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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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Following the sharp collapse in the pork cutout that occurred at the end of August, the cutout stabilized in the low $100/cwt. area for most of September. As of this writing, the cutout is just below the $100 mark, which is pretty impressive given the seasonal increase in pork production that occurred during September. That points to relatively good domestic demand so far, but that demand will be tested further as the industry attempts to work through a steady diet of kills in the 2.5-2.6 million head per week range over the next couple of months. The pork industry has long recognized the potential for price weakness during October as kills escalate toward annual peaks, so they offer incentives to retailers to feature pork aggressively as a way of helping the increased production clear the market. These "pork month" features are not likely to be sufficient to keep the cutout in triple digits, but they may keep it above $90/cwt. through October and perhaps part of November. Cash hog prices declined alongside the cutout in late August, and they continued to ease lower in September. That has allowed pork packing margins to expand some from the very tight levels of late summer, but because the hog supply is a little smaller than last year, margins have remained weaker than normal. We expect that, while packing margins are likely to increase as Q4 progresses, on average they will be well below what was seen in the past few years. Producer margins are also likely to be down from last year when stellar pandemic-driven demand helped improve margins for all of the players in the supply chain. As the pandemic fades, the hog and pork complex should continue to revert to more of a pre-pandemic demand structure and will help to offset some of the price-enhancing effect of a smaller hog herd and thus smaller pork supplies in 2023.

> The **pork cutout** was able to **hold over $100/cwt.** for most of September

SUPPLY PICTURE

Following the short kills around Labor Day, hog slaughter bounced back and averaged slightly over 2.5 million head per week for the balance of September. This was widely expected and pretty much in line with what the March/May pig crop indicated would be available for slaughter in the Sep/Nov quarter. The main difference between this fall and last is that this year the workforce inside packing plants has been replenished and is in good shape. That eliminates a potential bottleneck that was present last year and helped packers to realize very strong margins during Q4. Better labor availability and a smaller hog supply should cause Q4 margins this year to be well below the $30/head that they averaged last year. Based on USDA's survey of the March/May pig crop, we expect peak hog kills this fall to be around 2.61 million head. Given that last week's kill registered 2.49 million head, it is easy to see that most of the fall increase in slaughter levels has already happened.

Hog carcass weights are now moving seasonally higher and that should continue until the end of November. Weights are tracking 1-2 pounds over last year and that is consistent with the long-term trend toward increasing weights year after year. So far, it seems that hog producers are keeping pace on their marketings and there is little risk of hogs backing up in the production pipeline. We see total pork production during Q4 as down about 1% from last year, but because exports are expected to be a bit weaker than last year and the strong dollar could encourage stronger imports, overall per-capita availability might be very close to last year's level.

Last Thursday's *Hogs and Pigs* report confirmed that the industry is still slowly contracting, with the total swine herd down 1.4% YOY and the breeding herd down 0.6%. It is likely that producers

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are concerned about relatively poor export prospects over the next year or so in addition to the uncertainty about the Supreme Court's ruling on California's Proposition 12. If the Court should rule against California and hold that one state cannot mandate how production occurs in other states, that would bring a big sigh of relief from industry stakeholders and could set the stage for some modest growth in the hog herd by the end of next year. The most important number in Thursday's report was the Jun/Aug pig crop, which was pegged to be down 1.1% YOY and indicates that slaughter during the upcoming Dec/Feb quarter should be below last year by a similar amount.

DEMAND SITUATION

Domestic pork demand held up better than expected in September, with the cutout remaining above $100/cwt. while kills expanded to over 2.5 million head per week. **Figure 1** gives our average demand indexes by quarter, and it is clear that in the most recent quarter, pork demand was still above pre-pandemic levels. That is in contrast to the beef market where demand has fully moved back to where it was before the pandemic. Pork demand is probably seeing some benefit as cash-strapped consumers trade down from beef, but eventually consumers will trade down from pork also and thus we look for demand to continue to ease lower in the next few quarters. Recently, the futures market has undergone a sharp correction lower that can only be explained by a major downward revision in demand expectations because nothing in the supply fundamentals changed enough to warrant that type of sell-off. Traders have watched the equity markets around the world move sharply lower in anticipation of a global recession and that probably fostered some fears that pork demand, both domestic and international, could come under pressure in the months ahead. So far, we haven't seen signs of that in the data, but the job of the futures market is to anticipate future supply and demand conditions, so it could be a forebearer of what is to come. There are certainly plenty of macroeconomic factors present that would normally be expected to temper demand and the most influential right now are continued high inflation, particularly for food, and the bear market in equities, which causes consumers to feel poorer and thus spend less.

Export volumes have been rather disappointing recently, at least compared to the 2020-21 period where exports were very strong. The US dollar has strengthened considerably in the past few weeks and that will raise the cost of US pork to buyers in other countries. At the same time, the strong currency will lower the cost of importing pork into the US from other countries. Given that the US pork industry has historically exported between 23% and 25% of its commercial production each year, this upward shift in the value of the dollar has the potential to be a significant negative factor for domestic pork prices if it continues. Back in 2020, China was the number one buyer of US beef, but now that they have solved their African Swine Fever problems, they are purchasing much less (see **Figure 2**). That isn't expected to change any time soon because China's economy is struggling with relatively high unemployment and income losses due to covid lockdowns. So, the prospects for international trade appear to be dimming for the balance of this year and into 2023.

A much stronger dollar will present a challenge
for an industry that typically exports close to 25% of production

SUMMARY

The US hog and pork complex is heading into the largest production period of the year, with weekly kills expected to run between 2.5 and 2.6 million head per week until early December. Last week's kill registered 2.49 million head, so most of the transition from small summer kills to large fall kills has already occurred. Domestic demand has held up better than expected and the pork cutout remained above $100/cwt. for most of September. Carcass weights are rising as they normally do at this time of year, but it appears that hog producers have kept marketings current and there are no backups in the production pipeline. USDA reported another YOY decline in the swine herd last week along with a smaller pig crop. That means that slaughter levels are likely to remain below last year through at least February and perhaps beyond. There is simply too much uncertainty concerning things like Proposition 12 and export prospects for producers to become enthusiastic about expanding. Persistently high grain prices are also likely thwarting expansion. Domestic pork demand, while down considerably from its pandemic peak, is still not back to pre-pandemic levels. Pork demand is likely benefitting as consumers trade down from more costly beef in these inflationary times, but eventually it too will fade and return to a level that was typical prior to the pandemic. The recent strength in the US dollar has raised concerns about pork exports going forward and that may at least partly explain the recent sell off in the futures market. Buyers should look for pork prices to continue to ease lower over the next couple of months as production increases, but we don't expect prices to be significantly weaker than last year in the fourth quarter. **Table 1** provides our near-term price forecasts.

Figure 1: Demand Indexes Using Inflation-Adjusted Data, Pork Cutout

(shaded is forecast)

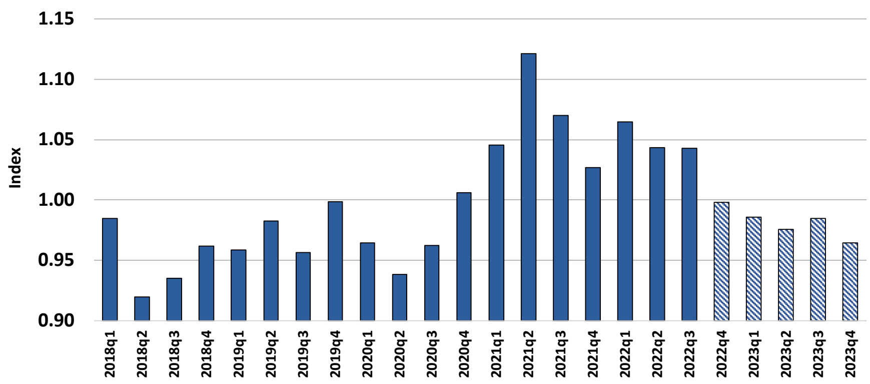

Figure 2: Pork Exports to China+Hong Kong, 2016-Present

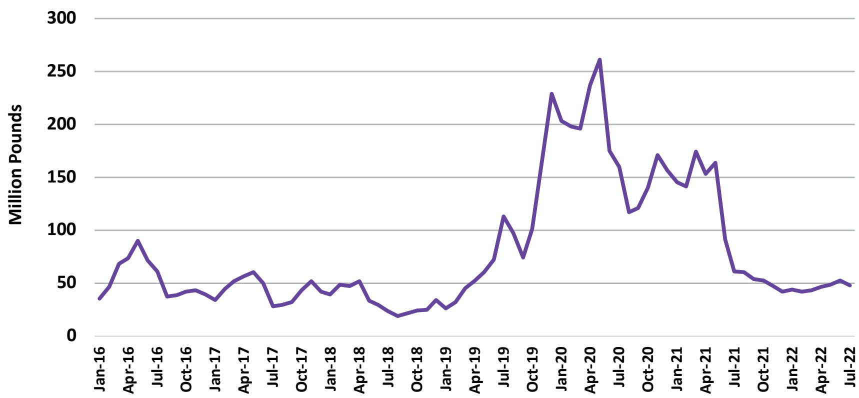

Table 1: JSF Hog and Pork Price Forecasts

	12-Oct	19-Oct	26-Oct	2-Nov	9-Nov	16-Nov
Pork Cutout	98.0	95.4	95.0	94.3	91.8	89.8
Loin Primal	92.4	90.0	87.5	86.3	86.7	84.4
Butt Primal	103.8	101.2	103.0	105.2	106.0	103.4
Picnic Primal	75.2	73.7	75.3	73.7	71.4	71.6
Rib Primal	129.1	128.2	131.0	132.6	132.0	130.2
Ham Primal	103.6	100.1	95.4	91.4	86.0	86.9
Belly Primal	125.2	121.6	127.3	131.1	125.6	117.3
Lean Hog Index	92.1	90.2	88.5	88.3	83.5	80.4

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