

Daily Livestock Report

Vol. 8, No. 176, September 10, 2010

“It was the best of times, it was the worst of times, . . . “
Charles Dickens
“A Tale of Two Cities”

The opening line of Dicken’s classic seems appropriate for this week’s pork bellies markets — the best of times for prices but the worst of times for the nearly 50-year old CME Pork Bellies futures contract. First the “best of times.”

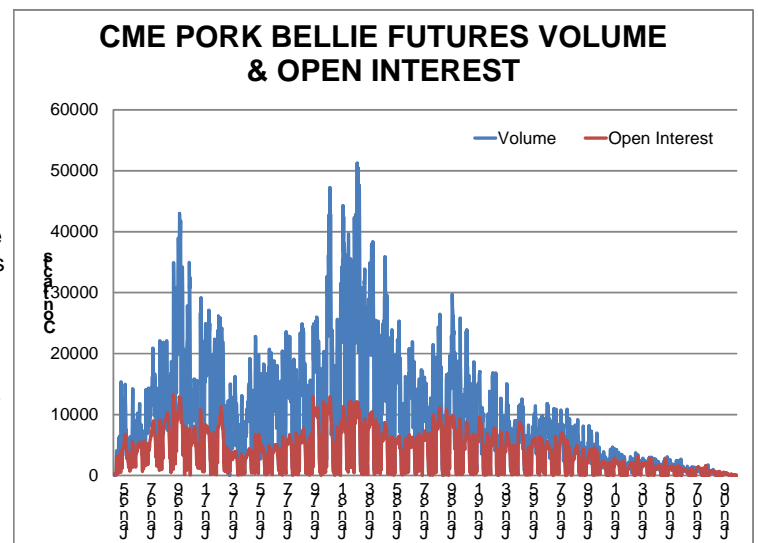
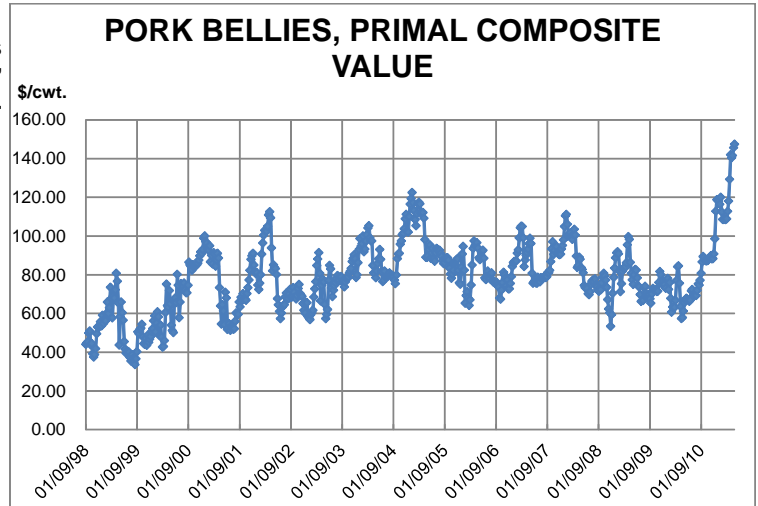
Cash pork bellies prices set a record for the second straight week last week with USDA’s Primal Composite Value for bellies reaching \$1.474/lb. That broke the previous week’s record of \$1.456 which had, in turn, broken the record of \$1.420 set just three week’s earlier. All of these August and September records eclipsed the old record set in May 2004. Actual prices for 12-14# and 14-16# bellies were quoted at \$1.54/lb. yesterday.

This surge in bellies prices has been driven by a confluence of factors. Bacon featuring this spring was quite aggressive by many manufacturers and retailers with many brands being promoted in “2 for \$5” ads where the 2 refers to 2 one-pound packages. The resulting draw-down in frozen pork bellies inventories pushed those stocks to their lowest level since October 2007 — in August. That is important since bellies stocks normally continue to decline through October due to lower summertime hog slaughter runs and late-summer BLT sandwich usage. When these lower stocks met lower-than-expected hog supplies since July 1, the bellies supply situation became critical and prices began to rise rapidly.

But this rally is larger than what we would expect based solely on bellies supplies. Neither inventories nor production are that far away from historic norms for this time of year, leading us to conclude that bacon and belly demand has improved. That conclusion is based solely on the performance of this market, though, since we have hardly any real-time metrics that measure the status of demand. The most recent Restaurant Performance Index from the National Restaurant Association indicates softening foodservice sector performance but it represents activity through only July. The most recent export data we have was certainly positive for pork exports but it represents shipments in June. It will be interesting to see if this increase in bellies prices foretells some improvement of foodservice trade since restaurant usage is such an important part of today’s demand for bacon and bellies.

The “worst of times” part of our Dickensian intro refers to the diminishing usage of CME Pork Bellies futures and the implications that has for the future of the contract. Total open interest stood at 11 contracts as of yesterday, all in the February contract. But this is just a continuation of a continued downtrend in Pork Bellies volume and OI that started in earnest in the late 1980s. Why has this happened?

The biggest reason is that the trade has moved away from frozen bellies to fresh bellies over this time period. There are two reasons for that: Less seasonality for bellies demand and less seasonality of bellies supply. Bellies demand has leveled seasonally primarily because of year-around use of bacon in foodservice applications such as sandwiches and salads. Supply seasonality has declined because of the decline in seasonal slaughter and production variation. The chart on page 2 shows that the quarterly pattern of pork production changed significantly from the 1950s through the 1980s. The result has been a reduction of seasonal price variation (bottom chart on page 2), especially since 1990, to the point where prices range only about +/-10% from the annual average, thus reducing the need for storage hedge coverage.



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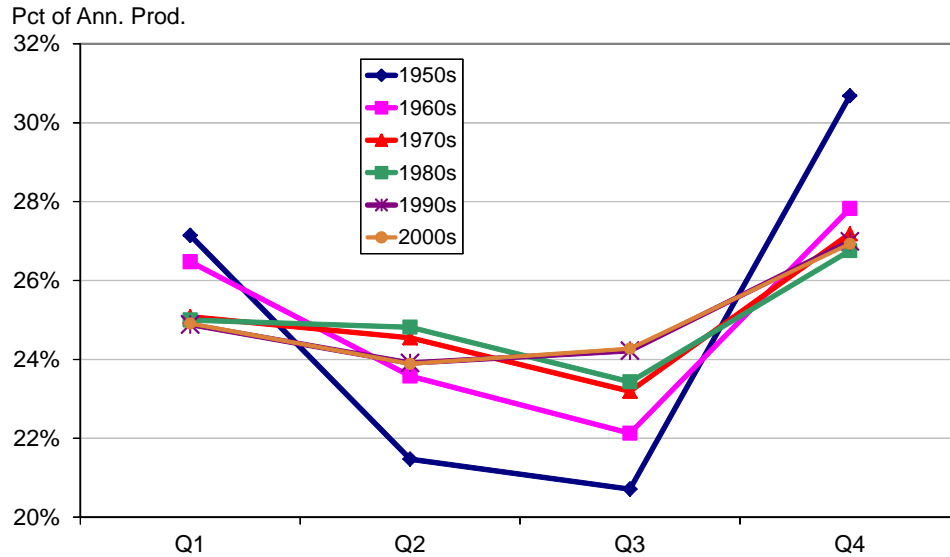
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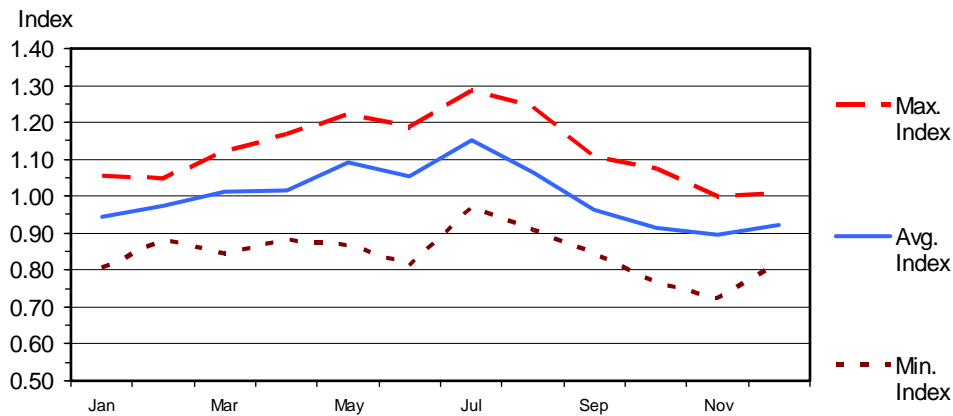
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PORK PRODUCTION SEASONALITY



SEASONAL PRICE INDEX -- PORK BELLY

Primal Composite, 2000-2009



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