WEEKLY OUTLOOK

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HOG PRODUCERS: GET READY FOR EXPANSION!

There seem to be two questions on the minds of hog producers these days. The first is,How long will these profitable prices last? The second follows from the first; Should I expand?

Profitable prices will most likely be with the industry through the summer of 2005, or for another full year. The reasons include, feed prices will be low, hog production will be moderate as breeding herd size has been reduced and demand will stay strong.

Last April, most hog producers started budgeting 2004 corn crop prices above $3.00 per bushel, now they are hoping to see prices below $2.00 per bushel. October soybean meal futures peaked at $257 per ton, but now are closer to $175 per ton. As a result of the bleak outlook last spring, sow slaughter was up 8 percent in the first quarter and up 3 percent in the second quarter. During the height of feed cost concerns - February, March, and April - sow slaughter was up 12 percent from the same period a year earlier. As a result, the U.S. breeding herd has been reduced, resulting in declining farrowings which stated last spring and are expected to continue through this winter. This means pork supplies will be close to previous year levels through next summer.

With moderate supplies, demand will continue to be the focus in hog price forecasts. Those forces are generally positive as well and include strong export demand, high U.S. retail beef prices causing consumers to turn toward pork, and narrow pork marketing margins which enable producers to receive a much higher portion of consumers= expenditures on pork.

In the spring, the fear was $50 per live hundredweight costs with $40 hogs. Those fears were quieted as the outlook reversed over the summer. For the coming 12 months, forecasts are that costs will average near $40, with average live hog prices in the higher $40s. Producers responded to this outlook reversal as well. Since early spring, sow slaughter dropped back to unchanged in the May through August time period. The question now is, When will expansion begin?

Some expansion can likely be expected this fall with the harvest of new crop corn. The increase in the number of gilts this fall will result in farrowings beginning to increase in the second quarter of 2005 with larger pork supplies by the fall of 2005. By historical standards, however, this expansion may be tiny and result in the breeding herd registering increases of only 2 to 4 percent. The last big expansion of the breeding herd was in 1998 when breeding herd numbers reached nearly ten percent above previous year levels. Everyone familiar with the industry recalls the disastrous results in late 1998 and 1999.

While the hog production and price cycle remains, the magnitude of production variation across the cycle is much smaller, but the magnitude of price and profit swings remain nearly as large as in the past. Prices appear to be extremely reactionary to small changes in supplies. While moderately lower supplies for the remainder of 2004 and the first half of 2005 mean positive prices and returns, this brings into question how low hog prices could go with even small increases of pork production in the fall of 2005 and in 2006. In addition, with corn utilization growing dramatically and 2005 yields not likely to achieve the lofty levels of this year, higher corn prices seem to be in the mix for the 2005 corn crop as well. If one continues to believe in the four year hog cycle, then 2004 and 2005 are the profitable years and 2006 and 2007 will be the difficult years, with 2006 targeted as the year with the potential for the largest losses.

Many questions remain. Has the expansion in Canada run its course? or will they continue to be the primary source of pork production growth in North America? Here it can be argued that the declining value of the U.S. dollar has taken away much of the incentive for expansion there. Secondly, has the excess expansion that occurred as the U.S. industry made the transition to an industrialized industry run its course? If so, margins in general could be more positive in the next five years compared to the last five. Finally, when will beef and poultry trade restrictions be resolved and discharge their bearish impact on hog prices?

Without question, there should be enough uncertainties in producers' minds to keep the coming expansion phase of the hog cycle at very modest levels.

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