



WEEK ENDING JANUARY 21, 2022

THE PORK WRAP

This week the pork cutout finally got enough traction to move above the \$90 mark. For the week, it was up \$4.66 to average \$92.03. Hams were the primary drivers, with a little assistance from the loins and bellies. Last week I noted that the hams had gotten ridiculously cheap and would likely attract some buying attention. That seemed to happen this week, but they also found support from light kills. Packers did a good job of cleaning up ham inventories coming into the week, so the light kill and low price levels made for an environment conducive to price gains. Bellies also showed some life this week and that may be a sign that processors are getting more labor back on line.

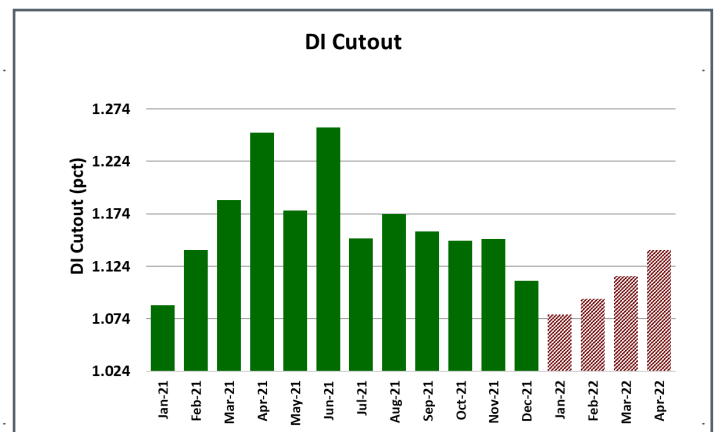
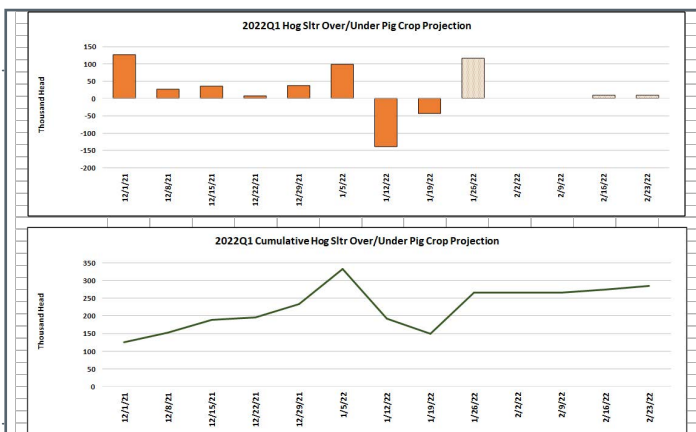
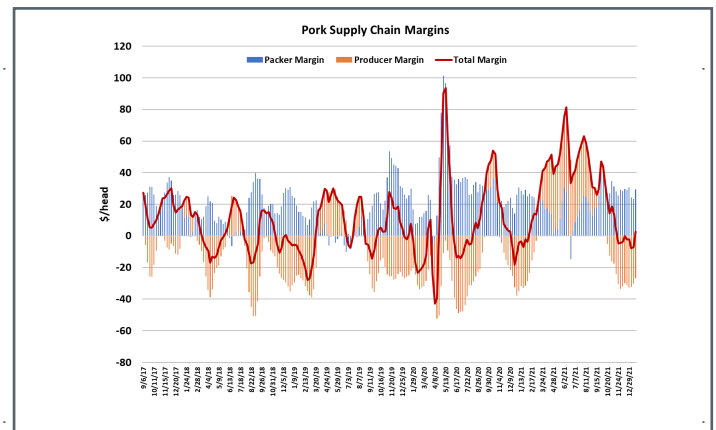
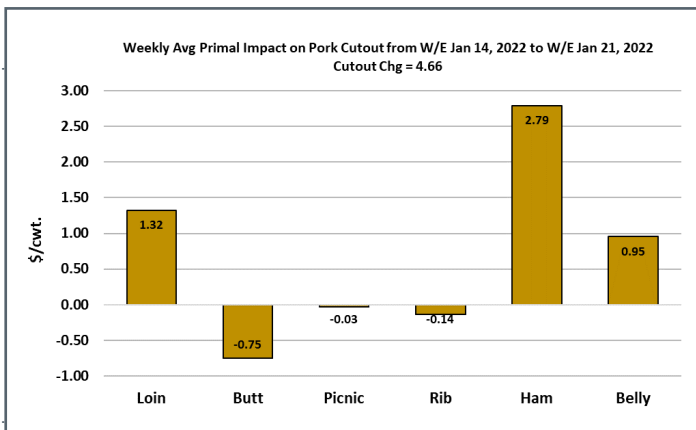
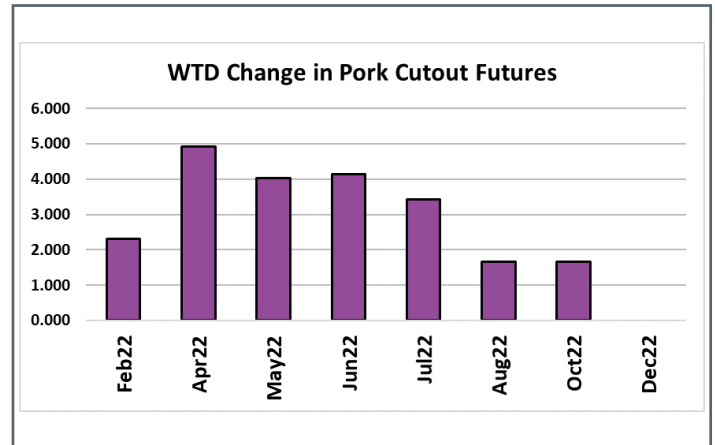
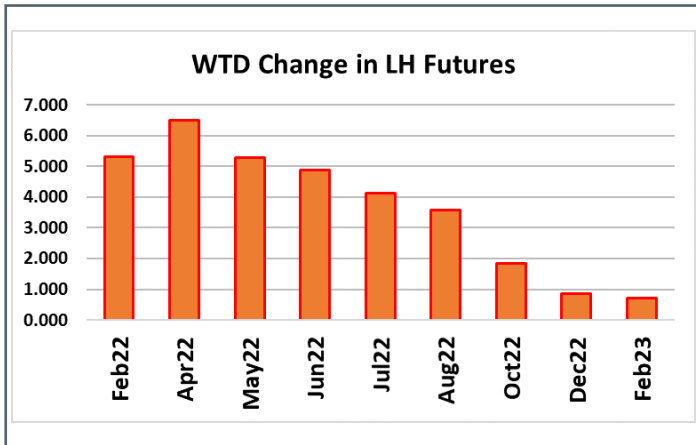
Currently, bellies aren't super cheap the way that hams were, but they are cheap enough that some users may be building freezer inventories ahead of tight fresh supplies this spring and summer. Pork loins are making their way into retail ads as an attractive alternative to expensive beef, especially now that holiday bills are landing in consumer's mailboxes. So there are good demand-side reasons why the cutout is pushing higher, but we have also seen kills constrained by omicron-related absenteeism and thus there is a supply-side component to the recent price strength as well. Packers managed to kill 2.44 million head this week with the help of a fairly strong Saturday kill, but the graph below indicates that was still about 50k less than what the pig crop indicated. Back in December, kills were running larger than the pig crop implied and that makes me think that USDA under-estimated the Jun/Aug pig crop moderately. So, if we hadn't had high absenteeism in the plants over the last couple of weeks, by guess is that the kills would have been larger than the pig crop implied by about 75-100k. Given that we underkilled by about 175k in those two weeks, it implies that we likely backed up about 250-275k hogs. That's not a huge backlog, but it also isn't insignificant.

The weight data is also starting to point to some backing up in the pipeline. Negotiated hog prices have been very volatile lately, moving up then down in big chunks, but on a weekly average basis, negotiated prices were a tiny bit lower this week. That also fits with the idea that there are some extra hogs in the system. With each passing week, packers should find it easier to get back on a full kill schedule. If they can keep hog prices contained, they may even opt to kill off some of the backlog in the next several weeks. That is the thought behind my forecast next week for a kill around 100k over what the pig crop suggested. A couple of weeks like that and the backlog problem will be solved. The wild swings in daily hog prices has made it difficult for futures traders to identify the trend in those markets, so instead they have just focused on the cutout which has been mostly up.

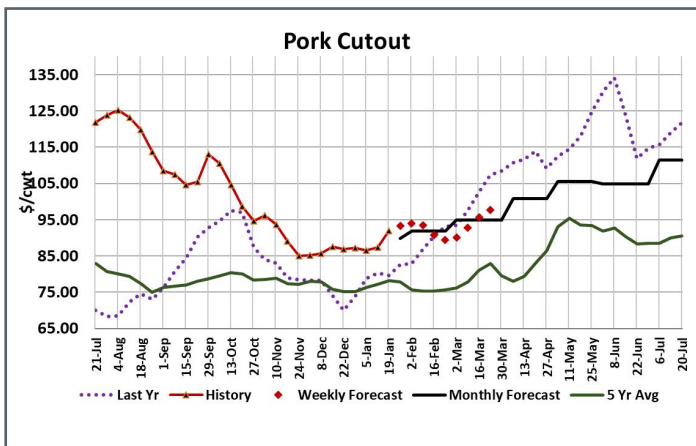
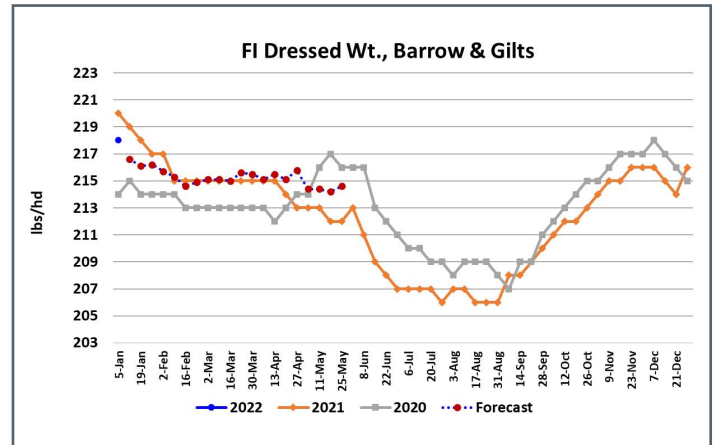
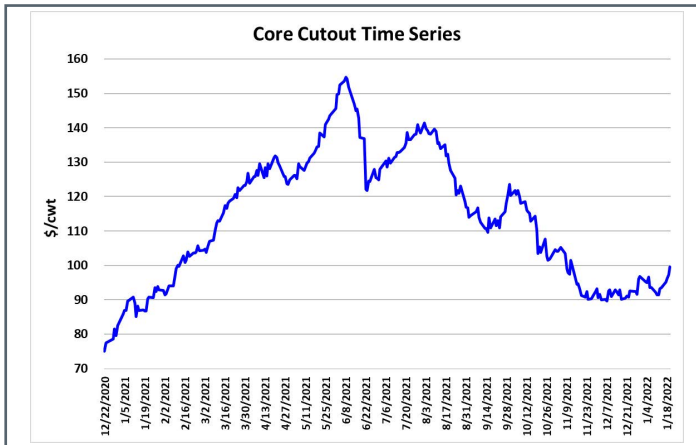
The Feb futures gained over \$5 this week and the Apr were up more than \$6 as a rising cutout brought the bulls back out. But even the cutout is difficult to decipher, often swinging \$5-10 from morning to afternoon. To help bring some clarity that problem somewhat, I created a "core" cutout that is comprised of one item from each primal that is minimally processed (so that labor is not a big factor) and weighted those items according to the percentage each primal contributes to the cutout. Trim is also included. The chart below indicates a strong move higher in the core cutout recently, going from around \$90 to near \$100 at the close today. So we have evidence that this recent move is solid and not just based on a shifting mix of products.

My guess is that improvements in labor availability over the next several weeks will cause the core cutout to track more steady than uptrending. With the cutout rising and the cash hog markets steady, packer margins added about \$6/head and are now close to \$29/head. That makes it the largest margin ever for this point in the calendar. Normally margins soften in January and February in response to seasonally softer demand, and I expect that will be the case this year as well. The forecast has packer margins averaging around \$26/head in January and \$19/head in February. In fact, margins should continue to work lower from now until mid-July in response to a seasonal downtrend in hog numbers. It is worth noting that international demand for US pork is looking pretty weak right now, compared to recent years. Fortunately pork production is also smaller, so that has helped to offset the impact of having to move a greater percentage of production in the domestic market. Demand in the domestic market seems okay, but not great.

The combined margin did turn higher this week, so maybe we are finally going to get that demand upcycle that has been anticipated. However, the bar chart below plots the cutout demand index by month and you can see that demand here in January is at almost the same level it was last January. Thus, the YOY difference in pork prices is being driven more by constrained supply than exceptional domestic demand. At this time last year demand was mediocre but "great pork demand surge of 2021" was about to begin in February. Now it looks like demand is back close to pre-surge levels. The combined margin chart gives that impression also. Next week, keep an eye on the daily kills for signs that the labor problem is easing. Also, watch the weekly weights for signs that hogs are backed up.



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