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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

DECEMBER 2022

Price levels in the US hog and pork complex drifted lower throughout November, with the cutout moving from about $100/cwt. at the end of October to about $91/cwt. today. At the same time hog prices were also working lower

> The **cutout continues to work lower** under the weight of seasonally-large supply and softer demand

the CME Lean Hog Index, which measures the all-in cost of hogs to packers, fell from around $94/cwt. at the end of October to about $85/cwt. at the end of last week. Softer pricing in the latter part of fall is par for the course, but this year's decline has been unusually orderly. Slaughter levels and pork production likely peaked in mid-November, but won't decline significantly until mid-January. At the same time that production was increasing, domestic pork demand has been slowly softening. That created the conditions where pork pricing was allowed to gently ease lower over a period of weeks rather than change abruptly. Hog and pork prices often see a small bounce following Thanksgiving week and that may be the case again this year, but usually that bounce is small and short-lived. Over the past 10 years, the lowest average cutout value and hog price have happened in the last week of the year. The hog herd has been in contraction mode

> **Packer margins** are currently running **around $13/head**, about half of what they normally are at this time of year

since the covid pandemic began and the industry has reached the point where packing capacity significantly exceeds hog availability. That has led packers to compete harder for hogs, driving up cash hog prices and compressing packer margins. Last week, we calculate that net packer margins were close to $13/head — a far cry from the ten-year average near $25/head. With just a few weeks remaining in 2022, we project the average annual packer margin this year will be just below $11/head. The last time that annual margins were smaller was in 2013 (and $11 went a lot further in 2013 than it does now).

SUPPLY PICTURE

Total hog slaughter during the third week of November reached 2.6 million head and that may very well prove the be the largest kill of Q4. In general, kills have come in just a little smaller than what USDA's *Hogs and Pigs* survey suggested. As we move into December, kills are likely to run between 2.55 and 2.6 million head until end-of-year holiday schedules curtail slaughter back towards 2.0-2.1 million head per week. Then, once the holiday are behind us, expect weekly slaughter rates to run just over 2.5 million. This week, the industry will start working on the Jun/Aug pig crop, which USDA estimated to be 1.1% below last year. That means we should expect a similar reduction in hog slaughter and pork output over the Dec-Feb period. Because Christmas and New Year's fall on a Sunday this year, the disruptions to slaughter are expected to be a little less than in years when those holidays come in the middle of the week.

Carcass weights have been trending seasonally higher over the past couple of months and they may still yet increase another 3-4 pounds before they reach their annual top. That said, there is not really anything out of the ordinary in the way weights have behaved this fall. If anything, they may have gone up a little slower than normal because with a smaller supply of hogs than in past years, packers had to pull a little harder to fill out their kill schedules. The tightness in the hog supply that kept negotiated prices strong this summer and in the early fall seems to have mostly dissipated now and those negotiated markets are easing lower with the rest of the complex. However, the fact remains that the hog supply in general is too small for today's packing capacity and so it is natural to expect that hog prices will remain several steps above where they were in years past when the herd was much larger. That will be most evident in the summer when hog supplies are seasonally smallest, but it remains an ongoing concern for packers.

USDA will provide its next *Hogs and Pigs* report on December 23rd, and we expect that it will show the breeding herd down close to 0.2% YOY, with the Sep/Nov pig crop down about 1%. Sow slaughter during the recent Sep/Nov quarter was a bit larger than expected given the size of the breeding herd on Sep 1, so that has reinforced our belief that this next report will continue to show declining hog numbers. Even though hog prices have been elevated compared to years past, the costs of producing a hog have gone up dramatically. Corn, soymeal, diesel and natural gas prices are all still very high and as a result, hog producers are finding it difficult to turn a profit. Production margins were over $20/head during July and August when hog supplies were tight, but here in Q4 it looks like producers may lose about $27/head on average. Right now, there seems to be very little financial incentive for producers to expand.

DEMAND SITUATION

Last month we wrote that pork demand appeared to be approaching a bottom, but that turned out to be a head-fake and demand is still working lower. Using our combined producer+packer margin as a proxy for the health of pork demand, we see that it has now fallen to levels last seen in February, 2019 if we ignore the sharp drop at the start of the covid pandemic (**Figure 1**). This softness in demand is not spread equally throughout the carcass however. Demand appears weakest for the loin, rib and belly primals while the ham primal and trimmings are seeing much better demand and very strong pricing (**Figure 2**). Ham demand got a boost from high turkey prices this fall as retailers prepared for Thanksgiving. Those high turkey prices were the result of avian influenza outbreaks in the US and Mexico. That also led to Mexico being quite active sourcing hams out of the US this summer and fall. We are just now beginning to see signs that ham demand is softening, but it has a long way to go before it will be considered back to normal. More concerning is the lack of demand for retail items, particularly loins. We think that this stems from the fact that retailers have kept pushing their everyday pricing higher this fall, even though wholesale loin prices have been falling. Consumers just aren't getting the chance to respond to lower prices at retail and that is shifting some loin demand to other items such as chicken breasts. Stocks of bellies in cold storage are much improved this year and that has had the effect of limiting price strength in that primal. It seems as though lower wholesale pork prices should be capable of "buying" away some demand from the other proteins in December, so perhaps we truly are now on the cusp of a modest turn higher in domestic pork demand.

International demand for US pork is lukewarm at best. China is no longer a huge buyer of US pork as it struggles with covid outbreaks and lockdowns. Even buying ahead of the Chinese New Year seems to be subdued. The US dollar has appreciated a lot relative to many Asian currencies and that has also had a chilling effect on international pork demand. Mexico remains the bright spot in the export picture, partly due to its need for US hams and the fact that its currency has held value well relative to the US dollar this year. This will mark the second year in a row where pork exports have posted a YOY decline after peaking back in 2020 when ASF was raging in China and demand from Chinese buyers was through the roof. Unfortunately, it may take several years before international demand expands back to the point where the 2020 high water mark for exports can be exceeded.

SUMMARY

Conditions in the US hog and pork sector softened further during November. Domestic pork production was down compared to last year, but demand has also been soft and that created conditions where both hog and pork prices have been slowly moving lower. A small amount of supply side relief will come from the holiday-reduced kills in a few weeks and there is hope that the demand side of the market will improve as well. Nonetheless, buyers shouldn't fear that pork prices are going to move significantly higher in the near term. If anything, there could be some modest price increases in items like loins or bellies which witnessed underwhelming demand during November. Ham prices are likely to work lower, but probably not rapidly until after the holiday break. Packer profitability has been about half of what it has been in recent years during Q4 due to hog supplies being less than optimal for the amount of processing capacity within the industry. Hog producers are struggling with high input costs and that is likely to keep them in contraction mode for at least a couple more quarters, if not longer. Domestic pork demand is back near pre-pandemic levels and that should cause prices to be less volatile (and more predictable) in the months ahead. That said, pork prices are likely to carve out a bottom during December and turn higher as we enter the new year. **Table 1** provides our near-term price forecasts.

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Figure 1: Combined Producer + Packer Margin

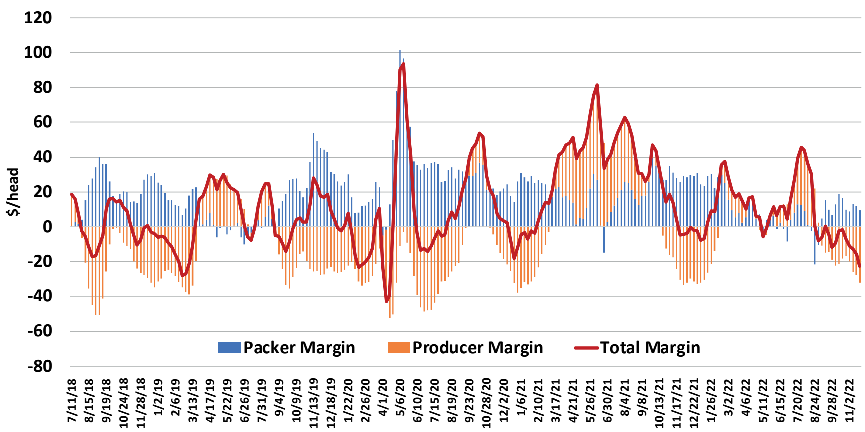

Figure 2: Ham Primal

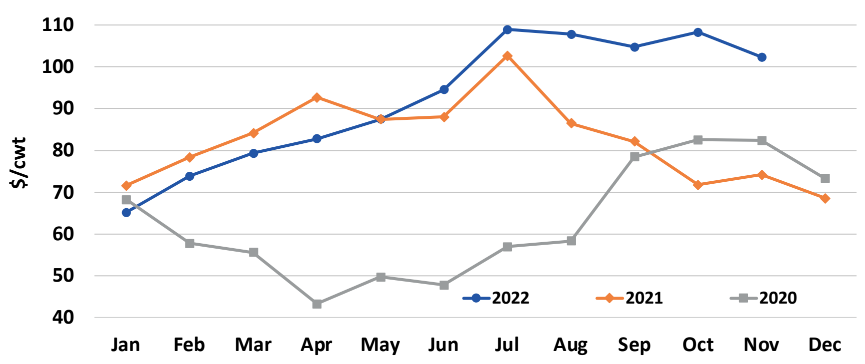

Table 1: JSF Hog and Pork Price Forecasts

	7-Dec	14-Dec	21-Dec	28-Dec	4-Jan	11-Jan
Pork Cutout	90.4	91.9	92.6	94.0	95.5	97.8
Loin Primal	81.1	84.0	85.2	86.7	88.3	92.6
Butt Primal	104.2	104.4	103.7	103.0	104.1	103.0
Picnic Primal	79.1	78.3	76.6	74.9	73.6	70.5
Rib Primal	123.6	127.3	129.7	130.8	136.1	138.3
Ham Primal	89.0	86.7	82.5	81.7	80.9	82.8
Belly Primal	118.6	126.0	135.8	144.3	150.7	156.5
Lean Hog Index	83.2	83.7	85.2	85.4	86.9	88.4

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