

Hog farmers: Don't stop herd liquidation



The U.S. hog herd is still way too big and needs to shrink a lot more before profits can return to that industry, one industry-watcher says.

The numbers are ugly: **Hog prices have been below breakeven in 20 of the last 22 months; prices have been below variable costs of production every month for the last year.** And now, even as feed costs fall, so have hog prices and demand, making it tough for herd liquidation to keep up pace -- let alone gain on -- the margin of loss.

"Based on late July futures for feed and hogs, it will be another 6 months before variable costs are covered and an additional 3 months to reach breakeven," says Iowa State University ag economist John Lawrence.

Liquidation remains the most effective way seen to slow the downward spiral. But, is that happening like it needs to? Lawrence says though it's a fairly cut-and-dried situation, producers may be hesitating to trim herd size, especially with feed costs stabilizing at lower levels. But, even though feed may be cheaper, that doesn't mean liquidation's not still needed.

"Yes, feed costs are coming down, but hog prices have fallen faster on weak demand and large supplies. National pork organizations and USDA will work to expand domestic and export demand, but producers determine supply. Breeding herd inventories are lower, but due to increased productivity, pork supply has not adjusted to economic signals. In fact, U.S. sow slaughter has decreased, not increased, more than 15% since the first of the year," Lawrence says. "While feed price is well below the 2008 levels, it remains higher than the pre-2007 era. Without new demand for pork, supplies will have to decline to support hog prices at the higher cost levels. The record export pace of 2008 has been slower thus far in 2009. Without smaller supplies prices will not recover.

"U.S. producers appear to be pushing on the accelerator rather than the brake," he adds.

Costs of culling

But, liquidation does come at a cost. Fixed costs, Lawrence says, do not change with shifts in output. But, variable costs do. So, on a per-head basis, liquidation does increase overall production costs. When you average that out over larger numbers, the cost equation does eventually tip the other way.

"Reducing pig output by 10% would result in a higher fixed cost per pig...a little more than a 1% decrease in total supply would cover this cost increase, all else equal," Lawrence says. "This calculation is for economic costs, but it is cash flow that pays the bills. Selling

sows increases near term income by the value of the sows and reduces near-to-intermediate expenses by reducing feed and other direct costs. However, eventually, you have fewer hogs to sell and income will go down unless the price has increased."

Also, when nailing down what level of liquidation is right for your farm, ask yourself these questions, Lawrence adds:

How will a production cut impact your costs?

Can you reduce overhead costs in addition to variable costs?

Are there benefits from less crowding, culling marginal sows, etc., that may offset some of the increased cost?

How is cash flow impacted with sow sales, less feed expense, but less hogs to sell later?

Are these permanent or temporary changes?

What if supplies don't fall?

If herd liquidation doesn't continue at sharper levels -- a 5% cut is thought to be required to get back to breakeven, versus the March-May '09 decline of 0.4% -- per-head losses will steepen soon.

"Accumulated losses per head in the current crisis for hog producers will surpass that of 1998-1999 in September," Lawrence says. "However, individual farms and the industry are larger and so is the loss of equity. And we are not done yet. We will drain 50% more equity than we have already lost by next summer given the current forecast."

Though overall liquidation hasn't taken place at the level where it's needed yet, the good news is the market may force that to happen as demand continues to weaken.

"Supplies must come in line with the higher cost structure and, at least currently, the weaker demand. Some producers have already cut production or announced their intentions, but the announced reductions of a few will not lead to profitability for the industry," Lawrence says. "Inelastic demand for hogs will provide a larger percentage increase in price for a given reduction in supply, all else equal. The productivity of the industry requires a significant cut in farrowings to achieve the supply response needed to return to profitable prices."