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Dairy and Products Annual

Recovery of the Dairy Sector on the Horizon but Challenges Remain

Approved By:

Lazaro Sandoval

Prepared By:

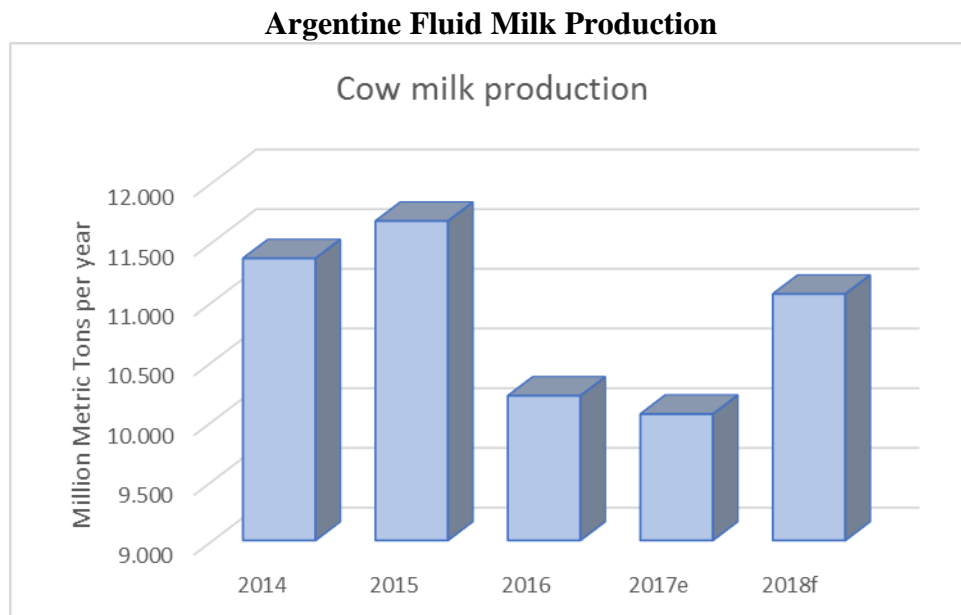
Andrea Yankelevich

Report Highlights:

After some years of decline, the Argentine dairy sector is beginning to recover. Milk output for 2018 is expected to rebound by 5 percent to 10.7 million tons (11,021 million liters) compared to 2017. This recovery is thanks to ongoing structural changes, higher prices, and better weather conditions after massive floods in 2016 and 2017. However, the sector's recovery still faces a myriad of obstacles as it confronts high costs and the lack of competitiveness in international markets.

Production

After two consecutive years of production decline, milk output in calendar year (CY) 2018 is projected to rebound at 10.7 Million Tons (11,021 million liters), roughly a 6 percent increase from Post's CY 2017 revised estimate. Forecast weather conditions are expected to deliver relief to a sector plagued by massive and damaging floods in 2016 and 2017. These floods along with the financial difficulties of SanCor, one of Argentina's top dairy producers, led to what producers believe is the worst crisis for the sector in the last 20 years. Next year's recovery is based on higher prices, stronger productivity (due to the consolidation of operations and withholding of more productive cows), and structural changes that are expected to streamline costs and allow the sector to become more competitive.



Source: Ing. Marcos Snyder, Dairylando

2017

Post estimates Argentine dairy production for CY 2017 at 10.09 million tons, a decline of one percent drop (equivalent to 9,796 million liters) from revised CY2016 levels. This decrease is based on a combination of high rain levels in the main dairy basins, high production costs (mostly feed and salary costs), and the infrastructure weaknesses that complicated dairy operations and limited product deliveries.

As was the case last year, Argentine dairy farmers faced unfavorable weather conditions – above average rains and floods – but in already deteriorated terrains which negatively affected milk production during the first half of the year. Production is expected to slightly rebound in the second half of the year but not enough to compensate, therefore milk output for CY 2017 is anticipated to be one percent lower than CY 2016. Conditions have improved in the Cordoba and Santa Fe production areas but the excess water from those regions drained to the Buenos Aires basin, which was already heavily saturated. Most production areas are dealing with poor access roads which have made dairy operations more difficult. It is also reported that feed reserves are very low or almost nonexistent.

Areas Impacted by Heavy Rainfall in the Provinces of Santa Fe, Córdoba, La Pampa, and Buenos Aires.

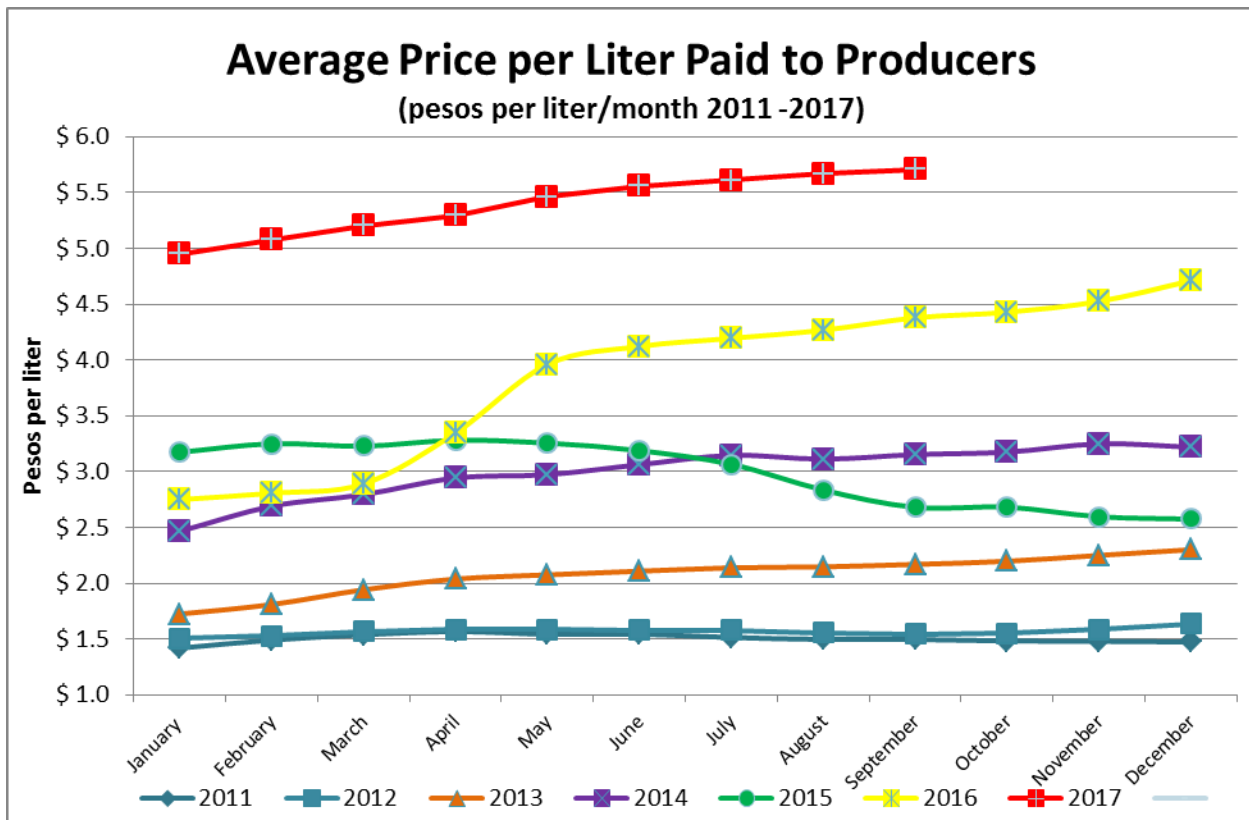


Source: CARBAP – Confederation of Rural Associations in Buenos Aires and La Pampa¹

Farm gate prices and production costs

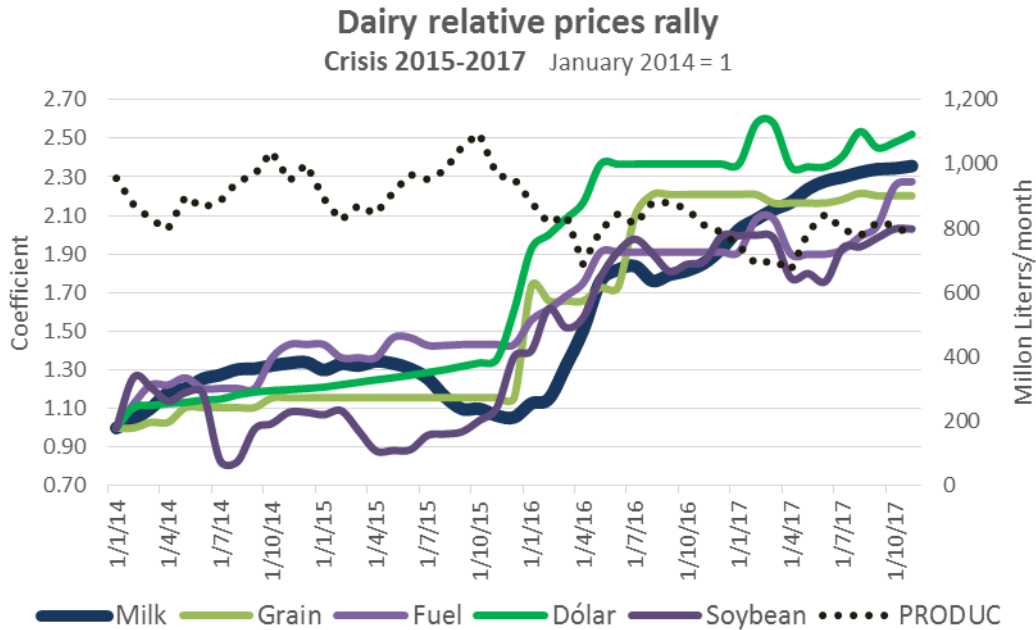
Farm gate prices increased significantly during 2017. The reported milk price for September 2017 was 5.71 AR\$ (approx. USD 0.32) which represents a 30.3 percent increase compared to September 2016, and a 0.6 percent increase from the previous month. The current corn/milk ratio (2.5kg corn/liter in September 2017) is very favorable. However, with high inflation and most production costs in dollars, many small and less efficient producers that produce on rented land are forced to close their dairy farms - in most cases by selling their cows to larger operations. These factors are accelerating ongoing concentration in the dairy sector, which is increasingly in the hands of large and highly efficient producers. In the primary producing province of Santa Fe, dairy closures were significantly higher than historical averages, especially for those dairies hit by floods during 2016. Reports show that between 500 to 600 dairy farms closed in 2016/2017. For this reason, the productive capacity of the sector and its recovery is significantly limited. Moreover, sector experts report that the sentiment among producers continues to be as one of fatigue, resignation, and lack of hope due to the accumulation of debt and unsolved structural problems that they do not see a resolution in short term.

¹ <http://www.lapoliticaonline.com/nota/108289>



Source: Argentine Ministry of Agriculture, Under Secretariat of Dairy

The above chart demonstrates relatively stagnant farm gate prices during the first quarter of 2016 and the years of 2014 and 2015. Contacts report these lackluster prices resulted in producers losing capital, increasing debt, or in the worst cases declaring bankruptcy. However, in May 2017 farm gate prices began to recover steadily along with input/product price.



Source: Ing. Marcos Snyder, Dairylando

The dairy sector's ongoing crisis has been exacerbated due to the developments of 2016 and the lack of recovery in 2017. As such, the dairy sector is requesting immediate assistance from the government on a number of issues, such as operation financing and infrastructure investments. This crisis reached a critical point with the news of Sancor, Argentina's largest dairy cooperative, facing the possibility of bankruptcy earlier this year.

Sancor: Argentina's Largest Dairy Cooperative Faces Financial Difficulties

Argentina's largest dairy cooperative, *Sancor*, is facing deep financial problems due to a number of longstanding issues and factors. This company has a processing capacity of up to 6 million liters of milk per year. However, only a third of this capacity is being utilized as the company has been forced to suspend operations in four of their plants.

Founded in 1938, *Sancor* is one of the leading dairy producers and exporters in Argentina. It represents one fifth of total dairy production in the country, producing fluid milk, powdered milk, cream, cheese, butter, yogurt, and desserts. It has been historically one of the largest Argentine exporters of dairy products. The company is based on the main dairy basin, the provinces of Santa Fe and Cordoba provinces. Sancor owns 16 industrial plants (currently operating with 12) with 4,000 employees.

Sancor's financial problems are rooted in longstanding problems. The cooperative overcame the 2001 Argentine crisis with debt and little chance of investment. In 2006, AdecoAgro almost acquired the cooperative, but a last minute agreement signed by former president Nestor Kirchner with his Venezuelan counterpart Hugo Chavez stopped the deal. Under that agreement, Venezuela primarily purchased Dry Milk Powder at lucrative prices, generally above international market ones. The

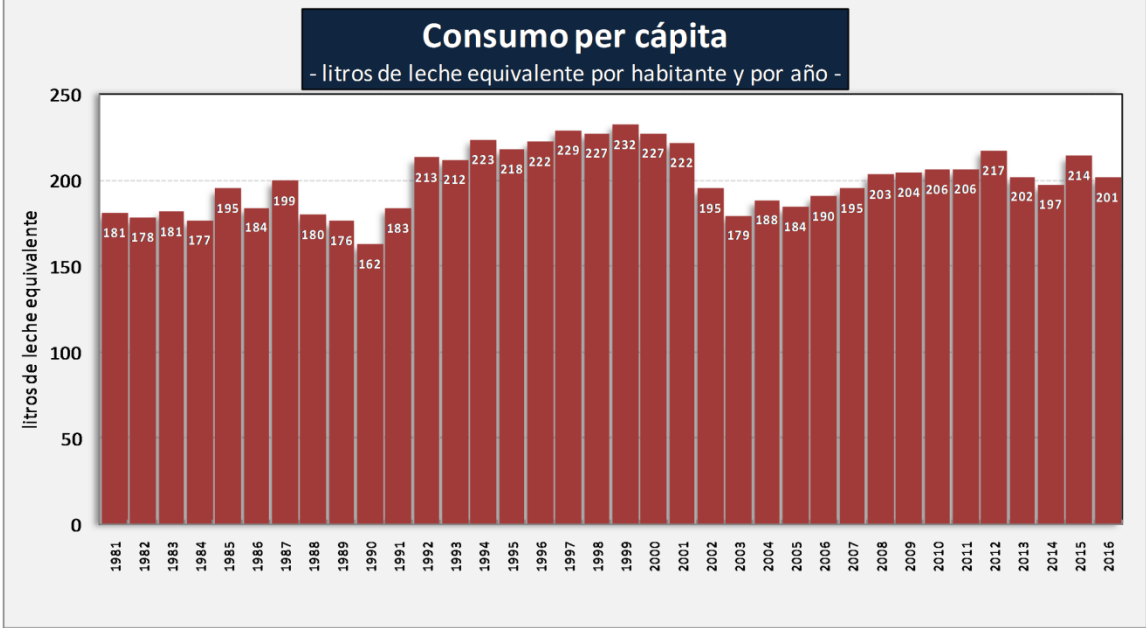
agreement continued for several years and Venezuela became Argentina’s main market for some time. This arrangement came to an end as Venezuela was increasingly unable meet its payment obligations due to its economic crisis. According to private sources, it’s estimated that the cooperative has incurred a debt level of US\$ 32 million. In several instances, the Government of Argentina had to provide financial assistance to the firm, with the last loan valued at US\$ 28 million signed at the beginning of last May. Contacts report that the future of the cooperative is still unclear. The government continues to evaluate other options to assist the company, and is evaluating offers from multinationals that might be interested in purchasing a share of the cooperative.

In July 2017, Fonterra, a New Zealand multinational dairy cooperative, confirmed that it was in talks with Sancor over the possibility of acquiring a part of the Argentine company. Reports from late October indicate that negotiations are advancing and that the government expects that Fonterra will soon finalize its plan to take over Sancor. The government is highly supportive of this move and is making efforts to facilitate a potential deal.

Consumption

Consumption is expected to rebound gradually in CY 2018, especially with inflation at lower levels and an improvement in consumer incomes. However, this recuperation will be slow. Domestic consumption slightly declined in CY 2017 as a result of high inflation and the loss of purchasing power of the Argentine consumer due to an economic recession. Despite the promotions and discounts at retail level, consumers purchased second brands and were mostly limited to basic products. Wholesale chains reported increased sales (up to 30 percent) to consumers.

Annual Per Capita Consumption of Dairy Products in Liters



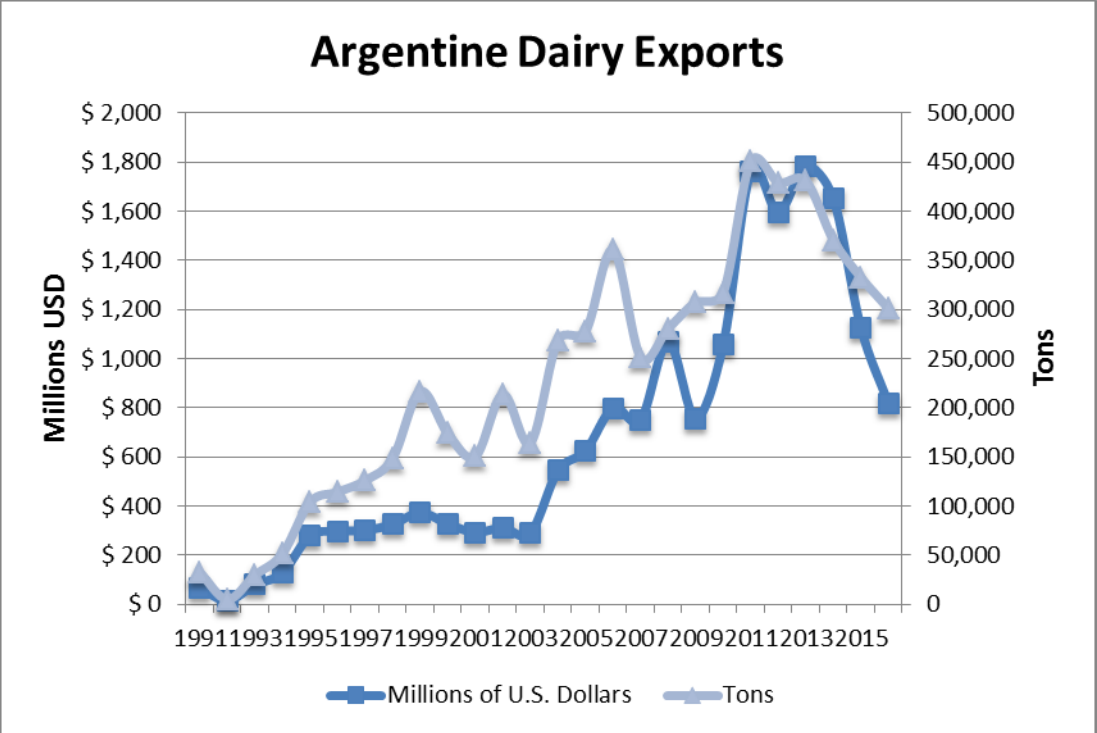
Source: Observatorio de la Cadena Lactea Argentina (OCLA)

Exports

Post forecasts total dairy exports of main products (Fluid Milk, Dry Whole Milk Powder (DWMP), Dry Non Fat Powder (DNFP), Cheese and Butter) for CY2018 at 183,000 MT. This forecast is mainly based on the modest recovery in milk production and the recovery of international prices.

In the first nine month of 2017, Argentina exports were almost 12 percent of total estimated production, the lowest value in this century. Factors behind this drop are lower production, better domestic prices, and lack of competitiveness in foreign markets due to increased costs, high taxation, and an overvalued Argentine peso

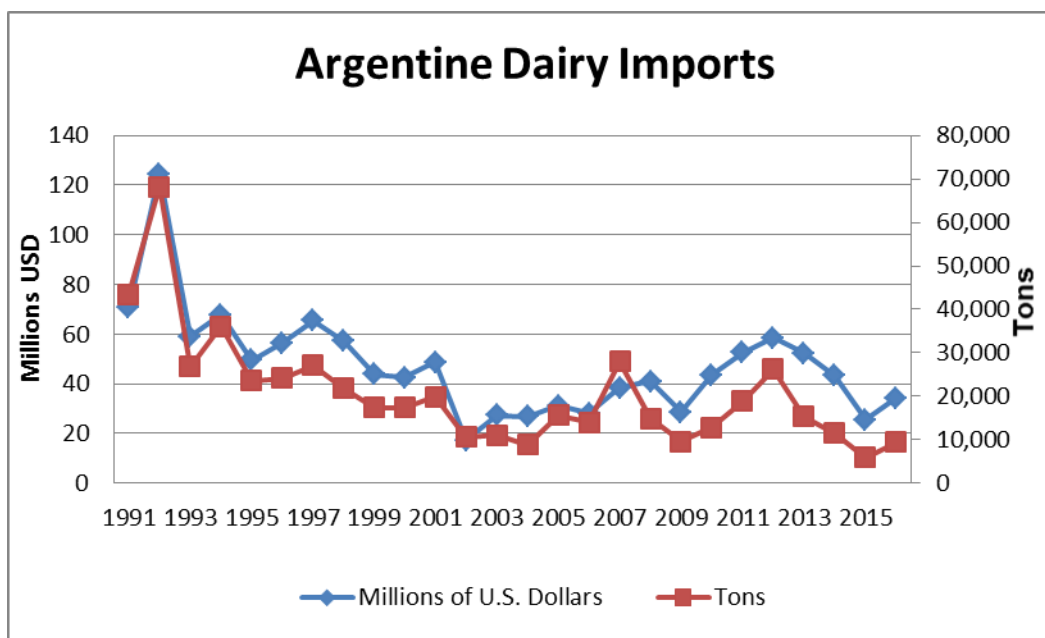
Argentina’s primary markets for dairy products in CY2017 were Brazil (42 percent), Russia (11.5 percent), China (8 percent) and Algeria (7.5 percent). Exported products with better performance in volume terms were Dry Whole Milk Powder (38.3 percent), Whey (24.7 percent), and Cheese (20.4 percent).



Source: National Statistics Agency (INDEC) in collaboration with the Ministry of Agro-Industry – Sub-Secretariat of Dairy

Imports

Imports increased in the first eight months of 2017 although volumes were marginal. Total imports for that period in volume were 38 percent higher than the same period in 2016. The increase is made up mainly of butter from Uruguay and caseinates from Germany.



Source: Ministry of Agro-Industry – Sub-Secretariat of Dairy

Policy

There has been no change in policy except for the government’s intention to introduce initiatives to provide more financing options for dairy producers along with the introduction of measures to make more transparent the dairy value chain and better the marketing of dairy products.

The government along with several banks (for example Banco de La Nacion Argentina) has been able to develop a credit line to help producers. Although these credit lines present a significant degree of flexibility, some contacts estimate that it’s not enough to help producers in deep financial problems.

Statistical Tables

Dairy, Milk, Fluid Market Begin Year	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
Argentina	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	1715	1720	1630	1672	0	1683
Cows Milk Production	10191	10191	10395	10090	0	10700
Other Milk Production	0	0	0	0	0	0
Total Production	10191	10191	10395	10090	0	10700
Other Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
Total Supply	10191	10191	10395	10090	0	10700
Other Exports	11	11	11	5	0	7
Total Exports	11	11	11	5	0	7
Fluid Use Dom. Consum.	1708	1708	1744	1681	0	1793
Factory Use Consum.	8472	8472	8640	8404	0	8900
Feed Use Dom. Consum.	0	0	0	0	0	0
Total Dom. Consumption	10180	10180	10384	10085	0	10693
Total Distribution	10191	10191	10395	10090	0	10700

(1000 HEAD) ,(1000 MT)

Dairy, Dry Whole Milk Powder Market Begin Year Argentina	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	45	45	25	32	0	25
Production	180	157	185	146	0	160
Other Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
Total Supply	225	202	210	178	0	185
Other Exports	110	109	80	90	0	91
Total Exports	110	109	80	90	0	91
Human Dom. Consumption	90	61	92	63	0	64
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	90	61	92	63	0	64
Total Use	200	170	172	153	0	155
Ending Stocks	25	32	38	25	0	30
Total Distribution	225	202	210	178	0	185

(1000 MT)

Dairy, Milk, Nonfat Dry Market Begin Year Argentina	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	12	0	10
Production	40	45	42	42	0	47
Other Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
Total Supply	40	45	42	54	0	57
Other Exports	26	26	22	24	0	26
Total Exports	26	26	22	24	0	26
Human Dom. Consumption	14	7	20	20	0	22
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	14	7	20	20	0	22
Total Use	40	33	42	44	0	48
Ending Stocks	0	12	0	10	0	9
Total Distribution	40	45	42	54	0	57

(1000 MT)

Dairy, Butter Market Begin Year Argentina	2016		2017		2018	
	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	4	4	4	3	0	2
Production	47	34	51	27	0	32
Other Imports	0	0	0	1	0	0
Total Imports	0	0	0	1	0	0
Total Supply	51	38	55	31	0	34
Other Exports	6	4	7	2	0	4
Total Exports	6	4	7	2	0	4
Domestic Consumption	41	31	44	27	0	28
Total Use	47	35	51	29	0	32
Ending Stocks	4	3	4	2	0	2
Total Distribution	51	38	55	31	0	34

(1000 MT)

Dairy, Cheese	2016	2017	2018
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Market Begin Year	Jan 2016		Jan 2017		Jan 2018	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Argentina						
Beginning Stocks	40	40	40	34	0	33
Production	515	432	535	424	0	466
Other Imports	3	2	6	5	0	3
Total Imports	3	2	6	5	0	3
Total Supply	558	474	581	463	0	502
Other Exports	53	53	50	50	0	55
Total Exports	53	53	50	50	0	55
Human Dom. Consumption	465	387	496	380	0	400
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	465	387	496	380	0	400
Total Use	518	440	546	430	0	455
Ending Stocks	40	34	35	33	0	47
Total Distribution	558	474	581	463	0	502
(1000 MT)						