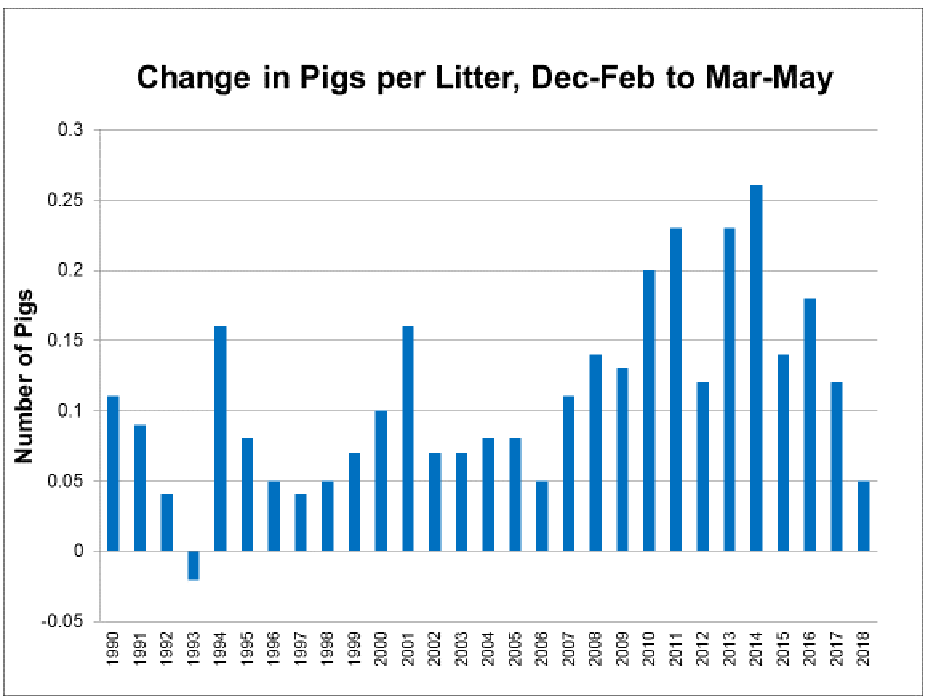
MEAT MARKETS
UNDER A MICROSCOPE

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

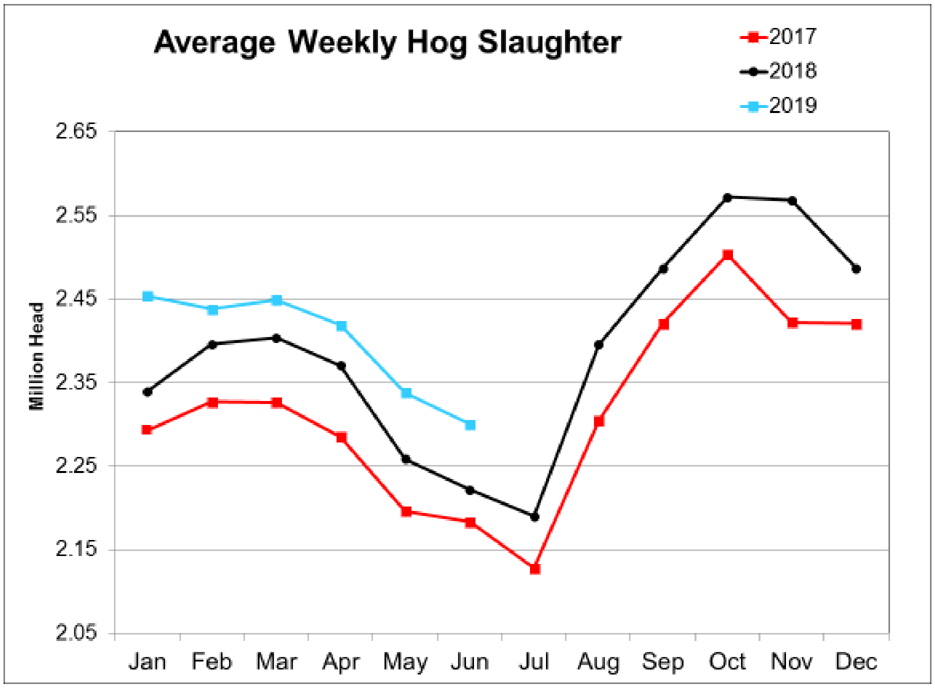
July 3, 2018

The surprise in last Friday's *Hogs and Pigs* report was the 3.5% increase in the breeding herd. This was the biggest year-over-year increase for any quarter in the last 20 years. On the surface, it seems to say that the pace of herd expansion has accelerated, but I don't think that's the case. Instead, it probably reflects an effort among producers to compensate for unusually high death loss among newborn pigs due to Porcine Epidemic Diarrhea virus in the spring. It is a reasonable theory, because there was indeed an exceptionally small increase in the number of pigs saved per litter from winter to spring this time around:



Otherwise, the U.S. market hog inventory is growing along the roughly 3% trajectory on which it has been for the past two years.

Going straight to the bottom line, on the next page I show my projections of average weekly hog slaughter over the next twelve months. As usual, these projections are as objective as I can make them, which means that I am taking USDA's estimates of the winter and spring pig crops, as well as summer and fall farrowing intentions, at face value. They are not adjusted by any secret hunch or mystical intuition on my part. The pigs per litter projections for this summer and fall assume that there will be a *slightly* greater than normal increase from spring to summer this year (because of the relatively small PPL this past spring), and a summer-to-fall increase that is quite in line with the last four years. Projected pig crops for June-August and September-November are calculated accordingly.



Complete objectivity also assumes that the relationship between average weekly slaughter in each quarter and the corresponding pig crop is very close to the five-year average. Finally, the distribution of each quarterly kill among individual months is likewise assumed to land in the "middle of the road".

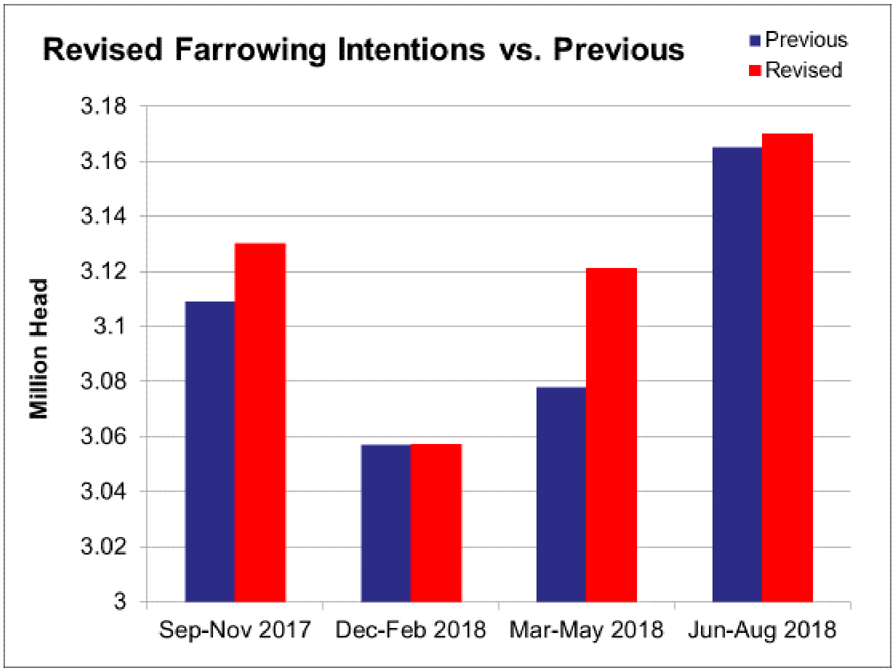
OK, now that the "baseline" slaughter projections have been established, we can look for places along the road where hog slaughter might deviate. **I can think of only one, really, and that is that the third quarter kill projections shown above could prove to be a bit too low**.

I did not expect any adjustment to this past winter's pig crop in the latest report, and there was none. For several years now, it has been USDA's *modus operandi* not to alter its previous estimate of the pig crop supplying the nearest quarter's kill. Do you know what I mean? For example, the original fall 2017 pig crop estimate was not adjusted until spring 2018 hog slaughter was "in the books"; likewise, I will look for an adjustment to the winter pig crop—but not the spring 2018 pig crop—in the September report.

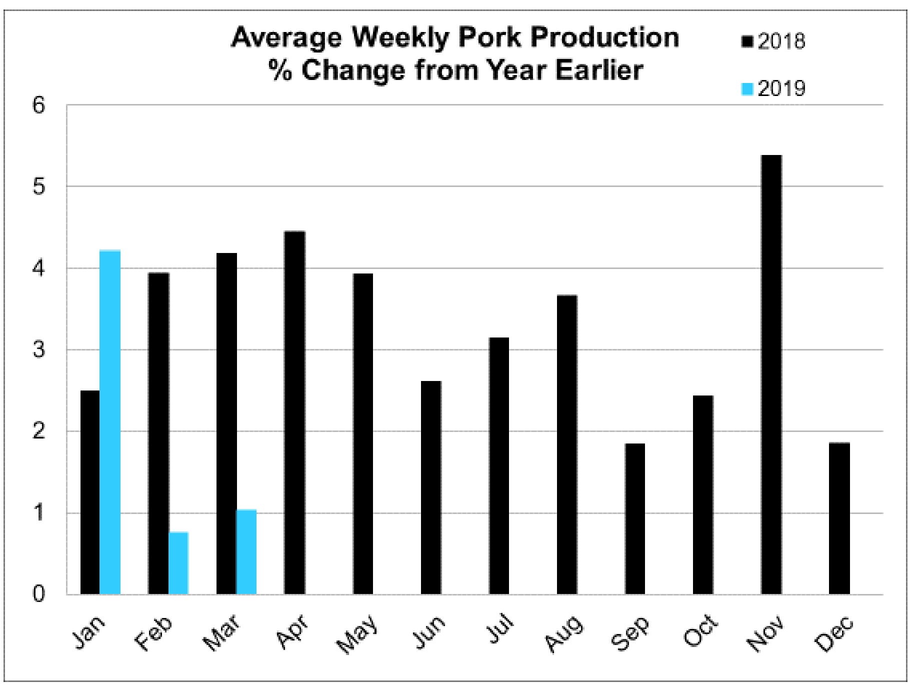
I am suspicious, though, that the December-February quarter was the *only* one in which farrowings were not revised upward. Actual fall 2017 farrowings turned out to be larger than the numbers reported in March; so were actual spring 2018 farrowings and summer farrowing intentions. I'm stumbling over myself trying to explain my point, so I'm afraid I'll have to show you a picture. It is at the top of the next page.

Thus, there is cause to suspect that average weekly kills will be bigger than 2,190,000 (up 2.9% from a year ago, holiday week included) in July; and bigger than 2,396,000 (up 3.9%) in August.

Otherwise, it is worth mentioning the likelihood that hog slaughter could easily be 6% above a year earlier in November, simply because last year, the November kill was extremely small in relation to the rest of the quarter. I'm still not sure why.



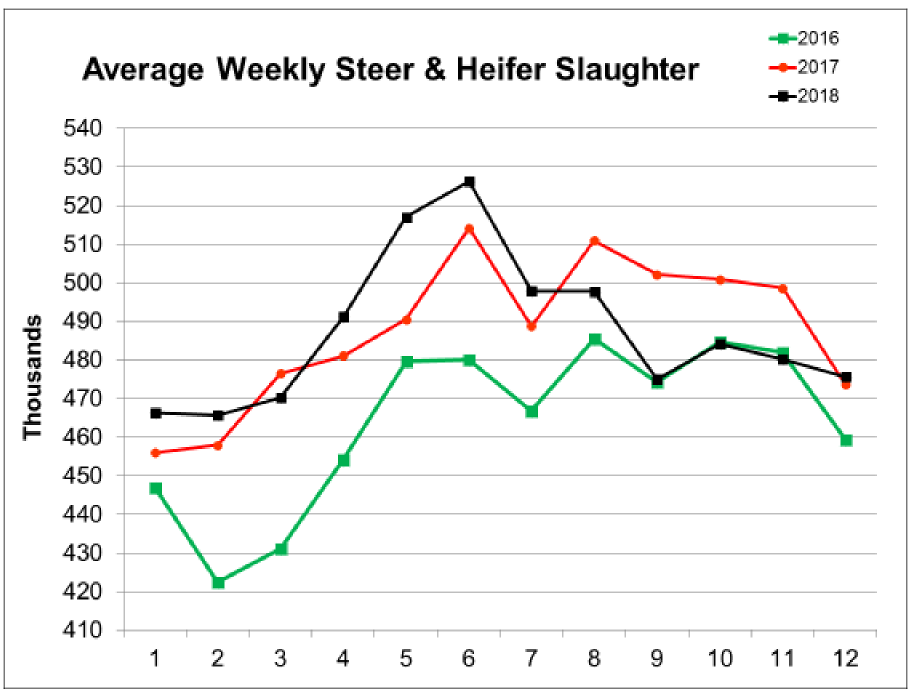
Meanwhile, if carcass weights follow along a fairly normal seasonal path, then they should drop below a year earlier in August and remain so through the end of the year—by roughly 1.25 pounds on average. It makes sense that hog producers might intentionally speed up the "throughput" with the specter of massive fourth quarter hog supplies looming. Naturally, this should result in a smaller year-over-year increase in pork production than in hog slaughter:



Finally, the increase in net domestic pork supplies—taking freezer stock flows, imports, and exports into account—could be smaller still, if U.S. pork exports exceed the depressed 2017 levels by 10% in the third quarter and by 5% in the fourth quarter, which is my best guess at the moment. Of course, the export outlook is much more cloudy than usual (at least in my mind) because it is so difficult to forecast the impact that tariffs in Mexico, Canada, and China may have. Foreign trade figure for the month of May will become available next Monday, and so I will sharpen my pencil next week.

In the World of Beef, the decline in cutout values is proceeding pretty much as expected. **The combined Choice/Select cutout, which was quoted yesterday at $209.11 per cwt, still appears to be headed for an interim low around $204-$205 in either the third or fourth week of July**. If you recall, a couple of weeks ago I mentioned that by the end of July it will have declined ten weeks in a row, and the longest string of losses at this time of year has been eleven weeks.

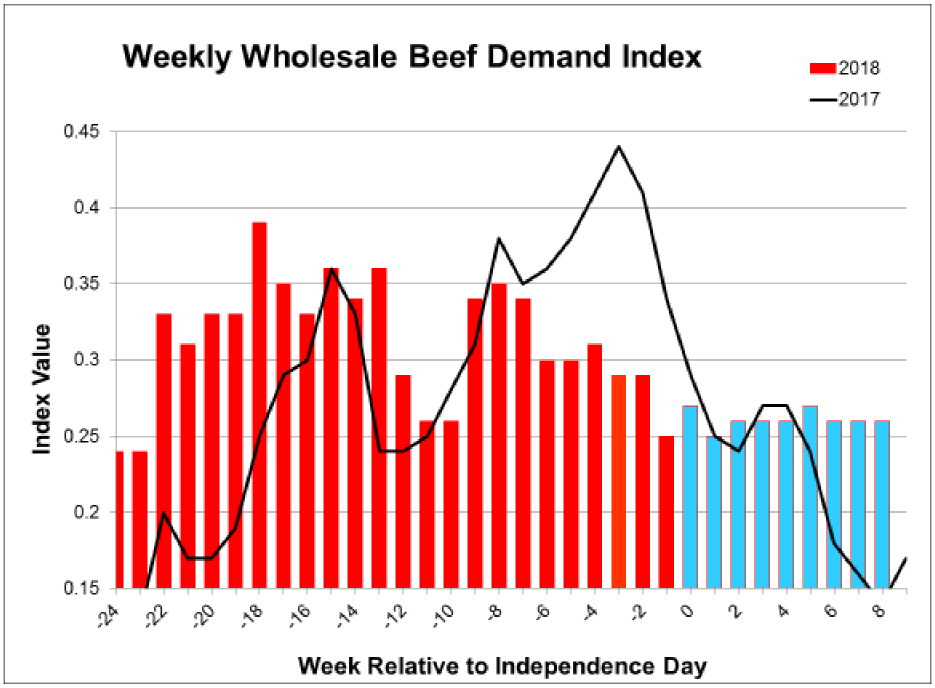
It is my expectation of a considerably steeper-than-normal decline in fed cattle slaughter through the summer that draws the most ridicule from my peers (it's at the top of a long list). Honest to God, it looks to me as though there will be a 5% drop from June to August this time around, compared with just 0.6% last year and the 15-year average of 2.9%. That should bring steer and heifer kills down 3% below a year earlier in August and 5-6% below in September through November. I have recounted the logic *ad nauseam* in the last few weeks (aggressive marketings up to this point, a shift to a premium structure in the futures market, etc.) and so I shall not wade through the same detail today. However, I would like to point out that it is not *that* unusual for fed cattle kills to be below a year earlier even though the inventory of cattle on feed 90 days or longer is up. It has occurred exactly 78 times (months) in the last 20 years; and it has occurred 52 times even when the increase in the "90-day" inventory was up at least 5%. I would present the entire list for you, but that would only demonstrate that I need a hobby.



Naturally, the supply picture, as I see it, endorses the notion that there will be solid support in the combined cutout value about $5 per cwt below the current quote.

This notion is also backed up from the demand side of the equation. As I show on the next page, the performance of wholesale beef demand over the last eight weeks has underperformed relative to the seasonal norm. However, if the demand index were to remain at its currently subdued level and simply follow a normal seasonal path from this point forward, then the combined cutout value would indeed hit bottom around $204 per cwt and then rally back to $214 or so into the middle of August. In the picture, the first blue bar represents the week we have just begun.

And just to remind you, forward bookings for delivery in late July and August have been pretty impressive, and so there is reason to think that the changes in wholesale demand over the next eight weeks will be at *least* as strong as the seasonal "par"….



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