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RED MEAT OUTLOOK: HOGS & PORK

Pork prices were extremely high during September and October and our theory is that a large amount of pork was entering export channels and thus leaving domestic availability tight. If that is indeed what was happening, it was happening under the radar since it didn't show up in a big way in the data sources that we use to gauge current movement into export channels. What was obvious however, was there was an unusually small volume of pork moving in the negotiated spot market relative to the size of the kill. That seemed to change last week as spot volumes swelled and the cutout retreated rapidly. The most obvious indication of this was in the belly market where the primal price dropped from the high $170s to the low $110s in just a matter of days. The other primals, outside of hams, have shown signs of weakening also and suggests that the cutout may stay on the defensive in the weeks ahead. After all, pork production reaches its annual peak in late November and if it is true that some export business has dried up, then that will leave additional product to be absorbed by the negotiated spot market. The die may have already been cast for pork demand however, since retailers, who where shocked by very high wholesale pork prices in September and October, likely shifted their ads to include less pork and more beef and/or chicken. Hams are the one primal that may have staying power in November as ham processors are behind on orders for Christmas and will be working furiously between now and Thanksgiving to get product ready for the end of year holidays.

> **Belly prices** have come crashing down, with the primal **dropping 35%** in a matter of days

SUPPLY PICTURE

There is not much talk anymore about hogs backlogged from the spring plant closures. The price and weight data have made it pretty clear that no such backlog exists. That doesn't mean that the industry is tight on hogs however and we are coming into the biggest slaughter weeks of the year during November. Last week, packers killed 2.68 million head, which, while impressive, still looks to us like it is a little short of what USDA's estimate of the March/May pig crop suggested. In fact, the industry has been under-killing that pig crop estimate in a small way for most of September and October. It is possible that the actual March/May pig crop was smaller than what USDA reported. By our calculation, to be consistent with the pig crop estimate, the industry will need to slaughter close to 2.8 million head for a few weeks in late November and early December. That would likely test packer capacity but we think that packers can manage kills that large by increasing the number that they slaughter on Saturdays. Sow slaughter from January through September averaged about 12% over last year — a sign that producers have been scaling back in the face of poor profitability for most of 2020. Recently however, sow kills have tapered back down closer to last year and that could be a result of strong producer margins in September and October when the cutout and cash hog prices both moved substantially higher.

> **Sow slaughter increased 12% YOY** from January to September – a sign that producers are scaling back

So far this fall, barrow and gilt weights have been working higher in the normal seasonal fashion, but those gains have been a little stronger than what we saw in the past couple of years. That could be due compensatory gains as hogs came off of maintenance rations at the end of summer and went back on full feed with fresh corn from this year's harvest. It is important to note that packer-owned hogs are considerably heavier than hogs owned by independent producers. Whatever the reason, it creates a risk that producers will lose some bargaining power and thus we could see hog pricing slip lower through the remainder of the year. Packers margins remain very healthy at over $20/hd and as the pork cutout declines, it is reasonable to expect them to pressure cash hog prices lower in order to protect their margins.

Up until September, it seemed logical to expect hog producers to reduce the herd size because the first eight months of 2020 were not kind to them. Producer margins were negative in every week from January through August, with producers losing on average about $30/head on every animal marketed during that eight-month period. However, as the cutout and cash hog prices soared in September and October, producers saw their margins climb back into the black to the tune of about $7/head. Those profits will likely be short-lived and we expect to see producer cash-to-cash margins back in the red by early December. It is unlikely that the brief period of positive margins producers experienced this fall will be enough to put them in expansion mode again. As a result, pork users can expect little or no growth production during 2021 compared to 2020. Price levels may average a bit lower in 2021 however, mostly because we expect the ongoing recession to curtail demand by a modest amount.

DEMAND SITUATION

It has been our contention that the big fall rally in pork prices was driven by much stronger exports which shorted the domestic market and caused domestic buyers to scramble to meet their needs. Further exacerbating this situation is the fact that pork in cold storage is very tight at present. Users drew down cold storage stocks during the plant closures in May and have not yet replenished those stocks (see **Figure 1**). We still see export demand as very strong, but it does seem to be tempering a bit in recent days. When the pork cutout climbed into the upper $90s during October, those users such as retailers who could substitute other proteins in place of pork got busy making plans to do that in November and December. We are already seeing the impact of this in the belly market, where prices have cratered over the past few days. It is very likely that demand for the other primals will temper as well and thus those users that have needs for November will likely find pricing below what they experienced in September and October. That should translate to a cutout value that hovers in the $80s this month, with perhaps some brief trips into the high $70s.

One metric that is useful in gauging the overall level of demand is the combined producer and packer margin. When demand is strong this metric rises because stronger demand allows for both segments of the supply chain to experience better margins. Likewise, when the combined margin is falling, it is a signal that weaker demand for wholesale pork is compressing the margins within the supply chain. **Figure 2** provides the pork combined margin and it is apparent that this margin tends to cycle in periods of roughly two months. The current cycle, which was accelerating upwards during September and October now has turned sharply lower. Further, this was a very strong cycle, peaking well above most other demand cycles except for the peak generated by panic buying as plants shutdown this spring. It is also worth noting that most often the downcycle doesn't end until the combined margin is at or below the zero line. If that is the way it is going to play out this time, then clearly this downcycle in demand has a ways to go. It is fortunate for buyers that this demand downcycle is coinciding with the period of the year when pork production is the highest. That creates the potential for some rather large price declines. However, while the price declines may be quite large, prices are coming down from an exceedingly high level, so it might not take the cutout much below the $80 level in the next couple of months.

SUMMARY

It appears that now the hog and pork complex has "rounded the bend" now and prices are coming down from the very high levels seen in the past couple of months. Kills will be large between now and the end of the year and may approach 2.8 million head per week near the end of November. Producers have experienced a brief period of positive margins in the last few weeks, but that is not likely to persist and they may soon be facing red ink once again. We expect producers to continue scaling back their breeding stock and that should keep pork production next year from growing much above this year's level. As the official export data becomes available in coming months, we expect to show very strong exports in September and October, probably destined for China. That export business is likely to continue to be relatively strong in November too, but domestic users who have been stung by exceedingly high prices in the past couple of months are likely to shift to other proteins and thus cause domestic pork demand to fall. The beginning of that downcycle in demand is already becoming apparent. How far and fast prices will fall is difficult to ascertain, but we think the days of $90 cutouts are behind us and the months ahead will be characterized by cutout values in the $80s and perhaps $70s at times. **Table 1** provides our near-term price forecasts.

Figure 1: End Of Month Pork in Cold Storage

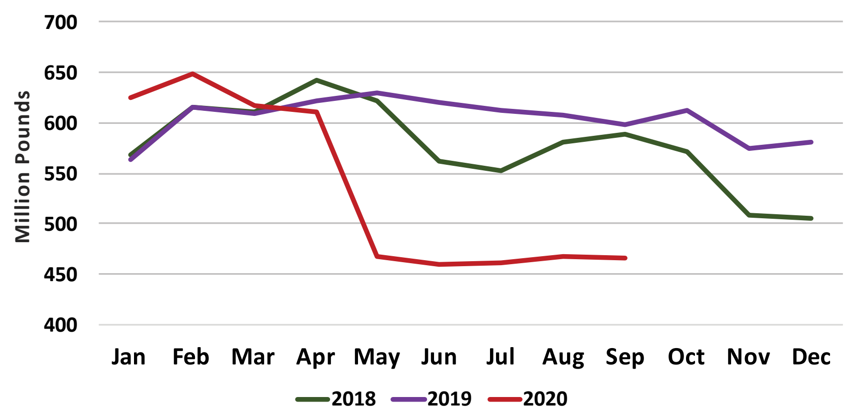

Figure 2: Combined Producer & Packer Margin

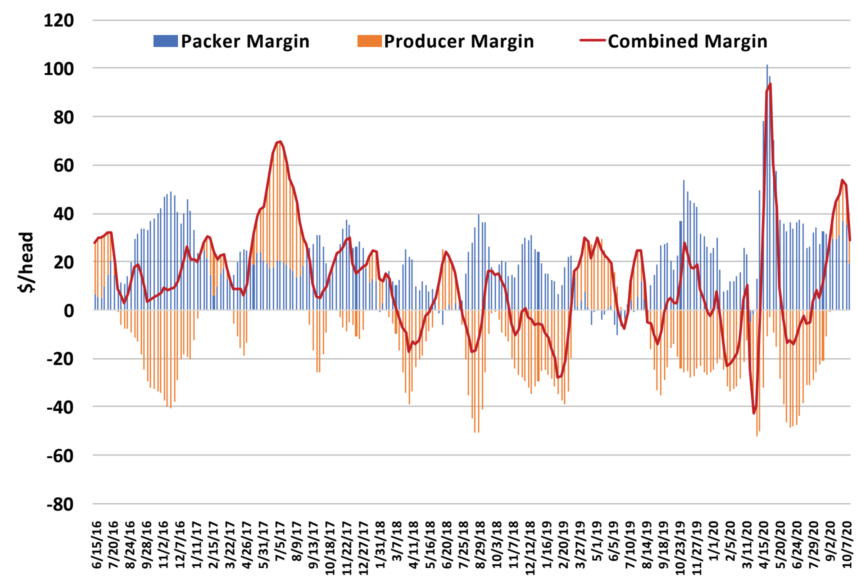

Table 1: JSF Hog and Pork Price Forecasts

	4-Nov	11-Nov	18-Nov	25-Nov	2-Dec	9-Dec
Pork Cutout	82.7	80.7	79.7	79.8	79.7	80.8
Loin Primal	78.1	77.2	77.5	76.5	76.2	75.1
Butt Primal	74.3	74.0	73.6	74.1	75.3	76.2
Picnic Primal	58.0	57.6	57.5	59.0	61.0	62.2
Rib Primal	132.1	130.4	128.0	130.5	132.2	134.3
Ham Primal	87.0	84.6	80.3	78.2	76.5	77.1
Belly Primal	112.2	105.6	106.7	110.0	109.3	115.4
Lean Hog Index	72.4	67.7	64.7	64.1	62.4	64.5

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