October 2013 – Livestock Market Update
Public Policy Department
Budget & Economic Analysis Team

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The General Economy: *The Backside of the Shutdown/Debt Limit Debacle*

Now that the Federal government is back to work and the debt limit has been repegged, it is at least worth an academic exercise to go over what that whole debacle did to the economy. The shutdown actually only directly affected about one-third of overall federal employees. Our military forces were not directly touched, nor were other essential employees such as Transportation Security Administration, air traffic controllers or meat inspectors.

But roughly 800,000 people did not report to work for a couple weeks. National parks were shuttered, FSA offices were closed and others were not able to get documents needed to move forward on home purchases. So what did all this do to the overall economy? We passed a law that will reimburse federal employees for their time away from the job, so that part will be replaced. Will there be any effect?

The federal shutdown was very, very obvious here in the Washington DC area. The commute was actually pretty pleasant. There were no lines at lunch at the various eateries around the American Farm Bureau Federation offices. Phones were a little quieter.

Nice as all that was, you could actually see some of the economic impact as it was occurring. One local fast food place typically employs 8 workers at lunch and has a line out the door. During the shutdown, they cut back to two employees. Recent conversation post-shutdown with the management says they are still 25-30 percent below their pre-shutdown sales levels. Our little park area in front of the building that houses AFBF has become home to numerous food trucks that all do a thriving business at lunch. During the shutdown we only had about half of the regular number, and those that did show up probably had about half the lines they did before.

And it is in areas like this where the shutdown probably had the greatest effect; government direct and indirect consumption that simply stopped when they closed the doors. These small businesses will never get that business back. Sure some of the federal employees that didn't show up at the downtown Quizno's may have gone to one in the 'burbs and boosted business there. But to at least a certain extent, some of that consumption just did not happen and never will.

Estimates by groups such as Moody's Economy.Com suggest the effect of the shutdown is a drop of economic activity of around $20 billion. Most of the effect of that is being felt in five states – Virginia, Maryland, West Virginia, Alabama and New Mexico – as well as the District of Columbia. This $20 billion hit will be enough to lower the economic growth rate level for the fourth quarter of 2013 by roughly one-half of one percentage point.

But probably the bigger effect of the entire shutdown/debt limit debacle will be in the long term. The United States dollar is the world's reserve currency. One dollar in U.S. Treasury bills is valued at one dollar around the world. It has zero – let's say that again – zero associated risk. This is a very valuable thing.

To the extent these repeated budget debacles make the country appear as if it is not going to be able to get its fiscal house in order, it makes other countries think about whether they want to hold this currency as a reserve. And coming within hours of a debt default and thereby driving the rest of the world into thinking that there may be a need to attach some risk premium to our federal treasury notes is questionable at best. This is where the long-term costs associated with this kind of legislative strategy could become very large.

Livestock Update

Back to Work for the Feds

This week marks the first full week back on the job for those federal employees who had been deemed non-essential during the recent sixteen day government shutdown. Of most immediate interest to me and other market-watchers, that means that USDA data is beginning to flow again. The shutdown period was a virtual information blackout: no price and sales volume reports from AMS, no production estimates from NASS, no retail price reports or situation and outlook updates from ERS. In fact, USDA essentially shut down its website so that it was virtually impossible even to access any existing historic information.

It will be a while before we get back to a normal routine with respect to USDA (and other government) reports. For example, the October *Crop Production* report (and associated supply/demand estimates) was cancelled. The normal schedule will be resumed in November. The *Cattle on Feed* report that was supposed to come out last Friday is being delayed until October 31. But weekly reports have resumed. In some cases, missed reports will be backfilled. This is the case with the *Broiler Hatchery* report, for which the three missed reports will be released on October 23 along with the next regularly scheduled edition. For some data, though, the gap will remain. With respect to price reports, data from mandatory reports will be filled in at some point in the future; however, gaps in voluntary reports will not be billed in. At least, however, we can now begin to see how the market stands relative to its late-September position.

The fed cattle market is of particular interest. It appears that prices moved higher throughout the shutdown. This is not all that surprising since rising fall prices are a seasonally normal phenomenon. It is notable, though, that cash prices have moved to new record high levels: last week's trade included $131/cwt fed cattle sales in Nebraska and Colorado. While the 5-Area weighted average price was not calculated for last week, it would probably have come in around $130. This compares with a 5-Area weighted average price at the end of September of $125.80 and is about $4 above the same week from a year ago.

Interestingly, fed cattle futures were sharply lower last Thursday as market information began flowing again. The December Live Cattle contract dropped by $1.48/cwt last Thursday. Most deferred contracts fell by at least $1 as well. With Southern Plains cash prices at $129, basis between cash and the December contract for that region was fairly wide before the decline. Thus, it appears that the futures market made a quick adjustment to the then-reported cash market situation. Certainly, market fundamentals remain supportive of prices, with continuing tight supplies and demand that appears to be at least holding steady.

As if to underscore the fact that cattle supplies are historically tight, Cargill announced last week that it would be closing its feed yard in Lockney, Texas (about 60 miles northeast of Lubbock). The yard is reported to have had a one-time capacity of 62,000 head, and is close to the Plainview, Texas packing plant that Cargill idled earlier this year. In an interesting bit of timing, I just received a copy of *2013 Directions*, the annual report of the NCBA. This report includes a number of industry top 10/20 lists compiled by CattleFax. Cargill Cattle Feeders, LLC came in at number 3 on that list, with an estimated capacity of 355,000 head in 5 yards. The closure of the Lockney yard will likely leave Cargill still just a bit ahead of the number 4 feeder, Friona Industries, whose capacity was reported at 290,000 head in 4 yards.

The difficult financial position of the cattle feeding sector in 2013 has been a topic of much discussion. Recent declines in corn prices as this year's harvest comes in seem to have revived a bit of optimism for a better year to come. Figure 1 shows the behavior of December Corn Futures on the CME since the first of the year.

Source: CMEGroup.com

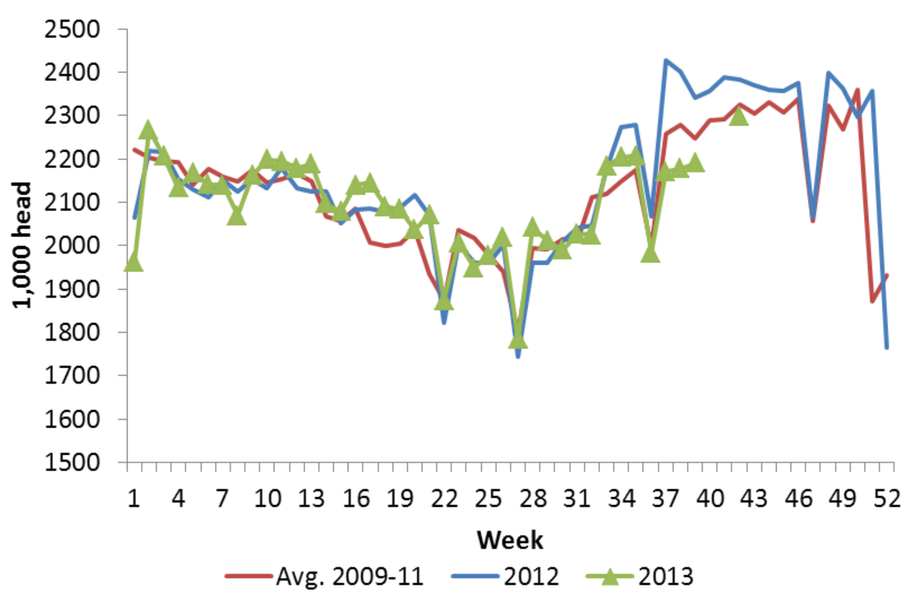
Figure 1. Daily December Corn Futures Price: Open/High/Low/Close

The decline in December corn futures from around $5.70 mid-year to below $4.40 presently represents a tremendous potential improvement in costs of production for the feeding industry. There are, however, lots of ways to lose money feeding cattle; if margins aren't being squeezed by corn prices, they can be squeezed by feeder cattle prices. As one should expect, the decline in corn prices has been bid into higher calf prices. In fact, since late-August, the March feeder cattle futures contract has gone up by about $10/cwt, implying that the potential gains from lower corn prices (which dropped about 50 cents over that same period) have been more than bid into calf prices.

Cash calf prices have been similarly impressive. In this week's Oklahoma City feeder cattle summary, 800-850 pound medium and large number 1 steers were reported at $161.20/cwt. The price on that class for the last week of August was $151.50. Prices this week appeared to be up a couple of dollars per hundredweight from the last USDA-reported sale at the end of September. Calf prices are supported not only by the decline in feed price expectations but also by the limited availability of cattle. While these high calf prices may pinch feeding margins, they are certainly welcome in the cow/calf sector. As has been noted here before in the last couple of months, it is virtually impossible to devise a scenario where the beef cow inventory is not lower this coming January 1 than it was last January 1. However, favorable returns this fall could go a long way toward convincing cattle producers to shift back into expansion mode in 2014.

Weekly Hog Slaughter

Hog slaughter remains below year-ago levels, and below the prior three-year average pace, continuing a trend that began a few weeks before the shutdown. Figure 2 shows weekly hog slaughter as reported by USDA.

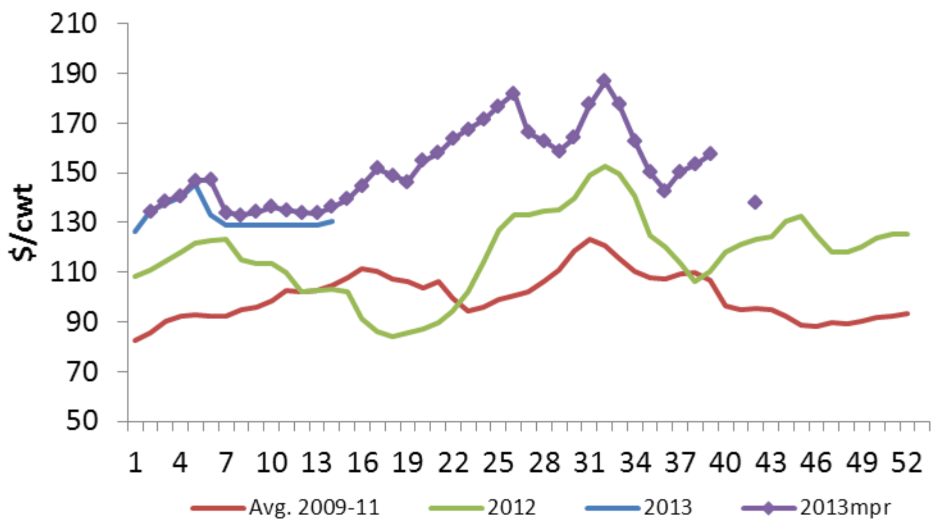


Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center

Figure 2. Weekly Hog Slaughter

Last week, hog slaughter was about 3.5 percent below last year. The gap between weekly slaughter rates has narrowed considerably, reflecting the fact that last year's accelerated pace in the third quarter had begun to slow down quite a bit by this time. Hog slaughter should begin to level off seasonally about now. If that doesn't happen in the next couple of weeks, it may suggest that the recent slowdown in slaughter has pushed some production back a bit rather than indicating that it just wasn't there at all.

Hog prices have not been on the same track as cattle prices of late. On Tuesday, USDA's afternoon direct price report showed barrow and gilt prices averaging $87.03/cwt. That is a bit over $2/cwt lower than the price level at the end of September. Hog prices have followed wholesale meat prices for the most part. At the end of September, the pork cutout worked out to around $102/cwt. On Tuesday this week, the cutout was down to just over $95/cwt. Bellies have been off rather sharply over that time period, declining roughly $30/cwt. That sounds like a sharp drop (and it is), but it is similar – at least in percentage terms – to the decline in belly prices last year, as figure 3 illustrates.



Data Source: USDA Agricultural Marketing Service through Livestock Marketing Information Center

Figure 3. Weekly Wholesale Pork Price: Belly Primal, FOB Plant