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J.S. FERRARO

THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

MARCH 2022

Spot pork prices in the US continued to work higher during February, not so much from any supply issues, but rather because domestic demand has been extremely good. At the same time, there is growing evidence that disease issues, PRRS in the US and PEDv in Western Canada, threaten to tighten the supply side of the market more than normal over the next couple of months. So far, those disease problems have not resulted in smaller-than-expected kills, but they have helped hog producers keep upward pressure on cash hog prices to the point that they are now near $100/cwt. Strong demand has bailed out packers, enabling them to keep strong margins even in the face of rapidly rising cash hog prices. This demand strength has mostly materialized after the omicron surge in January and much of it has been concentrated in processing items — hams and bellies — as second stage processors ramp up production in anticipation of stronger demand from the foodservice sector as life gets back to normal. We also think that consumers are in the process of climbing back down the protein ladder, trading expensive beef at retail for less expensive pork items. These two major trends converged, and the result has been excellent domestic pork demand. Neither trend will last forever, and we expect that at some point in the not-too-distant future, pork demand will cool off much like what we have been seeing the beef market lately. Futures traders have caught wind of the disease problems and that caused a buying spree that has pushed the entire hog futures curve to levels that approximate last year's top. Everyone remembers how PEDv back in 2014 shorted the supply side and ran prices sharply higher. It is not a given that the disease problems will be anywhere near that severe this year, but futures traders often buy first and ask questions later.

Cash hog prices recently approached $100/cwt as spot market availability has tightened

SUPPLY PICTURE

Weekly harvest levels during February averaged about 2.5 million head per week. That was modestly above what was expected based the pig crop that was born six months ago. There were a couple of weeks in January where omicron-related absenteeism caused kills to be below what the pig crop implied, but the industry bounced back quickly and all of the kills in February were stronger than the pig crop projected. It is curious to hear the reports of disease limiting hog production, yet more hogs showed up for slaughter than we expected. It may be that the problem won't manifest until later in the spring and it could be exacerbated by problems getting weanling piglets out of Western Canada. Farrowing operations there typically send a large number of piglets to the US Midwest for finishing, but this year PEDv outbreaks have hampered the supply of piglets and trucking problems (too few drivers, vaccine mandates, etc.) have made it more difficult to transport the piglets into the US. We think this has been a problem since at least December, so we could start to see supply tightness in May, when those piglets would normally been scheduled for slaughter. Hopefully, we will get more clarity on the issue when USDA issues its quarterly *Hogs and Pigs* report on March 30.

Another important supply-side consideration is rapidly escalating input costs for hog producers. Corn futures are very close to $7.00 bushel and the growing season is still a long way off (See **Figure 1**). Soybean meal is now over $450/ton. Prices for other inputs, such as natural gas to heat hog barns, have also increased considerably. We estimate that producers need to receive at least $93/cwt for hogs sold today just to breakeven. If hog prices don't keep up with breakeven levels, then there is a risk that some producers may let their barns go empty. Thus, it is

jsferraro.com | 130 Adelaide Street West, Suite 3302 Toronto, Ontario M5H 3P5 | 416.306.8788

Rising input costs, particularly for corn and soymeal, have pushed **hog producer breakevens to $93/cwt**

advantageous that hog and pork prices are currently high enough to cover costs and leave producers with a modest positive margin. Robust consumer demand has facilitated that up to now, but there is a risk that demand will soften over the next few months and leave fewer dollars in the system for participants all up and down the supply chain to use in meeting their costs. Most of the participants in the pork supply chain are margin players and they will not absorb cost increases indefinitely. They will either pass them on to consumers or go out of business.

We have scaled back our estimates of the breeding herd and pig crops for the next few quarters to take into account the disease problems and high input cost environment. Rather than growth, we now expect the breeding herd as of March 1 to be about flat with last year and the Dec/Feb pig crop is also pegged close to last year's total. However, any time that disease is a significant issue, there is always risk that USDA's survey will find animal numbers smaller than expected. Buyers should keep an eye out for that and be prepared. Diseases such as PRRS and PEDv are normally more problematic in winter and early spring and often recede when the weather warms up. Perhaps that will be the case this year, but keep in mind that it takes six months for a hog to reach market weight and so even if the disease problems abate this spring, it might not create a rebound in hog and pork supplies until the fall or early winter of 2022.

DEMAND SITUATION

There was great concern for US pork demand when it became obvious that China was going to have much less need to import US pork in 2022. That concern faded when the US consumer stepped up to fill the gap left by China over the last couple of months. However, with the pandemic winding down and restrictions being lifted, consumers are likely to place less emphasis on cooking at home and that probably means softer demand on the horizon. Consumers are beginning to exhaust the savings they accrued as a result of government stimulus during the pandemic, and they are facing widespread price inflation in almost everything they purchase. That should make them less eager to purchase pork, especially given near-record high pork pricing in grocery stores. Right now, sticker-shocked consumers are trading down from beef and that has benefitted pork demand, but at some point, probably not too far off, they will trade down from pork as well. When pork demand does begin to fade, it will put packers in a precarious situation. They may have little ability to pressure hog prices given the supply issues discussed above and thus their margins may come under serious pressure this spring. The typical response when that happens is for packers to intentionally cut the kill until pork prices rise enough to restore profits. If that type of situation arises this spring, pork buyers need to be prepared to weather several weeks of restricted production and high prices until packers get supply better aligned with the softer consumer demand. Even when inflation in the general economy dissipates, it is likely that the industry will be left with hog and pork prices well above pre-pandemic levels because labor costs will probably remain high after being raised during the pandemic to attract sufficient workers. Finally, a huge amount of uncertainty followed Russia's invasion of Ukraine last week and energy markets, which were already sky-high, moved even higher. That is likely to be a headwind for all protein demand in the weeks and months ahead.

The weekly export data provided by USDA has painted a rather dismal picture of pork exports. Most recently, USDA reported export levels 22% below last year. Movement to China has been running a whopping 73% lighter than this time last year. In fact, only Mexico and S. Korea are showing YOY increases in pork purchases from the US. To be sure, last year at this time exports were roaring stronger than we've ever seen, but the dramatic drop in export demand has left a lot more product that needs to clear through domestic channels. It is pretty clear that China's need to import US pork isn't likely to improve any time soon and there is risk that price sensitive markets like Mexico will begin to back away from high US prices in the future. In fact, high pork prices in the US are already attracting strong imports from countries where price levels are much lower (see **Figure 2**). That just adds to the supply of pork that the US population must consume.

SUMMARY

The US hog and pork complex is experiencing a period of very strong pricing as consumers turn to pork in reaction to high retail beef prices. This is the reverse of what happened during the pandemic when vast amounts of government stimulus allowed millions of consumers to "climb up" the protein ladder. It is unlikely to last more than a couple of months at most and we have already seen the impact on beef prices of consumers trading down. Soon, pork will be in the same position as consumers start to favor even cheaper poultry protein. The supply side of the market is relatively well-behaved at the moment with kills running near 2.5 million head per week and a little larger than what prior pig crops indicated. However, hog producers are experiencing serious input cost inflation on everything from labor to feed

Figure 1: Nearby Corn Futures

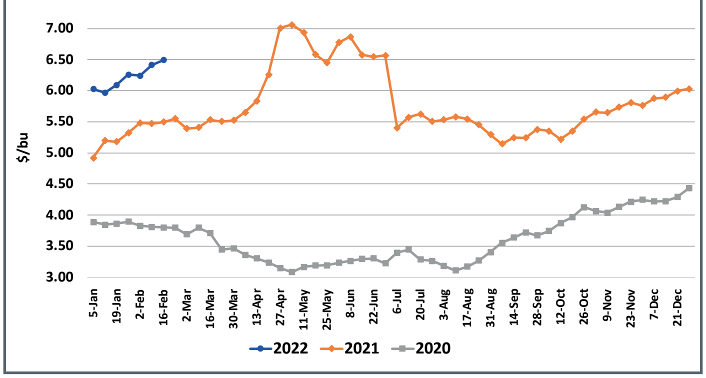

Figure 2: Total Pork Imports

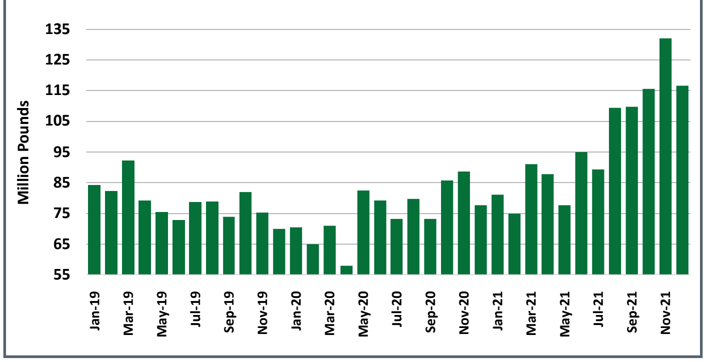

Table 1: JSF Hog and Pork Price Forecasts

	9-Mar	16-Mar	23-Mar	30-Mar	6-Apr	13-Apr
Pork Cutout	110.7	107.8	106.2	105.1	106.4	108.6
Loin Primal	110.2	107.3	103.8	101.5	103.3	103.8
Butt Primal	116.4	112.7	111.3	114.2	112.9	115.1
Picnic Primal	59.7	59.5	61.6	64.9	66.8	66.7
Rib Primal	174.5	178.0	176.6	177.5	173.9	171.1
Ham Primal	77.4	79.8	81.3	83.6	86.3	88.2
Belly Primal	211.8	196.0	189.2	177.0	178.7	188.2
Lean Hog Index	103.4	100.8	98.3	98.1	99.9	102.5

to natural gas and that has elevated their breakevens to over $90/cwt. Those costs must eventually be passed on to consumers, even if it means that less pork gets produced. To make things worse, there have been reports of above-average disease problems in US and Canadian hog barns this winter and that may crimp hog supplies this summer. USDA's next *Hogs and Pigs* report on March 30 will be critical to understanding just how serious those disease problems are. We look for the report to show the breeding herd nearly unchanged from last year but recognize that the risk is it could be smaller. A large amount of the recent gains in pork cutout are attributable to the bellies and hams and may be caused by processors ramping up production in anticipation of more travel and foodservice meals this spring and summer as life returns to normal after the pandemic. With all of the issues lurking under the surface that could result in continued strength pork prices (disease, input cost inflation, etc.), it would be prudent for buyers to remain vigilant least they get caught short if it turns out these issues are worse than currently understood. **Table 1** provides our near-term price forecasts.

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro

E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 31 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.