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Weekly Outlook: Hog Prices Join Corn and Wheat at Ten-Year Lows

Chris Hurt

Department of Agricultural Economics
Purdue University

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It is interesting to be an observer of agricultural price movements. However, for many producers of agricultural commodities, prices are a key driver of their financial wellbeing. Wide ranging price movements over time can vastly alter their financial conditions. It is clear that the financial impacts of price movements affect many agricultural input businesses as well.

What can happen to prices of agricultural commodities in a decade, and why look at the last decade? It is because it was 10 years ago in the fall of 2006 that agricultural commodity prices began to head upward in what can be described as a boom/moderation price cycle. Nearby futures prices are used to compare prices over time. Measured this way, prices for wheat, corn and lean hogs in the fall of this year fell to 10-year lows, dating back to 2006 or earlier. Unfortunately, costs of production are not at 10-year lows and this means narrow margins or losses are likely for many producing these commodities.

Focusing on lean hog futures prices, the low this fall was on the October 2016 contract at $40.70. The previous time lean hog futures had been this low was in October of 2002. This means lean hog futures in the fall of 2016 were the lowest lead contract price in 14 years. Lean hog futures have recovered somewhat since October, with the lead contract currently trading around $50, a level that is at the lower end of the ten-year range.

Cash prices also reflect these multi-year lows. Live prices of hogs for 51 percent to 52 percent carcasses are expected to average about $36.25 in the final quarter of this year. This will be the lowest fourth quarter price since 2002, the lowest cash prices in 14 years, the same as lean hog futures. The current quarter is shaping up to have the worst losses since the first quarter of 2008 when cash corn prices moved above $4 per bushel after many years around $2.

A three percent increase in this quarter's pork production is one of the forces keeping prices low, but shortages of packer capacity seems to be another factor that is an additional downward force on low farm prices. Over time, the pork industry growth has reached a point where more packer capacity is needed. In addition, the largest hog supplies of the year tend to be in the final quarter, which puts added seasonal pressure on capacity. It is generally thought that 2.5 million head per week is near federal inspection capacity. In four of the past seven weeks, the number of head processed at federal inspected plants has been above 2.5 million head.

When there is a shortage of capacity in any industry there tends to be high returns to those who own that capacity. That seems to be the case this fall as the farm-to-wholesale margin is at record high levels. Looking at the most recent USDA data, the farm-to-wholesale margin for January through October has averaged $0.68 per retail pound this year compared to $0.56 per retail pound for the same period in 2015. If all of this higher margin were bid into the farm level price it would increase live hog prices by $5 to $7 per live hundredweight.

After prices average about $36 for the final quarter of 2016, prices are expected to improve to about $40 for the first quarter of 2017 with head counts that are a little smaller. Then, seasonally smaller supplies in the second and third quarters could support live hog prices around $50.

Two new processing plants are expected to come on-line by the fall of 2017 and these should relieve the capacity shortage and allow hog prices to be higher a year from now, even though hog supplies will be higher. Current forecasts are for live hog prices to average about $43 in the fourth quarter of 2017. Live hog prices averaged around $50 in 2015, but will drop to about $46 for 2016 and are forecast to average near $46 again in 2017.

With current costs estimated at $49, this means losses for this quarter of about $34 per head and for the first quarter of 2017 of around $27 per head. The second and third quarters should be about breakeven, with loses of $19 in the final quarter of 2017.

The forecast of annual losses of about $11 per head in 2016 are expected to continue for 2017. More packer capacity will help hog prices in 2017. In addition, retail pork prices are expected to continue to drop and provide stronger domestic usage and pork exports are expected to grow in 2017 as well. Nevertheless, these positive factors will not be enough to bring the industry back to the breakeven level. The industry will need to consider a reduction in the breeding herd in the last half of 2017 in order to boost prices back closer to breakevens in 2018.