Rabobank

EU Pork Industry on Threshold of Changes

Potential 1.2 million tonne drop in combined EU pork production

Contents

As global demand for pork rises, EU hog prices are failing to keep pace with the US, Canada and Brazil. This raises two questions: are EU price declines structural and, if so, how will this impact the EU pork industry in the coming years? EU pork production could decline by 1.2 million tonnes over the next decade as financial impediments, extensive regulation and potential abolition of some import levies take their toll. For slaughter and processing companies supply security will become more important than price and will generate a wave of consolidation. Five criteria will be key to success as two business models emerge.

Introduction

Recent decades have witnessed the emergence of a pork supply chain driven by demand rather than supply. This shift is due to consolidation, internationalisation, globalisation, backward integration and coordination by the retail and foodservice sectors. Companies in the chain have increasingly focused upstream, raising their share in subsequent links to boost the added value.

A decline in European Union (EU) pork production will challenge companies active in the EU pork value chain to examine their current sourcing and sales structure and their customers – both retail and foodservice – in order to secure their supply. Supply security is expected to outweigh the importance of prices. Sourcing excellence will once again be a focal issue for slaughter and further processing companies in the EU. Companies will increasingly need to focus on to five key criteria if they are to find the 'winning' formula. Firstly, management must consider whether it can adapt its strategy and 'learn new tricks'. Secondly, companies have to review their core competence and position in the chain in terms of their sourcing needs. Thirdly, for supply relationship, companies must determine sourcing needs and the best model to secure sufficient, steady supply. Fourthly, the industry must examine the desired supplier characteristics to identify whether change is required in favour of more, albeit less preferential, suppliers. Finally, companies must try to find a specific, distinctive market segment to 'safeguard' supply and demand for part of their sales.

A pricing conundrum for the EU

Hog prices rose around the globe in 2010, especially in exporting countries like the United States (US), Canada and Brazil (when converted into euros). The reason was the rising global demand for pork due to continuing strong economic growth in Asia and lower pork supply following declining profitability in 2008 and 2009. In contrast, the average EU pork price in 2010 declined by 1.4 percent to EUR 1.40 per kg (*see Figure 1*). This development is even more striking in the knowledge that the euro depreciated against both the US dollar (-5 percent) and Canadian dollar (-14 percent) in 2010. Given the EU's better competitive position on the export front, EU pork exports surged (+257,000 tonnes, +15.5 percent) far above the increases in the US (+52,000 tonnes, +2.8 percent) and Canada (+22,000 tonnes, +2.0 percent) while Brazilian pork exports even declined (-67,000 tonnes, -11.0 percent). In 2011 EU pork prices started to rise, but the 11 percent increase from December to April is still below the increases in the US (+29 percent) and Canada (+20 percent) in the same period (converted into euros).

It is evident that the EU pork industry was not able to profit from the positive global trends despite rising exports, and is shooting itself in the foot with its policy of increasing cost price, to echo the words of the Directorate General Agriculture and Rural Development of the European Commission (EC) in February 2011. The current situation is reportedly the result of high production costs, as a consequence of EU policies on biotech crops, feeds and animal welfare, and not the result of low pork prices. This raises two questions: why did EU pork prices not rise and, if this is structural, how will it impact the EU pork industry in the coming years?

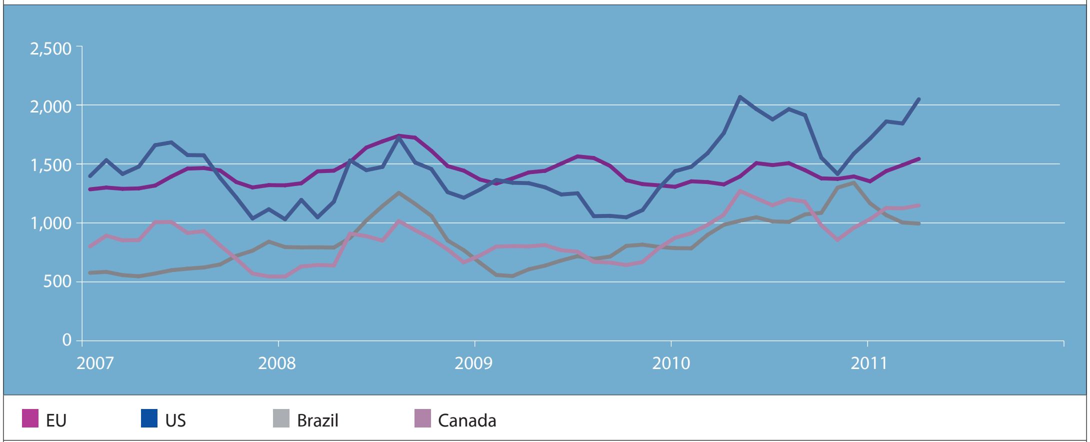
Factors influencing EU pork industry competitiveness

Import/export policy

The pork market in the EU can be seen as an island in the global market. Imports are negligible due to a stringent levy system and only a few countries have small import quotas. As a result, hog prices in the EU are determined by production, internal demand and the ability

Figure 1 Hog price trends for leading export countries, January 2007-April 2011

EUR/tonne



Source: Rabobank based on CAAA, Cepa, USDA, Eurostat, 2011

to export the remainder. Changes in EU pork production or demand immediately impact the export volume and export prices, while strong external demand and high prices generally have a positive influence on the EU hog price. Moreover, when hog prices are low for long periods, the EC can implement and finance private storage. This temporary regulation removes pork from the market to strengthen the hog price. The disadvantage is that the release of this stock, which must be within 90, 120 or 150 days, may slow down the price recovery.

Regulation

Another distinctive feature of the EU pork sector is the strict regulation on aspects such as animal welfare, environment, human health and spatial planning which increases the cost price well beyond that of all other countries. The average cost price of EUR 1.47 per kg carcass weight equivalent (CWE) in the EU was higher than in the US, Canada and Brazil in 2009 (*see Figure 2*). For example, the investment costs for a finishing place in the EU (EUR 300 to EUR 400) are some three to four times higher than in the US, Brazil and Canada (EUR 60 to EUR 110).

Zero-tolerance of GMO

The EU's zero tolerance policy on genetically modified organisms (GMOs) has increased the price of non-GMO soymeal, which is imported at a substantial price premium. Globally, just about 11 percent of the soybeans produced in the main exporting countries US, Brazil and Argentina was GMO-free in 2010, after the planted area was halved in the last five years. This has reduced the sourcing opportunities for the EU almost totally to Brazil, resulting in a price premium of about EUR 65 per tonne of soymeal in 2010, or an increase of EUR 57 per tonne since 2005. The subsequent EUR 0.04 per kg rise in the cost price in 2010 is not compensated for in the hog price. The non-GMO status of the EU has no impact on the supply of the other main components of pork feed – wheat, feed barley and rapeseed meal – which are generally sufficiently available in the EU.

Issues beyond control

Alongside cost price rises due to regulation, the EU pork industry faces rising feed costs and volatile exchange rates, capricious factors that have varying impacts on all hog producers globally.

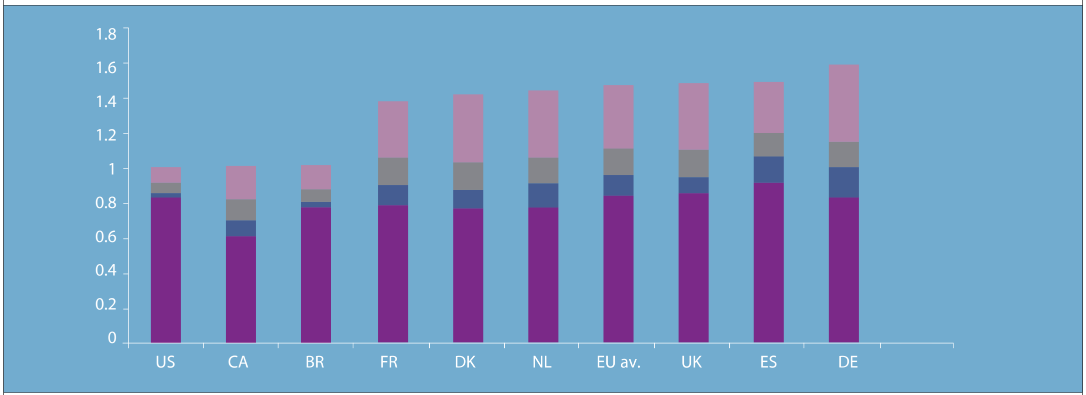
Feed Costs

Feed costs have a huge impact on the overall profitability of hog farmers. While feed costs generally constitute about 50 percent to 55 percent of the cost price of hogs, the current high feed costs have pushed this percentage up to about 65 percent to 70 percent. Rising global demand and weather-affected harvests have combined to drive hog feed costs up to these high levels for the second time in the last four years. Feed costs will likely remain high at least until the autumn of 2011, and very probably until mid-2012. The main drivers of these feed prices are continuing high demand – despite record-high commodity prices in recent months there is little if any meaningful demand rationing globally – and the need to restock. After 2012, Rabobank expects that commodity prices will remain at a higher and more volatile price level, prompted by continuously rising Asian GDPs and populations.
Generally, high prices of grains and oilseeds favour the livestock industry in countries with ample availability. The US, Brazil and Canada are all major exporters of grains and oilseeds. The EU is an important exporter of grains but is the world's second largest importer of soybeans, the key oilseed needed to fulfill the demand for vegetable protein. Pork producers in the EU have to deal not only with the EU's zero tolerance policy on GMOs but also with higher feed costs per tonne, which must be compensated for through higher productivity.

Euro clearly stronger than the Canadian and US dollars despite depreciation

Generally, the euro has been strong compared with the US dollar, Canadian dollar and Brazilian real since 2003. However, since reaching a peak in the spring of 2008, the value of the euro has depreciated against the US dollar (-13 percent), the Canadian dollar (-19

Figure 2 Cost-price comparison for pork for selected EU countries, 2009



Source: Rabobank estimate based on Interpig, USDA, 2010

percent) and the Brazilian real (-30 percent), improving the competitive position of the EU. As a consequence, EU pork exports have risen by 15.5 percent to 2.7 million tonnes.

However, with no increase in EU pork prices, an export boost of 257,000 tonnes was not sufficient to absorb the production growth in the EU. The remaining 389,000 tonnes therefore had to be sold in the internal market, which resulted in a slight decline in the EU pork price. By contrast, pork prices in the US and Canada increased on the back of lower production and rising exports, while in Brazil, strong internal demand due to the lower availability and higher price of beef drove pork prices higher. The EU failed to benefit from rising global pork demand in 2010, mainly due to the higher cost price. Until a few years ago, EU pork farmers, especially the export-oriented pork industry in the northwestern part of the EU, were able to compensate largely through their generally higher productivity. However, the lower productivity increase compared with the main competitors on the export markets between 2006 and 2009 has jeopardised the competitive position of the EU pork industry (*see Figure 3*).

International EU pork industry at a crossroads

In the coming years, the competitiveness of the EU pork industry will come under further pressure as new cost-price-increasing regulation undermines the attractiveness of EU pork in export markets, especially the increasingly self-sufficient Russian market, and as the opening of the EU market to pork imports draws closer. However, the total allowance of GMO soymeal, the removal of the meat-and-bone meal (MBM) ban and the rapidly increasing demand in Asia offer opportunities. This might result in better export opportunities, for EU pork.

2013 regulation to drive the EU cost price for hogs even higher

From 2013, additional environmental legislation will require adjustments in animal husbandry and/or air treatment systems (EU directive 2008/1/EC) while animal welfare legislation will introduce group housing of pregnant sows and the expansion of living area for weaned piglets and fattening pigs (Directive 2001/88/EC). The introduction of the sow-stall ban and the requirement to reduce emissions by installing air washers will increase the average EU cost price by about EUR 0.02 per kg, while more stringent, national legislation might increase the cost price even more (*see Figure 4*). This increase will not be compensated in the hog selling price.
The impact of legislation on cost price in the EU and, subsequently, competitiveness is demonstrated by Sweden and the UK. Their implementation of the sow stall ban in 1988 and 1999, respectively, saw pork production in the UK fall by 33 percent from 1991 and pork production in Sweden fall by 22 percent from 1995.

Self-sufficiency drive limiting export opportunities to Russia

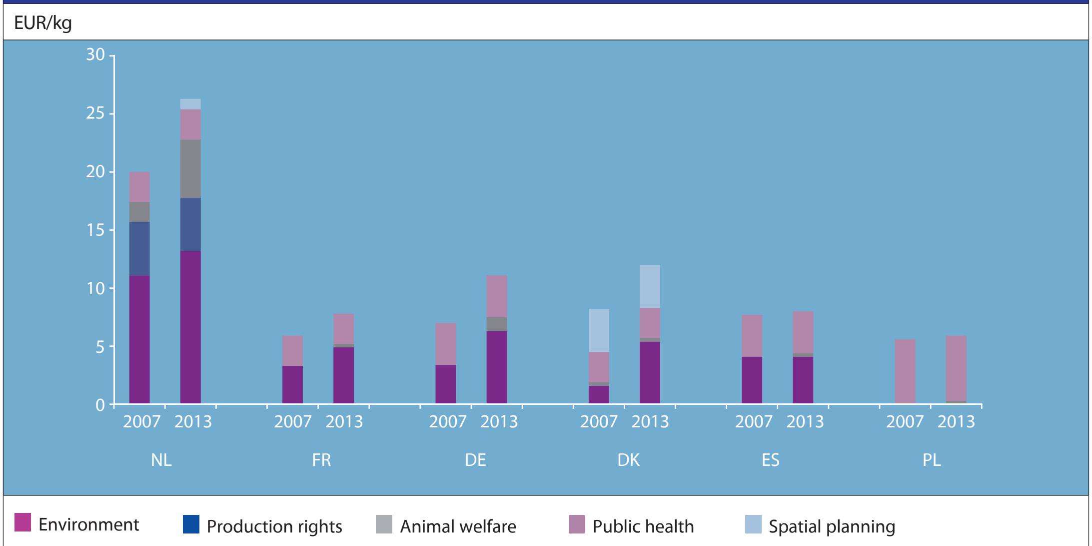
The Russian share of annual EU pork exports is 30 percent, making it the main importer. Moreover, due to the relative high share of 'lower value' products (about 50 percent are fats like lard), these exports are vital to the total carcass valuation in the EU. This volume will come under pressure in the coming decade as Russia pursues self-sufficiency in pork (85 percent by 2015 and 95 percent by 2020). Despite the increase of pork imports by 143,000 tonnes CWE to partly fill the increased demand (+702,000 tonnes)

Figure 3 Pigs sold per sow

	2006 (head)	2009 (head)	Increase 09 vs. 06 (%)
Netherlands	24.0	26.1	9%
Germany	20.3	22.5	11%
EU average	21.5	23.0	7%
US	17.4	19.3	11%
Brazil	15.5	23.2	50%
Canada	20.7	24.0	16%

Source: Rabobank, InterPig, 2011

Figure 4 Increased production costs due to EU and national policies in selected countries, 2007, 2013 (estimate)



Source: LEI, 2011

between 2003 and 2010, Russia is likely to reach its self-sufficiency target. Extreme profitability in pork production in recent years due to growing consumer demand and an excess of packing capacity is very helpful in this respect.

Bilateral trade agreement with Mercosur countries will result in reasonable pork imports

The threat of pork imports in the EU is rising. A World Trade Organisation (WTO) agreement somewhere in the coming decade is always a possibility, the current negotiations with the Mercosur countries (Argentina, Brazil, Paraguay, Uruguay) on a bilateral trade agreement with the EU might result in the EU opening its market to Brazilian pork in the near future as agricultural products gain access to the EU in return for Mercosur opening its market to EU products like cars and telecommunication equipment. This is not a real problem if there is a level playing field, with the imported products having to comply with the same legislation (i.e welfare, GMO, tracking & tracing) as those produced in the EU. However, this is not included in the current proposals, which reduces the competitiveness of the EU pork industry. The carcass valuation in particular will come under pressure if, as can be expected, Brazil starts to export specific, high-value products to the EU like hams and pork tenderloin. This would give the Mercosur countries, Brazil in particular, the opportunity to optimise carcass valuation as the lower-value pork products can be exported to China. The recent bilateral agreement between China and Brazil about pork imports is instrumental in this.

Change in Chinese pork self-sufficiency target

Developments in China might have a positive impact on EU hog prices in the near future. In the short term, the 3 percent drop in the Chinese sow herd caused by current outbreaks of foot and mouth disease (FMD) could lead to 2011 pork imports of 1.1 to 1.4 million tonnes, a fourfold increase on 2010. This may boost access to the Chinese market for EU countries while competition in other export markets will diminish. Longer term, the rapid industrialisation of Chinese pork production, which includes a western-style feed diet instead of table scraps, will dramatically accelerate demand for grains and oilseeds. Large industrial complexes have less flexibility in inputs compared with backyard farmers and need ingredients with uniform nutritional characteristics. China already imports 80 percent of its soybean demand and in 2010 it had to import corn for the first time in 15 years, taking 1.5 million tonnes from the world grain market. Moreover, China's capacity to increase grain production in the future is limited. It may even become a net importer of 25 million tonnes of corn as early as 2015. This is huge in the context of the current world corn trade of 93 million tonnes. The Chinese government could therefore face a fundamental choice: to further increase corn imports or else slow down the modernisation of the Chinese pork industry and become a net importer of pork to respond to growing demand. It is likely that China will choose to gradually increase its pork imports from all over the world. Not only can the EU benefit from this direct export opportunity but it can also pick up demand from other countries that used to be served by major exporters such as Brazil and the US.

Allowance of GMO soy and MBM

New EU legislation that allows traces of non-authorised GMOs in imported soybeans and soymeal up to a threshold of 0.1 percent may gradually reduce the current soy premium. It could also be the first step to further opening up the EU to GMO products and the complete removal of this premium in the future. The current discussions in the EC to re-allow MBM in animal diets in the EU will reduce demand for vegetable proteins and lower the cost price. The re-allowed MBM will be cross-species, and largely from poultry and pork since meal from cattle and sheep will not be included. Since pork meal cannot be fed to pigs this brings less competitive advantage to the industry.

Protecting the international position of the EU pork industry

The EU pork industry is currently experiencing its second period of high feed costs in the last four years. Furthermore, pork demand is still only slowly recovering from the decline resulting from the economic crisis. From 2007 EU pork farmers suffered four consecutive years of negative margins, the longest sustained period of losses since 1980 (*see Figure 5*). The prospects for 2011 do not look good either. The year began with very low hog prices due to the dioxin crisis in Germany. With feed costs expected to remain high during the whole year, this will stifle the impact of currently increasing hog prices. The prospect of a fifth consecutive year of negative margins will dilute the appetite and ability of many EU hog farmers to make the investments needed to comply with the 2013 legislation, resulting in a fall in EU pork production of around 300,000 tonnes (1 percent to 1.5 percent).

Four EU scenarios possibly to result from prevailing trends

Scenario 1: *Cost-price-increasing legislation results in a production fall of about 800,000 tonnes,*
Currently, only an estimated 40 percent of EU sow farms comply with the 2013 requirements, while the remainder stand at the crossroads of considerable investments. Research from Wageningen University in the Netherlands[1] calculated that a farmer with 500 sows will need to invest about EUR 175,000 to comply. On an EU scale, this means total investments estimated at more than EUR 3 billion, without taking account of depreciation of current equipment or any extra country-specific legislation (*see Figure 6*). The Wageningen research also concluded that, in the Netherlands, the pig population will decline by tens of percentage points. This is because, from 2013, Dutch pig farmers will have to comply with the Dutch Ammoniac Emission Decree for Housing, the Pig Decree, and the fourth Action Programme under the EU Nitrates Directive. Rabobank expects a less drastic decline for the Netherlands and the EU as a whole. Depending on profitability in 2012, a decline of about 4 percent or 5 percent seems more in line with developments in the past and in other animal species. This would reduce EU pork production by about 800,000 tonnes.

Scenario 2: *Russian self-sufficiency reduces exports by 125,000 tonnes by 2015.*
Russian pork production stabilised in 2010 due to the impact of the economic crisis. The average growth rate of 7 percent between 2007 and 2009 is expected to resume in Russia from 2012 onwards. Based on average consumption growth of 3.5 percent, Russia would then become self-sufficient by 2021. Assuming that the EU continues to supply about 50 percent of Russia's pork imports, EU exports will fall by 125,000 tonnes in 2015 compared to 2010. In 2020 EU pork exports will decline to 269,000 tonnes. While this fall may seem rather marginal in the light of total 2010 production of 22 million tonnes, the fact that the EU exports mainly lower-value pork to Russia makes it very difficult to find new markets. Consequently, a decline in EU pork production by the same volumes can be expected. However, the recent opening of China to Brazilian pork may reduce the competition in the Russian market and postpone the decline of EU pork exports to Russia.

Scenario 3: *Opening EU market to Mercosur pork imports reduces production by 300,000 tonnes.*
Assuming that the EU allows access for 150,000 tonnes of Mercosur pork in 2015, with annual increases of 30,000 tonnes bringing the total to 300,000 tonnes by 2020 (1.4 percent of current production), EU pork production will decline by at least the same volume. However, Brazil is expected to export mostly noble cuts (pork tenderloin, ham, etc.), which will put pressure on total carcass valuation and may induce further pressure on EU hog prices.

Scenario 4: *Pork exports to China could rise by about 100,000 tonnes.*
Pork imports in China will grow in the coming years, as shown by the recent bilateral deal to open the Chinese market to Brazilian pork. Assuming moderate Chinese import growth of 400,000 tonnes, from 350,000 tonnes in 2010 to 750,000 tonnes in 2018, the EU might fill 100,000 tonnes of this growth, which constitutes the same 25 percent share in global pork exports it currently holds. However, competition from the US and Brazil, might reduce this estimated volume.

Potential 1.2 million tonne drop in combined EU pork production

The combined impact of the difficult financial situation in the EU pork industry, cost-price-increasing legislation and the opening of the EU to pork imports might result in a decline of EU pork production by an estimated 1.3 million tonnes by 2020. With growing export opportunities in China and some other markets, the effect will be lessened to about 1.2 million tonnes. Assuming stabilising EU pork consumption at 20.5 million tonnes, EU self-sufficiency could drop to close to 100 percent by around 2020.

Winners and losers at the country level

In the last twenty years, Spain and Germany have emerged as winners in the EU pork industry almost totally at the expense of the Netherlands, the UK and, more recently, Poland (*see Figure 7*). The Spanish pork industry has been buoyed by rising purchasing power and growing numbers of tourists. Germany's rapid production growth started as the EU expanded to incorporate central and eastern parts of Europe. Due to the absence of a fixed minimum wage, the industry was able to hire relatively cheap labour from these countries. Growth was also fuelled by the expansion of German retail discounters across the EU, which are still partly supplied from Germany.

In the Netherlands, the government reduced both farm and slaughter capacity due to environmental concerns. In the UK, cost price and exchange rate disadvantages pressured production. The decline in Poland since 2007 was caused by high feed costs and subsequent low profitability in the relatively inefficient industry. The recovery seen in pork production in the last couple of years has been more the result of the depreciation of the Polish zloty (-19 percent in 2009) than anything else. The gradual decline in pork production in France was mainly due to problems related to acquiring the necessary permits to expand production. In Denmark, environmental constraints and the fact that the industry was not able to command competitive prices domestically resulted in the growth of piglet and hog exports and a decline in production.

In the coming decade, those countries that have sufficient access to competitively priced feed, have a modern, efficient production process both at the primary and the processing level and do not comply with legislation any stricter than required by the European Commission will be able to stabilise or even increase production. Germany will further strengthen its position while production in Spain, the Netherlands, Italy, Belgium and the UK is expected to more or less stabilise. The greatest pressure on production can be expected in central and eastern EU countries, Denmark, France and northern EU (Sweden, Finland). In the longer term (>25 years) production is likely to gradually move to central and eastern Europe, including the Black Sea region, due to rising production of grain and vegetable proteins in these regions.

Germany to cement its leading position

Germany will cement its leading position in the EU pork market, especially in the northwestern part of the EU. The large internal market limits dependence on export markets for total carcass valuation, while efficiency and particularly the labour cost advantage at the processing level will continue to support the industry.

In the northwestern part of the EU, the German, Danish and Dutch markets will increasingly become one market due to German dependence on imports of live hogs and piglets and the investments in German processing capacity by the export-oriented and consolidated Dutch and Danish pork industries. Consolidation of the German processing industry can be expected to continue; since 2006, the top four processors have accounted for more than 90 percent of the 8.2 million head increase in slaughter numbers.

Danish pork industry will remain pressured

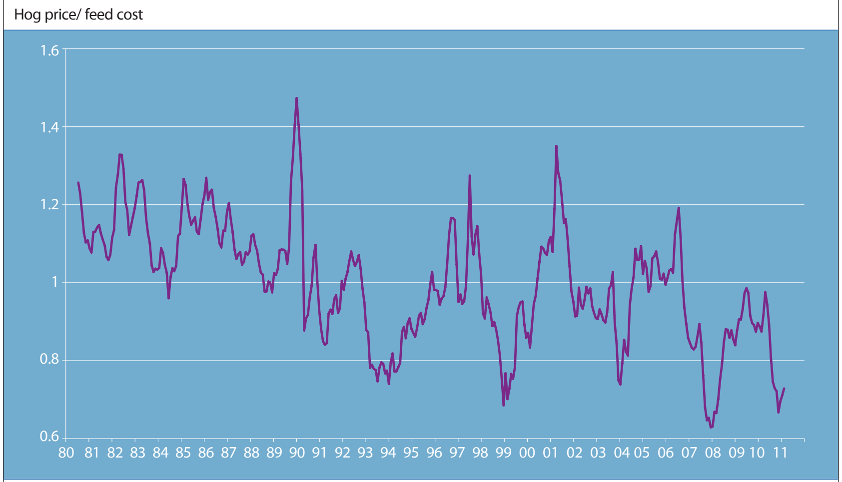
The Danish pork industry lost its leading position in the EU around 2005. This was due to the combined effect of the appreciation of the Danish krone, which is linked to the euro, against the US dollar and to environmental constraints, which result in higher returns for piglet production than hog production. The Danish meat industry was unable to pay competitive prices compared with its counterparts in Germany, which resulted in rising exports of piglets (+4 million head) and hogs (+500,000 head) at the expense of slaughter numbers (-1.2 million head).

In the coming years, Danish piglet exports will continue to grow, albeit at a lower rate, at the expense of hog production. The weak financial position of Danish farmers due to the prevailing financing structures and the still important link between livestock production and land for manure disposal will continue to favour piglet production.

Dutch industry to safeguard its position

The Netherlands has a special position in the global pork industry. It is the only country with a sizeable export-oriented pork industry without sufficient grain production of its own. The import of grains through the port of Rotterdam makes up for this disadvantage. The Dutch industry is further supported by its position close to all main EU consumer centres; its large food

Figure 5 EU hog price - feed cost ratio, January 1980- April 2011



Source: European Commission, 2011

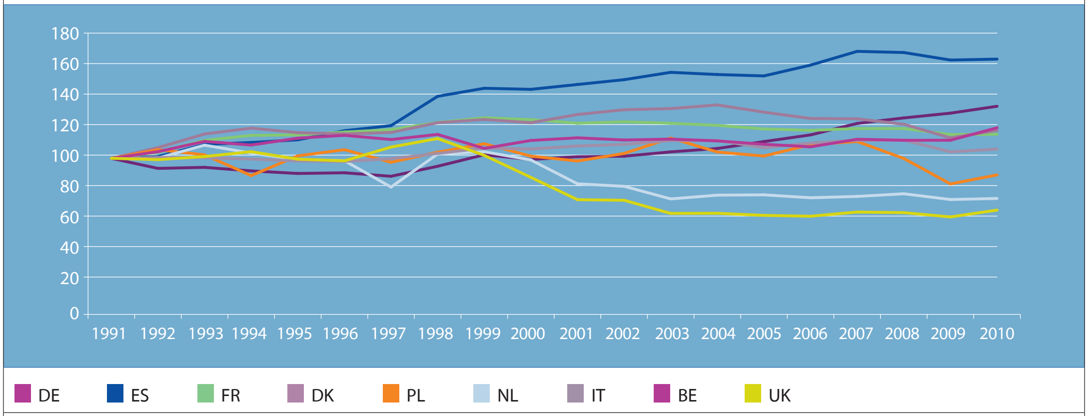
Figure 6 Estimated investment needed to comply with 2013 sow stall ban

	Compliant	Sow herd (head)	Non-compliant (head)	Investment needed (million EUR)
UK and IE	70-100	658,000	98,700	35
DK and NL	55-100	2,234,000	834,400	292
AU	50	279,000	139,500	49
DE	20	2,226,000	1,780,800	623
BE	20	535,000	428.000	150
FR	30-40	1,094,000	711,100	249
FR	30-40	3,144,000	2,043,600	715
Rest of EU	10	3,571,000	3,213,900	1,125
Total		13.891,000	8,721,500	3,238

Source: Rabobank estimate, 2011

Figure 7 Comparison of pork production in selected EU countries, 1991-2010

1991=100



Source: European Commission, 2011

industry, whose 'waste' is used as pig feed; its strong, knowledgeable infrastructure and its resulting efficient production process. These developments should enable the Netherlands to more less maintain its current slaughter production levels. However, this forecast is only valid if the Dutch animal protein industry can solve the manure problem. Depending on the scenario, Dutch manure production must be reduced by between 20 million kg and 50 million kg of phosphate by 2015. This equals the sum of the current overproduction, the decline in allowable manure application per hectare of arable and grassland, and the possible end of the derogation by the EC. The Dutch government has announced that there will be a new reduction in animal numbers if the manure surplus is not reduced by 2015.

UK to remain main pork importer

The introduction of the sow stall ban will further improve the competitive position of the UK pork industry. However, despite the modernisation of the industry and the positive effect of the 'Buy British' programme, including adoption by a few retailers, a strong recovery is not expected. The prevailing higher cost price due to more stringent animal welfare regulation will continue to support cheaper imports, while the impact of the constant currency fluctuations (British pound sterling against both the US dollar and the euro) will limit opportunities for stable profitability. Moreover, the UK preference for pork loins and hams, for which demand is 23 million and 19 million pigs respectively, will always require a substantial import of pork as the UK slaughtered only about 9.7 million hogs in 2010.

Spain set for structural change

In the long term, Spanish pork production has some comparative disadvantages: the lack of sufficient domestically produced grains, the lack of big sea harbours, which increases the price of the imported product, and low water availability. Together with the relatively fragmented industry structure, these factors result in a relatively low feed conversion ratio and high cost price. However, the specific eating culture with a strong preference for pork and many local specialties, the big internal market including the considerable influx of tourists during summer, and a fragmented retail structure support the industry.

In the coming decade, the industry will follow two different development paths: large, integrated companies emerging to supply modern retail in the local and export markets; and 'small' players producing the local specialties and supplying local retail, foodservice and specialised cold-cut producers. However, the high level of feed imports and problems in building stable export relationships due to the high, tourist-driven demand during summer will at best result in no more than a stable development of production.

France unable to exploit its potential

France has the potential to play an important role in the EU pork sector due to its abundant grain availability and efficient primary production. The cost price to produce hogs is generally among the lowest in the EU. However, French pork production has been in gradual decline since the beginning of the century. Besides the relatively domestic focus of the processing industry, growth is hampered by obstacles to acquiring permits to expand capacity. This means that industry modernisation has taken place inside old facilities, thereby putting production under pressure. This gradual decline may be exacerbated by the looming investments for compliance with the 2013 EU legislation.

Stable development in Italy and Belgium due to specific requirements

The Italian and Belgian pork industries will be able to hold their positions in the coming years. In Italy, the requirement for heavy pigs by the charcuterie industry and the constantly expanding demand for these products globally will stabilise production at around current levels. In Belgium, industry efficiency and Belgian consumer preference for generally larger meat cuts, which align perfectly with German demand, will prevent a production decline.

Poland and Romania best positioned in central and eastern EU

Negative profitability due to high feed costs has delayed modernisation of the pork industry in countries in the central and eastern part of the EU in recent years. Moreover, the still small-scale primary industry is not able to compete against cheap imports of standardised hogs and pork. This resulted in a drop of hog slaughter numbers by 20 percent to 33.6 million head between 2005 and 2010. Production will continue to be pressured in coming years due to high feed costs, pending investments and the self-sufficiency goal of Russia, an important export market. This decline is expected to stabilise by around 2015 and be followed by a modest recovery with positive long term (>25 years) prospects.

Poland and Romania in particular are well positioned to become major pork producers and possible exporters in the long term. Both countries have a large population with high preference for pork products, sufficient domestic grain production, and access to foreign investments which are accelerating the modernisation and resulting standardisation of the industry.

Conclusions

EU pork production could decline by an estimated 1.2 million tonnes due to the combined impact over the next ten years of financial impediments in the EU pork industry, more expensive regulation, and the EU opening up for pork imports. Growing export opportunities in China and some other markets will help to offset these burdens. If we assume that EU pork consumption will stabilise at 20.5 million tonnes, the EU's self-sufficiency rate could move close to 100 percent by around 2020.

Winners will be those countries with better availability of 'cheap' grains and oilseeds and, on an EU basis, a competitive, efficient production model. For the processing industry, declining production will make sourcing and capacity utilisation even more important. Winners will have a lean and mean production model with stable sourcing at competitive prices and have strong contacts with retail/foodservice via innovative forward-integrated activities.

The expected decline in EU pork production will change the industry landscape, with supply security becoming more important than price. This development will inevitably lead to further consolidation of the EU pork industry, both horizontally and vertically, and will result in the emergence of two different company models. Firstly, large forward-integrated companies with strong farmer relationships (which may or may not be contracted), a broad product range and strong relationships with a few big retail and foodservice companies. Secondly, smaller companies supplying local retail, foodservice and processing companies or a special market segment. Companies which are currently lean and mean, forward integrated and have direct access to retail or foodservice are best positioned to be among the winners.

However, the speed of this change process may be hampered by the strict labour regulation in the EU, which makes it difficult to adjust capacity easily. Furthermore, the extremely local nature of the demand for processed meat products, which differs not only between countries but even between regions in a country, limits opportunities to optimise capacity. Slaughter and further processing companies which are able to secure supply will become the linking pin between consumer demand and farmers/producers. Clear insight into and efficiency of product flows are vital. This includes quality demands, tracking & tracing, food safety and optimal stock-keeping throughout the chain. Together with strong innovative power to continue increasing the value of customers' sales, these companies might increase their influence on consumer buying behaviour and therefore boost growth opportunities further.

Currently, the companies with the best prospects will be lean and mean, with stable, reliable sourcing and the ability to optimise capacity utilisation including, if necessary, relatively easy adjustment of capacity. Such companies will be forward-integrated into convenience food products and/or processed meat to optimise carcass utilisation as well as have direct access to retail or foodservice. Winning companies will be those that rise to the challenge of focussing on the five key criteria: management skills, the company's core competence, supply relationships, supplier structure and the market segment.

1 Baltussen et. al., Economische gevolgen van bestaande regelgeving voor de Nederlandse varkenshouderij, Wageningen UR, LEI-Rapport 2010-010, 3-2010

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