Analysis & Comments

Livestock Marketing Information Center

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Cattle Market Outlook: Smaller Supplies Facing Uncertain Demand

Each of the next two years U.S. beef production will drop dramatically. Even if cattle weights increase generally on-trend in 2013, output is expected to reach the lowest level since 2004. Should the industry take the first step toward herd rebuilding by holding back more heifers for breeding purposes beginning in 2013, beef production in 2014 could drop to the lowest level in over 20 years. Tighter beef supply will be supportive of beef and cattle prices.

Compared to the supply side, beef demand aspects are much less clear and will be a key to how high cattle prices go. Beef demand has two major components, the domestic market (which remains the most important) and exports. In 2011, surging beef exports were the driver to higher cattle prices. Even though beef exports remained very strong by historical standards in 2012, export tonnage ratcheted back, a trend expected to continue in 2013. Any improvement of beef demand in the next few years depends largely on the U.S. consumer, hence the growth rate in our economy, or lack thereof.

Losses regarding consumer demand for beef could be quickly reflected in fed cattle prices as packer margins are likely to remain rather narrow. In turn, because cattle feeders have little financial cushion due to huge financial losses in the last two years, calf and yearling prices also are vulnerable to any negative consumer demand developments.

Because of the dismal economics of feeding cattle caused by record-high feedstuff costs, in early 2013 calf and yearling prices will not reach 2012's lofty levels. If the 2013 growing season is normal for both crops and pastures, calf and yearling prices will likely return to posting year-on-year gains in the second half of the year. Rather normal weather could take 2013's fourth quarter calf market well above this year's. Lower feedstuff costs would dramatically improve both cattle feeding and cow-calf returns.

Supply Aspects

U.S. calf crops have been shrinking in recent years; the 2012 crop was likely about 800,000 head smaller than 2011's. And the 2013 calf crop will be even smaller. Besides the smaller calf crop, in the next few years two additional factors will contribute to lower-trending U.S. cattle slaughter: 1) smaller cattle imports; 2) increased hold-back of U.S. heifers and cows for breeding herds. Lower cattle numbers will translate into large declines in beef production, so the supply side will tend to ratchet up cattle prices.

U.S. Cowherd Still Declining

The definitive answer to the size of the U.S. beef cowherd inventory will be provided by USDA's National Agricultural Statistics Service (USDA-NASS) when they release the January 1 count on February 1st. They also will provide state level data on herd numbers and changes. We know that two years of drought have dramatically impacted the U.S. cattle industry. On top of devastated pasture and range conditions, 2012's drought in the Midwest caused surging feedstuff costs. A cursory look at beef cow and heifer slaughter data provided USDA-NASS might lead to the conclusion that the cowherd is no longer shrinking, but that is likely incorrect.

Both the beef cowherd and the total inventory of cattle and calves in the U.S. are expected to be smaller than a year ago as of January 1, 2013. As a reminder, the number of beef cows in the U.S. as of January 1, 2012 at 29.9 million head a drop of 967,000 head or 3.1% from a year earlier. At mid-year, beef cows were 2.9% below a year ago.

Even though beef cow slaughter in 2012 came in below a year ago, that decline was not enough to result in national herd size stabilization, let alone growth. Beef cow slaughter in 2011 was huge (nearly 3.8 million head) and the largest since 1996. As a percentage of the January 1 beef cow inventory Federally Inspected slaughter in 2011 was 12% and 2012's was 11%. Rarely has the herd increased when annual beef cow slaughter was over 10% of the beginning inventory.

Overall, the U.S. beef cowherd decline during 2012 was at a slower rate than in the prior year, likely the annual decline as of January 1, 2013 will be reported at about half 2011's pace. Nationally, the number of heifers being held for beef cow replacement purposes could be slightly above the rather low level of a year earlier, that statistic could vary widely across the country.

Cattle Imports Expected to Drop, Too

In each of the last two years, U.S. cattle imports from Mexico have been the largest in many years (in 2011 those imports totaled 1.43 million head). The most severe drought in decades has devastated Mexican pastures, just like the U.S. Southern Plains, forcing producers to sell animals early and liquidate herds. U.S. imports increased even though the size of the Mexican cowherd was shrinking significantly prior to 2011. Animals from further south than normal in Mexico have been sold to U.S. producers along with many more non-typical animals (e.g. spayed heifers).

Since peaking in 2005, the Canadian beef cowherd has declined by 1.5 million head (27%), according to Statistics Canada. The impact of smaller Canadian calf crops became rather apparent in 2011 when U.S. imports dropped to the lowest level since BSE and posted a one year decline of about 380,000 head. Imports from that country in 2012 were only slightly larger than 2011's very low level.

If near normal precipitation continues in North America, U.S. cattle imports will decline quickly. Most of the year-on-year decline will be in Mexican cattle. In the U.S., the impacts of those changes will be most apparent on feeder cattle supplies available to Southern Plains feedlots and stocker operations. Our current forecast has 2013's year-on-year decline at a minimum of 400,000 head.

When Will Heifer Hold-Back Increase?

A major unknown is when significantly more heifers will be held-back for breeding purposes, kicking-off beef cowherd growth. Herd expansion will begin when cow-calf operations see that their pastures resources are being underutilized and the economic environment indicates improved returns. Higher returns will likely require both higher calf prices and lower feedstuff costs. That could happen by the end of 2013, causing heifer slaughter to decline significantly in 2014. Of course, Mother Nature or economic conditions could derail that scenario, again.

Increased heifer hold-back would combine with another smaller calf crop to dramatically reduce annual U.S. beef production. And until those heifers become cows and their calves are transformed into beef, U.S. beef production will continue lower. Further, compared to historical norms, cyclical growth in cow numbers will likely be very modest and may not show up until the USDA-NASS inventory count as of January 1, 2015.

Beef Production Declining

In 2012, U.S. Commercial cattle slaughter declined 3.4% from a year earlier, the lowest since 2005. Record heavy cattle weights compensated for much of the drop in slaughter numbers, resulting in a rather modest 1.2% year-on-year decline in beef production. At 25.9 billion pounds, that was the lowest U.S. beef output since 2009. Steer dressed weight averaged 859 pounds in 2012, up 18 pounds from the prior year and exceeded the 2009's record of 847 pounds. Very good cattle feeding conditions, especially during the first quarter of 2102, and increased use of beta-agonists were the drivers of the larger than trend gain in fed cattle weights.

Cattle slaughter in 2013 is forecast to decline in all categories (steers, heifers, cows, and bulls). For the year, slaughter is expected to be 4% to 6% below 2012's and cattle weights are forecast to drop back to trend increases. If realized, that suggests U.S. beef production in 2013 will drop about 5% from 2012's. U.S. beef production would be 24.6 billion pounds, the lowest since 2004. Each quarter of the year should post significant declines in beef production.

Preliminary forecasts call for continued beef production declines in 2014. Based on additional heifer calf retention beginning in 2013, forecasts put 2014 Commercial beef production at about 23.5 billion pounds, 4% to 6% below 2013's. That would be the smallest since 1993.

Demand: Beef and Cattle

In 2012, domestic consumer beef demand held together surprisingly well given the anemic U.S. economy. In fact, the beef demand indexes indicated positive shifts in each of the first three quarters of 2012 (latest data available). Demand indexes have gained ground in recent years and reached 2008 (pre-recession) levels in 2012.

On a tonnage basis, U.S. beef exports slipped in 2012 mostly because of record high wholesale meat prices and slow-downs in economic growth of some key foreign markets. From January through October, U.S. beef export tonnage was 12% below a year ago. In 2011, tonnage was record large. Beef exports are forecast to slip slightly, again in 2013. How much of a decline depends to a large extent on economic growth, especially in Japan (which is in recession), Canada, and Mexico.

The stronger the U.S. economy is the less consumer push-back against rising beef product prices will occur. In 2013, any significant consumer push-back could quickly become a strong headwind to wholesale beef prices and in turn fed cattle prices. Packer margins are expected to remain under pressure well into 2013 and at times might not even match the very low levels of 2012.

Cattle feeding returns underpin demand for calves and yearlings. The LMIC has been estimating commercial Southern Plains typical cattle feeding returns since the mid 1970's, 2012 was the worst ever. Even if cattle feeding returns improve in the second half of 2013 as expected (lower feedstuff costs and high fed cattle prices should support better margins), the three-year period from 2011 through 2013 will be worse than the torrent of red ink from 2007 through 2009. Estimated breakeven sale prices for fed cattle to be sold into early 2013 are record high and look to be difficult to cover given price forecasts.

Cattle Prices and Outlook

On a quarterly average basis, all cattle types posted prices above a year ago throughout 2012; in fact, annual average cattle prices were record high. However, calf and yearling prices were quite volatile, while those of slaughter cattle generally followed normal seasonal patterns.

High feedstuff costs translated into gushing red ink on feedlot closeouts and crashing calf prices last summer -- in the Southern Plains 500-to 600-pound steer calf prices dropped by \$28.00 per cwt. (16%) from the second to the third quarter of this year. In that same timeframe, yearling steers (700-to 800-pound) prices dropped by an average of nearly \$11.00 per cwt. (21%). In 2012, fed cattle prices averaged over \$120.00 per cwt. for the first time ever (up about 7% from 2011's).

As 2013 unfolds, the best case scenario for the whole cattle industry is for a "measured" cattle price assent. First, that would require packers are able to pass along to their customer's higher beef prices, meaning no U.S. recession. Second, it will require both improved spring and summer pasture conditions in the U.S. and normal feedstuff production. If that develops and prices increase in a measured way, damage to the U.S. cattle feeding business will be minimized. Still, the lack of cattle feeding profitability will remain the headwind to higher calf and yearling prices well into 2013.

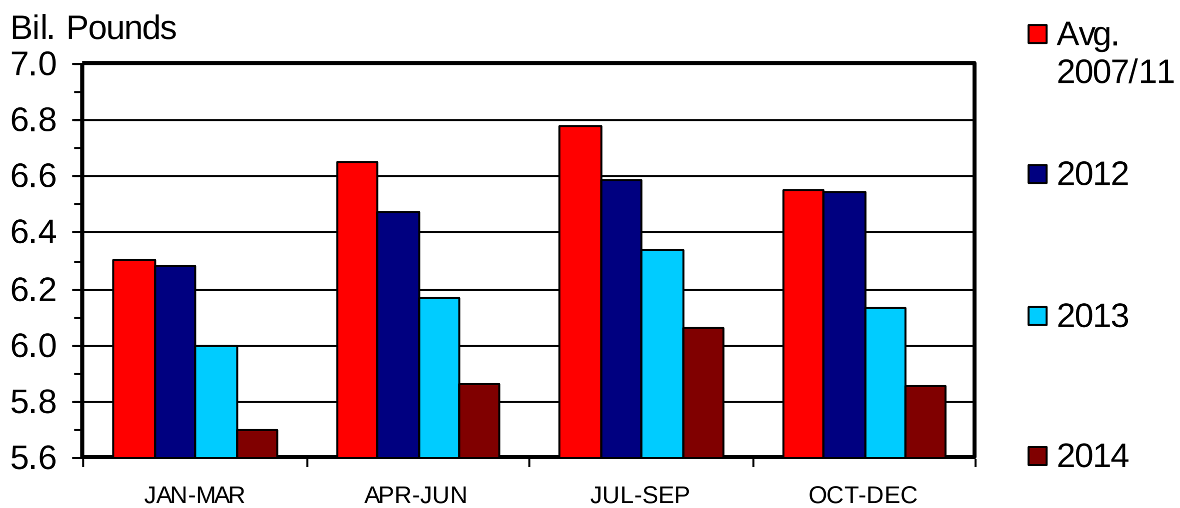
In early 2013, calf and yearling prices will not reach 2012's lofty levels. Feedlots simply cannot afford to pay last year's prices. If the 2013 growing season is normal for both crops and pastures, calf and yearling prices will likely return to posting year-on-year gains in the second half of the year. Rather normal weather could take 2013's fourth quarter calf market $5.00 to $10.00 per cwt. above 2012's.

Slaughter cattle (steers, heifers, and cows) are expected to have consistent year-over-year price gains throughout 2013. The highest fed cattle prices are likely to occur in the second and fourth quarters. For the year, fed cattle prices are forecast to average 5% to 7% above 2012's. Annual average cull cow prices next year will set all-time highs, supported by lower slaughter and very high prices for lean beef products, including hamburger.

Looking even further ahead to 2014, fed cattle prices should continue to gain. That suggests new record high calf, yearling, and cull cow prices, too. How high calf and yearling prices go mostly depends on the economics of cattle feeding and pasture conditions. If additional heifer calf retention for breeding purposes begins in 2013, numbers held-back will likely grow again 2014. For the fourth quarter of 2014, preliminary calf price forecasts put the year-over-year increase in the range of 5% to 12%.

COMMERCIAL BEEF PRODUCTION

Quarterly



Data Source: USDA-NASS, Forecasts by LMIC