Market Outlook for 2005

John D. Lawrence
Extension Livestock Economist and Director
Iowa Beef Center
Iowa State University
Ames, IA

Cattle producers will not soon forget 2004 and its market and emotional rollercoaster. All-in-all it was a profitable year for most producers and certainly turned out better than we expected at the start of the year. The year ahead will hold its own surprises; we just don't know what they are or when they will occur. Likely candidates include stable to weakening consumer demand, growing supplies, returning Canadian cattle, and resumption of Japanese exports. Add to these market drivers the fundamental cattle cycle rotation and 2005 should be an interesting, and yet profitable year for the cattle industry.

2004 in Review

Total red meat production in 2004 was 2.8% lower that the year before largely due to reduced beef production. Beef tonnage was 7% lower than 2003 on lower steer and heifer slaughter, down 6.6% and 7.6%, respectively, and sharply lower cow slaughter, 16.7% lower. Beef imports in 2004 were up 22% compared to 2003, but largely due to the lack of Canadian beef imports May 20-September 4, 2003. Compared to 2002, Canadian beef imports are down 2.7%. Imports were lower from Australia (-1%), but higher from New Zealand (+0.1%), Canada, and Uruguay, up 290% to become the fourth largest supplier to the U.S. No surprise, beef exports were down 82% compared to 2003 with hope for increased exports in 2005 and beyond. Poultry and pork production has increased in 2004. Poultry production was up 1.7% after several years of slower growth. Pork production was up 2.8% but perhaps more importantly pork demand was also higher in 2004. In fact, farm level hog prices have averaged 34% higher than a year ago in spite of the larger supplies. At least a portion of pork's good demand and good fortune has likely come due to the relatively high retail beef prices and growing pork export markets.

Two thousand four was a pretty good year for most in the cattle business in spite of volatile cattle prices and high feed costs early in the year. The Iowa State University Estimated Livestock Returns reported cattle feeders were profitable on yearling fed cattle sold from November 2002 though October 2004. Average profits for 2004 were $49 per head. Calf feeders were still profitable in February and had averaged near $90 per head for 2004. Both enterprises averaged nearly $200 per head profit in 2003, it is less in 2004 and is looking like a red-ink year in 2005 as feedlots bid much of the profits back into feeder cattle prices.

Western Kansas fed cattle prices averaged $84 per cwt live in 2004, about a dollar higher than the 2003 average. By contrast Oklahoma feeder cattle were quite a bit higher in 2004. Steers weighing 500-600 pounds averaged nearly $10 per cwt higher ($116 versus $96) and 700-800 pound steers averaged $16 per cwt higher ($104 versus $88). Projected breakevens on yearling cattle placed in the fall and to be marketed through the winter and spring had breakevens in the mid-to-upper $90s with some weeks over $100. While the lower corn prices will help the breakeven on these cattle, feedlots will be rebating much of the profits from the previous year to the cowherds and stocker operations.

Like the feedlots, packer margins also narrowed in 2004. Boxed beef prices and hide and offal were lower and fed cattle prices were higher. Choice boxed beef prices were lower this year by $2.50 per cwt while Select boxes were $2.30 per cwt higher in 2004. As a result the Choice-Select spread narrowed in 2004 to $8.50 compared to $13.40 the year before. The $8.50 spread is comparable to 1999, 2000, and 2001 levels. The rib price declined in 2004 compared to 2003, but the loin gained slightly in value. Hide and offal values averaged $.26 per cwt less (approximately $3.25 per head) in 2004. Packer costs were also likely higher in 2004 due to the reduced slaughter rate, down 8.4% for the year. Fewer cattle, higher plant cost, and prices of cattle, and higher imports of beef also squeezed packer margins. The farm to wholesale price spread (live animal to boxed beef delivered to a major city) decreased 15% compared to 2003 and is about equal to the 2002 levels reflecting the tighter packer margins.

However, retailers have pushed the prices higher to consumers. Retail beef prices averaged $3.61 per pound for the all fresh beef series, 10% higher than the same time period in 2003. Pork increased 5% and broilers 2.6% over the year earlier price. The wholesale-retail spread widen in 2004, increasing 26.5% over the 2003 level. The wholesale to retail spread was equal to 78% of the gross farm value over the 1994-2003 period, but is at 93% in 2004 as it was in 2002. Thus, the value-added beyond the box are worth almost as much as the steer. The price of beef compared to pork and poultry at the retail counter is at its highest level in the last 17 years and perhaps longer. The 1994-2003 average beef:pork and beef:broiler ratio averaged 1.13 and 1.80, respectively. This year, through November the ratios were 1.30 and 2.19 and consumers may be shopping for the cheaper product.

In summary, 2004 saw record average retail prices and wholesale to retail margins, but a decrease on farm to wholesale margins as boxed beef prices decreased and fed cattle prices increased. Feedlot margins that were positive most of the year turned red in November and will likely remain red through most of the winter as feeder cattle prices out paced fed cattle prices. The higher feeder prices benefited cowherds and stocker operations. Thus, the ends of the chain are benefiting at the expense of the middle – for now.

Looking Ahead to 2005

Two thousand five is expected to be a profitable year for cowherds, but feedlots are expected to return to more typical returns with losses at least early in the year. Cowherds have been profitable in recent years and have a larger feed supply than previous years and will likely begin an expansion phase. We should also see a resumption of trade in both live cattle from Canada and beef to Japan and other parts of the world. While the export borders may legally open, it will take time to win-back consumers to U.S. product. In addition to the market trading information and rumors about trade issues, the U.S. is still in an expanded BSE surveillance program increasing the probability of finding another positive animal or at least more inconclusive tests. As a result producers should evaluate the risk management tools available including the newly released Livestock Revenue Protection insurance products.

Cattle Inventories and Expansion

The USDA released the annual U.S. cattle inventory on January 28. Total cattle inventory is up 1% from one year ago, with steady to higher inventories in most major classes of cattle (Table 1.). There is evidence of expansion as the number of beef cows increased 0.6% and the number of replacement beef heifers are up 4.1%.

The smaller calf crop suggests tight supplies of feeder cattle until they are increased by either more importation or fewer heifers are retained by breeders. In addition, the supply of fed cattle is also tight and is expected to remain below packing capacity until substantial numbers of live cattle are once again imported from Canada.

Report Summary

Feeder cattle available for placement January 1 were up 1.7% from last year at almost 28 million head. This was the lowest January level in over three decades. The smaller 2004 calf crop (down 0.8%) does not suggest an immediate remedy to these short supplies. Any significant increases in feeder cattle supply will likely come from imports.

Beef cow herds are on the increase after 5-6 profitable years and two years of very good returns to cow-calf operators. Beef cow inventories are over 33 million head, with the first increase in the January inventory since 1996. Cow/calf operations have increased the quantity of replacement heifers to a seven year high, indicating the confidence they have in a continuation of significant returns. Along with more replacement heifers the number of cows was down also. Last year's cull cow slaughter was down 16% from the year previous. Cow numbers will likely continue to increase until feeder cattle prices soften.

The January inventory gives some detail as to what is happening to cattle number within individual states. Among the large cattle producing states (over 1 million beef cows) Texas, Tennessee, Kentucky, and Montana experienced reductions in their number of beef cows amounting to 156,000 fewer beef cows. On the other hand, Iowa, Missouri, Nebraska, Oklahoma, and South Dakota had a combined increase of 220,000 head of beef cows.

Feedlot Inventories

We started 2005 with cattle on feed inventory near year earlier levels, but with significantly more cattle on feed 120 or more days. Through the first week of March steer carcass weights averaged nine pounds heavier than 2004 and four pounds heavier than the 5-year average. However, they were less than the record 2002 levels thanks in part to bad weather in the High Plains region last fall.

The March Cattle on Feed report estimated there were 11.2 million head on feed March 1, 2% above 2004, and 6% above 2003. Placements during February were down 6% from 2004 and is the second lowest placement for February since the series began in 1996. February marketings were down 4% from the year before and is also the lowest February figure since 1996.

The lower fall and winter placements should reduce U.S. slaughter in the first half of 2005. September-February feedlot placements were 1.9% lower than the same period the year before. Non-fed slaughter will likely be higher in 2005 in spite of efforts to expand the cowherd. Dairy cow slaughter was 18% lower and beef cow slaughter 15.5% lower in 2004 than 2003. It will be difficult to reduce slaughter even lower. We expect to see additional reduction in heifer slaughter as cattle producers continue to expand their herd. Given the delayed marketings, lower cost feedstuffs, and relatively higher feeder cattle prices, carcass weights will likely stay above 2004 levels if we return to normal weather conditions. The exception that could lead to lighter weights is if the industry pulls cattle ahead in the absence of Canadian cattle. One factor that will add to U.S. cattle slaughter is the resumption of live cattle imports from Canada. The exact date that cattle enter from Canada is like picking a lottery number with "never" being a possible choice.

Canadian Border

Canada has been exporting boneless boxed beef to the U.S. since early September 2003 following the ban on their imports following the discovery of a cow in Alberta with BSE. Beef imports from Canada in 2004 were 43.5% above 2003, but 2.6% below 2002 the last normal year of trade. In 2002 Canada exported 160,000 feeder cattle, just over 750,000 steers and heifers for slaughter, and 400,000 cull or breeding animals. The cull and breeding animals will not be allowed in because of the 30 month rule.

March cattle on feed in Alberta and Saskatchewan, the major feeding region in Canada, was 36% higher than 2003, and 5% higher than 2002. September-February placements were 41% above 2003 and 7% higher than 2002 as Canadian producers geared up for the U.S. market that was expected to open March 7, but did not. Canada is increasing its slaughter capacity and has a national strategy to process more of its livestock at home and export meat. There is a lot of discussion about a 22% increase in slaughter capacity. Cattle slaughter in 2004 was 25% higher than it was in 2003 and 11% higher than it was in 2002. While some of the 22% capacity increase may be plans and wishful thinking, the 11% increase over 2002 is fact and growing. Near term, Canada has a modest increase in cattle on feed and a larger demand for cattle than it did before. Add in the weaker U.S. dollar compared to 2002 and the number of slaughter cattle coming from the Canada to the U.S. will likely be well below the 2002 level. Long term, Canada is shifting its focus on beef rather than cattle exports.

At this writing, the USDA has appealed the Montana court decision to block cattle imports and

USDA and R-CALF have a court date, July 27, on a permanent injunction against live cattle and the under 30-month boxed beef that is currently coming in. Until these court cases are settled the market will be trading new information, rumor, and announcements regarding the actual opening of the border and will be volatile.

Japanese Border

On Saturday, October 23 the U.S. and Japan announced an agreement to re-establish beef trade. Japan, the largest beef export market for the U.S. in 2003, has blocked U.S. beef since the U.S. announced finding a single confirmed case of BSE in the country on December 23, 2003. The announcement was welcome news to the U.S. beef sector, but markets and producers appear to be taking a wait and see attitude as progress has been slow to evolve.

There is considerable detail yet to be ironed out between the U.S. and Japan and it will take time to determine the final details and even longer to implement them. While some USDA officials announced that there would be U.S. beef on Japanese shelves in a matter of weeks, most analysts believe it may still be months away. Some of the key points to be worked out and their implications are the following:

- The agreement calls for two-way trade once both countries complete relevant domestic rule making process. The U.S. did import about a quarter million dollars of unique Kobe beef from Japan before BSE was discovered in Japan in 2001. The agreement asks (or requires; it is unclear) that the U.S. allow Japanese beef to be imported. This condition will not have a market effect because the volume is so small, but allowing a country with 15 confirmed cases of BSE to import to the U.S. may raise concerns with some groups that may try to block such action.

- Age verification that the U.S. beef exported to Japan is 20 months of age or younger. Age must be verified using production records for individual animals or groups of animals. Since then Japan has agreed to accept A40 maturity cattle determined by a USDA inspector at the slaughter plant. With this measure packers can identify the cattle in the plant that are eligible for export to Japan. However, if packers want to export variety meats to Japan or stage eligible animals for slaughter they will need age verification from the producer. Producers with these cattle and records will have a more valuable animal than those that are not eligible for export.

- Remove all specified risk materials (SRM). Currently, the U.S. is removing SRM from animals over 30 months of age. This requirement would require removing SRM from all cattle with beef destined for Japan. Without knowing the age of the cattle packers will have to remove SRMs from additional cattle and then sort the A40 maturity carcasses from these cattle. There is additional cost of removing SRM and there is some loss of product that has a value so packers will have to weigh the value of exporting a portion of their product against the cost of removing all the SRM.

The final chapter on exports to Japan is yet to be written. Packers are getting individual plants approved for export and will be unveiling their age verification program to producers. Producers should begin looking into how to qualify their cattle.

Summary

The year ahead looks promising for U.S. cattle producers, but also a volatile one. Fed cattle prices averaged near $84 per cwt in 2004 and 2005 is expected to average that level or higher. Domestic supplies will remain tight as cowherds continue to retain heifers to expand the herd. These offspring will begin to impact beef supplies in 2007 and beyond. Domestic demand has been a bright spot for the cattle market and is expected to continue to support prices, but may not grow at the pace seen since 1998 as the low-carb growth trends slows. Market uncertainty is significant and will come from the judicial and political decisions regarding trade with Canada and Japan. At one extreme, beef and cattle from Canada could be blocked and Japan could resume imports of U.S. beef.

At the other extreme, Canadian cattle could enter the U.S. and Japan not resume trade. Even at these extremes the price impacts will be modest and the transition to open either market will likely be slow.

Table 1. USDA Cattle Report Summary, January 1, 2005.

	1,000 head inventory	04-05 % change	1,000 head change
Cattle and calves	95,848	1.0%	960
Cows and heifers that have calved	42,060	0.5%	209
Beef cows	33,055	0.6%	194
Milk cows	9,005	0.2%	15
Heifers 500 pounds and over	19,673	1.7%	328
For beef cow replacement	5,746	4.1%	228
For milk cow replacement	4,133	2.8%	113
Other heifers	9,793	-0.1%	-13
Steers 500 pounds and over	16,511	1.4%	234
Bulls 500 pounds and over	2,219	0.6%	13
Calves under 500 pounds	15,385	1.2%	175
Cattle on feed	13,749	-0.5%	-64
Calf crop	37,625	-0.8%	-278

Notes: