

Negotiated Cash Mandates & Price Discovery in Fed Cattle Markets

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Reno, Nevada – October 30, 2022

Negotiated Cash Trade Mandates

- *Costs & benefits of mandates are benefits & costs of alternative marketing agreement (AMA) use.*
- *Alternative marketing agreements are formulas. 60-70% of fed cattle trade are formulas.*
- *Formulas do not change the supply/demand balance. More cash trade will not result in better prices nor change the market situation since 2016-17.*
- *AMAs are worth at least \$25/head to feedlots.*
- *AMAs are worth at least \$25/head to packers.*
- *Reducing AMA use will decrease calf prices \$50/head on the animals impacted.*
- *Cattle feeding outside of the Midwest U.S. – & aligned upstream cow-calf producers – impacted the most.*

Table 1: An Illustration of How Variation in AMA Volumes Do Not Impact Cattle Market Fundamentals.

	Low AMA Volume	High AMA Volume	Excess Fed Cattle Demand	Excess Fed Cattle Supply
Feedlot Availability:	100,000	100,000	90,000	110,000
Formula	40,000	80,000	80,000	90,000
Cash	60,000	20,000	10,000	20,000
Packer Needs:	100,000	100,000	100,000	100,000
Formula	40,000	80,000	80,000	90,000
Cash	60,000	20,000	20,000	10,000

What matters here and what doesn't matter?

- What matters is availability versus needs.
- What does not matter is the split of availability/needs into cash or formula.
- *If packers don't need to bid on them then feeders don't need to sell them.*

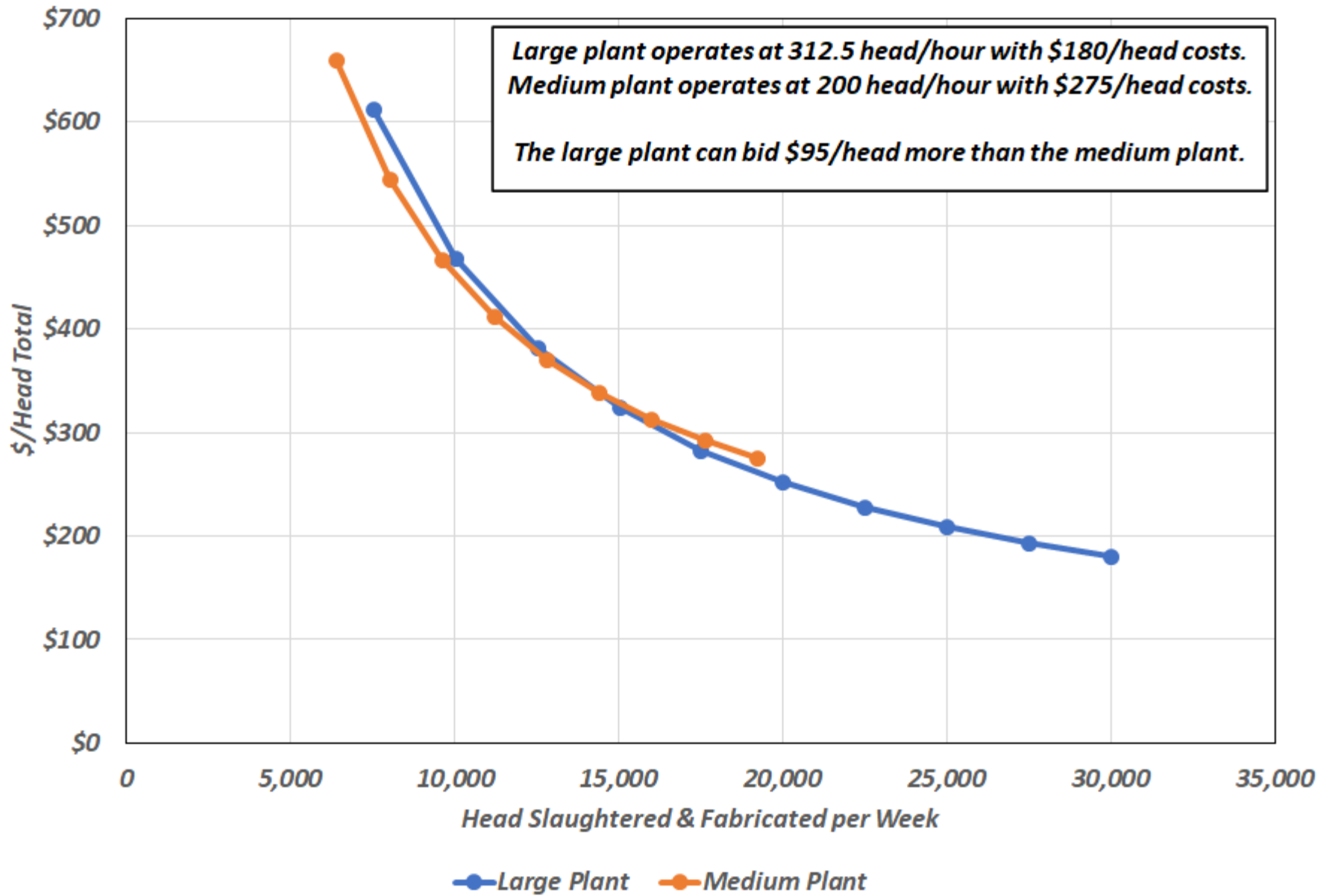
Negotiated Cash Trade Mandates

- *Impacts on system efficiency, cost reductions, & revenue improvement.*
- *Risk management impacted also.*
- *Value added...*
- *Domestic & international demand...*
- *Improved price discovery.*
- *Costs are high & benefits minimal to zero.*
- *Hundreds of millions for certain and likely billions of dollars of impacts – annually – mainly to cow-calf producers.*
- *Don't let me forget to mention AMAs require trust.*

The Dilemma...

- *What would you rather have?*
 - *4-5 bids from packers with \$700 per head costs.*
 - *3-4 bids from packers with \$500 per head costs.*
 - *Or 1-2 bids from packers with \$200 per head costs.*
- *Who has the high-bid most of the time?*
- *This is why we have the industry structure that we do have.*
- *The same applies to feedlots – banks, insurance, feed suppliers, retailers,...*
- *If you want a different industry structure, then don't sell to the high bid.*

Total Costs of an Example Large Versus Medium Plant



Let's get back to Price Discovery –
Consider the Following...

What is it that you buy a lot of?

Imagine from your front porch that you can see all you need for the next 2 weeks, 6 weeks, and 12 weeks. What you need is everywhere.

And then someone you usually trade with comes to you with another two week's supply.

What's additional supply worth? (& wait...)

Consider the Following...

That was the packing industry in 2017, 2018, 2019...

What's that additional two week's supply worth in 2017, 2018, 2019?

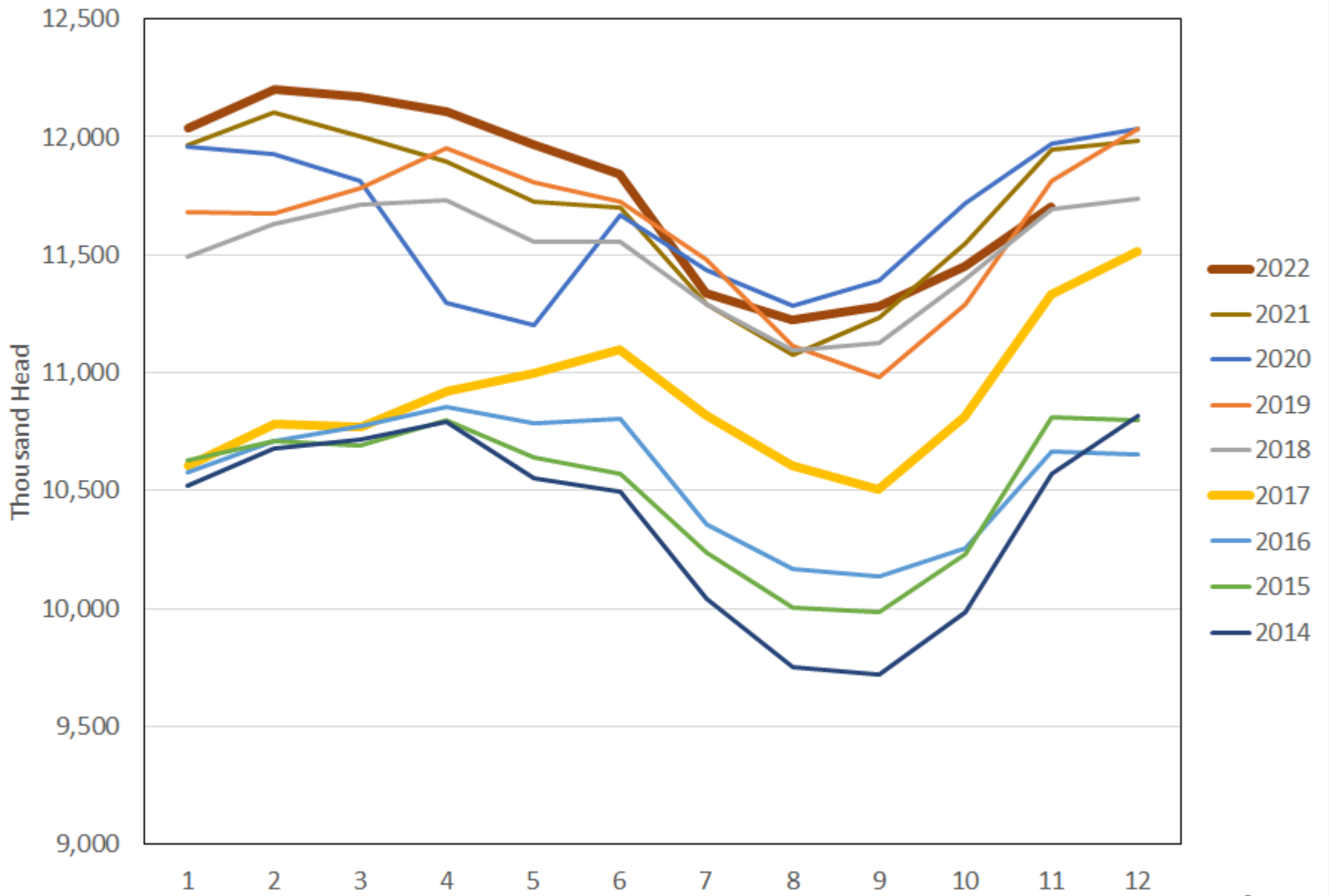
And then COVID hit, and plants were anticipated to be closed for two weeks. That's an enormous amount of rescheduling.

Now, during the summer of 2020, what's that additional two week's supply worth?

And the meat side?

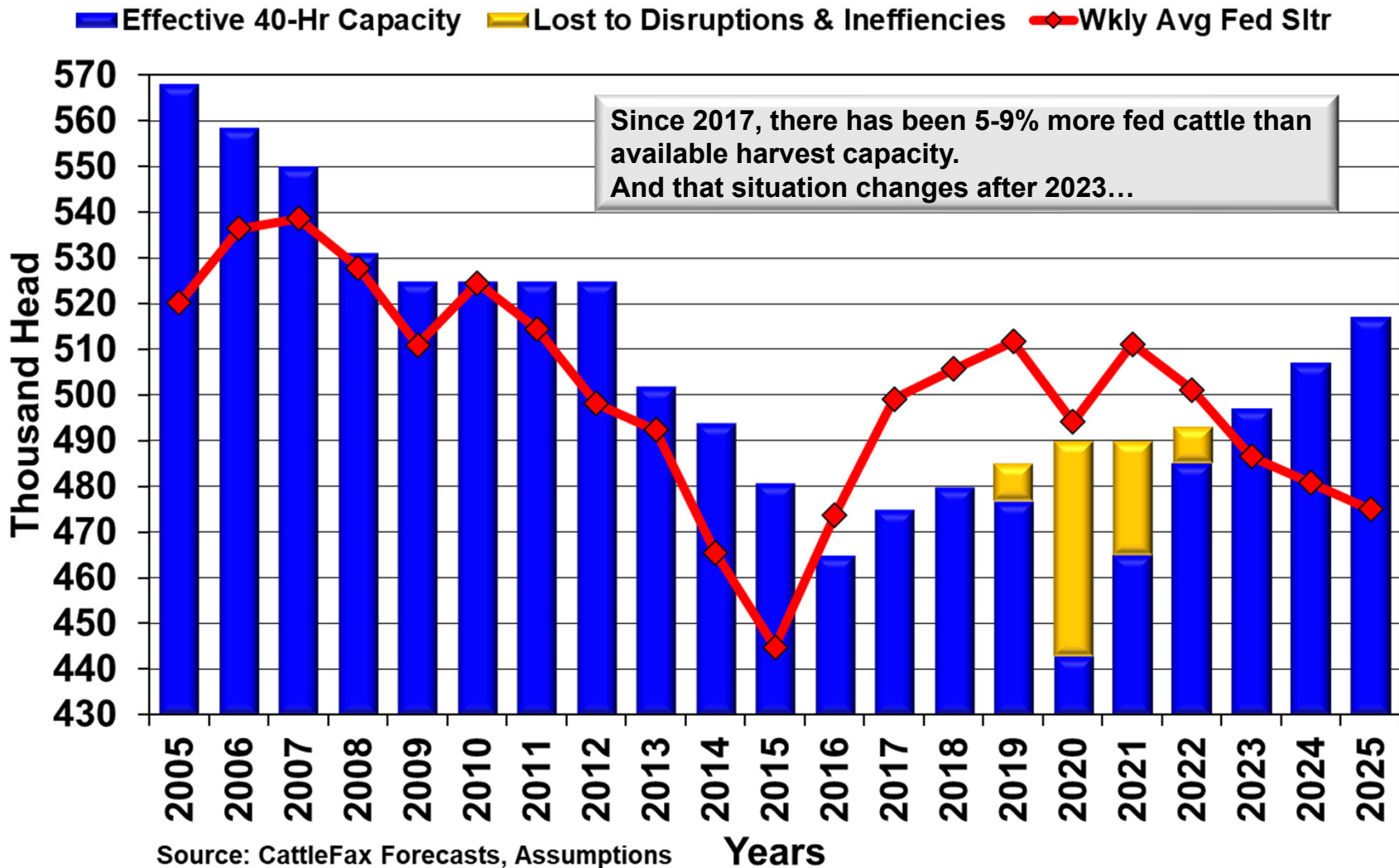
Does this situation communicate a price discovery problem? No.

Cattle on Feed



Fed Slaughter Capacity Utilization

Vs. Monday-Friday Packing Capacity

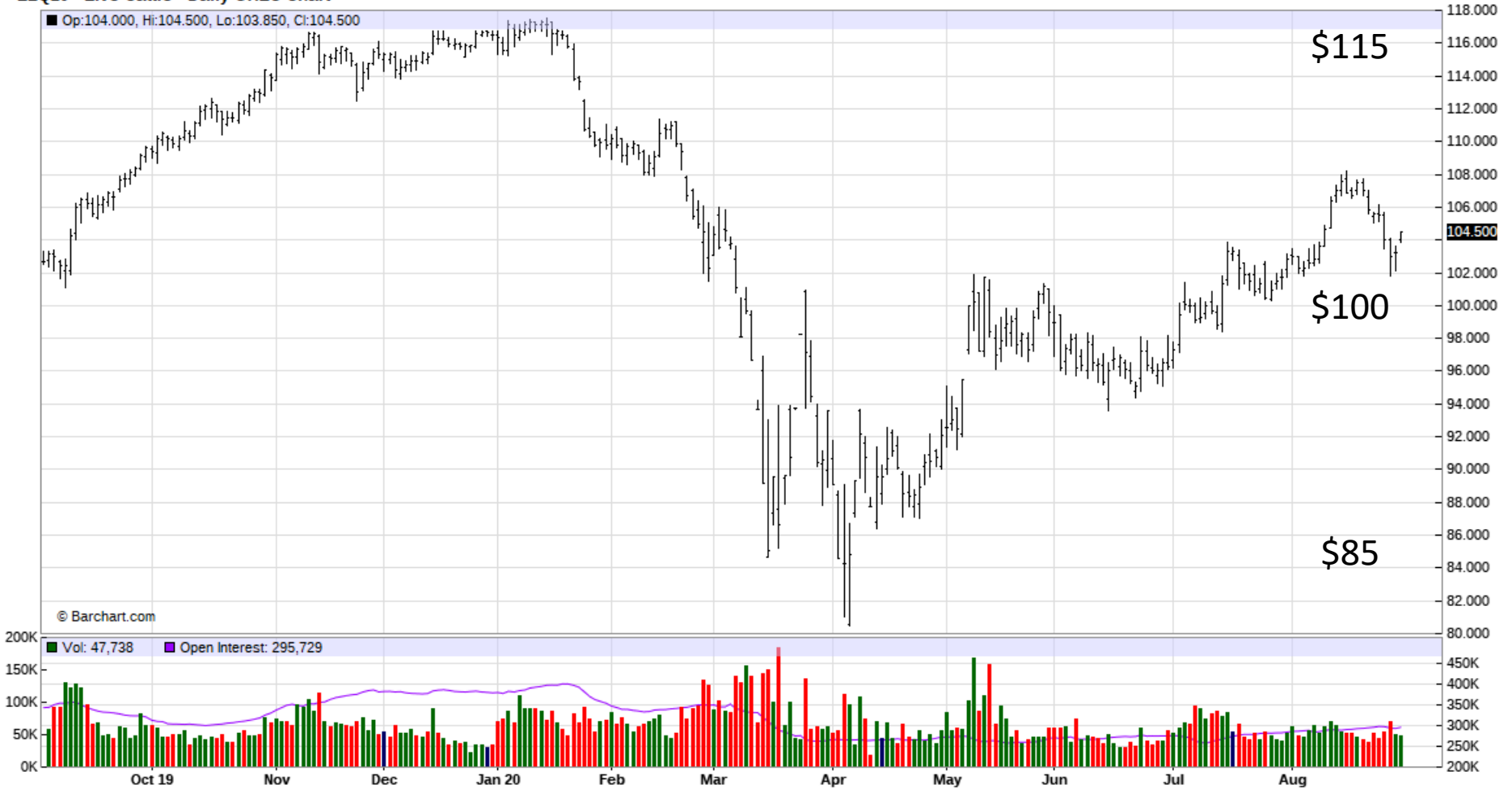


Since 2017, there has been 5-9% more fed cattle than available harvest capacity. And that situation changes after 2023...

The industry needs more harvest capacity to avoid this in the future. Some new capacity will come online in late 2022 thru 2024.

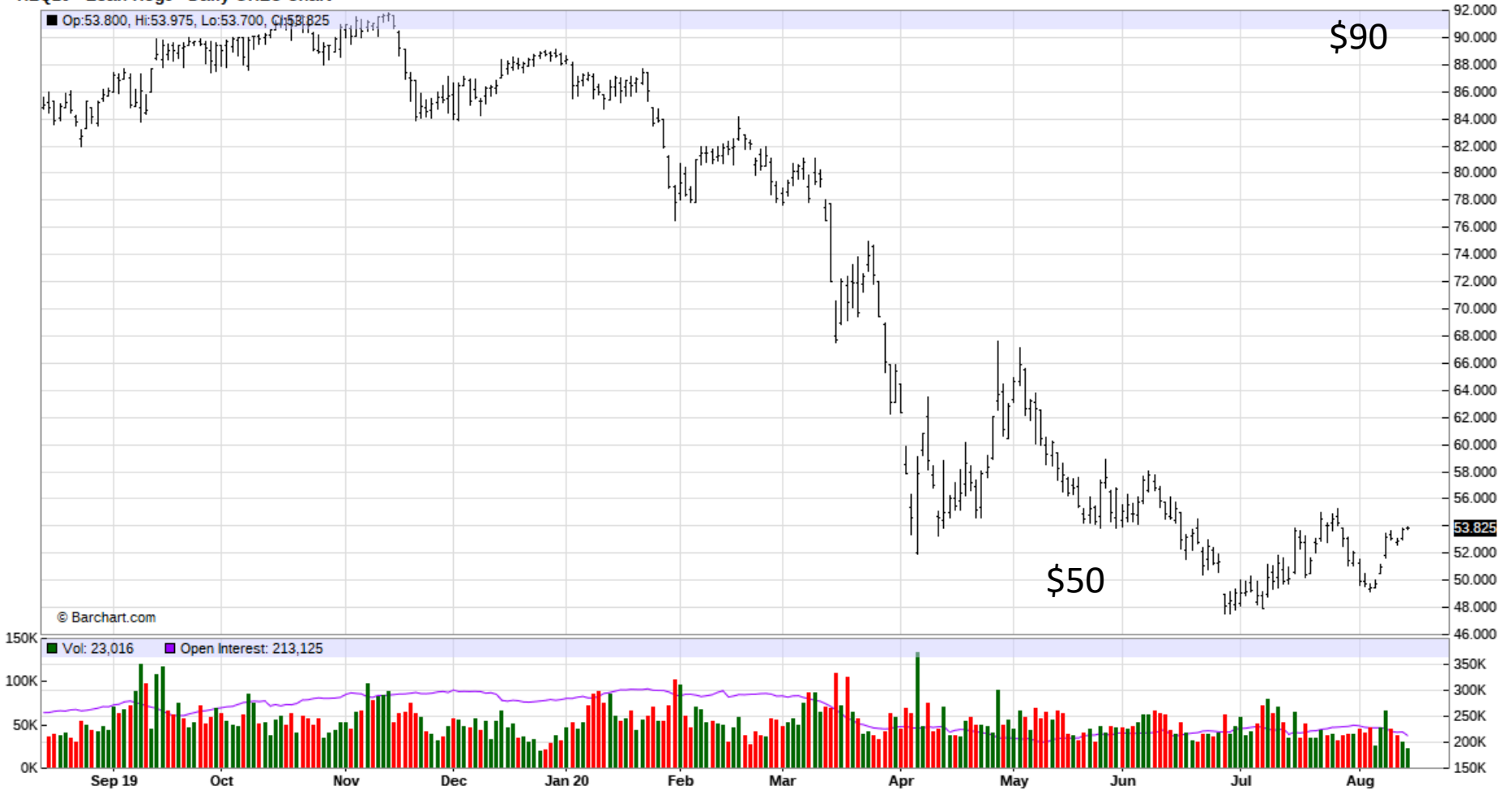
AUG 2020 Live Cattle Futures Contract

LEQ20 - Live Cattle - Daily OHLC Chart



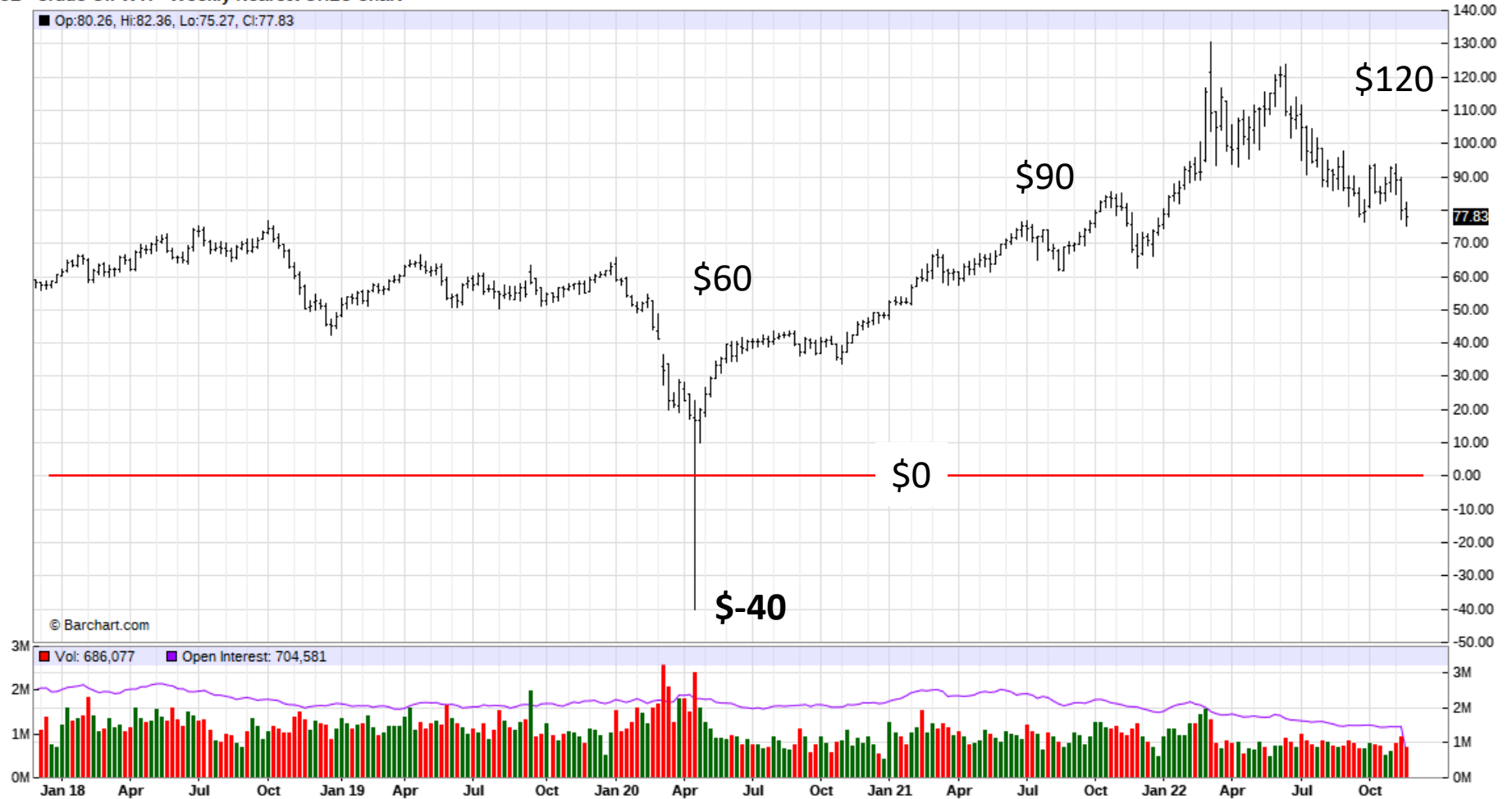
AUG 2020 Lean Hog Futures Contract

HEQ20 - Lean Hogs - Daily OHLC Chart

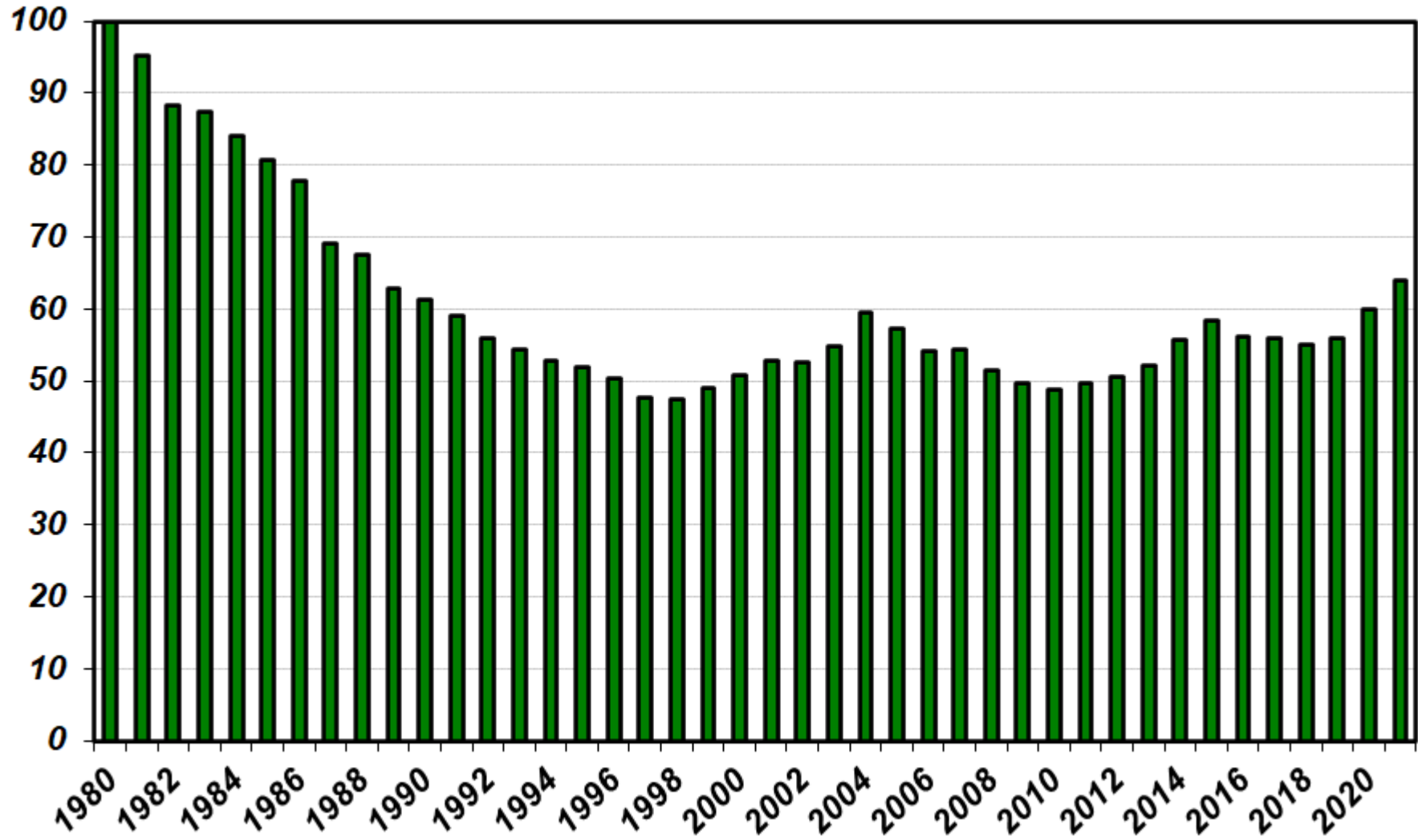


Weekly Crude Oil Futures Contract

CL - Crude Oil WTI - Weekly Nearest OHLC Chart



Beef Demand Index: Retail Prices

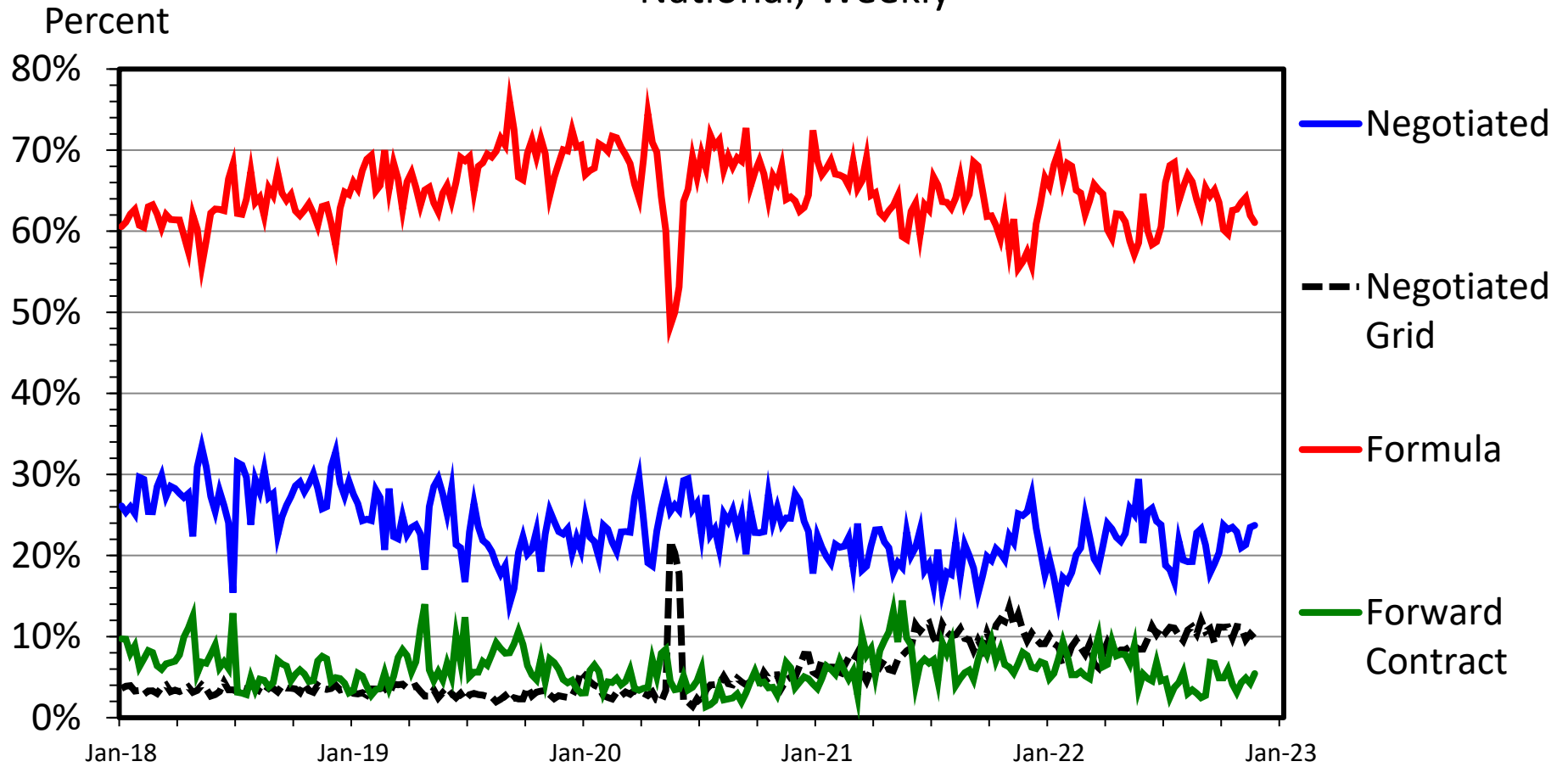


Why is Price Discovery Important?

- *Prices need to communicate underlying value.*
- *Beef demand collapsed 50% between 1980-1998.*
 - *Why? – product failures – lack of price discovering value.*
- *Demand is steady to improving in 1999-2004, 2011-15, & 2019-2022.*
 - *Why? – improved products – improved price discovery.*
 - *How? Value-based marketing.*
 - *Also, major consumer & producer education efforts...*
 - *And what is the #1 tool for value-based marketing? – Grid pricing.*
 - *And what is the #1 tool for grid pricing? – Formulas.*

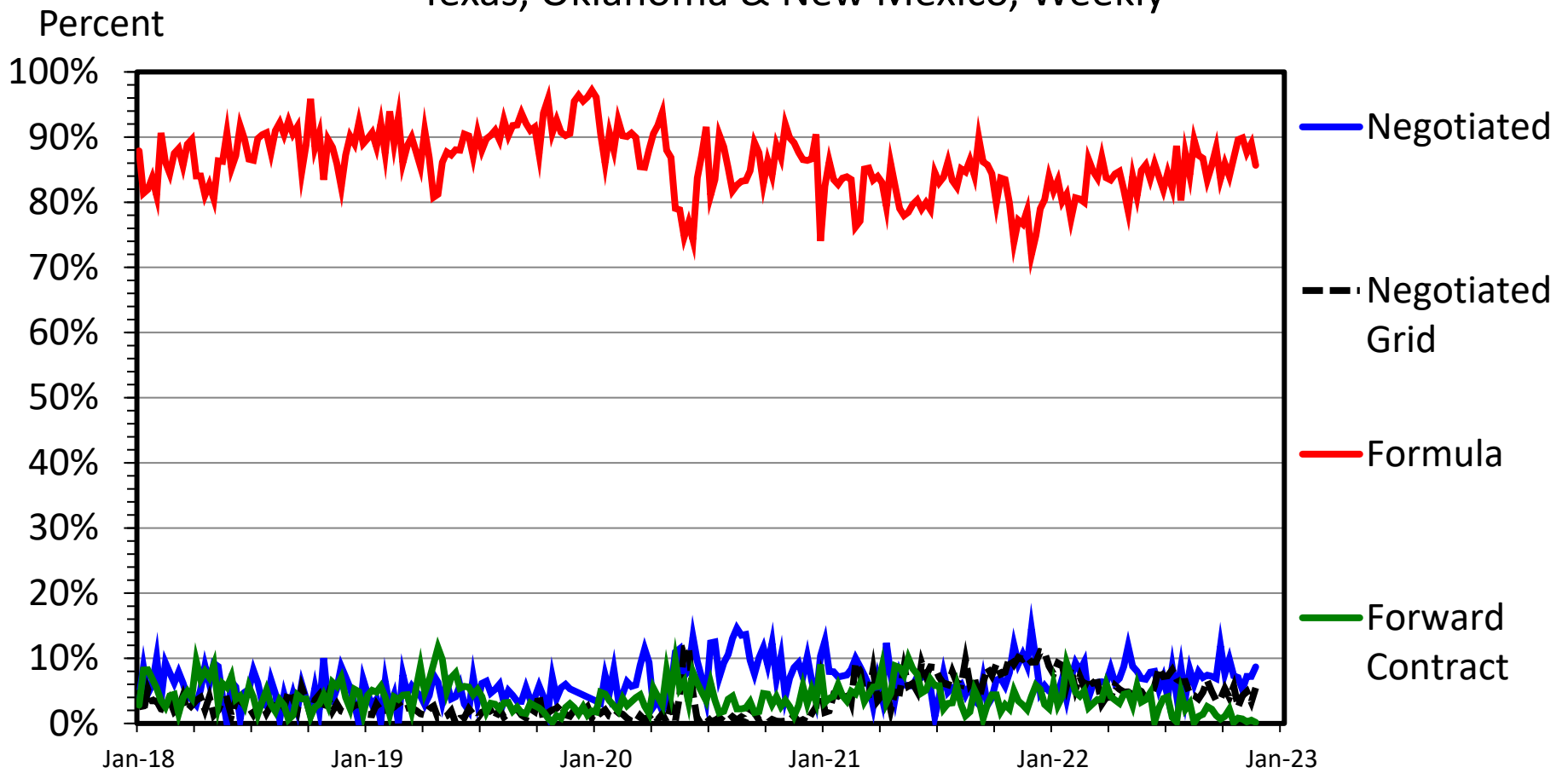
STEERS/HEIFERS SOLD BY TRANSACTION

National, Weekly



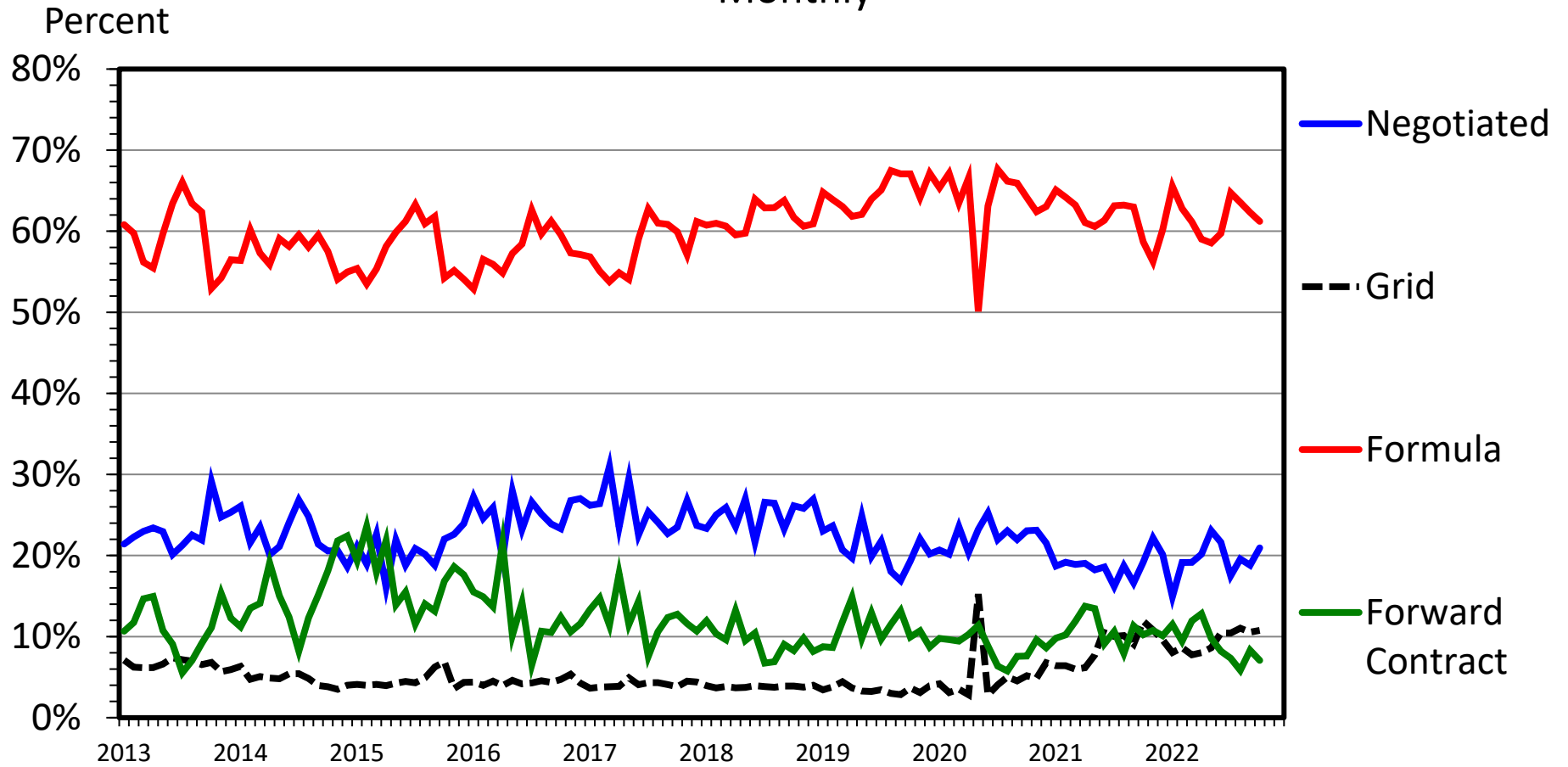
STEERS/HEIFERS SOLD BY TRANSACTION

Texas, Oklahoma & New Mexico, Weekly



TOTAL CATTLE SOLD BY TRANSACTION

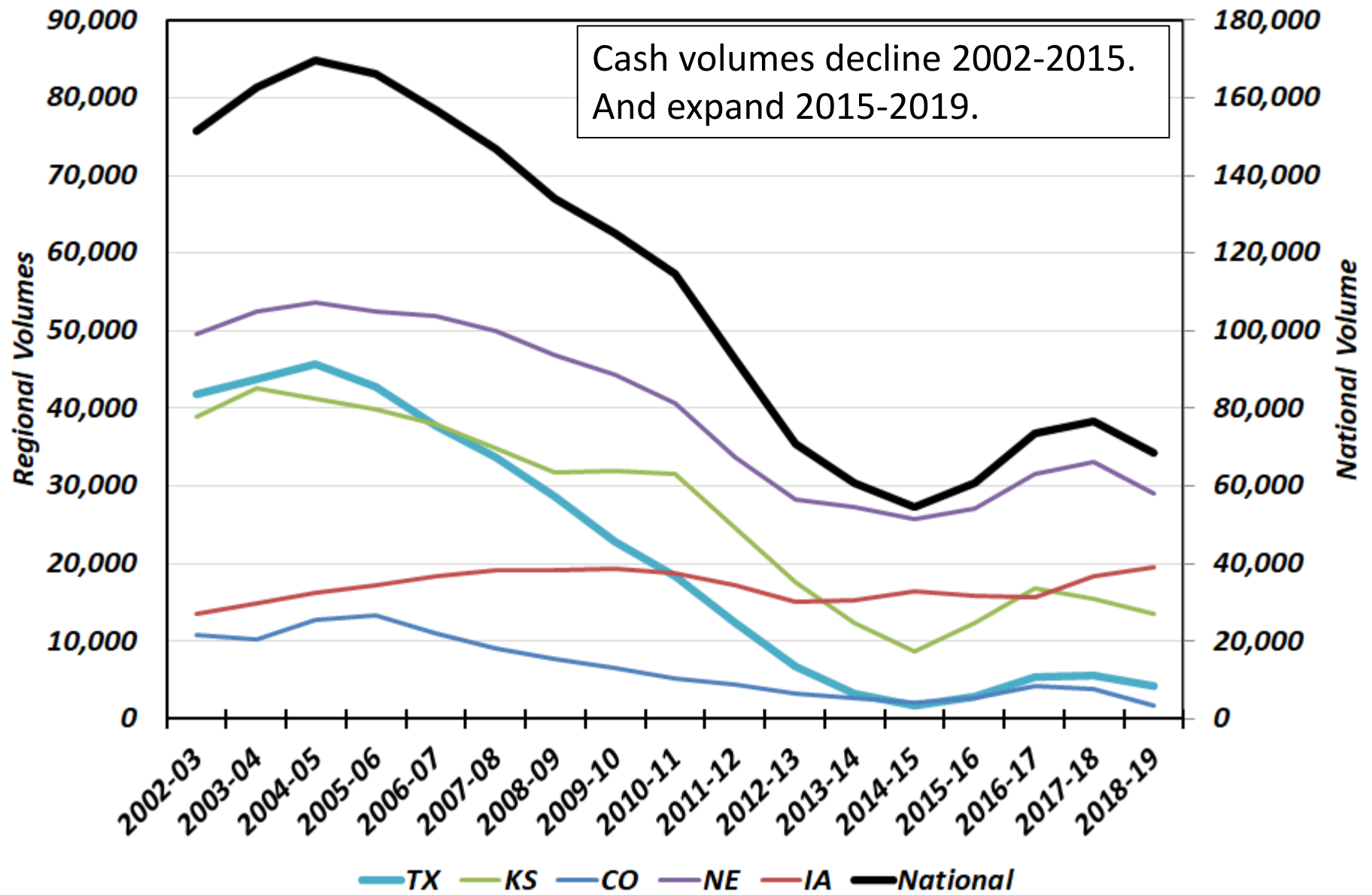
Monthly



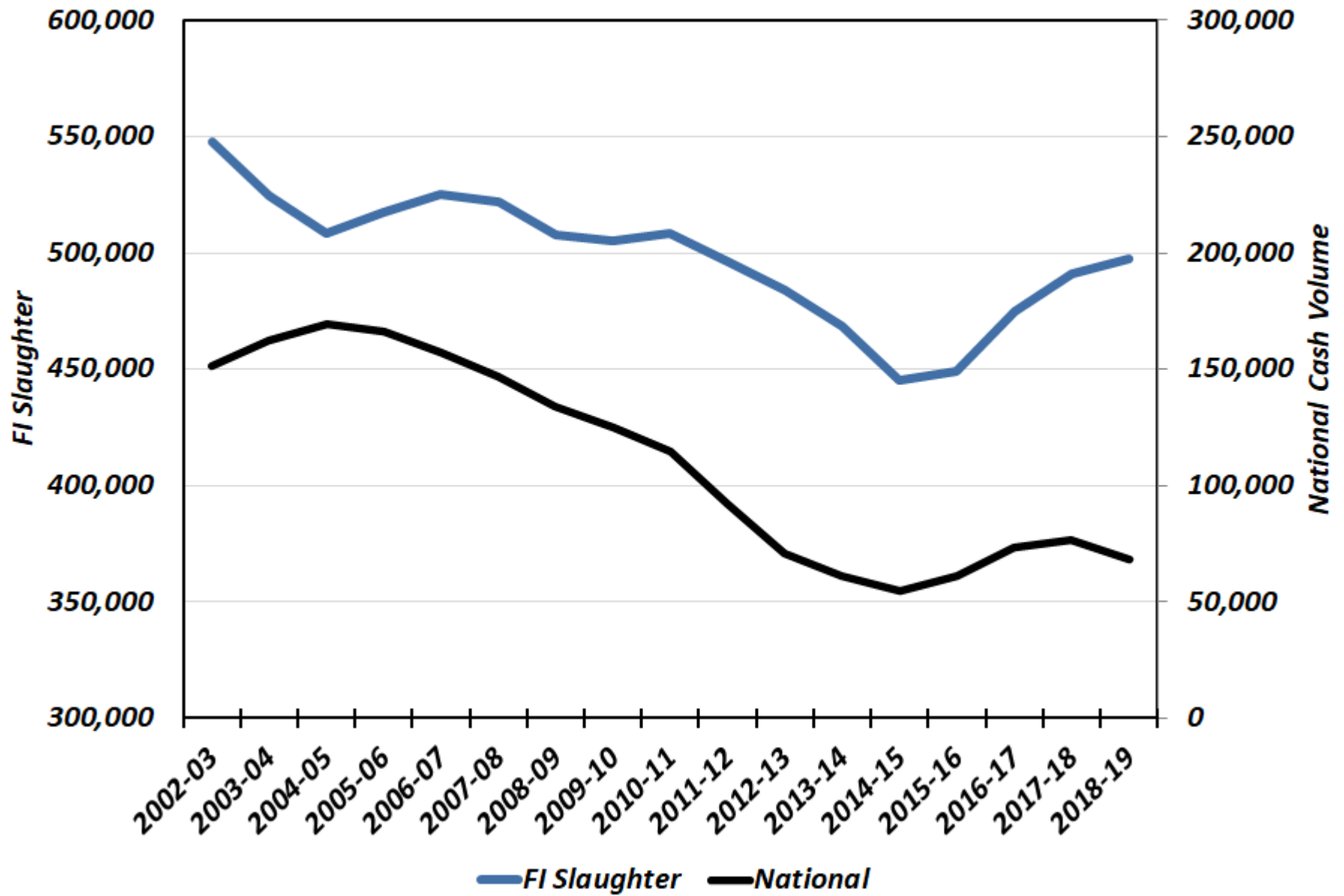
What is Price Discovery?

- *Price discovery is the impounding of new information into price – price changes that are both up & down.*
- *Price discovery measures are not the correct or fair price levels or correct or fair margins between beef & cattle prices. (And objectively define fair.)*
- *Three objective measures:*
 - *Information flows.*
 - *Component shares.*
 - *Information shares.*
- *In the end, if you want a fed cattle price, then you have to trade some fed cattle. How many?*

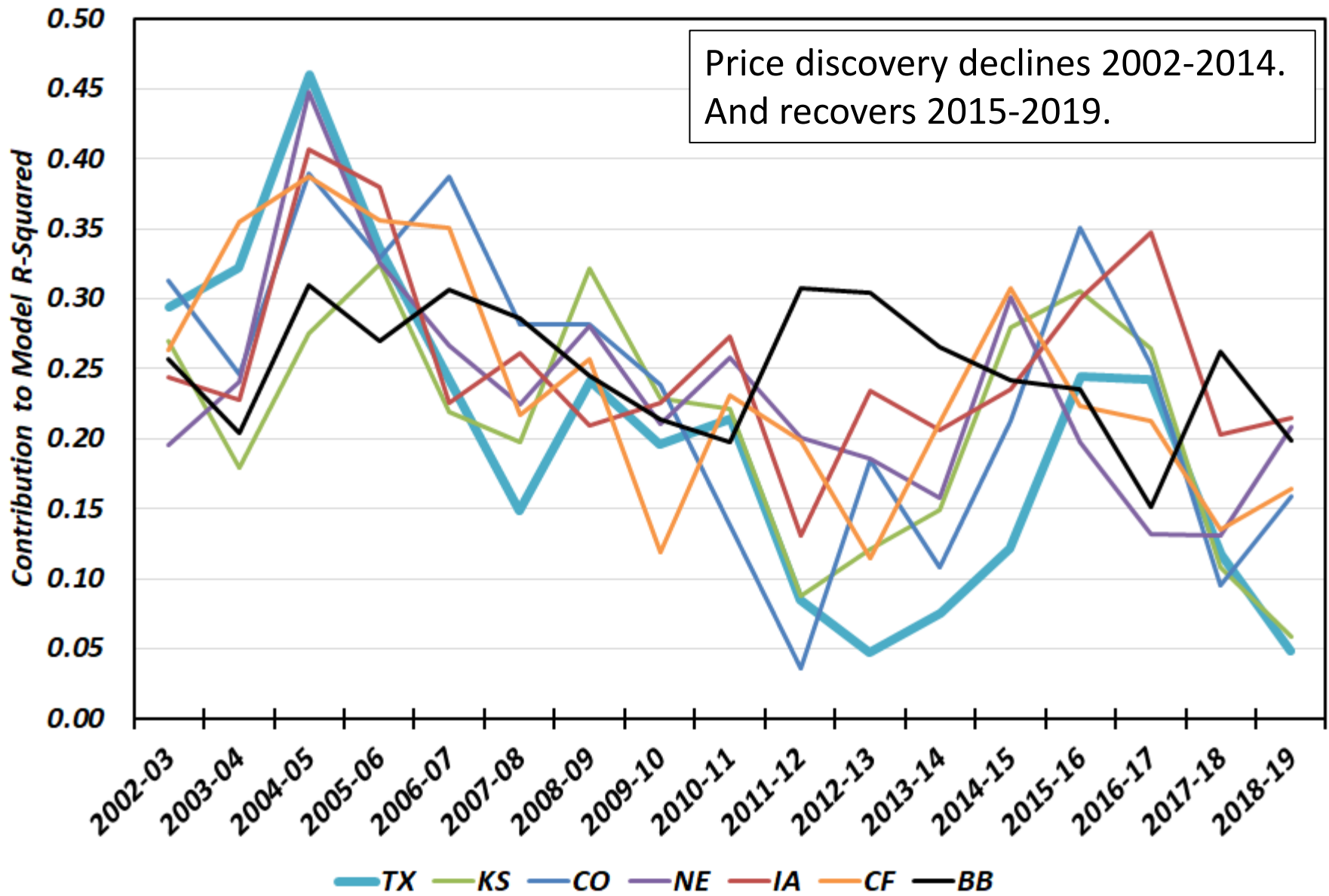
Average Weekly Negotiated Cash Volumes



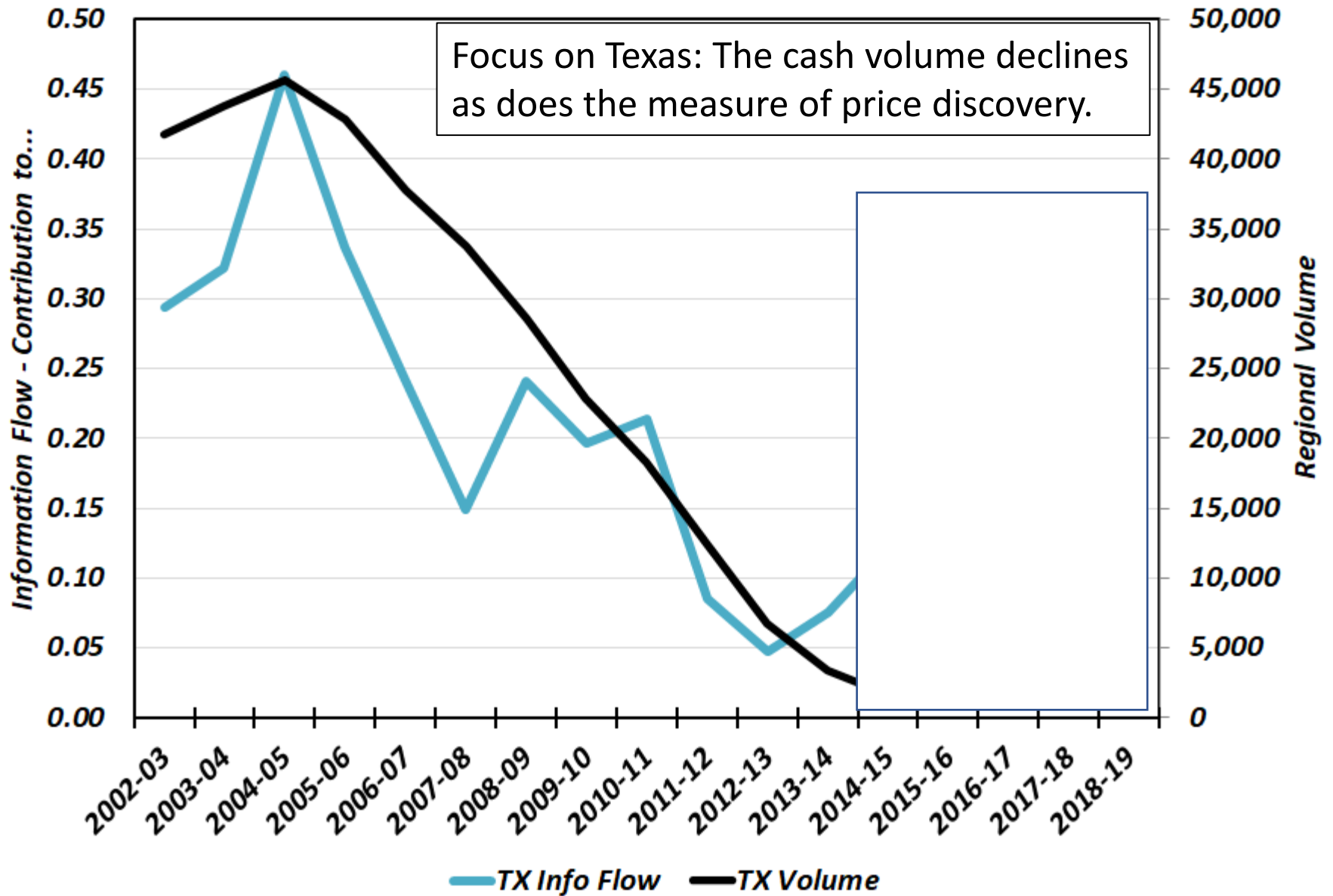
Average Weekly Volumes



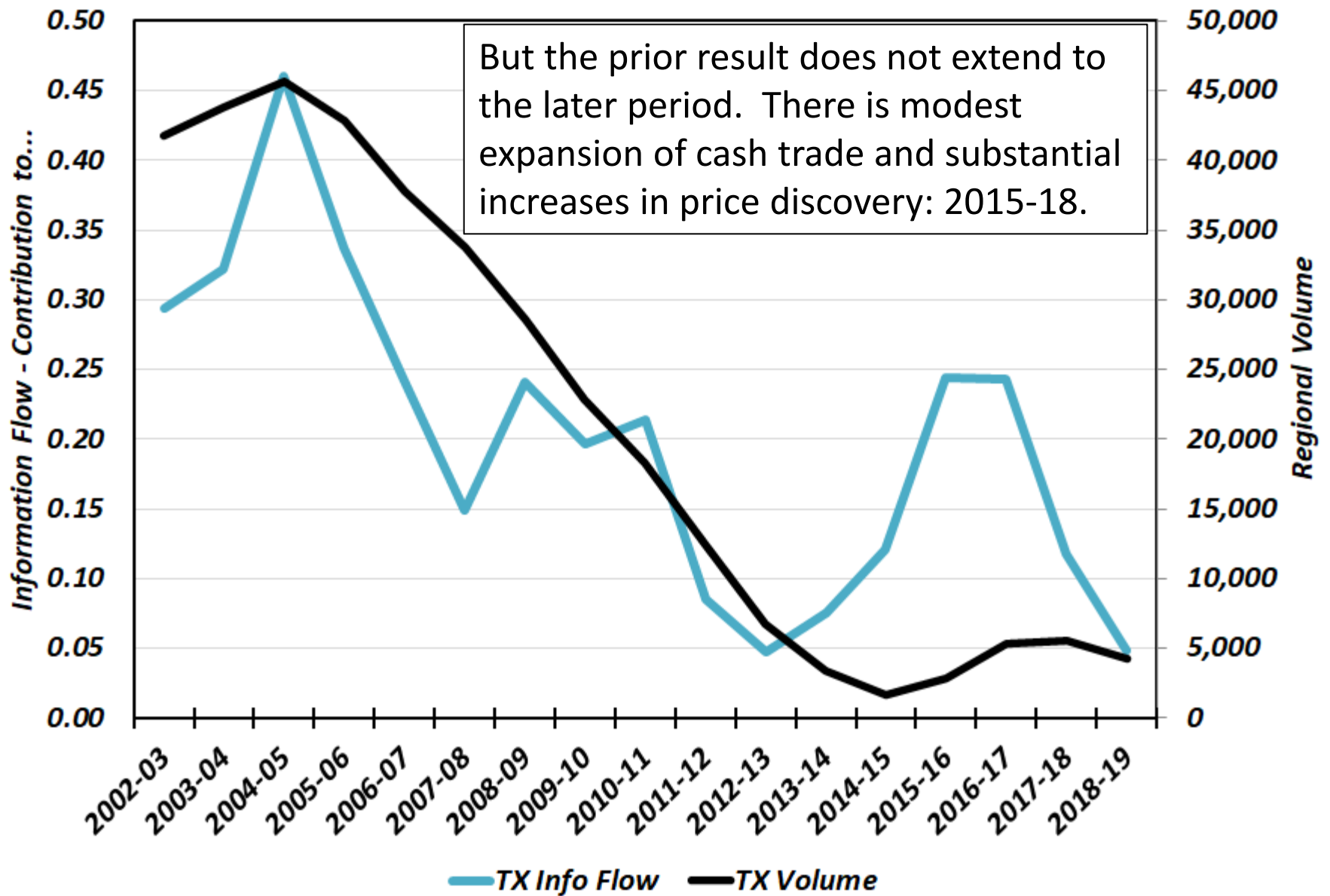
Strength of Information Flows



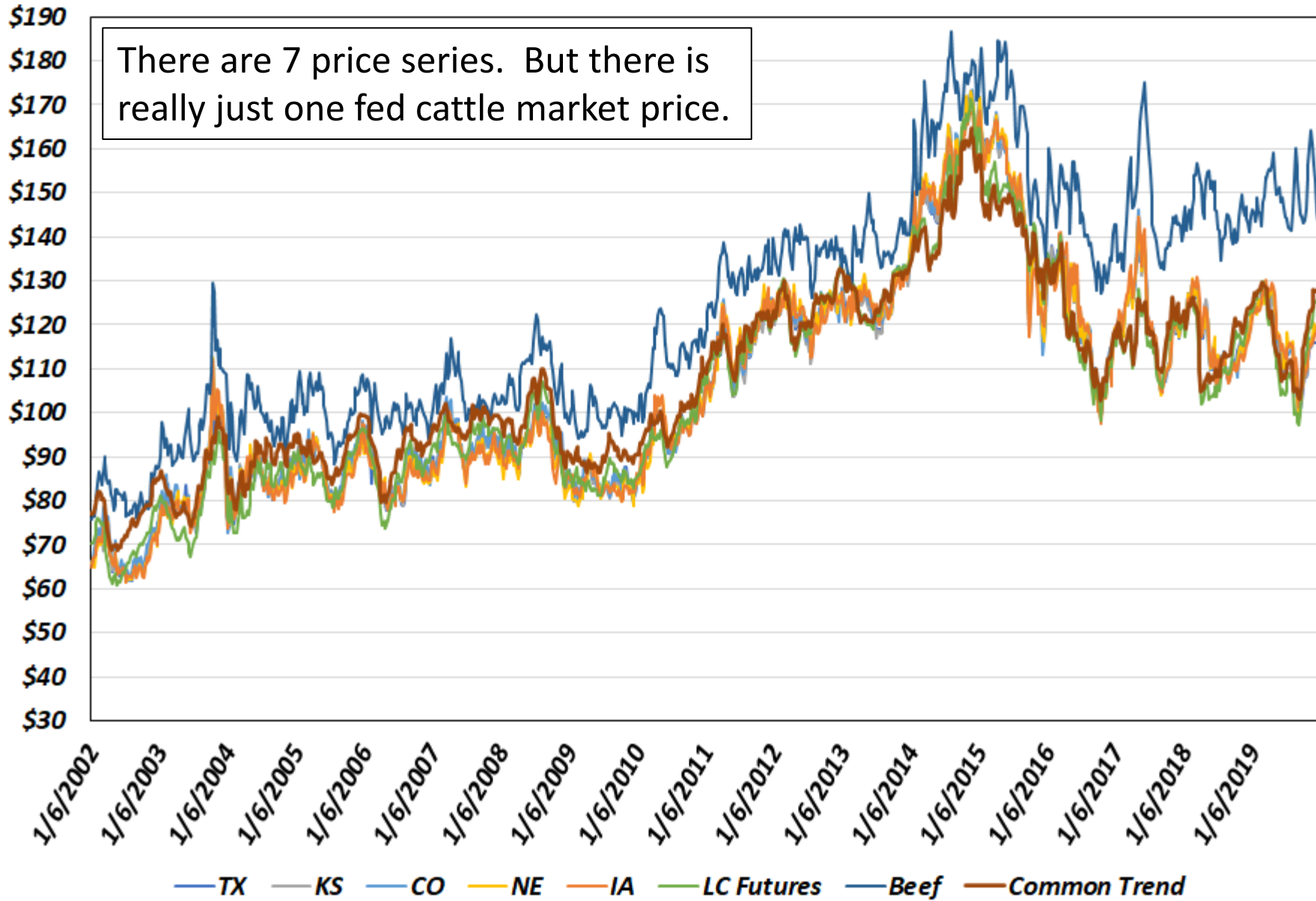
Strength of Information Flow & TX-OK-NM Volume



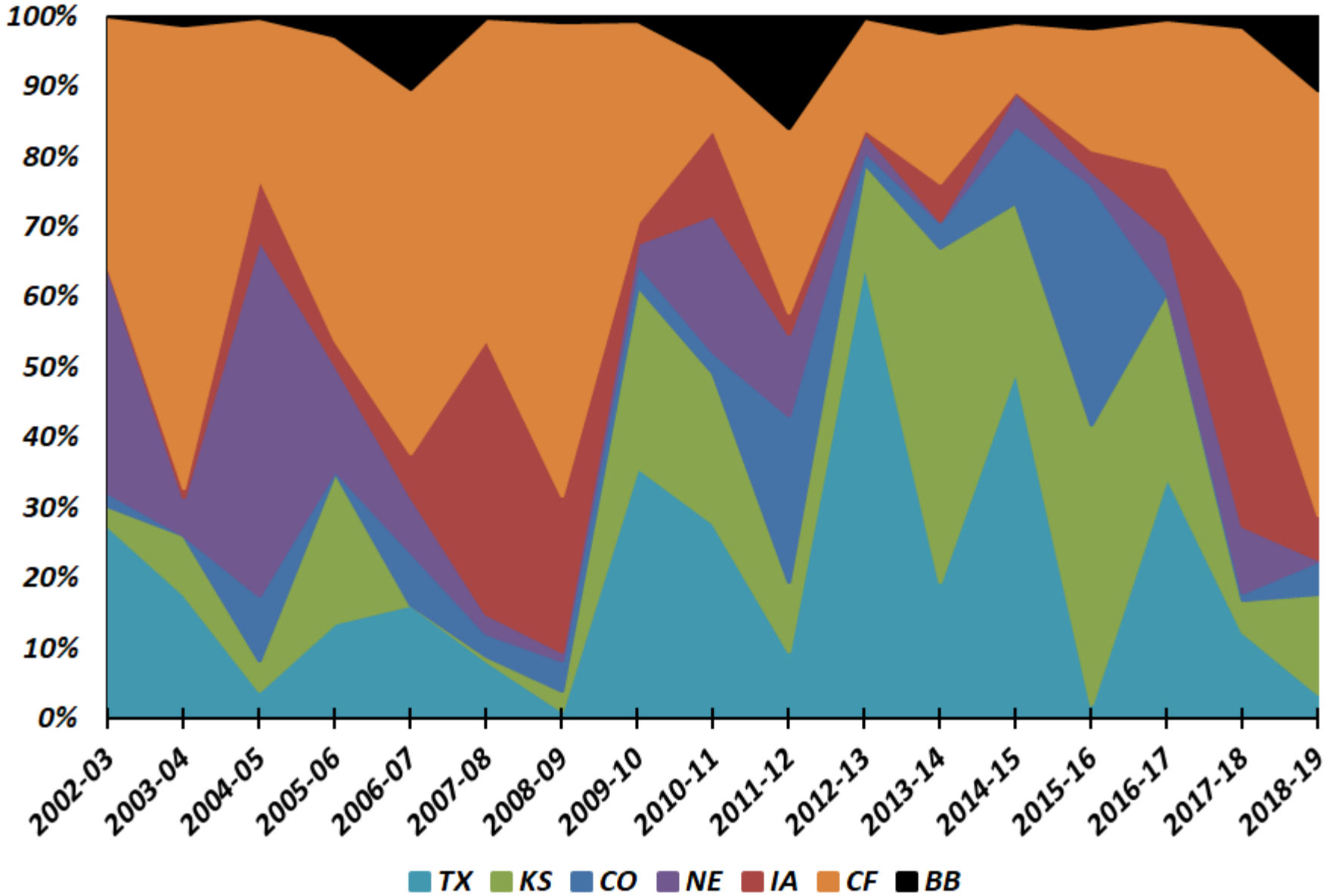
Strength of Information Flow & TX-OK-NM Volume



Cash Fed Cattle, Live Cattle Futures, Downstream Beef Value & Common Trend



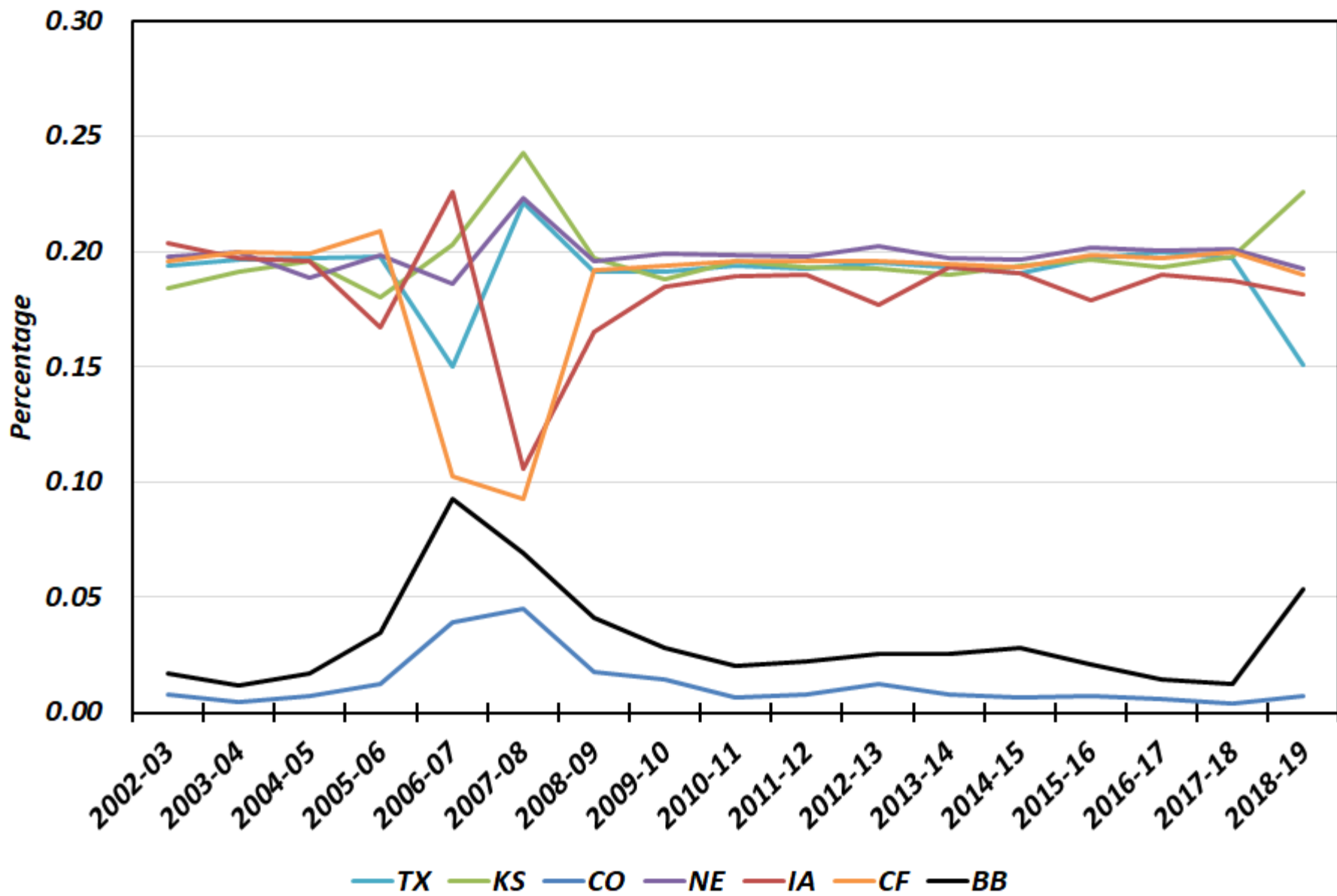
Relative Market Weights



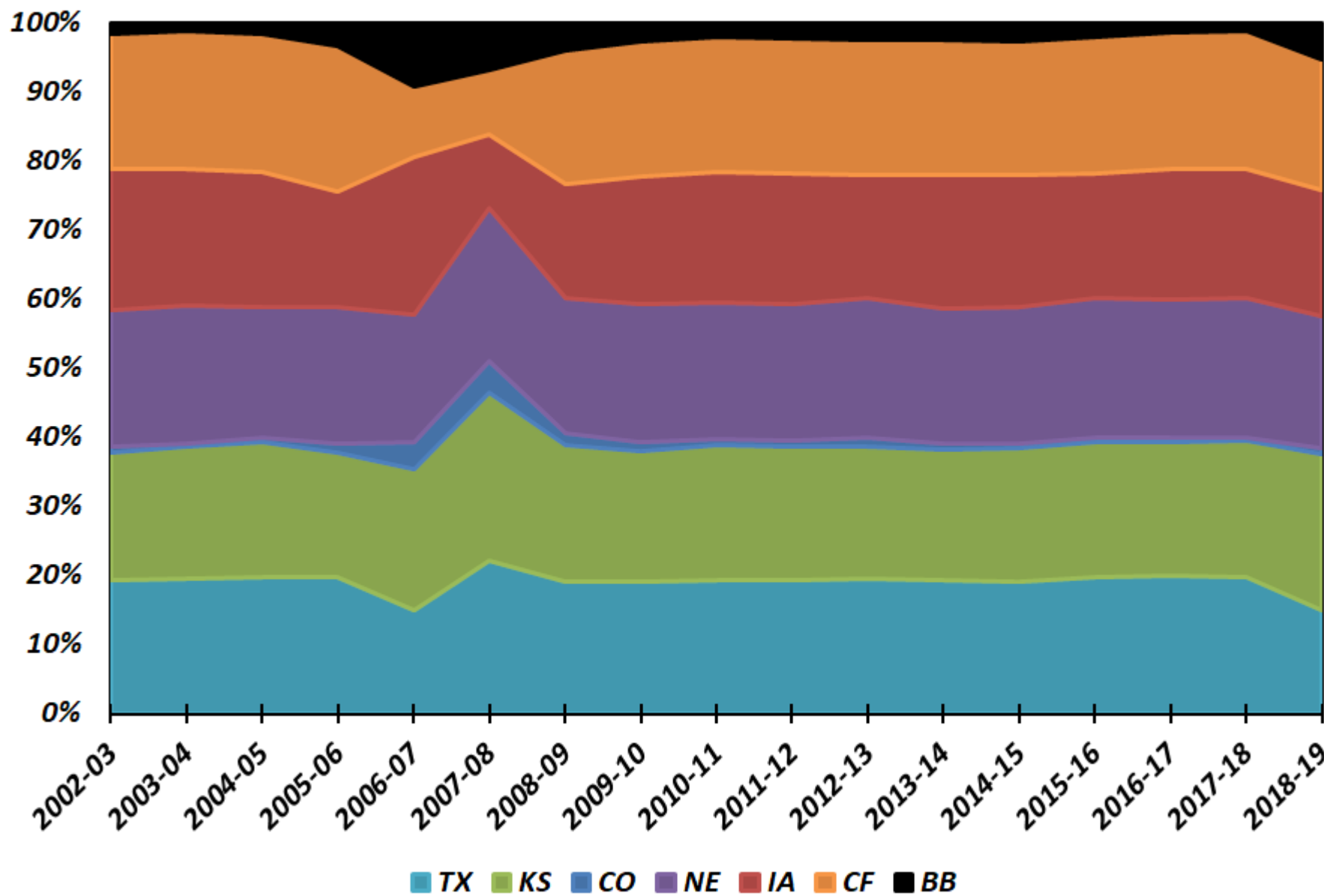
Relative Cash Market Weights



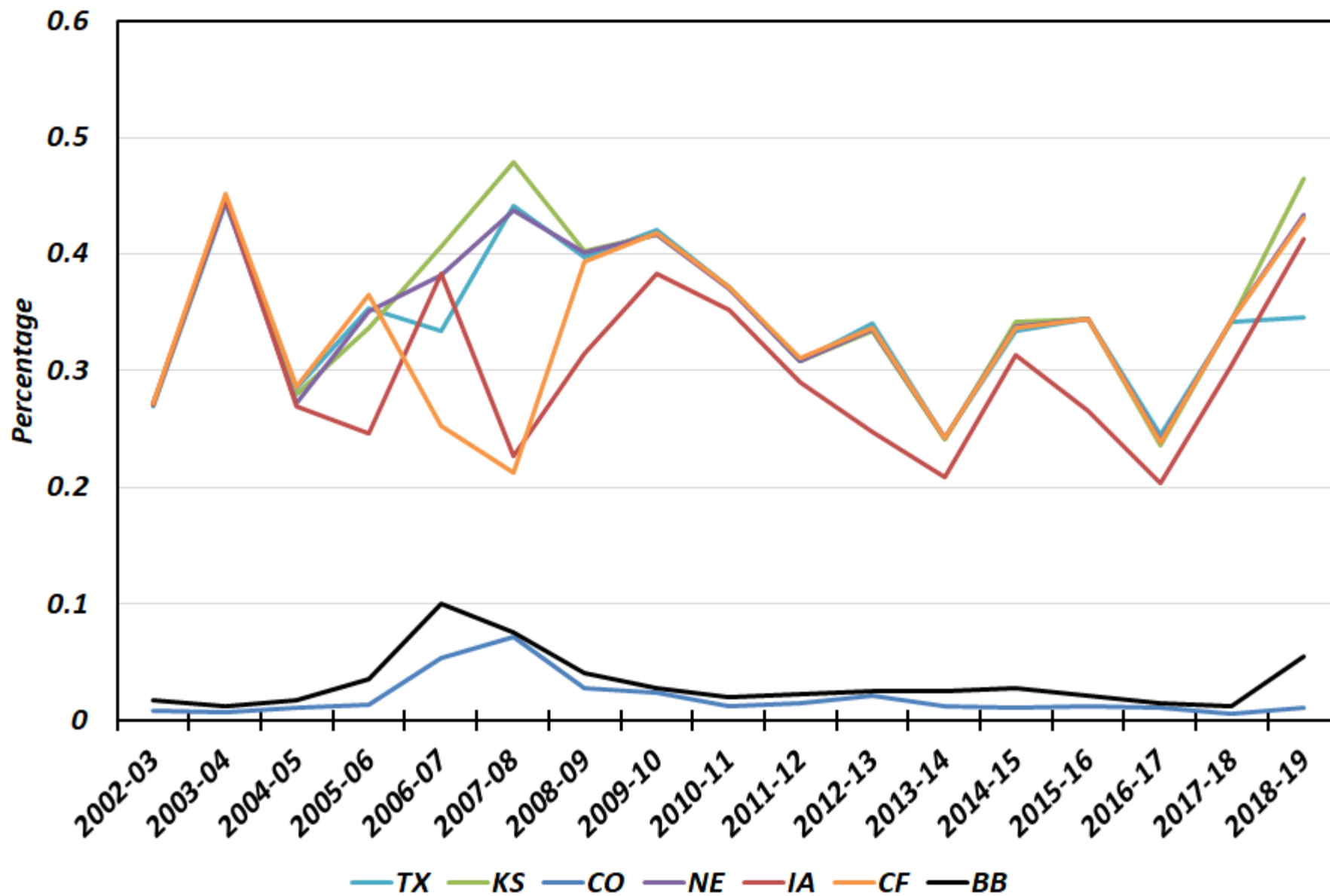
Information Share Averages



Relative Contribution: Information Share Averages



Information Share 75th Quantile "If Large How Large?"



Objective Price Discovery Measure Summary

- *One measure finds less price discovery from 2002 – the beginning on MPR – until 2014.*
- *It looks like there is a relationship between volume of cash trade and the amount of price discovery.*
- *But price discovery returns, as objectively measured, in 2015-17 with substantially less volume of cash trade.*
- *A second measure finds TX-OK-NM does a lot of price discovery when its volumes are smallest.*
- *A third measure which is – almost – a combination of the two finds persist & constant price discovery done by TX-OK-NM, KS, NE, IA, & futures & very little by CO & the downstream beef market.*

Price Discovery

- *Price discovery is work by people – bid & ask – it is a human activity. And is not so simple as to be determined by the volume of cash trade.*
- *There needs to be cash trade, but very effective price discovery is done with very little cash trade.*
- *Also requires strong, useful, and functioning market institutions.*
- *Mandates will cost with little to no benefit.*
- *Finally, price discovery is not better prices. It is the right price & often the right price is much lower. Market events of 2020-21 are testimony to that.*

What can you do for/about Price Discovery?

- *Have your association work to get California participating in USDA-AMS price reporting.*
- *Have your association work with other Cattlemen's associations to refine & detail of cattle grades & grading.*
- *Have your association work to compile & report price information – it's not a profit center.*
- *Report your direct trades.*
- *While there is not much you can do to benefit you there are things you can do that will cost you.*