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WEEK ENDING SEPTEMBER 17, 2021

THE PORK WRAP

Both the cutout and the LHI were down about $2.75 on an average basis this week, so packer margins didn't change much. They currently sit close to $17.50/head. The negotiated hog markets have been moving steady lower, with the WCB down $6.15 this week and the NDD down $4.56. Those declines haven't been fully reflected in the LHI yet, so it has some additional downside risk early next week. Nearby Oct futures rallied hard this week as traders came to realize that they were projecting too much of a discount. The chart below shows that the LHI has been on a steady downtrend since Oct became the nearby and if we project that trend all the way out to expiration (using the regression line), it would come in around $82.

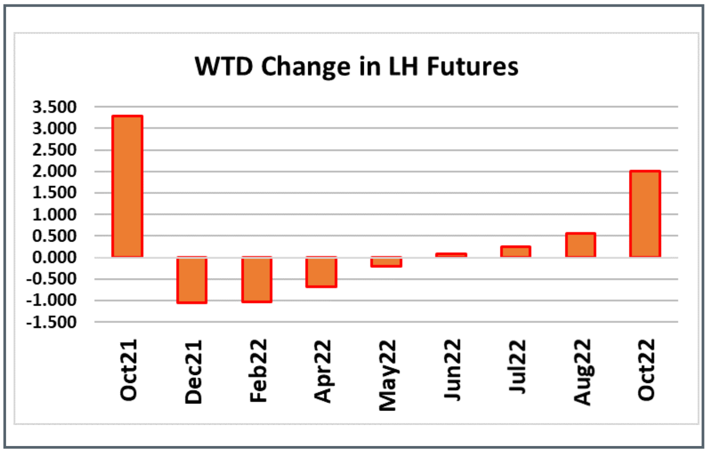
However, in recent days the weakness in the cutout has tempered and so far the cutout has managed to hold over $100. That should rightfully make traders question whether or not the trend in the Oct contract is going to persist at this rate. This week they decided it wasn't and that generated a $3+ gain in the Oct. The Dec contract got left behind as Oct rallied and so the Oct/Dec spread ballooned out to almost $12 at one point this week. That seems like way too much of a discount to put on Dec in this type of market where demand is very robust. Now the front seven contracts are all reasonably close to my estimate of fair value. Be advised that fair value could shift next Thursday when we get the next issue of the Hogs & Pigs report. I'm expecting the government survey to show about a 1% YOY decline in all swine, but about 2 million head more than were reported in the June report. A good bit of that is seasonal. I'm forecasting the Jun/Aug pig crop down 3-4%, although I think the risk is that it may be down less than that. Those will be the pigs that are slaughtered in the upcoming Dec/Feb quarter, so I'd expect relative tightness to persist in the hog supply well into Q1.

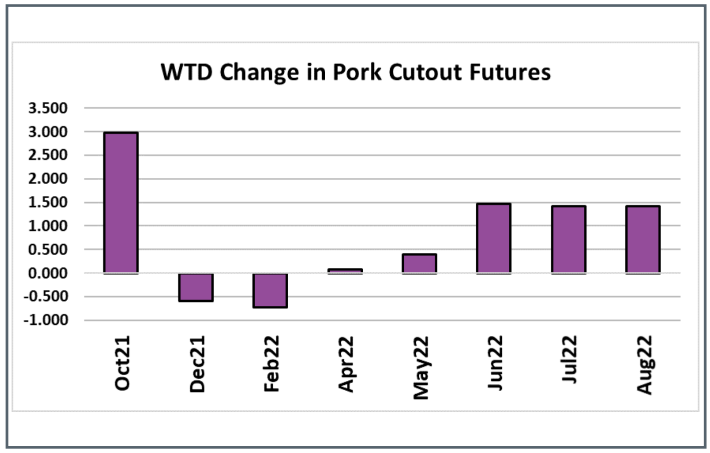
USDA is almost certain to make a major downward revision in the previous Dec/Feb pig crop because slaughter levels that we observed this summer came in way below what their survey suggested. That trend has continued into this quarter and the chart below shows that during the first three weeks of this quarter, slaughter has been about 250,000 head shy of what it should have been if the pig crop estimate was on target. So there is reason to believe that hogs will be tighter than advertised this fall, even though numbers will certainly increase seasonally. This week's kill came in at 2.54 million head–the biggest kill since late March. By early October, kills should be running over 2.6 million head and moving toward a peak around 2.68 million head around Thanksgiving. It is important to note that most of the expansion in hog kills during the fall happens between Labor Day and the middle of October.

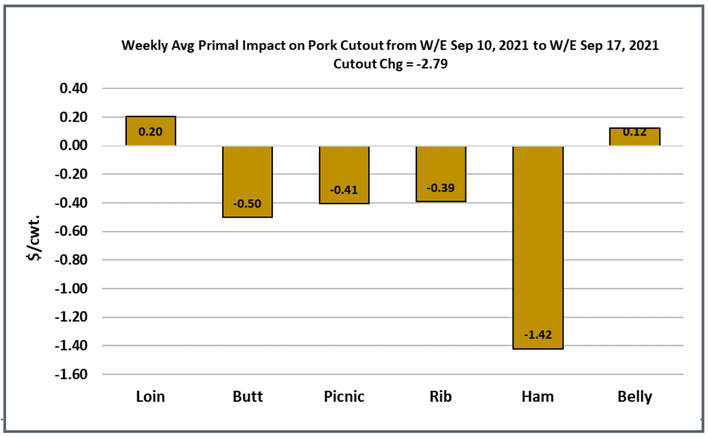
From the middle of October to Thanksgiving the increases are typically smaller. Hog weights are currently near their annual lows, but will be increasing seasonally in the next few weeks. The weight data does not provide any evidence that hogs are backing up in the pipeline. In fact, I'd say that the weight data suggest that the pipeline is quite clean. But we have been seeing packers pushing negotiated hog prices lower with relative ease, so that makes me wonder what is going on. It has crossed my mind that pork plants may already be feeling the stress of not enough labor and that is why packers haven't had much trouble procuring hogs at lower prices. If the labor problem is already arising, it should start to show up in the form of widening margins.

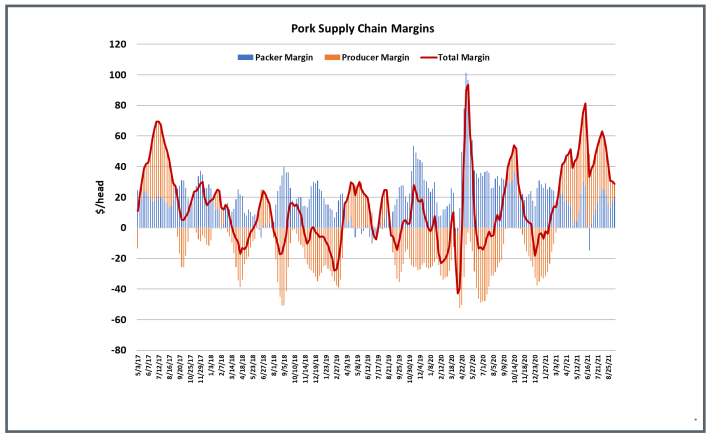
Margins are pretty good right now, but not exceptionally wide. Going forward, we need to keep a close eye on packer margins as an indicator of packing plant labor availability. I've included the annual bar chart of packer margins below, same as I did for beef. Pork margins haven't gone exponential in recent years like they have for beef, but it is pretty clear that something has been different since about 2014. When packing margins expanded in 2014-16, it attracted new capacity into the industry and that seemed to temper margins for a couple of years and then the pandemic came along. Margins for 2021 look like they will be about a third lower than they were in 2020. Domestic pork demand remains very good, but slowly working lower. The combined margin is still trending lower, but the trajectory has softened recently. In times past, the combined margin would almost always go negative before it turned higher, but I'm guess that in the current environment, it will turn well before it moves into negative territory.

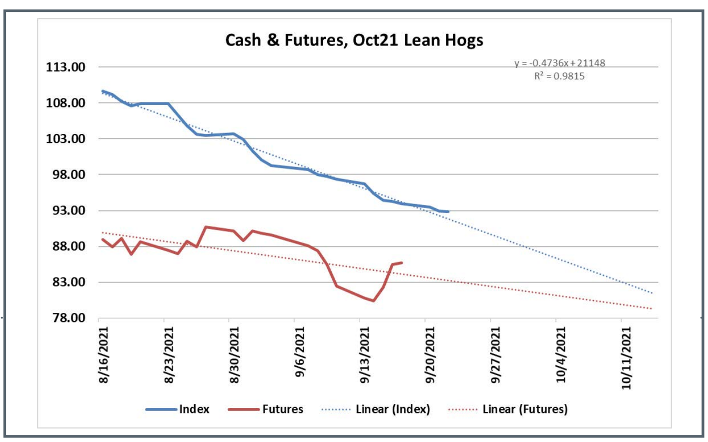
Exports are the weak link in the pork complex. Movement to China has softened considerably and other destinations are not picking up the slack. That has industry observers concerned and may explain why such a big discount is being assigned to the Dec contract. This week the hams were the biggest contributor to the softer cutout, but they appear to be close to a bottom and wouldn't be surprised to see them rally soon. Although consumer demand at retail is very good, I suspect that prices for the retail cuts will continue to track lower as kills expand this fall. Bellies and hams are more likely to provide support. The forecast has the cutout slowly working lower, but not breaching the $100 mark for at least a couple more weeks.

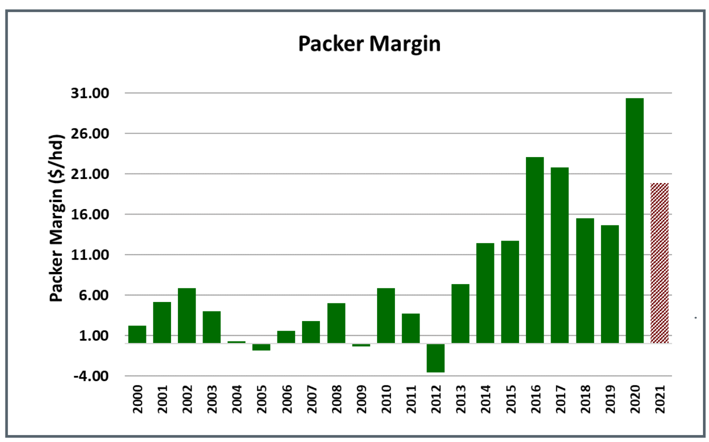

WTD Change in LH Futures
3.500
3.000
2.500
2.000
1.500
1.000
0.500
0.000
-0.500
-1.000
-1.500
Oct21
Dec21
Feb22
Apr22
May22
Jun22
Jul22
Aug22
Oct22

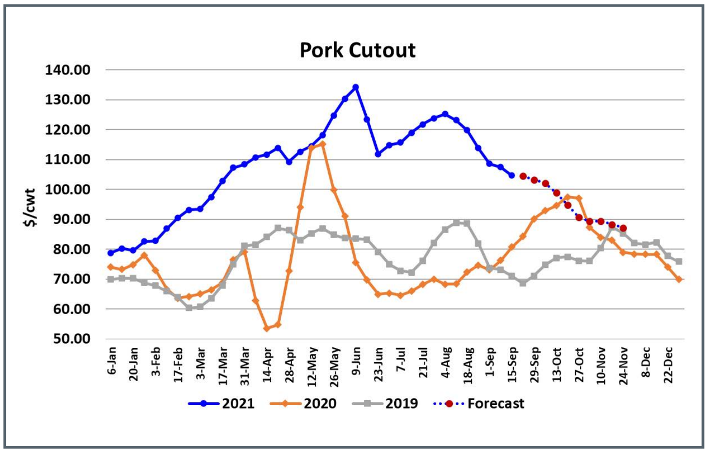

WTD Change in Pork Cutout Futures
3.500
3.000
2.500
2.000
1.500
1.000
0.500
0.000
-0.500
-1.000
Oct21
Dec21
Feb22
Apr22
May22
Jun22
Jul22
Aug22

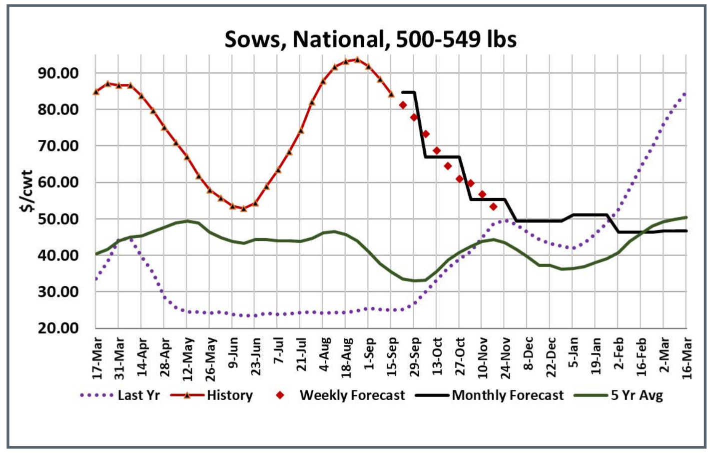

Weekly Avg Primal Impact on Pork Cutout from W/E Sep 10, 2021 to W/E Sep 17, 2021
Cutout Chg = -2.79
$/cwt.
0.20
-0.50
-0.41
-0.39
-1.42
0.12
Loin
Butt
Picnic
Rib
Ham
Belly

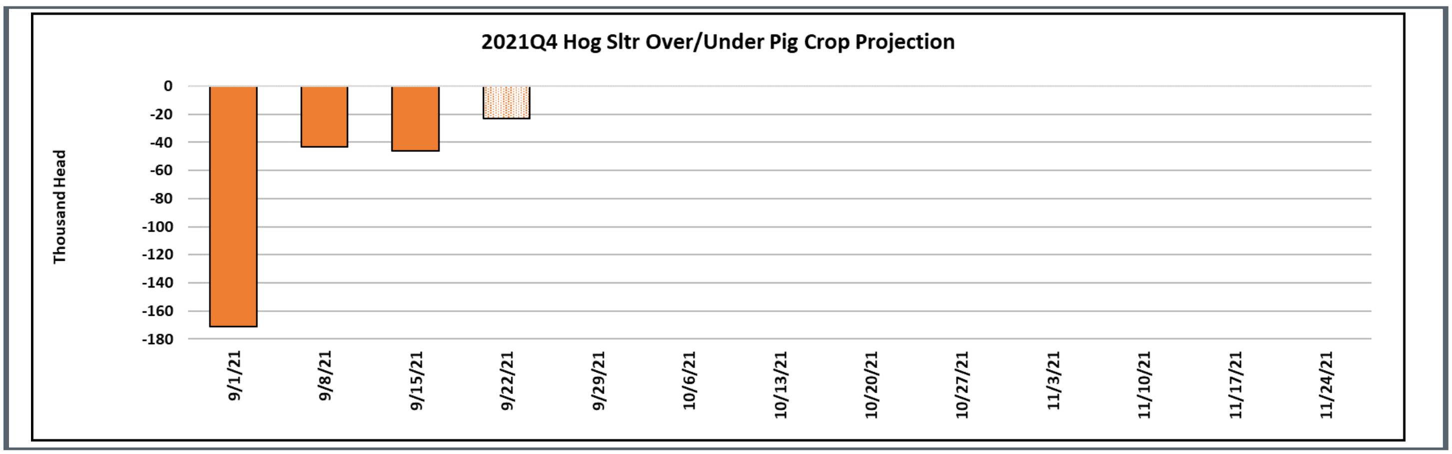

Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head
120
100
80
60
40
20
0
-20
-40
-60
-80


Cash & Futures, Oct21 Lean Hogs
y = -0.4736x + 21148
R² = 0.9815
113.00
108.00
103.00
98.00
93.00
88.00
83.00
78.00
8/16/2021
8/23/2021
8/30/2021
9/6/2021
9/13/2021
9/20/2021
9/27/2021
10/4/2021
10/11/2021
Index
Futures
Linear (Index)
Linear (Futures)


Packer Margin
Packer Margin ($/hd)
31.00
26.00
21.00
16.00
11.00
6.00
1.00
-4.00
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021







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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.