AgriMatters

AIB supporting the Irish Agricultural Industry

SPRING 2013

NEW ZEALAND STUDY TOUR / REVIEW AND OUTLOOK

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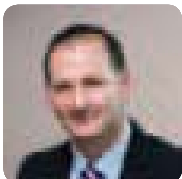

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Welcome to the Spring edition of *Agri Matters*

Michael Dowling, Editor, *Agri Matters*

Welcome to the first edition of *Agri Matters* for 2013 and a happy New Year to all our readers.

As is usual in the New Year edition we reflect in some detail on the year gone by and look forward to the coming 12 months. We hope, very sincerely, that weather conditions this year will return to normal. The appalling summer weather of 2012 spoiled what would otherwise have been a very good agricultural year.

Critical decisions on CAP reform are probable in the first half of the year. Indeed, as this issue is being finalised the first of these decisions - that relating to the EU's multiannual budget - has just been taken by the European Council. While this has still to be agreed with the European Parliament, the Council agreement greatly shortens the odds on the reform package being finally agreed in June. In this issue we feature the reform proposals and our understanding of some of the issues emerging in the negotiations. If there is agreement in June, an outline and analysis of the final package will be the centrepiece of our next edition.

This edition also features articles by two of our Agri Advisors:

- In the first, Patrick O'Meara reflects on a recent trip to New Zealand with a number of dairy discussion group members and his comments would indicate that some of our traditional views on the industry there may need to be updated.
- In the second, Eamonn O'Reilly comments on possible cash flow problems on Irish farms, especially due to last year's weather conditions.

We have our usual commentary on the national economy, in which we highlight some small signs of recovery. The key messages from two Dairy Discussion Groups of Ireland meetings held last December, as presented by Veijo Merilainen - a former director of the Finnish co-op Valio - are included. Finally, the experiences of three farmers who participated in the Farm Entrepreneurship and Leadership Programme (sponsored by the Agricultural Trust, Grant Thornton and AIB) at the DCU Ryan Academy are enclosed.

Michael Dowling
Editor

Overall Female Champion at the National Charolais Show 2012 was 'Prime Fatcha' shown by Declan Bourke with breeder Benny Keating and Eamon O'Reilly, Agri Advisor AIB, class sponsor.

ECONOMIC OUTLOOK

There was a positive tone to a lot of indicators published on the Irish economy in 2012, in contrast to the weakness evident in most other European economies. GDP growth did slow in 2012 as weak global demand impacted on Irish exports, but the economy still continued to expand.

National accounts data show that GDP rose by 0.2% in the third quarter following growth of 0.4% in quarter two. The economy is estimated to have grown by 0.5-1.0% in the year as a whole.

However, poor weather saw a fall in agricultural production in 2012, especially in crop and milk output. The CSO estimates that the volume of farm output fell by 1.3% last year, which, when combined with rising input costs, led to a 10% fall in farm incomes.

The recessionary conditions in Europe saw the growth of Irish export volumes slow to 2% year-on-year by mid-2012 from 5% in 2011 and 6% in 2010. However, against this, there were at last some signs of life in the domestic economy.

Consumer spending turned positive on a year-on-year basis in the third quarter, with retail sales continuing to rise in the final quarter of 2012. Meanwhile, business investment picked up strongly last year.

There were also signs of increased activity in the housing market, with increases in transactions and mortgage drawdowns. House prices also rose over the second half of the year.

There was also some better news on the Irish labour market. Employment fell by 0.3% year-on-year in the third quarter of 2012, the lowest rate of decline in four years. Indeed, employment in the private sector has been rising over the past year, and was up by 0.8% year-on-year in quarter three 2012. Furthermore, after stabilising at 14.9% in the first half of last year, the unemployment rate edged down to 14.6% in the final months of 2012.

These improved economic trends were reflected in the public finances. Tax receipts were ahead of schedule in 2012, rising by an underlying 5.3%, while the budget deficit fell to around 8% of GDP, also comfortably ahead of target.

Recent survey indicators suggest that the Irish economy is continuing to grow. Indeed, Ireland should remain one of the strongest performing EU economies in 2013. We are forecasting Irish GDP growth of 1.3% for this year (Table 1). This is modest growth, but it contrasts with expectations of negative growth in the eurozone again this year and growth of only 0.75% in the UK.

The eurozone debt crisis was the dominant factor impacting on currency markets during 2012. The euro remained under pressure in the first half of the year as the crisis in the eurozone deepened, with speculation of a Greek exit and even a possible break up of the single currency. It recovered in the second half of the year as European policymakers took steps to alleviate the crisis and underlined their support for the single currency.

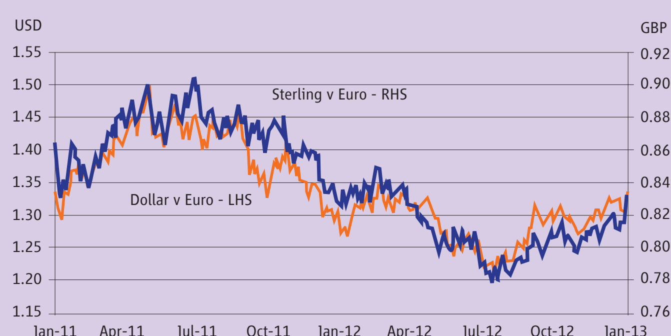
The euro finished last year on a relatively strong note (Figure 1), helped by decisions that ensured Greece would continue to receive funding under its EU/IMF bail-out programme. It received a further boost early in 2013 on indications from the ECB that it is no longer considering another cut in interest rates.

Overall, given the progress being made in tackling the eurozone debt crisis, we think that the euro has more upside than downside potential in 2013 *vis-à-vis* where it generally traded in 2012. Thus, we look for the euro to largely trade in a $1.30-1.40 range against the dollar and £0.82-0.86 range versus sterling in 2013, with the downside risks mounting for the UK currency in particular.

Adverse movements in exchange rates present distinct challenges for the export-orientated agricultural sector as they impact on its competitiveness. A stronger euro would hit the competitiveness of Irish agri-food exports to the UK and other non-eurozone markets and also impact vis-à-vis imports from these countries. Thus, exchange rates bear close watching in 2013.

Another challenge in 2013 is likely to be the continuing high cost of farm inputs, in particular the cost of energy and feed stuffs. At least oil prices have levelled off over the past year, which combined with a rise in the euro, should ease some of the upward pressure on farm input costs.

Figure 1: Relative performance of the Euro against the US Dollar and Sterling



Source: Thomson Datastream

Table 1: Economic Forecasts – Ireland

Annual % Change Unless Otherwise Stated

	2011	2012(e)	2013(f)	2014 (f)
Real GDP	1.4	0.7	1.3	2.5
Real GNP	-2.5	2.0	-0.5	1.8
Consumer Spending	-2.4	-1.5	-1.0	0.5
Government Spending	-4.3	-3.8	-3.0	-2.0
Fixed Investment	-12.6	0.0	1.0	5.0
Exports	5.1	3.0	3.0	4.0
Imports	-0.3	0.3	1.5	3.0
HICP Inflation (%)	1.1	1.9	1.6	1.5
Unemployment (%)	14.6	14.9	14.7	14.3
General Govt. Deficit (as % of GDP)	9.1	8.0	7.5	5.1

Source: AIB Economic Research Unit

(e) = estimate; (f) = forecast

Review and Outlook: Looking back to 2012

The past year was a difficult and somewhat perverse one for Irish farmers. On the one hand, prices in many sectors were at, or close to, historically high levels. On the other hand, many input costs were also at very high levels and, to compound matters, the appalling summer weather resulted in a spike in feed usage, a sharp drop in cereal yields and a substantial increase in harvesting difficulty.

The weather was, in fact, the story of the year and a very sad story it made. While weather conditions varied a little by region - and their consequences were different as between one soil type and another - in general, the persistent summer rainfall and reduced hours of sunshine added significantly to farm costs and created an air of depression in the sector, in what was otherwise an above-average year from a farm income point of view.

Output and input costs both rose during the year, to a somewhat similar degree [4 - 5%]. The big factor was, however, the weather effect on input, and in particular, feed usage. Teagasc estimates that this factor led, on average, to at least a 20% increase in feed usage and that for many farmers the increase in feed usage was much higher. This was the main element causing a drop in farm incomes in 2012, which, in aggregate, the CSO put at about 10.5%. This is a preliminary estimate but, if confirmed, would put the 2012 income figure a little above the average of the previous five years and above each of the years 2008 to 2010.

In what is also a preliminary estimate, Teagasc puts family farm income at €21,500, a drop of over 12% compared to 2011. While the fall - which was due almost exclusively to reductions in profitability in dairying and cereals - is significant, it still left family farm income last year higher in nominal terms than in all but one year since the full implementation of the McSharry reforms in 1995; and, in real terms, higher than all but a couple of years over the same period.

If the **dairy** sector was the big winner in 2011, then it was the heavyweight loser in 2012. Weakness in the market which began to appear in late 2011 intensified in the first half of last year and led to a sharp drop in milk prices from the historically high levels of the previous year. Over the year as a whole, prices fell on average by about 3.5c/litre to some 32c/litre (actual butterfat levels). In nominal terms, this was still a high price but when the weather effects (particularly adverse in this sector) are factored in, the result is a very sharp drop in dairy farm income. We would estimate the income reduction at between 25% and 30%. This still left dairying by far the most profitable farming sector in 2012. It would, however, be hard to overestimate the difficult conditions in which dairy farmers had to operate in order to generate the income they earned last year.

By contrast, **beef** farming, a lower margin business, enjoyed a relatively better year despite the weather. Prices rose by about 12% and, according to Teagasc preliminary estimates, incomes increased by 10% to 13%. Output was, however, down by some 11%.

The **pig** sector continued to experience difficulties during 2012, despite a 10% increase in prices and an increase in output of some 3%. Feed prices remained stubbornly high resulting in the margin over feed staying very tight. In fact, the average margin over feed has been at just break-even levels for the past three years. That was the position for much of last year also and, indeed, for part of the year the margin was below break-even level. More recently, the average margin has moved slightly into positive territory. These are, of course, average positions. The level of profitability varies significantly depending on scale and efficiency. Some producers were last year undoubtedly achieving significantly more than the 45c/kg margin over feed required to break even.

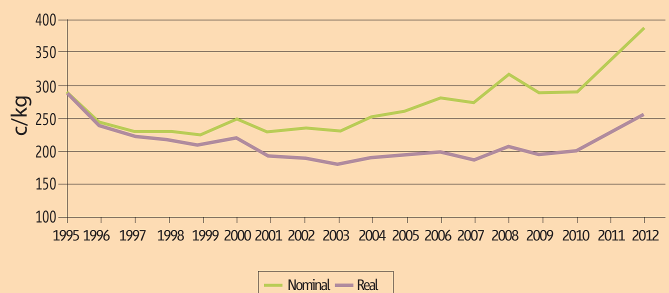
Sheep prices dropped by about 4% in 2012, with the main decrease coming in the second half of the year. On the other hand, output rose by about 12% and the increase accelerated through the year. It looks as if the trend of falling sheep numbers, evident for nearly a decade and a half, has been reversed.

It was a really perverse year in **cereals**. Prices were never higher – up some 30% on the very high levels of 2011. Acreage was down less than 10% but overall output fell from over 2.4 million tonnes to just 2 million tonnes. The cause, a drop of close to 25% in yields and lower quality, both of which were weather related. Harvesting conditions were extremely difficult. The overall result, according to Teagasc preliminary estimates, was a 19% fall in cereal farm income.

Looking further back

Owing to the fact that a variety of factors can significantly influence agricultural prices and incomes in a particular year, looking at one year in isolation does not always give an accurate picture of the reality of price and income developments. We have, therefore, looked briefly at longer term trends. We have picked 1995 as the starting point, as that was the year of the full implementation of the McSharry CAP reforms. Figure 2 and Figure 3 below show price developments in the beef sector (represented by R3 steer prices) and the dairy sector (represented by manufacturing milk prices) to present day in nominal and real terms.

Figure 2: Beef Price Development 1995-2012



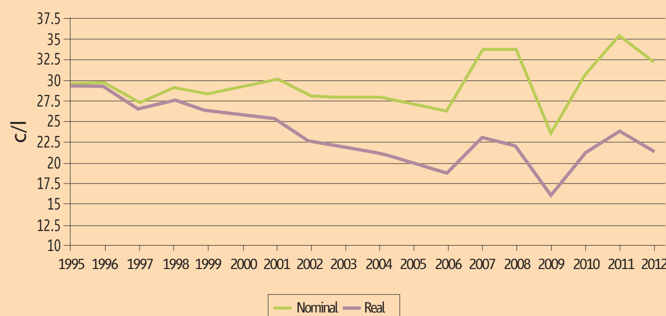
Source: Bord Bia

As one would expect, there have been significant nominal price increases since 1995, especially in the case of beef (Figure 2). The position in real terms is, however, somewhat different. Steer prices in real terms have fallen by about 11% over the period. When account is taken of the increase in beef premiums (equivalent to about 50c/kg in the case of steers) applicable from the 2000-2002 period and now incorporated in the Single Farm Payment, there has been a very small real price increase.

The position in regard to milk prices is very different. Even when the dairy element of the Single Farm Payment (3.5c/litre) is taken into account, real milk prices have fallen by about 20% since 1995 (Figure 3). The fact that profitability has been enhanced in the sector over the period is mainly due to improved efficiencies and greater scale of on-farm production.

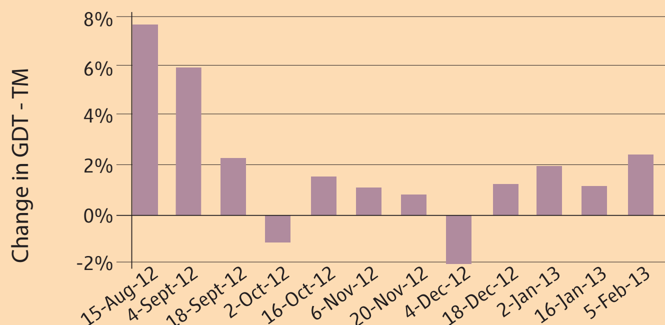
In order to compare price and input developments over the longer term we have looked at the price changes in real terms in each of the main sectors against the price movements for the principal sectoral input in each case. The results are set out in Table 2 opposite.

Figure 3: Manufacturing Milk Price Development 1995-2012



Source: CSO

Figure 4 : Changes in Global Dairy Trade Trade Weighted Index



Source: Global Dairy Trade

Table 2: Product and Input Price Changes 1995-2012

(% change in real terms)

	Full Year (Average 1995 v Average 2012)	Last Quarter (Q4 1995 v Q4 2012)
Cereal Prices	-1	+14
Fertiliser Prices	+43	+40
Pig Prices	-20	-13
Pig Feed Prices	-6	+2
Beef Cattle Prices	-11	-11
Milk Prices	-28	-23
Dairy Feed Prices	-11	-3

It is clear from the above table that, with the exception of fertilisers - the price of which has risen substantially - in real terms these input prices are little changed over the period. Product prices have fallen somewhat, but in the case of beef and cereals, the Agenda 2000 premium increase has offset those reductions. As noted above, the milk premium has not been sufficient to do the same in that sector and, of course, there are no premiums in the pig sector.

Looking ahead Professional weather forecasters say that it is not possible to make accurate predictions for more than about two weeks ahead. So nobody can say what the weather will be like in Ireland over the coming year. As in 2012, the prevailing weather conditions in 2013 will exert a significant influence on the overall operating environment and on incomes earned. But we have to make the assumption that 2013 will see a return to normal conditions. On that assumption, this year should see an increase in family farm income to levels reasonably close to, but not matching, incomes recorded in 2011.

Normal weather should see a significant drop in feed usage, although farms that were unable to produce adequate silage last year will have increased feed expenditure in the early months of the year. We expect soya prices to be lower as a bumper southern hemisphere crop is predicted. Current indications are that grain prices will also be a little lower than in the second half of last year but may not fall below the relatively high levels of 2011.

Milk price fell consistently through the spring and early summer of last year, bottoming out in July. Since then, they have risen by about 3c/litre. We would expect the improved price to be at least maintained this year, as dairy markets are in reasonable balance and international prices remain strong. Figure 4, showing the Global Dairy Trade auction results, graphically illustrates the strengthening of the international market since July.

With lower feed costs, no superlevy imposition and a strong milk price, we would expect to see a very considerable recovery in dairy farm income this year. Most of the 2012 decline should be reversed.

Cattle prices were at historically high levels last year, even if they fell off somewhat in the third quarter. The end of the year saw a strengthening of prices and we would expect the market to remain firm well into 2013. There may be a little more market pressure in the second half of the year as throughput increases from the very low levels experienced in 2012 (lowest level of slaughterings since 1995). This should not, however, be particularly serious, as the European and international markets are expected to remain fairly well balanced.

The ending of the suckler cow welfare scheme will, of course, lead to some loss of income. The expected drop in feed usage should, however, benefit the beef sector and, together with the continuation of relatively strong prices, should maintain beef farmer margins. The outlook for the sheep sector is very similar to that for beef. Here, too, we would expect relatively similar incomes to 2012 with prices down but output up.

The pig price rose steadily in the second half of last year from €1.65/kg to about €1.82/kg. Most in the industry expect further price increases in the first half of this year. Furthermore, there is a real prospect of some easing of feed prices, movements of which nullified most of the benefit producers got from last year's rising prices. These factors combined should see the margin over feed stay in positive territory and, accordingly, pig producer incomes should experience a modest increase.

Average incomes on cereal farms fell in 2012 despite the exceptionally high prices. The fall was due exclusively to the weather-related drop in yields. The return of normal weather should see the return of normal yields. Despite some reduction in price, the substantial increase in yields should see cereal farm incomes increase to about the average level of the six years from 2007 onwards. That would however, still leave cereal incomes considerably below the peak year of 2007.

As indicated previously, aggregate farm income is estimated to have fallen by some 10% in 2012. Our predictions for this year are largely centred on a return to normal weather conditions and very much lower feed usage, higher grain and beef output, strong beef, milk and pig prices and some modest moderation in feed prices. If these are correct, then the drop in aggregate farm income will be largely reversed.

New Zealand study tour

Patrick O'Meara, Agri Advisor, AIB, participated in a study tour to New Zealand with a number of dairy discussion group members in October 2012. Outlined below is his experience.

On a recent study tour of New Zealand, with a group of Irish dairy farmers, I was struck by how much Irish farmers can learn from their New Zealand counterparts, both from a positive and negative point of view. This was my first time studying the agriculture sector in New Zealand, and following this trip, I am significantly more positive about the Irish dairy sector and its strengths compared to those of New Zealand.

While the trip focused on the dairy sector, we also got some exposure to the beef, deer and sheep sectors, each delivering reasonable returns in a generally unsupported market where commodity prices are significantly lower than in Ireland. In 2011, average beef and lamb prices in New Zealand were $4.10/kg (€2.60/kg) and $6.42/kg (€4.08/kg) respectively. The average income on drystock farms in 2011 was $113,700 (€72,200). It is however important to note that the 'average' New Zealand drystock farm is very different to that of Ireland, consisting of 2,822 sheep, 291 beef cattle and 27 deer over their winter period!

In general, I was most surprised at the cost base in New Zealand. The cost of living seems high, land price is high, and both machinery costs and the cost of carrying out on-farm capital development is more expensive than in Ireland. While the condition of the stock we saw in New Zealand was excellent, farmers there are becoming higher cost producers, more reliant on imported feed than in the past. On average, dairy cows in New Zealand are fed 350kg of Palm Kernal per annum, just one of the imported feeds on farms. Their grassland management was poorer than I expected and, according to commentary on the trip, it has slipped in recent years.

How do New Zealand dairy farms compare with Irish dairy farms?

The New Zealand dairy sector has recorded an annual increase of 4.5% in milk production in the past decade, delivered principally from an increased national herd and larger land base devoted to dairy production. At farm level, the average New Zealand dairy farm (138ha) in 2011 produced 130,000kg MS from 386 cows (337kg MS/cow).

The average profit on owner-operator dairy farms in New Zealand, after accounting for operating expenditure (Table 3), equated to €1,784 per hectare.

Table 3: Operating Expenditure per cow on New Zealand Dairy Farms - 2011

	€	%
Feed	319	30
Labour (adjusted for unpaid labour)	219	20
Maintenance and running costs	177	16
Fertiliser	132	12
Depreciation	98	9
Animal health and breeding	81	7
Overheads (excluding interest)	66	6
Total	1,092	

The top quartile of dairy farmers in New Zealand were milking 474 cows, at a stocking rate of 3.14 per hectare, and achieving a profit of €2,917/hectare. In analysing these figures it should be noted that New Zealand farmers enjoyed a record milk price in 2011 of $7.90/kg MS (€5.01). Payout for the current year is forecast at $5.85/kg MS (€3.71), and is expected to average $6.10 to $6.50/kg MS in the medium term.

Looking forward, while I believe that while there will be further growth in New Zealand dairying, I think that it will be at a more modest rate. This will be driven by their high level of debt, access to quality labour, cost of capital development and increasing environmental constraints. If this transpires, it will be very important to Ireland as it will have a major impact on global dairy markets into the future.

Agricultural banking in New Zealand

Total lending to the farming sector increased by $30bn, or 141%, to $51.8bn (Table 4) in the past decade. This has been driven by a number of factors, including interest-only facilities, increased land value, high profits being achieved and significant expansion in the dairy sector.

Table 4: Rural Asset Book profile from 2003 to 2012

$ '000 m (June)	2003	2006	2009	2012	Distribution (2012)
Dairy Cattle Farming	11,177	15,956	28,626	30,549	59%
Grain Beef & Sheep Farming	5,148	8,366	10,840	11,171	22%
Horticulture & Fruit Growing	1,219	2,116	3,106	3,202	6%
Poultry Farming	154	170	192	250	-
Other Livestock Farming	459	641	922	1,110	2%
Other Crop Growing	92	56	102	106	-
Agri Business	2,744	2,881	4,514	4,271	8%
Services to Agriculture	483	919	1,058	1,174	2%
Total	21,476	31,105	49,360	51,833	

Source: Reserve Bank of New Zealand

Since the global financial crisis, the financial sector has changed in New Zealand. Banks are now focused on increasing their level of domestic funding and, as a result, deposit interest rates are relatively high compared to lending interest rates. The New Zealand reference rate is currently 2.5% but deposit interest rates are significantly higher at 4% to 5.5%. In addition, the banks' lending margin is increasing and credit is analysed on the basis of capital and interest repayments over 20 years instead of interest only as was previously the case.

Banks in New Zealand typically lend on the basis of 60% loan to value (LTV), where land, stock and shares are used as security. While working capital facilities are generally low compared to Ireland (€250/cow), overdraft interest rates are high at 12%. Interest rates for long-term facilities range from 5.5% to 7.5% and, from speaking to financial institutions, it appears that the majority of farmers are on rates closer to 7.5%. Sharemilkers are generally charged a 2% margin premium above this, due to their risk profile and not having land as security.

Currently, a large portion of milk price is going toward servicing the relatively high levels of debt on New Zealand dairy farms (Figure 5). In short, dairy farmers are now paying twice the amount of interest per kg MS compared to a decade earlier. The interest element equated to 30% of gross farm revenue in the 2008/2009 production year. Converted to a per cow basis, New Zealand farmers have an average borrowing per cow of $7,562 (€4,800) and their interest payment, excluding capital repayments, is $570 per cow (€362). Dairy NZ estimate that approximately one in four dairy farmers in New Zealand will not make enough money, at a $6/kg MS payout, to meet both living expenses and interest payments on their farm borrowings.

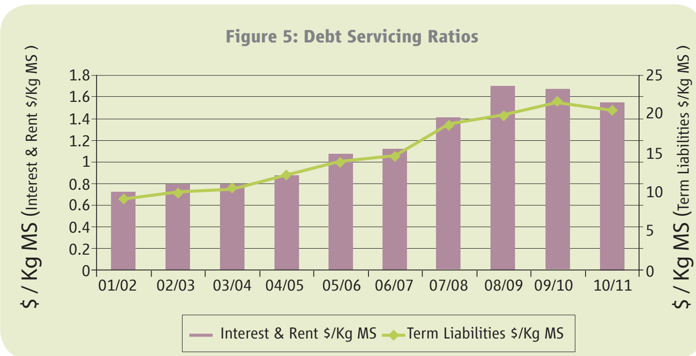


Figure 5: Debt Servicing Ratios

What were the key trends that I noticed?

- Farmers place a large emphasis on soil nutrient (particularly P, K & lime). Their goal is to get a farm growing its optimum level of fodder as quickly as possible. There were instances where farmers spread 'capital fertiliser' before they took over official ownership of land;
- The expansion in dairying is now taking place on more difficult land (climate and terrain). As a result, irrigation is becoming much more prevalent;
- Farmers often carry out 'big bang' expansion, rather than sporadic developments, principally to maximise the return to the business from the first day and avoid the business swallowing cash flow for a large number of years;
- There is a proposed large shift in economic values and emphasis toward fertility and survival in their Breeding Worth - BW (BW is similar to EBI in Ireland);
- There seems to be significantly less opportunities for sharemilkers to enter the sector and increasing instances of equity partnerships;
- 45% of the dairy herd are now cross-breds;
- There is generally a focus on-farm on three ratios – Loan to Value; Interest Cover; and Return on Equity, with analysis carried out on a Kg MS basis, and;
- There is a focus on farm governance at both farm and bank level.

What can we learn from New Zealand as the Irish dairy sector enters an expansion phase?

- Throughout the study tour, the importance of having good people employed in the business was clear and was a key element to having a profitable farm. Farmers and staff are focused on continual improvement through training, etc;
- When undertaking significant capital developments, New Zealand farmers typically employ a project manager who reduces the potential mistakes and over-runs in development costs. Without this, they believe that their own farm performance would likely suffer in this period of development;
- New Zealand farmers are very regimental about adhering to farm budgets, farm costs and capital development costs. As a result, to avoid budget over runs, they try to have fixed contracts in place for as much of the development as they can, particularly on items such as machinery work and for stone/gravel requirements;
- The New Zealand farmers that we visited had a very good understanding of their farm finances. They carried out detailed cash flow budgets and provided the bank with regular updates, where they explained any significant variations between actual and budgeted costs;
- An interesting presentation from Dairy NZ provided seven characteristics that differentiate the top quartile group of farms (based on profit per hectare) from the bottom quartile. It is worth considering that in 2011 there was a difference of €2,020/hectare between the two groups. In comparison to the bottom quartile, those in the top quartile were more likely to:

1. carry out benchmarking;
2. have reliable plant and equipment;
3. carry out budgeting but also compare actual and expected expenditure;
4. have a good network in the industry;
5. be confident in their own decision making;
6. have had dairy experience when at school, and finally;
7. be managed by couples.

** Please note that an exchange rate of $1NZ : €0.635 was used throughout this article*

Pictured at the final of the AIB/ Macra na Feirme Club of the Year Competition are members of the Johnstown/Coolgreany Macra, AIB Macra na Feirme Club of the Year 2012, with Alan Jagoe, Macra na Feirme National President and Liam Phelan, AIB Agri Advisor.

CAP reform

The CAP reform proposals made by the Commission in 2011 are well known and well debated at this stage, but we are still not clear on what the final outcome will be. It now looks, however, as if the decision will be taken in June.

Direct Payment System

The background to the proposals is an acceptance of the need to maintain the broad structure of the current policy while responding to the perceived need for a better distribution of direct aid, both among and within Member States, in addition to better targeting of measures to address environmental challenges. To meet these broad objectives, the following proposals have been tabled:

- To provide for a somewhat more even distribution of direct payment expenditure among Member States, amounts available to those countries below the EU average (measured in Euro per ha) would be increased to reduce 30% of the gap between their level of payment and the Community average. Expenditure available to those above the average would be reduced proportionately;
- 30% of the expenditure in each Member State to be reserved for uniform payments per ha for greening measures – setting aside of land for ecological focus areas, compulsory crop rotation and the maintenance of permanent pasture, and;
- A gradual movement to national uniform per ha payments over the period 2014 to 2019.

The average payment in Ireland (€271/ha) is almost identical to the EU average, so the overall amount available here (€1.24 billion) would be only marginally down on the amount currently received. In aggregate, therefore, the Irish position would be little changed by the proposals. Implementation of the second and third proposals would, however, lead to profound changes in the distribution of payments among Irish farmers.

For instance the greening proposal would be implemented from the beginning and would lead to a drop of between 15% and 22% in the Single Farm Payment of the 7,500 farmers with payments above €500 per ha. On the other end of the scale, those with payments of between €20 and €100 per ha would receive increases of between 75% and 100%. The full implementation of the proposals would see falls of over 70% in the payments to those with the highest rates of premium by 2019. Even those in the middle of the payment range (€450/ha) could face cuts of 40% or so. Those towards the bottom of the range would see spectacular increases - for instance almost 200% where the payment rate is €75/ha.

Pictured at the National Dairy Show with the Champion two-year-old heifer in Milk 'Glaslough Sanchez Brie' is (R to L) Donal Whelton, Agri Advisor AIB, Denis O'Neill and David Boyd (owner).

These adjustments are seen by many as being too dramatic and too sudden. Ireland is, therefore, one of a large number of Member States that, while generally accepting the distribution among Member States, are looking for flexibility in regard to the national distribution. As we understand it, the preferred Irish solution would be the gradual implementation, up to 2019, of a re-distribution mirroring what is proposed for the intra-Member State adjustment (i.e. closing 30% of the gap to 90% of the average payment).

Logically, that would include the phasing in also of the greening premium and its calculation as a percentage of the individual's basic premium rather than as a uniform fixed amount. If agreed, that would, for instance, see the middle-of-the-range payment fall by about 10%, the highest payments by about 20% and lower level payments (e.g. €75/ha) rise by 75% or more. Almost certainly, the final agreement will allow for some significant degree of national flexibility. It remains to be seen whether that will extend as far as the Irish position calls for.

Outside of the issues relating to the distribution of aid, a number of other sticking points have emerged during the negotiations, most notably:

- the extent of the greening percentage, with many arguing that allocating 30% of the aid to these measures is excessive, but the issue of the greening percentage would now appear to be agreed at 30% by the European Council;
- a number of Member States are also arguing that the measures to be regarded as greening should extend beyond the three proposed by the Commission and that there should be national flexibility to choose from a menu of greening measures;
- others argue that setting aside 7% of land, other than permanent pasture, as ecological focus areas is too much, and;
- many argue that the proposed minimum limit for crop rotation at 3 ha is unrealistically low and that furthermore the requirement should be for a two, rather than a three, crop diversification.

These and other reservations have emerged in the European Parliament, as well as in the Council of Ministers.

Market management measures

While the proposals relating to direct aid are the most contentious ones, there are other important elements in the package, particularly relating to market management and rural development. The proposals relating to the former would see the retention of the existing provisions on limited intervention, private storage aid and export refunds. The proposals would also empower the Commission to take specific action to deal with market disturbance caused by significant price rises or falls or other factors and also to adopt exceptional support measures (co-financed by Member States) in the face of animal disease outbreaks. Finally, the market management

measures provide for the ending of sugar quotas by 2015 - a proposal strongly opposed by many Member States which are looking for their extension up to 2020 (this position is also supported by a strong element in the European parliament).

Rural Development

The direct aid and market management measures constitute Pillar 1 of the CAP. Rural development constitutes Pillar 2. Under proposals relating to Pillar 2, there are three main objectives: competitiveness, sustainability and the rural economy. Within each are six priorities: knowledge, competitiveness, food chain, ecosystems, carbon and jobs. The proposals provide that 25% of national envelopes be reserved for environmental and climate change actions.

EU co-funding for rural development would typically be 50%; 80% for LEADER; 85% for certain less developed and outermost regions and 100% for measures relating to innovation. Funding would be provided, however, in a more complex structure than has been the case up to now.

Many existing measures would be retained in the new system, including LEADER (5% of the rural development expenditure would be ringfenced for this measure), agri-environment (provision of this measure would be compulsory for Member States) and afforestation. The forestry premium would, however, be limited to maintenance costs and payable for 10 years only. There would be new bio-physical criteria for designating less favoured areas. There would be new measures relating to:

- farm and business development;
- cooperative projects;
- producer groups; and,
- risk management.

The last mentioned would include crop and weather insurance and income stabilisation schemes. It is not clear whether the on-farm investment measure would extend to support farm development in the context of meeting the Food Harvest 2020 targets.

A major issue has been the division of the rural development funds among the Member States. This is to be done based on objective criteria which were undefined in the proposals. Depending on the criteria used, Ireland could have seen its current share of the fund maintained or, on the other hand, faced a sharp reduction. The European Council has now agreed on a new distribution that would seem to involve some modest reduction in the Irish share. There is a provision that would allow for a transfer of funds from one pillar to the other but it is likely that there would be very little, if any, potential for use of that provision here to meet a shortfall in our rural development allocation.

Conclusion

An overall complication in the agricultural negotiations is the still unresolved issue of the financial framework (i.e. the budget) for 2014-2020. The European Council has now just reached a budgetary agreement that represents about a 3% drop compared to the current position and which also settles a small number of other outstanding issues in the negotiations (see above). While the European Parliament has still to agree to the Council compromise, the decision now taken makes it considerably more likely that there will be an overall accord on the future of the CAP by the end of the Irish Presidency in June. The Council decision would see the Irish take from the EU's agricultural budget fixed at the considerable sum of about €1.5 billion a year. The funds to underpin the Single Farm Payment would remain just above €1.2 billion, just about 3% below the current figure. All this indicates that for most farmers the crucial issue - that relating to the distribution of the Single Farm Payment - remains to be decided, probably in June.

Even a June decision would probably not allow the new provisions to be operative in 2014, such is the level of detailed regulations and administrative arrangements that would have to follow the decision. A rollover of the current system for a year would therefore be necessary.

Whenever the decision is made, it is important that the new system is one that continues to provide reasonable support for Irish farm incomes and for the development of the Irish agri sector and for the rural economy generally. As far as one can judge from the outside, good progress has been made in the negotiations in having Irish concerns recognised. There must, therefore, be a reasonable expectation that the system that is eventually agreed will be one that continues to underpin a vibrant agri sector and a healthy rural economy.

Discussion Groups of Ireland - Key Messages

Veijo Merilainen, a private dairy consultant with 33 years experience as Director of Valio (a Finnish co-op that processes the majority of milk in Finland) spoke at two Dairy Discussion Groups of Ireland marketing meetings, which took place in Fermoy and Mullingar in December last. Among the key messages he presented at the events were:

- Ireland has all the attributes (e.g. positive brand image; presence in key emerging markets; cost and production competitive advantages) necessary to make it a global leader in dairy exports, albeit requiring continued industry re-organisation and innovation to ensure improvements in efficiency and marketing power post 2015;

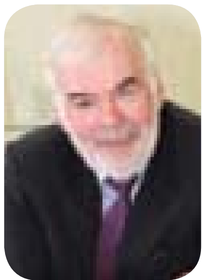
- Market dominance and sales power are absolutely essential in new and emerging countries. Investment in market research is, therefore, imperative, principally to gain an understanding of the nature and extent of competitor activity in addition to consumer demand. This will enable the targeted delivery of branded products;

- The Russian market offers good exporting opportunities for Ireland. Russia will not be self sufficient in dairy for at least 10 years and there are 140 million potential customers there;

- All major processing investment is being diverted into drying equipment. While this offers a short-term safety net to accommodate increased production, it increases the risk of price volatility post 2015, and;

- Understanding the relative value of products, and orientating toward the delivery of those at the higher end of the spectrum, offers mutual benefit for processors and farmers alike, principally in terms of control, stability and viability potential. Veijo highlighted the traffic light system in operation in Valio which highlights the net value in cents per litre a product is returning.

Kevin Twomey, Chairman Dairy Discussion Groups of Ireland



The global food landscape

The global food economy has changed substantially in recent years. In this article, Tom Arnold, CEO Concern Worldwide, identifies the key factors which have led to higher and more volatile food prices and discusses the consequences of high food prices, particularly for poor people.

In response to the increasing political importance of food, there have been a number of important policy changes. But the key question still remains: are these policies adequate to provide food and nutrition security for a global population set to increase from the current 7 billion to 9 billion in 2050?

The last time food security was as high on the global political agenda was in the early 1970s, when a combination of production shortfalls, low stock levels, and the first oil crisis, arising from conflict in the Middle East, drove world food prices to unprecedented levels. Between 1974 and 2005, the FAO index of real global food prices (inflation adjusted) fell by 75%. Over these three decades, many Governments appeared to take food security for granted. Investment in agriculture declined and aid programmes for agriculture were reduced.

International food prices increased dramatically in the 2005-2008 period, starting with a moderate upward trend until early 2007, and then accelerating to a peak in mid-2008. Prices of certain cereals more than doubled during this time while the price of rice doubled over a four-month period in 2008. The price of key agricultural inputs, particularly fertiliser, and fuel prices increased four-fold in 2008.

Food prices receded after June 2008 (although not to the pre-2005 levels) but surged again between June 2010 and June 2011. While prices eased after mid-2011, they increased again in 2012 when the price of maize reached an all-time high. Low stock levels and continuing weather worries in key commodity producing countries limit the possibility of substantial short-term price falls.

The political, economic and social implications of increased food prices are profound. Poor people spend large portions of their incomes on food. Price increases mean they purchase less, lower quality food, as well as cutting back on expenditures for health and education. Food riots involving people protesting about the price of food occurred in over 30 countries in 2008.

Over the previous four decades, steady progress had been made in reducing hunger, both in the absolute number of hungry people and as a proportion of the world's population. Notwithstanding this progress, some 860 million people were hungry in 2008. The sharp increase in food prices, allied to the emerging global recession, drove an additional 150 million into hunger.

This was the background which required political action and policy change. In April 2008, the UN Secretary General, Ban Ki-moon established a High Level Task Force on Global Food Security, led by Dr David Nabarro, to provide leadership and a coherent policy response to the food price crisis from across the UN system.

In addition to the coordinated UN approach, there have been a number of policy changes, at national and international level, which offer hope for the future. The main changes include: increased investment in agricultural and rural development; a reformed international agricultural research system; and a greater emphasis on nutrition, especially early childhood nutrition.

Developing countries are increasing investment in their agricultural and rural sectors. In 2003 at the African Union Summit in Maputo, African leaders committed to investing 10% of their national budgets in agriculture. Not all African countries have met this commitment but, under the Comprehensive Agreement for African Agricultural Development Programme (CAADP), an increasing number of countries are investing in small-holder agriculture on the basis that this is the best way to boost economic development, given the high percentage of the economy dependent on agriculture, and is one of the most effective ways of combating poverty.

Many African countries now have coherent policies for agricultural and rural development and these country-led policies are being supported by the major aid donors. G8 leaders in 2009 and 2012 have made significant commitments to support these policies.

There is a renewed interest in international agricultural research aimed at increased agricultural productivity in the decades ahead. The Green Revolution in Asia in the late 1960s achieved breakthroughs in plant breeding and agricultural productivity. This, in turn, provided the foundation for the future decades of Asian economic growth, which has been a key factor in increasing the global demand for food.

The Consultative Group for International Agricultural Research (CGIAR), the network of 15 international agricultural research centres which were at the heart of the first Green Revolution, has been undergoing a significant reform process in recent years. A more focused international research programme, allied to better linkages to national research and extension systems, offers the prospect of increased productivity and more sustainable production systems.

In 2010, the Scaling Up Nutrition (SUN) movement was set up to prioritise improved nutrition, especially during the 1,000 days comprising the period of pregnancy and the first two years of a child's life which are crucial to physical and mental development. The movement involves governments, civil society and the private sector, all of whom have committed to work together to reduce the level of early childhood under-nutrition. Currently, some 170 million children suffer from stunting which will impair their physical and mental development. The Irish and US Governments have provided international leadership in supporting the SUN movement and 33 countries have now committed to implement policies to reduce stunting.

These policies of increased investment in agriculture, improved agricultural research and a greater focus on nutrition are positive but it is by no means certain they will be sufficient to achieve national and international food security and reduce the number of hungry people in the world - 868 million according to the latest FAO estimate.

Looking to the future, the key factors of population growth and increased per capita income – leading to changing food consumption patterns - will underpin the increased demand for food.

The FAO/OECD Agricultural Outlook 2012-2021 projects that agricultural

commodity prices will, on average, be higher in nominal terms than in the previous decade. The Outlook also projects that prices will continue to be more volatile than in recent decades. Input prices will also be higher, so the ongoing challenge of deriving a margin from farming will continue.

Taking a longer term view, world population is expected to reach 9 billion by 2050. It is estimated that food production will need to increase by 70% by 2050 to meet additional demand for food, at a time when critical resources of water, land and energy become increasingly scarce. One huge uncertainty in this overall equation is what will be the impact of climate change on the level and predictability of food production.

The overall conclusion I draw from this analysis is that there will be significant opportunities for a major food exporting county like Ireland in the coming decades. However, if the world is to become more food secure, and the number of hungry people in the world significantly reduced, there will have to be a continuing high political priority given to food and nutrition security, based on an intensification of the policy initiatives introduced in recent years.

Tom Arnold has been CEO of Concern Worldwide since October 2001 and will retire from this position at the end of February 2013. He is also Chairman of the Convention on the Constitution.

Become a leader

A new Farmer Educational Initiative was launched last year by the DCU Ryan Academy*, sponsored by AIB, together with the Agricultural Trust and Grant Thornton. Here, we talk to Ann Horan of the Ryan Academy and three farmers who completed the course about the importance of up-skilling.

In October 2012, 22 farmers took part in a pilot course at the DCU Ryan Academy, which focused on business management and leadership. As Ann Horan, Chief Executive of the DCU Ryan Academy, explains, the course was established in response to a request from the farming community: "We organised a focus group, and the outcome was clear: farmers today need to be more entrepreneurial, more innovative and to view their farms as a business that must be profitable - particularly in light of the changing landscape".

After consultation with farmers, the Farm Entrepreneurship and Leadership Programme kicked off in October. Ann explained that the ultimate aim of the course was to enhance farmer skills particularly in the areas of corporate governance, leadership and communication, financial management, opportunity recognition and assessment, legal issues in running a business, understanding the business environment, risk management, ethics and self governance, entrepreneurship and innovation for a sustainable business.

The programme consisted of eight workshops over five days, a field trip and an assessment. All participants who completed the course received a certificate of completion, with a Level 6 FETAC Minor Award in Corporate Governance presented to those who took and passed the exam.

Bill Keane, a young farmer from Waterford, was one of the participants in the programme. Having finished in Kildalton Agricultural College in 2010, Bill set up his own dairy enterprise, milking 42 cows. Bill says that his aim is to increase this number to 56 this year and he believes that the lessons he learned at the DCU Ryan Academy will help him to achieve this. "The course was excellent - it taught me how to focus on making good, sound business decisions for my own farm and to evaluate risk. It opened my mind to the fact that we are not simply farming the land, but we are running a business, and every business needs to be profitable." Bill feels that what he learned from the course will also assist him in tackling future challenges. "The topics covered will help me to plan and budget and to better understand my business. Courses such as these help farmers to learn new methods of business suited to the changing landscape." With regard financial management, Bill explained that the course highlighted the importance of preparing a comprehensive business plan and having an understanding of your own business when approaching a bank.

Denis Finnegan, a dairy farmer from Cork, agrees that the course has helped him to become more business-focused. In 2006 Denis entered into a new farm partnership with his father and set out to double their dairy cow numbers. "We wrote a mission statement, which was to: maximise the quality grass grown on the grazing platform; breed the right type of cow that will best convert grass to milk solids; create two salaries; and enjoy doing it!" The pair has succeeded in doubling the dairy herd, to 150 cows now.

Denis commented "When the opportunity came to gain more education in the area of farming and business management, I was eager to take it." Denis notes that leadership and communication were two areas of real importance for him on the course. "If you are going to increase your business, you are going to be dealing with a lot more people – banks, staff, advisory services etc – so communication is key. Legal and ethical issues were areas of interest as well as learning how to manage your business through self-governance."

Concluding, Denis remarked that he is already applying what he learned on the course to his everyday work: "Last year was a tough year with feed costs at over 5c a litre. This year I have a goal in place to grow an extra 2t/DM/Ha of grass. By achieving this, I hope to reduce my feed bill by 2 cent/litre. A long-term goal is to go into partnership with a land owner to set up a second dairy unit."

John O'Brien, another dairy farmer from West Cork, also believes that all aspects of the course were very interesting. "On the business management side, I am already implementing the lessons I learned on the course. The whole idea of having a mission statement is new to farmers I think, but we should all endeavour to have one and review it constantly. Working with other farmers as part of a team on the course also highlighted the benefits of collaborative work to me and it makes projects far more interesting."

For more information on the Farm Entrepreneurship and Leadership Programme please visit www.ryanacademy.ie

**DCU Ryan Academy for Entrepreneurship is a partnership between Dublin City University and the family of the late Tony Ryan (Ryanair). It is a not-for-profit organisation.*

Dealing with farm cash flow

Eamonn O'Reilly, Agri Advisor, AIB examines how to approach short term cash flow pressure and considers options for managing future cash flow volatility.

As we move into the first quarter of 2013, the legacy of 2012 still remains evident on many Irish farms. Overall, 2012 will be remembered as a very difficult year for farming, albeit not nearly as bad as 2009. Adverse weather conditions were the major contributing factor in 2012. As outlined earlier in the Review and Outlook article, the weather conditions resulted in: a decrease in output, particularly cereals; a big increase in feed usage; and very difficult harvesting conditions. The impact at farm level was dependent largely on the system of production, individual levels of efficiency, stocking rate and soil type.

The difficult weather conditions and associated implications are likely to have impacted on cash flow on some farms. As a consequence, some farmers may now be experiencing cash flow problems, such as having difficulty funding regular farm or personal bills, which, historically, were not an issue or cause of concern. For the majority, this cash flow pressure is likely to be short-to-medium-term in nature. I have outlined below the steps to take, should your farm experience such pressure.

1. Identify the problem

The first thing to do is identify the root cause of your cash flow difficulty. Possible explanations may include: reduced output; poor animal thrive; increased operational costs; an increased number of animals on the farm; recent capital expenditure; increased personal drawings; unforseen expenditure; or increased tax liabilities. Indeed, the cause of present cash flow difficulties may be a combination of the above. Establishing the cause, and the length of time it is likely to last, is the key to identifying the extent of the problem.

2. Quantify the cost

When you have identified the root cause or causes, quantify the costs involved. In the current year establish how much the weather affected farm profitability and cash flow.

- What was the impact of reduced crop yields?
- How much additional feed will you require and how much will it cost?
- What effect did the weather have on animal thrive and selling weight?

In quantifying the effect of each issue, the level of financial support which your farm requires can be established.

3. Meet with your bank relationship manager

When you have identified the cause and quantified the cost of the present or envisaged cash flow difficulties, you should arrange a meeting with your bank relationship manager. Our advice to customers is to talk to the bank as early as possible. Should your situation be urgent, you should advise your relationship manager who will who prioritise your request. When meeting with your bank, take time to prepare and bring the appropriate information to support your case. You will be advised of the information required in advance. Where possible, it is of benefit to have the information supplied to the bank prior to your meeting. Typically, to allow a full assessment of your situation, financial institutions will require:

- A copy of up-to-date financial accounts;
- A statement quantifying the effect of 2012 issues on the farm business, and;
- A cash flow forecast for the next 6-12 months.

A cash flow forecast is a very effective management tool of major benefit to you and your farm business. It gives a blueprint of the expected cash position of the farm business and forecasts when cash is expected to flow in and out of the farm on a monthly basis. A simple cash flow template is available on the AIB website (www.aib.ie/farming) which can be used. However, a hand-written cash flow forecast for each month is also adequate. If you have not completed a farm cash flow plan previously, it may be beneficial to enlist the help of your accountant, Teagasc Advisor or Agri Consultant.

Lessons to be learned for the future

While 2012 was a tough year for Irish farmers, with cash flow impacted by adverse weather conditions, it almost certainly won't be the last year in which Irish farmers will have to deal with cash flow difficulties. Volatility is likely to be a feature of the market in the future. It is, therefore, important to have a plan in place for your farm and how it will deal with income volatility and cash flow difficulties.

One solution available to farmers is to provide a buffer during periods of higher returns, which can be utilised during periods of cash flow pressure and low income returns. This buffer can take many different forms such as surplus funds in a savings account coming from regular and/or periodic lodgements; additional stock which can be reduced during low income periods; or the forward purchasing of inputs (feed, fertiliser), which are paid from previous years trading.

While it is not possible to predict the possibility of all externalities, proper financial planning should mitigate against periods of income pressure. A cash flow forecast for the year ahead can help identify periods of cash surplus and deficit. Keep your bank up-to-date on the performance of your business, with early engagement advised should short-term cash flow problems arise.

When planning for expansion over the longer term, it is vital to analyse the net cash effect that a fall in market prices, reduction in output, and/or an increase in operating costs has on the farm business. Stress test your expansion plans for periods of depressed commodity prices. In addition, any increase or decrease in personal drawings and the impact of existing off-farm employment ceasing, may need to be considered. In particular, account for the impact of children entering or finishing education.

While the overall market indicators are positive in the medium-to-long term, market volatility is likely to remain a feature. It is important that you have allowed for this in your own farm plan and that you discuss this with your bank relationship manager.

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