

In this Issue:

Consumer confidence slides– but fundamentals remain sound
 Revised national income figures show the UK economy is still growing
 Plenty of scope for household savings to rise in a downturn
 Special report on the challenges facing the global food industry

SHARP FALL IN CONSUMER CONFIDENCE—A TURNING POINT?

Two surveys of consumer confidence published this week show the expected deterioration in consumer confidence in the wake of the terrorist attack on the United States and the subsequent global financial and economic turmoil. However the enormous difference in the change between the two indices of optimism, makes it difficult to gauge the likely impact on household spending and saving decisions for the rest of the year.

A UK Recession is not inevitable

Our economic fate rests in our own hands. If dealers in the stock market, businesses drawing up investment plans and consumers in the high street can all be persuaded that Britain can weather the storm, then there is every reason to believe that the country's economic prospects remain bright.

Lea Paterson

The Times

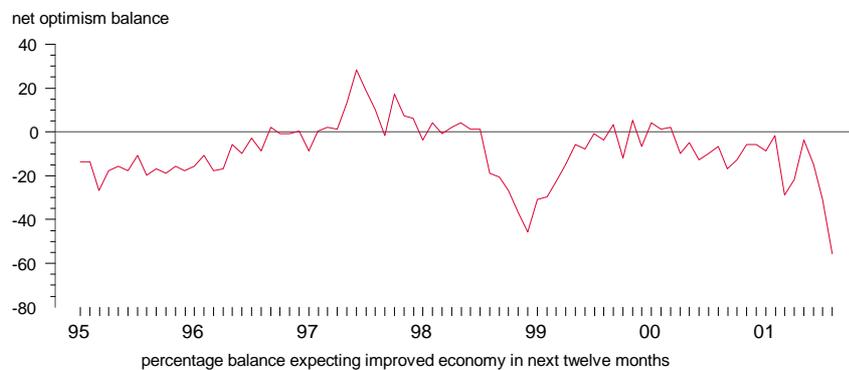
25 September 2001

MORI POLL—Confidence Collapses

The headline in the Times (dated 27 September 2001) carried the threat of a severe slump brought about by a collapse in consumer sentiment about the economy. The net balance of people expecting the economic situation to improve over the next twelve months fell from minus 31 points to minus 56 according to the September readings. This takes consumer confidence using the MORI poll to its lowest level since March 1980—a period when the economy was

(Continued on page 2)

MORI MONTHLY ECONOMIC CONFIDENCE INDICATOR



Special Report: Challenges for the Global Food Industry

In a world of technology and telecom bubbles bursting and a weakening international economy, attention has focused on the global food industry as a source of stability and investment opportunity. But the food industry is not without its own challenges. Food producers must grapple with a rapidly changing environment, particularly in relation to changing consumer tastes and increasing regulation.

A Substantial and Fast-Growing Market

There can be few more substantial industries than the global food industry. Euro Monitor estimate the size of the market at around \$200 billion, supplying a world population of 6 billion (2000) that is forecast to grow to 7.5 billion by 2020. Rising consumer incomes, mainly in the developed nations, are fuelling an increase in food consumption, particularly foodstuffs such as meat.

(Continued on page 3)

(Continued from page 1)

CONSUMER SLOW-DOWN THIS AUTUMN?

In the current uncertain environment, consumers are likely to become risk averse, especially if unemployment rises. We expect to see consumption dip temporarily below trend in coming month, along with a slowdown in the housing market.

Ciaran Barr

Chief UK Economist

Deutsche Bank

deep in the mire of one of the deepest recessions in its history. The percentage of people expecting the general economic condition to get worse over the next twelve months jumped from 43% in August to 64% in September. Fieldwork for the survey was carried out between September 20-25—over a week after the terrorist outrages and in the middle of a sharp fall in global equity prices and raft of job losses in several industries. Only 8% of people expect the general macroeconomic situation to improve in the next year. It is worth noting that the entirety of the MORI poll was collected **after** the 11th of September.

GfK Consumer Confidence—Less of a decline

The GfK consumer confidence survey shows a decline in optimism—but not on the same scale as the headline-grabbing MORI poll. The GfK monthly survey is a composite index based on replies to a series of questions. These include people's expectations on the UK economic situation; their own finances; changes in unemployment and inflation together with people's willingness to make major purchases such as a new car or expensive home improvements.

Overall confidence fell just one point (to minus 1) in September, although new data collected in the week after the terrorist attacks shows a further deteriora-

(Continued on page 4)

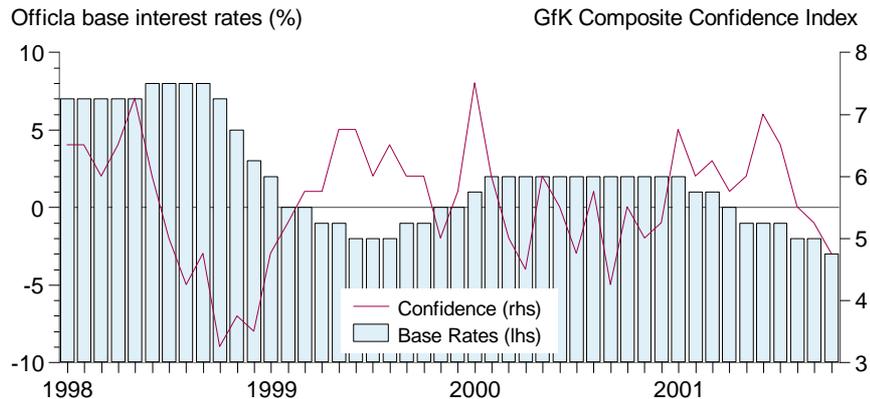
RE-WRITING UK ECONOMIC HISTORY

Revised national income figures were released this week. They show the UK economy growing at a rate of 2.3% in the second quarter of the year (compared to a previous estimate of 2.1%). The economy is undoubtedly slowing from its recent peak growth of 3.3% in the spring of 2000. But this is still a long way removed from a technical recession. National output expanded by 0.4% between April and June against a 0.6% increase between January and March.

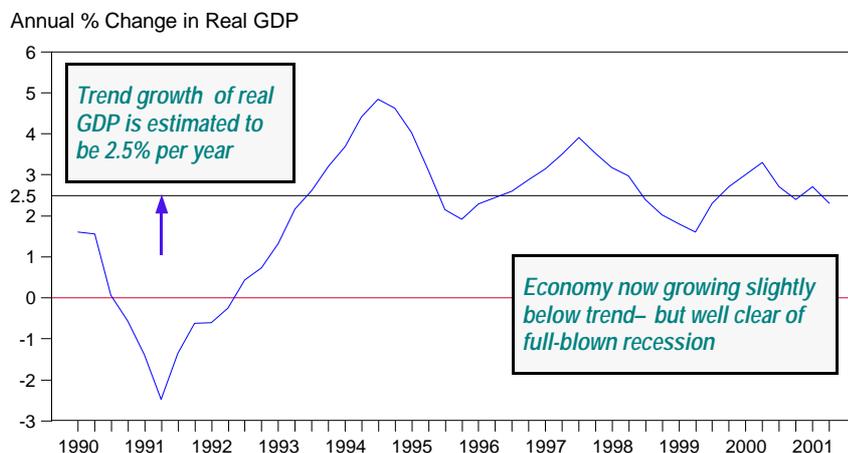
Tutor2u is a leading study portal for the economic and political sciences.

www.tutor2u.net

UK CONSUMER CONFIDENCE AND INTEREST RATES



GROWTH OF REAL NATIONAL OUTPUT



Case Study – A New Market Niche: the “Missed Breakfast”

Kelloggs has sought to reflect changing consumer demand and diversify away from traditional breakfast cereals.

The move away from breakfast eaten in the home to greater daytime grazing led Kelloggs to respond by introducing its “Nutrigrain” range of oat cereal bars, offered in five flavours and intended to be eaten anywhere.

And unlike markets such as telecoms and technology, the overall level of market demand is not subject to pronounced cyclical peaks and troughs that can make strategic planning so difficult.

But despite the attractions of fast-growing and predictable demand, the food industry is also complex. The environment in which food producers and retailers must operate is a challenging one. Amongst the challenges that impact almost all players in the market are:

Health scares – for example the impact of BSE, which have led to greater regulatory control over the food production process; tougher regulations place greater cost pressure on food manufacturers

Genetically Modified (“GM”) Foods – which have placed new consumer and regulatory pressures on food producers and retailers;

“Traceability” – where food manufacturers and retailers alike need to be able to ascertain whether or not their products include allergens and to comply with stricter labelling regulations;

Consumer activism – consumers voting with their purses or, in the case of animal rights activists, taking direct action against those they criticise for animal treatment;

Consolidation – a substantial wave of mergers and acquisitions that is increasing the relative size and market power of certain food producers and retailers, changing the nature of competition in the market;

International trade disputes – food remains at the centre of many international disputes of free trade;

Rapid and significant changes in consumer tastes and preferences – for example, the increased demand for ready-meals in substitution for basic cooking ingredients, and the growth in demand for organic products

Lets take two of these challenges – changing consumer tastes, and increased market concentration – and examine the issues briefly.

Changes in Consumer Tastes and Preferences

Some clear trends in the changing nature of consumer habits have emerged in the food industries of the developed economies. Two good examples are:

- People are choosing healthier food, but eating it “on the run” on in front of the television rather than in the dining room. Families eat less together; people tend to snack *or “graze” more often during the day.
- Demand for organic and low-fat foods is increasing, as is demand for better quality and “authentic” food. The demand for healthier food has led to increased sales of better quality meats

A key driver of the changes in consumer demand is social change. A wide range of social influences determine the nature of demand for food overall, and create new consumer segments.

For example, recent research by the **Institute of Grocery Distribution** identified the following key social changes impacting food consumption in the UK:

(Continued on page 5)

tion to minus 3. Optimism about the UK economy has fallen from -3 in June to -20 in September (and -28 in the latest survey post 11th September). To put this into context, the index was -8 in May in the aftermath of the Foot and Mouth crisis. Further comfort comes from people's expectations for their own finances. These remain relatively firm—most people think that their own circumstances will either remain the same or improve. And their willingness to spend hard cash on consumer durables is robust. There is little hard evidence showing through in the data that consumers expect a large rise in unemployment or a significant pick up in inflation.

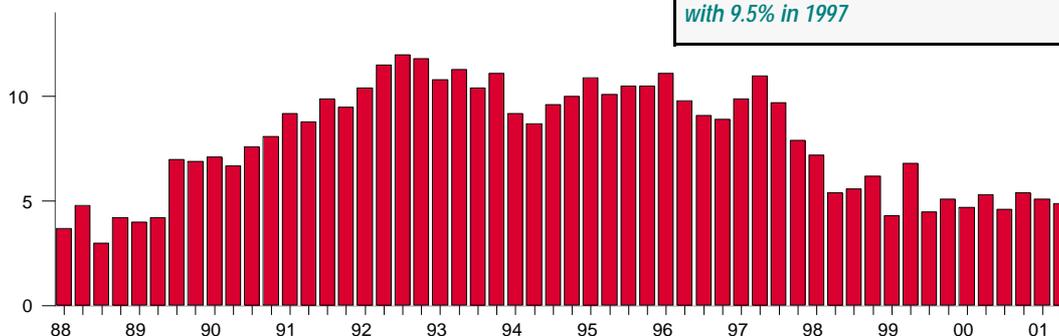
Most city economists have predicted a sharp decline in consumer confidence over the next two months followed by a rebound towards year end. The weight of evidence seems to be that the MORI poll is exaggerating the descent into pessimism. The economic fundamentals remain firmly in place. Unemployment is low, inflation is under control, the housing market is slowing down but is unlikely to collapse as it did in the early 1990s. And nominal interest rates are continuing to fall. UK base interest rates are likely to edge lower to 4.5% when the Monetary Policy Committee meets in October.

Household Saving—Room for an Increase in Precautionary Savings

The latest (revised) set of national income accounts show the savings ratio dipping below 5% in the second quarter of 2001. The rate of saving has stabilised over the last 2-3 years. Consumer spending has been strong, fuelled in part by a rising demand for credit. But higher real incomes have also helped to finance demand for goods and services. If confidence falls, we expect to see a rebound in saving as people build up their savings balances and seek to repay debts. There is little evidence of this at the moment—but there is plenty of scope for higher levels of saving in the months ahead.

THE SAVINGS RATIO FALLS TO 1980s LEVELS

Percentage of disposable income that is saved



UK households saved 5.0% of their disposable income in 2000, compared with 9.5% in 1997

THIS WEEK'S BEST OF THE WEB

You can find all these resources and more at Tutor2u Resources: [Find us at www.tutor2u.net/default.asp](http://www.tutor2u.net/default.asp)

Web Sites covering the Global Economy

IMF Economic Outlook	www.imf.org/external/pubs/ft/weo/2001/02/index.htm
OECD Economic Forecasts	www.oecd.org
HM Treasury (UK Forecasts)	www.hm-treasury.gov.uk/e_info/forc/comp/index.html
Bank One Economic Research	www.bankone.com/commercial/research/economics/pubs/
Tutor2u Global Links	www.tutor2u.net/default2.asp?tree=2083

- An ageing population
- Increasing affluence (rising average living standards)
- Increased divorce and separation rates
- Greater participation of women in the workforce in both part time and full-time employment
- Busier working lives– people in the UK work some of the longest hours in the European Union
- Increasing consumer polarisation

As social change creates new consumer segments, so food producers and retailers need to adjust their marketing strategy to meet the new consumer needs. For example, J Sainsbury now targets 12 specific consumer sectors within its customer base. These vary from the “cash-poor, time-rich” who place great emphasis upon value for money and the “cash-rich, time-poor” who are more likely to go for more expensive but higher quality foods, particularly “grab and go” convenience foods.

The Drive for Market Share

The international food production market has seen a substantial increase in merger and acquisition activity in recent years. Major food producers have sought to build their market share by acquiring similarly-sized competitors and squeezing profit out of the deal by cutting combined costs and selling “non-core” food and drink brands. A listing of some of the larger recent deals is given below:

Recent Global Food Transactions

Announced	Buyer	Target	Price (\$bn)
March 2000	Scottish & Newcastle	Kronenbourg	2.5
April 2000	Unilever	Slim Fast	2.3
June 2000	Unilever	Bestfoods	20.3
June 2000	Interbrew	Bass Brewers	3.4
June 2000	ConAgra	Int'l Home Foods	1.6
June 2000	Phillip Morris	Nabisco	14.9
July 2000	General Millis	Pillsbury	5.4
September 2000	Cadbury Schweppes	Snapple	0.9
October 2000	Kellogg	Keebler	3.6
December 2000	PepsiCo	Quaker Oats	13.4
December 2000	Diageo/Pernod	Seagram	8.2
January 2001	Tyson Foods	IBP	3.2
January 2001	Nestle	Ralston Purina	10.0
February 2001	George Weston	Bestfoods Baking	1.8
July 2001	Mars	Royal Canin	1.3
August 2001	Interbrew	Beck's	1.6

Source: *Financial Times*

What has driven this mergers and acquisitions boom?

One of the most compelling reasons is the need to achieve greater economies of scale. For example, Unilever's recent purchase of Bestfoods is forecast to produce cost savings (synergies) of \$800m by 2003. Dozens of factories are being closed with the loss of around 8,000 jobs as the combined business rationalises its production capacity around the world. But cost-saving is not the only issue. The need to increase market share relative the nearest competitor is a key driver. The food production industry is less concentrated than the food retailing industry where retail giants such as Walmart and Tesco hold significant power over suppliers.

Increasingly, major international food groups are seeking to build global food brands. The logic for this is obvious. A disparate portfolio of smaller brands tends to soak up a disproportionate amount of management time than a focused portfolio of international products. Marketing spend, which often needs to be substantial in mature food retailer markets, can be focused on the biggest and best brands rather than spread thinly across too many products.