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THE MONTHLY RED MEAT OUTLOOK: HOGS & PORK

FEBRUARY 2019

Cash hog prices bottomed in late December and then worked higher through mid-January. Since then, price levels have stalled and have been mostly sideways over the past couple of weeks. That price action seemed a bit odd since most analysts, as well as the futures market, had expected prices to continue higher right into February. One big reason that hog prices haven't been able to get much traction lately is that the pork cutout has struggled under the weight of bigger-than-expected production and softer-than-expected demand. Pork packer margins have remained relatively large through January and are averaging about \$15/hd as we head into February. During the first five weeks of 2019, packer margins averaged about \$4/hd above the same period last year. This has provided plenty of financial incentive for packers to slaughter hogs aggressively and the resulting large pork production has exerted pressure on the cutout. As we look forward, there are concerns on both the supply and demand sides of the market and the futures market has taken note, with the tone there turning much more bearish in the last few weeks.

Weekly kills in January ran **5-6%**
above last year

SUPPLY PICTURE

The hogs that are currently being killed in the Dec-Feb quarter were farrowed during the Jun-Aug quarter last summer. USDA's surveys estimated that the Jun-Aug pig crop was 3.3% larger than the same period a year prior. Thus, as a rough estimate, we would expect barrow and gilt slaughter during the Dec-Feb quarter to be up roughly 3.3%. So far during the quarter, total slaughter, which includes sows, is up about 2.8%. On the surface, it looks like slaughter is tracking fairly close to the pig crop estimate, but concerns were raised in early January when we began to see weekly kills that were 5-6% above last year. Market participants began to worry that perhaps USDA had understated the Jun-Aug pig crop and there were possibly more hogs in the supply chain than expected. The polar vortex that descended upon the Central US last week caused some packing plants to close for a day or more. Although packers tried to make up that lost production with a large Saturday kill, the weekly total last week fell

to 2.39 million head, about 2% below year-ago. That sharp reduction in kill will be felt this week with reduced pork availability and may help to stem the slide in the cutout that has been in place since mid-December.

This week's slaughter level will be very telling. If it bounces back up to 2.5 million head or more, then the supply concerns will re-surface and traders will once again expect that USDA has under-estimated the number of hogs becoming market-ready during February. Our calculations indicate that kills need to average 2.42 million head during this month in order to line-up with the pig crop estimate. We have been without official carcass weight data from USDA as a result of the government shutdown that began in late December and ended on January 25. Without this data, it is difficult to ascertain if hog producers are remaining current in their marketings or if hogs are starting to back up. Some of the liveweight data that we have been able to obtain seems to point to marginally increasing carcass weights and the possibility that hog producers are slowly falling behind in their marketings. The government is working to provide users with the missed carcass weight data, but it looks like they won't be caught up until perhaps the third week of February. Until then, we will still be somewhat in the dark as to how well producers have done at keeping hogs flowing through the supply chain. The next *Hogs and Pigs* report will be released on March 28 and we expect it will show the Dec-Feb pig crop was up 4.1%. These are hogs that will be slaughtered this summer between June and August. International trade data has been another casualty of the government shutdown and, while we believe that pork exports have remained good, it is impossible to know until the government publishes the missing data.

DEMAND SITUATION

Pork demand in the US appears to be struggling. Retailers continue to favor beef over both chicken and pork, and that has hurt consumer demand for pork. In addition to the scatter diagrams that we typically use to illustrate pork demand, we also use total supply chain margins as an indicator of demand. The idea is this: when consumer demand is strong it lifts pork prices and allows both packers *and* producers to make a good margin. The opposite is true when consumer demand is soft. **Figure 1** provides producer and packer margins along with the combined margin. Notice the two 2018 valleys on this chart, one in April 2018 and another in August 2018. These were two periods of very soft consumer demand for pork — a *pork demand*

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“air pocket” if you will. Now notice that the combined margin has been trending lower since late December and that raises concerns that perhaps consumer demand has hit another air pocket. The rate of descent hasn’t been as steep as what we saw back in April and August, but it is pretty clear that consumer demand is not very strong. Some of that is probably seasonal, since demand for all meats tends to soften after the holidays as consumers have to shift expenditures to cover bills that come due post-Christmas.

It looks like this soft demand environment will be with us for a few more weeks at least. As March approaches and the weather warms, demand should improve considerably. That will be the beginning of the spring grilling season and fresh pork often does well as consumers return to their grills after a long winter indoors. We really haven’t seen a strong increase in pork loin features, which is typical at this time of year. Retailers seem to still prefer beef over pork. However, they do so at the risk of endangering their margins since the spread between beef and pork prices is exceptionally wide. **Figure 2** illustrates the spread between the Blended beef cutout and the pork cutout. At present, it is more than \$20 over last year’s level and nearly \$40 over 2017.

Spread between beef and pork prices exceptionally wide

That provides a lot of financial incentive for retailers to pivot to pork for their retail ads. If they do, then that could help pull domestic pork demand out of the slump that we’ve seen in recent weeks.

A quick note on African Swine Fever (ASF) in China. Cases continue to be reported, but so far there has been little or no impact on international pork markets due to the spread of this disease. We think that it may never make much of an impact, but if it does, it might not materialize until early 2020 and so won’t be much of a factor to the US market this year. Futures traders seem to be coming around to this realization as much of the ASF premium that had been embedded in deferred lean hog futures has faded recently.

SUMMARY

The supply side of the market is a little unsettled with kills during January coming in larger than expected. Seasonally, hog supplies should taper down as we move through February but there is a risk that weather-related disruptions have put producers a bit behind on their marketings. Packer margins remain very good and that should keep packers wanting to kill all of the hogs they can get their hands on. Domestic pork demand looks a little soft at present and February is normally a soft demand month. As we get closer to March, demand should improve and help to pull the cutout out of its current malaise. Buyers may want to get ahead of this by extending coverage into March and April while hog and pork prices are still relatively low. **Table 1** gives our current price projections and shows the Lean Hog Index at February expiration near \$58.50.

Figure 1: Pork Supply Chain Margins

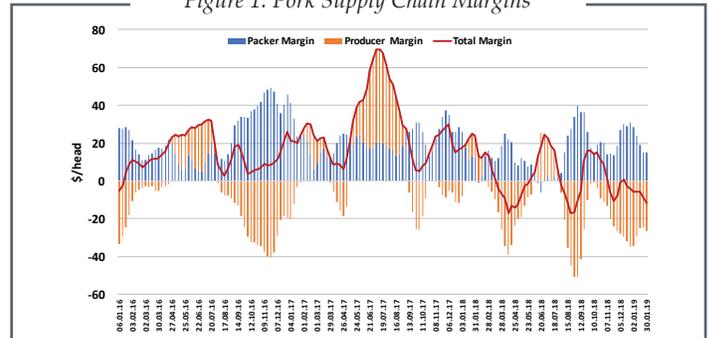


Figure 2: Blended Beef Cutout Minus Pork Cutout

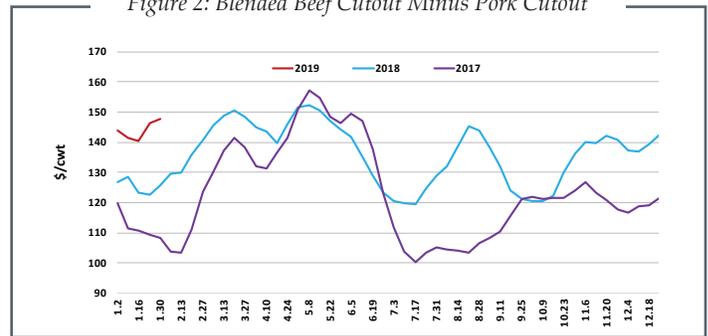


Table 1: JSF Hog and Pork Price Forecasts

	13-Feb	20-Feb	27-Feb	6-Mar	13-Mar	20-Mar
Pork Cutout	68.5	68.7	69.9	71.3	73.4	74.6
Loin Primal	68.3	68.6	69.7	71.1	73.8	75.2
Butt Primal	75.3	77.9	80.6	82.0	84.0	87.7
Picnic Primal	41.2	42.6	43.6	44.9	46.0	47.2
Rib Primal	130.4	130.1	129.5	130.3	131.8	130.2
Ham Primal	49.9	49.8	51.6	52.0	53.5	54.0
Belly Primal	110.2	107.9	108.6	112.0	116.0	117.4
Lean Hog Index	58.5	59.8	61.7	63.1	64.3	66.1



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