



WEEK ENDING MAY 6, 2022

THE PORK WRAP

It was steady-as-she goes again this week in the pork complex. The cutout averaged a mere \$0.20/cwt higher than last week and the NDD cash hog market gained \$0.29/cwt. That is about as boring as it gets for hogs and pork. The one little piece of excitement was a futures rally on Tuesday and Wednesday in response to a brief upward jiggle in the negotiated markets and cutout. Bellies also tried to provide some excitement with a significantly higher quote on Thursday, but it turns out that was a false flag and the belly primal finished the week lower, losing about \$3 on a weekly average basis. Given that almost nothing is moving significantly in either the hog or pork markets, futures traders thought that it might be prudent to remove a little more of the premium in the summer contracts and those lost from \$2-3 on the week. That has now pushed the Jun and Jul contracts below the fundamental forecast, but Aug still looks several dollars too rich. There is no doubt that there has been a reset of expectations in the hog and pork complex.

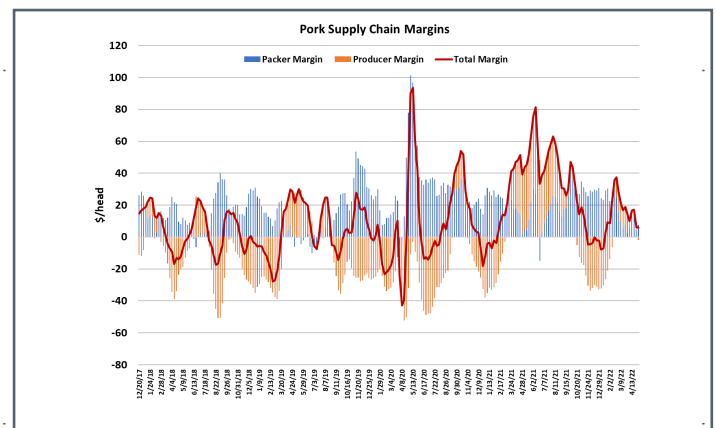
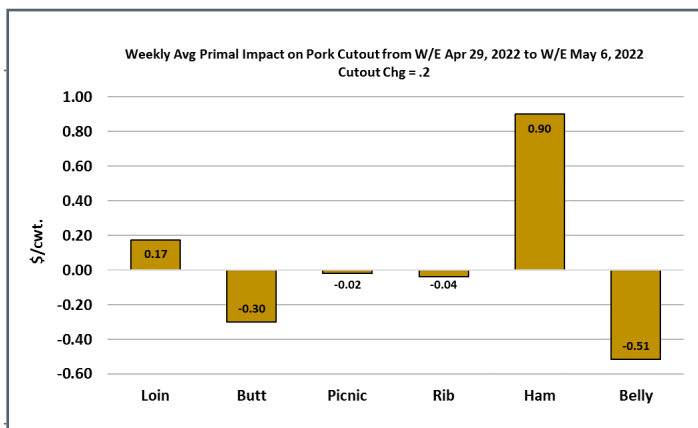
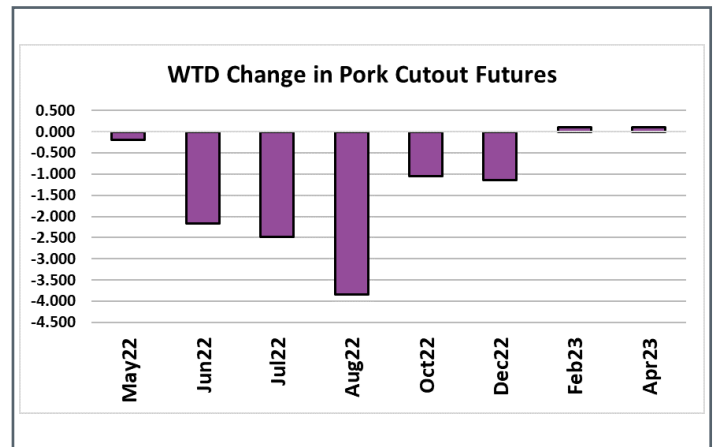
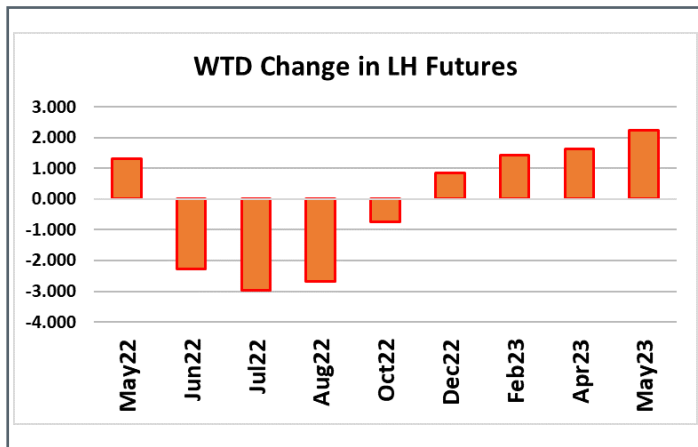
No longer do traders believe that disease issues are going to make the hog supply so tight this summer that packers will be paying \$130 for any hogs they can find. Instead, it looks like pork availability will be larger this summer than last due to drastically smaller exports. USDA reported March exports down 25% this week and that brought the Q1 export total to 20% below last year. I'm forecasting Q2 to be down about 14%. By the time we get to Q3, we could see some small YOY gains in exports, but that is only because we will have reached the point where exports really dropped off last year. Similar to beef, pork imports were up sharply—46% YOY. So with exports way down and imports way up, it is easy to see how there could be more pork available in the domestic market this summer than last year. Another concern that is beginning to creep into the picture is that it is starting to look like USDA might have underestimated the Sep/Nov pig crop which is now being slaughtered. This week's kill came in at 2.42 million head, which was about 100k more than what the pig crop suggested. Further, it looks like packers could be planning a similar sized kill next week and if that is the case then the cumulative over-kill for the March/May quarter would be about 225k.

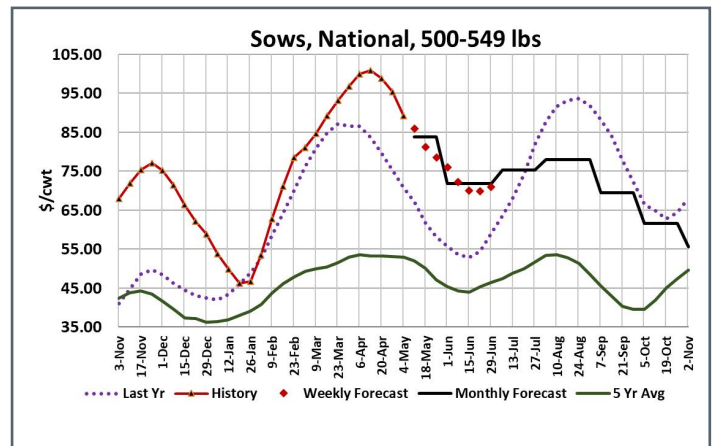
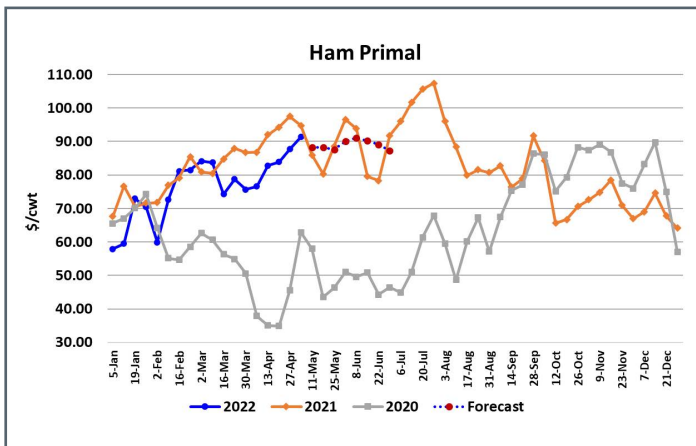
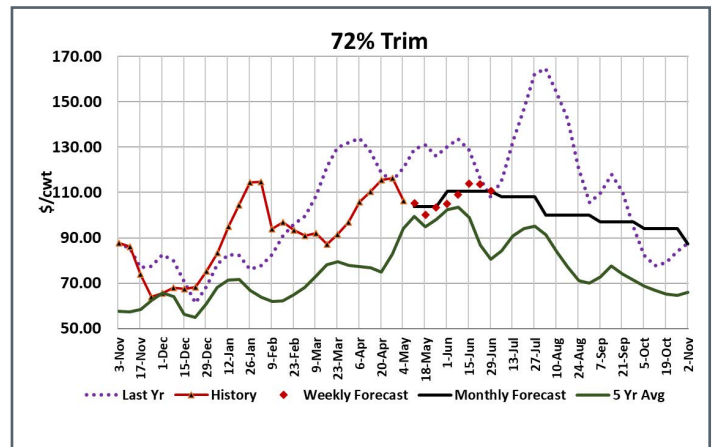
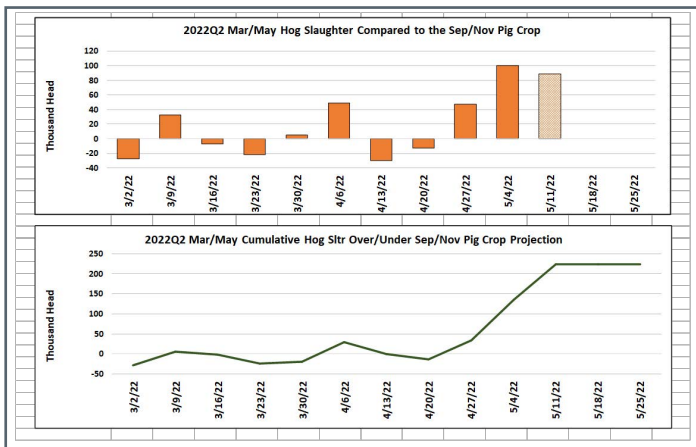
That's not a huge miss, but it does make me wonder if we will start to see consistently bigger-than-expected kills heading into summer. To put things in perspective, this week's kill was essentially the same size as the kill in late March/early April. The normal seasonal pattern would be for early May kills to be smaller than those. Perhaps packers will revise next week's kill downward and we could quickly get back on track relative to the pig crop, but for now we are seeing production a little larger than expected. This week I've included a chart on the sow kill, which is forecast based on the size of the breeding herd at the start of the quarter. Here, the positive and negative bars exactly cancel each other which means the sow kill this quarter has been almost perfectly aligned with the breeding herd. We are not liquidating sows or retaining them at this point. Hog weights have not yet started to decline seasonally, as USDA reported barrow and gilt weights up one pound to 217 this week. So, the bottom line is that pork availability next week will be every bit as large as it was this week and thus we are not yet seeing the normal seasonal tendency toward smaller production.

Will the cutout be able to hold its ground without smaller kills? Maybe not. I'm of the opinion that pork demand is slowly fading as consumers retreat back down the protein ladder in the face of economic headwinds, so I am counting on smaller production to give the cutout a little lift heading into summer. That smaller production may be delayed a couple of weeks and that could create a bit of pressure on the cutout, but eventually I think production will decline and price levels will rise modestly. Right now, the fundamental forecast calls for the cutout to top around \$113 in mid-June. A decent recovery in the bellies could quickly get us there. I'm calling bellies slightly higher next week, but bigger gains will probably come around Memorial Day. I don't think that we need to fear another big downdraft in the bellies. That said, it looks to me like the hams could be nearing a top. This week's average ham primal was almost dead on with last year, and that was pretty rich ham pricing.

At this time of year, ham is often purchased for processing into lunch meat products in anticipation of kids being out of school for summer. I also get the feeling that Mexico has been a big buyer of hams over the past few weeks and wonder if they will continue that at current price levels. It is pretty clear from the pricing data that packers are doing more ham boning and more product is leaving in boneless form. That alone has a tendency to lift the ham primal since those boneless products tend to generate a higher primal value than the bone-in product does under USDA's current conversion formula. I'm calling the hams more sideways to slightly lower in the next few weeks, which means that if the bellies can generate a reasonable rally, we should see the cutout improve. On the bear side of the ledger, I will note that trim markets seem to have stalled recently and may not be able to muster much additional upside. Sow prices are also declining rapidly (down \$6 this week) and that can sometimes be an ominous sign for the trim markets because sausage makers will substitute trim for sow meat when sow prices are very high. I calculate this week's packer margin at about \$7/head, which is up a little from last week and pretty typical for this time of year.

I'm looking for some further erosion packer margins as we move into summer, but not expecting them to go negative for any length of time. With the hog supply looking a little larger than expected, I think the LHI could continue to drift a little lower and so we might see May expiration very close to \$100. If you recall, April expired at \$99.98. It is pretty unusual not to see any gain in the index between April and May expirations and I take that as a sign that demand has eroded somewhat in recent weeks. Right now, I'm looking for Jun expiration around \$108, but it could be several dollars lower than that depending on how demand plays out. June expiring below April or May would be super unusual, but I think the odds of that happening are better this year than any year prior (excluding 2020, of course). Next week, watch the bellies for signs that the bottom is in and the hams for topping action. The hog and pork complex seems a bit boring right now, but when that happens it is usually just the calm before a coming storm.





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