

Canadian Pork Market Review

Market Analysis for the Hog and Pork Industry

December 5, 2008

THE MARKETS AT A GLANCE			
	Last Yr	Nov 29	Dec 5*
National Base Lean**	53.07	52.45	54.60
Nearby Hog Futures	55.47	59.50	57.45
2nd Deferred Hog Futures	66.72	73.50	69.37
USDA Pork Cutout	58.89	57.50	60.41
Canadian Pork Cutout***	120	139	146
Sask (SPI)	96.20	118	123.50
Manitoba (Man Agric)	99.53	120.87	127
Ontario (100% formula)	96.06	116.75	124.53
Quebec	81.17	111.15	111.63
Nova Scotia	88.90	117.29	118.92
US Slaughter	2,376,000	2,057,000	2,373,000
Cdn Slaughter	433,000	453,000	NA
*Estimated. **51-52% Lean. ***Primal values/ckg at standard industry yields Toronto. (US slaughter is FI; Cdn is FI and PI)			
<i>Note: Due to the wide variety of price reporting and collection methods, it is misleading to compare prices between regions.</i>			

Canadian Market Developments

The Government of Canada announced that it had requested consultations under WTO rules regarding the United States' Mandatory Country of Origin Labelling legislation. The Canadian Pork Council noted that the announcement was a clear signal that the government understands the adverse impact US COOL already is having and the grave threat its continued application poses to producers. (Source: Market Wire, December 1) A Canadian government-industry working group is monitoring the implementation of COOL to collect information on its economic impact on the Canadian livestock and meat industries. (Source: Meat and Poultry, December 2)

A WTO decision on the matter cannot overturn US law, rather the purpose of bringing the case before the WTO is to seek some form of dispute resolution via negotiation and, if that fails, the aggrieved party is then justified to impose sanctions of equal measure. Normally it takes about 60 days for the consultations and mediation between the two parties. If the dispute is not resolved, then the Dispute Settlement Body (DSB), which is basically all WTO members, creates a panel that hears the case and makes a final ruling. According to the WTO outline of the dispute resolution process, the entire process can take a little over a year to complete. (Source: Daily Livestock Report, December 2).

The timing suggested in the WTO guidelines may be optimistic. The Associated Press, December 4 noted that a formal WTO investigation can eventually result in punitive sanctions, but **“usually after years of litigation.”**

For its part Maple Leaf Consumer Foods executive vice-president Gary Maksymetz reports **the new labeling requirements have dramatically impacted the ability of Canadian processors to move product into the U.S. retail market.** It imposes restrictions on the movement, to some degree, into the U.S. because it does add complexity and cost for U.S. retailers which then translates into our ability to access those markets at the same kind of conditions that the Americans do. There is complexity of having to label and identify country of origin adds challenges in their merchandising. (Source: Farmscape.ca, November 25)

Maple Leaf’s comments are not surprising. Pork goes south in boxes which in turn must be cut and packaged for retail by US distributors in plants or in stores. Canadian pork will represent an added step and cost in the process. It also represents an added risk of mislabeling or marketing. This places Canadian product at a competitive disadvantage. Conversely, however, only about 40% of Canadian pork exports go to the US. Of the 40%, a large share is processing cuts which are not covered by COOL. In addition, some product would go to US foodservice purveyors and distributors which are also unaffected. **The main challenge for Canadian pork is in the large retail channels.** There are likely units within Canadian packing operations that are totally unaffected by COOL, while others would be adversely impacted. In any event, it is all an unnecessary impediment.

There is no doubt that packers and producers would welcome imposing a similar mandatory program in Canada. Packers are reluctant, however, to openly push for a Canadian labeling program. That is because their Canadian retail customers are strongly opposed. Expect for packers to be supportive but for producers to begin carrying the water on this effort.

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Meanwhile the live trade data continues to show a very interesting picture. On a year to date basis through November 29, Canadian feeder pig exports remain above year ago levels by 7%. In the fourth quarter, shipments south are down by 9%. The main impact of COOL would not have been felt until the fourth quarter. Market hog numbers flowing south are down by 37% on a year to date basis. **Since COOL has come into effect, market hog numbers have declined by 74%** compared to the same period of time last year.

COOL can’t be given all the blame for the decrease in shipments. Canadian slaughter is also playing a role. Slaughter is up by 1% for the year and 3% for the quarter. That quarterly increase of 3% amounts to about 14,000 hogs per week. That 14,000 head is only a small share of the 49,000 fewer market hogs crossing the border this year compared to last in the fourth quarter. The other explanation is that some of the operations that were finishing hogs in Canada are now finishing them in the US. The other reason, for fewer slaughter hogs going south is the **continued attrition in the Canadian herd.** The only live trade numbers on the rise are slaughter sows and boars. As of the October 1 inventory report, there were 1.4 million fewer market hogs in Canada compared to last year at the same time.

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Negotiations on a new pricing system are still going on in Quebec. Recall that a new completely formula-based system was supposed to be in effect in October. Moreover, while the negotiations are ongoing **the tensions are strong. Many producers are questioning the willingness of packers to come to an agreement.** Last week, some even suggested that they should pay a visit to packing plants. Cooler heads prevailed however. Disrupting slaughter just before Christmas would end up with hogs backing up in the barns.

There was a negotiation blitz this week between the FPPQ and the four packers (including Olymel) that are the most receptive to an agreement. The FPPQ is optimistic, but not to the point of giving an implementation date for the new marketing agreement. If an agreement can be reached, there are still big questions on whether the remaining 3 packers will sign. The whole deal will likely end in front of the Régie.

I find it confusing as to why Olymel is agreeing to the new deal. **Packers in Quebec will be very challenged to afford the flat US price formula.** That is especially the case with their higher cost structure. This base formula (in Quebec) will result in a high price relative to other markets in North America. The smaller packers such as Agromex and Lucypork, might have went for the deal simply to be assured of their hog allocation.

Pork Products

US Market Insights *The following is direct from the USDA's National Carlot Meat Trade Review, Week Ending December 4.*

The annual Thanksgiving hangover for retail pork cuts occurred this week, with many buyers sitting on the sidelines and sellers wondering where the next order can be found. Bone-in loins traded at mostly steady levels for the week as demand was just enough to keep offerings at bay. Alternatively, boneless loin cuts and credit items were plentiful and discounted throughout the week due to abundant supplies. Trading levels for butts crept higher early week as buyer interest was adequate for limited offerings. Bone-in ham offerings were light in spite of the large daily harvest. Most ham buyers had good bought positions going into the session which limited their needs for additional raw product. However, mid-week a few loads of hams traded sharply higher. The lighter weight hams remained virtually non-existent. Boneless ham price levels appreciated sharply as well, with several loads settling higher. This was mostly due to the fact that packers continue to ramp up boning operations in an effort to limit availability for bone-in hams thus forcing price levels higher for Christmas hams. Seedless belly offerings were more than ample to meet demand, which was light to moderate. At the same time, price levels continued to draw support from the futures market. Lean trimmings experienced moderate offerings with mostly moderate demand as sausage manufacturer's readily bought multiple loads of raw product to fill their immediate needs while replenishing their frozen inventories.

Canadian Market Insights

Not Available This Week

Market Drivers and Outlook

- Looking into the first quarter of 2009, I am expecting at least 400,000 fewer market hogs going south for slaughter. Even with that reduced volume, there remains a significant kill coming early in the year. Recall that the summer pig crop was a surprising 1% bigger than the summer of 2007. That means that **US based slaughter is likely to be up by one percent in the first quarter.** The bottom line is that first quarter 2009 slaughter is going to be about 29.2 million head. That is down by about 400,000 head from the first quarter of 2008 but still **the second biggest first quarter slaughter by a long shot.** Perhaps more importantly, if pork exports are down in the first quarter as USDA is expecting, that would mean that available supplies in the US market are going to be greater than in the first quarter of 2008. Furthermore, with the US dollar appreciation, the revenues and margins generated by those diminished exports are going to be less. Putting that together suggests to me that the first quarter is going to be a challenge to move above \$60 for an average. In fact if it does that would be a sign of significant market strength.
- The Iowa Farm Outlook, December, noted three of the four weeks ending November 15 posted a year-over-year decline in slaughter, not an increase. While smaller pork supplies are supportive of near term hog prices, sow slaughter also declined in November suggesting that herd liquidation may

have stalled. The decline in production arrived two months ahead of schedule and is expected to remain below year earlier levels through at least the first three quarters of 2009. **Pork exports are expected to have slower growth or even a decline in 2009 due to the global economic crisis and a resulting stronger US dollar.** Pork exports were higher across nearly all markets this year, but China and Russia posted the greatest change from 2007. Both of these markets have slowed their pace and will likely buy less in 2009 than 2008.

The Next Two Weeks

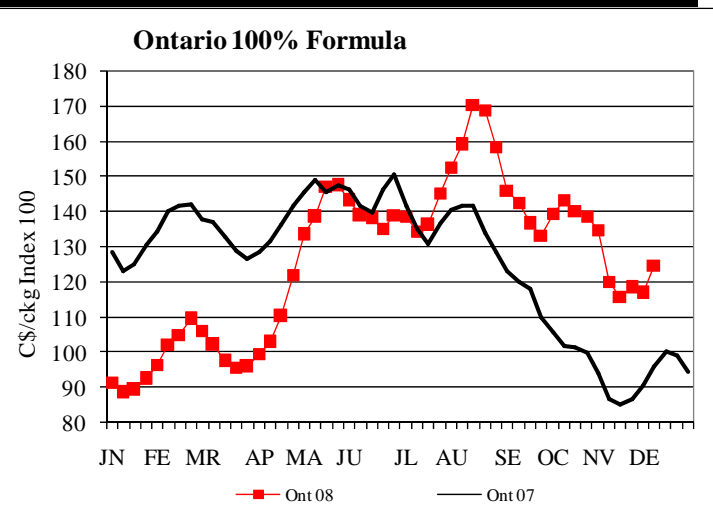
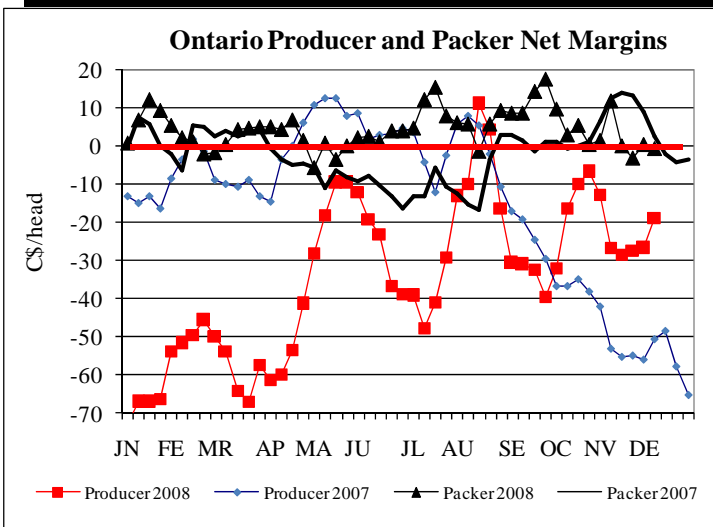
- Numbers have peaked but remain very plentiful. Packers are well bought but product market is beginning to cooperate. Watch for modest firming before Christmas.

George Morris Centre Hog Price Forecasts*				
Period	National Base Cost	Lean Hog Futures	Ontario C\$/ckg	Alberta C\$/ckg
Next Two Weeks	56	57.45	130-135	125-130
January	59	--	135-140	135-140
February	60	64.20	140-145	135-140
March	61	--	140-145	140-145
Second Quarter '09	75	75	175-180	170-175
Third Quarter '09	79	75	185-190	180-185

*Using a 0.78 exchange rate.

IMPLICATIONS/ACTIONS

US market prices were exceptionally strong in the last three years despite record production on top of record production. The reason for the strength was surging US exports. The surge in turn was caused by the growing world demand, an exceptionally competitive US packing sector and the depreciated US dollar. I did not fully appreciate the importance of global demand on the US market during the past three years in terms of its impact on pricing. Going into 2009, however, those same factors that were working in favor of the stronger US exports and stronger pricing are no longer positives. At the same time, however, the US dollar appreciation has only brought the dollar index back to the levels it was at in 2005 and 2006. In other words it is not out of line with recent history. I think there is more downside risk on both my forecasts and the futures based on the precarious situation in global credit markets and general economic conditions.



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