



WEEKLY OUTLOOK



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SUPERB HOG PROFITS WILL ERODE IN THE LAST-HALF OF THE YEAR

Hog producers are currently experiencing profit levels that have not often been seen in recent history. In the second quarter of 2001, returns are expected to exceed \$12 per live hundredweight, or \$30 per head. Since 1990, there have only been two other quarters (about four percent of the time) when profits achieved this level.

The current favorable returns are a result of three factors. The first is a low rate of expansion in the breeding herd. The most recent USDA *Monthly Hogs and Pigs* report says producers are not currently moving toward expansion. For the spring quarter, producers had indicated they would expand the breeding herd by somewhat less than 1 percent. In March, farrowings were up 1.4 percent, but April farrowings were actually down 0.3 percent. In addition, the number of sows and gilts bred in the month of April was down 0.3 percent from the number bred in March. In summary, there still is little movement toward expansion, which is favorable for the hog price outlook.

While controlled expansion of the breeding herd is expected to continue, the second important factor giving rise to strong profits apparently will not. This factor is the restriction on trade of European pork due to foot and mouth disease (FMD). Restrictions on European pork being shipped to most of the world helped to stimulate exports from the U.S., especially to Japan. In addition, the U.S. buys pork from several European countries. On May 25, the U.S. lifted the ban on European pork imports from countries other than those that have been positive for FMD (England, Ireland, France, Greece, and the Netherlands).

How big an impact will the opening of some European imports have on U.S. prices? In 2000, the U.S. imported about 200 million pounds of pork from Europe. This represented only 1 percent of our 18.9 billion pounds of domestic production and included the following volumes: 148 million pounds from Denmark, 24 million from Poland, 11 million from the Netherlands, and 9 million from Hungary. The current opening of imports from these countries, except for the Netherlands, means that live hog prices could drop by \$.75 to \$1.00 per live hundredweight. This is a relatively small impact compared to the loss of exports we would have sustained when Japan opened its borders to non-FMD European countries earlier this spring. In 2000, Denmark as an example, exported 1.2 billion pounds out of Europe. Since the break of FMD in Europe in February, the U.S. and Canada have been sharing in increased pork exports to cover the European shortfall. If the loss of these exports is added, the price impact is likely to approach \$3 per live hundredweight.

The final factor that has given rise to strong profits is low-priced feed. Near the first of the year, central Illinois corn prices reached \$2.10 per bushel, but have declined steadily since and are approaching \$1.70 per bushel. Soybean meal reached \$200 per ton in January, dropped to \$150 per ton in March and has since recovered to about \$170. Given these input prices, the cost of hog production has declined about \$3 per live hundredweight since the beginning of the year. Current costs of production are estimated to be in the \$35 to \$39 range.

Given the strong profits this spring, won't producers be encouraged to expand? The answer is not an overwhelming, yes. First, producers had just recovered sufficient profits by March of this year to cover the losses they had sustained in late 1998 and in 1999. In essence, they are just now back to the financial point that they were three years ago. Secondly, all producers knew that the U.S. would benefit from FMD problems in Europe, but that these benefits would likely be short-term, at least for countries such as Denmark that were able to remain FMD free. Finally, the devastation of FMD in England has been a constant reminder of what could happen on their farms if FMD were to break in the U.S. Many press articles and even some U.S. scientist and officials gave low probabilities of keeping the U.S. FMD free.

As the world returns to a somewhat more normal pork trading pattern, U.S. prices are expected to weaken into the summer and decline further as supplies increase in the fall and winter. Cash hog prices, which have reached \$53 at terminals in May, will likely be nearer \$50 for averages in June. By mid summer, prices are expected to decline into the higher \$40s, and drop into the lower \$40 in September. Fall prices could be near \$40 for an average, but be in the higher \$30s in late October and November. At this point, winter prices are expected to remain in the higher \$30, providing a modest profit.

Futures markets peaked in mid-April and have dropped \$6 to \$7 per lean hundredweight since. The latest indication that producers are not moving toward greater expansion will likely mean that futures price levels will recover some in coming weeks. If so, producers will be able to establish hedges at profitable levels through the coming winter.

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