Compression in Feeder-Cattle Futures

by JOHN MICHAEL RILEY,
Mississippi State University

In the early weeks of November, feeder-cattle futures contracts converged to what might as well be a single price, no matter the contract expiration month. In other words, there appears to be no seasonal influence in the market of late. This caught my attention, especially given the current supply situation in the industry and, even more importantly, the longer-term expectation that feeder-cattle supplies will further tighten.

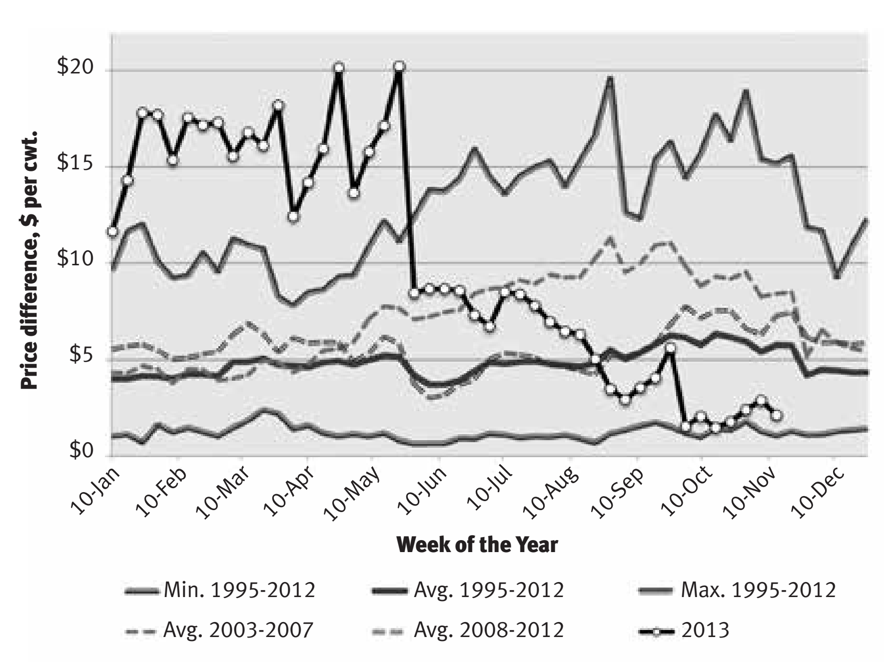
Fig. 1 shows the spread across all available contracts for a 12-month period (i.e., the difference between the highest contract price and the lowest contract price on the same date). While this is a crude measure, it does provide a quick assessment of the market conditions.

Typically, at any point during the year, the spread between all contracts is roughly $5 per hundredweight (cwt.). When 2013 started, the spread was well above the highest seen when looking back through 1995, at about $15 per cwt. and eclipsing $20 per cwt. at times. Once the spring contracts expired, the spread dropped to just under $10 and drifted lower. Currently, the spread is near the lows from 1995 through 2012, at about $2 per cwt.

What does this mean? Live-cattle futures contract prices are more differentiated and have a more typical seasonal pattern in place and do not appear to be an underlying reason for the narrow spread for feeder futures. One explanation could be that corn prices have declined, which has helped lift feeder futures prices across the board.

This appears to have led to a larger increase for nearby feeder prices while more deferred contracts wait to see what next year's crop looks like. Even so, in the winter and spring of this year the most deferred contract was at a significant premium to the nearby contract. This was not surprising at the time given the expectation of tight feeder supplies moving forward. While this is still the case (as of this Nov. 20 writing), for the most part, the fact that the spread has narrowed is indication of the uncertainty of future feeder-cattle demand since there is not a "time" premium currently in place.

Fig. 1: Difference between highest and lowest feeder cattle contract price (weekly average of daily closing prices, 1995-2013)



Editor's Note: *John Michael Riley is extension economist with the Department of Agricultural Economics at Mississippi State University. Reprinted with permission from the Nov. 20, 2013,* "In the Cattle Markets" *column published by the Livestock Marketing Information Center (LMIC).*