FCC Ag Economics

2017 Economic Outlook for Livestock Producers

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Canada

FCC Ag Economics helps you make sense of the uncertainty created by a rapidly changing world. This outlook for Canada's livestock sector outlines the expected impact of what we see as the most important trends in 2017: the Canadian dollar, interest rates, the global economy and commodity prices. These will affect the red meat and supply-managed sectors differently.

2017 outlook for the livestock sector

The livestock sector's profitability will be positive overall in 2017. The increase in available supply, both in Canada and in the broader North American market, along with investment in processing will drive the production growth that will be 2017's big story in the beef and pork sectors. Domestic demand growth and new marketing developments will spur production in dairy and poultry. Based on these factors, the livestock sector can expect prices to be stable to slightly higher than those in 2016.

The U.S. supply of red meats is expected to grow in 2017: pork by 3.8% and beef by 3.7%. Despite this, U.S. hog processing will be more competitive in 2017, with two large U.S. packing plants scheduled to begin operations in the fall. This should gradually ease the hog price pressures recorded in the U.S. and Canadian markets during the second half of 2016.

Production in the U.S. cattle sector will expand, but without the tight processing capacity issues facing the hog sector. Cow-calf operations are expected to remain profitable in 2017 – although the profit margins should be lower than the 5-year average, triggered by lower calf prices. This should bode well for feedlots, especially when combined with feed costs that are projected to be stable.

Production in Canada's poultry and dairy sectors will also grow. The demand for Canadian milk is expected to climb in 2017, buoyed by favourable consumption trends and low butter inventories. The farm price of milk has been pressured in the last 24 months because of three factors: 1) a surplus of solids-non-fat; 2) imports of U.S. proteins; 3) low world dairy prices. These pressures will ease in 2017.

How does this outlook affect your bottom line in 2017?

Here are our suggestions for how the livestock sector can improve performance in 2017.

A focus on efficiency and minimizing costs will help livestock producers remain competitive in the 2017 operating environment. 2017 also offers an enviable economic environment to invest and grow productivity at a time when it seems more likely revenue growth will come from strength in production numbers rather than higher prices.

Here's how the top trends will impact the red meat sector

The global economy: demand will be key for red meat supply chains

Domestic demand for beef and pork remains strong after retail prices softened in late 2016. While this pricing trend should continue, we don't expect retail price declines will drive consumption enough to absorb the larger supply entirely. Export markets will need to be strong.

2017's global economic landscape may challenge the red meat sector, which depends heavily on trade and healthy foreign markets. The global beef supply is also projected to continue growing – likely outpacing the growth in demand from major import markets such as the U.S. and China.

This will curtail any major improvement in prices. However, while anti-globalization sentiment seems to be growing, key export markets for Canadian red meat sectors still appear healthy. Of greatest importance, a strengthening U.S economy is projected to be a positive development for the red meat market.

China dominates the global pork market, producing half the world's hog output. The Chinese hog herd has shrunk recently, but its hog production is expected to climb in 2017, encouraged by a stronger outlook for profitability. From January to September 2016, Canadian pork exports to China had increased 186% from the same time period last year and had grown to account for about 20% of all Canadian pork exports in the spring of 2016. This performance may be difficult to repeat in 2017, but the market will continue to remain important.

2017 may see even further expansion of Canadian red meat export market access. The Canada-European Union Comprehensive Economic and Trade Agreement (CETA) is expected to be provisionally implemented in early 2017, phasing in additional access to Canadian pork and beef.

Interest rates to remain low while loonie to stay under its 5-year average

With the Canadian economy projected to record below-average economic growth in 2017, the Bank of Canada isn't expected to lift its key policy interest rate in 2017. Changes in farm production practices, efforts to modernize or capture added value in downstream markets need investments. Businesses should take note: borrowing costs are projected to climb off the historical lows reached in 2016, but should remain low by historical standards.

The Canadian dollar is expected to average US$0.75 for 2017 – a positive outcome for livestock sectors on two fronts. First, this makes Canadian products competitive in the world marketplace. The lower Canadian dollar also provides a boost to profit margins of the red meat sector.

Stabilized commodity prices will support profitability of the red meat sector

While the low loonie supports revenues of Canadian producers, it also raises the cost structure of livestock operations, particularly feed prices. Futures markets peg the 2017 average ratio of hog-to-corn prices at 16% above the 2016 average, suggesting improved profitability.

The ratio of cattle-to-feed prices is projected to decline in 2017 compared to the 2016 average. We expect feedlot profitability will be higher in 2017 than what was recorded in 2016 however, given the decline in feeder cattle prices.

Global outlook helps Canada's growing production in supply-managed sectors

World dairy prices should rebound slightly in 2017 as production cutbacks in New Zealand and the European Union lower the global supply of milk. Production in the U.S. is expected to rise by 2.1% in 2017, however, so the price rebound may be muted. A new marketing arrangement at the national level between Canadian producers and processors is expected to minimize the skim milk being diverted to low value markets. The result should be a milk price that is slightly up at the farm level from the 2016 average values which, combined with growing production volumes, yield a favourable outlook for profits in the industry.

Favourable consumption trends in the poultry sector remain the largest driver of profitability at the farm level. Expected growth in chicken production (1.5%) is in line with the 5-year annual average. The industry's costs of production should stabilize with feed prices in 2017 projected near 2016 levels, suggesting a stable farm price.

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