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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

DECEMBER 2020

Price levels softened somewhat in the US hog and pork complex during November, after coming off a red-hot market in October. As we enter December, the pork cutout is trading in the high $70s and the negotiated cash hog markets are in the high $50s (see **Figure 1**). We calculate last week's packer margin to be about $20/head, which is well below what packers have received in recent years at this point in the calendar (see **Figure 2**). Packer margins are often directly related to the number of hogs available relative to the amount of packing capacity. That would suggest that the supply of hogs is currently snugger than normal for this time of year. It wasn't all that long ago that analysts were fretting over a huge backlog of hogs that was expected to swamp the market this fall. Packer margins are telling us definitively that there is no longer a problem with backlogged hogs. Although pork exports remain fairly strong, domestic pork demand has been on the defensive over the past few weeks and we suspect that is the result of retailers reducing the amount of pork in their ads during November due to very high wholesale pork prices during October. That softer domestic demand is probably the most important factor in why the cutout worked lower during November and now sits in the high $70s rather than the high $90s that were observed back in October.

SUPPLY PICTURE

The industry is currently in the midst of the largest kills of the year. For the three-week period leading up to Thanksgiving kills averaged right at 2.7 million head per week. This week could see another 2.7 million head kill. However, kills never quite lived up to what USDA's estimate of the March/May pig crop. Now that the Sep/Nov quarter is complete, we calculate that slaughter during the quarter came in about 750,000 head less than what the March/May pig crop indicated. We suspect that USDA will revise their estimate for that pig crop lower when it releases the next issue of *Hogs and Pigs* on December 23. The initial estimate for the March/May pig crop was up 1.4% YOY, but in light of the slaughter levels observed this fall, a more realistic estimate would have been down 0.8%. That equates to a 2.2% over-statement of the March/May pig crop, but is well within the normal range of error for the survey that underpins the estimate. Too be fair, there was a lot of turmoil during the March/May quarter due to the COVID-19 pandemic so it might not be all that surprising that the survey missed the mark. Also, it is entirely possible that some pigs that were reported on the survey as having been born during the March/May quarter might have actually been euthanized when slaughter plants shutdown last spring and thus that could explain why this fall's slaughter was so much under the survey estimate.

> USDA appears to have **over-estimated** the March/May pig crop by about **750,000 head**

As we head into the Dec/Feb quarter, the industry will be killing hogs that were born during the Jun/Aug timeframe. USDA has estimated that pig crop to be down 3.4% YOY. That means that in the weeks and months ahead, the number of hogs available for slaughter will be significantly below last year. That should keep hog and pork prices elevated above last year's level and may also result in packer margins that are tighter than normal in Q1. When the industry expanded packing plant capacity in 2019, it was with the assumption that hog supplies would continue to grow year after year. Clearly that is not the case as we begin 2021 and thus the packing industry will have to scramble a little harder to fill the expanded slaughter capacity. That tightness in the hog supply could very well continue into Q2 since we expect USDA to report the Sep/Nov pig crop down 3-4% again when it releases its next *Hogs and Pigs* report.

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However, the number of animals going to slaughter is only part of the equation for determining how much pork will be available. Carcass weights are the other important variable. Last week, USDA reported barrow and gilt weights up 4 pounds YOY, a 2% increase. That means that the YOY decline in hog slaughter is being almost fully offset by the increase in carcass weights to produce weekly average pork production very close to last year. The data also indicate that packer-owned hogs are much heavier than producer-owned hogs and it has been that way for much of the fall. That should provide some support to the negotiated hog market since it seems that packers are the ones behind on their marketings, not producers.

DEMAND SITUATION

When we observed abnormally high pork pricing back in September and October, our working theory was that the market was being supported by strong export movement. We now have the official export data for September and it showed pork exports up 17.2% YOY, so we feel there was some validity to that theory. The official data for October will be released in a few days and we expect it to show exports up at least as much as in September, if not more. However, the export totals for November and December will have a hard time matching the very large numbers that were posted last year. If our Q4 export forecasts are close, then total exports for 2020 should be up somewhere in the neighborhood of 15% YOY. China is still importing large amounts of US pork, but that is likely to be dampened beyond the mid-December cutoff for shipping US pork in order to arrive in time for the Chinese New Year. China is aggressively rebuilding its hog herd and that has already shifted their import focus away from US hogs and more toward US corn and soybean meal. We think that the rapid expansion in the Chinese herd will curtail their need for US pork in 2021 and thus US sellers will need to find alternative destinations for pork that would have once been headed for China. Our current forecast calls for a 3.1% decline in pork exports next year.

2020 pork exports are projected to **be up 15%**, but **China is expected to pullback in 2021** as their hog herd rebuilds

Domestic pork demand has been softening since late October. We can see this most easily in the combined margin chart presented in **Figure 3**. We use the combined producer+packer margin as an indicator of demand strength under the idea that when demand is strong, it allows for more margin to both players in the supply chain. It is clear from **Figure 3** that the combined margin tends to run in cycles that last about 2-3 months and the industry is currently in the downward leg of that cycle. Also note that it is very rare for the cycle to turn higher without falling below the zero line. The current combined margin is still positive and that makes us think that this softness in demand still has another 2-3 weeks to go before we start to see it turn higher. That would put the next demand improvement beyond the expiration of the Dec futures contract, so traders that are long hoping for a demand surge to occur before expiration are likely to be disappointed. However, once the next upcycle in demand begins, it will likely run through January and February and we've already noted that hog supplies will be tighter than last year during that period. By combining tighter supplies with an improving demand outlook during Jan/Feb, this points to the potential for significantly higher pork pricing early in Q1 than buyers experienced last year. It would make sense for buyers to use the cash market softness in the next couple of weeks to extend coverage through at least the first half of Q1.

SUMMARY

The US hog and pork complex is currently in a good state of equilibrium. The cutout seems to be holding well in the upper $70s and cash hog prices are well above last year. Supplies this fall failed to meet the expectations set by USDA's March/May pig crop and that pig crop estimate will likely be revised lower. Poor producer profitability in 2020 has now manifest in a downsizing of the hog herd and there will likely be fewer hogs available during the first half of 2021 compared to this year. The industry is now on the cusp of transitioning into those smaller supplies. Barring any significant collapse in demand, the tighter supply situation is likely to result in stronger pricing during Q1 than we saw last year. Buyers would be wise to take some Q1 coverage sooner rather than later. Export business has been good this fall, but China is likely to pull back near the end of the year and that may leave a little more product available for domestic consumers. We don't foresee much additional weakness in the cutout over the next few weeks and expect that it will be moving higher again by the time January arrives. **Table 1** provides our near-term price forecasts.

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Figure 1: Western Cornbelt Cash Price

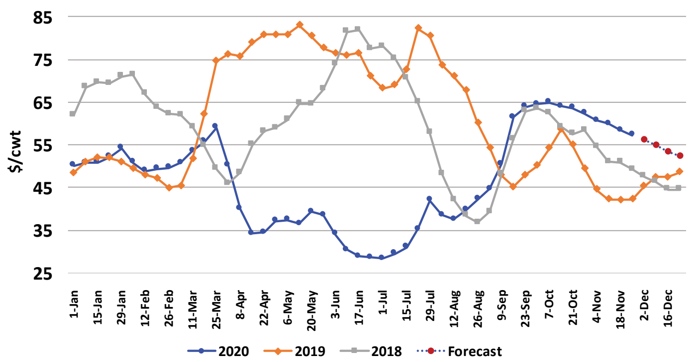

Figure 2: Packer Margin

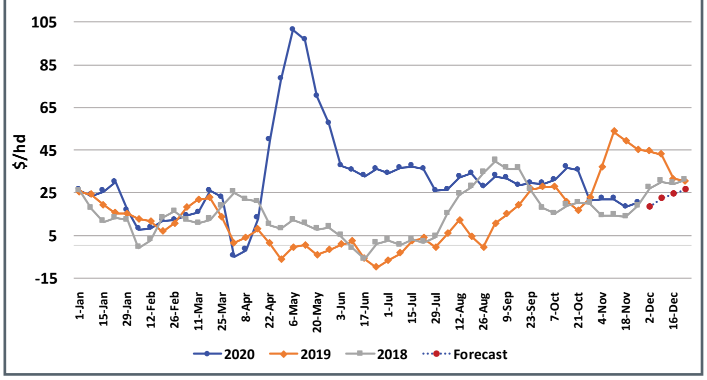

Figure 3: Pork Supply Chain Margins

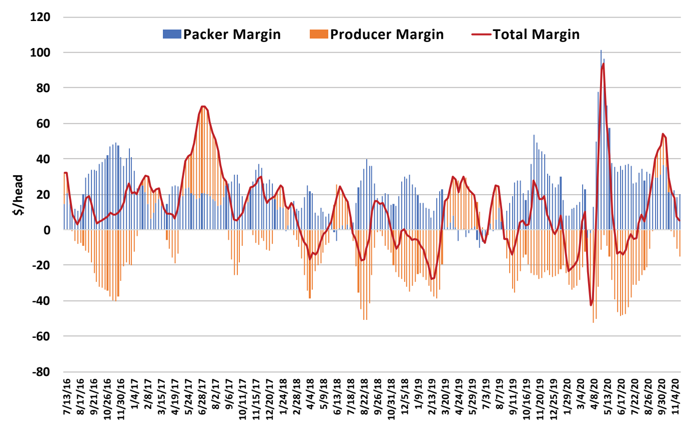

Table 1: JSF Hog and Pork Price Forecasts

	9-Dec	16-Dec	23-Dec	30-Dec	6-Jan	13-Jan
Pork Cutout	77.3	76.7	76.9	78.1	80.4	81.4
Loin Primal	72.8	74.3	74.2	75.8	76.3	77.1
Butt Primal	78.8	81.5	81.0	79.9	82.1	84.9
Picnic Primal	66.0	64.3	60.8	58.3	60.1	61.5
Rib Primal	135.6	131.5	129.6	130.9	134.4	138.5
Ham Primal	74.3	70.6	68.7	72.2	71.8	68.4
Belly Primal	95.4	96.0	103.9	106.0	116.6	123.0
Lean Hog Index	65.1	63.5	62.6	64.1	67.8	70.0

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