

Daily Livestock Report

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What is the best predictor of the prices for fed cattle or market hogs? There is no better predictor of one day's price than the previous day's price. But another good one is the sum of the cutout value and drop (by-product) value for the respective species. As the charts at right show, the cutout value plus drop value is highly correlated to the price of the slaughter animal (live cattle and carcass hogs) for both species over the past 12 years.

As a refresher — the cutout value is the weighted average value of all of the cuts from an animal's carcass. The price of each cut is multiplied by the proportion of the carcass that the cut represents and the resulting values are summed up to arrive at the cutout value. Cut prices are updated daily for beef and as often as they are traded and reported for pork — daily for some pork cuts but some important ones (most notably bellies) are either not traded or not reported on some days. Beef prices are reported every day they are traded since wholesale beef price reporting is mandatory.

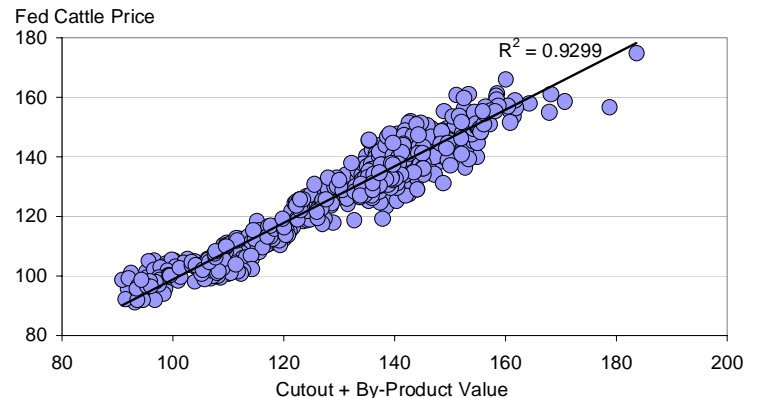
So, it is logical that the cutout value is highly correlated to the prices paid for the animals since it represents the lion's share of packers' revenues. Additional revenues are garnered from selling "the drop" or by-products that are not part of the carcass. For beef, the hide is a major portion of this value. Pig skins are far less valuable though they have seen some increase due to their use in Ugg brand boots now popular with teen girls. Organ meats, blood, ears and cuts from the heads are the other major drop components.

We do note that the very lowest hog price-cutout value observations come from the November 1998 through January 1999 period when pork packing capacity utilization was among the highest ever. These observations are the primary reason that a curvilinear regression line provides the best fit but dropping them from the data set does not result in a linear regression becoming the best fit. There is some non-linearity in the hog price—cutout value relationship even without these extreme observations. We think that is due to less excess packing capacity in the pork industry which causes hog prices to be more sensitive in the low part of the price/value range.

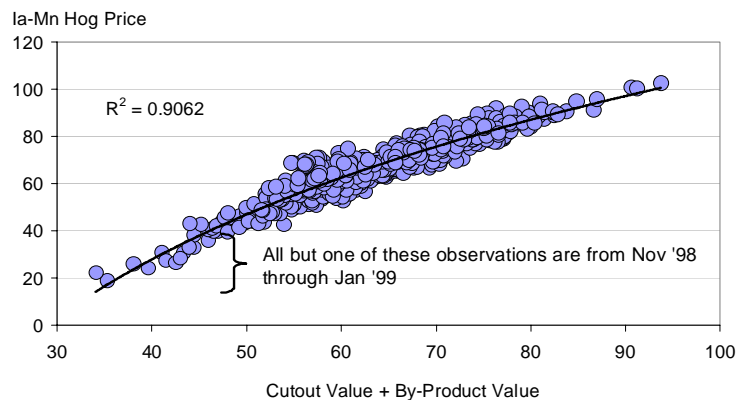
The relationship between cattle prices and cutout/drop values is linear and stronger than is that for pork. But also notice that the spread in cattle prices at each cutout + by-product value level is generally larger than is the spread for pork and that the spreads are not consistent across the range of values. There is a larger spread in cattle prices at high cutout+by-product values. Part of this variation could be differences in time since two adjacent dots could be from very different time periods.

Why are these relationships important? First, they provide us some insight into value and price determination in livestock markets. End-use value drives upstream price and does so with a rather high degree of accuracy. Second, the relationships help us relate one price to another in our forecasting efforts. Finally, these relationships may be quite important in the ongoing debate about market power in cattle and hog markets. Last Friday's USDA/DOJ Agricultural Competition Workshop in Ankeny, Iowa was the first of a series that will address this topic. The Ankeny meeting included some significant saber rattling by politicians and bureaucrats. We hope they take time to look at facts and relationships such as these in their rush to fix "problems". More on the workshop in tomorrow's DLR.

WTD. AVG. BEEF CUTOUT PLUS DROP VALUE VS. FED CATTLE PRICE, 1998-2009



PORK CUTOUT PLUS DROP VALUE VS. IA-MN HOG PRICE, 1998-2007



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