MEAT MARKETS
UNDER A MICROSCOPE

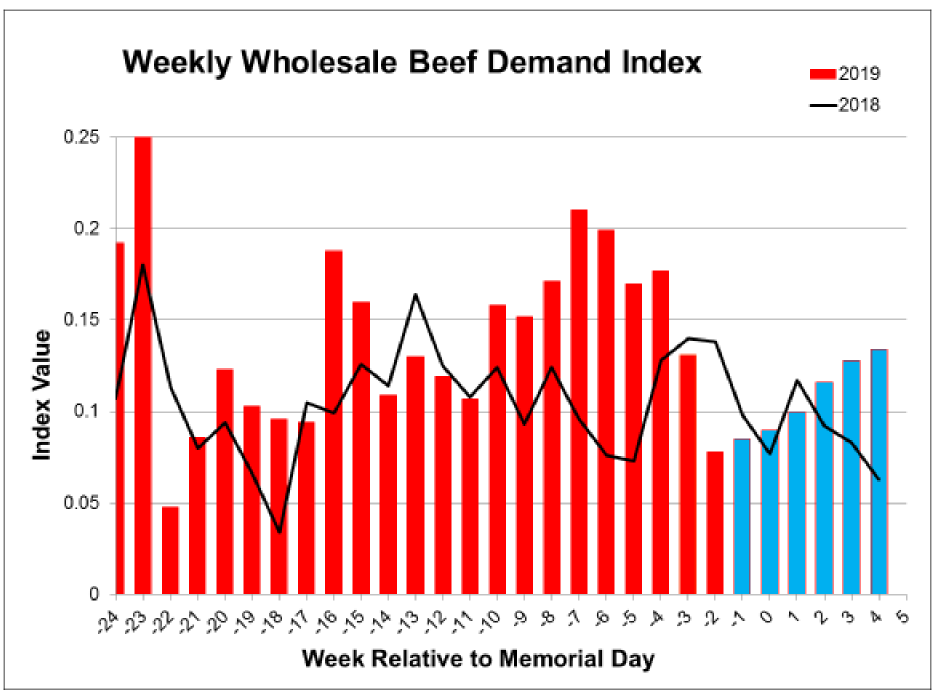
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

May 18, 2019

The combined Choice/Select cutout value has probably established its low until July. It has pulled back into a conspicuous support area on the chart (the November-February high, essentially), and supply and demand appear to have come into balance in the spot market at these price levels.

My guess, though, is that there will not be a meaningful advance until the middle of June. I'm keying off the pattern in forward booking volumes, which have picked up considerably and are now outpacing those of a year ago. I suspect that forward sales this past week--to be reported Monday--were quite active as well. However, the renewed interest did not surface until the end of April/early May, and so it pertains mainly to second half June deliveries. In the meantime, packers should have an ample amount of product to offer into the spot market.

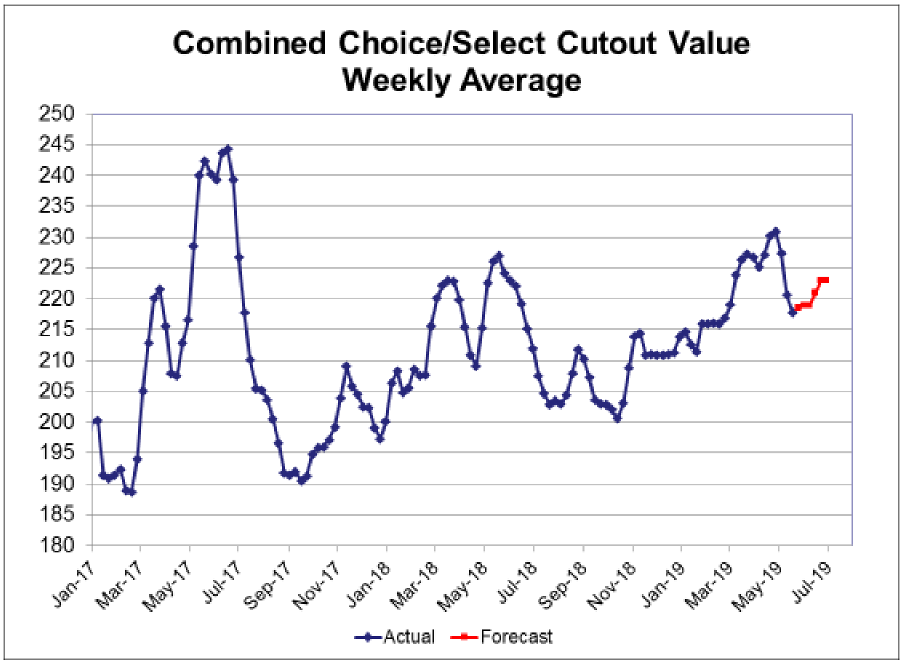
The weekly index of wholesale beef demand clearly confirms that demand has hit a "pothole" here in May….a natural consequence of the short term cycle, which peaked in April, and the relatively stiff prices that were offered in the forward market for May delivery:



In the picture to the left, this past week is represented by the final red bar. The blue-colored bars are my humble forecasts through June. It won't unfold as smoothly as I am showing here, but I am trying to depict the moderate recovery in demand that I think we're headed for….nothing spectacular, but significant.

Neither fed cattle slaughter nor carcass weights have delivered any real surprises lately. The former is running at a pace of about 534,000 so far in May, and it appears that both front-end cattle supplies and beef demand will support something in the same neighborhood in June (532,000 is the number I am using in the forecasting equation). It looks like steer carcass weights will average six pounds above a year ago at 854 pounds in May and--following along a seasonally normal path--nine pounds above a year earlier at 866 pounds in June.

When I combine the demand index projections shown above with this rate of fed beef production, I come up with the following forecast of weekly cutout values:

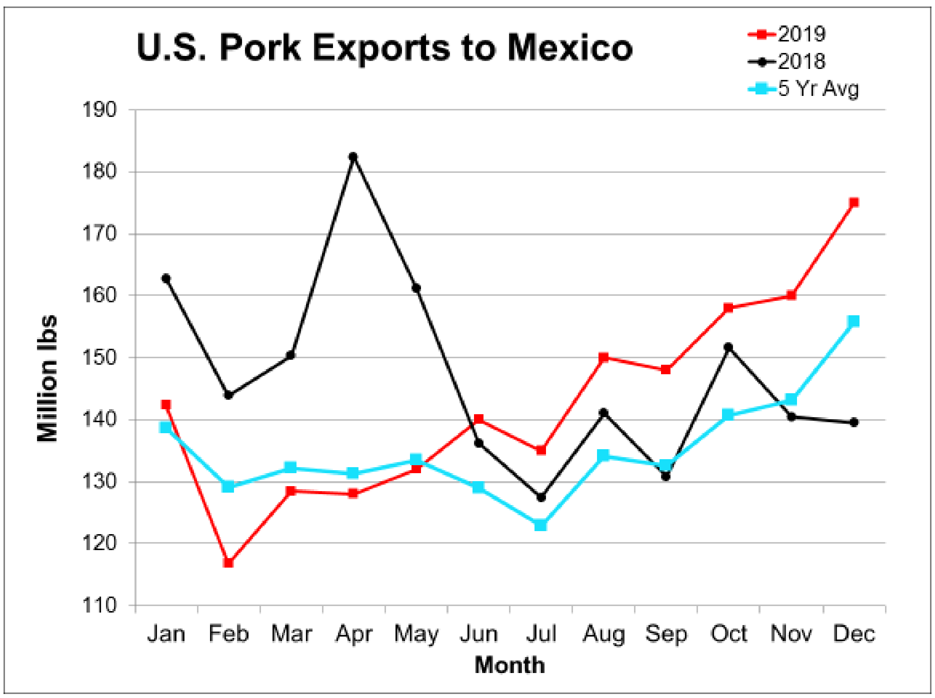


I'm talking about a basically sideways price pattern over the next three weeks, followed by moderate appreciation into Independence Day. This is a different pattern than we witnessed in the last three years, when the combined cutout value lost roughly 5% (or $11-$13 per cwt) from Memorial Day to the final week of June. It is a reasonable expectation, considering that it's pretty unusual for the market to lose ground during May as it has this year.

From a broader perspective, the market is doing what it needs to do in order to rebuild demand, and because of the timing of this development, we *probably* will not see cutout values fall as hard in July as we have come to expect in recent times. If the beef market behaves in June something like I show in the picture above, then my guess is that the combined cutout in July will average near $216 per cwt, $3 below Friday's quote and about 2.5% below the expected June average. The 2.5% decline from June to July compares with a 5.8% decline last year; but when you look a little farther back through the history, you find that it's not terribly unusual. The futures market, however, is discounting an average cutout value of $224 in June and then a 7% drop to $209 in July. **If futures-implied pricing reflects the majority opinion among traders, then the lack of weakness in beef prices after Independence Day will catch buyers and sellers by surprise…**and we all know what surprises can do to demand at the wholesale level. There is a good chance that as we move through July, the pipeline will empty out--i.e., buyers will allow their physical and "paper" inventories to draw down in anticipation of lower prices, and they will wind up bidding the spot market a bit more aggressively than they would have otherwise . This should result in somewhat stronger seasonally adjusted demand readings than we are witnessing right now. As a futures trader, this prospect makes me want to place a bet on the long side of the August futures contract (maybe not right away, but at some point), which closed Friday about $7.50 per cwt below the current cash market. This is not a popular opinion.

It sounds like the Mexican tariffs on U.S. pork are being lifted, and I surmise that this is happening immediately. I assume that since the U.S. tariff on Mexican and Canadian steel are being dropped as we speak, all retaliatory penalties will follow suit without having to wait for congressional approval (which takes almost as long as obtaining a building permit in Cook County, Illinois). This is of no consequence to the beef market, since neither Mexico nor Canada applied duties to raw beef last year.

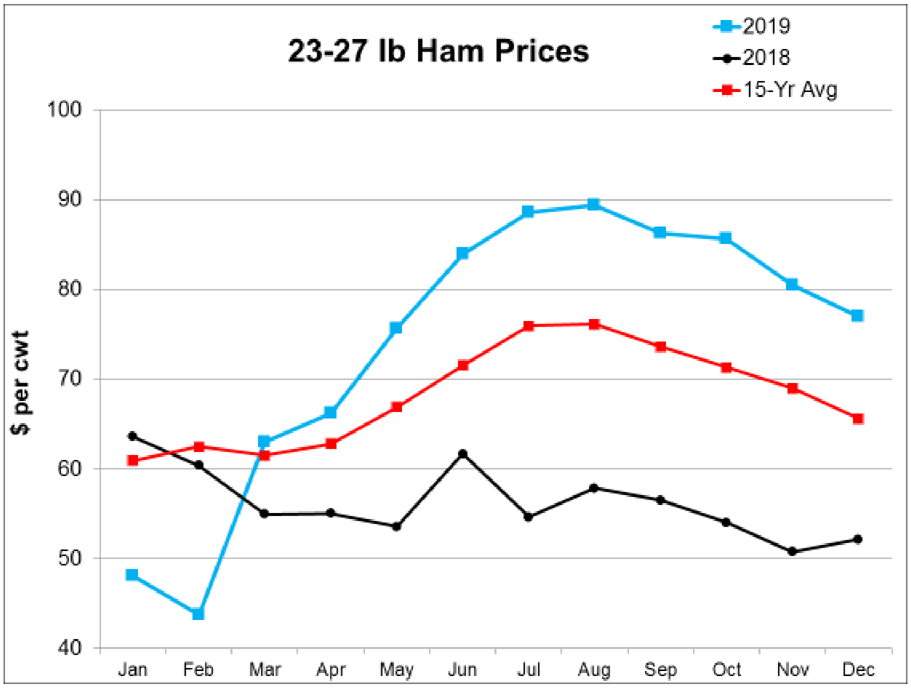
It *is* a big deal in the pork market, though, and specifically in the ham market. It's pretty obvious from the picture below that Mexican buyers loaded up on U.S. pork ahead of the tariff imposition in June, and then slacked off as one would expect. In the second half of 2018, shipments to Mexico dropped 9.5% below a year earlier, and they were down 15.2% in the first quarter of 2019. It's easy to figure out, then, why I am projecting a 10% year-over-year increase in the second half of 2019. The only think I can think of that would prevent exports to Mexico from rising further higher is the price level.



Ham prices rallied into new highs for the year this past week, and they stand at their highest level for this point on the calendar since 2014. While some of the strength *might* be attributable to anticipation that the Mexican tariff would be removed, the word in the Sewing Circle is that fairly large quantities of hams (and shoulders) have already been going to China.

When I try to project the ratio of ham prices to the pork cutout value month by month through the end of the year, the best I can do is to keep it close to the 15-year average. I would like to think I could better, but what is the alternative? This ratio has been swinging around quite a bit so far this year: in January and February it was far below its long-term average for that month; in March it was extremely high; in April it went back to a ten-year low; and here in May it is very high once again.

Anyway, when I apply the 15-year average ratios to my humble forecasts of monthly average cutout values (and I mean *very* humble), I come up with the prices shown in the next graph. I can't say that I have a high degree of confidence in these numbers, but I find them useful in evaluating forward price proposals, nonetheless.



It remains that the most important and least certain variable in the forecast of the cutout value is the rate of demand for pork at the wholesale level. Naturally, I am tracking this variable intently for any sign that it is beginning to stray from its normal seasonal path. I expect that it will do so, and I expect that the deviation will be toward stronger demand readings. I am leaning in this direction because it still looks as though Chinese demand for U.S. pork will be increasing at the same time that hog slaughter makes its final descent into the seasonal low. Much mystery surrounds the question of how much production has been devoted to carcass production (as opposed to full fabrication) destined for export. My perception is that up to this point, it has not been great….and that it could expand quite a bit within the next month or so.

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