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Pork profits fuel expansion

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Abstract

Livestock Outlook: Relatively low feed costs are giving hog producers a chance to maintain a profit, but they also encourage more production.

Disciplines

Agricultural and Resource Economics | Growth and Development

Comments

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RECORD HIGH SUPPLY: Pork profits linked to five years of lower feed costs are luring pork producers to expand production. The 67.5 million head U.S. market hog inventory on Sept. 1 was a record high, up 3% from last year.

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Livestock Outlook: Relatively low feed costs are giving hog producers a chance to maintain a profit, but they also encourage more production.

Lee Schulz | Oct 18, 2017

Much has been written about the new pork packing plants in Iowa and Michigan that are now slaughtering hogs and will soon be fully operational. Smaller ones opened in Missouri and Minnesota over the past 12 months. Another plant will open in Iowa next fall, if construction stays on schedule, and will be ramped up by early 2019. Some plants have expanded capacities slightly during the past year. Others could, if conditions warrant.

These additions first, and foremost, address the pent-up demand for more packing capacity. Market hog inventories have grown almost 25% in the past 15 years, with no notable additions to hog slaughter capacity until now. In recent years, fourth-quarter hog slaughter has run near, at or above theoretical capacity. Prices at times collapsed dramatically. Last fall's slaughter versus capacity situation was much worse than is expected this year.

Added capacity also creates room to grow. But profitability, not new packing capacity, drives hog expansion. The two are likely correlated. But correlation does not necessarily imply causation.

Hog producers expand production

Iowa State University's farrow-to-finish estimated returns data — a barometer of profitability — confirms what you probably already know. Pork producers have had a good run of profits. Since May 2013, 42 of the past 53 months have shown profits, averaging $20.87 per head. Profit prospects also matter. First-quarter 2018 returns are forecasted at $4 per head, second quarter at $19, third quarter at $18 and fourth quarter at a loss of $8 per head. The 2018 annual forecasted profit is $8 per head.

Will the pork industry kill the golden goose by expansion? Probably, at some point. Rational producers will up output to the point that the cost of adding one more unit of output is higher than the price that will be received for that unit. Current and upcoming profit levels will likely entice producers to "bid away" margins through expansion. But the modest growth so far suggests no impending price wreck.

Record inventories bring record supply

In surveys for the September Hogs and Pigs report, producers reported to USDA larger inventories than one year ago. The all hogs and pigs and market hog inventories were record large for the quarter, continuing the trend of the last two quarters. The breeding herd is the largest since 2008.

But the rise in numbers and magnitude caused little market reaction as the trade anticipated the growth. The average of analysts' pre-report estimates went three for three on precisely pegging these headline numbers. Has that ever occurred before?

The reasons for growth are not terribly complicated. Costs, relative to prices, drive supply. Fortunately, the very large 2016 U.S. corn and soybean harvests resulted in lower feed prices for the hog industry. Many expect feed prices to remain relatively low for the next couple of years, pending a major weather impact on yields.

The Sept. 1 market inventory of hogs over 120 pounds was up 3.9% from a year ago, implying that between September and roughly mid-November, weekly slaughter could set new records, topping 2.6 million head at times. Fall slaughter may encroach upon, but likely not breach, the increased packing capacity.

Need to hold the line on weights

Both slaughter numbers and weights drive total pork supply. The most commonly quoted weight series is USDA's Market News Service Weekly Estimated Average Weight of Barrows & Gilts report (NW_LS720). It reports the estimated average weight of barrows and gilts in Iowa, southern Minnesota and South Dakota direct hog reporting area. The week ending Sept. 30 tallied 855,000 pigs with an average live weight of 281 pounds. This is about the same weight on the same week in 2015 and 2016, but 3.4 pounds below the average weight in 2014.

With lower feed prices, and mostly profitable prices, weights have largely steadied, which at first glance, is a bit surprising. Industry chatter suggests some of this is likely due to producers feeding less ractopamine. Producers have also aggressively kept current on sales in light of profitable prices.

A wall of hogs is coming this fall. Keeping slaughter weights down will help in the event that the new packing plants face delays in becoming fully operational.

Time is also a big factor in the supply equation. The industry is growing, but at a measured pace. Some natural "governors" appear to be in place. The old hog cycle used to have very large expansions and then shrink dramatically. This measured growth has worked well for producers to help mitigate large price fluctuations. It also works well for packers to plan and invest in added packing capacity.

Sows still holding good value

The breeding herd is still growing. On Sept. 1, it was up 1.2% from last year, and up slightly from the previous quarter. Sow slaughter is 2.5% higher this year compared to last. Some of this is a reflection of more sows available as the inventory is higher. But a review of the cull sow market also suggests strong demand for cull sows.

USDA's Weekly National Swine report (LM_HG214) shows the 2017 Iowa-Minnesota average for 450 to 499 pound cull sows is $46.57 per cwt. Over the same period in 2016, the price was $42.38 per cwt. Summer 2017 cull sow prices reached as high as $74.62 per cwt. At this price, a 490-pound cull sow earns over $365, which goes a long way toward paying the genetic and production costs associated with replacement gilts and likely limits net breeding herd additions.

One generally consistent fundamental of growth in the hog industry has been productivity; namely, pigs saved per litter. It has averaged 1.4% annual growth over the last 10 years. However, the annual growth has been lower (irrespective of 2013 and PEDV) in recent years than the late 2000s and early 2010s.

The average number of pigs saved per litter was record-high at 10.65 for June-August 2017. However, this was only 0.7% above the same period a year earlier. While the March-May period saw similar litter size growth, the reasoning for this recent divergence from trend isn't clear. Pig crops and subsequent hog marketings could be much larger had pigs per litter been commensurate with productivity gains of years past.

Expect some added gyrations in market

Over time, new production facilities have been constructed or remodeled as the expansion of the U.S. herd continued. But this all takes time and dollars. And for an industry that has experienced periods of dramatic volatility. Producers have, at times, adopted a mind-set that 'cash is king'. And, while profitability drives expansion, ability to execute is another thing. Construction resources and other factors such as labor, feedstuffs and milling, and transportation can inhibit rapid expansion to occur. It can't happen overnight.

At the same time, the number of weaned pigs shipped to the U.S. is slowing. Year to date, Canadian feeder pig imports are up only 0.9%. This compares to year-over-year increases of 10.2% in 2015 and 7.4% in 2016. From July through mid-September, feeder pig imports have been down 6.8% compared to the same period in 2016. Fluctuations in imports help balance inventories in times of deficits and larger supplies.

The pork industry continues to expand and this will keep prices in check in 2018. Expect some added gyrations in the market with all that's going on.

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