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Weekly Outlook: Hog Prices Increase, But So Do Feed Costs

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The pork market has been favored by strong demand and that remains supportive for hog prices this year. Prospects remain positive for higher producer prices again in 2018 even in the face of a three to four percent increase in supply. However, a new threat to profit margins is being driven by dry weather in Argentina pushing up feed costs.

On the demand front, all signals continue to be positive. So far in 2018, pork supplies have been up by 2.5 percent, yet hog prices have also been higher by nearly four percent. There are several signs of positive demand growth. First, January retail pork prices were 18 cents per retail pound higher this year compared to January of 2017. This indicates that consumers are willing to pay more for pork even though there is more pork available. Second, packer margins have narrowed since last August as new capacity came on-line and continues to increase production. More competition among packers for hogs is helping strengthen bids for hogs and increasing the farmers share. Finally, exports remain strong finishing 2017 with 22 percent of our production being exported. USDA is expecting exports to be four percent higher again this year.

The market has caught on to strong demand with live prices so far this year averaging about $1.80 per hundredweight higher than the same period last year. In addition, the lean hog futures market has been strong as well.

Using those futures prices and historic basis, expected live hog prices for 2018 would average about $53.50 compared to $50.48 last year. The prospect of having hog prices this year be $3 per live hundredweight higher is a reflection that the futures market recognizes the strong demand outlook for this year. Time will tell if the current optimism can turn into reality.

Those expected prices are about $51 per live hundredweight for the first quarter, around $57 for the second and third quarters and then near $48 for the final quarter.

Higher hog prices are a joyful sound to hog producers, but there are two catches. The first uncertainty is whether hog prices can actually be as strong as current markets expect and the second uncertainty is feed cost.

The pork industry, like all animal agriculture, have become believers that feed supplies are abundant and that corn and soybean meal will remain cheap. Why? For the four crop years from 2014 to 2017, farm level corn prices received have averaged $3.49 per bushel and in the past three calendar years from 2015 to 2017, high-pro soybean meal at Decatur, Illinois has averaged $328 per ton.

Since the beginning of this year, hog price prospects have increased, but so have anticipated feed costs. For hog producers the increase in soybean meal prices has had a bigger impact on feed costs than has corn price increases.

March 2018 soybean meal futures have increased from about $320 per ton at the start of the year to $380 currently. My estimates are that a $60 per ton increase in meal price increases the costs per live hundredweight by $1.85 per hundredweight. March 2018 corn futures have risen by about 16 cents per bushel raising costs by $.70 per hundredweight.

Combining the estimated $1.85 costs per hundredweight increase from higher meal prices and the $.70 from corn means about $2.50 higher potential costs.

So far this year, hog price prospects are higher, but so are anticipated costs. The net effect is to reduce profit prospects modestly. Profits above all costs in 2017 were estimated at about $5 per head. In January of this year, our outlook suggested profit prospects for 2018 were for profits of $5 to $10 per head. With these recent developments, that outlook is lowered modestly to expected profits from $0 to $10 per head. Since the start of the year, costs prospects have risen somewhat more than hog price prospects.

Pork demand should remain positive through the year with strong U.S. and world economic growth. Longer-term however, higher wage rates, higher inflation, and higher interest rates may begin to constrain economic growth. Global demand for feed ingredients continues to grow, but favorable weather has resulted in near record global yields for the last four years. A shift to less favorable global weather has obvious consequences for animal industries.

As a reminder, the pork industry should strive to keep breeding herd expansion to around one percent per year. Keeping breeding herd growth to about one percent per year will increase production by about 2.5 percent per year which seems to be a sustainable growth rate.