HIGH CATTLE PRICES STIMULATE EXPANSION ITCH

Summary

It now appears that the old cattle price records are going to be replaced in the next 12 months. The outlook is for finished cattle prices to establish new calendar year highs near $86 per cwt. in 2004. Feeder cattle and calf prices are expected to set new highs as well. The highest price for calves is also expected to be coming this fall.

Leading the charge to new records are small supplies of domestic cattle and the anticipation that imports of live cattle from Canada will not be allowed in the short-run. It may be more likely that the U.S., Canada, and Japan will need to work together to open both import and export trade. If imports and exports are opened together, the implications are generally positive for cattle prices as the U.S. has tended to export more beef than it imports live cattle from Canada.

There is a bit of complacency growing in the cattle industry that no piece of information will be negative to prices. It should be remembered that large and dramatic price changes are possible with the uncertainties that still surround BSE and trade issues. The cattle price outlook should be viewed as having the potential to be much different than the expectations shown in this report.

Beef supplies are expected to be up modestly in the coming 12 months, led by a resurgence in cattle weights. While the number of animals available for slaughter is expected to be down 1.6 percent, weights may increase by 2.2 percent. Weights are expected to grow as time passes and exceed 3 percent greater than year-previous levels by the spring of 2005.

Finished cattle prices are expected to increase into the higher $80s in the fall and then reach perhaps the mid-$90s for highs next spring. Record high calf prices this fall could send 500 to 550 steer calves into the $1.20 to $1.40 range. There, however, could be wide ranges on calf prices depending on location and quality. Beef producers are expected to begin expansion plans over the next several years.

The Numbers

U.S. cattle numbers continue to drop as mid-year inventories were estimated at 103.6 million head, the lowest since July 1st data were started in 1973. Total numbers of cattle are down 8 percent from the last cycle high in 1995. Beef cow numbers dropped to 33.5 million, a reduction of just .3 percent, but down 7 percent from 1995 (Figure 1). Milk cows were down about 1 percent.

The first signs of expansion of the beef herd may be beginning as beef heifer retention is up, especially in Plains states recovering from years of drought. The expansion fever may be strongest for several of the Plains states where drought conditions are easing this year. Missouri leads the way with an 8 percent increase in beef cow numbers, while Nebraska’s herd is up 5 percent, Kansas is up 4 percent, and Oklahoma is up 3 percent. State data is limited in USDA’s mid-year report to only 11 individual states. Milk producers reported unchanged numbers of retained heifers.
The number of heifers weighing under 500 pounds that were not being retained for returning to herds as breeding stock were down nearly 2 percent from last year at this time, and the number of steers 500 pounds and heavier were unchanged from last year. The size of the 2004 calf crop is now estimated at 37.7 million, a .5 percent reduction from last year.

The number of cattle in feedlots was up 2 percent, which was lower than expected due to a small number of placements in June. With falling grain prices there had been anticipation that placements would be on the rise last month. However, the reported placements were actually down 2 percent, likely as a result of the small numbers of available calves and a still uncertain feed price situation in June. Feed lot managers appeared more willing to purchase young animals, with placements of calves weighing under 600 pounds up 24 percent, but stayed away from older animals with over 600 pound placements down 8 percent.

### Supplies Rise Due to Weights

Beef production is expected to expand somewhat in the coming 12 months due to a more rapid movement of cattle into feedlots because of lower feed prices and as a result of sharply heavier weights. Beef production is expected to rise by .6 percent. This is expected to be composed of a 1.6 percent decrease in slaughter numbers but a 2.2 percent increase in marketing weights. Tables 2, 3, and 4 show these relationships.

Several assumptions are built into this evaluation. The most important is that restrictions banning live animal imports from Canada stay in place for the next 12 months. It has now been 14 months since the May 20, 2003 announcement of the BSE cow in Canada. Efforts to restore trade with Canada have been surprisingly slow and have been complicated by trade concerns from Japan. Keep in mind that Canadian finished steers are currently trading at $54 per live hundredweight with U.S. prices at $85. If the border is opened (without restrictions) prices will equate between the two countries. Canada will rise to about $77 and U.S. prices will fall to about $79. The $2 difference will reflect transportation costs from western prairie provinces to U.S. packing plants.

A second assumption is that feed prices will be reflective of prices trading in late July 2004. These much lower feed prices with extremely strong live cattle futures prices imply that weights will be rising over the next 12 months. My projections are that weights will be up relative to year-previous quarters by the following percentages: 2004 (III) up 1.6 percent; 2004 (IV) up 1.9 percent; 2005 (I) up 2.3 percent; and 2005 (II) up 3.2 percent.

### Prices to Set New Records

It appears new record high prices for finished cattle prices will be set this calendar year. Calf and feeder cattle prices are expected to reach records this fall and winter as shown in Table 5. Calendar year 2004 prices are expected to average $86, breaking last year’s record of $84.69. In the January to July 2004 period, prices of Nebraska steers have averaged $85.07 and the general tone of prices is expected to be higher for the rest of the year. Nebraska steers are expected to average about $85 this summer, but move upward to $88 in the last quarter. The highest prices in the current forecast are in the first quarter of 2005 with an average expected to be in the higher $80s or low $90s. This could mean some absolute highs next spring in the mid $90s.
Beef demand has been improving since 1998 and appears to be the key reason for such strong cattle prices. In 1998, at the low point of consumer demand, per capita beef supplies in the U.S. were 68.1 pounds and Nebraska live steers averaged just $61.50. By 2001, supplies had dropped modestly to 66.2 pounds per person and live steer prices had risen to $72.43. This year, the per capita supplies are nearly the same, at 66.3 pounds per person, and live steers are expected to average near $86. The cause is related to at least three factors: 1) the number of articles suggesting the consumption of beef may have negative health impacts have been reduced; 2) high protein diets have become extremely popular; and 3) personal incomes are strong after emerging from the 2001 recession and slow growth period in 2002/03.

Feeder cattle and calf prices will likely be at all time highs as well. Feeder cattle futures have established new highs above $1.15 per pound as shown in Figure 2. Not only have prices made new records in the past nine months, but they have sharply exceed the previous highs around $.90 per pound in 1990/91 and again in 2000/01. Continued declines in grain, protein, and forages prices could continue the march to even higher calf prices into the fall.

Price forecasts for feeder cattle and calf prices are shown in Table 5. My computer models failed to forecast prices this high, but these models are based on history so that new record high prices such as these are not within the model’s ability to predict. About $8 per live hundredweight has been added to the model forecast. It is also important to say that the amount of error in these forecasts could be much larger than the historical errors mentioned in the footnotes of Table 5.

Oklahoma 500 to 550 pound steers are expected to average $125 to $130 per hundredweight this fall. While this appears to be a bold forecast, these calves were selling for $126 during the week ending July 24, 2004. Lower feed prices and/or stronger finished cattle futures would push those prices even higher. Feeder cattle in the 750 to 800 pound range are expected to be in the $100 to $110 range this fall, again at Oklahoma City. Somewhat lower prices are anticipated in the winter and next spring, but they should continue to be very high by historical standards. Generally, calves in the Eastern Corn Belt are $3 to $5 lower than quotes from Oklahoma City. Those spreads, however, could be wider in the next 12 months.

**Implications for the Cattle Industry**

Record high cattle prices mean record profits for the cattle industry this year, and will sustain U.S. farm incomes perhaps near record high levels as well. The bulk of the income will accrue to the brood cow sector which will sell the 2004 calf crop at record high prices.

Cattle feeders may see highly volatile incomes, as is often the case. Dramatic shifts in finished cattle prices have been a characteristic of the year and the possibility of more large shifts remains possible with the potential for new BSE announcements and for alterations in trade agreements either on imports or exports. Added to these is the dynamics of feed prices which have made feeder cattle and calf prices even more volatile than finished cattle. The year is full of risks, and where there are risks there are opportunities. However, those who are not in a financial position to take the potential wide swings should consider hedging alternatives with futures and options.

It is surprising to see beef producers edging toward expansion with the 4 percent higher beef heifer retention. It was expected that the uncertainties associated with the markets this
year would stem any movement toward expansion. At this point that appears to be wrong. If the cattle outlook got producers moving toward expansion in the past six months, then conditions may be ripe for further movement in that direction over the next year. Finished cattle prices will be strong, feed prices are going to be moderate, interest rates may not rise as much as had been feared, and the longer we live with BSE concerns, the more we are convinced that consumers will stay with beef. Additional heifer retention means even smaller beef supplies and further supports prices in the beginning of the expansion phase of the cycle. Finally, the Plains drought is retreating on the eastern side and will provide greater incentives for more expansion of brood cows there.

Although the uncertainties are well known for beef producers, there is a growing optimism that prices will be profitable for several years to come.

Cow-calf producers should examine their costs carefully before committing to expansion. While many may believe they can raise 500-600 pound calves for 70 to 80 cents per pound. Most University budgets suggest that is closer to $1.00 per pound if all costs of production are taken into consideration including a return for buildings, fencing, and especially the family’s time. While calves will exceed the $1.00 a pound level this year, historic prices have not achieved a similar threshold.

Issued by Chris Hurt
Extension Economist
Purdue University