The Red Meat Sector Operating Environment

Half-yearly review: July 2017

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Executive Summary

- After a firm 2016, the UK economy grew more slowly in the early part of 2017 as consumer spending came under pressure from a squeeze on incomes. However, business-to-business services continued to perform well and overseas demand for UK goods and services picked up. Business surveys had reported a more positive economic environment in the first quarter of 2017 (Q1) than the official data, but sentiment did drop in Q2. Despite many labour market indicators suggesting a return to 'normality', employment growth showed signs of lifting after pausing in late 2016.

- Inflation has risen sharply, moving well above the Bank of England's (BoE) 2% target due to rising import and commodity prices. Despite a robust labour market at close to full employment, pay growth has remained subdued. Now that inflation has risen, wages have fallen back in real terms.

- With the banking sector remaining more risk averse than in the first decade of this century, firms have shown signs of looking to alternative sources of financing. While some business surveys have reported subdued demand for credit, the official data shows firm growth in lending to companies and households. Growth in consumer credit remained strong, but it may have passed its peak.

- While the amount of money spent at retailers held firm in the spring of 2017, rising inflation meant that growth in sales volumes at food and non-food stores slowed.

- Monetary policy continues to support the UK economy, holding down interest rates for firms and households. Thus far, the BoE has been willing to accept above-target inflation. On the fiscal side, the UK government has signalled an intention to slow the pace of budget deficit reduction. While it has continued to lower taxes on labour income, working-age benefits are facing cuts.

- The euro area economy made a strong start to 2017, with the official data reflecting the optimism of business surveys. Although remaining elevated, unemployment rates continued to fall. The European Central Bank (ECB) maintained a loose monetary stance, but did adjust its message, indicating further loosening is off the aganda. Policy continued to support growth in lending to firms and households, but core inflation has remained stable. The EU Commission has affirmed its support for a small degree of fiscal expansion, but Member State budgets point to a neutral fiscal stance.

- Following last year's adjustment downwards in value, sterling has been more stable this year. In addition to sentiment about future trading relationships, changes in the outlook for monetary policy have become a more prominent driver of exchange rate fluctuations. A weaker sterling has made it easier for UK red meat exporters to compete in price sensitive markets at home and overseas.

- The UK economic outlook is mixed. Inflation is likely to stabilise at around 3% as past increases in imports and commodity prices have passed through supply chains into retail prices. With pay growth likely to remain soft, the squeeze on disposable incomes that began early in 2017 is likely to continue. Although some investment plans will remain on hold due to longer-term economic uncertainty, where a weaker currency has supported export activity, there is the potential for investment in additional capacity. With the UK economy close to full employment, employment growth may settle down again.

- On the red meat side, lower domestic production and a weak sterling have supported producer prices. Strong competition between retailers has held down meat price inflation in recent years, but this may be about to change as the supply chain begins to recover some of its increased raw material costs.

- Going forwards, beef and sheepmeat production is expected to fall in H2 2017, but pig production may begin to recover having contracted in late 2016 and H1 2017. Tight supply is likely to support import demand for beef and sheepmeat, while restricting export growth. For pigmeat, imports may struggle to match the highs of 2016, while exports may stabilise.

Contents

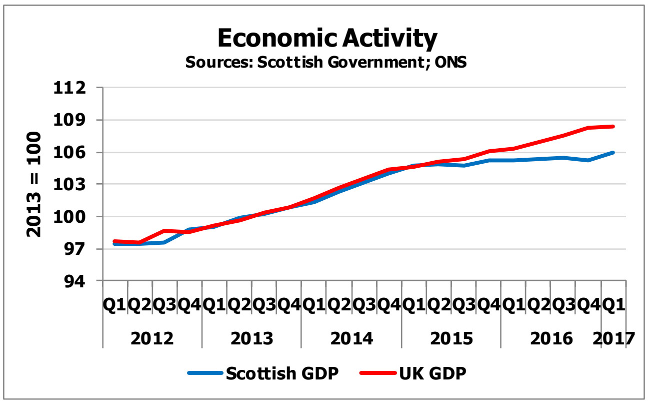
What is happening in the UK economy?

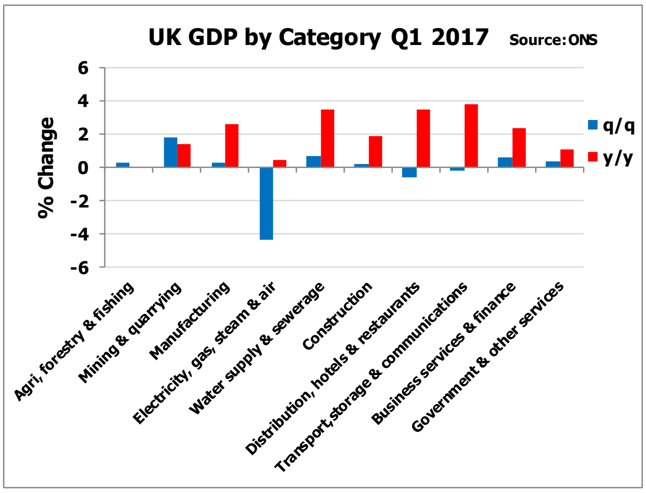
Macroeconomic Indicators

Economic Activity:

	Economic Growth Rates Source: ONS						
	Q1 2017		Q4 2016		Q3 2016		2016
	q/q	y/y	q/q	y/y	q/q	y/y	y/y
Scotland (GDP[1])	+0.8%	+0.7%	-0.2%	+0.0%	+0.1%	+0.7%	+0.4%
UK (GDP)	+0.2%	+2.0%	+0.7%	+1.9%	+0.5%	+2.0%	+1.8%

GDP





During 2016, the UK economy grew at its slowest pace since 2012. The Office for National Statistics (ONS) estimates that UK GDP increased by 1.8% in 2016, compared with 2.2% in 2015 and 3.1% in 2014. GDP grew in line with its historical average in the second half (H2) of 2016, with the vote to leave the EU having less of an impact than had been feared. However, moving into 2017, the pace of expansion slowed sharply, slipping to 0.2% in the first quarter (Q1).

The Scottish economy began to diverge from the wider UK economy in 2015 and GDP growth slowed markedly in 2016, only edging up by 0.4%. A difficult year for the Scottish economy was rounded off with a 0.2% contraction in Q4 2016. However, activity rebounded in Q1 2017, rising by 0.8%; its strongest quarterly expansion since Q4 2014. Manufacturing made a notable recovery of 4.1% on the quarter, pushing it 0.7% above Q1 2016 levels, while services rose by 0.3% on the quarter and by 1.2% on the year. However, construction posted its fifth consecutive quarterly contraction. Agriculture, forestry & fishing output rose by 0.4% in Q1 and was almost 1% larger than a year earlier.

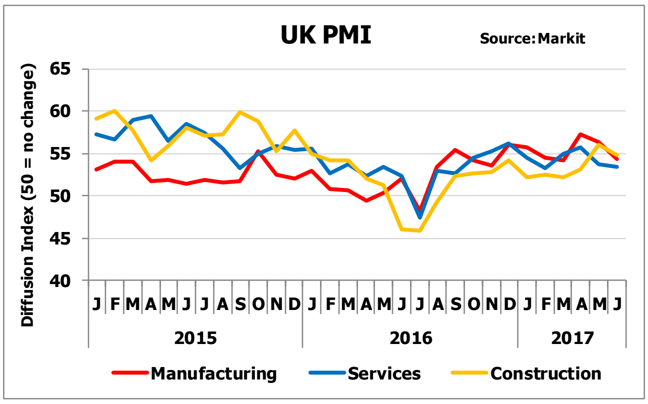
In 2016, the service sector continued to underpin the UK economy, growing by 2.9%, well above the 1.8% overall expansion. This was the 18th year in 20 in which services had out-performed the overall economy. However, in Q1 2017, services had their weakest quarter for two years, edging 0.2% higher. This lowered the annual growth rate to 2.4%. Consumer-facing services had a challenging quarter, but business-to-business activity and the financial sector grew at an above average rate.

[1] GDP (Gross Domestic Product) = GVA (Gross Value Added) + taxes on products – subsidies on products. It is a measure of the total economic output of the domestic economy. GDP is seasonally adjusted to allow comparisons from quarter-to-quarter and is referred to in real terms – adjusted for inflation.

The UK economy continued to rebalance away from production (of which manufacturing accounts for 70%) in 2016, lagging services for the 19th time in 20 years. Production rose by 1.2%, with manufacturing rising at a slower pace of 0.7%. In Q1 2017, manufacturing outpaced services, rising by 0.3% on the quarter and by 2.6% year-on-year.

In Q1 2017, UK construction output edged up by 0.2% on Q4 2016 and was 1.9% above year earlier levels. Having contracted by 3.4% in 2016, the agriculture, forestry & fishing sector recovered slightly in Q1 2017, and this was sufficient to return output to its year earlier level.

Purchasing Managers Index (PMI)



The monthly PMI surveys provide a more up-to-date measure of private sector activity. As can be seen in the chart, business activity growth held firm across the UK private sector in the first half of 2017 (H1). During Q2, all three sectors posted average scores of 54-56 that were similar to late 2016 and early 2017. However, it should be noted that a slowdown was reported in June.

Taking services first, June saw the smallest increase in new orders for nine months. There were also reports of falling consumer and business confidence, with an uncertain General Election result and the start of Brexit talks weighing on sentiment. Also, optimism about sales growth in the year ahead dropped to its lowest level since the immediate aftermath of the EU referendum. More positively, due to the level of projects already in the pipeline, backlogs rose further. An average of 54.3 for Q2 suggests that service sector output rose at a quarterly rate of around 0.4%.

In manufacturing, the PMI surveys point to continued growth in new orders from both the domestic economy and from overseas, with the latter underpinned by the weak sterling exchange rate. However, like in services, the June survey reported a slowdown in expansion while confidence about sales growth in the coming year dipped back. Nevertheless, confidence remained strong with 48% of firms expecting a rise in the coming twelve months versus only 7% expecting a challenging year. The Q2 rolling average rose to 56 compared with Q1's 54.8, indicating an expansion of around 0.6%.

In construction, order growth was underpinned by strong demand for new homes but demand for commercial and infrastructure projects grew more slowly, resulting in some idling of resources after completion. It was also reported that rising economic and political uncertainty had resulted in lower confidence and had led to delays in some commissioning.

During Q2 2017, there were increased reports of Brexit-related uncertainty leading to businesses taking a cautious attitude towards investment. In July, nearly 40% of firms responding to a CBI survey reported that Brexit had negatively impacted investment plans. The ONS estimates that business investment fell by more than 6% from the previous quarter in Q1 2017, but was still around 2.5% higher than a year earlier at £42.8bn. A breakdown by sector shows that, at £5.1bn, manufacturing investment fell by 10% on the quarter and on the year.

Summary

Official data indicates that the UK economy has grown more slowly in 2017. While manufacturing has been boosted by a weak currency and business-to-business services have continued to perform strongly, consumer-facing services have faced growing headwinds. Business surveys have reported firm demand for UK goods and services producers from both the home market and overseas, resulting in a backlog of work to process. However, rising economic uncertainty has led to a fall in confidence.

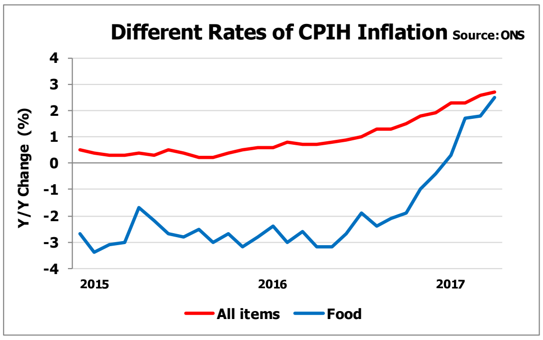
Inflation:

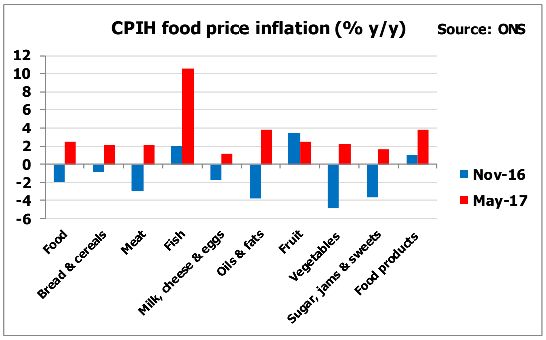
	UK Rates of Inflation (y/y)		Source: ONS
	Mar to May 2017	Dec 2016 to Feb 2017	2016
CPIH	2.5%	2.0%	1.0%
Core inflation[2]	2.3%	1.9%	1.6%

The Consumer Prices Index (CPIH) - the government's favoured measure of inflation - has been rising steadily since late 2015. Having held below the Bank of England's 2% inflation target from November 2013 until January 2017, it exceeded 2% in February and climbed to 2.7% in May. It was last higher in April 2012. Core inflation has also picked up, reaching a 65-month high of 2.5% in May.

It is of note that core inflation has picked up sharply since the turn of the year, having been relatively stable for most of 2016 despite the headline rate picking up. This suggests that the lagged impacts of rising commodity and import prices have filtered through the supply chain in 2017.

Food Prices





Food prices first dipped behind year earlier levels in mid-2014 and the rate of food price deflation ran at 2-3% for around two years until November 2016. However, by February 2017 food prices exceeded year earlier levels and by May, the rate of inflation had reached 2.5%. In May, the average cost of food was at its highest since June 2015 and contributed 0.19 percentage points to the headline CPIH inflation rate. Rising UK farmgate food prices and a lift in the cost of imported foodstuffs have reached the wholesale sector, with UK manufacturers reporting a 2.5% increase in their output prices for food products between February and May, leaving them 5.6% above May 2016 levels[3]. Although competition between retailers remains strong, this pressure has begun to pass through into shop prices.

Within the food basket, the strongest rates of inflation in May were for pizza and quiche (11.4%), sugar (15.1%) and fresh or chilled fish (16.6%). Other products rising faster than average included bread (5.5%), olive oil (6.3%), and preserved or processed fish and seafood based preparations (7.6%). Nevertheless, some groups still exhibited deflation, such as pasta products and couscous (-2.9%), tubers and products of tuber vegetables (-3.4%), and rice (-5.4%). Meat prices averaged 2.1% higher than in May 2016. Two meat categories remained slightly lower than last year – beef and veal (-0.3%) and poultry (-0.4%). However, lamb and goat (3.6%), edible offal (4.7%) and pork (7.4%) were significantly higher.

Survey evidence has also signalled a return of food price inflation. The British Retail Consortium (BRC) reported fresh foods inflation of 1.2% in May, having finished 2016 at -1.2%. Meanwhile, packaged foods moved from marginal inflation in December to 1.8% in May. Within the ONS retail sales data, the price deflator used to convert sales values into volumes in predominantly food stores was at a three-and-a-half-year high of 2.5% in May. This compares with -0.3% at the end of 2016.

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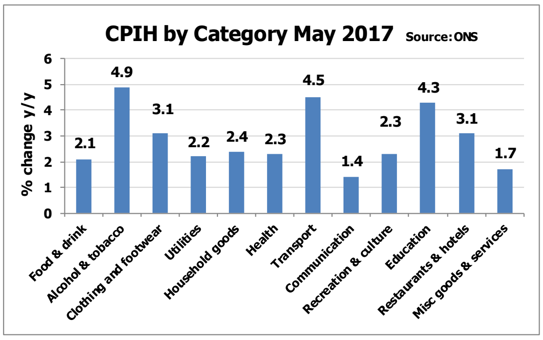
[2] Due to the tendency of food and energy prices to fluctuate sharply, the ONS publishes a more reliable indication of underlying inflation: CPIH excluding energy, food, alcohol and tobacco. This is commonly known as 'core inflation'.
[3] See series K37L in the ONS Producer Price Index dataset.

Fuel & Energy Prices

In addition to food, the cost of fuel and energy has gone from placing significant downwards pressure on the price level to being a major contributor to rising prices. With the sterling price of oil exceeding year earlier levels since August 2016, prices of refined hydrocarbons have risen and drivers have had to pay more for their fuel. As well as a weaker sterling, global oil prices were underpinned by collaboration between major oil producing nations to restrict supply growth. In the CPIH index, petrol and diesel have been more expensive than a year earlier since September 2016. However, after peaking at 19% in February, the rate of fuel price inflation has slowed, averaging 7.5% in May. The oil price has fallen back in recent months due to rising inventory levels in the US and lower than expected cuts to production amongst the OPEC nations. Meanwhile, the overall cost of energy rose 6% from a year earlier in May. The rate of gas price deflation has slowed sharply to around -0.5%, while electricity was 7% dearer than in May 2016.

Consumer Goods Prices



Goods price inflation moved into positive territory for the first time in over three years last November. Since then, rising input costs have passed through supply chains and inflation has gathered pace, reaching 3% in May and pushing it above the general level of inflation. According to recent PMI surveys, higher wages, raw material and transport costs have raised input costs, with a weaker sterling adding to the pressure where raw materials have been imported. Despite strong competition on the high street, consumer prices have begun to reflect supply chain pressures. However, some retailers may have felt able to raise prices due to the combination of elevated consumer inflation expectations and robust spending levels. Clothing prices are volatile from month-to-month but averaged 3.6% above year earlier levels in May. Meanwhile, furniture, furnishings & carpets inflation stood at 3.7%, and white goods, such as fridges and washing machines, were 4-5% more expensive than last year. However, some products have remained in deflation. For example, footwear prices were down marginally and kitchen products made from china and glass were down by 4%. In the ONS retail sales dataset for May, the deflator (inflation rate) for non-food stores picked up to 3%; its highest since October 2011.

Consumer Services Prices

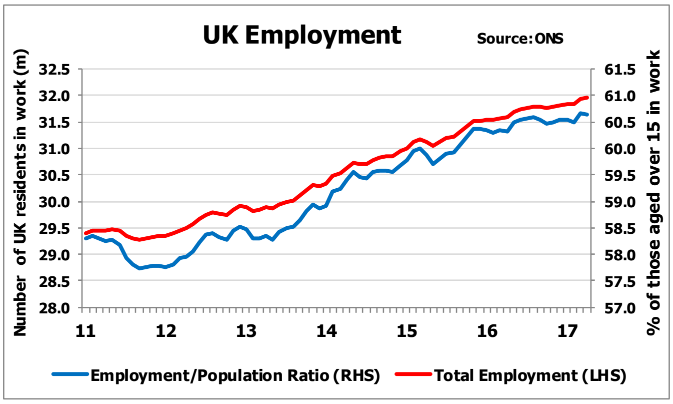
Service sector price inflation has been running at approximately 2.5% for a prolonged period and has remained well anchored in 2017, showing no signs of following goods price inflation significantly higher. In May, services inflation averaged 2.6%. Areas of the service sector to see above average increases in October included restaurants & cafes (2.9%); accommodation services (3.5%); cinemas, theatres, concerts (4.0%); and passenger transport by train (5.4%). In addition, increased insurance tax contributed to a 5.5% rise in the cost of insurance. However, financial services were 1% cheaper than a year earlier and the cost of air travel was down by 4%. According to the June PMI survey, competition was a limiting factor to price rises. Services price inflation is a good barometer of demand-linked inflation, so its relative stability points to steady growth in domestic demand.

Summary

Despite competition between retailers remaining strong, their rising cost base has been passed on to customers at an increasing rate and retail prices for consumer goods and foodstuffs have moved quickly from deflation into inflation. The CPIH inflation rate has exceeded the BoE's 2% target since February and core inflation has also moved well above 2%. However, services inflation has held relatively stable, suggesting that domestically generated inflation has not increased.

Labour Market:

Employment



According to the ONS Labour Force Survey, UK employment grew by 0.3% on the quarter and by 1.2% year-on-year in February to April 2017, raising it to a new record high of nearly 32m. During February to April, the UK economy created 109,000 more jobs than it lost, signalling a lift in employment growth following a stagnation last autumn and slower growth over the winter. As a result, having edged lower in the autumn of 2016 from 60.6% to 60.5%, the employment to population ratio rose to 60.7% in the February to April quarter. This was up from 60.3% a year earlier and was last higher in 1974. Meanwhile, the headline employment rate, for those aged 16-64, rose by 0.2 percentage points on the quarter and by 0.6 points on the year to reach a new record high of 74.8%.

The number of outstanding job vacancies in the UK stabilised in 2016 following three years of growth. However, moving into 2017, vacancies have risen again, lifting by 3% on the quarter and by 4.4% on the year during February to April.

Regular private sector surveys have also signalled rising employment in the UK economy. The PMI surveys for June were positive with services firms taking on staff at the strongest rate since April 2016 to help manage rising backlogs of work. Meanwhile, manufacturing firms increased staff levels for the eleventh consecutive month; though a fall in backlogs had seen the rate of employment growth slow. Construction firms also reported weaker employment growth.

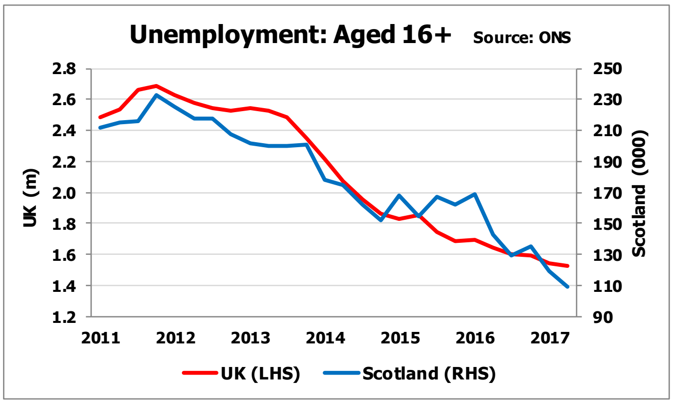
Underemployment

The ONS publishes quarterly estimates of the number of workers that are underemployed. In Q1 2017, underemployment was 5% lower than in early 2016. However, it had risen by 3.5% from Q4 2016. This quarterly increase was driven by workers reporting that they would like to have been able to work longer hours, either through their current job, taking on a new job with longer hours, or starting a second job. This change could be an early sign of the rise in inflation starting to squeeze household finances. However, it should be noted that within the Labour Force Survey for February to April, the number of people reporting a second job fell by 2% on the quarter and on the year.

Other proxy indicators for underemployment include the level of part-time and temporary work. In February to April 2017, at 23.5m, there were 0.7% more people working full time than in the previous quarter and 1.8% more than a year earlier, while those in part-time roles were down by 0.6% on both the quarter and the year, at 8.45m. The proportion of part-time workers that could not find full-time work was down by nearly 14% year-on-year and was at its lowest rate for eight years. Furthermore, those working part-time that did not want a full-time position increased by 2% from 2016. Meanwhile, the number of people in temporary employment was 3% lower than last year at 1.59m and of these people, the number reporting that they could not find a permanent position fell by 19% and was at its lowest rate since late 2008.

Labour market data is clearly signalling that the levels of insecure working have fallen and this is likely to have helped underpin consumer demand in recent months. It should also be noted that self-employment has stabilised at around 15% of workers over the past year, having trended steadily higher from it low point of 12% in 2003.

Unemployment



In February to April 2017, UK unemployment[4] stood at 1.53m, equating to 4.6%[5] of the labour force. This is the lowest the unemployment rate has been since 1975, having bottomed out at 4.7% in the early 2000's. At this level, unemployment is closing in on the point where the BoE estimates its long-term equilibrium rate to be – in theory the rate where a balanced labour market produces earnings growth consistent with the 2% inflation target. Labour market data indicates that the year-on-year decline in UK unemployment of 145,200 was driven by the net increase in employment of 371,700 exceeding growth in the economically active population of 226,400.

In Scotland, the labour market has improved significantly since early 2016. Prior to that, the Scottish economy had been hit by considerable job losses in the oil and gas supply chain. In February to April 2017, employment in Scotland was up by 0.5% on the quarter and by 1.7% year-on-year. This helped lower unemployment to 109,400 and the unemployment rate to 4%.

In February to April 2017, there were 2.0 unemployed UK residents for each vacancy. This was a record low for the series which has been published since 2001. This indicates greater competition for workers, potentially raising bargaining power in negotiations over pay and conditions.

One labour market indicator that has been less optimistic is the Claimant Count[6]. Back in February 2016 it slipped to its lowest level and rate since the mid-1970s (736,200 and 2.1%). Since then, it has been volatile, rising until November 2016 (808,000), then falling back to 739,900 in February 2017, before climbing to 802,600 and 2.3% of the labour force in May. This was up 3.4% year-on-year. Nevertheless, the Claimant Count rate remained well below its 2002-2007 average of 2.8%.

Earnings

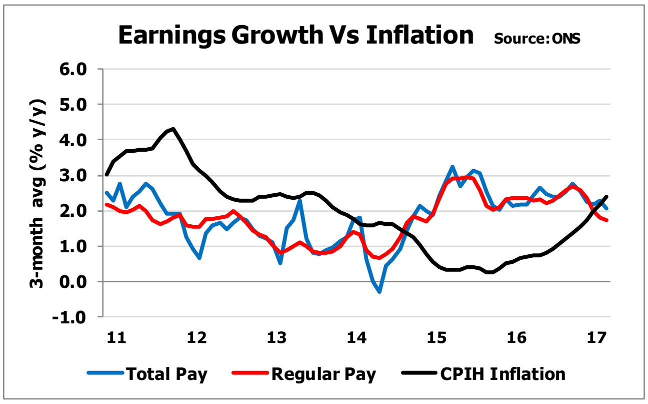
	UK average weekly earnings growth		Source: ONS
	Feb to Apr 2017 (y/y)	Nov 2016 to Jan 2017 (y/y)	2016
Whole economy total pay	2.1%	2.5%	2.5%
Whole economy ex. bonus pay	1.7%	2.4%	2.4%

In 2015 and 2016, UK earnings grew at the same annual rate of around 2.5%. However, moving into 2017, average pay growth has slowed significantly. At £502 (£26,100 per annum), average weekly pay exceeded year earlier levels by 2.1% in the February to April period, down from 2.6% in Q4 2016. Meanwhile, regular pay, which excludes bonus payments, averaged £472 and its growth rate slowed to 1.7% from 2.6% at the end of last year.

Pay growth has quickly reversed across the different sectors of the UK economy after accelerating towards the end of 2016. The dip in regular pay growth to 1.7% left it at its lowest level since the three months to January 2015. Meanwhile, total pay growth was at its slowest since the three months

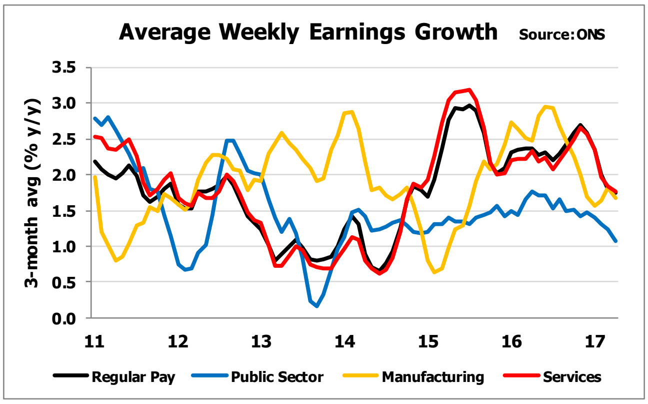
[4] Number of unemployed people aged 16+ that are part of the economically active population (able to and actively seeking work) plus the number of out-of-work claimants of Universal Credit.
[5] Proportion of the economically active population that is unemployed
[6] Those aged 18+ claiming Jobseeker's allowance and out-of-work Universal Credit

to February 2016. This fall in pay growth has occurred despite significant uplift in the minimum wage for workers aged over 25 in both April 2016 and April 2017.



The recent fall in earnings increases has come at the same time as inflation has returned to the UK economy. This has put to an end two-and-a-half years of real wage growth for the average worker. In the three months to April, the CPIH inflation rate averaged 2.4%, resulting in a 0.3% fall in inflation-adjusted earnings. Although consumer surveys do still indicate that people are feeling confident about their personal finances, a fall in real wages does question the sustainability of consumer spending growth which has underpinned the UK economy in recent years.

Market incomes have continued to grow much more slowly than the 4% average during the 5 years to Q2 2008. In economic theory, one would expect an unemployment rate at around its equilibrium level to be underpinning earnings growth as firms compete for staff through higher wages. The lack of a significant pick-up in wage growth therefore suggests that this competition has yet to deliver a substantial increase in workers' bargaining power. However, the historically modest level of pay growth may well reflect sluggish productivity growth and a prolonged period of low inflation in the wider economy. For employers, the sluggish level of wage growth does not point towards widespread skill shortages, though this could occur if the unemployment rate was to fall further[7].



As can be seen in the average weekly earnings chart, growth in regular pay in the service sector is closely linked to overall pay growth. This reflects the high share of services in UK GDP. After a brief lift in late 2016, services pay settlements averaged 1.8% above 2016 levels in the three months to April – a two-and-a-half-year low. Manufacturing earnings growth has also slowed to below inflation, averaging 1.7% in the April quarter. Meanwhile, tight control of public finances has continued to hold public sector pay growth down to only 1.1%.

Relative to the UK average for regular weekly pay, services pay averaged 3.5% lower while manufacturing exceeded the average by 18.5% and construction by 18%. Drilling a little deeper, business services and finance rewarded its workers 20% above average, while public sector pay exceeded the average by 6.5%, but wages were only 68.5% of the UK average in Wholesaling, retailing, hotels & restaurants; although this sector has been closing the gap in recent years.

Summary

Although the UK economy is approaching full employment, employment growth has picked up again in 2017. Numerous labour market indicators have returned to their pre-2008/9 recession levels and a rising population has continued to be absorbed. However, earnings growth has continued to disappoint, slipping back at a time when competition for staff should, in theory, be high. At the same time, the inflation rate has increased, eroding the real earnings of the UK workforce.

[7] Construction had been an exception with regular pay rising at around 4% throughout 2016. However, pay growth has slowed sharply in 2017, averaging just 1.2% in the three months to April.

Money & Credit:

Money Holdings

According to BoE data, the aggregate level of money and credit in the UK economy (M4) stood at a fraction above £2.3 trillion in April. This was up by 8.2% on a year earlier. A significant rise in M4 means that more money is sitting in bank accounts.

Breaking this down, the money holdings of households (includes sole traders and the non-profit sector) grew at a below average rate of 4.5% while money holdings growth surged to 9% at private non-financial corporations (PNFCs) - non-financial companies and partnerships. Holdings rose by one-fifth at financial institutions.

BoE statistics show that the overall increase in money holdings was supported by an increase in net lending by UK banks and building societies to both households and the private sector - M4 lending was up by 6.1% on the year. Within this total, lending to the household sector continued to grow at an annual rate of almost 4%, while there was a smaller increase in lending to PNFCs of just over 3%. Meanwhile, lending to financial services firms rose by more than 15%.

Business - Credit Availability and Demand

The BoE Agents' summary of business conditions report for May indicated that credit availability remained strong on a whole, but some small and medium-sized businesses had found it slightly harder to access lending. It also noted sluggish demand for credit from large companies, with some firms delaying long-term investment until greater clarity is provided over the UK's future trading relationships. According to the May inflation report, PNFCs moved away from bank loans and commercial paper towards bonds and equity in Q1 2017, but the overall level of finance raised fell from Q4 2016 despite falling interest rates. Looking back to the Q1 BoE Agents' summary, there was a suggestion that although there was strong competition between lenders, banks remained more risk averse than in the run up to the 2007/8 financial crisis. Smaller firms continued to make use of peer-to-peer lending and invoice and asset finance. BoE figures for April show that the outstanding value of loans to the agriculture, hunting, forestry and fishing sector was up by 4.6% year-on-year at £18.6bn, but loans to the manufacturing sector contracted by 3.7% to £36.9bn.

Consumer Credit

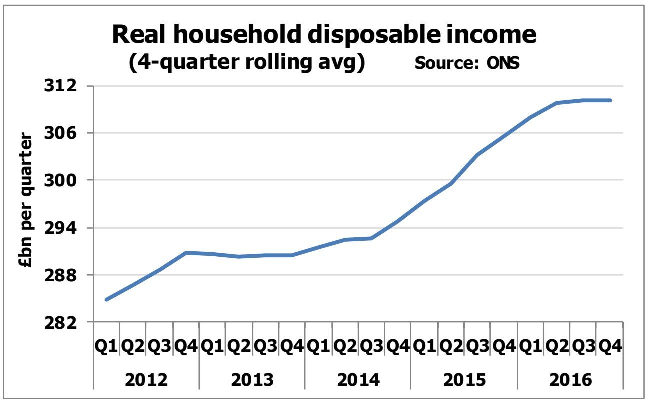
The main reason for overall lending to households growing more slowly than money holdings (4.5% v 8.2%) was that the outstanding stock of mortgages rose by 2.9% year-on-year in April and it accounted for 87% of all lending to individuals. New mortgage approvals for house purchases slipped to a 7-month low and were down by 2.3% year-on-year and re-mortgaging also dropped. Consumer credit continued to grow rapidly in April, up 10.3% year-on-year at £198.4bn. Credit card lending accounted for 34% of this total, and it rose by 9.7% year-on-year. Meanwhile, other loans to consumers increased at an annual rate of 10.7%, but this growth rate had opened 2017 even higher at 11.6%. This slowdown may suggest that the peak in cheap financing deals for new cars has passed.

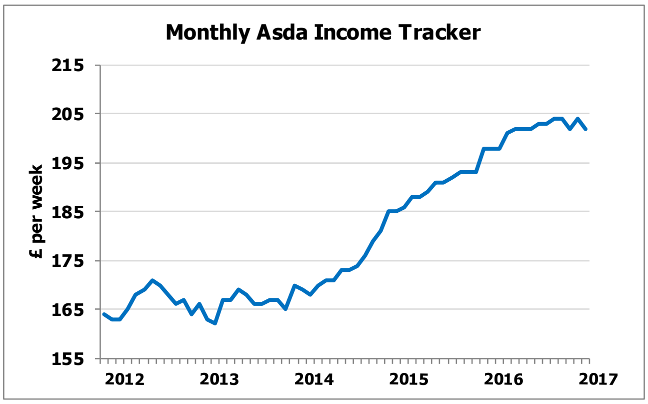
Summary

Although there is some evidence that demand for credit from businesses for investment has slowed, total credit provision has continued to grow strongly in 2017. Low interest rates have proved attractive to businesses requiring access to cheap credit. On the consumer side, house purchases have fallen back, but low interest rates have continued to support considerable growth in consumer credit, suggesting that households remain secure enough in their personal financial situation to borrow money for large purchases.

Consumer Indicators

Household Incomes

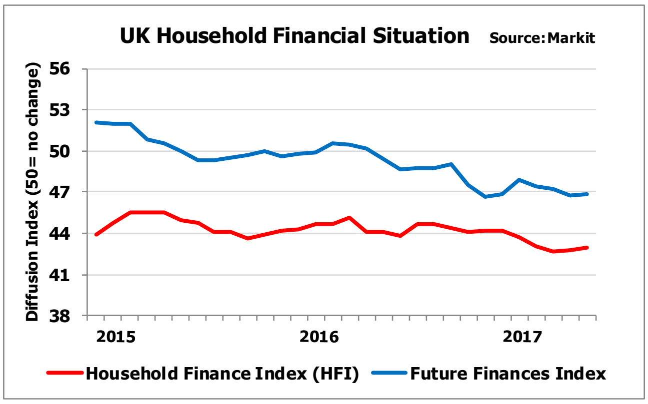




After growing strongly between late 2014 and early 2016, UK real household disposable income levelled off as 2016 progressed. At £619.8bn in H2 2016, disposable income was marginally lower than in H1 and 0.2% higher than in H2 2015.

During H2, household incomes were underpinned by a 3.1% increase in primary income. However, social benefits payments were flat while tax and national insurance contributions rose by 3.7% and 4.3%, respectively. As a result, disposable income was 1.6% higher in cash terms. After accounting for a 1.4% higher price level, disposable income was only marginally higher than 12 months before.

Asda, in conjunction with the Centre for Economic & Business Research (CEBR), produces a monthly indicator of disposable incomes. The chart demonstrates that the spending power of the average UK household has stabilised since Q2 2016, following for two and a half years of considerable growth. During the December to February period, disposable income was a fraction lower than in the previous quarter, but was still more than 3% above year earlier levels. While this may have left some room for consumer spending growth in early 2017, this window is likely to have passed. As 2017 began, earnings growth dipped back while food and housing costs picked up and fuel inflation held firm. The analysis also showed that, compared to a year earlier, income growth was slowest at the lower end of the income scale.

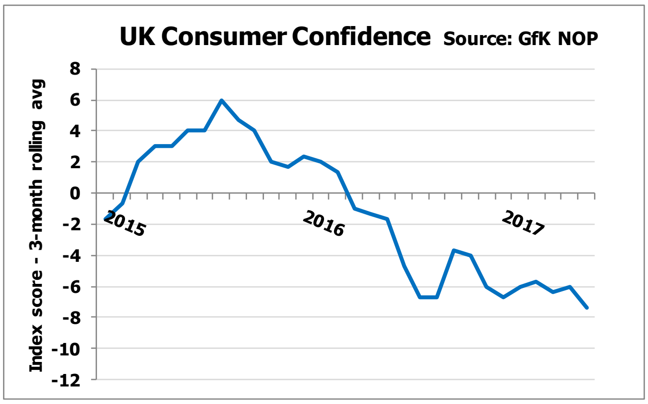


Markit's monthly UK household finances survey shows that during June there was a greater degree of pessimism than optimism[8]. With a score of less than 50 indicating net pessimism, the index was consistently in the 44-45 range from early 2015 until the autumn of 2016. Since then, the index has slipped below 43; although it did lift to a 6-month high in June and has remained above its 2009 to 2014 levels. In June, finances were supported by labour market participation and rising wages, but these gains were more than offset by a higher cost of living. Though it should be noted that households reported that inflation had dipped back since February.

Looking forward, household expectations of their future financial prospects have been trending downwards since the spring of 2016. Inflation expectations remain high for the coming year and 58% of households are anticipating that the Bank of England will raise interest rates in the next twelve months. Job security was also reported to have fallen. Households relying on public sector salaries reported the highest degree of pessimism, reflecting below inflation pay increases.

[8] The HFI has been running since 2009. The chart shows a three-month rolling average for each index.

Consumer Confidence



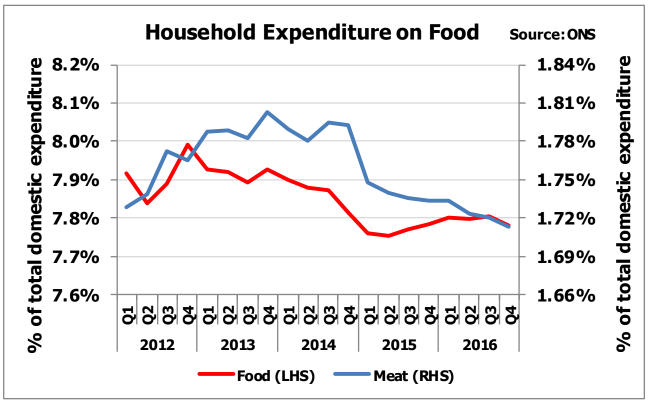
Having spent 2015 in positive territory, UK consumer confidence declined in 2016[9], dropping below zero in April and falling sharply in the immediate aftermath of the EU referendum. This drop was followed by a partial recovery, before it turned downwards again in Q4. Moving into 2017, confidence stabilised in negative territory, before deteriorating in June.

In the June survey, all five indicators weakened, reflecting falling real wages and heightened political uncertainty following the General Election. Consumers became marginally negative about their current personal financial situation, and the forward-looking index returned to neutral. Meanwhile, pessimism about the wider UK economy, which has been holding the overall index below zero for the past year, increased. However, consumers, on balance, still felt that it was a good time to make major purchases and to save money.

Consumer Spending

ONS data shows that in real terms, seasonally adjusted UK household spending was 1.5% higher in H2 2016 than it had been during H1, and was up 2.8% year-on-year. However, for households to sustain this level of spending growth, which underpinned UK economic activity, they needed to save less. According to the ONS, the seasonally adjusted UK household savings rate fell to a record low of 4.3% in H2 2016. This was significantly lower than the H1 2016 level of 6.0% and was down from 6.6% a year earlier.

The data for H2 reveals that although net tourism spending grew at a faster rate than spending in the domestic economy, spending within the domestic economy increased at the same quarterly and annual rates as the headline total (1.5% & 2.8%). The fastest growing category was household goods & services, rising 6.2% year-on-year. There was also strong growth in clothing & footwear (5.0%), miscellaneous (4.9%) and recreation & culture (4.4%). However, restaurants & hotels grew at a below average 2.1%. Real terms spending on food began trending higher in the summer of 2015 and in H2 2016 it was up 3% year-on-year at its highest recorded level.



Within food, fruit performed best in H2 2016, as spending rose by 5.3% year-on-year. Vegetables and sugar, confectionary & ice cream were not far behind. Meanwhile, real terms spending on meat and dairy produce increased by nearly 2% while spending on fish grew by closer to 3%.

Since falling in 2014, the share of food in total domestic spending has stabilised at around 7.8%. However, real terms spending on meat has continued to edge lower as a share of domestic spending, slipping to its lowest since late 2011. Real terms spending on meat as a proportion of spending on food steadied at 22.0% in H2 2016, but remained above its 2009-11 low point.

[9] The overall index is the average score for each of the five survey questions. Respondents are asked to give a score of 1 if there has been a large improvement; 0.5 for a small improvement; 0 for no change; -0.5 for a slight worsening; or -1 for a considerable deterioration.

Seasonally adjusted UK retail sales: March to May 2017				Source: ONS
	q/q change		y/y change	
	Value	Chained volume	Value	Chained volume
Total	**1.3%**	**0.6%**	**5.6%**	**2.3%**
Excluding automotive fuel	1.4%	0.4%	4.9%	2.6%
Predominantly food stores	1.4%	0.4%	3.0%	0.9%
Predominantly non-food stores	1.0%	0.2%	3.8%	1.5%
Non-store retailing	1.9%	1.9%	20.5%	16.9%

2017 has seen UK retail sales volumes growth slow significantly. In the March to May period, sales volumes, excluding fuel, rose by 2.6% year-on-year, compared with growth rates of 3.5-5.5% for most of 2014, 2015 and 2016. However, having picked up in H2 2016 after 18 months at 1-2%, growth in cash spending in shops held firm into the spring of 2017, at nearly 5%.

This changing retail environment reflects the resurgence of inflation. While a prolonged period of deflation meant that consumers could buy significantly more for the same amount of money for much of the 2014 to 2016 period, this has now reversed. Indeed, the deflator used by the ONS to convert retail sales values into volumes stood at 3.2% in May 2017 having been below zero in all but one month between March 2015 and October 2016. Consequently, 3.2% more money was required to buy the same volume of goods and services as in May 2016.

In food stores, where intense competition between retailers had kept prices in check between 2014 and 2016, prices have followed the overall trend higher, exceeding year earlier levels by 2.5% in May. Food store prices last grew at a quicker annual rate back in November 2013. As a result, significantly increased spending on food was required to purchase the same volume, and, on a quarterly basis, sales volume growth slowed to less than 1% from 3-4% throughout 2016.

Non-food stores have also experienced a slowdown in sales growth from the highs of the past three years. March to May saw sales volumes rise at an annual rate of 1.5% despite spending in these stores rising by close to 4% compared to last year. Sales volumes had been rising by 3-4% in late 2016 and early 2017 and last grew more slowly back in the quarter to August 2013. Within the non-food category there was considerable polarisation. On one hand, sales in textile, clothing & footwear stores rose by more than 6.5%. On the other hand, sluggish growth in cash spending meant that household goods stores achieved only marginal growth and there were small declines in volumes at non-specialised stores and other stores. Although some of the heat that built up in online retailing around the turn of the year has dissipated, the non-store retail sector still expanded at an annual rate of 17% in the March to May quarter.

The BRC and CBI also publish monthly retail sales updates and like the ONS data, point to a slowdown in growth. During the March-to-May period, the BRC reported stagnant turnover in non-food stores, but food stores had their best quarter since 2012. Non-food retailers were only just beginning to reflect rising input costs in their shop prices while modest inflation was seen at grocery stores. Meanwhile, in May's CBI distributive trades survey, sales volumes exceeded year earlier levels at 28% of the surveyed businesses, while they fell for 27% of firms. Inflation was at a six-year high and input buying had been cut back, particularly from overseas suppliers. However, wholesalers remained positive as 61% reported a year-on-year increase while just 8% experienced a contraction.

Summary

A prolonged period of significant sales growth across the UK retail sector appears to have come to an end. Although cash spending has held firm, rising prices have begun to have an impact on volumes.

What has been happening to economic policy in the UK?

Monetary policy:

Following last year's vote to leave the EU, the BoE's Monetary Policy Committee (MPC) acted quickly to support the UK economy by loosening monetary policy. In August 2016, they lowered Bank Rate to 0.25%; committed to a £60bn expansion of their stock of asset purchases (Quantitative Easing/ QE) to £435bn; and announced purchases of up to £10bn of corporate bonds. The Term Funding Scheme (TFS), which incentivised banks to lower their interest rates to borrowers in line with Bank Rate, was also announced.

Since then, the MPC has left interest rates on hold at 0.25% and met its corporate bond buying target in late April. At the June 2017 meeting, a majority of MPC members were willing to accept a prolonged period of above target inflation, deciding that the main driver of inflation was a combination of the past fall in sterling plus higher global commodity prices and that a rise in interest rates could have a negative impact on economic activity and employment. However, the June vote was more closely balanced than expected at 5:3. With economic data signalling that the UK economy remains on a growth path and inflation exceeding the 2% target, the member that had been voting for a return of Bank Rate to 0.5% since March was joined by two colleagues.

Fiscal Policy:

The Office for Budget Responsibility (OBR) forecasts that the UK government will run a budget deficit of 2.9% of GDP in 2017/18, up slightly from 2.6% in 2016/17, but well below 2015/16's 3.8%. Revenues are forecast to rise by 3.2% in 2017/18, due to the impact of a healthy labour market on income taxes and household spending growth on VAT. Meanwhile, spending is anticipated to rise by 3.8%. In terms of spending, falling government departmental budgets will be more than offset by the costs of an ageing population, such as rising pensions and health and social care costs, while infrastructure investment is to increase and there will be higher environmental levies.

Despite a change of attitude towards public spending in the UK Government, departmental budgets will continue to face expenditure cuts. This includes Defra, which is already short-staffed given the significant effort required to negotiate market access for red meat into third countries and to form a new agricultural policy system. However, the International Trade and Brexit departments may help reduce some of these pressures. The Defra budget is due to fall by around £100m in the current and next two financial years, lowering it to £1.4bn in 2019/20 from £1.7bn in 2016/17.

The beginning of the 2017/18 financial year saw the minimum wage for workers aged 25 and over rise by 4.2%. In addition, the income tax threshold increased further, adding around £2 a week to post-tax incomes, while pensions rose by 2.5%. However, at the lower end of the household income scale, analysis from the Institute for Fiscal Studies shows that welfare reforms will potentially have a considerable negative impact due to real-terms cuts to benefit payments, lower child tax credit payments and the move towards universal credit. These reforms have been slowly implemented up to now, so the impact will build over time.

Summary

Weaker monetary policy since last summer has helped sustain economic growth at a time of heightened uncertainty, maintaining the flow of credit to firms and households at affordable interest rates. On the fiscal side, a change in Government attitude has resulted in a slower anticipated pace of budget deficit reduction, and the potential for higher investment spending. Changes in taxation and pensions are likely to support incomes in the top-half of the income scale, but welfare reform is likely to reduce household incomes in the bottom half of the distribution.

What has been happening in the European economy?

Economic Activity:

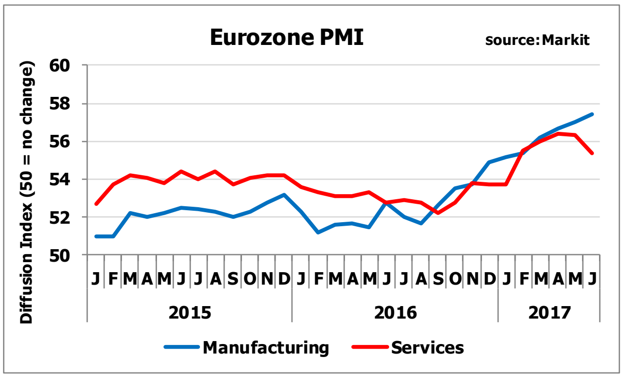
	Economic Activity in Prominent Scottish red meat markets			
	GDP Growth (%Q/Q)		GDP Growth (%Y/Y)	
	Q1 2017	Q4 2016	Q1 2017	2016
Bel	+0.6	+0.4	+1.6	+1.2
Fra	+0.5	+0.5	+1.1	+1.2
Ger	+0.6	+0.4	+1.7	+1.9
Hol	+0.4	+0.6	+2.5	+2.2
It	+0.4	+0.3	+1.2	+0.9
Spa	+0.8	+0.7	+3.0	+3.2
Euro Area	**+0.6**	**+0.5**	**+1.9**	**+1.8**
Den	+0.6	+0.4	+2.6	+1.7
Swe	+0.4	+0.7	+2.2	+3.2
UK	+0.2	+0.7	+2.0	+1.8
EU28	**+0.6**	**+0.6**	**+2.1**	**+1.9**
Nor*	+0.6	+0.4	+3.1	+0.9
Swi	+0.3	+0.2	+0.9	+1.3

Sources: Eurostat; Statistics Norway

*Mainland GDP (excluding oil & gas)

Euro area economic growth slowed marginally in 2016, but, at 1.8%, remained well above the 2011-15 average of 0.7%. The euro area economy had a firm end to 2016, expanding by 0.6% in Q4 and this rate was maintained in Q1 2017. As a consequence, the year-on-year GDP growth rate picked up to 1.9% for the first time since Q4 2015. A surge in business investment and trade drove the economic expansion with household and government consumption rising more slowly than GDP.

Across the most important countries for Scottish red meat exports, GDP grew at a similar pace in Q1. Growth rates were generally 1.6-2.4% when viewed on an annualised basis, except for Spain which continued to rise at a rate above 3%. For most countries, particularly Belgium, France and Italy, these rates were stronger than their annual increase in 2016, signalling a more buoyant economy. However, activity growth did slow in Holland and Sweden. In the wealthy non-EU European nations of Switzerland and Norway, economic growth proved sluggish in 2015 and 2016. While this has continued to be the case in Switzerland in early 2017, there appears to have been a bounce in Norway.



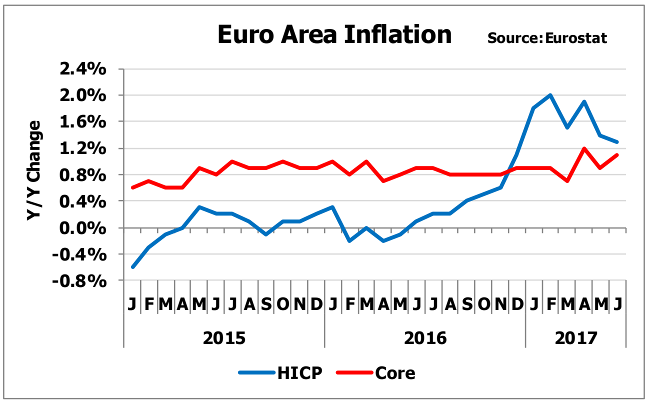
The monthly Markit PMI surveys of private sector activity fit with the rise in the GDP growth rate in late 2016 and early 2017. They have since signalled a further uptick in Q2, with the combined indicator for manufacturing and services at its highest since Q1 2011. A PMI of around 56 implies that the service sector is growing at a quarterly rate of around 0.7%, while a PMI of 57 signals manufacturing growth of around 0.8%. Order levels are reported to have strengthened significantly in both services and manufacturing, leading to rising backlogs of work. In manufacturing, there were rising orders from both domestic and export markets, and optimism was at its highest recorded level. Although services output growth dipped in June, it remained firm.

At the country level, manufacturing sector activity gathered pace in Germany, France, Italy and Holland during June, with Germany and Holland reporting particularly strong expansions. However, growth in Spanish manufacturing cooled. In services, though activity growth eased slightly in Germany, France and Italy, it remained firm. Meanwhile, the Spanish services sector had its best month in nearly two years. Looking out-with the euro area, the latest PMIs for Sweden pointed to high growth rates in manufacturing and services. The Swiss manufacturing sector has also been growing strongly in 2017, while Norwegian manufacturing reported PMI's of 54-55 in Q2.

Eurostat's latest industrial production figures showed that output was 1.4% above its year earlier level in April in the euro area and in the EU as a whole. Following steady growth in H2 2016, industrial activity has trended higher more slowly in 2017. Although output has now recovered to its highest levels since late 2008, it does still have a significant gap to make up before returning to its 2008 peak. The year-on-year expansion in the euro area in April was underpinned by the production of intermediate goods (+3%) and durable consumer goods (+4.6%). However, output of non-durable consumer goods and capital goods rose at below average rates of 0.6% and 1%, respectively, while energy production contracted marginally.

On a country level, monthly industrial output levels are highly volatile, but some trends emerge once Eurostat figures have been smoothed into a three-month rolling average. Denmark led the way with activity rising by nearly 4% year-on-year in the February to April quarter; though this was largely down to a strong end to 2016 with output falling back since. Industrial output also firmed in Belgium and Sweden, up nearly 3%, while Italy and Germany grew broadly in line with the euro area and EU averages of around 2%. However, industrial activity was more sluggish in France, Spain, Norway and the UK, at around 1%. Meanwhile, having risen at an annual rate of 4-5% for much of 2016 and early 2017, Dutch output dipped back in the spring, leaving it 0.5% higher than a year earlier.

Inflation:



After picking up through the autumn of 2016, euro area inflation spiked in December, with the HICP reaching 1.1% for the first time since September 2013[10]. It then rose further in early 2017, reaching a 49-month high of 2% in February, and then again in April. However, inflation then slowed to 1.4% in May and 1.3% in June, returning it back below the ECB's target of 'close to but below 2%'.

The surge in the euro area inflation rate in late 2016 was mostly driven by rising commodity prices, which took the cost of energy from deflation of 6% last summer to inflation of over 9% in February 2017. Meanwhile, unprocessed food prices went from a 1.4% inflation rate in June 2016 to more than 5% by February. More recently, a significant slowdown in energy and unprocessed food inflation has seen the HICP return to below the ECB target in May and June. In June, the former stood at 1.9% and the latter at 1%. PMI surveys for the euro area suggest that the upwards pressure on input costs has now dissipated. Core inflation, which excludes the more volatile commodity-linked categories, picked up slightly in Q2 2017, but at 1.1% in June, it did not suggest that past rises in business input costs have passed through the supply chain to any significant extent.

Reflecting this lack of pass-through, non-energy industrial goods inflation edged up to only 0.4% in June 2017 and was the same rate as in June 2016. This suggests that firms have hedged their input buying and/or have struggled to charge higher prices to their customers. However, inflation in the

[10] HICP: Harmonised Index of Consumer Prices – allows international comparison of inflation rates within the EU

service sector has picked up somewhat, reaching 1.6% in June, having held at a little over 1% for a prolonged period. This may suggest that service providers have sensed enough of a lift in consumer and business confidence to raise their charges slightly. Nevertheless, this rate remained at the lower end of the ECB target range for inflation, showing little evidence of demand-pull inflationary pressures.

In the main markets for Scottish red meat exports, inflation rates have risen above their 2015 and 2016 lows, but have remained relatively weak. In June, inflation rates in France, Italy, and Holland were below the euro area average at around 1%, with Danish and Swiss inflation even lower at just 0.4%. Meanwhile, Belgium, Germany and Spain were slightly above the euro area average and inflation was closer to 2% in Sweden and Norway.

The lift in euro area inflation away from zero is a welcome development for the economy as although it suppresses real incomes, it does help to grease the wheels of economic activity. Inflation rates closer to the ECB target may lead to changes in expectations that boost wage increases and result in consumers bringing forward purchases in anticipation of rising prices. Inflation also erodes the real value of debts, potentially making it easier for households and businesses to repay loans, supporting economic confidence.

Nevertheless, core inflation has yet to lift significantly, suggesting that economic activity has remained sluggish and has been mostly driven by commodity prices rather than from consumer and business demand. Furthermore, inflation rates have remained relatively similar in countries like Germany and Italy. This means that Member States still suffering from the legacy of the economic crisis will continue to find it challenging to improve their competitive position in the global economy.

Labour market:

Labour market in prominent Scottish red meat export destinations				
	Total Unemployment Rate		Youth Unemployment Rate May 2017 (%)	Labour Cost Index[11] Q1 2017 (% Change y/y)
	May 2017 (%)	y/y change (percentage points)		
Bel	7.6 (Mar)	-0.6	21.5 (Mar)	1.5
Fra	9.6	-0.5	21.6	1.8
Ger	3.9	-0.3	6.7	1.6
Hol	5.1	-1.2	9.0	0.0
It	11.3	-0.3	37.0	1.0
Spa	17.7	-2.5	38.6	0.0
Euro Area	**9.3**	**-0.9**	**18.9**	**1.4**
Den	5.7 (Apr)	-0.5	11.1 (Apr)	1.8
Swe	6.7	-0.4	17.6	1.7
UK	4.5 (Apr)	-0.4	12.5 (Apr)	1.8
EU28	**7.8**	**-0.9**	**16.9**	**1.6**
Nor	4.6	0.0	10.5 (Q1)	n/a
Swi	3.1	-0.1	2.7	n/a

Sources: Eurostat; Statistics Norway; Swiss Federal Statistics Office; ONS

[11] Wages & salaries in the business economy (private sector excluding primary industries)

The latest Eurostat figures indicate that during May 15.011m people were unemployed in the euro area. This was 0.1% lower than in the previous month and 8.9% below the May 2016 total of 16.463m. 9.3% of the labour force were unemployed, unchanged from the previous month but well below the year earlier level of 10.2%. Furthermore, it was last lower in February 2009. In the EU28, 19.092m people, or 7.8% of the labour force, were unemployed in May, down from 21.237m and 8.7% a year earlier. The strength of the upturn in the European economy has therefore been sufficiently strong to make a significant dent in unemployment. In the most recent month reported, every single Member State had a lower unemployment rate than twelve months before. In addition, the number of countries where it stood at 6.0% or below rose from five to twelve.

Unemployment rates have fallen across Scotland's main red meat export markets. The situation has been slowly but steadily improving in France with unemployment falling by 153,000 to 2.82m in the year to May, and the rate dropping by 0.5 percentage points to 9.6%. Meanwhile, the rapid improvements continued in Spain with unemployment sliding by a further 148,000 on the quarter and by 636,000 on the year to 3.989m. A strong downwards trend in unemployment has also occurred in Holland, with 19% fewer people being unemployed than a year earlier, while Danish unemployment was down by 11%. Despite being close to 'full employment', German unemployment has continued to fall, dipping below 4% in 2017 while the Swedish rate has fallen slightly over the past year. After a challenging 2016, the Italian economy has required additional workers in 2017.

Headline unemployment rates can however mask some considerable differences within a country and this is reflected in Eurostat's regional unemployment figures for 2016. This is particularly true in Belgium, Spain and Italy; and to a lesser extent in France, Germany and Holland. For example, in Italy, it can be as low as 3.7% in Bolzano in the Alps, but as high as 23% in Calabria on the southern tip of the mainland. By contrast, unemployment rates in Sweden ranged from 5.8% to 8.4% and Denmark's regions were all between 5.5% and 6.6%.

In addition to the official Eurostat data, the monthly Euro Zone PMI surveys provide a source of information on labour market trends. In Q2 2017, the reports remained optimistic in both the manufacturing and services sectors, indicating that rising demand had been pushing up backlogs of work, requiring firms to take on additional staff to handle increased order levels. It is reported that the pace of employment growth has lifted further from an already high rate.

While job numbers have improved significantly, income from employment has not. Wages and salaries in the euro area business economy rose by only 1.4% year-on-year in Q1 2017. In the EU28, they rose by 1.6%. Having averaged around 2% in 2015, wage growth slowed to around 1.5% in 2016 and remained there in early 2017. However, there has been divergence across the EU with wage pressures proving considerable across much of Eastern Europe but more muted in the wealthier economies. On the upside, Belgian private sector workers saw their best quarter since Q3 2013, while wage pressures were at their highest for three years in France and Italy. However, wage growth fell back below 2% in Denmark, Germany and Sweden, while Spanish and Dutch wages stagnated. It seems likely that persistently low inflation and low inflation expectations have continued to impact pay negotiations. In addition, the dip in German, Swedish and Dutch wage growth will have limited competitiveness gains for countries going through an economic rebalancing.

Summary

After the promising signs of economic recovery in 2015 and 2016, the European economy has made further progress in the early months of 2017. Economic activity has continued to grow strongly in Spain and rose at annualised rates of 1.6-2.4% in many of Scotland's main EU export markets. The previously stagnant French and Italian economies are showing signs of progress, leading to falling unemployment. However, core inflation remains below target and wage growth has continued to disappoint. Past increases to commodity prices had a short-lived impact on inflation, with little pass-through to output prices for manufactured goods, suggesting weak demand-side pressures.

Consumer Trends:

Selected statistics - prominent Scottish red meat markets				
	Retail Sales Volumes May 2017 (% change y/y)	Retail Sales Volumes – food, beverages & tobacco May 2017 (% change y/y)	Consumer Sentiment (% balance)	
			Jun 2017	Dec 2016
Bel	+0.3	+2.0	-1.1	-5.4
Fra	+4.2	+4.1	+0.5	-10.2
Ger	+2.3	+2.2	+5.0	-0.8
Hol	+2.6	-0.5	+14.8	+13.4
It	+0.8 (Apr)	+0.4 (Apr)	-16.3	-10.2
Spa	+2.9	+3.0	+1.4	-2.7
Euro Area	**+2.6**	**+2.1**	**-1.3**	**-5.2**
Den	+0.1	-1.7	+15.0	+8.5
Swe	+1.7	+1.6	+13.8	+14.9
UK	+1.0	+0.2	-7.4	-4.6
EU28	**+2.6**	**+1.7**	**-2.2**	**-4.7**
Nor	+2.4	+0.3	+11.1 (Q2 17)	+1.1 (Q4 16)
Swi	-0.4	+0.5	-8 (Apr 17)	-13 (Oct 16)

Sources: Eurostat; European Commission; Finans Norge; SECO

Inflation-adjusted household disposable income per person fell by 0.2% in Q4 2016 in the euro area, following a 0.2% gain in Q3. This meant that real incomes were only around 1% higher than in late 2015. Rising wages continued to support incomes, rising 0.5% in Q4; their strongest quarter since Q1 2008. Social benefits continued to edge higher, but taxes rose and property income fell back, leading to a 0.4% increase in nominal incomes. However, a significant lift in inflation more than offset this, resulting in a real terms decline. Despite lower real incomes, consumption spending firmed by 0.3% in Q4, pushing it around 2% higher year-on-year. As a result, the euro area savings rate dipped to 12.1%; its lowest quarterly level since Q4 2012, and second lowest over the past decade.

Moving on to consumer confidence, the EU Commission's monthly survey has shown an improvement over the past six months, with the overall balance only marginally pessimistic in June. In terms of Scotland's main red meat export markets, most have seen improvements in 2017. In particular, the French indicator surged, going marginally positive, while there were improvements of four to seven points in Belgium, Denmark, Germany and Spain. However, there was a further deterioration in Italy.

Euro area retail sales, in real terms, have been on a steady upwards trend since 2013. In May 2017, sales volumes exceeded year earlier levels by 2.6%. This was similar to the gains seen in the previous two months and higher than the 1.6-1.9% growth in late 2016/early 2017. In the EU28, turnover growth dipped to 2.6% from closer to 3% in the previous two months and an average of 2.2% around the turn of the year. Non-food stores performed best, growing at a 3-4% rate in recent months with food, drinks, tobacco growing by around 2%. Of Scotland's main red meat export markets, France led the way with an average growth rate of close to 4% during the spring. Meanwhile, Germany grew in line with the overall average and sales rose by 2-2.5% in Norway, Sweden and Spain. However, Belgium, Italy and Denmark disappointed, with sales rising by less than 1%. Markit's monthly Eurozone Retail PMI survey has also shown a lift in recent months. This improvement was led by France, with German sales also growing. However, Italian retailers still faced headwinds.

What has been happening to economic policy in the EU?

Monetary Policy:

At its June meeting, the Governing Council of the European Central Bank (ECB) decided to leave its three main interest rates on hold. This left the main deposit rate at -0.4%, the refinancing rate at 0%, and the marginal lending facility at 0.25%.[12] The monthly programme of asset purchases (QE), which is due to expire in December, was also left on hold at €60bn (£50bn) per month.

It has been judged that although the euro area economy has firmed and GDP growth forecasts have been revised higher, inflation expectations remain anchored and core inflation has held relatively stable. However, given the improvement in economic conditions, there was a small change in the communications strategy, with references to the potential for further cuts to interest rates being removed. However, the Governing Council did still state its willingness to expand and/or lengthen its asset purchase scheme should the outlook for the economy and inflation turn down again.

ECB monetary data for May showed that euro area broad money growth remained relatively stable at around 5% year-on-year. Within this, deposits by households rose marginally faster than the overall rate while deposits in bank accounts by non-financial corporations grew by 7-8% in the spring. Meanwhile, lending to households and non-financial companies grew at an annual rate of around 2.5%. In the household sector, growth in consumer credit firmed to over 6% in May while mortgages continued to grow at around 3%. However, small business loans contracted by 1%. Lending to non-financial corporations grew strongest for medium-term loans of up to five years, rising nearly 5%, whereas short-term lending for less than a year contracted by 3%. Long-term lending grew 2.5%.

Outside the euro area, Sweden has maintained a loose monetary stance as although its economy has been growing steadily, inflation has remained below target. In July, its central bank held the main interest rate at -0.5% and continued monthly asset purchases. The Swiss target range for interest rates has also remained below zero, due to weak inflationary pressures and to place downwards pressure on the Swiss currency. Norway's main interest rate has also been stable, at 0.5%.

Fiscal Policy:

In addition to loose monetary policy from the ECB, there has been a change in attitudes towards fiscal policy in the European Commission. Governments have been given leeway to raise spending on investment and to meet the cost of the refugee crisis. With the economics profession generally concluding that attempts to cut budget deficits at too fast a pace in the early part of this decade had a considerable long-lasting negative impact on economic growth across the euro area, a 'positive fiscal stance' has been recommended for 2017 given that the European economy remains relatively sluggish[13].

This positive fiscal stance involves both expansion and a change in the balance of policy measures, both within and between countries. This means that those Member States running budget surpluses, and hence with the greatest room for flexibility, have been advised to raise public investment to offset the downwards impact from those countries implementing spending controls and returning their budgets towards the constraints of the Stability and Growth Pact[14]. It has also been recognised that

[12] The ECB has three main interest rates. The deposit rate is the interest rate a bank receives on the money it holds overnight at the ECB; the refinancing rate is the interest rate charged to a bank for lending from the ECB for one week; and the marginal lending facility is the interest rate on overnight loans from the ECB.

[13] https://ec.europa.eu/info/publications/2017-european-semester-communication-fiscal-stance_en

[14] Governments are committed to run a maximum budget deficit of 3% of GDP, and 0.5% of GDP once the economic cycle has been adjusted for.

if all countries meet these constraints then the aggregate fiscal stance across them all may be too tight, leading to sub-optimal economic activity.

Permanent losses of economic capacity and elevated levels of unemployment caused by the 2008/9 global recession and the Eurozone crisis have reduced the long-term potential economic growth rate and so it is believed that greater government investment spending can help turn this round, supporting future productivity and employment growth. The Commission now believes that this is an opportune time to make these investments, given the low level of interest rates and likelihood that multipliers will be greater at a time of weak consumption and private investment growth.

In the euro area, a modest overall fiscal expansion took place in 2015 and 2016, but current Member State plans point to a neutral stance in 2017. The Commission has therefore recommended that this is adjusted towards an aggregate expansion of around 0.5% of GDP, but recognises that this may be hard to implement given the country-specific nature of targets. In terms of policy methods, the Commission has recommended that countries move away from tax increases and towards higher investment spending. They would also like to see reform of spending on health and pensions to make them sustainable going forward and for greater efficiency in administration. Greater use of investment fund programmes within the EU budget has also been recommended.

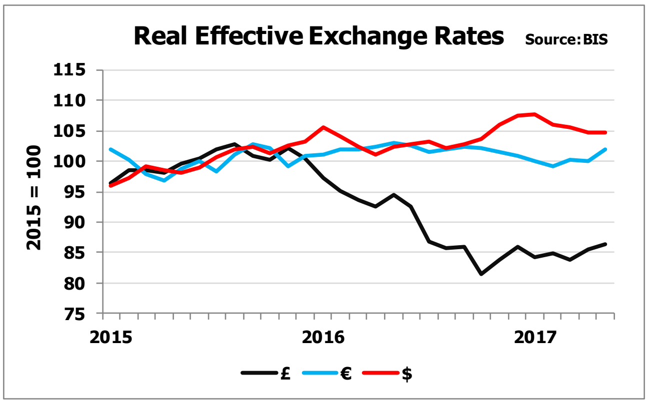
In line with an expansionary fiscal stance, the EU Commission estimated that euro area government spending rose by 1.9% in 2016 and has forecast a 1.5% expansion this year[15]. Public investment is expected to grow in line with the euro area economy this year, holding at 2.6% of euro area GDP.

Summary

With underlying inflation and inflation expectations remaining stable in the euro area the ECB has left its monetary policy unchanged in 2017. However, improved economic growth prospects mean that it is no longer referring to potential interest rate cuts in the future. A welcome change in the EU Commission's view on the fiscal stance means that governments with room to increase spending have been advised to invest in infrastructure and innovation in order to give a short-term boost to the European economy. In the longer-term, this change in focus could help reduce the significant macroeconomic imbalances across the euro area and help drive an expansion in productive capacity.

[15] European Commission. *European Economic Forecast – Spring 2017*

A focus on exchange rate movements

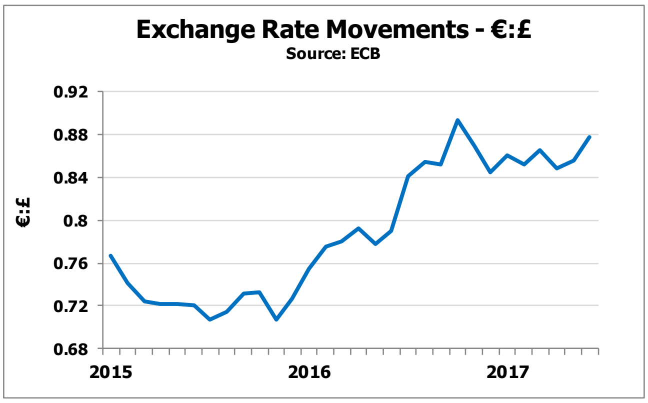


On a trade-weighted basis, sterling fell by 10.5% in 2016. With this being largely driven by the EU referendum, the currency has been relatively stable since a short time after the vote. It was down by 8.5% year-on-year in May.

Despite further monetary expansion in 2016, the trade-weighted euro rose by 2%, mostly down to sterling weakness. The euro weakened slightly in early 2017, in part down to an increased probability of populist electoral victories in Holland and France. However, their failure has seen this trend reverse. Nevertheless, the euro was 1% lower in May 2016 than twelve months before.

The US dollar climbed to a thirteen-year high in 2016, rising 3.5% above its 2015 level. This was supported by increased interest rates in December 2015 and December 2016, plus an initial bounce following the Presidential election as the new President had signalled his intention to underpin the US economy with tax cuts and infrastructure investment. A lower probability of fiscal stimulus has since led to some downwards pressure on the dollar, but it was still up by 2.5% on the year in May.

What factors have been influencing the €:£ exchange rate?



Until early 2016 monetary policy prospects in the UK and euro area were the main driver of the euro: sterling exchange rate. Then, the UK Government decided to hold its referendum on EU membership in June 2016, and exchange rate movements became closely aligned with changes in the probability of the UK voting to leave the EU. Then, as the referendum result became apparent, sterling plummeted in value. Having been worth less than 77p on polling day, one euro bought 80-81p following the vote. There was then a further fall to 84p in early July after the BoE indicated that, to reduce the risks of financial instability and of the economy slipping into recession, it would loosen the monetary stance.

After a period of stability, sterling then fell again in October 2016 as speeches by the Prime Minister and other members of the cabinet at the Conservative Party conference were interpreted as pointing towards the UK leaving the single market and negotiating a free trade deal with the EU. For most of the month, a euro was worth around 90p. However, this weakening reversed in November as it became apparent that the Italian Prime Minister was likely to resign. This had potential implications for the Italian banking sector and the financial stability of the euro area. In addition, economic data signalled that the UK economy had continued to expand, indicating that a further interest rate cut would not be required. At the year-end, a euro bought 85p.

Moving into 2017, political risk has remained a factor behind exchange rate movements. Elections in Holland and France were won by pro-EU parties, underpinning the euro. In the UK, the announcement of a General Election in mid-April initially boosted sterling, pushing the value of a euro below 84p. This was because financial market participants felt that the expected increase in the Government's Parliamentary majority raised the chances of a closer future trading and investment relationship between the UK and EU. This was based on the theory that the Government would be less reliant on the support of the staunchest Brexit advocates in the Parliament in order to pass legislation. However, a shift in support away from the Conservative Party in mid-May lowered the probability of an increased majority, pushing down sterling and raising the value of a euro to 87p at the end of the month. After the Government lost its majority on June 8, sterling weakened slightly further and the euro has traded at around 88p since.

Throughout H1 2017 a change in monetary policy outlook has also had an impact on the sterling exchange rate against the euro. Rising economic sentiment and upward revisions to GDP growth expectations on the continent have raised the prospect of the ECB tapering back its monthly asset purchases once the current programme expires in December. In addition, the change in guidance on monetary policy after the ECB's June Governing Council meeting supported the value of the euro (see pp.21). Meanwhile, in the UK, above-target inflation and split votes on monetary policy have given small short-term boosts to sterling (see pp.15). Furthermore, the BoE Governor has changed his tone, signalling an increased likelihood of an interest rate increase in H2 2017.

Nevertheless, the likelihood that there will be higher barriers to investment and trade in the UK economy in the future have left the value of sterling significantly lower than its pre-referendum level, as a weaker exchange rate would be required for the UK to remain price competitive. During H1 2017 sterling averaged around 10% weaker than a year earlier against the euro.

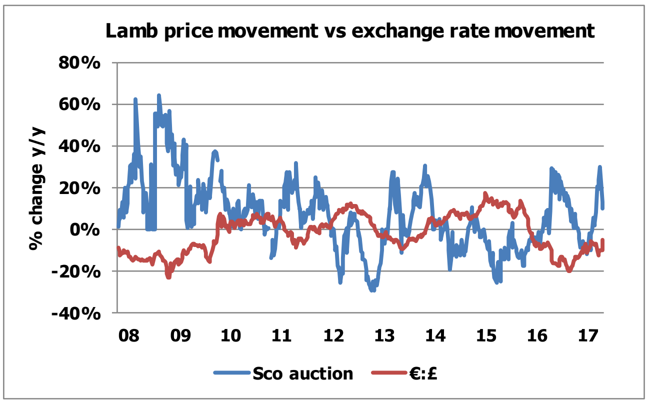
Moving into the second half of the year, the year-on-year differential has narrowed to 3% as the 2016 exchange rate to compare against has fallen now that the anniversary of the referendum has passed. The narrowing reflects that little has changed since the EU referendum – the same trade and investment rules still apply but the prospect of future trade barriers remains. However, the increased political uncertainty following the UK General Election has ensured that sterling has weakened slightly further.

What influence does movement in the €:£ have on the red meat industry?

During 2016, 86.5% of UK red meat exports by value were sold within the EU while 83% of imports came from Member States. A weaker sterling relative to the euro pushed up prices of red meat imports and exports and therefore provided a significant tailwind to the UK red meat market. UK red meat exports to the EU rose by 2% in 2016, helped by a 5% lower average price in euro. However, they averaged 7.5% dearer when converted back into sterling, raising export revenues by nearly 10%. With the exchange rate remaining weaker than a year earlier in H1 2017, in theory it has provided further support to exports and maintained the price competitiveness of home produced meat in price sensitive markets. However, it should be noted that the impact of an exchange rate movement will depend on the extent to which forward and spot exchange rates are used in transactions; whether pricing contracts have been fixed; and/or the sensitivity of demand to price changes. In addition, the responsiveness of trade to exchange rate movements may be limited by the presence of multinational red meat processing companies operating cross-border supply chains.

Starting with imports, a fall in the value of sterling means that each pound can buy fewer goods for the same euro price. Holding everything else constant, the likely consequence for UK producers is to raise the price processors are willing to pay for their livestock, given that the alternative has become more expensive. Exchange rate movements are likely to have the greatest impact where price sensitivity is strongest and a fall in sterling tends to provide a shield to the price of home produced red meat destined for the food manufacturing trade. On the supply side, if higher import prices encourage a smaller quantity of imports, then more home produced meat will be required, supporting its price.

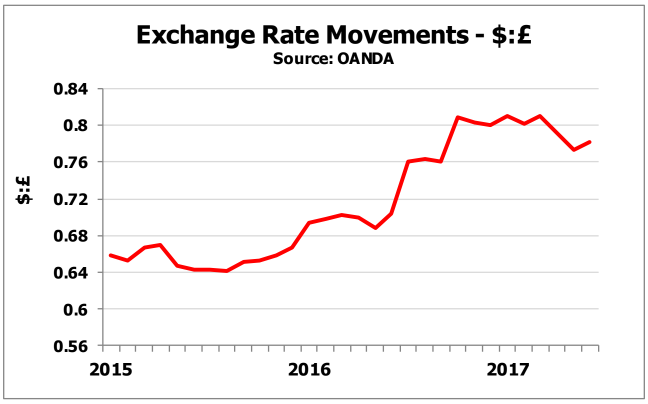
On the export side, a weaker sterling requires fewer euros for the same sterling price. Therefore, a British exporter could reduce their charge in euros while holding their sterling price constant. In a price sensitive market, the subsequent increase in sales volumes would boost sterling revenues. The alternative strategy of holding their euro price would also boost sterling revenues assuming the same volume of sales. If UK export quantities were to rise, then a smaller volume of meat will remain on the home market, supporting its price, unless domestic demand were to decline.



An illustration of the impact of exchange rates on domestic prices comes from the lamb market. Indeed, over an extended period, when sterling has been weaker than 12 months before, the auction price for lambs in Scotland has tended to be higher than a year earlier and vice versa.

The exchange rate with the euro also has an impact on the value of CAP support payments as subsidies are paid out from the EU budget in euros. In 2016, the conversion rate was the average exchange rate in September. Since the euro rose to £0.85228 compared with £0.73129 in 2015, an average Pillar I support payment of around €26,000 would have been worth £22,000 in 2016 compared to £19,000 in 2015; an increase of 16%.

What has been happening to the $:£ exchange rate and why does it matter?

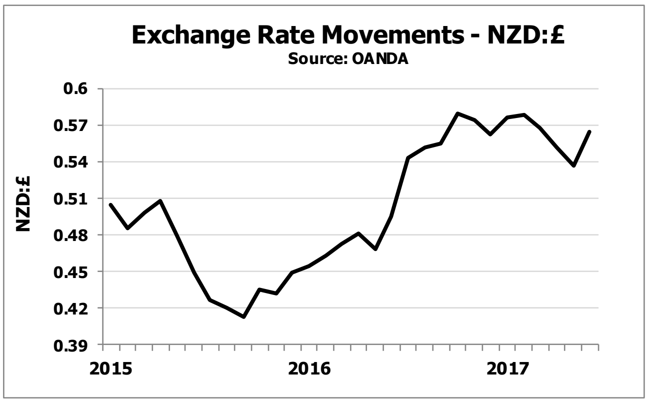


In late 2015, the climb in the US dollar was driven by a US Federal Reserve decision to raise interest rates in December. That this move was highly anticipated meant that it was mostly priced into exchange rates before implementation. However, in 2016 the exchange rate between sterling and the US dollar was influenced most by the UK's vote to leave to EU. Following the referendum, sterling fell even more sharply against the USD than it did against the euro, with a dollar worth 75p in early July. Then, in the autumn, the combination of a higher probability of the UK leaving the single market, following the Conservative Party Conference, plus the election of the new US President on a mandate to stimulate the US economy led to a further rise in the dollar. In Q4 2016, a dollar bought around 80p on average.

Moving into 2017, the exchange rate was broadly stable at this level until the announcement of a UK General Election in mid-April. This gave sterling a lift, resulting in a dollar value of around 77-78p. Since then the exchange rate has stabilised once again and sterling has not weakened against the dollar like it has against the euro since the outcome of the General Election. This may reflect some of the challenges the US President has faced in passing legislation, lowering the prospect of fiscal stimulus. It may also reflect that the US is on a well-documented path towards monetary tightening, whereas there has been a recent change in tone in the euro area. In July 2017, sterling has been trading around 1% weaker than a year earlier against the US dollar.

Exchange rate movements against the dollar have implications for the cost of energy and imported raw materials. Commodities such as wheat and soyabeans, that are imported for animal feed, and oil, which affects fuel, energy and fertiliser costs, generally have their price quoted in dollars. The stronger the dollar, the more expensive they are in sterling terms and the higher the cost of production is for UK businesses. Soyameal has been trading at similar levels to a year earlier in July in both dollar and sterling terms, but if sterling had been trading at its June 2016 value relative to the dollar, then it would be approximately 15% cheaper to import to the UK.

What has been happening to the NZ$:£ exchange rate and why does it matter?



With 75% of UK lamb imports coming from New Zealand, the value of the pound against the New Zealand dollar (NZD) is important in determining import volumes and prices.

The mid-2015 NZD decline had been driven by the Reserve Bank of New Zealand's (RBNZ) decision to cut interest rates, largely in response to the dairy crisis. However, a reduced likelihood of monetary tightening in the UK led to a partial recovery by the year-end. Moving into 2016, the NZD made further progress against sterling as prospects of tighter monetary policy in the UK dissipated and uncertainty around the UK's status within the EU mounted, approaching its late-2014/early 2015 level of 49-50p in the run up to the EU referendum. The NZD then increased significantly after the referendum, reaching 54p at the beginning of July, and then 58p in October. In mid-November, a further reduction in NZ interest rates resulted in a dip in the NZD, and it traded relatively steady at 56-58p until mid-April. Then, the announcement of the UK General Election resulted in some sterling strength and the NZD fell to 53 in May. However, post-election uncertainty saw the NZD firm again in June, reaching 57p. However, it then dipped to 56p in the final week of June after the RBNZ signalled that interest rates would be kept on hold.

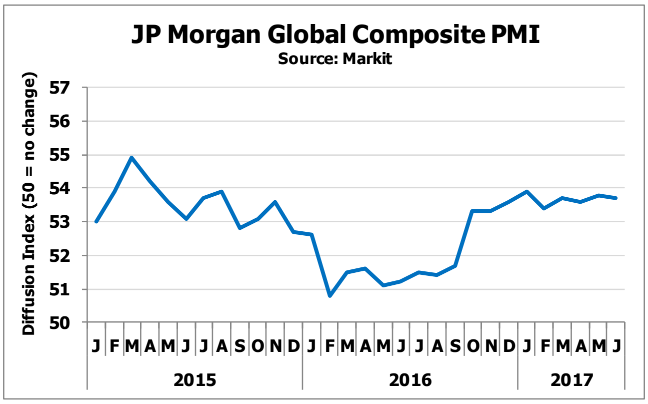
With the NZD trading nearly 4% stronger against sterling in mid-July than a year earlier, and around 15% stronger than pre-EU referendum, it is likely to have affected the competitiveness of the country's lamb exports to the UK. The NZ Farmers Weekly quotes an export price for a leg of lamb for the UK market and, in NZD, it was 18% dearer in the first week of July 2017 than twelve months before. After converting into sterling, it was up by 21% year-on-year at £4.73/kg. Compared with mid-June 2016, the price was 9% higher in NZD but 25% higher in sterling.

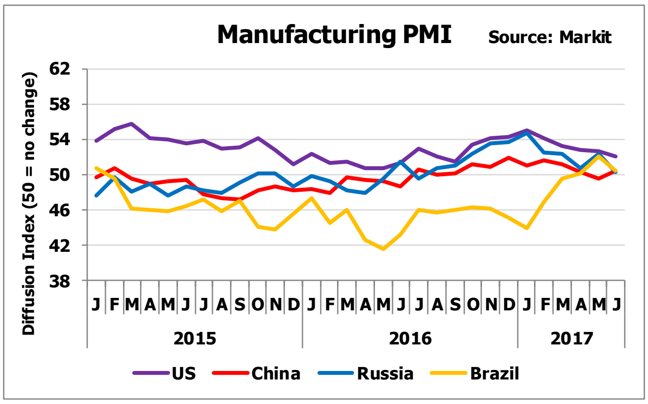
Economic Outlook

UK

General Economic Climate:

With higher inflation now eating into disposable incomes, consumer spending is likely to act as a drag on UK economic activity. Meanwhile, political and economic uncertainty is not conducive to business investment and with Brexit negotiations with the EU underway, potential implications will be high on the news agenda. However, a weak currency makes the UK an attractive tourist destination for both foreign and domestic travellers. It also supports the competitiveness of UK service providers and manufacturers, potentially supporting some business investment in export-facing sectors.





During H2 2017, a weak sterling and continuing growth in the EU and US should help underpin export demand from the UK's largest markets, while emerging markets are expected to have a better year in 2017 due to stronger commodity prices and a firm US dollar. The IMF has raised its 2017 global economic growth forecast from 3.4% to 3.5%. This compares favourably with 3.1% in 2016.

Economic Activity:

With UK economic growth slowing in Q1 2017, the BoE has revised down its GDP projections for this year. Quarterly growth rates are expected to remain similar to the 0.2% estimate for Q1, resulting in a dip in the year-on-year rate of expansion towards 1.5% in H2.

Inflation:

The BoE expects the past rise in commodity and import prices to continue underpinning retail prices in H2 2017 and has forecast that CPI inflation will average 2.8% in Q4. Since this forecast was made in early May, oil prices have cooled, potentially limiting the upside; though sterling has weakened.

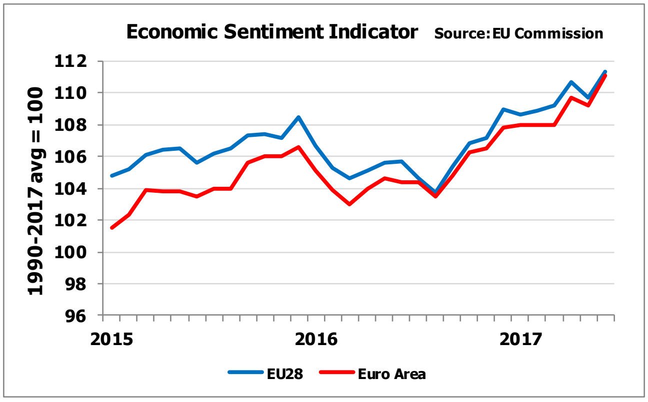
Labour Market:

BoE projections point towards a slowdown in the growth rate for both labour demand and labour supply this year. However, with both rising at similarly slow rates, the unemployment rate stabilises around its current level, close to full employment. Recent business surveys suggested that firms still had room to increase staffing levels in order to deal with backlogs of work, so it is possible that unemployment will continue to edge lower. Wage growth is forecast to remain sluggish in H2 2017 as uncertainty and non-wage labour costs bear down on the willingness of firms to raise pay.

Monetary Policy:

Split MPC votes since March mean that a potential interest rate increase back to its pre-EU referendum level of 0.5% is a distinct possibility. With inflation anticipated to remain well above target due to past increases in commodity and import prices, then a majority of MPC members could be found if indicators of domestically generated inflation were to also pick up, such as services prices and labour costs. However, these measures have yet to show any significant upturn and the MPC member that had been voting for an interest rate increase since March has now concluded their term, suggesting the balance of probabilities remains on the side of no change.

EUROPE



In its spring forecasts, the European Commission upwardly revised its 2017 economic growth estimates for the euro area and wider EU28 to a respective 1.7% and 1.9%, reflecting a strong start to the year indicated by private sector surveys and business confidence. However, this would still mean a three-year low for the euro area. In 2018, similar growth rates of 1.8% and 1.9% have been forecast.

It is likely that, although falling, elevated unemployment in a number of countries, and sluggish wage growth elsewhere, will result in a continued underperformance of consumer spending growth relative to the overall economy. High stocks of public debt following the financial crisis and the favouring of tight fiscal policy in some countries, including Germany, will limit any increase in public spending, also weighing on GDP growth. However, on the other hand, it is anticipated that low interest rates and an improved economic environment will generate investment, while a lift in global GDP growth will support exports, underpinning economic activity.

Optimistically, the rate of economic growth is expected to remain firm enough for continued labour market improvements. Rising economic prospects are likely to see further growth in the labour market participation of previously discouraged workers. Employment is anticipated to rise by 1.1% in 2017, more than offsetting a rise in the labour force, helping lower the euro area unemployment rate from an annual average of 10.0% in 2016 to 9.4% in 2017. For the EU28, unemployment is forecast to decline by 0.5 percentage points to 8.0% in 2017.

The ECB revised its inflation outlook lower between late March and late May due to the slide in oil prices, now anticipating an average HICP rate of 1.5% in 2017 and 1.3% in 2018. The dip in the global oil market in mid-June would therefore point to a further slowdown in headline inflation, potentially holding close to the June estimate of 1.3%. However, core price inflation, which has less of a link to commodity prices, remained relatively stable during the recent period of elevated inflation, and is likely to continue to do so, holding at close to 1% in H2 2017. The EU Commission Spring Forecasts (made in late April) had 2017 HICP at 1.6% in the euro area and 1.8% in the EU 28.

At a country level, Italy is forecast to grow the slowest in 2017. However, at 0.9%, it would be the strongest for many years. Economic growth is still expected to be subdued in Belgium, Germany, France and Denmark, ranging between 1.4% and 1.7%. However, Holland looks brighter, at 2.1%, while the Spanish and Swedish economies are expected to firm by 2.7-2.8%. Improving economies are expected to support job growth. Employment gains are expected to be strongest in Spain (2.3%), Holland (1.7%) and Sweden (1.5%). However, below average gains of 0.7-0.9% are forecast for Italy, France, Belgium and Germany, with Denmark marginally below average at 1.1%.

Expansionary monetary policy should continue to support the European economy in H2 2017, keeping interest rates low enough to incentivise investment. Meanwhile, the fiscal stance will be neutral at worst and public investment should help boost future productivity growth.

In summary, the self-fulfilling upturn in the domestic European economy is likely to continue in H2 2017. Growth rates are likely to remain at a positive though unspectacular level of 1.6-2% as consumer demand remains subdued. However, unemployment is likely to fall further throughout Scotland's main red meat export markets and core inflation is likely to hold steady. Given low interests rates, public and private investment should help stimulate economic expansion.

GDP Growth Forecasts for Prominent Scottish red meat markets					
	Q2 17	Q3 17	Q4 17	2017	2018
	% change q/q	% change q/q	% change q/q	% change y/y	% change y/y
Bel	0.3	0.4	0.4	1.5	1.7
Fra	0.5	0.4	0.4	1.4	1.7
Ger	0.5	0.5	0.5	1.6	1.9
Hol	0.5	0.4	0.4	2.1	1.8
It	0.3	0.3	0.2	0.9	1.1
Spa	0.7	0.6	0.6	2.8	2.4
Euro Area	**0.5**	**0.5**	**0.4**	**1.7**	**1.8**
Den	0.4	0.4	0.4	1.7	1.8
Swe	0.4	0.2	0.3	2.6	2.2
UK	0.3	0.3	0.3	1.8	1.3
EU28	**0.5**	**0.5**	**0.5**	**1.9**	**1.9**

Source: EU Commission (European Economic Forecast, Spring 2017)

Other Economic Forecasts for Prominent Scottish red meat markets in 2017				
	Unemployment Rate	Inflation (HICP)	Domestic Demand	Investment
	%	% y/y	% change y/y	% change y/y
Bel	7.6	2.3	1.3	2.1
Fra	9.9	1.4	1.4	2.6
Ger	4.0	1.7	1.9	1.9
Hol	4.9	1.6	2.2	3.5
It	11.5	1.5	1.1	3.6
Spa	17.6	2.0	2.4	3.4
Euro Area	**9.4**	**1.6**	**1.8**	**2.9**
Den	5.8	1.4	1.9	3.6
Swe	6.6	1.4	2.3	3.9
UK	5.0	2.6	1.4	0.2
EU28	**8.0**	**1.8**	**1.9**	**2.7**

Source: EU Commission (European Economic Forecast, Autumn 2016)

Exchange Rate Movements

€:£

The rebalancing of sterling following the vote to leave the EU seems highly likely to persist. With Brexit negotiations now underway, short-term fluctuations in the value of sterling against the euro will be driven by developments in the talks and speeches by Government ministers. Given the change in sentiment towards Brexit within the UK Parliament since the General Election, evidence of cross-party groups of MPs offering resistance to Government plans could also lead to currency movements.

The degree of closeness to the current trading relationship between the UK and the EU is likely to be a significant factor in determining the sterling exchange rate. If the UK negotiating position is communicated as being towards preserving tariff-free trade and investment through single market membership, then the sterling exchange rate could settle in the low-to-mid 80s. However, a position that indicates a move towards leaving the single market and customs union and negotiating a free trade agreement could push the exchange rate towards 90p. If the chance of the UK exiting without a deal increases, then sterling could fall significantly, pushing the euro above 90p.

However, the monetary policy stance is set to have an increasing influence on exchange rates. The value of sterling will gain support from BoE communications signalling an increased likelihood of an interest rate rise and vice versa. Meanwhile, ECB communications pointing towards a tapering of its asset purchases scheme from the beginning of 2018 will support the euro and vice versa.

The weaker the sterling exchange rate, the more expensive imports look and the more attractive exporting appears. Given the likelihood of the exchange rate remaining around its range since the EU referendum, it is likely to continue to underpin farmgate prices for cattle, sheep and pigs.

$:£

The step-change in the sterling dollar exchange rate of mid-2016 is likely to persist. Like with the euro, the outlook will be affected by the UK's Brexit stance and developments in monetary policy. The closer the likely future trading relationship between the UK and EU, and the higher the probability of a UK interest rate increase, the stronger sterling is likely to be.

However, a further driver is likely to be the policy platform of the US administration. Evidence that the new President could build enough Congressional support to loosen the fiscal stance by cutting taxes and raising infrastructure spending could support the dollar, as it raises the prospect of further increases in US interest rates to offset the potential stimulatory impact on inflation.

A relatively weak sterling against the dollar is likely to maintain the recent boost to the UK's competitiveness in the price sensitive global market for red meat. However, on the other side of the equation, a weaker currency has pushed up import prices for energy, fertiliser and feed prices, raising the cost of production for livestock producers.

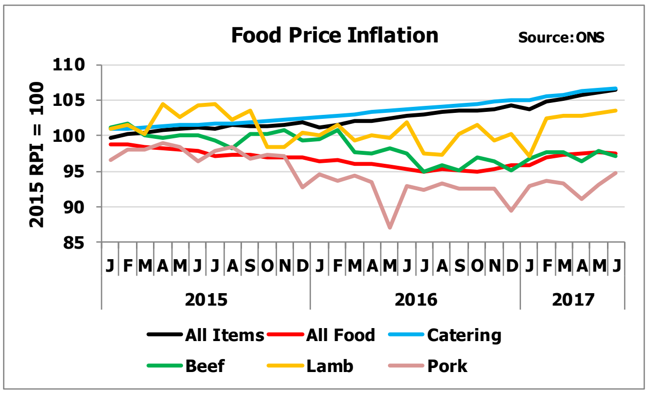
NZ$:£

A weak sterling against the NZD pushes up the cost of importing sheepmeat to the UK from NZ. Along with tight supplies in NZ, this is likely to place downwards pressure on UK import volumes while underpinning UK farmgate prices.

Following interest rate cuts in 2016, and subdued economic growth in NZ in Q1 2017, the RBNZ is expected to leave monetary policy on hold. Given this context, if the BoE signals an increased willingness to tighten, the NZD could fall against sterling. Like with the euro and US dollar, general Brexit-related movements in sterling will also impact the exchange rate.

What has been happening in the red meat sector?

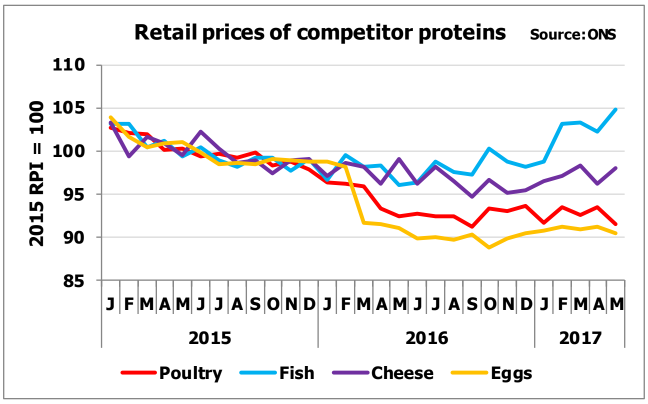
Food Price Inflation:



Following thirty-one consecutive months of food price deflation, ONS RPI data indicates that food prices moved above year earlier levels in February 2017. By May, food inflation had climbed to 2.1%.

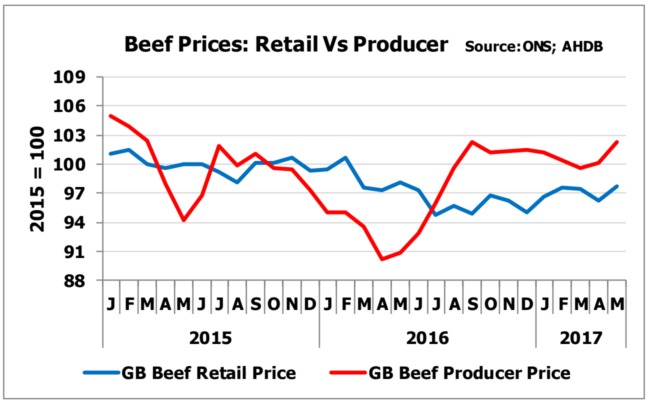
In the catering sector, prices are less reflective of raw material costs and have a higher basis in factors like the cost of labour and the willingness of consumers to spend money eating out. Catering prices rose steadily through 2015 and 2016 when food prices declined, and have continued to follow a steady upwards trend in 2017, leaving them 2.8% above year earlier levels in May.

By May, not all types of meat had made the same transition to higher prices as food in general; beef, poultry and bacon were still slightly lower. Heavy competition amongst retailers plus retail price falls in mid-2016 have kept meat price inflation down for longer than other products, but given the trend higher in late 2016/early 2017, the return of year-on-year inflation in H2 2017 is likely, even if retail prices were to steady.



Retail prices for competing proteins stabilised in H2 2016 following 18 months of price declines, making it difficult for red meat to gain market share. In early 2017, there has been some evidence of prices drifting slightly higher, so year-on-year price inflation is set to return in the coming months. Fish prices have risen most significantly, pushing them 9% above year earlier levels in May and to their highest since March 2014. Cheese prices have also picked up in 2017, reflecting the upturn in farmgate milk prices, but remained 1% lower than last year in May. Poultry and eggs have risen more marginally since last autumn, but also continued to trail year earlier levels by around 1% in May.

Beef:



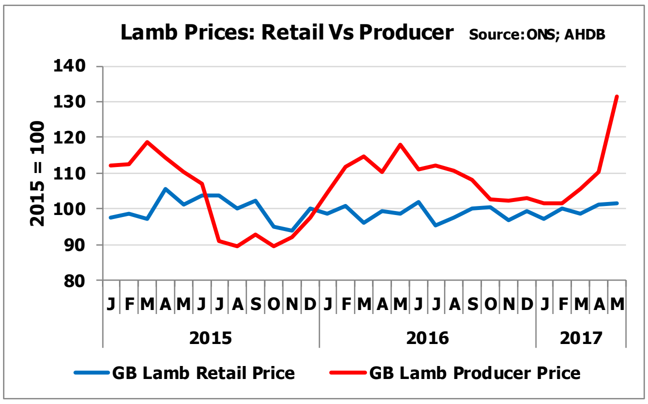
After two and a half years of relative stability, beef retail prices fell back in Q2 2016. Having steadied through Q3, they then trended slightly higher in late 2016/early 2017, before levelling again in the spring. The beef RPI remained below 2016 levels in May, down 0.5%. Meanwhile, GB producer prices averaged 12.5% higher than in May 2016, at 355p/kg dwt for a steer.

Over a prolonged period, the average beef retail price tends to stabilise. Given the context of rising farmgate prices, it will therefore be interesting to observe whether retail prices hold around current levels, or begin to firm. In recent years, farmgate beef prices have been more stable during the second half of the year than during H1. If this was to be the case again in 2017, perhaps the supply chain could absorb current farmgate values, but further momentum at the farmgate may lead to a squeeze in margins significant enough for wholesalers and retailers to need to raise prices.

Despite higher producer prices, in May, the average price of mince in the ONS sample was 2% cheaper than a year earlier at £7.32/kg. This was also the lowest average price for mince in 2017. While rump was down by 3.6% on last year at £16.01/kg and topside 5.8% lower at £11.13/kg, both were at their dearest since January.

AHDB provides a monthly comparison of GB producer and retail prices. This retail price is estimated by breaking down an average carcase into its different retail components. During June, the producer price averaged 51.8% of the average retail price. This was 5.3 percentage points higher than twelve months before and a six-month high. Nevertheless, it was still below the levels of 2012-13. The average retail price was estimated to have risen by 1.2% year-on-year to £7.00/kg.

Lamb:



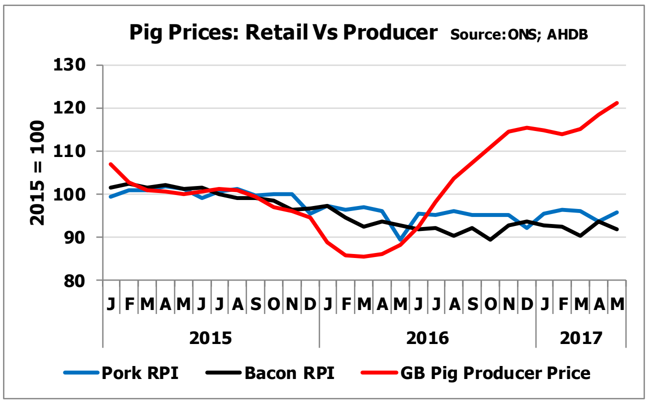
Lamb retail prices have been on a broadly stable trend since 2011. However, the price of home-killed lamb did reach an eleven-month high in May and averaged 2.9% above year earlier levels. Meanwhile, the sharp rise in the cost of importing lamb from NZ was partially reflected in the retail price of imported lamb, which was up 4% on last year in May. Farmgate prices in GB averaged 11% higher than last year in May, while NZ prices were around 40% higher in sterling terms.

The seasonality of producer prices means that the wholesale and processing chain tends to bear a sharp squeeze on their margins at the beginning of the new season. After a prolonged period of stable retail prices, there perhaps is some room for increases in retail prices if producer prices continue to trade well above year earlier levels, particularly if the cost of competing proteins has begun to pick up.

The ONS retail price dataset indicates that both loin chop/steak and bone-in shoulder were dearer than a year earlier in May, up by 1.3% and 2.8%, respectively, at £13.46/kg and £7.76/kg. Meanwhile imported frozen legs were priced 4.6% higher at £7.43/kg.

According to AHDB, the lamb producer price reached 60.2% of the average lamb retail price in June. This was 8.5 percentage points higher than in June 2016, but remained below its June 2013 level of 62%. AHDB's estimate of the average retail price was up by 1.3% year-on-year at £8.20/kg.

Pigmeat:



Following declines in late 2015 and early 2016, the retail price of pork has lacked direction since the summer of 2016. However, a short-lived drop in price in May 2016 resulted in a 7% year-on-year inflation rate in May 2017. Despite a prolonged period of price deflation, consumption of fresh pork has struggled, with consumers substituting it with processed pork and poultry. The resurgence in farmgate prices since March 2016, pushing them up 37% year-on-year in May, while retail prices have stabilised will have squeezed margins in the wholesale and retail chain. However, this followed a period of margin widening as the price of prime pigs fell sharply from late 2013 through to early 2016, so continued retail price stability is possible in the short-term, especially if pig prices follow their traditional seasonal profile by peaking in the summer.

Since bacon goes through a higher degree of processing than pork, in theory, its retail price may be less reflective of the price a processor pays for the raw material. However, bacon prices have shown a similar trend to pork prices in the past couple of years, falling until last summer and then steadying. The bacon RPI was down 0.9% year-on-year in May.

Bone-in pork loin averaged £6.12/kg in May; an annual increase of 5.2%. Meanwhile, back bacon was up by 0.6% at £7.26/kg, but gammon was 1.2% cheaper at £6.46/kg. Ham prices have risen sharply in H1 2017, pushing the cost of a 100-125g pack 9.5% above May 2016 levels at £1.84.

Review and Outlook for Meat Supplies

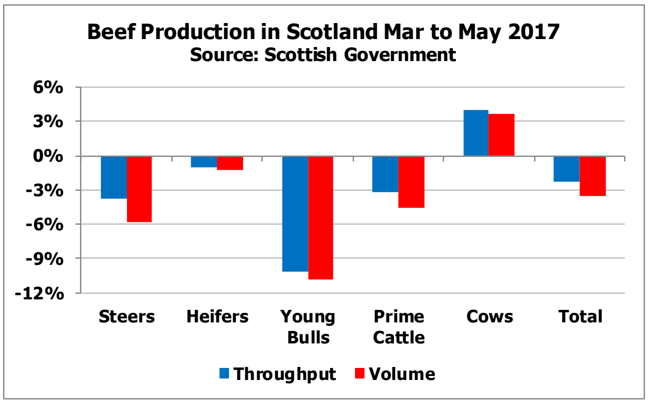
Beef:

UK beef supply: Q1 2017 (t)				Totals may not sum due to rounding
	2017	2016	Change 2017/2016 (t)	% change 2017/2016
Home Production	223,900	230,600	+6,000	-2.9
+ Imports	80,800	79,700	+1,100	+1.4
- Exports	33,000	36,600	-3,600	-9.8
= Net Supply	**271,700**	**273,600**	**-2,000**	**-0.7**

Home Production

Provisional Defra estimates of UK red meat supplies for Q1 2017 indicate that UK beef production fell by 2.9% to 223,900t. There were declines in slaughterings of prime and mature cattle, while the average carcase weight fell slightly for prime cattle but increased for cows.

In Scotland, abattoir production fell by nearly 2% in Q1. A 4% fall in prime production, down to lower throughput and carcase weights, was partially offset by increased cow beef production.



Looking at the most recently reported three months, March to May 2017, prime cattle slaughterings fell by 3% at Scottish abattoirs. The steer kill fell by 3.5%, heifers by 1% and young bulls by 10%. The heavier fall in young bull slaughterings reflects a fall in dairy sired calf registrations in the spring of 2016, while greater use of beef bulls in the dairy herd may have led to some substitution towards steers, which will reach the market in late 2017 or 2018. Meanwhile, although the cow kill continued to increase, the growth rate has slowed from double-digits.

Carcase weights have continued to place additional downwards pressure on beef production in 2017. Producers appear to have responded to abattoir pricing structures which provide a disincentive to exceed a certain carcase weight. As a consequence, the average prime cattle carcase weight at Scottish abattoirs was 5kg (1.5%) lighter than a year earlier in the three months to May, at 372kg. This turned a 3% shortfall in numbers into a 4.5% decline in prime beef volumes. With steers most likely to be facing weight-related penalties, their average carcase weight declined by 8.5kg (2%) to 389kg, but this was still above the target weight range for multiple retailer contracts. Meanwhile, the average cow carcase weight fell marginally, down 1kg (0.3%) to 343kg.

Trade

Imports add to domestic beef supplies and during Q1 2017 Defra estimates that UK beef imports edged 1.5% higher on the year to 80,800t. There was a small change in the balance of imports with fresh deliveries rising 1.5% to 58,800t, while frozen shipments rose by 1% to 22,000t. The share of imports in total UK beef supplies during Q1 rose by around a percentage point on the year to reach 30%. Looking at HMRC data for fresh and frozen beef, the Irish Republic delivered 5.5% more beef to the UK than a year earlier, with fresh up 2.5% and frozen by 15.5%. This raised the Irish share of UK imports. Imports from a number of smaller EU suppliers also increased, including Holland, Poland and Germany, whereas imports from non-EU countries fell by 44%.

Exports deduct beef supplies from the UK market. Despite a favourable exchange rate, Defra estimates that total volumes, including processed products, contracted by 10% to 33,000t in Q1. The share of domestic production exported fell by around 1.5 percentage points on the year to 14.5%, as tight supply in the home market limited product available for export. HMRC data shows that deliveries of fresh and frozen beef to the main markets of Ireland and Holland fell significantly. However, Ireland remained the largest export customer for the UK, reflecting cross-border supply chains within the British Isles. Outside the EU, Hong Kong provided a growing outlet for low value cuts.

Outlook

	GB cattle population: 1 April 2017		**Source: BCMS**	
	Still alive Apr 2016	Still alive Apr 2017	y/y Change	
Calves registered:			head	%
<6 months ago	1,116,699	1,095,848	-20,851	-1.9
6-12 months ago	1,383,770	1,378,521	-5,249	-0.4
12-18 months ago	976,700	987,382	+10,682	+1.0
18-24 months ago	981,875	990,373	+8,498	+0.9
24 to 30 months ago	510,394	539,862	+29,568	+5.8
30 to 36 months ago	390,031	400,725	+10,694	+2.7
Total pool	4,242,670	4,296,863	+54,193	+1.3

Looking forward into H2 2017, prime cattle supply is likely to exceed year earlier levels at the GB level. Growth in the spring 2015 calf crop relative to 2014 and then a further increase in spring 2016 should provide more cattle at around 18 and 30 months of age in H2 2017 than a year earlier. Slaughterings will generally be sourced from the cohort that were aged between 12 and 24 months in April 2017, and, as can be seen in the above table, these cohorts increased by a combined 19,700 head (1%) compared to a year earlier. Supplies of older prime cattle from the 24-30 month bracket in April will add further support to the slaughter pool. However, young bull numbers, drawn primarily from April's 6-12 month category, are likely to remain tight.

However, prime beef production volumes will depend on the evolution of carcase weights. Enforcement of carcase weight penalties has had some impact and carcase weights averaged 1% lower than last year in Q2 2017. If, as expected, this trend continues, it may offset increased prime cattle availability, resulting in stable prime beef production. Given firm farmgate prices, a second potential limiting factor to prime supplies in H2 2017 could be an increased heifer retention rate.

Cow beef production has inevitably fallen back in 2017 following sharp increases in 2015 and 2016. Given the small decline reported in the UK beef herd last December and an improved dairy market, tight supplies of cow beef may well reduce overall beef supply in H2 2017.

Looking at trade, the Irish Republic is well supplied in 2017, with the December 2016 census reporting increases of 7.5% for cattle aged 12 to 24 months and 2.5% for those aged less than one year. However, a weak sterling will support the use of UK product rather than imports in price sensitive food manufacturing and foodservice. Furthermore, Ireland has been proactively seeking alternative outlets for its beef and live cattle. Meanwhile, a tight UK beef market is likely to constrain exports.

To summarise, UK beef production is likely to fall in H2 2017 as any increase in prime cattle availability is more than offset by lower carcase weights and a fall in cow beef. As a consequence, import demand may increase while less beef is likely to be available for export.

Sheepmeat:

UK sheepmeat supply: Q1 2017 (t)				Totals may not sum due to rounding
	2017	2016	Change 2017/2016 (t)	% change 2017/2016
Home Production	70,500	70,300	+300	+0.4
+ Imports	28,100	37,000	-8,900	-24.0
- Exports	23,000	21,500	+1,400	+6.7
= Net Supply	**75,700**	**85,700**	**-10,000**	**-11.7**

Home Production

Despite a significant carryover of hoggs into 2017, due to the timing of slaughter for Easter, UK sheepmeat production only showed marginal growth during Q1 2017 to 70,500t. Though prime slaughterings fell, higher carcase weights pushed up prime sheepmeat volumes, but mutton production fell sharply.

At Scottish abattoirs, prime sheep production continued to fall in early 2017, down 3% year-on-year. Slaughterings fell by 5% but the average carcase weight rose by 2%. Moving forward to the most recently reported three months, March to May, it was a similar picture with prime slaughter down 5%, carcase weights up 2% and production down 3% on the year at 5,500t.

In contrast to Scotland, Defra estimates that across the UK as a whole, an additional 268,700 prime sheep were processed compared to 2016 between March and May. Numbers were up nearly 10% at 3m head. Carcase weights also increased, by more than 2.5%, pushing prime sheepmeat production 13% higher. However, since 3.5% less mutton was produced, total sheepmeat production rose 10%.

Trade

Imports add to the volume of sheepmeat on the UK market, so a 24% year-on-year decline resulted in a significant tightening of UK sheepmeat supply in Q1 2017, subtracting 8,900t. The 28,100t of sheepmeat that Defra estimates the UK to have imported during Q1 accounted for 37% of total supplies, down six percentage points on the year. HMRC figures for January to April, thereby including the entire Easter delivery window, indicate that import volumes declined by 17%. Product arriving from the major supplier, New Zealand (NZ), declined by 24%, reflecting lower production, but this was partially offset by a rise in imports from Australia and Ireland. In addition to reduced availability, sheepmeat was brought in at a significantly higher average price than in the spring of 2016.

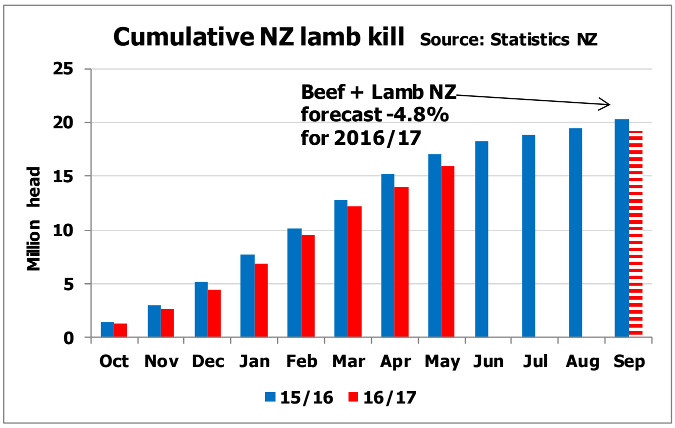
Moving to the export side, Defra estimates that volumes made a strong start to 2017, rising by 7% to 20,300t in Q1. This was added to by a 2.5% increase in live sheep exports, resulting in an overall export increase of 6.5% to 23,000t[16]. With exports subtracting from domestic supply, this expansion in trade removed a further 1,400t from the home market compared to Q1 2016. HMRC export data indicates that trade with the UK's main customer, France, contracted in early 2017, but that this was more than offset by expansion into Belgium, Germany, Italy, Ireland and Holland. However, French import data suggests that UK shipments have been more stable. A favourable exchange rate and tight supplies in NZ will have helped UK exporters increase market share on the continent. Outside the EU, like for beef, Hong Kong has provided opportunities for UK processors to sell lower value cuts, thereby supporting carcase balance.

[16] Most of the UK live sheep trade is exports from Northern Ireland to the Irish Republic for slaughter.

Outlook

To estimate the potential June 2017 lamb crop, the starting point is the 2016 December census. In England, the breeding flock is estimated to have risen by just over 1% to 6.7m head, whereas, north of the border, numbers fell by 3% to 2.9m. Combine these two together and you get a similarly sized breeding flock to autumn 2015. Therefore, any change in the lamb crop will depend on ewe productivity. In 2016, the lambs to ewes ratio was one of the highest recorded in both Scotland and England, so for the 2017 lamb crop to match last year's levels then an exceptional lambing will once again be required. In Scotland, industry sources suggest that this may well have been the case, potentially even improving slightly on 2016.

Based on a similar, or even slightly larger lamb crop, the level of early season marketings can be a useful gauge for slaughter supplies later in the year. At the GB level, auction sales of new season lambs in the ten weeks from early May up until mid-July increased by 2% year-on-year. Until July, they had been running higher by a cumulative 7%. This early season increase will reflect firm farmgate prices encouraging producers to market their sheep earlier than last year, while an earlier Ramadan brought demand forward by around two weeks. In addition, improved lamb growth rates may have contributed. Looking forward, the combination of a similar lamb crop and a strong start to the season may suggest a correction in supplies in the autumn. This could also be influenced by a higher retention rate, if producers are encouraged by strong farmgate prices. However, last year was characterised by a delay in lambs reaching sale weight and condition, so supply may end up running at a similar level to autumn 2016, but mean that fewer hoggs are carried over into 2018. Each year, peak lamb slaughter tends to occur in the run up to Eid al-Adha. This year, the celebrations take place over the first weekend of September. Consequently, processor demand is likely to spike significantly in mid-to-late August.



Moving on to trade, if Beef + Lamb NZ's forecast of a 5% fall in their total kill during the 2016/17 season ends up in line with the actual out-turn, then NZ slaughterings are likely to be at similar levels to 2016 between June and September. This would then signal similar volumes of product available for export through the summer and autumn as had been the case in 2016. However, mutton production has fallen more slowly than indicated by the forecast for 2016/17. Meanwhile, Australia's lamb production is expected to fall back by 2% in 2017 but the country's relatively small quota for the EU (19,600t) places a natural barrier on export shipments to the UK and so volumes are unlikely to change significantly from last year.

In terms of UK export prospects, a weak sterling will continue to underpin the price competitiveness of UK sheepmeat on the continent. Furthermore, the economic prospects look bright in many of Scotland's key export markets, with falling unemployment boosting consumer confidence. Outside of the EU, a weak sterling and tight southern Hemisphere supplies are likely to present opportunities for further growth in low value shipments.

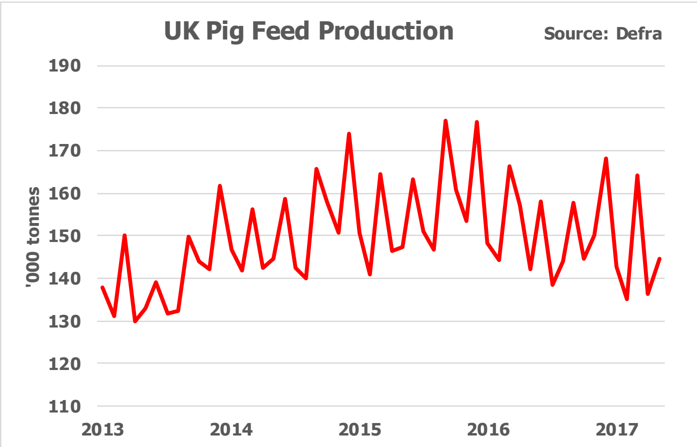
In summary, a similarly sized lamb crop to last year combined with earlier marketings may limit supply growth in the peak production period of the autumn. An increased retention rate may also have an impact. The timing of a key Islamic festival means that processor requirements are likely to spike in mid-to-late August. Meanwhile, the decline in imports seen in late 2016 and early 2017 is unlikely to continue as availability stabilises in NZ. Demand for UK exports seems likely to hold firm, but supply constraints in the home market may limit growth. Combining these factors points to supply remaining tight in H2 2017, but to a lesser extent than in H1.

Pigmeat:

UK pigmeat supply: Q1 2017 (t)				Totals may not sum due to rounding
	2017	2016	Change 2017/2016 (t)	% change 2017/2016
Home Production	211,000	231,800	-20,800	-9.0
+ Imports	211,600	171,400	+40,200	+23.4
- Exports	60,100	61,600	-1,400	-2.3
= Net Supply	**362,400**	**341,600**	**+20,800**	**+6.1**

Home Production

Although Defra estimates that, in 2016, UK pigmeat production increased for a seventh straight year and reached its highest level since 2000, things changed towards the end of the year with production falling by 3.5% in Q4. This was the lagged impact of the previous downturn in pig prices, with the fall in production occuring after the market had reached its low and was beginning to recover strongly. Moving into 2017, production fell more strongly, down 9%. Slaughter statistics for Q1 indicate that prime slaughter fell by 8% to 2.55m head while the sow kill contracted even more significantly, down 17.5%. Carcase weights for prime pigs averaged 0.5% higher than in early 2016, limiting the prime production decline to 7.5%, while sow carcases were marginally heavier.

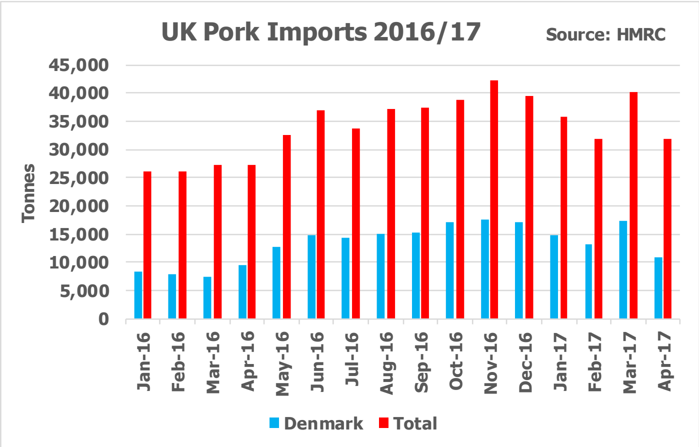


Neither June nor December census results picked up a fall in pig numbers in 2016, with both reporting further growth. However, pig feed production in the UK has shown a significant decline since the beginning of 2016, and fell short of year earlier levels in each month between May 2016 and April 2017. If the pig herd had continued to grow then the fall in pigmeat production would signal a sharp decline in productivity, following many years of improvement towards European levels. Given strong levels of investment in herd health made by producers in recent years, this would seem unlikely.

In Scotland, work to expand abattoir capacity in Q1 2016 meant that slaughter was well above year earlier levels in Q1 2017, increasing by more than 23%. Moving forward to the most recently reported three months, March to May, slaughter fell by around 2% from last year. With this decline including an increased capacity for sow slaughter in Scotland, prime throughput fell more significantly, down 7%. One contributor to the March to May 2017 decrease was a short-lived spike in slaughter in the spring of 2016 as maintenance work in England led to increased processing in Scotland.

At the UK level, March-to-May thoughput showed a smaller annual decline than Q1. Prime pig slaughterings fell by 4% to 2.56m head, but the production decline was restricted to 3.5% by an increase in the average carcase weight of around 0.5%.

Trade



Imports add to UK supplies and they are reported to have risen sharply relative to a year earlier in Q1 2017. Defra estimates that imports increased their share of UK pigmeat supplies to 58.5% in Q1 from 50% a year earlier. However, like the pig census, there is some scepticism amongst industry analysts around import data. A large import increase began showing in trade data from April 2016 and was largely driven by trade with Denmark. However, Danish export statistics showed a smaller rate of increase, but from a higher 2015 base. Though, it is plausible that this additional volume of imports could reflect cross-border supply chains, with the meat being imported for further processing in the UK. According to HMRC, import growth slowed in April and the increase during the first third of 2017 amounted to 17%. In addition to Denmark, shipments of pork from Germany, Ireland, Holland and Spain are also reported to have grown in early 2017. However, less was imported from France and Belgium.

UK pigmeat exports are estimated to have fallen by 2.5% year-on-year during Q1 2017. With production falling more sharply, the share of production exported increased by two percentage points to 28.5%, suggesting that demand held firm. According to HMRC, exports to most main EU markets fell significantly during the first four months of 2017, except Denmark, but China continued to offer a growing opportunity to balance the carcase through sales of lower value cuts of frozen pork.

Outlook

The industry consensus is for UK prime pig slaughterings to start recovering in H2 2017, rising by around 1% year-on-year in Q3 and then by 2% in Q4. This reflects an expectation that the period of herd consolidation is over now that farmgate prices have recovered to levels last seen in 2014. That the sector has moved from consolidation to expansion is also suggested by a 17.5% fall in UK sow slaughterings in Q1 2017. However, the increase in prime slaughter in the coming months is likely to be held back by a greater gilt retention rate. Increased carcase weights may offset this downwards pressure on slaughterings when looking at overall prime production volumes.

On the trade side, it seems likely that imports will struggle to match 2016 levels during H2, particularly if domestic production begins to recover. This reflects the high rate of growth last year plus the continued weakness of sterling and small gap between the UK farmgate price and the EU average.

For exports, the price competitiveness of UK pigmeat should help underpin overseas sales. In addition, if domestic production does grow, the need for processors to achieve carcase balance may lead to an increased surplus of pigmeat cuts which are less popular in the home market. However, a slowdown in Chinese import growth may result in a stabilisation of shipments to China. In addition, the same change in the pig production cycle that has been seen in the UK is taking place on the continent, potentially constraining import requirements in a number of EU countries.

The signals point towards a balanced UK pigmeat market during the second half of 2017. Domestic production is likely to show signs of recovery following a slump in late 2016 and H1 2017, adding to home market supply. Meanwhile, exports could stabilise as although UK pigmeat is likely to remain competitively priced, Chinese and EU import requirements may begin to stabilise. The combined increase in supply from home production and steady export volumes may well be offset by a contraction in imports.

Red Meat Sector Outlook

- The UK economy is entering H2 2017 in a more challenging position than it began the year. Household incomes are being squeezed by inflation running well ahead of wage growth, limiting disposable income for spending on discretionary goods and services. Meanwhile, although export-facing sectors are likely to expand capacity to meet demand growth following the fall in sterling, some longer-term investments are likely to remain on hold while the UK's future relationship with the EU is shrouded in uncertainty. The European economy has continued gathering pace, though subdued pressure on wages seems likely to constrain consumer spending growth.

- The rebalancing in global commodity markets and exchange rate depreciation that took place in H2 2016 has passed through supply chains, pushing up the cost of food in the UK. Although competition amongst retailers is expected to remain intense, higher import and farmgate prices relative to 2016 indicate that there is some potential for higher red meat retail prices. Even if they stabilise, they will move ahead of year earlier levels during H2.

- UK beef production is likely to fall in H2 2017, as increased prime cattle availability is offset by lower carcase weights and falling cow beef production. This fall in supply is likely to support imports, particularly as the main supplier, Ireland, has more cattle to process. Despite being competitively priced abroad, UK exports will be constrained by tight supply.

- A similarly sized lamb crop to last year combined with earlier marketings this summer and an increased retention rate may limit supply growth in the autumn. The decline in imports seen in late 2016 and early 2017 is unlikely to continue as availability stabilises in NZ. Demand for UK exports seems likely to hold firm, but supply constraints in the home market may limit growth.

- UK pigmeat production is expected to recover in H2 2017. However, imports may struggle to match H2 2016 levels and export growth looks challenging given the expectation that production will recover on the continent while the Chinese market steadies following substantial import growth in 2016.

- Demand for beef, lamb and pork with UK national or regional identification is likely to remain firm at the higher end of the market as consumers continue to seek traceability, provenance and quality. However, the renewed squeeze on household incomes may shift the focus back towards price rather than quality as the main factor behind protein choice.

- A structural shift in food consumption appears to be underway and is likely to continue. This includes faster growth in out-of-home consumption; meat being used as an ingredient rather than as the centrepiece of a dish; and meat being bought more often but in smaller volumes. Changing social attitudes towards health and food waste may also have implications for red meat sales.

- The prospect of a less open future trade relationship between the UK and EU is likely to continue weighing on sterling in H2 2017. This is likely to keep exchange rates close to recent levels, but monetary policy developments may result in small fluctuations. In the short-term, domestic produce is likely to benefit from the ability to compete well in price sensitive markets both at home and abroad.

- High-end EU markets continue to offer potential growth for Scottish produce due to a relatively small current base and trade facilitation work carried out by QMS. Economic prospects indicate that Sweden, Holland and Germany offer the most promise for expansion. However, it is of note that the Scottish red meat industry's largest export market, France, has shown signs of strengthening economic activity, while Belgium also looks brighter.

- Although a weak sterling will assist price competitiveness, politics and logistics will continue to heavily restrict trade with third countries, making it hard for processors to balance the carcase.

Sources

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HSBC
IGD
IMF
Institute for Fiscal Studies
Markit Economics
OANDA
Office for National Statistics
Scottish Government
SECO
Statistics Norway
Swiss Federal Statistics Office

Statistical Appendix

UK Economic Indicators

Sources: ECB; Eurostat; ONS

		Unemployment: Claimant Count		Whole Economy Average Earnings		Retail Sales Index		UK Inflation: All Items RPI		UK Inflation: All items CPIH		EU28 Inflation: HICP	Exchange Rate
		000	%	£/week	% change y/y	Total (2013 = 100)	Food (2013 = 100)	Jan 87 = 100	% Change Y/Y	2015 = 100	% Change Y/Y	% Change Y/Y	€:£
	2007	864.5	2.4	420	4.7	98.8	103.7	206.6	4.3	83.3	2.4	2.4	0.68434
	2008	906.1	2.5	435	3.6	98.9	102.8	214.8	4.0	86.2	3.5	3.7	0.79628
	2009	1527.7	4.3	435	0.0	99.1	103.6	213.7	-0.5	87.9	2.0	1.0	0.89094
	2010	1496.4	4.2	444	2.1	98.3	101.9	223.6	4.6	90.1	2.5	2.1	0.85784
	2011	1534.4	4.3	455	2.5	98.3	100.6	235.2	5.2	93.6	3.8	3.1	0.86788
	2012	1585.6	4.5	461	1.3	98.9	100.6	242.7	3.2	96.0	2.6	2.6	0.81087
	2013	1421.3	4.0	466	1.1	100.0	100.0	250.1	3.0	98.2	2.3	1.5	0.84926
	2014	1036.2	3.0	471	1.1	104.0	101.0	256.0	2.4	99.6	1.5	0.5	0.80612
	2015	798.0	2.3	483	2.5	108.5	103.2	258.5	1.0	100.0	0.4	0.0	0.72584
	2016	775.1	2.2	495	2.5	113.8	106.9	263.1	1.8	101.0	1.0	0.3	0.81948
					3 month rolling avg								
2016	Jan	762.4	2.2	490	2.3	112.6	106.1	258.8	1.3	99.9	0.6	0.3	0.7682
	Feb	756.7	2.1	486	2.1	111.5	106.1	260.0	1.3	100.1	0.6	-0.1	0.7413
	Mar	769.2	2.2	491	2.2	111.5	106.3	261.1	1.6	100.4	0.8	0.0	0.7227
	Apr	769.0	2.2	496	2.1	111.8	105.2	261.4	1.3	100.6	0.7	-0.2	0.7232
	May	772.9	2.2	494	2.4	114.1	106.9	262.1	1.4	100.8	0.7	-0.1	0.7229
	Jun	778.8	2.2	494	2.6	112.6	106.5	263.1	1.6	101.0	0.8	0.1	0.7204
	Jul	773.8	2.2	496	2.5	114.6	107.4	263.4	1.9	100.9	0.9	0.2	0.7075
	Aug	776.8	2.2	496	2.4	115.0	108.2	264.4	1.8	101.2	1.0	0.3	0.7134
	Sep	779.9	2.2	497	2.4	114.8	107.8	264.9	2.0	101.5	1.3	0.4	0.7324
	Oct	783.9	2.2	498	2.5	117.1	109.0	264.8	2.0	101.6	1.3	0.5	0.732
	Nov	790.9	2.2	500	2.8	116.6	107.8	265.5	2.2	101.8	1.5	0.6	0.7065
	Dec	786.8	2.2	499	2.6	114.1	106.4	267.1	2.5	102.2	1.8	1.2	0.7262
2017	Jan	768.4	2.2	499	2.2	113.6	106.7	265.5	2.6	101.8	1.9	1.7	0.7537
	Feb	766.0	2.2	499	2.2	115.2	107.1	268.4	3.2	102.4	2.3	2.0	0.7757
	Mar	789.3	2.2	502	2.3	113.6	106.6	269.3	3.1	102.7	2.3	1.6	0.7807
	Apr	800.9	2.3	503	2.1	116.4	108.0	270.6	3.5	103.2	2.6	2.0	0.7928
	May	808.6	2.3	503	1.8	115.1	107.0	271.7	3.7	103.5	2.7	1.6	0.7783
	Jun	814.5	2.3	490	2.3	112.6	106.1	272.3	3.5	103.5	2.6	1.4	0.7911

Retail Price Index: meat & other food items

Source: ONS

Jan 1987 = 100

		Beef	Lamb Home Killed	Lamb imported	Pork	Bacon	Poultry	Fish	Cheese	Eggs	All Food	Catering	All Items
	2010	174.6	259.3	218.9	203.2	210.8	130.9	208.8	220.1	264.1	195.0	279.8	223.6
	2011	181.8	291.3	284.1	213.8	215.3	138.4	228.0	232.7	266.7	206.6	291.2	235.2
	2012	201.7	306.0	280.2	228.6	216.6	139.8	237.7	240.9	262.6	213.3	300.2	242.7
	2013	213.4	307.9	261.5	240.6	228.6	145.2	246.8	241.9	259.1	221.2	308.4	250.1
	2014	219.1	313.4	262.3	237.7	227.7	144.6	254.1	251.7	252.0	221.3	315.5	256.0
	2015	219.3	318.2	267.4	231.1	217.8	136.2	246.5	244.1	230.9	216.2	320.6	258.5
	2016	212.7	314.3	260.6	219.7	202	127.5	241.5	236.4	211.7	211.5	327.4	263.1
	% Change YoY												
	2010	-0.5	8.2	2.3	3.6	-1.4	0.0	6.1	1.9	3.5	3.1	3.1	4.6
	2011	4.1	12.3	29.8	5.2	2.1	5.7	9.2	5.7	1.0	5.9	4.1	5.2
	2012	10.9	5.0	-1.4	6.9	0.6	1.0	4.3	3.5	-1.5	3.2	3.1	3.2
	2013	5.8	0.6	-6.7	5.2	5.5	3.9	3.8	0.4	-1.3	3.7	2.7	3.0
	2014	2.7	1.8	0.3	-1.2	-0.4	-0.4	3.0	4.1	-2.7	0.0	2.3	2.4
	2015	0.1	1.5	1.9	-2.8	-4.3	-5.8	-3.0	-3.0	-8.4	-2.3	1.6	1.0
	2016	-3.0	-1.2	-2.5	-4.9	-7.3	-6.4	-2.0	-3.2	-8.3	-2.2	2.1	1.8
2016	Jan	218	313.7	262.2	224.9	211.7	131.2	238.2	237.2	228.0	213.2	323.7	258.8
	Feb	220.7	321	263.4	222.7	205.8	131	245.4	240.7	226.5	213.6	324.3	260.0
	Mar	214	305.7	264.8	224.2	201.2	130.6	241.9	239.7	211.8	212.7	325.1	261.1
	Apr	213.4	316.8	258.9	222.2	203.8	127.2	242.2	234.7	211.4	212.4	325.9	261.4
	May	215.3	313.9	260.1	206.8	202.1	125.9	236.7	241.9	210.4	211.5	326.6	262.1
	Jun	213.4	324.1	263.3	220.9	200	126.3	237.6	235	207.4	210.8	327.1	263.1
	Jul	207.8	303.4	256.8	219.7	201	125.9	243.5	239.6	208.0	209.9	327.6	263.4
	Aug	210	310.4	250.8	221.8	196.5	125.8	240.4	235.7	207.1	211	328.2	264.4
	Sep	208.2	318.3	259.5	220.2	201	124.3	239.7	231.2	208.5	210.6	328.7	264.9
	Oct	212.2	320.1	263.9	220.2	194.8	127.2	247.0	236.1	205.0	209.9	329.3	264.8
	Nov	211.2	307.7	263.5	219.8	201.9	126.7	243.4	232.2	207.4	210.8	330.5	265.5
	Dec	208.3	316.5	260.3	212.8	203.7	127.5	241.9	233	208.8	212.1	331.3	267.1
2017	Jan	211.9	309.7	249.8	220.7	202.3	124.8	243.5	235.7	209.7	212.3	331.5	265.5
	Feb	214	318.7	270	222.5	201.2	127.3	254.2	237.2	210.6	214.7	332.7	268.4
	Mar	213.8	313.8	275.5	221.8	196.8	126	254.5	240.1	210.1	215.2	333.6	269.3
	Apr	211	322.2	268.8	216.4	204.1	127.4	251.9	234.8	210.5	215.6	335	270.6
	May	214.2	322.9	270.4	221.5	200.2	124.7	258.2	239.1	208.9	216	335.9	271.7
	Jun	212.9	323.6	271.6	225.2	200.2	124.7	263.0	231.3	209.5	215.6	336.4	272.3
	% Change YoY												
	Jun	-4.3	2.9	-1	-4.8	-3.8	-5.8	1.0	-3.8	-9.2	-1.8	2.5	2.2

Scottish Monthly Average Retail Prices of Selected Cuts

Source: AHDB

	Beef	Topside	Sirloin Steak	Rump Steak	Fillet Steak	Diced Stewing Steak	Braising Steak	Premium Mince	Standard Mince	**Pork**	Leg (boneless)	Fillet End Leg	Shoulder (boneless)	Fillet of Pork	Loin Steaks	Loin Chops	Diced Pork	Minced Pork
2016	Jan	1231	2492	1704	4021	1141	1171	848	627		717	829	675	977	1088	783	767	751
	Feb	1221	2423	1715	4015	1141	1151	848	621		748	829	693	980	1088	770	769	752
	Mar	1147	2519	1720	3995	1141	1185	848	625		730	829	689	978	1096	758	775	746
	Apr	1228	2522	1721	3996	1141	1180	848	621		720	829	687	980	1102	751	727	736
	May	1218	2522	1711	3996	1141	1178	848	621		722	829	689	937	1088	750	727	724
	Jun	1218	2522	1736	3996	1141	1178	841	627		736	805	686	985	1040	749	733	746
	Jul	1187	2522	1734	3996	1141	1184	844	627		712	799	691	985	946	744	733	732
	Aug	1192	2522	1734	3996	1141	1169	848	627		732	805	692	972	946	770	733	736
	Sep	1202	2522	1711	3996	1141	1191	845	617		750	829	695	981	921	762	733	724
	Oct	1215	2489	1664	3997	1130	1171	845	617		725	829	700	969	940	757	733	732
	Nov	1227	2522	1690	4008	1130	1184	845	617		722	829	698	996	920	746	733	702
	Dec	1063	2525	1701	4019	1134	1191	846	625		736	829	703	951	949	762	707	699
2017	Jan	1121	2528	1688	4019	1134	1178	845	626		732	829	703	987	949	762	720	711
	Feb	1212	2527	1684	4019	1106	1178	846	626		708	829	701	1001	934	755	720	715
	Mar	1227	2526	1690	4033	1077	1190	846	633		718	829	697	980	945	762	723	709
	Apr	1163	2526	1681	4037	1077	1184	846	631		720	829	704	990	939	762	733	716
	May	1224	2526	1719	3984	1077	1184	840	610		705	829	690	998	928	754	733	718
	Jun	1243	2526	1667	3998	1077	1191	838	605		702	829	699	998	933	752	733	718

	Lamb	Whole Leg	Fillet End Leg	Shoulder (Bone-in)	Shoulder (Boneless)	Lamb Steaks	Loin Chops	Cutlet Chops	Diced Lamb	Minced Lamb
2016	Jan	1252	1390	739	1269	1760	1519	1659	1548	1445
	Feb	1252	1390	739	1269	1760	1519	1659	1548	1445
	Mar	1216	1345	739	1301	1776	1532	1637	1555	1442
	Apr	1227	1336	752	1273	1736	1524	1644	1539	1464
	May	1242	1380	751	1264	1755	1528	1654	1544	1469
	Jun	1253	1398	761	1325	1790	1571	1679	1579	1445
	Jul	1245	1383	764	1366	1765	1548	1679	1578	1458
	Aug	1248	1401	762	1366	1776	1548	1679	1576	1455
	Sep	1262	1398	773	1366	1782	1548	1679	1576	1463
	Oct	1271	1428	770	1366	1790	1548	1679	1571	1451
	Nov	1275	1435	749	1366	1790	1548	1679	1576	1469
	Dec	1205	1318	762	1366	1790	1548	1679	1570	1477
2017	Jan	1278	1409	771	1366	1790	1548	1679	1582	1462
	Feb	1259	1456	781	1366	1751	1523	1648	1551	1463
	Mar	1245	1449	786	1366	1738	1514	1637	1539	1455
	Apr	1251	1459	789	1366	1738	1514	1637	1539	1460
	May	1249	1457	775	1366	1719	1514	1637	1539	1460
	Jun	1247	1452	781	1366	1719	1514	1637	1539	1460

UK Farm-to-Retail Price Spreads (p/kg) Source: AHDB

	Beef				Lamb				Pork			
	Average Farm Price	Average Retail Price	Price Spread	Producer Share (%)	Average Farm Price	Average Retail Price	Price Spread	Producer Share (%)	Average Farm Price	Average Retail Price	Price Spread	Producer Share (%)
2006	202.8	427.6	224.8	47.4	258.0	550.2	292.3	47.0	104.8	294.3	189.5	35.6
2007	206.0	453.1	247.2	45.5	235.8	576.6	340.8	40.9	108.0	304.0	196.0	35.5
2008	257.6	518.3	260.7	49.7	291.3	627.6	336.4	46.4	126.0	337.2	211.2	37.3
2009	279.0	558.6	279.5	50.0	358.3	679.7	321.3	52.7	146.2	364.7	219.0	39.9
2010	268.3	564.2	295.8	47.6	390.5	698.9	308.5	55.9	141.8	364.0	222.3	38.9
2011	307.0	584.4	277.4	52.5	433.7	751.9	318.2	57.8	141.6	363.6	222.1	39.3
2012	341.6	633.6	292.0	53.9	412.6	777.5	365.0	53.1	150.2	377.1	226.8	39.8
2013	385.8	668.7	283.0	57.7	417.1	790.6	373.6	52.7	165.5	391.6	226.1	42.2
2014	348.3	701.5	353.2	49.7	421.8	818.8	397.0	51.5	159.7	395.1	235.4	40.4
2015	345.9	699.9	354.0	49.5	383.8	799.6	415.8	48.0	135.7	387.6	251.9	35.0
2016	334.5	688.3	353.8	48.6	409.6	804.9	395.4	50.9	131.6	380.9	249.3	34.6
Jan 16	330.0	697.6	367.6	47.3	391.5	797.5	406.0	49.1	121.6	384.0	262.4	31.7
Feb 16	328.7	687.6	359.0	47.8	419.1	809.3	390.2	51.8	116.7	388.3	271.6	30.0
Mar 16	325.2	683.0	357.7	47.6	431.0	796.8	365.8	54.1	116.0	384.0	268.0	30.2
Apr 16	313.3	695.6	382.3	45.0	422.8	796.8	374.0	53.1	116.8	377.9	261.1	30.9
May 16	314.8	688.9	374.2	45.7	430.6	804.1	373.6	53.5	119.5	376.1	256.6	31.8
Jun 16	321.8	691.6	369.8	46.5	419.0	810.0	391.0	51.7	124.4	376.1	251.8	33.1
Jul 16	331.2	688.9	357.7	48.1	419.0	807.1	388.1	51.9	130.7	376.1	245.4	34.7
Aug 16	343.8	688.9	345.2	49.9	417.2	809.3	392.1	51.6	137.9	381.6	243.7	36.1
Sep 16	353.0	685.6	332.6	51.5	406.2	810.0	403.8	50.1	141.9	381.6	239.6	37.2
Oct 16	350.9	685.6	334.7	51.2	388.8	807.1	418.3	48.2	147.3	382.2	234.9	38.5
Nov 16	350.1	692.3	342.2	50.6	382.6	810.0	427.4	47.2	152.1	379.8	227.7	40.0
Dec 16	351.3	673.6	322.3	52.2	386.9	801.2	414.3	48.3	154.5	382.8	228.2	40.4
Jan 17	351.2	683.0	331.7	51.4	380.7	820.3	439.6	46.4	153.9	384.6	230.8	40.0
Feb 17	348.2	692.3	344.1	50.3	383.1	821.0	437.9	46.7	153.2	377.9	224.7	40.5
Mar 17	344.8	702.2	357.5	49.1	399.5	818.8	419.3	48.8	154.6	381.6	227.0	40.5
Apr 17	348.1	693.6	345.5	50.2	419.6	824.0	404.4	50.9	159.0	380.4	221.3	41.8
May 17	355.9	700.2	344.4	50.8	479.5	817.4	337.9	58.7	163.2	377.9	214.7	43.2
Jun 17	362.6	700.2	337.7	51.8	494.0	820.3	326.3	60.2	165.6	377.9	212.3	43.8

EU Economic Indicators

Sources: Eurostat; ONS; Statistics Norway; Swiss Federal Statistical Office

Country	Q1 2017			Q4 2016			Q3 2016			Q2 2016		
	Economic Growth (%)*	Unemployment Rate (%)	Inflation Rate (%)	Economic Growth (%)*	Unemployment Rate (%)	Inflation Rate (%)	Economic Growth (%)*	Unemployment Rate (%)	Inflation Rate (%)	Economic Growth (%)*	Unemployment Rate (%)	Inflation Rate (%)
Bel	0.6	7.6	3.0	0.4	7.2	2.0	0.1	7.8	1.9	0.5	8.3	1.6
Ger	0.6	3.9	1.9	0.4	4.0	1.0	0.2	4.1	0.4	0.5	4.2	0.0
Est	0.8	5.6	3.1	1.9	6.6	1.6	0.5	7.3	1.2	0.8	6.6	0.1
Ire	n/a	6.8	0.4	2.5	7.1	-0.3	4.0	7.8	-0.2	0.8	8.3	-0.1
Gre	0.4	22.6	1.5	-1.1	23.3	0.2	0.7	23.3	0.2	0.4	23.6	-0.1
Spa	0.8	18.2	2.7	0.7	18.6	0.8	0.7	19.3	-0.3	0.8	20.2	-1.0
Fra	0.5	9.6	1.5	0.5	10.0	0.7	0.2	10.0	0.4	-0.1	10.1	0.1
Ita	0.4	11.6	1.3	0.3	11.8	0.2	0.3	11.6	-0.1	0.1	11.7	-0.3
Cyp	0.6	12.5	1.2	0.7	13.2	-0.6	0.7	13.1	-0.5	1.2	12.9	-2.0
Lat	1.6	8.9	3.1	1.2	9.4	1.5	0.5	9.8	0.2	0.7	9.6	-0.7
Lit	1.4	7.9	3.0	1.5	7.5	1.2	0.5	7.7	0.4	0.7	8.3	0.4
Lux	0.1	6.1	2.6	1.2	6.2	1.0	1.0	6.3	-0.1	0.9	6.3	-0.5
Mal	0.2	4.3	1.3	1.8	4.2	0.8	1.3	4.8	1.0	0.7	4.9	0.9
Hol	0.4	5.2	1.3	0.6	5.5	0.5	0.7	5.8	-0.2	0.7	6.3	-0.2
Aus	0.6	5.7	2.2	0.6	5.8	1.5	0.6	6.1	0.8	0.1	6.1	0.6
Por	1.0	9.9	1.4	0.7	10.5	0.8	0.9	10.9	0.7	0.2	11.2	0.5
Sln	1.5	7.3	2.0	1.3	7.9	0.7	1.2	7.8	0.0	0.8	8.1	0.4
Slk	0.8	8.6	1.0	0.8	9.0	-0.1	0.6	9.5	-0.7	0.8	9.9	-0.6
Fin	1.1	8.8	1.1	0.6	8.8	0.8	0.9	8.8	0.5	0.2	8.9	0.3
Euro Area	**0.6**	**9.5**	**1.8**	**0.5**	**9.7**	**0.7**	**0.4**	**9.9**	**0.3**	**0.3**	**10.2**	**-0.1**
Bul	0.9	6.4	0.8	0.9	6.8	-0.8	0.7	7.4	-1.1	0.9	7.9	-2.3
Cze	1.5	3.3	2.5	0.4	3.6	1.5	0.2	4.0	0.5	0.8	4.1	0.1
Den	0.6	6.0	0.8	0.6	6.3	0.2	0.8	6.4	-0.1	0.6	6.2	-0.1
Cro	0.6	11.6	1.1	0.6	12.3	0.2	1.4	13.0	-1.1	0.8	13.5	-1.1
Hun	1.3	4.3	2.6	0.7	4.5	1.3	0.5	4.9	0.1	1.2	5.2	0.0
Pol	1.1	5.1	1.7	1.7	5.6	0.4	0.4	6.1	-0.4	1.0	6.3	-0.4
Rom	1.7	5.3	0.4	1.5	5.5	-0.1	0.7	5.7	-0.1	1.6	6.0	-2.1
Swe	0.4	6.6	1.6	0.7	6.9	1.4	0.6	6.9	1.0	0.4	6.8	1.0
UK	0.2	4.5	2.2	0.7	4.7	1.2	0.5	4.8	0.7	0.6	4.9	0.3
EU28	**0.6**	**8.0**	**1.8**	**0.6**	**8.2**	**0.8**	**0.5**	**8.5**	**0.3**	**0.4**	**8.7**	**-0.1**
Nor	0.6	4.3	2.7	0.4	4.6	3.9	0.1	4.9	4.5	0.5	4.7	3.8
Swi	0.3	5.0	0.5	0.2	4.8	-0.2	0.0	4.9	-0.2	0.5	4.9	-0.5

* % change compared with previous quarter