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RED MEAT OUTLOOK: HOGS & PORK

The US hog and pork sector made significant progress toward normalization during the month of August. Kills were large and helped to clear any backlogged animals that remained from this spring. Price levels slowly moved higher, helping to bring them closer to typical levels for this time of year. The process is still underway, but there is reason to hope that by mid-September all backlogged hogs will be gone and the industry will be functioning much like it was before the COVID-19 pandemic threw the complex into chaos last spring. There are still some labor shortages in the further processing portion of the industry and that has depressed price levels of items such as hams that require additional processing after harvest in order to prepare for retail and foodservice consumption. As time passes, we expect these labor issues to get resolved and that should provide more price support and price stability for the processed pork items. Fall always implies a seasonal increase in hog slaughter due to better conception rates and productivity in the spring months and this year should be no exception. Packers demonstrated last week that they are capable of producing a kill near 2.7 million head and that is important because by mid-October the industry will need to produce kills of that size or larger on a regular basis. Fall and early winter is also the time of year when hog producers struggle to find profitability as large supplies typically depress price levels. Because of the COVID-19 disruptions this spring and the ensuing backlog of hogs, producers operated in the red all summer long and missed out on what is normally their best profits of the year. There is little doubt that producers are under a lot of financial strain currently and we expect that to result in a downsizing of the US hog herd over the next few quarters.

> Cash prices and carcass weights suggest **the backlog of hogs is nearly gone**

SUPPLY PICTURE

Packer margins held in the $25-35/hd range throughout August and that provided plenty of incentive for packers to kill as many hogs as they could. By our estimate, packers killed about 330,000 head more hogs in the Jun/Aug quarter than was called for by prior pig crops. That was constructive towards clearing out backlogged hogs, but the backlog stood at over 3 million hogs heading into the quarter and so it is quite obvious that the industry will be unable to slaughter its way out of the backlog. Instead, a large number of hogs had to be euthanized and we think that process has been completed and that if any backlog still persists, it is relatively small. In the upcoming Sep/Nov quarter, the industry will be slaughtering hogs born in the Mar/May timeframe. USDA's survey indicated that the Mar/May pig crop was 1.4% larger than last year. That would imply bigger kills this fall compared to last, but it is possible that some of that Mar/May pig crop was euthanized and so the actual increase in Sep/Nov slaughter might be smaller than advertised. The next two weeks will see light kills due to the Labor Day weekend, but after that kills during September should run between 2.65 and 2.7 million head per week.

Barrow and gilt carcass weights were most recently reported at 209 lbs, which is three pounds heavier than last year. That is significant since it adds about 1.5% to production, but we need to keep in mind that the long-run trend implies about a 0.6% increase (1.3 lbs) each year (see **Figure 1**). So, about half of the current three-pound carcass weight gain was expected due to trend and only about a pound and a half would be considered "abnormal". If there really was a huge backlog of hogs in the industry, we would expect that abnormal portion of weights to be

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much larger. This is the point in the calendar where hog weights bottom and begin to trend seasonally higher through the end of the year. We look for that pattern to repeat again this year but suspect that the gap between this year and last will narrow as we move deeper into fall.

All of this points to pork production this fall that will be large, but not overly burdensome. Our current projections have commercial pork production in Q4 up only 0.5% from last year. That is significant given that since 2015 the YOY increase in Q4 pork production has averaged over 4% (see **Figure 2**). If exports strengthen this fall as expected, it is entirely possible that the amount of pork available to domestic consumers will be 1-2% less than it was a year ago. With that in mind, it is important to recognize that the pork cutout averaged nearly $80/cwt in Q4 last year and, while demand is almost certain to be softer this year due to the recession, cutout levels in the mid $70s should not be hard to attain. One further factor that should not be overlooked is that the amount of pork in cold storage is way down, coming in at 25% below last year as of the end of July.

Q4 pork production expected to **be up less than 1% YOY**

DEMAND SITUATION

August saw some significant strengthening in pork demand. It is not clear yet exactly where this came from, but our working theory is that foodservice and institutional buyers finally started to get more confident that there wouldn't be additional lockdowns and thus they became more willing to bring their inventories back up to more typical levels. The August strength appears to be coming solely from the domestic market and not the international markets. Stronger demand helped to lift the pork cutout into the low $70s after spending much of July in the mid-to-upper $60s. We don't see this demand improvement as a temporary blip but rather a regaining of the normal demand that was lost during the COVID-19 upheaval. Clearly, it was not all related to retail buying ahead of Labor Day. It is our expectation that demand will hold up well in September and October as the industry moves further along the path of normalization. That said, there is demand risk because government assistance to the 16 million unemployed is running out and new stimulus measures seem to be stalled in Washington. If a new deal cannot be struck, then protein demand is likely to suffer but pork shouldn't be hit as hard as beef due to its lower price point.

US pork exports have not looked good recently. Data for June indicated only a 3.3% YOY increase in pork exports. That was pretty underwhelming after the 40% gain that was posted in Q1 and the nearly 16% increase registered in Q2. China has recently become wary of imported frozen meat because authorities there believe it has the potential to carry the COVID-19 virus. That has resulted in a lot of new testing and a slowdown in movement. USDA's weekly export numbers show movement to China during August at the lowest levels so far this year. The volumes are still large in a historical context, but they don't seem to be increasing and that is concerning. Perhaps Chinese buyers are waiting for lower pork prices this fall before ramping up purchases. Further, there is often an increase in movement to China during Q4 as that country gears up for its New Year's celebrations. Both of those scenarios factor into our expectations that pork exports will strengthen later in the year, but between now and then it is likely that USDA will continue to report disappointing export volumes.

SUMMARY

Things are slowly returning to normal in the hog and pork complex following the upheaval this spring caused by the pandemic. It appears that the backlog of hogs has been nearly eliminated, partly through increased slaughter and more significantly through euthanasia. Packer margins remain wider than normal for this time of year and that will encourage high slaughter rates in the weeks ahead. The pork cutout has now established itself in the lower $70s and could have some near-term upside risk due to Labor Day reduced kills. Hog supplies will grow as we move through September and into October, but we don't expect them to be overly burdensome. Domestic demand has been very good lately and we suspect it is due to restocking by foodservice and institutional buyers. That should continue in September and help maintain the cutout in the low $70s, although there may be periodic trips into the high $60s. International demand has been lethargic, but is expected to improve as the end of the year approaches, mostly due to improvement purchases destined for China. If exports do meet our expectations in Q4 then it would imply 1-2% smaller domestic availability than last year. Labor shortages have plagued the further processing sector this summer but hopefully that situation will improve in the next couple of months. **Table 1** provides our near-term price forecasts.

Figure 1: Annual Hog Carcass Weight, 1980-2020

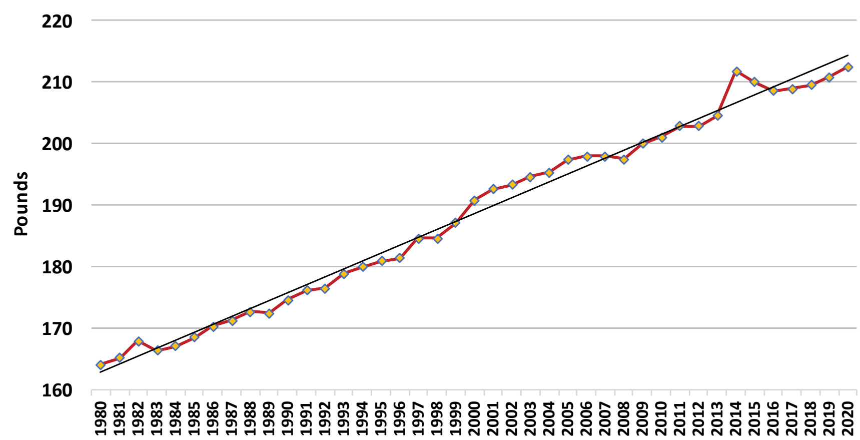

Figure 2: YOY Change in Q4 Commerical Pork Production

(2020 is JSF Forecast)

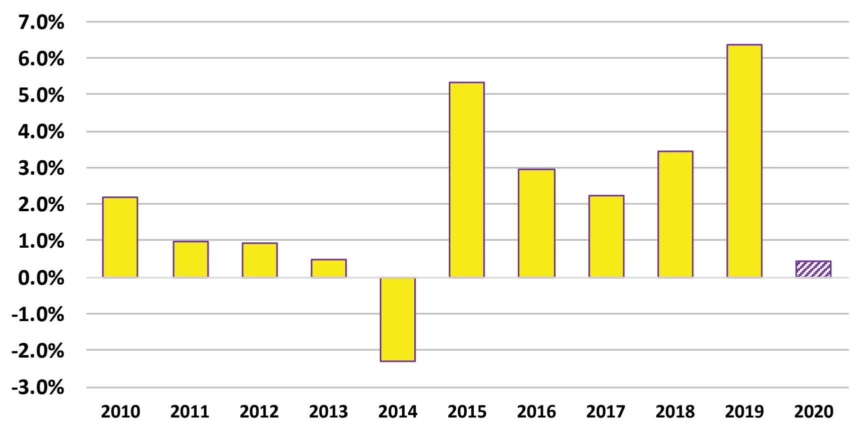

Table 1: JSF Hog and Pork Price Forecasts

	9-Sep	16-Sep	23-Sep	30-Sep	7-Oct	14-Oct
Pork Cutout	72.6	72.6	73.3	73.8	73.1	72.1
Loin Primal	71.4	71.0	71.5	72.1	71.3	70.5
Butt Primal	82.1	82.0	81.3	80.2	78.1	75.4
Picnic Primal	44.3	47.0	49.8	51.4	53.1	54.9
Rib Primal	124.0	123.3	120.4	123.0	122.7	125.6
Ham Primal	58.4	60.0	62.3	62.5	60.3	59.1
Belly Primal	111.6	108.2	107.1	107.3	108.3	104.2
Lean Hog Index	58.6	59.5	60.8	61.3	59.7	57.4

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