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J.S. FERRARO & COMPANY | RETAIL READY Foods Inc.

THE MONTHLY

RED MEAT OUTLOOK: HOGS & PORK

APRIL 2019

What a difference a month can make! The US hog and pork markets have gone completely berserk since our last issue of the Red Meat Outlook (RMO). In our March RMO the pork market was lethargic and drifting lower under the weight of big supplies and soft demand. The mayhem began on March 7, when the weekly USDA report on pork exports was released and showed a huge volume of pork forward sold into China. Several analysts latched on to this big number and proclaimed that China, because of their losses to African Swine Fever (ASF), was now going to import huge quantities of US pork. The futures shot higher and continued higher for several days in a row. That set off a panic in the cash hog and pork markets that is still reverberating today. Pork buyers, who had become complacent while pork prices were drifting lower, suddenly rushed into the cash market seeking to buy product and jolting the cutout higher. Hog producers, watching what was going on in the futures and pork markets, demanded sharply higher money for their hogs. What resulted was a self-reinforcing feedback loop where futures continued higher because pork and hogs were rising rapidly and the higher the futures got, the more panicked pork buyers became and they chased the cutout even higher. On March 22, the June lean hog futures traded very close to $98, up $22 from where it was before the episode started just two weeks earlier. Since March 22, the futures have retraced about half of that move **(Figure 1)**. Why? Because this hysteria requires a constant diet of supporting news and that eventually dried up. We never bought into the idea that June hogs were worth $98, or anything close to that. The facts are this: China is importing more pork from the US—about on the level of what South Korea normally takes. However, there has been a substantial dropoff in exports to Japan, S. Korea and Mexico, the three biggest destinations for US pork. So, total pork exports are up only about 10%. That is price supportive for sure, but its not worth nearly the $22 that the market wanted to add to the price of hogs. The Chinese have lots of options to deal with their pork shortfall. They can import from the EU, Canada or Brazil. They can consume a protein other than pork, or cut back on the amount of animal protein they consume. China is long been a sporadic buyer of US pork, often stepping into the market to make a big buy and then disappearing. It's beginning to look like that is just what happened since USDA hasn't reported further huge forward sales to China since that March 7 report. Yes, we do think that China's herd has been reduced substantially because of ASF, but probably not to the degree that some reports (which want to peg the losses at up to 20%) have suggested. China will probably continue to take bigger-than-normal amounts of product from the US, but it won't be earth-shattering. Futures traders grossly over-reacted to the situation and now reality is beginning to set in. The net result is that this recent wave of "hog hysteria" has destabilized the whole complex. Buyers and sellers are not sure what to think or what the future holds and that makes it likely that prices in all three markets: cash hogs, pork, and futures, will remain volatile for months to come. The nature of this situation also makes it likely that it will happen again any time there is a hint of an uptick in pork exports to China. Our suggestion is to ignore the hype and fear and concentrate on the facts.

A sharp rally in hog futures sent pork buyers into a panic, boosting the cutout

SUPPLY PICTURE

Weekly hog kills in March averaged about 2.5 million head per week, about 4% higher than in March 2018. For the month, that was about 100,000 head more than what the reported Sep/Nov pig crop indicated **(Figure 2)**. So, the industry has been over-killing slightly, but not enough to cause serious problems. In order to attract those hogs away from producers however, packers had to escalate cash hog prices considerably. Further, when producers see the futures market indicating sharply higher hog prices in the future, their tendency is to slow down marketings and try to hold hogs back from slaughter where they can. This may have created a small amount of backlog in the marketing chain, but now that the futures are retracing, producers should be more eager to keep the hogs moving.

Hog weights haven't shown much indication of a backup so far. Our detrended and de-seasonalized carcass weights are still negative by a small amount so it appears that producers are still relatively current in their marketings. Kills should taper down in April and even further in May. Our slaughter forecast has kills falling to about 2.4 million head per week by the end of April and 2.15 million head per week by the end of May. This is a normal seasonal trend. USDA released their quarterly Hogs & Pigs report last week and it showed the breeding herd expanded 2% year-over-year

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and the Dec/Feb pig crop up close to 3%. That pig crop was a little smaller than our forecast, but it still suggests that there will be ample hog supplies in the Jun/Aug quarter when those pigs are scheduled to be slaughtered.

DEMAND SITUATION

Recent events have made it difficult to discern where domestic demand currently stands. Using our traditional methods of assessing demand, it would appear that demand is red hot because prices soared while quantity sold didn't change very much. But that is purely due to the panic buying in response to the surging futures market. That type of demand is normally transitory and not reflective of the level of demand that would have registered had the futures not gone haywire. Our sense is that buyers will take a "better safe than sorry" approach and try to keep more product around them in these uncertain times. That should result in a better domestic demand scenario, probably right through summer. Needless to say, the demand "air pocket" that we described last month is long gone.

Figure 1: Jun 19 Lean Hog Futures

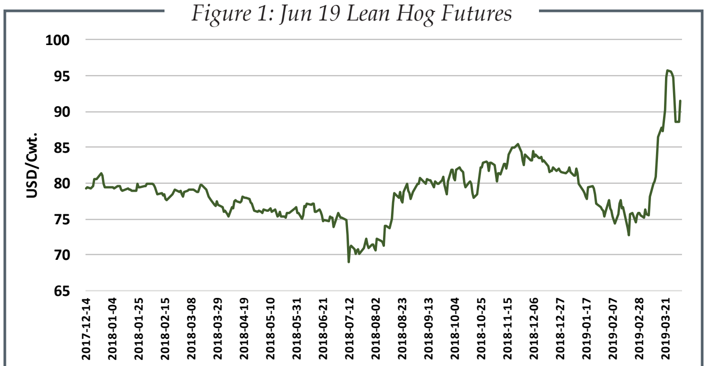

Figure 2: 2019Q2 Hog Sltr Over/Under Pig Crop Projection

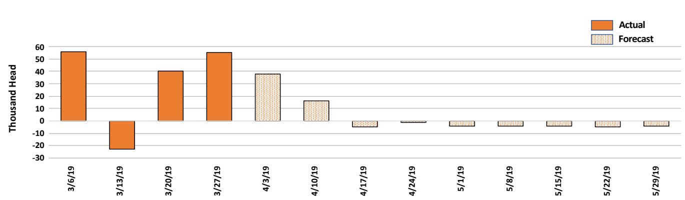

Table 1: JSF Hog and Pork Price Forecasts

	10-Apr	17-Apr	24-Apr	1-May	8-May	15-May
Pork Cutout	76.9	75.7	74.3	74.3	75.1	76.1
Loin Primal	71.3	72.5	72.4	74.0	74.9	75.8
Butt Primal	81.2	80.1	81.0	81.8	82.7	83.6
Picnic Primal	41.9	41.1	40.7	41.2	42.0	42.7
Rib Primal	126.0	126.3	128.0	129.7	132.0	133.9
Ham Primal	62.7	59.9	57.3	55.9	56.2	57.1
Belly Primal	135.4	131.3	125.4	124.0	125.3	126.6
Lean Hog Index	69.6	66.8	66.2	67.5	69.0	71.0

International demand is the real wild card here. On one hand we have China obviously taking more product out of the US, but we also have seen export slowdowns to other major destinations. And, now with prices much higher than they were just a few weeks ago, overseas buyers may be further discouraged from looking to the US for pork. Another thing to note is that all of the tariffs are based on a percentage of the purchase price, so as prices rise so does the absolute value of the tariff. China currently imposes about a 70% tariff on US pork and Mexico has a 20% tariff in place. For now, our forecasts have pork exports in calendar 2019 not too far different from 2018. That could change of course, but we will need to see more sustained large volume purchases out of China before adjusting exports upward. The advice to buyers is to try and refrain from ***panic buying***. Pork prices will certainly be higher this summer than they were in Q1, but that is the case every year. Base purchasing decisions on observable facts and don't be swayed by emotion.

> Pork **exports to China are up**, movement to other countries lags

SUMMARY

The US hog and pork complex is in a wild state of flux brought on by fears that China will gobble up large quantities of US pork. To date, those fears are largely unsupported by the data, but the potential for it must be respected. We can expect US pork production to be about 3% larger than last year in April and probably right on through the summer. Unless pork exports grow considerably from current levels the market should be well supplied. Economic slowdowns outside of the US have the potential to crimp pork exports in the coming months, but ASF in China has the potential to do the opposite. Accurate forecasting in these unsettled and highly volatile markets is very difficult, but we are willing to take a stab at it. Our weekly price forecasts through April can be found in **Table 1**.

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