confusing for everyone to know where to get information, limiting how effectively it is used to improve productivity.

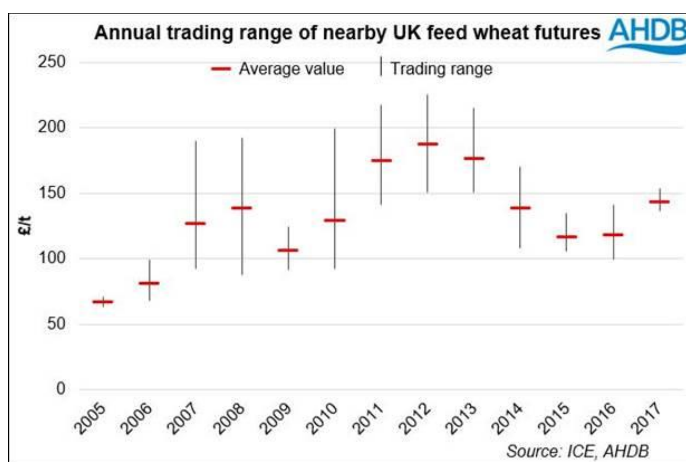
On people, the report highlights under-investment in training and skills development by British farmers and growers. According to a 2013 survey, only a third of UK farm managers had undertaken formal training, compared with over 60% in countries such as France, Germany and the Netherlands. Although more younger farmers had been trained, the UK was still well behind its EU competitors. Other surveys paint a similar picture, with nearly 60% of farm businesses not in any Continuous Professional Development schemes, only 25% having a formal business plan which they reviewed annually and only 25% regularly reviewing their budget. Again, this might be partly attributed to a crowded landscape, along with limited co-operation between farmers and providers.

On a more positive note, though, the report concludes that, if the industry bodies such as the AHDB and government work together, they can "create a more coherent and co-ordinated knowledge and innovation pipeline that better supports our farmers and growers." This would involve more effective funding of research and development, a unified evidence base on what works, co-ordination of knowledge exchange, better skills training and more opportunities for farmer to farmer learning. One of the ways of doing the latter is through AHDB's network of 46 demonstration and monitor farms, under its Farm Excellence programme. A directory of these farms is published alongside the productivity report.

The full AHDB report can be downloaded by clicking here. More coverage of the Oxford Farming Conference will appear in next week's newsletter.

### *UK wheat market least volatile in a decade*

The trading range in annual UK feed wheat futures (nearby) hit a 12 year low in 2017 with the gap between the minimum and maximum values seen as just £17.75/tonne. Large global stocks and bigger than anticipated world wheat crops, have kept the market subdued throughout the year. The traded range may have been smaller still were it not for the spike seen in June, when fears of US droughts and the impact that they might have on spring wheat supplies pushed up global wheat markets.




### *South American rains ease soya concerns*

Rainfall in key South American regions for soyabeans, notably in Brazil, has eased concerns about crop development which had been growing due to dry conditions. One impact was to delay planting, which could create an issue for the second ('safrinha') maize crop, which is planted after the soyabean harvest, later in the year. Although conditions remain dry in Argentina, forecast rain this week should ease the situation there too. As a result, it is likely that estimates for the South American soyabean crop could rise when updates are published in the next few weeks.

As a result of the improved weather, prices for oilseeds have fallen, with Chicago soyabean futures hitting their lowest level in four months over the festive period. However, crude oil prices have been rising of late, which could push up demand for vegetable oil to be used in biodiesel production, giving some support to the oilseed complex.

### *Consumers hit by food price rises*

Having just been through a period when food consumption has been prominent in many of our minds, it is perhaps an appropriate time to catch up on some of the latest developments in the groceries market. Perhaps the most prominent

news of late has been about higher prices. In the 3-month period up to early December, analysts Kantar Worldpanel report grocery inflation running at 3.6%, its highest level since 2013. For those following the dairy market, it will come as little surprise that the biggest price increases have been for butter, up by a third compared with a year earlier. Sugar prices were up 10%, with many other types of food also seeing higher prices. Despite the higher prices, sales held up pretty well, with the value of groceries purchased up 3.1% year-on-year.

The rise in food prices has led to a raft of headlines about the cost of Christmas dinner this year, although that is a regular theme in the run-up to the festive season. 2016's Christmas period was the biggest ever in terms of spending, partly due to shoppers trading up to premium ranges, which saw growth of 13%. Tradition also took hold, with gammon and turkey doing well 12 months ago, but there was an element of shoppers choosing cheaper meats, with some switching from more expensive lamb to pork. It remains to be seen whether these trends have been sustained for Christmas 2017, although pork has been doing well in recent months.

Another trend which continues, and which was apparent last Christmas, is the growth of the discount retailers, particularly Aldi and Lidl. In the latest period (up to early December) both recorded year-on-year growth of around 15%, gaining further market share from the Big 4 supermarkets, all of which grew more slowly than the market as a whole. Waitrose, Iceland and the Co-op also lost market share. Although online grocery sales growth has slowed considerably to less than 3%, it is still likely to be a record December for grocery e-commerce.

Despite the squeeze on wages, we are still eating out more. Total spending on food purchased and eaten out of the home was up 2.8% in the second quarter of 2017, with spending reaching £54.4 billion. Although this was partly down to higher prices, the number of visits to foodservice outlets was also up 1%, at 11.4 billion. This is their highest level since 2008, when eating out was in rapid decline due to the financial crisis. Much of the growth has come in older age groups, particularly those aged over 65, while younger people ate out slightly less often. Nevertheless, with busier lifestyles, the food-to-go market is growing rapidly, including at breakfast.

Beyond these headlines, AHDB's Consumer Insight team have highlighted a range of other interesting trends in recent articles and these can be accessed by clicking here.

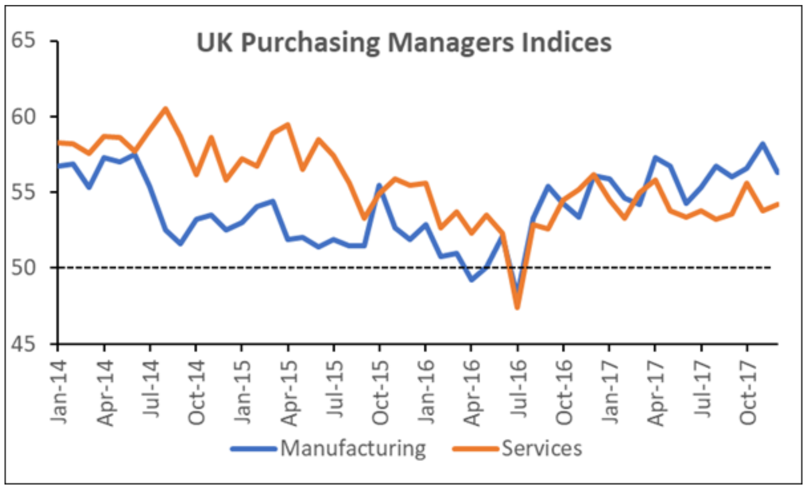
### *Manufacturing outlook remains solid*

The UK manufacturing sector ended 2017 on a positive note, according to the latest Purchasing Managers' Index (PMI) from Markit Economics. Although the December reading of 56.3 was below November's 4-year high, it remains well above the 50-mark, which represents no change in activity, indicating growth remained solid during the month. Output growth accelerated in the intermediate and investment goods sectors but slowed for producers of consumer goods. Improved export sales were a big contributor to the strength of new orders, with improved demand from Europe, the USA, China and the Middle East.

Manufacturing in the Eurozone was performing even better, with the December PMI at a record 60.6 (the survey dates back to 1997). Austria, Germany and Ireland also saw record highs in December, while France's reading was at a 17-year high and Greece's at its highest for over 9 years. Capital goods were leading the way and high levels of new business are reported to be testing capacity, with a marked increase in the backlog of work. The outlook was also positive, with business optimism at its highest level ever (although this series only dates back to 2012).

In the UK, the construction PMI also eased back slightly in December, although remaining above 50, reflecting a continuing slowdown in commercial construction, although house building was more positive.

The services PMI which covers the bulk of the UK economy, however, having fallen in November, showed a significant upturn, rising from 53.8 to 54.2. Business activity continued at a high level although service providers noted that clients' willingness to spend was still being held back by uncertainty in relation to Brexit. Volumes of new work are reported to have increased at a solid pace in December but the upturn was the slowest recorded for 16 months. Optimism for the year ahead, although still subdued in comparison with the long-term average, picked up to a 7-month high, with around 43% of respondents expecting a rise.

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