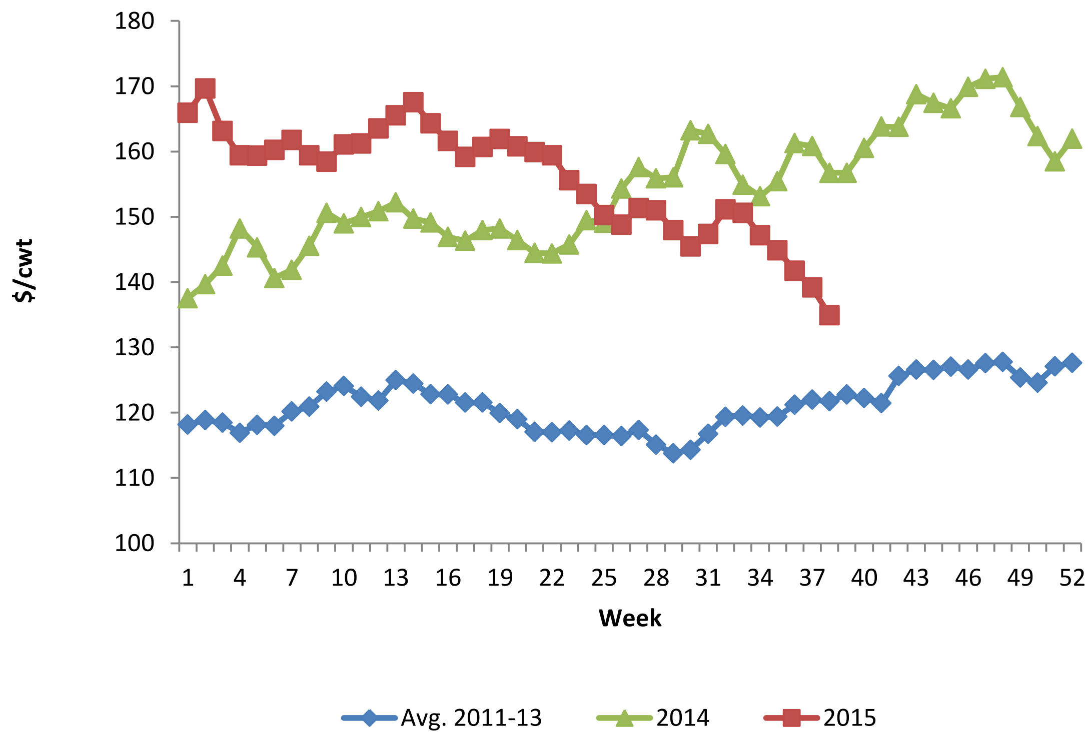
September 2015 – Livestock Market Update
Public Policy Department
Budget & Economic Analysis Team

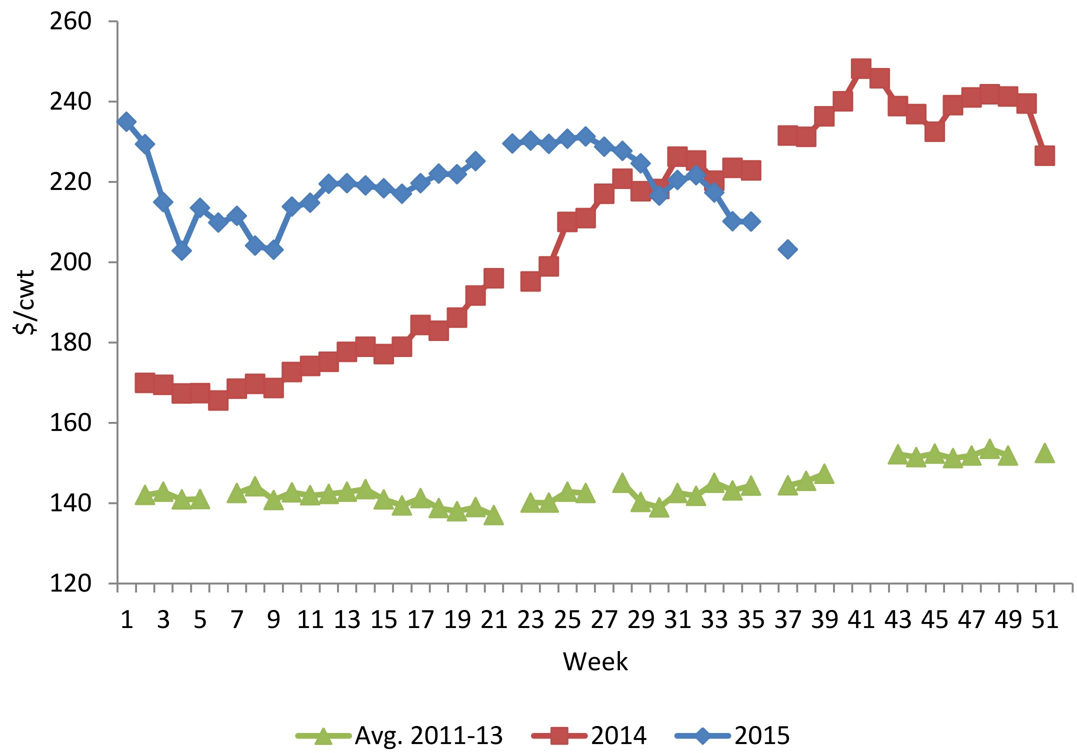
What's Behind the Cattle Market Meltdown?

Over the past couple of weeks, action in the cattle market has started to feel like a full-blown wreck. Last week, the 5-area weighted average fed steer price (live basis) dropped by over $4 per hundredweight (cwt) from the prior week – working out to just under $135/cwt. These are the lowest fed cattle prices we've seen since the end of 2013. Figure 1 plots the 5-Area fed steer price, illustrating just how ugly the year-over-year comparisons have gotten in the last few weeks.



Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center.
Figure 1. Weekly 5-Area Weighted Average Fed Steer Price (Live Basis)

I'm pretty sure that I'm on the record somewhere saying that the late-July temporary bottom at around $145 would be the summer low. That was $10 ago and the seasonal fall rally is still nowhere in sight. Stocker and feeder cattle prices are, of course, being driven down as fed cattle market prospects erode, as shown in figure 2.

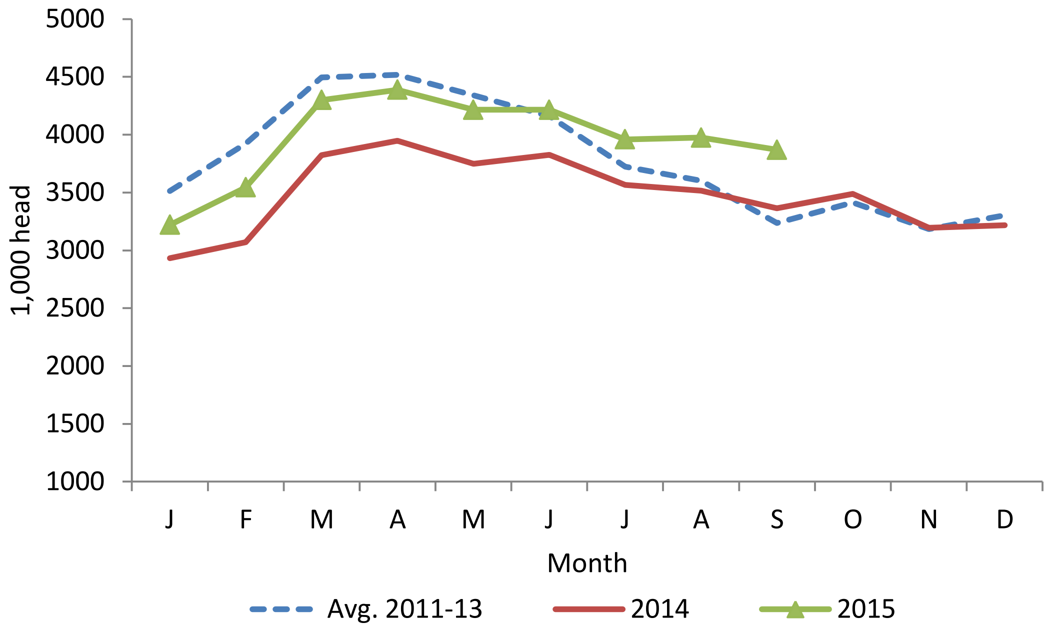


Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center.

Figure 2. Weekly OKC Feeder Steer Weighted Avg. Price (M&L #1, 700-800 lbs.)

Based on Monday's action, it looks like this week's OKC 7-weight steer price will work out to less than $200/cwt for the first time in over a year. It's not hard to see why. A 750 pound steer costing, let's say, $197 standing in a Southern Plains feedlot this week that feeds for $0.82 per pound of gain (putting on 600 pounds) breaks even sometime next March at a fed steer price of around $145. Given where the April Live Cattle futures contract is now, that's a little more than a $100 per head loss. For much of the year, cattle feeders have been willing to bet on some market improvement and so have paid up for feeder cattle. With losses mounting and optimism about prospective fed cattle prices being challenged, the bidding strategy has changed.

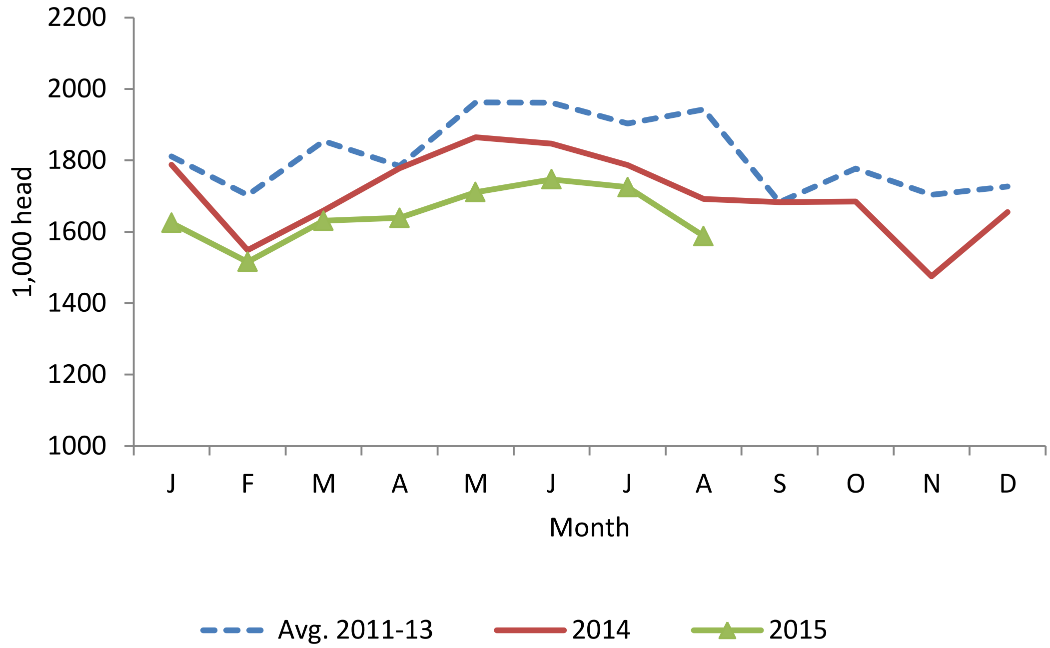
It seems that the primary reason for the change in mood in the cattle market is the growing awareness that, despite the low overall cattle numbers, the short-run supply situation in really pretty challenging. We touched on this issue in last month's newsletter, but given what has happened in the market since then, it's worth going back to the issue of front-end supplies. Figure 3 shows the inventory of cattle on feed for more than 120 days.



Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center.
Figure 3. Inventory of Cattle on Feed for 120+ Days: 1,000+ Head Feedlots

While the total on-feed inventory on Sept. 1 was up by just 2.7 percent from the prior year, the inventory of cattle on feed for more than 120 days was 15 percent higher than a year ago.

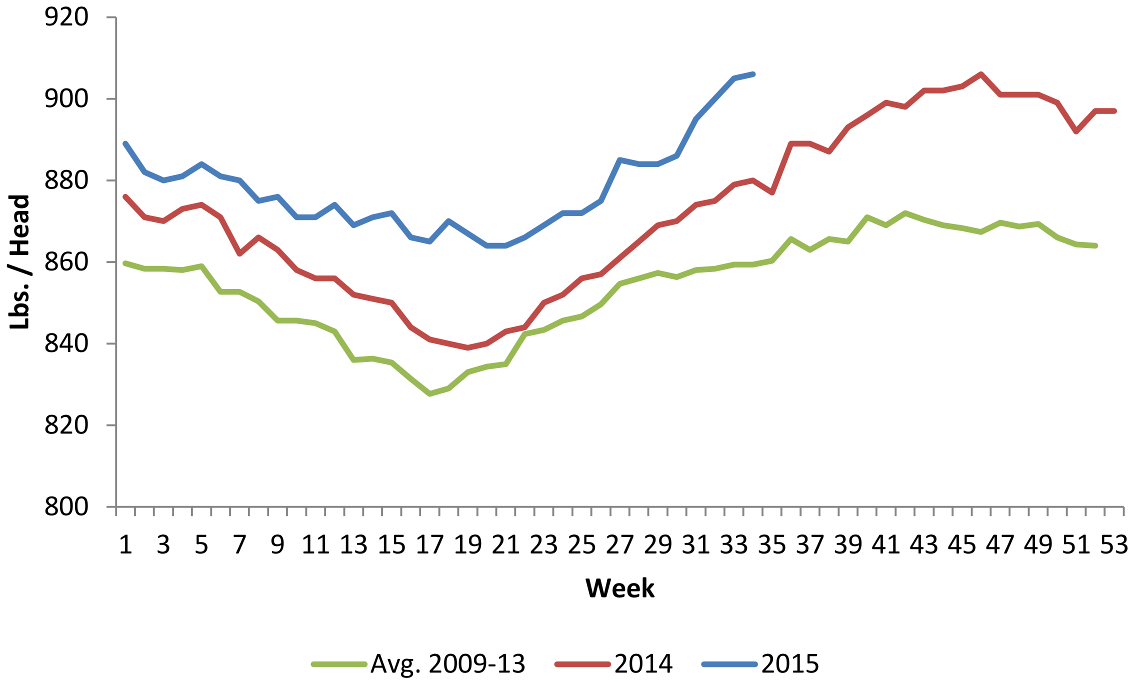
Clearly, placements have not been all that large. Going back to the beginning of this year, placements have been above the prior year's level in only two months and those increases were miniscule: up by 0.4 percent in March and up by 0.9 percent in June. The current large front-end supplies are really the result of slow marketings. Fed cattle marketings have been rather sluggish for a long time now. The last time marketings increased year-over-year was Dec. 2013. The slow pace of marketings is evident in Figure 4, which shows monthly fed cattle marketings as reported in the monthly Cattle on Feed report.



Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center.
Figure 4. Monthly Fed Cattle Marketings: 1,000+ Head Feedlots

The situation over the past couple of months is arguably a bit worse than figure 4 makes it out to be: marketings have been lower out of a larger supply of market ready cattle.

The incentives for slower marketings are clear. With fewer cattle available, feeders have wanted to sell as many pounds as possible on each animal. With feed prices generally declining over most of the last several months, this strategy was especially attractive. Indeed, cattle weights have increased dramatically in 2015 – and they were already high. Figure 5 shows the recent history of weekly average fed steer dressed weights. In July, fed steer dressed weights were over 16 pounds heavier than the prior year. This amounts to quite a few additional pounds of beef on the market. For example, the most recent Livestock Slaughter report summarizing July slaughter data indicates that commercial cattle slaughter in July was down by 4 percent from the prior year. Due to heavier weights, though, beef production for July was only down by 2 percent.



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

Figure 5. Weekly Average Fed Steer Dressed Weights

The question now is when will the market bottom out and come back from this wreck? Certainly, the longer-run supply fundamentals in the market remain favorable. And burdensome front-end supplies of fed cattle can't last forever, though it could easily take the better part of the fall to get these big numbers of big cattle worked off the books. Stephen Koontz at Colorado State University made an interesting observation in this week's In the Cattle Markets newsletter from the Livestock Marketing Information Center. In commenting on placements that were well on the low side of pre-report expectations, he pointed out that the industry generally "places its way out of trouble instead of marketing its way out of trouble." This is a good point, and it fits very well with the meltdown in feeder cattle prices over the last few weeks. The trouble is that placing your way out of trouble can be a pretty slow process, which means this fall will most likely end up being a real disappointment.

More of the Same in the Hog Market

Last week, the weighted average base price on producer-sold hogs dipped below $70 for the first time since early summer. Prices are about 30 percent below where they were a year ago. As bad as that sounds, the year-ago comparison is not as bad as it has been for most of the year. There is no real mystery to what's happening in the hog market; the story hasn't changed much all year. Production is really large. Through August, weekly pork production ran from 8 to 10 percent above the prior year, and that's about where it still is. At the same time, the demand environment is pretty tough. Exports are down on a strong dollar and a slowing Asian economy. Through July, pork exports were down by 12 percent, year-over-year. This means that we are having to move a lot of pork to domestic consumers at the same time that competing meats supply (i.e., chicken) is increasing. In short, then, it has been a tough year for the pork market and will most likely remain so this through year end – as normal seasonal factors pile on with these other factors the market has been dealing with all year.

Looking ahead, USDA releases the quarterly Hogs and Pigs report this Friday. Pre-report estimates have come out over the past few days; and analyst estimates highlight the challenge facing the market right now. It's not all that different from the cattle market situation discussed earlier. Analyst forecasts project large supplies of big market hogs, with declining numbers further back up the chain. The average pre-report estimate is for the inventory of 180+ pound hogs to be up almost 10 percent from the prior year; 120 to 179 pound hogs to be up about 7 percent; 50 to 119 pound hogs to be up 3 percent; and under-50 pound hogs to be about steady with a year ago.

The June-August pig crop is expected to be about even with a year ago as higher pigs-saved-per-litter is just about offset by lower farrowings. Farrowings for September-November are expected to be down by around 3 percent, which would probably be enough to more than offset growth in pigs-per-litter. December-February farrowings are expected to come back closer to year ago levels but are still projected to be down by about a percent.

The bottom line on market expectations is that the hog pipeline is still going full blast, but numbers are slowing down. Next year looks like a pretty flat year in terms of pork production. This lines up well with the most recent forecast from USDA, which projects 2016 pork production as being up less than one percent from 2015. If these production expectations hold and pork exports can make any kind of recovery, next year could be a big improvement over this one from the hog market's perspective.

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