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Department of Agricultural and Consumer Economics, University of Illinois Urbana-Champaign

Weekly Outlook: Pork Industry's Sustainable Expansion

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The pork industry has been in expansion now for three years dating back to 2014 when the PED virus reduced pork supplies and sent hog prices to record highs. After an initial surge of breeding herd expansion of two to three percent three years ago, that expansion has been steady at between 1.2 and 1.5 percent for the past four quarters. States with the most robust expansion over the past three years as measured by the largest increases in breeding herd animals include: Missouri +50,000; South Dakota +40,000; Texas +35,000; Illinois +30,000; North Carolina +30,000 and Oklahoma +25,000.

The good news is that a breeding herd expansion of about one percent is sustainable. This means that pork supplies will grow at two percent a year, or maybe slightly higher. This is about the same rate that consumption is increasing. So with the current rate of expansion, hog prices would be expected to stay near levels that are reasonably close to total costs of production.

Pork supplies this fall are expected to be about three percent higher than year-previous levels. In the first three quarters of 2018, pork supplies are expected to be up about two percent.

Live hog prices are expected to average in the mid $40s in the final quarter of this year and then move upward to the higher $40s in the first quarter of 2018. Prices are expected to rerun to the mid-$50s in the second and third quarter next year and then be back around the mid $40s in the final quarter.

For calendar year 2017, prices are expected to average about $50 on a live weight measure. For 2018, current futures estimates are for hogs to be about $1 higher, near $51. Production is anticipated to rise by 2.4 percent in 2018 and that would generally mean slightly lower prices. However, strong pork demand and reduced packer margins may help bolster hog prices somewhat above those of 2017.

While hog prices may be somewhat higher in 2018 compared to 2017, feed costs may also be somewhat higher. Current estimates suggest that the U.S. farm price of corn for calendar year 2017 may average about $3.38 per bushel. That is the lowest calendar year price since 2006. My estimate for calendar year 2018 is currently higher at $3.60. The $3.60 estimates is based on current corn futures prices where there is a high level of futures carry. This simply means that the market is providing higher prices in the future to provide a sufficient financial incentive for market participants to store corn. The reason for the large futures carry is the surplus corn inventory. Large surpluses do not sound like a reason to think corn prices should be higher next year. The point is that while forward prices in futures markets suggest corn prices will be rising over the next two years, the ultimate price levels may not rise as much if surplus inventories continue.

Expected soybean meal prices based on current futures suggest that Decatur hi-protein meal will average about $325 a ton in calendar year 2018 compared to $315 in 2017. So, meal is also expected to be somewhat higher in 2018 on a calendar year base.

What do estimated returns look like for 2017 and 2018 for average costs farrow-to-finish production? Right now, returns in 2017 and 2018 are expected to be similar. For 2017, live hog prices are expected to be near $50 per live hundredweight with costs about $1 less. For 2018, costs are expected to rise about $1 per hundredweight with hog prices up about the same amount. The bottom line is that annual estimated average returns will be about $2 per head above all costs in both 2017 and again in 2018. Of course, many events in 2018 could change that near equilibrium situation.

The pork industry continues to expand the breeding herd to meet new packer capacity, but is doing so in an orderly way, at least so far. Pork consumption is growing as well with expansion in both the domestic and the export sectors. This means the industry can grow at a rate of two to three percent per year and not generate excess supplies that would depress prices below costs of production. This is consistent with the current one percent growth rate of the breeding herd.

While pork demand growth has supported the expansion of the recent steady breeding herd expansion, there are a couple of issue to remember. The first of these is that export sales have to continue growing. There are many things that can disrupt this growth and unfortunately, those include trade issues that could harm U.S. agriculture. Those start with NAFTA negotiations currently underway. As a reminder, Mexico and Canada have purchased 41 percent of our total pork exports so far this year. Concerns over trade with South Korea and China have also been in the news with those two countries representing an additional 19 percent of our pork exports so far this year.

With feed prices expected to stay moderate for the fourth year in a row in 2018, pork producers may be getting complacent as lower feed prices become the new norm. Producers can lock in these low prices for much of the coming 12 months. While world inventories of grains and oilseeds are abundant now, short yields in a major growing region can still have an upward impact on feed prices. Owning cash corn inventory and covering some meal feeding needs feels like a prudent strategy during this fall’s harvest.