

**CME's Weekly Agricultural Options offer a unique tool for managing risk surrounding high impact events such as USDA reports.** Options on Live Cattle, Soybean Meal and Soybean Oil were added last fall to that already-listed options on Corn, Soybeans and Wheat. The appeal of these options, of course, is that their time value component is relatively low but they still provide protection against large short-term moves in futures prices. DLR readers can get more information simply by clicking on the banner at the bottom of this page.

**Following up on yesterday's brief discussion of demand indexes — Dr. Derrell Peel of Oklahoma State University contends in his most recent Cow/Calf Corner newsletter that "while supply is clearly the main driver pushing cattle and beef prices upward, it is consumer beef demand that will determine just how far prices will go.** He believes — and we agree — that one reason for the importance of consumer-level demand this coming year is that it is perhaps the biggest unknown in the price equation.

Exports can frequently be a wild ride but it appears the U.S. dollar will remain low relative to major customers' currency, that BSE-era restrictions will, if anything, decline and that the world's taste for U.S. fed beef is strong. Dr. Peel (and we) expect this aspect of U.S. beef demand to be solid barring any unforeseen circumstances.

In addition, the supply situation is set for 2012 and, as has been well-documented in many places, it will get tighter as the year progresses. There will not be any more calves created that will impact this year's beef supply. Heifer retention has already begun in places that have forage available. While the Southwest U.S. drought is not yet over, the map at right shows clearly that conditions have improved substantially, meaning that Oklahoma and Texas could join the heifer retention/cow herd expansion movement this spring.

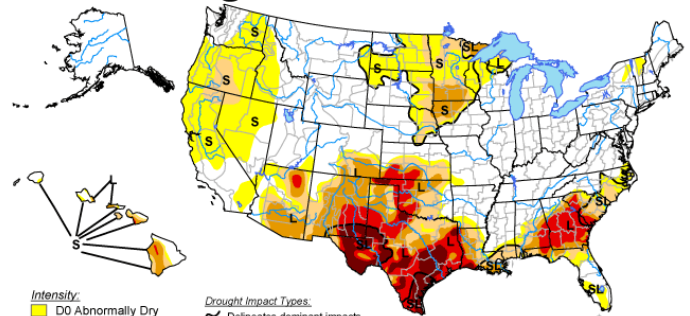
So that brings us to domestic demand. Dr. Peel points out that beef demand (or demand for any other item, for that matter) is a combination of willingness and ability to purchase a given quantity of product at a given price. Lower 2012 beef supplies suggest higher 2012 beef prices, all other factors held constant.

But all other factors are seldom constant. Key among these is the set of factors that underlies all demand — tastes and preferences — another term for consumer desires. Peel points out that "There is no significant indication that consumer preferences for beef have declined," even as consumers have been forced to change their spending patterns. He also quite correctly points out that the beef is "not one product but many different products" and that consumer preferences may well have changed in terms of product mix.

The past few years have seen prices of historically lower-value cuts such as trimmings, rounds and chucks increase sharply while prices of "high-end" cuts such as loins, ribeyes and tenderloins grew only slightly at best. Are these changes driven by changes in the willingness to pay or the ability to pay? Very likely some of both as consumer incomes have stagnated, especially since the onset of the Great Recession. It is no accident that high-end cuts have struggled at the same time NRA's Restaurant Performance Index (RPI)

## U.S. Drought Monitor December 27, 2011

Valid 7 a.m. EST



### Intensity

- D0 Abnormally Dry
- D1 Drought - Moderate
- D2 Drought - Severe
- D3 Drought - Extreme
- D4 Drought - Exceptional

### Drought Impact Types

- S = Short-Term, typically <6 months (e.g. agriculture, grasslands)
- L = Long-Term, typically >6 months (e.g. hydrology, ecology)

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.

<http://droughtmonitor.unl.edu/>



Released Thursday, December 29, 2011  
Author: Brad Rippey, U.S. Department of Agriculture

has indicated sever challenges for the foodservice sector.

Dr. Peel also points out that consumer purchases are driven by value — or better yet, relative value. The prices of pork and chicken are important as well. On this point, four new record-high monthly retail pork prices in 2011 (thru November) helped beef demand. Continued high pork prices will support it in 2012. 2011 retail beef and pork prices, through November, both grew by about 10% relative to 2010. Whole broiler prices, though, increased by only 2% and the composite broiler price (which is based on individual chicken cut prices) grew by only 0.7% last year. Peel correctly points out that this is a sign of strong preferences for beef versus chicken — that consumers would pay substantially higher prices. It also implies that the ongoing reductions of chicken supplies and, hopefully, higher chicken prices will add strength to beef demand in 2012. We add that the same holds true for pork demand in the coming year.

The big question may well be the "ability" of U.S. consumers to pay for beef in 2012. Peel points out that the Great Recession caused "significant adjustments in consumer spending and may have permanently changed spending patterns."

Economic growth in 2011, which was hampered by Japan's earthquake and tsunami and the ongoing saga of European sovereign debt, was anemic even relative to the slow post-recession pace of 2010. Job growth remains slow, real personal disposable income declined slightly in the second and third quarters of 2011. Expectations for 2012 are better, but not by much.

But Dr. Peel points out that there are reasons for optimism. The savings rate has declined some. We aren't sold that is a good development for the long run but it certainly helps consumer spending in the near term. The holiday season appears to have been good but not great. And, as we discussed yesterday, NRA's RPI has indeed moved higher this fall.

**Announcing Weekly Live Cattle Options  
Now Trading**

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