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THE MONTHLY RED MEAT OUTLOOK: HOGS & PORK

JANUARY 2019

Packer margins peak near \$30/hd in December

Pork packer margins finally got back on track in December as cash hog prices trended lower while the cutout actually managed a small gain. At their peak, packer margins in December were about \$30/hd (**Figure 1**). That's well below the December peaks in the past couple of years, but there were additional plants operating this year and that likely contributed to the packer's inability to achieve margins as large as in recent years. Hog availability hasn't been a problem and thus packers have managed to put together fairly large kills outside of holiday weeks. But, the pendulum is now swinging back toward tighter hog availability and that has resulted in some packer margin compression. We expect packer margins to be back down to about \$10/hd by the end of January. It is not unusual for packers to see margins decline in January and February since seasonally soft demand usually limits gains in the cutout but tighter hog supplies often result in hog prices trending higher during that period.

SUPPLY PICTURE

Hog slaughter during December came in pretty close to forecast, with kills running 2.56 to 2.61 million head during the non-holiday weeks. Packers were even able to put together an all-time record kill of 2.74 million head in the week leading up to Christmas. Of course, the holidays brought reduced slaughter, but the industry should be quick to ramp kills back up in early January. Kills are expected to fall back to 2.5 million per week by mid-month and could be closer to 2.4 million at the end of the month. The Sep/Nov pig crop, which are the animals coming to slaughter in the first quarter of 2019, was reported up 2% from the previous year and our calculations suggest that would support weekly average kills of around 2.4 million head through the month of March. Carcass weights are currently very near year-ago levels and may stay pretty close to last year through much of the first quarter. The big kills in December and January should keep hog producers current in their marketings and so we see little risk of hogs backing up in the supply chain. Winter weather affects hogs differently from cattle. Since most hogs are raised

in heated confinement barns, snowstorms and cold weather generally do not have much of an impact on production levels. Instead, winter snowstorms tend to disrupt movement of animals to packing plants and the movement of pork out of packing plants to consumer destinations. Those are typically short-term events that can impact pricing in both the hog and pork markets for a few days but are often resolved fairly quickly. The *Hogs and Pigs* report released last month indicated that the number of hogs held for breeding purposes increased almost 3.5% over the previous year (**Figure 2**) and that does raise some concerns for supply later this year. It is true that there will be an additional slaughter facility operating in 2019 that wasn't there last year, but it would only take about a 1% increase in the breeding herd to support that new facility. The fact that producers increased the breeding herd so sharply seems to indicate

Global slowdown may keep 2019 exports below 2018

that they are expecting further growth in the export markets to soak up the additional production. It's possible that could happen, but we are somewhat skeptical. While we have seen a number of analysts projecting 5-10% growth in exports this year, we are actually looking for a slight decline in exports as the slowdown in the global economy deepens and reduces demand for US pork overseas. If we are right on exports slowing in 2019, then the big increase in the breeding herd (and subsequently pork production) will leave a lot of pork that must clear through domestic channels at lower prices. The futures market has yet to take this into account.

DEMAND SITUATION

Domestic pork demand was lethargic coming into December and didn't improve much by the time the year came to a close. Loins have traded well below last year's level recently and it's clear that many retail features focused more on beef middle meats to the detriment of pork loins. However, Q1 normally sees an increase in pork loin features and perhaps that will help that primal to recover in the next couple of months. Hams

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Figure 1: Estimated Pork Packing Margins

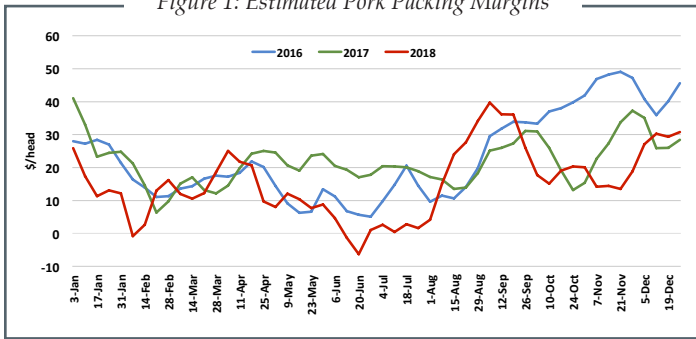


Figure 2: US Breeding Herd by Quarter, 2016-2018

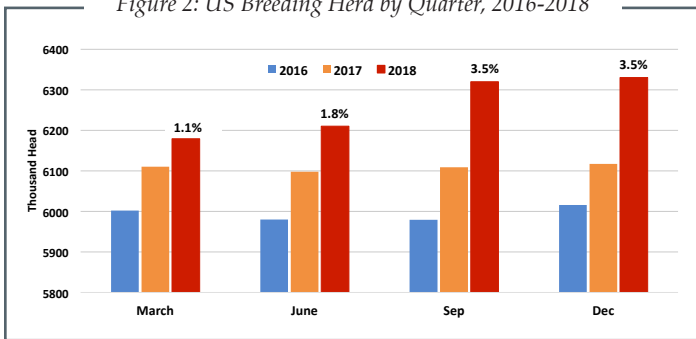


Figure 3: Primal Impact on Pork Cutout from Nov 30, 2018 to Dec 31, 2018

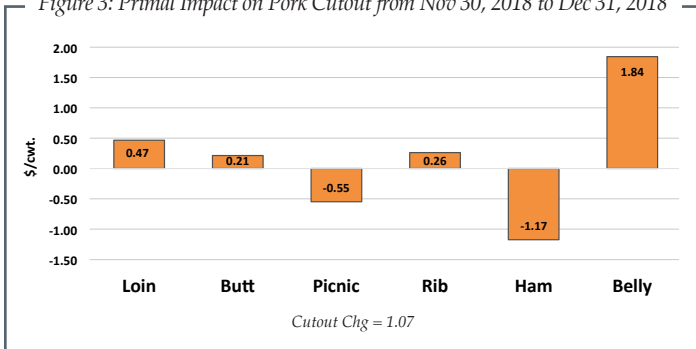


Table 1: JSF Hog and Pork Price Forecasts

	16-Jan	23-Jan	30-Jan	6-Feb	13-Feb	20-Feb
Pork Cutout	72.4	72.1	71.4	70.7	70.0	69.7
Loin Primal	66.4	67.4	68.1	68.5	69.1	69.4
Butt Primal	78.3	77.3	77.8	78.3	79.1	80.0
Picnic Primal	44.6	45.0	45.7	46.6	45.1	45.2
Rib Primal	124.7	124.6	125.4	125.6	126.0	126.9
Ham Primal	47.6	48.2	49.0	50.0	49.2	48.5
Belly Primal	138.2	134.4	126.2	118.2	114.8	112.5
Lean Hog Index	58.9	61.5	62.2	62.3	62.6	62.0

were also a major drag on the cutout during December. Bellies continue to be the star performer of all pork items and the cutout was able to hold its value during December mostly because the belly primal remained strong (Figure 3). At some point here in the near future, high wholesale belly prices will temper retail enthusiasm for bacon features and when that happens the belly primal could come crashing down, taking the cutout with it. We've noted that the global economy appears headed for a slowdown in 2019 and that could temper pork exports this year. Here in the US however, if the macroeconomy starts to weaken, it won't likely hurt pork demand nearly as much as beef. In fact, some consumers will trade down from beef to the cheaper pork and chicken alternatives and, while it won't be a net positive for pork demand, it should limit the potential demand damage. Another thing to consider is that during 2018, domestic pork demand hit two serious air pockets, one in April and another in September, which caused hog and pork prices to tumble well below expectations. It's difficult to forecast when those kinds of short-term demand lulls will hit, but there is a good chance that we will see one such event before the middle of the year. Buyers should be prepared to ramp up purchases during such times of price weakness since they rarely last more than a few weeks.

SUMMARY

Hog slaughter should slowly decline moving through January and into February, but pork production will still be larger than last year due to expansion in the herd and carcass weights that could be slightly higher than last year. A new plant will begin operations this month and that will also add marginally to pork supplies. Domestic pork demand is mediocre at best although there could be some improvement in Q1. Export demand still looks very strong but is at risk of declining as the global economy slumps and leaves international customers with less income as a result. Look for cash hog prices to rise in January, but it may be difficult to get the cutout much above the low \$70s due to seasonally weak demand and the potential for belly prices to retrench from their current lofty levels. Table 1 provides our weekly price forecasts for all of the pork primals. The CME Lean Hog Index is projected to be near \$62 when the February contract expires.



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