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WEEK ENDING DECEMBER 31, 2021

THE PORK WRAP

The hog and pork complex remained stuck in neutral for yet another week. The WCB cash market averaged $0.25 lower on the week, while NDD cash market posted a $0.94 gain. The cutout managed $0.33 higher on a weekly average basis. As a result, the LHI was almost unchanged on the week, averaging $71.93. It feels like participants all up and down the supply chain are just waiting to see what happens next. Last week's Christmas-shortened kill was the second smallest weekly kill of the year, yet the cutout went nowhere in the ensuing days. That is because buyers also take the holidays off and plan well in advance for these last weeks of the year. The real challenge will come next week when buyers are back at their desks and pork production ramps back up to non-holiday levels.

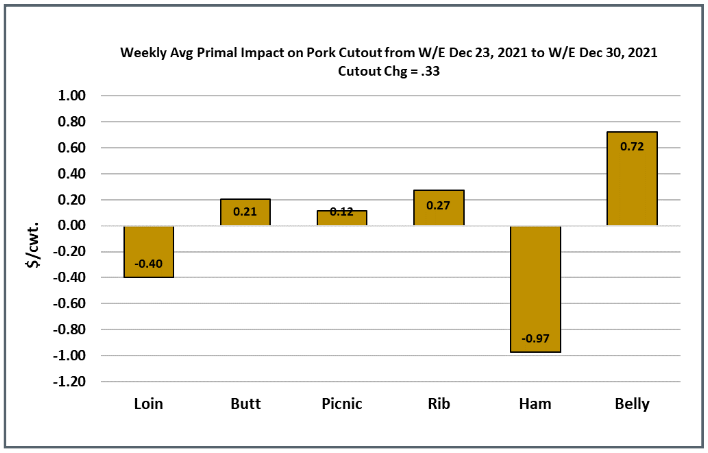
I am seeing some signs in the retail cuts that they may be poised to move higher in the next few weeks. We've already seen some steady price increases in the butts and ribs, but I think now the loin primal could start to attract some interest. The worst is probably over for the hams and their next move should be higher, but it will be more of a slow steady grind higher rather than a rocket launch. The chart below indicates that the hams were the biggest drag on the cutout again this week, but modest improvements in belly pricing largely offset the weakness in the hams. Overall pork demand appeared to be making a near-term bottom a couple of weeks back, but the combined margin chart indicates that the holiday period disrupted any chance for it to gain traction. Now that the holidays are behind us, perhaps that demand upcycle will get back on track. Soaring omicron infections in the US remain a potential risk/benefit to pork demand. The risk part lies with the possibility that so many consumers get sick that they just don't feel like eating at all and certainly don't feel like going to the grocery store.

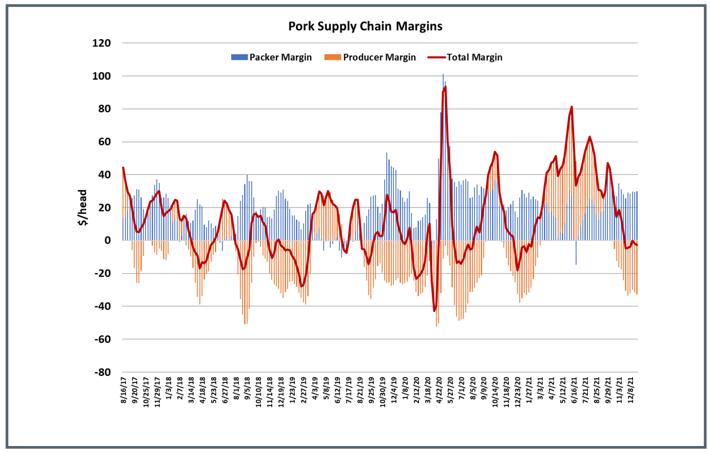
The benefit potential is related to the chance that consumers return to a stay-at-home approach for a while and thus shift a significant portion of their consumption from the foodservice channel to retail, which we already know is positive for demand. Another risk from the omicron surge is the potential for plant workers to get sick en masse and thus cause packers to have to scale back the kill substantially. This seems like a very real possibility that hasn't been talked about nearly enough. So far, the daily kills have held up well, but states where most hog packing plants are located have yet to see the surge like the coastal states have. It is just a matter of time before states like Iowa see huge spikes in infections. North Carolina, where the largest hog slaughter facility in the nation is located, is now recording huge increases. It is true that the packing plant workforce is more than 90% vaccinated, but this variant seems to make people sick in spite of being vaccinated. And then there is the issue of kids, who are getting sick in record numbers. That could cause school closures in early January and thus generate high absenteeism as plant workers stay home to care for their kids.

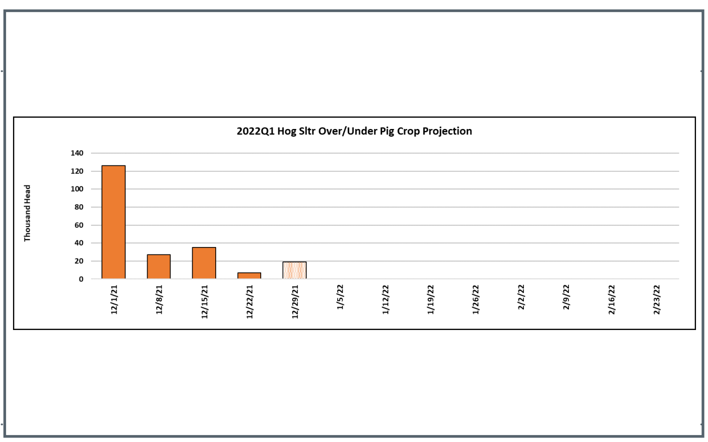
Keep in mind that hog supplies are seasonally very large. This would be a bad time to lose a chunk of processing capacity. If plants do get constrained by labor problems, then I think we can expect the cutout to rally as buyers get shorted and we would probably see some retrenchment in the negotiated hog markets. Any such labor constriction probably wouldn't last very long, perhaps 2-3 weeks, because people infected with this variant seem to recover rather quickly, especially if they are vaccinated. Epidemiologists tell us that we are likely to see a huge and rapid spike in infections and then a very quick decline. So the worst of it might be over by the end of January, but it could do plenty of damage to the pork supply chain in just a few weeks. This week's kill looks like it is on track to come in at 2.16 million head, but we won't know for sure until Monday because Friday was a USDA holiday.

Next week, I see the kill bouncing back to about 2.45 million head if covid doesn't cause too many problems. Kills are still coming in a little above what the prior pig crop implied, but the over-killing doesn't seem to be as severe as it was in the recently completed Sep/Nov quarter. USDA reported barrow and gilt weights down a pound this week, but they could bounce back in the next couple of data reports that will cover the holiday period. At present, weights seem to be pretty normal and don't indicate any backing up in the pipeline. With demand due to cycle higher and supplies potentially getting crimped by covid, the potential for higher pork prices in the next few weeks is high. Traders who were long the February contract seemed to grow tired of waiting for some upward movement in the lean hog index and that contract lost almost $2 on the week. More importantly, the spread between the Feb pork cutout futures and the Feb hog futures increased substantially this week and that shows that traders are revising their expectations for packer margins in February upward.

Packer margin expansion is exactly what we would expect to happen if processing capacity gets compromised, so it looks like traders are starting to position themselves for a higher probability of slaughter disruptions in the weeks ahead. In all though, the futures curve doesn't look too far out of line with my fundamental forecast, at least through June, and the supply picture beyond June depends on pig crops that haven't been born yet. Next week, watch the daily covid infection counts and watch the daily slaughter numbers for signs that throughput is being affected by the virus. The omicron surge is going to be the main story of interest for the next couple of weeks.


Weekly Avg Primal Impact on Pork Cutout from W/E Dec 23, 2021 to W/E Dec 30, 2021
Cutout Chg = .33
$/cwt.
1.00
0.80
0.60
0.40
0.20
0.00
-0.20
-0.40
-0.60
-0.80
-1.00
-1.20
-0.40
0.21
0.12
0.27
-0.97
0.72
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


2022Q1 Hog Sltr Over/Under Pig Crop Projection
Thousand Head
140
120
100
80
60
40
20
0
12/1/21
12/8/21
12/15/21
12/22/21
12/29/21
1/5/22
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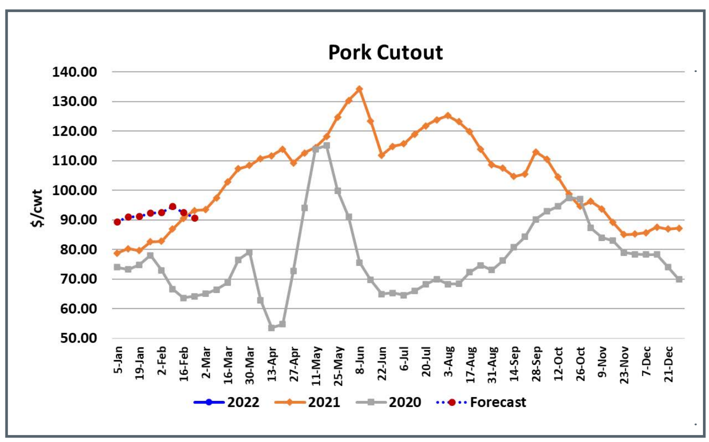
2/9/22
2/16/22
2/23/22


Pork Cutout
$/cwt
140.00
130.00
120.00
110.00
100.00
90.00
80.00
70.00
60.00
50.00
5-Jan
19-Jan
2-Feb
16-Feb
2-Mar
16-Mar
30-Mar
13-Apr
27-Apr
11-May
25-May
8-Jun
22-Jun
6-Jul
20-Jul
3-Aug
17-Aug
31-Aug
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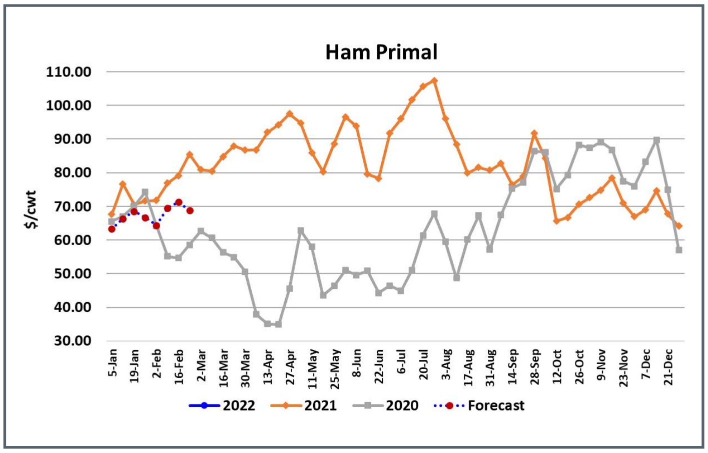
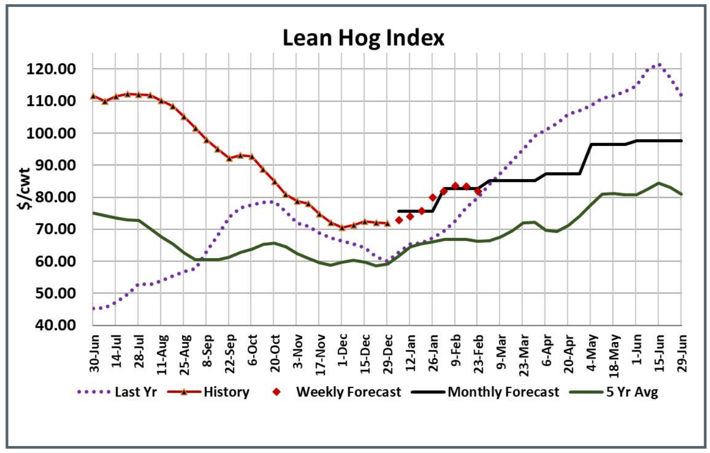
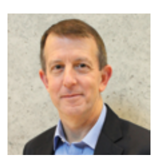
26-Oct
9-Nov
23-Nov
7-Dec
21-Dec
2022
2021
2020
Forecast







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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.