



# WEEKLY OUTLOOK



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## **HOG PRICES BEAT EXPECTATIONS: WHAT'S NEXT?**

Hog prices have considerably outperformed expectations this summer, adding a smile to the faces of many pork producers. The much improved price performance since May has caused the futures market and analysts, to look for explanations and to increase the forecasts of fall and winter prices.

The year got off to a rugged start. In the first four months of 2006, live hog prices averaged \$42.24 per live hundredweight. That was more than \$9.00 below the average in the same period in the previous year and kept revenues just above costs of production. Why were prices so depressed? First, meat and poultry production were very high. During the first quarter beef production was up 6 percent, pork was up near 4 percent, and poultry was up near 4 percent. Secondly, avian influenza in Europe in the winter and spring resulted in reduced broiler exports with that production pushed back into the domestic market. Finally, the pork market expected pork supplies would continue to grow throughout the year with more breeding herd expansion. What evolved was different from expectations. Broiler exports picked up again late in the spring, the growth in pork supplies early in the year yielded to more moderate increases in the summer, and the USDA's June *Hogs and Pigs* report confirmed little expansion of the U.S. breeding herd.

The pork industry is less interested in history than in price forecasts for this fall and winter. Futures markets have increased price expectations. October lean hog futures traded around \$56 in the spring, increased to near \$60 in the summer and increased to about \$66 in the past month. The price increase from late May to the current time period has been about \$8 and \$5 for the February 2007 contract.

Fundamentally, pork supplies are now expected to be up only 1 to 2 percent for this fall and winter. This summer's farrowings are expected to be unchanged and fall farrowings are up only 1 percent. Higher corn prices after this fall's harvest may keep marketing weights fairly close to unchanged as well. Foreign demand for pork has continued to enhance hog prices. With data currently available, exports for the year have been up 15 percent. With more pork moving out of the country, the available supplies in the domestic market have been up less than 1 percent this year. Finally, indications are that retail margins have been narrower than anticipated this summer, which has added to farm level prices as well.

For the months of June, July, and August, hog prices averaged \$3.40 higher than during the same period in 2005. If this additional margin were to continue, as now appears likely, hog prices would average about \$49 in the last quarter of 2006 and around \$46 in the first quarter of 2007. These prices would be consistent with current futures prices of around \$66 on October and \$62 on February lean hog futures.

Should producers be hedging? The answer is up to individuals. However, these are clearly substantially better pricing opportunities than had been anticipated. They will provide a considerable profit margin for most producers. Finally, forward pricing of lean hog futures for the fall and winter is often recommended to be completed by the end of August or early-September when summer cash prices still tend to be high. These are each compelling reasons to forward price now.

One mystery is why producers have not yet expanded? The pork production industry has been profitable since the spring of 2004. Producers, however, relate their concerns about large market uncertainties and high cost of buildings as two important reasons. In addition, uncertainty over rising corn prices with booming ethanol use has many extremely cautious.

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