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Cheese Market News®

INSIDE

CMN's annual round table:

Panelists discuss outlook on dairy prices and trade issues

MADISON, Wis. — International trade will continue to loom large as a major issue affecting the U.S. dairy industry, panelists in *Cheese Market News'* annual round table agree. To address trade and other diverse top-of-mind issues, the *CMN* staff has convened a panel of U.S. dairy executives to share their thoughts.

This week and next, panelists in *CMN's* 23rd annual year-end round table will tackle trade and other hot topics including consumer convenience and culinary trends and the use of the term "milk" in non-dairy products.

This year's round table participants are:

• Blake Anderson, president and CEO, American Dairy Products Institute, Elmhurst, Illinois;

• Alyssa Badger, director of operations, and manager, dairy market intelligence, HighGround Dairy, Chicago;

• Ralph Hoffman, president of Optimally, a Schuman Cheese dairy services agency, Fairfield, N.J.;

• Joe Moreda Jr., vice president, Valley Ford Cheese & Creamery, Valley Ford, California;

• Kathleen Noble, senior economist and research specialist, Blimling and Associates Inc., Madison, Wisconsin;

• Rob Vandenheuvel, senior vice president, member and industry relations, California Dairies Inc. (CDI), Visalia, California; and

• John Wilson, senior vice president and chief fluid marketing officer, Dairy Farmers of America (DFA), Kansas City, Kansas.

We thank each of our round table participants for taking time in the midst of busy schedules to provide written responses to our questions.

How do you believe U.S. dairy prices will track for key commodities in 2019? What will be the key factors affecting U.S. dairy prices over the course of 2019?

Anderson: It's hard to predict with the trade flow disruptions relative to politics. However, based on basic supply and demand principals, U.S. milk production continuing to grow, and current inventories of the basic commodities, expect dairy commodity prices to remain relatively low and stable to current. Key factors will include the impact of continued trade wars and tariffs, trade relationship gains by Europe resulting in greater supply into Mexico, and continued low

Turn to PRICES, page 8

U.S. milk production climbs 0.6 percent over year earlier

WASHINGTON — Milk production in the 23 major milk-producing states during November totaled 16.37 billion pounds, up 0.8 percent from November 2017, according to data released this week by USDA's National Agricultural Statistics Service (NASS). *(All figures are rounded. Please see* CMN's *Milk Production chart on page 15.)*

October revised production, at 16.86 billion pounds, was up 0.9 percent from October 2017. The October revision represented a decrease of 18 million pounds or 0.1 percent from last month's preliminary production estimate, NASS says.

Production per cow in the 23 major states averaged 1,877 pounds for November, 18 pounds above November 2017. This is the highest production per cow for the month of November since the 23-state series began in 2003.

The number of milk cows on farms in the 23 major states was 8.72 million head, 16,000 head less than November 2017, and 8,000 head less than October 2018.

For the entire United States, estimated November milk production totaled 17.37 billion pounds, up 0.6 percent from November 2017.

Production per cow in the United States averaged 1,856 pounds for November, 19 pounds above November 2017, NASS reports.

The number of milk cows on farms in the United States was 9.36 million head, 38,000 head less than November 2017 and 8,000 head less than October 2018.

California led the nation's milk production with 3.27 billion pounds in November, up 2.9 percent from its production a year earlier. The state was home to 1.73 million cows, down 12,000 head from November 2017 and 1,000 head less than October 2018.

Wisconsin followed with 2.44 billion pounds of milk produced in November, up 0.1 percent from November 2017. Wisconsin was home to 1.27 million cows in November, down 5,000 head from a year earlier and down 1,000 head from the previous month. **CMN**

USDA establishes standard for bioengineered food labeling

Milk from cows fed GMO feed is exempt

WASHINGTON — USDA Secretary Sonny Perdue yesterday announced the National Bioengineered Food Disclosure Standard. The National Bioengineered Food Disclosure Law, passed by Congress in July 2016, directed USDA to establish this national mandatory standard for disclosing foods that are or may be bioengineered. The standard requires food manufacturers, importers and certain retailers to ensure bioengineered foods are appropriately disclosed.

"The National Bioengineered Food Disclosure Standard increases the transparency of our nation's food system, establishing guidelines for regulated entities on when and how to disclose bioengineered ingredients. This ensures clear information and labeling consistency for consumers about the ingredients in their food," Perdue says. "The standard also avoids a patchwork state-by-state system that could be confusing to consumers."

Earlier this summer, the environmental advocacy nonprofit Center for Food Safety filed a lawsuit against USDA's Agricultural Marketing Service (AMS) for failing to establish the national standard and procedures necessary for implementing the National Bioengineered Food Disclosure Law by July 31, 2018, a 2-year deadline that

Turn to GMO, page 14

ROUND TABLE *CMN Exclusive!*

PRICES

Continued from page 1

oil prices in the Middle East that impact our export capability to that region.

Badger: While sentiment has been negative throughout much of the fourth quarter, it is important to remember seasonalities. It is not unusual for milk prices to move lower into the end of the year, though the rate at which commodities are selling off within the dairy sector has been propelled by global trade uncertainty. U.S. relations have seemingly improved with both China and Mexico/Canada; however, retaliatory tariffs remain in place from the United States' biggest trade partners, which may continue to stifle prices into 2019. Key factors outside of trade will be how strong the Northern Hemisphere spring flush will track, coming off a record season from New Zealand.

Hoffman: Cheese prices for 2019 look to be well below historical averages to start the year and rebound more seasonally as we enter the second half. It's atypical for November spot cheese prices to be so low and this does not portend well for the start of 2019. It's realistic to continue seeing cheese prices depressed through the first quarter at a minimum, but with a chance to rebound as the flush ends.

Blake Anderson
AMERICAN DAIRY PRODUCTS INSTITUTE

Alyssa Badger
HIGHGROUND DAIRY

Ralph Hoffman
OPTIMALLY/ SCHUMAN CHEESE

Butter prices, while higher than historical norms, are at a slight discount compared to the past couple of years through March, closer to recent averages in the second quarter and at a premium for the second half of 2019. Fat is still in demand globally and as powder demand picks up, we could see more cream availability and lower prices through the first half of 2019. However, given the past run-up in prices globally, commercial hedgers tend to jump on prices in the low $2.00 range, which lends support to butter prices. Too many end-users have been caught under-hedged when butter runs up over $2.40 per pound.

Trade wars and tariffs, excess global milk production, expanding cheese inventories and domestic farmer attrition are all key factors that will drive prices during 2019. Solving the tariffs with Mexico and China will help provide support to U.S. prices as our exports will become more competitive and help consume some of our excess production.

Demand in the United States has been strong during 2018, and hopefully our economy continues at its current growth rate. Otherwise the bloated cheese inventory will provide even more headwinds later into 2019. Given the low milk prices and the specter of sub $14.00 milk through March 2019, average dairy farmers may lose $1-3 per hundredweight, causing even more cows to leave the herd, eventually leading to lower milk production. However, it may take up to six months for this impact to be felt in the market.

Vandenheuvel: For the sake of on-farm profitability, producers absolutely need to see a strengthening in the year-over-year dairy commodity prices in 2019. At this point, I believe there is a very good chance we will continue to see upward momentum in nonfat dry milk market prices in the near term. Further, butter continues to hold at historically high levels despite some softening in global prices. Cheddar cheese and dry whey are the big question marks, as they face a combination of headwinds coming from high inventory levels, retaliatory tariffs and continued strong milk production in key cheesemaking regions of the United States.

Wilson: Generally, we think prices will be modestly better in 2019, largely because we expect to see a continued reduction in the number of dairy cows. Milk production also will likely be down, and we don't anticipate seeing much growth in this segment. Butter has been a real outlier compared to other dairy commodities as we continue to see strong consumption, both domestically and internationally, which should help positively impact prices. Finally, we think it's likely that we'll see some improvement in cheese prices, potentially by the second half of the year.

What is your overall takeaway from the new United States-Mexico-Canada Agreement (USMCA)? Are you pleased with it? What do you believe will be the long-term impacts on the U.S. dairy industry?

Badger: Mexico is the U.S. dairy industry's most important relationship within the export market, which means preserving and extending the agreement leans positive overall. USMCA also included a contingency plan to resolve issues with Canada's pricing mechanisms, another win for the industry if Canada complies. The real advantage will be if and when the United States removes steel and aluminum tariffs on the two countries, since that provoked Mexico to add tariffs to U.S. cheese imports. Should that get resolved, I believe U.S. cheese prices will begin to advance from the multi-year lows they have been experiencing for this time of year. Longer term, while security of North American trade is good, the United States needs to continue to pursue free trade agreements with other nations as well to encourage greater export demand.

Hoffman: The USMCA does provide more access for U.S. dairy products to enter Canada's somewhat closed market. It's not a game changer, but it's a good start. With Mexico, we had a very favorable free trade deal under NAFTA, so once the Trump administration and the Mexican government separately agree to resolve the steel and aluminum tariffs, hopefully the tariffs on U.S. dairy products will disappear and we can get back to serving our largest dairy trading partner duty free. It is crucial for the well-being of U.S. dairy farmers to ratify this deal, but ratifying it in a changing Congress may prove challenging.

Moreda: The new USMCA is a positive step toward a new, up-to-date, more fair overall trading relationship within North America, and the administration should be commended for prioritizing

Turn to USMCA, page 9

ROUND TABLE *CMN Exclusive!*

Joe Moreda Jr.
VALLEY FORD
CHEESE & CREAMERY

Kathleen Noble
BLIMLING AND
ASSOCIATES

Rob Vandenheuvel
CALIFORNIA DAIRIES INC.

John Wilson
DAIRY FARMERS
OF AMERICA

USMCA

Continued from page 8

dairy specific issues which will benefit dairy producers and processors nationwide. The elimination of the Canadian Class 7 pricing system, incremental increases of U.S. product quotas into Canada, and the continuation of the successful U.S.-Mexico dairy relationship were all important for the industry. While key issues remain, such as Mexican tariffs on U.S. cheese and details of the elimination of the Canadian Class 7 price, expect the deal to get finalized and ratified in a bipartisan manner in Congress. The long-term benefits from a more fair and equal trading system will outweigh the short-term pains currently being experienced through tariffs. The tough approach to trade was likely needed in order to shake up the status quo and ultimately make better deals. Expect more agreements to be struck with key allies, while the ultimate goal of a more balanced relationship with China takes priority.

Noble: The headlines said: this is big news. The details … are not quite as exciting. Getting rid of retaliatory tariffs with Mexico is a bigger deal than any concessions from Canada.

Wilson: We're hopeful that this will provide some improvements to trade with Canada. Long term, we think farmers will likely see some benefits, but it probably will not provide much help in the short term.

Beyond USMCA, what are some of the global factors, including but not limited to trade tariffs, that you believe will have the largest impact on U.S. dairy trade and pricing in the coming year?

Badger: Despite ongoing trade disputes, U.S. exports have remained impressive. One of the bigger concerns has been the reaction from emerging market currencies as the two largest economies have attempted to work through the ongoing trade war. Global currencies have been dropping aggressively this year, diminishing the buying power from these countries. Furthermore, the U.S. dollar has strengthened for nine months. Another factor that has the potential to disrupt U.S. dairy trade has been the bear market in energies, another blow to demand from the Middle East / North Africa region.

Hoffman: Tariffs and trade wars with Mexico and China are at the forefront of all global factors impacting dairy. While China is not a large importer of U.S. cheese, they are of whey and milk powder. Mexico is a huge importer of both milk powder and cheese, and with the pending EU/Mexico free trade agreement, the United States faces even more competition for some dairy products if the tariffs are not removed.

Outside of trade issues, strong milk production in New Zealand and in parts of South America will help provide more export price headwinds throughout the first half of 2019. Continued stable EU milk production (the largest collective production zone in the world) certainly doesn't help either. Any weather-related event in 2019 would be a catalyst to change the price trajectory we are on these days.

Moreda: Many factors will impact U.S. dairy trade and pricing in 2019, including but not limited to: 1) A worldwide slowdown in economic growth (not including the United States); 2) Growing global (and domestic) milk supply; 3) Demand for dairy products in key buying regions; 4) High inventory stock levels, domestically and globally; 5) Industry consolidation; 6) A strong U.S. dollar; 7) Global dairy product price fluctuations; 8) The re-emergence of milkfat as an acceptable and valuable ingredient; 9) Foodservice demand and monitoring of the Restaurant Performance Index; 10) New product innovation; and, 11) Scientific breakthroughs. All of these are topics to monitor as they will help shape 2019 trade and pricing.

Noble: What trade partner are we gonna pick on next? More than anything, though, we believe Europe still matters most. They are still making more milk and they will remain competitive versus the United States.

Vandenheuvel: CDI is closely monitoring the progress of trade talks with China. Part of this is related to the retaliatory tariffs that have eliminated our exports to customers in China. However, on a broader scope, the United States has not had a level playing field in China, even prior to the retaliatory tariffs. This is a potentially huge market for U.S. dairy products if we simply level the playing field and receive the same market access as our fellow global dairy exporting countries of Oceania and the European Union. As we often tell our elected leaders, CDI has two primary goals when it comes to global market access: (1) Give us a level playing field with our competing global exporters (which includes lowering/eliminating both tariff and

Turn to TRADE, page 10

ROUND TABLE *CMN Exclusive!*

TRADE

Continued from page 9

non-tariff barriers, such as geographic indicators); and (2) Include the whole bucket of milk in the agreements (all varieties of dairy products).

Do you think the first trade mitigation package announced by USDA earlier this year was helpful in addressing low milk prices? What else do you think USDA could do to help dairy farmers struggling in the current economic climate? *(This question was posed prior to the second round of trade mitigation being announced; please see the related article in this issue.)*

Anderson: Based on direct feedback from dairy producers — no. The best thing USDA can do is be able to better influence the current administration to be more strategic in thinking about the real impacts of sanctions and retaliatory tariffs across a broader array of products. We need to play chess and not checkers or "whack-a-mole" as the case may be here. USDA has expertise, experience and real data, and given the opportunity to be heard and "understood" could be a valuable asset in these matters.

Hoffman: Trade not aid is a common theme among dairy farmers. The USDA package helps but falls far short of providing meaningful assistance. It is anticipated that a second round of assistance will be announced, and if so, hopefully is more impactful and benefits our farmers.

Noble: A check from the government may have helped producers pay a few bills, but government payments do little more than dull market signals. Government aid should come in the form of helping to build up trade, not trying to patch it up after it's torn down.

Vandenheuvel: The trade mitigation package fulfilled its goal of injecting money into the U.S. agricultural economy. However, USDA readily admitted early on in the process that the program was not intended to fully mitigate the impact that trade conflicts are having on agricultural and milk prices. Specific to the dairy industry, it is pretty clear that it replaced only a very small portion of the lost income our farmers faced as a result of the trade conflicts. While there may be some additional payment made under the trade mitigation package, the best thing the administration can do for the long-term success of the U.S. dairy industry is to use this opportunity to truly open additional markets for all U.S. dairy products.

Wilson: The first mitigation payment from USDA was pretty insignificant for dairy farmers and really didn't offset the loss of exports. We're hopeful that USDA will come through with a second-round package that will increase the payments for dairy farmers.

Now that California has officially entered the federal milk marketing order (FMMO), how do you think this will impact pricing and price discovery across the dairy industry?

Anderson: It really depends on the product and the sales channel to market. Cheese, butter and nonfat dry milk all have index relationships to the CME and always have. So, while dairymen/dairy-women in California now under a FMMO potentially will see some upside (tbd) on their milk checks, the prices customers pay for butter, cheese, etc. are based on CME activities relative to supply and demand. Processors of the milk could see higher input cost but that is no guarantee that they will realize higher sales prices. It really gets back to managing efficiencies in manufacturing, supply chain and overheads and providing a better value proposition for customers versus one's competitor. Transportation cost and how same are handled under the FMMO versus the old CDFA will be a huge factor in pricing and margin impacts to both producers and processors.

Badger: Two large regulatory changes in the FMMO will be the elimination of transportation credits provided to California processors to move milk around the state, and the new option for plants to de-pool milk from the order. Should cheese plants choose to de-pool from the FMMO, they will not be forced to pay the minimum order price required, but they have the ability to forward contract milk at a fixed price in an attempt to provide more stability to U.S. dairy farmers. The transition will take time as the state learns how to be profitable within the new order, but long-term effects will include California's Cheddar cheese barrel exposure within the cheese price that farmers receive (formerly known as Class 4b). While this may not have created concern in prior years, the recent volatility in the block/barrel premium has the potential to hinder milk prices given that the barrel value has descended to multi-year lows beyond block losses.

Moreda: It's not that California being in the FMMO will directly impact pricing and price discovery, but that it will put California dairy producers on a more even playing field in comparison to the rest of the country. The discrepancy between how the FMMO and the California order valued dry whey in their cheese milk formulas led dairy producers in California to receive less payment for their milk going into cheese vats for the past several years. However, studies show that the average price for milk in California will rise by cents rather than dollars. The overall effect of the new California FMMO will only be an incremental price improvement and not a solution. Rapid expansion of production over the past decades has not been met with equal growth in processing capacity. Very rarely do you read articles about major new processing developments happening in California. Until California decides to promote a better business environment with lower taxes, less regulations, and more sensible environmental expectations, it will continue to have a difficult time staying economically viable as a premier place of business.

Turn to FMMO, page 11 ⇨

NEWS / BUSINESS

Canada announces phase 2 of farm program

OTTAWA, Ontario — Canadian Minister of Agriculture and Agri-Food Lawrence MacAulay recently announced that starting Jan. 7, 2019, requests for funding will be accepted under the second and final phase of the C$250-million Dairy Farm Investment Program. The program is designed to support dairy farmers as they find new ways to improve productivity and efficiency in their operations. Dairy farmers will have until Feb. 8, 2019, to apply for Phase II funding, valued at C$98 million.

The program now will have a two-stage application process involving a pre-selection step which, if an applicant is selected, will be followed by the submission of a full application. This new process will give all applicants an equal opportunity of being selected for funding. Projects will be eligible for a contribution of up to C$100,000. Between 1,000-1,5000 projects are expected to be funded in Phase II.

The Dairy Farm Investment Program originally was launched in August 2017, and more than 2,500 of Canada's 11,000 dairy farms applied to the program under Phase I. More than 1,900 projects were funded, with an average of more than C$68,000 per project. Projects received funding for upgrades such as automatic feeding systems, robotic milking systems and herd management equipment.

The Canadian government also has announced the formation of new working groups to develop mitigation strategies to support farmers and processors as they adjust to the Canada-United States-Mexico Agreement (CUSMA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). **CMN**

ROUND TABLE *CMN Exclusive!*

FMMO

Continued from page 10

Noble: The move to the California FMMO shifts dollars within California but does not add money to the market. New regulation does not somehow make cheese or butter or powder more valuable. Over time, premium structures and participation levels will evolve to adjust.

Vandenheuvel: With only a month under California's belt in the federal order system, it is difficult to pinpoint what the impact will be both within California and around the country. It will likely take a few years to see the impact this will have, as both dairy farmers and milk buyers re-evaluate the California model under this revised structure.

Wilson: We think the implementation of the California federal milk marketing order will have a modest impact on the overall pricing climate. To the degree that California cheese and milk powders move east, the price surface of cheese and other dairy products will not look greatly different than it does today.

How are mergers, acquisitions and joint ventures shaping the future of the U.S. and global dairy industry? How do these impact cheese companies, dairy farmers and consumers?

Anderson: M&A will continue to have big impacts in all areas of dairy including producers, co-ops, processors, sellers and marketers. Small farms continue to close or sell out to larger operators, same with co-ops and processors over time. There most likely will be a balancing of manufacturing assets to the milk pool and consumer driven consumption of dairy products. It is the reality of the age-old adages of "survival of the fittest" and "evolve or die." Look at the grocery store industry over time, from neighborhood "mom & pop" markets to supermarkets to mega-markets and club stores and now the evolution of "e-commerce" and "home delivery."

Economies of scale cannot be ignored, and robots are playing a bigger role in these economies in the struggle to remain economically viable/sustainable. Innovation will increase in importance as the consumer will ultimately decide what wins or loses in the marketplace. Innovation, not just in finished products but in farming, processing, manufacturing, packaging and distribution technologies. All in the "cow to consumer" supply chain will be impacted in one way or another.

Badger: On a farm level, acquisitions and farm consolidation have materialized across the Midwest. Unfortunately, large-scale dairies with lower pain points on milk pricing have been buying out neighboring properties. Increased efficiency from the larger farms has meant that they can survive lower milk prices far longer than a typical family farm, resulting in uninterrupted collections and lower cheese prices.

At a processing level, joint ventures and leadership changes continue to represent a majority of processing investment within the United States. In Michigan, Glanbia, DFA and Select are replicating their successful model in New Mexico to build another cheese plant. There are increasing amounts of foreign processors looking to the United States to continue their growth. While additional processing is generally welcomed, especially in areas like Michigan with excess milk, U.S. co-ops have not been able to invest as heavily, leaving farmers with less ownership in processing overall.

Moreda: The fact that companies are willing to spend capital, take on debt, and invest in U.S. businesses are positive economic signs that project confidence in the U.S. dairy industry. However, mergers and acquisitions are concerning when too much consolidation can give a small number of entities too much leverage. Multiple local artisan cheese companies have recently sold out to large companies from overseas. In many cases these companies continue to thrive, as their parent companies have a very hands-off approach to management. However, there also is another specific example of a large local yogurt company being purchased from an overseas buyer. They are in the process of closing the local manufacturing facility and ending contracts with their farmers, leaving a dozen family organic dairy farmers without a home for their milk. This topic is truly a case-by-case situation.

Wilson: When it comes to consolidation, the dairy industry is no different than other industries. On a long-term basis, the consolidation of farms, plants and processors can ultimately help the industry not only be more efficient, but also more competitive globally. **CMN**

NEWS / BUSINESS

USDA notes benefits of dairy safety net tool

WASHINGTON — More than 21,400 dairy producers opted for coverage through the Margin Protection Program for Dairy (MPP-Dairy) in 2018, up by more than 2,000 producers from the previous year. This USDA program was significantly updated in February by the Bipartisan Act of 2018, and Agriculture Secretary Sonny Perdue says those changes attracted more producers to enroll in the safety net program or to increase their coverage.

"Dairy producers have long been battling low prices, high input costs and a surplus in the global market. Unfortunately, the 2014 Farm Bill did not provide a sufficient safety net to dairy producers and so it was timely that Congress opted to provide additional support through the Margin Protection Program last February," Perdue says. "We are pleased to announce that roughly half of our nation's dairy producers enrolled for coverage under this reworked program, providing additional capital to keep some of these folks afloat.

Perdue says the department understands this is not a total fix nor long-term solution for dairy producers.

"USDA is looking forward to prioritizing the implementation of the Dairy Margin Coverage Program, the new longer-term, more comprehensive dairy safety net program, following the passage of the 2018 Farm Bill," he says. (*See related coverage in this issue and "Industry lauds passage of 2018 Farm Bill, urges Trump to sign" in last week's issue of* Cheese Market News.)

MPP-Dairy, administered by USDA's Farm Service Agency, protects dairy producers by paying them when the difference between the national all-milk price and the national average feed cost (the margin) falls below a certain dollar amount elected by the producer.

Many producers received their first MPP-Dairy payments in February 2018, and most producers who have chosen premium coverage levels of \$7, \$7.50, or \$8 have seen a payment for every month since February. For these seven months, more than \$253 million in payments have been made to dairy operators.

The Bipartisan Budget Act made several changes, including:

• Providing monthly payments instead of bi-monthly;

• Permitting of dairy operations that had not participated before to enroll in the program;

• Covering 5 million pounds of production (instead of 4 million) on the Tier 1 premium schedule;

• Significantly reducing premiums per hundredweight under the Tier 1 premium schedule; and

• Exempting limited resource, beginning, veteran, and disadvantaged dairy operators from paying the annual administrative fee.

While enrollment for MPP-Dairy has closed, USDA encourages dairy producers to consider other programs, including the Dairy Revenue Protection Program, Livestock Gross Margin Insurance for Dairy Cattle, Environmental Quality Incentives Program and Conservation Stewardship Program. **CMN**