MEAT MARKETS
UNDER A MICROSCOPE

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

March 29, 2019

As one would expect, projections of pork exports to China that have been published lately are all over the board. No one in this business of forecasting and trading really has a good idea what China will wind up doing. The best we can do is to monitor the developments closely and adjust quickly. But I am inclined to place a bit more credence in those put forth by the Foreign Agricultural Service's office in Beijing, because….well, just *because*. The analysis contained in USDA's latest *Global Agricultural Information Network* report on the subject, dated March 11, is timely and thorough. And so it is upon this source that I base my own forecasts.

USDA's "Post" in Beijing is saying that Chinese imports of pork from all sources will increase by 440,000 tons this year, from 1.561 million tons in 2018 to 2.0 million in 2019. That's an increase of 970 million pounds. If that increase is concentrated in the April-December period, then it amounts to 108 million pounds per month.

Just how the additional volume will be distributed among the various supplying countries involves some guesswork. Frankly, I'm not quite certain what the market shares were in 2018. The latest figures I have read place Germany at the top of the list with a 19% share, followed by Spain with 18%; Canada and Brazil with 13% each; the U.S. with 10%; Netherlands with 7%; Denmark with 6%; and UK, France, and Chile with 4% each. However, the GAIN report also states that Brazil recently surpassed everyone else to become the largest supplier.

Let's be optimistic and say that China's 62% tariff on U.S. pork will revert back to the 12% "Most Favored Nation" rate sometime this spring, and that U.S. packers are able to pick up 50% of the incremental business. In that case, U.S. shipments to China would increase by an average of 54 million pounds per month (compared with a year earlier) during the April-September period.

Intuitively, I am inclined to bump this number upward--by quite a bit, actually. My reasoning is the likelihood that death losses from African Swine Fever are substantially greater than we have been led to believe, and that FAS may be underestimating the amount of imported pork that China will ultimately choose to buy. [Currently, FAS is forecasting a 5% reduction in Chinese pork production this year; a number of private estimates are in the 15-20% range.] Also, I notice that in 2008, in the wake of "Blue Ear" disease in China, monthly imports from the U.S. to China/Hong Kong/Taiwan reached 148 million pounds per month. I don't see why this rate could not be achieved in 2019.

And so I am guessing that U.S. pork exports to China/Hong Kong/Taiwan combined will rise from 32 million pounds in January to 110 million pounds in June, and to 150 million in the fourth quarter. That would make for an average year-over-year increase of 85 million pounds during the April-December period.

It places my projection of total U.S. pork exports shown in the table below. It looks a little bit different than I was showing you a week ago:

Million Pounds

	Q2	% Change	Q3	% Change	Q4	% Change
China/HK/Taiwan	270	+119	360	+362	440	+356
Mexico	415	-14	438	+10	485	+12
Japan	280	-7	267	-9	285	-7
Korea	205	+5	120	+9	222	+5
Canada	133	+7	143	+2	141	+1
Colombia	88	+27	75	+34	104	+13
Australia	66	+31	57	+14	71	+4
Total	1639	+8	1630	+26	1959	+27

Meanwhile, it looks like U.S. pork production will be up 3% from a year earlier in the second quarter; up 5% in the third quarter; and up about 3.5% in the fourth quarter. As always, I am taking USDA's farrowing and pig crop estimates at face value. In normal times I would go into detail on the production projections immediately following a quarterly *Hogs and Pigs* report, but that issue is taking a back seat right now.

Thank God.

We can get together tomorrow and go through it then if you like?

I'd rather have my toenails pulled out.

OK. Let me know if you change your mind.

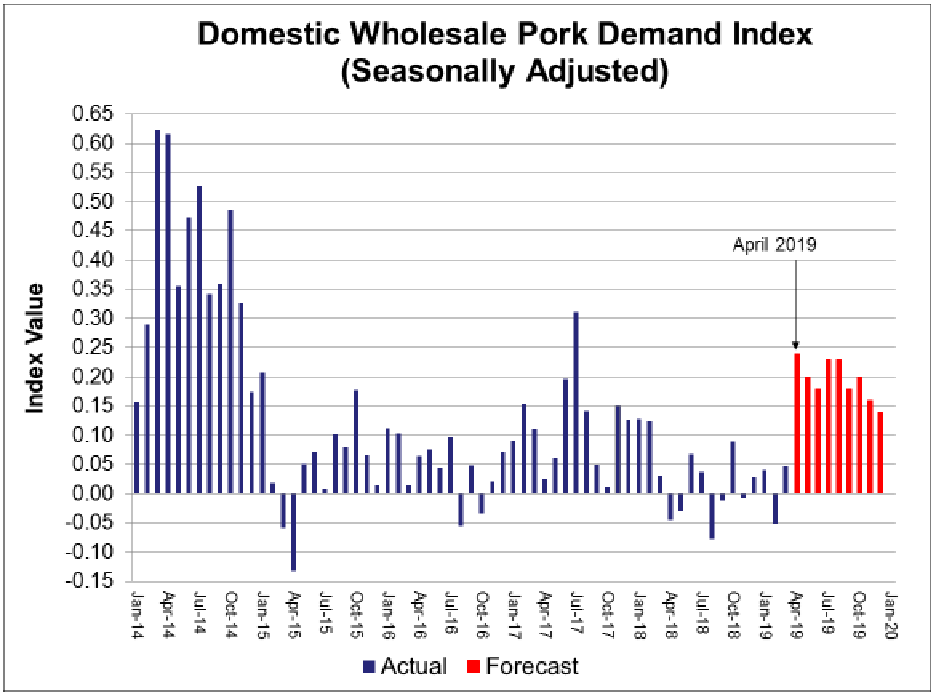
My production projections include the assumption that carcass weights will track along a normal seasonal pattern from this point forward. I have no reason to assume otherwise.

OK, so combining production and foreign trade, it appears that net domestic pork supplies will be down about 1.4% from a year earlier in the second quarter; down 1.5% in the third quarter; and down 4.4% in the fourth quarter, after being up 3.4% in the first quarter.

Of greater importance than exports in the pricing equation is the demand for pork at the wholesale level (this is a statistical fact). And projecting demand at this juncture involves at least as much guesswork as projecting exports, if not more.

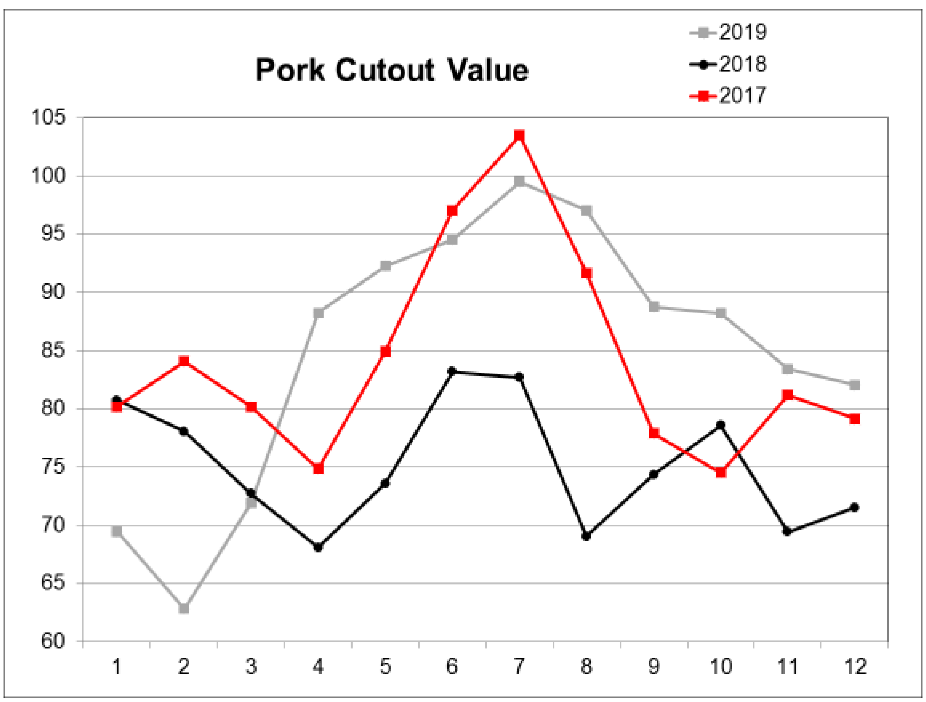
The "juncture" to which I refer is this transitionary period from larger domestic pork supplies to smaller supplies, from bearish price expectations to bullish price expectations. Suddenly buyers have become willing to pay much higher prices while aggregate supplies have not changed materially, which defines an increase in demand. There has been a rush among meat processors and end users to "get covered"--to accumulate inventory, either through physical storage or on paper. As I show in the picture on the next page, the jump in wholesale pork demand from February to March was extraordinary, and the increase from March to April will be extraordinary as well.

As net domestic supplies tighten, wholesale demand will remain in a distinctly higher tier. But chances are, the sharpest increase will occur in the early stages of this transitionary period. Such was the case in the last major bull market in 2014; demand index started to jump in late 2013, and by March 2014 it had peaked.



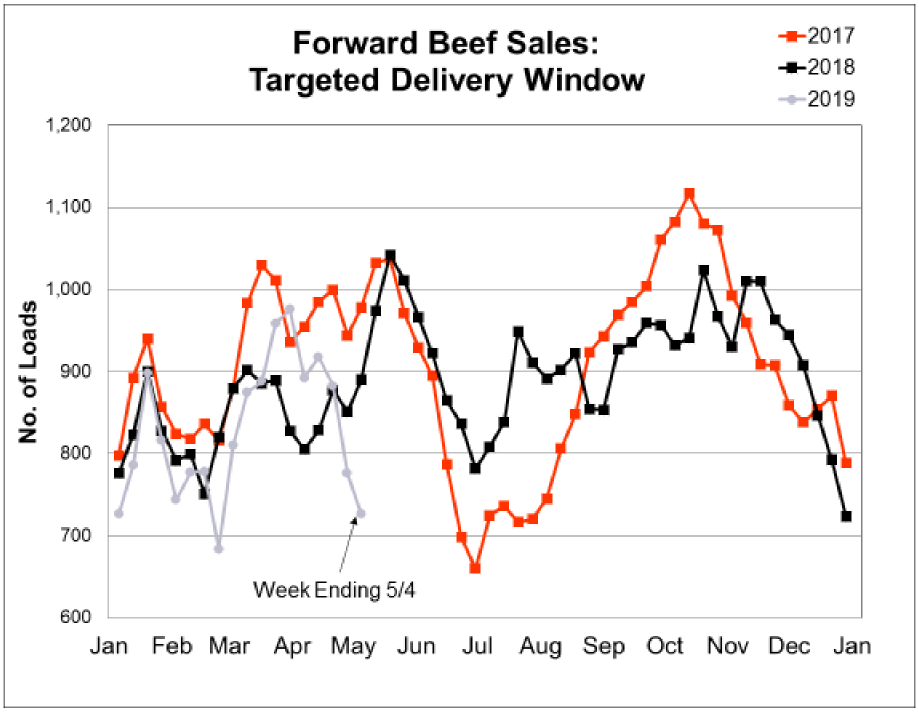
My guess of what the pattern in the demand index will look like is displayed in the graph to the left. Choosing the point at which it will peak is highly conjectural; however, I'm a bit more confident that it will slip backward later in the year as the market adjusts to higher prices. I hope that I'm making sense.

Finally, then, when I combine these demand index values with the net domestic supply projections that we just discussed, I come up with the following forecast of monthly average cutout values. As a friend of mine stated a few days ago, "You have to stick your stake in the ground somewhere".



Let's move on.

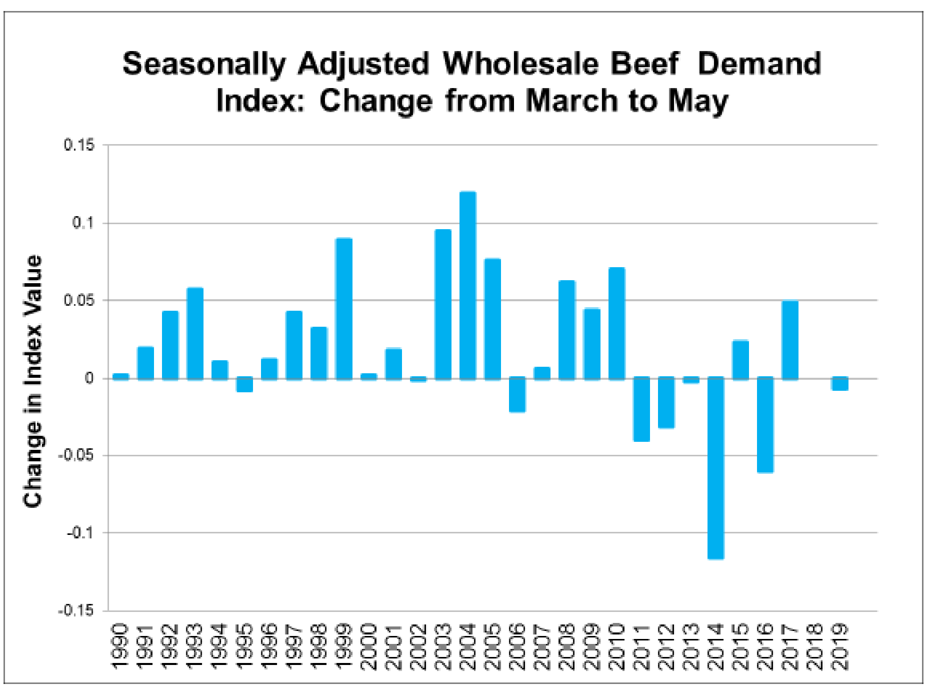
The beef market is headed for a slow descent over the next three weeks. We are still in the midst of a period into which a sizeable amount of beef was pre-booked, and so packers have not had much product to sell into the spot market (which, in turn, explains why cutout values have held up as well as they have here in late March). This condition will persist for another week, possibly two; but it's starting to look as though things will change in the second half of April.



As I show in the picture to the left, demand for late April/early May deliveries has slowed quite a bit. This is unfortunate timing, since it *should* coincide with a rather dramatic increase in fed beef production.

Steer and heifer slaughter has made one step upward, from 470,000 per week at the beginning of March to 482,000 over the last two weeks, and I expect that it will rise above 500,000 before the end of April.

As you can see, last year forward bookings for late April/early May were headed in the opposite direction. This is one reason why I do *not* anticipate the same sort of jump in cutout values from April to May as occurred in 2018. In fact, I regard my forecast of an average Choice/Select cutout value of $228-something in May as somewhat optimistic. But it *is* a reasonable forecast, since it assumes that wholesale beef demand will merely undergo a typical seasonal change from March to May--no better, no worse. Such would be reflected in a seasonally adjusted demand index that is the same in May as it was in March:



There will, of course, be a seasonal improvement in demand from March to May, but why would it be any greater than usual? It's not as though wholesale prices have become cheap enough to spur aggressive retail features….quite the opposite, actually. In particular, I notice that prices of 81% lean ground beef are finishing the month of March at their highest levels of the year and a full 15¢ per pound above a year ago. The same can be said of knuckles, bottom round flats, and inside rounds.

The chart of the combined Choice/Select cutout value shows nothing in the way of support between the current quote ($225 per cwt) and about $217, and so this seems a likely place for the next low point. The April 2018 low, by the way, was $209.

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.