Dairy Update

Was it Julia Childs or Erma Bombeck that said “everything is better with a little more butter?” Butter has certainly been the story for the last few months. McDonald’s move to using butter as opposed to liquid margarine was one driver of boosted butter sales, a move which has certainly driven up butter prices. This rise in butter prices has held Class III prices above $15/cwt and taken Class IV prices to over $16/cwt in the last few months. We have returned to the land where the “higher of” between Class III and IV is once again part of the conversation.

This move has certainly caught several dairy analysts by surprise—including this one—as many of us were of the mind that prices would begin to settle in the last quarter as additional supplies came on board and most of the holiday purchasing was onboard.

A little of that downward move has started to show up in the futures market, with the nearby contract off about 20 cents from contract highs. More alarming is the drop between December and January contract levels. With a gap of more than 50 cents per pound, it would imply a substantial drop in milk prices at the start of the New Year. Class IV prices on the board show a full $2/cwt drop between December 2015 and January 2016, reflecting that expected fall in butter prices.

Our strong butter prices have effectively killed any exports. Shipments are down 69 percent on a year-over-year basis through October according to the Agricultural Marketing Service. This recent collapse in butter prices may still have farther to fall as the gap between prices here versus Oceania or Europe remains more than 50 cents per pound.

Early months of 2016 are going to be a real stress on dairy farmers. Both Class III and Class IV futures prices are back down in the $14-14.50/cwt range, although they do show some strength back above $16/cwt in the latter half of the year. Milk supplies are now essentially unchanged from 2014 levels, with California production down more than 5 percent.

It is going to take both milk production growth slowing down—if not stopping—and some additional demand pop—like another McDonald’s—in order for prices to move much above the levels suggested by futures markets. The potential is also certainly there that if California were to see some weather improvements leading to improved forage quantity and quality that their production alone could kill any kind of price rally.

Unfortunately 2016 for the dairy sector anyway is shaping up to be another challenging year. Unless we can get Paula Deen a new prime time show…

Contact: Bob Young, 202-406-3620

Fed Cattle Prices at Multi-Year Lows. Have Retailers Noticed?

For the last couple of weeks, fed cattle prices have been sitting at about the lowest level of the year. Last week's 5-Area weighted average live steer price worked out to $116.64, down from $118.15 the prior week and a new low for the year. In fact, last week's price was the lowest weekly average cash fed cattle price in quite a long time. Figure 1 shows the 5-Area weighted average fed steer price for the past five years.

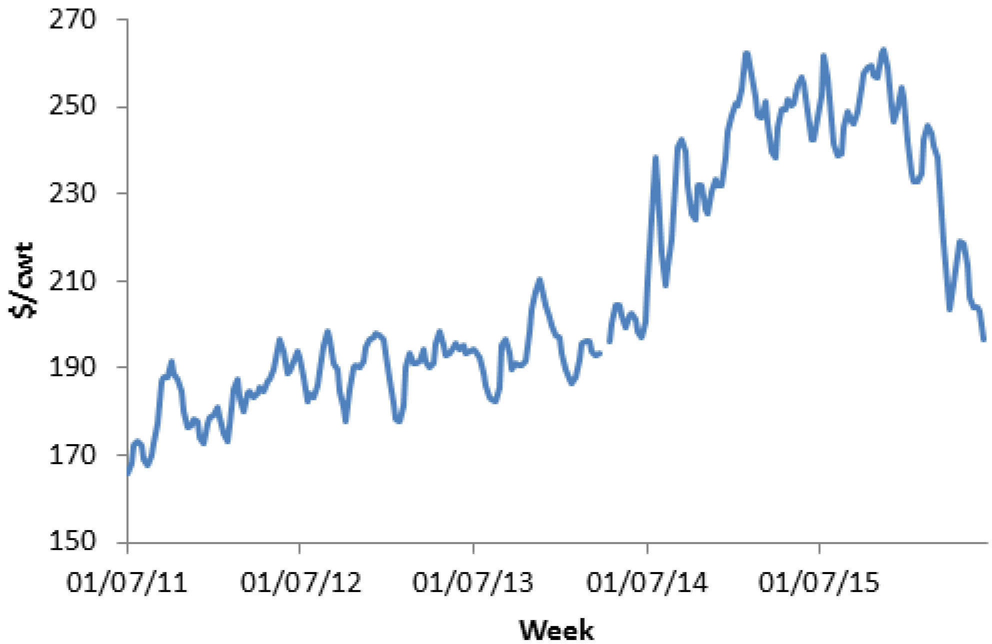
Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center

Figure 1. Weekly 5-Area Weighted Average Steer Price (Live Basis): Jan. 2011 – Dec. 2015

The current cash price is back down to about where the market was in mid-summer 2013 before the beginning of the historic rally that started then and ran through its last gasp in late-March/early-April this year when prices briefly spiked back above $165. To be a bit more precise about it, last week's cash price was the lowest since the weekly 5-Area price came in at $114.16 for the week ending ***July 29, 2012.***

The decline in cash cattle prices over the past six months or so has been about as dramatic as any in living memory—certainly as dramatic as any decline that has occurred in the absence of a major shock to the market such as the 2003 BSE event that we all recall so fondly at this time of year. With cattle prices falling so far and so fast, it is natural to inquire about the behavior of beef prices. Here, it is useful to focus on different levels of the market.

At the wholesale level, beef prices have closely paralleled fed cattle prices. Figure 2 shows the weekly average price of the Choice boxed beef cutout value over the last five years—that is, the same period of time covered by cattle prices in Figure 1. Clearly, the two price series are very similar. Cattle prices have fallen a bit further than wholesale beef prices. The 5-Area fed steer price has declined by about 30 percent since its early-April peak. By contrast, the Choice boxed beef cutout has fallen by just over 25 percent since its peak in mid-May. Clearly, the experience in both the live cattle and wholesale beef markets has been very similar.

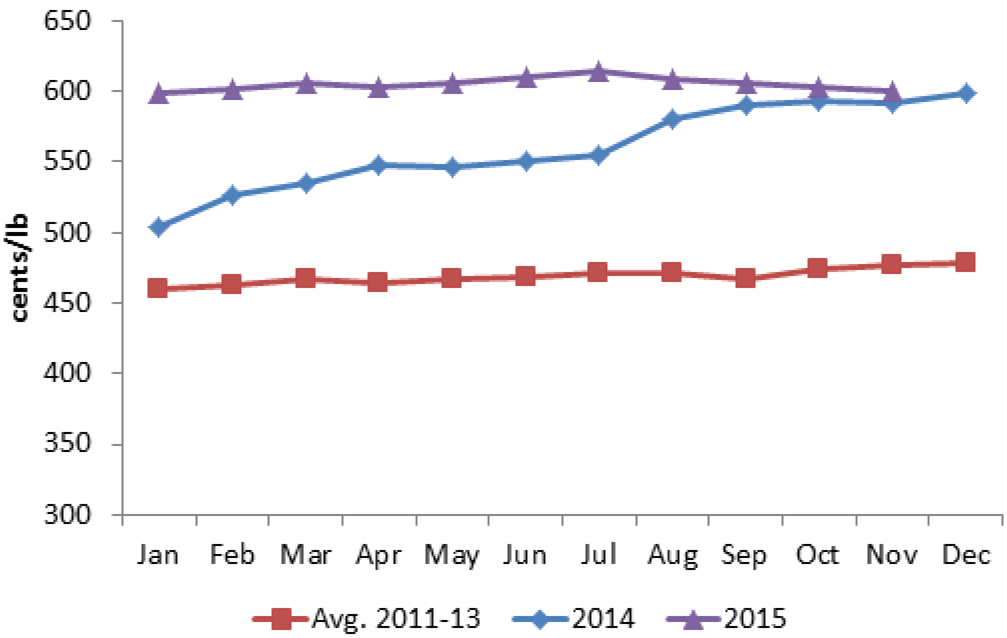


Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center

Figure 2. Weekly Average Choice Boxed Beef Cutout Value: Jan. 2011-Dec. 2015

Retail beef prices, on the other hand, have not yet shown a whole lot of movement. Last week, USDA Economic Research Service (ERS) released their monthly update of retail beef prices. For November (the most recent data available), the average of retail beef prices for all fresh beef items was 600.3 cents per pound. The retail price of beef has been coming down— the all fresh average price has been lower every month since July—but the decline has been very slow relative to cattle and wholesale beef prices. Since July, the all-fresh beef price has fallen by not quite 3 percent. Figure 3 shows the monthly average all-fresh beef price reported by ERS. While cattle and wholesale beef prices are at multi-year lows, retail beef prices are still just a touch above year-ago prices that were—to that point in time—record high.

The behavior of retail prices in the current downturn is not really unusual. Retail prices (for any product, not just meat) are generally quite a bit stickier than wholesale or farm level prices. Retailers are not inclined to dramatically alter their prices for a variety of reasons. For example, forward purchasing by retailers means that retailers' costs are not directly tied to the week-to-week changes in wholesale prices. Also, retailers generally want to be fully convinced of the durability of a change in prices at the farm and wholesale level before they work that change into retail prices. The basic fact of life seems to be that consumers really, really dislike price volatility, and retail pricing patterns reflect this.



Data Source: USDA Economic Research Service

Figure 3. Monthly Average Retail Beef Price: All Fresh Beef, Avg. 2011-13 through 2015

Having said all that about retail price stability, it is worth noting that the ERS data on retail meat prices probably overstates the degree of stability in retail meat pricing. It does not capture much of the featuring activity that goes on in grocery stores and is a key tool that retailers use to generate sales on specific items. USDA Agricultural Marketing Service reports quite extensively on weekly retail featuring activity and that data probably provides a better near-real-time assessment of what is going on with retail prices week-to-week than the monthly ERS data (which, to be fair, is probably a better tool for assessing longer-term trends in retail meat prices).

For the second half of 2015, the five most featured beef items (measured by the average number of stores running a weekly feature on that item) were chuck roasts, 80/20 ground beef, chuck steaks, boneless New York strips and London broil. The December (month-to-date) average feature price on these items is down by around 10 percent compared to the average feature price in June. The New York strip price is a bit of an outlier here: it is down almost 14 percent over that period of time.

The challenge for the beef sector, from a demand standpoint, is that despite the modest retail price declines in the latter half of 2015, beef items typically remain expensive relative to the competition. Year-over-year price comparisons make that point crystal clear. Consider three of the most featured items across the three major species: 80/20 ground beef, boneless/skinless chicken breasts and boneless center-cut pork chops. Through the first three weeks of December, the average December feature price of ground beef was down about 7.5 percent from a year ago. In comparison, the average feature prices of chicken breasts and pork chops were down by 17.7 and 15.6 percent, respectively. So, considered either from the standpoint of farm/wholesale prices in the beef sector or from the standpoint of competing meat prices, retail beef price likely still have a considerable distance to fall. In terms of stimulating movement of product to help clean up the tough supply situation that the industry is facing, the sooner it happens, the better.

Cattle on Feed Makes Christmas Merrier

Friday's Cattle on Feed (COF) report included a bit of holiday cheer for the cattle market. Overall the report appeared to be bullish for the market. Marketings were well to the high side of expectations at 103.9 percent of the prior year. More notably, though, placements were down 10.8 percent from the previous year. In fact, November placements were the lowest since this report series began in 1996. I am reminded of something that Stephen Koontz of Colorado State University wrote some months ago to the effect that the cattle market tends to place its way out of supply-side jams rather than market its way out. Well, the effort to place its way out of its recent troubles is well underway: placements have been well below the prior year for the past four consecutive months.

I don't know that I would make too much of the year-over-year rise in marketings: last year's November marketings seem to have been unusually light, at least partly reflecting the fact that there was one less business day in the month last year. Still, taken as a whole, the COF report shows market fundamentals moving in a more positive direction. Add to this the fact that winter weather is helping to take some pounds off of average slaughter weights and the fed cattle supply situation is arguably looking better than it has in months. Hopefully, the market will begin to take some notice.

Contact: John Anderson, 202-406-3623, johna@fb.org
