

# **Situation and Outlook in Irish Agriculture**

## **Mid Year Update 2009**

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#### **Introduction**

The ongoing global economic crisis conditions the outlook for dairy, beef, sheep and cereals in 2009. While cost inflation was the main influence on farm margins in 2008, changes in output prices are the main factor behind the story for 2009. Dairy and cereal enterprises will experience the greatest difficulties in 2009 due to substantial decreases in milk and grain prices relative to 2008. Reductions in input expenditure on dairy and cereal farms will be moderate and, as a consequence, negative net margins will be widespread. By contrast, in 2009 output value will decline on beef and sheep enterprises due to falling prices, but margins may actually increase as these output price reductions are more than offset by savings in input expenditure.

#### **Macroeconomic Situation**

Economies in the developed world moved into recession in 2008, while economic growth in developing economies has decreased to low levels. The recession has continued through 2009 and its precise duration remains unclear. The current consensus is that the global recession may not be quite as protracted or as severe as was feared 12 months ago.

There are some positive signs that the beginning of a recovery may emerge in 2010. Data from China indicates that the stimulus package for the Chinese economy is working effectively and economic growth in 2009 has been ahead of expectations. In addition share prices are rising around the world and this is normally a leading indicator of higher economic growth. However, there are no signs as yet of an increase in industrial demand for crude oil which would be a leading indicator of increased industrial output.

From an agricultural perspective the recession has impacted on global food demand and has contributed to the decrease in commodity prices that has been observed over the last 12 months. Over the short term this recession will continue to dominate the outlook for agricultural commodity prices. Little economic growth is forecast in developed economies in 2009 or 2010 and current expectations are that economic growth in the developing world will be very limited in this period.

The depreciation of sterling against the euro has made Irish output less competitive in the UK and has reduced the value of Irish exports to the UK including agricultural exports. While sterling has appreciated against the euro by about 15 percent since the beginning of 2009, at 85 pence (July 2009) sterling remains well below its historical average against the euro. To the extent that exports from specific sectors of Irish agriculture are normally destined for the UK, this will be a particular problem over the short term.

In addition to the challenges presented by the global recession the Irish economy faces its own specific difficulties due to the size of its budget deficit. Measures are being taken throughout the economy to reduce public expenditure and these have included the support provided to the Irish agricultural sector. Further reductions in public expenditure are recommended in the report of the Group on Public Service Numbers and Expenditure Programmes and, to the extent that these recommendations are ultimately implemented, this will further reduce the level of support for agriculture in Ireland.

Lower government expenditure on some agricultural schemes will reduce payments to many Irish farmers, but the impact of these changes will be largely felt in medium term rather than in the current year.

## Situation and Outlook for Crops

### Mid-year update for 2009

*A significant decline in cereal prices is forecast at harvest 2009 relative to the already depressed price paid at harvest 2008. Furthermore, indications to date for 2009 are that direct input costs on crop farms have not moderated to the same extent as that experienced on the livestock side, due to the seasonality of input purchases. Direct cost inflation is estimated to be in the region of -1 percent to +2 percent depending on the crop examined. Hence, it is estimated that the 2009 harvest year will result in depressed margins for crops with negative net margins experienced on the majority of tillage farms.*

*This paper considers the situation on crop farms in the year to date and looks at the outlook for 2009 as a whole.*

Relative to 2008, present indications are that direct cost inflation on crop farms is set to be the region of – 1 percent to + 2 percent depending on the crop, in 2009. Furthermore, significantly lower on-account cereal prices for the 2009 harvest, means that margins on crop farms for 2009 will be under significant pressure.

Fertiliser costs typically comprise about 27 percent of direct costs and 13 per cent of total costs on tillage farms. While CAN prices have been falling in the first half of 2009, the price of P and K based compound fertilisers have remained relatively high. Furthermore, given the seasonality of fertiliser purchases on crop farms, any further decreases in fertiliser prices that may arise after May are not relevant to margin calculations for 2009. Hence, it is estimated that fertiliser expenditure will be between 3 percent and 8 percent higher than 2008 levels depending on the crop, with fertiliser expenditure up slightly higher on winter cereals compared to spring cereals due to seasonality of purchases. This contrasts with the situation on livestock farms where a decrease in fertiliser expenditure in 2009 is anticipated

Purchased seed on crop farms are a less significant cost than fertiliser on cereal production, comprising between 10 and 15 per cent of direct costs for cereal production and just over 11 per cent on average on all tillage farms in 2007. In terms of the composition of total costs, seed represents around 5 per cent of total costs. Cereal farmers experienced a significant increase in seed costs in 2008 relative to previous years due to the significant upward movement in the cereal markets in 2008. However, blue label seed costs for the 2009 harvest year remained at similar prices to 2008 despite the significant reduction in cereal prices experienced at harvest 2008. That the seed market did not reflect the downward pressure on cereal prices was explained by the failure of a large proportion of seed crops to meet the minimum quality standards. As a result, a large proportion of the seed requirement for 2009 was imported from the UK and the extra cost of these seeds was reflected in a stabilisation of seed prices at 2008 levels.

The expenditure on crop protection by specialist tillage farms in recent years has accounted for approximately 20 per cent of direct costs and 10 per cent of total costs. However, the contribution of crop protection to the composition of costs can vary significantly depending on the crop, with the percentage spend on winter crops higher than on spring crops. Compared to other significant costs on tillage farms, the increase in expenditure on crop protection has been limited over the recent past and this trend has continued in 2009, with an estimated increase in expenditure on crop protection products of just over 1 percent.

Energy and fuel are important inputs in crop production. Given that a number of direct costs and overhead costs are directly influenced by energy and fuel prices the trend in energy

prices is of significant importance for the average tillage farmer. In this analysis it is assumed that hired machinery and transport costs from direct costs and machinery operating expenses from overhead costs are influenced by energy inflation. These cost items represent approximately 25 per cent of total costs on tillage farms.

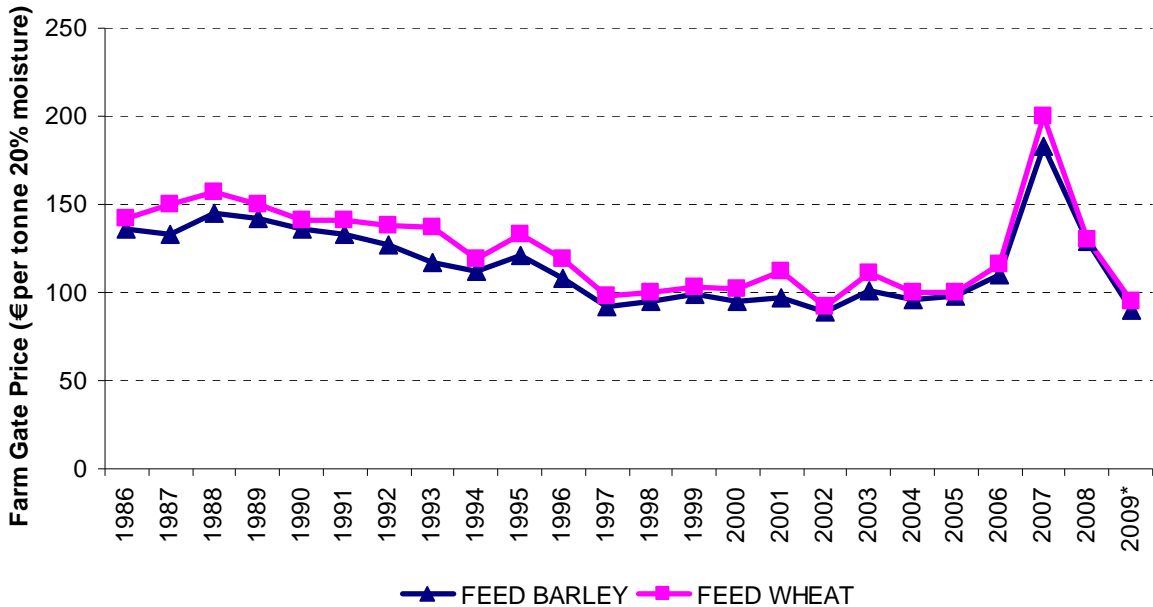
At US \$50 per barrel, crude oil prices have averaged much lower in the first half 2009 than in 2008. Although, the CSO fuel price index has fallen, it would seem that farmers have not yet seen the full benefit of the oil price reduction. Crude oil prices have risen again in July 2009 to US \$70 and if futures prices are accurate, an average price of US \$ 60 for the year as whole is likely. This would represent a 35 percent decrease in crude oil prices relative to 2008 and on crop farms this should deliver at least a 25 percent reduction in the fuel bill in 2009 compared with 2008. Contracting costs are also falling, reflecting lower fuel and related input costs and could be down 10 percent on the 2008 level. Demand for these input items tends to be relatively inelastic with respect to price and therefore it is assumed that usage in 2009 will be on a par with the 2008 level.

Given the rising unemployment rate, labour costs in 2009 are likely to be unchanged on the 2008 level. CSO estimates indicate that agricultural 'other costs' will be up 2 percent in 2009 on the 2008 level.

The average cost of land rental on specialist tillage farms is around 5 to 10 percent of total costs. Given that farm gate cereal prices increased significantly in 2007 there was a consequent increase in land rental prices. It is estimated that land rental prices in 2009 have returned to 2007 levels.

Taken together all of the aforementioned direct cost changes would deliver around a 1 percent increase in direct costs for winter wheat per hectare and a 2 percent decrease in direct costs for spring barley per hectare.

**Figure 1: Farm Gate Cereal Prices €per tonne (1986-2009\*)**



Source: Authors' Own Estimates (\* Provisional - Based on early harvest on-account prices)

Due to a large global oversupply of cereals and carry over of global stock into the 2009 harvest year, there is considerable downward pressure on Irish cereal prices at present. On account prices are likely to be in the region of €80 per tonne for barley and €90 per tonne for wheat. However, it is expected that these on-account prices will be reviewed as the harvest progresses and estimates of plus €10 per tonne of barley and plus €5 per tonne of wheat are expected. Low global stock levels has been reflected in high levels of volatility in world grain prices has emerged over the last few years. However, the low prices quoted for Irish cereals at present have not been seen for over 20 years. The price differential per tonne between 2008 and 2009 on-account prices is -25 percent for wheat and -30 percent for barley.

In terms of Irish yields for 2009, given current knowledge of grain fill to date and comparisons with average moisture and yield levels last year, it is estimated that the winter wheat and spring barley yields will be down in 2009 relative to 2008. This yield decrease coupled with an estimated 20 percent reduction in cereal area in 2009 relative to 2008 means that total Irish cereal production in 2009 could be down as much as 25 percent relative to 2008 production.

Overall, due to lower prices and reduced yields, gross output values for the winter wheat and spring barley crops will be down 26 percent and 32 percent in 2009 relative to 2008. With direct costs up 1 percent for winter wheat and down slightly at 2 percent for spring barley, gross margins are estimated to be approximately €110 per hectare for winter wheat and minus €80 per hectare for spring barley, for farmers with average levels of technical efficiency.

Even the most efficient winter wheat and spring barley producers will be left with a gross margin of only €330 per hectare and €125 per hectare respectively to pay overhead costs. With average overhead costs estimated to be around €480 per hectare on specialist tillage farms in 2009, it is evident that even the most efficient produces will be left with a negative margin. However, it must be remembered that a large proportion of fixed costs will be borne by the farmer even in a situation where the crop is not planted in 2009. Hence, to determine whether the return from growing the crop in 2009 provides a positive or negative margin it is necessary to subtract the quasi-fixed cost items from enterprise gross margin. If the gross margin for the cereal enterprise remains positive after the quasi fixed costs are accounted for it makes economic sense to grow the crop in 2009. The fixed cost items assumed to be quasi fixed costs are labour and machinery operating expenses. These cost items would not be incurred if the land was not cropped in 2009. All remaining fixed cost items would be fixed regardless of the level of production, such as car, electricity, phone, machinery depreciation, building depreciation, and other miscellaneous fixed cost items.

With the production related overhead costs on specialist tillage farmers estimated to be in the region of €120 per hectare in 2009, it is estimated that the top one third of winter wheat producers will be left with €210 per hectare and spring barely producers with a negative margin of approximately €5 per hectare from growing the crop in 2009.

## **Situation and Outlook for Dairying**

### **Mid-year update for 2009**

*A rapid decline in milk prices, coupled with only a slight moderation in costs, means that 2009 will be a very poor year for dairy farm margins.*

*This paper considers the situation on dairy farms in the year to date and looks at the outlook for 2009 as a whole.*

At the mid point of the year indications are that costs on dairy farms are set to decrease in 2009 relative to 2008. While feed, fuel and fertiliser prices have moderated in 2009, they remain expensive when compared with the low level of producer milk prices in 2009.

Purchased feed (concentrates) typically accounts for about 20 percent of total input expenditure on dairy farms, although this varies by farm and by year. Dairy meal prices have been falling since the beginning of 2009. This reflects the low harvest price in Ireland in 2008 and falling international grain prices.

It is expected that the quantities of purchased feed in 2009 will be slightly lower than the 2008 level. Data for the first 3 months of 2009 provided by DAFF indicates that aggregate dairy feed purchases were down about 5 percent on the 2008 level. Weather conditions over the rest of the year will play a part in determining the outcome for the year, but to some degree the anticipated decrease in feed usage may reflect some dairy farmers' inability or unwillingness to incur feed costs given the current low producer milk price. In 2009 expenditure on feed is forecast to be down 20 percent, largely reflecting a decrease in price compared with 2008, and a modest decrease in volume.

Pasture and forage costs typically comprise about 18 percent of total production costs on dairy farms. Fertiliser purchases comprise about half of the pasture and forage input costs. The other half is comprised mostly of contractor costs. Both of these costs look like they will decrease in 2009 relative to 2008. Urea and CAN prices have been falling in the first half of 2009, due to depressed demand, and further price declines are expected. For 2009 as a whole, fertiliser prices could be down by 20 percent on the 2008 level. Contracting costs are also falling, reflecting lower fuel and labour costs and could be down 10 percent on the 2008 level. Overall, a reduction in pasture and forage expenditures of 15 percent is anticipated for 2009 relative to 2008.

On dairy farms energy and fuel are less important inputs in dairy production, comprising just 8 percent of total costs. Electricity typically comprises about 30 percent of the total expenditure on energy and fuel with fuel accounting for the remaining 70 percent.

At US \$50 per barrel, crude oil prices have averaged much lower in the first half of 2009 than in 2008. Although, the CSO fuel price index has fallen thus far in 2009, farmers have yet to see the full benefit of the crude oil price reduction. Crude oil prices began to rise again in July 2009 to a level of US \$70. If futures prices are accurate, an average price of US \$ 60 for the year as whole is likely and this would represent a 35 percent decrease in crude oil prices relative to 2008. On dairy farms the decrease in oil prices should deliver at least a 25 percent reduction in the fuel bill in 2009 compared with 2008.

Electricity prices have been reduced in May 2009 following a recommendation by the Commission for Energy Regulation. As the next price review is not planned until October 2009, it is likely that average electricity prices for the year will be similar to the average for

2008. Overall, a decrease of 15 percent in total energy and fuel expenditure is anticipated on dairy farms in 2009.

Given the rising unemployment rate, labour costs in 2009 are likely to be unchanged on the 2008 level. Other miscellaneous costs look like they will be up 2 percent in 2009 on the 2008 level.

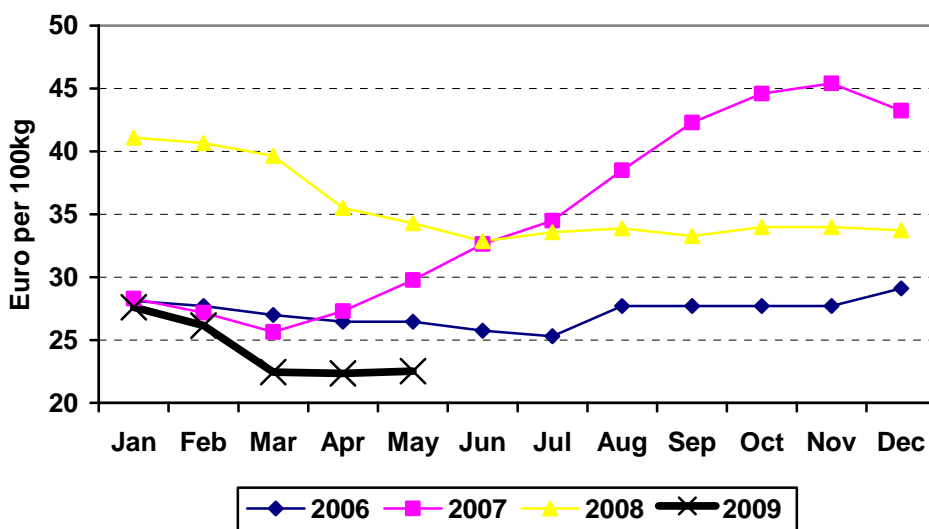
Taken together all of these cost changes would deliver a cost reduction of about 2 cent per litre in 2009 compared with the 2008 level.

Due to the seasonality of production, the fall in milk price in the second half of 2008 still left the annual average milk prices in 2008 at 32 cent, down marginally on 2007. The economic crisis has depressed the demand for dairy products and dairy prices have continued to fall in the first half of 2009. The global dairy sector has entered a very difficult period and world dairy prices are now lower than they were in advance of the spike in prices in 2007/08.

The European Commission has intervened to support third country exports through the restoration of dairy export subsidies and intervention is now absorbing a substantial amount of SMP and butter production. The European Commission has announced that the intervention window will be extended to continue to support the EU dairy market in the final quarter of 2009.

Producer milk prices in Ireland opened 2009 at about 28 cent per litre and have dropped rapidly in the year to date and are now less than 23 cent per litre. Due to the seasonality of Irish milk production, much of the production season has already passed. There is little prospect of a producer milk price increase in the third quarter of 2009 and any improvement in prices that might occur in the final quarter, will come too late to have any major impact on the average producer milk price for 2009, which at present looks like being just 23 cent per litre. This would represent a reduction in price of over 25 percent compared with 2008.

**Figure 2: Monthly Irish Producer Milk Prices 2006 to 2009**

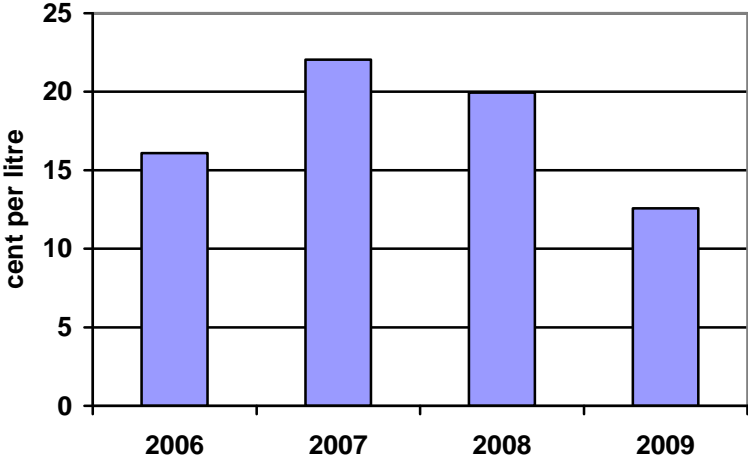


Source: Eurostat

Reflecting the low producer milk price, Irish milk production in the current milk quota year is below the level of 2008/09 and at this point it seems unlikely that the Irish milk quota will be filled. At an EU aggregate level it also seems that there will be a milk quota underfill of as much as 3 or 4 percent.

Overall, gross output values on Irish dairy farms will be down over 25 percent in 2009. With only a moderate reduction in input costs, gross margins are likely to be just 12 cent per litre on average. This will mean that many Irish dairy farms will struggle to record a positive net margin in 2009.

**Figure 3: Gross margin per litre for Irish Creamery Milk Producers 2006 to 2009**



Source: Derived from National Farm Survey and Author's Estimates

## Situation and Outlook for Cattle

### Mid-year update for 2009

*This paper considers the situation on cattle enterprises for the year to date and looks at the outlook for 2009 as a whole. The four enterprises examined are single suckling, weanling to store/finish, store to finish and cattle rearing on dairy farms.*

*At the mid point of the year indications are that costs on each of the four cattle enterprises examined are set to decrease in 2009 relative to 2008. While gross output is also likely to decline due to lower prices, gross margins are likely to be higher in 2009 than in 2008 due to an improvement in the cost price ratio for cattle production.*

Purchased feed (concentrates) account for varying proportions of the direct costs of cattle enterprises. On the weanling to finish and store to finish enterprises, concentrates typically account for over 40 percent of direct costs, while on single suckling enterprises the share of direct costs is typically lower than 30 percent. Cattle meal prices have been falling since the autumn of 2008 reflecting the reduced Irish cereal prices in 2008 and falling international grain and oilseed prices.

Data for the first quarter of 2009 provided by DAFF indicates that aggregate cattle feed purchases are up about 4 percent on the 2008 level. This first quarter 2009 increase may reflect the higher volumes of feed that can be purchased at lower prices by farmers who operate a fixed feed budget. Over the full year total feed purchases will be affected by weather. Barring a significant deterioration in weather, we expect the annual volume of feed purchased to be largely unchanged on from 2008 levels but due to lower prices expenditure on feed is expected to decline by 15 percent.

Pasture and forage costs are the second “big ticket” direct cost item on cattle farms and the share of direct costs accounted for by this input category varies from over 50 percent of direct costs on single suckling enterprises to around 35 percent on weanling to finish and store to finish enterprises. Fertiliser and fertiliser spreading costs (contractor and own) look set to decrease in 2009 relative to 2008. Urea and CAN prices have been falling in the first half of 2009, due to depressed demand and further price declines are expected. For the year as a whole, fertiliser prices could be down by 20 percent on the average for 2008. Overall, a reduction in pasture and forage expenditures of 22 percent is anticipated for 2009.

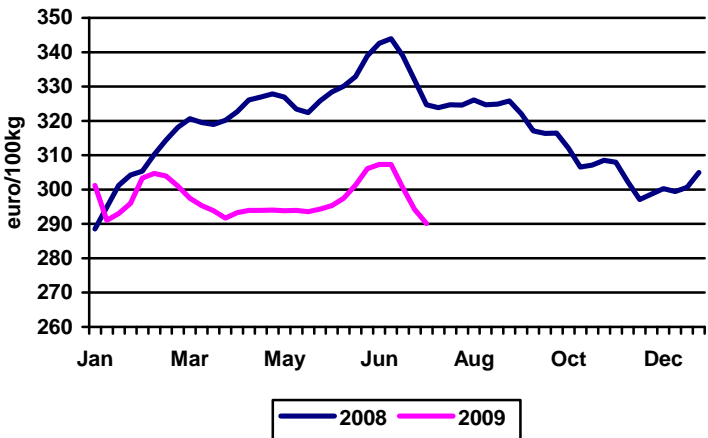
Categories such as energy and fuel, electricity and labour costs account for relatively small shares of the total costs of production on cattle farms. In 2009 these costs are expected to decline relative to 2008. With rising unemployment we do not expect labour costs to increase relative to 2009 levels. Energy prices (electricity, diesel etc.) are expected to decline. In the first half of the year fuel prices have declined by 20 percent compared to 2008 and this lower level is expected to persist for the remainder of the year.

When total direct costs are considered across the four cattle enterprises on a per LU basis, we expect that the decline, relative to 2008 levels will range from approximately 18 percent for the single suckling enterprises to 16 percent for the cattle on dairy farm enterprise.

Lower prices have been observed on Irish cattle markets in 2009 when compared with 2008. Weekly and monthly data published by the European Commission and CSO for cattle carcasses and live cattle allow us to examine the extent to which the decline in cattle prices has been uniform across weanling, store and finished cattle. To date finished cattle prices

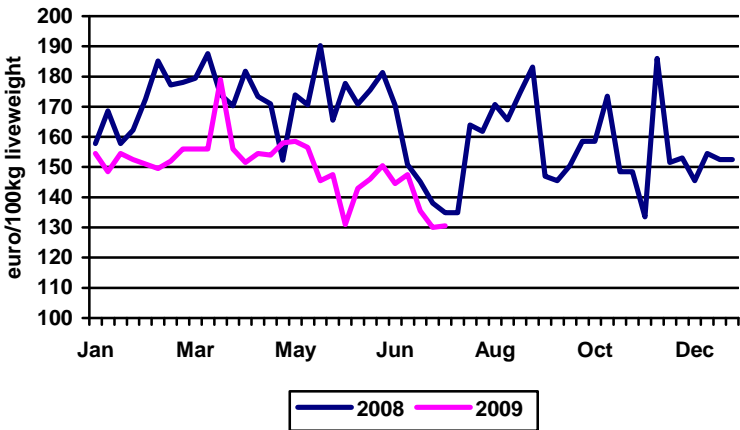
(R3 steer) are 8 percent lower than in 2009. The prices of weanlings and store animals in the first half of 2009 are between 11 and 12 percent lower than over the same period in 2008.

**Figure 4: Price of Finished cattle 2008 and 2009**



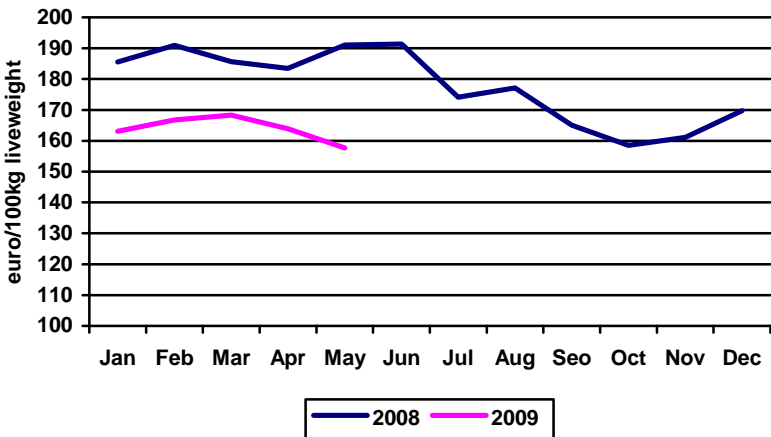
Source: European Commission

**Figure 5 Price of Weanling cattle (6 to 12 months < 300kg)**



Source: European Commission

**Figure 6: Store Cattle (300 – 349 kg)**



Source: CSO

Based on data available in July 2009, we estimate that gross output per LU across the four different systems will decline by between 8 and 9 percent in 2009 relative to 2008. Smaller declines in gross output should occur on farms purchasing in weanling and store animals and bringing them to finish.

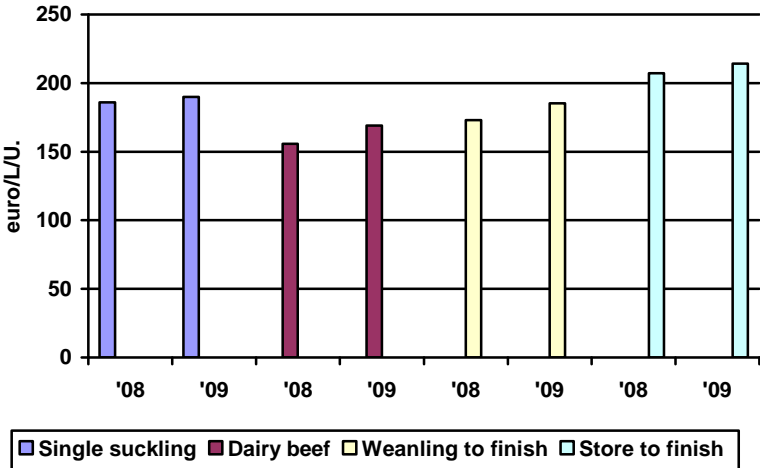
The decline in gross output on all of the cattle enterprises results from lower cattle prices in 2009. The UK market in 2008 accounted for over 54 percent of Irish beef exports. The weak pound sterling has put downward pressure on Irish cattle prices. The decline in cattle prices contrasts with the developments over the year so far on lamb markets where prices are more or less equal to those in 2008. Importantly the principal market for Irish lamb is France where the euro sterling exchange rate effect is absent. If the pound sterling weakens further, especially during the peak months for cattle slaughter in the final quarter of the year, gross output on all cattle systems could decline by more.

The suckler cow welfare scheme is still in operation and in this analysis contributes to gross output. The reduction in the rate of payment in 2009, when compared with 2008, is the basis for the largest reductions occurring in gross output from the single suckling enterprise.

With the value of gross output on Irish cattle enterprises estimated to contract by between 6 and 8 percent in 2009 compared with 2008, and direct costs contracting by between 16 and 18 percent, gross margins on Irish cattle enterprises are estimated to increase in 2009 by between 7 and 16 percent. The largest increases are estimated in the gross margins of weanling to finish and store to finish systems where lower concentrate feed costs and the differential in the decline in finished cattle and weanling and store prices combine to bring a slightly greater reduction in costs. Margins on single suckling enterprises also improve, though the reduction in the value of the suckler cow welfare payments and lower cattle prices will largely offset the benefits of lower feed and fertiliser costs.

Gross margins do not account for all of the costs of production. When overhead costs of production and costs which are difficult to allocate across different farm enterprises are subtracted from gross margins, this provides the net margin. Despite improved gross margins average cattle enterprises will still return a negative net margin in 2009.

**Figure 7: Cattle Enterprise Gross Margins**



Source: Own calculations and NFS

## Situation and Outlook for Sheep

### Mid-year update for 2009

*This paper considers the situation on the principal lowland sheep enterprise (mid-season lowland lamb) for the year to date and looks at the outlook for 2009 as a whole.*

*At the mid point of the year indications are that costs of production on sheep farms are set to decrease in 2009 relative to 2008, while output prices should be close to the prices observed in 2009. With declining costs and steady output prices, the level of average gross margins from the mid-season lamb enterprise should increase in 2009 relative to 2008.*

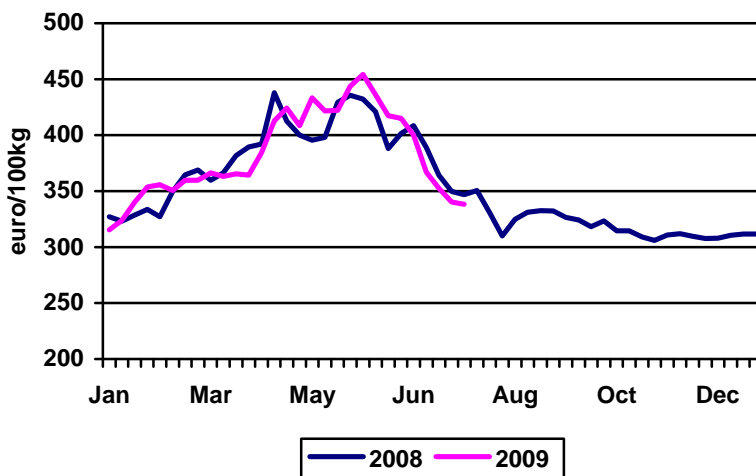
Purchased feed and winter forage account for close to 50 percent of direct costs on the mid-season lamb enterprise. Animal feed prices have been declining steadily since the autumn of 2008. With declining prices, expenditure on feed and winter forage in 2009 are estimated to be lower than in 2008. Data for the first quarter of 2009 provided by DAFF indicates that aggregate sheep feed purchases are up by over 5 percent on the first quarter 2008 level. Feed purchases are weather dependent and in the absence of deterioration in weather we expect the annual volume of feed purchased to be up on 2008 levels. However, with lower feed prices expenditure on feed by sheep producers is estimated to be 11 percent lower in 2009 than in 2008.

Pasture and forage costs account for approximately 30 percent of direct costs on mid-season lamb enterprises. Fertiliser and fertiliser spreading costs (contractor and own) look set to decrease in 2009 relative to 2008. For the year as a whole, fertiliser prices could be down by 20 percent. Overall, a reduction in pasture and forage expenditures of 22 percent is anticipated for 2009.

When total direct costs are considered the estimated decline in 2009 relative to the 2008 level is currently estimated at 9 percent.

In contrast to cattle prices, lamb prices over the first 29 weeks of 2009, have not declined when compared with the same period of 2008. Based on European Commission data on heavy lamb prices, Irish lamb prices and lamb prices in our principal export market (France) have been largely steady at their 2008 average level.

**Figure 8: Irish Heavy Lamb Price**

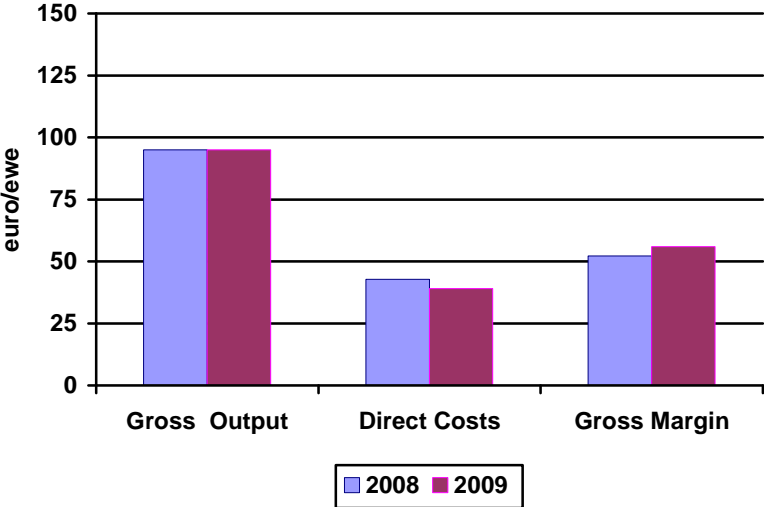


Source: European Commission

To this point in the year, Irish lamb prices are 1 percent higher than in 2009. For the remainder of the year we consider that the marginally higher level of prices may not be maintained, but we expect that gross output per ewe and per hectare on mid-season lamb enterprises should in 2009 be largely equivalent to gross output in 2008. A combination of lower direct costs and steady gross output will leave gross margins up by 7 percent on the level in 2008.

Despite increased gross margins on the main lowland sheep enterprise on average net margins on mid-season lamb enterprises (exclusive of decoupled payments) are still likely to be negative. The prospect of the re-introduction in Ireland of coupled direct payments for sheep producers under Article 69 provisions could further improve sheep margins in the future.

**Figure 9: Gross Output, Direct Costs and Gross Margin per Ewe**



Source: European Commission

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