MEAT MARKETS
UNDER A MICROSCOPE

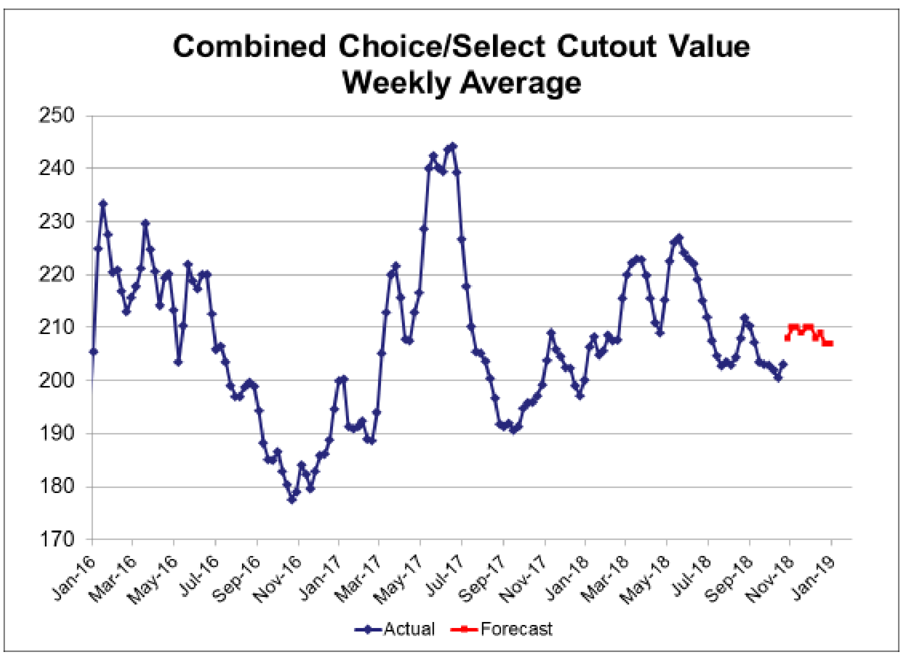
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

October 24, 2018

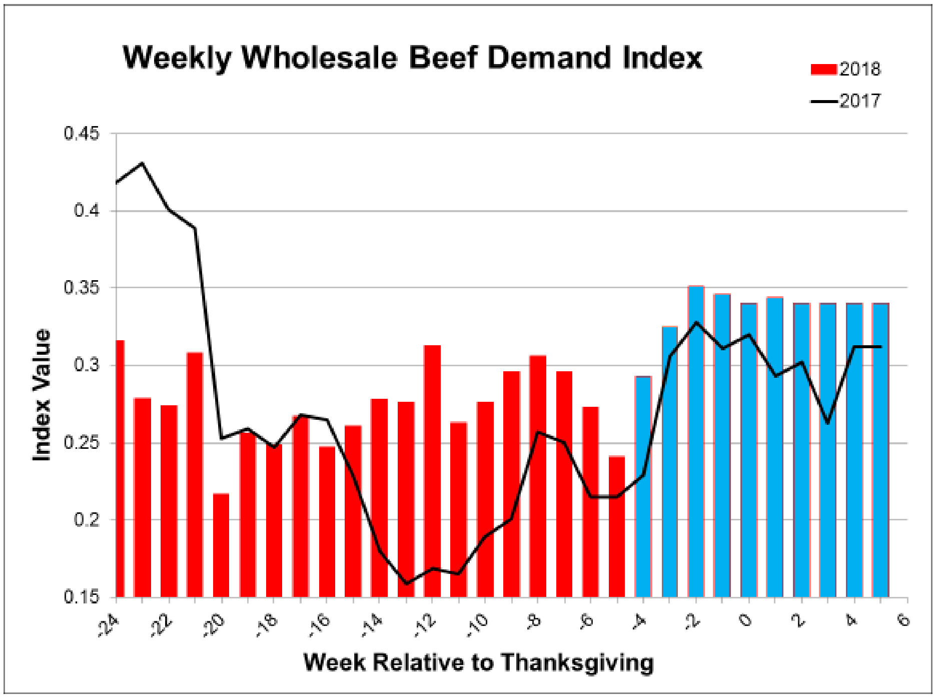
The chart of the combined Choice/Select cutout value looks like it's headed for $112 per cwt (its previous peak), and I guess I couldn't argue against that. It's not very far from this afternoon's quote of $208.75, so it's not worthy of a long debate. I'm more interested in what happens from that point through the end of the year.

As you probably know by now, my general approach to forecasting weekly cutout values in the short term is to identify the pattern that best fits the typical seasonal pattern as well as the most likely demand scenario. The latter criterion, of course, implicitly includes my forecast of weekly beef production.

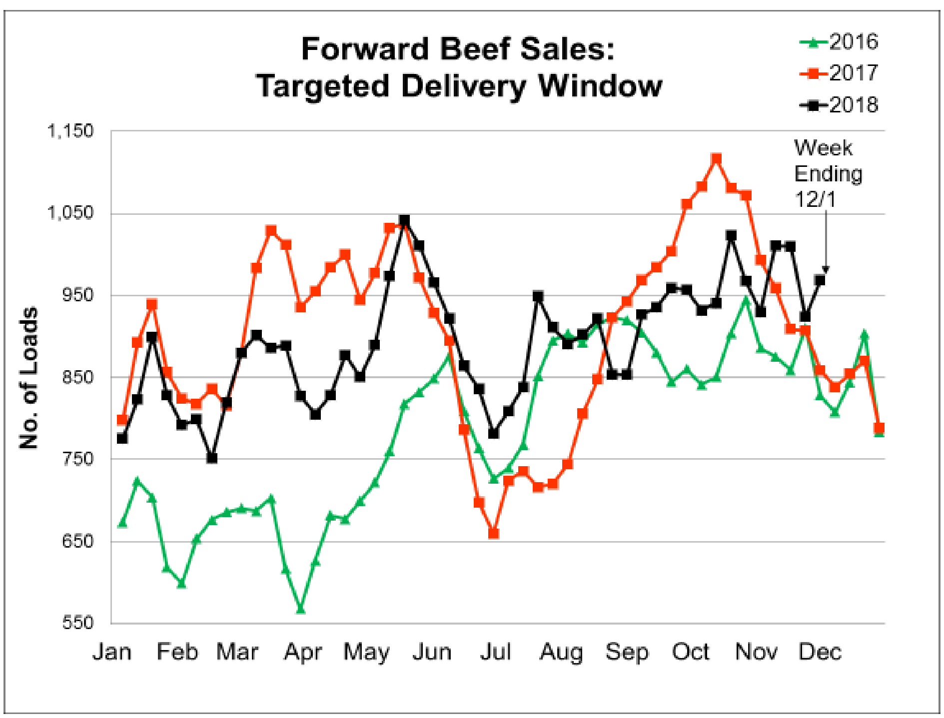
On the latest iteration, I came up with the following:



It is a flat pattern, with the cutout value essentially reaching a peak next week but not really receding from that peak before Christmas. This makes sense to me because the current strength in the cutout is being driven by products that are likely to hold on to their gains: round cuts, briskets, chuck rolls, fat trimmings, and grinds. Of course, ribeyes and tenderloins have also helped pull the cutout value upward, but these will deflate in mid-December.



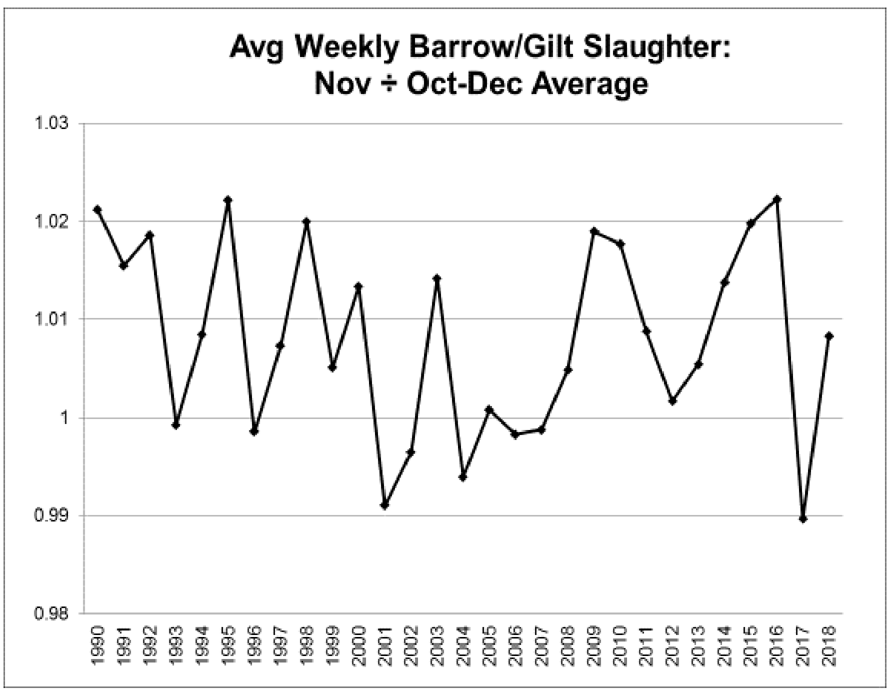
Now, this will require a stronger-than-seasonally normal pattern in demand, as I show in the picture to the left. [I am assuming that steer and heifer kills will hold mainly in the 495,000-505,000 range in the remaining non-holiday weeks of 2018.] But this, too, makes sense because the weekly demand index would remain above a year earlier, as it has been for the past eleven weeks. And forward bookings for November deliveries have been more active than a year earlier, in spite of slightly smaller fed beef production.



If things unfold as I have just described, then it will have some longer-term implications as well. Namely, the monthly demand index in November (with average weekly beef production at 522 million pounds and an average cutout value of $209.50-$210.00) will achieve its strongest reading since last March. The implication would be that a seasonally normal pattern in demand from that point forward would pull the combined cutout value up to an average of $213 in January…..

The pork cutout value is descending, but not quite as rapidly as I had expected, now that hog slaughter has taken another step upward. In regard to wholesale demand, I have seen no evidence of any foreign buying related to the African Swine Fever problem in China. My guess is that we won't see any such activity to speak of until the first quarter, and some of my astute colleagues think that even that is too early. If demand is to outperform its seasonal norm in November and December, it would most likely be the result of shorter-than-expected production.

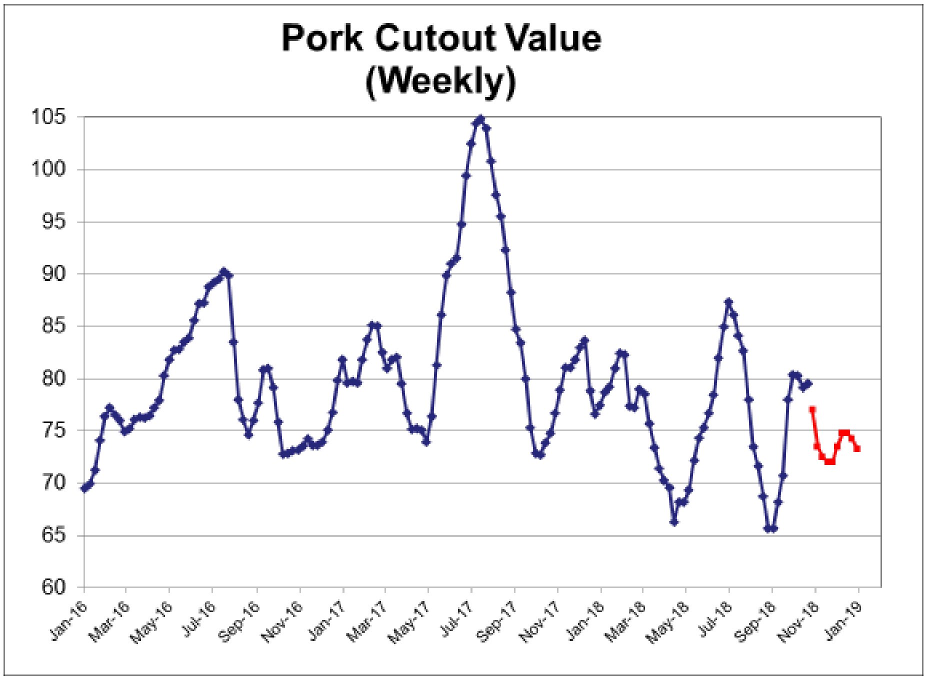
So what are the prospects of *that* happening? Well, even though hog slaughter in the six weeks since Labor Day has been down 1.3% from a year ago, it is dangerous to assume that USDA seriously miscounted the spring pig crop (which was reported to be up 4.3%). It is much more likely that fall 2019 hog slaughter will be more heavily skewed toward the latter stages and away from the earlier stages—quite the opposite of last year's pattern, which was rather odd. If weekly kills increase to an average of 2,635,000 in the three weeks prior to Thanksgiving as well the four weeks afterward, fourth quarter slaughter will still align pretty well with the spring pig crop estimate; and as I show in the next picture, the month of November will carry a typical share of the quarterly total.



So, then, odds are that production will *not* be unexpectedly short in the weeks ahead and therefore, demand will *not* stray very far from its normal seasonal path. This combination of supply and demand point to the sort of pattern in the cutout value that I show in the graph on the next page, a decline to a bottom near $72 per cwt in the week prior to Thanksgiving. Just looking at the aforementioned weekly graph, the notion of a bottom around $72 makes some sense to me.

How would the cutout get there, exactly? Following are my humble guesses of the quotes we will see in the week ending November 17:

23-27 lb Hams	$.57/lb	Boneless Picnics	$.75/lb
Bone-in Loins	$.83	¼" Trimmed Butts	$1.00
Boneless Loins, Strap On	$1.18	Spare Ribs	$1.27
Bellies	$1.11	72% Lean Trim	$.55



Finally, there has been a fair amount of talk around the Sewing Circle lately regarding the government's "Trade Mitigation" purchases of pork. I'll tell you what little I know about it. According to USDA's Agricultural Marketing Service website, the plan is to purchase up to $558,815,000 worth of pork, to be delivered in four separate, quarterly tranches beginning December 16. The first solicitations went out on October 17 for delivery beginning December 16, 2018 and extending through March 31, 2019. I get the impression that deliveries will be distributed fairly evenly throughout 2019.

On the list of products were frozen ham; frozen pork chops and loin roasts; pork patties; pulled pork; and taco filling. Thus, it looks as though the items to impacted price-wise will be hams, loins, and trimmings. Assuming that the products are made and stored ahead of time—presumably when it is most advantageous to do so—the price impact will begin immediately and will be spread out without any big surges. Thus, the government purchases should serve to keep a higher floor underneath the market.

OK, now for some Cowboy Calculus. Let's say that the average unit price of all products is $1.50 per pound, including freight; $559 million divided by $1.50 per pound would bring the total purchased quantity to 373 million pounds over the next year, or seven million pounds per week. Average weekly pork production over the next twelve months should be around 517 million pounds per week, so the government will be buying—in addition to its regular food assistance programs—roughly 1.4% of total production. The percentages of hams, loins, and trimmings would be greater….and so it can be counted as significant. And hey—it was *supposed* to be significant, wasn't it?

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.