WEEKLY OUTLOOK

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THE RETAIL-TO-FARM MARGIN FOR PORK

THE RETAIL-TO-FARM MARGIN FOR PORK is getting a great deal of scrutiny from analysts since it appears to be wider than normal. The margin stood at $1.21 in June, the most recent month for which data are available. This is down from its October peak of $1.34 but still considered wide relative to the absolute margins observed prior to 1982. From 1979 to 1981, this margin generally ranged between 90 cents and $1.10.

The significance of the wide margin is that it may narrow in a cyclical fashion this fall. Some analysts believe that as this margin narrows, retail prices may decline at a more rapid rate than farm prices. This is because the retail price of pork has fallen only 11 percent since last October's high of $1.91 a pound, while hog prices have fallen 25 percent since peaking last August at about 63 cents per pound. There is little question in anybody's mind that retail prices will be under pressure, given the large increase in pork supplies that must be moved into consumers' hands this fall. If a substantial decline in retail prices does occur, it is quite possible that hog prices may decline only slightly from their present levels. That is, hog prices could average above $45 per hundredweight rather than near $40.

This argument is plausible, but several concerns must be expressed about it. The first is that regardless of the width of the margin, the respective declines of 11 percent and 25 percent in retail pork and farm hog prices since their peaks appear in line with their market-level flexibilities. That is, for an equal change in quantity at the two market levels, farm prices would be expected to change more proportionately than retail prices.

Another concern is that margins tend to change in association with the direction of change in hog slaughter. When hog slaughter is declining, the margin typically narrows, and vice versa. Thus, even though the margin is now wide, it is likely to stay wide as hog slaughter increases this fall. There are exceptions to this rule: in 1979, when hog slaughter increased substantially, the margin narrowed by over 11 cents from March to November.

The final concern is that while the absolute margin appears wide, hog prices, as a percentage of retail prices, are close to the average of the last four years. In June, the average hog price of 47 cents per pound represented 28 percent of the retail price. The average for the last four years is 29.7 percent. The margin in June is slightly wider than normal, but it is not extraordinary, given past relationships that ranged as low as 21 percent (April, 1980).

As a final comment, it must be pointed out that some analysts are looking solely at the retail-to-wholesale margin. This relationship does appear to be wider than normal in both absolute and relative terms. Some analysts believe that it is possible for the margin to narrow as the result of a retail price decline relative to wholesale prices. This also would have the effect of supporting farm prices, assuming that the wholesale-to-farm margin remains constant. As one might guess, however, even the latter margin is usually in a state of flux.

It is accepted that at least a portion of the overall retail-to-farm margin is wider than normal, but the overall margin is not out of line with its four-year average. If any support for cash hog prices is to be derived from a narrowing of the retail-to-wholesale margin, it appears to be limited at this time.

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