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Weekly Outlook: Cattle Producers Show Surprise Interest in Expansion

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While beef supplies will be very short for several more years, the USDA's *Cattle* report indicated that the very early stages of beef cattle expansion has begun as beef heifer retention has increased a modest one percent. However, the big picture is that beef cow numbers dropped 3 percent last year and this will mean a smaller calf crop in 2012 that will keep cattle slaughter small for 2013 and 2014. If producers follow through with more heifer retention in 2012 and 2013, slaughter supplies will decline over the next two years and increase finished cattle prices even more.

There have been two dominate drivers of cow numbers in recent years. The first was the dramatic increases in feed prices after calendar year 2007. The beef industry could not pass higher feed costs on to consumers in 2008 and 2009, but rather had to suffer negative margins. Poor returns led to liquidation of beef cows that has continued into the current report. The second large driver was the drought in the southern Plains in recent years that caused further liquidation of cows due to lack of pasture and forages.

The impact of these two factors resulted in U.S. beef cow numbers dropping 3 million head, or nine percent, since 2007. Every region of the country reduced beef cow numbers since 2007. In the past year, the impact of the drought was felt most heavily in Texas where beef cow numbers were down 660,000, representing 13 percent of their herd. The second largest impact was in Oklahoma where the cow herd was reduced by 288,000 head, or 14 percent, last year. The cows that were liquidated from the southern Plains in 2011 went in two directions. First, cow slaughter was high all year indicating that many went directly to packers. However, a portion moved to areas that had better pastures and forage supplies. The biggest recipient was likely Nebraska where cow numbers were up 112,000 last year, but also Iowa with cow numbers up 55,000 and Colorado up 22,000 head.

There are now indications that the longer term trend of cow liquidation driven by high feed prices may be coming to an end. This is because beef supplies have now adjusted downward and cattle prices adjusted sharply higher. In addition, feed prices are expected to moderate if 2012 U.S. yields are close to normal. Beef cows have become very valuable property because of the shortage of beef that will be experienced in 2012 and beyond. This was demonstrated in the Cattle report by a one percent increase in the number of heifers being retained to go back to breeding herds. This is the first increase in heifer retention since feed prices began increasing. The drought continues to retard expansion in Texas where heifer retention is down ten percent and in Oklahoma where retention is down 16 percent. However, the expansion of the breeding herd appears to be underway in Nebraska, South Dakota, Colorado, Wyoming, and Iowa where retained heifers are up by double-digit percentages.

What does this first hint of expansion mean to cattle prices in 2012? While some may see the early signs of heifer retention as bearish for 2012 prices the opposite is most likely true. This is because the retention of heifers reduces slaughter supplies and beef supplies. Because of the reduction in the cow numbers, the calf crop will be down over two percent in 2012. If heifer retention continues to grow in 2012 and 2013, beef supplies will not increase until 2015. So, the modest heifer retention now is actually a price enhancing factor in the short-run with the bearish implications not occurring until 2015 and beyond.

Will cow-calf operations continue to expand in 2012? They probably should wait for two conditions to develop. The first is continued improvement in moisture conditions in the southern Plains. There are mixed signals for that region. Rainfall for much of the southern Plains has been above normal for the past couple of months, while NOAA continues to forecast that drought conditions will persist through at least the spring for that area and that drought will continue, or develop, for much of the southern tier of states from California to Florida. The second condition is to wait for an assurance that the 2012 U.S. crops will have favorable yields. This is because NOAA is forecasting that a region of the western Corn Belt will continue to be very dry into the spring, which raises concerns for corn and soybean meal prices. Higher feed prices would tend to depress calf prices.

The first signs of expansion do little to change the bullish cattle price forecasts. Look for finished cattle prices to push into the higher $120s this spring, moderate to the mid-$120s this summer, and finish the year near $130. Spring highs in 2013 could climb to the low $130s.