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JOINT COMMITTEE ON AGRICULTURE, FOOD AND THE MARINE
REPORT ON MANAGING MARKET VOLATILITY IN THE DAIRY
INDUSTRY

Managing Market Volatility in the Dairy Industry

Background

Milk quotas are being abolished on 31st March 2015 within the European Union, having been in place since 1984. This represents a once in a generation opportunity for Irish dairy farmers to expand their operations and volume of milk produced without facing EU penalties for over-production.

The Joint Committee on Agriculture, Food and the Marine (the Joint Committee) agreed to examine the area of market volatility in the dairy industry for its Work Programme for 2015 and invited several industry stakeholders before it. These stakeholders included the Irish Dairy Board (IDB), Bord Bia, Irish Corporate Organisation Society (ICOS), Positive Farmers, Allied Irish Bank (AIB), Bank of Ireland (BoI), Ulster Bank under the umbrella of The Irish Banking & Payments Federation and Teagasc.

This report will focus on several key areas which should be considered by farmers in anticipation of expansion.

Contextual Background

Milk prices have fluctuated considerably in the 18 months prior to 2015, driven by several global factors which will be considered in detail below. Price highs in 2013 contrasted with low prices by the end of 2014, and this level of volatility – should it continue - has the potential to impact significantly on the financial status of Irish farmers when quotas are lifted. Markets have been delivering returns ranging from 20c per litre to over 40c per litre over the last three years. Average milk prices per litre were 38 cent in 2014 and 26 cent in 2015, a decline of nearly a third in a short space of time.

The Food Harvest 2020 programme contains a targeted increase of 50% in dairy output by 2020, with an associated increase in jobs and exports. Growing the dairy industry in that timeframe coincides with the abolition of milk quotas and anticipated increases in global demand.

Recent Price Fluctuation

Milk prices began to rise in mid-2012, driven by a curtailment in supply because of a drought in New Zealand. In the spring of 2013, prices continued to rise as a result of an EU cold snap and a US drought. High prices were sustained throughout 2013 as a result of continued Chinese demand. In 2014, however, prices began to plummet as a result of decreasing Chinese demand, and an increased worldwide supply of dairy produce as a result of good weather. The Russian ban on EU produce in the autumn of 2014 exacerbated the problem and prices continued to fall into early 2015.

The IDB noted that volatility in the dairy market is driven by the supply side of the market, which is weather driven. Other factors recognised by the IDB include currency, energy supply and demand, biofuel versus conventional fuels, geopolitical events such as the Russian ban, and the pace of global economic growth – particularly in regard to emerging markets.

Market Outlook – Short-Term

The market outlook for the dairy industry in the short term is not promising, with 2015 shaping up to be a perfect storm causing low milk prices. Many of the factors which saw declining prices in the second half of 2014 are likely to continue into 2015, including the Russian ban on EU produce, and declining Chinese demand. The global record milk output in 2014 will further dampen prices throughout the year.

Market Outlook –Medium – Term

The medium to long-term outlook for the market is positive post-2015. China is expected to re-enter the dairy market towards the end of the year and Russia may do so too. The exceptionally fine weather in 2014 which resulted in a massive supply of dairy products is unlikely to be replicated in 2015, which should push prices upwards. With these factors in mind, the medium-term outlook is positive for milk prices.

Market Outlook –Long – Term

The long-term outlook for the Irish dairy industry is very promising in the long-term. The global population is growing rapidly, and the planet's population is expected to be around 8.5 billion people by 2025. This global population growth will result in an

increased demand for dairy products, particularly in emerging markets such as Brazil, Russia, India, China, and South Africa (BRICS). As disposable income in these regions increases, westernised diets will follow, boosting demand for dairy produce. Increasing urbanisation worldwide will further fuel demand. Active aging campaigns and sporting nutrition are also areas in which the benefits of dairy in the diet will increasingly be recognised over the coming decade, particularly in India and China which will see expanding middle classes.

Superlevy

Ireland overproduced by 5.07% over quota for 2014, resulting in a superlevy fine of around €100 million being imposed on Irish farmers. This super levy has been cited by various Irish farming organisations as a serious impediment to the expansion of dairy operations to take advantage of the quota abolition. The impending super levy fine has resulted in farmers scaling back on dairy investment for fear that they will face upcoming cash flow difficulties because of the super levy payments.

However, in March 2015, a positive development emerged for dairy farmers regarding the super levy fine. A Commission proposal enabling more flexibility to dairy farmers facing surplus levy bills this year was approved by Member States. Aimed at addressing cash-flow problems in the context of recent investment and lower prices in recent months, the concept allows Member States to enable producers to pay the amounts due from the 2014/15 quota year in 3 interest-free instalments over 3 years.

EU rules require that Member States still pay the Commission the amounts due by the end of November 2015, but this change provides flexibility on recovering the levy from the individual producers.

Member States will have to indicate the number of beneficiaries under the scheme and the amount not yet recovered every year until the end of 2017. The first yearly payment must be made by 30 September 2015.

Finance

Without adequate support from financial institutions, Irish dairy farmers will be unable to take full advantage of the opportunities for expansion in a post-quota world. The Irish Banking and Payments Federation is the umbrella group for Irish banks, and a representative of the IBPF appeared before the Committee along with representatives from AIB, BoI and Ulster Bank to outline the financial mechanisms available to Irish farmers both for expansion, and for managing price volatility.

AIB noted that the price fluctuations experienced by Irish farmers over the last two years could continue and that price volatility should be considered the new norm. Their representatives recommended a 'better before bigger' mentality for the dairy industry to achieve an efficient cost base for the future to manage volatility. AIB outlined a number of ways in which this efficient cost base can be achieved and maintained: improving production efficiencies, managing the cost base, undertaking strong financial management including cashflow budgeting, and building a cash buffer in good years to support price drops in leaner years. AIB cited their history of assisting dairy farmers during previous price lulls in 2009 and 2012-2013 by meeting with farmers on an individual basis to find solutions and noted that those experiences demonstrated that there was no one universal solution to price volatility. They have available range of measures including reviewing monthly payment commitments; short-term increases to working capital facilities; short-term loan facilities; and interest-only periods for repayments on existing borrowings.

AIB said that they take a tailored approach to address issues faced by each individual farmer as opposed to utilising a one-size-fits-all approach. They cited their 'Prompt Pay' scheme, whereby a farmer facing a significant tax bill or superlevy fine can apply to AIB to have the bill paid off up front by AIB and then the farmer can repay AIB over a period of time.

AIB noted that the general financial state of farmers in Ireland mean that they are well placed to take advantage of the quota abolition, pointing out that Central Bank figures of agricultural debt in Ireland fell from €5.5bn in 2009 to €3.4bn in 2014. Furthermore, credit balances in farmers' current accounts are up 27% year on year in 2015.

Ulster Bank emphasised the importance of utilising grass-based production to take advantage of expansion opportunities in the dairy industry. Ulster Bank outlined a number of initiatives which they offer to assist farmers which are implemented by a team of 30 agri-specialists. Ulster Bank launched an agri-accreditation course in 2014 which supplements annual agri-training courses. Ulster Bank also committed to meeting farmers on their farms at flexible times to solve problems. In anticipation of the abolition of milk quotas, Ulster Bank has launched a dairy expansion loan programme, which has an interest-only provision for two years to support farmers while they set up for expansion. They offer unsecured loans of up to €30,000 to young farmers in the absence of collateral. They also offer pasture loans to farmers who wish to invest in soil fertility, reseeding, and building paddocks or waterways.

Ulster Bank maintains contact with stakeholders in the industry, including dairy processors, farm organisations, advisory bodies and farm consultants in addition to participating in trade missions to markets such as China. Ulster Bank educates young farmers by hosting seminars and panel discussions with prospective dairy farmers, and by stressing the importance of financial management at these meetings.

Ulster Bank provides a dairy farmer tool kit which includes options such as increased working capital facilities, a capital repayment freeze, or interest-only repayments for a period of volatility. Ulster Bank also meets with individual farmers on their farms in order to construct a tailored financial solution to their needs. Ulster Bank analyses the state of dairy processors and industry stakeholders, looking at a long-term outlook when calculating repayment capacity.

Bank of Ireland informed the Committee that there had been an increase in loan applications for farm building and development over the last 12 months in anticipation of the abolition of milk quotas. A joint report published by Bank of Ireland in conjunction with Teagasc identified a €1.5bn investment in the dairy sector to hit Food Harvest 2020 targets. Bank of Ireland has accordingly established a €1bn investment fund to assist in hitting the FH 2020 targets.

Bank of Ireland noted that Irish farmers have relatively low debt levels compared to farmers in other Member States as well as having lower costs of production, which places them in a good position to take advantage of the impending quota abolition.

Bank of Ireland anticipated that while prices will increase in the medium to long-term, that increase will not be linear and will instead consist of peaks and troughs. To combat this volatility, Bank of Ireland has developed 'AgriFlex', a suite of financial options available to farmers, including interest-only repayments. Bank of Ireland have already received a relatively small number of applications for credit relief, mostly arising from difficulties imposed by the super levy.

Northern Ireland and New Zealand

The expansion of dairy farming in Northern Ireland and New Zealand in recent years has not resulted in increased margins or profits for dairy farmers in those countries. The experiences of farmers in the two countries should serve as a cautionary tale for farmers considering expansion post-quota.

Recommendations

1. Irish farmers and state agencies offering assistance should focus on sustainable, grass – based production methods to capitalise on market opportunities. A grass-rich approach may be the most efficient mechanism to improve margins.
2. Dairy farmers should utilise a 'better before bigger' approach when considering expansion. Efficiencies should be maximised before production is increased.
3. All stakeholders involved in the dairy industry should cooperatively examine the potential for an insurance fund for the industry, whereby a certain amount of profits obtained during a period of peak prices are invested in an insurance fund for periods of lower prices.
4. All stakeholders involved in the dairy industry should examine the logistics of forward selling in the markets to ensure a more sustainable price in the long term and limit price volatility into the future.
5. Financial institutions should take a flexible approach to farmers seeking loans, and work closely with them to ensure funding is available for dairying expansion.
6. All stakeholders within the dairy industry should consult regularly with each other to ensure a cooperative approach is taken towards expansion.

