Outlook 2010: Costs of Production in Farming

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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)

Source: CSO

Annual price change: -7%
October ‘09/October ‘08: -17%
Q1 ‘09/Q1 ‘08: -2%
Fertiliser Prices

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

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

Source: CSO
Output, Costs and Margins: A brief reminder
Output, Costs and Margins

- Enterprise Gross Output defined as
  - \((\text{Sales} - \text{Purchases})\times\text{Price}\)
    - Excludes decoupled direct payments, includes coupled payments

- Direct Costs
  - Enterprise specific production costs
    - e.g. feeding stuffs, fertilisers, seeds

- Gross Margin = Gross Output – 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

- Net Margin = Gross Margin – Overhead Costs
Total Cost Shares in 2008

Source: NFS 2008
Review of 2009
Feed Prices: 2007 to Present

Average prices per tonne (Dairy Meal)
- in 2008 - €285
- in 2009 - €264

Annual: 7% price decrease
October to October: 17% price decrease
Straits down over 20% October 09/08

Prices only getting back to 2007 levels in 2009 Q4

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 week 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

- Annual dollar decrease: 36%
- Annual euro decrease: 33%
- Fuel costs in Ireland down 14%

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

Calcium Ammonium Nitrate (27.5% N)  Compound 0-10-20  Compound 14-7-14
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
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, price 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