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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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The pork cutout was in a holding pattern for much of August but has now started to work lower as pork supplies increase seasonally. As is often the case, the downturn in pork values originated with the processing items (hams, bellies), while the retail items have continued to see good demand. Hog supplies reached their low point back in mid-July and are now increasing in normal seasonal fashion. Supplies are smaller overall this year due to the smaller pig crops that were reported earlier and there is fairly good evidence that USDA over-estimated the size of recent pig crops. That may mean that, over the next few months, hog and pork supplies fall short of industry expectations, much like they have for most of the summer. Prices for both hogs and pork are still at very high levels in a historical context, and that seems to be making futures traders nervous that the seasonal price decline from summer into fall might be a lot larger than normal this year. For a while, the Oct futures contract was carrying a $20 discount to the Lean Hog Index but in recent days that has been trimmed closer to $15. Historically, something closer to a $10 discount would be more typical. It is unclear at this time if the action in the cash market will eventually justify the big discount in the nearby futures, but it is pretty clear that the direction of prices over the next couple of months is likely to be lower.

> October hog **futures are pointing toward a $15-20 decline** in hog prices this fall

SUPPLY PICTURE

Weekly hog slaughter is now approaching 2.5 million head per week after bottoming around 2.28 million head per week back in mid-July. However, the industry is now working through the March/May pig crop and USDA reported that to be down 3.1%

> Pork production this fall is **expected to be down at least 3% YOY,** with risk that it is even smaller than that

from last year, so that implies that hog slaughter this fall ought to be roughly 3% below last year. It could be down even more because slaughter levels during Jun/Aug came in about 1.3 million head below what the Dec/Feb pig crop implied and that makes us a bit nervous that USDA may have also called the March/May pig crop too high. Although smaller-than-expected hog supplies can be a headache for pork users, it might be a welcome thing this year due to the labor issues that are plaguing packing plants. We see peak kills this fall right around 2.69 million head per week, which is significantly below the 2.8 million head peak that was observed last year. That might leave just enough slack in the system so that packers can get all of the hogs killed this fall even in spite of a difficult labor market.

Hog weights have been very well behaved this summer. They declined in normal seasonal fashion to a bottom in early August and will now be working higher into fall (see **Figure 1**). Cooler fall weather and freshly-harvested corn will promote hog weight gains, although the higher price of corn this year could have some producers dialing back the energy component of rations and thus tempering weight gains. The de-trended and de-seasonalized carcass weights that we watch as indicators of currentness in hog barns have been relatively low lately and that tells us that there is no problem with hogs backing up in the pipeline. Cash hog prices have been on the defensive lately, but that is the typical price pattern when hog supplies increase off of summer lows.

Sow slaughter through August looks like it is down about 4.4% from 2020, but 2020 was a big sow slaughter year (up 10% from 2019) due to all of the uncertainty surrounding the COVID-19 pandemic. Thus, it isn't appropriate to view the industry as liquidating the breeding herd at the present time, but it also probably isn't growing very rapidly either. Producers are caught in the middle of two powerful forces. On one hand, super-strong domestic pork demand since February and super-high pork prices are sending strong signals to expand. On the other hand, there are concerns that pork exports to China are going to slow dramatically in the coming year and if that happens, perhaps expansion of the breeding herd is not the best strategy. Producers are also keeping a cautious eye on the situation in the Dominican Republic where a recent ASF outbreak has brought the dreaded virus within striking distance of the US mainland. They know very well that if ASF is discovered in the US, export markets will dry up overnight and very low hog prices will quickly result. Thus, while we are projecting a slight quarter-to-quarter increase in the breeding herd when USDA releases its next edition of *Hogs and Pigs* on September 24, we recognize that risks to the future export picture could limit those gains and might even cause producers to reduce the herd a bit.

DEMAND SITUATION

Domestic pork demand has been very strong all summer long, but recently the cutout has been pressured lower by softening demand for the hams and, to a lesser degree, bellies. Most of the retail cuts continue to see strong demand and that fits with the idea that rising COVID-19 infections are causing consumers retreat to the safety of their homes and thus the retail sector is seeing a demand boost. The recent softness in ham demand is not clearly understood but could be related to lack of demand form second-stage processors who are having trouble finding enough labor to process hams. We've also noticed that as the price of 72% lean trim has declined over the past few weeks, so has the price of bone-in hams (see **Figure 2**). Perhaps some of the excess value in those hams was related to their grinding value as a replacement for lean trim. Nonetheless, hams look like a pretty good value right now and we expect that those processors who still need to cover holiday ham needs will help the ham market to put in a bottom very soon. Cold storage stocks of ham at the end of July were 12% below the five-year average and stocks of bellies were 31% smaller than their five-year average, so there is less opportunity for processors to avoid the fresh market this year. Beef pricing is very high at present, so that is also supportive to domestic pork demand. The outlook for domestic demand has it softening a bit from current levels, but not making a drastic move lower. It will likely be expanding pork supplies, not drastically weaker demand, that pressures the cutout lower in the coming weeks.

Export demand for US pork appears to be softening at a fairly strong clip and that is concerning. The weekly export numbers suggest that China's need for pork out of the US is dwindling fast and may soon reach the point where China imports more beef from the US than pork. What an odd situation that would be. China claims to have rebuilt its herd back to the level it was at prior to the ASF outbreak in 2018 and, while others have cast doubt on that, it seems to us that price levels and import volumes seem to support that assertion. If the Chinese go back to being a minimal buyer of US pork, then that will leave a pretty big hole in international demand for US pork that probably cannot be fully made up for by other importing nations. However, it may be a bit premature to declare the China business dead. Chinese interest in US pork typically surges in Oct/Nov in preparation for the Chinese New Year and it is possible that we will see the Chinese come back into the US market in a big way this fall after US prices moderate from this summer's high levels.

SUMMARY

The US pork industry is in the process of turning the corner from very tight summer supply toward much-expanded fall supply. That seasonally expanding supply will likely be what pressures hog and pork prices lower, not a significant decline in domestic demand. Strong profitability in the hog sector over the past six months is sending an economic signal to producers to expand, but there are concerns about international demand in the future as China scales back on imports of US pork, so producers might think twice before adding to their breeding herd. We think the next read on the breeding herd, which comes in late September, will show a mild quarter-to-quarter gain. Packing plants are still having difficulty finding enough labor to run at full capacity and, while that is not a big issue at present, it could become a more significant issue later this year as the number of hogs that need to be processed increases significantly. The recent surge in COVID-19 infections is likely to slow the reopening of the economy and sending consumers back into stay-at-home mode. That is positive for red meat demand an thus even though domestic pork demand is at a very high level currently, we don't look for it to deteriorate rapidly. Instead, growing supplies will pressure prices this fall. It's a good bet that price levels will be well above what pork buyers, and also consumers, have become accustomed to. **Table 1** provides our near-term price forecasts.

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Figure 1: FI Dressed Wt., Barrow & Gilts

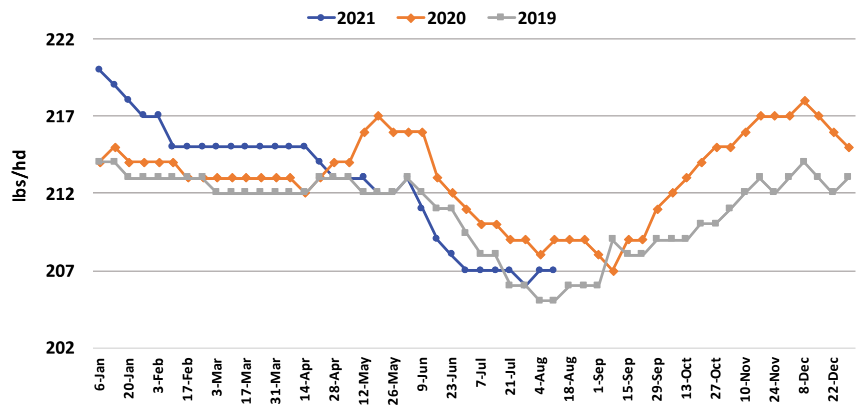

Figure 2: Ham Primal vs Pork 72s Since June

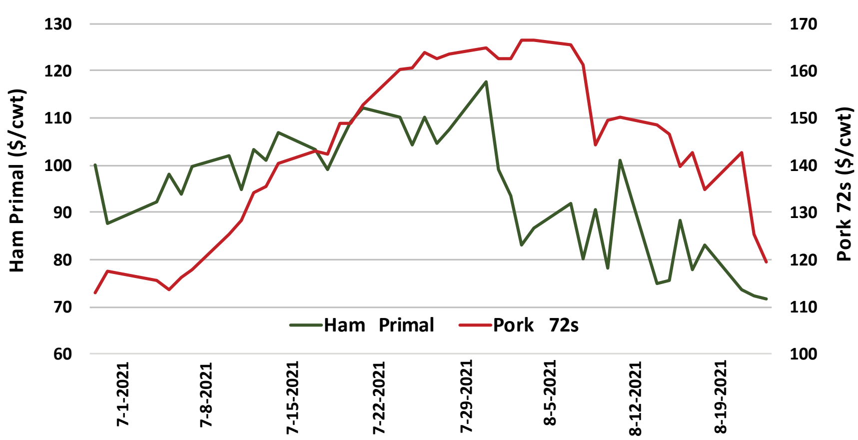

Table 1: JSF Hog and Pork Price Forecasts

	1-Sep	8-Sep	15-Sep	22-Sep	29-Sep	6-Oct
Pork Cutout	108.3	106.5	105.3	104.7	103.8	102.9
Loin Primal	118.2	116.0	111.3	104.6	100.6	98.4
Butt Primal	125.8	123.1	120.0	118.4	119.1	116.2
Picnic Primal	77.3	74.2	68.6	63.5	65.6	66.7
Rib Primal	149.3	144.9	142.3	143.5	141.6	138.0
Ham Primal	73.6	78.2	80.3	84.1	86.3	85.0
Belly Primal	173.6	164.1	169.0	175.3	171.2	173.0
Lean Hog Index	102.7	99.1	96.6	93.6	90.2	87.7

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