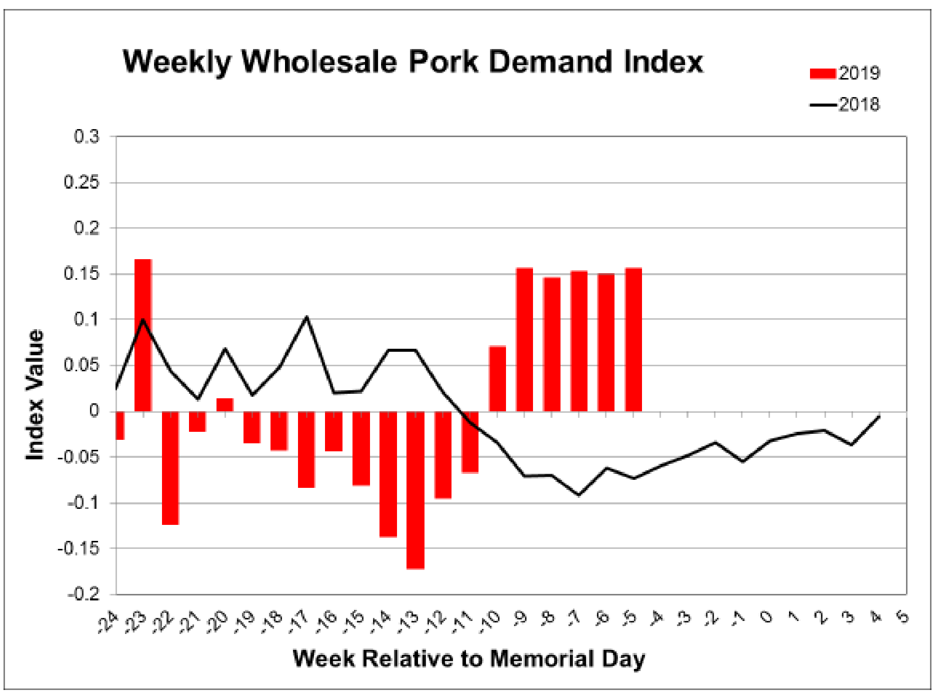
MEAT MARKETS UNDER A MICROSCOPE

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

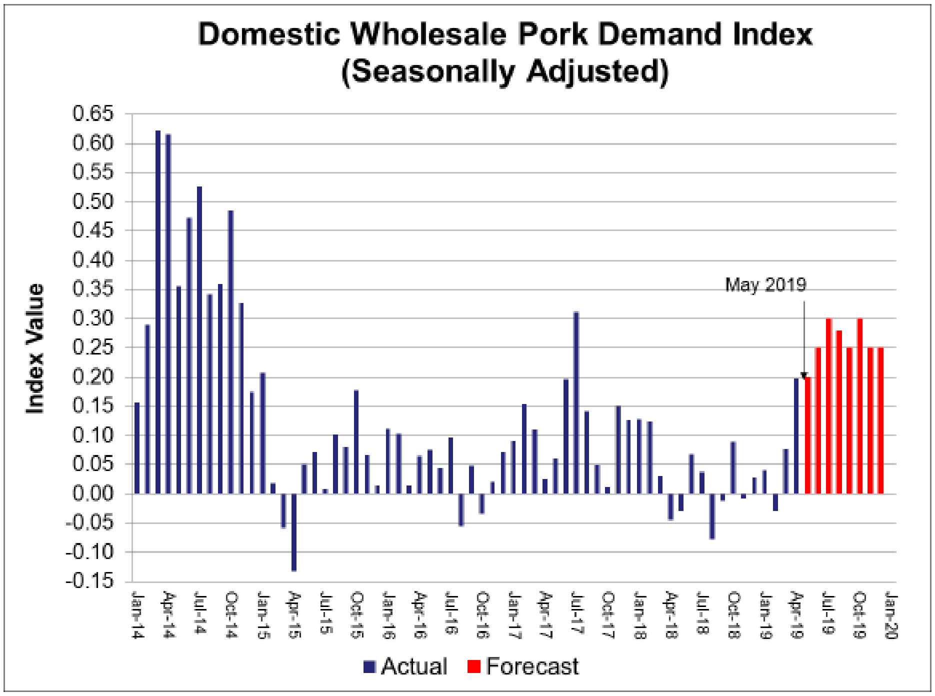
May 1, 2019

Clearly, the most critical variable in the pork pricing equation at the moment is the rate of demand for pork at the wholesale level. And while I fully expect that it will remain well above a year earlier, I am now thinking think that my previous projections were overly ambitious.

This was not revealed to me through a vision, but simply by acknowledging its recent behavior. In hindsight, it is now quite obvious that the initial surge in demand, commencing with the first reports that China had actually begun to purchase large quantities of U.S. pork, lasted about two weeks. In the four weeks that have passed since then, demand has merely undergone normal seasonal changes. This is reflected in the seasonally adjusted index shown in the picture below, which has remained flat:



So, then, will demand continue along a seasonally typical path? I have to think it will do better than that, because the market is transitioning from larger domestic supplies to smaller supplies (relative to a year earlier, I mean). As supplies shrink--as they are increasingly siphoned off into the Chinese market--the more elastic layers of demand are peeled away and the "hard-core", inelastic layers are exposed. As this occurs, greater price increases are required to bring supply and demand into balance. The result is stronger demand measurements. I realize how insane this may sound, but it really does work this way.



It's hard to move away from this subject, which I have addressed *ad nauseam* in recent weeks, because it makes all the difference in the world. For example, if my projections of production and exports are in the right ballpark; and if the demand index were to hold steady at its April reading (i.e., if demand were to follow its normal seasonal path, no better, no worse); then the pork cutout value would rise to a peak monthly average of $97 per cwt in July. That would make for a sub-par increase from April to July, as compared with the 15-year history. On the other hand, if the index value were to jump to, say .45, nearer to the spike highs of 2014, then under the same supply assumptions, the cutout value would average $117 per cwt in July.

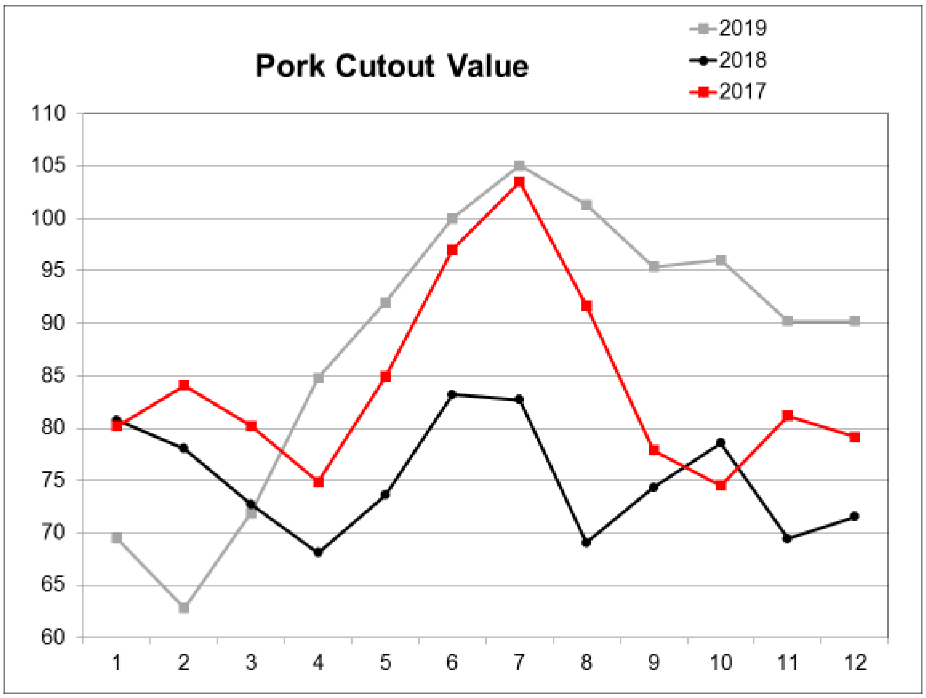
As you can tell from the chart, I am choosing a scenario that lands somewhere in-between. I have clumsily explained why pork demand should outperform its seasonal norm over the next few months. The reason I doubt that it will leap to its 2014 extremes is because it is unlikely that the market will be dealt any sudden, intermittent surprises. In 2014, we didn't really know what Porcine Epidemic Diarrhea *was,* and had no way of predicting how much damage it had done to hog supplies; we found out week by week, and the market had not taken any meaningful preparations. In the current case, although we don't know how much pork China will eventually import, it looks as though the purchases will come in a relatively even flow of increasing volumes, rather than in big, unannounced chunks (as occurred in 2007-2008). The market is most certainly preparing for the increase in exports and higher prices, and has been for some time now.

I have not changed my export projections within the past couple of weeks, although I know that they will continue to be a moving target. They are displayed in the table on the next page. I shall not try to defend the projections for each individual destination at this time, but I will say that among my assumptions are a removal of the 20% Mexican tariff by early summer; the beginning of a drawn-out schedule of reduced Japanese tariffs under a new bilateral accord; and a withdrawal of the 50% retaliatory tariff by China late in the second quarter--although I do not regard these as a major impediment to *de facto* shipments (via Hong Kong) to China in the meantime.

Finally, my current guesses of monthly average cutout values are also show on the next page.

U.S. Pork Exports (million pounds)

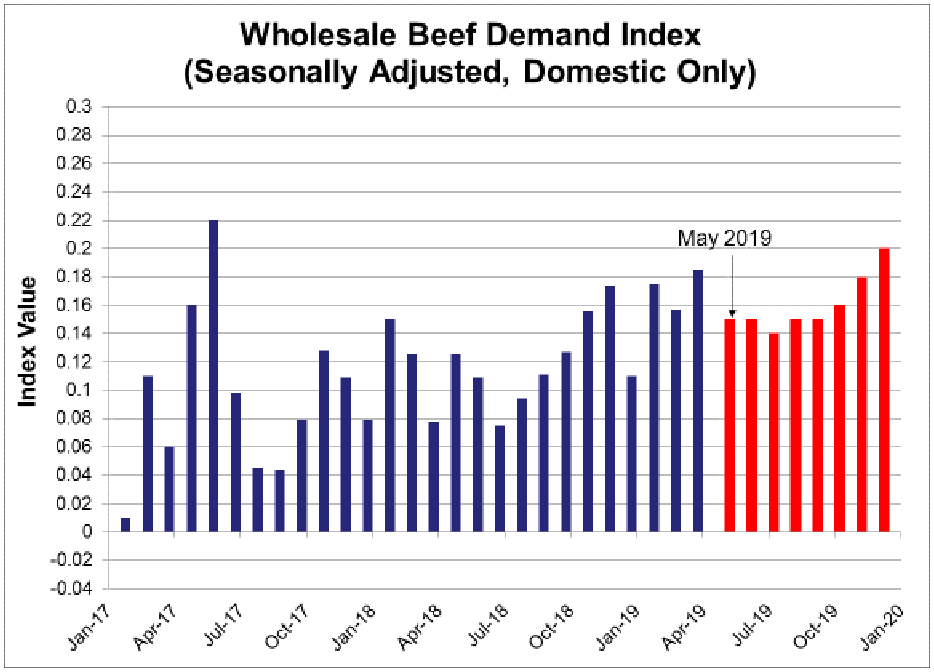
	Q2 Quantity	Yr/Yr Change	Q3 Quantity	Yr/Yr Change	Q4 Quantity	Yr/Yr Change
Mexico	395	-18%	428	+7%	490	+14%
China/HK/Taiwan	285	+131%	410	+427%	490	+408%
Japan	290	-3%	279	-5%	291	-5%
Korea	195	Unch	120	+9%	222	+5%
Canada	130	+4%	140	-1%	140	+1%
Columbia	82	+18%	69	+23%	95	+3%
Australia	73	+44%	53	+6%	65	-5%
Total	1639	+8%	1676	+29%	2011	+30%



It looks as though the combined Choice/Select cutout value has established a new level of resistance at last week's high of $232.21, one that might very well hold up through the end of the year. It has slipped $3 per cwt since that high was made, and the undertone is weak as we head into the month of May. Even so, it still seems more likely that the trend will be sideways--not lower--between now and Memorial Day.

Without question, wholesale beef demand is due for a short-term cyclical setback following its unusually strong performance in April. The notion that the seasonal increase in demand from April to May will be sub-par this time around is confirmed by the relatively light volume of product that was booked ahead for May delivery--which in turn indicates that supermarket features will be unaggressive. I'm sure that you're sick of hearing this story by now, and so I'll spare you the details today.

But I am trying to build into the forecast a substantial drop in the monthly demand index, as I show on the next page, and yet I come up with an average combined cutout value in May that is very close to yesterday's closing quote ($229 per cwt). And this makes sense to me, because all of the Choice middle meats, although they have probably realized their full upside potential, appear to be in pretty decent balance. Among other major items on the menu, only ground beef seems vulnerable to a downturn. I include this one because it has been bumping against the $2.00 per pound resistance level since mid-March and asking prices this week have softened.



Preliminary indications show that demand for June deliveries *may* be perking up. It's too early to draw a conclusion, though, since bookings for June retail features are still being made. I must say, I am a bit doubtful that beef ads in June will prove to be the type of low-priced, high-volume attractions that would result in tight spot market supplies. Up to this point, buyers have not been given an opportunity to lock in product costs that are cheap enough to make this happen--especially since retail margins are rather thin right now.

I'll give you some examples. In the past couple of weeks, forward price offerings on Choice boneless ribeyes have been in the neighborhood of $8.50 per pound; Choice short loins, $6.75; Choice strips, around $8.25; in all of these cases, forward prices are on par with the current spot market.

The same sort of "ho-hum" forward pricing exists in other items: briskets at $2.65 per pound; inside rounds at $2.20-$2.25; bottom round flats at $2.00-$2.05; and 81% lean ground beef at $2.05. They're not bad, just not terribly exciting.

It is apparent to me that before there is to be another surge in wholesale beef demand like that which we witnessed in April, prices will have to come down first….and I mean more than just a little bit.

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.