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WEEK ENDING OCTOBER 22, 2021

THE PORK WRAP

This week it was the bellies' turn to pressure the cutout lower. The chart below indicates that after several weeks of being the bad guy, hams actually added a small amount to the cutout. But that wasn't nearly enough to offset the pressure that came from the belly primal. On a weekly average basis, the cutout dropped almost $6 this week. Cash hogs also moved lower, but not as much as the cutout. WCB negotiated hogs were only down $1.40 this week. The LHI lost a little over $3.50, reflecting the drop in the cutout in addition to the smaller decline in cash hog prices. With pork prices down more than hog prices, packer margins shrank.

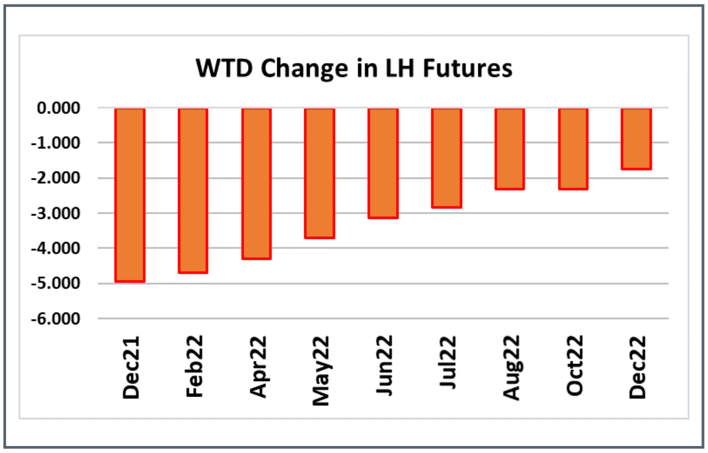
I estimate packer margins at $26/head, down about $5 from last week. The pork drop credit is also declining as kills increase seasonally. Margins are very close to the five-year average for this time of year, but with demand still very strong, I expected them to be larger. Perhaps the smaller supply of hogs this fall is working to counter the margin enhancement that should arise from stronger-than-normal demand. Packers posted a 2.6 million head kill this week, slightly smaller than last week. The difference was a little bit smaller Saturday kill this week. However, that kill was nearly dead on with what the March/May pig crop implied. The bar chart below shows that the kill in recent weeks has been a lot closer to the pig crop than it was earlier in the quarter. That gives me some confidence that I've likely got the projected kills right over the next few weeks. We are not far away from the peak kill which should total around 2.68 million head near the end of November. Carcass weights are rising seasonally now and that is also adding to production. Unfortunately, the export market doesn't appear to be soaking up as much product as it has in recent years.

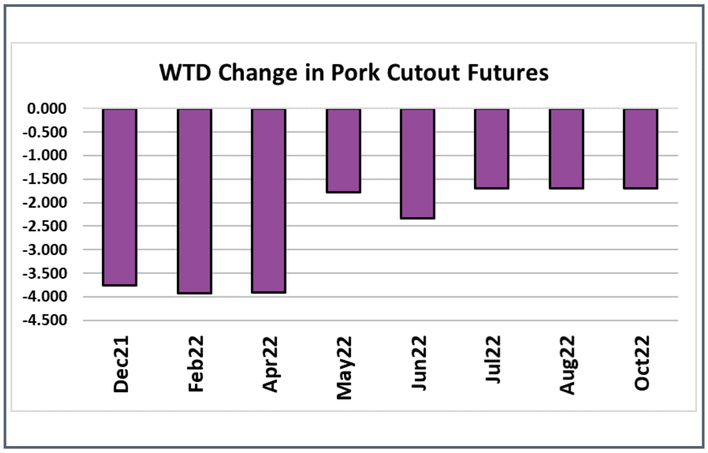
Still, strong domestic demand can cover for a lot of sins and demand is definitely strong in an historical context. I'm looking for the Q4 cutout demand index to come in around 1.12, which is below the 1.17 average of the first three quarters in 2021, but the second highest Q4 demand ever recorded. The combined margin chart tells us that demand has resumed its near-term decline after a brief, but large, head fake a couple of weeks ago. Clearly, we have seen belly demand erode over the last 10 days or so, but I also think we are seeing some slippage in demand for the retail items. Hams may be close to a bottom now. It is hard to imagine that 23/27 hams below $48 won't be seen as a great value by buyers.

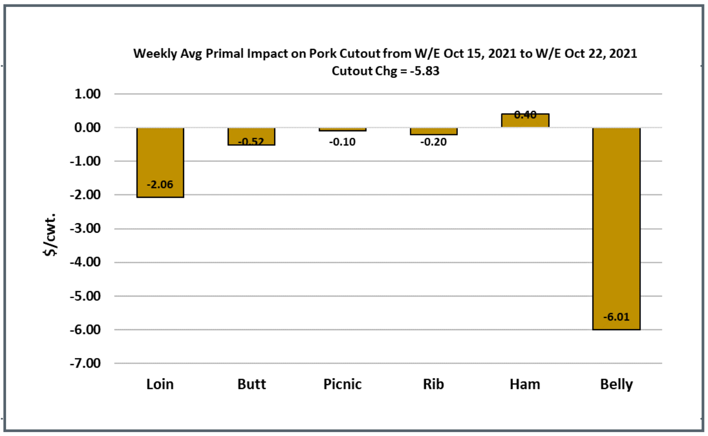
Of course, many of the buyers that use bone-in hams process them further and so perhaps labor is constraining their demand for hams this fall. The cutout has now printed below $100 four days in a row and it looks like it has further downside potential as kills expand further in the next few weeks and belly demand stays on the defensive. I'm forecasting the cutout to move into the mid $80s sometime around Thanksgiving. I think the risk is that it may go there sooner. The lack of Chinese interest in US pork is one of the more disappointing features of the market this fall. The weekly export volumes to China continue to decline and their forward book doesn't indicate that they plan on ramping up imports from the US anytime soon.

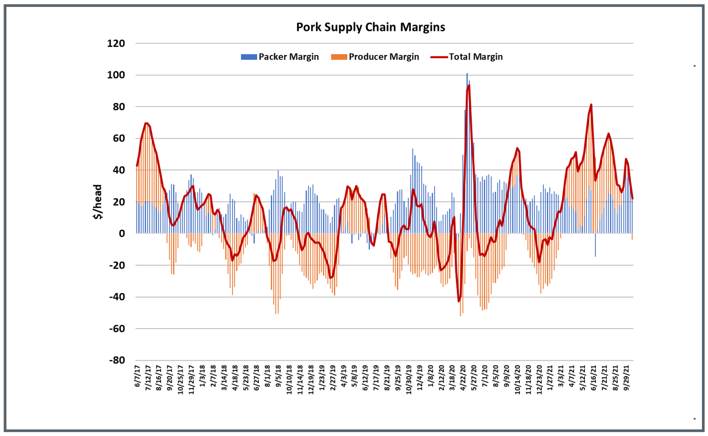
In addition, retailers have jammed pork prices to all-time highs after several months of super-high wholesale pricing. That is likely to cool consumer interest in pork and it is coming right when the biggest production of the year occurs. Pork has very inelastic demand, meaning that relatively small changes in the quantity available can result in big changes in price. That is partly why I'm concerned that a mid $80s cutout could come sooner than most expect. Hog producers have enjoyed great margins for most of 2021 (chart below), but the recent decline in cash hog prices has producer margins on the verge of going red. The last two months of 2021 are likely to see producer losses of more than $20/head. Lean hog and pork cutout futures were lower on the week, with the biggest losses coming in the front end of the curve.

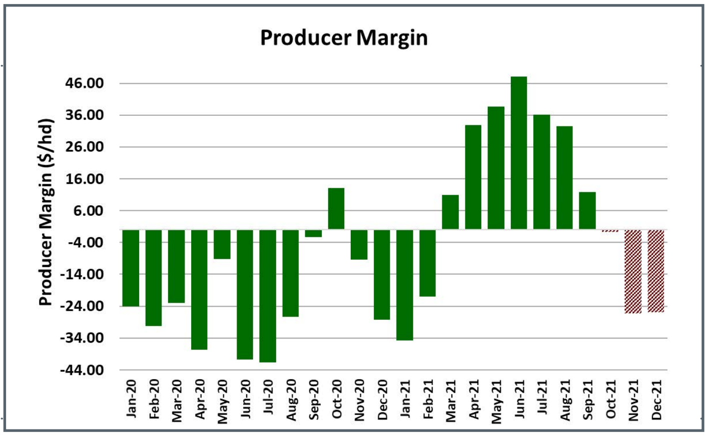
Traders were quick to adjust their price expectations as the cutout moved below $100 and the bellies made their downward trajectory clear. Dec hogs lost $5 on the week and are now about $9.50 under the LHI. With seven weeks to go until expiration, it is reasonable to expect the Dec contract to remain well below the index as long as the cutout and index are trending lower. Next week, watch those bellies for further softening and keep an eye on the hams in case low prices should start to attract some buying interest.

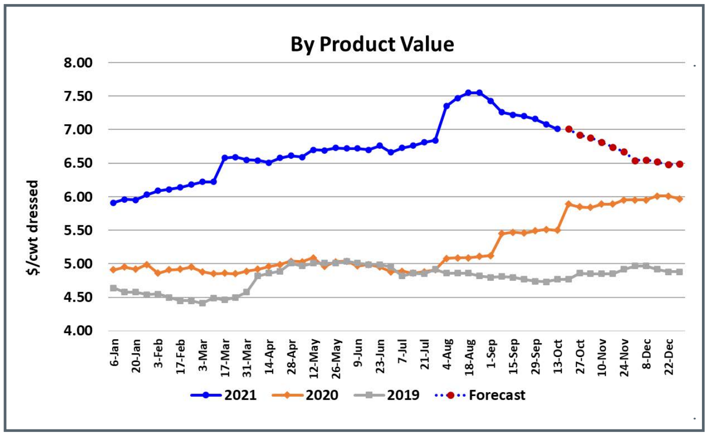












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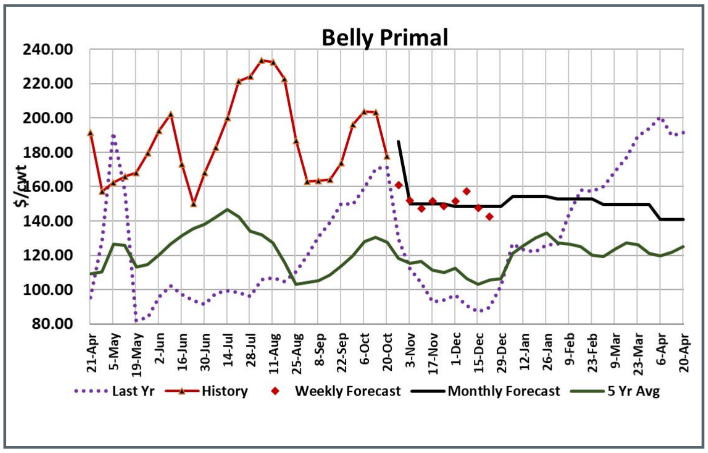

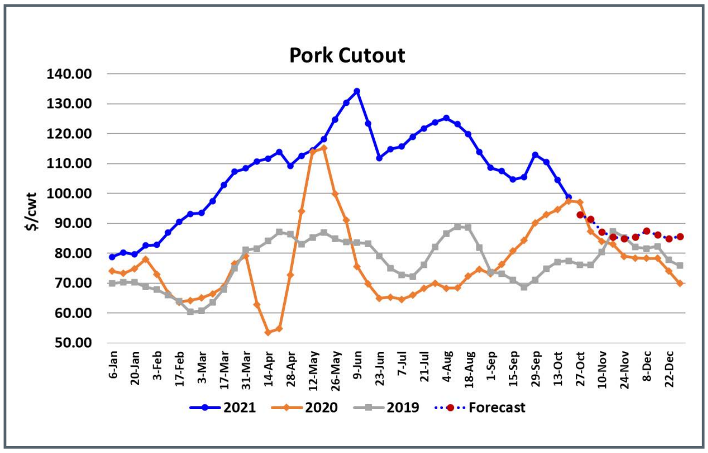

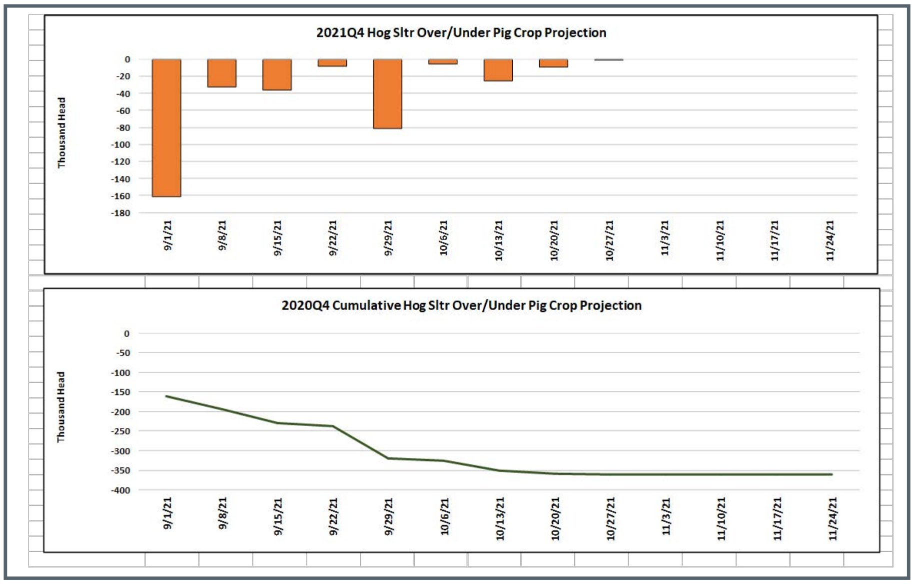

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Dr. Rob Murphy is an agricultural economist and business leader with over 29 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.