Irish agrifood: A successful Mix and Match export strategy

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Executive summary

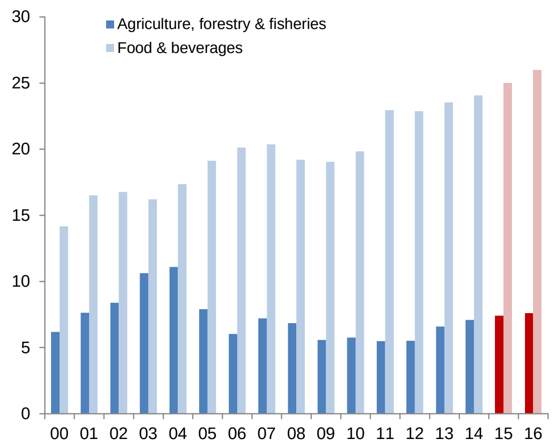
- Agrifood is Ireland's largest sector, contributing to 25% of manufacturing sales and two thirds of manufacturing employment
- Irish food and beverages (F&B) output is forecasted to reach EUR26bn by 2016 (+8%), and EUR8bn for Agriculture thanks to dynamic local demand and high openness to foreign trade
- Agrifood represents 12% of total Irish exports, led by meat and dairy products (40% of agrifood exports).
- Meat and dairy exports have grown +7% annually between 2010-14 and are expected to maintain momentum with relaxing regulations (e.g.: lifting of EU Dairy quota in March 31st 2015)

Industrial production for food and beverages (F&B) has enjoyed strong continued momentum with an average annual volume growth of +9% since 2010

This makes the F&B industry three times as large as the agricultural sector, gross output being worth EUR 24 and 7.1bn respectively. In value though, agriculture has risen faster than F&B (+6% vs. +4.9%), between 2010 and 2014, thanks to quicker growth in farm product exports than those of (industrially) prepared products.

Euler Hermes forecasts Irish output of F&B to reach EUR26bn (+8%) by 2016. This forecast is based on a combination of strong domestic demand and dynamic foreign trade. Domestic household expenditures for F&B have consistently improved these past years at +2.8% per annum in 2010-14: while food and non-alcoholic beverages grew by +4.5%, Alcohols haven't made any headway (+0.7%).

Chart 1: Agriculture and Food industry output (EURbn)



Sources: Oxford Economics, Cso, Euler Hermes

This trend underpins the national objective to expand sales of Irish Spirits – brewery and whiskey first – abroad, particularly to Asia. More generally, the agrifood industry relies heavily on the dynamism of export activities. The evolution of global commodity prices, that considerably influence income levels, is therefore decisive for the Irish agrifood industry.

The downward trend of agricultural prices is particularly harmful for Irish farmers, making it harder to reach break-even

The Global Food index, representing average price of agricultural commodities worldwide, further declined in June 2015 (-19.2% y/y) reaching a 6-year low. This stems mostly from Dairy products which experienced a sharp drop (-29% y/y), combined with a fall in all other agricultural commodities, including meat (-17.5% y/y).

However, the overall situation is shaded by the positive net trade effect (NTE) Ireland enjoys. According to the Central Statistics Office and the Department of Agriculture, the difference between world prices and those of Ireland favors the latter and amounted to a gain of EUR368mn in 2014.

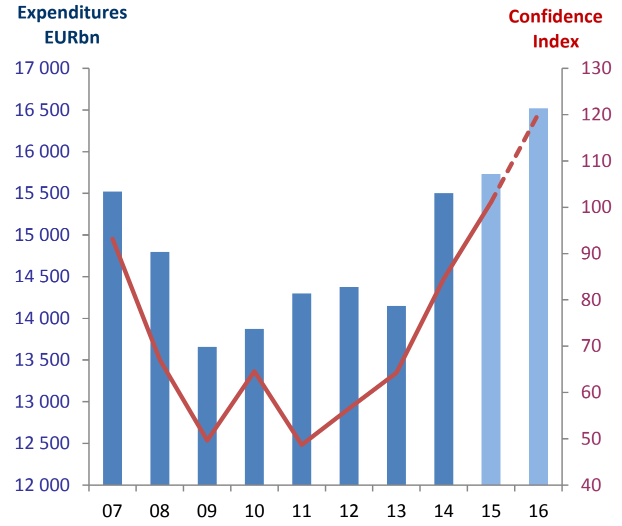
This is notably attributable to Ireland's choice to position on premium products' exports, while not betting solely on niche markets. The country has not invested beyond certain measures in specific brands, like the Angus in Scotland for instance, but asserts the finer quality of their products (e.g.: grass fed cows). This positioning is particularly interesting taking into account the great expansion of the worldwide Middle-class – forecasted to nearly double by 2020 – and the observed general shift of diets towards finer foodstuffs as people get wealthier.

Ireland has been diversifying its trade partner portfolio in order to mitigate concentration risk stemming from close ties with the UK

Irelands benefits from a strong positioning in Europe, particularly with the United Kingdom absorbing 44% of Irish F&B exports. To mitigate this strong dependency risk, Ireland has been focusing on (i) long-standing partners (Belgium, Denmark) but also (ii) new and remote destinations (Vietnam, Nigeria). However, results appear long in coming since the share of UK has only ceded 1 point since 2009.

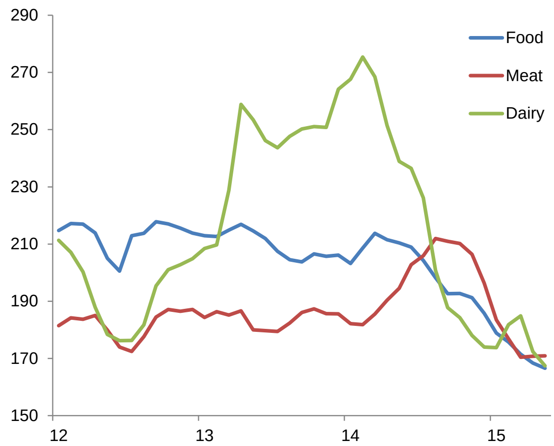
However, new growth opportunities for Ireland are arising in the US and China with the successive lifting of meat import bans granted in early 2015. While the US might be a challenging market to penetrate, given the difference in consumer expectations pertaining to meat quality, China may prove easier - especially regarding pork. Additionally, the lifting of the dairy production quota in the European Union, that occurred in April 2015, offers significant development possibilities for Ireland in the long-run. China also seems particuarly promising, where demand for infant formula is very high.

Chart 2: Household F&Bexpenditures vs. Consumer Confidence (Ireland, EURbn)



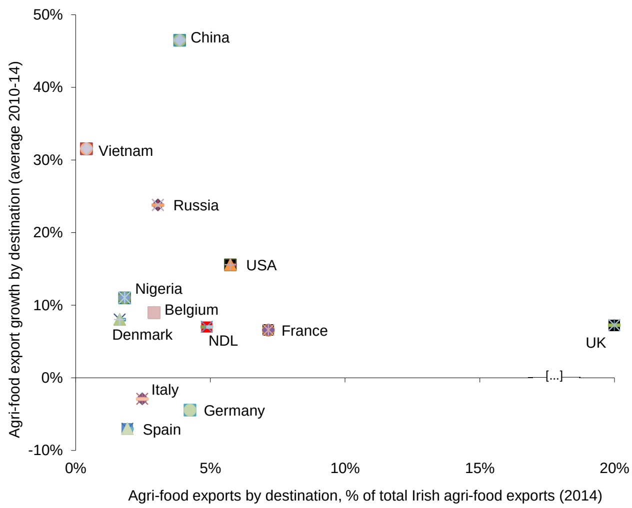
Sources: CSO, IMF, Euler Hermes

Chart 3: Agriculture commodities price (Index: average 2003-2007=100)



Sources: FAO, Euler Hermes

Chart 4: Irish Agrifood exports (% growth)



Sources: ITC, Euler Hermes

Meat and Dairy represent 61% of the F&B operating surplus and nearly half of Irish agrifood exports in 2014.

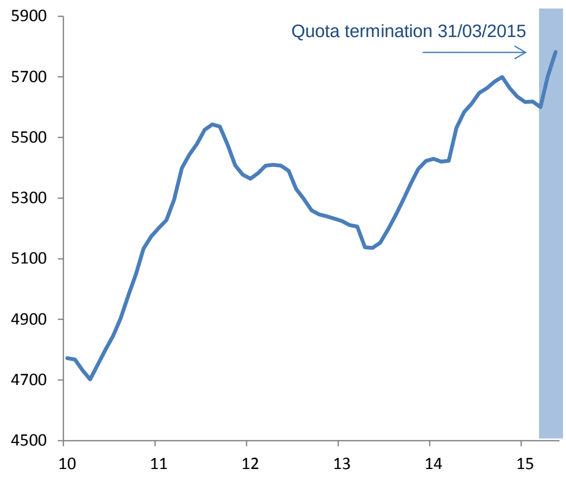
The limitation to the development of Dairy exports will be potential supply issues in Ireland, as the extension of production capacity and herds can only be progressive. Though, farms' investments doubled between 2010 and 2014 to EUR900mn. Dairy production is forecasted to increase by half within five years. The immediate negative effect of this is the drop of dairy prices in response to sudden upturn in production. Dairy farms are signing longer-run contracts (2 to 3 years) with cooperatives in order to ensure steadiness in prices and their bottom line, contributing This will certainly contribute to stabilizing prices in the long run. It appears that the Irish dairy sector reports strong fundamentals, with Family Farm Income (FFI) being twice as high as the average, and hardly dependent on Common Agricultural Policy (CAP) funding: Direct Payments from the EU represent 33% of FFI compared to more than 100% for Meat producers.

Irish meat is particularly reliant on exports, being that production is seven times higher than domestic consumption.

Meat exports are forecasted to reach EUR2.8bn in 2015 and EUR 3bn in 2016. This export dependency is a matter of particular concern as the UK assesses the possibility of exiting the EU (Brexit). Should they abandon their membership, the UK would reassess all trade agreements and possibly seek cheaper supply, possibly from Brazil. These two countries are among the world's largest meat producers, with utterly distinct product positioning when compared to Ireland: more volume, less expensive. This risk is limited however by the high standards expected by European consumers in terms of quality, providing to Ireland a good chance of remaining in the race. However, this implies a need to strictly monitor sanitary risks, as they greatly damaged the Irish meat industry in the late 90's and early 2000's

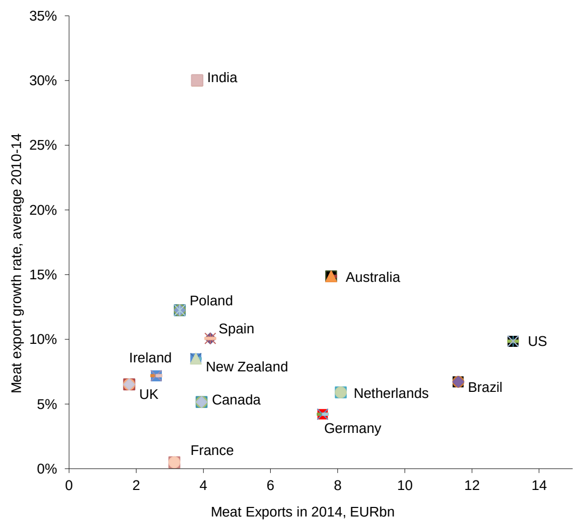
Overall, global demand and supply for meat is forecasted to grow hand in hand over the next decade at +12.5%, fueled by the Middle East and Asia while European output should stagnate (or even drawback). The ability of Ireland to strengthen its position in China and the US will be decisive to ensure the continuation of positive NTE.

Chart 5: Intake of Milk by Creameries in Ireland (Rolling 12 months, Million liters)



Sources: CSO, Euler Hermes

Chart 6: Irish meat exports (EURbn)



Sources: ITC, Euler Hermes