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HOG MARKET KEEPS FAILING THE TEST

Just like the college student who couldn't pass the chemistry test, the hog market has continued to fail one "price test" after another so far this year. The USDA's March *Hogs and Pigs* report provided renewed hope for higher prices in the futures market, yet cash prices remained stuck in the lower $30s one week after the release. Losses continue to mount as the market must now rely on the traditional spring price rally to salvage a return to a breakeven situation. Needless to say, producers need to see the hog market pass this test.

The March inventory report from USDA indicated that producers across the country have reduced the size of their breeding herds by 4.5 percent. Given the large financial losses over the past year, even greater reductions in the herd can be expected throughout 2003. Farrowing intentions for this spring and summer are down at least 3 percent, which should reduce the number of market animals through next winter. The direction is correct, but there remains a question of whether the magnitude of the reduction is large enough to push hog prices back into profitable ranges.

Minnesota was the only major production state to have an increase in the size of its breeding herd, up 4 percent. Oklahoma and Texas breeding herds remained unchanged. Illinois and Iowa herds were down 7 percent, Indiana was down 6 percent, Nebraska was down 4 percent,k and both Missouri and Ohio were off 3 percent. Producer decisions to decrease their herds may have been influenced in the Eastern Corn Belt by the small corn crop (121 bushel average in Indiana and only 88 bushels per acre in Ohio). However, the record corn crop in the Western Corn Belt does not explain large decreases in the Iowa herd, where yields averaged 165 bushels per acre.

The market herd was reported to be down only 1.6 percent. There is some hopeful news in the weight breakdowns, as it appears that the number available for slaughter should soon begin to drop. The 180 pound and over category was more than 1 percent greater than last year at this time. However, most of these hogs should have been marketed by early April. Pigs that will come to market in April through August were down from 2 percent to 2.5 percent. If so, this could finally mean that slaughter supplies will soon be coming down, and provided the needed stimulus for rising prices.

Producers have been operating at a loss for the last 13 months, dating back to March of 2002. Those losses were the most severe in the last quarter of 2002 when they averaged an estimated $21 per head for average costs producers. Losses were more moderate in the first quarter of 2003, but still were about $9 per head. Low hog prices helped packers to their best margins in four years during this period.

Given the larger than expected supplies so far this year, pork production for the entire year may only be down 1 percent. However, that means about a 2 percent reduction for the remainder of the year. With continued small beef supplies and the potential for a recovering economy, hog prices are expected to average $37 to $38 for the year. The highest prices are still expected to come this spring, when daily highs could move into the lower-to-mid $40s. Late summer prices are expected to drop back toward the higher $30s. Prices in the mid $30s should be expected for late in the year, with prices moving into the higher $30s for the first quarter of 2004.

Moderation in costs of production should also be expected over the next 12 months. Interest rates remain low, and could even dip somewhat before increasing late in 2003. Fuel and energy prices are likely to move lower with the resolution of military conflict in Iraq and the increase of oil supplies from that country into the world market. Feed prices face the uncertainty of the coming growing season, but a "normal" weather situation in the U.S. could lower both corn and meal prices somewhat, although dramatic reductions in corn prices should not be expected at this time.

Continued financial discouragement needs to stimulate more producers to reduce their herd sizes allowing for even larger reductions in the national breeding herd later this year. Unfortunately, it appears that the industry is slow to adjust hog numbers downward at this time, likely due to the concentrated industry structure and the newness of capital investments made over the last 10 years. In past hog cycles, it has taken around one and one-half years from a period of losses until the industry reduced production and returned to profits. If the timing is similar on this cycle, this would mean we are just entering the time when higher prices would be expected, with the highest prices and profits not anticipated until 2004.

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