FCC Ag Economics helps you make sense of the top economic trends likely to affect your operation in 2019:

- A slightly higher milk price
- Food preferences that will support Canadian dairy consumption
- A slower rate of growth in milk production
- Expansion in market access to foreign dairy products
- A weaker Canadian dollar and higher interest rates

While Canadian dairy profitability is expected to be positive overall, higher interest rates, limited upside for the farm milk price and slower growth in domestic milk production dampen the outlook. Recent growth in consumer demand for dairy products and a lower Canadian dollar will support sector revenues which, on average, should remain just above costs.

Butter inventories reached a record high in July 2018 in response to significant growth in Canadian production between 2015 and 2018. Production-limiting measures and quota cuts slowed annual butterfat production growth to under 5% in the second half of 2018, yet 2018 inventories were higher than the previous year. Demand will still grow, but will likely moderate butterfat production growth to under 2% in 2019.

A surplus of solids non-fat in Canada has led to price pressures at the farm level, amplified by low world prices for dry skim milk. With those two trends likely to continue in 2019, we expect limited gains in the milk price this year. That will coincide with an increase in average production costs of 2% in 2019. As a result, profit margins in the P5 milk pool are expected to average $1 per hectolitre (hl) throughout 2019. The balance of fluid and industrial milk in the Western pool should reduce price pressures there, helping average margins reach $5 per hl.

**How will this affect your bottom line?**

With the sector’s expected drop in production growth and tight profit margins, 2019 will be a good year to seek efficiency gains by working to reduce the ratio of operating costs relative to revenues. Proper evaluation of financial risks will be especially important on loans due for renewal in 2019, as periods of rising interest rates may require greater shares of revenues to cover interest payments. Watch your debt repayment capacity, given the slowdown in income – especially for operations with recent, significant investments.

**Trends to watch in 2019**

**Uncertain recovery of international dairy prices**

The U.S. price for dry skim milk influences Canadian dairy revenues. We believe strengthening demand will drive a small projected increase in that price. However, U.S. prices remain depressed compared to the 2012-14 period, and aren’t projected to rebound significantly in 2019.

Milk production in the U.S. is estimated to have climbed 1.1% in 2018 and the USDA projects it will grow an additional 1.4% in 2019. European milk production in 2019 is expected to increase moderately, while New Zealand maintains its production pace and Australia’s production declines.

**Retail dairy prices to spur consumption**

Consumer preferences for natural fats have boosted demand for dairy. Retail prices that compare favourably to other proteins have also helped. In the last 12 months, the retail price of cheese dropped while overall food inflation reached 1.8% in 2018. Retail butter prices have trended up slightly. The price trend for fresh milk also remained, on average, under food inflation.
Demand is therefore expected to continue growing in 2019. Consumer disposable income is expected to increase as a tight labour market pushes wages beyond inflation. However, higher retailers’ costs for labour and energy are likely to be passed on to consumers and generate stronger food inflation.

Foreign dairy products gain greater access to Canadian market

Three recent trade agreements – CETA, CPTPP and CUSMA, the Canada-U.S.-Mexico Agreement – will shape Canadian dairy in 2019. Each introduces possible import volumes entering the Canadian market duty-free. Time will tell how quickly this will occur. Estimating import volumes as a share of expected production is challenging, as quota announcements, incentive production days, the pace at which producers can claim production credit days, weather conditions, etc., all influence the actual volume of milk produced.

- In 2019 (Year 3 of CETA implementation), Canadian imports of European cheese should total 8,000 metric tonnes (MT) in 2019 (1.5% of anticipated 2019 cheese production).
- The second year of implementing CPTPP could potentially raise Canadian imports of various cheeses by 5,000 MT (roughly 1% of estimated domestic production), about 1% of expected butter 2019 production and 2% of expected skim milk powder production.
- CUSMA, likely implemented in 2019, will allow gradually increasing volumes of U.S. dairy, although how much will depend on the deal’s ratification and implementation date. CUSMA calls for the elimination of Class 7 and limits on Canadian exports of skim milk powder. At this point, the impact on the price of milk is unknown.

Higher borrowing costs and weaker loonie to pressure net income

The loonie declined steadily in 2018. We forecast it to average US$0.75 for 2019. A lower Canadian dollar relative to the U.S. dollar will support the price of milk marketed in lower-value classes based on pricing in the U.S. market, but also raise the cost of equipment and feed prices.

Helping to depress the Canadian dollar this year:

- Challenged 2019 oil prices, as production increases and demand slows.

- Rate increases on both sides of the border. Enjoying its second-longest economic expansion period ever, the U.S. will break the record if that growth extends into summer. Watch for the Federal Reserve to hike interest rates three times in 2019. Here at home, the Bank of Canada expects inflation to hit its 2.0% mid-point target, with an economy near full capacity. Financial markets currently expect no more than two overnight rate increases of 25 basis points this year, with a first hike coming in the second half of 2019.

On the radar

- Federal-provincial working groups’ recommendations for mitigation strategies and industry adjustments to CUSMA and CPTPP.
- The next chapter in U.S.-China trade tensions. If unresolved, an increase in U.S. seeded acres of feed grains could lower Canada’s dairies’ costs. However, lifting tariffs and retaliation measures would mean stronger demand from China – and higher feed prices.
- Expectations of a weaker global economy in 2019, driven in part by uncertainty around China’s ability to sustain its debt-fuelled economic expansion without triggering inflation. Chinese debt is a growing risk to monitor.
- Elevated probability of an El Nino event disrupting 2019 dairy production as drier conditions are expected to prevail in New Zealand and Australia. European dairy production could also be disrupted by feed shortages caused by a prolonged period of dry conditions.

Curious about the 2019 outlooks for other Canadian sectors? Here’s what is available:

- Agribusiness
- Broilers
- Food processing
- Grains, oilseeds and pulses
- Horticulture (new in 2019)
- Red meat

Learn more about economic events that could impact our industry and your bottom line. Our team of economists and researchers share their unique perspectives in reports, videos, blogs and articles available on our website.

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