IS THE CATTLE MARKET TOO CAUTIOUS?

The beef industry was stung by two negative events in the past two months that have left market traders uncertain about their longer term impacts. For now, market participants are taking a cautious approach until consumers more clearly define if they will reduce beef consumption.

The issue over lean finely textured beef (LFTB) played badly for cattle producers in early March and the fourth BSE cow found in the U.S. was announced on April 24. Finished cattle prices were about $129 per live hundredweight in early March before these news events, but have since declined to about $120. The decline in cash cattle prices has not been as severe as the drop in live cattle futures. At the start of March, June 2012 live cattle futures settled near $128, but declined about $15 to $113 as of April 27. In a similar manner, the December 2012 live cattle futures have declined by about $12 per hundredweight since the first of March.

The much larger decrease in futures prices as compared to cash prices could be signaling that futures participants have over-responded to the fears of the negative impacts on beef demand of these two events. There of course can be other possible explanations such as the possibility that futures markets were just too bullish on cattle prices in early March. This argument would suggest that the excess optimism had to be taken out of the futures with prices forced to drop more than cash. Regardless, the recent declines are coming off of record high cattle prices, a situation that often does result in a large price correction when the upward momentum is broken.

Most in the cattle market are cautious. That means they are watching cash cattle prices closely for any indications of demand losses. Since LFTB was primarily taken out of hamburger, this should have reduced the supply of beef, specifically hamburger. That impact by itself would have increased overall beef prices assuming demand stayed constant. Of course demand may have also decreased and that would have been a price dampening factor. Many market analysts believe that the discovery of another BSE cow should not have any lasting impacts on domestic beef demand because it was atypical (naturally occurring), was only the fourth discovered in the U.S., and posed no
health risk to humans. However, it is not what analysts think that counts, but how consumers react that determines prices.

The April 2012 BSE cow should not affect beef trade since tolerance levels have been established. However, we will watch the reactions of South Korean beef consumers most closely for any protest or pushback against U.S. beef. Consumers there have been the most difficult to convince of the safety of U.S. beef, so they may be the most discriminating this time as well.

Market participants are also cautious because these two negative demand impacts occurred close together in time. The combined impact may be bigger than the impact of each event if separated by more time. Some consumers may not have changed beef consumption if just the LFTB event had occurred, but when they hear two negatives against beef in a short time they might change consumption behavior. Probably a final reason to be cautious is the worry that, “the other shoe is going to fall.” This simply means that a third negative event could have even larger impacts. That might include something like finding another BSE cow in the U.S. herd that increased concerns of a larger problem.

On the positive side of these two negative events for the cattle industry is the fact that beef supplies will continue to be very small this year, with U.S. beef production down four percent. So far this year, the number of head slaughtered has been down five percent with total production down somewhat over three percent. The recent decline in cattle prices may also discourage some cattle producers from expanding the herd at this time. Cow and heifer slaughter has remained high in 2012, adding credibility to the argument that expansion has not begun, at least not in any major way.

Finished cattle prices averaged about $125 in the first quarter. Current live futures prices are suggesting that the second quarter will only average about $117, followed by $114 in the third quarter and $119 in the final quarter this year. Those prices seem excessively low and futures traders seem to be extra cautious to the tune of $3 to $5 per hundredweight.

If no new negative events arise for the cattle industry, one can at least make the argument that forward prices are too depressed right now. However, the market is cautious for legitimate reasons. Time will tell if price recovery is in the future or if the cautious marketplace turns out to be the correct opinion.

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