



WEEK ENDING FEBRUARY 18, 2022

# THE PORK WRAP

Cash hog prices continued higher this week as the WCB negotiated market was up \$5.80 on a weekly average basis and the National negotiated market gained a little over \$8. Those gains were enough to push producer margins into positive territory after over three months of being deep underwater. Packers could afford to pay those high hog prices because the prices they were receiving for pork increased. The cutout gained \$7.18 this week to average \$109.53. Triple digit cutouts in February are pretty rare and it's even rarer to see triple digit hog prices, but that may be where we are headed very soon. The LHI is currently poised to reach \$97 early next week and expected to average over \$101 by the time next week is done. Packer margins remain very healthy, with this week's margin estimated to be over \$31 per head. As a result, packers are eager to push the kills higher and not afraid to pay up for hogs if they have to. This week's slaughter clocked in at 2.51 million head, just a hair smaller than last week, but still about 90k stronger than what the Jun/Aug pig crop implied.

Next week is the end of the Dec/feb quarter and it looks like the industry will have over-killed USDA's estimate of the prior pig crop by about 500k. I guess it is a good thing that the hog supply was larger than advertised over the past few weeks or else price levels likely would have surpassed the eye-popping levels that we are currently experiencing. Barrow and gilt carcass weights declined another pound this week and seem to be behaving in normal seasonal fashion. Both kills and carcass weights both should plateau for the next several weeks and thus hold pork production relatively steady around 535 million pounds per week. Toward the end of March, both kills and carcass weights should start to move seasonally lower and by the time we get to mid-May pork production will likely only be about 500 million pounds per week. That would be about 3.3% below last year's production level, but keep in mind that exports aren't likely to be nearly as strong as what we saw last year, so that will help to offset some of the YOY production decline. When we get into the summer months, the industry will be slaughtering the Dec/feb pig crop, which USDA hasn't reported yet, but my estimate is that it will be about 1% larger than last year.

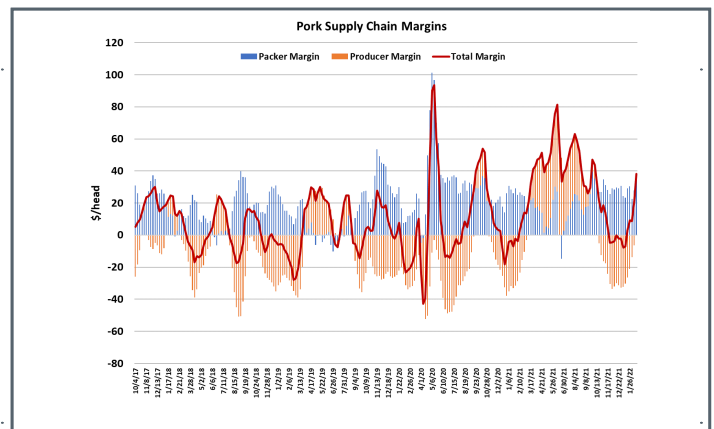
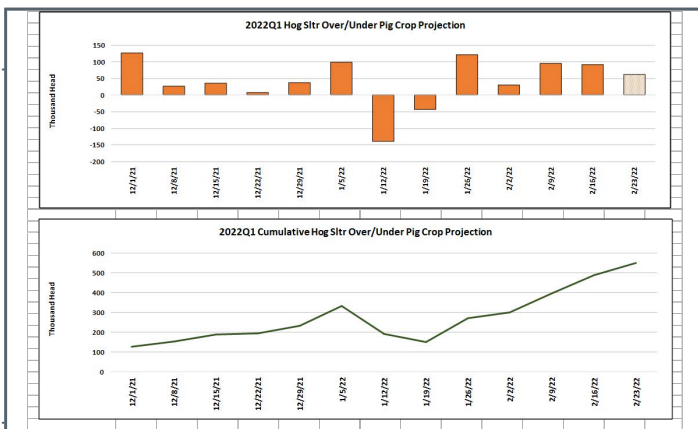
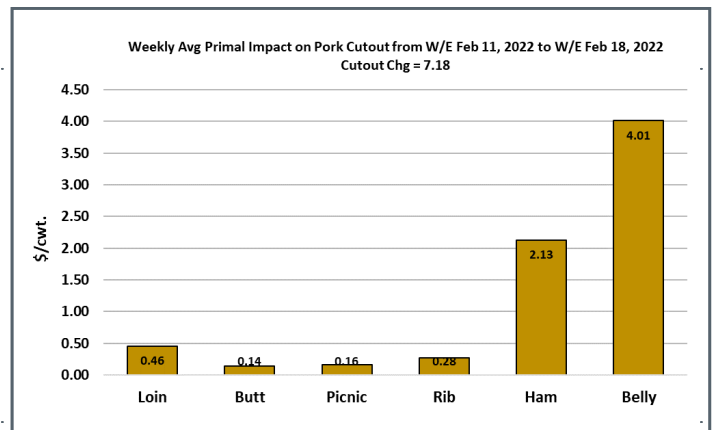
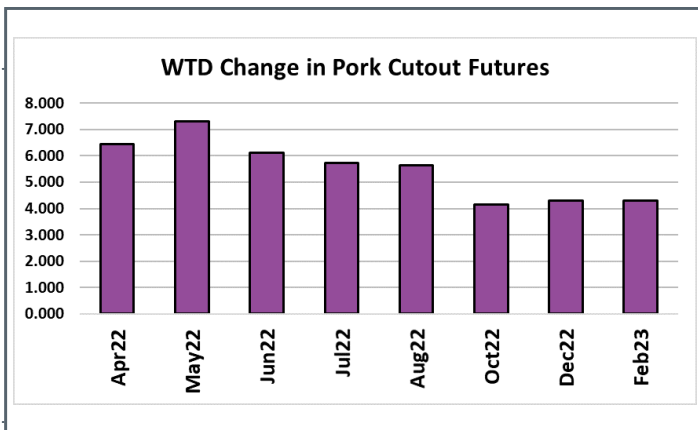
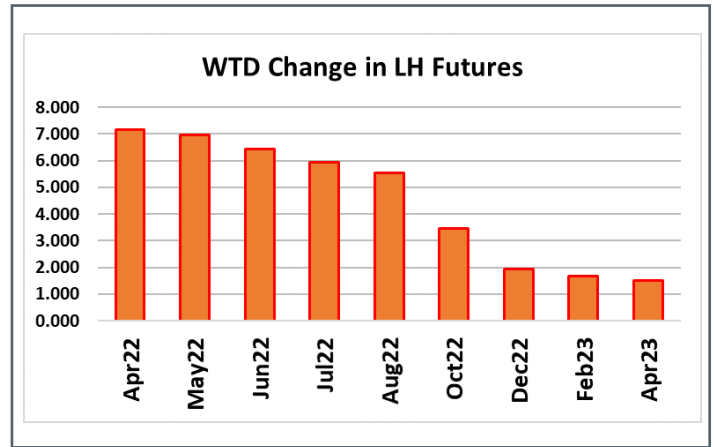
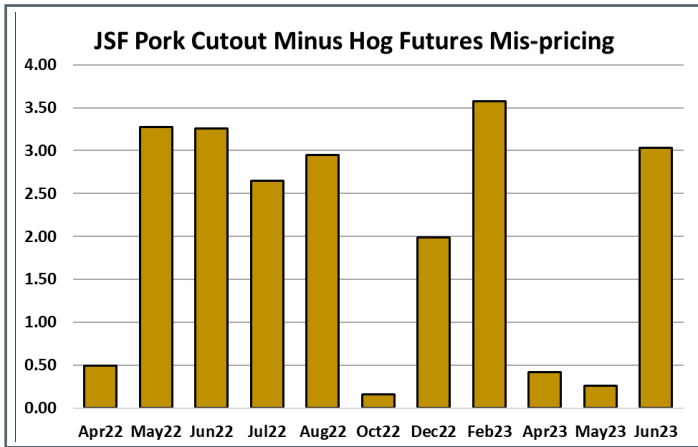
In all, the supply side of the market looks a bit tighter than last year, but not excessively tight, particularly as we move deeper into spring and early summer. It is the demand side that is causing most of the headaches right now. I estimate that the cutout demand index for January was 1.09, up about half a percent from last year and the February demand index is close to 1.2, up 5.2% from last year. Just to put that 1.2 February demand index into perspective, prior to 2021 the highest February demand index on record was 1.07 in 2017. So, this is by far the strongest February demand environment ever seen. That is why the cutout is brushing up against 110. Of course that begs the question, "Why now? Why is demand suddenly so strong for pork?" I suspect that it is related to consumers climbing back down the protein ladder and trading out of beef and into pork as their pandemic savings dwindle and high prices on everything else in the economy gobble up any extra disposable income they might have.

If that theory is correct, then this demand strength isn't likely to last a long time since consumers will eventually move down from pork to poultry. The one caveat to that is that the poultry sector is nervously watching the spread of avian influenza right now and that has the potential to disrupt things for all animal proteins. If the bird flu spreads widely to commercial broiler operations, then massive depopulations will be necessary and that will seriously limit broiler production, raising prices and thus supporting pork demand. On the other hand, if it doesn't spread widely but it does cause our trading partners to ban US poultry, then there is the risk that poultry prices plummet in the US as we try to clear a lot more chicken through domestic channels that would normally have gone overseas. That would hurt pork demand. And finally, if a "bird flu epidemic" starts to be reported in the popular press it can depress consumer demand for poultry and thus boost beef and pork demand. So, there are a lot of different angles to the avian influenza story that we need to keep an eye on in the coming weeks. This week it was big gains in both the bellies and hams that drove the cutout higher, with only a small amount of help from the retail primals.

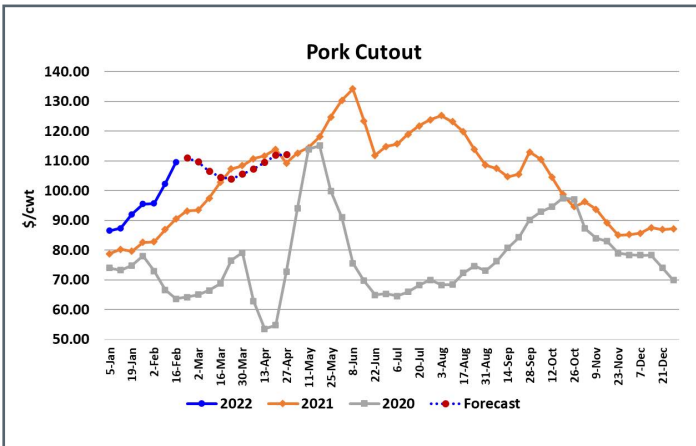
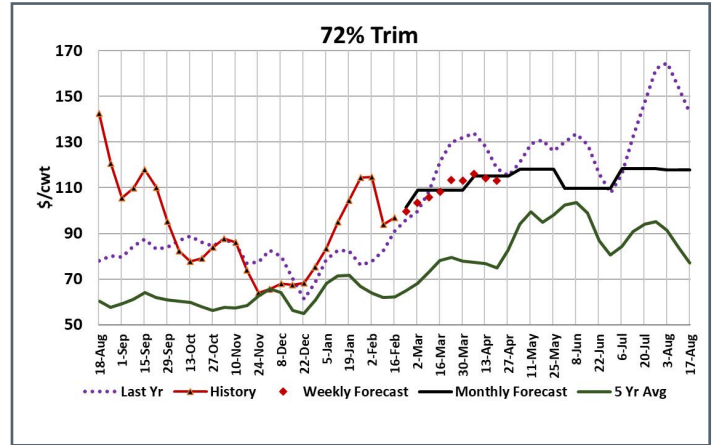
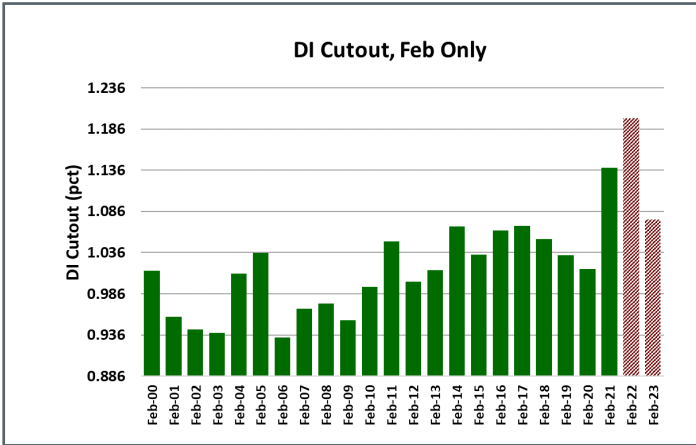
That tells me that the demand surge is coming primarily from the processing sector. Belly slicers are probably ramping up production in order to fill increasing orders from foodservice as the pandemic wanes. Americans will likely travel in record numbers this spring and summer after two years of not being able to travel safely. That should drive consumption through the foodservice channel higher and a lot of bacon is used in foodservice applications. With the hams, I think we may be seeing signs that more boning labor is becoming available because the amount of hams sold bone-in over the last few weeks seems to be down from where it was back in Q4. When processors are able to debone more hams, thus adding value to them, the price level for the ham primal should be generally higher. We should watch trimmings prices closely because as more deboning occurs, that should increase trim volumes and thus drive prices lower. So far that hasn't happened to a large degree. 42s have been trending solidly higher since mid-December and likewise for the 72s, except for a sharp drop two weeks ago.

This week, the 72s regained their footing and added about \$3/cwt. Futures traders have been busy buying the futures curve with both hands. The Apr contract has gone from about \$86 in mid-January to over \$109 today. That's \$23 gain in a month is astounding. Shorting this market has been like standing in front of a runaway train. Those that have tried it probably don't want to do it again anytime soon. The mis-pricing chart shows just how inflated the futures curve is now relative to my read of the fundamentals. Once the demand side of the market cools down however, a good bit of the recent strength in the curve is likely to get removed. Next week, watch the bellies and hams, those have been the primary price drivers. Keep an eye out for news on avian influenza because that has the potential to become a big market disruptor.

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