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CANADA PROVIDES RECORD CATTLE/HOG PRICE SPREAD

A milestone was recently passed in the livestock industry as the live cattle futures price passed the previous record high of \$84.30 reached in March 1993. The new high futures level (to date) of \$84.90 was reached on August 28. On the other hand, hog prices are much lower. On the same day, the daily high of the nearby live hog futures price, when converted to a liveweight, was \$40.77. What a contrast. Live cattle futures were trading at a \$44.13 per hundredweight premium over the approximate equivalent live hog futures.

Cash cattle prices are setting records relative to cash hog prices as well. In the first eight months of this year, cash steer prices have averaged about \$38 higher than cash hog prices, measured as the live equivalent of 51 to 52 percent lean hogs. The previous record annual cattle premium was \$33 per hundredweight in 1992. While current premiums are high, premiums of cattle prices over hog prices have been trending upward for several decades.

What is contributing to the growing premiums for cattle? Three factors stand out. Long time observers of the livestock industry know that the wide swings in price relationships of cattle and hogs is not new. Perhaps the most dominant factor causing price variability is the changing supply across the production cycle. The beef production cycle tends to be about 10 to 12 years in length. The current cycle is unusually long, now up to 14 years, and is at the low production point.

The hog production cycle, however, tends to be about 3.5 to 4 years in length. Currently, we are in a mild liquidation phase of the cycle, yet pork production has just barely begun to come down. Thus, cattle production is at "low tide" and hog production is still fairly close to "high tide." Obviously, separate production cycles of widely different length cause large fluctuations in relative prices over time.

The second issue covers a range of topics. Many argue that the "industrialized" nature of the hog industry has reduced costs, narrowed profit margins, and resulted in an industry that is slow to make downward adjustments in supply. In addition, beef demand seems to have improved in recent years while pork demand has been more stable. Each of these contribute to higher cattle prices relative to hog prices.

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Finally, the current cattle price premiums are clearly related to the May 20 to August 8 closing of the Canadian border to beef shipments due to the BSE cow. The impacts have been dramatic for both cattle and hogs.

For cattle, U.S. supplies were sharply curtailed this summer as over 8 percent of the 2002 beef supply had Canadian origins. Somewhat over one-half of the total came as live cattle and the other portion as processed beef. The Canadian supply, of course, dropped to zero after May 20. Smaller supplies with a stable demand in the U.S. meant higher live cattle prices, and feedlot managers further responded with lighter marketing weights as they made every attempt get more cattle to market before prices collapsed. Marketing weights since May 20 have been down by about 3.4 percent from the same period in 2002.

Hog prices have been lowered due to the BSE cow in Canada. While the border was closed to beef, it was open to pork. The only outlet for Canadian beef this summer has been the Canadian consumer. Canadian consumers increased beef consumption which displaced some pork consumption. Pork and hog flows then increased to the U.S. For processed pork, June imports from Canada increased by 13 percent over May. The flow of live animals has also increased. Slaughter hog imports from Canada were about 1.5 percent of slaughter in early May, but expanded to 3 percent of slaughter by mid-August. In 2002, Canadian live hog imports (feeders and slaughter hogs) represented 5.7 percent of slaughter. By August of this year, that rate was exceeding 8 percent.

The Canadian situation has clearly contributed to record high cattle prices and premiums over hogs. Who are the winners and losers? The U.S. cattle industry and Canadian beef consumers have been the primary beneficiaries of an event that involved one cow with a positive BSE test. The losers have been the Canadian cattle industry, U.S. beef consumers, and U.S. pork producers.

Perhaps no one cow ever had such a large economic impact? Even Mrs. O'Leary's cow in Chicago only burned one town, while this one cow caused large economic distortions of livestock economies throughout an entire continent.

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