Hog Outlook and Situation 1999-00:
The Candle at the End of the Tunnel
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Hog producers have suffered through the lowest prices in 50 years and the greatest losses in history. By some measures, losses since November 1997 wiped the profit slate clean back to the beginning of 1991 making producers 8 years older, but no richer. The government approved $175 million in direct payments to producers for losses experienced during late 1998 and is still searching for silver bullets to bolster prices. Industry leaders are proposing solutions from sow buy-outs to more packing plants as they too search for fixes to current problems. Meanwhile, industry consolidation continues, as does the trend to greater producer – packer coordination via marketing contracts. Approximately two-thirds of the hogs are procured on some type of long-term agreement as the spot market that underlies these contracts gets thinner and thinner. In spite of these ongoing gloomy trends, net herd liquidation remains modest. The light at the end of the tunnel is in sight, but appears to be a dimly lit candle.

The June USDA Hogs and Pigs Report estimated all hogs and pigs on farms in the U.S. at 60.5 million head. This estimate is 2.7 percent below the June 1, 1998 number and 5.5 percent above 1997. The breeding herd is 6.4 percent below that of 1998 and the market hog inventory is 2.2 percent lower. These reported numbers are 1 to 2 percent above the pre-report expectations.

Hogs weighing over 180 pounds are 2.1 percent above 1998, and 120 – 179 pound hogs are near year earlier levels at 99.4 percent. Slaughter in June was 2 percent higher than in June 1998 and July slaughter was even with the year before suggesting that the report is tracking pretty well. The inventories of lighter pigs are down, reflecting the decrease in the breeding herd that has been occurring since December 1998. Hogs weighing 60 – 119 pounds are down 2.8% and those under 60 pounds were down 4.6%.

The March – May pig crop was estimated at 26.3 million pigs, down 2.5 percent from 1998. Sows farrowing during the March – May period were down 3.1 percent, while the pigs per litter increased from 8.75 in 1998 to 8.80 in 1999. Farrowing intentions for the June – August period were estimated to be down 3.9 percent and the September – November intentions are estimated to be down 4.1 percent from 1998. The March – May farrowings and the farrowing intentions were also larger than the pre-report expectations.

Table 1 shows the inventory levels, pig crop, and farrowing intentions for the U.S. and 10 Corn Belt states. Breeding herd liquidation is generally greater in the traditional hog producing regions of the Corn Belt. This trend is likely to continue because of the recent investment outside of the region. Older facilities will be retired, but newer facilities will continue to operate, albeit maybe under new ownership. Market hog inventories in the Corn Belt have not declined as much as the breeding herd, confirming the obvious. Finishing will move to cheaper grain. Feed is a relatively small part of sow costs.

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In general, the rate of liquidation was not as great as expected. Coupled with the heavy
slaughter weights, large cold storage and depressed exports, prices have been less than expected
based on historic relationships and reported inventories. While an anticipated increase in this
fall’s Canadian slaughter capacity is expected to reduce the threat of a packer capacity constraint
such as we experienced last fall, there could still be several weeks in late 1999 of burdensome
supplies.

Table 1. June USDA Hogs and Pigs Summary

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<th>U.S.</th>
<th>Corn Belt</th>
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<tbody>
<tr>
<td></td>
<td>1,000</td>
<td>% Change</td>
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<tr>
<td>All Hogs and Pigs</td>
<td>60,536</td>
<td>-2.7</td>
</tr>
<tr>
<td>Breeding Herd</td>
<td>6,515</td>
<td>-6.4</td>
</tr>
<tr>
<td>Market Hogs</td>
<td>54,020</td>
<td>-2.2</td>
</tr>
<tr>
<td>Pig Crop</td>
<td></td>
<td></td>
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<tr>
<td>Dec - Feb</td>
<td>25,293</td>
<td>-0.7</td>
</tr>
<tr>
<td>Mar – May</td>
<td>26,301</td>
<td>-2.5</td>
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<tr>
<td>Farrowing Intentions</td>
<td></td>
<td></td>
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<tr>
<td>June – Aug</td>
<td>2,936</td>
<td>-3.9</td>
</tr>
<tr>
<td>Sep – Nov</td>
<td>2,870</td>
<td>-4.1</td>
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Corn Belt includes OH, IN, IL, IA, MO, NE, SD, MN, WS, MI

**Slaughter Weights:** Slaughter weights continue to run above year earlier levels. Weights
through midyear were running 5 or more pounds over the year before. The hot weather in late
July had narrowed the spread to 3 pounds by early August. The additional pounds put more pork
on the market for the same number of hogs. Through the end of July, slaughter was up 1.6
percent compared with a 3.1 percent increase in pork production. Seasonally, weights declined
from June through August.

**Cold Storage Stocks:** Pork in cold storage set new records. The June 30 inventory was down
from the peak in April but still a record for June. Seasonally, supplies should begin to decline
until September. The June inventory of 536 million pounds represents about 1.6 weeks of pork
production compared with a 5-year average of 1.2 weeks of production, a 33 percent increase.

**Canadian Live Hog Imports:** Imports of live hogs from Canada were 4 percent of the annual
slaughter for 1998. The number of imports has leveled off in recent months while the
percentages that are feeder pigs continue to increase. In 1998, 35% of the imports were less than
110 pounds, compared with nearly 50% for the first few months of 1999. The number of
slaughter hogs imported into the U.S. should continue to decrease after a new Canadian slaughter
plant comes on line later in the summer. Estimated imports through May are down slightly from
1998 numbers.

**Retail Prices:** Retail prices and the farm-to-retail spread continue to be a mystery. Throughout the
pork glut of 1998, reported retail prices remained very stable. Farm-to-retail margins skyrocketed.
Examples of Christmas hams selling for more than the entire hog were not uncommon. In spite of
the stable prices, per capita consumption increased nearly 4 pounds from 1996 to 1998. Why? Economists tend to think that demand reflects long-term preferences of consumers and is not something that bounces dramatically up and down. Did demand increase in 1998, or are reported retail prices inaccurately reflecting actual prices paid by consumers?

**Exports:** Exports have trailed year earlier levels since midyear 1998. The strong start for exports in 1998 was due largely to Russian trade that has declined sharply. Exports to Japan, which is suffering from the Asian flu and accused of depressing ag prices, are actually 7 percent higher than the year before. Exports to Russia have fallen 111,000 cwt from the same period last year. Export customers see little need to buy ahead and stimulate prices, considering the current outlook.

**Production and Price Outlook…**

Third quarter 1999 pork production is forecast to meet or exceed year earlier levels. Slaughter levels should decline to levels slightly below those of a year ago by late summer, but weight may make up the difference. Live prices dropped dramatically following the report, but have rebounded somewhat. However, given the lingering supplies and lower than expected prices, we expect prices for the quarter to average in the $32-35 range.

Fourth quarter production is expected to average 3 percent below that of fourth quarter 1998. The March-May pig crop was 3 percent lower and weights should continue heavy, but gilt slaughter and Canadian hog imports should both be lower than last year. Live prices are forecast to average near $30 compared with $20.50 in 1998. Given this report, there may be several weeks of slaughter near 2 million head a week or higher and prices in the $20s. Prices below $20 cannot be ruled out.

After the first of the year, supplies will be driven by the summer and fall pig crops. Farrowing intentions for both quarters were down 4 percent from a year ago. Depending on farrowing rates and weights, supplies could be only 1-3 percent lower. Live prices for the first quarter are forecast to average $32-35 and second quarter should average $35-38. If the market decline following the report triggered additional liquidation, the summer and fall farrowings may be lower than intended resulting in higher prices in 2000.

**Wild Cards…**

Unknowns to watch that can impact prices include:
- When and to what extent the new Canadian slaughter plant is operational this fall to stem the tide of hogs moving south.
- Slaughter weights are running 2.5 percent higher than the year before and have a big impact on supplies. Grain prices will likely impact weights.
- Changes in exports and frozen stocks.
- Changes in producer decisions following weak summer prices and a discouraging report.

**Industry Issues**

Consolidation is continuing. The Iowa State–Missouri study suggests that we are approaching a situation in which half of the hogs are owned by 140 or so firms marketing 50,000 hogs a year or more. Their share was 7 percent in 1988. Approximately two-thirds of the hogs are under a long-term agreement and the remaining 35-36 percent of the hogs perform the price discovery function for all the hogs in the U.S. and Canada. About 44 percent of the hogs are
priced on a formula tied directly to the spot market price. Another 7-8 percent of the hogs are bought on a ledger contract where the producer borrows at a higher price until higher prices occur. Approximately 12-15 percent of the hogs are owned by packers.

**Hog Cycle:** Next to death and taxes, hog farmers and econometricians could count on a hog cycle. It is too early to declare the hog cycle dead, but we may want to start writing the obituary. Thus far, this liquidation started on schedule, has had greater sow liquidation than past cycles, and has followed earlier cycles on hog slaughter. We should soon know for sure if this one has changed, but for now, it is too early to call. Given the amount of production infrastructure in place and the recent experience of packers when capacity is tight, it is doubtful that prices will return to what the producers would call the “good old days.”

**Summary:** Prices are expected to remain below the cost of production until summer 2000, although they will cover variable cost for most producers. Cash infusions to smaller producers will provide small Band-Aids to large gaping equity wounds. This cash will likely include direct payments to hog enterprises and LDP to the grain enterprises, but the bottom line is that this will help the farmer hobble along. Some who have seen their equity disappear have or will try to cut their losses by selling out. Those who saw their equity shift to a packer-controlled ledger will continue to produce. Recent investments in appropriately sized, technologically sound facilities will enable some operations to continue, but possibly under different ownership. Early adopters of technology who were strongly financed, aggressively forward priced, or both will reach the candle at the end of the tunnel, but in the dim light, they may not recognize the good times when they see them.

**Iowa State University Swine Marketing Resources:**
John Lawrence homepage (Outlook, Basis estimate, Special reports)
http://www.econ.iastate.edu/faculty/lawrence/
Iowa Farm Outlook
http://www.econ.iastate.edu/faculty/lawrence/MARKETS.htm/
Estimate Livestock Returns
http://www.econ.iastate.edu/faculty/lawrence/EstRet/Index.html/
Pork Industry Materials
http://www.econ.iastate.edu/faculty/lawrence/HOGS.htm/