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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

JULY 2022

Both the pork cutout and cash hog prices firmed up further during June as the impact of seasonal supply tightening took hold. The Western Corn Belt negotiated hog market gained about $8 over the course of the month, with price levels now in the lower $120s (see **Figure 1**). On a monthly average basis, the cutout was up a little over $6 in June compared to the month before. With cash hog prices rising faster than the cutout, pork packer margins have come under increasing pressure and are now slightly in negative territory. That shouldn't shock anyone since it is relatively common for packer margins to turn negative near mid-summer as hog supplies reach their lowest point of the year. Recent kills have been depressed by the July 4th holiday, but they should remain near the annual low for the next several weeks before expanding into August. USDA provided the industry with another look at the supply side of the market in last week's release of *Hogs and Pigs* and it indicated that producers continue to be cautious and have actually reduced the nation's hog herd slightly over the most recent quarter. One might think that with the Lean Hog Index near $110 that producers would be enjoying strong profitability, but input cost inflation has robbed them of that benefit. Corn prices, although down from their earlier highs, remain extremely elevated and the corn futures are telling producers that prices are likely to stay well above historical norms for the foreseeable future. That is not the type of cost environment that encourages expansion, particularly when there are considerable concerns about pork demand moving into the second half of 2022.

SUPPLY PICTURE

The Independence Day holiday fell on a Monday this year and that encouraged packers to give their workers a long weekend. The Saturday kill was almost zero and Friday saw a sharp kill reduction also. As a result, last week's kill only registered 2.29 million head and this week's kill, which will reflect no slaughter on Monday, could total only 1.97 million head. In effect, this holiday has resulted in two short kill weeks. That has created

> USDA recently reported total **swine numbers down almost 1% YOY**

a little short-term tightness in pork availability and thus kept price levels supported. Slaughter levels so far in the Jun/Aug quarter have lined up pretty closely with USDA's estimate of the Dec/Feb pig crop, which was reported to be down 1% YOY. Last quarter's slaughter also conformed fairly well with the prior pig crop estimate and that gives us confidence that the pig crop-implied slaughter for July and August will be close to actual kill levels. Thus, hog kills should slowly expand in July, reaching the 2.35 million head per week level near the end of the month. By the end of August, kills should be running close to 2.5 million head per month.

> Hog slaughter should slowly increase going forward and **could reach 2.5 million head per week** by the end of August

The weather has provided some concerns in recent weeks, with some forecasts showing a heat dome forming over the Midwestern hog production regions. That extremely hot weather has yet to materialize, although it remains a possibility in the weeks ahead and market participants would be wise to keep an eye on the forecast because a prolonged period of hot weather could cause hog weight gains to slow and thus reduce pork availability further. Right now, carcass weights appear to be behaving normally as they decline seasonally toward a bottom that typically occurs in early July. The weather can have a lot to say about when the actual bottom in hog weights occurs. For now though, the weight data seems to suggest that the hog production pipeline is functioning normally and there are no problems with hogs backing up or being pulled forward.

USDA's recent *Hogs and Pigs* survey found that the US breeding herd increased slightly from the level they reported back in March, but was still about 1% below last year. In addition, USDA found that the March/May pig crop was 1% smaller than last year (see **Figure 2**). That information helps provide the basis for our pork supply forecasts through the balance of 2022 and it looks like we can expect Q3 hog slaughter to be near even with last year and Q4 slaughter to be down about 1.6% YOY. So, there is some further supply tightening on the horizon, but it should happen in an orderly fashion and won't be excessive. One thing that did stand out in the recent report is that the productivity of the US herd is beginning to rebound and that will partially offset some of the supply-reducing effects caused by having a smaller breeding herd.

DEMAND SITUATION

Pork demand in the US held up fairly well during the run-up to summer. Our demand indexes for the May/June period were down about 4 percentage points from last year's torrid demand, but still way above the longer-term average. The general sense that pork demand is slowly retreating remains in place and we expect that to be the case for the balance of 2022. US consumers are facing a number of headwinds in the macroeconomy such as strong price inflation and the potential for a recession later this year as the Federal Reserve raises interest rates to combat the inflation problem. Even without those headwinds, we would expect pork demand to decline as the population adjusts to the new post-pandemic environment, but the storm clouds in the macroeconomy make further demand erosion seem almost certain. In our opinion, the softening of demand over the next few months will outweigh the impact of smaller pork supplies and thus keep price levels below last year's level and perhaps even on a downward trajectory. Price levels for both beef and chicken, which are pork's main competitors, are both in decline right now and should remain in a softening mode for the remainder of the summer. That will create increased competition and thus we can expect retailers to shift some features away from pork unless price levels fall enough to keep their interest. There will still be small cycles where pork demand improves then declines, but the overall trend in should lean toward softer demand in the months ahead. We are a long way from getting back to normal with domestic pork demand. Consider that for the first six months of 2022, our pork demand index averaged 1.19 and that compares to the pre-pandemic 5-year average of 1.04. Clearly there is a lot of downside risk as pork demand slowly works its way back down to more traditional levels.

Demand for US pork from the international community has been relatively flat over the past year, with shipments averaging in the range of 500-550 million pounds per month. That is way down from the 600-625 million pound range that was common during the last half of 2020 and early 2021, but still very strong compared to years past. The main problem is that export demand is no longer growing and could be setting up for a decline if the rest of the world follows the US into a recession as a result of central bank actions to tame inflation. The US pork industry is heavily dependent upon the export sector, with close to 25% of production being exported in most years, so any downturn in export demand will quickly exacerbate the any price softening as a result of slipping domestic demand. There are some that believe that China will soon become a big buyer of US pork once again as it was back in 2019-2020, but we are not among them. Instead, the industry will need to focus on increasing sales to more traditional markets like Japan and South Korea and finding ways to build on the strong demand that has been coming out of Mexico in recent years.

SUMMARY

The US hog and pork complex appears to be in good balance right now, although pork production is near the annual low. Users can expect availability to increase from this point forward, but the improvement will be stronger after July is complete. As a result, buyers are advised not to extend coverage much beyond the current month. Domestic demand is good, but slowly fading, as consumers begin to revert back toward pre-pandemic buying patterns. Inflation, rising interest rates, falling housing prices and a declining stock market all present obstacles to demand over the next six to twelve months and we think that the demand erosion caused by these factors will more than offset any price-enhancing effect of smaller pork production. So far, the weather this summer has been rather benign, but there is always the risk that an exceedingly hot weather pattern will set up over the Midwest, causing hogs to lose weight faster than normal and creating a short-run availability problem. Even without a weather problem, near-term pork prices will likely be supported by small production but by the end of summer, pork buyers should find price levels much more to their liking. **Table 1** provides our near-term price forecasts.

Figure 1: Western Corn Belt Cash Price

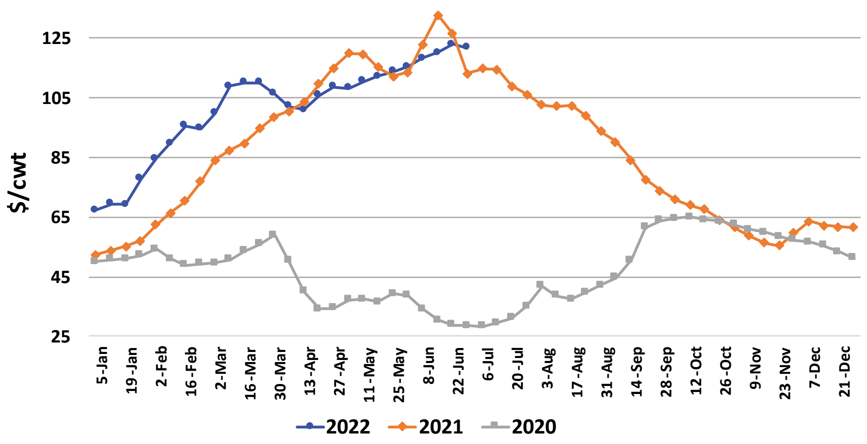

Figure 2: USDA-reported Pig Crop

(shaded is forecast)

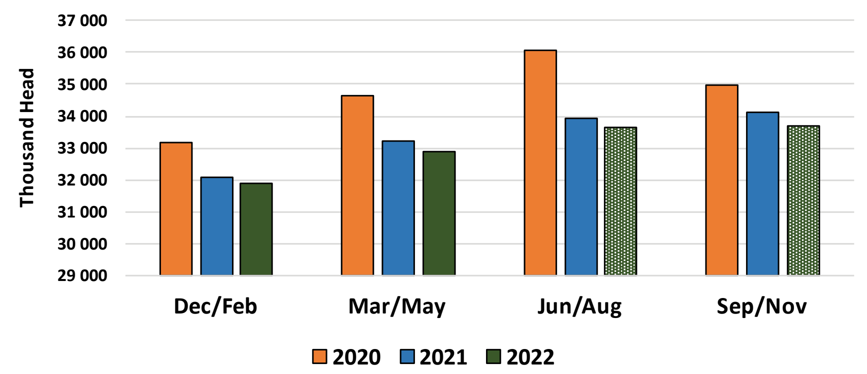

Table 1: JSF Hog and Pork Price Forecasts

	13-Jul	20-Jul	27-Jul	3-Aug	10-Aug	17-Aug
Pork Cutout	106.5	105.6	103.5	102.5	102.7	103.2
Loin Primal	96.6	94.5	94.3	95.6	96.7	98.2
Butt Primal	139.7	130.6	122.7	116.4	112.1	114.8
Picnic Primal	67.8	68.5	68.1	65.4	64.5	64.1
Rib Primal	174.2	169.6	165.9	163.9	161.1	157.8
Ham Primal	88.3	85.0	82.6	84.8	82.0	77.8
Belly Primal	167.4	177.5	175.0	170.0	178.1	184.8
Lean Hog Index	108.5	106.4	103.4	100.6	99.8	98.8

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