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WEAKER EURO A CONCERN FOR PRODUCERS AND PROCESSORS

SINCE the start of the year, the plight of the Eurozone economy has remained in sharp focus. Early in the year, Eurozone finance ministers and the European Central Bank became increasingly concerned about the threat of deflation and their response has been to engage in what is known as quantitative easing.

This effectively means that the European Central Bank is now in the business of printing money. The hope is that increasing the amount of money in circulation will encourage spending and thereby drive inflation and economic growth. However printing money also undermines the value of a currency, and that is exactly what has happened to the euro in recent months. Since 16 December 2014, the value of the Euro against sterling has fallen from 79p to a low of 70p. It has since rebounded to 73p. At the current exchange rate the euro is back at 2007 levels.

From 2004-2007, the euro was generally worth in the region of 65-70p. However, its value relative to sterling soared from 2007 until 2011. Since then the exchange rate fluctuated sharply, but the general trend has been a decline in the value of the euro against sterling with the rate headed back to pre-2007 levels.

Several major banking analysts are estimating that the euro will remain at or around its current value over the next year, although there is some variation with some forecasting slightly higher values and others forecasting slightly lower values. If it's long-term value settles at current levels, or lower, this will have significant implications for the NI red meat industry.

Impact on CAP payments

In recent years, farmers have kept a particularly close eye on the exchange rate on 30 September. The Pound v Euro rate on that date determined the value of their Single Farm Payment since 2005. This system determined that producers benefited from larger Single Farm Payment receipts in 2009 when the euro was worth around 92p on 30 September that year. On 30 September 2011, the value of the euro had fallen to 87p, but relative to 2007/08 levels, this still guaranteed a fairly healthy Single Farm Payment in sterling terms. By 30 September last year the euro was worth 77.7p and this resulted in a significant decline in the value of the Single Farm Payment for NI producers compared to earlier years.

From 2015, CAP reform means that there will be a gradual redistribution of CAP funding under the new Basic Payment Scheme and Greening Payments. Some producers can expect a gradual decline in their CAP income over the course of the transition to flat rate area based payments, while others can expect a gradual increase in payments.

All producers, will however, be impacted if the value of the euro remains weak. If the sterling/euro exchange rate was 70p in September 2015, then on a like-for-like basis, CAP payments would be down by about 11 per cent from 2014 levels in sterling terms.

Unlike previous years, the exchange rate used for calculating payments will not be based on the value of the euro on 30 September. Instead, the average exchange rate for the entire month of September will be used and this an important change, which should help smooth the effect of any market volatility.

While September is still six months away, producers should be preparing for the prospect that the euro could remain at its current low levels against sterling and could potentially decline further.

"Double Whammy" impact on Trade

In terms of its impact on trade, a weak euro hits the Northern Ireland red meat industry with something of a "double whammy". Not only does a weak euro make UK red meat less competitive in the Eurozone, it also make Eurozone beef more competitive in the UK market, which means more competition from beef from the south of Ireland.

Meanwhile, the weak euro has a serious impact on the price that ROI buyers can pay for Northern Ireland lambs and this has already undermined the lamb trade in 2015 with prices have stagnated at a time of year when they should perhaps be rising.

In terms of beef, the stronger pound has pushed Great Britain R3 male prices to 509c/kg (Week Ending 8 March 2015). Corresponding prices in Northern Ireland are sitting at 490c/kg. The average EU price is 393c/kg (see Figure 4).

With NI prices 25 per cent higher than the average EU price, this makes the NI beef industry less competitive relative to the

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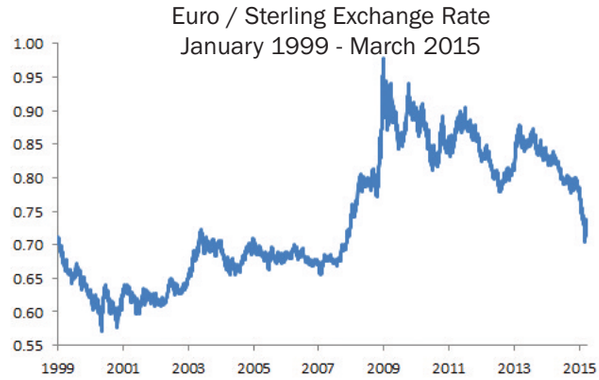


SUCKLER BEEF COSTS OF PRO

The Farm Business Survey for the 2013/14 accounting year shows that the average cost of producing beef from the NI suckler herd averaged £4.49/kg. This was 9 per cent higher than previous year levels (see Table 1 below).

Last year, variable costs associated with suckler to beef production increased by 20p/kg to £2.25/kg, reflecting very difficult production conditions in the first quarter of the year (April - June 2013) and a hangover from particularly poor weather conditions in the year to March 2013. This led to greater reliance on bought-in fodder with cattle housed for longer than normal early in the year. Fixed costs also increased driven mainly by higher costs associated with the upkeep and running of machinery.

Higher forage costs in 2013/14

The higher production costs in 2013/14 were mainly driven by increased forage and grazing costs, which were in turn caused by the difficult weather conditions. The weather in the first quarter of the financial year was very poor with grass very slow to appear. On its own, this may not have presented a significant problem for producers, but this followed a year of very difficult production conditions.

The heavy rain and colder weather in 2012/13 meant that grass growth had been poor and this in turn led to a very light silage crop which in many cases was also lacking in quality. This was exacerbated by the very poor weather conditions in late March / early April 2013. The heavy snowfall at that time caused significant difficulties for all producers, particularly those in the hills.

The late start to spring delayed grass growth at a time when producers were already short of silage. This created a fodder crisis across the island of Ireland, with producers forced to buy-in silage and some producers imported straw from Great Britain.

This served to drive up the market price of silage, hay and straw early in the 2013/2014 financial year (see Figure 1). During 2013/14 as a whole silage made an average of 16 per cent more than the previous year while straw prices were 13 per cent higher.

The higher price of silage was no guarantee of quality and there were reports of silage being of poorer quality in early 2013. This meant that many producers struggled to achieve the same performance out of their stock.

From July 2013 onwards, the weather was particularly good, with excellent conditions for grass growth however this was not enough to compensate for the production difficulties of the previous year on many NI farms. With store cattle not thriving as well during the 2012/13 year it is likely that this affected their lifetime performance and producers did not achieve the same liveweight gains in 2013/14 as a result. Average carcase weights were 12kg lower in 2013/14, meaning costs (fixed and variable) were spread over fewer kilos of beef produced.

Increased concentrate usage

With cattle struggling to reach target weights due to the poor weather and perhaps also due to the quality of feed, producers were in some cases compelled to spend more on concentrates to supplement diets.

In the 2013/14 financial year, NI sales of beef cattle compounds and coarse mixes and blends were up by 2.4 per cent year-on-year. There was a three per cent decline in the cattle kill, meaning that there was an even greater increase in concentrate usage per head of stock. Expenditure on beef concentrates was up by four per cent.

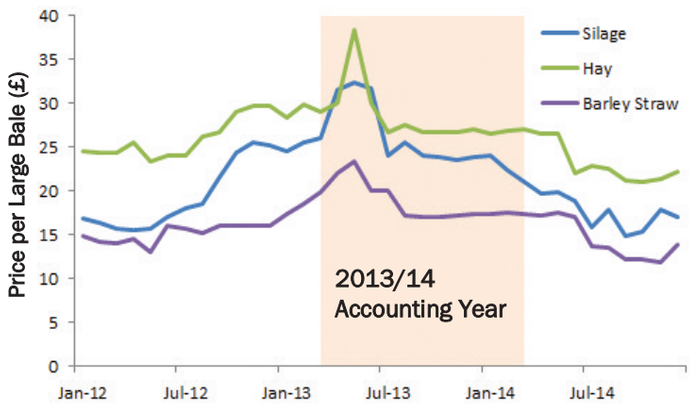
Early in the year, there were continued reports of increased mortality on Northern Ireland farms, following on from a trend that emerged in the previous year.

Table 1. Fixed and Variable Costs for Suckler Beef Producers Excludes Land, Labour and Working Capital (£/KG DW)

Costs / Year	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14
Variable	£1.19	£1.27	£1.48	£1.61	£1.61	£1.72	£2.05	£2.25
Fixed (Excl Depreciation)	£0.95	£0.96	£1.01	£1.14	£1.15	£1.25	£1.26	£1.37
Sub-Total	**£2.13**	**£2.22**	**£2.49**	**£2.74**	**£2.77**	**£2.97**	**£3.31**	**£3.62**
Depreciation	£0.66	£0.67	£0.69	£0.81	£0.86	£0.85	£0.83	£0.87
Total	**£2.80**	**£2.89**	**£3.18**	**£3.55**	**£3.62**	**£3.82**	**£4.14**	**£4.49**

Figures may not add due to rounding

Figure 1. Cost of Hay, Silage and Straw (Large Bales) in Northern Ireland, 2012-2014



WHAT COSTS ARE INCLUDED?

The figures used to calculate the cost of suckler beef production in NI are from farm enterprises that rear and/or finish suckler calves. These costs are for a combination of steer, heifer and young bull production including suckler cow maintenance costs.

Hidden Costs

These costs include:
- Costs of purchased inputs
- Depreciation costs
- Bank interest and rent
- Herd replacement costs

These costs exclude:
- Unwaged family labour
- Opportunity cost of:
  - Own Land
  - Working Capital

With no provision for hidden costs in these figures, producers therefore need to consider that the enterprise must also cover the cost of their own labour, land and working capital.

Depreciation

Depreciation, which is associated with current and historical investment in capital, contributes significantly to overall farm costs. It is important to note however, that this type of capital investment is not entirely funded by the suckler enterprise with other revenue streams such as the Single Farm Payment, LFACA, Farm Nutrient Management Scheme and Farm Modernisation Scheme important factors in driving investment. Care should therefore be taken when interpreting these figures given that these grants and subsidies are important factors in the investment decision.

Mixed Farms

On any farm business there may be a number of different enterprises. For example, a suckler producer may also be involved in lamb production alongside a broiler breeder operation. Care is taken in the Farm Business Survey to ensure that costs for each enterprise are allocated correctly and proportionately.

RODUCTION RISE IN 2013/14

Higher veterinary and medicine bills were also recorded with costs increased by 13 per cent during the year.

Increased fixed costs

Fixed costs associated with the suckler beef sector have increased by eight per cent in the last year. This was driven by several factors, the most significant of which was increased costs associated with the running of machinery. These increased machinery costs may be associated to some degree with longer housing periods and the increased need to carry feed to cattle.

A four per cent increase in the cost of conacre is a reflection of a general increase in the cost of conacre in recent years. This has been driven by strong competition for land from dairy producers in some regions.

While depreciation of machinery was unchanged in 2013/14, costs associated with the depreciation of fixed capital increased during the year. Depreciation continues to account for around 20 per cent of overall suckler-to-beef costs. These costs stem from current or historical investment in fixed assets or machinery. The cost of the initial investment is accounted for in the form of depreciation in the farm accounts for the following 10 years.

For example, between 2007-2009, under the Farm Nutrient Management Scheme (FNMS) many beef producers invested in new housing and slurry stores with the support of grant-aid. These depreciation expenses will appear on the accounts of these farms until 2017-2019. The Single Farm Payment (SFP) has been another important source of finance for machinery purchases on many farms in recent years, with tax incentives further encouraging such investments. Clearly income sources like the FNMS and SFP must be taken into account when considering how the enterprise covers these depreciation costs.

Comparison with prices

Figure 4 shows a comparison between suckler beef production costs and farmgate prices paid for suckler origin cattle. The red line shows the average farmgate price paid for prime suckler-origin beef (*source: Price Reporting*). The green bar shows costs, excluding depreciation, while the pale blue bar shows depreciation costs. These costs do not include a return on farmers' own land, labour and working capital.

The figures show that the average suckler beef price (prime cattle were £3.65/kg) just covers costs excluding depreciation (£3.62/kg). With prices not sufficient on average to cover depreciation, it shows that there is no room in the farmgate price to fund investment in the average suckler farm. This highlights the importance of the Rural Development Programme and the proposed farm business improvement scheme. More importantly however, it highlights the importance of focusing on improved efficiency.

It is important to consider that these figures are average costs calculated from the accounts of a wide range of beef farms participating in the Farm Business Survey. Some of these farms will be more efficient, with lower costs of production, while other farms will be less efficient with higher costs of production.

This may mean that some beef farms are not even covering their cash costs. On the other hand, some suckler beef enterprises will be covering all of their costs and taking a margin from their enterprise. This wide range of efficiency was highlighted by CAFRE's Jim Freeburn at the LMC conference in November and it was clear that there are very good examples of highly efficient suckler enterprises in Northern Ireland.

The CAFRE benchmarking programme is an excellent source of support for producers who want to improve their efficiency by comparing their farm against similar enterprises to identify improvement measures.

Contact CAFRE Benchmarking on 028 9442 6771 or visit the website at ruralni.gov.uk.

Figure 2. Suckler Beef Production
Index of Variable Costs - 2006-2014

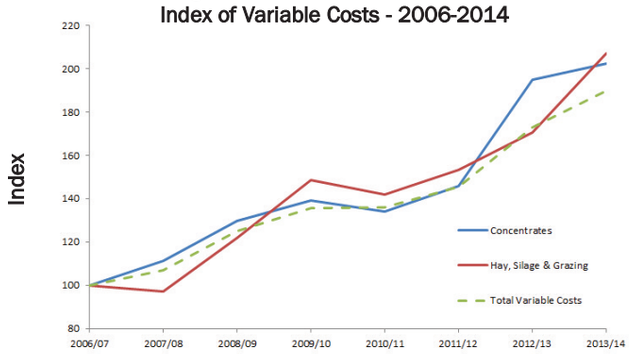


Figure 3. Suckler Beef Production
Index of Fixed Costs - 2006-2014

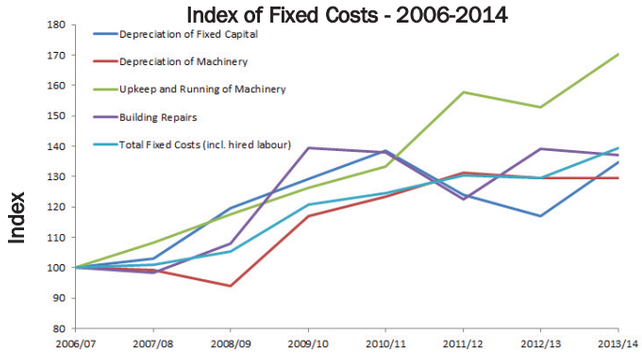


Figure 4. Suckler Beef Production 2009-14
Average Costs v Average Farmgate Price Paid for Suckler Origin Beef

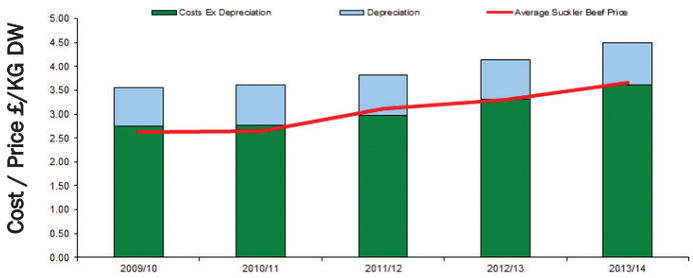
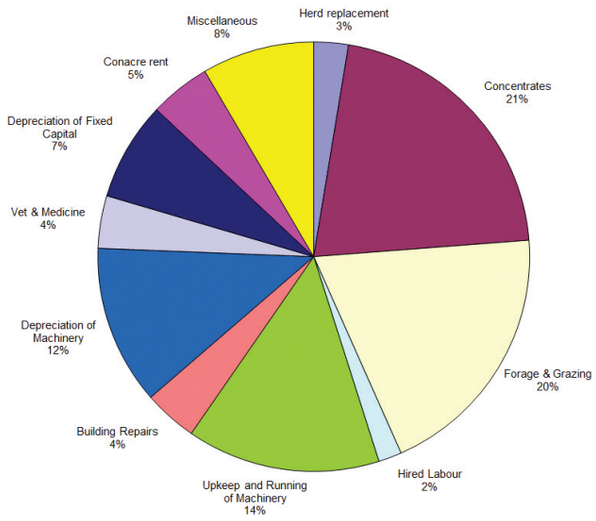


Figure 5. Suckler Beef Production
Breakdown by Cost Centre - 2013/2014



WEAK EURO IS A CAUSE FOR CONCERN

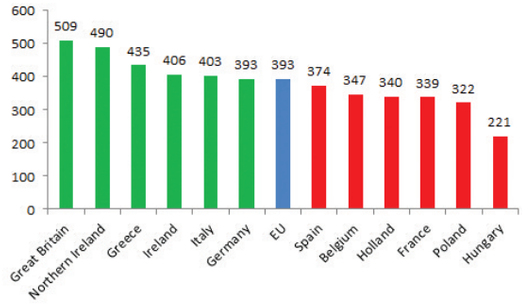
European industry, or rather, it makes the Eurozone market less attractive for NI exporters. Indeed, mainland Europe has been an unattractive market for Northern Ireland beef exporters for some time now, such is the wide differential in beef prices between the European and domestic UK market.

However, it is worth noting that the NI beef industry has a limited number of export options due to the legacy of the 1996 export ban. For example there are attractive markets for beef in Asia and the USA, but for now, the UK industry does not have access to these key markets. Until access to third country markets is widened for NI beef, the trade here will always be reliant on the EU market as the only major alternative to the UK retail and foodservice markets

Since the horsemeat crisis in 2013, UK farmgate beef trade has consistently outperformed the trade in the Eurozone. This is due to strong demand for UK origin beef by British retailers since the horsemeat crisis combined with the strong performance of sterling against euro.

The weaker euro is making imported Eurozone (mainly Irish) beef increasingly tempting for British retailers with significant farmgate price differences. If British retailers turn more to Irish product, this will inevitably undermine the domestic market. The UK retailers' commitment to sourcing British beef will be tested by the offer of cheaper imported beef, particularly as memories of the horsemeat crisis continue to fade.

EU Male Cattle Prices - Week Ending 8th March 2015



Ultimately there is very little positive to take from these developments. Producers and processors are currently being impacted by the implications of these changes in the currency markets. While the recent recovery in the value of the euro provides some reassurance, it serves as a reminder how volatile currency markets can be.

It remains to be seen what the long term value of the euro will be and right now it should be at the forefront of industry thinking.

HIGH PRICES FOR STORE CATTLE

Mart reports early in the year have made very positive reading for primary cattle producers, with prices for calves, weanlings and stores at significantly higher levels compared to 2014 levels. The strong prices for good quality younger cattle will put some necessary confidence back into the primary sector where the number of suckler cows were down by two per cent in the year to December2014.

Tight supplies of cattle between 6 - 24 months of age are part of the explanation for the high prices being paid for store cattle at the moment. However, it is not the whole story. Prices for dropped calves in recent weeks have also been performing strongly despite an improvement in availability. There has been a 10 per cent increase in the number of cattle aged up to six months old on the ground when compared to year earlier levels.

The other half of the price equation is demand and a variety of factors appear to be driving demand for cattle generally. One widely reported factor is the new phenomenon of *"the active farmer"*. These are of course non-farming landowners, who wish to continue to claim entitlements post CAP reform by passing an active farmer test. To achieve this some farmers are buying cattle or sheep.

The price producers are prepared to pay for cattle will also depend on the price and availability of feed and forage. This year there is an abundance of silage available given the good production conditions this time last year and the price of round bales is significantly lower. The price of straw and barley are also much lower than 2014 levels.

Producers planning to finish cattle also may have gained confidence for the strong rise in farmgate beef prices between September and December 2014. With supplies forecast to remain tight this year, this may have given encouragement to producers in the market for store cattle. While these prices are positive for primary producers, there are of course concerns about producers further up the supply chain over-stretching themselves in their drive to buy in raw material.

Although finished cattle supplies are predicted to remain tight this year, there is no guarantee that this will deliver a strong enough beef price to cover the cost of finishing stock bought at high prices. Indeed, given the issues created by the weak euro, it is possible that a disconnect is emerging between store and finished cattle prices. Such a disconnect is not unusual, but it has the potential to leave finishers in a precarious position.

One can only assume that buyers paying these strong prices are behaving rationally. However, the rationale for paying higher prices may differ from farm-to-farm. It is hard to be certain on the level of influence so-called "active farmers" are having on the market but as they strive to maintain the value of their entitlements, it may be the case that a profit margin on the beef enterprise may be a secondary consideration. Some of these 'active farmers' are potentially resigned to making a loss on the beef enterprise with the priority being to secure their Basic Payment Scheme and Greening payments.

For other producers, the primary consideration when buying cattle is to run a profitable enterprise. This is difficult to achieve at the best of times, but there is probably a growing realisation that at current prices for calves and store cattle, this may prove more difficult than in previous years.

Yet, for a variety of reasons few farmers will be inclined to withdraw from the market. The current high store prices are likely to have prompted some producers to enter the ROI market for cattle, where prices are much lower. In recent weeks there has been an increase in the number of ROI origin calves on the ground in NI when compared to the same time last year. The market price of finished nomad cattle in NI is of course significantly lower than the price for UK origin cattle but finishers may be making a rational judgement that there is a greater margin in feeding these cattle, than with domestic stock.

The broad aspiration of all involved in the beef sector is to have a profitable industry at every step in the supply chain. However, this is far from simple to achieve and in some cases, profit for one producer might lead to a loss for another. Good communication in this regard is vital and some farming and processing figures have been urging caution with regards the higher calf / store prices being paid. If the high prices put some confidence back into the suckler herd it will be welcomed as herd rebuilding is badly needed.

However, producers must remain aware that there is no guarantee that beef finishing is profitable at these input prices and that is a risk that the industry must manage in 2015.

STORES - Av.price of steers 300-400 kg (£/head)