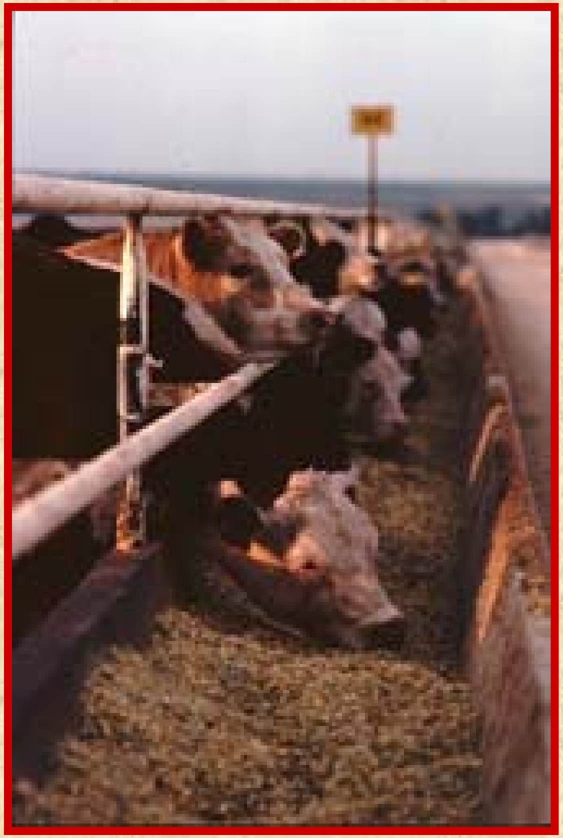
Cattle Price Situation & Outlook



AAEA Extension Livestock Outlook

July 25, 2005

Providence, Rhode Island

Darrell R. Mark, Ph.D.
Livestock Marketing Specialist
University of Nebraska-Lincoln
dmark2@unl.edu
http://agecon.unl.edu/mark

Cattle Price Situation & Outlook[1]

Darrell R. Mark, Ph.D.
Extension Livestock Marketing Specialist
Institute of Agriculture and Natural Resources
University of Nebraska-Lincoln

Overview

International trade of live cattle and beef has dominated the market situation and outlook for cattle prices for over two years. Immediately following the first case of bovine spongiform encephalopathy (BSE) in Canada on May 20, 2003, the U.S. banned imports of both live cattle and beef. While imports of selected beef products resumed in August 2003, live cattle trade only resumed last week (July 18, 2005) as a result of a lengthy USDA rule-making process and a difficult legal struggle between the USDA and a faction of the cattle industry (which is not completely resolved yet). Meanwhile, two additional cases of BSE were identified in Canada (January 2 and 11, 2005). The discovery of a Canadian-origin cow in the U.S. testing positive for BSE on December 23, 2003 resulted in the immediate loss of all U.S. beef exports. A year and a half later, only a small portion of the U.S. export market had been resumed when a native U.S. cow was determined to have BSE, which further slowed the resumption of export trade.

Not surprisingly, these events have significantly affected the psychology of the market and cattle and beef prices over the last two years. Before the disruptions in trade occurred two years ago, net U.S. beef exports approached $2 billion. Interestingly, by historical standards, the U.S. imports less than 15% of its commercial beef production and exports less than 10% of commercial beef production on a volume weight basis. This suggests that the high prices seen in the cattle market in the past two years are a function of more than just the imposition of various international trade bans, but also fundamental domestic supply and demand factors. Historically tight supplies coupled with substantial demand increases resulted in record high annual feeder and slaughter cattle prices in 2003, again in 2004, and are likely in 2005.

Domestic Supplies Remain Tight

The July 22, 2005 mid-year Cattle Inventory report estimated the number of all cattle and calves in the U.S. at 104.5 million head, up less than 1% compared to last year's historical low (see slide 6). Inventory numbers in 2005 are increasing for the first time since 1995, following the longest-ever liquidation phase of the cattle cycle. Driven by drought severely limiting carrying capacity in western U.S. pastures and high feeder prices discouraging retention and rebuilding of herds, the eight-year liquidation resulted in an historically small calf crop in 2004 (37.6 million head) and less than 40 million head of feeder cattle outside of feedyards (slide 7). This record tight domestic supply of calves, coupled with the lack of Canadian feeder cattle, resulted in more than a 15% increase in feeder cattle prices in 2004 compared to 2003. Feeder cattle prices in 2005 are on track to surpass the 2004 annual average.

[1] Presented at the Livestock Outlook Organized Symposium, American Agricultural Economics Association annual meeting, Providence, Rhode Island, July 25, 2005.

Growth in the beef cow inventory has been relatively modest thus far. The number of beef cows increased 250,000 head in 2005 following last year's 4% increase in the number of heifers being held for beef cow replacements. Friday's Cattle Inventory report estimated this year's beef cow replacements would increase about 4.2% (slide 8). The growth in beef cow numbers will lead to increased supply of feeder calves in the next several years, suggesting feeder cattle prices have peaked. However, the moderate growth expected should still support strong feeder cattle prices for the next 2-3 years.

Although monthly cattle on feed numbers have been below the 5-year average for the past couple of years, on feed inventory numbers have been increasing throughout 2005. Year-to-date cattle on feed in the U.S. is up 1.7% compared to 2004. Last Friday's Cattle on Feed report indicated that the July 1, 2005 inventory at 10.4 million head, is 2.8% higher than a year ago and steady with the 5-year average (slide 9). Following the BSE discovery in Canada on May 20, 2003, cattle on feed numbers dropped substantially in Alberta and Manitoba because of the loss of access to U.S. slaughter plants. As slaughter capacity in Canada increased (more than 25% in 2004, see slide 23) and the border reopening to the U.S. continued to be delayed, Canadian cattle on feed numbers have increased. The July 1, 2005 on feed inventory was up 18.2% from last year, but still more than 7% lower than the 5-year average. The increased cattle on feed numbers in recent months will help offset some feeder cattle imports into the U.S.

Placements of cattle on feed were higher in June 2005 than June 2004, both in the U.S. and Canada (slide 10). U.S. feeders posted net placements of 1.7 million head last month, an increase of nearly 9% from June 2004. While placements of feeders weighing less than 600 lbs. and 600-699 lbs. were down 10.4% and 2.5%, respectively, placements of heavier feeders increased substantially. 700-799 lb. placements increased 7.1% last month and 800+ lb. feeder placements jumped to 530,000 head, a 41.3% increase. The large placements of heavy-weight feeder cattle in June will lead to pressure on fourth quarter fed cattle prices. And, depending on the price of corn, these placements will likely result in significant losses for cattle feeders based on the relatively high prices paid for the feeder cattle.

Average daily marketings were down 0.2% in June 2005 and 6.5% lower than the 5-year average for the month. Year-to-date federally inspected commercial cattle slaughter is down 2.6% (slide 11). As on feed inventory numbers began increasing earlier this year, this summer's marketings have languished somewhat, causing U.S. feedyards to become less current. The number of cattle on feed for more than 120 days was an estimated 3.3 million head on July 1, 2005, 9.3% higher than last year and 6.7% higher than the 5-year average. The growing supply of market-ready cattle in feedyards has led to rapid increases in cattle weights, which will translate into increased beef production in the third and fourth quarters of this year.

Although domestic cattle supplies have stayed near their historical lows in 2005 and imports of Canadian live cattle did not resume until July 18, 2005, other U.S. imports have increased. Live cattle imports from Mexico are up 17% thus far in 2005 compared to last year (slide 13), largely in response to the lack of feeder cattle from Canada. Further, with the significantly higher cattle slaughter in Canada, imports of boxed beef from Canada have jumped dramatically. In May (most recent month for which there is data), beef imports from Canada were over 46% higher than May 2004. Year-to-date, Canadian beef imports into the U.S. are up 17% (slide 14). The increases in both Mexican feeder cattle and Canadian beef are likely direct results from the ban on Canadian cattle imports and are likely to decrease as live cattle trade with Canada returns to pre-trade ban levels.

Can Demand Continue Strong?

Demand for retail choice beef increased substantially in 2003 and 2004 (slide 16). Much of the increase has been attributed to a shift in consumer tastes and preferences for protein products, stemming from the popular adoption of high protein and low carbohydrate diets. The number of consumers on a high protein/low-carb diet began to decrease late in 2004 (slide 18), and could be down again in 2005 following a brief increase in January and February (an increase likely associated with New Year's resolutions). Beef demand for the first half of 2005 appears to have leveled off. For the first quarter of the year, beef demand decreased 1.2% while it increased 0.6% in the second quarter.

The prospects for another sizeable increase in demand this year, relative to the past two years, is relatively unlikely. However, a stable level of demand may occur, and would generally be supportive to beef and cattle prices. There are several reasons to expect a more constant demand for beef this year, or even a slight decrease. First, the high protein/low-carb diet trend is likely to subside throughout the year as consumers grow weary of this particular dietary restriction and move on to the next popular diet craze. Second, consumers are likely to increasingly substitute pork and poultry for beef as real retail beef prices continue to increase relative to other meats (slide 17). The real (2000 dollars) retail choice beef price, for example, increased from \$3.65/lb in the fourth quarter of 2004 to \$3.72/lb in the first quarter of 2005 to \$3.75/lb in the second quarter of 2005. Real retail pork prices actually declined from \$2.55/lb in fourth quarter 2004 to \$2.54/lb in the first half of 2005. A third factor likely to impact beef demand is the larger proportion of disposable income spent on energy needs. With substantially higher gasoline prices this year, consumers may find themselves spending less on other goods, including higher valued beef products.

Export demand has been notably weak (or non-existent) for 2004 and much of 2005. Over 40 countries banned U.S. beef following the positive BSE case in the U.S. in December 2003. While Mexico, as a major export customer, resumed purchases within a few months and recently is approaching its historical level of purchases (slide 19), the U.S. has only regained about 25% of its beef export market (volume basis) compared to pre-trade ban levels. Although resumption of beef trade with Japan and Korea (the top two export countries) appears hopeful and even eminent at times, there will not likely be a substantial volume of trade to occur in

2005. Further, while the resumption of trade would be a positive signal, the impact on prices will not likely be as significant as many might expect. For example, in 2003 Japan accounted for 37% of U.S. beef exports, or roughly 3.7% of U.S. commercial beef production (assuming exports are 10% of production). Based on average beef price flexibilities, this would likely translate to around a 5-6% price increase, or about $5/cwt for $85/cwt fed cattle price.

The Minimal Risk Regions Rule

USDA published its minimal risk regions rule on January 4, 2005. The rule created requirements for classification of regions that present minimal risk for the U.S. to introduce BSE, classified Canada as such a region, and defined the type of cattle and beef trade that may occur after the rule was scheduled to take effect on March 7, 2005. On March 2, 2005, the District Court of Montana issued a preliminary injunction that suspended implementation of the minimal risk regions rule. The preliminary injunction was overturned on appeal on July 14, 2005. Although the District Court was scheduled to hear arguments for a permanent injunction on July 27, last week the court vacated the argument, essentially postponing the hearing until the appellate court issued its opinion in overturning the preliminary injunction. As a result, the minimal risk regions rule was implemented immediately following the appeal court ruling.

Regions classified as minimal-risk are those that have diagnosed animals infected with BSE but having domestic regulatory measures that would make introduction of BSE into the U.S. unlikely. After USDA conducted a risk assessment of Canada's regulatory measures and other BSE safety precautions, USDA approved it as the first minimal-risk region (other countries could be added following a risk assessment by USDA). USDA indicated that Canada met the minimal-risk standards by having 1) import restrictions since 1990 that would limit BSE exposure to Canadian herds, 2) surveillance for BSE at or above international guidelines, 3) a ruminant-to-ruminant feed ban since 1997, and 4) risk mitigating measures imposed as necessary following BSE investigations and risk assessments.

Under the rule, the U.S. may import from Canada 1) live cattle for feeding or slaughter provided they are slaughtered before 30 months old, 2) boneless or bone-in beef from cattle less than 30 months of age, and 3) cattle livers, tongues, gelatin, and tallow. Live cattle imports from Canada must meet several standards to insure they are less than 30 months of age before slaughter. First, they must be branded with "C/\N" on their right hip and be individually identified with an ear tag that can be used to trace the animal back to its herd of origin. Cattle that are imported to feed prior to slaughter may not be moved between feedyards (i.e., they can only be fed at one feedyard prior to slaughter). All cattle destined for feedyards or slaughter must be shipped in sealed containers, verified by USDA-APHIS veterinarians or its approved representatives. In addition to certification from Canada of the animals' age, feeding history, and identification, the health certificate for the imported cattle must include the origin and destination of the animals, the responsible parties, and the individual ear tag numbers of all the animals.

Examining pre-BSE imports of feeder and fed cattle from Canada can provide some indication as to the number of cattle that may arrive in the U.S. yet this year. Figures 1 and 2 show the average weekly feeder cattle and fed cattle imports from Canada from 2000-2002, respectively. Historically, weekly feeder cattle imports are seasonally lowest during the summer months and increase into the fall and winter, peaking in February. The average August to December feeder cattle imports from 2000-2002 is about 100,000 head, or about 4,800 head per week. These numbers, however, are somewhat inflated by the unusually large feeder cattle imports in 2002 that resulted from drought conditions in Canada. Fed cattle imports are seasonally highest in the third and fourth quarters (Figure 2). The average August to December fed cattle imports (2000-2002) is 340,000 head, or about 16,000 head per week. The average 2000-2002 August to December cattle imports from Canada accounted for about 3% of U.S. commercial cattle slaughter during those months. As a result, a negative price impact of roughly 4-4.5% may be expected, or about $3.50/cwt based on the current $80/cwt slaughter cattle market.

This large of a price impact is not likely to occur, however, for several reasons. First, it would assume that beef imports remain at their current level. As noted earlier, beef imports from Canada reached an historical high in May (114 million lbs), up 47% from last May. Year to date, 2005 beef imports from Canada are up 17% from last year. As the minimal risk regions rule is implemented, Canadian slaughter

Figure 1. Average Weekly Feeder Cattle Imports from Canada, 2000-2002 (Pre-BSE Trade Ban)

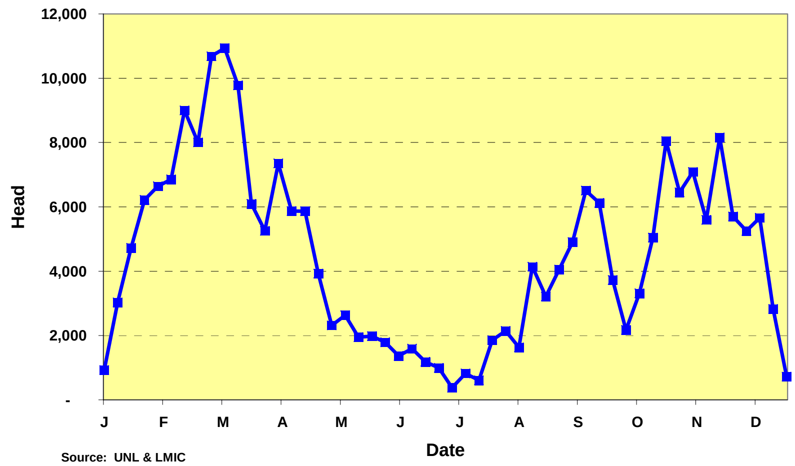
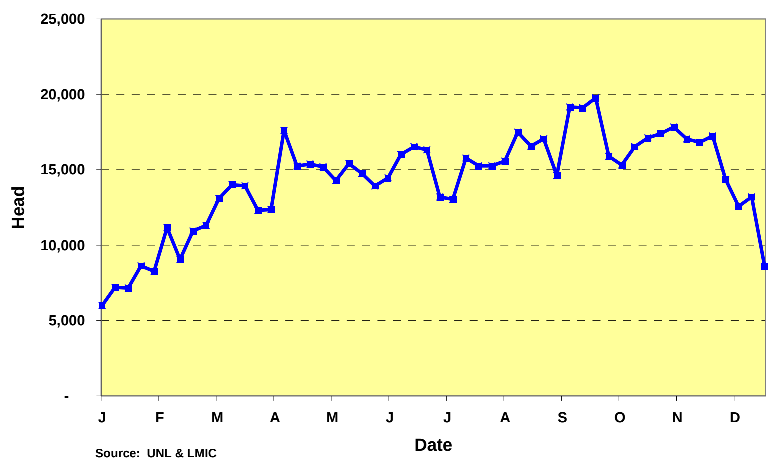


Figure 2. Average Weekly Fed Cattle Imports from Canada, 2000-2002 (Pre-BSE Trade Ban)



capacity will likely be used for cattle more than 30 months of age while cattle less than 30 months of age are directed to the U.S. This should lower the amount of beef available in Canada for export to the U.S. Second, the 2000-2002 pre-BSE trade ban numbers above are likely high based on the large Canadian feeder cattle imports in 2002 that resulted from drought conditions. Third, Canadian slaughter capacity is running significantly higher than in 2000-2002. While it is likely that some decrease in Canadian slaughter will result from the reestablishment of trade, a larger proportion of Canadian cattle will be slaughtered in Canada than before the trade bans were put in place. Fourth, increases in the number of cattle on feed in Canada in recent months should help reduce the number of feeder cattle available to export to the U.S. Fifth, the narrowing spread between U.S. and Canadian live cattle prices in recent months should help moderate the volume of cattle traded (this spread will likely drop close to zero when trade does resume).

Price Outlook

Feeder cattle prices are likely to fall more than fed cattle prices as a result of the Canadian border reopening, particularly for late third quarter and fourth quarter 2005. While large losses in cattle feeding and the potential for higher corn prices will tend to weigh on prices, the relatively tight supply should provide support. Look for 700-800 lb. feeder steer prices to hold above $100/cwt (basis Nebraska) for the remainder of 2005. Prices likely will be in the upper $90s to lower $100s throughout 2006 for yearling steers as Canadian imports reach their historical levels and domestic supplies begin to increase following this year's slightly larger calf crop. That larger calf crop in 2005 should also serve to bring prices on 500-600 lb. feeder steers down from the lofty levels seen this past year.

Commercial slaughter is forecast to increase 1-2% for the remainder of the year. With a 1% increase in dressed weights, commercial beef production will likely be 2.5-3% higher for the remainder of the year. This should result in fed cattle prices trading in the upper $70s through the third quarter of 2005 and into the fourth quarter. Later in the year and into 2005, there likely will be slaughter cattle priced over $80/cwt, following the typical seasonal trend. Year-over-year increases in slaughter and dressed weights in 2006 will lead to at least a 3% increase in beef production next year. Thus, fed cattle prices are not likely to see the $90/cwt range for much of 2006, but instead trade in the upper $70s to lower $80s.

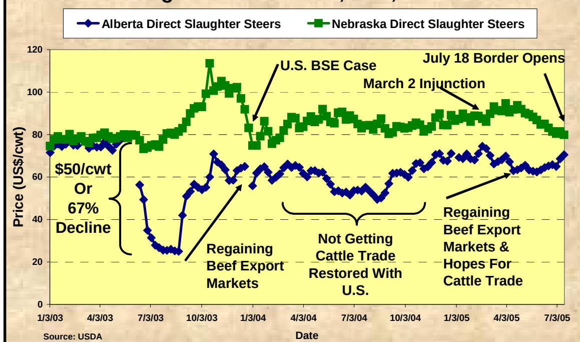
3

North American BSE Timeline

- May 20, 2003 — Positive BSE Test In Canada
- Dec 23, 2003 — Positive BSE Test In U.S.
- Jun 25, 2004 — Inconclusive BSE Test In U.S.
  - ✓ Jun 30, 2004 — Confirmed Negative
- Jun 29, 2004 — Inconclusive BSE Test In U.S.
  - ✓ Jul 2, 2004 — Confirmed Negative
- Nov 18, 2004 — Inconclusive BSE Test In U.S.
  - ✓ Nov 23, 2004 — Confirmed Negative
- Dec 29, 2004 — Inconclusive BSE Test In Canada
  - ✓ Jan 2, 2005 — Confirmed Positive
- Jan 11, 2005 — Positive BSE Test In Canada
- Jun 10, 2005 — Nov 18 U.S. Case Retested & Reactive
  - ✓ Jun 24, 2005 — Nov 18 U.S. Case Confirmed Positive

4

Alberta, Canada and Nebraska Direct Slaughter Steer Prices, US$, 2003-05

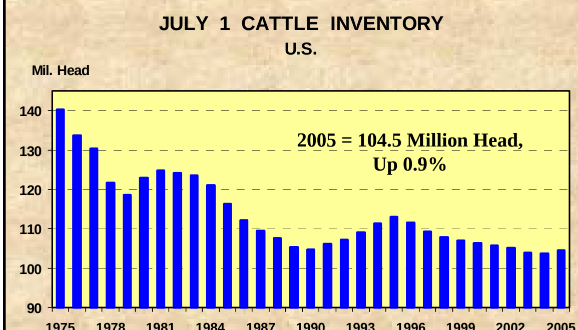


5

Supply Side

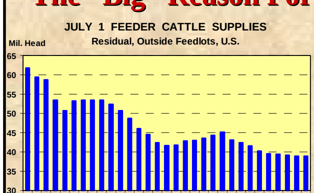
6

Generally Tight Supplies…

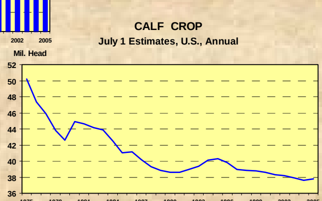


7

The "Big" Reason For High Feeder Prices

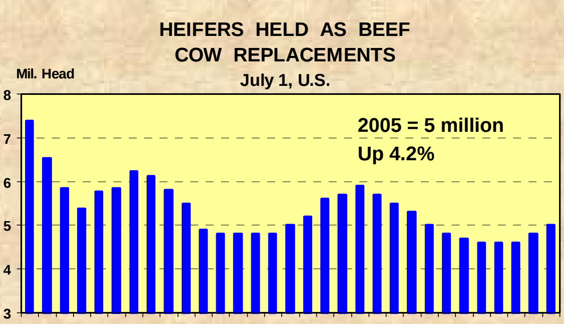


1[st] Time In 10 Years Calf Crop Increased



8

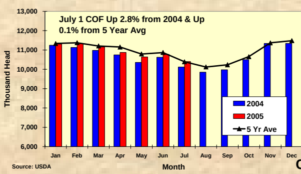
Two Years Of Herd Rebuilding



Darrell R. Mark, Ph.D.
University of Nebraska-Lincoln Extension

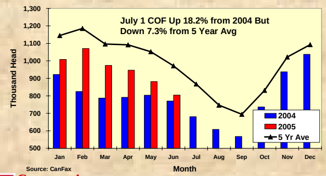
AAEA Extension Livestock Outlook Organized Symposium
Providence, Rhode Island
July 25, 2005

9

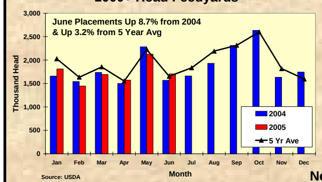


2005 U.S. Cattle on Feed Up 1.7% YTD

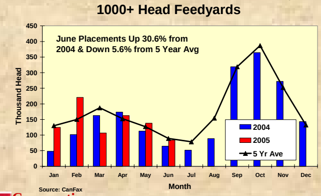
2005 Canada Cattle on Feed Up 20% YTD



10

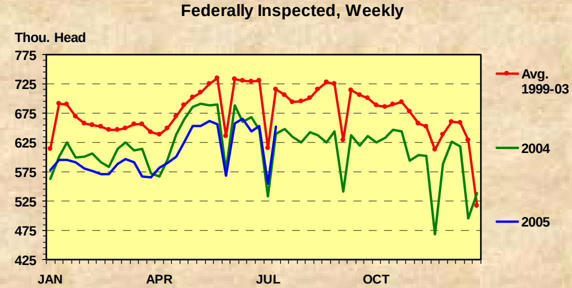


- **Heavy Weight Placements To Pressure 4th Quarter Prices**
- **800+ lb. Up 41%**



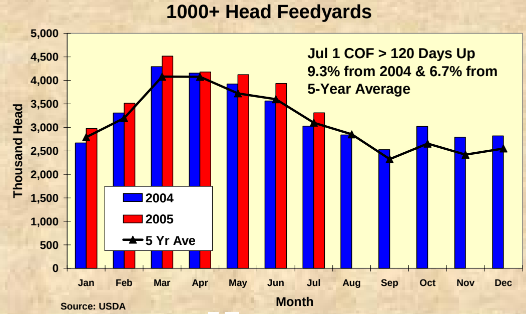
11

YTD FI Cattle Slaughter Down 2.6%
2004 FI Cattle Slaughter Down 11.2%



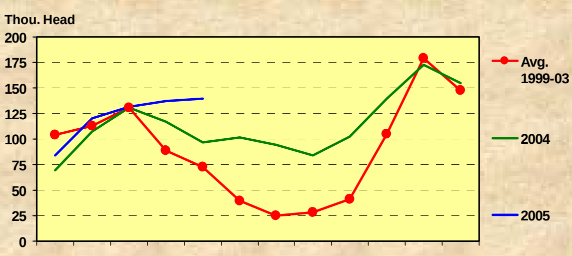
12

Feeders Losing Currentness
Dressed Weights Currently 10 lbs. Heavier



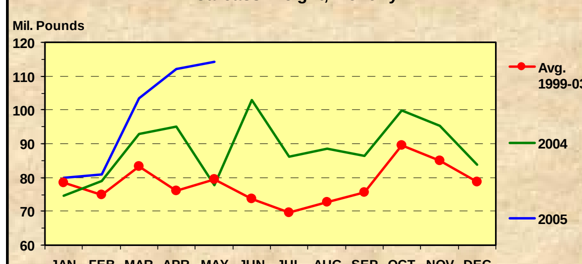
13

2005 YTD Mexican Cattle Imports Up 17%



14

2005 YTD Canadian Beef Imports Up 17%

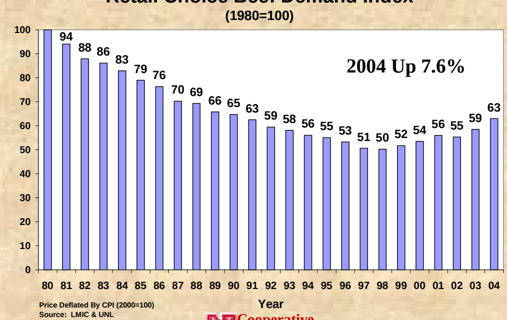


Darrell R. Mark, Ph.D.
University of Nebraska-Lincoln Extension

Demand Side

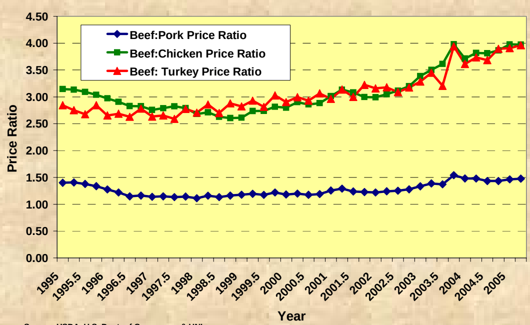
2005:I Choice Beef Demand Down 1.2%
2005:II Choice Beef Demand Up 0.6%

Retail Choice Beef Demand Index
(1980=100)



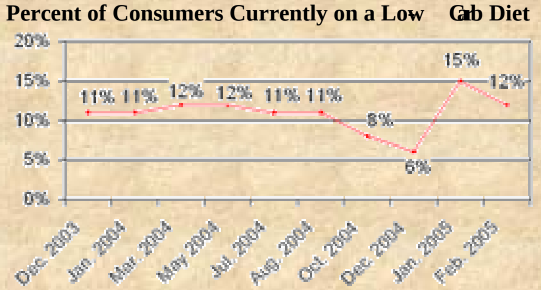
Beef Is Getting Relatively More Expensive

Relative Real Meat Prices, 1995-2005, Quarterly



Is The Low-Carb, High Protein Diet Trend Wearing Off?

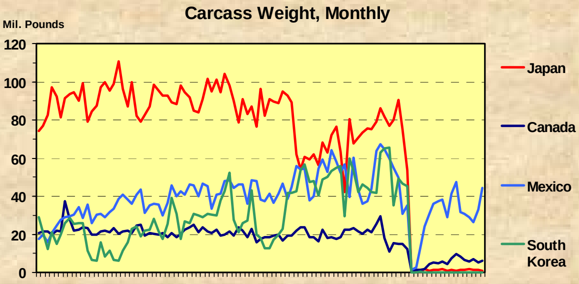
Percent of Consumers Currently on a Low Carb Diet



Source: Opinion Dynamics

Regain About 25% Of Export Market Since Lost in May 2003

U S BEEF EXPORTS TO MAJOR MARKETS
Carcass Weight, Monthly



What Would It Mean To Regain Japanese Trade?

- 2005 Commercial Beef Production = 25.1 Billion Pounds
- If We Exported 10% Of Production, 37% Would Go To Japan Under 2003 Conditions
  - ✓929 Million Pounds, 3.7% Of Production
- For Each 1% Of Supply We Don't Have To Consume Domestically, We Might See Fed Cattle Price Increase ~1.6%
  - ✓5.9% Increase, Or $5.00/cwt On $85/cwt Price

Darrell R. Mark, Ph.D.
University of Nebraska-Lincoln Extension

21

Minimal Risk Regions Rule Allows Importation Of Canadian…

1. Live Cattle For Feeding Or Slaughter Provided They Are Slaughtered Before 30 Months Old & Go To Only One Feedyard
2. Boneless Or Bone-In Beef From Cattle Less Than 30 Months Old
3. Cattle Livers, Tongues, Gelatin, & Tallow

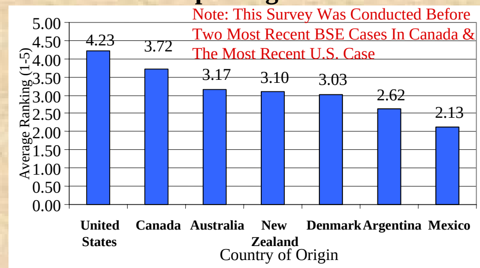
- There Are Substantial Transaction Costs Involved
- Canadian Capacity Will Shift To More Slaughter Of Older Cattle For Domestic Consumption
- Beef Exports From Canada Should Drop
- Live Cattle Imports From Mexico May Drop

Cooperative Extension

22

What Might Consumers Think?

Perceived Safety of Meat Products
From Exporting Countries



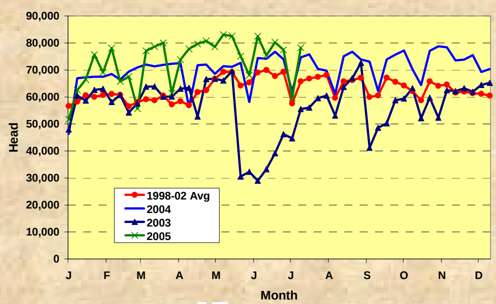
Source: Loureiro and Umberger. "Assessing Preferences for Country-of-Origin Labeled Products." *Journal of Agricultural and Applied Economics*. April 2005.

Cooperative Extension

23

Canadian Slaughter Up >25% In 2004
2005 YTD Up 6% Over 2004

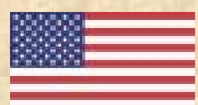
Canadian Federally Inspected Cattle Slaughter



Cooperative Extension

24

Who Will Be Better Able To Meet International & Domestic Demands For Traceability & Other Assurances?



Cooperative Extension

25

Price Outlook
Nebraska Basis

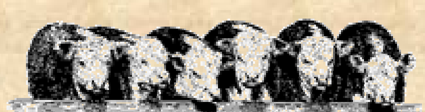
	Fed Steer	7-800 lb Steer	5-600 lb Steer
2005:III	$78-80	$109-115	$130-140
2005:IV	$79-83	$104-110	$114-124
2006:I	$83-85	$96-103	$115-125
2006:II	$83-86	$96-105	$113-125
2006:III	$77-80	$98-108	$110-120
2006:IV	$79-82	$95-105	$103-115

Cooperative Extension

26

For More Information

"In The Cattle Markets" Weekly E-newsletter



dmark2@unl.edu
http://agecon.unl.edu/mark

Cooperative Extension

Darrell R. Mark, Ph.D.
University of Nebraska-Lincoln Extension