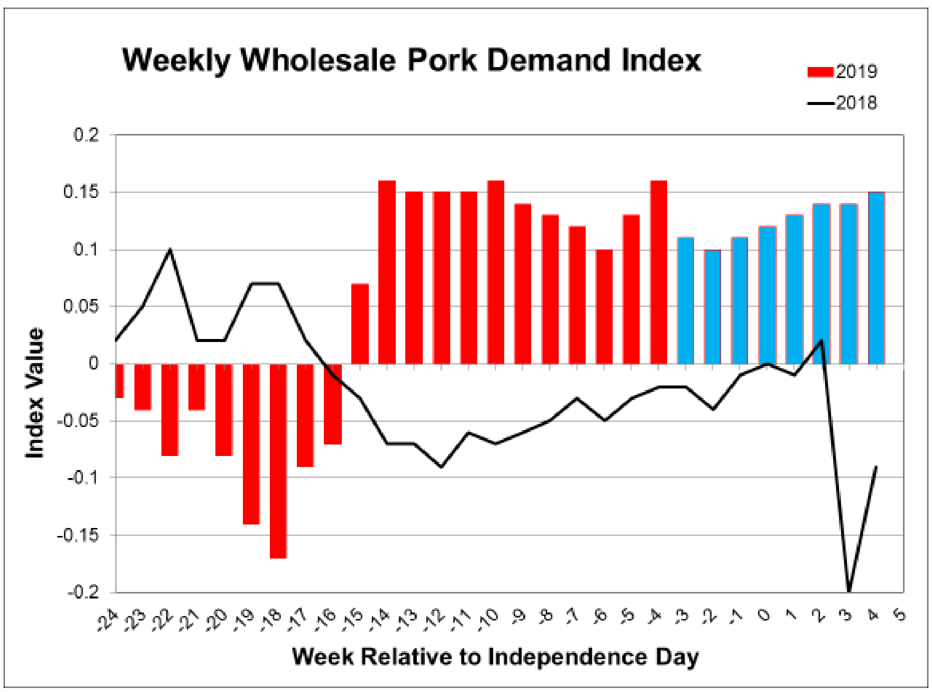
MEAT MARKETS
UNDER A MICROSCOPE

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

June 10, 2019

As an economist on the eternal quest for the Most Convenient Explanation of Things, I *want* to say that the reason why the pork cutout value has recently stalled is this: exports have not accelerated as rapidly as the spot market had discounted, and domestic demand has struggled to pick up the slack. And I'm sure that this is true to some extent; the statistics bear it out. But considering this past week's giant production level, the pork market has actually held up rather well:

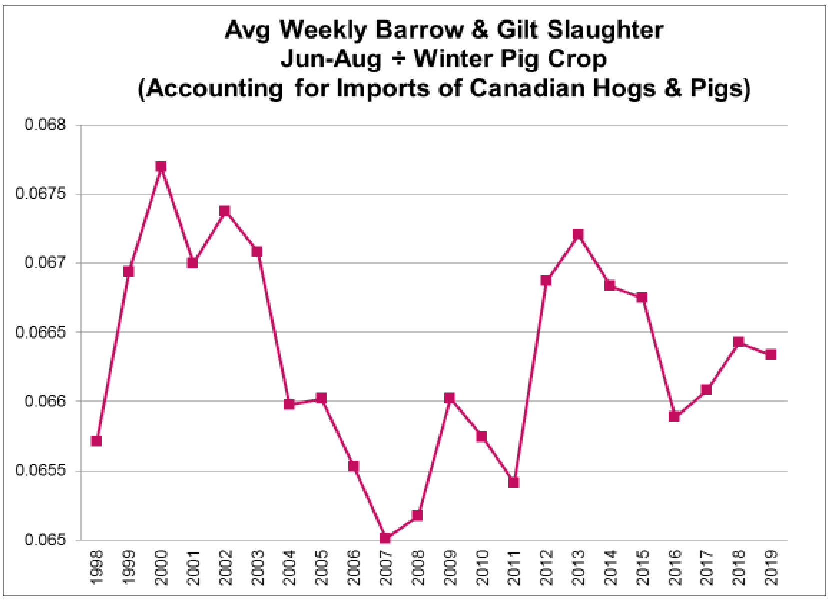


In this graph, as always, the final red bar represents the week just ended. It is simply saying that in the fourth week prior to Independence Day, the combination of a 520 million pound pork output and an average cutout value of $83.59 per cwt was pretty impressive; seasonality taken into account, it required as strong a rate of demand as we have seen at any point so far this year.

But what's up with hog slaughter? This past week's kill of 2,417,000 was an eyebrow-raiser. Is the hog supply a lot bigger than we have been led to believe, or can we still expect production to make another leg downward from here? At this juncture, the probabilities seem to favor the latter.

The most objective approach is to assume that USDA's pig crop estimates are reasonably accurate (unless, of course, there are multiple weeks of evidence to the contrary--which there is not. In that spirit, I notice that March-May hog slaughter aligned closely with the fall pig crop estimate; so has the second quarter-to-date kill. In both periods, the ratio of hog slaughter to pig crop was/is very close to the 15-year average. Now--*even if slaughter in June matches a 19-year high relative to the rest of the quarter*, then it will average 2,310,000 over the next three weeks--107,000 less than last week's total.

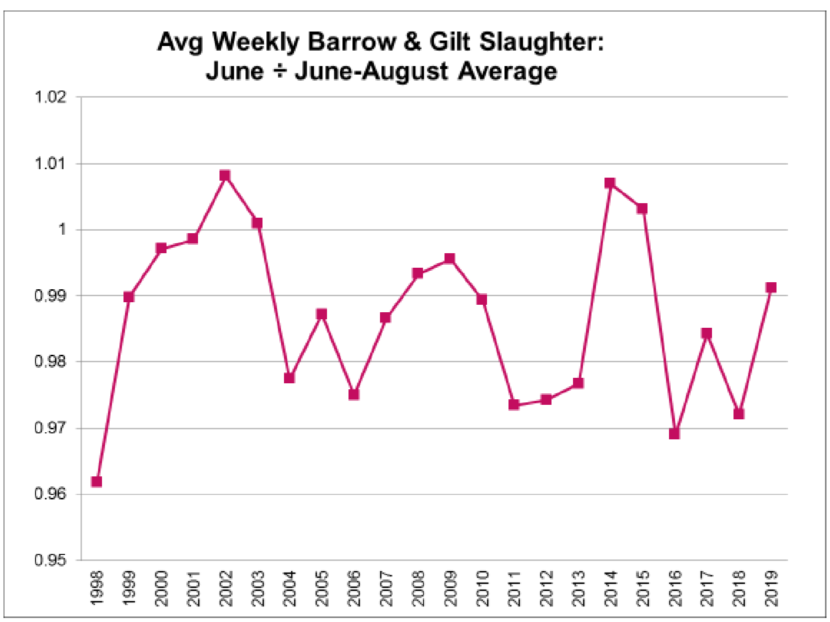
Below I show pictures which I regard as objective projections of: a) the June-August kill relative to the winter pig crop estimate; and b) June hog slaughter relative to the June-August average.



This calculation places the average kill over the next three weeks at 2,285,000. An equivalent calculation places the average kill in the non-holiday weeks of July at 2,310,000.

I also notice that hog slaughter in April was up 1.1% from a year ago; in May it was up 1.7%; and the projections I just talked about would be up 4.3% in June and up 4.2% in July. From this angle, they seem fairly generous.

It's possible that *much* milder temperatures in the Midwest so far this spring have allowed hogs to gain weight faster than they did last year. Based on USDA's daily LM_HG201 report, carcass weights are running three pounds heavier than a year ago.



It could also be that carcass production (for export to China) is already approaching the 60,000-70,000 per week objective that I hear about in the Sewing Circle. That, of course, would reduce the supply available to the domestic market.

Anyway, it seems likely that pork production will drop substantially, and very soon.

So, then, why do I suggest (in the graph on the first page) that the demand index will fall right back to where it stood just prior to Memorial Day? I don't really have a good reason, except that if I assume that it holds at this past week's reading, it would make for some unusually sharp increases in the cutout value…e.g., as much as $10 per cwt within two weeks. I have not been very successful betting on higher cutout values lately.

As for the export picture, my revised projections following Friday's release of actual data for April are shown in the table below:

U.S. Pork Exports (million pounds)

	Q2 Quantity	Yr/Yr Change	Q3 Quantity	Yr/Yr Change	Q4 Quantity	Yr/Yr Change
Mexico	387	-19%	418	+5%	482	+12%
China/HK/Taiwan	198	+61%	355	+356%	450	+367%
Japan	284	-5%	271	-7%	281	-8%
Korea	190	-2%	102	-7%	188	-11%
Canada	147	+18%	155	+10%	151	+8%
Columbia	90	+30%	80	+43%	104	+13%
Australia	80	+58%	67	+34%	75	+9%
Total	1572	+4%	1625	+25%	1943	+26%

On this subject, I read in USDA's *Global Agricultural Information Network* that the Chinese government is accepting applications from Chinese businesses and trade groups for exemptions from the retaliatory tariffs implemented a year ago. If I am interpreting the GAIN report correctly, this could have the same effect as a negotiated elimination of the tariff.

U.S. Beef Exports (million pounds)

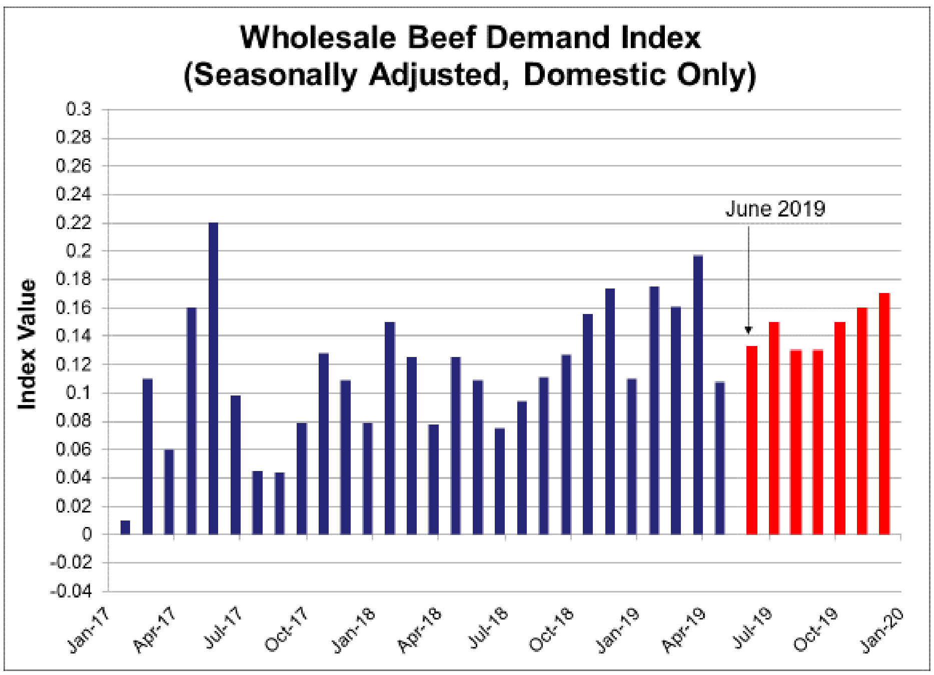
	Q2 Quantity	Yr/Yr Change	Q3 Quantity	Yr/Yr Change	Q4 Quantity	Yr/Yr Change
Japan	201	-13%	225	-9%	198	-3%
Korea	185	+12%	196	+8%	171	+10%
China/HK/Taiwan	107	-14%	127	+5%	189	+13%
Mexico	113	-2%	119	-3%	115	+1%
Canada	73	-11%	67	-9%	70	-5%
Total	763	-5%	815	-1%	833	+4%

By all indications, China's appetite for imported beef is as strong as ever. This notion is corroborated not only by trade statistics, but also by noting the aggressive bids that Chinese importers are laying on the table. However, it is difficult to forecast more than a mild increase in U.S. beef exports to the "Greater China" region as long as the zero-tolerance policy on ractopamine remains in place, and I assume that it will. The increase that I am projecting--from 5% below a year ago in the second quarter to 4% above a year earlier in the fourth quarter--would largely be the result of U.S. packers "filling the holes" in the market left by Brazil, Australia, New Zealand, and Canada. I notice that as of two weeks ago, outstanding beef export sales stood 27% above a year ago.

But it is domestic demand that should keep the beef market better-supported through July than most traders are anticipating, if the futures market is any indication. As of Friday's close, the futures market was pricing in a combined Choice/Select cutout value of about $205 per cwt in July and $201 in August. [The current quote is $219.02.] In order for prices to drop this low, demand at the wholesale level would have to show a *much* greater than seasonally normal decline from its already depressed status in May.

This prospect is contradicted by the increased volume of product that has been booked for delivery in late June and July, the result of more aggressive asking prices in the forward market. It looks very much as though demand reached a short-term cyclical low in May; and in that case, chances are that the demand index will actually *increase* from May to July this year.

You're probably tired of looking at this picture week after week, but it holds the key to near-term price behavior:



The type of moderate recovery in the demand index that I'm suggesting would place the combined cutout value at an average of $219-$220 in July and $215-$216 in August. This assumes an average weekly steer and heifer kill of 505,000 per week in July (including the holiday week) and 519,000 in August.

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.