State of Industry Report

Q4 2022

Executive summary

- Food and drink manufacturers were less pessimistic in Q4, with industry confidence reaching -47%, its highest level since Q3 2021 and above the record low of -79% in Q3 2022.
- Business conditions for Q1 2023 are expected to remain the same or worsen.
- Labour shortages eased to 7.0% in Q4, down from 9.1% in Q3. These vacancies range from high-skilled roles (engineers or scientists) to production operatives (machine operators or night shift workers).
- Manufacturers expect total costs to increase on average by 10% and selling prices by 7% during 2023.
- 47% of manufacturers think that market competitiveness with the EU has worsened over the last year.
- To tackle cost pressures, 54% of businesses are changing procurement strategies and 49% are making production more energy efficient.
- 64% of businesses are developing new products (including packaging), and 54% are restructuring operations to maintain competitiveness.

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Read more from FDF business insights and economics

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Agricultural raw materials	
Sunflower oil ($/mt)	▼ - 17.4%
Rapeseed oil ($/mt)	▼ - 13.2%
Palm oil ($/mt)	▼ - 29.6%
Wheat, US HRW ($/mt)	▼ - 16.8%
Maize ($/mt)	▼ - 3.8%

Inflation commentary

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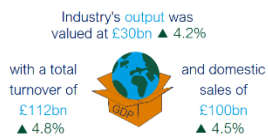
Industry facts and stats



Encouraging signs despite persistent risks

2023 started with encouraging signs that the tide of high costs may be turning, though many risks lie ahead.

Wholesale gas prices are down markedly since November while the gas futures curve has fallen over 2023, signalling market participants believe the drop in prices is here to stay. However, today's gas prices are around double those of 2019. Global supply chain pressures have eased since their height in summer 2021, but snags persist and smooth, pre-pandemic logistics operations are yet to return. Oil prices are around 25% cheaper than in June 2022 and sterling has recovered lost ground.

UK producer price inflation has shown initial signs of easing, with prices of imported ingredients decreasing for the first time in a year and a half, while monthly inflation of UK-sourced ingredients has decelerated (Chart 1). Global food prices have persistently declined since March of last year, but they are 40% above their 2019 level.

In a nutshell, cost pressures are easing, but not fully dissipating. This means that food inflation is likely to ease this year, also as base effects will take hold, but will remain elevated compared to pre-pandemic levels.

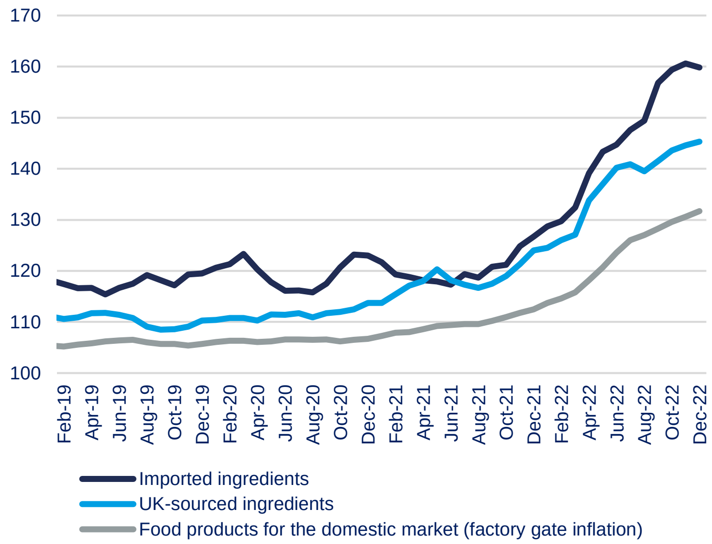
Continued cost pressures will test the industry and wider economic conditions will compound these challenges. The UK economy is slowing and so is consumer spending. Food sales rose 7.9% in Q4, according to BRC-KPMG, while food inflation ran at 16.6%. This suggests volume sales declined by over 8%, so manufacturers are losing sales, while their margins are being squeezed by the barrage of rising costs.

It is, then, not surprising that food and drink insolvencies have doubled in 2022 compared to 2019 (Chart 2), significantly above the trend in the wider economy: there was a 25% rise in insolvencies across the Great Britain.

Investment in the industry has been on a downward trajectory since Q3 2021 (Chart 3). To deal with intense cost pressures, manufacturers cut training or marketing budgets, but also paused or cancelled investment projects. Higher financing costs and heightened uncertainty put further brakes on investment. Lower investment means less innovation and limits growth and productivity gains.

Uncertainty continues, with expected volatility in global food prices driven by low global grain stocks, low projected output in Ukraine, high fertiliser prices and adverse weather impacts. Labour shortages are likely to persist, and financing costs may increase further.

Chart 1: Producer price inflation



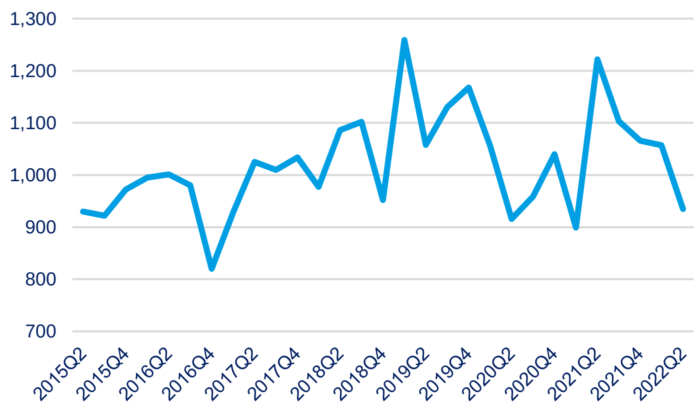
Source: ONS

Chart 2: Number of insolvencies

	2019	2022 (Jan-Nov)	2022 insolvencies as % of 2019 insolvencies
Food manufacturing (GB)	95	173	182%
Drink manufacturing (GB)	27	71	263%
Manufacturing (GB)	1,540	1,769	115%
Great Britain	18,205	23,185	127%

Source: The Insolvency Service, gov.uk

Chart 3: Business investment in the food and drink manufacturing (in £m, 2019 = 100)



Source: ONS

Manufacturers regain some hope

Manufacturers were less pessimistic in Q4, with industry confidence reaching -47%, its highest level since Q3 2021 and above the record low of -79% seen in Q3 2022 (Chart 4).

On the face of it, this jump in confidence seems to indicate a sharp improvement in the mood of manufacturers. However, given the way the this confidence score is calculated, a higher score may indicate either better or largely unchanged business conditions, with the latter being the case this quarter.

The score is calculated as the difference between those who thought general business conditions have improved in Q4 2022 from the previous quarter and those who believed conditions have deteriorated, but excludes businesses facing the same conditions. In Q4, 55% perceived conditions to have deteriorated, 37% thought they faced similar conditions, while only 8% saw improving conditions compared to Q3.

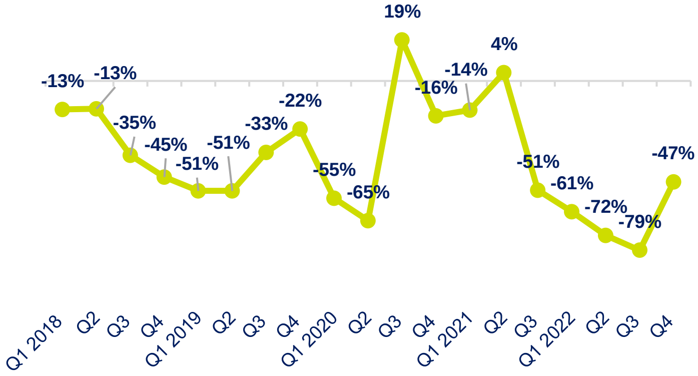
The reality is that the Q4 results shows that conditions remain challenging. The Energy Bill Relief Scheme and its recent extension to most of our sector has eased immediate pressures, as has persistent falls in global agricultural commodity prices. However, geopolitical unknowns and the slowdown of the UK economy make for highly uncertain times.

In Q4, businesses thought conditions have continued to worsen. Over half (52%) of manufacturers with a turnover of £500m+ saw conditions worsen from the previous quarter, compared to 100% in Q3 (Chart 5). Small businesses saw a similar trend, with 40% seeing a worsening, down from 67%. Mid-sized companies fared the worst, with 76% feeling conditions deteriorated, however this is still down from 85% in Q3.

Business conditions in Q1 2023 are expected to remain the same or worsen, although the sentiment is more optimistic than previously. 38% of all businesses believed conditions would deteriorate compared to Q4, lower than 54% in Q3 who had the same feeling for Q4. 43% of respondents believe conditions will remain the same, and 15% believe they will improve.

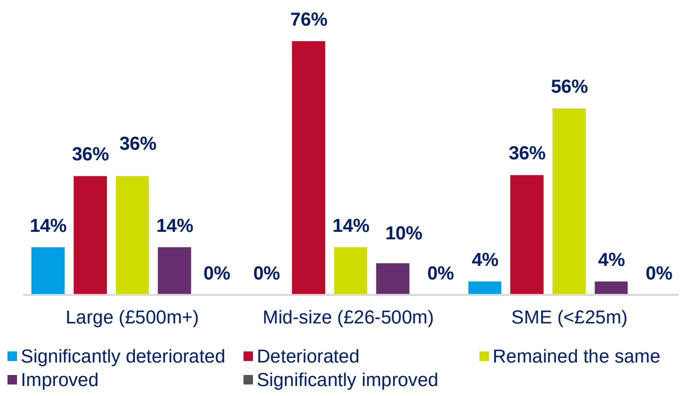
The outlook for Q1 2023 is relatively consistent across all business sizes (Chart 6). Immediate cost increases and market volatility have impacted small companies, but with these starting to slow, the outlook is less negative. Larger manufacturers will have started new contracts on key purchases of inputs and while cost pressures continue, there is hope that they may get worse.

Chart 4: FDF net confidence tracker



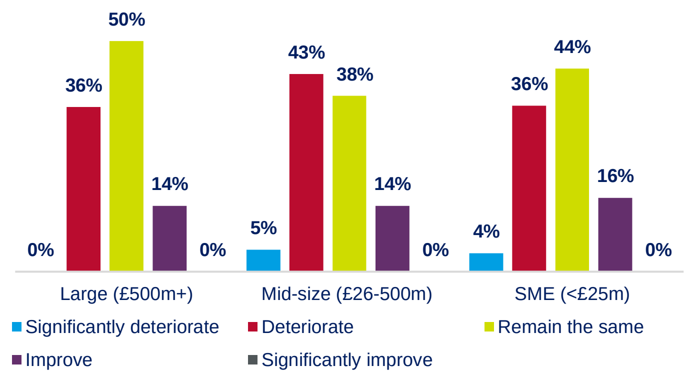
Source: FDF State of Industry Survey

Chart 5: Business conditions in Q4 2022 compared to Q3 2022



Source: FDF State of Industry Survey

Chart 6: Expectations about business conditions in Q1 2023 relative to Q4 2022



Source: FDF State of Industry Survey

Unfilled vacancies starting to ease

Unfilled vacancies have eased in Q4, however, food and drink continues to struggle compared to the UK labour market performance as a whole or the wider manufacturing sector. The reported vacancy rate (the number of vacancies per 100 employees) this quarter has fallen to 7.0% from 9.1% in Q3. Our industry's vacancy rate is more than double that of the UK (3.8%) or manufacturing (3.3%) (Chart 7).

Just over half (52%) of manufacturers report a vacancy rate of 0-5% (Chart 8).The average vacancy rate was 6.7% for large businesses, 5.2% for mid-sized businesses, and 7.4% for small businesses. With vacancies in the wider economy still at significantly high levels, smaller firms, with lower market power, bear the brunt of labour market shortages.

Shortages were reported across a wide range of roles and skills, including:

- **High-skilled workers:** R&D specialists, engineers, procurement specialists, scientists, commercial, finance, and marketing roles.
- **Technical specialists:** bakers, specification technologists, food technologists, NPD technologists.
- **Production operatives:** production and machine operatives, delivery drivers, packing operators, night shift workers.

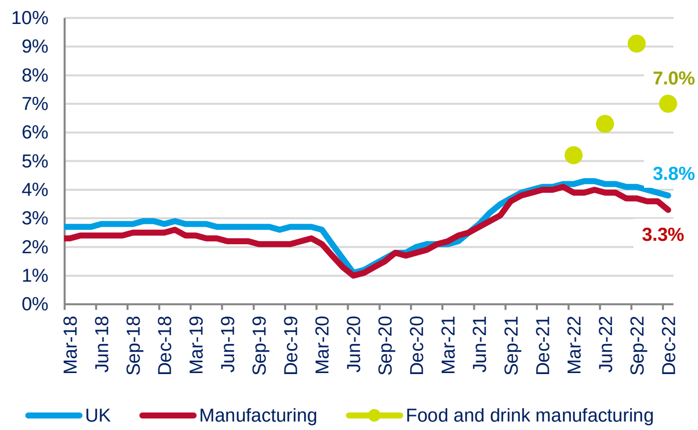
The fall in vacancies is explained by lower demand for temporary workers and a slowdown in production. Some manufacturers will flex their workforce in Q3, as they ramp up production to meet peak Christmas demand. This elevated output is usually completed by the end of October and the demand for temporary workers reverses during the final quarter of the year. At the same time, ONS figures show that employment in the industry fell by 4,000 in Q3, to 456,000 (Chart 9). This suggests vacancies are more likely being closed than filled.

Over a quarter (28%) of manufacturers have reduced product lines and 11% have reduced working hours over the last quarter to reduce the pressures of increased ingredient, packaging, energy and transportation costs. Severe labour shortages have acted as a drag on industry growth and have compounded cost increases.

Businesses aim to solve this issue by increasing production automation, but that takes time and investment is squeezed by high costs, which means the short-term outlook remains challenging.

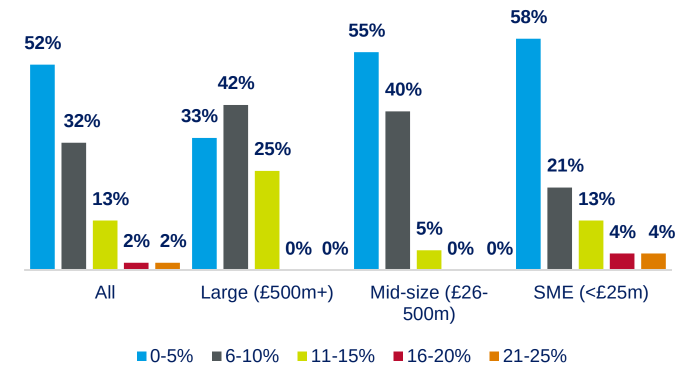
Chart 7: Vacancy rate in UK, manufacturing and food and drink manufacturing

(number of vacancies per 100 employees)



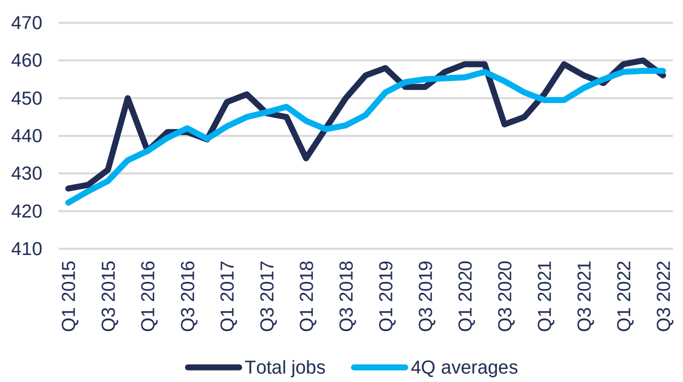
Source: FDF State of Industry Survey and ONS

Chart 8: Labour vacancies by business size



Source: FDF State of Industry Survey

Chart 9: Jobs in the food and drink manufacturing – total and 4Q averages (in '000)



Source: ONS, JOBS03 and JOBS04 series

Costs expected to continue to rise in 2023

Over the past year (Q1-Q4 2022), the majority of manufacturers (94%) have reported total production cost increases, averaging 21%. The largest share of businesses (39%) reported cost increases of 10-19%, with almost a quarter (24%) reporting increases between 30-50% (Chart 10).

Businesses expect total costs to increase by an average of 10% in 2023. Half of large companies (50%) expect increases of 10-19%, while just over half (54%) of small businesses expect increases of less than 10%. While some cost pressures are starting to subside, margins will continue to be squeezed. Higher financing costs, slowing demand and labour shortages will increase the costs of doing business. With some businesses tied into fixed term contracts, all of this points to persistent high food price inflation throughout 2023.

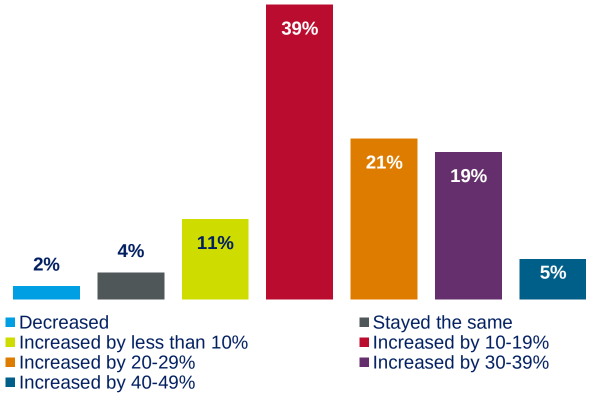
Labour costs have become more expensive, with the majority of respondents (86%) reporting cost rises of up to 20%. Half of manufacturers (50%) reported increases of less than 10% and a third (36%) saw labour costs increase between 10-19%. This was consistent across all business sizes, with 100% of large, 90% of mid-size and 76% of small businesses reporting increases of up to 20% to their labour costs (Chart 11).

To deal with the barrage of cost pressures, manufacturers have had to pass on a proportion of increased costs to their customers. Average selling prices rose by an average of 9% in 2022, with 38% of businesses raising their average selling price by less than 10%, while 38% increased theirs by 10-19%. Smaller businesses found it more difficult to share rising costs with customers, 20% of them seeing their average selling price staying the same.

Businesses expect increases in the average selling price to average 7% over the next year. 58% of small businesses expect an increase of less than 10%, highlighting the difficulty they face securing cost price increases.

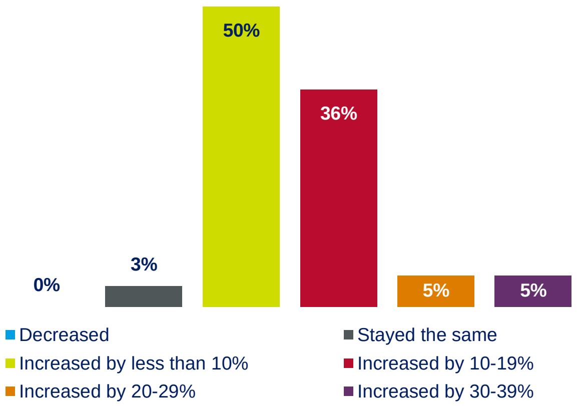
Manufacturers are also tackling cost pressures in other ways to limit the scale of price increases. 54% are changing procurement strategies and 49% are making production more energy efficient. 39% are pausing or cancelling capital investment projects and some are cutting other marketing or training budgets (Chart 12).

Chart 10: On average, how have your production costs changed over the last year (Q1 2022 – Q4 2022)?



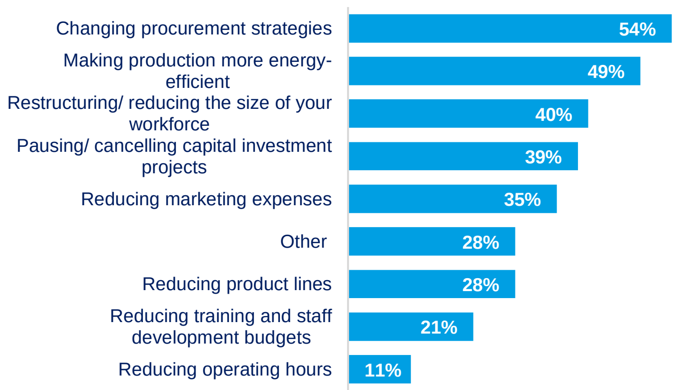
Source: FDF State of Industry Survey

Chart 11: On average, how have your labour costs changed over the last year (Q1 2022 – Q4 2022)?



Source: FDF State of Industry Survey

Chart 12: How are you managing increased cost pressures?



Source: FDF State of Industry Survey

Strong focus on new product development

Manufacturers remain committed to growth despite the challenging circumstances. While 44% of companies stated that their production had increased during 2022, production remained unchanged for 28% while almost a third (29%) reported that output was down (Chart 13).

Over the next year, more than three quarters (78%) expect their production to increase or remain the same. Overall, the expectation for 2023 is that output will flatline.

With mounting costs, planned capital investment expenditure for 2023 relative to 2022 has been impacted. 43% are planning for it to fall, 30% are keeping it the same and 27% are planning to increase investment. Small businesses are remaining resilient with their capital expenditure, with 54% expecting it to remain the same in 2023 compared to 2022.

Access to markets is critical for future growth in UK food and drink. Almost half (47%) report that market competitiveness with the EU declined during 2022 (Chart 14).

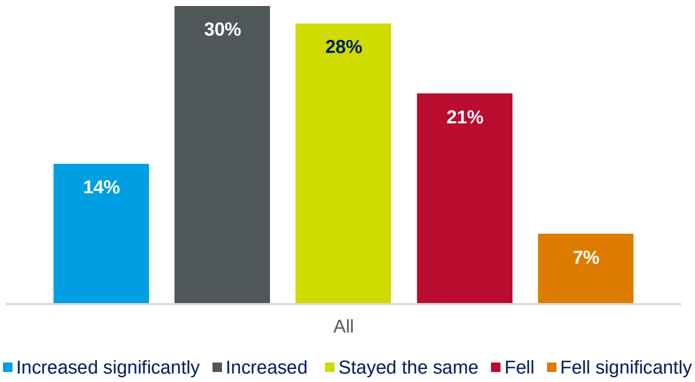
Continued challenges relating to product and documentary checks at the border, uncertainty regarding the Northern Ireland Protocol and generally disappointing business conditions in Europe has meant that manufacturers have found it more difficult in the past year to access EU markets. In comparison, the view on competitiveness in the UK market was more positive, with 72% saying it improved or stayed the same.

Over the next year, competitiveness is expected to largely remain the same for UK, EU and non-EU markets. There is a positive outlook for UK competitiveness, with 87% expecting it to improve or remain the same.

After a challenging 2022, this upcoming year is a fresh opportunity for manufacturers to target growth. 64% of businesses are developing new products (including packaging) and 54% are restructuring operations to maintain competitiveness.

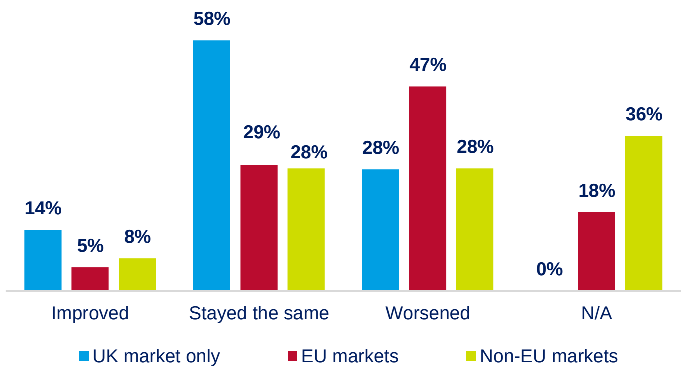
Competitiveness and further developing the range of products on offer to consumers is at the forefront of manufacturers' priorities, with nearly a quarter (23%) also committing to developing healthier products (Chart 15).

Chart 13: How has your volume of output changed over the last year (Q1 2022 – Q4 2022)?



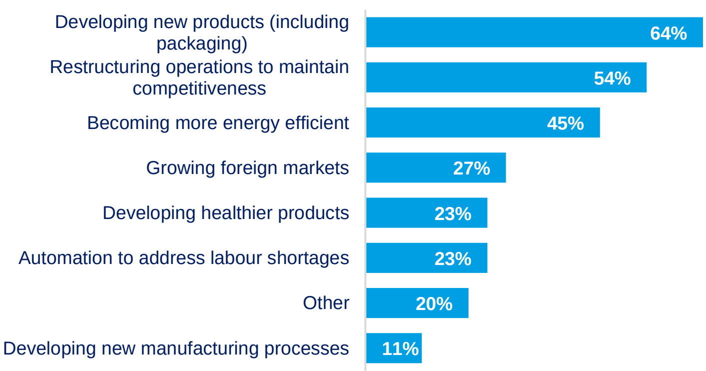
Source: FDF State of Industry Survey

Chart 14: How has your competitiveness been impacted over the last year in the following markets?



Source: FDF State of Industry Survey

Chart 15: What are the top three growth priorities for your business for 2023?



Source: FDF State of Industry Survey

Who responded?

Businesses responding to this survey in Q4 represented 16% of our industry by turnover, representing all turnover bands, all employment sizes and a wide range of different sub-sectors of our industry.

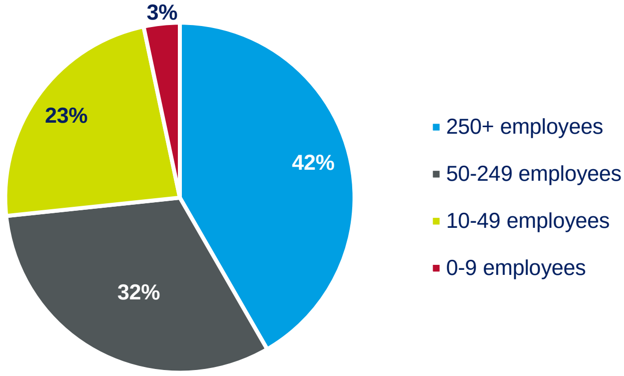
42% of the businesses surveyed are large employers with more than 250 employees, while 3% of the respondents are micro-businesses with fewer than 10 employees (Chart 16).

Our survey included a good representation of companies of all sizes by turnover. 17% of responses were from small companies with a turnover of £5m or less, while 10% have a turnover in excess of £1bn (Chart 17).

Responses were received from a wide variety of sectors (Chart 18). About half (48%) operate within the 'Other food products' sector, which includes manufacturers producing ingredients, confectionery, condiments, and prepared meals. The second best-represented sector was bakery, with 33% of the overall respondents.

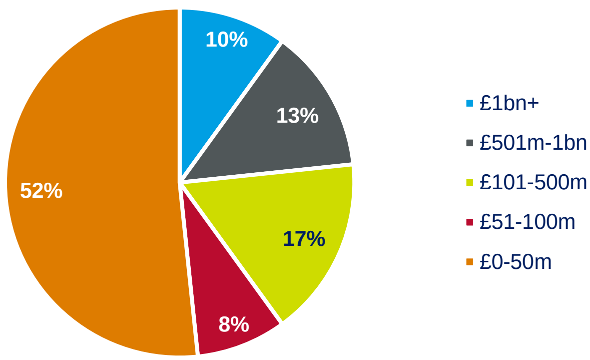
Three quarters of respondents operate in England, while 22% manufacture in Scotland and 15% have production located in Wales.

Chart 16: Share of respondents by employment size



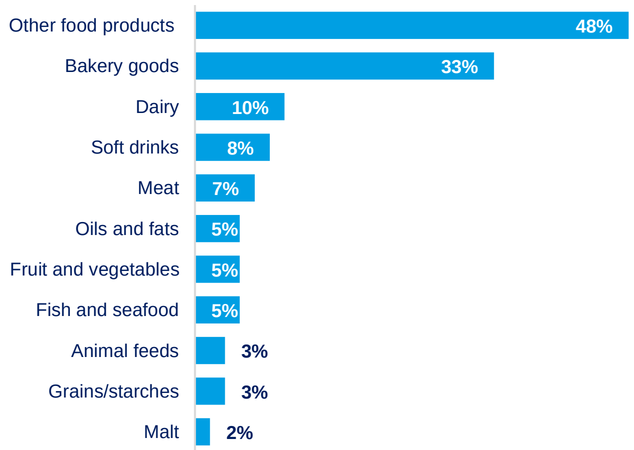
Source: FDF State of Industry Survey

Chart 17: Share of respondents by turnover



Source: FDF State of Industry Survey

Chart 18: Share of respondents by sector



Source: FDF State of Industry Survey

About the FDF

The FDF is a powerful voice for the UK's vibrant, resilient and diverse food and drink manufacturing industry. For over 100 years, we have successfully contributed to policy making and legislative development, championing our members' views – large and small – on the critical issues of the day.

We bring together business, government and stakeholders to ensure our manufacturers have the right conditions to grow, invest and employ, while continuing to produce high quality, nutritious and affordable food and drink. With more than 1,000 members – from the most recognisable global brands to the most innovative start-ups – we represent the largest manufacturing sector in the country.

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