VOLUME 3, ISSUE 2
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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

FEBRUARY 2020

Just when things were starting to look bullish in the hog complex, along comes the coronavirus outbreak in China. This development has changed the calculus for US hogs and pork dramatically. With the "phase one" trade deal now signed and due to go into effect on February 15, there were hopes that China would accelerate its purchases of US pork and help lift price levels across the complex. The emergence of the coronavirus has forced China to implement travel restrictions, quarantines and an extension of the Chinese New Year in an attempt to control the spread of the disease. Foodservice business in China has been hit hard since citizens have been told to stay home if possible. There have been reports of congestion at Chinese ports due to workers staying home out of fear of the virus. With ships backing up waiting to unload, it was inevitable that Chinese pork buyers would slow their purchases of North American pork. That was really bad news for the US pork industry which had ramped up production in anticipation of huge shipments to China. The impact was felt first in the cutout, which had been trading in the high $70s in late January but has fallen over $15/cwt in just three weeks. Eventually the cash hog market came under pressure as well. In previous issues of the RMO, we raised a caution flag because US pork industry was becoming dependent upon big, continuing exports to China and that put the industry at risk if the Chinese business suddenly declined. Of course, most observers would have argued that due to African Swine Fever (ASF), the China business would remain solid for months, if not years, and would probably keep expanding. No one imagined a human disease emerging that would slash Chinese demand, but that is exactly what has transpired. It is a painful lesson that there are always black swans lurking and nothing in commodity markets is ever "for sure."

> December US pork exports
> **up 29%** YOY

SUPPLY PICTURE

Even before the coronavirus outbreak, the US hog and pork industry was dealing with huge pork production. Near the end of January, packers posted a 2.7 million head weekly kill, which was much larger than expected and way above what the Jun/Aug pig crop suggested. In fact, kills for most of the Dec-Feb period have been running larger than expected and it looks as though when this quarter ends on the last day of February, the industry will have killed close to 1.2 million more hogs than what was reported for the Jun/Aug pig crop. **Figures 1 and 2** provide a look at the weekly over/under kill in the Dec/Feb quarter and the cumulative total. USDA definitely underestimated that pig crop and will undoubtedly revise it higher in their next Hogs and Pigs report on March 26. At first, that didn't seem to matter much as price levels remained strong in December and January due to large exports to China. The pork cutout averaged $6.50 over last year during the Dec-Jan period even though pork production was almost 11% higher than the year prior. But now, with China pulling back due to the coronavirus problem, that big production is really weighing on both the hog and pork markets.

Carcass weights were also heavier than last year and that added to pork production. The winter has been uncharacteristically warm and that helped hogs to gain at a slightly better-than-expected rate. Even though hogs are raised indoors, those buildings must be heated in winter and milder winters make that task easier and thus hogs can gain weight slightly faster when it's not really

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cold outside for long stretches. That said, producers seem to have done a pretty good job of marketing hogs on schedule as fat packer margins encouraged them to keep slaughter levels high. However, we fear that producers may now be starting to fall behind. The de-trended and de-seasonalized weights that we watch as an indicator of timely marketings has crept higher in recent weeks and thus the danger of a backlog developing has increased. Reduced movement of pork to China because of the coronavirus has the potential to make that situation worse. This bears watching in the weeks ahead, more so for the hog market than for pork, because when producers fall behind in their marketings, packers have more price leverage and can force hog prices lower.

It is important to keep in mind that all of the hogs that will be slaughtered in the next six months are already born and in the barn. The production pipeline has been set at least through June and nothing can be done to change that. Given that USDA under-estimated the Jun/Aug pig crop, we now have to wonder if they also under-estimated the Sep/Nov pig crop. If they did, then we could easily see larger-than-projected hog supplies into early summer. Further, no one knows how long pork movement to China will be slowed due to the outbreak, but as long as it's happening, price levels in the US will be depressed in order to clear the excess production. Our best estimate is that it will take at least a month before China is able to get back to the level of US pork imports that it was taking prior to the disease outbreak. But don't be surprised if it takes longer.

DEMAND SITUATION

Domestic pork demand is difficult to gauge because we are unsure of how much pork is actually flowing to China at present. One thing that we watch in our shop is how the daily pork cutout price relates to the number of loads sold that day. This is a very short-run estimate of domestic demand, but recently it has declined to a relatively low level (see **Figure 3**). Domestic pork buyers can sense that with China in a state of flux, packers will have a lot more pork to dispose of in the domestic market and thus they tend to bide their time and wait for prices to fall further before making purchases. Thus, domestic demand shows up weak and price levels decline. There is danger in this strategy however, because if China suddenly starts to increase their purchases, those short-bought domestic buyers will likely panic and send pork prices rapidly higher as they seek to cover needs they probably should have covered earlier. But as long as the coronavirus outbreak continues to expand, it is reasonable to assume that US pork buyers will stay relatively short-bought as they wait for prices to move even lower.

International demand remains a bright spot for pork. The December export numbers were released last week and they showed a whopping 29% YOY gain. That comes on the heels of a 21% gain in November. Purchases by China surged in December to 229 million pounds—by far the largest monthly total ever to China. Now we know why the cutout averaged close to $80 during December, one of the largest production months of the year. This has given traders hope that once the coronavirus outbreak starts to recede and economic activity in China returns to normal, that exports to that destination could surge to unprecedented levels. They could very well be right. The December export numbers were stunning and if China were to buy at those levels or higher in the summer when hog supplies are much tighter, then US price levels could soar. Of course, all of that is dependent upon getting the coronavirus situation resolved and at the present, that seems like it could be a long way off.

> The Pork cutout **falls $15 /cwt** in just three weeks

SUMMARY

The US hog and pork complex has been rattled by coronavirus outbreak in China. Demand for pork in China has been curtailed by restrictions on travel and citizens being sequestered at home in an effort to contain the spread of the disease. China has been the engine that has helped the US industry plow through very large production without much price concession. Hog slaughter in the US has been running well above what prior pig crops projected and there is risk that will continue into spring. A timely resolution to the coronavirus problem in China will be necessary in order to lift price levels going forward. Prior to that disease outbreak, China was taking very large quantities of US pork and there is hope that export volumes will surge above that level when life gets back to normal in China after the coronavirus outbreak recedes. For now however, there is much uncertainty and price levels are depressed. Buyers might be wise to use this opportunity to extend coverage into summer in case the coronavirus issue fades and export to China surge. **Table 1** provides our near-term price forecasts.

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Figure 1: 2020Q1 Hog Slaughter Over/Under Pig Crop Projection

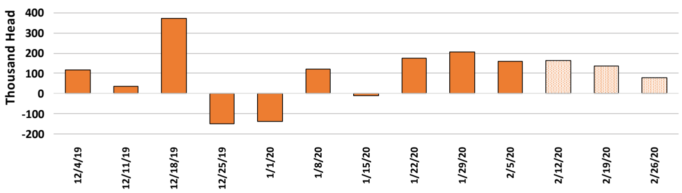

Figure 3: Short-Run Pork Demand

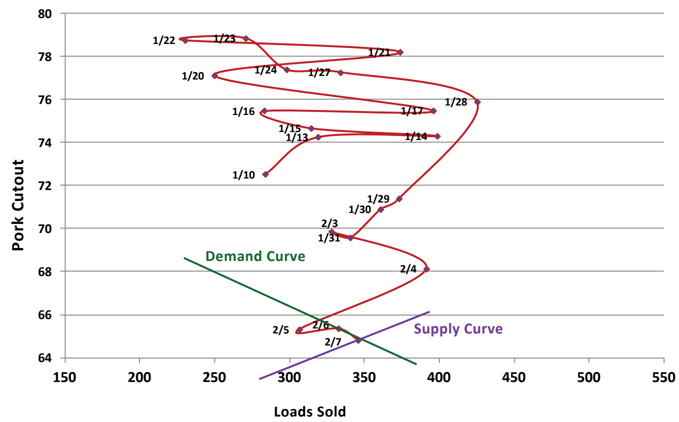

Figure 2: 2020Q1 Cumulative Hog Sltr Over/Under Pig Crop Projection

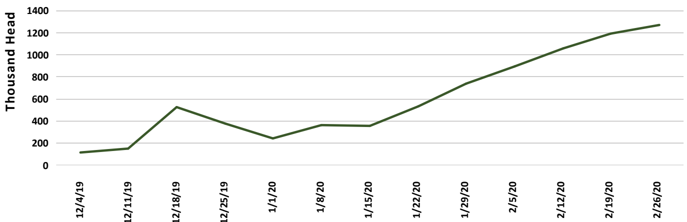

Table 1: JSF Hog and Pork Price Forecasts

	19-Feb	26-Feb	4-Mar	11-Mar	18-Mar	25-Mar
Pork Cutout	68.7	71.2	74.1	76.3	76.4	76.5
Loin Primal	67.2	67.4	68.0	68.8	69.7	70.4
Butt Primal	69.5	70.3	72.6	74.4	75.7	77.8
Picnic Primal	47.3	46.1	45.5	45.0	43.9	44.3
Rib Primal	141.5	142.0	144.0	146.8	148.0	145.8
Ham Primal	57.7	60.8	63.1	65.0	65.3	64.2
Belly Primal	96.6	108.0	120.4	128.9	127.0	127.3
Lean Hog Index	59.4	61.8	63.4	65.3	66.5	67.5

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