



# WEEKLY OUTLOOK



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## **HOG PRODUCERS TO RECEIVE FINANCIAL REDEMPTION**

Pork producers continue to reduce the size of the breeding herd and pork supplies will remain moderate over the next 12 months. Profitable prices should remain in place, at least through the first-half of 2001.

The nation's breeding herd on June 1 was reported by the USDA to be down 4 percent from year ago-levels and more than 10 percent below the bloated breeding herd inventory in 1998. Most states continued to reduce their herds, with the largest reductions in the eastern corn belt with Wisconsin down 19 percent; Illinois down 7 percent; Indiana down 15 percent; Ohio down 20 percent; and Michigan down 8 percent. The total reduction for the past year in these five eastern corn belt states was 155,000 animals, representing 12 percent of their breeding herd. The downward adjustment in the eastern corn belt has been even more dramatic when viewed over the past two years, when 385,000 animals have been cut, representing 26 percent of the breeding herd in the region.

Adjustments have been much smaller in the western corn belt, where breeding herd numbers are down for the last year as follows: Minnesota (3 percent), Iowa (3 percent), Missouri (7 percent), and Nebraska (10 percent). As a region, these states dropped their breeding herd by 5 percent in the past year and by 10 percent over the past two years.

Some have asked, "Why aren't producers expanding since they are now making money?" There are multiple reasons. The first is the large amount of debt that producers incurred during 1998 and 1999. Now that the hog enterprise is generating positive returns, it is the desire of both producers and their lenders to restore their equity position to a more comfortable level. In fact, some now consider that "comfortable level" to be an even smaller debt percentage than was the guideline prior to late 1998. This factor will likely continue to delay expansion. Fear is another powerful behavioral modifier at work. The depth of losses in 1998 and 1999 was so extreme that many producers will forgo expansion until they are very comfortable with their financial position and with the longer-run outlook for pork production profitability. Finally, the recent survey was conducted around June 1, when the issue of new crop feed prices was still very uncertain due to the forecast of drought in the Midwest.

The movement toward expansion will likely begin this fall. By September, producers will have had six months of profitable hog prices to restore financial reserves. The 2000 crop size will be pretty well determined (looking like a very large crop with low feed prices at this writing). Finally, considerable confidence will be restored in the future of the industry by that time and the longer-term outlook will feel more positive. Producers confirmed this pattern with farrowing intentions for the summer down 2 percent, but with intentions for the fall up 1 percent.

Pork supplies will remain below year-previous levels through this fall; by winter they could be nearly equal; and by spring of 2001 will begin to rise above year-ago volumes. Given the favorable demand picture

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expected, both domestically and in the export market, this means a period of favorable hog and pork prices over the next 12 months.

Terminal liveweight prices are expected to average \$48 to \$51 this summer, which is several dollars higher than the previous forecast. Fall prices will likely drop into the \$43 to \$47 range for an average. Winter prices are expected to be another \$1 to \$2 lower. Spring 2001 should see strong seasonal recovery, with prices once again moving back to the higher \$40s on average.

Costs of production are likely headed back toward the \$35 to \$37 per live hundredweight range for average cost farrow-to-finish operations. Prices are expected to average \$8 to \$10 higher over the next 12 months. The days of financial redemption have come for those who were able to hold their units together.

What next? Expect to see a few of the family operations that dropped out of hog production come back into production, but only a handful of that large group. Pork production corporations have also been stung hard and we can expect to see some continued consolidation and to see far fewer return to the growth pattern of the late-1990s. Packers have already allocated their enormous profits of 1998-99 and will face lean margins with discouraged stockholders over the next 12 months. They will have little interest in owning more hogs. Independent family farms are likely to continue to push for ways to control more of the value added in processing. It is likely that some new processing capacity will be put in place through these groups, and this will redirect equity capital toward processing and away from expansion of production. All of this favors a continued period of slower than normal expansion.

A slow and controlled expansion is just what is needed. First, sow productivity growth, which has exceeded 3 percent per year, is more than sufficient for current domestic and foreign demand growth. Second, the industry has to shift away from the strategy of expansion by putting more sows in place. This strategy led to the catastrophe of 1998-99. The strategy of the 2000s is to expand by intensification of existing units, or by acquisition. Finally, as producers consider expansion, it must be done in coordination with an assurance of shackle space. This most likely means long-term marketing arrangements. Nearly perfect coordination of production volumes and processing volumes is now a requirement.

Facing current challenges is always part of running a business, but at least pork producers will have money in their pockets to face the challenges of the next 12 months.

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