MEAT MARKETS
UNDER A MICROSCOPE

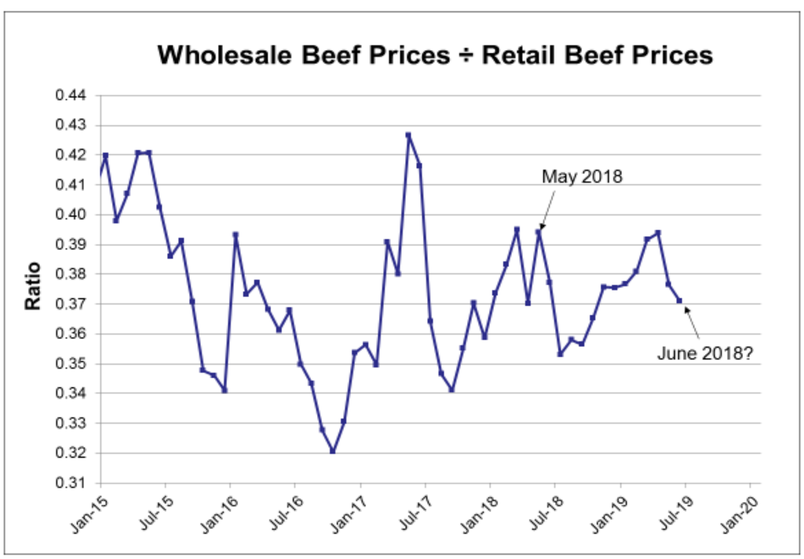
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

June 22, 2019

I had expected to see some sort of an upturn in beef cutout values in the second half of June, but it's not happening. Entering the final week of the month, the combined Choice/Select cutout stands roughly $4 per cwt lower than it started out, with no bounce in between. I was basing this expectation on the sizeable amount of product that was booked for second half June/first half July delivery, but obviously, it looks as though the beef is not being pulled through the pipeline fast enough to tighten the spot supply. I can only surmise that retail prices are too high to generate much "fill-in" business; supermarkets apparently are trying recapture margins at the expense of volume. Considering that wholesale-to-retail price spreads were quite narrow in March and April, this explanation makes sense.

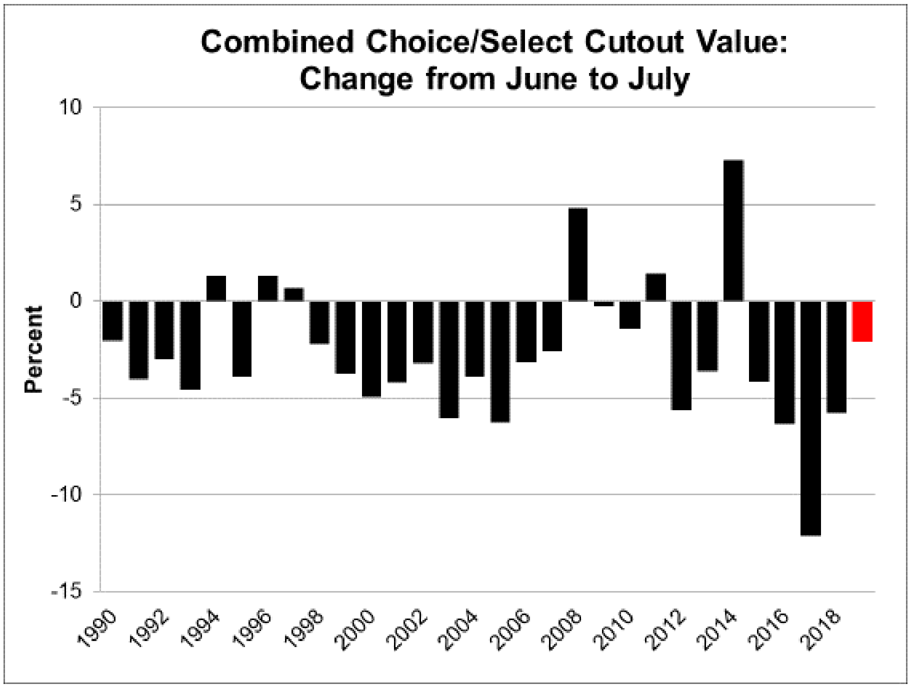
I am reminded that forward booking volumes are helpful indicators of planned retail feature activity, but they are not infallible. Retailers are generally pretty good at estimating how much product they will move at various price points and various times of the year; but sometimes they underestimate, and sometimes they aim a bit too high. The sticker price they choose to advertise makes a big difference.

So, then, what are the prospects for the summer? Well, retail margins did widen out quite a bit in May and have widened further here in June, such that retail prices are probably on the decline. It's hard to predict how much, though. Forward bookings for delivery in the second half of July are just so-so.



In the picture to the left, the projected ratio for June compares the almost-certain June cutout value with May retail prices.

There seems to be a good chance that the seasonal decline in wholesale beef prices in July will be relatively mild (much more so than the futures market is discounting). One reason I'm thinking this way is because I detect virtually nothing to suggest that the change in demand from June to July will be any weaker than normal. In fact, given that demand probably hit a short-term cyclical low in May and has barely improved here in June, any deviation from the seasonal norm is more likely to be upward than downward. But if the seasonally adjusted demand index were to remain perfectly flat (i.e., if demand were to precisely follow its 15-year average seasonal path), then the combined cutout value would average about $212.50 per cwt in July. [I am assuming that steer and heifer kills will average 505,000 per week in July, including the holiday week. Thus the decline from June to July would amount to only a shade more than 2%....not *terribly* unusual, but considerably smaller than last year's 5.8%:



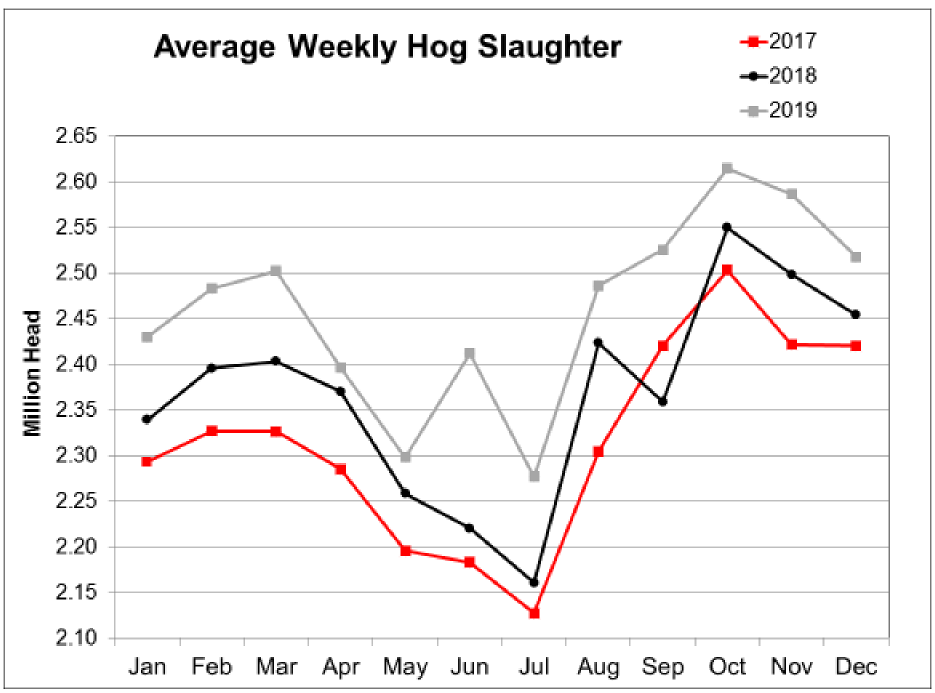
I also consider that the seasonal decline in the cutout value is highly correlated with the extent of the drop in middle meat prices. This time around, there has been no rally whatsoever in prices of ribeyes, strips, or short loins since Memorial Day (and farther back than that). Choice-grade boneless ribeyes are currently trading about 50¢ per pound below a year ago and $1.00 above last summer's low; Choice 0x1 strips are down about $1.40 from a year ago and about $1.15 away from the low of late July 2018. Select-grade ribeyes and strips are already matching last summer's lows. What I'm trying to say is that there seems to be considerably less downside potential in these items that there was at this time last year. What reason is there to think that last summer's lows will be penetrated? A $1.00 per pound drop in Choice ribeyes and a drop of $1.15 in Choice strips, all else being equal, would remove a bit more than $5 per cwt from the combined cutout value between now and the July bottom. At the same time, the 15-year average change in end meats from now to the third week of July is +0.9%; in the ground beef/trim complex it is -0.5%; and in "thin meats" (including briskets, bottom sirloin cuts, flanks, and cap meat), -5.0%. If we insert these changes into the calculation, the projected July bottom in the combined cutout value still turns out to be in the neighborhood of $210 per cwt vs. Friday's quote of $215.56. This price, by the way, is the approximate location of the long-term uptrend line originating from the major cyclical low of October 2016.

Front and center in the pork market is the shockingly large hog slaughter. So far in June, it is running 9.7% above a year earlier. This follows a 1.1% increase in April and a 1.8% increase in May.

In view of the sudden bulge in kills, I think it's fair to say that the marketing pace was slowed significantly in April and May in hopes of capitalizing on the anticipated sharp increase in prices….and the result has been a backlog of market-ready hogs. I realize that on most large hog farms, throughput is tightly scheduled and there is not a lot of "wiggle room" to adjust it either way. But how else can this odd pattern in hog slaughter be explained?

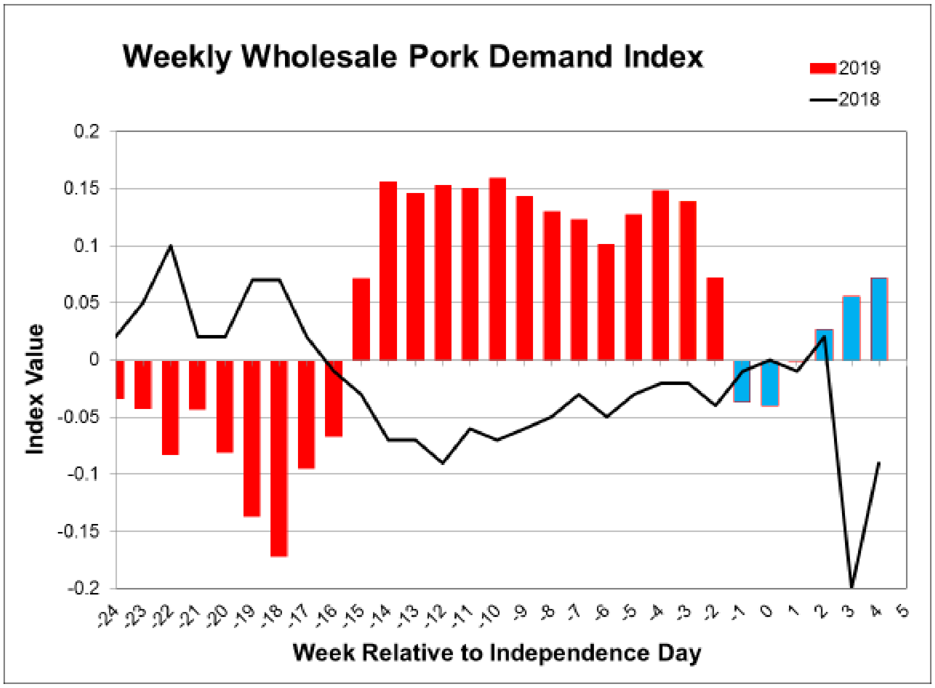
And yet, this appears to be more than just a temporary backlog. The total second quarter kill will wind up being unusually large in relation to the fall pig crop--the highest ratio of the former to the latter, in fact, since 2005. This presents some pretty convincing evidence that the fall pig crop was underestimated. Naturally, this makes one wonder if the winter pig crop was also underestimated--that the summertime hog supply will be bigger than we have been led to believe. I have to think so. Therefore, I have raised my slaughter projections for the third quarter.

But by how much? I am always hesitant to bet my money on the assumption that USDA's pig crop estimates have missed the mark. Their track record is remarkable. And so my approach is to keep the June-August total as closely aligned as possible with the winter pig crop estimate and, at the same time, keep the June kill in reasonable proportion to the other two months. In essence, I am trying to solve an equation that places an upper limit on one variable (the ratio of June-August slaughter to the winter pig crop), and a lower limit on another variable (the ratio of the June kill to the June-August total). Here, then, is what I'm working with:



This still leaves the June-August kill at its highest ratio to the winter pig crop since 1995….and it *still* makes for an extraordinarily steep drop in hog slaughter from June to July.

Because of the surprising rate of production here in June, the market is obviously having to absorb a much larger supply than it was anticipating--even though export commitments are expanding. Demand at the wholesale level is greatly influenced by actual vs. expected conditions. Thus, the much bigger-than-expected supply has caused the demand measurements to tumble, as I show on the next page.



In this picture, the blue bars represent my humble guesses--and they are *guesses*--of how the seasonally adjusted demand index will perform over the next six weeks. If weekly kills drop down to 2,325,000 in the non-holiday weeks of July as I am proposing; and if demand recovers only timidly as I show in the graph to the left; then the pork cutout value will rally roughly $10 per cwt from Friday's quote of $76.73 by the end of July. It sounds like a lot, but this is a far cry from what the trading world was looking for a couple of weeks ago. It will take some time to bring supply and demand in the pork market back into balance, but it will happen….at higher price levels than we're witnessing right now.

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