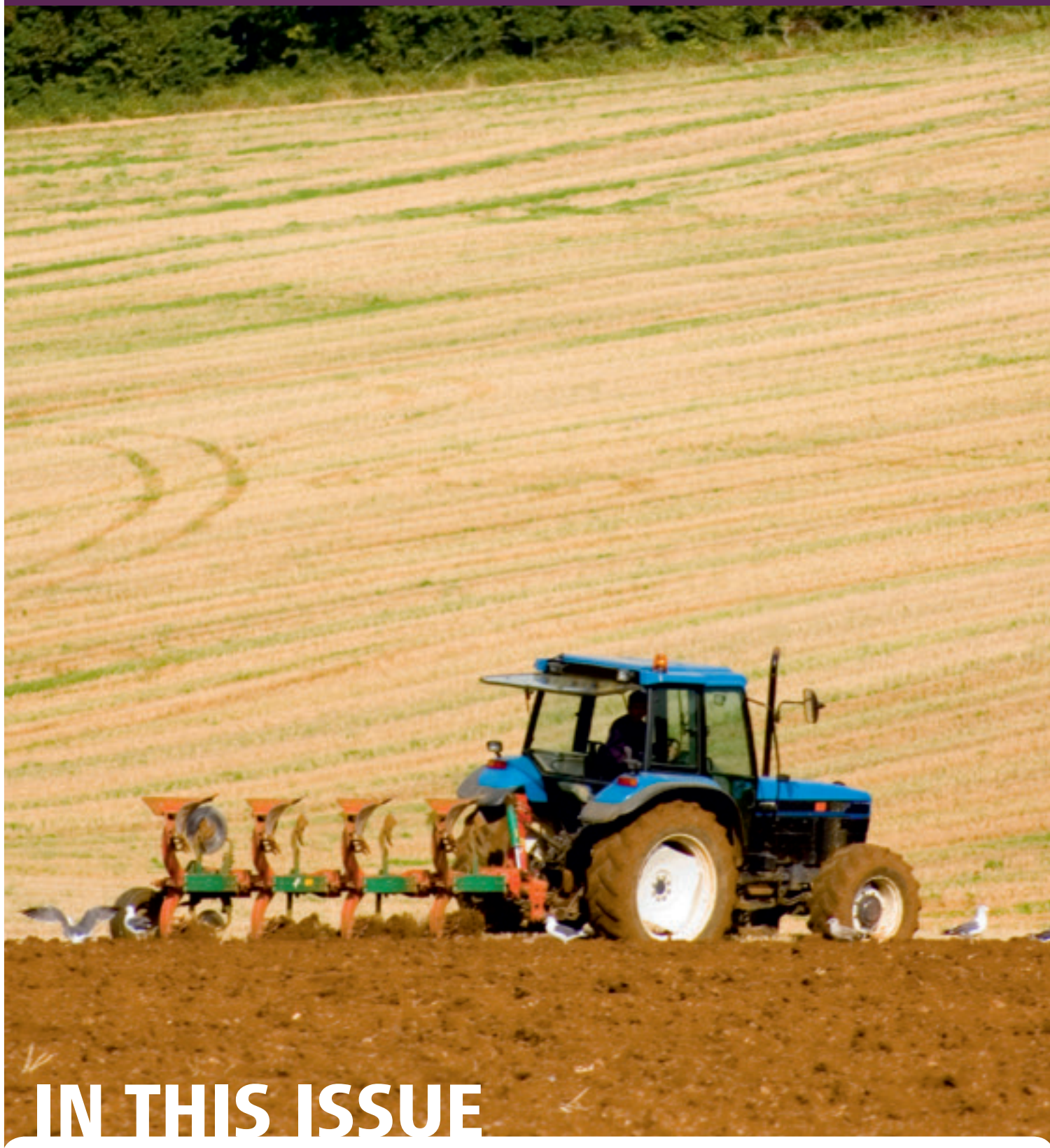


AgriMatters

AIB supporting the Irish Agricultural Industry



Autumn 2011



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OECD-FAO Agricultural Outlook / CAP Reform

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Welcome to the Autumn edition of *Agri Matters*.

Michael Dowling, Editor, Agri Matters

This edition features an article on CAP reform and an article from Eamonn O'Reilly, one of our Agri Advisers, on banking the beef sector. Other topics covered include:

- the Irish and the global economic outlook;
- the OECD-FAO projections for world agricultural commodity markets for the period up to 2020;
- the World Bank's views on the consequences of high world food prices; and,
- a review of the Irish farming scene in 2011.

I hope that readers will find something of interest in the mix.

This edition is published to coincide with the National Ploughing Championships, the major agri event of the year. We wish the organisers, competitors, exhibitors and, of course, visitors a very successful and enjoyable experience.

If you want information on AIB's banking services, have a query of any kind or just wish to have a chat, call into our stand. You will be very welcome.

Michael Dowling
Editor

Our Agri Adviser Team



TADHG BUCKLEY
AIB MALLOW



PATRICK BUTTERLY
AIB DROGHEDA



PATRICK O'MEARA
AIB NENAGH



EAMONN O'REILLY
AIB TULLAMORE



LIAM PHELAN
AIB ENNISCORTHY



DONAL WHELTON
AIB BANDON



At the official opening of the Tullamore Show and AIB National Livestock Show are (L to R) Eddie Buckley, Regional Director, AIB; Michelle O'Neill, Minister for Agriculture and Rural Development, Northern Ireland; Canadian Ambassador the Honourable Loyola Hearn; Shane McEntee TD, Minister of State at the Department of Agriculture, Food and the Marine; Freda Kinnarney, Show Secretary, and George Gill, Show Chairman.

Market Review

In our edition published last month, we reviewed the market to-date this year and set out our view on the likely outcome for the year as a whole. Nothing has changed in the meantime to alter that view in any significant way. Market prices remain strong and, despite the rise in input costs, farm incomes this year should rise noticeably, but not to anything like the extent of last year's increase.

There has been little change in the market outlook for the livestock or milk sectors since our last publication, with prices up across the board and throughput increases for all products, except beef where a 5% drop seems likely. With high feed costs, margins in the pigs sector remain under some pressure despite the improved prices. The grain harvest is reasonably well advanced and the results to-date confirm our view that the overall tonnage will be well above last year's level. Contrary to our earlier position it looks as if the price will be marginally up rather than down.

At this stage it looks as if the outcome for the individual sectors may be as follows:

	Volume	Price
	%	%
Beef	-5	+15
Sheep	+5	+7.5
Pigs	+10	+7.5
Milk	+7.5	+10
Grain	+25	+5

We expect that input prices will have risen by about 15% compared to 2010, with feed and fertiliser costs rising well above the average. The increase in energy costs should be close to the average but likely to be higher in the second half of the year.



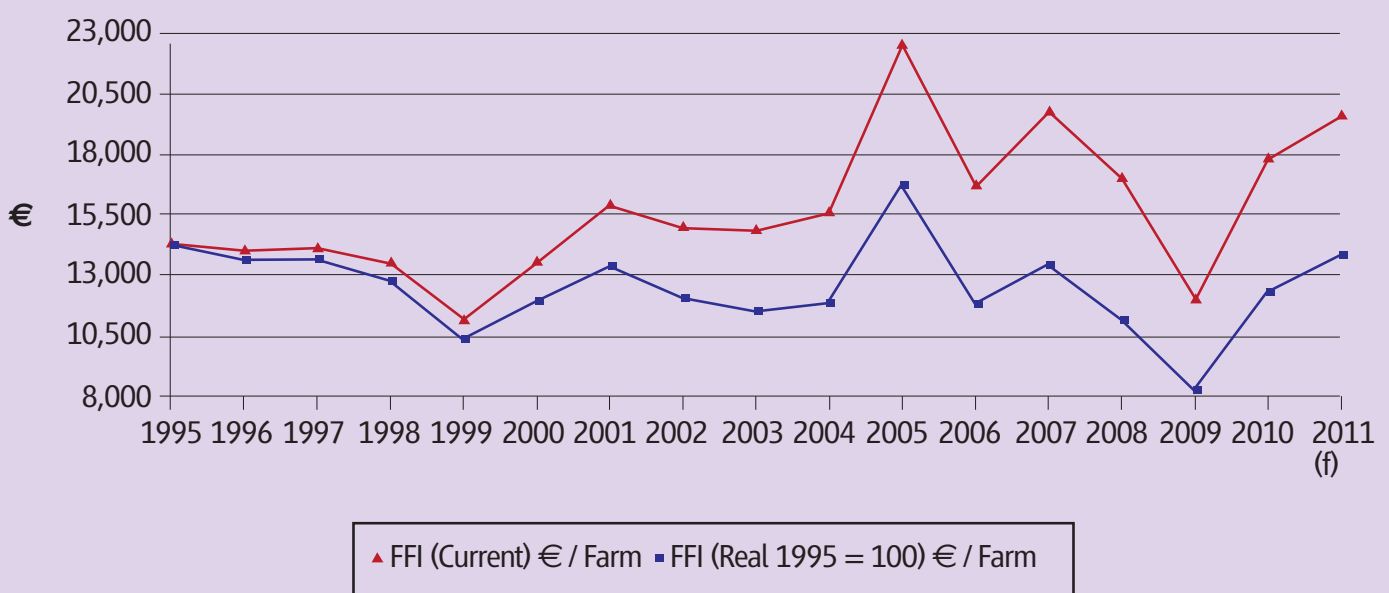
Pictured presenting the award at Emerald Expo, to the winner of the two year old heifer in milk is Liam Phelan, AIB Agri Adviser, sponsor; David Boyd owner, with Glaslough Miss Petra, class winner, led by Denis O'Neill and Glaslough Miss Shelly, class runner up led by Izzy Whittaker.

Based on these predictions (tentative at this stage) we would expect aggregate farm income to rise by a little under 10% in 2011, with family farm income rising by over 10%. If this prediction turns out to be accurate, it would represent a good outcome for the sector this year. There could, however, be a twist in the tail before the year is out.

Regarding the superlevy situation, we again reiterate our advice that all milk producers need to exercise caution and those exposed to a significant superlevy need to take urgent action.

All milk suppliers who face any risk of superlevy should stay in very close contact with their co-op or other purchaser. Those who, nevertheless, incur a significant superlevy charge and/or significant income loss from the purchaser suspending milk payments for part of the year are encouraged to contact their bank as early as possible to see how any cashflow problems can be most effectively dealt with.

Figure 1: Family Farm Income (FFI) per farm 1995 - 2011



OECD-FAO Agricultural Outlook – Strong prices predicted for next 10 years

In June the OECD and FAO published their latest joint outlook document covering the period 2011 to 2020. In general, it paints a very positive picture of the strength of the main agricultural markets in the decade up to 2020. The two organisations comment that agricultural commodity prices rose steadily from early 2010 to the first half of this year. The FAO food price index was at historically high levels in February last. Two questions are asked: are prices likely to stay high over the next decade?; and are price surges likely in the light of market prospects? According to the authors the answer to both is 'yes'.

After an initial dip as markets re-adjust following the price spikes of the past 12 months or so, international prices are likely to resume their upward movement. In real terms cereal and livestock prices are likely to be 20% and 30% higher respectively in the 2011-2020 period than in the previous decade. In nominal terms the prices of all commodities are likely to be substantially higher, spectacularly so in the case of butter and ethanol. The position in regard to butter is a function not just of the likely strength of the market in the future but also of its weakness in the early years of the last decade.

While it predicts generally strong world markets, the report does not envisage the very high price levels of 2011 being achieved in the forthcoming period. It does, however, foresee the 2008-2010 levels being exceeded in nominal terms in the case of all commodities other than wheat, rice, oilseed meals and raw sugar. In real terms it sees the prices of those four commodities, and of cheese and, to a marginal degree, whole milk powder, somewhat lower compared to the 2008-2010 period. The prices of all other products, including meat, butter and skim powder, should be higher in real terms compared to that period.

Dairy Products: The popularity and increasing range of dairy products and the westernisation of diets are expected to underpin a continuing firm international market. After an initial downward adjustment, prices are expected to rise in nominal terms, but be somewhat more flat in real terms. An average increase of about 2% a year is predicted. Compared to the

decade ending in 2010, prices in real terms are expected to range from 10% (skim powder) to 40% (butter) higher in 2020.

Meat: International meat prices are at historically high levels this year. The report predicts that prices will remain firm up to 2020 but be fairly flat in real terms compared to the last few years. Compared to the 2001-2010 decade, international prices in 2020 are likely to show the following very substantial increases:

Beef:	26%
Pigmeat:	32%
Poultry:	60%
Sheepmeat:	46%

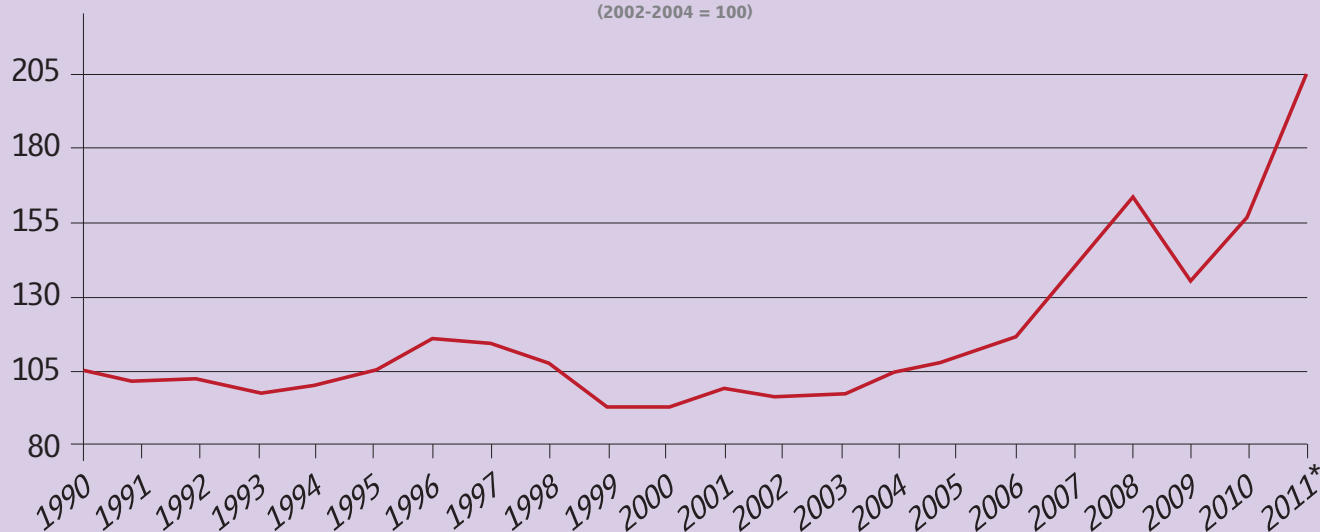
The report does, however, indicate that there needs to be a supply adjustment in the case of the white meats to safeguard their relatively strong price levels.

Cereals: Current world prices are well above historical levels and the report expects them to stay high. It is predicting, for instance, that the coarse grain price in 2020 will be 36% higher than the 2001-2010 average. It also expects, however, that there will be a slow recovery in stock levels from the low point of 2010. This should ease nominal price pressure and see some fall in prices in real terms. It is predicting world price levels for wheat and coarse grains of \$240 and \$203 per tonne respectively by 2020.

The Position in the EU

As is clear from the above, the report is predicting a continuation of strong international markets compared to the past decade but, compared to the generally favourable position of the past few years, the prediction is for relatively stable prices in real terms through to 2020. It does not expect that the highs of 2011 will be achieved in the next decade. Its predictions for the EU market are somewhat similar but, because in many sectors starting price levels are different, the predictions are not identical. The table overleaf sets out the price changes it envisages on world and EU markets by 2020 compared to the average of the 2008-2010 period.

Figure 2: FAO Annual Real Food Price Index
(2002-2004 = 100)



* August 2011

Source: Food and Agricultural Organisation of the United Nations

Table 1: % Change by 2020 v the 2008 - 2010 Average

	World Markets	EU Markets
	%	%
DAIRY PRODUCTS		
Butter	11	-5
Cheese	5	-8
SMP	18	17
WMP	10	-3
Casein	5	5
MEAT		
Beef	18	9
Pigmeat	26	23
Poultry	16	7.5
Sheepmeat	20	1
CEREALS		
Wheat	-10	-11
Coarse Grain	2.5	20

Within the next decade it is anticipated that there will be some volatility from one year to another but, on average, prices look like staying relatively close to the levels obtained in what was a high price period by historic standards. Milk price in the longer term, for instance, is seen as being likely to be about 31c/litre, a drop of about 1.5%. Obviously, these predictions are predicated on the assumption of reasonably normal economic and weather conditions and on continuing economic and social improvements in the emerging markets of Asia (especially China and India), South America and some of the former Soviet Union. These markets appear to be considerably less affected by the current financial turmoil than markets in developed countries.

World Bank View

The World Bank shares the view that international agricultural prices remain exceptionally high, even though there has been a slight drop since their peak in February last. In July this year, global food prices were 33% higher than a year earlier. In fact, the increases in the prices of some stable foods were substantially greater – maize, sugar and wheat prices were up 84%, 62% and 55% respectively in the same period. Oil prices rose by 45% and fertiliser prices by 67% since July 2010, thus making an expansion of agricultural production in countries most affected by high commodity prices more difficult. While overall supplies are improving somewhat, stock levels remain low. For instance, the stock to use ratio in maize at 13% is the lowest it has been since the early 1970s. In those circumstances, even small variations in yields can have a disproportionate effect in raising prices.

The effect of high international commodity prices varies considerably between countries, depending on their individual circumstances and domestic policies. Current high world prices are having the biggest impact on domestic prices in Central and South America and in East Africa. Except where famine is a factor, the adverse consequences of high food prices are felt most severely by those living in urban areas. In the World Bank's view, high commodity prices are a factor in the current crisis caused by the famine in the Horn of Africa but by no means the only factor. Drought and man-made factors are of even greater significance. Inevitably, the crisis has been responded to by emergency measures to deal with the immediate problems. The World Bank argues that in the longer term such disasters can be avoided only by integrated agricultural, food security, poverty and climate policies.



Pictured at the Discussion Groups of Ireland 'Dairy Ireland – Grasping the Opportunity' conference, sponsored by AIB are Tadhg Buckley, Agri Adviser, AIB; Kevin Twomey, Chairman, Discussion Groups of Ireland; Sir Henry Van Der Heyden, Chairman, Fonterra and Joe Gill, Bloxham Stockbrokers.

Dates for your Diary

- October 1: National Charolais Show - Golden Vale Mart, Tullamore
- October 3: IGA student conference 2011 - Killerig Hotel, Tullow, Co. Carlow followed by farm visits in the afternoon
- October 15: National Dairy Show - Green Glens Arena, Millstreet, Co. Cork
- October 18: Teagasc Pig Conference, Cavan Crystal Hotel, Cavan
- October 29-30: Macra na Feirme National Conference, Little Island, Cork
- November 15: Teagasc National Equine Conference - Moorepark Conference Centre, Fermoy, Co. Cork
- November 15: Teagasc National Dairy Conference - Rochestown Park Hotel, Cork
- November 16: Teagasc National Dairy Conference - Hodson Bay Hotel, Athlone

CAP Reform – Leaked Proposals

In our August edition we continued our series of articles on the forthcoming CAP reform negotiations by commenting on the agricultural aspects of the Commission document, outlining its proposals on the EU's financial perspectives for the 2014-2020 period. These aspects, together with the principles set out in an orientation document from the Commission late last year, gave a clear indication of the shape of its definitive proposals expected to be unveiled in the first half of October.

From a document leaked in early August setting out draft proposals from the Agriculture Directorate of the Commission on the future of direct payments, we now have an even clearer indication of at least the direction in which that Directorate wish to go. While the proposals do not cause us to alter our view that Ireland's take from the direct payments 'pot' is not likely to be in any way disproportionately affected, they would, if enacted, significantly alter the distribution of payments within the country and will be looked at with some disquiet by many recipients.

The principal elements in the leaked document are as follows:

- The historical reference for the Single Farm Payment would be phased out by the end of 2018.
- A uniform national or regional payment per hectare would be phased in.
- Member States would be required to set aside 30% of their direct aid envelope for 'green' top-up payments. These payments would be for compulsory measures in addition to cross-compliance, which would require beneficiaries to practice crop diversification, maintain permanent pasture and designate 5% of their land for ecological purposes. Organic farmers would be automatically entitled to these new payments (i.e. would presumably not necessarily have to meet the same conditions as those applied to other farmers).
- Member States would also be required to set aside 5% of the envelope for additional area-based aid for farmers in less favoured areas (these payments would be additional to those in the general less favoured area scheme).
- A system of capping of direct payments would be phased in beginning at €150,000 and rising progressively to €300,000, above which no payment would be made.
- A special simplified support scheme for small-scale farmers would be introduced.
- Direct aid would be targeted at active farmers.
- Between 5% and 10% of a Member State's direct aid envelope could be used for coupled aid to sectors important to a specific region for social or economic reasons.

The direct aid scheme would be more flexible in future with it being possible to adapt aid levels to changing economic conditions.

The document does not deal with the issues of the distribution of aid between Member States, the definition of active farmers or the nature of the small-scale farmer scheme. As such, it is not complete. Also, it sets out the views of DG Agri and its Commissioner and not of the Commission as a whole and, since it is an early leak, even those views may yet be somewhat modified. At the time of writing (late August), the document is expected to be completed before the end of the month and enter into inter-Directorate discussion in the first half of September.

The financial perspectives document stipulated that the distribution of aid among Member States should be progressively adjusted so that eventually

every Member State would receive at least 90% of the EU average payment per hectare. As Ireland receives almost exactly the average per hectare payment at present, implementation of this provision has no implications for us. Ireland's take from the direct payments 'pot' could fall only if the overall amount provided is cut and then only in a strictly proportionate way.

Implementation of the proposals outlined in the leaked document could, however, significantly change the distribution of aid within the country. Those with large-scale entitlements per hectare at present could see their payments substantially cut unless there is some offsetting mechanism introduced (e.g. some link to a proportion of payments received in recent years). Intensive livestock and tillage farmers who benefited from large premium payments in the old coupled system would fall into that category, as would farmers who consolidated their entitlements. On the other hand, farmers with less intensive production systems and some specialist dairy producers could gain. Also, the limited provision for coupled payments could provide at least a partial remedy for some of those farmers who would otherwise be losing out (it would also allow for a suckler cow premium as recommended by the Beef Activation Group).

It is important to remember that these are not yet even Commission proposals and may be changed before they are official. They will then be negotiated in the Council of Ministers and in the European Parliament and between Parliament, the Council and the Commission. The whole process is not likely to be completed before the first half of 2013 and what eventually emerges will undoubtedly be somewhat different from what is originally proposed. It is, therefore, too early to be definitive about the implications for Ireland. But it is important that these implications are teased out as the negotiations progress. We will return to the issue in our next edition after the official Commission proposals are published.



Pictured at the Limerick Show is Conor Lynch, Ballingarry, holding the winning Holstein Friesian Heifer Calf born after 1st January 2011 with Patrick O'Meara, AIB Agri Adviser and Kelley Lyons, Business Banking AIB.

Economic Outlook

There have been increasing concerns about the prospects for the world economy. These have arisen from some weaker than expected short-term economic indicators; the worsening sovereign debt crisis in the euro area and concerns about the ability and willingness of the US to face up to its own serious fiscal problems, which culminated in the downgrading of that country's rating by Standard & Poor's. The resulting period of turmoil on financial markets from these adverse developments over the summer months brings further risks to the economic outlook.

At time of writing it is unclear whether there will be a double-dip recession in the major economies. On balance, at this stage it looks as though such an outcome will be avoided and that the major economies will muddle through with slow growth. Under these circumstances, inflation rates should decline and central banks should have little or no reason to hike rates from current levels for the foreseeable future. Indeed, the US Federal Reserve says it expects to keep interest rates at current exceptionally low levels until mid 2013. The trend in the eurozone is less clear given the ECB's single mandate of keeping headline inflation at or close to 2% over the medium-term, but it may keep rates unchanged also.

Weaker global growth provides the major threat to the Irish economic recovery. Ireland remains very much a dual economy and emergence from recession is being very much export-led. Meanwhile, the domestic sector continues to contract. A number of factors have been weighing on the domestic economy, including de-leveraging by households and the banking sector and the slump in the housing sector.

Indeed, residential investment has been a particularly big negative drag on the economy, having taken 2% off real GDP growth in 2010, 3.5% in 2009 and 3% in 2008. Excluding housing, the Irish economy actually expanded by 2.3% last year. However, there are signs that we are now approaching the bottom of the sharp fall in housing output. There was a marked slowing in the rate of decline in housing completions in the first half of this year and we are anticipating that there will be only a small decline in housing output for 2011 as a whole.

The cut backs in Government expenditure are also weighing on the domestic economy with real Government spending on goods and exports set to decline in total by some 12.5% over the 2009-2012 period. Meanwhile, contracting employment and falling wages saw consumer spending decline by 0.8% in 2010, a trend that is continuing in 2011.

However, Ireland is a very open economy with exports equating to 96% of GDP last year. The strong performance by exports, which rose by 6.3% in 2010, is thus providing Ireland with a way out of recession. Net trade (exports minus imports) has provided an important cushion against the weakness of the domestic economy, adding 3.8% to GDP in 2009 and 3.4% last year. Exports continued to perform strongly in the first quarter of the year, rising by a seasonally adjusted 3.8%, again offsetting the weakness of the domestic economy where consumer spending has remained particularly weak.

Boosted by the strength of exports, it would appear that the Irish economy, while remaining generally weak, could be bottoming out.

Boosted by the strength of exports, it would appear that the Irish economy, while remaining generally weak, could be bottoming out. While the trend in quarterly GDP data since the start of 2010 has been erratic, the most recent figures, which are for Q1 this year, show that output in the economy expanded by a seasonally adjusted 1.3% in the quarter. There had already been a marked easing in the rate of contraction with GDP declining by 0.4% in 2010 compared to the falls of 7.0% and 3.0% in the previous two years.

On the basis that the export-led recovery will continue, most forecasters expect that GDP will grow by between 0% and 1% in 2011. The pace of recovery could then pick up to around 2% in 2012, as the headwinds facing the domestic economy begin to ease. Domestic spending is expected to contract by around 4% this year and a further 1% in 2012, but should grow from 2013 onwards.

As the Irish economy begins to emerge from recession, the labour market is showing signs of stabilising. There has been an easing in the pace of job losses since early 2010 as the rate of economic contraction slows. Unemployment has levelled off in the past year with a fall in the number of redundancies and a pick-up in emigration. While progress is likely to be slow, unemployment should start to move downwards from 2012 as growth picks up and the jobs market improves.

Table 2: Economic Forecast – Ireland

Annual % Change Unless Otherwise Stated				
	2009	2010 (e)	2011(f)	2012(f)
Real GDP	-7.0	-0.4	0.5	2.0
Real GNP	-9.8	0.3	-0.5	1.2
Consumer Spending	-6.9	-0.8	-2.5	-0.5
Government Spending	-4.5	-3.8	-3.0	-2.0
Fixed Investment	-28.7	-24.9	-13.5	-3.0
Exports	-4.2	6.3	5.0	5.0
Imports	-9.3	2.7	2.0	3.0
CPI (%)	-4.5	-1.0	2.7	2.2
HICP (%)	-1.7	-1.6	1.4	1.2
Unemployment (%)	11.8	13.6	14.2	14.1
General Govt. Deficit (as % of GDP)	14.3	32.4*	10.0	8.6

* Includes full upfront support to parts of the banking sector

Source: AIB Economic Research Unit



Banking the Beef Sector

Eamonn O'Reilly, Agri Adviser, AIB, discusses the performance of the beef sector and related financial issues.

Beef production is the main enterprise on more than 58,000 Irish farms, and is the most diverse sector within Irish agriculture. There are major differences between beef farms in terms of system, scale, intensification, efficiency, off-farm employment, overall management and dependency on direct payments.

Profitability in the sector over the past number of years has been low and remains heavily dependent on direct payments. It is likely that farm income on beef farms will be 10% to 15% up this year but the differential with the other farm systems, especially dairying and tillage, will not be significantly changed.

Performance of the Beef Sector

Beef farmers in Ireland have achieved low returns for the past number of years and are highly dependent on direct payments. Since August 2010, however, beef prices have risen by over 15%. Initially, the main beneficiaries of price increases are beef finishers, but this benefit ultimately passes back to the primary producer i.e. suckler and dairy farmers selling weanling, store or beef cattle as they realise the full benefit of price increases. For farmers in other cattle production systems (store to beef, winter finishing or intensive finishing), the initial cost of purchasing the animal has a direct correlation to beef prices (store cattle prices have also increased by around 15% since August). Hence, margins in all other beef systems will remain fairly similar to previous years.

Some beef farmers make their management decisions based on short-term planning. There is a distinct requirement for long-term goals to be set on individual farms. This will allow for performance to be measured against goals and corrective action to be taken when goals are not being achieved.

The level of efficiency on many beef farms can be quite low. This is, in the main part, due to beef farmers not measuring and analysing their cost of production or not analysing the level of performance from their livestock. It has been proven in the sector that farmers who record and analyse their costs of production and measure performance are placed in the top 20% from a profitability viewpoint.

Farm debt is relatively low on beef farms in Ireland. Over the last 12 months there has been some increased demand for stocking facilities due to stronger store cattle prices. However, we have also found that some beef farmers have reduced numbers as opposed to increasing their borrowings to purchase store cattle. The benefit of this decision is dependent on their level of efficiency. Efficient farmers may be losing an opportunity for additional revenue, however inefficient farmers may actually save some of their direct payments.

The Food Harvest 2020 report initially highlighted the potential of the beef sector to increase the value of output by 20%. The improvement in markets generally since the report was published has resulted in the Beef 2020 Activation Group recommending a doubling of the output value increase for the beef sector to 40%.

Since the report was initially published:

- Beef prices have increased by over 15% whilst throughput (cattle slaughtered) is starting to decline. It is estimated that 100,000 less finished cattle will be available for slaughter this year.

- There has been a large swing towards bull beef production, with a 21% increase in the throughput of young bulls with only a corresponding decline in steers of 14%.
- Live exports of calves are down 41% in the first six months of 2011 compared to the corresponding period in 2010. These calves have remained in Ireland and will increase throughput from March 2012 onwards.

The above dynamics offer beef farmers an opportunity to generate additional revenue; however, this depends on the prevailing beef price and the efficiency level on farm.

Financing the Beef Sector

In general, we are coming across beef farmers who are renewing and seeking additional stocking, and working capital facilities; while some farmers are also seeking additional funding for machinery and land purchase. Substantial capital investment took place on beef farms in 2007 and 2008 under the Farm Waste Management scheme and farmers are continuing to reduce their level of debt. We find that when increasing scale, (i.e. increasing cow numbers) farmers often tend to fund this, from cashflow.

The decision to invest in the farm business – be it additional stock, machinery, farm development or land purchase – is very important and requires planning. When presenting a proposal to the bank, farmers should put their best foot forward and show the bank their strengths. A strong proposal details: long-term plans; management accounts such as a profit monitor; efficiencies achieved; and production costs. In all cases, up-to-date farm accounts are required. It may be desirable for the farmer to seek the support of their farm adviser and/or accountant in completing the proposal.

When assessing a funding proposal, the bank will consider a number of fundamental issues including: the borrower's credit history, reliability, and capacity to repay the debt. In addition, the bank will consider the conditions and trends in the agri-food sector. It is important to outline how the farm will cope with likely or potential changes in market conditions. The proposal needs to show how the farm will generate sufficient cashflow to repay the credit facility that is sought. It is necessary to examine at least three years of farm accounts, which should allow for particularly strong or particularly weak years, to give an understanding of the farm's performance over time. Lastly, the bank will look at the security which is available to protect its position should the business be unable to repay the loan. Ultimately, the lending decision will be based on the capacity of the business to repay the finance, irrespective of any security that may be provided.

In Conclusion

Overall, the beef sector has capacity to increase production from existing levels. Efficient farmers with existing low levels of debt have the capacity to service increased bank facilities in order to increase stocking rates and, in turn, generate additional revenue. Providing sufficient understanding of the farm business and detail of the proposition as outlined above considerably strengthens any funding proposal. Whilst speculation and uncertainty will remain until current CAP reform is completed (see separate article in this edition), the short and medium-term view of the sector is positive with market prices for commodities expected to remain strong.

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