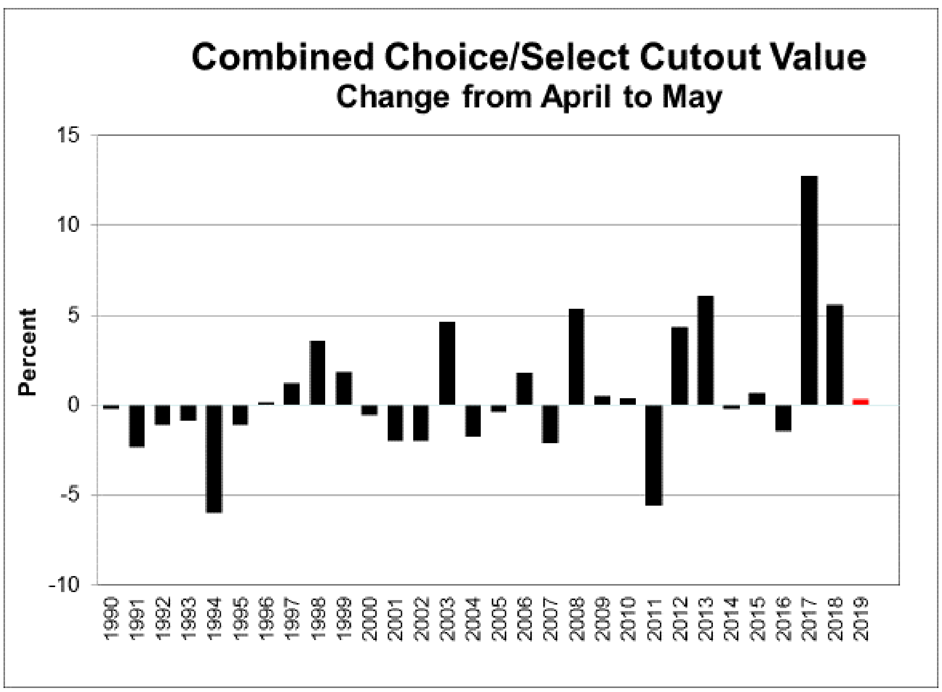
# MEAT MARKETS
# *UNDER A MICROSCOPE*

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

April 14, 2019

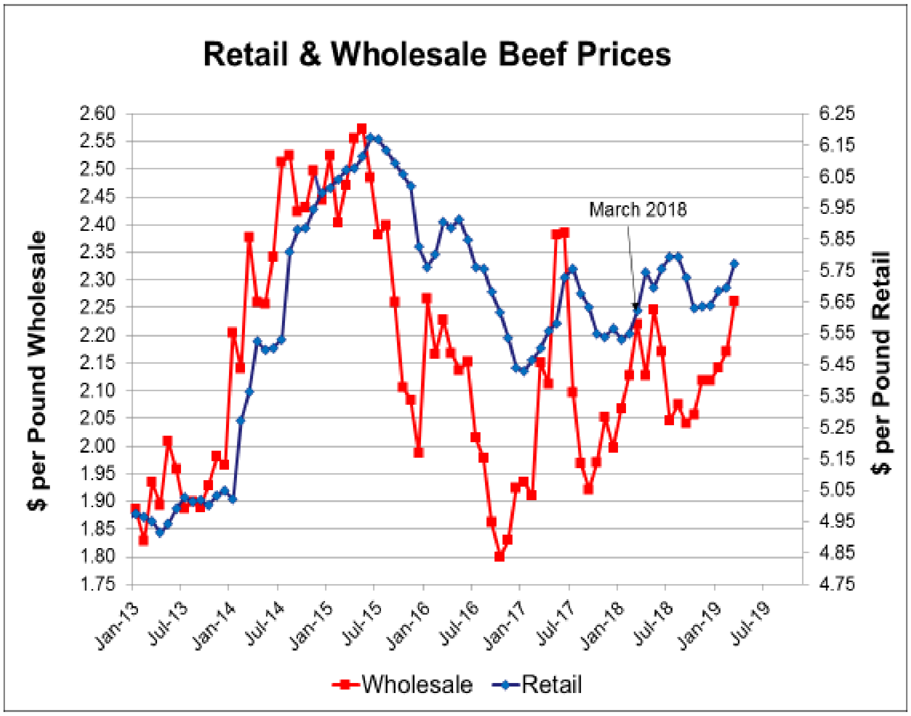
**There seems to be a pretty pervasive anticipation of a big rally in beef cutout values in May. Frankly, I don't see it happening.** I have to acknowledge, though, that the seasonal tendency toward stronger demand in May is unmistakable; over the last 20 years, the average change in beef production has been +5.1%, and this has been accompanied by a 1.4% increase in the combined Choice/Select cutout value:




My humble forecast of only a slight (0.3%) appreciation from April to May this time around would be below average, but not by much, really. In fact, there have been nine years since 1998 in which the average price in May was *lower* than it was in April.

My reasoning hinges on the fact that forward bookings of beef for delivery in May have been significantly smaller than they were for April deliveries, and far below a year ago. As best I can tell, fed beef production will increase about 4.5% from April to May, and will slightly exceed a year earlier. If supermarkets are going to promote beef aggressively next month, they are concealing their plans well.

**Retail beef prices are higher than a year ago and rising**. According to the U.S. Bureau of Labor Statistics, the simple average price of three comprehensive categories--"All Uncooked Ground Beef", "All Uncooked Beef Roasts" and "All Uncooked Beef Steaks"--was $5.77 per pound in March vs. $5.70 in February and $5.62 a year ago.



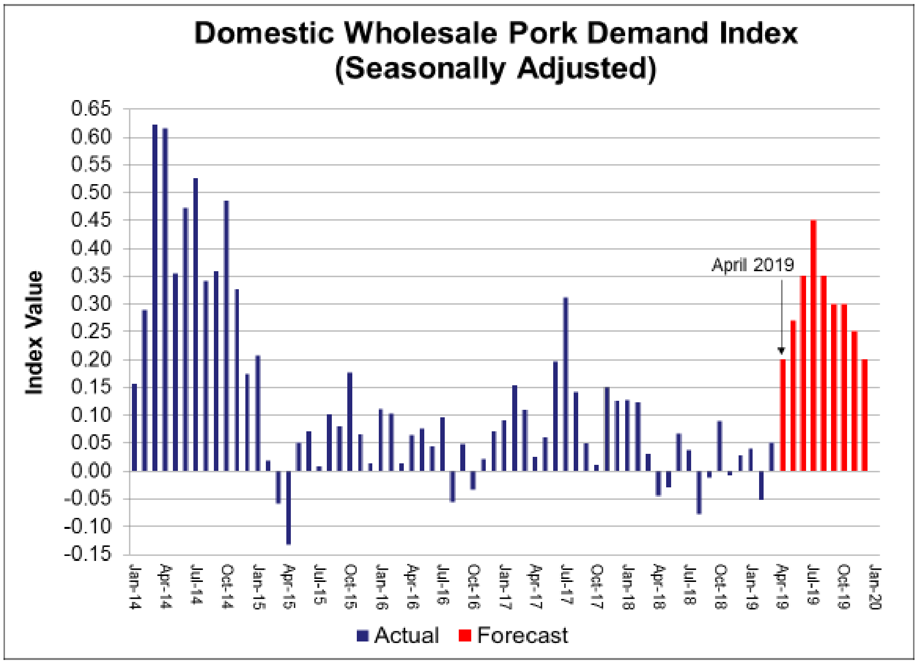

True, the robust economy is allowing the market to better absorb higher retail prices; even so, the *trend* is not conducive to a more rapid rate of "pull" through the pipeline….quite the opposite, in fact. Also, the spread between wholesale and retail beef prices is at the narrow end of its three-year range. One would think that retailers would be less willing to give up margin under these conditions.

I notice also that forward prices for May delivery (those offered in late March and early April) were not terribly attractive, implying that most retailers never had the opportunity to lock in cheap product costs that might have permitted more aggressive beef features. Last year, in contrast, Choice short loins could have been bought below $6.00 per pound for May delivery vs. roughly $6.50 this time around; Choice strips could have been bought in the $6.90 range vs. $7.10-$7.30 this year; and about the best one could do in the forward market for 81% lean ground beef this year was $1.95 per pound, whereas $1.85 was available last year.

There remains some upside potential in Choice-grade ribeyes, strips, and short loins prior to Memorial Day, but it seems pretty limited. In view of the foregoing discussion, I am inclined to think that the May 2018 peaks of $8.70, $8.65, and $6.83 per pound, respectively, would present practical barriers to the May 2019 market. In each of these cases, the spring seasonal rally got underway earlier, and there has been no setback in the meantime. If these price levels do indeed act as ceilings, then this group will have added a maximum of $4 per cwt to the cutout value by the time they peak. As I scan the menu, I can find three other areas of potential strength over the next month: 50% lean trimmings (which might be good for an approximate 10¢ per pound rally); the bottom sirloin family; and flank steaks. If no other prices were to change during this stretch, then we would be looking at a peak in the combined cutout value in the neighborhood of $233 per cwt. This I would describe as a "best-case" scenario; my guess, though, is that the top will be nearer to $230, as shoulder clods, briskets, knuckles, bottom round flats, and round eyes all succumb to the additional supply-side pressure.

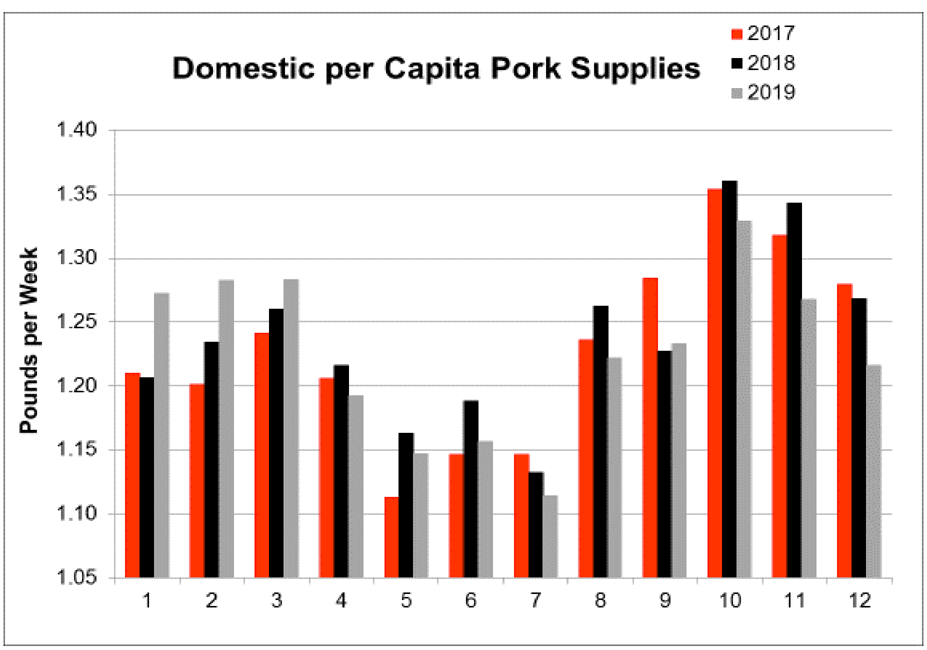
**The seasonal decline in pork production has finally gotten underway.** This past week's kill, at 2,384,000, was 4.4% smaller than the average of the previous five weeks. Although it may have been stunted somewhat by a midweek blizzard, it was a veritable first step. From this point, it should trend basically sideways through mid-May, and then drop down to an average of 2,287,000 in June. Naturally, this will help keep the rally in the pork cutout value going.

**As I mentioned in last week's report, the rally up to this point has been driven mainly by the demand side of the equation; from this point forward, it should receive a boost from both sides**. I think I also pointed out that demand at the wholesale level will be the key determinant of how the cutout value can reach at its peak this summer. I have made a few minor adjustments to my Honest-to-God-Best-Guess projections of the seasonally adjusted demand index, but this variable is important enough that it warrants a revisit:




The main premise is that demand will continue to intensify until net domestic pork supplies hit bottom in July. I have included a graph showing the domestic pork supply, taking into account an 11% increase in U.S. pork exports in the second quarter and a 30% increase in the third and fourth quarters.

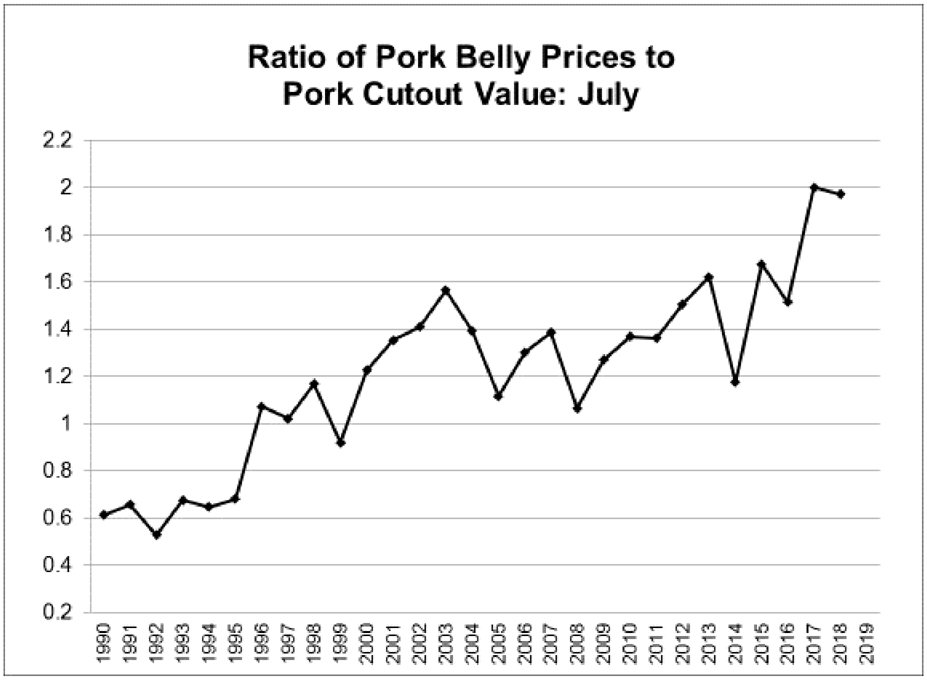
This is a difficult concept to explain without sounding completely insane, but let me try to summarize in one phrase: the smaller the supply becomes, the harder the market has to work to ration demand. It all has to do with relative elasticity. I'll leave it at that for now.




The combination of the net domestic supply and the wholesale demand projections shown above result in monthly average pork cutout values of about $99 per cwt in May; $109 in June; and $118 in July. From there, they taper off as supplies grow seasonally and demand pulls back.

Since it probably represents the high point, let's focus on the month of July for a minute and specifically address one subject that I have conveniently avoided in the past few weeks….that would be pork bellies.

I haven't seen any actual figures lately, but the marketing channel for bacon is split into two parts of roughly equal proportion: the foodservice/restaurant segment, in which demand is highly inelastic; and the supermarket segment, in which retail prices are adjusted fairly frequently and the quantity demanded ebbs and flows accordingly.




I won't go into great detail at this time, but the demand for pork bellies has a fairly effective regulator in the supermarket sector. Demand overall is less elastic than it is for loins, butts, and ribs, but more so than hams or trimmings. You'll notice, apart from the fact that bellies have become more valuable relative to the rest of the pork market over time, that in 2008 (when China last was a huge buyer of U.S. pork) and 2014 (when the supply was cut deeply by Porcine Epidemic Diarrhea virus), the ratio in the picture above was somewhat subdued. If this is any indication, then we might look for a ratio this July somewhere in the area of 1.5 to 1.6 (taking the long term uptrend into account). Paired with a cutout value of $117 per cwt, this would result in an average belly price of $1.75 to $1.87 per pound. There is more to this story, but this is at least a starting point….



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