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RED MEAT OUTLOOK: HOGS & PORK

US hog and pork prices continued to slide lower throughout January, but now appear to be nearing a bottom. Many market participants were caught off guard by the long length of the current downcycle. We think that it is a sign that the hog and pork demand is in the process of resetting to levels more consistent with pre-pandemic demand rather than the exceptionally strong demand structure that was in place for most of 2021 and 2022. Unfortunately, pork producers are caught in a vise between sharply lower pork demand and high costs of production that haven't relented much in recent months. Negotiated hog prices are now near the $70/cwt. mark and we calculate that hogs sold today need to bring close to $100/cwt just to breakeven. That means hog producer margins are negative by a little more than $60/head. Pork producers are familiar with negative margins in the winter months when pork production typically expands, but the current margins are at all-time record lows. When corn prices surged in 2021 and 2022, producer margins were largely rescued by very strong pork demand, which lifted hog prices to levels that helped offset those higher input costs. Now that pork demand is retreating to pre-pandemic levels, or even lower, producers can no longer count on exceptionally strong hog prices to counter persistently high feed costs. Thus, we may see some hog operations forced to exit the industry if demand remains soft over the next few months and feed grain prices remain high. If feed grain prices are going to remain elevated for years, then economic theory projects that the industry should shrink until hog prices rise to a level high enough to restore reasonable profit margins. Some of that has already taken place, but the herd shrinkage has been rather mild so far. This current set of margin woes may hasten the speed of herd contraction.

> The **pork cutout** has been stalled near **$80 for the past month**

SUPPLY PICTURE

Pork packers may have already produced their largest harvest of 2023, when in the second week of January the kill registered 2.69 million head. That was larger than any weekly slaughter during 2022 and is especially stunning considering that the Jun/Aug pig crop was reported to be down 1.3% YOY. As we have tracked recent hog kills, it is becoming obvious that USDA must have under-estimated the summer pig crop by somewhere between 500-800,000 head. That is a pretty significant miss and helps to explain why negotiated hog prices have failed to gain any traction so far in 2023. Further, it raises questions about whether or not the Sep/Nov pig crop, which was also estimated down 1.3% YOY, may actually be larger than the survey indicated. The industry will start working through the Sep/Nov pig crop in March.

Adding to the over-supply problem is that some hogs probably got backed up during the three reduced-kill holiday weeks at the end of last year. We saw the de-trended and de-seasonalized carcass weights jump in the first two weeks of January and that usually points to some backlog in the hog supply. The big kills in January helped to alleviate that problem, but it may take a couple more weeks before the pipeline is back to normal. Seasonally, we expect carcass weights to remain mostly sideways through February and March before starting their annual descent in mid-April.

With producer profit margins at all-time lows and packer margins well below normal for this time of year, it is clear that there just isn't much margin in the supply chain right now. **Figure 1** shows our combined producer+packer margin and it has recently moved to its lowest level in our dataset. This combined margin is indicative of what an integrated hog producer would be realizing at present and the picture isn't pretty. The big integrators are not in any danger of going out of business, but their quarterly earnings are going to look pretty dismal after this quarter. Smaller, independent hog producers with higher-than-average cost structures are the ones most at risk during this current margin squeeze. Readers will notice that the combined margin has recently tick just a little bit higher, so that may signal that the worst is now behind us, but we probably shouldn't expect margins to return to the super-strong levels that prevailed during the pandemic when demand surged mightily.

DEMAND SITUATION

Last month we noted that domestic demand was in a downcycle beyond what we had become accustomed to over the past couple of years. There was no abatement of that demand softness during January and that helped drive hog and pork prices to their lowest levels in almost two years. As prices dropped last fall, some users took that opportunity to move pork into cold storage as a hedge against tight supplies in the spring and summer of 2023. USDA recently reported that total pork in cold storage at the end of 2022 was up 16% YOY. For bellies, the YOY increase was +66%.

Price gains this spring may be **limited by cold storage stocks** that are up 16% YOY

These large cold storage stocks will act as a buffer against high pork prices this spring. So, while demand for fresh pork may be just now turning higher, the exceptionally soft demand in the past few months has been "pushed forward" in the form of higher inventories and that are likely to keep pork prices from reaching the levels that were seen last spring and summer when stocks were lower and intrinsic demand was much stronger. Yes, pork production should be down YOY this spring and summer if USDA surveys were correct, but that isn't likely to fully compensate for the impact of a much softer demand structure. Buyers may want to position themselves to protect against some near-term price increases now that demand appears to be poised to move higher, but we would caution against booking product at fixed prices for late spring and summer delivery, because spot prices may undershoot what packers are currently asking in that timeframe. **Figure 2** provides our calculated demand indexes for the month of January since 2000. The demand index for January 2023 rivals those seen in 2009 and 2010 when the economy was in recession due to the financial crisis. Truly, we have just come through an exceptionally weak demand downcycle and market participants should expect demand to be much softer in the balance of 2023 than it was last year.

Post-holidays, US pork exports seem to be tracking back close to year-ago levels, but we have seen some concerning weakness in movement to Japan and S. Korea. On the other hand, a lot more US product is moving into Canada than what we saw last year at this time. China remains a buyer of US pork, but not nearly to the scale that was seen a couple of years ago and much of what China buys these days is offals, not muscle cuts. Mexico had been a strong buyer of US hams back in Q4, but it seems like those orders are coming in less frequently these days. We know that hog and pork prices in Mexico are well above those in the US currently, so it is a bit of a mystery as to why there hasn't been more interest in US product from south of the border.

Domestic **pork demand** is coming through a period **of exceptional weakness**

SUMMARY

The biggest story in the hog and pork complex over the past few weeks has been the "air pocket" that pork demand seems to have stumbled into. To make matters worse, it appears as though USDA under-estimated the summer pig crop and thus there are more hogs available to market than anticipated. This has kept pork prices under pressure and created some of the worst losses hog producers have ever experienced. It now looks like demand may be starting to recover and there should be some gentle easing in kills during February, so that should allow prices on most pork items to move higher. Cold storage stocks may limit how much prices can increase however, as they are well above last year, particularly for bellies. The events of the last couple months appear to be signaling that the hog and pork complex has fully forgotten the euphoria that 2021 and 2022 spawned and is now more closely resembling the pre-pandemic marketplace. That means that market participants should expect lower highs and lower lows in the pricing cycles than what we saw over the past couple of years. One thing that hasn't returned to pre-pandemic levels is feed grain pricing and thus hog producers are caught in a nightmare scenario where the hog price that the pork market will support is not nearly high enough to cover their cost of producing hogs. If this persists, and we think that there is a good chance it will, then the only solution for producers is to further reduce the size of the herd. That is something that pork buyers should be on the lookout for, but it won't happen quickly and in the interim pork pricing should remain relatively favorable for users. **Table 1** provides our near-term price forecasts.

Figure 1: Pork Supply Chain Margins

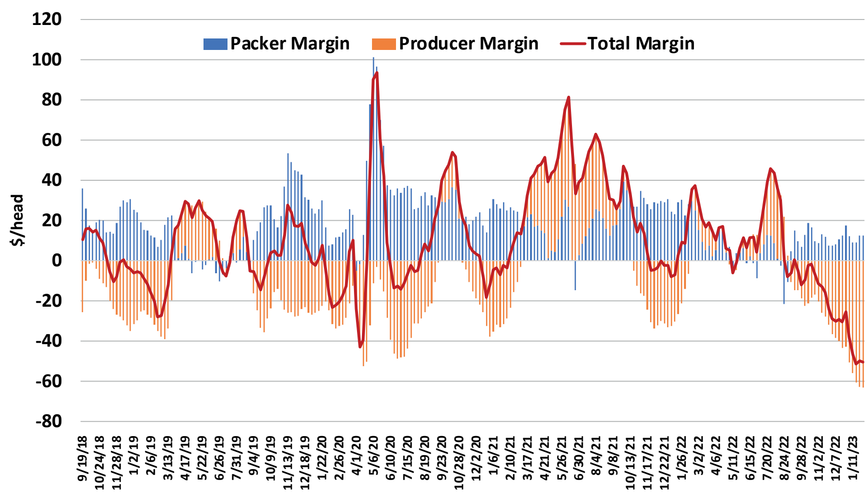

Figure 2: Pork Cutout Demand Index for January

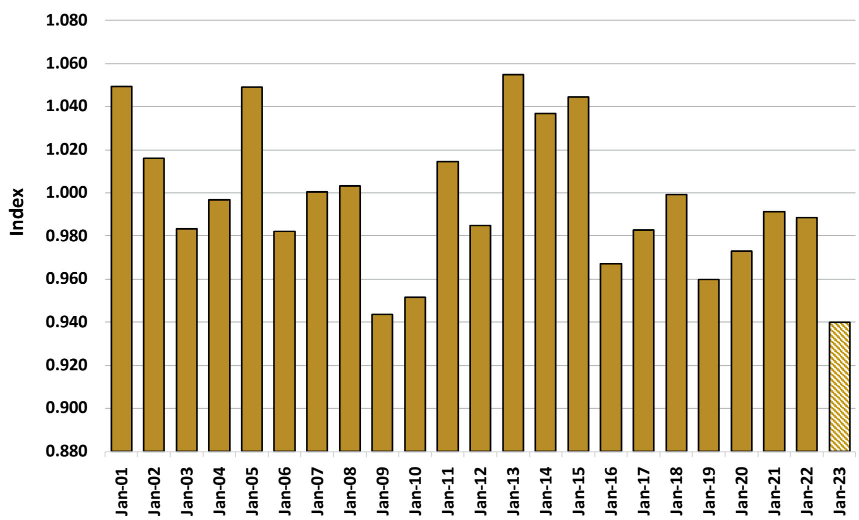

Table 1: JSF Hog and Pork Price Forecasts

	15-Feb	22-Feb	1-Mar	8-Mar	15-Mar	22-Mar
Pork Cutout	83.6	85.6	87.2	89.7	91.8	93.5
Loin Primal	84.5	86.1	87.7	88.7	87.9	90.1
Butt Primal	98.3	101.7	105.8	108.1	110.5	112.3
Picnic Primal	61.1	62.2	59.8	60.1	62.7	64.5
Rib Primal	118.4	120.5	122.0	124.6	125.1	127.4
Ham Primal	79.3	78.4	78.3	80.1	83.7	84.2
Belly Primal	106.6	114.3	120.5	128.4	133.4	136.2
Lean Hog Index	76.8	79.5	80.5	83.0	85.4	86.5

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