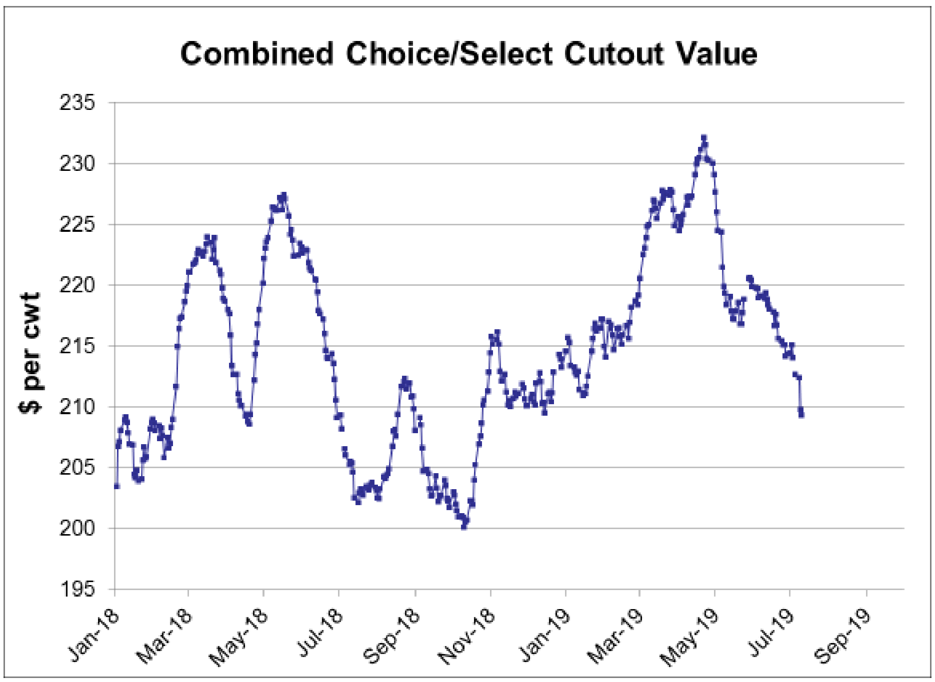
MEAT MARKETS
UNDER A MICROSCOPE

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

July 10, 2019

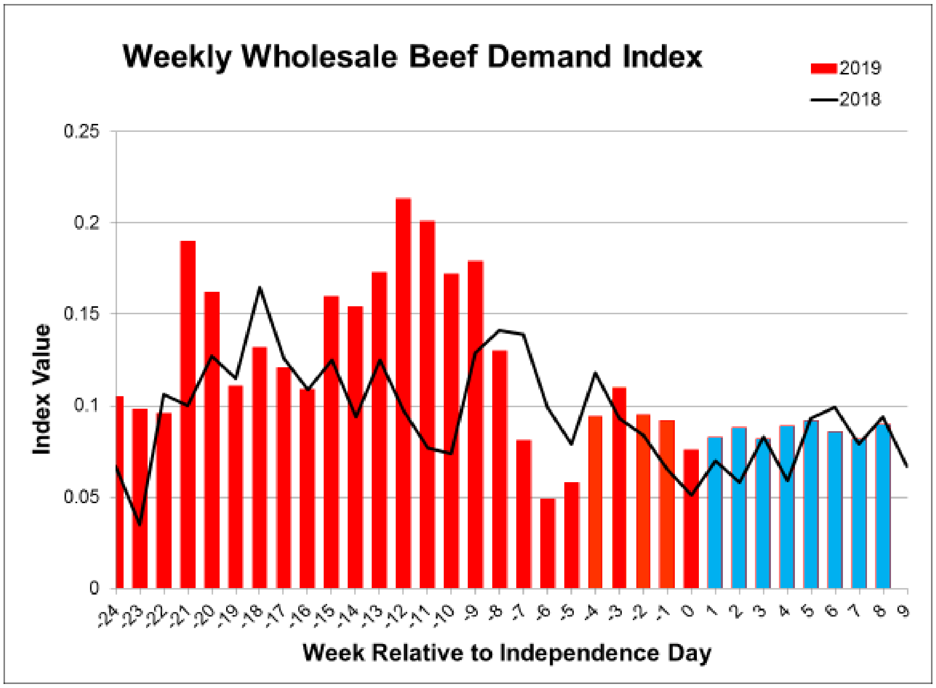
The combined Choice/Select beef cutout value has certainly been weaker than I had expected in the post-holiday trade, and so now I am searching for reasons….and for clues of whether it is headed into its usual slide through July, or whether it will stop right here instead.



First of all, let's define what we mean by the "usual slide". If we calculate the 15-year average cutout value for each week on the calendar, we find that the lowest price occurs in the third week following Independence Day (i.e., the week after next). The average change during this upcoming two-week period is -2.3%, which in this case would place it at $205 per cwt. From the looks of the chart, this seems to be a realistic expectation. The next peak occurs, on average, three weeks later in the second week of August, and this recovery has averaged +2.7%....which would pull it back up to $210-$211. All neatly packaged.

But this scenario implies that wholesale beef demand is actually going through a slightly greater-than-seasonally-normal decline, which is the opposite of that which I had expected. Since I spend an unhealthy amount of time obsessing over the meat markets, this bothers me. The seasonally adjusted demand index moves in pronounced, if not clearly-defined cycles, and it still looks very much as though a cyclical bottom was reached in May and June. Its normal behavior, then, would place it on the upswing here in July and on into August. And so the way it is acting right now is confounding.

If the market is to follow the path I just described--moving down from its current quote of $209 down to $205 two weeks from now, and then back up to $211 in mid-August--then there would have to be no cyclical recovery in demand whatsoever from its weak status of June, as I show below:



I had thought that the relatively low forward price offerings into this time frame (and they are still quite low) would attract the interest of retailers and result in a better-than-seasonally-normal demand performance. It could still happen, although forward bookings for second half July and first half August delivery have not been overly impressive. Out of respect for the signals that are currently flashing, I feel like I have to go with the rather pessimistic picture I just painted. But even if it is being delayed for some reason, it seems highly likely that the next material change in wholesale beef demand will be upward.

By the way, the demand projections shown in the graph above assume that steer and heifer kills will average 516,000 through the balance of July and 518,000 in August. These compare with 508,000 and 516,000 a year ago, respectively.

The "dead weight" in the cutout value at the moment is in the middle meat group (which was to be expected) and parts of the round complex (which has come as a surprise to me). In regard to the latter, I notice first that bottom round flats have slipped from $2.20 per pound to $2.05 since the first week of June, a time during which this item has consistently gained ground in the past. But I also notice that the flats are now priced just a nickel above the 85% lean trimmings, which have been relentlessly stout all year long. This is a supportive factor that was not present last summer; at this time last year, the flats traded at $2.08 and the "85's" traded at $1.89. The same goes for the eye of round, although the pullback has been a bit more modest. Currently it trades about even with a year ago at $2.15. Knuckles have gone through a catharsis of sorts this week, in what appears to be a one-off, high-volume, "clean-up" type affair. Inside rounds have held steady since early June. None of these items has a bearish track record between now and the end of the month; in fact, knuckles and round eyes show a distinctly upward bias. The bottom line: I don't think this complex is in serious trouble.

Meanwhile, the near-term prospects for ribeyes, strips, and top butts are a matter of guessing the price at which either: a) steak cutters begin to put a lot of product into the

freezer, on the notion that major lows are being made; or b) packers get enough meat sold into pre-Labor Day time slots that they don't have to discount prices any further in order to keep supply and demand in balance. I don't think that any of the middle meats are far away from those "trigger points".

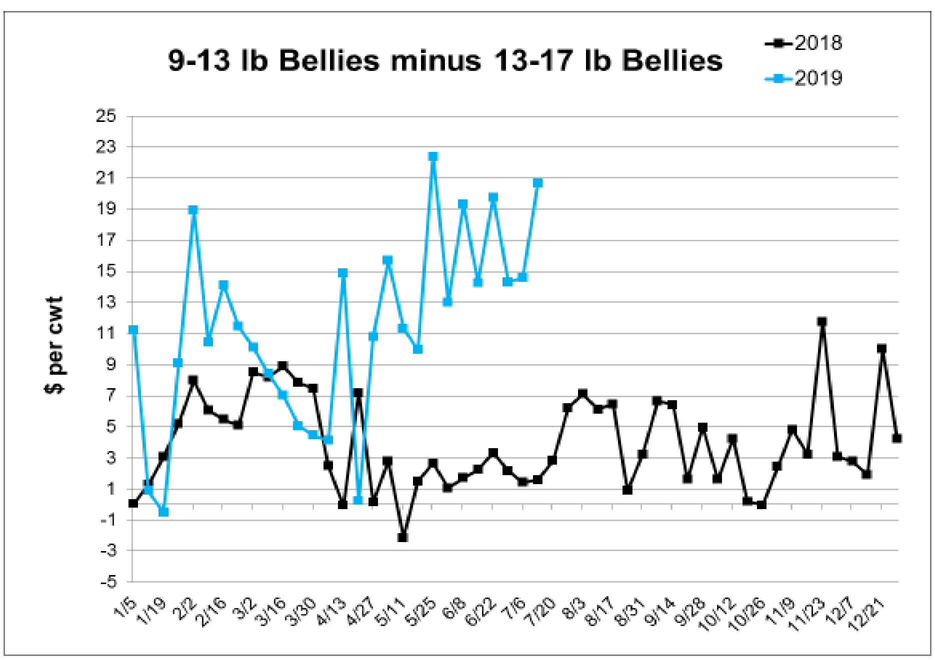
Prices of Choice ribeyes (let's call the boneless market $7.50 per pound) have been considerably more stable since Memorial Day than they were last year, and I regard this as a reason to think that there is no vacuum in demand lying below the surface. Therefore, there may be no cause for this market to reach all the way down to the July 2018 low of $6.65 on this go-round. The January 2019 low of $7.20 could very well be the place for it to "catch". Why not?

Choice 0x1 strips are approaching $5.50 per pound, leaving last summer's low just 30¢ away. There was no "demand-snuffing" rally in June; in fact, prices declined consistently throughout the month.

Choice top butts are situated around $3.15 this week, compared with $3.50 at this time a year ago. They have not been this cheap coming out of Independence Day since 2011, and in that year--coincidentally, perhaps, but maybe not--they bottomed at precisely this point.

Let's talk about pork bellies. **It has been tiresome trying to guess exactly when they will begin to rally in earnest, but one thing seems certain: because of the depressed state of the market this far into the summer, the inevitable rally will be accentuated….and it will last longer than it normally does**. By most accounts, demand for bacon from the supermarket sector is building fairly rapidly, which suggests that retail promotions in August will be active.

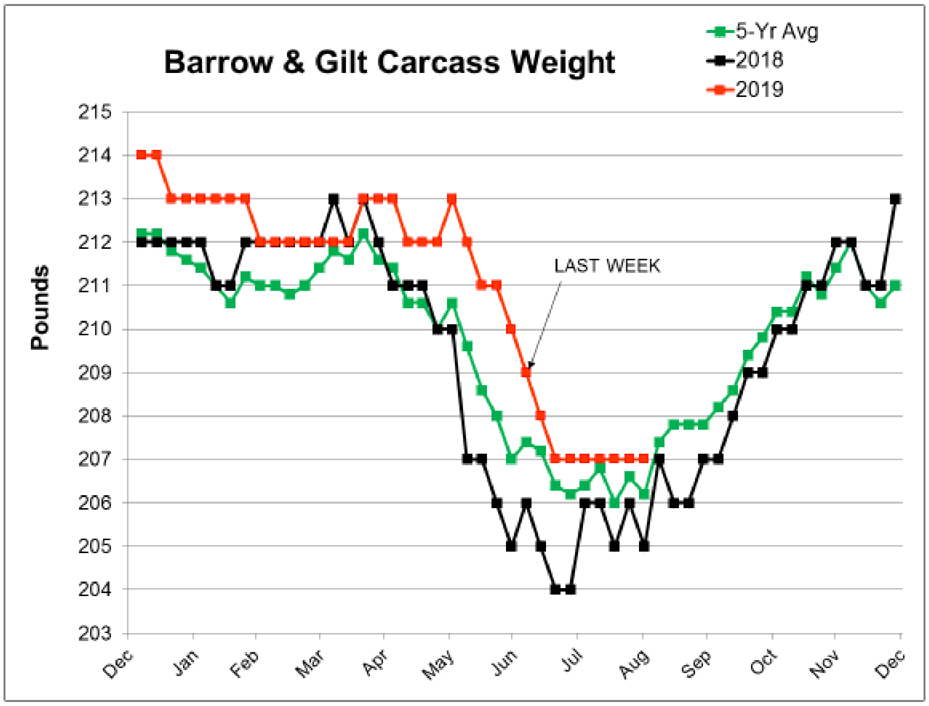
I'm told that one of the biggest problems that the belly market has struggled with over the past six weeks or so has been the excess supply of heavyweight product. The spread between 9-13 clearly illustrates the situation:



The two sizes are not interchangeable, due to finished product specifications. And since the volume of trade reported in the heavier weight category has been far greater, the pork belly primal value quoted by USDA has been suppressed.

So, then, what will cause this condition to change?

The answer is obvious, at least in the short term: lighter carcass weights. And carcass weights are indeed falling, after being inflated by exceptionally cool weather in May/June, and quite possibly by producers delaying marketings in expectation of rapidly escalating prices.



Barrow and gilt carcass weights have dropped four pounds over the last five weeks and at the rate they're going, it should not be long at all before the "overhang" of heavyweight product evaporates and undertone of the market turns improves noticeably. Given the inelastic nature of bacon/belly demand, and especially in view of the special circumstances that I mentioned a minute ago, I'm guessing that the ascent in prices will be steep. An immediate upside target would be approximately $1.40 per pound, where the latest recovery attempt failed (that was on May 20). Last summer's peak of roughly $1.75 seems well within reach. A $.75 per pound rally in belly prices would add roughly $12 per cwt to the pork cutout value…..

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