China, Corn and Cattle

Analyst explains their linked and bullish outlook.

by ***Miranda Reiman***

The No. 1 factor in cattle feeding profit or loss is not fed- or feeder-cattle price, beef demand or the nation's shrinking cow herd. It's the price of corn.

"You've got to be focused on grain prices and your ingredient prices," Dan Basse, president of AgResource Co. of Chicago told producers, "because it's going to determine who stays in business, who makes money, who expands and who goes."

Basse addressed crowds at the Feeding Quality Forum Nov. 9 in Grand Island, Neb., and Nov. 11 in Amarillo, Texas. The market analyst examined the interactions between corn and beef markets, starting with global factors that affect both.

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"It used to be when I woke up in the morning I would look at the weather forecast as one of the first drivers for grain markets," Basse said. "Now I get up and the first thing I think about is, what are the Chinese markets doing?"

In general, that economy is bullish, its gross domestic product (GDP) expanding at 8%-12% per year. As such countries emerge, demand rises for all raw materials, Basse said.

The average income for a Chinese worker is $4,300, significant because studies indicate people start including more meat in their diets as annual incomes reach $5,000.

"Feeding those people in that new higher economic status is going to be important for us all," he said. "China is now consuming record amounts of rice, corn and cotton. We've seen these commodity markets just explode upwards as China finds its dominance in terms of world economic power."

The Chinese government has historically placed a great emphasis on being food secure and holds high volumes of commodity reserves, but that's changing in an effort to curtail food inflation.

"If Chinese food inflation is rising above 5.5% or 6%, that's a warning sign to their government," Basse said. "If you're making $4,000 per year and you're already spending 60% of that amount on food to begin with, and food inflation is taking control of another 6%, that's a worry."

Since March, China has sold corn reserves on weekly auctions trying to regain control, but even after a record crop in that country, food prices are still rising.

Competition for grain

"You're selling a million tons a week and prices are still rising — what are you going to do next?" Basse asked. "You better go and get some of that U.S. corn, and I don't care what price it is because we need food security. I don't know how the Chinese avoid buying U.S. corn sometime after the first of the year."

U.S. grain ending stocks are relatively tight, too.

"U.S. cattlemen, why I'm so focused on China is that not only do we have to fight the ethanol monster each and every day, but we have to fight the Chinese for what's left," Basse said.

There is increasing global competition for byproducts as well.

"China can import distillers' grain without a tax. Corn comes in with a 13% tax, but distillers' grain comes in tax-free, and they like the product," he said.

Even Brazilian sugar price affects the industry. It has been trading at 31¢ per pound (lb.) this fall, but breakeven for using sugar in ethanol production is near 18¢ per lb.

"If you are the biggest ethanol producers in Brazil, what do you do?" Basse asked. "You sell sugar on the world market and you bring in ethanol from somewhere else."

So foreign markets are helping prop up U.S. corn-based ethanol production, he said — and with current price relationships, it would take at least $6.50-per-bushel (bu.) corn before those margins turn negative.

"You are going to be fighting the corn market for multiple years," he said.

Domestic and export demand for U.S. corn requires 13.8 billion bu. If there are 87 million planted acres next year, the yields need to be at least 174 bu. per acre to break even with demand. This year, yields were the third-highest in history at 154.3 bu. per acre.

"The corn market is what drives everything, and, unfortunately, I don't see a way we can get corn prices relaxing unless we have multiple years of good weather," Basse said. A drought, or any other major yield detractor, would push prices even higher.

Good news

There is good news for cattle producers, however: Global meat demand is higher.

"We're now back to exporting one in 10 head of the cattle we slaughter," he said. "We're getting back to pre-BSE (bovine spongiform encephalopathy) days."

The pork industry derives twice as much business from overseas, exporting one in five head. If the beef industry reached that point, fed-cattle prices could reach $118 per hundredweight (cwt.) to $120 per cwt.

"That would create real competition between the U.S. consumer and the world," Basse said. "Quality is something we always want to be cognizant of, because it's our key marketing grounds that we'll have for working our beef into those Asian markets."

He's predicting cattle prices to reach record highs in 2011.

"Being bullish on cattle is one thing, but what I really want you to be focused on is the margin on grains," he said. "Only the producers who have vision on feed prices will make money and hold on to equity long-term."

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