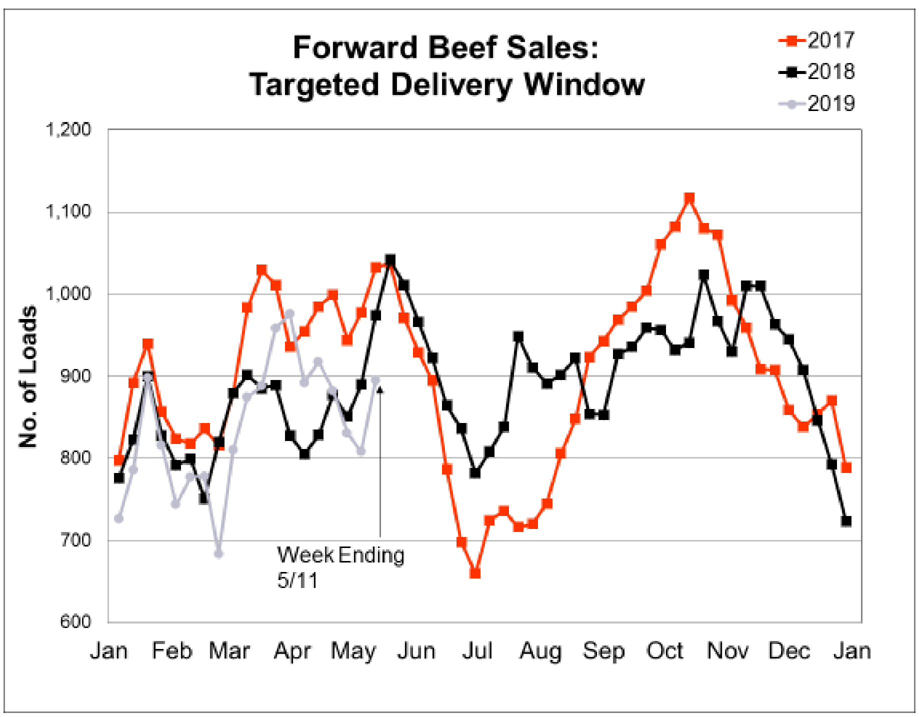
MEAT MARKETS UNDER A MICROSCOPE

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

April 7, 2019

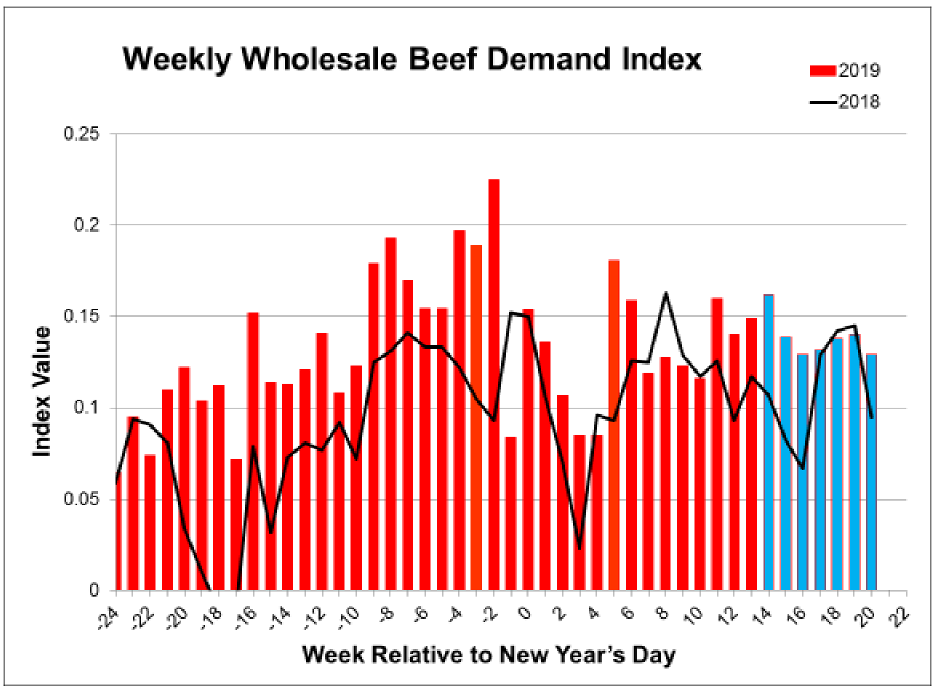
The beef market has held up a little better than I had expected, but then why should I be surprised? The robust volume of product that was booked ahead for delivery in late March and the first half of April was a hint that packers would have relatively little to sell in the spot market in this time frame, and indeed that has been the case. However, as I show in the picture below, there has been considerably less interest in deliveries in late April and the first half of May. Forward bookings into that window have lagged behind a year ago.



Each of the data points in this graph shows the volume of product that was booked four to eight weeks prior for delivery 22 to 60 days out front (whether negotiated or formulated). These numbers really should be interpreted loosely, but they *should* be a decent reflection of supermarket featuring plans. And right now they are suggesting that high-volume, aggressively-priced beef features are not in the works after Easter. Steaks and ground beef *will* be featured, of course; but perhaps not at prices that will move enormous quantities.

I'd like to add a side note on that subject. If pork prices continue their rapid rise--and let's face it, they probably will--then retailers will eventually tend to promote beef in spots where they would not otherwise have done so. But this sort of substitution is a couple months off in the distance, and pork prices are not yet high enough to trigger it. Strap-on, boneless pork loins can still be bought for $1.25 per pound; bone-in loins are available at $.85; pork butts are priced under $1.00. These prices compare with 80% lean ground beef at $1.95.

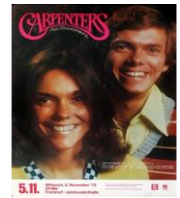
Anyway, my guess is that the current setback in the combined Choice/Select cutout value--which has amounted to only $2 per cwt in its first two weeks--will wind up being a mild one, and this will be followed by a relatively modest rally in May….in other words, a more stable mid-spring market than we saw in each of the past three years. Why not? In recent weeks, wholesale beef prices in general have been neither low enough to spark a surge in demand during May, nor high enough to suffocate it. In each of the last three years, in contrast, there was a $14-$16 per cwt difference between the March weekly high and the April weekly low; the sharp sell-off presented the opportunity to lock in attractive prices for May delivery, which stimulated aggressive beef ads and sparked a strong rally in May. Obviously, the pattern will be different this time around. [If it were to follow its 2016-2018 path, then the market would have lost a lot more ground by now.]



Based on the forward booking statistics, the projected pattern in the weekly demand index shown in the picture to the left (in which the blue bars represent the next seven weeks) seems to be a reasonable expectation. If it unfolds this way, then the combined cutout value will slip about $4 per cwt over the next two weeks, and then climb to a peak of $229-$230 in the middle of May. Friday's quote, by the way, was $225.87.

My forecast includes the assumption that steer and heifer kills will hold steady this coming week at about 483,000 and then work their way up to 530,000 by the week ending May 18. I am expecting that they will average 514,000 per week between now and Memorial Day, which would practically match that of a year earlier….a target well within reach, I think, since the inventory of cattle on feed 120 days or longer was up 7% at the beginning of the month. Feedlot inventories are turning over a bit more slowly this spring, at least in part because price expectations are clearly more bullish than they were at this time last year; the June futures contract is currently trading about $4.50 per cwt under the cash cattle market, compared with a $14.50 discount in the first week of April 2018….offering an incentive to hold on to cattle a little longer.

The pork cutout value has made no headway over the past week and a half, indicating that supply and demand have come into a temporary balance. I emphasize the word "temporary" because the seasonal reduction in hog slaughter has only just begun.



This past week's kill totaled 2,458,000, which was below the March average of 2,497,000; but if we can believe USDA's fall pig crop estimate, then it will drop to an average of around 2,375,000 in the non-holiday weeks of May and to 2.285,000 in June. The $21 per cwt rally that we have witnessed so far has been driven almost entirely by the demand side of the equation.

Last week I showed you some longer-term forecasts of cutout values. Today I'll do the same, only under some different assumptions.

First of all, having attended a summit on African Swine Fever and discussed the topic with several whom I regard as experts within the past week, I am inclined to adopt the following scenario into the pricing equation:

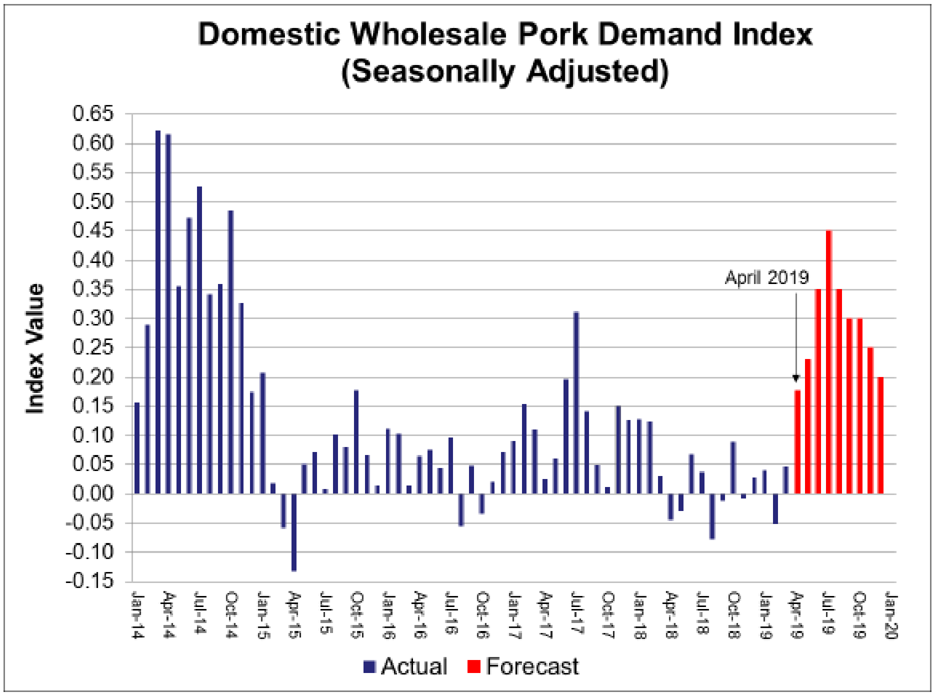
	2018	2019	Change
Chinese imports of pork muscle cuts	1.561 MMT	2.561 MMT	+1.000 MMT
U.S. exports of pork muscle cuts to China/HK/Taiwan	0.199 MMT	.0604 MMT	+0.405 MMT
U.S. exports of pork muscle cuts to China/HK/Taiwan	438 mil lbs	1332 mil lbs	+893 mil lbs
U.S. exports to CH/HK/TAI, Apr-Dec	298 mil lbs	1185 mil lbs	+887 mil lbs
Avg monthly U.S. exports to CH/HK/TAI, Apr-Dec	33 mil lbs	132 mil lbs	+99 mil lbs

According to my sources, the numbers in the table align with a 25-30% reduction in Chinese pork production in 2019. And importantly, they assume that of the one million ton increase in Chinese imports, the EU and the US will garner 40% each, and all other suppliers (mainly Canada, Brazil, Chile, and Mexico) will split the other 20%. A 40% U.S. share may seem a bit ambitious, but I consider that: a) if China needs pork this badly, then the retaliatory tariff on American product will be removed, one way or another; and b) among China's current suppliers, the U.S. has the greatest capacity to expand shipments to China.

My export projections are somewhat higher than I was proposing last week. But the variable that I'm *really* scrutinizing right now is the domestic demand for U.S. pork at the wholesale level.

Of all the variables in the pork pricing equation, this is the most influential. At the moment, it is the most volatile, and the most difficult to project. Although I feel as though I'm just taking a blind stab at it, I am taking a few key considerations carefully into account.

One is the reference to 2014, which was the last time domestic pork supplies took such a sharp downturn as we are facing today. This gives us some idea of how high the demand index can go, as rapidly tightening supplies clash with an inelastic demand for hams, bellies, trimmings, and boneless picnics. The demand for loins, butts, and ribs is more responsive to wholesale product costs because these items are marketed primarily through supermarket channels, where consumer-level prices are adjusted more quickly. Anyway, the seasonally adjusted demand index spiked dramatically in 2014, as I show in the picture on the next page. I am adjusting my projections to assume that the index values approach, but do not quite match, their 2014 peaks. The reason to think that the peaks might be lower in this case is because the market has been given more time to anticipate the decline in production. In 2014 we were dealing with the PED virus, which was a brand new, and more mysterious, phenomenon.

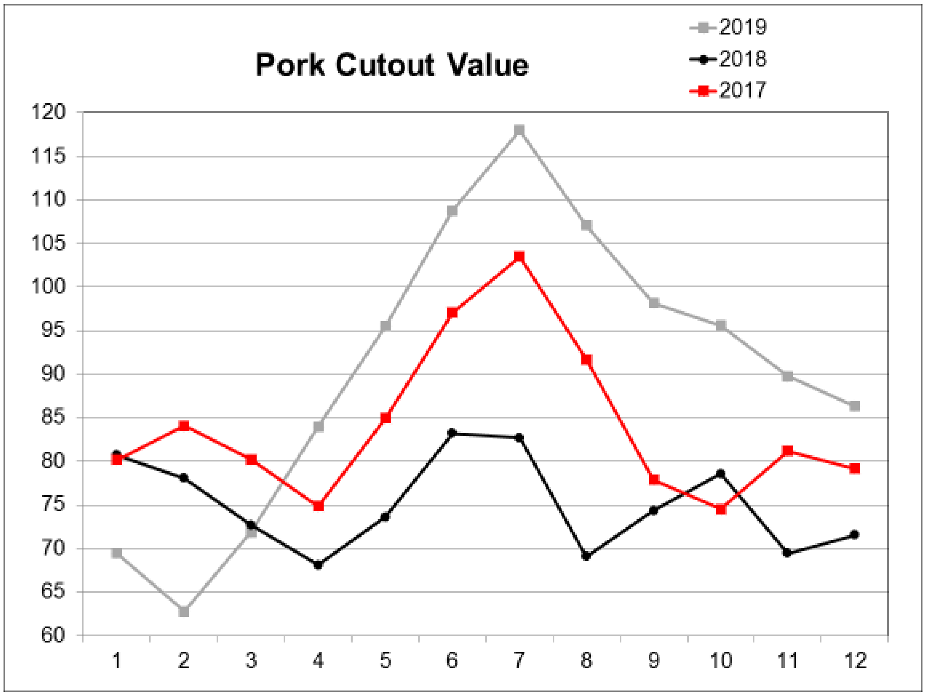


A second consideration is that the sharpest increases in wholesale demand are likely to occur in the early stages. The current leap in demand got underway in the second half of March, and my guess is that it will have reached its zenith by July. Something similar occurred in 2014. There is a sort of panic that sets in as buyers first realize that something big is happening, and they scramble to secure some degree of price protection. The aggressive buying posture persists, but after the initial "rush" it becomes more measured.

A related consideration is that over time, the market does adjust to the smaller domestic supply. It's not difficult to imagine that China will outbid U.S. consumers for American pork, but the result will be a contraction in domestic demand. As wholesale prices escalate, supermarket sticker prices and restaurant menu prices will also rise to the point that marketing and promotional plans will be altered; the flow of product through the domestic "pipeline" will slow down. At what point? Well, that's what we're trying to figure out. All this will take some time, of course, probably months; but it will happen eventually.

Apart from China, foreign demand for U.S. pork will also be affected by substantially higher prices. But I will leave that discussion for another time.

And so, when I combine the demand projections shown above with a roughly 4% increase in U.S. pork production and a 30% increase in total U.S. pork exports in the second half of the year, I come up with the cutout value forecast displayed on the next page. It suggests that the cutout value will climb another 45-50% before it reaches a peak in midsummer.



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