CattleFax Outlook

Strong demand, leverage shift adds optimism for year ahead.

by Kasey Brown, Shauna Hermel & Troy Smith

Beef demand is strong and with U.S. cattle numbers plateauing, prices are likely to be stronger in the year ahead as consumers at home and abroad support industry profitability. That was the message delivered Feb. 6 during the popular CattleFax Outlook Session hosted as part of the 2020 Cattle Industry Convention in San Antonio, Texas.

Weather is expected to play a supporting role for agriculture during the year ahead, according to Art Douglas, professor emeritus at Creighton University (see "Weather outlook"). He said that following repeated *El Niño* events during the past five years, the United States will shift to a *La Niña* pattern, which will shift much of the nation outside of the northwest and southeastern portions of the country toward conditions slightly warmer and drier than last year, which will be favorable for planting and growing conditions during the spring and summer.

CattleFax Vice President of Research and Risk Management Services Mike Murphy predicted corn and soybean acres will increase during the year ahead, with corn plantings rising 4 million acres to 94 million acres and soybean acreage rising 7 million acres to reach 83 million acres (see "Grain and energy outlook"). He predicted 2020 spot corn prices to trade in a range of $3.50 to $4.00 per bushel, down 15¢-20¢ per bushel from 2019, unless weather issues become a significant factor.

He noted, however, that trade could present an upside to the projected prices, particularly in light of the recently signed U.S.-China trade agreement (see "Export outlook," page 66).

Beef, cattle markets

Trade will play a significant role in beef and cattle markets, said CattleFax Vice President of Industry Relations and Analysis Kevin Good, who said he expects higher total animal protein production to be offset by strong demand and increasing exports.

"The function of the market is to spread cattle supplies to where they're needed," said CattleFax Vice President Kevin Good. "We are starting to see that."

Unfavorable weather in much of the Plains last year and disappointing calf values last fall contributed to a cooldown in the expansion, and even some liquidation, of the U.S. beef cow herd in the last 12 months, said Good. After five years of expansion, the national herd inventory plateaued in 2019, settling in at 31.3 million head Jan. 1, 2020. That plateau is expected to continue.

Likewise, at 26.4 million head, the Jan. 1 feeder cattle and calf supply outside of feedyards is down 0.4% from 2019, likely slowing growth of feedyard inventories in 2020.

Yet record-large beef production — 27.7 billion pounds (lb.) — is expected in 2020, the result of increases in production and efficiency that Good called a tremendous sustainability story for the beef industry.

"As we look in the rearview mirror and think about where we've been since our peak, we've seen about a 30% reduction in total numbers," said Good. "At the same time, beef production per cow has increased roughly 50%, more than offsetting that decline in numbers. … We have record production with 30% less supply from a headcount standpoint, improving efficiencies and sustainability."

The CattleFax analyst suggested the plateau in beef cow numbers would continue and annual beef production increases would slow, peaking at more than 28 billion lb. Though starting the year elevated, he said, cow slaughter numbers would retract, more so in the second half of the year than the first.

"Feed shouldn't be a huge issue in 2020 for the cow-calf operator's budget," said CattleFax's Mike Murphy.

Good suggested beef calf numbers would remain basically flat for the next 12-24 months. Looking at what is in the pipeline, he said, CattleFax expects fed cattle slaughter to be up by about 250,000 head in 2020.

CattleFax data would indicate placements into feedyards being up the last four months of 2019 and January 2020.

"In the last five months we've placed roughly about 425,000 head of cattle more than in the same period of time a year ago," said Good. But, looking at available feeder cattle and calf supplies and a smaller calf crop last year, "at some point as we move forward over the next six to nine months, we should see a period of time where placements year over year start to track below year ago levels."

Leveraging shackle space

Good predicted slaughter levels would be about 250,000 head this year, basically 1,000 head per day with a five-day kill week.

"If you look at the packing industry today, they are much more efficient," Good said, suggesting a silver lining to adjustments made following the plant fire in Finney County, Kan. "We see more shifts going online this year, so we're going to suggest that, on a daily basis, capacity will be 1,500 to 2,000 bigger this year than it was a year ago.

"Even though the packing industry is going to have a very robust year from a profitability standpoint," Good said, "the leverage component is starting to swing … back into the cattle feeder's favor."

Facing seasonally tight supplies the next 30-60 days, the market is starting to incentivize cattle feeders to sell cattle, said Good. "We won't be surprised if we see harvest rates going through February and March maybe exceeding our expectations, pulling some of those cattle away from those bigger placements in the summer."

Another component of production, weight, has typically increased about 5 lb. per year, said Good. Last year, weights were down, but with better feeding conditions this year weights are expected to be up about 10 lb. Harvest rates up about a quarter million and weights up 10 lb. equates to increased production of basically 2%, he noted.

Trade's impact

Good was optimistic about gaining more access to China and reduced tariffs going into Japan, forecasting a 5% increase in exports this year. Imports, he predicted, would be smaller, primarily because of relationships of 90% trim prices in the United States compared to Australia and the fact Australia has experienced severe liquidation during the past two years due to drought. With rain in the forecast, they should start to expand, diverting pounds of beef from the market.

"An improvement in the balance of trade of 10% (imports down 5% and exports up 5%) on 3 billion pounds, is roughly 300 million pounds," Good said. "As you think about that in the big picture perspective, we're suggesting that beef production is going to be up 600 million pounds, so the balance of trade this year could easily take 50% of that production increase off the market, keeping our domestic supplies more manageable."

Weather outlook

"Welcome to the start of a *La Niña*!"

Those words from climatologist and Creighton University professor emeritus Art Douglas serve as encouragement to farmers and ranchers across much of the United States as they mean weather patterns are expected to change. Douglas said forecasting models indicate development of *La Niña* is underway.

A weather-breeding phenomenon, *La Niña* is characterized by cooler-than-normal sea surface temperatures in the tropical region of the eastern and central Pacific Ocean. While sea temperatures along the equator haven't cooled yet, Douglas explained that very cold water now found off the coasts of California and Chile is a precursor for rapid development of *La Niña*.

"The NOAA (National Oceanic and Atmospheric Administration) forecasts, now, are indicating that by July we are going to have a *La Niña*," stated Douglas.

With the change come expectations for a reversal of weather patterns associated with the lingering *El Niño* phase that began in 2014. That means the wet conditions that have challenged crop plantings and hay harvesting, and caused flooding and prolonged muddy conditions in much of cattle country, are likely to shift toward drier and warmer weather patterns.

Douglas said expectations for spring include cold in the Great Lakes region, warmer temperatures in the Corn Belt and the West. Throughout the spring, dry conditions are expected to intensify in the Southwest, central Rockies and Plains regions. His forecast called for a hot summer in the High Plains and West, but near normal temperatures in the Midwest.

"The Corn Belt should be okay for both moisture and temperature," predicted Douglas, saying there is no reason to expect a repeat of 2019's flooding.

Generally drier summer weather is expected for most of the United States, except in the Pacific Northwest and Southeast. For a good many U.S. cattle producers, the forecast looks favorable. Douglas said there is concern, however, that *La Niña* could bring drought to Texas and the Southwest.

Good noted the importance of export values.

"About $350-$360 per head is generated from overseas sales," he emphasized. "From a fed-steer standpoint, that represents about 20% of its value."

Good predicted per capita consumption for the year would increase 0.4 lb. from last year to 58.4 lb.

Competing proteins pork and poultry have also increased production, with pork expected to be up 2.5% and broiler production up 3.7%. Pork exports are expected to be up 15% and broiler exports up 8%, taking more than half of the increased production off the domestic market, said Good. "Unfortunately, with the increase from a production standpoint, it still tells us we have a bigger supply of protein on the domestic market to work through as we go through the next 12 months."

Since 1998, expenditures for beef have gone up basically double the rate of inflation, indicating very good demand growth, Good explained. "There's more dollars coming into our business than ever before. … Over the last 20 years the industry has responded with higher-quality product, more consistency, a better message and we have seen an increase in market share."

The animal protein industry has a bigger pie than it had 20 years ago, and beef now has a bigger share of that pie, he said. "Consumers are willing to spend more for beef than they are for pork and poultry."

The beef industry has benefited from a robust economy during the last 20 years, Good cautioned. When the economy is in a recessionary state, the beef industry tends to suffer because of beef's higher price point.

"As we go forward messaging our product on sustainability is going to be huge as you think about continuing gains in

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Grain and energy outlook

Last year was not an easy year for crop growers. Reports have shown acres harvested were better than expected, but yield was hit hard, said Mike Murphy, CattleFax vice president of research and risk management services. However, stocks-to-use quantities are still comfortable at around 13%. This year, weather predictions look to be more favorable during growing seasons, so he anticipates both corn and soybean acreage to increase. Demand for corn will increase from both the pork and poultry industries, while beef will stay stable. Ethanol demand will increase on the export side.

The United States is still the biggest producer of crude oil, so we are adequately supplied in terms of energy, said Murphy, adding that he doesn't expect much change in energy prices.

Since stocks-to-use levels are comfortable for corn, Murphy said he expects prices to be in the $3.50-$4.00-per-bushel range. Prices will be a little higher for soybeans, around $8.75-$9.75 for spot futures. He predicted hay prices to average around $160 per ton.

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consumer confidence and to continue the trend of more dollars being spent on our product compared to that competition out there," Good said.

Forecasting prices

"With strong demand for U.S. beef at home and rising demand overseas, the modest increases in supply will be more than offset by a growing consumer appetite for our product," said Good, who projected all-fresh retail prices will rise to reach an average of $5.87 per lb. during the year ahead, an increase of 5¢ per lb. over 2019.

"Higher wholesale beef values are a reflection of improving domestic and global beef demand," Good noted, pointing out CattleFax projects composite cutout prices will rise $3 during the year ahead to reach $222 per hundredweight (cwt.).

Growing demand and increasing beef prices at the consumer level will be supportive of cattle prices, with leverage beginning to shift away from the packing sector as more shackle space becomes available during the year ahead. Good said CattleFax projects fed-steer prices to average $120 per cwt. during 2020, an increase of $3 from the previous year. Through the year, he noted downside risk to the $108 level, with resistance at the top near the $130 level.

"Rising demand has meant more dollars flowing into the industry, which adds to the profitability of all segments of our business," said CattleFax CEO Randy Blach. Although the leverage has been held by packers, he said, that will begin to shift during the year ahead, with more dollars flowing back into live-cattle segments.

Calf prices are also expected to move higher in the year ahead, with 550-lb. steer prices trading in a range of $155 to $180, averaging $170, up $6 per cwt. from 2019 levels. Feeder prices will also rise, with 750-lb. steers trading from $140 to $160, with a yearly average of $150, also $6 per cwt. higher than last year's average.

He projected utility cow prices should range from the low $70 level to a fall low near $55, while averaging near $65 per cwt. for the year, an increase of $5 per cwt. over 2019 levels.

Wrapping up

CattleFax CEO Randy Blach closed the session highlighting the strong demand that is highly favorable to the entire industry. He noted that there is significant outside interest in U.S. protein production, which is also highly supportive and a positive sign for the future.

Focus on consumers is a requirement for continued beef industry success.

"The days of boom and bust in our industry are behind us," said Blach. "Thanks to strong demand at home and abroad, we're likely to see far less volatility in the market during 2020 than we saw last year."

Blach noted that global demand for all proteins is strong, with beef being a major beneficiary of that demand.

"Rising demand has meant more dollars flowing into the industry, which adds to the profitability of all segments of our business," said Blach, who noted that although the leverage has been largely held by the packing sector, that too would begin to shift during the year ahead, with more dollars flowing back into the live cattle segments.

"That investment should begin to incentivize increases in shackle space during the years ahead," Blach said. "In turn, as supplies begin to flatten out, packing margins have likely peaked and we'll begin to see margins at the packing sector begin to narrow as we move through 2020."

Blach pointed out that although the market outlook is positive during the year ahead, the U.S. beef industry needs to maintain a competitive posture.

"There is strong demand for our product, but that's the result of the fact that our business has paid attention to market signals and we've been producing a consistent, quality product that has gained a greater piece of that retail dollar. We need to protect that," said Blach. "Cattle must continue to be better over time.

"We must pay attention to what the consumer is telling us," he continued. "That means conversations about topics like traceability and sustainability only become more important as time goes on. We have to listen to the consumer and respond with action to meet their needs and demands if we're going to continue to be successful in a hyper-competitive global protein market."

Editor's note: This article includes information provided as a news release by the National Cattlemen's Beef Association.

Export outlook

African Swine Fever (ASF) has been a dominating headline in 2019, and while that may not seem to affect beef producers, it absolutely does, said Mike Murphy, CattleFax vice president of research and risk management services.

ASF was first reported in August 2018 and has affected most of southeast Asia. While nearly half of the global swine herd was in China pre-ASF, the disease has decimated China's pork supply. It is not a highly contagious disease, but it is incredibly deadly, with a 95% mortality rate.

This means China has to import more protein, and some Chinese consumers are eating more beef as a result. The newest Phase One trade agreement with China opens the door for American beef. It will take China about 24-36 months to restock its livestock numbers once an ASF solution has been found, so Murphy said this opens a window of opportunity for American agriculture.

While America has exported about 30 million pounds (lb.) per year to China since our regained access in 2017, Australia and other countries have exported about 650 million lb. Global beef prices are high, and demand is currently higher than supply.

In 2017, ag exports to China and Hong Kong were worth about $22 million. Murphy predicted increased access can cause that to jump to about $35 billion in 2020 and more than $40 billion in 2021.

"That is a significant increase. It will make a huge impact in agricultural products that incorporate corn, beef and ethanol," he said.

For beef, this trade deal gets rid of three major barriers: China will accept hormone products, China will accept U.S. traceability meeting FSIS standards, and it will conduct a risk assessment on ractopamine and might be willing to accept beef from calves that have received it in the future.

"For the long term, this is an optimistic situation," he said. "We will be in position to supply grain-fed beef, something our competition isn't able to do."