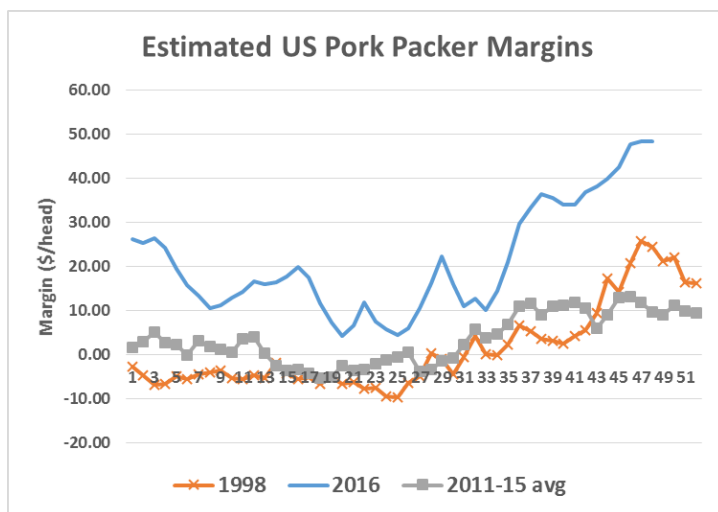


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The Discussion of Pork Packer Margins Continues

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Back in September, packer margins were by far the main story in the hog and pork markets. Three months later, nothing has changed in that respect; packer margins have climbed even further, while hog prices have dropped in tandem, almost one for one. Yet even as estimated slaughter returns reach an all-time high near \$50 per head (\$US), change is in the air. Margins the past two weeks have plateaued, as have carcass weights. The seasonal tendency is for packer returns to level off or decline in December on a softer pork cutout and gradually waning hog supplies. Certainly that was the case in 1998, the last time actual slaughter exceeded estimated weekly kill capacity.



This turn of events would run counter to a common narrative that December will turn into a complete disaster for hog markets, with a further price meltdown. The negative case is supported by yet another record high for slaughter and US pork production last week, with a whopping 2.54 million head kill. Not that \$40 US cash or \$1.00/kg Index 100 prices aren't enough of a disaster already for producers. Of course it all depends on whether or not hog supplies have been pulled ahead this fall, as producers anticipated the supply crunch. In my scenario, as the pork cutout eases in December, packers will absorb those declines into their hefty margin cushion. And, as hog supplies tighten more noticeably in early 2017 on absolute terms, packer margins will erode further. Indeed, the lean hog futures are anticipating something to this effect, although I would not be surprised to see even more upside potential than the traders are dialling in at this point.

How far will packer returns drop? No one knows, but it seems reasonable to see them return close to year-ago levels, which would still be exceptional returns historically. That kind of a move could easily put \$20/cwt or more onto US cash hog prices or about \$50/ckg on Canadian returns, returning the industry to breakeven levels. And that could happen even with little or no improvement in the pork cutout.

December 2, 2016

Perhaps this is an overly optimistic outlook. But there is good reason to expect at least a modest rebound in cash hog prices in early 2017.