UNIVERSITY OF ILLINOIS EXTENSION

# WEEKLY OUTLOOK

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## HOG PRODUCERS SLOW TO RECOGNIZE THE ETHANOL ERA

Maybe it's because hog producers have yet to witness the local ethanol plant using much of the corn they use to feed, but as a group they have not gotten the message yet. And what is that message? Feed prices are much higher and the quickest way for hog prices to move higher is to cut production. Instead they continue to expand.

In the March inventory update from USDA, hog producers reported they have increased the size of the breeding herd by one percent. This means pork production will continue to increase by about two percent in 2007, establishing the eighth consecutive year of record pork production.

The national breeding herd on March 1 was 56,000 animals larger than the herd of last year. Most of the increase occurred in the Eastern Corn Belt (ECB) where numbers are up 50,000 head. The increases by state in the ECB are: Illinois 20,000, Indiana 10,000, Michigan 10,000, and Ohio and Wisconsin each 5,000 head. In the Western Corn Belt, Iowa's herd was down 20,000 head which was offset by a similar increase in Minnesota. Across the country, the market herd was up by a bit over one percent. Farrowing intentions are down modestly for the spring quarter, but unchanged for the summer quarter, perhaps finally indicating some slow down in the expansion.

On the demand front, export growth is also expected to slow sharply this year, but still be up five percent. This rate of growth is sharply reduced from the 75 percent increase in exports over the three previous years. High retail beef prices will cause some domestic shoppers to turn to the pork case.

What does this mean for prices? On a liveweight basis, prices are expected to average near $50 in the second and third quarters this year then and near $46 for the last quarter of 2007 and the first quarter of 2008. This means an average of about $48 over the next 12 months. The lean hog futures market is more optimistic about price prospects. Using the settlement prices on April 5, 2007 and the historic basis for the Eastern Corn Belt, futures were suggesting an average price closer to $51 over the next 12 months. Part of the reason futures are more optimistic seems to lie in the euphoric reaction of the pork industry to the 90.5 million acre corn planting intentions number. This probably caused some liquidation of short positions in lean hog futures.

The break in corn prices after the USDA's March 30 *Prospective Plantings* report was welcomed by hog producers, giving them added hope that crop producers could provide enough corn for both fuel and feed in the 2007-08 marketing year. However, one week after the report, costs of production are still expected to increase from around $47 per live hundredweight currently to near $49 by late 2007 and early 2008. In the week after the report, corn prices dropped sharply, but also recovered substantially, and meal prices were little changed. After all the excitement of the March 30 report, estimated costs of hog production are down less than $.50 per live hundredweight over the next 12 months.

Using the $48 expected price for the next 12 months, pork producers are looking at about a breakeven situation, with $2 of profits per hundredweight this spring and summer followed by $3 of loss for the last quarter of 2007 and first quarter of 2008. Lean hog futures are more optimistic, which means producers could establish about a $2 per hundredweight profit margin by hedging lean hog futures and feed prices. Most should probably consider establishing some positive margins while offered. Lean hog futures tend to move higher seasonally in April and early May, so this is a time to be watching those markets closely.

Producers need to realize that national pork supplies will have to be reduced before the industry will recover back to profitability. So far, the cost increases have been absorbed by reductions in pork producers' bank accounts. Assuming costs are now about $7 per hundredweight higher, pork producer returns will be reduced by about $2.0 billion in 2007 alone.

There are a few signs of adjustment, such as lighter weights and unchanged farrowing intentions, but producers need to make greater adjustments to the ethanol era. Larger declines in the breeding herd are needed in coming months.

Issued by Chris Hurt
Extension Economist
Purdue University