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RED MEAT OUTLOOK: CATTLE & BEEF

The beef cutouts stalled during November, with price gains in the ribs and tenderloins being more than offset by weak pricing in the remainder of the carcass. Prices for cuts from the round, chuck and brisket all moved substantially lower, as did the price of lean and fat trim. The gains in the middle meats suggest that demand in the foodservice sector remains robust, while the struggles in the other cuts point to demand problems in the retail sector. Cash cattle prices worked a little higher during November, as cattle feeders took advantage of the fact that packers had a large book of forward deals that needed to be delivered upon just prior to the Thanksgiving holiday and thus they needed to keep the kill elevated for that reason. Last week, cash cattle prices in the US averaged close to $156, up from around $151.50 near the end of October. With cattle prices moving higher and the cutouts sliding lower, packer margins came under increasing pressure. We estimate that near the end of November packer margins dipped into the red for the first time since January, 2020. Gone are the days from the pandemic when packers regularly earned several hundred dollars per head processed (**Figure 1**). Hopefully, packers banked some of those extra-normal profits because the next few years are looking pretty lean from a packer profitability perspective. Rising costs and poor profitability in the production segments of the supply chain has fostered a downsizing in the breeding herd that will be felt acutely by packers, retailers and end users over the next 2-3 years. Naturally, we might expect that this will be accompanied by higher prices, but it is important to remember that demand, not just supply, plays a role in price determination and as we head into 2023, the demand side of the equation does not look very healthy.

> Last week cash cattle prices averaged **close to $156, the highest since 2015**

SUPPLY PICTURE

Steer and heifer slaughter during November averaged close to 520,000 head per week in the non-holiday weeks. That was a little stronger than what our flow model projected and it certainly helped keep feedyards current and they were comfortable insisting on higher prices for their cattle. Packer margins have been compressed to the point where many plants were probably operating in the red near the end of the month. Normally, the elixir for this problem is for packers to scale back on the kill, which should raise beef prices and lower cattle prices, thus improving margins. So far packers haven't been willing to employ that tactic. Some have joked that packers made so much money for so long during the 2019-2022 stretch that they forgot how to respond when margins got tight. Well, they had better drag out the old playbook and study up a bit because they are likely to struggle with small margins for the next several years as the beef herd contracts further and the supply of cattle falls well short of processing capacity. One potential explanation for the failure to scale back slaughter levels in the face of declining profitability has to do with the fact that packers have just recently replenished their labor force and perhaps they don't want to risk losing these new workers by slashing hours. The flow model suggests that there will be fewer market-ready cattle available in December, so perhaps we will see fed slaughter drop back closer to 510,000 head in the non-holiday weeks ahead.

Steer carcass weights look very close to a seasonal top and should now slowly work lower. That, along with smaller kills in December, will work to reduce beef production. Weights can be expected to trend lower from now until mid-April. The de-trended and de-seasonalized weights are still rising and that implies that feedyards are potentially losing a little bit of currentness, but so far that hasn't translated into any sense of urgency to market cattle. Perhaps that will come in December. The weather in cattle feeding country has been conducive to strong gains, and normally that would cause the DTDS weights to rise and feedyards to lose currentness, but packers have been aggressive in keeping slaughter rates high and that has limited the loss of currentness. Of course,

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this is the time of year when nasty winter weather can start to have a serious negative influence on weight gains. That hasn't materialized yet, but it bears close watching. Normally two or three years out of every 10 turn into "weather markets" where high precipitation and frigid temperatures combine to limit feedyard performance and in these situations it is not unusual to see both cattle and beef prices spike.

Cattle feeders seem to be getting a little less eager to keep their yards brimming with cattle. Feeder cattle prices have been mostly sideways this fall and USDA recently reported that feedyard placements during October were down about 6% from a year earlier. Slowing placements, combined with strong offtake, now has feedyard inventories about 1% below last year and we expect that by the end of Q1, those trends will result in feedyard inventories down 5% YOY, or more. Of course, that will translate into tighter domestic beef production and potentially higher beef prices in the new year.

By spring, the **total feedyard inventory** could be **down 5%** or more YOY

DEMAND SITUATION

Despite all of the bullishness that is contained in the supply side of the market, the demand side seems to have enough of a bearish tone to more than offset it. Consumers are slowly coming down off of the financial "sugar high" that was the pandemic and price inflation in the macroeconomy is still near 8% YOY. That is forcing consumers to be more judicious with their spending and beef demand has come under pressure as a result. The Federal Reserve seems intent on moving interest rates higher over the next few months until they see some meaningful reduction in inflation. The labor market has remained strong, but layoff announcements have increased lately and there are widespread expectations that the economy will enter a recession sometime in 2023. That probably means that domestic beef demand remains some what subdued. Even more troubling is the fact that beef demand failed to show its normal end-of-year strength. Normally, November is a very strong beef demand month as buyers ramp up purchasing in advance of the holidays. This year however, the gains have been modest and constrained to a handful of middle meat items used by high-end foodservice outlets. It makes one wonder, that if we can't get a demand boost in November, what will happen in January and February when consumers are stretched by post-holiday bills and beef demand is notoriously weak? One problem is that retailers have been very slow to lower the retail price that consumers see even while wholesale prices are moving lower (**Figure 2**). That constrains movement and shows up as soft demand in our calculations and scatter plots. Inflation in the macroeconomy has given retailers cover to keep beef prices high and our guess is that they will come down at a much slower than normal pace over the next few months. That doesn't bode well for near-term demand prospects. It is possible that some last-minute buying ahead of the holidays will lift wholesale prices in early December, but beyond about mid-month, demand can be expected to slip lower again and that should carry into the new year.

International demand for US beef seems to be holding up better than domestic demand currently. The weekly export numbers during November tracked relatively close to last year. China continues to struggle with covid lockdowns and their appetite for US beef has been a bit subdued lately, but other countries have stepped up so that total exports haven't declined much. A little bit weaker US dollar may also help support export business in the near-term, but we maintain that the global macroeconomy is no better than that of the US and eventually beef demand in other countries will soften. Of course, if US beef prices continue to trend lower, that could start to manifest stronger exports but that usually takes time and may not become apparent until January or later. For now, we rate international demand as good, but not great, with the prospect that it probably deteriorates some before it improves.

SUMMARY

The US cattle and beef complex is currently plagued by strong production and weaker-than-expected demand. That has caused price levels on everything outside of ribeyes and tenderloins to fall below our original projections. Retailers have been slow to lower the prices that consumers see and that may continue to limit movement in the near term. Packers have now met most of their forward commitments for the holiday season and so perhaps they may be more willing to entertain a reduction in slaughter levels that is necessary if they are going to lift their margins back into the black after a dismal performance this fall. We see small, and possibly negative, packer margins as a general theme that will persist for the next couple of years at least. Eventually margins may get so bad that one or more packers is forced to close a plant in order to better align processing capacity with available cattle supplies. Beef buyers should be prepared for much tighter availability in 2023 compared with this year and 2024 will likely be even tighter. That could mean sharply higher pricing over the next couple of years, but if demand stays sub-par then perhaps prices won't reach the level that futures traders and other prognositcators currently want to assign. Near-term, buyers will likely find availability tight on high quality middle meats, but should have no problems sourcing other parts of the carcass at prices well below where they were a couple of months ago. Our near-term price forecasts for cattle and beef are provided in **Table 1**.

Figure 1: Monthly Average Beef Packer Margin, 2019-2022

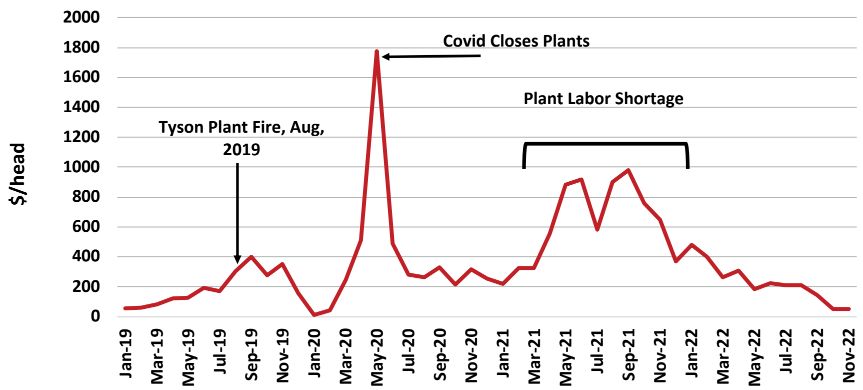

Figure 2: Retail Beef Price as a Percent of the Blended Cutout

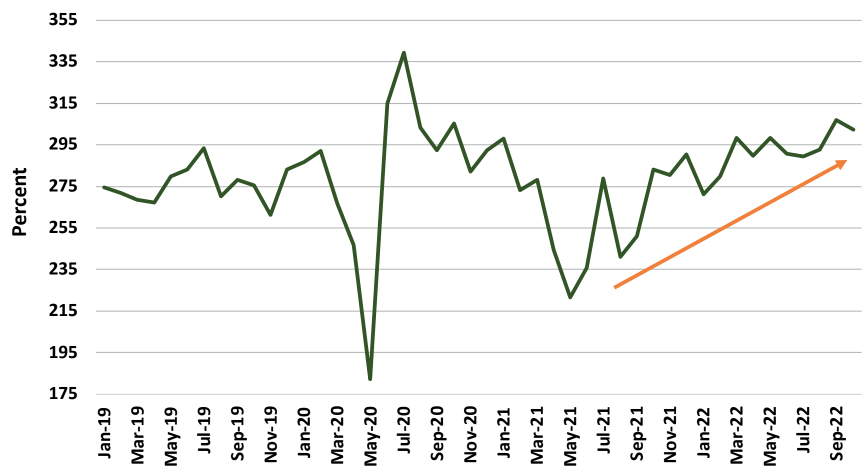

Table 1: JSF Cattle and Beef Price Forecasts

	7-Dec	14-Dec	21-Dec	28-Dec	4-Jan	11-Jan
Choice Cutout	251.4	248.0	245.3	240.7	238.3	236.3
Select Cutout	225.2	223.9	224.9	223.0	223.7	225.6
Choice Rib Primal	461.2	440.7	422.1	397.4	384.8	372.3
Choice Chuck Primal	202.3	198.7	202.6	194.8	190.4	186.0
Choice Round Primal	203.3	200.2	204.3	209.0	214.8	218.1
Choice Loin Primal	327.7	330.0	316.6	313.3	309.7	311.1
Choice Brisket Primal	185.3	187.9	192.1	191.3	186.1	182.3
Cash Cattle	153.9	152.1	151.0	148.5	147.1	147.2

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