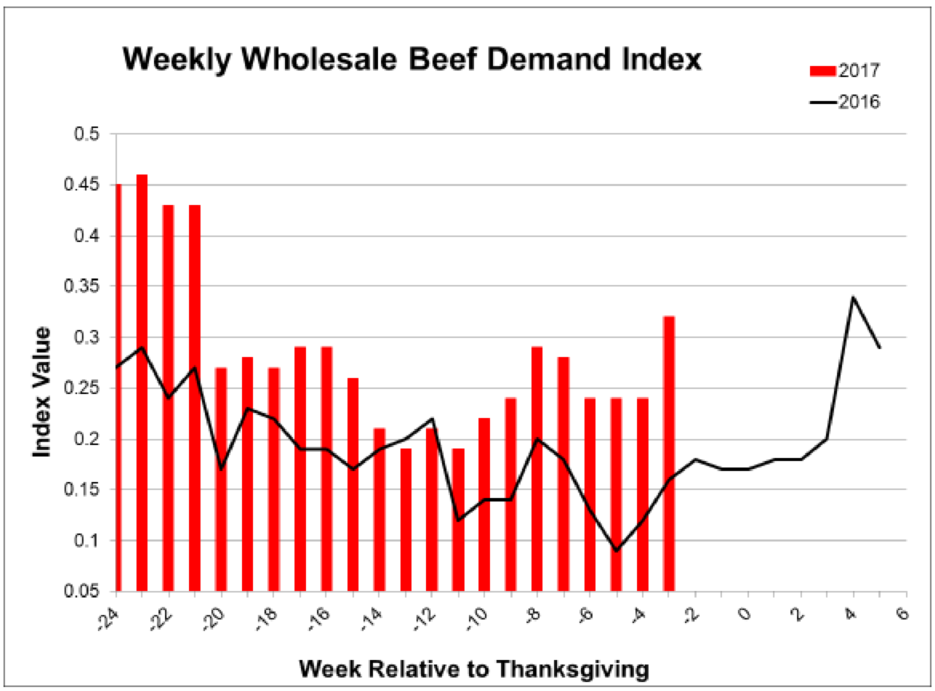
MEAT MARKETS
UNDER A MICROSCOPE

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

November 5, 2017

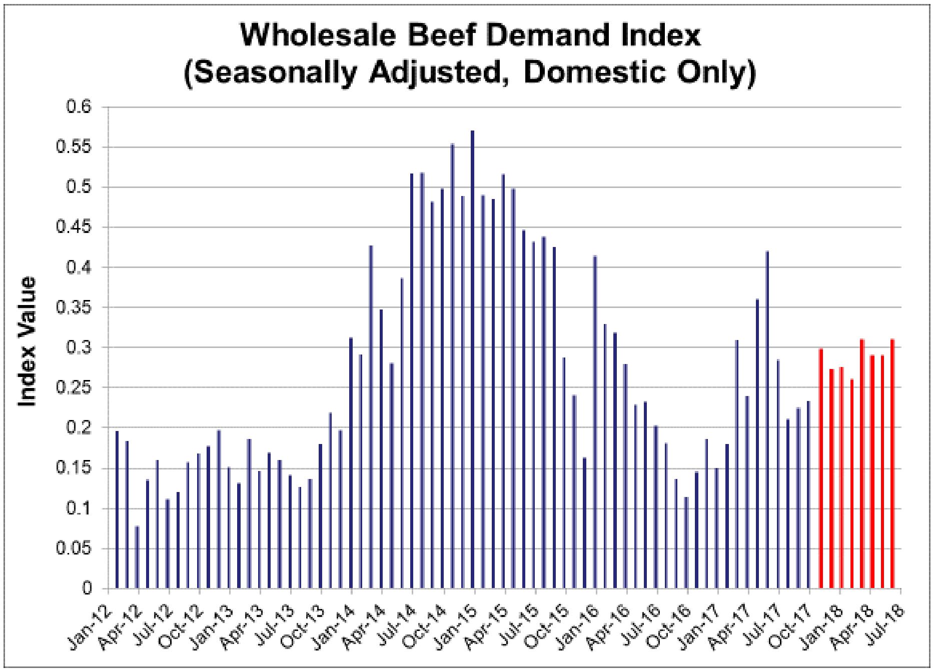
Fed cattle slaughter was much bigger than I had anticipated this past week, coming in at 508,000 vs. 492,000 the week prior. With the combined Choice/Select cutout value gaining more than $3 per cwt Friday-to-Friday in the meantime, this reflects unequivocally stronger demand:



I guess this should not surprise us, considering that forward bookings were quite active in the second half of September, hinting that packers were committed to delivering large quantities of beef from the end of October through mid-November. If the weekly demand index were to level off at its currently elevated status—i.e., if wholesale demand were to follow a seasonally normal path from this point forward—and if fed cattle slaughter drops back to 485,000-490,000 per week from now through mid-December (excluding Thanksgiving), then the combined cutout value would gain another $3-4 per cwt; flatten out for several weeks; and then begin another leg up into January.

The notion that production will be reduced over the next several weeks is supported by the facts that: a) even with a relatively aggressive marketing rate, the inventory of cattle on feed 90 days or longer points to such a reduction (if not a sharper one); and b: spot packer margins have taken a nosedive, and now stand at their narrowest point since the first week of May. Presumably, packers will be more inclined to restrain production schedules, especially now that cash cattle prices have jumped more than $12 per cwt over the past two weeks.

From a longer-term perspective, the seasonally adjusted wholesale demand index is probably reaching a cyclical peak here in November. In the picture below, the first red bar represents November 2018. While the November reading is far from being "in the books", the estimate shown below should be in the right ballpark. I notice that



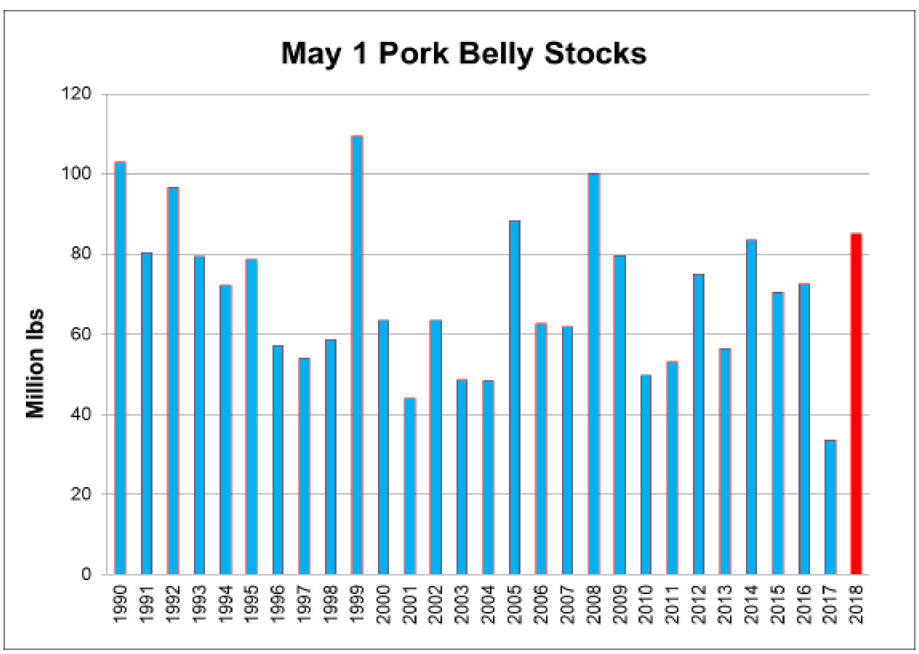
I notice that the rebound since August has been substantial, and it is now nearly three months in duration—which, unless demand is undergoing a major shift into a new stratum, is the approximate length of a typical cyclical phase. [Such major shifts occurred in 2014 and 2016, for example, as well as during the 2008-2009 recession.] To state it in English, tops and bottoms in wholesale demand are usually precipitated by unforeseen changes in supply or, more commonly, by ebbs and flows in retail featuring. On the subject of the latter, whereas forward pricing has been quite attractive for the past three months (building a foundation for aggressive beef promotions here in the fall), it is quite likely that buyers will encounter much stiffer pricing for deliveries after the first of the year. In the meantime, though, can you tell me why demand through the holidays would *not* be robust? Supermarkets still have a considerable amount of margin to give up, and I suspect that they will….for a while. I notice that forward sales during the week ended October 28 as a percentage of expected production were brisk; this activity was targeted mainly for delivery in December.

I have heard surprisingly little talk about a sudden change in the "grade-out" which might be caused by a recalibration of testing instruments in cattle slaughter plants. But I still regard this as a realistic possibility, and a potentially bullish impact on Choice middle meats—especially ribeyes and tenderloins. This change was supposed to take place this past week, and actual grading statistics for that week will not be published until November 13. I could not help noticing, though, that the Choice cutout value was up $5.78 per cwt while the Select cutout manage to gain only $1.39. The last time there was anywhere near this much of an increase in the Choice/Select spread in the first week of November was in 1996; since then, the greatest has been $1.97. Coincidence? Maybe. I'm just sayin'….

Certainly, the continued buoyance in the pork cutout value over the past week is due in large measure to a relatively light rate of production. It seems absurd to describe a weekly kill of 2,453,000 as "light", but last week's total did indeed fit the description within the context. Equally importantly, the word in the Sewing Circle is that this week's total will be something similar. In the two weeks combined, then, hog slaughter will have been 2% *below* a year ago. Does this mean that the hog supply is not as big as it's "supposed" to be? I doubt it. Last Monday's kill was substantially reduced by pre-planned maintenance, and this coming Saturday's schedule will be shortened by the Veteran's Day holiday. So yes, I'm suggesting that the industry is currently "underkilling" the hog supply. If slaughter were to remain at this rate through the week of November 13, then I would think differently. But packer margins did, in fact, widen significantly over the past week, which supports my theory.

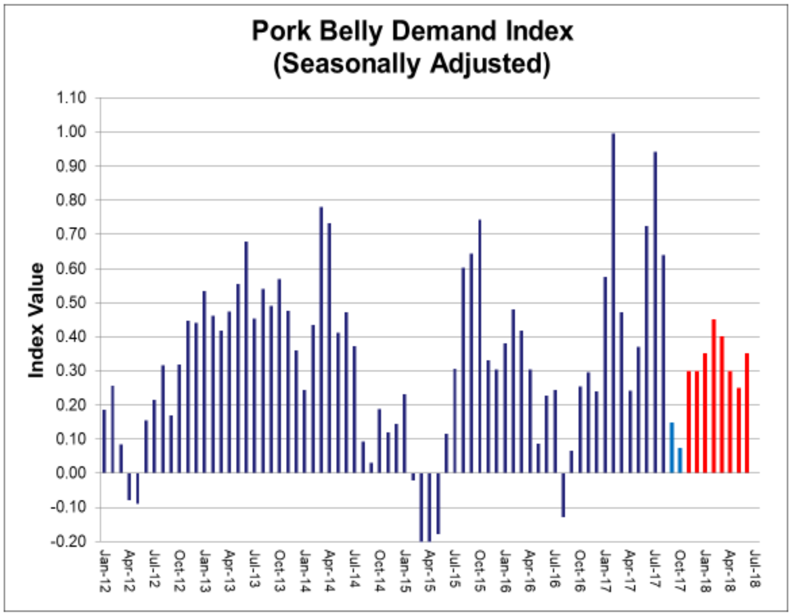
But instead, I expect that next week's total (the week of November 13) will jump to 2,550,000, to be followed by 2,575,000 or so after Thanksgiving. That should bring about lower prices in just about everything except pork bellies and hams. But even in the case of 23-27-pound hams, lower prices are just as common as higher prices between now and Thanksgiving.

I think we can safely say that pork bellies registered a major bottom in the final week of September at $.90 per pound, simply because they have rallied 25¢ since then. Although I have nothing particularly negative to say about bacon demand, I suspect that demand for *pork bellies* (remember, this is distinct from bacon demand) is being driven by a considerably stepped-up flow of product into the freezer than we saw in the fourth quarter of 2016. Last year, there was an unprecedented net drawdown of frozen belly stocks during the fourth quarter, leaving an acute shortage of frozen product in the critical summer period. I would *think* that the market would be keen to avoid another shortage this time around, would it not? I'm guessing that expansion of frozen inventories here in the fourth quarter will amount to roughly 40 million pounds, exceeding the 2000-2015 average of 33 million. If they continue to follow a semi-normal seasonal path in the first four months of 2018, then they will peak on May 1 around 80 million pounds and vastly exceed those of a year earlier:



Assuming that hog slaughter aligns reasonably well with USDA's current pig crop and farrowing estimates; and assuming that imports and exports of pork bellies are proportional to total pork imports and exports; then per capita domestic pork belly supplies should be equal to a year earlier in the first quarter, and up 3% in the second quarter.

Finally, then, if pork belly demand remains in "moderate" territory, as it is here in November, then monthly average pork belly prices should range from around $1.17 per pound in January to around $1.32 in June, with a "hiccup" from March to May. My humble forecasts—and I mean, *really* humble—are shown in the table below, along with demand projections. In the demand index picture, the first red bar represents November 2018:



	2016/17	2017/18
Oct	$111.52	$95.74
Nov	$105.31	$112.00
Dec	$107.09	$110.00
Jan	$133.56	$117.00
Feb	$177.15	$127.00
Mar	$137.90	$129.00
Apr	$118.18	$122.00
May	$131.86	$116.00
Jun	$172.40	$132.00

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 (cell) or (224) 227-6281 (office), or visit our website at www.procurementstrategiesinc.com.