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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

JULY 2021

The hog and pork complex finally topped in mid-June, with the cutout coming within $3 of the all-time record high. The top was defined by a sharp drop in the belly primal that pushed the cutout rapidly lower and the other primals soon joined suit as buyers began to back away. Shortly thereafter, packers began to pressure the negotiated hog market lower and it has continued in a downtrend ever since (see **Figure 1**). We don't think that the sudden reversal in the wholesale pork market reflects a huge drop in consumer demand for pork, but rather the recognition on the part of buyers that pork prices were very vulnerable at such high levels. In addition, export demand appears to be softening and that has led to improved availability in the domestic market. All of this is happening at the point in the year where hog supplies and pork production are near their annual low, so the downside price movement is currently being constrained by very tight supplies. Further, the market is currently experiencing low production due to plant downtime associated with Independence Day. That has the potential to support price levels in the very near term, but we don't think it will spark a sustainable rise in pork prices. It is clear that the prevailing trend in the market is toward lower prices and soon supplies will be expanding, so that should further the trend. For months, we have seen the deferred lean hog futures as being severely over-priced. Now the market is in the process of deflating and that over-pricing is being removed.

SUPPLY PICTURE

Pork packers ran into a bit of a margin problem when the cutout turned sharply lower in mid-June. Prior to the turn in the cutout, margins had been running over $25/head, but they quickly moved into negative territory as the cutout fell (see **Figure 2**). That reduced packers' incentive to kill aggressively and soon the negotiated hog market was heading lower also. Weekly average kills were about 2.4 million head during the non-holiday weeks in June, but here in July the average is expected to be closer

> The pork cutout topped near $135 in June **has dropped close $20 over the past three weeks**

to 2.3 million head. That should be the annual low and by the time Labor Day approaches, kills should be solidly back above 2.55 million head per week. So, the industry is now in the process of transitioning from declining hog kills to expanding kills and slaughter levels should continue to grow until December. Packers continue to struggle to attract enough labor to work the plants, but because kills are near annual lows it doesn't pose a huge problem at the moment. It will become a much bigger issue this fall as kills swell seasonally, so packers need to raise wages or do whatever it takes to make sure enough labor is available to handle the fall surge.

Carcass weights are coming down rapidly now that the weather is warming. In the most recent data, barrow and gilt weights were four pounds under last year and two pounds under 2019. The weather in the Midwest hasn't been exceptionally hot yet this year, but corn prices are very high and that is likely causing producers to alter rations where they can and may be contributing to the drop in weights. We expect weights to bottom within the next 3-4 weeks and then turn higher towards a seasonal top near the end of the year. For pork buyers, the downturn in weights restricts overall pork availability and also results in lower fat trim production than would otherwise be the case.

USDA's recent *Hogs & Pigs* survey showed a modest quarter-to-quarter expansion in the breeding herd, but it was down 1.5% YOY. The Mar/May pig crop was reported 3.1% lower than last year, although it too was up incrementally from the prior quarter. The industry will be killing the Mar/May pig crop during the Sep/Nov quarter this year and so it is safe to assume that the total number of hogs coming to slaughter this fall will be less than last year by at least 2.5%. That will be moderately supportive to prices, but the bigger price influencer is likely to be the demand side of the market, which could be softer than what we saw last fall.

DEMAND SITUATION

After months of increasing steadily, domestic pork demand finally appears to have turned lower. As the pandemic fades, consumers have a lot more things to do than simply stay at home and cook. Also, stimulus money is probably starting to run low. Look for domestic pork demand to begin to ease back toward more traditional levels over the next few months and that will almost certainly cause price levels to work lower. So far, it has been the retail cuts (loins, butts, ribs) that have shown the most demand softening while processing items like hams and bellies are still seeing good spot demand. Part of that probably is related to very low cold storage stocks of hams and bellies, which is forcing buyers into the spot market who would normally be drawing down freezer inventories at this time of year. Foodservice demand has increased considerably now that consumers feel much more confident about visiting public places and traveling once again. However, protein eaten away from home will reduce the demand for protein in supermarkets and the overall impact of the return to "normalcy" is that total demand should fall. We are seeing the beginnings of that now and as long as COVID-19 infections don't surge again, we think that pork demand will slowly erode over the balance of the summer. It may not pull back completely to previous levels however, because we sense that consumer dietary patterns shifted toward more animal protein consumption in the first half of 2021 and that effect should be much slower to fade. Another demand-depressing development is the fact that wholesale beef prices have been retreating rapidly and that will cause retailers to shift away from pork unless pork prices decline enough to make that switch less attractive.

From what we have seen in the weekly export data, export demand for US pork looks like it is fading. The monthly data for May was just released and it showed a very strong 11% YOY increase in exports, but the weekly data for June has painted a much bleaker picture. Most concerning is a sharp drop in future orders by Chinese buyers and lower actual shipments as well. Some of that may have to do with the extraordinarily high pork pricing seen in the US so far this summer, but a bigger influence is probably the rebuilding of the Chinese herd in the wake of its massive African Swine Fever (ASF) outbreak over the past two years. Hog and pork prices in China have declined rapidly in recent weeks and while some have suggested that is due to massive liquidation in response to ASF flare-ups, we think it is more likely due to a strong supply response by Chinese hog producers to the very high internal prices they have experienced over the past two years. Whatever the reason, US pork is no longer attractively priced relative to Chinese pork and that is likely to limit buying interest in the next few months. We think it will be difficult for other export destinations to increase their buying enough to cover the drop in Chinese purchases, so total export demand is likely to soften as we move into fall.

Hog supply this fall should be 2.5% below last year, but that may not mean higher pricing.

SUMMARY

The pork market in the US finally topped and turned lower during June after six months of impressive price strength. Most of the blame for the turn lower can be placed on the demand side of the market since supplies have been getting steadily smaller throughout the spring and early summer. Kills will begin to expand after mid-July and carcass weights could also begin to increase, thus the supply side of the market will soon provide some measure of relief to buyers. As the pandemic fades and consumers resume normal activities, demand is slowly shifting away from the retail channel toward more pork consumption in foodservice environments. We think that will lead to lower overall pork demand and help keep pressure on pork prices. The futures market, which for months has greatly over-valued the deferred hog futures, is starting to reflect this new softening of demand and thus has been moving lower in recent weeks. The cutout may get some brief support from the short kills associated with the July 4 holiday, but in general, we see the overall direction as lower for the balance of the summer. The hog supply this fall should be about 2.5% below last year, but that doesn't guarantee higher pricing because there is a strong chance that demand this fall will be softer than last year. Buyers are advised to remain close bought in the weeks ahead as demand softens and price levels work lower. **Table 1** provides our near-term price forecasts.

Figure 1: Western Corn Belt Cash Hog Price

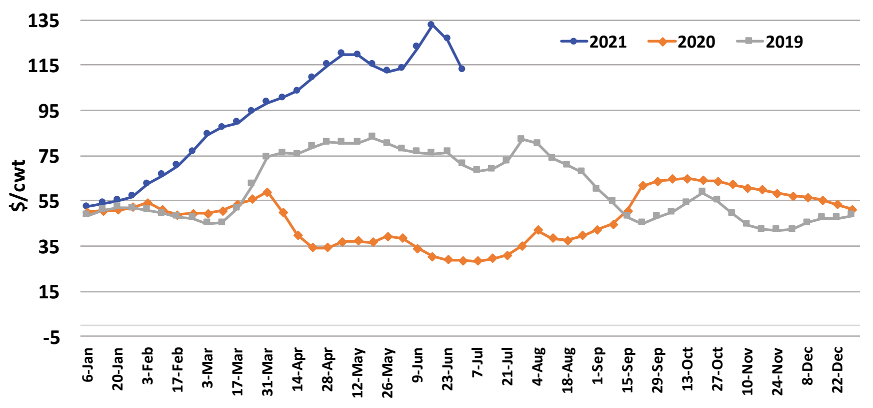

Figure 2: Packer Margin

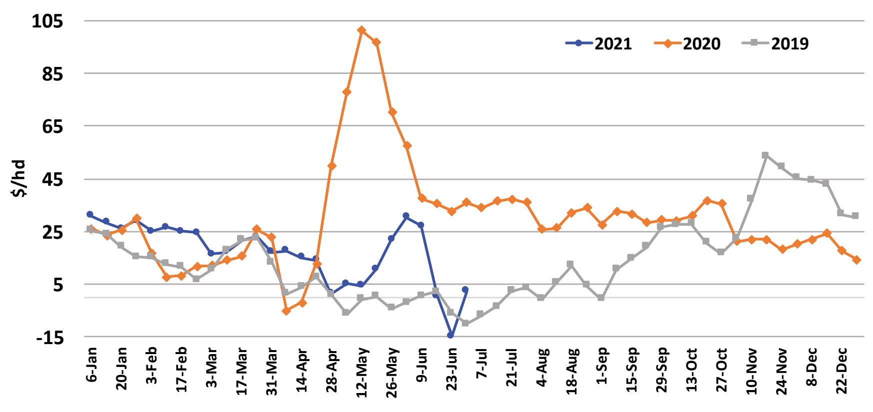

Table 1: JSF Hog and Pork Price Forecasts

	14-Jul	21-Jul	28-Jul	4-Aug	11-Aug	18-Aug
Pork Cutout	108.4	107.1	106.3	103.8	100.8	100.1
Loin Primal	101.0	101.3	99.4	97.2	97.0	98.7
Butt Primal	154.0	148.1	144.0	141.3	135.2	133.0
Picnic Primal	71.5	68.4	69.2	70.3	67.5	68.6
Rib Primal	153.3	148.2	148.9	152.2	154.0	156.7
Ham Primal	87.1	88.4	85.7	82.4	79.6	78.1
Belly Primal	166.2	163.0	167.4	160.3	152.0	147.1
Lean Hog Index	108.0	106.6	104.6	100.8	96.0	94.5

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