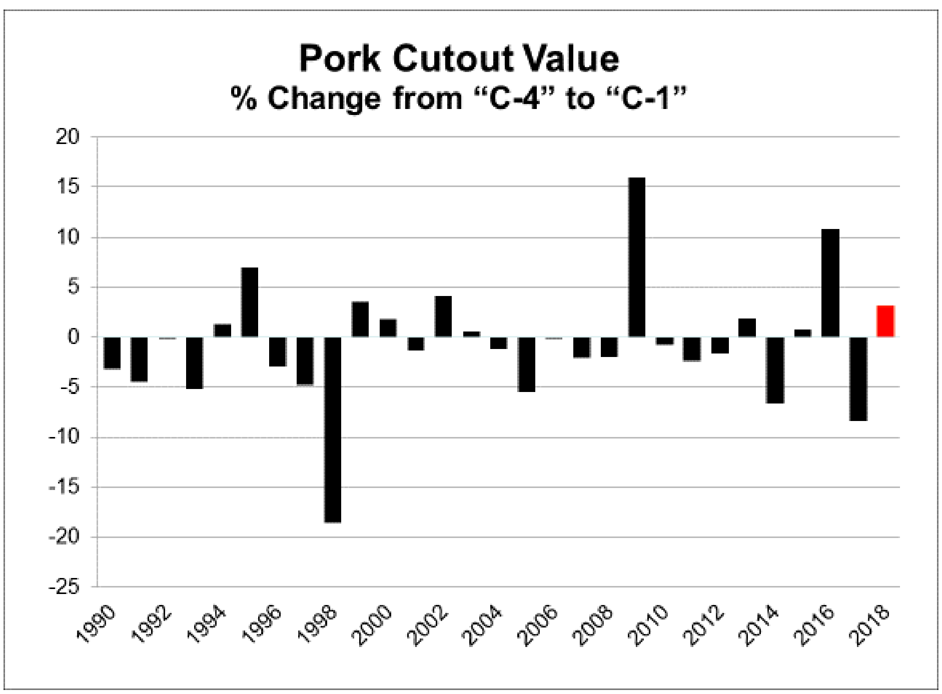
MEAT MARKETS
UNDER A MICROSCOPE

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

November 27, 2018

It would hardly be a bold prediction to say that the pork cutout value is on bottom right now. Last week it came within $1.54 per cwt of the August 24 low, which itself was within $.30 of a nine-year low. Hog slaughter should be at its peak next week, so the supply-side pressure should never be greater. [That peak probably would have occurred this week, were it not for the weather.] And a little bit of hindsight is helpful, as it came out of the gate yesterday on the plus-side.

We are now four weeks away from Christmas. From this week ("C-4", I call it) to the week prior to Christmas ("C-1"), the net change in the cutout value has historically shown a slightly downward bias. My guess is that this time around, though, the net change will be positive:



One reason I think so is because during this particular interval, the bone-in loin market has, by far, shown the strongest correlation with the change in the total cutout value. As of this morning, bone-in loins are being quoted below $.70 per pound. What more do I need to say? As far back as I bothered to check (which predates my Mullet Days), the only other time that this market was below $.80 at this point in time was in 2016….and in that year they gained 20¢ per pound by Christmas.

Hams are the second most influential item when it comes to the change in the cutout value during this interval.

No s___. Everybody knows that hams and loins make up half of the carcass weight!

Yes, but the correlations are not constant throughout the year. There are other times when hams or loins are not so influential—-

Aw, shut up.

So anyway, ham prices are matching a 15-year low for this particular week. Also, there has been hardly any pre-holiday rally this year; in fact, there has been virtually no change in this market in the last seven weeks. And so I have to wonder: if there is no pre-holiday rally, how much of a post-holiday break can there be? Not much, I'm thinking. But even if prices were to undergo the 15-year average change, which is -8%, in this case that would amount to only 4¢ per pound….subtracting only about $1.00 per cwt from the cutout value, which could easily be offset by other products.

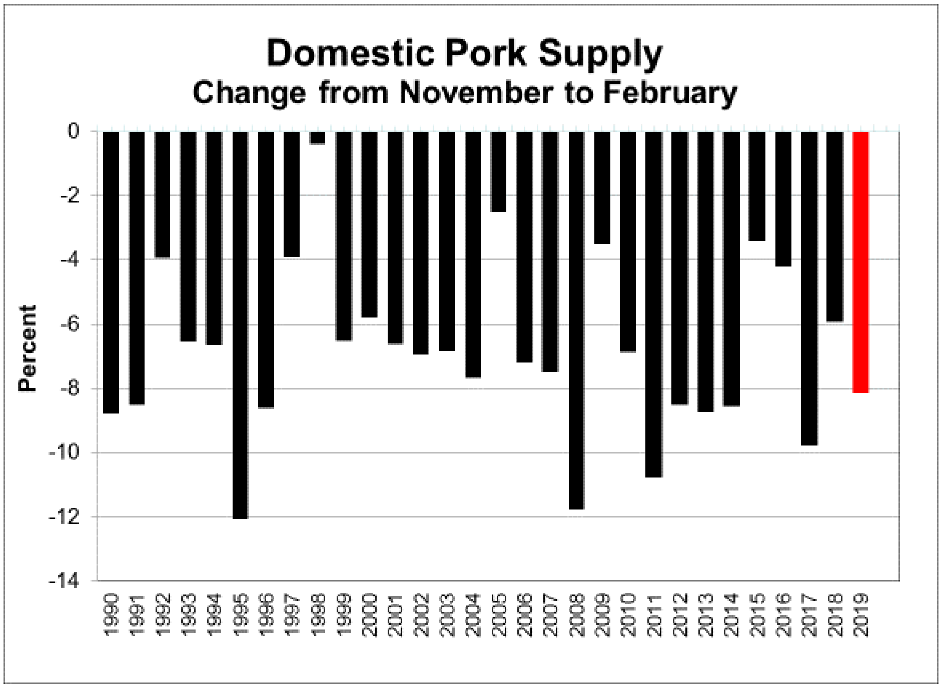
You get the idea. **Whereas the pork cutout value typically records its lowest point of the year in the week *after* Christmas, it looks very much as though the low that is currently being established will not be penetrated for a *long* time—not for at least six months**.

I am assuming, of course, that U.S. pork exports will pick up noticeably soon after the first of the year. I am building into the pricing equation a rather arbitrary 12% year-over-year increase in first quarter exports and a 23% increase in the second quarter, which compares with a 1% increase here in the fourth quarter. If you recall, I arrived at these figures by mirroring the pattern in Chinese imports of U.S. pork that occurred during China's struggle with "Blue Ear Disease" in 2007-2008. What other prototype is there? The situation is different in this case—especially because of the ongoing trade dispute between the U.S. and China—but in some ways it is similar.

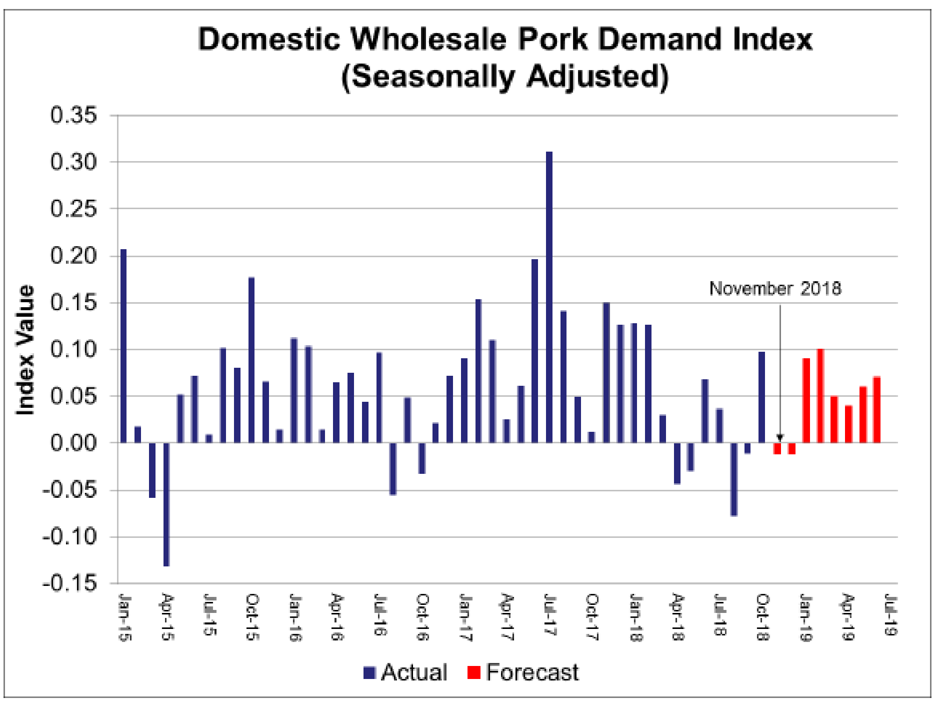
I am also expecting that Mexico will lift its 20% tariff on U.S. pork shortly after the holidays. This, too, is based on my interpretation of new stories, not on Inside Information. I understand that a new trade pact, replacing the North American Free Trade Agreement, must be ratified by Congress (as well as the legislatures in Canada and Mexico), but it is scheduled to be signed this Friday during the G-20 summit. What would prevent both sides from removing the tariffs that were put in place earlier this year in the meantime?

It's not difficult to envision a $10 per cwt rally in the pork cutout value between now and February. A quick look at the first two pictures shown on the next page clearly exhibit the underlying reasoning.

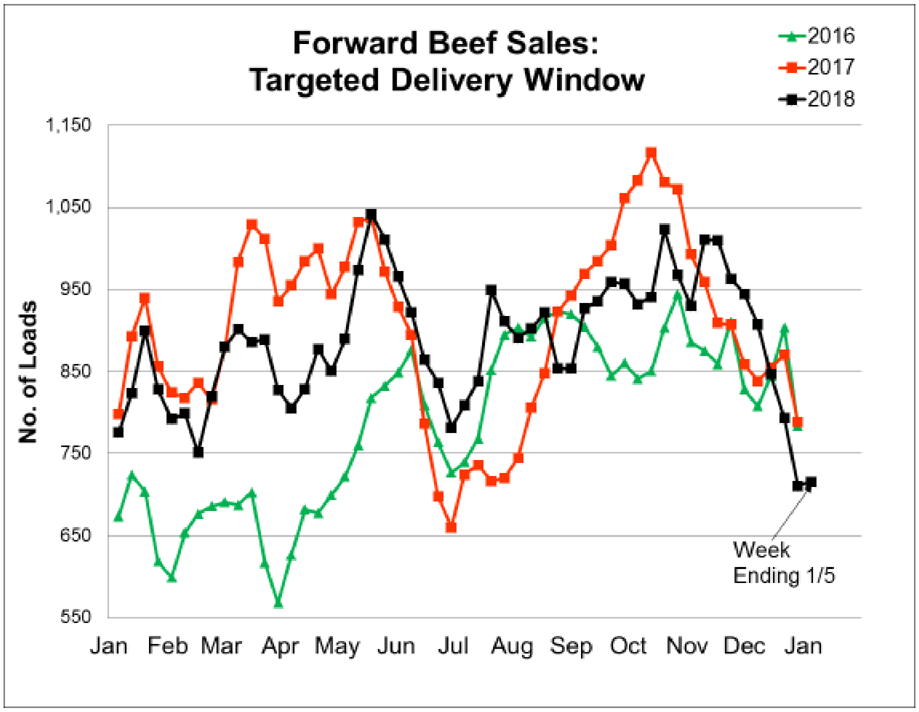
If hog slaughter aligns in typical fashion with USDA's summer pig crop estimate, and if U.S. pork exports are running 11% above a year earlier in February as I am proposing, then there will be an unusually steep decline in net domestic pork supplies between now and then….not a record, but greater than average. Since 2000, the average change in the cutout value from November to February has been +4.7%, which in this case would carry it up to about $72.50 per cwt.



That's one part of the story. Another is that there is a good chance that wholesale pork demand will return to more "normal" levels by January….simply because the demand readings here in November are turning out to be pretty dismal. This "recoil" in demand is probably short-term in nature, and probably is a backlash from the sharp run-up in pork prices during September and most of October. The elements are in place for aggressive retail pork features into the holidays and beyond….contrary to the situation in the beef market.



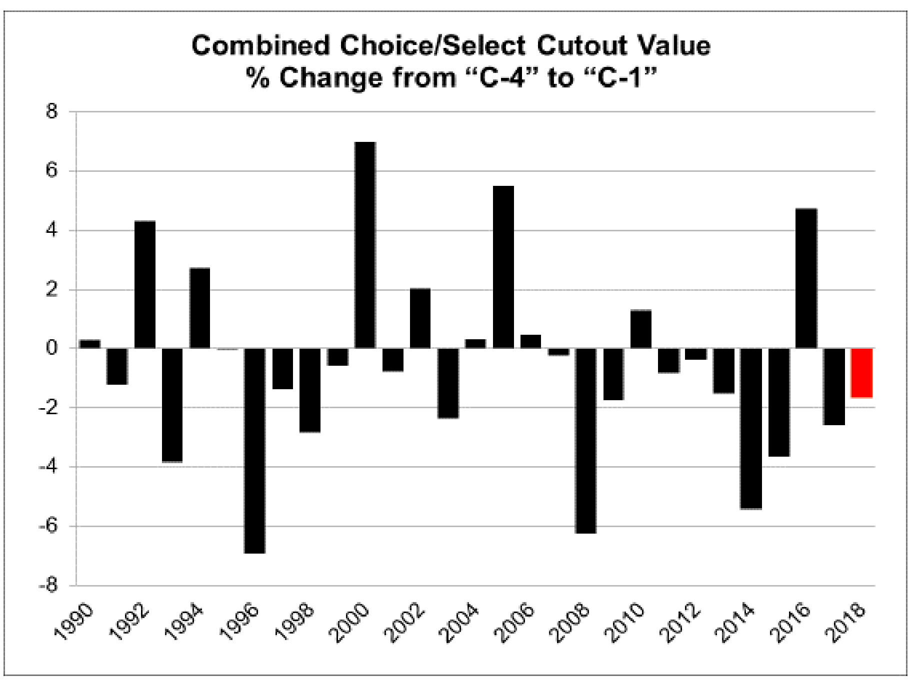
As I show in the picture on the next page, forward bookings of beef have fallen rather sharply in the last few weeks, possibly reflecting lackluster demand for beef delivering after mid-December. I use the word "possibly" because I am hesitant to place *too* much faith in the forward booking statistics as an indicator of future demand. Yet, the notion that cheap pork prices are (or soon will be) cutting into beef demand makes sense, doesn't it?



Mainly because of the slowdown in forward beef sales, I am anticipating a mild downtrend in the combined Choice/Select cutout value over the next three weeks or so. I'm talking about something on the order of $4-5 per cwt from yesterday's quote of $211.69. Ribeyes, tenderloins, 50% lean trim, and round cuts should be the biggest "drags" on the cutout value in the near term.

By the way, this expectation is based on weekly fed cattle slaughter of 495,000-500,000 per week during December (excluding the holiday week), which is slightly below the current pace.

There would be nothing terribly unusual about a $4-5 decline in the combined cutout between now and the week prior to Christmas; actually it would be a bit milder than that which we experienced last year:



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