MEAT MARKETS
UNDER A MICROSCOPE

A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

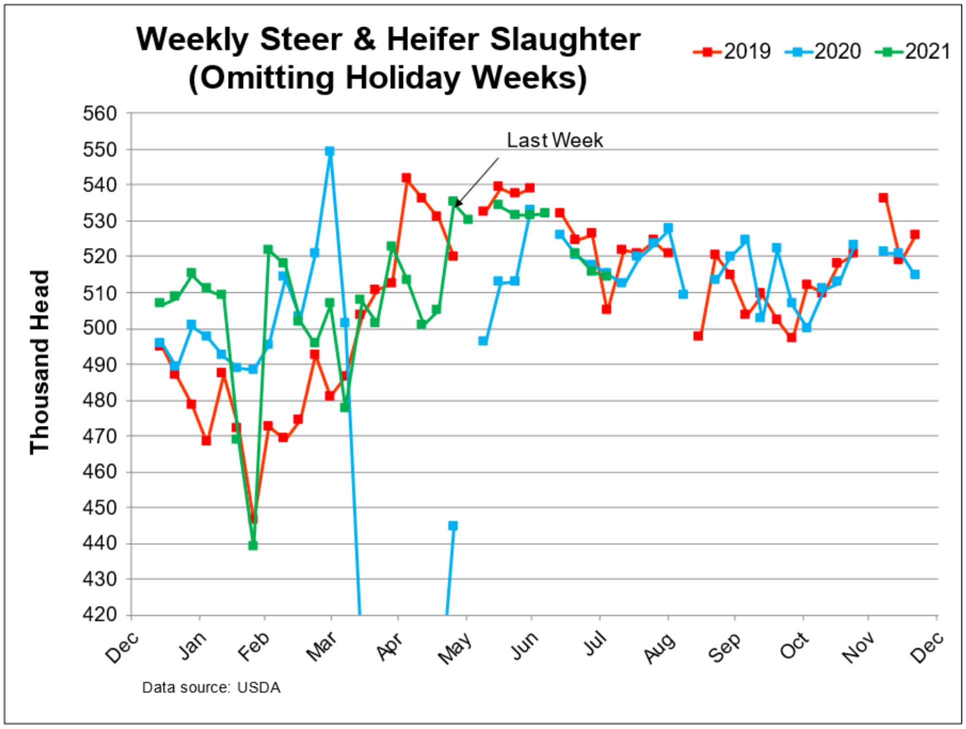
May 23, 2021

There are three primary “margin-type” variables in the beef pricing equation that are unsustainable at current levels: cattle feeding margins (too low); packer margins (too high); and retail margins (too low). One could argue that calf production margins are also unacceptably poor. All of these variables gravitate toward a sustainable equilibrium, though it takes some time to get there—and some take longer than others. And they usually do not all come into balance at the same time.

But as extreme as the circumstances may be, the current case will be no exception. Cattle feeding and retail margins will recover, and packer margins will decline. The relative speed at which these adjustments occur will determine the path of beef prices through the summer. So let’s take a closer look at each.

Since it does not look as though feed costs are coming down any time soon, it’s probably safe to say that cattle feeding margins will improve only via higher cattle prices. In order for cattle prices to go up, packer margins will have to shrink. And in order for *that* to happen, front-end cattle supplies will have to tighten relative to slaughter capacity. Right now, packers do not really have to compete for cattle supplies, and their margins have ballooned. The front-end cattle supply can be reduced by either restricting the flow of feeder cattle into feedlots or by accelerating the outflow of finished cattle. The latter, however, is not a viable option since packing plants (as of this past week) are already operating at full capacity. I’ll return to this subject in a minute. And so the only tool in the cattle feeder’s toolbox right now is to cut placements….which they apparently have only begun to do here in May. Taking into account placements during January-April and projecting typical marketing rates, it looks like the inventory of cattle on feed 150 days or longer will not decline appreciably until August. At the earliest, competition among packers for live cattle will begin to pick up in July; in the meantime, front-end cattle supplies will be abundant, and production will be pushed to the maximum. The economic incentive to run plants as hard as possible has rarely, if ever, been greater.

This past week’s steer and heifer slaughter jumped up to 535,000 this past week, following two surprisingly light weeks at 501,000 and 505,000. It is quite possible that production in the first two weeks of May was smaller than packers had initially planned, and this may have been largely responsible for the last $15 per cwt or so that the combined Choice/Select cutout value gained over the last two weeks. It must have made *some* difference, anyway. It remains to be seen whether or not fed cattle kills can be maintained at 530,000-535,000 week after week through June, considering the severe labor constraints. **The point is that there likely will be more beef pumped into the system than there has been recently**.



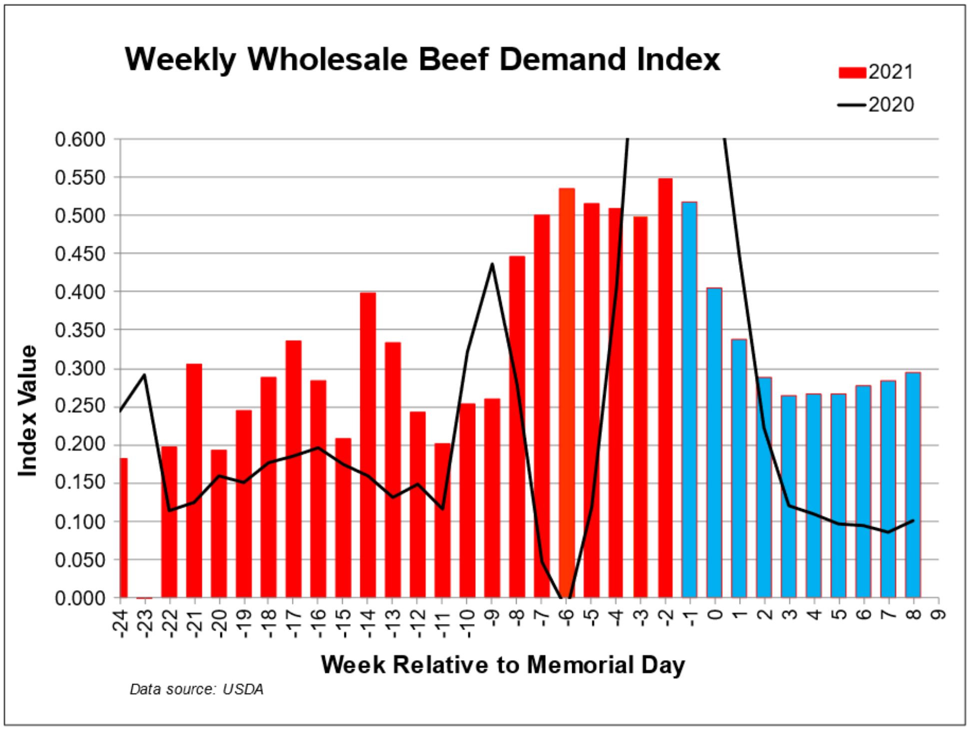
I am assuming as much, as I show in the picture to the left. For what it's worth, fed cattle slaughter in June 2019, when labor was not much of an issue, averaged 537,000 per week; current capacity is surely somewhere below that rate.

The current squeeze on retail margins in the beef category is not as extreme as the wide packer margins, but there is no question that it will draw a reaction from supermarket chains. Among the primary variables listed at the beginning of this report, retail margins are the quickest to be adjusted. They are adjusted, of course, by raising sticker prices and avoiding loss-leaders. Last week I showed you a graph of the spread between wholesale and retail prices, and so I shall not show it again today. **But if typical gross margins are applied to current wholesale prices, then retail prices in June will be *$1.75 per pound higher* than they were in April….which would be a 27% increase in just two months' time.** Do I honestly expect that retail prices will jump that high in June? Not really. But that's where we're headed.

Up to this point, I have been shocked at the market's ability to keep moving product through the pipeline at these higher price levels, which has translated into the magnificent wholesale demand index readings that we have witnessed lately. But then again, it is possible that retail prices have been held down here in May, prior to Memorial Day; we don't know yet. The transition from pre- to post-Memorial Day would be a natural time to implement changes in retail marketing strategies. What I'm suggesting is that a sharp increase in retail beef prices may very well be at the doorstep.

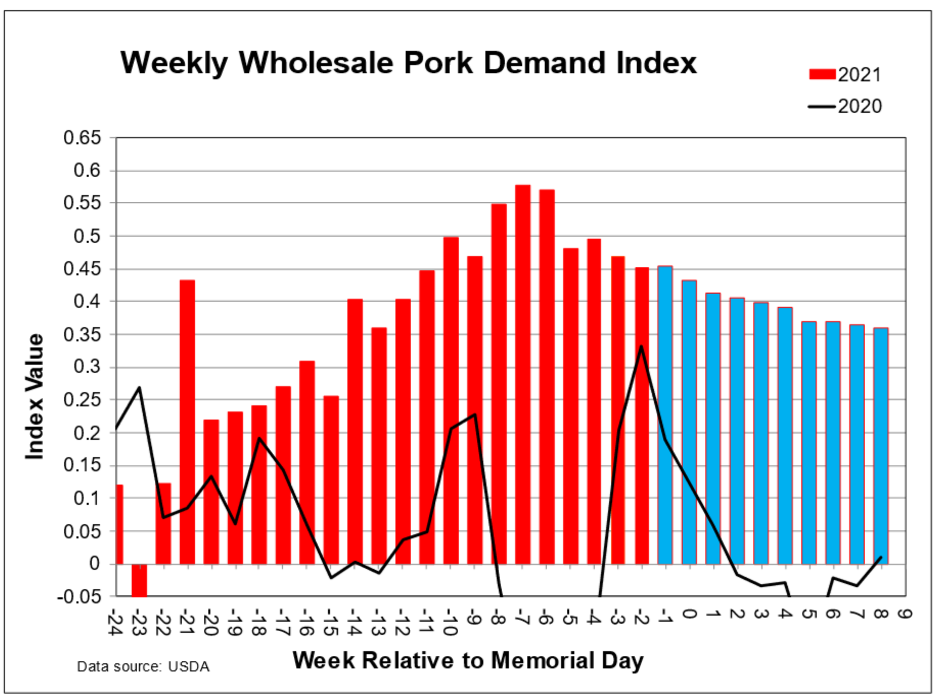
Will consumers greatly increase their spending on meat in the grocery store *from this point forward*? This is what they would have to do if the current rate of demand at the wholesale level is to be maintained. If they do not, then product movement will slow down and wholesale demand will drop. Remember that this would take place while fed beef production presumably remains in a higher gear.

It seems likely that most consumers will be "trading down" in the supermarket in order to stay within the loose boundaries of the household food budget. I mean, there must be *some* limit on what they are willing to pay, isn't there? From this angle, a pullback in the weekly demand index of the sort I am suggesting in the following graph would appear reasonable:

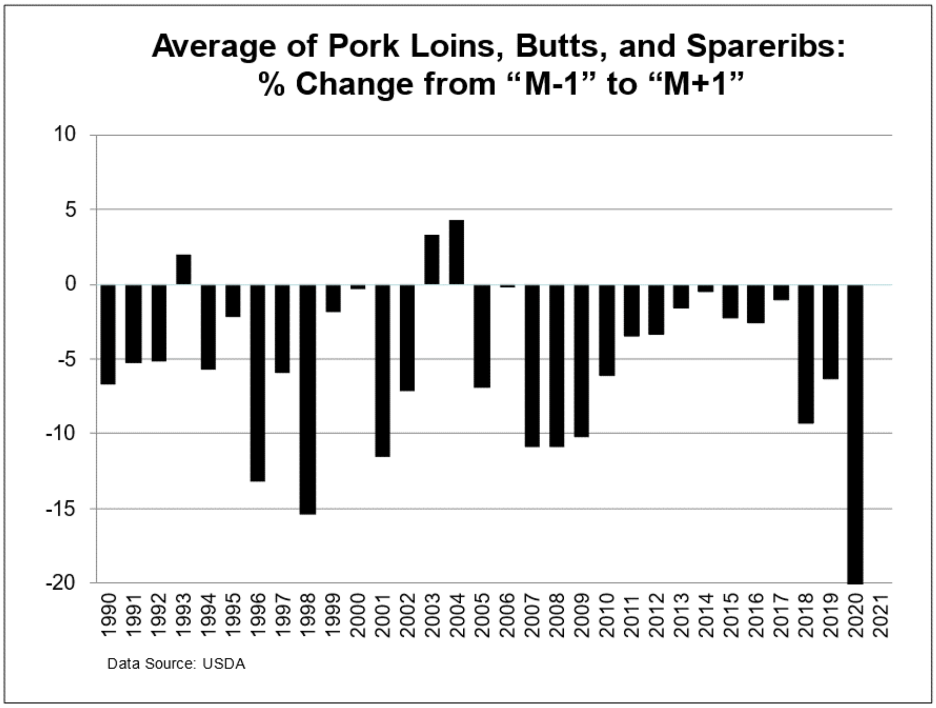


This sort of pattern, combined with weekly steer and heifer kills averaging 532,000 (in the non-holiday weeks) would push the combined cutout value down to $240 per cwt by the end of June….as ridiculous as that may sound.

The "down-trading" among consumers to which I refer should benefit demand for pork loins, butts, and ribs in supermarket channels. I think this has already had a bullish impact on these items here in May. Retail pork prices are going up as well, and probably will be increasing further after Memorial Day; but compared with prices of steak cuts and even chuck and round cuts, they will not be perceived as quite so expensive. In the past three weeks, loins, butts, and ribs have clearly been the source of support in the pork cutout value.



It is mainly for this reason that I am expecting a milder pullback in wholesale pork demand than in wholesale beef demand over the next six weeks. Still, the boost in demand generated from high beef prices should not completely offset the negative impact of higher retail prices on the fresh pork retail cuts. Apart from these special influences, it is typical for fresh pork prices to set back as we move through the holiday. I notice that the simple average of loin, butt, and sparerib prices has historically shown a distinctly downward bias between now and the week after the holiday:



While this is just a short-term consideration, I have to keep in mind that if beef prices break substantially—not necessarily to the extent that I am forecasting, but substantially—then supermarket featuring could shift back toward beef, and away from pork, in July.

Meat Markets Under a Microscope is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523, or visit our website at www.procurementstrategiesinc.com.