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EXTENSION

WEEKLY OUTLOOK

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HOG PRICES RECOVER, WHAT NEXT?

How can hog prices be $8 at Christmas and $30 three weeks later? If hog prices are $30 today, how could the depressed levels of December be justified? In any case, the entire industry is breathing a sigh of relief and beginning to ask what went wrong? and what are the lessons to be learned?

First, lets examine what has changed since the price lows were made in December. Of most importance is the reduction in slaughter. It has been well documented that slaughter numbers in December exceeded the ability to adequately handle the flow of hogs from producers. In the week prior to Christmas, the industry processed a record 2.243 million hogs. By the third week of January, slaughter dropped to 2.015 million, more than a 10 percent decline.

Second, the slaughter rate has been fairly close to USDA inventory estimates for the first three weeks of 1999. Weekly slaughter in December ran from 9 to 16 percent above the same week a year earlier. In the first three weeks of January, weekly slaughter was up from 4 to 6 percent. USDA's inventory count for January suggested that slaughter should be about 4 percent higher.

Adding to the supply glut in December was a backlog of hogs from late November and early December. This led to an increase in weights as hogs were forced to stay on farms longer than intended by producers. Hog weights advanced from a weekly average of 258 pounds in late November to 262 pounds by mid-December. By the third week of January, weights had backed off once more to 258 pounds.

Just as important has been the remarkable recovery in wholesale values of pork. In the week before Christmas, wholesale pork belly prices were 35 cents per pound, hams were 29 cents, and loins 68 cents. By the third week of January, belly prices had risen by 46 percent, hams by 45 percent, and loins by 63 percent. Measured as the wholesale value of a typical hog, the "cutout value" rose by 46 percent.

Two factors have provided the sharp increase in wholesale values. The first was the lowering of retail pork prices starting about mid-December. Consumers purchased more pork as they responded to lower prices, more featuring of pork in grocery store adds, and the blitz of media reports detailing the plight of the producer. The second factor was the adverse winter weather which disrupted shipments of hogs from farms to packers during the first three weeks of the year. With stores featuring pork at bargain prices and packers unable to supply the same volume of hogs, some shortages of featured pork cuts, such as pork loins, actually developed in January.

The final factor providing sharp recovery in hog prices was the narrowing of margins for retailers and packers. Retailers failed the pork industry in 1998 by keeping retail prices excessively high. They failed to send the price signals to consumers that pork was in large supply relative to demand. They kept retail prices almost constant when wholesale prices dropped sharply. This changed in late December and January.

Packer margins also increased dramatically in November and December, resulting in large profits. Packers could have paid higher prices for hogs in relation to the product value of the pork they were selling. Preliminary estimates are that in relationship to the wholesale value of pork, packers could have paid about $28 per hundredweight for hogs in December (and still covered costs) as opposed to the $14 that was reported by USDA. However, packers are in a commodity business where processors normally only pay producers an amount sufficient to keep raw product moving to their facilities. At times in December, packers could have bid $4 per hundredweight, or less, and had sufficient supply.

As of the third week of January, packers could pay in the range of $35 per hundredweight for hogs, and USDA reported prices in the high $20s or low $30s. Packer margins were still positive, but had narrowed from the December levels.

In summary, we can identify the sources of the approximately $20 per hundredweight improvement in hog price between Christmas and January 25th. As measured at the farm level on a liveweight basis, wholesale prices rose by around $12 per hundredweight and packer margins narrowed by about $8 per hundredweight.

Every market observer is now watching the daily slaughter levels to assess price potential. Slaughter rates have moderated and are close to inventory numbers reported by USDA. However, major disruptions in marketings did occur in the first three weeks of January due to the weather. To what extent is the improved supply situation simply a weather related delay in marketings? Will the USDA inventory numbers hold when normal marketings resume in late January and February?

Retailers may have gotten the message to "keep pork margins in line in '99" or risk investigations of pricing policies. Packers also must tread lightly in regards to increasing margins to the extent they did in November and December. And of course, producers must report actual inventory numbers of hogs to USDA so that the industry will have more accurate information to match processing capacity with the number of market hogs. Finally, we must integrate the hog supply and processing data for the North American pork industry, including Canada and the United States.

If the USDA market numbers hold as reported, hog prices will trade in the higher $20s in February, low $30s in March, and reach the mid-$30s by April. Summer prices should be in the high $30s to $40, with fall prices moving to the lower $40s.

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