

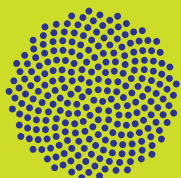
Q1

Food Drink Ireland Business Monitor

February
2017

Brexit risks crystallise

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FD Food
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Paul Kelly
Director

A year of challenges and opportunities

Growth in both domestic and export markets is the top line message for the Irish food and drink sector in 2016.

Last month Bord Bia reported that exports increased by 2% to €11.15 billion and in the domestic market, the CSO Retail Sales Index shows grocery volumes up by almost 2%. However, there are dark clouds on the horizon with a drop of €560 million in UK exports in 2016, primarily driven by the immediate currency hit arising from the Brexit vote. Domestically sales value growth for grocery substantially lagged volume growth at only 0.6% for the year suggesting further pressure on margins in the domestic grocery sector.

The food and drink sector faces an extremely challenging climate in 2017 and beyond. The UK vote to leave the EU is a fracture of the single market and the most immediate challenge facing the Irish agri-food sector. Market diversification and overall export growth will be challenged by a new global trade environment caused by the US withdrawal from TPP negotiations, a general move away from multi-lateral to bi-lateral deals and the potential for trade wars which could result in a damaging displacement effect in markets. The EU single market faces other challenges beyond Brexit including moves by France and other member states to introduce mandatory country of origin labelling.










“There are dark clouds on the horizon with a drop of €560 million in UK exports in 2016”

A mixed picture is likely from a further upturn in commodity prices. The global dairy demand pick up in 2016 is expected to continue in 2017 whilst increased cattle supplies will in turn increase beef export volumes. The UN-FAO Food Price Index has risen over 16% in the last year – driven by sharp increases in sugar and oils and towards the end of the year increases in dairy. Secondary processors will thus face increased input costs which will put pressure on margins in the absence of cost recovery in the marketplace.

The longer term opportunities largely remain for the Irish food and drink sector. However the immediate response must be to ensure the sector is fit for purpose to meet the substantial challenges ahead in a world that has changed radically in 12 months. This brings into sharp focus the need to ensure the necessary policy measures are implemented so that the Irish food sector is highly cost competitive and innovative. With one in eight jobs in the economy linked to agri-food, failure to do this will be damaging to the wider economy and not just the food and drink industry.



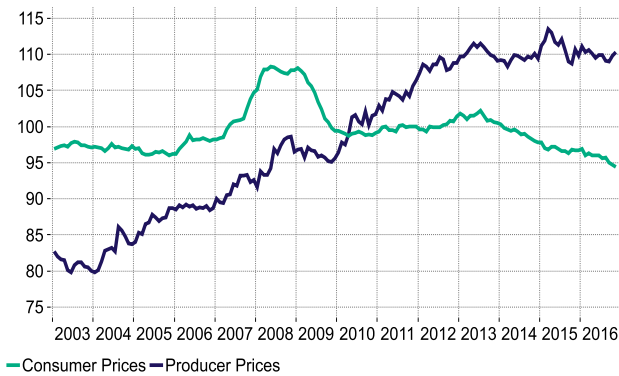
Food business snapshot

| | | 2016 VS 2015 | Q4-2016 VS Q4-2015 | Dec 16 VS Nov 16 | Dec 16 VS Dec 15 |
|---|----------------------------|--------------------|--------------------------|------------------------|------------------------|
|  | Food prices | -1.4 | -2.4 | -0.2 | -2.6 |
|  | Core retail sales | 1.8 | 0.8 | 25.9 | -0.4 |
|  | Food retail sales | 2.5 | 0.5 | 0.5 | 0.4 |
|  | Exchange rates | 12.8 | 20.4 | -2.6 | 16.2 |
|  | Crude oil prices | -11.3 | 17.1 | 13.9 | 40.3 |
|  | Food commodity price index | -1.5 | 10.2 | -1.0 | 11.0 |
|  | Irish food exports* | 2.7 | 4.9 | 8.9 | 9.1 |
|  | UK food retail sales | 1.8 | 2.6 | 0.0 | 1.8 |
|  | US food retail sales | 2.4 | 3.0 | 9.8 | 3.9 |

* At the time of publication the latest available CSO data for food exports was November 2016. For this variable, the first column looks at the first 11 months, the second column compares the first two months of quarter 4, the third column compares November with October and the fourth compares November 2016 with November 2015.

Domestic market

Figure 1: Food prices

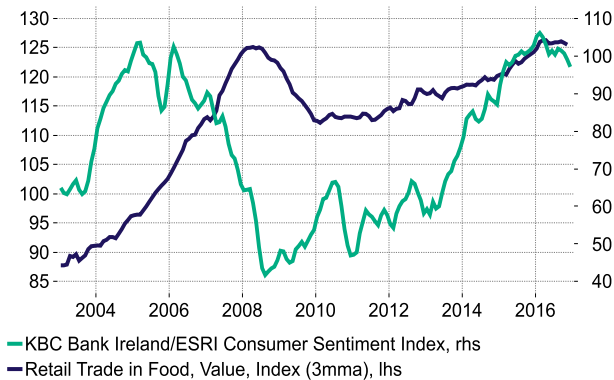


Food prices

In Ireland, food price inflation remains negative despite Ireland's rising economy. Producer prices on the other hand, continued to rise steadily over the last 14 years despite the economic crash in 2008. In 2016 producer prices did fall by 0.9%, however, consumer prices fell by more than 1.9%.

Food & non-alcoholic beverages fell mainly due to lower prices across a range of products such as sugar, chocolate & confectionery, bread & cereals and mineral waters & soft drinks.

Figure 2: Food retail and consumer sentiment



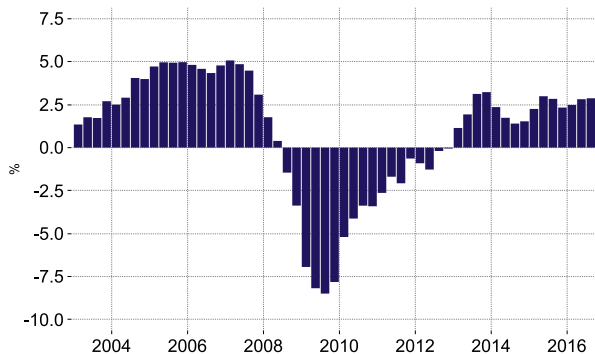
Solid recovery in the aisles despite relentless quest for value

Since 2008 there has been a significant divergence between retail sales volumes and turnover. Core retail sales volumes are currently 3.2% higher than they were in 2008, while turnover is 13% lower. Growth in volumes continued to outstrip turnover in 2016 as volumes grew 4.4% while turnover was only up 2%. This phenomenon has not happened to the same extent in supermarkets, as last year turnover was up 2.6% while volumes grew 3.3%.

According to the retail sales index, grocery volumes have increased by 2% but sales value growth lagged volume growth at only 0.6% suggesting further pressure on margins in the domestic grocery sector.

While overall growth in 2016 was positive, a worrying trend has emerged. Growth in turnover slowed significantly in the second half of the year. Retail turnover was up 3% in the first 6 months in 2016 and was followed by growth of 1% in the latter half of the year.

Figure 3: Employment, y-on-y % ch

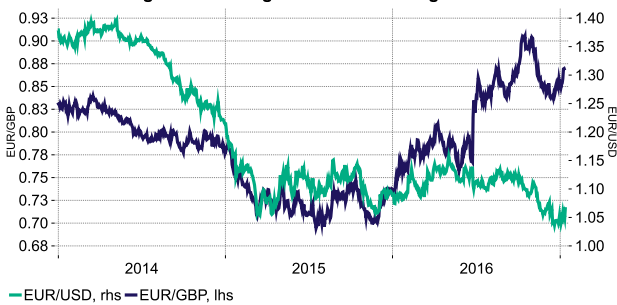


Employment

Employment in Q3 2016 rose by 2.9% (57,500) annually as the labour market continued to perform well ahead of other indicators. The growth continues to be mostly full-time with employment in full-time positions up by 44,800 (2.9%) over the course of the year. Employment grew in 12 of 14 sectors. As it stands all but 6 sectors of the economy have returned to their 2007 peaks in terms of employment. Only in retail (31,900) and importantly construction (134,000) is employment significantly below its pre-crisis peak.

Macro Trends

Figure 4: Sterling and dollar exchange rates



Exchange rate volatility poses continued challenge to some categories

The Euro/Sterling exchange rate is currently 12% weaker than it was before the Brexit referendum. This is already having an impact as total good exports to the UK (excluding machinery) were down 2% in the months following the referendum. Recent gains by Sterling versus the Euro are likely to be reversed once the UK government triggers Article 50. Over the longer term we expect that fundamental weakness in the UK economy will mean a level of Euro/Sterling above £0.90. On a more positive note, the Euro/Dollar exchange rate is now close to parity and is at its lowest rate since 2003.

WTI crude oil
(Spot price, USD)



Crude oil prices

While oil prices have made a slight recovery due to the new OPEC agreement to cut output, the weak Sterling will put downward pressure on import prices which will keep overall inflation low.

Wholesale energy prices were 13% lower in 2016 than 2015. However, there was a substantial increase in the second half of the year as prices were 10% higher than they were at the beginning of the year.

Figure 6: Food commodity indices

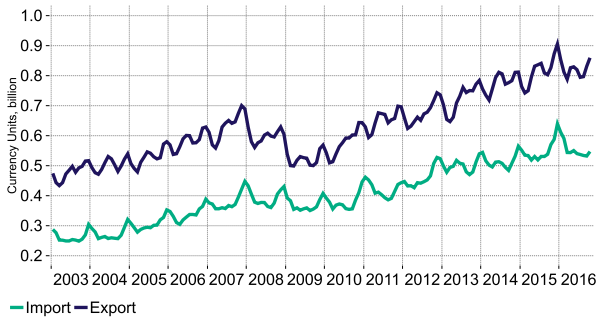


Food commodity prices

The FAO Food Price Index (FFPI) averaged 173.8 points in January 2017, up 3.7 points (2.1%) from the revised December value. At this level, the FFPI is at its highest value since February 2015 and as much as 24.5 points (16.4%) above its level in the corresponding period last year. The strong rebound in the January value of the FFPI was driven by a surge in international sugar quotations and sharp increases in export prices of cereals as well as vegetable oils. Meat and dairy markets remained more stable.

Trade

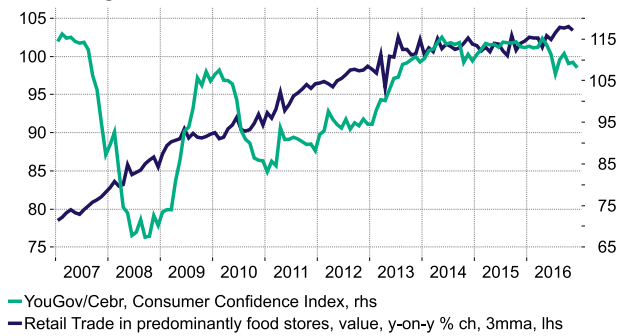
Figure 7: Irish monthly food trade, 3 mma



Irish monthly food trade

Since the Brexit vote, Sterling has depreciated by 12% against the Euro. The day before the vote happened one Euro bought 76p but at the beginning of February it bought 86p. The UK accounts for almost 1/3rd of Irish imports and up to and 37% in the food sector. Along with weaker exports and the possibility of crossborder shopping the weaker Sterling may also see some multinational retailers re-examine their sourcing strategies for the Irish market over the coming months. Due to the 12% weakening of Sterling against the Euro there was a drop in value across meat, dairy and prepared consumer foods.

Figure 8: UK consumer confidence and food retail

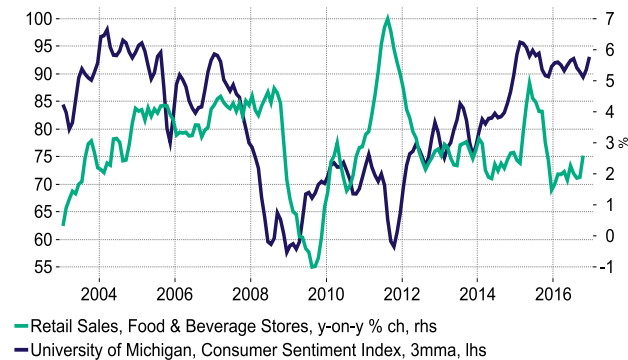


UK consumer confidence and food retail

Consumer sentiment in the UK fell substantially after the Brexit referendum. Since then, it made a slight recovery, however, it is still lower than it was last year. This did not impact consumer spending however, as retail sales continued to grow at existing rates. Grocery sales were up 1.8% in 2016.

Inflation in the UK was 0.7% last year but there was a significant rise in prices at the end of the year. In November prices were 1.2% higher than the same month in 2015 and were 1.6% higher in December. The UK currently runs a trade deficit of €30 bn in food products. A weak Sterling makes food imports more expensive so it is likely that this will put further pressure on food prices this year.

Figure 9: US consumer confidence and food retail



US consumer sentiment and food retail

Consumer sentiment in the US remained low in the first half of the year but then picked up significantly in October. In December sentiment was 6% higher than the same month in the previous year and January was 7.1% higher. This post-election surge in confidence was driven by a more optimistic outlook for the economy and job growth during the year ahead as well as more favourable economic prospects over the next five years.

Grocery sales experienced steady growth since 2011 and are currently 15% higher. Overall, food turnover is up 2.4% in 2016 with stronger growth in the second half of the year.



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