Weekly Outlook: Beef: High Prices Cure High Prices

Chris Hurt
Department of Agricultural Economics
Purdue University

October 26, 2015

farmdoc daily (5):198

The adage that the cure for high prices is “High Prices” is evident this year in beef markets. Finished cattle prices reached record highs around $170 in late 2014 and early spring of 2015. Prices then fell below $120 by October. Prices have fallen $50 per hundredweight in what must be the greatest decline ever. Interestingly, the decline in beef prices was preceded by a similar decline in live hog prices from mid-2014 into early 2015. It is likely that the escalated 2015 egg prices due to Avian Influenza may also face a similar descent at some point.

When analyst look back on these boom/bust price patterns, the supply and demand data never seem to fully justify how high prices go in a period of shortage, nor how quickly they fall afterward. The tendency for prices to “overshoot” on the upside and then to “undershoot” on the downside is repeated often. The excesses on the upside may be related to the human emotion that is inherent in agricultural markets when there is uncertainty with regard to food shortages. Regardless, cattle markets seemingly overshot to the upside, then undershot to the downside, and are now seeking to better evaluate equilibrium.

Certainly some of the roller coaster price action in the cattle markets can be explained by basic supply and demand relationships captured by the statement “the cure for high prices is high prices.” This has been illuminated in 2015 by higher cattle weights, by sharp increases in beef imports and declining beef exports, and by consumption shifts due to high retail beef prices.

Everyone knew that cattle numbers would be small this year and processing numbers have been down six percent. But high prices have provided incentives to get additional beef supplies to consumers. The first is by higher weights. Record high finished cattle prices in combination with limited feeder cattle and abundant feedlot capacity provided strong incentives for feedlot managers to finish the animals that were available to much higher weights. Current weekly slaughter weights are approaching 1400 pounds per head. For the year, weights are up an average of 2.5 percent. So six percent lower numbers are partially offset by higher weights such that domestic production so far this year is only down 3.5 percent.
But record high U.S. cattle and beef prices, along with a strong U.S. dollar, have also stimulated major shifts in trade patterns that have also increased the domestic availability of beef. High prices have attracted considerably more imports of beef. Trade data through August show that beef imports have increased 32 percent over the same period in the previous year. The three countries with the largest added sales to the U.S. are Australia, New Zealand, and Mexico. Brazilian beef exports to the U.S. are the fourth largest increase where the U.S. dollar has appreciated about 40 percent over the past year. High U.S. prices and a strong dollar have damaged U.S. beef export volumes. Through August, beef exports were down 12 percent, lead by reductions of 31 percent to China, 23 percent to Mexico, and 12 percent to our biggest customer Japan.

The surprising bottom line is that U.S. consumers have had more beef available so far this year—not less. Reviewing those number just mentioned: animal numbers for processing have been down six percent, but weights have been up 2.5 percent and net trade impacts (more imports and less exports) have contributed an additional 4.5 percent to supplies. So, the six percent lower animal numbers have been more than offset by seven percent more supply from weights and net-trade impacts. That makes available supplies up one percent so far.

Retail beef prices probably have also contributed to the record drop in finished cattle prices this year. Retail beef prices rose to a high of $6.42 per pound in May (USDA). These record high prices sent signals to consumers to consider looking for beef substitutes and they found them in growing pork supplies at declining prices and abundant chicken at prices similar to those in the previous year. Again, given time, high prices provide a cure for high prices for demand as well as for supply. After cattle prices have seemingly overshot and undershot, the market is now attempting to find the “correct” equilibrium price. Of course that “correct” price is never known and one of the primary functions of markets is to discover that price.

Finished cattle prices bottomed in the first-half of October somewhat under $120 and recovered to the high $120s last week. Using current futures prices as a forecast suggests that a strong recovery will occur into the end of 2015 into the low $140s. Then, prices would be expected to reach their 2016 highs in late winter or very early spring in the mid-to-higher $140s. Seasonal weakness would drop prices back to the mid-to-higher $130 by the end of summer.

Most likely, the highest cattle prices on this cycle are behind us. Finished cattle averaged near $155 in 2014. They are expected to be near $150 for 2015 and then moderate even more into the high $130s or low $140s for 2016.

Meanwhile high prices are continuing to do their job of stimulating expansion of the cow herd, with female slaughter (heifers and cows) so far this year down ten percent. Indeed, given enough time, high prices will solve the dilemma of high prices.