



June 2003 Livestock Outlook
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Beef: Mad Cows and the Summer Market
Hogs: Prices Surge; Canadian Dynamics

Beef: Mad Cows and the Summer Market

As of Memorial Day it appears the US cattle industry has dodged a bullet – US beef consumers didn't appear to flinch in response to the Canadian BSE scare. Obviously, as the tangled trail of evidence unfolds in the continuing Canadian investigation, the possibility of outcomes harmful to US cattle industry could be introduced, but the odds of this happening appear to be slim. For those with cattle to sell during the next couple of months who are still wary of potentially demand busting events, June put option premiums fell sharply after Memorial Day and minimum prices in the lower \$70's (futures) could be locked in. If a highly negative BSE related event occurs, the value of the option would increase greatly and partially offset a cattle seller's losses in the live cattle markets.

If demand remains un-phased by the event, US feedlots will benefit from the temporary ban on the movement of cattle and beef from Canada. The key question is how long will this ban last. Many market observers have noted that Canadian cattle imports account for about 4% of all cattle slaughtered in the US each year and that Canadian beef imports are equivalent to about 4% of all US beef production. However, these figures are a bit misleading as they smooth out seasonal differences. The ban is likely to extend for June and maybe July and August. Historically, June is a low month for Canadian live cattle imports. In June 2002, for example, Canadian slaughter cattle imports accounted for only 2.8% of US slaughter and Canadian feeder cattle imports accounted for only 0.6% of US feeder cattle sales. Canadian beef imports were about average during June of 2002 and June of 2001, however. Hence, the demand boost from the ban will be a little weaker than what most analysts who have used annual statistics have predicted.

In particular, there should be little impact on feeder cattle markets so long as the ban does not extend past July. Canadian imports of feeder cattle account for less than 1% of the market during June and July. If the ban extends into August and September, however, feeder cattle prices could experience a noticeable boost. In 2002, Canadian imports accounted for 2.4% and 3.7% of feeder cattle sales during these two months; the loss of this supply could mean a few more dollars in cow-calf producers' pockets.

Stepping away from the BSE incident, it remains clear that the base demand for beef remains strong. May beef production was 2% above beef production in May 2002. Prices in May of 2002 average \$65 while prices this May averaged \$78. You don't need to be an economist to figure out that a 2% increase in supply coupled with a 20% increase in live cattle prices means stronger demand.

Much of this surge is driven by the demand for choice beef, with the choice-select spread hitting the \$18 mark during May – about \$10 over its seasonal average. This is due to cattle marketing dynamics. The weights of slaughter steers are well below year ago levels and many feedlots were anxious to market cattle before the larger supplies of summer come along. This race to the slaughterhouse further exacerbates the difficulty of locating cattle that can grade choice. The need for cattle that can grade choice was evident in recent movements in the feeder cattle markets. In Kentucky 8 cwt. feeders were selling at a premium to 7 cwt feeders, which is a rare event and signals just how eager feedlots are to get cattle to market that can grade choice before the inevitable seasonal decline in the choice-select spread and before the large feedlot placements from March and April crowd late summer slaughter houses.

The biggest news from the latest Cattle on Feed report was that feedlots placed 427,000 more cattle (+27%) on feed during April 2003 than in April 2002; no analysts had predicted such a surge and it is among the largest year-over-year increases in placements in some time. However, as I mentioned in last month's column, April 2003 feeder cattle sales were 25% above April 2002 feeder cattle sales and foretold of the massive movement of cattle into the last stage of production. May 2003 feeder cattle sales figures are about 15% higher than May of 2002, suggesting that the flow of cattle into US feedlots will again run above year ago levels, though official figures will not be available until the June Cattle on Feed report. Needless to say, however, late summer beef production will increase both as the number of cattle coming to slaughter increases and as weights rise seasonally.

Barring BSE related news, prices should drop from the upper-\$70's to the mid-\$70's by the end of June and then gradually fall to the upper-\$60's by September. If the Canadian ban persists beyond June, I would add \$1.50 to these prices. Prices will then begin their seasonal climb in October and move toward the mid-\$70's by December.

Hogs: Prices Surge; Canadian Dynamics

Over the past 7 weeks hog prices rose about \$10/cwt on a live weight basis or by more than 20%, rekindling hope for those who are still producing hogs after a year and a half of steady losses. For those who are still gun shy or need to lock in a profit, the options market can provide a floor price in the low-\$40's, which would provide a profit for most producers in the \$2 to \$3/cwt range. I project that those going without price protection will average cash returns above costs in the \$5-6/cwt range (live weight basis) for the summer and about \$2/cwt for the next 12 months so long as feeder pigs can be sourced near cost (about \$40 per 50 lb. pig). Eastern Corn Belt prices should average about \$46 for the summer and about \$42 over the next 12 months.

May prices indicate a marked turnaround in demand from May of 2002. Consider this: May 2003 slaughter was 4% lower than May 2002, but live hog prices were up 40%. But still, given the strength of beef prices one could imagine demand being even stronger, perhaps similar to 2001 when Hoof and Mouth Disease in Europe sparked a tremendous demand for US pork abroad. In May of 2001 production was 1.6% lower than May of 2003 and prices were about 10% higher (around \$50).

The recent price increases were not enough to keep Land o' Lakes from exiting the contract hog business, however. The firm lost more than \$20 million during 2002 and \$4.1 million in the first quarter of 2003. Land o' Lakes provided contracts that helped shield producers from downside risk in hog prices. While hog producers fared better than their non-contracted counterparts over the past year, Land o' Lakes and other contractors featuring similar contracts absorbed massive losses, which just goes to show that in the new era of hog production, even the big operators can fall.

On the supply side, US pork packers estimate that there are 450,000 empty finishing pens in the Midwest alone. Sow slaughter also continues to run ahead of figures from last year, suggesting that there are unlikely to be any supply side surprises in next month's Hogs and Pigs report, i.e., the US herd will continue to shrink.

On the demand side, the positive effect on pork demand from the Canadian Mad Cow scare never materialized with live prices actually declining slightly during the week following the incident. Increasingly, however, the fate of US and Canadian hog producers is tied together. Let's consider how several Canadian issues will impact the situation for US producers in the coming months.

The first issue is that of the Mad Cow disease outbreak. The initial reaction was that consumers across the continent might lose faith in beef and turn to pork for summer grilling needs. Barring any new developments, this is unlikely to occur. Even in Canada, where the danger would be the greatest, consumers do not seem phased. Couple this with the ban on beef exports from Canada, and you have a Canadian marketplace flooded with cheap beef. Confident Canadian consumers may turn away from pork and take advantage of the bountiful beef conditions. This leaves surplus pork, which will drive down price and make it more attractive compared to US pork, both in the US and in key importing countries like Japan. Hence, the mad cow scare may increase pork supplies in the US until our border is reopened for Canadian beef.

These trade dynamics are only likely to persist until normal beef trade resumes between the US and Canada. Another longer-term, offsetting issue is arising due to dynamics in the currency markets. In short, the weakening US dollar means the cost of sourcing feeder pigs or pork in Canada has increased by more than 10% compared to last year. While finishers in the US like Canadian feeder pigs for many reasons and while many supply chain relationships will be immune to currency fluctuations, a 10% increase in the effective cost will likely have a dampening effect on the flow of feeder pigs into the US from Canada. Whether this means that the current upward trend in this flow will merely flatten or whether it will actually retreat is yet to be seen, but currency futures don't suggest a turnaround in the exchange rate trend over the next year.