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Spring Cattle Market Review

Matthew Diersen

South Dakota State University, Matthew.Diersen@SDSTATE.EDU

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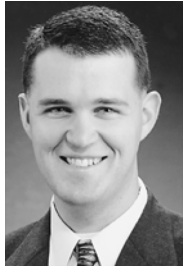


ECONOMICS COMMENTATOR

South Dakota State University

No. 474

May 4, 2006



SPRING CATTLE MARKET REVIEW

by

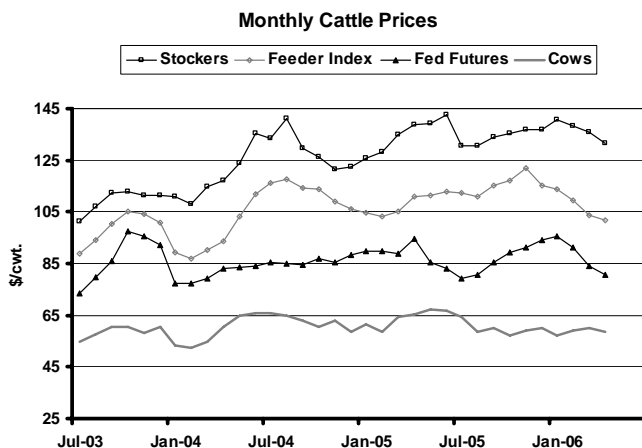
Matthew A. Diersen

Associate Professor/Extension Specialist

A variety of fundamental factors influence cattle prices over time. Likewise, input price changes can also affect returns to cattle operations. The purpose of this *Commentator* is to summarize various changes to cattle prices, input costs, and how they in turn affect risk management strategies. This effort is a synthesis of information covered in monthly "Cattle Market Review" summaries posted on-line, price outlook presentations, and market segments produced for *Today's Ag*.¹

Cash prices for stocker cattle, feeder cattle, and fed cattle declined sharply in recent months (figure 1). The price for cull cows remained steady. The decline disappointed producers that fed cattle during the past few months expecting larger returns.

Figure 1.



Sources: CME, USDA-AMS, & SDSU

In addition to the drop in cash prices, there was a sharp decline in futures prices, limiting the desirable price levels from earlier in the year. The futures prices from late January and late April show the large relative declines for the more nearby live cattle contracts (table 1).

Table 1. Select Futures Price Levels (\$/cwt.)

Contract	January 20	April 21
Live Cattle		
April	94.12	81.40
August	85.67	76.63
December	89.55	82.03
Feeder Cattle		
May	112.50	102.25
August	113.17	103.65
November	111.00	102.00

Source: Chicago Mercantile Exchange

Price Situation

The February *Cattle on Feed* report had an annual breakdown of capacity, activity by feedlot size, and activity for small feedlots (less than 1,000 head). Feeder cattle prices continue to stay at levels generally higher than price levels where most producers pencil out a profit. Capacity in 2006 of large feedlots is 16.8 million head, up from 16.6 million head in 2004 and 2005. The additional capacity will likely continue to pressure feeding margins.

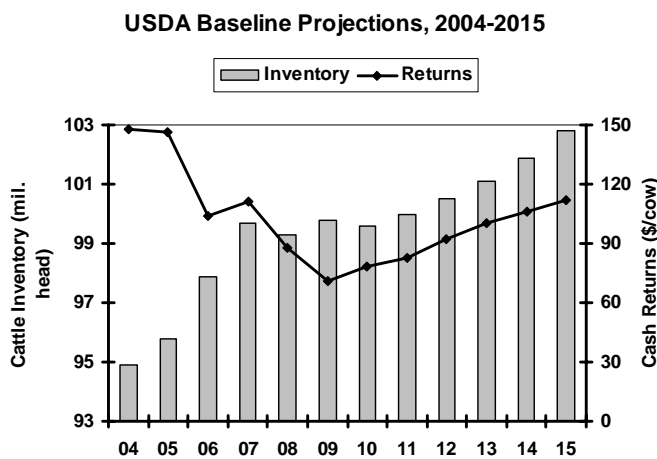
In the April *Cattle on Feed* report, bearish news continued as placements were at the high end and marketings at the low end of trade expectations. While the heifer mix is lower than in 2005, the absolute number of heifers on feed went up. This suggests expansion has curtailed, pressuring prices until fall. The end result is a continued pattern of on feed totals above last year and the five-year average.

In eastern South Dakota producers are talking about high prices for light feeders. The sellers are

pleased, while buyers looking for cattle to graze are not excited, especially in the face of higher rental rates for pasture. There is also talk that anything heavy has been discounted. Across the Dakotas in recent weeks the average sale prices for different weight feeder cattle show a relatively steep price slide, confirming demand for grass cattle and a reluctance to pay much for heavy feeders destined for a crowded feedlot setting.

Related to the 2006 inventory levels are the USDA baseline projections. USDA expects a sharp increase in cattle inventory levels in 2007, followed by a short period of stability, and then continued expansion (figure 2). As the inventory levels increase they will reduce returns to cow-calf producers. Eventually, as export markets resume and the general price level increases, returns will grow also.

Figure 2.



Source: OCE-2006-1, February 2006

Much of the recent market analysis has focused on Avian Influenza and its potential influence on the various markets. At the trade level this was covered in *Livestock and Poultry: World Markets and Trade*, a report typically issued twice a year by the Foreign Agricultural Service. A web link for that report can be found on the Economic Research Service Cattle page. The report gives a breakdown of inventory levels, production amounts, and consumption amounts for cattle, hogs, and poultry.

One way to use detailed trade information is to assess the impact of “news” and put it in perspective. For example, the per capita consumption of beef is given

for major consuming countries. As an international publication, the consumption is given in kilograms per person. The BSE impacts from 2003 can be seen by comparing the U.S. and Canada. Consumption in the U.S. dipped in 2003, while consumption in Canada increased relative to the surrounding years. Losing the export markets of Japan and South Korea was accompanied by lower consumption in those countries. Regaining access to those markets is important as they could significantly increase consumption to reach recently observed levels.

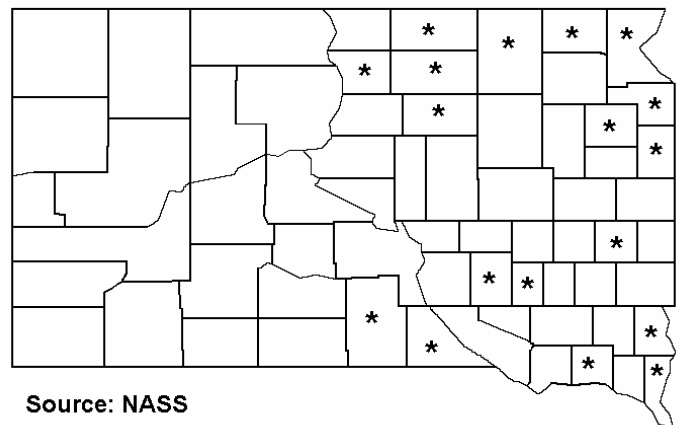
Input Prices

On the input side several grazing fees and pasture rents were released for 2006. The Agricultural Marketing Service (AMS) reported grazing fees for southwestern South Dakota in report labeled TO_LS150.ⁱⁱ The fees are unchanged from last year; mostly \$20-25 per month for cow-calf pairs and \$12-18 per month for yearlings.

NASS released *South Dakota 2006 County Level Land Rents and Values* in April, showing high, low, most-common, and average rental rates for pasture. A large number of counties (starred in figure 3) had an increase of \$5 or more per acre from 2005. The counties are concentrated in the northeast and southeast parts of South Dakota.

Figure 3.

Counties with a \$5 (or greater) per acre increase in the most frequently reported pastureland rent in 2006



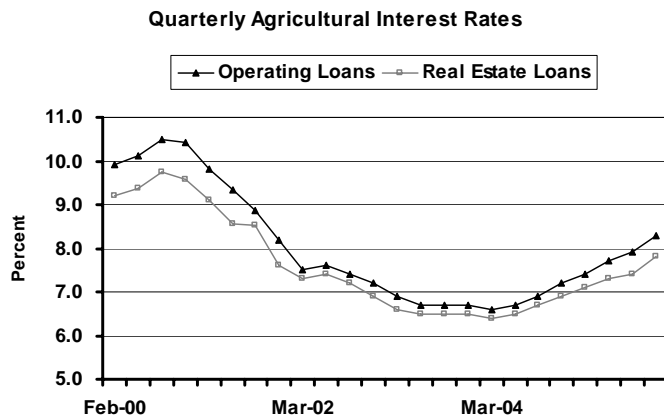
Source: NASS

In the *Prospective Plantings* report, NASS states producers intend to harvest 4.0 million acres of hay in South Dakota in 2006, reflecting no change from harvested acres in 2005. For cattle

producers, hay prices would be expected to be stable for 2006.

Another input is interest. As interest rates increase they reduce the feeding margin (and price) for feeder cattle. Quarterly interest rates for operating and real estate loans have increased since the first quarter of 2004 (figure 4).

Figure 4.



Source: Federal Reserve Bank of Minneapolis

Marketing Tactics

In response to the changing supply situation, feedlots increased the number of head forward contracted to packers. AMS reports weekly volume of fed cattle contracted, a range of basis paid, and average basis in report labeled LM_CT153. The volume contracted is up sharply compared to last year (table 2).

Table 2. Packer-Owned Fed Cattle (Head)

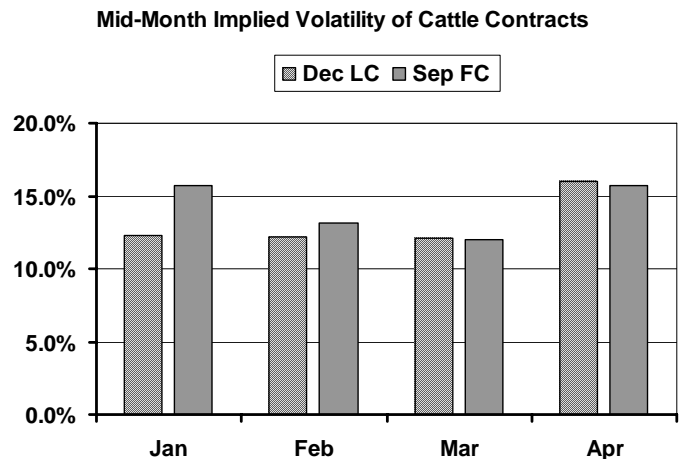
Delivery Month	2005	2006
April	152,245	250,824
May	116,815	153,962
June	110,138	160,194
July	39,488	64,682
August	38,103	55,247
September	20,938	63,619
October	19,983	36,004
November	12,714	38,407
December	19,392	13,773
January	9,951	25,141
February	14,538	5,551
March	2,555	1,500
Total	556,860	868,904

Source: USDA-Agricultural Marketing Service

Various trade disruptions, the new BSE case in Canada, and sharp price declines combined to increase current market volatility or day-to-day price movements of fed and feeder cattle. The same factors carried over into futures and options markets. Thus, the prices for options went up during the past month. One can measure the impact by using the implied volatility (from a hedger's perspective the cost of insurance), which has increased in recent weeks.

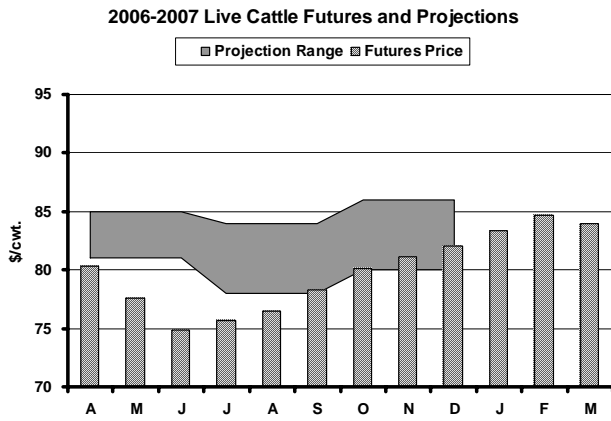
The implied volatility backed out of option premiums observed at mid-month for December live cattle contracts and September feeder cattle contracts show a pattern of volatility dropping from January to March, followed by an increase in April (figure 5). Thus, the cost for an at-the-money option increased for those contract months despite the reduced time value. Coupled with lower price levels for futures, viable floor prices were lowered substantially.

Figure 5.



The latest WASDE and ERS reports did not adjust price projections for fed and feeder cattle, but the futures prices dropped since March. For fed cattle, there may still be some upside price potential for the second quarter of 2006 (figure 6). Note also that the trade has relatively high prices expected for the first quarter of 2007. For feeder cattle the upside remains limited for all of 2006 (figure 7).

Figure 6.



In the monthly “Cattle Market Review” comments I include a special box called “In the Chute”. There I list various upcoming reports and programming opportunities. In the coming months, I expect to highlight the trade situation with Canada and monitor changes in the feed situation as it influences cattle prices.

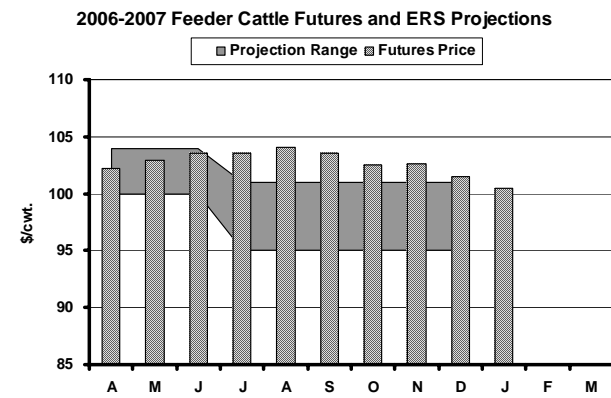
ⁱ The comments are available on the Department website, <http://econ.sdstate.edu/>. *Today’s Ag* airs on SDPTV, Fridays at 9:00 p.m. CT.

ⁱⁱ AMS reports can be found by their number on the AMS website, <http://www.ams.usda.gov/>.

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Department of Economics <http://econ.sdstate.edu>
 South Dakota State University Phone: 605-688-4141
 Box 504 Scobey Hall Fax: 605-688-6386
 Brookings, SD 57007-0895 E-Mail: Penny_Stover@sdstate.edu
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Figure 7.



SOUTH DAKOTA STATE UNIVERSITY
 Department of Economics
 Box 504
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