



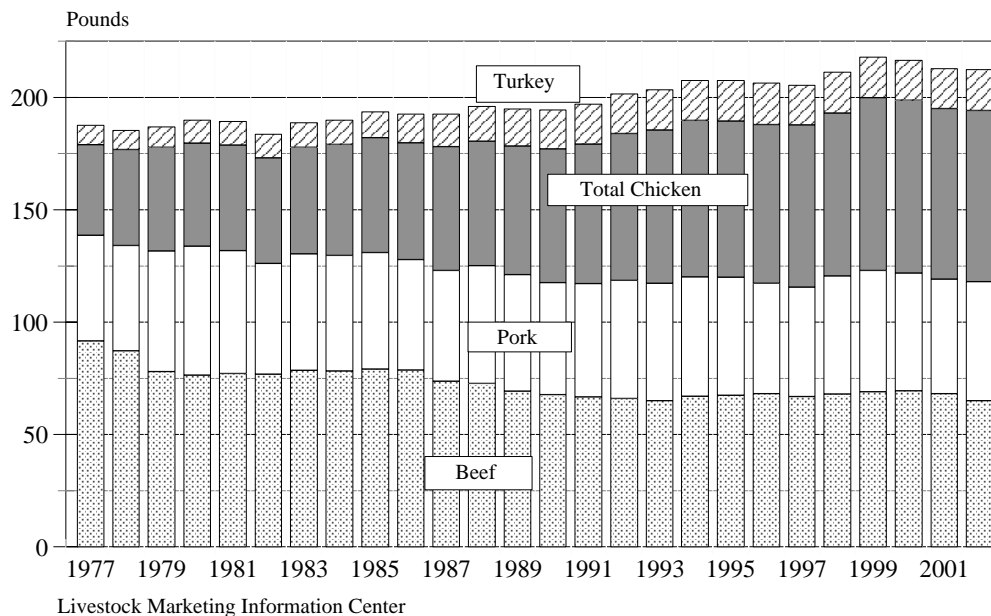
Livestock Market Situation and Price Forecasts*

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Across the board, Kentucky livestock producers have been making profits over the past year. According to USDA figures, the breakeven price for a farrow to finish hog operation was about \$37 per cwt. in mid 2000, and it has changed very little since then. With selling prices for hogs in the mid \$40s (\$43/ cwt. in August, 2000, \$47 in August, 2001), hog production has been profitable. This is the third consecutive year of profits in the hog industry. While such breakeven standards are not available for calf production, the high calf price has been good for cow-calf operations. For most of the past two years, the Kentucky average price for 400 -500 lb. steers has been over \$1/lb.

Weakness in the U.S. economy will hurt the livestock industry. Consumer incomes have been a strong factor behind increases in meat demand in recent years (since 1998 for pork, since 1999 for beef). The September 11 attack and aftermath is adding to economic weakness. It is too early to forecast the extent of the impact on the meat industry and how it will affect particular segments, such as at-home compared to away-from-home consumption.

U.S. Red Meat and Poultry Consumption (Per Capita, Retail Weight, Annual)



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Meat consumption

Total per capita meat consumption for 2001 is forecast by the USDA to be about 216 pounds, down about 3 pounds from 2000's level and four pounds under the 1999 record. However, it will still be at the fourth highest level of all time. The 2001 decline came from small drops in beef, pork and poultry. For 2002, further small declines are expected, however the causes will be different. Increases are expected in both pork and poultry, but those are expected to be more than offset by a 3 pound per person drop in beef consumption.

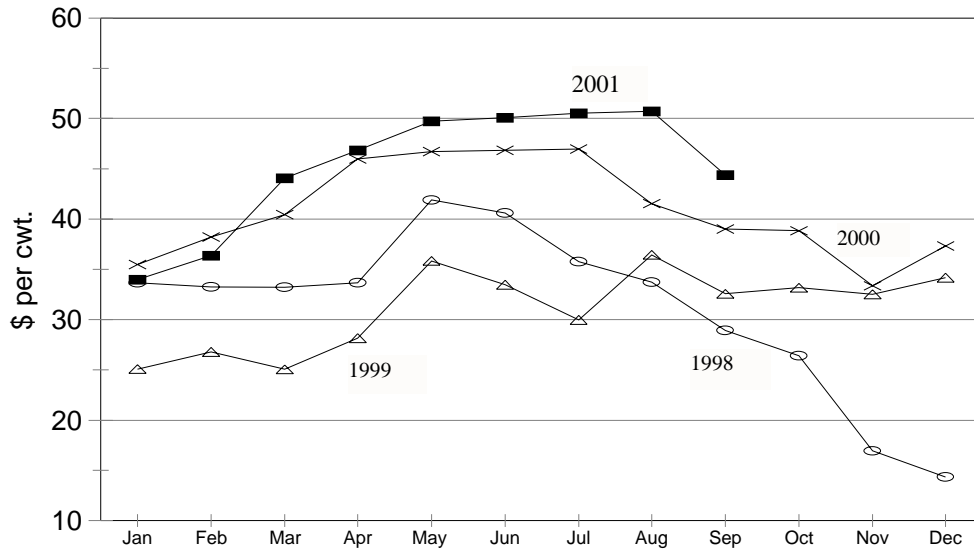
With the changing economy, expenditures are difficult to forecast. Personal spending on meat as a percent of disposable income hit an all time low of 2% in 1995. It has since risen to about 2.5% because of higher prices and greater consumption. Beef prices are beginning to decline even with slightly less beef on the market, a preliminary indication of a weakening of demand.

Hog Market May See More Production, Lower Prices

According to the University of Missouri, hog production has been profitable in 17 of the past 19 months, a trend which typically leads to expansion. While there are some indications that a modest expansion may be starting, it is unlikely to have a major market impact before the second half of 2002.

Recapping recent history, after the price disaster of 1998, when a 10% increase in production led to prices below \$20/cwt. the industry has rebounded. Demand strength has been an important factor, with trade also helpful. In 1995, U.S. pork industry exports exceeded imports for the first time in decades. Since then, it has continued to have a net positive trade balance of about 2% of domestic production.

Hog Prices (220-250 Lbs., Live Weight)



The best evidence of demand strength is that even with some increase in production, prices have strengthened considerably over the past three years. In 1998, consumption was 52.5 lbs. per person and the average price was \$32/cwt. 2000's consumption was 52.4, yet the average price moved up 37% to \$44/cwt. While domestic demand has probably stabilized, an increase in exports will have left U.S. per capita consumption 3% lower than the 2000 level and has led to slightly higher prices.

If demand remains stable, production levels will be the key factor in price determination. Given the continued profitability of the industry, modest expansion of 2% to 4% is expected. The price impact will be a \$3 to \$5/cwt. price decline resulting in an average price for 2002 in the low \$40s (about \$58 on a carcass weight basis). If economic weakness leads to demand drops, prices for market hogs could be considerably lower, perhaps in the \$33 to \$38 range for the year. With breakeven prices in the upper \$30s, producers would face modest losses for the first time in about two years.

While spring 2002 hog prices had been forecast in the mid \$40s, those expectations have been tempered. The most likely scenario are prices in the upper \$30s during the winter, rising into the low \$40s during the late spring and up into the mid \$40s for the summer. If expansion has resulted in more pork, late 2002 hog prices could drop into the mid to low \$30/cwt. area.

Beef Demand and the Cattle Cycle are the Keys to the Cattle Market

During both 1999 and 2000, beef consumption rose and cattle prices also rose. This is the definition of an increase in demand and is a key to a profitable industry. A modest decline in cattle slaughter for this year has helped increase prices further, especially in the first part of 2001. A 5% drop in slaughter led to an increase in slaughter cattle prices up to \$79/cwt. Prices have declined in the second part of the year and will probably be near the low \$70s, about the same as in 2000. Feeder cattle prices have followed the same trend, settling at 2000 levels.

Since early September, Kentucky feeder cattle prices have declined by \$7 per cwt. With all of the attention the economy is receiving, it appears that demand weakness has moved through the beef industry. And while there is some truth in that reasoning, the fact is that a very similar price drop occurred in feeder markets in 2000. From early August to mid September, 2000, the Kentucky average price for 400 to 500 pound feeder steers dropped from \$107 per cwt. to \$97 per cwt. The lesson is that there are many factors affecting the market and they must be carefully analyzed before changing production and marketing strategies.

The weak economy is affecting demand, but it is too early to know the extent of the weakness. As an independent factor, this demand weakness would lead to lower prices. However, declines in beef production may offset the weakness in buying and help hold prices up.

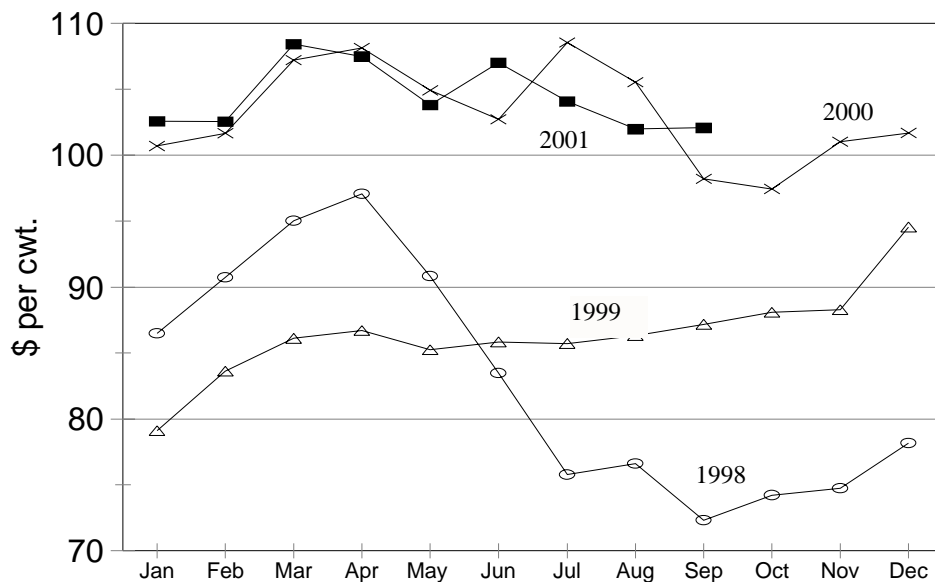
The September USDA Cattle on Feed report includes two key factors affecting the market. The first is that the number of cattle on feed is up 5%, an indicator that beef production over the next few months is likely to increase. The result will be weaker slaughter cattle prices, with declines into

the upper or even mid \$60s for finished cattle. The positive factor for the longer run is that placements during August were 10% under the 2000 level and 9% below August of 1999. If the decline in placements continues, beef production for 2002 will decline by 2% to 4% and slaughter cattle prices will average in the mid to upper \$70s. Strength of demand will determine whether this potentially strong market actually occurs.

Strong slaughter cattle prices, with cheap feed, leads to strong feeder cattle prices - which is the expectation for 2002. Again, assuming that demand does not crash dramatically, with building in modest weakness in demand, Kentucky feeder cattle prices are likely to rise slightly in 2002.

Backgrounding opportunities for Kentucky operations have been profitable and this trend is likely to continue. In the winter of 2000-01, a simple buy/sell margin of 400 lb. calves in the fall compared to the price of 700 pound yearling steers in the spring was about -\$14/cwt. This buy/sell margin level is about typical and is the most likely scenario for the 2001-02 backgrounding season. A simple budget with 400 pound calves purchased at \$100/cwt. has breakeven price of \$73 per cwt. , expected to give net returns over cash costs of \$40 to \$50 per head.

Feeder Steer Prices (400-500 Lbs, Liveweight)



While demand will be the driving force for next several months, the cattle cycle will be the key factor over the next two to four years. Based on the USDA Cattle Inventory Report, the number of cattle in the U.S. continues to decline slowly. The number of cattle, beef cows and beef replacement heifers are all down. The number of beef cows is at its lowest level since 1991. Fewer cattle, less beef, stronger prices is the process that has helped the industry in the past three years. Rebuilding of the cow herd has not begun - yet. Current weakness in cattle prices may discourage some cow herd managers. Others will look at lower feeder heifer prices and decide to hold heifers for breeding now that they are worth less. As heifers are held away from feedlots, beef production

will decline and cattle prices will remain strong until the calves from the expanded herd reach the market. Given the current rate of expansion, this is not expected until 2004 or 2005.

Broiler Industry - More Expansion Expected

The broiler industry has had a history of 2% to 3% annual expansion. With little increase in production, strong exports, per capita chicken consumption actually is declining in 2001 from 77 to 76 pounds. The 12 city, wholesale price level has risen about \$.03 per pound, and will probably end the year near \$.60 per pound.

Based on chick placements, broiler production is expected to increase, probably 2% to 3% for the rest of 2001. If the trend in strong exports continues, the increase in production will be sent to other countries and U.S. consumption will stay flat. As a result, wholesale broiler prices are likely to average in the upper \$50s to low \$60s for 2002.

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