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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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Last month we covered the sharp rise in pork prices driven by consumer stockpiling at the beginning of the COVID-19 pandemic. This month, market participants are faced with another spike in pork prices, but this time it is supply-driven as COVID-19 has shuttered some slaughter facilities and forced packers to slow chain speeds in others. We raised the issue of potential plant disruptions in last month's issue, but they have turned out to be far more severe than we imagined. Slaughter levels have plunged and pork availability has gotten very tight, driving the cutout to over $100 (**Figure 1**). Packing company executives have warned that the plant disruptions will result in shortages of meat in US supermarkets, and that spurred President Trump to issue an order requiring meat plants to remain in operation. However, the spread of COVID-19 in packing plants has been so extensive that workers fear for their safety and absenteeism is running high. Thus, the order from the President is a nice gesture, but it won't magically make the COVID problem disappear, nor encourage workers to return to plants where they fear they will contract the illness. As a result, market participants should be prepared for light production to continue for at least several more weeks. The industry's inability to get hogs slaughtered is weighing heavily on hog producers. Prices for cash hogs are extraordinarily low relative to what pork is selling for and packer margins have become extremely wide.

SUPPLY PICTURE

The disruption in slaughter plants couldn't have come at a worse time for hog producers. The hog production pipeline is stuffed full because producers were banking on China taking large quantities of US pork this year due to shortages caused by the African Swine Fever (ASF) outbreak that dominated the news last year. Unfortunately, China cannot take live hogs from the US, they must first be converted into pork and that is where the problem lies. So now the US industry is caught in a terrible predicament where there are ample hogs and good overseas demand for pork, but the industry can't convert hogs to pork in order to meet that demand. Last week's hog slaughter dropped to 1.55 million head — far below the 2.6 million per week that need to be slaughtered in order to keep the production pipeline flowing smoothly.

> Plant closures and slowdowns **reduced hog slaughter 35% YOY** last week

Figure 2 illustrates the alarming drop in hogs slaughter during April. By our calculation, the industry is approximately two million hogs behind in slaughter for Q2 and that number could grow to four million by Memorial Day.

What will happen to all of those hogs? The first step that producers employed was to lower the energy content of rations in hopes of slowing down the rate of gain in hogs. That helps, but it is not a long-term solution. There have been discussions of euthanizing hogs on farms or at packing plants and sending the carcasses to rendering. Very little of that has occurred so far, but it might accelerate in the very near future. Hog carcass weights are starting to inch higher and will likely continue in that direction as long as slaughter capacity is constrained. Even if all of the slaughter facilities were able to magically process at full capacity starting tomorrow, it would take several weeks to work through all of the hogs that have been backed up. Needless to say, cash hog prices are languishing at low levels and the financial burden on hog producers is mounting.

The likely result of this serious disruption in the production pipeline is that hog producers will dramatically scale back production. The most recent *Hogs and Pigs* report indicated that has already started as producers reported adding far fewer gilts than normal to their breeding herd. The next step will be to liquidate sows and that will impact the industry's ability to ramp back up once the COVID crisis settles. That points to higher hog and pork pricing down the road, perhaps by Q4 or early in 2021. The magnitude of this herd liquidation will depend on how long it takes to get slaughter plants back up and running to normal capacity levels. We are not optimistic that will happen quickly and thus the financial pain for producers and the ensuing liquidation is likely to be substantial.

DEMAND SITUATION

Last month, domestic demand was looking really weak after the consumer stockpiling event had run its course. The high level of uncertainty about the future caused buyers to pull back and go into hand-to-mouth mode. Those buyers were caught short as packing plants started to close and pork production dropped dramatically. That led to a flurry of buying interest as the short-bought users scrambled to get coverage.

> Buyers seeking coverage drove the cutout **over $100** last week and **$125 looks obtainable**

With prices rising daily, strong domestic demand has returned since buyers know that if they don't buy today, it will likely cost more tomorrow. At some point, as more slaughter capacity comes back online, the cutout will top and that will likely send buyers back to a hand-to-mouth approach. We expect to see that happen somewhere around Memorial Day and should bring with it a softening of domestic demand in early June. Of course, all of this makes buyers very nervous because not only is demand highly unpredictable, but available supply is also unpredictable. Our advice is for buyers not to try and pick the top, but rather wait until the cutout has clearly turned lower before moving back into a hand-to-mouth regime. The cutout cleared $100 easily last week and could very well test $125-130 before the top is made.

International demand for US pork remains quite strong as China has been taking increasing amounts of pork out of the US. It looks like total pork exports for Q1 will be up around 40% from last year. It is pretty amazing that the industry can achieve such a strong export showing in the midst of a global pandemic. There is one danger here that is worth pointing out. With pork supplies so tight currently and prices skyrocketing, there is a possibility that the idea of shutting off exports will get floated. That action would need to be initiated by the President and he has not been shy about closing borders in the past. Such a move would help consumers by bringing fresh pork prices down, but it would absolutely crush hog producers who depend on those export markets to keep prices high enough for them to turn a profit. The futures market would likely sell-off hard if exports were halted. We don't know if that idea will get serious consideration with policy makers, but market participants should remain cognizant of the fact that it could happen.

SUMMARY

The hog and pork complex is being buffeted by shutdowns and slowdowns in the packing and processing sectors as a result of COVID-19 getting into plants. The President has issued an order for all meat plants to remain open, but the ultimate decision will rest with the workers in those facilities who are currently fearful of contracting the virus at work. We do expect that capacity will come back online, but it will be a gradual process that probably takes several weeks to complete. There will be a backlog of hogs that need to be processed and that should prevent cash hog prices from escalating in the near-term. In the interim, buyers should expect pork pricing to remain high. If packing companies find that they cannot safely reopen slaughter facilities, then this period of tight pork supplies and high prices could well last deep into summer. We have raised the possibility of shutting down exports as a means of dealing with domestic pork shortages, but that would require action by the President. Users can expect prices to remain very volatile over the next couple of months as the industry tries to recover from the COVID-19 problems and get back to some semblance of normalcy. **Table 1** provides our near-term price forecasts.

Figure 1: Pork Cutout

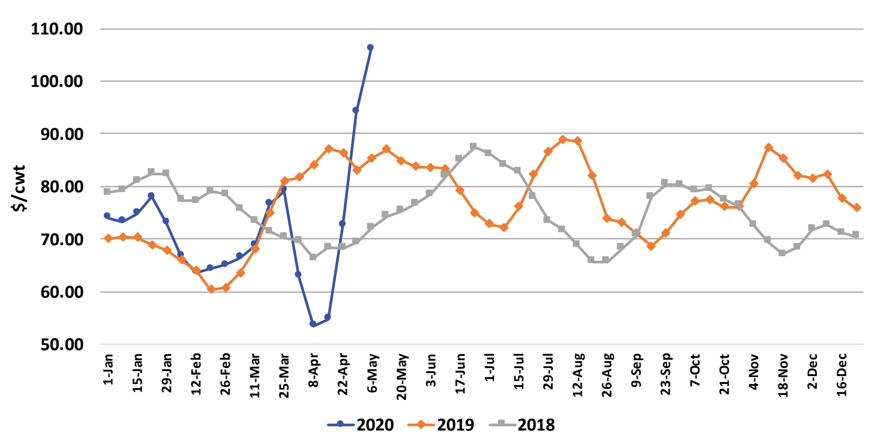

Figure 2: Weekly Average Hog Slaughter

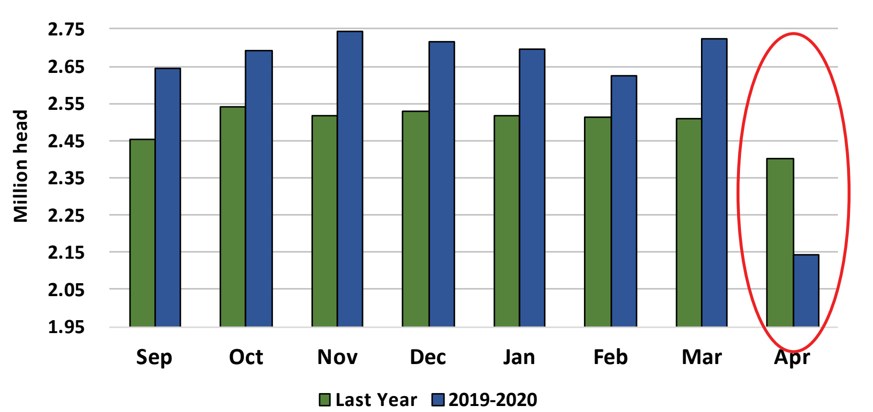

Table 1: JSF Hog and Pork Price Forecasts

	13-May	20-May	27-May	3-Jun	10-Jun	17-Jun
Pork Cutout	103.7	94.3	86.8	82.0	78.7	76.2
Loin Primal	122.0	107.9	97.8	92.1	89.3	86.8
Butt Primal	117.3	106.4	97.8	92.4	87.0	81.1
Picnic Primal	75.6	66.7	60.2	57.6	55.1	52.9
Rib Primal	169.3	154.2	147.1	140.5	138.7	135.0
Ham Primal	70.4	66.2	62.0	58.3	56.2	55.4
Belly Primal	145.7	134.0	122.6	115.1	108.4	104.5
Lean Hog Index	62.1	59.7	58.4	58.4	59.0	57.7

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