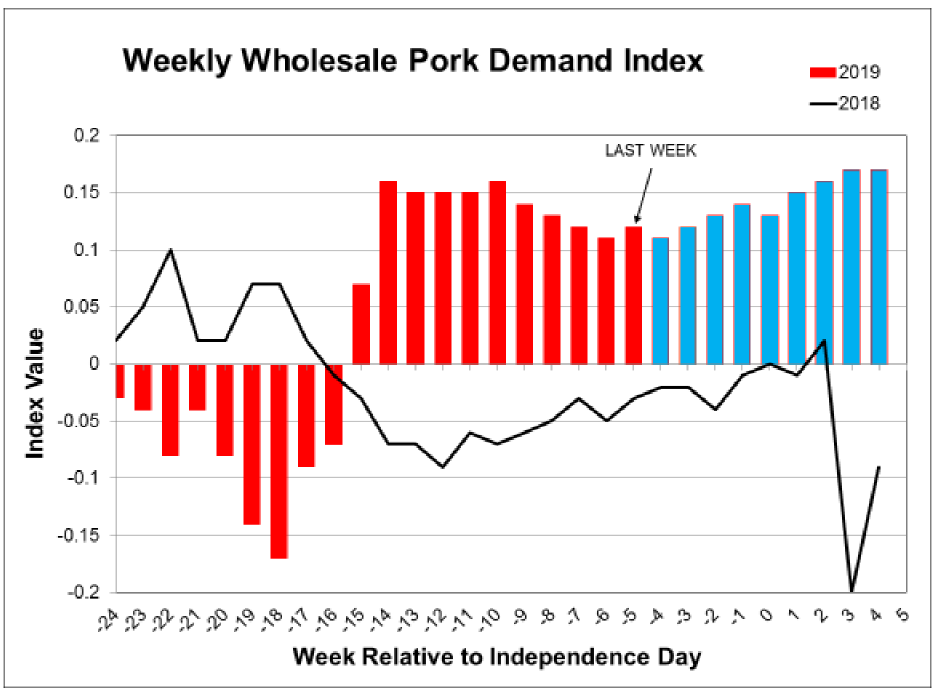
MEAT MARKETS
UNDER A MICROSCOPE

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

June 2, 2019

The course of wholesale pork demand, the most influential variable in the pricing equation, remains exceptionally difficult to predict. In hindsight, it is clear that there was a period of about two weeks during which buyers rushed in *en masse* to extend coverage, motivated by fear. It was a logical response, and *somewhere* down the line it is likely to be repeated. Most likely, this will happen when there is a major development of some sort relating to Chinese demand. I'm thinking specifically of a relaxation of Chinese tariffs on U.S. pork (that would most certainly do it), or a leap in new export sales (which may or may not be included in USDA's weekly reports).



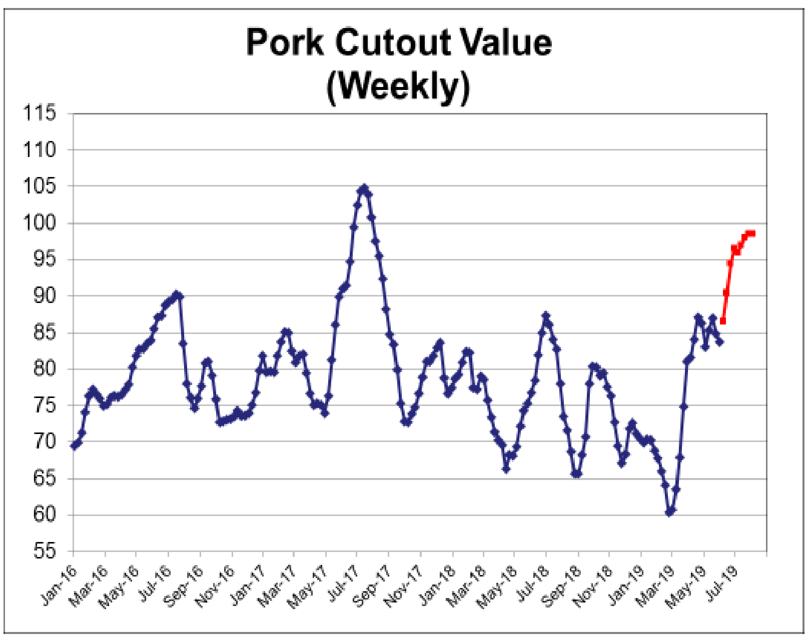
In the meantime, the fear has gone into remission. The "pipeline" has been temporarily stocked with physical and contractual inventory. And so demand has subsided somewhat, left to be guided by the seasonal swings in spot market demand.

I'm trying to forecast as objectively as possible, and the best I can do right now is to assume that nothing will happen until it happens--i.e., that demand will not stray too far from its typical seasonal path from now through July. I would be foolish to bet my money on some sort of wild guess about when tariffs will be cut or Chinese buying will surge, even though I expect that both will eventually occur.

Speaking of foreign trade, I have upwardly adjusted my projection of U.S. pork imports from Canada, now that the Mexican tariff has been removed and U.S. product has suddenly become more competitive; and I have downwardly adjusted my export projections in the near term to reflect a more gradual increase in Chinese demand. Basically, I am factoring in a growth in shipments to China/Hong Kong/Taiwan from 52 million pounds in March (an official figure) to 80 million pounds in June (up from 34 million a year earlier) to 100 million in July (vs. 28 million a year earlier), and to 160 million in the fourth quarter. As this growth coincides with the seasonal tightening of hog supplies, it should make for at least a slightly stronger-than-normal demand trajectory over the next two months.

And as a postscript on this subject, I am not yet making any allowance for the President's latest threat to place a new, 5% tariff on Mexican goods, and the possibility that Mexico might retaliate. All I know is that I'm getting tired of having to think about constantly changing tariffs.

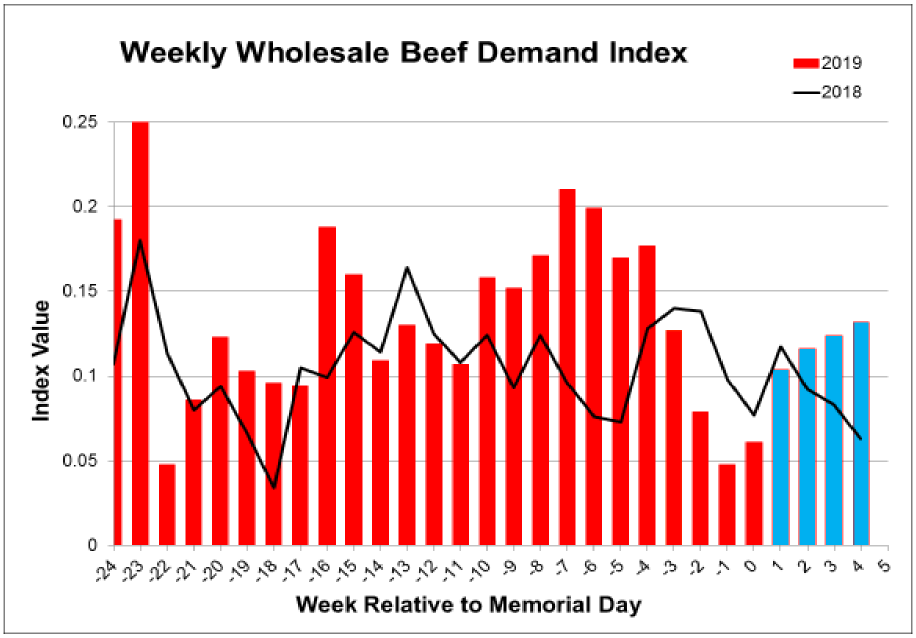
Hog slaughter, meanwhile, is still tracking pretty closely to USDA's pig crop estimates. I have to assume that it will continue to do so, and that hog slaughter in June will align in typical fashion with the rest of the quarter. In that case, we can expect weekly kills to average about 2,275,000 in June, 2.6% greater than a year earlier but down from the average of 2,344,000 in the four non-holiday weeks of May. They should increase modestly in July, to about 2,295,000.



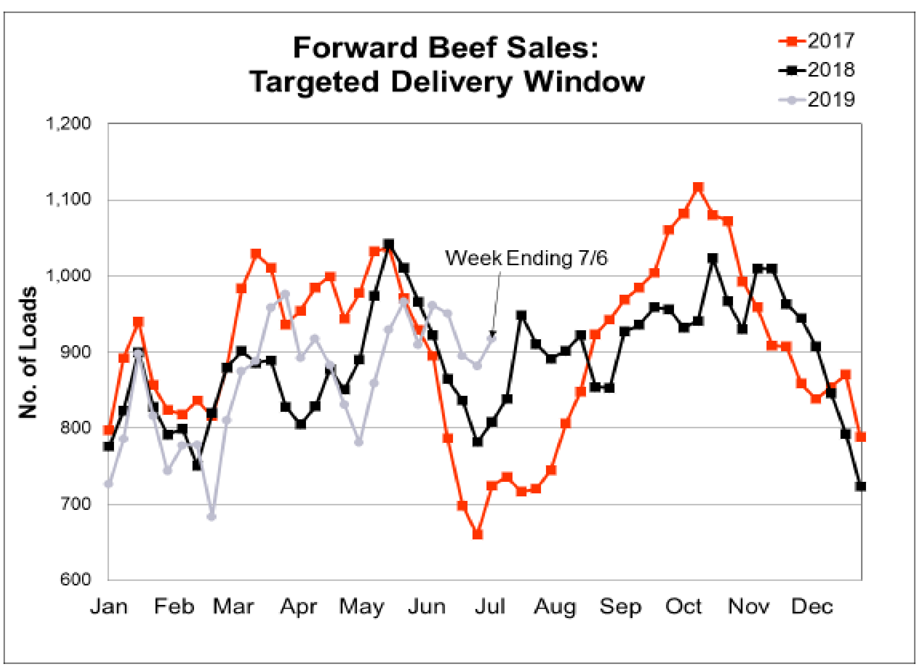
Combining this rate of production with the demand and export projections that I described above, I come up with the pattern in weekly cutout values shown in the picture to the left. The cutout value has spent the last five weeks within a sideways band bounded essentially by \$83 and \$89 per cwt, and a breakout to the upside--which I fully expect , and very soon--would seem to create a target of \$105.

In spite of the great uncertainty surrounding wholesale pork demand, such a sharp incline in the cutout value is made likely by the current primal pork belly quote, which looks cheap at \$1.06 per pound. Not since 2015 has this market emerged from Memorial Day so low; last year it averaged \$1.27 in the first week of June. I think we can expect a lot of business to be generated from this latest plunge, such that a recovery up to at least \$1.40 could be achieved rather quickly. All else being equal, that would add roughly \$5.50 per cwt to the total cutout value. My guess is that frozen belly stocks currently stand about even with a year ago, as they were on May 1.

The combined Choice/Select cutout value was able to gain significant ground last week, which I am reading as confirmation that it will work its way gradually upward through the month of June. The nearest resistance level on the chart is in the neighborhood of $225 per cwt, and I'm guessing that this is where it's headed. That could prove to be a conservative target, considering that Friday's quote stood at $220.07….so it's not very far away.



The blue bars in the picture to the left show the sort of moderate recovery in the demand index that would be required to push the cutout value up to $225 by the end of the month, if steer and heifer kills average near 530,000 per week. [Any deviation from this pace would likely be upward, but even if I bump this up to 535,000 it does not materially alter the complexion of this graph.] I'm only suggesting that seasonally adjusted demand will return to its status of early May, nowhere near the higher peaks of April. The notion of improving demand is well-supported by forward booking volumes, which indicate much greater interest in second half June (and early July) deliveries than a year ago:



I should mention that if the demand index *were* to climb back to its April average, then we would be talking about an objective of $235 in the combined cutout by the end of the month. I don't *think* that will happen, but who really knows? One way to gauge the probabilities is to make an item-by-item forecast and put these together to arrive at a cutout value.

So here goes. In the table below are my guesses of where the individual product prices will stand in the third week of June, and the changes from Friday's quotes. I'm not listing all of them, just the major ones.

Middle Meats	**Current**	**W/E 6/22**	**Change**
CH Bnls Ribeye	$7.68	$8.10	$.42
CH 0x1 Strip	$6.63	$7.25	$.62
CH 0x1 Short Loin	$6.00	$6.50	$.50
CH Top Butt	$3.17	$3.40	$.23
CH Tenderloin	$9.71	$9.70	($.01)
SL Bnls Ribeye	$6.77	$7.00	$.23
SL 0x1 Strip	$5.76	$5.75	($.01)
SL 0x1 Short Loin	$4.91	$5.25	$.34
SL Top Butt	$2.77	$3.00	$.23
SL Tenderloin	$8.71	$8.70	($.01)
Flap Meat	$5.08	$5.05	(.03)
Ball Tip	$3.03	$3.00	($.03)
Tri Tip	$4.02	$4.20	$.18
End Meats & Trim	**Current**	**W/E 6/22**	**Change**
Chuck Rolls	$2.67	$2.80	$.13
Shoulder Clod	$2.25	$2.25	0
Knuckle	$2.36	$2.30	($.06)
Inside Round	$2.09	$2.10	$.01
Btm Round Flat	$2.21	$5.05	($.06)
Eye of Round	$2.21	$2.15	($.06)
Brisket	$3.49	$3.30	($.19)
81% Lean Grind	$2.00	$1.92	($.08)
50% Lean Trim	$.89	$.83	($.06)
Combined Cutout	**$220.00**	**$221.50**	**$1.50**

Hmmm….when I approach the question from this angle, I come up with an increase in the cutout value of only about $1.50 per cwt. First of all, this lends a degree of confidence to the notion that the presumed appreciation during June will not go beyond the $225 resistance level.

But in which products might I be underestimating the near term upside potential? Well, the Choice-grade middle meats are across-the-board candidates. Choice boneless ribeyes are trading at a five-year low for this point on the calendar and are down $.80 per pound from a year ago. Choice 0x1 strips likewise stand at a five-year low, but these are down $1.75 from a year ago. And top butts have not been this cheap coming out of Memorial Day since 2011; currently they trade $.50 per pound below a year ago.

Otherwise, I would not be shocked if the grinds and 50% lean trimmings were to contradict their seasonal biases and maintain their current price levels into late June. These items performed better than the beef market as a whole during May.

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