Roddy McLean Director of Agriculture, Commercial & Private Banking at RBS gives us his view on the outlook for UK Agriculture and how RBS is supporting those in the industry. Roddy McLean joined RBS almost 11 years ago and has supported the Bank's agricultural activity and its 150 strong agricultural relationship manager team.

We ask him some key questions:

1 Over the last 10 years the value of agricultural land has increased dramatically, with some premium blocks of agricultural land in the east of England now changing hands for sums in excess of £20,000 per acre, do you consider these figures to be sustainable?

The value of land has continued to grow over time in 1900 land cost around £20/acre. Just 20 years ago prime arable land would have commanded a price of circa £2,500 per acre when the wheat price was £110/t - not far from the current market price.

Are the current prices sustainable? If looked at from the typical return that can be generated from farming the land, 2-3%, probably not. However there are a number of other factors that buyers will be taking into account, including:

- Capital appreciation
- Tax (IHT)benefits

I think that possibly my grandchildren but certainly my great grand children will be of the view that £20k per acre for good quality land was incredibly cheap and why didn't I buy any! It is an asset that if looked after properly doesn't wear out.

2 With it looking likely there will be a referendum on Europe in 2017, what would your view be for UK agriculture if the country voted to leave the EU?

There will undoubtedly be impacts on the sector; leaving the EU would mean that existing CAP support would no longer be available and it would be up to the UK government or administrations to decide what arrangements would or should be put in place. I am not yet aware of any discussions/ pronouncements by government around this. If we voted to leave the EU the UK might have to contend with such things as import tariffs and quotas which are currently in place with the likes of NZ for their lamb exports to the EU.

If we were to leave the EU I believe that the UK is strong enough to stand on its own, however I also feel that the journey required to extract ourselves from the EU would occur over a protracted time frame and be a bumpy road.

In my mind it is important that the proposal to leave the EU is fully explored and the implications both positive and negative fully explained to us the electorate allowing a balanced and reasoned decision to be arrived at, before voting.

3 Following the election it looks like we will have a period of relative stability in terms of tax policy. If you were Chancellor for a day what one tax change would you make?

I'd like to see Parliament put long term policies in place to give businesses more confidence/security for the future and encourage them to grow and develop.

The introduction of averaging profits over 5 years for tax purposes is to be welcomed given the increased volatility in input and output prices the industry is facing.

Annual investment allowance the current limit is £500k and was due to revert back to £25k from 1/1/2016. The chancellor has now stated that the limit will not be reduced to £25k but a quick decision on what the limit will be going forward will help businesses plan their investments.

4 Interest rates have never been lower, what is the bank's view as to when rates might increase and by how much?

The markets expect a rise next year, possibly with the first step being taken during quarter 2. By the end of 2016 there is a 50% probability that rates will be in the range of 0.5-1.5%, but remember the balance of probability that rates may be outwith this range.

It is worth noting that six years ago rates were expected to rise and were being forecast to reach 4.5% by mid 2015.

5 With BPS payments to be set on the average European Central Bank rate over the month of September, what is the bank's view on the exchange rate for the year ahead?

The exchange rate outlook is always uncertain and it would be wrong to plan on the basis of any particular forecast. Considerable uncertainty hangs over the Euro area; growth is slow with the ECB pursuing quantitative easing. In the UK, growth is decent and the markets expect Bank Rate to rise next year. These are circumstances in which there is likely to be a further fall in the value of the Euro relative to sterling – we could be heading towards the low €1.40s to the pound (possibly 68 – 72p per euro) by the end of the year.

6 With the fall in commodity prices and likely delays in BPS payments, how is the bank helping to support farmer's tight cashflows?

Given the increasing possibility that farmers may not receive their new BPS payment in early December, the time they have become used to under the old single payment regime. As a key agricultural bank we are very aware of the challenges this may bring in managing and meeting their working capital requirements.

To give our customers confidence of our support to them we announced in early June that we would advance them a maximum of 60% of last years SPS receipt on a like for like claim basis. This will be paid into their account during the first week of December when they would have been expecting their support payment allowing any payment commitments to be met eg HP. The advance will be repaid when the support payment is received. We will not be charging a fee, interest on the advance will be at the customers current interest rate. Customers can request this advance be put in place from their relationship manager from mid September.

7 How do you think global economic pressure and worldwide political uncertainty will affect all important commodity markets for UK farmers?

Markets are likely to remain just as volatile in the future, so farmers need to get more adept at managing that volatility on both the output and input side of their businesses. This is not unique to UK agriculture, but is a global issue. Successive reforms of the support mechanisms have now left UK & EU farmers more exposed to global prices.

Key for all farm businesses will be technical efficiency and cost control. Moving forward the industry needs to be more collaborative and share knowledge. The sector needs to continue to focus its efforts on sustainable, efficient production – monitor farms and similar groups can help with this process. Progressive beef and sheep farmers are also refocusing on grassland management and that is another positive step. These on-going developments and the advances in technology, which provide easier measurement and recording systems, will help provide the information that businesses can use to improve performance.

There also needs to be further and better collaboration along the supply/value chain with farmers, suppliers and down stream buyers all working as one. Understanding what is important to the other "partners" in the chain and identifying improvement that can be made to deliver better returns/cost savings to all.

8 This time next year what do you think will be:

a. The price per tonne of feed wheat

Global grain stocks are at a 5 year high and are currently forecast to further improve by the end of the 2015/16 marketing season to 103 days or 28% stock to use ratio. For many uses grains are interchangeable at the right price/value. It is difficult to currently see feed wheat price being any better than in the range £115-£135 per tonne over the coming marketing season. I'd like it to be higher; the price will be governed by fundamentals of global supply & demand. But a lot could happen between now and harvest either climatically or politically which could affect the basic dynamics of the global market.

b. The price of a litre of milk

The price of milk will be driven by what is happening as regards global supply and demand and the impacts this has on price. Irish milk production was up 4.2% above 2014 levels for the first quarter of this year and is forecast to be up 4% for this year as whole. UK milk production is forecast to be up 1.5% in 2015, with the EU as a whole forecast to produce just over an additional 1% (1.5 billion litres) for the next two years. The USDA is forecasting their production for 2015 to be up just over 1% or just under a billion litres with a further increase in 2016 of 2.3%. The New Zealand 2015/16 milk year doesn't start until September, but the drought conditions experienced earlier this year don't appear to have been as severe as first thought, which is likely to limit any longer term impact.

China is a major buyer of milk powders and has effectively withdrawn from the market since 2014. There was some thought during the first quarter of this year that green shoots of growth were reappearing in the market as Chinese import volumes were getting close to 2013 levels. Since then it has been reported by the USDA that China's stocks of whole milk powders were higher than originally estimated at 300,000 tonnes - twice earlier estimates. Resulting in forecasts as to their import requirement being downgraded by a third to 400,000 tonnes. China historically accounts for around 33% of the global whole milk powder trade a decrease in their purchasing will act as a drag on the global dairy market.

While the sector is currently facing challenges, the longer term prospects look better with an estimated additional requirement of 20 billion litres of milk will be required over the next 10 years due to increasing global population and per capita consumption.

The International Farm Comparison Network (IFCN) has forecast that the average budget milk price would be around 29ppl over the next ten years with volatility of +/- 20% being the norm with this increasing to +/- 50% at times.

In the UK we currently have a price range from over 32ppl to around 17-18 ppl depending on processor and the contract individual producers are on. Speaking about an average price in this situation has less relevance other than to indicate a direction of travel of the price.

In New Zealand Fronterra & Westland are forecasting a milk prices of NZ$ 5.25 and NZ$ 5.60-6.00 per kilogram of milk solids for the 2015/16 milk year. Fronterra's final payout for the 2014/15 season is likely to be around NZ$ 4.40 per KgMS.

In the UK we expect that by spring of next year prices will be heading towards more sustainable levels.

Output price is just one side of the equation and farmers need to review and potentially address their total costs of production particularly when times are tough this will also pay dividends in better times.

9 From the bank's point of view has lending to agricultural businesses increased over the last 5 years? Is the view that this pattern will continue or is a change forecast?

According to the Bank of England, lending to the agricultural sector has increased from £12.3 billion in July 2010 to £16.8 billion at the end of April this year. (Agricultural figures from BoE include fishing and forestry).

The average rate on inflation (CPI) from June 2010 until December 2014 was 2.92% which suggests that if borrowing has kept pace with inflation the total would currently be around £14.5 billion.

Our dedicated agriculture teams have also seen an increase in activity on the front line.

The industry has been in a cost price squeeze since the mid/late 1990s. Up until this point agricultural price and output index tracked fairly well the inflation index. Since then product price growth has fallen behind inflation with cost growth remaining closer to inflation – resulting in a cost price squeeze. In the last 10 years product prices made up a significant proportion of the ground lost to inflation, but costs also continued to rise with the result that the cost price squeeze has not closed.

Increasing borrowing is not necessarily bad. For many businesses it will have been for the right strategic reasons – looking to grow/ make their business more efficient and resilient. Some seek funding to bolster their working capital requirement as adjusted profit is not sufficiently high enough to cover all the businesses cash requirements; as was the case with the horrendous weather experienced in 2012 and the blizzards in spring 2013 which affected sheep farmers in particular with significantly lower expected lambing. The current output price challenges being faced in many sectors most acutely the dairy & potato sectors will also be applying additional demands on their working capital requirement.

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