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AGRI-ECONOMIC BULLETIN



Edited by Eoin Lowry and Phelim O'Neill

Agriculture a key sector to economy

I am delighted to introduce the second edition of the Agricultural Economics Bulletin, produced by my colleagues Phelim O'Neill and Eoin Lowry and with considerable input from economist Ciaran Fitzgerald, well known from his time in IBEC.

This publication is designed to bring the message of the importance of agriculture and the agri-food industry to a wider audience than typical readers of the *Irish Farmers Journal*.

As we exit recession, there is a danger of drifting back to the Celtic Tiger-era syndrome of seeing foreign direct investment as the holy grail for the Irish economy. It is important, but in truth the core benefit of such investment is the employment that is created. Raw materials and profits come from and are repatriated elsewhere.

In agriculture, the cow that calved in any parish in Ireland has its milk processed locally and usually sold abroad. Wealth and value are created and added in every townland in the country, not just around the M50, and export revenue and profits are typically re-invested locally.

We are bringing this message and updates on performance of the various sectors that make up our industry to you in this edition. We encourage you to peruse it, and we welcome any feedback or views that you have.

Justin
McCarthy
editor and
CEO of the
Irish Farmers
Journal

By economist Ciaran Fitzgerald

.The investment

Financing growth in Ireland's agri-food sector

Ireland's low corporation tax regime has given the IDA and successive governments an unbeatable financial offering to help secure investment from large foreign multinational companies. Unfortunately, under current EU state aid rules, the Government does not have an equivalent suite of unbeatable incentives to encourage investment by indigenous companies, particularly those in the food sector.

The food sector accounts for 60% of Irish manufacturing exports and even

more significantly spends over €20bn on raw materials and services in the Irish economy. As explained in a previous issue of this bulletin, the multiplier impact of agri-food and drink growth and investment is four to five times greater in terms of direct and indirect employment than foreign direct investment. So, despite the fact that growth and ongoing investment by large indigenous food companies in the agri-food sector are hugely supportive of jobs and economic activity across the regional Irish economy, Ireland's industrial development policy does not have an equivalent level of support for these companies.

Investment costs and rates of return in food production and food process-

problem

ing have always been problematic. The agri-food sector has always been characterised by relatively high capital requirements yielding positive but relatively low and long-term returns. Right up until 2007/2008, the specific challenges of investment in the agri-food processing sector were addressed through the FEOGA EU funds that allowed for up to 40% of capital expenditure to be supported by member states.

Indeed, in the 1980s and 1990s, the FEOGA allowed for up to 75% funding of food processing facilities in disadvantaged areas, with money coming principally from central EU funds.

The latest set of state aid rules were published in 2014 in the midst of the

ongoing recession in the EU. They reflect a non-interventionist, austerity-based mindset that has severely constrained if not completely undermined the capability of Enterprise Ireland and other industrial development authorities to provide meaningful capital support for growth projects in food and agriculture.

Moreover, the challenge of access to cost-effective bespoke finance reflective of the specific needs of the sector has not been diminished, but exacerbated throughout the banking crisis.

What is doubly unfortunate, given the non-interventionist state aids mindset, is



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AgriBusiness Editor

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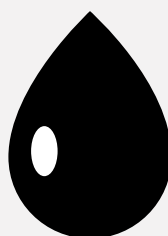
that the abolition of milk quotas has created an opportunity to expand and grow the dairy sector, with knock-on effects in beef and other sectors. As a consequence, there is an opportunity for growth and demand for finance that has not existed for 30 years.

Another aspect of the abolition of quotas and reduction in market supports as part of the post-quota policy, which requires innovative financial instruments, is price volatility. Unfortunately, the Irish banking sector, as identified in numerous reviews of SME lending (not least the report on lending to the consumer foods sector by IBEC/FDI), has not responded to the new demands of the sector either in terms of loan costs or flexibility. In fact, surveys of EU-wide SME lending costs show that Irish SMEs, including farmers, are paying a significant premium above the average EU borrowing costs rates, notwithstanding the fact that banking finance is available at all-time low rates. Thankfully, through its MOU with the European Investment Bank, the European Commission under Commissioner Hogan has recognised the need for new and innovative sources of finance. Furthermore, from an Irish perspective the national pension fund NTMA/ISIF has prioritised the agriculture and food sector.

The EU rules on state aids are due for review in 2016. Is there an appetite at national and EU level to better align these rules with the needs of a still-stagnating EU economy? Is there an appetite to develop an industrial development support policy that is as supportive of domestic indigenous enterprises as our corporate tax policy is of large multinational companies?



Surveys of EU-wide SME lending costs show that Irish SMEs, including farmers, are paying a significant premium above the average EU borrowing costs rate



oil & food

With lower oil prices likely to last throughout 2016, the effect on costs of production and global food prices is worth considering. There is a significant number of positives and negatives from the low oil price for the Irish agri-economy. One of the key issues is the impact of low oil prices on demand, particularly for dairy products from countries whose food demand is driven by oil returns.

As the chart opposite from the FAO shows, low oil prices would seem to coincide with declining global food prices. This is particularly relevant for Middle Eastern, north African and west African countries. Much of the analysis of the impact of oil prices focuses on the effect of lower prices on agricultural input costs. Oil price falls reduce food production costs through their impact on inputs such as chemical fertilisers, fuel and transportation costs. At the same time, lower oil prices change the relative profitability of biofuels that use coarse grains and vegetable oil for production, and therefore reduce the pressure that biofuels have on the demand of food commodities and agricultural land.

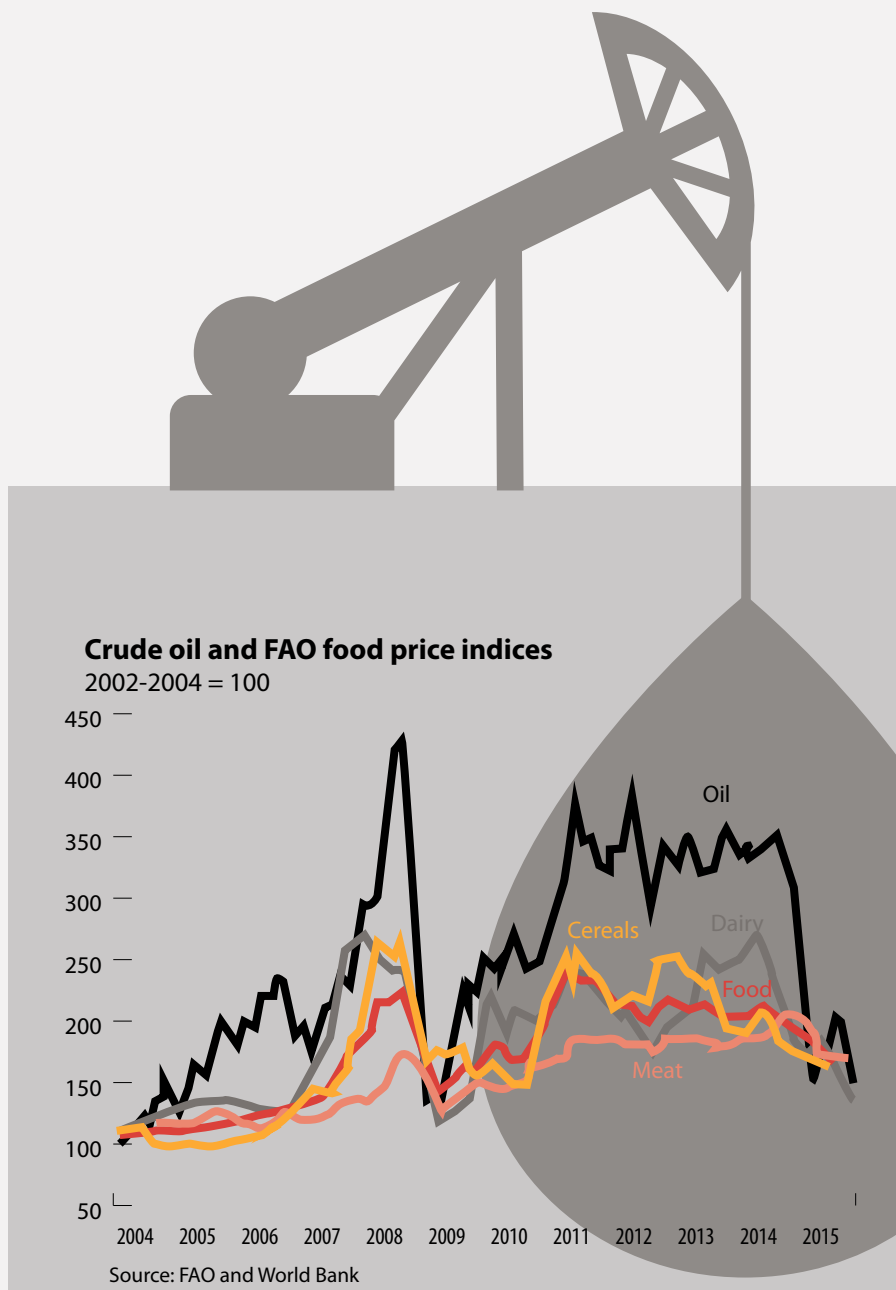
From an Irish grass-based production perspective, the impact of lower oil

prices in reducing the cost of fertiliser is welcome. However, the impact of lower oil prices in terms of lower animal feed costs means greater net benefits on the production of food from systems based on grain and animal feeds.

Impact of lower oil prices on the EU agricultural market outlook

A recent study from the European Commission published in April found that world and EU prices of agricultural commodities are lower compared with previous (baseline) projections. This is due to the reduction in production costs allowing farmers to lower their selling prices and stimulating crop production worldwide, which results in lower output prices. EU price declines ranged between 5% for milk to 10% for wheat on average compared with the earlier normal oil price predictions. Given the lower oil price, production costs and in particular energy and energy-related costs, but also feed for animal products, contract to a larger extent than output prices, resulting in slightly improved income at sector level,





in particular in the longer term.

The analysis also looked at the impact of a continuing decline in the euro/dollar exchange rate on prices. The depreciation of the euro compared with the US dollar in 2015-2017 has two main effects – an increased EU competitiveness stimulating higher exports in the short term, but at the same time a limiting of the positive impact of cheaper imports (in particular energy prices) compared with our competitors. Therefore, the decrease in EU producer prices is lower than observed worldwide in 2015-2017.

Dairy: Lower oil prices and the deterioration of the Russian economic environment contribute to a lower import demand in main export markets and lead to lower milk prices compared with the baseline projections. Average EU milk prices are now projected to remain around 33c/litre in the first years, recovering only in the medium term. However, over the medium term, cheaper feed and lower energy input costs allow for maintaining or even improving producers' margins as milk price declines to a lesser extent than input costs.

As a consequence, milk production remains almost unchanged.

Lower oil prices = lower global food prices?

An impact of falling prices that is not always considered is the effect low oil price returns have on the affordability of food in countries that are depending on oil dollars for their purchasing power. In the case of the Chinese and Indian economies, the view is that declining oil prices contribute to improved global demand, including for food. The net effect on food prices is, however, hard to predict because declining costs and demand factors work in the opposite direction of increasing demand.



**The decrease in EU
producer prices is lower
than observed worldwide
in 2015-2017**

Farming benefits from Brazilian economic turmoil

Eoin Lowry

Irish Farmers Journal
agribusiness editor

As the country edges into recession, farming is booming in Brazil thanks to the falling Real.

Brazil was once among the fastest-growing large countries in the world, booming at China-like growth rates of more than 7.5% only five years ago. This year its economy is predicted to shrink by 2.8% and next year it is expected to suffer a further 1% contraction. Unemployment runs at about 7% and central bank interest rates are at 14%. The government and president have little support.

However, the financial and political turmoil is contributing to one of the best years ever for domestic farmers. In the past, one US dollar bought 2.5 real; today it buys four real. The weaker currency is boosting exports for the largest producer of sugar cane and the second-largest producer of cattle and soyabean in the world. Farmers are feeling the direct benefit and are still ahead despite the global com-

modity prices being back.

Agriculture, which accounts for 23% of Brazil's economy and 40% of its exports revenue, is expected to rise to a sixth straight annual record this year and grow again in 2016. While soyabean futures fell 14% this year in the US, touching the lowest levels since 2009, prices in real rose 23%. This is boosting soya plantings across Brazil rather than contracting them as would have been expected with the global price drop.

Beef export sales are also receiving a boost, despite lower volumes and lower global prices since this time last year. But the weaker currency is making the cost of imports such as farm equipment and crop inputs from overseas far more expensive. Fertiliser sales are almost 7% back and sales of machinery have fallen by more than a third.

There is no doubt that Brazil will the country to watch in 2016, particularly for beef. While it may not be a direct threat to Irish beef, as they focus on growing demand in China and look set to regain access to the US market, this could displace competing regions, having a negative effect on the price of beef.



Downward turn in global dairy prices

Jack Kennedy

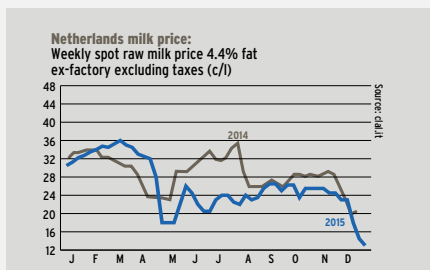
Irish Farmers Journal
dairy editor

2015 saw a significant swing downward in global dairy commodity prices. On average, Irish dairy farmers will have received about 30c/litre for milk in 2015. On average, milk price has ranged from 33c/litre at the start of the year to 24c/litre in November/December. Irish processors have also supported milk price to the farmer since the middle of the year, which will reduce balance sheet profits.

Favourable currency exchange rates have helped Irish milk prices as almost 90% of Irish dairy product is exported. The fact that the euro to US dollar rate went from \$1.40 in January to \$1.09 more recently shows the extent of the swing from one end of the year to the other.

However, on the downside, the price of Brent oil has dropped from over \$100 per barrel in January 2015 to less than \$40 per barrel by mid-December 2015. This has the effect of dampening demand for dairy product in the oil-producing countries.

On a global scale, the buoyant US economy drove the US to the top of the EU export market for butter and cheese. The firm trade for butter and cheese in the US has resulted in a current price



of 35.3c/litre equivalent for US dairy farmers. This contrasts with the latest EU November milk price of 30c/litre and 23c/litre for New Zealand.

The reason for the large differences is mainly supply and demand driven. EU milk supply is up 1.5% year on year and demand is down. The most notable drop in demand for dairy product has come from China. The reduction in Chinese imports of whole milk powder (down 52% for the same period 2014 to 2015) is driving the WMP product price down. The dairy sector has seen a reduction on a scale nobody saw coming as 621,000t of Chinese powder imports in January to October 2014 have dwindled to 300,000t for the same period in 2015.

Global markets need to see a reduction in EU supply and a further reduction in New Zealand milk supply before market sentiment is expected to recover.



Beef

Challenging market conditions ahead

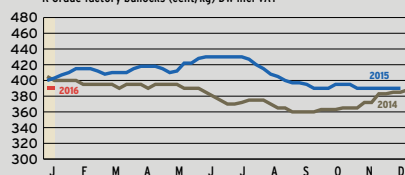
Phelim O'Neill

Irish Farmers Journal markets specialist

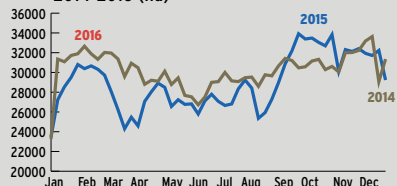
The year 2015 closed with Irish farmgate prices coming off a record differential with their UK counterparts at €1.11/kg, amounting to €400 on a typical 360kg beef carcass. This closed somewhat as the year ended due to falling UK prices. Elsewhere, Irish beef performed well compared with mainland European trading partners, with only Germany ahead of Ireland at €3.99/kg compared with €3.78 in Ireland, €3.71 in France, and €3.57 in Italy. In terms of production, the major change was the decline in live exports of 55,000, accounted for by the decline in store and weanling trade to Spain and Italy, both of which were weak markets in 2015. The decline in calf exports accounted for 16,000 of this, with new disease restrictions making it impossible to send Irish calves to Belgium, previously the main customer.

The number of cattle processed in Irish factories was down, but at around 63,617 head on the recent high of 2014, not the 150,000 that had been expected. This means that either more are carrying over or, more likely, cattle have been killed younger this year, reflecting the outstanding animal performance. Export

Factory bullocks: Under 30 months
R Grade factory bullocks (cent/kg) DW incl VAT



Weekly cattle slaughtering
2014-2016 (hd)



markets have continued to grow, with 1,500t of high-value muscle cuts exported to the US and 500t to Japan. However, the absence of manufacturing beef approval to the US has been a missed opportunity for Ireland at a time when US prices were at record highs, up to €1/kg higher than EU averages. Trade discussions with the US through TTIP and Mercosur with South America plus the return of Argentina to international markets with change of Government all suggest tough market challenges lie ahead.



Sheep

Seasonal price rise slower to kick in

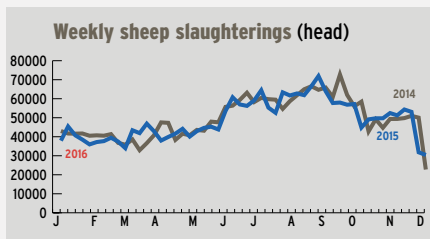
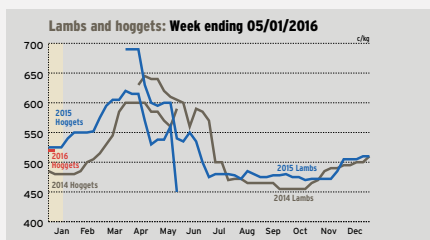
Darren Carty

Irish Farmers Journal livestock specialist

Lamb prices in the last quarter of 2015 averaged 10c/kg to 20c/kg ahead of 2014 and 2013 during October.

The seasonal price rise as the year drew to a close was, however, two to three weeks slower to kick in compared with last year. Prices crept upwards from mid-November and have settled around €5/kg in recent weeks, on a par to 2014. Throughput was running slightly behind 2014 levels in October but has marginally exceeded year-earlier levels in recent weeks. This occurred on the back of farmers responding to strong factory purchasing activity and also moving lambs to cope with torrential rainfall and rapidly deteriorating ground conditions.

The yearly kill at mid-December was running 5,000 head above 2014 levels. Breeding sales concluded with mixed results. Breeding ewes remained a solid trade until the end of sales but hoggets continued to be a difficult trade. Reports suggest a combination of an oversupply of hoggets and fewer producers seeking replacements cast a shadow over the trade. The year drew to an end in difficult conditions for primary producers with



grass supplies diminishing much faster due to poor grazing conditions. Many farmers have been forced to house ewes earlier or introduce supplementary feeding. Where concentrates are required at this stage of the year for mid-season lambing ewes, farmers enter 2016 facing higher feed costs. On a positive note, scanning operators report the first mid-season lambing ewes scanning favourably, with comparably high litter sizes and a tight lambing spread. This builds on positive scanning results in early lambing flocks.



Grain

Heavy grain stocks weigh on market

Andy Doyle

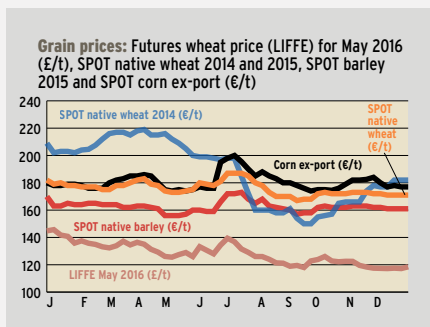
Irish Farmers Journal
tillage editor

The global crop sector entered 2015 on the back of a record 2,013m tonne global harvest in 2014. This resulted in an increase in global grain stock levels from 407m to an estimated 444m tonnes coming into the current harvest.

And with another big harvest projected, these stock levels have come to weigh on the market and depress price levels. Many growers around the world face another year of below-cost production if this situation continues.

Lower price levels have been a feature of the market since last harvest and this continues to pressure producer margins around the world. This is partly the reason why crop acreages reduced for 2015, especially maize area in the US, but greening requirements in the EU also affected the crop acreage makeup as growers were forced to have a range of crops on every farm to meet the crop diversification requirement.

The spring growing season was untypical in many parts of the world and it led to output concerns. Drought and heat were problems in some areas, while excessive rainfall continues to generate output uncertainty, especially for maize, in parts



of the US midwest. Market conditions remain very volatile as a consequence. Occasional price hikes occurred which provided growers with a forward selling opportunity and some took this.

Looking towards prospects for the year ahead, it would seem that the global small grains harvest will be good in most regions, with drought having a significant negative impact in a few countries.

The bigger maize harvest is much more uncertain. Maize output, especially in the US, can still have an impact on production and on price sentiment. The wet conditions will have an impact on overall output, but it is possible that what is not negatively affected could be positively impacted because, in general, rain makes grain.



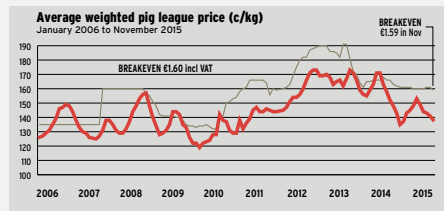
Difficult times for pigmeat producers

Deirdre O'Shea

IFA pigs specialist

At the end of 2015 there were about 150,000 sows in Ireland, with an average herd size of 540 sows. The number of commercial pig production units is 416, owned by about 300 farmers.

The number of commercial farmers has fallen in recent years following tight margins and increased volatility in the sector. To date in 2015, the average pig price is €1.48/kg DW (including VAT), significantly below the previous five-year average of €1.62/kg. With pig prices falling 11% versus 2014, this is the lowest pig price since 1999, a year when slaughtering capacity proved a major issue. Current pig prices are ranging from €1.37/kg to €1.40/kg, while average production costs are €1.60/kg. This 20-23c/kg deficit is not sustainable in the long term. The margin over feed for the past 12 months averaged €0.37/kg DW, down 25% on the 2014 level. Teagasc estimates this figure needs to be €0.50/kg in order to break even. Feed currently constitutes 71% of the total cost of producing a kilogramme of pigmeat, with non-feed inputs contributing the remaining 29%. The composite feed price to date in 2015 is €303/t, down 4.5% compared with 2014. Farmers continue to increase efficiencies, despite



considerable economic constraints.

These increased efficiencies are reflected in the rising number of pigs produced per sow per year, increasing to 25.3 in 2014. This in turn has contributed to the output of pigmeat per sow per year increasing to 2,052kg. The home market consumes 50% of production and our main export market is the UK, while China and other Asian markets are becoming increasingly important for our product. Exports for the first six months of 2015 increased 12.5% (volume), while value of exports increase just over 7% (Jan-July). Russia used to be a major world pork buyer, but in 2015 its pork imports were estimated at just 200,000t. The net reduction in Russian demand has dramatically affected world pork markets, forcing large exporters such as the US and the EU to compete aggressively for new business. In 2013, Ireland exported over 17,000t of pigment to Russia and the introduction of the import ban in 2014 has significantly affected farmgate prices here.

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