UNIVERSITY OF ILLINOIS EXTENSION

# WEEKLY OUTLOOK

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## HOG INDUSTRY GETS WINDFALL PROFITS: HOW LONG?

Hog producers are basking in a the rare air of unexpectedly large profits. With hog prices moving toward $50 per live hundredweight and with moderate feed prices, its fun to raise hogs again.

The windfall is a result of somewhat smaller than expected supplies, high retail beef prices, and especially foot-and-mouth disease (FMD) in Europe. To add further fuel to a bullish situation, the latest USDA *Quarterly Hogs and Pigs* report indicated a smaller winter pig crop than had been expected and that producers' plans to expand the breeding herd remain moderate.

The latest quarterly report caused the market to reverse opinions on breeding herd productivity gains. The new *Monthly Hogs and Pigs* reports had indicated that farrowings and the number of pigs per litter were high for the winter quarter. However, the quarterly report resulted in revisions that lowered the number of farrowings and sharply revised downward the weaning rate. As an example, the monthly reports had estimated the number of pigs weaned per litter at 8.89 and 8.94 in December and January, respectively. These were revised to 8.74 and 8.77, respectively, in the quarterly report.

The bullish numbers came in two forms. First, the winter pig crop was up only 1.5 percent, rather than the 4 percent the market had been expecting. Second, producers indicated they would expand the breeding herd by only 1 percent in both the spring and summer quarters. The modest rate of expansion after a full year of profitable prices relates to the cautious attitudes of producers who still have memories of the price disaster in late 1998 and 1999. In fact, the losses accumulated during that period are just now being replaced by the profit stream from the past year. A second reason was that hog prices had not been all that encouraging from October 2000 through February 2001, when prices at times dipped to the mid-$30s and averaged under $40. The profit windfall, driven by higher prices, did not occur until March, too late to be revealed in the March inventory survey.

The bullish outlook for hog prices has three components. The first is that supplies are now expected to be smaller than previously thought. It had been anticipated that supplies would be up by 4.1 percent for the remainder of this year. That projection is revised down to 2.7 percent. Second, domestic demand has improved as a result of economically conscious consumers shifting some higher priced beef consumption to pork. However, the biggest of the bullish factors results from FMD in Europe and the added U.S. pork exports that are expected.

The break of FMD in Europe is big news for the U.S. pork industry. Pork production in Europe is more than double that of the U.S. and Canada combined. Most of the pork produced in Europe is consumed in Europe. However, about 3 billion pounds of pork are exported, primarily to Japan, Hong Kong, and the U.S. The U.S. and Canada export only 3.2 billion pounds combined. If Europe was unable to export pork, the loss of world pork supply would about equal all of the exports from the U.S. and Canada.

To date, England, Ireland, France, and the Netherlands have broken with FMD. The inability of those countries to export pork could account for $2 to $4 higher U.S. prices. All of that impact would be from France and the Netherlands, since England and Ireland are both net pork importers. The largest European exporter is Denmark. If FMD should break there, hog prices could rise by an additional $4 to $6 per live hundredweight, although that possibility may already be partially reflected in the market.

Two additional critical questions are, How long will the higher prices last? and Will FMD visit North America? Answers cannot be accurately evaluated. However, the number of FMD cases continues to grow, indicating the disease is not yet contained. USDA officials are already saying they will look at procedures to accept European pork once the disease is contained. This would likely be in the summer, at the earliest. As for the U.S., the financial impact of the disease could be disastrous or moderate, depending on how it is isolated and contained.

For this price analysis I assume that FMD does not come to North America or Denmark and that the spread is contained in Europe over the next month. Live hog prices are expected to move into the lower $50s during late May and early June. Prices may begin to ease into July and August when they would average in the mid-to-higher $40s. By late summer, prices could move back to the lower $40s and average near $40 in the final quarter before dropping to the very high $30s in the winter.

Producers are strongly encouraged to consider forward pricing opportunities for hogs to be marketed in late May and early June. This is the time period that cash hog prices are expected to be near their peak, and futures often reflect some of the optimism. Hogs could be forward priced with futures, options, or forward cash contracts with packers.

The windfall profits this spring are likely to stimulate a greater desire to expand the herd. However, producers should wait a few months to see how the FMD outbreak evolves. Resolution of FMD in Europe, or an outbreak in North America, could quickly cause windfall profits to blow away.

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