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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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The US hog and pork markets caught fire during September, led by a cutout that moved from the high $50s at the beginning of the month to over $90 by the end of the month. Hog prices advanced rapidly too, with the Lean Hog Index moving from the high $50s to the mid $70s over the same time frame. No one saw this coming and it has left many observers wondering what is going on. We can say with confidence that this is not a supply-driven rally.

> Pork markets **have been on fire**, with the cutout **adding $40** in just **over 30 days**

Hog slaughter has been increasing in normal seasonal pattern and pork production last week was nearly equal to the level produced last year at this time, yet the pork cutout was nearly $20 higher than the same week last year. That points to demand strength as the culprit for this unusual fall rally. At this point, our best guess is that much of this demand strength is coming from international markets which are sucking product out of the US at an increasing rate and thus leaving complacent US buyers to scramble to secure their needs from a smaller domestic supply. The weekly data reported by the Foreign Agricultural Service (FAS), indicates that over the past five weeks, net sales of pork to international destinations has been up about 185% from last year (see **Figure 1**). Net sales to China are up over 500% YOY in the last five weeks. The FAS data is typically less reliable than the official trade data released by the Economic Research Service (ERS), but it does seem to point to much stronger export activity.

> International sales of pork over **past 5 weeks up 185% YOY**

We know that when packers make export sales they begin putting product aside to fill those orders in the future. That could very well be what is driving the current market strength.

SUPPLY PICTURE

Hog slaughter has been steadily increasing in normal seasonal pattern. Last week's kill registered 2.6 million head, which was only about 0.5% below last year's level. However, because carcass weights are still a little heavier than last year, total pork production is running about a half percent above last year. Packer margins are currently estimated at about $30/head, so there is plenty of financial incentive for packers to keep kills as large as they possibly can. However, last week's kill was still about 80,000 head less than what the Mar/May pig crop indicated would be available during this period. Perhaps USDA over-estimated that pig crop or perhaps the new COVID-19 protocols are limiting slaughter and a portion of the pig crop is going un-slaughtered. One thing looks pretty certain — at current slaughter levels, packers are not making any headway into clearing backlogged hogs and in fact may be adding to the backlog. That has implications for the cash hog market, but does not materially impact pork pricing.

There has been much speculation about just how many hogs remain backlogged following the COVID-19 related plant shutdowns this spring. There was hope that last week's *Hogs and Pigs* report would provide some clarity into the size of that backlog. Indeed, the report did show the number of hogs that weigh over 180 pounds was up almost 10% from last year as of Sep 1 and the number in the 120-179 pound category was up about 6% YOY. That would suggest a significant backlog still exists. However, most, if not all, of those hogs in the 180+ pound category would have been slaughtered during the month of September and we have certainly not seen anything near a 10% increase in slaughter. In fact, September slaughter was about even with last year. It is possible that packers couldn't slaughter more hogs than last year due to COVID-19 protocols and thus those extra hogs are still out there. But, if those

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hogs were still out there, we would expect them to be getting really heavy by now and producers would market their heaviest hogs first. Next, we turn to the carcass weight data for supporting evidence and find that barrow and gilt carcass weights are only running a pound heavier than last year. Thus, the weight data points to either no backlog or a backlog that is significantly smaller than what USDA reported. It is possible that some heavy market gilts were slaughtered as sows, thereby reducing the backlog without it showing up in market hog slaughter. Sow slaughter in the weeks prior to the plant shutdowns was running about 8% over last year and since then it has been running about 15% over last year.

The recent *Hogs and Pigs* report indicated that the breeding herd as of Sep 1 was 1.5% less than last year. That was a smaller breeding herd reduction than expected, but it does reflect the fact that the industry is downsizing for the first time since the 2009-10 period following the Great Recession. Given that sow slaughter during the Jun/Aug quarter for which this report covered was up 12%, having the breeding herd down only 1.5% seems very strange. To make those numbers fit together, producers would have needed to retain 12.5% more gilts into the breeding herd than they did last year (see **Figure 2**). That also seems strange. Why would producers be aggressively retaining gilts for breeding purposes as a pandemic swept the globe and the world economy moved into deep recession? Perhaps they did it because they couldn't get the animals slaughtered and figured it might be better to just retain them as breeding stock instead. That would reduce the backlog of market hogs, but only by a relatively small amount. Clearly, the *Hogs and Pigs* report did not provide the answer to the backlog question that many were hoping for.

DEMAND SITUATION

As mentioned in our opening paragraph, export demand for US pork appears to be surging. We are seeing indications of that in the weekly export data and the sharp increase in pork prices over the past several weeks also points in that direction. We think much of the increase in export demand is coming from China. That would make sense because this is the time of year the Chinese buyers typically begin increase purchases of foreign pork in order to meet demand for the Chinese New Year (CNY). The CNY is on Feb 12, 2021 and US product would likely need to be shipped by the middle of December in order to clear customs and be in position to sell to Chinese consumers for the CNY. Normally this buying activity takes place in October and November, but perhaps buyers are starting early this year because they expect issues surrounding COVID-19 to slow shipments. The degree of this export activity will likely become clearer in the next few weeks as additional data is released by FAS, but the reaction of price levels in the second half of September already points to something important going on.

Domestic pork buyers likely grew pretty complacent over the summer months when the cutout was languishing in the $60s and low $70s, so many of them probably came into the fall close bought. Our theory is that the surge in export business caught them off guard and when it came time to fill their needs from mid-September onward, they had to chase product and that sent prices spiraling higher. October is typically known as "pork month" because the pork industry provides financial support to retailers during October to encourage them to feature more pork than normal. If buyers had "pork month" features planned but waited until September to actually procure the product because they expected big kills to push prices even lower than what was seen this summer, then this would create a pool of pent-up domestic demand. It is worth noting that if a retailer has committed to features tied to "pork month" then they cannot substitute beef or chicken to fill that need. Their hands are tied and they are forced to pay whatever it takes to secure the product. Thus, we are facing a double whammy of strong export demand at a time when domestic buyers are short bought. That creates panic buying and the result is a cutout that is currently $20 stronger than last year, even though pork production is not all that different from last year. If indeed it is strong demand from China that is fueling this market, it is a good bet that won't subside until December approaches. In fact, it may get more intense as we get closer to December. With this in mind, we have substantially raised price forecasts for Q4.

SUMMARY

Price levels in the hog and pork complex have risen rapidly in recent weeks. It does not appear that this has anything to do with tightness in the hog supply. Instead, we believe it is being driven by a surge in demand coming from China as buyers try to get a head start on their purchasing for the CNY. Domestic pork buyers likely got caught in a short-bought condition and that has helped fuel the rally. The domestic component of this surge will likely subside within a couple of weeks, but the international component could easily last a couple more months. That has forced a re-think on pork prices this fall and price forecasts have been raised accordingly (see **Table 1** for our near-term price forecasts). The question of how many hogs remain backlogged in the production pipeline remains unanswered. USDA's recent *Hogs and Pigs* report seems to suggest that a substantial backlog remains, but carcass weights and spot hog prices paint a different picture. The backlog, if any, will be inconsequential to the pork market this fall because packing capacity won't allow for "extra" hogs to be slaughtered beyond what prior pig crops indicated. If a large backlog still exists, it could have negative consequences for the hog market, but pork pricing will be largely driven by strength in international and domestic demand for the finite amount of pork that can be feasibly produced by packing plants. What a fitting way to close out a year that has been the very definition of abnormal.

Figure 1: Net New Pork Export Sales, FAS Reported

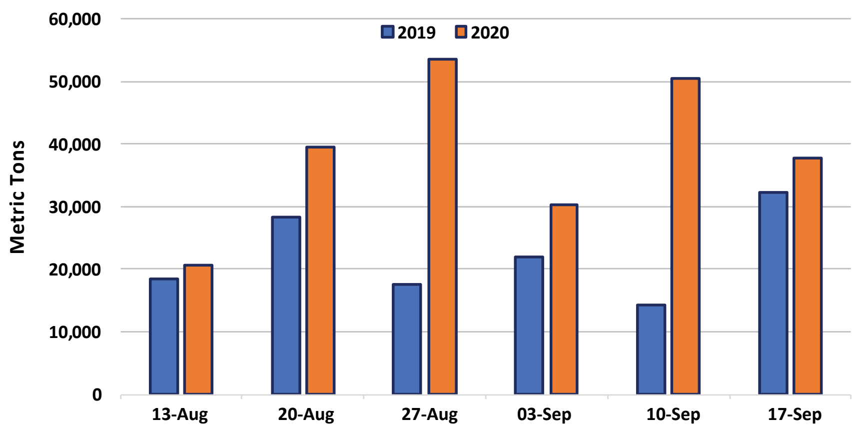

Figure 2: Gilts Added to Breeding Herd, Q3

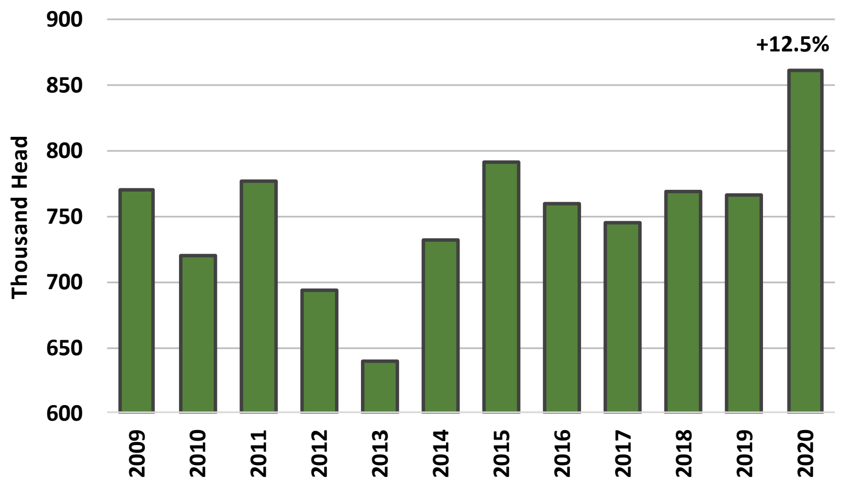

Table 1: JSF Hog and Pork Price Forecasts

	7-Oct	14-Oct	21-Oct	28-Oct	4-Nov	11-Nov
Pork Cutout	91.2	88.8	86.5	84.6	83.8	83.3
Loin Primal	74.8	73.2	71.0	71.6	71.6	71.3
Butt Primal	85.3	84.1	84.0	83.3	85.1	84.2
Picnic Primal	65.1	63.4	62.5	61.9	63.3	64.8
Rib Primal	134.5	135.6	137.5	134.7	132.7	134.5
Ham Primal	84.7	80.1	77.4	74.8	75.0	73.6
Belly Primal	162.0	158.3	152.1	144.5	137.0	135.4
Lean Hog Index	77.6	75.6	71.5	68.6	68.6	67.5

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