

Losses Mount and Inventories Grow for Pork Producers

The USDA released the December Hogs and Pigs report on the 27th and estimated the inventory of all hogs to be 65.1 million head, up 4.2 percent from a year earlier. The market hog inventory was up 4.5 percent while the breeding herd increased 1.1 percent indicating that herd expansion is still underway. The USDA reported numbers were higher than the pre-report market hogs estimates of +3.5 percent and equal to the pre-report breeding herd estimate. The report will likely be seen as neutral to bearish by the trade.

The Iowa State University Estimated Returns to Farrow-to-Finish operations reported losses of nearly \$29/head on November sales. Losses on hogs sold in December are expected to nearly as large. Given corn and soybean meal prices predicted for 2008, cost of production for farrow-to-finish operations is projected to be near \$70/cwt carcass weight or in the mid-\$50/cwt live weight. Hog prices are forecast to be below breakeven throughout the year with the exception of possible profits on the summer highs. Thus, 2008 is shaping up to be a negative return year for pork producers.

Table 1 summarizes the December report for the US and Iowa. The US inventory increased in all categories. The heavy weight category is up 6 percent, but is less than the nearly 10 percent increase that has occurred in December slaughter. Slaughter levels are expected to stay approximately 5% higher than the year before through the first half of 2008 as additional Canadian slaughter hogs are added to the US expansion. If the USDA has under estimated the inventory, slaughter will continue to exceed the reported inventory.

Table 1. Summary of USDA December Hogs and Pigs Report for US and Iowa.

	US Mil. Hd	% Chg 1 year	Iowa Mil. Hd	% Chg 1 year
All Hogs	65.11	4.2	18.30	5.8
Breeding Herd	6.16	1.1	1.10	1.9
Market Hogs	58.95	4.5	17.10	5.4
Under 60	21.36	4.4	5.30	7.9
60 - 119	14.46	3.8	4.70	5.1
120 - 179	11.74	4.1	3.70	4.5
180 & over	11.39	6.1	3.40	3.0
Pig Crop				
Jun - Aug	27.65	4.2	4.16	1.1
Sep - Nov	28.00	4.2	4.58	5.4
Sows farrowing				
Dec - Feb	2.98	2.4	0.47	3.3
Mar - May	3.04	0.1	0.49	2.1

The glimmer of light at the end of the tunnel is that March-May farrowing intentions are unchanged from the year before. This is a fourth quarter slaughter indicator and suggests that supplies in Oct-Dec 2008 will be similar to the records set in

2007. Increased pigs per litter will add to the supply. Canada has been reducing its breeding herd and may result in fewer feeder pigs and slaughter hogs from the north by next fall. However, historically producers have suffered a year of losses before reducing the breeding herd. If March-May farrowings are unchanged from the year before it would be one of the quickest turn around from expansion to contraction in recent history.

Iowa's inventory is also increasing. The 18.3 million hogs in nearly 6% larger than the December 2006 inventory and the breeding herd and market hog inventories both increased. The fall pig crop and inventory under 60 pounds show large increases. Iowa accounted for 29 percent of the US market hog inventory.

The USDA did make revisions to its September report. In that report it estimated fourth quarter slaughter to increase approximately 3 percent from the year before. Through the first 12 weeks of the quarter, hog slaughter was 8.3 percent higher than the same period the year before. Eleven of the 12 weeks had slaughter of 2.3 million head or larger (Thanksgiving week had over 2.0 million), each larger than the largest week in 1998 (2.265 million). The week before Christmas slaughter was estimated to be 2.449 million head. This increased 4th quarter hog slaughter came from several categories: barrow and gilt slaughter was up 8.1 percent and sow slaughter increased 4.8 percent. Included in these totals are nearly a 33 percent (188,000 head) increase in market hogs and 8.2 percent (7200 head) more sows from Canada for slaughter compared to the fourth quarter in 2006.

Approximately 2.7 million market hogs for slaughter and 6.25 million feeder and weaned pigs for finishing were shipped from Canada to the US in 2007. These figures are up 11 and 24 percent, respectively from 2006. However, unlike the US breeding herd that is expanding, the Canadian breeding herd is contracting, down 1.8 percent in October compared to the year before. This Canadian contraction is expected to continue given the record high prices for feed-grade wheat and barley in addition to increases in corn prices that the US has experienced. The weakness of the US dollar relative to the Canadian dollar is also making Canadian exports of pigs, hogs or pork, more expensive in the US than it has been in recent years. However, given the relatively cheaper cost of gain and relatively high market hog price, pigs are expected to continue moving to the US for finishing.

The bulk of the increased fourth quarter slaughter came from more US hogs than expected thanks in part to the vaccine for circovirus that increased the number of hogs reaching slaughter weight compared to the year before. Three questions remain regarding the circovirus affect: 1) Have USDA revisions fully captured the impact on slaughter? 2) Did producers over-breed to compensate for the high deathloss and if so have they returned to normal throughput? And 3) will the vaccine continue to work successfully and be widely used? The forecast here assume #1 and 3# are true and #2 is false. Carcass weights are another source of supply, and have averaged 1.67 pounds, about 1 % heavier than a year ago. However, carcass weights are forecast to be steady or lower in 2008 due to higher feed costs and lower hog prices.

Demand Factors...

Pork exports are on track to set another record in 2007 and now account for over 15 percent of US production on a tonnage basis. The lower wholesale pork prices and weaker US dollar has increased the pace of exports in the fourth quarter. Domestic

demand is difficult to measure, but appears to be relatively strong. Fourth quarter pork production increased 9 percent over 2006 levels but wholesale pork prices decreased only a little more than 10 percent. A smaller price adjustment than might typically be expected. At the same time pork in cold storage in November increased only 1.6 percent suggesting that the product is either being exported or eaten at current prices. The prices forecast here assume that pork exports increase 10 percent in 2008 over 2007.

The primary drivers of short run domestic demand are prices of competing meats and consumer income. Economic indicators suggest that the US economy has slowed from a year ago and is expected to have a negative impact on consumer spending. Supplies of beef and poultry are higher than a year earlier and should pressure pork at the retail counter. Fourth quarter beef and poultry production is up 3.5 percent and 5.4 percent, respectively. While retail prices are not readily available, wholesale prices for beef and chicken for the fourth quarter are actually higher than the year before, up 1.1 percent of beef and 7.9 percent for broilers, in spite of larger supplies. This price strength in competing meats has helped pork prices.

Looking ahead, beef supplies are expected to decline seasonally through the winter but be at or below 2007 levels through much of the first half of 2008. Egg sets and chicks placed in the fourth quarter are up 3.5 and 4 percent, respectively from a year ago indicating that poultry supplies will continue to increase faster than population growth.

Forecast...

Pork production in 2008 is forecast to increase over 2007 record levels. The continued expansion of the US breeding herd is expected to take several months to slow and switch to a contraction and then approximately two more quarters before slaughter and supply will decrease. Table 2 provides a quarterly forecast of production and price based on the December Hogs and Pigs report. It also lists the basis adjusted futures price forecast using the closing prices immediately prior to the release of the report.

	% Change Production	ISU Forecast Carcass	Basis Adjusted Futures 12/27
Q1	+5%	55-58	59.76
Q2	+5%	65-68	67.70
Q3	+4%	64-67	70.87
Q4	+2%	55-58	66.66
2008	+4%	60-63	66.33

Given the expected cost of production for Iowa farrow-to-finish operations, 2008 will be a year of negative returns for most producers. Table 3 estimates of cost of production per one hundred pounds of carcass weight based on the ISU Estimated Returns Series:

http://www.econ.iastate.edu/faculty/lawrence/Lawrence_website/livestockreturns.htm

The current conditions have approximately \$73/head costs in addition to corn and SBM which are variables in the table. Live weight is assumed to be 270 pounds with a 75% carcass yield. With corn in the \$4/bushel range and soybean meal near \$300/ton,

breakeven total cost of production is estimated to be \$70/cwt carcass or approximately \$54/cwt live weight.

Table 3. Estimated Total Cost of Production per Cwt Carcass

SBM/Corn	3.00	3.25	3.50	3.75	4.00	4.25	4.50	4.75
250	62.64	64.12	65.59	67.06	68.53	70.01	71.48	72.95
275	63.53	65.00	66.47	67.95	69.42	70.89	72.36	73.84
300	64.41	65.89	67.36	68.83	70.30	71.78	73.25	74.72
325	65.30	66.77	68.24	69.72	71.19	72.66	74.13	75.61
350	66.18	67.65	69.13	70.60	72.07	73.55	75.02	76.49
375	67.07	68.54	70.01	71.48	72.96	74.43	75.90	77.38
400	67.95	69.42	70.90	72.37	73.84	75.31	76.79	78.26
425	68.84	70.31	71.78	73.25	74.73	76.20	77.67	79.15
450	69.72	71.19	72.67	74.14	75.61	77.08	78.56	80.03
475	70.60	72.08	73.55	75.02	76.50	77.97	79.44	80.91
500	71.49	72.96	74.43	75.91	77.38	78.85	80.33	81.80