

Agricultural Outlook Forum 2002

Presented Friday, February 22, 2002

MEAT DEMAND IN UNCERTAIN TIMES

Kevin Bost
Topco Associates, LLC

There is always some degree of uncertainty surrounding free markets. However, uncertainty assumes differing forms from time to time. When it involves a high degree of doubt regarding future spending power, demand for consumer goods—including meat—tends to slacken. This was certainly the case in the latter part of 2001, as an incipient slowdown in the economy was aggravated by terrorist attacks on the United States in September. Consumers began to trade down in the market for meats, consuming more meals at home and opting for less expensive meals on the road.

Markets are determined by human behavior. Human behavior is based on what we think we know about the past, and what we think we know about the future. The less confident we are about either one, the more conservative we become in our decision making. When the two towers of the World Trade Center and part of the Pentagon were blown up, we instantly became less certain about the future *and* the past. These events took place after a lot of people had already lost their jobs. The economy was already slowing down. And so the last four months have been unusually uncertain.

There has been a collective "drawing in of the reins", and this conservative, cautious mindset has naturally affected the way people spend their money. That has had quite an impact on the meat markets.

We have been dealing with two major sources of uncertainty: one is the stagnant economy, the other is a newfound apprehension toward air travel.

The economy has been in a recession. When the economy slows down, people get laid off. When people get laid off, their incomes go down and they become less confident about their prospects for income in the future. They spend their money more conservatively. The first things to be cut out of the family budget are the less essential items, like vacation travel and trips to a nice restaurant. People still eat, of course, but they eat out less often. They consume more meals at home. People eat differently at home than they do on the road. Meals purchased in the grocery store and prepared at home are more likely to include meat products that would not be ordered in a sit-down restaurant (and vice-versa). And when they're spending more conservatively, those who normally eat dinner at home six or seven nights a week will tend to buy less expensive meat products. They're downshifting, so to speak.

The recession has also affected the spending patterns of people who still have their jobs. Maybe their paychecks have not been reduced, but they have experienced a perceived loss of spending power because of the decline in the stock market. The stock market is no longer just a barometer of the business climate. It has a more direct impact on consumer spending than it used to, because so many more people are directly involved in it. In 1995 the average daily volume on the NYSE was 41 million shares; in 2000 it was 458 million. More people are controlling their own investment portfolios and 401K plans. They are tuned into the ups and downs of the Dow Jones and the NASDAQ and when they see their investments declining in value, they start to spend more conservatively as well.

A new generation of professional stock traders that has emerged within the last five years or so. These are the 35-year old men and women who have spent the last few years sitting in front of their computers at home, trading stocks in their underwear. This group has suffered a very substantial loss of income over the past 12 months. Quite likely, they have been loyal customers of upscale restaurants.

The events of September 11th not only caused the recession to accelerate, it made people think twice about getting on an airplane. Restaurant traffic—particularly high-end restaurant traffic—and airline traffic are linked. Upscale restaurants garner a large portion of their business from travelers, especially business travelers.

As a whole, meat demand has not declined substantially. It probably would, if the recession were to become severe. But that prospect does not seem a likely at this point. What we *have* seen is a shift of demand across the different tiers of the meat sector.

Meat demand has shifted away from the more expensive end and toward the less expensive end. Some of the white table cloth business has been lost to middle-tier, casual restaurants; some of the middle-tier business has gone to fast food restaurants and supermarkets. Even within the supermarket there has been some downshifting, perhaps from the full-service case to the self-service case. Not everyone loses in this game. Clearly, though, the primary victim is the more expensive, white table cloth establishment. So among individual meat markets, those that have been hit the hardest are those which depend most heavily on that white table cloth sector.

The markets that have been hit the hardest are at the upper end of the beef market: the prime and choice ribeyes, short loins, strips, and tenderloins. These are the raw materials for prime rib, T-bone steaks, New York strips steaks, and filets.

One way to measure demand is by calculating per capita expenditures in the wholesale market. This is done by estimating the quantity of each cut produced, multiplying by the wholesale price, and dividing by the population.

As measured by per capita expenditures, total wholesale beef demand was 9% above the five-year average in the fourth quarter of 2001. By contrast, demand for choice ribeyes and choice strips was unchanged from a year earlier; demand for choice tenderloins was 9% lower. These are the cuts that depend most heavily on the high-end restaurant sector.

Select-grade cuts are generally less expensive and therefore more widely featured in retail ads. The select side of the beef market is less dependent upon the foodservice sector. In the case of ribeyes and strips, demand for select-grade products was significantly stronger than for choice. In the case of tenderloins, the select side was actually weaker. There is no clear-cut explanation for that. But even the select-grade tenderloins are heavily dependent upon the foodservice sector. The tenderloin is about the most expensive of all beef cuts; even a select tenderloin typically sells for about \$7.00 per pound in the wholesale market.

The boneless pork loin represents the high end of the pork market, but does not enjoy a strong presence on upscale restaurant menus. Whereas demand for choice beef tenderloins dropped sharply in October and November, demand in the high end of the pork market held up relatively well.

Demand for boneless chicken breast also held up much better than the choice beef tenderloin. The wholesale cost of beef tenderloins is usually about seven times that of a boneless chicken breast. There is a lot of boneless chicken breast served at white table cloth restaurants. But there is also a lot of boneless chicken breast served at McDonalds and Burger King, and a lot sold through supermarkets as well. So as this downward shift occurs, demand for chicken picks up as least as much at some levels as it loses in others.

Two other markets that were hit fairly hard by the downturn in travel and restaurant traffic in the wake of September 11th were chicken wings and pork back ribs. Prices in both markets fell substantially in October.

The worst of the meat market's demand problems are behind us. Even though the unemployment figures may not have peaked out just yet, consumer spending is likely to improve as the year goes by. Also, airline traffic should gradually pick up. That trend seems to be in place already. In October, most major airlines reported year-over-year declines in passenger miles of 20-25%; in January that figure appears to be somewhere between 5% and 10%. It's still down, but it's improving. As time goes on, that's going to mean more business dinners; more vacation travel and the meals that go along with it; and more Saturday night splurges at a fancy restaurant. Altogether, it should bring a gradual increase in demand for T-bones, prime rib, New York strips, and filets. And that will be good news for the beef market, which has suffered the most during this period of heightened uncertainty.

Meat Demand in Uncertain Times

Kevin Bost

White Table Cloth Restaurants



Casual Restaurants

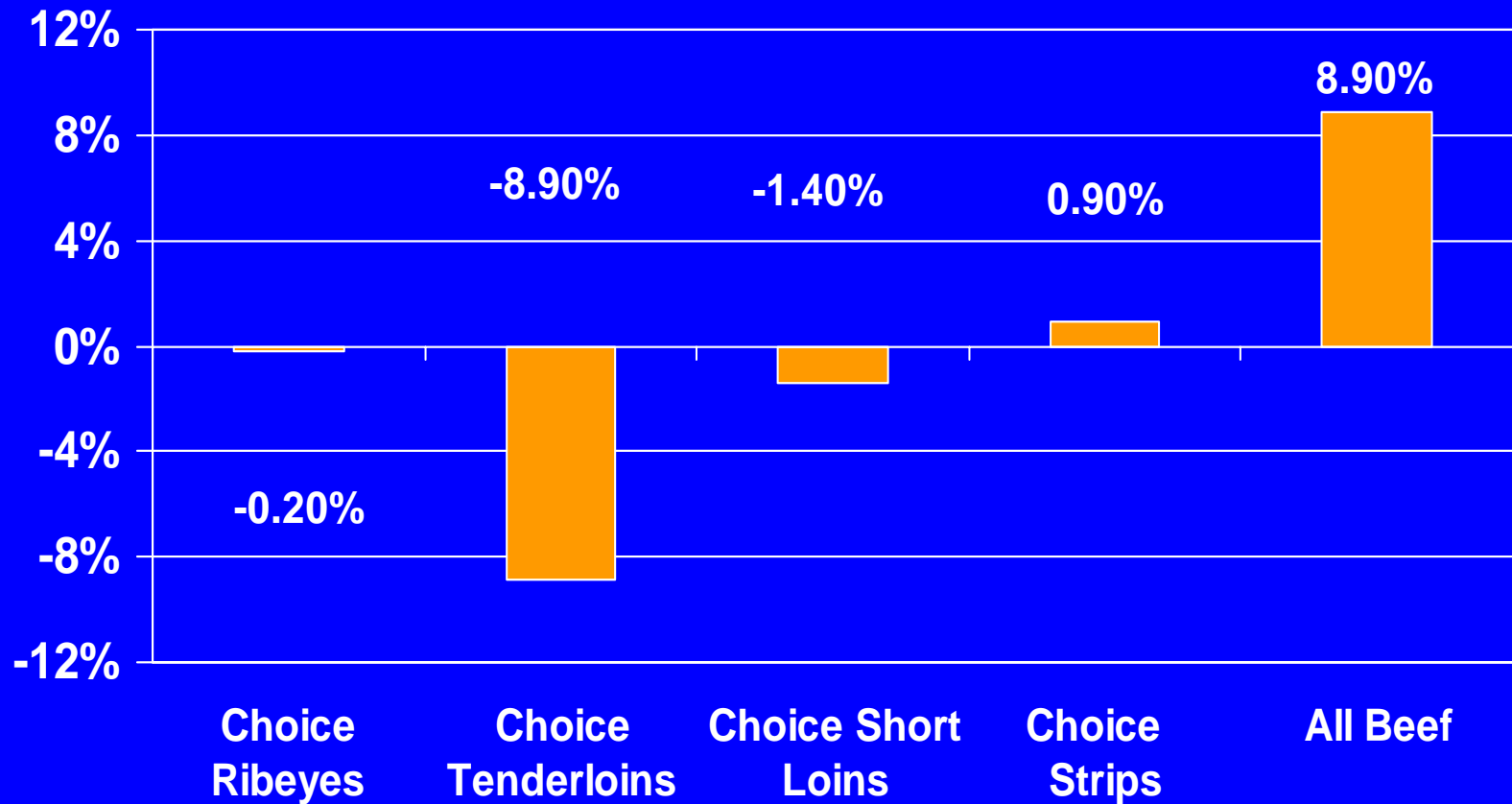


Fast Food Restaurants

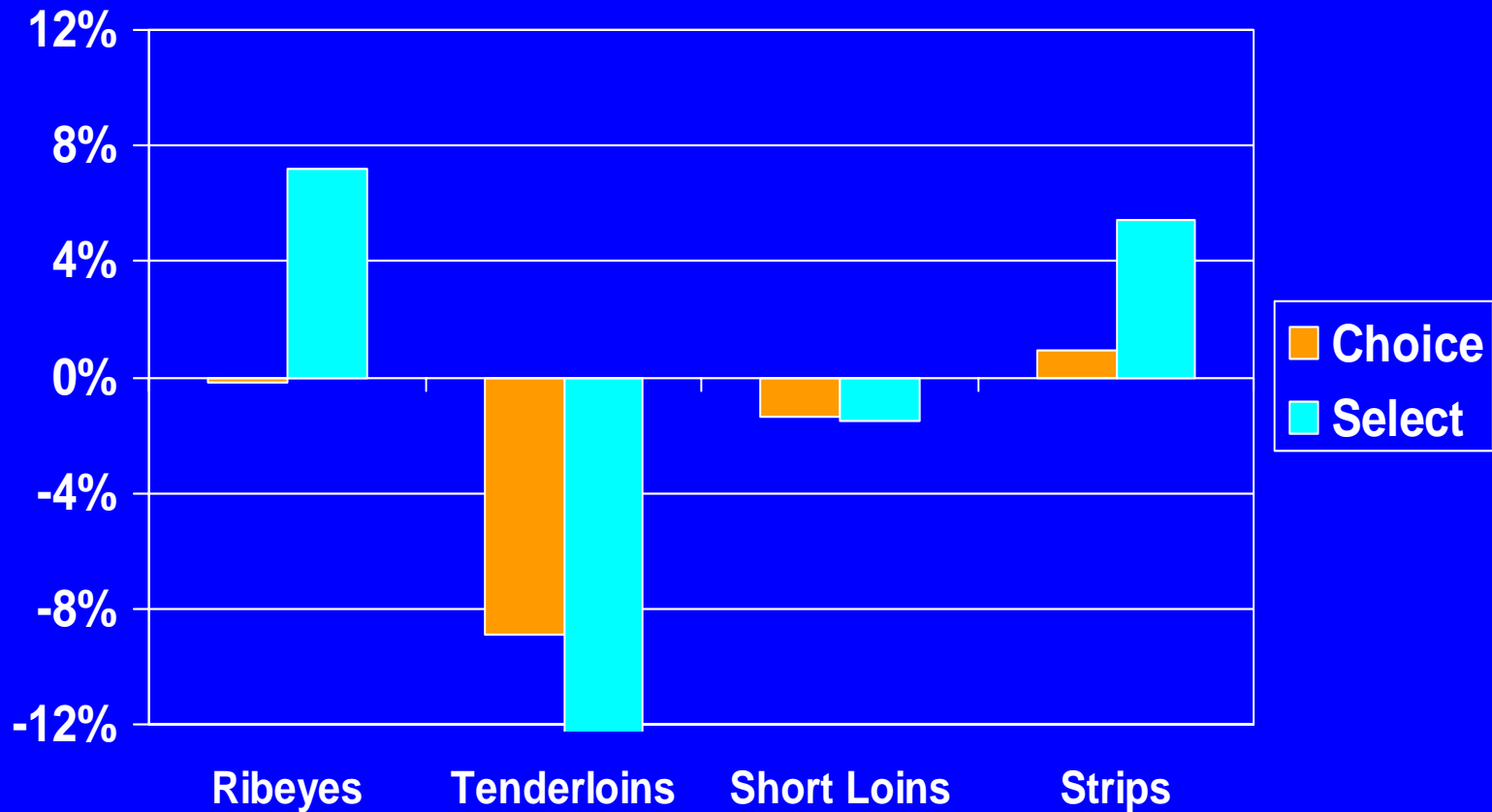


Supermarkets

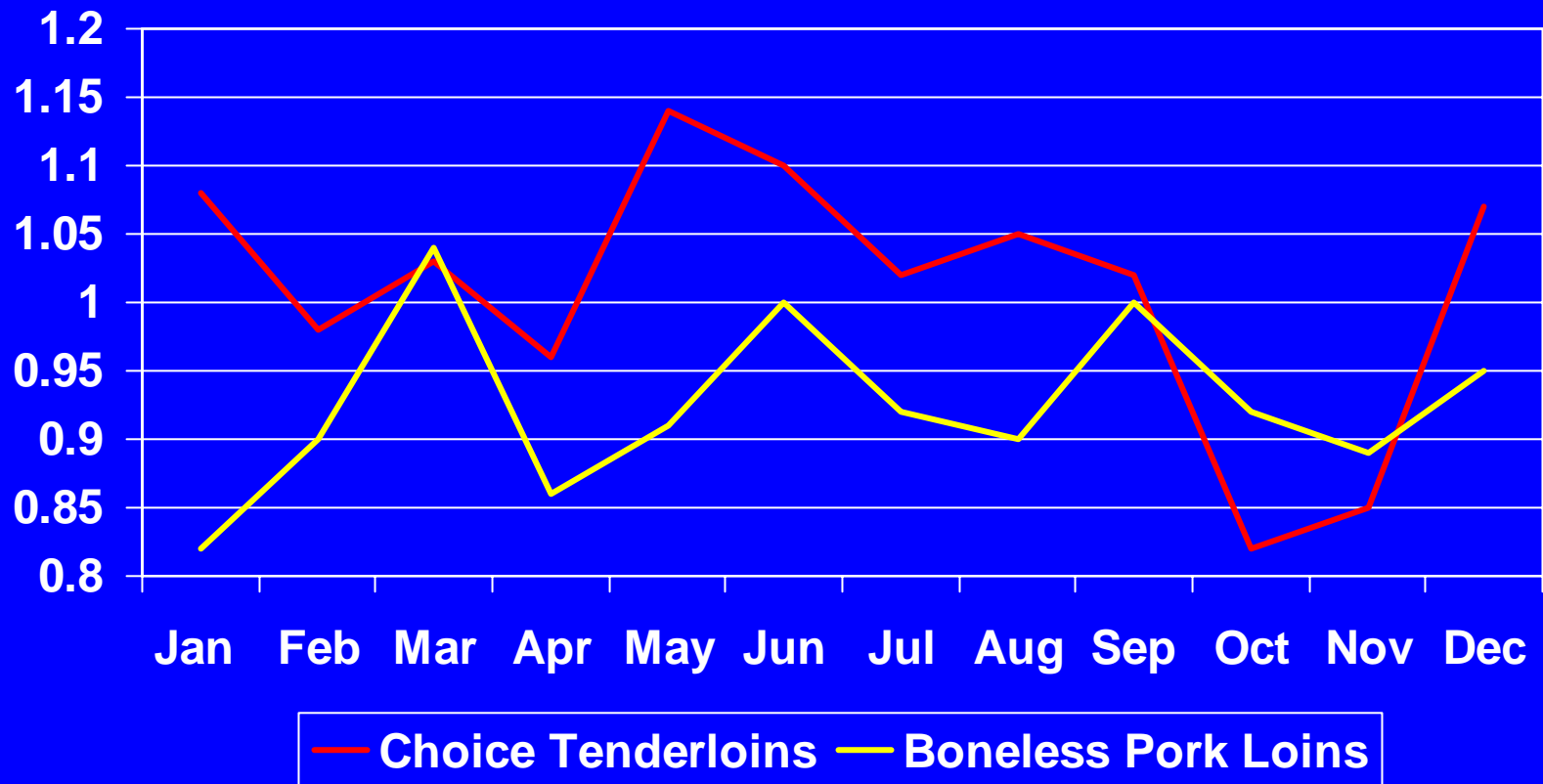
Per Capita Expenditures Oct-Dec 2001 % Change From 5-Year Average



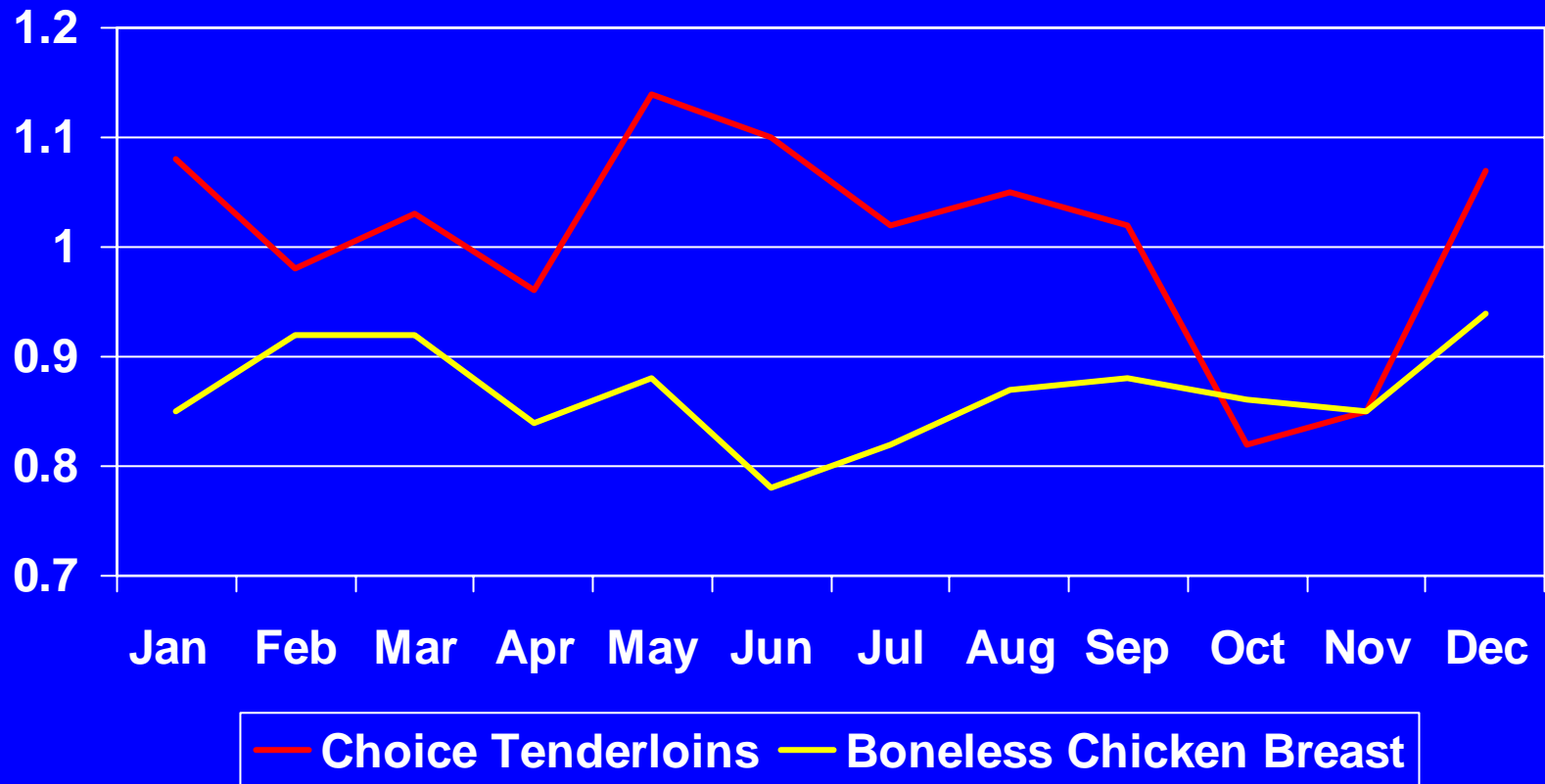
Per Capita Expenditures Oct-Dec 2001 % Change From 5-Year Average



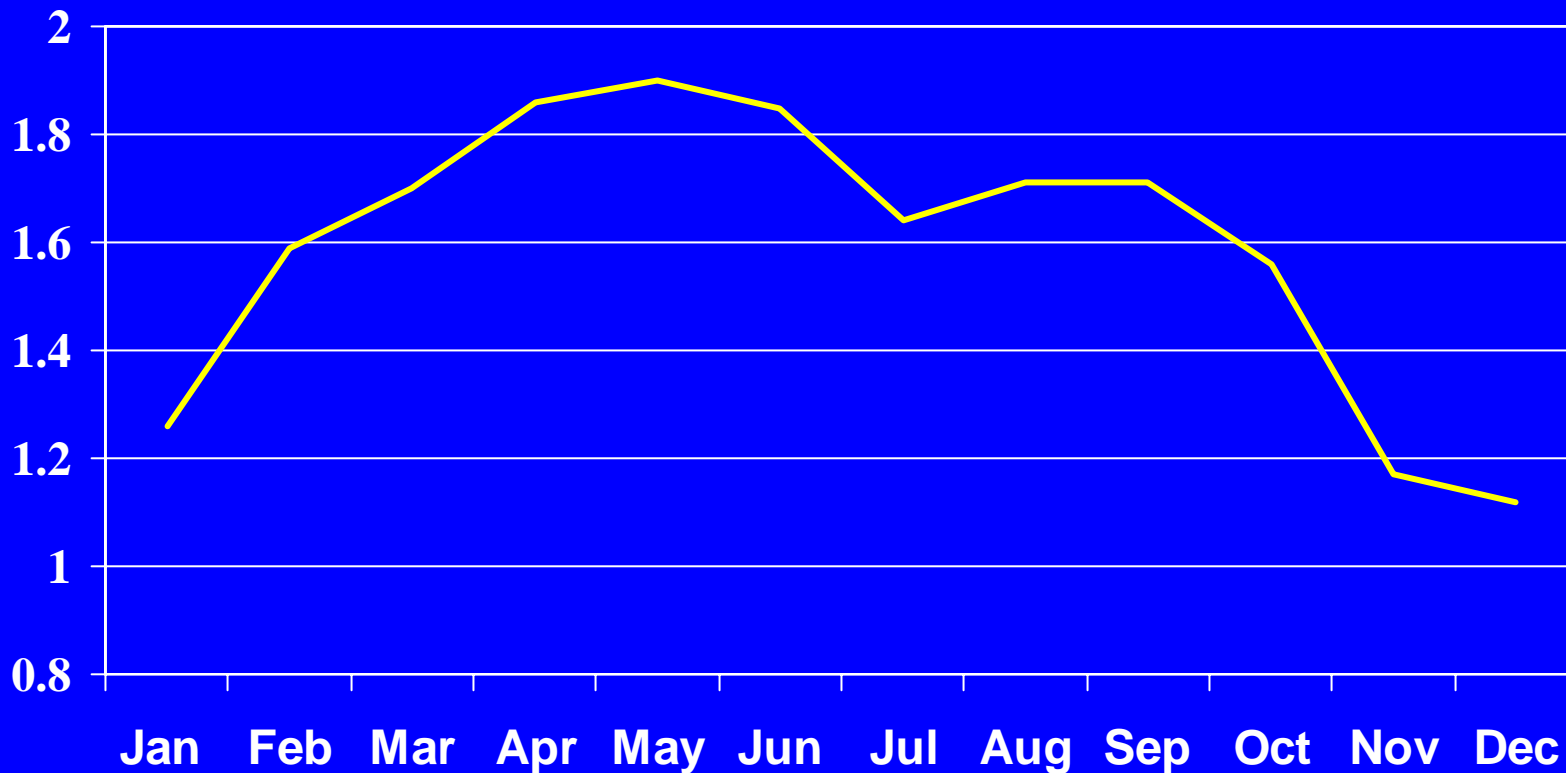
2001 Per Cap Expenditures Indexed to Five-Year Average



2001 Per Cap Expenditures Indexed to Five-Year Average



2001 Chicken Wing Prices Indexed to Five-Year Average



Prospects For Meat Demand Are Positive:

- Improving Economy**
- More Frequent Airline Travel**
- Beef Market Will Benefit Most**