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WEEK ENDING JUNE 24, 2022

THE BEEF WRAP

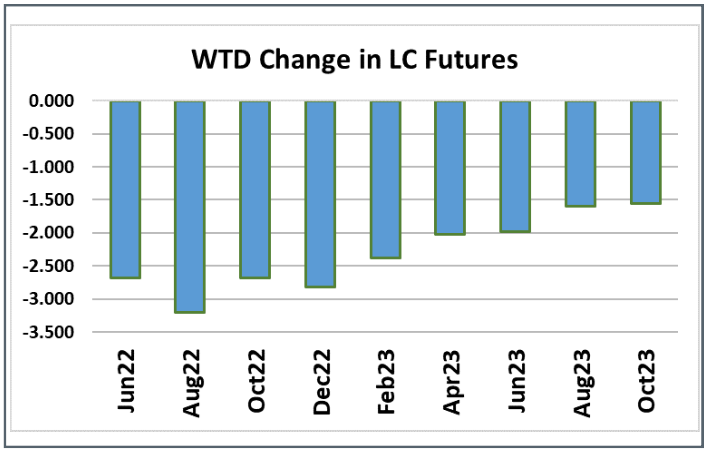
Beef packers' margin situation got a little more precarious this week as the cutouts turned lower yet cash cattle continued higher. On a weekly average basis, the Choice cutout lost $2.27/cwt and the Select was down $0.56/cwt. Thus it looks like the rally in boxes that began in mid-May has now run its course. The attached chart shows that it was the middle meats that were responsible for pushing the cutout lower this week. The chuck, which traded higher, tried to help, but fell short. With Father's Day now behind us and all of the buying for July 4 now completed, it isn't too surprising that the middles would come under pressure. It seems to me that this was just the first step in a series of weekly price declines for middle meats. In addition to the weakness in the middles, fat trim finally posted lower pricing this week. That could be related to the completion of July 4 buying, or it could be that kills have just been so big lately that some supply-side pressure is beginning to show up in the trim. Lean trim seems to be holding up very well and we saw the 90s price gain about $2 this week.

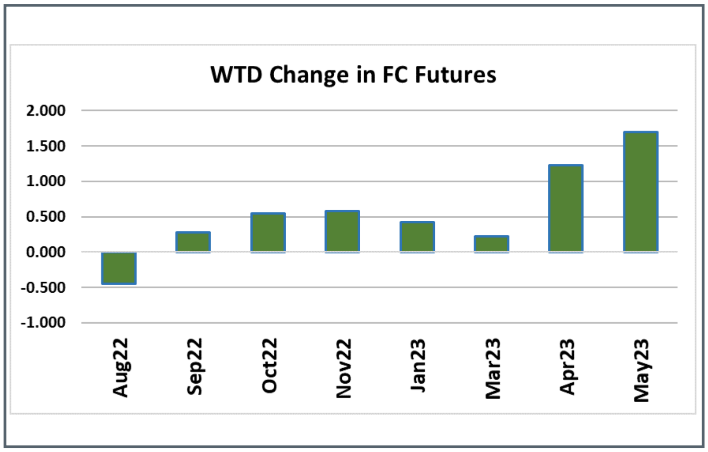
As the macroeconomic conditions deteriorate over the next few months, it is reasonable to expect stronger ground beef demand and weaker middle meat demand as consumers increasingly trade down toward cheaper proteins. While the beef market was struggling this week, the cattle market continued to advance. The average price of cash cattle increased almost $1 to $144.50. Cattle in the North traded at $146 or better and in the South the trade was at $138 or a little lower. That is a huge regional price differential. Back in pre-pandemic times, when cash prices differed that much between regions, packers would buy cattle in the low price region and then truck them to the higher price region. They would usually only need to do that for a few weeks before prices would equalize. Now I'm wondering if this big price differential is persisting because of a much higher cost to transport cattle. High fuel costs and shortages of truck drivers might be making it cost-prohibitive to buy cattle in one region and slaughter them in another. Regardless of the cause, the inability of packers to get cattle bought cheaper is going to become a real problem in the weeks ahead as the cutouts move lower.

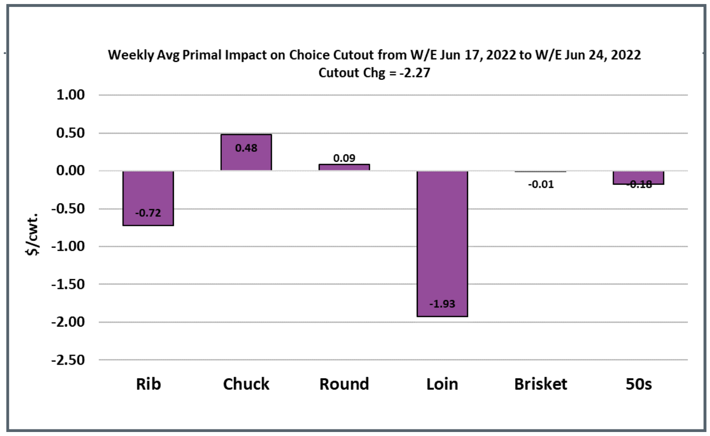
I calculate this week's packer margin at $155/head and am projecting margins less than $100/head in the coming weeks. Cattle feeders, on the other hand, are seeing their margins improve. The combined margin turned lower this week and it now looks like the industry has moved back into a demand downcycle. Close inspection of the combined margin chart indicates that the last 4 demand cycles have peaked at lower and lower levels. The most recent demand cycle was particularly anemic and it looks to me like the combined margin will be in negative territory soon. Given that feedyards are full of cattle, the combination of weaker demand and big supply points to lower cattle and beef pricing down the road. This week's fed kill came in at 523k, almost identical to the week before. Next week, I expect that packers will leverage the holiday weekend to do a very small Saturday kill and thus keep the fed kill in the 500-510k range. It is the perfect excuse to cut the kill and make it look like they want to be nice to their workers by giving them a long weekend. The official July 4 holiday is a week from Monday, but it is common for packers to pull back on the Saturday before when the holiday falls on a Monday. Then the following week, there will be no kill on Monday and so the fed kill might fall as low as 470k. So for the next two weeks packers have a prime opportunity to cut kills and hopefully strengthen their margins. The smaller kills might not be enough to boost the beef market, but it almost certainly will help stop the price increases in the cash cattle market. Cattle carcass weights continue to drop. Steer weights were reported down another 3 pounds this week. We are way beyond the normal point in the calendar where weights bottom. If nothing else, the upcoming short kill weeks will likely cause carcass weights to turn higher. The DTDS weights continued to plunge this week, dropping to -10 lbs after registering +30 lbs just a few weeks back. There are a number of theories floating around about why packers keep having to pay up for cattle when the number of cattle on feed is record large. One of them is that they are "chasing the grade". Another is that they need to fill previously booked orders.

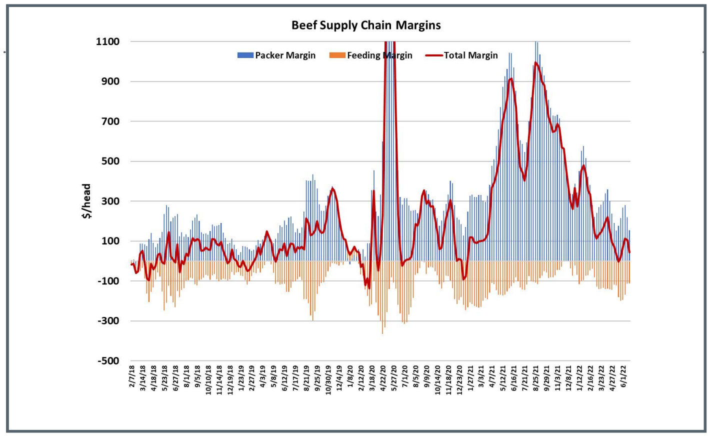
But the weight data is very clear and it tells me that a lot of cattle are just not ready for slaughter right now. Maybe it is the heat or maybe it is a change in rations by cattle feeders, but the front end supply is quite current judging by what weights are telling us. It is true that there are record numbers of cattle in the nation's feedyards, but that supply must be tilted more toward July and August than June. USDA gave us another look at the cattle supply in today's Cattle on Feed report. They pegged placements during May down 2.1% and June 1 on-feed totals up 1.2% and the largest on record for this time of year (since 1996). The placement number was about 2% smaller than what analysts were expecting, so it might generate some buying in the futures on Monday, but I believe that traders are now more focused on potential demand problems down the road and so any rally generated by the COF numbers is likely to be short-lived. This week the contracts on the front end of the futures curve lost between $2.50-$3.00 as traders grew increasingly concerned about what high inflation and a cratering stock market would mean for beef demand. I definitely agree with them that these are the things that will determine pricing across the complex in the coming months.

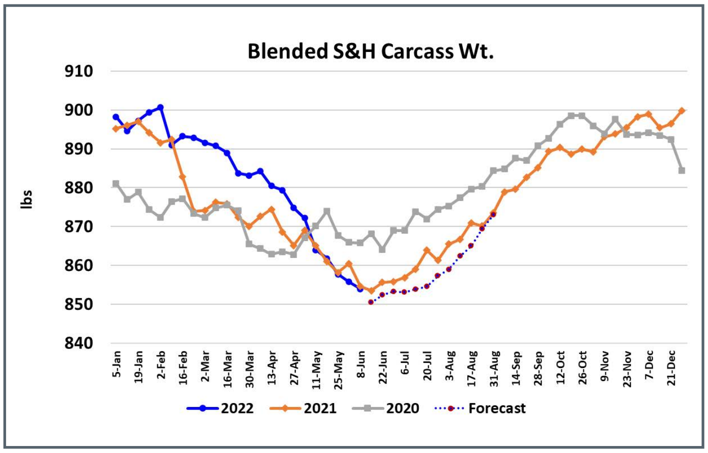
Gasoline prices have started to ease a tiny bit but still remain very high and with each passing day that is putting more strain on consumer's budgets. Interest rates are rising and it won't be long before that starts to seriously impact housing prices. Declining housing values are a lot like declining stock prices–it makes consumers feel poorer and thus curtail spending on non-essentials. We can already tell from the combined margin chart that beef demand is way off of its 2021 levels. So beef demand is coming into this period of macro headwinds in an already weak position. That causes me to think that things could really get ugly on the demand side over the balance of the year. Buyers would be wise not to extend coverage very far into the future unless it is at price levels much lower than what we see today. Next week, watch for further erosion in the cutout and keep an eye on the Saturday kill because if it is exceptionally small that might be the straw that breaks the cattle feeder's back and finally gets cash cattle prices heading lower.

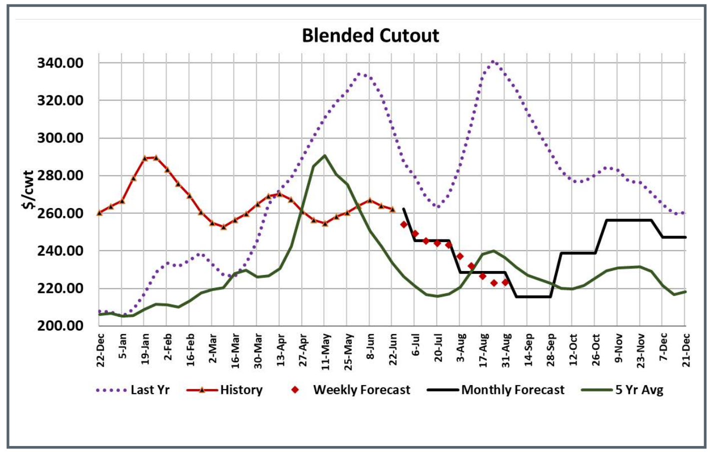

WTD Change in LC Futures
0.000
-0.500
-1.000
-1.500
-2.000
-2.500
-3.000
-3.500
Jun22
Aug22
Oct22
Dec22
Feb23
Apr23
Jun23
Aug23
Oct23

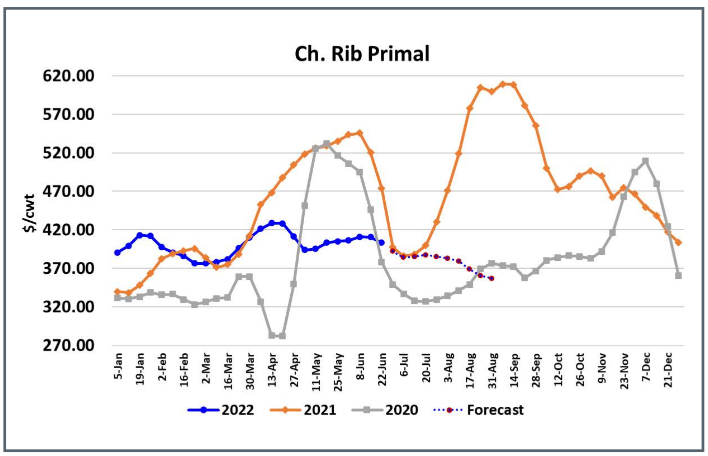

WTD Change in FC Futures
2.000
1.500
1.000
0.500
0.000
-0.500
-1.000
Aug22
Sep22
Oct22
Nov22
Jan23
Mar23
Apr23
May23

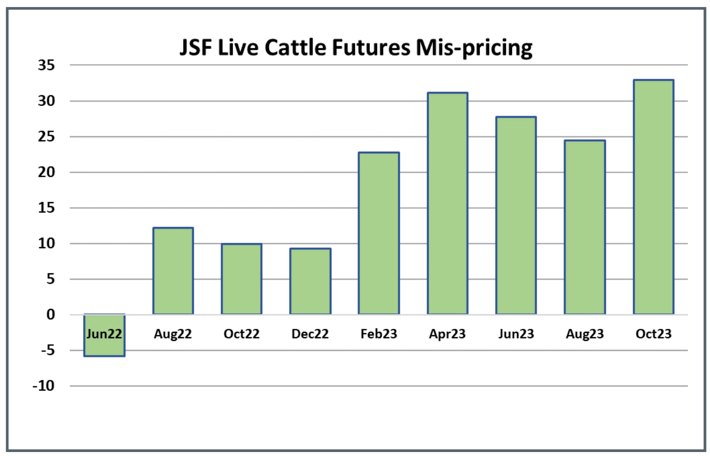

Weekly Avg Primal Impact on Choice Cutout from W/E Jun 17, 2022 to W/E Jun 24, 2022
Cutout Chg = -2.27
1.00
0.50
0.00
-0.50
-1.00
-1.50
-2.00
-2.50
$/cwt.
-0.72
0.48
0.09
-1.93
-0.01
-0.18
Rib
Chuck
Round
Loin
Brisket
50s

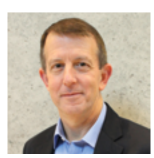

Beef Supply Chain Margins
Packer Margin
Feeding Margin
Total Margin
1100
900
700
500
300
100
-100
-300
-500
$/head











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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.