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THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

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During November, prices in the US hog and pork complex remained on their soft glidepath lower. The pork cutout declined from around $87 at the beginning of the month to near $84 currently. The main supply side feature that stands out is that the supply of market hogs continues to be larger than expected. This was evidenced last week by slaughter that totaled slightly over 2.7 million head. If USDA's estimate of the March/May pig crop was correct, the top in slaughter should have been not much larger than 2.6 million per week. The big supply of market ready hogs has provided packers with more leverage in price negotiations as producers struggle to make sure every animal has a spot on the slaughter schedule. As a result, packer margins are now approaching $25/head, which is well above the single digit margins that were posted last year at this time. Unfortunately, pork demand remains quite soft and that kept prices inching lower and pushed producer margins deeper into the red. This is the market's way of saying that there is too much production out there for the current level of demand. Producers are getting that message and appear to be actively trimming back the breeding herd, but strong productivity has largely offset that effort. At this point, there are two potential paths to restore industry profitability. One is for demand to improve to a level that allows more margin to be shared by players in the supply chain. That could certainly happen since demand is very weak at the moment and demand is something that tends to run in cycles. The other is that producers slash the breeding herd even more aggressively to better match the level of demand. Perhaps the most likely path forward involves a combination of the two that eventually generates price improvement.

> **The March/May pig crop** was estimated **up 1% YOY**, but recent slaughter suggests it was really 2.5% larger

SUPPLY PICTURE

When we reported the 2.68 million head weekly kill last month, it was hard to imagine another weekly kill exceeding that level, but the industry surprised us last week with a slaughter that was estimated at just over 2.7 million head. Hopefully, that will be the high-water mark for 2023. As we move into the Dec/Feb quarter, the industry will transition to processing the Jun/Aug pig crop, which USDA estimated to be up 0.4% from last year. However, USDA estimated the March/May pig crop to be up 1% and actual slaughter during Sep/Nov makes it look like that pig crop was actually up close to 2.5%. That is a fairly significant miss and if the Jun/Aug pig crop was also underestimated by a similar amount, then we can expect strong slaughter levels to continue through most of Q1. Our current projections suggest weekly kills near 2.65 million head for the weeks prior to Christmas and then slaughter closer to 2.6 million per week in early January.

Even though the supply of hogs coming to market is larger than expected and that has caused soft pricing in the cash hog market, producers are not fighting against the situation and have kept their marketings high. As a result, the probability of hogs backing up in the pipeline seems rather small at present. Barrow and gilt carcass weights are in their normal seasonal up-trend but are still running two pounds below last year. However, weights probably won't reach a top until near the end of December and by then it is likely that the gap between this year and last will have evaporated. Hog supplies will stay large in early Q1, so it is imperative that producers continue to market aggressively in order to prevent backlogging. We think that they understand that, but doing so might require lower hog prices than we originally envisioned for the early part of next year.

The hog industry has a profitability problem and seems to recognize that fact. Sow slaughter in the recently completed Sep/Nov quarter was about 62,000 head above what we would normally expect given the size of the breeding herd at the beginning of the quarter (**Figure 1**). So, producers are actively downsizing. However, in that process they are getting rid of the least productive sows and retaining the more productive ones which creates strong gains in productivity. In order to make meaningful progress in downsizing the production potential and restoring margins, producers may need to undertake a much deeper culling than what has transpired so far. The market is adept at sending the appropriate signals to make that happen and in this case the signal is coming in the form of producer margins that are currently around $35/head in the red. For 2023 as a whole, we estimate that producer losses will be close to $30 per head. That is by far the worst annual margin in our dataset that goes back to 2007. Who wants to be in a business where you lose $30 on every item sold for an entire year? Clearly it is time for some producers to exit the business and focus on something else.

There is still much work to be done in **reducing the hog herd** to better fit with **soft consumer demand**

DEMAND SITUATION

Last month we warned about the potential for "pork fatigue" to set in as consumers are asked to consume large production for weeks on end. We are probably experiencing some of that right now and it could get a little worse in the next couple of weeks. Bellies, in particular, are the weak sister of the pork complex right now. The belly primal averaged close to $101/cwt in November, but recently it has been reported as low as $84/cwt. (**Figure 2**). That isn't quite as bad as what we saw back in the spring, but it is close. Cold storage stocks are not burdensome at present, so one might expect belly users to be building stocks while prices are low in anticipation of higher pricing next spring and summer. Some stock building is underway, but so far it has been too light to have a material impact on price levels. Ham demand appears to be in much better shape, and we've seen some modest price gains there over the last few weeks. Still, that hasn't been enough to completely offset the weakness in bellies and the retail items, so the cutout has been slowly working lower. Normally we see ham demand crash around mid-December as processors have less need for raw materials over the holiday weeks. If that happens this year, it will take away the strongest leg of support and would likely drive the cutout lower. Demand hasn't strengthened post-Thanksgiving like it sometimes does, so it is beginning to look like the cutout may remain on a downward trajectory through the balance of 2023. Retail buyers should remain close bought in anticipation of further price slippage in those items but should be on guard for some price increases after the holidays when availability will tighten up modestly.

Soft demand for bellies remains an **ongoing concern**

Low prices across the pork complex have been supportive to pork exports. In particular, movement to Japan and S. Korea has been very strong recently. These are the same two countries that have seen exceptionally weak demand for US beef, so perhaps the fact that relative wholesale pricing favors pork strongly at the moment is driving some international demand away from beef and towards pork. China seems to be the exception, as soft economic conditions there are leading to declining demand for both beef and pork simultaneously. Right now, the US has some of the cheapest pork on the planet, so that should foster good international demand until something changes.

SUMMARY

It is starting to look less likely that the pork complex will experience the bump in demand that would be needed to lift the cutout post-Thanksgiving. Instead, larger-than-expected slaughter levels are an ongoing concern and that could be enough to keep the cutout slowly drifting lower through December. Belly demand is particularly weak at the moment, and it is hard to imagine much lift occurring in the cutout without some improvement there. Still, we know that demand runs in cycles and perhaps the cycle will turn higher after the holidays and produce some price gains. Producers remain in a terrible financial bind, with margins now more than $35/head in the red. It looks like the industry will need to undertake much sharper reductions in the breeding herd than originally anticipated if profitability is to be restored. Packers are doing better than expected, with margins now close to +$25/head — a result of large hog supplies and limited packing capacity. The balance of power between packers and producers should improve modestly as the calendar turns to January and hog supplies start to moderate seasonally. However, meaningful improvement in the prospects for industry-wide profit improvement will require some demand recovery in combination with sharp reductions in the hog herd. That will take some time to accomplish and for now, pork buyers can probably be comfortable remaining close bought as the risk of substantial price gains appears rather low. **Table 1** provides our near-term price forecasts.

Figure 1: 2023Q4 Sep/Nov

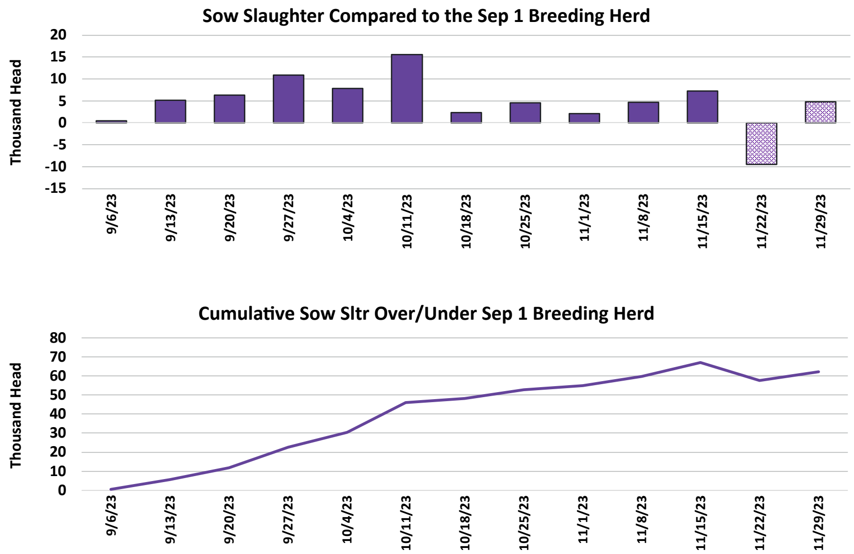

Figure 2: Belly Primal

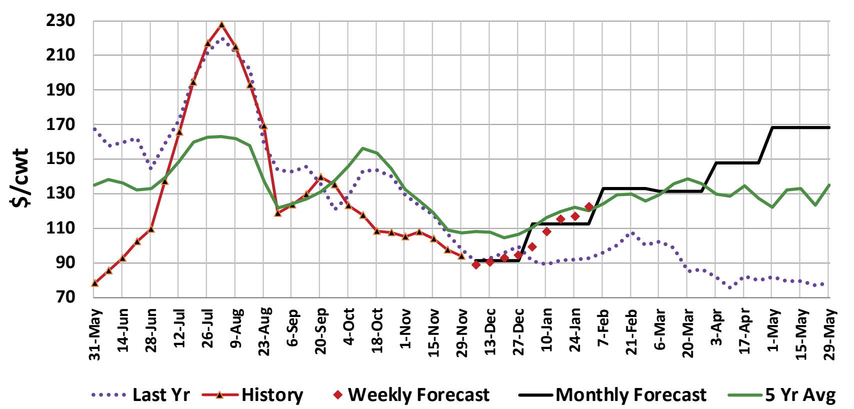

Table 1: JSF Hog and Pork Price Forecasts

	13-Dec	20-Dec	27-Dec	3-Jan	10-Jan	17-Jan
Pork Cutout	84.1	83.1	82.0	82.8	82.4	82.5
Loin Primal	83.4	85.6	87.3	87.2	86.0	84.5
Butt Primal	102.8	101.9	97.4	98.8	96.2	94.0
Picnic Primal	77.8	75.4	71.8	66.8	59.7	57.1
Rib Primal	114.0	115.4	116.3	118.7	120.2	123.0
Ham Primal	84.0	77.6	73.7	75.3	73.1	71.7
Belly Primal	90.3	92.8	94.5	99.3	108.0	115.3
Lean Hog Index	70.5	70.8	71.3	72.6	73.4	73.9

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