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

THE MONTHLY **MAY 2019**

RED MEAT OUTLOOK: HOGS & PORK

April saw some stability return to the US pork market with the cutout finishing the month very close to where it was at the end of March. The cash hog market however, continued to escalate as we saw the Lean Hog Index (LHI), which measures the spot value of hogs, increase over $7. With the cutout flat and hog prices rising, packer margins got severely compressed. We estimate that packers are now losing a little over $6 on every hog they process **(Figure 1)**. Tight packer margins are pretty common in May, June and July when the hog supply is seasonally at it's lowest, but –$6 so early in May is a lot tighter than normal. This signals that available hog supplies have tightened a bit more than packers expected and this year we have more packing capacity chasing after those hogs. The African Swine Fever (ASF) story out of China seems to have cooled a bit for US markets although market participants are still jittery at the prospect of US shipping large quantities of pork to China for an extended period in the future. The cutout is trading quite a bit higher than we expected for early May and that probably reflects some stockpiling by end users driven by ASF fears.

> Without a US-China trade deal, the pork cutout **may struggle to reach $90** this summer

SUPPLY PICTURE

Recently hog kills have been running about 2.38 million head per week and that is very close to what the Sep/Nov pig crop indicated for slaughter in the Mar/May quarter. Kills are tapering down seasonally as they always do at this time of year. Soon, the industry will start to kill hogs born during the Dec/Feb quarter and that pig crop was up 2.8% year-over-year. By our calculations, that means that weekly hog kills should bottom somewhere in the 2.25-2.30 million head range in the last week of June or early July. Of course, packers could always scale back on the kill in coming weeks in an effort to improve the tight margins that they are currently experiencing, but they are less likely to do that when the hog supply is naturally snug than in the winter when hogs are plentiful. Therefore, it is quite possible that packers will have to live with slightly negative margins for the next couple of months or so.

There is nothing in current hog carcass weights that would suggest any problem with hogs backing up in the pipeline. The *de-trended* and *de-seasonalized* hog carcass weights that we watch as an indicator of whether or not hogs are backing up still sits in negative territory, indicating there is no problem. Hog carcass weights always move lower at this time of year and should bottom sometime in late July or early August. Thus, with slaughter set to decline in May and June, and carcass weights also moving lower, the total amount of pork produced will tighten up. Overall pork production is expected to remain about 2.5% over last year in May and could be closer to 4% over last year during the month of June. Of course, what really matters for pricing purposes is how much of that production is available to US consumers (per capita consumption) and imports and exports play a role in determining that variable. Our forecast looks for exports to be up about 6% from May through August and thus we see only an increase in per capita consumption of about 1.5-2.0% during the summer months. This is where we diverge from what the futures market is pricing. Clearly, futures traders are looking for US pork exports to be up something on the order of 20% or more this summer as a result of massive amounts of product moving to China. USDA's export data currently lags two months, so we only have information through February at this point. For the months in 2019 where data is available (January and February), exports were down about 4.8%, so it was a soft export environment early in 2019. USDA does collect weekly data on exports that is more timely, but it often does not correlate well with the more accurate (but less timely) monthly totals. There has been impressive movement to China in the weekly export data and the most recent reported data (for last week of April) showed China importing about 4400 metric tons per week **(Figure 2)**. This is about the amount of product that South Korea took last year at this time, so China has become a very big export destination. The bad news however, is that export volume to almost all of the other major destinations (i.e. Mexico, Japan, South Korea, and Canada) was down close to 20% during that week. So, the net effect of China taking way more than normal, and other countries taking way less, is that total pork exports in the last week of April were about the same as they were in 2018. This is the problem with focusing totally on China. Yes, US exports to China are way up, but if you step back and look at total exports, the picture is not nearly as impressive (or bullish).

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DEMAND SITUATION

Domestic demand for pork surged higher in April as buyers reacted to renewed fears of limited availability due to the ASF situation in China. That seems to have cooled off now. It has been almost two months now since USDA first reported big sales to China and even though there have been additional large sales reported, actual evidence of China sucking up large amounts of US pork has been limited. As we've said before, it is always prudent to look at the factual data and not get caught up in anecdotal reports. It now looks as though the tide may be turning on domestic pork demand. The combined packer/producer margin peaked two weeks ago and is now heading lower. That is usually a good sign that overall demand is fading.

Figure 1: Pork Packer Margin

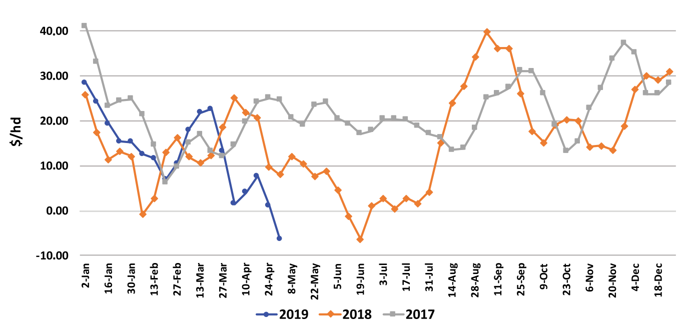

Figure 2: Weekly Pork Exports to China

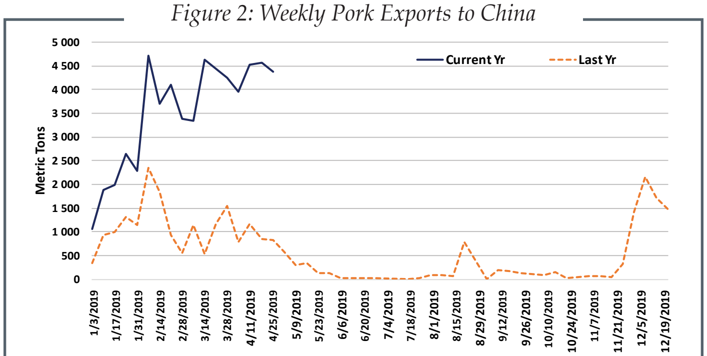

Table 1: JSF Hog and Pork Price Forecasts

	15-May	22-May	29-May	5-Jun	12-Jun	19-Jun
Pork Cutout	85.2	86.4	87.6	86.8	87.0	87.5
Loin Primal	79.0	80.2	82.4	83.6	85.4	86.0
Butt Primal	112.3	109.0	105.1	102.3	100.8	98.6
Picnic Primal	62.9	62.8	64.0	62.5	60.6	59.9
Rib Primal	157.0	153.9	148.6	147.1	145.6	143.2
Ham Primal	67.4	69.5	70.0	69.1	68.2	69.0
Belly Primal	120.3	125.9	132.2	130.3	133.1	136.6
Lean Hog Index	82.7	83.1	83.4	82.5	84.5	86.3

Of course, in this environment it won't take much to re-kindle buyer's fears and so the market is likely to remain jumpy. One particular risk in this regard is if the US and China announce a trade deal that would remove the tariffs both countries have put in place over the past year. But even that could be a bit of a head fake. For one, it is unlikely that the tariffs will come off immediately on the day a deal is announced. It's more likely that a splashy announcement will confirm the existence of a deal

> Domestic pork **demand** appears to be sliding **lower**

but then both countries would take several months to operationalize that deal, including the removal of tariffs. There is little doubt however that the removal of China's 62% tariff on US pork would result in a lot more pork flowing from the US to China than we are seeing today. But also keep in mind that would probably come at the expense of smaller exports to most of the traditional destinations for US pork.

SUMMARY

The cash markets for pork in the US seem to have cooled a bit in recent weeks. Hog supplies appear to be consistent with previously-reported pig crops and slaughter levels are trending seasonally lower. Carcass weights will also be working lower until late July. Pork availability will be tighter than it was in Q1, but still about 2% larger than last year in Q2. Domestic demand for pork seems to be cooling off as well and that will help limit price gains this month. China is taking a lot more US pork than normal, but other countries are taking less, resulting in total pork exports close to last year's level. An announcement of a US-China trade deal remains the biggest risk to the market since that would almost surely send buyers into a frenzy and drive prices higher. We think the trade deal will take longer than advertised and thus hog and pork prices will probably not perform as strongly in May and June as they did last year. Our price forecasts for the next several weeks are provided in **Table 1**.

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