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

Weekly Outlook: Pork Industry Faces Tight Margin Year

Chris Hurt

Department of Agricultural Economics
Purdue University

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Pork producers in 2016 are expected to experience another year of tight margins similar to the year just completed. Pork production is expected to rise by about one percent, but beef production will rise by four percent and poultry by about three percent. There will be plenty of meat and poultry for consumers and retail prices will likely fall to encourage them to buy more. The global marketplace is also casting shadows on the U.S. pork industry with weak income growth in some countries that buy our pork and a strong U.S. dollar that encourages more pork imports and stimulates pork production in competitive countries.

First, a review of last year. The industry recovered from the PED virus that reduced baby pig numbers from October of 2013 to August of 2014. The impacts of those baby pig losses created gaps in slaughter hog numbers from April of 2014 to February of 2015. This slaughter gap helped create a period of record high hog and pork prices. However, since March of 2015, there has be little impact on slaughter numbers due to PED.

Pigs per litter also bounced back quickly once the disease was controlled. In 2015, pigs per litter set new quarterly records in each quarter. Annual pigs per litter set a new record high in 2015 at 10.38 pigs. This compares to just 9.0 pigs per litter in 2005, a 15 percent increase in ten years.

Hog prices were depressed in 2015 due to a seven percent production increase on a combination of eight percent higher numbers and one percent lower weights. Pork trade was also a negative for hog prices in 2015 as the strong U.S. dollar encouraged more pork imports, especially from Canada. Data currently available on trade suggest that higher pork imports increased pork supplies by an additional two percent. With seven percent higher production and two percent greater imports, total available supplies in the U.S. were up nearly nine percent. The large supply surge became a concern in the last two months as prices fell to six-year lows that were well below costs of production.

What about 2016? The recent USDA *Hogs and Pigs* market hog inventory suggest some let up in the large market supplies in late 2015. The USDA inventory suggest that the market supplies for December 2015 were up five percent, but should begin to taper off with the New Year. First quarter supplies suggested by the USDA inventory would be up about one percent, but weights are expected to be down, so total first quarter pork production may be unchanged to up one percent if USDA inventory numbers are accurate. Using the USDA inventory numbers, second quarter pork production would be down one percent.

What about summer and fall pork production? Pork producers indicated to USDA that they would reduce farrowings this winter by two percent with farrowings unchanged in the summer. If so, pork production would be down one percent in the second quarter unchanged in the third quarter and up one to two percent in the fourth quarter. Thus for 2016, production would be unchanged to one percent higher than last year.

How will trade impact hog prices in 2016? USDA's current outlook is for pork exports to increase by four percent with steady imports. If they are correct, trade would help increase prices a bit for 2016. However, the strength of the U.S. dollar will likely be a continued shadow over improved pork trade. Two factors will support a continued strong dollar: non-U.S. economic growth looks weak and rising U.S. interest rates. A strong dollar would provide headwinds against improved trade as USDA now forecast.

Further headwinds for 2016 hog prices will come in the form of growing supplies of competitive meats led by a four percent expansion of beef supplies. Poultry production will rise by about three percent and with about one percent more pork, total meat supplies will be nearly three percent higher. The beneficiaries will be consumers who will see lower retail pork and beef prices in 2016.

For the year, live weight hog prices are expected to average in the higher $40s after averaging near $50 in 2015. First quarter prices are expected to average in the mid-$40 before moving upward to average in the low-to-mid $50s in the second and third quarters. Prices then are expected to drop to the mid $40s for the final quarter.

My 2015 costs of production estimate for farrow-to-finish production was $51 per live hundredweight. A modest reduction to $50 cost is expected for 2016. The slight reduction is due primarily to lower soybean meal prices that will be the lowest since 2007.

Margins are expected to be negative for the year with an average loss of about $4 per head. There will be large differences by quarter with loses near $16 per head in the first and the fourth quarters and profits of about $8 per head in the second and third quarters.

The bottom line is that the pork industry has already expanded enough to drive prices back below costs of production. Any further expansion in the pork industry at this time will likely lead to even larger losses. The beef and poultry sectors are also expanding which means more abundant meat and poultry supplies in 2016. Retail meat and poultry prices will need to move lower to move these larger supplies. In addition, the strong U.S. dollar and weak non-U.S. economic outlook likely mean that trade prospects could be an additional factor that could weaken hog and pork prices.