VOLUME 3, ISSUE 6
EN | FR | ES

J.S. FERRARO

THE MONTHLY

JUNE 2020

RED MEAT OUTLOOK: HOGS & PORK

Pork packers have invested a lot of money into the effort to stop the spread of COVID-19 in their plants and keep their workers safe. That investment seems to be paying off as the number of infections among plant employees has fallen and plants have been able to increase production to almost the level it was at before the crisis began. Predictably, the pork cutout has declined rapidly as production increased and now looks like it is headed to the mid $60s in the near-term. That takes a lot of pressure off of pork buyers who were struggling just a couple of weeks ago when the cutout topped out at $122. It hasn't done much to help hog producers, however. During the period when COVID-19 was rampant inside plants, kills were cut nearly in half that that caused a lot of hogs to become backed up in the pipeline. By our estimate, the industry under-killed the pig crop between March and May to the tune of about 3.6 million head (**Figure 1**). What became of these hogs? Well, a small number were euthanized but the majority were put on low energy diets to help slow their weight gains while slaughter facilities were closed. A large proportion of those backlogged hogs are still alive and awaiting their turn at the slaughter plant. Packers saw margins soar to over $100/head during the period when plants were closed, but now that the cutout is falling, those margins are back down to about $35/head (**Figure 2**). That is still a very good margin for packers in the summer when margins often go negative. So, there is plenty of incentive for packers to push as many animals through the packing plants as they can. As long as there remains a large number of backlogged hogs in the system, hog producers will have very little ability to affect cash hog prices. As the cutout sinks lower, it is a good bet that packers will put downward pressure on hog prices in order to preserve their margins.

> With more than **3 million hogs backlogged**, pork supplies should be abundant this summer

SUPPLY PICTURE

At the nadir of the plant closings back in late April, packers were only able to kill about 1.5 million hogs per week. This week, it looks like hog slaughter will be close to 2.5 million. So, there has been a remarkable recovery in the packing sector over the past six weeks. We know that the industry can kill as many as 2.8 million head per week when it is firing on all cylinders since we saw them accomplish that last December. Fortunately for producers, kills are naturally smaller in the summer and that will leave a little headroom in packing capacity to help clear out some of the backlogged hogs. We think that it is possible that at some point later this summer packers will put together kills close to 2.7 million head per week. Of course, that will put a lot of pork on the market and likely keep price levels depressed. Cutout levels could dip into the $50s, and possibly $40s, as the increased pork production works its way through the system. Clearly, this is not going to be a normal summer in terms of pork pricing.

Hog weights normally decline into summer as warm temperatures depress hog appetites. However, with the backlog that exists this summer, weights are not likely to decline in a normal seasonal fashion. Carcass weights have moved counter-seasonally higher during this period of COVID-related plant slowdowns. That adds to production and will further weigh on pork prices. It could take months to clear the backlog of hogs and weights will likely remain higher than normal while that occurs. It is almost inevitable that more hogs will have to be euthanized since even if packers manage to kill 200,000 head more per week than would normally be ready at this time of year, it would take too many weeks to erase a backlog of over three million hogs. In the interim, hog prices

jsferraro.com | 130 Adelaide Street West, Suite 810 Toronto, Ontario M5H 3P5 | 416.306.8788

could get really low—maybe even dropping below $20/cwt in the negotiated markets at some point later this summer.

All of this has been financially devastating for independent hog producers who were not hedged coming into the crisis. Government programs have provided some aid to hog producers but it is not nearly enough to make them whole. And, the financial pain is not over yet. As a result, we are likely to see some producers go out of business and others scale back their operations. That will result in much tighter hog supplies in the distant future, but it will not help producers today. USDA will issue its next quarterly *Hogs and Pigs* report on June 25 and we expect it to show the first decline in the hog breeding herd in over five years. This may be the first in a series of herd contractions that leaves us with a much smaller production sector a year from now.

DEMAND SITUATION

Over the past couple of months, domestic pork demand has been swinging wildly. It was sharply higher during the period when consumers stockpiled meat, then it was sharply lower as stay-at-home orders hobbled the foodservice industry. Next, it was red-hot again as COVID infections closed packing plants and sent buyers scrambling to find product. Now, demand is falling again as production increases and buyers step back and wait for the market to fall further. What a roller coaster ride this has been. Assuming that the worst of the COVID-induced problems are behind us, the market will now have to deal with its aftermath. In the case of domestic pork demand, that aftermath involves huge numbers of unemployed workers and a restaurant segment that is open but only operating at a fraction of its pre-COVID level. We think that means pork demand will be soft for the foreseeable future unless infections surge again inside packing plants and force another round of closures. With demand expected to be softer-than-normal and supplies expected to be larger-than-normal as the industry works through the backlogged hog supplies, the stage is set for weak hog and pork pricing over the next several months.

Last year at this time, the industry was laser-focused on ramping up production to meet huge demand coming from China. Producers were confident that prices would be high and profits would be good for years. Not so now. The China story has been all but forgotten amid the COVID-19 pandemic. There have been rumors that China is ordering its state-owned enterprises to halt purchases of US pork and soybeans. No evidence of that has shown up in the data yet, but if it were to occur it would be devastating to the industry. The recent weekly export data has shown pork exports in decline, notably to countries other than China. As a result of the soft signals coming from the export market, we have dialed back our expectations on 2020 pork exports to +14% from a year earlier. You may recall we started the year at +25% and there were others in the industry projecting 40-50% YOY increases in pork exports. Producers are now learning the dangers of unbridled expansion on the hopes of incredibly large exports.

> Pork **export interest has cooled** and 2020 exports are now expected to **increase only 14%** over last year

SUMMARY

The packing sector has managed to get its COVID infection problem under control in amazingly short order. Kills have ramped back up almost to pre-virus levels. As a result, production has increased rapidly and pushed the cutout sharply lower. The large kills will need to continue for several months to help clear the backlog of hogs in the pipeline. Packers are in control and will likely maintain very wide margins throughout the summer by pushing cash hog prices lower as the cutout falls. Pork buyers should remain close bought in this situation, but remain alert for a potential resurgence in the virus and possibly a return to plant closures in the future. The hog industry will necessarily undergo some downsizing in the months ahead as producers struggle financially. That will impact pricing and availability in 2021, but won't help stop the near-term slide in prices. The demand side in the next few months will be colored by high unemployment and tepid consumer interest as a result. **Table 1** provides our near-term price forecasts.

Figure 1: Q2 Hog Slaughter Shortfall by Week

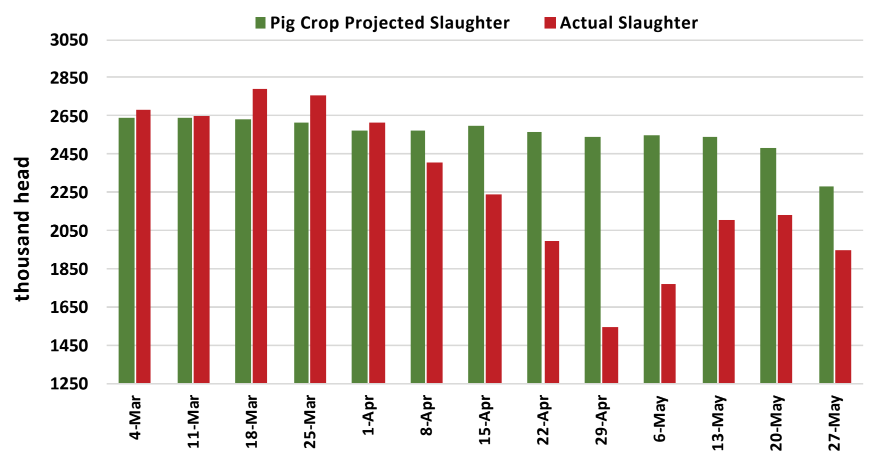

Figure 2: Packer Margin

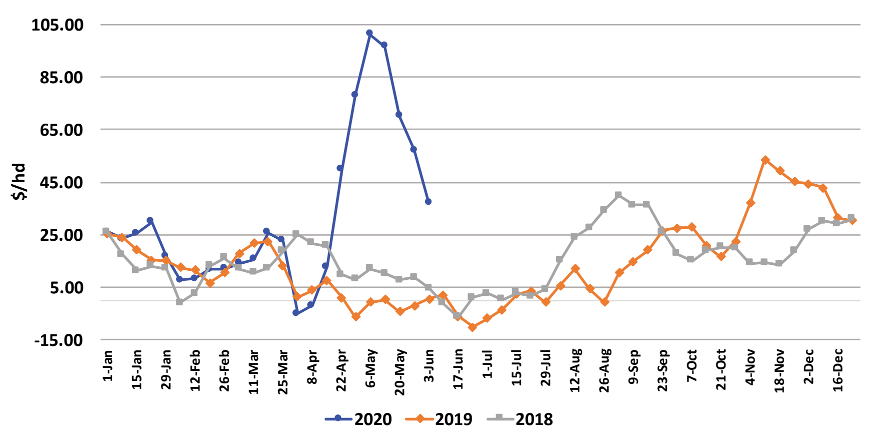

Table 1: JSF Hog and Pork Price Forecasts

	17-Jun	24-Jun	1-Jul	8-Jul	15-Jul	22-Jul
Pork Cutout	68.5	65.9	65.1	62.6	62.9	61.9
Loin Primal	82.8	78.7	77.0	75.1	76.9	77.0
Butt Primal	62.1	58.8	60.8	62.7	63.0	60.4
Picnic Primal	46.2	47.0	50.9	45.3	42.2	43.0
Rib Primal	118.5	121.9	115.4	111.3	108.0	109.2
Ham Primal	52.4	51.2	49.3	49.0	49.3	48.4
Belly Primal	102.0	95.2	93.0	85.0	86.2	82.3
Lean Hog Index	49.0	46.1	48.0	47.4	48.6	49.0

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.