

Pork Industry Makes Turn for the Better

July 2004

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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 are expected as well in the next 12 month period-about \$6 to \$7 per live hundredweight 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 a result of much better foreign and domestic demand as well as 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 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 continued to drop to 5.9 million head. This is the eighth consecutive quarterly drop in the breeding herd dating back to the spring of 2002. In a somewhat longer context, the U.S. breeding herd has dropped by 1 million head since June of 1998, or 15 percent. In contrast since 1998, the Canadian breeding herd has increased by 357,000.

Market hogs at 54.2 million head were up one percent. Farrowings in the spring were down one percent and producers intend to farrow one 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 two percent for animals coming to market in July and August, but down nearly one percent for those destined for market in September through November.

Pork Supplies to Moderate

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

Canadian live hog imports continue to mount, but hog producers need to keep in mind that Canadians are also buying much more processed pork from us this year as well. 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.

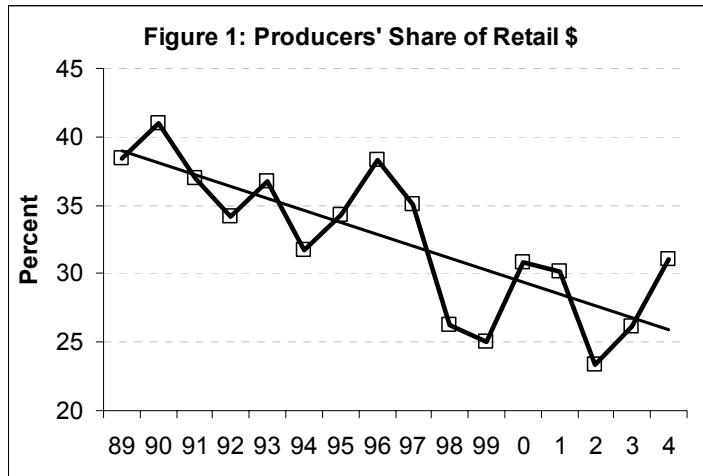
But Demand is The Key to Prices

Where did these much higher than expected hog prices come from and will they last? The answer is certainly not supplies which were up about four percent in the first-half of the year, but rather demand both 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%), a record 10 percent of U.S. production. Pork imports were down about eight percent. In total, net trade (exports – imports) improved disappearances of pork by about two 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 retail pound. In contrast, pork has averaged \$2.71 per retail pound. Thus, 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) were \$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. You can see in Figure 1 that in the years when producers' portion is above the trend line, those 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 is below the trend line were

low price years: 1992-\$42.31; 1994-\$39.57; 1998-\$32.32; 1999-\$34.00; 2002-\$34.91.

The failure to predict this narrowing of marketing margins this year appears to be the primary reason my hog price forecast 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. You can see from the figure that the producers' portion 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. (You should note that there are critics regarding using the marketing margins as I have here 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 four percent in the first-half of 2004 are expected to moderate as shown in the table below 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 discuss in the previous section.

With these points in mind, prices are expected to average in the low \$50s for 51%-52% lean carcasses on a liveweight basis for the third quarter. This likely would mean prices would be in the mid-\$50s for much of July and August but closer to the high-\$40s to near

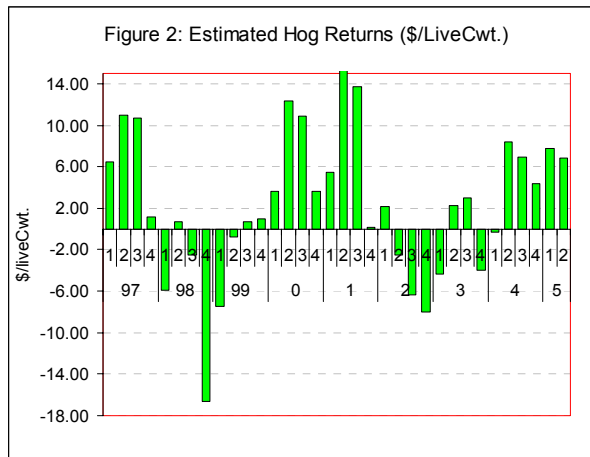
\$50 in September. Fall prices are expected to average in the middle \$40s with possible lows in October or early-November in the lower \$40. Winter prices may turn upward by February and March with the first-quarter average moving back toward the higher \$40s, with spring prices possibly moving above \$50s once again.

PRODUCTION			Percent	
Year	Quarter	Production Million#s	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%	
Year		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%	
Year		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%	
Year		19,945	1.2%	
2004	I	5,130	4.7%	
	II	4,890	3.1%	
	III	4,975	3.5%	
	IV	5,434	-1.2%	
Year		20,429	2.4%	
2005	I	5,056	-1.4%	
	II	4,940	1.0%	

PRICES			Liveweight	
Year	Quarter	Price \$/cwt.	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%	
Year		\$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%	
Year		\$34.92	-23.8%	
2003	I	\$35.38	-10.3%	
	II	\$42.64	21.9%	
	III	\$42.90	26.7%	
	IV	\$36.89	17.5%	
Year		\$39.45	13.0%	
2004	I	\$44.18	24.9%	
	II	\$54.85	28.6%	
	III	\$51.90	21.0%	
	IV	\$45.50	23.3%	
Year		\$49.11	24.5%	
2005	I	\$49.70	12.5%	
	II	\$51.30	-6.5%	

Hog Producers Making Money

The outlook for the pork industry has shifted 180 degrees since the early April. At that



time, feed prices were near their peaks and there was grave concern that any weather difficulty could send feed costs well above costs of production. I personally argued for producers to consider protecting breakeven margins for the summer and fall. Since that time, the decline in corn futures prices have 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. My estimates are for about \$6 to \$7 of profit per hundredweight given my price expectations and futures prices for corn and soybean meal on July 8th.

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 grave 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 our BSE cow December 23rd. 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 (my guess is in the 10.5 to 10.7 billion bushel range as of today), there is still some potential for adverse weather that could send feed costs higher than current expectations. 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 develops as a 3.0 billion bushel crop and South American production returns to near normal. Under these scenarios, futures meal 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 of our Northern neighbors 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 six percent and continued to grow by seven 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.

Table 1. Hogs and Pigs in the United States, June 1, 2004

	2003	2004	2004 as % of 2003
	thousand head		percent
Inventory			
All hogs and pigs	59,602	60,083	100.8
Kept for breeding	6,006	5,913	98.5
Kept for market	53,596	54,169	101.1
Market hogs by weight			
Under 60 pounds	20,433	20,308	99.4
60-119	12,972	13,251	102.2
120-179	10,828	11,077	102.3
180 and over	9,363	9,535	101.8
Sows farrowing			
Dec 03 - Feb 04	2,769	2,814	101.6
Mar 04 - May 04	2,885	2,857	99.0
June 03 - Aug 03 ¹	2,906	2,867	98.7
Sept 04 - Nov 04 ¹	2,841	2,837	99.9
Pigs saved per litter			
Dec 03 - Feb 04	8.81	8.85	100.5
Mar 04 - May 04	8.88	8.93	100.6
Pig crop			
Dec 03 - Feb 04	24,399	24,895	102.0
Mar 04 - May 04	25,627	25,520	99.6

¹ Intentions

Table 2. U.S. Market Hogs Weighing 60 to 179 Pounds on June 1, and Commercial Slaughter in Calendar Quarter from July through Sept

	thousand head		percent
1990	20,253	20,346	100.5
1991	21,201	21,376	100.8
1992	22,613	23,746	105.0
1993	22,455	22,777	101.4
1994	22,970	23,673	103.1
1995	23,200	23,264	100.3
1996	22,500	22,711	100.9
1997	22,576	22,666	100.4
1998	24,795	25,038	101.0
1999	24,577	24,960	101.6
2000	23,957	24,097	100.6
2001	23,528	23,635	100.5
2002	24,445	25,120	102.8
2003	23,800	24,747	104.0
2004 ^a	24,328	25,398	104.4

^a Projected

Table 3. U.S. Sow Farrowings and Pig Crop Compared to U.S. Commercial Slaughter (1,000 head), with 7-month Lag 1992 to 2004

Year	Sows Farrow	Pig Crop	Ratio	Year	Commercial Slaughter	Ratio
<u>December-February</u>				<u>July-September</u>		
92/93	2,808	22,871	8.15	1993	22,777	99.6
93/94	2,885	23,368	8.10	1994	23,673	101.3
94/95	2,886	23,851	8.27	1995	23,264	97.5
95/96	2,735	23,054	8.43	1996	22,711	98.5
96/97	2,684	23,164	8.63	1997	22,679	97.9
97/98	2,929	25,480	8.70	1998	25,038	98.3
98/99	2,891	25,247	8.73	1999	24,960	98.9
99/00	2,798	24,522	8.76	2000	24,097	98.3
00/01	2,748	23,963	8.72	2001	23,635	98.6
01/02	2,835	24,857	8.77	2002	25,120	101.1
02/03	2,769	24,399	8.81	2003	24,747	101.4
03/04	2,814	24,895	8.85	2004 ^a	25,699	103.2
<u>March-May</u>				<u>October-December</u>		
1992	3,368	27,208	8.08	1992	25,138	92.4
1993	3,220	26,135	8.12	1993	24,574	94.0
1994	3,390	27,984	8.26	1994	26,322	94.1
1995	3,170	26,373	8.32	1995	25,198	95.5
1996	2,930	24,833	8.48	1996	23,833	96.0
1997	2,911	25,229	8.67	1997	25,152	99.7
1998	3,086	26,989	8.75	1998	27,584	102.2
1999	2,986	26,272	8.80	1999	26,732	101.8
2000	2,885	25,565	8.86	2000	25,714	100.6
2001	2,870	25,509	8.89	2001	26,470	103.8
2002	2,941	26,001	8.84	2002	26,715	102.7
2003	2,885	25,627	8.88	2003	27,608	107.7
2004 ^a	2,857	25,520	8.93	2004 ^a	27,292	106.9
<u>June-August</u>				<u>January-March</u>		
1992	3,020	24,590	8.14	1993	23,057	93.8
1993	2,972	24,041	8.09	1994	22,746	94.6
1994	3,107	25,547	8.22	1995	24,229	94.8
1995	2,976	24,813	8.34	1996	23,650	95.3
1996	2,718	23,244	8.55	1997	22,342	96.1
1997	2,946	25,696	8.72	1998	24,776	96.4
1998	3,054	26,634	8.72	1999	25,571	96.0
1999	2,920	25,862	8.86	2000	25,019	96.7
2000	2,889	25,548	8.84	2001	24,578	96.2
2001	2,878	25,539	8.87	2002	24,148	94.6
2002	2,883	25,725	8.92	2003	24,654	95.8
2003	2,906	25,869	8.90	2004	25,713	99.4
2004 ^a	2,867	25,660	8.95	2005 ^a	25,329	98.7
<u>September-November</u>				<u>April-June</u>		
1992	2,992	24,086	8.05	1993	22,661	94.1
1993	2,982	24,003	8.05	1994	22,965	95.7
1994	2,997	24,517	8.18	1995	23,646	96.5
1995	2,815	23,479	8.34	1996	22,201	94.6
1996	2,731	23,327	8.54	1997	21,834	93.6
1997	2,939	25,494	8.67	1998	23,631	92.7
1998	2,993	25,902	8.66	1999	24,292	93.8
1999	2,844	24,973	8.78	2000	23,105	92.5
2000	2,838	25,112	8.85	2001	23,280	92.7
2001	2,889	25,492	8.82	2002	24,280	95.2
2002	2,833	25,094	8.86	2003	23,922	95.3
2003	2,841	25,359	8.93	2004	24,681	97.3
2004	2,837	25,420	8.96	2005 ^a	24,827	97.7

^a Estimates

^b Mean of previous three years

Table 4. U.S. Commercial Slaughter, Carcass Weights, and Quarterly Pork Production 1991-2005

Year	Quarter	Commercial Slaughter (1,000 head)	Carcass Weight Per Hog	Pork Production (million #'s)	Percent Change Year-Ago
1991	I	21,508	181.4	3,902	0.0
	II	20,921	181.3	3,792	4.0
	III	21,371	178.8	3,822	5.0
	IV	24,365	182.0	4,434	8.0
1992	I	23,802	181.5	4,321	10.7
	II	22,202	181.7	4,033	6.4
	III	23,746	179.6	4,264	11.6
	IV	25,138	181.7	4,567	3.0
1993	I	23,057	182.5	4,207	-2.6
	II	22,661	183.2	4,151	2.9
	III	22,777	181.7	4,138	-3.0
	IV	24,573	184.5	4,534	-0.7
1994	I	22,746	183.9	4,182	-0.6
	II	22,965	184.6	4,240	2.1
	III	23,673	182.7	4,326	4.5
	IV	26,322	186.6	4,913	8.4
1995	I	24,229	185.2	4,488	7.3
	II	23,646	185.8	4,394	3.6
	III	23,264	182.3	4,240	-2.0
	IV	25,198	186.1	4,690	-4.5
1996	I	23,650	185.6	4,389	-2.2
	II	22,201	184.9	4,104	-6.6
	III	22,711	182.4	4,143	-2.3
	IV	23,833	186.7	4,449	-5.1
1997	I	22,342	187.7	4,194	-4.4
	II	21,834	187.4	4,091	-0.3
	III	22,666	185.0	4,196	1.3
	IV	25,152	189.5	4,766	7.1
1998	I	24,776	189.2	4,688	11.8
	II	23,631	187.5	4,429	8.3
	III	25,038	184.7	4,625	10.2
	IV	27,523	188.9	5,239	9.9
1999	I	25,571	190.3	4,865	3.8
	II	24,292	190.6	4,630	4.5
	III	24,960	187.2	4,672	1.0
	IV	26,732	191.2	5,110	-2.5
2000	I	25,019	192.8	4,824	-0.8
	II	23,107	193.8	4,478	-3.3
	III	24,097	191.1	4,606	-1.4
	IV	25,714	194.8	5,010	-2.0
2001	I	24,578	195.5	4,805	-0.4
	II	23,280	195.3	4,546	1.5
	III	23,635	192.4	4,548	-1.3
	IV	26,470	197.9	5,239	4.6
2002	I	24,148	197.9	4,780	-0.5
	II	24,280	197.6	4,797	5.5
	III	25,120	192.4	4,832	6.2
	IV	26,715	196.7	5,255	0.3
2003	I	24,654	198.7	4,898	2.5
	II	23,922	198.2	4,741	-1.2
	III	24,747	194.2	4,807	-0.5
	IV	27,608	199.2	5,499	4.6
2004	I	25,713	199.5	5,130	4.7
	II	24,681	198.1	4,890	3.1
	III ^{ac}	25,550	194.7	4,975	3.5
	IV ^a	27,292	199.1	5,434	-1.2
2005	I ^a	25,329	199.6	5,056	-1.4
	II ^a	24,827	199.0	4,940	1.0

^a Projected

^c Average of the two estimation methods (Table 2 and 3)

^b Preliminary

Table 5. Actual and Forecast Hog Prices, Lean Carcass Prices, and Retail Pork Prices^a

Year	Quarter	Barrow and Gilts 6-Mkt Price (\$/cwt)	Lean Value (Live Price/74 yield) (\$/carcass cwt)	Retail Pork ¢/carcass cwt
1991	I	\$51.50	\$69.59	215.2
	II	\$53.34	\$72.08	213.2
	III	\$50.85	\$68.72	214.6
	IV	\$39.84	\$53.84	204.6
1992	I	\$38.68	\$52.27	198.9
	II	\$44.83	\$60.58	195.9
	III	\$43.86	\$59.27	200.6
	IV	\$41.84	\$56.54	197.0
1993	I	\$43.96	\$59.41	194.6
	II	\$46.83	\$63.28	194.3
	III	\$47.49	\$64.18	200.2
	IV	\$43.23	\$58.42	201.3
1994	I	\$45.19	\$61.07	200.8
	II	\$42.44	\$57.35	198.8
	III	\$40.07	\$54.15	199.0
	IV	\$30.56	\$41.30	193.6
1995	I	\$38.19	\$51.61	191.6
	II	\$38.57	\$52.12	190.2
	III	\$48.32	\$65.30	195.6
	IV	\$42.86	\$57.92	201.8
1996	I	\$45.33	\$61.26	206.3
	II	\$54.84	\$74.11	214.9
	III	\$57.96	\$78.32	230.4
	IV	\$55.10	\$74.46	231.9
1997	I	\$51.06	\$69.00	231.0
	II	\$56.41	\$76.23	229.7
	III	\$54.45	\$73.58	234.5
	IV	\$43.69	\$59.04	231.0
1998	I	\$34.74	\$46.95	233.0
	II	\$39.42	\$53.27	226.9
	III	\$33.95	\$45.88	231.0
	IV	\$19.30	\$26.08	226.9
1999	I	\$28.83	\$38.96	235.8
	II	\$35.18	\$47.54	238.4
	III	\$35.70	\$48.24	246.4
	IV	\$36.29	\$49.04	245.2
2000	I	\$41.14	\$55.59	249.8
	II	\$50.43	\$68.15	257.3
	III	\$46.43	\$62.74	264.3
	IV	\$40.78	\$55.11	261.3
2001	I	\$42.83	\$57.88	262.5
	II	\$52.05	\$70.34	267.0
	III	\$51.05	\$68.99	275.0
	IV	\$37.30	\$50.41	273.0
2002	I	\$39.43	\$53.28	270.9
	II	\$34.99	\$47.28	267.7
	III	\$33.86	\$45.76	264.1
	IV	\$31.34	\$42.35	260.2
2003	I	\$35.38	\$47.81	260.9
	II	\$42.64	\$57.62	262.2
	III	\$42.90	\$57.97	269.8
	IV	\$36.89	\$49.85	270.2
2004	I	\$44.18	\$59.70	269.3
	II ^p	\$54.85	\$74.12	274.3
	III ^a	\$51.90	\$70.14	
	IV ^a	\$45.50	\$61.49	
	I ^a	\$49.70	\$67.16	
	II ^o	\$51.30	\$69.32	

^a Predicted prices for 2004 (III) forward are made with two equations with the results averaged.

^p Preliminary

