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RED MEAT OUTLOOK: HOGS & PORK

China and the United States are expected to sign a "Phase One" trade deal on January 15, 2020. As part of that deal, China is agreeing to step up its purchases of agricultural products from the US and pork is certainly high on the list of commodities they need. Interestingly, the hog futures market took the news in stride and didn't rally as much as one might have expected given all the angst over China in the market. The fact of the matter is that China is already purchasing a large amount of pork from the US and while it has helped boost pork prices somewhat, it has not blasted them into the stratosphere like some traders had hoped.

> A partial **US-China trade deal** is expected to be **signed on Jan 15th**

The bigger risk, that has gone largely unnoticed, is that the US pork industry has quickly become dependent upon the Chinese to offload a significant portion of its huge production. If something were to go wrong and China pulled back completely, then price levels in the US could easily fall $10/cwt in a matter of days. Perhaps what is being viewed as a trade deal has actually become another bargaining chip in the pocket of Chinese Premier Xi. For now though, market participants are acting cautiously optimistic as they anticipate bigger Chinese purchases in 2020.

SUPPLY PICTURE

The industry has now worked through its biggest kills of the year and it is typical for slaughter levels to decline slowly throughout the first quarter. The biggest weekly kill clocked in at 2.81 million head in the week prior to Christmas. In January, we look for kills to fall back toward an average of 2.55 million head per week. Make no mistake, those are still very large kills but just not quite as large as the kills of early December. The industry has managed to move more product into cold storage recently and as of Dec 1, cold storage stocks were 13.2% above last year. That will help to keep a lid on price rallies in Q1 as production levels decline. Bellies, in particular, have seen strong growth in cold storage stocks and the belly primal is currently trading at its lowest level in almost 18 months.

Barrow and gilt carcass weights are now running two pounds over last year, which is also adding to production (see **Figure 1**). However, weights are not signaling any problem with hogs backing up in the pipeline just yet. The de-trended and de-seasonalized weights are still running comfortably in the safe zone. Carcass weights will start to trend lower slowly from here until they reach a bottom sometime in mid-summer. With many packers now refusing to accept hogs that have been fed ractopamine, it is likely that the YOY gain in carcass weights will be smaller than normal in 2020.

USDA issued its quarterly *Hogs and Pigs report* on December 23 and it showed that the Sep/Nov pig crop was up 1.8% after upward revisions to the 2018 Sep/Nov pig crop. That is a little smaller than we expected and think that the actual pig crop might be larger than what the USDA survey indicated. That Sep/Nov pig crop will be slaughtered in March through May of 2020, so we know that supplies should be well above last year, at least until May. The US breeding herd was reported up 2.1% as of December 1 and that growth in the production base likely means larger pig crops to come (see **Figure 2**). The farrowing rate that USDA reported looks abnormally low and that is what leads us to believe that the actual pig crop might be larger than advertised. All in all, the data point to commercial pork production during the first half of 2020 being 4-5% larger than the year before. In absolute terms, that is 700 million pounds more pork than H1 of last year and is more pork than China took from the US during the first ten months of 2019. Clearly, China will need to expand its purchases if US pork prices are to stay above last year in the next two quarters.

DEMAND SITUATION

Domestic demand for pork appears a little soft at the moment, but could make a turn higher during the month of January. Scatter diagrams, which are the go-to analytic tool for evaluating domestic demand, have been rendered a little less useful in this environment where so much depends on how much product is leaving the market through export channels. Because the official export data is almost two months delayed, we must rely on export forecasts in order to build scatter diagrams for the current or recent months. All of the uncertainty around the level of those exports creates uncertainty in our demand measurements using scatter diagrams. Still, it is our sense that domestic pork buyers are in no hurry to build ownership positions and that has kept domestic demand muted.

On the international front, of course the big news is the pending trade agreement with China. The Trump administration has hailed the deal as a major breakthrough but we aren't so sure that it portends anything substantial for the pork industry. The retaliatory tariffs on US pork that China put in place in response to US steel and aluminum tariffs, will stay in place. Chinese officials have indicated that they will grant some tariff waivers to individual companies in order to spur purchases. That might help incrementally, but pork prices in China are already so high that US pork can be landed in China at prices well below China's domestic market, even with the tariffs. It will be interesting to see just how much higher exports to China go in early 2020, but our sense is that it won't be an astronomical increase. More likely, it will be a small increase over Q4 and not enough to offset all of the increased production that is now coming down the production pipeline. Stay tuned, because price levels will be very much influenced by China's interest in US pork in 2020.

US **pork production** is expected to post a **4-5% YOY increase in Q1**

SUMMARY

The hog and pork complex is now past its peak fall/winter production and supplies should slowly tighten as we move deeper into Q1. However, pork production may still be 4-5% over last year and so price levels could be depressed unless exports increase strongly and remove some of that excess production. The recent *Hogs & Pigs report* confirmed that hog supplies will be larger than last year at least through May, and likely for all of 2020, given the increase in the breeding herd. Domestic demand has been soft lately, but could see a rebound in January. International demand will be key to pricing in 2020 and China will continue to be the main focus. US producers have done their part and filled up the production pipeline and now it is time for Chinese buyers to step up and take even more US product or else prices here in the US will come under pressure. We see the pork cutout averaging about $79 during January and $77 in February. That would be about $10 stronger than last year. We are counting on strong export demand and a rebound in domestic demand to achieve those target levels. **Table 1** provides our near-term price forecasts in the hog and pork complex.

Figure 1: FI Dressed Wt., Barrow & Gilts

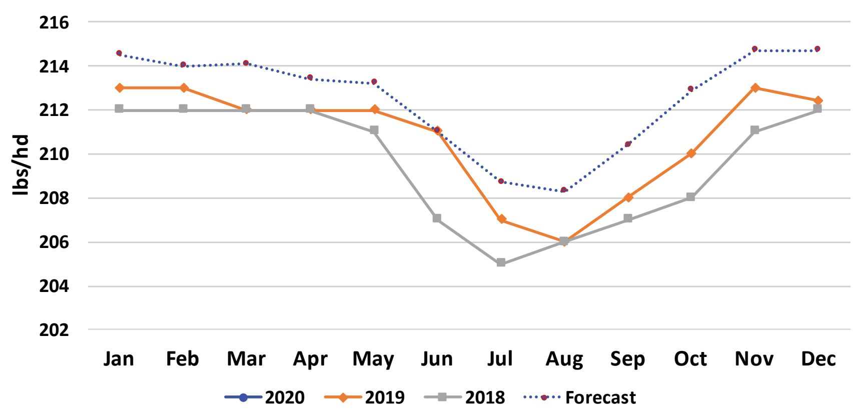

Figure 2: US Swine Breeding Herd, 2005-2020

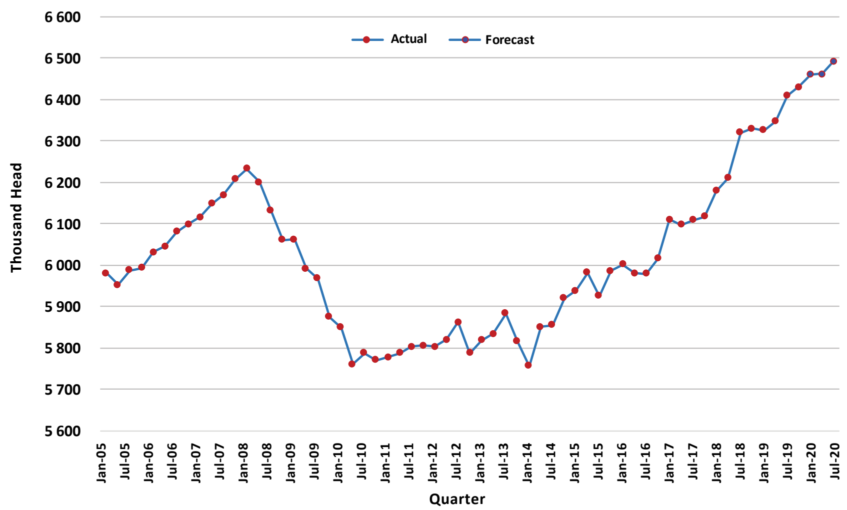

Table 1: JSF Hog and Pork Price Forecasts

	15-Jan	22-Jan	29-Jan	5-Feb	12-Feb	19-Feb
Pork Cutout	80.1	79.9	78.7	77.8	77.1	76.6
Loin Primal	73.1	72.2	71.0	70.0	68.7	67.2
Butt Primal	86.3	83.5	79.4	76.1	75.0	74.2
Picnic Primal	65.2	59.7	57.4	54.6	51.3	48.2
Rib Primal	136.4	135.0	134.7	131.0	127.4	123.2
Ham Primal	69.1	68.1	66.5	64.3	63.0	61.8
Belly Primal	116.6	125.5	127.0	132.0	136.1	142.0
Lean Hog Index	63.8	65.7	66.7	67.0	67.4	67.7

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