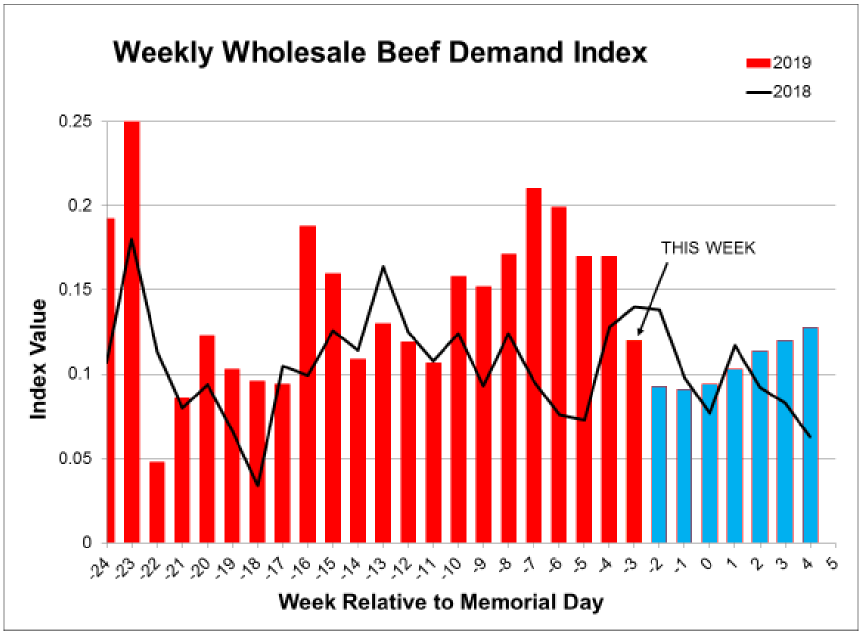
MEAT MARKETS UNDER A MICROSCOPE

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

May 10, 2019

By now, it is clear that beef packers were not very "well-sold" into the month of May, and consequently have wound up with a lot of product to be offered in the spot market. It is also clear that the "pipeline" is fairly full; if it weren't, then buyers would have been more anxious to snap up the heavy offerings for nearby delivery. To state the obvious, the demand at the wholesale level is not keeping pace with the seasonal increase in production.

OK, so where does it go from here? Well, a snapshot of demand is always a good place to start. While I had suspected that the change in demand from April to May would be sub-par (due to the light forward booking volumes and the extraordinary spike in demand during April), the drop in seasonally adjusted demand readings is surprising. In the picture below, the blue bars represent the final seven weeks of the second quarter:



What has happened here is that seasonally adjusted demand has simply fallen back to where it stood in the second half of February and the first half of March--which was quite respectable, just not as strong as it was during the "April Spike".

Now, while you might raise an eyebrow at the decline that is predicted for next week, this is, in fact, what the demand index value will be if the combined Choice/Select cutout value holds steady at yesterday's quote ($219 per cwt) and steer and heifer kills remain just above 530,000. Remember, the index is comparing the current supply/price combination with the 15-year average *for the same week*.

Prices have adjusted pretty quickly to the imbalance of supply and demand (after all, the combined cutout value has dropped more than $10 per cwt over the last eight trading days), and considering where the demand index now stands, it seems reasonable to think that it will remain about where it is through the balance of May. Apart from a hard cutback in production (a ridiculously unlikely possibility at this juncture), there is really nothing the market can do to change the course of demand prior to Memorial Day.

However, retail ads for the second half of June are still in play. In order for these ads to be generated, pricing into that delivery period will have to come down. This process has already begun (although it has *just* begun), now that spot pricing has plunged, and the June futures contract is carrying a $9 per cwt discount to the cash cattle market. Hence, the upturn in the projected demand index depicted by the blue bars in the graph on the first page.

Anyway, if fed cattle slaughter holds basically steady with its current rate and demand follows the suggested path, then the combined cutout value will also hold basically steady, finding an equilibrium around $220 per cwt through the month of June. This will make for a different price pattern than we witnessed in the last two years, when the combined cutout lost $13-$14 from the second week of May to the fourth week of June.

Items of particular interest:

- <u>Chuck rolls:</u> This item has been depressed all year, and I am embarrassed to admit that I don't know why. Whereas the total cutout value has averaged $.07 per pound higher than a year ago so far in 2019, chuck rolls are down $.38 per pound. Currently they trade at their lowest levels since August 2017. It is especially puzzling because this has been a favorite in Korea, where export business has generally been very stout. All I can say is that whenever--and for whatever reason--they turn around, they have a *lot* of upside potential from here.

- <u>Inside rounds and bottom round flats:</u> While the former have suddenly dropped roughly $.25 per pound after being remarkably stable all year long, the latter have consolidated for a month since they took a dive in late March/early April. The similarity between the two is that they are now situated just above $2.00 per pound, which should be a solid floor….largely because 85% lean trimmings are trading at practically the same price level, which means that they are worth more as grinding material (considering the cost of fabrication and packaging).

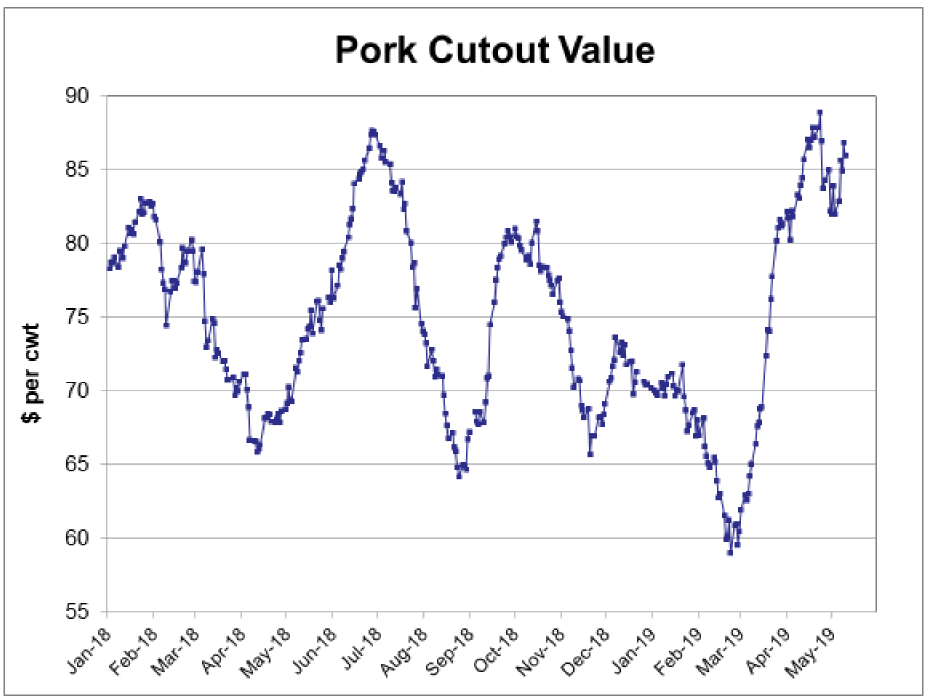
- <u>50% lean trimmings:</u> The 10¢ per pound pullback over the past week and a half looks like a correction within an uptrend. Even though fed beef production has ramped up and there has been a fairly consistent seasonal tendency over the last 15 years toward lower prices into June, there is a good chance that the April 22 high ($.92 per pound) will be exceeded by the end of the second quarter. I'm not sure how interchangeable beef and pork trimmings really are, but I notice that since 1990, the premium of pork "72's" over beef "50's" has never exceeded 38¢ per pound during the summer months. Pork trim has already topped $1.00 per pound this spring, and is sure to go higher once the split-carcass shipments begin to go to China in meaningful quantities.

The official export statistics for the month of March yielded a *few* clues to what is (or is not) happening in the way of shipments to China. The bipolar futures market has swung from euphoric to depressed and back with each morsel of hearsay that surfaces regarding trade talks or export sales, and I'm sure it will continue to do so. That's what makes it fun, isn't it?

The only information we can treat as Gospel right now are the actual volumes counted by the U.S. Census Bureau as they leave the U.S. port--which, unfortunately, are reported about five weeks after the end of each reference month. But I'm not complaining.

The amount of pork shipped to China/Hong Kong/Taiwan during March, at 52 million pounds, was pretty close to my guess--giving me some false confidence in the projections I'll show you in a minute--and notably, it increased by 16 million pounds from February. This compares with a 1.5 million pound *decrease* during the same period last year and an 8.7 million pound increase the year before. It was the third largest February-to-March increase since 2000, behind 2016 (22 million) and 2015 (18 million). So it was indicative of the budding business that we *think* lies ahead.

We have all been comfortable with the notion that the market would tell us when there were significant volumes of product being siphoned away from the U.S. market, but it's not easy to interpret the signals. I notice, though, that the pork cutout value rallied $28.43 per cwt from the first of March to the 23rd of April, then pulled back just $6.93 over the following week; and since then it has turned back upward:



To me, this suggests that it "overshot the mark" (as it always does), but not by a whole lot. The fact that it has stabilized at this sharply higher level might also suggest that there is more to this rally than can be explained by a seasonal decline in hog slaughter or a short-term cyclical upturn in domestic demand. Naturally, I would assume that if the cutout value is able to push through its April 23 peak, it will have begun another major leg upward.

Now, I realize that pork bellies were mainly responsible for the downward correction in the cutout value, and they will largely determine the trajectory of the cutout value from this point forward. It is obvious now that belly prices had to come down substantially in order for processors to generate a sufficient amount of bacon business (through forward contracting) for the remainder of the spring and early summer. This has become a sort of springtime ritual over the last couple of years. What is apparently different this time around is that it took much less time to get these orders written….which makes perfect sense amid the fear of skyrocketing prices this summer. If pork belly prices have indeed begun an extended upward trek, then it should not be long before the cutout value pushes into new highs for this move.

It is also worth mentioning that pork loins likely will be widely featured by supermarket chains through the balance of May, and quite likely beyond. This is the word in the Sewing Circle, and I can believe it. First of all, considering the lack of aggressive beef ads scheduled for May, pork is a logical beneficiary. Secondly, pork loins are not expensive. In fact, they are still cheap. Bone-in loins are averaging about $.96 per pound this week, the same as they were at this time last year--and 26¢ per pound below the 15-year average for this date. Boneless loins, at $1.22, though up 11¢ from a year ago, are 40¢ per pound below the 15-year average. I am amazed by the stories I am reading about how more expensive pork is driving business toward beef. Really? Down the road, probably, but certainly not now.

OK, then, back to exports. I am guessing that U.S. pork exports to the "Greater China" region will move gradually upward, from 52 million pounds in March to 80 million here in May and 115 million in July, and eventually up to about 165 million per month in the fall. At the same time, shipments to Japan will continue to lag because of the much more favorable tariffs that are being applied to European and Canadian product; and shipments to Korea are running strangely below a year ago, for reasons I do not know. Anyway, here is the total picture as I see it:

U.S. Pork Exports (million pounds)

	Q2 Quantity	Yr/Yr Change	Q3 Quantity	Yr/Yr Change	Q4 Quantity	Yr/Yr Change
Mexico	384	-20%	428	+7%	490	+14%
China/HK/Taiwan	245	+99%	400	+414%	490	+408%
Japan	276	-8%	267	-9%	280	-8%
Korea	155	-20%	97	-12%	182	-14%
Canada	142	+14%	151	+7%	147	+6%
Columbia	81	+17%	69	+23%	95	+3%
Australia	70	+38%	54	+8%	65	-5%
Total	1529	+1%	1638	+27%	1962	+27%

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.