The Milkweed

Dairy's best information and insights

"Float like a butterfly, sting like a bee."
— Muhammad Ali

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Canadian Trade War "Victory" Claims for U.S. Dairy are Bogus

by Pete Hardin

Bull flatulence! That's about the substance of "Victory" shouts emanating from the likes of President Donald Trump, Wisconsin governor Scott Walker and the dairy co-op lobby – National Milk Producers Federation. The recently-concluded United States Mexico Canada Agreement (USMCA) accomplishes virtually nothing for U.S. dairy farmers and processors, in terms of dairy exports to Canada.

The USMCA will actually move tiny percentages of overall U.S. dairy product categories … starting about 2020 if the nations' governing bodies all give their approval. (See table below for percentages of various U.S. dairy items that will be allowed into Canada for Year 1 and Year 6 under the USMCA. The base year for these comparisons is 2017.)

See pages 6-7 for tables that break down the USMCA agreement's specifications for annual sales of U.S. dairy products into Canada. Those totals are presented in metric tons.

Two recent trade inequities remain unaddressed by the USMCA: Canada's subsidies for firms processing dairy protein powders, and Mexico's 25% tariffs on U.S. cheese imports.

Canada's powder plant subsidy stays

Canada's scorned "Class 7" price for nonfat milk solids – used to lowball U.S. exports of dairy protein powders – has been barely neutered. Canada must adopt USDA-generated reference price for dairy protein powders. ***But*** … Canadian dairy processors may continue enjoying an ultra-liberal manufacturing allowance that dramatically subsidizes their exports by what *The Milkweed* estimates is about $.325 per pound, after the currency values are equalized. (Note: USDA allows a $.1678/lb. "make-allowance" for nonfat dry milk, through the federal milk order system.)

Thus, Canadian powder plants producing Skim Milk Powder and nonfat dry milk will enjoy an approximate 16-cent per pound advantage in "make allowances" over their U.S. competitors. The USMCA does impose modest penalties if Canada's dairy protein powder exports exceed certain levels.

Six years ahead — in 2025 — based upon 2017's total domestic dairy product output, here are several examples of the microscopic volumes of dairy exports that will be allowed to enter Canada. (Note: Figures are stated in terms of percent of total U.S. 2017 production for those commodities.)

(Note: Fluid milk exports to Canada are dramatically restricted to industrial use, so will gain no significant premium value. Butter imports may look relatively high, but in recent years Canada has been our primary export destination for butter.)

% of U.S. 2017 Dairy Products to Canada Years 1 & 6 — After USMCA Signing

Category	Year 1	Year 6
Fluid Milk:	0.0003%	0.002%
Cheese:	0.0003%	0.002%
Skim Milk Powder:	0.0052%	0.031%
Butter:	0.0008%	5.3680%
Yogurt:	0.0003%	0.002%
Ice Cream:	0.0001%	0.0001%

Mexico's 25% cheese tariffs will remain!

Meanwhile, looking South of the Border, it appears that Mexico's 25% tariffs on United States cheese exports will remain in place. Those tariffs were imposed in early July 2018, in response to the United States slapping on 25% tariffs on Mexican steel imports and 10% atop aluminum products shipped in from Mexico. In recent years, Mexico has been the United States' biggest foreign buyer of cheese.

As an interim measure, following Mexico's setting 25% tariffs on U.S. dairy imports early last summer, many U.S. exports had cut costly deals with their Mexican buyers: splitting the costs of those tariffs. For example … if U.S. cheese were priced at $1.60/lb. to a Mexican buyer, the 25% tariff would total $.40/lb. Thus, the exporter and importer would each "eat" $.20/lb. in tariff costs. For the short-term arrangement, such private deals helped keep cheese moving from the United States to Mexico. But longer-term, that's a tremendous, indeed impossible cost for U.S. cheese exporters to absorb.

Rain has deluged major areas of Wisconsin and surrounding states since mid-August. Harvest of corn and soybeans is seriously delayed by saturated soils and flooded fields. What had looked like a perfect corn crop in southern Wisconsin in early August is now turning to disaster at harvest.

Dick Groves, the editor-publisher of *Cheese Reporter* (an excellent weekly industry publication) noted in his October 5, 2018 editorial comment: "One final negative here: it appears that Mexico's tariffs on US cheese imports will remain in place. So from that perspective, US dairy trade to Mexico, at least on the short run, is worse off than it was a year ago."

Industry sources report that European interests are keenly interested in details concerning Mexico's cheese tariffs levied against U.S. imports. That's because the European Union recently concluded a trade deal with Mexico that should offer Europeans increased access to Mexico's dairy markets. If U.S. exports to Mexico are impaired by the continued 25% tariff, advantages previously enjoyed by U.S. firms selling cheese to Mexico will be dramatically eroded.

Wisconsin Farmers Union's criticisms …

The Wisconsin Farmers Union has voiced criticism of USMCA trade deal. WFU has worked hard to explain details of Canada's farm milk quota system during the past year. WFU has put a positive light on Canada's efforts to tailor farm milk production to market needs. It should be noted that WFU chose not to defend Canada's Class 7 price that low-balled dairy protein ingredients costs.

Darin Von Ruden, WFU president, stated, "A 1.5 percent increase in dairy products sold is not going to be the salvation of our dairy industry." He noted that the United States has increased milk production by about 1.5 percent in 18 out of the last 20 years. "This small increase in sales to Canada may not even offset our own domestic production increase this year, not to mention where we'll be at 2 or 3 or 10 years down the road. We need to exercise some discipline on our own side of the border rather than looking for salvation outside our borders."

WFU president Von Ruden also listed further deficiencies in the USMCA trade deal:

• There is no provision for Country of Origin Labeling for meat products sold to consumers in the United States. Von Ruden asserted that 90% of Americans support "Country of Origin Labeling."

• The USMCA also fails to eliminate the so-called "Investor-State Dispute Settlement (ISDA) mechanism. ISDA allows multi-national corporations to legally challenge U.S. laws that might reduce profits. "ISDA prioritizes the profits of multinational corporations over the needs of U.S. citizens, and is a direct affront to U.S. sovereignty," Von Ruden asserted.

The "dairy trade war" with Canada was in great part a phony contrivance. And now that war has been declared over amid cries of "Victory" from U.S. politicians and dairy co-op leaders, the fruits of "victory" are equally baseless.

Barrel Cheddar Prices Out of Whack – CME Blocks vs. Barrels & CME Barrels vs. AMS Survey Prices

by Pete Hardin

The ups and downs of 50-lb. Barrel Cheddar cash prices at the Chicago Mercantile Exchange (CME) are creating great confusion in the cheese industry — reflecting a failed cash market system. *The Milkweed* digging has uncovered a prime reason for current low Cheddar barrel prices:

Absent stricter quality parameters for Cheddar barrels sold at the CME, an Idaho-based plant is selling low-quality barrels at CME. Those low-quality products are driving away barrel buyers, who are reluctant to buy or offer to buy barrels at CME. Recently, weekly national average prices for manufacturers' barrel Cheddar sales reported to USDA have ranged roughly 15 to 20 cents per pound higher than CME prices. End result: the Cheddar barrel market's dregs have become the price-setters at CME – another example of an overall lack of integrity in dairy cash markets at CME.

A far greater source of wisdom than *The Milkweed* is reporting unrest among cheese makers over the block-barrel "split" and other, more subtle cheese pricing inequities. For the week of October 1-5, 2018, USDA's Dairy Market News reported: **"The large block to barrel gap at the CME is doing little to pacify concerns from cheese contacts across the country."** (Emphasis added.)

During 2018 – as well as the preceding couple years – prices for 500-lb. Cheddar barrels have at times been seriously distorted … sometimes doubly out of whack. At press time for the October issue, we've re-entered one of those "doubly out of whack" periods. One more time, cash market prices for barrel Cheddar at the Chicago Mercantile Exchange (CME) are groveling far below other measures of Cheddar pricing. Examples? Let's cite data from the week ending Friday, October 5:

• October 5 saw the CME cash price for 40-lb. block Cheddar close at $1.65 per pound. That price contrasts sharply with 500-lb. barrel Cheddar cash prices that day, which fell by 1.75 cents down to $1.3675/lb. Thus, the block/barrel split at CME on October 5 was 28.25 cents per pound. Until recent years, the industry's rule of thumb for a normal block-barrel "split" at CME was 3.5 to 4 cents per pound.

• That same week, USDA announced the prior week's survey price for barrel Cheddar prices and volumes. Each week, manufacturers must report to USDA their sales and prices for a range of dairy commodities – including both block and barrel Cheddar. Those reports cover events one to two weeks prior. During the week of October 5, 2018, USDA reported a national average Barrel Cheddar price (38% moisture) of $1.5262 per pound. Sidenote: That price of $1.5262 per pound was 15.87 lower than the September 28, 2018 barrel Cheddar price at CME.

After grasping that recent, divergent data on barrel Cheddar prices, one need only go back a few weeks – to Monday, August 24 — when CME prices for barrel Cheddar zoomed up to $1.6425 per pound and actually topped block Cheddar prices 3.25 cents. How could an ***honest*** block market rise and fall so dramatically? No honest answers come forth. Such up-and-down shenanigans have persisted, on and off, for at least the past couple years.

Losers & winners

It's easier to list the losers than the winners in this barrel Cheddar pricing foolishness. Losers include:

• Cheese plants producing barrel Cheddar. Why? Monthly Class III prices are greatly determined by the weighted average of Cheddar blocks and barrels in he monthly average of USDA's weekly price surveys for that given month. **Cheese plants producing barrel Cheddar whose producers are paid on the basis of federal milk order Class III (cheese) milk prices have their costs determined by the higher values of USDA's survey prices. But in many instances, sales of Cheddar barrels are based upon CME indices. Buying (milk) high and selling (cheese) low is a guaranteed prescription for cheese plants to lose money.**

• Temporarily, dairy farmers are "winners" in this barrel Cheddar pricing foolishness, only because some cheese plants to which they ship are paying higher prices than they should, if their patron prices are based on federal milk order Class III prices. But such "winners" are only temporary. Cheese plants cannot afford to pay out undue milk costs. In the Upper Midwest, we're seeing numerous cheese plants depool many of their producers from the federal milk order. For such cheese plants, being associated with the federal milk order has far more negatives than benefits.

• Another big loser will be California dairy producers. That's because the state's milk pricing formula – which will end on October 31 – uses CME price quotes to as a major basis for setting monthly Class 4b (cheese) milk prices. Nothing like going out with a kerflop.

Why the CME vs. AMS difference?

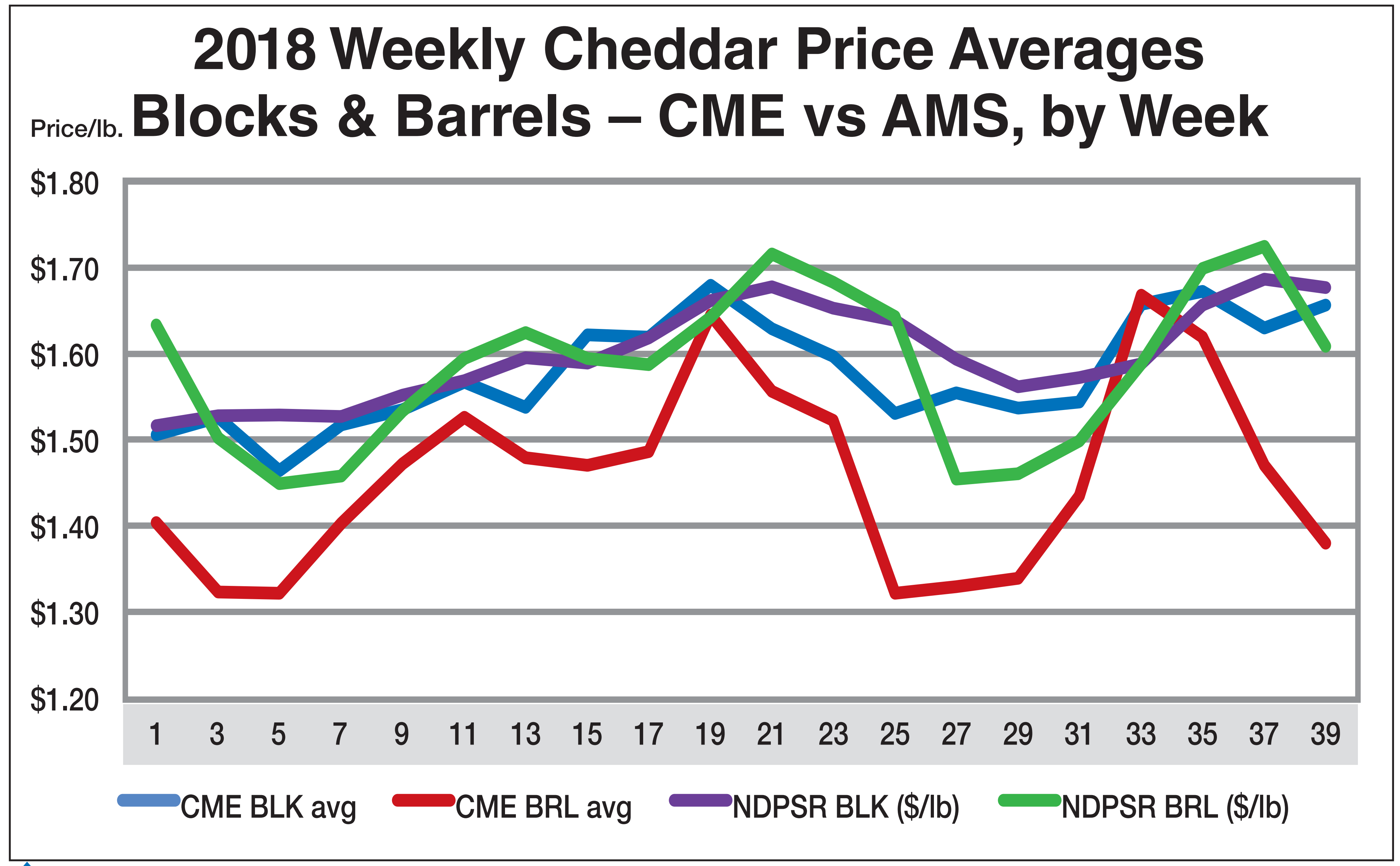
Each week, barrel Cheddar manufacturers report between 10 to 13 million lbs. of product sold in response to Agricultural Marketing Service's weekly survey. Those reports are Mandatory. So why, if all Cheddar plants must report their sales to USDA each week, does there appear such a "split" between the AMS prices and the CME cash markets for 500-lb. barrels … even if accounting for a delay of a week or two difference in the AMS reports? There are no good answers.

Literally … the bottom of the barrel

In this latest go-round of tumbling barrel Cheddar prices, dairy's ever-fertile rumor mill is spinning out tales of large quantities of poor-quality, barrel Cheddar in Idaho. This explanation contends that sellers believe they have a better chance of dumping substandard barrel Cheddar on a low-priced market than if barrel Cheddar prices were higher.

How can sub-standard barrel Cheddar be sold at CME??? Industry sources explain that CME rules entail almost no rules regarding quality, other than at the request of the buyer. Buyers may request grading barrel Cheddar to conform with WI State Grade or USDA Extra Grade. But few, if any, buyers have ever done so, these sources explain.

Thus, quality issues have spooked buyers of barrel Cheddar at the CME … leaving CME cash markets as a possible "dumping ground" for low end Cheddar barrels. Sellers cannot know the identity of firms offering barrel Cheddar at CME. Sellers are obviously paying more money off the CME to direct suppliers of barrel Cheddar, using the AMS weekly price and sales data as an indicator.



The line graph above shows four separate weekly price averages for Cheddar cheese. The red and dark blue lines reflect weekly averages barrel and block Cheddar traded at the Chicago Mercantile Exchange, respectively. The dark purple and green lines represent weekly average prices for block and barrel Cheddar as reported by manufacturers to USDA's Agricultural Marketing Service.

The color-coded bands of data below show the specific weekly average prices for the four different Cheddar prices depicted on the line graph at the top of this page. The data is for the first nine months of 2018.

Week	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
CME BLK AVG	$1.51	1.4555	1.5263	1.5145	1.4635	1.517	1.5175	1.5288	1.535	1.583	1.567	1.56	1.5375	1.5585	1.6215	1.6205	1.6195	1.657	1.679	1.609
CME BRL AVG	$1.40	1.2855	1.3231	1.346	1.3215	1.359	1.4025	1.4794	1.4715	1.509	1.526	1.5225	1.4788	1.4475	1.4705	1.4815	1.486	1.579	1.6445	1.5695
NDPSR BLK ($/lb)	$1.52	1.5221	1.5275	1.5491	1.5283	1.5357	1.5266	1.5308	1.5513	1.5565	1.569	1.5876	1.5953	1.589	1.5889	1.6017	1.6181	1.64	1.6614	1.6787
NDPSR BRL ($/lb)	$1.63	1.5735	1.5024	1.4768	1.4488	1.4392	1.4573	1.4821	1.5329	1.5668	1.5945	1.6125	1.6246	1.6228	1.5941	1.5852	1.5868	1.5927	1.6421	1.6987

Week	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39
CME BLK AVG	1.6285	1.6081	1.5965	1.62	1.5305	1.4925	1.5544	1.5505	1.537	1.518	1.544	1.611	1.657	1.637	1.672	1.6794	1.63	1.617	1.656
CME BRL AVG	1.556	1.5444	1.5225	1.515	1.3215	1.278	1.3294	1.357	1.3385	1.4355	1.435	1.5345	1.6675	1.5905	1.619	1.5844	1.47	1.3935	1.38
NDPSR BLK ($/lb)	1.6775	1.6661	1.6526	1.6456	1.6382	1.6228	1.5935	1.5725	1.5615	1.5765	1.5725	1.5687	1.5877	1.628	1.6562	1.6578	1.6869	1.6891	
NDPSR BRL ($/lb)	1.7161	1.6971	1.683	1.6573	1.6428	1.5276	1.4538	1.4456	1.4604	1.4629	1.4984	1.5329	1.5878	1.681	1.6991	1.733	1.7248	1.6781	

TRQ-CA1: Milk

Quota Year	Aggregate Quantity (MT)
1	8,333
2	16,667
3	25,000
4	33,333
5	41,667
6	50,000

TRQ-CA2: Cream

Quota Year	Aggregate Quantity (MT)
1	1,750
2	3,500
3	5,250
4	7,000
5	8,750
6	10,500

TRQ-CA3: Skim Milk Powders

Quota Year	Aggregate Quantity (MT)
1	1,250
2	2,500
3	3,750
4	5,000
5	6,250
6	7,500

TRQ-CA4: Butter, Cream Powder

Quota Year	Aggregate Quantity (MT)
1	750
2	1,500
3	2,250
4	3,000
5	3,750
6	4,500

TRQ-CA6: Cheeses of All Types

Quota Year	Aggregate Quantity (MT)
1	1,042
2	2,083
3	3,125
4	4,167
5	5,208
6	6,250

TRQ-CA7: Yogurt and Buttermilk

Quota Year	Aggregate Quantity (MT)
1	689
2	1,378
3	2,068
4	2,757
5	3,446
6	4,135

TRQ-CA8: Whey Powder

Quota Year	Aggregate Quantity (MT)
1	689
2	1,378
3	2,068
4	2,757
5	3,446
6	4,135

TRQ-CA10: Milk Powders

Quota Year	Aggregate Quantity (MT)
1	115
2	230
3	345
4	460
5	575
6	690

TRQ-CA13: Ice Cream and Ice Cream Mixes

Quota Year	Aggregate Quantity (MT)
1	115
2	230
3	345
4	460
5	575
6	690

Explaining the Accompanying Export Data Tables

The accompanying tables on the left show the annualized export volumes that the United States will "enjoy" starting in 2020, when the United States Mexico Canada Agreement (USMCA) takes effect.

The data was derived from "Appendix C" of documents released by the White House following announcement that Canada had signed on to the USMCA in the wee hours of September 30. Strangely, when *The Milkweed* sought to retrieve Appendix C on October 10, that document was no longer listed.

Starting in "Year 1" (2020), modest volumes of U.S. dairy products and commodities exported to Canada will rise incrementally through "Year 6." After that, exports will increase annually by one percent.

Notably, butter and cream are among the specific products/commodities enjoying the greatest overall growth, starting at Year 1. However, it's important to note that for the past several years, Canada has been this nation's biggest destination for butter exports. Canadian consumers are using ever-increasing amounts of butter and cream. The "Double-Double" coffee (2X sugar, 2X cream) sold at the Tim Horton's franchise of donut shops is incredibly popular up north.

The value of "Milk" exports to Canada under the USMCA are overstated, if only looking at the bare numbers. Provisions contained in the USMCA will limit about 85% of those "Milk" exports to industrial use.

Please review the table on page 1 of this issue that refers to the Year 1 and Year 6 export volumes for some of the key commodities. These volumes are expressed in terms of their percentages of 2017 dairy products processed in the United States. As a percentage of our total output, the exports to Canada (except for butter) are miniscule and certainly offer little, if any, price-lifting advantages.

After the USMCA was announced, Canadian Prime Minister Justin Trudeau claimed that Canada got the deal that it wanted. From a dairy standpoint, Trudeau's analysis looks pretty accurate.