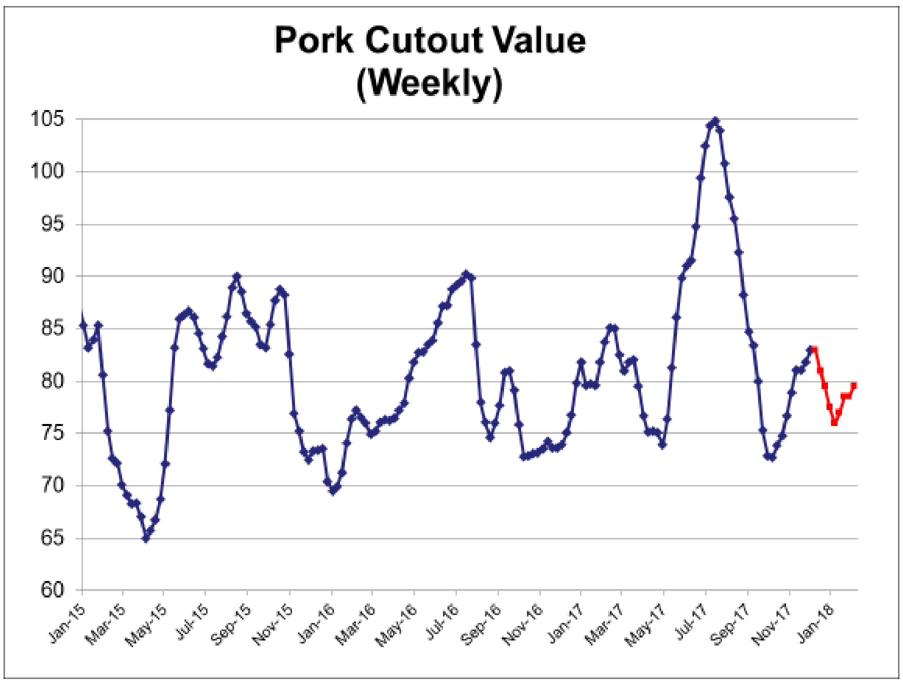
MEAT MARKETS
UNDER A MICROSCOPE

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

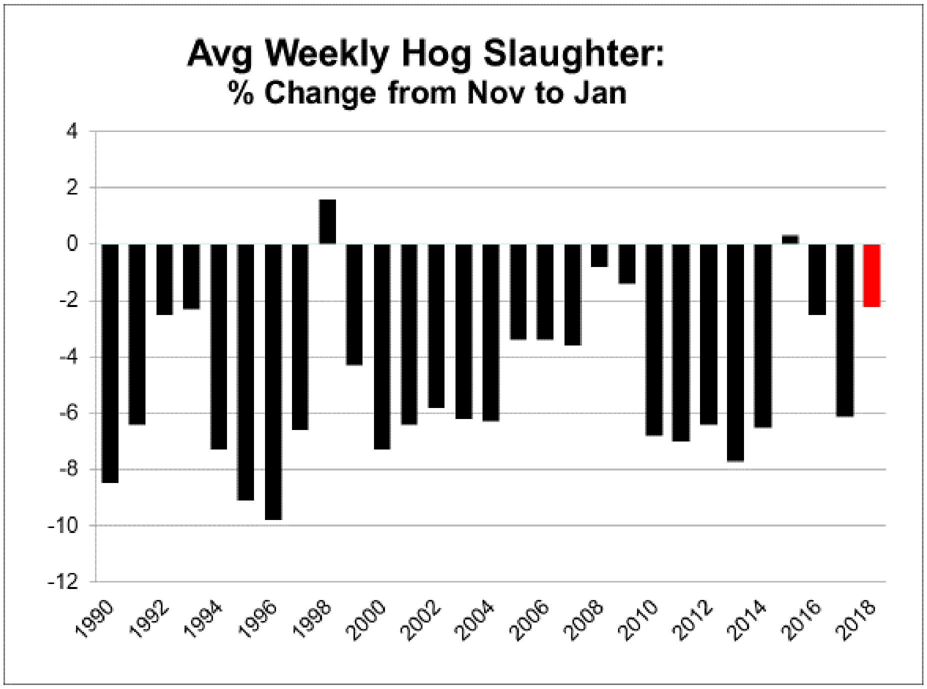
December 5, 2017

I realize that I have said this a little too often recently, but the road map for the pork cutout value seems to point downward from here. I'll show you what I have in mind:



The red bars represent my humble forecasts through January. As you can see, I am thinking that $85 and $72 will be major boundaries—not just in the near term, but through the first quarter as well.

First of all, there is credible evidence that the spring pig crop was overestimated—that evidence being that the ratio of September-November hog slaughter to the spring pig crop estimate was the lowest of the last 20 years. *However, this does not imply that the summer pig crop was also underestimated*. There is simply no historical precedent for this to happen. And so, reading the "tea leaves" as best I can, I think it is prudent to plan on an average weekly kill of 2,555,000 in December; 2,430,000 in January; and 2,365,000 in February. [I'm excluding the holiday weeks. Also, for the Detail Cops out there, I am taking into account the 2% year-over-year increase in feeder pig imports during June-August.] In this case, we are facing a smaller-than-usual seasonal decline in slaughter from November to January, as I show on the next page. Naturally, this prospect suggests that the trajectory of the cutout value between now and mid-winter will be weaker than normal.



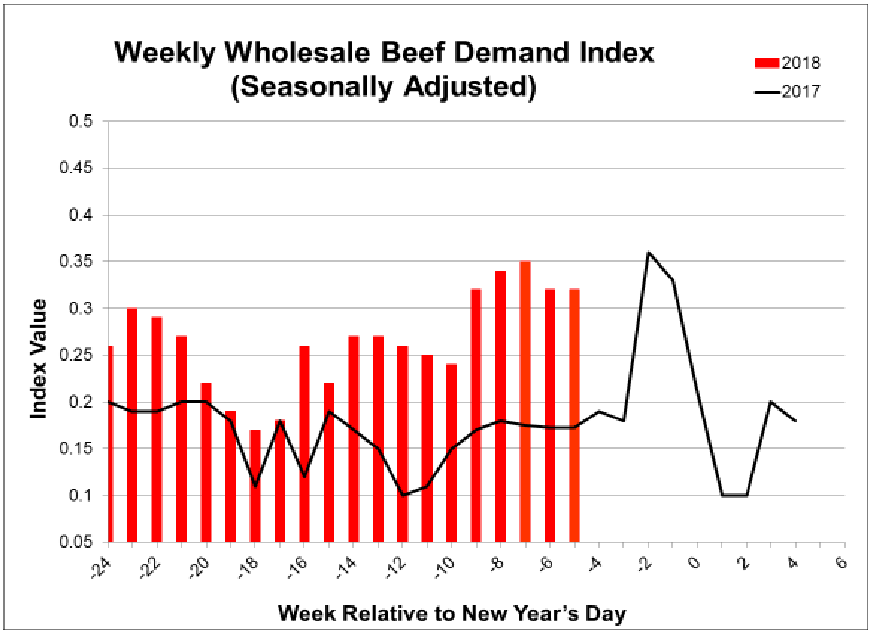
It depends equally, of course, on demand. And this picture, while rather vigorous at the moment, does not look particularly rosy a month or two down the road. The seasonally adjusted monthly demand index might very well be at a cyclical top right about now. I say this not solely because it has increased immensely since September/October and is currently near the upper end of its two-year range—although this would, by itself be a valid reason—but also because the belly market may have gotten a bit ahead of itself, so to speak. Not that there is any deep-seated problem with bacon demand, but this market has rallied 50¢ per pound since mid-October and now stands 46% above a year ago. It will be a tough act to follow in the first quarter. Once again turning to the change from November to January, the 15-year average change in monthly prices is +5%; even if bellies manage an average price increase this time around (which is questionable), they would still center around only $1.32 per pound in January, and $1.40 in February….both of which are significantly below today's quote. The sort of declines that we're talking about in bellies and hams will be difficult to offset by the rest of the carcass.

My guess, then, is that the pork cutout value—currently $83.94—will average $80 per cwt in December; $78 in January; and $79 in February. I'm thinking that largely due to the belly market, the monthly demand index will be slightly below a year earlier in the first quarter.

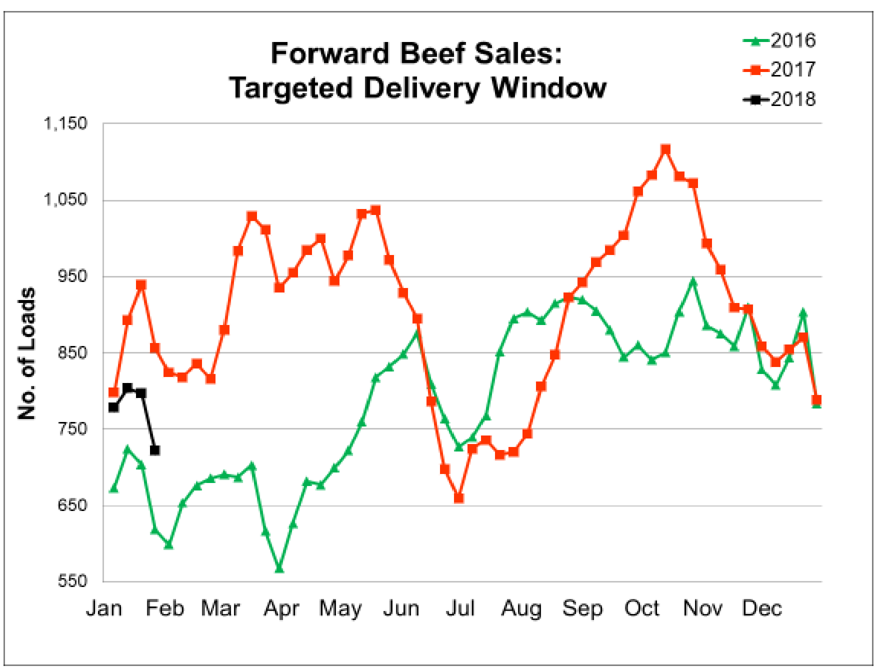
Moving on to the beef market, it is pretty clear that last week's decline in cutout values—which made me feel like a fool—was due in large measure to another round of heavy production. This past week's steer and heifer kill, at 514,000, was not far from the summertime peaks. Without taking the time to look up the details, I can say that this is quite unusual. It is not only large for this time of year, it is also large in relation to the inventory of cattle on feed 90 days or longer….which is another way of saying that marketing rates remain aggressive. Along with the fact that steer carcass weights are running 16 pounds below a year ago, this is hard evidence that front-end cattle supplies are current.

And this is worth mentioning because it should not be easy for packers to maintain this rate of production without digging more deeply into their margins. Thus, I have to think that supplies will lighten as we move through the month of December. Naturally, lighter production will be supportive of beef prices in the near term.

Meanwhile, wholesale demand readings are fairly stout, and I cannot think of a compelling reason why they would crumble before Christmas. By most macroeconomic indications, this holiday season will be a good one for beef demand. If the seasonally adjusted demand index were to hold steady from this point—i.e., if wholesale demand were to merely follow its typical seasonal course through the balance of the year—then the combined Choice/Select cutout value would gain $3-4 per cwt between now and Christmas.



Of course, ribeyes will take a hard "hit" in the second half of the month. A typical decline in boneless ribeye prices would carry Choice product down to about $6.50 per pound, and Select-grade product to just below $6.00, at the end of the month. These seem like pretty reasonable targets under the circumstances. Measuring against current prices, together these would subtract almost $5 per cwt from the combined cutout. But this negative impact should be more than offset by advances in just about all other major items, with the exception of 50% lean trimmings.



Beyond the holidays, wholesale beef demand becomes clearly more suspect. I am basing this notion largely on the slackening forward sales volumes for the post-holiday period, which I attempt to illustrate in the picture at left. I'm taking the weekly forward booking volumes (both fixed-price and formula-priced) for delivery four to eight weeks out, and projecting them into the delivery weeks that might be encompassed. And what they show (so far) is that packers will have considerably more product to sell into the spot market in January than they did a year earlier. These figures also imply that wholesale beef demand—much like the situation in the pork market—reached a cyclical peak in November, and will decline into the early part of 2018.

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.