

Cattle Business in Mississippi – February 2006 **“Stocker Cents” article**

Cattle Markets in Transition

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Fundamental supply and demand factors in the cattle market have been interesting over the last couple of years to say the least. On top of major trade disruptions related to BSE, the US industry at long last reached a turning point in cattle inventory numbers. The convergence of beef trade problems and cyclically low cattle numbers was actually quite fortunate. Had major beef export markets been closed at a time when cattle and beef supplies were abundant, the impact on prices could have been severe. As it turned out, the market weathered the worst of the trade disruption very well, with cattle prices remaining at historically high levels.

As 2006 gets into full swing, major transitions in the US beef industry will continue. For one thing, the market will experience increasing cattle numbers: a situation it has not seen in a decade. Also, agreements with key Asian trading partners means that trade will once again be an important outlet for beef for the first time since the end of 2003. On top of these developments, upward trends in the production of pork and poultry signal increasing competition for the consumer's food dollar. And on the subject of consumer dollars, higher energy costs could have implications for just about all consumer products. With all this going on in the market, it is a good time to look ahead at what some of these key issues might mean for the cattle industry in general and for stocker backgrounding operations in particular.

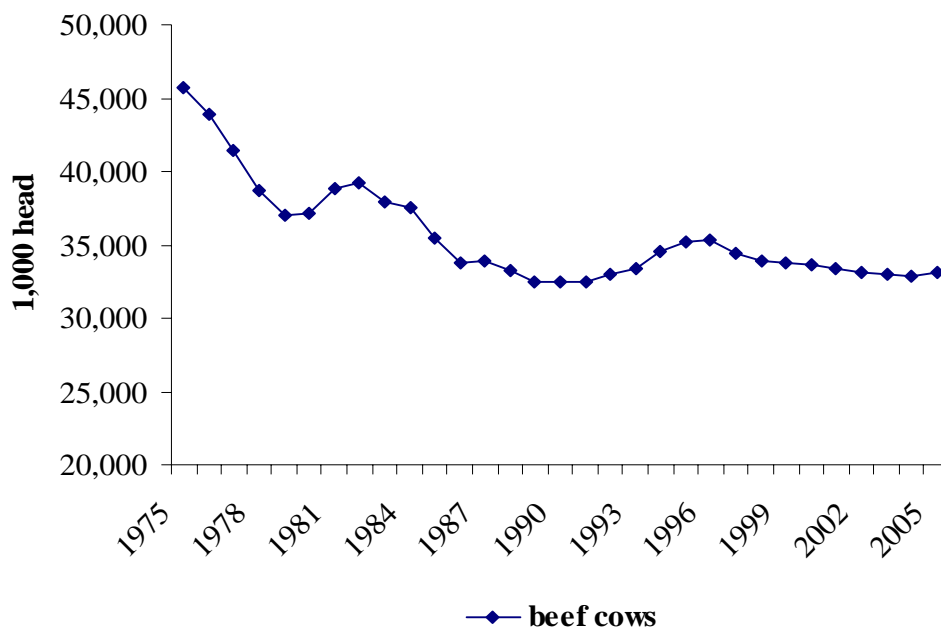
The issue of beef trade is a good place to start. Around mid-December, Japan agreed to resume imports of US beef. In mid-January, South Korea also lifted its two-year-old ban on US beef imports. These markets have been very important export destinations for US beef. According to USDA, in 2003 US beef production totaled 26.2 billion pounds. Of this total, 919.5 million pounds (3.5%) was exported to Japan, and 587.7 million pounds (2.2%) was exported to South Korea. These two markets along with Mexico (which purchases about the same amount of US beef as South Korea) comprise our three largest export markets.

The agreements governing the resumption of beef trade with Japan and South Korea are not without restrictions. Japan will not accept beef from cattle over 20 months of age. South Korea will accept beef from cattle as old as 30 months of age; however, only boneless products are eligible for export. It's hard to say how these restrictions will affect the market. If buyers begin to have trouble procuring eligible beef for the Japanese market due to their more restrictive age requirements, a premium could develop for younger calves. At this point, this seems unlikely. USDA's press release announcing the resumption of trade with Japan reported that 94% of US ruminant products would be eligible for export. This number is probably too high; however, there

should be enough eligible product to meet Japanese demands without too much trouble. That is certainly true for the foreseeable future – as trade is likely to resume fairly gradually.

Cyclical changes in cattle numbers are another factor that will be influencing the market in 2006. In its annual beginning cattle inventory report, USDA estimated that the inventory of beef cows in the US on January 1, 2005 had increased by about 1% compared to the previous January 1. Figure 1 shows the January 1 US Beef Cow inventory from 1975 through 2005.

Figure 1. January 1 US Beef Cow Inventory



Source: Livestock Marketing Information Center

That slight upward tick in the last point on the graph in Figure 1 may not look too impressive, but it is certainly significant in that it represents the first year-over-year increase in beef cattle inventories since 1996. Thus, last year marked the beginning of a new cattle cycle – ending the previous one that had begun in 1990.

The historically low cattle numbers indicated in Figure 1 have provided very strong support for cattle prices, especially given the fact that demand for beef has improved markedly since about 1997. Now, producers will have to think about what increasing cattle numbers mean for the cattle market – something that we haven't had to consider in a decade.

While the July 2005 *Cattle* report (USDA's estimate of mid-year cattle inventories) did indicate a slightly higher calf crop in 2005 compared to the previous year, increased heifer retention associated with herd expansion was more than enough to offset the

slightly higher number of calves. Thus, a slightly larger numbers of calves born in 2005 did not translate into additional pressure on calf prices this past fall. Next year's calf crop will be larger still. The Livestock Marketing Information Center estimates that when the next inventory report is released, the number of beef heifers kept for replacement could be the highest since 1997. Numbers on female slaughter in 2005 also indicate that producers held onto more females in 2005 than in previous years. While total cattle slaughter for 2005 was up about 1% from 2004, heifer slaughter was down about 3% and beef cow slaughter was down a little less than 5%. These numbers all support the idea that beef herd expansion is well under way.

For stocker cattle backgrounders, that fact that cattle numbers are increasing should begin to influence planning for 2006. By this coming fall, calf supplies will likely be larger than they were this past fall. The 2006 calf crop will be larger than in 2005, and while herd expansion will continue to support good demand for females, the rate of heifer retention may begin to slow. Calf prices for 2006 could thus be off some from 2005, but by historic standards, they will likely remain pretty high. Of course, the biggest concern for backgrounders is that prices will break significantly between the time when cattle are purchased and when they are sold. In an environment of increasing cattle numbers (not to mention increasing production of competing meats) that scenario probably becomes a bit more likely. Thus in 2006, risk management could become more important to backgrounders than it has been for some time. For backgrounding operations, this means actively looking for and carefully evaluating forward pricing opportunities. It also means constantly seeking ways to keep costs of production down – by improving cattle performance and/or cutting expenses.

For calves currently in the middle of backgrounding programs, the market should remain relatively strong through Spring 2006. Feeder cattle supplies are likely to remain pretty tight this spring. Feeder cattle futures prices increased considerably through the last couple of months of 2005. For example, the price on the May feeder cattle futures contract averaged around \$107 in October. In mid-January, the May feeder cattle futures contract was trading at around \$112. That futures price level suggests feeder steer cash prices in Mississippi of around \$104 to \$108 this spring. Given where stocker calf prices were this past fall (around \$124 for 4-weight steers in October), the average buy/sell margin on calves coming out of backgrounding programs this spring should be around -\$18 per hundredweight. As noted in this column last July, the average buy/sell margin for winter backgrounding has been about -\$15 per hundredweight over the past 10 years. Thus, this year's buy/sell margin will probably end up being less favorable to backgrounders than average (though it looks much better than it did when calves were being purchased this fall). In this situation, maintaining animal performance while keeping costs low will be critical to maintaining profitability on this year's calves.