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WEEK ENDING SEPTEMBER 23, 2022

THE PORK WRAP

This felt like a bad week for the hog and pork complex, but I'm not sure that the story the data are telling is as bad as the futures market implies. Certainly, traders turned bearish in a big way, driving the front of the futures curve down $4-5/cwt this week. That action was precipitated by growing dark clouds on the macroeconomic front and a couple of weak prints from the belly primal. In the end, the cutout was down $2.72/cwt. on a weekly average basis, but the Lean Hog Index was about $0.10/cwt higher on the week. Negotiated hog markets were steady-weak with the WCB up $0.76 and the NDD down $1.04. The attached chart indicates that it was definitely the bellies that applied the most pressure to the cutout this week. So, what is going on with the bellies? The first thing to note is that belly prices have been steady-soft for 4 weeks now and that is something that almost never happens.

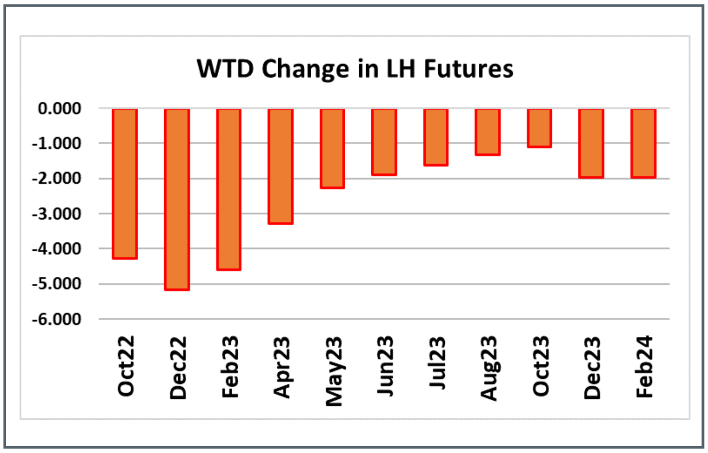
They are normally moving either up or down. This week the belly primal broke through the $145 level that had acted as support in the past two price downdrafts, so it is now at its lowest level of the year. Last year, the lowest belly prices were observed just ahead of US Thanksgiving, when kills were near their annual highs. That makes sense. Does that mean that belly prices are just going to keep trending lower between now and Thanksgiving? Probably not. Last year, bellies made a low near the middle of September and then rallied hard to the middle of October. I suspect that we are going to see another early October rally this year, but it probably won't reach last year's level because demand isn't nearly as strong as it was last year. Those users that put bellies into the freezer during the fall months will likely be tempted by the fact that belly prices are at the lowest level of the year right now.

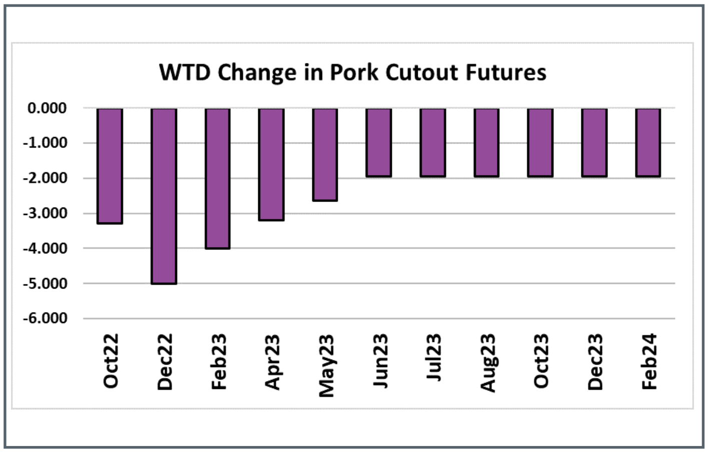
USDA released the cold storage numbers for the end of August this week and it showed belly stocks at 32.5 million pounds, which was about double the 17 million pounds that were in cold storage at the end of August last year. That is another reason that any fall belly rally is not likely to reach last year's level. However, 17 million pound in storage last year was unusually low and the 32 million pounds from this year is much closer to levels that we saw in 2018-2020. The peaks and troughs in belly pricing are largely driven by retail feature activity and retailers tend to do the same thing year after year, so I think it is a good bet that we will see bellies garner some modest price strength in the next few weeks. The ham primal was down about $2.50/cwt. this week, but there still seems to be good interest in bone-in hams and thus I suspect that while hams may keep slipping lower, the decline will be very gradual. Of course, pork availability is growing week-by-week now as hog supplies increase seasonally and that likely to keep the cutout from having a lot of upside potential in the next couple of months.

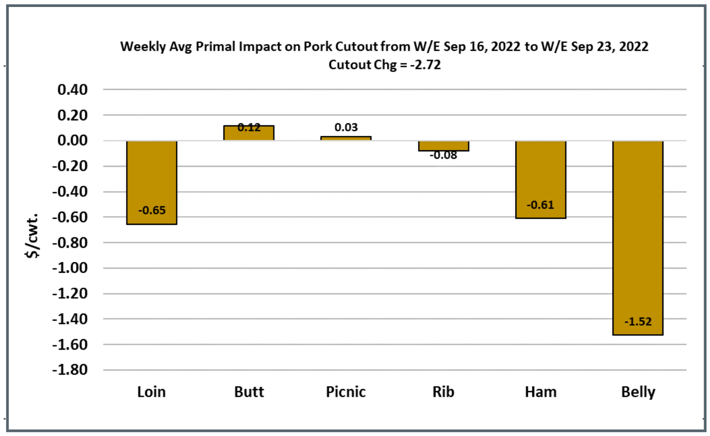
This week's kill registered 2.54 million head and was just a little over what the pig crop implied. So far this quarter, kills have been a little lower than what the pig crop suggested, but to a much smaller degree than what we saw this summer. According to my model, the Mar/May pig crop implies a peak kill this fall right around 2.61 million head and if USDA was a little high on the pig crop, as it seems so far, then maybe the peak kill will be just below 2.6 million head. That isn't very far from what was killed this week, so the bulk of the supply increase has already occurred and yet the cutout has managed to stay in triple digits. That suggests that pork demand is holding up pretty well. However, the cumulative effect of 2.5-2.6 million head kills week after week will eventually start to wear the market down and some "pork fatigue" is likely to set in. That is how we will end up with a cutout bottoming in the low $90s or upper $80s during November or early December.

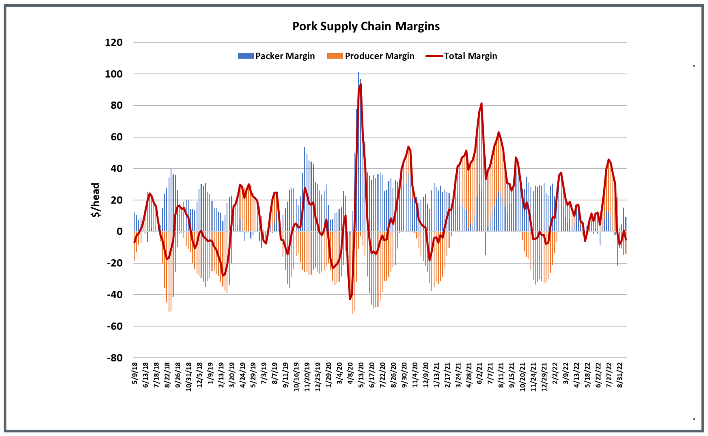
My current forecast has the cutout holding around $103 for two more weeks and then working lower towards $95 by Halloween. Of course, both beef and chicken prices are working lower at present and that will increase competitive pressure on pork, but many retailers already have pork slotted in for October features due to the financial incentives offered by the industry, so it might not matter until we get closer to November. The combined margin ticked down a little this week, but it is hard for me to believe that it is going to move substantially lower given that it is already below zero. I'd see this week as a head-fake and expect it will post some gains in the next couple of weeks to resume the uptrend. Packer margins averaged about $9.50/head this week and I'm forecasting them to remain below $15/head through October.

I realize that is smaller-than-normal for that time of year, but we have less hogs this fall than we did last year and the same amount of packing capacity chasing after them. So some margin compression should be expected. There is no sign that hogs are backing up in the pipeline. Barrow and gilt weights were reported 2 pounds higher this week, but the data are for the recent short kill week, so I wouldn't expect that type of increase to repeat. Weights will continue to move seasonally higher from now until early November. There seems to be a growing consensus that tougher macroeconomic conditions lie ahead for both the US and many of its trading partners. Depending upon the severity of the downturn, it will likely be a negative for pork demand, but in the early stages of a potential recession, trading down by consumers could keep pork demand afloat better than expected. I already have dialed in further demand weakness into my Q4 price forecasts, so that's already factored in and I still end up averaging about $90 in both November and December. My fear is that I may be too pessimistic on demand. Next week, watch for a rebound in the bellies and keep an eye on the hams for further softening. Any strength in either of those primals is likely to precipitate a rally in the front of the futures curve.









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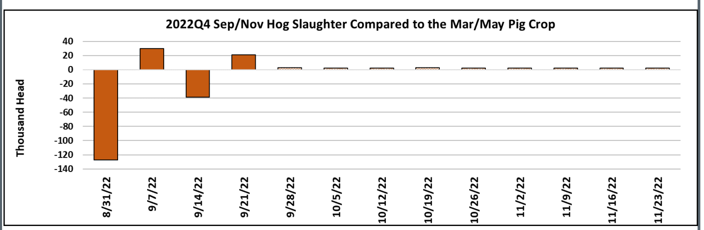

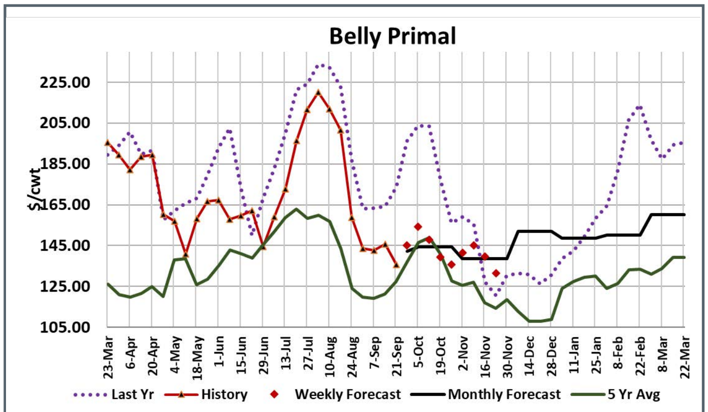

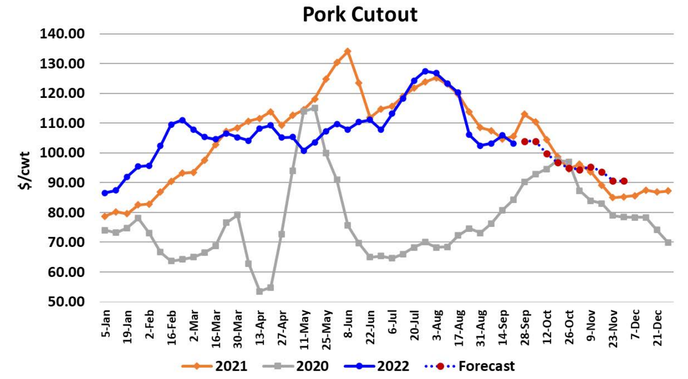

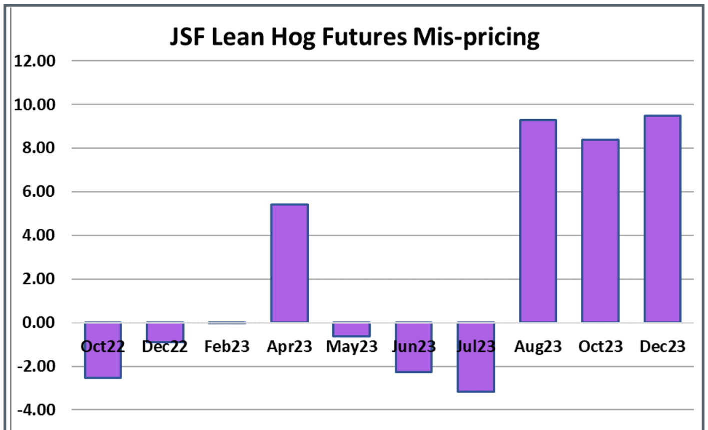

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