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Weekly Outlook: Pork Industry: Some Recovery from Decade Low Prices

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The U.S. pork industry has been expanding the breeding herd and growing since mid-2014. The rate of breeding herd expansion peaked in early 2018 at a 3.5 percent annual growth rate. Financial losses and heightened uncertainties from trade tariffs have reduced that breeding herd expansion rate to 2.4 percent currently. Financial losses are expected to persist again in 2019, but will not be as large as last year's trade reduced prices. To get back to profits, the industry must secure more markets for U.S. pork or further reduce the rate of expansion.

Inventories of animals in the latest USDA *Hogs and Pigs* report were generally smaller than the trade had anticipated. The numbers indicated that pork supply estimates be revised somewhat lower for 2019. The breeding herd was 2.4 percent higher and the market herd was about two percent higher.

The weight breakdowns for the market hogs indicate that first quarter slaughter will be nearly three percent greater than the previous year. Second quarter hog numbers would drop to about two percent great.

Farrowing intentions for this winter are up 2.5 percent, but up only 1.5 percent in the spring. Market weights have been lower recently as producers respond to low hog prices and negative margins. This pattern of financial losses is expected to continue until the spring and encourage producers to market at somewhat lighter weights. These lighter weights will also help reduce total pork supplies in 2019.

For 2019, total pork supplies are expected to be up around two percent except for the summer quarter when they may be up closer to three percent. Thus for the year, pork supplies may rise by slightly over two percent. This is somewhat lower than my previous thoughts and gives some modest optimism to higher price expectations for 2019.

The year of 2018 was a bad year for hog prices and is another reason to be more hopeful for 2019. Prices in 2018 averaged only $45.92 per live hundredweight for 51% to 52% lean carcasses (USDA).

This was the lowest annual price in a decade dating back to 2009. The 2018 average price was $4.54 lower than the previous year in 2017.

What went wrong in 2018? Looking at monthly prices for 2018 and 2017, the unrecoverable damage to hog prices was in the third quarter of 2018 when hog prices were about $12 lower than the same period in 2017. The most extreme month was September 2018 when prices were $20 lower than in September 2017. The collapse of hog prices in the third quarter of 2018 appears to be related to the U.S. trade policy. As the U.S. put tariffs on products we import, countries retaliated by putting tariffs on Ag products they import from the U.S. Of particular concern for pork were Mexico and China which together purchased nine percent of U.S. production in 2017 as pork imports. As a result of these concerns, both futures and cash market prices collapsed. Ultimately, pork exports were not reduced as much as was feared (especially to Mexico) and market prices began to recover into the fall.

So where does this leave price expectations for 2019? Using current lean hog futures and a historical basis, live hog prices are expected to average near $49 in 2019. That is an increase of $3 per live hundredweight over last year's $46.

Prices are expected to average in the low-to-mid $40s in the first quarter. Second and third quarter averages are expected in the low-to-mid $50s and then back down to the mid-$40s in the final quarter of 2019.

My estimated total costs of production for average farrow-to-finish operations is around $51. Corn costs this calendar year are expected to be about 25 cents per bushel higher than last year. Soybean meal is expected to be about $20 per ton lower. Higher costs are also expected for debt capital and for labor costs.

A familiar seasonal pattern is expected in 2019 with low prices and financial losses in the first and the fourth quarters and the highest prices and some profits in the second and the third quarters. For the year, current estimates of losses are $6 per head compare to $12 per head in 2017. Those 2017 losses were the largest annual losses since the drought year of 2012 (high feed prices).

By my estimates, average costs farrow-to-finish producers have been in a negative margin situation since late 2017. These extended periods of losses begin to erode cash flow and generally weaken the financial foundation for most operations. The firms in the weakest financial condition may face debt repayment difficulty as a result of their negative cash flows. In today's industry this most likely means some smaller hog producers may leave the industry and force further consolidation among larger producers.

The outlook for 2019 is still closely tied to resolution of trade disruptions with Mexico, Canada, and China. The USMCA with Mexico and Canada must be approved in the three countries. Current negotiations with China remain a high-stakes. If there is no agreement with China and current Chinese tariffs remain in place, then 2019 price prospects will likely fade. On the other hand, a negotiated settlement with China will likely restore our pork exports to them, with a considerable chance that they will agree to measurably increase agricultural purchases with pork being one of the products to benefit.