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WEEK ENDING MAY 6, 2022

THE BEEF WRAP

Things just keep getting worse in the beef world. The cutouts were down again this week with the Choice losing $4.92/cwt on a weekly average basis and the Select down $4.00/cwt. What's worse is that the losses are being driven by declines in middle meat pricing–a very unusual occurrence in early May. While beef is losing value by the day, packers haven't had any luck reducing their cattle costs. This week's cash cattle trade averaged $143.43, almost unchanged from last week's average. We still have a two-tiered market, with cattle in the South trading for mostly $140 and cattle in the North bringing $146. With cattle steady and beef pricing moving lower, packer margins fell again this week and now average $193/head. The last time packer margins were below $200/head was for a brief period in January, 2021. Keep in mind that in Jan/Feb of this year, packer margins were running in the $400-500/head range. January and February are normally the time of year when packer margins are the worst and April/May is normally when they are at their best. What a strange market situation. In most years, retailers are actively buying middle meats in early May for the upcoming Memorial Day holiday, but not this year. The attached chart shows that it was the ribs and loins that did the most damage to the cutout this week.

My guess is that 2 things are going on simultaneously. First, retailers were fearful of another high-priced spring market like they experienced in 2021 and so they got busy earlier in the year and booked a lot of product in advance, thus they don't need to be in the spot market right now. Second, they are finding that middle meats are not moving very well out of the meat case. It isn't unusual for retailers to cancel orders if the product isn't moving for them. This highlights one of the peculiar characteristics of the modern day meat buyer–they tend to put undo emphasis on what happened last year and expect that it will repeat. That turns out to be a huge mistake this year and it really should have been pretty obvious that conditions were setting up for this year's consumer demand to fall well short of last spring. I won't go through my well-worn list of reasons why consumer demand is softer this year, because everyone has heard that many times, but this week we can add one more negative to that list–a rapidly declining stock market. Beef, more so that the other proteins, is sensitive to macroeconomic conditions and this week we had the Fed raise interest rates by a half-point and the stock market move sharply lower in response.

In 2019, the S&P 500 posted a 31.5% increase, in 2020 it was up 18.4% and in 2021 it was up nearly 31%. So, for the past three years consumers have grown used to very strong gains in their equity accounts and that makes them feel wealthier and spend more freely. The fact that it lasted for 3 years straight probably had a lot of them thinking this was going to be the new normal. Now, in 2022, the S&P 500 is down 14% so far and the outlook suggests that it could fall 20% or more for the year. That is a cold slap in the face for consumers who not that long ago were feeling like their wealth was going up forever. In this environment, it won't be hard for a consumer to pass on $15/lb ribeyes in the meat case. Further, it will be much easier for them to pass on it in July/Aug when the dog days of summer arrive than it is right now ahead of Memorial Day. So, my guess is that the demand problem for beef will get a lot worse before it gets better. You may remember a few months back I talked about the brisket primal as a good indicator for stay-at-home smoker demand. The attached chart shows how brisket pricing continues to fade. As expected, consumers are spending their money on travel and experiences they missed out on during the pandemic.

Concert ticket sales have been through the roof lately. Airports have been jam packed. Staying home and smoking a brisket on their shiny new pellet grill is not nearly as high of a priority as it was in 2020 and 2021. It might be a good time to look for some very lightly-used smokers for sale. Now that we have established that the demand side of the beef market is in trouble, lets consider the supply side. This week's fed kill came in at 510k, up 3k from last week and just a little shy of what I calculate should be market-ready in May. I think we will see at least one 520k kill before Memorial Day and once June rolls around kills could routinely run 520-530k per week. Blended steer and heifer carcass weights were reported 11 pounds over last year this week and we will soon reach the point where carcass weights stop declining seasonally and start to increase. That should be late May/early June. So, lots of cattle coming and those cattle are pretty heavy. I'm sure that packers have been thinking hard on how to move the cattle market lower in order to improve their margin situation. The unusual tightness in the Northern market has limited packer's ability to pressure the cattle market so far.

It's impossible to move packing plants in the North closer to where all of the cattle are in the South, so the only alternative is to move cattle from the South to the North. That is a much costlier proposition than used to be with fuel costs at very high levels and truck drivers hard to find. As a result, I think that packers have just had to bite the bullet and pay whatever it takes to source cattle in the North. The supply imbalance should begin to resolve as we move into bigger numbers in June and July and that will remove a major roadblock to lower cattle prices. The Jun futures closed below $133 today, which is a full $10 lower than the current cash market. Clearly futures traders think there is a big break coming. I actually have fair value for June at $130, so I'm even more bearish than the futures at this point, but I'm more concerned about what happens in late summer and fall. I think traders have this mistaken belief that because inflation is strong in the economy that means that cattle will need to sell for a lot more than they have in the past. Not in the short run. Cattle prices have been held up by very strong demand, but that is fading now. It is true that costs for inputs and for labor have increased dramatically in recent months, but if consumers are resistant to price increases (and it seems they definitely are now), then the only margin relief comes from pushing down on input costs.

For packers, this means that they will need to pressure cattle lower and if feedyards resist too much then packers will just cut the kill until feedyards are forced to relent. In the longer run, high inflation will cause cattle prices to rise, but that only happens after the herd has been reduced dramatically. The long biological cycle in beef cattle means that it takes a long time to bring about that kind of change. So cattle feeders that have had visions of $150-160 cash cattle dancing in their heads are more likely to find the reality is a $115-125 cattle market this fall. And, given what they've been paying for feeder cattle lately, along with $8 corn, the losses in the feeding sector are likely to be huge. Once that reality hits home, they will follow the same script and press down on the one input cost they can control–feeder cattle prices. USDA released the trade data this week and it showed March exports up 1.2% from last year, but March imports were up almost 30%. That means that for the third month in a row, the US has been a net beef importer. Next week, watch the middle meats for even a modest rally because we will be in the sweet spot for Memorial Day buying. Also watch for some softening in cash cattle prices, particularly in the South.

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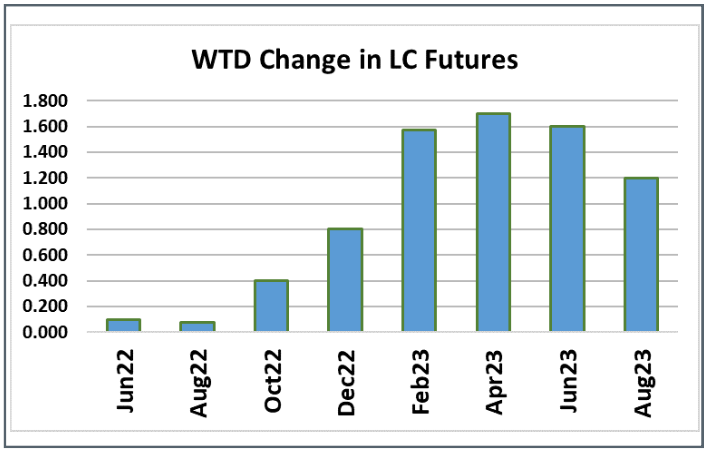

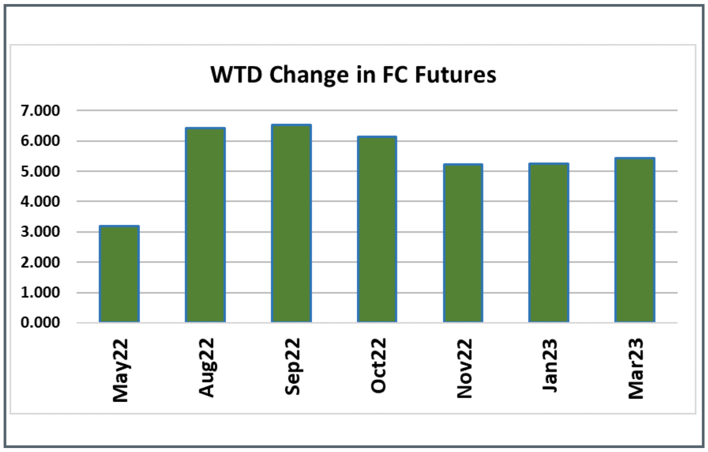

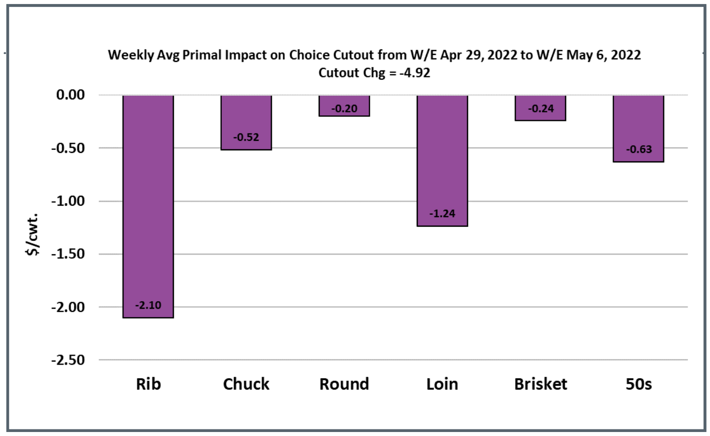

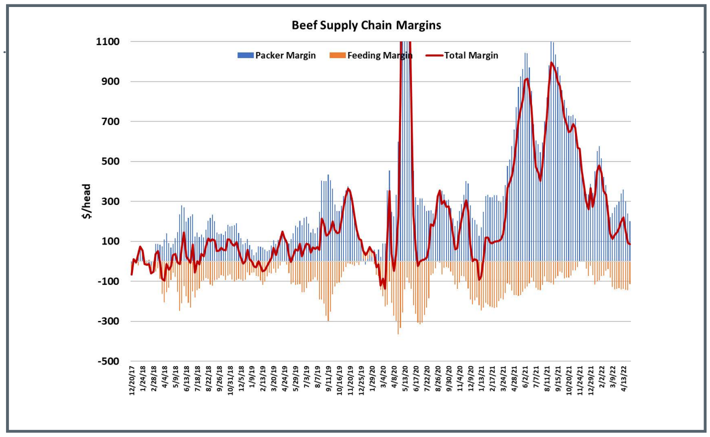

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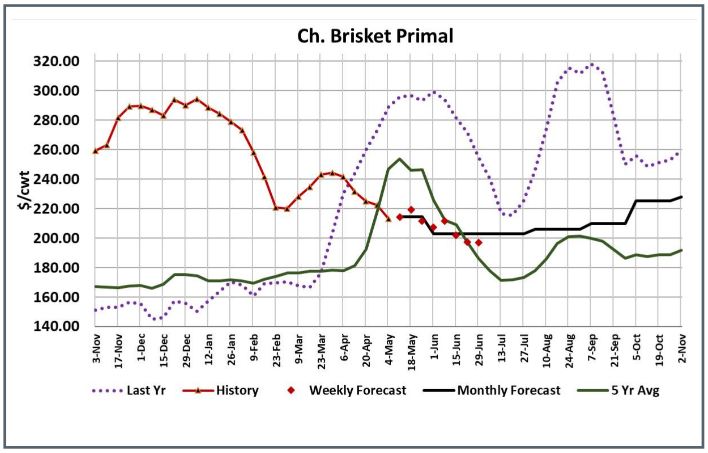

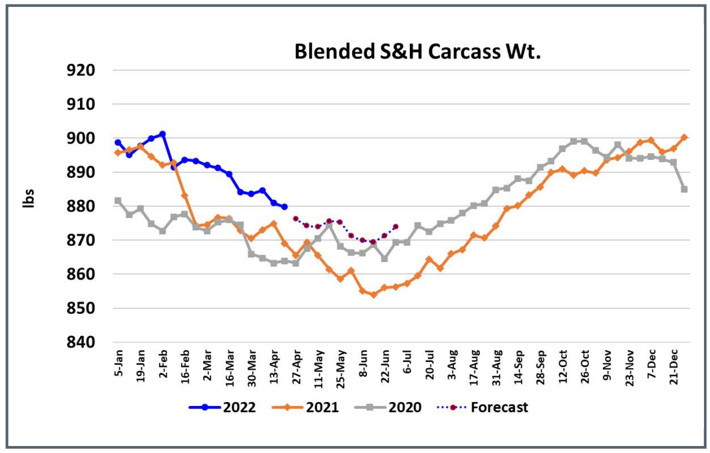

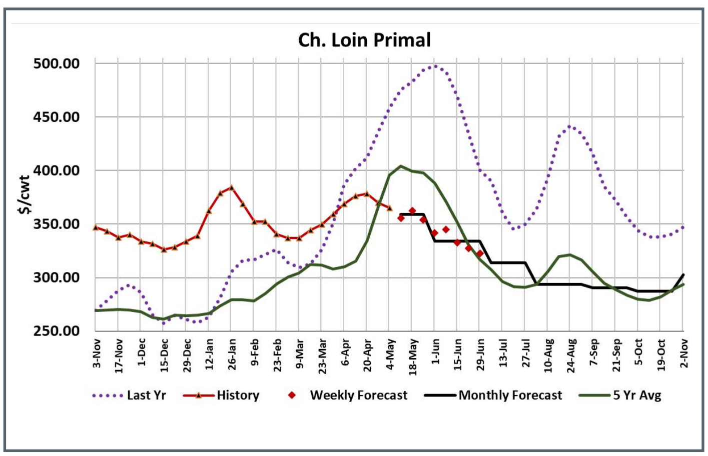

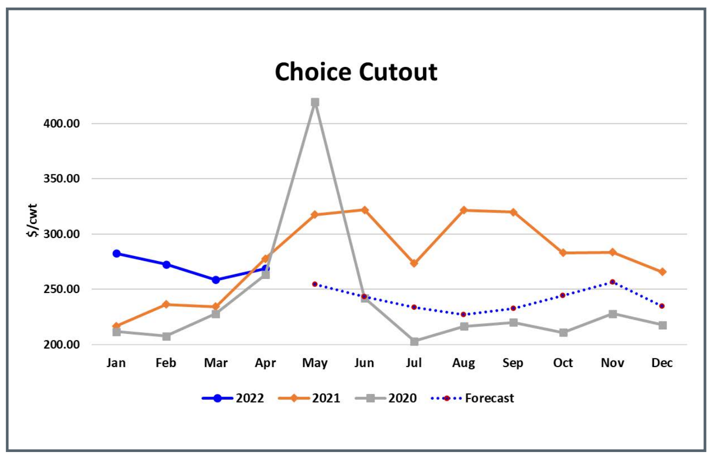

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Dr. Rob Murphy is an agricultural economist and business leader with over 29 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.

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