WEEKLY OUTLOOK

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PORK INDUSTRY FACES TWIN HORRORS

Most pork producers who take the market risk are in the midst of another financial disaster. The North American industry remains on pace to suffer the most damaging financial year ever due to a period of twin horrors. They face a period of excessive pork production while also battling feed price escalation of historic proportions. There seemingly is no cure until the financial carnage is sufficient to decisively reduce the size of the breeding herd.

The unrelenting excess pork supplies that began last October continue in 2008. In the final quarter of 2007, pork supplies were up an astonishing 10 percent. The New Year brought no relief as production through March 1, 2008 was up 11 percent, and there is no end in sight. Sow liquidation is in the planning stages, but not yet showing up in the slaughter numbers. Smithfield's has announced a reduction of 40,000 to 50,000 sows. The Canadian government is going to subsidize liquidation of sows in a national buyout program that may help reduce their breeding herd by up to 10 percent. Producers there will have to keep those herds out of production for three years.

U.S. sow slaughter so far this year does not yet indicate a movement toward liquidation. While the total sow slaughter has been modestly higher than last year, the rate of slaughter as a percent of the herd has not increased. In other words, the higher slaughter is a result of the larger breeding herd. A high rate of farrowings has likely extended through at least February 2008. These pigs will be coming to market over the next six months, so the earliest a reduction in the extremely high rate of pork production can occur is September of 2008. This implies continued high slaughter rates through the summer of 2008 and is a price depressing factor for summer 2008 lean hog futures prices.

Hog prices in the first two months of 2008 averaged near $40 per live hundredweight, with costs of production for farrow-to-finish operations estimated to be near $54. First quarter losses are now anticipated to be about $34 per head after estimated losses of $19 per head for the final quarter of 2007. The record quarterly losses, from my estimates, were in the final quarter of 1998, at $45 per head.

Hog prices will improve this spring and summer. However continued large pork supplies are not expected to allow hog prices to catch up to spiraling costs. Live weight prices are expected to rise to the high $40 in the spring quarter and to the extremely low-$50s for a third quarter average. Some reduction in supply should be evident by the last quarter of 2008, with prices in the higher $40s. For the year, an average price of about $47 per live hundredweight is expected.

Grain and soybean prices are expected to face a year of unprecedented height and volatility. The pork industry must unfairly adjust to this extreme risk to their margins. Given corn and soybean meal prices observed in the futures market on March 3, 2008, costs for farrow-to-finish producers are estimated to currently be in the high $50s and are estimated to reach near $60 this summer. For all of 2008, estimates are for costs near $57 and hog prices near $47, for an average loss of $27 per head. This compares with an estimated loss of $15 per head in 1998, the previous record loss year.

Lean futures prices suggest higher cash prices than forecast here. Using current lean futures (and adjusting basis about $2 lower than average) provides hedging opportunities at about $54 for the third quarter of 2008 compared to the forecast in the very low $50s. For the final quarter of 2008, futures are providing about $52 compared to the forecast of $47 to $48.

Hog prices probably will not improve sufficiently to reach breakeven levels until the late-spring of 2009. Then, the last-half of 2009 and 2010 could be a period of favorable profits. But the question remains, who will be left standing by that far-distant point?

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