Required Report - public distribution

Date: 10/22/2013
GAIN Report Number: UP1334

Ukraine

Dairy and Products Annual

Report

Approved By:
Randall Hager

Prepared By:
Alexander Tarassevych, Agricultural Specialist

Report Highlights:
High raw milk prices became the major factor restricting competitiveness of Ukraine's dairy products on the world market. Some milk production increase is utilized mainly by domestic producers of whole milk products. Ukraine will remain to be the biggest cheese supplier to Russia in 2013 and 2014. Trade in dairy products will remain fragile and subject to restrictions in major export markets. Small import markets for high quality cheese, butter, and consumer-oriented dairy products will continue to develop in the country in 2013/14.

Data included in this report is not official USDA Data. Official USDA data is available at http://www.fas.usda.gov/psd

Executive Summary:

The livestock population in the country stabilized in 2012 after decades of decline, with moderate growth outlook for 2013/14. Total milk production is growing slowly driven by increased productivity and high prices. Insignificant contraction of dairy cows number will be offset by increased productivity. Production of all types of dairy products grew in 2012-13 reflecting growing disposable incomes.

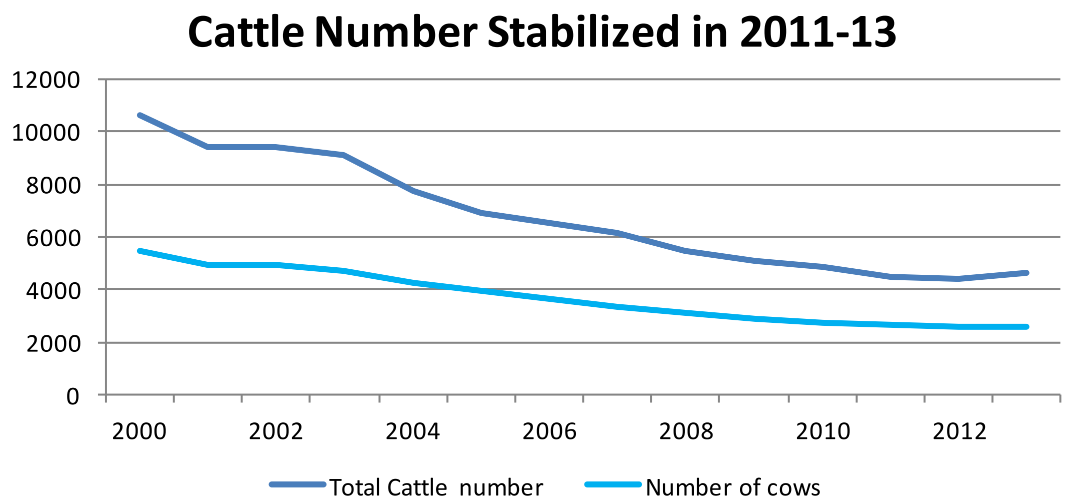
Exports to foreign markets remain limited for all dairy products but cheese. Ukraine will remain the largest supplier to world's largest cheese market--Russia. Multiple trade conflicts that Ukrainian exporters faced had only limited negative impact. The trade in cheese is expected to remain close to 2012 numbers in both 2013 and 2014. Exports of Nonfat Dried Milk (NFDM) would also contract due to problems on the major export markets.

Import of dairy products will continue to grow. Many Ukrainian consumers with higher incomes prefer higher quality imported cheese, butter and whole milk products. Although insignificant in 2012-13, Ukraine's imports may create a rather big import niche market in the future. Most of the imports arrive from EU countries.

If Ukraine signs the Association Agreement which will empower the Free Trade Agreement with the EU in the end of November of 2013, it could result in increased imports of processed dairy products from the EU in 2014 and beyond. At the same time it can cause problems with Ukraine's exports to Russian Federation.

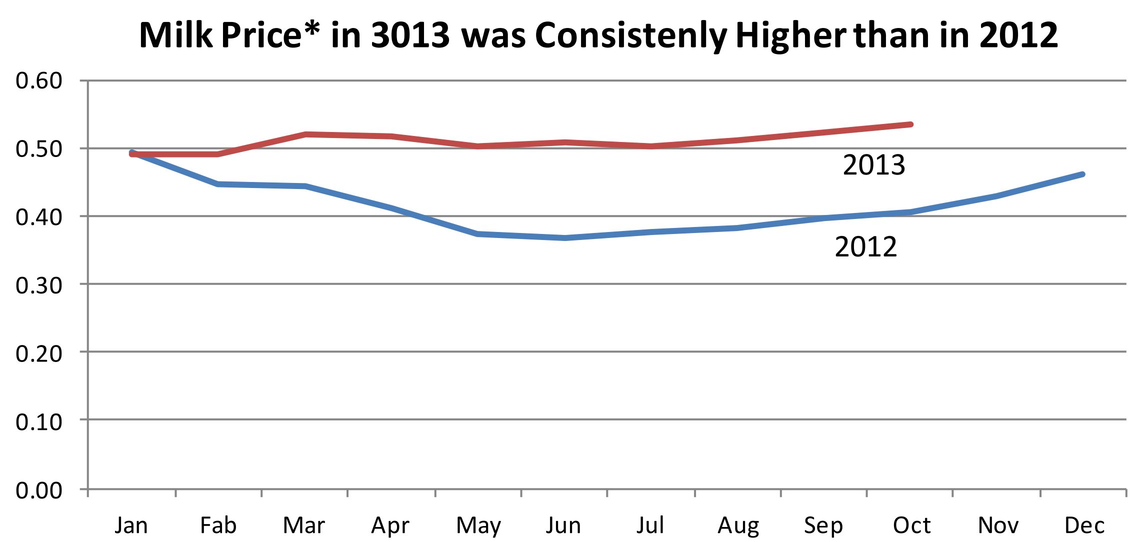
Production:

Milk production in Ukraine is expected to grow moderately in 2013 and 2014. The overall increase will be close to one percent. The number of cows will continue to decline while per cow yield will be growing in both household sector and industrial farms. Efficiency increase is especially evident among industrial enterprises, which decreased the cow inventory by 1.3 percent (as of August of 2013 in comparison to August 2012), but managed to increase total raw milk yield by 1.6 percent.



Source: State Statistics Committee of Ukraine

Overall milk supply in Ukraine remains rather limited, driving prices up. In 2013 Ukraine's domestic raw milk price was constantly above the 2012 price and significantly higher than milk price on many foreign markets. Raw milk price imposed a significant restriction on exports of dairy products.



Sources: Ukrainian Association of Milk Producers; MilkUA.info; FAS own calculations
** Prices ($/KG) for the first grade milk procured form the industrial farms*

Raw milk production in Ukraine continues to be concentrated mainly in households (78 percent of total production in 2013). Milking practices there lead to quality problems and reduced procurement price. Supply of milk from households is very difficult to control: backyard milk production is very seasonal with a significant production drop during winter and peak during spring-summer months. It also has rather high real production cost in comparison to industrial farms. Milk collection, cooling and transportation constitute additional problems.

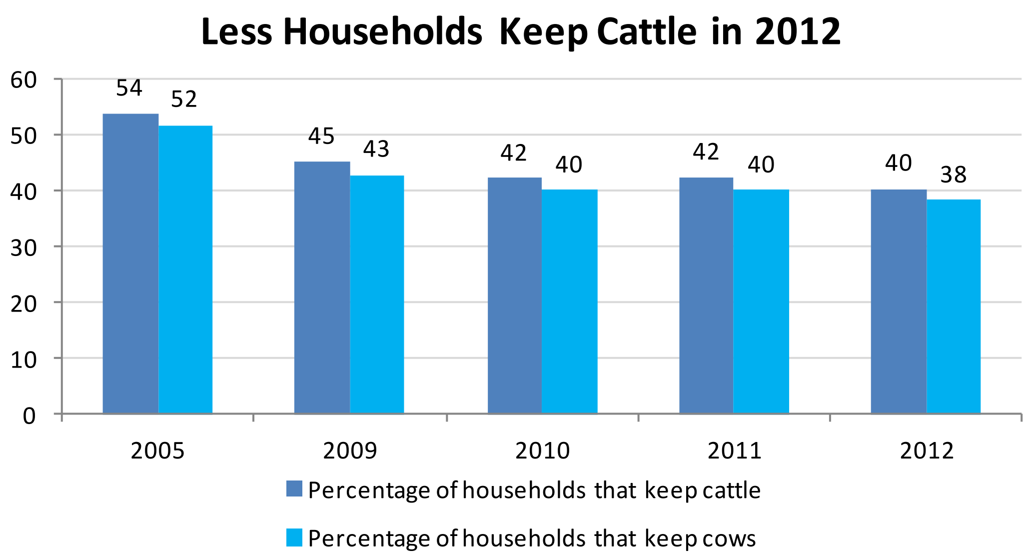
Table1. Milk Production at Farms of all Types Jan 1 – Aug 1 (1000 MT)

Milk production	2012		2013		2013% to 2012
	Volume	Share	Volume	Share	
Farms of all types	7884	100	7951	100	100.9
Industrial Farms	1757	22	1785	22	101.6
Households	6127	78	6167	78	100.6

Source: State Statistic Committee of Ukraine

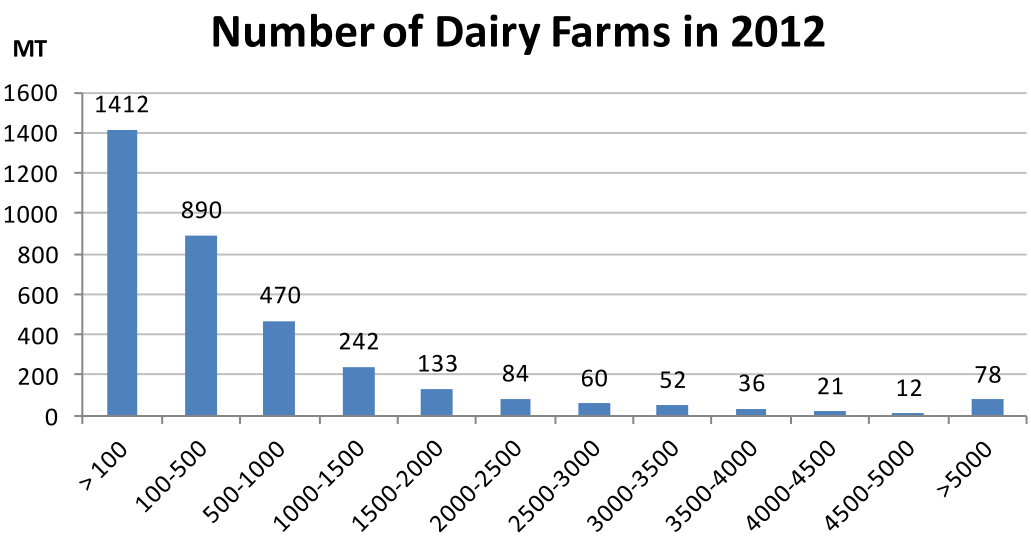
Insignificant industrial milk production leaves Ukrainian dairy processors no choice but to procure milk from households. Many processors enter into cooperation agreements with individual suppliers or with village communities in an attempt to increase quality and decrease seasonality. Processors often offer long-term contracts with more attractive pricing, supply some villages with modern refrigeration systems and milk tanks. Many run educational programs on sanitary rules.

The rural population considers household dairy production as a "safety net" in case big industrial farms where many are employed experience economic difficulties. A typical dairy enterprise with one to three cows provides much needed off-season cash flow, when other sources of income are unavailable. However due to increased age of rural population and better employment opportunities in urban areas and in big industrial farms number of cattle in households keeps decreasing over time.



Source: State Statistics Committee of Ukraine

Milk from industrial farms continues to be the most desirable by the processors due to consistent quality. This milk allows for production of high-margin whole dairy products and cheese. The vast majority of milk is produced by small not specialized dairy farms producing less than 1,000 MT of milk annually. However recent investments into dairy farms led to rapid growth of big specialized farms producing milk of very high quality. In 2012 Ukraine had 78 large farms with over 5,000 MT annual milk production.



Source: State Statistics Committee of Ukraine

A significant share of agricultural land in Ukraine is rented by large agricultural producers with planted area ranging from 10,000 hectares (24,700 acres) to 700,000 hectares (1.7 million acres). Many big producers with land acquired dairy enterprises and maintain dairy production. At the same time very few invest into enterprise to develop profitable business. Similarly to households, cows are usually viewed as social safety net aimed at maintenance of rural employment.

High milk prices in 2013 encourage some investments into large industrial dairy production. There are Ukrainian farms that have turned to the U.S. for high quality animals and dairy genetics. A bilateral U.S.-Ukraine protocol for live breeding cattle signed in September of 2013 will facilitate further growth of Ukrainian dairy industry.

The 2012/13 good grain crop had positive impact on milk production. Due to some shifts in the crop planted areas between 2012 and 2013 growing season’s wheat, corn, and rapeseed areas increased in 2013 providing dairy industry with good feed base. Improved winter crop conditions in 2013 also resulted in more winter wheat being available for harvesting. Although corn is not completely harvested when this report was drafted, the coarse grain crop is expected to be better than average.

Increased production of whole dairy products (WDP) in 2012/13 became the major driving force of high milk price. In 2013 production growth is expected to continue with 2-10 percent increase for major product groups. Ukrainian WDP market is oriented at domestic consumption and less vulnerable to external shocks.

Table 2. Production of Selected Whole Milk Products

	2008	**2009**	**2010**	**2011**	**2012**	**Change 2011/12**
Sour Milk Products	510	477	464	448	486	108,5
- incl. yougurt	79	73	79	81	89	109,9
Whey	18	16	19	32	36	112,5
Soft Cheese	92	85	79	78	79	101,3

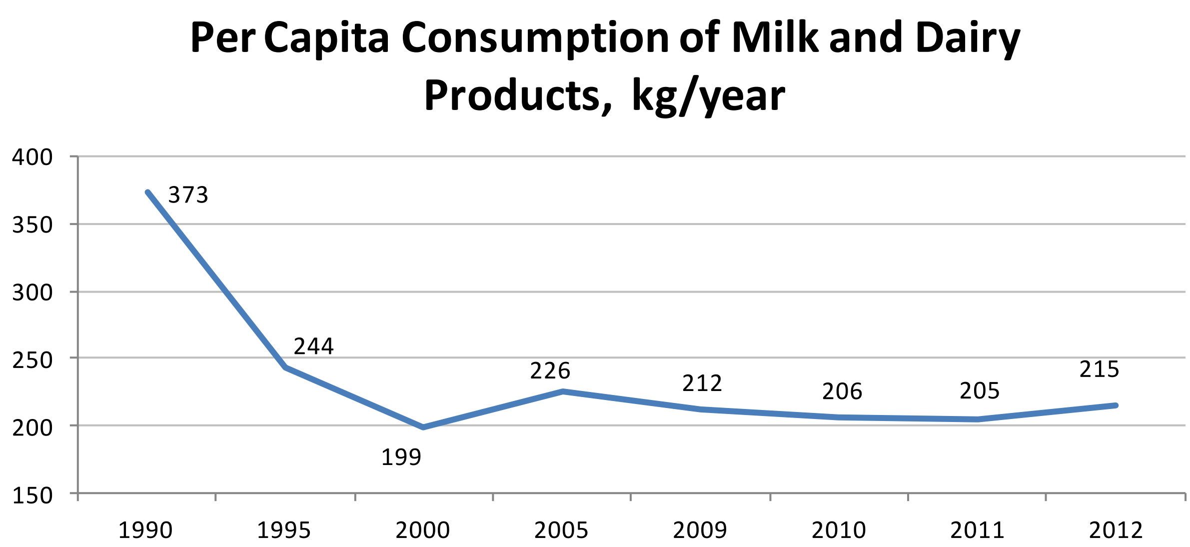
Source: *Ukrainian Dairy Union, State Statistics Service of Ukraine, FAS/Kyiv own calculations*

Part of the increase in animal number in the households can be attributed to state support programs initiated in 2012 that targeted households. The program covers registered young bovine animals (registration sometimes is not the case in the households) that were born in households and not slaughtered. For 3-5 month old cattle the GOU allocated UAH 250 ($31.25) per head, for 6-8 months old cattle, UAH 500 ($ 62.50) were allocated, and for 9-11 month olds, the amount is UAH 750 ($93.75). In the future the state budget support program will be targeting longevity of young animals. The sum would be equal to UAH 250 ($ 31.25) per head every three months until the animal reaches 11 months of age. Although the support sum is relatively small, money distribution is often delayed and access to it is not straightforward the program may have had a limited impact.

Another factor positively influencing cattle number was relatively high and stable beef prices. The domestic market is influenced by the high prices in Russian Federation where majority of exports go. Despite multiple trade disturbances exports to Russia are expected to continue in 2013-14.

Consumption:

Ukrainian economy entered the 2013 in recession due to GDP contraction in the last two quarters of 2012. Economic decline continued in 2013 with 0.5 percent GDP drop in the first and 1.3 percent in the second quarters of 2013. Many international financial institutions forecast zero or slightly negative GDP for 2013 with some rebound in 2014. Although economy took a dive in the second half of 2012 real disposable income grew by 9.7 percent in comparison to 2011. The majority of the increase came in a result of social transfers and wages increase leading to 14.4 percent spending for goods and services increase. A significant part of this increase was absorbed by dairy producers. Ukrainians continue to spend over half of their disposable income for food products. This led to significant increase in production of WDP and increased imports.



Source: *State Statistics Service of Ukraine*

Affluent Ukrainian consumers who are dissatisfied with the inconsistent quality of domestic cheese and butter consider high value added products imported from abroad providing opportunity for foreign exports. Significant import growth of cheese and butter in 2013 confirms this trend.

Trade:

Due to high price for raw milk competitiveness of Ukrainian dairy products diminished through the 2012/13. Nonetheless Ukraine continues to supply significant quantities of cheese and non-fat dried milk abroad. Majority of these products goes to traditional Former Soviet Union (FSU) countries markets with Russia being the major consumer. At the same time a significant domestic market for high quality imported dairy products continues to grow. Though its development is withheld by cumbersome import procedures and difficulties with obtaining the veterinary permits. Customs valuation of imported products also remains an obstacle for further trade growth.

Due to Free trade Agreements signed with seven Commonwealth of Independent States (CIS) countries (Russian Federation, Kazakhstan, Belarus, Kirgizstan, Moldova, Tadzhikistan and Armenia) Ukraine was able to keep its preferential status as cheese exporter to Russian Federation. When import duties were increased in early 2013 Ukraine received a significant competitive advantage in comparison to its EU competitors (mostly Germany and Netherlands).

Additional trade restrictions imposed by Russia allowed for a significant export price increase. Ukrainian cheese price went up from $5,500 in the end of 2012 to $5900 in the middle of 2013. The price of German and Dutch cheese also grew, but remained significantly lower at $4,700 - $4,900 per ton.

The situation may change in November of 2013, if Ukraine signs an Association Agreement with the EU. The Agreement will allow for the empowerment of the Free Trade Agreement which was negotiated between Ukraine and the EU in 2012. The Association Agreement may have far reaching trade implications impacting Ukraine’s trade with CU countries. Russian politicians made multiple statements about review of existing preferential status of Ukrainian exporters should Association Agreement be signed in November.

Many analysts believe that exports to Russia will become more complicated. It is difficult to consider all factors and build forecast for 2014 due to high role of political component. Current analysis envisages existing trade regime and moderate export restrictions level on major export markets.

Cheese

Cheese remains Ukraine’s major exportable dairy sector commodity with over 87 percent of all exports going to Russian Federation. Dependence of the cheese trade from trade regime in Russia is very significant. During 2012-13 there were multiple trade disruptions for Ukrainian cheese producers as Russian controlling authorities stopped exports. The biggest problem appeared in February of 2012 when Rospotrebnadzor banned imports from six major Ukrainian producers: Pyriatynsky Cheese plant, Ahtyrka Cheese Plant, Dubnomoloko, Prometei, Gadiachsyr and Lozovsky Daory Plant. The allegations were disconfirmed in April with limited cheese supplies renewed in May. Full scale exports continued to be restrained till August of 2012 with additional control imposed till April of 2013. According to Russian authorities additional 1,260 samples were taken during 2012 and early 2013.

The list of approved facilities was changing rapidly throughout last year. In August 2013 Rosselkhoznadzor discovered antibiotics in cheese produced by two Ukrainian plants: Prometey and Mensky Syr. This triggered additional import controls of each cheese batch produced at these two plants. In October 2013, Molis Company returned to the list of approved suppliers. Currently the list includes 17 Ukrainian producers approved for export to Russia and changes are possible at any moment.

According to the Ukrainian Dairy Union assessment, in 2013 exports will remain close to 2012 numbers. Russian market remains attractive for a number of reasons:

- Cheese price in Russian Federation remain significantly higher than in Ukraine, which makes sales profitable despite relatively high raw milk price
- Exports to Russia allow Ukrainian producers to diversify sales and decrease production risks
- Companies can receive a foreign currency flow to mitigate Ukrainian currency devaluation risks

Butter

High raw milk price decreased competitiveness of Ukrainian butter abroad. Exports are not expected to exceed 1,000 MT in both 2013 and 2014. In most cases Ukrainian product is just more expensive in comparison to the main competitors form the New Zealand, Uruguay or Australia. Import regulations on the biggest export market in Russia also leave little hope for export growth. In addition Ukraine is struggling to sell its NFDM, which is an important co-product in butter production. Production and export of cheese looks more attractive for the vast majority of Ukrainian dairy plants.

Imports of butter grew throughout both 2012 and 2013. Quality of imported butter is preferred by many affluent Ukrainian consumers. Many of them have heard of quality problems with Ukrainian butter and use of vegetable oils in "butter" marked products. Although imported butter is significantly more expensive, its market share is growing. In 2013 Ukraine may double its import.

Nonfat Dry Milk /Whole Milk Powder

In 2013 Ukraine met a significant problem with export of its NFDM. By mid 2013 exports decreased by 67 percent, while production of the dried milk products in the country dropped only by seven percent (official statistics does not distinguish between NFDM and WDM). Production of butter grew by one percent. Ukrainian producers will have to significantly increase export of the NFDM by the end of the year or end up with very significant carryover stocks.

Production and export of WDM is expected to remain stable in 2013-14. Ukrainian producers consider WDM production and export less attractive as availability of seasonal milk is decreasing and price remains high throughout the entire season. This high raw milk price does not allow for profitable WDM production when Russia delists cheese production facilities although this option was used by many producers in the past.

Information on the state purchases of dried milk products is unavailable, although the Agrarian Fund (GOU operated agency) promised processors to procure some dry milk in late 2012. State interventions are restrained by lack of financing and not likely to be significant in 2013-14.

Trade estimates for 2012 were revised to converge with official statistics. The trade forecast for the remaining months of 2013, as well as for 2014 remains subject to trade policy changes and possible new TBT introductions.

Statistical Tables

Fluid Milk PSD Table*

Dairy, Milk, Fluid Ukraine	2012		2013		2014
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014
	USDA Official	New Post	USDA Official	New Post	New Post
Cows In Milk	2,582	2,582	2,560	2,554	2,540
Cows Milk Production	10,900	11,080	11,050	11,160	11,220
Other Milk Production	300	298	310	310	320
Total Production	11,200	11,378	11,360	11,470	11,540
Other Imports	5	4	7	7	12
Total Imports	5	4	7	7	12
Total Supply	11,205	11,382	11,367	11,477	11,552
Other Exports	0	0	0	0	0
Total Exports	15	6	10	10	10
Fluid Use Dom. Consum.	5,345	5,588	5,487	5,667	5,692
Factory Use Consum.	4,845	4,716	4,900	4,800	4,900
Feed Use Dom. Consum.	1,000	1,072	970	1,000	950
Total Dom. Consumption	11,190	11,376	11,357	11,467	11,542
Total Distribution	11,205	11,382	11,367	11,477	11,552
1000 HEAD, 1000 MT					

These are not official USDA numbers

Cheese PSD Table*

Dairy, Cheese Ukraine	2012		2013		2014
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	0	0	0	0	0
Production	165	145	170	147	150
Other Imports	16	14	18	18	23
Total Imports	16	14	18	18	23
Total Supply	181	159	188	165	173
Other Exports	70	64	65	65	60
Total Exports	70	64	65	65	60
Human Dom. Consumption	111	95	123	100	113
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	111	95	123	100	113
Total Use	181	159	188	165	173
Ending Stocks	0		0	0	0
Total Distribution	181	159	188	165	173
1000 MT					

*These are not official USDA numbers

Butter PSD Table*

Dairy, Butter Ukraine	2012		2013		2014
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	0	0	0	0	0
Production	85	88	90	90	92
Other Imports	7	7	5	12	14
Total Imports	7	7	5	12	14
Total Supply	92	95	95	102	106
Other Exports	1	0	2	1	1
Total Exports	1	0	2	1	1
Domestic Consumption	91	95	93	101	105
Total Use	92	95	95	102	106
Ending Stocks	0	0	0	0	0
Total Distribution	92	95	95	102	106
1000 MT					

*These are not official USDA numbers

Nonfat Dry Milk PSD Table*

Dairy, Milk, Nonfat Dry Ukraine	2012		2013		2014
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	2	2	2	2	2
Production	48	52	50	52	52
Other Imports	4	3	3	2	3
Total Imports	4	3	3	2	3
Total Supply	54	57	55	56	57
Other Exports	23	26	23	17	20
Total Exports	23	26	23	17	20
Human Dom. Consumption	29	29	30	39	35
Other Use, Losses	0		0	0	0
Total Dom. Consumption	29	29	30	39	35
Total Use	52	55	53	56	55
Ending Stocks	2	2	2	2	2
Total Distribution	54	57	55	58	57
1000 MT					

*These are not official USDA numbers

Dry Whole Milk Powder PSD Table*

Dairy, Dry Whole Milk Powder Ukraine	2012		2013		2014
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	0	0	0	0	0
Production	11	11	11	11	11
Other Imports	1	1	1	2	2

Total Imports	1	1	1	2	2
Total Supply	12	12	12	13	13
Other Exports	2	1	2	0	0
Total Exports	2	1	2	0	0
Human Dom. Consumption	10	11	10	13	13
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	10	11	10	13	13
Total Use	12	12	12	13	13
Ending Stocks	0	0	0	0	0
Total Distribution	12	12	12	13	13
1000 MT					

*These are not official USDA numbers