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Beef Supply Will Tighten In 2011

THE amount of beef available on the U.S. market on a per capita basis will tighten again in 2011, as it has done for many years. The supply (known as disappearance) will be an estimated 58.1 lbs per person, the smallest supply since 1952. That's because domestic production might be down as much as 2.5% on last year, while exports and imports will be close to 2010 levels. The disappearance number also reflects a population increase. A breakdown of overall production reveals a contrasting picture. Fed beef supplies are likely to be slightly larger than a year ago into the third quarter but might decline sharply in the fourth quarter. Manufacturing beef supplies are likely to be in even shorter supply throughout 2011 than in 2010.

The biggest decline might be seen in domestic lean beef supplies if cow slaughter declines as much as analysts forecast it will. Imported beef supplies might also remain at last year's levels if Australia's catastrophic floods disrupt its beef exports in the first quarter. Australia's strong dollar against the U.S. dollar in large part caused Australian beef shipments to the U.S. to fall 26% in 2010 from 2009. This factor will likely continue to limit its shipments in 2011.

Estimates of 2011 beef production vary from a low of 25.762 billion lbs (USDA's latest forecast) to 26 billion lbs. USDA estimate would put production down 2.5% on 2010's 26.413 billion lbs, while the latter would put production down 1%. Analysts' estimates of quarterly production vary somewhat. All have first quarter production up 1.5-2%. Some have second quarter production up nearly 2% while others have it down 1.7%. All have third quarter production down, by 1-2%. The biggest decline will come in the fourth quarter, with a likely 5-6% year-on-year reduction.

Even more important is that disappearance will be 58.1 lbs per capita, versus 59.7 lbs in 2010 and 61.1 lbs in 2009. USDA forecasts that exports in 2011 will be flat at 2.300 billion lbs (2.303 billion lbs in 2010) and that imports will total 2.445 billion lbs ((2.331 billion lbs in 2010). Private analysts have higher export and lower import estimates, suggesting the U.S. will be a net beef exporter in 2011. If this is the case, available per capita supplies will be even lower than USDA's latest forecast.

Chicken Will Fill The Protein Hole

Chicken is poised to fill the protein hole left by declining beef and pork supplies. USDA forecasts that pork production will be 22.566 billion lbs, up 100M lbs from 2010. Per capita supplies though will fall to 46.9 lbs from 47.8 lbs. It forecasts that broiler production will be 36.851 billion lbs, up 394M lbs from 2010. Per capita supplies will increase to 83.4 lbs from 82.8 lbs. Consumers will eat less red meat and poultry in 2011 than in 2010 because of the overall decline in available supplies. USDA forecasts that total disappearance will be 206.8 lbs per person, versus 209.4 lbs in 2010 and 210.6 lbs in 2009. This would be the fifth consecutive year of declines and the smallest supply since 1997.

The decline in the meat supply has been driven largely by red ink caused by high feed costs, says the University of Missouri's Ron Plain. Taking corn from $2 to $5 per bushel has caused a downsizing of the nation's herds. Unfortunately, costs of gain are likely to be record high this year. The key to how high cattle and hog prices will rise this year is what happens with meat demand, he says. As the beef industry continually produces less beef each year, consumers necessarily will eat less beef and prices will rise, says the University of Nebraska's Darrell Mark. Although it depends on the relative quantity and price changes and the elasticity of demand, this will likely translate to a decrease in beef demand. Further, higher beef prices could cause consumers to shift away from beef to poultry. While this isn't a certain outcome yet, the stage appears to be set for this to play out, he says.

Ground Beef Will Be Key Driver

GROUND beef looks set to be the key price driver in the beef complex in 2011. That's because ground beef in various forms accounts for nearly 50% of all beef disappearance at retail and foodservice. But manufacturing beef supplies will be even tighter this year than in 2010. The battle will intensify between retail and foodservice buyers for this beef, say analysts. Fed beef supplies look like being equal to last year into the third quarter. The only possible decline in beef production in the first half of the year will come in non-fed beef, they say.

That's assuming that cow slaughter throughout the year is smaller than in 2010. If this occurs, more fed beef primal cuts (chucks, rounds and sirloins) will go into the grinder. Ground beef from these three cuts already set a record in terms of the percentage of all ground beef sales in 2010. Another factor is whether Australian exports to the U.S. will recover after declining sharply last year. Devastating floods have temporarily halted most beef processing and all exports from Queensland. But exports might rebound in a few weeks time, say reports.

Ground beef will lead the complex because that's where the shortage will be, says Mike Sands, Informa Economics. Imported 90CL beef will sell at record levels. The industry will put more primal cuts through the grinder out of necessity, he says. Last week's market reinforced Sands' points. Lean manufacturing beef was in extremely short supply and Australian 90CL boneless beef sold Wednesday at a record $2.01 per lb after talk about floods disrupting Australia's production, says Graeme Goodsir, Graeme Goodsir & Associates. But the Queensland government expects beef production to rebound within weeks after floods recede, to exploit current high prices. This though is subject to transport logistics being restored, he says.

Cow slaughter in 2010 was 6.437M head, up 4.8% from 2009. This unexpected increase helped offset the 295M lbs decline (from 2009) in beef imports. USDA forecasts that imports will increase 114M lbs from last year to 2.445 billion lbs. But analysts say cow slaughter might be down more than 8%, to 5.9M head. Overall lean beef supplies in 2010 were down from 2009 because of the import decline, say analysts. They will fall again this year to their lowest level since 1999. If the industry wants consumers to eat the same amount of ground beef this year than last year, it will have to pull cuts from the fed beef supply. Ground chuck, ground round and ground sirloin accounted for a record 34% of total ground beef sales in 2010. This compared to 31% in 2009 and 26-29% in preceding years. The nine blended categories from ground 73s to 93s accounted for the other 66% of all ground beef sales.

The increased use of primal grinds has narrowed the price spread between them and blended grinds. The widest spreads were in 2004, 2005 and 2006. Some of the narrowest spreads have occurred in the three years since then. For example, ground sirloin had a $1.02 per lb premium to ground 81 CL in 2007 but a $0.72 premium in 2010. Retailers consider primal grinds to be a premium product but better value than blended ground beef, say analysts. So they will sell a bigger percentage of ground beef from primal cuts. Retailers will raise their ground beef prices soon to reflect record high wholesale prices and because consumers will absorb such price increases better than the expected increases on more expensive beef cuts. If there isn't an increase in lean beef imports this year, current wholesale prices for all grinds will appear to be cheap, say analysts.

Packers Will Trim Saturday Kills

PACKERS will likely trim their Saturday kills this year if and when numbers of fed and non-fed cattle tighten. Several years of declines in beef cattle numbers have already forced packers to adjust to running their plants differently than in the past. Packers no longer predicate their capacities based on operating 5.5 or 6 days per week. They look to operate at close to maximum levels Monday through Friday, with a Saturday kill that varies in size according to market conditions.

This means the ongoing decline in North American cattle numbers is unlikely to result in any slaughter plant closures in the coming year. The sector has slight over-capacity but nothing like the 30% over-capacity in the cattle feeding sector. Saturday kills historically averaged 40,000 head or more. But they declined drastically in 2009 due to the recession and its impact on domestic beef demand and beef exports. Saturday kills in 2009, excluding holiday weeks, totaled 932,623 head, an average of 20,274 head. Including holiday weeks, they totaled 1,251,888 head for an average 23,620 head per week.

Last year saw a significant increase in Saturday kills because steer and heifer slaughter was larger and cow slaughter was much larger than in 2009. Overall federally inspected slaughter in 2010 was 2.9% larger than in 2009. Saturday kills last year, excluding holiday weeks, totaled 1,098,031 head, an average of 24,400 head. Including holiday weeks, they totaled 1,430,500 head for an average 27,510 head per week. This was 20.4% higher and 14.3% higher than in 2009 for, respectively, non-holiday Saturdays and all Saturdays. Putting it another way, Saturday kills in non-holiday weeks were 165,408 head larger than in 2009 and 178,612 head larger in all weeks. This was despite 2010 having one less Saturday than in 2009. The smallest non-holiday Saturday kill last year was on Feb 13 (5766 head) while the largest was on Aug 21 (43,005 head).

Cow Killers Will Adjust Hours

Steer and heifer slaughter is expected to remain similar to last year well into the third quarter. But non-fed slaughter, notably of beef cows, might decline as much as 8-9% from last year's elevated levels. So Saturday kills might revert to 2009 levels as the year progresses. Many cow slaughter operations ran extended hours in 2010 to take advantage of the large cull cow offering and stronger than expected wholesale prices for manufacturing beef. If cull cow numbers decline this year, processors will eliminate their Saturday kill and reduce their other shifts from 10 to 8 hours if necessary, they say. Fed cattle processors also have the flexibility to kill only a few cattle on Saturdays and run two full daily shifts in their plants during the week.

Packers will attempt to raise boxed beef prices to offset higher cattle costs. But if live cattle prices average $110 per cwt, they would need an average blended cutout of $180 per cwt, says Mike Sands, Informa Economics. Both prices seem unlikely to be as high as this, as they would impact retail and foodservice beef sales.

Packers will continue to rely on record high by-product values to make money. Values (for a butt branded steer) averaged $10.75 per cwt in 2010, versus $7.66 in 2009. They could set a new annual record this year, says Jim Robb, Livestock Marketing Information Center. Values set a new weekly record of $12.42 pert cwt the week before last and looked set to set another record close to $12.50 last week.

National Has Record First Quarter

NATIONAL Beef Packing Co., Kansas City, Mo., reports net income of $54.5M for its fiscal 2011 first quarter ended Nov 27. This was a record for the quarter and exceeded last year's record $41.265M. National prior to that had lost money in five successive first quarters. National's record earnings came despite a 15.3% increase in live cattle prices in the quarter, versus the prior year's quarter. That's because its average sales price per head increased 14.3% and it processed 4% more cattle than a year earlier. Sales for the quarter were $1.587 billion versus $1.343 billion, an increase of $244.7M or 18.2%. Demand for beef products was stronger in the quarter compared to the year earlier quarter, says National. Operating income for the quarter was $56.8M versus $46.2M.

National's net income of $54.5M implies a net margin of around $54 per head. This far exceeds analysts' calculations of packer margins for those three months and suggests that current packer margins might not be as negative as reported. It also confirms that National's per head margins are larger than those of other large packers.

National’s record first quarter followed a record $248M in net income in fiscal 2010, which meant a net margin of more than $60 per head.

National anticipates that fed cattle supplies will remain above prior year levels through the winter quarter, it says. This follows active late summer placements and favorable cattle feeding conditions through the fall. The anticipated greater supplies and heavier weights should contribute to gains in beef production compared to the prior year. Beyond the first calendar quarter, it expects fed cattle supplies to tighten following placement of cattle with more diverse placement weights and the continuing calf crop decline.

Larger cow and bull slaughter during 2010 continues to imply herd liquidation and the trend of smaller cattle supplies into the coming years, it says. While the cattle supply may appear negative to its operation, recent beef demand, supported by beef export tonnage near that of pre-BSE levels and encouraging domestic economic conditions, appears positive. Absent significant deterioration in domestic and global economic conditions, it expects cattle and beef prices to remain strong throughout 2011, it says.

Cattle On Feed: Analysts' Forecasts

David Anderson, Texas A&M University: COF 105.0%, placed 110.0%, marketed 103.6%;

Andrew Gottschalk, HedgersEdge.com: COF 104.7%, placed 114.9%, marketed 106.9%;

Ron Plain, University of Missouri: COF 104.9%, placed 112.0%, marketed 103.0%;

Lori Porter, Drake Trading Group: COF 104.5%, placed 116.6%, marketed 105.2%;

Bob Price, North America Risk Management Services: COF 103.8%, placed 111.6%, marketed 104.7%;

Jim Robb, Livestock Marketing Information Center: COF 103.3%, placed 108.9%, marketed 106.0%;

Shawn Walter, Professional Cattle Consultants: COF 103.8%, placed 108.9%, marketed 103.3%.

Red-Hot Futures Drive Cash Higher

CASH live cattle prices move higher as the futures market catches fire and puts in new life of contract highs. Futures prices have been driving the cash market for the past six weeks despite fundamentals that suggest futures and cash prices should move lower. Trade began first in Kansas Thursday morning at $108 per cwt, $2.75 higher than the bulk of the trade there the previous Tuesday. That’s also $2 higher than the 2010 highs in Kansas on December 29. Cash prices were expected to be even higher in Texas, where cattle feeders turned down bids under $110.

The rally was a stunning reminder of the power of commodity funds to fuel markets to levels that bear little reality with the fundamentals, say analysts. Current supply-demand factors suggest lower not higher cattle prices. These include: 5-6% more cattle on feed January 1 than a year ago (as will be seen in this Friday’s Cattle on Feed report); a front-end supply (cattle on feed 120 days or more) that will be progressively larger than a year ago into April; carcass weights well above year ago levels (up 11 lbs the last week of 2010 versus the same week a year earlier); the approach of the weakest two demand months of the year, February and March.

The futures are suffering another case of irrational exuberance, similar to what occurred in 2008, say analysts. Oil appears to be leading the commodity charge. But fund buyers and others also appear to be equating rising corn futures prices with live cattle prices. This ignores the fact that, for packers to be able to afford cattle at higher prices, they have to sell the beef at higher prices. Yet strong price resistance to higher boxed beef prices was setting in late last week.

Cash live cattle were expected last week to be steady at best. But the futures went up Monday and up even more sharply Tuesday and Wednesday (with new contract highs for all contracts). Thursday saw the February contract ease slightly. But its $109.90 per cwt close was still up 353 points from the previous Friday. The April contract Thursday closed at $114.45, up 390 points. Other months put in new contract highs again.

It is difficult to see how cash prices can sustain these levels, given the fundamentals, say analysts. Beef sales do not start picking up until mid-April. Moreover, the high wholesale prices through December and so far this month (the Choice cutout was at $169.00 per cwt last Thursday, up $2.70 in five days) have yet to show up in grocery stores. Retailers might start raising prices and feature beef less in February, the weakest demand month of the year, say analysts. Retail features last week were conspicuous by their focus on beef roasts, with few ground beef ads, and on much cheaper pork and chicken items.

Meanwhile, cattle feeders face even higher corn prices this year, based on USDA's latest crop report. USDA raised its estimate of the average price $0.10 per bushel to $4.90-5.70. This was after it reduced this year's corn production to 12.447 billion bushels, a 67M bushel decline from its December report. It based the decline on a lower yield of 152.8 bushels per acre, down 1.5 bushels from December. USDA reduced its feed/residual use by 100M bushels but it increased ethanol use by the same amount and made no changes in corn exports.

This meant that corn ending stocks are an estimated 745M bushels, down from USDA's previous estimate of 832M bushels. The stock-to-use ratio declined to only 5.6%. That's against a historical average of 15% and is the lowest ratio since 1995-96. Corn futures prices rallied sharply after the report. The May and July contracts each closed above $6.50 per bushel Thursday. Prices set new contract highs, exceeding the highs of the previous day. USDA's forecast of a feed use decline came despite it raising its forecast of 2011 U.S. meat and poultry production by 50M lbs from its December forecast.