MEAT MARKETS
UNDER A MICROSCOPE

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

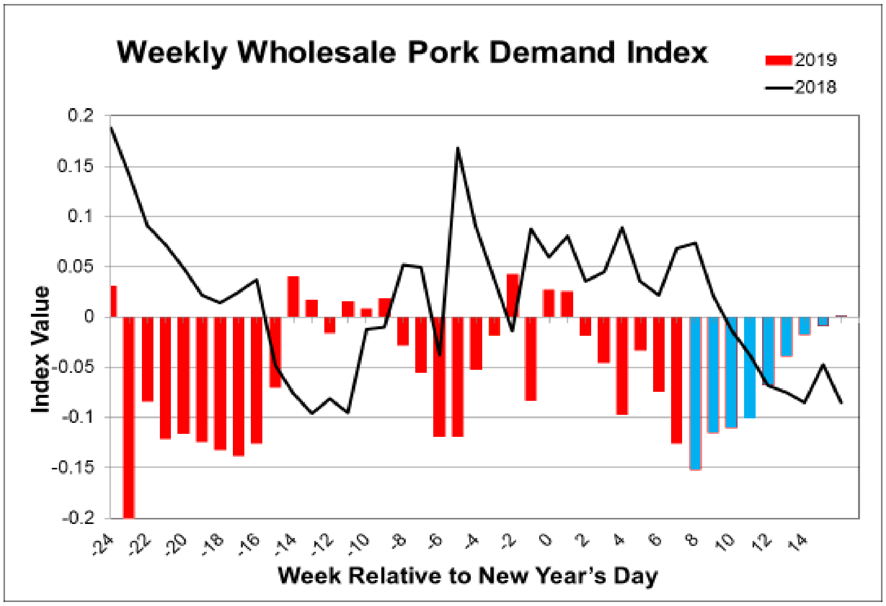
February 24, 2019

If it seems that I am obsessed with pork demand at the moment, it's because I *am.* But clearly, this is the variable in the equation that has pulled the cutout value down to its lowest level in more than nine years. And why has demand been so weak? I think it's because larger-than-expected hog slaughter has created a residual supply of pork that has struggled desperately to find a home. It is my perception that in the meat markets, prices at any single point in time are determined "on the margin"--that is, it takes only a small excess of supply over demand to push prices significantly downward, and a relatively small shortfall in supply can drive prices significantly upward. This, obviously, is a case of the former.

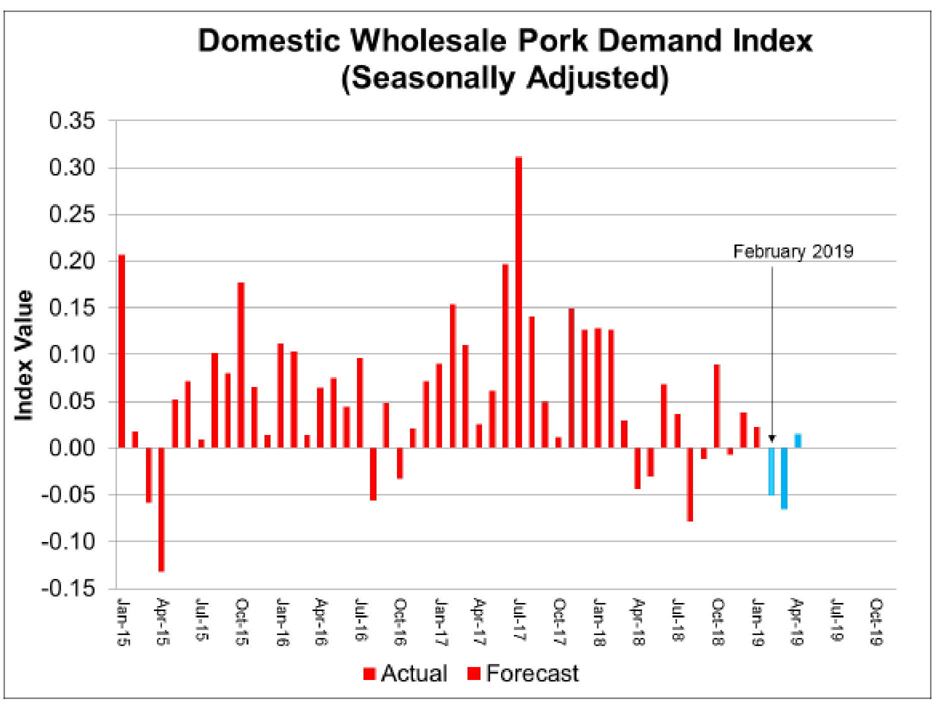
First, let's try to identify the rate of hog slaughter that we're most likely see over the next two months. In the first eight weeks of 2019, barrow and gilt slaughter has been up 4.6% from a year ago. The summer 2018 pig crop was estimated to be up 3.3%. This could, of course, mean that the entire first quarter kill will show a 4.6% increase, and in that case, weekly slaughter would stay right where it is, averaging 2,517,000 over the next five weeks. But it doesn't necessarily work that way. Each year, there is a somewhat different distribution of quarterly slaughter among the individual months, for a number of reasons. It is worth noting that November slaughter was up 3.6%; in December it was up 3.0%; in January, up 3.9%; and so far in February it is up 5.2%. The point is that it could be more likely that USDA's summer pig crop estimate--being the most comprehensive and scientific estimate available--is not quite so far off the mark; it's just that a smaller portion of the first quarter kill will land in March. There's no single best way to go about this. But the approach that seems most sensible to me is to minimize the difference between the summer pig crop and the first quarter kill, while assuming that March's share of that total will fall within a "typical" range….while adopting the notion that to some degree, hog marketings were delayed from January to February due to the weather. And by the way….I checked back as far as 1980, and never has there been an increase in hog slaughter from January to February as great as we are witnessing right now. That explains a lot, doesn't it?

Using this approach, my best guess is that weekly kills will average about 2,480,000 in March. That would be only 3.1% above a year earlier; but this does not seem unreasonable, considering that last fall's pig crop was reported to be up 2.0%. March is sort of a "transition" month between the summer and fall pig crops.

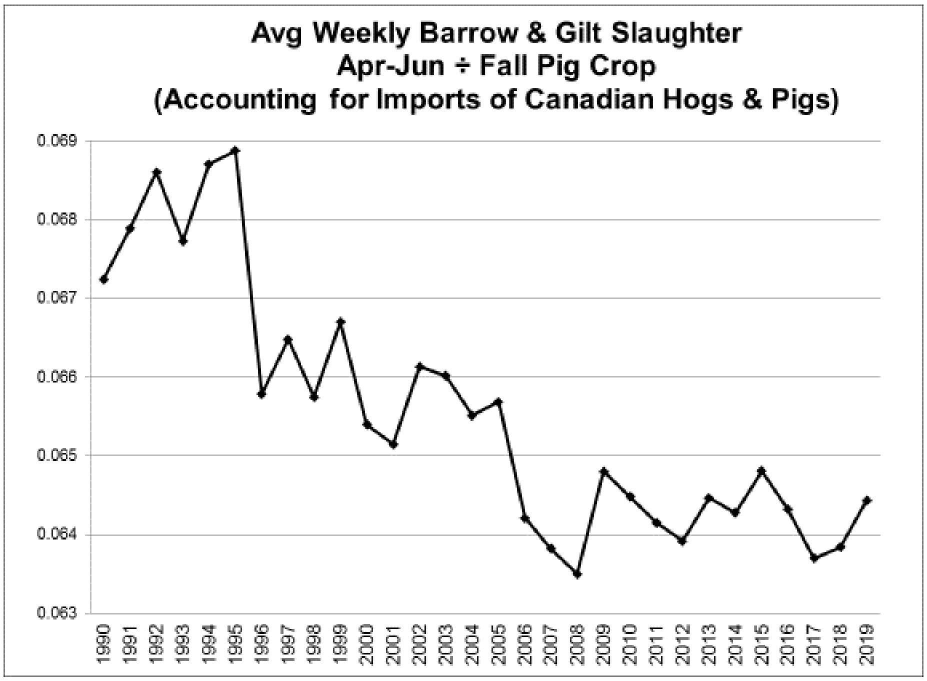
OK, so we were talking about demand. On the next page I show both the weekly and monthly demand indices.



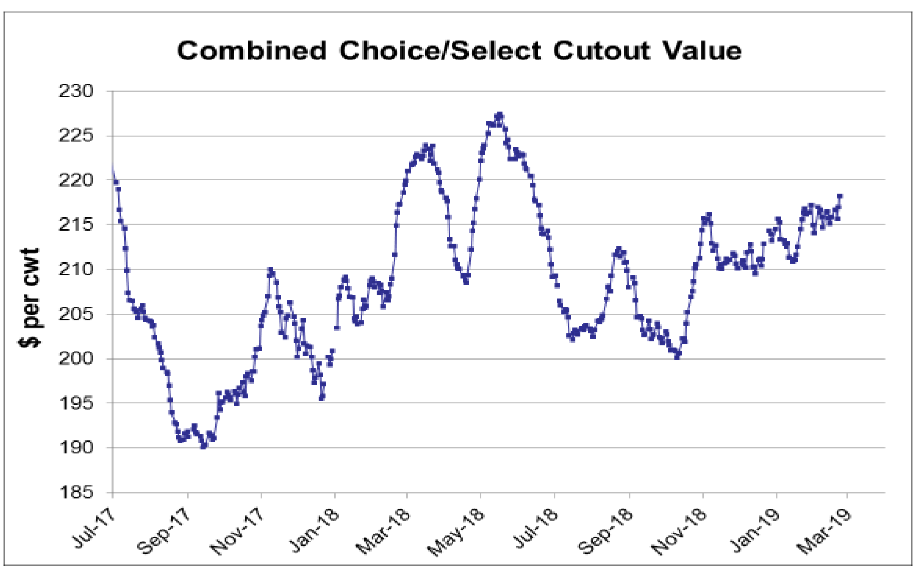
Using a seasonally adjusted measurement, it is clear that demand for pork at the wholesale level has receded to the depths of mid-August to mid-September--a period of free-falling pork prices which seemed, at the time, as if it would have no end. But it *did* come to an end, and it did so abruptly. Starting in late September and extending through early November, the demand index climbed well above a year earlier and above the base period, which is the 2009-2018 average. Something similar happened between late November and late December, only on a smaller scale. Quite likely, it will happen again….but how soon? It will happen when that "residual supply" to which I referred disappears, which I *think* will occur as weekly kills take a step downward. I have gratuitously included my projections for the next nine weeks, which are represented by the blue bars. In this scenario, which assumes a very gradual recovery in demand coupled with weekly kills of 2,480,000 in March, the cutout would approach $70 per cwt by April 1. [It was quoted Friday at $59.01.]



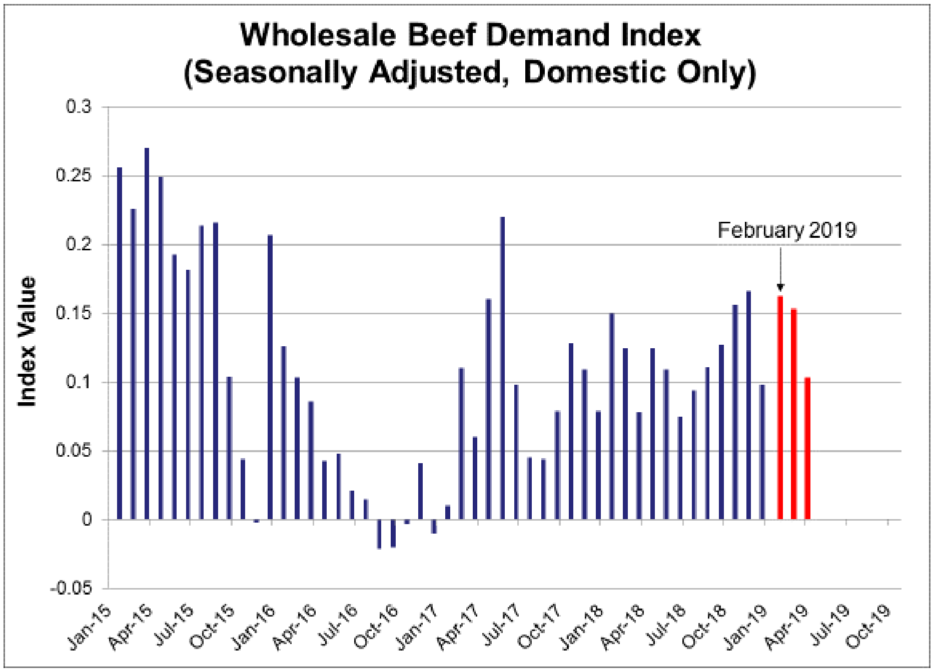
The longer-term picture likewise highlights the severity of the depression that has occurred, but it also suggests that one to two months is about what it takes for the market to clear up its problems--i.e., for cheap prices to generate additional demand. My guess of a $65 average cutout value in March assumes that the monthly demand index will actually show a lower reading in March than in February. From that angle, a $65 forecast looks pretty conservative. And the still-timid demand projection for April shown in the picture above, combined with an average weekly kill of 2,410,000, would result in an average cutout value of about $71 per cwt in April. In case you're wondering whether we can honestly expect weekly kills to drop 100,000 head by April, I show the basic assumption of how second quarter slaughter will align with the fall pig crop estimate. It's about as objective as it can be, based on the information with which we have to work:



The combined Choice/Select beef cutout value appears to be performing as scripted, on its way to the March rally that should carry it up into the upper $220's per cwt from the current quote ($218.26 on Friday). The next chart shows two conspicuous resistance levels--one at $224 and the second at $227--which provide convenient targets for a peak in the middle of March. Of course, there is no rule stating that a new resistance level cannot be forged, but anything materially beyond $227 seems doubtful. My personal choice of a high weekly average of $228 already requires some pretty aggressive achievements of the loin and rib cuts within the next three weeks: Choice boneless ribeyes at $8.75 per pound; Choice 0x1 strips $7.50; Choice top butts $4.00; and Choice tenderloins $11.00. It also requires another 10¢ up in 50% lean trimmings, to $.80.



The situation in beef demand remains quite a contrast to that of pork, especially as we look out into April. The demand index reading here in February is/has been surprisingly stout, practically matching its 2018 peaks. However, it is still trending basically sideways and exhibiting its short-term cyclical swings. From my convoluted perspective, there was virtually no January rally in the end meats and grinds (which is atypical), and therefore nothing of the usual crash in these items in February; and this probably accounts for the recent recovery in the demand index.



Where, then, from here? Well, my forecast of a $226 average combined cutout value in March assumes that the demand index will not back off appreciably over the next month. But it is certainly due for a material setback; and if it does not happen in March, then it's likely to happen in April. The projection I show for April would still place it significantly above a year earlier. And this projection, combined with average weekly steer and heifer slaughter at 494,000 per week (vs. 491,000 in April 2018), would make for an average cutout value of "only" $217 per cwt. The futures market, by the way, is expecting something much better than that.

To express it in English, it is difficult to find anything on the Beef Menu that would attract the attention of retailers and prompt aggressive supermarket features any time soon. The lone possible exception might be ground beef, but even that one is a bit of a stretch. Eighty one percent 81% lean "regular" grinds are averaging the same as a year ago so far this month, and ground chuck prices are about 4¢ per pound higher. Choice boneless ribeyes, meanwhile, are 53¢ per pound higher; Choice 0x1 strips are up 10¢; and Choice top butts are up 12¢. The loin cuts will almost certainly be featured in March and April, but probably not at prices that would greatly accelerate the movement of product through the "pipeline"….yielded costs would appear to be prohibitive.

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.