MEAT MARKETS
UNDER A MICROSCOPE

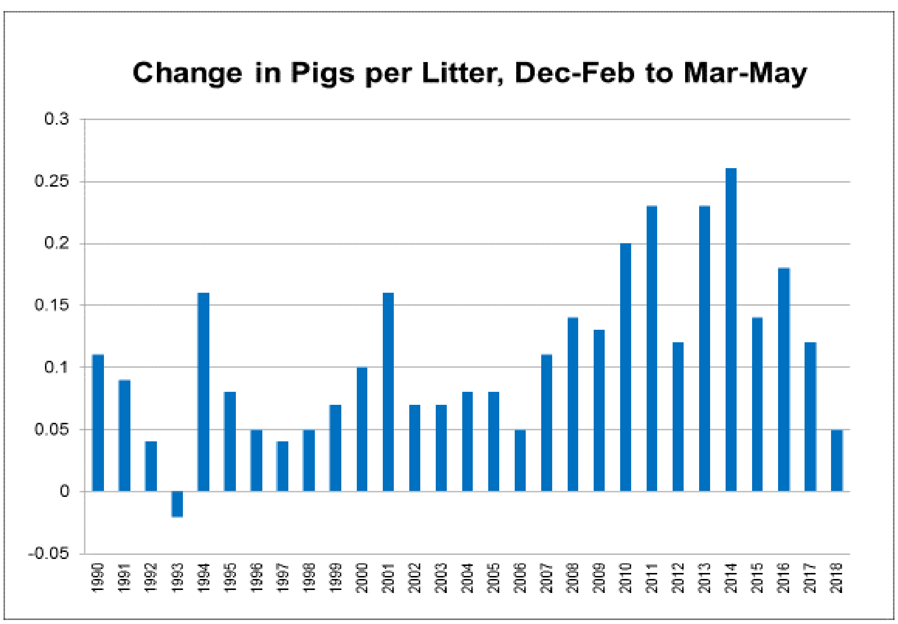
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

October 1, 2018

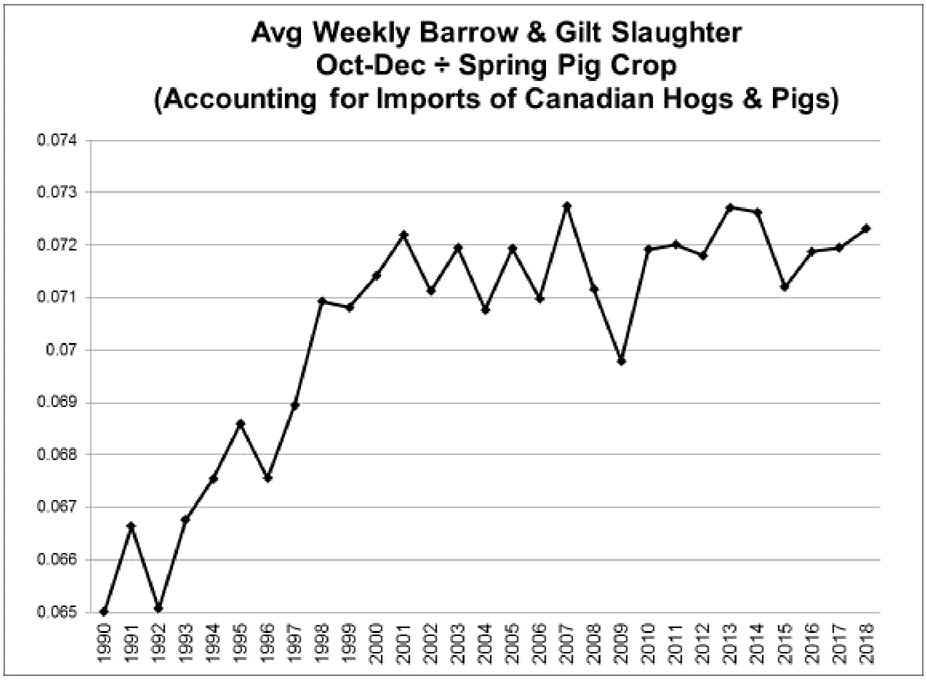
In the refreshed look at the U.S. hog inventory, the underlying themes are that: a) the rate of growth has been remarkably consistent over the last couple of years and b) there is no sign that it is slowing down. In each of the last ten quarters, the year-over-year increases in the market hog inventory have ranged from 2% to 4%. Sure, USDA's projected farrowing intentions show smaller increases for this fall and winter than this past spring and summer; but ever since the summer of 2015, actual farrowings have wound up greater than the initial intentions. The $20 per cwt rally in cash hog prices during September and the big premiums in 2019 futures contracts probably have engendered enough optimism to keep the expansion going for a while.

You should know by now that my approach to hog slaughter projections is to take the numbers at "face value", to assume that USDA's farrowing and pig crop estimates are basically accurate, and alterations are made only when they are solidly warranted. Lacking access to any Secret Information, it is the best approach I can take.

I cannot help but notice, though, that the spring 2018 pig crop estimate—which, as usual, was left unchanged from the first actual count—included a curiously small seasonal increase in the number of pigs saved per litter from winter to spring this last time around:



I should point out that the long-term trend toward larger litter sizes remains very much intact, and so gains in productivity are not slowing down. Not being able to find a suitable explanation, I am using this as justification to think that fourth quarter hog slaughter will be a bit on the high side relative to the spring pig crop. I show this picture on the next page.

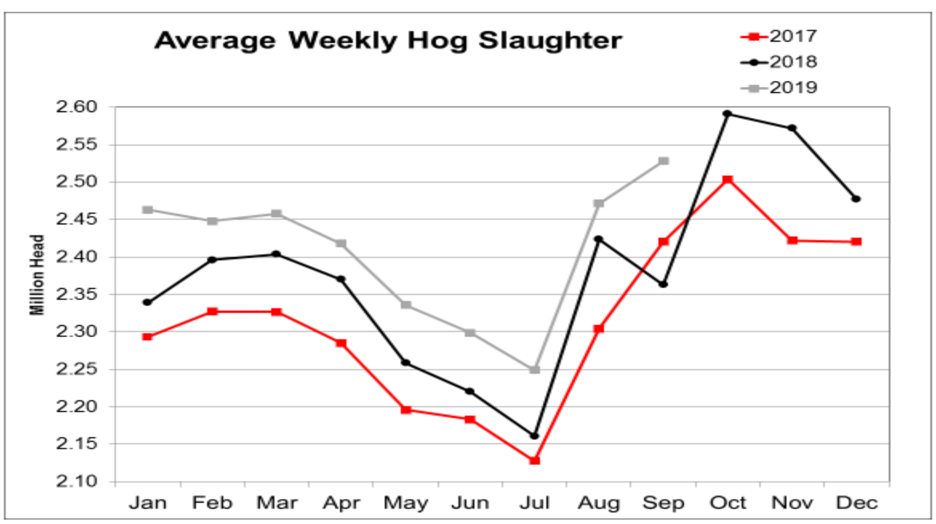


I also consider that there were something like 400,000 hogs that should have been marketed in September but will instead be moved in the fourth quarter because of Hurricane Florence.

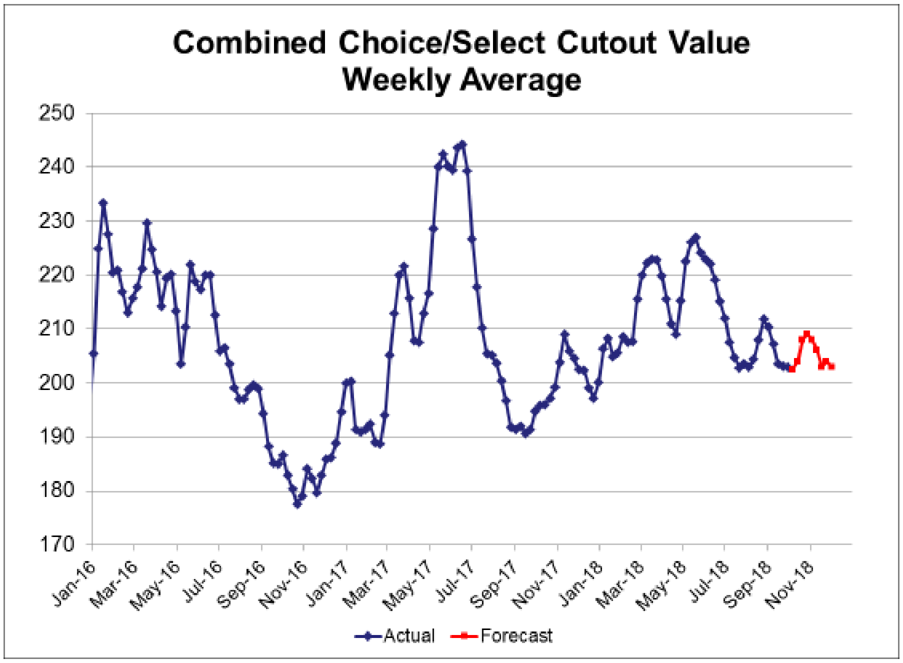
Otherwise, the *modus operandi* is to place the quarterly kill in a "middle-of-the-road" relationship to the corresponding pig crop.

I extend that objective logic to develop projections for each month, assuming that the quarterly total will be distributed in typical fashion among the individual months. In 2017, the kill in November was extraordinarily low in relation to the fourth quarter total, and in December it was extraordinarily high; this explains why I am anticipating a 6.2% year-over-year increase in November and a 2.3% increase in December. For the same reason, I am projecting that kills in January will be up 5.3% and February up only 2.2%.

Without going into detail on the subject today, my assumption that fourth quarter pork exports will be up 5% from a year ago in the fourth quarter and up 7% in the first quarter. It is particularly difficult to factor in the potential impact of African Swine Fever in China at this point, for obvious reasons. Let it suffice to say that my export forecast does *not* allow for a full-blown pandemic. Anyway, the larger exports make for much smaller increases in net domestic pork supplies than the slaughter projections alone would suggest.



It still looks as though the combined Choice/Select cutout value is bottoming out right here. My guess is that it will rally up to about $110 per cwt in the week ending October 27, and then give it all back by the end of November. The first half of that plan is not at all unusual; the second half is a significantly weaker-than-average price behavior.



The scenario that I am describing would be the product of a flat pattern in the weekly demand index and fed cattle slaughter that averages 501,000 in October and 504,000 in the non-holiday weeks of November. [Over the last three weeks it averaged 520,000.] In regard to the rate of production, I am taking into account the record-large inventory of cattle on feed 120 days or longer (record large for October 1, that is); the clear incentives for feedlots to slow the marketing pace (premiums in the futures market, cheap feed costs, relatively high replacement costs); and the unseasonably wide packer margins, which will shrink but not enough to prompt a severe cutback in kill schedules. My partly subjective/partly statistically-based slaughter projections would be the same as a year earlier in October and down 1.3% in November.

The flat demand index projection is the assumption that wholesale beef demand will follow a typical seasonal pattern over the next nine weeks. I see no compelling reason to expect otherwise. The demand index has been on a very mild ascent over the past eight weeks. Forward booking activity indicates that retailers are planning on moving big volumes around the first of November, but demand for deliveries between now and then has been rather neutral—providing no cause to think that the index will veer from its current path.

One thing I've been wondering about: the seasonal rally in ribeyes got off to an early start this year and prices are already high by several standards; does this stunt the potential October rally that lies just ahead? I *had* to investigate, of course, and the answer appears to be….uh, no. First of all, the sort of 3% change in the combined cutout value that I'm forecasting over the upcoming four-week period is, coincidentally, very close to the 15-year average change; and the 15-year average change in Choice boneless ribeyes would carry them up to about $8.65 per pound, which is below the peaks of both last fall and this past summer. I hear nothing around the Sewing Circle to suggest that buyers are pushing back on the price gains that we have seen so far. [Friday's quote was $8.10.]

Actually, the change in the combined cutout value from September to October is *not* very closely correlated with the concurrent change in ribeye prices. In fact, strips, short loins, and tenderloins show a considerably stronger correlation than the ribeye. The items showing the strongest correlation to the change in the cutout value at this time of year are inside rounds and briskets. This supports the notion that I have put forth in the last couple of weeks, which is that the ability of the round complex to “get off the ground” will be an important determinant of both the timing of this short-term cyclical low and the extent of the ensuing rally. Indeed, the undertone in the round complex at the end of this past week was noticeably stronger than it was a week earlier.

Meat Markets Under a Microscope is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523, or visit our website at www.procurementstrategiesinc.com.