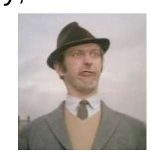
MEAT MARKETS
UNDER A MICROSCOPE

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

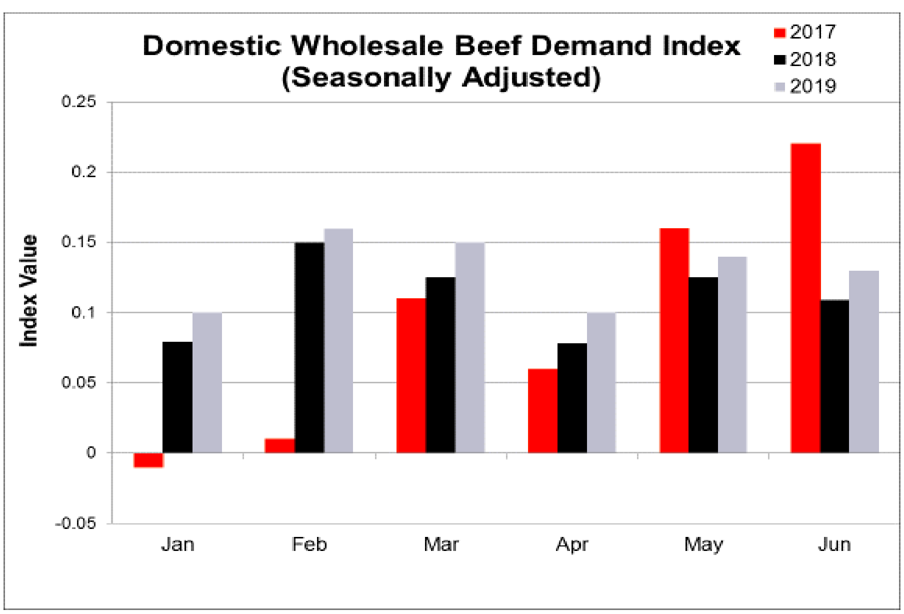
February 17, 2019

One thing I think we can all agree upon is that cutout values have been relatively stable since the first of the year, and especially so in the last three weeks. It would be fair to say, then, that supply and demand in the beef market have been in pretty good balance lately. What will alter that balance?

The answer is a seasonal increase in demand. Over the last 20 years, fed beef production has increased by an average of 0.5% from February to March, accompanied by a 4.0% increase in the combined Choice/Select cutout value; so it would also be fair to say that normally, demand increases from February to March. This is high-level stuff we're talking about here.



I am expecting the February-to-March increase in fed beef production to be a bit above average this year, about 1.5% (with steer and heifer slaughter near 481,000 per week in March, and fed cattle carcass weights about five pounds heavier than a year ago). And my guess is that the combined cutout value will average $226 per cwt in March, up 4.1% from what is shaping up to be a $217 average here in February. Nothing radical about that. In order to achieve a $217 average, it will have to begin its seasonal rally before the end of the month, which I also anticipate.



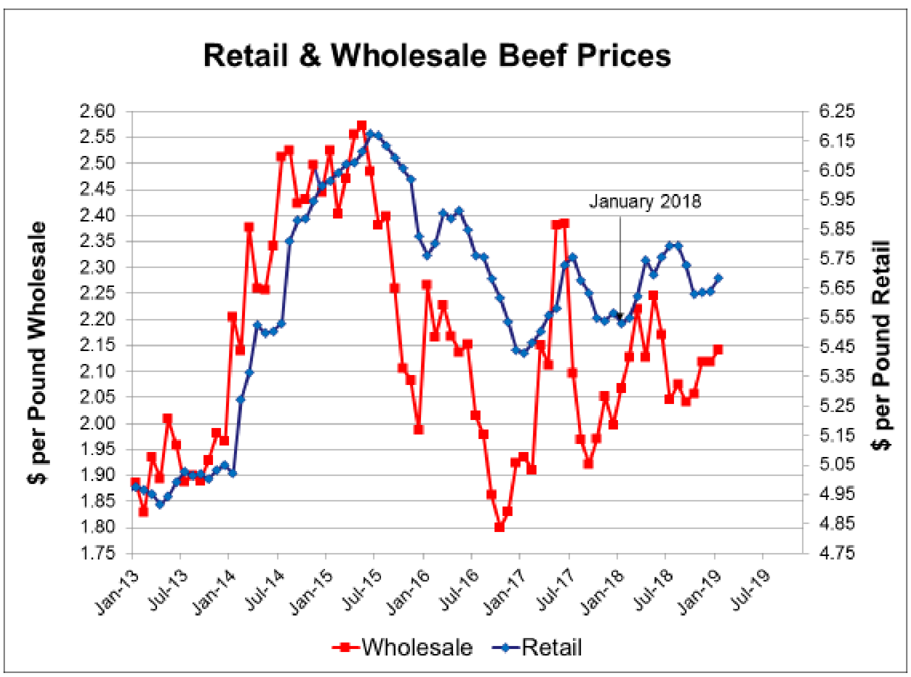
At the core of my forecast is a projection of the seasonally adjusted demand index as shown in the picture to the left. Wholesale demand was up modestly from a year ago in January, and it appears that the same can be said for February. Why not, then, also for March and the entire second quarter? The demand scenario that I am projecting would place monthly average combined cutout values at $217 per cwt in April (remember, Easter falls as late as possible this year); $226 again in May; and $221 in June.

As I pointed out last week, the immediate upside potential in middle meats appears to be restricted by the fact that most of these items are already priced significantly higher than a year ago, limiting their appeal as feature items during March. I don't see why prices could not exceed their March 2018 peaks to some degree. But if the following are reasonable expectations of the March 2019 peaks, then collectively they would add roughly $12 per cwt to the combined cutout from its current quote ($215.88)….which would place the high weekly average in March at $228, if nothing else were to change.

March 2019 peaks?

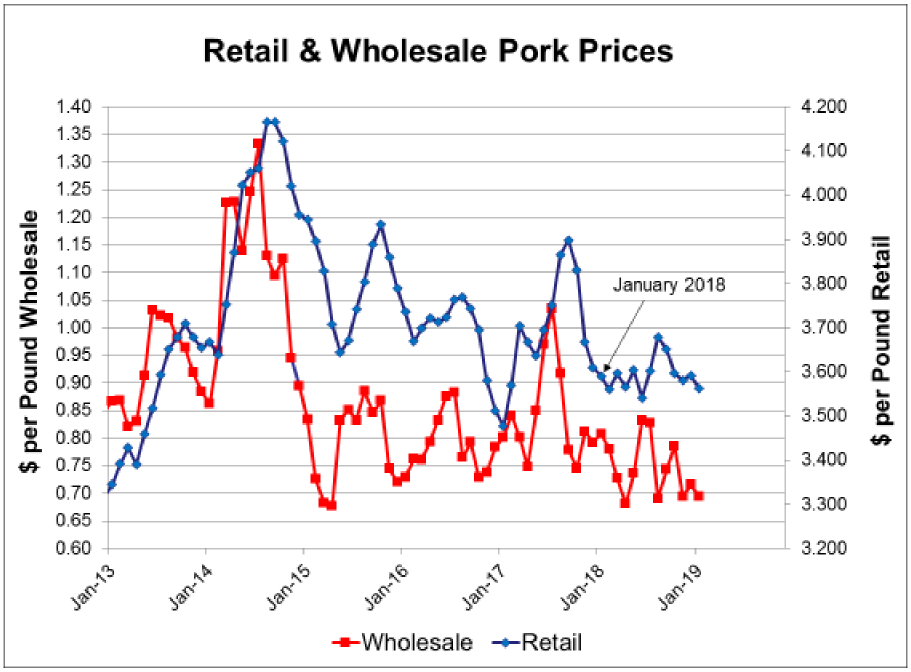
CH Bnls Ribeyes	$8.75	SL Bnls Ribeyes	$7.75
CH 0x1 Strips	$7.50	SL 0x1 Strips	$6.00
CH Top Butts	$4.00	SL Top Butts	$4.00
CH Tenderloins	$11.00	SL Tenderloins	$11.00

Frankly, though, I regard these upside targets as a bit generous. Also, it is likely that 50% lean trimmings will *gain* some 20¢ per pound by the second half of March, but bottom round cuts are likely to lose as much. When I include these items in the calculation, I wind up at about the same point--a $228 weekly peak, which fits the notion of a $226 monthly average.

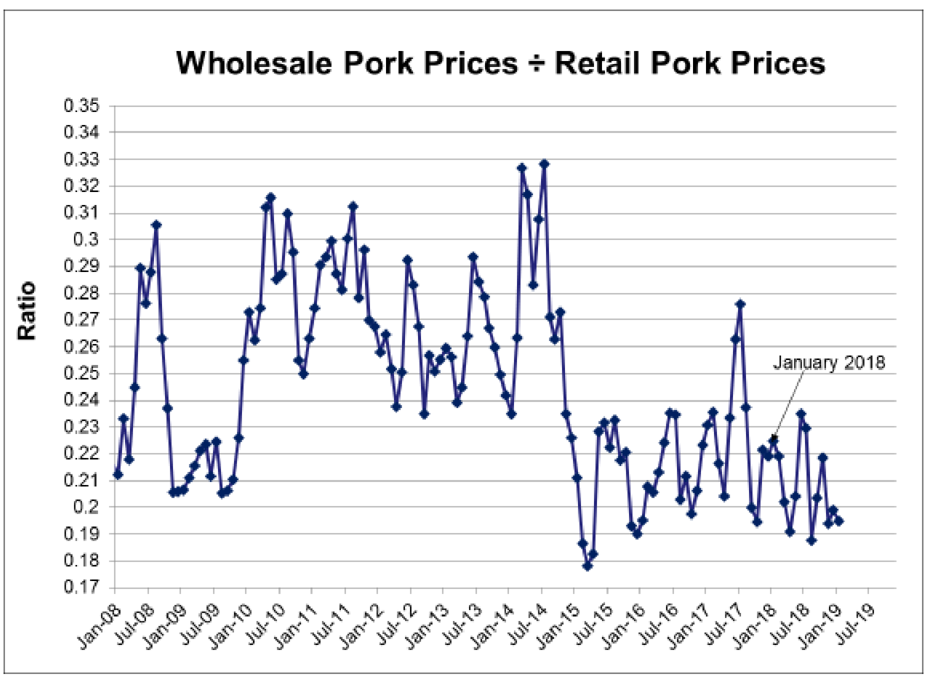


Retail beef prices are trending upward, which is not particularly favorable to the prospects of demand at the wholesale level. This according to the U.S. Bureau of Labor Statistics, which reports that in January, the simple average of "All Uncooked Ground Beef"; "All Uncooked Beef Roasts"; and "All Uncooked Beef Steaks" stood 15.4¢ per pound higher than a year ago and up 5.5¢ since October. At the same time, implied retail margins (comparing the retail composite with cutout values) are slightly narrower than a year ago. Under these circumstances, I have to question my own assumption that the wholesale demand index will be any stronger than a year earlier through the spring….

This picture is quite different in the case of the pork market. Retail pork prices are moving downward, and retail margins are relatively wide. I show this picture at the top of the next page.



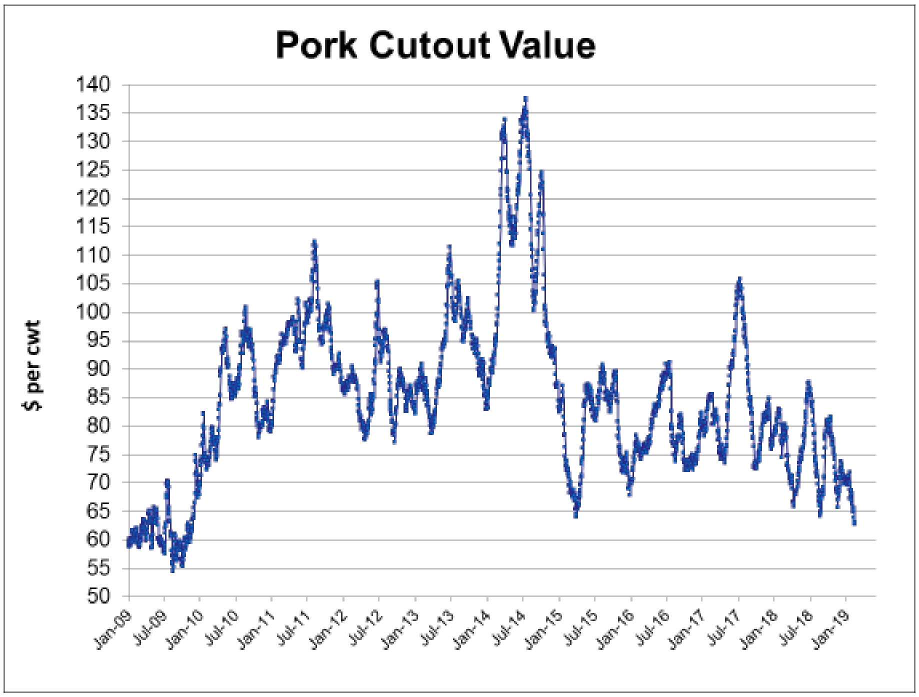
While retail prices are virtually the same as they were at this time last year, they have declined 3.4¢ since October, and the broader trend points downward. I'm looking at a simple average of the categories labeled, "Sliced Bacon"; "All Pork Chops"; "All Ham (not canned)"; and "All Other Pork (excluding canned)". I am including a second picture to illustrate that the spread between wholesale and retail pork prices is quite a bit wider than it was at this time last year, and near its widest point of the last three years. The implication is that there is ample room for retail prices to be adjusted downward from here. That would, of course, accelerate the movement of product through the "pipeline' and increase demand at the wholesale level.



It's also worth pointing out that retail bacon prices are 13.6¢ per pound lower than a year ago. That was as of January, and pork belly prices now stand nearly 19¢ below their January average. Maybe--*maybe*--this means that the belly market will find support right here, in the $1.05-$1.10 per pound range, instead of sliding all the way through April, as it did last year.

In hindsight, the fact that retail prices have recently been unchanged from a year earlier while domestic supplies have been 5% larger might help explain why demand at the wholesale level has fared so poorly since the first of the year….surprisingly poor.

The cutout value has lost more than $7 per cwt since January 2, and its decline over the last two weeks was the second steepest of the last 30 years for that particular time frame. Thank God for us Experts who had predicted that it would begin another leg up at the end of January. While hog slaughter has been *somewhat* larger than I had anticipated, it was clearly the weak wholesale demand that veered "off course".



The chart of the cutout value shows nothing in the way of support between here and the August 18, 2009 low of $54.37. Can it go that low? Well, of course it *can,* since markets are controlled by mystical, evil forces whose sole purpose is to see to it that we are wrong and miserable, no matter what we do.

But really, now….how likely *is* it that the cutout value will continue to sink if hog slaughter comes in as it's supposed to from this point forward? I'm talking about falling back from 2,515,000 in the last two weeks to 2,470,000 within the next two weeks and holding at that rate through March.

In the context of the topic we just discussed, a material improvement in demand seems imminent. It would require only a very minor improvement to push the cutout value up to its nearest resistance level on the chart, which is $70-$72 per cwt., by mid-March.

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.