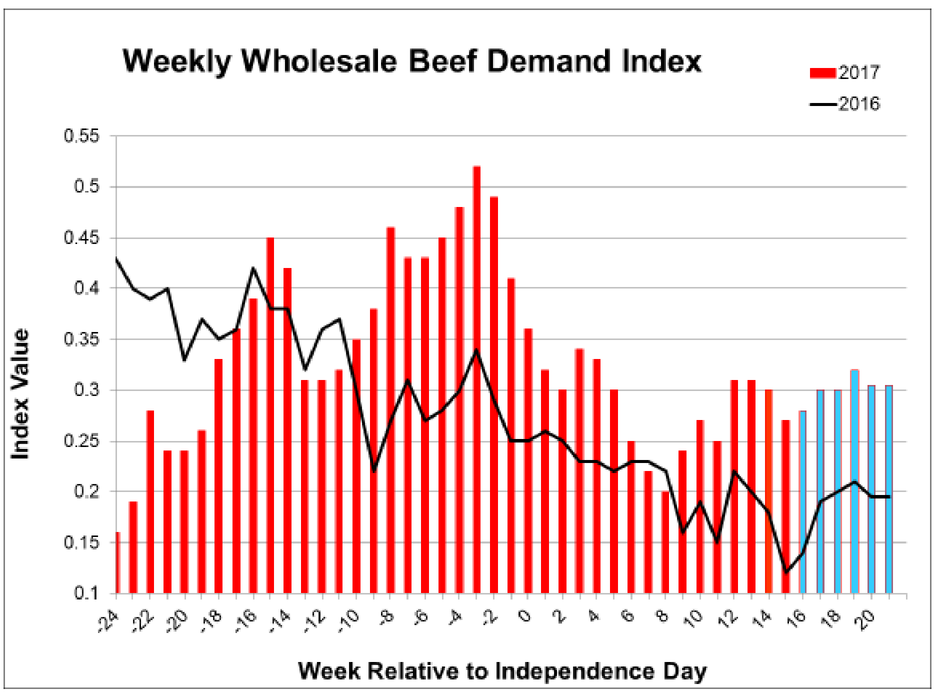
MEAT MARKETS
UNDER A MICROSCOPE

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

October 20, 2017

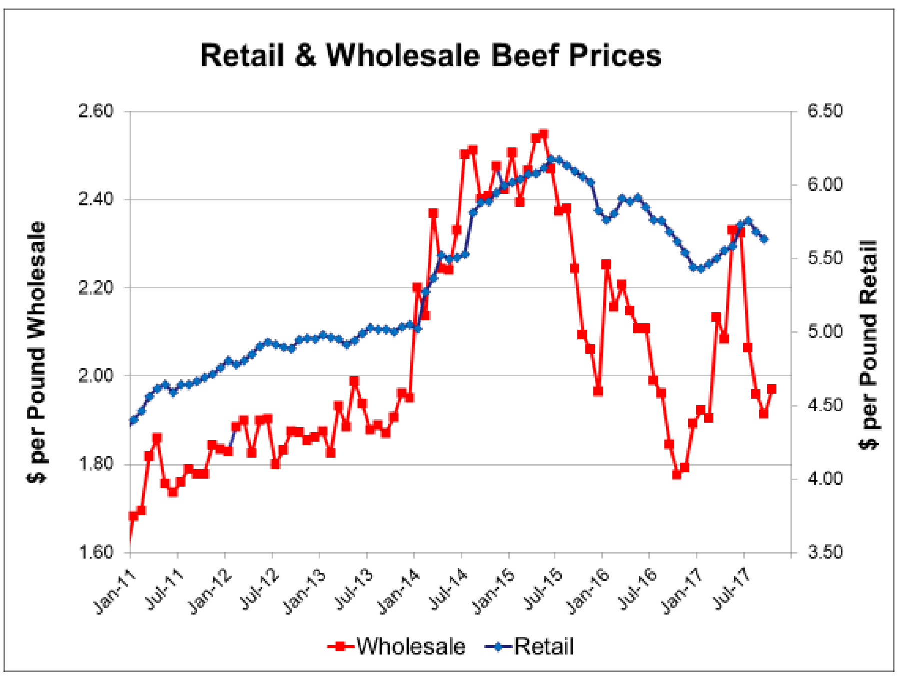
The beef market has been in pretty good balance over the past three and a half weeks, as evidenced by a basically steady trend in the combined Choice/Select cutout value. Nothing wrong with that, except that I had been expecting a higher market by now. Weekly fed cattle slaughter has been trimmed back to 497,000—it looks like it will be at that level for the second week in a row—from a peak of 519,900 in the second week of September, which has helped keep a solid floor underneath. The weekly demand index has slipped backward a bit, which came as a bit of a surprise to me, but I don't think this marks a change in the trend. In the picture below, the final red bar represents the current week, and the blue bars represent my humble projections through November—which assume that wholesale beef demand will follow a seasonally typical course between now and then.



I still have to think that the combined cutout value will march, albeit gradually, up to its nearest resistance level of $202-$204 per cwt within a relatively short period of time, compared with today's mid-day quote of $196-something. I am encouraged, of course, by the fact that that yesterday it reached its highest level since August 17. But also, a further reduction in fed beef output is probably in order, given the inventory of cattle on feed 90 days or longer and the fact that the seasonal increase in steer carcass weights has fallen distinctly behind its average pace. [Between September 16 and August 7, they actually dropped two pounds, whereas the ten-year average shows a gain of 5.5 pounds over the same period.]

And on the demand side of the equation, what reason is there, really, to expect a sub-par performance over the next six weeks? True, forward booking activity slowed down materially last week, but this mainly reflects deliveries during the Thanksgiving holiday and beyond; product delivering before mid-November should be well spoken-for, considering the brisk rate of forward sales in the second half of September. There should be a noticeable presence of beef in supermarket ads until the Thanksgiving "lull" sets in.

On that subject, it appears that retail beef prices are turning downward once again, as one would expect in light of the fact that according to the U.S. Bureau of Labor Statistics, retail margins have reached their widest point since November 2016. Lower retail prices tend to speed up the rate of "pull" through the supply chain, which translates into stronger demand at the wholesale level, all else equal. I acknowledge that wholesale pork prices are quite cheap; yet, retail pork prices are the highest they have been relative to beef in *three years*. We have to keep in mind that consumers see only the retail price. It is mainly for this reason that I am willing to embrace the notion that August marked a cyclical low point in wholesale beef demand, and that the measured increase in cutout values that is now underway is not likely to reverse course any time soon. In other words, the beef market should be able to hold its gains.



The ability of the beef market to sustain should be as much the result of the normally "weak links" to hold their ground heading into Thanksgiving (and perhaps beyond) as the ability of the normal stalwarts to advance. In the case of the latter, of course, I'm talking about ribeyes, tenderloins, and 50% lean trim; in the case of the former, I'm referring to end meats and all other loin cuts.

Quite simply, it is my perception that the typical "losers" at this time of year have already become cheap enough to counterbalance the usual seasonal slowdown in demand: e.g., Choice strips at $5.00 per pound; Choice short loins at $4.40; Choice top butts at $2.50. Among the end meats, I guess that chuck rolls and round eyes (Eyes of Round? Eye of Rounds? none of them sounds right) have room to accommodate their average seasonal declines; but the rest are already standing just above obvious support levels. I remind myself that overall wholesale beef demand is considerably stronger than it was in the fourth quarter of 2016.

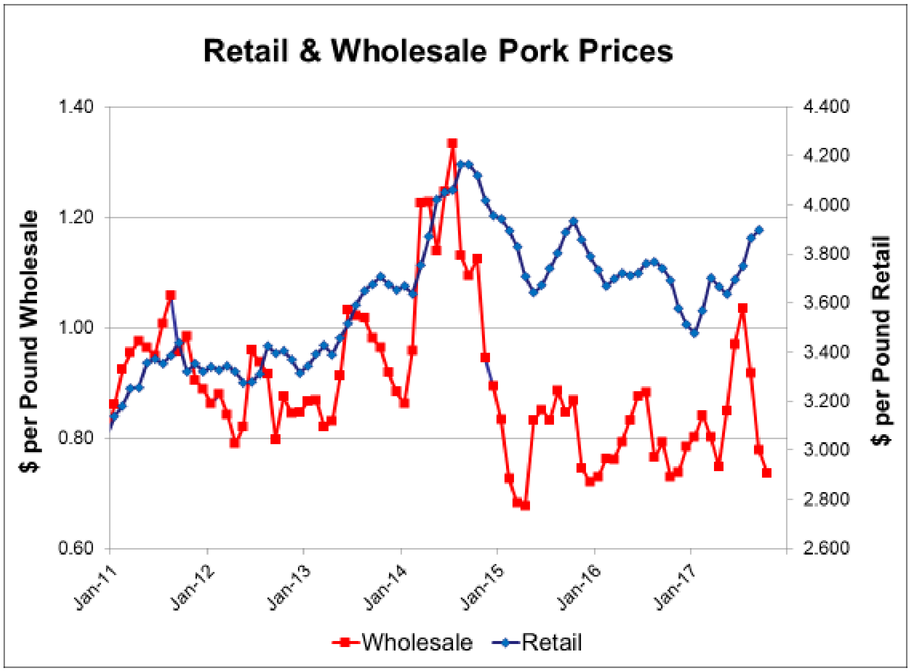
Anyway, below is a summary of the 15-year average price changes between the fifth week prior to Thanksgiving (which is where we are now) and the week prior to the holiday:

Choice Boneless Ribeyes	+12.3%
Select Boneless Ribeyes	+7.9%
Choice Tenderloins	+9.7%
Select Tenderloins	+4.9%
Choice 0x1 Strips	-4.6%
Select 0x1 Strips	-0.8%
Choice 0x1 Short Loins	-4.8%
Select 0x1 Short Loins	-1.6%
Choice Top Butts	-4.1%
Select Top Butts	+0.8%
Flap Meat	-0.2%
Ball Tips	+0.1%
Tri Tips	+1.7%
Briskets	+0.3%
81% Lean Ground Beef	-1.3%
50% Lean Trimmings	+14.3%
Chuck Rolls	-7.4%
Shoulder Clods	-2.1%
Knuckles	-4.6%
Inside Rounds	-2.3%
Bottom Round Flats	-7.6%
Eye of Round	-7.5%

Meanwhile, in the World of Pork, the likelihood of one final leg up in hog slaughter is the dominant issue. This week's kill turned out to be a bit lighter than I had expected, but otherwise, hog slaughter since Labor Day has aligned pretty closely with the reported spring pig crop. And I must add vaguely that the expansionary momentum in hog supplies at this point is unmistakable. In any case, there is very little statistical evidence that USDA's spring pig crop was overstated. Purely objectively, I have to think that weekly kills will jump to 2,600,000 in the week after next, and remain in that neighborhood through early December. That is a rather far cry from this week's total of 2,485,000.

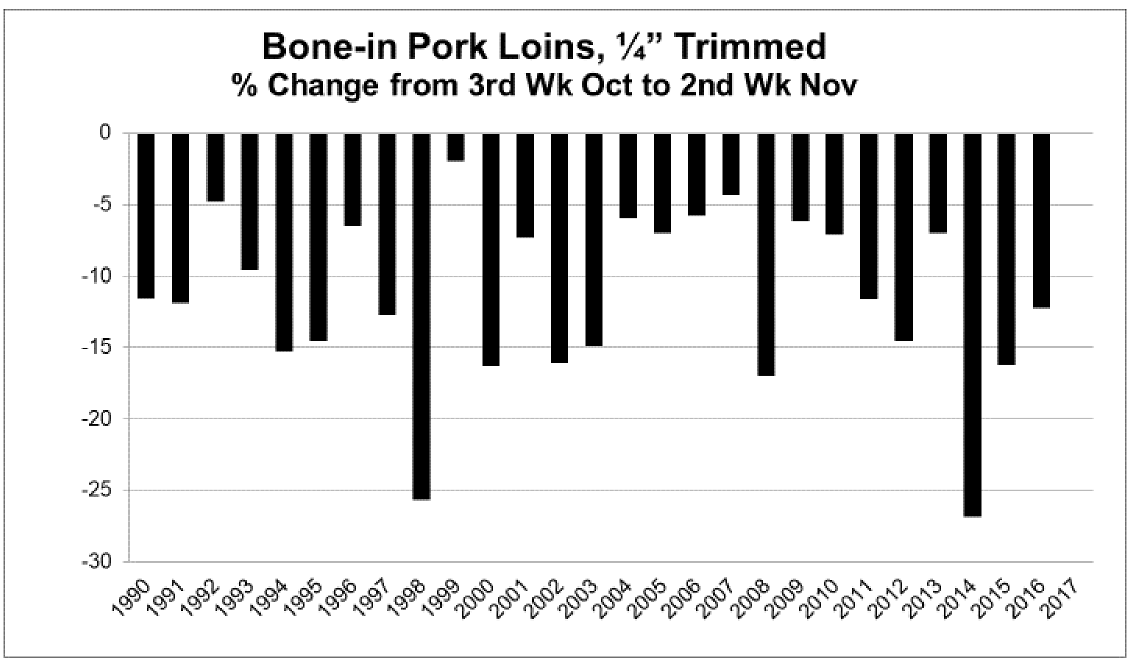
Judging from the weekly demand index, which has held steady at its lows of the year (on a seasonally adjusted basis, mind you) for the past three weeks, the pork market is not equipped to handle this additional supply without taking prices downward another notch. **Even with a moderately stronger-than-normal change in demand from October to November, such a rate of production would result in a $4-5 per cwt decline in the pork cutout value from its current quote by Thanksgiving**.

As I hinted previously, the direction and standing of retail pork prices is not particularly conducive to a surge in demand at this point. As I show on the next page, average retail pork prices in September were 4% higher than a year earlier, and up more than 6% since July. [I should explain that my calculation of "average retail pork prices" is just a simple average of four categories reported by BLS: "Sliced Bacon"; "All Pork Chops"; "All Ham Not Canned or Sliced"; and "All Other Pork Excluding Canned or Sliced".]



One positive piece of this picture is that the spread between wholesale and retail pork prices is very wide; however, it is pretty close to where it stood a year ago at this time. While my inclination is to think that this will make room for a reduction in retail pork prices, that reduction is likely to come too slowly to impact wholesale demand within the next month.

There will most certainly be a "run-up" in the ≤ 23-pound category of hams, and pork bellies trade at a price level that should attract enough freezer demand to offset the further increase in supply. The same can be said about spareribs. But all other major cuts have such dismal track records over the upcoming three-week period that they are hard to bet against. Pork loins are the most dismal of them all:



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