Market Advisor: The good, the bad and the ugly

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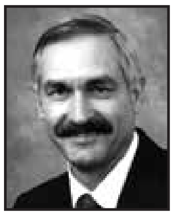

One of the 1960s "Spaghetti Westerns" that Clint Eastwood starred in titled *The Good, The Bad, and The Ugly* typifies quite well the cattle market of the last couple years. I am writing this column just prior to Christmas 2015, and in some respects the current cattle market brings memories back to the same time in 2003 when the first case of bovine spongiform encephalopathy (BSE) was confirmed in the United States.

Probably the biggest difference between the cattle market decline in late 2003 into 2004 and the late 2015 decline is that BSE was a single catastrophic event. The 2015 situation was an unfortunate compilation of many bearish fundamental (supply and demand) factors that affected the market. Individually, each factor would likely have not had a huge impact on the market, but collectively the impact resulted in a record decline in prices.

In 2014 most fundamental factors were good, but by mid-2015 many turned bad, and by late 2015 the market became ugly!

To set the stage, we need to go back to 2014, or even mid-2013, when cattle prices staged the most dramatic increase in history. Indeed, 2014 was a year for the record books, with many unforeseen factors coming together at once.

A near perfect set of both demand and supply circumstances during 2014 created record-high cattle prices. Beef supplies were tight as expected — U.S. commercial cattle slaughter in 2014 declined just more than 7% from 2013. Even with heavier average carcass weights, beef production dropped 5.7% year-over-year.

Beef demand, both domestically and internationally, for U.S. meat products was the positive surprise. Beginning in the second quarter of the calendar year, domestic consumer demand exceeded all expectations. On the international side, export tonnage of beef was rather strong and the value of all exported products (meat, variety meats, etc.) set a new high.

Both pork and chicken production were expected to ramp up with declining feed prices. Yet output of pork and chicken in 2014 was not nearly as large as earlier anticipated. Hog slaughter was constrained by the porcine epidemic diarrhea virus (PEDv) that caused the death of millions of baby pigs. Reduced pork production raised wholesale pork prices dramatically in early 2014. Chicken production increased slightly, but much less than expected. Growth in breeding supply flocks was limited by genetic problems and production constraints.

Feed costs ratcheted down as U.S. corn production in 2014 surged to a new record of 14.4 billion bushels. In fact, drought-impacted record-high corn prices in 2012 led to record production in 2013, the all-time record in 2014, and the third-largest crop ever in 2015. Keep in mind that increase in production following record-high prices when the record livestock prices in 2014 and subsequent production increase in 2015 is discussed later.

A different story in 2015

Lower feed costs and increasing fed-cattle prices turned cattle feeders into aggressive buyers of the cyclically smaller feeder-cattle supply. Cattle prices remained at record-high levels in the first half of 2015, but significant headwinds developed that negatively impacted prices the rest of the year. It seems just about every positive fundamental factor that was so supportive to prices in 2014 turned bad.

Beef production for 2015 was down about 2.5% due to beef herd rebuilding and fewer cows and heifers being slaughtered. However, beef production increased during the last several months due to record-high steer carcass weights that became even more excessive. A backlog of heavyweight cattle fueled the contra-seasonal decline in fed-cattle prices the second half of the year. That decline, along with corresponding feedlot negative margins, spilled over into feeder-cattle prices. Feeder-cattle prices had been supported by declining feed costs, but that also ran its course with corn prices stabilizing at low levels.

Competing meat production also ramped up, with pork production increasing about 7.5% and chicken production up about 4.5%. Both were all-time record-high amounts, which meant total meat production was also record-high. Record production and a struggling meat export market led to record-high meat stocks in cold storage; and sharply declining prices for cattle, hogs and chickens. A number of other negative factors also surfaced.

The cattle market really turned ugly late in the year when only bearish sentiment caused a volatile and plummeting futures market.

It was impossible to anticipate all the positive fundamentals that caused the record increase in cattle prices in 2014, followed by the seemingly endless negative fundamentals that fueled the record decline in 2015.

Looking forward

Now we need to turn our attention to 2016 and 2017. Unforeseen circumstances seem to have been the norm in the meat complex. Plus, world political, economic, meat production and trade issues are ever-changing. The huge decline in cattle prices that occurred in 2015 is behind us.

While moderately increasing cattle and beef supplies will mean a declining price cycle, more normal seasonal price patterns are expected. Although record red meat and poultry production is again forecast for 2016, with increasing domestic demand, increasing meat exports and declining beef imports, only a slight increase in U.S. meat consumption is expected. Following all those factors will give us plenty of material for future "Market Advisor" columns.

Editor's Note: *Tim Petry is a livestock marketing economist with the North Dakota State University Extension Service.*