



Weekly Outlook: Cattle Prices, More Room for Recovery?

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Some are saying this is the most volatile cattle market ever. An evaluation of that statement would take considerable number crunching, but everyone can agree that few expected cattle prices to go above \$170 per hundredweight in late-2014, and then to fall below \$100 in mid-October 2016. That was an incredible decline of \$75 in about two years.

Of course there is the old adage that "what goes up, must come down." If finished cattle prices dropped by nearly \$75 in the two years after the 2014 high price, how much did they rise in the two years before the high? The lowest weekly price of finished steers in 2012 was \$113. Prices rose by \$59 before falling by \$75.

Of course the supply and demand for beef are the primary drivers of finished cattle prices. Small supplies of cattle in 2014 were the result of the devastating Southern Plains drought and of high feed prices in the 2010 to 2014 time period. Small cattle supplies meant high finished cattle prices. In 2015 and 2016, lower feed prices and more cattle coming out of feedlots resulted in lower prices. However, another little-reported potential driver of this price volatility lies in the fact that adjustments at different levels in the beef chain occur at different rates. Stated most simply, cattle prices and wholesale beef prices tend to adjust quickly to changes in cattle supply while retail prices adjust more slowly. As cattle prices rise, retailers are slow to increase retail beef prices. This keeps the quantity of beef demanded strong and more of the retail price is bid back into the cattle price. This may "overstimulate" cattle prices.

We are now on the other side of that relationship as retail beef prices have been slower to come down, keeping retail beef prices higher and weakening the quantity of beef demanded and thus lowering the share returned to the cattle price. This may cause cattle prices to drop more sharply and overshoot on the downside. This overshooting on the downside may have occurred most recently. Packer and retail margins were narrow in 2014 and the farmer's share of the retail dollars spent on beef was 55 percent, the highest annual level since 1993. This year the opposite is true, with packer and retail margins at record highs resulting in the farmer's share of only 45 percent.

Into 2017, retail beef prices will likely continue to decrease and marketing margins will likely decrease with a greater share of the retail beef dollar getting back to the cattle price. While it is difficult to accurately

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predict how large this impact will be, it seems within reason to expect about an \$8 to \$12 improvement in finished cattle prices just based on narrowing marketing margins in 2017.

Trade is going to help as well in 2017. As U.S. beef prices come down in 2017 there will be less beef imports and more beef exports. USDA's current projections are for 11 percent less beef imports and a six percent rise in beef exports. Even though U.S. beef production could be up three to four percent in 2017, the positive impacts of trade mean that per capita beef supplies in the U.S. may only rise less than one percent. If demand stays similar, 2017 finished cattle prices would be expected to be modestly lower than this year's \$118 to \$120.

There continues to be a wide variation of opinions about the cattle market in 2017. Cash cattle prices have recovered about \$7 in the past three weeks. Futures prices also recovered. However, futures traders remain far more pessimistic than the current fundamentals seem to suggest. Using futures prices on November 7 as a proxy for cash prices suggest 2017 finished cattle would average in the higher \$90's. USDA analysts who use fundamental price models are forecasting the average finished cattle price to be \$112 to \$121. The mid-point of their forecast range is \$116.50 per hundredweight, which is more consistent with current supply and demand expectations.

Clearly, wide swings in the cattle market over the past four years has made it difficult to establish benchmarks of what a high price, or a low price, for cattle should be. Cattle prices have lost their price reference points. Nevertheless, it should be remembered that it is the role of markets to "discover" the correct price over time.

The cattle industry has been through numerous shocks, including high feed prices and drought, in recent years. In trying to discover the right price, markets often have to overshoot and then undershoot as they continue to adjust in the search for the correct price. Finding the right price is not easy, yet markets are generally considered the most efficient way to find that elusive level. At the same time, we need to remember that the volatility implied in finding that right price has major financial consequences on participants in the entire beef chain, from cow-calf operations, to feedlot owners, to packers, to retailers.