October 2011 - Livestock Market Update
Department of Economic Analysis

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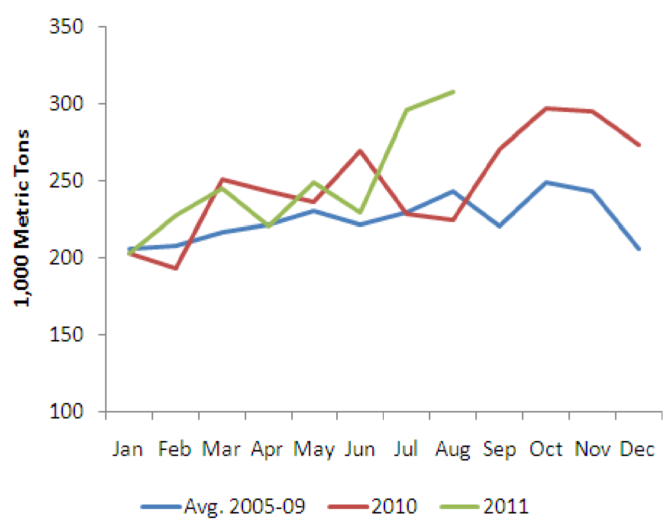
Livestock Update

Has the Broiler Industry Turned the Corner?

I have written before in the last few months about the difficult conditions the broiler industry has faced so far this year. Costs are up sharply, demand has been lackluster, and prices have been essentially stagnant. This situation has driven large losses in the sector and contributed to substantial downsizing in the industry. We haven't seen much major restructuring to this point (the Allen Family Foods bankruptcy is a notable exception), but there have been a good many minor adjustments including plant closings, shift terminations at processing plants, and the like.

After this difficult time, there are some signs that maybe things are beginning to turn around for the industry. Wholesale broiler prices have managed to make modest but consistent gains over the last couple of months. The wholesale broiler composite price reported by USDA Economic Research Service improved to 74 cents per pound for September – its highest value of the year and the second straight month of improvement. Last week, the Georgia Dock wholesale price on whole broilers/fryers topped $88 for the first time in over two years. While high costs will continue to keep margins thin, this product price improvement is a most welcome development for the industry.



Part of support for prices appears clearly to be coming from improving exports. Trade disputes with Russia and China, our best foreign markets for broilers in recent years, have hampered broiler exports for most of the past two years. Over the summer this year, that situation began to improve. August export data from USDA Foreign Agricultural Service shows that chicken exports in that month were the largest (on a quantity basis) in at least the past 15 years, topping 307,000 metric tons. Figure 1 shows monthly broiler exports this year compared to last year and the preceding 5-year average.

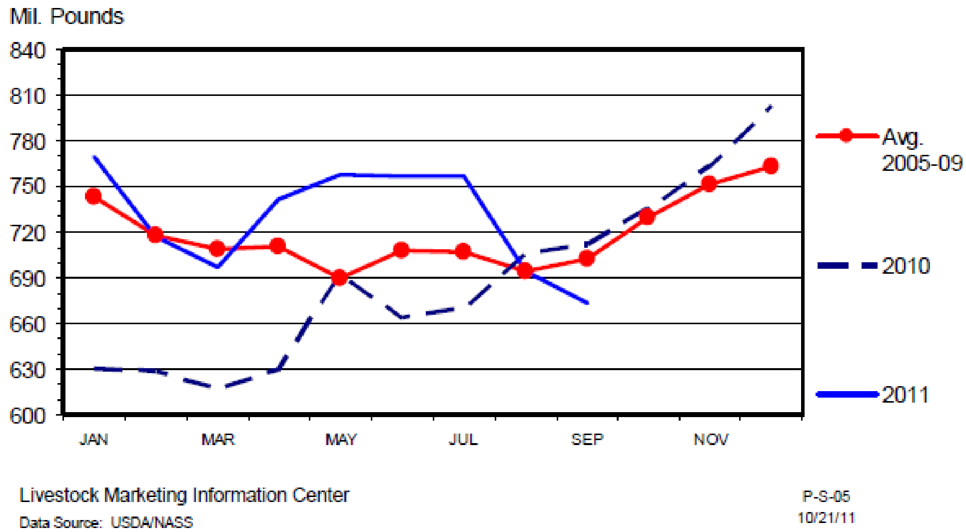


Figure 2. Chicken in Cold Storage: End of Month

While we have almost certainly not heard the last of our trade disputes with Russia; that country was the fourth largest foreign market for U.S. chicken in August. China, meanwhile, continues to be a reluctant customer, remaining just the fourteenth largest foreign market in August. Interestingly, by far the largest market for U.S. chicken in August was Mexico, which purchased almost 40,000 metric tons of fresh and frozen U.S. chicken. Unfortunately, this fact represents something of a warning to the industry. Mexico is currently pursuing an anti-dumping suit against U.S. chicken. An adverse finding for the U.S. on this issue would open up the industry to retaliatory tariffs from Mexico. The timing for that could hardly be worse as the U.S. industry struggles to regain its footing after multiple years of similar problems in the key Chinese and Russian markets.

Last week's *Cold Storage* report also pointed to some improvement in the chicken market. Frozen chicken stocks as of September 30 were down 3% month-over-month and 5% year-over-year. This was the second consecutive month of lower frozen chicken inventory, and it suggests that the balance of supply and demand in the industry has shifted sufficiently to allow a drawing down of inventories. In fact, as Figure 2 shows, frozen chicken inventories at the end of September stood at their lowest level since mid-2010.

The broiler industry has cut production rather sharply in an effort to get back to some level of profitability. There are signs that this effort is paying off. Now the trick will be to maintain these modestly improved price levels while getting back to a higher level of production. Until this occurs, contract growers will not be able to feel much of the benefit of these recent improvements in the poultry market.

Beef and Pork Production Forecasts

The October *World Agricultural Supply and Demand Estimates (WASDE)* report included some interesting revisions from last month for beef and pork production and use through 2012. Let's start with beef. Production for 2011 was raised modestly, reflecting the well-established pulling ahead of younger cattle and more aggressive culling of females – both largely a function of the Southern Plains drought. With this higher production, export projections were also raised slightly, and import projections were lowered a bit. The bottom line for 2011 after these adjustments was a slight reduction in total domestic use. The really interesting adjustments were in 2012 projections. Production, which was already projected to fall by almost 4.5% between 2011 and 2012, is now projected to fall by almost 5%. At the same time, export projections were raised by almost 7% from last month, and import projections were lowered by nearly twice that amount. The result is an estimate for 2012 domestic consumption that is a little more than 5% lower than 2011 consumption. On a per capita basis, beef consumption is now forecast to fall by 3.4 pounds between 2011 and 2012 – a decline of 5.8%. If realized, this will be the largest percentage decline in per capita beef consumption in 25 years.

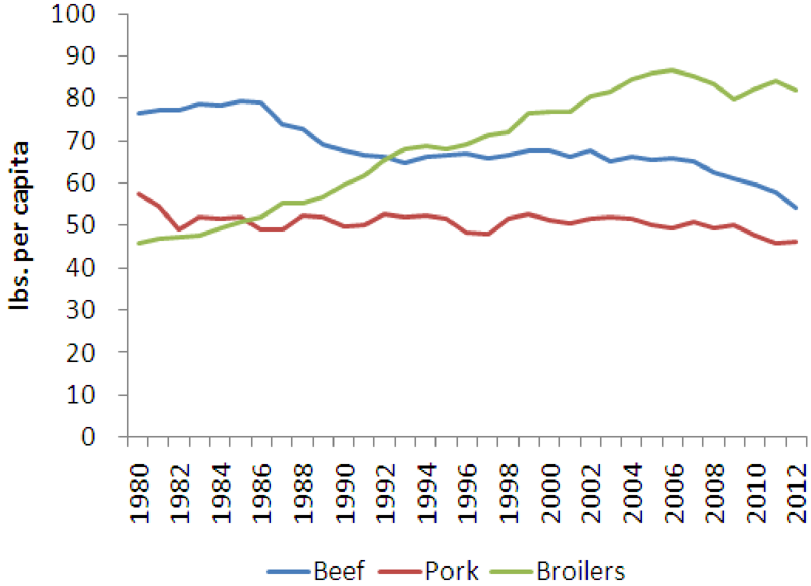


Figure 3. U.S. Annual Per Capita Beef, Pork, and Broiler Consumption: Retail Weight
Source: USDA Economic Research Service through Livestock Marketing Information

By way of contrast, the October *WASDE* report suggests that the pork industry is continuing on the path of slow, steady growth. The pork production estimate for 2011 was increased slightly from the September report. Looking ahead to 2012, the pork production forecast was raised slightly while the export forecast was lowered slightly. If these forecasts hold, the result will be an increase in per capita domestic consumption of 0.4 pounds. Figure 3 shows beef, pork, and broiler per capita consumption since 1970.

The relative positions of the three major meats in the domestic market have clearly changed quite a bit over the past few years. Growth in broiler consumption has slowed dramatically as the steady production gains of the 1990s have waned. Domestic beef consumption has fallen sharply since the mid-2000s as production has stalled and exports have grown rapidly. Pork consumption has also generally declined – though substantially less than beef – as slow production growth did not keep pace with rapid export growth. Looking ahead, current projections suggest that pork consumption is set to rebound as exports hold at something close to current levels while production gradually expands. On the other hand, beef consumption will probably continue to decline for at least another couple of years as export growth remains strong and as production falls further as the beginning of herd expansion keeps more animals off the market. It is not inconceivable that a few years down the road, domestic pork consumption could exceed domestic beef consumption.

It is always worth emphasizing in the context of per capita consumption numbers that per capita consumption is not demand. The numbers in figure 2 say nothing about the health of demand for any of the three major meats. Evaluating demand requires simultaneous consideration of both the quantity of product consumed and the price that consumers are willing to pay for it. Price and quantity data from the last couple of quarters suggest that domestic demand for both beef and pork has, in fact, been better in 2011 than in 2010 and export demand has been generally outstanding. Still, the per capita consumption data holds some interesting implications. For beef in particular, it indicates an industry dealing with an ongoing transition. Export business is growing fairly rapidly relative to the domestic market. Thus, export business will become increasingly important to the success of the industry. The pork industry has largely already undergone this transition. For 2011, over 20% of pork production will be sent overseas. For beef, that percentage is only a little over 10%, but that is the highest it has ever been and it is increasing quickly. At some point, the drought in the Southern Plains will end and interest in industry expansion will intensify. Export business will be more important to supporting that expansion than it has ever been before.

Cattle on Feed

Last Friday, USDA released the October *Cattle on Feed* report. Key numbers from the report are summarized below:

Table 1. October *Cattle on Feed* (*COF*) Summary: Actual vs. Pre-Report Figures

		% of Previous	Pre-Report Estimates*	
	1,000 head	Year	Average	Range
On Feed October 1	11,312	104.9	103.9	102.5 – 105.2
September Placements	2,469	100.2	96.5	89.4 – 101.7
September Marketings	1,813	100.6	100.6	98.5 – 103.0

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

This month's *COF* had a moderately bearish tone. Marketings were right in line with expectations; however, both placements and the October 1 on-feed number well to the high side of the pre-reports. However, the market mostly shrugged off the report in Monday's trading. Positive manufacturing figures out of China supported outside markets, and this was enough to overcome the bearish *COF* data. April Live Cattle somewhat underperformed relative to other contract months, reflecting the impact of continued high placements of lightweight cattle that will translate into relatively large fed cattle supplies in late-Spring/early-Summer 2012. In fact, the under-600 pound weight category was the only one for which September placements were up from last year, with placements in that category posting a 34% increase year-over-year.

Energy Update: *"Oil Markets Seem To Love the $80s"*

Oil markets for the past month have been hovering around the $80 to $90 per barrel mark. Price fluctuations have been caused primarily with the concerns over weak demand and continuing uncertainty about the European debt crisis. Nevertheless, energy markets over the past month have been following close in tact with macroeconomic variables (value of the dollar, European debt crisis, etc.) and have been broadly focused on equity markets. However, it almost seems like yesterday, and not six months ago, that we were discussing oil prices nearing $115 per barrel. The beauty of markets is that they have the ability to change on a second-by-second basis, but it also can make reality tough when prices increase to high levels. However, over the past month, it seems that oil prices love the $80s while the fundamentals never cease to lie.

Oil in the $80s

Over the past month, oil markets received bearish news driven by macroeconomic factors affecting the domestic and global economy. With the European debt crisis fueling uncertainty, markets have been fearful of another downturn within the global economy. Moreover, oil prices have been following the overall value of the dollar. Over the past month, the dollar has appreciated (strengthened) against the euro which has put downward pressure on oil prices. As I have mentioned in previous newsletters, the relationship between the value of the dollar to the price of oil tends to be quite simple; depreciation (weakening) in exchange rates reduces the purchasing power of the dollar, creating higher import prices and lower export prices. For the most part, the price for WTI crude oil has traded in the $80 per barrel range over this past month. Let's take a look at the weekly events that have occurred over the past month that try to explain the fluctuations in the price of crude oil.

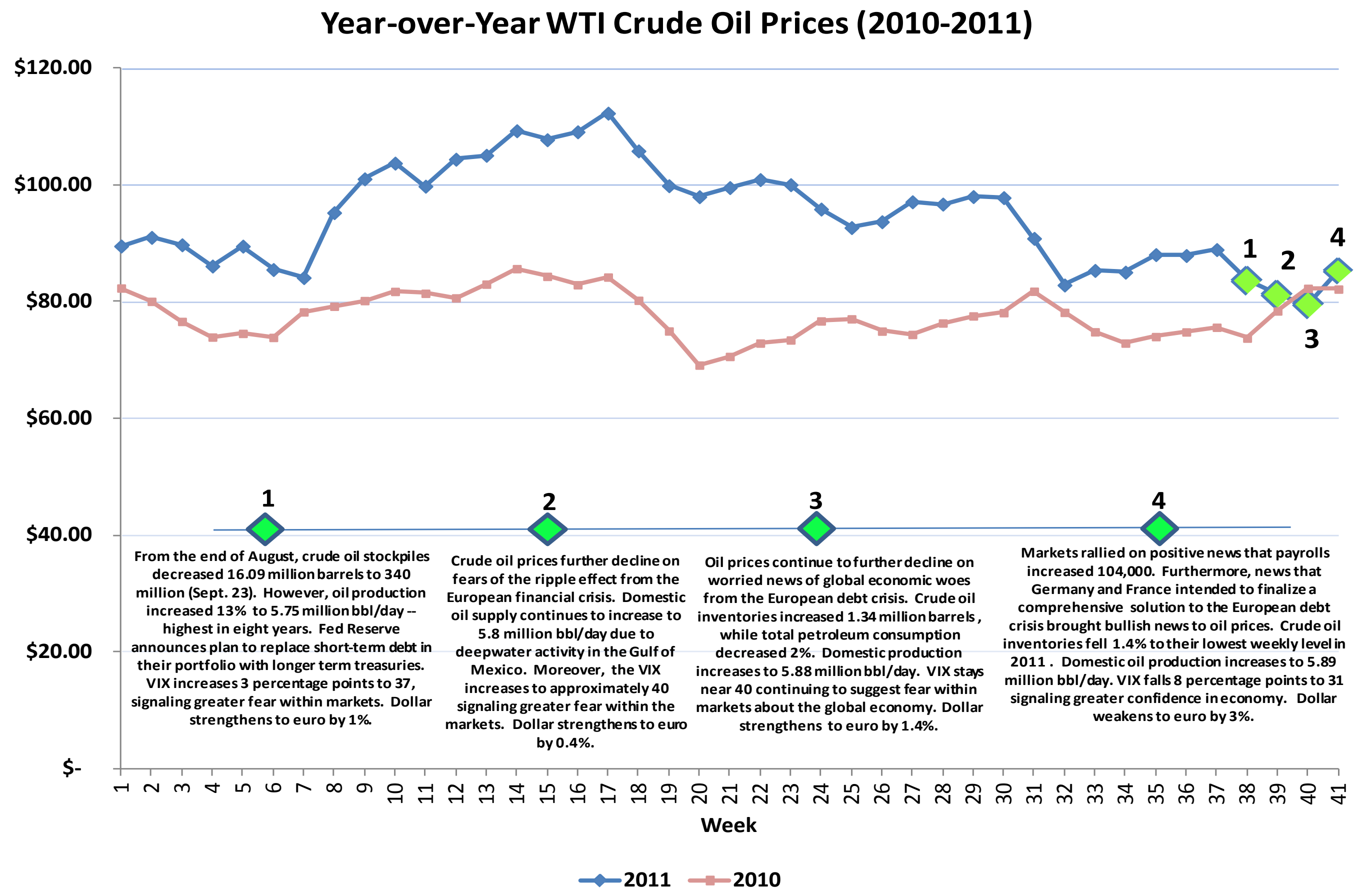
Week-ending September 23 brought bearish news to crude oil as prices decreased 6 percent (point 1 below in graph). From the end of August to September 23, crude oil stockpiles decreased 16.09 million barrels to 340 million barrels per day. But, an eight-year weekly high in domestic oil production of 5.75 million barrels per day caused by deepwater activity in the Gulf of Mexico brought downward pressure to crude oil prices to around $83.65 per barrel. However, the macroeconomic situation from the European debt crisis and the value of the dollar were the driving force in downward pressure for crude oil prices. Week-over-week the dollar strengthened to the euro by 1 percent and the volatility index (VIX), the "fear" indicator in markets, increased 3 percentage points up to 37.[1]

Week-ending September 30 brought further bearish news as crude oil prices declined another 3 percent (point 2 below in graph). Bearish behavior was dominated by the European debt crisis which created fears of another global recession and the dollar further strengthening against the euro. The potential ripple effect from the European financial crisis struck fear into investors as the VIX reached approximately 40 – indicating that investors became increasingly pessimistic with their investments. Furthermore, domestic oil production continued to increase week-over-week due to the deepwater activity in the Gulf of Mexico. As a result, domestic oil production increased to 5.8 million barrels per day.

Continuing the recent trend of bearish news over the past month, week-ending October 7 saw oil prices decrease by another 2 percent, which finished the week averaging just below $80 per barrel (point 3 below in graph). The European debt crisis continued to cast a gloomy shadow over the economy. Furthermore, news from EIA indicated that crude oil inventories increased 1.34 million barrels and total petroleum consumption decreased by 2 percent which brought further bearish news to crude oil prices. Domestic oil production continued to increase, however at a slower rate, to 5.88 million barrels per day due to the deepwater activity within the Gulf. Moreover, the continued fear from gloomy economic news kept the VIX near 40 and further downward pressure in crude oil price was brought about as the dollar strengthened to the euro by 1.4 percent.

Ending the month brought some good news for market bulls. Going against trend over the past month, crude oil prices rallied during week-ending October 14 as news from the U.S. Labor Department indicated that payrolls increased by over 103,000, and reports that France and Germany intended to finalize a comprehensive solution to the European debt crisis (point 4 below in graph). The news of a potential comprehensive solution being finalized to the European debt crisis brought a sign of optimism to markets as the VIX ended the week 8 percentage points lower than week-ending October 7. Furthermore, the dollar weakened to the euro by 3 percent creating further upward pressure to crude oil prices.

[1] VIX Interpretation: Any number above 30 is considered by many analysts a sign that investors are becoming increasingly pessimistic with their investments.



October 2011 Short-Term Energy Price Outlook

From September to October, crude oil forecasts for 2011 and 2012 continue to decrease. Forecasted prices for 2011 fell below $92.50 per barrel as concerns over weak demand and uncertainty over the European debt crisis take hold of energy markets. Over the past month, weekly WTI crude oil prices have decreased in the range of $79 to $85 per barrel. During this time, negative macroeconomic news continued to lead the explanation. Oil prices have followed the value of the dollar as the dollar has strengthened relative to the euro by approximately 2 percent. Moreover, continued fears of U.S. job gains stagnating, lower estimates of economic growth and the European debt crisis have rolled over from last month and continue to affect the global and domestic economy. The October Short-Term Energy Outlook has prices for WTI spot crude oil averaging $92.36 per barrel for 2011 and decreasing to $88.00 per barrel for 2012. This forecasted decrease in the price of WTI crude oil is highlighted by U.S. gross domestic product (GDP) estimates slightly lower than last month's projections at 1.5 percent for 2011 and 1.8 percent for 2012. As for the 2011 current average, crude oil prices are on pace to average approximately $94.46 per barrel. Comparing the current 2011 average crude oil price against the October forecast for 2011 and 2012, respectively, EIA expects average crude oil prices to decrease 2.2 percent for the rest of 2011 and to further decrease by 6.8 percent in 2012.

Bearish news was forecasted for retail gasoline prices from the October Short-Term Energy Outlook. Retail gasoline prices are projected to average $3.52 per gallon for 2011. Over the past year, gasoline prices have increased due to the rising cost of crude oil, but also changes in the average U.S. refinery

	2011 Current Average	September Outlook 2011 Forecast	October Outlook 2011 Forecast	September Outlook 2012 Forecast	October Outlook 2012 Forecast
WTI Crude ($/barrel)	$94.46	$94.40	$92.36	$94.50	$88.00
Gasoline ($/gal)	$3.56	$3.56	$3.52	$3.54	$3.43
Diesel ($/gal)	$3.83	$3.85	$3.80	$3.87	$3.73
Natural Gas ($/MMBtu)	$4.18	$4.20	$4.15	$4.30	$4.32

All Prices for "2011 Current Average" Column end October 17 and October 18, respectively

Source: EIA

gasoline margin.[2] In 2010, the average U.S. refinery gasoline margin increased from $0.34 per gallon to $0.51 per gallon. However, for 2012, the U.S. refinery gasoline margin is forecasted to decrease from $0.51 per gallon in 2011 down to $0.43 per gallon. From the forecasted margins reflects lower prices in 2011 and 2012 for retail gasoline. For 2011, retail gasoline prices are currently averaging $3.56 per gallon. However, EIA forecasts expect a slight drop for 2011 with gasoline prices averaging $3.52 per gallon for 2011 and a continued decline in 2012 to $3.43 per gallon.

Similar to that of gasoline and crude oil, bearish news was forecasted for retail diesel prices. Weekly retail diesel prices are currently averaging $3.83 per gallon, which is currently $0.03 per gallon lower than the October forecasted average for 2011 and $0.10 per gallon lower than the October forecasted average for 2012. Similar to that of gasoline margins, U.S. refinery diesel margins increased from 2010 to 2011, but are expected to decrease from 2011 to 2012. EIA projects U.S. refinery diesel fuel margins to increase from $0.39 per gallon in 2010 to $0.64 per gallon in 2011, then fall to a projected $0.56 per gallon in 2012.

Natural gas prices received mixed signals from the October Short-Term Energy Outlook. Although projected price behavior for natural gas was relatively slight, short-term bearish trends for 2011 are projected, while bullish trends from 2011 to 2012 are projected. The name of the game for natural gas continues to be the overall level of working inventories. Natural gas working inventories closed the month of September at approximately 3.4 trillion cubic feet, which is approximately 2.6 percent below 2010 September levels. However, EIA expects natural gas inventories to increase and approach last year's high levels by the end of this year's injection season. Natural gas prices continue to average well below the 5-year average price level (2006 – 2011: $5.91 per MMBtu) at $4.18 per MMBtu. Price projections for 2011 are expected to average $4.15 per MMBtu. However, natural gas prices for 2012 are projected to increase slightly to $4.32 per MMBtu, which continues to be well below the 5-year average level for natural gas.

[2] U.S. refinery average margin equals the difference between refinery wholesale gasoline prices and the average cost of crude oil.