Good drought recovery

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Take Home Messages

- Back to back droughts are extremely rare.
- The year following a drought is almost always better than the year preceding a drought.
- The cropping area will increase because of de-stocking during the drought and the need to generate cash flow.
- Cereals will dominate 2007-08 rotations, some farmers will "go for broke" whilst others will include fallow to minimise risk and set them up for 2008-09.
- Cropping farmers must take a conservative approach to expenditure on fertiliser, crop protection inputs and machinery.
- Farm debt levels are at a record high and there will be a strong demand for seasonal finance next autumn. Financial institutions must adopt a responsible approach to lending.
- Farmers should approach their lenders early and set up their lines of credit.
- Livestock numbers are down so recovery in the southern beef and sheep industries will take longer.

Introduction

We can look forward to a good recovery in value of production after the drought. Neil Clark & Associates has conducted research into the past seven droughts and the good news is that the year following the drought has always been better than the year preceding the drought. Success will depend on the "break" so for this article we have assumed a conservative "break" and below average growing season rainfall - something we are now used to.

Back to back droughts are rare

Long term wheat yield trends confirm that back to back droughts are extremely rare on a national scale although there may be some local occurrences. National wheat yields have been used as an indicator of climate variability. Note that in Figure 1 wheat yields following droughts are usually good.

Of interest is that yields growth was spectacular between 1983 and 2002 but the five year rolling average (black line) indicates yields are now in decline, mainly due to the current run of drier years and limited moisture availability. Other factors applying downward pressure on yield include the impact of crop intensity and attitude to investment in farm inputs during a period of low commodity prices.

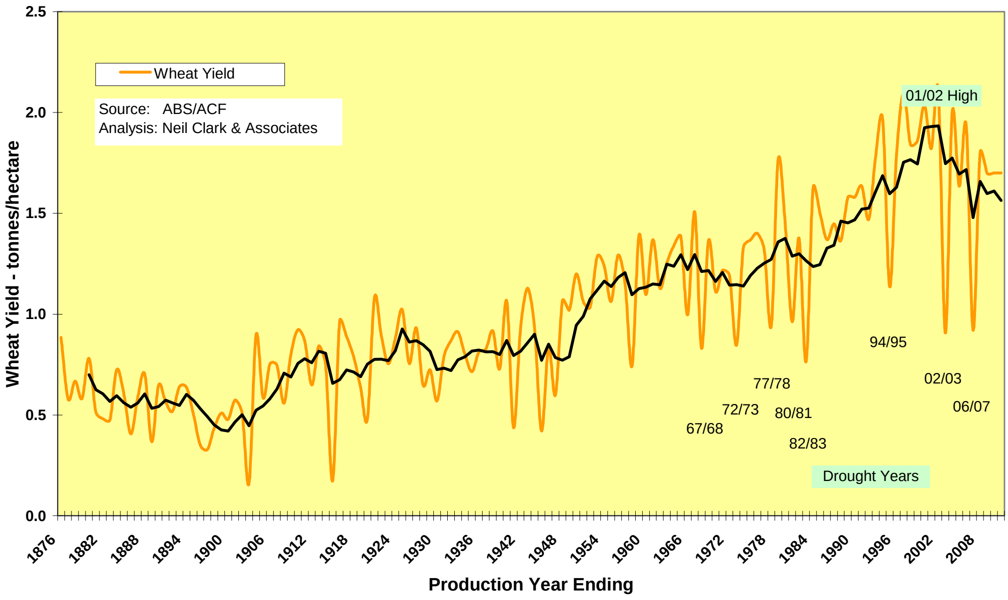

Figure 1: Wheat Yields - 1876 to 2011 with 5 year rolling average

A good year lies ahead

Our research into the past seven droughts shows that post drought crop performance is generally better than the pre drought year. Cropping land is rested during the drought year, almost like a compulsory fallow and recovery is rapid. Price signals for the 2007-08 production year are also strong. Leading edge farmers have already hedged a proportion of next year's production. Locking in good prices will counteract the effect of below average growing season rainfall.

Cereals will dominate 2007-08 rotations, they are less expensive to sow and less risky to grow. Cropping area will increase because of de-stocking and the need for post drought cash flow. Some farmers will incorporate more fallow to set themselves up for the 2008-09 production year. Other farmers will "go for broke" if we get a good early "break".

Value of farm production

Value of production will recover quickly after the drought just as it has done in the past. The recovery will be greater on grains and mixed cropping industries. Sheep and cattle numbers are down so recovery will be slower in these industries.

Traditionally there has been a close relationship between value of production and expenditure on farm inputs but that will not exist next sowing season because cropping farmers should be adopting a very conservative approach to expenditure on fertiliser, crop protection and the purchase of machinery.

Farm debt is a worry

On a regional basis crop production trends have been highly variable over the past six years to 2005-06. In some areas farmers, input providers and the community are under severe stress including the Victorian Wimmera and Mallee and the South Australian Mallee.

According to the Reserve Bank of Australia (RBA) farm debt levels rose to $45.7 billion at June 2006 and farm debt levels now exceed the value of production. Debt will rise again this financial year and the value of production will fall to about $32 billion. Figure 2 shows the rapid increase in debt to income ratio and this is a worry. It has risen from 0.8 in 2002 to an estimated 1.4 by June 2007.

The cost of servicing debt is now very high along with other farm input costs. Cash flow will be very tight in the cropping zone so farmers must take a conservative approach to expenditure on farm inputs and machinery.

There has been some cash flow from livestock sales, old and new season's crop sold at good prices, pool payments and Farm Management Deposits (FMDs); but seasonal finance will be in demand to sow the 2007 crop. Financial institutions will need to adopt a responsible approach to farmer lending, farmers should approach their lenders early and set up their lines of credit.

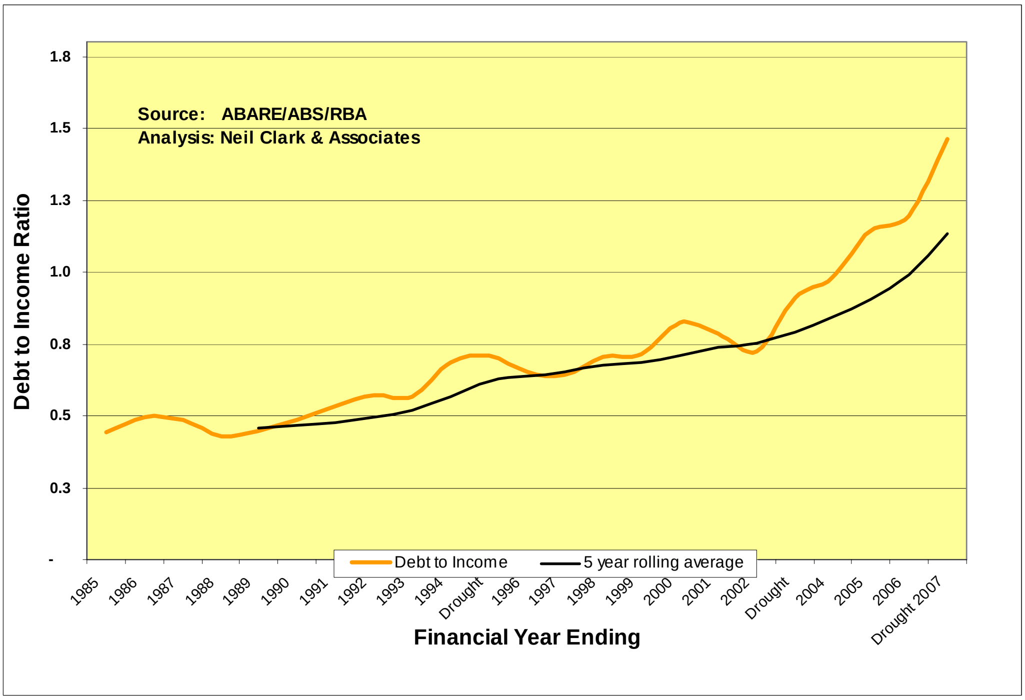

Figure 2: Debt to Income Ratio – 1985 to 2007

Livestock numbers are down

Beef and dairy cattle populations will drop by 1.2 million to 27.9 million and sheep population will drop by 5 million to 96 million by June 2007 (ABARE).

Livestock numbers generally recover quite quickly after a drought and will impact on the cropping area by 2008-09. Dairy will recover quickly but the Goulburn Valley district of Victoria will undergo major adjustments linked to water availability; and farmers will invest in animal health inputs to guarantee good stock health and fertility.