VOLUME 4, ISSUE 6
EN | FR | ES

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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

JUNE 2021

Pork prices continued their steady escalation throughout May and the cutout is now approaching the $130 level. The all-time record high for the pork cutout was $137.56, which was recorded on July 18, 2014 when the pork market was dealing with very tight supplies due to the spread of PEDv (see **Figure 1**). Given that it is only early June right now, there is a reasonable chance that seasonal tightening of production over the next few weeks will cause the cutout to challenge that all-time high. The difference between this year and 2014 is that the current rally is being driven more by the demand side and not so much by unexpected hog shortages. In fact, the negotiated hog market has been working lower over the past couple of weeks, which is further evidence that this strong market is not being caused primarily by short supplies of market-ready hogs. We have been talking about exceptional demand strength in the pork market for at least four months now and attribute it to a shift toward high protein diets as consumers prepare to exit the pandemic along with high savings rates that have greatly increased consumer's disposable income. The generous government stimulus that was provided in Q1 is part of that increase in disposable income. June and July will see the tightest pork availability of the year due to seasonal reproductive patterns in the hog herd, so if demand stays as strong as it was in May, it is a pretty good bet that pork prices won't give up much ground in the near-term. Retailers are struggling with poor margins as wholesale pork prices have risen faster than they have been able to increase retail prices. That means consumers are not having to pay fair value for pork and thus they are scooping it up with both hands. At some point, probably in the next few weeks, retail pricing should rise to a level that may cause consumers to balk. It is a pretty good bet that once retailers get their asking prices high enough to generate a reasonable margin, they won't reduce them even if the wholesale market starts to recede. That is the point where domestic demand will begin to get choked off and wholesale prices could fall fast, especially since hog supplies will be increasing after Independence Day.

> The pork cutout appears poised to test **the $130 level** soon and **may run even higher**

SUPPLY PICTURE

Hog slaughter has drifted lower in normal seasonal fashion and last week's kill registered 2.38 million head. The kill this spring has been very closely aligned with the estimate of the Sep/Nov pig crop reported by USDA back in December. From June through August, the industry will be slaughtering the Dec/Feb pig crop, which USDA estimated to be down 1.4% from the year prior. Of course, last summer the industry was dealing with a backlog of hogs created by the plant shutdowns at the start of the pandemic, so YOY slaughter comparisons aren't very fair. Still, it does look like hog supplies will be a bit tighter than they have been in recent summers, 2020 aside.

Hog carcass weights are another important input into total pork production and those are running only one pound above 2019 (for barrows and gilts) and seem to be following the normal seasonal downtrend towards a bottom in early-to-mid July. Hot weather can cause hogs to eat less and thus gain less in summer, but the weather forecasts currently project a rather mild start to the summer season so there is little risk of a heat wave-induced drop in weights over the next few weeks. The de-trended and de-seasonalized weights that we watch as an indicator of currentness at the producer level are at the low end of their typical range, which suggest there is no problem with hogs backing up in the pipeline. Pork packers have the same labor issues that are plaguing beef packing plants right now, but because we are

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near the smallest kills of the year, those labor problems are not restricting the kill. If the labor issues persist into the fall and early winter, when the largest kills typically occur, then packers may have difficulty slaughtering all of the market-ready hogs and we could see some back-ups occur. In that situation, it would be normal to see hog prices drop precipitously and packer margins balloon out to extreme levels.

USDA will release its quarterly *Hogs & Pigs* report on June 24 and we expect that it will show the first significant expansion in the breeding herd in over a year. High hog and pork prices this spring have been very profitable for producers and that should create a supply response that leads to a bigger breeding herd and larger pig crops down the road. In that report, USDA will provide its estimate of the Mar/May pig crop, which will determine available supplies for the Sep/Nov quarter. We project that pig crop to be down about 1.5%, based on the smaller breeding herd as of March 1. However, if the breeding herd expands as expected on June 1, then there is a reasonable chance that the pig crop born this fall (Sep/Nov) will post a 1-2% YOY gain and the industry will be solidly back into expansion mode. High prices bring profits for producers, they expand, and eventually larger supplies and lower prices are the result. It is doubtful that the current exceptional demand strength will last long enough to prevent significantly lower pork prices in 2022 as the herd expands.

DEMAND SITUATION

The strength in domestic demand that we have highlighted over the past few months remains in place. At one point about a month ago, it appeared that demand was beginning to falter based on a downturn in the combined producer+packer margin that we use as an indicator of overall demand health. That turned out to be a one-week head fake and the combined margin is back on an upward trajectory (see **Figure 2**). Observers may be wondering how long this incredible demand strength can last and to answer that question, it is important to understand what is driving it. It is pretty clear to us that this is not the normal-type demand cycle that oscillates every 2-3 months. Instead, we think this being driven by changes in consumer spending patterns associated with emergence from the pandemic. Part of it may be driven by a shift toward high protein diets as consumers look to shed weight they gained during the pandemic. That effect could last six months or more before it fades. Part of it is probably attributable to increased savings, government stimulus, and disposable income built up during the pandemic. That might have another 2-3 months to go before it has run its course. Finally, a portion may be related to the desire to celebrate and eat good as summer approaches and vaccinated individuals are free to gather in groups once again. That is likely to last most of the summer. If these are indeed the root sources of this demand surge, then in our opinion, it has at least two more months to go and possibly some of it may still be felt as long as six months from now. Now that doesn't mean that prices will continue to rise for the next six months because hog supplies will begin to increase after Independence Day. But as far as demand strength, which is reflected in how high the current data point rides over the average demand line, we see that as enduring for at least another two months and possibly longer.

Export demand for US pork, while not growing at a rapid pace, still looks very strong in a historical context. Q1 exports were down 4.8% from last year, but in Q1 last year exports were exceptionally large. Based on the weekly export data, we think there is a good chance that Q2 exports will exceed Q1, which is pretty amazing given how high pork prices have been here in Q2. Our export forecasts have recently been raised and now we look for a 5-6% YOY increase in pork exports for 2021 as a whole. That comes on top of a 15% increase in exports last year. Exports are not the main driving factor in this recent price rally, but they are helping to support it. Interestingly, China is not driving an increase in US pork exports—movement there has been relatively flat for most of 2021. Instead, it is big gains in movement to other countries, such as the Philippines, which have not traditionally been large importers of US pork, where the growth is occurring.

Cold storage stocks are 25% below normal, forcing more participants into the spot market

SUMMARY

The hog and pork complex in the US continues to be characterized by exceptionally strong domestic pork demand and seasonally shrinking pork supplies. There is no evidence of anything out of the ordinary on the supply side of the market as both slaughter numbers and carcass weights are behaving as expected. Stocks of pork in cold storage remain about 25% below normal and that is forcing more users into the spot market than might normally be the case. However, the most important factor driving the current market is strong demand from US consumers as vaccinations increase and COVID-19 infections wane. We think that demand strength is being driven by a shift toward high protein diets,

Figure 1: Pork Cutout, 2021 vs 2014

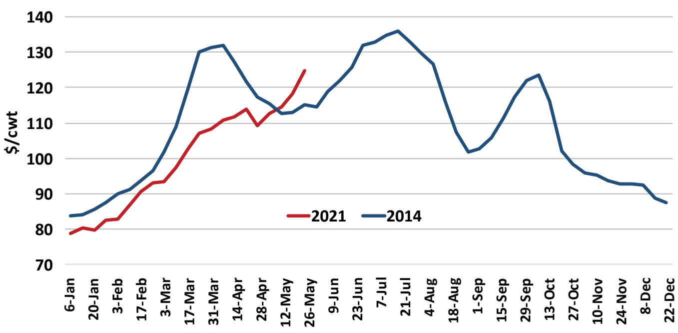

Figure 2: Pork Supply Chain Margins

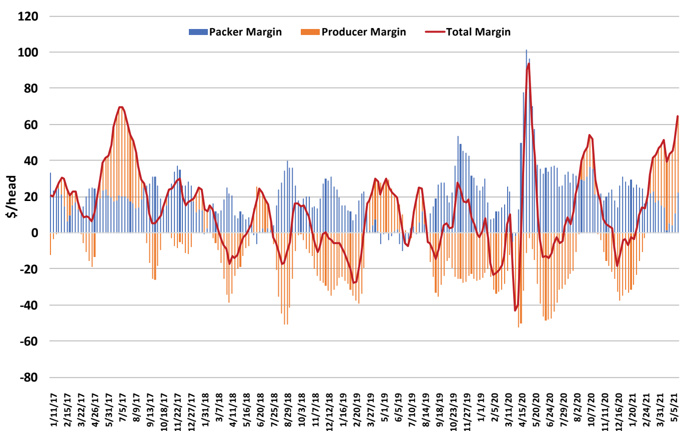

Table 1: JSF Hog and Pork Price Forecasts

	9-Jun	16-Jun	23-Jun	30-Jun	7-Jul	14-Jul
Pork Cutout	127.4	130.0	126.2	122.3	117.8	114.2
Loin Primal	119.1	121.4	118.2	115.1	111.6	108.2
Butt Primal	169.2	172.0	166.7	160.0	152.4	146.6
Picnic Primal	84.3	86.2	83.0	79.2	74.6	72.1
Rib Primal	300.2	303.3	294.0	282.3	266.0	249.7
Ham Primal	95.3	98.1	95.2	92.4	90.0	91.3
Belly Primal	186.6	190.7	185.0	180.3	174.2	165.1
Lean Hog Index	114.6	116.4	113.1	111.5	109.1	106.9

combined with extra purchasing power built up by high savings rates during the pandemic and further exacerbated by a desire to celebrate as life returns to normal in the US for the first time in over a year. We see the exceptional demand staying in place for the remainder of the summer, but price levels could begin to fade once hog supplies initiate their seasonal increase by mid-July. Futures contracts for the fall and winter months continue to look way over-priced and may not be taking into account the risk of tight labor supplies restricting slaughter capacity during Q4 and thus exerting strong downward pressure on hog prices. Super strong pricing this spring and summer is likely to put hog producers back into expansion mode and that, along with an eventual fading of demand, will be what brings the hog and pork complex back to more traditional price levels later this year. **Table 1** provides our near-term price forecasts.

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