MEAT MARKETS
UNDER A MICROSCOPE

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

June 18, 2018

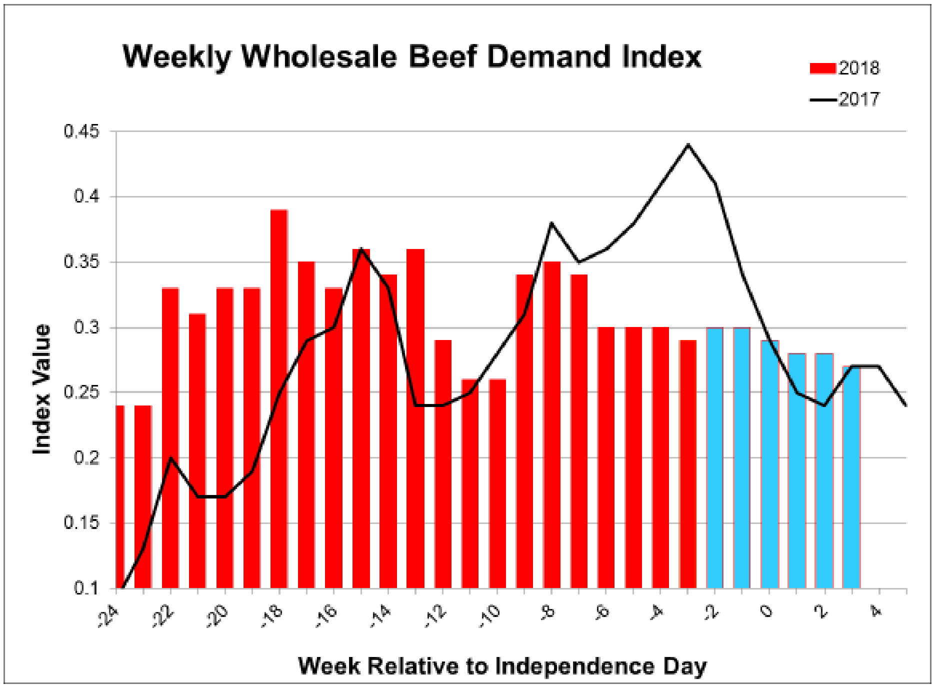
I apologize for the gap between this issue and the last. Between the World Pork Expo and my wife's surgery (no, really!) and a random audit from the National Futures Association, not to mention the appointments with my parole officer, my schedule has been a bit disrupted lately. **Anyway, the question on my mind concerning the beef market is how far away the seasonal bottom might be**.

In regard to the timing, the end of July still seems to be the most likely target. When we calculate the 15-year average combined Choice/Select cutout value for each week on the calendar, the lowest in the summer series falls in the third week after Independence Day. Also, if it loses ground every week from this point, the cutout will have registered ten consecutive weekly declines by then, which is an unusually long string of losses; the longest at this time of year has been eleven weeks (in 2017), and only three times in the last 20 years has it lasted longer than six weeks.

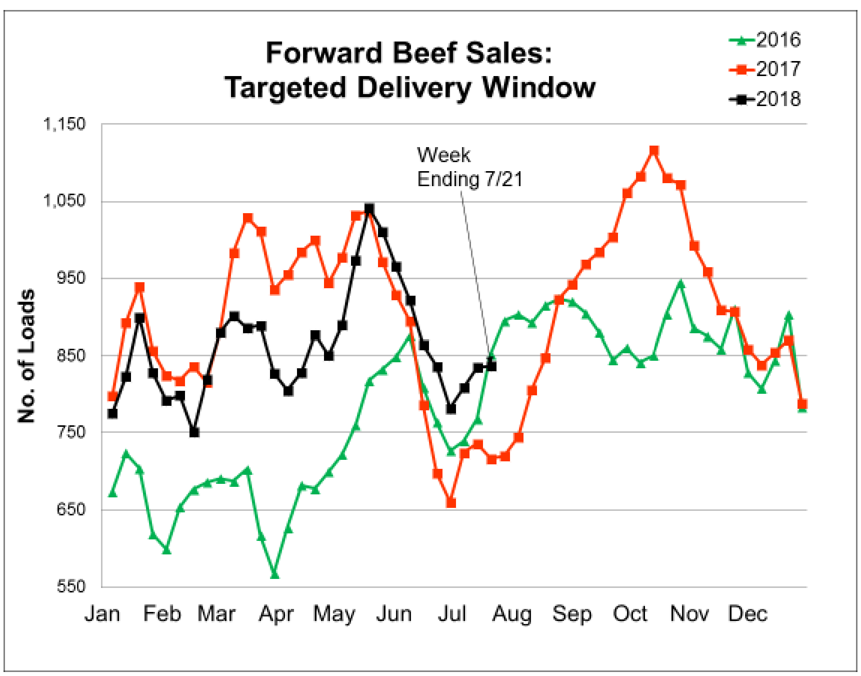
So far, the combined cutout value has been behaving fairly normally for this time of year. It peaked in the third week of May and has lost 3.5% since then. Among the last 20 years, I find eight in which there were similar declines over the same time frame. Among these instances, the changes between now (the third week prior to Independence Day) and the July/first half August low ranged from -7% to +1%, averaging -4.3%. This past week, the average quote was $219.04 per cwt. **A 7% decline, then, would place the bottom just below $204, and a 4.3% decline would place it at about $209.50. These just happen to be two conspicuous support levels on the chart.**

So much for the history. One factor that should help prevent the market from dropping more than 7% this time around is that steer and heifer kills *should* show a greater-than-average decline from June to July. My humble projections, which are based on inventories of cattle on feed 90 days or longer and fairly normal marketing rates, show a drop of 7.2% from July to August vs. the 15-year average of 5.3%; and a 7.0% decline from June to August vs. the 15-year average of only 2.9%. I should add that I expect a sharp contraction in packer margins after Independence Day, which should also serve to restrict production schedules even though they remain "in the black".

Wholesale demand has been generally healthy, and the indications for July are not bad either. As I show in the picture on the next page, the weekly demand index has been flat for the past four weeks….meaning that demand has followed a seasonally normal path since mid-May. In this picture, by the way, the red bars are actual readings through last week, and the blue bars are my guesses through the end of July:



Now, up to this point I have been assuming that the slowdown in demand from June to July/August would be more pronounced than the seasonal norm, as reflected in the graph. But I am beginning to question this assumption. For one, the volume of forward bookings for July deliveries has been more robust than I had anticipated….and much more active than a year ago. Maybe it's the economy, maybe it's because retail margins have been decent (and I *do* consider that to be true), but forward booking activity for July delivery has not slackened all that much.



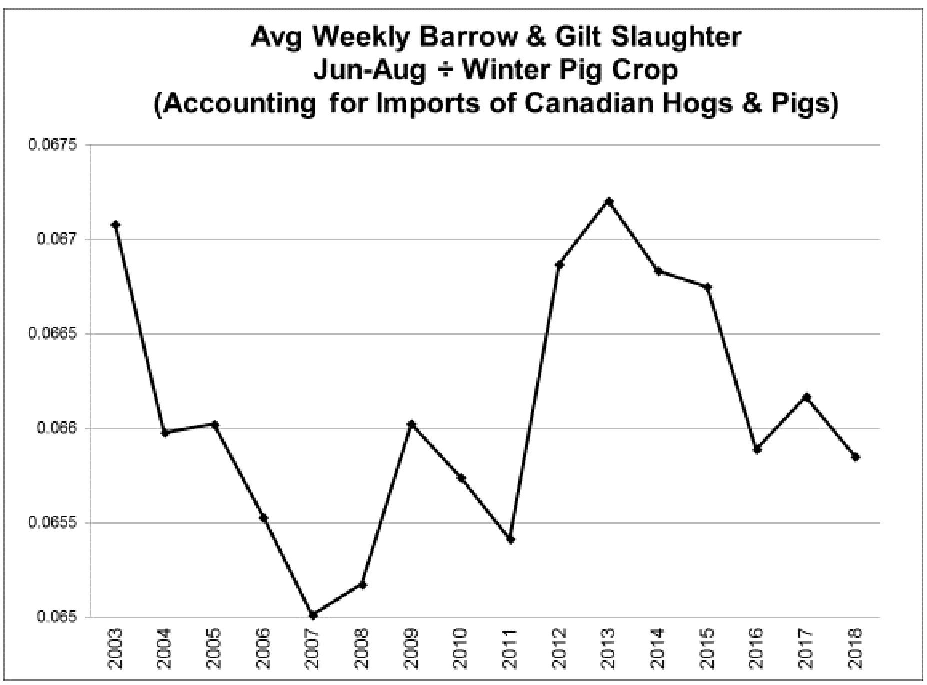
Secondly, I had suspected that retail beef prices might be rising at a pace that would "put the brakes" on product movement a bit too hard in midsummer. But the most recent report from the U.S. Bureau of Labor Statistics actually showed a small decline in retail prices from April to May. And as I alluded to a minute ago, the BLS numbers indicate that wholesale-to-retail price spreads are much wider than they were at this time last year.

Anyway, even if demand does indeed slip as shown in the first graph on this page, then the combined Choice/Select cutout value will finish the month of July at about $205 per cwt. If, on the other hand, demand were to stay on its normal seasonal path, then the cutout would be near $210 at the end of July. Do these numbers sound familiar?

Hog slaughter has come up surprisingly short here in June, such that the second quarter kill is going to wind up on the low side relative to USDA's fall 2017 pig crop estimate—not drastically so, but enough to make one wonder if USDA's *winter* pig crop was overestimated. It makes a big difference, of course, in the path that pork prices will take between now and Labor Day.

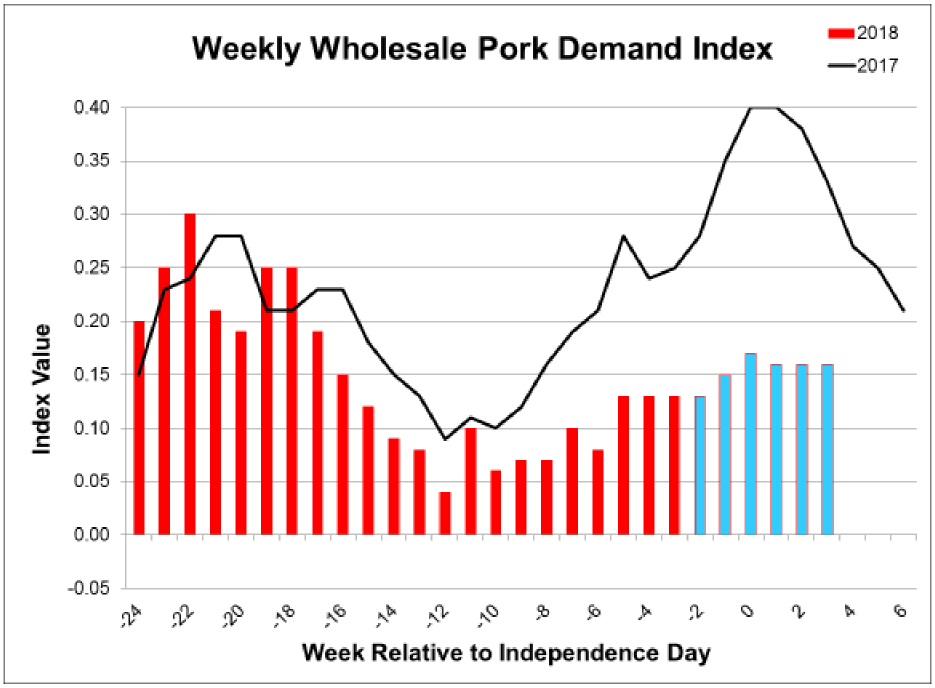
First of all, I'm not convinced that the *fall* pig crop was undercounted. Temperatures in Iowa and other parts of the upper Midwest have been pretty far above normal ever since Memorial Day, and that probably has slowed the movement of pigs through grow-out barns….but it has not eliminated them from the supply chain. Over the past four weeks, barrow and gilt carcass weights have declined a bit more than normal for this time of year, which supports this notion.

It's dangerous to go questioning the integrity of the winter pig crop estimate on the basis of so few observations that would suggest that the fall pig crop may have been miscounted. And yet, I don't want to ignore the fact that weekly kills here in June—assuming a total of about 2,200,000 in the week ahead and around 2.250,000 in the week after—will wind up averaging 30,000 head or so below initial indications. And so, I am willing to modestly reduce my summertime slaughter projections, to 2.275,000 in the non-holiday weeks of July and 2,375,000 in August. That would place the June-August kill just slightly below the 15-year average in relation to USDA's winter pig crop estimate as it stands:



These projections would place hog slaughter 3.5% above a year earlier in July and up 3.0% In August, following 3.7% and 2.9% increases in April and May. From this angle, they seem reasonable.

Demand for pork, meanwhile, has improved a bit beyond the seasonal norm in the past three weeks, but it has not been overly impressive considering that supplies are currently running below most expectations. As you have probably heard me say before, significant deviations from expected supply (in either direction) usually result in significant changes in demand at the wholesale level.



In the picture at left, the blue bars represent my humble forecasts of the wholesale demand index over the next six weeks.

Combined with the slaughter projections I just described, they suggest that the top in the pork cutout value is very close at hand. They should remain in the neighborhood of $85 per cwt into early August, but a material advance beyond that level is unlikely.

My forecast of a cutout value that finds a near-term equilibrium around $85 aligns with the notion that the pork belly market will encounter formidable resistance at $1.50 per pound; and that equivalent resistance lies at $1.10 in bone-in loins; $1.30 in pork butts; $1.65 in spareribs; $.70 in hams; and $.95 in boneless picnics. Lean trimmings, which have gained almost 15¢ per pound over the past week, are probably overextended already. If all were to reach their respective resistance levels simultaneously, then the cutout value would make it up to $90 per cwt—but only *very* temporarily. Under the prescribed supply and demand conditions, none of these price levels could be sustained. Spareribs and pork butts, in particular, will undergo sizeable setbacks once buying for Independence Day is completed.

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.