FCC Ag Economics

2018 Outlook for the Canadian cattle and beef sectors

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Canada

FCC Ag Economics helps you make sense of the top economic trends likely to affect your operation in 2018. In this outlook for the Canadian cattle and beef sectors, we look at:

- Global and domestic demand supporting sector profitability
- Interest rates and the loonie

This year, expect more pressure on profitability in the Canadian cattle and beef sector compared to 2017. Things started out tough last year, but eventually corrected to allow profits along the entire supply chain.

Cow-calf margins should be positive throughout 2018, but we expect feedlots will feel pressure. Smaller feedlots will likely feel the greatest pinch, appearing by early summer. Future prices for live cattle show a decline between December 2017 and December 2018, while prices for feeder cattle should hold steady throughout the year.

Weight gains will drive growth in Canadian production in 2018. Beef production grew 2.2% in 2017, but is expected to slow to 0.2% in 2018. The number of replacement heifers is expected to increase in 2018, slowing the decline in numbers, but no growth in herd size is expected until 2019. Canadian slaughter is expected to fall in response to heifer retention and increased exports of live cattle to the U.S. for both feeding and slaughter.

We estimate the cattle-to-feed price ratio will fall throughout the year. However, that could change if global stocks of coarse grains are depleted on the heels of lowered global production. The early 2017 boost from Canadian feed prices on our own abundant feed stocks has disappeared with a challenged 2017 harvest.

And because global demand for feed grains is unlikely to diminish in 2018, with estimated global livestock production up almost 2.0%, feed prices may pressure margins more than they have recently.

Canadian demand for beef isn't strengthening, but should continue to be robust. As measured by the Canadian Consumer Price Index, beef prices fell as much as pork prices between November 2015 and October 2016. They haven't changed since, even as pork retail prices rose 1.4% in the 12 months following and 2017's increased production should keep prices low early in 2018. The relative price advantage could help spur additional demand for beef.

How will this affect your bottom line?

2018 may be an excellent time to take advantage of opportunities to expand export markets beyond the U.S.

Beef right now is a Canadian export "sweet spot." Fresh beef exports generate some of the world's highest food export values and are a Canadian specialty. Frozen beef is one of the world's fastest-growing food export categories.

The U.S. market is already well-established, but CETA and possible avenues made available by a revived Comprehensive and Progressive Agreement for Trans-Pacific Partnership (formerly the TPP11), will allow Canadian producers to remain world leaders.

Trends to watch in 2018

Domestic retail competition will support demand for beef

Renewed consumer preferences for natural fats and protein may help to maintain beef demand in developed countries, as the industry counters consumer concerns with improved products that satisfy needs for different food characteristics. Demand is likely to stay strong, especially if retailers continue to keep meat prices lower than the overall food inflation trend.

Disrupted and emerging trade flows will shift beef prices

World economic growth is projected at 3.7% in 2018, stable from the estimated 2017 expansion. And continued improvements in the U.S., Chinese and European economies will create market opportunities for Canadian exporters of beef. The OECD-FAO projects an 11.0% growth in global consumption of beef by 2026, driven largely by an expected 16.0% growth in demand from developing countries. As Chinese consumption continues to outpace its domestic production, their imports, forecast to grow to 2.5 million tons in 2018, will likely come from non-U.S. sources.

India's ban on bovine slaughter, introduced in 2016, may significantly impact global beef in 2018 if successfully defended in court. Because India is the world's largest exporter of water buffalo, a cheaper, lower-quality alternative to beef, the ban drove up world prices on fears of a reduced supply.

Interest rates to remain low while loonie to stay under US$0.80

The Bank of Canada projects economic growth in Canada to be slightly weaker in 2018 relative to 2017. They also expect inflation will trend around 2.0%, the Bank's mid-point target. Financial markets suggest there will be two or three hikes of 25 basis points in the overnight rate for 2018.

Businesses should take note: although interest rate increases will likely be muted, borrowing costs are projected to climb off historical lows reached in 2016 and 2017. Financial markets currently expect bond yields to climb moderately. This would mean, for example, that a 5-year, fixed-rate mortgage would be priced at the end of 2018 around 75 basis points higher than it was at the end of 2017.

The Canadian dollar is expected to be higher in 2018, though still low enough to support profit margins. It should average US$0.78, assuming West Texas Intermediate (WTI) crude oil prices trade in the US$55 per barrel range. Interest rates in Canada and the U.S. should follow similar patterns. A low CAD benefits the cattle and beef sector.

On the radar

- The outcome of the renegotiations of the North American Free Trade Agreement (NAFTA) will have possible implications for:
  - the value of the Canadian dollar
  - trade taxes and market access rules applied to Canadian exports and imports
  - dispute settlement procedures

  Changes in any of these could impact prices of ag commodities in Canada.

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