



Living with Higher Feed Costs

Livestock producers are well aware that feed costs are higher than they were two years ago. The higher prices are expected to encourage increased world production of grains and oilseeds, but growing demand for food, feed and fuel will remain strong. While we can debate what the new price levels will be, there is nearly universal agreement that higher grain prices are not a passing fad. Eventually, we expect livestock and poultry prices to increase in response to the higher feed costs and reach a level that yields enough margin to sustain the industry. However, the transition may not be smooth or timely. The challenge for producers is to survive the short-term transition and prepare for long-run success.

Cattle and hog producers have experienced significant losses on animals sold since the fall of 2007. In addition to higher feed prices, there will also be greater grain price volatility. The loss of equity, higher input costs and price volatility lead to greater risk for producers. Short-term survival and long-term management in the future will require a review and possible revision of both production and business practices.

The first step is to recognize that the world has changed. Strategies that worked well when corn was readily available and under \$2/bu may not work when it's difficult to buy and the price is over \$5/bu. Secondly, implementation of changes in management and practice are important. Recognizing that things have changed isn't worth much unless you adjust to the change. Put another way, how do you change habits that were developed when feed costs were low? Many times the change needed is not a one-time correction, but rather an ongoing practice that must be continued.

What will feed prices be?

Given enough time, more land will be used for grain

production worldwide, yields will increase, livestock demand for grain will decline and cellulosic ethanol production will be commercially viable, filling part of the ethanol demand. These expected changes in supply and demand will help moderate corn prices. However, in the coming year or two, corn prices are expected remain near \$5/bu. This spring's delayed plantings may push that number higher, as will adverse weather during the growing season. A recent study by the U.S. Center for Agricultural and Rural Development (CARD) indicates that even a bumper U.S. corn crop would only lower crop year average prices to near \$4/bu, but a severe drought could push average prices to almost \$8/bu. With the price of barley tied to the price of corn, barley can only follow.

This study reinforces two important management considerations. Firstly, farmers should not wait for \$2 barley — anything near \$4 will probably be a good purchase. Secondly, prices may become very high if weather problems occur, as we have seen with the weather problems in the central Corn Belt (e.g. Iowa). **Do farmers have a strategic reserve of barley to get through a period of very high prices or will they have to buy grain during these volatile times? Do they have borrowing capacity and storage to purchase some or all of their feed needs if the opportunity presents itself?** Or will they have to use highly valuable barley produced on their own farm?

When will livestock prices adjust?

There are two ways that commodity prices can increase: higher demand or lower supply. Domestic demand depends largely on the price of competing meats, consumer income and consumer preference. Rising feed costs have impacted all animal proteins, so prices of competing meats are expected to be impacted some-

what similarly. What impact will Country of Origin Labelling have on the Canadian price of feeders and finished animals? Consumer spending is being negatively impacted by a weaker economy and rising gas prices and there is little indication that they prefer pork or beef more than they did before, all else equal. Demand also depends on exports, and pork exports have been strong in recent months. Beef exports continue to grow slowly and there is hope that South Korea will be supportive for exports. After a slow start in 2007, pork exports have increased rapidly since the fall. At least a portion of the increased sales are likely related to the lower pork prices that occurred from October to March and may decline somewhat due to the higher prices seen in the summer.

Given the demand outlook, livestock production at the higher feed costs will likely have to decline in order to restore profitability for livestock and poultry producers. Liquidation of both hog and beef cattle breeding herds has begun. Beef cow and heifer slaughters are higher than the previous year. This adds to the current supply of beef, but will reduce supplies in the future. Higher pasture and forage costs and downward pressure on calf prices are squeezing cow herd margins, which in turn will continue to encourage a reduction in cow herds. Lower placements of cattle into feedlots will reduce slaughter later in 2008 and prices are forecast to be higher than we saw in the spring. However, sustained higher price levels will require further reductions to cattle inventories.

By mid-May hog prices had improved, but feed and total costs are expected to trend higher and prices are expected to decline again in the fall, meaning red ink will likely return. The sow herd liquidation now underway is expected to lead to slightly higher hog prices in 2009. There is concern that the reprieve this summer may slow or stop the liquidation that is needed to return to profitability levels with the higher feed costs.

U.S. pork production from October 1, 2007 to mid-May 2008 was 10.1 per cent higher than the same period the previous year. Prices similar to those seen in late 2006 and early 2007 will not be profitable in 2009. Export growth may help. The U.S. exported approximately 15 per cent of its production in 2007, which translates into more room for Canadian hogs. Through the first three months of 2008, U.S. exports were 40 per cent higher than the same period in 2007. If this pace is

maintained, total U.S. demand will increase by six per cent. In addition, Canada has reduced its breeding herd. But the bottom line is that U.S. and Canadian producers will need to significantly reduce their breeding herd to achieve long-term profitability. Some estimates predict a reduction of 10 per cent or more is needed in the higher corn/barley price era.

Managing risk

Grain prices will be volatile and sensitive to weather this growing season. Likewise, hog and cattle prices will be volatile as we move from high to lower supplies. Exports, the economy and producer reaction to volatile corn prices will all impact these selling prices.

Producers are encouraged to recognize these risks and focus on the margin between revenue and costs rather than simply prices. While opportunities will exist in volatile markets, it may be wiser to be more cautious in the months ahead.

Futures, options, forward contracts and livestock insurance products are tools that can help protect producers from significant shocks to their operating margins. Locking in an acceptable margin on at least a portion of production may be a better strategy than hoping things work out for the best. ■