

June 2013 – Livestock Market Update

Public Policy Department

Budget & Economic Analysis Team



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Livestock Update: Summer Fed Cattle Price Prospects

Over the years, one of the safest bets in the cattle markets has been that fed cattle prices would decline from spring to summer. The summer slump in fed cattle prices is about as strong a seasonal tendency as you can find in any commodity market. Figure 1 shows the fed cattle seasonal price index based on twenty years of the monthly 5-area weighted average fed steer price (live basis). This index shows the price for each month as a percent of the annual price, on average, over the past twenty years.

The seasonal tendency to relatively high spring and fall prices with relatively low mid-year prices is illustrated nicely with the index. Typically, the spring placement of feeder cattle coming off of winter grazing contributes to supply side pressure on the summer market, contributing to the lower prices. Note here that the rough parity between the spring and fall highs in the market is a more recent phenomenon. An index based on prices ending in the early 2000s or so would show a spring price that would be markedly higher than the fall price. It appears that fourth quarter demand has been better in comparison to first and second quarter demand in recent years than it has been historically.

You will note on the seasonal index in Figure 1 that index values are about the same in March and April. This reflects the fact

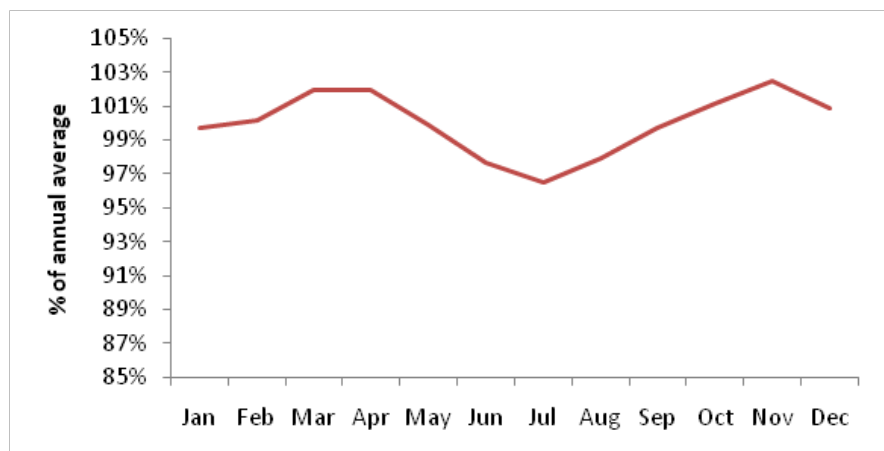


Figure 1. Seasonal Price Index for the 5-Area Weighted Average Fed Steer Price
Data Source: USDA Agricultural Marketing Service via LMIC

that, while the seasonal high in the fed cattle market generally comes in the late winter or early spring, the timing of that high is not terribly consistent. This is easier to see in looking at a weekly price series. On average, over the past ten years, the spring high in the fed cattle market has occurred at week 16 (around mid-April). This is, however, a fair amount of variability in when that occurs. In the last decade, the high price for the first/second quarter of the year has been set as early as the first week of the year (2008) and as late as the 19th week (2004 and 2010).

This year, the 5-Area weighted average price hit \$129.02 for the first week of May. The interesting question now is how much of a price decline we should expect for the summer. Where would a “normal” seasonal decline put the market for a summer low? Again, using the last ten years as a benchmark, the average decline from the spring high to the summer low has been a little over 11 percent. Applying that percentage change to this year’s high yields a forecast for the summer low of right around \$115. As for timing, the market has averaged bottoming out in the latter half of July. How do current market expectations compare to this normal seasonality? Right now, based on August Live Cattle futures, the market is projecting a July/August low more in the ballpark of \$120 - \$121, substantially better than an average seasonal decline would suggest.

It is important to make clear that seasonality is not destiny in any market. There is considerable value in understanding seasonality. For one thing, it helps establish a benchmark for expected price changes throughout the year. This provides a useful context for evaluating pricing opportunities throughout the year. It also provides a useful background for evaluating market fundamentals. For example, if forward price expectations differ from the normal seasonal pattern, there should be some logical reason based on supply and demand fundamentals in the market. This year historically tight cattle supplies provide a strong argument for a less-than-typical seasonal slide into the summer. Last Friday’s *Cattle on Feed* figures are relevant to that point. Table 1 below summarizes the key numbers from that report:

Table 1. June *Cattle on Feed* Summary: Actual Figures vs. Pre-Report Estimates

	1,000 head	% of Previous Year	Pre-Report Estimates* Average	Pre-Report Estimates* Range
May Placements	2,049	98.3	95.9	84.3 – 99.8
May Marketings	1,948	96.6	97.9	97.0 – 101.1
June 1 On-Feed	10,736	96.9	96.5	94.3 – 97.6

*Source: Dow-Jones Newswires through the Livestock Marketing Information Center.

The report was at least mildly bearish, with both placements and marketings coming in on the negative side of market expectations, but the inventory of cattle on feed continues below year-ago levels. Interestingly, the June 1 on-feed number was almost identical to the May 1 on-feed number. This is very similar to the on-feed pattern from last year, which was a bit atypical. Normally, the total on-feed inventory declines from May to June; May placements were skewed toward heavier weights. Placements in the above-700-pound weight categories were up while placements in the lighter weight categories were down. It may be that the heavy weights include

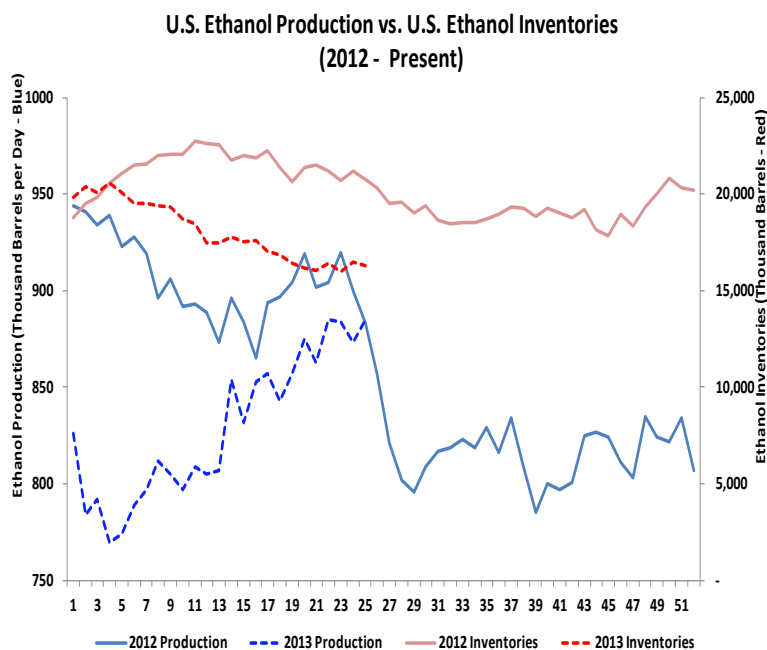
a good number of heifers that were being considered for replacements. Dry conditions and high feed prices are still making it hard to hold onto cattle in some parts of the country.

The notion that the movement of cattle off of farms has been higher than expected is also supported by cow slaughter figures. For the last couple of months or so, cow slaughter has run about even with the 2009-11 average, a fairly impressive pace given how much cow inventories have been depleted over the past two years. USDA took note of this fact in the June *World Agricultural Supply and Demand Estimates (WASDE)* report released earlier this month. In that report, the estimate of beef production for the second quarter of this year was raised by nearly 4 percent from the report in May. A big part of the explanation for that increase, which was a fairly large month-to-month adjustment, was the continued high level of cow slaughter. Of course, as has been pointed out many times by many market observers over the past few years, higher cow slaughter may keep supply-side pressure on the market temporarily, but it will inevitably (eventually) lead to further supply reductions down the road.

Energy Update: Ethanol Production Continues to Rebound

Production Rebounds, Exceeds Year-Over-Year Levels

For the most part, the Energy Information Administration’s report was friendly to ethanol producers. Put in another way, the report was straightforward on the ethanol market situation: tight stocks and increased production – nothing bearish about it! Since ethanol production hit a bottom at the end of January (770,000 barrels per day on week ending January 25), ethanol production has been trending in an upward direction and has increased 15 percent to 885,000 barrels per day over the 21-week period. Since the beginning of the summer driving season and for the month of June, ethanol production has stayed relatively consistent with three of the four weeks of ethanol production averaging over 880,000 barrels per day. Ethanol production has been rebounding over the course of the month due to healthy producer margins along with the summer driving season helping uplift the need for more gasoline to meet demand. For week ending June 21, ethanol production tied its yearly high and was reported at 885,000 barrels per day, which is annually equivalent to 13.57 billion gallons of ethanol [which is still under the RFS obligated volume for 2013] and roughly 4.9 billion bushels of corn. For the first time this year, ethanol production saw a greater level of output than last year’s levels. Output is currently 2,000 barrels per day higher than levels seen at this time last year. Without any weather and disaster related

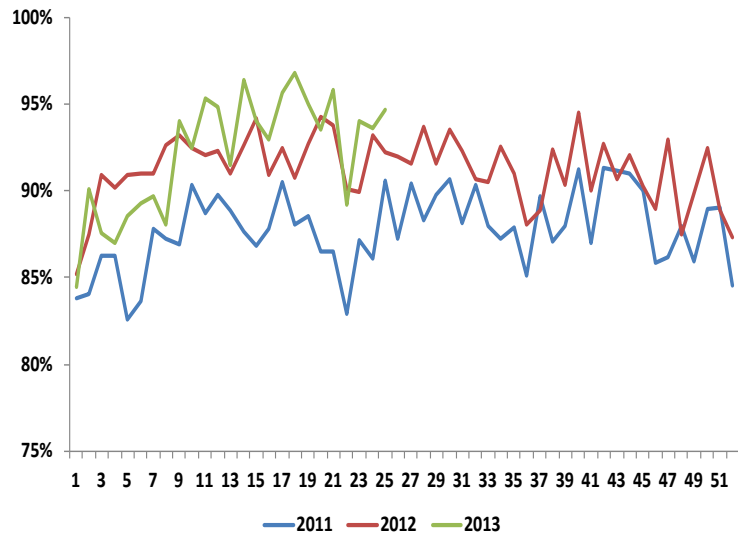


circumstances to the nation's new corn crop, ethanol production should remain above year-over-year levels as the drought of 2012 affected ethanol production beginning late last June.

Ethanol stockpiles have been following the opposite trend than ethanol production for most of 2013 and over the past month. Stockpiles slumped 1 percent to 16.3 million barrels, about 22 percent lower than levels seen a year ago. Stockpiles continue to struggle to rebound to levels prior to last summer's drought. Lower stockpiles and increased production have led to higher prices for ethanol.

In fact, ethanol's discount to gasoline tightened to the narrowest in three weeks and narrowed to approximately \$0.26 per gallon as production jumped to the highest level in three weeks and stockpiles declined to a two-week low. Moreover, higher prices for ethanol have led to increased imports over the course of the year. Foreign purchases fell 42 percent to 38,000 barrels a day last week and have averaged 20,000 barrels a day so far this year which is up from 7,000 barrels during the same period a year earlier. The fact is that ethanol production is recovering, but the high price for ethanol due to low stockpiles and increasing production is driving the price up for ethanol which is leading to increased imports so far in 2013. Even though parts of the Midwest have experienced a lot of rain this spring, its last year's drought that is certainly having an immediate impact on ethanol markets right now!

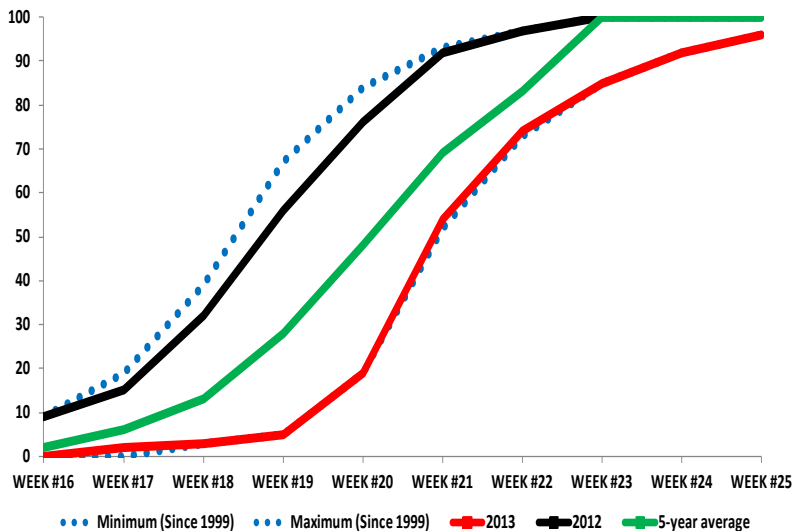
Percentage of Ethanol in Total U.S. Gasoline Pool



Ethanol-blended gasoline improved over the past month. Ethanol-blended gasoline made up 95 percent of the total U.S. gasoline pool for week ending June 21 compared with 94 percent the previous week. Over the course of 2013, ethanol-blended gasoline has averaged 92 percent of the total U.S. gasoline pool.

Overall, ethanol markets clearly remain bullish due to increased production and low stockpiles. Market signals indicate bullish behavior over the summer

U.S. Corn Emergence Progress Since 1999



months due to ethanol production recovering and a rather tight supply situation for stockpiles left from the 2012 drought. In addition, it remains to be seen what this year's corn crop will bring with issues of late planting and now emergence issues on the forefront. It's really plain and simple: the old corn crop is still short and the new corn crop is not proceeding quickly! As a matter of fact, from 1999 to today, U.S. corn emergence is currently at its slowest pace. All eyes will be focused on the months of July and August as the dog days of summer take "heat" to the nation's corn crop.

Oil Prices: What In The World Are They Going To Do?

Every year during the beginning of the driving season, a question always arises: "What will the price of oil be over the summer months?" My best answer to this exact number is like any good economist...it depends! Predicting the future is best said by Nils Bohr, a Nobel laureate in Physics: "Prediction is very difficult, especially if it's about the future." And predicting crude oil prices is no exception to this quote. However, weekly crude oil prices since 2008 are showing quite an interesting pattern as crude oil has been stuck in a \$10 to \$15 price range since last summer and narrowing to a tighter band between \$90 and \$95 per barrel. The chart below in this section shows that crude oil is following a very distinct pattern used in technical analysis called a symmetrical triangle. Symmetrical triangles can be characterized as areas of indecision, but eventually this indecision is met with resolve and usually explodes out of this formation due to heavy volume. Even though I am somewhat contrary to EIA's bearish forecast for crude oil this summer, narrowing symmetrical triangle patterns often end with strong moves and prices are currently testing the

upward formation of this symmetrical triangle at close to \$100 per barrel. By following this narrowing pattern and with the summer driving season in full force, I am rather bias to the upside with crude oil testing \$100 per barrel during the summer months heading in to Labor Day. For the next several weeks, volume levels will and should be highly monitored as this will give a good indication of how this symmetrical triangle will eventually trend and play out.

