VOLUME 5, ISSUE 9
EN | FR | ES

J.S. FERRARO

THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

SEPTEMBER 2022

August saw very strong pricing across the US hog and pork complex. Cash hog prices continued on their upward trajectory and the Western Corn Belt negotiated market reached the low $130s. That suggests that producer-owned hog supplies remain tight, and packers have been forced to pay up to fill their kill schedules. Hog prices are expected to moderate as the calendar moves into fall and hog supplies increase seasonally, but at the present moment producers seem to have the upper hand in the spot hog market. The pork cutout was also very strong in August, driven by strong ham and belly pricing, but demand for both of those primals has softened, pushing the cutout lower here in late August. Lean hog futures for August delivery expired just under $122/cwt and traders have been exceedingly pessimistic of the price prospects for October, pricing that contract down into the low $90s. Given that both the cutout and spot hog markets will be coming down from very high levels, it is natural to assume that the price decline will be steep. However, the fact that spot hog markets are tighter than expected may work to slow the price reductions and prove the futures' pessimism excessive. Slaughter levels are increasing seasonally now and probably won't peak until late November or early December. That should keep prices throughout the hog and pork complex working lower, but the pace of that decline is uncertain. Consumer demand for pork has been better than expected this summer, but there are still a number of headwinds in the macroeconomy that could put the brakes on pork demand this fall.

> Tight supplies of spot hogs pushed **cash hog prices over $130** in August

> October lean hog futures in the low **$90s** appear **overly pessimistic**

SUPPLY PICTURE

Weekly hog slaughter during August averaged around 2.37 million head. That was below what USDA's estimate of the Dec/Feb pig crop projected and for the summer as a whole (Jun-Aug), it appears that barrow and gilt slaughter was about 700,000 head below what the pig crop implied. That may provide a partial explanation for why hog and pork prices got so high this summer, but relatively strong consumer demand also played a role. The two weeks around Labor Day will see reduced kills that may average around 2.27 million head per week, but after Labor Day, slaughter levels should jump back up to 2.45-2.50 million head per week. From there, kills should continue to slowly expand until they reach 2.61 million head per week in late November. Of course, there is always the concern that if USDA over-estimated the Dec/Feb pig crop, they may have also over-estimated the Mar/May pig crop that will be slaughtered this fall. That makes us think there is more risk that slaughter this fall will fail to live up to expectations rather than exceed them.

Hog carcass weights are approaching their annual low point and will soon turn higher as cooler fall weather increases animal appetites and enhances weight gains. Barrow and gilt weights were last reported at 207 pounds, which is dead-even with last year (see **Figure 1**). The de-trended and de-seasonalized carcass weights are at relatively low levels and that suggests that hog producers are current in their marketings and there is little risk of hogs backing up in the supply chain. As the calendar moves into September, we look for carcass weights to climb steadily higher and are likely to remain a pound or two above last year's level.

jsferraro.com | 130 Adelaide Street West, Suite 3302 Toronto, Ontario M5H 3P5 | 416.306.8788

Some have suggested that disease problems this summer were responsible for the tightness in the spot hog supply and the high price levels that ensued. If so, there is a good chance that won't be resolved quickly. The hog herd has grown too small for the available packing capacity and that has caused packer margins to be much narrower than normal this summer. Last week's margin was calculated at close to -$20/head — a very unusual occurrence this late in the summer (see **Figure 2**). Further, our forecast suggests there is more red ink in store for packers over the next few weeks. There are just too few hogs to fill all of the available shackle space. Packers may use the upcoming Labor Day weekend to constrain the kill in an attempt to improve their margins. That might help, but it isn't a long-term solution. It is likely that packer margins through the balance of 2022 will be a lot smaller than in recent years. Producers will be the beneficiaries and are likely to experience a stronger Q4 margin environment than in years past.

DEMAND SITUATION

The upcycle in domestic pork demand peaked near the end of July and is now solidly back in the downcycle phase. This is what is driving the profitability problems for packers. Demand is no longer strong enough for them to sell the pork at high enough prices to cover the cost of production. That wasn't a problem during the July demand upcycle, but now it is a major headache. This particular downcycle probably has 3-4 more weeks to run, and pork production will be increasing at the same time, so it should result in significantly lower pork prices in the near-term. Consumer spending has held up better than expected this summer, but that is probably because consumers leaned heavily on their pandemic savings to support their lifestyles as the price of everything increased this summer. At some point, the consumer will need to curtail spending and that is likely to be a negative for red meat demand. This winter is likely to see strong demand for US natural gas to be shipped to Europe and that would raise home heating costs for US consumers. They can find other, cheaper, things to eat, but there is not much that will substitute for natural gas in a home that is built to use it. That is just one way that pork demand could get crimped in Q4. Now that summer vacations are done, consumers are faced with the credit card bills generated on those trips and back-to-school expenses as well. That, more than anything else, could be the factor that causes this demand downcycle to be deeper than those in the recent past. Of course, beef demand suffers more than pork demand as the macroeconomy slows and there is potential for some beef demand to shift to pork, so that may mitigate the negative demand influence somewhat this fall. Inflation, outside of energy prices, appears to be slowing. While that, of itself, won't boost pork demand, it may slow the demand erosion process.

International demand for US pork is uninspiring at present. USDA reported June pork exports down almost 6% YOY and the prospects for the July data don't look much better. Movement to China remains rangebound at levels well below the boom years of 2019 and 2020. Mexico has re-emerged as the largest customer for US pork, but high US prices in July and August probably limited interest from south of the border. Strength in the US dollar will likely be a further hinderance to pork exports this fall, but could encourage more imports, and thus improve availability. We are rather lukewarm on the prospects for pork exports this fall, expecting them to remain rangebound and not add much to the overall demand picture for pork.

SUMMARY

US pork demand has peaked and is headed lower. At the same time, hog and pork supplies have bottomed and are now moving seasonally higher. Softer demand and bigger supplies are the recipe for lower pricing and that has been evident in the market recently. Bellies and hams have come way down from the highs they made near the beginning of August and that has weighed on the cutout. Hog supplies seem to still be relatively tight as evidenced by continued strong pricing in the negotiated spot market, so that could temper the downside potential in pork prices over the near term. Packers are struggling with negative operating margins at a time of year when margins are normally positive and growing. This is largely because the current hog supply is insufficient to run all pork plants at the level packers would prefer. As a result, the balance of power has shifted away from packers and toward producers. As hog supplies increase seasonally this fall, expect to see that change and packers will once again have the upper hand in daily price negotiations for hogs. International demand for US pork seems stagnant at present and isn't expected to change much during the balance of 2022. Pork buyers will find pricing this fall much more favorable than what existed this summer, but there will still be periods of demand strength that could result in moderate counter-seasonal price increases. The prospects for expansion of the US breeding herd don't look particularly good in the near-term, so the if there is to be lower pork pricing next year, it will probably need to originate from softer overall demand rather than any substantial growth in hog supplies. **Table 1** provides our near-term price forecasts.

Figure 1: FI Dressed Wt., Barrow & Gilts

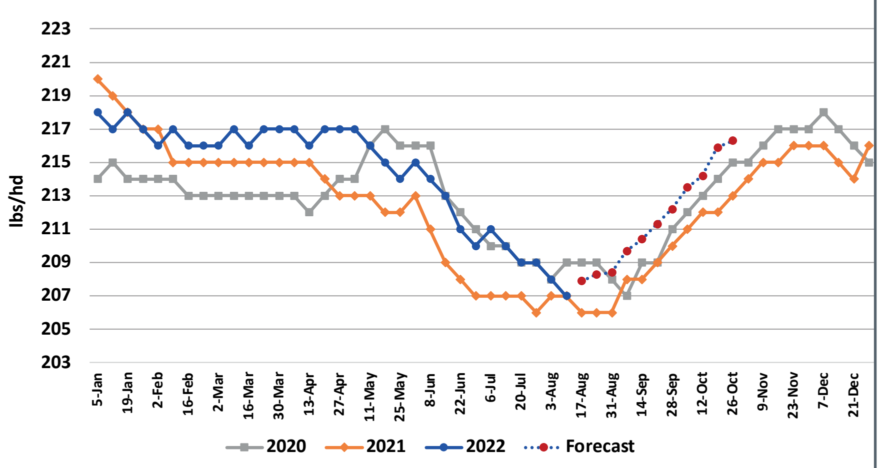

Figure 2: Estimated Packer Margin, Final Week of August

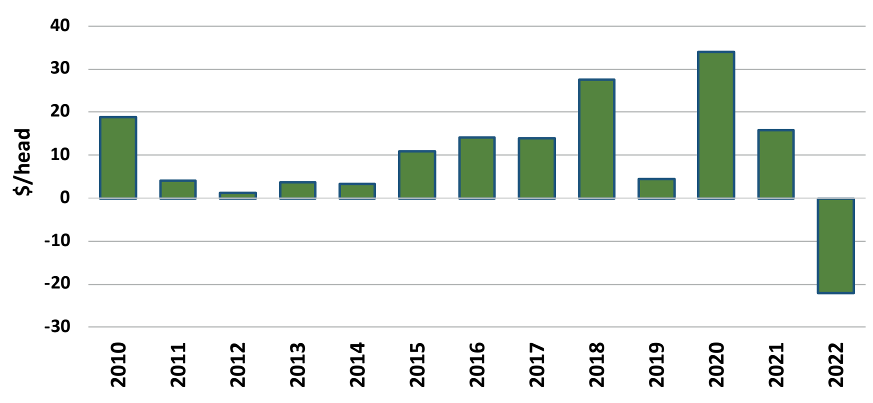

Table 1: JSF Hog and Pork Price Forecasts

	7-Sep	14-Sep	21-Sep	28-Sep	5-Oct	12-Oct
Pork Cutout	104.2	103.8	100.0	97.0	95.0	94.1
Loin Primal	103.6	99.7	98.6	95.3	93.2	91.1
Butt Primal	104.2	102.1	100.3	101.6	103.4	104.8
Picnic Primal	80.4	78.3	75.5	72.7	70.3	67.2
Rib Primal	133.6	136.1	134.0	136.2	136.8	139.2
Ham Primal	91.6	92.4	88.2	83.3	80.5	83.6
Belly Primal	158.0	162.8	152.1	147.6	143.9	137.6
Lean Hog Index	108.5	106.6	102.0	98.0	94.8	92.2

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro

E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 31 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.