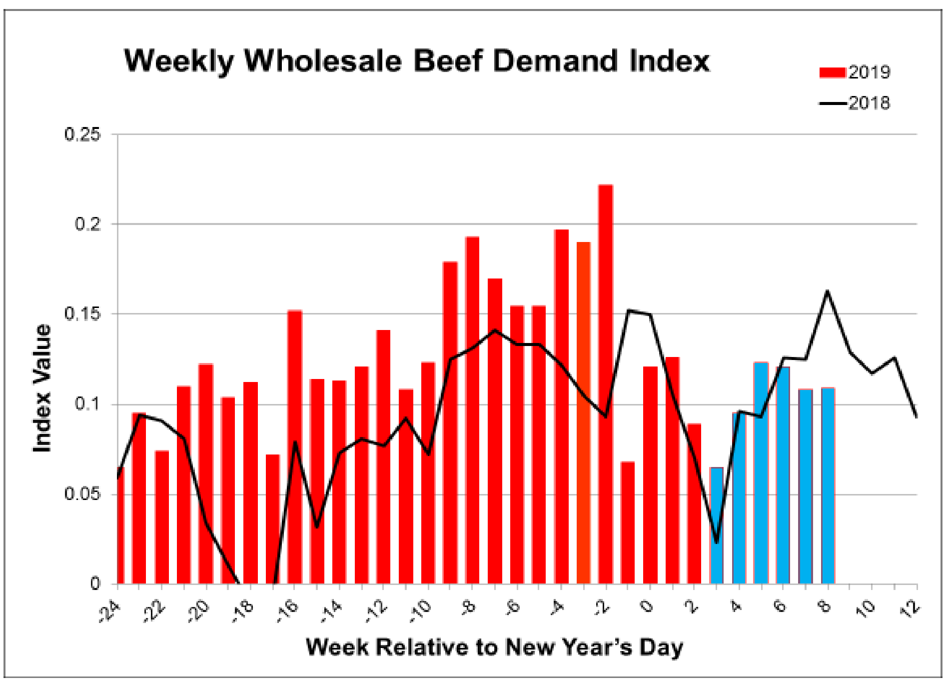
MEAT MARKETS
UNDER A MICROSCOPE

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

January 17, 2019

As best I can tell, the combined Choice/Select cutout value will move sideways through mid-February, remaining within the range in which it has been in since early November. It doesn't seem like it, but the weekly averages have held between $210.85 and $214.71 for 12 weeks now. Currently the market stands near the bottom of that range. My guess is that it will move up to the upper boundary and then back down to the lower boundary, all within the next four weeks. It's a foolishly precise forecast, but here's what I'm thinking.

Production will be cut back substantially, because packers are struggling with a sagging beef market and tight front-end supplies due to the weather. In this situation, it's the only tool they have to boost "kill and cut" margins. It's not that they are losing money—they're doing quite well compared with historical January margins—but they are probably not meeting expectations. And so, fed cattle slaughter should drop from last week's total of 490,000 to 475,000, where it should hold through February. Naturally, this will lend some support to beef prices. I expect that initially, the kill cutbacks will generate enough demand to add several dollars to the cutout value.

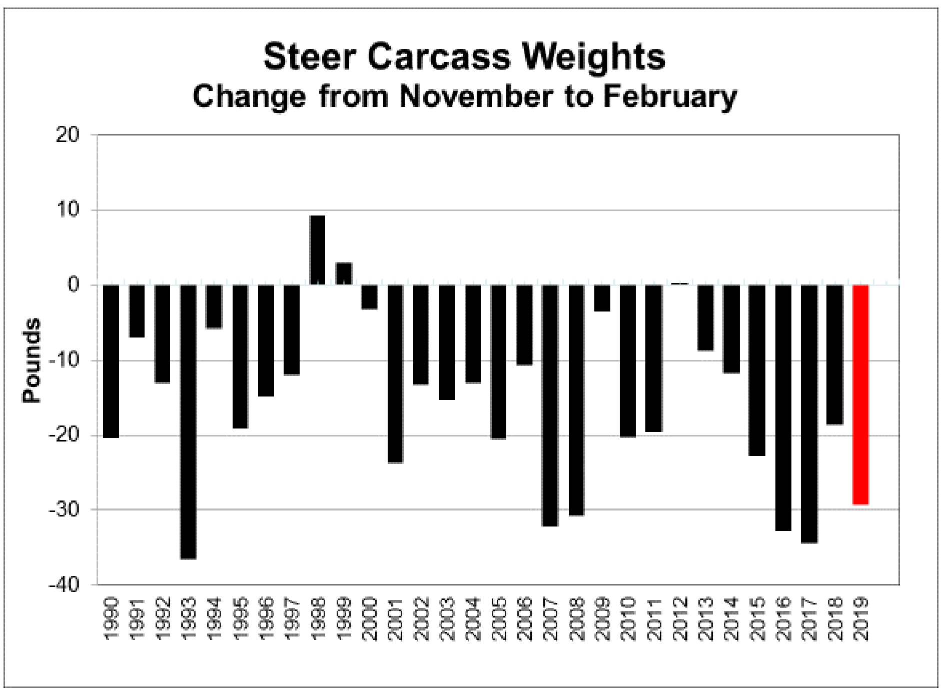


But as yet, I see no sign that retailers will step up their beef promotions any time soon. I *do* notice that large volumes of several key items (ground beef, bottom round flats, shoulder clods) have been trading this week, but today is January 17; if this flurry of activity is related to retail features, the product is probably not delivering before the end of February.

And this is why I doubt that the initial round of reactionary price increases will entirely “stick”. A couple of items, yes—those which have become ridiculously cheap in relation to the rest of the beef market. I’m thinking of flats, 50% lean trimmings, and to a lesser degree, ground beef and inside rounds.

Eventually, forward prices will come down enough to stimulate retail features once again and ignite a sustainable rally in cutout values. I’m guessing that such a rally will get underway at the end of February. If steer and heifer kills average near 480,000 in March as I am projecting, and if demand matches that of the past three years at the same time, then the combined cutout value will average around $225 per cwt. In March 2018 it averaged $222.

Of course, I am factoring into the equation a steep drop in carcass weights. It sure would help if we knew exactly where they stood right now. But I believe the stories I hear from cattle feeders in Nebraska and Kansas who say that these are the among the worst pen conditions they have ever witnessed. Below I show you what I mean by “steep”:



Forgive me if you’ve seen this picture before, but my mind is going. Anyway, this topic is front and center in the cattle and beef markets right now, and it is the main reason why cattle prices have jumped $8 per cwt since early December. It is to be kept in mind that with the exception of grinds and trimmings, carcass weights are not usually a major determinant of *beef* prices; the number of cattle being processed is far more influential.

Finally, I must say that I am surprised by the resilience of the ribeye market. Although the extent of the post-holiday decline in Choice-grade product, measured in percentage terms, so far has been pretty normal, this market appears to be bottoming out at a much higher price level than it did last year—about $1.00 per pound, in fact. Nothing similar can be said about most other beef products. Between now and mid-February, the historical tendency has been toward a sideways market, and I have no reason to expect anything different this time around. The same, by the way, applies to strips, short loins, and top butts.

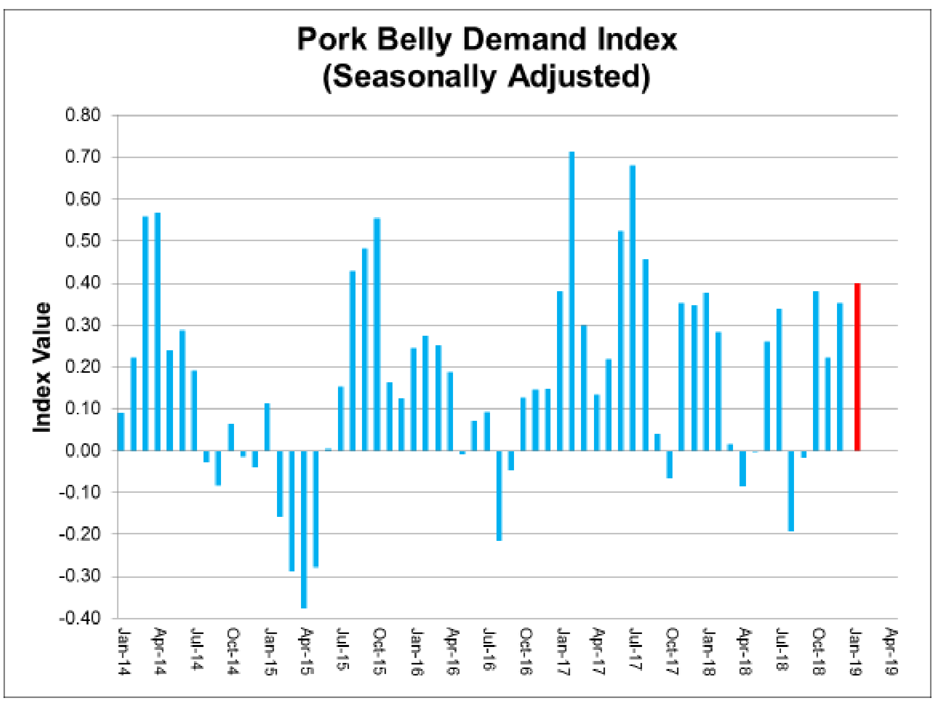
Meanwhile, the pork cutout value is not advancing quite as rapidly as I had anticipated. But I still have to think that declining production will push it upward into early February. It looks as though this week's kill will be down roughly 50,000 head from last week's total, and another 50,000 head will be shaved off by the first week of February.

Pork bellies threw a "curve ball" by taking a big step backward this week. The 13¢ per pound setback in belly prices made a negative contribution of about $2 per cwt to the cutout value, largely explaining why it has failed to get off the ground. So what's this all about?

I have to think that if there were some deep-seated problem with belly demand—enough to cause prices to head into a tailspin as they did in February/March in each of the last two years—then prices probably would have continued downward after the initial plunge on Tuesday; instead, they have held steady for the past three days.

But beyond such extremely short-term considerations, I notice that in the first two weeks of January the belly market stood a full 15¢ per pound above the last two years. Maybe it just got a little bit ahead of itself; such that the market was in danger of shutting off demand from the supermarket sector. [It is the supermarket sector, not the restaurant sector, that operates as the regulator when prices become too high or two low in the short run; that's because consumer-level prices do not change very often in foodservice outlets.] Now, following the setback, belly prices are actually below those of late January 2017 and 2018.

While belly demand can be capricious in the short run, the demand index in January—so far—is shaping up to be at the high end of its range of the past 14 months:



If the index value remains in the .30-.40 zone, then the market will average between $1.33 and $1.43 per pound in February. From this angle, it appears likely that we are witnessing a simple "reset" in pricing instead of the onset of a protracted decline. And if *that's* the case, then it seems the cutout value can only go upward from here. What, among the rest of the items on the menu, has enough downside potential to prevent this from happening?

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