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P.O. BOX 3947 ENGLEWOOD, COLORADO 80155 303 - 694-0323

November 14, 2002

COMMENT

Ms. Jean A. Webb
Secretary, Commodity Futures Trading Commission
Three Lafayette
1155 21st Street, NW
Washington, DC 20581

Re: CME proposed amendments to the spot month speculative position limits for the live cattle futures contracts.

Dear Jean,

The Live Cattle contract as it functions today is not a reliable risk management tool. Today more than ever, the cattle industry needs a risk management tool to effectively manage price risk. The lack of basis predictability with the present contract is a major concern. The basis with the current contract has weakened significantly as the deliverable supply of cattle has declined. The lack of a predictable basis in the spot month has discouraged hedger participation in the live cattle contract. The weakening basis has also impacted packer basis bids on live cattle. Because of the lack of convergence, packers appear to be bidding more risk premium into basis bids, which effectively lowers the net selling price on basis contracted cattle.

In 1995, Cattle-Fax estimated that 17 percent of the total fed cattle supply was marketed through various marketing arrangements, alliances, and grids or were packer fed. In 2001, this same number was estimated at 47 percent and in 2002 these non-cash supplies will likely account for between 51 and 52 percent of the total. Very few of these cattle are available for delivery; therefore the deliverable supply has declined significantly during the past seven years.

Steer carcass weights have increased 50 pounds on average (770 lbs. to 820 lbs.) from 1995 to 2002 ytd. Assuming a 63 percent yield, the contract specs for steer live weights would have needed to increase nearly 80 pounds to keep pace with the trends in the feeding industry. Average carcass weights have increased at the rate of 5.9 lbs. per year since 1975. The current live cattle contract specifications for average live weight is 1300 pounds, which is equal to an approximate 820 to 830 pound carcass weight. Even with the live weight increase that will go into affect with the June 2003 contract, when the average weight will increase from 1300 to 1325 pounds, the carcass weight equivalent will average 835-850 pounds. A significant percentage of the potential deliverable supply of fed cattle is not deliverable because the current and proposed weight specifications are too low. USDA data shows that in 1995, 44 percent of the total fed steer and heifer carcasses weighed less than 750 pounds. During 2002, only 22 percent of steer and heifer carcasses weighed below 750 pounds and 78 percent weighed above 750 pounds. It should also be noted that nearly all of the heavy-weight discounts that exist in the industry today are not applicable until a carcass weighs above 950 pounds. This is nearly one hundred pounds of carcass weight or 155 pounds of live weight above the average weight limit that will exist with the revised specifications that will go into affect with the June 2003 contract.

Speculators are a very important part of any successful futures market. Market liquidity is essential yet basis predictability is just as important if the hedger is to use the tool. Lowering the speculative position limits in the delivery month should allow for a more orderly and predictable convergence of futures and cash into contract expiration. Speculative interest and liquidity in the deferred contracts should not be impacted significantly with the CME proposal.

The ultimate goal is for the cattle industry to have a fair and honest contract that works well for hedgers and speculators alike. Both longs and shorts would benefit from a contract that has more predictable basis in the delivery month. It is the duty of the CFTC to keep the contract in balance and guard against excessive speculation and to protect all market participants. If the contract were working efficiently, the actual number of physical deliveries would be very small because the market would seek out an economically justifiable price level and the need for physical deliveries of live cattle would be diminished.

It is clear that the deliverable supply of fed cattle has declined during the last several years because of significant weight increases and the trend toward more marketing arrangements and fewer cattle available for the cash trade. It is essential that the deliverable supply of fed cattle and the speculator position limits be in balance to help assure improved basis predictability and convergence. The proposed speculative position limit reduction should help promote more orderly trade and liquidation in the delivery month.

The live cattle contract as it exists today is not an affective risk transfer mechanism for cattle producers to use in marketing programs. It could very quickly become obsolete if necessary contract and position limit changes are not instituted. We support the CME decision to lower speculative position limits from 600 to 300 contracts in the delivery month beginning with the December 2002 contract. This is the first step toward improving the overall usefulness of the live cattle contract.

Sincerely,

Randy Blach

Randy Blach
Cattle-Fax