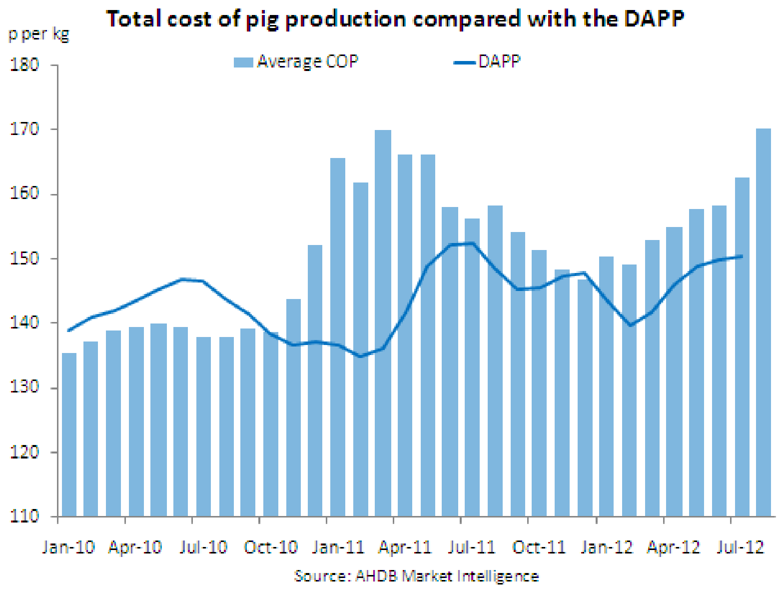
Feed price rises put pressure on pig industry

- High and rising feed costs mean that the total cost of producing pigs is currently much higher than the price which farmers received, leading to an average loss of about £15 for each pig
- Pig producers have been in a loss-making situation for almost two years, dating back to October 2010
- Prices for wheat and soya, the most important ingredients in pig feed, have risen rapidly in the last few weeks due to weather conditions in South America, the US and the Black Sea region
- Increasing pig prices would put great pressure on a processing sector where margins are already tight, evidenced by plans to close a key abattoir in Scotland
- Unless action is taken to improve the functioning of the supply chain, there is a real risk that the UK pig industry will contract at a time when there will also be lower supplies available for import

Cost of production

Latest provisional estimates of the cost of pig production in August put the total cost at a record level of over 170p per kg. Feed costs make up 112p per kg, just over 60 per cent of the total. These figures do not take full account of recent rises in feed prices (see below) and the cost of production is likely to rise further in the coming weeks. While prices are particularly high in the short-term, the cost of production will remain as high as 167p per kg post-harvest, based on futures prices, and is unlikely to drop much below 160p per kg for the foreseeable future.



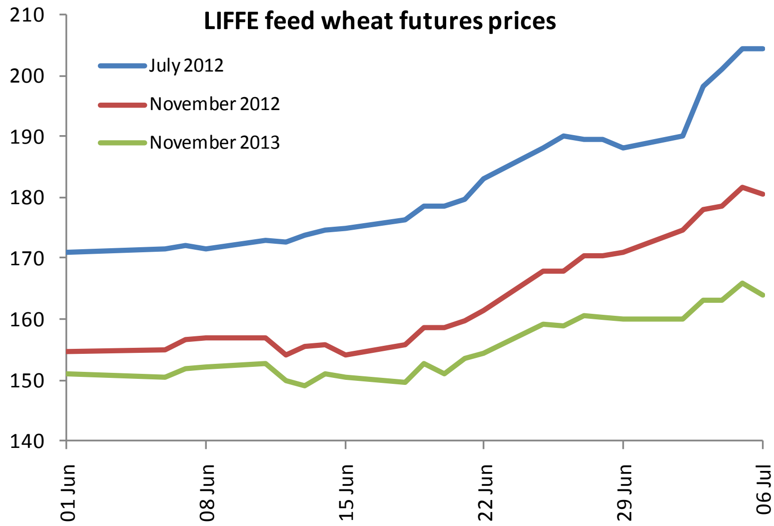
The current average price paid for pigs is around 150p per kg. Based on the August cost of production estimate, this means that producers are losing an average of 20p per kg, equivalent to a loss of over £15 per pig. In recent months, feed costs have risen faster than the DAPP, increasing the losses experienced by producers. However, producers have now been in a loss-making position for 22 of the last 23 months, dating back to October 2010. Cumulative losses during this period are now approaching £150 million.

High costs will also impact on pig producers elsewhere in the world, including the EU Member States which provide most of the pig meat imported to the UK. Indeed, the weakness of the euro means that feed prices rises may be even higher there, given the importance of commodity markets priced in US dollars. This comes at a time when many EU producers still need to make investments to comply with the new welfare regulations which come into force at the start of next year.

Feed prices

In recent weeks, the price of **feed wheat**, the most important component of pig feed in the UK, has risen by over £20 per tonne. At the start of June, UK LIFFE feed wheat futures for July delivery stood at £171 per tonne. By 15 June, this had risen marginally to £175 per tonne. Three weeks later, on 6 July, the price had reached £204.25 per tonne. Delivered prices have followed futures prices fairly closely but vary somewhat across the country. This price increase partly reflects the likely delay in this year's harvest as a result of adverse weather conditions, putting pressure on the remaining supplies from last year's harvest. While this impacts on feed costs in the short term, of more significance is the movement in futures prices for new crop feed wheat.

At the start of June, LIFFE feed wheat futures for November delivery stood at £154.75 per tonne as prospects for the 2012 harvest looked promising. This figure changed little during the first half of June but then began to rise sharply. By Friday 6 July, the price had reached £180.50 per tonne and rose further on Monday 9 July. Futures prices for November 2013 have also risen, albeit less sharply, to over £160 per tonne.



While recent price rises partly reflect concerns about the UK harvest, of far more significance is the situation in the US, the most important producer of maize for animal feed. Although maize is not widely used in pig feed in the UK, it is the major component of feed in most of the world and, hence, its price has a heavy influence on feed wheat prices. Weather has been the main driver of maize prices, with hot and dry conditions creating concerns over the yield potential of the US maize crop. The area planted is the highest since 1937 but, after a promising start, the crop has deteriorated in the heat. The most recent USDA crop condition report, published on 9 July, cut the share of crops rated good or excellent to 40 per cent, with 30 per cent poor or very poor; this time last year 69 per cent were rated good/excellent. Drought conditions have also impacted on the important Black Sea region this year and any rain is likely to be too late to improve yields as the harvest has already started.

At the same time, prices for the other major component of pig feed, **soya meal**, have also been rising rapidly, a trend which began around the turn of the year. As at 6 July, CBOT soya meal futures were up nearly 20 per cent since the start of June and more than 50 per cent since the start of the year. UK prices have followed a similar trend, with home produced Hi-Pro soya meal ex-mill Liverpool reaching £440 per tonne, having been below £300 at the start of 2012. Rising soya meal prices have also pulled up prices for alternatives such as rape meal and sunflower meal.

Again, weather conditions are the main reason for higher soya prices, impacting on both the South American and North American crops. Argentinean farmers have nearly finished harvesting their soyabean crop, with production estimated at 40.5 million tonnes (49Mt in 2011/12). US soyabean crops have also been affected by the drought with just 40 per cent considered in good or excellent condition. Farmers in southern growing states, who had harvested wheat early, had hoped to double crop land with soyabeans but the opportunity to do this may be limited due to low soil moisture.

Changes to feed composition

The overall cost of production calculation referred to above assumes a stable mix of ingredients in pig feed. However, in reality the mix changes in response to prices. There is no easy way of tracking changes in the short-term but longer-term trends can be followed. For example, each month Defra publishes data on the use of different ingredients in all animal feed, although not for individual species. This shows that in the three months to May 2012, the amount of soya meal used was marginally lower than a year earlier but the amount of sunflower meal used was 47 per cent higher. There was also evidence of the impact of price movements in the cereals used, with wheat increasing at the expense of barley, prices for which have been consistently high in recent months due to increased demand from distillers and brewers.

Supply chain implications

As outlined above, the current financial situation of UK pig producers is serious. Losses at current levels are not sustainable and could force a significant number of producers to leave the industry. This would reduce pig meat production, driving up prices and increasing the UK's reliance on imported products. Given that high feed costs are likely to persist for the foreseeable future, the only way that this will be avoided is if pig prices increase significantly.

Availability of imports could be lower in future as well, since high feed costs will impact on the profitability of producers across the EU. Irrespective of feed prices, the new welfare regulations are forecast to result in a fall of around five per cent in pig meat production over the next two years. If feed prices remain high, production could fall even more, with a significant impact on prices.

If pig prices do increase significantly it will put greater pressure on the processing sector, which is already experiencing tight margins. Evidence for this comes from the recent announcement that Vion is considering closing its pig abattoir at Broxburn in Scotland. This could have serious implications for the Scottish pig industry, since the plant slaughters around three-quarters of Scottish pigs, but it also emphasises the difficult trading conditions facing all processors.

The vulnerability of the pig meat supply chain was highlighted in a recent independent study by the Centre for Research on Socio-Cultural Change (CRESC) at Manchester University. It says there is a continuing crisis which cannot be resolved because of "opportunist dealing" right along the chain, which undermines efficiency and create a dysfunctional, adversarial food supply chain. The report recommends that, to improve the functioning of the supply chain, there should be more vertical integration between processors and retailers and more horizontal integration between producers, through the formation of large co-operatives. This should help make the supply chain more resilient to price shocks, such as the rise in feed prices, and enable it to plan and invest for the future.