

PHOTO BY GARY BARBER

Livestock's long road

Recession, global pullback weigh on producers

Last summer on a road trip to sell pure-bred Holstein bulls, Steve Strickler saw many reminders of the new pressures faced by livestock and dairy producers.

On a single rural highway in western Kansas, Strickler counted four bankrupt dairy farms. Across the state border, the story was similar: At least six dairies in Colorado had also recently declared bankruptcy.

A dairy farmer himself, Strickler has personally experienced the toll of rapidly declining milk prices, rising feed costs and weaker consumer demand caused by the recession. The market pressures are hard to avoid, but by selling bulls to other farmers, he has been able to limit some of the pain.

“It just drove home once again how dire the situation is,” Strickler says of the bankrupt dairies. “So much has changed in just the last couple of years. 2007 was one of our best years, and 2009 is easily the worst.”

At Strickler’s dairy farm in Iola, Kan., the numbers tell the story. Last fall, he estimated

that it cost his farm about \$15 to produce one unit of milk, known as a hundredweight. With market prices topping out at \$13 per hundredweight at the time, Strickler has been forced to find innovative ways to deal with his farm’s losses.

“I’m lucky that I have another source of income by merchandising bulls, but even that market has been severely impacted,” Strickler says.

Similar declines across the livestock industry last year also have put hog and cattle producers in a tough spot, with many operations going out of business or taking losses that can add up to thousands of dollars a day.

For farmers like Strickler, who are used to dealing with the ups and downs of the agricultural market, the sudden disappearance of profits has been a unique challenge complicated by the recession and shifting consumer patterns, according to Brian Briggeman and Jason Henderson of the Federal Reserve Bank of Kansas City.

Briggeman, an economist at the Bank's Omaha Branch, and Henderson, an economist, Omaha Branch executive and vice president, recently explored the problems livestock producers face as they deal with higher production costs and lower demand.

"The livestock industry's profitability has really taken a hit in the last year," Briggeman says. "The likelihood of sluggish consumer spending coming out of the recession could be another issue for livestock producers in the near future."

During past recoveries, it has taken a while for protein consumption to bounce back, Henderson says.

"That could also be the case this time because there have been fundamental changes in the labor market, forcing people to change their protein consumption by choosing lower-cost products," he adds. "Slower income gains and higher unemployment levels are limiting U.S. consumption."

According to the economists, the best opportunity for U.S. producers to capture new profits lies in rising global demand.

Vanishing profits

As recently as 2007, livestock producers enjoyed strong profits as protein demand increased worldwide amid balanced supplies. Dietary fads, such as the low-carb Atkins Diet, boosted consumer spending on red meat. Meanwhile, rising incomes in developing countries pushed worldwide demand for protein higher as consumers in countries such as China, India and Brazil spent more on meat products.

Livestock producers responded by increasing their production, Briggeman and Henderson found. According to the U.S. Department of Agriculture, red meat and poultry production rose 10 percent from 2004 to 2008, while milk production rose 11.2 percent during the same period.

Unfortunately for livestock producers, the peak came just when the recession arrived. In 2009, U.S. consumer spending on food items

fell 1.5 percent as consumers spent less on food away from home. For livestock producers, the decline in consumer spending on beef, pork, poultry and milk was slightly larger at 1.65 percent.

Livestock producers also had to deal with a decline in export volume as the recession's effects were felt worldwide. In the first five months of 2009, meat and dairy exports fell 23 percent from a year earlier.

Another factor that came into play last spring was the rise in fears related to the H1N1 virus and its associated name, "swine flu." In the spring of 2009, China banned U.S. imports of pork based on the belief that the virus can be transmitted by eating contaminated pork products. No link has been found, and in late October, Chinese officials agreed to lift their pork ban. But the damage was done.

"The weak demand and oversupply resulted in many producers operating in the red throughout 2009," Briggeman says. "Livestock prices dropped below break-even levels, and profits vanished."

Producers also faced higher input costs, especially for feed. Rising crop exports and higher demand for corn to produce ethanol helped push feed costs up 48 percent above 2007 levels. The combination of higher feed costs, lower exports and declining domestic demand resulted in what Strickler calls a "triple whammy."

"The feed cost is really something that seriously impacted us," Strickler says. "It's probably about 50 percent of the total production cost. It really hurt."

Herd liquidation

At the Klausmeyer Dairy Farm southwest of Wichita, Kan., school buses drop off children during the week to give them an idea of a working dairy farm. The children can watch cows getting milked and take turns feeding baby calves.

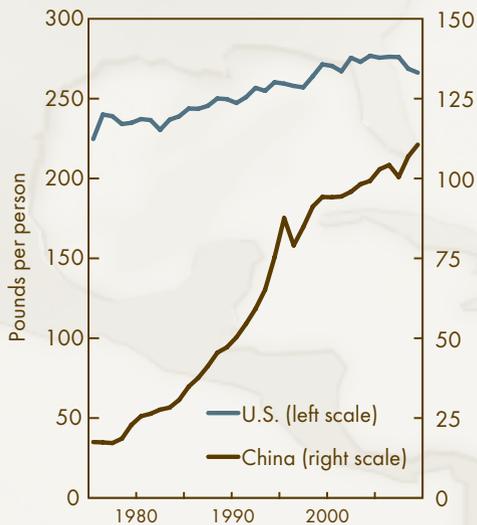
The tours provide a welcome second source of income for owners David and Debbie Klausmeyer. David has been working on dairy



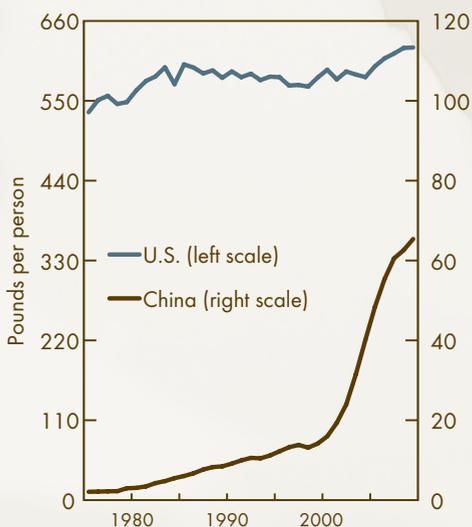
U.S. and Chinese consumption of meat and milk

While consumption of protein and milk has fallen in the United States because of the recession, consumer demand for such products continues to grow in China, providing an opportunity for U.S. exporters.

Beef, Pork and Poultry Consumption



Milk Consumption



Source: Calculations based on Foreign Agriculture Service data.

farms for as long as he can remember.

“The market has been pretty hard on us,” David Klausmeyer says. “I did away with any hired help and do the milking by myself. The tours are basically keeping us above water.”

The Klausmeyers have also been forced to liquidate some of their herd. The farm’s herd has dropped from about 90 head of cattle to 60 in the last year.

“We’ve culled real hard since the milk prices have gone down,” David Klausmeyer says. “The fact is, until the industry gets rid of more cows, the production is going to be too great.”

According to Briggeman and Henderson’s research, the livestock industry has been cutting herds steadily since the downturn began. The number of cattle being fed has declined 6.6 percent, according to one recent estimate, while the number of hogs used for breeding is down 2.7 percent.

A dairy industry program called Cooperatives Working Together has been focused on buying cows from producers in an attempt to remove some of the oversupply in milk production. In four herd-retirement auctions since June 2008, the program has removed more than 250,000 cows representing some 4.8 billion pounds of milk production. The program announced another herd retirement last fall and says it is starting to make an impact on the dairy market.

“Those efforts have helped adjust the supply of milk more in line with demand,” says Jerry Kozak, president and CEO of the National Milk Producers Federation, which manages Cooperatives Working Together. The herd retirements “along with a stabilizing global economy should further accelerate the recovery in dairy farmers’ prices.”

But despite the production cuts so far, more may be needed.

“The herd and flock liquidations have helped narrow losses,” Henderson says. “But analysts are suggesting that more cuts need to be made, especially in dairy and pork production.”

Overseas opportunities

Briggeman and Henderson say the biggest opportunity for a return to profitability in the livestock industry likely lies overseas, as developing countries are set to experience stronger gains during the economic recovery. Much of these gains will be felt in the countries' middle class populations, which bodes well for protein consumption.

"For example, China has seen a rapid rise in its median income, and that has coincided with consumers adding more protein to their diets," Briggeman says. "If China and other developing countries grow as expected, they will outpace their livestock production capacity, leading to export opportunities for U.S. producers."

But as the effects of China's ban on U.S. pork products show, capitalizing on those potential export opportunities could be difficult in practice. Briggeman and Henderson say several trade barriers related to food safety still pose an obstacle for U.S. producers.

The H1N1 scare last year wasn't the first health-related problem for U.S. livestock exporters, Henderson says. In 2003, Mad Cow Disease was found in a slaughtered dairy cow, closing off some foreign markets to U.S. beef.

"The markets were slow to re-open afterward, and the demand for U.S.-produced beef slowed significantly in foreign markets," Henderson says.

Organizations such as the Denver-based U.S. Meat Export Federation (USMEF) have been working to promote U.S. livestock as safe and healthy in foreign markets. Earlier in 2009, the USMEF sponsored a trip to South Korea and Japan to help Midwest cattle farmers connect with distributors, packers and retailers in those countries.

David Hamilton, a beef producer from Thedford, Neb., traveled with the group as a representative of the Nebraska Beef Council. He says Japanese consumers seem to have accepted American beef as safe, but there are still challenges in South Korea.

"Their impression (in South Korea) is that we export different beef than we feed to our

own families, which is obviously not the case," Hamilton says.

However, Hamilton still sees "tremendous potential for beef sales" in Asian markets, including South Korea, as Asian consumers learn more about American beef.

Henderson and Briggeman say the livestock industry has previously found innovative ways to meet changing consumer tastes in the United States, such as offering pre-packaged and pre-cooked meals. That drive to find solutions seems to be taking hold in overseas markets as well.

In Japan, the recession has led to an increase in the popularity of bento boxes, which are quick and affordable lunches sold in Japanese convenience stores. With the help of the USMEF, American beef has become a main ingredient in these products, providing a new export market for producers and helping to re-establish Japanese consumers' trust in American beef.

"There are challenges for producers trying to compete in a global market, and producers can penetrate foreign markets by targeting global tastes," Henderson says. "The opportunities exist, but the industry must continue to create new products for new consumers."



BY BILL MEDLEY, SENIOR WRITER

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