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Foods Inc.

# THE MONTHLY RED MEAT OUTLOOK: HOGS & PORK

DECEMBER 2019

November was marked by huge hog kills and very soft hog pricing. The sheer number of animals that became market ready in November tested the industry's slaughter capacity and allowed packers to keep pressure on the negotiated cash market. Amazingly, while the hog market was headed south, the pork cutout was headed north. The pork cutout came very close to matching its highs posted back in late July/early August when kills were far smaller. Packer margins swelled to nearly \$54/hd at one point in the month – an all-time record. That proved to be the incentive that packers needed to run hard and process the big supply of the market-ready hogs.

The industry just notched its **largest kill ever, nearly 2.8 million head per week**

Normally, Q4 sees the lowest pork prices of the year, but the fact that the cutout was so strong in November is an indication that very large volumes of product are leaving the market into export channels. However, the lagged nature of the export data means that we have no hard evidence of that yet. Still, the unusual price behavior leads us to believe that China greatly stepped up its buying of US pork and that forced domestic buyers to compete more vigorously for the remaining product. The timing of these purchases coincides with the Chinese New Year, which is on January 25, 2020. Because of the long lead time involved in ocean shipments, product needed to be bought and on the boat by about the first week of December in order to arrive in China ahead of the New Year's celebrations.

## SUPPLY PICTURE

Last week the industry killed nearly 2.8 million hogs. That is an all-time record large slaughter and reflects the fact that strong profitability in 2019 coerced producers into expanding production. By our calculations, USDA came very close on the last two pig crops as slaughter in the Sep/Nov quarter was only 100,000 head larger than what the

March/May pig crop indicated and slaughter in the Jun/Aug quarter was only about 50,000 head above the Dec/Feb pig crop estimate. However, last week's huge kill was itself about 120,000 head over what the Jun/Aug pig crop suggested. It is only one data point, but we are watching closely for signs that there may be more pigs out there than what the USDA's estimate of the summer pig crop suggested.

Barrow and gilt carcass weights have been running above last year, but not to an unusual degree. In the most recent data for the week ending Nov 23, carcass weights were about one pound over last year. These heavier weights are further adding to pork production on top of the large slaughter numbers. Pork production in Q4 is projected to be almost 6% greater than last year as a result. So, it is quite stunning that with all of that additional production, the pork cutout in Q4 looks like it could average about \$9 higher than last year. Part of the answer to that paradox lies in the export market, which has been siphoning pork off of the domestic market at a record clip.

Last week's huge kill probably represents the largest kill of the year and slaughter levels should slowly begin to ease from that point forward. Producers have been willing sellers in the market this fall, even as cash hog prices weakened. That has kept the pork production pipeline free of backlogs and sets the stage for a rebound in cash hog prices as we move deeper into December and into Q1. Heading into December, the industry is now working through the Jun/Aug pig crop, which USDA reported to be 2.9% larger than last year. As mentioned above, we have some concerns that perhaps that estimate is too low, and we will be watching kills closely in coming weeks for verification. We will get another issue of USDA's quarterly *Hogs and Pigs* report on December 23, and that will provide an estimate of the size of the Sep/Nov pig crop which will come to slaughter in March through May of 2020. We expect that pig crop to be up 3-4% from the year prior. The industry is definitely responding to the strong pricing signals that have been coming out of the futures market since the ASF crisis broke in China over a year ago. US producers have ramped up production, and in the process, have become increasingly dependent on the Chinese export market to remove a large proportion of that extra production.

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## DEMAND SITUATION

Export markets are front and center in the demand picture for pork. China has been taking increasing quantities of pork out of the US as it seeks to tame its internal pork price inflation caused by massive African Swine Fever (ASF) losses. In the recently released export data for the month of October, total pork exports were up about 4% YOY. **Figure 1** shows that China has been taking increasing volumes of US pork as 2019 developed. China's share of US export volume in October was almost 20% and it now ranks as a close second to Mexico in terms of total shipments (see **Figure 2**). That is an amazing turn of events given that in the five years prior to 2019, China only accounted for roughly 10% of US exports. Hog and pork prices in China have soared as the country grapples with the ASF crisis and thus US pork is considerably cheaper than Chinese pork, even when the near-70% tariff is factored in. So, while the US-China trade war rages on other fronts, the Chinese have quietly been snapping up increasing quantities of US pork. Our guess is that without the Chinese business, pork prices this fall in the US could have been as much 15% below current values. That is how important the Chinese market has become to the US. With this new dependency comes risk: if the Chinese were to suddenly ban imports from the US (*as they did with Canada this summer*) then the US would be awash in pork and prices would plummet. It is not likely that the Chinese will pull out of the US market anytime soon. But it is possible to imagine a scenario where US diplomats anger the Chinese and provoke a similar response.

Domestic pork demand also looked very good during November (see **Figure 3**). We think that is partly because US buyers were caught off-guard by the surge in exports and were forced to run prices higher as they scrambled to fill their needs. Pork buyers normally count on the Nov/Dec period as being one of large supplies and will often remain short-bought heading into that period in anticipation of reloading

at low price levels. This November the cutout at times neared \$90, and caught those buyers out of position; many are now struggling to obtain coverage. Hams have been particularly strong, with price levels on the ham primal an eye-popping 73% higher YOY in November. Those prices are not likely to moderate until January and even then, could be 40-50% stronger than the year before. Over time, US buyers will adapt, but at least for the next few months they should expect price levels well north of what they have experienced in the last couple of years.

**China is poised to soon become the #1 destination for US pork exports**

## SUMMARY

The hog and pork complex is currently experiencing its biggest production of the year, yet pork prices remain uncharacteristically high. We speculate that this is because pork exports to China have been unusually strong ahead of their New Year's celebration and that caught many US buyers out of position. Hog supplies should trend lower from this point forward, but Q1 production could still be 5-6% greater than last year. If export interest remains strong, and we think it will, then pork price levels in Q1 could be higher than last year even in light of big YOY production. Hog prices remain depressed because supplies are so large that they are testing the industry's slaughter capacity and thus putting pricing leverage in the packer's hands. As kill levels recede in the coming weeks, producers should recover some pricing power and thus be able to force cash hog prices higher. **Table 1** provides our near-term price forecasts in the hog and pork complex.

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Figure 1: US Pork Exports to China & Hong Kong, 2019

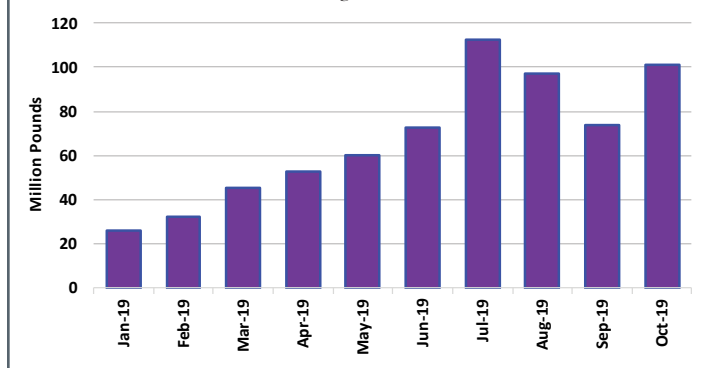


Figure 1: Pork Cutout vs. Per Capita Domestic Disappearance, Nov

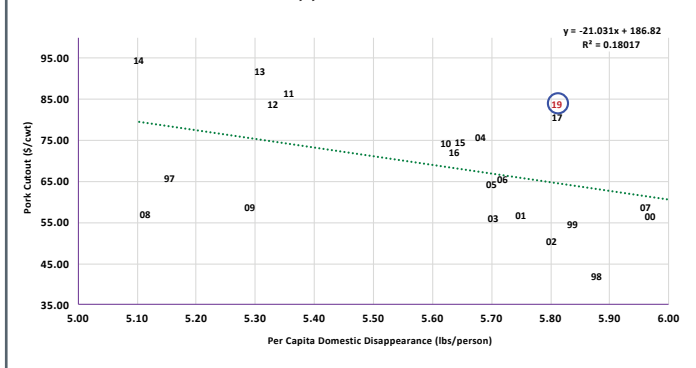


Figure 2: Share of US Pork Exports, October 2019

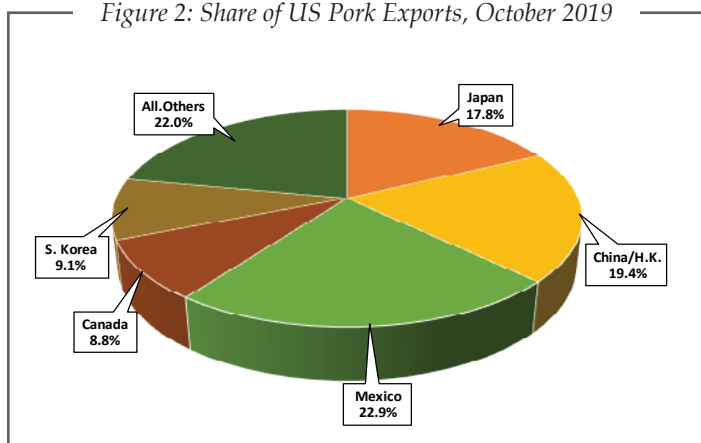


Table 1: JSF Hog and Pork Price Forecasts

	18-Dec	25-Dec	1-Jan	8-Jan	15-Jan	22-Jan
Pork Cutout	80.8	80.2	79.5	79.2	77.5	76.9
Loin Primal	71.8	72.9	73.3	74.7	73.1	72.2
Butt Primal	85.7	83.3	80.7	78.2	75.5	74.6
Picnic Primal	65.2	60.4	57.6	52.8	50.5	47.6
Rib Primal	126.5	128.0	126.8	124.4	124.0	123.7
Ham Primal	83.3	80.4	77.4	74.1	69.3	68.1
Belly Primal	103.8	107.9	112.0	119.4	122.7	125.5
Lean Hog Index	60.4	61.5	62.1	64.3	64.5	65.2



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