

# Livestock Price OUTLOOK

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## PORK INDUSTRY MAKES TURN FOR THE BETTER

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### Summary

After a period of grave concern regarding depressed hog prices and rising feed prices in the spring, markets have turned positive for hog producers. Feed prices have dropped sharply with growing prospects of record corn and soybean crops and hog prices made a significant jump, lead by strong demand factors and narrow marketing margins.

Live hog prices are expected to average near \$50 over the next 12 months compared to \$44.70 over the past 12 months. Profits of about \$6 to \$7 per live hundredweight are expected in the next 12 month period after an extended two year period of losses from April of 2002 through March of 2004.

Reduction in farrowings this past spring and extending into this summer are expected to result in modest reductions in pork supplies this fall and winter.

Improved prices are the result of much better foreign and domestic demand and reductions in marketing margins and not due to reduced supplies. These demand factors are likely to remain positive for the last-half of 2004 and the first-half of 2005.

Corn prices may reach their lows in late July or early August, but soybean meal may not reach lows until the winter of 2005 if the U.S. crop is record large and a large South American crop develops as well. There appears to be little need to consider expansion in the U.S. due to the uncertainty over how restoration of beef and broiler trade will occur and due to the fact that Canadian breeding herd expansion is expected

to supply sufficient hogs to the U.S. in the coming year.

### The Numbers

The size of the breeding herd dropped to 5.9 million on June 1, 2004. This is the eighth consecutive quarterly drop in the breeding herd dating to the spring of 2002. In a somewhat longer context, the U.S. breeding herd has dropped by 1 million, or 15 percent, since June of 1998. In contrast, the Canadian breeding herd has increased by 357,000 since 1998.

The number of market hogs, at 54.2 million, was up 1 percent. Farrowings in the spring were down 1 percent and producers intend to farrow 1 percent fewer sows this summer with unchanged farrowings in the fall. By state, the declines in the breeding herd sound familiar, coming from the heart of the traditional hog-corn belt: Iowa (-1%); Ohio (-3%); Michigan and Nebraska (-5%); and Indiana and Missouri (-6%).

The market herd was up about 2 percent for animals coming to market in July and August, but down nearly 1 percent for those destined for market in September through November.

### Pork Supplies to Moderate

While summer pork supplies are expected to remain 3 to 4 percent higher than last summer, there could be some moderation by fall. Both fall and winter production are expected to be down about 1 percent, reflecting smaller farrowings this past spring as well as this summer.

Canadian live hog imports continue to mount, but Canadians are also buying much more processed pork from the U.S. this year. Live

animal imports so far this year are up nearly 40 percent and represent 8.5 percent of total slaughter in the U.S, compared to 7.4 percent in 2003. Some of these imported hogs are headed back to Canada in the form of processed pork. Canada so far this year has purchased 30 percent more U.S. pork.

Beef prices remain low in Canada due to the continuing restrictions on live animal exports due to BSE. As a result, Alberta finished steer prices at the end of June were trading at \$51(U.S.) per hundredweight compared to \$88 in the U.S. This makes retail beef prices much cheaper than in the U.S. and stimulates additional beef consumption in Canada. Obviously added beef consumption is resulting in reductions in pork consumption and more Canadian hogs are flowing southward.

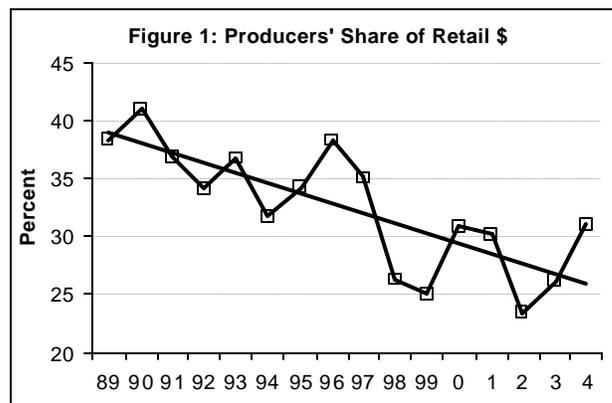
### But Demand is The Key to Prices

Where did these much higher than expected hog prices come from? and will they last? The reason for high prices is certainly not supplies, which were up about 4 percent in the first-half of the year, but rather demand in foreign markets and at home. Strong export demand has been driven by world income growth, restrictions on beef and broiler exports, and a weaker U.S. dollar exchange rate. Pork exports in the first four months of the year are up a remarkable 30 percent including: Mexico (+92%); Canada (+30%); and Japan (+9%), accounting for a record 10 percent of U.S. production. Pork imports were down about 8 percent. In total, net trade (exports minus imports) improved disappearances of pork by about 2 percent of total U.S. production.

On the domestic front, personal income adjusted for inflation rose by 3.4 percent in the first quarter, providing strong buying power for pork. In addition, the increasing interest in high protein diets continued to gain momentum and stimulated pork demand. Retail beef prices have been record high this year-just over \$4.00 per pound. In contrast, pork has averaged \$2.71 per retail pound. There has been some "substitution effect" as some consumers put down the beef tray and picked-up a pork tray. These "cross effects" are smaller than most believe, but have added \$.50 to \$.75 per live hundredweight to hog prices so far this year.

In the first-half of the year, live hog prices (51%-52% lean) averaged \$49.51 compared to \$39.01 in the same period of 2003. How did we get the additional \$10.50? It appears that the strong

export and domestic demand resulted in retail prices rising which contributed about \$3.00 per live hundredweight to live prices. But the most important factor appears to be narrow marketing margins this year compared to the same period last year which contributed about \$7.50 per hundredweight. Producers so far this year are receiving 31 percent of the retail price compared to only 25 percent for the same period last year.



The portion of the retail dollar that gets back to producers is directly related to the strength or weakness of live hog prices. The years when producers' portion was above the trend line were favorable hog price years: 1990-\$54.45; 1993-\$45.38; 1996-\$53.29; 1997-\$51.30; 2000-\$44.69; 2001-\$45.81; 2004 to-date \$49.51. Years when producers' portion was below the trend line were low price years: 1992-\$42.31; 1994-\$39.57; 1998-\$32.32; 1999-\$34.00; 2002-\$34.91 (Figure 1).

The failure to predict this narrowing of marketing margins this year appears to be the primary reason hog price forecasts were too low for this spring and summer. The more important point is that if the marketing margin remains narrow, hog prices will continue to be very strong. The producers' portion of the retail dollar has tended to be strong for two years in recent cycles (1995 and 1996 as well as 2000 and 2001). If that is the case this time, hog prices could be surprisingly strong for the remainder of 2004 and 2005. [It should be noted that there are critics of using the marketing margins which come from the Bureau of Labor Statistics (BLS). Retailers and others believe that the BLS series does not accurately record retail prices and therefore marketing margins are in error.]

## Prices Turn Upward

Will the “much better than expected” prices continue? The answer lies with a host of factors which tend to generally look positive. First, pork supplies, which were up 4 percent in the first-half of 2004, are expected to moderate starting in the last quarter of this year and into the first quarter of 2005. Secondly, pork exports are expected to remain strong with continued restrictions on beef exports and perhaps broiler exports. Third, prospects for strong consumer income growth remains positive. Fourth, people are losing weight on high protein diets so that demand factor looks positive into the future. Finally, the narrow marketing margin may continue for the rest of this year and into 2005 as discussed in the previous section.

With these points in mind, prices are expected to average in the low \$50s for 51-52 percent lean carcasses on a liveweight basis for the third quarter. This likely means that prices will be in the mid-\$50s for much of July and August, but closer to the high-\$40s to near \$50 in September. Fall prices are expected to average in the middle \$40s with possible lows in October or early-November in the lower \$40. Prices may turn upward by February and March, with the first-quarter average moving back toward the higher \$40s, and spring prices possibly moving above \$50s.

### PRODUCTION

Year	Quarter	Production Million#s	Percent Change vs. Year-Ago
2001	I	4,805	-0.4
	II	4,546	1.5
	III	4,548	-1.3
	IV	5,239	4.6
		19,138	1.2
2002	I	4,779	-0.5
	II	4,800	5.6
	III	4,832	6.2
	IV	5,290	1.0
		19,701	2.9
2003	I	4,898	2.5
	II	4,741	-1.2
	III	4,807	-0.5
	IV	5,499	4.0
		19,845	1.2
2004	I	1,530	4.7
	II	4,890	3.1
	III	4,975	3.5
	IV	5,434	-1.2
		20,429	2.4
2005	I	5,056	-1.4
	II	4,940	1.0

### PRICES

Year	Quarter	Live Weight Price \$/cwt.	Percent Change vs. Year-Ago
2001	I	42.83	4.1
	II	52.05	3.2
	III	51.05	10.0
	IV	37.30	-8.5
		45.81	2.5
2002	I	39.43	-7.9
	II	34.99	-32.8
	III	33.86	-33.7
	IV	31.39	-15.8
		34.92	-23.8
2003	I	35.38	-10.3
	II	42.64	21.9
	III	42.90	26.7
	IV	36.88	17.5
		39.45	13.0
2004	I	40.58	14.7
	II	44.00	3.2
	III	42.25	-1.5
	IV	38.67	4.9
		41.38	4.9

## Hog Producers Making Money

The outlook for the pork industry has shifted 180 degrees since early April. At that time, feed prices were near their peaks and there was concern that any weather difficulty could send feed costs well above costs of production. I argued for producers to consider protecting breakeven margins for the summer and fall. Since that time, the decline in corn futures prices has approached \$1.00 per bushel in some contracts. New crop soybean meal futures prices declined \$40 from their spring high and lean hog futures have increased \$5.00 to \$7.00 per lean hundredweight, depending on contract.

Figure 2 shows the prospects now for a profitable period in the next 12 months. Prospects are for about \$6 to \$7 of profit per hundredweight given current hog price expectations and futures prices for corn and soybean meal on July 8<sup>th</sup>.

### Implications

Sometimes things just work out! That appears to be the case for pork producers in 2004 as a host of positive factors have shifted the outlook from one of concern in the spring to one of considerable optimism this summer. The transition is the result of generally favorable weather for the 2004 crops and much better hog prices than expected due to strong demand factors and to narrow marketing margins which are allowing a higher portion of the consumer's expenditure to get back to producers.

The outlook now favors a very favorable last-half of 2004 and strong first-half of 2005. Normally, profits of the magnitude that are being experienced would cause producers to begin to think about expansion. However, expansion plans are expected to be delayed this year because of some unusual uncertainties. Part of the strength in hog prices is related to lost beef exports from the BSE cow discovered on December 23<sup>rd</sup>. When beef trade is restored, pork exports will likely weaken. If live cattle are allowed to come from Canada before beef exports are restored, beef prices will drop as well and be a negative for domestic pork consumption. Full restoration of broiler exports would also be a negative factor for hog and pork prices. While the corn crop should be record large (perhaps in the 10.5 to 10.7 billion bushel range), there is still some potential for adverse weather that could send feed costs higher. The odds of weather related price hikes are greater for soybean meal than for corn, as much of the corn crop will be assured by late July, while soybean yields can still be highly influenced by August and even early September weather.

Grain and oilseed markets are currently focused on large supplies. In large crop summers, price lows are often made by late July or early August. This may be a favorable time period to consider pricing corn for new crop needs as world corn and wheat supplies remain tight and strong utilization is expected for the 2004 crops. On the other hand, soybeans have the potential to have a negative price tone into the winter of 2005 if the U.S. crop is near 3.0 billion bushels and South American production returns to near normal. Under these scenarios, meal futures prices could drop back to the \$160 to \$180 range.

Since 1998, U.S. hog producers have been surprised by the growth of the Canadian industry. While U.S. producers cut their breeding herds, Canadians were expanding and shipping more of their animals to the U.S. as SEW pigs and as market hogs. Some of this expansion in Canada can be attributed to the weak Canadian dollar from 1999 through 2002. The Canadian dollar today is about 15 percent stronger than at the start of 2003 which helps reduce the incentive to produce pigs in Canada and ship them to the U.S. While this would have served to reduce the stimulus for hog expansion in Canada over the last one and one-half years, it has not slowed their expansion. In 2003, the Canadian pig crop was up about 6 percent and continued to grow by 7 percent in the first-half of 2004.

If the Canadian industry continues to grow at this rate through 2004, there will be a pool of about 1 to 1.5 million more hogs flowing to the U.S. in 2004. Given that rate of expansion, there would appear to be little need to expand the U.S. breeding herd in the coming year.

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