

HORIZON

Bitesize

Brexit prospects for UK dairy trade



HORIZON

Bitesize

FOREWORD

AHDB has been at the forefront of analysis and insight relating to Brexit's impact on UK agriculture. We have explored areas including trade, policy, availability of labour and the regulatory environment in our Horizon series of publications in order to help farmers and growers understand the changes ahead and how they can best prepare their businesses in these uncertain times.

At the time of writing (January 2019), there remains considerable uncertainty regarding many aspects of Brexit, including the UK's future trade relationship with the European Union (EU). The prospect of a 'no deal' Brexit cannot be ignored and we now find ourselves in a very fluid and rapidly changing political environment. A 'no deal' scenario could have a seismic impact on UK

trade in agricultural products and, subsequently, major implications for all of the UK's agricultural sectors. It is crucial that this is understood by farmers and policy makers if disruption throughout the industry is to be avoided.

In response, AHDB will be publishing relevant information to help our farmers and growers understand the evolving situation, what it means for them and how they can prepare.

The aim of this report is to provide readers with an understanding of how Dairy trade could be affected once the UK leaves the EU, under both an agreed withdrawal and under a 'no deal' scenario.



DAIRY



Patty Clayton
Lead Analyst
AHDB Market Intelligence

The UK is well placed for exports of premium products that are sold directly to consumers and where quality is key – a pack of mature Cheddar would be a good example. Products will have to be tailored with the end consumer in mind, ensuring flavour profiles and format align with their needs and consumption habits.

Global consumption of dairy is growing, with demand for fresh and processed products forecast to increase by 2.1% and 1.7% a year over the next decade respectively. Fresh products currently make up three-quarters of overall dairy consumption in developing countries, with consumption of processed products varying between regions. For some areas in Africa, Asia and the Middle East, consumption is growing at a faster pace than production and this is where potential opportunities lie for the UK.

China is the largest importer of dairy products and the growing middle class in the country have been introducing more dairy into their diet. Traditionally, dairy products don't feature in large quantities in

Chinese diets, due to the high levels of lactose intolerance. So, products with a lower lactose content, such as butter and mature hard cheeses, are likely to provide a better opportunity for market development than fresh-milk products.

In August 2018, a new dairy trade deal between the UK and China, estimated to be worth £240 million over the next five years, was agreed. It allows the UK to export dairy products (excluding infant milk formula) that have been made with dairy ingredients (excluding raw milk) sourced from third countries. The agreement is designed to give more flexibility for UK dairy processors in sourcing ingredients for products targeted at the Chinese market.

Recently, frayed relationships between the USA and other global superpowers have introduced uncertainty into global markets. Both China and Mexico have introduced additional tariffs on a range of dairy products from the USA. This could potentially provide market access to the UK as both of these countries look to source products from elsewhere. There could be an opportunity for the UK to capture some of the USA's share in these markets, and if they remain competitive, this share could be retained once relations between the countries are resolved.

Canada also offers potential as an export market. The UK is currently the third largest exporter of dairy products to the nation, with butter and cheese being the main products. If the UK can maintain market access post-Brexit, there are potential opportunities for high-quality products such as cheese and butter.

Export opportunities for fresh milk and cream are limited due to the relatively short shelf life and relatively high water content, and so this could have an impact on wider trade links. However, milk powders, whey powders and hard cheeses all have comparatively long shelf lives. As a result, these products have a wider scope for export opportunities. Freezing butter is common, meaning it can be exported globally.



International competition from New Zealand, the world's largest exporter of dairy products, is likely to remain strong in the future. New Zealand also has a range of free trade agreements within the Asian markets, including China, is geographically closer to these markets and has the capacity to produce in-demand products.

As the likes of New Zealand have preferential access to these growing markets, the UK needs to be price- and/or quality-competitive depending on the market.

The UK also faces competition closer to home. Recently, the EU has been proactively gaining preferential access into markets through free trade agreements. Post-Brexit, the UK will be in direct competition with EU countries to capture market share.

In a 'no deal' Brexit scenario, tariffs on UK exports to the EU could cause particular issues for the cross-border trade with Ireland. Large volumes of raw milk in the UK are exported for processing in the Irish Republic and a proportion of the processed product is then exported back to the UK. Tariffs on UK exports to the EU and/or UK imports from the EU would likely make this trade with Ireland uneconomical.

Apart from tariffs, there could be delays for exports of products of animal origins. The UK will need to be listed as a third country by the EU and the lists of products for export to the EU will need approval. As the EU's response and timing regarding this is uncertain, this could potentially stop exports of dairy products to the EU for a period of time.

On the plus side, if tariffs are placed on UK imports of dairy products, import substitution could potentially be important for the dairy industry. While the UK has a trade deficit in some key dairy products, there's enough knowledge in the country to produce these (e.g. Cheddar, butter and yogurt). Investment in improving or expanding processing capabilities will be key to reduce the UK's reliance on imports and there are some examples of companies acting on this. For instance, in January 2018, Arla Foods announced a £72 million investment to be spent on improving processing facilities in the UK.

For more information regarding opportunities for UK dairy trade, Meat and Dairy – see the AHDB report, Meat and Dairy- Our Prospects in the global marketplace

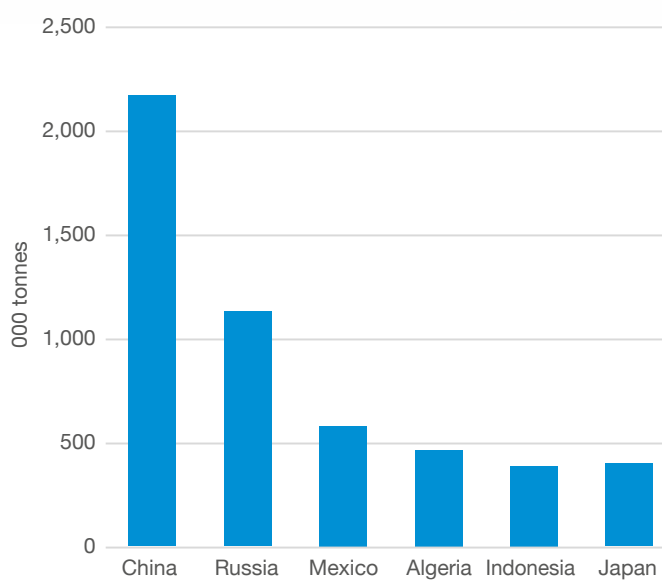


Figure 1. Leading dairy importers (excluding EU), 2017

Source: IHS Maritime & Trade-Global Trade Atlas®

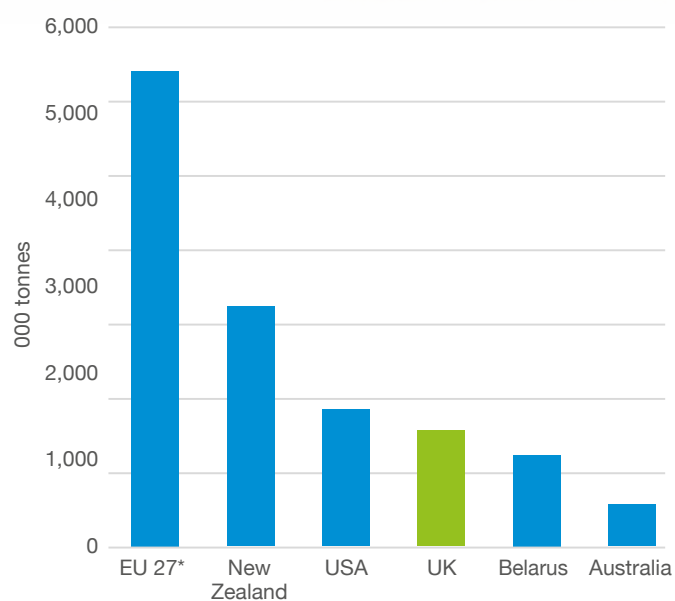


Figure 2. Leading dairy exporters, 2017

* Not including the UK

Source: IHS Maritime & Trade-Global Trade Atlas®/HMRC

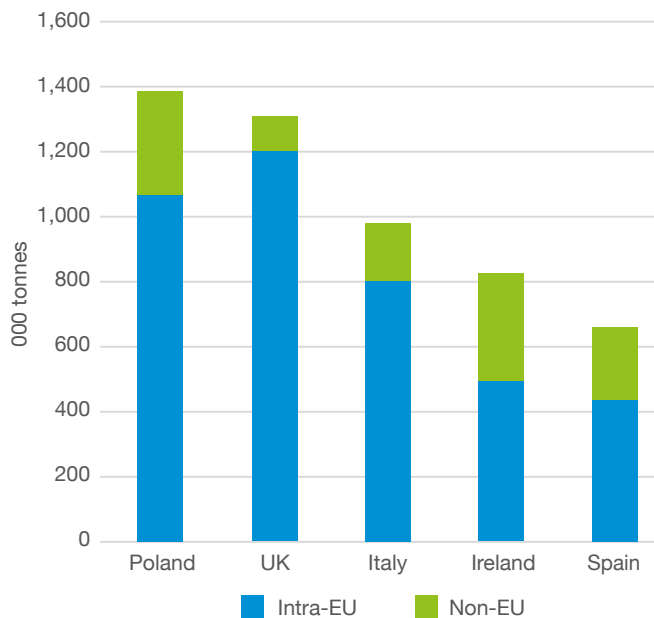


Figure 3. Leading EU dairy importers, 2017

Source: IHS Maritime & Trade-Global Trade Atlas®

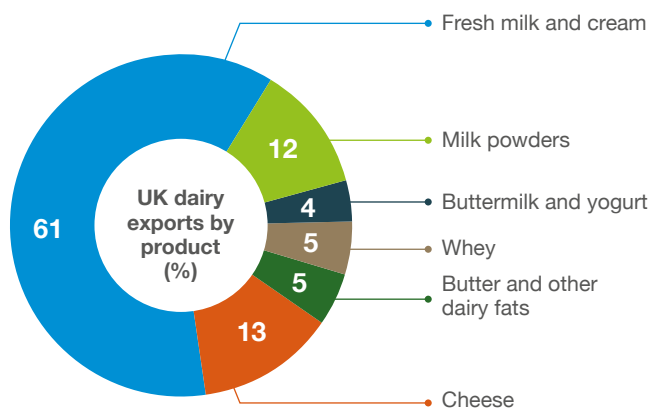


Figure 4. UK dairy exports by product (2013-2017 average)

Source: IHS Maritime & Trade-Global Trade Atlas®/HMRC

What's the current trade situation?

Between 2013 and 2017, the UK on average exported 1.1 Mt of dairy products per year, which equated to an average value of £1.3 billion. During this period, more than 90% of exports were shipped to the EU, highlighting the significance of the EU market to the UK dairy industry.

In volume terms, liquid milk and cream are the most significant export products for the UK dairy sector (Figure 4). Between 2013 and 2017, the UK exported on average 680,000 tonnes per year; however, the majority of this figure (92%) comprises movement across the Irish border. Most of the milk exported to Ireland is then processed and a proportion of the finished products will return to the UK market. Other exports of liquid milk are mainly UHT sales.

In value terms, cheese is the most significant export product for the UK dairy sector. The UK on average (2013–2017) exported 150,000 tonnes per year, with a value of £495 million. This trade is also dominated by the EU (83%), with Ireland and the Netherlands the main export destinations.

Cheddar is the largest exported cheese variety, in both value and volume terms. Between 2013 and 2017, Cheddar alone accounted for over half of all cheese exports and accounted for nearly 55% of the total value of exported cheese. Cheese exports have steadily increased over the past decade, with 2018 export volumes on track to be the largest on record; a reflection of the dairy sector as it looks to increase export volumes.

Exports of milk powders, including skimmed milk powder and whole milk powder, on average account for 12% of dairy exports. Ireland is the largest export destination, followed by the Netherlands, where a proportion may be exported to non-EU countries via the port of Rotterdam.

Exports to non-EU countries predominantly consist of cheese and powders. China in particular has become a significant export outlet. Exports of milk powders alone have increased dramatically from just 180 tonnes in 2012 to 7,300 tonnes in 2017.

TOP 5 DESTINATIONS FOR UK DAIRY EXPORTS (2017)

Ireland 71%
Netherlands 8%
France 4%
Belgium 3%
Germany 2%



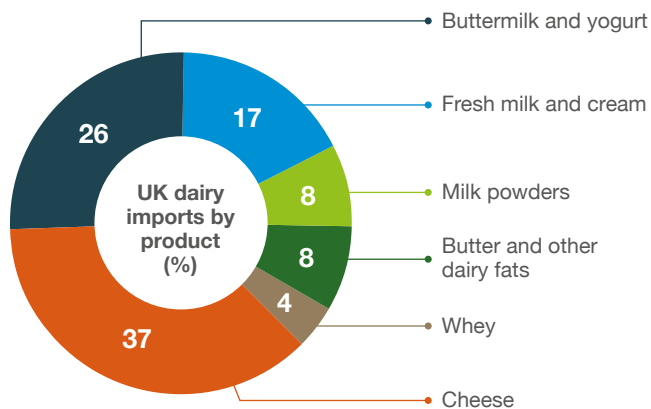


Figure 5. UK dairy imports by product (2013-2017 average)

Source: IHS Maritime & Trade-Global Trade Atlas®/HMRC

Between 2013 and 2017, imports of dairy products remained relatively steady, averaging at just under 1.3 Mt a year. Similar to exports, the EU is the key trading partner, with nearly all (99%) dairy imports sourced from the bloc.

Cheese is the largest imported dairy product (Figure 5), of which Cheddar is the most common variety (the majority of which comes from Ireland). Over the five-year period, fresh speciality cheese (including mozzarella) made up 38% of all imported cheese, with France and Germany the main import origins.

Around a third of imported dairy products come from Ireland, of which a proportion will be made with milk from the UK. Between 2013 and 2017, the UK imported on average, 135,000 tonnes of cheese and 62,000 tonnes of butter from Ireland every year.



TOP 5 ORIGINS FOR UK DAIRY IMPORTS (2017)



Ireland 33%
France 18%
Germany 16%
Belgium 8%
Denmark 7%

TOP 5 ORIGINS FOR UK CHEESE IMPORTS (2017)



Ireland 28%
France 16%
Germany 14%
Denmark 10%
Netherlands/Italy 8%

Across the five-year period, buttermilk, yogurt and other fermented dairy products (including kefir) on average accounted for 26% of total imports, with France, Germany and Belgium the main source nations. Of this, yogurt accounted for around 40% of the category, with an average of 133,000 tonnes of product imported every year during the period.

What does the domestic supply and demand situation look like?

Traditionally, dairy exports have been used as a means of clearing excess stock, surplus to demand in the domestic market (Figure 6, see page 9). Therefore, in a year when production is up, exports tend to follow accordingly.

Between 2013 and 2017, dairy product production has generally grown, reaching just over 8 million tonnes in 2017, 3% (311,000 tonnes) higher than in 2013. There was however a sharp decline in 2016 following a decline in milk production due to adverse weather and low farmgate prices. During the same period, exports mirrored the production movements.

The UK has a trade deficit in dairy and is therefore a net importer of dairy products. The extent of this deficit is impacted by a number of factors including manufacturing capacity, availability of raw materials and consumer product preference.



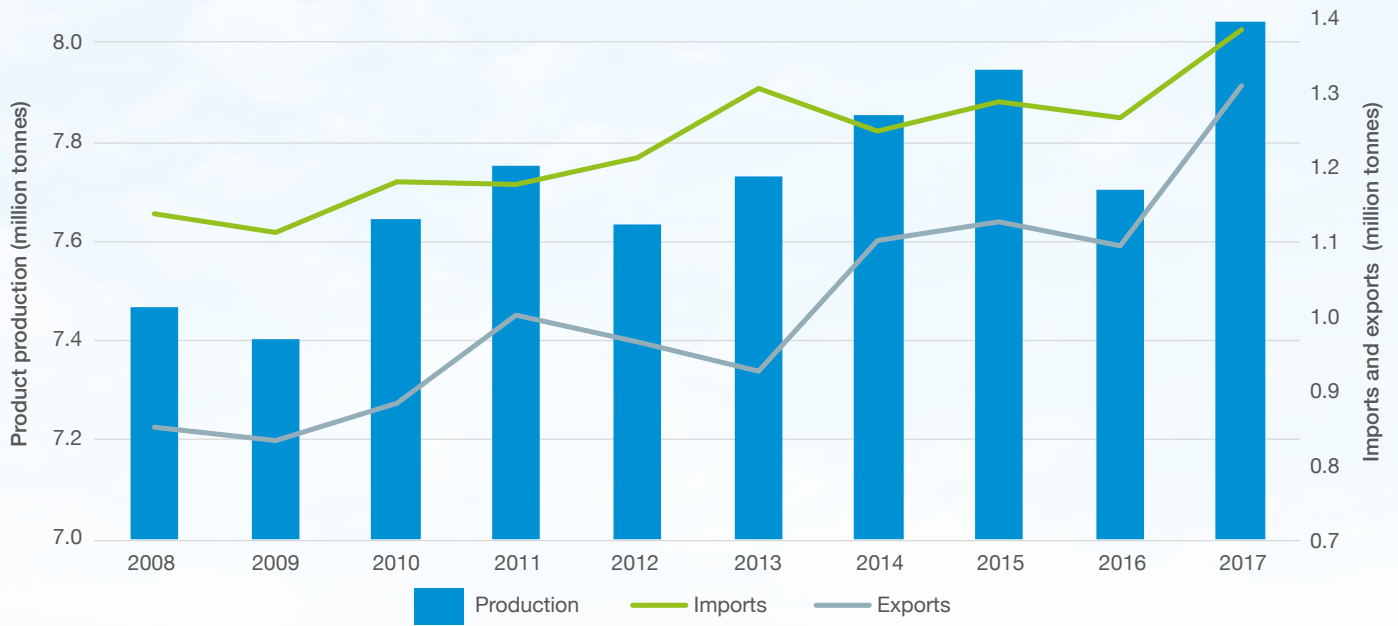


Figure 6. UK dairy product production and trade

Source: IHS Maritime & Trade - Global Trade Atlas®/HMRC/AHDB



How do the UK's costs of production compare with its competitors?

Production costs for typical UK dairy farms sit around mid-table of the selected countries (Figure 7). As such, the UK is not the most price-competitive source of raw milk globally. This demonstrates the need for the UK dairy industry to improve efficiency in order for British products to compete on international markets.

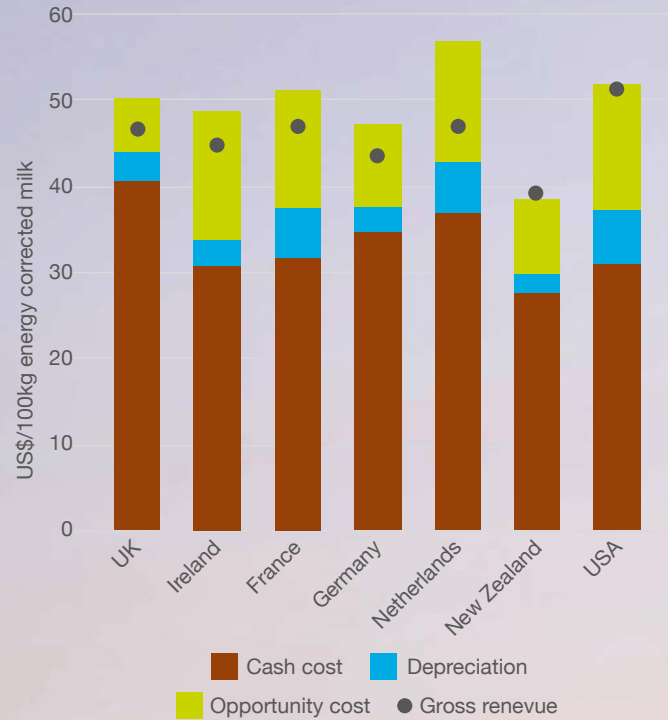


Figure 7. Milk average* cost of production and revenue (2013–2017)

*Average of representative farms in a given country, not the national average
Source: agri benchmark

AHDB's Optimal Dairy Systems programme is an example of tackling inefficiency in the British dairy industry. The aim of this work is to encourage farmers to make informed decisions on focusing on one of two production systems: block calving and all-year-round calving.

Total production costs on UK dairy farms are higher than the gross revenue, indicating there is still some reliance on subsidies. The recent Agriculture Bill stated that direct payments for England will be phased out over a seven-year period from 2021, giving the industry a timeframe in which it needs to improve efficiency.

If tariffs were implemented on UK dairy exports, shipments could be limited as they would be less price-competitive on the export market and therefore export revenues could see a decline. A lack of export demand could potentially weigh in on prices and, ultimately, profits. However, overall, the UK is a net importer of dairy products and so if the UK decided to place tariffs on imports, this would support domestic prices and help profitability (all else being equal).

Nevertheless, there is the opportunity for the UK to take advantage of more mature markets, where quality rather than price drives demand, with high-price premium items such as cheese and butter.



Please note that these percentage splits could change in the future as negotiations are ongoing

How could tariffs affect trade?

Most dairy products imported into the EU are subject to tariffs, which are usually fixed based on the product weight or weight of lactic matter in the product. The tariffs effectively mean that most non-EU exports are uncompetitive on the EU market.

Under a 'no deal' scenario, the UK would also be subject to these tariffs, which is likely to reduce the competitiveness of British products on the European market. With 91% of dairy-product exports destined for the EU, this would significantly impact the UK dairy industry.

Table 1 demonstrates the impact these tariffs could have. For example, exports of butter in less than 1 kg packaging would be subject to a €1,896 per tonne tariff.

How much the tariffs would actually impact prices is influenced by a number of factors, including the unit price and exchange rates. For example, in 2015, the tariff on butter in less than 1 kg packaging would have accounted for 63% of the unit price, whereas in 2017, it declined to 41%. This was due to a considerably higher unit price and a weaker sterling/euro exchange rate relative to 2015 levels.

The EU does, however, have a number of TRQs, mainly covering butter and cheese, which allow limited volumes of product to enter from non-EU countries at significantly reduced tariff levels. When the UK leaves the EU, existing TRQs will be split between the two (see full report for more details). Most dairy-product TRQs would be split in favour of the EU, with the exception of the New Zealand cheese for processing TRQ (4,000 tonnes) and Canadian Cheddar TRQ (4,000 tonnes)¹. Comparing the typical level of UK cheese imports with the TRQs that may be available, it is likely that most UK cheese and butter imports would be subjected to the full tariff rates.

While geographical indications (GI) can offer some protection against lower-cost imports, the designation is dependent on EU laws. For the 18 registered GI cheeses currently made in the UK, continued protection will be dependent on a common agreement between the UK and the EU.

¹ Please note that these percentage splits could change in the future as negotiations are ongoing.



Table 1. Top 5 dairy products exported by the UK (2017) with effective ad valorem rate comparison (2015 and 2017)

Code	Product	Tariff rate	Effective ad valorem (2015 export unit price)	Effective ad valorem (2017 export unit price)
04012099	Milk and cream, not concentrated or sweetened: Fat content 3-6%, in immediate packing of >2 litres	€21.8/100kg	74%	63%
0406021	Cheddar-(not grated or for processing)	€167.1/100kg	42%	40%
04012091	Milk and cream not concentrated or sweetened: Fat content 3-6%, in immediate packings of <=2 litres	€22.7/100kg	39%	42%
04021019	Milk and cream, not concentrate or sweetened in solid forms, unsweetened fat content <=1.5%, immediate packings >2.5kg	€118.8/100kg	63%	79%
04051019	Natural butter, fat content <= 85%, in packings >1kg	€189.6/100kg	63%	41%

If the UK wishes to register the protected cheeses post-Brexit with the EU, it would first need to set up its own national approval scheme. Only when products have been approved by a non-EU country's own national scheme can they be considered for approval under the EU protected food scheme. In the event of a common agreement, any GI-designated products would then also be protected by countries which have a free trade agreement or bilateral agreement with the EU.

Out of all of the EU member states, Ireland looks poised to be the most impacted in dairy terms, due to the nature of the border separating Northern Ireland from the Republic. As mentioned previously, the UK and Ireland deal in a lot of cross-border dairy trade, where raw milk is exported and the processed products subsequently imported. Therefore, the introduction of duties or any trade barriers would seriously impact dairy industries in both Northern Ireland and the Republic of Ireland.



EU import tariff rates for selected dairy products

Within a report of this kind, it is impractical to list tariff rates for all dairy products. The table below, therefore, covers a selection of the main products either imported or exported by the UK.

Code	Product	Tariff rate	Effective ad valorem rate (2015 prices)	Effective ad valorem rate (2017 prices)
0401	Milk & cream, not concentrated or sweetened			
04012011	Fat content 1-3%, in immediate packings of <=2 litres	€18.8/100 kg	39%	42%
04012099	Fat content 3-6%, in immediate packings of >2 litres	€21.8/100 kg	74%	63%
04015039	Fat content 21-45%, in immediate packings of >2 litres	€109.1/100 kg	50%	37%
0402	Milk & cream, concentrated or sweetened			
04021019	In solid forms, unsweetened, fat content <=1.5%, in immediate packings >2.5kg	€118.8/100 kg	63%	79%
04022118	In solid forms, unsweetened, fat content 1.5%-27%, in immediate packings >2.5kg	€130.4/100 kg	46%	39%
04022919	In solid forms, sweetened, fat content 1.5-27%, in immediate packings >2.5kg	€1.31/kg of lactic material + €16.8/100 kg	n/a	n/a
0403	Buttermilk, yogurt and similar products			
04031091	Yogurt, flavoured or with added fruit, nuts or cocoa, of milkfat content <=3%	8.3% + €12.4/100 kg	14%	17%
04039091	Buttermilk and similar products, flavoured or with added fruit, nuts or cocoa, of milkfat content <=3%	8.3% + €12.4/100 kg	12%	16%
04039093	Buttermilk and similar products, flavoured or with added fruit, nuts or cocoa, of milkfat content 3-6%	8.3% + €17.1/100 kg	12%	20%
04039099	Buttermilk and similar products, flavoured or with added fruit, nuts or cocoa, of milkfat content >6%	8.3% + €26.6/100 kg	17%	18%
0404	Whey and whey products			
04041002	In solid forms, unsweetened, protein content <=15%, fat content <=1.5%	€7.0/100 kg	6%	8%
04041014	In solid forms, unsweetened, protein content >15%, fat content 1.5%-27%	€135.7/100 kg	52%	45%
0405	Butter, fats/oils and dairy spreads			
04051011	Natural butter, fat content <=85%, in immediate packings of <=1kg	€189.6/100 kg	49%	40%
04051019	Natural butter, fat content <=85%, in immediate packings >1kg	€189.6/100 kg	63%	41%
04052010	Dairy spreads, fat content 39-60%	Derived by formula based on constituents	n/a	n/a
04059010	Other fats & oils derived from milk, fat content >=99.3%, water content <=0.5%	€231.3/100 kg	63%	41%

Note: effective ad valorem rates calculated using export unit prices for that year

Code	Product	Tariff rate	Effective ad valorem rate (2015 prices)	Effective ad valorem rate (2017 prices)
0406	Cheese and curd			
04061030	Fresh Mozzarella, fat content <=40%	€185.2/100 kg	41%	43%
04061050	Other unripened cheese, fat content <=40%	€185.2/100 kg	59%	42%
04061080	Unripened cheese, fat content >40%	€221.2/100 kg	68%	67%
04062000	Grated or powdered cheese	€188.2/100 kg	50%	48%
04063010	Processed Emmental, Gruyere and Appenzell cheese	€144.9/100 kg	34%	42%
04063031	Other processed cheese, fat content <=48%	€139.1/100 kg	36%	34%
04063039	Other processed cheese, fat content >48%	€144.9/100 kg	22%	25%
04064090	Blue-veined cheese other than Roquefort, Gorgonzola	€140.9/100 kg	14%	14%
04069021	Cheddar	€167.1/100 kg	42%	40%
04069032	Feta	€151.0/100 kg	28%	24%
04069061	Grana Padano, Parmigiano Reggiano	€188.2/100 kg	19%	14%
04069081	Cantal, Cheshire, Wensleydale, Lancashire, Double Gloucester, Blarney, Colby and Monterey	€151.0/100 kg	19%	21%
04069089	Other cheese, fat content <=40%, water content >52% – <=62%	€151/100 kg	21%	22%
04069099	Other cheese, fat content >40%	€221.2/100 kg	50%	40%

AUTHORS



Amandeep Kaur Purewal
Senior Analyst



Felicity Rusk
Analyst

Produced for you by:

AHDB

Stoneleigh Park
Kenilworth
Warwickshire
CV8 2TL

T 024 7669 2051

E comms@ahdb.org.uk

W ahdb.org.uk

 [@TheAHDB](https://twitter.com/TheAHDB)

If you no longer wish to receive this information, please email us on comms@ahdb.org.uk

All other trademarks, logos and brand names contained in this publication are the trademarks of their respective holders. No rights are granted without the prior written permission of the relevant owners.

While the Agriculture and Horticulture Development Board seeks to ensure that the information contained within this document is accurate at the time of printing, no warranty is given in respect thereof and, to the maximum extent permitted by law, the Agriculture and Horticulture Development Board accepts no liability for loss, damage or injury howsoever caused (including that caused by negligence) or suffered directly or indirectly in relation to information and opinions contained in or omitted from this document.

© Agriculture and Horticulture Development Board 2019. All rights reserved.

