Beef Prices Expected to Fall with Herd Rebuilding

After seven years of liquidation, Southwest cattle operators are slowly rebuilding their herds. Beef production is expected to increase by the end of 1990, pushing down beef prices. Southwest ranchers are concerned about how far beef prices will fall and that beef may have lost market share as a result of a decrease in demand for beef because of health concerns.

During the most recent cattle cycle, cattle producers have been particularly slow to increase their beef inventory in response to positive returns over cash costs. The cattle industry has experienced positive returns since 1986. Cattle producers, however, continued to liquidate their inventory, and only now are they slowly rebuilding their herds.

Cattle Producers Cautious About Rebuilding Herds

Several factors may contribute to the cattle operators' cautious approach toward herd rebuilding: drought, debt service, reduced investment capital, and concerns about price declines in the future.

Drought decreased cattle producers' returns in 1988 and 1989, which discouraged herd rebuilding. Insufficient moisture increased producers' production cost by reducing water supplies and increasing the cost of feed. Moisture conditions have now improved throughout much of the Southwest.

Debt service may have prevented some cattle operators from rebuilding their herds. Although returns turned positive in 1986, producers had experienced negative margins for nine of the previous twelve years. Some producers had to reduce debt accumulated during the years of negative margins before they could begin herd rebuilding.

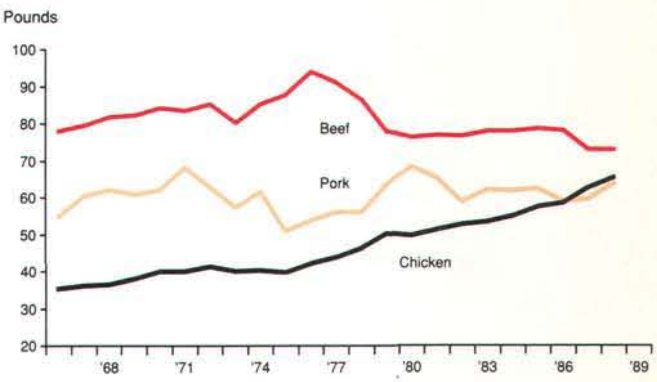
Tax law changes reduced the availability of investment capital to cattle producers and likely slowed herd rebuilding. Limited partnerships, a major source of cattle-based investment funds, were stimulated by favorable tax treatment in the early 1980s. The 1986 Tax Reform Act, however, eliminated this tax advantage and reduced the return on these investments.

Uncertainty about beef prices in the future may also explain why producers are slow to respond to positive returns. Increasing the cattle supply will place downward pressure on beef prices. Producers want to be sure that prices will remain high enough to cover the costs of their increased inventory. Producers are worried that concerns about cholesterol have encouraged consumers to shift their demand away from beef. This shift would reduce beef prices and the profitability of cattle production.

Declining Market Share: Prices or Health Concerns?

Beef has lost market share to pork and poultry over the last 15 years. (*See the chart.*) Since 1976, beef consumption declined 25 percent, while consumption of pork and chicken increased 17 percent and 58 percent, respectively. Though some of the reduction in market share may be the result of a shift in consumer demand away from beef because of health concerns, changes in beef prices strongly suggest that consum-

Per Capita Consumption, Retail Weight



ers have reduced beef demand because of the increasing relative price of beef.

Beef prices have increased 72 percent since 1976, compared with increases of 37 percent and 43 percent for pork and chicken, respectively. If consumers were reducing beef consumption for health reasons, then beef prices would have fallen relative to chicken prices and demand would have shifted away from pork, another red meat. Pork consumption, however, has risen while beef consumption has dropped.

Increases in the relative price of beef have contributed heavily to reduced beef consumption and have overwhelmed any reduction in consumption due to health concerns. Beef prices were most likely rising in response to the decreasing supply of beef associated with herd liquidation. Although health concerns affect some consumers' demand for beef, beef's market share appears to be determined by the relative price of beef.

—Fiona Sigalla

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