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J.S. FERRARO & COMPANY | RETAIL READY Foods Inc.

THE MONTHLY RED MEAT OUTLOOK: CATTLE & BEEF

OCTOBER 2019

For the last few weeks, the US cattle and beef markets have been in the process of normalizing following the fire that closed Tyson's Finney County slaughter facility. Enough time has passed to allow both buyers and sellers to make the necessary adjustments to deal with the reduction in capacity. The cash cattle market initially cratered, with prices dipping as low as $100/cwt on a weekly average basis, but has since recovered into the $104-105/cwt range. Further upside is anticipated. The beef market, which soared as buyers scrambled to find product to replace orders out of the dis-abled plant, has also normalized. The Choice cutout is now trading very close to where it was pre-fire. Packer margins

Packer margins near $345/head

remain very large as would be expected when slaughter capacity is suddenly reduced. We estimate that packer margins last week were on the order of $345/hd, down from a peak of about $435/head in early September. Now the focus is on when the Finney County plant will be re-opened. Tyson officials have indicated that it should be back online in early January and that seems reasonable given the extent of the damage. Packer margins are likely to stay abnormally large until the plant reopens, but once it does, the increased competition for a tightening cattle supply should sharply reduce overall packer margins. Another consequence of the plant fire was that it caused cattle feeders to become very cautious about placing cattle on feed in August and September and that will manifest as tighter fed cattle supplies in the first quarter of next year.

SUPPLY PICTURE

Packers have done an admirable job of shuffling cattle around to other plants after the fire. They have demonstrated that they are still plenty capable of killing the number of cattle needed to keep feedyards relatively current. Since the fire, steer and heifer slaughter has been running around 520,000 head per week — about the same as pre-fire levels. With the huge margins packers are enjoying, they have a very strong incentive to push as many animals through their plants as possible. We look for fed kills to remain around 520,000 per week until mid-October and then beyond that, tightening availability should cause some modest reductions in fed slaughter rates. Cow kills, on the other hand, should continue to rise until the end of November and that will boost the availability of lean trim and likely put some pressure on 90s prices. We look for cow and bull slaughter to top out at around 145,000 head per week in late November.

Carcass weights are in the midst of their normal seasonal increase and should reach a top somewhere around late October or early November. The most recent USDA data shows steer carcass weights five pounds below last year while heifer carcass weights are on par with 2018. Immediately following the fire, there was some concern that reduced slaughter rates would cause cattle to back up in feedyards and thus pressure cash cattle prices lower. That worry was a big part of what drove the October futures down to $94 in early September. Those fears turned out to be unfounded and the October futures have rallied $11 after making that low. The de-trended and de-seasonalized carcass weights that we watch as an indicator of feedyard currentness are on the rise, but they are coming up from such low levels that we don't believe they are indicating any serious problem with cattle backing up (See **Figure 1**).

The September *Cattle on Feed* report indicated August feedyard placements were down 9% from the previous year and marked the fourth month in a row where placements fell short of last year. That resulted in a 1.3% YOY decline in total on-feed inventories as of September 1. This is the first time that the number of cattle in feedyards has been below the previous year since November, 2016. Furthermore, it appears as though placements were down again in September as cattle feeders remained cautious about placing animals due to the uncertainty caused by the plant fire. We look for September placements to be about 1.8% below last year, resulting in an October 1 on-feed inventory that is 1.7% less than last year. Bottom line, cattle supplies are not burdensome at present and that is fortunate given the temporary loss of slaughter capacity due to the Tyson plant fire.

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DEMAND SITUATION

Although official estimates for September retail beef prices haven't been released yet, (expected Oct. 10, 2019), our sense is that retailers did not raise non-feature beef prices all that much. Which suggests that they *correctly* viewed the situation following the fire as transient. It does look like they pared back retail features a bit and put a little more pork and poultry in their weekly ads. That is a normal response, but the impact wasn't large enough to put a big dent in domestic beef demand at retail. Now that the beef market has returned to equilibrium and wholesale prices are much lower, we think that retailers will step up beef feature activity in Q4. Consumer confidence numbers continue to look good and consumers have shown a strong preference for beef over the last year, so retailers will want to capitalize on that while they can. This has the potential to create a bit of a rebound effect in domestic beef demand. It comes at an opportune time since buyers will soon begin bidding up middle meat items as they prepare for the end-of-year holidays. However, the US economy remains a risk to beef demand going forward. By most measures the economy is in pretty good shape currently, but it is hard to see it getting much better from here. In fact, the more likely scenario is that it starts to deteriorate at some point, but it is really difficult to pinpoint the timing on that. Buyers need to keep that in the back of their mind and monitor the macro data and stock market for signs of weakness and be prepared to adjust for softer beef demand if it looks like the US economy is weakening.

The official export data for August won't be available until October 7, but it is a pretty good bet that exports will come in softer than last year since the sharp rally in prices after the fire on August 9 probably curtailed interest from foreign buyers. However, that was a temporary situation and is now water under the bridge. The export picture should be better in Q4 now that beef prices have normalized. The US signed a bilateral trade agreement with Japan last month that will put it on equal footing with other beef suppliers shipping beef to that country. This is something that was badly needed and we have raised our Q4 export forecasts slightly to reflect this improvement. We now see beef exports down only 1% in Q4 following a 2.6% decline in Q3. **Figure 2** provides our calculated beef demand indexes by quarter for 2017-2019. It is clear that both Q2 and Q3 demand was significantly better than last year, and our forecasts for Q4 has beef demand down only slightly from last year's stellar showing.

> October 1 **feedyard inventory** expected to **be down** almost **2%**

SUMMARY

The post-fire normalization process is about complete in the beef market but still has further to go in the cattle market. Look for beef prices to be a little stronger in October than they were in late September, but not by much. Holiday middle meat buying will get going in earnest this month and that will more than offset any weakness that might develop in the end meats. Packer margins remain very good and that will incentivize them to keep the kill large enough to prevent any material backup of cattle in feedyards. In fact, the cattle market is expected to continue to work higher in coming weeks and that will narrow packer margins somewhat. Feedyard placements have been lower than last year for four months in a row and we expect that September will be the fifth month in that string. That means that fed cattle supplies (and thus beef production) will be tighter than normal in the first quarter of next year and buyers might want to get ahead of that now by booking Q1 product while the Feb and Apr futures contracts are still underpriced. US beef demand appears to be in good shape, but the risk of an economic downturn remains a threat. Overall, we expect Q4 beef prices to be reasonably close (See **Table 1**) to where they were last year.

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Figure 1: Detrended & Deseasonlized Steer Carcass Weights

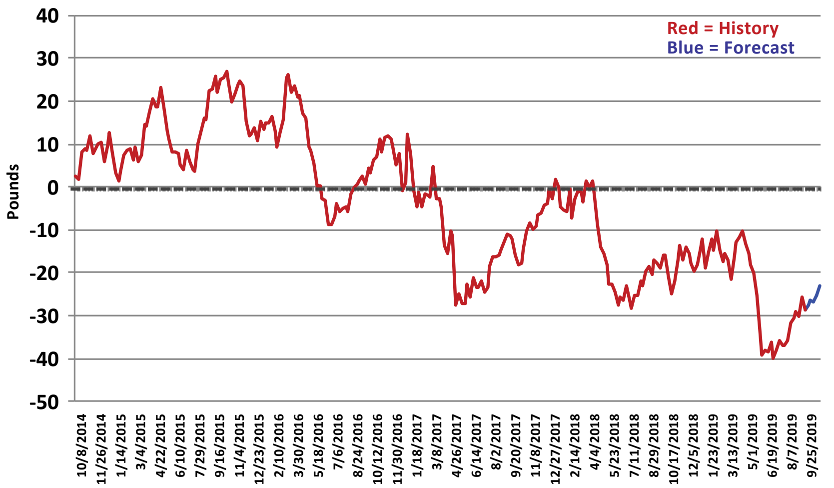

Figure 2: JSF Beef Demand Index, 2017-2019

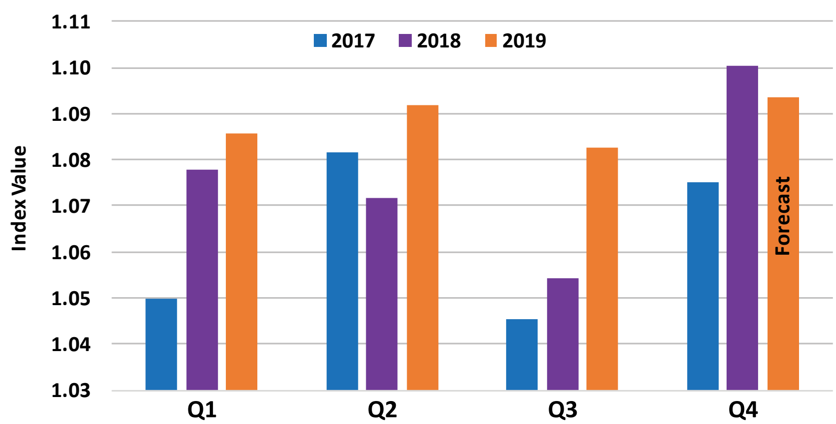

Table 1: JSF Cattle and Beef Price Forecasts

	9-Oct	16-Oct	23-Oct	30-Oct	6-Nov	13-Nov
Choice Cutout	211.0	211.4	213.5	213.1	213.3	213.1
Select Cutout	189.0	188.2	188.9	187.3	186.6	184.7
Choice Rib Primal	378.0	383.1	390.0	393.0	400.0	406.0
Choice Chuck Primal	171.6	173.3	175.0	173.6	172.3	171.5
Choice Round Primal	174.1	175.0	174.8	172.0	170.5	167.3
Choice Loin Primal	268.2	265.4	268.3	270.2	270.9	271.6
Choice Brisket Primal	189.7	185.4	188.2	189.1	187.3	185.1
Cash Cattle	104.6	105.3	107.6	107.5	108.6	108.6

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro & Company
E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 28 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.