



GEORGE MORRIS CENTRE

Canadian Market Hog Price Forecast 2010 and 2011

Kevin Grier

Senior Market Analyst

October 29, 2009

This paper provides an outlook on Canadian market hog prices for 2010 and 2011. The purpose of the paper is to help Canadian hog producers and their financial advisors as they develop business plans.

The starting point is to note that the vast majority of hog prices in Canada are simply formulas based on prices in the US adjusted for the exchange rate. As such, in order to forecast Canadian hog prices, it is necessary to forecast US prices and the exchange rate.

US Prices

The US prices are forecasted by analyzing the data on pork and hog market supply and demand conditions in North America.

2010 Supplies

One of the best gauges for future hog and pork supplies is the quarterly US Hogs and Pigs Report. The quarterly report provides detailed information on US inventories of market hogs, the pig crop and the breeding herd. It also provides information on producer farrowing intentions in the coming half year. With this information on hog supplies, the hog slaughter in the following 3-4 quarters can be estimated. Estimations of Canadian exports of live hogs are the final step in the hog slaughter forecasts.

Going beyond the next 3-4 quarters forecast for hog slaughter requires more estimation of hog supplies and producer intentions. This estimation is done by analyzing where the industry is at and where it is headed in the "Hog Cycle." The hog cycle is somewhat recognizable pattern of producer financial returns and their impact on hog production. Many assert that the hog cycle is about four years from peak to peak or trough to trough of production. In recent years, that pattern has been less reliable, but the concept of margins and their impact on production remains a solid guideline.

The most recent US Hogs and Pigs Report was released at the end of September. That report contained the following important information regarding hog supplies and intentions:

- U.S. inventory of all hogs and pigs on September 1, 2009 was 66.6 million head. This was down 2 percent from September 1, 2008.
- Breeding inventory, at 5.87 million head, was down 3 percent from last year.
- Market hog inventory, at 60.8 million head, was down 2 percent from last year.
- The June-August 2009 pig crop, at 28.8 million head, was down 2 percent from 2008.

- U.S. hog producers intend to have 2.94 million sows farrow during the September-November 2009 quarter, down 3 percent from the actual farrowings during the same period in 2008, and down 8 percent from 2007. Intended farrowings for December 2009-February 2010, at 2.93 million sows, are down 3 percent from 2009 and down 5 percent from 2008.

This information is important due to the strong relationships that exist between the inventories and future slaughter. For example there is a very strong correlation between the pig crop and slaughter six months later. Market hog numbers also provide a good guide to slaughter in the coming two quarters. Farrowing intentions can be used to estimate slaughter 2-3 quarters further out.

As a starting point, a brief glance at the September report suggests that US based slaughter is going to be down in 2010 compared to 2009. How much US based slaughter is going to decline will vary by quarter. The June-August 2009 pig crop indicates that US based slaughter will be down by just two percent in the first quarter of 2010. The farrowing intentions the fourth quarter of 2009 and the first quarter of 2010 provide an argument that slaughter could decline by 3% in the second and third quarters of 2010.

Beyond that relative certainty of the June-Aug pig crop, however, it is necessary to apply other insights such as breeding herd slaughter rates and producer margins. With regard to breeding herd cull rates, it is not yet apparent that the US industry is beginning to cull its sows at an accelerated rate. With that said, anecdotal insights indicate that the packer demand for culls is less than the supply of culls on offer by producers. In addition, there is some discussion among market watchers that there have been more once-bred gilts culled. If they are in good condition they will be marketed and recorded as slaughter hogs, not sows. In other words culling rates might be poised to increase. This of course is closely related to the ongoing producer losses in the United States. Iowa State University budget models show that US producers have been in a serious loss position for two years. These losses are now estimated to be greater than those experienced in 1998 and 1999.

Based on these factors, it is estimated that US-based slaughter in the second half of 2010 should decline by up to 4%. That in combination with continued reductions in Canadian live shipments will mean that total 2010 slaughter should decline by 4%. Slaughter in 2009 will total about 113.5 million head while 2010 slaughter should be about 109 million. The following graph shows actual slaughter for 2008 and the first three quarters of 2009. The fourth quarter of 2009 and 2010 are forecasts.

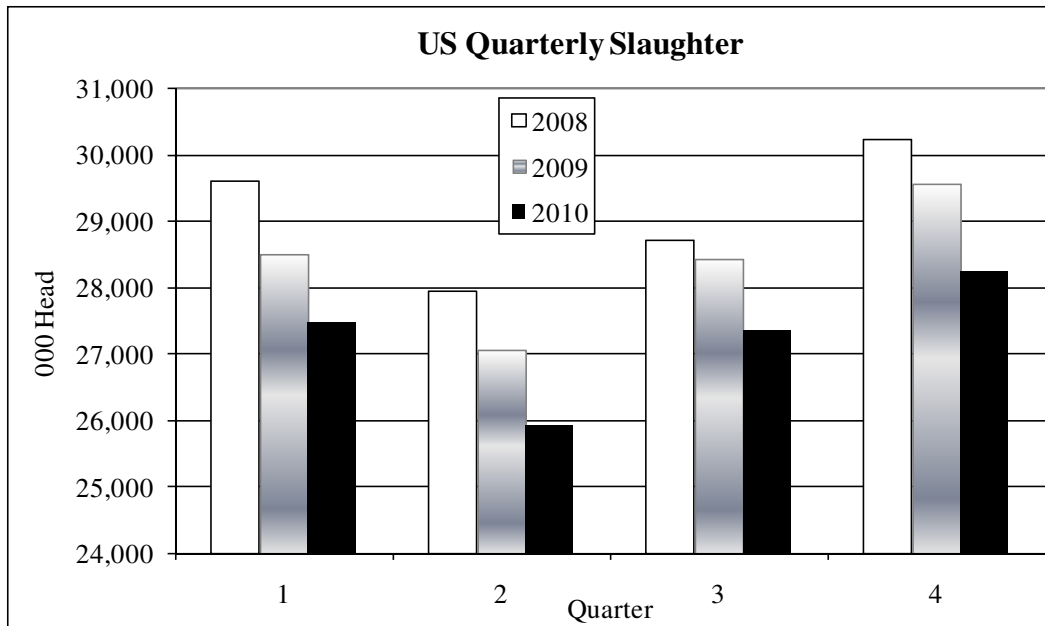


Figure 1 Source: USDA National Agricultural Statistics Service and George Morris Centre estimates

2010 Demand

Demand can be broken down into two main variables: domestic and export. With regard to domestic demand, North American demand for pork has been stagnating or declining for the past five years. In the mid to late 2000's North American demand for pork has weakened. .

With regard to export demand, the following graph shows the value of US pork exports from 1999 through the estimated value for 2010.

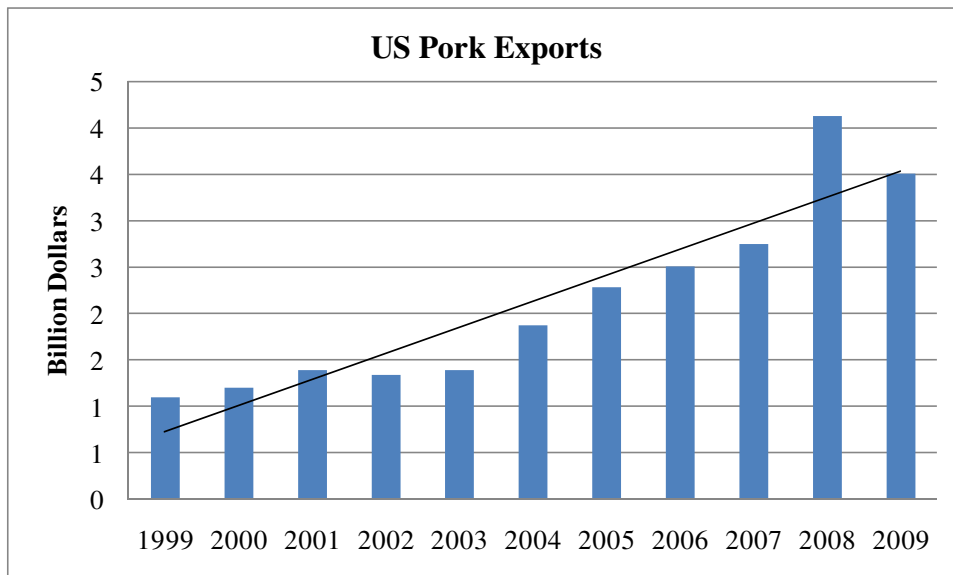


Figure 2 Source: USDA Foreign Agricultural Service

Exports in 2009 will decline by about 15% from the extraordinary total in 2008. The decline is due to the slower global economy and the lingering effects of H1N1. Despite that decline, as can be seen, exports in 2009 were right on the longer term upward trend line.

Looking forward the domestic and export demand for pork in 2010 will be largely dependent upon global macroeconomic conditions. The impact of H1N1 remains uncertain and a negative on overall prospects. The North American and domestic economies are in a very slow recovery from a very deep recession. While economic conditions are expected to improve, the rate of improvement will be slow and from a very low level. On the positive side, however, China and the US seem to be making progress towards normalizing pork trading relations. In addition, the US dollar depreciation is likely to help US exports in 2010. Domestically, it is noted that wholesale pork demand has been really weak post-H1N1. There could be some snap back in market conditions if domestic demand returns to more historically normal levels.

Generally speaking with regard to demand, conditions should be considered to be similar to 2009 at the worst. More likely, however, domestic and export demand conditions should be better than 2009.

2010 US Hog Prices

Based on the supply and demand forecasts, the following are the quarterly US carcass based price forecasts for 2010:

1st Quarter; US\$60/cwt

2nd Quarter; US\$74

3rd Quarter; US\$72

4th Quarter: US\$64

The average price could be approximately \$68/cwt. These forecasts are reasonably close to futures markets contracts for the relevant time periods but a much higher than forecasts generated by Iowa State University and the University of Missouri.

According to budgets generated by Iowa State University, the breakeven selling price in 2009 would have been close to \$70/cwt. As such, if costs are similar in 2010, producers in the US will be in a loss position for 2010. If the George Morris Centre price forecasts are correct, producers could see losses in the first and fourth quarters and narrow margins in the second and third quarters.

The net result is that 2010 should see continued contraction in the US breeding herd.

2011 US Pricing

Ongoing contraction through most of 2010 will result in further reductions in slaughter during 2011. Based on expected breeding herd reductions in 2010 and early 2011 of 2-4% each quarter, slaughter in 2011 should decline from 2009 by about 7% to around 105-106 million head. By 2011, demand conditions in export markets are likely to have improved and as such, exports could provide more of a pricing boost than in 2009 and 2010. In addition, it is reasonable to

assume that H1N1 will no longer be the negative factor that it has been in 2009. The following are the forecasts for 2011.

1st Quarter; US\$68/cwt
2nd Quarter; US\$80
3rd Quarter; US\$78
4th Quarter; US\$72

The average price should be at least \$75 in 2011.

Canadian Prices

As noted, Canadian prices are largely US prices adjusted on a formula basis. In addition to forecasting the US price, the exchange rate must also be forecasted. Needless to say, there are varying forecasts by the major banks on the Canadian dollar's performance in 2010 and 2011. TD Bank Financial Group' Quarterly Economic Forecast from September 2009 sees a par exchange rate in the first quarter of 2010. It also forecasts a gradual quarter by quarter depreciation from that point. They expect the exchange rate to be US¢/C\$0.93 by the end of 2010 and 0.89 by the end of 2011. The Bank of Montreal's BMO Capital Markets Economics, October 23 sees a gradual appreciation from 0.99 in the first quarter of 2010 to 1.02 in the last quarter of 2011. The Scotiabank Group Global Economic Research is closer to the BMO in seeing a par currency in the future. As of the end of October, Canadian dollar futures were trading around 0.93 through 2010.

For the purposes of this forecast, a US¢/C\$ exchange rate of 0.95 will be used. Based on the exchange rate forecast of 0.95 as well as the US forecasts above for 2010 and 2011, the following table shows expected Ontario index 100 prices through 2011.

Ontario Hog Price Forecasts					
US\$/cwt	Q1	Q2	Q3	Q4	Year
2009	130	124	106	105	116
2010	115	142	138	123	129
2011	130	153	150	138	143