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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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The rapid spread of the COVID-19 virus across North America has impacted the hog and pork markets in a huge way. It has dominated the markets over the past month, pushing aside any hopes that North American producers had of capitalizing on the African Swine Fever (ASF) outbreak that has halved China's hog herd. Stay-at-home orders across much of North America have decimated the foodservice industry and sent consumers scrambling to stockpile meat at home. That stockpiling began in earnest in mid-March, shortly after the World Health Organization (WHO) declared the COVID-19 outbreak a global pandemic. Grocery store meat cases were stripped clean of not only pork, but all animal proteins. That sent grocers scrambling to replenish and sent the pork cutout roaring higher, gaining about $17 over the last three weeks of March.

> The pork cutout shot **$17 higher** as grocers sought to replenish **after consumer stockpiling cleared supermarket shelves**

The stockpiling by consumers has now ended and the cutout has fallen precipitously in recent days. The hardest hit primals have been those that have a heavy foodservice exposure, such as bellies and ribs. Packers are struggling to shift production from products packaged for foodservice toward those used in the retail trade. As the cutout has retreated in recent days, packer margins have remained intact as cash hog prices have been pushed rapidly lower. This is a period of major adjustment, unlike any the industry has experienced before, and that uncertainty has sent hog futures plunging lower. Currently, the futures are pricing June hogs below the $50 mark, which is an incredibly low value for hogs during a time of year when prices are normally at their highest. Futures traders greatly fear a situation where COVID-19 could force the closure of one or more large pork packing plants. Should that happen, cash hog prices would plummet and pork prices would likely rise rapidly.

SUPPLY PICTURE

In late March, USDA released its quarterly *Hogs and Pigs* report, which showed that Dec/Feb pig crop was 4.7% larger than the previous year. That huge increase in the pig crop comes on the heels of huge increases during 2019 and guarantees that pork production this summer (which is when the Dec/Feb pig crop comes to slaughter) will remain well above last year. The last year-and-a-half of rapid expansion was brought about by hopes that the ASF crisis in China would greatly boost China's demand for US pork and thus, cause sharply higher price levels in US markets. The futures market fed this fire by remaining at extraordinarily high levels for much of 2019. Economists refer to this phenomenon as a "supply response" which simply means that if the market promises strong returns for a long enough period, then producers will expand production in anticipation. The risk created by this situation lies in the potential for something to change the landscape before the original impetus (China's ASF problem) has time to bear fruit. That is exactly what has happened with the emergence of the COVID-19 pandemic. Suddenly, the market has jettisoned the ASF bull story and begun to focus on the COVID-19 bear story. Futures markets have tanked and are no longer offering positive profits to producers, yet their die has already been cast in the form of a pork production pipeline that is stuffed full for at least the next six months.

> **USDA estimated** the Dec/Feb pig **crop up 4.7%** – ensuring ample pork supplies this summer

Adding to the problem is the fact that USDA appears to have grossly under-estimated prior pig crops and the number of hogs coming to slaughter this spring has way out-paced what was expected given those prior estimates. Hog slaughter during March averaged 11% over last year and we think that slaughter in April could

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be 5-6% greater than last year, or more. That is a lot of pork that needs to find a home in this new environment where consumers have retrenched, job losses have soared, and the economy is in a recession. Looking forward to summer, it is unlikely that weekly hog slaughter will drop much below about 2.45 million head per week in non-holiday weeks. It wasn't that long ago that the industry routinely saw kills drop into the 2.1-2.2 million head per week range during the summer. So, this summer is shaping up as one of abundant pork supplies and there is nothing that producers can do at this point other than market their way through this problem at prices well below last year's levels.

It does seem that producers are finally getting the message and if they are not, then the very depressed levels of deferred futures contracts will drive the point home. It is time to stop expanding and start contracting the breeding herd. In the most recent report, USDA estimated that the US breeding herd was up only 0.4% after several quarters of 1.5-2.5% increases. Producers accomplished this slow rate of growth by sharply curtailing the number of gilts that they held back as breeding stock during the Dec/Feb quarter. The numbers show that gilt retention in Dec/Feb was more than 9% below last year (**see Figure 1**). This big shift from rapid expansion toward almost no expansion will eventually slow the flow of hogs to market and support price levels, but not until late in the year. Between now and then, the hogs will keep coming to slaughter at a huge rate and prices will struggle.

DEMAND SITUATION

After months of focusing on the demand implications arising from overseas, now demand in the domestic markets have taken center stage. Chief among these is how the industry will handle the seismic shift of demand away from the foodservice sector and into retail channels. So far it is not going well for primals such as bellies, which have a high foodservice exposure and where foodservice packaging is not consistent with what is needed to market bacon at retail. Last week the belly primal averaged $35.93, by far the lowest value placed on bellies in the last 20 years (**see Figure 2**).

> Last week the belly primal averaged **$35.93 – lowest value** placed on bellies **in the last 20 years**

Hams are also struggling because retail needs require ham sliced and packaged as lunch meat but product being shifted out of foodservice applications is not very amenable to that transition. On the other hand, fresh retail cuts such as loins and butts have fared much better, with both primals skyrocketing during the consumer stockpiling panic a few weeks back. In the end, we think that the consumer shift toward more retail-purchased pork will be positive for pork demand (since the per-bite cost is much lower for home prepared meals), but this period of transition is likely to be painful and involve sharply lower pricing.

The recession that is now gripping the global economy will also have a negative effect on pork demand, but it is probably not as detrimental as it will be to beef demand due to pork's lower price point. Still, with unemployment soaring and millions of workers joining the ranks of the unemployed weekly, it is hard to imagine that some retrenchment in pork demand can be avoided. We have scaled back our expectations on pork demand for the balance of 2020 as a result. The weekly data on US pork exports continues to indicate good demand from overseas, particularly China. It is encouraging that exports to China held up well as that nation went through the initial waves of the COVID-19 pandemic. Now that price levels in the US are much lower, it greatly increases the odds that China's purchases of US pork will expand. The forecast for other destinations is not so rosy, however. Movement to traditional destinations such as Mexico, S. Korea and Japan is threatened by economic slowdowns in those nations. We still think US pork exports will be up double digits in 2020, almost entirely as a result of Chinese purchases. But we are now questioning whether or not that will be enough to offset big domestic production and the loss of demand in North America as it too falls into recession.

SUMMARY

The hog and pork industry has never before faced a challenge like this one, at it comes at the worst possible time after the industry has expanded enormously in recent years. Producers have begun to realize that it is time to scale back production, but that will take many months before it is able to have an impact on price levels. Between now and then, the industry will have to deal with the demise of foodservice business and the surge in demand from the retail sector. There still remains a very large risk in the next several weeks that one or more packing plants will be forced to shutter due to COVID-19 infections. If that happens, hog prices will tank and pork prices will shoot higher. Users should consider forward booking some portion of needs into June as a hedge against the risk of rapidly rising pork prices should plants begin to close. With futures prices so low currently, those forward offers should be at very attractive levels. Near-term, expect the pork market to remain unsettled as the industry transitions toward products packaged for retail and away from foodservice applications. It is very challenging to forecast price levels in this uncertain environment, but we gave it a go and **Table 1** provides our near-term price forecasts.

Figure 1: Number of Gilts Added to the US Breeding Herd

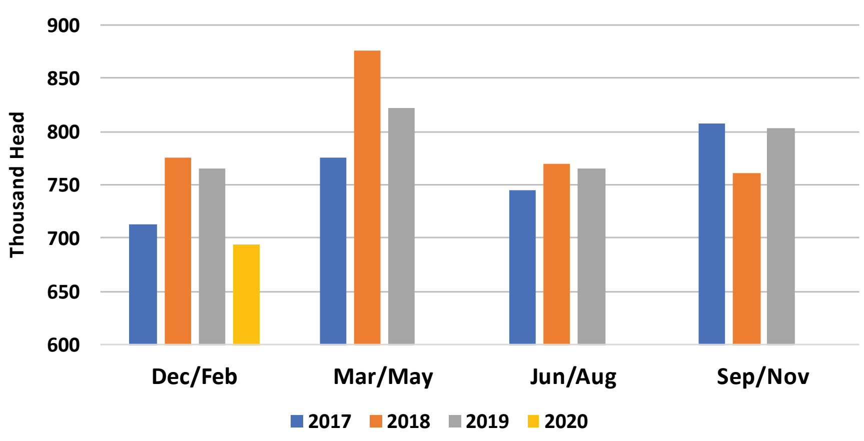

Figure 2: Belly Primal, Weekly Avg Price

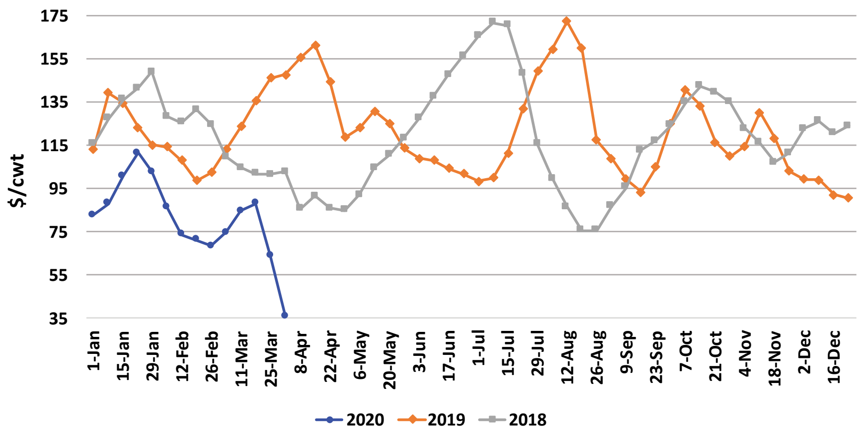

Table 1: JSF Hog and Pork Price Forecasts

	15-Apr	22-Apr	29-Apr	6-May	13-May	20-May
Pork Cutout	65.1	68.3	71.9	72.6	74.5	77.2
Loin Primal	90.4	92.0	91.2	88.4	89.0	88.0
Butt Primal	84.0	86.0	90.0	91.1	89.6	91.4
Picnic Primal	48.0	51.1	50.2	51.3	52.6	54.7
Rib Primal	110.0	112.0	118.0	120.0	119.3	121.0
Ham Primal	32.0	35.0	46.3	47.9	50.8	58.4
Belly Primal	72.2	81.4	83.9	88.7	95.6	99.0
Lean Hog Index	51.0	53.3	56.4	58.1	61.4	64.9

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