IOWA STATE UNIVERSITY
University Extension

Iowa Farm Outlook

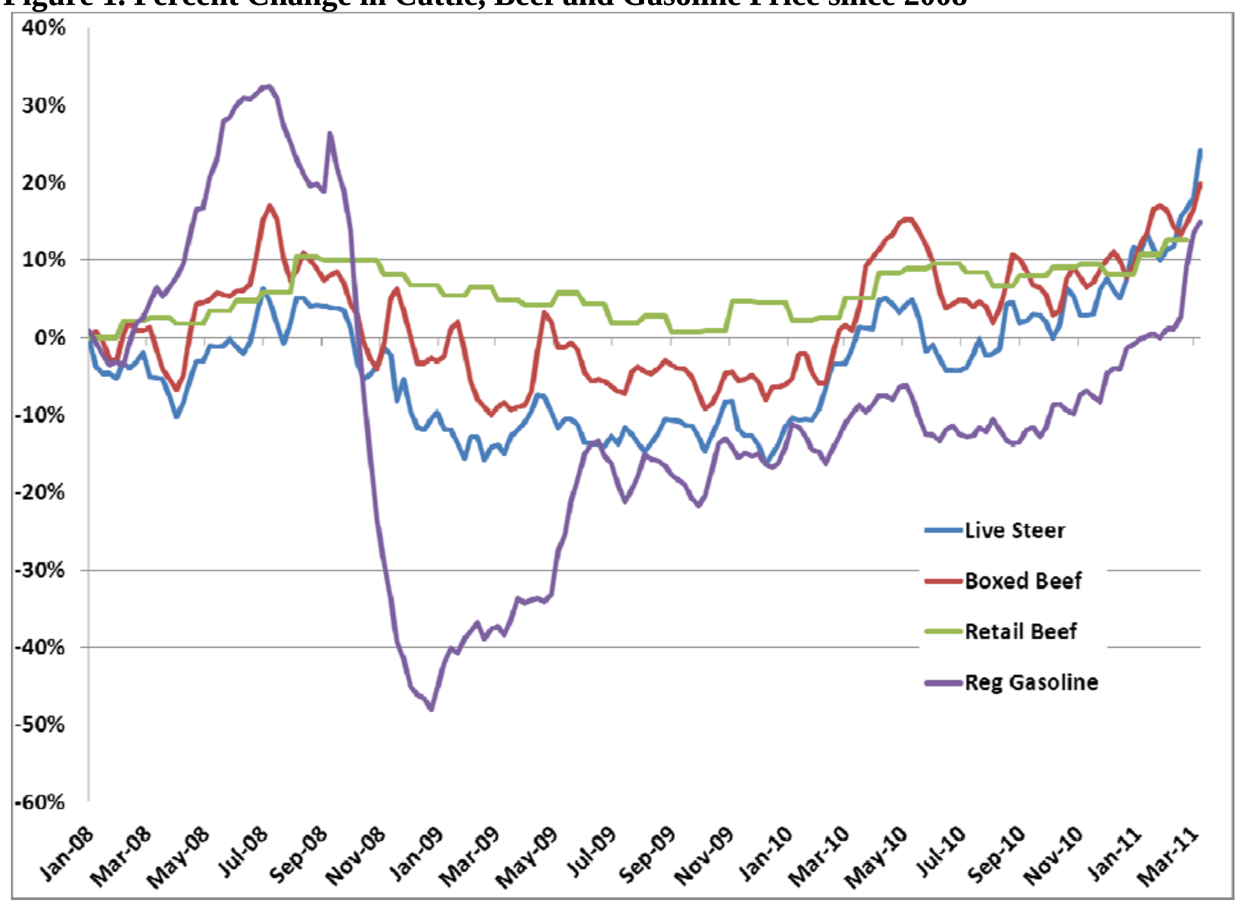
Department of Economics
March, 2011 Ames, Iowa Econ. Info. 2011

Will Increasing Beef Prices Impact Consumer Demand

The beef industry has entered uncharted territory with the possibility of $120/cwt fed cattle occurring during this year. This is great news for cattle feeders as the costs of production are keeping up the pressure and cash market margins are expected to be tight or get tighter (if they are not tight enough already). The industry is also facing the challenge of short feeder cattle supplies and cow-calf sector that is slow to build beef cow numbers. Through the fed and feeder cattle price turmoil there is a question most producers have on their minds. "How much will the consumer be willing to pay for beef?" Eventually consumers will look for cheaper protein alternatives, but to say when that will be is difficult to say. Per capita consumption of beef has been on a long term downward trend and could decline as much as 2 percent as there will be about 1.5 percent less beef produced for a growing population and export market.

Consumers are well aware that the price of everything is going up, so they are expecting to see prices at the meat counter going up. They may not like it, but they are not surprised. It is the degree of "sticker-shock" that will determine the push back from consumers. Consider the percentage change in price of beef and gasoline in the past three years. Figure 1 tracks the percent change in the price of cattle, beef and gasoline since the beginning of 2008.

Figure 1. Percent Change in Cattle, Beef and Gasoline Price since 2008



Several observations about price variability can be made from this graph. First, retail prices are much more stable than cattle and boxed beef prices. Second, even though retail beef prices are at record highs they are not nearly as volatile as the retail gasoline price. Retailers also try to insulate their customers from dramatic price variations. Most grocery retailers are absorbing a portion of the rising cost of wholesale foods including meats. Consumers are still carrying some degree of sensitivity to their personal economic situation, and demand for ground product has remained strong even after the general economy was declared to be in recovery. Ground beef prices have increased at a faster rate than whole cuts as consumers maintained the preference for ground product they developed during the lowest points of the recession.

So then what would make consumers start to move away from beef? The beef market is still connected to the economy, so a second dip in the recession would have a definite impact. Just as with the economic slowdown that occurred in 2008 a recurrence of the recession will force consumers to take a hard look at their expenditures and cut back where possible. A second factor that could impact beef prices is the price of competing meats. Pork and poultry prices have also increased, and there is not a significant increase in supply on the horizon that would drive down prices.

Beef supplies are expected to continue to decline over the next 3 to 4 years which will keep bullish pressure on the market. In short, as we see declining consumption in the coming years a small portion of it may be a loss of quantity demanded, but that loss will be far out shadowed by the declining supply of beef available to be utilized. In the meantime, tighter feeder cattle supplies and an energy driven corn market will also keep profit margins tight. In the new world of higher commodity prices, increased revenues and costs, profitability continues to be fleeting and elusive, and risk management more essential than ever.

Shane Ellis

Crop Markets Are Looking to Buy Acreage

The corn and soybean markets aren't the only markets with strong prices. Wheat and cotton prices have surged as well. And that sets up an interesting battle for crop acreage in 2011. Table 1 shows the harvest futures prices for spring wheat, corn, soybeans, and cotton. With all of these crops experiencing at least 40% increases in prices, farmers are seeing strong crop margins across the board. Given the overall crop price strength, it is expected that overall crop area will increase significantly this year. The questions are: How big will the increase be, and How will it split among the crops? USDA will provide the first official estimate, based on farmer surveys, with the Prospective Plantings report at the end of the month. But USDA has provided a preliminary set of acreage numbers already.

Table 1. 2011 Harvest Futures Prices

	Wheat MGE Sept.	Corn CME Dec.	Soybeans CME Nov.	Cotton ICE Dec.
	($/bu.)	($/bu.)	($/bu.)	($/lb.)
June 1, 2010	5.81	4.04	9.22	0.75
Mar. 4, 2011	9.56	6.16	13.63	1.27
% Change	65%	53%	48%	68%

At the recent USDA Ag. Outlook Forum, USDA's chief economist, Joe Glauber, outlined the preliminary estimates. Those estimates had corn area at 92 million acres, soybeans at 78 million acres, wheat at 57 million acres, and upland cotton at 12.8 million acres. So corn would gain 3.8 million acres, soybeans would gain 600,000 acres, wheat would gain 3.4 million acres, and cotton would gain 2 million acres. All of the big 4 crops would have larger plantings. That is a rare event and hasn't happened since 1984, following the Payment-in-Kind (PIK) program. In fact, USDA also projects that sorghum and barley will also pick up additional acres. In total, the 8 major crops (corn, soybeans, wheat, cotton, rice, sorghum, barley, and oats) would have 255.3

million acres planted, a level that has not been reached since 1997. So this year's surge in acres will exceed the increase we saw during the last bull run in 2007 and 2008.

Figure 1. Corn Exports (Source: USDA-FAS)

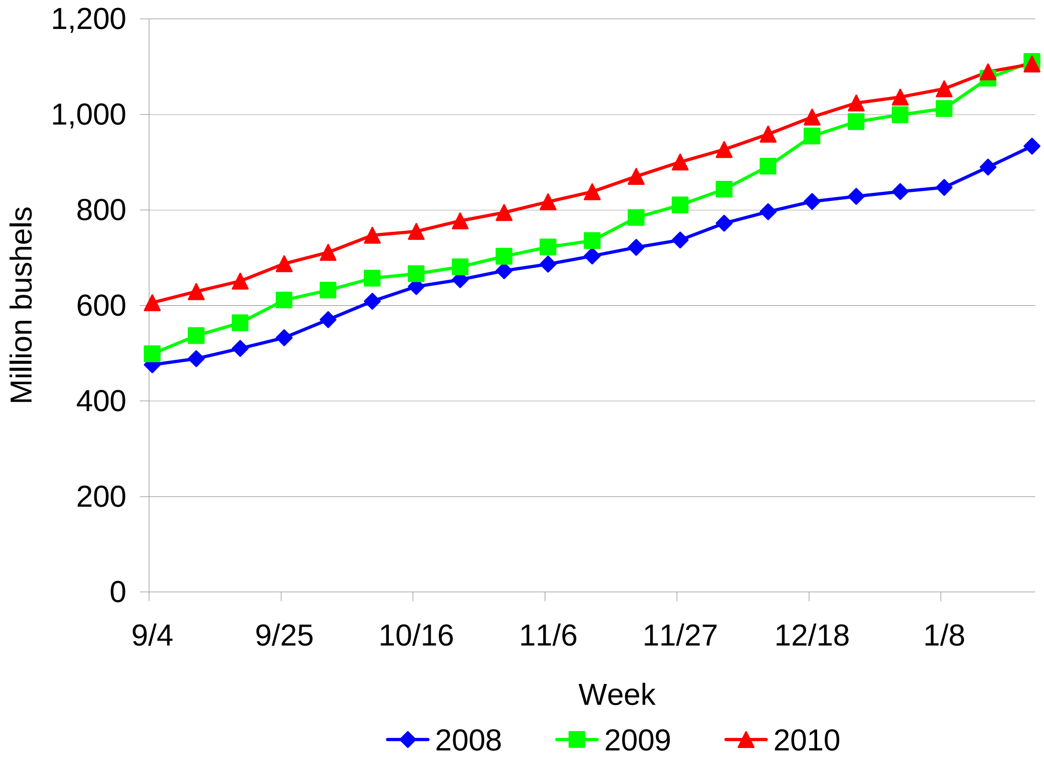
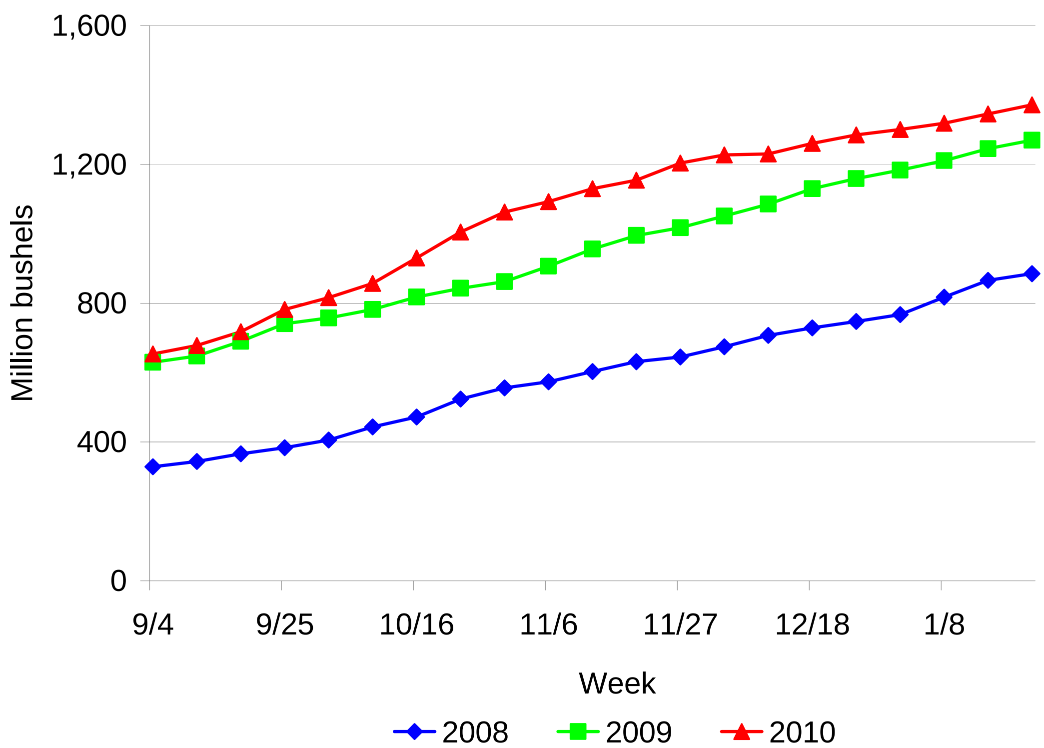


Figure 2. Soybean Exports (Source: USDA-FAS)

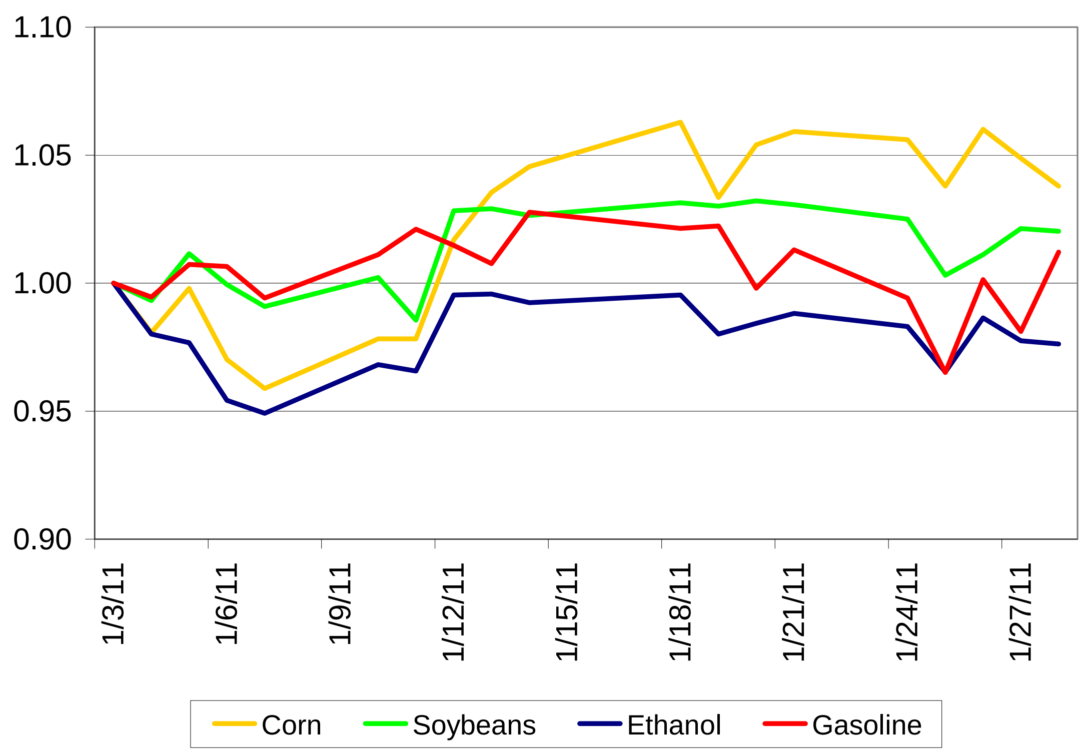


Much of the land for this surge comes from prevented plantings over the last two years, especially in the Dakotas. But given the roughly 10 million acre increase USDA has projected, some additional land is needed to reach the projections. And since the USDA also projects that CRP area will increase by 500,000 acres in 2011, the additional land must be coming out of pasture. However, with the current strength in cattle prices, it is hard to envision a lot of land shifting from pasture to crops. Given that, my own outlook is that CRP area will not increase and soybeans may lose 600,000 acres. If so, then total crop area is about where we were in 2008. I've picked soybeans for the land squeeze because it is the crop with the weakest price surge since last summer. Cotton looks to be in a dominant position through the Southeast, while corn and spring wheat are ahead in the Northern Plains and Corn Belt.

While the 2010 soybean export pace is still ahead of the 2009 pace, that gap has been decreasing as well. The shift seems to have started in mid-December. Early in the marketing year, soybean export demand had been up by over 10%. The gap is down to 8%. The vast majority of the export increase is from China. But even their buying pace has shown signs of weakening. Soybean sales to the European Union, Japan, and Taiwan are down 9 to 14%.

For the ethanol industry, blending margins remain in good shape as gasoline prices are holding above ethanol prices. But for the ethanol plants, costs have been rising faster than revenues. As Figure 3 shows, corn prices were up roughly 4% over January, while ethanol prices fell 2%. So production margins were being pinched and concerns were growing that the trend would continue. However, weekly ethanol production numbers are still hovering around record levels. And the unrest in Egypt has pushed energy prices higher. That could provide some room for ethanol prices to catch up to corn.

Figure 3. Price Movements (Jan. 3, 2011 = 1)



But even if demand is beginning to weaken, current crop price levels are very strong. USDA has the midpoints of their season-average price estimates at $5.30 per bushel for corn and $11.70 per bushel for soybeans. Futures, as of Jan. 28, pointed to season-average prices over $5.40 per bushel for corn and over $12 per bushel for soybeans. If these price hold, the 2010 corn and soybean crops will be the highest valued crops on record. The 2007 crops currently hold the record with season-average prices of $4.20 per bushel for corn and $10.10 per bushel for soybeans. The 2010 crops weren't small; we had the 3rd largest corn crop and the 2nd largest soybean crop. But demand has been sensational, strong enough to pull average cash prices over a buck above record levels.

The projected level of ending stocks for the 2010/11 crops remain very tight. And the futures markets have shifted some bullish pressure to the new crop contracts. In fact, futures-based projections of the 2011/12 season-average prices have those prices above this year's. As of Jan. 28, those projections were $5.60 per bushel for corn and $12.69 per bushel for soybeans. In evaluating 2011 crop prospects, the month of February is important as the crop insurance guarantees are based on average futures prices during the month. Given current prices, it looks like those crop insurance guarantees will also be record levels. This creates a good news/bad news situation for farmers. The good news is those record insurance guarantees that will provide substantial risk management protection for 2011. The bad news is that those guarantees will be paired with higher crop insurance premiums, as the premiums are directly tied to price levels.

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