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Report Highlights:

Due to the severe drought, Post forecasts a slight decrease in dairy output, estimating a decline of just over one percent to 11,441,000 MT in volume by the end of 2023 compared to 2022. Projections for 2024 are complex as several factors could lead to a significant drop in production, particularly during the first half of the year. One major concern is the possibility of currency devaluation, which could have severe consequences. The Government of Argentina (GOA) announced on October 4, 2023, export duties on dairy merchandise and by-products would be lifted until December 31, 2023. However, the continuation of these duties will be determined by the results of the presidential election on November 19, 2023.

General conditions

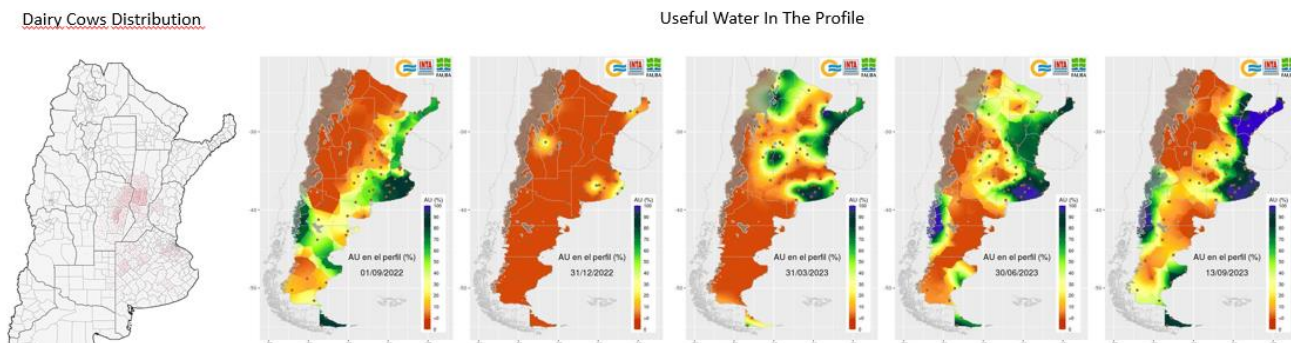
Weather

The first several months of 2023 were extremely dry in Argentina's main dairy basins, although with some exceptions in the large region. Rain began to fall in the east of the Pampas region in June and spread more towards the center of the region in July. Thus, September began with better conditions, with humidity decreasing from the east to the west of the milk basins, but still with a strong drought in the west.

All indications are that conditions will improve in the last months of 2023, since there is a consensus among climatologists that the El Niño phenomenon has already begun, which is synonymous with abundant, if not excessive, rainfall for the main Argentine dairy basins.

The forecast leads to assumptions of good conditions for the coming spring and summer for the development of pastures and crops for the preparation of reserves, but also a bad environment for the herds, with mud, insects, and high humidity. These are all factors that have been absent in the last three summers, which were dry and favored the comfort of the animals, good feed consumption and good conversion of feed into milk, variables that favor the productivity of the herds.

Image 1.

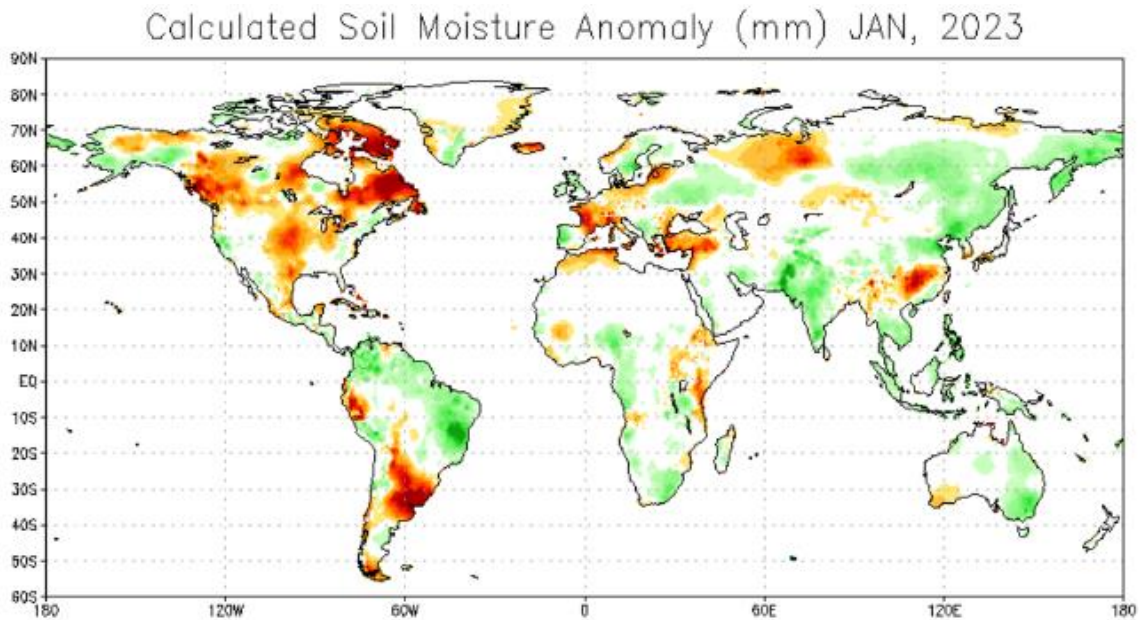


Source: SENASA

Source: Servicio Meteorologico Nacional

Regionally, drought was a determining factor in the behavior of export destinations and dairy commodity prices. The NOAA image below of precipitation anomalies provides a good illustration of the global soil moisture situation; the greatest impact of the drought took place in the main dairy producing region of South America: Southern Brazil, Uruguay, and the Pampas region of Argentina.

Image 2.



Source: NOAA

Dairy cow stocks and production stratification

Official dairy cattle stock figures for 2022 have not yet been released, so the last known official data corresponds to 2021 at which time 1.56 million dairy cows were reported, the distribution of which may be seen in the following table: 4.8 percent of the dairy farms gather 23.8 percent of the country's dairy cows, in line with a trend towards concentration of milk production.

Table 1.

Cows Range	Productive Units			Total Cows		
	Count	% of Farms	% of Cows	Count	% of Farms	% of Cows
Up to 50 cows	1.802	17,8%	17,8%	35.828	2,3%	2,3%
51 -100 cows	1.823	18,0%	35,8%	118.573	7,6%	9,9%
101 - 250 cows	4.469	44,1%	79,9%	619.652	39,7%	49,6%
251- 500 cows	1.544	15,2%	95,2%	432.450	27,7%	77,2%
501 - 1000 cows	373	3,7%	98,9%	188.259	12,1%	89,3%
More than 1000 cows	114	1,1%	100,0%	167.383	10,7%	100,0%
Total	10.125			1.562.145		

Costs

Production costs, primarily feed concentrates, corn and soybean derivatives were particularly expensive in terms of milk purchasing power during much of 2021 and 2022.

Global droughts and the conflict between Ukraine and Russia led to a sharp increase in grains over the last 2 years. In 2021 there were times when it was possible to buy just 1.3 kg of corn/Lt. of milk, a very low purchasing power considering that it is normally around 2 kg/Lt. of milk. The trend started to

change in the first semester of 2023 when the price of corn began to fall, reaching 2.12 kg/Lt. in July. However, the 20 percent devaluation in August 2023 caused the purchasing power to fall once again.

Somewhat similar occurred with soybeans, although in this case the ratio was not as bad as that of corn at any point in time. It is expected that devaluations will likely continue, and ratios will continue to fall as raw milk prices are unlikely to keep pace with devaluations.

Milk production

According to official data, 2022 ended with a total output of 11.557,000 MT, which is 0.04 percent higher than that of 2021. Despite the drought, lower pasture supply, higher costs, and poor milk-concentrate ratio, production remained stable due to the animal welfare generated by the dry weather and enhanced herd management. This led to an increased feed-to-milk conversion efficiency.

In early 2023, it was speculated that production for the year could sharply decrease due to similar factors as in 2022. The intense summer drought and heat resulted in lower production and quality of corn silage, further contributing to this belief.

However, official figures indicate that until July 2023, the output was estimated at 6,211 million liters. This represents a decrease of 0.34 percent compared to the first 7 months of 2022 and is likely due to the same factors mentioned above. In addition to the good management and comfort generated by the dry environment mentioned above, there was a drop in the international price of corn, which significantly improved the purchasing power of corn expressed as Kg of corn/Liter of milk, until August 2023 due to the devaluation already mentioned.

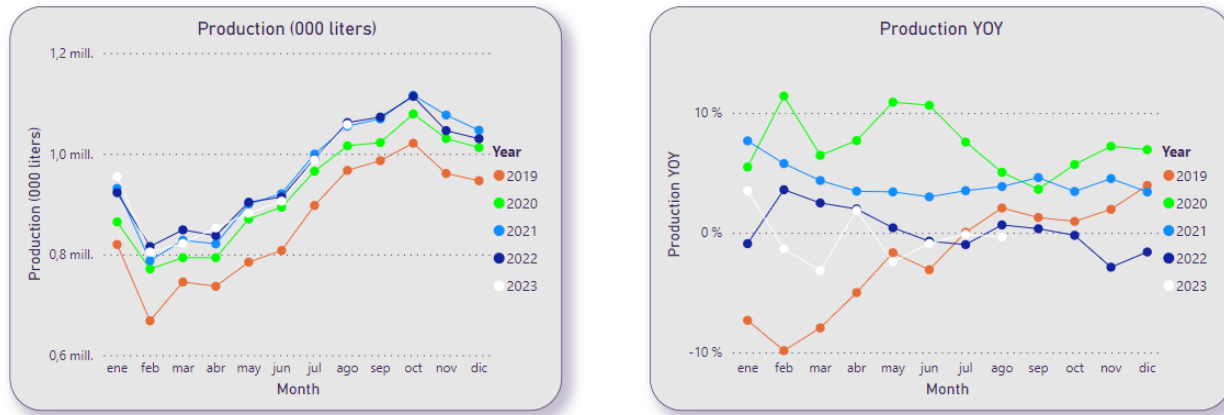
Producers sustained production by maintaining or increasing herd supplementation to compensate for the reduced pasture availability. However, this decision made their financial situation complicated, resulting in a financial burden for the second semester of 2023 and constant changes in feed purchasing power. These factors alone justify a change in production trends. Furthermore, there is a consensus that this year is an El Niño year, which has already started to show signs of commencement in some dairy regions due to abundant rains. If the situation worsens, it may require changes to the aforementioned comfort. Additionally, the fall in international prices, lower demand from Brazil, and a recessionary domestic market as the seasonal production peak approaches exacerbate the situation. All of these factors contribute to a decline in raw milk prices, making the outlook even more complex.

Post projects a slight drop in output, estimating a slightly over one percent decrease to 11.441,000 MT in volume by the end of 2023 compared to 2022.

For 2024, a complex projection, a series of factors could lead to a sharp production decrease, particularly in the first half of the year. One significant factor could be a devaluation which may have severe consequences, as previously stated. Additionally, it is important to consider the impact of weak global prices.

Based on these conditions, production in 2024 is estimated to decrease by at least 3 percent to 11,098 MMT. Monitoring the variables' dynamics is crucial to adjust the estimates, as changes in any of them can significantly affect the production projection.

Chart 1.



Source: Secretariat of Agriculture, Livestock, Fisheries and Food

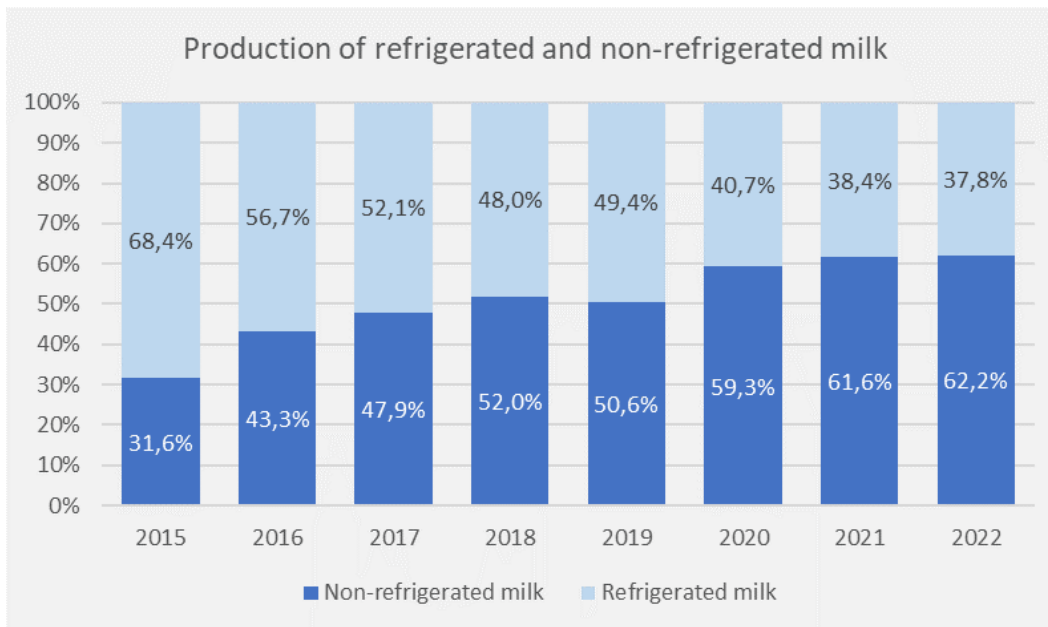
Fluid Milk: Domestic fluid milk sales decreased by 2.6 percent to 1,650 MT in 2022 compared to 2021, due to the country's challenging economic situation and its impact on the purchasing power of the population.

Nevertheless, official figures show that fluid milk consumption grew by 2.2 percent during the first half of 2023 in comparison to the same period in 2022. This trend may continue in the second half of the year despite the decrease in consumer purchasing power. Therefore, Post predicts that fluid milk consumption in 2023 will be 1,836 MMT. Inflation and devaluations are expected to impede consumption. Consequently, there will likely be an increase in the availability of long-life milk offers at very low prices due to it being a commodity during price crises. As a result, the supply will put pressure on prices and cause an increase of approximately 2 percent in fluid milk consumption, not due to increased demand, but rather due to supply.

Post estimates that the consumption of fluid milk in 2024 will decrease by at least 3 percent as compared to 2023 to 1,780 MT. This is due to the lower anticipated production volumes and economic adjustments that may impact consumption in the first semester.

With regards to the proportion of long-life and refrigerated milk in the fluid milk consumption, the percentage of long-life milk continues to go up. However, the rise in 2022 was lower compared to preceding years, with long-life milk accounting for 62.2 percent of all fluid milk consumption.

Chart 2.



Source: Magyp

Skimmed milk powder (SMP): During 2022, processing of skimmed milk powder reached 47,591 MT, representing a 10.45 percent growth compared to 2021. Of this amount, 18,253 MT were destined for domestic consumption, 27,797 MT were exported, and the rest is completed by a positive stock difference. Thus, according to official data, 2022 closed with a stock of 8,746 MT.

Of the total exports in 2022, 44 percent were destined for Brazil and 35 percent for Algeria.

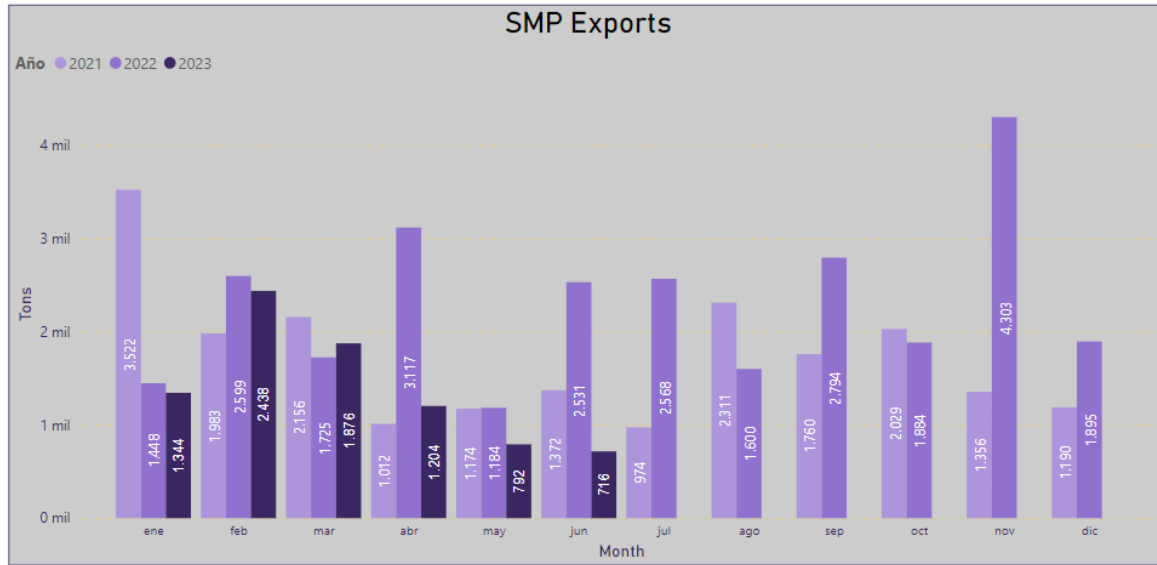
During the first half of 2023, production decreased by 32.1 percent compared to the same period in 2022, based on official data. Domestic sales and exports also dropped by 27.8 percent and 34.11 percent, respectively.

This downward trend in export volumes is expected to continue during the second half of 2023 due to low international SMP prices, predicted poor milk production trends, and reduced demand from Brazil. Post predicts that for 2023, SMP export volumes may decrease by 30 percent compared to 2022, and may reach 18,000 MT.

For 2024, Post forecasts that 34,000 MT of SMP will be produced and 27,000 MT will be exported.

It is important to note that external sales during the first few months of 2022 might include stocks that were committed in 2021 but could not be shipped due to logistical challenges. This also applies to the export of dairy products.

Chart 3. Skim Milk Powder Exports

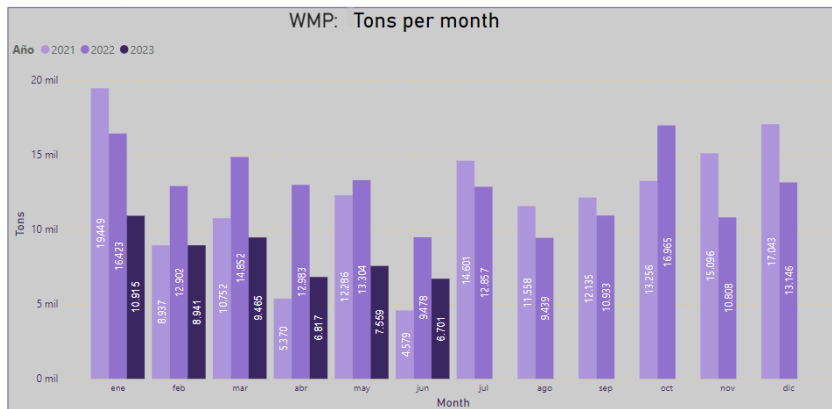


Source: Economía Láctea

Whole milk powder (WMP): According to official data, domestic sales of WMP in 2022 fell 12.0 percent from 2021 to 57,791 MT. Exports increased by 6.4 percent to 154,340 MT. Finally, considering the inventory difference (negative), it is estimated that processing reached 209,167 Tn, a volume 5.38 percent lower than in 2021.

In the first semester of 2023, processing fell by 23.0 percent compared to the same period of 2022. Exports were down 36.9 percent and domestic sales were up 8.1 percent. Processing is expected to improve slightly year-over-year in the second half of the year. Post forecasts WMP 2023 output at 188 MT.

Chart 4. Whole Milk Powder Production



Source: Economía Láctea

The region of the world that experienced the most severe drought from 2022 to the first half of 2023 was the region of southern Brazil, Uruguay, and the Pampas region of Argentina. During the second half of 2022 and the first half of 2023, this led to a severe milk shortage in Brazil and a significant increase in external demand, mainly supplied by Argentina and Uruguay, Brazil's Mercosur partners.

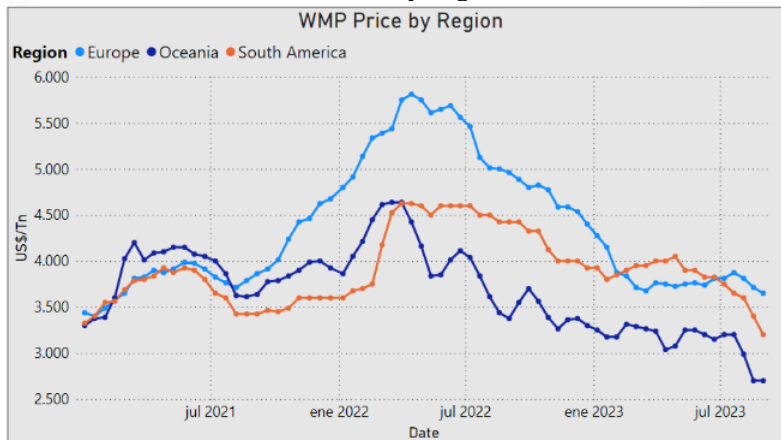
Chart 5. Whole Milk Powder Exports to Brazil



Source: Economía Láctea

The second consequence of this extreme weather phenomenon and Brazilian demand was that WMP prices in South America decoupled from the fall in Oceania prices from the second quarter of 2022 and were even higher than those in Europe between February and June 2023. This favored the milk price to be steady and as a consequence also helped production output not to drop.

Chart 6. Whole Milk Powder Price by Region



Source: USDA

For the remainder of 2023, it is expected that the industry will need to dry more milk due to seasonal production growth in a context of very weak international demand. This is likely to lead to an increase in stocks to be sold in the early months of 2024, when regional supply will begin to decline, and exporters will be able to liquidate exports at a much more favorable dollar value than at present.

Post estimates 2024 production of WMP at 225,000MT.

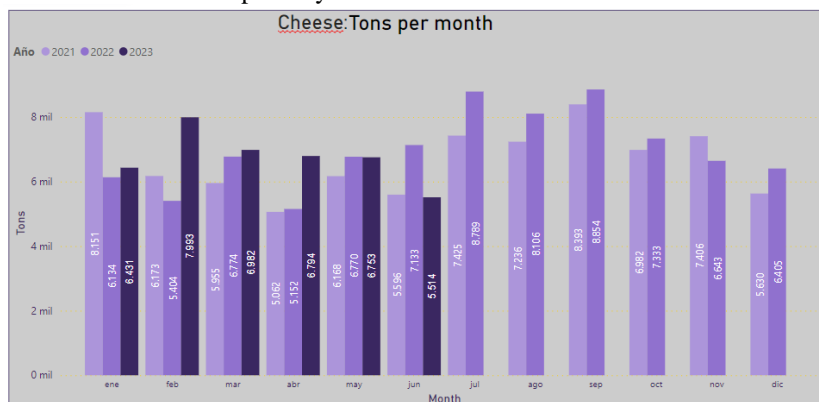
Cheese: In 2022, cheese production reached 462,541 MT, an increase of 2.13 percent compared to 2021. Of this total 82,421 MT were exported, a volume 6 percent higher than in 2021. Domestic sales increased by 2.4 percent to 379,939 MT.

In the first half of 2023, cheese processing grew by 7.6 percent compared to the same period in 2022. This growth was mainly due to exports, which increased by 11.6 percent, while domestic consumption increased by 0.5 percent.

Post forecasts that in the second half of 2023 this growth rate in processing will slow down and the year could end with a 6 percent growth in cheese processing, reaching 490,000 MT, with exports growing by 12 percent to 92,000 MT and domestic consumption falling by 5 percent as a result of the economic crisis the country is going through. This would lead to an increase in ending stocks.

Post forecasts that by 2024, production is expected to decline significantly to 451,000 MT due to the fact that domestic consumption is expected to fall, especially in the first half of the year after strong adjustments in economic variables, and that the year would begin with high stocks, which would result in depressing prices.

Chart 7. Cheese Exports by Month



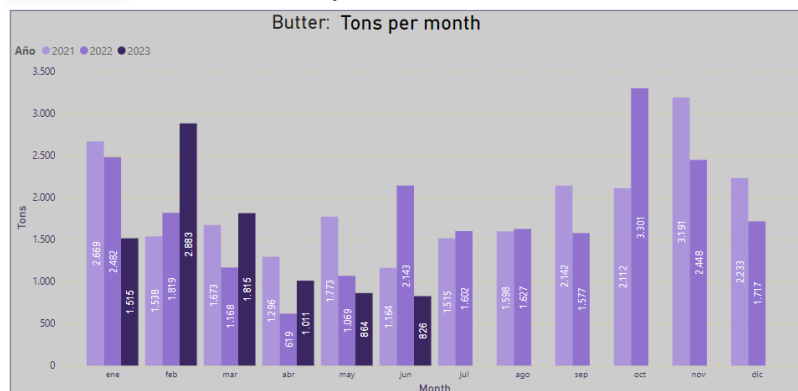
Source: Economía Láctea

Butter: Butter production in 2022 increased by 2.6 percent compared to 2021, reaching 44,217 MT. Of this total, 21,366 MT were destined for domestic sales, an increase of 3.1 percent with respect to 2021. Of this total, 21,769 tons were exported, a decrease of 5.1 percent compared to 2021.

The first half of 2023 is estimated to have closed with a sharp drop in butter production, according to official figures of 11 percent, as shown in the dairy balance. There is nothing to suggest that this trend will change in the rest of the year, therefore Post forecasts a 10 percent drop in butter production in 2023 to 39,000 MT.

For 2024, Post forecasts that processing will decline in line with lower milk production to 39,000 MT.

Chart 8. Butter Production By Month



Source: Economía Láctea

Policy

Export Duties: The Argentine Secretariat of Agriculture, Livestock and Fisheries announced on October 4, 2023, the publication in the Official Gazette of Decree 506/2023, which suspends export duties on dairy products and derivatives until December 31, 2023.

Decree 506/2023 (in Spanish) <https://www.boletinoficial.gob.ar/detalleAviso/primera/295450/20231004>

Secretary Juan José Bahillo emphasized the government's "commitment to supporting producers in the face of the fall in international prices" and stated that "this decision will allow them to improve their income levels".

The initiative includes products such as milk powder, different types of milk, yogurt, whey, butter, cheese, lactose, dulce de leche and ice cream among others.

Whole milk powder is Argentina's main export product and a benchmark for raw milk prices, especially in the second half of the year. Given the rigidity of the industry's cost structure, the impact of export tariffs falls on the price of the raw material.

For example, at an export price of USD 3,800/TON, export duties amount to USD 0.04/liter of milk.

Despite the temporary measure announced by Decree 506/2023, the future of export duties will depend on the outcome of the elections. According to the results of the primary elections, the probabilities of the candidates are divided into thirds. Two of the candidates with a high probability of winning the elections would immediately eliminate export duties on dairy products.

Exchange rate policy: One of the most important policy changes with a strong impact on the dairy industry has been and continues to be exchange rate policies. Concentrate feeding is the category that has the greatest impact on the cost structure of dairy farms, with corn as the primary energy source and soybean meal as the primary protein source.

The current government regulates the value of the commercial dollar, which, along with international prices, determines the value of agricultural commodities exported by Argentina.

With high inflation, grain producers tend to gradually liquidate the crop as they need capital, leaving the rest in storage to maintain value.

Therefore, in September 2022, in view of the need for dollars, the government established a differential price for the so-called "soybean dollar", which was 30% above the value of the commercial dollar. The measure was implemented for only one month, but was subsequently applied in December 2022 and in April and September 2023. Although a similar measure for corn has been discussed on many occasions, it has never been implemented due to the impact it would have on animal protein production. However, at the end of July, a dollar value with a 20 percent difference was introduced for the liquidation of corn, which lasted only 20 days, as after the primary elections a 20 percent devaluation of the commercial dollar was generalized.

All of these policies caused significant damage to milk producers, since they led to unexpected increases and uncertainty in one of the main components of production costs, and since it was an asymmetric devaluation, it did not improve income.

The exchange rate turbulence is expected to continue until the new government takes office. The damage to producers is very significant, even if it is not significantly reflected in production volumes until at least August 2023. As it is the end of winter, the need for concentrates is even greater. Production remains steady, but producers' finances are tightening.

After the elections, the peso is expected to depreciate sharply, which, depending on the winner, could even lead to a complete liberalization of the dollar. At the beginning of September, the gap between the value of the commercial dollar and the "free" dollar was in the range of 100%. Another fact is that in the futures market at the beginning of September for the September position the dollar was traded at 360 \$/US\$, while for the January 2024 position it was traded at 707 \$/US\$, which means that the market would speculate on a 96% devaluation.

The relevance of this issue lies in the fact that in Argentina, where 75-80 percent of the milk remains in the domestic market, whenever there is this kind of adjustment, the production costs, which are mostly dollarized, adjust immediately to the new dollar value, while the milk takes between 3 and 5 months to adjust to this new exchange rate, due to the fact that consumers also need time to feel this adjustment in their incomes. Therefore, as has happened in other recurrent currency crises that the country has experienced, the purchasing power of the main inputs, expressed in liters of milk, suffers a sharp decline in the first months after the devaluation, which is one of the fundamental issues to be analyzed in the growth projection for 2024.

Removal of subsidies: The policy of removing subsidies from various categories, such as energy, especially electricity, is maintained. As a result, the cost of energy is rising faster than inflation and faster than the price of milk, making the product more expensive.

Attachments:

No Attachments