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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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Pork product values in the US were increasing during July after experiencing a sharp drop back in June. At the same time, cash hog prices have been working slowly lower. The combination of those two events has restored packer profitability, with margins recently estimated at $21/head. The reason that packers have been

> Packers clamped down on the kill in July and that **boosted margins back over $20/head**

so successful at improving margins is because they have limited slaughter levels over the past few weeks. The Saturday kill has been very small since mid-June when packers experienced a sharp decline in margins due to rapid fall in cutout values. That experience put them in margin management mode and they have been very disciplined ever since by keeping the kill closely aligned, or maybe even a little below, available hog supplies. It is true that hog supplies are tighter than expected this summer and that has probably caused packers to re-think their production schedules for July and August. Smaller kills have meant less pork production and that has supported pork prices. The pork cutout finished last week near $124, up about $10 from where the market was at the start of July. Domestic pork demand seems to be fairing well, but this mid-summer rally is more about tight hog supplies than it is about super-strong demand. As supplies begin to expand in August, it is natural to expect both hog and pork prices to retreat. However, buyers are advised not to expect prices to return to pre-pandemic levels this fall. Our forecast has the pork cutout holding over the $100 mark beyond Labor Day.

SUPPLY PICTURE

Back in March, USDA's *Hogs and Pigs* survey pegged the Dec/Feb pig crop down 1.4% YOY. It is now becoming clear that the survey

> It looks like **USDA over-estimated** the Dec/Feb pig crop by **more than a million head**

over-estimated that pig crop by something close to a million head and will probably issue a revision on the next report in September. We know that because kills this summer have been woefully short of USDA's estimate (see **Figure 1**). Hog slaughter appears to have bottomed in late June/early July and last week's slaughter totaled 2.31 million head. That should steadily increase until the industry is killing a little over 2.5 million head at the end of August. Beginning in September, the industry will be slaughtering the March/May pig crop, which USDA estimated to be down 3.1% from last year. Of course, the fear is that if USDA over-estimated the Dec/Feb pig crop there is also a good chance that they may have also over-estimated the March/May pig crop and we may actually end up with less hogs available this fall than advertised. However, if the pig crop estimate is correct, kills this fall should top out just shy of 2.7 million head per week. That is a lot of hogs, but less than the 2.8 million peak from last year, so there should be enough processing capacity to handle all of them. Whether or not there is enough labor available to staff the plants is another question. We know that beef packers are struggling to find enough labor to process all of the market ready cattle, and that same situation could emerge in the hog complex this fall if the labor situation in plants doesn't improve.

Although the weather in the Midwest has not been overly hot this summer, hog carcass weights are really light. The most recent data out of federally inspected plants showed barrow and gilt carcass weights three pounds below last year at 207 pounds. Weights are now close to a seasonal bottom and will turn higher soon.

Corn prices are very strong this summer and that is probably also inducing producers to alter rations in a way that keeps hogs from gaining excessively. So, with kills near their annual low and weights also near annual lows, total pork production is about as small as it will get in 2021, although we should see it start to expand soon.

Hog producers have enjoyed a long string of positive margins this year. We estimate that producer margins peaked at about $57/head back in June and are now sitting at $39/head (see **Figure 2**). Although hog prices are working slowly lower and corn prices are high, it appears that producers can look forward to another 2-3 months of positive profits before bigger production this fall forces margins back into negative territory. That long stretch of profitability has the potential to encourage expansion in the industry and we think that the next *Hogs and Pigs* survey will show another modest quarter-to-quarter increase in the breeding herd.

DEMAND SITUATION

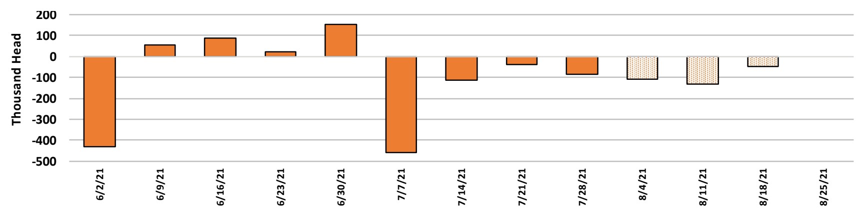
It is tempting to view the increase in the pork cutout over the past few weeks as a result of improving demand, but it seems to be more a function of very light supply. Make no mistake, domestic pork demand is still very good in a historical context but we don't sense that it has gotten a lot stronger recently. Now that could change of course, and one factor that might support stronger pork demand in the next few weeks is rising beef prices. We have also seen strong growth recently in consumer incomes as employers in traditionally low-wage industries have been forced to raise wages in order to attract much-needed labor into their businesses. Packing plants fall into that category also. It seems inevitable that wages will need to continue to track higher through the balance of 2021 and that should be a strong positive for pork demand this fall. The resurgence of COVID-19 infections in the US also has the potential to alter the demand outlook for the next few months. We know from past experience that if people return to staying home more, then that will be a positive for red meat demand. It does look like the US is set for another wave of COVID-19 infections and thus we could see some demand improvement from the retail channel as people once again begin to shun foodservice establishments in favor of at-home meals.

The export picture for US pork looks less rosy than it has in a long time and this is a huge risk for both hog and pork prices going forward. China seems to be slowly backing away from the US pork market and with good reason — US pork is now more expensive than pork sourced from the EU or S. America. There is a fear that the export “hole” left by the Chinese pullback will be too large for other nations to fill and thus a fairly significant decline in overall demand for US pork from overseas could be the new reality during the second half of 2021. The Chinese claim that their herd is largely rebuilt now following the ASF outbreak that began in 2018. It is difficult to ascertain if that claim is true or not, but it is not difficult to see that Chinese interest in US pork is waning. Of course, China could come back into the US market this fall and buy product intended for the Chinese New Year celebration. The winter Olympics are also scheduled to take place in Beijing immediately following the Chinese New Year and that may also boost demand for US pork. A lot will depend on how the global COVID-19 situation plays out this fall. If infections are still high, it is very likely that the Chinese will follow Japan's example and ban spectators from Olympic events, which would seriously dampen their need to import pork for the event.

SUMMARY

The US hog and pork complex is in the process of transitioning from the tightest supplies of the year toward much larger supplies this fall and winter. That is a normal seasonal pattern, but the growth this year might be smaller than normal because there are concerns that USDA may have over-estimated the pig crop that will come to slaughter this fall in much the same way as they over-estimated the pig crop that was slaughtered over the summer. Producers have kept hog weights low in this high corn price environment and that is also likely to limit pork availability over the next few months. The domestic supply situation looks tighter than in recent years, but exports remain a big unknown. The recent data suggest that China is whittling down its pork purchases from the US and if that continues into the fall then suppressed exports may boost the amount of pork that needs to be disposed of in the domestic market. Time will tell on that. Domestic pork demand looks good, but doesn't seem to be expanding strongly. There are plenty of reasons to believe that pork demand will be above average this fall — primary among them is strong growth in consumer income. Demand could also see a boost from a return to meals at home if the current surge in COVID-19 infections continues into fall. In general though, we expect the growth in supply over the next few months to outpace any additional strength in demand and thus price levels should work lower, but remain well above historical norms. **Table 1** provides our near-term price forecasts.

Figure 1: 2021Q3 Hog Sltr Over/Under Pig Crop Projection



2021Q3 Cumulative Hog Sltr Over/Under Pig Crop Projection

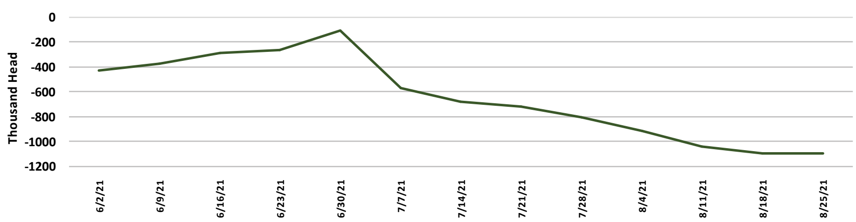


Figure 2: Estimated Hog Producer Margin, 2020-2021

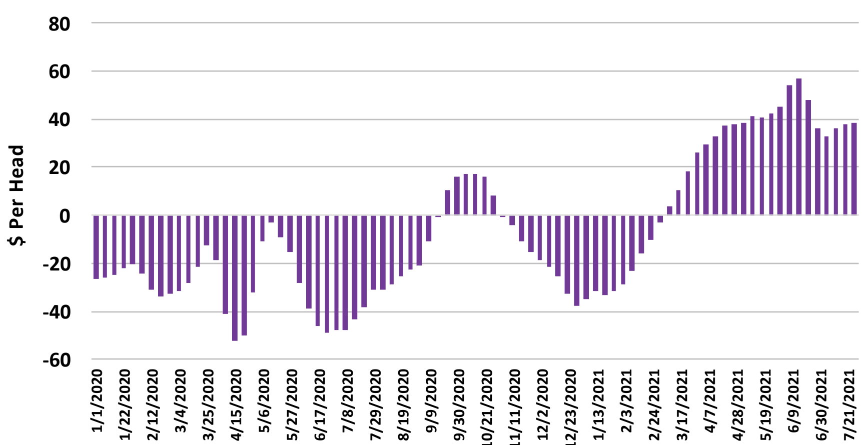


Table 1: JSF Hog and Pork Price Forecasts

	11-Aug	18-Aug	25-Aug	1-Sep	8-Sep	15-Sep
Pork Cutout	120.4	117.5	114.1	111.5	107.6	106.1
Loin Primal	111.0	109.1	104.6	102.0	97.4	96.3
Butt Primal	108.4	105.5	106.0	102.1	99.0	96.6
Picnic Primal	97.1	94.0	90.2	88.3	86.0	82.1
Rib Primal	139.3	142.0	139.5	141.6	143.8	147.0
Ham Primal	106.3	106.0	101.4	99.2	94.3	93.6
Belly Primal	210.3	199.3	195.7	190.6	184.4	182.0
Lean Hog Index	111.7	108.8	104.9	101.6	97.6	95.8

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