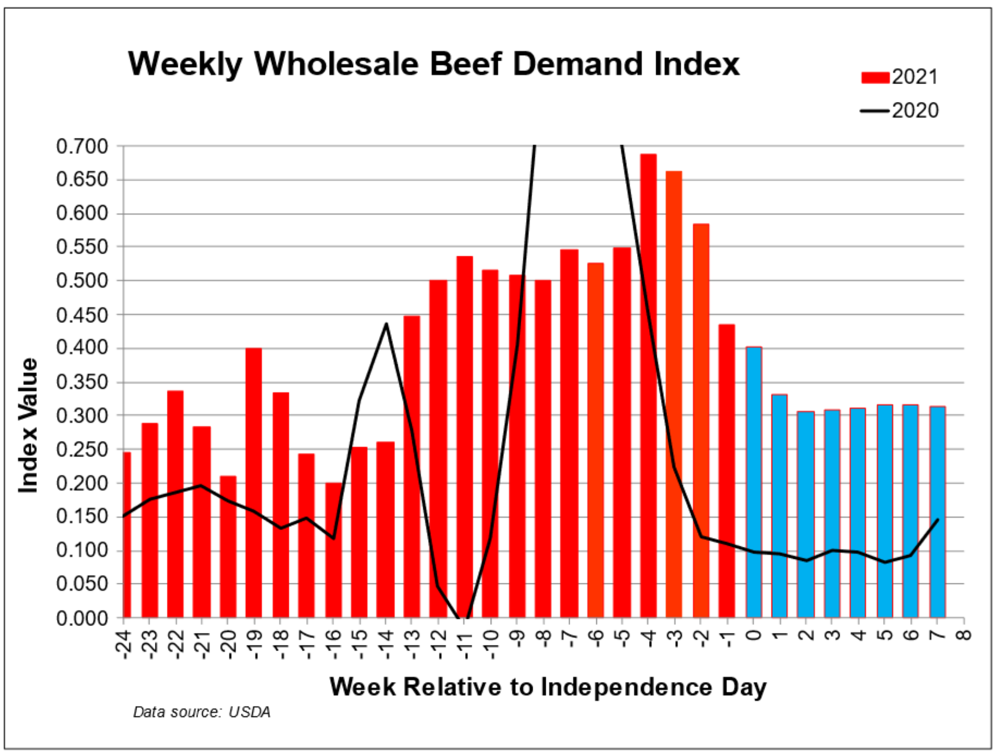
MEAT MARKETS
UNDER A MICROSCOPE

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

July 4, 2021

Demand for beef at the wholesale level is finally showing measurable signs of a slowdown. Last week's market performance was unimpressive—by recent standards, anyway—as the combined Choice/Select cutout value lost $17.82 per cwt from Friday to Friday despite an unusually sharp drop in production a head of the holiday. This is reflected in the seasonally adjusted demand index, which last week fell to its lowest reading since the end of March:

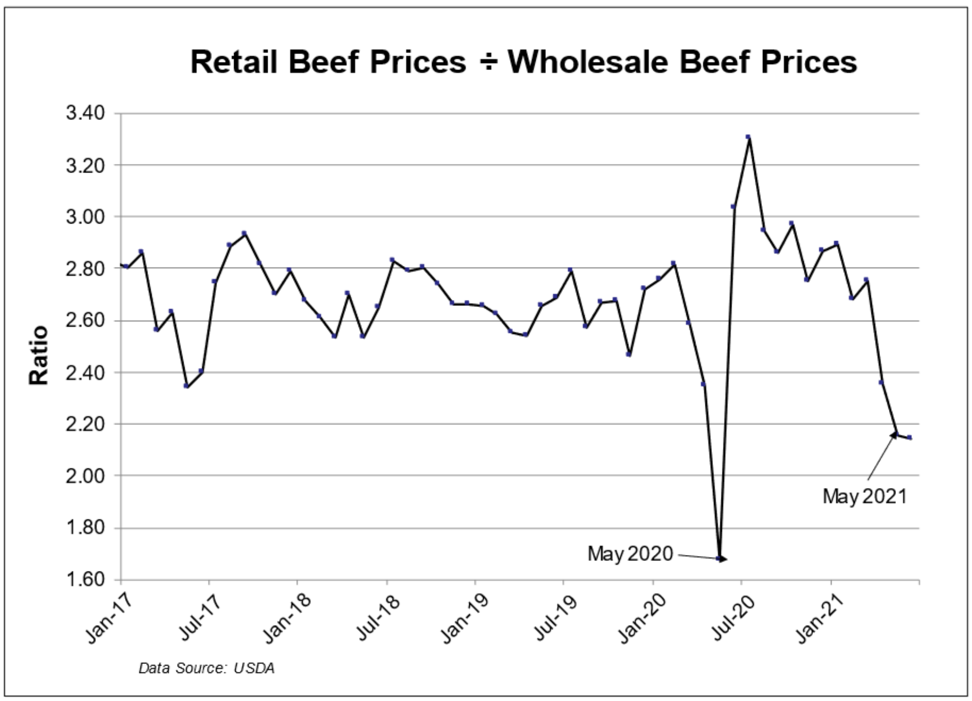


We have to keep things in perspective, though. The longer-term measurements indicate that beef demand has moved up into a permanently higher "bracket", and so I am inclined to view this as only a temporary setback. My humble guess is that the weekly index value will decline a little further in the next week or two and then flatten out through the end of August, essentially returning to its first-quarter status. But notice how much higher these projected values are in relation to a year earlier (represented by the black line in the chart above). I would hardly regard my demand projections as "pessimistic".

And yet, the demand pattern that I am suggesting would place the Choice/Select cutout value at $240 per cwt in the final week of July, another $40 down from the current quote. That price, of course, is the nearest support level on the chart, which somehow renders it a likely target for the next cyclical low point. I am assuming that weekly steer and heifer kills will range mainly from 505,000 to 515,000 from next week through the end of August. That would be below the pace that was set during the three weeks following Memorial Day (528,000), but quite a bit higher than last week's total (485,000).

The central issue remains the escalating retail prices, and how much tolerance consumers will have for them. I presume that the market has encountered some "push-back" lately, and this is why the wholesale demand index has dropped off. But there is more to come (in the way of retail price increases, I mean), possibly a *lot* more.

The Commerce Department has not yet reported retail prices for the month of June, but it's highly doubtful that they increased enough to bring retail margins back within targeted ranges.

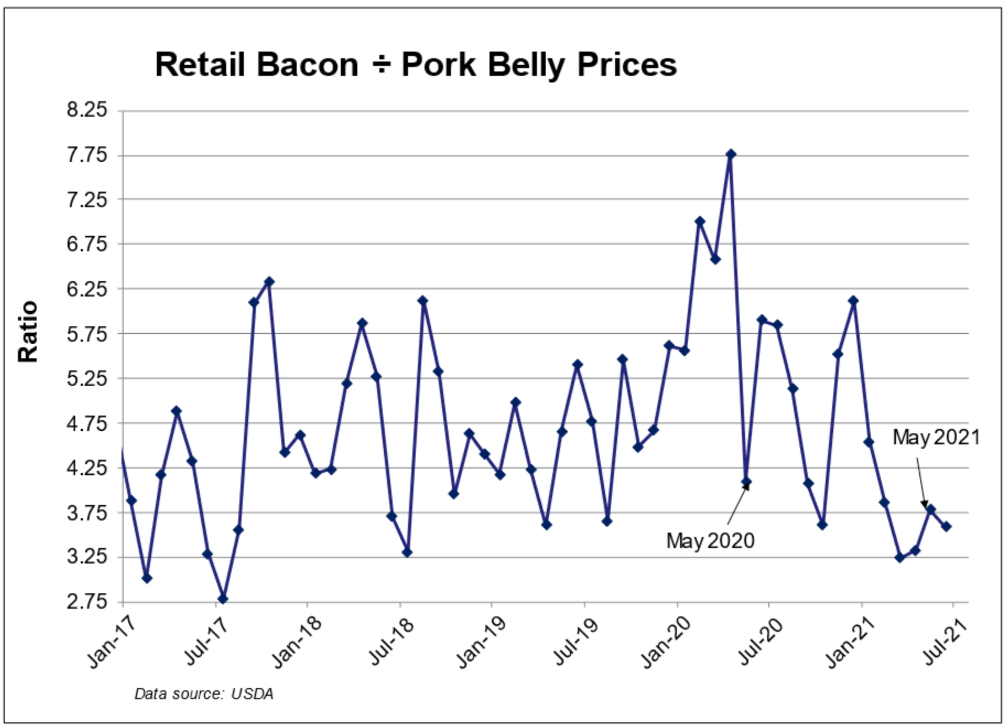


The picture to the left shows the actual ratio of retail-to-wholesale beef prices through May. I have included an additional data point comparing June wholesale prices with May retail prices, in order to estimate the sort of retail prices that will be required to bring retail margins back up to sustainable levels.

We're not talking about just a "tweak" here. Using the actual cutout value in June, in order to pull the ratio shown above up to, say 2.6, average retail prices would have to increase by 21% from May levels, taking them up to almost $1.00 per pound above the 2020 *peak* (which was itself a record high). Once again, we don't know how much was tacked on in June; but this should give us a glimpse of what may be in store for July. The scenario does not promise much in the way of supermarket beef featuring. Now, if cutout values drop to an average of $250 per cwt this month, as I am forecasting, then a meaningful reduction in retail prices could be in order during August….but not before then.

And so, as a trader, I am allowing a lot of room for wholesale prices to come down over the next 30 days of so, knowing that they are likely to "overshoot the mark" to the downside. Also, I anticipate that once the next cyclical low is essentially established, it would probably be another couple of weeks before they turn back upward again.

OK, so after this short-term cyclical downward phase in wholesale beef demand—and pork demand as well—has run its course, will the next upward phase carry it back up to this past spring's peaks? I'm afraid I'll have to "punt" on this question. It depends on how much of the recent burst in consumer spending power can be sustained. If we have been escorted into a new era of inflation by a vast increase in government spending and money supply, then there is reason to think that higher meat prices are here to stay. If the enhanced unemployment compensation programs and direct payouts and general "Post-COVID Euphoria" have played a major role up to this point, then the demand performance of the first half of 2021 would probably not be repeated. All I can say is that *if* the beef demand index were to return to its May/June peaks, then the combined Choice/Select cutout value would average just under $300 per cwt in the fourth quarter. The relationships between retail prices, retail margins, and wholesale demand are not as far out of balance in the pork market as they are in the beef market. However, the conditions surrounding pork bellies and bacon are worth a look, particularly because belly prices have been swinging wildly for the past two weeks….and of course, they are usually the most influential product in the determination of the cutout value in July and August.



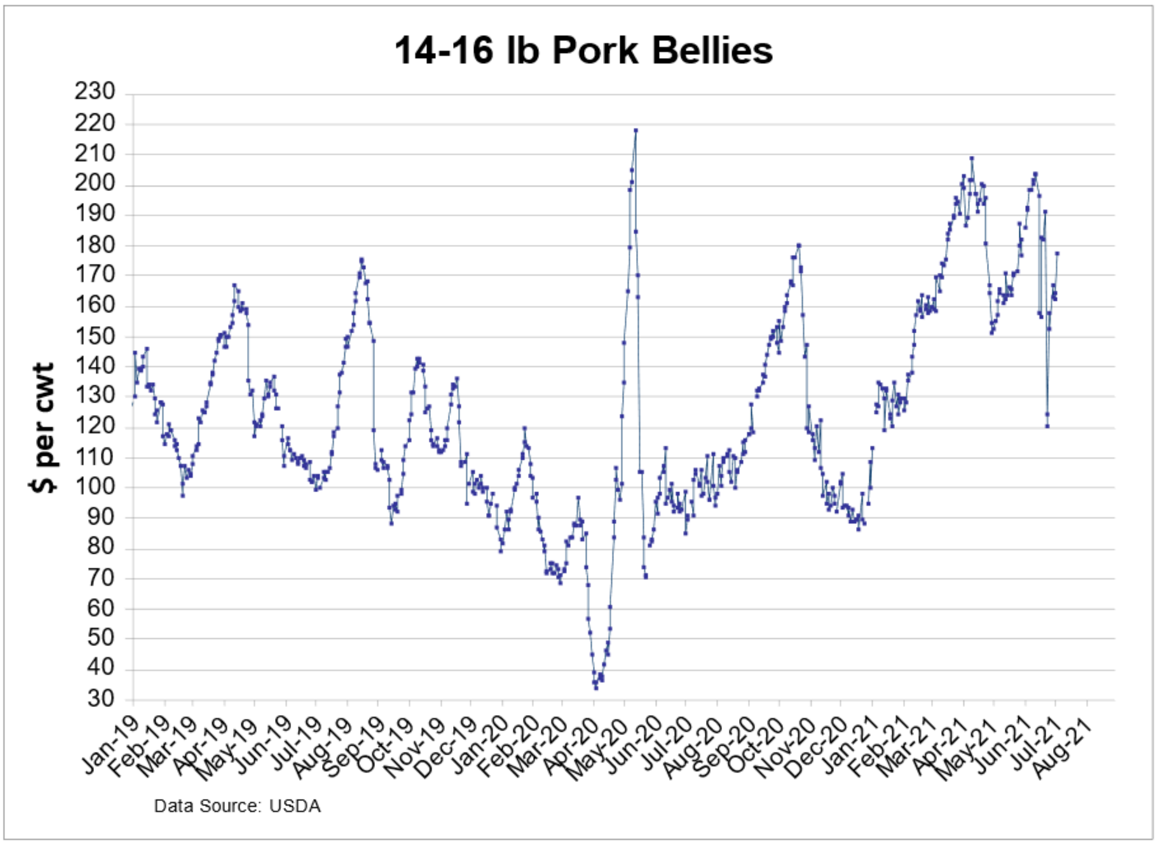
Retail margins in the bacon subcategory are not being squeezed *dramatically*, but they are exceptionally thin…and they have been that way for three months now. Thus, even though retail bacon prices were already matching their previous all-time high in May, it looks as though they are still trending upward. It would be fair to say, at least, that bacon will not be prominently featured in July. [Pork belly prices, by the way, averaged 5% higher in June than in May.]

It seems sensible to me that most of the near-vertical rally in belly prices between February 1 and April 1, which carried them from $1.30 to as high as $2.09 per pound, was tied to inventory replenishment in the foodservice sector. Bacon prices in the supermarket were rising rather sharply at the same time, rationing demand at that end of the pipeline.

It also makes sense to me that by now, most of the foodservice inventory replenishment should have been completed. Meanwhile, bacon demand from the supermarket sector is still being rationed; at least it's not being *encouraged*. And so, what would be left to push belly prices up above $2.00 per pound for a third time this year? The only thing I can think of would be light pork production, and this prospect is not likely. If USDA counted the winter pig crop accurately, then hog slaughter in July should actually be larger than it was in each of the last two weeks.

I wonder how the belly market could have dropped as hard as it did in the second half of June unless an extensive amount of demand had been rationed earlier in the spring—not only in supermarkets, but in the foodservice sector as well. The first big setback in belly prices, which occurred between April 9 and April 29, could have been written off as a correction—a normal "reboot" following a sharp rally, necessary for processors to generate a sufficient volume of sales through the summer. But this second setback? The timing is odd.

Since daily belly quotes (skin-on equivalent) have ranged anywhere from $1.20 to $1.90 per pound in just the last ten trading days, I'm going to pick a number near the midpoint—call it $1.60—and turn that into my forecast for the month of July. How's *that* for science?



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