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RED MEAT OUTLOOK: CATTLE & BEEF

Things finally came to a head in the red meat markets during June after a very impressive spring rally. The Choice cutout topped at $340 just after Memorial Day and has been in a steady downtrend ever since. Last week, the Choice cutout averaged $290 and the Select cutout averaged $269. The reduction in boxed beef values is not over by any means, but there is a sense that the rate of decline is going to slow over the next few weeks and there could even be some brief periods of rising prices. For reference, consider that the Choice cutout has averaged about $208 during July over the past five years. We don't expect it to get anywhere near that low this year because demand remains quite strong and beef production is still being limited by labor constraints in the packing plants. The cattle market has been mostly unfazed by the downturn in the beef market because packer margins were so incredibly large this summer that packers didn't feel the need to pressure cattle prices as the beef market retreated. Our calculation suggests that packer margins peaked at just over $1000/head in early June and as of last week they stood at about $675/head (see **Figure 1**). Further, packers have managed to keep slaughter levels relatively strong over the past few weeks and that has helped to improve the currentness of cattle in the nation's feedyards and thus has provided them with enough leverage better resist lower cattle pricing. In fact, cash cattle prices advanced into the $125-126/cwt range near the end of June. A very wide Choice-Select spread has made packers keen to seek out and pay higher money for animals that grade well. The Choice-Select spread now sits at around $20/cwt, but did approach $40/cwt at times over the past few weeks. The unusually strong spread between Choice and Select seems to be driven by strong consumer demand for Choice product at a time when the quality grade for slaughtered cattle has been slipping lower (see **Figure 2**).

The Choice-Select spread recently made an all-time high near $40/cwt

SUPPLY PICTURE

Steer and heifer slaughter during June averaged about 480,000 head per week, but that number was biased downward by the week containing Memorial Day falling mostly in June and the cyberattack that hobbled JBS slaughter facilities early in the month. Toward the end of the month, packers were comfortably killing about 525,000 head per week. The slaughter slowdown in early June probably backlogged some cattle, but the event doesn't seem as though it will have a lasting impact. Our flow model suggests that packers need to keep the fed kill up in the 525-530,000 head range during July in order to limit the potential for further backups in the cattle supply. The good news is that by the time August arrives, cattle supplies will be reduced to the point where the industry only needs to kill about 515,000 head of fed cattle per week. That will fit much better with packing plant capacity that has been limited in recent months by very tight labor conditions inside plants.

Carcass weights continued to trend lower during June, bucking the seasonal pattern that normally sees weights reach a low point in early May. Blended steer and heifer carcass weights are running about 11 pounds below last year at present. Recall that carcass weights at this time last year were exceptionally elevated due to the plant shutdowns that resulted from the COVID-19 outbreaks in the spring. We suspect that carcass weights are now at or near their low point, but the fact that they are solidly below last year gives hope that the backlog of cattle in the system is minimal. The de-trended and de-seasonalized weights

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that we watch have now dropped back into negative territory at -10 pounds and that is further evidence that cattle in feedyards are not excessively heavy at present. It also means that cattle feeders' bargaining position in their weekly negotiations with packers is improving.

The most recent issue of USDA's *Cattle on Feed* report showed placements during May down 6.2% from last year and the number of cattle in feedyards as of June 1st was 0.6% below last year. Cattle feeders have shown remarkable constraint in placing animals recently, especially since the deferred futures contracts are pointing toward fat cattle prices at or above the $130 level late in the year and into Q1 of next year. Very strong corn pricing is likely contributing to their decision not to place aggressively at the moment. The corn crop is now entering the crucial pollination stage and will be very vulnerable to hot, dry weather in the next few weeks. That is likely to cause some wild gyrations in corn futures and discourage cattle feeders from filling their facilities until they have a better picture of how the corn crop is going to play out this year.

DEMAND SITUATION

The red-hot demand environment that we witnessed in the first half of 2021 is finally beginning to cool, but not before it pushed the cutouts to levels that have never been seen when all plants were operating. The source of that tremendous demand strength is difficult to know for sure, but we suspect it was related to a surge in consumer discretionary income from government stimulus along with huge household savings during the pandemic. Some shift in consumer dietary patterns toward higher protein diets likely helped the cause as well. But now, as stimulus money runs out and life returns to normal following the pandemic, beef demand is beginning to fade. We don't expect it to decline all of the way to pre-pandemic levels however, since dietary changes tend to stick for some time and the household wealth effect will linger as well. Thinking about future price levels, it makes sense that beef prices going forward will be higher on average than they were pre-pandemic. That is because packers will be forced to pay more to fully staff their plants in coming years and that cost will get passed on to consumers in the form of higher beef prices. That is not a demand effect per se, but it does have the end result of raising price levels at all levels of the supply chain beyond the packing segment.

International demand for US beef remains solid, even in the face of very high prices this spring and early summer. The weekly export data released by USDA suggests that beef exports are slightly above where they were last year at this time and the official monthly data for May was a whopping 69% stronger than last-year's COVID-constrained number. China is the primary driver behind the strength in exports, with movement to that destination up over 700% year-to-date. The Chinese hog herd has made big steps toward recovering from its ASF problems, and that has improved domestic protein production greatly, but Chinese consumers still seem to be infatuated with US beef and thus it has grown into a very important export destination. Other important destinations, such as Mexico, have continued to take larger-than-expected quantities of US beef in spite of a very high price environment. All of this bodes well for international beef demand in the second half of the year.

Beef **exports to China**
are up over 700% year-to-date

SUMMARY

Beef markets in the US have finally topped and are heading lower. The phenomenal demand strength that was seen this spring has begun to fade, but it still remains quite strong in a historical context. We don't expect demand to return completely to pre-pandemic levels in 2021 and thus beef pricing in the second half of the year is likely to be above traditional levels. On the supply side, packing capacity is still being constrained by a shortage of workers, but packers are working to rectify that problem. Our guess is that it will take several more months before packing capacity is back to pre-pandemic levels. Slaughter levels should remain strong during July and that will keep some downward pressure on the cutouts, but by the time August rolls around, available cattle supplies will be tighter and beef buyers could experience reduced availability. The cattle and beef industries have been buffeted by one crisis after another since the Tyson plant fire back in August of 2019. With any luck, those destabilizing events will be much less frequent in the future and thus allow the market to be better behaved as we move forward. Our near-term price forecasts for cattle and beef are provided in **Table 1**.

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Figure 1: Packer Margin

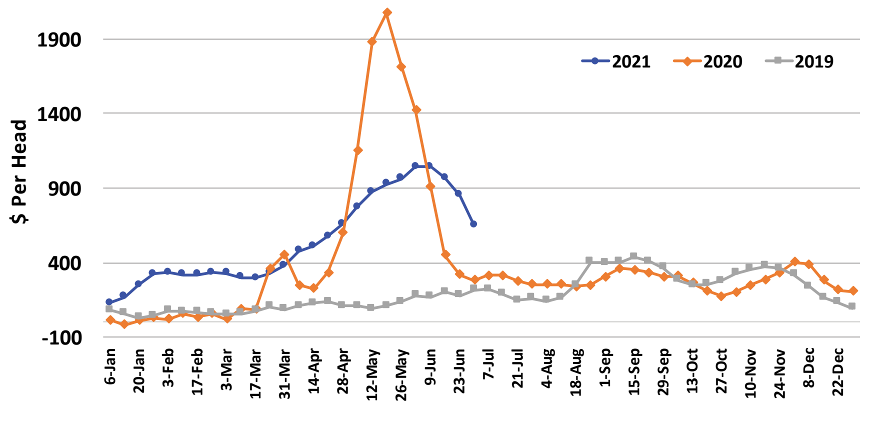

Figure 2: Percentage Cattle Grading Choice or Higher

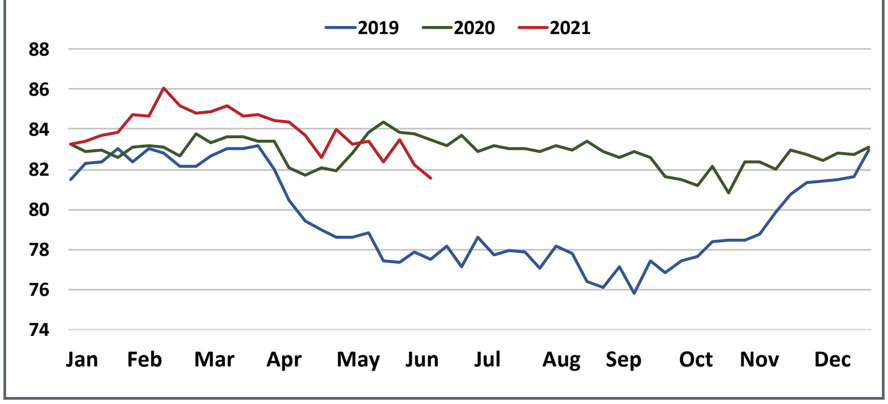

Table 1: JSF Cattle and Beef Price Forecasts

	14-Jul	21-Jul	28-Jul	4-Aug	11-Aug	18-Aug
Choice Cutout	273.1	266.2	262.7	259.1	255.9	253.9
Select Cutout	254.1	245.0	242.4	236.7	233.8	233.6
Choice Rib Primal	370.3	362.5	360.0	363.6	369.0	374.4
Choice Chuck Primal	228.4	225.7	225.8	222.1	218.8	218.5
Choice Round Primal	237.8	230.7	223.0	220.3	217.2	215.5
Choice Loin Primal	377.8	364.8	361.0	353.6	346.0	338.8
Choice Brisket Primal	234.7	232.3	229.5	222.4	218.0	212.7
Cash Cattle	123.0	120.6	121.6	121.7	121.0	121.7

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