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## **In The Cattle Markets**

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### **Distillers Grain Prices**

Last week, USDA significantly revised its corn supply and demand estimates for the 2008-09 marketing year by increasing last fall's production to 12.1 billion bushels and reducing total demand by 235 million bushels compared to its estimates last month. As a result, ending stocks increased by 316 million bushels to 1.79 billion bushels. With such an adequate carryout, corn prices fell sharply last week (nearby March CME corn futures closed the week down about \$0.20/bu from its previous week's close after declining as much as \$0.43/bu at midweek). USDA's demand reductions in the January WASDE report reflect lower expected livestock use (50 million bushels less than projected in December), lower export demand (another 50 million bushels decline since the previous forecast), and a 135 million bushel drop in food, seed, and industrial use. Of this latter category, 100 million bushels of the decline was due to a drop in corn use for ethanol.

Several observations can be made from the January crop production report. First, with the highest carryout inventory in three years and an increase in the stocks-to-use ratio to 15%, there is little reason for old-crop corn prices to rally during the remainder of the 2008-09 marketing year (which ends August 31, 2009). However, new crop prices (basis December 2009 CME corn futures) likely has to rally to provide more of an incentive for growers to plant their acres to corn and not switch to soybeans. This may support old crop prices though. Despite the drop in fertilizer prices and other inputs (which some producers had already locked in), cost of production for corn remains well above current new crop cash forward bid prices in the Western Corn Belt. So, planting intentions this spring are expected to show a decline in planted acres. Too much of a decline, however, may result in a moderate rally in new-crop futures because the 2009-10 balance sheet will get increasingly tight. Some quick calculations based on some reasonable assumptions and scenarios can result in a very small ending stocks number for 2009-10. Such assumptions include a planted acreage of about 83 million acres (3 million acres less than 2008), trendline yield of 157 bu/acre, and constant to lower exports and livestock feed use. Simply increasing the ethanol use to the corn grind that would be needed to meet the 2010 renewable fuels standard without using RIN credits (around 4.2 million bushels) quickly reduces ending stocks to zero. Of course, price will ration bushels such that ending stocks don't drop to zero, which means prices would increase. For these reasons, livestock producers should consider price risk management strategies to protect against rising corn prices, particularly in deferred months. Maximum price contracts, call options, and futures hedges are tools to consider and take advantage of when feeding margins provide a profit and/or corn prices dip.

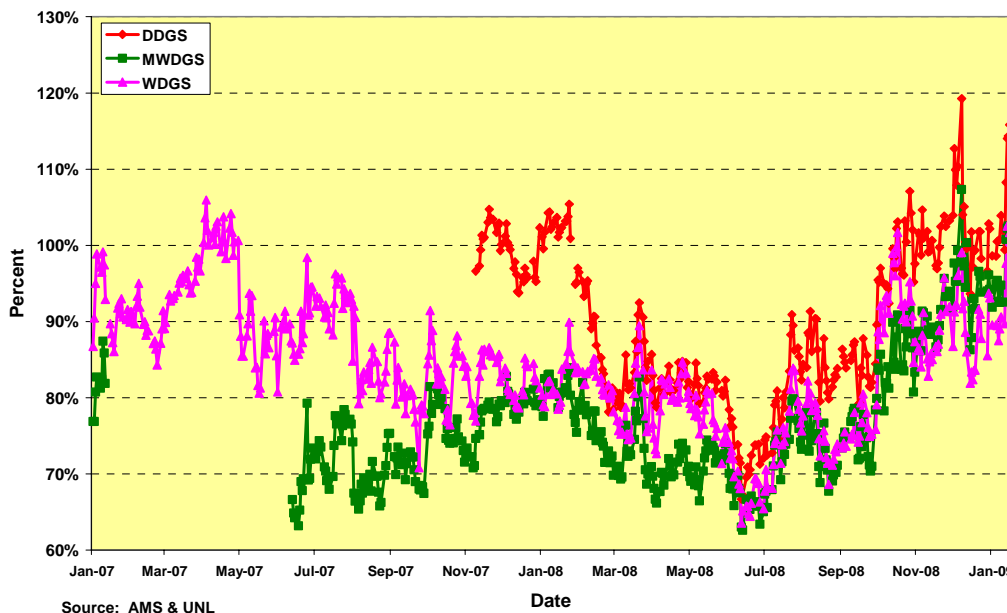
The 100 million bushel drop in corn for the ethanol grind reflects lower capacity utilization rates (prompted by declining ethanol margins) and the non-operating status of several ethanol plants that are in or seeking bankruptcy protection. The decline in this year's ethanol grind

relative to last month's forecast is still 600 million bushels higher than last year. Further, while ethanol plant construction and production expansion is likely to level off in the future, existing plants will be used in the long run – likely by new owners with lower fixed costs and capital investment. Note current media stories indicating that one major ethanol producer currently in Chapter 11 bankruptcy is seeking to auction off several of its plants. Most of the ethanol plant infrastructure is too new to be abandoned, and by recapitalizing it with new owners, can be profitable. Thus, the corn demanded by these plants isn't likely to decline substantially.

In response to the competition for corn from the ethanol industry, cattle feeders have used distillers grains to partially offset the higher price of corn. While overall costs have increased, feeding dry and wet distillers grains and other coproducts have been good risk management strategies to employ because they improve performance and typically are priced less than corn (on a dry matter basis). Interestingly, in the past two weeks, as corn price dropped dramatically and ethanol plants have shut down, supply of these coproducts has become limited. This is especially problematic for cattle feeders who can't simply remove it from rations once cattle have been fed this highly palatable feed. Given strong local demand and reduced supply, the cost of distillers grains has increased dramatically relative to corn (despite absolute prices dropping). The graph below shows that the price of dried distillers grains reached 115% of the corn price (on a dry matter basis) and wet distillers grains averaged 101% of the corn price, well beyond its typical level, last week in Nebraska.

The bottom line to last week's new corn supply and demand numbers is that the immediate drop in corn price increases could be offset in the longer run by additional costs, whether it be future corn prices or rising relative coproduct prices. Not surprisingly, last week's corn price decline didn't improve projected calf-finishing profits much – most of the gain was offset by higher calf prices.

**DDGS, MWDGS, and WDGS as a Percent of Corn Price,  
Dry Matter Basis, Nebraska, 2007-2009**



## The Markets

The slaughter cattle market found strength last week during a rally in boxed beef cutout prices. Dressed prices in Nebraska averaged \$1.45/cwt higher last week, while weekly average prices for live cattle sales in Kansas were about steady with the previous week. Choice boxed beef prices were up more than \$5/cwt, but the Choice-Select spread narrowed by \$0.60/cwt. Feeder cattle prices were steady to \$1/cwt weaker in Kansas last week. In Nebraska, yearling steer prices were softer as well, but calf prices increased by \$3/cwt in reaction to falling corn prices. Through Thursday last week, corn prices, basis Omaha, NE, were \$0.42/bu lower, which contributed to a \$3.50/ton drop in distillers grain prices.

	<b>Week of 1/16/09</b>	<b>Week of 01/09/09</b>	<b>Week of 01/18/08</b>
Kansas Fed Steer Price, live weight	\$83.60	\$83.74	\$90.56
Nebraska Fed Steer Price, dressed weight	\$135.34	\$133.89	\$142.77
700-800 lb. Feeder Steer Price, KS 3 market average	\$96.74	\$97.74	\$97.60
500-600 lb. Feeder Steer Price, KS 3 market average	\$109.54	\$110.32	\$111.91
700-800 lb. Feeder Steer Price, NE 7 market average	\$97.53	\$98.65	\$95.20
500-600 lb. Feeder Steer Price, NE 7 market average	\$116.24	\$113.25	\$122.15
Choice Boxed Beef Price, 600-900 lb. carcass	\$149.78	\$144.50	\$147.34
Choice-Select Spread, 600-900 lb. carcass	\$7.37	\$7.97	\$7.66
Corn Price, Omaha, NE, \$/bu (Thursday quote)	\$3.49	\$3.91	\$4.74
DDG Wholesale Price, Iowa, \$/ton	\$124.00	\$127.50	\$185.00