

**Subject:** Cattle Markets

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## **Why Cattle Markets are Having a Cow**

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Cattle prices are on the hoof lately. But don't just blame Ben Bernanke.

There are plenty of other places to point the finger if you want to assess responsibility for record livestock prices. You can start with wrongheaded U.S. energy policy, tightfisted herders and soaring food demand.

Like so many other commodity markets, cattle have been in full trot since the Federal Reserve said in November it would loosen the money supply to keep the economy crawling along. Futures prices for live cattle, the ones being fattened up for slaughter, hit an all-time high last month after rising by nearly a third over the past year, and the action in cash markets has been every bit as wild.

This has been a dramatic rise in the last few months," said Paul Engler, who runs Cactus Feeders, an Amarillo, Texas-based cattle feeder.

The Fed's monetary laxity is surely a contributing factor, though it is far from the only one. Prices for all agricultural goods have been screaming higher over the past year, as demand from fast-growing developing countries threatens to overwhelm supplies that aren't growing nearly as fast.

With incomes rising throughout developing Asia, in particular, the draw on food crops has grown intense. Among the biggest price gains have come in corn and soybeans, both used as livestock feed, which is in great demand as emerging

markets consumers clamor for protein. That trend is only expected to intensify in coming years.

"Almost no one can envision a reversal of the tight supply situation," said Glynn Tonsor, who teaches agricultural economics at Kansas State.

Meanwhile, the cow herd has been thinning out. U.S. beef production rose 1% last year, but the U.S. cattle herd shrank last year to 92.6 million cows, down 10% since 1996 and marking its lowest level since 1958. Beef output shrank last year in Argentina, Australia and Canada.

That means rising beef prices as far as the eye can see, in all likelihood. Retail beef prices rose 3% last year and have risen 10% since 2006, the government says.

But more increases are coming, thanks to the late-year surge in cattle prices. McDonald's (MCD), for instance, recently said it will raise prices this year.

"We are going to see higher prices facing consumers," said Tonsor.

Higher prices should spell good news for the U.S. beef industry, whose exports rose 18% last year. U.S. ranchers should field robust overseas demand for years if they can get their act together.

Not too volatile, usually

But the industry finds itself at a crossroads thanks to years of underinvestment and what looks like a permanent shift in agricultural markets.

"The beef industry was built on cheap grain, but we aren't going to have cheap grain anymore," said Derrell Peel, an agricultural economist at Oklahoma State. "We're at critically low inventory levels, and the industry is either going to have to rebuild the herd or face losing market share."

Though farmers often respond to surging commodity prices by growing more of whatever is in demand, expanding a cattle herd is a bit more complicated than planting more corn.

Cows are born one at a time, unlike pigs or chickens, and take two years from birth to enter the beef herd. Record high prices can slow that process even further by pushing farmers to sell now rather than holding cows off to the side

to produce more calves.

"That's just the biology of this industry," said Peel. "There is always the dilemma between breeding and feeding."

Raising cattle is also more land intensive than farming chicken or pigs. Cattle producers thus find their decisions complicated by factors like surging land prices -- and by America's insane embrace of corn-based ethanol as a motor fuel.

Amber waves

The government's ethanol subsidy has taken millions of acres out of feed production and put it into inefficient biofuel production, right at a time when global food demand was lifting off. The "ethanol juggernaut" is part of what's behind the near tripling of corn prices since 2006, Peel says.

You'd think that development might send a signal to Washington that what it's doing isn't working, but you'd be wrong. The government recently cleared the use of cars that use fuel containing half again as much ethanol as previously permitted. With oil prices rising under the same global demand pressures felt by agriculture, there is no sign of relief for the rising prices on grains.

Peel says the agricultural repricing is forcing farmers and others to re-examine the economics of decisions that had looked settled for years, when prices were lower -- such as where to grow grain and where to feed cattle.

Still, if all these factors seem to be pushing irresistibly toward higher and higher prices, it's worth considering an alternative, just for form's sake.

Tonsor notes the threat, however unlikely, of a health-related beef scare. Take the 2003 outbreak of bovine spongiform encephalopathy that devastated beef exports in Washington state for several years, for instance. There's nothing like a disease outbreak to curb what looks like unstoppable demand.

"Everything looks like these prices are just going to go up," Tonsor said. "But I think we've heard that one before."