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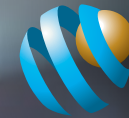
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TOKIO MARINE  
HCC

# Food & Drinks Sector Report

## A member of the Tokio Marine HCC group of companies

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## Summary

**Price pressures continue to ease:** food and non-alcoholic beverages inflation came in at 1.5% in June 2024, the lowest reading since October 2021.



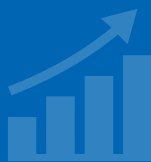
The phasing in of new, **Brexit-related border checks** for agricultural products in early 2024 has not caused material supply chain stress overall.



**Sectoral wage growth remains high but the number of job vacancies is falling.** Anecdotal evidence points towards persistent skill shortages in the food sector though.



**Business optimism in the industry** has risen to the highest reading since the launch of the data series in 2018.



**Anticipated interest rate cuts** will help to stimulate building activity but this effect will be small in size and be felt with a delay.



That said, recent data shows that **take-home grocery sales growth has fallen** to 1.0% in June 2024, the lowest rate of expansion since mid-2022.



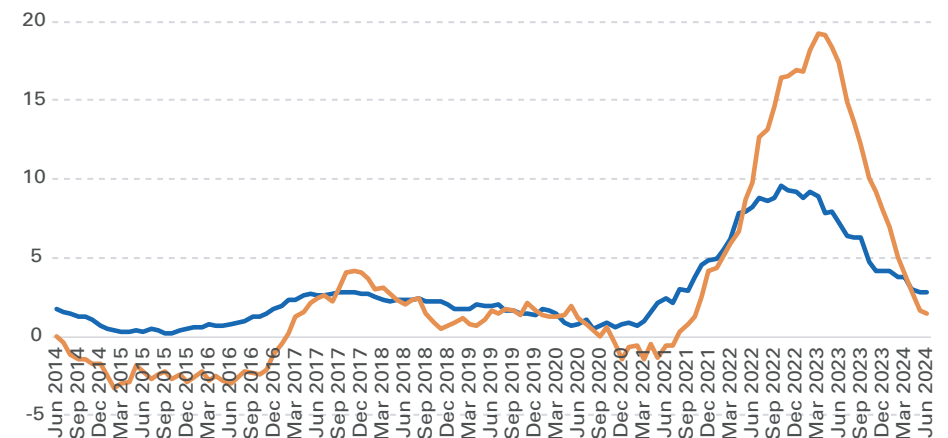
**Credit risk is likely to fall in 2024;** most recent data already shows sizeable drops in company insolvencies in the food and drinks sector in the **January to May period.**

## Key trends in 2023-24

### Inflation

Positively for the sectoral outlook, the cost of living crisis is slowly coming to an end. Latest data from the Office for National Statistics (ONS) shows that the consumer price index including owner occupiers' housing cost (CPIH) increased by 2.8% year on year (y/y) in June 2024 while the CPI increased by 2.0% in the same period. This is down from the peak of 9.6% in October 2022 which was roughly five times the Bank of England's (BoE) inflation target of 2%. That said, a split between services (6.0% inflation) and goods (where prices have fallen by 1.4% y/y in June) has emerged over the past quarters.

### UK Food Price Inflation (in %)



Source: ONS



Meanwhile, the improvements in the food and drinks industry were even larger: inflation in the sector had reached 19.2% in March 2023, a 45-year high. It exceeded the CPIH rate between April 2022 and March 2024 before gradually moving lower. By June 2024, inflation in the food and drinks industry had dropped to 1.5% only, the lowest reading since October 2021. Furthermore, price pressures in the hotel and restaurant industry have also moderated over the past quarters: between early 2023 and mid-2024, sectoral inflation has almost halved from 12.1% to now 6.3%<sup>1</sup>.

For the second half of 2024 and next year, the outlook for sectoral inflation rates remains encouraging. Aggressive monetary tightening,

conducted by the BoE in 2022-23 has largely removed upward pressures on prices. Simultaneously, most agricultural products have become cheaper in a y/y comparison. According to July data from the Financial Times, wheat prices have fallen by 21.2% y/y, corn has dropped by 24.8% and soy beans by 26.9% y/y. While there are some outliers (coffee and cocoa prices have risen by 70.3% and 161.8%, respectively), it is likely that the cheaper input costs will filter through the production processes and transmission channels over time, leading to subdued inflation rates in the months ahead. UK food retail market leader Tesco recently announced that it expects food price inflation to stay in the very-low single digit rate for the remainder of 2024<sup>2</sup>.



<sup>1</sup> <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/june2024>

<sup>2</sup> <https://www.xm.com/research/markets/allNews/reuters/tesco-ceo-sees-low-single-digit-food-inflation-for-rest-of-the-year-53809625>

## Supply Chain Risk

Problematically for supply chain integrity, food imports from the EU have become more bureaucratic and costlier in 2024. After the implementation had been postponed five times during the pandemic, new post-Brexit rules were introduced in January and in April as physical checks on certain product groups such as fresh meat, fruits and vegetables were phased in. Health passes (issued by vets) have also become mandatory, adding additional red tape when exporting from the EU to the UK<sup>3</sup>. While no controls have been implemented in Anglo-Irish agricultural trade yet, the old government had planned to launch checks by November, a timetable now uncertain given the recent change in government<sup>4</sup>.

Challengingly, with the UK importing a sizable part of its food supply (for example 49% of its pork supply originates from the EU, 83% of all fruits sold in the UK are imported), the new trading regime will increase costs for UK companies. The British government had estimated that domestic firms will face a

GBP330m per annum bill, potentially increasing inflation by 0.2 percentage points over the next three years. Encouragingly, anecdotal evidence indicates that, so far, British authorities have adopted a “light-touch” approach; physical checks continue to be the exception rather than the norm and the overwhelming majority of shipments still arrives UK customers on time.

Also positively, the UK government’s first UK Food Security Index shows that risk levels have remained stable across seven dimensions (including global food supply for human consumption and business investment) while the energy and fertiliser as well as the agricultural total factor productivity sub-indices have improved in 2024<sup>5</sup>. Problematically, global warming poses an ever-increasing long-term risk to food security in the UK while the wet winter and spring (October 2023 to March 2024 was the second wettest six-month period on record, rainfall was 60% above the ten-year average) create some short-term challenges for the UK agri-food sector<sup>6</sup>.

<sup>3</sup> <https://www.bbc.com/news/business-68126880>

<sup>4</sup> <https://www.bbc.com/news/articles/c72pz0vjd57o>

<sup>5</sup> <https://www.gov.uk/government/publications/uk-food-security-index-2024/uk-food-security-index-2024>

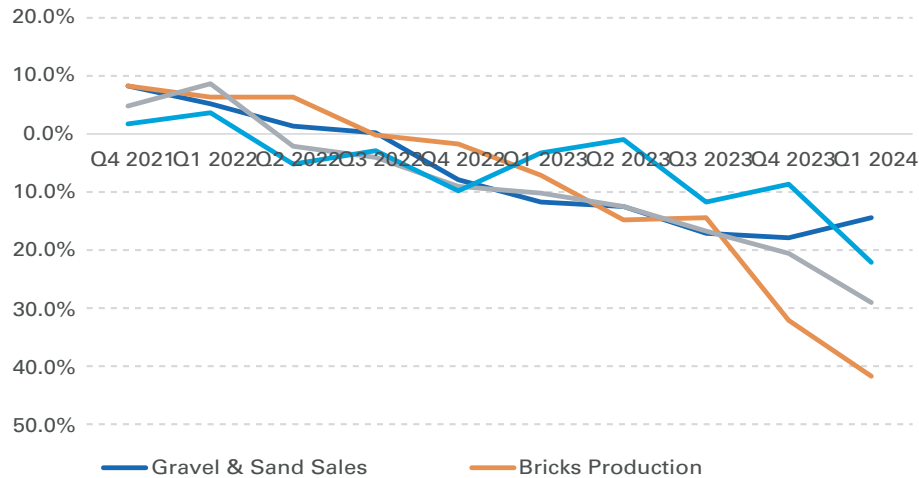
<sup>6</sup> <https://defrafarming.blog.gov.uk/2024/05/14/wet-weather-and-temporary-adjustments-to-agri-environment-agreements/>

## Labour Market

Although the country has come out of recession in Q1 2024 and the outlook is somewhat brighter than a year ago (see Business Optimism chapter), the UK labour market has continued to cool down somewhat over the past quarters with both

wage growth and the number of job vacancies coming down. Data from the ONS shows that there were 889,000 job vacancies in the UK in April-June 2024, the lowest reading since April-June 2021 (when Covid distorted the comparison) but still above the pre-pandemic reading of 810,000 vacancies in late 2019<sup>7</sup>.

### Job Vacancies in the UK Accommodation and Food Services Industry (in thousands)



Source: ONS

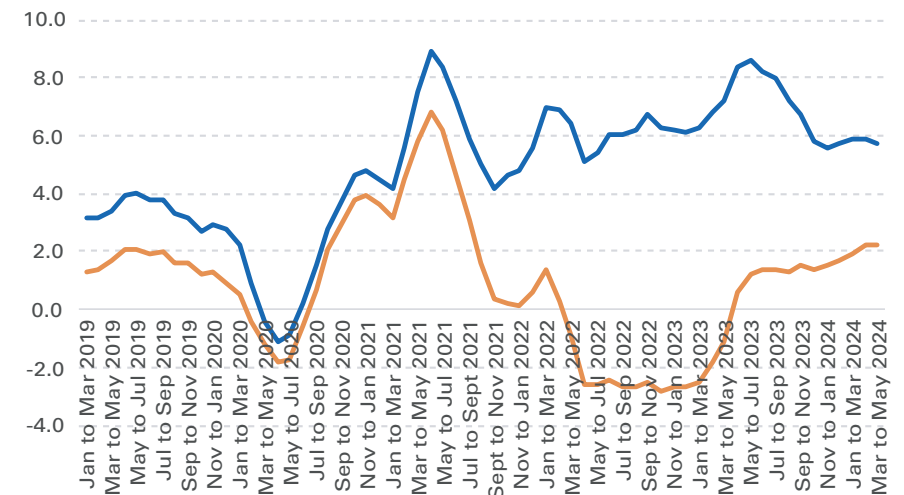
In the accommodation and food services sector, the number of vacancies has also fallen over the past years. After having peaked at 176,000 in April-June 2022, the number of open positions has

dropped to 101,000 only two years later. However, despite the fall in vacancies, the sector is still one of the most impacted ones when it comes to labour shortages. Out of 21 sectors covered by the ONS,

only electricity, steam, gas and air conditioning supply had a higher vacancy ratio (measuring the amount of open positions per 100 employee jobs): with a reading of 3.8, the sector also displays a much higher ratio than the national average (2.8), virtually unchanged from the last pre-Covid reading of 3.7. Furthermore, British food and drinks manufacturers also highlight ongoing labour shortages. According to the State of Industry Report Q1 2024, published by the Food and Drink Federation in May, vacancy rates in food manufacturing are roughly twice as high as in other manufacturing industries<sup>8</sup>.

Wage growth figures also point towards a gradually cooling labour market. ONS data shows that average weekly nominal earnings growth for the UK has moderated to 5.7% y/y in the three months to May 2024, down from 8.6% in mid-2023. In real terms, the picture is very different though: as inflation has fallen substantially over the past quarters, purchasing power adjusted wage growth is very high. Since April to June 2023, real wage growth has been in growth territory, reaching 2.2% in March-May 2024, the highest reading since mid-2015 (if the Covid-distorted 2020-22 period is ignored)<sup>9</sup>.

### Average Weekly Earnings Growth in the UK (y/y change in %)



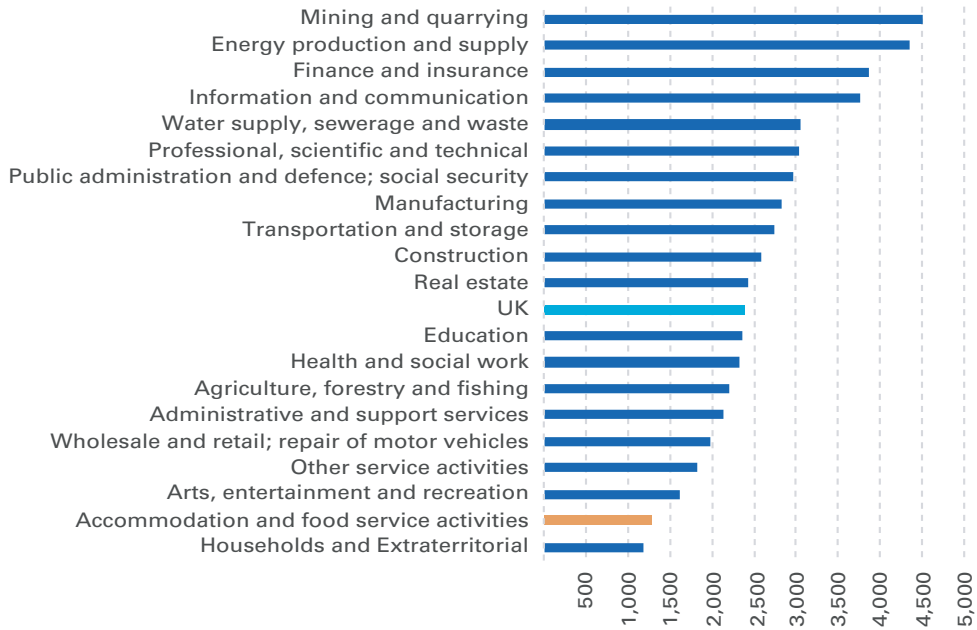
Source: ONS

<sup>7</sup> <https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/datasets/vacanciesbyindustryvacs02>

<sup>8</sup> <https://www.fdf.org.uk/globalassets/business-insights-and-economics/dfd-state-of-industry-survey/si-q1-2024.pdf>

<sup>9</sup> <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/averageweeklyearningsingreatbritain/july2024>

## Monthly Median Pay per Sector in the UK (in GBP), May 2024

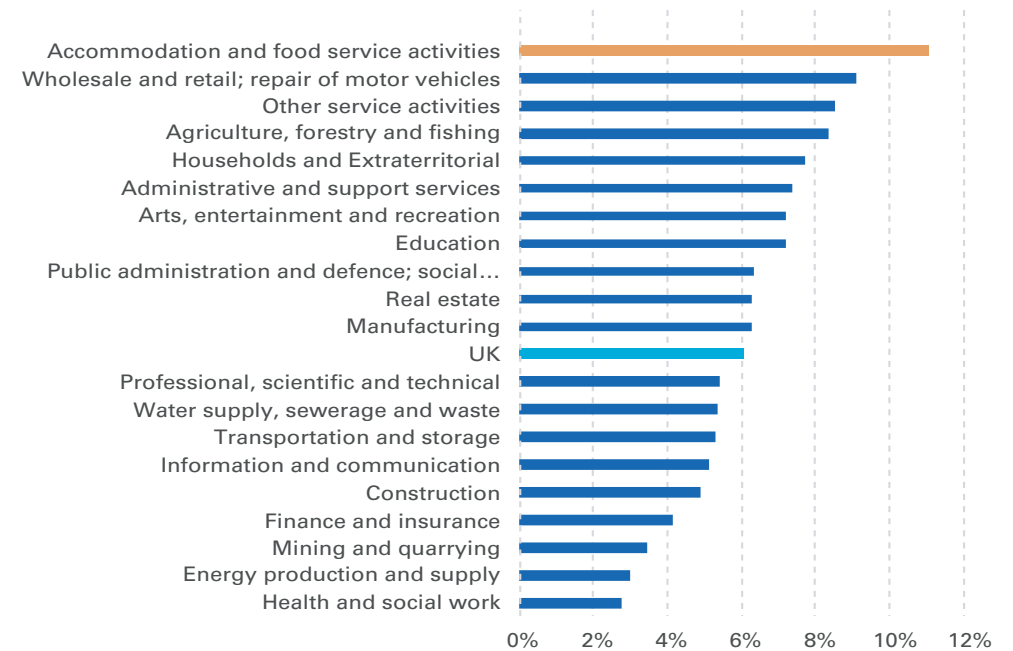


Source: ONS

In a sectoral comparison, the accommodation and food services industry has seen rapid wage growth in recent months, albeit from a very low base. Out of 20 sectors surveyed, the industry has the second lowest median monthly pay, standing at GBP1,285 only (the UK average is GBP2,394).



## Average Monthly Median Pay Growth by Sector in May 2024 (y/y change in %)



Source: ONS

That said, nominal wage growth in the sector has been robust in a year on year comparison, outpacing all other 19 sectors covered by the ONS. Between May 2023 and May 2024, the average monthly median pay in the accommodation and food services sector has grown by 11.1%, compared with the UK average of 6.0% only.

Agriculture, forestry and fishing (+8.3% y/y) and manufacturing (of which food manufacturing is the largest part when measured by turnover<sup>10</sup>) have also seen above-average pay growth, indicating that companies' labour costs are seeing upward pressure at the moment, thereby undermining profit margins.

<sup>10</sup> <https://www.great.gov.uk/international/content/investment/sectors/food-and-drink/>

## Return to Office

Positively for the market potential of food services outlets (and supermarkets) in inner cities, many companies in the UK have continued with their return to office policies. Latest available data from the ONS shows that in June 2024, only 11% of all workers were exclusively home-based, down from 16% one year earlier<sup>11</sup>. That said, hybrid arrangements continue to be popular: one in four UK workers are now at least being entitled to some working from home days per week with half of UK employers now offering this option<sup>12</sup>.

Survey data from Remit Consulting shows that office occupancy rates had reached the highest reading since the outbreak of the Covid pandemic in March 2024 before dropping slightly again in April and May<sup>13</sup>. As many companies are currently increasing pressure on employees to reduce working from home days, footfall in business districts is likely to increase somewhat going forward. That said, a return to pre-pandemic levels is unlikely: currently, office occupancy rates stand at around 35%-40%, compared with pre-pandemic readings of 60%-80%<sup>14</sup>. The reduced demand will hence continue to be a drag on the hospitality industry.



<sup>10</sup> <https://www.bbc.com/news/articles/cldd6x6gglxo>

<sup>11</sup> <https://bmmagazine.co.uk/news/new-homes-built-in-the-uk-in-2024-plunges-by-fifth-in-blow-to-government-house-building-targets/>

<sup>12</sup> [https://www.savills.co.uk/research\\_articles/229130/359081-0](https://www.savills.co.uk/research_articles/229130/359081-0)

<sup>13</sup> <https://return.remitconsulting.com/resource-centre/50-news-release-three-years-on-from-the-easing-of-lockdown-restrictions-and-uk-remain-stable-at-around-a-third-of-office-capacity>

<sup>14</sup> <https://www.fmj.co.uk/monthly-figures-show-uk-office-occupancy-hit-highest-levels-in-march/>

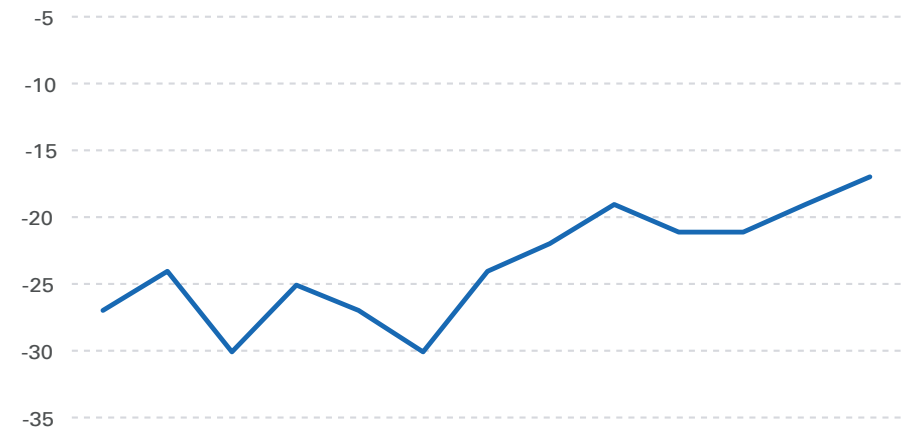
## Outlook

### Business Optimism

Positively, the country's macroeconomic backdrop has improved in recent months. Real GDP growth has surprised on the upside in Q1 2024 and the UK has officially left recession<sup>15</sup>. The IMF has recently upgraded its full year growth

forecast from 0.5% to now 0.7%. Furthermore, with disposable income rising, consumer confidence is also on a generally upward trajectory. As the BoE is likely to cut interest rates in the second half of 2024, households' willingness and ability to spend more on food and drinks is likely to grow over the next quarters.

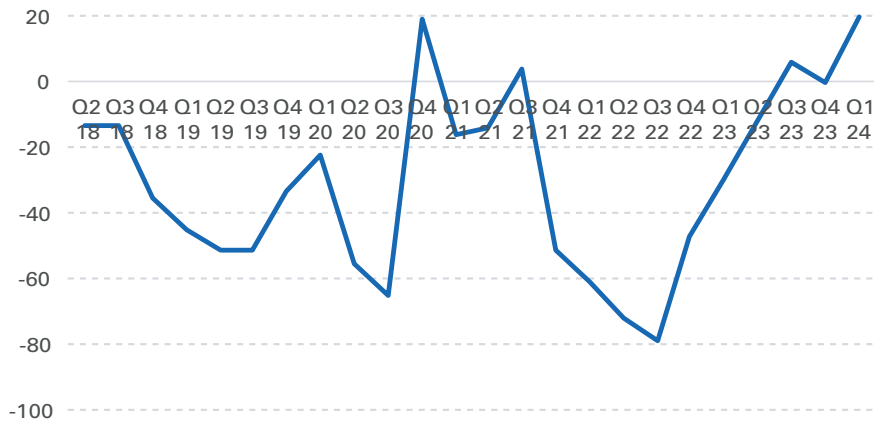
### UK Consumer Confidence Indicator



Source: GfK

<sup>15</sup> <https://www.theguardian.com/business/article/2024/may/10/uk-out-of-recession-gdp-economy>

## FDF Net Confidence Score (Range: -100 to +100)



**Source:** Food and Drink Federation

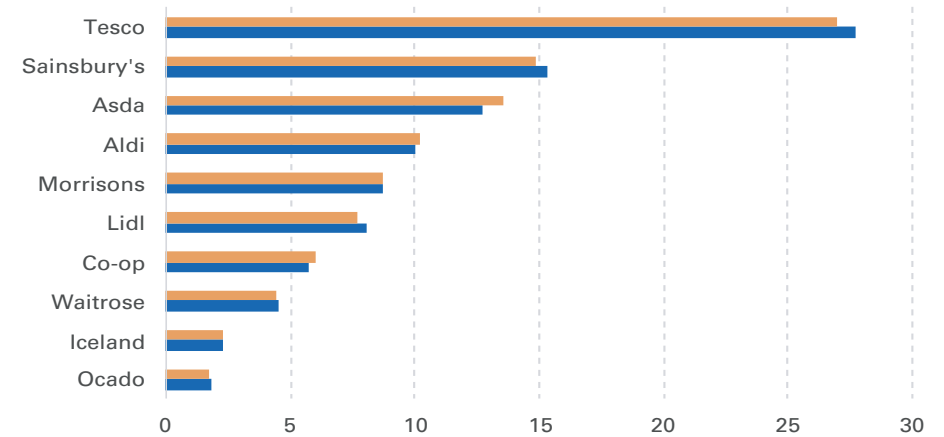
The generally improving economic conditions are mirrored by sectoral confidence indicators. The State of Industry Report Q1 2024, produced by the Food and Drink Federation shows growing optimism amongst survey respondents. The FDF net confidence score came in at 20 points in January-March, the highest reading since the launch of the score in 2018. While 54% of survey participants reported no change in business conditions in Q1 2024 (compared against Q4 2023), 33% have seen improvements, up from 27% in the Q4 2023 report.

Generally, larger companies (turnover >GBP500m) were more upbeat about the operating environment in Q1 but SMEs are also increasingly optimistic<sup>16</sup>.

Latest data from research company Kantar shows that take-home grocery sales increased by 1.0% only in the four weeks to 9 June, the slowest increase in two years. The poor weather also caused some unusual shopping patterns (sun care items sales are down by 25% y/y while soup sales are up by 24%) while average footfall has also

<sup>16</sup> <https://www.fdf.org.uk/globalassets/business-insights-and-economics/dfd-state-of-industry-survey/si-q1-2024.pdf>

## UK Grocery Market Share (in %), Twelve Weeks Ending



**Source:** Kantar

stalled: the average shopper visited a supermarket 16.3 times, virtually unchanged from the same four-weeks period a year ago<sup>17</sup>.

Best performing food retailer (for the fourth month in a row) was online-only Ocado. In the 12 weeks to 9 June, the company increased its sales by 10.7%, comfortably outperforming the average online market growth rate of 4.0%. Around a quarter of British households did their shopping online in the March-June period, Meanwhile, bricks and mortar supermarkets saw

much lower growth in the twelve weeks to 9 June. Lidl's sales were flat, followed by Aldi (+0.8%) and Morrisons (up by 1.1%), market leader Tesco (+4.6%) and Sainsbury's (+4.9%).

In terms of market share, Tesco is defending its leading position. In the twelve weeks to early July 2024, its market share stood at 27.7%, compared with 27.0% a year earlier. Sainsbury's also increased its market share (by 0.4 percentage points to now 15.3%) while Asda was the biggest loser: its market share fell

<sup>17</sup> <https://www.kantar.com/inspiration/fmcg/2024-wp-grocery-growth-slows-but-financial-outlook-brightens-for-shoppers>



from 13.6% to 12.7%. Aldi remains the UK's fourth biggest grocer (10% market share), followed by Morrisons (8.7%) and Lidl (8.1%).

Worryingly from a financial perspective, both Asda and Morrisons have in recent times been party to leveraged take-over deals. This adds an element of overhead into the businesses in the form of interest cost which in the current operating environment remains at a constant cost within the businesses and puts additional pressure on the businesses to perform.

It is also worth noting that interest rates at present in the finance market continue to be elevated with leveraged retailers having to contend with much higher interest rates when refinancing now compared to many maturing debt instruments.



## Credit Risk

Positively, credit risk in the industry is likely to fall, albeit from very high levels. In 2023, England and Wales have seen the highest number of company insolvencies since the early 1990s. The food and drinks sector were not immune to this negative trend. While the overall number of company insolvencies has increased by 14% in 2023, crop and animal production has seen a 10% rise, manufacture of food a 21% increase while the number of insolvencies in the drinks manufacturing industry increased by an even higher 29%<sup>18</sup>.

Retail sales of food and beverages witnessed an increase of insolvency figures by 33% while food and beverage service activities were hit even harder: in 2023, 3,473 companies went bankrupt, equivalent to almost 14% of all insolvencies in England and Wales and up by 38% against the previous year. With demand patterns not having adjusted back to pre-Covid years (and unlikely to do so) and the 16-24 years age group hit particularly hard by the cost of living crisis in 2022-23, beverage serving companies were even more severely impacted; insolvency figures rose by 50% in 2023.

Positively, the insolvency risk outlook for 2024 is somewhat brighter. Interest rates are likely to fall, the economy has switched into a slightly higher gear and consumer and business sentiment is on the rise. The improved conditions are already visible in the 2024 year-to-date insolvency statistics: overall, figures in England and Wales were down by 2% y/y in the January to May period with food and drinks related industries often also recording improvements. Manufacture of food products has seen a 38% y/y drop in the first five months of 2024, retail sale of food and beverages reported a 29% contraction. Food and beverage service activities has seen a very small improvement in January-May (insolvency figures decreased by 1% y/y) while manufacturing of beverages reported no change. The only outlier is crop and animal production (+4%) but its overall importance is rather small: there were only 65 company insolvencies in this industry in 2023.

<sup>18</sup> <https://www.gov.uk/government/statistics/company-insolvency-statistics-june-2024>