WEEKLY OUTLOOK

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PORK PROFITS BEGIN TO CLAW BACK DEPLETED EQUITY

Return to profitability is the theme for the pork industry in 2010. The large losses began in the fall of 2007, so it has been nine quarters of losses, with some very large losses. Those losses were a result of soaring feed prices in 2007 and 2008, recession in late 2008 and 2009, and a dose of H1N1 that sickened pork demand.

But, let's look forward where the sun is shining. The pork industry will benefit this year from reductions in supply, from improvements in demand, and from some moderation in feed costs. The industry has reduced the breeding herd by six percent over the past two years. So far in 2010, pork production in the U.S. has been down by seven percent, with about a six percent reduction in slaughter and about one percent lower weights. Lower market weights are probably related to the cold winter in which animals did not grow as quickly. Looking forward, pork production for the year is expected to be down by two percent.

Stronger demand is expected to come from higher exports, from a recovering U.S. economy, and from the passing of H1N1 from front page news. USDA expects exports to increase by eight percent this year. This means an additional one percent of U.S. production will go into foreign markets and not be available at home. Most importantly, per capita domestic supplies of pork are anticipated to be down by four to five percent this year given smaller production, more exports, and some population increase.

Another contributor to higher hog prices in 2010 will be more moderate retail margins. When retail margins are high, a smaller portion of the retail pork price tends to get back to producers. As an example, last summer and early fall the retail margin was about $1.85 per retail pound, but this dropped to about $1.60 per pound by this winter. This meant that the producer's share of the retail sales went from about 23 percent to nearly 30 percent more recently. More modest retail margins will likely continue to contribute to higher farm level prices for much of this year.

Prospects for feed costs have moderated as well after the January 12 USDA crop updates. Estimated cost of production for farrow-to-finish production was $54 per live hundredweight in 2008 and $50 in 2009. For 2010, those costs are expected to be about $47 to $48.

Hog prices have already responded to the much improved outlook, with more to come. Live hog prices began the year in the mid-$40s and reached the very low-$50s by late February. The early spring rally should be ready to take-off, hopefully with no failed launches as occurred last year when H1N1 hit the news on April 24th. Live hog prices are expected to move into the higher $50's in the late spring and early summer. Second quarter prices are expected to average in the mid-$50 and third quarter prices about $1 lower. The last quarter of 2010 and winter of 2011 may see prices drop back seasonally to the $47 to $49 range.

Live hog prices are expected to average about $51 for 2010 with costs around $47 per live hundredweight. If so, this means a profitable year of about $10 per head, with the best of those profits coming this spring and summer. This compares with estimated losses of $17 and $23 per head for 2008 and 2009.

If this positive outlook does develop, pork producers will be able to recover some of the equity erosion that has occurred in the past two years. However, $40 of losses ($17 and $23 per head in 2008 and 2009) over the past two years will not be recovered with $10 per head of profits in 2010.

The bottom line message to the industry is that feed costs are much higher and more volatile in these early years of the biofuels era. In response, the industry had to adjust to lower production, and most of that has been done. But the industry should not interpret the outlook for a little black ink in 2010 to be a signal to race back toward expansion. As an example, a U.S. drought in 2010 would quickly send feed costs back above breakeven levels.

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