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Global Agricultural Information Network

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Ukraine

Dairy and Products Annual

Annual Report

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Report Highlights:

Production of raw milk will grow slightly in 2012/13, driven by higher efficiency of dairy farms. Production of dairy products is expected to grow modestly with exception of cheese. Exports of cheese, butter, and whole milk dairy products will continue to be limited to Former Soviet Union Countries. Exports of dried milk products will continue all over the world. Exports of cheese will be significantly hampered by trade restrictions imposed by the Russian Federation, with severe negative impact on domestic production.

Executive Summary:

The number of dairy animals in the country had ended its 21 year declining trend and will stabilize in 2012. The trend for improved efficiency of dairy animals will continue in the near future, thus milk production has passed its minimum in 2011 and will be modestly increasing in 2012-13. Significant raw milk production increases are unlikely due to limited international and domestic demands for Ukrainian dairy products.

The price of raw milk is expected to remain high following the high price of feeds and other inputs. Recent trend for investments into industrial dairy farms will continue, but the number of upgraded farms is likely to remain insignificant with limited impact on total milk production.

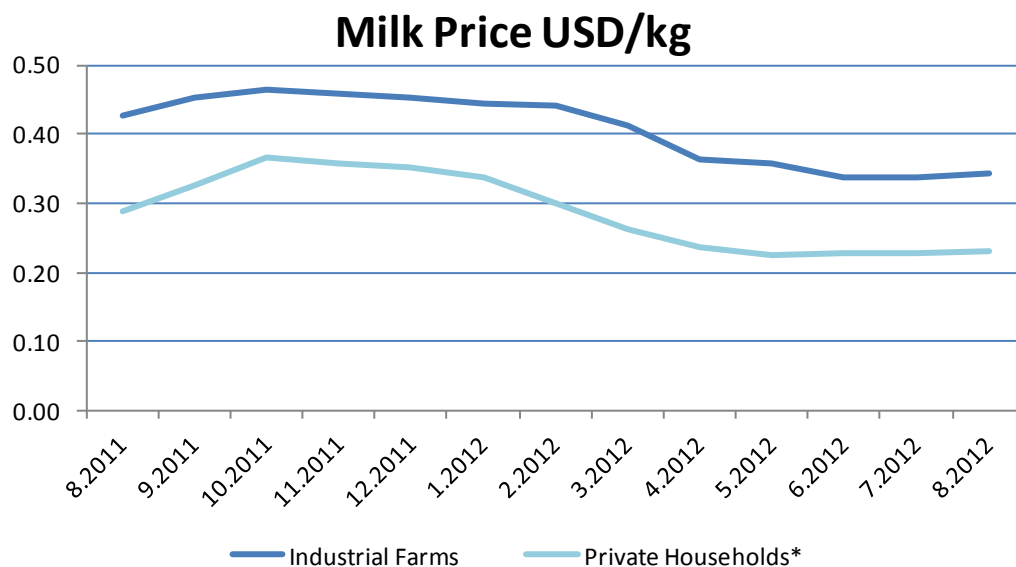
Cheese will remain the most profitable Ukrainian exports commodity with markets in Russia and Former Soviet Union (FSU) countries. Cheese will continue to face serious sanitary and technical barriers in destination markets. Production and exports in 2012 are expected to be below forecasted level due to export barriers. Exports of dried milk products will remain the second best alternative and will continue to utilize the extra milk that became available after cheese exports contracted.

Imports of butter from New Zealand, Belorussia and EU will grow in 2012, but would remain insignificant overall. The cost of imported products puts them in the upper market segment due to expensive logistics and custom clearance.

Production:

Raw Milk

Dairy farms are not expected to suffer from a lack of feed in the 2012/13 MY. Despite somewhat unfavorable weather conditions, a good grain crop is expected. Ukraine has also accumulated significant ending stocks of major crops that should allow the country to fully satisfy its domestic consumption needs and to have some exportable surplus. For more information please read the most recent [Grain and Feed GAIN report](#). However, due to world market demand domestic feeds price is expected to grow to high levels, comparable to those in 2008. This growth will support the milk price at least until the 2013 crop or until a price drop on the international markets. Most big Ukrainian industrial milk producers possess sufficient resources to survive possible cost increases even in unlikely case of a milk price drop.



Sources: Ukrainian Association of Milk Producers; MilkUA.info

* Price in USD per liter

Relatively high milk prices continue to inspire investors' interest in dairy businesses. During 2011-12, a number of agricultural companies announced expansion plans for their dairy herds, despite long decreasing trend in the number of cows and milk produced. Investments came mainly from big vertically integrated agricultural holdings previously specializing in crop production. These investments are numerous and usually range in size from 500 to 7,000 dairy cows per project. Investors are careful due to the significant investment needed, high risks and long payback period. It is not clear if the flow of investments would continue if milk prices decline, but the need for diversification is apparent for many major crop producers. New and renewed dairy farms became responsible for the milk production increase in 2012. Household production remained almost the same as in 2011.

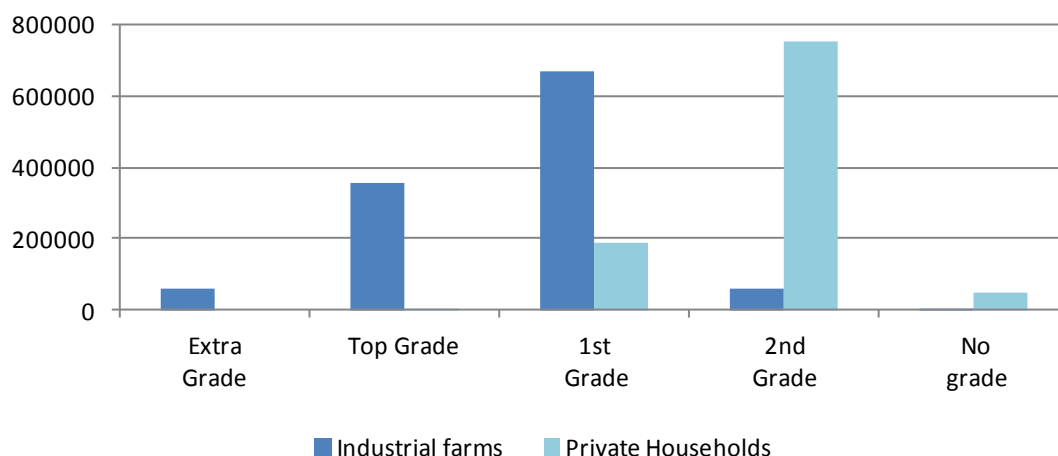
Table1. Milk Production at Farms of all Types Jan 1 – Aug. 1 (1000 MT)

Milk production	2011		2012		2012% to 2011
	Volume	Share	Volume	Share	
Farms of all types	7709	100	7898	100	102.5
Industrial Farms	1554	20	1758	22	113.2
Households	6155	80	6140	78	99.7

Source: State Statistic Committee of Ukraine

Households remain the suppliers of lower quality milk procured by the dairy processors with significant price discounts. According to producers this milk could not be used for cheese production and for many high margin whole milk products.

Households are not able to Supply High Quality Milk



Note: For grades description, please refer to 2011 [GAIN Dairy Report](#).

The low quality of Ukrainian dairy products has always been the major obstacle limiting expansion on the world market and served as the formal reason for the Russian import restrictions on Ukrainian cheese products.

Ukrainian dairy processors tried to minimize procurement of raw milk from households, but are not able to switch to industrially produced milk completely. Despite a 78 percent share in the total milk production, households' share in industrial processing is much lower and constitutes only 46 percent of all procured milk. The majority of this product is procured as second grade milk.

Raw milk quality improvement programs implemented at dairy processing facilities are expensive and rather inefficient. Raw milk quality control at the village collection point has been difficult to implement. Using raw milk quality improving technologies at the dairy processing facilities is too expensive for broad use. Bacteria, the presence of antibiotics in raw milk, and contamination within somatic cells remain the major problems for Ukrainian processors.

Cow numbers and milk for 2011 were changed in the PSD table to reflect official changes in the Ukrainian State Statistics Service year-end statistics. Production levels have been changed to match the new GOU revisions.

Dairy Products

In 2012/13, production of whole milk products (WMP) in Ukraine is expected to grow despite long term stagnation of the industry. The growth will be modest around 1.5-2.5 percent.

Whole Milk Product Production (1000 T)

	2008	2009	2010	2011	Change,% 2009/08	Change,% 2010/09	Change,% 2011/10
Milk	536	526	513	500	-2	-2	-3
Sour Milk Products	510	477	464	448	-6	-3	-3
- incl. yogurt	79	73	79	81	-8	8	3
Whey	18	16	19	32	-11	19	68
Soft Cheese	92	85	79	78	-8	-7	-1
Total WMP	1156	1104	1075	1058	-4	-3	-2

Sources: Ukrainian Dairy Union, State Statistics Service of Ukraine, FAS/Kyiv own calculations.

This growth is expected in fluid milk and soft cheese categories, with stable production of sour milk products. Production of WMP will be boosted by reduced production of hard cheese, which will make additional volumes of raw milk available to WMP producers. They already benefited from the spring raw milk price decrease, when the cheese industry lost export markets and had to contract production.

Production of cheese in 2012 is expected to be significantly lower than previously forecasted due to severe contraction of the export markets in the Russian Federations and Custom Union (CU) in general. The first eight months of 2012 statistics show an almost nine percent production drop. Assuming unchanged import policies in Russian Federation FAS/Kyiv decreased 2013 production and export forecasts as well. Crisis developments of 2008 made many producers to switch to "cheese product" where animal fats were replaced by palm oil. These products are significantly cheaper and target the lowest income consumers.

Public perception of the "cheese products" is not very favorable. Many people prefer original cheese, but some price-cautious consumers still buy them. There were some heated debates in the press when those products were spotted on shelves with real cheese and without proper marking or separation of the two. There is no perception of the cheese product as "healthy" or "no cholesterol." The presence of cheese products on the shelves of Ukrainian supermarkets was used as an argument for import restrictions introduced by the Russian Federation.

Production of dried dairy products completely depends on production and export of cheese. In case of further problems with cheese exports to Russia production and trade in dried products will increase. Profit margins for non-fat dried milk and butter combination is significantly lower than margins from cheese production, thus producers will do their best to maximize cheese output.

Consumption:

Ukraine's economic growth was slowing down through the first half of 2012. Many experts and international financial organizations decreased their GDP forecasts for 2012 from 3.5-4.0 percent to very modest 0.5-1.5 percent. Most of this insignificant growth was already achieved in the first half of 2012 as many analysts predict one percent or zero growth rate for last two quarters of 2012. Forecasts for 2013 are dim. Disposable income continued to grow in early 2012 and likely continue to do so due to heavy social spending programs implemented by the GOU in view of parliamentary election in late October 2012. This would support dairy products consumption till the end of 2012. In 2013 the demand is expected to stabilize, or grew insignificantly. There are also other macroeconomic factors that are outside of the scope of this report.

Overall consumption of dairy products (both produced in households and industrial operations) has

been decreasing slowly in recent years. According to Ukrainian statistics, between 2005 and 2010, consumption dropped from 225 to 206 kilograms per capita (in milk equivalent). However, there is an increase in consumption of industrially produced dairy products. This trend is expected to continue in 2013. With the increase of consumers' disposable incomes, more yogurts, sour cream products and better quality cheeses are being consumed. Concomitantly, rural dwellers will see the sales of their home made dairy products (cottage cheese, sour cream, milk and butter) shrink. Consumption of high-quality cheeses, both domestically produced and imported, will continue to increase.

Trade:

In 2012 Ukraine made significant efforts in order to keep export market for animal products opened. Most activities concentrated on traditional FSU markets. On July 30, 2012 Ukraine ratified the Free Trade Agreement (FTA) with seven countries belonging to the Commonwealth of Independent States (Russian Federation, Kazakhstan, Belarus, Kirgizstan, Moldova, Tadzhikistan and Armenia). The Agreement was signed by official representatives of eight Commonwealth of Independent States (CIS) countries earlier, on October 18, 2011. Among other goals this FTA is considered a tool that would help to keep traditional Russian markets open for Ukrainian dairy products.

No EU markets are expected to be opened for Ukraine in the foreseeable future despite on-going negotiations of the Free Trade Agreement (FTA) between the European Union and Ukraine. After three and a half years of negotiations the initial agreement between the parties was reached in October 2011. The text was initialed much later in July 2012. Although the agreement is not yet public, some mass media reported zero TRQ for the Ukrainian dairy product. Ukraine's milk collection practices and deficiencies of the control system are named as major factors for the lack of progress.

Import procedures will remain complicated, and obtaining veterinary permits will continue to be difficult for a potential importer. Customs valuation of imported products remains an obstacle for further trade growth.

Export

Custom Union (CU) countries (mostly the Russian Federation) will remain major destinations for Ukrainian dairy products. Russian markets are usually preferred by Ukrainian processors as export price is often significantly higher than the price they can receive for their product domestically. Geographical proximity and trade restrictions imposed by CU countries on other dairy exporters make Ukrainian product even more competitive. At the same time Russian Federation (and now CU) periodically limits imports through veterinary-sanitary measures or through the technical barriers (application of state standards). Many producers fear spillover of the existing Russia-based trade restriction to other CU member states.

Cheese

Cheese remains the most profitable dairy product for Ukrainians processors and the number one exportable commodity. Almost 90 percent of all cheese exports go to neighboring Russia. Ukraine's access to other markets is limited and situation is not expected to change in 2012/13. Dependence of the industry on the sole export market allows the major trading partner to exercise its monopsony power.

Given the similarity of food safety systems and common production practices in two countries, some observers suspect political component in those limitations. Cheese export trade restrictions had wide public coverage in mass media. The negative economic impact on industry under sanctions was bigger in cases when dependence on export market in Russian Federation was significant and no alternative markets were developed. Currently Russian list of inspected facilities contains only [27 entries](#) with 12 facilities under "temporal restriction."

Ukrainian agricultural industry has a long story of these restrictions introduced in different time periods by Russian authorities. The first restriction on exports of Ukrainian dairy products was introduced back in 2006, when Russia stopped almost all imports causing a crisis in the industry. The year 2012 did not differ much and Ukrainian cheese producers were hit by a new trade restricting measures introduced by Russian food safety authority (Rosspotrebnadzor) on February 7, 2012. Import of Ukrainian cheese from selected facilities was banned due to incompliance of Ukrainians product with Russian Technical Regulation on dairy products. In a result 32 tons of Ukrainians cheese was removed from the shelves in the Russian stores with another 120 tons detained at the border.

Some relaxation of the restriction took place in the late May, when Russia allowed some imports with compulsory laboratory testing of each shipment. Some facilities resumed exports, but new trade restrictions followed in September. On September 26, 2012 the Russian veterinary authority, Rosselkhoz nadzor, published the results of the System Audit conducted by the veterinary specialists of the Custom Union (CU) Counties in June 2012. As a result the CU countries imposed temporary export restrictions on 5 Ukrainian dairy producers starting from October 4, 2012. One dairy processing facility was completely delisted. This time the restriction is CU-wide.

Import restrictions were imposed on producers of cheese, dried milk and butter: Molis Ltd., Globinsky Butter Plant; cheese maker Bell Shostka Ukraine; whole milk product producers Danon Dnipro and Lactalis Mykoiv. The Bilotserkivsky Dairy Plant was completely delisted. On October 15th another cheese producer – Dubnomoloko joined the list of temporarily banned facilities.

Permanent trade limitations had negative impact on the Ukrainian industry. Business planning and production became unpredictable even for approved facilities, as many feared possible trade problems at any moment. Uncertainty spilled to the raw-milk market where price took a dive in March. This is a quite unusual situation for Ukrainian milk producers who counted on a good milk price in milk-deficient early spring. This did not come as a surprise since Ukrainians cheese makers use almost 40 percent of all milk procured for industrial processing.

Due to the cheese export restriction, trade is expected to be 13-17 percent below 2011 levels. The milk price drop observed in middle of February 2012 led to increased animal slaughter and beef production spike. Depressed milk price continued modest negative impact on livestock industry throughout 2012, although impact was less significant.

According to some dairy market analysts, estimations the Ukrainian dairy processing industry combined annual revenue loss can reach \$35 million from the forgone export revenues alone. Additional losses occurred by raw-milk producers, transport companies, etc.

Cheese production and export forecasts were decreased according to the new market situation. Some kind of trade restriction in Russian Federation is expected to remain in place in the future. Chances of quick cheese export expansion to other market (beside Russia, Kazakhstan and

Moldova) are insignificant.

Butter

Butter production in 2012 is expected to increase due to Russia's cheese export ban and availability of excessive volumes of raw milk that can be processed into NFDM and butter. Export markets for butter are quite limited, although NFDM can be exported to markets where quality requirements are modest. Producers will have no other choice, but to accommodate additional quantities domestically.

Trade in butter will remain limited due to a number of factors. In most cases Ukrainian product is just too expensive in comparison to the main competitors from the EU and New Zealand. In the late 2000's, Ukraine lost most of its traditional export markets in Russia and former Soviet Union, and was not able to recapture them in recent years.

Beside the price problem, in the past Ukrainian butter gained bad reputation due to its poor quality. Many Russian traders complained about use of vegetable oils in the production process. Import requirements and controls increased significantly since then and Ukrainian product will have hard time should producers decide to renew exports.

The major driving force behind production of butter in Ukraine remains world market demand for NFDM and lack of alternative use of raw milk. Domestic market of WMP is saturated and no international markets are available at this point.

Imports of butter grew as imported product slowly occupies the upper market segment. However this product remains too expensive for the majority of Ukrainians consumers. Many Ukrainians are aware of quality problems with Ukrainian butter and use of vegetable oils in "butter" marked products. They prefer to pay higher price for guaranteed quality. There is almost no "healthy food" or "low cholesterol" public perception of spreads. Margarines and spreads are considered to be of low quality and generally avoided by consumers.

NFDM / WDM

Usually production of dry milk in Ukraine depends on availability of seasonal milk. Dry products production lines are launched only if no other use of milk is possible. In 2012, the situation was a little bit different. Hammered by the Russian cheese import restrictions many facilities had no choice but to switch to dried milk products. However the situation in the world market did not favor Ukrainian producers of dried milk products in the first half of 2012. Lack of foreign markets or butter imposes restrictions on NFDM production.

Dependence on export dried milk markets led to price drop domestically which in turn caused fluid milk prices to drop. Fluid milk market situation had a policy consequence. The GOU got concerned about the social impact on rural households, which produce almost 80 percent of the milk. In exchange for a high raw milk price, the Agrarian Fund (GOU operated agency) promised processors to procure some dry milk to keep the market balanced. Information on these purchases is not public and cannot be included in the dried milk PSD tables. However, due to tight budget situation in the country, the volumes could not be significant. According to the Ministry of Agrarian Policy and Food, price for fluid milk was stabilized in late May 2012 at a level comparable to May 2011.

The GOU decided to use some administrative concepts recently. On June 7, 2012 the Ukrainian

Parliament included raw milk into the list of products subject to state price regulations (previously the list already included dried milk and butter). On August 30, the Cabinet of Ministers of Ukraine exercised its power and established minimal price for milk procured from households at UAH 2.2 (\$0.27) before value added tax per liter. If implemented and enforced, the measure will be binding for the majority of regions, although efficiency of such measures remains unknown. Adjusting market-justified prices may force dairy processors to look for ways around this measure or to stop milk procurement completely.

Trade estimates for 2011 were revised to converge with official statistics. The trade forecast for the remaining months of 2012, as well as for 2013 remains subject to trade policy changes and possible new TBT introductions.

Statistical Tables

Fluid Milk PSD Table*

Dairy, Milk, Fluid Ukraine	2011		2012		2013	
	Market Year Begin: Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	2,631	2,631	2,560	2,582		2,560
Cows Milk Production	10,800	10,804	10,550	10,900		11,050
Other Milk Production	300	281	330	300		310
Total Production	11,100	11,085	10,880	11,200		11,360
Other Imports	2	3	2	5		7
Total Imports	2	3	2	5		5
Total Supply	11,102	11,088	10,882	11,205		11,367
Other Exports	0	0	0	0		0
Total Exports	15	11	15	15		10
Fluid Use Dom. Consum.	5,437	5,442	5,337	5,345		5,487
Factory Use Consum.	4,600	4,615	4,500	4,845		4,900
Feed Use Dom. Consum.	1,050	1,020	1,030	1,000		970
Total Dom. Consumption	11,087	11,077	10,867	11,190		11,357
Total Distribution	11,102	11,088	10,882	11,205		11,367

1000 HEAD, 1000 MT

*These are not official USDA numbers

Cheese PSD Table*

Dairy, Cheese Ukraine	2011		2012		2013	
	Market Year Begin: Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0		0
Production	185	179	200	165		170
Other Imports	12	12	14	16		18
Total Imports	12	12	14	16		18
Total Supply	197	191	214	176		188
Other Exports	75	80	70	70		65
Total Exports	75	80	70	60		65
Human Dom. Consumption	122	111	144	111		123

Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	122	111	144	111		123
Total Use	197	191	214	176		188
Ending Stocks	0	0	0	0		0
Total Distribution	197	191	214	176		188

1000 MT

*These are not official USDA numbers

Butter PSD Table*

Dairy, Butter Ukraine	2011		2012		2013	
	Market Year Begin: Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0		0
Production	80	76	80	85		90
Other Imports	4	5	4	7		5
Total Imports	4	5	4	7		5
Total Supply	84	81	84	92		95
Other Exports	2	2	2	1		2
Total Exports	2	2	2	1		2
Domestic Consumption	82	79	82	91		93
Total Use	84	81	84	92		95
Ending Stocks	0	0	0	0		0
Total Distribution	84	81	84	92		95

1000 MT

*These are not official USDA numbers

Nonfat Dry Milk PSD Table*

Dairy, Milk, Nonfat Dry Ukraine	2011		2012		2013	
	Market Year Begin: Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	2	2	2	2		2
Production	51	43	48	48		50
Other Imports	1	2	1	4		3
Total Imports	1	2	1	4		3
Total Supply	54	47	51	54		55
Other Exports	25	22	20	23		23
Total Exports	25	22	20	23		23
Human Dom. Consumption	27	23	29	29		30
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	27	23	29	29		30
Total Use	52	45	49	52		53
Ending Stocks	2	2	2	2		2
Total Distribution	54	47	51	54		55

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1000 MT

*These are not official USDA numbers

Dry Whole Milk Powder PSD Table*

Dairy, Dry Whole Milk Powder Ukraine	2011		2012		2013	
	Market Year Begin: Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0		0
Production	14	10	14	11		11
Other Imports	0	1	0	1		1
Total Imports	0	1	0	1		1
Total Supply	14	11	14	12		12
Other Exports	4	2	5	2		2
Total Exports	4	2	5	2		2
Human Dom. Consumption	10	9	9	10		10
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	10	9	9	10		10
Total Use	14	11	14	12		12
Ending Stocks	0	0	0	0		0
Total Distribution	14	11	14	12		12

1000 MT

*These are not official USDA numbers