



ANALYSIS AND COMMENTS

Livestock Marketing Information Center

State Extension Services in Cooperation with USDA

Letter #50

December 20, 2002

CATTLE MARKETS: REVIEW OF 2002 AND OUTLOOK

Many cattle producers were disappointed by prices in 2002, as cyclically higher cattle prices did not materialize. Depending on weight and location, cattle prices in 2002 were 5 to 10 percent below 2001's. Further, many U.S. cow-calf operations faced severe drought in 2002.

Looking ahead to 2003 and 2004, if Mother Nature is a bit more cooperative than in recent years and if the U.S. and world economic conditions continue to improve, cattle and beef prices are expected to overcome the disappointments of 2002. The major factor supporting higher prices in 2003 will be cyclically smaller cattle numbers. Recent declines in feedlot placements coupled with what appears to be a return to the seasonal patterns in cattle weights implies smaller beef supplies in early 2003. Further, in contrast to 2002, U.S. pork production in 2003 is expected to decline and the rate of growth in U.S. poultry output may be one of the lowest in decades.

Still, several factors could overwhelm basic supply fundamentals and bring lower than anticipated cattle prices in 2003. Those factors include: poor pasture and range conditions, reduced feedstuff production, deterioration in foreign demand for U.S. meat and poultry products, and/or a major domestic economic downturn.

Review of 2002

After cattle prices collapsed during the fourth quarter of 2001, a solid recovery developed in the first quarter of 2002. But cattle prices eroded in the second quarter and did not recover until late 2002. U.S. beef production was record large in 2002 and record large competing meat and poultry supplies in the domestic market compounded the pressure on beef and cattle prices.

Except for November and December, U.S. cattle feeders lost money throughout 2002. As the year progressed, the industry began to come to grips with excess capacity in commercial feedyards, though actual physical structural adjustment was limited. During the summer of 2002, corn prices ratcheted-up from the low levels of recent years exacerbating red ink and capping calf and yearling prices.

On an annual basis, U.S. beef production exceeded 27 billion pounds for the first time in 2002. U.S. frozen stocks of beef were record large as of October 31, 2002. Low U.S. prices did spur beef export tonnage for several months.

Throughout 2002, beef sales to Japan, remained well below a year earlier, as the discovery of BSE in Japanese cattle in late 2001 continued to limit beef consumption in that country. But, U.S. sales to Mexico and South Korea were robust. Until late 2002,

U.S. beef export tonnage was generally above 2001's and was larger than forecast, additionally, U.S. beef imports were a little below expectations. At the time of this article (December 2002), data on U.S. international trade was essentially only available through October. The trend of beef tonnage sold to Mexico and South Korea compensating for year-to-year reductions in sales to Japan stopped in October. Historically, Japan has been the largest foreign market for U.S. beef and veal. In October, for the first month in relevant history, Mexico was the largest foreign market for U.S. beef on a tonnage basis. Much of the year-to-year decline in U.S. beef sales to Japan in October was likely tied to disruptions at all major U.S. west coast ports (the issues between dockworkers and management have since been resolved).

From an economics perspective, the fundamental factors that limited or pressured cattle prices in 2002 were, in order of importance: 1) beef supply; and 2) competing meat and poultry supply. In fact, U.S. consumer beef demand held up rather well in 2002 and generally continued the positive trend of recent years.

During the first quarter of 2002, cattle prices recovered from most of the problems that began in the fourth quarter of 2001. U.S. beef production was above the weather-reduced levels of early 2001. Slaughter was below 2001's, but heavier slaughter weights put U.S. beef production 3 percent above a year earlier. Fed cattle prices averaged over \$70.00 per cwt., while in the Southern Plains 700-to 800-pound steers averaged over \$82.00 per cwt. and 500-to 600-pound steers averaged over \$97.00 per cwt.

In the second quarter, record large production levels of beef and poultry precipitated lower beef and cattle prices. Further, the supply of chicken in the domestic market surged with international trade disputes with Russia. On a quarterly basis, U.S. beef production was up just over 5 percent from a year earlier, with the bulk of the year-to-year increase coming from heavy

dressed weights. Pork production also increased over 5 percent from a year earlier. During the second quarter of 2002, U.S. broiler production increased by just over 3 percent from 2001's. However, the domestic supply of broiler products rose by over 11 percent from a year earlier as U.S. sales of chicken items to Russia were restricted and faltered to some other countries. The bottom line, prices were under pressure. For example, fed cattle prices were 13 percent below 2001's and headed lower in the second quarter of 2002.

Not much improved for the summer quarter of 2002. For the first quarter in history, U.S. commercial beef production in the third quarter exceeded 7 billion pounds.

So, for the first three quarters of 2002, cattle prices remained below a year earlier. Record heavy dressed weights were common; the average Federally Inspected dressed steer weight over the first three quarters was 819 pounds, 30 pounds larger than in 2001. Those weights resulted in total U.S. beef production (commercial plus farm) being up nearly 5 percent for the first nine months of 2002. During the first three quarters of 2002, fed cattle prices averaged \$66.69, down \$9.00 per cwt. from 2001's and were the lowest since 1999's. In Western Kansas, 500-to 600-pound steer calves averaged \$91.89, down \$11.00 per cwt. (11 percent) from the respective period in 2001. Feeder steers (700-to 800-pounds in Western Kansas) averaged about \$10.00 per cwt. lower than a year earlier at \$80.14.

Cattle prices improved during the fourth quarter, with most of the rally taking place in late November and early December. In the fourth quarter of 2002, prices for fed steers averaged about \$5.00 per cwt. above 2001's, but were still more than \$2.50 below 2000's. Calf and yearling prices remained mostly below a year earlier as on-going losses by cattle feeders and higher feedstuff costs helped keep prices in check. Slaughter cattle, calf, and yearling prices may continue to gain ground into early 2003.

Outlook for 2003

The current cattle cycle has been rather unique; drought was a major factor perpetuating the cycle in 2002. Cow-calf producer returns have mostly been positive in recent years when compared to calculated cash production costs (typical High Plains cash expenses plus forage and costs, including pasture). However, in 2002, like 2001, cow-calf returns were well below expectations and the high return years of the 1990's. Cattle inventory estimates for January 1, 2003, are expected to show modest declines in most categories.

As of January 1, 2003, the U.S. total inventory of cattle and calves may be down less than 1 percent (preliminary estimates suggest a year-to-year decline of 0.8 percent). The U.S. cowherd is expected to be essentially unchanged as of January 1 compared to a year ago (down 0.2 percent on beef cows and unchanged on dairy cows). Regions of the U.S. not impacted by drought in 2002 will tend to show year-to-year increases in beef cow numbers and growing numbers of heifers over 500 pounds held (intended) for breeding.

The beef industry should expect to see higher prices next year supported by lower cattle numbers coupled with smaller competing red meat supplies. U.S. cattle slaughter is forecasted to be down between 3-4 percent from 2002's. In 2003, dressed weights are expected to increase at a much more modest annual rate compared to 2002's. So, U.S. beef production should be about 2 to 4 percent below 2002's.

On a quarterly basis, year-to-year declines in U.S. beef production are expected throughout 2003. U.S. pork production also is forecast to decline throughout 2003. Poultry production is forecast to increase rather modestly in 2003. In fact, data in late 2002 suggested that U.S. poultry output could post modest year-to-year declines in early 2003.

Two key factors will interact in early 2003 to determine fed cattle marketings. First, the cattle on-feed inventory ended 2002 well below a year ago (as of December 1, 2002 down 8 percent from a year earlier) and for the historically reported 7-states the number of cattle in feedlots was the smallest since 1996. The second key will be the turnover rate (marketings as a percentage of cattle on-feed). The feedlot turnover rate has been slow by historical standards for two years, but began to return to normal rates in October. Faster feedlot turnover rates in early 2003 will moderate the year-to-year decline in feedlot marketings significantly. In contrast to an on-feed inventory about 8 percent below a year ago, feedlot marketings (and weekly average steer and heifer slaughter) might decline by only 4 percent.

Dairy cow slaughter may remain rather large in early 2003. In contrast, beef cow slaughter will continue to moderate, compared to a year earlier, if pasture and range conditions are normal. Further, normal pasture and range conditions will allow cow-calf operations to hold onto heifers for their breeding herds that in recent years have been re-directed to feedlots by drought.

For calendar year 2003, current forecasts are for year-to-year increases in fed and feeder cattle prices. Fed cattle prices could increase 8 to 11 percent compared to 2002's. Fed cattle prices are expected to be above a year earlier for each quarter of 2003. Prices are forecast to be in the high \$70's in February through April. During the summer, fed cattle prices will likely retreat to a seasonal low in the mid to upper \$60's and then rebound in late 2003. Calf and yearling cattle prices may not exceed a year earlier until the second quarter of 2003.

Perspective on 2004

Normal weather in 2003 and 2004 would set the stage for another cyclical increase in cattle prices in 2004. That year should bring rather noticeable reductions in U.S. heifer slaughter as cow-calf operations see financial incentives to move towards breeding herd re-

building. Some states, those without drought in 2002, will be further along this re-building path than the national numbers indicate.

Preliminary forecasts are for U.S. beef production to decline from 2003's by 1 to 2 percent. In terms of beef production, reduced heifer slaughter and a slight decline in steer slaughter in 2004 could be compensated for by a surge in dressed cattle weights. A beef production decline should support further year-to-year increases in beef and cattle prices.

Competing meat supplies could return as a factor limiting beef price increases in 2004. U.S. pork production could be on the upswing by late 2004, but the most likely increases would come from poultry producers.

Potential Forecast Risks

Looking ahead to 2003 and 2004 the cyclical aspects of cattle numbers should be supportive of prices. But, as was the case in 2002, other factors can overwhelm the cattle cycle. A key uncertainty that remains is drought; are we near the end of or in the middle of a drought cycle? Drought can impact cow-calf producer breeding herd decisions rather quickly, it often changes the flow and weights of cattle into feedlots, and it can dramatically depress calf prices if feed grain prices skyrocket.

In terms of competing meats and poultry, the major uncertainty will be broiler production. Broiler production can ramp-up rather quickly in the U.S. and in countries that increasingly provide competition in foreign markets (i.e. Brazil and Thailand).

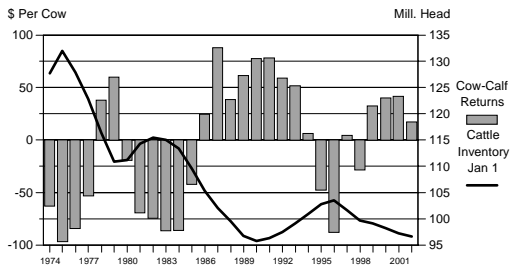
International trade will be a bigger risk factor for cattle prices in this decade than it was in the last two decades. The reason is that U.S. exports of beef are now a significant proportion of production. One lesson from 2002 was that the beef industry must also look at the indirect impacts of international trade. That is, imports and exports of broilers and pork can have an impact. Trade disputes and policy in other countries and on beef and

other products, including grains, can spill over into the domestic market for beef and cattle.

Will domestic beef demand continue to increase? If packer gross margins tighten in 2003, as expected with cyclically smaller fed cattle supplies, what level of industry investment in new products will occur? Of course, a broad array of food safety developments could impact beef demand (either a positive or negative).

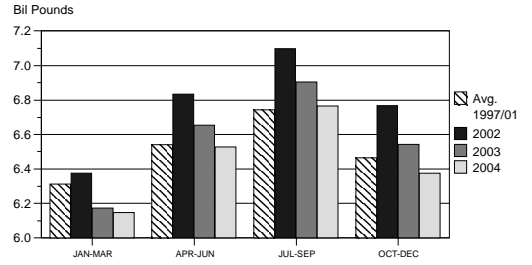
COW-CALF RETURNS AND CATTLE INVENTORY

Annual



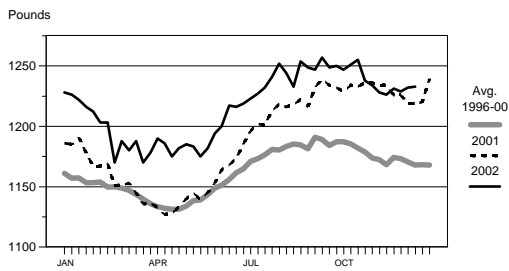
COMMERCIAL BEEF PRODUCTION

Quarterly



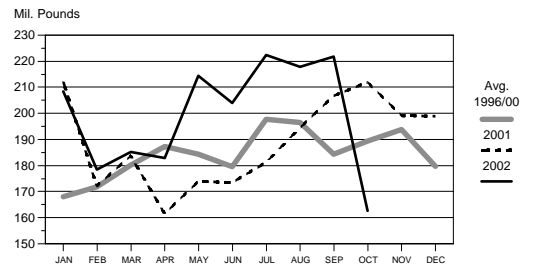
LIVE WEIGHT - STEER AND HEIFER

Texas/Oklahoma Panhandle Area, Weekly



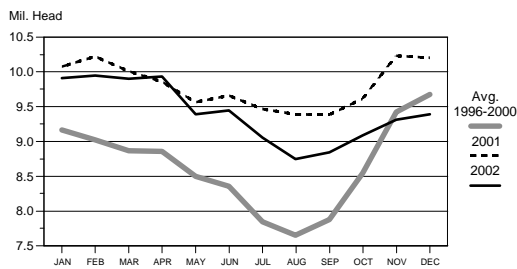
U S BEEF AND VEAL EXPORTS

Monthly, Carcass Weight



CATTLE ON FEED

Seven Historical States, Monthly



FED CATTLE MARKETINGS

As a Percent of Cattle On Feed, Monthly

