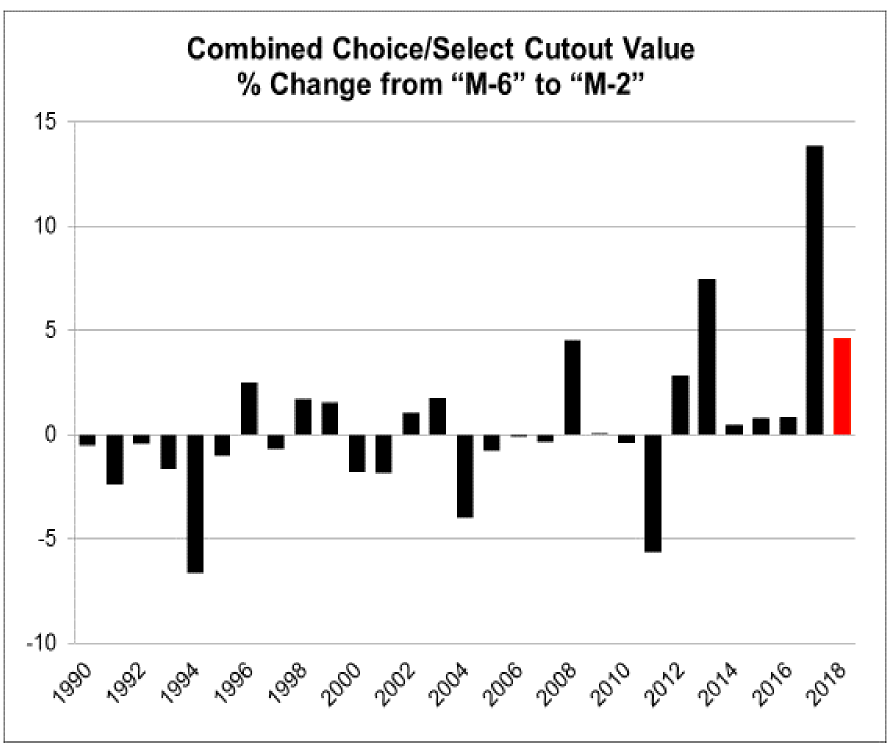
MEAT MARKETS
UNDER A MICROSCOPE

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

April 24, 2018

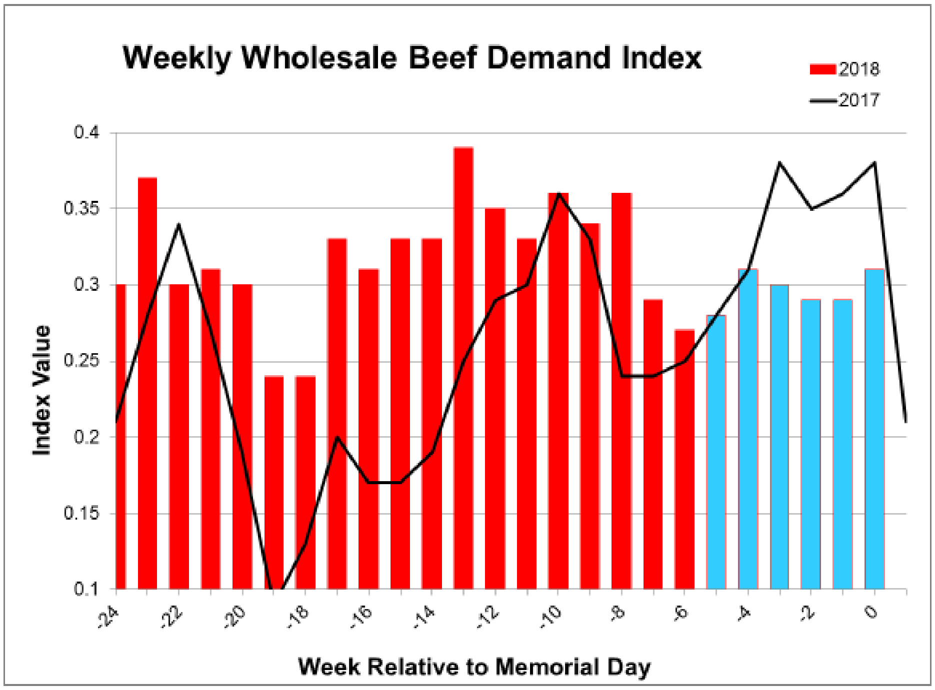
Judging from the 15-year history, the combined Choice/Select cutout value is due to make its next high in the 2nd week prior to Memorial Day…. in the sense that on average, the highest value of the year is registered at that time. It's funny that we're talking about the "next high" when the market has been on the decline for five consecutive weeks and has just now begun to turn around. The fact that the recent slide was prolonged figures into the forecast, and it helps explain why I'm suggesting that the cutout will increase more than usual over the next four weeks.

Over the past two weeks the market lost 2.9%, which is quite unusual. In 16 of the last 20 years, it has appreciated significantly over this time frame. The seasonal rally, in other words, is late getting started…. and because of the delayed start, it will still be relatively young by the third week of May ("M-2" in the graph below). Am I making sense? Picture a short-term cycle that has shifted to the right.



The 4.6% appreciation that I am proposing (from last week's average, that is) would place the combined cutout value—which was quoted at $214.55 per cwt this afternoon—at $220 in the week ending May 19. As you might have guessed already, I don't think this will be the ultimate peak. Because of the demand dynamics that seem to be taking shape, that peak is more likely to occur in June.

So, then, let's talk about demand for a minute. The beef market's hesitation is reflected in the short-term demand readings, which I show in the picture on the next page. The pattern clearly demonstrates that the change in demand since the first of the month has been weaker than the seasonal norm.



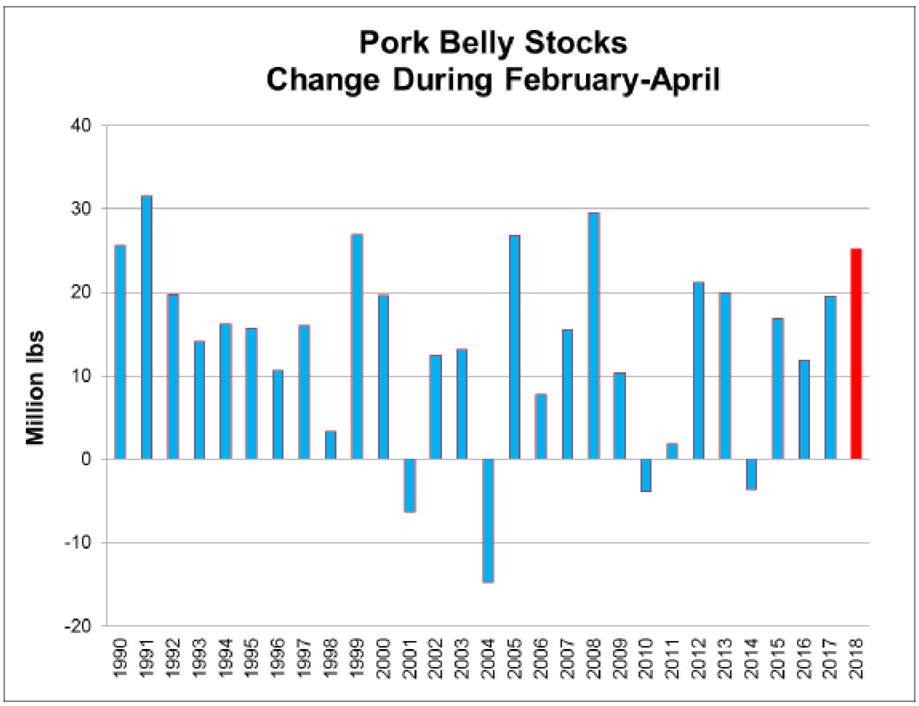
Maybe it's just a convenient explanation, but I think the recent weakness in demand is linked to a lack of forward booking activity for this time frame. If you recall, the quantity of product purchased in advance for delivery in April was rather tepid, and it isn't so hot for the first half of May, either. But it has begun to improve in response to more aggressive forward-pricing by packers. While most of this resurgence will be for June delivery, some of it will fall in the gateway to Memorial Day. As you can see in the picture above, I am assuming that the weekly demand index will remain below its February and March readings until the holiday is upon us (meaning that demand changes will be pretty close to the seasonal norm from *this* point forward) …. and under that assumption, my calculations yield combined cutout values of $218-$220 per cwt in the final three weeks of May. Hence, the 4.6% increase between now and "M-2".

OK, so what about the big increase in production that is supposedly at the doorstep? Well, the demand index takes into account both the seasonality *and* the rate of beef production. In this case, I am factoring in steer and heifer kills that jump from last week's total of 495,000 to 525,000 in the first half of May and 535,000 in the second half. [Some of my astute colleagues tell me that it won't ramp up quite so quickly, because the "calf-feds" in the northern Plains won't be ready for marketing until later. I'm just telling you what the feedlot inventory statistics imply. And I am recognizing that there is a strong incentive for feedlots to market cattle as promptly as possible.] What I'm saying, then, is that under the rather subdued demand scenario described above, an increase in production of this magnitude does not prevent the cutout from gaining another $5-6 over the next four weeks.

Another note on the subject of cattle slaughter: I might have brought this up before, but the issue of slaughter capacity has been mentioned to me by more than one packer. I don't know exactly where the threshold of practical capacity lies, but I can make a guess. In 2017, the maximum daily steer and heifer kill was 98,000. If that rate is sustained Monday through Friday, then the five-day total is 490,000. Add to that the greatest Saturday production of 52,000 in a non-holiday week, and I arrive at 542,000. It may indeed become an issue, especially in June.

Hog slaughter, meanwhile, was up 6% from a year ago this past week, for the second week in a row. So far, second quarter slaughter is matching up fairly well with USDA's fall 2017 pig crop estimate. If it continues to do so, then we should expect weekly kills to average just under 2,300,000 in May (including the holiday week) and about 2,265,000 in June. From the April average of 2,375,000, these seasonal declines would be quite typical.

I maintain more than my usual half-hearted interest in the *Cold Storage* reports because of the pork belly market. **I am becoming increasingly comfortable with the notion that the summer peak in belly prices will fall short of many traders' expectations.**

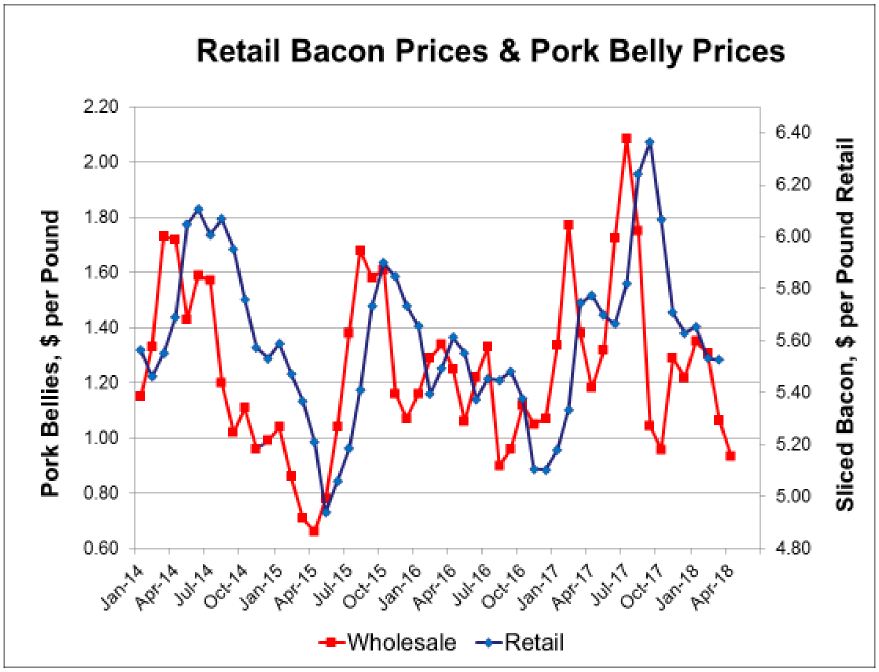


One major reason, of course, is that the buffer stock of frozen product will be much larger than it was last summer. The accumulation of frozen inventories in late winter and early spring has been more aggressive this time around—not dramatically so, but we started out with much more product in the "box" this time. I am assuming that here in April, stocks will have grown by ten million pounds, about the same as in March. That should place the May 1 peak at almost 70 million pounds vs. 34 million a year earlier.

Add to that a presumed 4% year-over-year increase in fresh production, and it looks as though per capita belly supplies during the critical June-July period will be up 6% and the largest since 2002. Mind you, in the "big picture", bacon demand is still growing; and eight weeks of subdued prices here in the springtime have certainly helped lay a foundation for solid retail business through the summer. In June and July 2018, belly prices averaged $1.72 and $2.08 per pound respectively; those levels seem far out of reach.

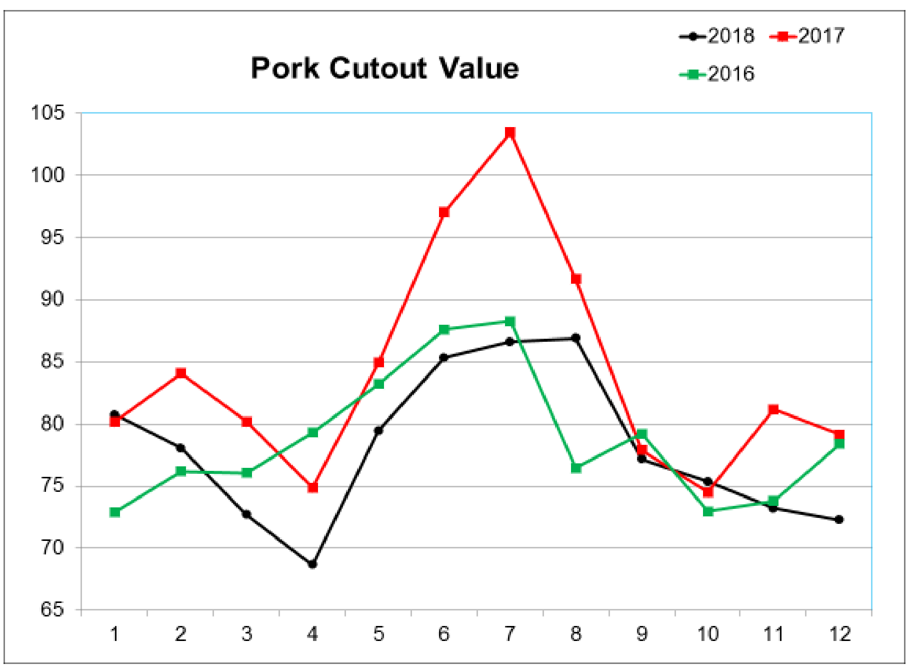
I have three more pictures to show you, so bear with me. They take up a lot of space, but that's better than listening to my blather.

On the next page, I show the situation in pork belly and retail bacon prices as of March. The picture is a healthy one for pork belly demand prospects over the next three months or so.

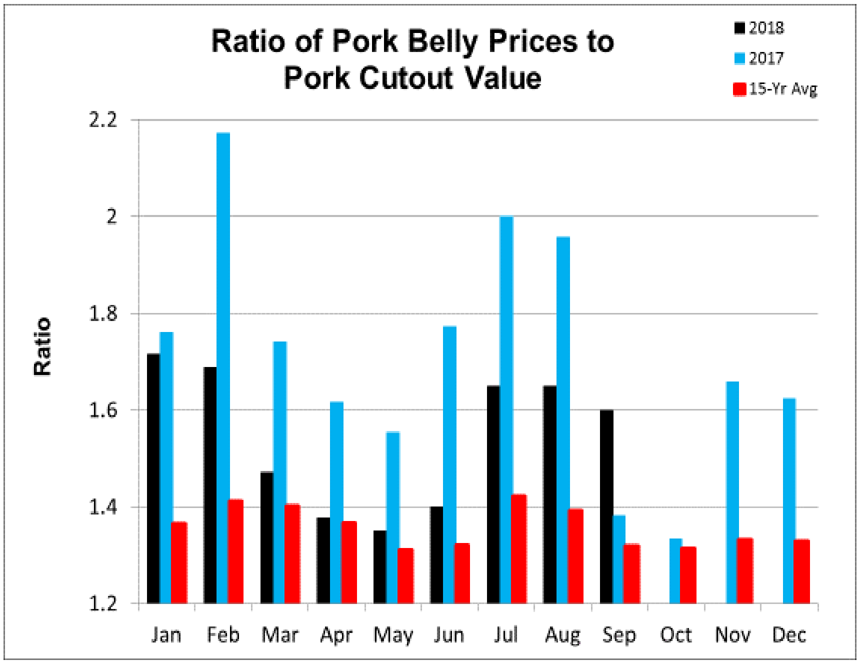


It is bullish of demand because retail bacon prices are trending downward; and it is bullish of demand because the spread between pork belly prices and retail bacon prices is relatively wide. The latter, of course, leaves room for retailers to absorb an increase in wholesale product costs without raising "sticker" prices. I have extended the wholesale price graph to include the month of April.

In next picture I show my humble forecasts of monthly average pork cutout values. Without going into detail at this time, my key underlying assumptions are that: a) USDA's farrowing and pig crop estimates are accurate; and b) the seasonally adjusted demand index will make a rather sharp recovery from its depressed reading here in April and return to where it stood from December 2017 through February 2018…. a pretty reasonable assumption, I think.



In picture at the top of the next page I show the ratio of pork belly prices to the total cutout value, compared with a year earlier and the 15-year average. In March and April, the share of the cutout value carried by pork bellies dropped back to the 15-year average (pretty close, anyway). For reasons I just described, it *should* distance itself from the 15-year average in the third quarter; but I see no compelling reason to think that it will match the exaggerated levels of summer 2017.



Applying these ratios to the forecast of the cutout value, I come up with the following guesses for monthly average pork belly prices:

May	$1.07
June	$1.19
July	$1.43
August	$1.41
September	$1,21

I'll close with a random thought. If North Korea becomes a part of the World Economic "Club", then would this not open a new market for U.S. pork and beef? I know nothing about North Korean culture, but since south Korea is such a big buyer of U.S. pork (averaging 46 million pounds per month over the last twelve months) and beef (averaging 41 million), then why wouldn't North Korea become a customer as well?

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.