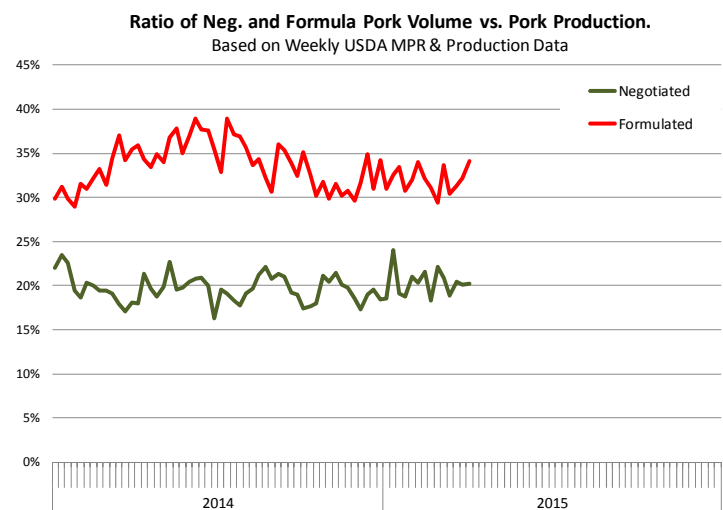
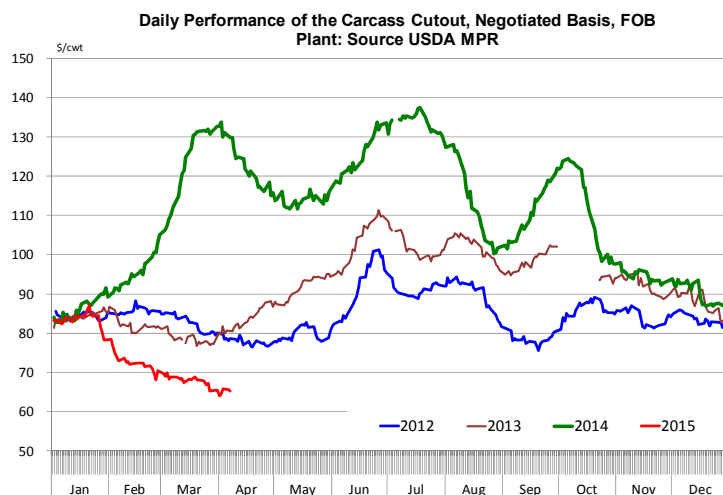
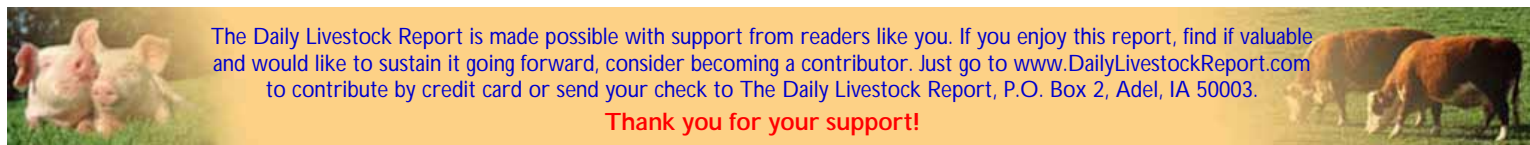


The brief rally in hog futures appeared to stall yesterday, in part due to ongoing weakness in wholesale pork prices. The pork cutout was quoted at \$65.32/cwt yesterday afternoon (although USDA also issues a report at noon). The latest cutout quote was 38 cents lower than the previous day. The decline was largely due to ongoing weakness in the pork belly market. The belly primal value last night was \$63.76, \$3.6/cwt lower than the previous close and now an astounding 69% lower than a year ago and 54% lower than in 2013. It appears that the dramatic price increases in bacon prices in 2012, 2013 and 2014 have caused some structural changes to how foodservice operators utilize this product. We say foodservice since it is the largest user of pork bellies. One way in which foodservice operators respond to the price rise is to offer less bacon per unit sold, be this by reducing the number of slices or by slicing it thinner. Some large fast food chain operators, who also are some of the largest users, have been reporting lower sales in recent months, which also does not help with overall belly demand. At this point, **the ongoing weakness in the belly market accounts for about a third of the overall decline in the value of the cutout** even as the belly primal only is 16% of the carcass.

It has been speculated that part of the reason for the sharp drop in the value of the pork cutout (it is about 50% lower than a year ago) may be due to the fact that end users are opting to reduce the amount of pork loads they do on a formula basis. Looking at the data, however, this does not seem to be the case. The chart to the right shows the trend in the volume of pork sold on a negotiated and formulated basis. Because of the shift in overall pork volume this year vs. last year, we calculated the ratio of weekly pork sales, reported under Mandatory Price Reporting, to overall weekly pork production. The pork production number is on a carcass weight basis so we had to convert the MPR sales to a carcass weight base equivalent using the standard 0.7 factor. As you can see, **the percent of pork sold on a negotiated basis has been fairly steady since last year.** As for formula sales, they are a bit lower but only marginally so. The data set is somewhat limited to make sweeping generalizations but at this point we do not see any dramatic shifts in the way in which pork is being priced this year vs. last year. What has changed is the supply of pork available in the market and the level of pricing required to clear the market. Pork export sales were likely very strong in March but this does not necessarily mean that demand was better. Rather than prices were low enough to get product sold. **US pork exports continue to face two significant headwinds.** First, the strength in the value of the US dollar has negatively impacted the relative pricing in world markets. It has made US product prices more expensive and lowered the price for competitors, especially Europe. Pork sales to China have been very weak and we think the relative change in exchange rates has played a role. The second negative factor for pork exports is the loss of the Russian market. Russia is a very large global pork buyer. They have dramatically reduced their pork buys and shifted their demand away from Europe and North America. This has created significant



imbalances in the world pork markets, forcing US and EU packers to compete aggressively to replace the lost Russian business. The drop in the value of the Russian currency and impending recession there means that pork sales to Russia overall will likely be down substantially in 2015. Losing an important pork buyer at a time when global pork supplies are expanding is a significant negative factor that industry will continue to struggle with into the summer and fall. For now, hog futures are looking at cash markets for a cue as to the kind of seasonal improvement we will see this year. Slaughter numbers are expected to be burdensome and if weights hold up, we could continue to see markets struggle to absorb the additional supply.



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