

**Production forecast and expected changes in the trade situation in the UK
on re-introduction of OTM cattle born after 01-08-1996 into the food chain**

Introduction

The government announced last week that it intends to replace the OTM rule with a robust and rigorous system of testing cattle for BSE as recommended by the Food Standard Agency. The likely effect of these changes is that OTM cattle born after 01-08-1996 will get back into the food chain starting from September 2005. In this paper, we examine the effects this could have on the tonnages of OTM beef returning into the food chain and the likely implications on trade (imports, exports) and price.

OTM beef or cow beef is used as a raw material for the production of processed beef products such as ready meals, pastry products and beef burgers. Part of the carcass is used for the retail and food service sector as fresh mince. In addition, some cow hindquarters are used as high value cuts and are most valuable in continental Europe.

Summary / Conclusion

We expect 140,000 to 165,000 tonnes of UK product weight back into the food chain in 2006; this is the equivalent to 185,000 – 215,000 tonnes of carcass weight. Export will be limited as long as the DBES is not lifted and even if lifted, in the short/medium term most product is expected to be consumed within the UK.

The return of this significant amount of manufacturing beef into the food chain will replace EU imports and will especially have a large effect on our largest importer, the ROI. However, with production deficit in the EU of manufacturing beef as large as 350,000 tonnes in 2005, the ROI should be able to find other markets in their already established sales market within the EU. This could prevent a situation, where the UK manufacturing beef needs to heavily undercut the price of current imports. The sizeable quantities of OTM manufacturing beef coming back onto the market could have a dampening effect on price. However, taking into account positive post de-coupling effects on price and the growing market for manufacturing beef, the OTM beef price could very well be similar to the current O3 and P2 prices of today. These are respectively £1.28/kg and £0.84/kg. Currently the OTMS rate is £0.89/kg.

Production forecast OTM cattle for food chain

If the OTM cattle will be allowed in the food chain from September 2005 onwards, we expect the following production figures for NI and the UK.

	NI	UK
September–December 2005		
Cattle slaughtering	53,000	329,000
'000 Tonnes carcass weight	13.8 – 15.7	85.5 – 97.8
'000 Tonnes Product weight (77% of carcass weight)	10.6 – 12.1	65.8 – 75.3
2006		
Cattle slaughtering	115,500	719,000
'000 Tonnes carcass weight	30.0 – 34.3	187.0 – 213.6
'000 Tonnes Product weight (77% of carcass weight)	23.2 – 26.4	144.0 – 164.5

Assumptions for forecast:

- estimates based on 2003 and current cow numbers
- adjusted for seasonality
- minus 15% for 2005 and 10% for 2006 for cows born before 01-08-1996
- 5% increase on OTM kill due to OTM ban lifted, i.e. improving herds, quicker replacements etc
- 3 months prior to September OTM slaughtering will slow down to 25% of normal kill in August
- September and October 2005 kill will be exceptional high due to earlier three months slowdown and seasonality effects

(See graphs: NI and UK OTM slaughtering)

Expected changes in the trade situation in the UK

Even if the DBES is lifted and export of beef is allowed, it is still likely that most of the OTM beef will be consumed in the UK. The reason being that the UK has currently a production deficit in manufacturing beef and is 60% self sufficient in total beef and beef products. Mainly imports from ROI and other European countries fill this gap today. We expect that UK OTM beef will replace EU produce, especially from the ROI.

Imports from non-EU countries like Brazil and Argentina are either high value cuts or very cheap processed meat and are thought not to be affected by the return of UK OTM beef into the food chain.

The EU export to the UK in 2003 is up to 220,000 tonnes of beef product weight (beef & veal and processed beef). The ROI, as the largest exporter, will be most affected by the return of UK OTM beef in the food chain. Other EU exports from The Netherlands, Germany and France to the UK will also be affected. Based on our UK production forecast and the UK import figures of 2003, 47.5% – 55% of the total EU imported beef will be replaced by UK OTM beef.

The country which is most affected by the return of OTM beef in the food chain is the ROI. However, with an estimated production deficit of 350,000 tonnes in 2005 in the EU, the ROI will adapt to the new situation and find other export markets. This is possible especially because the ROI redmeat industry has well developed export markets within the EU.

Price

There are several factors which will influence the manufacturing beef price in 2005 and onwards. Firstly, manufacturing beef consumption is growing rapidly and is becoming more important in total beef production. For example, the O3 cow price in percentage of the R3 steer price in the ROI has increased from 72% in 2003 to 78% in 2004. The rising prices in manufacturing beef or forequarter beef reflect the tighter EU beef supply situation. This trend is likely to continue and O3 cow price could therefore continue to rise.

Secondly de-coupling is expected to have a positive effect on beef prices and this should include O3 prices and perhaps P2 as well. The current subsidy effects on prices will disappear and during 2005 we will see a beef price largely unaffected by subsidies. To encourage the cattle producers to continue producing beef at a profit, and to better finish cows for the market, the deadweight price of all grades should rise. The overall expected effect of de-coupling is a reduction in cattle numbers in the next five years (mid-term), leading in the tighter supply situation.

Thirdly the EU production deficit is likely to increase in the coming years, due to global competitiveness. This is a result of the expected WTO agreement in 2006, which leads to more imports from non-EU countries. Significant beef imports from the new EU countries are unlikely in the mid-term future. The redmeat industry in the new EU countries compared to original EU 15 is 'underdeveloped', i.e. not utilising full capacity, and will take time to be established. In the long term the new EU countries could develop a significant redmeat industry as wages and land costs are lower than for example in the UK.

Finally, the short term price effect of large volumes of beef re-entering the marketplace can be negative and result in a temporary over supply situation. Also, an over supply situation of O3 cow beef could have a negative price effect on all grades, as an O3 carcass will still provide some good quality cuts and raise competitiveness against other higher grades.

However, the current ROI price for O3 and P2 is a reasonable indicator of what the UK OTM beef price could become after September 2005. The O3 price in the ROI is £1.28/kg and the P2 price is £0.84/kg. Currently the UK OTMS rate is £0.89/kg.

The estimated value of the NI and UK OTM produce based on our estimate that 50% O3 and 50% is P2 is:

	NI	UK
2005		
'000 Tonnes carcass weight	13.8 – 15.7	85.5 – 97.8
Estimated value in Million of Pounds	£ 14.6 – 16.6 million	£ 90.6 – 103.7 million
2006		
'000 Tonnes carcass weight	30.1 – 34.3	187.0 – 213.6
Estimated value in Million of Pounds	£ 31.9 – 36.4 million	£ 144.0 – 164.5 million

Based on these figures the improvement in cull cow value in NI that will be achieved over current value is estimated at £2.3-2.6 million in 2005, and £5.1-5.9 million in 2006. This is below LMC's previous estimate that the OTMS is costing NI £11 million per year because it is based on the assumption of 50%P2/50%O3 grades resulting from the average cow finisher receiving 17p/kg above the current OTMS rate. However, beef cow finishers and some dairy finishers will improve feeding/management and lift grades from P2 to O3 in a proportion of OTM cattle, which would result in a 39p/kg increase in return compared to the current OTMS price. The eventual improvement to the industry will thus depend on the proportional lift between 17 and 39 p/kg; for example if half the cattle get better grades another 11p/kg will be achieved on top of the predicted 17p/kg, which is a further 65% increase to total industry improvement.