

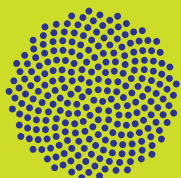
Q3

September
2017

Food Drink Ireland Business Monitor

The cost of competitiveness

Brought to you by



FD Food
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Director

An intense and ongoing focus on cost competitiveness in the face of Brexit

The threat of Brexit looms large for agri-food

Whilst agri-food is most at risk in the event of hard Brexit there is a more immediate impact from sterling. FDI's econometric analysis, published in September 2016, showed that the growth rate of Irish agri-food exports to the UK begins to slow at an exchange rate sterling/euro level above 80p and that approaching 88p Irish agri-food exports to the UK begin to fall. Every 1% weakening in Sterling results in a 0.7% drop in Irish exports to the UK, a sustained period at 90p translates to losses of over €700 million in food exports and about 7,500 Irish jobs and at parity year on year reductions of 17% in exports would be experienced - each and every year.

A hugely important measure to mitigate these risks is to implement policies within our power in order to control our cost base. This must be done whilst helping companies innovate and improve productivity. The primary concerns in this regard are labour costs, poorly designed regulation and rising insurance costs. It is also imperative that measures to improve utility and transport costs are taken in order to provide a hedge against possible future cost increases as a result of Brexit.

Government must reflect the realities faced by many companies in the face of Brexit when setting regulated wages such as the minimum wage and avoid increasing the minimum wage in 2018. Government should also avoid adding additional costs through unnecessary labour market regulation or by increasing the overall tax burden on labour.










Transport costs are already a major cost item for agri-food businesses. Brexit will pose further challenges to the cost competitiveness for Ireland's logistics and transport with the UK being a key trade conduit for Ireland and now facing the cost, complexity and disruption associated with applying and administering a customs border. Additionally higher transport costs through increased insurance or fuel prices add directly to costs whilst poorly developed infrastructure adds indirectly to costs through delays and longer journey times.

Although energy, waste and water costs in Ireland are now relatively competitive they are large cost items for business. We also still remain exposed to global fluctuations due to our size and import dependency. Continued policy measure such as completing major cost reducing infrastructure projects, minimising further increases in the PSO levy and avoiding introducing any legislation that would needlessly undermine the cost-effectiveness in the waste sector should be pursued.

Employer Liability and Public Liability Insurance policies already represent a substantial operating cost to Irish business, typically equating to around two percent of a firm's payroll cost. The recent upward trend in annual premiums is proving unsustainable for low margin businesses, particularly those impacted by Brexit and must be addressed as a matter of urgency.

Responsibility for cost competitiveness issues is dispersed across multiple Departments and local government bodies. This has led to a lack of policy coherence and inaction. The Department for Business, Enterprise and Innovation must now commence an 'Action Plan' to address cost competitiveness issues in the face of Brexit. This should include regular analysis of cost competitiveness issues, assigning clear policy responsibility and monitoring implementation on a quarterly basis.

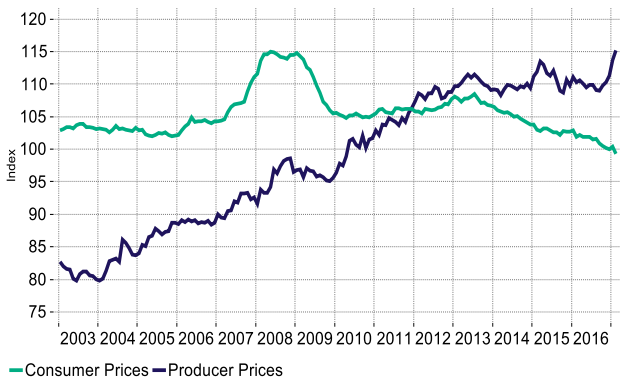
Food business snapshot

		2016 VS 2015	Q2-2017 VS Q2-2016	July 17 VS June 17	July 17 VS July 16
	Food prices	-1.4	-2.4	0.4	-1.9
	Core retail sales	1.8	3.7	-0.6	3.3
	Food retail sales	2.5	3.2	-1.7	1.0
	Exchange rates	12.8	9.3	1.0	5.4
	Crude oil prices	-11.3	6.0	3.3	4.1
	Food commodity price index	-1.5	9.2	2.2	10.2
	UK food retail sales	1.8	3.0	2.0	3.2
	France food retail sales	0.46	2.5	-4.3	-1.1
	Food exports*	3.2	18.4	7.4	25.8

* At the time of publication the latest available data for food exports was June 2017. For this variable, the third column compares June with May and the fourth compares June 2017 with June 2016.

Domestic market

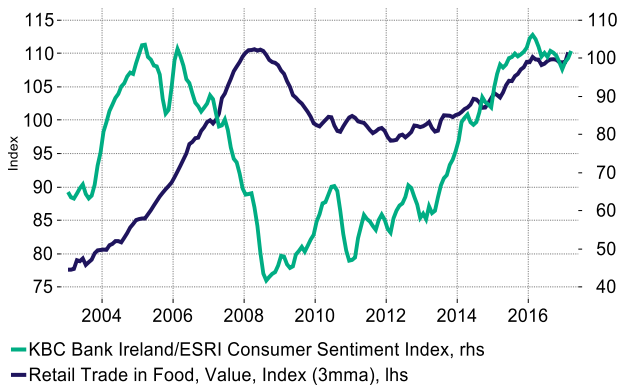
Figure 1: Food prices



Food prices

According to the latest CSO figures, food prices in Ireland decreased by 2% in July compared to the same month in 2016. Food and Non-alcoholic beverages fell due to lower prices across a range of products such as bread & cereals, jam, honey, chocolate & confectionery and vegetables.

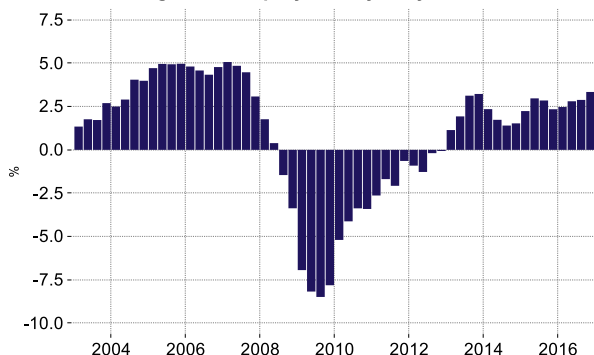
Figure 2: Food retail and consumer sentiment



Retail sales and consumer sentiment

The most significant aspect of the June retail sales figures for supermarkets and convenience stores is the early signs that deflationary pressures are easing. Much of 2016/17's deflation has been imported as a 'Brexit effect' as sterling weakened. Volatility in consumer prices highlights that competition remains fierce within the sector and retailers are continuing to rely on deep discounting and promotional activity to drive footfall and sales. Low inflation was one of the main drivers for the stronger consumer sentiment in June 2017 alongside reduced fears of a hard Brexit after the UK General Election result, earlier this summer, and continuing strengthening economic indicators.

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

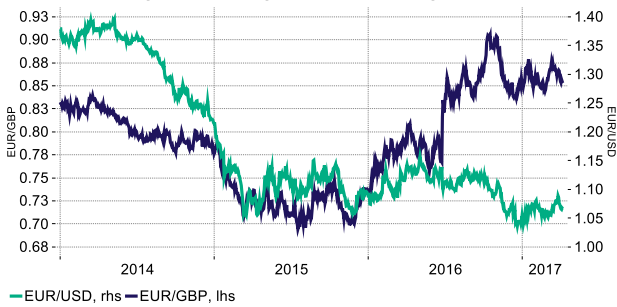


Employment

The CSO's most recent monthly unemployment estimates contain an implied estimate of employment growth for the first half of the year. These estimates suggest that the pace of employment growth was 3.4%. This represents a pick up on employment growth of 2.9% in 2016 and is well ahead of expectations. All indicators suggest that the labour market is now tightening rapidly and weathering Brexit uncertainty well. It is still likely that some slowdown in the pace of employment growth will occur in 2018 as Brexit begins to bite on labour intensive sectors such as tourism and manufacturing.

Macro Trends

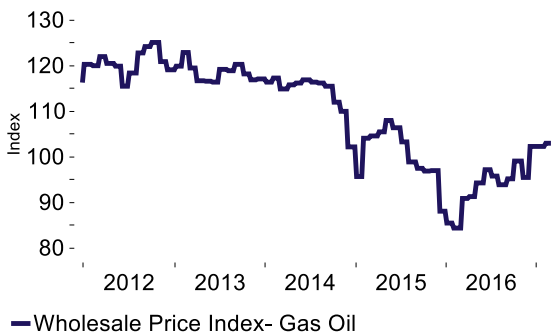
Figure 4: Sterling and dollar exchange rates



Sterling exchange rate

In a Food Drink Ireland report, published last September, we showed that the growth rate of Irish agri-food exports to the UK begins to slow at an exchange rate sterling/euro level above 80p and that approaching 88p Irish agri-food exports to the UK begin to fall. Similar Bord Bia/PWC findings show that while only 11% of Irish agri-food companies expect to struggle with an exchange rate between 80p and 85p, a move from 85p to 89p increases that figure to almost 40%. A move from 90p to 95p would see a real challenge in over 80% of firms. There is a dual impact at play here with Irish food exports falling and Irish consumer foods being pushed off the shelves at home by cheaper British imports.

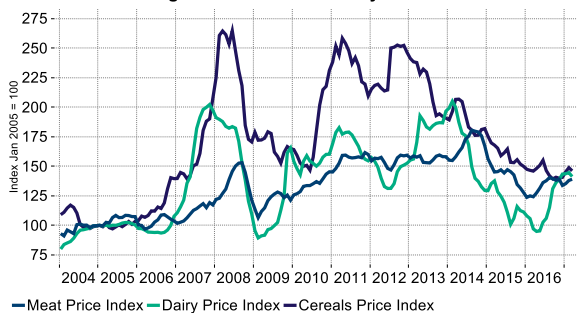
Figure 5- Wholesale Price Index- Gas Oil



Wholesale price index – gas oil

The price of Energy products decreased by 0.1% in the year since July 2016, while Petroleum fuels increased by 2.8%. In July 2017, the monthly price index for Energy products increased by 3.2%, while Petroleum fuels decreased by 0.1%.

Figure 6: Food commodity indices

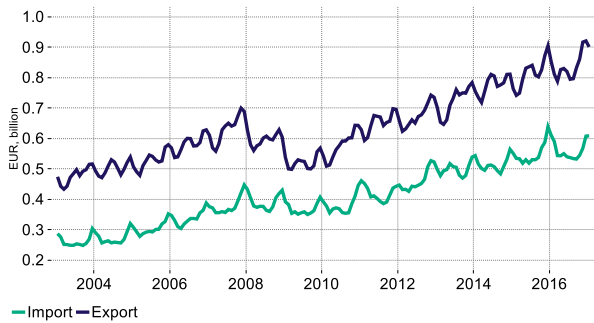


Food commodity indices

The FAO Food Price Index, the organisation that measures monthly change in international prices of a basket of food commodities, reported an increase in July 2017, it is the third successive month of increases. The latest rise put the Index above last year's level and at its highest since January 2015. A combination of supply constraints and currency movements provided support to prices of most cereals, sugar and dairy.

Trade

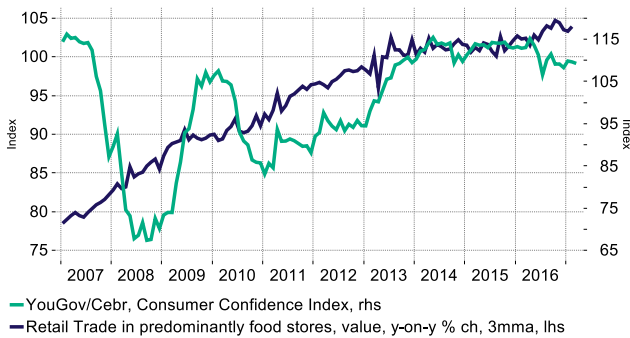
Figure 7: Irish monthly food trade, 3 mma



Irish monthly food trade

Irish food exports experienced strong growth in the first half of 2017 and were up 13.5% on the same period in 2016. The price of milk has increased significantly in recent months and this has increased the value of our dairy exports which were up 42% in the first half of this year. Food exports to the UK made a recovery this year and were up 7% (4% excluding dairy). However, this will not continue if the recent depreciation in sterling persists.

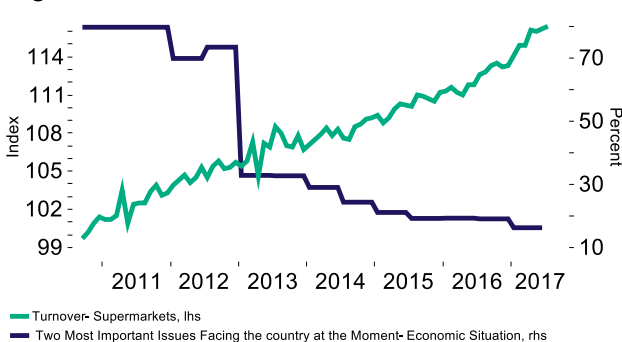
Figure 8: UK consumer confidence and food retail



UK consumer confidence and food retail

GDP is yet to show signs of slowing in the UK as it grew by 2% in Q1 this year. Other indicators are however showing worrying signs. Business investment fell by 1.5% last year. Despite a slight uplift of 0.8% in Q1, it is still lower than it was before the EU referendum. Both industrial and manufacturing output fell by about one-quarter of a percent in May. Inflation was 2.4% in the first 5 months of 2017. As this is higher than wage growth, it will reduce purchasing power and may lead to lower consumer spending over the coming months.

Figure 9: EU consumer confidence and food retail sales



EU consumer confidence and food retail sales

Growth prospects in the eurozone look very promising. Last year all countries in the currency union experienced positive economic growth with the eurozone as a whole growing by 1.8%. The unemployment rate for the eurozone is now in single digits at 9.3%. This positive momentum is expected to continue in 2017 as all countries are expected to experience positive growth.



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