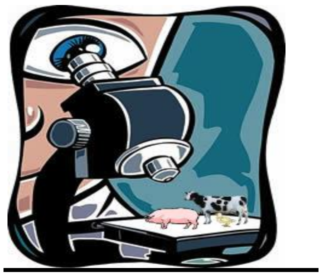
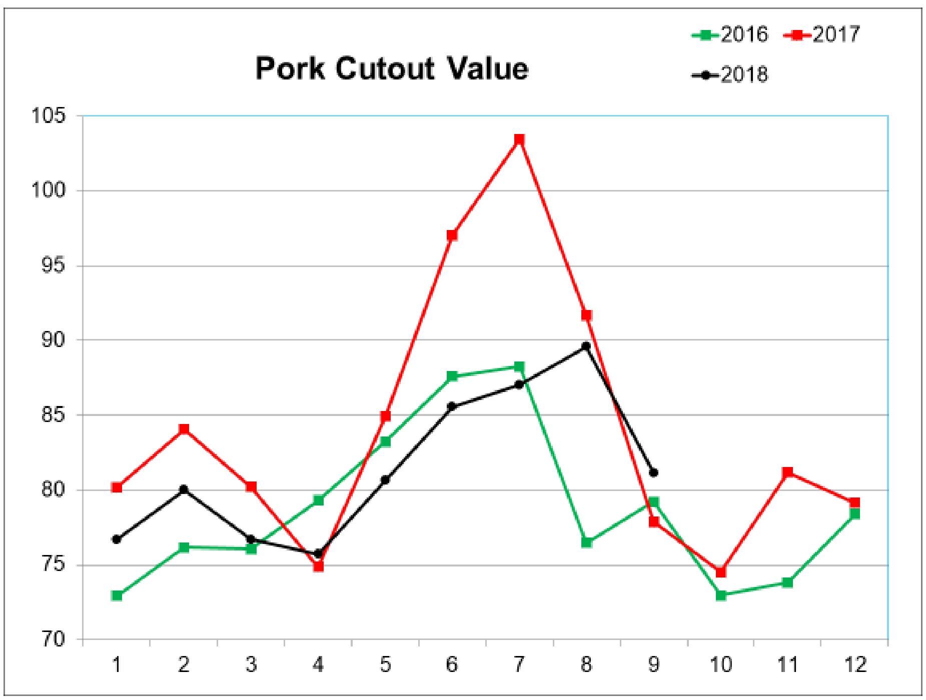


# MEAT MARKETS
# UNDER A MICROSCOPE

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

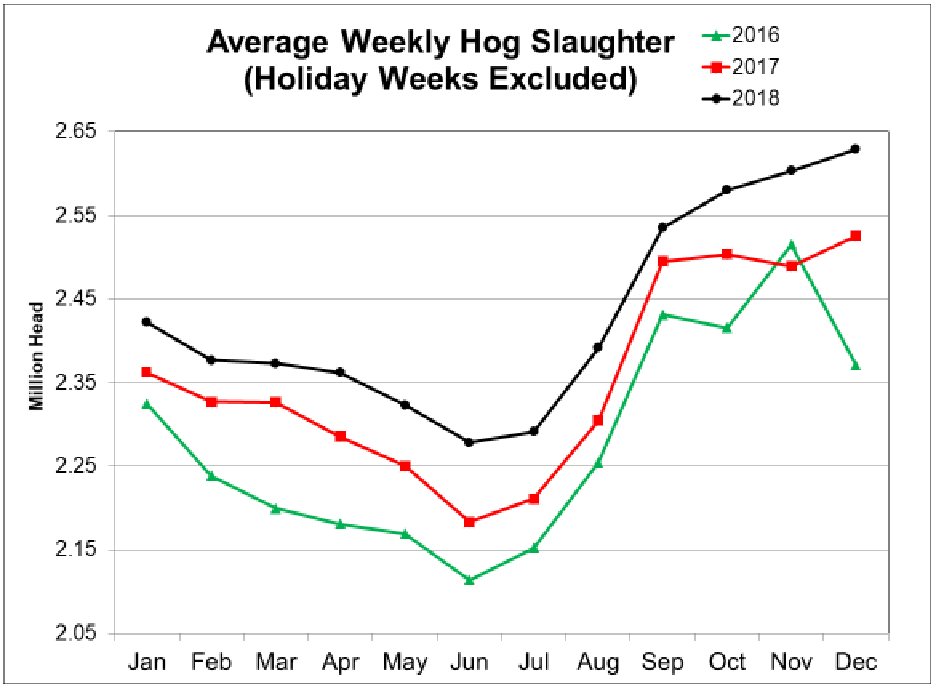
January 3, 2018

**Pork supplies will be bigger than a year earlier this winter and spring, therefore demand must increase by the same amount, or else there will be deflation in pork prices.** Isn't that the way it works? In the long run, absolutely. I'll get straight to the point and say that I do not expect incremental demand to keep pace with the increase in supply, at least not in the first half, and the pork cutout will be lower. The month of April could be an exception. I'll explain why in a minute:




As usual, in projecting hog slaughter, I take USDA's pig crop estimates at face value. I am not privy to any sort of Secret Information that would compel me to do otherwise. Besides, USDA's estimation procedures are scientific and thorough. Next, I assume that Each quarter's total hog slaughter will align in typical fashion with the corresponding pig crop. Finally, I assume that each quarter's kill will be typically distributed among the individual months. This a bland approach, but it helps ensure that the resulting projections will be as least wrong as possible. They are shown in the picture on the next page.

Most likely, then, hog slaughter will exceed a year earlier by a bit more than 2% in the first quarter and between 3% and 4% in the second quarter.




Pork production, however, will be up more than 3% this winter and nearly 5% this spring, if carcass weights follow a normal seasonal path from this point forward. Currently, they are running two pounds heavier than a year ago.

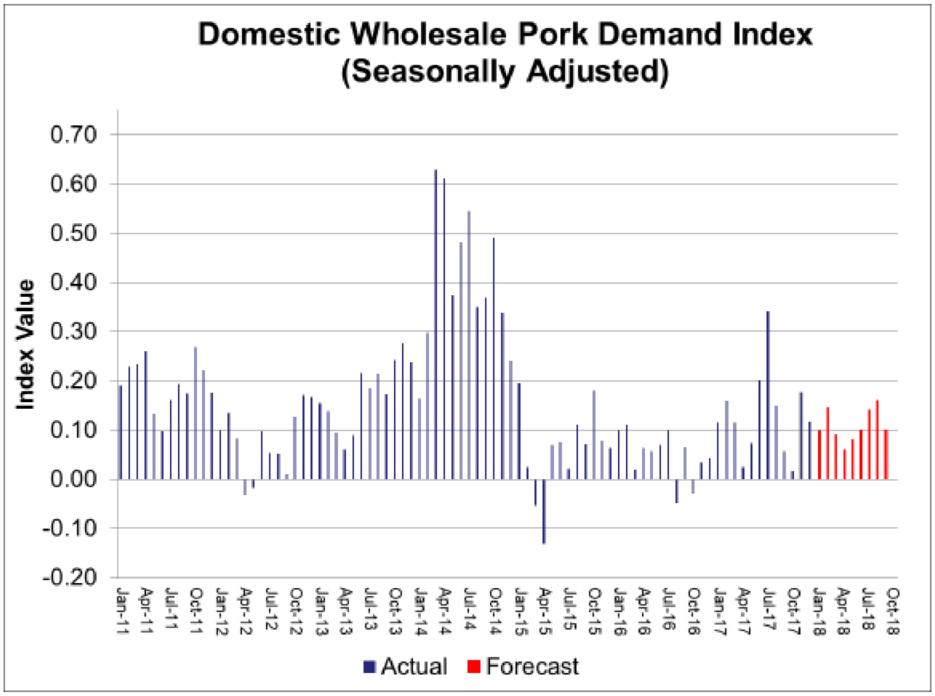
I account for foreign trade in the equation by adding imports and substracting exports to arrive at a net domestic supply figure.

Following is a bare-bones summary of expected trade flows. I won't go into detail on them at this time, but I hope that you will let me know if any of these look off-base to you. Volumes are expressed in million pounds:

| | Q1 Volume | Yr-Yr % Change | Q2 Volume | Yr-Yr % Change |
|---|---|---|---|---|
| Total Imports | 274 | +4 | 270 | -4 |
| Exports-Mexico | 480 | +3 | 465 | +9 |
| Exports-Japan | 310 | -3 | 306 | -1 |
| Exports-Korea | 164 | +5 | 141 | +6 |
| Exports-HK/CH/TAI | 127 | -7 | 161 | -10 |
| Exports-Canada | 122 | -2 | 127 | -1 |
| Total Exports | 1439 | 0 | 1456 | +2 |

**My guess is that on a per capita basis, net domestic pork supplies will be up 2.7% in the first quarter, and up 4.9% in the second quarter.** These are substantial increases. So, then, what are the chances that domestic demand will strengthen equally? Not very good, in my humble opinion. While average retail pork prices are declining, as of the most recent reading in November they were still higher than a year earlier. [This, according to the U.S. Bureau of Labor Statistics.] Meanwhile, wholesale-to-retail price spreads are roughly the same as a year ago, and a bit narrower than the average of the past 24 months. So there is not a lot of room for wholesale prices to rise without causing retail prices to turn back upward, or at least to level out. Don't get me wrong—the retail price and margin conditions are not particularly bearish at this juncture; they just do not indicate that any surge in wholesale demand is imminent.

Otherwise, the demand conditions that I am building into my price forecast are pretty much in the "middle-of-the-road", in the sense that they do not stray very far from the midpoint of the last two and a half years. And why should they, really? There is likely to be some point along the way at which wholesale pork demand spikes either upward or downward, but it is almost impossible to predict when that might happen….because such spikes are usually associated with some sort of major surprise, and surprises are, by definition, unexpected. The most recent spikes occurred in November (upward), October (downward), June (upward), and June/July (upward). All of these were produced by rather extreme swings in pork belly prices….

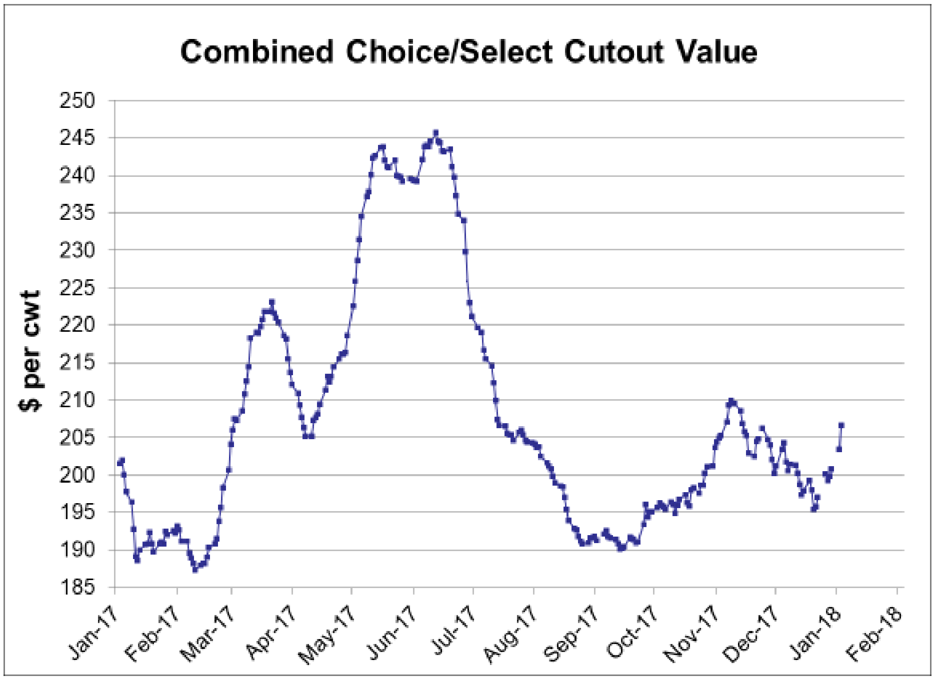



….which leads me back to the subject of April, which looks like perhaps the only month in the first half in which the cutout value should match, or even slightly exceed, a year earlier. If you own a pair of ACME X-Ray glasses, you can see in the chart at left that in each of the last three years, the month of April has been a distinctly soft point for wholesale pork demand (even after adjusting for seasonality). Last April it was especially soft, and so there is a better chance that wholesale pork demand will exceed a year earlier. It's as simple as that. And the reason? Pork bellies, of course. Suffice it to say that last year's unwieldy swings in belly prices ($1.05 per pound in December to $1.85 in February to $1.10 in April to $2.15 in July) are not likely to be repeated this time around, assuming that storage stocks will reach considerably more comfortable levels. And my guess is that they will stand near 70 million pounds on May 1 vs. 34 million a year earlier.

**As for the beef market, the near-term direction is clearly upward**. The combined Choice/Select cutout value was quoted at $206.68 per cwt this afternoon, having gained nearly $7 so far this week and more than $11 from its previous low (December 20). There is no respectable resistance on the chart this side of $210, which is a big one. I show this chart on the next page.

So, then, how long will this strength persist? The seasonal history is always worth a look, and in this case, the short-term track record is pretty compelling. From New Year's week to the second week after the holiday, the combined cutout has gained ground 14 times in the last 20 years. OK, the bias is not overwhelming, but it's hard to bet against.

I do, however, have some reservations about beef demand here in January. My doubt is based on the rather slow forward booking activity for January deliveries. Generally speaking, there has been less product booked "out front" for January delivery than there was last year; and my almost all indications, production will be larger. That is not a bullish combination.




An average change in cutout values between now and mid-January would carry the combined cutout up to a peak of $213.50 per cwt in the week ending January 20. I think we have a legitimate reason for this year's performance to fall below par. The prospective demand conditions make the chart resistance at $210 look like an insurmountable barrier.



*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](http://www.procurementstrategiesinc.com).