Beef Industry May Now Shine in 2007

August 2006 Chris Hurt

The outlook for the cattle industry has brightened in recent weeks with the opening of beef exports to Japan, a larger than anticipated U.S. corn crop and an improved outlook for the general economy with slower growth but moderating inflationary pressures.

Beef supplies this year have been up about six percent yet prices are only off three percent. Cattle price prospects have improved with the opening of the Japanese market and it now appears that the average price for Nebraska live steers in 2006 will be near $86, only $1.30 under last year's record.

Shipments to Japan will be slower to recover than many hope. This is because the entire supply gap left by the non-importation of U.S. beef was covered by larger beef imports from other countries and by larger pork and broiler imports. The re-opening of Japan to U.S. beef means that U.S. beef must now take-away that consumption from someone else.

There is little expansion in the brood cow herd and this year's calf crop is only expected to grow by .3 percent. This along with strong finished cattle prices will keep calf and feeder cattle prices high as well. Steer calves weighing 500 to 550 pounds at Oklahoma City are expected to average about $120 to $125 this fall with heifers around $110 to $115 per hundred. Eastern Corn Belt calves tend to be $3 to $4 lower.

The Numbers

The cattle expansion remains slow. In the mid-year *Cattle* report, USDA indicated that the total inventory was 105.7 million head, just one percent greater than last year at this time. The calf crop for 2006 is estimated at 37.9 million head fractionally higher than last year.

The beef industry is in the second year of a brood cow expansion, but so far the growth is very moderate. Beef cow numbers reached their cycle low in July 2004 at 33.4 million head. This summer's inventory of 33.8 million head represents just slightly over a one percent expansion in the past two years. So clearly, there is no rush to expand brood cow numbers. In addition, producers' report they do not intended to increase cow numbers in the near future as they are retaining the same number of beef replacement heifers as last year. Thus they are replacing cull cows, but are not likely to expand in the coming year.

Dairy cow numbers were up one percent and replacement milk heifers were also up nearly three percent. This seems to be signaling interest in growing the dairy herd in the coming year, even in the face of $12 to $13 milk prices for the remainder of this year and into 2007.

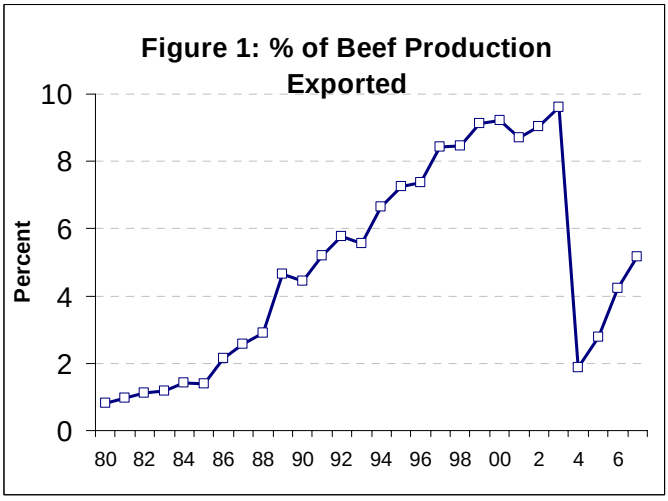
The bearish surprise in the mid-year inventory report came as a much higher level of June placements than expected. Given the dismal financial performance for feedlot cattle so far this summer, there was an anticipation that placements would be down about one percent. However, USDA reports June placements rising ten percent above year-previous figures. High June placements were followed by a 17 percent surge in July placements leaving the on-feed number up seven percent on August 1.

The large placement surge was made on lightweight calves. June placements less than 700 pounds were up 31 percent and up 32 percent in July. On the other hand, calves over 700 pounds were actually down five percent in June, but up five percent in July. The location of the large lightweight calf placements is related to ongoing dry weather in the southern, central and northern plains. Colorado placements were up 35 percent in June and 36 percent in July, those in Nebraska were up 28 percent in June and Texas was down four percent in June, but up 32 percent in July. The advantage for market prices of large light-weight placements is that their slaughter dates tend to get scattered more than when a surge of heavy-weight cattle go on-feed.

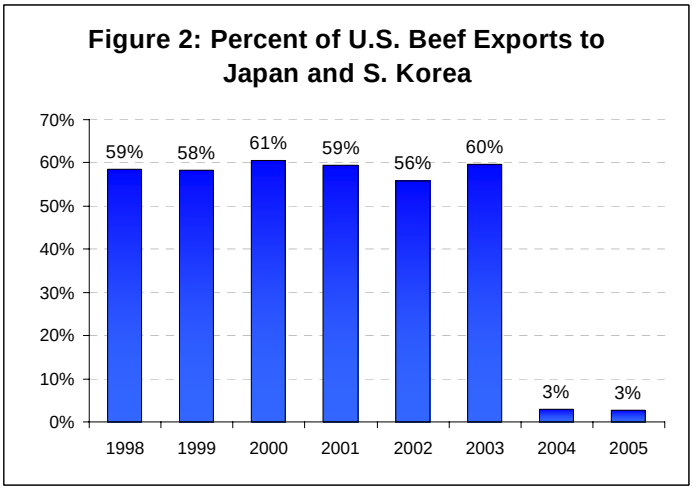
Dry weather has been a detriment to keeping cows and calves on pasture this summer. Pastures have just been too dry to support calves, and thus they have moved to feedlots earlier than intended. In USDA's *Crop Progress* report released August 14, Colorado pastures were rated 60 percent in "poor" or "very poor" condition. These same numbers stood at 80 percent for Oklahoma, 78 percent in Texas, 70 percent in Nebraska, 74 percent in South Dakota, and 58 percent in Kansas.

Japan Opening

The importance of opening the beef export market to Japan on July 27, 2006 was welcomed, but their purchase volumes still remain uncertain. Futures market participants seemed to anticipate sizable shipments as futures rose as much as $5 per hundredweight in the two weeks after the announcement. This may be overly optimistic however.



For perspective, all U.S. beef exports reached nearly ten percent of production in 2003, progressing from about two percent in the mid-1980s. After the announcement of U.S. B.S.E. on December 23, 2003, exports plunged back to two percent of production in 2004 as shown in Figure 1. The loss of the Asian market was the big blow as shown in Figure 2. Exports to Japan and South Korea combined were 60 percent of total U.S. exports in 2003.



How quickly will exports to Japan and South Korea recover? An important point is that as of this writing in mid-August 2006, a South Korean agreement to accept U.S. beef still had not been worked out. There is considerable pressure from members of Congress and the beef industry to formalize this agreement, but it is an indicator that the U.S. probably will not regain those markets quickly.

The recovery will take a number of years and thus be much slower than the beef industry would hope. The reasons lie in how Japan adapted after the loss of U.S. beef imports after 2003. In 2003, the U.S. shipped about 900 million pounds of beef to Japan. In 2004, when the U.S. shipped very little beef to Japan, their beef imports were only down about 450 million pounds, and then down only 250 million pounds in 2006 compared to 2003. The point is that Japan was able to buy beef from other exporters to cover about one-half of the U.S. export shortfall in 2004 and about 70 percent of the shortfall by 2006. Secondly, Japan increased imports of pork by 150 million pounds from 2003 to 2006 and broiler meat by 90 million pounds. Thus the shortfall of about 250 million pounds of beef was covered by the added pork and broiler imports. In addition, it is likely that seafood consumption also increased somewhat to help fill the animal protein gap left by U.S. beef.

Export data for beef to Japan will be watched closely for indications of the volumes that we will be able to sell there. USDA's estimates are modest with beef exports of 1.1 billion this year rising to 1.4 billion next year. This increase will represent about 1.7 percent of domestic production, and should improve finished cattle prices by about $2 to $3 over what they would have been in the absence of market opening. While the impression in the marketplace seems to have been that price increases would be more robust, the final impact will be determined by actual volumes we are able to sell.

Supplies and Prices

So far this year, beef supplies have been up almost six percent on four percent higher slaughter and two percent higher weights. Choice steer prices have averaged about $84.50, roughly $2.50 lower than during the same period in 2005. Overall, demand has held well this year with supplies six percent higher and prices only down three percent.

Finished cattle prices have likely already seen their summer lows in the higher $70s. The summer quarter is expected to average around $84 with prices moving upward to near $90 for the average price in the last quarter of the year. If these prices hold, 2006 prices

will average about $86 on Nebraska live steers. This is just $1.30 lower than the record prices of 2005 at $87.18, (see the Table at the end of this section).

What about 2007? While this year's calf crop is estimated as only fractionally higher, weights will likely be up some for next year, however not as much as this year due to higher feed costs and higher interest rates, see Table 4. For 2007, beef production is expected to be up about two percent in the first-half of the year, and then a similar amount in the last-half. With growing exports, this means that prices could be as high, or even somewhat higher than 2006. First-quarter choice steer prices are expected to average in the lower $90s with second quarter prices in the $84 to $88 range.

Feeder cattle and calf prices may feel some downward price pressure this fall and in 2007 with higher feed costs and modestly higher interest rates. Prices in the first-half of 2006 for 500 to 550 pound steer calves at Oklahoma City averaged $131 per hundred compared with $123 in the first-half of 2005. My forecast for this fall is for these calves to be about $120 to $125 per hundred compared to $130 last fall.

Heifer calves are expected to be about $110 to $115 per hundred this fall compared to $125 in the fall of 2005. Prices and quantities are shown below and in Table 5.

		Beef Production		Cattle Prices ($/cwt.)			
			%Change	Finished	450-500#	500-550#	750-800#
Year	Qtr.	Mill. #'s	Year-Ago	Steers	Heifers	Steers	FeederSteers
2004	I	5,838	-7.1%	$82.16	$103.57	$111.50	$87.98
	II	6,253	-9.4%	$88.15	$116.47	$122.45	$104.58
	III	6,360	-10.2%	$83.58	$123.51	$129.12	$116.27
	IV	6,097	2.1%	$85.09	$112.94	$125.13	$110.19
	Year	**24,548**	**-6.4%**	**$84.75**	**$114.12**	**$122.05**	**$104.76**
2005	I	5,725	-1.9%	$89.09	$122.70	$129.75	$104.09
	II	6,189	-1.0%	$87.96	$124.70	$136.05	$113.36
	III	6,560	3.1%	$81.41	$124.40	$131.48	$111.50
	IV	6,209	1.8%	$90.27	$125.09	$131.46	$114.84
	Year	**24,683**	**0.5%**	**$87.18**	**$124.22**	**$132.19**	**$110.95**
2006	I	6,078	6.2%	$89.24	$127.42	$132.18	$106.23
	II	6,700	8.3%	$80.39	$123.02	$130.39	$104.08
	III	7,069	7.8%	$84.05	$112.78	$119.72	$103.88
	IV	6,443	3.8%	$89.78	$111.78	$120.25	$104.95
	Year	**26,290**	**6.5%**	**$85.87**	**$118.75**	**$125.64**	**$104.79**
2007	I	6,264	3.1%	$91.60	$121.04	$128.63	$102.87
	II	6,762	0.9%	$86.31	$116.13	$122.51	$101.77

More detail can be found in Table 5

Implications

The beef cattle cycle is in the first two years of an expansion phase. However, the number of brood cows has only expanded one percent so far, and a small number of retained heifers indicate little growth in cow numbers into 2007. In addition, the opening of the Japanese market will improve demand for exports and South Korea should also open their market in coming months as well. Added to these positive factors is a slower growing U.S. economy, but one which may also see moderating inflationary pressures, thus suggesting a bit better general economic environment for beef and meat demand. Large corn and soybean crops have also delayed the concern about increases in feed costs, specifically corn and sorghum prices.

The high level of placements into feedlots this summer remain a concern for the short-run as these animals come to market in the late winter and next spring. Feed prices will be watched closely. Corn supplies will be abundant this fall, and livestock users should consider owning all the cash inventory they can. This fall is likely the last of the "cheap corn" perhaps for years to come. Futures and basis levels are both depressed as elevators are struggling with logistics of storing large carryover inventories from past years as well as above trend yields from this year's crop. However, by the spring of 2007, the surplus will be eaten away, and prospects for 2007 corn prices will have to be high enough to encourage large increases in acreage to meet record corn demands. The magnitude of acreage shift to corn in the 2007 crop will still depend upon the size of the 2006 crop and the 06/07 marketing year usage, however, it is not unreasonable to anticipate 5 to 8 million more acres of corn in 2007. Shifts of these magnitudes are currently beyond the "comfort zone" of U.S. producers and thus strong price incentives will be needed. In addition, weather concerns in the spring and summer of 2007 could lead to highly volatile prices and scary days for livestock users.

Less urgency is anticipated for soybean meal. Soybean inventory surpluses are expected to remain large through the summer of 2007. However, sharp reductions in 2007 acreage will mean that weather could also impact soybean meal prices, yet there is an added "supply cushion" that will not exist for corn. Distiller's grains will also be plentiful by the summer of 2007 as new ethanol plants come on-line. Higher supplies of distiller's grains will have a moderating impact on soybean meal prices as well.

Profit levels should remain favorable for brood cow operations for this fall's calf crop and the 2007 crop as well. Dry weather from the Dakota's to Texas mean that beef cow numbers will be unlikely to grow, and could even drop a bit. That large region of drought should also be watched closely. The longer the drought continues the longer cattle prices will remain strong.

Table 1. Cattle Number, 1995 - 2006: Data in 1,000s

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	% Change vs. 2004
All cattle and calves													
January 1	102,785	103,548	101,656	99,744	99,115	98,199	97,298	96,723	96,100	94,888	95,438	97,102	
July 1	113,000	111,600	109,200	107,700	107,000	106,300	105,800	105,100	103,900	103,400	104,500	105,700	1.1%
Beef cows													
January 1	35,190	35,319	34,458	33,885	33,745	33,569	33,397	33,118	32,983	32,861	32,915	33,253	
July 1	36,100	35,700	34,800	34,400	34,150	33,950	33,900	33,750	33,600	33,400	33,750	33,850	0.3%
Milk cows													
January 1	9,482	9,420	9,318	9,199	9,133	9,190	9,183	9,112	9,142	8,990	9,005	9,058	
July 1	9,500	9,400	9,300	9,200	9,150	9,250	9,100	9,150	9,100	9,000	9,050	9,150	1.1%
Heifers 500 lbs. +													
Beef replacement													
January 1	6,452	6,189	6,042	5,764	5,535	5,503	5,588	5,561	5,624	5,518	5,691	5,905	
July 1	5,700	5,500	5,300	5,000	4,800	4,700	4,600	4,600	4,600	4,800	5,000	5,000	0.0%
Milk replacement													
January 1	4,121	4,090	4,058	3,986	4,069	4,000	4,057	4,060	4,114	4,020	4,118	4,278	
July 1	3,900	3,700	3,600	3,600	3,700	3,700	3,600	3,700	3,600	3,600	3,700	3,800	2.7%
Other heifers 500 lbs. +													
January 1	9,302	9,948	10,212	10,051	10,170	10,147	10,131	10,057	9,891	9,806	9,763	9,795	
July 1	8,000	8,100	8,200	8,100	8,100	8,100	8,200	7,900	7,700	7,550	7,500	7,700	2.7%
Steers 500 lbs. +													
January 1	17,513	17,815	17,392	17,189	16,891	16,682	16,441	16,790	16,554	16,277	16,476	16,923	
July 1	15,400	15,100	14,800	14,600	14,400	14,300	14,600	14,500	14,200	14,200	14,400	14,900	3.5%
Bulls 500 lbs. +													
January 1	2,385	2,384	2,350	2,270	2,281	2,293	2,274	2,244	2,248	2,206	2,219	2,263	
July 1	2,400	2,400	2,300	2,200	2,200	2,100	2,100	2,100	2,100	2,050	2,100	2,100	0.0%
All Calves < 500 lbs.													
January 1	18,341	18,384	17,826	17,401	17,290	16,815	16,206	15,763	15,545	15,210	15,250	15,626	
July 1	32,000	31,700	30,900	30,600	30,500	30,200	29,700	29,400	29,000	28,900	29,000	29,200	0.7%
Calf Crop	40,264	39,823	38,961	38,812	38,796	38,631	38,280	38,224	37,903	37,505	37,780	37,900	0.3%

Source: USDA, NASS *Cattle* reports

Table 2: Ratios of Commercial Slaughter Steers and Heifers to Beginning Cattle Inventories, 1995 to 2006

	July 1 Inventory Steers and Heifers 500+[B]	Second Half Steer and Heifer Slaughter	Ratio[C]	Calves < 500 Pounds July 1	First Half Steer and Heifer Slaughter Next Yr	Ratio[C]
	- - - - - -thousand head - - - - - -			- - - -- thousand head - - - -		
1995	23,400	14,554	62.2	32,000	14,742	46.1
1996	23,200	13,831	59.6	31,700	14,680	46.3
1997	23,000	14,861	64.6	30,900	14,446	46.8
1998	22,700	14,447	63.6	30,600	14,794	48.3
1999	22,500	15,001	66.7	30,500	15,159	49.7
2000	22,400	14,942	66.7	30,200	14,351	47.5
2001	22,800	14,607	64.1	29,700	14,502	48.8
2002	22,400	14,859	66.3	29,400	14,526	49.4
2003	21,900	14,207	64.9	29,000	13,579	46.8
2004	21,750	13,420	61.7	28,900	13,243	45.8
2005	21,900	13,779	63.8	29,000	13,861	47.8
2006[A]	22,600	14,577	64.5	29,200	13,958	47.8

[A]Projected for next 12 months

[B]Excluding replacement heifers

[C] Projections based upon estimates

Table 3: Cow Inventory, July 1 and Cow and Bull Slaughter for the Following 12 Months

	Cow Inventory	Cow Slaughter	Ratio Slaughter /Inventory	Bull Slaughter	Ratio Bull Slaughter to Cow Slaughter
	-----thousand head-----			thousand head	
1995	45,600	6,545	14.4	689	10.5
1996	45,100	7,007	15.5	715	10.2
1997	44,100	6,351	14.4	666	10.5
1998	43,600	5,846	13.4	615	10.5
1999	43,300	5,643	13.0	648	11.5
2000	43,200	5,667	13.1	620	10.9
2001	43,000	5,660	13.2	627	11.1
2002	42,900	5,984	13.9	611	10.2
2003	42,700	5,658	13.3	597	10.6
2004	42,400	4,992	11.8	554	11.1
2005	42,800	5,014	11.7	503	10.0
2006[A]	43,000	5,246	12.2	556	10.6

[A] Projected for next 12 months

Table 4. Commercial Beef Slaughter, Production, and Dressed Weights

Year	Slaughter (1,000 hd)	Weight (lb)	Production (lbs)	Slaughter (1,000 hd)	Weight (lb)	Production (lbs)
	----------January-March----------			**----------April-June----------**		
1988	8,575	664	5,696	8,759	660	5,784
1989	8,180	676	5,529	8,694	664	5,777
1990	8,117	678	5,507	8,541	671	5,733
1991	7,858	685	5,383	8,299	686	5,694
1992	8,032	697	5,597	8,255	694	5,726
1993	7,910	677	5,357	8,469	672	5,690
1994	8,162	704	5,745	8,615	701	6,042
1995	8,418	699	5,888	9,053	699	6,325
1996	8,971	703	6,303	9,589	693	6,642
1997	8,912	686	6,112	9,307	690	6,419
1998	8,681	716	6,215	8,995	718	6,461
1999	8,733	733	6,397	9,176	722	6,627
2000	9,005	739	6,653	9,195	729	6,699
2001	8,500	727	6,182	9,033	720	6,501
2002	8,408	758	6,376	9,158	746	6,833
2003	8,352	752	6,282	9,463	729	6,902
2004	7,873	741	5,834	8,530	733	6,254
2005	7,592	754	5,725	8,289	747	6,189
2006	7,840	775	6,078	8,805	761	6,700
2007[A]	8,052	778	6,264	8,862	763	6,762
	----------July-September----------			**----------October-December--------**		
1988	9,199	672	6,186	8,538	653	5,575
1989	8,612	684	5,892	8,430	686	5,785
1990	8,449	688	5,814	8,112	686	5,564
1991	8,453	711	6,012	8,074	707	5,710
1992	8,451	709	5,991	8,122	696	5,654
1993	8,673	701	6,076	8,268	704	5,819
1994	8,825	723	6,377	8,629	709	6,114
1995	9,279	714	6,625	8,890	706	6,277
1996	9,123	700	6,390	8,900	684	6,084
1997	9,300	710	6,603	8,879	705	6,258
1998	9,071	732	6,638	8,737	726	6,339
1999	9,337	733	6,841	8,915	732	6,525
2000	9,256	747	6,914	8,791	741	6,511
2001	8,987	748	6,720	8,844	758	6,700
2002	9,265	766	7,097	8,900	762	6,783
2003	9,542	742	7,081	8,097	738	5,973
2004	8,344	762	6,360	7,978	764	6,096
2005	8,487	773	6,560	8,011	775	6,209
2006[A]	9,110	776	7,069	8,313	775	6,443

[A] Projected for next 12 months

Table 5. Beef, Pork, Poultry Production, Nebraska Steer Prices, and Oklahoma City Feeders by Quarter

		Beef Production	Pork Production	Poultry Production	Nebraska Choice Steer Price	Oklahoma City 450-500 Heifers	Oklahoma City 5-550 Steers	Oklahoma City 750-800 Steers
		----------million pounds----------			----------$/cwt.----------			
1996	I	6,303	4,389	7,880	$63.06	$53.54	$62.12	$58.11
	II	6,642	4,104	7,949	$60.26	$50.24	$59.83	$56.79
	III	6,390	4,143	8,043	$67.35	$56.18	$64.90	$63.29
	IV	6,084	4,449	7,930	$70.39	$57.55	$67.49	$66.15
1997	I	6,107	4,194	7,875	$66.40	$70.64	$81.28	$69.44
	II	6,416	4,091	8,341	$66.63	$81.28	$90.28	$75.88
	III	6,603	4,194	8,275	$65.65	$83.97	$92.65	$80.44
	IV	6,258	4,767	8,259	$66.56	$78.81	$89.90	$78.98
1998	I	6,215	4,687	8,135	$61.73	$81.43	$83.44	$75.49
	II	6,461	4,429	8,316	$64.11	$81.54	$86.71	$74.00
	III	6,638	4,625	8,244	$58.97	$69.11	$74.41	$67.89
	IV	6,339	5,239	8,452	$61.06	$72.67	$79.21	$69.80
1999	I	6,397	4,865	8,501	$62.43	$78.03	$87.35	$71.93
	II	6,627	4,630	8,928	$65.04	$80.49	$89.12	$72.17
	III	6,838	4,672	8,848	$65.12	$82.36	$87.12	$77.57
	IV	6,522	5,110	8,760	$69.65	$85.28	$93.20	$83.87
2000	I	6,653	4,824	8,887	$69.32	$96.90	$106.13	$84.91
	II	6,699	4,478	9,146	$71.59	$96.16	$101.64	$84.76
	III	6,914	4,606	8,934	$65.43	$93.46	$101.80	$86.25
	IV	6,511	5,010	8,929	$72.26	$93.57	$97.97	$88.76
2001	I	6,182	4,805	8,879	$79.11	$100.39	$107.78	$86.82
	II	6,501	4,546	9,369	$76.41	$102.17	$107.22	$89.47
	III	6,723	4,548	9,276	$70.19	$97.06	$103.00	$91.13
	IV	6,700	5,239	9,317	$65.13	$90.75	$98.21	$85.37
2002	I	6,376	4,779	9,240	$70.19	$94.87	$102.35	$81.24
	II	6,833	4,800	9,697	$65.58	$87.47	$91.76	$77.16
	III	7,097	4,832	9,670	$63.29	$81.49	$88.38	$78.87
	IV	6,783	5,255	9,418	$69.10	$84.30	$93.02	$83.08
2003	I	6,282	4,898	9,166	$77.82	$89.79	$97.68	$78.48
	II	6,902	4,741	9,714	$78.49	$92.81	$99.18	$82.49
	III	7,081	4,807	9,857	$83.07	$95.97	$104.33	$94.90
	IV	5,973	5,499	9,663	$99.38	$102.37	$111.23	$103.51
2004	I	5,838	5,130	9,504	$82.16	$103.57	$111.50	$87.98
	II	6,253	4,897	9,858	$88.15	$116.47	$122.45	$104.58
	III	6,360	5,047	10,229	$83.58	$123.51	$129.12	$116.27
	IV	6,097	5,435	9,926	$85.09	$112.94	$125.13	$110.19
2005	I	5,725	5,136	9,891	$89.09	$122.70	$129.75	$104.09
	II	6,189	5,022	10,334	$87.96	$124.70	$136.05	$113.36
	III	6,560	4,999	10,306	$81.41	$124.40	$131.48	$111.50
	IV	6,209	5,510	10,275	$90.27	$125.09	$131.46	$114.84
2006	I	6,078	5,321	10,291	$89.24	$127.42	$132.18	$106.23
	II[P]	6,700	5,000	10,525	$80.39	$123.02	$130.39	$104.08
	III[A]	7,069	5,127	10,410	$84.05	$112.78	$119.72	$103.88
	IV[A]	6,443	5,679	10,395	$89.78	$111.78	$120.25	$104.95
2007	I[A]	6,264	5,319	10,375	$91.60	$121.04	$128.63	$102.87
	II[A]	6,762	5,114	10,675	$86.31	$116.13	$122.51	$101.77

[A]Estimates

*Prices are point estimates, but users should look at a range of possible prices at least in a band that both adds and subtracts the following $/cwt. These are the estimation errors:
Nebraska steers: $2.00/cwt.; 450 to 500# heifers and 500 to 550 # steers: $2.50/cwt.; 750 to 800 # steers: $3.00/cwt.
This range has included about 67% of the prices from the historical price estimates.