July 2016 – Livestock Market Update
Public Policy Department
Budget & Economic Analysis Team

Lamb in Cold Storage Weighs on Slaughter Prices

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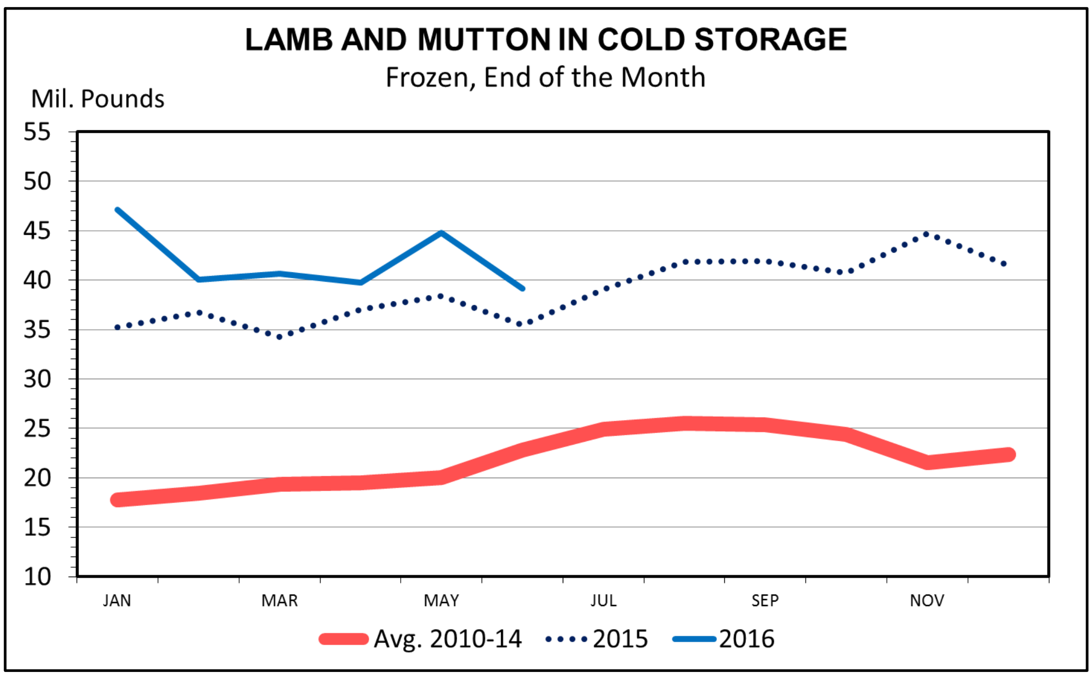
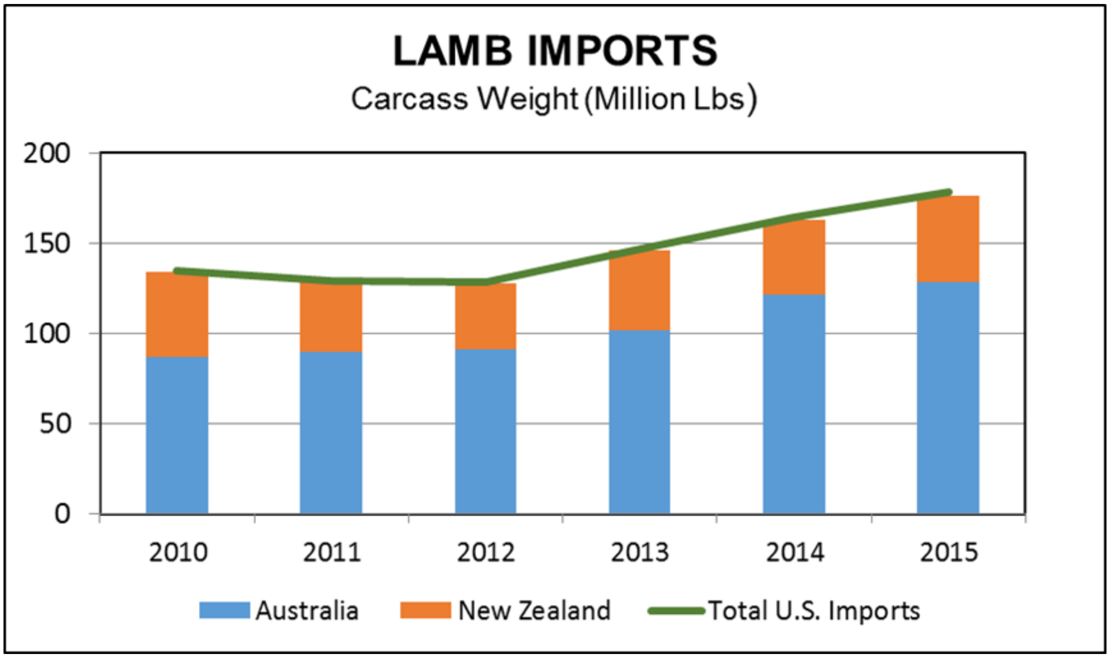
Sheep and lamb prices face strong headwinds in 2016 with the overhang of nearly 45 million pounds in cold storage inventories. Two main factors have contributed to this burgeoning supply of lamb and mutton: imports and exchange rates. Figure 1 shows the current year's cold storage levels compared to last year and the five year trend.

Figure 1: U.S. Lamb and Mutton in Cold Storage
Source: USDA-NASS, compiled by LMIC



Commercial lamb production has remained stable over the last two years, changing less than half a percent in 2014 and 2015. Over those two years cold storage inventories have increased nearly two fold. Imports of lamb increased year over year in 2013 (14 percent), 2014 (12 percent) and 2015 (9 percent). The U.S. imported new record highs of lamb from Australia in 2014 and 2015. New Zealand also increased exports to the U.S. in 2013 and 2015, up 21 percent and 15 percent respectively from preceding years. Total U.S. lamb imports increased between 14 million and 20 million pounds (carcass weight basis) in each of those years compared to the previous year and set new record highs for lamb imports in 2014 and 2015. Figure 2 shows annual lamb imports 2010-2015 from Australia and New Zealand compared to U.S. total lamb imports. Mutton imports were similar, increasing 5 percent, 16 percent and 15 percent in 2013, 2014 and 2015, largely due to increases from Australia.

Figure 2: Annual U.S. Imports of Lamb 2010-2015
Source: USDA-ERS, compiled by LMIC

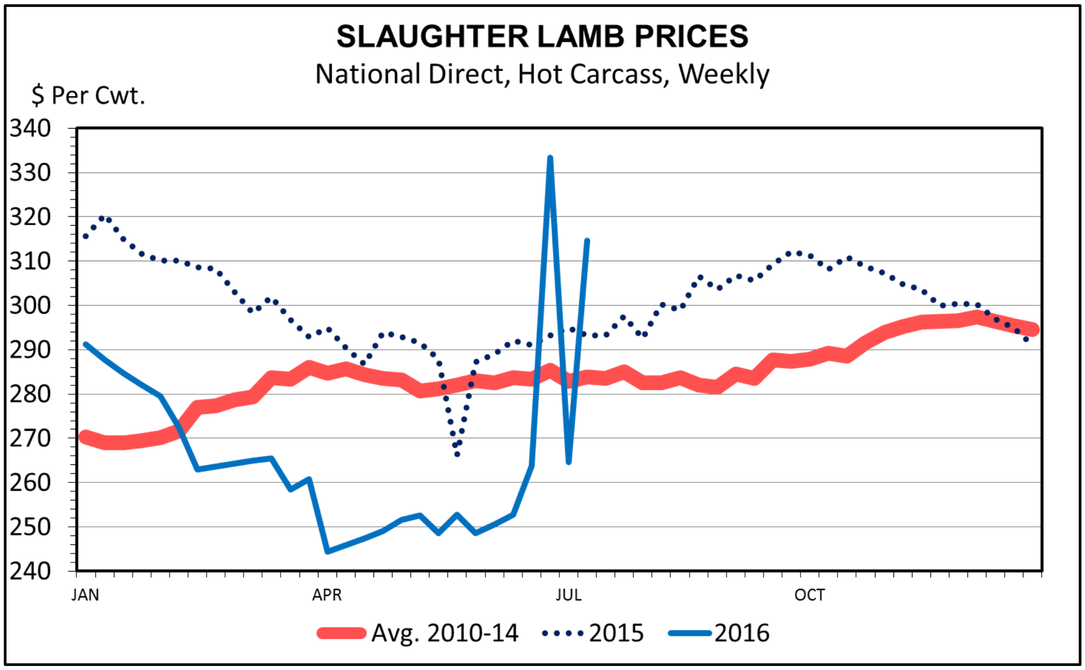


Drought induced flock liquidation in Australia and exchange rates played a key role in both creating a less expensive imported product relative to U.S. lamb products and dampening U.S. exports of lamb.

Through the first half of 2016, the exchange rates relative to Australia and New Zealand still remain favorable to importing lamb and mutton. Year to date (data available through May) total lamb imports are up 23 percent relative to the first five months on last year. Mutton imports are also posting year over year increases, up 15 percent over January through May of 2015. January through May cold storage data indicated inventories continue to grow and have averaged 17 percent over year ago figures.

National direct slaughter lamb prices have been well below last year's levels, but have experienced some increased volatility in recent weeks (See Figure 3). Reports out of Australia and New Zealand indicate production will be smaller in 2016, leading to a decrease in exports to the U.S. Domestic prices are not incentivizing flock inventory growth, but pasture and range conditions are favorable and feed prices are weakening. Expect some price improvement through the second half of 2016 due to smaller imports and seasonality. Although on an annual basis, slaughter lamb prices are expected to remain below 2015 by about 10 percent.

Figure 3: National Direct Slaughter Lamb Prices Weekly, Hot Carcass Basis
Source: USDA-AMS, compiled and analyzed by LMIC



June Hog Returns Highest in Over a Year

The quarterly hogs and pigs report released June 24, 2016 by USDA-NASS came as a surprise, coming in much larger than pre-report trade estimates. All hogs and pigs June 1 inventory was a full 1 percent higher than trade expected and 1.8 percent above the previous year, coming in at 68.4 million head. One of the largest surprises was the number of sows farrowed in March-May was up 1.5 percent over 2015, compared to the decline estimated in the March Quarterly Hogs and Pigs report. Market hog inventories were up 1.8 percent, supported by the largest March-May pig crop on record.

The June report also provided a first look at farrowing intentions for September-November, as well as revisions to the June-August farrowing intentions first estimated in March. In March respondents suggested June-August farrowings would be down a full 3.5 percent. In June this number was revised to a decline of 2.3 percent. September-November farrowings are expected to continue the trend, estimated 1.7 percent below year ago numbers. Overall, farrowings indicate caution in the hog market even though returns to finishing hogs have improved.

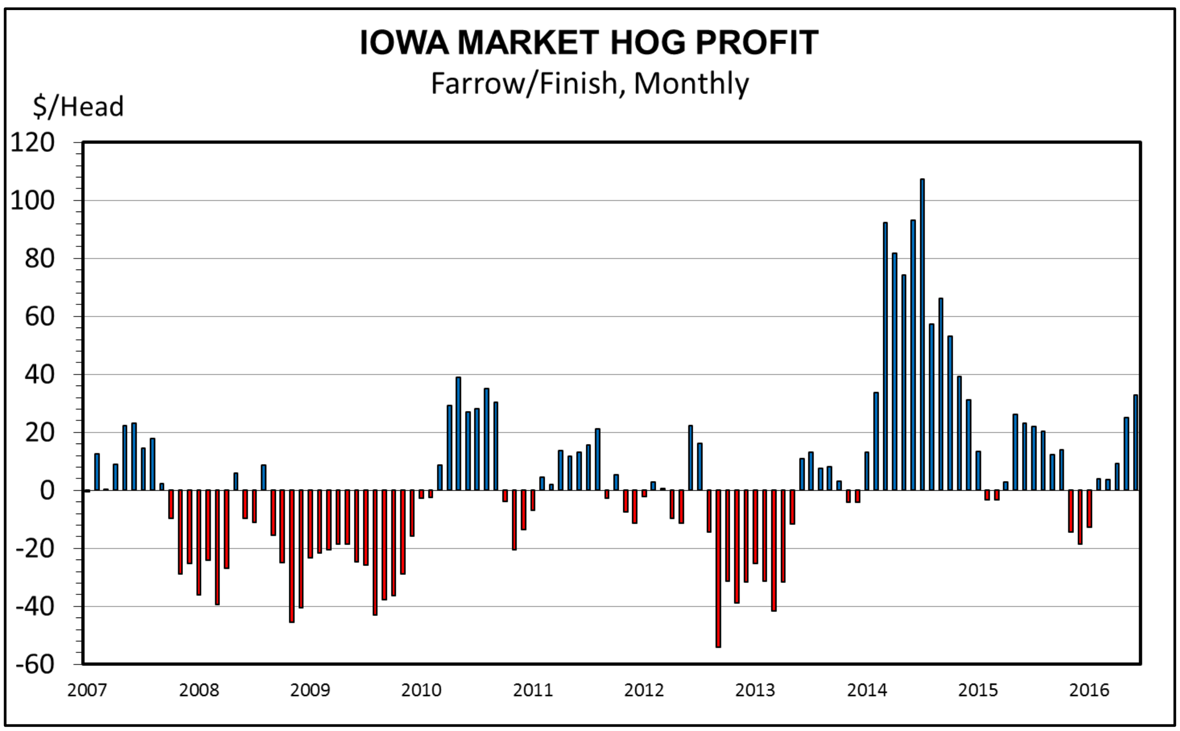
Hog returns have grown steadily in the first half of 2016 and in June the farrow to finish sector reached the highest profit per head since fourth quarter 2014. Figure 4 shows historical estimated monthly Iowa hog returns since 2007. Much of the increase in returns can be attributed to higher carcass base prices, which have increased steadily in the first half of this year. More recently in the first few weeks of July, prices have softened with expectation of larger numbers of hogs coming to market in the coming months.

At least one of the major hog producers has gone on record that they are pricing wheat into their rations. Winter wheat harvest yields are setting new record highs this year. Estimates in July put winter wheat yields at 53.9 bushels per acre, up over 10 percent from the previous high in 1999, and causing the price ratio of wheat to corn to tip in the favor of wheat. Wheat prices need to be below 110 percent of corn prices on a per bushel basis to account for the higher protein content to make a ration adjustment. Usually this happens when wheat is plentiful and priced as a feed grain as opposed to a milling grain. The adoption of wheat in the feed ration for market hogs and broilers tends to be through the life cycle of the animal, making the pricing consideration relatively short.

Price movements have been fairly normal this year. Concern over the large increase in market hogs will likely be addressed by the four new hog plants that are expected to come online in the fourth quarter of this year and next year. This should bolster the demand for live hogs and support prices in the once the plants are operational. A few other wild cards remain in the mix for the outlook of pork:

- Porcine Epidemic Diarrhea Virus (PEDv) remains at large for this winter. There were no major issues last year and are not expected to be issues this year.
- China's Pork Production: If the U.S. and China are both ramp up pork production, will there be enough demand to support the increased supplies?

Figure 4: Iowa Farrow to Finish Feeding Returns Monthly, 2007-Present
Source: Iowa State University, compiled by LMIC



Australia Cattle Prices Climb to New Highs

For the last 18 months, eastern young cattle prices in Australia have spiked more than 50 percent after a four year period of drought decimated herds and left behind the tightest cattle supplies in 20 years. In more recent weeks young cattle prices have surged to new record highs, after rain soaked the eastern states of Australia.

Meat and Livestock Australia (MLA) indicated the slaughter numbers are estimated to fall 18 percent in 2016, as producers try to re-stock herds. Heifers as a percent of cattle heading to slaughter has already declined significantly and expected to continue to fall. Similar to what the U.S. experienced in 2014, rebuilding the beef herd will take time and support prices in the meantime.

For U.S. producers this will likely mean less competition for exports and smaller imports of Australian beef into the domestic market now and for some time in the future. Australia exported 74 percent of beef production in 2014, a number that has been steadily growing of the last decade according to MLA. Exports from Australia have declined 17 percent so far this year. The U.S. and Australia primarily compete in Japan and Korean markets for beef. In 2015 South Korea was the fourth highest destination for U.S. beef behind Japan, Mexico and Canada. Year to date figures for beef exports suggests the U.S. is gaining market share; January through May data indicated a 6 percent increase in exports to Japan and a 21 percent increase in beef exports to South Korea compared to the same period in 2015.

The U.S. is well positioned to be competitive in the global beef market as Australia begins its recovery. The U.S. is one of few countries adding inventories at this point. The cattle on feed report released by USDA-NASS on Friday, July 22, established data halfway through the year and echoed this trend. June placements were up 3 percent from year ago levels, while total placements since January are up 560 thousand head compared to 2015. Heifer inventory in feed lots for July increased 5 percent, indicating fewer heifers are being held back for breeding purposes and a slowing in total herd growth. USDA-NASS did not release a mid-year cattle inventory report this year due to budgetary issues, eliminating an early estimation for the 2017 calf crop.

Global Milk Production Trends

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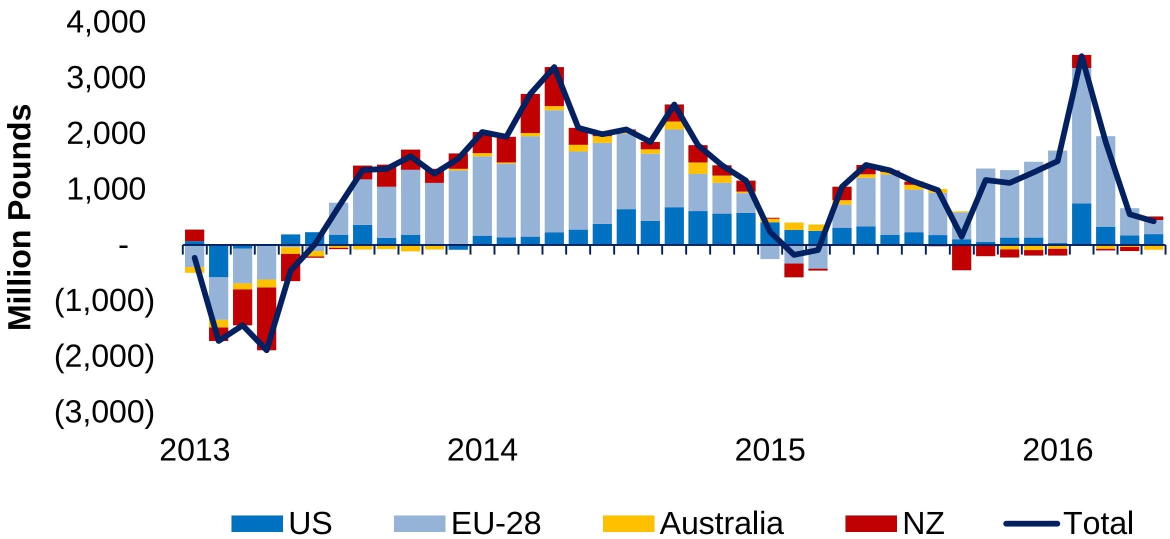
In April 2015, the longstanding European Union (EU) milk quota system expired and was the catalyst—along with record high dairy prices in 2014—for a substantial outward shift in the supply of milk and finished dairy products available around the world. During the full year since the expiration of the EU quota, U.S. milk production has increased three billion pounds with EU milk production rising 14 billion pounds over prior year levels. Meanwhile, Australia and New Zealand milk production is down 432 million pounds since April 2015.

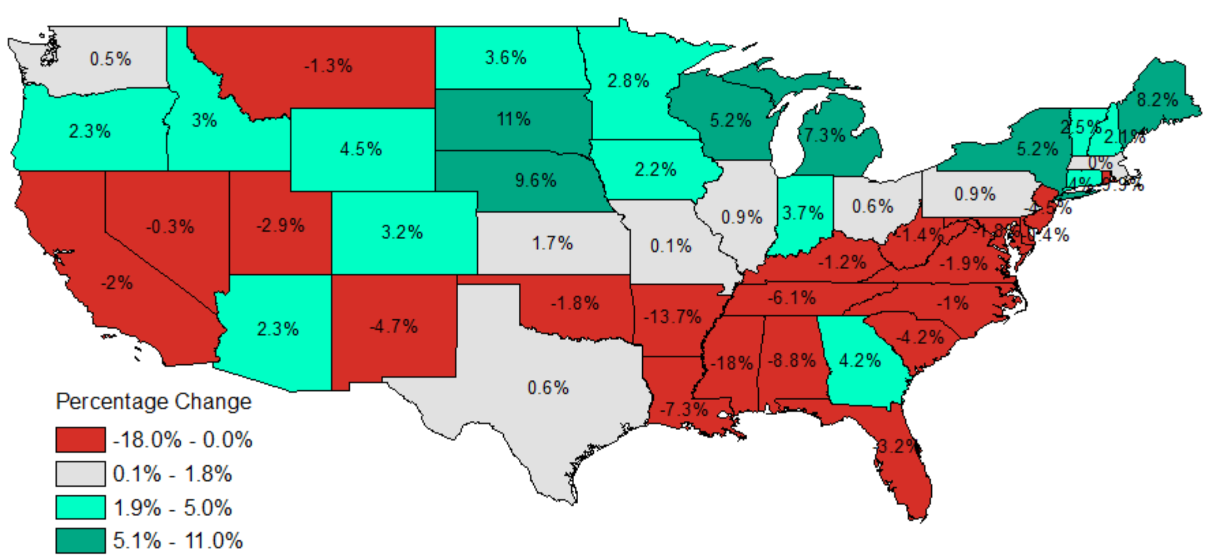
Figure 1. Year-over-year change in milk production, big four exporters, 2013 to May 2016
Source: USDA-NASS, Euro Stat, DCANZ, Dairy Australia and author's calculations



As demonstrated in Figure 1, the year-over-year (YoY) change in milk production has indeed slowed in recent months. A majority of the slowdown has occurred in EU milk production. During May 2016, EU milk production growth was up 0.8 percent YoY, Australia milk production was down 5.5 percent YoY and New Zealand milk production was up 3.5 percent YoY. The pace of growth in the U.S. milk supply increased in June to 1.5 percent YoY.

For the first half of 2016 U.S. milk production totaled 107.4 billion pounds and was up 1.6 percent compared to prior year levels. U.S. milk production growth has been different across milksheds. The Upper Midwest and Northeast continue to improve over prior year milk production levels while portions of the West (California) and the Southeast have cut back on their milk production volume. Figure 2 highlights state-level changes in milk production for the first half of 2016 compared to the same time period in 2015.

Figure 2. Year-to-date change in milk production, January to June 2016 compared to January to June 2015 (includes leap year)
Source: USDA NASS and author's calculations



USDA's most recent WASDE forecast for 2016 U.S. milk production stands at 212.4 billion pounds of milk (+1.8 percent YoY). Based on the current growth rate of +1.6 percent, the pace of U.S. milk production growth is behind what is needed to reach this WASDE estimate. In order to reach 212.4 billion pounds of milk produced in 2016 U.S. milk production growth needs to accelerate to +2.0 percent for the second half of the year. It will be important to monitor weather forecasts in key milk producing regions to determine the likelihood of reaching the WASDE projection.

Price Implications

In order for milk prices to make a meaningful recovery the pace of milk and dairy product supply growth needed to slow or consumption needed to accelerate. While we are seeing such a production slowdown in major dairy exporting regions, U.S. milk production growth is not showing signs of contraction. Additional U.S. milk production and increased dairy product imports have resulted in record high cheese inventories (1.252 billion pounds) and end of June butter holdings at their highest levels since the 1950s (326 million pounds). Offsetting the higher supplies, stronger domestic consumption of cheeses and butter has led to recent strength in U.S. milk prices. Will the market continue to look past current inventory levels in anticipation of strong domestic consumption for the remainder of the year? If so, milk prices can be expected to hold at or above current levels. However, price uncertainty remains and any prolonged milk price recovery will depend more on strength in global powder markets and on the ability for U.S. dairy product exports to draw down cheese and butter inventories.