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

THE MONTHLY RED MEAT OUTLOOK: HOGS & PORK

OCTOBER 2019

The hog and pork complex remained on the defensive for most of September as seasonally increasing supplies were met with lackluster demand. Hogs that are coming to slaughter now were born in the March/May quarter and the USDA survey indicated that pig crop was up 3.7%. This has left the market awash in pork, requiring lower price levels to move all of the product through the system. African Swine Fever (ASF) continues to spread in Asia and has now been reported in South Korea and the Philippines. China's Ministry of Agriculture reports that its sow herd is now down 39% as a result of the disease and many observers believe this number understates the size of the losses. Hog and pork prices in China have surged to record levels and consumers there are finding it difficult to source pork in some provinces. China has upped its imports of pork and promised to purchase more from the US as a goodwill gesture ahead of trade talks in Washington on October 10. That has set the futures market on an upward path once again, but so far, the price impact in US markets has been minimal. The story this fall is going to revolve around large US supplies, not huge exports to China, and price levels are expected to remain low. The futures market runs the risk of getting it wrong once again, but this time US pork buyers do not appear to be panicking like they did earlier this spring when December hog futures soared to over $90/cwt. In our opinion, that is the correct response and buyers will be rewarded for their discipline with low prices this fall.

> Weekly hog slaughter set to **reach 2.7 million head** by the end of October

SUPPLY PICTURE

Last week, US hog slaughter reached 2.65 million head, fully 3% larger than last year at this time. If USDA's estimate of the March/May pig crop is correct, and so far, it appears right on target, then weekly hog slaughter could touch 2.7 million head before the end of October. Those big hog supplies are going to be with us through the end of the year and will likely keep price levels contained throughout Q4.

The biggest consequence of super-high futures prices this spring is that they incentivized US hog producers to ramp up production. Producers who hedged their Q4 and Q1 production when the futures shot up this spring have guaranteed themselves record profits at a time of year when producers are usually deep in the red. Economists call this a "supply response" and that is at the root of the old trader adage that states "the cure for high prices is high prices". The US pork industry has been kicked into high gear and we saw evidence of that in last week's *Hogs and Pigs* report where the summer pig crop (Jun/Aug) was estimated to be up 2.9%. Those hogs will come to market in Dec/Feb. The total breeding herd as of September 1st was reported to be up 1.6%, but the most stunning number in the report was the whopping 11.11 pigs saved per litter, which was 3.6% stronger than last year (See **Figure 1**). Producers are finding ways to make their herds more productive in response to the futures market's optimism over ASF in China and that is the first step in boosting supply to meet the overseas demand that the futures market continues to insist is coming. The next step, which is already underway in some locations, is to build new hog production facilities to accommodate an even larger herd in 2020. The industry had better hope that China comes through on its perceived need for lots of US pork next year, otherwise the industry will find itself in a situation of significant overcapacity and domestic prices will tumble. For now however, the market looks well supplied and that is likely to preclude any serious rebound in hog and pork prices this fall.

DEMAND SITUATION

All eyes are on the international markets as ASF continues to spread in Asia. Chinese hog and pork prices are at record levels — so high that US pork could easily be delivered into China at a price well below the internal Chinese price (including paying all tariffs). That is a powerful incentive for Chinese pork buyers to import US product and they have been taking big quantities compared to historical norms since spring (See **Figure 2**). Expect this to continue, but we don't see additional upside in exports to China in the near term due to the ongoing trade war. China has pledged to buy some additional US pork ahead of the October 10 resumption in trade talks, but our guess is that the trade talks won't yield any significant breakthroughs and the bump in exports is likely to be temporary. In fact, now that Washington is consumed with impeachment proceedings against President Trump, it is likely that trade talks garner less attention than they would have otherwise and the prospect of impeachment makes it more likely that the Chinese will take a "wait and see" approach with Trump. When the US export data for August is released next week, we expect it to show a 21% YOY increase. That amounts to about 95 million pounds more than last year, but August pork production in the US was 142 million pounds more than last year. So, exports are helping to clear some, but not all, of the extra US production in recent months. Look for that to continue through the end of the year.

> Deferred hog futures look **more than $10** too high

Domestic demand for pork was soft during September as illustrated in **Figure 3**, which plots the historical price-quantity relationship during the month. In this approach to demand measurement, points that lie below the regression line correspond to years where September demand was weaker than normal. We think October demand will be better, in part because retailers saw an advantage in moving pork to a more prominent role in retail ads after beef prices became elevated in August and September. With export demand strong and domestic demand improving in October, that will help to mitigate some of the price depressing effects of big production this fall. As a result, the Q4 average cutout could be a couple of dollars higher than last year, with the biggest improvement coming late in the quarter. **Table 1** provides our near-term price forecasts for the major primals and hogs.

SUMMARY

Big production remains the primary story in the hog and pork complex this fall. That will continue to be a factor into next year as the *Hogs and Pigs* report seems to indicate that the pork industry is priming the production pipeline in response to elevated deferred futures prices. Once this production is set in motion, it will be imperative that exports remain at very high levels. Anything that disrupts exports in the midst of this ongoing large production has the potential to crater prices. One such possibility that doesn't get much attention is ASF being discovered in the US. If that happens, all exports would probably cease immediately and prices would fall to levels that would cripple the industry. Our advice to buyers is to remain relatively close bought this fall since we see little risk of prices spiking higher with production levels so large. Buyers should also resist the urge to forward price 2020 needs based on deferred futures which look more than $10/cwt. too high relative to our take on what the fundamentals will look like next year.

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THE MONTHLY

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Figure 1: YOY Change in Pigs Per Litter

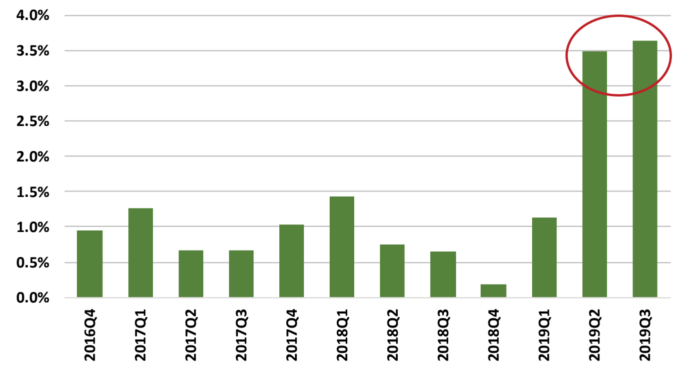

Figure 3: Pork Cutout vs. Per Capita Domestic Disappearance, Sep

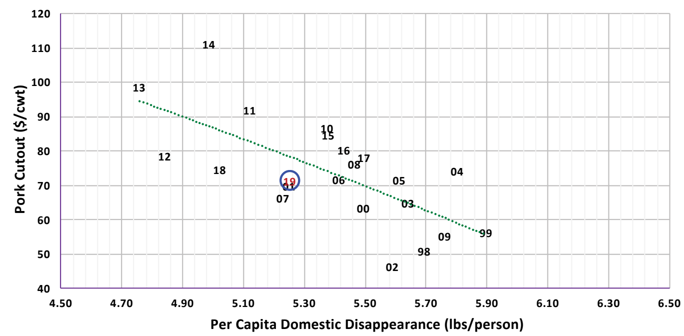

Figure 2: Weekly Pork Exports to China

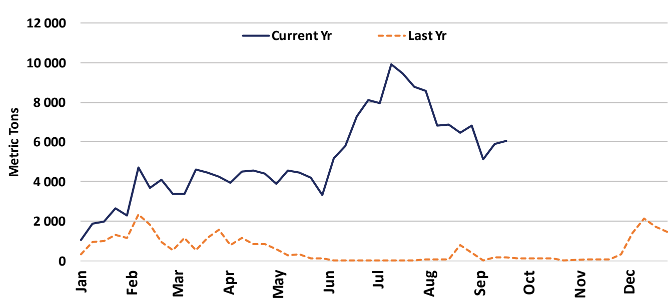

Table 1: JSF Hog and Pork Price Forecasts

	9-Oct	16-Oct	23-Oct	30-Oct	6-Nov	13-Nov
Pork Cutout	74.8	74.4	73.2	73.9	75.4	77.4
Loin Primal	72.7	72.4	70.3	68.5	68.3	69.3
Butt Primal	84.9	82.9	82.3	83.6	84.9	86.6
Picnic Primal	52.7	54.0	55.2	56.3	57.2	59.0
Rib Primal	111.3	109.9	108.8	111.1	113.8	116.2
Ham Primal	62.1	59.8	57.6	59.1	62.2	63.8
Belly Primal	112.4	114.6	113.0	115.9	119.0	124.0
Lean Hog Index	60.6	58.9	55.5	56.5	59.3	61.5

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