AgriMatters

AIB supporting the Irish Agricultural Industry

Spring/Summer 2009

IN THIS ISSUE

Fertiliser Prices / The Dairy Market

Contents

Exchange rates 2

Fertiliser prices 3

Review and outlook 4

Economic outlook 5

Maximising Ireland's natural advantage 6

The dairy market 7

Farming on a cyclical rollercoaster 8

Our Agri Adviser Team

PATRICK BUTTERLY
AIB DROGHEDA,

PATRICK O'MEARA
AIB NENAGH,

DONAL WHELTON
AIB BANDON,

TADHG BUCKLEY
AIB MIDLETON,

Welcome to the Spring/Summer edition of Agri Matters

Michael Dowling, Head of Agri Strategy, AIB

Welcome to the Spring/Summer edition of Agri Matters which is being published at a time when the agriculture industry is in many sectors experiencing a challenging year. A number of the articles reflect on the extent of that challenge.

In this edition we feature:

- a note on exchange rate movements in recent years
- a reflection on the outlook for fertiliser prices
- a review of 2008 and a look at this year's likely outcome
- the usual economic and market analysis
- an article on the current dairy market.

There are two special articles in this edition. Tom Quigley, who recently retired after a long career as a senior agricultural adviser in the Bank, writes about how the agri scene has changed over the years. The centerpiece of the edition is the article by Adrian Van Bysterveldt, dairy farm systems technologist at Moorepark, on how to maximise profits on Irish dairy farms. I hope that you will find something of interest in the mix.

Michael Dowling
Head of Agri Strategy

Exchange rates

A look at the movement of exchange rates over the last five years offers an insight into the influence of currency on the agri-food sector.

Movements in specific exchange rates have a major influence on the competitiveness of Irish agri-food exports. Much of international trade is denominated in US dollars and the US is itself a major importer and exporter of agricultural products. The UK is the biggest single market for Irish agri-food exports, hence the importance of movements in sterling rates. Argentina, Brazil, Australia and New Zealand are major competitors on both European and world markets and the strength of that competition is influenced by, among other factors, movements in the exchange rates of their currencies against the euro.

In that context, it is interesting to look at how all of these currencies have moved over the past five years. The table below shows the exchange rates of the various currencies against the euro in mid April in the selected years and the percentage change that has occurred between 2004 and 2009.

Table 1: Exchange Rates

	US	UK	Brazil	Argentina	Australia	NZ
2004	1.19	0.67	3.50	3.40	1.62	1.88
2007	1.35	0.68	2.75	4.18	1.62	1.83
2008	1.59	0.81	2.66	5.05	1.71	2.02
2009	1.32	0.89	2.88	4.85	1.83	2.31
% change*	-10	-25	+22	-30	-12	-19

** % change between 2004 and 2009*
Source: Central Bank & Financial Services Authority of Ireland

It is clear that, with the exception of the two South American currencies (which moved substantially but in opposite directions), there was relative exchange rate stability in the three years up to 2007. Since then, however, all but one of these currencies have depreciated against the euro and, with the exception of the Brazilian Real, all are considerably weaker than they were five years ago. This has had a clear knock-on effect of making the position of Irish and other European traders more difficult both on the European and third-country markets.

Fertiliser prices

In our last edition we highlighted the fact that fertiliser prices were on the rise. The situation has remained very difficult since then and it warrants having another look at the issue.

Fertiliser prices have been rising since the beginning of this decade. However, up to 2007 that rise was quite gradual. For instance, between late 2002 and December 2007 urea prices rose by about 7% a year and compound prices by about 6%. In the following nine months urea rose in price by 35% and compound fertilisers by over 65%.

So, why did this spike occur? There are many reasons but a number of the major ones can be pinpointed:

Demand: Strengthening growth, especially in developing economies, burgeoning commodity prices and the growth in ethanol production, all combined to increase the demand for fertilisers sharply. This had been growing in any event (between 2005 and 2008 fertiliser usage grew by 4% a year, well over twice the rate of the previous ten years) but the rapid increase between 2007 and 2008 was more than the production capacity (which in any event had been falling) could cope with. This was the main driver of price increases in the first five months of last year.

Energy costs: Natural gas is the main input used to produce ammonia which is the main feedstock for the production of nitrogen fertilisers. Oil and electricity are the other main production costs in fertiliser manufacture. The prices of all these energy sources rose by 60% -100% between 2007 and their peak in the late summer of last year. This was the main factor in driving fertiliser prices last summer and autumn.

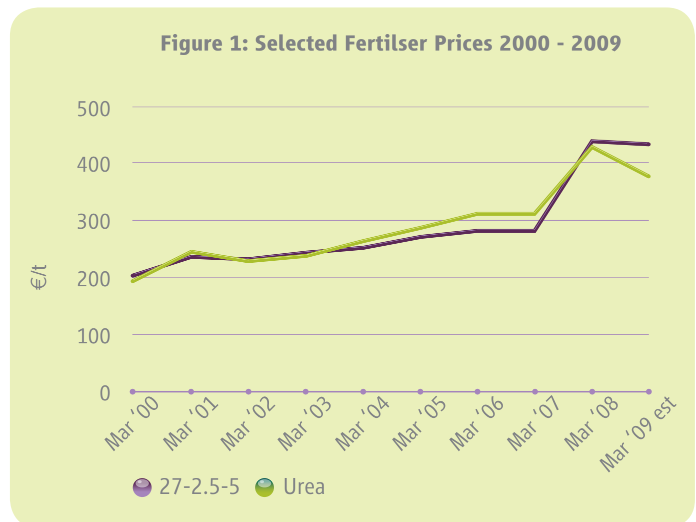
Transport costs: Freight costs rose by 400% or so between 2005 and 2008.

National policies: There are a relatively small number of countries producing fertilisers and national policies can have significant effects on global supply and prices. For instance, China, previously the largest exporter of urea and second largest exporter of phosphate, imposed an additional fertiliser export tax of 100% last year in an effort to ensure that there would be adequate domestic supplies.

The situation in regard to most of these factors has changed dramatically since the latter part of 2008. Global growth rates and commodity prices have plummeted, reducing demand in all countries, including emerging economies. Energy costs have also rapidly declined and fertiliser supply is up. Shipping costs have been falling since their peak early last year. Even allowing for the fact that some high priced forward contracts were still being worked through, all of this led to fertiliser prices falling back substantially.

Prices dropped by about 25% in the US in the last quarter of 2008 and that trend has continued since. The reaction in Ireland was slower, where prices were only marginally down in December last, compared to their peak. The pace of adjustment to the changed market situation has, however, picked up significantly since, with prices in late March down an estimated 10% to 20% and continuing to fall. Given the level of prices internationally (e.g. in Britain) the indications are that this trend should continue at least in the short to medium term. The attached graph charts the development of fertiliser prices over this decade so far.

The long-term outlook is somewhat more problematic. When global economic growth resumes, it is expected that some of the factors that led to last year's spike in price will reassert themselves and that demand for agricultural commodities, especially in countries like China, and production will pick up again. This could again put pressure on the fertiliser market, although it is unlikely to be as severe as over the past twelve months. Furthermore, the economic outlook continues to worsen and the recovery will be somewhat more delayed than originally envisaged. Therefore, the period of falling and (relative to 2008) fairly low fertiliser prices is also likely to be correspondingly more prolonged.



Source: CSO & AIB Forecast

Recent Appointments

Michael Gowing

Michael Gowing has been appointed as the 32nd National President of Macra na Feirme. A native of Portlaoise, Co. Laois and a beef and sheep farmer by trade, Michael will take over from Catherine Buckley - the first woman to hold the position of National President in Macra. Michael, 31, is a former FBD Young Farmer of the Year and will hold the position of National President until May 2011. AIB would like to congratulate Michael on his appointment and wish him every success in the future.

Pat Smith

Pat Smith has recently been appointed as General Secretary of the IFA. Pat, a native of the Tierworker/Kilmainhamwood Parish in North Meath, joined the IFA 20 years ago as Executive Secretary of the Farm Business and Environment Committees. A year later in 1990, he took over as Director of Organisation, a position where he has successfully developed the membership, organisation and financial resources of the IFA. AIB wishes Pat every success in his new role into the future.

Dates for your diary

June 9:	Moorepark Food Research Centre, Open Day
June 18:	Moorepark Dairy Production, Open Day
August 9:	Tullamore Show/AIB National Livestock Show
September 22 – 24:	National Ploughing Championships, Athy

Review and outlook

Following a very difficult year in 2008, it seems that 2009 will also have its challenges, although the drop in input costs may cushion the sector against serious income decline.

Last year was a difficult one and in a way that was somewhat unexpected. We all foresaw some retreat from the peak dairy and grain prices of the autumn of 2007 but not to the extent to which it actually materialised. Furthermore, few anticipated the extent to which input prices would increase.

In fact, livestock prices held up well: beef prices increased by some 10%; pigmeat by 9%; and lamb prices by about 4%. Milk prices at about 32c/litre were similar to 2007, on average, but that statistic hides more than it reveals. The reality is that the year began with milk prices at the historically high level of about 39c/litre and ended the year some 10c or so less (see page 7). When the fact that livestock output dropped somewhat is taken into account, the overall outcome is that there was a very minor increase in the value of livestock and livestock products last year.

There was also a small increase in the value of the output of crops in 2008. Grain prices, however, were down by over 30% and output up by over 25%.

"The rise in the price of some other inputs was, however, almost meteoric"

Overall, the value of gross agricultural output rose by about 2.5% in 2008. The exceptional rise in input costs – up some 12.5% - turned that modest rise into a drop of about 16% in the value of net farm output. The rise in the cost of feed, the most important farm input, was close to the average cost increase. The rise in the price of some other inputs was, however, almost meteoric. Fertiliser prices rose by over 60% (indeed for part of the year some fertiliser prices were double the previous year's level) and energy costs by over 20%.

When the level of direct subsidies and certain other factors are taken into account, the drop in the value of net farm output converts into an income decline of about 12% (excluding subsidies, farm income was down about 21%). This comes after a rise of a similar proportion in 2007. The outcome for the year underlines once again the current importance of the direct payments - accounting for one quarter of the value of gross farm revenue and over 80% of net farm income in 2008.

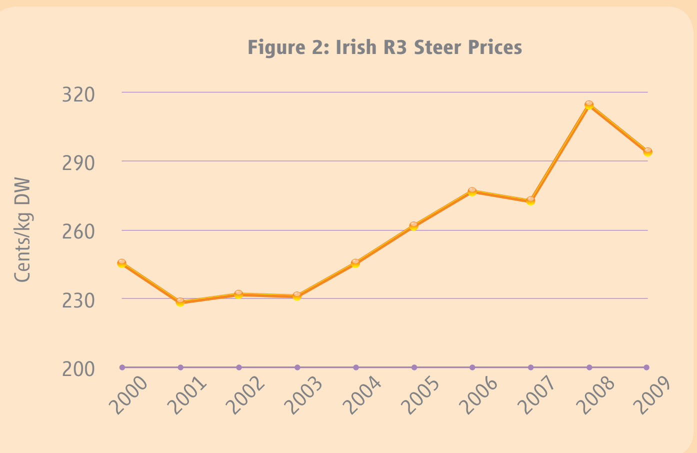
Looking forward

Beef: Beef prices in this decade peaked in June 2008 and it does not appear that that level will be achieved this year. In fact, for the first time in the decade the spring price this year was less than the autumn price in the previous one. This is despite a cut in supply. At the same time, it is worth pointing out that the current price is still high by historical standards (see graph) and that situation should continue. It is also a fact that the beef element in the single farm payment is substantially higher (to the tune of some 50c/kg in beef price terms) than it was at the start of the decade. Nevertheless, the autumn/spring price ratio will have put very severe pressure on winter fatteners and those producing off summer grass may feel some pressure later in the year as an expected higher than usual increase in supply materialises.

Sheep: Sheep prices have tended downwards over the decade to date, with a modest recovery over the past two years. Early indications are that prices this year will be slightly ahead of 2008 levels (average €3.70/kg) and that supply will again be down but by less than half the rate of decline of last year (-12%).

Pigmeat: Pigmeat prices have, as always, been cyclical with peaks in 2001, 2006 and 2008. Prices fell from their peak in September last up to early this year but in recent weeks (March/April) prices have stabilised and, with lower throughput, we would expect a modest recovery as the year progresses. It is not likely, however, that last year's average price (€1.45/kg) will be equalled in 2009.

Grain: While prices last harvest were at the upper end of the historical scale, they represented a sharp deterioration compared to 2007. Conacre prices reflected the exceptional price levels of the previous year and this, together with the very sharp rise in input costs, caused real stress to many tillage farmers. The outlook is somewhat better for this year. Conacre and input costs have fallen. There is a noticeable fall in land under tillage in the EU and other areas which, given normal yields, should see a drop in production. Global carry over stocks, while above the levels of recent years, are not out of line with what would be considered normal. We would, therefore, expect to see prices for this year's harvest to be higher than in 2008 but still somewhat below the exceptional levels of 2007.



Source: Bord Bia

Milk: The indications are that market prices have bottomed out after the dramatic falls of 2008. They remain, however, at relatively low levels and are unlikely to begin to rise significantly before the final quarter of this year. Milk prices, which are currently (March 2009) in the range of 21c to 27c/litre, may well fall further before beginning to rise in the autumn. An average price of 23c/litre (VAT inclusive) seems likely for this year, with prices moving to more than 25c/litre during 2010. The situation in the milk market is dealt with in more detail separately (see page 7).

Input costs: Fertiliser, feed and energy costs have begun to fall and will fall further as the year goes on. Other costs should moderate in line with cost movements in the economy generally. At the very least, the 12% rise in input costs that occurred last year should be reversed.

Economic outlook in recessionary times

The Irish economy is in the grips of a deep recession, driven in large part by a very sharp decline in housing activity. However, in addition to this marked fall-off in housing output, the economy is also grappling with other significant headwinds, including the marked slowdown in the global economy, a higher exchange rate, ongoing problems in the financial sector (which has resulted in tightened credit conditions), rising unemployment, weakening confidence and fiscal tightening. Thus, after a contraction of 2.3% last year, GDP growth is forecast to fall by as much as 8% this year. Conditions are set to remain difficult into 2010, when GDP is forecast to contract by another 3%. The economy is then expected to recover from 2011 onwards as the global economy swings upwards.

While the economy is going through a very turbulent period at the moment, 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 22% by 2020. Thus, some commentators, including the ESRI, believe that the economy continues to have the potential to grow by an average 4% or more over the medium term.

For now, however, the downturn in the economy is having a severe negative impact on the public finances, which have deteriorated rapidly after more than a decade of budget surpluses. The general Government budget balance moved from a small surplus in 2007 to a deficit of 6.3% of GDP in 2008. Even after taking severe corrective action, the Government currently anticipates a very large budget deficit of 10.75% of GDP for 2009. In addition to the tough measures already announced, the Government has indicated that further corrective fiscal measures will be introduced over the next four years to reduce the budget deficit to 3% of GDP by 2013.

The slowdown in economic activity is also having severe consequences for the labour market. The unemployment rate has been on a sharp uptrend for more than a year now. It had climbed to 11.4% by April 2009, up from 4.5% in late 2007. It looks set to rise to 15% over the next couple of years. Ireland has not been unique in terms of this rapid slowdown in the pace of growth, with the contraction in the euro-zone as a whole, as well as the ongoing problems in credit markets and falling inflationary pressures, leading to official interest rates being cut to historically low levels of 1% at the May ECB meeting. Rates are expected to remain at a very low level of 1% for a prolonged period of time, certainly well into 2010. Indeed, a further cut in ECB interest rates to below 1% cannot be ruled out at this stage.

Similar to trends seen internationally, Irish inflation has been on a downward trend for some months now and by March of this year the annual CPI rate had fallen to minus 2.6%, compared to a rate of increase of 5.0% for the same period last year. Given the scale of the downturn in the pace of economic activity, as well as falling interest rates and the trend in international commodity prices, easing price pressures are expected to be a feature for some time yet. The CPI is forecast to decline by an average of over 3.7% for 2009 as a whole, before rising modestly in 2010.

ROI Economic Forecast (% annual change unless stated otherwise)				
	2007	**2008 (f)**	**2009 (f)**	**2010 (f)**
Real GDP	6.0	-2.3	-8.0	-3.0
Real GNP	4.1	-3.1	-8.2	-3.0
Consumer Spending	6.3	-0.8	-8.0	-4.0
Government Spending	6.0	2.1	-0.5	0.0
Fixed Investment	1.2	-19.9	-27.0	-14.0
Exports	6.8	-0.4	-6.0	-3.0
Imports	4.1	-4.4	-10.0	-5.5
CPI (%)	4.9	4.1	-3.7	0.5
Unemployment Rate (%)	4.6	6.1	12.0	15.2
General Govt. Balance (as % of GDP)	0.2	-6.3	-10.75	-10.75

(f) = forecast
Source: AIB Economic Research Unit, April 2009

Tadhg Buckley, AIB Agri Adviser, is pictured with Bryan Daniels, who features in the new AIB TV Advertisement to promote the AIB Young Farmers' Package, and Bernie Farrell, Branch Manager AIB Carrick-on-Suir.

Pictured at the launch of the IFA Skillnet Seminars on Managing Banking Relationships in a Difficult Economic Climate are: Michael Dowling, Head of Agri Strategy AIB; and James Kane, Chairman, IFA Farm Business Committee.

Irish dairy farmers have to take advantage of Ireland's natural advantages

Adrian Van Bysterveldt, Dairy Farm Systems Technologist at Teagasc Moorepark in Fermoy, discusses the importance of maximising Ireland's natural ability to grow grass. Adrian's time in Ireland is partly funded by the FBD trust.

It is often said: 'businesses lose their competitive edge in the good times'. In dairy terms, the price stability over the recent medium-term that has resulted from having dairy production restricted by quotas should be viewed as that period of time when farming business lost their competitive edge. Quotas and subsidies have shielded farmers from the realities of the market, where consumers can be very fickle and the volume purchased and the price they are prepared to pay can change significantly within short periods of time.

Dairy farmers have not realised that they have become at risk because they appear to have been making a comfortable amount of money. Dairy farmers, who bundle milk and stock income, along with various subsidy payments, into their cash accounts have had a big shock. This simple exercise has masked the poor level of profitability in many dairy farm businesses.

The rapid escalation of milk prices to the high of early last year gave the appearance of greater boom times ahead, but hidden behind the headlines was just as great an explosion in costs and now, with the crash in the milk price, these higher costs are only gradually receding.

As bad as it seems, Irish dairy farmers are better off than most of their EU counterparts. This is simply because of the lower cost of production. This is, however, of little comfort for over 50% of Irish dairy farmers whose costs of production per litre of milk are now higher than the milk price. The best estimates of milk prices in the future suggest that they will fluctuate wildly, as will the cost of inputs like fertiliser and oil-based products. The former is because of the ability of many farmers in the world to ramp production up quickly through the use of cheap grain when consumer demand increases; and the latter is because the current financial crisis is preventing investment in exploration and future fertiliser and fuel production. Eventually, consumer demand will return and farmer demand for fuel and fertiliser will increase, with prices following.

In that scenario, Irish dairy farmers will maintain their competitive advantage only if they increase their level of productivity gain, which, at 1.4% a year, is lower than in other EU dairy industries. But, increasing productivity is not solely about working harder! It can be about using new technologies, like information technologies to make better decisions, or automation; or it can simply be about better on the job organisation. Invariably, it is either about using less resources (including money) to make the same amount of product, or using the same resources to make more product.

Other dairy farmers around the world have faced the challenge of being exposed to the market and, while initially times were stressful, they have developed production systems that are now much more resilient and continue to provide good incomes even in periods of low product prices.

The starting point of increasing productivity gain, and reducing cost, is to understand the underlying competitive advantage Ireland has to produce dairy products. Ireland, unlike its EU competitors, has two major advantages. Firstly, it has the ability to grow grass all year round; and secondly, Ireland has a climate that is kind to cattle so they do not have to be housed. These advantages should be the basis of a dairy industry that has a lower cost structure than any other EU country and also should have a higher level of productivity and a higher level of productivity gain each year.

To realise these advantages Irish dairy farmers need to:
- get more skilled in growing and managing grass
- invest in highly fertile cows that are best suited to harvesting grass and turning it into high quality milk
- measure their performance in milk solids/ha produced off grass
- greatly reduce their expenditure on concentrates
- restrict their investment in buildings and machinery
- scale up their enterprises through leasing or buying land and integrating it into larger more economic parcels.

The constraints of the quota system, and the financial incentives of the old coupled premium schemes, encouraged the development of additional farm operations and also resulted in a very narrow focus on per cow milk volume production. This may be a suitable strategy for farmers in other EU countries where: grass growth is not all year round; the climate is too harsh for cows to be outdoors for the long winter months; and cereal growing is the dominant agricultural business. However, even these countries are questioning this approach.

With this background, it is of concern to see so much grass currently (early April) covering Irish fields without an animal in sight grazing it. Right now is the very time of the grass growing year when excellent grazing managers are operating their farms with only just enough grass to feed their cows each day. By doing this they will be better able to control the surge of spring growth that is about to occur and, in doing so, keep quality pasture for longer.

Most farmers are now putting cows into grass that is already far too strong. They should instead be stepping over paddocks, leaving them for silage. Cows should be grazing younger leafy grass, which is nutritionally better and which the cows will properly graze out, thus leaving the field ready to grow more leafy nutritious grass.

The dairy farmers that will be the most profitable are not necessarily those that produce the most milk per cow or per hectare, but those that use grass sensibly to produce milk with little additional expense. These farmers will still be profitable in times of low milk price and will bank large profits in times of high milk price without having to change the way they farm. Even in the lowest payout, farmers should aim to retain 40% of the gross income and when good payout years come this target must be lifted to 70% of their gross income. These are the targets needed to meet family and business needs.

Tullamore Show and AIB National Livestock Show

Pictured at the new Tullamore Show site are Tom Maher, Chairman, and Freda Kinnarney, Secretary of the Tullamore Show, with Christy Byrne, Branch Manager AIB Tullamore. The Butterfield Estate, Greatwood, Blueball, Tullamore, will host this year's Tullamore Show and AIB National Livestock Show on Sunday, August 9. AIB wishes the Tullamore Show every success on their move to the new site.

The dairy market

Here we examine the changing global landscape of the dairy market over recent years and conclude that the medium to long-term outlook for milk prices remains positive.

In the period 2000 to 2006, dairy prices in the EU were relatively stable. This was reflected in average annual European milk prices to farmers which ranged in that period between 28c and 31c per litre. In the same period Irish prices ranged between 26c and 30c annually. While world prices fluctuated significantly in terms of the US dollar, they were considerably more stable in terms of other major trading currencies. As a result, for instance, annual New Zealand milk prices remained in the range of 16c/litre to 18c/litre in the period.

Increased demand, largely from emerging economies, somewhat reduced supply due to climatic conditions and a run down of stocks led to a spectacular rise in dairy commodity prices in 2007 and early 2008. For instance, in dollar terms, world butter prices in March 2008 were three-and-a-half times higher than in March 2000 and, in euro terms, they were more than double the earlier price. The prices of other dairy commodities also rose dramatically.

Table 2: World Dairy Prices

	Butter	SMP	Milk price equivalent	Export refund equivalent
	€/t	€/t	c/l	c/l
Mar 2000	1260	1630	20	7.5
Mar 2004	1325	1510	19.5	7.5
Mar 2008	2605	2510	34	-
Mar 2009	1370	1350	18	4.7

The situation changed equally as dramatically through 2008. Supply reacted to the price stimulus; demand fell in the face of the higher prices, the economic downturn and the melanine crisis in China; and climatic conditions returned to normal. By March of this year prices had fallen to the levels of the start of the decade. Table 2 illustrates the development of world butter and SMP prices over the decade so far and the return from the world market in terms of milk price equivalent and export refunds on the selected dates.

Farm gate prices reflected these changes. Irish milk prices which had fallen to about 26c/litre in 2006 rose to an average of about 33c in 2007 and a peak of 39c in the autumn of that year. Because of the high price, which pertained in early 2008, the average price for the year was only 1c to 2c below the 2007 figure. There was, however, a drop of about 10c between the beginning and end of the year. At present (March 2009), Irish milk prices are in the range 21c to 27c/litre and look set to fall further before they begin a recovery towards the end of the year.

European milk production will this year be well below quota. US production is forecast to fall also as milk prices in some States have decreased to below the level of operating costs and climatic conditions have slowed the growth in supplies in other major milk producing countries. All of this points to lower global production which, even allowing for the effect on demand of the economic recession, should see some upward movement in prices towards the end of the year.
On the assumption that global economic growth will resume over the next couple of years, the medium to long-term outlook for milk prices remains positive with the view being that the market prices for dairy products will be considerably higher in the next ten years than they have been on average in the years prior to 2007.

Table 3 illustrates the development of Irish manufacturing milk prices from 1984 (first year of milk quotas) to 2008 in current terms and at constant 2008 prices.

Table 3: Irish Manufacturing Milk Prices

	Actual price	Price at constant 2008 prices
	c/l	c/l
1984	20	43
1994	28	43
2000	29	39
2004*	28	31.5
2006**	26	28
2007**	33	34
2008(e)**	32	31
2009(f)**	23	24

** Direct payment of 1.2c/l also made*
*** Direct paytment of 3.5c/l included in the single farm payment*

Fixed or Variable Interest rate?

In the historically low interest rate environment and current economic climate that we find ourselves, borrowers are considering whether or not to fix their interest rates at this stage. Since joining the euro, Ireland doesn't control its own interest rates. Instead, they can be influenced by the larger countries in the euro-zone and their financial circumstances. As a result, we could, in certain circumstances, have a higher interest rate than our economic conditions would require.

The ECB rate is currently 1.0% (information correct as at 07/05/2009), it was at 4.25% just nine months ago. Historically, if a borrower chooses to avail of a fixed rate option, the best time (in terms of lowest rate) to fix interest rates, has been before the last reduction in the official ECB interest rate, as the last cut has often been factored into the market of the fixed interest rate. Interest rate movements are generally cyclical in nature and the bottom of the cycle, is the time when most people will be considering fixed interest rates to hedge their risk. It is however difficult to judge when that last fall will take place and as a result difficult to predict the most opportune time for one to fix their interest rate. At the moment, the Cost of Funds for 10-year fixed interest rate is 3.24%*, compared to our 3-month Cost of Funds (BLR) of 1.779% (information correct as at 30/04/2009).
When weighing up whether to fix or not, borrowers should take the following issues into account:

- term of borrowing;
- requirement for interest only;
- likelihood of early reduction / clearing of facility and potential breakage cost involved in an early repayment;
- ability to cope with a potential higher interest rates if one doesn't fix; and,
- personal risk appetite.

Fixing an interest rate is not suitable for everyone and on a practical level when people are unsure whether or not to fix, they may split the borrowing into a portion of it fixed and a portion of it on a variable rate. In any case, it is a personal decision and one that only hindsight will tell whether one was correct or not.

*This is an indicative rate only for a typical €2000,000 loan, with quarterly interest and capital repayments, over a ten year fixed rate term and is subject to change. A funding premium and bank margin may also be added to the rate. Details are correct as at 29/04/2009.

Farming on a 'cyclical rollercoaster'

Tom Quigley, retiring Agricultural Adviser at AIB, looks back over his 31 years with the bank and asks how the present farming situation relates to earlier years.

I graduated three years before Common Market entry, when farming had high expectations that were, by and large, fulfilled by the CAP through transition. For most of a quarter of a century, farming enjoyed more 'certainty' than in any other previous period.

Since de-coupling in 2005, year-to-year fluctuations in profits have featured, especially in milk and grain production. Previously only pig and potato producers (enterprises not benefiting from price supports under the CAP) had to live with such swings. We have already seen how a relatively small deficit or tightening in supplies (e.g. grain and milk in 2007) can push prices very high and also how small surpluses (e.g. grain and milk in 2008) can swing the pendulum quickly to low prices: expect vice versa over the years ahead. In a market-led environment, profit fluctuations are inevitable, just like in the Sixties.

The significant, positive difference between 2009 and 1969 is the fact that direct payments (Single Farm Payment, REPS and LFAs) now provide a backbone for farm income.

Present-day farmers have to learn (just like farmers pre-EU) to ride the profit roller coaster, because there are now less mechanisms in the CAP to compensate for losses in bad years or for rectifying mistakes (bad investment decisions) made on the strength of exceptionally good years. There are already lessons learned from experiences over the last three years, e.g. high prices, for grain after the 2007 harvest, and for milk caused surges in global production in 2008 resulting in the lower prices now. It is often said that the best cure for high prices is high prices.

In tillage enterprises, production can fluctuate from year to year. In livestock enterprises the cycle length is dictated by the breeding cycle and slaughter age. High expectations (rising prices) can cause an acute swing in beef and pig production through the diversion of stock from the food chain into breeding, thereby reducing meat supplies further and pushing prices to 'cyclical highs'. However, when the extra breeding animals produce progeny, the extra production causes a supply surge, leading to sharp price reductions.

It would be a fantastic advantage to be able to predict such swings correctly, i.e. produce more when prices are high and less when enterprises are making a loss. Some farmers get it right, sometimes, but there are other factors that move the goal posts. For instance, a coincidence such as weather abnormally affecting output worldwide can create a cycle within a cycle. Major currency swings and oil price fluctuations also impact.

We are in a global economy so it is not just the swings on the Irish and British markets that affect Irish prices and profits. Just as Irish farming has become more exposed to, and is learning to manage, cyclical profitably again, we now find that global recession is putting pressure on all food prices. There is little doubt that the recession is acting and will act, in a variety of ways against farm commodity prices. Already, we have seen the effect of the weaker sterling and US dollar on export prices.

World population growth is increasing demand for food. Supplies of cheap surpluses on world markets are drying up and over the next decade there will be years when grain will be scarce. The lack of alternative sources of necessary commodities may force the EU to put renewed emphasis on its own food security perhaps from 2015 onwards. The extent to which farmers will benefit is difficult to predict, but I assume the trend will be somewhat favourable.

Present-day farmers can learn from older farmers who, pre-EU, were more tuned in to price cycles. The main messages from their time which can be applied to the current situation are:

- don't overreact to high or low prices;
- decisions to borrow for spending on buildings, expanding the farm, machinery or to invest outside of farming should never be made based only on the 'good year' or on high expectations;
- neither should depression be allowed to set in after one 'bad year';
- make investment decisions based on performance over a full cycle (a three to five-year period including a 'good' and 'bad' year); and,
- mixed farming (two or more complimentary enterprises) tends to level out year-to-year profit cycles.

The 'modern messages' that complement the above are:

- focus on efficiency - whether output is stable or increasing, watch margin over costs. Better farmers watch unit cost of production (litre of milk, kilo of livestock or tonne of grain) and improve margins by keeping unit cost low; and
- farm profit should be greater than the value of the direct payments (SFP, REPS and Area Payment). If it is not, changes should be made as it makes no sense using these payments to subsidise loss-making enterprises.

Lenders in banks are advised to look for underlying repayment capacity, when assessing applications. We all know that there are good and bad years in any farm enterprise. It is the average performance (minimum three years up to five years) that gives the real picture on which farm and bank decisions can be soundly based.

AIB/Macra na Feirme Club of the Year

Celebrating their win as 2008 AIB / Macra na Feirme Club of the Year are representatives of Mountmellick Macra pictured with Tom Quigley, AIB Agri Adviser, and Catherine Buckley, Macra na Feirme National President.

Allied Irish Banks, p.l.c. is regulated by the Financial Regulator. Registered Office: Bankcentre, Ballsbridge, Dublin 4. Registered in Ireland: Registered No. 24173.
© Allied Irish Banks, p.l.c. 2009. All rights reserved in the copyright of the newsletter.
The content of this newsletter is expressed in broad terms and is limited to general information purposes only. Readers should always seek professional advice to address issues arising in specific contexts and not seek to rely only on the information in this newsletter. To the fullest extent permitted by law, AIB Bank excludes completely all liability for loss or damage of any kind, and any warranties or duties it may owe, express or implied, arising from or relating in any way to the material and or use of the newsletter.

AIBM/CBB 51 05/09