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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

JULY 2023

The US hog and pork complex is starting to look like a phoenix rising from the ashes. The cutout has been on a solid upward trajectory since the middle of April and the gains have been accelerating lately. The cash hog market has followed the cutout higher, and we are now seeing negotiated hog prices in the mid $90s. The feel of this market here in mid-summer is vastly better than it was during the dark days this spring when it looked like the entire supply chain was collapsing. Futures traders have been treating the market a bit timidly, almost as though they were reluctant to believe that things could get better. Proposition 12 is now in effect in California and so far there haven't been any major disruptions. The real key to this recovery has been steady improvement in domestic pork demand coupled with the normal seasonal decline in hog supplies this summer. Hog supplies are unlikely to expand materially until early August, so if demand holds on its current trajectory, price levels could continue upward. It now appears as though the industry is making some headway in chewing through the burdensome levels of pork in cold storage and that is breathing new life into items such as ribs and bellies. USDA's recent inventory survey found modest reductions in the breeding herd as of June 1 and that wasn't surprising given how poor producer margins were earlier in the year. However, producers are now on the cusp of realizing modest positive margins for the first time since last August and that could temper the impetus for herd reduction this fall.

> **Pork demand** seems to be **recovering well** from the dismal showing earlier this year

SUPPLY PICTURE

This is the time of year when the supply of market hogs typically reaches a low point. Last week's slaughter registered 2.33 million head and this week the Independence Day holiday is likely to shrink the kill down to 2.0 million head or less. From there, slaughter should hover around 2.3 million head per week until early August when larger numbers should become evident. However, the kills we have seen recently have been larger than what USDA's estimate of the Dec/Feb pig crop implied. If that holds, it will be the third quarter in a row where the pig crop was under-estimated. In the survey released last week, USDA pegged the March/May pig crop at 32.89 million head, up 0.8% YOY. Those are the hogs that will come to slaughter in the Sep/Nov quarter. The survey also revealed a strong jump in pigs per litter, signaling that productivity is on the rebound after a couple of soft years. There are concerns that the survey underestimated the number of sows farrowing and that makes us think that the pig crop estimate may once again be too low.

Even though we are seeing slightly more hogs come to slaughter this summer than last, pork production is actually lower YOY due to lower carcass weights. The latest federally inspected carcass weight data put barrow and gilt weights down 1.9% from last year and that continues a string of YOY declines that has been in place for all of 2023. Exceptionally poor margins this spring kept producers eager to market their hogs and so they were probably getting pushed out of the door a little quicker than normal. That kept the hog pipeline rather lean and now packers are having to compete vigorously to acquire any hogs they need in the spot market. As evidence of how current the hog supply is, our de-trended and de-seasonalized carcass weights are now at the lowest level on record (**Figure 1**).

> **Carcass weights are exceptionally light**, suggesting that the production pipeline is very lean at present

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Packers typically see their smallest profit margins of the year during the middle of summer when hog supplies are at their low point, and that will likely be true this year. However, improving pork demand has lifted margins across the supply chain and packers have been able to keep their margins slightly positive so far this summer. Producers have seen the biggest margin gains, going from -$65/head in April to near breakeven today. There has been much speculation about poor margins causing liquidation of breeding stock and we did see some of that in the most recent *Hogs and Pigs* report, but with price levels and profits looking better with each passing week, producers may now have new hope and thus curtail their plans for reductions in the breeding herd.

DEMAND SITUATION

The improved tone in the hog and pork sector is partly due to seasonally shrinking supplies, but demand improvement has probably been the more dominant feature. In that regard, spiking wholesale beef prices this spring and early summer have probably shifted some protein demand in pork's direction. Pork also holds a significant price advantage to beef at the retail level and now that the major beef holidays (Memorial Day and Father's Day) are behind us, consumers may be more inclined to substitute cheaper pork for pricey beef. USDA's recent report on cold storage stocks indicated that frozen pork inventories at the end of May were almost 4% below last year (**Figure 2**). That is the first YOY decline since February of 2022. Clearing out a big chunk of frozen stocks has forced more buyers into the spot market and thus helped improve demand for fresh product. That has been particularly important for ribs and bellies. Pork belly prices have been unusually soft since last fall, but it now looks like they are gaining traction and building upward momentum. That has been a key component in pushing the cutout higher. Hams are another item that warrant watching. Processing demand for deli meat normally runs strong through July and if that repeats again this year, we could end up with both ham and belly prices increasing at the same time. So far, the Prop 12 issue hasn't affected fresh pork demand very much and it may have even boosted demand in late June as California buyers sought to own product before the law went into effect. USDA is reporting Prop 12 compliant pork in its weekly "specialty pork" report and so those higher-priced items are not making their way into the regular cutout that gets reported twice a day. There could be a delayed effect from Prop 12 yet to come, but that might not become apparent until hog supplies begin to increase seasonally in the fall.

Prop 12 is now in effect,
but has not yet created any market disruptions

International demand for US pork continues to be healthy, even as pork prices have been rising. We are watching movement to Mexico closely as it seems to be slipping from strong levels this spring. Hams will be the item most affected if Mexican buying cools further. China remains a significant buyer of US pork, although the quantity is well below what we saw during the height of their ASF crisis. We continue to see very strong demand for US pork from countries in the "others" category and that is a very good sign since it indicates a broadening reach for US products.

SUMMARY

The economic recovery in the US hog and pork sector has been picking up steam recently. Cold storage stocks are being whittled down from unusually high levels, thus removing one of the biggest burdens on price levels. With less frozen product available, more buyers are having to engage with the fresh spot market and that has been beneficial for price levels. The supply of market ready hogs is near its seasonal low point and that has also been supportive to pricing. Hog carcass weights tell a story of very current hog barns that has also helped the producer's cause. Margins in the production sector have gone from awful levels this spring to near breakeven today. USDA recently reported a modest decline in the hog breeding herd as of June 1. Further liquidation is still likely in ensuing quarters, but the dramatic improvement in producer profitability may temper the amount of the reduction. There are still unknowns that pose risks, the biggest of which is California's Prop 12 law that went into effect on July 1. Right now, the law isn't being actively enforced, so the market disruption has been minimal, but that could change in the months ahead. For now though, it is a story of improving fundamentals and the recovery of a sector that was on the ropes just a few months back. Peak pricing is probably not far away, so buyers should concentrate forward pricing efforts on the short run, especially since the full effect of Prop 12 on prices has not yet been realized. **Table 1** provides our near-term price forecasts.

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Figure 1: Detrended & Deseasonalized Barrow & Gilt Carcass Weights

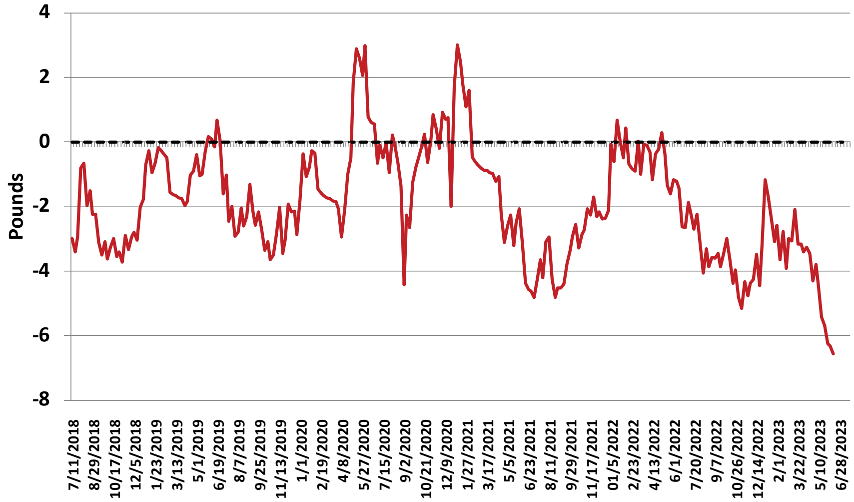

Figure 2: Total Pork in Cold Storage

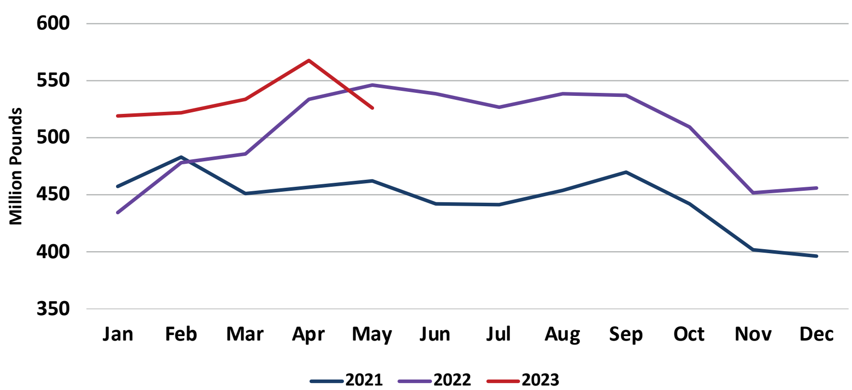

Table 1: JSF Hog and Pork Price Forecasts

	12-Jul	19-Jul	26-Jul	2-Aug	9-Aug	16-Aug
Pork Cutout	103.1	102.0	100.8	99.4	98.1	98.3
Loin Primal	95.7	96.2	94.4	92.2	90.9	91.5
Butt Primal	161.3	153.9	147.7	145.1	143.3	141.1
Picnic Primal	85.7	86.8	87.0	83.9	80.8	78.9
Rib Primal	158.5	152.2	145.0	140.5	134.9	130.0
Ham Primal	92.7	88.6	87.8	86.1	84.1	84.8
Belly Primal	118.1	122.3	125.1	128.3	130.7	134.1
Lean Hog Index	98.1	97.7	97.0	96.4	96.0	96.1

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