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RED MEAT OUTLOOK: CATTLE & BEEF

After finishing 2021 at close to $140/cwt, the cash cattle market worked a little lower during January. Last week's cash trade averaged around $137/cwt. As expected, a surge in COVID-19 infections caused a high level of absenteeism that limited throughput in packing plants. That, in turn, helped raise beef prices and caused packer margins to expand. It is likely that some cattle were delayed in their date with the slaughterhouse and the resulting backlog has made it difficult for cattle feeders to move the cash market higher. The recent COVID-19 surge also seemed to send consumers back into stay-at-home mode, which improved demand through the retail channel. The Choice cutout finished 2021 at $265/cwt, and by the end of January, it was near $295/cwt (See **Figure 1**). End meat prices have moved higher as is typically the case in January, but the loin primal was the strongest primal during the month. In particular, buyers seemed to be aggressively bidding up top butts, perhaps as a lower-cost steak item for retailers to feature. Boneless top butt prices increased 35% from Christmas to the end of January. Retailers have kept beef pricing strong and up to this point consumers have paid up without too much fuss. We think that is starting to change. February has historically been a weak demand month for beef and with retail prices at record high levels, there is risk that consumers start to balk. It looks like the recent upcycle in beef demand is on the verge of turning lower, bringing with it lower cutouts and smaller packer margins. By our calculation, packer margins were close to $600/head at the end of January. As beef prices cycle lower in February, there is some risk that packers begin to exert more pressure on the cash cattle market. With a modest backlog of cattle in the yards and excellent winter feeding conditions, it is unlikely that cattle feeders could resist much if packers insisted on lower cattle prices. That pressure probably wouldn't start to emerge until packer margins have contracted at least a couple hundred dollars, but the potential is there.

> Packer margins **surged back to $600/head in January** as beef rallied but cattle did not

SUPPLY PICTURE

In November and December there was buzz about tightness in cattle supplies. No one seems to be talking about that now. Drought across the US pushed a lot of feeder cattle into feedyards over the past few months and feedyard inventories are now slightly larger than they were at this time last year. Our flow model was projecting steer and heifer slaughter during January to be about 500k per week, but with the omicron-related slowdowns, kills only averaged around 485k in each of the four weeks of January. That would leave about 60,000 head that went unprocessed during January that will have to be dealt with in coming months. Fortunately, February is normally a slow slaughter month and we have been expecting fed kills to average around 490k per week (See **Figure 2**). So, if the absenteeism problem resolves quickly then there will be room to kill off some of the backlog over the next 30 days. That is good news for cattle feeders, but enticing packers to actually step up the kill during February might not be easy, particularly if the beef markets turn lower as expected.

When the slaughter pace slows down, cattle gain weight. Steer weights were last reported only three pounds under last year and last year at this time the cattle were very heavy. Winter has been relatively mild across the cattle feeding regions and cattle have been finishing ahead of schedule. Carcass weights should trend seasonally lower from now into April or May, but they are starting from a high level and that will have implications for beef production in the next couple of months. Corn futures have been trending higher for the last few months and cash corn in Western Kansas is currently running close to $6.50/bushel. As a result, cattle feeders are getting a bit more stingy about what they are willing to pay for feeder cattle. We calculate that cattle feeders would need to get close to $145/cwt for cattle that are exiting

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the feedyards now in order to breakeven. The futures market says that is not going to happen any time soon and so cattle feeders may be faced with yet another year where they struggle financially. The problem lies in the fact that the cattle supply is just too large relative to slaughter capacity. As the herd shrinks, supply will be better aligned with capacity and cattle feeders' financial prospects will brighten, but that is likely more than a year away and could easily be two years down the road.

The most recent *Cattle on Feed* report indicated the largest feedyard placements for the month of the December since the series began back in 1996. Placements were 6.5% over last year and that left the on-feed inventory up 0.6% as of January 1. So there are plenty of cattle in the feedyards, but packing plants remain the bottleneck. Steer and heifer beef production is projected to be nearly even with last year during Q1, although if packing plant labor remains a problem then production may fall a little short of last year's level. Per capita availability is projected to be almost 1% above last year during Q1 as large imports are expected to add to the US beef supply.

DEMAND SITUATION

January saw improving beef demand and most of that was focused on the retail sector. The omicron surge naturally moved a lot of consumers back into stay-at-home mode as they were either sick or caring from someone who was infected. The surge also had a negative influence on the supply chain as well and consumers started seeing empty grocery shelves once again. That always creates a certain amount of stockpiling behavior and it is likely that consumers built up beef stocks in January and that is part of what drove the cutouts higher. However, the omicron surge has crested and infection levels are likely to fall dramatically in the next couple of weeks. That should cause a swing back toward softer demand as consumers once again adapt a more-normal lifestyle and cooking at home becomes less of a focus than it was in January. Another element of the demand picture comes from price inflation throughout the US economy. The Consumer Price Index rose over 7% on an annualized basis in December. Everything consumers buy is costing more and that leaves less money to spend at the meat case. We have noted in the past how hourly wages saw strong gains during the pandemic, but now price inflation is taking away a big chunk of the benefit that consumers were getting from higher wages. It is logical to conclude that if the surge in wage rates drove strong beef demand back in 2021, then the erosion of those wages by inflation will temper beef demand in 2022. It looks like the end of the COVID-19 pandemic is within sight. It is clear that the pandemic and the government assistance that it spawned has been very good for beef demand. As life gets back to normal post-pandemic, we can expect beef demand to return to normal also after an astounding run during the pandemic.

Interest in US beef from overseas buyers remains strong. The US exported almost 300 million pounds of beef in November, up 7.6% YOY. For 2021 as a whole, we see beef exports up almost 17%. Those numbers will likely be hard to match in 2022 and we look for a modest 3% YOY decline in exports this year. As the rest of the world sees COVID-19 infections decline in the months ahead, it will likely temper US beef exports in much the same way that we expect domestic demand to stumble. One thing to keep an eye on is strong imports. In November, import tonnage was nearly equal with export tonnage and we expect a similar result when the December trade volumes are released next week. High US beef prices are likely to continue to be a magnet for imports. In 2022, we look for exports to outpace imports by about 8%, but hitting that target will require considerably softer domestic beef prices than what we saw in 2021.

Recent packing plant slowdowns have likely **backlogged at least 60,000 fed cattle**

SUMMARY

The omicron surge boosted beef demand during January and helped the cutouts to strengthen. Now that infections are falling rapidly, we expect that demand strength to ease and push price levels lower. International demand for US beef should remain good during Q1, but large imports are likely to erase some of the price benefit that comes with strong export demand. Omicron infections definitely restricted packing plant throughput during January and, in addition to boosting beef prices, it caused a moderate backlog of market-ready cattle. Feeding conditions have been mild this winter and cattle performance is very strong. That, along with the plant slowdowns, resulted in heavy carcass weights that will likely limit producer leverage in the cash cattle market over the coming weeks. Packer margins surged higher on the January production problems, but should now begin to retreat. At some point, packers may feel the need to pressure cash cattle prices, but that may not happen until we move deeper into February. The futures market is pricing cash cattle close to our fundamental forecast from February through June, but beyond that, it looks way too high. Perhaps traders are not expecting demand erosion to occur in the second half of the year. Beef prices are now moving back into a downcycle and high retail beef prices will likely limit consumer off-take during February. After a stressful January, beef buyers may move back into more of a hand-to-mouth mode in the coming weeks. Our near-term price forecasts for cattle and beef are provided in **Table 1**.

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Figure 1: Choice Cutout

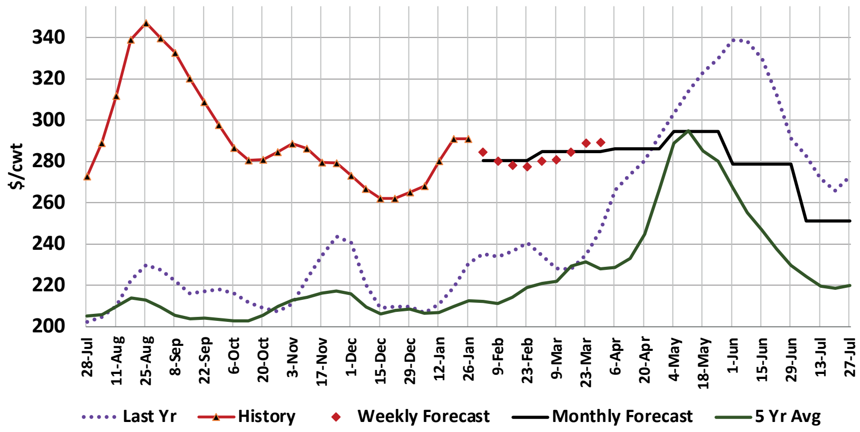

Figure 2: Weekly Average Steer & Heifer Slaughter

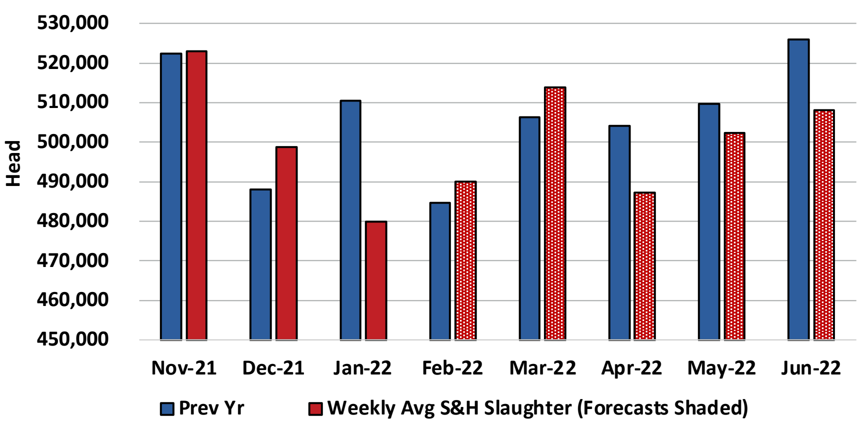

Table 1: JSF Cattle and Beef Price Forecasts

	9-Feb	16-Feb	23-Feb	2-Mar	9-Mar	16-Mar
Choice Cutout	280.4	278.3	277.6	280.0	280.9	284.6
Select Cutout	271.0	269.7	268.9	271.8	273.3	275.8
Choice Rib Primal	394.7	403.5	411.3	419.6	431.8	447.8
Choice Chuck Primal	250.3	247.0	241.1	237.4	231.6	228.7
Choice Round Primal	232.6	230.5	232.0	233.7	228.7	229.4
Choice Loin Primal	374.2	369.0	368.2	376.0	384.6	394.0
Choice Brisket Primal	273.1	270.8	272.0	275.6	280.7	285.8
Cash Cattle	135.6	134.8	132.2	134.0	136.8	140.5

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Dr. Rob Murphy is an agricultural economist and business leader with over 31 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.