Cooperative Extension Service

WEEKLY OUTLOOK

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HOG EXPANSION TO END GOOD PROFITS

The recent USDA report revealed that hog producers have expanded their breeding herds by 6 percent. Lower hog prices will erode away the recent very favorable profits of pork producers. Producers have enjoyed profitability since late 1989. The current expansion comes in response to those favorable profits.

As an example of the favorable profitability, the average farrow-to-finish farm on Iowa State University's record system obtained a $34.14 per head return above all costs in 1990, the peak profit year of the cycle. Return on their capital investment averaged 57 percent a year. The most profitable one-third of the Iowa farms had an average return on capital of 86 percent in 1990. This level of return draws attention, not only from pork producers, but from non-farm investors as well.

There is a lag from the time profit occurs until an increase in the breeding herd begins. This lag is due to the need for producers to begin to think about expansion, to get buildings and equipment in place, and to acquire debt capital and breeding stock. Typically, the lag from a period of high profits until the response of a higher breeding inventory is about one year, or four quarters. That time lag now seems to be holding for this cycle, as we look back to the most profitable period coming one year-ago, in the second and third quarters of 1990.

Unfortunately, it is likely we are only at the beginning of the breeding herd expansion. The favorable profits through the summer of 1991 mean that the herd could continue to expand for a year following these profits, or through the summer of 1992. In past expansion phases of the hog cycle, the breeding herd has expanded for 5 to 7 quarters. An exception to this was the 1983 expansion when drought forced feed prices sharply higher, resulting in an abortion of that expansion at 3 quarters. The current expansion is only two quarters old. Without some extraordinary influence such as drought, the breeding herd can be expected to continue to expand at least through the March 1992 report, and perhaps until the September 1992 report.

When will we reach the highest pork production of this cycle? Maximum pork production occurs roughly six months after the maximum breeding herd is reached. This implies that in late 1992 through the first half of 1993 pork production will likely be at the highest levels of this cycle. Highest pork production generally means the lowest prices of the cycle.

Thoughts of low hog prices make hog producers wince, but there are at least two positive thoughts to keep in mind. First, while hog prices typically do fall into the mid-to-higher $30s sometime in the cycle, typically they only average at that level for one quarter. The average yearly prices for the low years of the last two hog cycles have averaged about $44 at terminal markets. Those years were 1985 with $44.50 average terminal prices, and 1989 with prices at $43.80. Somehow, $44 sounds survivable.

The second positive thought to keep in mind is that producers still have a "window of profit opportunity" in the short run. Prices of hogs at terminal markets are expected to average near $50 for the July through September period. In fact, prices will likely stay above $50 until near the end of August. The last quarter of the year is expected to provide average prices near $45 per hundredweight. Assuming moderate feed prices, production costs would average near $40 for this period. The next six months promise a reasonable profit stream. However, producers will want to use this favorable stream to prepare for 1992.

Terminal hog prices in the first quarter of 1992 will be hammered by the 7 percent increase in farrowings this summer. With continued higher weaning rates and higher selling weights, pork production in early 1992 is expected to be up nearly 8 percent. Prices are expected to average in the $42 range for the quarter. Only modest price improvement can be expected in the second and third quarters of 1992, with summer prices recovering only to the mid-$40s.

The lowest prices of the cycle may well come late in 1992 and early 1993. This will be a time when producers will be pleased they made a good decision during that "window of profit opportunity."

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