

# Outlook 2010: Costs of Production in Farming

Kevin Hanrahan

Rural Economy Research Centre  
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Heritage Hotel, Portlaoise



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# Overview

- Background
- Interpreting price changes
- Enterprise output, costs and margins
  - What are they and how are they calculated
- Look at input prices in 2009
- Prospects for 2010
- Summary and conclusions

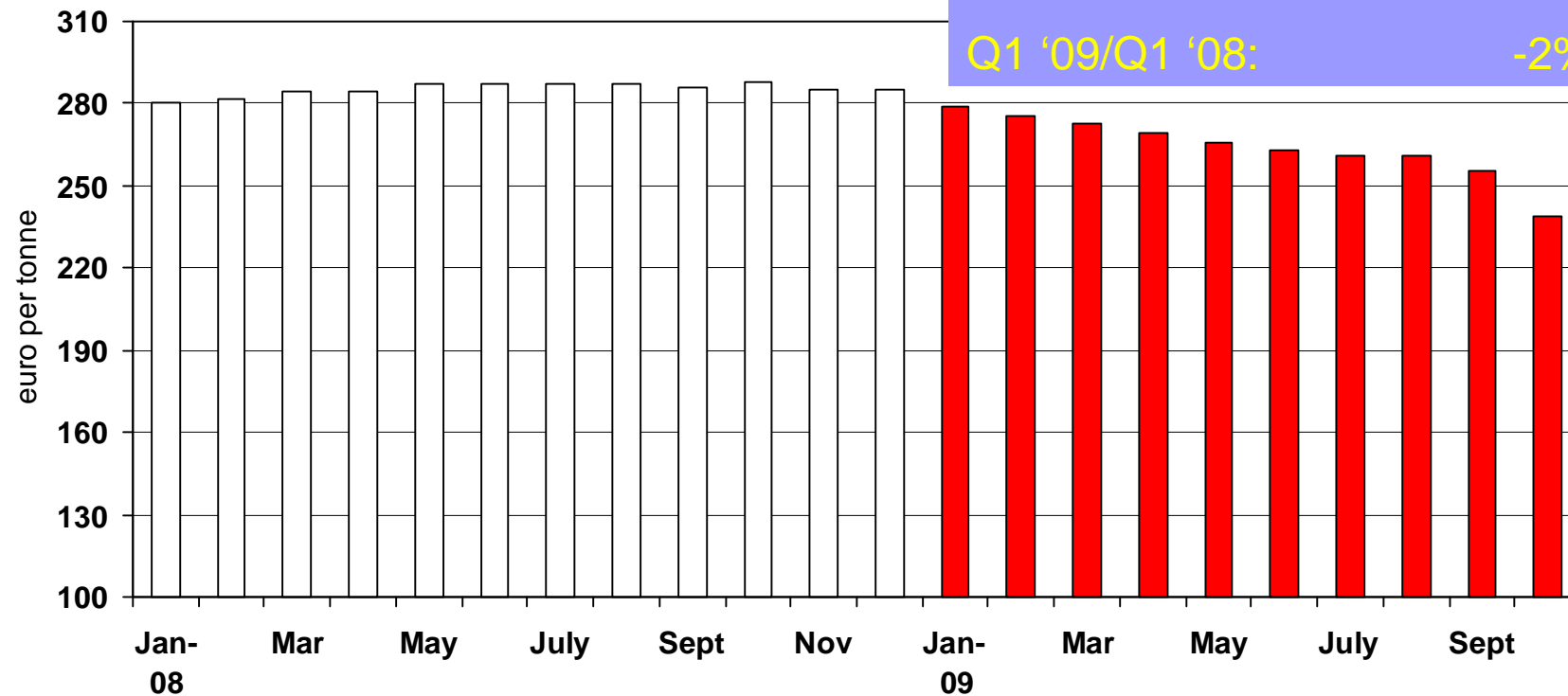
# Price Changes

- How much have prices changed in 2009?
  - Relevant price change can depend on enterprise of concern
- Type 1: Annual price changes
  - The change in average annual prices year on year
- Type 2: Changes in prices over the course of a year
  - i.e. changes in price from January to December
- Type 3: Changes in prices between two points in different years: October 2009 vs. October 2008



# Feed Price (Dairy Meal)

Annual price change: -7%  
October '09/October '08: -17%  
Q1 '09/Q1 '08: -2%

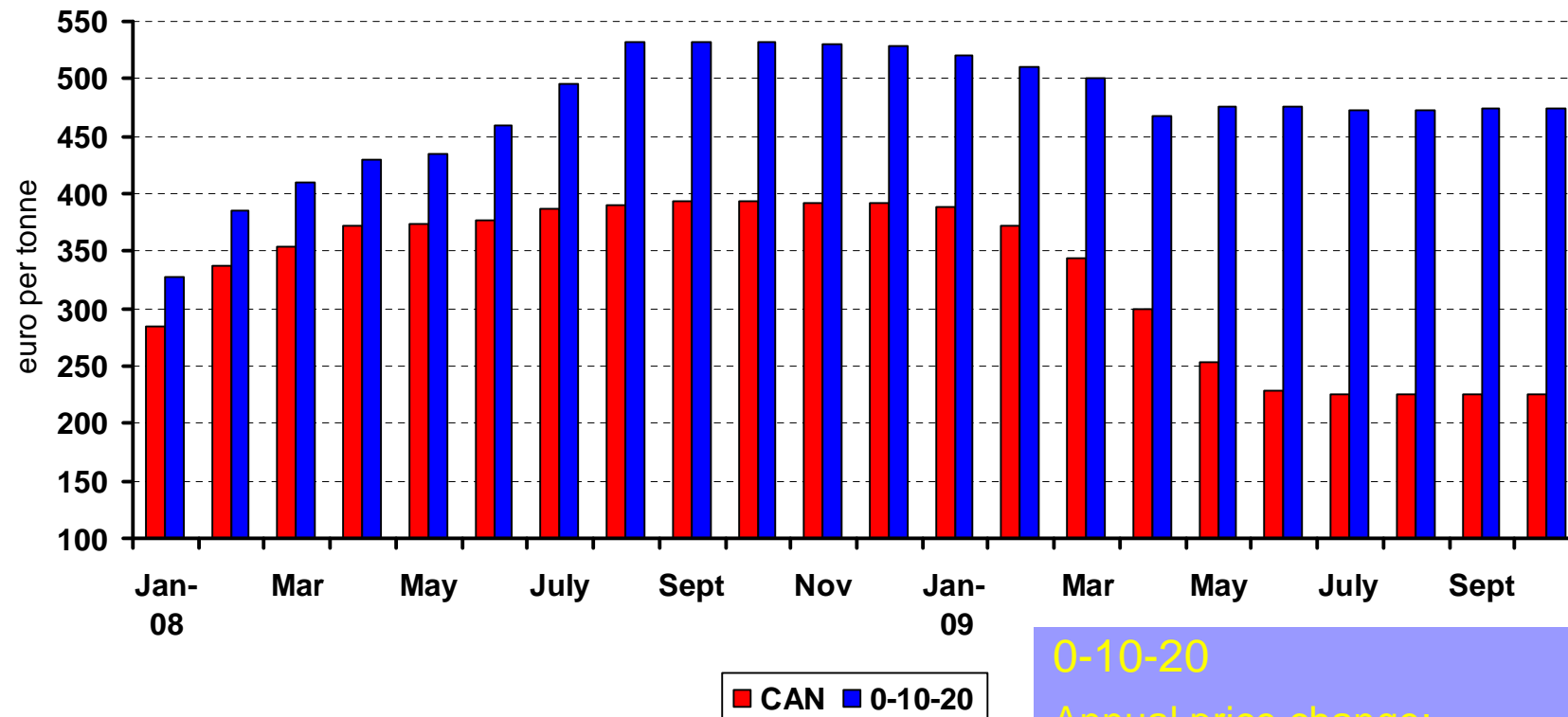


Source: CSO



# Fertiliser Prices

**CAN**  
 Annual price change: -24%  
 October '09/October '08: -43%  
 Q1 '09/Q1 '08: +13%



Source: CSO



**0-10-20**  
 Annual price change: +7%  
 October '09/October '08: -11%  
 Q1 '09/Q1 '08: +36%

# Output, Costs and Margins: A brief reminder



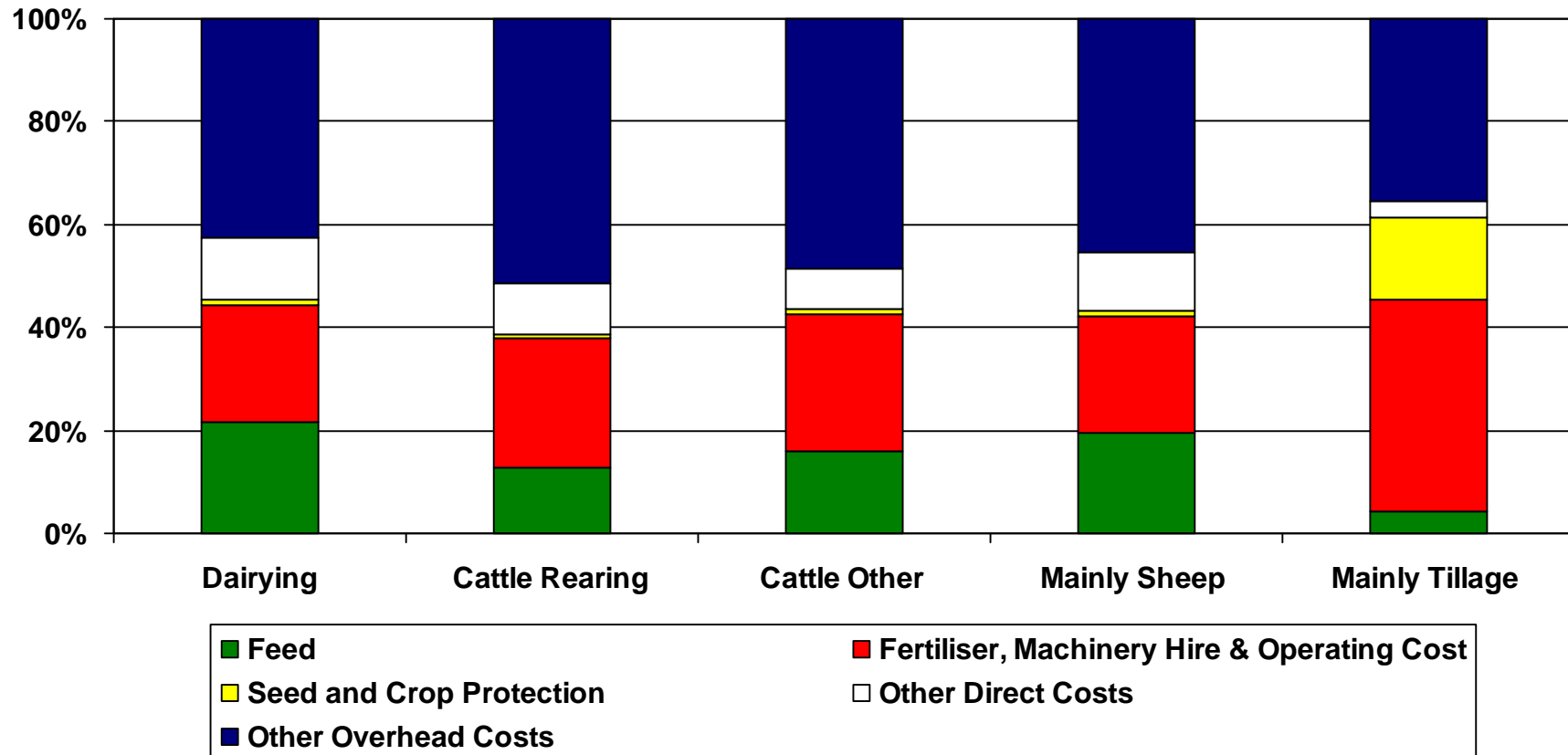
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# Output, Costs and Margins

- Enterprise Gross Output defined as
  - $(\text{Sales} - \text{Purchases}) * \text{Price}$ 
    - Excludes decoupled direct payments, includes coupled payments
- Direct Costs
  - Enterprise specific production costs
    - e.g. feeding stuffs, fertilisers, seeds
- $\text{Gross Margin} = \text{Gross Output} - \text{Direct Costs}$
- Overhead Costs
  - Costs that cannot be allocated directly to a specific farm enterprise
    - e.g. conacre, machinery and buildings depreciation, interest charges
  - Allocated to farm enterprises on the basis of their share in market based gross output
- $\text{Net Margin} = \text{Gross Margin} - \text{Overhead Costs}$

# Total Cost Shares in 2008



Source: NFS 2008



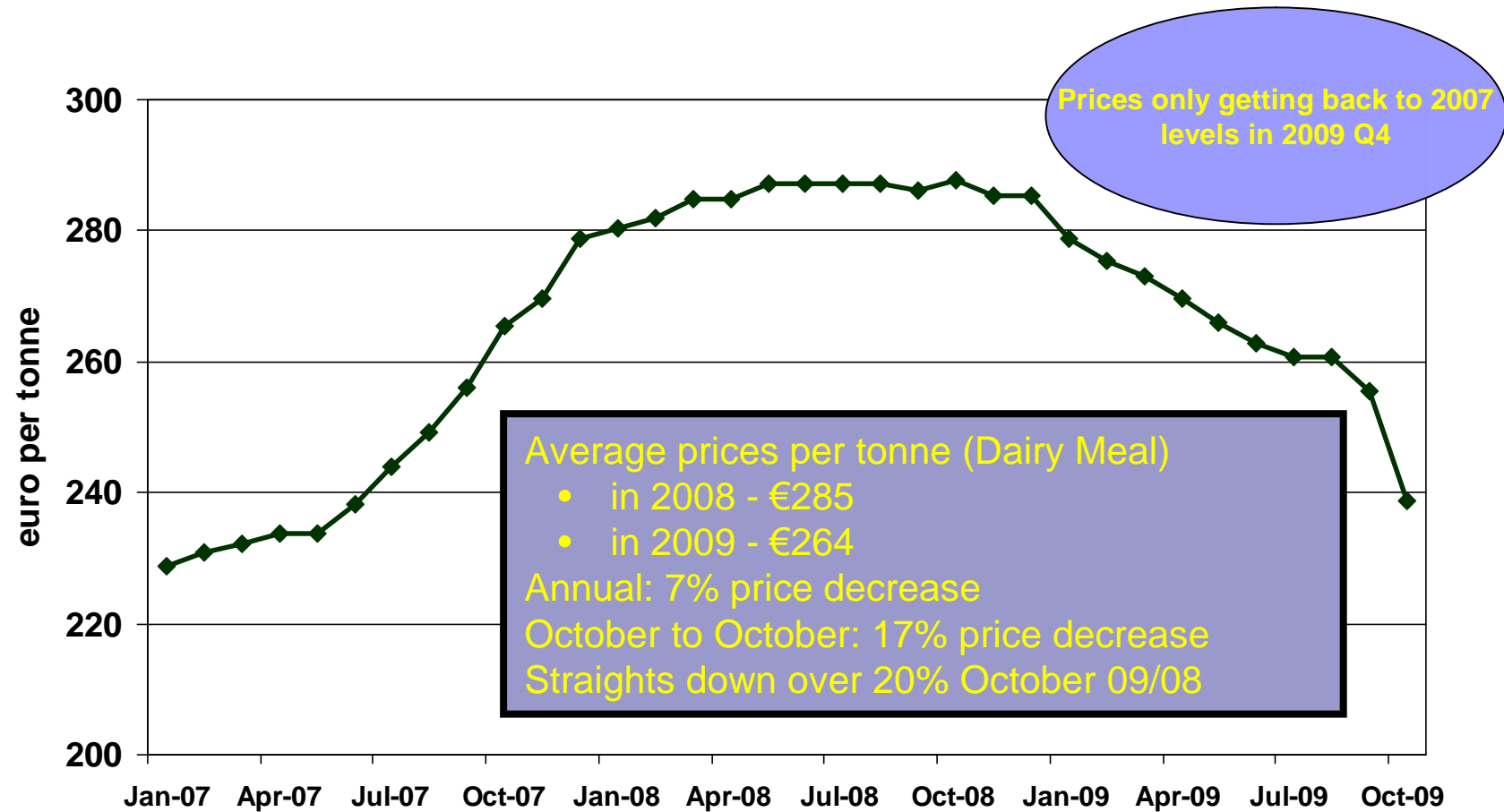
# Review of 2009



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# Feed Prices: 2007 to Present



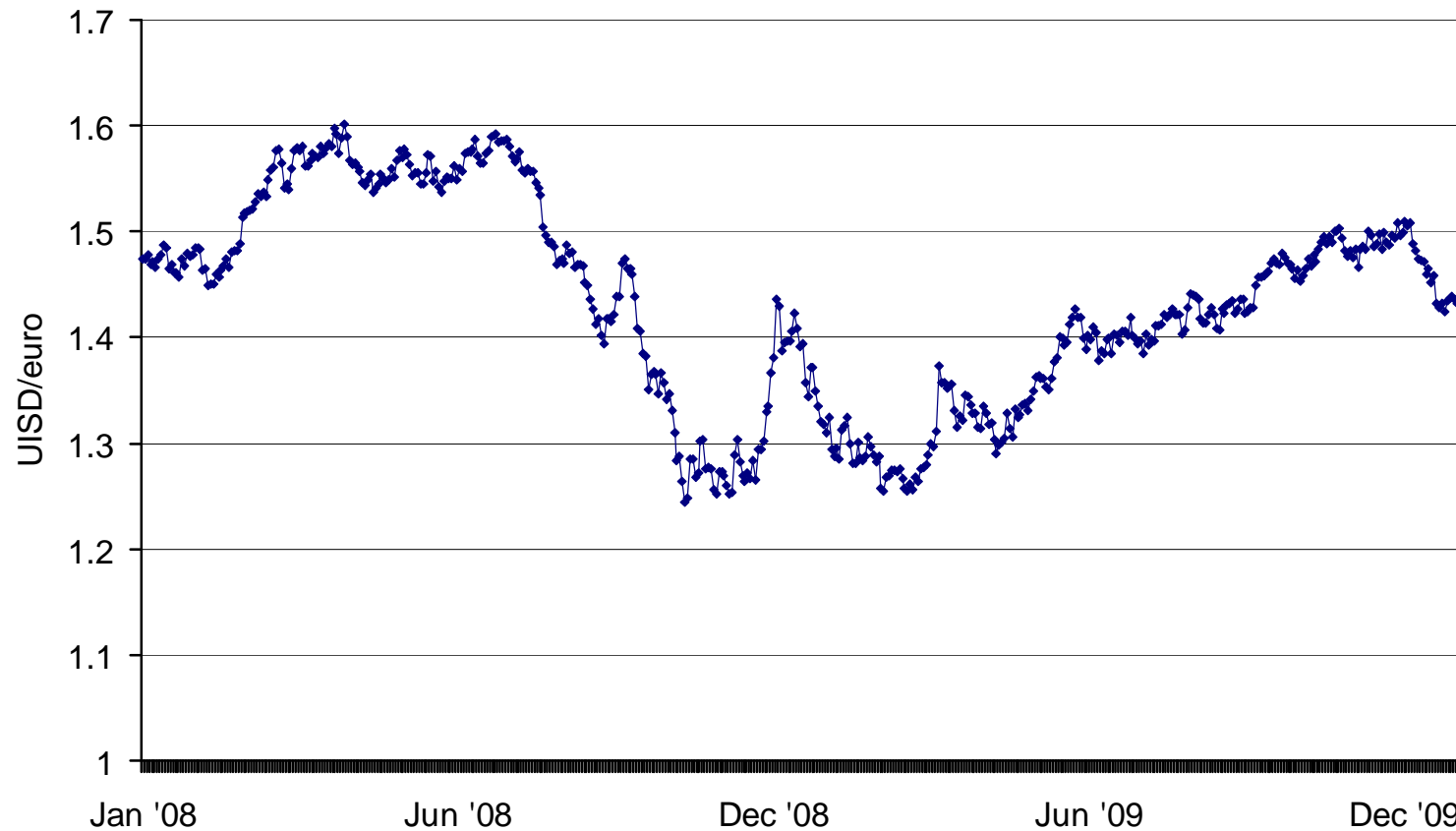
Source: CSO



# Feed Prices 2009

- Major cost item: 36% of average direct costs in 2008
- Factors pushing feed prices downward in 2009
  - Good international harvest
  - Continuing weak demand for feed and other cereal use
  - Build up of global cereal stocks
- Reductions in cereal prices in 2008 fed into reduced 2009 feed prices
  - Non cereal feed ingredients price declines not as large
  - Protein crop and ingredient prices still high
- Cereal prices drop will take time to work itself through to the feed market
- 2010 feed outlook: Prices will decline through first half of year and then begin to increase

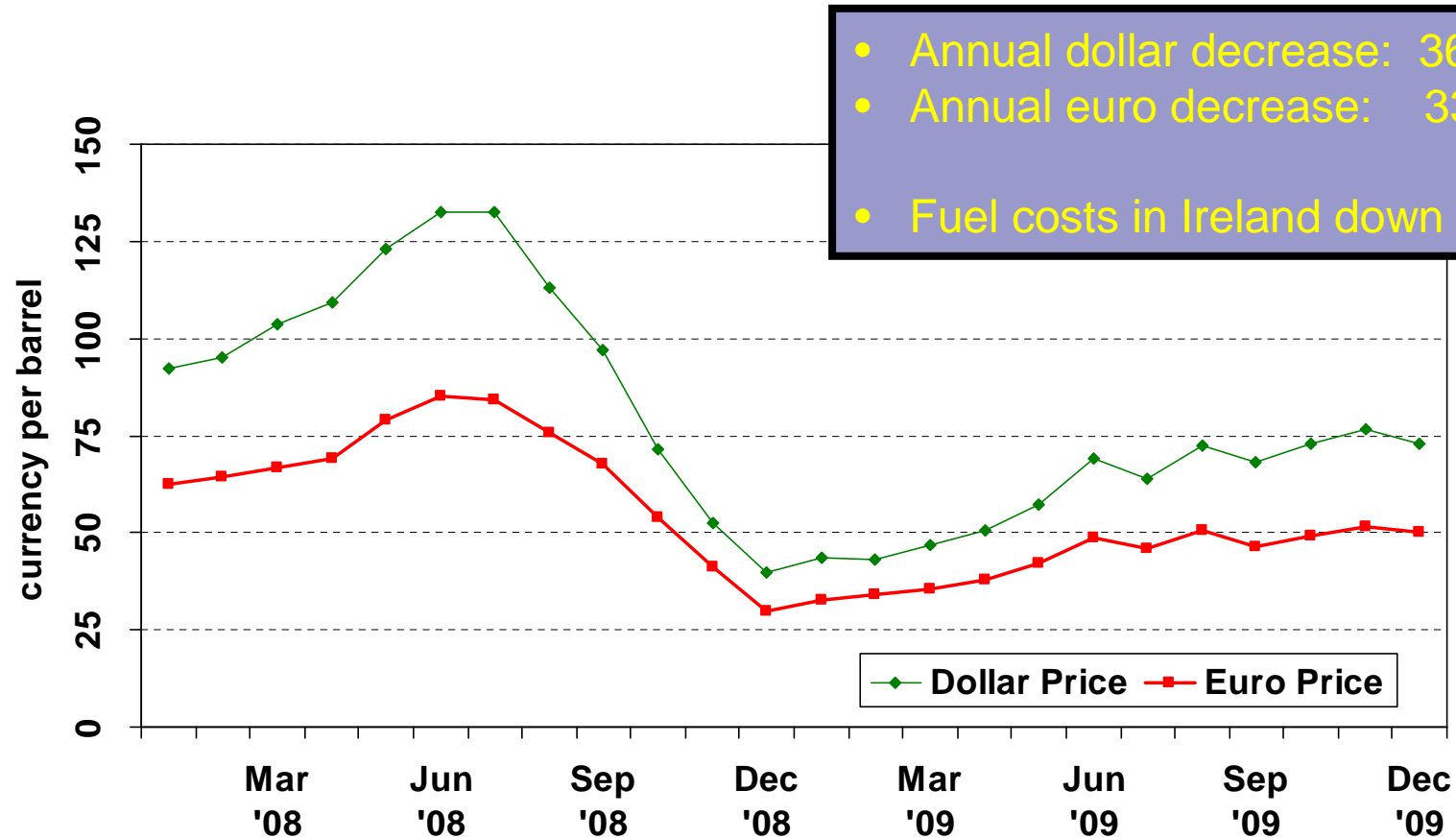
# US Dollar Euro Exchange Rate



Source: St Louis Fed



# Brent Crude Prices



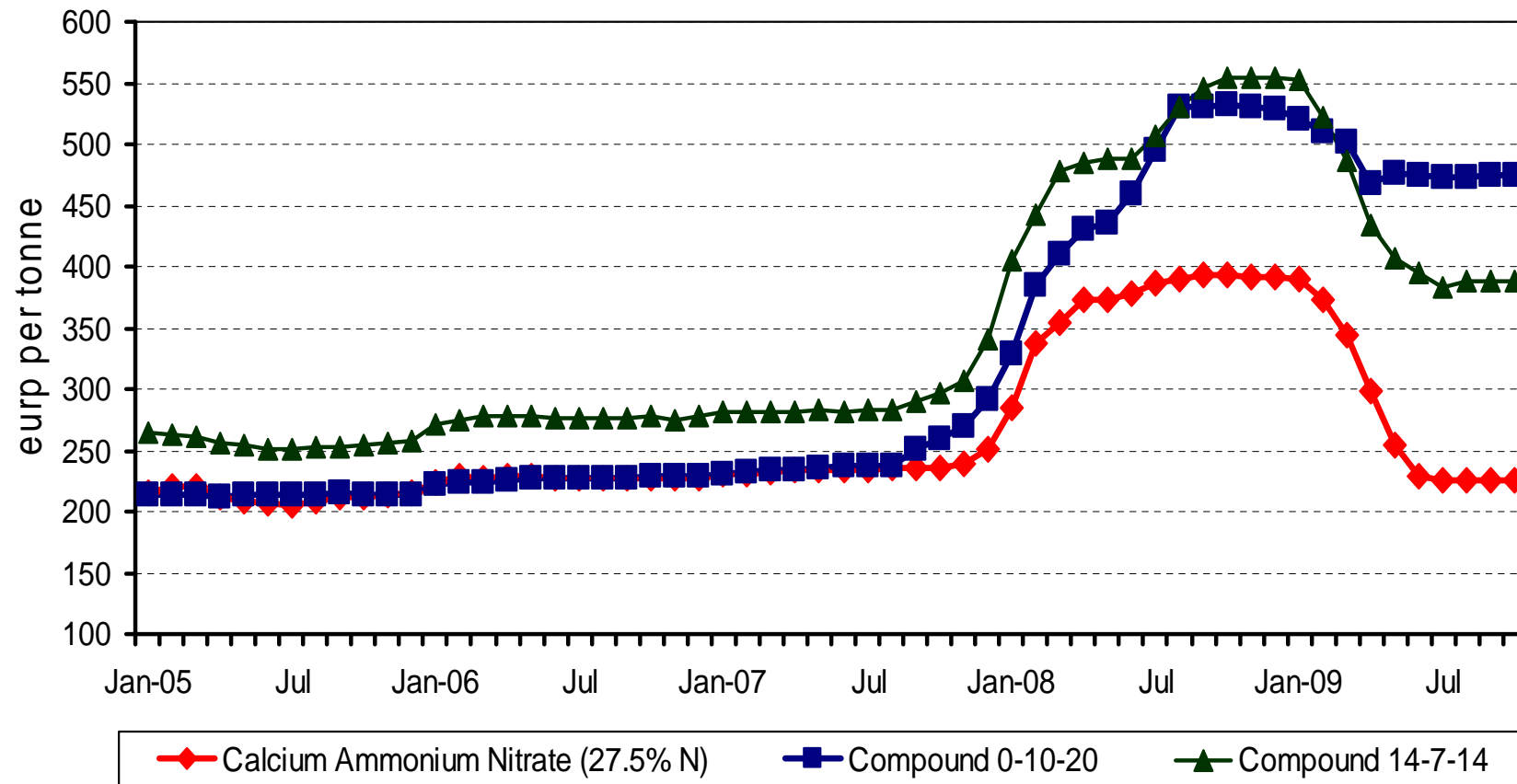
Source: St Louis Fed



# Fertiliser 2009

- Pasture and forage costs
  - Major item: about 37% of average direct costs
  - 50:50 Contractor costs and fertiliser purchases
- Contractor Costs: down 10%
  - Declining fuel prices
  - Contraction in construction has also increased supply of contractor services available to farming
- Fertiliser prices: Steady downward trend
  - Due to some weakening demand
  - Decreased energy prices
  - Continuing divergence between N and P&K price trends

# Fertiliser Prices



Source: CSO



# Electricity and Fuel in 2009

- Demand for electricity and fuel is relatively inelastic
  - Electricity accounts for relatively small share of total costs (5%)
  - Diesel costs share is larger (10%)
- Irish electricity prices regulated (CER)
  - Price increased by 3% in early 2009
  - Price were reduced by 11% in May 2009
- Average 2009 electricity price was 5% higher than in 2008
  - Electricity prices rises occurred in late 2008 and exceeded subsequent declines in 2009
- Fuel prices declined significantly with prices 14% lower in 2009

# Labour & Other Costs in 2009

- Quantity of labour and other costs is relatively price inelastic
  - Minor cost element (2.5%)
  - Volume likely to change little year on year
- Labour costs: largely unchanged in 2009
- Other input items: up by 2% in 2009

# Looking ahead to 2010



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# Feed prices in 2010

- Cereal Prices: 2009 harvest prices down 30 % on 2008
  - Cereal prices forecast to increase in 2010
- 2010 Feed Price Forecast: Price drop of 15% on 2009 level
  - Protein prices have not declined in line with cereals
- Feed usage: Weather conditions have a strong impact
  - not possible to predict weather in 2010
  - dairy feed: 5% increase in feed usage
  - beef feed: No increase in feed usage forecast

# Crude Oil in 2010

- Energy a key input for farming
- Oil futures contract prices?
  - Current crude oil futures prices average for 2010 is approx. \$80 per barrel
  - about €53 per barrel
- Average crude oil price in 2010
  - An increase of 25% on the average 2009 level
  - Increased crude oil prices and carbon tax in 2010
  - Both reflected in an increase of 10% in farm diesel price

# Fertiliser in 2010

- Factors that led to downward movement in fertiliser prices in 2009 unlikely to be present in 2010
  - Reduced production capacity internationally
  - Recovery of international demand
- CAN and Urea prices in 2010
  - Annual price forecast to be 15% to 20% higher than in 2009
  - However prices increases expected later in the year and given most purchases occur in Q1 costs should not be dramatically higher than 2009
- P & K:
  - P & K prices likely to fall in the first quarter of 2010 (when compared with Q1 2009) but increase in line with N over remainder of 2010
  - Most tillage farms purchasing/spreading P&K spread early in the year

# Energy (Electricity & Fuel) in 2010

- Electricity prices lag changes in international energy prices
- Decrease in electricity prices is unlikely given forecast increases in crude oil and natural gas prices
- We are forecasting a 10% increase in electricity prices in 2010 over 2009
  - Depends on the Commission for Energy Regulation (CER)
- Farm diesel prices forecast to increase by 10% due to increased raw material costs (crude oil) and carbon tax imposition after April



## Labour costs & general inflation in 2010

- Labour costs to remain largely unchanged
  - Economic downturn to continue into 2010
  - Unemployment rate rising to 18% in Ireland
  - Dampens wage expectations
- Economy wide inflation rate in 2009 was negative, likely to remain low in 2010

# Take Home Message

- Price of most farming inputs declined sharply in 2009
  - But, declining costs of production coincided with sharp declines in the prices of agricultural output
- Mixed outlook for 2010:
  - Some key input prices will increase (energy, fertiliser) while others will decline (feed)
  - Overall costs of production for most enterprises should fall relative to 2009.
  - Implications of lower input prices for farm profitability will depend on use and expected output prices in 2010

# Thank you



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