AgriMatters

AIB supporting the Irish Agricultural Industry

Autumn 2008

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Welcome to the autumn edition of Agri Matters

Michael Dowling, Head of Agri Strategy, AIB

As expected, this year has seen a retreat from the peak cereal and dairy prices of 2007. Nevertheless, prices in those sectors remain reasonably high and other sectors have seen substantial increases over last year. There have, however, also been exceptional cost increases and very difficult weather conditions. These trends are reflected in the review article and elsewhere in this edition.

There is much besides – including economic commentary, articles on the machinery market, on planning for retirement and on the purchase of milk quotas, and a note on convenience banking. We hope that in the mix you will find something of particular interest.

This edition is being published to coincide with the National Ploughing Championships. We wish every success to the organisers, competitors and exhibitors and a pleasurable and informative experience to all who attend. Finally, we hope the clerk of the weather is in a more benign mood than at other times this summer and autumn.

Michael Dowling
Head of Agri Strategy

Our Agri Advisor Team

PATRICK BUTTERLY
AIB DROGHEDA, NORTH EAST

TOM QUIGLEY
AIB EYRE SQUARE, WEST/NORTHWEST

DONAL WHELTON
AIB BANDON, WEST CORK/KERRY

TADHG BUCKLEY
AIB MIDLETON, SOUTH EAST MUNSTER

PATRICK O'MEARA
AIB NENAGH, MID WEST

Fertiliser prices on the rise

As fertiliser supply tightens and prices increase globally, efficient use of crop nutrients in Ireland is paramount.

The price of fertilisers has risen sharply over the past 12 months. The CSO report an increase of 63% for the year to the end of June. While industry analysts are uncertain as to whether potassium and phosphorous prices have yet peaked it is now clear that Irish fertiliser usage is back this year by something in the region of 10%.

Traditionally, fertiliser prices have tracked grain prices. As the price of grain increases, global fertiliser use increases in expectation of higher yields and, as a result of increased plantings, thus increasing demand. On the supply side, according to international analysts, global fertiliser production is at, or near, capacity and delays have been reported in expanding that capacity. The increase in energy prices has also impacted on fertiliser prices, not least in the increased freight costs associated with transporting bulky material.

According to the International Fertiliser Industry Association, global fertiliser consumption increased by almost one third between 1996 and 2008. Consumption is undoubtedly set to continue in line with increased global food production. Tighter fertiliser supply and significantly increased prices are considerably more serious issues for developing countries in terms of reduced output and, consequentially, increased food prices. In Ireland the efficient use of crop nutrients will undoubtedly become more important going forward.

Selected Input Price Comparisons

	June 2008	2007	2000
	€ / t	€ / t	€ / t
Soya Bean Meal	391	316	277
Cattle Feed (Nuts)	300	253	198
Pig Feed (Fattening Meal)	333	284	238
Fertilizer (10 - 10 - 20)	501	288	224

Source: CSO

International beef prices

The most striking thing about the change in international beef prices over the past year has been the rapid relative increase in Brazilian prices. The average steer price in Brazil in the first seven months of 2007 was 40% of the EU price (taken as the French R 3 steer price); the equivalent price this year was over 60% of the EU price. This relative price improvement is continuing. In early August, the Brazilian price was 70% of the EU price (80% of the O3 price), over 7% above the US price and almost 30% better than the Australian price. A similar, but less pronounced, improvement has taken place in beef prices in Uruguay.

World Cattle Prices (Steers)			
	Average in first 7 months		
	2008	**2007**	**% Change**
	€ / 100 kg dw	**€ / 100 kg dw**	**2008 / 2007**
Brazil	201	134	50
Argentina	120	113	6
Uruguay	170	150	13
US	210	241	-13
Australia	179	185	-3
France	318	310	2.5
Ireland	322	280	15

Source: Bord Bia

Grant application deadline

Farmers should be aware that, in order to obtain the grants available under the revised Farm Waste Management Scheme, all work must be completed by farmers and a payment claim lodged with the Department of Agriculture by the end of December 2008. The Scheme, which was introduced in March 2006, provides grant-aid at a standard rate of 60% (70% in the four Zone C counties) to farmers who complete investments such as animal housing and slurry storage under the Scheme.

In order to be eligible for grant-aid, all work must be completed to Department specifications and no payments will be made for partially completed work. The payment claim must include all eligible receipts for the completed works and these receipts should be listed on Form FWM 20, which was sent to farmers with their approval documentation.

Farmers are advised to keep copies of all receipts and to forward their claims by registered post to the local office of the Department.

The World Holstein Friesian Conference

Pictured at the launch of the World Holstein Friesian Conference at AIB Bankcentre are Dave Beehan, Chief Inspector, Department of Agriculture, Fisheries and Food; Kevin Dillon, Chief Executive, IHFA; Brendan Smyth, Minister for Agriculture, Fisheries and Food; Mervyn Eager, President, IHFA; and Michael Dowling, Head of Agri Strategy, AIB.

Pictured at the Imokilly launch of the Macra na Feirme AIB Club of the Year, were from left Paul Ormond Tipperary captain; Joe Morrissey, Imokilly Macra; Pat Butterly, AIB; Catherine Buckley, National President Macra na Feirme and Flor O'Gorman, Munster Vice-President Macra na Feirme.

Dates for your diary

October 9 – 11:	World Holstein Friesian Conference 2008, Killarney
October 23:	Teagasc Liquid Milk Conference, Red Cow Hotel, Dublin
November 6:	Teagasc REPS Conference, Tuallamore
November 26:	Teagasc National Dairy Conference, Rochestown Park Hotel, Cork
November 27:	Teagasc National Dairy Conference, Hodson Bay, Athlone

The year in review

Coming after the exceptional market developments of 2007, this year was always likely to be more low key, however some notable differences are evident.

Some retreat from the dairy and cereal price peaks of last autumn was expected and materialised. Nevertheless, markets this year have remained strong and in some cases have exceeded their 2007 levels. In all the major sectors this year's prices are significantly above the average market prices of this decade so far (see Table 1 and Figure 1). On the other side of the equation input costs are also running well above the average of the decade (Table 2).
Looking at the individual sectors there are again some significant differences.

Milk: The average price this year is likely to be 32c or so per litre, which is close to the average 2007 price. This is well above the prices paid in the earlier part of the decade but well below the peak price of last autumn. Output is likely to be slightly up because of the increase in the milk quota. International dairy prices, having come back from the 2007 spike, have stabilised (August 2008) at what are historically high levels, and look likely to stay reasonably strong into the medium-to-longer term.

Beef: On a weekly basis in September, beef prices are running some 20% ahead of last year and we estimate that this year's average price will be about 15% above the 2007 average. Output is likely to be down about 5%. The increasing EU beef deficit, and the virtual absence of Brazil from the Community market, is ensuring that strong price conditions should continue into the medium term. There is no sign that Brazil will be in a position any time soon to put forward large numbers of farms that can meet EU standards.

Lamb: Prices this year are expected on average to be about 10% up on 2007. Output is likely to be down by a roughly similar percentage. Ewe numbers peaked in the mid 1990s and have consistently declined since, to the extent that they are now about one-third less than peak. Even allowing for improved efficiency, these statistics indicate that output will continue to fall.

Pigs: Pig prices are currently (early September) running some 21% ahead of 2007 on a weekly basis. We expect the end-of-year price to be some 30% ahead and the 2008 average price to be about 15% or so above last year's average. After a very difficult period through much of 2007 and the early months of this year, the industry is now back in reasonable profitability, despite the sharp rise in feed costs (up about 30% in less than two years). The expected post-harvest decline in feed prices should further strengthen the position of the industry late this year and into 2009. Output this year will be down by about 2%.

Tillage: The poor summer weather has created some problems for all tillage sectors, perhaps most of all for potatoes. In the case of the latter, this is compounded by lower prices than have been experienced over the previous two years. Fruit and vegetable prices are generally good. Cereal prices, which rose spectacularly in 2007 (up 70%), are back by about 25% this year. Even though this still leaves them at historically fairly high levels and output is up by some 15%, the sharp rise in input costs, especially in fertiliser prices, will squeeze margins this year. The very poor mid-to-late harvest weather will have intensified that margin pressure.

Input Costs: By mid-year we had seen some of the sharpest increases in farm input costs in living memory. The increase in fertiliser prices was most pronounced, but there were also steep increases in the price of feed (the most important farm input) and in energy costs (except for electricity, which had fallen in price but with a sharp increase signalled for the autumn). These are outlined in Table 2.

Table 1: Output Price

		2008 (f)	2007 (e)	2000 - 2007 Average
Milk	**c/l**	32.5	32.5	28.7
Beef (R3 Steers)	**€/kg**	3.20	2.76	2.53
Lamb	**€/kg**	3.9	3.54	3.63
Pigs	**€100/kg**	150	133	133

Source: CSO & AIB Forecast

Farm Income: These cost increases are putting pressure on farm incomes and offsetting the benefits of the strong price buoyancy. Taking all the factors together we would expect aggregate farm incomes in nominal terms to fall by some 3% in 2008. In a year when inflation generally is likely to average over 4%, farm input cost inflation is expected to be over 12% and the accuracy of even that figure depends on the rate of increase in on farm costs moderating somewhat in the second half of the year.

Table 2: Input Price Changes

	2008 v. 2007	2008 v. 2000
	%	%
Total	24	58
Feed	21	45
Fertilisers	63	119
Energy	26	80

Source: CSO & AIB Forecast

Table 3: Global Consumption

	2008 v. 2000
Wheat	11%
Coarse Grain	23%
Oilseeds	34%
Vegetable Oils	55%
Meat	20%
Milk	15%

Source: AIB

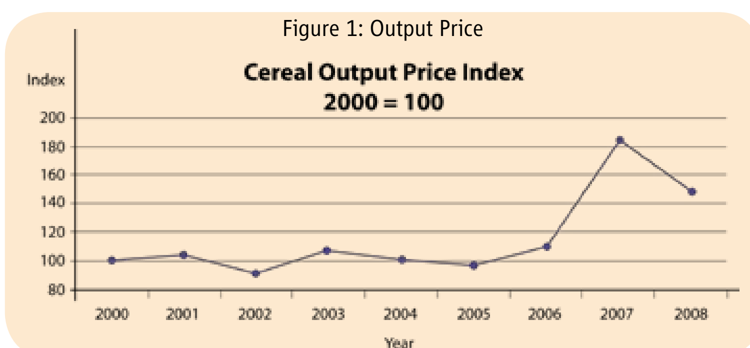
Conclusion

Global food consumption has been steadily rising throughout this decade and this trend should continue (Table 3). China and India, together with some other emerging economies, will fuel that growth. This should be sufficient to keep international agricultural commodity prices well above the levels we were used to in the past (but, in the foreseeable future, below last year's levels). This should be the case, even if the growth in biofuel production slows down. European and international prices are increasingly linked, so EU prices should also remain relatively strong.

Following the breakdown of WTO negotiations it is unlikely that they can be salvaged this side of the US elections. While this indicates that nothing is likely to happen for up to two years, it would be rash to assume that this round is dead. The move towards greater trade liberalisation and lower agricultural subsidies is probably irreversible and will move forward multilaterally eventually and possibly bilaterally in the medium-term. This will present us with significant challenges, but not ones that are insurmountable, particularly if we can secure a more balanced outcome for the beef sector than was envisaged this time round.

In Ireland this decade has seen substantial falls in sheep and pig throughput of about 16% each, and a small fall (4%) in cattle throughput. Output in the pigs sector is cyclical and, therefore, the fall will be partly reversed. The fall off in sheep numbers is, however, likely to continue, as will the drop in cattle numbers but to a much lesser extent. With the agreed increase in quotas, milk output should increase by approximately 5% over the next five years. With the elimination of set aside and reasonable price prospects, we would expect the area under cereals to expand gradually from this year's level, which was the second highest in the past ten years.

Figure 1: Output Price



Source: CSO & AIB Forecast

Challenging times for economy

The Irish economy had lost considerable momentum this year. In addition to a sharp decline in housing output, the economy is also facing other significant headwinds in 2008/2009, including a marked slowdown in the global economy, a sharply higher exchange rate, tightening of credit conditions, increases in interest rates, rising unemployment, weakening confidence and fiscal tightening.

The sharp downturn in the residential housing market is likely to take 4% off GDP growth this year and another 2% off growth in 2009. Housing completions next year are expected to fall to around 30,000 from a peak of 90,000 not that long ago. There are also clear signs of a slowdown in private non-residential investment spending as the economy weakens. Consumer spending has also lost considerable momentum, with a marked decline in new car sales in particular. GDP growth is expected to be flat at best over 2008-2009, with a contraction in domestic spending offset by a positive contribution from the traded sector.

The fundamentals of the economy remain sound so growth should pick up from 2010 onwards as the downturn in housing bottoms out and the global economy improves. Furthermore, the medium term growth prospects for the economy remain very favourable, judging by demographic trends. Ireland has the youngest population in the EU and the EU authorities expect the Irish population to rise by 22% by 2020. The ESRI sees Irish GNP growth averaging 4% in the period 2010-2014.

Inflation has picked up a lot over the past two years, especially the headline CPI. The annual headline rate of CPI inflation averaged 4.9% in 2007, the highest inflation rate for six years. In the seven months to July 2008, inflation averaged 4.6%, indicating no real improvement in the situation. Indeed, on more than once occasion since the beginning of the year the inflation rate has been as high as 5%. Higher mortgage costs have been a key factor putting upward pressure on inflation, reflecting not only the fact that the ECB hiked rates from 2% to 4.25% between end 2005 and mid 2008 but also the problem of higher wholesale money market interest rates due to the problems in credit markets, as well as the lagged impact of higher house prices.

Higher energy and food prices are also having a negative impact, a phenomenon being experienced by all global economies. At the beginning of the 2007, Irish food price inflation was running at just 1.8% but it is currently running at 6.8% as the cost of a whole host of products has risen on international markets. The cost of energy products, meanwhile, was up 13.9% in year-on-year terms in July of this year.

Headline inflation is likely to average 4.8% this year, while the core rate (excluding mortgage interest) is forecast to average 3.6%. Both measures are forecast to fall back in 2009 but to still remain above long term average rates.

The downturn in the economy is having a severe negative impact on the public finances with a marked drop in tax receipts, led by a big decline in property related taxes. As a result, the Government will struggle to keep the budget deficit under 3% of GDP this year. Very tight budgets are in store for the next couple of years as the Government reins in growth in public spending.

RoI Economic Forecast

(% annual change unless stated otherwise)

	2006	2007	2008 (f)	2009 (f)
Real GDP	5.7	6.0	-0.5	0.5
Real GNP	6.3	4.1	0.5	1.0
Conumer Spending	7.1	6.3	1.5	1.0
Government Spending	4.8	6.0	4.0	1.0
Fixed Investment	4.0	1.2	-17.5	-12.5
Exports	5.7	6.8	3.5	3.0
Imports	6.3	4.1	0.2	0.0
CPI (%)	4.0	4.9	5.0	4.0
Unemployment Rate (%)	4.4	4.5	5.3	6.8
General Govt. Balance (as % of GDP)	3.0	0.3	-2.6	-3.0

Source: AIB Economic Research Unit, August 2008

Convenience banking

The potential for convenience banking, which is using either the phone or internet to manage your daily banking, as a control for the business finances is something that should be examined by farm businesses.

Developments in convenience banking services, coupled with the fact that business owners don't always have time to visit their branch, has encouraged more business and farming customers to conduct some of their banking in a convenient and secure manner from their own home.

Banking requirements can be conducted via telephone, internet or mobile phone, cutting out the need to visit your local branch when it is not convenient to do so. With convenience banking, banking transactions can now be carried out 24 hours a day.

Convenience banking allows businesses to have better control over their finances. Most convenience banking services offer balance and transaction information, mobile phone top-up services as well as enabling you to pay bills and transfer money over the phone or on the internet. This allows you to take control of your finances anytime and anywhere. Convenience banking has many benefits, the principal one being the opportunity to save you time.

"Convenience banking allows businesses to have better control over their finances"

Banking services have become very sophisticated in the past few years with advancements in online business services. Financial institutions are now offering advanced payment and cash management systems, which enable businesses to pay staff and suppliers in an automated manner and to make domestic and international payments.

Some businesses have been hesitant in the past about convenience banking. However, more and more farmers are availing of convenience banking options for greater flexibility.

Irish farm machinery market overview

Tom Keogh, Sales & Development Manager, AIB Finance & Leasing

Significant investment in machinery by farmers and contractors is boosting machinery sales.

Tractor and machinery sales have continued to increase over the past 12 months and the machinery market in Ireland is now valued at close to €450 million.
The buoyancy in farming over the last year has had a big impact on machinery sales. There are, however, also a number of other important factors contributing to the significant investment by Irish farmers and, indeed, contractors in new and used machinery.

Farmers who view their farm as a viable long-term business are investing in its long-term potential. At AIB we are seeing evidence of this in the machinery and equipment market. Increased incomes may have contributed to a bumper year for tractor sales. New tractor sales for 2007 surpassed the 5,000 mark, representing an increase of almost 20% on 2006. Second-hand tractor sales have however, remained fairly static, showing only a marginal increase on 2006 levels.

Improved farm incomes

The increased incidence of off-farm employment has improved farm incomes over the past decade. This has increased the capital available to these farmers to invest in their farms and ultimately in farm machinery. The increase in off-farm employment has necessitated an increase in efficiency due to time pressure. Labour-saving investments to counter labour shortages and the cost of labour are common.

New tractor sales for the first seven months of 2008 are back marginally on 2007 levels, which can in part be attributed to the slowing construction industry. It is expected that this slowing in machinery sales will carry through into 2009. This is in contrast with the trend in combine harvester sales for the year to date. Sales are well in advance of previous years. Most were ordered at the end of last year when grain prices were very strong.

For many, the Farm Waste Management grant has proved an attractive incentive to upgrade existing slurry and farmyard manure equipment. As a result, sales of agitators and slurry tankers are well ahead of previous years.

Contractors

Contractors account for the majority of all silage harvesting and the vast majority of the slurry spreading on Irish farms. There is an onus on contractors to update their machinery continually. In general contractors supply the latest in cutting edge technology to maximise efficiency for farmer customers. In an attempt to maximise grass intake farmers want to take advantage of the latest available technology.

Buying abroad

There has always been a good used tractor market in Ireland. However, some farmers have tended to travel abroad, particularly to the UK to avail of more competitive prices. The current weakness in sterling has made machinery in the UK and Northern Ireland more attractive than previously, particularly for those registered for VAT. It is expected that the favourable sterling exchange rate will result in an increase in second-hand tractor sales through the second half of 2008.

Plan ahead

The lead-in time for new state-of-the-art machinery and specialised equipment can be as long as three or four months. Increased demand from other EU countries can sometimes impact on availability. The message is to plan ahead, check availability and order early.

Irish Farmers Journal & AIB launch new dairy DVD

Launching the new *Irish Farmers Journal* & AIB dairy DVD - "Cash Cows, milking more money from grass" - in Rockwell College were: Timmy McCarthy, current Cork hurler and dairy farmer; Jack Kennedy, Dairy Editor, *Irish Farmers Journal*; Michael Dowling, Head of Agri Strategy AIB, DVD sponsor; and Bobby Ryan, ex-Tipperary All Star and dairy farmer.

Planning for the future

Ed Kissane, AIB Pensions Manager, discusses succession and retirement planning

If there is one aspiration we all have, it is that in the not so distant future we will no longer have to work and we can enjoy our latter years without relying on others for financial support. Here, we take a look at the key steps you should take now so you can realise your ambition of financial independence in retirement.

Succession and retirement planning is vital. If succession and retirement are not adequately planned for, this can often lead to:

- The sale of assets/land to fund retirement income
- The sale of assets/land to settle an inheritance tax bill
- Increased tax liability

In the worst-case scenario, failure to plan for succession and retirement can lead to the break-up of the farm and even a breakdown in family relations.

An effective exit plan should take account of the emotive and financial interests of family members, as well as the funds required to give you the retirement you deserve.

There are two simple steps you can take now, to work towards a smooth transfer of ownership and financial independence for yourself. Firstly, don't put your succession plan on the long finger; and secondly, start a pension plan as soon as possible.

Tackle your succession plan now

The low level of succession planning amongst farmers is most often not down to a lack of will on the farmer's part, but rather is just a case of having more demanding short-term priorities. However, the personal and financial decisions you make now can have serious implications for the transfer of assets at a later date, so succession planning is not something you should leave to the last minute.

Here are some simple things you can do now to bring about a smooth transition of ownership to your chosen successor:

1. Choose your successor: Involve all relevant family members in the succession planning process. This will help you accurately gauge their future ambitions and intentions, although, ultimately, it will be your decision.
2. Communicate: Once you decide on your successor, communicate it early and discuss it openly with all family members. This should help avoid future conflicts or disappointments over the hand-over date.
3. Both you and your successor(s) should consult your own legal/tax/financial advisors to help minimise any tax liabilities and identify the best way to fund the business and your personal goals (e.g. retirement).

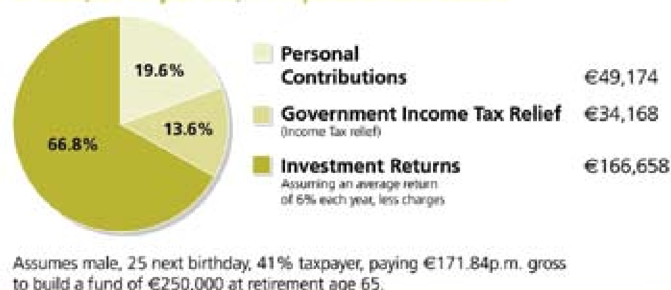
Succession planning can range from being relatively straightforward to fairly complex. The key is, however, to start early, seek advice and communicate openly and honestly with all parties involved.

Provide for your retirement

The earlier you start providing for your retirement, the less likely you will need to sell land/assets or draw from the farm to give you an income in retirement. Starting a pension plan as early as possible is very important.

Why a pension plan?

A pension plan is one of the most tax efficient vehicles you can use to invest for your future. Before investing any surplus cash for the long term, you should ask yourself: if there is a more tax-efficient way to invest than in a pension?



Source: Ark Life, Sept 2008

Tax efficiency of a pension*:

A farmer wishes to put aside €5,000 from this year's gross profits towards his long-term future. If he put this money into his personal account he would have to pay up to €2,050 in income tax, meaning he gets to save only €2,950 (top rate taxpayer). However, if he was to put this money into a pension plan, no income tax is deducted, meaning that the full €5,000 would go into the pension plan (so if he was a top rate taxpayer he would be saving almost double towards his retirement).

Let's look at someone who has built up a considerable nest egg using a pension plan:

The example above shows how a farmer has built up a retirement fund of €250,000, at a personal net cost of just over €49,174. This has been made possible by:

1. Starting early – If you start work at 25 and retire at 65, you will have been working for 40 years. But you could spend at least the next 20 years of your life in retirement – and that's the equivalent of one year in retirement for every two years working.
2. Tax relief on your contributions (as illustrated in the earlier example and the chart above)
3. Tax free growth: Any money invested in a pension grows tax-free (i.e. there is no CGT, DIRT, Income Tax deducted from the growth).

Sit down with a Financial Adviser as soon as possible to find the most appropriate and efficient way for you to save towards the retirement you deserve. This will help you kick-start your succession plan.

**This information is based on AIB's understanding of current law, tax and revenue practice, September 2008*

Concerns about pensions

"When I die, will my pension die with me?"

With the introduction of Approved Retirement Funds (ARF) in 1999, you no longer have to buy a pension annuity on retirement. Provided you have a guaranteed income of €12,700 p.a. (incl. the state pension), you may put your accumulated pension fund into an ARF and access it whenever you wish. What's more, an ARF can be a very tax efficient vehicle to transfer wealth to your family.

"I don't want a pension as I don't want to invest in shares"

You have control over what way your pension will be invested. Whether you like the security of deposits or the growth potential of stocks or property – you choose.

Purchasing milk quota – key considerations

Donal Whelton, Agri Advisor, discusses investing in milk quota.

Given the increase in milk prices over the last 12 months and the possible abolition of milk quota in 2015, I feel that, on the ground, there has been a significant increase in confidence and enthusiasm in dairy farming. Since milk quotas were introduced in 1984 the opportunities to expand milk production have been limited to buying milk quota with land or leasing land and quota over a long period. Now, however, with the increase in grant aid for farm buildings, the introduction of the milk quota exchange scheme, the relatively poor return from secondary farm enterprises and the introduction of the decoupled premium, dairy farmers find themselves with decisions to make. In addition, under recently announced new proposals from the Department of Agriculture, Fisheries and Food non-dairy farmers will be allowed buy milk quota in the next round of the Milk Quota Exchange, which will be for the 2009/2010 quota year.

I feel that currently dairy farmers can be categorised into three groups:

1) Those with large scale plans to increase milk production without necessarily investing in milk quota;
2) Those with smaller plans to invest by purchasing milk quota through the milk quota exchange scheme each year;
3) Those with no plans to increase milk production.

Large scale plans

Farmers in the first category will leave themselves open to a superlevy risk. Their appetite to increase production without investing in milk quota is driven by a number of factors, including: improved milk prices; the determination of the EU Commissioner for Agriculture and Rural Development not to extend quotas beyond 2015, with a soft landing being created within this timeframe; and the fact that there has been a superlevy in Ireland in only five years since quotas were introduced in 1984. Generally, these farmers are in the fortunate position that they have access to land within walking distance of the parlour.

With the 2% increase in milk quotas for all producers in the current quota year and with the EU Commission proposing that 1% extra quota be allocated each year between now and 2013 (though this remains under discussion as part of the Health Check), the value of milk quotas could reduce significantly over the coming years. There is to be a further review of the quota system in three years time and it is possible that other changes may be proposed to facilitate a soft landing, which would coincidentally make the system less onerous and so encourage expansion in regions where production costs are relatively low. I am thinking in particular of a reduction in the rate of superlevy or applying the quota system on an EU wide basis, (i.e. charging the levy only if the EU as a whole is over quota). While there is much speculation nothing has been agreed (at the time of writing), even in regard to the current proposals, and given that there was a superlevy incurred in 2007/2008, superlevy remains a very real risk and should be factored into any decision on whether or not to buy milk quota.

As expected, the high milk prices of 39 cent per litre achieved towards the end of 2007 were unsustainable and prudent farmers should budget for a milk price closer to 30 cent per litre going forward. Therefore, with a superlevy bill currently set at over 28 cent per litre, even the most efficient farmers would suffer losses from any over quota milk produced. Furthermore, increases in milk quotas could lead to increased milk price volatility and, in a bad year, prices could well be below the budget price referred to above. Until we get closer to the abolition of quotas there is some continued risk of superlevy and, while milk price may generally remain above the rate of superlevy, any levy charge will have a negative impact on the cashflow of even the most efficient farmers.

Purchasing milk quota

The second category includes farmers who are expanding on a smaller scale and are seeking to purchase quota through the milk quota exchange and non-dairy farmers who are considering bidding in the next exchange. These farmers need to consider the price at which it is sensible to buy quota. Last year saw a significant increase in the price of milk quota compared to the first exchange prices in 2006. This was to be expected, even though the extent of the increase in some cases was surprising.

The drop in milk prices in 2008, combined with some fall-off in demand due to the quota increases already received or proposed, should see quota prices reduce somewhat this year. In any event, farmers buying quota at the 2007 average milk trading price of 23 cent a litre, and borrowing this money over seven years, i.e. over the period the milk quota is expected to remain, would incur a financial cost of 3-4 cent per litre. This should still leave a comfortable margin on a milk price of 30 cent per litre. Although they are investing in an asset that is likely to reduce in value over time, this should not be a cause of concern if the additional quota enables them to expand milk production profitability at an earlier stage than would otherwise be the case. In addition, over the last number of months, the feeling among farmers is that demand for quota should have eased by the next quota exchange, given the 2% increase already received, the increased milk price volatility and increases in input prices.

The **final category of farmers,** i.e. farmers who have no plans to expand, generally comprises those who haven't a successor identified and see no merit in expanding in milk quota or else are restricted by the lack of available land close to the milking parlour.

Conclusion

Without doubt there is uncertainty among dairy farmers as to what the best course of action should be: whether to risk expanding without extra quota or invest in buying quota, even if the value of the investment is likely to depreciate over the coming years. Expansion without quota remains a risk, although that risk will almost certainly diminish over time. From the above calculations, I feel that, with the expected relatively high milk prices, the real risk of superlevy and the financial cost of borrowing the necessary finance, purchasing milk quota is a very positive option for many farmers.

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