VOLUME 4, ISSUE 11
EN | FR | ES

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THE MONTHLY

NOVEMBER 2021

RED MEAT OUTLOOK: HOGS & PORK

Except for a brief two-week upswing in late September, the pork cutout has been trending lower since early August and it has recently traded below the $100 mark for the first time since early March. There are both supply and demand factors at work.

> Pork cutout values recently **fell below $100** for the first time **since March**

Supplies have been increasing seasonally since midsummer and will likely reach their annual peak within the next 30 days. Demand has been slowly eroding as consumers react to high retail prices and government stimulus money is drying up. To be sure, demand is still way stronger than in years past and that has kept price levels way higher than in the past, but the air is starting to come out of the demand balloon. Export volumes have declined since midsummer also and that is a bad omen for an industry that is accustomed to seeing at least a quarter of its production move through export channels. Perhaps it was a wise move that hog producers adjusted herd size downward this summer even though profit margins were very strong. No one expected the bonanza that was 2021 to carry on forever and now we are seeing the deflation of the profit bubble the industry has been operating in for the past year and a half. There are headwinds for the industry that will persist into 2022: declining exports, high feedgrain prices, labor shortages and the threat of ASF now in the Western hemisphere. We should also list the waning pandemic as a headwind for the industry because it benefitted mightily when consumers were forced to hunker down at home as the pandemic raged. As vaccinations increase and COVID-19 infections fall, consumers will have a lot more options when it comes to spending and we expect that will mean less time preparing meals at-home and less demand for pork through the retail channel.

SUPPLY PICTURE

Total hog slaughter in the US recently eclipsed the 2.6 million head mark and could expand perhaps another 100,000 head per week as it peaks in late November or early December. Based on what USDA reported for the March/May pig crop, it seems unlikely that there will be any weekly kills larger than 2.7 million head this year. That is fortunate since labor shortages at many points within the supply chain might make it difficult to handle production levels much above that. As the calendar turns to December, the industry will start working on the Jun/Aug pig crop, which USDA recently estimated to be down 6% from last year. That means that pork availability should be reduced considerably compared to last year, at least through February. Once kills peak, they normally plateau through February and then hog numbers begin to decline seasonally in March. If we were just considering the supply side of the market, the conclusion would be that price levels should be higher in early 2022 than they were in 2021, but an overall softening of pork demand might prevent that from happening.

Carcass weights are increasing now according to typical seasonal patterns. In the fall, cooler weather and freshly harvested grain foster weight gains. Barrow and gilt weights were most recently reported at 212 pounds, which is just one pound short of last fall's heavy weight and three pounds over this point in 2019. Weights are expected to continue working higher until mid-December when they should stabilize and move sideways for a couple of months. At this point, there is nothing concerning in the carcass weight picture. The de-trended and de-seasonalized weights are rising, but from a very low level so it doesn't look to us like hogs are backing up in the pipeline. As long as labor constraints don't restrict kills over next couple of months, the supply chain should remain in good order. However, if it gets to the point where packers cannot process all of the hogs on schedule this fall, then we would expect to see weights quickly rise over last year and price levels for producer hogs take a sharp turn lower.

Hog producers have had a great year in 2021. By our calculation, producer margins have been positive since March. However, recent declines in hog prices now threaten to send margins into the red (see **Figure 1**). That is pretty normal for this time of year when the supply of hogs is largest. The outlook for 2022 is not rosy either, since producers could still be facing much higher costs of production as feedgrain prices hold firm and labor costs rise. The super-strong demand environment of the past 12-18 months has allowed hog prices to more than cover these higher costs of production, but as that demand starts to fade in 2022, it will expose higher cost structures. Negative profit margins in the hog production segment are likely to become more common.

DEMAND SITUATION

The upturn in pork demand discussed last month was short-lived. The cutout advanced modestly for about two weeks and then turned lower again. Of course, some of that downward price pressure arose from growing hog and pork production, but it also looks like domestic pork demand is beginning to fade again. As COVID-19 infections fall, consumers are slowly coming out of the house and resuming some of their pre-pandemic activities. That means less meals prepared at home and thus less pork procured through retail channels. In addition, beef prices have come down considerably in the past couple of months and thus beef is now a stronger competitor for space in retail circulars. Government assistance in the form of direct payments to consumers is still a force in the market, but it has declined considerably from the levels we saw back in the spring and summer. Thus, there are a lot of factors in place right now that should temper consumer demand. In recent weeks, the considerable softening in demand for hams and bellies have been largely responsible for the declining cutout. The belly primal, which is famous for its rapid price moves, was trading over $205 in the middle of October and it is now in the mid $150s (see **Figure 2**). Hams are more of a head-scratcher, but it looks like movement to Mexico slowed a bit and that left extra product that had to be disposed of in the domestic market at lower prices. Once ham and belly prices started to drag the cutout lower, buyers for other items pulled back and now some of those prices are declining as well. From a historical perspective, pork demand is still very strong but it has been tempered somewhat from the levels we saw this spring and summer. Our guess is that if the pandemic continues to wane, then domestic pork demand will slowly deteriorate over the next few months.

> **The belly primal has dropped to the mid $150s,** but a bottom may be near at hand

Export demand for pork is clearly not as strong as it was earlier this year. Each week, it seems that China takes less North American product. Quantities being shipped to China from the US are only about half of what they were last year at this time. The amount of product booked by China for delivery in the next couple of months is also way down from last year. This reduction in demand from China is logical because hog and pork prices in China are far below where they were a year ago. Some observers have speculated that this is because ASF flare-ups in China are causing producers to panic and send hogs to market before they can contract the disease. Others believe that the low prices are simply the result of a rebound in the Chinese herd post-ASF and thus more pork is being produced. We tend to fall into the latter camp, although the truth may lie somewhere between the two. As is the case with domestic demand, international demand for US pork is very good in a long-run historical context, but it looks soft when compared with the super-strong export picture over the past couple of years.

SUMMARY

Wholesale pork prices have been on the defensive recently, with both supply and demand factors to blame. Hog and pork production are approaching their annual highs and that has weighed on price levels. At the same time, domestic and international pork demand have been slowly softening from the record levels seen this spring and summer. In recent weeks, weaker demand for hams and bellies bear most of the responsibility for lower cutout values. Pork buyers are relieved to see price levels finally coming down, but must recognize that today's pork prices are still about $20/cwt higher than what would have been typical at this time of year before the pandemic. Hog producers have enjoyed very strong profitability this year, but that hasn't translated into herd expansion. Producers seem to be wary of expansion in the current environment where it appears that demand from China is waning and labor costs are escalating. For nearly two years, the industry has had to deal with a variety of situations posed by the pandemic. Some of these were positive, like strong pork demand for stay-at-home meals, while others, such as severe labor shortages, proved to be challenges for the industry. Everyone is ready for the pandemic to pass and life to get back to normal. It appears that North America is headed in that direction but the timing is uncertain and another COVID-19 surge could upend things once again. For now, it looks like bigger pork supplies and softening pork demand will translate into lower wholesale prices as we close out 2021. **Table 1** provides our near-term price forecasts.

Figure 1: JSF Estimated Hog Producer Margin, 2016-2022

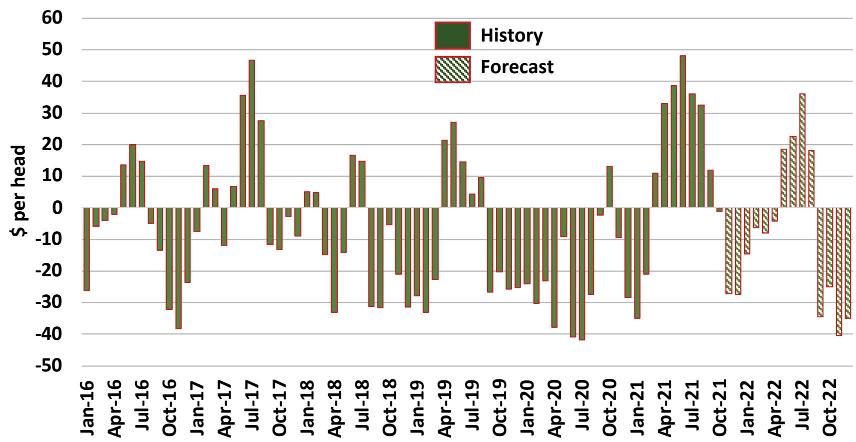

Figure 2: Belly Primal

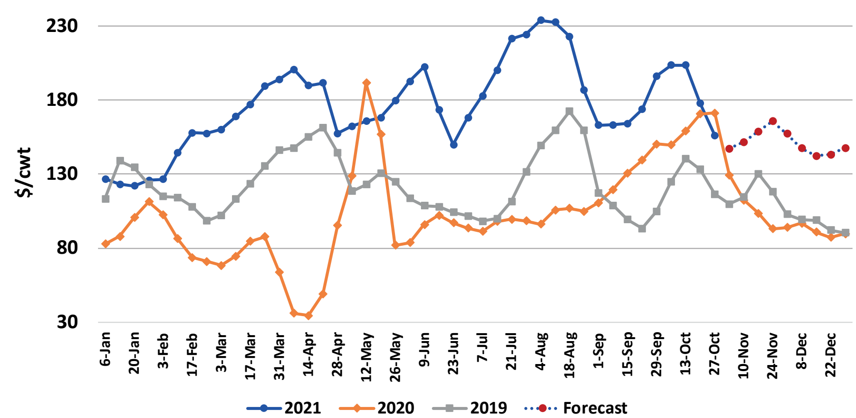

Table 1: JSF Hog and Pork Price Forecasts

	10-Nov	17-Nov	24-Nov	1-Dec	8-Dec	15-Dec
Pork Cutout	91.3	90.3	89.9	87.0	85.5	85.2
Loin Primal	90.4	86.5	84.6	84.2	86.1	85.0
Butt Primal	89.9	90.2	90.5	91.3	89.1	87.0
Picnic Primal	61.2	63.3	62.9	61.3	62.1	63.0
Rib Primal	129.7	127.5	128.0	130.1	131.5	134.9
Ham Primal	75.6	70.3	66.3	60.4	58.9	62.1
Belly Primal	151.7	158.9	165.7	157.2	147.5	142.4
Lean Hog Index	77.9	75.6	74.5	72.2	71.0	71.9

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