



Your Steak will get More Expensive

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Over the past several years, beef prices at the consumer level have increased more than other consumer items. This is likely to continue to increase even more in 2014. This short paper explains why this is happening and explores the possible implications.

Beef Price Performance

The Statistics Canada Consumer Price Index (CPI) is an indicator of the changes in consumer prices experienced by Canadians. The CPI measures price changes by comparing, over time, the cost of a fixed basket of goods and services. This basket is based on the expenditures of the target population in a certain reference period, which is currently 2011. The CPI measures a wide variety of products including a basket of retail prices for beef from Canadian grocery stores.

The CPI measure has its critics, particularly grocery retailers, who say that it does not capture the weight of products sold on feature, which can be huge. With that noted, the CPI does provide a good overall indication of pricing direction and magnitude of changes.

Over the past 14 years from 2000 to 2013, all items in the CPI, from furniture to cars and milk, increased at a compound annual rate of 2%. Over that 14 year time frame all food items increased by 3% while beef increased 4% each year. During 2013, consumer beef prices increased by 3%, while food and all items increased by 1%. During January of 2014, beef prices increased by 4% compared to January of 2013. Meanwhile in January all food and all items increased by just over 1%. The bottom line is that over the longer of the past decade or the shorter term of the past year, beef prices at the consumer level have been accelerating at a faster pace than food and all items in total.

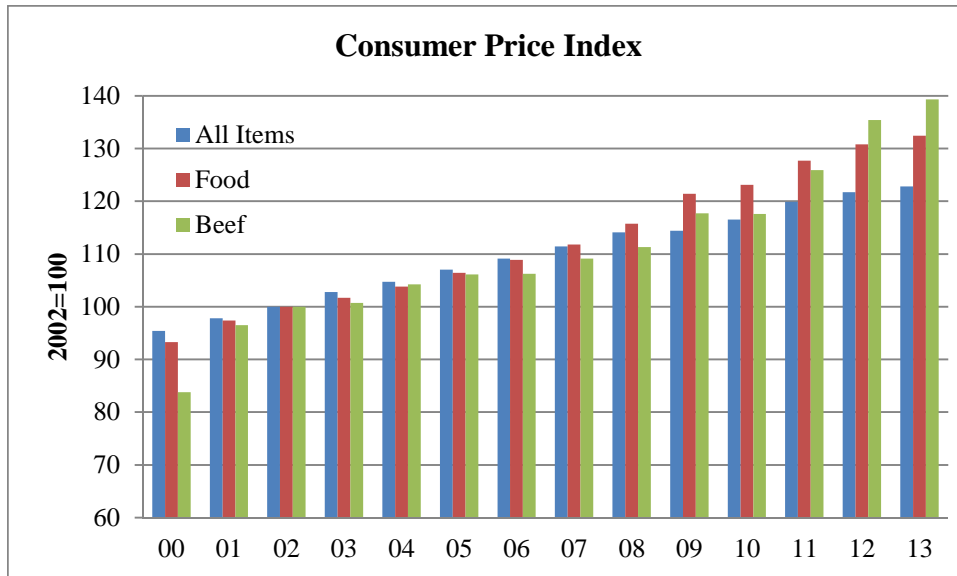


Figure 1 Source: Statistics Canada

Beef Demand

The performance of beef prices is important because it has implications for beef consumption, which in turn has implications for the beef industry.

At a basic level, demand is the combination of price and quantity consumed. Under normal demand circumstances, the higher the price of a product, the less of that product demanded and vice versa. In those “normal” circumstances, demand for the product is neither increasing nor decreasing. Declining demand occurs when prices are declining and yet consumption is also declining. Being unable to attract consumers despite lower prices is a very challenging time for any industry. Conversely when prices are increasing and yet consumption is increasing, that is a period of increasing demand. Being able to increase price and still draw consumers is a very positive development for any industry.

In the case of beef, it appears that over the past 20 years or so, demand has been behaving normally. That is, when prices are high, Canadians eat less and when prices are low Canadians eat more. The graph below shows that from 1991 through 2013 when the deflated CPI for beef increased, like last year, Canadian per capita consumption of beef declined. Conversely when prices were lower as in the late 1990’s and 2000, Canadians ate more beef. Again that behavior is relatively normal and to be expected.

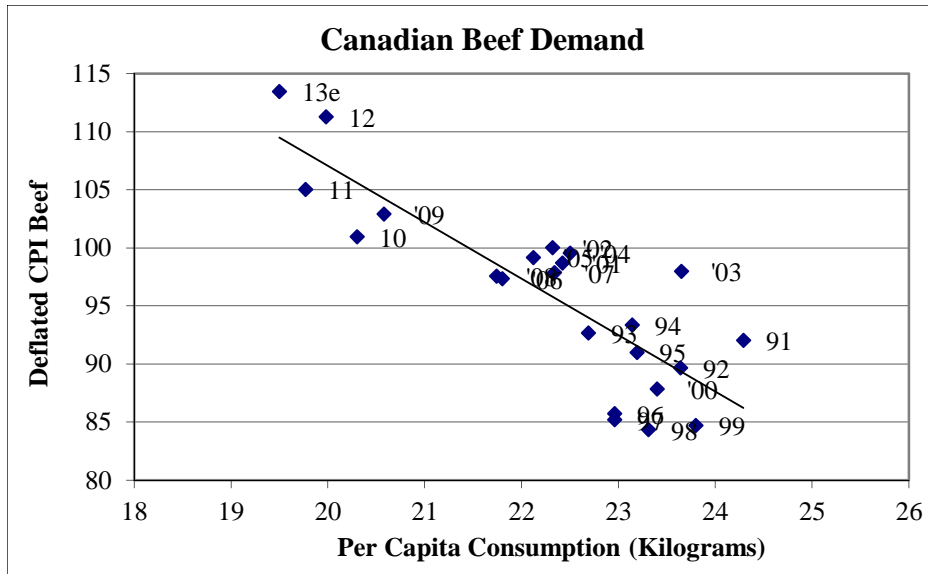


Figure 2

Beef and Cattle Comparisons

Statistics Canada not only tracks consumer price indexes but also the price indexes of raw products and livestock such as cattle. Tracking the beef versus the cattle indexes shows, perhaps not surprisingly, that there is a strong relationship between consumer beef prices and Canadian cattle prices. As cattle prices go, consumer beef prices follow. In fact when tracked on a quarterly basis and lagged by one quarter, there is a nearly 80% R-squared relationship between year over year changes in the two prices. That suggests that cattle prices are a good explanation of consumer beef price direction.

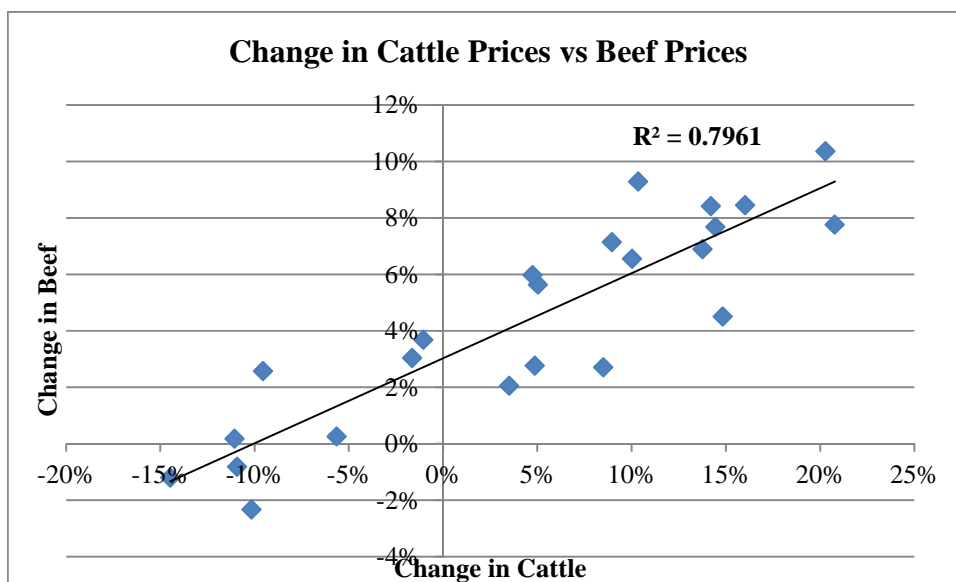


Figure 3

Another way to look at the relationship is that the quarterly change in cattle prices in Canada tends to lead the changes in consumer beef prices. When cattle prices increase, beef prices increase and vice versa. Cattle prices are more volatile than consumer prices. Raw commodities tend to be more volatile than consumer goods for a variety of reasons. One reason is that grocers have more control over their own retail pricing than packers or cattle feeders can exert on cattle prices. Grocers desire less volatile upward or downward movement in store prices from a marketing perspective.

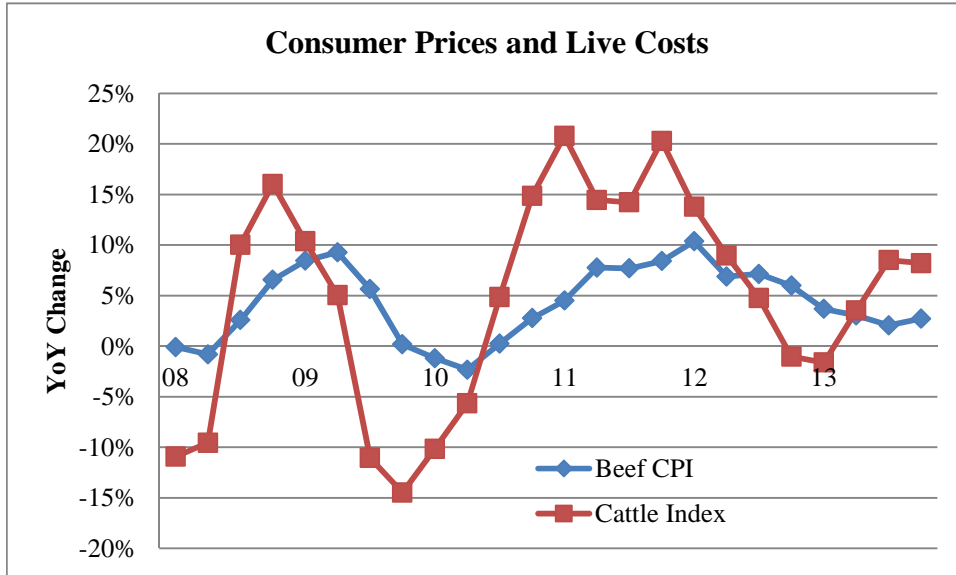


Figure 4 Source: Statistics Canada

During the last two quarters of 2013, cattle prices increased by 8% on a year over year basis. Meanwhile over that same time period, consumer prices increased by just 2-3%. That means that consumer prices have not kept pace with cattle prices. The bottom line is that if the past performance of prices is any indication of the future, then beef prices are headed up by another 5% or so during the first half of 2014.

Expensive Compared to Other Meats

While beef prices at the consumer level have increased more than other items and are likely to continue to increase even more, another factor is relative prices. It is important to look at the price of beef relative to pork and chicken at the wholesale level. The relationship between the three main meats can be measured at the wholesale level using the Canfax boxed beef cutout value in comparison to the R.A. Chisholm pork cutout and the Chicken Farmers of Canada chicken composite.

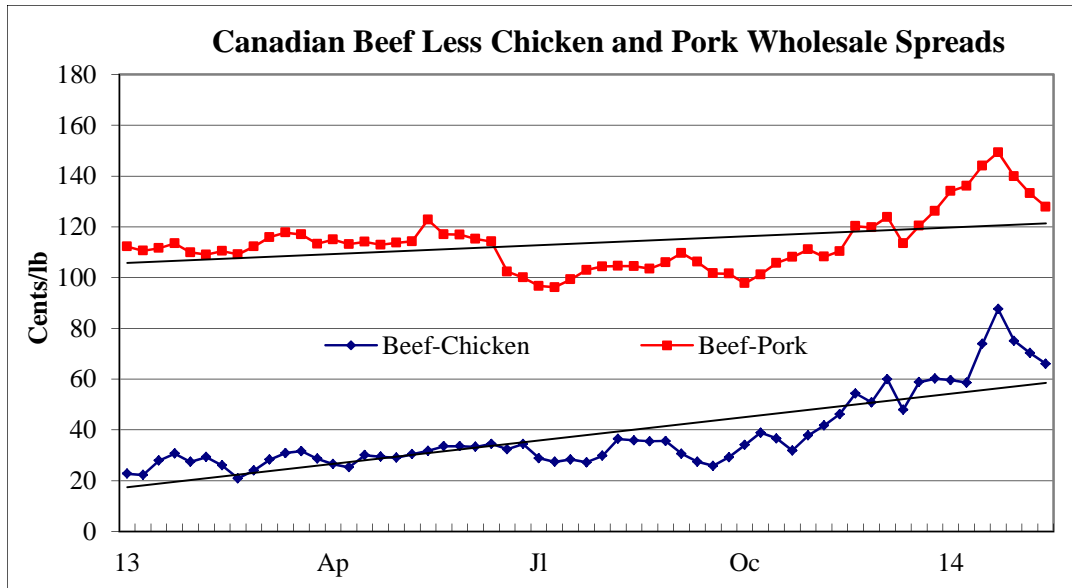


Figure 5 Source: Canfax, R.A. Chisholm and Chicken Farmers of Canada

During the first seven weeks of 2014, the beef spread relative to chicken has been running 3-4 times more than the average during 2009-2013. The spread relative to pork is running about 1.5 times more than the five year average. The fact that beef is more expensive relative to the other meats and relative to history suggests that beef would be viewed less favorably by retailers.

While consumer prices have been increasing sharply, as noted above, they are not keeping pace with cattle prices or wholesale boxed beef prices. Wholesale boxed prices were up about 8% in the second half of 2013 compared to 2012, which is similar to the cattle cost increase noted above. The relative performance of the competing meat prices in combination with retail and boxed beef prices means that retail beef margins are struggling. In fact relative to the previous five year average, current beef margins are running about 20-25% less than average. Pork and chicken margins are close to the five year average.

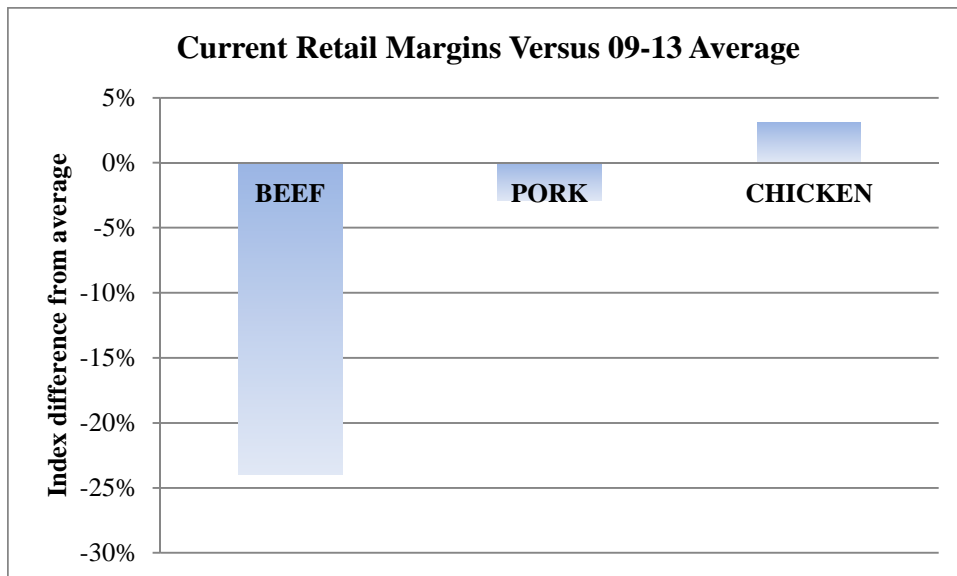


Figure 6

Beef Featuring Declines

As another point of note, the George Morris Centre tracks beef features in grocery flyers at the major banners across southern Ontario. During January, beef comprised 31% of fresh meat features in Ontario flyers. During the previous eight years, beef comprised 37% of fresh meat features during January. In addition, the Centre tracks features on the front pages of grocery flyers across Canada. Over the last several years, beef typically has featured on two thirds of the front pages of flyers across the country. The share of beef on flyer front pages has been declining in recent weeks in 2014.

As the wholesale price of beef increases, retailers are obviously finding it increasingly difficult to feature beef. That is, the higher the wholesale price of beef becomes, the less attractive beef can be priced at in flyers. Retailers appear to be responding rationally to the higher beef costs and weaker margins by featuring less. That is important because flyers can move anywhere from 2 to 5 or even 10 times the normal volume of a regularly priced beef item.

Summary and Implications

The following are summary points:

1. Beef prices have risen rapidly during 2013.
2. Beef prices are likely to rise even more during 2014.
3. Beef has become very expensive relative to the competing meats.
4. Retail beef margins are weakening.
5. Beef featuring is showing signs of decreasing.

The bottom line for the cattle and beef industry is that there is going to be serious challenges to beef market share during 2014. Part of the challenge is that grocers and consumers will turn their attention towards competing meats, particularly chicken, given the pricing performance noted above. Fewer features mean that beef sales tonnage will decline in Canada. In addition, even ignoring features, the overall price of beef is going to increase. Given the demand discussion noted above, that means that Canadians will simply eat less beef.

While not discussed in this paper, the forecast for beef production in North America during 2014 is for a decline of at least 3%. As such, the sales tonnage decline will be in addition to the fact that there is simply less North American beef production expected in 2014.

The cattle industry is likely to enjoy very strong returns in 2014 which is good news for an industry which has struggled for many years. Within that context, however, the reduced sales and tonnage means that the industry risks losing market share. For an industry that has struggled to keep consumers, a loss of market share will be a challenge when production begins to increase in the future.

A version of this report first appeared in the George Morris Centre publication, Canadian Cattle Buyer. If you would like a free two month trial to Canadian Cattle Buyer, just e-mail Kevin Grier at kevin@georgemorris.org