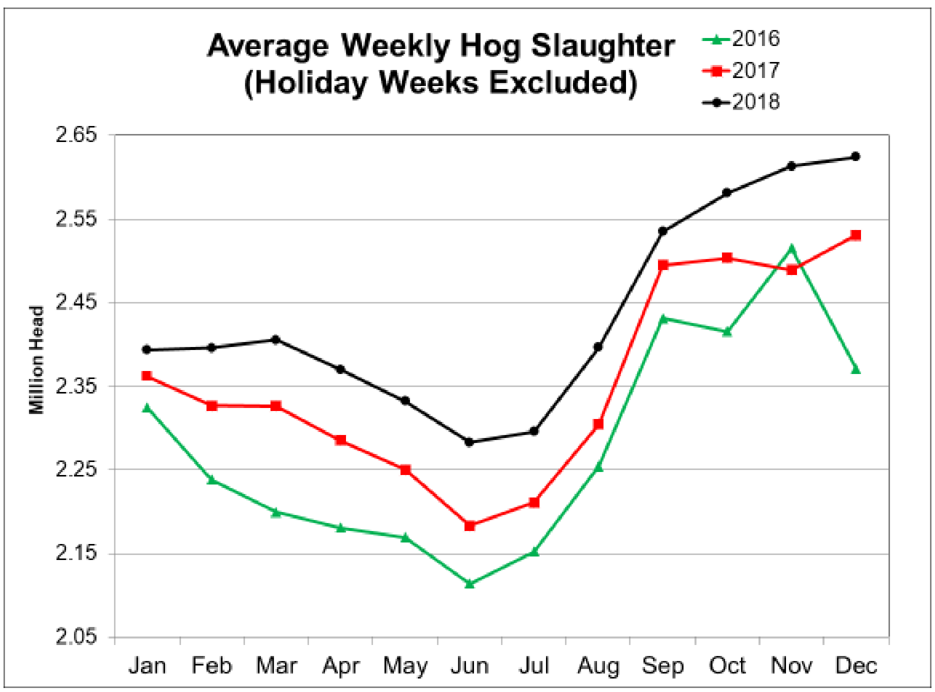
MEAT MARKETS
UNDER A MICROSCOPE

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

April 4, 2018

I assume that you have already seen the numbers in last Thursday's *Hogs and Pigs* report, and so I shall not waste your time by recounting the details of how many pigs were born, and where they live, and what sort of diseases they have dealt with. Instead, I'll start with the bottom line:

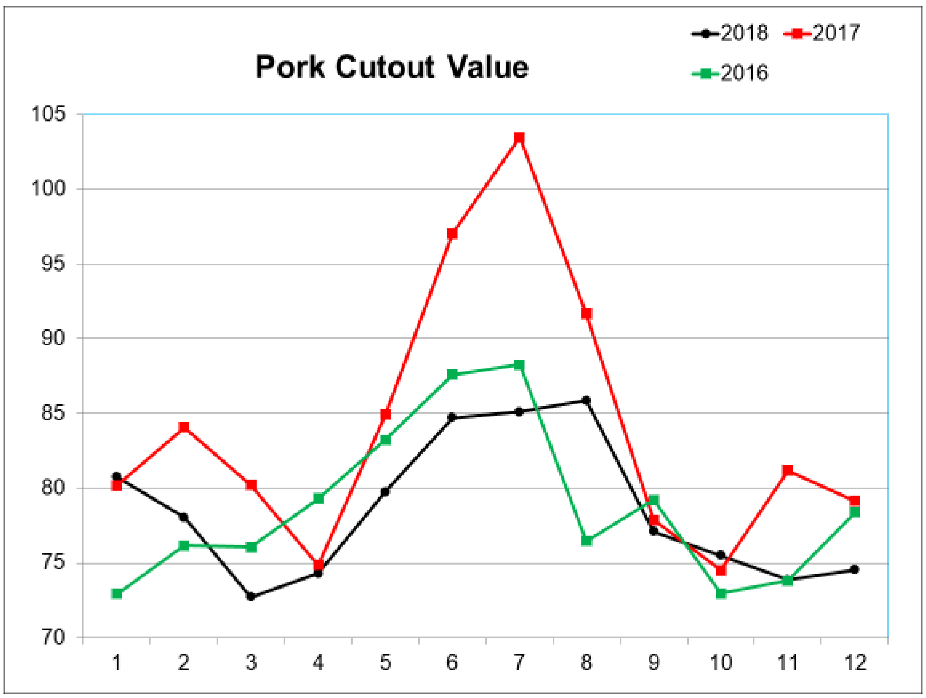


As always, I take USDA's pig crop counts and farrowing intentions at face value. I'll leave it to the People With Secret Information to figure out how and why the government's comprehensive survey is off-base. I also insert into the equation "middle-of-the-road" projections of quarterly hog slaughter relative to the corresponding pig crop; the monthly distribution of each quarter's slaughter; and seasonal changes in pigs per litter this spring and summer. I come up with the slaughter projections shown in the picture above.

If you are keenly perceptive, you'll recognize that supplies are still expanding. In fact, the increase in market hog inventories reported in March was the 13th consecutive quarterly increase. Assuming a typical distribution of each quarterly kill among individual months, the greatest year-over-year increases should be seen in June and November (5%), and the smallest in September (2%).

A more comprehensive measurement of the coming pork supply incorporates carcass weights, freezer stock flows, and foreign trade. I'll go into more detail on these calculations in my next report, after we receive trade data for February. Until then, let it suffice to say that net domestic pork supplies look like they will be up nearly 6% from a year earlier in the second quarter; up 2.5% in the third quarter; and up 4% in the fourth quarter.

Finally, in regard to the pork supply, the question arises again: what is the risk that hog supplies will exceed industry-wide slaughter capacity? Well, according to my better-informed colleagues, it's not likely to happen *as long as spring farrowings wind up near USDA's reported intentions, and as long as at least one of the two new pork plants (in Sioux City and Coldwater) has added a second shift by this fall*. If these things happen, then total capacity should be in the neighborhood of 2,650,000 per week with one of the second shifts added, and almost 2,700,000 with two. Hog supplies should be about 2,615,000 in November and 2,625,000 in December.

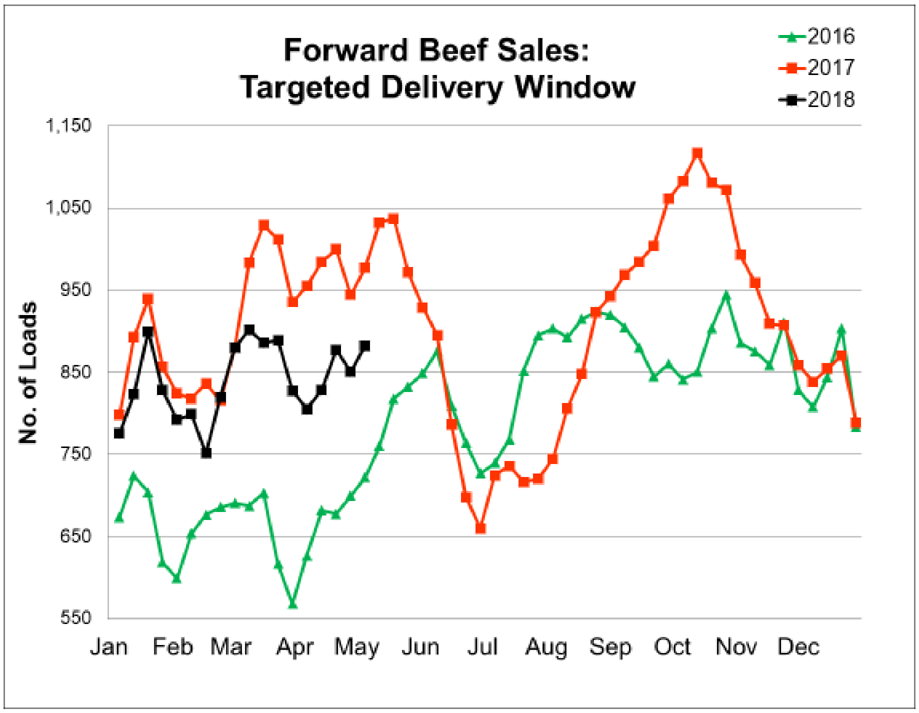


Demand, of course, will be a major determinant of pork prices down the road. I use the same "middle-of-the-road" approach in my attempt to project wholesale demand. I assume that from its present state, it will follow a normal seasonal path, with "normal" being defined as the 20-year average—unless I have a compelling reason to assume otherwise.

In February and March, demand for pork at the wholesale level stood in "moderate" territory in comparison with the past seven years or so, which makes the prospect of a normal seasonal path from this point forward seem likely. One factor that could cause demand to deviate toward the stronger side is that retail pork prices are trending downward, while retail margins are relatively wide right now. These conditions tend to speed up the flow of product through the "pipeline", resulting in stronger demand at the wholesale level. For this reason, I am shading the demand forecast upward between now and the summer…. somewhat. In other words, I am expecting the change in demand to be a bit stronger than the seasonal norm between now and then.

I could go into more detail on this subject, but I'll save that for another time. But when I apply these vaguely-described demand conditions to the supply outlook, it suggests that the pork cutout value will find a summertime equilibrium around $85 per cwt.

In the beef market, I cannot help being influenced by the relatively light volume of product that has been booked ahead for April delivery. I should explain once again that each data point in the picture below is the average weekly volume that was purchased four to eight weeks prior, whether fixed-priced, formula-priced, or otherwise forward-contracted. The final black dot represents the week ending May 5:

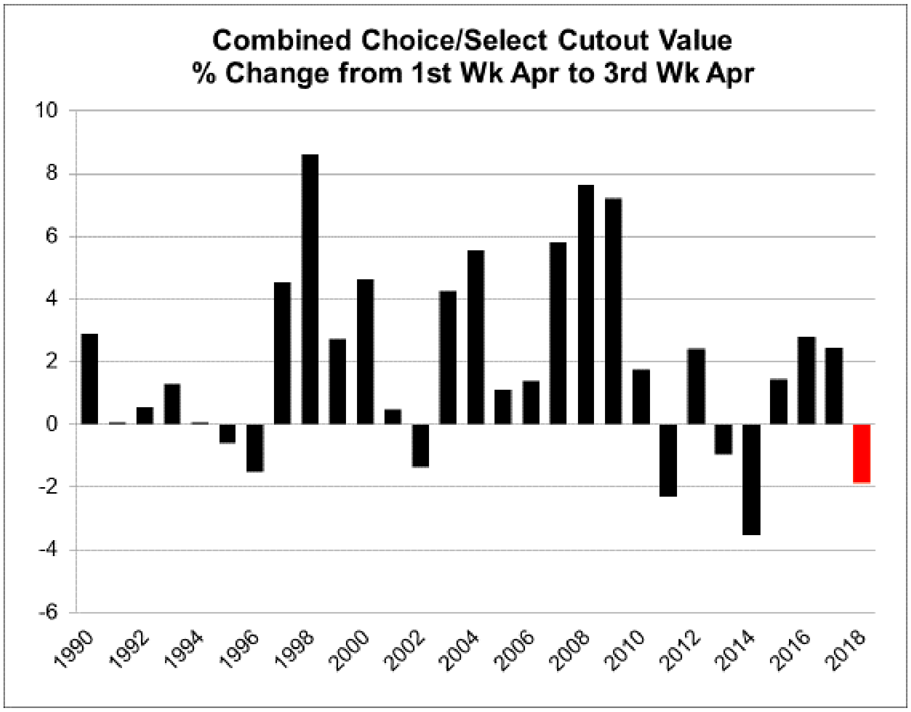


It appears that retailers are not as willing to spend margin in order to generate sales revenues as they were last spring. The statistics generally agree with anecdotal reports that supermarket chains are not satisfied with recent margins.

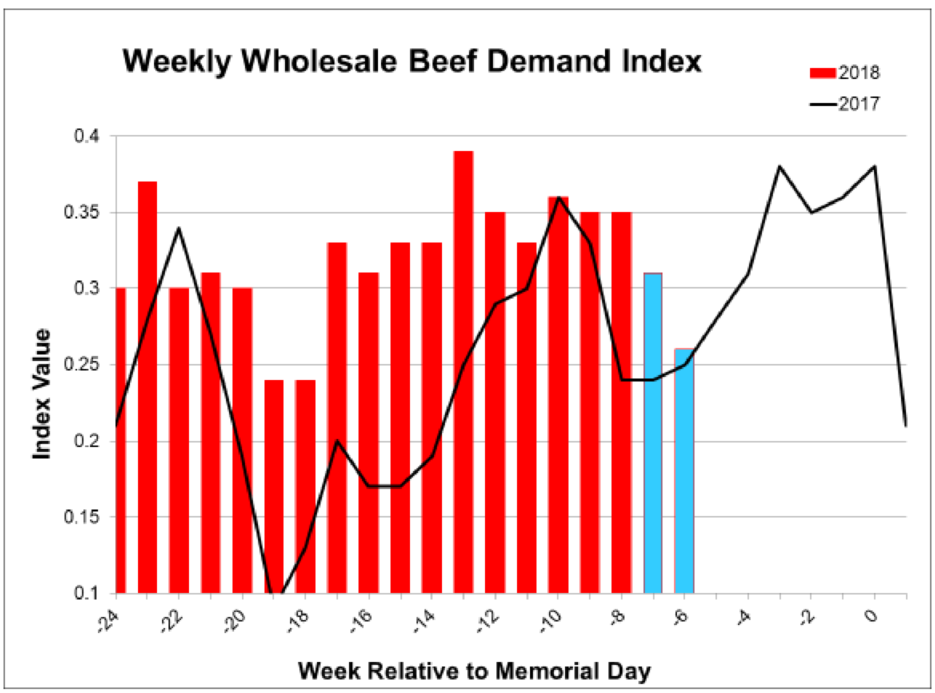
The indication is that demand will be subdued throughout the month of April, and possibly into early May. [Here again, this must be interpreted within the context; demand normally increases from March to April, and I am suggesting that this year's increase could be a bit less than normal.] As I consider the generous amount of product being offered in the spot market right now and the leap in production that looms in the second half of April, I suspect that the current downtrend in cutout values will accelerate.

The combined Choice/Select cutout value was quoted this morning at $217 per cwt. The nearest support level on the chart stands at $210. If it is fall that far before recovering again, then it probably will happen within the next two weeks. And that, in turn, would require an extraordinarily counter-seasonal drop from the first week of April to the third week of April. I show this picture on the next page.

I don' *think* that the combined cutout will go any lower than $210 per cwt before it turns back upward. One reason I say this is because to do so would take an extremely sharp decline in demand within the next two weeks, and demand prospects are not *that* bleak; in fact, this week's demand index reading is turning out to be near the highest of the year so far. I'm sorry, but I have to show you a graph of this as well, in order to explain exactly what I mean by a "sharp" decline. This will be the second picture on the next page.



And why do I think that the cutout will hit bottom by the third week of the month? I admit that I'm simply betting on past performance. In the last 15 years there have been 13 in which the cutout value hit a peak in March and fell backward into April. Among those 13 years, in eleven of them the decline lasted four weeks or fewer (in the other two years it persisted for six weeks. By the third week of April, the current setback will be five weeks old.



And finally, lost among the panic surrounding China's imposition of an additional 25% tariff on U.S. pork is the fact that Japan's "safeguard" tariff on frozen U.S. beef expired over the weekend, reverting the total tax back to 38.5% from 50%. There's not a whole to say about this except that since the safeguard measure went into effect last July, total Japanese imports of U.S. beef have been 20% greater than a year earlier. Hmmm….

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.