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Livestock Sector: Clash Between More Variability In Demand And Less Flexibility In Supply

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The Sunday flier for one of the national grocery chains with stores in our community offered boneless pork loins for $1.59 per pound. That same circular had 14-18 pound New York strip loins for sale for $3.99 per pound, only 40 cents lower than a boneless chuck roast.

Over the last eight years, the lowest sale price for boneless pork loins has been $1.99 a pound and the regular price has been a fairly steady $3.99 per pound. Likewise, the lowest price we have seen for New York strip loins has been an infrequent $5.99 per pound with the usual price running between $8.99 and $9.99, when they are in the meat counter. Most often all that is available are the packaged steaks at a higher price.

While the temporary low prices are a boon to the consumer, they indicate serious problems in the livestock sector.

In the 1998-2001 period, the crop sector experienced a long period of prices that were well below the cost of production. During that same period, animal agriculture was able to expand based in part on low feed costs.

Today crop prices are double what they were at that time and animal agriculture is facing profitability pressures from all directions. Feed costs are up significantly and live animal prices are well off the highs seen in the 2004-2008 period. Milk prices that were recently as high as $22 per hundredweight are now in the $12-$14 per hundredweight range. Dairy farmers increased their productive capacity in response to increased export demand only to see parts of that market vanish.

No one planned for the worldwide financial crisis and the resulting shrinkage of consumer spending. Who plans for an event that last happened in 1929?

Not surprisingly, those operations that have the greatest debt are the ones under the greatest financial pressure. During the period of low input prices and high market prices, some operations expanded in response to increased profitability and to meet what were thought to be permanent increases in demand.

Today they are in shaky condition as the result of market changes beyond their expectations.

Last fall we saw the bankruptcy filing of broiler producer Pilgrim's Pride who in 2006 bought out their competitor, Gold Kist. As a result some Pilgrim's Pride growers are in distress as well.

To compensate for over expansion and higher grain prices, the poultry sector and scores of agribusiness associations, through the Alliance for Agricultural Growth & Competitiveness (AAGC), are calling on the USDA to relax the rules governing the release of land that is currently enrolled in the Conservation Reserve Program (CRP). The AAGC is calling for rules that would not penalize grain farmers for taking non-environmentally sensitive land out of production in "time of low supply, as well as growing and shifting demand patterns in an intensely competitive global environment." The short story is they want to see an increase in the grain supply and lower grain prices (will they likewise support reducing crop acreage when crop prices are below the cost of production?).

In mid-November 2009, Coharie Hog Farms in North Carolina filed for Chapter 11 bankruptcy. Prior to its Chapter 11 filing, "Successful Farming" listed Coharie Hog Farms as the 22nd largest pork producer in the US. The company will be liquidated if it cannot find additional finances.

Recent news would suggest that tough times are not limited to producers. A recent press release indicated that JBS, the Brazil-based meat processing firm that bought Swift & Co. in 2007 and Smithfield Beef in 2008, is facing a steep decline in revenue leading it to seek a $2.5 billion cash infusion into its US operation. That cash infusion will allow JBS to continue with its plan to purchase its Brazilian rival, Berlin, and US-based Pilgrim's Pride. How well JBS will fare in its attempt to capitalize on the distress of others depends in part on forces beyond its control: the speed and nature of the global recovery, exchange rates, how meat producers in other countries will respond to the current climate and the desire for food security, and whether or not the change in consumer demand is transitory or more permanent.

There was a time when conventional wisdom held that the opening up of international markets would stabilize prices and reduce risk. Instead, we are seeing just the opposite. For US producers, export demand is more variable than domestic demand, leading to over expansion and the subsequent painful collapse in prices. This is just as true for the animal agriculture sector as is has been for crop agriculture.

While exports are promoted as a tool for market expansion, the other side of that equation is often ignored. The corollary to increasing exports is the possibility of increasing imports that cut into that somewhat stable domestic demand. If imports match or exceed exports, the opening up of markets can have a distinctly negative impact on domestic prices.

One of the arguments in favor of vertical integration and consolidation in the livestock sector is that the resulting firms would have greater control over the supply chain and therefore would be more stable. Recent events would suggest that is not true.

In some sense the old-fashioned diversified farm operation was better situated to weather the cyclical distress that is characteristic of agriculture. Seldom do we see a simultaneous bottom in both grain and livestock. Operating on that knowledge, when grain prices were low, farmers would add a few hogs, steers, chickens, or cows and make some additional income. Likewise when meat and milk prices were low, they could reduce their numbers and count on more profitable crop prices.

Integrated firms don't have that flexibility. They have all of their money invested in one portion of an economic sector that often faces wide swings in prices, due to events both internal and external to the sector. These firms are well situated to capitalize on the upswing and can function well in steady times, but have limited flexibility when prices turn sharply lower and demand goes south. Δ

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