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Mid Year Outlook for Irish Agriculture: 2012

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Teagasc

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1. *Introduction*

In general 2011 was quite a good year for farming with incomes rising in most sectors as farmers benefited from the favourable market conditions for dairy, beef and sheep in particular. The pig sector was an exception as high feed cost and stagnant pig prices gave rise to losses in the sector.

The increase in farm income in 2011 will not be sustained for all farm sectors in 2012. Incomes will be adversely affected by an increase in feed prices and fuel costs. Summer rainfall levels have been well above normal in many regions of Ireland and this is affecting a range of farm activities including silage making, slurry spreading, spraying and even grazing in some locations. Expectations are that yields will be adversely affected in the tillage sector and that production costs may rise in the grassland livestock sectors and the pig sector.

This publication supplements the more detailed Teagasc Outlook produced in January 2012. It begins with a summary of the Irish and global macroeconomic situation. Following this, a review of the developments on the main agricultural input and output markets in the first half of 2012 and forecasts for the latter half of 2012 are presented. Together with predictions on the volumes of inputs used and output produced, gross margin forecasts for the various faming sectors are presented.

2. Macroeconomic Situation

Recession or slowing economic growth across the global economy remains a threat to agri-food markets in 2012. However, recent reports by Rabobank suggest that growing consumption in emerging economies is likely to offset relatively depressed demand from the developed world, and that demand for food products is likely to remain strong. Rabobank also anticipate that lower than average stock levels of many agri-food commodities will support prices and while harvests are expected to be large, the global supply response is still catching up with demand.

In the Eurozone uncertainty associated with the capacity of some Eurozone members to manage their debt obligations has continued throughout 2012. This has led to a weakening of the euro against both the US dollar and sterling, which has in turn improved the competitiveness of Irish exports to the UK and to third country markets. Overall, the rate of food consumption growth remains weak in the EU.

3. Input Expenditure

In general the direction of input prices in 2012 is upward. Higher feed prices reflect rising cereal prices associated with a lower than expected grain harvest in 2012, while higher fuel prices are due to the weakening of the euro versus the US dollar.

Concentrate Feeds

In spite of the moderate harvest price of 2011, feed prices have been on the rise in 2012. The feed price rise is being driven by low grain stocks levels and a deteriorating outlook for grain harvests in key production regions in 2012, notably in the US, where drought conditions are now a serious problem, and also in the Black Sea region where dry conditions look also set to negatively impact production volumes.

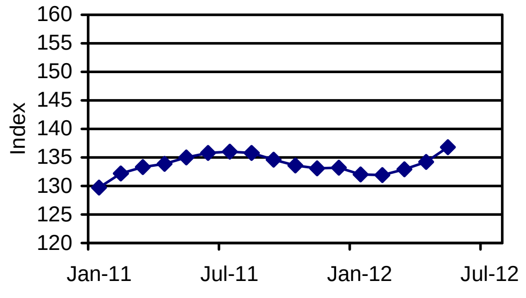
The feed price outlook for the rest of 2012 will primarily depend on the impact adverse weather conditions have on harvests across the Northern Hemisphere. In much of northern Europe rainfall levels are negatively impacting on cereal yields which may further depress global cereal production in

2012. An increase of more than 20% in cereal prices in 2012 relative to 2011 is now a possibility. This is likely to result in a 15% increase in Irish feed costs in 2012 relative to the average level in 2011.

DAFM data indicates that dairy feed sales volumes were down about 5% in the first quarter of 2012 and that beef feed sales were down 15% in the same period. These reductions can be attributed to mild winter conditions, good fodder availability and lower than normal milk production to limit the superlevy obligation in the 2011/12 milk quota year.

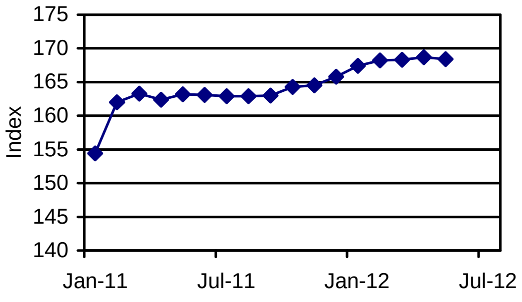
Below normal grass growth and difficult grazing conditions have been a feature at various points in the second quarter of 2012 and while official data are not yet available, it is likely that feed usage will have been above normal for this period. For grazing livestock the outlook for feed usage in 2012 as a whole remains weather dependent and may also be impacted by rising feed prices. Overall, feed volumes could increase in 2012 by 10% dairy and beef farms. The combined effect of rising feed prices and additional feed usage will lead to a forecast increase of about 25% in feed expenditure and this figure could be subject to quite an amount of farm specific variability due to localised weather factors.

Figure 1: Monthly Irish Feed price index



Source: CSO

Figure 2: Monthly Irish Fertiliser price index



Source: CSO

Fertiliser

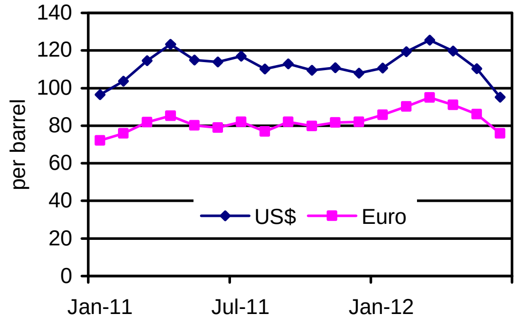
In the first quarter of 2012 fertiliser prices have risen relative to the corresponding period in 2011 and the outlook for the remainder of 2012 is for prices to remain largely unchanged. This outcome would represent an increase in the annual average price in the order of 5% in 2012 relative to 2011. Usage levels are expected to remain more or less unchanged despite the rise in costs, increasing total expenditure on fertiliser by 5% on the 2011 level.

Energy

Brent crude oil prices have fluctuated considerably so far in 2012. In the first quarter of 2012 concerns about oil exports from the Middle East drove prices over $120 per barrel, but prices dropped below $100 in the second quarter following renewed concerns about the global economy. Taking futures prices into consideration, an annual average price of $108 per barrel for Brent crude in 2012 looks possible, which would be broadly in line with the price level in 2011 and consistent with our January 2012 Outlook. However, farm diesel prices in Ireland have risen in 2012 due to the depreciation of the euro versus the dollar and if this euro weakness persists, then the average Irish fuel price in 2012 is likely to be about 8% higher than in 2011.

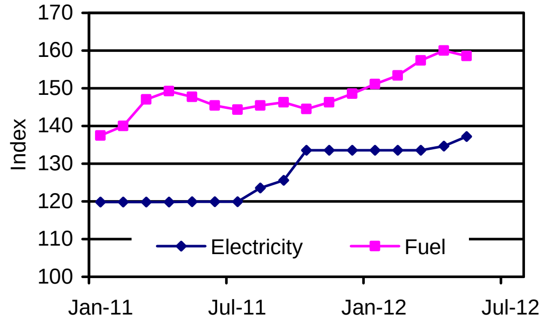
Irish electricity prices have been unchanged since the increase in October 2011. While a reduction in prices may take place towards the end of 2012, it is likely that average electricity prices for 2012 will be about 8% higher than in 2011.

Figure 3: Brent Crude Oil Price



Source: St Louis Fed

Figure 4: Indices of Fuel and Electricity Price



Source: CSO

Other Direct Costs

Inflation in other direct cost items continues to be flat and is in line with projections made in our January 2012 Outlook. One exception to this generally flat outlook for other costs is in relation to crop protection. While CSO statistics so far in 2012 show a relatively benign picture in relation to crop protection costs, industry reports indicate that crop protection expenditure has increased by approximately 10% in the current year. This increase in expenditure is due mainly to additional applications at higher rates due to recent weather conditions.

4. Output Value

2012 is likely to be a year of mixed fortunes for the various farm sectors. Dairy product prices have been falling for over 12 months, while beef and pigmeat prices have risen and sheepmeat prices have remained stable. Tillage farmers can expect a substantial increase in 2012 harvest prices for grains relative to 2011, but this must be set against the likelihood of a significant decline in yields. In the following sections the developments on the main agricultual commodity markets will be reviewed and the outlook for the remainder of 2012 will be presented.

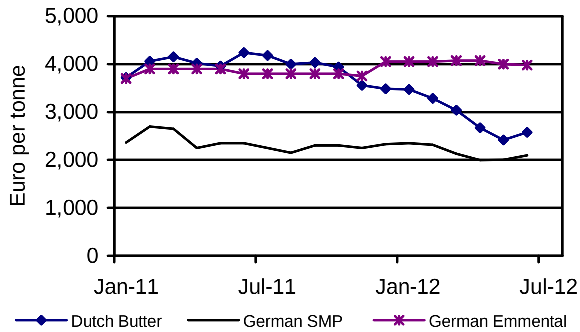
Dairy Sector

The negative dairy market sentiment which prevailed at the outset of 2012 has been shown to be justified. EU production for 2011 was more than 2% higher than in 2010. The excess supply of dairy commodities anticipated due to higher volumes of milk availability in key production and export regions last year has led to a decline in some international and EU dairy commodity prices in the first 5 months of 2012. The butter market in particular has seen the sharpest price declines as EU third country butter exports have fallen.

Dairy market price prospects for the remainder of 2012 remain uncertain. While prices appear to have stabilised, the prospect of accumulating Private Storage Aid (PSA) butter stocks could overhang the market. On the other hand, concern about global dairy product availability in the early months of 2013 could prompt the beginnings of a recovery in prices towards the end of this year.

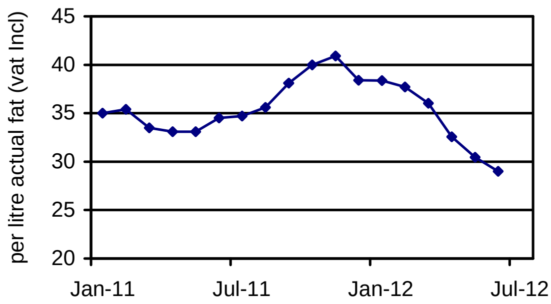
To date Irish milk production in the 2012 calendar year is behind the trend of 2011. Nevertheless, Irish milk production for the first half of 2012 remains about 2% ahead of the quota profile. With over 60% of the 2012 calendar year milk production now delivered, the average farm milk price for the year will depend on whether further milk price reductions are passed on by processors in the short term. An annual average price of about 30 cent per litre in 2012 is forecast, which would represent a 15% decline on the 2011 level.

Figure 5: EU Dairy Product Prices



Source: Dutch Dairy Board

Figure 6: Monthly Irish Farm Milk Price



Source: CSO and authors estimates

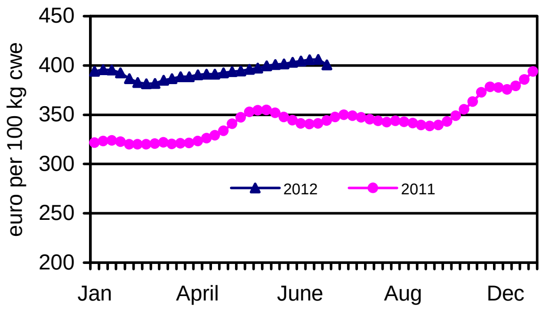
Beef Sector

Prices of calves, weanlings, store and finished cattle during the first half of 2012 have been well ahead of the levels observed in the first half of 2011 and the outlook for the remainder of 2012 is for continued buoyant cattle prices. Contraction in supplies of cattle in Ireland and across the EU, when combined with higher global cattle prices and a weakening euro, have been sufficient thus far in 2012 to offset the impact of weaker EU consumer demand for beef.

For the remainder of the year the outlook for Irish cattle prices remains buoyant with finished cattle prices expected to remain higher than prices in 2012. Finished cattle prices over 2012 are forecast to be 18% higher than in 2011. Irish prime cattle throughput is 17% lower over the first half of 2012 when compared with 2011, while AIM data indicate that the volume of cattle available for slaughter through the remainder of 2012 is going to be significantly lower than in 2011. The contraction in production of beef occurring in Ireland is also occurring in the UK and continental EU markets. Prices on these markets are expected to be strongly ahead of prices observed in 2011. The weakness of the euro versus sterling is also helping to boost Irish prices on the UK market which continues to account for almost 50% of Irish beef exports.

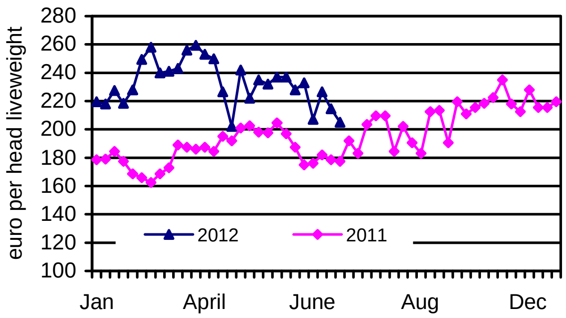
The strong growth in finished cattle prices has also been reflected in strong growth in weanling and store cattle prices. Weanling prices in the first half of 2012 have been over 26% higher than in 2011. Despite a narrowing of the gap between this and last year's prices in recent weeks, the average 2012 price for weanling and store cattle is expected to be up to 15% ahead of prices observed in 2011.

Figure 7: Weekly Irish Finished Steer Prices



Source: DG Agri

Figure 8: Weekly Irish Weanling Prices



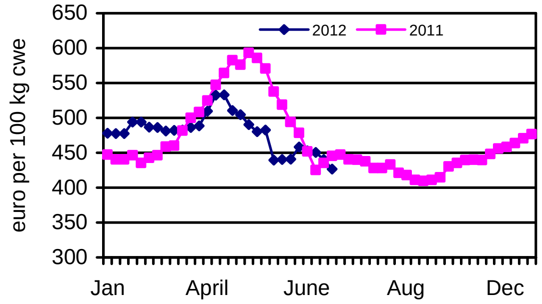
Source: Dg Agri

Sheep Sector

Sheep prices over the first half of 2012 have been marginally lower than prices in the first half of 2011. Increased supplies of lamb as a result of the growth in the Irish ewe flock will constrain the prospects for growth above 2011 price levels. Imports of lamb into the EU market so far in 2012 are reported by the EU Commission to be at least 20% lower than in 2011. This drop in imports reflects a partial reorientation of New Zealand lamb exports away from the slow growing EU market and towards more dynamic Middle East and Asian markets.

The current high lamb price and the ongoing weak EU economy are likely to continue to constrain prospects for significant price growth on continental EU markets. However, the ongoing weakness of the euro relative to sterling and the Ramadan festival are expected to positively affect EU and Irish lamb prices during the second half of 2012.

Figure 9: Weekly Irish Lamb Prices



Source: DG Agri

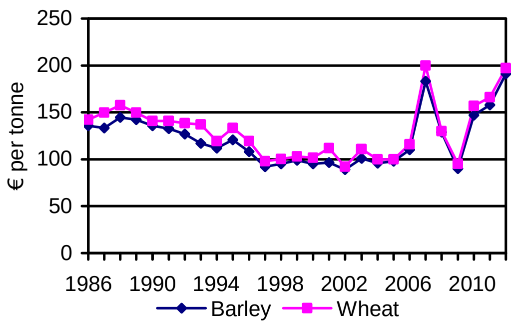
Irish lamb prices are forecast to increase for the remainder of 2012 and the annual average lamb price is likely to be close to the average price level in 2011. Increases in sheep numbers recorded by the CSO are largely being driven by flock rebuilding on existing sheep farms rather than by new entrants. Taking account for this a small increase in lamb produced per hectare is forecast for 2012.

Cereals Sector

Due to drought pressure in the US in the past month or so, price levels for the main cereals produced in Ireland have increased significantly. Downgrading of the potential US harvests of soyabean and corn, in particular, have had a large effect on price levels since the beginning of June. Weather conditions over the growing season in Europe and the Black Sea region, have also resulted in a downgrading of harvest potential.

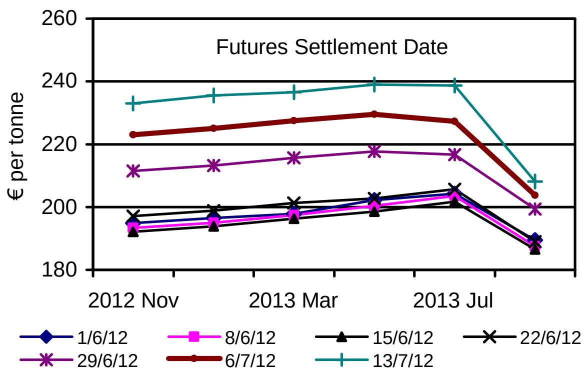
In Ireland the latest on account forward prices are in the region of €190 - €200 per tonne for green wheat with green barley trading about €5 to €7 less. Varying levels of world ending stocks have contributed to the considerable volatility in world grain prices over the last number of years. The very high prices currently being quoted for Irish cereals are similar to those experienced in 2007, which was the highest level for 25 years. The price differential per tonne between 2011 and 2012 on-account harvest prices is between 15 and 20% for feed wheat and barley at present in Ireland.

Figure 10: Cereal Harvest Prices: 1986-2012



Source: Authors' own estimates

Figure 11: LIFFE Futures Prices



Source: HGCA

Futures trading prices are at present still quite 'bullish'. Figure 11 shows the trajectory of LIFEE futures trading prices up until harvest 2013. Based on current market reports, a weather risk premium may be present across the grains sector for prices until the end of the marketing year. A significant correction in prices is not expected before the US harvest is complete.

It is extremely difficult to provide estimates of yields for the main Irish cereal crops given that harvesting has not yet begun. Given the knowledge of crop progress up until early June of this year the yield potential of planted crops seems to be on a par with 2011 record yield levels. However, due to persistent inclement weather conditions in the past number of weeks disease pressure is expected to take its toll on yield outcome.

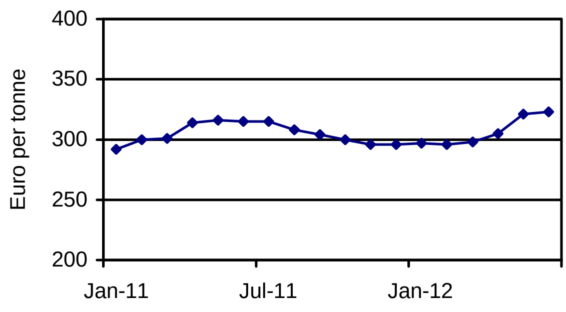
At best it is estimated that trend yields will be achieved for spring barley, which would see a 10% reduction in average Irish yields for 2012. It is estimated that at best a 15% reduction in average yields for winter wheat is likely, given that disease pressure is currently more prevalent for this crop. However, industry reports of significant disease pressure in certain areas over and above the aforementioned estimates (due to Barley Yellow Dwarf Virus and Fusarium, along with lodging and slug problems) could see yield losses upwards of 20% for both crops. Assuming the former optimistic outturn for yields, a national average for winter wheat and spring barley yields in 2012 would be 8.7t/ha and 6.8t/ha. Assuming a less optimistic outcome, with a 20% or greater decrease on 2011 yields, national average winter wheat and spring barley yields in 2012 could be 7.5t/ha and 5.9 t/ha.

Pig Sector

The Irish pig industry continues to show increased performance efficiencies during 2011 and to date in 2012. The Key Performance Indicators (KPI) from the Teagasc Pigsys recording system showed improvements for Born Alive (12.33) and Pigs Produced Per Sow (24.1). A slight deterioration in Wean-Sale feed conversion efficiency (2.48-2.53) may reflect the increased throughput of pigs on units leading to a reduction in the optimum space allowance per pig.

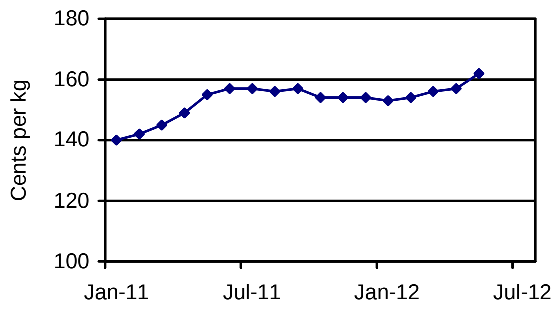
The high feed cost continues to cause severe problems for the pig industry globally. The moderate pig price and the falling price of feed ingredients at the end of 2011 had indicated that 2012 could be a profitable year. However, the severe drought affecting the South American soyabean harvest and the depreciation in the euro during spring 2012 resulted in an increase in feed ingredient prices. The upward trend in feed prices has recently been compounded by drought conditions in the US and the Black Sea Region. These issues have resulted in a significant ingredient price rise (from January to June) for soyabeans (€300 - €490), wheat (€195-€255) and barely (€185-€250), while the pig price over the same period has only risen by 6% (153-162 cent/kg). This has generated a further tightening of previously slim margins.

Figure 12: Irish Composite Pigfeed Price



Source: Teagasc

Figure 13: Irish Finished Pig Price



Source: CSO

The pig price for the second half of 2012 is dependent on the international supply of slaughter pigs and the strength of the export market outside the EU. In Ireland the supply of slaughter pigs is currently running 4% higher (Jan-June, 2012) when compared to the same period in 2011. However, this is in sharp contrast to the situation in the other principal pig producing countries within the EU. The aggregate decline of production in Germany, Denmark and the Netherlands (35% of total EU production) is currently 3%. This rate of decline may accelerate further due to the impending Loose Sow Housing legislation which comes into force in January 2013. The EU export of pigmeat continues to remain very robust (7% increase year-on-year) with the principal export destinations being China (25%), Hong-Kong (15%) and Russia (14%). It is imperative that these markets continue to perform strongly in the latter part of 2012 to support the current pig price.

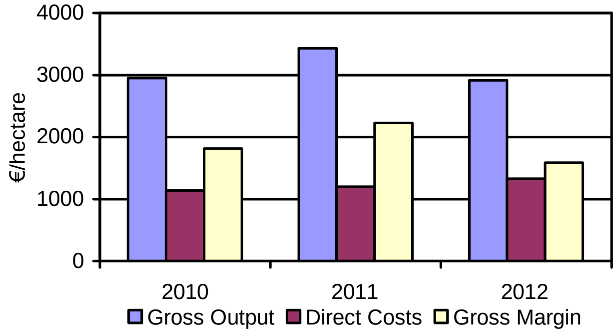
The current crop conditions and yield forecast provide little optimism for feed price to fall over the next six months. Soyabean supply is forecast to remain tight for the next twelve months with the current US drought conditions affecting crop developments. The hope from the global pig industry perspective is that the actual crop harvest volume exceeds current estimates. Overall, the outlook for financial margins in the Irish pig sector is to remain very tight until the end of the year.

5. Outlook for Farm Gross Margin

Drawing on the discussions on input and output prices above, gross margins per hectare for the various land-based farm systems are forecast for 2012. The following Figures present gross margins per hectare for 2010 and 2011 based on the published Teagasc National Farm Survey data and a forecast for 2012.

Dairy Sector

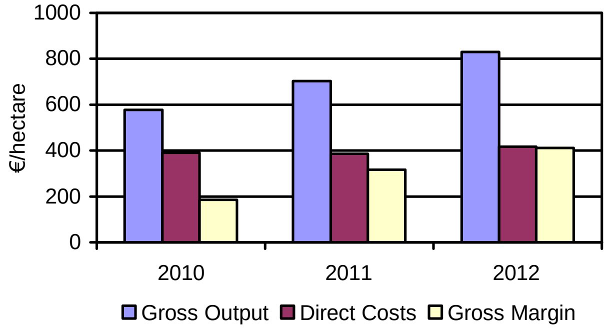
Figure 13: Dairy Gross Margin per Hectare: 2010, 2011 and 2012 forecast



Gross margin per hectare increased by 23% from 2010 to 2011. The decline in milk price in 2012 will cause the value of gross output to fall by 15%. A considerable increase in feed prices and use causes feed costs to increase by 25% and total direct costs to increase by 10% in 2012. The gross margin per hectare for the dairy enterprise is forecast to fall by 30% in 2012 relative to the 2011 levels.

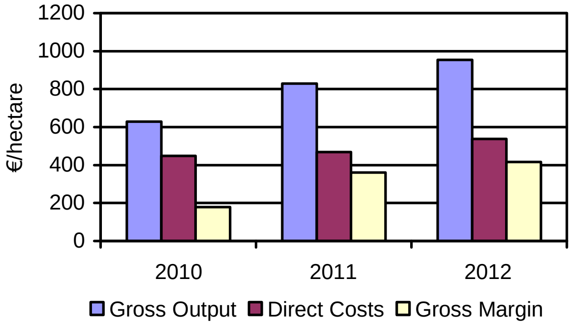
Cattle Sector

Figure 14: Single Suckling Gross Margin per Hectare: 2010, 2011 and 2012 forecast



Gross margin per hectare on single suckling farms increased by 70% from 2010 to 2011. The continued positive outlook for beef prices means that the value of output per hectare is forecast to increase by a further 18% in 2012 compared with 2011. A rise in feed prices and feed use will causes total direct costs to increase by 8% in 2012 compared with 2011. The gross margin per hectare for the suckling enterprise is forecast to increase by over 30% in 2012 relative to the 2011 levels.

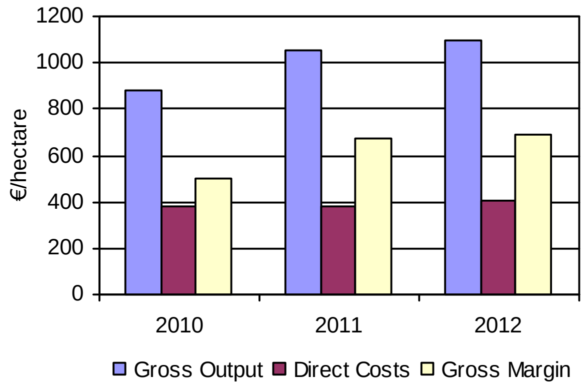
Figure 15: Cattle Finishing Gross Margin per Hectare: 2010, 2011 and 2012 forecast



Gross margin per hectare for cattle finishing increased by over 100% from 2010 to 2011. On the back of strong prices, the value of gross output per hectare is forecast to increase by over 15% from 2011 to 2012. Considerable increases in feed prices as well as volumes of feed used, leads total direct costs to increase by almost 15%. The gross margin per hectare for the finishing enterprise is forecast to increase by 15% in 2012 relative to the 2011 levels.

Sheep Sector

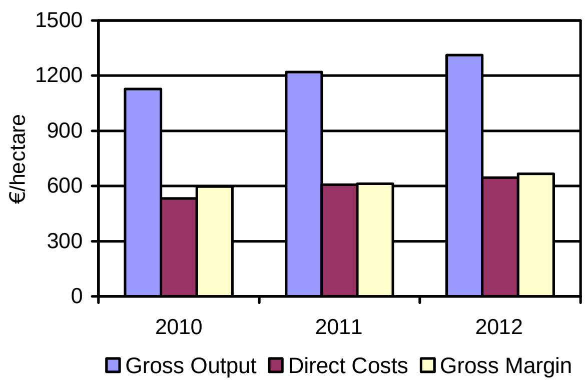
Figure 16: Mid-Season Lamb Gross Margin per Hectare: 2010, 2011 and 2012 forecast



Gross margin per hectare increased by 35% from 2010 to 2011. The price outlook for sheep meat markets for the remainder of 2012 remains positive. An increase in the volume of production per hectare is expected. This means that output value per hectare is forecast to increase by 4% in 2012 relative to 2011. A rise in feed prices is forecast to cause total direct costs to increase by over 4%. The gross margin per hectare for the mid-season lamb enterprise is forecast to increase by almost 3% in 2012 relative to the 2011 levels.

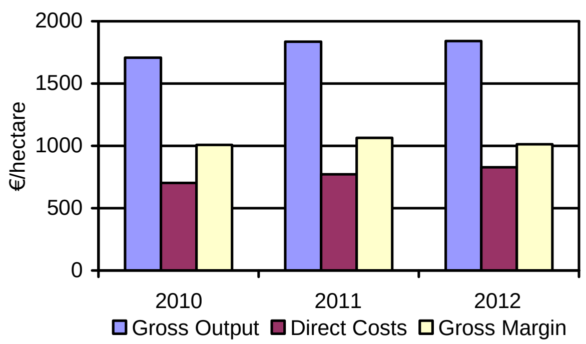
Cereals Sector

Figure 17: Spring Barley Gross Margin per Hectare: 2010, 2011 and 2012 forecast



Gross margin per hectare for spring barley increased by 3% from 2010 to 2011. While the 2012 outcome for the value of gross output will depend on yield, the output price is likely to be up considerably on 2011 levels. A conservative 10% reduction in yield in 2012 will result in only a slight improvement in the value of gross output per hectare in 2012. Upward pressure on costs, including fertiliser, crop protection, fuel and seed will causes total direct costs to increase by 6%. Gross margin is forecast to increase slightly for spring barley in 2012.

Figure 18: Winter Wheat Gross Margin per Hectare: 2010, 2011 and 2012 forecast



Gross margin per hectare for winter wheat increased by 3% and 4% respectively from 2010 to 2011. As with spring barley the outlook for price in 2012 is very positive for winter wheat, but a 15% reduction in yield is likely to occur. Again, the upward pressure on input costs will increase total direct costs in 2012 and as a result, gross margin per hectare is forecast to be down slightly on the 2011 levels.

Summary

Overall 2012 is likely to see an increase in margins on drystock farms, margins on cereals farm will be dependent on harvest yields and dairy farm margins are forecast to decline. In the pig sector, financial margins are set to remain very tight until the end of the year.