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WEEK ENDING JULY 15, 2022

THE PORK WRAP

The pork cutout surged higher this week, gaining $4.13 through Thursday to reach $118.51 and demolishing my theory that last week was the top in the cutout. The LHI gained $2.21 through Thursday as it reacted to the higher cutouts and should have at least another $2 worth of follow-through if nothing else changes. The negotiated hog markets were stalled this week and the NDD average through Thursday was down about $0.55/cwt. That allowed packer margins to expand with the cutout and I have margins averaging a little over $7/head this week. As a result, packers are likely to continue to bid aggressively in the negotiated markets and it wouldn't be surprising to see them gain some next week. The processing items led the way this week, with both bellies and hams moving higher. Together, the belly and ham primals make up 41% of a hog carcass so when they start moving in the same direction it is a powerful force.

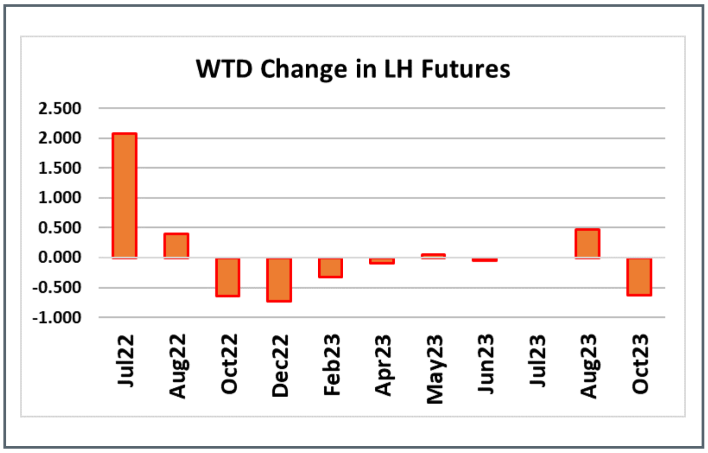
23/27 bone-in hams were quoted over $118 on Wednesday and through Thursday the weighted average was $108.31. Clearly, someone was needing bone-in hams pretty badly. The belly move higher was less surprising, only because the bellies were rather lethargic during June and were overdue for an increase. It is worth noting that the retail primals also posted gains this week and that could just be from a general tightness in availability coming off of the holiday week. When we put it all together, it equates to a strengthening cutout and the big question is whether or not this week's momentum can be continued. The sharp increase in the cutout moved the combined margin higher and makes it look like perhaps a new demand upcycle is starting.

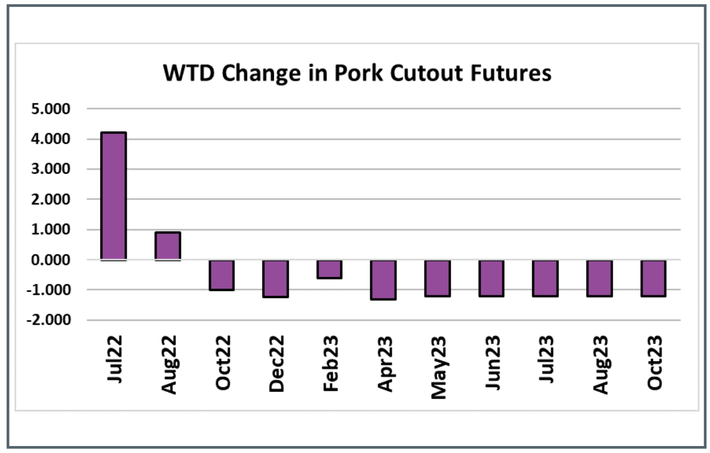
The timing of that is a bit surprising to me, but it is difficult to argue with the data. So, it is possible that we might have to wait a little longer to see the cutout top. Slaughter levels will likely remain pretty constrained in the next few weeks, so the amount of supply side relief for prices should be limited. I'm projecting this week's slaughter at 2.27 million head, which is just a hair smaller than the week leading up to Independence Day. If that forecast is correct, then this week's kill would be almost dead-on what the pig crop implied. Now that packers have a little margin back in their pockets, they might look to expand the kill next week, provided they can find the hogs. They will need to walk a fine line because if they press it too much, they run the risk of accelerating the negotiated market higher.

All of this renewed price strength happening right before the July expiration has been a problem for the bears and it now looks like July will expire close to $115. This week's price action has also caused me to revise most price forecasts higher. I now see fair value for Aug somewhere close to $110, but there is a very real risk that it trades a lot higher before that. There is some very warm weather forecast for the next two weeks in the Midwest and that creates a concern about hog weights falling faster than expected and thus reducing the available supply of market-ready hogs in the near term. That has the potential to be price supportive at a time when prices are already rising. I am factoring that into my forecast for the Aug futures and buyers should be watching the weather forecast closely in the next couple of weeks. USDA released its estimate of retail pork prices for June this week and the average price was up almost $5/cwt to $493.10.

That is another all-time record and I don't expect that retailers will be lowering prices much, if any, until after Labor Day when they should be seeing much more favorable wholesale pricing due to larger slaughter levels. The macro picture remains pretty dismal, with equity markets moving consistently lower and increasing fears that the Fed will send the economy into a recession this fall as it raises rates to battle inflation. Eventually, those things will matter to pork pricing, but right now seasonally small supplies and weather issues far outweigh demand concerns. Hog and pork prices are rising fairly fast in China and that raises the potential that they will purchase more pork out of the US, but so far we haven't seen any indication of that in the data. If they do become bigger buyers of US pork, they would likely wait until fall when price levels should be much more to their liking.

A very strong US dollar could work to discourage pork exports and encourage imports in the second half of the year. Traders in the corn market are watching the weather situation carefully too. Corn futures are well off of their highs, with new crop corn trading around $6/bu, but the next couple of weeks encompasses the critical pollination phase for corn and if it is too hot and dry during that period, yields will suffer. I estimate that the drop in corn prices, along with rising cash hog prices, has helped restore profitability to the hog production sector, where margins are now around $17/head. Next week, watch the weather above all else and keep an eye on the hams and bellies too because they are the engine that has been responsible for the recent upward burst in the cutout.


WTD Change in LH Futures
2.500
2.000
1.500
1.000
0.500
0.000
-0.500
-1.000
Jul22
Aug22
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23


WTD Change in Pork Cutout Futures
5.000
4.000
3.000
2.000
1.000
0.000
-1.000
-2.000
Jul22
Aug22
Oct22
Dec22
Feb23
Apr23
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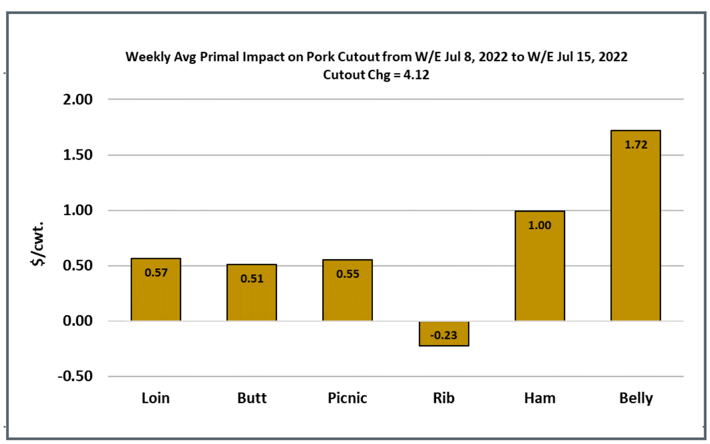
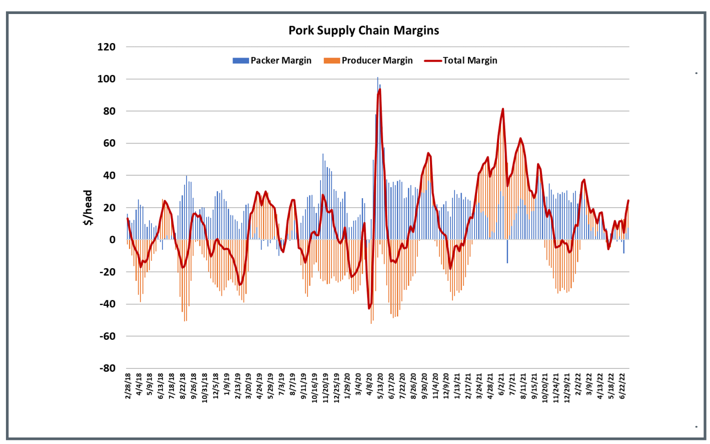
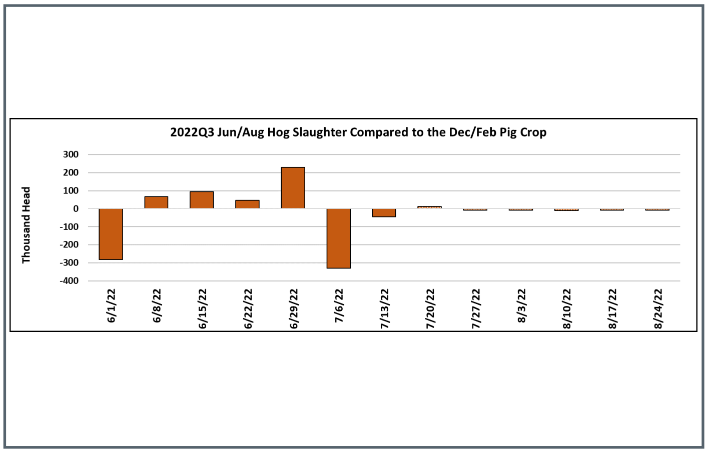
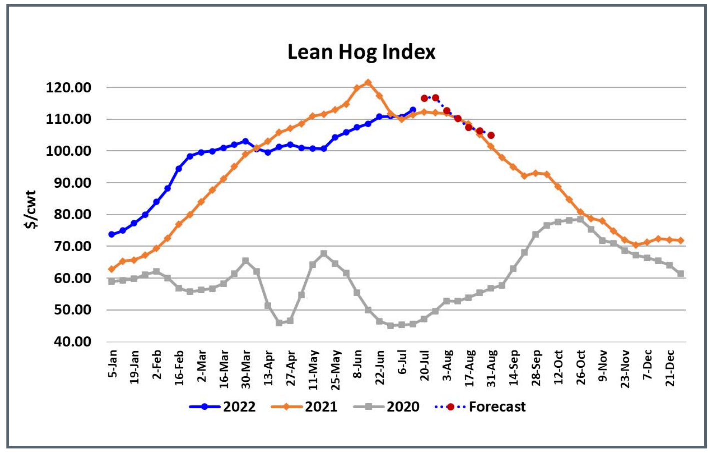
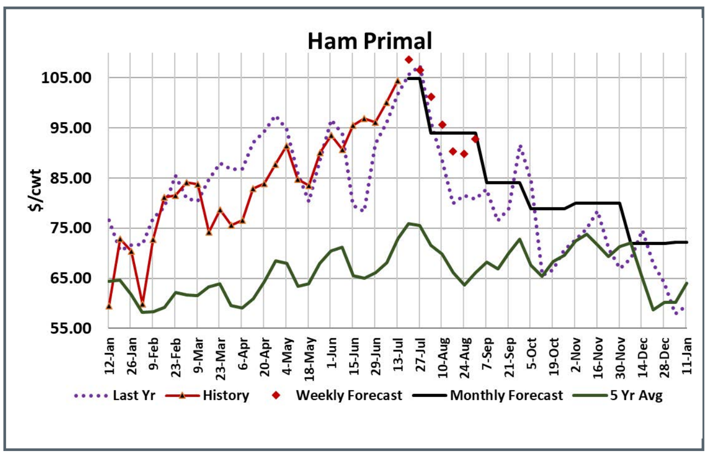
Jun23
Jul23
Aug23
Oct23

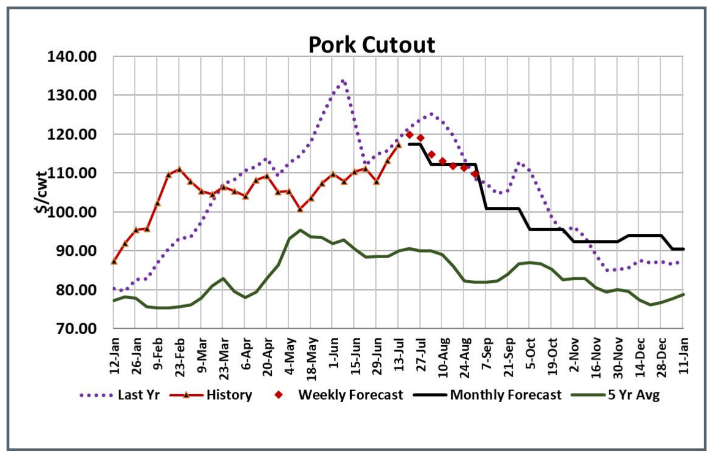

Weekly Avg Primal Impact on Pork Cutout from W/E Jul 8, 2022 to W/E Jul 15, 2022
Cutout Chg = 4.12
$/cwt.
2.00
1.50
1.00
0.50
0.00
-0.50
0.57
0.51
0.55
-0.23
1.00
1.72
Loin
Butt
Picnic
Rib
Ham
Belly

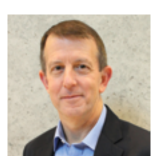

Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head
120
100
80
60
40
20
0
-20
-40
-60
-80











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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.