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ECONOMICS COMMENTATOR

SOUTH DAKOTA STATE UNIVERSITY

No. 359 February 15, 1996



CATTLE TRENDS: REVIEW AND WHERE WE ARE GOING

by

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Throughout 1995, feeder calf prices followed a downward trend. Prices once above \$80 early in the year were replaced by the mid-\$60's by late Fall, or about equal to slaughter steer prices. Continued price declines late in 1995 and early in 1996 have resulted in feeder cattle prices below fed cattle prices. The last time that relationship occurred was in the mid-1970's. A brief look at how we got to the position we are in and where the industry is headed is the focus of this Commentator article.

A Quick Review

Cattle inventory levels peaked in the mid-1970's at over 130 million head. That large inventory helped pressure prices for 400-500 pound calves into the \$30 area. Heavier calves (700-800 pounds) were in the mid-\$30's and slaughter steers were in the low \$40's.

The large inventory of the mid-1970's resulted in at least two things in addition to the prices noted above: (1) herd liquidation and (2) large beef production. Herd liquidation continued until 1979, when inventory levels once again started to move higher. Beef production, partly because of genetics, crossbreeding and feeding out more cattle to heavier weights, didn't really drop off as inventories decreased. Then, when inventories started moving higher in the late 1980's, production also increased. Currently, about 25 billion pounds of beef is produced every year from an inventory of only about 104 million cattle. That compares to about 24 billion
(Continued on page 2)



VOLATILE SPRING MARKET EXPECTED

by

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Marketing Specialist

Since final crop production and stocks reports were issued by the USDA, the grain markets have been looking to the weather and export demand developments for direction. Dryness in soybean producing regions of Brazil and wind and cold temperatures in southwest Kansas have diminished world crop potential. Sizable wheat sales to China and rumors of a sale to former Soviet Union (FSU) countries provide just enough bullish news to keep market prices moving sideways with occasional tests of resistance and support levels on the charts.

World and U.S. grain stocks are at historically low levels (Figure 1). Consequently, spring and summer weather could have explosive impacts on commodity prices. On the other hand, "perfect" growing season

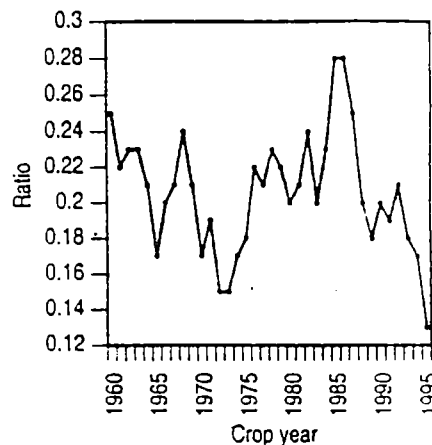


Figure 1. World grains stock-to-consumption ratio

(Continued on page 3)

(Cattle ... Continued from p.1)

pounds of beef produced in 1975 from an inventory of 132 million cattle.

One of the major reasons for cattle inventory increases during the past six years has been calf prices -- high enough to earn most cow-calf producers positive returns. The end result is increased production -- something which is not quickly reversed. Some have likened the cattle industry to a long, heavily loaded freight train. Even when the engine has been shut off, the train coasts for a long time. For the cow-calf industry, the engine (high calf prices) was shut off for some producers sometime in 1994 and for others in mid-1995. Inventory reductions probably will be noted in 1996 and 1997.

The small (1 percent) increase in the nation's cattle inventory on Jan 1, 1996 (compared to Jan 1, 1995) probably is the end of the "cattle train's movement" (end of increased inventories) for several years. The lower calf prices go, the quicker the "train" will stop -- and reverse. If prices don't go extremely low (into the low \$50's or upper \$40's for Fall calves), recovery will be slower.

Where Are We Going?

As noted earlier, cattle inventories could drop in 1996. Calf prices are low enough so that most producers are in "the red". That doesn't mean numbers will drop a lot. Many factors could keep "the liquidation" at a relatively slow pace, including low cow and replacement heifer prices, resistance to herd downsizing by small-scale producers (50% of the nation's cow herd is in herds of less than 100 head), and the belief by some that the time to expand is when prices are low. Nonetheless, some liquidation should occur in 1996.

As inventory is reduced, production should increase -- normal production from fed cattle is supplemented by beef from animals (cull cows, bulls, etc) being sold from the herd. Eventually, and that may be two or three years, beef production should decrease. How much will depend on how far inventories are reduced in the liquidation phase.

The cattle inventory should be braced for a 2-3 year period of low prices. The production (supply) side of the picture is somewhat set on high production for that long. Several other factors still must be considered. First, much of what happens to feeder cattle prices will depend on the corn market. A large corn crop (10 plus billion bushels) certainly is possible. More acres will be planted to corn in 1996, and what happens there is

weather dependent. If corn prices drop \$1.00 per bushel, prices for 500 pound calves could move up by \$15 per hundredweight. The impact on 750 pound yearlings could be \$9-10 per hundredweight.

Second, there is plenty of other meat available to consumers. The poultry industry keeps expanding and pork also should be in larger supply. Both industries are "more corn dependent" than beef. If corn prices stay fairly high (lower than now but not \$1.00 lower), some impacts on production could occur. Currently, however, the best estimate is for large supplies of all meats.

Third, the export market is extremely critical. Continued large gains in exports, especially beef and pork, may not occur. It is important that they not be lost. In 1996, as much beef could be exported as imported. More pork could be exported than imported. Price impacts of exports on the U.S. cash markets have been estimated to be \$3-5 per hundredweight for pork and \$6-7 for beef.

Putting all of the above together yields a picture that isn't very optimistic for at least the next two or three years. Prices in the \$60's could hold most of the time for fed cattle. Feeder cattle prices could be as much as \$10 below that level if corn production doesn't increase and \$10 above that level with a large corn crop.

South Dakota Situation

While the total cattle and calf inventories in South Dakota did not change, both the beef cow inventory and 1995 calf crop were 3% above a year earlier (see table below). Evidently, the calf losses which occurred in the South Central part of the state in April were offset by increased numbers elsewhere.

Cattle and Calf Inventory, Jan 1, 1996

	<u>U.S.</u>	<u>Change</u>	<u>S.D.</u>	<u>Change</u>
Total Inventory	103.8 mil	+ 1%	3.9 mil	0
Beef Cow Inventory	35.3 mil	+ 1%	1.72 mil	+3%
Calf Crop, Total	40.3 mil	+ .2%	1.78 mil	+3%
Cattle Operations	1.21 mil	- 1%	21,000	0

Since cattle are a major source of income in South Dakota, the net effect of a stable supply but at sharply lower prices is very negative. Lower prices mean lower gross income, that means lower net income and that means less spending by producers. The impact on

businesses in many communities will be affected as will revenues at various levels of government. Since prices are not likely to turn-around quickly, the impact will be felt for several years. And, lower feeder cattle prices could lead to herd liquidation, adding even more "negative" to the situation.

(Shane ... cont'd from p.1)

weather could lead to large crop production and free fall in commodity prices (remember 1994 when stocks were low and weather was perfect) . Extreme volatility in market prices characterized by abrupt changes in direction and large changes in price is very probable this spring. Past pricing activity by producers suggests that most opportunities during volatile markets are missed. A written market plan will help marketers take advantage of opportunities should they materialize.

Your market plan should contain information concerning costs of production broken down into major segments like pre-harvest cost, harvest cost, debt service, family living and return on investment. This breakdown will assist the marketer in setting trigger prices -- the price at which a designated percentage of expected production will be priced. The marketing alternative(s) that is (are) acceptable at each trigger should be listed. Action(s) to be taken when a trigger is activated also should be enumerated. This last step of market plan execution is where many plans fail. If the psychology of the market bias or trend keeps you from pulling the trigger, have actions in place with grain buyers or your broker to automatically execute the strategy.

Follow-up strategies are also important in a market plan. For example, if you cash forward contract with the local grain elevator for harvest delivery of soybeans at \$6.50 per bushel, you may state that an at-the-money new crop call option will be bought on a price dip of 20¢ per bushel in order to retain upward price potential while continuing to use the contract for downside price protection.

If the first price trigger of the marketing plan doesn't call for pricing 100% of expected production, a second trigger should be included. A third, fourth or even more triggers can be included along with accompanying strategies to use, execution actions to take and follow-up ideas and actions.

Most marketers have difficulty in "pulling" the trigger and executing their marketing plans for each sale

of commodity. The detailed market plan suggested previously only makes this process more difficult as the follow-up actions usually require another strategy decision and execution.

Strategies included in your marketing plan should include the alternatives with which you are familiar and comfortable. If you cannot sleep at night because of the fear of margin calls, you should not hedge and probably not use a fence or window which requires selling an option and margining. If you detest paying insurance premiums, you probably won't want to pay premiums for options either. In this case, you may be limited to cash price alternatives. If you are extremely concerned about production risk and failure to deliver on a cash market contract, an option purchase that implies no obligations may be best for you. Whatever you do, be prepared because market opportunities will happen quickly and traditionally have been short lived.

Being prepared includes writing your market plan; opening an account with a broker, if futures and options contracts are used; communicating with local cash markets to find out details about alternatives available; and lining up credit for potential margin or premium payments. Being prepared also means informing all major players in your business of your marketing intentions and the potential consequences. Disaster could result if a working spouse comes home to a margin call for several thousand dollars and has no idea what that means.

A word of caution is in order concerning implementing a marketing strategy that your neighbor and friend have executed. Each business situation and producer psychology is different. Be sure the triggers, strategies and execution methods fit your risk position and personality. In a conversation with two farmers about pricing 1996 expected soybean production, one said "I don't mind paying 20-30¢ option premiums to set a minimum price because I have to participate in explosive weather markets this growing season." The other said, "I will never pay those large premiums, but locking in a profitable price is important--I will leave a small percentage of my expected production unpriced in case of an extreme situation this spring or summer. At least I can say I priced some at a very high price." As you can see, these two farmers, living only a few hundred yards apart, have very different ideas about how to market grain. Do what is best for you now because only with hindsight do we know if a better alternative existed.



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Hear experts give estimates for 1996 prices for commodities. Past price history will be furnished--you write in this year's estimates. There is no charge. Everyone interested in agriculture is urged to attend.

Holiday Inn Convention Center
Thursday, February 29th, Brookings

9:30 Registration & Coffee
Courtesy of: First National Bank & Dakota, Minnesota, & Eastern Railroad

10:00 Corn & Soybeans -- Jim Conner
Harvest States Cooperatives

11:00 Oats -- Bruce Roskens
The Quaker Oats Company

11:30 Livestock -- Gene Murta
SD Cooperative Extension Service

12:00 Lunch (on your own)
Wheat -- Terry Garvert
Cargill, Inc.

1:45 Sunflowers -- Larry Klingartner
National Sunflower Association

2:30 1996 Planning Prices and Costs --
Dick Shane, SD Cooperative Extension Service

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