

Food and drink

Price inflation and shortages

September 2021

Agricultural commodity prices rises and labour shortages are creating a scenario where products may be unavailable or subject to price rises during the run up to Christmas

Structural change in the seasonal labour market which presents producers and processors with an ongoing shortage of labour impacting productivity as they enter the seasonally higher demand quarter.

Reducing trade with the EU due to logistical challenges and customs requirements which add cost and complexity.



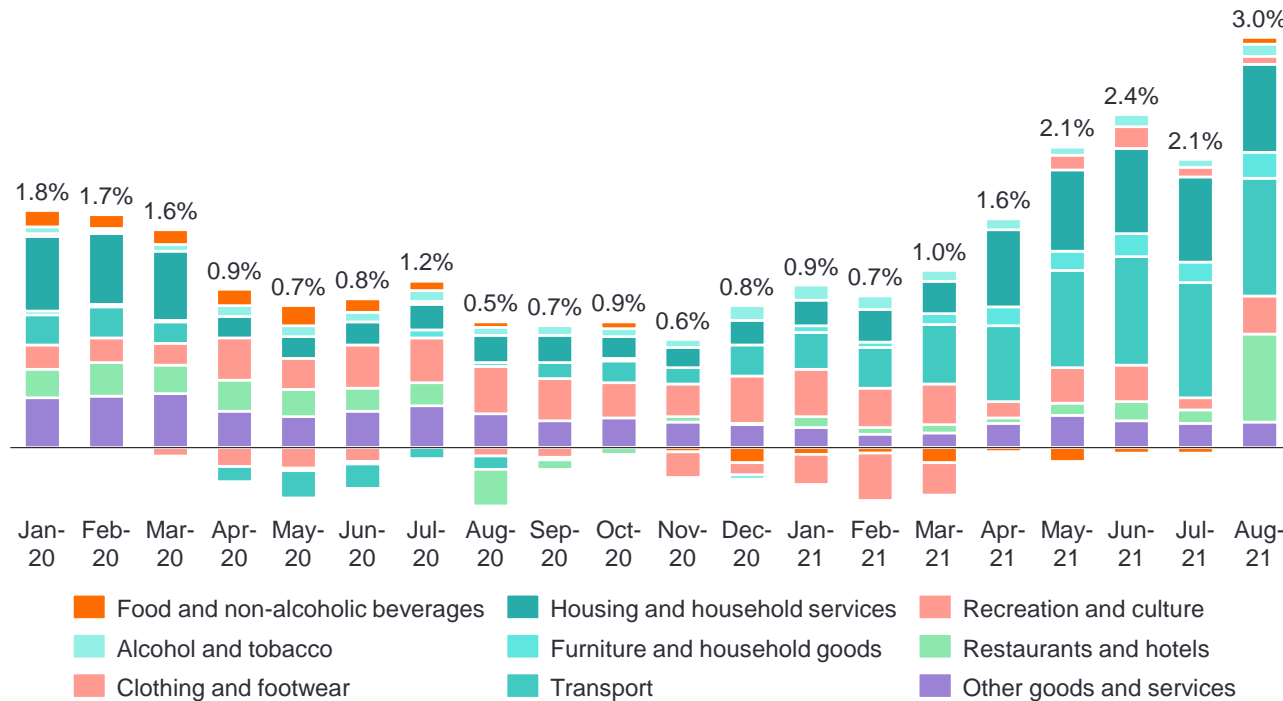
Product scarcity and gaps on supermarket shelves which are expected to increase in the run up to Christmas.

Increased cost for consumers.

Margin pressure on producers, processors and supermarkets.

It would appear that the cost impact of supply chain issues and commodity price increases are currently being absorbed by processors and supermarkets

Consumer price inflation (inc. owner occupier housing costs)



- ▶ The CPI 12-month inflation rate rose by 3.0% in the 12 months to August 2021.
- ▶ The largest upward contributions to the inflation rate came from i) transport (0.87 ppt), due to the price of fuel, and ii) housing (0.65 ppt), as a result of energy prices and the cost of construction materials.
- ▶ Inflation linked to Restaurant and Hotel spend (0.65 ppt, in green) was primarily responsible for the jump in inflation in August as prior year pricing was artificially low due to the impact of the UK Government's 'eat out to help out' scheme.
- ▶ At present, food and non-alcoholic drinks is estimated to have a negligible impact on inflation (0.05 ppt).
- ▶ It would appear that suppliers, food processors, and supermarkets are currently absorbing input cost inflation.

Reporting first-half results to 1 August 2021, Morrisons noted:



As well as the direct effects of the pandemic, other features of the first half this year were the impacts of rising commodity prices and freight inflation, plus a shortage of HGV drivers across the UK. We absorbed many of these industry-wide price and cost pressures, which was an investment in margin, and helped us sustain lower prices and deflation for customers.

Morrisons reported first-half results showing PBT of £105m in the period to 1 August 2021, down from £167m in the same period last year.



We expect some industry-wide retail price inflation during the second half, driven by sustained recent commodity price increases and freight inflation, and the current shortage of HGV drivers.

The Financial Times recently reported:



In the UK and Europe, food inflation has been relatively contained, but the British Retail Consortium warned that prices could rise in the second half of the year. Helen Dickinson, BRC chief executive, said: "While prices are currently falling thanks to fierce competition between retailers, there are many cost pressures around the corner."

1. Office for National Statistics, consumer price inflation <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest>

2. Morrisons, Interim results for the half year to 1 August 2021, released 9 September 2021

3. Financial Times, 'Global food prices post biggest jump in decade', 3 June 2021, <https://www.ft.com/content/8b5f4b4d-cbf8-4269-af2c-c94063197bbb>

Ongoing disruption and the new trading relationship with the EU has reduced the flow of food and drink products between the UK and EU

UK food and drink exports and imports

- ▶ The ongoing impact of the Covid-19 pandemic and the new trading relationship with Europe following Brexit resulted in a drop in EU exports of 16% compared to H1 2020 and 27% compared to H1 2019 albeit the monthly run rate has been recovering from the poor January and February figures despite the trade barriers.
- ▶ Exports to Republic of Ireland, the UK's biggest export market, decreased by 22% compared to H1 2020 and 27% compared to H1 2019 – a reduction of roughly £0.5bn.
- ▶ There has been a recovery in exports to non-EU countries with sales up 13% compared to H1 2020 due to increased demand from China, Singapore, Australia, Japan and the Gulf region.
- ▶ Imports from the EU are yet to recover to pre Covid-19 levels which is likely to be a consequence of ongoing disruption to the supply chain caused by Covid-19, including the HGV driver shortage.

Outlook

- ▶ Brexit rules were due to step up on 1 October 2021 but some aspects - including mandatory veterinary health certificates for meat, eggs, dairy, fish, etc, - have recently been pushed back to 1 July 2022 to allow more time for supply chains to recover. However, full custom declarations and controls will be introduced from 1 January 2022.
- ▶ The additional custom requirements are likely to add further cost, resulting in downward pressure on volumes and margins, and complexity which is likely to extend supply chain times even further.
- ▶ These factors could lead to a business re-considering how competitive it can be and in what sectors it operates.
- ▶ Previously, consumers benefited from the 'just in time' delivery infrastructure that was available to suppliers under the single market. However, the Food and Drink Federation have noted that under current conditions 'the just-in-time system is no longer working' and unlikely to work again.

UK exports – top 5

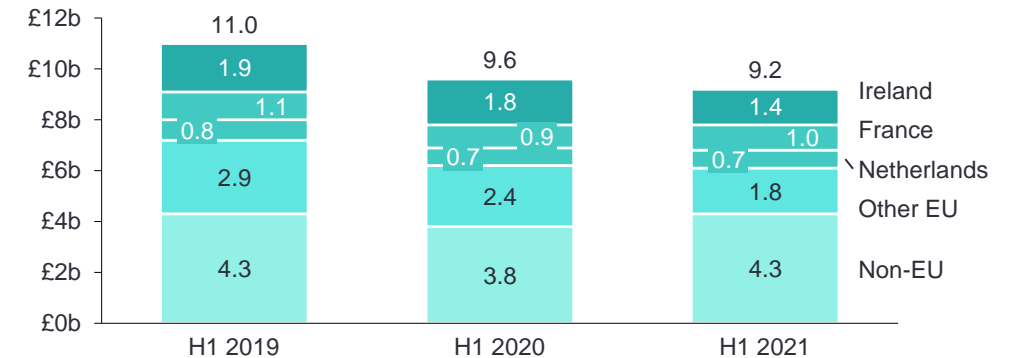
£m	H1 2019	H1 2020	H1 2021
Whisky	£2.2b	£1.5b	£2.0b
Salmon	£394m	£303m	£356m
Chocolate	£347m	£311m	£329m
Pork	£252m	£299m	£301m
Cheese	£344m	£301m	£249m

Note: exports of pork have increased due to additional demand from China, USA and Australia. Demand from China is expected to weaken as their domestic herd rebuilds following African Swine Fever.

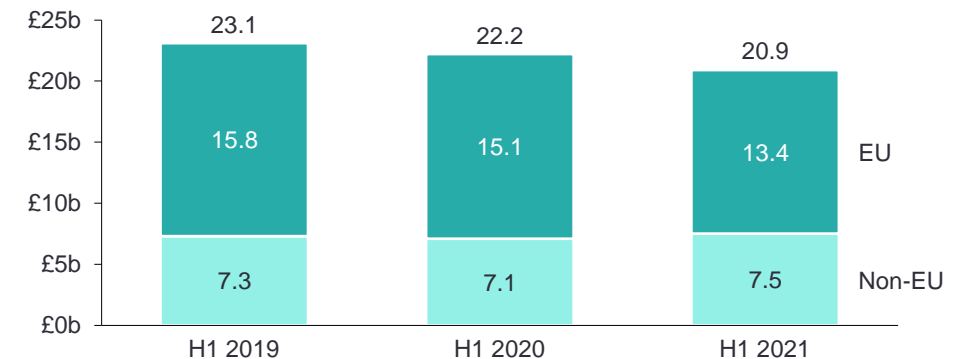
Sources:

1. Food and Drink Federation, 'Exports Snapshot: H1 2021', 2 September 2021 <https://www.fdf.org.uk/tdf/resources/publications/exports-reports/exports-h1-2021/>
2. BBC News, 'Food shortages could be permanent, warns industry body' 11 September 2021, <https://www.bbc.co.uk/news/business-58519997>

Exports



Imports



Labour shortages are likely to restrict UK food production and supplies which may result in food price inflation

The UK food and drink sector is currently facing chronic labour shortages

A report commissioned by 12 trade bodies has warned that the food and drink sector – which employs c.4.1m people, roughly 13% of the UK workforce – is currently facing significant worker shortages with an estimate of 500k vacancies (including c.100k HGV drivers and c.188k hospitality workers).

These shortages cover the full breadth of the supply chain from farm to fork and are therefore having an impact on production, processing and delivery.

The report calls for the UK Government to consider a 12-month Covid Recovery Visa to help alleviate the food supply workforce shortages.

In response to the shortages, some companies have increased salaries or provided incentives to attract workers – for example, Tesco has offered a £1,000 joining bonus for HGV drivers and entry-level meat-processing jobs are being advertised at £22k compared to £18k one year ago.

The UK Government is expected to take action to streamline the HGV testing process to accelerate new entrants to the driver pool.

There is no one reason for this and it is a combination of a number of factors, ranging from

- ▶ The age profile of employees in the sector is increasing – inability to attract young people to perform seasonal work.
- ▶ Reliance on migrant workers which has been restricted following the EU exit and subsequent change in migration policy which restricts the supply of EU labour (end of free movement of people) together with the impact of Covid-19 on travel.
- ▶ Negative perceptions of careers in the food and drink sector and logistics.
- ▶ Alternative work during lockdowns.
- ▶ Competition from other large distributors and online retailers (e.g. Amazon).
- ▶ The geographical spread with the typically rural nature of the sector presenting challenges in attracting and retaining workers.
- ▶ The introduction of IR35 regulation is a contributing factor to the current shortage of HGV drivers.
- ▶ Increased strength of Sterling making salaries less appealing to European workers.
- ▶ Time to train an HGV driver when other comparatively paid jobs are immediately available.

1. Establishing the labour availability issues of the UK food and drink sector', 26 August 2021, prepared by Grant Thornton LLP

2. BBC News, 'Tesco offers £1,000 joining bonus for HGV lorry drivers', 27 July 2021 <https://www.bbc.co.uk/news/business-57983698>

3. Financial Times, 'Global food prices post biggest jump in decade', 3 June 2021, <https://www.ft.com/content/8b5f4b4d-cbf8-4269-af2c-c94063197bbb>

4. BBC News, 'Government to shorten HGV driver testing process', 9 September 2021, <https://www.bbc.co.uk/news/business-58487347>

There has been much comment in the media on labour shortages across the food and drink sector

“

Heck boss warns of Christmas food shortages

Heck founder and managing director Andrew Keeble explained “Some of the pig processors are having to cut down on how many pigs they are processing a week so that is going to have a knock on effect on the shelf this autumn and winter”

The Bedale-based sausage maker is also facing staff shortages, urgently needing to fill roles across dispatch, distribution and marketing. Continued shortages of HGV drivers has forced Heck to train its own workers to distribute its sausages to customers.

Food Manufacture, 31 August 2021

“

UK's biggest chicken producer says industry is at breaking point

2 Sisters owner Ranjit Boparan asks the government to support two fertiliser plants that were shut by gas price surge.

The UK's largest chicken producer has warned the meat industry is at breaking point and called on the government to tackle a gas crisis now threatening the country's food production.

The meat industry is facing an acute shortage of carbon dioxide after surging gas prices prompted two large UK fertiliser plants to suspend production.

Financial Times, 19 September 2021

“

Broccoli and cauliflower wasted in droves in labour crisis

Substantial amounts of vegetables are going to waste that would otherwise be destined for fresh produce or frozen food processors because of the lack of labour required to harvest them.

The East of Scotland Growers Group has estimated it will have scrapped 3.5m heads of broccoli and 1.9m heads of cauliflower so far.

The issue is being compounded by the lack of lorry drivers required to distribute fresh produce and provide any oversupply of vegetables to the freezing industry.

Food Manufacture, 1 September 2021

“

Labour shortages leave UK farms with 70,000 surplus pigs

UK's pig producers have warned they are weeks away from culling healthy animals after labour shortages in abattoirs caused a backlog of 70,000 surplus animals on farms.

The National Pig Association is the latest group to sound the alarm over the effects on its members from a lack of workers that has hit food production and haulage, with knock-on effects to many UK supply chains.

Meat processors have also had to reduce the range of cuts available and were struggling to fulfil orders due to the shortage of staff, said Nick Allen, chief executive of the British Meat Processors Association.

Financial Times, 26 August 2021

“

Nando's shuts restaurants as it runs short of supplies

Nando's says it will lend some of its staff to its suppliers to help "get things moving" in the supply chain after shortages hit some of its shops.

The restaurant group has had to shut around 50 outlets temporarily after apparently running short of its staple fare: peri peri chicken.

BBC News, 17 August 2021

Agricultural commodities are also coming under price pressure with variable harvests and labour shortages

Recent trends in key agricultural commodities . . .

- ▶ A number of fundamental agricultural commodities have increased in price compared to prior years:
 - ▶ The UK harvest of **wheat and barley** is expected to be in line with prior years but poor harvest outlooks due to dry and hot weather conditions in key growing regions, particularly Canada and the Black Sea, has filtered through to increase the UK price as millers look to purchase a higher proportion of home-grown grain.
 - ▶ Modest price increases for **vegetables and potatoes** compared to prior year but expected shortages in labour during the harvest period may result in wastage and shortfalls in supply to supermarkets and processors.
 - ▶ **Cattle** prices have been supported by strong UK domestic demand during BBQ season together with restrictions in Argentina (the Argentine government has limited exports to 50% of volume) which has resulted in the highest prices in a number of years.
 - ▶ UK retailers are turning to EU imported **pig** products due to constraints on slaughter capacity in the UK and cheaper prices for EU product which is linked to excess production and weakened demand from China as their domestic herd rebuilds following African Swine Fever.
 - ▶ **Sheep and lamb** prices have been strong in 2021 as a result consistent demand in the context of a decreasing domestic flock and logistical difficulties in importing product from New Zealand, Australia and Ireland.
 - ▶ **Agricultural feed crops and fertiliser** have all increased in the past 12 months which is increasing cost pressure on output prices for agricultural commodities.
 - ▶ **Imported feed** crops, including maize gluten feed and soyabean meal, which are utilised for UK cattle and pig rearing have increased in price due to expected shortfalls in harvests as a result of dry weather in the key growing regions in South America.
 - ▶ Indirect input costs, such as **vehicle, building maintenance and energy**, have all increased in the past 12 months as motor fuel costs rebound following Covid-19 and due to shortages in construction materials resulting in price increases.
 - ▶ Droughts and cold temperatures in Brazil (the world's leading grower) have resulted in soaring prices for imported goods like **coffee** and **sugar**. Further, recent lockdown restrictions in Vietnam, the world's second biggest grower of coffee, have resulted in reduced supply and therefore put further pressure on coffee prices.

1. Agriculture and Horticulture Development Board, Harvest progress in the Great Britain, 27 August 2021, <https://ahdb.org.uk/cereals-oilseeds/gb-harvest-progress>

2. The Guardian, 'Disastrous season means UK shoppers could pay 50% more for pasta', 9 September 2021 <https://www.theguardian.com/food/2021/sep/09/penne-in-your-pocket-uk-shoppers-could-pay-up-to-50-more-for-pasta>

3. Reuters, 'Argentina extends beef export cap, stoking farm tensions', 31 August 2021, <https://www.reuters.com/world/americas/argentina-extends-beef-export-cap-stoking-farm-tensions-2021-08-31/>

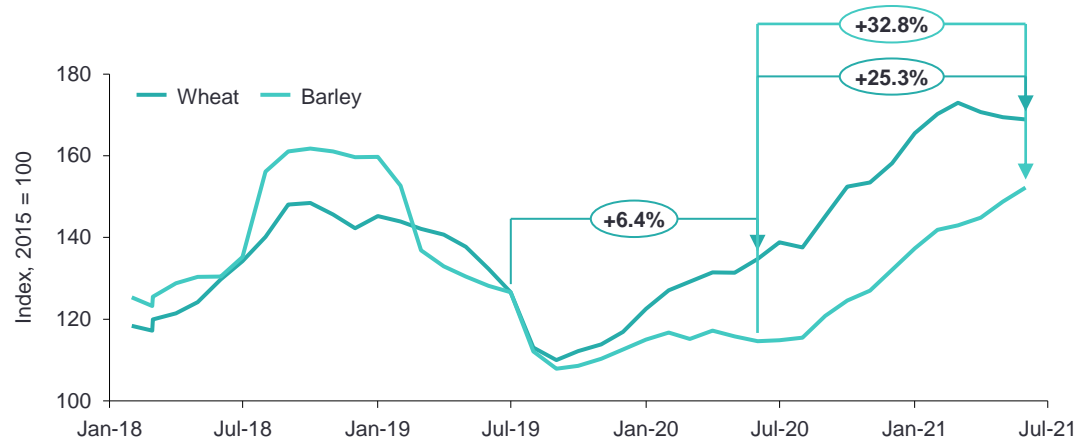
4. National Pig Association, 'Pig prices record biggest drop in five years as staff shortages bite', 9 September 2021, http://www.npa-uk.org.uk/Pig_prices_record_biggest_drop_in_five_years_as_staff_shortages_bite.html

5. Agriculture and Horticulture Development Board, UK Sheep Outlook, July 2021

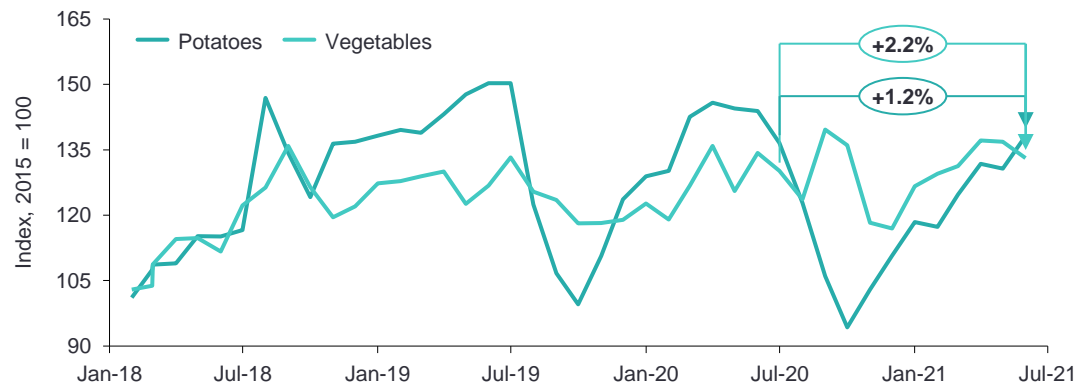
6. Financial Times, 'Weather shocks in Brazil ripple across global commodities markets', 18 August 2021, <https://www.ft.com/content/e0dd4c70-a2bf-41da-842a-a427e72f6d35>

Selected agricultural commodities

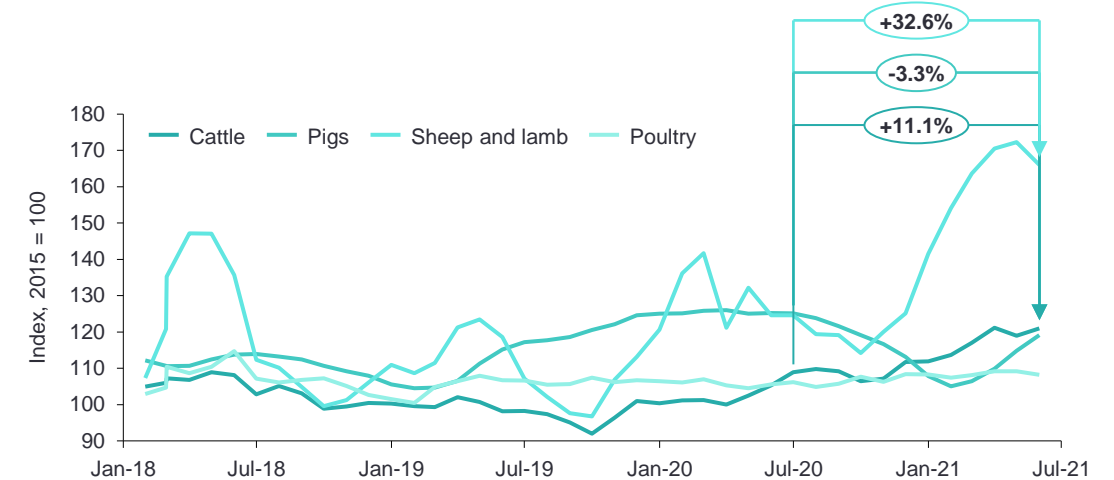
Cereals – Wheat and Barley



Potatoes and vegetables



Animal products - cattle, pigs, sheep and lamb, poultry



- ▶ Year on year prices rises for **wheat** and **barley**.
- ▶ A successful UK harvest may limit further price inflation in the short term but increasing global demand and unpredictable weather patterns in key growing regions is likely to support long term inflation.
- ▶ **Vegetable** and **potato** prices are broadly in line with seasonal trends in prior years but labour shortages may result in supply shortages to supermarkets and price inflation during the second half of 2021
- ▶ Sector reports note that producers have previously relied on labour from Europe and in 2020 on furloughed workers and university students.
- ▶ Strong domestic demand for **cattle** and **sheep** together with logistical challenges on imports has resulted in price increases which may continue as feed prices continue to rise.
- ▶ **Pig** prices depressed to excess global supply resulting in challenges for UK producers.

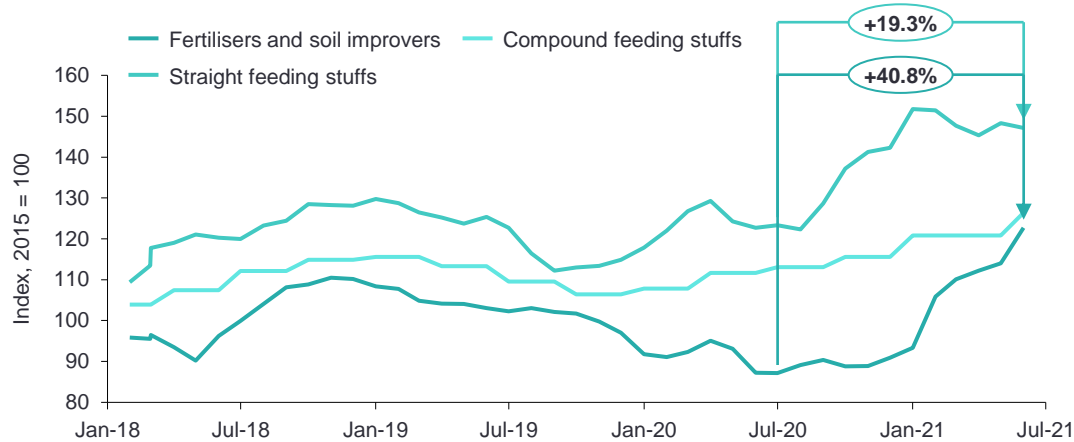
1. Department for Environment, Food and Rural Affairs 'Agricultural Price Index – June 2021' published 26 August 2021

2. Agriculture and Horticulture Development Board, Harvest progress in the Great Britain, 27 August 2021, <https://ahdb.org.uk/cereals-oilseeds/gb-harvest-progress>

3. The Grocer, 'Higher than ever crop losses expected as fruit and veg labour crisis hits record levels', 9 September 2021

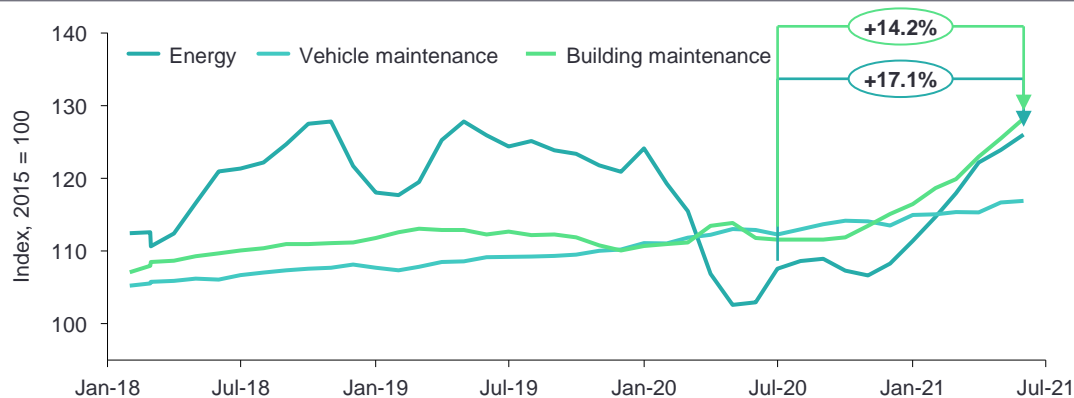
Agricultural input costs

Agricultural input costs - fertiliser, straight feeds, compound feeds



- ▶ Global demand for **grain and other feed crops** (rapeseed, soya, etc.) together with concerns about harvest shortfalls due to dry weather patterns is reflected in increasing animal feed costs.
- ▶ **Fertiliser** prices have increased due to higher input costs, particularly natural gas, which is a key component of agricultural fertilisers. Refinery curtailments due to Covid-19 restrictions have also limited supply.
- ▶ **Energy costs** (motor fuel, electricity, etc.) have recently increased to be broadly in line with 2018 and 2019 following a reduction in 2020 primarily caused by the depressed oil price during the initial Covid-19 lockdowns.
- ▶ **Building maintenance** costs have increased as the construction sector has experienced a sharp increase in material costs, particularly timber and cement, caused by supply shortages in the context of increased demand.

Agricultural input costs – energy, vehicle maintenance, building maintenance

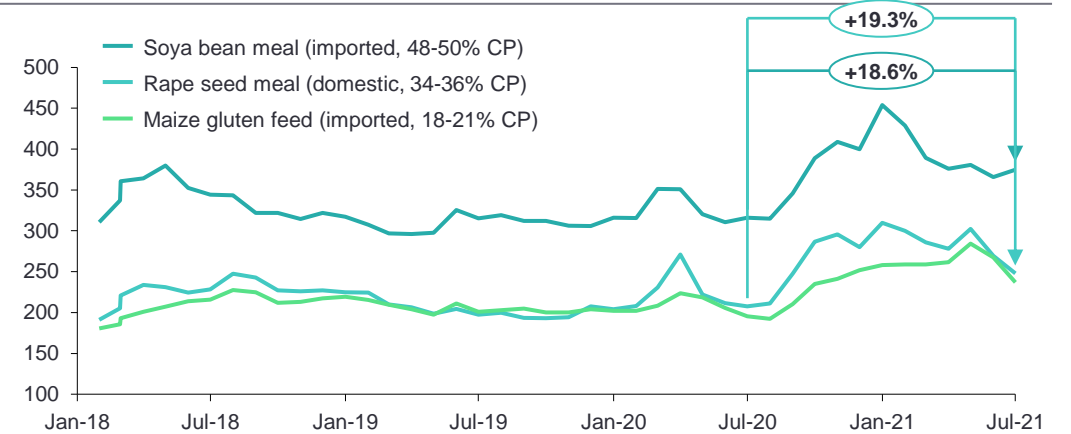
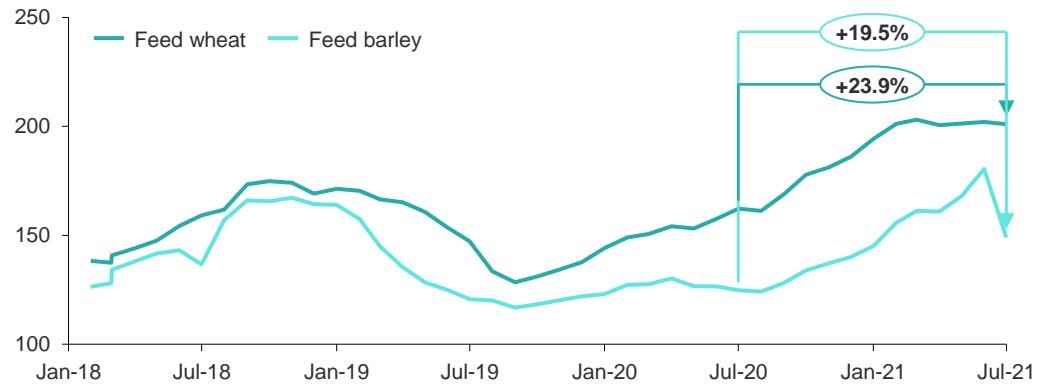


Appendix

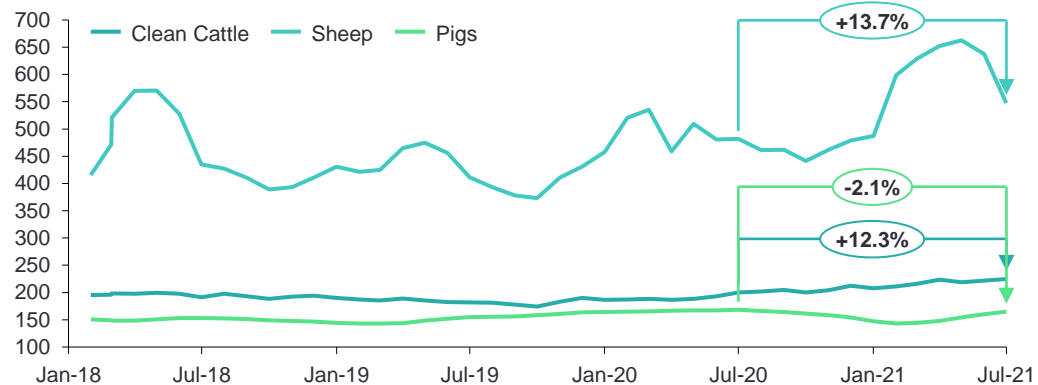


Selected market prices – animal feed and products

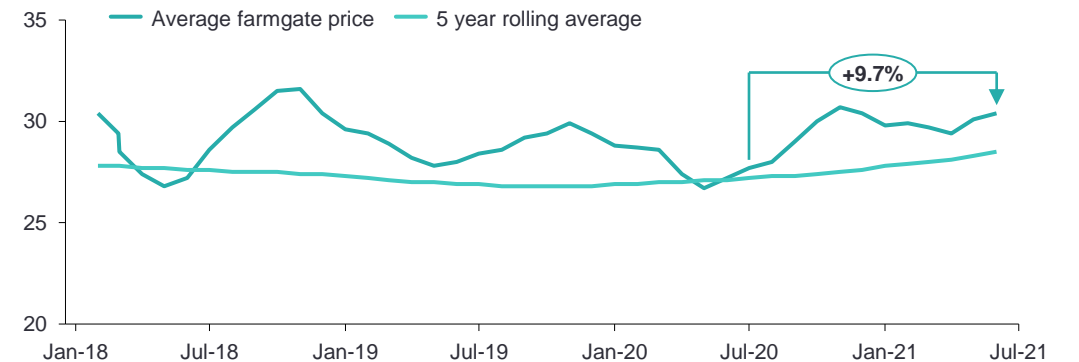
Feed Price (£ / tonne)



Livestock (p / kg)

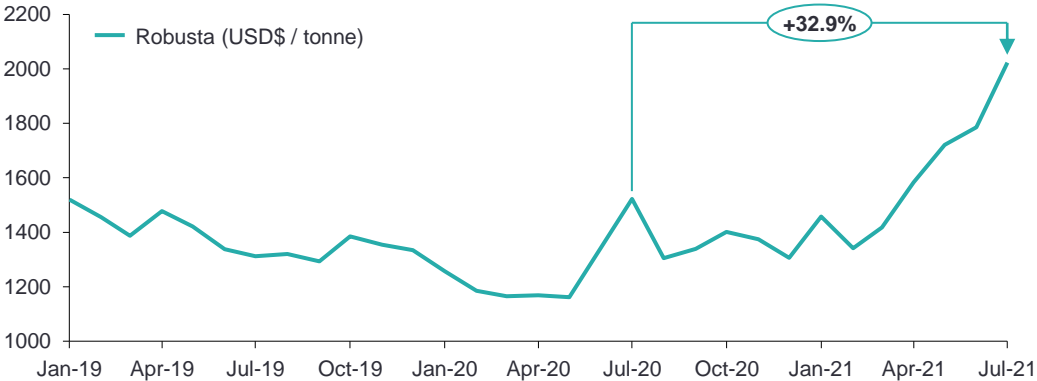
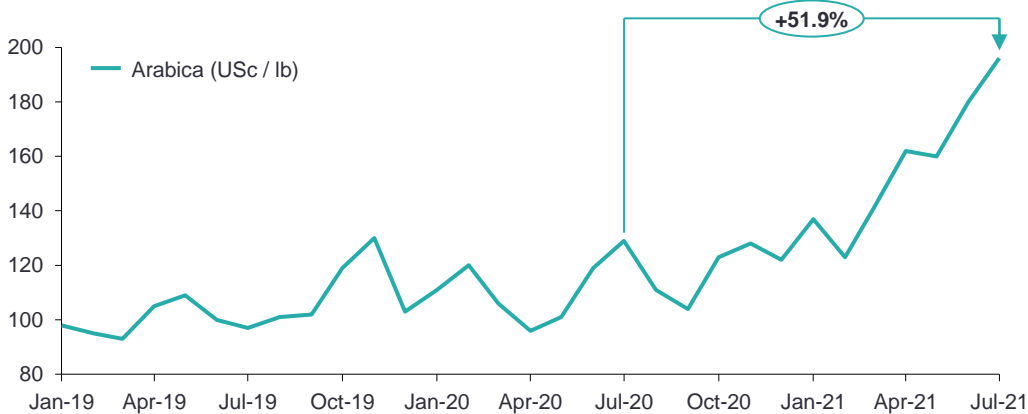


Dairy (p / litre)

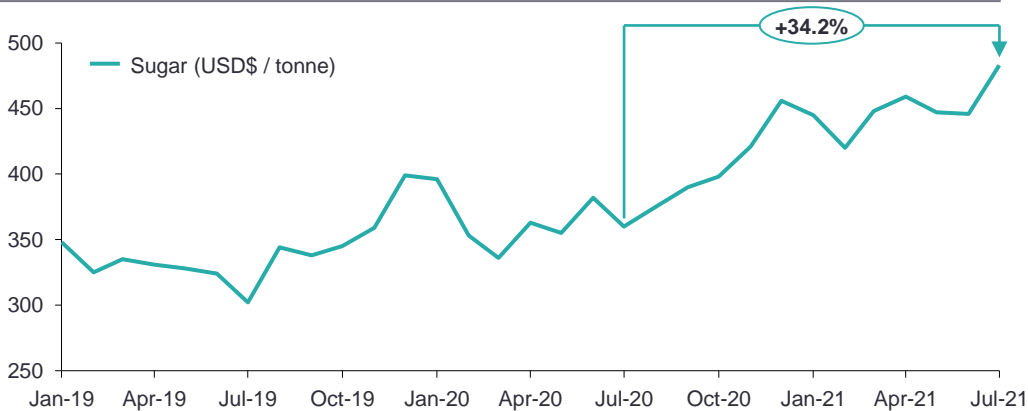


Selected market prices – imported products

Coffee



Sugar



EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.



EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

© 2021 Ernst & Young LLP. All Rights Reserved.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com