WEEKLY OUTLOOK

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HOGS PRICES: DO YOU BELIEVE IN MIRACLES?

Could this be a miracle? Where have these “high” hog prices come from? It’s almost as if prayers have been answered!

In mid-March, Eastern Corn Belt hog prices were $35 on a liveweight basis. Today they are $58. The huge financial losses have slowed as hog prices have recovered much closer to costs of production. What an amazing turn-around in such a short period of time. Just how surprising is this reversal of fortune? The average seasonal price increase from early April to early June over the past five years was $11 per live hundredweight. This year the seasonal increase has been $23 so far, more than double the normal. Next, consider this remarkable price increase is occurring with pork production up about 10 percent, almost defying basic economics.

Perhaps some hog producers don’t want to question a miracle, but the rest of us want to know why. Since supplies are sharply higher, demand is the most likely place to look for the answer and export demand is the most probable source. Unfortunately, trade data are only available through March of this year, but that data shows a robust export period. In the first quarter of 2008, pork exports were up 40 percent and imports were down ten percent. The net impact was a 61 percent improvement in net trade volume. As a percent of U.S. production, this was 14.8 percent in the quarter, compared with 10.2 percent for the same period in 2007. The bottom line was that additional trade enhancement in the first quarter accounted for nearly five percent of all production.

Pork producers know that pork has been cheap in the U.S., but with the rapid devaluation of the U.S. dollar, U.S. pork was doubly cheap to some foreign buyers. As a result in the first quarter, shipments to Hong Kong (mostly trans-shipments to Mainland China) were nearly seven times larger. Chinese purchases were up nearly three times. Exports to Russia were more than double exports to Japan rose by 8 percent and Korea by 27 percent.

China of course deserves a special note as pork production there was reduced in 2007 by nine percent due to disease problems. They are in the process of rebuilding the herd but are willing to import more pork in an attempt to reduce the inflationary pressure on pork and food prices in general.

Domestic demand may be a reason for some of the strength in hog prices as well. Pork is cheap and the American shopper is in a mood to look for bargains as both food and fuel price increases have cut into family budgets. In April, as an example, retail beef averaged $4.17 per pound and pork was $2.86. That's a savings of $1.31 per pound. On a 10 pound meat purchase, that's a savings of $13 and will buy enough gasoline to get the family vehicle another 60 or 70 miles down the road.

There may also be an almost intangible demand component in pork right now. Some would call it "speculation," others might say it is "inflation expectations." This is the idea that all agricultural commodities must eventually have a major increase in price to account for much higher production costs. It was thought that hog producers would have to cut herds to get pork prices to rise enough to cover higher production costs. Maybe those cuts in production will come in the form of other world producers cutting their production such that U.S. exports can accommodate large domestic production. If the latter case holds, U.S. producers may not have to reduce herd size as much.

What does this mean for the future? Using futures prices for corn, soybean meal, and lean hogs on Monday, May 19, and adjusting for historical basis levels, hog prices would average about $54 for the second quarter and $55 for the summer. The fall decline would be moderate, with prices only dropping back to $53.50, and then taking off in 2009 with the first quarter average at about $57.50 and the second quarter at about $64. Cost would be about $58 this spring, summer, fall, and winter providing $2 to $4 of loss for farrow-to-finish operations. The world finally brightens for hog producers in the spring of 2009 with prices moving toward the mid-$60s with costs near $59 for $5 to $6 of profits.

Overall, the current futures forecasts says the losses will not be nearly as bad for the rest of this year as had been anticipated. But the markets also agree that it will be the spring of 2009 before the industry gets back into the black.

I had suggested it would take a 6 to 8 percent cut in the breeding herd to return to profitability. Now, it appears that more modest cuts may return the industry to profits, at least if the world keeps buying "high value" U.S. pork. Thank goodness for miracles, and thank goodness economist's bleak forecasts aren't always right.

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