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WEEK ENDING AUGUST 26, 2022

THE PORK WRAP

Well, it finally happened. The pork market underwent a major downward correction this week, led by the bellies. It started on Tuesday morning when the AM pork report showed the belly primal sharply lower on big volume. By that afternoon, the cutout printed down $12 from the day before as the bellies were joined by the hams and the trims in sharp decline. Any hopes that the pork market would quickly recover were dashed as the cutout stayed in the low $100s for the remainder of the week. In the end, the cutout averaged $106.11, down a little over $14/cwt from the previous week. Futures traders had been sensing for some time that a big correction was near as the Oct contract sold off the week before and was carrying a huge discount to the LHI. The futures continued lower on this week's pork collapse, but the week-over-week losses were not huge because much of the selling had taken place the week before.

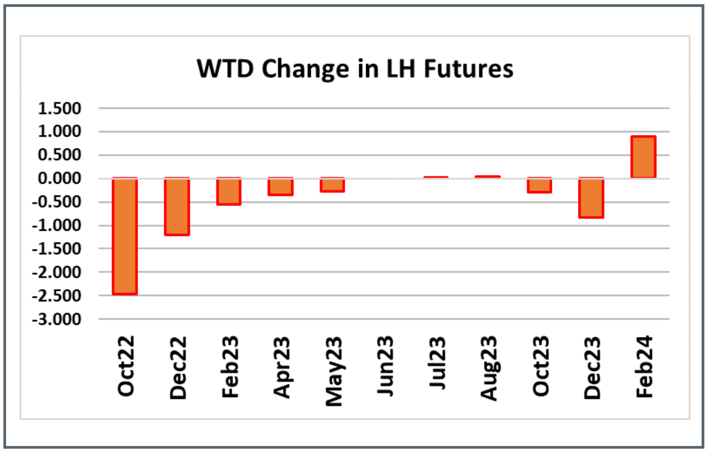
I don't think anyone expected the sky-high hog and pork prices from August to continue unabated into fall. A correction was needed and it came swiftly. That is the way it works in the hog and pork complex. The market will grind higher for months when it is on the rise, but when it moves lower it is often sharp and deep. Consider that the pork cutout was trading around $107 back in May just before Memorial Day and it took all summer for it to peak near $127 (weekly average) in early August. Now, just three weeks later, the cutout is back below $107. As is often the case, when the pork corrects lower, the negotiated hog market isn't too far behind. Producers know that when the cutout tanks that packer margins go deeply red and they will slash the kill if they can't get hogs bought cheaper. Rather than risk a backlog of hogs, producers begin to accept lower negotiated prices.

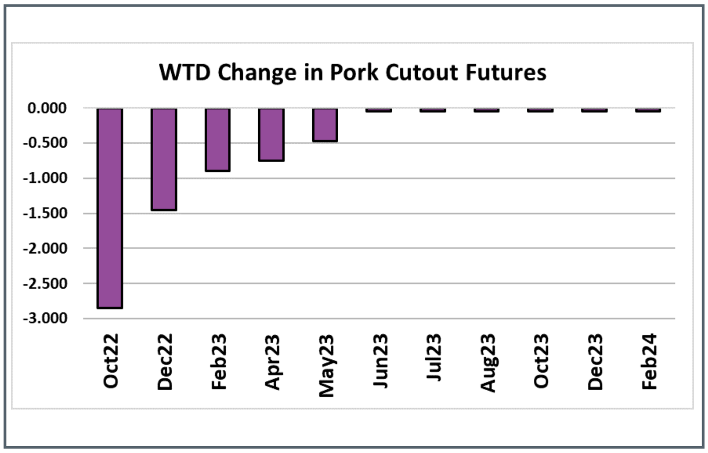
This week the WCB negotiated market dropped about $3.50 to average $125.15/cwt and further, faster declines are likely on tap for next week. I calculate packer margins this week at -$24/head, but some of that is because the LHI hasn't yet caught up to the rapid decline in the cutout. But clearly packers are in the red and they responded by producing a rather tepid kill this week of 2.39 million head, with a very small Saturday kill. Further, they have two short kill weeks on the horizon due to Labor Day, so that will allow them to do some margin management without having to be obvious about their motives. This week's small kill and the two to come will likely stabilize the cutout in the low $100s and could even cause it to increase some. Bellies are now so cheap that it is hard to see much further downside in that primal. Hams are likely to have further downside risk, but the small kills should help slow the decline.

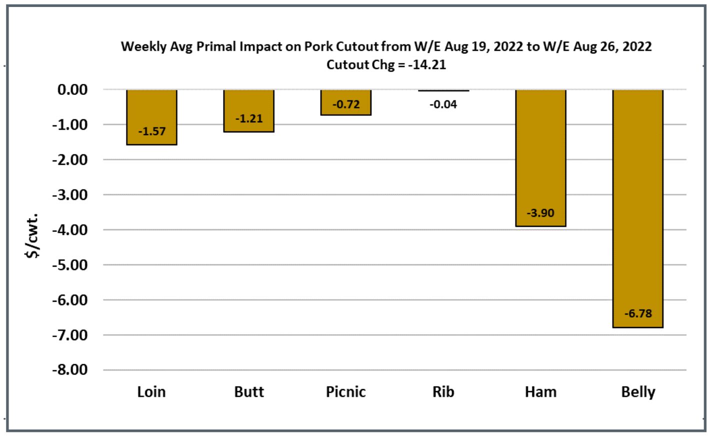
Trim prices should also get some support from the small kill and processing downtime around the holiday. The retail primals appear to be in good shape. There were some modest declines in the loins, butts, pics and ribs this week, but that was probably cause more from buyers hitting the pause button while they watched the cutout fall and they will likely be back in the market next week. So, I don't see a lot more downside risk in the cutout over the next few weeks. My guess is that it will wallow around in the low $100 to maybe high $90s through the first half of September. Growing kills as fall progresses are likely to push the cutout into the low $90s during October. The big reset has happened now and once market participants catch their breath and think things through, I suspect that the fear will abate and thus allow the market to trade with more confidence next week. If the cutout and negotiated markets were to hold where they are today, then the LHI should settle in somewhere in the $105-107 range.

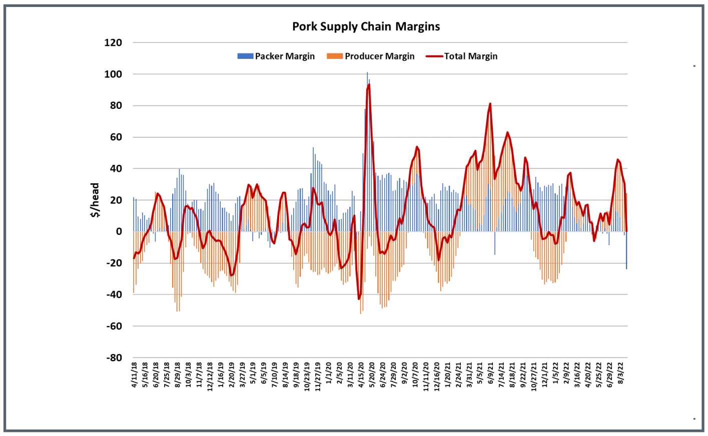
That is still a very long way from the near-$90 price that traders are putting on the Oct LH futures. Interestingly, the pork cutout futures settled today just over $101, which indicates that traders don't think the cutout is going to decline much between now and the middle of October. In fact, I'd guess that most traders believe there is a rebound in the cutout coming and that it will move higher before trading lower into expiration. I can see that scenario playing out also. As a result, I think the risk to my forecast is that prices turn out to be somewhat higher than what I currently have dialed in. Slaughter this week was once again lower than what the pig crop implied and since this was the last slaughter week of the quarter, we can see now that slaughter during the Jun/Aug quarter was close to 700k below what the pig crop implied. Expect packers to do a very light Friday and Saturday kill next week and of course there will be no kill a week from Monday.

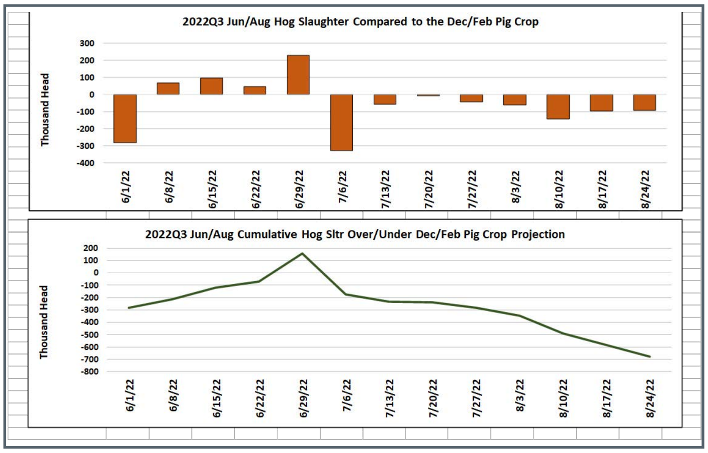
Carcass weights moved one pound lower this week and are likely now at their annual low. Weights should increase steadily during the fall as cooler weather fosters faster gains. USDA didn't report any usable trade data this week, but it probably wouldn't have shown much improvement in the export picture if they had. Next week, look for the pork market to settle down and perhaps even advance some as buyers anticipate the short kills ahead. Watch the negotiated markets. For most of the summer the story has been one of exceptionally tight uncommitted hog supplies. This recent reset in the pork market will be a good test of just how tight the spot hog market is now. If packers push it lower with ease then maybe supplies are not so tight, but if negotiated prices remain stubbornly high then that would be strong evidence that the shortfall in uncommitted hogs is real.

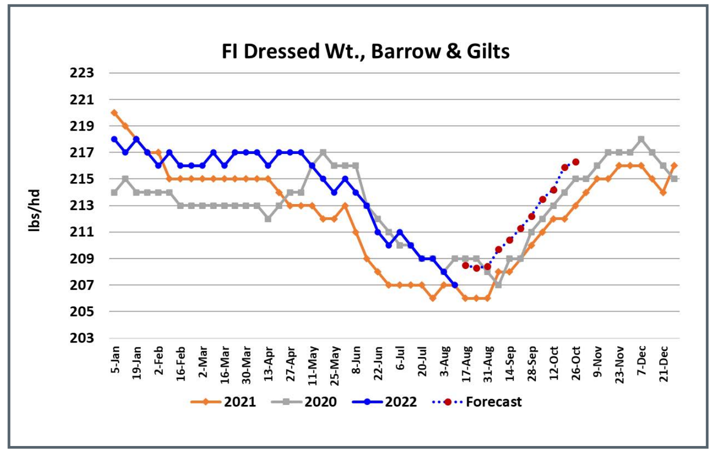

WTD Change in LH Futures
1.500
1.000
0.500
0.000
-0.500
-1.000
-1.500
-2.000
-2.500
-3.000
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23
Dec23
Feb24

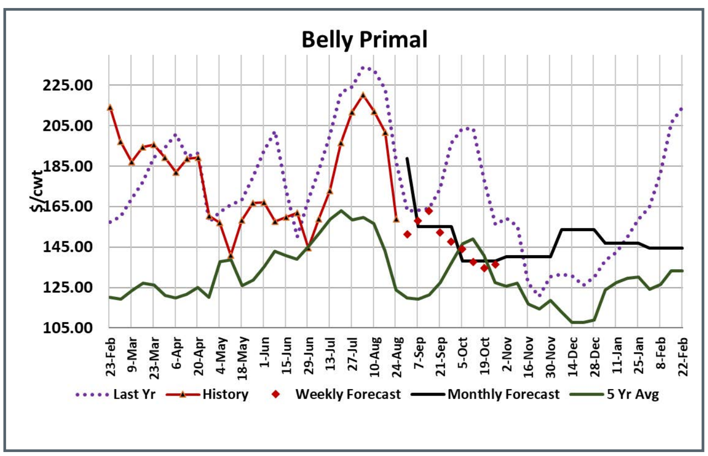

WTD Change in Pork Cutout Futures
0.000
-0.500
-1.000
-1.500
-2.000
-2.500
-3.000
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23
Dec23
Feb24

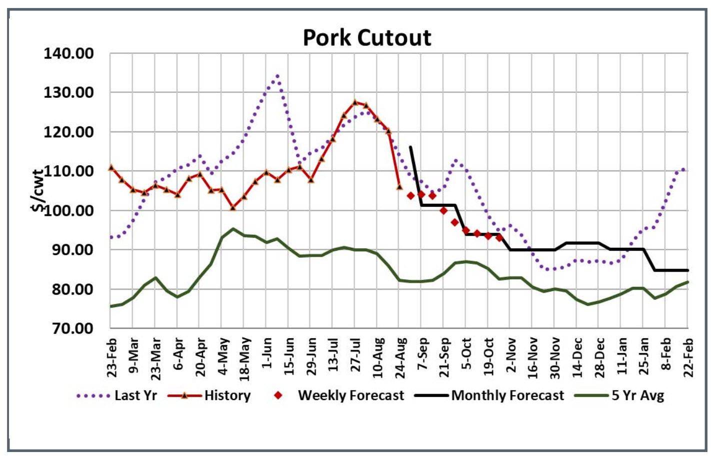

Weekly Avg Primal Impact on Pork Cutout from W/E Aug 19, 2022 to W/E Aug 26, 2022
Cutout Chg = -14.21
$/cwt.
0.00
-1.00
-2.00
-3.00
-4.00
-5.00
-6.00
-7.00
-8.00
-1.57
-1.21
-0.72
-0.04
-3.90
-6.78
Loin
Butt
Picnic
Rib
Ham
Belly

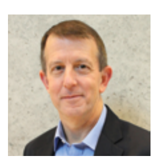

Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head
120
100
80
60
40
20
0
-20
-40
-60
-80











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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.