

Box 1 The position and outlook in the fisheries sector – what is the explanation for poorer profitability?

Deteriorating profitability in the fisheries sector has been under discussion recently. As pointed out in this chapter, it is out of the question to describe profitability in the first quarter as bad, even though it was not as good as in the past two years, which set records in the industry. Profitability within certain fisheries segments, however, is significantly poorer than that of the sector as a whole, or the part of it which is visible in the Icelandic equity market. This applies in particular to shrimp processing, which has been retrenched recently in Iceland and elsewhere.

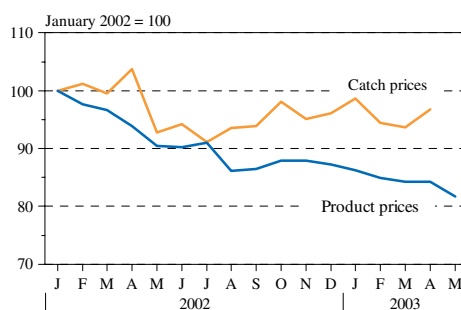
There are many reasons for poorer profitability. The strengthening of the króna has certainly squeezed fisheries. Thus the price of foreign currency in Q1/2003, weighted with the merchandise export basket, was roughly 12% lower than a year before. It should be borne in mind, however, that the relative exchange rates of Iceland's main trading partner countries have changed markedly at the same time. For example, the euro fell by only 5% against the króna, but the US dollar by 23% and sterling by 13%. After taking into account that fish meal is largely sold in sterling and fish oil almost solely in dollars, the US dollar weighs close to 23% and sterling roughly 30% in Iceland's exports of marine products. Thus sterling has a considerably heavier weight in exports than in the exchange rate index, where it is just over 12%. The US dollar has a similar weight at just under 25%. Approximately 40% of marine products are exported to the euro area or European countries whose currencies are linked to the euro, while their currencies weigh 52% in the exchange rate index. It has a hefty impact when the large gains that a strong dollar generated for a company selling to the American market in 2000-2001 are completely wiped out.

The changes in the exchange rate between Q1/2002 and Q1/2003 have hurt branches of the industry that depend on the US and UK markets, or have made sales agreements in dollars or sterling without fully hedging against exchange rate risk.¹ In particular this applies to

shrimp processing companies, which sell almost exclusively to the UK market, and also to fish meal producers who have made unhedged sales agreements in sterling. Specialised producers for the American market have been hit in the same way. Since a substantial share of EBIDTA over the first months of the year is based on processing of pelagic fish into meal and oil, the weakening of sterling has probably had a significant effect on profitability. The problem faced by shrimp processors is compounded by oversupply resulting mainly from a massive increase in shrimping by Canada, which has also consolidated its position by virtue of the weak Canadian dollar,² and by lower catches from Icelandic shrimp grounds as cod stocks strengthen there. Only an insignificant part of the difficulties of the shrimp industry can therefore be attributed to the strong króna.

Another problem faced by the fisheries sector is that prices of raw material for processing do not always completely move in pace with product prices. Recently, product prices have declined sharply in króna terms, while raw material prices have not followed suit. This hits fish processing companies which

Demersal fish product and catch price indices January 2002 - May 2003



Source: Statistics Iceland.

1. In efficient markets, however, the price formation of fish meal, which is a relatively homogeneous good, ought to reflect the change in the sterling exchange rate in the long run.

2. In Q1/2003 the Canadian dollar had slid by 18% against the króna compared with the same period in 2002. Canada has also increasingly sidestepped tariffs by having its catches processed in EU countries, especially Denmark, and mixing them with domestic production.

are not engaged in fishing operations as well. Cod for processing, for example, was priced 4% higher over the first four months of 2003 than a year before, at the same time as demersal fish prices fell in export markets and the króna strengthened. Prices of shrimp for processing over the first four months of 2003 decreased by only 4% from the same period the year before, which is far less than the fall in product prices in króna terms. This is a structural problem within the fisheries sector and exchange rate policy cannot rectify it. High fuel prices in Q1 also had a negative effect on the profitability of fishing operations.

All the above shows that the fisheries sector is not beset by a single problem which the buoyant króna can

be identified as causing. Admittedly the stronger exchange rate has squeezed fisheries profitability since last year, when it was at one of its highest levels. Nonetheless the problem lies in revenue imbalances within the fisheries sector as a whole and specific problems in various segments such as the shrimp industry which cannot be blamed on exchange rate developments. The flexibility of the fisheries sector will also determine how it fares – for example, in the success of new market penetration, exchange rate hedging and product development. It may be added that fisheries companies are now generally much better equipped to tackle temporary setbacks than they have been in the past.