Cooperative Extension Service

WEEKLY OUTLOOK

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HAVE WIDE PORK MARGINS TAKEN $4 BILLION FROM PRODUCERS AND CONSUMERS IN 1998?

Hog prices dropped below $20 per hundredweight recently, their lowest level since 1971. These levels are similar to those experienced in the pre-inflation era prior to 1973. Costs on the other hand, remain at 1990's levels. Pork producers are suggesting that financial conditions are the poorest since the great depression of the 1930's. With hog prices at $16 per hundredweight and costs near $36, losses per hog are mounting at the rate of $50 per head, likely a record level over the past 50 years. Modest sized family farms of 300 sows could be losing nearly $1,000 a day. Many of these have already had a difficult year with low crop prices and, in some cases, poor yields.

Anxiety is high and everyone is asking What is the cause of the current depressed conditions? What can be done? and, When will prices improve?

As always, it will take time to sort out the reasons. First, is the large supply of pork being produced this year. Production will be up about 9 percent over 1997. Second, is the concern regarding the Asian economic downturn. Weak demand from Asia this year has kept many commodity prices depressed. However, pork exports have actually been up nearly 20 percent in 1998. Poor export demand is not the cause of low prices. A third concern has been the record large imports of live hogs from Canada. Imports will likely exceed 4 million head during 1998, about 4 percent of total U.S. slaughter. Another problem is wide marketing margins. This has been especially true at the retail level.

Official data lags somewhat, but indications are clear that pork marketing margins are very large. The extreme levels are a concern not only to producers, but to every consumer of pork in the country. These wide margins may be driving producer prices lower and keeping consumer prices high. The data for September show that retailer pork margins reached $1.38 per retail pound. This was $.23 higher than the average of September margins from the previous two years. Even allowing for 3 percent inflation in retail margins over the past two years, retailers may have extracted an additional $275 million from producers and consumers in the month of September.

Packer margins for the first 9 months of 1998 averaged only 1.5 cents per pound higher than the previous year, after allowing for an inflationary increase in costs. It is likely that margins have widened in October and November, but official data are not yet available. Wider margins by packers may be needed to increase slaughter capacity on Saturdays and even Sundays in order to handle the current large flow of slaughter hogs.

Estimates for the entire year of 1998 show that the large margins may have negatively impacted producers and consumers by up to $4 billion. Researchers need to probe the complex issue of margins to better evaluate whether undue market power is putting pork producers and consumers at a disadvantage.

What can be done? There are possibilities on both the demand and supply side. For demand, an evaluation of margins, particularly at the retail level, could provide some help. Why have retailers not lowered pork prices more this year to send consumers the clear signal that an abundant supply of pork awaited them? The federal government also has some modest ability to buy pork for school lunch programs, as well as for export aid programs. The current Russian food assistance package is an example. Hopefully, they will be aggressive in including pork at every opportunity.

Adjustment in supply has historically come as a result of large financial losses encouraging a sufficient number of producers to reduce production. It is likely this will be the supply solution this time also. Some would argue that large producers are now of sufficient size to influence the national market price. However, even if a few very large producers representing 10 percent of the industry would cut their production by 10 percent, the net result would only be a 1 percent reduction in supply. Attempts to organize producers to cut-back would fail since those who cut-back bear the costs, and those who do not cut-back receive benefits (higher prices on full production).

On a positive note, hog prices generally make their seasonal lows in early November and begin to improve in late November and December. Packers are gearing up to add more slaughter capacity on the weekends and sow slaughter numbers since mid-August indicate more liquidation. It is now likely that farrowings for this fall and winter will not be as large as noted in the USDA's September report. In fact, a 2 percent to 3 percent reduction in farrowings this winter is likely. Beef supplies will continue to drop this winter, providing a greater incentive for retailers to lower pork prices and move the large supply to consumers.

Hog prices should be higher in December, but profitable levels cannot be anticipated until late next spring. If farrowings are cut this winter and harsh winter weather cuts into the weaning rate, hog prices can move back into the low-to-mid $40 next summer.

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