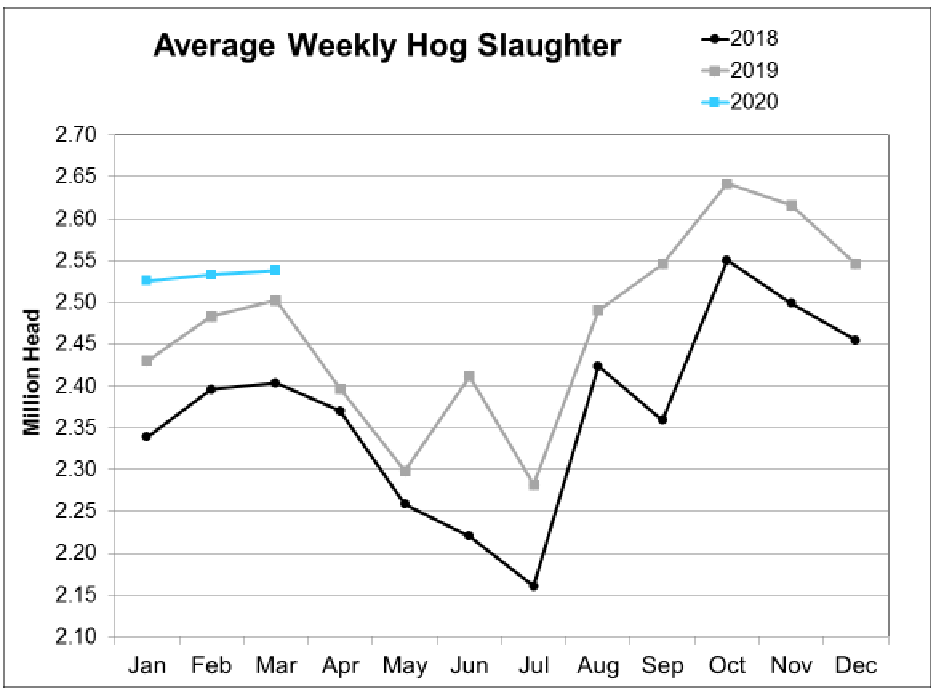
MEAT MARKETS
UNDER A MICROSCOPE

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

July 2, 2019

On the subject of hog supplies and last Thursday's *Hogs and Pigs* report, I'll get right to the bottom line. Taking the new pig crop estimates at face value and doing so as objectively as I can, I am constructing my price forecasts on the basis of the following slaughter projections:



Before I dive in, though, I should acknowledge how I had proclaimed that USDA would not revise its winter pig crop estimate at this stage of the game, but would wait until summer hog slaughter had been counted. For years now, this has been its *modus operandi.* Well, I was wrong about that. From time to time I need to be reminded that I'm not as smart as I think I am.

Second quarter kills turned out to be extraordinarily large in relation to the fall 2018 pig crop estimate, and so the latter was naturally adjusted upward. Apparently, the discrepancy was large enough to cause the scientists at the National Agricultural Statistics Service to rethink the expansion factors used in its estimation procedure, or something of the sort.

OK, so now that the upward adjustment to the winter pig crop has been made, and even though it was not great (from 3.7% to 4.1% above a year earlier), for the sake of objectivity I have to assume that the revised figure is accurate….that this summer's kill will align in typical fashion with the new pig crop estimate.

This makes for a very odd pattern in hog slaughter--namely, an abnormally big drop in kills from June to July. In the four non-holiday weeks of July they should average near 2,340,000, compared with the June average of 2,421,000. A decline of this magnitude is quite rare, but not unprecedented; something similar occurred in 2014, 2002, and 1995. Prior to 1995, such steep drops were more common. I am willing to buy into the theory that hogs were held off the market during April and May in expectation of sharply higher prices and that the resulting backlog was a main reason for the swollen rate of production in June. I don't know how else to explain the record-large increase in kills from May to June.

I have to think that the pork cutout value will be sensitive to a slowdown in production of this magnitude, especially considering that it has lost more than $15 per cwt since the middle of May. It's likely that prices are "overshooting the mark" to the downside, such that they have *probably* fallen farther than is necessary to keep supply and demand in balance with the (presumably) lighter rate of production in July. This is a difficult concept to explain in a way that makes sense, but I'll give it a try.

Let's take the 15-year average as a benchmark or "base period", and calculate the average pork supply and the average cutout value over that period. The supply measurement I'm using is the net domestic supply per capita: [pork production + imports - exports +/- change in freezer stocks] ÷ population. This total is then expressed in a weekly rate in order to account for any differences in the number of business days. We'll make a separate calculation for each month, so as to account for seasonality. The table below shows a comparison of 2019 supplies and prices and their deviations from the base period. I have included my humble projections of second half of 2019 supplies:

	(1) 2019 Supply vs. Avg Supply	(2) 2019 Cutout vs. Avg Cutout	(3) Sum of Columns (1) and (2)
Jan	+4.9%	-6.3%	-1.4%
Feb	+10.4	-17.4	-7.1
Mar	+9.8	-4.9	+4.9
Apr	+5.7	+10.8	+16.5
May	+4.3	+4.3	+8.7
Jun	+14.3	-4.2	+10.1
Jul	+8.0		
Aug	+5.6		
Sep	+2.1		
Oct	+1.2		
Nov	+1.0		
Dec	-0.3		
Jan-Jun '19 Avg	+8.2	-3.0	+5.3

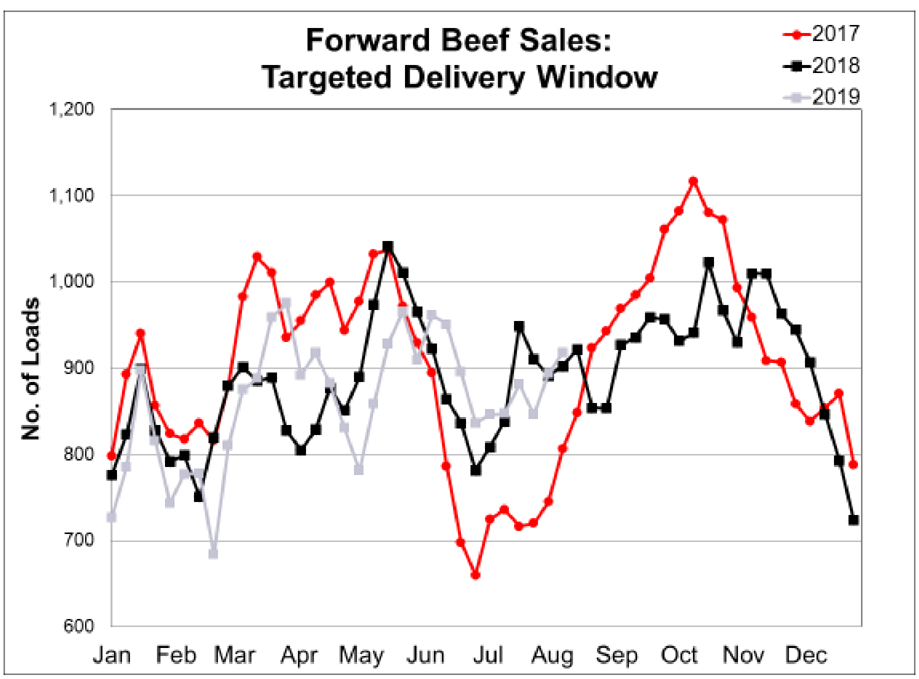
So far this year, the net domestic pork supply has averaged 8.2% above the 2004-2018 base period; the pork cutout value has averaged 3.0% below the base period. Since the decline in price is less than the increase in supply, it's fair to say demand for pork at the wholesale level has been above the 15-year average. Now, the most objective, if not ingenuous, way to project demand is to assume that the differentials listed in column (3) will continue to fluctuate around the year-to-date average of 5.3. This is usually a valid assumption as long as demand exhibits no time trend--which lately it has *not*; over the last four years, the trend has clearly been sideways. So what, then, could we expect the cutout value to do under such demand conditions?

Well, there would be a rally during July, and a pretty stiff one.  The cutout value would average near $85 per cwt in both July and August, quite a distance away from the current quote of $73.21. It would then set back only slightly from that point into the fall, still averaging above $80 in October.

What I'm doing here, of course, is verbally describing the seasonally adjusted demand index, to which I often refer in my market reports. I'm not doing this for fun, but to force myself to think through my own projections of demand at the wholesale level--an obviously critical element in the price forecasting equation. So let's move on.

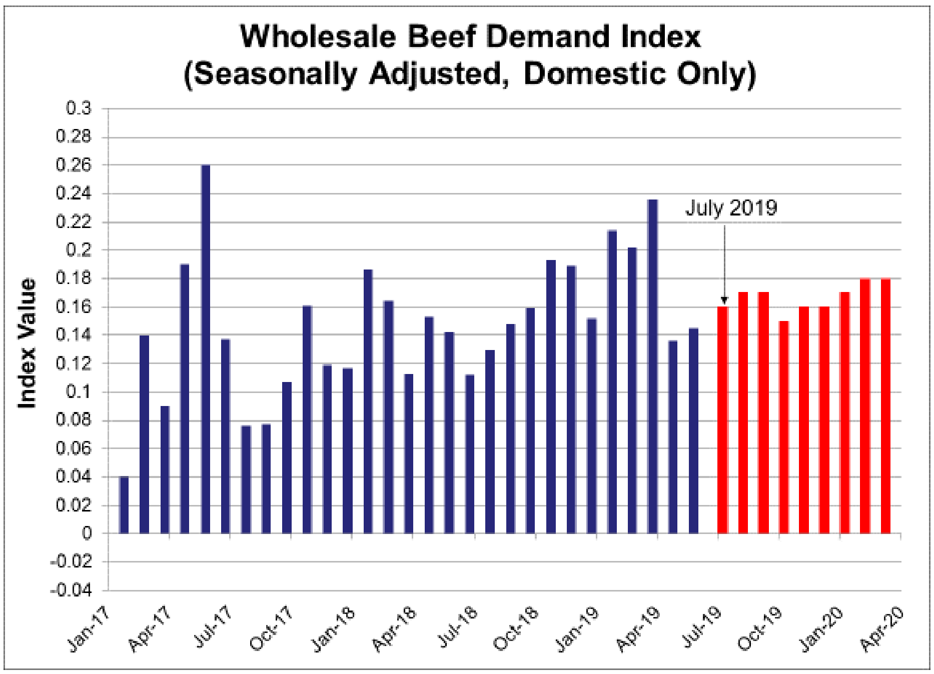
The beef market, meanwhile, remains in pretty good balance. The combined Choice/Select cutout value today trades at about the same price as it did at this time last week, and actually a bit higher that it finished last Friday. It's still early yet, but so far, this a sharp contrast to the way it behaved around the Fourth of July last year; in the week of Independence Day 2018, the market lost $4.48 per cwt and still had another $5 to go before the summertime low was established two weeks later.

I don't see anything on the near term horizon that would bring about a serious decline between now and the end of the month. First of all, the volume of product booked for delivery in the second half of July is just "OK"--not great, but not indicative of any "potholes", either. Quantities booked for delivery in early August are larger. This number is not failsafe, but it is usually a pretty good reflection of the amounts that retailers expect move, based on their featuring strategies.



Secondly, as best I can tell, the only items that appear to have any material downside potential in the near term are the Choice middle meats. On that subject, there remains a substantial distance between current quotes and the July 2018 lows; but I wonder if we really can expect these members of the family to match those lows, considering that there was no demand-dampening rally whatsoever during the month of June. The major chuck and round cuts are not offered heavily for delivery within the next few weeks, and now that the briskets--which have been a major drag on cutout values over the last five weeks--have dropped into a likely support area (let's call it $2.50 per pound), there is seemingly little downside potential remaining. Ground beef and 50% lean trimmings likewise are showing no sign of a surplus at the moment. Select-grade ribeyes have already traded down to last summer's low, and Select strips, short loins, and top butts have already fallen below that point….by a good bit. It would not be surprising to see some counter seasonal strength develop in these items.

Finally, as I have mentioned quite often, it appears that the seasonally adjusted demand index hit a short-term cyclical bottom in May, and should be on the upswing--even if it is to be only a modest recovery. But even if there were no such improvement in the demand index from its June reading; and if weekly steer and heifer kills were to average 515,000 over the next four weeks and 515,000-520,000 in August; then the combined cutout value would still trade mainly in a range between $210 and $215 from now through Labor Day.



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