FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

March 29, 1985 Number 1652

Stronger cattle and hog prices expected, after 1Q drop

Livestock prices retreated to unexpectedly low levels during the first three months of 1985. The drop in prices reflects a higher than anticipated level of meat production during the quarter, along with continued large imports. However, livestock slaughter and red meat production are expected to drop below last year's level during the second quarter. Despite expectations of continued large gains in poultry output, many analysts believe the drop in red meat production will provide some strength for cattle and hog prices this spring.

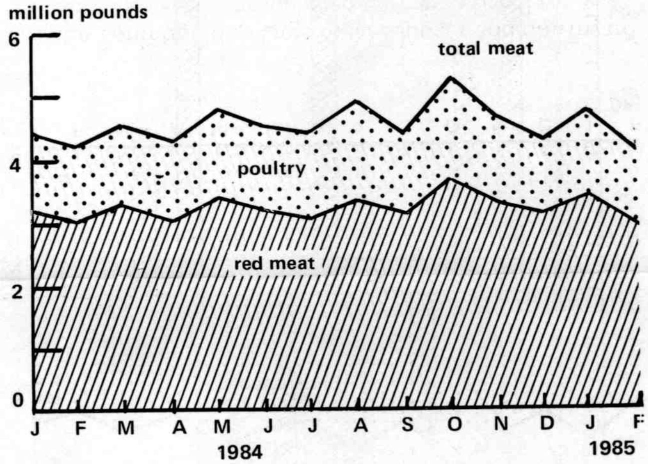
The downtrend in livestock prices through the early months of this year pushed cattle prices as low as about $58 per hundredweight and hog prices to about $43 per hundredweight. As a result of the sharp downturn, average prices for the first quarter are down from a year ago. Preliminary information suggests that choice steers at Omaha averaged less than $63 per hundredweight for the period, while barrow and gilt prices at the seven major markets averaged less than $48 per hundredweight. Compared to first quarter prices a year ago, choice steer prices were off about $5 per hundredweight and barrow gilt prices about equaled the average level for the first three months of 1984.

These low prices reflect the high level of meat production that has persisted during the first quarter. Preliminary indications are that first-quarter cattle slaughter was down slightly from the high level of a year ago, while beef production was up about 1 percent. The rise in beef output is largely attributable to the increased marketings of cattle from feedlots which nearly offset the drop in cow slaughter. The number of fed cattle marketed in the seven leading states during the first two months of the year was up more than 4 percent from a year earlier, implying that cattle from feedlots accounted for a larger share of total cattle slaughter.

As a result of the proportionate rise in fed-cattle marketings and lower feed costs, average slaughter weights increased from a year ago. Through February, dressed weights for all cattle averaged 2 percent more than last year. The largest gain was in heifer weights, up 3.6 percent from last year, while the average dressed weight for steers was up 2.6 percent. Through the first two months of 1985, the average dressed weight for cows was down 2 percent from the same period last year, reflecting a shift from dairy to beef cow slaughter.

Cow slaughter during the first quarter was expected to drop sharply below last year because of the winding down of the dairy paid diversion program and improving profit prospects for beef cow operations. However, cow slaughter through February was down only 8 percent from last year's very high level, as higher beef cow slaughter partially offset the reduction in dairy cow slaughter.

Commercial meat production



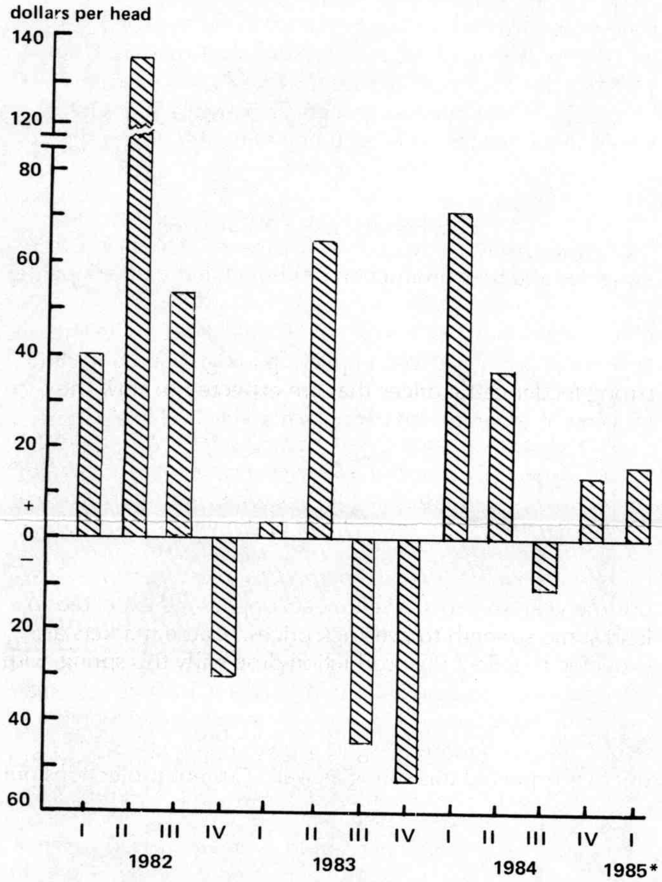
A smaller than expected drop in pork production this year has also contributed to large meat supplies and downward pressure on prices. Through February, hog slaughter was about 2 percent below the year ago pace. However, an increase of more than 1 percent in average dressed weights held pork production for the period only slightly below the year-ago level.

Imports of live hogs and pork products appear to be maintaining downward pressure on prices as well. Data available for the months of January and February indicate that live hog imports were nearly 80 percent above the year-ago level, and equal to about 2.4 percent of hog slaughter during those months. In addition, imports of pork products during the period, at 70 thousand tons, registered a substantial increase from a year ago, and equaled about 6.5 percent of January-February commercial pork production.

The large inflow of live hogs and pork products to this country has added substantially to meat supplies. Much of the increase in pork imports and virtually all of the jump in live hog imports have come from Canada. The incentive to purchase hogs from Canada is attributable to lower hog prices there after adjusting for foreign exchange values. However, it has recently been indicated that the rise in the value of the U.S. dollar is not the only factor contributing to the increased flow of imports.

The U.S. Commerce Department has determined that the subsidies that Canada pays its hog producers have affected the relationship between prices in the two countries, setting in motion a series of actions that may result in the imposition of countervailing duties. In a preliminary decision, the Commerce Department indicated that the payments to Canadian hog producers effectively subsidized the price of hog and pork exports by about U.S. $3.90 per hundredweight. Moreover, this decision will require U.S. importers of Canadian

Cattle producers' operating margins



*First quarter 1985 includes only January and February data.
SOURCE: Iowa State University

hogs and pork products to begin paying an estimated duty or to file a bond equal to the value of the subsidy. Commerce Department investigators are scheduled to make a final determination in June on the existence and extent of the subsidy. If it is determined that Canada does subsidize hog and pork exports, the International Trade Commission will decide if imports from Canada are injuring the U.S. pork industry. Then, if a determination of injury is made by the commission, countervailing duties will be assessed for the amount of the subsidy.

The increase in beef output and the marginal decline in pork production through the early months of the year have held total red meat supplies near year-ago levels. Through February, commercial red meat production totaled almost 6.4 billion pounds, up less than 1 percent from the same period in 1984.

Despite the moderate rise in production, livestock prices have dropped considerably from a year ago. While imports of meat have also increased supplies, a major factor affecting livestock prices has been a rapid increase in poultry output this year. Through mid-March, federally inspected poultry production totaled more than 3 billion pounds, a jump of more than 11 percent from the comparable period of a year ago. Broiler output, which accounts for about 85 percent of the total, was running 9 percent ahead of last year's pace. Production of other chicken and turkey were up 33 percent and 19 percent, respectively, from 1984 levels. This sharp rise in poultry production combined with a moderate, but larger than expected rise in red meat production has substantially increased total meat supplies, pressuring prices downward.

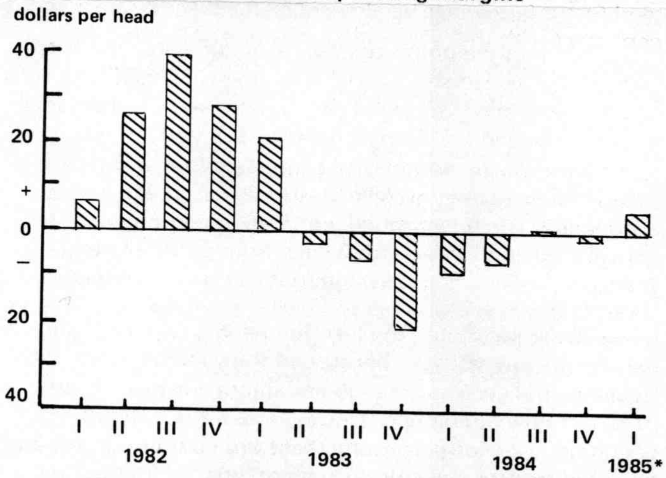
Low returns to cattle feeders and financial losses among hog farmers have characterized recent months. Iowa State University livestock budgets suggest that returns from feeding yearling steers fell short of costs by almost $12 per head during the third quarter of 1984, before rebounding to an average gain of about $13 per head during the fourth quarter. Although still low, returns climbed to about $16.50 per choice 1,100 pound steer marketed during January and February.

The budgets for an Iowa farmer marketing hogs from a typical farrow-to-finish operation depict substantial losses through much of 1984. The only period in which losses were not recorded was the third quarter when returns about equaled costs. During the early months of 1985, however, hog producers operating margins moved above the breakeven level. Estimated returns for hogs marketed during January and February, Although still quite low, averaged more than $5 per head compared to losses of $9 per head during the first two months of last year.

The losses incurred by livestock producers have encouraged them to maintain their production at current lower levels. According to the USDA's most recent *Hogs and Pigs* report, the March 1 inventory of hogs in the 10 leading producing states is down more than 1 percent from last year, and is the lowest March 1 inventory since 1976. Market hog inventories were down about 1 percent from a year ago, but at the lowest level since 1978. The only weight group to register a year-to-year increase was market hogs weighing less than 60 pounds, up 1 percent.

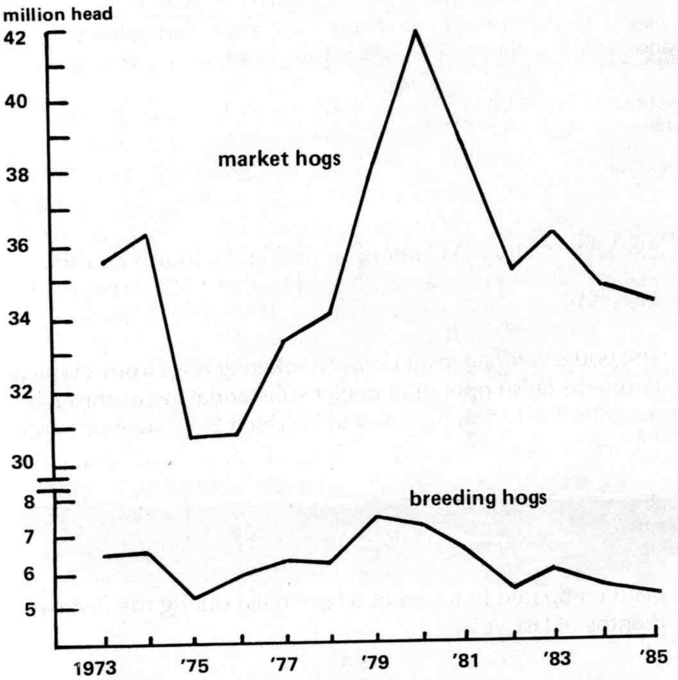
The inventory of hogs held for breeding purposes was down more than 4 percent from a year ago. Combined with last year's drop of more than 9 percent, this year's March 1 inventory of breeding hogs was the lowest recorded since estimates for the 10 state group became available in 1973. However, with sow slaughter running below the year-ago

Hog producers' operating margins



*First quarter 1985 includes only January and February data.
SOURCE: Iowa State University

March 1 hog inventories



SOURCE: USDA

level, it appears that hog producers have slowed the pace at which they are liquidating their breeding herd.

Farrowings during the December to February quarter were consistent with producers' intentions as stated last December. The 1.9 million sows that farrowed during the period represented a decline of 1 percent from a year ago. However, a milder winter this year pushed the average litter size to a record 7.51 pigs-per-litter, up sharply from the 7.27 pigs per litter average for the comparable period last year. As a result, the December-February pig crop registered a year-to-year increase of almost 2 percent, but was still 9 percent below the level of two years ago.

During the spring and summer quarters, producers' intentions point to continued declines in the number of sows farrowing. During the March-May period hog producers intend to cut farrowings by almost 5 percent from a year ago, consistent with their December intentions. The initial measure of producers' intentions for the June-August quarter suggests the number of sows farrowing may be down by almost 3 percent from last year.

These latest measures of hog inventories and farrowing intentions suggest that hog slaughter will continue to trend downward. The ten-state inventory of market hogs weighing between 60 and 179 pounds, which will be marketed this spring, is down about 2 percent from last year. If the ten-state inventory is indicative of the U.S. total and hog imports recede from recent high levels, commercial hog slaughter may be down 2 to 3 percent during the second quarter. However, the inventory of hogs weighing less than 60 pounds, reflecting the larger winter pig crop, was up 1 percent from last year, suggesting that third quarter hog slaughter could register a year-to-year increase.

Initial farrowing intentions for spring and summer foreshadow a downturn in hog slaughter at the end of this year and the beginning of the next. Although subject to change, year-to-year declines in the number of sows farrowing in the second and third quarters of 5 and 3 percent, respectively, would imply similar declines in hog slaughter during the fourth quarter of 1985 and the first quarter of 1986.

Additional support for livestock prices during the second quarter will likely come from year-to-year declines in cattle slaughter and beef production. Although fed-cattle slaughter is expected to be above year-ago levels, total cattle slaughter in the second quarter is expected to fall. Further declines in cow slaughter, along with improving forage conditions and strong feeder cattle prices that are expected to slow the movement of forage-fed cattle to markets, will likely more than offset any increase in fed-cattle slaughter. As a result, USDA projections point to a year-to-year decline in second quarter beef production of 4 to 5 percent, with a somewhat smaller decline in the second half of the year.

Despite continued increases in poultry production throughout the year, the cuts in red meat supplies are expected to lend some strength to livestock prices. Cattle markets are expected to reflect the production drop early this spring, with prices moving back into the mid to upper $60 per hundredweight range. Last spring, cattle prices averaged about $66 per hundredweight. Upward movement in hog prices is expected this spring as well. Current projections put second quarter prices in the upper $40-per-hundredweight range, and many analysts expect prices in the low $50-per-hundredweight range this summer. While these prices would be a welcome recovery from the current low level, they represent little year-to-year gain in hog prices this spring and summer.

Peter J. Heffernan

AGRICULTURAL LETTER (ISSN 0002-1512) is published bi-weekly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Gary L. Benjamin, economic adviser and vice-president, Peter J. Heffernan, economist, and members of the Bank's Research Department, and is distributed free of charge by the Bank's Public Information Center. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.

To subscribe, please write or telephone:
Public Information Center
Federal Reserve Bank of Chicago
P.O. Box 834
Chicago,IL 60690
Tel.no. (312) 322-5111

Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Receipts from farm marketings *($ millions)*	September	11,634	4.2	-10	-5
Crops*	September	5,846	11.1	-7	-6
Livestock	September	5,685	-0.8	-1	-5
Government payments	September	103	-40.8	-88	-10
Real estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	10.2	2.1†	12	20
Federal Land Banks	December 31	47.7	-0.9	-1	1
Life insurance companies	December 31	12.4	-0.9	-2	-3
Farmers Home Administration	September 30	10.2	0.9†	6	9
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	41.7	0.9†	7	13
Production Credit Associations	December 31	17.2	-2.8	-8	-15
Farmers Home Administration	September 30	16.8	0.6†	6	5
Commodity Credit Corporation	September 30	6.47	-0.8†	-47	-38
Farms loans made *($ millions)*					
Production Credit Associations	December	2,535	34.7	-13	-22
Federal Land Banks	December	201	1.7	-24	-37
Life insurance companies	December	66	158.5	-58	0
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	January 1	13.64	-5.6†	0	-5
Real estate loans	January 1	13.36	-4.6†	0	-6
Commodity Credit Corporation	April	9.75	6.8	-6	10
Agricultural exports *($ millions)*	January	3,142	-11.9	-11	1
Corn *(mil. bu.)*	January	209	0.6	20	19
Soybeans *(mil. bu.)*	January	73	-16.9	-10	-16
Wheat *(mil. bu.)*	January	109	-18.7	-10	-27
Farm machinery sales[p] *(units)*					
Tractors, over 40 HP	February	2,730	-45.3	-42	-35
40 to 139 HP	February	2,052	-43.4	-38	-41
140 HP or more	February	678	-50.3	-51	-7
Combines	February	173	-76.7	-72	-76

* Includes net CCC loans.
† Prior period is three months earlier.
[p] Preliminary

AGRICULTURAL LETTER
FEDERAL RESERVE BANK OF CHICAGO
Public Information Center
P.O. Box 834
Chicago, Illinois 60690
(312) 322-5112

AG001
LOUISE LETNES, LIBRARIAN
DEPT. OF AGRIC. & APPLIED ECON.
231 CLASSROOM OFFICE BUILDING
1994 BUFORD AVENUE
ST. PAUL, MN 55108