VOLUME 6,
ISSUE 8

J.S. FERRARO

THE MONTHLY

AUGUST 2023

RED MEAT OUTLOOK: HOGS & PORK

The price recovery in the hog and pork sector continued during July to the point where the cutout has now tested the $115/cwt. level. It does look like the gains are slowing however, and the markets could be in the process of making a top over the next couple of weeks and then beginning their normal seasonal decline as hog and pork supplies rebound. This recovery has been a remarkable one that saw producer margins go from a low near -$65/head this spring to almost +$20/head last week (**Figure 1**). True, some of that margin gain can be traced back to reductions in feed costs, particularly corn, but the lion's share has come from strong improvements in hog prices. Last week, the Western Corn Belt negotiated hog market averaged over $105/cwt., which is a $35/cwt. improvement over the prices that producers were getting back in April. The summer market has turned out to be softer than in the past couple of years, but way better than we expected back in the spring. However, we have now reached the point in the calendar when hog supplies start to increase seasonally and that will likely be the dominant factor in pricing as we move through August and into September. Pork still enjoys a significant price advantage over beef in the retail meat case and that may be sufficient to keep demand from wilting too much over the near term. In our opinion, futures traders are overly pessimistic about the market this fall and for 2024, particularly if producers carry through on plans to reduce the breeding herd.

SUPPLY PICTURE

Looking back, it now appears that the smallest non-holiday weekly harvest of 2023 was 2.32 million head, registered in the third week of July. It seems unlikely that any of the weekly kills during August will be that low. We see slaughter progressing from about 2.4 million head per week at the beginning of August to just over 2.5 million head at the end of the month. It will be difficult for hog and pork prices to appreciate in that environment. When September rolls around, the industry will begin slaughtering the March/May pig crop, which USDA recently estimated to be 0.8% larger than last year. Given the propensity of USDA's survey recently to underestimate pig crop size, it seems that we should expect kills during the Sep/Nov quarter to be at least 1% stronger than last year and 1.5% might be more likely.

> **Weekly slaughter should** expand **back to 2.5 million head** before the end of August

Hog weights haven't yet reached their seasonal low yet but are getting very close to it. Dressed weights for barrows and gilts were last reported at 207 pounds and the forecast has another 1-2 pounds of decline built in before weights turn seasonally higher. A heat wave in the Midwest that began last week has the potential to take hog weights lower than what we have forecasted, but that wouldn't show up in the data for at least another couple of weeks. Our sense is that producers are still very current in their marketings and the de-trended and de-seasonalized weights confirm this. That raises the risk that the heat wave presents and thus could keep negotiated hog prices firm for longer than expected.

Back in the spring, there was a general consensus in the industry that the hog herd needed to shrink in order to restore profitability to producers. Now that producers are earning decent positive margins, some of the incentive to reduce the breeding herd has been alleviated. Will producers follow through on their plans

> **Hog production margins have turned solidly positive** and that could cause producers to re-think liquidation plans

jsferraro.com | 130 Adelaide Street West, Suite 3302 Toronto, Ontario M5H 3P5 | 416.306.8788

to liquidate sows this fall, or will they roll the dice and assume that improved pork demand will be sufficient to keep them afloat without further herd reductions? We think that modest liquidation will still occur over the next few quarters, partly as a result of huge losses earlier this year, but also partly due to headwinds such as Prop 12 compliance and seemingly softer export demand for US pork. Packer margins, at over $12/head last week, are unusually large for this time of year. That alone tells us that the hog supply is too large and further reductions are needed so that producers can reclaim some of the margin that is currently going to packers.

DEMAND SITUATION

Domestic pork demand has been steadily improving since spring and that is evidenced by our demand index for the cutout, which tracked near 0.95 during July after a dismal 0.82 showing back in April. At the same time, the combined margin indicator has been steadily rising since April. The fact that beef prices at retail have been rising while retail pork prices have been declining, has probably been beneficial to domestic pork demand. In addition, there has probably been some amount of trading down by consumers who are feeling a budget pinch due to continuing inflation in the general economy. That said, it does look like the current demand cycle is nearing a top and will probably turn lower by the middle or end of August. When that happens, the market will be faced with the double whammy of increasing supplies and decreasing demand, resulting in pork prices trending lower. The October futures contract has been reflecting this expectation by carrying a steep $17-19 discount to the August contract. We think that the price decline won't be quite that severe, but that prices will move lower, with bigger declines coming after Labor Day and smaller ones before the holiday. As a result, buyers would do well not to extend coverage much beyond the end of August, unless packers are willing to offer exceptionally low forward pricing consistent with the big discount in the futures market. In general however, it looks like domestic pork demand is now well on its way to returning to normal after taking a gut punch back in the spring. With beef prices expected to reach stratospheric levels in the next two years due to ongoing herd liquidation, the longer-term prospects for pork demand appear very good.

However, there are some gray clouds forming on the demand side because recent export volumes have looked a little weak and forward sales into export channels are soft as well. It isn't unusual to see exports taper off in the middle of summer when US pork prices are typically at their highest, so this may just be a short-term dip that will recover once production increases in the fall and prices are at lower levels. The biggest concern arises from Mexico, our largest international customer. The weekly FAS data was showing pork exports to Mexico at around 13-15k MT per week during the first half of 2023, but recently that has fallen to 7-8k MT per week and is about 30% below last year (**Figure 2**). Mexico is experiencing some relatively high hog and pork prices this summer, so the big drop in exports s somewhat puzzling and might be due to a data error of some type.

The uptrend in hog and pork prices appears to be stalling and could **turn lower soon**

SUMMARY

The industry has made great strides this summer in clawing back out of the deep, dark hole that it found itself in this spring. Producer margins are now positive by about $20/head and packer margins are better-than-expected for this time of year at $12/head. Hog slaughter has continued to come in larger than what prior pig crops implied this summer, but packers have done a very good job of managing supplies. The current upcycle in demand looks like it is nearing a top and is expected to turn lower soon. That will coincide with the normal seasonal increase in hog supplies and thus prices are expected to turn lower. That said, the futures board looks overly pessimistic with respect to pricing this fall and for much of 2024, particularly if producers follow through on plans to reduce their breeding herds. International demand appears to have hit a soft spot here in late summer that might be temporary, but bears watching because export markets can have a sizable impact on US hog and pork pricing. So far, the implementation of Prop 12 has not played out the way many traders assumed, as hog and pork prices have done nothing but get stronger since it went into effect on July 1. However, it is too early to assume that Prop 12 won't impact the market at all. If there is going to be a price-depressing effect from Prop 12, we would expect it to be more evident late in the year when hog and pork supplies are seasonally large and California officials are more focused on enforcement than they are now. **Table 1** provides our near-term price forecasts.

Figure 1: Estimated Hog Producer Margins, 2023

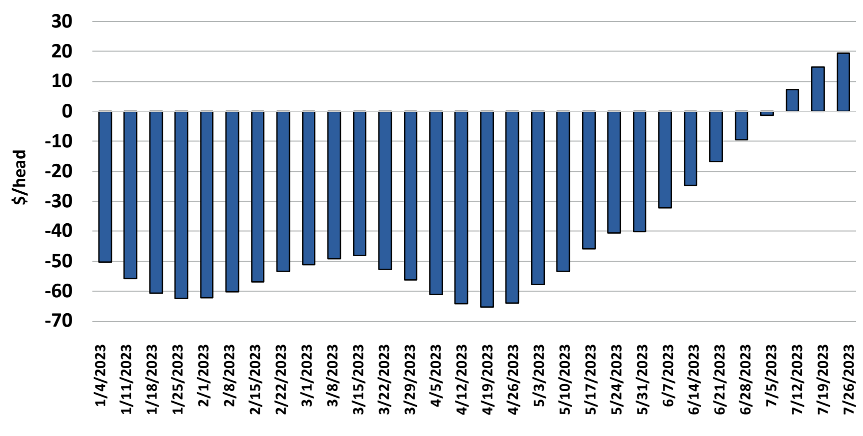

Figure 2: Weekly Pork Exports to Mexico

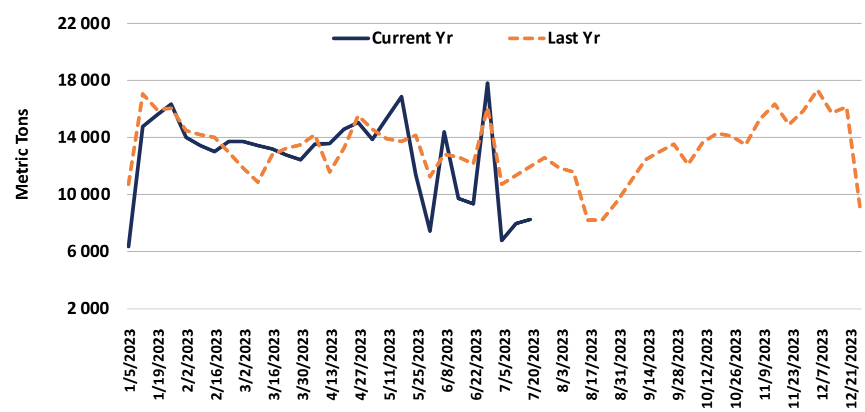

Table 1: JSF Hog and Pork Price Forecasts

	9-Aug	16-Aug	23-Aug	30-Aug	6-Sep	13-Sep
Pork Cutout	115.6	113.6	110.9	107.0	103.6	100.8
Loin Primal	102.2	100.5	96.6	95.4	94.7	92.4
Butt Primal	104.1	105.3	105.6	107.1	106.0	107.6
Picnic Primal	78.9	80.0	78.6	77.8	75.2	73.6
Rib Primal	116.4	118.0	121.3	119.4	121.4	120.6
Ham Primal	97.5	94.3	93.1	88.2	87.2	83.7
Belly Primal	227.0	220.5	212.1	198.5	182.9	175.9
Lean Hog Index	107.2	105.4	103.2	100.4	97.6	94.7

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro

E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 32 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.

SUBSCRIBE NOW to receive our monthly edition