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J.S. FERRARO

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RED MEAT OUTLOOK: CATTLE & BEEF

The spread of coronavirus (COVID-19) remains front and center in the live cattle futures market and, by extension, in the cash cattle market. Last week, cases began to mount in areas outside of China and the US Center for Disease Control (CDC) issued a warning that the US should prepare for the spread of the disease within its borders. That sent the equities markets down hard and created a "risk off" environment where sellers dominated most all markets, including live cattle futures. On February 19, the April live cattle futures were trading near $120 and last Friday they settled in the $107-108 area. **Figure 1** illustrates the dramatic drop in live cattle futures last week. Almost all of that can be attributed to fears over the coronavirus, since the fundamentals of the cattle and beef markets did not change materially over that period. As the futures crashed lower, nervous cattle feeders agreed to sell last week's showlists for mostly $115, down $5 from the week before. Such a low price in the cash cattle market was completely unexpected just a week earlier. In certain instances, and this is one of them, the fear created by the futures market can spread to the cash market without any major change in the fundamentals. The beef market however, was relatively unscathed by the coronavirus panic and the blended cutout advanced modestly last week. With beef prices advancing and cash cattle prices falling sharply, packer margins have ballooned back toward $150/hd. We have been saying for some time that one of the big risks to the cattle and beef complex is a slowdown in the global economy. It now appears that the coronavirus outbreak is going to be the trigger than sends the global and US economies into recession. That is what is driving fear in the financial markets, including live cattle futures.

> **Spread of COVID-19** and recent sharp declines in financial markets **heightened risk** of a global recession

SUPPLY PICTURE

Slaughter levels have been larger than expected for the last few weeks. Past placement patterns indicated that fed kills during February should have been around 470-480,000 head per week. Instead, we have seen steer and heifer slaughter closer to 490,000 in the final weeks of February. The likely explanation for this is that cattle have performed very well in a rather mild winter environment and those cattle are now finishing as much as 30 days ahead of schedule. That helped to fill in the expected dip in cattle supplies and facilitated the larger-than-expected kills. However, that influence will not persist much longer as spring is just around the corner and the benefit of a mild winter will soon begin to fade. We look for fed kills in March to run around 480,000 head per week before expanding out to about 505,000 head per week in April. If we average those two months together it amounts to about a 1.7% increase over the same period last year.

The impact of the mild winter can be seen in carcass weights, which are now running about 3% heavier than last year. Of course, last year at this time weights were down substantially due to a harsh winter in early 2019. Still, carcass weights appear abnormally heavy at the present and that is confirmed by the de-trended and de-seasonalized carcass weights that we monitor. **Figure 2** shows that these weights have moved well above the zero line and are now at their highest level in over three years. In our opinion this is a flashing red alarm that feedyards are falling behind in their marketings. In these situations, pricing leverage shifts toward packers and their margins expand greatly. It is unfortunate for cattle feeders that this weight situation is

jsferraro.com | 130 Adelaide Street West, Suite 810 Toronto, Ontario M5H 3P5 | 416.306.8788

developing at the same time coronavirus fears are rattling global markets. What is badly needed in this market is some seasonal demand improvement that will cause packers to pull harder on the available supply and thus drag carcass weights back down to a more-normal range. An early, warm spring would go a long way in that regard.

Feedlot placements for January were reported on par with last year, so cattle feeders are being a bit cautious about restocking feedyards. It is likely that the whole coronavirus situation will cause them to become even more cautious. In recent days the futures board has moved to levels that make it impossible to hedge placed cattle at a profit and that is a big determinant in the cattle feeder's decision on how many cattle to place. Still, as of Feb 1, feedyard inventories were 2.2% larger than last year, so it would likely take more than one month of lower placements to take inventories back below last year. All of the feeder cattle will eventually get placed, but if beef demand erodes because of virus fears or a recession, then the price of those feeder cattle will need to fall substantially in order to incentivize placements.

DEMAND SITUATION

With February now behind us, the beef market should be able to look forward to improving domestic demand this spring. The sooner the weather warms, the faster that demand improvement will occur. Of course, if the coronavirus gains a large footprint in the US and full city quarantines become necessary like is currently happening in China, then domestic beef demand would suffer greatly. Beef has the highest exposure of any of the proteins to the foodservice sector and the restaurant business gets hit pretty hard when people can't travel or leave their homes. So, that is a risk. But assuming that the virus does not become widespread in the US, then we should expect the normal spring rally in beef prices that should approach last spring's tops. However, as long as the coronavirus risk is taking up a large part of the news cycle, we can expect beef buyers to be somewhat cautious and remain short-bought. They will be reluctant to forward book beef out of fear that a virus pandemic could leave them holding expensive beef that they will struggle to merchandise. Given the big selloff in the futures however, there should be some very attractive forward pricing opportunities out there. Those buyers willing to roll the dice could end up with a price advantage over those that remain close bought.

All indications are that international demand for US beef remains robust, but there too the coronavirus creates a risk. Recently, the virus has gained a foothold in S. Korea and Japan, both of which are major buyers of US beef. If quarantines become necessary in those countries, we could see US export volumes decline. So far that hasn't happened, but it remains a risk. US beef is attractively priced at present and that should continue to support strong export interest. We are currently projecting Q1 beef exports to be up about 12% from the year prior. Demand for lean trim out of Australia has fallen recently because China is the primary customer for that category and the Chinese are struggling to get product unloaded at their ports and distributed throughout the country due to coronavirus protocols. Imported beef prices have fallen considerably and that is pressuring US lean beef prices lower, although they remain above last year.

> Excellent feedyard performance
> **has lifted carcass weights**
> to dangerous levels

SUMMARY

It is hard to overstate the impact that the coronavirus scare is having on the US cattle and beef complexes. In our opinion, the markets have over-reacted to the downside, but until it begins to look like the virus is contained, beef buyers are likely to remain cautious and beef pricing may be sluggish. The spring market is nearly upon us and we think that once the virus fears recede, beef prices will rally and approach last spring's tops. Middle meats hold the most upside risk. The market is well supplied currently for the level of demand, but supplies of market-ready cattle are not expected to expand much over the next four to six weeks and that creates the upside price risk in the beef market as demand improves this spring. Cattle markets may not see the same degree of increase however, because it is our sense that cattle feeders are somewhat behind in marketings and thus will not have much leverage in their price negotiations with packers. Carcass weights are a big concern, but stronger demand and seasonal declines should help mitigate the influence of heavy carcasses on beef prices during March. Our near-term price forecasts for cattle and beef are provided in **Table 1**.

Figure 1: Change in Live Cattle Futures, Feb 24 to Feb 28

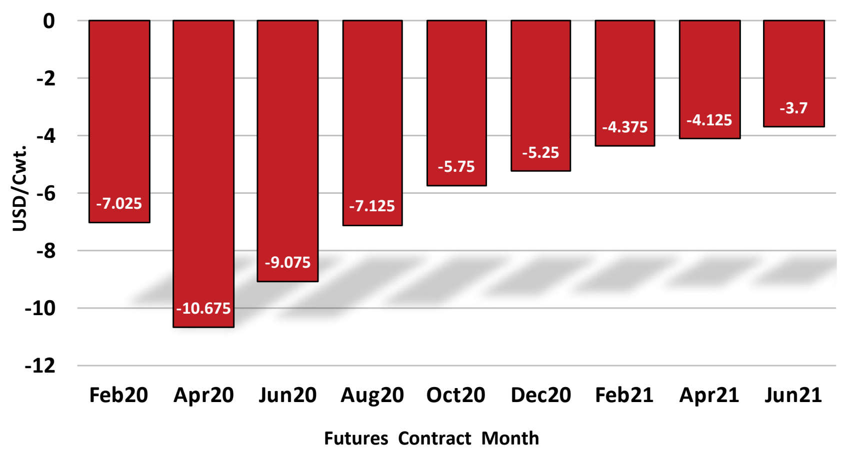

Figure 2: De-trended & De-seasonlized Steer Carcass Weights

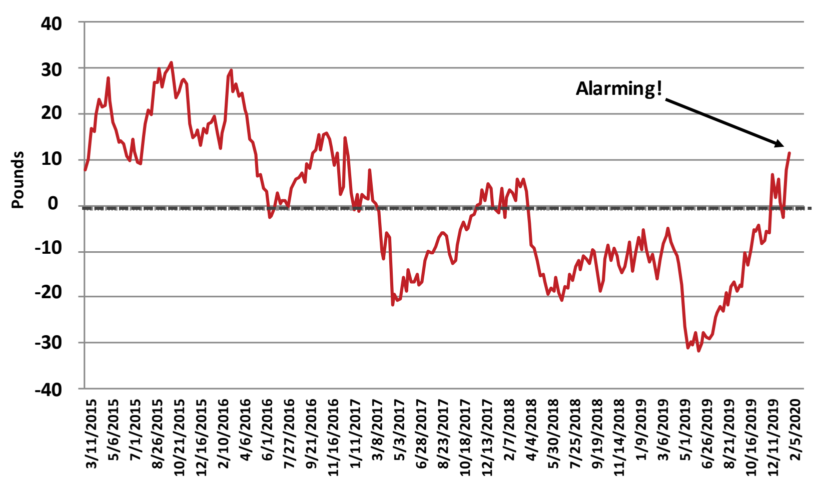

Table 1: JSF Cattle and Beef Price Forecasts

	11-Mar	18-Mar	25-Mar	1-Apr	8-Apr	15-Apr
Choice Cutout	208.9	213.0	216.8	220.2	223.2	224.9
Select Cutout	202.9	207.2	210.7	213.5	216.0	217.5
Choice Rib Primal	341.1	351.0	359.0	368.2	373.3	379.0
Choice Chuck Primal	165.0	166.9	169.0	170.0	171.2	170.0
Choice Round Primal	178.6	179.0	180.2	180.0	181.3	183.1
Choice Loin Primal	284.0	293.1	300.4	308.0	314.0	318.0
Choice Brisket Primal	160.0	162.0	165.0	168.0	172.0	177.0
Cash Cattle	113.3	115.6	118.8	120.6	123.5	124.2

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro

E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 29 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.