FCC Ag Economics

2018 Outlook for the Canadian hog sector

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Canada

FCC Ag Economics helps you make sense of the top economic trends likely to affect your operation in 2018. In this outlook for the Canadian hog sector, we look at:

- Global demand
- Processing capacity
- Interest rates and the Canadian dollar

The Canadian hog sector is looking profitable in 2018.

Farrow-to-finish operations are projected to record profit margins between break-even levels and $20 per head, on average, depending on size of the operation. Finishing operations are projected to record average margins of around $5 per head.

Eastern Canadian profit margins are expected to be slightly above the west, given a slight price advantage in corn over barley. Tight Canadian barley supplies from the 2017 harvest have elevated feed costs. Relief may be on the horizon, thanks to the unexpected 50.0% tariff India applied to Canadian pea imports in October 2017. Additional peas will be diverted to the feed market in 2018.

In 2017, the North American hog sector expanded because of growth in demand, increased production, and expanded U.S. slaughter capacity. This story continues into the new year, with increasing U.S. production and record slaughter. But overall, global demand for pork will be key for Canada's hog sector in 2018.

Canadian hog sector profitability depends heavily on the U.S. market. Rising U.S. hog production and inventories are expected to increase pork supply 5.0% in 2018, possibly reaching record-high levels. Even if U.S. pork consumption increases the expected 4.8%, U.S. exports will need to be strong in 2018. Otherwise, hog prices may have to fall to spur stronger domestic demand.

A larger pork supply in 2018 could lead to softer prices for Canadian hogs and tighter margins. The USDA is forecasting lean hog prices to average US$46-$49 per cwt, a 5.7% decline from the 2017 average. These price pressures will be tempered by new slaughter facilities as packers bid more aggressively for animals.

How will this affect your bottom line?

With hog prices expected to weaken in 2018, revenue growth in the hog sector is likely to come from production growth. Minimizing feed costs will be especially important to preserve healthy profit margins in 2018. Tight barley supplies indicate that corn-based rations have a $2 per head advantage over barley-based rations. Investigating feed ration alternatives may help hog producers remain competitive in 2018.

Trends to watch in 2018

Strong global demand

In 2018, the global economic landscape may provide both opportunities and potential disruptions to the Canadian hog sector.

An abundance of U.S. corn and increased U.S. slaughter capacity are projected to increase Canadian exports of weanlings and feeder hogs to the U.S. in 2018. However, higher U.S. hog production and slaughter capacity will mean Canadian pork exports to the U.S. will likely decline. Export markets outside the U.S. will be important for Canada.

Chinese demand for pork is a wild card. Their pork import demand declined in 2017, but is expected to grow in 2018 as the Chinese hog herd contracted in October 2017 6.6% year-over-year. The Chinese pork industry is still adjusting to new environmental regulations that have forced many smaller hog producers to exit the industry. Despite additional cost pressures, China's pork production in 2018 is expected to grow 2.3% while Chinese consumption is expected to grow 2.1%. Even if China's pork production is realized in the year ahead, the market will offer important export opportunities for Canadian pork.

Investments in processing capacity

Canadian slaughter will also increase in 2018, following domestic investment in additional processing capacity in Alberta, Manitoba, Ontario and Quebec. Domestic demand has been strong and is expected to remain competitive relative to Canadian demand for both beef and chicken. Stiff competition in the retail food market led to a decline in retail pork prices in 2017. As a result, Canadian pork consumption increased 4.0% in the third quarter of 2017 and is expected to remain strong in 2018.

Interest rates to remain low while loonie to stay under US$0.80

The Bank of Canada projects economic growth in Canada to be slightly weaker in 2018 relative to 2017. They also expect inflation will trend around 2.0%, the Bank's mid-point target. Financial markets suggest there will be two or three hikes of 25 basis points in the overnight rate for 2018.

Businesses should take note: although interest rate increases will likely be muted, borrowing costs are projected to climb off historical lows reached in 2016 and 2017. Financial markets currently expect bond yields to climb moderately. This would mean, for example, that a 5-year, fixed-rate mortgage would be priced at the end of 2018 around 75 basis points higher than it was at the end of 2017.

The Canadian dollar is expected to be higher throughout 2018 compared to 2017, but still low enough to support profit margins. It should average US$0.78, based on the assumption that WTI crude oil prices trade in the US$55 per barrel range. Interest rates in Canada and the U.S. should follow similar patterns.

On the radar

- The outcome of the renegotiations of the North American Free Trade Agreement (NAFTA) will have possible implications for:
  - the value of the Canadian dollar
  - trade taxes and market access rules applied to Canadian exports and imports
  - dispute settlement procedures

  Changes in any of these could impact prices of ag commodities in Canada.
- Possible market access gains if negotiations to revive the Trans-Pacific Partnership (TPP) agreement are successful.
- Shifts in acres devoted to feed grains in the U.S. and other major producing countries in 2018 could possibly result in shrinking global stocks and higher feed prices.
- Efforts to rebuild the Chinese hog herd and its impact on the import demand for pork

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