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Foods Inc.

THE MONTHLY RED MEAT OUTLOOK: HOGS & PORK

SEPTEMBER 2019

Both the hog and pork markets have been in steady decline since the last issue of the Red Meat Outlook. The cutout has dropped over \$20 since peaking near \$90 in mid-August and cash hog prices are down almost \$30 over the same period. Seasonally expanding hog supplies are the primary cause of the quick price retreat, but we think that some softening of domestic demand also played a role. Below normal temperatures in hog producing regions during August also allowed hogs to quickly gain back the weight that was lost during the heat wave in early July. Now past Labor Day, the market has transitioned from one of tight supplies in the summer to one of greater availability

**Hog slaughter set to eclipse
2.6 million hd/wk, pressuring
pork prices**

as fall approaches. The African Swine Fever (ASF) situation in Asia continues to be an issue causing hog and pork prices in that part of the world to continue rising to very high levels. When, or if, that results in stronger pricing in North America remains to be seen. So far it has had little impact, but the specter of ASF continues to be on the minds of US pork buyers and the futures market remains very volatile as a result. In the absence of a trade deal with China that results in a major reduction of China's tariffs on US pork, the market this fall looks like it is going to be one of ample pork supplies and average demand. That should keep pork prices on the defensive although there will surely be periodic upticks in pricing. Buyers are advised to remain close bought in September and October unless the cutout drops below \$68. At that level, increased ownership would be recommended. Buyers should also keep a close eye on US/China trade developments and be prepared to cover quickly if it begins to look like a trade agreement will happen. Right now, a trade deal looks very unlikely.

SUPPLY PICTURE

Hog slaughter easily reached our target of 2.5 million head by the end of August and with the Labor Day holiday behind us, slaughter levels are expected to continue to grow further. Before September is done, look for the industry to register one or more weekly kills in excess of 2.6 million head (**Figure 1**). As a reminder, the hogs that will be killed in the Sep/Nov quarter were born in March/May and USDA reported the March/May pig crop to be almost 4% above last year. That means that the market will have to find a way to clear a lot more pork this fall than it did last fall (2018) when the pork cutout averaged about \$74 over the Sep/Nov period. With the additional pork production expected this year, it is reasonable to assume that this year the Sep/Nov cutout will average several dollars under last year and could be as much as \$10 lower than last year if the demand side of the market fails to perform as expected.

**China's share of US exports
swelled to 21% in July**

USDA will issue its next *Hogs and Pigs report* on September 27 and we are expecting it to show a 1.5% YOY increase in the Jun/Aug pig crop, which will be slaughtered in the upcoming Dec/Jan quarter. While that might seem like a small pig crop given the big productivity gains that were seen in last report, it reflects about a 2% reduction in the number of sows farrowing and a smaller gain in the number of pigs saved per litter than what was reported last quarter. We could be underestimating productivity however, and so there is a significant chance that USDA may report a larger pig crop than what we currently project. We will also be watching for expansion in the breeding herd as some producers may have taken advantage of the absurdly high futures prices this spring to lock in very high selling prices for their fall and winter hogs and thus, they might be incentivized to ramp up

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production as much as their facilities will allow. Our current forecast looks for the breeding herd to be up 1.4%, but as with the pig crop, we think there is more risk that it comes in larger than that, rather than smaller.

DEMAND SITUATION

USDA released its official trade data for July last week and it showed a huge 27.5% YOY gain in pork exports. The lion's share of that gain went to China, although movement to Japan was up over 4% and movement to Canada increased almost 12%. We need to keep in mind that price levels in July were moderately lower than they were last July and that likely helped boost the July export numbers. Exports to China/Hong Kong registered 113 million pounds. That represented about 5.1% of total US pork production that was flowing into China. That is pretty impressive, but much has transpired in the US/China trade war since July and we expect that the totals for August and September will be down considerably when those data are released. Hog and pork prices in China have been rising rapidly in recent weeks and it appears that even with the 72% tariff on US pork entering China, the landed cost of US pork is well below the Chinese internal price. Normally, we would expect a surge in movement to China under such circumstances, but the Chinese government is actively discouraging imports of US pork and that is likely to limit exports to China until something changes in the trade negotiations. Since 2010, the US has consistently exported between 20% and 23% percent of its pork production. This year looks like it will come in at the high end of that range if China doesn't significantly pull back from the market in the last four months of the year. **Figure 2** highlights China's growing importance as a destination for US pork. Exporting 23% of total production is good, but it is nowhere near enough to cause a major increase in US pork prices. If a trade agreement with China was negotiated that removed all tariffs on US pork, then we could very well see exports approaching 27% of production in 2020; which would probably add about \$10 to the pork cutout next year. However, the US and China appear to be a long way from a trade deal and it's entirely possible that the Chinese decide to wait until after the 2020 elections in the hopes that Trump will be defeated and they might obtain a better result bargaining with the next president.

Presently, domestic pork demand appears mediocre. That is a little surprising given that beef prices have soared in the wake of a fire that closed one of Tyson's largest cattle harvest facilities ([see Special report: Tyson Fire](#)). The fire happened over a month ago and now beef prices are in retreat, which won't help domestic pork demand much going forward. US chicken is also competitively priced this fall. The demand indicators are suggesting that domestic demand during September will be below the long-run average. But often those dips in demand are followed by improvement the following month, so participants might look for demand to perk back up in October.

Domestic pork demand currently soft, could improve into October

SUMMARY

The most important factor in determining pork pricing over the next couple of months will be escalating slaughter levels. Look for improved availability as kills move to 2.6 million head per week later this month and approach 2.7 million head per week in early November. Carcass weights will also be increasing, further adding to supply. In addition, an announcement of a trade deal between the US and China would create the biggest upside risk to pricing. But right now, that looks to be a long way off. Domestic demand appears to be struggling a bit here in September and, with bigger production on the way, has the potential to push the cutout below \$70 later this month or in early October. Buyers should remain close bought, but monitor the US/China trade situation closely in order to avoid a surprise. Forward bookings based on deferred futures should also be avoided as we estimate that most of the 2020 contracts are \$10 or more over-priced. Futures traders continue to keep an ASF premium built into deferred futures, but there is no need for pork buyers to pay that premium in the current environment. **Table 1** gives our price forecasts for selected items over the next several weeks.

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Figure 1: Weekly Average Hog Slaughter

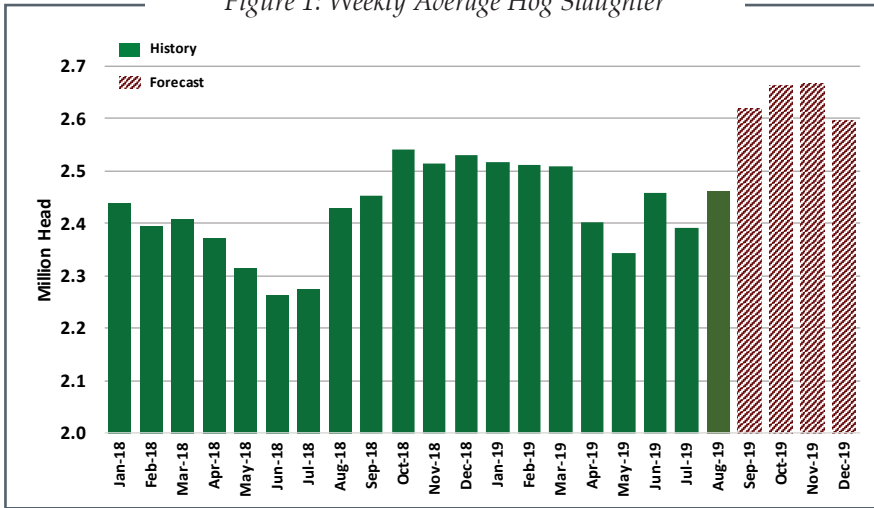


Figure 2: Exports to China/Hong Kong as a Percent of Total US Pork Exports

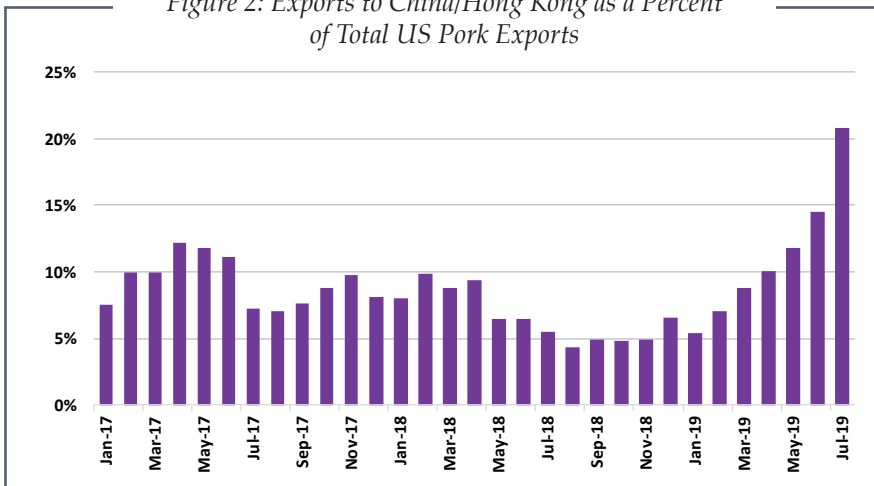


Table 1: JSF Hog and Pork Price Forecasts

	18-Sep	25-Sep	2-Oct	9-Oct	16-Oct	23-Oct
Pork Cutout	73.7	75.5	75.9	75.0	74.5	72.8
Loin Primal	69.5	70.9	71.8	72.7	72.4	70.3
Butt Primal	93.0	92.0	90.0	88.0	86.0	84.0
Picnic Primal	50.8	52.3	53.1	54.1	54.3	53.6
Rib Primal	111.1	113.2	115.0	115.1	113.7	112.6
Ham Primal	58.7	58.9	60.3	60.1	57.8	55.6
Belly Primal	111.7	119.4	118.4	112.4	114.6	113.0
Lean Hog Index	63.0	64.3	62.9	60.8	59.0	55.2



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