J.S. FERRARO

130 Adelaide Street West, Suite 3302
Toronto, Ontario M5H 3P5

416.306.8787 | jsferraro.com

RED MEAT OUTLOOK: SPECIAL UPDATE

CORONAVIRUS IMPACTS DEMAND IN THE MEAT MARKETS

In light of recent developments, we thought this might be a good time to take a look at how the coronavirus pandemic is affecting the beef and pork markets in North America (NA). First, let's point out that the coronavirus is now front and center in most American's minds. Grocery store shelves are empty in a lot of places as consumers rush to stock up on food. Almost all mass gatherings have been cancelled, including business conferences and sporting events. Schools in many areas are shutting and moving classes online where possible. And, after weeks of downplaying the risk posed by the virus, the President has now declared it a national emergency.

> **Coronavirus will boost** near-term meat demand, **but hurt demand** a few months down the road

The first and most obvious impact on the meat markets will be a shift in demand from foodservice to retail grocery stores as consumers hunker down at home in an effort to avoid infection. Consumers will continue to consume the same amount of calories as they did before the pandemic, but they will just do more of it at home and less in restaurants. The cost of a bite of protein prepared at home is far less that the cost of a bite of protein eaten in a restaurant. Any economist will tell you that when the per-unit cost of an item is lowered, consumption rises. The conventional wisdom is that because the population will be traveling less and thus going out to eat less, that meat demand will fall. That is erroneous thinking. People will still need to eat and they will desire to consume meat, so demand will simply be shifted away from foodservice and into retail channels where the cost per bite is lower. This almost certainly won't be a negative for beef and pork demand and could actually be quite positive.

In the very near-term, the run on grocery stores will boost demand significantly as those stores now need to come back into wholesale market and re-stock their meat cases. Thus, we expect this "re-stocking" demand in the next couple of weeks to boost both the beef and pork cutouts. Then comes a lull in demand as consumers work through the large stocks of meat they purchased during the panic. But meat is perishable and in the panic many consumers probably bought more than they can reasonably consume before it goes bad. Sure, it can be frozen, but not all consumers have the capability to do that and so it's possible that some portion of the panic-bought meat will be lost to spoilage. In addition, meat that is held in storage by institutions that are now closed (like schools) could also see large losses to spoilage. That is net positive to demand. Thus, contrary to conventional wisdom, we think the spread of coronavirus is going to be positive to beef and pork demand over the next few weeks.

Longer-term, the effect on demand could be more negative. The responses to the virus, like the slowdown in travel and cancelled events will slow consumer spending and that makes up almost 70% of the US economy. There will be layoffs in the travel and foodservice industries as those companies pare back in an effort to better match their production with this reduced demand. There is a very good chance this will cause unemployment to rise and greatly raises the risk that the NA economy will fall into recession during the second half of 2020. A slowing economy is negative for all animal proteins since it generates a need for households to spend less. Beef will suffer the most in a recession, not only because it is the highest priced protein, but also because it has much more exposure to foodservice than pork does. Families that might have once bought beef will now consume more pork and poultry. Chicken has high foodservice exposure, but it also has the lowest cost per unit of the three proteins, so the overall impact of a recession on chicken demand is uncertain. Evidence from past recessions indicates that pork demand only takes a modest hit. So, if we assume that the NA economy will be in recession during the second half of 2020, then its reasonable to expect beef demand to decline by a large amount and pork demand to decline to a lesser degree.

Over the past couple of weeks, the live cattle futures market has been reflecting anticipation that beef demand will fall as the economy weakens. For a while, the cattle futures traded in lock-step with the stock market as traders assumed that movement in the stock market was a good proxy for what would happen to future beef demand. However, the losses in the futures market have greatly exceeded what we deem as a reasonable loss of beef demand in a recession environment. Part of that is just due to panic selling as traders look to reduce their risk. But there is another element at play here. At some point late last week, traders

J.S. FERRARO

130 Adelaide Street West, Suite 3302
Toronto, Ontario M5H 3P5
416.306.8787 | jsferraro.com

became aware of what might happen if one or more plants were forced to close due to the coronavirus outbreak. They can easily recall how fast and hard the futures fell last August when a large beef packing plant operated by Tyson was shutdown due to a fire. Further, there is the issue of labor in plants. As schools close, some parents that work in meat plants will be forced to remain home with their children. The National Pork Producer's Council (NPPC) highlighted this in a recent letter to President Trump stating that the supply of available workers for the plants was extremely tight and noting that if the capacity to process pork is reduced by events surrounding the coronavirus spread, then hog producers could face severe financial hardship. They called for more work visas to increase the supply of labor for packing plants, but that flies in the face of several years of work by the Trump administration to reduce immigration so it is likely to fall on deaf ears.

We think beef and pork users need to be on high alert for packing plant disruptions. Should they occur, it would cause the price of live animals to plummet and the **price of beef and pork to rise substantially** as users scramble to procure product. It would be very similar to the situation in beef last August when the Tyson plant fire occurred. At some point, a worker in either a beef or pork plant is going to test positive for coronavirus. What happens then? The medical community would say they should close the plant and monitor all of the other workers for symptoms. That could take weeks to resolve. The packing industry is not amenable to "work from home" like other industries. What if several plants

Beef and pork buyers need to be on high alert for **packing plant disruptions**

get coronavirus positives in their employees at once? You can see how this could quickly spiral into a bad situation for both meat buyers and meat producers. We recognize that in times of uncertainty like this, the natural tendency on the part of meat buyers is to remain close-bought, but the risk of a packing plant disruption warrants re-consideration of that position in this case. Futures are low at present and forward pricing should be very attractive (See **Figures 1 & 2**). **We recommend that beef and pork users extend coverage beyond immediate needs as a hedge against sharp price increases and supply shortages should one or more packing plants be forced to go dark for a period of time.** Foodservice users are naturally concerned about extending coverage when future demand looks like it will be very weak, but there is probably some core amount of business that can be expected and foodservice entities should work to obtain coverage on at least a portion of those needs. We see this as a short-term danger, so the coverage need not extend more than 2-3 months in the future.

China was the first country to get hit with the coronavirus and now, after undertaking serious preventative measures, the number of new infections is receding there. It took about three months for that process to play out. NA might be looking at a similar three-month timeline before the virus starts to recede and things return to normal. That means the crisis might begin to abate in June, but it probably will get a lot worse before it starts to get better. However, at that point it is likely to be obvious that the NA and global economies are moving into a recession. **Users should be prepared for weakening demand in the second half of 2020.** Beef producers are already responding to the possibility by reducing feedyard placements dramatically, so softer demand could be met by smaller production, thus limiting the downside price risk. The pork industry, on the other hand, is in full-blown expansion mode in order to supply vast quantities of pork to China over the next couple of years. Pork supplies look more than ample for the foreseeable future and any downturn in domestic demand or exports could cause prices later this year to tumble. In summary, we expect the coronavirus panic to boost short-term demand for beef and pork, but it will likely trigger a global recession that will be negative to demand in the second half of the year.

Figure 1: June 2020 Live Cattle Futures

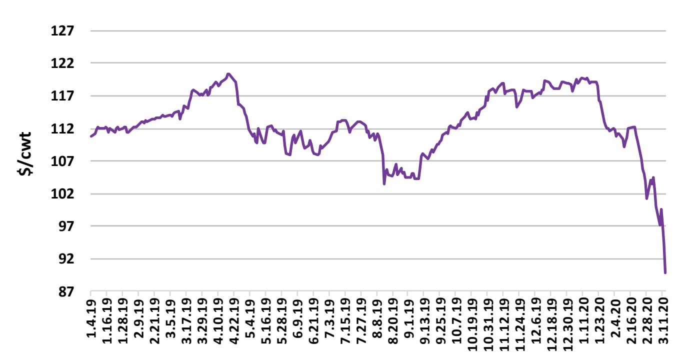
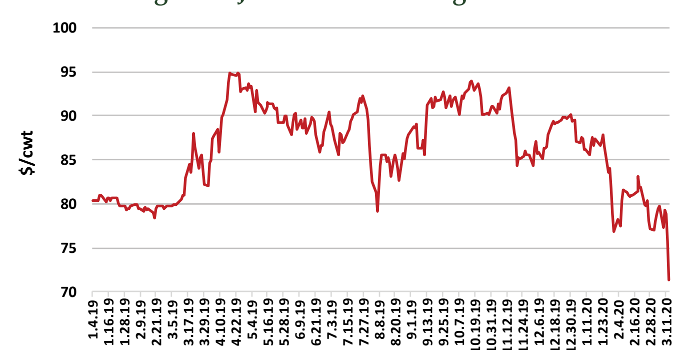
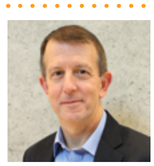


Figure 2: June 2020 Lean Hog Futures



SUBSCRIBE NOW for our market alerts



DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro

E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 29 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.