



# Agri-food - Sector report United Kingdom





Looking forward, we see a number of key trends and challenges that will shape the industry:

- 1. Geopolitics:** The invasion of Ukraine has affected the global food supply and therefore prices. Before the conflict, Ukraine supplied 12% of the world’s wheat, 15% of corn and 50% of sunflower oil. As geopolitical tensions continue, we expect continued volatility in agricultural prices.
- 2. Growing population:** As the world’s population hits 8.05bn people in 2023 (UK: 68mn people, +0.35% y/y), ensuring access to food is key to avoid a global food crisis in the coming years.
- 3. Climate change:** Changes in temperature, humidity and rainfall patterns, as well as the frequency of extreme weather events (storms, droughts, wildfires) and the prolongation of the “El Nino” phenomenon into 2024 will continue affecting farming practices and food output capacity.
- 4. European energy crisis:** With natural gas and electricity prices to remain above historical levels, we expect the price of fertilizers to remain relatively high as well in the short term.
- 5. Veganism:** Much of the world is trending toward plant-based eating and this global shift could be here to stay, representing a considerable decrease in consumption of animal meats and animal-derived products. In the UK, it is estimated that around 8% of the population is already following a plant-based diet.
- 6. Online distribution:** Through apps and websites, virtual grocery shopping has become more attractive, especially for young people. This trend will continue to gain momentum and we believe that it will become a challenge for physical retailers.

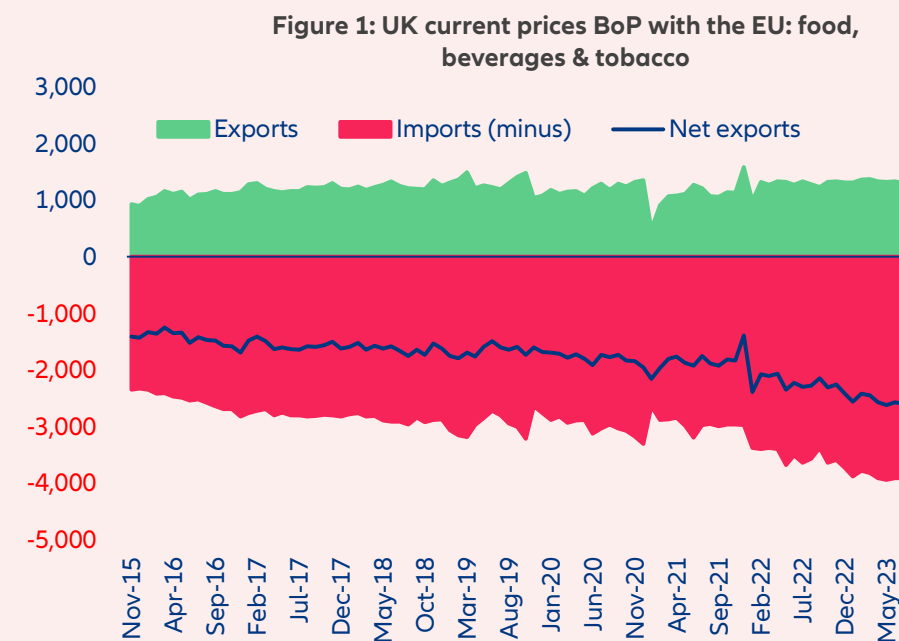
Sector rating (global): **Medium Risk**

Sector rating (United Kingdom): **Sensitive Risk**

Strengths	Weaknesses
Pricing power for farmers in the upstream segment, and for some specific products and brands in the downstream segment	Vulnerable to climate change: more frequent and severe floods and storms affect crops and livestock, limiting food supply
Continuous growth potential: strategic sector considering the vital role of feeding an exponentially growing population	Food-processing and packaged-food companies continue to struggle with high input costs, which could lead to further pressures on margins in fragmented segments where low prices are key to attract clients
Increasing revenues, despite inflation, given the non-cyclical nature of the sector and the strategic pricing that have made companies resilient	Labor shortages in the food and farming industries in the UK are leading to higher personnel expenses

### Sector Overview:

It is estimated that around 70% of UK land area is used for agricultural production. However, as not all land is suitable for growing crops – and the land in some regions suitable only for certain crops – most of this land area is grassland for grazing. To secure the national food supply, the UK relies both on its own production (around 60% of its internal food consumption) and on imports. But despite the fact that UK’s self-sufficiency index has remained stable over the last two decades, even through major changes such as Brexit in 2020, the UK is actually a net food importer, importing more than it exports, both relative to the rest of the world and also with respect to the EU (Figure 1).



Sources: Office for National Statistics (ONS), Allianz Research

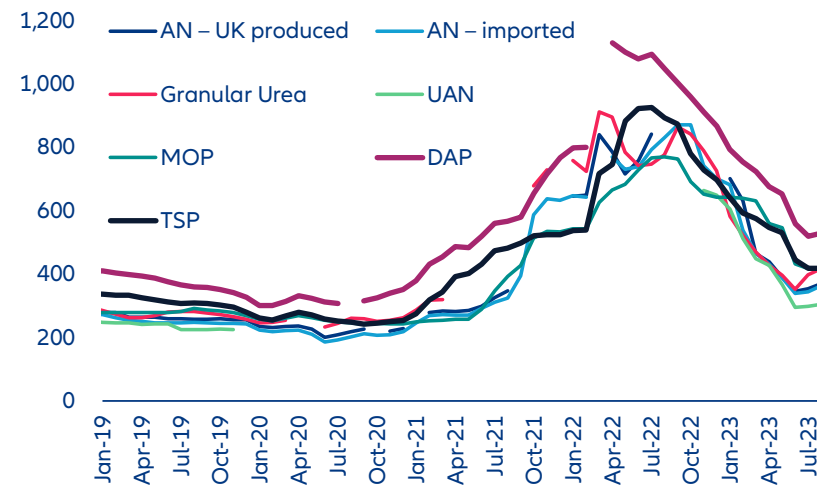


## Sector Overview:

Climate change is likely to have a significant negative effect on the proportion of arable farmland available in the UK, which could put food supply at risk due to soil degradation. In parallel, other climate-related adversities such as droughts and flooding are expected to recur with greater frequency and intensity, damaging existing crops. For instance, the El Niño weather phenomenon, which has been quite strong in recent months, is predicted to continue at least until April 2024. This could have a strong impact on global food prices, affecting both the supply and cost of various staple commodities. Domestic production in the UK also faces other risks, such as animal diseases (eg. swine fever or avian flu), fertilizer shortages and changing labor markets.

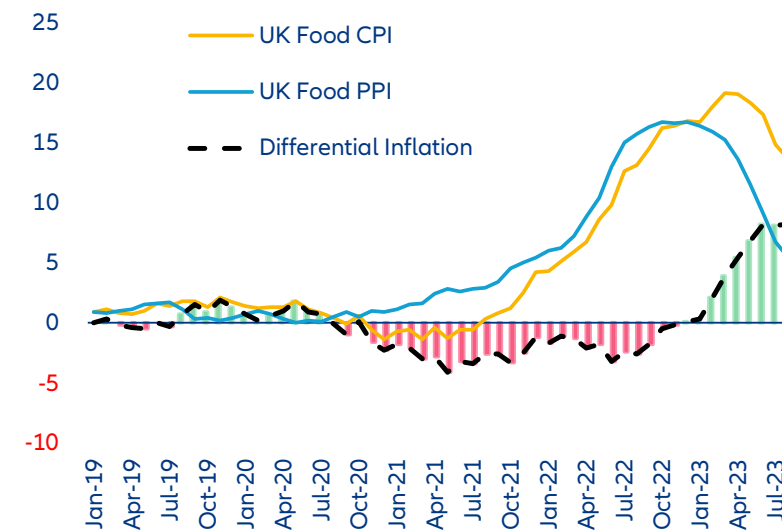
Russia is the world's largest supplier of natural gas and is responsible for 33% of the world's fertilizer production. As a result, the trade sanctions imposed on Russia tightened the supply of fertilizers globally throughout 2022 and 2023, while in parallel, other key fertilizer-producing countries, such as Germany, were forced to limit production due to high energy costs. At one point in late 2022, around 70% of Europe's ammonia production capacity was substantially reduced or shut down. The aftermath has been an unprecedented increase in the price of fertilizers, which represent around 12% of input costs of field crop farms. In the UK, for example, fertilizer prices more than tripled and peaked in summer 2022 (Figure 2). Fortunately, so far in 2023, they have become more affordable as a reflection of declining natural gas prices. However, lingering supply issues amid an inflationary backdrop mean prices will remain above historical averages for the next few quarters, alongside those of most soft commodities.

Figure 2: Fertilizer prices in the UK (GBP/ton)



Source: AHDB, Allianz Research

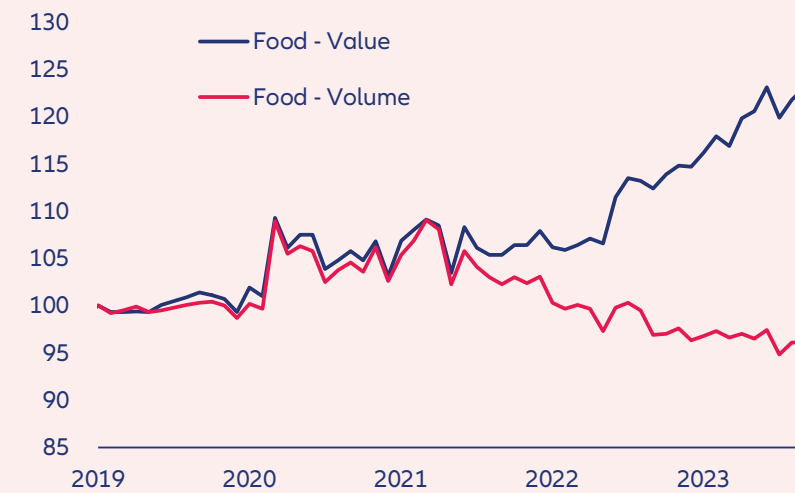
Figure 3: Food CPI and PPI in the UK



Source: Bloomberg, Office for National Statistics (ONS), Allianz Research

In recent months, both the EU and the UK have experienced a notable trend of food inflation outpacing headline inflation. This obviously reflects the rise in agricultural commodity prices that we highlighted above, stemming from supply-chain disruptions, the Russia-Ukraine war and rising logistics and fertilizers costs. In Europe in particular, surging energy prices have more severely impacted food-production costs in the region than anywhere else, especially for energy-intensive processes such as food refrigeration, processing and transportation. As shown in Figure 3, the UK's consumer prices have been beating producer prices so far this year. The reversal of 2022's adverse differential inflation has helped food retailers to stabilize their margins despite the fact that sales volumes have been weakening.

Figure 4: Food retail sales in the UK (index, 2019 = 100)



Source: Office for National Statistics (ONS), Allianz Research

When compared to its G4 peers (Eurozone, the US and Japan), the UK is the country where the increase in food CPI has been most remarkable over the past year, followed by the US. The fact that households are paying more for food has led to spending increasing but consumption decreasing, even if food is clearly a staple. Figure 4 shows how food retail sales in the UK have been falling in volume terms since the end of 2021 (-1.0% YTD), while in value terms food retail sales have been progressively increasing (+5.6% YTD). Because premium brands have been increasing prices more than cheaper labels, thanks to their higher pricing and branding power, consumers – notably low-to-mid-income ones – have chosen to downgrade their pantries (switching to cheaper labels when possible), which in parallel has intensified the price war between low-budget food retailers.

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