



The Commodity Update

The Monthly Newsletter for Multi-Unit Foodservice Purchasing Executives

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Happy Holidays!

Highlights:

Christmas trees
in short supply
page 1

OPEC / Russia cut
crude oil output
page 2

USDA cuts 2019
cheese price forecast
page 3

China's ASF issue
big for pork in 2019
page 4

► Eco Outlook

Financials or fundamentals? The financial markets are running scared. Stocks are declining and the yield gap between long and short-dated U.S. Treasury securities is shrinking. Both of these financial indicators have been precursors to past recessions. Oil prices plummeted in Oct/Nov, signaling weaker global demand and a supply glut. Other investors' anxieties include spiraling U.S. debt levels, the U.S. China trade-war/cold-war, a deteriorating Trump presidency and the impending Brexit disaster for the U.K. However, at least for 2019, economic fundamentals tell a different story.

Studies by economists at both UBS Securities and J.P. Morgan agree that there is no recession on the immediate horizon. J.P. Morgan's model says there is high risk in 3-to-4 years, but just a 21% probability on a downturn in the next 12 months. Key economic indicators remain positive. Corporate profits (driven by tax cuts) will be up for the year. On the job front, U.S. employers have added 2,268,000 new net jobs in 11 months so far this year, already exceeding the 12-month total for 2017. U.S. consumer spending was up 2.9% in Oct from a year earlier, exceeding the 2.4% average of the past 4 years. Productivity growth in Q2 & Q3 was among the best of the expansion.

In July, the current U.S. economic recovery will become the longest one on record. That doesn't automatically mean it will end soon, but it does mean we are at the mature stage of the expansion cycle. In 2019, the U.S. economy will be vulnerable to higher inflation, interest rate increases, a softening housing market, higher employment costs, immigration restrictions and trade wars. Some of these issues are unavoidable and some are self-inflicted. A *Wall Street Journal* survey of 60 economists in Nov showed a consensus forecast for an average GDP growth rate of 3.1% in 2018, 2.3% in 2019 and 1.8% in both 2020 & 2021.

Restaurant numbers held steady in Oct. The NRA's Restaurant Performance Index edged up 101.2 in Oct from 101.1 in Sept. According to TDn2K's Black Box Intelligence index, year-over-year same-store sales were up just 1.0% in Nov, following a 0.8% gain in Oct. Customers, however, remain elusive. Year-over-year traffic declined 1.9% in Nov after a 2.2% decline in Oct. Labor will again be the biggest challenge in 2019. According to the Bureau of Labor Statistics, there were 1,040,000 unfilled "accommodation and food service" jobs on Nov 1, up 25% from a year ago.

The Grinch may have gotten his greedy fingers into this year's Christmas tree market. Tree prices are running as much as 25% above a year ago. A spokesman for the National Christmas Tree Association (yes, there really is one) said that tree production peaked in 2005 and then demand (and prices) fell sharply after the financial crisis in 2008. As a result, growers cut back on plantings. Since trees take 7-10 years to reach maturity, we are now feeling the pinch of tighter supplies.

California wildfires, a North Carolina hurricane, sky-high freight rates and a scarcity of seasonal migrant workers have compounded supply/cost issues. In the Pacific-Northwest, some farmers have moved away from planting Christmas trees and instead have focused on more profitable crops, such as marijuana. (Note that it is now legal to own and decorate marijuana plants/trees in many states. They are the perfect size for an apartment or small home and make a great conversation piece at your holiday party.)

If you want a tree taller than 6-feet this year, you will pay the biggest premium. As supplies tightened over the past 3 years, growers cut trees earlier than expected to fill demand – so we are now short taller trees. (sorry, couldn't help myself). However, most of us will pay well below the

\$2,900 shelled out for a 24-footer that was sold in the SoHo section of NYC last week. So far, retailers report brisk early-season sales driven by a healthy economy and strong consumer spending. Amen to that!

► Focus: Crude Oil Prices

The West Texas Intermediate (WTI) crude oil futures, the U.S. benchmark, peaked at a 4-yr high of \$76.41 per barrel on Oct 3, and has since plummeted by 33% to close at \$51.09 on 12/12. The President tweeted in late Nov “Oil prices getting lower. Great! Like a big Tax Cut for America and the World. Enjoy!” Not too long ago, when the U.S. was a massive net oil importer, Trump would have been spot-on. But in today’s world, because of fracking technology, the U.S. has become the top producer of oil and natural gas and the effect of lower crude oil prices is more complicated.

As far as consumers are concerned, fuel efficient vehicles have made them less sensitive to changes in fuel prices. Also, cheap natural gas has shifted commercial and residential energy needs away from oil in the areas of the country that have access to it. The U.S. economy now consumes just 0.4 barrels of oil to produce \$1,000 of GDP, down from 1.1 barrels in 1972. When oil prices dropped from over \$100/barrel to low-\$50s in 2014, the impact on consumer spending was significantly less than economists had expected. In the trucking industry, lower fuel prices are a godsend for margins but driver shortages will likely prevent customers from seeing much of a drop in freight rates.

On the production side of oil there is a greater sensitivity to prices. In the past, oil production was limited to big oil companies focused on the Gulf of Mexico. Oil rigs were expensive, and long-term investments were not very responsive to short term fluctuations in oil prices. Today, U.S. oil output comes from a large number of small shale deposits that require constant drilling by many smaller companies. Many of these drillers carry high debt-to-asset ratios and are very sensitive to lower oil prices that diminish their cash flow. From 2012 to 2017, the 30 biggest U.S. shale producers lost more than \$50B. From mid-2014 to late-2016 they laid off 190,000 workers and crippled local economies in areas of TX, OK and ND.

So what’s the goldilocks price that keeps U.S. suppliers in business without hurting fuel consumers? Consulting firm R.S. Energy says that excluding cost for land acquisition and overhead, companies can survive with existing wells for \$37/barrel in the Permian Basin (W. Texas), \$42 at Eagle Ford (S. Texas) and \$47 for Bakken (ND). However, as existing wells dry up and new drilling (on new land) is necessary, that the all-in break-even for the Permian Basin is \$51. It’s \$57 at Eagle Ford and \$64 for Bakken. With WTI crude aver-

aging \$51.86 in 2017, shale producers were barely in the black, with profits at 1.3% of revenues.

If prices stay near \$50, U.S. producers will be unable to attract investment money and drilling actively and production will slow significantly. WTI crude oil futures are averaging \$65.92 YTD. U.S. consumer spending, albeit within a strong employment economy, has been remained strong this year. So \$65 looks to be a pretty good number for both producers and consumers in the U.S. Globally, it’s a different story. The global benchmark, Brent Crude, is trading just above \$60/barrel. Brent looks to average \$71.40 for 2018, but its 4-year average (2015-2018) is just \$55.54. According to the International Monetary Fund, Saudi Arabia needs an average price of \$88 to balance its budget.

So it should not have been much of a surprise last week when OPEC and Russia cut a deal to collectively cut oil output by 1.2M barrels per day (800,000 OPEC, 400,000 Russia). The decision marks a reversal in Saudi energy policy. Over the last six months, the Saudis ramped up production by more than 1 million barrels per day - a move cheered by Trump - to help offset the loss on Iranian oil in global markets due to sanctions. Now the Saudi’s will shoulder most of the 800,000 bpd in OPEC cuts.

Despite Trump’s threatening tweets, the Saudi’s are going to take care of themselves first. Brent prices briefly jumped to \$63 after the cartel’s announcement, before falling back again. Cutting supply will only induce higher prices if demand remains steady. If the global economy is cooling and oil demand is falling, the cuts may not have much of an impact. World oil supplies and the Brent market have a strong influence on U.S. oil prices. This time around, it may be a positive one. If WTI prices can move from \$50 to \$60 without cutting production ourselves, that would be a positive thing for the U.S. oil industry and the U.S. economy. For the first time in many decades, an OPEC production just might be good news for the U.S.

► Beef

In Nov’s Cattle on Feed Report, the USDA said new placements onto feedlots in Oct were down 6.1% vs. Oct 2017. However, the Nov 1st feedlot inventory at 11.7M head was still 3.2% above a year ago. Heifer feedlot numbers now exceed the 36% threshold that historically indicates that ranchers are liquidating enough breeding stock for the cattle herd to begin contracting. Heifer slaughter so far this year has averaged about 7% above year-ago levels, but that pace has slowed to just 1.5% over year-earlier levels in the past month. A downward turn in the cattle cycle is coming, but it’s going to take years to get there – probably not before 2022/2023. The USDA has continually revised

(downward) its beef production forecast through the year. USDA is now projecting a 2.9% increase in 2018 and 3.1% in 2019. USDA says cattle prices will average \$116.91/cwt in 2018 and \$118.00 for 2019.

Choice quotes as of 12/11: Prices for holiday items peaked in Nov and are headed lower. #189A tenderloin at \$11.61/lb are down \$.07 from a month ago and should dip below \$9.00 in Jan. 112A ribeye at \$8.64 is down \$.28 and looks to be sub-\$7.00 by year's end.

Middle meat markets bottomed in Nov and are headed higher: #180 boneless strips at \$4.93/lb are up \$.21 from a month ago and look to be \$5.25 for the year-end holidays. #174 XT (0x1) short loins at \$4.70 are up \$.13 and will continue to edge higher. #184 top butts at \$3.32 (up \$.14) look steady in Dec.

Prices for end cuts and roasts will be firm through winter. #168 XT top rounds at \$2.10 are up \$0.03 and should gain another nickel in Dec. #120 brisket at \$2.70 is up \$.06 and looks to be \$2.60-\$2.70 through Jan. Beef 50s fat trim are \$.68 (down \$.05) should bottom near \$.60 in Dec before getting back above \$.70 in Jan. Lean 90s trimmings at \$1.94 (down \$.03) are close to a bottom and should be \$2.00 by Feb. The USDA said it expects lower imports of processing grade beef (mostly 90s) from Australia in 2019. Oct imports from Australia were 11% below a year ago.

► Coffee

Global supply fundamentals are bearish for prices. The International Coffee Organization reported October global coffee exports at 10.41M bags - up 17% from a year ago. The ICO said the 2017/18 season ended with a global surplus of 1.6M bags. However, record high forecasted Brazilian and Vietnamese crops for 2018/19 will likely leave a 6-10M bag surplus next year. Short of a major weather incident, the coffee market looks to be dead in the water for 2019. Coffee futures hit 12-yr lows of \$.92/lb on 9/18, rebounded to \$1.22 in mid-Oct, and has since retreated to \$.97 (12/11). Forward futures contracts for 2019 are averaging \$1.08.

► Dairy

Milk output faded in Oct to 0.8% above a year ago. That follows strong 1.3% gains in Sept and 1.4% in Aug. In Tuesday's WASDE, the USDA lowered milk production forecasts for both 2018 (+1.1%) and 2019 (+1.3%) due to slower growth in milk per cow and lower cow numbers. The USDA said weak returns are expected to result in a smaller 2019 cow herd. Class III milk futures peaked at \$16.55/cwt on 9/5 and have since plummeted to \$13.71 (12/12). In Tuesday's WASDE, the USDA projected Class III to average \$14.55 in 2018 and \$15.05 in 2019.

Block prices, at \$1.3475/lb on 12/12, continue to fall seasonally, from \$1.42 in mid-Nov and from an annual high of \$1.7475 on 10/1. In Tuesday's WASDE, the USDA cited "current price weakness and continued high stock levels" as its rationale for dropping its 2019 cheese price forecast from \$1.6050 to \$1.5350. That matches a projected \$1.5350 for 2018. Nov 1st cheese in cold storage was 8.2% above a year ago. Cheese production in Oct was up 3.0% from a year ago and year-to-date output through Oct is up 2.5%.

Just in time for the holidays, cream is getting tight. Cream is available on the west coast, but it's stuck there due to high freight rates. But at this point in the holiday season, demand begins to drop and supplies start to build. Butter, at \$2.1850 (12/12) is down from \$2.33 pre-Thanksgiving. Nov 1st butter in cold storage was 5.9% above a year ago even though Oct butter production fell short, 0.3% below 2017 levels. In Tuesday's WASDE, the USDA forecast butter prices to average \$2.2550/lb for both 2018 and 2019.

► Grain

There were minimal changes in Tuesday's (12/11) WASDE report. The USDA said the outlook for 2018/19 U.S. corn is for less corn going into ethanol production, reduced imports, and larger ending stocks. The USDA left its season-average 2018/19 corn price forecast unchanged at \$3.60/bu. Corn futures, at \$3.76 (12/12) are at the high end of a \$3.50-\$3.76 trading range over the past 3 months.

The USDA said the outlook for 2018/19 U.S. wheat is for unchanged supplies, lower exports, and higher ending stocks. World 2018/19 wheat supplies are modestly higher as additional Russian carry-in stocks and a larger Canadian crop more than offset a reduction in Australian production. USDA raised its season-average 2018/19 wheat price forecast by a nickel to \$5.15 per bushel. Chicago wheat futures peaked at \$5.74/bu in early Aug, dropped to \$4.71 in Sept and have since rebounded to \$5.15. Similarly, Kansas City (hard winter) wheat has gone from \$5.86 to \$4.83/bu (12/12).

► Oil

In Tuesday's WASDE, the USDA left U.S. soybean stats for 2018/19 unchanged, with ending stocks record-high at 955M bushels. The U.S. and China have reached a tariff truce, but nothing has changed yet regarding exports. In 2017/18, the U.S. exported 48% of its soybean crop and half of those exports went to China. The USDA made no changes to its soy-oil stats and left its 2018/19 U.S. soy-oil forecast unchanged at \$.30/lb. Soy-oil futures closed at \$.2880 on 12/12. Fundamentals remain bearish for prices and forward futures contracts for 2019 averaging \$.2983.

► Pork

Two export-related factors will set the direction for hog/pork prices in 2019. The first is the new Nafta or USMCA agreement. On Nov 30 in Buenos Aires, Trump signed the new trade deal with Mexico and Canada. It was expected that Trump might use the signing as an opportunity to lift steel and aluminum tariffs on Mexico and Canada and begin living the spirit of the trade agreement immediately, But that didn't happen. The deal still needs to be approved by Congress – so nothing's changed yet and Mexican tariffs on U.S. pork remain in place. Total U.S. pork exports were up 1.1% from a year ago in Oct, but exports to our largest customer, Mexico, were down 2.7%.

The second issue revolves around African swine fever (ASF). China has suffered more than 72 ASF outbreaks, which kills pigs and has no cure or vaccine. Half of China's production is outdoors, on small farms, with little or no biosecurity. China's agriculture ministry just reported (today) two new ASF outbreaks in the Sichuan and Qinghai provinces. How big of a problem is this? China is the world's top hog producer and largest pork consumer. If China lost 17.5% of its pork output to ASF, that volume would equate to all of the pork production in the U.S. in 2017.

Thus, despite tariffs of U.S. pork imports, China (in Nov) placed an order for 3,348 tons of U.S. pork for immediate shipment, and 9,384 tons for next year. U.S. lean hog futures rallied to \$61.03/cwt on the news, but have since settled back to \$54.73 (12/12), about where they were a month ago. Still, the prospects of large exports to China in 2019 is a huge wildcard for prices.

Prices as of 12/11: The 20-23 lb hams at \$.65, up \$.11 from a month ago, have rallied on strong Christmas demand. But, it's all downhill from here. Hams should finish out the year in the low \$.50s. 9-13# derind bellies, which were expected to decline seasonally, at \$2.15 are up \$.11. These days, we can always count on our own industry to take advantage of any dips in the bacon market. Even so, heavy supplies should help bellies finish the year below \$1.90 before bouncing back in Jan. Loin back ribs at \$2.16 are up a nickel but should bottom near \$2.10 in late Dec. 72% lean trim at \$.55 (up \$.08) has rebounded a bit after a big drop in Oct but still looks to be mid-\$.40s by year's end. 42% trimmings at \$.29 (up \$.09) look to be low \$.20s in Dec, mid \$.20s in Jan/Feb.

► Poultry

With the chicken industry in an over-supplied situation, it is increasingly critical for producers to clear excess supplies through export sales. So far, despite retaliatory tariffs from multiple destinations, U.S. export sales are booming. Oct exports of broiler/chicken

products at 670M lbs was the single highest monthly total since Oct 2013. For sure, cheap prices are helping. But growing affluence across the world has also stimulated demand for U.S. protein, particularly pork and chicken. In Tuesday's WASDE report, the USDA raised its broiler export forecast for both 2018 and 2019, with 2018 exports now forecast up 3.9% from a year ago. Total broiler exports in Q3 were up 7.4% from a year ago. The broiler industry will need a little help on trade policy to keep the ball rolling in 2019.

Price quotes as of 12/11: USDA boneless skinless breast at \$.84/lb are unchanged from a month ago and appears to be at a market bottom. BSB looks to trade upper \$.80s in Dec but not get back above \$1.00 until Feb. Leg quarters at \$.28 are up a penny and look to be trending higher through Q1. BS thighs at \$1.16 are unchanged from last month but could finish the year as high as \$1.30. USDA whole wing markets at \$1.33 are down \$.14 – unheard of at this high-usage time of year. Look for wings to be \$1.55 by year's end and to peak near \$1.70 in late Jan ahead of the Super Bowl.

► Produce

Romaine and e-coli had their 3rd hook-up for 2018. While contaminations are believed to have occurred in Oct, the CDC responded on 11/20 by advising all consumers, retailers and restaurants to toss out any products containing Romaine. As recently as last Thursday, CDC reported 9 more cases. All told, there have been 52 e-coli/romaine cases in 15 states since Oct, and dozens more in Canada. Consumer confidence in the product is shattered. Demand/prices for all alternatives – Iceberg, bib lettuce, baby spinach, arugula, etc - are sky high as a result. *Prices as of 12/11:*

Avocados – MX Hass 2-layer cartons 32s-36s \$25.75; 40s-48s \$24.25; 60s-70s \$23.25; 84s \$18.75

Broccoli – AZ cartons bunched 14s \$22.55

Lettuce – AZ Iceberg 24s \$50.60; Romaine 24s \$18.96; Boston 24s \$43.53; Green Leaf \$52.33; Red Leaf \$52.33

Onions – WA Yellow Hybrid 50# sacks jumbo \$4.75; medium \$5.50

Peppers – MX Bell green 1 1/9 bushel cartons exlge \$18.95; lge \$16.95; med \$12.95

Potatoes – ID U.S. Russet Burbank 10 5-lb Bag "A" 50s \$8.50 60s-70s \$9.00; 80s \$8.75; 90s-100s \$8.50

Strawberries – FL 8 1-lb with lids med \$25.90

Tomatoes – MX 2 Layer Vine Ripe 4x4 \$23.95; 4x5 \$23.95; 5x5 \$21.95; 5x6 \$21.95

Freight – AZ truck quotes as of Tues 12/11 Atlanta \$4350; Chicago \$4200; Dallas \$2900; NY \$6650