Hog Futures Offer Great Pricing Opportunities?

Lean hog futures are dangling a huge carrot in front of hog producers. That carrot is the opportunity to forward price 2005 production at levels that would result in a repeat of last year’s great returns. While no one knows how market events will unfold, there are several bearish clouds that producers need to consider.

What was the source of last year’s nearly $53 average live weight price, and will those factors continue for 2004. Pork production in 2004 was up nearly three percent to a record 20.5 billion pounds. Generally, record high production would result in low prices, but demand was the stimulant to high prices.

On the demand front, pork exports last year were up 25 percent led by increases of 15 percent to Japan, 18 percent to Canada, and over 50 percent to Mexico. The those huge expansion was dominated by the nearly 80 percent drop in U.S. beef exports. The world bought more pork from the U.S. last year since much of the world was not buying U.S. beef.

The pork trade picture will likely change in 2005. The probable opening of the Canadian border to live cattle imports in March will increase domestic beef supplies and lower cattle and beef prices. More competitive meat supplies will not be positive for hog prices.

The potential opening of beef exports to Japan, South Korea, and other countries may still occur by mid-year. This is a high priority for the new Secretary of Agriculture, and progress appears hopeful. If beef exports are resumed, demand for pork exports will be dampened in the last-half of the year. On the trade front, then, hog prices may not have as much support as last year.

On the domestic side of demand, high-protein diets were often mentioned as a reason consumers were so anxious to get their hands on pork last year. This was likely a very positive factor for prices, but there are far fewer press articles promoting the advantages of these diets this year compared to the first-half of 2004.

The final domestic demand concern is the issue of marketing margins. Packer margins and retailer margins were narrow in 2004. In fact, those smaller margins accounted for about $5.25 per live hundredweight higher hog prices. Another way to say this is that the average 2004 hog
price of $52.59 (51% to 52% lean hogs) would have been $47.30 if marketing margins had been closer to the more normal levels of 2003.

Of course, pork supply could provide some source of worry as well. While USDA has reported that U.S. producers have not yet expanded the breeding herd, the March *Hogs and Pigs* report would be the earliest to show some signs of expansion based upon a one-year lag from very favorable hog prices in the late winter of 2004.

What is the size of the “forward pricing carrot?” Using lean hog futures prices on February 28, 2005 and historical basis levels, forward pricing opportunities appear to provide a net live cash hog price of about $54 for hogs to be delivered from March through September. For the March through December period the average is nearly $51.00 on a live weight basis. These are obviously extremely profitable prices and a sufficient reason to be forward pricing right now. But is early March the best time of year to be forward pricing? The historical seasonality of July and December live/lean hog futures says no! For both the last 10 years and the last 25 years, peak futures prices, on average, were reached in the first-half of May. In fact, on average from early March until peak prices were reached in early-May, July futures prices tended to rise about $2 to $3 per live hundredweight, and December futures about $1.50.

In summary, forwarding pricing opportunities are currently excellent. History suggests that some further seasonal strength may be expected going into early May. However, opening of live cattle and beef trade this spring and early summer may cause lean hog futures to increase less than normal. Each pork producer needs to weigh the current pricing opportunities against the threats, but the important message is that producers should be watching that “tempting carrot” closely and be prepared to take a few bites in the next couple of months.

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