The Red Meat Sector Operating Environment

Half-yearly review: July 2018

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Executive Summary

- The UK economy has made a sluggish start to 2018. However, business-to-business services continued to perform well and the construction sector has rebounded from a difficult winter. Business investment has underpinned the economy, though has been weaker than in the past given current economic conditions. Employment growth has firmed in 2018 after briefly slowing last autumn.

- Though inflation has remained above the Bank of England's (BoE) 2% target, it has eased from previous highs as the impact on prices of a weaker sterling has begun to dissipate. Helped by record employment and rising labour needs, pay growth has edged above inflation, supporting real wages.

- While some business surveys have reported subdued demand for credit, the official data shows firm growth in lending to companies and households. Supported by low interest rates, growth in consumer credit remained strong, but it has passed its peak.

- Retail sales have recovered since Easter, supported by a slowdown in inflation and a period of warm dry weather. Both food and non-food retail showed improvement after a challenging period.

- Monetary policy continues to support the UK economy, holding down interest rates for firms and households, but the BoE has signalled a small Bank Rate increase is likely this autumn. 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 has shown signs of slowing from the highs of late 2017, but growth indicators remain firm and businesses have been taking on staff to reduce spare capacity. Unemployment rates have continued to decline rapidly, while wage growth has risen to its highest for many years, but consumer spending remains subdued. The European Central Bank (ECB) has maintained a loose monetary stance, though it has reigned in its asset purchase programme. Policy continued to support growth in lending to firms and households, but core inflation has remained stable. Member State budgets point to a neutral fiscal stance.

- Sterling has been stable in 2018, remaining at an historically weak level against the euro, with developments in Brexit negotiations and changes in sentiment around monetary policy having a limited impact. A relatively weak sterling has continued to make it easier for UK red meat exporters to compete in price sensitive markets at home and overseas.

- Looking forward, UK inflation is expected to ease further towards the 2% target as the impact of past increases in import and commodity prices continues to diminish. Pay growth is likely to edge up due to the tight labour market, delivering a small boost to disposable incomes. Although some investment plans will remain on hold due to longer-term economic uncertainty, investment is likely to underpin economic activity, particularly in export-linked sectors.

- Strong retail competition has restrained meat price inflation in recent years, resulting in the beef and pork supply chains absorbing higher raw material costs. By contrast, lamb is a less price sensitive product, and higher farmgate prices at home and abroad have been reflected in retail prices.

- Going forwards, beef production is expected to steady in H2 2018 while pigmeat production grows. However, a significant decline in sheepmeat production seems likely after a challenging lambing. A hot dry summer may have implications for the marketing pattern. Imports of frozen beef may begin to cool after surging in late 2017 and early 2018, particularly if the manufacturing grade beef market has become oversupplied, but a weak currency may continue to support export activity. For sheepmeat, rising import prices may act as a barrier to import demand, while exports are likely to be limited by falling home production. Rising pigmeat production may support exports of the products that are less in demand on the UK market, but demand from China is likely to weaken and increased competition at home and overseas from other EU countries seems likely.

Contents

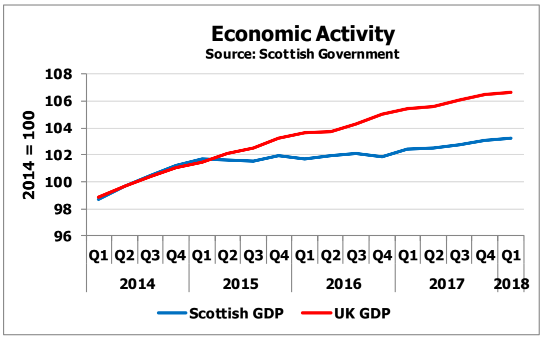
What has been happening in the UK economy?

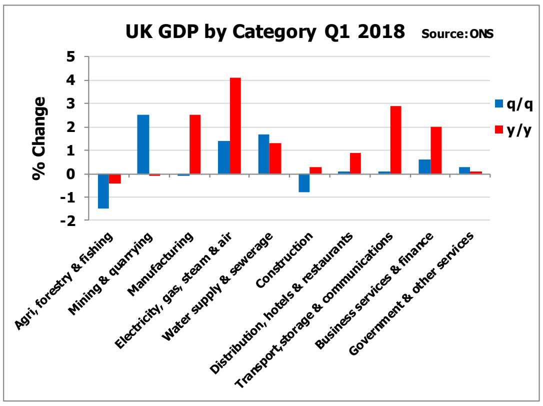
Macroeconomic Indicators

Economic Activity:

	Economic Growth Rates				Source: ONS; Scottish Government		
	Q1 2018		Q4 2017		Q3 2017		2017
	q/q	y/y	q/q	y/y	q/q	y/y	y/y
Scotland (GDP[1])	+0.2%	+0.8%	+0.3%	+1.1%	+0.2%	+0.6%	+0.8%
UK (GDP)	+0.2%	+1.2%	+0.4%	+1.3%	+0.4%	+1.7%	+1.7%

GDP





During 2017, the UK economy grew by 1.7%. According to The Office for National Statistics (ONS), this was its slowest since 2012. Activity growth relative to a year earlier slowed as the year progressed, starting at 1.8% in the first quarter (Q1) and ending it at 1.3% in Q4. Growth slowed further in early 2018, edging 0.2% higher on the quarter to be up 1.2% year-on-year. This compares with an average growth rate of 2.2% between 1993 and 2017. Bad weather was a significant headwind in Q1.

Scotland's economy began to diverge from the wider UK economy in 2015, with the contraction of the oil and gas sector supply chain a significant influence on Scotland's subdued growth rate. Slower population growth in Scotland has also been a factor. However, in late 2017 and early 2018, average quarterly growth rates were sluggish in both Scotland and the UK, at around 0.3%. In Q1 2018, Scottish GDP rose by 0.2% on the quarter and 0.8% on the year.

A strong period for UK manufacturing output (10% of the UK economy) came to an end in early 2018, with output falling back by 0.1% following five quarters of increases averaging 0.9%. Recent growth ensured that manufacturing output was still 2.5% above year earlier levels.

Meanwhile, the steady expansion of UK service sector output (79.6% of the UK economy) continued with a 0.3% quarterly increase in Q1. However, this saw its year-on-year growth rate fall to 1.2% - its slowest since Q4 2011. Consumer-facing services made a sluggish start to 2018 and the foodservice sector fell by 0.1% on the quarter and by 1% year-on-year. Business-to-business services and finance continued to perform strongly, up 0.6% on the quarter and 2% on the year.

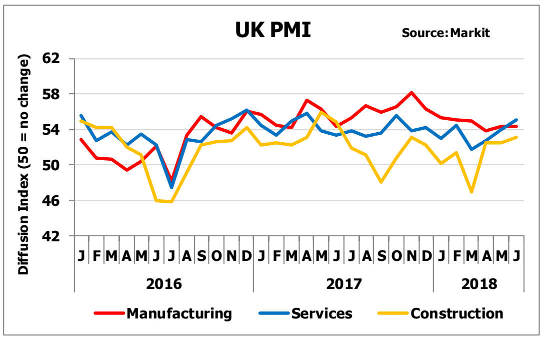
Following three quarters of sluggish growth, the construction sector (6% of GDP) contracted by 0.3% in Q1 2018, and was only 0.3% above year earlier levels. Agriculture, forestry & fishing output (0.7% of GDP) fell by 1.5% on the quarter and by 0.3% on the year.

[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.

In Scotland, manufacturing (11.2% of the economy) made a strong start to 2018, expanding by 1.8% on the quarter to be up 1.6% on the year and at its highest level since then end of 2015. Meanwhile, services (75.1% of Scottish GDP) continued to grow steadily, rising 0.4% from Q4 2017 and by 1.4% on the year. Construction activity (6.4% of output) has contracted considerably since 2015 and the downturn continued in early 2018, sliding by 3.5% on the quarter to be down 9.2% on the year. Agriculture, forestry and fishing (1.4% of GDP) rose in line with the Scottish economy in Q1 and was up 1.3% on the year.

Purchasing Managers Index (PMI)

Monthly PMI surveys provide a more up-to-date measure of UK private sector activity. Having ended 2017 at its highest level of the year of 54.7, a weighted average score for the three sectors slipped to an 18-month low of 53.1 in Q1 2018, before edging back up to 53.9 in Q2. This compares with a 2014-18 average for Q2 of 55.2. PMI surveys continue to suggest that the UK private sector has been growing at an annual rate of around 1.5%. Scotland's PMI hit a four-year high of 54.5 in June.



Taking services first, June saw a lift in output growth to its highest level since October 2017. Order growth rose to its highest level in over a year, underpinned by demand from corporate customers, while warm dry weather boosted some consumer services. However, uncertainty did continue to hold back interest in services linked to business investment. Given that the general lift in demand for services had come as an unexpected boost while firms continued to face recruitment difficulties, backlogs of work built significantly. A quarterly average score of 54 for Q2 was up from 53.1 in Q1 but was slightly below the Q2 2017 reading. It suggests that service sector output rose at a quarterly rate of 0.4-0.5%.

June's PMI report for manufacturing continued to point to a weaker performance for the sector than in 2017. Orders are reported to have picked up from May but output growth continued to slow, with production adjusting to the slowdown in orders seen earlier in the year. One factor behind the general weaker rate of order growth seen this year has been a cooling of export demand from the highs of 2017. June saw demand from home and abroad rise at a similar rate. The Q4 average PMI score of 54.2 was down a point on Q1 and the lowest since Q3 2016.

The UK construction sector began to diverge from services and manufacturing in mid-2017. However, it did show a recovery in Q2 2018, and order levels climbed to their highest in over a year in June. Housing demand continued to underpin the sector. The Q2 reading of 53 was a significant improvement on a Q1 average of slightly below 50, and was its highest for a year.

Business Investment

The ONS estimates that, at £47.7bn, UK business investment was equivalent to 9.5% of GDP in Q1 2018. Following three quarters of growth, investment fell by 0.4%, but it was still up by 2% on a year earlier. The BoE's May Inflation report showed few signs of a lift in investment indicators.

Summary

Official data indicates that UK economic growth slowed through 2017 and made a weak start to 2018. Manufacturing output edged lower in early 2018, but its year-on-year growth rate remained well above the whole economy level. Business-to-business services remained in strong demand, but consumer services had a challenging period, likely influenced by a harsh winter. However, business surveys suggest that Q2 saw some optimism return. Though business investment has out-paced the general economy, political and economic uncertainty has left it subdued relative to historical averages.

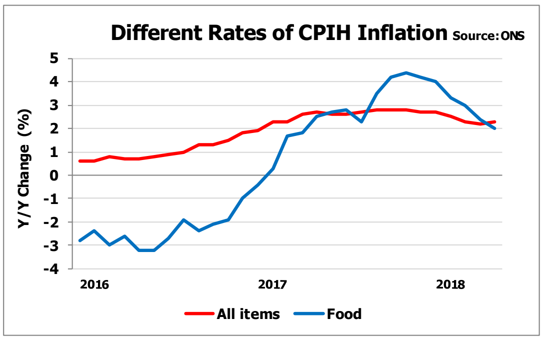
Inflation:

	UK Rates of Inflation (y/y) Source: ONS		
	Mar to May 2018	Dec 2017 to Feb 2018	2017
CPIH	2.4%	2.6%	2.6%
Core inflation[2]	2.0%	2.3%	2.3%

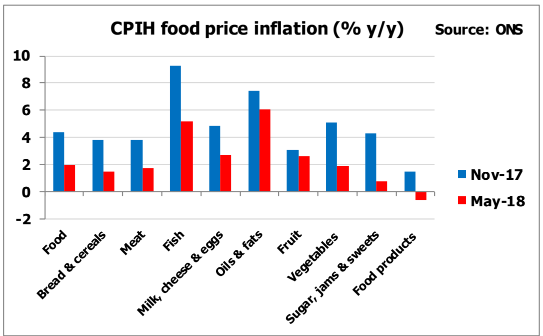
The Consumer Prices Index including owner-occupiers' housing costs (CPIH) – the ONS' favoured measure of inflation – has fallen back in 2018. Following ten months at 2.6%-2.8%, it dipped to 2.3% in March before running at 2.4% in April and May. May was the sixteenth consecutive month in which the CPIH exceeded the Bank of England's 2% inflation target.

Core inflation has also drifted lower again, steadying at 2% in April and May compared to an average of 2.5% last autumn, but it remained higher than its 2014-2016 average of 1.5%.

Food Prices



After trending lower for more than two years, food prices rose significantly from the summer of 2016 until late 2017, as the combination of rising farmgate prices and exchange rate movements passed though the supply chain. The cost of food has since fallen back slightly. Reflecting this, having opened 2017 in deflation, the year-on-year rate of food inflation climbed to 4.4% by November, but by May 2018 it had cooled to 2%. At this level, food contributed 0.15 percentage points to the headline CPIH inflation rate, down by half since late 2017. Retail prices followed wholesale food prices higher between mid-2016 and the end of 2017. UK food manufacturers reported an 8.6% increase in their output prices over this time, while competition limited food retail price growth to 5.5%[3]. Moving into 2018, retail prices averaged 0.4% lower in May than in December while wholesale prices were 0.5% lower than at the year-end.



In general, most food categories exhibited a significantly lower inflation rate in May than last November. Dried fruit & nuts and fresh fish were the most notable examples, with the former going from 8.5% in November to deflation of -4.5% in May, while the latter slipped from 15% to 2.4%. Whole milk was one exception, climbing from 1% last autumn to 8% in the spring. Meat prices returned to year-on-year growth in April 2017 and their inflation rate peaked at 4.2% in December. By May, this had eased to 1.7%. Beef & veal and pork slipped 1.7% behind year earlier levels while offals remained in deflation, down 2.8%. Cured meats eased to 1.1% compared to a Q4 2017 average above 6%. By contrast, poultry prices were up 1.3% in May, having trailed a year earlier in six out of the previous seven months, and past increases in farmgate and import prices saw lamb & goat inflation reach 13.1%, up from around 9% in late 2017.

ONS retail sales data has also indicated a decline in food price inflation. The price deflator used to convert retail sales values in predominantly food stores into volumes eased to 2.1% in May compared

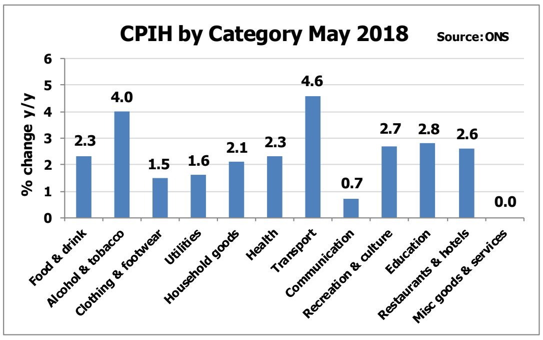
[2] Due to the tendency of food and energy prices to fluctuate sharply, the ONS publishes a more reliable indication of underlying inflation: CPIH excluding energy, food, alcohol and tobacco. This is commonly known as 'core inflation'.
[3] See series K37L in the ONS Producer Price Index dataset.

to a late-2017 peak of 3.6%. However, survey evidence from the British Retail Consortium (BRC) suggests a more stable rate of food price inflation, with May's 0.9% for fresh food and 1.7% for non-perishable products little different to late-2017.

Fuel & Energy Prices

Past collaboration between major oil producing nations to restrict supply growth, political tensions in the Middle East, and a lift in global economic activity have all placed upwards pressure on the oil market over the past couple of years. In the CPIH index, the average cost of energy has been increasing at an annual rate of 4-6% for the past year. After a period of double-digit inflation, electricity dipped to 4.5% in May and gas price inflation remained relatively low at 1.1%. However, heightened geopolitical tensions pushed up oil and hence fuel prices significantly in May, with diesel costing 8.9% more than a year earlier and petrol showing a 7.6% increase.

Consumer Goods Prices



Increased input costs passed through supply chains in 2017, raising goods price inflation to a peak of 3.4% in December. Since then, goods price inflation has eased slightly, averaging 2.5% in May. According to recent PMI surveys, although raw material costs have fallen back this year, demand was strong enough to allow past increases in input costs to continue to filter through into retail prices, before inputs rose in price again in May. A stronger sterling against the US dollar in the opening months of 2018 is likely to have helped ease inflationary pressures on imported components and final goods prices; though its past depreciation may have continued to have an impact through lagged adjustments to prices and attempts to rebuild margins. May saw inflation rates for clothing and footwear, housing goods, household goods, and recreational goods slow to around 1.5-2% compared to around 3% late last year, while deflation in audio-visual products strengthened. In the ONS retail sales dataset for May, the deflator (inflation rate) for non-food stores slipped to a 15-month low of 1.3%. It had peaked at 3.1% last August.

Consumer Services Prices

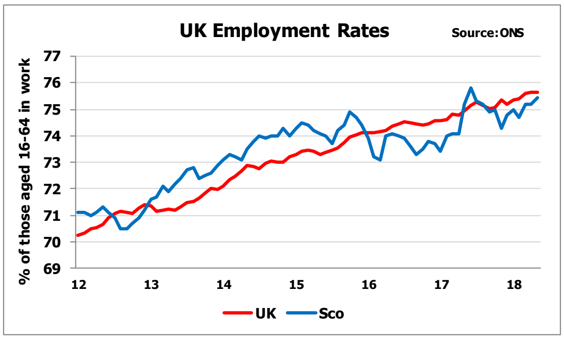
Service sector price inflation had been well anchored at approximately 2.5% for a prolonged period After showing no signs of following goods price inflation higher in 2016 and 2017, it has followed goods inflation lower in 2018, averaging 2.1% between January and May. Areas of the service sector to see inflation move from below average to above it included sports and culture, moving from around 1% last autumn to 3% this year. Many categories showed relatively stable inflation, including care homes (4.7%), the foodservice sector (2.8%) and household tradespeople (around 1%). The cost of a haircut has continued to increase, but at a slightly slower pace, while inflation in accommodation prices has similarly eased, with both slightly below average in May. Meanwhile, insurance inflation has eased sharply and deflation in the cost of financial services strengthened. Services price inflation is a good barometer of domestic demand so its rebalancing in 2018 may suggest a slight weakening.

Summary

The contribution of past increases in the price of raw materials and other inputs to consumer prices peaked in late 2017 and has since eased back. Strong competitive forces have seen this filter into the retail sector and food prices have been no exception. Although the headline CPIH inflation rate has continued to exceed the BoE's 2% target, core inflation has dipped back to be more in-line with the target. A slight drop in the rate of services inflation may suggest a small weakening of domestic demand, but, at this level, it does still indicate a relatively healthy level of consumer confidence.

Labour Market:

Employment



According to the ONS Labour Force Survey, UK employment was 0.4% higher in the March to May 2018 period than in the previous three months, with the UK economy generating 76,000 more jobs than it lost. Compared to a year earlier, employment was up 1.2% at 32.4m. Both of these growth rates were slightly ahead of the average for the past year, but down slightly on their five-year average. The upwards trend in the employment-to-population ratio continued, reaching 61.1%. This was up from 60.7% a year earlier. Meanwhile, the headline employment rate, for those aged 16-64, rose by 0.3 percentage points on the quarter and by 0.8 points on the year to set a new record high of 75.7%. Just under 15% of employees reported that they were self-employed. This proportion has been relatively stable since the beginning of 2014, having previously trended higher from a level of around 12-13% in the last decade, suggesting no disproportionate uplift in insecure work as part of the so-called gig-economy.

In Scotland, labour market data is more volatile than at the UK level, due to a smaller sample size for the Labour Force Survey. The Scottish employment rate moved closer to the UK average in the March to May quarter, up 0.5 points on the quarter and 1.4 points on the year, at 75.5%.

Having risen significantly through most of 2017, job vacancies in the UK economy showed signs of stabilising towards the end of the year and this continued into 2018. However, vacancy growth returned in Q2 2018, leaving them up 0.8% on the quarter and 5% on the year.

The PMI surveys carried out in June indicated that job growth had continued across the UK private sector. However, hiring had slowed relative to the highs of last year in manufacturing, while weaker job growth across service sector firms was linked to the challenge of finding adequately skilled staff. By contrast, hiring gathered pace in the construction sector to meet increased orders.

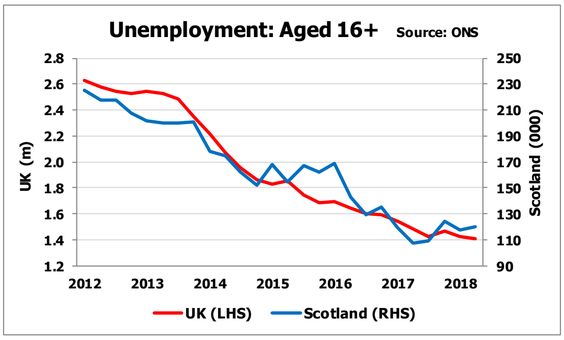
Underemployment

In Q1 2018, the ONS estimates that underemployment fell back on the quarter and on the year. All three measures of underemployment declined, with fewer people wanting to either increase their current hours, take a new job with longer hours, or to take on a second job.

Other proxy indicators for underemployment include the level of part-time and temporary work. In March to May 2018, at 23.86m, there were 0.7% more people working full time than in the previous quarter and 1.4% more than a year earlier. Meanwhile, slightly fewer people were in part-time roles than three months before, though numbers were still above year earlier levels, at 8.54m. The proportion of part-time workers that could not find full-time work continued to trend lower, edging down to 11.8%. This had peaked at 18.5% five years before. Temporary employees were marginally more common than in the previous quarter, but they continued to be fewer in number than a year earlier. However, while the share of temporary employees reporting an inability to find a permanent position was down on the quarter, it remained elevated relative to last year.

Unemployment

Underpinned by continued employment growth, UK unemployment continued to fall in the March to May 2018 quarter. At 1.41m, unemployment was down by 0.9% on the quarter and by 5.6% on the year[4]. At 4.2%[5] of the labour force, the unemployment rate held at its lowest since the spring of 1975, having previously bottomed out at 4.7% in the early 2000's. At this level, unemployment is at the level the BoE estimates to be its long-term equilibrium rate[6]. The year-on-year decline in UK unemployment of 83,900 was driven by the net increase in employment of 388,400 exceeding growth in the economically active population of 304,500. The Scottish figures was close to the UK average, with an unemployment rate of 4.3%. This was up from 4.1% on the quarter and from 3.8% a year earlier because the economically active population rose faster than employment.



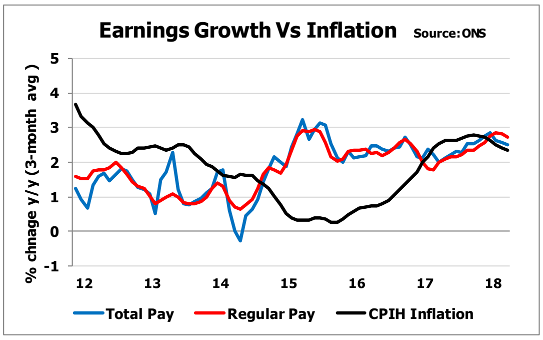
In March to May 2018, there were 1.7 unemployed UK residents for each vacancy, equalling the record low (since the series began in 2001) set in the previous quarter. This is another indicator of firm competition for workers, potentially raising bargaining power in negotiations over pay and conditions.

Earnings

	UK average weekly earnings growth		Source: ONS
	Mar to May 2018 (y/y)	Dec 2017 to Feb 2018 (y/y)	2017
Whole economy total pay	2.5%	2.8%	2.3%
Whole economy ex. bonus pay	2.7%	2.8%	2.3%

UK earnings have continued to trend higher in 2018, with average weekly earnings reaching £516 (£26,850 per annum) in the March to May period. This was a year-on-year increase of 2.5%. However, earnings growth has dipped back from a peak at 2.8% in the three months to February 2018, in part down to smaller bonus payments. Nevertheless, this was up slightly on 2017 and well above the 1.9% average for 2013-17. Regular pay, which excludes bonuses, averaged £485. Its growth rate also eased back from early 2018, but remained well above its five-year average of 1.8%.

The slight slowdown in pay growth in the three months to May was common across much of the economy. However, for the lowest earning sector – wholesaling, retailing, hotels & restaurants – the opposite was true with regular earnings growth strengthening to its highest in over a year, reaching 2.5%, helped by a further lift in the minimum wage for workers aged over 25 in April 2018. Construction sector pay growth also climbed, reaching a considerable 5.6%, potentially indicating recruitment difficulties.

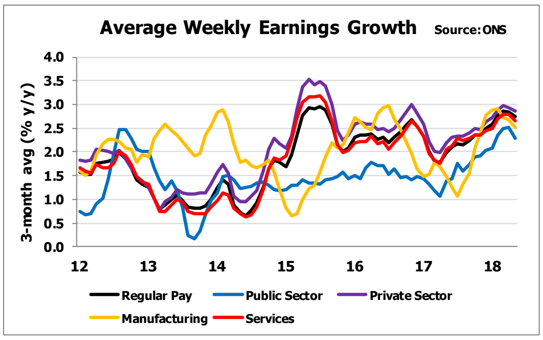


Although pay growth showed some signs of slipping back in the spring of 2018, it has moved in front of the UK inflation rate, boosting real wages. With the CPIH inflation rate averaging 2.4% in the three months to May, inflation-adjusted earnings rose by 0.2%. Real terms pay has, on average, been slightly in positive ground since the beginning of 2018, following a small squeeze on real earnings which lasted from the spring of 2017 until the year-end. With it being only marginal, it does not point towards households having disposable cash to raise their

[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] In theory, the rate where a balanced labour market produces earnings growth consistent with the 2% inflation target; any lower and recruitment difficulties become more widespread, pushing up wages and in turn prices.

spending to any significant extent. Indeed, consumer surveys still point to a balanced position between optimism and pessimism on personal finances.

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 underpin 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 and it does not yet point to widespread skill shortages. 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.



As can be seen in the average weekly earnings chart, service sector and private sector pay are linked closely to the overall average due to their high share of UK employment. Regular pay growth in the private sector was at an above average 2.9% in the three months to May, with service sector pay growth running in line with the overall average. Manufacturing earnings growth has been volatile in recent years, but has converged to the overall average again, standing at 2.5%. While tight control of public finances has continued to hold public sector pay growth below average, a sustained rise through 2017 has left it at its highest level in many years. In March to May 2018, public sector pay was up 2.3% year-on-year.

UK earnings March to May 2018 (Annualised weekly earnings)			Source: ONS	
	Regular Pay	% of average	Total Pay	% of average
Whole economy	25,220	100	26,850	100
Private sector	24,830	98.5	26,790	99.8
Public sector ex. finance	26,830	106.4	26,910	100.2
Services	24,360	96.6	26,010	96.9
Manufacturing	29,810	118.2	31,240	116.3
Construction	30,610	121.4	31,920	118.9
Finance & business services	30,110	119.4	33,980	126.5
Wholesaling, retailing, hotels & restaurants	17,190	68.2	18,520	69.0

Summary

The UK economy has continued to create jobs despite a weakening in the overall rate of economic activity growth. Strong demand for labour has exceeded the increase in the working age population, leading to a further increase in the employment rate and unemployment has fallen to around its estimated equilibrium level. While pay growth has picked up to exceed its five-year average, the tight labour market has yet to show signs of widespread recruitment challenges forcing up wages. With inflation slipping back, real wages have returned to marginal growth this year, but not to the extent that would suggest a jump in disposable income to spend.

Money & Credit:

Money Holdings

According to BoE data, the aggregate level of money and credit in the UK economy (M4) stood at £2.37 trillion in May. This was up by 2.7% on a year earlier, compared with increases of around 5% in H2 2017. Rising 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) continued to grow at a below average rate, of 2.5%, while although money holdings growth cooled at private non-financial corporations (PNFCs) - non-financial companies and partnerships - it remained at a significant 7.5%. By contrast, holdings were down 0.2% 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 2.3% on the year in May. Within this total, lending to the household sector was up 3.6% on a year earlier, while there was a smaller increase in lending to PNFCs of 2.9%. Meanwhile, lending to financial services fell back to be only 0.2% ahead of a year before.

Business - Credit Availability and Demand

The BoE Agents' summary of business conditions for Q2 indicated some polarisation in credit availability due to increased risk aversion. Lenders continued to be willing to supply lending to companies with a firm financial footing, but access had reduced for small businesses and companies with construction or property interests. The Inflation Report noted that credit has become slightly more expensive as last November's interest rate increase has been passed on to floating rate contracts. On the credit demand side, the BoE Agents noted limited interest, but investment did remain in positive territory, mainly down to firms investing in labour-saving technology due to the tight labour market and exporters continuing to boost production capacity. BoE figures for May show that the outstanding value of loans to the agriculture, hunting, forestry and fishing sector was up by 1.3% year-on-year at £19bn, while loans to the manufacturing sector surged by 11.9% to £50.6bn.

Consumer Credit

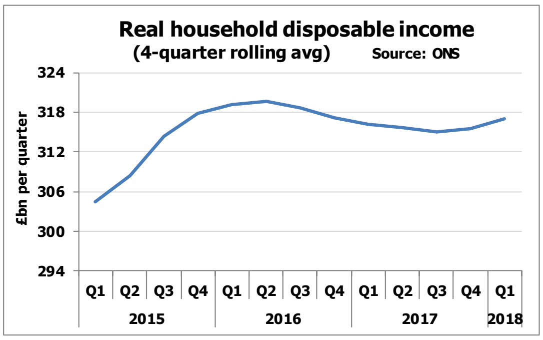
Overall lending to households grew more quickly than money holdings (4% v 2.8%) compared to a year earlier in May. This was despite the outstanding stock of mortgages, which accounted for 87% of all lending to individuals, increasing at a slower 3.3% annual rate. In turn, this occurred despite new mortgage approvals for house purchases falling relative to a year earlier for an eighth month, down 2%; though remortgaging did rise by nearly 16%. Consumer credit continued to grow strongly in May, up 5.9% year-on-year at £211.6bn, but this growth rate has been drifting lower. Credit card lending accounted for 34% of this total, and it rose by 5.1% year-on-year. Meanwhile, other loans to consumers increased at an annual rate of 6.3%, supported by favourable interest rates, which have risen little from their historical lows of 2017. Growth in credit card finance has been stable, while other lending growth has cooled, in part reflecting a slowdown in car sales.

Summary

Total credit provision continued to grow in the spring of 2018, supported by willingness to lend. Competition between lenders has kept interest rates at attractive levels for businesses looking to expand or renew their capital stock. On the consumer side, house and car purchases have fallen back, but low interest rates have continued to stimulate spending on credit cards, suggesting that households remain confident in their personal financial situation.

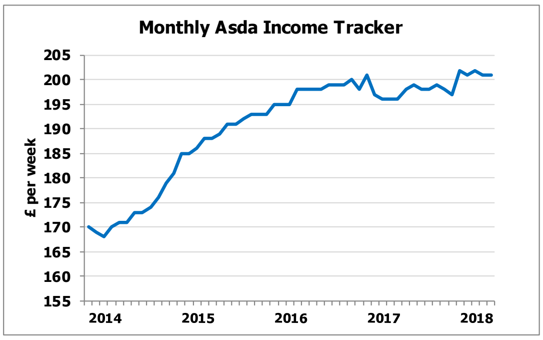
Consumer Indicators

Household Incomes

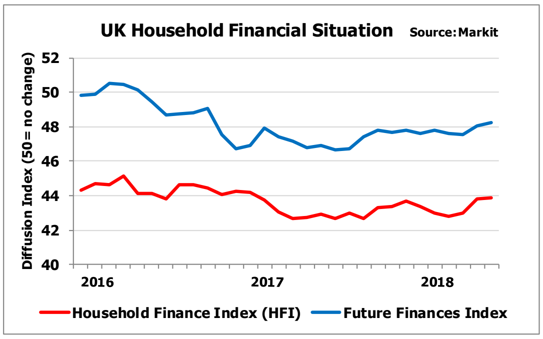


Following five consecutive quarters of contraction relative to a year earlier, UK household disposable income returned to inflation-adjusted growth in Q4 2017. This was largely down to a step change between Q1 and Q2 2017, with incomes lacking direction since. This left real disposable income up 2% year-on-year in Q1 2018 at £317.5bn. While still 2.1% below its Q3 2015 peak, it was 2.5% ahead of its 2013-17 average.

During Q1, household incomes were underpinned by annual increases of around 5% in income from employment and from investments. However, social benefits receipts fell by 1.9% while tax and national insurance contributions rose by 1.3% and 0.3%, respectively. This saw tax and national insurance fall to 26.8% of household resources from 27.4% in Q1 2017. The net result of these changes was a 4% lift in disposable income in cash terms. After accounting for a 2.1% higher price level, disposable income rose by 1.9% on a year earlier.



Asda, in conjunction with the Centre for Economic & Business Research (CEBR), produces a monthly indicator of disposable incomes which is based on a calculation which deducts taxes and essential spending from household income. The spending power of the average UK household dipped at the start of 2017, but then recovered towards the year-end. After reaching a record high of £202 in January 2018, it has been relatively stable at £201-£202. During the three months to May, disposable incomes averaged £201, which was a 0.7% increase on the three months to February and 2.7% above year earlier levels. In Scotland, year-on-year growth in discretionary income is estimated to have been running at a slower 0.5%-1% in 2018. Discretionary income has recovered in 2018 as a result of slowing inflation, except for the cost of fuel, plus higher earnings growth than last year.

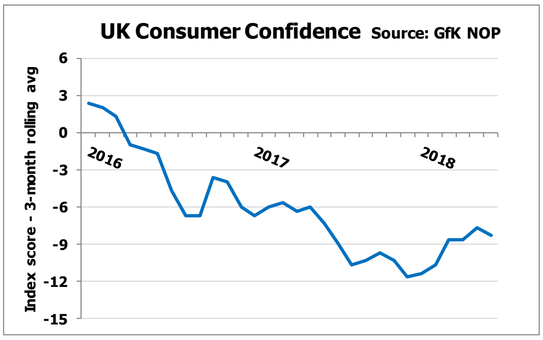


Markit's monthly UK household finances survey shows that during June there was a greater degree of pessimism than optimism[7]. A score of less than 50 indicates net pessimism, and the index has remained in negative territory. However, it has recovered from a dip in the early part of 2018, reaching an 18-month high of 43.9 in Q2. This compares with 42.8 in Q1 2018 and 42.9 in Q2 2017, but remined below the 44-45 seen through much of 2015 and 2016. In June, finances were supported by labour market participation, job security and rising wages, but these gains were more than offset by a lift in the cost of living.

Looking forward, household expectations of their future financial prospects have also become less pessimistic in 2018, despite inflation expectations for the year ahead rising significantly. This may partially reflect a change in expectations of the future path for monetary policy as fewer households were anticipating another increase in Bank Rate in the next three, six or twelve months; though 72% were still expecting one in the coming year.

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

Consumer Confidence



UK consumer confidence[8] has been pessimistic since April 2016. This pessimism worsened in mid-2017 and the indicator dropped to a four-year low in December. However, the degree of pessimism has eased a little in 2018.

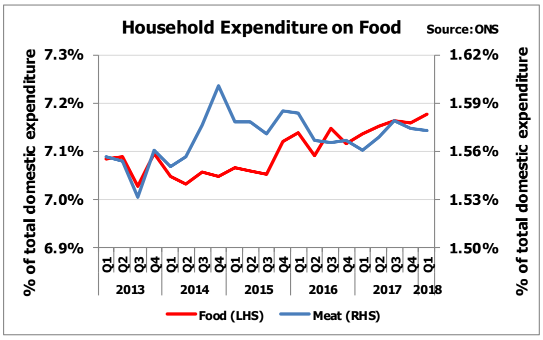
On balance, consumers still feel better about their own financial conditions than those of the wider economy, which they are considerably pessimistic about. This relatively better position of personal finances means that consumers are balanced between those that have the funds available for large purchases and to save, and those that do not.

Consumer Spending

ONS data shows that, in real terms, seasonally adjusted UK household spending was 0.2% higher in Q1 2018 than in the previous quarter and was up by 1.2% on the year. Quarterly spending growth was supported by a fall in the household savings ratio but, at 4.1%, the ratio remained well above the 3% rate seen in Q1 2017 (a record low for the series which began in 1963), placing downwards pressure on the year-on-year increase in consumer spending.

The data for Q1 reveals that net tourism spending rose sharply on the quarter, returning it to year earlier levels, while spending in the domestic economy edged up by 0.1% to be up 1.2% on the year. The fastest growing category relative to early 2017 was household goods & services, rising 5.9%, and there was also firm growth in health (2.9%) and miscellaneous (3.1%). Food & drink, communications, and housing all rose by around 2%. Meanwhile, real terms spending on recreation & culture and clothing & footwear edged higher, but there were small declines for restaurants & hotels and education, while spending on transport and alcohol, tobacco & narcotics was around 2% lower than a year before. Transport spending is likely to have been suppressed by bad weather.

Within food, oils & fats had the best year-on-year performance, rising 3.7% in Q1, while spending on sugar, confectionary & ice cream grew by 3.2%. Meanwhile, there were slightly above average increases of 1.9% for milk, cheese & eggs and 2% for meat. The categories which lagged the overall growth in real terms consumption in early 2018 were other food (0.6%), bread & cereals (0.8%) (fish (0.9%), fruit (1.3%) and vegetables (1.5%). Real terms spending in most of these slower growing categories was held back by considerable rates of inflation. For example, cash spending on fish and fruit rose by around 7% year-on-year.



The share of food in total domestic spending has been trending slightly higher since the second half of 2015, approaching 7.2% in early 2018. Having previously trended lower, the share of real terms spending on meat has begun to recover over the past year. As a result, the share of real terms spending on food accounted for by meat has stabilised at around its long-term average of around 22% since mid-2016, following a brief lift towards 22.5%. This suggests that the increased prominence of plant-based diets have yet to filter through into reduced meat consumption.

[8] 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 GB retail sales: March to May 2018				Source: ONS
	q/q change		y/y change	
	Value	Chained volume	Value	Chained volume
Total	**1.3%**	**0.9%**	**4.2%**	**2.1%**
Excluding automotive fuel	1.5%	1.2%	4.2%	2.2%
Predominantly food stores	1.8%	1.3%	3.2%	0.9%
Predominantly non-food stores	0.5%	0.3%	2.9%	1.4%
Non-store retailing	4.8%	4.9%	13.9%	11.2%

Following three years of strong retail sales volume growth, performance deteriorated as 2017 progressed and sales were only 0.7% above year earlier levels in Q4. Q1 2018 saw a slight recovery, before the year-on-year increase lifted to a nine-month high of 2.1% in the March to May period. The weakening of retail sales volume growth during 2017 was largely driven by the return of inflation rather than a decline in spend. Indeed, turnover growth actually increased in 2017 to average around 5% year-on-year, approximately double its 2014-16 rate, and then ran at around 4% in early 2018. Meanwhile, the deflator used to convert sales values into volumes shifted from an average decline of 1.6% in the 2014-16 period to inflation of 3% in 2017 and then back to around 2.5% in 2018. Firm turnover growth suggests that consumers are continuing to buy, and news headlines about job losses and business closures in retail may therefore be more a reflection of changing consumer habits.

In food stores, sales volumes trailed year earlier levels in nine of the eleven months between May 2017 and March 2018 as although turnover increased at an average rate of 2.3%, inflation climbed to 3%. With inflation easing back below 2.5% in April and May 2018 while turnover growth firmed, sales volumes returned to growth, up 1% in April and 2.8% in May. May's 5% increase in turnover was the strongest for any month since February 2012.

Non-food stores had a weak patch in early 2018 where cash spending rose by less than 2.5% year-on-year between February and April, compared to a 2013-17 average increase of more than 3%. However, like food stores, May saw a turnaround in fortunes, with turnover up 4.5%. Given that inflation also eased, to a 15-month low of 1.3%, sales volumes rose 3.2% - their best performance since December 2016. Within non-food stores, textile, clothing & footwear stores reported a 2% contraction in sales relative to last year in the March to May period. This followed a strong 2017. By contrast, a sluggish 2017 turned into a positive spring for non-specialised stores and household goods stores, reporting sales volume growth of 1.6% and 3.2%, respectively. Other stores, including chemists, sports shops and IT stores, continued to post the fastest growth, of 3.3%.

The BRC reported a strong May for its members, in line with the ONS figures. However, their indicator for the wider March to May period showed a 3% decline for non-food and a 2% increase for food. Although online sales of non-food increased strongly, they failed to offset the decline in shops, meaning that total non-food sales fell by 1.4%. Meanwhile, sales volumes had grown over the past year at 43% of businesses in June's CBI distributive trades survey, while they fell for 10% of firms, with grocery stores, non-specialised stores and online retailers performing notably well. Wholesalers' performance was more balanced however, with 41% reporting growth and 38% a contraction.

Summary

On average, household finances are in positive condition, with pessimism in consumer confidence surveys reflecting concerns about the general economy rather than the personal situation. After a slowdown in retail sales volume growth in 2017 and early 2018, the situation improved after Easter, helped by a dip in inflation. Structural change in the retail sector reflects the changing ways in which consumers are spending their money, rather than a decline in the amount being spent.

What has been happening to economic policy in the UK?

Monetary policy:

At the June meeting of the BoE's Monetary Policy Committee (MPC), there was a 6:3 vote in favour of holding Bank Rate at 0.5%, the rate at which it has been since November 2017's 0.25 percentage point increase. At the March and May meetings, seven members had voted for stability. Meanwhile, other BoE monetary stimulus packages were unanimously left in place. These were the £435bn stock of asset purchases (Quantitative Easing/ QE), plus a £10bn stock of corporate bonds.

The six members favouring no change were generally of the opinion that the UK economy had recovered from a weather-induced slowdown in Q1. However, they also worried that the global economy had weakened in Q2 and that the financial sector had become more cautious in its attitude towards lending. Accordingly, they were insufficiently confident in the strength of the underlying economy to vote for an interest rate increase.

By contrast, the three dissenting voices were more confident in the recovery of the domestic economy from its winter blip. They favoured a small interest rate increase, judging that a tight labour market was leading to stronger upwards pressure on wages than they had previously expected. They also felt that raising interest rates now could reduce the risk of a future wage-price spiral which would risk the need for a faster pace of monetary tightening going forward.

Fiscal Policy:

The Office for Budget Responsibility (OBR) forecasts that the UK government will run a budget deficit of 1.8% of GDP in 2018/19, down from 1.9% in 2017/18 to its lowest since 2001/02. Revenues are forecast to rise by 3.1% in 2018/19, as a healthy labour market supports income tax and national insurance receipts, while household spending growth should boost VAT and corporation tax receipts are forecast higher due to rising corporate profitability. Meanwhile, spending is anticipated to rise by 1.9% due to the increased costs of an ageing population, such as rising pensions and health and social care costs, more than offsetting a decline in infrastructure investment. The Government is currently considering its revenue-raising options to fund a significant expansion of the health budget.

Although there has been a softening in the UK Government's position on public spending, many departments are continuing to face a tight overall spending settlement, particularly in inflation-adjusted terms. Despite significant pressures from planning for EU withdrawal, both the Defra and International Trade budgets are due to fall by around £100m in the current financial year.

The beginning of the 2018/19 financial year saw the minimum wage for workers aged 25 and over rise by 4.4%. In addition, pensions rose by 3%. At the UK level, the threshold for beginning tax payments increased by another £350, adding around £1.35 to weekly pay. In Scotland, devolved tax powers made taxes more progressive, with a reduction for those earning up to around £33,000, but increased taxes for those on higher incomes. At the lower end of the UK household income scale, real-terms cuts to working-age benefit payments are continuing to have a negative impact.

Summary

The Bank of England has left interest rates on hold in H1 2018, but the level of dissent has grown. Monetary policy remains highly accommodative, supporting the flow of credit to firms and households at affordable interest rates. On the fiscal side, a change in Government attitude has slowed the anticipated pace of budget deficit reduction and provided extra funding for public investment. Changes in taxation and pensions are likely to support incomes in the top-half of the UK 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:

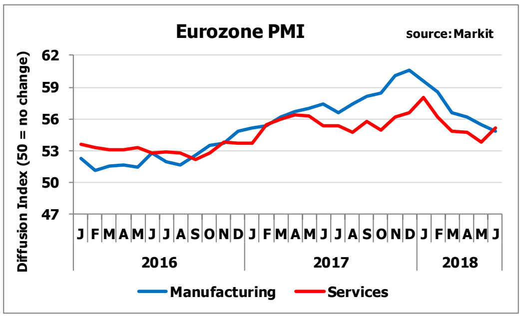
	Economic Activity in Prominent Scottish red meat markets			
	GDP Growth (%Q/Q)		GDP Growth (%Y/Y)	
	Q1 2018	Q4 2017	Q1 2018	2017
Bel	+0.3	+0.5	+1.5	+1.7
Fra	+0.2	+0.7	+2.2	+2.2
Ger	+0.3	+0.6	+2.3	+2.2
NL	+0.6	+0.9	+3.1	+2.9
It	+0.3	+0.4	+1.4	+1.5
Spa	+0.7	+0.7	+3.0	+3.1
Euro Area	**+0.4**	**+0.7**	**+2.5**	**+2.4**
Den	+0.4	+0.9	-0.6	+2.3
Swe	+0.7	+0.7	+3.3	+2.3
UK	+0.2	+0.4	+1.2	+1.7
EU28	**+0.4**	**+0.7**	**+2.4**	**+2.5**
Nor*	+0.6	+0.7	+0.9	+1.9
Swi	+0.6	+0.6	+2.4	+1.1

Sources: Eurostat; Statistics Norway

*Mainland GDP (excluding oil & gas)

Euro area economic growth firmed to a ten-year high of 2.4% in 2017, well above the 2013-17 average of 1.5%. However, after five consecutive quarters growing at 0.7%, growth eased to 0.4% in Q1 2018. This meant that after two quarters running at an annual rate of 2.8%, year-on-year GDP growth cooled to 2.5%. Consumption and investment continued to underpin economic growth in early 2018, but government spending steadied and exports declined for the first time since late 2012.

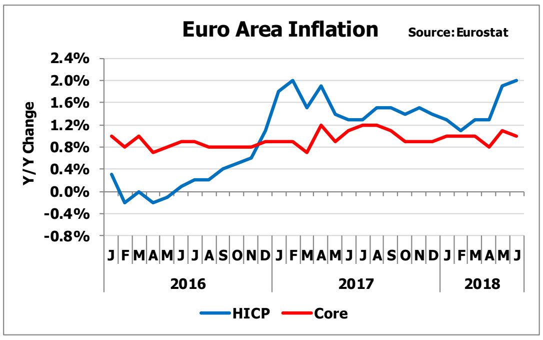
Across the most important countries for Scottish red meat exports, GDP tended to grow more slowly in Q1 2018 than it had in 2017 and continued to grow more slowly than the euro area average. However, on a year-on-year basis, growth remained similar to its 2017 rate and was generally above its five-year average. Spain, Sweden and the Netherlands continued to show the strongest performance, while the Danish economy continued to recover from a mid-2017 recession. In the wealthy non-EU European economies of Switzerland and Norway, GDP growth remained on a firm footing in early 2018 having picked up in the second half of 2017 after a sluggish couple of years.



The monthly PMI surveys of private sector activity published by Markit have signalled a slowdown in the pace of economic growth on the continent. After slumping to an 18-month low in May of 54.1, the combined indicator for manufacturing and services recovered to 54.9 in June. Though down from a peak at 58.8 in January, it remained in front of its 2013-17 average of 53.2. Both manufacturing and services have seen a slowing of growth in H1 2018, with a more significant weakening taking place in the former. Indeed, the services PMI exceeded manufacturing for the first time in 16 months in June, having averaged 2.4 below it over the past year. Despite slowing, PMI's of around 55 signal healthy quarterly output growth of around 0.6%.

At the country level, manufacturing sector activity growth reached a new record high in Germany in December while the Netherlands remained very strong at a score of over 62. French manufacturing also picked up strongly, while the rate of expansion in Italy and Spain dipped back but remained firm. Service sector activity growth has continued to trend higher in France, Germany and Italy, but has eased slightly in Spain. Looking out-with the euro area, the latest PMIs for Sweden pointed to high growth rates of 1-1.5% in manufacturing and services. The Swiss manufacturing sector has also been growing above 1% in H2 2017 while Norway's manufacturing PMI reached 57.8 in December.

Inflation:



After stabilising between 1.3% and 1.5% for most of the period between May 2017 and April 2018, euro area inflation picked up strongly to reach a 13-month high of 1.9% in May[9]. A provisional estimate for June indicates that the rate edged higher, reaching 2% for the first time since February 2017. This meant that it breached the ECB's target of 'close to but below 2%'. However, core inflation has remained well-anchored, suggesting no lift in underlying inflation despite a prolonged period of robust economic growth. Indeed, the June estimate for all items excluding energy, food, alcohol and tobacco eased back to 1%, leaving it only marginally above its 2013-17 average of 0.9%.

A breakdown of inflation into categories reveals that the main reason for the lift in the headline inflation rate in May and June was a sharp lift in the cost of energy relative to a year earlier. Having run at an annual rate of just over 2% in the first four months of 2018, energy inflation reached 6.1% in May and then is thought to have hit 8% in June. Rising food inflation was a secondary driver of the overall HICP, with the inflation rate for unprocessed food picking up to 2.4% in May and 3% in June compared with an average of less than 1% in early 2018. PMI surveys for the euro area suggest that the upwards pressure on input costs that dissipated in the summer returned again in the autumn.

Inflationary indices for non-energy industrial goods and services show that underlying inflation has yet to pick up. For the former, inflation was 0.3% in May and an estimated 0.4% in June, little different to its January to April average of 0.4%. For the latter, inflation did lift to 1.6% in May - its highest level since last summer - before easing back to 1.3% in June, which was in line with its average for the opening four months of 2018. Continuing sluggish inflation rates in these categories suggests that firms have weak pricing power and are lacking the confidence to raise prices.

In the main markets for Scottish red meat exports, inflation rates generally showed significant increases in May, climbing from levels around 1-1.5% up to 2%. Denmark, Italy and Switzerland were the exceptions, with inflation lifting from around 0.5% up to 1%. Most of the upwards pressure came from sharp increases in the cost of energy, with underlying inflation remaining low.

With most countries' inflation rates now running around the ECB target, it may support changes in expectations that underpin wage increases. Inflation also erodes the real value of debts, potentially making it easier for households and businesses to repay loans, supporting economic confidence; though if inflation continues to trend higher, it could begin to suppress real incomes. Nevertheless, the continuing sluggishness of core inflation does suggest that consumer demand has yet to pick up. Furthermore, similar rates of inflation across Europe make it harder for those countries still recovering from the financial crisis to improve their competitive position in the global economy.

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

Labour market:

Labour market in prominent Scottish red meat export destinations				
	Total Unemployment Rate		Youth Unemployment Rate May 2018 (%)	Labour Cost Index[10] Q3 2017 (% Change y/y)
	May 2018 (%)	y/y change (percentage points)		
Bel	6.0	-1.3	17.0 (Mar)	2.3
Fra	9.2	-0.3	20.4	1.9
Ger	3.4	-0.4	6.1	2.5
NL	3.9	-1.2	6.9	2.2
It	10.7	-0.7	31.9	-0.1
Spa	15.8	-1.5	33.8	1.9
Euro Area	**8.4**	**-0.8**	**16.8**	**2.0**
Den	5.2	-0.5	10.1	1.8
Swe	6.2	-0.6	15.5	2.0
UK	4.3	-0.3	12.0	4.3
EU28	**7.0**	**-0.7**	**15.1**	**3.0**
Nor	3.7 (Apr)	-0.8	8.9 (Apr)	2.2
Swi	4.9 (Q1)	-0.1	8.8 (Q1)	n/a

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

Eurostat figures indicate that nearly 13.6m people were unemployed in the euro area during May. This was 0.9% lower than in the previous month and 8.4% below the May 2017 total of 14.9m. 8.4% of the labour force were unemployed, unchanged on the month, but down from 9.2% a year earlier and a 2013 peak of 12.1%. Furthermore, this was the lowest rate since December 2008. At the EU28 level, 17.2m people, or 7.0% of the labour force, were unemployed in May, down from 19.0m and 7.7% a year earlier. At this level, it was closing in on its record low of early 2008. The apparent softening of economic growth in 2018 has yet to affect the labour market, with every Member State reporting a lower unemployment rate in the spring of 2018 than twelve months before. In addition, the number of countries where it stood at 5% or below doubled from seven to fourteen.

Across Scotland's main red meat export markets, the healthy declines in unemployment seen through 2017 have continued into 2018. For example, after an average year-on-year decline of around 9% in 2017 in Belgium, Germany and Denmark, average declines were a respective 19%, 10% and 14% in the first five months of 2018. The pace at which unemployment has been sliding also picked up from 2% to 7% in Sweden, and from 19% to 22% in the Netherlands. Even Italy, where the economic recovery has lagged other countries, unemployment has been falling, averaging 3% in 2017 and 4% so far this year. However, the fall in unemployment has slowed slightly from around 12% through 2017 to 10% this year in Spain and Norway, and from 6% to 2% in France. By May 2018, unemployment rates had slipped to 5% or below in Denmark, Germany, Norway, Switzerland and the Netherlands, and stood at around 6% in Belgium and Sweden. However, unemployment remained elevated at 9% in France, 11% in Italy and 16% in Spain.

Headline unemployment rates can however mask some considerable differences within a country and this is reflected in Eurostat's regional unemployment figures for 2017. 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 3.1% in Bolzano in the Alps, but as high as 22% in Calabria on the southern

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

tip of the mainland. By contrast, unemployment rates in Sweden ranged from 5.9% to 8.4% and Denmark's regions were all between 5.3% and 6.1%.

In addition to the official Eurostat data, the monthly Euro Zone PMI surveys provide a source of information on labour market trends. In Q2 2018, the reports remained optimistic in both the manufacturing and services sectors. While growth in orders and output had slowed in recent months, there had been no let-up in hiring as firms were still dealing with growing backlogs.

Over the past year there have been welcome signs of a lift in wage growth in the euro area, with Eurostat estimating that private sector wages and salaries have been growing at an annual rate of 2% since Q2 2017. For the wider EU28, wage growth firmed from around 2.5% in 2017 to 3% in early 2018. These compare favourably against 2013-17 averages of 1.6% for the euro area and 1.9% for the EU as a whole. They were also above headline inflation in Q1 2018, leading to increased wages in real terms. Higher wage growth may indicate that a tightening labour market due to growing economic activity has raised the pay settlements required to keep existing, and attract new, staff.

Divergence in salary increases across the EU remained in Q1 2018, with wage pressures proving considerable across much of Eastern Europe, but more muted at around 2-3% in the wealthier economies. Belgian private sector workers saw their best quarter for five years, while Spanish wage pressures picked up strongly to reach a six-year high. Meanwhile, wage growth remained above its five-year average in Denmark, France, Germany and the Netherlands. However, wages grew at a slightly slower pace than their five-year average in Norway and Sweden, and a weak Italian economy saw wages decline relative to a year earlier for a second quarter.

Consumer Trends:

Selected statistics - prominent Scottish red meat markets					
	Retail Sales Volumes: non-food ex. fuel May 2018 (% change y/y)	Retail Sales Volumes: food, beverages & tobacco May 2018 (% change y/y)	Consumer Sentiment (% balance)		Actual Individual Consumption (EU28 = 100)
			Jun 2018	Dec 2017	2017
Bel	-0.2	+0.1	-1.6	+1.8	112
Fra	+3.5	+3.4	-10.5	-3.9	109
Ger	+0.2	+1.5	+4.6	+6.1	122
NL	+2.9	+3.5	+17.1	+18.3	110
It	-0.5	-0.1	-3.2	-6.4	98
Spa	+0.3	-0.6	+1.8	-1.5	90
Euro Area	**+1.6**	**+1.7**	**-0.5**	**+0.5**	**105**
Den	+5.5	+1.6	+16.0	+16.1	112
Swe	+3.1	+3.3	+13.6	+16.7	109
UK	+5.5	+1.9	-7.0	-7.0	114
EU28	**+2.8**	**+2.0**	**-1.3**	**-0.6**	**100**
Nor	+6.0	+3.1	+19.6 (Q2 18)	+18.3 (Q4 17)	132
Swi	-1.1	-0.3	+2 (Q2 18)	-2 (Q4 17)	126

Sources: Eurostat; European Commission; Finans Norge; SECO

Inflation-adjusted household disposable income per person rose by 0.3% in Q4 2017 in the euro area. This was down from the previous two quarters but maintained an annual rate of increase of around 1.5%, in line with 2016 and up slightly on 2014 and 2015. Rising wages underpinned incomes in late 2017, with a 0.6% quarterly growth rate the strongest in almost ten years, while property income and social benefits receipts edged up. Taxes deducted slightly less from incomes than in the previous quarter, but higher inflation turned a 0.7% money income increase into the 0.3% real terms increase. Despite real disposable income increasing, consumption is estimated to have stagnated in real terms during Q4 2017, its weakest performance since it last fell in early 2013 and down from average quarterly increases of 0.4% earlier in 2017. Given this context, the euro area household savings rate picked up in Q4 2017, reaching 12.2%. This was up 0.2 percentage points on the quarter and at its highest since Q3 2016.

Moving on to consumer confidence, the EU Commission's monthly survey has shown a slight deterioration in H1 2018, driven mainly by increased pessimism about the general economic environment plus some weakening in job security. The overall balance shifted from slightly positive to slightly negative in the euro area and became slightly more pessimistic in the EU as a whole. Nevertheless, both indicators remained considerably better than their 2013-17 averages of -7.4 for the EU and -9 for the euro area. In terms of Scotland's main red meat export markets, confidence changed little during H1 2018. France was the main exception, with confidence slipping to an 8-month low, largely down to fears over the performance of the French economy in the next year.

Euro area retail sales, in real terms, have been on a steady upwards trend since 2013. In the first five months of 2018, the average year-on-year growth rate was 1.6%, with the May reading at 1.4%. Non-food stores performed slightly better than average, once vehicle fuel has been excluded, rising by an average of 2.2% in early 2018, and 1.6% in May. Food, drinks & tobacco stores have reported an average volume increase of 1.2% in the opening five months of 2018, with May coming in at 1.7%. At the wider EU28 level, non-food has outperformed the euro area, while food, drinks and tobacco have shown slower growth. In Scotland's main red meat export markets, non-food has generally out-performed food this year. Food, drinks and tobacco stores have seen growth of around 1% so far in 2018 in Germany, Sweden, Norway and Switzerland, with sales declining by around 1% in Belgium, Denmark, Spain and Italy. France has been the one exception, posting an average increase of nearly 3%. In non-food, Belgian and Swiss retailers have seen little improvement on last year and Germany showed weak growth of 1.6%. Elsewhere, volumes have risen by 3-4%, except for Italy where they have been sliding by around 1%. Markit's monthly Eurozone Retail PMI survey has shown a lift in May and June following a challenging Easter. This improvement was centred on Germany, with French and Italian retailers still faceing headwinds.

Summary

Following the promising signs of economic recovery in 2015 and 2016, the European economy made further progress in 2017. Although overall GDP growth weakened at the beginning of 2018, consumption and investment indicators held firm. Private sector surveys have continued to signal a weakening from 2017 levels of output growth into Q2 2018, but firms have continued to hire new staff. Except for in Italy, the economic indicators are generally positive, with a tightening labour market supporting a healthy level of wage growth. However, while rising energy prices have pushed up the cost of living in May and June, underlying inflation has remained stable, suggesting that consumer demand remains sluggish despite some growth in real wages.

What has been happening to economic policy in the EU?

Monetary Policy:

The Governing Council of the European Central Bank (ECB) left its interest rates unchanged in June: the main deposit rate at -0.4%, the refinancing rate at 0%, and the marginal lending facility at 0.25%.[11] However, the monthly programme of asset purchases (QE) is to be halved to €15bn (£13bn) in September before ceasing at the end of 2018. It has been judged that a tightening labour market is beginning to generate some upwards pressure on wages, but that since underlying inflation remains sluggish, there is a continuing need for loose monetary policy to help sustain the recovery of domestically generated inflation. This was reinforced by guidance that interest rates are unlikely to change in the coming 12 months while returns on its stock of assets will continue to be reinvested.

ECB monetary data for May showed that euro area broad money growth remained relatively stable at around 4% 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 close to 6%. Meanwhile, lending to households and non-financial companies grew at annual rates of 2.9% and 3.6% respectively. In the household sector, year-on-year growth in consumer credit held firm at over 7% in May while mortgage lending continued to grow by 3%. However, small business loans contracted by 1.2%. Lending to non-financial corporations grew strongest for medium-term loans of one to five years, up 4.1%, with short-term lending up 3.3% and long-term lending by 2%.

Outside the euro area, Sweden's central bank has judged it necessary to hold its main interest rate at -0.5% to keep inflation at its targeted rate. The Swiss target range for interest rates has also remained below zero, with this having the additional effect of ensuring currency weakness supports inflation. Norway's main interest rate remains at 0.5% for now, but is expected to rise in September.

Fiscal Policy:

In 2017, the European Commission had recommended that the euro area as a whole should switch towards a 'positive fiscal stance' to support the recovery in economic growth[12]. However, following encouraging signs of economic performance during the year, its guidance for 2018 changed back to a recommendation for a 'neutral fiscal stance'. This allows countries with healthy public finances to boost spending on investment, while those with high debt and deficit levels continue to focus on returning public finances to a sustainable footing under the Stability and Growth Pact[13]. Meanwhile, the overall recommendation is for a change in budget composition towards investment, to underpin short-term and longer-term growth.

In its Spring 2018 economic forecast, the EU Commission estimated that euro area government spending rose by 1.2% in 2017 and will rise by 1.6% this year, before easing to 1.4% in 2019. Public investment is expected to grow in line with GDP this year, stabilising at 2.6% of euro area GDP.

Summary

Signs of rising wage pressures across the euro area have led the ECB to announce a further reduction and then ending of its asset purchase scheme. However, with only a gradual rise in underlying inflation expected, interest rates remain at very low levels. Government spending is expected to grow at a faster pace this year, with a bias towards investment.

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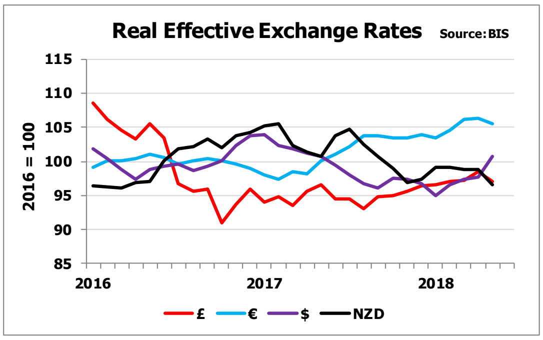
[11] The ECB has three main interest rates. The deposit rate is the interest rate a bank receives on the money it holds overnight at the ECB; the refinancing rate is the interest rate charged to a bank for lending from the ECB for one week; and the marginal lending facility is the interest rate on overnight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

[12] https://ec.europa.eu/info/sites/info/files/economy-finance/com-2017-770-en.pdf

[13] A maximum budget deficit of 3% of GDP, and 0.5% of GDP once the economic cycle has been adjusted for.

A focus on exchange rate movements

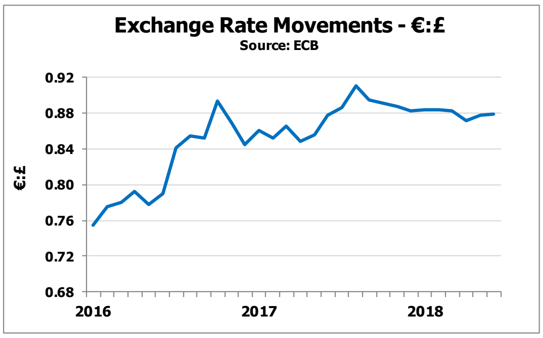


On a trade-weighted basis, sterling has been relatively stable since a short time after the EU referendum of June 2016. However, it did firm slightly in H1 2018. During May, it was 0.5% stronger than a year earlier, but was still 8% short of its May 2016 level.

The euro strengthened in the summer of 2017 after populists failed to win elections in the Netherlands and France and a strengthening economy resulted in a shift towards tighter monetary policy. After stabilising for a number of months, the euro rose again this spring, leaving it up 5.4% year-on-year in May.

The US dollar drifted lower through much of 2017. The combination of global political tensions and prospects for a faster pace of monetary tightening than previously expected then gave the dollar a boost in May 2018, returning it to its year earlier level. However, the NZ dollar was 4% lower than a year earlier, having found a new level after a change of government last autumn.

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



The rebalancing of sterling against the euro which followed the EU referendum has persisted. This reflects reduced expectations for future UK economic growth and returns on investment due to the future prospect of increased barriers to trade.

The last significant move in the sterling to euro exchange rate took place through the summer of 2017 and into the autumn. Sterling initially weakened around the time of the UK General Election as the loss of the Government's majority introduced uncertainty into the process of passing legislation relating to the UK's EU withdrawal. There was also uncertainty regarding the progress of exit negotiations, with agreement on the first stage of talks being delayed.

On the monetary policy side, August saw a change in expectations, with reduced economic growth and inflation forecasts indicating a delay to monetary tightening in the UK. For a short period, the euro rose to be worth 91p. However, the outlook for UK monetary policy quickly reversed, and it became apparent that the emergency cut in Bank Rate implemented after the EU referendum was to be reversed. By the time Bank rate was raised in November, sterling had recovered the ground it lost in August, and a euro was valued at 88p.

Since last autumn, there have been no major shifts in the exchange rate with the euro. Political and economic developments on both sides of the Channel have led to only small fluctuations and the euro has been worth 87-89p for more than eight months. Between January and May, this left the euro generally 2-4% weaker than a year earlier, and then little different to a year ago in June and July.

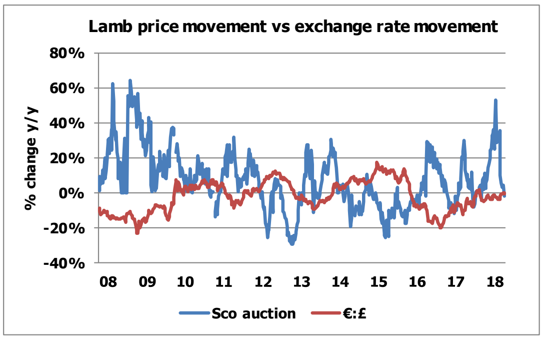
What influence does movement in the €:£ have on the red meat industry?

During 2017, 86% of UK red meat exports by value were sold within the EU while 84% of imports came from Member States. An historically weak sterling was one factor behind a 10% rise in the average sterling price of imports and exports, thereby providing a significant tailwind to the UK red meat market. The volume of UK red meat exports to the EU rose by 4.5% in 2017, with a 3% higher average euro price translating into a 10% sterling terms increase, raising export revenues by 15%.

With the value of sterling averaging slightly lower than a year earlier in H1 2018, this has provided some further support to the competitiveness of domestic red meat products both at home and overseas, most notably in price sensitive markets. In addition, domestic products have remained significantly more competitive than prior to the EU referendum. With the impact of an exchange rate movement able to be shielded by hedging of exchange rates and fixed price contracts in the short-term, over time the beneficial competitive boost from the weaker sterling becomes more evident. However, 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 in the short-term.

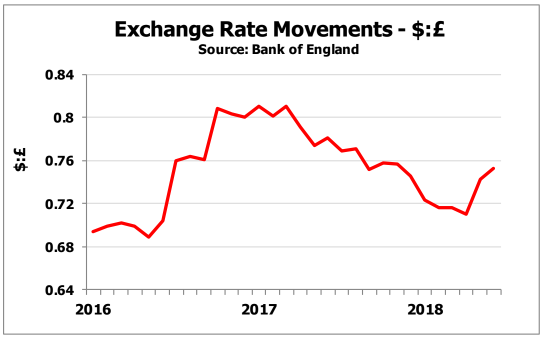
On the export side, a weaker sterling requires fewer euros for the same sterling price. Therefore, a British exporter could reduce their charge in euros while holding their sterling price constant. In a price sensitive market, the subsequent increase in sales volumes would boost sterling revenues. The 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 2017, the conversion rate was the average exchange rate in September. Since the euro rose to £0.8947 compared with £0.85228 in 2016, an average Pillar I support payment of around €30,000 would have been worth £26,840 in 2017 compared to £25,570 in 2016; an increase of 5%[14].

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



2017 saw much of the rebalancing of sterling against the US dollar that followed the EU referendum being reversed. Initially, the election of Donald Trump as US President led to expectations of a boost to the US economy from increased spending on public infrastructure and a reduction in taxes. However, it quickly became apparent that the new President would face challenges in passing legislation, lowering the prospect of fiscal stimulus in the US and easing the

[14] Scottish Government Agricultural Subsidy Payment Information indicates that 18,435 businesses received Pillar I funds totalling £405.5m in the October 2015 to October 2016 CAP year. At the 2015 conversion rate, this would be €554.6m, averaging €30,000 per business.

expected path of interest rate increases. In addition, it then became apparent that the BoE was highly likely to raise interest rates at its November meeting, and sterling firmed a little further.

Perhaps surprisingly, when legislation proposing tax cuts eventually did gain approval in both houses of the US Congress towards the end of 2018, there was no significant rebalancing of the dollar. The Federal Reserve also raised interest rates in December, without significant exchange rate implications. When it did shift in January, it fell sharply. This saw the dollar valued at a 20-month low of 72p. This move occurred against a range of currencies, reflecting financial markets adjusting to expectations that other central banks would begin to tighten monetary policy in 2018, while Germany's central bank announced plans to add Chinese currency to its reserves, which would have consequences for its holdings of US dollars.

After more than three months trading at 70-72p against sterling, the dollar then began to recover in mid-April, climbing to 75p by the end of May and then settling at around 76p in June and July. This boost in the dollar value appears to have been driven by economic and political factors. On one side, domestic economic data from the US has firmed. In particular, inflation has picked up more strongly than expected, suggesting that a faster degree of monetary tightening may be required, and interest rate setters have raised their projections for the level of interest rates in 2018 and 2019. A second driver of the dollar has been heightened geopolitical tensions, with the cancelation of the Iran nuclear deal and imposition of protectionist trade measures by a range of countries raising the dollar's safe-haven appeal. After a prolonged period of year-on-year strength against the US dollar, by mid-July, sterling was little different to its year earlier level.

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. Therefore, a period of strength against the dollar had been helping ease some of the pressure of rising dollar commodity values on input costs until recently.

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.

For much of the 14 months following on from the EU referendum, the NZD traded at 55-57p, compared to an average of around 50p in the five years prior to the vote. On average, this meant that the NZD was 13% stronger. However, towards the end of September, it was then the turn of NZ politics to place some downwards pressure on its exchange rate. Firstly, the centre-right government lost its electoral majority. Then, in mid-October, there was a surprise announcement that the centre-left opposition would take over and lead a new coalition government. With this potentially leading to a significant change in economic and trade policy, the NZD fell considerably and, by November, it was worth around 52p. Since then, there has been no further rebalancing, with the NZD trading in a narrow range of 51-52.5p.

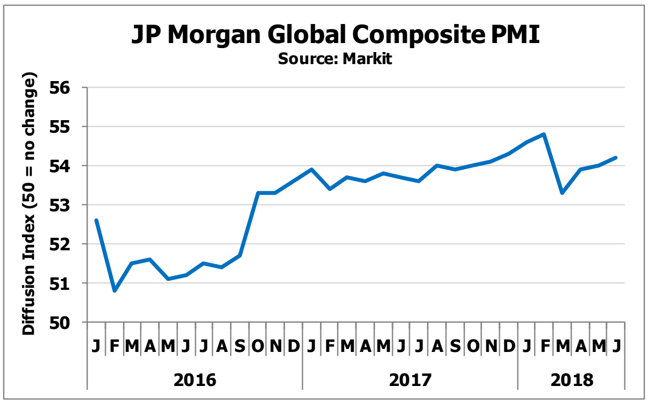
In mid-July, the NZD traded 9% weaker against sterling than a year earlier, giving some support to the competitiveness of the country's lamb exports to the UK. However, this is within a context of it rising significantly in price over the past couple of years. The NZ Farmers Weekly quotes an export price for a leg of lamb for the UK market and, in NZD, it was 8% dearer in the second week of July than twelve months before. After converting into sterling, it was 2% cheaper year-on-year at £4.59/kg. Nevertheless, compared to two years ago, lamb legs were 17% more expensive in sterling, and the ONS RPI index shows that the past rise in the cost of imported lamb has continued to pass into retail prices, with June the ninth consecutive month of double-digit increase. Meanwhile, in July 2018, NZ farmgate prices remained higher than twelve months before in NZD and sterling terms.

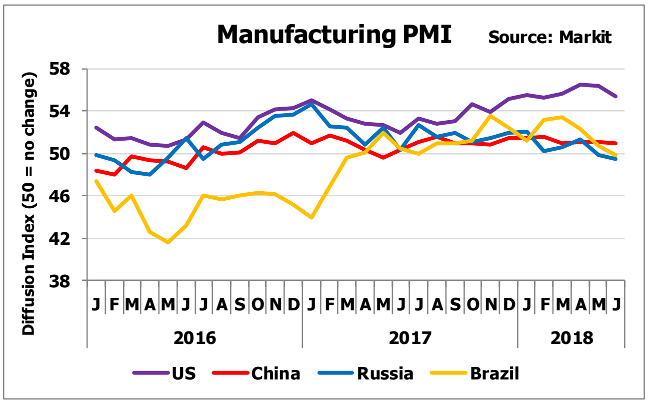
Economic Outlook

UK

General Economic Climate:

Domestic consumption growth is likely to remain muted as although a firm labour market should continue to underpin wage growth, a rise in the cost of energy is passing through to consumer prices. However, the political and economic uncertainty related to Brexit may continue if the conclusion of the withdrawal agreement between the UK and EU slips to December from the previously expected October conclusion, potentially leading to further delays in some major business investment projects.





During H2 2018, a weak sterling and firm economic growth in the world's advanced economies should sustain export demand from the UK's largest markets. However, rising protectionism could begin to negatively impact global trade volumes. The IMF has forecast global economic growth of 3.9% in 2018, up from 3.8% in 2017 and 3.2% in 2016, but has warned that this upturn is temporary.

Economic Activity:

Between February and May the BoE downwardly revised its forecast for UK GDP growth in 2018 to 1.4% from 1.8%, largely down to weather-related constraints on activity in Q1, but also reflecting weaker productivity growth than anticipated. However, underlying activity growth is expected to stabilise at just over 0.4% per quarter, pushing up GDP by 1.75% in 2019. Consumption is expected to continue lagging overall economic growth, with exports and investment driving the upturn, helped by a 21-month implementation period where UK-EU trade rules are unchanged.

Inflation:

The BoE has revised down its forecast for CPI in Q4 2018 to 2.2% from 2.4%, before edging lower next year. This revision reflects the weaker pass-through of past increases in import prices. Going forward, rising energy prices and labour costs should be partially offset by productivity growth.

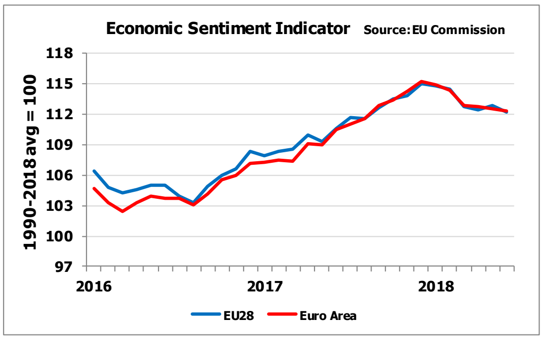
Labour Market:

BoE projections point towards slower labour supply growth compared to recent years as the population ages and net migration falls. However, demand for staff is likely to remain firm, maintaining downwards pressure on the unemployment rate, which is forecast to ease to 4% by the year-end. A tight labour market is likely to underpin average earnings growth through retention pay awards and greater competition for staff, lifting it to around 2.75% this year and above 3% in 2019.

Monetary Policy:

Following its June MPC meeting, the BoE stated that some monetary tightening is likely to be required to keep inflation from exceeding its target over the next couple of years, as growth in demand is expected to run ahead of domestic supply. The May Inflation Report had an increase in Bank Rate to 0.75% factored in for late 2018/early 2019 and another 0.25% lift in H2 2019. June's MPC minutes stated that a reduction in the stock of asset purchases is unlikely until Bank Rate has reached 1.5%.

EUROPE



In its spring forecasts, the European Commission upwardly revised its 2018 and 2019 economic growth estimates for the euro area and wider EU27. In 2018, GDP is forecast to grow by 2.3% in both the euro area and wider EU27, compared with respective autumn 2017 forecasts of 2.1% and 2.0%. For 2019, forecasts have been increased from 1.9% to 2.0% for the euro area and from 2.0% to 2.2% for the EU27. Although private sector surveys have fallen back from their strongest position for many years, they have remained at a level which points to robust economic confidence feeding into continuing activity growth.

Despite unemployment continuing to fall at a fast pace and wage growth firming, domestic consumption is forecast to continue lagging overall economic activity growth. This reflects that unemployment rates remain relatively high in many countries and economic confidence remains sluggish. High stocks of public debt built up in the aftermath of 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, given the low interest rate environment, business investment is forecast to grow strongly, helped by a robust global economy providing exporting companies with the confidence to invest.

The strength of economic activity in the euro area is expected to result in further progress in the labour market recovery, as firms adapt to higher order levels and workers re-join the labour market. Total employment is anticipated to rise by 1.3% in 2018 and 1.1% in 2019, down from 2017, but broadly in line with long-term historical averages. As a result, the unemployment rate is forecast to slide from 9.1% in 2017 to average 8.4% this year and then slip below 8% in 2019. Wage pressures are expected to build this year, returning close to historical averages, before weakening to just under 2% in 2019. With inflation forecast to stabilise at around its target level of close to but below 2%, this should deliver some modest real-terms growth to household disposable income.

At a country level, Belgium, France and Germany are expected to see GDP grow at an annual rate of around 2% in H2 2018, with stronger performance of 2.5-3% in Denmark, the Netherlands and Spain. However, Italy is forecast to remain a laggard and Swedish activity is expected to cool, with a past expansion of the construction and housing sector anticipated to come to an end. Growth of closer to 1.5% has been forecast in both of these countries. Employment gains are generally estimated at around 1% in 2018 and 2019, with the Netherlands and Spain expected to out-perform this average. Despite further progress, unemployment rates will remain elevated above historical averages in Spain, France and Italy, but will be considerably lower in Germany.

Monetary policy is expected to tighten slightly in H2 2018 as the ECB winds down its asset purchase scheme further. However, its guidance indicates no change in interest rates until next summer at the earliest. Meanwhile, a neutral fiscal stance and its emphasis on 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 2018. Growth rates are likely to be lower than last year, but remain above the average of recent years. However, consumer spending is likely to remain relatively subdued with business investment remaining the principal tailwind for the economic recovery, supported by low interest rates and export demand. Unemployment is likely to fall further throughout Scotland's main red meat export markets and core inflation is likely to hold steady. Monetary policy will continue to support the economic recovery.

GDP growth forecasts for prominent Scottish red meat markets					
	Q2 18	Q3 18	Q4 18	2018	2019
	% change q/q	% change q/q	% change q/q	% change y/y	% change y/y
Bel	0.5	0.5	0.5	1.8	1.7
Fra	0.4	0.5	0.5	2.0	1.8
Ger	0.6	0.6	0.5	2.3	2.1
NL	0.7	0.7	0.7	3.0	2.6
It	0.3	0.4	0.3	1.5	1.2
Spa	0.7	0.7	0.6	2.9	2.4
Euro Area	**0.5**	**0.5**	**0.5**	**2.3**	**2.0**
Den	0.7	0.7	0.7	1.8	1.9
Swe	0.6	0.4	0.4	2.6	2.0
EU27	**0.6**	**0.6**	**0.5**	**2.5**	**2.2**
UK	0.4	0.4	0.3	1.5	1.2

Source: EU Commission (European Economic Forecast, Spring 2018)

Other economic forecasts for prominent Scottish red meat markets in 2018				
	Unemployment Rate	Inflation (HICP)	Domestic Demand	Investment
	%	% y/y	% change y/y	% change y/y
Bel	6.4	1.6	1.8	4.0
Fra	8.9	1.7	1.8	3.7
Ger	3.6	1.6	2.1	3.2
NL	3.8	1.6	3.1	5.2
It	10.8	1.2	1.5	4.8
Spa	15.3	1.4	2.7	4.6
Euro Area	**8.4**	**1.5**	**2.1**	**4.2**
Den	5.5	0.8	2.0	3.8
Swe	6.3	1.9	2.4	3.7
EU27	**6.9**	**1.6**	**2.3**	**4.5**
UK	4.4	2.5	1.3	2.1

Source: EU Commission (European Economic Forecast, Spring 2018)

Exchange Rate Movements

€:£

The rebalancing of sterling following the vote to leave the EU seems highly likely to persist. Going forward, the likely degree of closeness to the current trading relationship between the UK and the EU will be a significant factor in determining movements in the sterling exchange rate. The UK Government's stated aim for negotiations appears to be one of an initial implementation period of 21 months where the current trade relationship will continue to apply, followed by a free trade agreement for goods and agricultural products with as few trade frictions relative to now as possible. It is possible that signs of a deal on these, or similar, terms may give some support to sterling, pushing it towards the low 80s. However, if developments point towards a scenario without a free trade agreement and relying on WTO rules, then the exchange rate could slip back into the 90s. In Q4 2018, the UK and EU will have to finalise the withdrawal agreement and, as well as the approval of the UK Government and EU Council, this will require the support of both UK and EU Parliaments. Around this time, sterling is likely to be sensitive to the news flow and statements from important participants. Related political developments could also have an impact on sterling.

Monetary policy stances held by the BoE and ECB are also likely to have an impact on exchange rates. The value of sterling will gain support from BoE communications signalling a further lift in interest rates and vice versa. Meanwhile, ECB communications pointing towards an earlier interest rate increase than signalled by current guidance 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.

$:£

Developments in the Brexit process and monetary policy are likely to influence sterling's relationship with the US dollar. The closer the likely future trading relationship between the UK and EU, and the higher the probability of a further UK interest rate increase, the stronger sterling is likely to be.

With the US economy growing at a firm pace and its labour market tightening, the US Federal Reserve is likely to continue on its current path of monetary tightening. A faster pace of interest rate rises could lead to some dollar strengthening, but if trade protectionism begins to have a negative impact on the US economy, then currently expected rate rises could be delayed, lowering the dollar.

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 continues to underpin import prices for energy, fertiliser and feed prices.

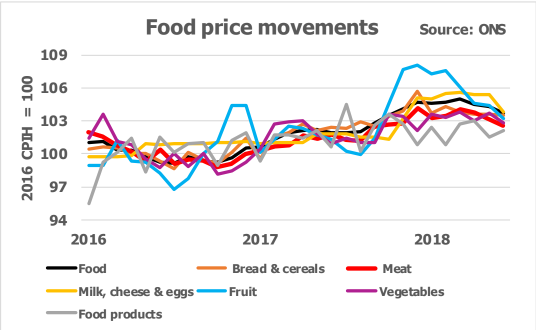
NZ$:£

The Reserve Bank of New Zealand (RBNZ) expects to leave its monetary policy on hold as while domestic economic data has continued to look healthy, inflation has remained stubbornly low. This is likely to place some downwards pressure on the NZD if, as expected, the BoE begins to tighten its monetary stance. However, like with the euro and US dollar, developments in the Brexit talks will be a factor as H2 2018 progresses.

If sterling was to strengthen, it may offset some of the increased cost of importing lamb from NZ due to firm NZ farmgate prices.

What has been happening in the red meat sector?

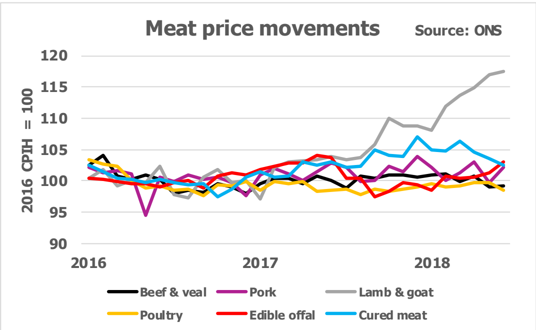
Food Price Inflation:

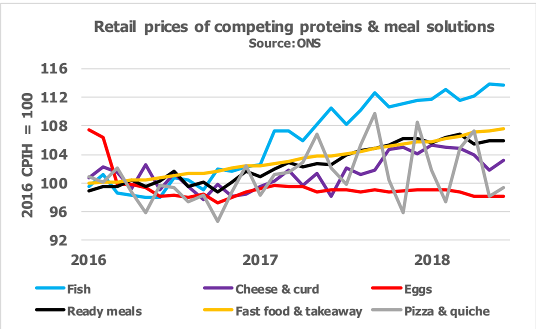


Following a prolonged period of deflation, food prices began to trend higher in the autumn of 2016. Having steadied through the spring and summer of 2017, they began to pick up again in late 2017, before stabilising over the winter. Q2 2018 saw food prices start to ease back and, in June, the cost of food was at an eight-month low, but still 1.7% dearer than a year earlier. Food price inflation had peaked at 4.4% in November 2017.

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. As a result, catering prices rose steadily though the period of food deflation in 2015 and 2016, rising at an annual rate of around 3%. This has continued into 2018, with prices up 2.9% year-on-year in June.

Having trended lower for most of 2016, meat prices rebounded in 2017, ending the year around 4% higher than they had started it. Prices then lacked direction in the first four months of 2018, before cooling in May and June. This fall left the average cost of meat 0.8% dearer than a year earlier in June. Since mid-2017, the price trends for different types of meat have diverged significantly. Most notably, the cost of sheepmeat has risen significantly, reflecting higher farmgate and import prices, to be up 13.2% year-on-year in June. By contrast, beef, pork, offal and cured meat products were all cheaper than last year by 0.4-0.8%, while the cost of poultry was only a fraction higher.

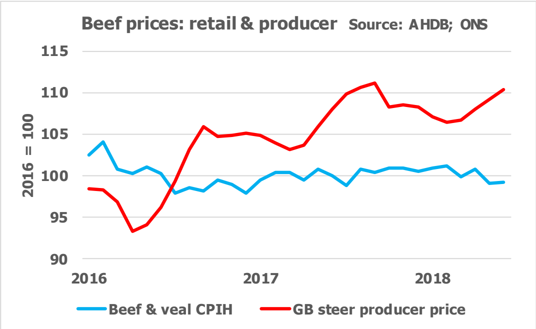




Retail prices for competing proteins have shown significant divergence since the beginning of 2017. Cheese and fish prices trended significantly higher through 2017 before rising more gradually in early 2018. By contrast, egg prices have been edging lower for eighteen months. In June 2018, cheese and fish were up by a respective 5.1% and 2.9% on the year, whereas eggs were 0.9% cheaper. Meanwhile, the cost of pizzas and quiche has been highly volatile from month-to-month, while lacking an overall direction of travel. The cost of ready meals followed the general trend in food prices higher through 2017, suggesting a quick pass through of increased raw material costs, before steadying in H1 2018, whereas the price of fast food and takeaways have risen at a steady pace, suggesting little link to raw material costs.

Beef:

Since dropping by around 5% in H1 2016, beef retail prices quickly recovered around half of this fall, before steadying for over a year. They then dropped slightly in May 2018 and stabilised in June. This left them trailing year earlier levels by 0.8%. After eighteen months running lower than twelve months before, the beef CPIH had returned to year-on-year inflation in July 2017 and was 1-2% above year earlier levels between August and January, before easing back again. Meanwhile, GB producer prices have been averaging higher than a year earlier since September 2016. This year-on-year increase peaked at 12-13% in May and June 2017, but had eased to around 3-4% by September, holding at this level until May 2018. Since May, producer prices have risen more slowly than last year, reducing the year-on-year premium to around 1% in early July. However, they have been running around 4-5% ahead of their 2013-17 average. In the second week of July, prime cattle averaged 385p/kg dwt in Scotland and 362p/kg in England & Wales.

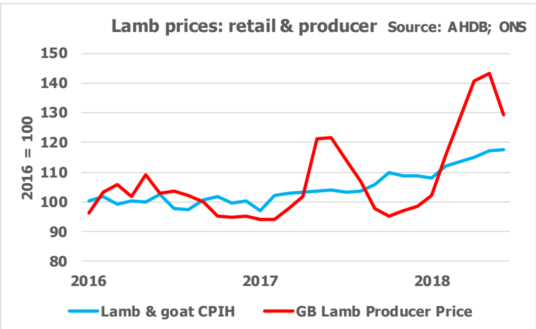


Over a prolonged period, the average beef retail price tends to stabilise. Given the context of a sustained year-on-year increase in farmgate prices, it is therefore interesting to observe the lack of retail price inflation over the past couple of years. This suggests that the supply chain has been willing to absorb higher farmgate values, in order to maintain price competitiveness.

In the ONS' RPI dataset, prices for a range of cuts are published each month. In June, mince was 5.8% cheaper than a year earlier at £7.01/kg. This followed a significant price cut in February, and a drift lower thereafter. Topside was also significantly cheaper than last year, down 3.9% at £10.95/kg, but its price tends to be volatile from month-to-month. By contrast, rump steak was 0.6% more expensive than last year; though it was cheaper than in any month between July and April.

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 51.5% of the average retail price. This was 0.3 percentage points lower both on the month and on the year. However, it was 1.6 points above the five-year average for June. The average beef retail price was estimated to have risen by 2.6% year-on-year to £7.18/kg.

Lamb:



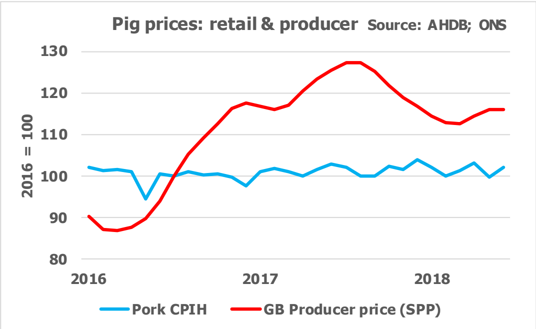
Following two-and-a-half years of relative stability, lamb retail prices made a step change in the autumn of 2017. They then increased again in the spring of 2018, before rising further at the start of the new season in May and June. This suggests that the higher level of farmgate and import prices of 2016, 2017, and early 2018 have been passed through into retail prices, with the supply chain aiming to offset the pressure on margins from rising raw material costs. Evidence from the RPI inflation dataset suggests that the rise in lamb retail prices in the second half of 2017 was driven by imported lamb, while the further increases in 2018 have been down to both home-killed and imported lamb. Indeed, the monthly average RPI inflation for home-killed lamb averaged 2.7% in H2 2017, 3.8% in Q1 2018 and then 11% in Q2, while for imported lamb, inflation has been averaging 10-15% since the autumn of 2017. Following the highs of this spring, year-on-year growth in GB farmgate prices cooled in June to average 2% higher than last year, while NZ prices were around 8% higher in sterling terms.

The seasonality of GB 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, and a more limited squeeze in the early part of the calendar year. However, the opposite can be true in the autumn. Now that farmgate prices have fallen back more closely in line with year earlier levels, it is possible that the recent uplift in retail prices could come to an end. However, this may depend on to what extent margins were squeezed in the spring and the level of repair deemed to be required. Though this will have to be balanced against the willingness of consumers to pay higher prices.

In contrast to the average retail price of home-killed lamb, June's ONS retail price dataset indicates that lamb loin chop/steak was 1.3% cheaper than a year earlier at £13.42/kg. However, it did still average above its average for the previous 12 months. By contrast, the cost of bone-in shoulder was up 15.1% on the year at £8.92/kg and imported frozen legs were priced 10.3% higher at £8.24/kg.

According to AHDB, the lamb producer price was equivalent to 59.5% of the average lamb retail price in June. Due to the seasonal pattern of farmgate prices, this was a four-month low, and it was 6.3 percentage points below its May level. In addition, it fell behind year earlier levels for the first time since October 2017, down 0.8 points. However, it was 3.3 points above the five-year average for June. AHDB's estimate of the average retail price was up by 7.5% year-on-year at £8.82/kg.

<u>Pigmeat</u>:



Back in late 2015 and early 2016, pork retail prices fell by around 5% in a short period of time. Since this rebalancing, prices have lacked overall direction. While some month-to-month fluctuation can lead to inflation rates well above or below zero, the average for H1 2018 reflected the stable trend, coming in at only 0.1%. May and June readings were both in negative territory, with deflation of -1.7% in June. Despite prices settling at a lower level, consumption of fresh pork has struggled, with consumers substituting it with processed pork and poultry. While the sharp uplift in prime pig prices of 2016 and 2017 suggests that wholesale and retail margins may have come under significant pressure, in 2018, farmgate prices have fallen back from their recent highs and have been running slightly behind their 2013-2017 average level. Given subdued demand for pork, this suggests that there is scope for retail prices to continue to trend flat.

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 the summer of 2016 and then steadying. The bacon RPI was up 1.4% year-on-year in June.

Within the ONS RPI dataset, retail prices for bone-in pork loin increased significantly in the spring of 2018, leaving them up 4.5% on the year in June, at £6.50/kg. Though at a six-month low, back bacon was also dearer than last year, up 3.6% at £7.50/kg. Gammon prices have also drifted lower through H1 2018, but remained 0.3% higher than in June 2017. Meanwhile, the cost of a 100-125g pack of ham continued to decline and was, at £1.79, 3.2% cheaper than a year earlier. Pork sausages can fluctuate significantly on a month-to-month basis. They were up 1.6% year-on-year at £4.97/kg.

AHDB estimates that, during June, farmgate pig prices were equal to 39.6% of the average retail price of pork. With farmgate prices rising seasonally, this was a four-month high. Though well behind the June 2017 level of 43.8%, it remained above the five-year average for June of 38.8%. Pork retail prices are estimated to have averaged £3.86/kg in June, which was a year-on-year increase of 2.1%.

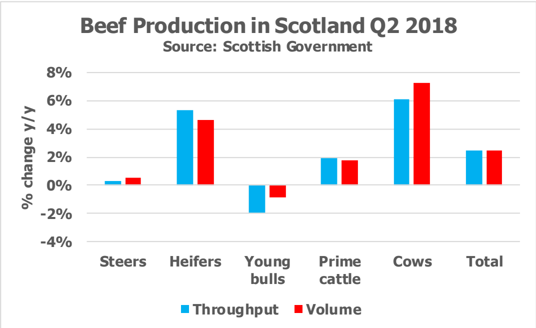
Review and Outlook for Meat Supplies

Beef:

UK beef supply: Q1 2018 (t)			Source: Defra	Totals may not sum due to rounding
	Q1 2018	Q1 2017	Change 2018/2017 (t)	% change 2018/2017
Home Production	230,200	226,100	+4,100	+1.8
+ Imports	87,850	80,050	+7,800	+9.7
- Exports	37,100	32,700	+4,400	+13.4
= Net Supply	**280,950**	**273,450**	**+7,500**	**+2.7**

Home Production

Provisional Defra estimates of UK red meat supplies for Q1 2018 indicate that UK beef production rose by nearly 2% to 230,200t. This was also 2% higher than the five-year average for Q1. Beef production growth was underpinned by a 5% rise in mature cattle slaughter. Meanwhile, prime slaughter and carcase weights rose marginally.



In Scotland, abattoir production fell by nearly 1.5% in Q1. Prime throughput declined by 1% while mature slaughter fell 2% and carcase weights were marginally lighter. Q2 2018 saw a recovery in prime cattle slaughterings to be up 2%. This was driven by a significantly increased heifer kill, up more than 5%, while the steer kill edged higher but 2% fewer young bulls were processed. Steer carcase weights rose marginally on last year while young bulls were up 1%. However, heifers proved 0.7% lighter. Meanwhile, the cow kill returned to growth, rising 6%, and carcase weights picked up.

The slight lift in steer carcase weights in Q2 2018 followed eight quarters of year-on-year declines. This change may signal that the period of carcase weight rebalancing, linked to abattoir disincentives for producers who present animals for slaughter outside the weight range required to meet the product specifications of multiple retailers, has drawn to a close. Nevertheless, an average steer carcase weight of 387kg in Q2 still points to a significant proportion of steer carcases being penalised. Following a prolonged period of declines, the average cow carcase weight rose by 1.1% to 347kg.

Trade

Imports add to domestic beef supplies and during Q1 2018, Defra estimates that UK beef imports exceeded year earlier levels by 9.7%, reaching 87,850t. This followed a near 4% increase in 2017 which took calendar year imports to a record high. The balance of imports continued to shift away from fresh beef, with frozen imports surging by 32% to reach 29,000t while fresh beef volumes edged 1.3% higher to 58,850t. As a result, fresh beef accounted for 67% of imports, down sharply from 72.5% in Q1 2017. Meanwhile, total imports accounted for 31.3% of UK beef supply in Q1, up two percentage points on the year and 1.8 points above the five-year average. HMRC trade data indicates that Irish Republic delivered 12% more beef to the UK than a year earlier, with Ireland's share up 0.7 percentage points at 74.3%, but shipments from Poland and the Netherlands fell by around 10%. Imports from non-EU countries surged by 44%, but remained well below their five-year average.

Exports deduct beef supplies from the UK market. Supported by a weak exchange rate and a slight increase in UK beef production, Defra estimates that total export volumes, including processed products, rose by 13.4% to 37,100t in Q1. This was a seven-year high for the quarter and up nearly

9.5% on the five-year average. In addition, the share of exports in home production rose by 1.6 percentage points on the year to 16.1% - a five-year high for Q1. According to HMRC, sales to Ireland - in part reflecting cross-border supply chains within the British Isles - were up nearly 35% while volumes shipped to the Netherlands were a fifth higher. By contrast, deliveries to non-EU markets contracted by 29%, with shipments to Hong Kong, of mostly low value cuts, sliding by 7%.

Outlook

	GB cattle population: 1 April 2018		**Source: BCMS**	
	Still alive Apr 2017	Still alive Apr 2018	y/y Change	
Calves registered:			head	%
<6 months ago	1,095,850	1,085,100	-10,750	-1.0
6-12 months ago	1,378,500	1,387,400	+8,900	+0.6
12-18 months ago	987,400	971,550	-15,800	-1.6
18-24 months ago	990,350	986,550	-3,800	-0.4
24 to 30 months ago	539,850	542,000	+2,150	+0.4
30 to 36 months ago	400,750	408,300	+7,600	+1.9
Total pool	8,172,550	5,580,250	-38,650	-0.5

Looking forward into H2 2018, prime cattle supply across GB is likely to fall short of year earlier levels. This is based on the population between 12 and 24 months of age plus dairy males aged 6-12 months at April 1 2018 being 1.2% smaller than twelve months before. Dairy-sired cattle will continue to bear down on overall supplies, more than offsetting a small increase in beef-sired males and females. However, if the hot dry weather leads to some early slaughter or a reduction in the retention of heifers, then supply may prove more stable than anticipated in the short-term before tightening later in the year. April's small increase in cattle aged 24-30 months may also provide short-term support.

Given the expectation of a slightly reduced abattoir throughput, the rate of change in prime beef production volumes will depend on the evolution of carcase weights. With carcase weight penalties less likely in the autumn due to a seasonal fall in carcase weights, the rebalancing due to market incentives may have come to an end. However, if the hot dry summer has impacted growth rates, carcase weights may well decline further, adding to the expected fall in throughput in H2.

The December 2017 census pointed to a relatively stable UK breeding herd, so in theory cow throughput should be relatively stable this year. However, UK throughput rose by close to 7% in H1 2018 and, given the challenging summer grazing conditions, a higher rate of culling may continue through H2. This has the potential to offset the expected fall in prime production, resulting in overall stability in UK beef production.

On the trade side, supplies in the Irish Republic are likely to be slightly higher than last year during H2, with the December 2017 census reporting an increase of 0.6% in cattle aged less than two years old. However, an early seasonal slide in cow prices suggests that H2 has begun with an oversupply of manufacturing grade beef, so it is possible that the recent surge in frozen beef imports from Ireland will slow. Meanwhile, a favourable exchange rate may help give a small boost to exports.

To summarise, UK beef production is likely to be relatively stable in H2 2018 with a slight shortfall in prime cattle availability and lower carcase weights being offset by increased cow culling. A well supplied market for manufacturing grade beef may limit import growth in H2, but there is the potential for further export growth.

Sheepmeat:

UK sheepmeat supply: Q1 2018 (t)			Totals may not sum due to rounding	
	Q1 2018	Q1 2017	Change 2018/2017 (t)	% change 2018/2017
Home Production	73,050	70,500	+2,600	+3.7
+ Imports	28,000	28,150	-150	-0.5
- Exports	24,450	22,950	+1,500	+6.5
= Net Supply	**95,350**	**93,150**	**+2,200**	**+2.4**

Home Production

Defra estimates that UK sheepmeat production rose by 3.7% year-on-year in Q1 2018 to reach a ten-year high for the quarter of 73,050t. With a cold wet winter resulting in reduced carcase weights, the overall expansion was driven by higher slaughter. Indeed, while the former fell by nearly 3% to 19.4kg, the latter rose by 7.6% to 3.14m head, as more hoggs were carried into the New Year. Mutton production rose slightly as a 2% increase in numbers was almost offset by lower weights.

At Scottish abattoirs, prime sheepmeat production contracted by 2.9% year-on-year in Q1, with falls of 1.9% in slaughter and 0.9% for carcase weights (to 20.4kg). Production then fell by 19% in Q2 as an earlier Easter meant some slaughter had been brought forward to March, while a challenging spring delayed the arrival of new season lambs on the market. Prime slaughter fell by 15.9% and carcase weights averaged 3.8% lower at 19.6kg. Mutton processing increased from a very low base.

Defra estimates that across the UK, the prime sheep kill fell by 13.5% to 2.6m head in Q2 2018 while carcase weights averaged 1.1% lighter than twelve months before. As a result, prime production fell by 14.4%. With mutton production sliding similarly, total sheepmeat production declined by 14.3%.

Trade

Since imports add to the volume of sheepmeat on the UK market, a 0.5% year-on-year decline subtracted a small volume relative to a year earlier in Q1 2018. They also took a reduced share of home market supply, accounting for 36.6%, down 1.1 percentage points on the year and 4.2 points below the five-year average. HMRC figures indicate that imports from NZ declined by 2.3% and there was a fall of around a fifth from Australia. However, these declines were partially offset by significant growth in shipments from Ireland, the Netherlands and Iceland. Sheepmeat arriving from the Southern Hemisphere continued to prove more expensive than a year earlier.

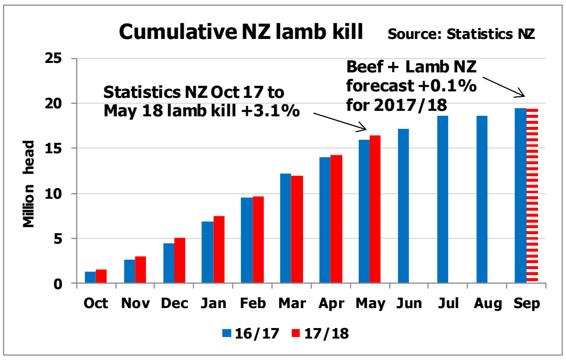
Defra estimates that UK export volumes rose by 7.6% on last year to reach 22,050t in Q1. This was a four-year high and 3.4% above the five-year average. Although a 2.7% contraction in live sheep exports in carcase weight terms did act as a partial offset, total exports removed 1,500t from the home market relative to a year earlier. It should be noted here that most of the UK live sheep trade is exports from Northern Ireland to the Irish Republic for slaughter. HMRC figures indicate that sales to the UK's main customer, France, edged higher, while there was strong growth into most other EU markets, assisted by a favourable exchange rate. Sales to non-EU countries fell and were less than 5% of the total, though Hong Kong provided a growing market for low value cuts, helping processors to balance the carcase.

Outlook

In terms of home production in H2 2018, the tightness of supply in the early weeks of the 2018/19 season is likely to continue. Firstly, the GB ewe flock was estimated to have been almost unchanged year-on-year in the autumn 2017 breeding season. Then, given the challenging winter and spring across many regions of GB, ewe mortality is likely to have increased and productivity is likely to have fallen as ewes in poorer condition are likely to have given birth to fewer twins and triplets than in 2017. Losses at lambing are also likely to have increased. If the ewe flock ended up being unchanged on 2016/17 due to higher mortality, rather than increasing slightly as indicated by the December 2017 census, while the lambing ratio regressed to 2013 levels, when it had fallen sharply after a cold wet winter, then a fall in lamb crop as large as 10% is not out of the question.

As well as the basic supply of lambs, the harsh winter and spring followed by a hot dry summer are likely to have influenced marketing patterns and carcase weights. The average prime sheep carcase weight at UK abattoirs in June was up slightly on last year and, in the auction ring, the proportion of new season lambs weighing outside the 25.5-45.5kg SQQ weight range has risen by 3.2 percentage points in England & Wales and by 7.5 points in Scotland. It is possible that increased mortality and fewer twins have pushed up the carcase weights of those lambs being marketed early in the season and that this trend may eventually reverse as summer moves into autumn, placing some additional pressure on supplies, particularly if the hot dry summer leads to tight grazing availability and slower lamb growth. Meanwhile, it is possible that where lambs born in hill and upland areas did survive, they may be lighter and in poorer condition than usual, delaying their eventual arrival on the market. Furthermore, the summer conditions may see a greater proportion of lambs being traded in the store ring, delaying the traditional marketing profile.

On the demand-side, the sheep market is likely to reach its peak in mid-August with Eid al-Adha being celebrated in the third full week of August, compared to the first weekend in September last year. Higher retail prices for home produced and imported lamb may limit retail demand, but those consumers still buying lamb are likely to be those that tend to shop at the premium end of the market.



Moving on to trade, New Zealand had good lambing in late 2017, but Beef + Lamb NZ have forecast a stable supply of export lambs due to strong prices encouraging a greater replacement rate. A late-2017 drought did however lead to a short-term rush of lambs on to the market, and slaughter rose by 3% year-on-year between October and May. If full season supplies are to flat-line, supply would have to tighten in the coming months, suggesting reduced imports to the UK. If the NZ breeding flock has expanded, imports may begin to rebound in the run up to Christmas and New Year. Though, high prices may limit any increase. Elsewhere, Australian lamb is also more expensive than in the past, while its relatively small quota for the EU (19,600t) places a natural barrier on export shipments to the UK. Like GB, a difficult winter is likely to have restricted Ireland's surplus of lamb for export and slaughter fell by 5% in the eleven-week period from early May to mid-July.

In terms of UK export prospects, a weak sterling will continue to underpin the price competitiveness of UK sheepmeat on the continent, while falling unemployment and rising consumer confidence in Scotland's key EU export markets should support demand. However, tight domestic supply is likely to heavily constrain export opportunities.

In summary, a challenging winter and spring are likely to have resulted in a significantly smaller lamb crop while the hot dry summer may delay the arrival of lambs on the market, with more being sold store. This expected fall in domestic production is also likely to limit exports. Import availability is likely to prove tight in Q3, but it may recover in time for the festive period. However, like home-killed lamb, imported lamb is likely to remain dear compared to the past. The timing of Eid al-Adha means that processor requirements are likely to spike in mid-August, around ten days earlier than in 2017.

Pigmeat:

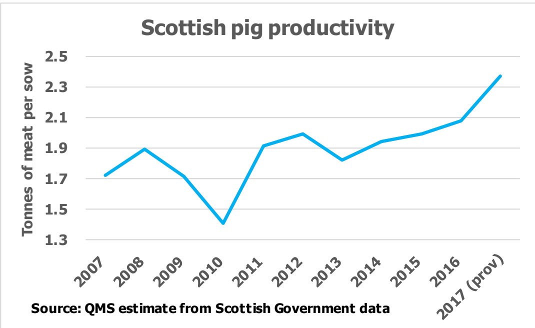
UK pigmeat supply: Q1 2018 (t)				Totals may not sum due to rounding
	Q1 2018	Q1 2017	Change 2018/2017 (t)	% change 2018/2017
Home Production	222,900	214,100	+8,800	+4.1
+ Imports	176,400	210,700	-34,300	-16.3
- Exports	64,600	60,150	+4,450	+7.4
= Net Supply	**334,700**	**364,600**	**-29,900**	**-8.2**

Home Production

Defra estimates that UK pigmeat production contracted by 2.6% in 2017 – its first fall since 2009. However, after four consecutive quarters of year-on-year declines, production recovered in Q4 2017 and rose further in early 2018, up just over 4%. This left it around 3% above its five-year average. Short-lived decline followed by recovery was the lagged impact of the market downturn of late 2014 to early 2016. Slaughter statistics for Q1 2018 indicate that prime slaughter rose by 3.6% to 2.64m head while the sow kill was up nearly 11%. Prime carcase weights averaged 0.5kg heavier than in Q1 2017, at 84.2kg, pushing prime production up by 3.8%, but lighter sow carcases limited the growth in sow meat production to around 8.5%.

In Scotland, Q1 saw prime pig slaughter rise by 7.8% year-on-year to 83,550 head. This was the highest Q1 throughput since the closure of Broxburn abattoir in 2012. However, sow processing is estimated to have fallen back. Moving into Q2 and these trends continued, with the prime kill rising by more than 10% while sow throughput is estimated to have fallen sharply.

At the UK level, Q2 is estimated to have seen a continued rise in prime pigmeat production. Numbers were up 4% on the same period of 2017 at 2.61m, while carcase weights were 0.5kg heavier at 82.9kg. As a result, prime production showed a 4.6% expansion. Meanwhile, sow meat production rose 11% as a higher throughput, by 13%, was once again partially offset by lighter weights.

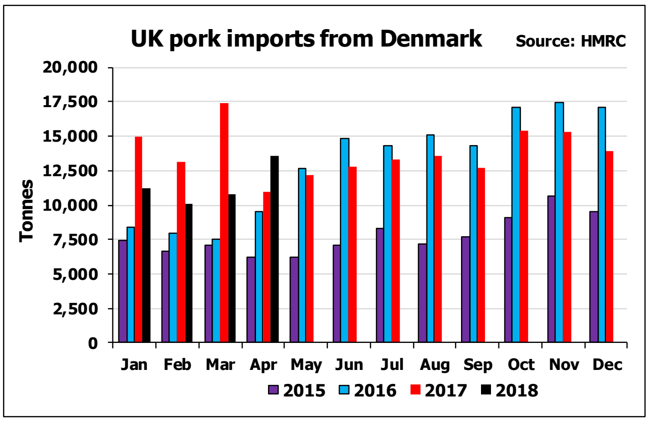


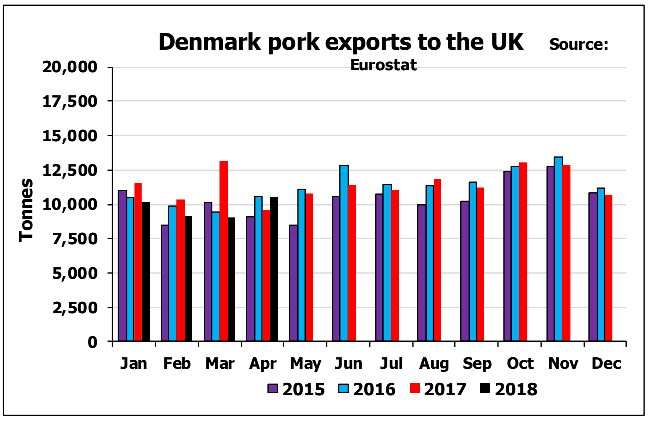
Pigmeat production has trended higher across the UK over the past decade, underpinned by productivity growth. In Scotland, producers have focused on improving herd health and this has delivered benefits in terms of the number of pigs produced per sow and in faster growth rates which have boosted carcase weights. As a result, the volume produced per sow, based on the average number of sows from the June and December census, has risen strongly.

Trade

Imports add to UK supplies and Defra estimates that the volume of pigmeat brought into the UK has fallen back sharply after a surge between Q2 2016 and Q1 2017. The Q1 2018 estimate, of 176,400t, was a year-on-year decline of more than 16%, but it was in line with the Q1 average for 2012 to 2016. At this level in Q1 2018, imports were equivalent to 52.7% of total supply, down 6.1 percentage points on the year, but only half a point below the 2012-16 average for Q1. There has been some scepticism around the 2016/17 surge in imports, as it showed up in UK trade statistics as mostly coming from Denmark, whereas Danish export statistics signalled a much smaller increase, though from a higher base. HMRC data for Q1 2018 points to a 29% fall in imports from Denmark, lowering the country's share of pork imports relative to a year earlier by 8.2 percentage points to 33.8%. However, this volume was still well above the average Q1 imports from Denmark between 2012 and

2016. HMRC figures suggest that while imports from the Netherlands also trailed a year earlier, more pork came in from Germany. Imports of cured pigmeat are estimated to have fallen significantly, as a rise from the Netherlands was more than offset by lower deliveries from Denmark and Germany.





During Q1, UK pigmeat exports are estimated to have grown to a 19-year high for the period, up 7.5% at 64,100t. Since this out-paced production growth, exports were equivalent to 28.7% of output, up 0.9 percentage points on the year and 2.2 points above the five-year average for Q1. According to HMRC, rising exports to Denmark, the Netherlands and Ireland were partially offset by a fall in trade with Germany and a cooling of import demand in China. Nevertheless, China continued to prove an important outlet for lower value cuts of frozen pork, helping carcase balance.

Outlook

The industry consensus is for UK prime pig slaughterings to continue increasing on a year earlier in H2 2018. However, the rate of increase is expected to slow, with a 1.3% increase in slaughter forecast for Q3 and then 1.5% in Q4. Sow slaughterings may also continue to increase, as year-on-year declines in farmgate prices for prime pigs at a time of rising input costs, due to a tighter global market for cereals, encourages culling in an attempt at boosting cash flow and to raise herd productivity further. The evolution of carcase weights will also play their part in the balance of supply, and it is possible that weights will continue to edge higher in H2. However, in the short-term, the hot dry summer may lead to a check in growth rates and hence more stability in carcase weights relative to last year, before edging higher again in the autumn.

On the trade side, imports may be more stable relative to last year in H2 2018 after the sharp decline of early 2018. On the one hand, the renewed gap between UK and EU farmgate prices are likely to support the use of imported product in the UK market, but this may be offset by the continuing exchange rate weakness plus the anticipated lift in domestic production, in a context of steady home demand.

For exports, the historically weak sterling will continue to underpin overseas sales of UK pigmeat and help processors find outlets for the increased production of pigmeat cuts which are less popular in the home market. However, a well-supplied Chinese market may result in a continuing decline in exports to China from the highs of 2016 and 2017. In addition, with EU pigmeat producing nations facing similar market conditions, their import requirements may be constrained.

The signals point towards a well-supplied UK pigmeat market during the second half of 2018. Domestic production is likely to remain above year earlier levels. Meanwhile, export growth may run out of steam as although UK pigmeat is likely to remain competitively priced, Chinese and EU import requirements may cool. Imports may also struggle to match 2017 levels.

Red Meat Sector Outlook

- The UK economy appears to be in a slower-growth phase. However, a small lift in wage growth and cooling inflation should boost real incomes and personal finances are, on average, strong. A weak sterling is likely to underpin investment in export-facing industries, while business-to-business services are likely to see further momentum. Nevertheless, investment is expected to remain below the level that might have been expected, reflecting uncertainty about the UK's future trade and investment conditions. On the continent, economic activity is set to remain healthy, leading to further declines in unemployment and wage growth, but consumer spending growth may continue to lag.

- With UK farmgate prices proving more stable relative to a year earlier than in 2017, there is the potential for meat retail prices to hold steady given the context of strong competition in the retail sector. Lamb may be the exception however, with past price movements continuing to pass through the supply chain.

- UK beef production is likely to be relatively stable year-on-year in H2 2018, as a small decline in prime cattle availability is offset by higher cow beef production. Prime cattle availability is expected to tighten as the second half progresses, with an increased population of older animals supporting in the short-term. Import volumes may come under some pressure due to a more stable supply in Ireland plus a well-supplied manufacturing grade beef market. UK exports will be constrained by stable supply, but an historically weak currency could support modest increases.

- Increased mortality and a lower lambing percentage is expected to have resulted in a significantly smaller lamb crop in 2018, reducing production in H2 2018. Nevertheless, tight supply in NZ and price inflation over the past year may prevent imports from covering the shortfall in home production. While a weak sterling and healthy European economy should underpin export demand, supply constraints are likely to see export volumes struggle to match H2 2017 levels. Demand for lamb is likely to peak in mid-August ahead of Eid al-Adha later in the month.

- UK pigmeat production is expected to rise in H2 2018. Higher production and competitive prices on the continent may raise competition at home and in export markets, but some growth in exports should be possible for products that are in weak demand in the UK. Chinese import demand is likely to remain subdued.

- 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.

- A structural shift in food consumption 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 2018. This is likely to keep exchange rates close to recent levels, but monetary policy developments may result in fluctuations. Domestic produce is likely to continue benefiting from the ability to compete 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. Economic data points towards Germany, the Netherlands and Sweden offering the most promise, but France, Belgium and Denmark have seen some optimism return.

- 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.

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SECO
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Statistics NZ
Sverige Riksbank
Swiss Federal Statistics Office
Swiss National Bank

Statistical Appendix

UK Economic Indicators

Source: Bank of England; ONS

		Economic Output		Labour Market				Retail Sales Index		UK Inflation		Private sector credit growth	Exchange rate
		Inflation-adjusted GVA index		Unemployment 16+	Unemployment rate 16+	Avg weekly earnings		All retailing	Predominantly food	CPIH Index		M4 Lending (ex. OFC's)	€:£
		2015=100	% change y/y	thousands	% of 16+ active population	£	% change y/y	2016 = 100	2016 = 100	2015 = 100	% change y/y	% change y/y	Sterling value of €1
2008		92.9	-0.2	1,786	5.7	435	3.6	88.0	97.1	86.2	3.5	n/a	0.7944
2009		88.9	-4.3	2,403	7.6	435	0.0	88.1	97.8	87.9	2.0	n/a	0.8902
2010		90.5	1.9	2,497	7.9	444	2.1	87.3	96.1	90.1	2.5	n/a	0.8573
2011		91.7	1.3	2,593	8.1	455	2.5	87.3	94.8	93.6	3.8	-7.6	0.8675
2012		92.9	1.3	2,572	8.0	461	1.3	87.7	94.6	96.0	2.6	0.0	0.8106
2013		94.2	1.5	2,474	7.6	466	1.1	88.8	94.3	98.2	2.3	-1.0	0.8492
2014		97.6	3.5	2,026	6.2	471	1.1	91.9	95.0	99.6	1.5	-3.8	0.8057
2015		100.0	2.5	1,780	5.4	483	2.5	95.6	96.7	100.0	0.4	0.2	0.7256
2016		102.4	2.4	1,633	4.9	495	2.5	100.0	100.0	101.0	1.0	5.4	0.8175
2017		104.2	1.8	1,480	4.4	506	2.2	101.9	99.9	103.6	2.6	4.0	0.8762
			3-month rolling avg % change y/y	3-month rolling average	3-month rolling avg % change y/y		3-month rolling avg % change y/y						
2017	Jan	101.7	2.6	1,580	4.7	499	2.2	100.6	101	101.8	1.9	5.3	0.8611
	Feb	101.5	2.5	1,559	4.7	500	2.1	101.4	101.7	102.4	2.3	4.6	0.8524
	Mar	101.6	2.5	1,541	4.6	503	2.4	100.7	101.3	102.7	2.3	4.6	0.8660
	Apr	101.6	2.3	1,530	4.6	503	2.2	102.4	102.6	103.2	2.6	4.9	0.8476
	May	101.9	2.4	1,495	4.5	505	2.0	101.1	100.9	103.5	2.7	4.9	0.8550
	Jun	102.2	2.3	1,484	4.4	506	2.1	101.7	101.8	103.5	2.6	3.8	0.8770
	Jul	102.2	2.5	1,455	4.3	506	2.2	101.8	102.1	103.5	2.6	3.6	0.8864
	Aug	102.4	2.4	1,443	4.3	508	2.3	102.9	103.2	104.0	2.7	3.9	0.9112
	Sep	102.4	2.1	1,425	4.3	510	2.3	102.1	102.3	104.3	2.8	3.9	0.8940
	Oct	102.5	2.0	1,429	4.3	510	2.5	102.6	102.7	104.4	2.8	4.2	0.8907
	Nov	102.8	1.8	1,439	4.3	512	2.5	103.5	103.6	104.7	2.8	4.1	0.8882
	Dec	102.9	1.6	1,470	4.4	513	2.6	102.2	102.3	105.0	2.7	4.4	0.8826
2018	Jan	103.1	1.4	1,453	4.3	513	2.8	102.3	102.5	104.5	2.7	4.5	0.8825
	Feb	102.9	1.3	1,423	4.2	513	2.8	103.1	103	104.9	2.5	3.8	0.8841
	Mar	102.9	1.3	1,425	4.2	515	2.6	101.9	102.5	105.1	2.3	3.6	0.8828
	Apr	103.1	1.4	1,416	4.2	516	2.6	103.8	104	105.5	2.2	3.1	0.8713
	May	103.4	1.4	1,411	4.2	517	2.5	105.2	105.5	105.9	2.3	2.7	0.8774
	Jun							104.6	104.8	105.9	2.3		0.8789

Consumer Prices Index (CPIH): meat & other food items (2015 = 100)

Source: ONS

		Food	Meat	Beef & veal	Pork	Lamb & goat	Poultry	Edible offal	Dried, salted or smoked meat	Fish	Cheese & curd	Eggs	Ready-made meals	Fast food & takeaway food	Pizza & quiche
2008		84.0	84.0	n/a	n/a	n/a	n/a	n/a	n/a	78.3	n/a	n/a	n/a	n/a	n/a
2009		88.7	89.5	n/a	n/a	n/a	n/a	n/a	n/a	81.2	n/a	n/a	n/a	n/a	n/a
2010		91.4	90.3	n/a	n/a	n/a	n/a	n/a	n/a	86.5	n/a	n/a	n/a	n/a	n/a
2011		96.1	95.2	n/a	n/a	n/a	n/a	n/a	n/a	94.5	n/a	n/a	n/a	n/a	n/a
2012		99.1	98.8	n/a	n/a	n/a	n/a	n/a	n/a	97.9	n/a	n/a	n/a	n/a	n/a
2013		103.1	102.6	n/a	n/a	n/a	n/a	n/a	n/a	101.1	n/a	n/a	n/a	n/a	n/a
2014		102.8	103.2	n/a	n/a	n/a	n/a	n/a	n/a	103.6	n/a	n/a	n/a	n/a	n/a
2015		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2016		97.6	95.9	97.3	94.7	98.3	93.9	99.3	94.1	97.7	96.7	91.9	99.0	102.2	102.1
2017		100.0	97.6	97.5	96.1	102.6	92.8	100.4	96.9	106.3	98.3	91.1	102.7	105.0	105.3
Annual rate	2016	-2.4	-4.1	-2.7	-5.3	-1.7	-6.1	-0.7	-5.9	-2.3	-3.3	-8.9	-1.0	2.1	1.1
	2017	2.5	1.8	0.3	1.5	4.4	-1.2	1.1	3.0	8.9	1.6	-0.9	3.7	3.1	3.7
2017	Jan	98.2	96.2	96.8	95.6	95.4	92.5	101.1	95.4	100.2	96.3	91.2	99.9	103.4	103.5
	Feb	98.9	96.6	97.7	96.5	100.4	93.8	101.7	94.7	104.8	97.0	91.6	101.0	103.7	103.9
	Mar	99.5	96.7	97.7	95.7	101.2	93.4	102.1	94.9	104.8	98.5	91.4	101.9	104.1	104.2
	Apr	99.7	97.5	96.8	94.7	101.4	93.8	102.1	96.9	103.5	96.4	91.5	101.3	104.5	104.7
	May	99.8	97.2	98.0	96.1	101.7	92.4	103.4	96.5	105.8	98.0	90.8	101.7	104.9	104.9
	Jun	99.5	97.6	97.3	97.4	102.1	92.5	103.0	96.9	107.9	94.9	91.0	101.6	105.0	105.0
	Jul	99.5	97.1	96.2	96.7	101.6	92.6	99.8	96.2	105.8	98.8	91.0	102.9	105.2	105.2
	Aug	99.6	97.0	98.1	94.6	102.0	91.9	99.8	96.3	107.6	97.8	90.8	103.5	105.3	105.6
	Sep	100.4	98.3	97.7	94.7	104.1	92.6	96.7	98.7	110.0	98.5	91.0	103.8	105.6	106.0
	Oct	101.0	98.5	98.2	96.9	108.1	92.3	97.7	97.9	108.1	101.2	90.8	104.3	105.9	106.4
	Nov	101.6	98.6	98.2	96.1	106.9	92.6	99.1	97.7	108.5	101.6	90.9	105.1	106.2	106.7
	Dec	102.2	99.9	97.8	98.4	106.9	92.9	98.7	100.8	109.0	100.6	91.0	105.2	106.5	107.0
2018	Jan	102.1	99.0	98.2	96.8	106.2	93.4	97.8	98.8	109.1	101.9	91.0	104.5	106.5	107.0
	Feb	102.2	99.2	98.4	94.7	110.0	93.0	100.1	98.6	110.5	101.6	91.0	105.4	106.8	107.4
	Mar	102.5	99.8	97.2	96.0	111.7	93.2	99.8	100.0	109.0	101.4	90.7	105.8	106.9	107.7
	Apr	102.0	99.5	98.0	97.6	112.9	93.6	99.9	98.4	109.6	100.5	90.2	104.4	107.5	108.3
	May	101.8	98.9	96.4	94.4	115.0	93.7	100.6	97.5	111.3	98.5	90.2	104.8	107.8	108.5
	Jun	101.2	98.4	96.5	96.7	115.6	92.5	102.3	96.5	111.1	99.8	90.2	104.9	108.8	101.4
Annual rate	Jun	1.7	0.8	-0.8	-0.7	13.2	0.1	-0.7	-0.4	2.9	5.1	-0.9	3.2	3.6	-2.7

Retail Prices of Red Meat and Competitor Foods

Source: ONS

		Beef			Lamb (home-killed)	Lamb (imported)	Pork (home-killed)	Processed pigmeat				Chicken	Fish		Cheese	Eggs	Avocado
		Premium mince	Topside	Rump steak	Bone-in shoulder	Bone-in leg	Bone-in loin	Gammon	Back bacon	Ham	Pork sausages	Roast	White fish	Salmon fillets	Cheddar	Free range	
		p/kg	p/kg	p/kg	p/kg	p/kg	p/kg	p/kg	p/kg	Per 100-125g pack (p)	p/kg	p/kg	p/kg	p/kg	p/kg	Per dozen	Per pear (p)
2008		545	826	1100	488	522	553	669	821	134	376	280	1048	999	696	n/a	76
2009		597	884	1153	546	596	593	701	890	144	402	290	1075	1136	750	n/a	81
2010		602	895	1175	603	612	599	676	863	146	405	288	1107	1396	779	319	84
2011		615	950	1277	690	792	628	699	903	157	420	313	1164	1531	780	319	90
2012		725	1042	1424	732	788	663	714	891	156	440	313	1285	1584	789	316	92
2013		797	1058	1602	759	723	687	799	908	176	484	330	1274	1556	778	307	97
2014		811	1058	1613	785	739	665	784	904	178	490	333	1362	1704	802	309	99
2015		786	1134	1635	778	729	652	739	852	166	482	313	1310	1491	767	278	98
2016		741	1152	1629	759	711	619	659	726	168	457	292	1343	1518	719	259	102
2017		741	1095	1591	767	760	612	653	730	183	488	282	1430	1608	718	245	106
2017	Jan	741	1177	1603	739	682	621	647	725	172	470	286	1400	1619	711	258	102
	Feb	744	1097	1598	767	742	615	646	731	178	474	284	1417	1510	707	245	105
	Mar	746	1093	1587	746	757	613	643	711	179	480	294	1407	1570	720	245	105
	Apr	741	1027	1586	772	739	598	654	742	182	492	291	1402	1580	708	245	107
	May	732	1113	1601	776	743	612	646	726	184	483	280	1420	1589	704	243	103
	Jun	746	1111	1556	775	747	622	653	724	185	489	282	1426	1653	708	244	103
	Jul	737	1032	1588	766	745	614	649	726	182	491	282	1416	1626	705	244	105
	Aug	738	1124	1601	774	744	593	659	734	184	482	278	1403	1629	712	242	108
	Sep	744	1038	1608	774	778	596	659	729	191	492	279	1453	1691	733	243	107
	Oct	749	1118	1590	805	810	617	653	740	186	486	276	1480	1591	734	243	109
	Nov	737	1136	1580	758	816	616	660	734	184	499	279	1486	1642	744	242	108
	Dec	741	1070	1589	747	822	626	666	740	194	516	279	1455	1597	733	242	110
2018	Jan	744	1140	1576	757	806	608	670	757	182	508	284	1468	1627	746	242	108
	Feb	714	1121	1595	767	825	628	666	759	185	492	284	1391	1729	748	239	103
	Mar	711	1058	1597	792	829	648	675	758	189	498	286	1407	1741	746	238	107
	Apr	707	1154	1593	844	809	655	656	757	180	507	288	1415	1734	738	238	106
	May	707	1108	1545	904	816	630	654	752	182	490	289	1377	1787	717	237	103
	Jun	701	1095	1565	892	824	650	655	750	179	497	284	1417	1789	730	238	99

GB Producer to Retail Price Spread

Source: AHDB

		Beef				Lamb				Pork			
		Average Farmgate Price	Average Retail Price	Price Spread	Producer Share (%)	Average Farmgate Price	Average Retail Price	Price Spread	Producer Share (%)	Average Farmgate Price	Average Retail Price	Price Spread	Producer Share (%)
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
2017		359.4	698.6	339.3	48.6	418.7	824.9	406.2	49.2	160.1	381.0	220.9	42.0
2017	Jan	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	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	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	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	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	362.6	700.2	337.7	51.8	494.0	820.3	326.3	60.2	165.6	377.9	212.3	43.8
	Jul	368.4	698.3	329.8	52.8	457.7	821.8	364.1	55.7	167.9	381.6	213.7	44.0
	Aug	371.4	698.3	326.8	53.2	432.9	831.3	398.4	52.1	167.8	382.2	214.4	43.9
	Sep	372.5	702.9	330.4	53.0	396.3	832.8	436.5	47.6	165.2	381.6	216.3	43.3
	Oct	361.9	698.9	337.0	51.8	386.0	842.3	456.3	45.8	160.0	382.8	222.8	41.8
	Nov	364.7	709.6	344.9	51.4	395.0	829.8	434.8	47.6	156.3	381.6	225.3	41.0
	Dec	362.8	704.2	341.4	51.5	400.3	818.8	418.5	48.9	154.2	381.6	227.4	40.4
2018	Jan	359.1	710.9	351.8	50.5	415.2	837.2	422.0	49.6	151.0	381.6	230.6	39.6
	Feb	355.0	717.5	362.6	49.5	470.1	833.5	363.4	56.4	148.9	375.5	226.6	39.7
	Mar	357.6	708.9	351.3	50.4	520.5	829.8	309.4	62.7	148.5	379.8	231.2	39.1
	Apr	362.4	711.6	349.2	50.9	570.4	854.8	284.4	66.7	148.6	384.6	236.0	38.6
	May	366.5	706.9	340.4	51.8	570.9	867.2	296.3	65.8	151.0	388.9	237.8	38.8
	Jun	369.9	718.2	348.3	51.5	524.4	881.9	357.5	59.5	152.8	385.8	233.0	39.6

EU Economic Indicators

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

Country	Q1 2018			Q4 2017			Q3 2017			Q2 2017		
	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	0.3	6.1	1.6	0.5	6.4	2.0	0.2	7.1	1.9	0.5	7.3	2.0
Ger	0.3	3.5	1.3	0.6	3.6	1.6	0.7	3.7	1.7	0.6	3.8	1.6
Est	-0.1	6.0	3.2	2.1	5.5	4.1	0.1	6.0	4.0	1.6	6.5	3.4
Ire	-0.6	5.8	0.5	2.8	6.3	0.5	4.5	6.7	0.1	3.1	6.7	0.0
Gre	0.8	20.5	0.3	0.2	21.0	0.8	0.5	20.9	0.8	0.8	21.5	1.3
Spa	0.7	16.2	1.1	0.7	16.6	1.6	0.7	16.8	1.8	0.9	17.3	2.1
Fra	0.2	9.2	1.5	0.7	9.1	1.2	0.7	9.5	0.9	0.7	9.5	1.0
Ita	0.3	11.0	0.9	0.4	11.0	1.1	0.3	11.2	1.3	0.4	11.2	1.6
Cyp	1.0	9.4	-0.8	1.1	10.3	0.1	1.0	10.4	0.2	0.9	11.4	1.3
Lat	1.5	7.9	2.0	0.4	8.3	2.5	1.6	8.6	2.9	1.4	8.9	3.0
Lit	0.9	6.4	3.1	1.4	6.8	4.1	0.5	6.8	4.5	0.7	7.2	3.4
Lux	2.0	5.3	1.2	0.1	5.3	1.8	1.8	5.5	2.0	1.2	5.6	2.0
Mal	0.6	4.4	1.3	-0.2	4.6	1.4	2.2	4.6	1.2	1.6	4.6	1.1
NL	0.6	4.1	1.3	0.9	4.4	1.4	0.6	4.7	1.5	1.0	5.0	1.0
Aus	0.8	5.0	2.0	0.9	5.4	2.4	0.9	5.4	2.2	0.8	5.5	2.2
Por	0.4	7.6	0.9	0.7	8.1	1.8	0.6	8.8	1.3	0.3	9.2	1.7
Sln	0.6	5.6	1.5	1.9	5.8	1.5	1.1	6.5	1.3	1.3	6.6	1.4
Slk	0.9	7.1	2.4	0.9	7.6	2.0	0.8	7.9	1.6	1.0	8.3	1.0
Fin	1.3	8.0	0.8	0.8	8.3	0.6	0.3	8.5	0.7	0.5	8.7	0.9
Euro Area	**0.4**	**8.6**	**1.3**	**0.7**	**8.7**	**1.4**	**0.7**	**9.0**	**1.4**	**0.7**	**9.1**	**1.5**
Bul	0.9	5.4	1.6	0.7	5.8	1.7	0.9	6.1	0.9	1.0	6.3	1.4
Cze	0.5	2.3	1.7	0.7	2.4	2.5	0.5	2.7	2.4	2.3	3.1	2.3
Den	0.4	5.0	0.5	0.9	5.4	1.2	-0.8	5.7	1.5	-1.1	5.7	0.7
Cro	0.2	9.5	1.1	0.0	10.1	1.5	0.6	10.8	1.4	0.7	11.3	1.1
Hun	1.2	3.7	2.0	1.3	3.9	2.3	1.1	4.1	2.5	1.1	4.3	2.1
Pol	1.6	4.0	1.0	1.0	4.5	1.8	1.4	4.8	1.5	0.9	5.1	1.5
Rom	0.1	4.5	3.7	0.3	4.7	2.4	2.2	5.0	1.0	1.6	5.0	0.6
Swe	0.7	6.2	1.7	0.7	6.5	1.8	0.6	6.8	2.2	1.1	6.7	1.8
UK	0.2	4.2	2.7	0.4	4.4	3.0	0.4	4.3	2.8	0.2	4.4	2.8
EU28	**0.4**	**7.5**	**1.5**	**0.6**	**7.7**	**1.7**	**0.7**	**8.0**	**1.7**	**0.6**	**8.2**	**1.7**
Nor	0.6	4.1	2.0	0.7	4.4	1.2	0.7	4.3	1.5	0.6	4.6	2.2
Swi	0.6	4.9	0.7	0.6	4.8	0.9	0.7	4.8	0.6	0.5	4.7	0.5

* % change compared with previous quarter