# A Look into the Future of the Cattle Industry

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Weather, cattle supplies, beef demand, prospects of herd expansion (or the lack thereof), and similar issues currently dominate many industry conversations. Some clarity and signals for the future may appear in the closely watched January Cattle report, released February 1. However, the future of the cattle industry can best be understood when considered against the backdrop of the unique beef cattle market situation that has developed.

**Economic Outlook Overview: Cow-Calf**

The Livestock Marketing Information Center (LMIC) estimates cow-calf returns over cash costs (including pasture rent) based on typical production and marketing practices in the Southern Plains. The estimated numbers are designed to serve as a barometer for returns, thus actual returns may vary considerably, especially in drought years like 2011 (Southwest) and 2012 (nationally).

Over time, cow-calf returns have varied dramatically and years of positive and negative returns tend to be in clusters. The most recent negative return year was in 2009 (-$32 per cow). In the last 29 years of LMIC estimates, seven years (24%) had negative returns, with only two of those years posting losses greater than $75 per cow (1984 and 1996). Over that same timeframe, seven years had positive returns of over $75 per cow (1987, 1990, 1991, 2003, 2004, 2005, and 2011). In early spring 2012, projections called for 2012 returns of greater than $200 per cow which may have been enough profitability to entice a cautious and slow expansion of the nation's beef cattle industry. However, the 2012 drought and resulting high cost of feed significantly lowered estimates ($57 per cow) and inevitably delayed expansion of the beef cattle herd.

Looking forward, preliminary forecasts for 2013 suggest returns may set a new record high (exceeding the $150 per cow returns in 2004), as the uptrend in calf and cull animal sale prices are forecasted to out-pace production cost increases.

**Economic Outlook Overview: Stocker**

Current conditions open up more stocker production possibilities in terms of a wider range of beginning weights and heavier ending weights. A feeder cattle price pattern exists with the increasingly familiar bent shape reflecting sharp price decreases from calves to middleweights, and then smaller price decreases from middleweights to heavy feeders. In addition, larger increases in prices for lighter-weight feeder cattle relative to heavier feeder cattle has caused a larger spread that narrows the profit margin when feeding lightweights to heavier weights. There may be opportunities to purchase middleweight feeder cattle and market them heavier than normal and not be squeezed by the price slide.

The reality of high corn prices will continue to be reflected in feeder cattle prices as the market signals to add weight to cattle prior to feedlot placement. The extent to which this is a good market opportunity will depend on the cost of production. Even with relatively expensive feed costs, a cost of production under the value of gain may be possible. Information from the feeder cattle futures market combined with basis forecasts can be utilized to garner value of gain projections to help guide retained ownership and backgrounding decisions. Currently, there are some historically high values of gain, which are expected to remain given projections. Of course these projections do not take into consideration costs of adding additional weight and producers will need to compare that to the values of gain. The likelihood of lower values of gain in 2013 is difficult to forecast, but will be greatly impacted by what the corn market does this next year.

**Economic Outlook Overview: Feedlot**

The feedlot sector continues to have excess capacity concerns. The drought improved this in the short-run as calves and feeders showed up on the market sooner than they would have otherwise. However, this makes the situation even worse down the road as the longer the industry delays building the herd and holding back heifers, the greater the issue of tight feeder cattle supplies will be in the future. Basically, there is fixed amount of bunk space available while the calf crop and the associated feeder cattle supply are dwindling. This particular mismatch continues to be a pinch point for the feedlot industry.

Cattle feeders have seen margins continue to tighten. Data from the Iowa State University Estimated Returns for finishing yearling steers estimates net returns for closeouts in December at -$64.60 per head. While less extreme than the past few months, these significantly negative returns remain largely due to elevated feed prices and placement costs relative to fed cattle prices. Computed cattle "crush" margins (http://www.econ.iastate.edu/margins/) based on futures market prices suggests returns will improve in coming months reflecting lower placement costs and increased sales prices. After June, profitability may not return until January of 2014 if the current futures prices for cattle and corn prove to be a true prediction.

Forecasts call for a 4 to 6 percent pull-down in commercial slaughter in 2013 and repeated again in 2014. This may be partially offset by higher carcass weights, but not enough to offset the reduction in the number of animals. Year-to-date, the higher than normal two percent increase in carcass weights comes in part as packers have tried to manage box-beef supplies in light of decreasing slaughter levels. Overall, expectations call for a net reduction in beef production in total and per capita in 2013 and 2014.

**Cattle Herd Status**

As the beef cattle industry moves into 2013, some things about the cattle supply are becoming clearer and some are still uncertain. What is clear is that two more years of liquidation have put the industry in an even tighter supply situation. The 2013 U.S. calf crop is likely to be the smallest since 1942. What is unclear is the persistence of the drought. Continued drought will moderate the short-run effect by provoking more liquidation and postponing heifer retention. If drought conditions improve, herd inventories will stabilize and some heifer retention may begin in 2013. Any herd expansion will likely be led by those with lower than average costs of production given their ability to bid more for favorable breeding stock. This also reflects Kansas State University based research findings of profitability differences across cow-calf operations to be primarily driven by cost rather than revenue differentials.

**Beef Demand**

While there is general agreement on tight supply fundamentals in 2013 and 2014, there is less certainty regarding beef demand. A quarterly *All Fresh* beef demand index maintained at Kansas State University indicates year-over-year gains in demand for 8 of the 9 quarters ending in September 2012. As per capita supplies are reduced to historically low levels in coming years, the willingness of some U.S. consumers to pay likely record high retail beef prices is paramount to monitor. The combination of higher prices and reduced per capita supplies will likely be met by more requests for beef quality and associated requirements for additional investment and management adjustments.

**Summary for Cow-Calf Producers**

The entire U.S. cattle industry is in the middle of several structural changes outlined above and in the associated presentation. These adjustments coupled with issues more external to the industry are effectively increasing the overall uncertainty of profitability for producers. This increased uncertainty will be welcomed by some producers who in turn may choose to expand their herds in coming years. Conversely, other producers uncomfortable with this uncertainty or facing favorable alternatives to cow-calf production will stabilize or further reduce their herds. The net impacts of these adjustments will dictate the collective make-up of the U.S. cow-calf industry for years to come.

Related and updated information is regularly available at: Iowa Farm Outlook & News (http://www.econ.iastate.edu/ifo/), Iowa State University Ag Decision Maker (http://www.extension.iastate.edu/agdm/), and Kansas State University Ag Manager.info (http://www.agmanager.info/).