Brexit impacts and strategies - Crop sector March 2019

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Julian Bell,

Senior Rural Business Consultant,

SAC Consulting, SRUC

Julian.bell@sac.co.uk, 07795 302 264

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Overview

1) Deal or no deal? Timing
2) Background to trade
3) Tariffs
4) Non-tariff barriers
5) Opportunities
6) No-deal prep

The clock is ticking - will Brussels blink? Will the UK Parliament agree a deal?

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May goes back to Brussels

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What are the possible outcomes?

- Deal
- No deal
- No Brexit

What are the possible outcomes? (1) Deal

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- Deal – must be agreed by
  - UK government and EU Commission √
  - EU heads of state – 27 countries – √
  - EU Parliament – 751 MEP's - √
  - UK Cabinet – 23 Ministers – √
  - ~~The Democratic Unionist Party – 10 MPs ?~~
  - ~~UK Parliament – 650 MPs - ?~~
- If this fails what?

What are the possible outcomes? (2) No deal

- If this fails what?
  - UK goes back to Brussels to renegotiate
  - UK goes back to Brussels for Art 50 extension
  - UK election – new government re-negotiates
  - UK second referendum – No Brexit a poss. outcome
  - Both would require an extension to Article 50 period
- No Deal – <u>almost</u> no-one wants this – but may happen by accident.

UK trade

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Trade with EU critical for grains – 70-80% of UK imports & exports

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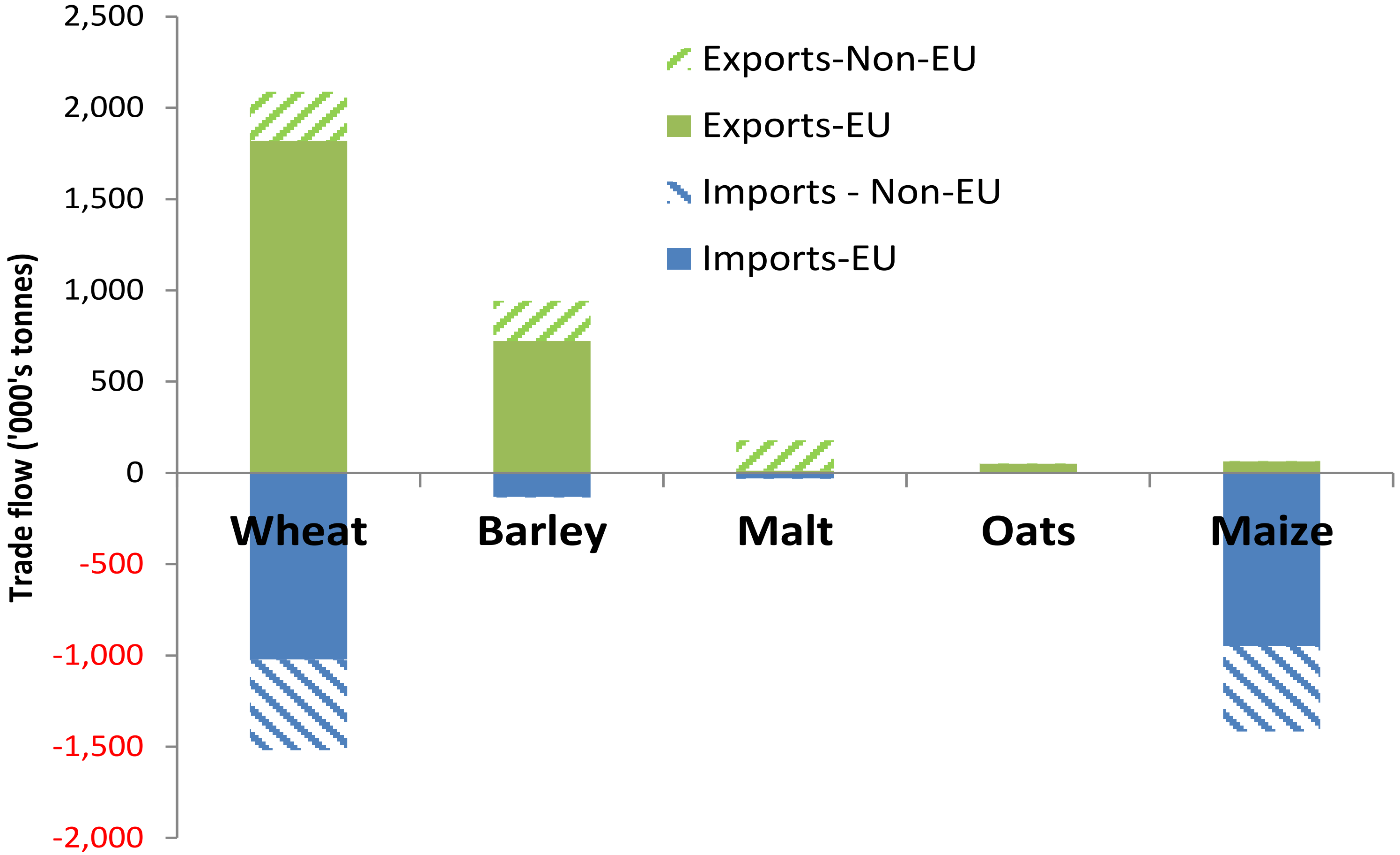

Source: 5yr average, AHDB. SAC Consulting

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Grain use & trade in Scotland differs from rUK - use 51% feed, 46% whisky

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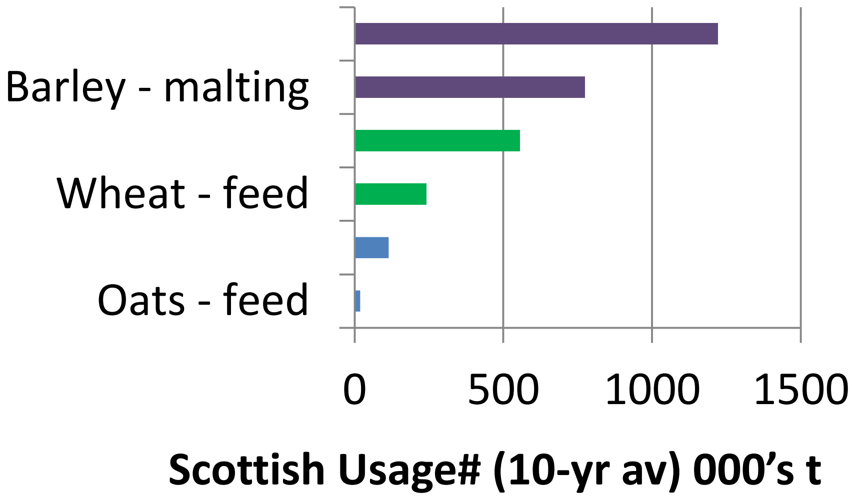

BARLEY
65% feed - 41% malting

WHEAT
65% distilling - 28% feed

OATS
71% milling - 12% feed

Scotland – main Imports

- Milling wheat (Eng., EU, Can)
- Malt (Eng. and EU)
- Maize (EU, S. Am)
- Feed wheat (Eng. EU)

Scotland – main Exports

- Rapeseed (Eng., EU)
- Feed barley (EU, S Arabia)
- Malting barley (Eng. and EU)
- Oat products (EU, N Africa, Mid East)

Source: #Scottish Government, 10-yr av. Production of 2.882mt, * - includes small amount of mainly soft milling wheat use, ~ SAC

Potatoes - domestic market structure
Scotland - pre-pack and seed dominate
England - processing key

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Potato production by intended use

Total Production	Scotland (1.2mt)	England (4.0mt)
Fresh bags	2%	5%
Fresh chipping	1%	16%
Pre-pack	54%	34%
Processing	2%	40%
Other ware	2%	1%
Seed	40%	4%
	100%	100%

Source: AHDB Potatoes

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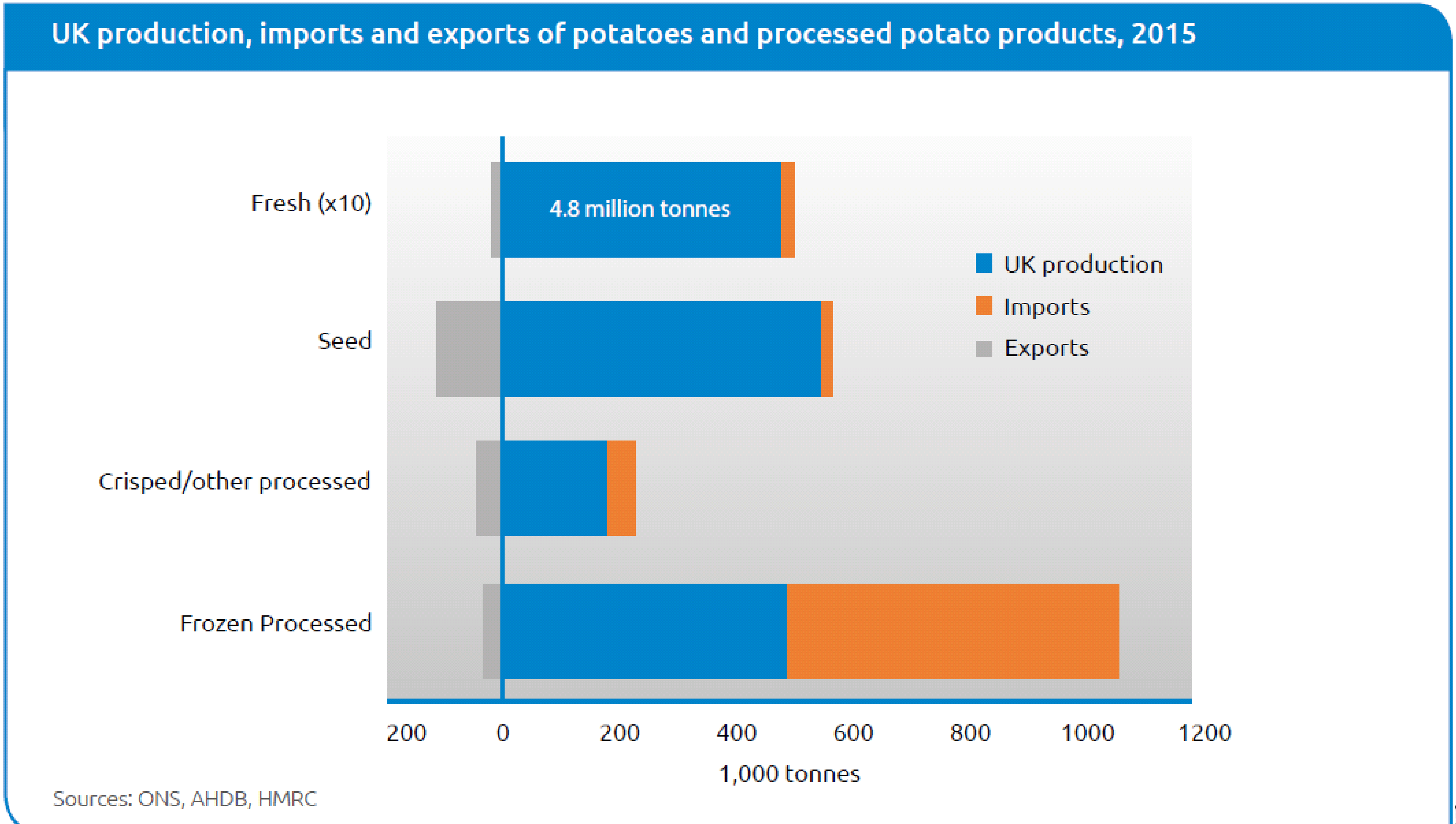
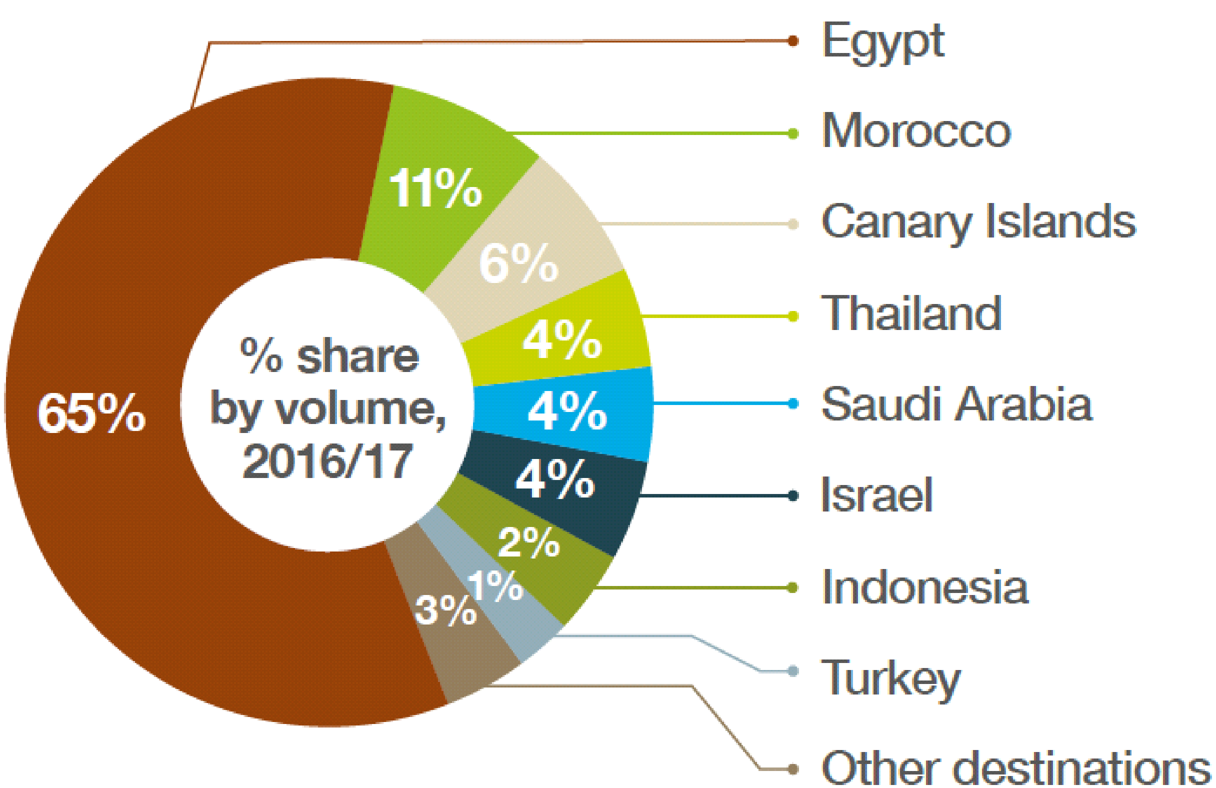
UK potato exports
- dominated by seed, crisps



Source: AHDB Potatoes

Scotland – seed exports 65kt pa, ware 10kt
- seed exports 78% non EU, 22% EU
- overly reliant on Egypt

Potato production by intended use



Source: AHDB Potatoes

Potential trade barriers in a No Deal

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Potential trade barriers

- Tariffs
  - EU – UK
  - UK – EU
  - UK – 3rd country

- Non Tariff Barriers
  - Phytosanitary
  - Variety certification

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Customs, Trade and Movements: Determines Soft or Hard Brexit

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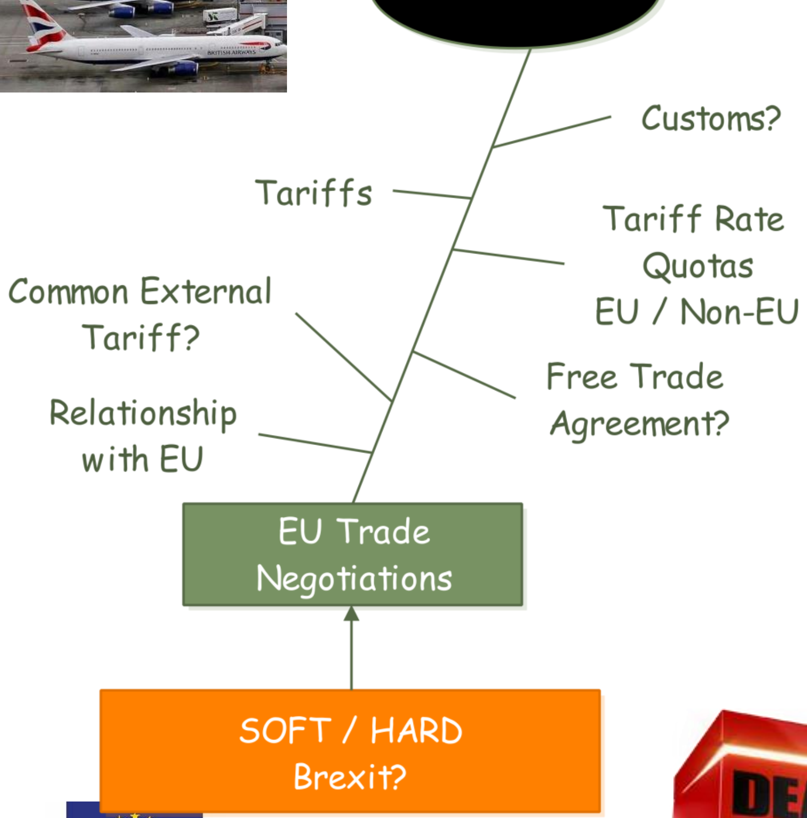

- **Single Market** (4 freedoms)
- **Customs Union**
- **EEA** – extension of single market
- **FTA** – offer preferential market access
- **WTO** – rules for multilateral trade

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Trade and Tariff Barriers

- **EU's large food tariffs exist to protect agriculture**
  - Frozen, boneless meat of bovine animals 112% effective tariff
  - Carcases or half-carcases of bovine animals, fresh or chilled 92% effective tariff
  - Fresh or chilled lamb carcases or half- carcases 45% effective tariff
  - Fresh or chilled boneless cuts of sheep 64% effective tariff
  - Wheat ~75% tariff
  - Barley ~ 90% tariff

We need a deal to avoid having to pay these

Tariffs – No Deal and possible future trade deal

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- UK to adopt EU “WTO Schedule of Tariffs”
- This sets a ceiling to UK Tariff levels
- In a No Deal UK plans to lower these; for certain commodities, for a defined period – to protect UK consumers from price rises.
- Most Favoured Nation status – UK must apply the same tariff to all countries except where a comprehensive Free Trade Deal (FTA) has been agreed

Tariffs – No Deal proposed UK IMPORT tariffs

- Cereals - 0%
- Potatoes – 0%

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EU market protection – WTO default for agriculture outside EU – without FTA*

- Tariffs

- € X per tonne, € x per kg,
- Ad valorem – charged as a % of value
- WTO limited

- Tariff Rate Quotas

- Set quantities available at reduced or zero tariff
- Country specific
- Or general first come first served

- Non Tariff Barriers

- e.g. GM varieties, phytosanitary standards

* Free Trade Agreement

Grain tariffs into the EU – UK example – WTO rules EXPORTS

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UK wheat exports to EU (low grade*)

- 2015/16 - 2.28mt
- 2016/17 - 1.44mt

- UK wheat price today £170/t

- EU exports <u>within 4.0mt TRQ</u>
  - less tariff of €12/t / £10/t = £160/t

- EU exports <u>out with TRQ</u>
  - less €95/t / £82/t = £78/t
    - Divert to non EU markets at £160/t (vs Russ)

* *Tariffs zero on high grade bread wheat, zero/variable on maize, TRQ's for barley*

Grain tariffs into the EU – UK example – WTO rules

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EU wheat imports under TRQ (low grade)
- Add tariffs on £170 + £0 so ~£170/t

WTO summary
  - impact on wheat exports today -£10 to -£20/t,
  - potential gain of +£0/t wheat when importing
  - But will vary widely season to season
  - Increased volatility but survivable with weak £
  - **Whisky is zero tariff under WTO so less risk**
  - But other grain user; livestock face higher tariffs

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UK to adopt EU potato tariffs – but apply at 0% for 1st 9 months in a No-Deal

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EU tariff rates, above Tariff Rate Quotas, are high for many products. This gives an idea of the barriers which will face UK exporters if UK exports to the EU are subject to these tariffs

Code	Product	Tariff rate
07011000	Seed potatoes	4.5%
07019090	Fresh/chilled potatoes, excluding new, seed and potatoes for manufacture of starch	11.5%
20041010	Frozen cooked potatoes	14.4%
20041099	Other frozen potato products	17.6%
20052020	Crisped potatoes	14.1%
20052080	Other non-frozen potato products	14.1%

Source: AHDB Potatoes

Potato tariffs – EU to retain tariffs on UK EXPORTS under No Deal - WTO rules

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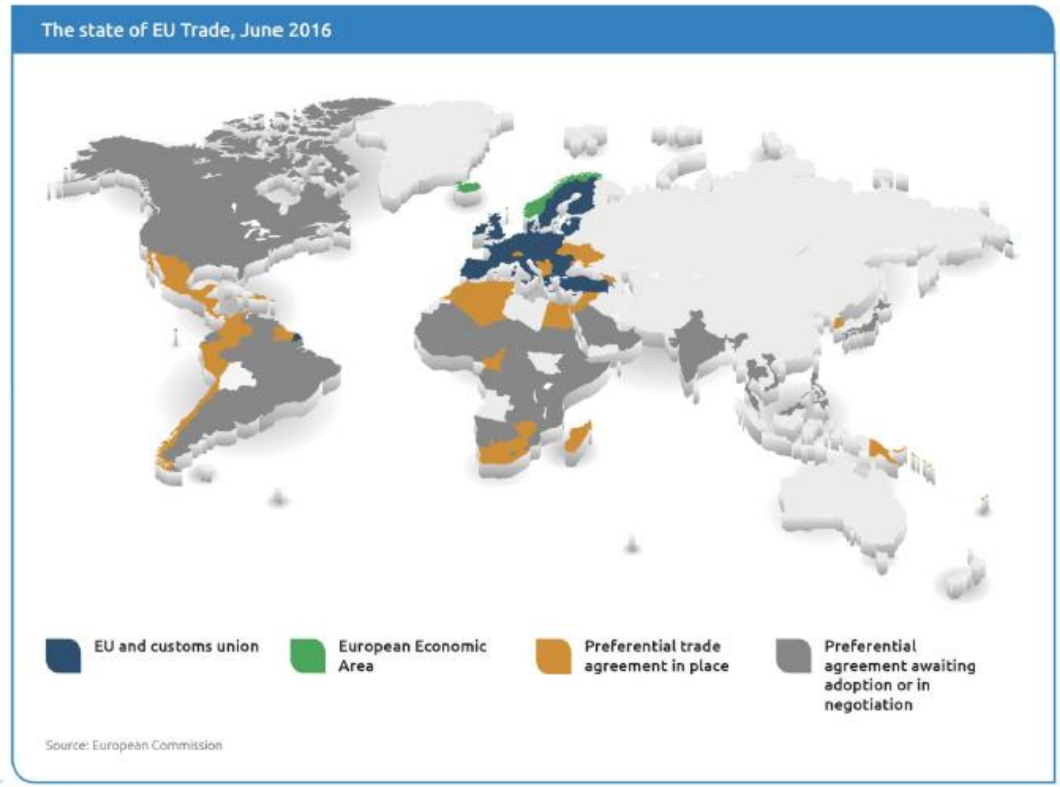
UK seed potato exports to EU - import tariffs

- UK price - £325/t ex farm – deduct tariffs @ 4.5% or £15/t so ~£310/t ex-farm
- Unless alternative markets can be found

	Current	No Deal
Ex-farm Scotland	£325/t	£310/t
Transport	£40/t	£40/t
Tariff	-	£15/t
Delivered EU	**£365/t**	**£365/t**

Tariffs to non EU countries – depends on replicating EU trade agreements



Non-EU Tariffs

Seed potatoes

- Egypt 2%, Moroc 2.5%
- But both countries require access to UK market for new potatoes / fruit and veg so likely to agree reciprocal deal with UK
- **Malt** – Japan - 39% of UK exports, 19% import duty

Source: AHDB Potatoes

Deal – essential to facilitate trade with EU, less impact on 3rd country trade

Post March 2019 – UK exits EU

<u>If transition deal agreed</u>

<u>UK - EU trade</u> – expected to remain unaffected up until at least end of 2020, possibly longer as 2 years not enough to complete FTA with EU.

<u>UK – 3rd Country trade -</u>

– UK loses access to all 750 FTA deals EU has negotiated with 70 countries

Non-Tariff Barriers under a No Deal – UK potato exports to EU likely to cease for an unknown period, may hinder some cereal trade

Post March 2019 – UK exits EU

UK - EU trade

- UK varieties no longer recognised by EU
- UK phytosanitary standard no longer recognised by EU
- Tariffs imposed
- = UK i.e. Scottish seed potato exports to EU cease – loss of 20kt market
- UK has already agreed to accept EU seed potatoes for 1 year in first instance
- = EU seed potato exports to UK continue – Scotland fail to displace 30kt of Dutch seed imports

<u>UK – 3rd Country trade -</u>

– Limited impact as similar to Deal situation

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Post - Brexit price impacts

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"Deal" | "No deal"

	Price change (2015 to 2022)			
	Baseline	FT	WTO	LT
Milk	6%	7%	37%	-2%
Beef	6%	6%	29%	-39%
Sheep	7%	7%	-22%	-20%
Barley	16%	15%	13%	11%
Wheat	20%	20%	17%	17%

Summary Table 1: Summary FAPRI price projections (2022 compared to 2015) under post-Brexit trade scenarios

Key

FT – Free Trade deal with EU, assume 0% tariff

WTO – UK adopts EU tariffs 10-90% tariffs on Ag.

LT – Lowered Tariffs on Ag.

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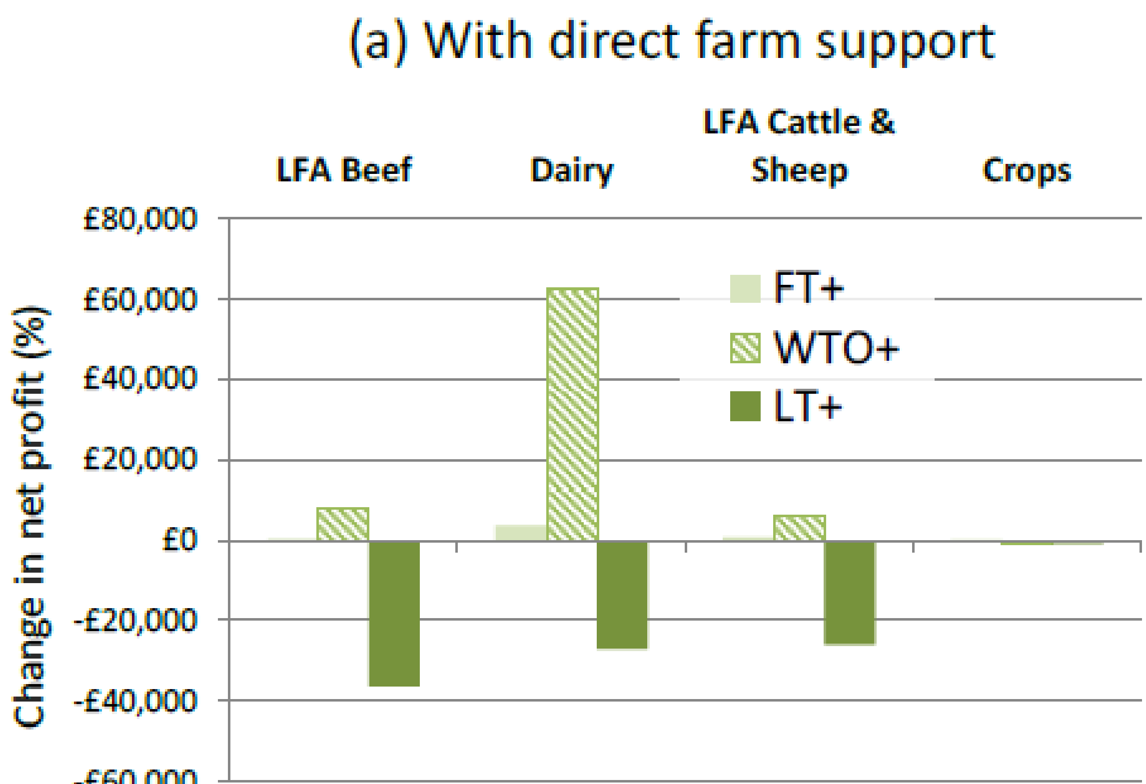
SRUC estimated net farm profit changes – with support

Figure 1 – Estimated average difference from the baseline net profit in 2022 resulting form post-Brexit trade and policy Scenarios, source: SRUC



WTO and FT manageable for most sectors.

Lowered Tariffs hit livestock hard, crops OK

Opportunities

Subsidy support to be maintained to 2022/23

- **UK**
- - 2019 to 2020 – as is (cut to LFASS in Scotland)

- **Scotland**
- - 2021 to 2023 – continue Direct Payments system, some changes,
- > 2023 – continue with Direct Payments? Would coupled payments be allowed – SUSS, SBCS? Simplification? More Public Good?

- **England**
- - 2020 to 2027 – England phase out DP
- - > 2028 - England move to “public money for public goods”

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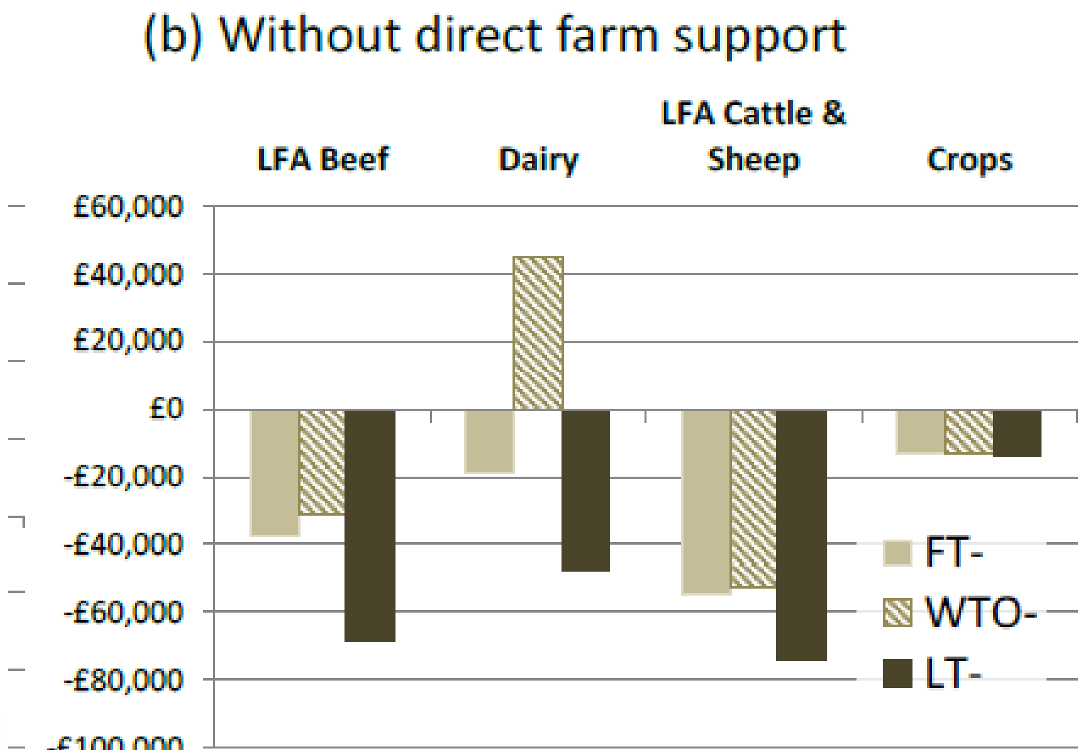
Loss of subsidy / market protection could free up land for expansion?

Figure 1 – Estimated average difference from the baseline net profit in 2022 resulting form post-Brexit trade and policy Scenarios, source: SRUC



All sectors worse off except Dairy under WTO, beef and sheep hit hard in all scenarios

Is No Support really likely? More like <u>less </u>support?

AHDB find top 25% of producers can compete what ever Brexit outcome – yield and costs key (not just cereal sector)

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Cereal Margins - Scotland Farm Accounts Scheme 2015 crop year

£/t of grain

	Winter wheat		Spring barley	
	Average	Top 25%	Average	Top 25%
Yield (t/ha)	9.3	10.64	6.25	6.96
Price (£/t)	112	112	114	126
Straw (£/t grain)	10	13	16	15
OUTPUT (£/t)	122	125	130	141
Variable costs (£/t)	54	46	58	49
Gross Margin (£/t)	68	78	72	92
FIXED COSTS (£/t)	87	65	130	99
TOTAL COSTS (£/t)	132	98	172	133
(less straw sales)				
Prodn. margin (£/t)	-10	26	-42	9
BPS and coupled (£/t)	21	15	31	23
Profit (after BPS) (£/t)	**11**	**41**	**-11**	**32**

Source: Farm Accounts Scheme, 2015 harvest

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New malt distilleries coming – 10 in 2019, 40 by 2021

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SCOTCH WHISKY DISTILLERIES TO OPEN IN 2019

01 January 2019 by Becky Paskin

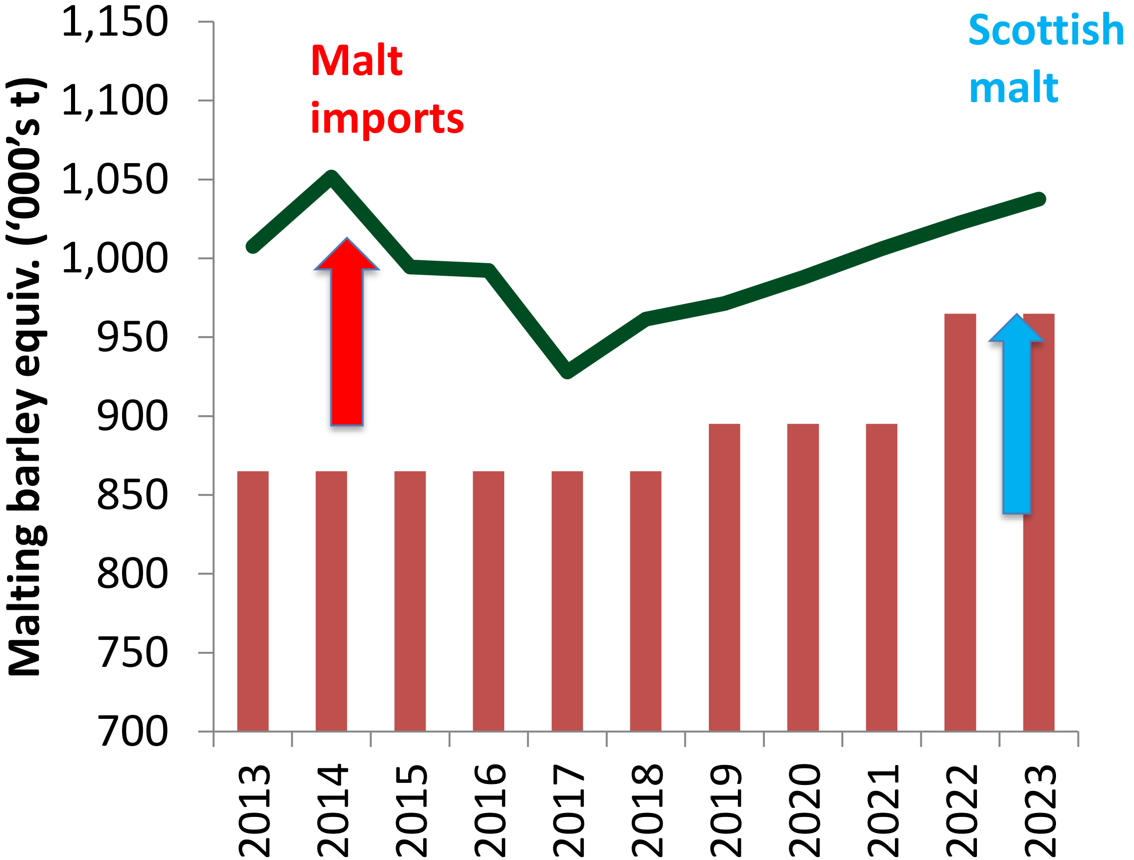
The past 12 months have been relatively quiet in terms of new distillery openings, but as Becky Paskin reveals, 2019 will be an even more exciting year for Scotch whisky.

2019	Spirit capacity (m LPA)	Malt use (t malting barley equiv)
Ardnahoe	750,000	2,259
Ardross	1,000,000	3,012
Brora	800,000	2,410
Cabrach	45,000	136
Falkirk	750,000	2,259
Holyrood	100,000	301
Lagg	800,000	2,410
Port Ellen	800,000	2,410
Rosebank	800,000	2,410
Total	**5,845,000**	**17,605**

Source: scotchwhisky.com, Scotch Whisky Industry Review 2017

New maltings planned - will need local barley to replace imported malt

- Bairds +30kt capacity in 2019, + 70kt by 2022



Scottish/Berwick malting capacity estimates – barley equivalent
2018 – 865kt
2019 – 895kt
2022 – 965kt

Source: Scotch Whisky Industry Review 2017, SAC Consulting

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Why is this a good time to strengthen long-term supply agreements?

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1) Brexit uncertainty

- only UK based buyers can guarantee frictionless markets
- only UK farmers can guarantee frictionless supply
- Expected UK reduction /removal of area subsidies (BPS) means “growing to order”
- Focusing on home markets reduces exposure to swings in the value of the pound

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Why is this a good time to strengthen long-term supply agreements? (cont.)

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2) Scotch Whisky – malting barley requirements

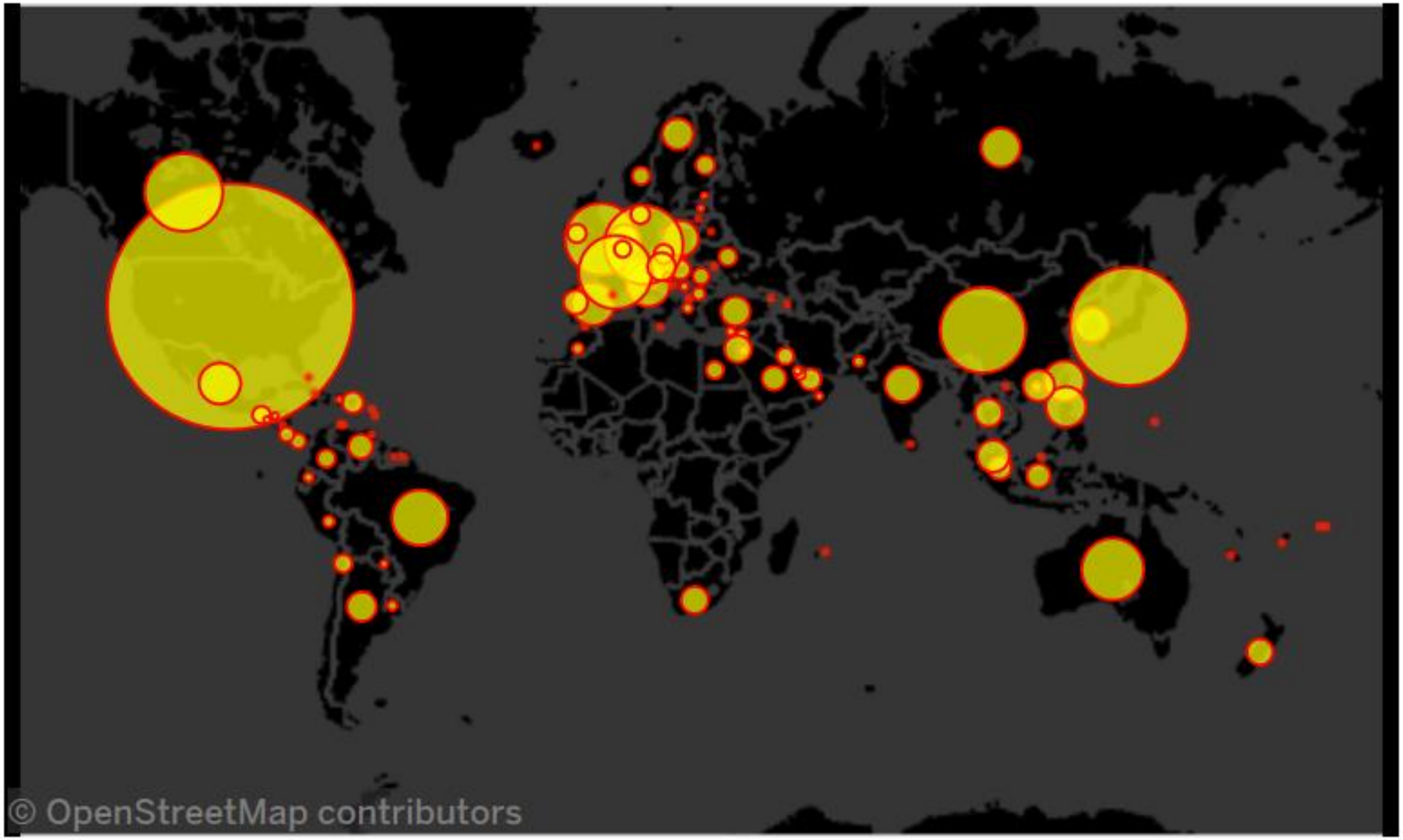
- Specific (non-GN*) malting varieties and low N
- Both increasingly hard to source or sell outside Scotland

3) Scotch Whisky – grain distilling requirements

- High spirit yields – maize or soft wheat
- Non-GM# grain requirements
  - Only EU maize – access at risk from Brexit
  - All wheat non GM but only UK grows right
  - soft wheat varieties

(Note - * GN - Glycosidic Nitrile, # GM – Genetically Modified)

Where there's MacDonalds, there's fries – and processing potatoes!



Source: Guardian

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Seed potato exports new market Sub Saharan Africa key target

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Scottish seed potato exporters set to increase tonnage to Brazil and Kenya

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Source: Potato pro

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No Deal preparation

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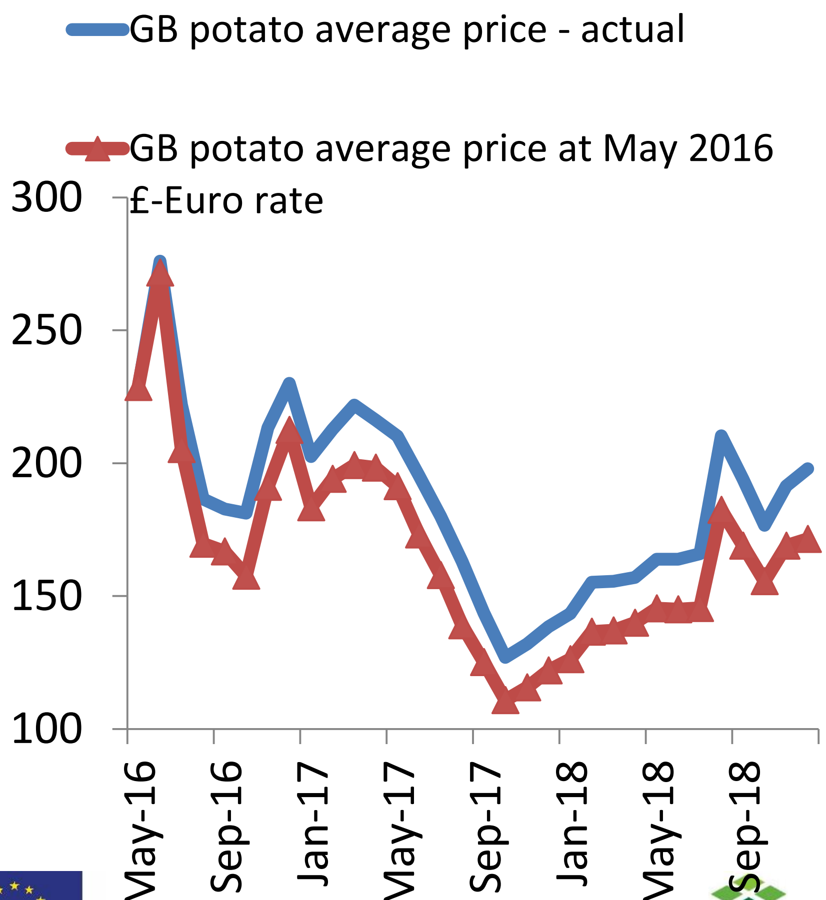
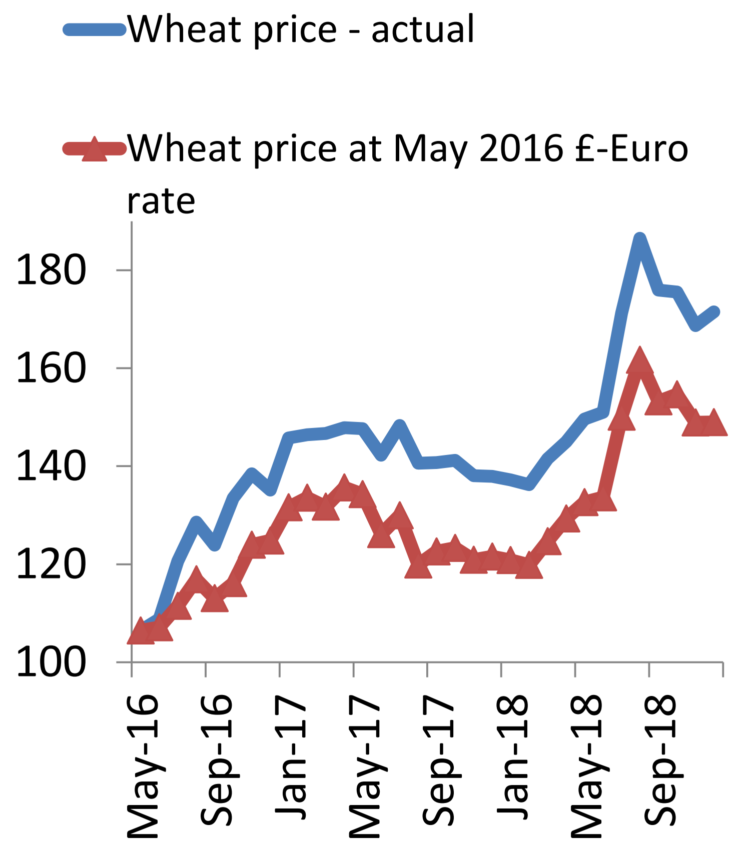
Weak £ adds £20/t to UK potato / grain price since EU ref. "No Deal" could add another £20/t, "Soft or No Brexit" could take £20/t away.





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Source: AHDB, SAC Consulting

Sterling is not the only currency facing issues in the year ahead -

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Euro -

Italy spending

US dollar -

Trump, the economy, China

Euro -

France protests

Source: AHDB, SAC Consulting

Should I sell forward given the heightened currency uncertainty?

Well yes, with care.

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- The sterling exchange rate is a natural hedge against a "Hard Brexit"; weaker currency = higher grain prices.
- Input costs will also rise but net farm income effect is positive
- On the other hand a favourable Brexit outcome and the £ strengthens = lower grain price.
- Response? – sell forward a proportion of expected crop as usual to cover <u>current</u> costs (seed, fert, fuel) and sterling costs (rent, interest), hold crop unsold to cover future costs

No-deal Brexit prep –
"low cost, low opportunity cost"?

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Finance

- Reduce borrowing
- Move overdraft onto long term loan
- Move to fixed interest rates

Sales and inputs

- pre March 2019 - bring forward crop sales to cover increased forward buying / storage of;

- (1) Ag Chem – for whole of 2019 growing season??
- (2) Fuel, Fertiliser – as storage permits

Start to understand typical trade flows, <u>potential</u> Opportunities & Risks

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Potential Opportunities

- Import substitution – e.g. bread milling wheat (risky in Scotland), feed wheat to replace maize
- Demand from livestock sectors **gaining** from tariffs
- High value domestic or export e.g. whisky (0% tariff)

Potential Risks

- Feed wheat and feed and malting barley exports
- Feed demand from livestock sectors **losing** from trade/tariff changes e.g. barley for beef
- **Caution - too early to pick winners!**

Crops - Brexit outlook

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1) Crop sector exposed to Brexit uncertainties

- EU accounts for 70-80% of UK cereal trade ~ 20% of seed potatoes
- Fortress EU makes trading on WTO terms difficult
- Scotland less exposed to EU but linked via UK trade
- Potatoes 3rd co exports more secure, EU main risk
- Livestock key market for grains and straw

2) In uncertain times, get closer to your markets

- Brexit may bring changes in tariffs, trade-flows
- Understand buyer's requirements
- Be aware of domestic / export exposure of target market, Brexit impacts & opportunities

Nobody knows what's going to happen- can you lower risk / increase resilience?

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1. Increase financial resilience

- Move loans from short term to long term
- Delay investment, hold cash

2. Diversify markets and income

- Favour dual use varieties, e.g. swop hard feed wheat for good soft distilling, yield penalty but choice of two markets
- Diversify income – AD crops, off-farm income

3. Minimise Apr – Jun trading exposure

- Forward buy essential spring inputs before March – seed, fert, agchem, fuel <u>where feasible</u>
- Consider risks for holding grain unsold after March

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Brexit update summary

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Short term – its all about the deal or not

- **Deal –** status quo on subsidies, trade and regulation – more or less until 2020
- **No-deal** – high impact – shift in cereal trade, loss of EU seed potato markets for 1yr or more, 3rd cos less affected, probability? Judge for yourself!

Medium term

- **Subsidies – 2019 - 2020 - 2022** – Scotland – subsidy regime 'similar', **2023+** - unclear >public good < £direct payment?
- **Trade and regulation -** If we avoid No-Deal then depends on nature of EU deal – unlikely to be concluded by 2020 – could be 2025 or later. EU orbit or US? Impact varies by sector.

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