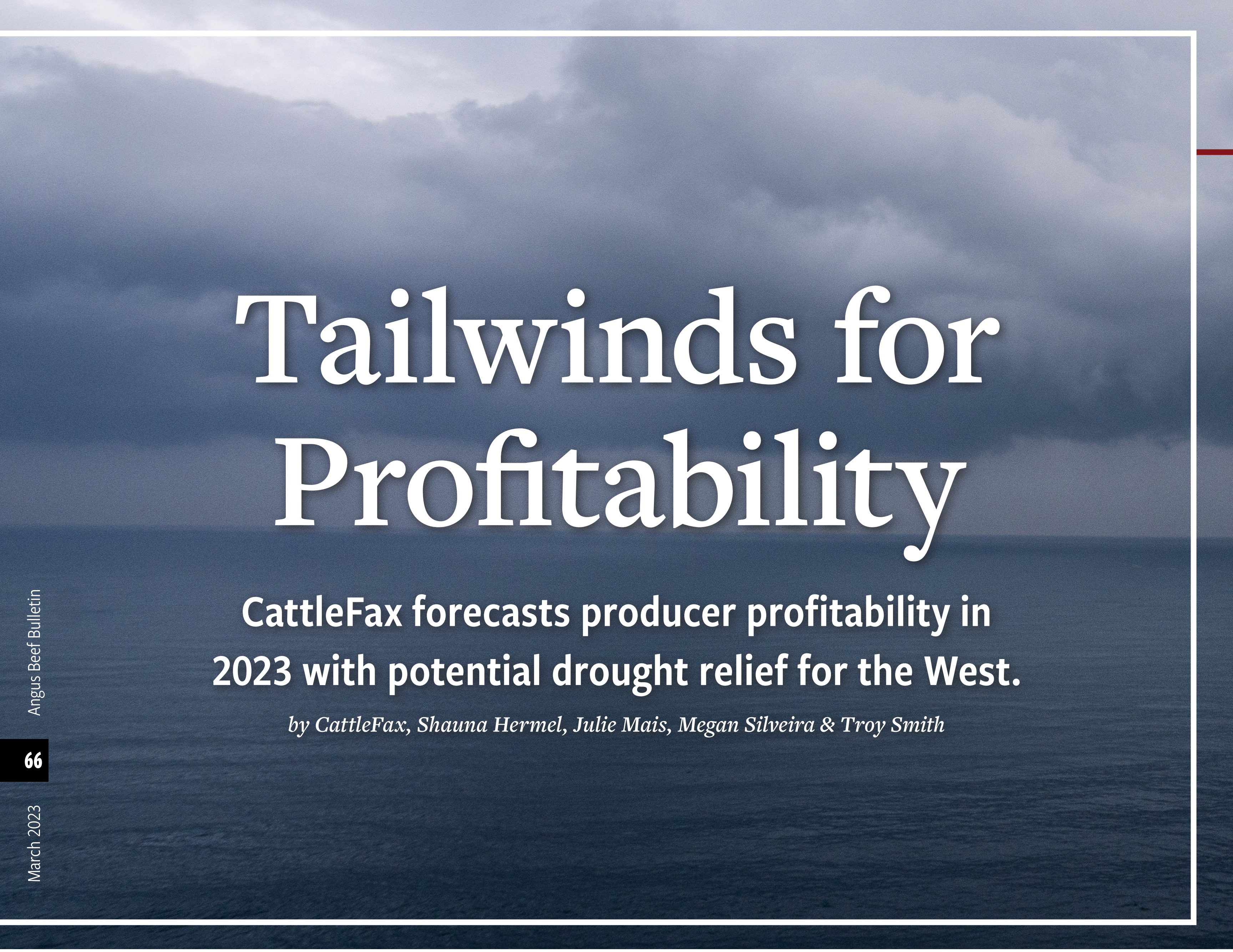


Tailwinds for Profitability

CattleFax forecasts producer profitability in 2023 with potential drought relief for the West.

by CattleFax, Shauna Hermel, Julie Mais, Megan Silveira & Troy Smith

Prices and profitability will favor cattle producers in 2023, according to analysts presenting at the CattleFax Outlook Seminar hosted Feb. 2 during the 2023 Cattle Industry Convention and NCBA (National Cattlemen's Beef Association) Trade Show in New Orleans, La.

The cattle industry is entering 2023 with the smallest cattle supply since 2015 as drought postponed herd expansion and caused the industry to dig deeper into the supply of feeder cattle and calves, analysts noted. While the exact timeline for drought relief is unknown, improvements are expected to translate to moderating feed costs, especially in the second half of 2023.

Combined with increased cattle prices, the analysts said, cattle producers, especially cow-calf operators, will continue to see improvement in margins for the next several years. Here's how they broke it down.

Changing weather pattern

"We're about to slam the door on *La Niña,* and what does that mean? We're opening the door to something new," CattleFax Meteorologist Matt Makens said.

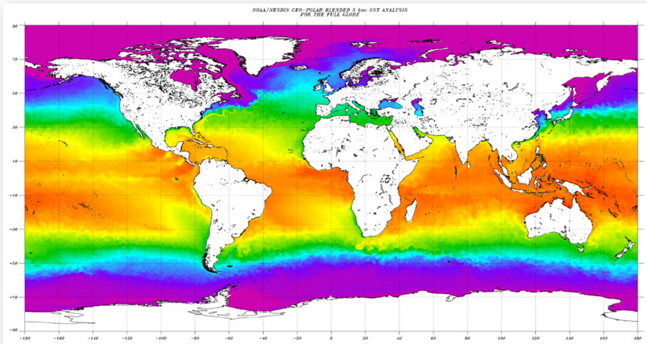
Makens said he has been monitoring clues indicating *La Niña* is fading away for the past several months. The ocean is slowly warming up, he noted, reminding producers ocean conditions and sea surface temperatures drive weather patterns.

El Niño, he explained, is a weather pattern in which the surface waters near the equator in the Pacific Ocean warm. When the ocean is warm, more clouds form, and trade winds push those clouds east, providing rain to the United States and South and Central America.

Despite positive signs in the waters, Makens said, it takes more than a few perfect days of ocean temperatures to bring about *El Niño.* The atmosphere has to fall into accordance as well.

"We're about to slam the door on La Niña.*"*

Matt Makens



NOAA maps showing ocean temperatures indicate *La Niña* is fading.

"The atmosphere and the ocean do work together, but maybe several months or several seasons offset from one another," he said. "That's the point: It's going to take time."

El Niño will make an appearance in small pockets this year, Makens predicted, adding that it will be 2024 before *El Niño* becomes a complete reality.

On a global scale, Makens pointed to healthier crops in southern and northern Brazil. Vegetation is noticeably healthier in Spain and France. Europe hasn't seen much change from 2022, but snow levels are certainly lower, leading Makens to anticipate a slow buildup for the upcoming growing season.

As *El Niño* comes into the picture, water will leave European regions and be seen in surplus in the United States.

"We will gain some traction," he said. "Things will recover heading into the spring."

The past year, vegetative health in the Ohio and Tennessee valleys suffered. However, Makens said the coming spring will supply a lot of "valuable moisture" in Nebraska or Wyoming. The trend will continue in "hit and miss" spots in the valleys.

Makens said it will be a cooler-than-average spring in the United States, thanks to the amount of snow and ice in the northern High Plains and upper Midwest.

Moving into the summer, the monsoon will be robust. Makens said the moisture will continue to even out, as he predicts favorable precipitation patterns in the Rockies. He warned producers it will be give and take, as the Corn Belt will see drier tendencies. There will be neutral to cooler temperatures compared to average levels in pockets in growing areas across the country.

Rounding out with the fall season, Makens said there's a 52%-53% chance of *El Niño* hitting full-force. He offered two potential realities based on the strength of *El Niño's* initial appearance — one exceptionally wet, the other a bit more neutral.

Makens leaned his prediction toward the neutral zone, adding that moisture will still be spread farther west. The Dakotas, Nebraska and parts of both Kansas and Missouri have a positive precipitation outlook.

Until September and October, Makens said, cattlemen can expect the Ohio Valley, the upper Midwest, California, Arizona, Utah and Nevada to stay relatively dry.

Input costs

High input costs, inflation and drought in much of the country affected the cattleman's budget in 2022. In 2023, cattlemen will get some relief in hay prices, but they will continue to deal with elevated interest rates and energy prices, said Mike Murphy, CattleFax vice president of research and risk management services.

Inflation, rising interest rates and general economic uncertainty will continue to affect consumer purchasing decisions as many look to limit spending, the analyst noted.

Inflation reached a 40-year high in 2022, triggering the U.S. Federal Reserve to raise interest rates seven times last year with intentions for further rate increases until inflation falls. The U.S. economy is expected to slow in 2023, with most economists calling for a mild recession in the second half of the year.

Murphy projected an improvement in inflation rates and, by the end of the year, a 3%-4% year-over-year growth.

Interest rates influence the bottom line, he said, adding that he expects to see another one or two quarter-point increases going into the spring.

Economy, feedstuffs, weather — what producers can expect in 2023.

"From our standpoint though, as we get in here towards the prime rates at 8-, 8.25% , we don't really see any relief for the remainder of the year," he said.

Energy will continue to be a "wild card," Murphy added, suggesting crude oil in the mid-70s, which is on the low end of the range, for the remainder of the year.

Natural gas stocks are now above the five-year average, he said, calling it "an incredible correction,"

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bringing stocks into more balance.

What does that mean for diesel? Murphy predicted prices will remain elevated due to small stock levels and high consumption.

"For the farming, ranching community, we see this really wide spread between retail diesel and retail gasoline prices," he explained. "And that has had a huge impact on us as producers from a cost-of-production standpoint. Unfortunately, there's not a lot of resolution to this as we look at 2023."

Murphy said he expects corn stocks to be stable, just under 9%, which will help stabilize prices, maintaining the current trading range. That will continue to support a market above $6 per bushel (bu.) and provide resistance near $7.50 per bu. into the summer, with a yearly average price of $6.50 per bu. expected.

Potential planting delays due to cool soil temperatures this spring could cause some anxiety in the market and could be reflected from a price standpoint, Murphy said.

Hay production is at the smallest level since the mid-1950s, noted Murphy. National Dec. 1 on-farm hay stocks were down 9% from a year ago at 71.9 million tons, with hay prices averaging $216 per ton in 2022.

With the lower beef cow numbers, Murphy said, he expects hay stocks to build up more quickly and prices to decline.

"Between now and summer, do we expect any decline in hay prices?" Murphy asked. "The answer is no, but once you get past into the fall, assuming we have the production that we think we will, we will see a big decline in hay prices."

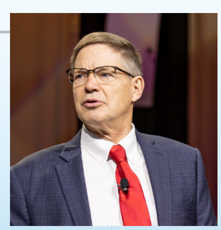
That's good news, he said.

The good news: prices

Reduced herd numbers will start to affect beef supply in the coming year, predicted Kevin Good, vice president of industry relations and analysis at CattleFax. U.S. cattle inventories have already fallen 1.5 million head from cycle highs. He predicted the 2023 beef cow herd to be down about another 1 million head this year to nearly 29.2 million.

Drought affected nearly half of the beef cow herd over the last year, exacerbating the liquidation of 2022, Good said. On average last year, 25% of the cattle herd was in exceptional or extreme drought conditions, 50% were in drought conditions and 65% were in dry or drought conditions throughout the year.

> *"Drought improvement and higher cattle prices should drastically slow beef cow culling through 2023."*
> ***Kevin Good***



"That was the headwind that we faced along with the input cost," Good said of factors encouraging a culling rate of 13.5%. "That's 1% higher than any year in history.

"Drought improvement and higher cattle prices should drastically slow beef cow culling through 2023," he said.

At 25.1 million head, feeder-cattle and calf supplies outside of feedyards are smaller than 2022. Cattle-on-feed inventories were expected to begin 2023 at 300,000-400,000 head below last year, at 14.3 million head, and remain smaller. Commercial fed slaughter in 2023 is forecast to decline by 750,000-800,000.

"With drought-forced placement and culling, beef production was record large in 2022 at 28.3 billion pounds (lb.). Expect production to drop over the next several years — declining 4%-5% in 2023 to 27 billion pounds," Good said. "The decline in production in 2023 will lead to a 2.2-pound decline in net beef supply to 57 pounds per person."

Good forecast the average 2023 fed-steer price at $158 per hundredweight (cwt.) — up $13 per cwt. from 2022 — with a range of $150 to $172 per cwt. throughout the year.

All cattle classes are expected to trade higher, said Good, and prices are expected to continue to trend upward.

- The 800-lb. steer price is expected to average $195 per cwt., with a range of $175 to $215 per cwt.

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- The 550-lb. steer price is expected to average $225 per cwt., with a range of $200 to $245 per cwt.
- Utility cows are expected to trade for an average of $100 per cwt., with a range of $75 to $115 per cwt.
- Bred cows are expected to average $2,100 per head, with a range of $1,900 to $2,300.

Good noted that though beef demand has softened, it remains historically strong, and consumers have shown willingness to continue to buy beef in a new and higher range. He said he expects the 2023 USDA all-fresh retail beef prices to average $7.35 per lb.

Wholesale demand prices, he said, will not go up at the same rate of inflation despite tighter supplies. The cutout value should move higher to average $270 per cwt. for 2023.

Global protein demand continues to rise, and tighter global protein supplies should broadly support prices in 2023. After more than 20% of growth across the last two years, U.S. beef exports are expected to moderate, declining 3%.

Japan and South Korea remain the top U.S. beef export destinations. Meanwhile, Chinese demand has continued to grow, with tonnage up 20% last year.

Putting it all together

A shift to weather patterns more favorable to forage production, moderating corn prices, cyclically tighter cattle supplies and continued strong demand for beef — it's good news for cattle producers, said Randy Blach, CEO and chief market analyst for CattleFax. The lower cattle numbers and reduced beef supplies should support cattle prices and producer profitability.

"If we have an Achilles' heel, it's not enough profitability in the cow-calf segment," he said. "We need to see calf prices significantly higher than they are now, but we need to be able to sustain higher price levels."

CattleFax analysis suggests 2023 prices for 550-lb. steer calves will range from $200 to $245 per hundredweight (cwt.), averaging $225. For 800-lb. steers, prices are expected to range from $180 to $215, averaging near $200 per cwt. Fed cattle are expected to trade in a range from $150 to $172 per cwt.

"But we could see unprecedented volatility, even as prices gradually push higher for the next three to four years," Blach cautioned, warning price swings could be wide.

He reminded producers from all segments to control production costs, and suggested they'd see little to no relief from high interest rates. Blach said total interest cost has increased by about $100 per head in just the last 12-18 months.

"We think we still have a couple more smaller rate hikes ahead of us, and we're not expecting to see any significant reductions in interest rates anytime soon," Blach added.

Fed-cattle sellers may gain leverage if expected expansion in beef harvest capacity comes online in 2025 and 2026, when supplies of fed cattle will be low, Blach pointed out. Increases in cattle from beef-on-dairy programs will fill part of the void. Blach said he also anticipates a halt to packers' Saturday slaughter shifts.

Increasing numbers of fed cattle are sold on negotiated grids, because of the record-wide value differences, Blach said.

"The price spreads have been rewarding," he said, explaining how the average price across all grades is about $45 per head higher than what the cash market averages on a weekly basis. Looking at the cattle that grade 80% Choice and Prime, the value appreciation is about $65 per head.

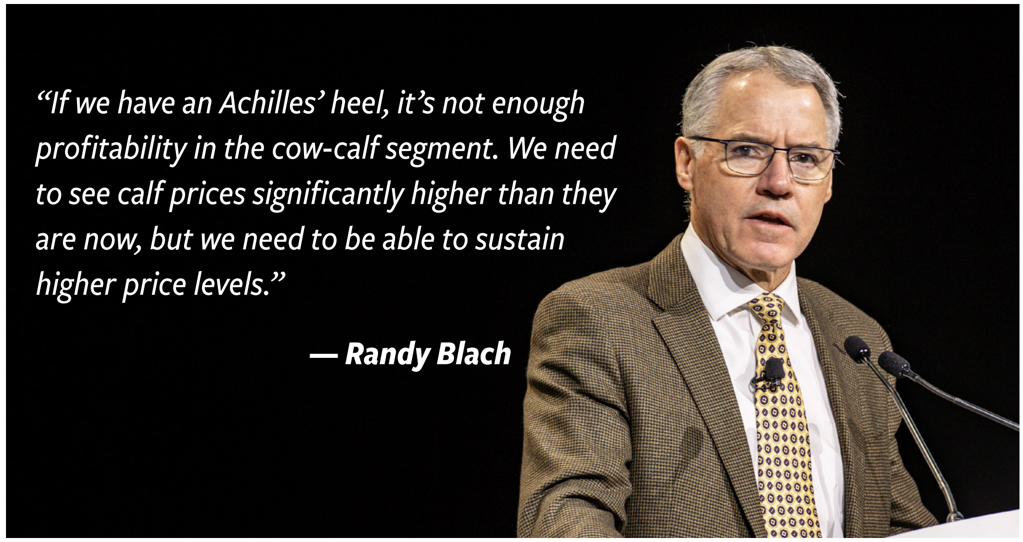
"If you've watched these spreads over the course of the last quarter of the year, there's been cattle that have really hit the targets — 90%-plus Choice and Prime animals that have been bringing $150- to $200-a-head premiums," Blach said. "Those are the market signals we need."

Product grading Choice or better now represents 83% of total production. Consumers show a continued willingness to pay for higher quality and demand for Select beef has not grown.

In summary, CattleFax staff predicted:

- tighter cattle supplies for the next three to four years;
- increased harvest capacity;
- reduced total beef production;
- relatively strong demand, with some decline in domestic consumption and flattening of export volume; and
- record-high prices for all classes of cattle, albeit with market volatility. New highs for fed cattle prices are likely for 2023, then will spread to feeder and calf markets. ABB

Editor's note: Julie Mais is editor and Megan Silveira is assistant editor of the *Angus Journal*®. Troy Smith is a freelance writer and cattleman from Sargent, Neb.



Digital EXTRAs

Scan to listen as Miranda Reiman and Mark McCully host CattleFax CEO Randy Blach for *The Angus Conversation* podcast.