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OUTLOOK FOR HOGS AND SHEEP

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In second-half 1986, hog producers returns have risen sharply due to the rally in hog prices and low feed costs. Net returns are near 1982 levels, when the last expansion phase of the hog cycle occurred. The outlook for 1987 is for relatively high net returns to continue because low feed costs are expected to continue and hog prices for the year are expected to be higher than in 1986. Given expected high net returns, the big question is not whether hog production will increase, but when and how sharp will those increases be. Increases in sustained profitability usually lead to an expansion of the breeding herd and a year-over-year increase in the number of sows farrowing with about a 6-8 month lag.

The September market hog inventory and farrowing intentions suggest that pork production may be below year-ago levels this fall and the first half of 1987. As a result of declining pork production, producers' returns are likely to remain relatively large due to higher hog prices and lower feed costs. But a previous long period of lackluster returns and continued financial pressure (especially for producers with large debt to equity ratios) will continue to hold gilt retentions lower than what might have been expected from historical relationships.

Implications for 1988

The policy change marked by the Food Security Act of 1985 and two large back-to-back corn crops have drastically lowered feed costs. At the same time, a continuing cutback in hog production has brought about a sharp rally in hog prices. As a result, producers' returns are among the highest on record and are expected to provide an incentive for expanding production. In past years, a comparable magnitude of positive returns would have triggered a double digit increase in pork production by late 1987. However, due to the prolonged earlier period of poor returns and financial problems, sharp increases in pork production are not likely to occur before late 1987 or early 1988. Even then, increases may be moderate, compared to historical standards.

The cattle inventory like the hog inventory has been declining in recent years. However, the sharp drop in grain prices should provide the incentive for continued large fed cattle marketings. But lower nonfed slaughter will reduce total beef supplies. Poultry production is already responding to increased producer returns. Although beef production will continue to decline in 1988, poultry and pork production may more than make up this difference and push total per capita meat consumption toward 1985's record levels. This would imply, though, a sharp break in hog prices in 1988 if supply increases too quickly. However, if feed costs remain low, many large, efficient producers may still be able to cover cash production costs even if market prices decline considerably.

Inventory Down 5 Percent

The September 1 inventory of all hogs and pigs in the 10 quarterly reporting States totaled 39.6 million head, 5 percent below last year and the lowest September 1 inventory since 1975. The breeding inventory at 4.84 million head, was 10 percent below last year and the lowest September breeding inventory since 1973, when estimates for these comparable 10 States first became available.

The market hog inventory totaled 34.7 million head, 5 percent below last year and the lowest since 1975. The June-August pig crop was 15.9 million head, 6 percent below a year ago and the smallest June-August pig crop since 1975. Sows farrowing during June-August totaled 2.03 million head, 7 percent below last year. In March, producers indicated intentions to farrow about the same number of sows in June-August as a year ago, but in the June survey producers indicated intentions to farrow 8 percent fewer than a year ago. The breeding season for sows farrowing during June-August was February-April. From the first week in February to the first week of April, hog prices declined about $5 per cwt probably discouraging producers from breeding more sows and gilts. During most of the breeding season, cash receipts were below cash expenses and replacement costs.

One factor holding up pork production in recent years has been an increasing number of pigs per litter. Pigs per litter averaged 7.79, compared with 7.73 in the comparable period last year. The 7.79 pigs per litter was a record high and continued gradually increasing trend. Pig per litter have shown a year-over-year increase for 9 consecutive quarters. Most of the increase is due to genetics and better management practices.

Farrowings To Remain Down Sharply

As of September 1, producers indicated intentions of having 2.06 million sows farrow during September-November, nine percent below the comparable period in 1985. If these intentions are realized, farrowings would be the lowest for this period since 1975. Moreover, farrowing intentions for December 1986-February 1987 are even lower, at 1.83 million head, 6 percent below a year ago. Recent higher producer returns raise the question of whether these intentions will be realized or whether actual farrowings will be higher? The most recent experience with high returns was in 1982. In September 1982, producers in the 10 quarterly reporting States indicated intentions to have 4 percent fewer sows farrow in December 1982-February 1983. However, the number of sows actually farrowing increased 6 percent from December 1981-February 1982. One factor that is different today is that financial problems for many of these producers have increased substantially since that period. This could hamper producers ability to expand despite their improved returns.

Commercial Pork Production in 1987 is Expected to Decline Slightly

Commercial pork production in 1987 is expected to total 13,775 million pounds, down 1 percent from projected 1986 production. In 1986, production was expected to total 13,968 million pounds, down 5 percent from 1985. Commercial slaughter in 1987 is expected to be about 78.7 million head, down 1 percent from the projected 80 million head for 1986. The projected 1986 slaughter would be down 6 percent from 1985.

Hog slaughter in both the first and second quarters of 1987 is projected at 5 to 7 percent below a year earlier. Relatively cheap feed may encourage producers to continue feeding barrows and gilts to weights larger than the historical average. Packers will not likely discount the heavier weight hogs because of the tighter supply of slaughter hogs and genetic improvement reducing excess fat. From the September Hogs and Pigs report there were two indicators of first-quarter slaughter, the market hogs weighing under 60 pounds and the June-August pig crop. The market hog inventory was down 8 percent and June-August pig crop was down 6 percent. Over the past several years, the pig crop has been a more reliable indicator of slaughter than the market hog inventory. The average dressed weight may be about the same as a year ago. Thus, commercial pork production may total about 3,350 million pounds in the first quarter, down 6 percent from last year.

Commercial pork production in the second quarter may also total about 3,350 million pounds, down 6 percent from last year. Based on producers' September 1 farrowing intentions and a continued rise in pigs per litter, the 10-States September-November pig crop is estimated to be down about 7 percent. However, the number of sows farrowing nationally is not expected to drop as sharply as in the 10-States. The June 1 10-States breeding inventory accounted for a smaller proportion of the national breeding inventory in 1986 than in 1985. Thus, a smaller year-over-year decline is expected in the U.S. pig crop than in the 10-States.

Based on September 1 intentions and a slight rise in pigs per litter, the December 1986-February 1987 pig crop is projected to be about 5 percent below the comparable period in 1985-86. Commercial slaughter in third-quarter 1987 is projected at about 19 million head. The average weight is expected to be about the same as this year's 174 pounds. Thus, commercial production is expected to total about 3,300 million pounds in third-quarter 1987, up 2 percent from 1986.

The very high producer net returns since mid-1986 and the outlook for relatively high net returns continuing through most of 1987 should encourage producers to begin expanding output over the next several quarters. The March-May 1987 pig crop is expected to increase about 5 percent from 1986. In turn, the fourth-quarter 1987 slaughter is projected to be 4 to 6 percent higher than expected in fourth-quarter 1986. With the average dressed weight expected to be about the same in 1987 as in 1986, commercial pork production would be about 3,775 million pounds, up 5 percent from the 1986 levels.

Hog Prices To Continue High

Barrow and gilt prices at the 7 major markets averaged $61 per cwt in the third quarter. This is the highest price since 1982 and well above the $44 of a year ago. The high prices were due to a sharp drop in pork production, low pork stocks, and only a slight increase in beef supplies. In addition, government purchases of red meats for export and domestic feeding programs required by the Food Security Act of 1985 contributed to higher prices. A modest increase in per capita income also helped.

Lower year-over-year pork and nonfed beef production will help strengthen hog prices in fourth quarter 1986 and first-half 1987. Nonfed beef competes with pork in the processed meat market. Low stocks of pork in cold storage will also help strengthen prices. On the other hand, large and increasing poultry production will continue to pressure hog prices and consumers' income is expected to continue lackluster growth. For these reasons, hog prices are expected to average in the low- to mid-$50's in the fourth quarter and the mid-to-high $50's per cwt in the first and second quarters of 1987.

In second-half 1987, hog prices are expected to fall below 1986 levels as pork production increases slightly on a year-over-year basis. Nonfed beef production is expected to continue to be below year-earlier levels. Poultry production increases will continue to pressure hog prices. Cold storage stocks of pork are expected to continue to be relatively low, supporting hog prices. Hog prices are expected to average in the mid- to high $50's in third-quarter 1987. In the fourth quarter, prices are expected to drop into the high-$40's to low-$50's as the projected 5 percent larger March-May pig crop goes to market.

Pork Imports To Increase Slightly in 1987

Pork imports totaled 807 million pounds, carcass weight, during January-September, down 7 percent from a year ago. Imports from Canada, the largest exporter to U.S. rose 51 million pounds, 16 percent over a year ago. Imports from Denmark, the second largest exporter to the U.S. declined 84 million pounds, down 25 percent from a year ago. The Canadian dollar has been slightly weaker against the U.S. dollar this year compared to last year. As the Canadian dollar weakens, U.S. pork prices are higher in Canadian dollars. Meanwhile, the Danish krone strengthened and the European Community reduced its export subsidies during the first half of 1986. However, the European Community recently reversed its policy and increased its export subsidies. For all of 1986, imports of pork products are expected to total about 1,080 million pounds, down 4 percent from 1985. Imports of pork products are expected to rise about 2 percent in 1987 as the U.S. market remains relatively favorable for the major exporters. Increased European Community subsidies are expected to raise Danish exports and Canada is expected to continue relatively high exports to the United States.

The number of live hogs imported from Canada during January-September totaled 418,137 head, down 61 percent from a year ago. Countervailing duties of Can$4.386 have slowed Canadian exports of live hogs to the United States for all of 1986. Live hogs imported from Canada may total about 500,000 head, less than one half of the number imported in 1985. In 1987, the number of hogs imported from Canada is expected to decline further.

U.S. pork exports totaled 58 million pounds during January-September, down 40 percent from a year ago. The decline is largely due to reduced shipments to Mexico. Continuing financial difficulties of Mexico are responsible for the greatly reduced marketings. Exports for the year may total 90 million pounds, down 30 percent from 1985. Exports in 1987 may increase from 1986 especially if the Japanese yen remains strong against the dollar.

Pork Prices Rise Sharply in Second-Half 1986, Will Continue High in 1987

Retail pork prices in third-quarter 1986 averaged $1.89 a pound, up 17 percent from a year ago and up 15 percent from the second quarter. Prices are expected to average nearly the same as in the fourth quarter. Lower hog slaughter and fewer hams in cold storage will contribute to higher retail prices. However, larger supplies of turkeys may temper these price increases. In addition, retail prices in September averaged $1.94 a pound, the highest monthly average since records were established. For all of 1986, retail prices may average about 9 to 11 percent in than in 1985. In 1987, retail prices are expected to average about 3 to 5 percent higher as red meat supplies decline further.

Farm-to-retail spreads averaged 99 cents a pound in September, up 3 cents from a year ago. For all of 1986, the spread may average about 94 cents a pound, up 3 cents from 1985. The farm-to-retail spread has ranged from a dollar to 77 cents per pound in 1986. The farm-to-retail price spread is expected to average 3 to 5 percent higher in 1987 than in 1986.

Frozen Pork Stocks Lowest since 1982

Frozen pork totaled 186 million pounds on September 30, 1986, down 33 percent from a year ago and the lowest for this date since 1982. The low pork stock are due to relatively high pork prices and anticipated increases in pork production, which would lower pork prices. For the same reasons, pork movements into stocks during 1987 are expected to be modest, compared to stock movements in recent years.

Sheep and Lambs

Although lamb prices have reached record levels in 1986, prices have been quite volatile. With relatively high lamb prices and low feed costs, sheep producers' net returns are higher. High returns usually cause producers to expand their flocks. During January-September, mature sheep slaughter as a percentage of total slaughter was 5.8 percent, compared with 6.9 percent a year ago. In recent years, when mature sheep slaughter fell below 7 percent the stock sheep inventory began to stabilize or possibly expand. Total commercial lamb and sheep slaughter in January-September fell 8 percent from a year ago. The January 1, 1986 inventory of all sheep and lambs was down 5 percent.

Based on the number of ewes 1 year and older on January 1 and a lambing rate near 1985's 102 lambs per 100 ewes, 1 year and older, the lamb crop would be about 6.9 million head. Total commercial slaughter is projected at about 5.7 million head. If live animal exports remain low and death rate is about the same as in 1985, the inventory of all sheep and lambs may decline 2 to 4 percent.

For all of 1986, production is expected to total 329 million pounds, down 7 percent from a year ago. Production in 1987 is projected at 320 million pounds, down 3 percent from 1986.

Lamb prices at San Angelo averaged $69 per cwt this summer, compared with $71 last summer and $77 this spring. Prices are normally the highest in the spring then decline in the summer and fall. In the fourth quarter, lamb prices are expected to average $60 to $63 per cwt. For all of 1986, prices may average $68-$69 per cwt, about the same as last year. In 1987, lamb prices are expected to average $66 to $72 per cwt, depending upon the level of lamb imports and heavy weight lamb discounting.