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The Outlook for Livestock*

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Livestock

Developing a credible statement on the outlook for the livestock market is seldom easy. It is a particular challenge at this time, in view of unexpected developments in the markets so far this year. Cattle prices in particular have been a discouraging surprise, averaging much lower than generally forecast during the late winter and spring, then dropping to even lower levels in July. Omaha Choice steer prices in late July were in a $49-$50 per cwt. range, the lowest since March of 1978, down $16 from early January and down $15-$16 from a year earlier. This is in contrast to fairly widespread expectations that prices at this time would be at least as high as a year ago and probably higher. I doubt that forecasting errors have ever been greater. The average price of Choice slaughter steers at Omaha during January-June of this year was around $60.35, compared to $67.45 in 1984.

Developments in the hog market have been a bit less startling, but still less favorable than expected. Slaughter has exceeded expectations somewhat and prices since mid-winter have been lower than were generally forecast. The January-June barrow and gilt average at seven terminal markets was $45.20 per cwt., down from $48.60 in 1984.

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Total Red Meat and Poultry Supplies

Total supplies of red meat and poultry have been very large so far this year--up 3% from 1984 during the first half of the year and a little larger than had been expected. Red meat production was up only slightly, with beef output up .7% and pork output down .7% from 1984. But production of all poultry meat increased by around 6%. Per capita supplies of total red meat and poultry have been record large; and for the year 1985 the supply will likely be the largest on record at a little over 211 lbs. Demand analysis indicates the competitive impact of chicken on both beef and pork has become stronger in recent years. And at high levels of meat and poultry supply, this effect may have been especially strong in recent months.

Farm to Retail Spreads

I believe relatively wide farm-to-retail spreads or margins on beef and pork have been a significant factor in the lower than expected livestock prices this year. USDA margin estimates on Choice beef for March-June averaged $1.092 per retail pound, up from $0.990 per pound the preceding four months and $1.009 in the same four months of 1984. Based on a conversion factor of 2.4 pounds of live animal per 1.0 pound of retail beef, the wider farm-to-retail spread would explain around $3.50 per cwt. of the year to year decline in cattle prices and around $4.25 per cwt. of the price decline since late last year.

On pork, the March-June 1985 farm-to-retail spread estimates averaged about $0.91 per retail pound, compared to $0.865 per pound in the previous four months and $0.830 in March-June of 1984. Since it takes about 1.7 pounds of live hog to yield a retail pound of pork, the wider spread would have a negative impact on prices of around $2.65, compared to November-February and around $4.65 per cwt. compared to March-June of 1984. Changes in these spreads can have a direct impact on live cattle and hog prices. In addition, the failure of retail prices to adjust down in proportion to live and wholesale level changes, may have slowed movement of these meats, to the extent that retail prices have been higher than available supplies would seem to warrant.

While beef production has shown only a small increase for the year, the sizable increase in average slaughter weights on fed cattle and the prolonged excess supply of over-finished yield grade 4 cattle have had a particularly negative impact on prices. The product from the over-finished carcasses is less desirable and adds weakness to the entire beef complex. Some of the increase in live and carcass weights also reflects the shift in slaughter mix to more grainfed cattle and a fairly sharp cutback in cow slaughter.

In the case of beef, lower value of by-products, including hides, has also contributed to the year to year price decline. But this effect is probably in the $1.00 to $1.50 range.

While some analysts argue that supply factors including the build-up of heavy cattle, largely explain the level of cattle and hog prices so far this year, I think there is also evidence of demand weakness. This appears especially true in the past month as cattle prices dropped to the $50 level and below for Choice steers and hog prices dropped sharply after a period of moderate seasonal strength.

Market Environment for the Next Year

General economic activity in the year ahead is not expected to be particularly strong, but I'm assuming the economy will continue to show positive economic growth. While demand for red meats is not likely to be robust, it should be comparable to the past year or perhaps better.

Overall supplies of red meat and poultry will probably drop somewhat, with a decline in red meat offsetting a moderate increase in poultry. But the total supply will still be large enough to rule out more than moderate increases in retail meat prices. There may be some validity to the view that red meat and poultry supplies in the 208-210 pound per person range largely satisfy current U.S. consumer demand for these products. But products in smaller supply in the year ahead should fare somewhat better pricewise, relative to those with steady to larger volume.

Hogs and Pork

Present indications are that hog production is still trending downward, with June 1 breeding stock inventories estimated to be 5% below a year earlier. And sow farrowing intentions for June-November were estimated to be down 4% from a year earlier. Inventories of market hogs already on hand at that time also indicated slaughter during the last 3 to 4 months of 1985 could be below the previous year by 2 to 4 percent. Actual farrowings during June-November could be slightly larger than June intentions, however, some reduction from 1984 appears likely. If farrowing conditions remain favorable throughout this period, litter size could average near the record level of a year earlier. But present indications still point to at least a small cutback in pigs raised for slaughter during the first 5 or 6 months of 1986.

Large feed supplies and relatively low feed prices will provide some incentive for larger sow farrowings in the December 1985-May 1986 period. But I feel any expansion will be modest--unless there is a significant recovery in hog prices in the late summer and fall. Financial constraints may also be a real limitation on significant expansion. My present guess is that December-February sow farrowings will be close to the previous year and that farrowings next March-May will show an increase that is no more than 5 percent.

These assumptions suggest domestic pork supplies will be 2 to 4% below a year earlier during September-December, 3 to 4% below 1985 during the first half of 1986 and about even with this year in the third quarter of next year. Volume of imported pork will probably remain relatively high, with imports from Canada and Europe likely as large or larger than in the past 12 months. Considering potential imports, total pork supplies may show a slightly smaller percentage decline than domestic production.

Supplies of competitive meat and poultry products in the year ahead should be a bit smaller, with a decline in beef more than offsetting increases in poultry supplies.

Retail pricing and margin developments will continue to be an important influence on hog prices. I know of no good procedure for forecasting margins, and will assume the farm-to-retail spread on pork will be at least as high as in the year earlier periods.

Price forecasting procedures that I use normally would suggest 4th quarter average prices for barrows and gilts in the low $50's ($52.00) during both the 4th quarter of this year and 1st quarter of 1986. Prices would drop to the $47-$48 range in the 2nd quarter and in the same general range in the 3rd quarter of 1986. But in view of lower than expected prices in recent months, I'm inclined to lower the forecasts for the next two quarters to the $45-$48 range in the 4th quarter, and the $46-$49 range in the 1st quarter of next year. If margin and demand conditions are favorable, we might do better than this.

Prices in the range forecast, in combination with expected fed costs, would generate moderate profits for most producers over the next year. If so, increased gilt holdback could be expected, with farrowing intentions moving to the 5 to 10% range during the last half of 1986. And this would lead to larger pork supplies in 1987 and a downward trend in prices.

Cattle and Beef

Supply fundamentals for cattle and beef prices look encouraging, indicating a strong probability of some downtrend in beef production in the year ahead and into 1987. Severely depressed cattle prices this summer, however, add considerable uncertainty to the price levels that might result from smaller beef supplies. Supplies of pork and poultry and other demand influences will obviously be very important price factors.

The number of cattle on feed July 1 in 13 feeding states was estimated by USDA to be unchanged from a year earlier. Increases in steers weighing over 1100 pounds and heifers over 700 pounds offset decreased numbers in lighter weight groups. April-June feedlot placements were reported at 7% under the previous year, with placements for the full January-June period down 5%.

July 1 cattle inventory estimates, in combination with cattle on feed estimates, indicated the number of young cattle outside of feedlots and not held for herd replacement was around 4% smaller than a year earlier. This reflects in part a 3 1/2 percent decline in the 1984 calf crop and a further 3 percent drop in the preliminary estimate of the 1985 calf crop. Placements are expected to remain below a year earlier this summer and fall, in view of the smaller potential feeder supply and very low prices on fed cattle and large losses on fed cattle marketed in recent months.

Fed cattle marketings are expected to drop below 1984 levels this fall, possibly down 2 to 3 percent in the 4th quarter. I think they will continue to show small year to year declines throughout 1986. Cow slaughter this summer has been running around 20 percent below a year earlier, and for the year to date is down about 15 percent. Slaughter for the balance of the year is expected to be 15 percent or more below 1984, but with only small decreases in the first half of 1986. Total slaughter in the 4th quarter may be around 5% below a year earlier. A higher proportion of fed cattle in the total slaughter and low feed costs will probably keep average weights heavier than in 1984. But beef production is expected to be down 2 to 4%.

For the first two quarters of 1986, I look for cattle slaughter to be 2 to 3% below 1985 levels, with small year to year declines in slaughter of both fed and non-fed cattle. This assumes there will be enough recovery in cattle prices later this year to encourage movement of cattle into feedlots, with no major change in slaughter of non-grainfed steers and heifers. I'm also assuming that further liquidation of breeding stock will be moderate in the early months of next year.

The very depressed condition of the cattle market at this time adds uncertainty to the timing and extent of price recovery. I believe prices are lower than can be explained by usual market influences and relationships. Demand for beef has been adversely affected in recent years by diet changes, health concerns, lifestyle changes and population composition. But it seems unlikely that basic demand for beef has changed materially in the past few months, compared with earlier this year or a year ago. If this is the case, cattle prices will recover from current levels when the problem with heavy, over-finished cattle eases and retail prices more fully reflect the sharply lower wholesale and live prices.

The turnaround in cattle prices should develop over the next several weeks, with recovery to around the $60 level for Choice steers, Omaha, likely by mid to late September. If slaughter is at the levels forecast, I expect prices by late this year and in the first half of 1986 to be in the mid $60 range and possibly higher. But if there has been some recent negative shift in beef demand, lower levels are likely.

Feeder cattle prices have not dropped quite as much this summer as slaughter cattle, possibly because of low grain prices and some remaining optimism that fed cattle prices will eventually rebound. Recovery in fed cattle prices to the low $60 range or above, in combination with low grain and feed prices, would probably bring a fairly strong demand for feeder cattle. Prices for 600-700 lb. steers this fall are expected to be from the high $50's to mid $60's, with 400-500 lb. steer calves from the high $60's to mid $70's. At these levels, there should be at least modest profit potential on fed cattle in the first half of 1986.

Longer Term Cattle Prospects

The USDA's mid-year cattle inventory report was favorable for longer term cattle market prospects. The number of cattle on farms and ranches July 1 was estimated at 116.3 million head, down 4% from a year earlier. The number of cows and heifers that have calved was estimated at 5% below a year earlier, including a 7% drop in beef cows but 2% more milk cows. Beef replacement heifers were also reported to be down 11% from last July 1. The preliminary estimate of the 1985 calf crop was down 3% from 1984; and this follows a 3 1/2% drop in the 1984 calf crop.

Inventory and calf crop estimates indicate a strong probability that beef production will show a moderate decline over the next couple of years. Some further modest liquidation of inventories is expected until improved returns bring more optimism abut future prices and profit levels. Demand conditions and the supplies of other meat and poultry products will be important influences on cattle prices over the next couple of years. But I expect the drop in beef supplies to bring at least a moderate uptrend in prices of both feeder and fed cattle in the 1986-87 period.