

Bellies Are a Whole New Animal

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By Dennis Smith

Of course bellies are not an animal. That's not what I mean. I'm referring to the "new demand curve" for bacon and its impact on fresh belly prices and more importantly the impact on hog prices.

Starting from the beginning, bellies are taken from the lower part of the hog carcass, typically the fatter portion of the meat carcass. Whereas the pork loin, lean and much less fatty is located on the high side of the back. Now you know where the saying "living high on the hog" comes from. However, as bellies are smoked and cured the aroma and taste is delicious.

Years ago there was a pork belly futures contract. This was a frozen belly contract. Back then the seasonality of bacon demand was extremely seasonal. Bellies would be frozen and stored in warehouses during the fall and winter months when pork production was high and bacon demand was low. Then, in the spring and summer season pork production would taper off and bacon consumption (largely through the BLT sandwich) would increase. Thus, during the summer, bellies would be pulled out of storage. The belly contract was a useful hedge vehicle for commercial users and a popular speculative vehicle for traders looking for profit. In the late 1990's the demand for bacon began to change. The seasonality of consumption began to flatten out. Basically, demand was becoming more constant. This killed the frozen belly contract as a commercial hedging tool. Volume and open interest dried up and the belly contract was delisted.

Pork belly demand, (bacon demand) has been improving during the years. In my opinion one of the largest drivers of increased bacon demand has been the fast food restaurant outlets. First it was a successful launch of serving breakfast. This was a new concept in the fast food industry. Next came the invention of putting bacon on burgers, which quickly gained widespread popularity. Recently the fast food outlets have turned to an all-day breakfast menu. Bacon popularity has been increasing in other food consumptive areas such as in the foodservice industry. Bacon is now featured on nearly everything, especially salads, but also on desserts. High end restaurants also now feature bacon on their menus. There's only one reason they do this...bacon sells.

In the fourth quarter of last year, we experienced something in the belly market NEVER experienced before. Belly stocks were drawn down in the fourth quarter. What makes this incredibly remarkable is the fact that pork production in the fourth quarter was record large. In addition, the resulting surge in belly prices has continued during January and most of February. As of this writing fresh belly prices are trading at their 52-week high. I contend this not only portrays an increase in the demand curve for bacon, but it also likely means a steeper demand curve for bacon. What I'm referring to is the elasticity of demand for bacon. Simply put, a steeper demand curve for bacon means it will take larger increases in prices (than in the past) to ration supply or curb consumption. Basically, what I'm saying is that old time hog fundamental guys,

and belly traders, need to forget everything they know or thought they knew about pork bellies because we're dealing with a whole new animal!!!

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