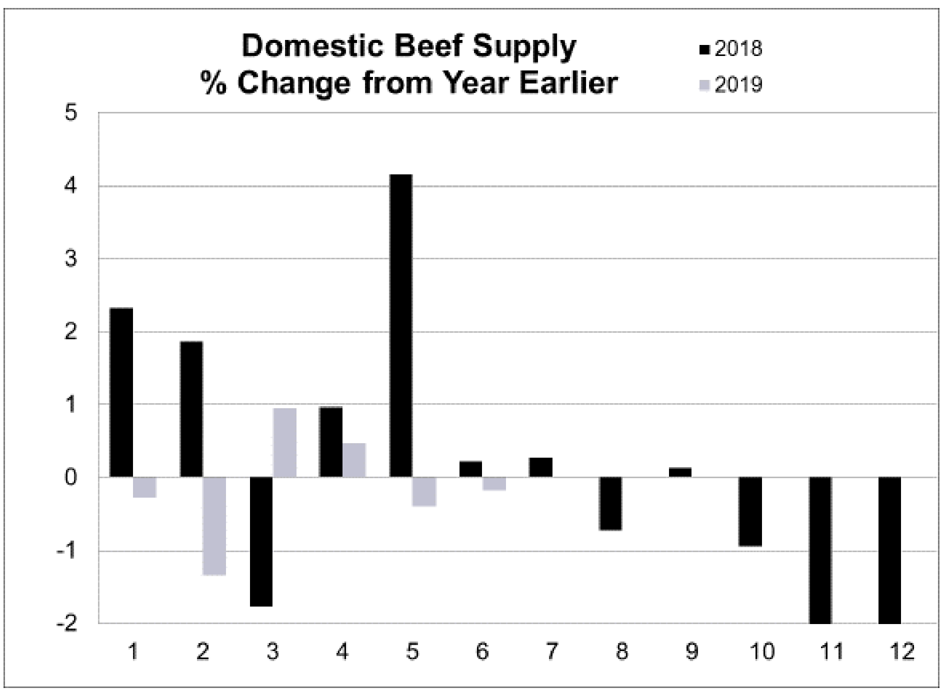
MEAT MARKETS
UNDER A MICROSCOPE

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

November 13, 2018

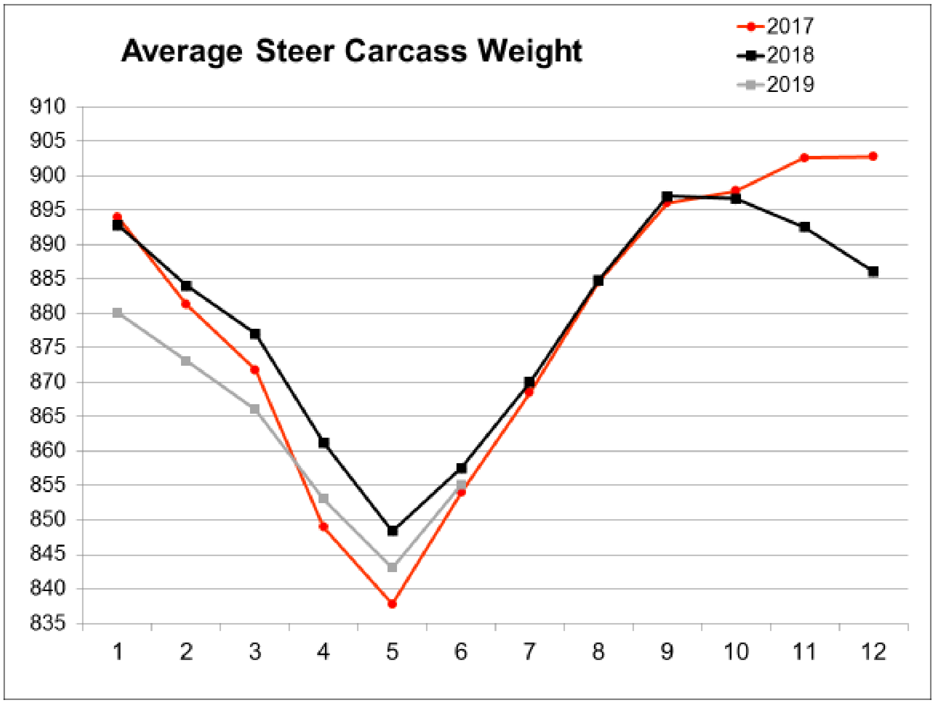
It seems pretty clear to me that neither fed cattle nor cow slaughter has reached its long-term cyclical peak, and that both will be up from a year earlier again in 2019. After all, the 2018 calf crop is supposed to have grown another 1.9%, and the beef cow herd, according to the Smart People, will show a 1-2% increase on January 1.

But there are mitigating factors in the outlook which suggest that net domestic beef supplies will actually be a bit smaller than a year earlier in the first half of 2019.



One of these is carcass weights. Steer carcass weights have behaved oddly in the last few weeks, dropping eight pounds between the first week of October and the fourth week of October. Such a decline has never occurred during this particular time frame (at least in the last 40 years, which is as far back as I bothered to check). The 20-year seasonal average change is just above zero (i.e., a slight increase); the only times when it came close were in 1989 and 1995, both showing a seven-pound reduction.

OK, so the point is that if carcass weights follow a fairly normal seasonal path from this point forward, then they will remain significantly below a year earlier at least through the winter. *However*—weather conditions have hardly been favorable in Feedlot Country as we head into the winter, with excessive rains resulting in muddy feedlots. If they freeze this way, and especially if heavy snow comes along on top of it, then carcass weights will track *below* the seasonal norm, and the year-over-year reduction will widen. **Naturally, lighter carcass weights would have a concentrated bullish impact on the market for trimmings, in addition to total beef production.**



The other factor that should serve to reduce net domestic beef supplies is a further increase in U.S. beef exports.

I'm not making any outlandish assumptions regarding beef exports, and indeed I think the futures market is overplaying the potential "spillover" effect on global beef demand from the presumed shortage of pork supplies in China. That line of reasoning propounds that African Swine Fever will cut into not only Chinese pork production but worldwide pork supplies to the extent that consumers will turn to beef as a substitute. And to some degree, this notion is valid….I'm just not yet convinced that it will turn into a big deal.

Anyway, U.S. beef exports have demonstrated a distinctly and consistently upward momentum, and it seems logical to assume that this momentum will persist into 2019—albeit, perhaps, to a lesser degree. They have been up in each month of 2018 so far, by an average of 13%, and my guess is that the growth rate will slow to about 5% in the first half of 2019:

U.S. Beef Exports (million pounds)

	Q4 2018	Q4 2017	Q1 2019	Q1 2018	Q2 2019	Q2 2018
Japan	206	190	213	197	239	231
Korea	191	135	153	136	171	165
HK/Taiwan/China/VN	183	178	145	140	136	124
Mexico	120	111	105	98	114	114
Canada	76	79	71	71	79	82
Total	872	782	776	730	829	799

Net domestic pork supplies will also drop below a year earlier in the first half of 2019, despite a 3% increase in production. Only in this case, it has nothing to do with carcass weights, but has everything to do with exports.

U.S. Pork Exports (million pounds)

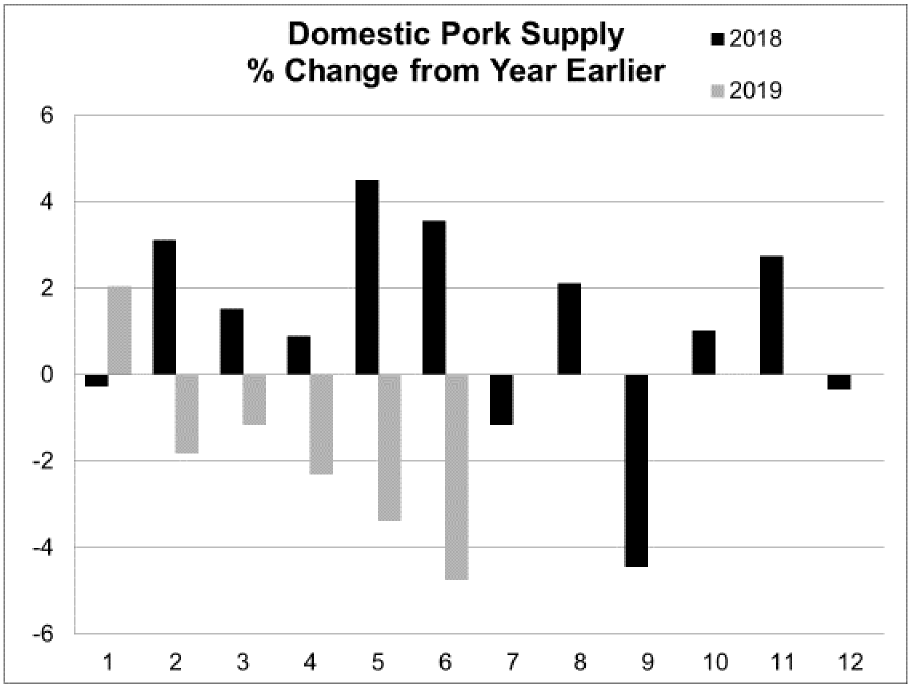
	Q4 2018	Q4 2017	Q1 2019	Q1 2018	Q2 2019	Q2 2018
Mexico	477	494	465	457	467	480
Japan	306	320	327	314	317	300
Korea	193	159	239	211	223	195
Canada	139	137	122	125	127	125
China/HK/Taiwan	127	145	240	141	405	123
Columbia	74	66	73	65	75	69
Australia	62	59	63	62	52	51
Total	1554	1544	1692	1516	1859	1518

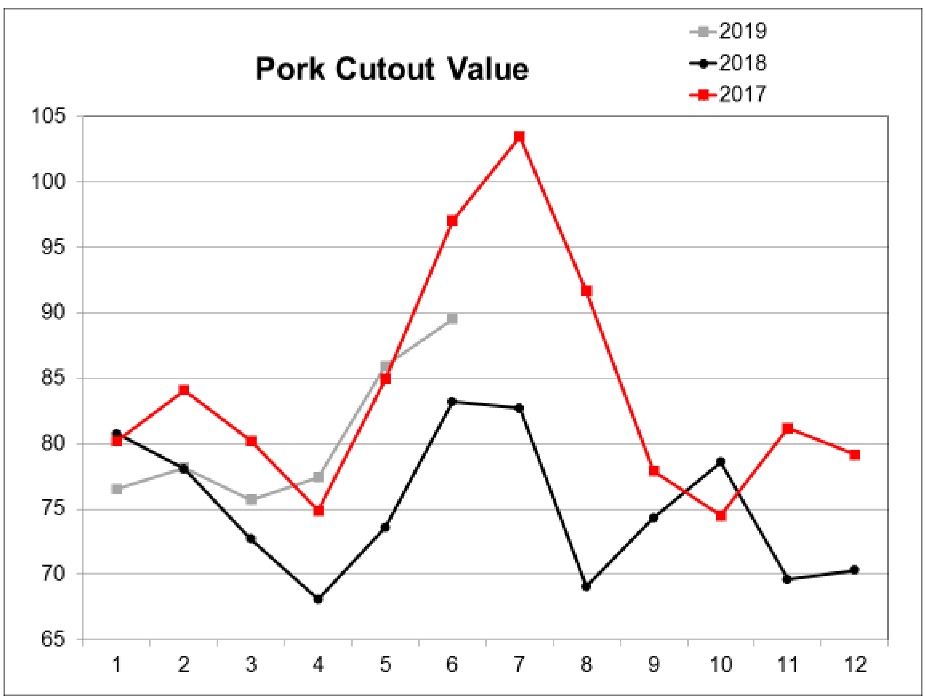
Of course, there is a lot of guesswork involved here (much more than usual). But I have to try. To begin with, I don't see how China can emerge from its outbreak of African Swine Fever *without* a severe reduction in hog inventories and pork production. Some of my fellow Unfortunates in the Meat Business theorize that the "backyard" pig farms, which comprise a major portion of the Chinese swine population, will vanish rather quickly, and will eventually be replaced by large, dedicated operations. This makes perfect sense to me, since it would be one way to curb the spread of AFS (and other diseases, for that matter). Also, since AFS kills animals of all ages—not just baby pigs, as is the case with Porcine Reproductive and Respiratory Syndrome—the impact on the pork supply will be immediate. This is why I am willing to assume that U.S. pork exports will have increased noticeably by the first quarter. For lack of a better guideline, I am including in the price forecast the assumption that direct exports from the U.S. to China will reach the same level that they did in 2008, after the Chinese pig herd was decimated by "Blue Ear" disease. These consisted mainly of frozen, quartered carcasses.

I realize that China's demand for imported pork likely will be directed first toward non-U.S. producers—namely Brazil, Europe, and Canada—because of the current U.S./Chinese trade spat. If so, then the first clues will be an increase in shipments to countries currently being supplied by the other three of the "big four", whose business is being diverted to China. For this reason, I am paying close attention to Columbia and Chile, as well as Korea and Japan….not to mention a host of other destinations which would not otherwise show up on the radar screen. My contacts in Brazil, by the way, tell me that their pork shipments to China have increased substantially just within the last two months….a signal, perhaps?

A second consideration on the same subject is when Mexico will lift its 20% tariff on U.S. pork. Based purely on my own intuitive interpretation of the rhetoric, I am anticipating that this tariff will be lifted near the end of this year. If this happens, it should increase the flow of pork into Mexico (ask me how I figured *that* out!), as well as the flow of pork from Canada into the U.S. While the extent of the latter might be curbed if/when Canada steps up its business with China, it also makes sense that Canada has been shipping more pork to Mexico since the Mexican tariffs on U.S. pork went into effect last June and July. It was about that time that shipments from Canada into the U.S. dipped, and they have maintained their reduced level ever since. This is not a major factor in the price equation, though, since the difference is only five to ten million pounds per month.

And so, I am projecting a net domestic pork supply that is 1-2% below a year earlier in February and March, and roughly 3% below a year earlier in the second quarter. My humble forecast of the pork cutout value under this scenario is shown in the second picture on the next page.


Domestic Pork Supply
% Change from Year Earlier
2018
2019
6
4
2
0
-2
-4
-6
1
2
3
4
5
6
7
8
9
10
11
12


Pork Cutout Value
2019
2018
2017
105
100
95
90
85
80
75
70
65
1
2
3
4
5
6
7
8
9
10
11
12

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.