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WEEK ENDING MARCH 4, 2022

THE PORK WRAP

They say that all good things must eventually come to an end and this week the cutout party that had been going on since Christmas came to an abrupt stop. The pork cutout dropped $3.23 on a weekly average basis and was pushed lower by a big drop in belly prices. The bellies had reached very high levels and were starting to look toppy, but a sharply lower print on Thursday sealed the deal for them. This is the way that cutout rallies often end–with the bellies crashing from a high level and that causes buyers for the other parts of the carcass to take a step back. When they do that, it creates a small air pocket in demand that the other primals fall into. That is the real risk here. Beef cutouts have been showing us the blueprint for what is next in pork and this week the downtrend got started. The combined margin chart clearly indicates that the demand upcycle that has characterized the market since Christmas has now peaked. It is worth noting that this peak was below any of the other peaks that we saw during the super-strong demand environment of 2021.

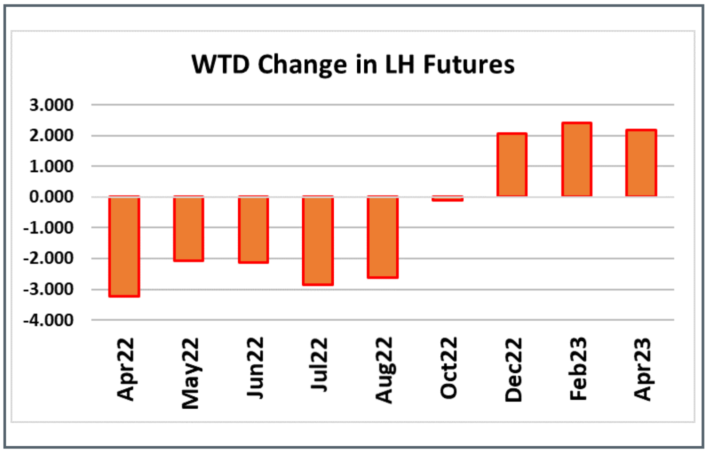
It looks to me like pork demand is working back down to more-normal, pre-pandemic levels. Beef is now more competitive with pork than it has been in a long time and that should catch the eye of retailers as they plan their spring features. That means that demand for the retail primals will likely come under pressure in the next few weeks and help move the cutout lower. The decline shouldn't be huge because there are a couple of factors that will soften the blow. The first is that the spring grilling season is fast approaching and that should keep retail pork demand from sagging too much. The second is that kills will be declining seasonally over the next few months and so prices will get some support from the supply side. I am currently forecasting the cutout to pull back into the upper $90s before moving higher in April, but I do think there is more risk that the cutout slips lower than that. That should put some pressure on the LHI, which averaged $99.68 this week. How much pressure depends on how the negotiated market reacts to the declining cutout. Negotiated prices forged higher this week, even as the cutout was slipping.

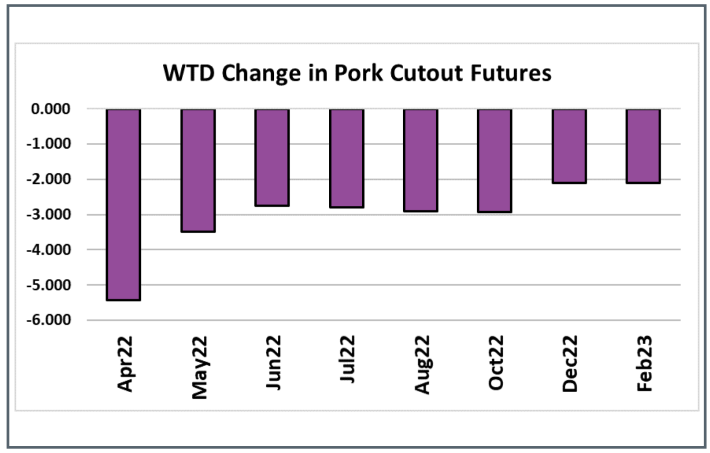
The NND market added $6.21. That squeezed packer margins down to only $15/head–the lowest they have been since September. I think there is a real danger that margins fall below $10/head next week. Packers are already working on margin management by slashing the Saturday kill. Packers only plan to slaughter 59,000 head tomorrow compared to 126,000 on the previous Saturday. That brought this week's total to 2.43 million head, down from 2.5 million last week. We are now working on the Sep/Nov pig crop, which was estimated down 3.6% YOY. This week's kill was about 20k below what the pig crop implied. The working theory is that unusually high incidence of PRRS in the Western Corn Belt is limiting hog supplies in that region and that is what has kept negotiated prices so firm over the past month or so. During the month of February, the WCB price averaged $6.27 over the NDD. That is the biggest spread ever recorded. The 10-year average spread for February is less than $1.

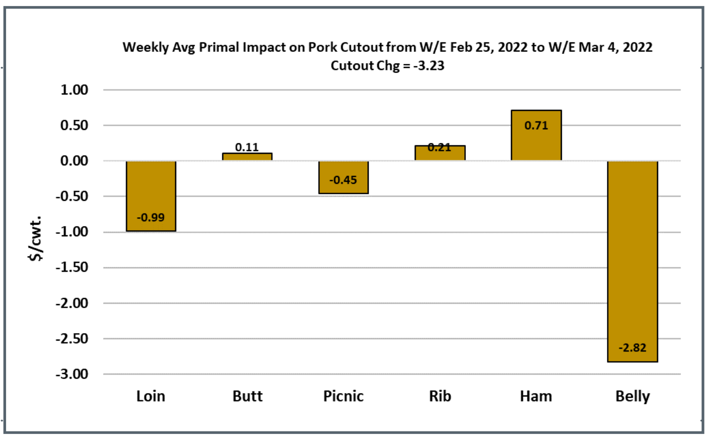
We saw a similar thing happen last spring during May and June where the WCB ran at a $5 premium to the NDD. If you remember, that was a period of rapidly escalating hog and pork prices. This spread warrants close watching in the next few weeks to see if it narrows up when packer margins come under further pressure. If it doesn't then that is probably a good indicator that hog numbers in the WCB are really tight and we can expect packers to be timid with the kill in an effort to keep the cutout high enough to preserve their margin. I'm looking for kills to run in the low 2.4 million head area for most of March and then move into the high-to-mid 2.3 million head area for all of April. If kills during this Mar/May quarter start to run consistently below what USDA's pig crop suggest then that could be an indicator that disease problems have resulted in smaller litters or higher death loss than normal. Producer margins were +13/head this week, only the third positive margin of 2022 so far.

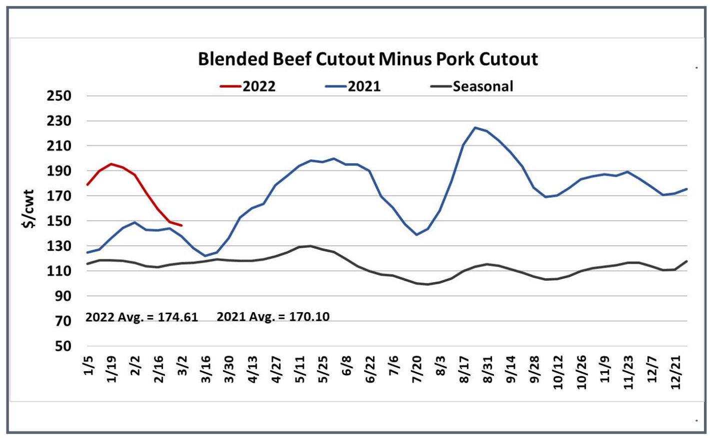
However, I expect that producers will soon move back into the red as their breakevens escalate and prices in the hog and pork complex cycle lower. Today's breakevens are just a tad over $93/cwt, but they are set to rise to $99/head by the end of April. If the corn and soymeal futures keep pressing higher, then it is very likely hog producers will have breakevens over $100 this summer. That, in turn, means producers won't be wildly profitable and might even see negative margins for a while during the period of the year when they normally make the most money. That should dampen any desire they might have to expand their herd. The export markets certainly aren't offering producers a lot of hope these days. Thursday's weekly export data showed total pork exports down 25% YOY. China has moved back to being a minor player for US pork exports. It seems very likely that, going forward, hog and pork prices will need to be above pre-pandemic norms as producers struggle to cover all of their escalating input costs. Last year a super-strong demand pull bailed producers out, but that doesn't appear to be in the cards this year.

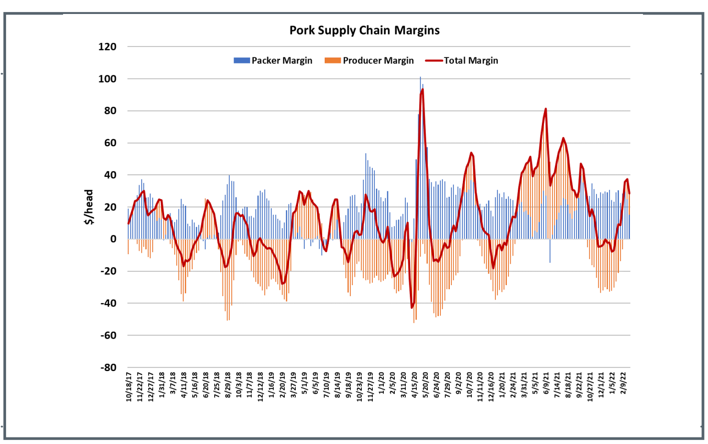
As a result, I'm projecting 2022 margins to average around -$10/head. Last year, they were a little over +$8/head. The futures market began the week higher and at one point nearby Apr traded $107.45, but that all came to an abrupt end when traders started to sense the belly collapse. Apr finished the week at $100.45, which was less than $1 higher than the current LHI. That contract may be about to transition from negative to positive basis. If the demand cycle has really turned now and the cutout is going to ease for a few weeks, then futures traders are likely to want to keep the nearby modestly discount to the LHI. Next week, it is all eyes on the bellies to see how far and how fast they slide.

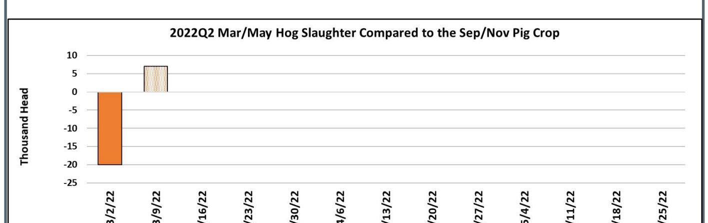

WTD Change in LH Futures
3.000
2.000
1.000
0.000
-1.000
-2.000
-3.000
-4.000
Apr22
May22
Jun22
Jul22
Aug22
Oct22
Dec22
Feb23
Apr23


WTD Change in Pork Cutout Futures
0.000
-1.000
-2.000
-3.000
-4.000
-5.000
-6.000
Apr22
May22
Jun22
Jul22
Aug22
Oct22
Dec22
Feb23


Weekly Avg Primal Impact on Pork Cutout from W/E Feb 25, 2022 to W/E Mar 4, 2022
Cutout Chg = -3.23
$/cwt.
1.00
0.50
0.00
-0.50
-1.00
-1.50
-2.00
-2.50
-3.00
-0.99
0.11
-0.45
0.21
0.71
-2.82
Loin
Butt
Picnic
Rib
Ham
Belly


Blended Beef Cutout Minus Pork Cutout
2022
2021
Seasonal
$/cwt
250
230
210
190
170
150
130
110
90
70
50
2022 Avg. = 174.61
2021 Avg. = 170.10
1/5
1/19
2/2
2/16
3/2
3/16
3/30
4/13
4/27
5/11
5/25
6/8
6/22
7/6
7/20
8/3
8/17
8/31
9/14
9/28
10/12
10/26
11/9
11/23
12/7
12/21


Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head
120
100
80
60
40
20
0
-20
-40
-60
-80


2022Q2 Mar/May Hog Slaughter Compared to the Sep/Nov Pig Crop
Thousand Head
10
5
0
-5
-10
-15
-20
-25
3/2/22
3/9/22
3/16/22
3/23/22
3/30/22
4/6/22
4/13/22
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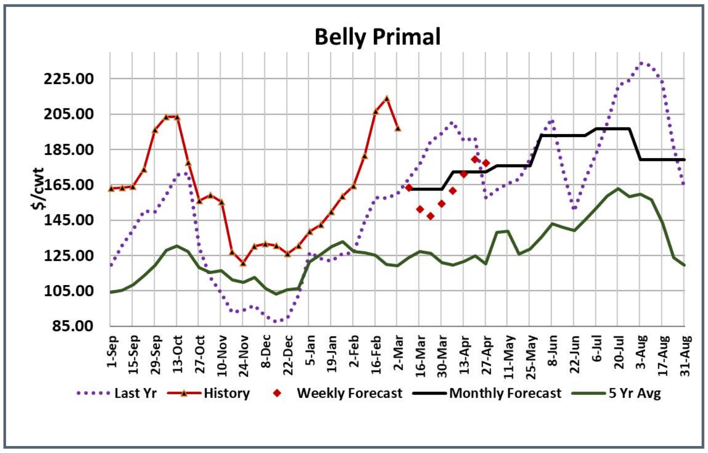
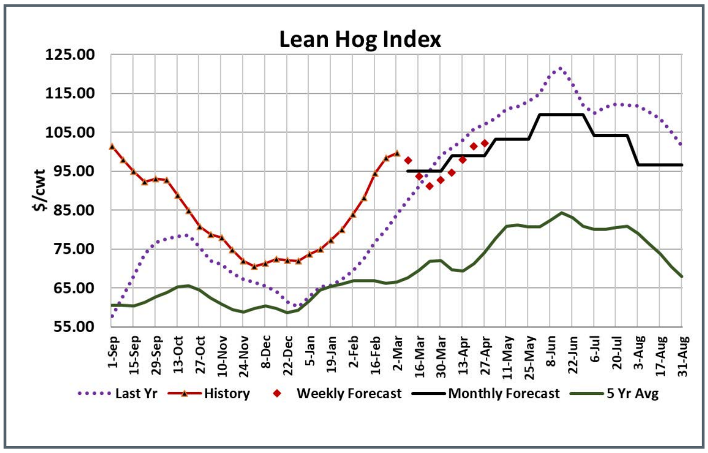
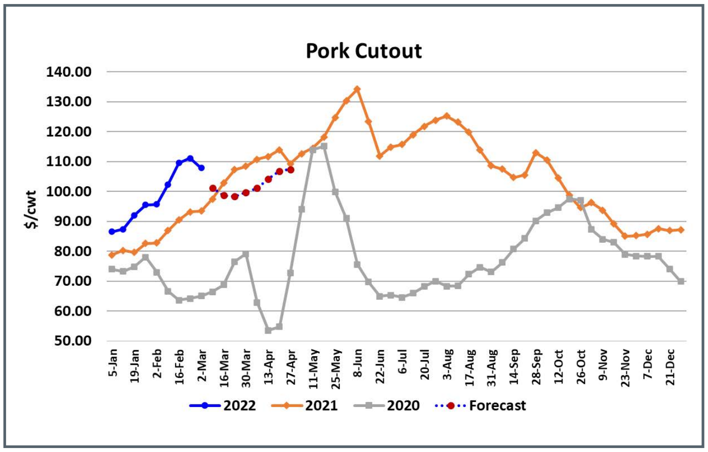
4/27/22
5/4/22
5/11/22
5/18/22
5/25/22







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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.