UNIVERSITY OF ILLINOIS EXTENSION

WEEKLY OUTLOOK

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HOG EXPANSION LIKELY TO RETURN RED INK

The pork industry has initiated an expansion which is expected to result in hog prices dropping below costs by late next summer. The December inventory update from the USDA indicated that the breeding herd had increased by 1 percent. The number of sows farrowed was up 1 percent last fall, is expected to rise by 4 percent this winter, and by a more modest 1 percent next spring. The expansion is in response to favorable profits in the second and third quarter of 2000 when returns averaged nearly $12 per hundredweight. These strong returns resulted from favorable hog prices which exceeded $50 at times, and from low corn prices, especially last summer.

Expansion was not uniform across the country. The eastern corn belt has expanded their breeding herd by about 4 percent, led by Illinois with a 7 percent increase and Indiana with a 5 percent increase. This region had about a 25 percent reduction in the herd following the 1998/1999 financial crisis. Herd recovery is far short of pre-1998 levels, but at least there has been some willingness to rebuild. Breeding herd numbers were down 1 percent in the western corn belt, led by a 3 percent decrease in Iowa and a 7 percent decrease in Missouri. Expansion continued on the Southern Plains with the Kansas breeding herd up 7 percent, Oklahoma up 10 percent, and Texas up 6 percent.

Some of the more interesting regional numbers came from western states where the breeding herd was dropping. In Colorado, the breeding herd was down 10 percent with National Hog Farms in depopulation. In Arizona, the breeding herd dropped by 90 percent. Sow numbers in Arizona are relatively small, but were primarily owned by one large operation, which now appears to have depopulated. Similar to Arizona, the sow herd in California has also decreased by 20 percent, again this is likely a large hog production operation that has depopulated. These decreases seem to be reflecting two facts. First, hog production costs are higher in the west and southwest compared to the midwest, and secondly, large hog production units have been forced to cut back because of financial losses, as well as environmental concerns, just like smaller family farms.

It also appears that producers have listened closely to the warnings of analyst who pleaded for a modest expansion. Discussions of large potential losses in late 2001 and early 2002 seemingly have caused some producers to decide to not farrow as many sows this spring and summer. The fear of 1998/1999 still is vivid in all pork producer's minds. A number of family managers have told me, "I can't afford another period like late 1998, and I won't go through that again." Some of these producers may back up their words with actual behavior as farrowing intentions drop from a 4 percent increase this winter to only a 1 percent increase in the spring. It is unusual to see the rate of farrowing increases tail-off this early in an expansion, and likely does indicate that some producers are cutting the number of sows they breed this winter.

Even though this is a modest expansion, it still will likely increase supplies sufficiently to plunge the industry back toward financial losses by late summer. Pork supplies are expected to rise by 3 percent for the year, to 19.5 billion pounds. First quarter supplies may be about unchanged with last year's same quarter, with second quarter supplies growing by 3 percent. The bulk of the supply increase will come in the last two quarters, when pork production is expected to rise by 6 percent and 4 percent, respectively. The 6 percent rise in the summer will result from the 4 percent farrowing increase anticipated for this winter, along with higher weaning rates and somewhat higher market weights. The cold winter we have underway could, however, keep weaning rates from expanding much.

After averaging $44.70 per live hundredweight in 2000, hog prices are expected to drop to an average of about $38 for 2001. In the first quarter, prices are expected to average in the higher $30s and then move upward to the low $40s for the spring quarter. Growing supplies after mid-summer are expected to put downward pressure on prices with the third quarter averaging in the $35 to $38 range. Fall prices are expected to drop another $3.

In addition to an $8 decrease in hog prices from 2000, costs are expected to increase by about $1.50 to $2.00 per hundredweight. These will be led by higher corn, soybean meal, and energy costs. Production costs for farrow-to-finish operations are expected to increase to about $38.50 per live hundredweight with prices about $1 less. In the first-half of the year, profits might average about $2 per live hundredweight, with the best returns in the second quarter. However, in the last-half of the year losses could return, mounting to $5 per live hundredweight in the last quarter.

The hog industry now appears to be a low margin, intensively managed industry, but still with a cyclical component. In the four years 1998 through 2001, hog prices are expected to average a lowly $37. Unfortunately, costs have been somewhat higher, and the industry on average has operated on about a $.50 per hundredweight loss.

Needless to say, with the outlook provided here, and with such a dismal four year record, any thoughts of additional expansion in sow numbers should be discouraged or the financial losses will continue well into 2002.

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