

OUTLOOK FOR LIVESTOCK AND POULTRY

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The livestock and poultry sectors experienced a stressful year in 2002 as a confluence of weather, disease and trade disturbances affected markets. Drought gripped much of the nation, diminishing forage and increasing grain costs. As a result, economic conditions which might have been favorable for cow/calf producers to hold back heifers to add to the breeding herd were overshadowed by the continued inability of the forage base to maintain the existing herd and the cattle cycle entered its 7th year of liquidation. Hog producers expanded farrowings by about 3 percent in the first half of 2002 but as hog prices dropped in mid 2002 and grain prices rose to 5 year highs, producers began liquidating sows and reduced farrowings below year earlier levels. As a result, inventories which were 3 percent above 2001 on June 1 finished the year 1 percent below 2001. The poultry sector was hit with several outbreaks of disease which although having limited impacts on aggregate production, resulted in disruptions of trade flows. Coupled with ongoing disputes with Russia on poultry imports, exports fell sharply and pushed large supplies on the domestic market. Faced with poor returns, the broiler industry began a sustained production cutback in the fall of 2002.

As the sector moves into 2003, prospects for livestock and poultry are somewhat improved. Although grain prices are higher than a year ago, a return to normal weather may insure adequate forage supplies for the reduced inventory. Tighter inventories should help support livestock and poultry prices during the year, setting the stage for an expansion in inventories in the next years. Hog inventories may begin increasing next year and cattle, the year beyond. Trade prospects are improved. Although several countries have instituted barriers which may limit growth in exports to those countries, it is hoped that they will bring a degree of normalcy to trade patterns. However, a number of uncertainties overhang any forecast in 2003. The economy remains sluggish and any economic disruption could limit meat demand. Disease and food safety concerns are increasing and could derail any expansion if foreign or domestic consumers shy away from meat consumption.

Cattle Inventory Decline Continues

The cattle sector continues to decline as the liquidation enters its eighth year. The number of cattle and calves on farms on January 1, 2003 were 1 percent lower at 96.1 million head, down 7 percent from its 1996 peak. Tighter feeder calf supplies are conducive to producers beginning to retain heifers for addition to the breeding herd and the most recent *Cattle* report supports that idea, heifers for beef cow replacement were 1 percent higher on January 1 and bred heifers were 3 percent higher. If producers follow through with their plans, heifer calves from this year's calf crop would be retained, bred in 2004 and calve in 2005. Thus it is unlikely that beef production will rise before 2006. However, drought

continues to overhang many producer decisions. Although it has mitigated in the Southeast, the drought has continued in the West and is extending East through the central Corn Belt. Much of this new drought area saw an increase in cow numbers as cattle were moved to areas where forage was available. Stocks of hay on farms were reported 6 percent lower on December 1 which implies that some producers may find it difficult to support their cow herds until forage conditions improve.

However, should producers be able to carry through with their expansion plans, placements in feedlots are expected to drop sharply in 2003. The 2002 calf crop was the smallest since 1951 which means that the available pool of calves for slaughter will be lower than last year. Although the number of calves outside feedlots on January 1 is estimated to be 1 percent above last year, this is more than offset by a 7-percent decline in cattle on feed on that date. Many of those cattle outside feedlots are on small grain pasture and will be moving into feedlots during the first quarter, but feedlot numbers are still expected to average 7-9 percent below year earlier. Feedlot numbers are expected to tighten further during the year as supplies of calves drop and producers retain heifers to add to the breeding herd. However, if forage supplies remain tight into summer or beyond, feedlot placements may be higher than expected, especially if producers alter breeding herd decisions and retain fewer than expected heifers.

Beef production is expected to decline about 4 percent in 2003, as slaughter drops and recent gains in weights moderate. First half beef production is expected to decline by less than 1 percent as feedlots continue marketing animals placed in the latter part of 2002 and both dairy and beef cow slaughter remains relatively strong. As feedlot inventories decline, slaughter is expected to fall about 8 percent in the second half of the year with the largest beef production declines occurring in the fourth quarter of the year.

As production declines, fed cattle prices are forecast to rise. Prices in 2002 averaged \$67.04 per cwt and likely will average in the mid-\$70's through much of this year. Despite high retail prices in 2002, demand for beef remained relatively strong. Retail prices in 2003 could exceed 2001's records as supplies of beef tighten in late 2003. Spurred by higher fed beef prices and tighter calf supplies, feedlots are going to bid up the price of feeder calves. Feeder calf prices are forecast to rise from the mid-\$80's per cwt in the first half to touch the low \$90 range by the fourth quarter.

Beef exports in 2002 reached a record 2.48 billion pounds. Growth was strongest to Mexico and Korea while sales to Japan, still recovering from the BSE scare, remained substantially below 2001. Exports are forecast to grow further in 2003, reaching 2.57 billion pounds as sales to Japan recover. However, higher beef prices and continued weakness in the currencies of major importing countries may slow growth to more value conscious customers. Imports are expected to increase 3 percent to 3.3 million pounds as U.S. supplies of processing grade beef decline.

Hog Producers Cautious

Faced with higher grain prices and falling hog prices, producers appear to have cut short a planned expansion and lowered inventories in 2002. The December 1 hog inventory indicated that there were 1 percent fewer hogs and pigs on farms compared to December 1, 2001. In early 2002 producers were

poised to increase production after two years of prices in the mid \$40 per cwt range,. Farrowings in the first half of 2002 averaged 3 percent higher and concerns were being expressed that slaughter numbers in the fourth quarter might begin to stress slaughter capacity. However, grain prices began to increase last summer and hog prices had begun to move lower in the second quarter. By late summer producer returns were being squeezed and, with concerns of substantially lower prices in the fourth quarter, producers scaled back their production plans. Sow slaughter jumped sharply and producers reduced farrowings to 2 percent below the previous year. By December 1, the breeding herd inventory was 3 percent below 2001.

Although pork production in 2002 increased almost 3 percent to a record 19.67 billion pounds, lower beginning inventories and a much more cautious view of hog markets is likely to lead to lower production in 2003. Producers have indicated that they expect to farrow 2 percent fewer sows in the first half of the year. Although hog prices are forecast to rise during the year, it is unlikely that returns will be sufficient to trigger any inventory expansion before 2004. First quarter production is expected to be about 1 percent above 2002 as the last of the second half 2002 inventory expansion reaches market weight. In subsequent quarters, production is forecast to fall below last year despite a continued trend towards higher carcass weights. For all 2003, production is forecast to be 19.46 billion pounds, about 1 percent below last year.

Hog prices in 2002 averaged \$34.92 per cwt, below break even for much of the sector. Little relief is expected in the first quarter of 2003 as prices are expected to average \$34-36, about \$5 per cwt below first quarter 2002. However, as supplies of pork tighten, hog prices are forecast to increase to \$38-42 in the spring and summer quarters. Additional price support will likely come from reduced supplies of other meat, particularly beef. However, even in the face of high wholesale beef prices in the past several months, pork prices have increased very little. Retail prices in the first quarter are expected to be below last year, reflecting relatively large supplies of pork but then strengthen later in the year. In the fourth quarter, both live hog and retail prices are expected to decline from their seasonal peaks but remain above 2002. For the year, live hog prices will average \$37-\$39 per cwt and retail prices will average in the upper \$2.60's per pound range.

Pork exports rose about 4 percent in 2002 to an estimated 1.62 billion pounds carcass weight. Exports to Japan and Korea expanded while trade with Mexico and Russia was weaker. Despite lower U.S. production, some export growth is expected during 2003 as income growth in a number of key countries stimulates demand. However, in the case of Mexico, the forecast for U.S. exports is somewhat clouded. Mexico has instituted an anti-dumping investigation against U.S. pork. Although the investigation phase is still underway, preliminary findings may be announced as early as mid-July. The assessment of duties may have a depressing impact on pork exports. U.S. pork imports climbed about 15 percent as shipments from Canada reflected higher Canadian production. Higher pork prices in 2003 will help attract larger imports although the rate of growth will likely be tempered by slower growth in Canadian production as drought in 2001-2002 raised grain prices. Imports in 2003 are forecast to increase 2 percent to about 1.08 billion pounds.

Sheep and Lamb Inventory Decline Continues

The inventory of all sheep and lamb fell in 2003 continuing the long downturn. On January 1, 2003 the sheep and lamb inventory totaled 6.35 million head, down 5 percent from 2002. The breeding sheep inventory also declined 5 percent from a year ago, compared with a 1 percent decline last year. Despite the ewe lamb retention program instituted as part of the Lamb Industry Improvement Initiative, drought in many sheep producing regions has forced continued liquidation. In 2003, commercial production of lamb and mutton is projected at 208 million pounds, down 5 percent from a year ago. Carcass weights declined from their highs in 2001 and may be slightly lower if grazing remains poor and grain prices remain relatively high.

Prices have begun the year quite strong and are forecast to average in the upper \$90's per cwt through the early April religious holidays. Thereafter, prices will likely decline seasonally, dropping to the low \$80's by the fourth quarter. However, for 2003, prices are forecast to average \$84-89 per cwt, \$14 above 2002.

In 2003, lamb and mutton imports are expected to total about 172 million pounds, up 6 percent. In 2002 imports rose about 12 percent. Strong U.S. prices will likely encourage increased imports from Australia and New Zealand.

Broiler Producers Scale Back

Broiler producers began 2002 following through on an increasing pace of expansion begun in late 2001. Production in the first 3 quarters of 2002 averaged 4 percent growth, but weakening prices in the face of large supplies of total meat and trade disruptions beginning in April forced a scaling back of production in the fourth quarter. Production in the first 2 quarters of 2003 are expected to decline, the first two-quarter decline in Federally Inspected broiler production since 1975. Broiler production in 2002 rose 3.3 percent to 32.3 billion pounds on the basis of both higher slaughter levels (up 1.6 percent) and heavier weights (up 1 percent). However, gains were tempered by a slowdown in production in the last quarter. Beginning in August, eggs set and chicks placed data pointed to a sustained decline in production as producers began to respond to an extended period of lower prices.

From August through December, weekly eggs set averaged 2 percent below 2001. As a result, during the fourth quarter, the number of birds processed was down 0.2 percent although an increase of 1.6 percent in average slaughter weights supported a small increase in broiler meat production. With continued weakness in prices, the decline in eggs set has extended into its 27th week. Thus, production in the first and second quarters of 2003 are expected to be about 1 percent below 2002. However, prices are forecast to begin to recover as stocks are drawn down and fresh supplies tighten. With a return to steady export movement, producers may see incentives to expand production beginning in the latter part of the second quarter. This is expected to lead to a 1-2 percent increase in second half production. For the year, production will likely increase less than 1 percent, the slowest rate of growth since the early 1970's.

Broiler prices in 2002 were depressed as large supplies of broiler meat were forced on the domestic market to compete with increased pork and beef production. The 12 City broiler price averaged 55.6 cents per pound, their lowest level in 10 years. However, as stocks are drawn down, prices are expected to recover steadily through the year. Prices in the first half are likely to increase 7 percent, averaging 58-62 cents per pound and remain close to that level for the year. For 2003, broiler prices are expected to average 58-62 cents per pound.

Disruptions in trade were an important factor in the increase of domestic supplies in 2002. Total exports declined from 5.56 billion pounds in 2001 to an estimated 4.87 billion pounds in 2002. Extended trade issues with Russia caused the biggest decline in exports. Exports to Russia through November during the year fell an estimated 31 percent due to a temporary ban in March and further disruptions caused by restrictive import licensing procedures. However, Russia was not the only market where exports declined. Exports to most major markets fell as disease outbreaks in various flocks at various times led to bans on trade from certain States. As a result, stocks of poultry, particularly dark meat built up and kept parts prices lower than a year earlier. In 2003, several issues have arisen which continue to cloud the outlook for broilers.

Russia has recently indicated that it will place a quota on poultry imports starting around May 1st. The quota is expected to be 744,000 metric tons (1.64 billion pounds), with 553,500 metric tons (1.22 billion pounds) allocated to the United States. Over the 8-month period this would average out to 152.5 million pounds a month. This is almost 40 million pounds a month less than in 2001, when the U.S. exported a record 2.3 billion pounds of broiler products to Russia. Furthermore, Russia is in the process of certifying which U.S. poultry processing plants will be allowed to continue to export to Russia. Russia has stated that before June 1, all plants that want to export to Russia should be re-inspected and approved by Russian veterinarians. USDA and Russian veterinarians continue to negotiate the terms of the inspections after Russia failed many plants in the first round of inspections. To date, only a small number of plants have passed this certification process and no new plant inspections are currently scheduled.

As of January 1, 2003, according to the NAFTA, all quotas and tariffs on poultry products entering Mexico were phased out. However, the United States agreed to Mexico's introduction of a provisional safeguard on chicken parts imports under NAFTA. The provisional safeguard establishes a tariff rate quota and allows duty free imports of chicken legs quarters, thighs, and drumsticks up to 50,000 tons during the next 6 months. Additional imports of these products in this 6-month period will be subject to a 98.8 percent tariff, which was the 2001 tariff level. Presently, there has not been an official announcement about quota levels after the initial 6 months.

Currently there are ongoing discussions with the Chinese government regarding changes in poultry labeling requirements. China insists on labels printed directly on shipping cartons and plastic inner liners. China has placed a deadline of April 1, 2003 on this new requirement after which shipments without the correct labeling will be refused entry.

Nonetheless, it is expected that there will be some opportunities for growth in broiler exports. Russia's quota, if applied entirely to broilers, is almost 20 million pounds above average shipments to Russia

during the first 11 months of 2002. The Mexican TRQ is well above historic levels of leg quarter exports to that country and there are no tariff constraints on exports of other poultry products. Lastly, USDA continues to negotiate with the Chinese over the labeling issue. Broiler exports in 2003 are forecast to increase to 5.25 billion pounds, 8 percent above 2002 although below 2001's record 5.56 billion pounds.

Turkey Production About Unchanged, Prices Slightly Higher

Weak returns to turkey producers in 2002 are expected to lead to slower growth in 2003 turkey production. Turkey production in 2002 increased 3 percent to 5.7 billion pounds, despite disease related slaughter and weakening returns. Although over 4 million birds were slaughtered due to an outbreak of Avian Influenza in the mid-Atlantic region in April 2002, production growth in the first 2 quarters averaged 4 percent. However, as turkey prices softened and grain prices rose, returns were squeezed and producers began to cut back on production. Third and fourth quarter 2002 production increased about 1 percent and production in the first quarter of 2003 is forecast to be about 1 percent below year earlier. As stocks are worked down, prices are expected to firm and production by mid-year should be about 1 percent higher than last year. However, relatively large supplies and weak exports are likely to moderate prices and keep production for the year at about 5.73 billion pounds, about equal to last year. Eastern Region Hen prices are forecast to average 65-69 cents per pound in 2003, about 2 cents above 2002.

Turkey exports dropped sharply in 2002 as disease outbreaks and disputes with Russia limited trade. Exports to Mexico, the U.S.'s largest market, fell 13 percent through November and exports to Russia were less than half last year's level. However, a doubling of exports to Hong Kong helped mitigate some of the decline. Total turkey exports in 2003 are forecast to rise 5-6 percent, and will be driven primarily by shipments to Mexico. Exports to Russia will likely be tempered by the policy change in the global poultry quota, due to be instituted in early May. If importers choose to focus on importing broiler legs, turkey exports to Russia may drop further.

Egg Production Flat, Prices Higher

Egg production in 2003 is forecast to be about unchanged as returns remain weak. Although outbreaks of Exotic Newcastle Disease (END) have resulted in quarantines and destruction of birds in California, Nevada, and Arizona, thus far the impact on national egg production has been limited. Table egg production is forecast to be about unchanged at 6.16 billion dozen in 2003, and hatching production is also about unchanged at 1.07 billion dozen. Hatching use is expected to dip in the first half of 2003 as broiler production falls but will increase later in the year. Eggs broken are expected to increase in 2003 as consumption of eggs as ingredients in products continues to increase and the food service sector uses more pasteurized egg products. Egg prices are forecast to strengthen in 2003, rising to the highest level since 1998. Prices for the year are forecast to average 70-75 cents per dozen.