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J.S. FERRARO & COMPANY | RETAIL READY Foods Inc.

THE MONTHLY RED MEAT OUTLOOK: HOGS & PORK

JUNE 2019

You might remember a couple of months back when the lean hog futures were in a frenzy over ASF in China and we forecasted that the June contract was not even remotely worth the $98 at which it was being traded. Well, here we are a few days from the June contract's expiration and it looks like it will settle somewhere near $79. That is a little higher than our initial forecast, but not much. The whole episode illustrates how hysteria can sweep through a market and take price levels far away from the value justified by the fundamentals. Buyers need to remember this event and be prepared to hold firm and not overpay in the next wave of hysteria that is almost sure to sweep through the market before summer is over. Cash markets for pork and hogs have been slowly working lower in recent weeks and it is beginning to look like the market may have already made its seasonal top. That top normally comes in late June or early July, but this year it appears to have come unusually early (in May), aided by ASF fears. The futures market does not yet believe that the top is in, as it is pricing the July and August contracts almost $5 higher than the June contract at this point. Clearly there is still some worry that China will start to take huge amounts of pork out of the US and thus keep price levels high even though hog supplies will be expanding after Independence Day (July 4). The problem with that line of thinking is that trade tensions have worsened between the US and China in recent weeks and it looks like there will be no resolution to the spat anytime soon. Furthermore, President Trump rattled Mexican buyers last week with talk of new tariffs on Mexican goods in an effort to secure Mexico's help with illegal immigration. This doesn't seem like the type of trade environment that is conducive to large export shipments of US pork this summer and fall.

Cash hogs seem to have **topped at $85**

SUPPLY PICTURE

Hog supplies are tightening seasonally, as they always do this time of year. But, we still expect supplies throughout the summer to be well above last year. So far, the smallest non-holiday weekly kill was 2.33 million head in the week before Memorial Day. Slaughter bounced a little higher after the holiday, but our forecast looks for kills to edge back lower between now and early July. We still anticipate the non-holiday bottom will be in the 2.25-2.30 million head range.

Right now, the industry is working through the Dec/Feb pig crop, which USDA estimated to be 2.8% larger than the year before. That means, that roughly, we can expect slaughter over the Jun/Aug period to be up a similar amount. On June 27, USDA is scheduled to release its next quarterly *Hogs and Pigs* report, and we project that it will show the March/May pig crop was up about 2.5% from last year. That means that the year-over-year increases in hog slaughter are likely to continue into fall and early winter. Further, hog carcass weights have been heavy lately which will add to pork production. Normally, hog weights trend lower towards a bottom in late July as a result of hot temperatures limiting feed intake. Carcass weights are about 1% heavier than last year and that could easily continue, or even expand that gap, throughout the summer (**Figure 1**). That will add another one percent or more to summer pork production. We believe that hog weights have remained elevated because producers slowed down marketings this spring. This is a result of high summer futures, which led producers to delay the sale of their hogs until higher prices arrived. That works for a while, but if the futures break lower that will send a signal to producers to speed up marketings, which would push cash prices lower. The *de-trended* and *de-seasonalized* carcass weights that we watch as an indication of hogs backing up in the pipeline are starting to flash some yellow caution signals. It is fortunate for the industry that this potential backlog is occurring in summer, when hog numbers are seasonally low, rather than winter when numbers are high and packing plants are running at near capacity. A summer backlog can be worked through much faster and with smaller price concession than one that occurs when the hog supply is seasonally large.

DEMAND SITUATION

On the international front, we continue to see good demand for US pork from China and weak demand in many of the other major destinations. The official export data released last week showed total pork exports in April down 4.3%, which is contrary to the hype about ASF in China causing huge US pork exports. Furthermore, China/Hong Kong was only responsible for 10% of pork exports (**Figure 2**). The concerning part about this data release is that it showed lower pork exports to most of the major importing countries such as Japan, Mexico and South Korea. The weekly export data that has been released since April seems to suggest that this trend carried right into June. Another concern surrounding international pork demand is that the US threatened more tariffs on both China and Mexico and in the process caused those countries to be less friendly toward trade with the US. Anyone who was hoping for a quick trade deal with China will likely be disappointed – this dispute might carry on for

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months or even years. Chinese authorities will probably do whatever they can to discourage their pork buyers from doing business with the US. The net result: it is unlikely that the US will realize the level of exports that futures traders are expecting this summer and fall. That probably means futures prices will have to come down considerably, but traders won't allow that to happen until the evidence is staring them in the face.

There are also some concerns around domestic pork demand. When the futures surged sharply higher in April, panicked buyers scrambled to get as much pork around them as they could. Now that actual June prices are much lower than what the futures advertised back in April, those buyers are caught with large inventories of expensive pork. As they work through those inventories, they won't be as active in the spot market and that could put pressure on cash prices. Our price-quantity scatter diagram analysis for June shows 2019 demand very close to the level we saw in 2018. In the previous two months, 2019 pork demand was way above last year. So, domestic demand has cooled a bit. Another element to consider is that as retailers were planning their features for the summer, the high level of hog futures probably caused them to reduce the amount of pork they were planning to put in their ads out of fear that the price that they would have to charge would be so high that it wouldn't be attractive to consumers. Further, beef prices have declined a lot in the last month and probably have additional downside risk. So beef will be a very attractive alternative to pork for retailers this summer.

> April **exports** reported **down 4.3%**

Figure 1: FI Dressed Wt., Barrow & Gilts

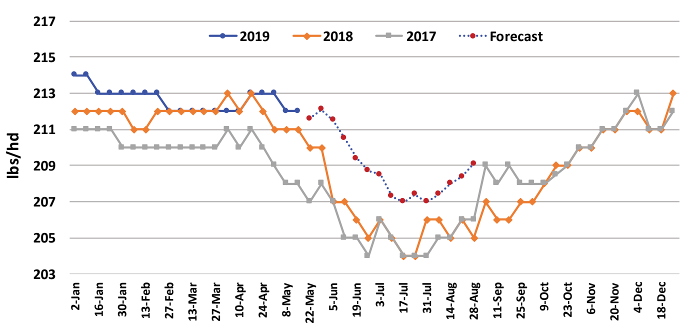

Figure 2: Destinations for US Pork Exports, April, 2019

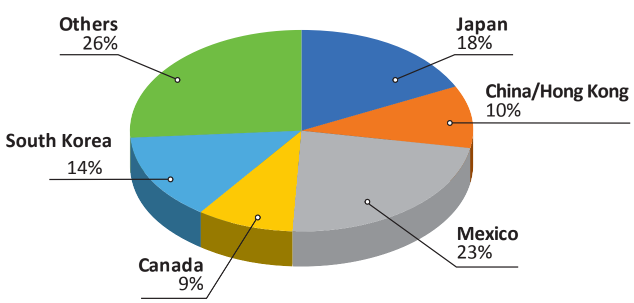

Table 1: JSF Hog and Pork Price Forecasts

	19-Jun	26-Jun	3-Jul	10-Jul	17-Jul	24-Jul
Pork Cutout	84.7	83.8	82.2	80.4	79.3	79.0
Loin Primal	85.2	83.1	80.3	78.2	75.3	74.4
Butt Primal	93.9	90.7	88.5	86.8	83.7	84.3
Picnic Primal	59.4	57.2	54.3	52.4	50.6	50.9
Rib Primal	132.5	130.1	124.8	122.5	124.3	124.0
Ham Primal	78.1	77.4	77.0	75.2	74.5	72.4
Belly Primal	112.3	115.6	116.0	114.3	116.2	119.0
Lean Hog Index	80.1	80.0	78.3	76.3	74.0	72.9

SUMMARY

Cash hog and pork prices have failed to achieve the lofty levels that the futures market projected a couple of months ago and that trend is likely to continue through the summer. Hog slaughter will likely work slowly lower for the next month or so before it begins to expand in early July. Hog weights are unusually heavy however, and that will add to production. There is a possibility that hogs are backing up in the pipeline and when producers flush them out, it could cause a downward correction in cash prices for both hogs and pork. The international trade picture has grown more ominous lately as the US threatens both China and Mexico with new tariffs and those could become a further hinderance to US pork exports. Domestic demand for pork may be stifled in the coming weeks by low retail feature activity and more competitively priced beef. Buyers are urged to remain short bought, particularly beyond July, since both the supply and demand factors are pointing to lower prices from mid-summer onward. **Table 1** gives our price forecasts for the next several weeks.

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