Market Comments

While there is broad expectation among US market participants that the surge in grain prices will eventually push beef and pork prices higher, for the moment beef and pork prices at the wholesale level are below year ago levels. The reality is that it will take time and plenty of pain along the supply chain to reconcile higher feed costs with what the consumer is willing to pay. On the pork side, it is important to recognize the importance of the export market and the outsize impact it has on the overall pricing structure. The share of US pork going to export markets has been increasing steadily, underpinning US hog prices and helping avoid the kind of structural changes needed to cope with $6, $7 and now $8 dollar corn prices. In 2007, just as corn prices were starting to ratchet higher, pork exports accounted for about 14% of US pork production. By the third quarter of 2011, however, pork exports were 23% of overall US pork output, a dramatic increase that helped put the pork cutout over $105/cwt. (see chart). In the first half of 2012, pork exports continued to be very strong, accounting for almost 25% of all US pork output. That does not necessarily mean stronger demand given that pork prices were soft, rather, that at the lower price levels exports were able to absorb more US product. Going forward, it will be critical for export demand to hold up, otherwise major reductions in hog production capacity will be needed. The US pork cutout on Thursday was quoted at $92.8/cwt, $16.6/cwt or 15% lower than a year ago and also 8% lower than what it was at the end of June. Much of the argument for the lower year over year price decline centers around the softer outlook for US pork exports in the second half of the year and that is likely a driver. However, we would argue that softer domestic demand for pork this summer clearly is a major factor. Two items have been particularly problematic in recent weeks, loin and ribs. This past July was the hottest on record and apparently that negatively impacted the willingness of the US consumer to spend time barbecuing in the backyard. The loin primal cutout is currently running some 24% below year ago levels while the rib primal is down 26% from last year. On the other hand, the belly primal is down just 2% from a year ago while the ham primal is down 13%.

The choice beef cutout on August 9 was quoted at $1.8250/cwt, $4.5/cwt or 3% higher than a year ago. Strong promotions of choice beef at retail helped the cutout hit annual highs in June but then prices slipped in July as hot weather took its toll. The expectation is for choice beef to track near or above 2011 prices into the first half of 2012, pork exports continued to be very strong, accountant for about 14% of US pork production. By the third quarter of 2011, however, pork exports continued to be very strong, accounting for almost 25% of all US pork output. That does not necessarily mean stronger demand given that pork prices were soft, rather, that at the lower price levels exports were able to absorb more US product. Going forward, it will be critical for export demand to hold up, otherwise major reductions in hog production capacity will be needed. The US pork cutout on Thursday was quoted at $92.8/cwt, $16.6/cwt or 15% lower than a year ago and also 8% lower than what it was at the end of June. Much of the argument for the lower year over year price decline centers around the softer outlook for US pork exports in the second half of the year and that is likely a driver. However, we would argue that softer domestic demand for pork this summer clearly is a major factor. Two items have been particularly problematic in recent weeks, loin and ribs. This past July was the hottest on record and apparently that negatively impacted the willingness of the US consumer to spend time barbecuing in the backyard. The loin primal cutout is currently running some 24% below year ago levels while the rib primal is down 26% from last year. On the other hand, the belly primal is down just 2% from a year ago while the ham primal is down 13%.

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