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MCT COMPASS

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USMCA More Hype than Not

Following months of nail-biting negotiations and threats to pull-out of the North American Free Trade Agreement (NAFTA), the United States and Canada finally agreed to a revamped trade deal last month. But what the United States actually will gain under the United States, Mexico, and Canada Agreement (USMCA) is complicated and could fall short of the heady press releases.

The touted outcomes of the negotiations with Canada sound more impressive than the benefits they likely will actually yield.

The part of the deal that covers Mexico is straightforward for dairy. It preserves NAFTA's duty-free trade for dairy products, which for the U.S. dairy industry was the most important aspect of the renegotiation. While completion of USMCA does not remove U.S. tariffs on steel and aluminum implemented by President Donald Trump, Canada and Mexico have started to push for the end of the tariffs now that negotiations have concluded. Furthermore, an annex to USMCA, pushed by the International Brotherhood of Teamsters, brought back the long-resolved issue of Mexican truck licenses and their ability to perform long hauls in the United States. That point of contention between the two nations in the 2000s resulted in Mexico implementing retaliatory tariffs on U.S. agricultural products. Mexico has already signaled a willingness to impose tariffs on the United States to once again resolve this matter.

The touted outcomes of negotiations with Canada sound more impressive than the benefits they likely will yield. While USMCA provides access to Canada's dairy market, much of that access already exists and likely would have been provided under the Trans Pacific Partnership had the United States not pulled out of that agreement. At the same time, the United States is providing Canada with reciprocal market access via tariff rate quotas (TRQs) on a first-come, first-served basis, but the impact of access to the U.S. market is not clear. By year six, Canada's TRQs will be 12,500 metric tons (MT) for U.S. cheese, with 50% of the volume limited to commodity cheese; 4,500 MT for butter, with 85% of

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

At first glance, increased access to Canada's dairy market appears to be a huge win for U.S. dairy producers and manufacturers, but how it actually plays out will be the real determiner of whether the anxiety created by updating NAFTA was ultimately worth the cost.

It appears that many of the so-called U.S. wins with Canada are not really all that beneficial to the U.S. dairy industry, and full implementation of the agreement will take time. The earliest USMCA could be implemented would be in mid-2019, but even that is optimistic. Senate Majority Leader Mitch McConnell, R-Kentucky, has already said that the issue will not be taken up by the U.S. Congress until sometime in 2019, and Implementation won't occur until 105 days after all three parties sign the agreement.

Moreover, President Trump has once again threatened to pull out of the newly revamped trade deal if Mexico does not halt the migrant caravan now walking toward the U.S. border. Even if that threat is averted, a lot of work remains to be done on the areas of the agreement that still contain unclear language, which has been kicked into the implementation phase of the deal. **MCT**

Freight Rates Drive Cheese Lower

Sellers pressured CME markets to multi-year lows in October. Blocks have not traded this low in October since 2009 and barrels since 2006. Freight allowances could be a major driver behind the large volumes of product headed to the CME. For instance, the cost to move cheese from Dalhart, Texas, to Green Bay, Wisconsin, is 8–9¢ per pound, but the CME freight allowance for that same distance is 1.87¢ per pound—enough to drive higher volumes. Between 2006 and 2016, CME barrel trades represented 3% of the weekly National Dairy Product Sales Report (NDPSR) volume. Over the past two years, that number has increased to 9% with expectations that it could reach 12% this year. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Oct	1.6100	1.3250	15.50	2.2675	14.96	0.4425	0.8750
Nov	1.5700	1.2775	14.80	2.2425	14.90	0.4700	0.8800
Dec	1.5150	1.3075	14.71	2.1825	14.65	0.4725	0.8800
Jan	1.5125	1.2900	14.60	2.1200	14.36	0.4750	0.8775
Feb	1.4900	1.3150	14.60	2.0925	14.16	0.4925	0.8675
Mar	1.5100	1.3475	14.77	2.1050	14.08	0.4950	0.8525

** CME prices.*
***NASS prices.*

...Loopholes could offset some benefits

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butter reserved for further processing in year one; 7,500 MT for SMP; and 2,760 MT for MPC. Bear in mind that U.S. butter exports to Canada have averaged 7,700 MT per year for the last three years, and cheese exports have averaged 13,448 MT. While some of that volume could be related to a re-export program, over the next six years the United States will gain access to less than what it already has today. Moreover, a loophole exists in which Canada can grant import licenses, satisfying World Trade Organization requirements, but like it has done with European cheese, issue licenses to entities that choose not to import product. These companies could then hold the license to prevent others from importing. (For more details on USMCA provisions, go to the Office of the United States Trade Representative)

Two of Canada's milk classes, 6 and 7, will also be eliminated six months after USMCA is implemented. Class 6 covers ingredients used in processed milk products including skim milk powder (SMP), milk protein concentrate, and ultra-filtered milk. Class 7, created in early 2017 to deal with the country's surplus skim milk solids, allows Canada to export product well below the world market price. Following USMCA implementation, the country will reclassify Class 6 and 7 products—except for SMP, MPC, and infant formula—and establish prices based on end use. Canada will price the three exempt products at no lower than the U.S. nonfat dry milk (NFDM) price minus Canada's processor margin times the country's yield factor for that product. There is also a provision that penalizes Canada if exports of SMP, MPC, and infant formula exceed specified levels. These provisions will be reviewed in five years and every two years thereafter, and at that time, they can be modified or eliminated if both the United States and Canada agree.

However, there is an understanding that Canadian make costs could be two to three times those in the United States, which could easily offset the benefit of eliminating Class 6 and 7 milk prices. Moreover, in most months, U.S. NFDM prices are the lowest in the world. And finally, the language is silent on the export penalty, suggesting Canada will collect the money and use it to recharge its coffers. **MCT**

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