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THE MONTHLY

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RED MEAT OUTLOOK: CATTLE & BEEF

The beef market continued to cruise higher during May, with the Choice cutout going from $297 at the end of April to $330 by the time the May books were closed. It is not unusual to see strong beef demand and price gains during May, but what was seen this year was well beyond the normal seasonal improvements.

> The Choice cutout has now **reached the $330 level** and has further **upside potential**

The cattle market struggled, holding in the $118-120 range for most of May and there is a sense that packers were intentionally supporting the market because if they had let the market clear naturally, cattle prices would have been much lower. The problem seems to be labor shortages in packing plants which are limiting the daily fed kill. This labor shortage problem is not unique to the beef industry — other proteins are seeing similar problems and even restaurants are having difficulty attracting qualified help. Many have pointed to expanded unemployment benefits as the cause behind workers reluctance to return to these jobs, but I suspect there is more to it than that. Restaurants and packing plants share two common characteristics — the work is difficult and the pay is poor. The pandemic forced many of these low-wage workers to find other means of support. In many cases they may have found better jobs at higher pay and are not ever going to go back to the packing plant or restaurant. There is also the issue of what economists call "availability bias", which simply means that people believe that something that just occurred is more likely to occur again in the future. In the case of restaurant and packing plant employees, they discovered that their chosen careers were very vulnerable in a pandemic. Never mind that pandemics like this only come around once every 100 years or so. In their minds, they believe the chance of it happening again is very high and they don't want to be caught in the same situation again. Thus, they shun those industries where people work shoulder to shoulder and have high contact with the public. Of course, the solution is for packers to raise wages to the point where they do attract enough workers to fully staff packing plants. That is a slow process however, because packers to do not want to raise wages so fast that they over-shoot the equilibrium wage. It is very difficult to reduce wages once they have increased. Instead, expect packers to slowly raise wages and then carefully gauge if they need to be raised more. It could take months or even years to get plants adequately staffed as this process plays out. One thing is for sure — higher wages in the packing plant will lead to higher beef prices down the road.

SUPPLY PICTURE

Favorable weather in cattle country this spring seems to have accelerated the finishing process for cattle and they have become market-ready sooner than expected. Steer and heifer slaughter during May averaged around 510,000 head in non-holiday weeks and our flow model suggests that weekly kills will need to average around 530,000 head per week in June and even larger in July. It is not clear that packers can handle that volume on a consistent basis with the labor issues that they've been experiencing. As a result, there is a very real risk that some cattle will become backlogged in coming weeks, if they haven't already. Toward the end of May, packer margins were approaching $900/head, so we know that packers would definitely have slaughtered more animals if they could. The biggest weekly fed kill that we saw in May was

> Packer margins are now **over $900/head** and likely to stay exceptionally **large throughout the summer**

535,000 head, but that was likely a one-shot accomplishment in preparation for Memorial Day deliveries. This is why we say that packers have been purposefully supporting cash cattle near $120 because, as cattle started to backlog, prices would have gone lower had it not been for packers generously sharing some of their outsized margin.

Carcass weights and grading are also pointing to cattle backing up in the system. We have now reached the point in the calendar when carcass weights would make their annual low and turn higher into fall. **Figure 1** shows that steer carcass weights are only slightly below the elevated level of 2020 and no where near 2019's level, which would be considered normal. This is a result of cattle not being slaughtered in a timely fashion. **Figure 2** provides the de-trended and de-seasonalized (DTDS) weights that we watch as an indicator of currentness in the cattle feeding sector. Those weights are now approaching +25 lbs, which is very high in a historical context and was exceeded only during the COVID-19 related plant closures last spring. These elevated DTDS weights are a flashing signal that cattle are backing up in the supply chain.

There are only two paths out of this situation for cattle producers. The first would be for packing plants to magically find enough workers to run above their rated capacity. That is not going to happen anytime soon. The other solution would be for cattle feeders to begin placing less cattle on feed so that by the time those cattle get ready for market, the number of animals will better align with what packing plants can handle. So far, cattle feeders don't seem to grasp that because they placed about 100,000 head more than expected during the month of April and appeared to be doing the same during May. They have been encouraged to place aggressively by the high price levels at which the deferred live cattle futures have been trading. That sets up a situation where cattle (and beef) prices later this year could end up being well below what the futures have implied so far this spring.

DEMAND SITUATION

Regardless of what is happening in the supply side of the market, the main story for 2021 has been extraordinarily strong beef demand. It is hard to overstate just how impressive domestic beef demand has been this spring. Analysts are still scratching their heads over this one, but I think that strong demand for animal protein stems from a shift toward more high protein diets by consumers as they prepared for post-pandemic life and much more disposable income caused by very high savings rates during the pandemic. COVID-19 cases are falling rapidly in the US and more than 50% of the adult population is vaccinated now. That has led to a burst of activity as society returns to normal activities. One of the things that people missed to most during the pandemic was being able to gather in groups and, when people gather in groups, meals are very often a part of the program. Now that consumers feel safe gathering again, they are not being cheap with the meals they sponsor. There is a sense of rejoicing and it matters not what the meal costs, it only matters that it be of high quality. This post-pandemic euphoria has been very good for domestic beef demand and is likely to continue for most of the summer. I expect that as the summer starts to draw to a close, so will the partying phase of re-opening and beef demand will drop back toward more traditional levels.

International demand for US beef has held up surprisingly well in the face of rapidly escalating prices. USDA reported beef exports up 12.3% YOY in March and it was the first time in history that beef exports registered over 300 million pounds in a single month. The weekly export data that USDA has provided for April and May suggests that export volumes in those months have been very close to, if not above, what was registered in March. This suggests that the same conditions that have led to strong domestic beef demand as the pandemic wanes have also influenced demand similarly in other nations. That is a good sign for the beef industry and it is particularly encouraging that beef exports to China have remained very strong all spring. However, as good as exports have been, they are not the main driver of the demand surge this spring. That honor falls to US consumers.

SUMMARY

Beef prices continued higher in May and will likely stay elevated for most of the summer as US consumers exhibit strong demand for beef as part of their "return to normalcy" plan now that the pandemic is fading. There is a labor crunch affecting beef packing plants and they will probably not be able to kill all of the cattle that become market-ready during June and July. As a result, packing margins are expected to remain extraordinarily wide and cattle prices low. This labor problem could be an ongoing feature of the beef complex for many months to come because this is not the type of problem that is easily solved overnight. That means that beef output is likely to be smaller than it would have been otherwise and beef pricing is likely to be higher than it would have been otherwise. Carcass weights are already telling us that a cattle backlog is beginning to develop. This disconnect between the price of beef and the price of cattle will make it very difficult for users to hedge beef costs using live cattle futures for the remainder of 2021. We recommend forward pricing with suppliers through the end of July, but would rather wait to price beyond that because the demand euphoria may start to fade near the end of summer and that could bring prices down. Beef prices likely peaked around Memorial Day and could work a little lower in June/July, but we don't expect dramatic declines. Our near-term price forecasts for cattle and beef are provided in **Table 1**.

Figure 1: FI Steer Carcass Wt.

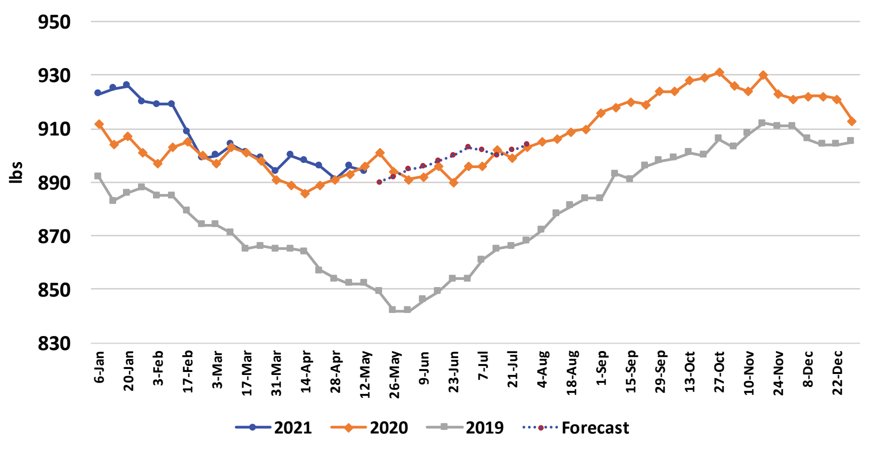

Figure 2: Detrended & Deseasonalized Steer Carcass Weights

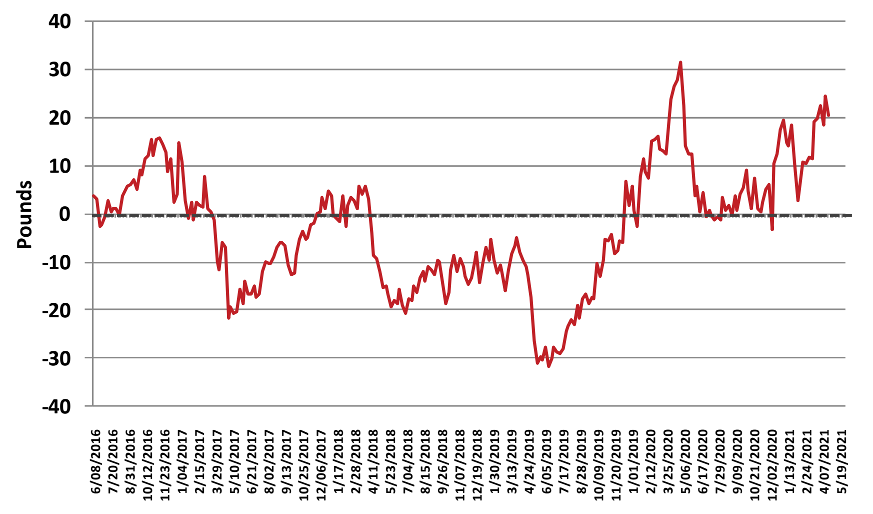

Table 1: JSF Cattle and Beef Price Forecasts

	9-Jun	16-Jun	23-Jun	30-Jun	7-Jul	14-Jul
Choice Cutout	332.1	335.9	329.9	321.7	309.2	296.9
Select Cutout	310.9	317.5	314.0	307.2	297.1	286.2
Choice Rib Primal	542.2	544.0	538.2	527.0	509.2	491.0
Choice Chuck Primal	248.6	251.2	248.3	241.0	229.6	218.7
Choice Round Primal	260.3	264.2	260.1	252.3	240.4	231.4
Choice Loin Primal	498.0	506.5	493.3	482.0	466.2	447.7
Choice Brisket Primal	290.4	288.6	276.3	265.5	253.6	242.1
Cash Cattle	120.7	122.7	123.1	121.0	118.3	117.8

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