Commodity outlook and financial performance of farms in South West Victoria

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This paper presents the current commodity outlook and the recent financial performance of some key agricultural industries in Victoria, highlighting the performance of the beef, dairying, cropping and sheep farms within the state as well as the dairy industry at the regional level.

The South West region covered in this paper is outlined in map 1. The major regional centres include Ararat, Ballarat, Colac, Hamilton, Portland and Warrnambool.

map 1: South West Victoria
Agricultural sector profile

Milk is South West Victoria’s most significant agricultural product in value terms. In 2004-05, milk accounted for 30 per cent or nearly $690 million of the $2109 million total value of agricultural production in the region (figure A).

figure A: Value of agricultural production, South West Victoria, 2004-05

Cattle slaughter accounted 17 per cent of total production while sheep and lamb slaughter contributed 15 per cent to the total value of agricultural production. Wool production accounted for a further 14 per cent of the total value of regional agricultural production and poultry production accounted for around 3 per cent.

Vegetable production accounted for around 3 per cent of total value of agricultural production for the region and wheat production around 3 per cent. Pasture and hay production accounted for just over 6 per cent of total value of agricultural production and barley, canola and other oilseeds each accounted for around 2 per cent of and in 2004-05.

Number and type of farms

Australian Bureau of Statistics data indicate that there were 7 917 farms in the South West Victoria region with an estimated value of agricultural operations of more than $5 000 in 2004-05 (table 1).
In the South West Victorian region, almost 90 per cent of farms are involved in livestock production; with sheep, beef cattle and dairying the most common activities. Farms are classed in table 1 according to the activities that generate most of their value of agricultural production. Almost 50 per cent of the total number of sheep in Victoria are located in this region.

Only a relatively small number of farms in the region receive most of their income from grains or vegetable production – around 2 per cent. However, farms that combine sheep or beef production with cereal grain production accounted for 9 per cent of farms.

**figure B: Distribution of farms in South West Victoria by value of agricultural production, 2004-05**
Most farms in the South West Victorian region are small to medium in size with over half of the farms producing less than $150 000 in agricultural outputs in 2004-05 (figure B). More than a quarter of farms produced between $150 000 and $350 000 and there were only 3 per cent of farms that produced more than $1 million of agricultural production in 2004-05.

**Employment**

Australian Bureau of Statistics data from 2007 indicate that around 294 000 people were employed in South West Victoria. The retail sector is the largest employer employing almost 15 per cent (15 300 people), 12 per cent (35 000 people) of the workforce was employed in the manufacturing sector, including the food processing industries (figure C). Around 27 000 people or 8 per cent of the workforce were employed in the agriculture, forestry and fisheries sector.

*figure C: South West Victoria employment profile, 2007*

**Dairy farm performance — Victoria and Australia**

During 2006-07, dairy producers in Victoria and nationally recorded large reductions in farm cash incomes resulting from increases in farm expenditure and reduced production. The effect of dry seasonal conditions was more pronounced for Victorian producers during 2006-07, with income falling by more than 70 per cent compared to a decline of 39 per cent nationally.
In 2007-08, farm cash income is projected to improve significantly for dairy producers in both Victoria and across Australia. Milk prices, on average, are forecast to increase by around 30 per cent to result in one of the largest one year increases in farm cash incomes in the past 20 years for both Australia and Victoria (figure D). Despite some further reduction in milk production in 2007-08 due to reductions in cow numbers, total cash receipts for Victorian dairy farms are projected to increase by over 25 per cent, on average. Farm cash costs are forecast to decline by around 10 per cent as improved seasonal conditions allow for some reduction in fodder expenditure.

**Dairy farm performance — South West Victoria**

Farm cash income for the South West Victorian dairy farms fell sharply in 2006-07 as sustained drought reduced milk yields and increasing fodder costs although reductions in milk yields were partially offset by an increase in the number of cows milked within the region (figure E). An increase in the number of dairy cows milked led to a lesser reduction in milk receipts in South West Victoria compared to many other dairying regions.

In 2007-08, farm cash incomes in the South West Victoria are forecast to recover markedly on the back of improved seasonal conditions, higher milk prices and reduced fodder costs. Farm cash income is projected to rise by more in this region than the state average due to a lesser reduction in milk production in this region compared to irrigation regions in the north of the state (figure E).

**figure D: Farm cash income, dairy farms in Victoria**
Financial performance, Australia and Victoria
Dairy industry

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>Victoria</th>
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<tbody>
<tr>
<td></td>
<td>2005-06</td>
<td>2006-07p</td>
</tr>
<tr>
<td></td>
<td>2005-06</td>
<td>2006-07p</td>
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<tr>
<td>Total cash receipts</td>
<td>$416,900</td>
<td>$394,400</td>
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<td></td>
<td>$331,460</td>
<td>$360,800</td>
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<tr>
<td>Farm cash income</td>
<td>$85,440</td>
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<tr>
<td>Farms with negative farm cash income</td>
<td>% 15</td>
<td>% 36</td>
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<tr>
<td>Farms with negative farm business profit</td>
<td>$18,970</td>
<td>-39,500</td>
</tr>
<tr>
<td></td>
<td>$2,835,420</td>
<td>$3,206,000</td>
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<tr>
<td>Farm capital at 30 June a</td>
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<td>Farm debt at 30 June bd</td>
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<td>% 84.3</td>
</tr>
<tr>
<td>Rate of return e</td>
<td>- excl. cap appreciation</td>
<td>% 2.3</td>
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<tr>
<td></td>
<td>- incl. cap appreciation</td>
<td>% 7.0</td>
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<td></td>
<td>na 82.5</td>
<td>na 82.7</td>
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figure E: Farm cash income, dairy farms in South West Victoria

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**Broadacre farm performance — Victoria and Australia**

Australian broadacre farm financial performance is projected to strengthen markedly in 2007-08, after recording the lowest incomes since 1992-93 in 2006-07. Increased grain and livestock production, combined with higher grain and wool prices and strong prices for beef cattle, sheep and lambs are projected to result in farm cash incomes on broadacre farms nearly doubling in 2007-08, to average around $78,200 per farm (figure F). In addition, total cash costs are projected to be slightly lower for livestock farms as improved seasonal conditions enable reduced expenditure on fodder and agistment.
Average farm business profit across Australia is projected to recover by even more than the increase in farm cash income in 2007-08. This largely reflects a build up in the value of trading stocks as producers increase livestock numbers and replenish on-farm inventories of fodder and grain.

3 Financial performance, Australia and Victoria

<table>
<thead>
<tr>
<th></th>
<th>Average per farm</th>
<th>All broadacre industries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Australia</td>
<td>Victoria</td>
</tr>
<tr>
<td>Farm cash income</td>
<td>$74 240</td>
<td>55 374</td>
</tr>
<tr>
<td>Farms with negative farm cash income</td>
<td>41 100 (12)</td>
<td>39 240 (16)</td>
</tr>
<tr>
<td>Farm business profit</td>
<td>$- 8 190</td>
<td>- 5 755</td>
</tr>
<tr>
<td>Farms with negative farm business profit</td>
<td>52 600 (10)</td>
<td>- 50 920 (12)</td>
</tr>
<tr>
<td>Farm capital at 30 June</td>
<td>$3 466 940 (a)</td>
<td>2 619 209 (5)</td>
</tr>
<tr>
<td>Farm debt at 30 June</td>
<td>$3 60 540 (b)</td>
<td>2 214 808 (9)</td>
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<tr>
<td>Equity ratio bd</td>
<td>% 65</td>
<td>% 62</td>
</tr>
<tr>
<td>Rate of return</td>
<td>% 7.4</td>
<td>% 6.9</td>
</tr>
</tbody>
</table>

Note:
- (a) Excludes leased plant and equipment.
- (b) Average per responding farm.
- (c) Harvest loans are not included in farm debt.
- (d) Equity expressed as a percentage of farm capital.
- (e) Rate of return to farm capital at 1 July calculated as farm business profit plus interest paid expressed as a percentage of total farm capital.
- (p) Preliminary estimates.
- (s) Provisional estimates. na Not Available.

figure F: Farm cash income, broadacre farms in Victoria
Average farm cash income for Victorian broadacre farms is projected to rise by around 70 per cent to $69 000 in 2007-08. Further, positive farm business profit is forecast for Victoria following two losses in 2005-06 and 2006-07 (figure G).

**figure G: Financial performance, broadacre farms in Victoria**

Over the past four years the demand for rural land has remained strong. Rising land values have increased average farm capital values underpinning farm equity and offsetting the impact of higher farm debt. This has enabled producers to borrow more both for working capital to meet the reduced cash flow during the drought and for new investment in land, plant, machinery, vehicles and improvements. Increases in farm capital values have resulted in rising rates of return including capital appreciation in recent years despite average rates of return excluding capital appreciation remaining very low. Rates of return are calculated on a full equity basis (farm business profit plus interest paid), as if the farm were fully owned by the operators (table 3).

**Broadacre farm performance — South West Victoria**

Farm cash income for South West Victorian broadacre farms fell in 2006-07, reflecting prolonged drought conditions within the region.
In 2007-08, farm cash income in South West Victoria is projected to increase, but the increase is not projected to be as large as for Victoria as a whole. Increased receipts from wool and sheep are expected to be partly offset by slightly lower beef cattle receipts as farms reduce cattle turnoff and rebuild herds.

**figure H: Farm cash income, broadacre farms in South West Victoria**

Farm cash income in the region was below the state average throughout much of the 1990s and early 2000s due to the region’s relatively high dependence on wool through this period of historically low wool prices (figure H). However, in recent years average farm cash income for South West Victorian broadacre farms has been similar to the state average, reflecting increased receipts from beef cattle.

Average to above average rainfall in the early summer months encouraged producers to rebuild herds and flocks. Consequently the number of beef cattle sold is projected to fall in 2007-08 and beef cattle receipts are forecast to be lower as producers rebuild herds. Recoveries in lamb marking rates are projected to be sufficient to allow small increases in sheep and lamb turnoff, which should partially offset the reduction in beef cattle receipts.

**Beef farm performance — Victoria and Australia**

In 2006-07, farm cash incomes for Victorian beef specialist producers (defined as farms with the majority of their income derived from beef cattle sales) deteriorated markedly as drought conditions
reduced farm production and contributed to increased production costs (figure I). The impact of reduced sale numbers on farm receipts was exacerbated by lower prices, caused by increased turnoff of more unfinished and younger stock.

Farm cash income for Victorian beef specialists is projected to rise only slightly in 2007-08. Beef receipts are estimated to be constrained by reduced turnoff as farms rebuild beef cattle numbers. Improved seasonal conditions have allowed producers to reduce outlays on fodder expenditure and consequently total cash costs are projected to fall slightly. Farm cash income is projected to remain similar to 2006-07 at around $35 000. However, increases in beef cattle numbers are projected to boost the value of trading stocks raising farm business profit to around $30 000 in 2007-08 following an estimated average business loss of $40 000 in 2006-07.

figure I: Farm cash income, beef specialists in Victoria

Grains farm performance — Victoria and Australia

The financial performance of Australian grain specialist producers (defined as farms with the majority of income derived from crop sales) was relatively poor in 2006-07 as adverse seasonal conditions in much of the grain belt restricted winter crop plantings and production (figure J). In addition, the below average conditions resulted in poor pasture growth and forced many producers to use grain for livestock feeding which further reduced the level of receipts.
In 2007-08 farm cash incomes are projected to improve significantly due to a recovery in grain production and higher grain prices. Increased receipts from grain are expected to be partially offset by a small reduction in sheep and cattle receipts as flocks and herds are rebuilt. In Victoria the improvement in farm cash income is projected to be larger than the increase nationally with both a larger increase in cash receipts and a slightly larger reduction in cash costs.

**figure J: Farm cash income, grains specialists in Victoria**

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**Sheep farm performance — Victoria and Australia**

The financial performance of Victorian sheep specialist farms (defined as farms with the majority of their income derived from sheep and wool) declined in 2006-07, the result of increased production costs as producers increased expenditure on fodder and agistment (figure K).

In 2007-08, farm cash incomes for Victorian sheep specialist farms are projected to increase sharply as improved seasonal conditions boost production and as a result of higher wool prices and strong sheep and lamb prices. The improvement to sheep producer incomes in Victoria is expected to exceed that across Australia with both a larger increase in cash receipts and a larger reduction in fodder expenditure.
Outlook for selected commodities

Seasonal conditions update

The Australian Bureau of Meteorology in its latest seasonal rainfall outlook (23 April 2008) for the May to July period, shows a moderate to strong shift in the odds favouring a wetter than normal season in a broad band from northern WA and the NT through to southern Queensland and northern NSW.

The chances of exceeding median rainfall over May to July are between 60 and 70 per cent over far northern WA, most of the NT, northwest and southern Queensland, and the far north of NSW. Over the rest of the country, the chances of exceeding the three-month median rainfall are mainly between 45 and 60%. So the chances of being wetter than normal are about the same as the chances of being drier.

The Bureau also announced that a La Niña event in the Pacific Basin is weakening: computer models indicate a return to neutral conditions over the outlook period of May-July. La Niña events typically bring wetter than normal conditions across much of the eastern half of Australia.
Livestock

Dairy

World prices for the major dairy products rose sharply in 2007-08 and have remained relatively high in the first two months of 2008. In 2007-08, world prices for cheese are forecast to be up by 70 per cent, skim milk powder prices up by 40 per cent and butter prices up by 95 per cent. In 2008-09 world prices for most dairy products are forecast to decline as production and exports rise in response to recent higher world prices.

In 2008-09 and 2009-10, world dairy production is forecast to grow at a relatively slow rate. Production in the major dairy exporting countries of the European Union, New Zealand and Australia is forecast to grow relatively slowly. This is a result of changes to production incentives under the Common Agricultural Policy (CAP) in the European Union, higher feed prices and lead times in herd-building in New Zealand and recovery from recent drought conditions and associated irrigation water supply constraints in Australia.

Global demand for dairy products remains relatively strong in a world market influenced by strong economic growth, particularly in developing countries in Asia. Demand is also expected to be strong in developed countries such as the European Union.

The ability of Australian dairy farmers to recover quickly from drought will depend largely on the financial situation of individual farmers, the availability of irrigation water and the ability of farmers to rebuild milking cow numbers. While good rains in late 2007 and early 2008 have been helpful, uncertainty remains about the possibility and timing of increased allocations of irrigation water in the southern Murray Darling Basin, and the availability and price of fodder. Australian milk production is estimated to have fallen by more than 5 per cent in 2007-08, to around 9.1 billion litres. In 2008-09, Australian milk production is forecast to begin to recover, rising by almost 2 per cent to around 9.25 billion litres.

After averaging around 45c in 2007-08, Australian farm-gate milk prices are forecast to rise by a further 20 per cent to 54c a litre in 2008-09. The forecast of relatively high farm gate milk prices reflects both the prices needed by dairy farmers to cover the high cost of feed and other inputs (such as purchased irrigation water entitlements) and the ability of the dairy industry to benefit from strong world prices for dairy products.
Beef

The Australian weighted saleyard price of beef is forecast to increase by 7 per cent in 2008-09 to average 315 cents a kilogram. Underpinning the rise in prices will be a decline in numbers of cattle turned off for slaughter as producers move to rebuild herds. The extent of the price increase is expected to be moderated by weaker demand for Australian beef in Japan and Korea as competition from the United States increases, particularly toward the latter half of the year.

Reflecting an increased retention of female cattle for breeding, total slaughterings are forecast to fall by 2 per cent to 8.6 million in 2008-09. As a result, beef production is also forecast to decline by 2 per cent in 2008-09, to 2.1 million tonnes.

Total beef exports are forecast to fall to 880 000 tonnes in 2008-09 as a result of lower production, as well as an expected increase in competition from US beef in Japan and Korea. Exports to Japan in 2008-09 are forecast to fall by 6 per cent, while exports to Korea are forecast to fall by 19 per cent.

Exports of live cattle are forecast to increase in 2008-09, to 700 000 head, despite a forecast rise in prices, reflecting an expected increase in demand. Over the medium term the number of cattle exported live is projected to rise, driven by solid demand in South East Asian markets, a projected fall in cattle prices and an assumed weaker Australian dollar.

Sheep meat

Lamb production is forecast to rise by 2 per cent to 412 000 tonnes in 2008-09, as a result of higher slaughterings and a slight increase in slaughter weights. Reflecting an expected increase in export and domestic demand, the Australian weighted saleyard price for lambs is forecast to rise by 7 per cent in 2008-09, despite the higher production, to 355 cents a kilogram (dressed weight).

High wool prices over the past year, combined with strong saleyard prices for lambs and sheep, are expected to provide an incentive for producers to begin rebuilding flocks in 2008-09, and beyond. With producers likely to hold on to additional ewes for flock rebuilding in 2008-09, slaughterings of sheep are forecast to fall by 17 per cent to 8.5 million, but then to increase gradually as flock numbers grow over the medium term. Reflecting lower supply of sheep and increased demand as producers begin to restock, the Australian weighted saleyard price of mutton is forecast to rise by 9 per cent in 2008-09 to average 180 cents a kilogram.

Total Australian lamb exports are projected to increase by around 2 per cent, to 163 000 tonnes in 2008-09. In 2008-09, Mutton exports are forecast to fall by 24 per cent to 108 000 tonnes (shipped weight), as a result of lower production. Live sheep exports are forecast to fall to 3.7 million in 2008-09, constrained by a limited supply of sheep suitable for live export.
**Wool**

Strong prices for both sheep meat and wool, in addition to the encouragement provided by the recent good rains in many areas, can be expected to result in wool producers moving to expand flock sizes. Australian shorn wool production in 2007-08 is forecast to be 395 000 tonnes, down 7 per cent from the previous year. Australian shorn wool production is forecast to rise slightly in 2008-09 to 404 000 tonnes, largely as a result of a slightly higher number of sheep shorn and increasing fleece weights.

In the face of strong export demand, the lower production of shorn wool contributed to continued increases in the eastern market indicator price in 2007-08. Reflecting these further upward movements in wool prices, the eastern market indicator price in 2007-08 is forecast to average 970 cents a kilogram clean, 12 per cent higher than in 2006-07.

China is by far the largest consumer of Australian raw wool, which it processes and manufactures into a range of commodities from textiles to clothing. Substantial quantities of these products are exported to developed country markets. Since the largest export market for wool products is the United States, changes in US demand will have repercussions along the supply chain. Chinese imports of raw wool from Australia will be affected by expectations of Chinese processors about next year’s US orders for wool products. Any perceptions on the part of Chinese buyers of a softening in US demand for wool apparel and textiles could translate into lower Chinese imports of raw wool, thereby putting downward pressure on Australian wool prices.

Assuming uncertainty about US economic growth and its effect on demand for finished wool products is reflected in Chinese buying activity, the eastern market indicator price is forecast to fall by 1 per cent in 2008-09, to average of 960 cents a kilogram clean.

**Grains**

**Wheat**

The world wheat indicator price (US hard red winter, fob Gulf ports) has been at record highs in both nominal and real terms, in 2007-08. In 2008-09, world wheat supplies are forecast to increase by 12 million tonnes as global wheat production is forecast to increase by 19 million tonnes. This increase in wheat supplies is forecast to outweigh an increase in wheat demand and result in the world wheat indicator price falling by around 15 per cent in 2008-09. However, low wheat stocks will provide support to prices, maintaining them at historical high levels.

Global wheat production in 2008-09 is forecast to increase to 622 million tonnes, an increase of 3 per cent on the previous year. High wheat prices in 2007 and early 2008 are expected to encourage a larger area to be sown to wheat in many northern hemisphere countries, and are also likely to result in an increased area sown to wheat in southern hemisphere countries later in the year.
World wheat consumption is forecast to increase to 616 million tonnes in 2008-09, 5 million tonnes above the previous season. The major use of wheat is for human consumption, which accounts for around 70 per cent of global consumption. However, the increase in wheat consumption forecast for 2008-09 is largely the result of a forecast increase in demand for wheat for livestock feeding purposes.

Assuming average seasonal conditions in Australia, it is reasonable to expect a sharp increase in the area sown to wheat in 2008-09. The area sown to wheat is forecast to be a record 13.4 million hectares in 2008-09. Wheat production is forecast to increase to nearly 26 million tonnes in 2008-09.

Increased Australian wheat production in 2008-09 means that wheat exports will rise by a forecast 9 million tonnes. The value of Australian wheat exports is forecast to increase to $4.7 billion - more than double the value in 2007-08. The pool return for Australian premium white wheat (APW 10) is forecast to decline by around A$80 a tonne to average A$359 a tonne in 2008-09.

Coarse grains

World coarse grain prices are forecast to remain high through 2008-09 as production and consumption remain firmly balanced for a second year. The world indicator price for coarse grains (US com, fob Gulf) is forecast to average around US$198 a tonne in 2008-09, around US$5 a tonne higher than the previous year.

World coarse grain production is forecast to reach 1.1 billion tonnes in 2008-09 – 16 million tonnes higher than the record output of the previous year, and reflects the expectation of continuing strong grain prices. A recovery in coarse grain production in the European Union, Ukraine and Australia will more than offset a forecast decline in US corn production.

World coarse grain consumption is forecast to rise by 1 per cent to 1.1 billion tonnes in 2008-09, reflecting the continuing growth of the worldwide ethanol industry and the use of corn as a major feedstock. In the United States, the amount of corn used in ethanol production increased by 50 per cent to an estimated 81 million tonnes in 2007-08 – representing around a quarter of US corn production. Adding to the tight coarse grain market in the United States has been the strong growth in corn exports. US corn exports are estimated to have increased by 15 per cent to 62 million tonnes in 2007-08, reflecting to a large extent the effect of a weaker US dollar on price in importing country currencies and stronger demand from the European Union.

In Australia the area planted to barley is forecast to increase by 4 per cent in 2008-09, while production is forecast to increase by 51 per cent. The expected larger harvest means total coarse grain exports are forecast to increase by 83 per cent in 2008-09, with the bulk of the increase comprising shipments of barley which are forecast to increase by 80 per cent to around 5 million tonnes. The value of coarse grains exports is forecast to rise 72 per cent to around $1.8 billion, reflecting the larger volumes shipped and continued relatively high prices in the global market. In response to a forecast dramatic
improvement in production, Australian grain prices are likely to fall in 2008-09, however, prices are expected to remain at relatively high levels.

Oilseeds

The world oilseed indicator price (soybeans, cif, Rotterdam), has been at record highs during 2007-08. In 2008-09 prices are forecast to increase further as increased demand (particularly for biodiesel) provides support to prices. The world oilseed indicator price is forecast to increase from an average of US$503 a tonne in 2007-08 to an average US$513 a tonne in 2008-09.

World oilseed production is forecast to increase to 405 million tonnes in 2008-09, a 4 per cent increase compared with the previous year. Production of soybeans and canola/rapeseed (two of the major oilseeds) are both forecast to increase in 2008-09. In the United States – the world’s largest soybean producer – the area sown to soybeans is forecast to increase in 2008-09. In 2008-09 the area sown in Brazil is forecast to increase once again. However, the strong appreciation of the Brazilian real against the US dollar may to some extent limit the price incentives for expanded plantings. In Canada in 2008-09 yields are forecast to return closer to historical averages and production is forecast to increase. In 2008-09 the total area sown to canola/rapeseed in the European Union is likely to fall slightly. Despite record canola prices and the policy changes to ‘set-aside’ land (reduced to zero) in the European Union, it is expected that more area will be sown to wheat.

World oilseed consumption is forecast to increase by 2 per cent to 414 million tonnes in 2008-09 compared with the previous year, as demand for oilseed products increases. Vegetable oil consumption is forecast to increase to 130 million tonnes in 2008-09, and oilseed meal consumption is forecast to rise by 9 million tonnes. The growth of biodiesel is leading to increased demand for vegetable oil, a product derived from oilseeds. Industrial use of vegetable oil has more than doubled since 2000-01, from 8.7 million tonnes in 2000-01 to 22.8 million tonnes in 2007-08. With rising investment in biodiesel plants across the world, industrial use of vegetable oils is expected to continue to increase in 2008-09.

With grains prices remaining high and early seasonal indications looking reasonably favourable, it is forecast that there will be a record area sown to winter crops in 2008-09. The area sown to canola is forecast to increase by 10 per cent in 2008-09. Australian canola prices are forecast to fall by 10 per cent in 2008-09 to average A$568 a tonne. The decrease in price can be attributed to forecast increases in production. However prices are still expected to remain high in both the short and medium term.