MEAT MARKETS
UNDER A MICROSCOPE

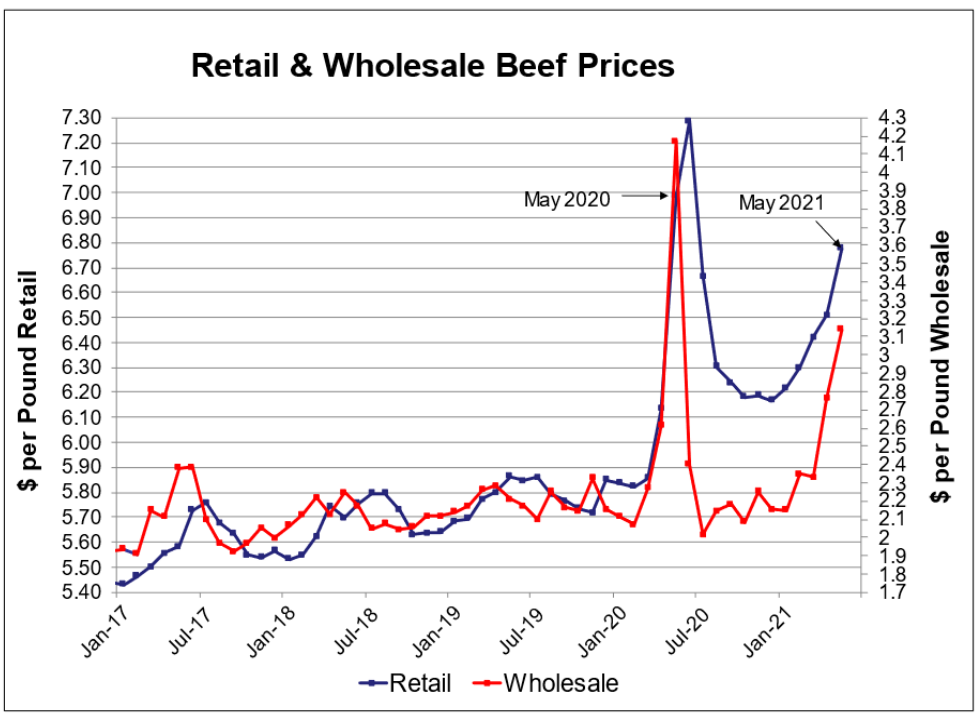
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

June 20, 2021

The distinct downturns in both beef and pork cutout values this past week were sufficient to pronounce an end to their months-long uptrends—and quite likely, enough to establish high-water marks that will stand for the rest of the year. Given the price levels, this is hardly a bold prediction.

It turns out that composite beef prices actually peaked two weeks ago. But until now, I was not thoroughly convinced that the top was "in". In the first five days that ensued, all we saw was a "shift into neutral"; last week, however, the downward momentum clearly accelerated. And rather suddenly, we notice that the combined Choice/Select cutout value has fallen $19 per cwt from its high.

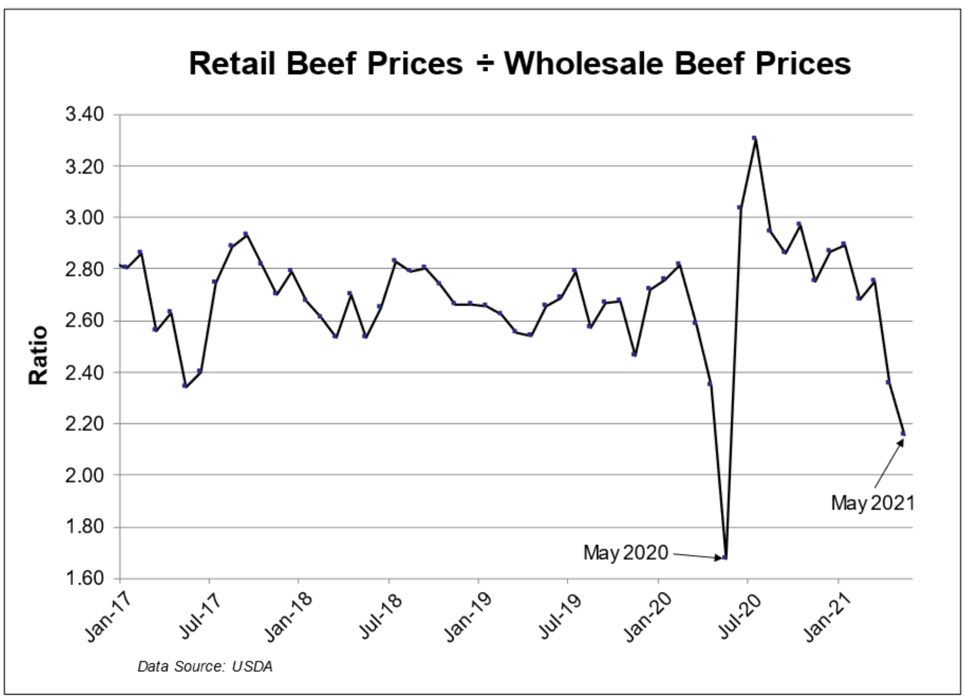
My assumption is that prices have "overshot the mark" over the past several weeks (as they almost always do), and that the supply/demand balance is shifting over to the bearish side. Naturally, then, the task at hand is to figure out how low prices—both beef and pork—will have to drop in order to find a new, short-term equilibrium.



First of all, it is a simple statement of fact that on the chart of the combined Choice/Select cutout, the nearest support level lies near $240 per cwt, $77 below Friday's quote. It seems like an impossible amount of ground to cover in a short period of time, but it has happened before.

The more cerebral question is, how did the market get so high in the first place? I cannot pretend to know, but I have an idea. There have been two primary forces fueling this rally in meat prices: one is the enormous amount of cash that has been injected into the system through the Coronavirus Aid, Relief, and Economic Security Act; the other is the recovery in restaurant traffic….hardly revealing, as these same two factors are on everyone's list. But below the surface, it is the way that these forces have developed and interacted that tells the story, I think.

OK, so in the spring of 2020, restaurants and foodservice outlets of all types were shutting down because people were staying at home. And because people were staying at home, supermarket sales enjoyed a windfall. So there was a major shift in meat demand away from the foodservice segment and into the supermarket segment. Everyone knows this. Everyone also knows that this trend is reversing. But the increase in foodservice demand and the decline in supermarket demand are not occurring simultaneously, stride-for-stride. It became obvious as early as January that restaurant business was starting to pick up and inventory replenishment was taking place accordingly. Meanwhile, grocery stores were still moving a lot of meat and were not raising prices. Why *would* they, with margins remaining relatively wide early in the year?



I suspect that had it not been for the CARES Act, wholesale meat prices would still have increased from that point—though not nearly as much—because supermarket and restaurant chains were competing more intensely once again for the Consumer Food Dollar. Supermarket meat sales would have slowed, and margins would have tightened sooner. Restaurants would have recaptured a bigger piece of the pie, but the size of the pie would have remained essentially the same.

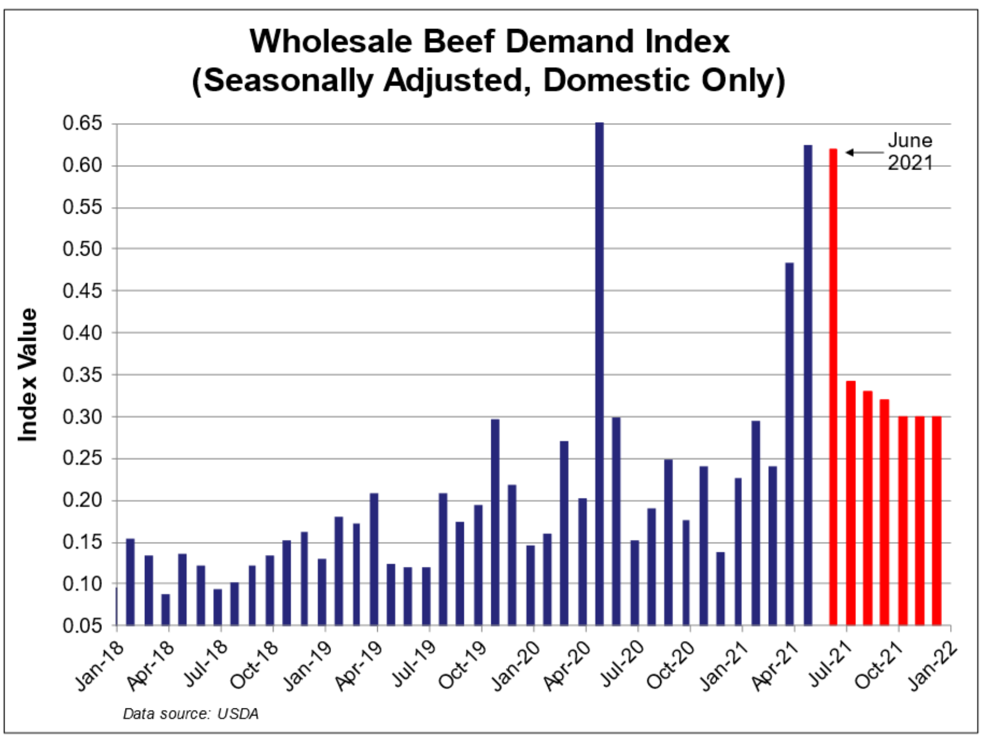
But household incomes received a giant boost from various government payouts, and the pie got bigger all of a sudden. Even though retail beef prices increased substantially in February, March, and April, supermarket meat sales did not slow down materially.

By April, though, retail meat margins were being squeezed hard; and by May, retail prices were increasing sharply. And despite the much higher retail prices, retail margins got even worse.

And so it has now reached the point—or so it seems, anyway—that product movement through supermarket channels is finally slowing down. Retail prices have become high enough to create “sticker shock”. And we are now beginning to witness the other half of the transition of meat demand; that is, the reduction in supermarket sales. It is occurring four or five months after the recovery in restaurant demand got underway. And this makes sense to me also, that the loss of restaurant traffic/increase in supermarket business occurred abruptly, but the reverse would occur gradually.

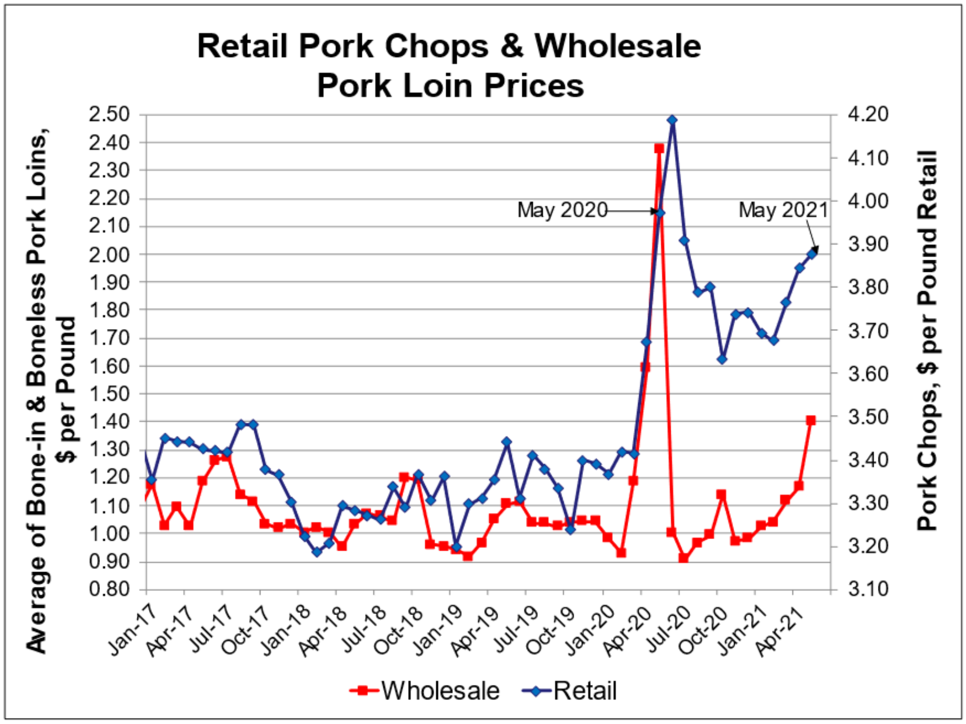
The total “pie” remains bigger than it was prior to the government stimulus programs; that is, demand for beef and pork have taken a major step upward. However, there will still be short-term cyclical fluctuations around the higher midpoint. We are just now heading into a downward phase of that cycle.

I can only make a semi-educated guess about the price level at which the next cyclical low will land, but the $240 per cwt support level in the combined cutout value that I mentioned earlier seems a reasonable target. It would require only that the seasonally adjusted wholesale demand index return to a level that is closer to Earth, but still significantly above any month prior to April (with the exception of the outlier in May 2020):



One thing about which I am fairly confident is that the “Search for the Next Bottom” (i.e., the next short-term equilibrium) will take some time. If the deceleration of product flow is to be as extensive as I think it will be, then retail prices will need to turn back downward a bit before it will begin to pick up again. I don’t see that happening util mid-July at the earliest. We have to keep in mind just how high prices have become.

There is reason to believe that the decline in the pork cutout value from this point forward may not be as great as the decline in beef prices. The pork cutout has quickly dropped $15 per cwt from its peak on June 8, and the nearest support level on the chart lies only about $5 below Friday’s quote. And if hog slaughter aligns with USDA’s winter pig crop estimate, then weekly kills will pull back to around 2,370,000 in the three weeks following Independence Day, compared with 2,440,000 in the last two weeks.



Retail prices of pork chops—and presumably butts and ribs as well, though the U.S. Commerce Department does not specifically include these in its monthly reports—have not increased to anywhere near the extent that beef prices have. And retail margins, while quite narrow by historical standards, are not as extreme. Also, movement of fresh pork cuts through supermarket channels could be propped up by their relative value in comparison with beef.

However, I'm not going to bet on the prospect of the pork cutout value bottoming out at $115 per cwt (its nearest support level). It's curious that pork bellies and hams have lost a lot of ground over the past week and a half, which might indicate that a good deal of the runup in pork prices in general has been anticipatory in nature—in other words, due to buying that took place in expectation of even higher prices yet to come. Those expectations may not materialize. In that case, the slowdown in demand for pork at the wholesale level could be steeper.

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