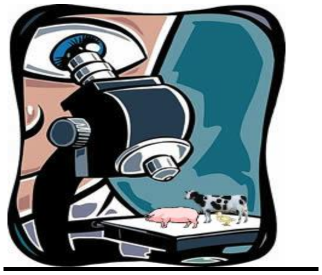
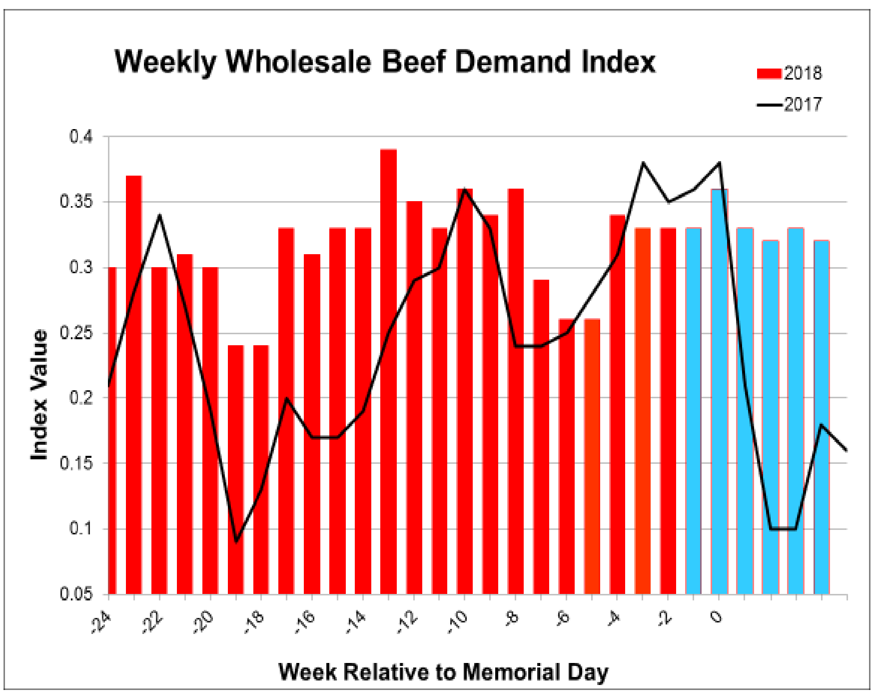


MEAT MARKETS UNDER A MICROSCOPE

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

May 22, 2018

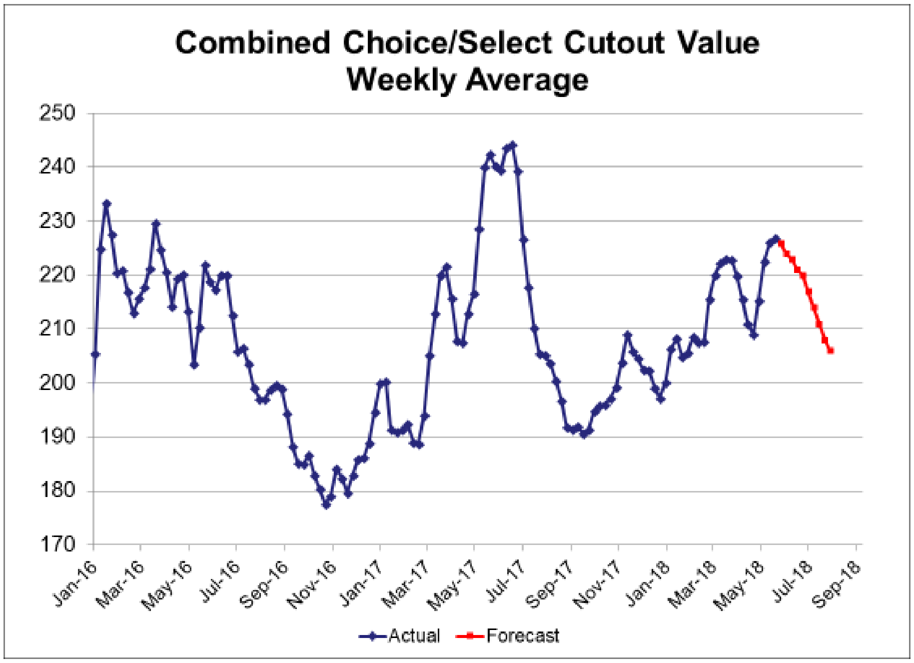
Demand for beef at the wholesale level is holding near its strongest levels of the year, after having rebounded from a "soft spot" in April. Of course, it's typical for demand to improve from April to May, but this time around the increase is going beyond the seasonal norm. The proof lies in the fact that domestic beef supplies have increased 1.1% *less* than the 20-year average, while the combined Choice/Select cutout value has risen 4.4% *more* than the 20-year average. It is reflected in the weekly demand index, which is adjusted for seasonality and which increased substantially in the first week of May and has held its ground since then. In the picture below, the final red bar represents the week just ended:



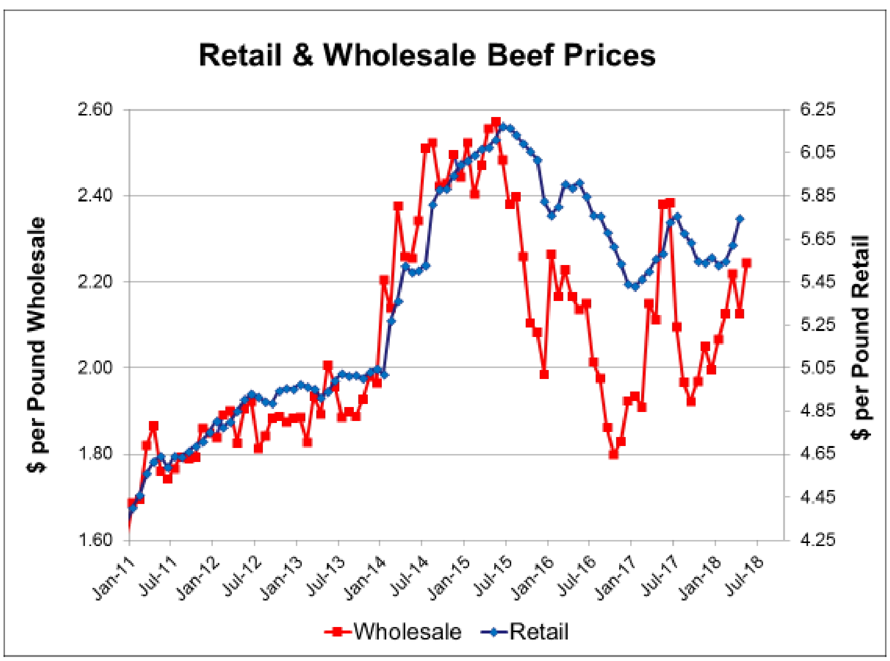
My assumption is that the index will remain basically steady from now through June, which means that the changes in demand over the next six weeks will follow a typical seasonal course. I don't know why they would not. True, prices of pork loins are cheap, but there is nothing new about that; and the volume of beef pre-booked for June delivery have so far been pretty decent….indicating that supermarket beef features will not disappear after Memorial Day.

I am also assuming that fed cattle slaughter will hold steady through June, after reaching 534,000 this past week. The cattle supplies are sufficient (as measured by the inventory of cattle on feed 90 days or longer) and the economic incentives are present (deeply discounted futures prices and very wide packer margins); yet, practical slaughter capacity should restrict them from going appreciably higher.

When I combine these supply and demand assumptions, I come up with a combined cutout value that slips from its current reading of $226 per cwt down to $220 in the middle of June and about $215 at the end of the month:



In the picture at left, I am extending the forecasts through the end of July. I'll address the July conditions in more detail at another time. For now, let it suffice to say that while it looks as though demand should hold up through June, its prospects after Independence Day seem a bit more doubtful. The reason is because of the pace at which retail prices are increasing. Now, I try not to read *too* much into the information provided by the U.S. Bureau of Labor Statistics' retail price series, since it is incomplete and inexact; but it is the best that we have.



Anyway, the average retail beef price in April, as reported by BLS, was already matching the 2017 peak (registered in July). I am convinced that one reason for the huge drop in wholesale demand between June and August 2017 was the increase in retail prices. Now, I do not expect a slowdown of the same magnitude this summer, because the increase in wholesale prices into June will not be anywhere near as sharp as it was last year; still, there is reason to think that there will be a greater-than-normal tapering of demand beyond June.

So, then, how will a combined cutout value of $220 per cwt be comprised four weeks from now? Here is my humble guess:

	Current	W/E 6/16
CH Boneless Ribeyes	875	865
CH 0x1 Strips	850	830
CH Top Butts	370	350
CH Tenderloins	1000	1000
SL Boneless Ribeyes	700	730
SL 0x1 Strips	485	510
SL Top Butts	335	315
SL Tenderloins	900	900
CH Shoulder Clods	228	220
CH Chuck Rolls	290	270
CH Inside Rounds	238	225
CH Knuckles	235	220
CH Bottom Round Flats	203	200
CH Eye of Round	235	225
CH Briskets	250	260
CH Ball Tips	250	260
CH Flap Meat	590	590
CH Tri Tips	350	370
81% Lean Ground Beef	194	180
50% Lean Trim	78	75

And that's all I have to say about that.

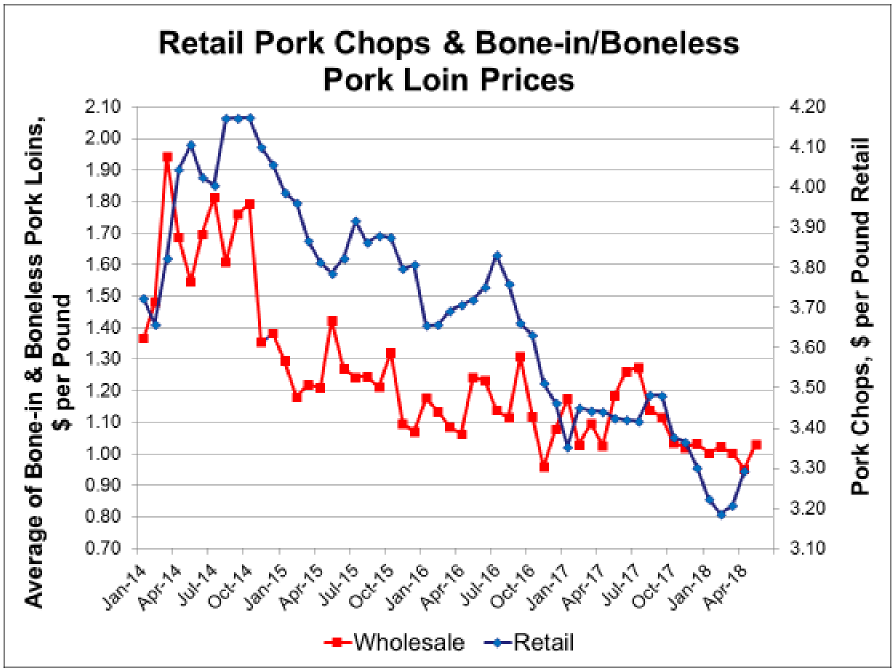
Let's talk about pork, then, using the same approach.

Hog slaughter has not delivered any recent surprises relative to USDA's fall pig crop estimate. Through the first seven weeks of the second quarter, it is up 3.3% from a year earlier. This was a *little* light in relation to the pig crop, and so, under the assumption that the pig crop was accurately counted, the year-over-year increases should be somewhat greater through the balance of the quarter. The most objective projection I can muster is that slaughter will be up 4.5% over the next six weeks, with weekly kills hitting bottom at 2,260,000 in the third week of June. From last week's total of 2,348,000, then, there should be another 90,000 head to be shaved off before the bottom is reached. Naturally, this will help propel the cutout value to its seasonal peak—which, at this point, I am guessing will be in the neighborhood of $85 per cwt (Monday's quote was $76.10).

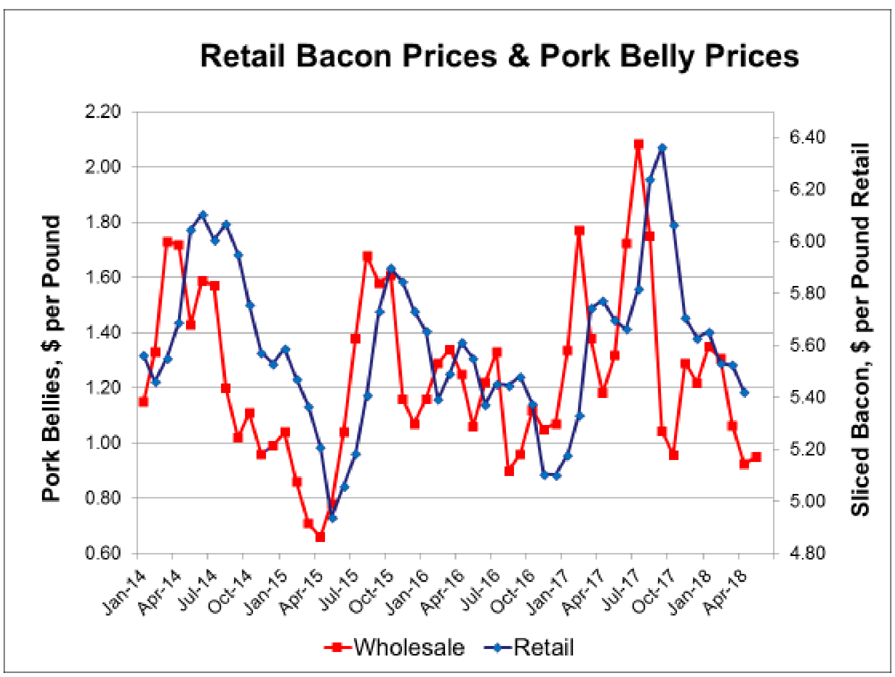
My basic assumption in regard to demand is that it will follow a stronger-than-usual path into the summer, simply because the market has been in a "demand-building" mode for roughly two months now….and by that, I mean surprisingly low prices over an extended period of time. This condition applies mainly to hams, boneless loins, and bacon. What has happened is that price expectations have come down substantially and along with them, forward prices; together, these factors begin to change promotional plans in both supermarket and restaurant sectors. Notice that I did not include pork butts on this list. These are now trading above the summer peaks of both 2017 and 2016, in spite of the larger supply.

In general, the situation in retail pork prices and margins is quite different from that of beef. Retail prices are coming down, and the spread between wholesale and retail prices is wide. As of April, the average retail price of pork was matching a 14-month low. In case you're interested, I am measuring the average retail pork price by calculating a simple average of the categories described by the U.S. Bureau of Labor Statistics as "Sliced Bacon"; "All Pork Chops"; "All Ham, Not Canned or Sliced; and "All Other Pork Excluding Canned". The latter category presumably includes butts and pork roasts.

It is more meaningful to look at retail prices and margins by individual products. I won't try to cover all of them today, but I'll show bacon and pork chops in the two graphs below:



The downtrend in retail pork chop prices (represented by the blue line) is obvious. In April, they stood 4.3% lower than a year ago and up just 3.4% since February, which was an *eight-year* low. It's kind of hard to tell from this picture, but the ratio of wholesale loin prices to retail chops was the lowest in a year and a half.



In the instance of bacon, retail prices in April were down a hefty 6.1% from a year ago and off 4.1% just since the first of the year. The ratio of pork belly prices to retail prices was lower than a year ago and the near the bottom of its five-year range. Of course, probably less than one half of all bacon is marketed through grocery stores; but this segment, in which demand is much more elastic, will be counted upon to absorb the additional supply—which I expect to be up 8% from a year earlier in June-August—without snuffing out the seasonal rally in the belly market altogether.

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