After the referendum...

June 2016

The few days since the announcement of the referendum vote in favour of leaving the EU have certainly been momentous. Some UK voters may be extremely happy with the result whilst others are concerned and fearful about the impact that it will have, both in the short and long term.

This document sets out the key short term effects on UK dairy farms. At Kite we are currently working up a number of potential scenarios for the medium to long term impacts and will share these at a later date.

Short term impacts of Brexit vote

Currency devaluation

The short term impacts of the Brexit vote are already being felt in the wider economy. Sterling has devalued on currency markets and stock markets are volatile. The Government and Bank of England are working to try to stabilise markets. But what does this currency devaluation mean for UK dairy farmers?

In the short term currency changes will have three impacts on UK dairy farmers:

1. Milk price impact
2. Cost impact
3. Single farm payment impact

Milk price impact

History has shown that if currency falls agriculture generally sees improvements in price as a result. In the short term the impact of the value of Sterling falling on world currency markets will be felt in improved milk prices for UK farmers. This is because dairy commodities are traded internationally and the UK is a net importer, being 81% self-sufficient, so a currency devaluation will benefit domestic producers as our relative domestic price becomes higher. It is our estimate at the time of writing that milk prices could improve by around 10 per cent as a result of this impact, adding between 1.5 and 2 pence per litre (ppl) to UK farm gate prices.

This is in addition to the impact of the current tightening in global dairy markets, so combines with milk prices that were likely to start increasing anyway.

There will be an "Arla effect" in the UK, since their price has a built in stabiliser for currency changes which will slow the impact of price increases due to currency alone. The impact will feed through over the next 2 years. Because Arla is a market leader in the UK then other players could delay their increases. We will have to be aware of this impact.

Cost impact

Of course, what the currency changes mean is that domestic grain prices will also improve, helping the beleaguered arable sector. We estimate that wheat prices could increase by around

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£10-15/tonne for the reasons outlined above. In theory, global feed commodities such as soya should become dearer as a result of currency moves, and we have seen immediate impact on soya prices. However global stock levels of soya could ease back prices by the autumn, countering the currency impact. Overall the more likely result is an average concentrate feed price increase of around 5-7 per cent.

As well as feed the other two commodity cost areas for most dairy farmers are fuel and fertiliser. UK fuel prices are likely to increase as a result of currency values but fuel is a relatively small cost for most dairy farmers, so the impact of fuel prices increases at a farm level are expected to be relatively minor.

Finally, fertiliser costs will possibly increase, but fertiliser prices have been under some pressure due to the poor returns in the arable sector, so our estimate is that fertiliser price increases will not be large.

Our overall estimate at this stage is that typical dairy farm costs could rise by around 0.7ppl to 1.0ppl, as a result of currency moves alone.

Single farm payment impact

Assuming that farmers haven't already fixed their Single Farm Payment in Euro then the impact of currency changes will be positive in terms of the amount paid to UK farmers in Sterling.

Staffing

UK agriculture is reliant on overseas workers in many sectors of primary production and this is certainly the case in the dairy sector. These workers will, quite understandably, be concerned about what the Brexit vote means for their own circumstances. If a farm employs staff from other EU countries then our recommendation is to speak to those staff and reassure them that, in the short term, there is no need to make rash decisions. They remain an important part of our labour force and shouldn't panic – their rights to remain in the UK are unaffected by the referendum result in the short term.

Interest rates

There is already debate about what the impact of the Brexit vote might be on interest rates. There is some expectation that the Bank of England may have to reduce base rates even further to stimulate the economy but there is also talk of margin rates rising. What we can foresee is that rates are likely to remain at or around an all-time low for now and this means that fixed rate borrowing remains competitive and could offer a way of managing financial risk in the medium term. If you are interested in how interest rates could affect your own business risk then please speak to your Kite consultant, who can advise you based on your own circumstances.

Looking forward…

At the moment it is too early to say what the impacts might be in the medium to long term because so much remains dependent on the timing of Brexit and the shape of the agreements reached with the EU. We can be certain of uncertainty, however!

At Kite we intend to work through a range of scenarios and will examine in more detail what the implications for UK agriculture, and particularly the dairy sector, may be and will feed this analysis into policy makers. The range of options available to HM Government is huge – from an approach like that taken by Norway, offering full access to the common market in exchange for agreements on migration through to the opposite situation whereby the UK could completely separate from the common market and operate on world markets. The picture also remains unclear on how and even if agriculture would be supported in a post-Brexit UK.

One thing is certain and that is we will have to develop a more resilient agriculture and that is something we will be working on in our planning. We will need to acquire the skill sets we typically see in New Zealand where farmers have been exposed to world markets with no protection other than the skills they possess to manage change in tough volatile markets.

Summary

In summary, don't panic! Economic uncertainty is unlikely to have a major detrimental impact on UK dairy farm incomes in the short term and is likely to even offer slight improvements in farm returns for the dairy sector.

On a broader scale, our access to trade markets and labour remains the same for at least two years whilst Brexit is negotiated, so the short term impact on dairy markets shouldn't be too significant.

As always, dairy farmers should plan for efficiency and resilience in their businesses and our consultants remain available to discuss individual concerns and advise on how best to manage your business through these uncertain times.

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