DOMESTIC MARKET REPORT | Q4 2023

CANADA BEEF

REPORT FROM CANADA BEEF

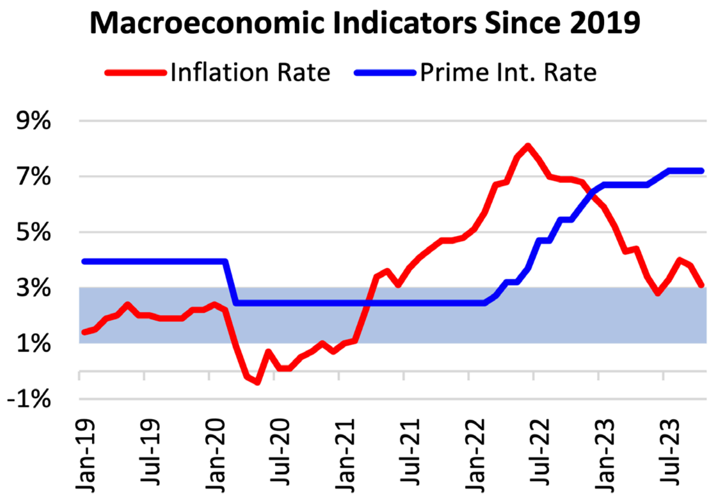
Executive Summary

Macroeconomic indicators continue to signal that previous interest rate increases have been effective. Canada narrowly missed going into a recession in the third quarter, unemployment moved slightly higher, and inflation is slowing. In contrast, U.S. data indicates an economy on fire. Retail beef prices have moved seasonally lower, declining 12% month-over-month to under $20/kg in October. The drop in retail prices allowed meat price ratios to re-align with long-term averages. Canadian and U.S. retailers are promoting pre-packed holiday meals that are budget friendly. Choice cutout values (wholesale prices) have been slowly softening for several months, nonetheless they remain well above historical averages. The food service sector is also seeing seasonal softening. Cost increases have climbed faster than revenues, resulting in some restaurants in facing a bleak financial situation. Beef imports continue to be well above last year and the five-year average in both volume and value.

Economic Outlook

At the end of November, data provided initial observations on the state of the economy in the fourth quarter. Canada narrowly missed moving into a recession in the third quarter. Statistics Canada GDP data showed a contraction of 1.1% in the third quarter. However, they also revised second quarter GDP higher, showing a 1.4% increase, compared to original data showing a 0.2% contraction. Despite the positive tone, several macroeconomists think there are still headwinds to navigate. October inflation came in at 3.1%, down 0.7% from September, suggesting that previous interest rate increases have been effective. The unemployment rate also moved a slight 0.1% higher in October, to 5.8%. Increasingly, opinion pieces are discussing the timeline of interest rate cuts, rather than further increases.

At their December meeting, the Bank of Canada policy makers opted to leave the overnight interest rate at 5%. This is the third consecutive meeting with the overnight rate unchanged. One of the metrics that are used to determine future rate movements is the core inflation rate. Core inflation excludes volatile pieces that are included in the larger inflation calculation, such as food, energy, and mortgage interest costs. The core inflation rate in October was 2.7%, down a slight 0.1% from September and is the second consecutive monthly decline. Core inflation has dropped from 5% in January.



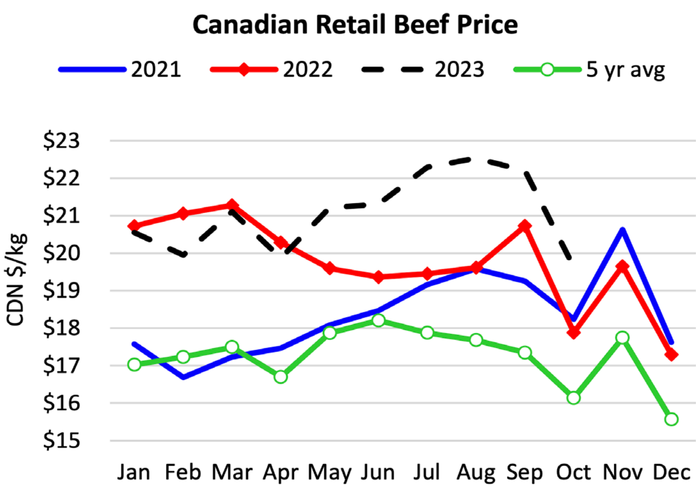
Source: Bank of Canada

Moving into 2024, the Bank of Canada believes that interest rates have peaked, barring a resurgence in inflation or wage growth. Interest rate cuts are expected to begin in the second half of 2024; though a rate cut as early as April is being tossed around by some economists.

Looking south of the border, the U.S. economy grew 5.2% in the third quarter (annualized), a substantial increase from the second quarter, which showed a 2.1% increase. The inflation rate dipped to 3.2% in October. Core inflation dipped a slight 0.1% from September to October, to 4%. The unemployment rate climbed slightly to 3.9% but remains well below the historical average near 5%. The most recent numbers suggest that the U.S. economy remains immune to the recessionary bug, that may be beginning to enter other economies.

Retail Sector

Statistics Canada shows a significant decline in average retail beef prices heading into the fall months. The 12% decline from September to October moved the average price of retail beef below $20/kg for the first time since April and followed a distinct seasonality: also, for the first time since April. Higher-priced beef cuts saw significant month-over-month declines; the largest price declines were on top sirloin cuts (-23.3%) and rib cuts (-14.2%), Moderate declines were also seen on striploin cuts (-8%). Lower priced stewing beef and ground beef were mixed; stewing cuts declined a moderate 4.5%, but ground beef moved a very slight 1% higher. Retail beef prices remain elevated compared to both last year and the five-year average. Considering how tight supplies appear to be, higher than historical retail prices should not be surprising.



Source: Statistics Canada

In October, 3.82 lbs of beef were able to be purchased per hour worked, an improvement from the spring and summer, when an average of 3.59 lbs could be purchased per hour worked. This is slightly higher than the long-term average of 3.78 lbs purchased per hour worked, showing improved affordability for Canadian consumers.

Cuts	Retail Price Oct. 2023 (CDN)	Change from Sept. 2023	Change from Oct. 2022	Change from the Five-year Average for Oct.
Beef rib	$23.17/kg	-14.2%	+9.1%	+23.2%
Beef striploin	$25.47/kg	-8.0%	+8.3%	+13.9%
Beef top sirloin	$20.04/kg	-23.3%	+24.9%	+35.4%
Beef stewing cuts	$17.66/kg	-4.5%	-4.0%	+17.1%
Ground beef	$11.82/kg	+1.1%	+15.7%	+22.4%
Total Retail Beef	$19.63/kg	-11.6%	+9.8%	+21.6%

Source: Statistics Canada

There are budget-friendly beef options for consumers at the meat counter. Chuck roast from the shoulder has traditionally been the go-to option for roasts in a slow cooker or a dutch oven. However, cuts from the neck are a very economical alternative. And when done properly, the extra time and effort to prepare and cook this cut is worth the effort.

Large U.S. grocery retailers (think Target and Walmart) are finding that pre-packaged holiday meals are very popular among consumers, both in terms of value and convenience. These meal options were first launched in mid-October in the U.S. in time for Thanksgiving. Popularity for these economically priced pre-packaged meals encouraged retailers to put them back on the shelf for the winter holiday season. These occasion-focused pre-packaged meals come with all the trimmings expected of a holiday meal. Most of these pre-packaged meal options are priced from US$5-10/person (up to US$15/person), providing affordable options to host a special dinner for friends or family on a reduced budget. In Canada, Walmart is offering a similar promotion, where a complete holiday meal can be purchased for under C$50 and is most likely suitable for a group or family of four to six people. Although these pre-packaged holiday meals don't include beef, a AAA beef sirloin tip roast at $22.20 can be substituted for the boneless smoked ham at $14.97 and still be under the $50 threshold.

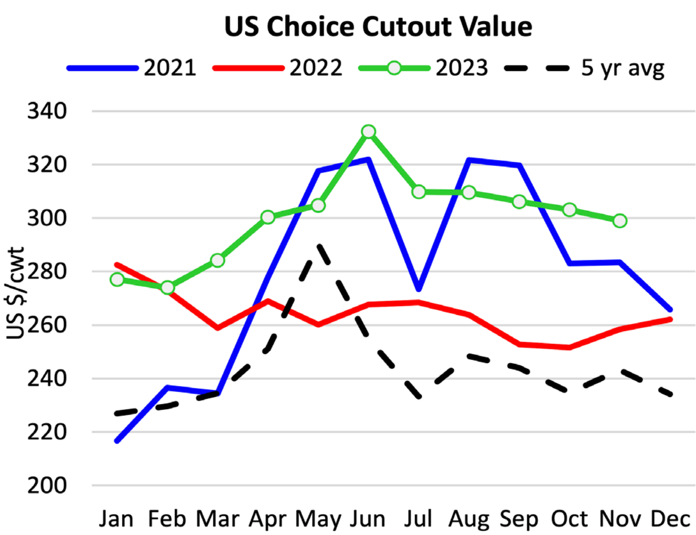
Looking at competing meats, October retail pork prices were 3% lower than September, at $9.56/kg. Retail chicken prices increased a slight 1% to $10.12/kg. The significant drop in retail beef prices, combined with a much smaller drop in retail pork prices and an increase in retail chicken prices allowed price ratios to re-align in October. The beef-to-pork ratio stood at 2.05:1, only slightly above the long-term average of 1.94:1. In contrast, the beef-to-chicken ratio fell to 1.94:1 and is currently below the long-term average of 2.02:1. The recent convergence of price ratios toward long-term averages should help reduce substitutions at the meat counter of the grocery store.

Seasonally adjusted supermarket and grocery sales in September totaled $8.97 billion and were down a very slight 0.2% from August. September's sales were 2% lower than the YTD annual high in July. Food inflation in September was 5.9%, down 0.9 percentage points from August and down 1.9 percentage points from July. October's food inflation at 5.6%, shows a continued slowdown in the increase in the price of food.

Wholesale Sector

US Choice cutouts have been drifting lower over the past three months, averaging just shy of $300/cwt in November, easing 3% since August. Despite the recent softening, Choice cutouts remain 16% higher than November 2022 and 23% higher than the five-year average for November. Cutout values have very loosely followed historical trends through the summer. However, this trend was violated in October. The five-year average indicates an increase in cutouts values from October to November, though there was a continued softening in cutout values this year.

Looking at primal values, support for the overall cutout has been hard to come by, especially over the last 8-10 weeks. Rib primals have been the bright spot, increasing steadily and put in new all-time highs for each of the last two weeks, climbing to US$573/cwt by the end of November. YTD, the rib primal has averaged $485/cwt, 18% higher than last year and 22% higher than the five-year average. Loin primals have seen significant movements this year, peaking near $500/cwt, then plummeting 37% before re-gaining its footing. Loin primals have since made incremental gains every week, reaching US$388/cwt. Though loin primals may have under-performed this fall, they have averaged $405/cwt, 15% higher than last year and 25% higher than the five-year average. Since the beginning of September, end meats have mostly moved in lockstep with each other, peaking at the end of October and sliding significantly since. End meat values have moved 10-15% lower over the last five weeks. Similarly to middle meats, end meats remain priced at a considerable premium to both last year (+10-15%) and the five-year average (+20-22%).



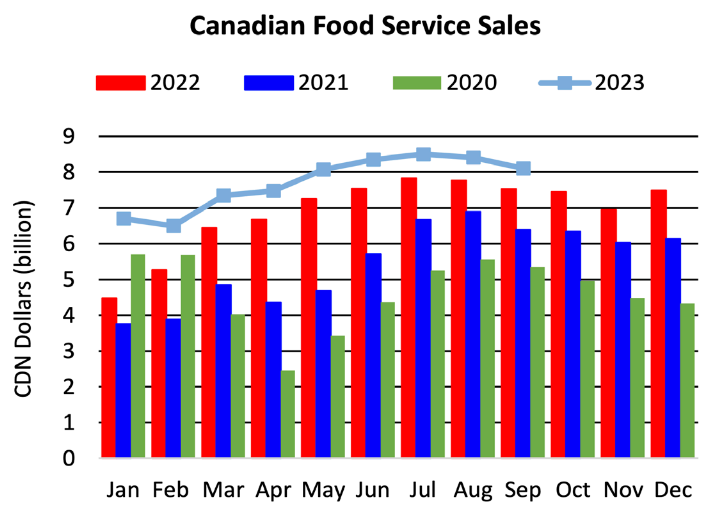
Source: USDA, Canfax

Recent signs of demand erosion, including higher non-housing debt balances (auto loans, student loans, and credit card debt), are weighing heavy on U.S. consumers. From the first quarter of 2020 to the third quarter of 2023, credit card debt has increased 21%, auto loan debt has increased 18%, and student loan debt has increased 7% in the U.S. A weakening U.S. economy is likely to spill into Canada.

Live cattle futures have seen some significant movements since late October, creating increased volatility on both sides of the border. The December live cattle futures ranged from US$181-187/cwt in July but fell to US$170-184/cwt ($180-184/cwt 1st week of November; $170-177/cwt there after in November), a 4% drop. This is very strongly correlated with the same 4% drop seen on Alberta fed steers (live) from July to November (C$230/cwt), and once again highlights the effect that U.S. markets have on Canadian prices.

Food Service Sector

YTD, food service sales totaled $69.5 billion, a significant 14% increase from 2022 and a substantial 48% increase from 2021. Third quarter sales remained historically strong, up 8% from the third quarter of 2022 and up 26% compared to the third quarter of 2021, at $25 billion.



Source: Statistics Canada

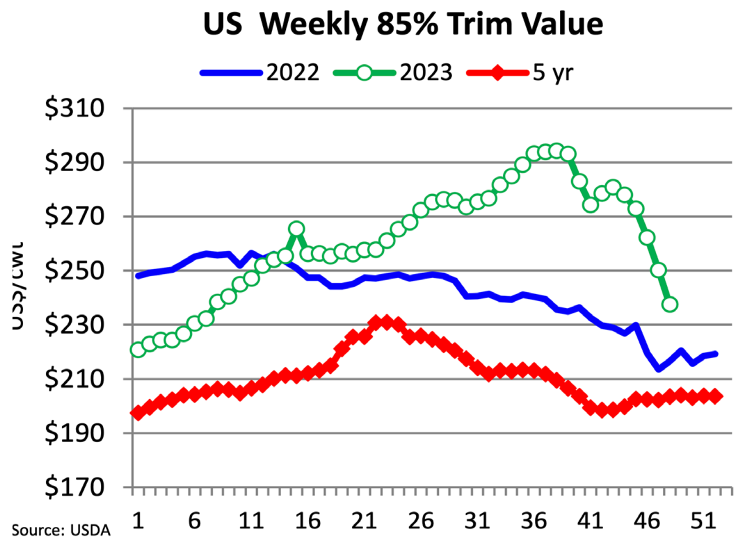
Seasonal softening entered the food service sector by September; food service sales were a moderate 4% lower than August, but were 8% higher than September 2022, at $8.1 billion. Special food sales (catering and special events) were 10% higher, sales from bars and pubs were 4% higher, full-service restaurant sales were 6% higher, and limited-service restaurant sales (fast food) were 9% higher than September 2022.

However, the food service is facing significant challenges. Some of these include higher wages to attract and retain employees, higher rent, and significantly higher than normal food inflation. On the other side of the dining coin, general demand for dining out is decreasing, as consumers contend with smaller paychecks relative to their living costs. Looking at the past three years (2020-2022), food services sales continue their downward trend through October and November, then rebound in December as families and workplaces get together for holiday gatherings and end-of-year meals.

According to a recent report from Restaurants Canada, around half of its members are facing a bleak financial situation, bordering on insolvency. This despite total spending in restaurants that is projected to be up 10% from last year; costs have risen faster than revenues. A revision of the CEBA repayment plan timeline and changing the tax laws to allow restaurant meals to be a tax-deductible expense are a couple of specific items that would help the bottom line of the restaurant industry and keep some 1.1 million people employed.

Imports and Distribution

Heavy liquidation in Australia in the second half of 2023 has put a significant volume of lean trim on the market, and some of that excess lean trim is coming to North America. Since mid-September, U.S. lean trim (85%) has softened 24% to $225/cwt the first week of December. With tighter North American beef supplies, increased beef import volumes should be seen as a positive. This keeps beef on consumers' plates. As supplies increase, convincing consumers to switch from beef with an international label to Canadian beef is easier than convincing consumers to switch from pork or poultry back to beef.



Beef import volumes in October were 13% higher compared to a year ago and were 21% higher than the five-year average for October. Year-to-date, beef imports were up 12% in volume and 11% in value from last year.

Year-to-date, beef imports declined from the EU27 (-12%), the UK (-63%), and Argentina (-73%), and increased from the U.S. (+2%), New Zealand (+59%), Uruguay (+64%), Australia (+54%), Mexico (+22%), and Brazil (+105%).