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WEEK ENDING AUGUST 27, 2021

THE PORK WRAP

The hog and pork complex was on the defensive this week, with the cutout losing $6.25 on a weekly average basis and the negotiated hog markets dropping by more than $4. With the pork coming down faster than the hogs, packer margins compressed. By my calculation packer margins declined $9 this week to average $12.50. One thing we've learned this summer is that packers don't tolerate sub-$20 margins for long and I'm sure they are already contemplating corrective action. Fortunately (for them), with holiday weeks just ahead they have the perfect excuse to curtail production if they need to in order to improve margins and with hog numbers increasing, such a strategy would likely prove effective.

Bellies were the primary drag on the cutout this week as the chart below indicates. Hams, which had been the weak sister up to this point, were down only modestly this week. Hams look like a value at this level and I'd expect them to see some buying interest soon. I don't think that will be enough to rescue the cutout however. As long as bellies stay weak, that will be enough to keep the pressure on the cutout. Both the 42s and 72s are falling like a rock now and we've seen the same thing in beef 50s. Apparently fat is falling out of favor all of a sudden. That's not a good omen for the bellies. I don't really look for the retail cuts to crumble, but as pork production increases heading into September they will come under supply pressure even if demand at retail remains strong.

The real supply pressure will materialize after Labor Day, since the holiday will shorten the kill for the next two weeks. That might slow, or even reverse, the decline in the cutout briefly, but buyers who can wait until kills pick up after Labor Day will likely be rewarded for doing so. As trim prices fall, so will the grinding value of hams, which might undermine one of the main pillars of support for the cutout. Picnics, which are often used in grinding/sausage applications are starting to come under pressure recently too. The combined margin continued lower this week and the big question in my mind is whether or not it will bottom at the same level it bottomed following the early summer pullback. I'm betting that it won't. Packer margins could certainly get better, but the outlook for producer margins is not great. They are still profitable for sure, but their margins are only about half as large as they were at their peak earlier in the summer when cash hog prices were near $130. Those same cash hogs are now under $100 and falling daily. The corn market seems to have found a home around $5.50/bushel, which is about $2/bushel higher than it was last year at this time. As a result, producer breakevens are in the low $90 area and it won't be long before the negotiated hog markets test that level.

I'm looking for this week's kill to be approximately 2.44 million head, about the same as last week. If we don't get a 2.5 million head kill before the holiday, it will almost certainly come quickly after the holiday. It is clear the USDA badly over-estimated the pig crop that we killed this summer and so they may have also over-estimated the pig crop that the industry will kill from Sep through Nov. The futures curve has moved lower so far this week and one of the reasons is probably disappointing export numbers. China has really scaled back on its purchases of US pork this summer and traders fear that trend will continue into fall.

I think there is a reasonable chance that sales to China will pick back up once US price levels decline this fall and Chinese buyers start to think about filling their needs for the Chinese New Year. If they don't, it could be a tough winter for hog producers as that extra production would need to clear the domestic market at lower prices. Traders in the Oct contract are pricing it about $15 below the Lean Hog Index, when last week they thought $20 below was more appropriate. The index is coming down in big chunks now, but should level off at about $103, if there are no further declines in the cutout or cash hog markets. Both seem pretty likely though and traders sense that. The best hope for bulls in the market right now is that reduced production over the next couple of weeks is enough turn the cutout higher and thus stop the slide in the LHI. Packers are scheduled to kill over 100k head on Saturday this week to help make up for very light production due to plant maintenance on Monday. Next week, watch the bellies for signs of further weakening and watch the rate of decline in the trim markets because those can sometimes be leading indicators for the other parts of the carcass.

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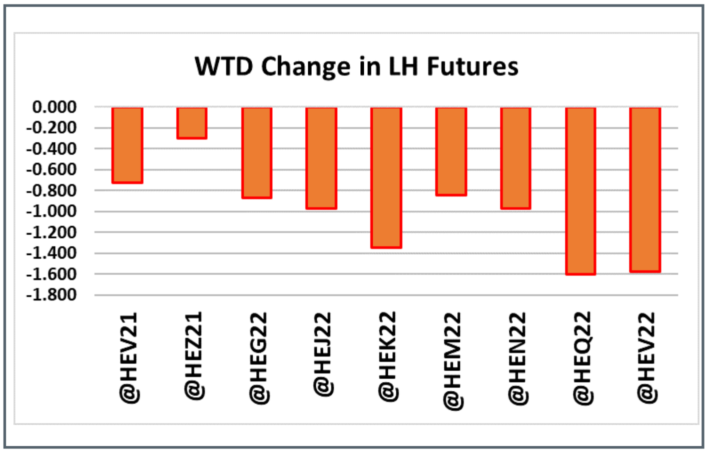

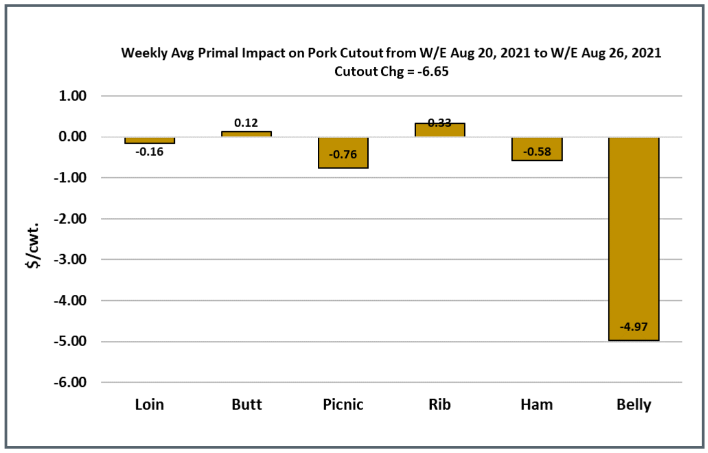

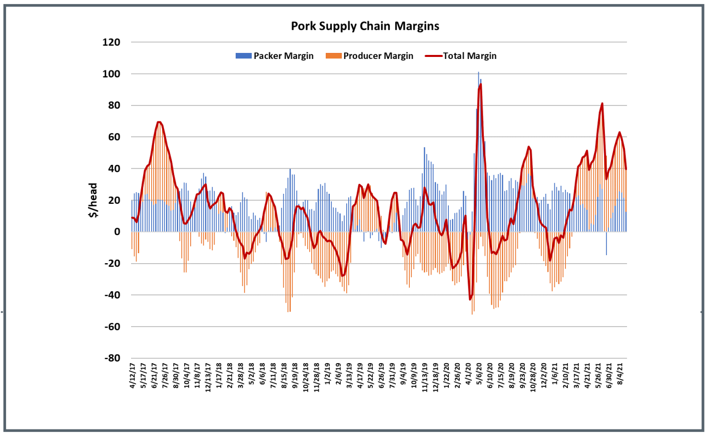

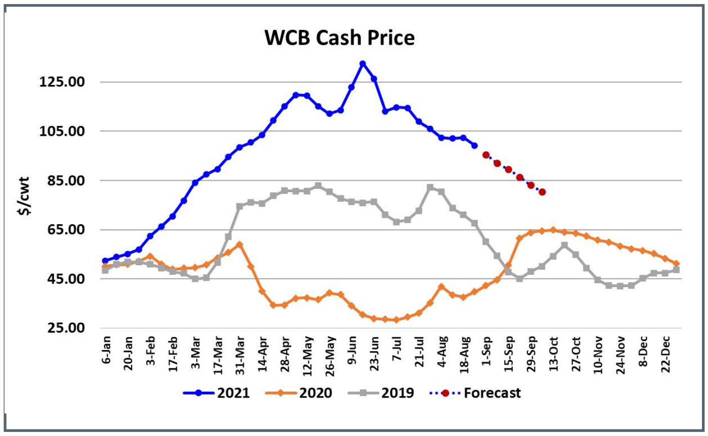

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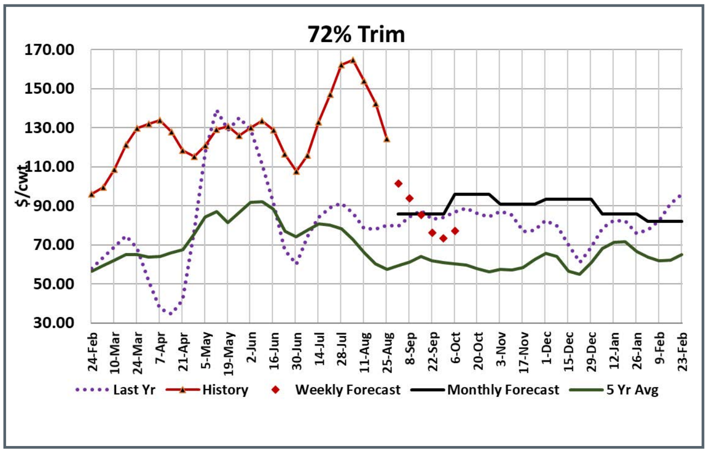

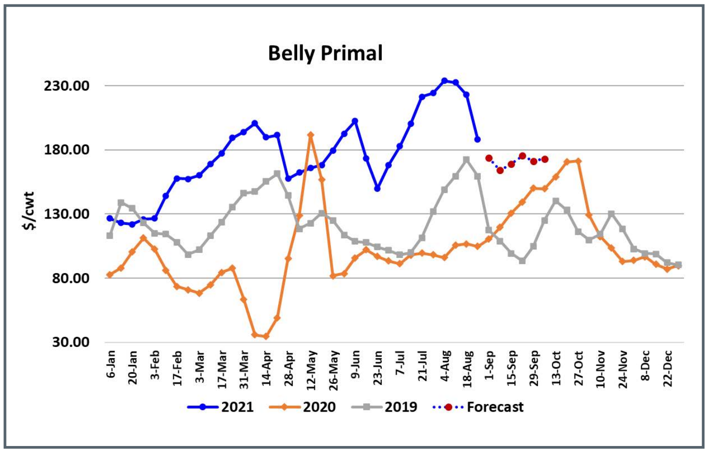

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Dr. Rob Murphy is an agricultural economist and business leader with over 29 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.

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