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WEEK ENDING MAY 20, 2022

THE PORK WRAP

The pork cutout rebounded this week, gaining $2.80/cwt to average $103.57. That is still a bit below the $106 average that has characterized the pork market since the middle of February, but does help erase some of the bearishness that was prevalent the week before when the cutout dipped below $100 and thus enabled the May lean hog futures to expire near $100. The attached chart shows that it was gains in belly pricing that were largely behind this week's cutout improvement. Hams also showed some price gains, but they started the week with a couple of low prints, so the weekly average didn't reach the previous week's level. All of the retail primals were rather ho-hum–just churning along in a sideways pattern as they have been for the past couple of months. It has really gotten to the point where movement in the cutout is primarily dependent upon price changes in either the bellies or the hams. Of course it won't stay that way forever, but right now that seems to be program. The negotiated hog market moved higher this week, with the WCB adding $1.74/cwt on a weekly average basis and the National negotiated market up $3.23/cwt.

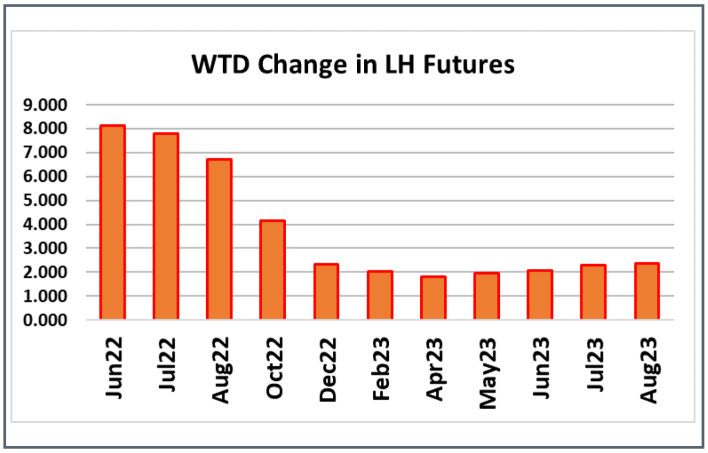
Those gains, combined with the improvement in the cutout, helped to break the LHI out of its downtrend and got it moving higher toward the end of the week. Further gains in the Index are expected next week as the negotiated improvements flow fully into the calculation. If the cutout and the cash hog market were to remain where they were at the end of this week then the LHI should move into the $104-105 range. Of course, futures traders got excited about the cash market improvements and added $8 back on the Jun and Jul contracts after taking almost $6 off of the Jul contract the week before. This is characteristic of a directionless market, where traders simply react to the day-to-day movements in the cash market fundamentals. Right now it looks to traders like the market is going up, but in reality it is probably just coming back toward that $106 average cutout that has been the norm for so long. In order to reach the $109 value that traders put on the Jun contract today, the cutout is going to need to break out of its trading range and move above $110.

The combined margin moved a little higher this week and although it looks like it might have bottomed just below the zero line, I want to see how next week's data comes in before declaring that demand has moved back into an upcycle. All of the last-minute buying for Memorial Day is now behind us, but that was probably more important for the retail primals than for the processing items. If both the hams and bellies can move higher together, then that would be a powerful force that could take the cutout several dollars higher next week. However, even if demand is beginning a new upcycle, I suspect that it won't be a very long one or a very robust one given all of the demand-defeating elements of the macroeconomy right now. Inflation, high energy prices and a declining stock market should all work to temper pork demand in the longer run.

Normally at this time of year, I would be pointing to shrinking pork supplies as a supportive factor for hog and pork prices, but we actually saw the kill increase this week to 2.41 million head. That is very similar to the kill levels we saw back in March. It may be that packers are anticipating doing a very small Saturday kill next weekend (Memorial Day weekend) and thus are trying to build some inventory to compensate. In any regard, it will be interesting to see if that puts pressure on the pork market next week. This week's kill was about 70,000 head greater than what the Sep/Nov pig crop implied and marks the fourth week in a row where the industry has overkilled the pig crop. That seems to suggest that there are plenty of market-ready hogs out there, but the rise in negotiated prices this week suggests otherwise. Packer margins improved this week to about $4/head after being -$2/head last week. I suspect that packers are going to struggle with margin problems for the next couple of months.

Recall that the industry added several large packing plants back in 2018-19 in anticipation of growing export demand and a bigger hog herd. Well, now export demand is in decline and high input costs are causing producers to shrink the hog herd. If plants want to run at a reasonable capacity utilization rate, they may be forced to chase hogs this summer and that could have a detrimental impact on margins. If they have to chase hogs while demand is declining, that would be particularly bad for their profitability. Hopefully, demand is going to turn higher soon and a stronger cutout this summer will leave packers more room to pay up for hogs. It doesn't look like the export market is going to bail them out this summer. China is still dis-interested in S pork and that could get worse as COVID lockdowns and port congestion continue. There is a good possibility that China's economy is going to slump throughout the balance of 2022 and that wouldn't be good for US pork exports. Producers are still struggling to turn a profit, despite the triple-digit cutout and hog pricing.

High input costs have now pushed their breakevens close to $103/cwt. That could lead to further reductions in the breeding herd and smaller supplies down the road. We get another look at the breeding herd when USDA releases the next edition of Hogs and Pigs on June 29. Corn futures pulled back a bit this week, but given that the crop is not even fully planted, I don't expect traders to let it decline a lot more from here. As long as there is war in Ukraine and oil prices are in triple digits, it is a good bet that corn will remain above $7/bushel and could go as high as $9-10/bushel under the right circumstances. Next week, watch the cutout to see how it is going to respond to this week's larger-than-expected production. If we do see further increases, that will likely add to the bullishness in the nearby futures and most likely will push it well above what it is capable of achieving before the Jun contract expires in three weeks.


WTD Change in LH Futures
9.000
8.000
7.000
6.000
5.000
4.000
3.000
2.000
1.000
0.000
Jun22
Jul22
Aug22
Oct22
Dec22
Feb23
Apr23
May23
Jun23
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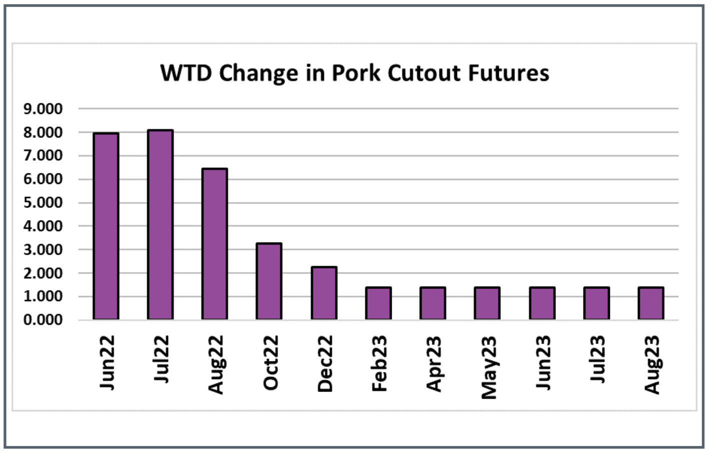
WTD Change in Pork Cutout Futures
9.000
8.000
7.000
6.000
5.000
4.000
3.000
2.000
1.000
0.000
Jun22
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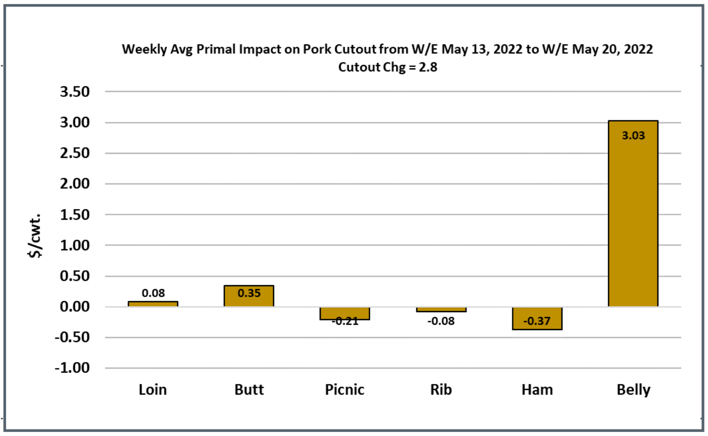
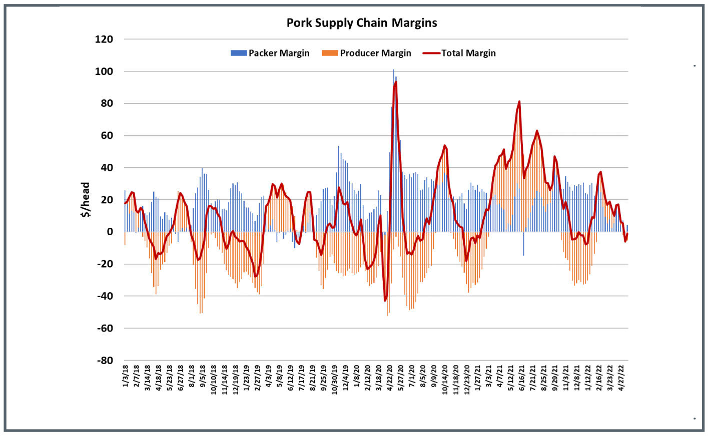
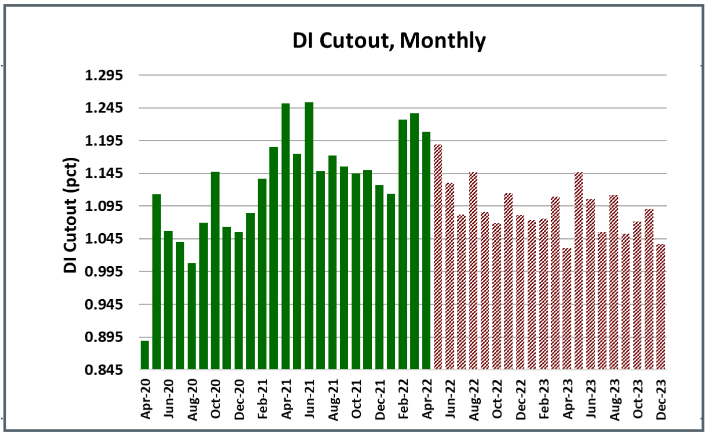
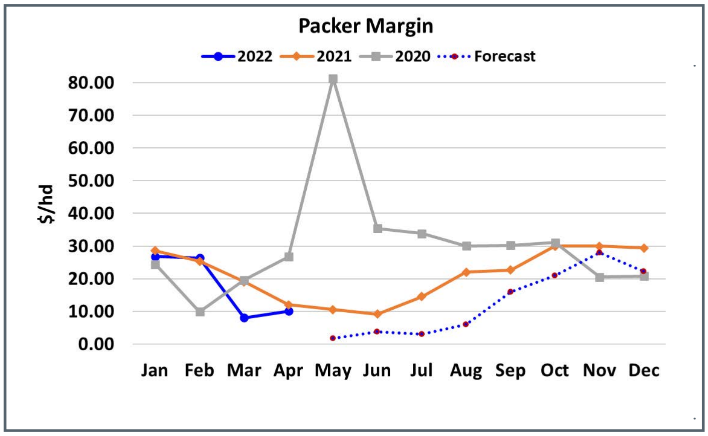
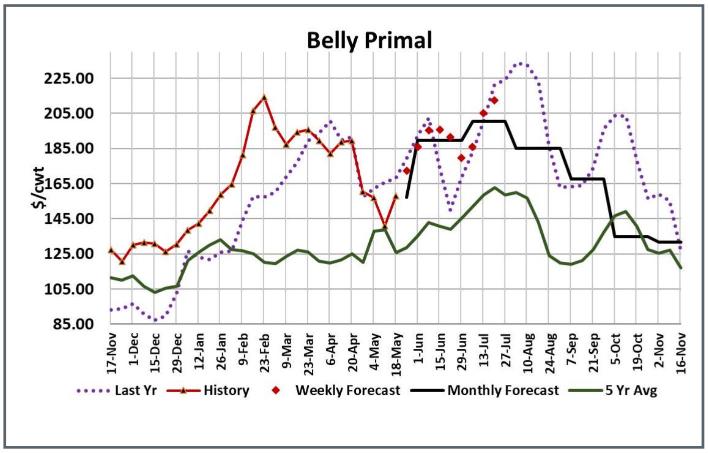
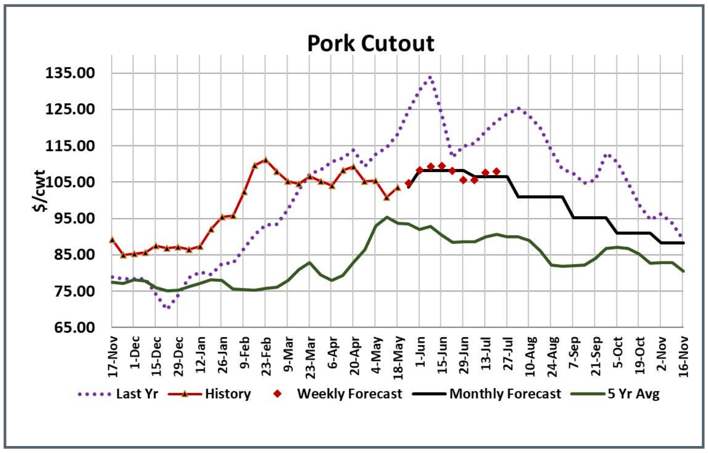

Weekly Avg Primal Impact on Pork Cutout from W/E May 13, 2022 to W/E May 20, 2022
Cutout Chg = 2.8
$/cwt.
0.08
0.35
-0.21
-0.08
-0.37
3.03
Loin
Butt
Picnic
Rib
Ham
Belly

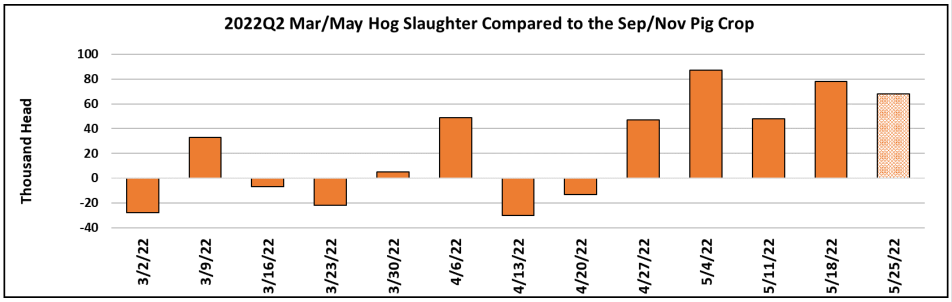

Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head


DI Cutout, Monthly
DI Cutout (pct)


Packer Margin
2022
2021
2020
Forecast
$/hd
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec







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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.