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THE MONTHLY
RED MEAT OUTLOOK: HOGS & PORK

JANUARY 2021

Both the cutout and cash hog prices worked lower throughout December, but the market now appears to be on the cusp of turning higher. The futures market certainly thinks so, given that it is pricing the February contract near $70 while the Lean Hog Index is hovering around $60. With the backlog of hogs now a distant memory, the market is now operating in more typical fashion and price levels are reflecting that. The main question that faces market participants now is how fast, and for how long, the next uptrend in the cash market will last. The answer to that question hinges on the behavior of the cutout, which is currently trading in the low $70s (see **Figure 1**). January and February are typically some of the slowest demand periods of the year, so getting a lot of lift in the cutout might be difficult to achieve. The cutout is currently trading close to where it was last year at this time and it is worth noting that last year the cutout added about $4 during January, but then rapidly lost about $12 in the first two weeks of February, so the net effect was a softer cutout at the end of February than when the year began. The only primal that appears to be significantly undervalued at present is the butt, so it is difficult to see where the strength will come from to lift the cutout substantially higher in the next couple of months. Our forecast has the cutout holding in the mid-to-upper $70s for much of January and February, which is some improvement over late-December values, but not a huge risk for pork buyers. Packer margins are currently running about $25/hd, which is in-line with where they have been over the past couple years. Margins normally compress as Q1 progresses and if that happens again this year, then hog prices could see more appreciation in January than the cutout does.

SUPPLY PICTURE

December saw the largest kill of the year in the week leading up to Christmas, when slaughter levels touched 2.8 million head per week. After a couple of very short kill weeks during the holidays,

> **USDA** recently **revised the Jun/Aug pig crop** upward by closeto one million head

slaughter during the first weeks of January should run near 2.65 million head per week before moving to 2.55-2.60 million head per week in February. That is a little below last year's level, but not much. The industry is currently slaughtering the Jun/Aug pig crop, which USDA initially reported to be down 3.4% YOY, but then they had a change of heart and revised the Jun/Aug pig crop upward by almost a million head in the most recent *Hogs and Pigs* report. After that revision, the Jun/Aug pig crop turns out to be down only 0.9% rather than the 3.4% decline that was initially reported. The bottom line is that there are considerably more hogs out there than initially anticipated for January and February. This change has led to a lowering of price forecasts for Q1 of 2021.

Not only are there more hogs out there than initially envisioned, those hogs are way heavier than they were last year at this time. The most recent weekly data release from USDA showed barrow and gilt carcass weights running four pounds heavier than last year. It is worth noting that the biggest YOY weight gains seem to be in packer-owned hogs, not those owned by independent producers. That means the heavy weights might not be all that influential to the LHI, since it is calculated only from prices paid to independent producers, but the additional weight still exists and will eventually have to clear the market. That could help limit the gains in the cutout during the weeks ahead. Further, weather forecasts for the Midwest indicate a long spell of warmer-than-normal weather during the first half of January and that may help to keep average carcass weights running strong relative to last year. Corn prices have been in a sharp uptrend lately and should

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that continue, producers may begin to feed to lighter weights. Longer term, if high corn prices persist, it could spur a reduction in the hog herd as producers struggle to remain profitable. In our opinion, it would take at least six more months of strong corn prices to induce additional herd liquidation.

With kills down slightly from last year, but carcass weights running solidly above last year, there is the potential for pork production during Jan/Feb to be modestly above last year's level. Further, pork exports during January and February of 2020, were exceedingly strong and it seems unlikely that exports this year will match that. If that is the case, the amount of pork available to domestic buyers stands a very good chance of being larger than last year by 1-2%. Given that the pork cutout averaged about $71 over the Jan/Feb period last year, one might expect it to be lower than that in 2021 due to greater product availability. However, it is our sense that demand is considerably stronger this year than last and so our forecast of a cutout that averages about $76-77 over the Jan/Feb period reflects our belief that relatively strong demand will persist over the next couple of months.

DEMAND SITUATION

Domestic demand for pork tends to run in cycles that are driven by retail feature activity. The last demand cycle peaked in mid-October and trended lower through November and December. We use the combined producer+packer margin to measure pork demand on a macro level. **Figure 2** indicates that combined margin bottomed near -$20/head last week and has now turned higher. This suggests that the market will see improving demand over the next 6-8 weeks. With COVID-19 infections still running strong in the general population, it seems reasonable to assume that consumers will continue to purchase much more pork through retail channels rather than at foodservice. That is demand-enhancing, as we noted in our recent special report. If vaccinations accelerate and infections begin to fall, that could begin to shift consumption back in the direction of foodservice, which would be a negative for demand. Market participants need to be cognizant of that, but we think it is still probably 4-6 months down the road and thus not likely to impact near-term pricing prospects.

Export demand for US pork this fall has been good, but in Q4 it is falling short of the lofty levels that were seen last year in Q4. China has been the main driver of US pork exports for the past couple of years, but there are reports that the Chinese hog herd has rebounded dramatically following the decimation of their herd in the African Swine Fever outbreak. That probably means that China will have less need to import US pork in 2021 compared to last year and thus we look for export demand to be softer than last year, but still quite strong in a historical context. Our current projections have 2021Q1 exports down 6.4% from last year's big numbers. As China recedes as a US pork buyer, there is a good chance that other countries will step up to fill part of the void. Movement to Mexico has been particularly impressive recently and movement to other Asian destinations such as Japan and S. Korea also looks promising.

Pork exports are projected to be **down 6.4% in 2021**

SUMMARY

We have scaled back our price expectations for Jan/Feb based on USDA's recent revision to the Jun/Aug pig crop which added almost a million head. Kills will still likely be a little below last year, but weights are well above last year and that means overall pork production in the next two months could marginally exceed last year's level. Exports are not expected to match last year's big numbers in Q1, further adding to domestic availability. The counterbalance to this large production forecast is that demand appears to be heading into an upcycle and the seriousness of the COVID-19 spread is likely to keep consumers sourcing more pork from retail channels, which is also positive to demand. Pork buyers might anticipate a moderate increase in the cutout over the next couple of weeks as the pipeline refills following the holidays, but it is difficult for us to see the cutout much above $80 at any point during Jan/Feb. Packer margins are plenty strong enough to encourage big kills, but those margins should narrow as we move deeper into Q1. That will support the LHI to some degree, but in our opinion the Feb futures, now trading around $70, look a little too rich relative to what the fundamentals will support. **Table 1** provides our near-term price forecasts.

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Figure 1: Pork Cutout

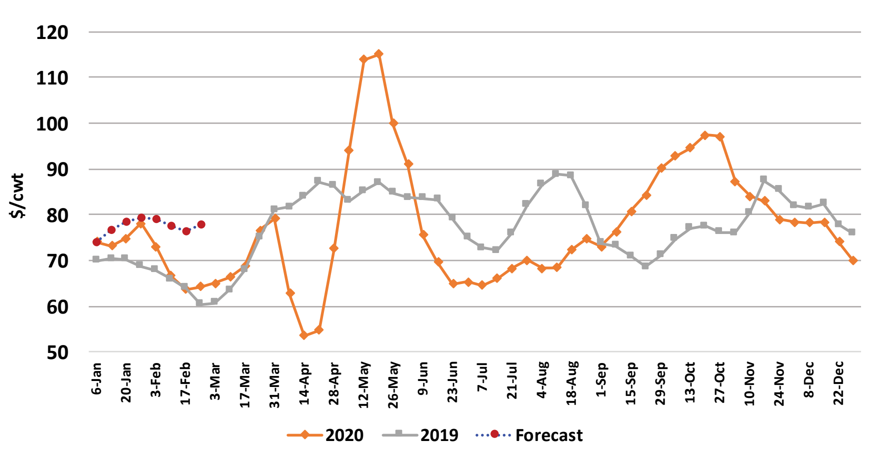

Figure 2: Pork Supply Chain Margins

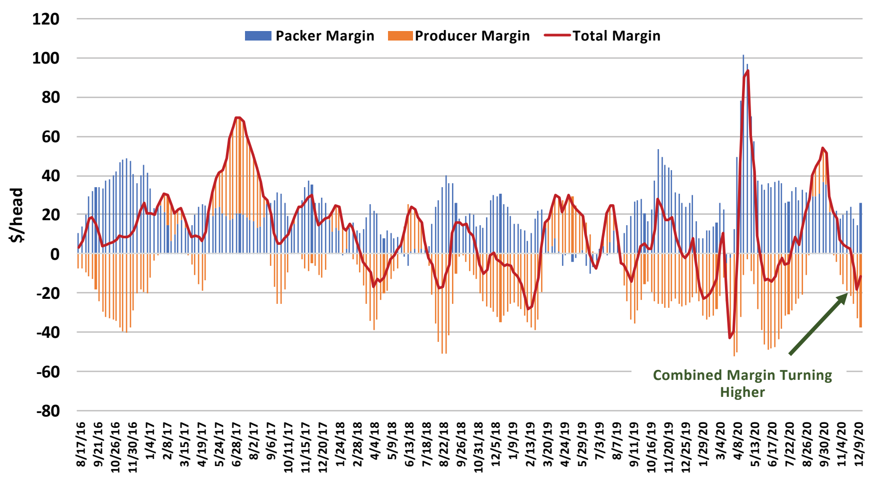

Table 1: JSF Hog and Pork Price Forecasts

	13-Jan	20-Jan	27-Jan	3-Feb	10-Feb	17-Feb
Pork Cutout	76.7	78.6	79.5	79.2	77.6	76.5
Loin Primal	75.7	77.9	77.5	76.6	75.3	74.6
Butt Primal	75.5	77.3	78.4	79.6	80.3	82.2
Picnic Primal	51.1	53.2	54.7	55.8	55.0	54.3
Rib Primal	143.6	141.7	142.3	138.9	135.4	132.2
Ham Primal	65.3	67.4	67.3	65.2	62.4	60.1
Belly Primal	114.4	116.8	121.0	122.9	120.4	118.3
Lean Hog Index	62.7	65.8	68.2	68.8	68.2	68.6

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