Make Informed Decisions

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# Connecting Beef Demand and Cattle Prices

When attempting to forecast or guess where cattle prices are going, the focus is usually on supply. Inventories and cattle on feed provide guidance as to cattle supplies and likely slaughter. From there estimations of price are attempted. Supply only tells half the story on cattle prices. This article looks at the importance of demand in determining cattle prices.

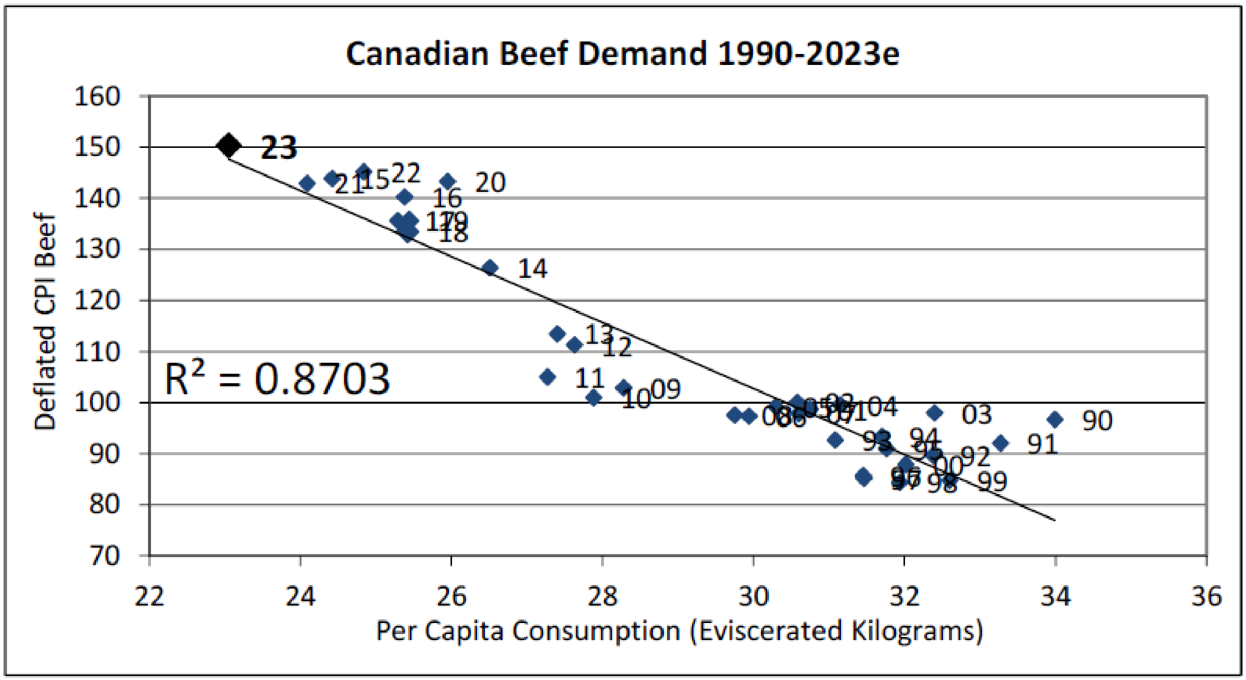
Statistics Canada recently released its annual per capita consumption data for 2023. Beef per capita consumption fell by nearly 2 kilograms to hit 23.05 kilograms on a carcass basis. That is the lowest on the StatsCan records and is about half the total of the mid-1970's. The other record that was set last year was the price of beef. The StatsCan Consumer Price Index for beef was the highest on record, even on a deflated basis. In other words, even taking out the effects of overall inflation, real beef prices were still a record by a wide margin.

## Solid Canadian Demand in 2023

Demand is more than just consumption. It is the combination of consumption and price. Multiplying price and consumption gets you close to a beef demand estimate. Combining consumption and price in any given year and comparing to other years can give a picture of demand. Using that methodology, beef demand declined in 2023 compared to 2022. Nevertheless, despite that decline, beef demand in 2023 was among the strongest years since 1990. In fact, beef demand in Canada has been very robust since about 2014. In other words, Canada has seen about ten years of solid beef demand performance.

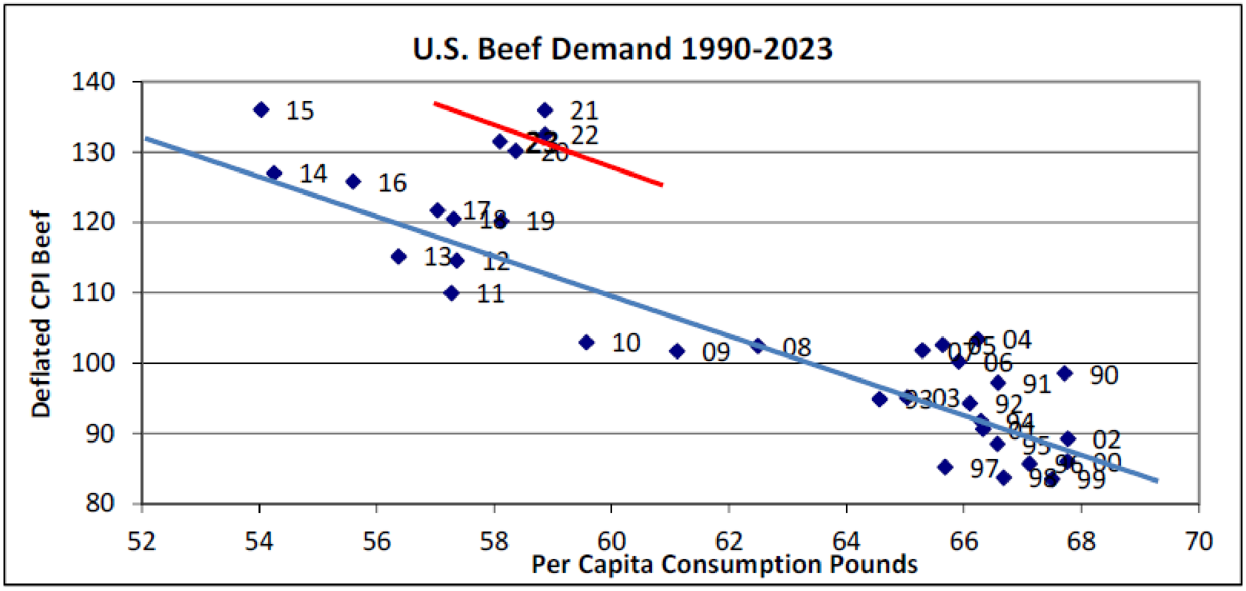
Another point of interest is that Canadian beef demand has been relatively stable. The higher the price the less Canadians eat and the lower the price the more we eat. Conversely the lower the supply available per person, the higher the price and vice versa.

As seen on the graph below, Canadian beef demand has exhibited a classic economic relationship of consumption responding predictably to price. There has been a very glaring and obvious beef price and consumption relationship in Canada. As a general statement, beef demand in Canada has been steady for about thirty-five years. Within that broad context, over the last ten years, beef demand has been better than the previous 25 years.




## Outstanding U.S. Demand

In the United States beef demand was rock solid from 1990 through 2019. From 2020 through 2023, beef demand hit a whole new level. Unlike Canada where higher prices mean lower consumption, in the U.S. higher prices in the past four years was met with increased consumption. That means that unlike Canada which has seen steady demand, the U.S. has seen increased demand. That is seen graphically as a shift in the demand curve to the right. On the graph below, the blue demand curve represents 1990-2019 and the red demand curve represents 2020-2023.




## Where to From Here?

Industry participants can be certain about very few things in the market. One thing that appears certain is that production will be down this year. Large carcass weights will only partially offset reduced slaughter in 2024. In addition, production will be down next year compared to this year's lower tonnage. That forecast is based on inventories and inventory trends. Lower inventories of cattle now mean lower slaughter later. So, there is a level of confidence on the supply side. Demand is another question.

The summary point of the demand discussion above is that beef demand has been excellent in the United States and in Canada (but to a lesser extent) over the past four years through 2023. U.S. beef demand has been excellent this year so far as well. Beef prices in the United States hit record levels in April. Despite record high beef prices total dollars spent on beef are up materially according to anecdotal and other data sources. That means the demand is holding again in 2024 in both Canada and the United States. This excellent demand performance is despite high interest rates, record high gas prices, soaring inflation and spiraling housing costs.

The summary point is that based on current production and trade trends as well as consumer price trends, full year 2024 U.S. demand will be outstanding. It will belong on the new level red demand curve as shown above.

## Demand is Topping Out

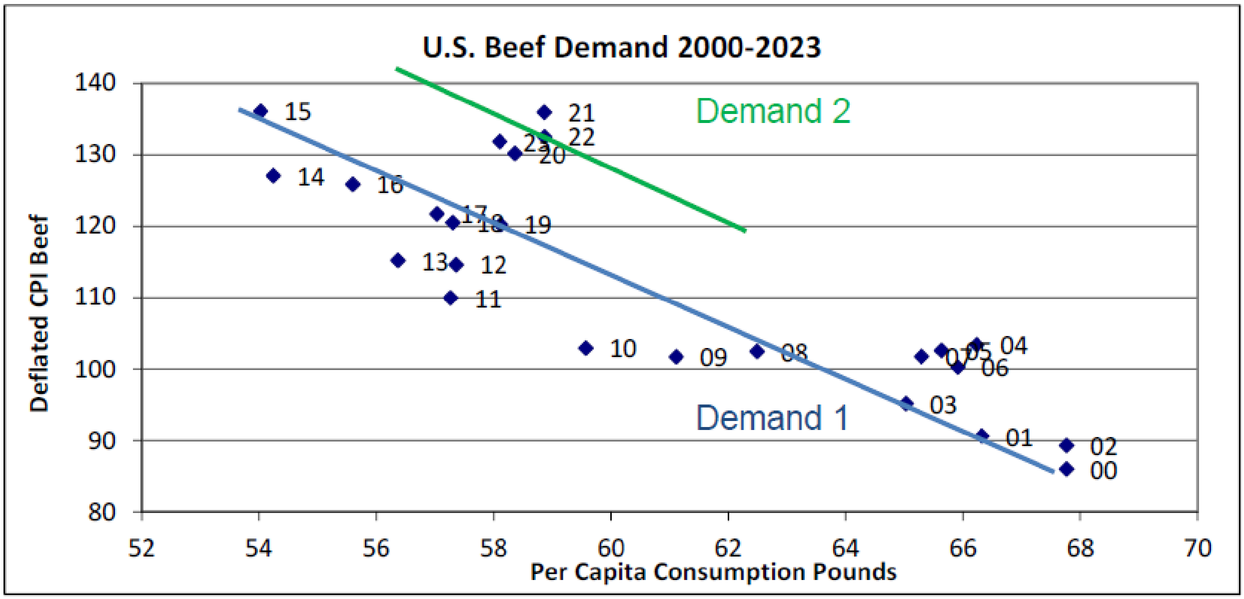
With those positive demand points noted, it would not be prudent to assume that demand will be better than current levels. In other words, demand is unlikely to move to an even higher level. The reason for that statement is that consumer resistance to higher prices is having a market impact.

- Consumers are switching to lower priced meats, particularly chicken.
- Higher end branded beef product movement is slowing.
- More and more of the carcass is going to grinds.
- Grocers and restaurants are switching to AA and Select to lower costs.
- An unusual share of beef is being sold on feature as consumers balk at paying regular prices.
- More and more beef in the meat case and on the flyer comes from Mexico and Australia.
- Menus are moving to lower priced beef items.

Prudence suggests that demand stays at these excellent levels in 2024 and 2025; it neither increases or decreases from the outstanding levels of 2020-2023. What that means for cattle and beef prices in 2025 will depend on a variety of plausible outcomes, such as plant closures.

## Another Look at the Next Level Demand

As noted above, U.S. demand went to a whole other level in 2020-2023. Take another look at U.S. consumer beef demand on the graph below. On the graph below, U.S. beef demand from 2000 to 2019 was at demand level 1 as shown on the blue line. At D1 from 2000-2019, consumption and price behaved just as could logically be expected. On D1, the higher the price, the less Americans ate, and the lower the price the more they ate. Another way to look at it is that on D1, the less that was available, the higher the price and the more that was available, the lower the price. From 2020-2023, however, demand jumped to level 2 on the green line. Consumers ate more beef even though prices were higher. This is increased beef demand compared to D1 2000-2019.

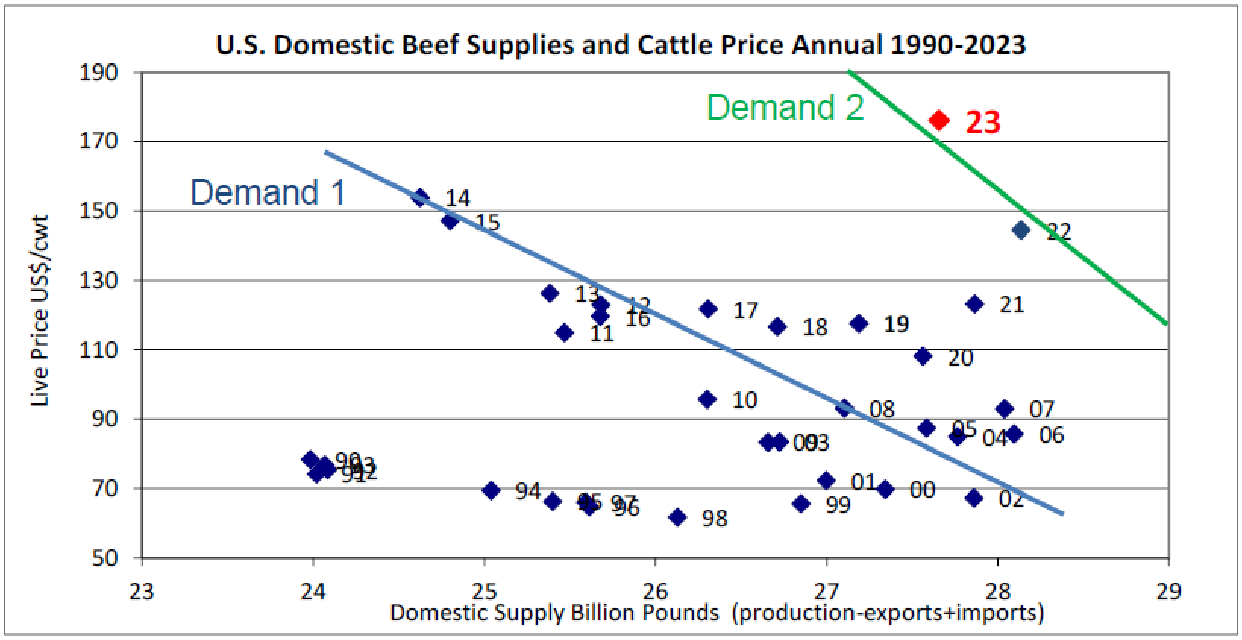



## Strong Demand Supported Higher Cattle Prices

Improved levels of consumer demand have helped to drive beef cutout and cattle prices higher than they otherwise would have been in 2020-2023. The graph below shows annual U.S. beef domestic availability (production plus net imports) and annual live cattle prices. The level of beef demand that held sway from 2000 to 2019, is represented as “Demand 1” on the graph below. That is the level of consumer demand that corresponds to D1 on the graph above. Consider that last year, U.S. beef domestic availability was about 27-28 billion pounds. At D1 on the graph below, beef availability in the 27-28 billion pound in 2000-2019 range would have meant live prices of about $90+-/cwt.

As noted on the first graph above, beef demand in the last few years has improved to a whole new and stronger level, Demand 2. That new level is shown on the graph below as “Demand 2.” Beef availability in the 27–28-billion-pound range can generate a 2023 average cattle price of $176. That would not have been possible without the demand surge of the last few years.

In 2024, production is likely to fall short of 2023 by about 2%. Based on pricing performance so far combined with my forecasts for the second half, live prices in 2024 will likely average $186, about $10 more than last year. The 2024 annual cattle average of $186 is consistent with Demand 2 on the graph above.




In 2025, production is almost certain to decline again. Futures are suggesting that prices could average about $190. My own first half 2025 forecast is for $192-194 which is more bullish than the futures.

## Plant Closures?

The only way that $190 or higher can be achieved, however, is if the cutout rises much more than it has this year. Packers have been deeply in the red almost every week this year, notwithstanding the current breather in the black. JBS reported first quarter 2024 beef profits of $11 million on the heels of a fourth quarter loss of $141 million. Tyson reported calendar Q1 2024 loss of $35 million after losing $200 and over $300 in the 3rd and 4th quarters of 2023. The point is that unless the cutout allows for positive packer margins, then plants will begin to close in 2025. As David Hales said in his June 17 newsletter, "it appears to us the race to close some slaughter plant or plants is just about to start..."

If one or more plant closes, the chance of getting to $190 next year diminishes.

## What Cutout Level is Needed?

What cutout value would be necessary to generate black ink if the live price in 2025 is going to get to $190? Prior to the Tyson Finney County plant fire of 2019 and prior to the COVID lock downs of 2020-2022, the cutout generally was about 65% higher than the live price, on average. That sort of ratio, along with the by-products would generated typical or normal margins for packers. During the 2019-2022 period when packer margins soared, the cutout averaged 105% more than the live price. In 2022 it was 127% more than the live price. Those were, as noted often, phenomenal years for packer margins.

So far this year, the choice cutout has averaged about $301, and the five area has averaged about $184. That puts the cutout at 64% more than the live price. That is like the pre-lockdown relationship. That means that the live and cutout relationship is back to normal! Despite that, this relationship has generated serious red ink for packers in 2024. The trouble now is that operating costs have soared in the post-COVID lockdown period. Some plants have seen operating costs up by 50% or 75% between pre and post COVID. Instead of a 2024 cutout average of $301, it is likely that the cutout would need to be $325 to generate a half decent margin with a $184 live. That is just a back of the envelop estimate.

If the 2025 live is going to be able to hit $190, what cutout is needed to generate a packer margin with some black? The same back of the envelop method suggests the cutout would need to average at least $335 perhaps $340. The highest annual average was $299 in 2023. That $299 in 2023 was a year of unsustainable poor packer margins.

## How to Get There?

The cutout has trended to that $335 level or higher in the past few years, but only temporarily. To generate sustainable black ink and forego possible plant closures, the cutout needs to stay at those levels for the better part of the year. That is if the live is going to stay at $190 or more.

There are three ways that need to combine next year to get the cutout to that $335+ level.

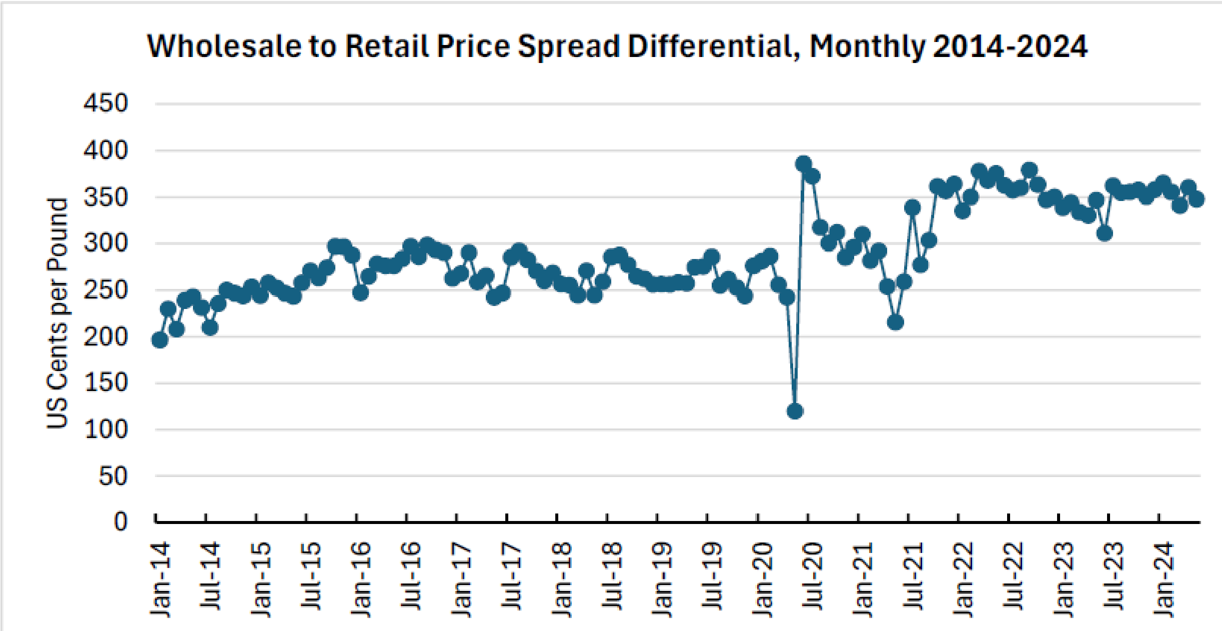
1. Demand stays at current very high levels.
2. Ground beef trimmings drive the cutout.
3. Retail margins narrow.

As noted in the last report, it is not reasonable to expect that consumer demand go to another new better level. A new higher level would mean that consumers not only pay higher prices, but they also pay more and eat more. That might happen, and if it did, this discussion would be academic. It is more realistic to expect/hope that current excellent demand holds as is.

It is not probable that the cutout rises in 2025 based on strong middle meat demand. Those rib and loin cut prices at retail are already out of reach of most consumers unless they are on feature. Even when they are features, the movement is disappointing. Instead, what needs to propel the cutout to $335 is hamburger. Consumers are trading down to ground beef. Retailers and restaurants can and will keep hammering away on hamburgers and ground beef features. More importantly, there is room for those retail and menu prices to increase. That demand will propel the fed cattle end meat prices as they head to the grinder. The chuck and the hip can continue to carry the cutout to $335.

## Tighter Retail Margin Needed

Lastly, retailers are going to have to take a margin cut if the cutout is going to hit an average of more than $335. Consumer prices are already very high. It is not likely that the product will move well is retailers keep passing on the cutout increases. As with packers, retailer costs have increased in the post-lockdown period. With that acknowledged, the price spread differential between the cutout value and the retail value, on a retail equivalent basis have increased notably in the last few years. An argument can be made that the retail margin can and will absorb some of the run-up to $335+.




Those three points that need to happen are entirely possible. If they do happen, then $190 or more is also possible. If not, then as David Hales says, "the race to close some slaughter plant or plants is just about to start..."

A version of this note first appeared in two recent editions of the Canadian Cattle Market Report. If you would like a free three-month trial email kevin@kevingrier.com

Kevin Grier, July 2024

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