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ARE INVENTORY ESTIMATES IN HOG REPORT TOO HIGH?

The USDA's March *Hogs and Pigs* report did not solve the mystery of why hog slaughter has been so low this winter. The report indicated that the herd is still expanding and is about 4 percent larger than year ago levels. These numbers would be extremely bearish if the market believed they were true. However, markets will likely disregard this report after a few days and begin to closely monitor the daily and weekly slaughter levels for clues to future supplies.

The problems for the statisticians began in the December 1992 report. That inventory count indicated that first quarter slaughter should be up about 3 percent. The actual slaughter, however, was down 4 percent. Some of the discrepancy of 7 percentage points could have been explained by the harsh winter and the poor quality of corn in the upper midwest. It is not unprecedented to see the slaughter drop this low relative to the December inventory, but one has to return to the winters of 1977 and 1978 to see a similar winter impact. This past winter was not as bad as those and many more hogs are now in climate controlled buildings compared to the late 1970s.

A more telling concern, however, involves the reported 5 percent greater inventory of pigs weighing over 180 pounds on March 1. Most of the hogs in this weight category would have come to market in March 1993. The actual slaughter during March has been down about 3.5 percent rather than up 5 percent. The difference between the expected slaughter from the *Hogs and Pigs* report, and the actual slaughter continues to be in the 7 to 8 percentage point range.

Corn quality in the upper midwest has been a concern. I just visited a north central Illinois hog producer who said he has now used up all of his better quality corn and is moving into his poor quality corn. The impact of corn quality would most likely be to reduce weight gains and slow the progress of hogs to market weights. However, it is difficult to imagine that this factor could keep slaughter low relative to the inventory numbers for 3 months.

A rapid expansion in the breeding herd could help explain a small portion of the low slaughter. The report indicated that the breeding herd in Iowa was up 11 percent from a year ago. Iowa producers were slow to enter the expansion, but seem to be in full swing now in response to high hog prices and low corn prices. The North Carolina herd also continues to boom. In this report, the North Carolina total hog inventory exceeded those of both Indiana and Nebraska for the first time. This puts North Carolina in fourth position among the state ranks. They will likely pass Minnesota later this year to become number three and may be able to reach Illinois' inventory numbers by 1995, taking over the number two spot.

Among other major production states the breeding herd was up 5 percent in Illinois, 3 percent in Wisconsin, 2 percent in Nebraska, and 1 percent in Minnesota and Missouri. Major production states which had a reduction in breeding herd inventories were Indiana and Kansas down 3 percent and Ohio down 8 percent.

The dichotomy in the inventory numbers and the slaughter numbers will be the central focus of futures markets in the near term. In attempting to resolve these differences, I talked with the USDA agencies in Washington who release these reports. Both feel they have done everything to insure integrity in their numbers and are unable to reconcile the differences at this time. The slaughter numbers are felt to have the greater accuracy since they are line counts made by federal and state inspectors. This implies that the inventory numbers may be too high. The market may need to dismiss the inventory report after a few days, but will watch the daily and weekly slaughter numbers for signs that slaughter may begin to either rise, and thus lend credibility to the inventory numbers, or remain low, suggesting that USDA got an inferior reading in the March *Hogs and Pigs* report.

What does all this mean for prices? Futures markets are likely the best estimates of forward prices at this time. The uncertainty about which supply data to use in price modeling does not provide a high degree of confidence in my own price estimates. If the March report is correct, summer hog prices will average near $44, with highs in June in the high $40s. If the March report is correct, fall hogs will average in the very low $40s and trade at times in the high $30s. The extent to which futures prices trade above these levels is an indication of the futures market's distrust of the March *Hogs and Pigs* numbers.

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