

Dairy, a Trade War Casualty

Escalating U.S. trade wars are spreading like cancer, damaging prices on both commodities and equities. On June 25, Harley-Davidson announced it would move some of its iconic motorcycle production to Europe, its second largest market, to avoid the financial impact of trade-war tariffs. Later that day, the Dow Jones Industrial Average closed down more than 400 points, erasing what remained of 2018's gains, and commodity markets dropped to levels not seen since 2009. In heavy trading, CME Cheddar barrels fell 8¢ to \$1.205/lb., the lowest price since July 30, 2009. In just three weeks—since the announcement of Canadian, Mexican, European, and Chinese retaliatory tariffs on U.S. products—the CME July Class III futures contract declined 13.5%. For every \$1/cwt. decline in the Class III milk price, U.S. dairy producers lose more than \$180 million in monthly revenue based on the current rate of milk production.



For every \$1/cwt. decline in the Class III milk price, U.S. dairy producers lose more than \$180 million in monthly revenue based on the current rate of milk production.

The massive sell-off over the past week could reflect concerns that trade-war tariffs may have staying power.

How tariffs on U.S. dairy products affect long-term market prospects will vary. Canada announced tariffs on U.S. yogurt, as well as pizza and quiche, both of which contain dairy. Mexico directly targeted U.S. dairy with tariffs on cheese, an approach similar to that taken in 2010 when Mexico temporarily placed duties on U.S. cheese in response to a trucking dispute. Mexico is the top export destination for U.S. cheese, and for years exporters have enjoyed steady year-over-year volume growth. U.S. Cheese exports to Mexico totaled 96,612 metric tons (MT) last year. Cheese exports last year were equally weighted between “grated or powder cheese” and “Cheddar and Colby” at 46% and 42%, respectively, of total volumes.

Cheddar, along with “fresh cheese,” was tariffed at 25%, with other categories at 20%. One category—styles similar to Egmont and Cheshire—was left off the list. When used in cheese processing, styles similar to Egmont and Cheshire could be close substitutes for Cheddar. In 2010 and 2011, U.S. exports to Mexico of these cheese styles increased from zero to 2,213 MT and 7,666 MT,

Continued on page 2



by Ken Meyers
President, MCT Dairies Inc.

No one wins a trade war. While the Trump administration has promised that U.S. agriculture would not be used as collateral damage—somehow compensating U.S. producers for lost sales—details on how that would work have been lacking.

Nonetheless, U.S. dairy producers stand to lose a staggering \$1 billion or more in revenue by the end of this year if milk prices decline by just \$1/cwt. due to lost sales. However, markets are fluid, and while the United States could ship less product to Mexico and China, a drop in U.S. dairy prices could support greater domestic demand and increased exports to other countries. World demand for milk powders remains robust enough that if New Zealand ships more volume to China, displaced supply from the United States could fill the needs of countries that once looked to New Zealand.

With dairy in the cross hairs of today's escalating trade disputes, it can be difficult to remember that dairy is only one casualty of the trade war. Job losses are already being announced. For example, Missouri-based Mid-Continent Nail, the nation's largest nail manufacturer, whose steel costs have escalated due to U.S. tariffs on Mexican imports, laid off 60 people this month. If these types of losses mount, the resulting impacts to dairy could be compounded. **MCT**

Buyers Finding Value in Trough

After milk and dairy futures prices bottomed on Monday, prices have been slowly regaining lost

ground as June winds down. That makes sense. Given day after day of declining markets, buyers are finding some value at current levels. World markets remain willing to consume more dairy, and the recent price decline could be the edge exporters need to regain a competitive advantage. Still, prices are well below where they were at the end of May and could be prone to bouts of volatility as retaliatory tariffs take effect. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Jun	1.5800	1.4500	15.22	2.3475	14.95	0.3050	0.8250
Jul	1.5400	1.4275	13.93	2.3625	14.63	0.3175	0.8000
Aug	1.6250	1.5175	14.59	2.4675	15.00	0.3150	0.8075
Sep	1.6675	1.5575	15.15	2.5800	15.45	0.3100	0.8175
Oct	1.5800	1.4300	15.02	2.6500	16.03	0.3075	0.8225
Nov	1.6425	1.5275	14.88	2.5600	15.87	0.3100	0.8250

* CME prices.

**NASS prices.

...containing the Mexican fallout

continued from page 1

respectively. In 2011, the United States lost just 6.5% of cheese export volume to Mexico. U.S. exports of Cheddar and Colby declined by 6,296 MT, but exports of styles similar to Egmont and Cheshire of 5,453 MT offset that loss.

U.S. cheese markets could recover if exporters lose less than 10% of volumes sold to Mexico, but several differences this year compared to 2010 could cause current losses to mount. First, relationships between trade partners are strained and several reports suggest Mexico and others find the United States to be a less reliable trade partner than in the past. Second, the announcement of U.S. tariffs on Mexican steel and aluminum caused the peso to devalue to a 16-month low vs. the greenback, reducing Mexican consumers' spending power for U.S. goods. Lastly, in 2010, Europe was operating under a quota program, while today Europe is an active exporter of cheese. This year, Mexico and Europe agreed to modernize a free-trade agreement, and if the U.S.-Mexico trade dispute persists into 2019, a modernized agreement could provide the growing Mexican market with cost-competitive EU cheese.

The trade dispute between the United States and

China is more complicated. China has long employed non-tariff barriers on U.S. dairy products. In addition, lost U.S. intellectual property to Chinese competitors provides good cause to highlight China's unfair trade practices. Some economists argue that U.S. participation in the Trans-Pacific Partnership would have brought China into compliance. Instead, the United States tarified Chinese aluminum and steel and more recently announced \$50 billion in tariffs on Chinese products to compensate for estimated trade losses. China has retaliated, hitting a variety of U.S. agricultural products. On July 6, China will increase tariffs by 25% on U.S. dairy products including whey, whey protein concentrate, nonfat dry milk, cheese, and butter. China also hinted at using non-tariff barriers like slowdowns through port and no grace period for dairy products already on the water.

As a result, Chinese orders for U.S. dairy products are rumored to have been cancelled by several buyers as they look to other regions to fulfill voids left by U.S. dairy products. The impact of the U.S.-China trade dispute could be prolonged. New Zealand and Europe stand ready to capitalize on the situation by filling orders for dairy products lost by U.S. dairy companies. Furthermore, China has voluntarily relaxed tariffs on agricultural products from other countries, suggesting both sides could be settling in for the long term. **MCT**



The information contained in this newsletter is for general guidance only. It is not intended to constitute or substitute investment, consulting or other professional advice or services. The information presented is not an offer to buy or sell commodities. Compass accumulates then distributes opinions, comments and information from and based upon other public and reliable sources, but it cannot warrant or guarantee the accuracy of any of the data included in the newsletter. From time to time MCT Dairies, Inc. may hold futures positions in commodities discussed in the newsletter. Always contact a registered financial advisor before making any decisions. MCT Dairies, Inc. shall not be held liable for any improper or incorrect use of the information contained in the Compass or for any decision made or action taken in reliance on the information in this newsletter. Reproduction with permission only. **MCT Dairies, Inc., 15 Bleeker St., Millburn, NJ 07041 (973) 258-9600 fax: (973) 258-9222 www.mctdairies.com.** For more information, email info@mctdairies.com.