Economic and Market Outlook for 2006

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2006 Thus Far

Cattle markets have generally been under pressure since the beginning of 2006. This is especially true for fed cattle prices, which started the year unexpectedly high around $95/cwt and decreased counterseasonally to current levels in the lower $80s. Feeder cattle prices have likewise dropped by roughly $15/cwt. as a result of the weak fed cattle market and the additional pressure of drought induced feedlot placements. Calf prices have been the most resilient but even these have weakened somewhat recently in the face of a generally weak cattle and meat complex and drought impacts.

Most of the pressure on fed cattle prices so far this year has been the result of unexpectedly large meat supplies in a domestic market where meat demand is relatively good but limited by strong meat prices and energy-impacted consumer incomes. Increased beef production so far this year, up 6 percent in the first quarter, has been compounded by increased poultry production and weaker than expected poultry exports. The result has been a meat complex that is struggling to absorb increased supplies of cheap poultry dark meat and has been very sensitive to increased beef production.

Feeder cattle markets have been impacted, not only by the weak fed cattle market but also by the impacts of drought in the Southern Plains this winter. The wheat belt in Texas and Oklahoma, which usually provides winter grazing for many stocker cattle has been extremely dry since last October. As a result, many lightweight cattle moved into feedlots from November through March. Many feedlots in the region are quite full now and this is a major factor in reduced feeder cattle demand that has caused heavyweight feeder cattle prices to drop since January.

The Current Situation

With the adjustments already noted so far this year, cattle and beef markets seem to have generally stabilized at the current time, albeit at significantly lower prices than were anticipated just a short time ago. Fed cattle prices are expected to remain in the low $80s for the next few weeks before moving seasonally lower into the third quarter. Feeder and calf prices will likewise see some seasonal pressure the extent of which will depend on forage conditions going into summer. Right now most of Texas and Oklahoma, along with parts of Arkansas and Louisiana are very dry and dry conditions are spreading into the southwest and north into Kansas.

Feedlot inventories on April 1 were nine percent above a year ago, indicating that there will be ample supplies of fed cattle in the coming months. In fact, this inventory level sounds worse than it really is. Early placements of cattle this spring will be partially offset by relatively smaller placements in April and May. Depending on the marketing rate the next couple of months, the feedlot inventory by June 1 could be down to perhaps four percent above a year ago. This is more indicative of the true feedlot situation. Remember that we started the year with an estimated increase in feeder supplies of less than two percent above last year. Canadian feeder cattle imports could add another one to two percent to that suggesting that on an annual basis the total potential for increased feedlot production is in the range of three to four percent above 2005 levels. The issue then is more one of timing than excessive production increases and suggests that some of the messiness of the first half of the year should improve in the second half of 2006.

Trade Situation

Beef and cattle trade so far this year has not been a significant negative factor in the markets but have been disappointing nevertheless by the continued absence of beef market access in Asia. The briefly open Japanese market now seems bogged down in a quagmire of internal Japanese politics. A couple of cases of carelessness on the part of exporters serve to illustrate two important facts for the future of beef exports. First, most every market will different requirements and it will take specific efforts to service those markets. Secondly, the extra costs associated with exporting to a variety of different export markets means that these markets will be less valuable now than previously. It is important to develop and service these markets but it must be remembered that the future will forever be different than the past.

Fortunately, exports continue strong to Mexico, a particularly important market for some of the lower value cuts. This is important not only as a relatively higher value market for these cuts but also for the positive indirect effects on the domestic market of removing these products from the U.S. market. Exporting Chuck and Round products to Mexico is the beef market equivalent of exporting chicken legs to Russia.

Cattle imports from Canada have been fairly strong and, as noted above, feeder cattle imports are contributing to a net increase in U.S. feeder supplies. There is significantly less impacts of imported fed cattle. These cattle go directly to slaughter and therefore count in the 6 percent increase in U.S. beef production so far this year. However, live fed cattle imports are being offset to a large degree by decreased imports of boxed beef from Canada so the net impact on U.S. beef supplies is significantly less than the cattle import numbers would suggest.

The Cattle Cycle

The mostly short run market factors discussed above are playing out against the backdrop of cyclically low cattle numbers and an industry engaged in herd expansion. Unless the drought in the Plains states gets bad enough to overshadow growth elsewhere, the cow herd will likely grow one to two percent in 2006. The only possibility for growth to be faster than that would be to withhold an exceptionally large number of heifers out of available feeder supplies, which would in turn mean that feeder markets would remain tighter in the short run. On the other hand, modest herd expansion implies that net increases in the calf crop in 2006 and 2007 will likely be somewhat limited thereby extending the generally strong prices for another 18 to 24 months. There is little doubt that cattle prices peaked cyclically in 2005 and will be lower in 2006 and 2007 but probably by a relatively modest rate of decline.

Summary

Cattle and beef markets are soft at the current time due to both supply and demand factors. Large supplies of competing meats is contributing to demand weakness at the same time that beef production is increasing. Recent increases in energy costs further threatens to dampen beef demand this summer. The situation for the third quarter looks pretty tough with ample supplies of feedlot cattle available. Many feedlots are currently losing money and may do so for much of the summer. Fed cattle will likely trade in to the upper or middle $70 range for summer lows before recovering somewhat in the fourth quarter.

Feeder cattle prices are expected to hold steady to slightly weaker through the second half of the year capped by the fed market but downside potential should likewise be limited as feedlot demand recovers in the third and fourth quarters. Calf prices are likewise expected to hold steady to slightly weaker through the third quarter to a seasonal low in the fourth quarter. Cow-calf profitability will be less than in 2005 but still positive.

There several key factors to watch in the remainder of the year including total meat supplies, energy impacts on consumers and producers, and the potential reopening of Asian export markets. General recovery of cattle markets by the end of the year is likely but the extent will depend critically on these factors.