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Global Agricultural Information Network

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Russian Federation

Dairy and Products Annual

Import Embargo Provides Limited Benefits to Dairy

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Report Highlights:

The milking herd will decrease 3 percent to 7.32 million head in 2017 due to low investment in cattle in the past two years. Because large farms improve per cow yields, milk production is forecast at 30.195 MMT, only 0.5 percent less than in 2016. Factory use grows to 19,450 MT while fluid milk consumption declines, reflecting contrasting trends in commercial and backyard sectors. Higher dairy prices may ease the impact of uncertain state support. Domestic competition and soft consumer demand contribute to a forecasted 0.5 percent decline in cheese production and steady butter, WMP, and SMP production. With the extension of counter-sanctions trade restrictions until December 31, 2017, Belarus will remain Russia's primary source of dairy imports.

Executive Summary

Cows-in-milk inventories will decrease to 7.32 million head due to limited investments in new and replacement dairy cattle in 2015 and 2016. Fluid milk production will decline at a slower pace than milking herd numbers due to rising per cow yields at leading industrialized farms.

Commercial dairies are expected to increase fluid milk production in 2017, while backyard farms continue to decrease output. The increase will not offset the decline at backyards, as uncertainty in state agricultural support programs and budgets has stalled new investment. As a result, total production of fluid milk in 2017 is forecasted to decline 0.5 percent to 30.195 MMT.

Milk production estimate for 2016 was revised up to 30.350 MMT, still a 0.68 percent decline year-on-year. Good harvests of feed crops and forage grasses in 2016 lessened some costs, and large commercial dairies improved per cow yields by more than 4 percent in January-August 2016, which increased milk production by 1.8 percent, better than previously forecasted.

FAS/Moscow forecasts growth in factory use of fluid milk from 19,350 MT in 2016 to 19,450 MT in 2017, while consumption of unprocessed fluid milk continues a long term decline to 9,085 MT. This reflects the contrasting production trends at commercial and backyard farms.

The market remains favorable for domestic dairy processors as the counter-sanctions trade restrictions on significant western exporters have been extended until December 31, 2017. However, FAS/Moscow forecasts a minor 0.5 percent decrease in cheese and curd production in 2017 to 840,000 MT. Many cheese making operations that economized on quality to supply the necessary quantity to the market in 2014-2015 will reduce or stop production due to increased competition among domestic producers. Additionally, higher prices on quality raw milk suitable for cheese production are expected to constrain the growth of cheese sector.

FAS/Moscow anticipates 245,000 MT butter production in 2017, which is equal to the revised 2016 butter production estimate. The 2016 butter production estimate was decreased to 245,000 MT, a 5.7 percent decline from 2015, due to price pressure from the continued use of vegetable fat substitutes in dairy products. Dairy processors' margins from butter sales dropped, and they switched to other products that promised better profits. Some recovery of butter production is possible in the last quarter of 2016 due to increased butter prices in August-September 2016.

FAS/Moscow forecasts production of 38,000 MT of WMP and 65,000 MT of SMP in 2017. Considering the flexibility of the industry to reduce or increase powder production according to profitability in other products, the annual output of milk powders depends on world market prices for milk fat and milk protein and the pricing policies of the government of Belarus.

Belarus will likely remain Russia's primary source of dairy imports as long as the counter-sanctions [ban](#) on imports of milk and dairy products (HS codes 0401, 0402, 0403, 0404, 0405, and 0406) remains in place. Total imports are forecast unchanged from the revised 2016 numbers: fluid milk at 345,000 MT, cheese and curd at 235,000 MT, butter at 90,000 MT, WMP at 44,000 MT, and SMP at 120,000 MT.

Table 1. Russia: Fluid Milk Supply and Distribution, 1,000 MT

Dairy, Milk, Fluid Market Begin Year	2015		2016		2017	
	Jan 2015		Jan 2016		Jan 2017	
Russia	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	7,750	7,750	7,550	7,550	0	7,320
Cows Milk Production	30,550	30,560	30,085	30,350	0	30,195
Other Milk Production	0	0	0	0	0	0
Total Production	30,550	30,560	30,085	30,350	0	30,195
Other Imports	328	328	320	345	0	345
Total Imports	328	328	320	345	0	345
Total Supply	30,878	30,888	30,405	30,695	0	30,540
Other Exports	42	42	20	45	0	40
Total Exports	42	42	20	45	0	40
Fluid Use Dom. Consum.	9,500	9,500	9,185	9,250	0	9,085
Factory Use Consum.	19,140	19,146	19,200	19,350	0	19,450
Feed Use Dom. Consum.	2,196	2,200	2,000	2,050	0	1,965
Total Dom. Consumption	30,836	30,846	30,385	30,650	0	30,500
Total Distribution	30,878	30,888	30,405	30,695	0	30,540

(1000 HEAD) ,(1000 MT)

NOTE: Not Official USDA data;

Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>Cows in Milk Inventories

FAS/Moscow anticipates a 3 percent decline of cows-in-milk inventories in 2017 to 7.32 million head. Despite the expectations of Russia's return to marginal GDP growth in 2017 and some improvement in the current macroeconomic outlook, the long term negative trend of milking cows' numbers will likely continue for another year due to low incentives for inflow of private investments to commercial milk production and continued negative trends at backyard farms. In 2017, leading commercial dairies will further improve herd management practices and genetics, thereby increasing yields. These companies improve their efficiency but do not have enough incentives for expansion. As a result, production of milk for factory use at industrialized agricultural establishments will likely continue growing in 2017 while the milking herd at these industrial farms will continue to decline.

Since structural changes in Russian economy began in the 1990's, several major agricultural companies have emerged in the country. Large, successful, food-producing companies in Russia often control the whole supply chain from growing crops through processing or retail stores. This phenomenon of "vertically integrated agro-holdings" first appeared in Russia in the segments that promised higher margins, such as poultry, pork, and sugar. In the meantime, the dairy sector has struggled for decades with insufficient financing for modernization and replacement of local dual purpose (milk and beef) cattle with highly productive dairy breeds.

Investments in Russian milk production sector have been considered risky, with volatile milk prices, margins trending downward, a long payback period on investments, a history of inconsistent implementation of the state dairy programs, the increased use of vegetable oil substitutes by processors, dependence on highly consolidated retail chains, and declining demographics and lack of skilled work force in rural areas. Further, during the economic crisis of 2015-2016, low consumer demand for high-margin dairy products depressed milk prices and producers' margins, which will result in further declines in cow inventories in 2017.

Currently there are no "vertically integrated" milk production corporations large enough to influence the national market. However, there are several emerging leaders at the regional level, which grow as "vertically integrated" businesses. Dairy processing plants invest in dairy farms to improve the supply of quality milk, especially for cheese production, large milk producers launch dairy processing and develop their own brands, successful companies from other segments launch dairy farms to diversify operations.

On July 1, 2016, Rosstat reported 3.837 million head of cows at household farms or nearly half the total herd. Dairy farming remains perhaps the least industrialized sector in Russian agriculture, and raw milk from household farms is excluded from or has limited access to the industrial dairy processing supply chain. At that time the total cow¹ herd, both dairy and beef, was 8.367 million head, which is a 2.1 percent decline from the inventories in July 1, 2015. Cow inventories declined by 176,000 at household farms and by 53,000 at agricultural enterprises. As mentioned above, the reduction of cows at commercial dairies is combined with continued improvements in operational efficiency, mitigating potential loss of production.²

Rosstat reports that small and peasant farms increased their cow herds by 48,000 head in July 2016 compared to the same month of 2015. Inventories at small farms grew in the first half of 2016 in all Federal districts excluding the Southern Federal District, where small peasant farms lost one percent of their cows reportedly due to strong competition with large agricultural enterprises.³

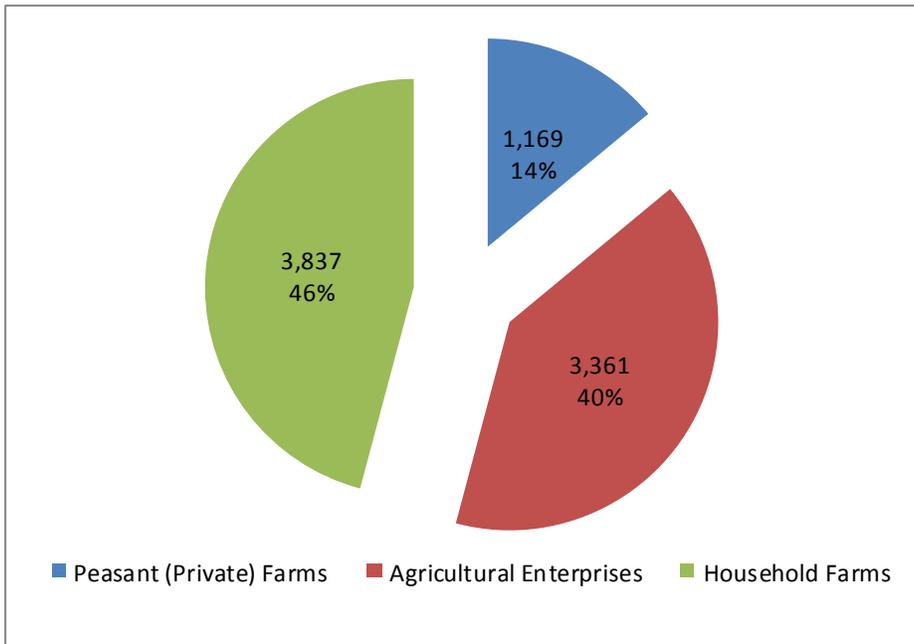
¹ Rosstat "cows" number includes all beef and dairy cows. For details on beef cattle inventories please refer to GAIN Report [RS1648 Russian Livestock and Products Annual](#)

² Agricultural Establishments increased milk production by 181,000 MT in January-August 2016 compared to the same period of 2015, Source: Rosstat.

³ "Farmers from southern Russia against the dominance of agricultural holding companies,"

http://rbth.com/politics_and_society/2016/08/24/route-barred-for-russian-farmers-on-tractor-march-to-kremlin_623881

Chart 1. Russian Cow Inventories by Type of Farm as of July 1, 2016 (1,000 head; %)



Source: Rosstat

The herd growth at small peasant farms will likely continue in 2017 as authorities encourage backyard farmers to register their businesses as legal, taxable entities. In addition, the veterinary surveillance services follow policies to encourage swine farmers to switch to other types of livestock operations, preferably cattle, due to outbreaks of African swine fever in summer of 2016. New veterinary sanitary rules for swine farms imposed in March 2016 by the [Decree of the Ministry of Agriculture N 114](#) became obligatory for all types of swine farms beginning July 18, 2016, and may stimulate further growth of cattle stocks at small peasant farms.

Leading commercial farms have proven the economic benefits of highly productive dairy cattle, and recent decisions indicate agricultural authorities also recognize the need to enhance the genetics of the country's milking herd. The GOR will likely continue to support cattle breeding operations; however, budget constraints in 2017 will encourage authorities to seek alternative measures to support operations of breeding farms. For example, the recently extended counter-sanctions [trade restrictions](#) on agricultural products from major western suppliers do not restrict live cattle or genetic material. Additionally, in June 2016 President Putin signed the [Amendments to the Tax Code](#) to exempt from VAT payments the trade operations with purebred breeding agricultural animals. The Amendments reduce the VAT rate from 10 to 0 percent until December 31, 2020. The zero VAT rate shall be applied to trade operations with domestic and imported purebred breeding cattle, embryos, and semen of purebred breeding bulls.⁴ For imports, the exemption shall be granted upon the submission of the documents to Customs in accordance with the Federal law [123 FZ – 08.03.1995 On Livestock Breeding](#).

⁴ The VAT exemption is also applicable to purebred breeding animals and genetic material of other agricultural animals including poultry (hatching eggs), swine, sheep, goats, and horses.

According to Russian customs data, the country did not export any dairy heifers or cows in 2016⁵ as there is a shortage of quality cattle in the domestic market. The market for breeding dairy cattle is still developing and remains non-transparent in terms of tracking and defining the fair market price for breeding cattle of local origin. Industry contacts confirm that there is a strong demand for replacement dairy heifers, and the domestic prices are currently comparable to prices for imported heifers. The average price for an imported purebred breeding dairy heifer in 2016 was USD 2,365 per head. According to industry contacts, supplies of replacement heifers in 2016 were below demand, and growth in imports may be expected as soon as the overall economic situation improves. Despite the difficulties in financing new cattle purchases, imports of dairy heifers are expected to continue in 2017 at levels comparable to 2016. The Federal Customs Service reported 42,008 head live cattle imports (dairy and beef⁶) in January-July; the total value of these shipments was USD 65.428 million. Russia imported purebred breeding dairy heifers in this time from mostly EU suppliers - the Netherlands (6,067 head), Germany (2,107 head), Hungary (1,187 head), Denmark (587 head), France (583 head), Ukraine (300 head), and Finland (117 head).

Fluid Milk

Government Policy and Macroeconomic Outlook

In the beginning of 2016, the Government of Russia (GOR) set mid-term goals of 4 percent annual inflation in 2017 and the budget deficit target within 3 percent of GDP. Russian fiscal and monetary authorities consolidated their efforts in pursuing these goals. The Central Bank of Russia (CBR) has followed the moderately tight monetary policy keeping the key rate at 11.0 -10.5 percent in January-September 2016. Inflation has demonstrated a decline in line with the CBR's baseline forecast. The annual consumer price growth in September 2016 was estimated at 6.6, and CBR decreased the [key rate to 10 percent](#) on September, 16 2016. The monetary regulator likely will be keeping the key rate at this level for "a rather long period of time"⁷.

In the meantime, the Ministry of Finance has implemented 10 percent spending cuts to the original 2016 budget. However, in October 2016 GOR proposed amendments to the current budget law to increase the deficit ceiling to \$48.02 billion (3.66 percent of GDP). Thus, the budget and, as a result, the actual implementation of agricultural programs in 2016 remains ambiguous. The GOR has not executed dairy sector support programs as planned, most likely, due to issues with 2016 budget allocations. For example, the GOR postponed the start of the state intervention purchases which were intended to stabilize prices for raw milk during the seasonal price drop in summer months.

The on-going revision of the current year budget and frequent changes in dairy programs increase the degree of uncertainty related to the state budget law for 2017, in which the programs of agricultural support will [reportedly](#) be further revised. The total funds for agricultural programs will likely be reduced from 237 billion ruble in 2016 to 204 billion rubles in 2017, and 54 budget lines for agriculture support programs may be consolidated to seven. According to Minister of Agriculture Alexander

⁵ In January-July Russia exported 3,449 head of live cattle (HS code 0102) mostly for beef/ feedlots to Kazakhstan, Azerbaijan and Georgia. Exports of live cattle from Russia decreased by 80 percent compared to the same months of 2015.

⁶ 67 percent of these imports, 26,672 head, were beef steers for feedlots from Australia (HS Code 010229).

⁷ Source: The Bank of Russia <https://www.cbr.ru/>

Tkachyov, the consolidation of the subsidies “will empower the regions to define the priorities of agricultural policy.”⁸

The GOR plans to introduce a new program to improve access to subsidized credit for agricultural projects in 2017. The aim of the program is to delegate most of the administrative functions from regional governments to the authorized banks and expedite the transfer of the funds to the final recipients. New rules aim at improving the financial performance of agricultural businesses by changing the existing model of interactions between the state, banks, and producers. According to the GOR, the new rules are designed to stimulate banks to facilitate up to one billion rubles of short-term loans for operational needs of agricultural producers⁹ and up to 10 billion rubles in long-term loans for investment projects at 5 percent maximum interest rate. Currently, agricultural producers can apply to any bank for a loan, and the bank is to determine the interest rate based on its internal rules and policies. To become eligible for subsidies and reduce the cost of the borrowed capital, agricultural producers must apply to the regional authorities for the pre-approval of their project for subsidies. Producers currently receive the actual payments from the regional budgets, usually with delays. The new approach, which would apply only to new projects, is determined by the [Draft Rules](#) of reimbursing expenses of the authorized banks facilitating the loans to agricultural producers at 5 percent interest rate. According to the draft, subsidized loans for beef and dairy projects are intended to have a payback period from two to 15 years. The government commits to reimburse the difference between 5 percent interest rate and the interest rate which corresponds to the bank’s requirements for credit approval. To define the responsibilities of the banks and the commitments of the authorities, the parties will be signing specific agreements for each particular project. New rules intend to eliminate investors’ risks related to delays of subsidies payments. The negative impact of any disruption of subsidies payments will be transferred from the final borrowers to the lenders and the government.

Considering the lengthy period for return on investment in the milk production business, milk producers favor consistency over volume of support. Industry has persistently advocated for the government to abstain from any changes in dairy policies and rules. Even for these credit programs, milk producers are concerned about the changes and raise questions on the transparency of the project selection process by the authorized banks. According to the National Union of Milk Producers “Souzmoloko”, the dairy lobby convinced authorities to keep the subsidies “[per one liter of sold milk](#)” as a separate budget line and allocate 12 billion rubles for the program in 2017. In 2016 GOR started the capital expenditures (Capex) reimbursement program, and committed to compensate up to 35% of capital expenditures in pre-approved dairy projects. The program likely to continue in 2017, however, it’s not clear how many dairy projects will be selected.

Fluid Milk Production

Commercial dairies are expected to increase fluid milk production in 2017, while backyard farms continue to decrease output. As a result the total production of fluid milk by all types of farms in 2017 is forecast at 30.195 MMT, which is a 0.5 percent annual decline. Fluid milk production will be

⁸ Sources in Russian : <https://ria.ru/economy/20160728/1473064121.html> ;
http://milknews.ru/index/V_2017_godu_na_subsidii_na_litr_tovarnogo_moloka_vydeljat_12_mlrd_rub.html
http://milknews.ru/index/novosti-moloko_6366.html

⁹ including livestock, poultry, dairy farmers and plant growers

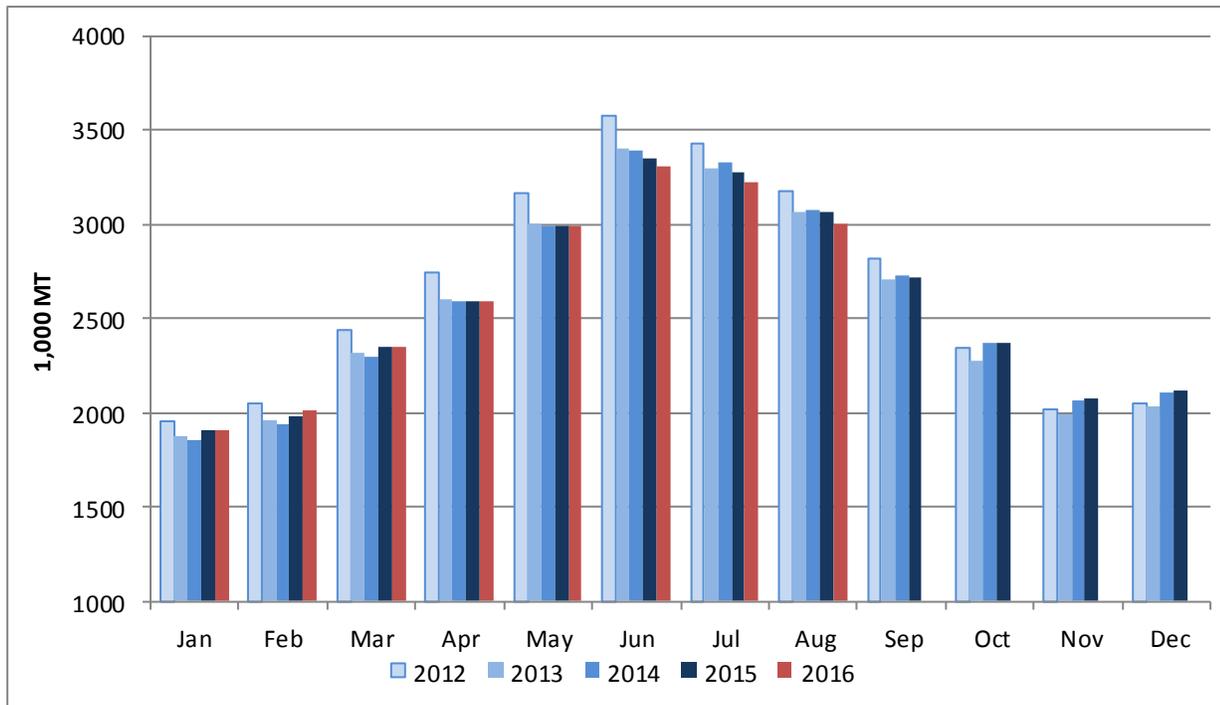
declining at a slower pace than milking herd inventories due to improvements in per cow yields at leading industrialized farms, which harvest more milk from a smaller number of cows.

Most of the GOR agricultural programs have been designed to support the development of large companies, and even with expected changes in the dairy programs in 2017, major funds will be directed to the largest companies, so the trends of “vertical integration” in milk production are likely to develop further in 2017¹⁰. Leading commercial dairies are likely to continue investing in improved herd genetics, equipment, and enhanced herd management. Some dairy projects are implemented by large companies as part of their business diversification. So, the risks associated with changes in state dairy programs for these companies may be mitigated by availability of corporate funds or credit lines.

FAS/Moscow increased its 2016 milk production forecast to 30.350 MMT, which is still a 0.68 percent decline year-on-year. Large and medium dairies (Rosstat term “agricultural establishments”) increased milk production in January-August 2016 by 1.8 percent, and produced approximately by 180,000 MT more than in the same months of 2015. Commercial dairies improved per cow yields by more than 4 percent in January-August 2016, better than previously forecasted. Good harvests of feed crops and forage grasses in 2016 helped leading commercial dairies mitigate the impact from the economic recession. Average wholesale prices for raw milk in 2016 were more stable than in 2015. Moreover, in August 2016, Rosstat reported the producer price for one MT of raw milk sold by commercial farms at 21,153 ruble, which is 8.8 percent increase year-on-year. The normal seasonal price increase started earlier than usual indicating some recovery of demand for raw milk, and for milk fat in particular, as the prices for butter also started growing. However, the increase in commercial milk production has not offset the decline of production at backyard farms, so the total output of fluid milk in 2016 is estimated at 210,000 MT less than it was in 2015.

¹⁰ 2015 production number is revised based on final Rosstat production data released in September 2016.

Chart 2. . Monthly Fluid Milk Production in 2012 – Aug 2016 (1,000 MT; All producers)



Source

: Rosstat

The greatest development in Russian industrial milk production is in Voronezh Region, where the regional government designed a unique regional program offering incentives for dairy farmers. Commercial farms in Voronezh region increased milk output by 14 percent (+45,000 MT) in January-August 2016. Other top regions with growing milk production at commercial farms are the Republic of Tatarstan (+ 25,600 MT), Udmurtia Republic (+20,000 MT), Kirovskaya Oblast (+19,500 MT) Krasnodarsky Krai (+17,300 MT), Leningrad Region (+15,900 MT), Kaluga Region (+13,100 MT), Republic of Bashkortostan (+12,300 MT), and Vologda Region (+10,800 MT)¹¹

¹¹ Source: Rosstat “Production by Agricultural Establishments in January-August 2016”. The data set is exclusive of production by backyard farms and small peasant farms.

Fluid Milk Consumption

FAS/Moscow forecasts total domestic consumption of fluid milk in 2017 at 30.5 MMT, which is a decline of approximately 0.5 percent compared to 2016, mostly due to the projected decrease of rural consumption of fluid milk, which is projected to decrease by approximately 165,000 MT to 9.085 MMT. At the same time, FAS anticipates continued growth of factory use consumption in 2017 by 100,000 MT as commercial dairies will likely increase the output of milk for industrial processing. Industrial dairy plants are expected to process 19.45 MMT (19.065 MMT will be supplied by domestic producers and 0.345 MMT imported, mostly from Belarus).

Total domestic consumption of fluid milk in 2016 is estimated at 30.65 MMT, which is 0.64 percent decline year-on-year, but a correction upward from the previous forecast due to better than expected demand from processors and increased supplies from the local producers.

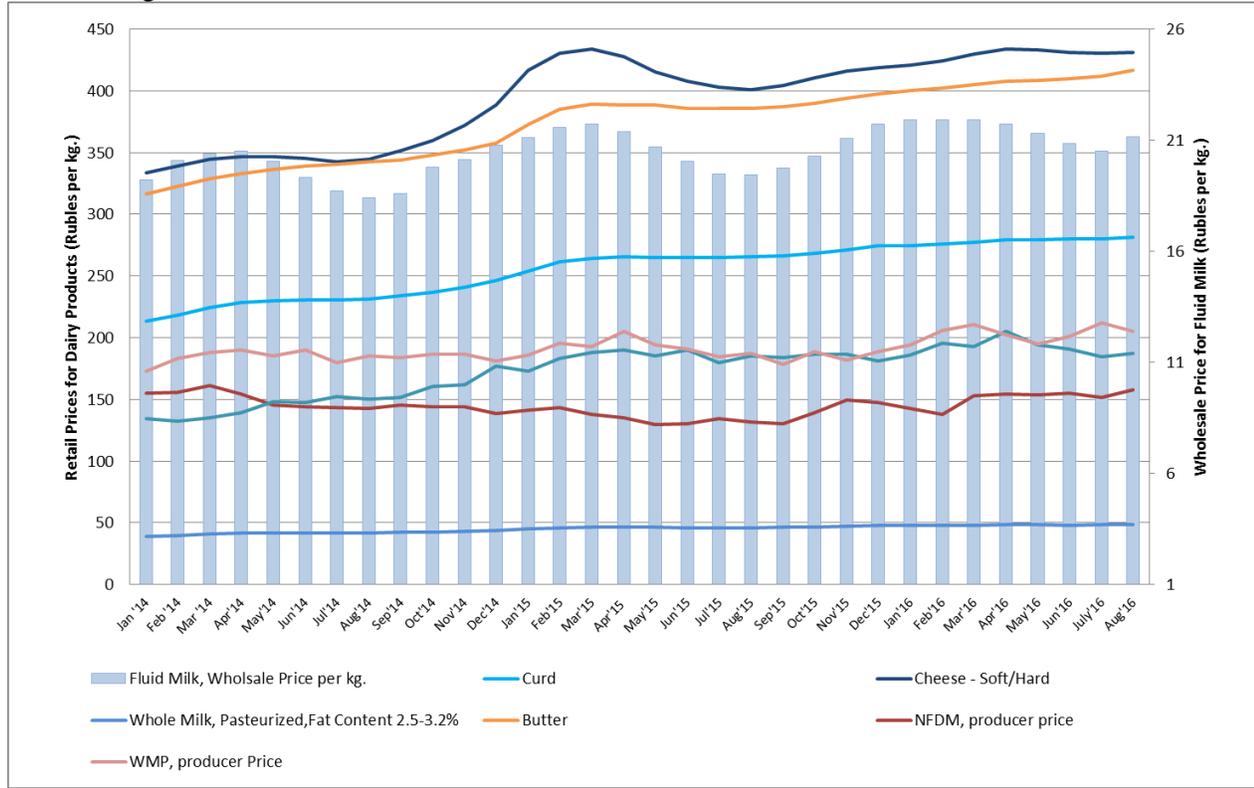
It's important to mention the unusual seasonal pattern in commodity milk market in the 3rd quarter of 2016. Prices for raw milk in Russia have seasonal fluctuations and traditionally drop during the “high milk season” between May and August. The difference between maximum and minimum prices due to seasonality varies between 15-20 percent depending on the region and the annual specifics. Typically a moderate monthly price growth starts in September and reaches the peak in the first quarter of the year, February or March; the price then drops to its annual minimum in August. This year, however, the wholesale milk prices unexpectedly grew more than three percent in August compared to the previous month. The increase in prices reflects some shortage of milk fat due to disruptions of exports of dairy products from Belarus after the series of SPS restrictions imposed by Rosselkhoznadzor (VPSS) on multiple dairy plants in Belarus in summer 2016. In addition, USD prices for butter in the world market grew 25 percent year-on-year in August 2016 following fluctuations in world currency and commodity markets.

In the end of September, 2016, major Russian retailers announced that prices on dairy products will grow 5-10 percent in the near future due “to increase of world commodity prices”¹². There are concerns that the growth of retail prices may result in further decline of consumer demand for high margin products, pressing commodity milk prices downward.¹³

¹² Source: [Milknews](#)

¹³ Spource: “[Argoinvestor](#)” Magazine

Chart 3. Commodity Prices for Fluid Milk in Russia and Consumer Prices for Basic Dairy Products in 2014 – August 2016



Source: Rosstat

Fluid Milk Trade

In 2017 imports of fluid milk are anticipated at 345,000 MT, unchanged from the revised estimate of 2016 imports. The counter-sanctions food import [ban](#) will continue to influence trade on a variety of agricultural products (including milk and dairy HS codes 0401, 0402, 0403, 0404, 0405, and 0406 (except for specialized lactose-free milk and dairy products for therapeutic dietary nutrition) from a number of western countries. The GOR has extended the trade restrictions until the end of 2017. According to Presidential Decree #305, the restrictions are identical to those of June 24, 2015, except that the terms are extended for 18 months, through December 31, 2017. (Please refer to GAIN reports [RFATO038](#) and [RS1540](#) for detailed information).

Belarus accounted for 94.6 percent of fluid milk imports to Russia in January-July 2016, and will likely remain the only major exporter of fluid milk to Russia in 2017. According to statistical data from Belstat, the January-July average price for one MT of fluid milk declined 15 percent in 2016 to USD 534, which followed a 28 percent fall in 2015. The sharp decline in price in 2015 resulted from the devaluation of the Russian and Belarus currency, but the 2016 price decrease came out of an actual decline in demand for Belarusian fluid milk in Russia. Taking into consideration that over 98 percent of Belarusian exports of fluid milk is shipped to Russia, exporters will likely continue offering favorable prices, but the volume of the exports of fluid milk from Belarus is anticipated to stabilize at 2016 levels. Relatively stable milk prices in Russia during first three quarters of 2016 indicate that the current market

is balanced in terms of supply and demand of raw cows' milk. No major increase in production of cheese and butter is anticipated in 2017, and Russian commercial dairies have enough capacity to maintain sufficient supplies of raw milk to dairy processing plants.

FAS/Moscow projects 2017 milk exports at 40,000 MT, and has revised its 2016 export estimate to 45,000 MT based on available trade data. The Federal Customs Service of Russia reported a significant increase of milk exports to Ukraine in January –July 2016 ¹⁴ to 20,900 MT from just 3,113 MT shipped during the same months of 2015. These are exports from Russia to parts of the Donetsk and Luhansk regions of eastern Ukraine. Export to Ukraine accounts for the most of the increase of total Russian raw milk exports in 2015 and in January- July 2016. The bilateral trade between these countries in 2017 is vulnerable to political instability in the region.

Cheese and Curd (HS Code 0406)

Table 2. Russia: Cheese and Curd Supply and Distribution, 1,000 MT

Dairy, Cheese Market Begin Year	2015		2016		2017	
	Jan 2015		Jan 2016		Jan 2017	
Russia	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	30	30	35	35	0	30
Production	861	861	860	845	0	840
Other Imports	214	216	235	235	0	235
Total Imports	214	216	235	235	0	235
Total Supply	1105	1,107	1,130	1,115	0	1,105
Other Exports	23	24	25	25	0	20
Total Exports	23	24	25	25	0	20
Human Dom. Consumption	1047	1,048	1,075	1,060	0	1,060
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	1,047	1,048	1,075	1,060	0	1,060
Total Use	1,070	1,072	1,100	1,085	0	1,080
Ending Stocks	35	35	30	30	0	25
Total Distribution	1,105	1,107	1,130	1,115	0	1,105

(1000 MT)

NOTE: Not Official USDA data;

Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

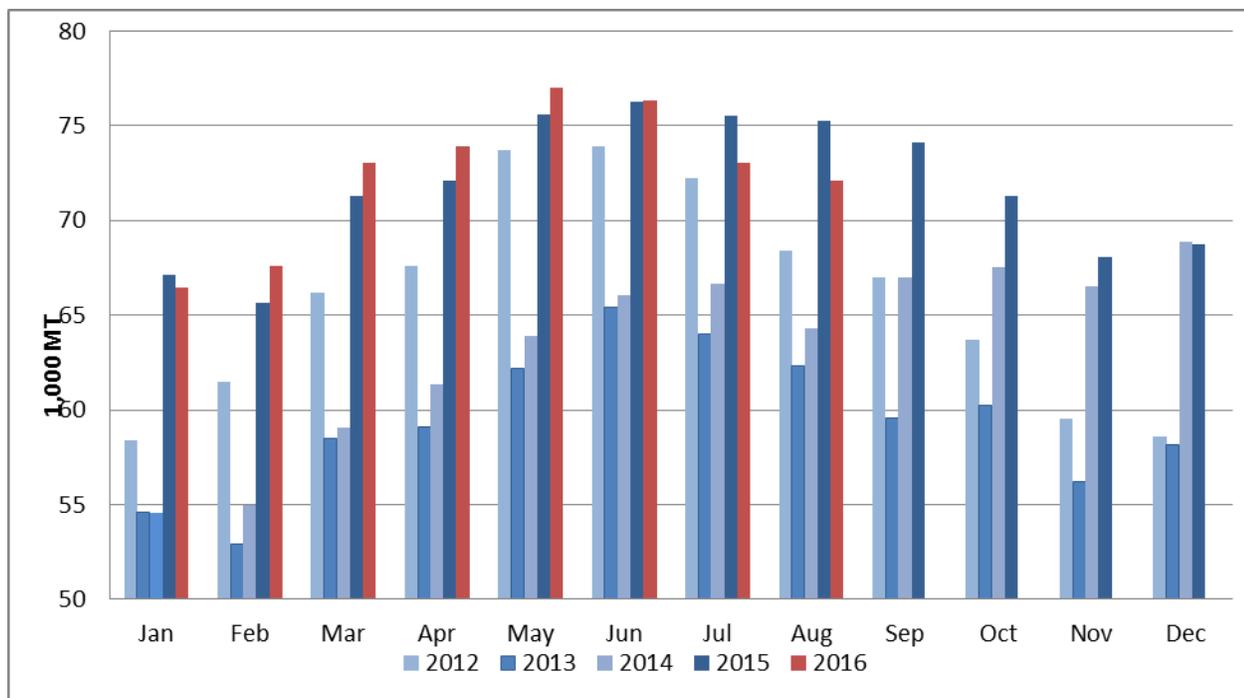
¹⁴Important Note: the State Customs Committee of Ukraine reports 0 MT of HS CODE 0401 imports from Russia in January-July 2016

Cheese and Curd (HS Code 0406) Production

FAS/Moscow forecasts cheese and curd production in 2017 at 840,000 MT, a minor 0.5 percent decrease from 845,000 MT projected in 2016. Multiple trends from the current market will likely remain in 2017, including weak consumer demand for premium high-margin cheese and strong competition from non-banned exporters in the market. Additionally, higher prices on quality raw milk suitable for cheese production are expected to constrain the growth of cheese sector.

The forecast of cheese production in 2016 was changed to 845,000 MT, a 1.8 percent annual decline from the previous 860 MT (flat from 2015) based on Rosstat production data for summer months showing lower than expected demand for cheese and.

Chart 4. Monthly Production Cheese and Curd (HS Code 0406) in Russia in 2012- Aug 2016 (1,000 MT)



Source

: FAS/Moscow estimate based on Rosstat Monthly Production Data

Absent competition from banned EU exporters, the market remains favorable for domestic cheese producers. Reputable large cheesemakers will likely maintain production at 2016 levels; however, many cheese making operations that economized on quality to supply the necessary quantity to the market in 2014-2015 will reduce or stop production due to increased competition among domestic producers. Stable prices for cheese in 2016 suggest that the market is close to saturation, in particular in the economy segment. Because the market does not need low quality products in the amounts supplied in 2014-2015, a minor decline of 0.8 percent of total supply in 2017 is anticipated. Further growth may be seen after significant recovery of the purchasing power of households, when the consumer interest shifts back to the premium and middle product categories. The macroeconomic forecasts available to date do

not anticipate such disposable income in 2017, so the market likely will remain balanced with cheese supplies comparable to 2016.

After declining in 2015 and the first quarter of 2016 due to weak demand, the average consumer price for cheese slightly increased. As Rosstat reported in September 2016, the average price for cheese increased 3.14 percent since January 2016 and was 7.4 percent higher than in September 2015. Prices on ‘tvorog’, a less expensive traditional fermented milk product, which was a dairy product of choice for Russian consumers during the crisis, also increased 6.56 % year-on-year. The cheese market is balancing near its saturation, and manufacturers are switching their focus to quality of their products and efficiency of operations to maintain sales.

Cheese and Curd Consumption

FAS/Moscow anticipates 1.060 MMT domestic cheese and curd consumption in 2017, unchanged from the revised 2016 level, approximately 7.45 kg. per capita. Stable supplies of recognizable cheese and tvorog brands from reputable producers and further expansion of private labels will contribute to the anticipated stabilization of cheese consumption in 2017.

Cheese prices in the economy and middle segments have remained stable in the course of 2016 due to stabilized supplies of branded, reasonably priced products of consistent quality from the leading companies¹⁵. In response to empty cheese shelves after the counter-sanctions food embargo, numerous new local brands emerged in 2015. However, consumers have not demonstrated loyalty to these brands because they were not satisfied with the quality of the new products; cheese consumption declined approximately 2 percent in 2015. The situation became favorable for expansion of well-known, locally produced brands and private labels, which have been able to fill in the market niche. Leading cheesemakers will likely maintain the sales in 2017. Cheese and curd consumption is expected to recover one percent, from 7.35 kg per capita to 7.45 kg. per capita in 2016 and remain at this level in 2017, despite expected price growth on dairy products.

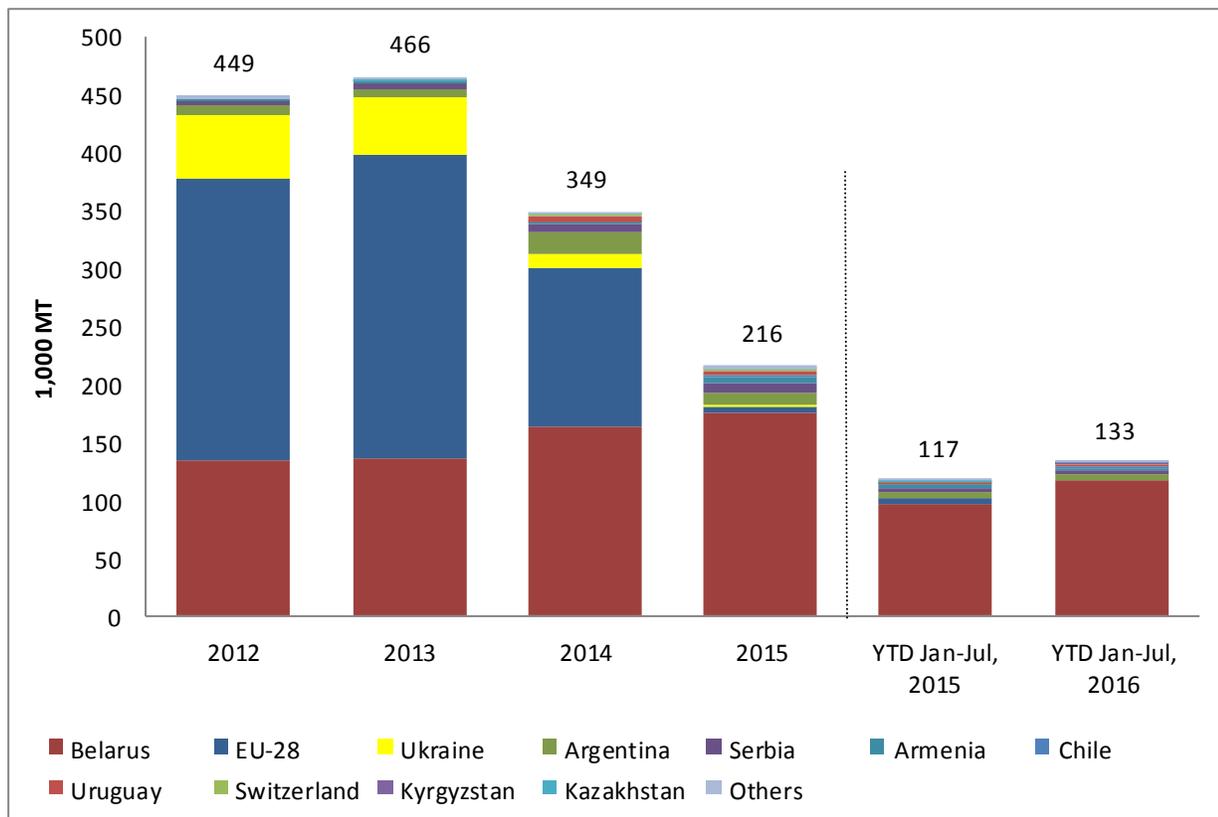
According to multiple media publications, milk producers complain that the problem of illegal palm-oil use in cheese production remains unsolved. The precise share of falsifications and improper labeling of goods in each dairy product group is difficult to determine due to the illegal nature of these activities, but it remains high. If authorities detect that a dairy processor uses palm-oil in violation of the technical and labeling regulations, the processor is most likely is charged a fine. However, these fines are small and typically do not motivate processors to stop the illegal practices. Also, retailers are not willing to terminate contracts with suppliers of products that sell well even if they are mislabeled. Milk producers, lawmakers, and authorities are considering several initiatives to enhance the control of palm oil use and improve the differentiation of the products, but actual implementation of most of these initiatives requires time, as it’s related to changes in technical and labeling regulations at the level of the Eurasian Economic Union.

¹⁵ Pepsico: “Lamber”; Valio: “Viola”, “Oltermanni”; Molvest in partnership with Arla Foods; Danone is a leader in the market of traditional tvorog.

Despite stabilization of cheese supplies in the medium and economy market segments, there is no adequate replacement of premium imported cheeses. Local producers were not able to fill in the segment of premium cheeses, and consumers continue to prefer the less expensive grocery items within product groups. As a result the middle price range varieties of cheese “Rossiysky”, “Gollandsky”, “Poshekhonsky”, and “Adygeisky” remain the bestselling hard and semi-hard cheeses and are increasing their share in the market. “Rossiysky” is the most popular variety of cheese, with over 60 percent share of total consumption. Low price, national branding and local production were named among the product’s attractive features. Purchases of “Gauda” and “Maasdam” continue to decline because consumers have not adjusted to the new local taste of cheeses that had been mostly supplied by imports prior to the embargo.

Cheese and Curd Trade (HS Code 0406)

Chart 5. Russian Imports of Cheese and Curd (HS Code 0406) Annual Series: 2012 - 2015 & Year to Date: 07/2015 & 07/2016 Quantity (MT); Major Suppliers



Source

: Federal Customs Service of Russia; Belstat

FAS/Moscow continues to forecast imports of cheese and curd at 235,000 MT in 2016 and anticipates the same level in 2017. Stable cheese prices in 2016 indicate that current market is balanced, and no dramatic changes in the sources of cheese supplies are expected in 2017. All the key cheese exporters, who could influence the Russian cheese market, remain excluded from competition until the end of 2017

due to the extended counter-sanctions ban¹⁶. Assuming the current restrictions remain unchanged, Belarus cheese exporters will remain the major supplier and will likely maintain the volume of cheese and curd shipments to Russia.

Cheese and curd export forecast for 2016 is unchanged at 25,000 MT; however, a decline in exports to 20,000 MT is possible in 2017 because prices for raw milk in Russia are anticipated to increase due to stagnation of the milk production sector. A resulting growth of export prices for cheese will make Russian products less attractive for traditional buyers in the Eurasian Economic Union and CIS region.

Butter and Anhydrous Milkfat (HS Codes 040510, 040590)

Table 3. Russia: Butter and Anhydrous Milkfat Supply and Distribution, 1,000 MT

Dairy, Butter Market Begin Year	2015		2016		2017	
	Jan 2015		Jan 2016		Jan 2017	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Russia						
Beginning Stocks	19	19	14	16	0	10
Production	260	260	250	245	0	245
Other Imports	88	90	100	90	0	90
Total Imports	88	90	100	90	0	90
Total Supply	367	369	364	351	0	345
Other Exports	3	3	3	4	0	3
Total Exports	3	3	3	4	0	3
Domestic Consumption	350	350	351	337	0	332
Total Use	353	353	354	341	0	335
Ending Stocks	14	16	10	10	0	10
Total Distribution	367	369	364	351	0	345

(1000 MT)

NOTE: Not Official USDA data; Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

Butter and Anhydrous Milkfat Production

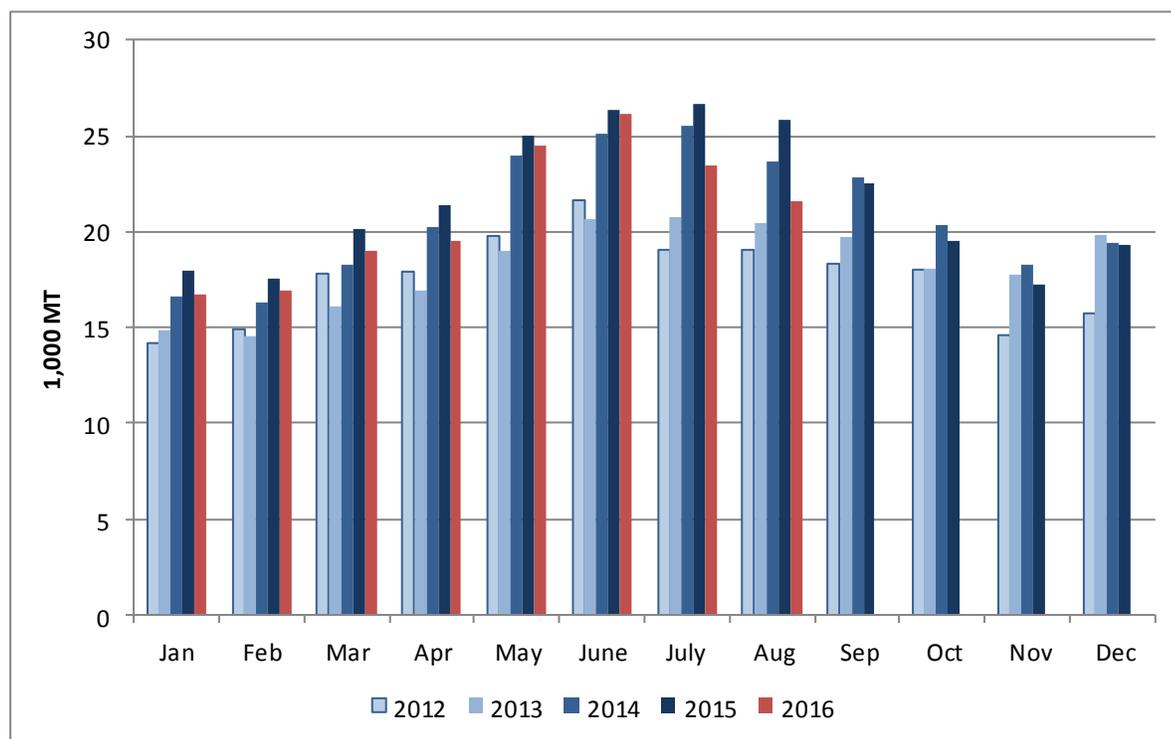
FAS/Moscow anticipates 245,000 MT butter production in 2017, which is equal to 2016 butter production estimate. The forecast of 2016 has been decreased to 245,000 MT of butter, a 5.7 percent decline from 2015. The decrease of butter production is largely a negative consequence of the increased use of milk fat substitutes in dairy products.

The trade restrictions of 2014 resulted in shortages of some dairy products and temporary growth of butter prices followed by a decline due to weakened consumer demand in 2015 and first half of 2016. Meanwhile, the presence of less expensive dairy products with palm oil dramatically increased in the

¹⁶ For detailed information about the current trade restrictions please refer to GAIN [Report RS1584](#).

market. Estimates¹⁷ of total imports of palm oil for the needs of the food processing industry grew 25.8 percent year-on-year to 888,900 MT in 2015. The palm oil imports continued to grow during the eight months of 2016, and have reached 562,000 MT which is 6.4 percent increase year-to-date. Some dairy products with palm oil do not label their use of vegetable oils, exerting strong pressure on the prices of real dairy products and leading producers of reputable dairy brands to complain about enforcement of the existing labeling regulations. Producers' margins from butter sales dropped due to the unfair competition, and they switched to other products that promised better margins. As a result, production of butter declined 6.3 percent during the first eight months of 2016¹⁸ compared to the same period in 2015.

Chart 6 . Russian Monthly Production of Butter (HS Codes 040510, 040590) in 2012–Aug 2016



Source: Rosstat

Some recovery of butter production is possible in the last quarter of 2016 due to recent growth of butter prices in August-September 2016. The world prices for butter in August 2016 were on average 25-30 percent higher than in 2015. Despite trade restrictions, the price growth in the world market pushed domestic prices up because Russia currently imports approximately 25 percent of the dairy butter it consumes from non-banned suppliers.

Butter and Anhydrous Milkfat Consumption

¹⁷ Source: www.specagro.ru

¹⁸ Source: Rosstat

FAS/Moscow anticipates a minor 1.5 percent decline in total domestic butter consumption to 332,000 MT or 2.33 kg. per capita in 2017 due to an expectation of some increase in butter prices in a price-sensitive market. The total supply of milkfat will likely decrease by approximately 6,000 MT due to lower stocks in the end of 2016 compared to previous year, while both the production and the imports of butter remain unchanged.

FAS/Moscow changed the 2016 butter consumption forecast to 337,000 MT or 2.36 kg per capita, which is a 3.7 percent decline from 2015. Monthly domestic output decreased unexpectedly in August 2016 when SPS problems disrupted dairy imports from Belarus. Increasing world prices limited butter imports from other sources, and the sudden lack of availability caused a spike in butter prices in August-September 2016. This price spike indicates that butter supplies in August 2016 declined below the market sufficiency level; however, domestic production will not likely rise to meet demand as long as other products provide higher profit margins. Because consumers remain price sensitive in the current economy, high prices will most likely slow recovery of consumer demand for butter.

Butter and Anhydrous Milkfat Trade

Imports of Butter and Anhydrous Milkfat (HS Codes 040510 and 040590) in 2017 are forecast at 90,000 MT, unchanged from the revised estimate for 2016. FAS/Moscow decreased its 2016 butter imports estimate from 100,000 to 90,000 MT due to 25-30 percent growth of world prices on milk fat August-September 2016. Also, the imports of palm oil continue to grow in 2016. The use of the vegetable substitutes of milk fat will likely remain unchanged in 2017.

Consumer prices for dairy products were growing below the rate of inflation in 2015 and the first half of 2016, and profitability for the dairy processors has been negatively impacted. Consumer demand remains weak: real disposable income dropped 8.3 percent in August 2016 year-on-year and retail sales decreased 5.7 percent even from the low base of the same months in 2015¹⁹. With weak demand, dairy processors will be unwilling to increase production costs by replacing vegetable oil ingredients with expensive butter in the end of 2016 and 2017.

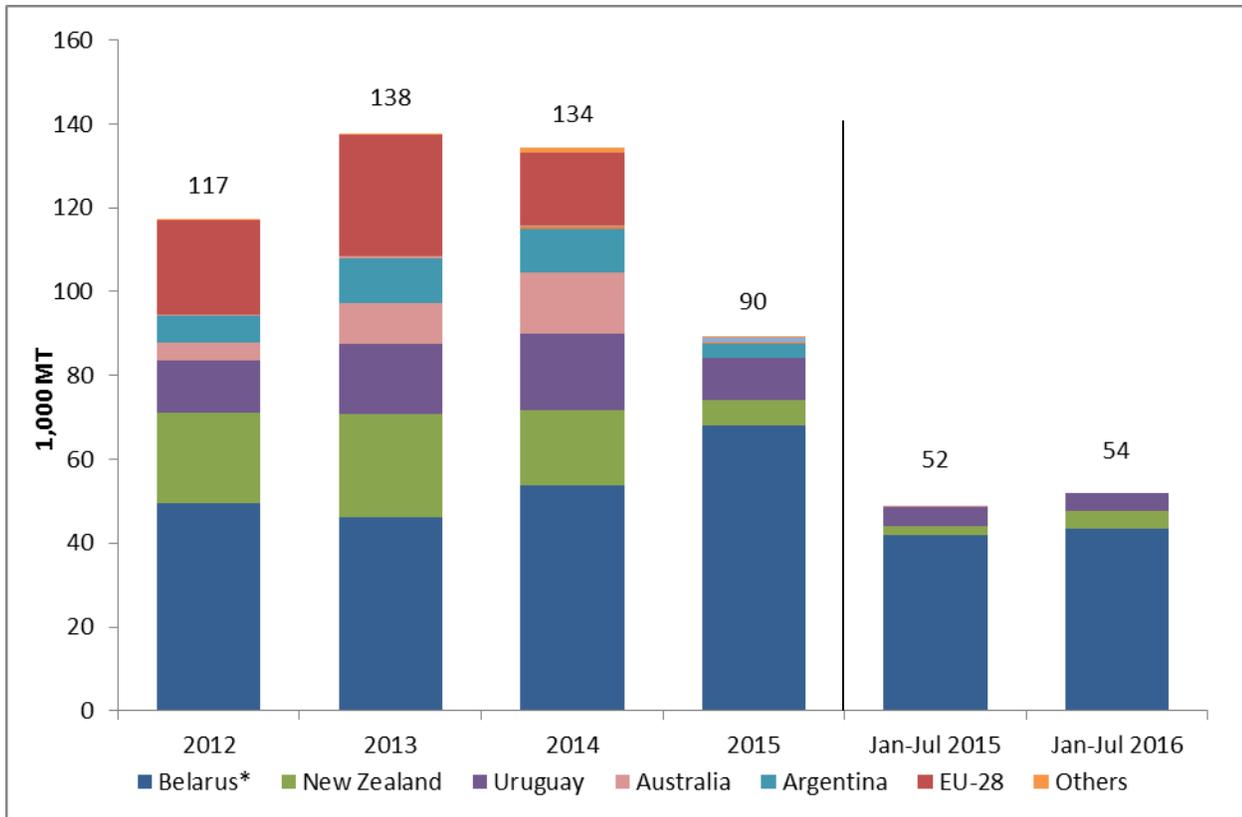
Butter is on the list of food products banned from import from several countries in retaliation for economic sanctions, and trade will be affected by the current restrictions at least until December 31, 2017. Belarus will remain the key exporter of dairy butter to Russia in 2017, and will likely maintain volumes of 60,000-70,000 MT. The Belarus share in Russian butter imports has grown to 80.6 percent in January-August 2016. By comparison, in 2013, Belarus accounted for 33 percent of Russian butter imports, 39.9 percent in 2014, and 76 percent in 2015. Bilateral trade will likely stay strong due to proximity and trade preferences under EAEU regulations.

Imports from Belarus were favorably priced in the first half of 2016 – its butter prices averaged 15-20 percent lower than those of local producers. The average price of one MT of imported butter from Belarus in the first half of 2016 was USD 3,356. New Zealand shipped 4,197 MT of butter at an average price of USD 3,633 per MT, while Uruguay supplied 4,280 MT of butter to Russia at the low price of USD 2,997 per MT. The average wholesale price for butter in Russia during the first eight

¹⁹ Source: Rosstat

months of 2016 was USD 3,863 per MT (Rub 261,919 at an average exchange rate 67.88 Rub per USD). Imports from Belarus were priced on average 15-20 percent lower than the prices of local producers in the first half of 2016. However, following the world trend, Belarus has increased its recommended export price for butter by 34 percent from 220 rubles per kg. in the beginning of the year to 295 rubles per kg. on October 10, 2016. Such price fluctuations contribute to an overall flat estimate for 2016 imports.

Chart 7. Russian Imports of Dairy Butter (HS Codes 040510, 040590) Annual Series: 2012 – Jul 2016
Quantity (MT); Major Suppliers



Source: Federal Customs Service of Russia; Belstat

Dry Milk Powders: WMP (HS Codes 040221, 040229) and SMP (HS Code 040210)

Table 4. Russia: Whole Milk Powder Supply and Distribution, 1,000 MT

Dairy, Dry Whole Milk Powder Market Begin Year Russia	2015		2016		2017	
	Jan 2015		Jan 2016		Jan 2017	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	5	5	4	4	0	5
Production	42	42	44	38	0	38
Other Imports	38	38	38	44	0	44
Total Imports	38	38	38	44	0	44
Total Supply	85	85	86	86	0	87
Other Exports	2	2	2	1	0	2
Total Exports	2	2	2	1	0	2
Human Dom. Consumption	79	79	80	80	0	80
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	79	79	80	80	0	80
Total Use	81	81	82	81	0	82
Ending Stocks	4	4	4	5	0	5
Total Distribution	85	85	86	86	0	87

(1000 MT)

NOTE: Not Official USDA data;

Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

Production of WMP and SMP

FAS/Moscow forecasts 38,000 MT production of WMP in 2017, unchanged year-on-year. The estimate of WMP production in 2016 was corrected from 44,000MT to 38,000 MT, which is an annual decrease of 4,000 MT. FAS/Moscow also decreased the production estimate of the Skimmed Milk Powder (SMP) to 65,000 MT anticipating the same level of SMP production in 2017. In the beginning of 2016 GOR had announced plans to purchase 4,000 MT of WMP and 6,000 MT of SMP in nine regions where milk production traditionally grows during summer months. The program is aimed at easing the seasonal drop of milk prices and to create additional demand for milk powders produced in Russia. Eventually, the GOR decided to postpone the program, mostly due to a lack of funds. Without state support, local producers of milk powders had no incentives to increase output because prices for milk powders were growing slower than producers' expenses. Also, exporters, especially from Belarus, offered lower prices for both commodities.

Table 5. Russia: Skimmed Milk Powder (SMP) Supply and Distribution, 1,000 MT

Dairy, Milk, Nonfat Dry Market Begin Year	2015		2016		2017	
	Jan 2015		Jan 2016		Jan 2017	
Russia	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	8	8	7	9	0	8
Production	69	69	70	65	0	65
Other Imports	110	120	110	120	0	120
Total Imports	110	120	110	120	0	120
Total Supply	187	197	187	194	0	193
Other Exports	2	2	2	1	0	2
Total Exports	2	2	2	1	0	2
Human Dom. Consumption	178	186	180	185	0	185
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	178	186	180	185	0	185
Total Use	180	188	182	186	0	187
Ending Stocks	7	9	5	8	0	6
Total Distribution	187	197	187	194	0	193

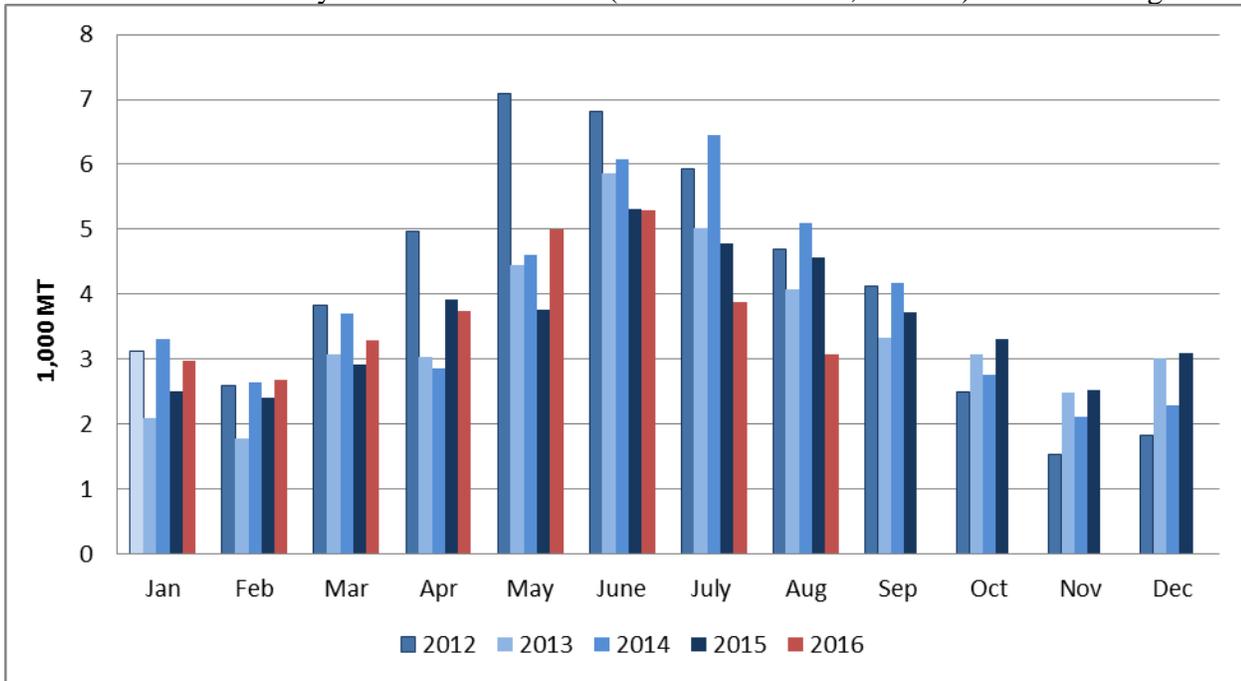
(1000 MT)

NOTE: Not Official USDA data;

Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

According to Rosstat, in January-August 2016 dairy processors in Russia produced 80,300 MT of milk powders (WMP and SMP), which is 5.3 percent less than production in the same months of 2015. The production of WMP will likely remain below 2015 levels during the last quarter of the year. Meanwhile, the production of SMP will likely recover in the last months and will offset the unusually low results of August 2016. As processors increase the output of butter in response to the shortage of milk fat in the market, SMP production in the last quarter of 2016 will also rise as a consequence.

Chart 8. Russian Monthly Production of WMP (HS Codes 040221, 040229) in 2012 – Aug 2016

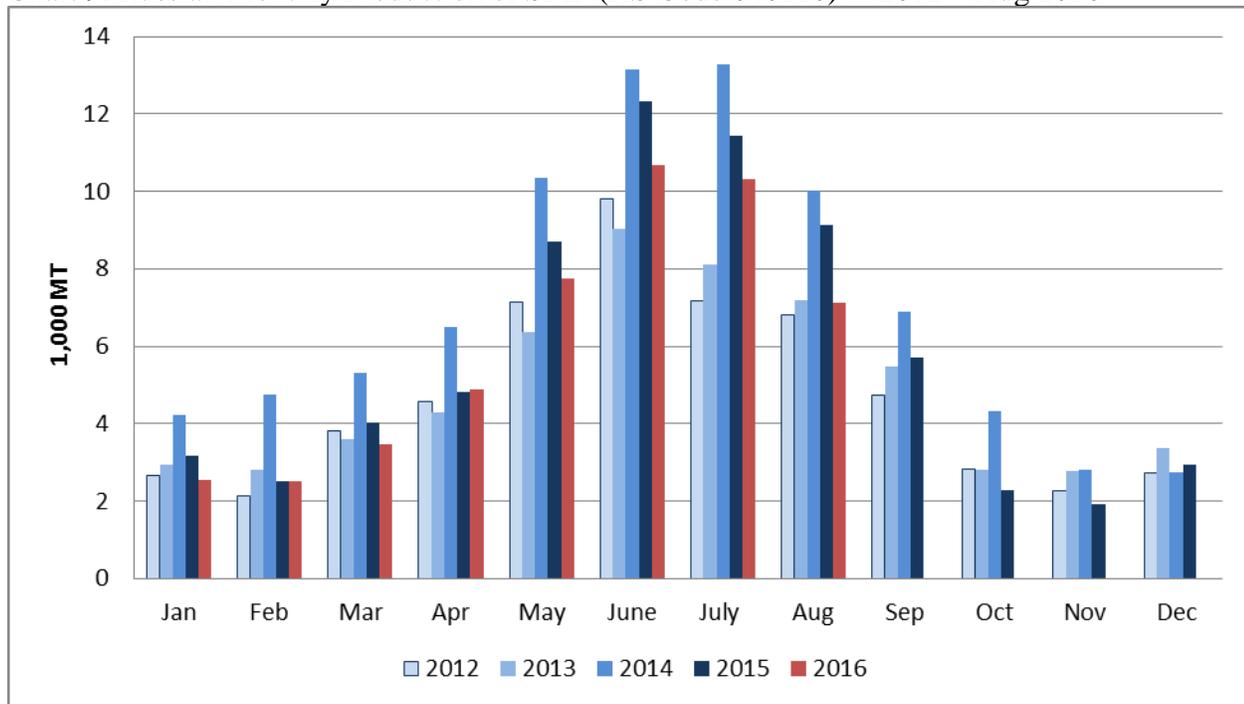


Source

: FAS/Moscow estimate based on Rosstat

Milk powder output traditionally increases in Russia between May and September each year, and most of the producers do not specialize exclusively on milk powder production. Processors add the powders to their summer assortment, store it and use between November and March to reduce expenses during the “low milk season”. Some unused capacity at drying facilities exists and dryers may increase the output of milk powder when the immediate market is favorable and additional sales are promising profits. Considering the flexibility of the industry to reduce or increase powder production, the annual output in 2017 will be influenced by pricing policies of the government of Belarus.

Chart 9. Russian Monthly Production of SMP (HS Code 040210) in 2012 – Aug 2016



Source

: FAS/Moscow estimate based on Rosstat

WMP and NFDM Consumption

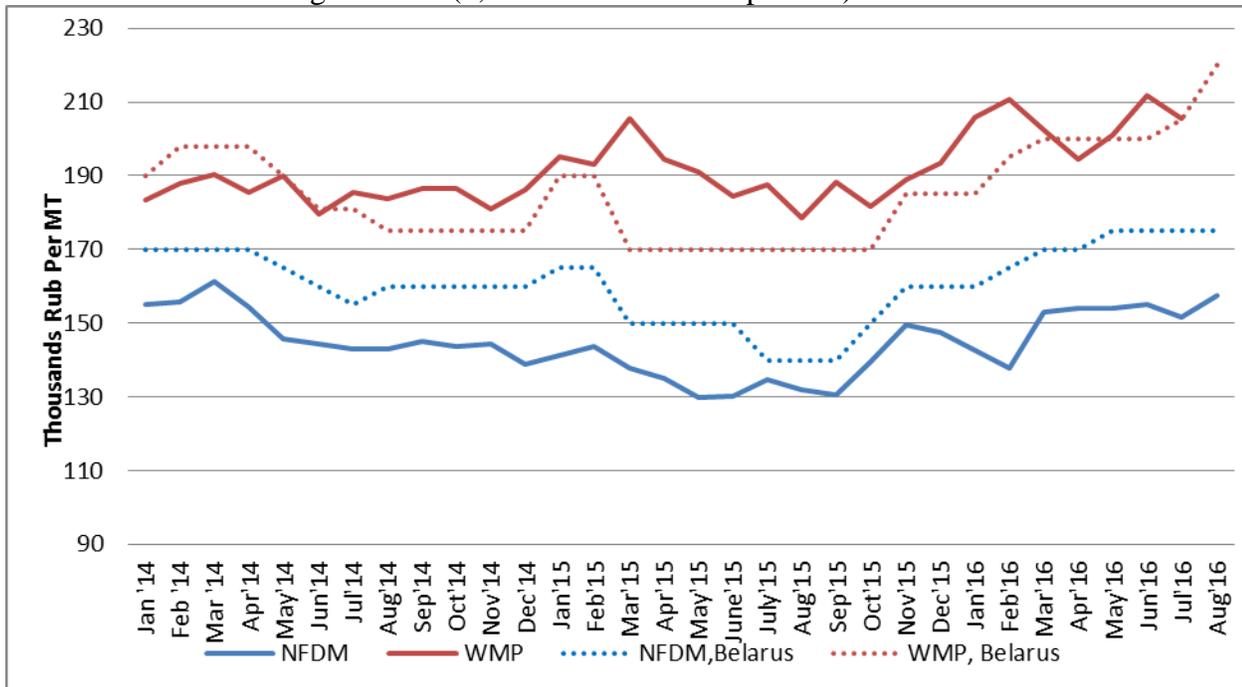
Based on the available production and stocks data for the first half of 2016, FAS/Moscow revised the estimate of 2016 SMP consumption to 185,000 MT, while the WMP consumption estimate remains unchanged at 80,000 MT. The consumption of milk powders, both WMP and SMP in 2017 is anticipated to remain at 2016 levels. The demand for milk powders from the domestic food processing industry has stabilized at 2015 level, and is not anticipated to change significantly next year. The consumer demand for confectionary, bakery, chocolate and other dessert food items remains weak. Exports of confectionaries are growing, but the growth is not strong enough to offset soft domestic demand.

WMP and NFDM Trade

FAS/Moscow increased 2016 imports estimate for WMP to 44,000 MT (from the previous 38,000 MT) as well as the estimate of SMP imports to 120,000 MT (from the previous 110,000 MT) based on the available trade data for the first half of the year. The import of milk powders, both WMP and SMP, is anticipated to remain unchanged in 2017. The projection is based on the assumption that Belarus will continue to benefit from its role of the major non-banned supplier until the end of 2017, and will be following a price strategy that allows it to win the price competition with Russian producers of milk powders.

In January-July 2016 Russia imported 23,769 MT of WMP (HS Codes 040221, 040229) and 71,281 MT of SMP (HS Code 040210). Belarus accounted for 75.3 percent of the total volume of WMP and 84.6 percent of the SPM imports. The share of imports in domestic consumption of milk powders is anticipated to remain at the level of approximately 61 percent. The exports of both commodities will remain insignificant as the Russian produces will unlikely be able to offer competitive export prices for mil powders to potential importers.

Chart 10. Wholesale Prices for Dry Milk Powders in Russia and Minimum Recommended Export Prices in Belarus in 2014 – August 2016 (1,000 Russian Rubles per MT)



Source

s: Rosstat, Ministry of Agriculture and Food of the Republic of Belarus

Production Information

Table 5. Russian Quarterly Milk Production, All Types of Producers, 1999- Q2 2016, 1,000 MT

Year	Annual	Quarters			
		I	II	III	IV
1999	32,274	5,846	10,784	10,347	5,297
2000	32,259	5,861	10,646	10,323	5,429
2001	32,874	5,879	10,766	10,419	5,810
2002	33,462	6,240	10,813	10,352	6,057
2003	33,316	6,358	10,519	10,400	6,039
2004	31,861	6,149	10,081	9,844	5,787
2005	31,070	5,880	9,677	9,559	5,954
2006	31,339	5,946	9,552	9,633	6,208
2007	31,988	6,080	9,723	9,766	6,419
2008	32,363	6,218	9,814	9,835	6,496
2009	32,570	6,201	9,764	9,898	6,707
2010	31,847	6,270	9,610	9,573	6,394
2011	31,646	6,109	9,380	9,524	6,633
2012	31,756	6,434	9,480	9,427	6,415
2013	30,529	6,155	9,007	9,074	6,293
2014	30,791	6,114	9,018	9,184	6,428
2015	30,550	6,200	8,839	8,956	6,553
2016		6,276	8,807		

Source: Rosstat

Trade Tables

Table 6. Russian Imports of Cheese and Curd (HS Code 0406) Annual Series: 2012 - 2015 & Year To Date: 07/2015 & 07/2016 Quantity (MT); Major Suppliers

Partner Country	Calendar Year				YTD Jan-Jul, 2015	YTD Jan-Jul, 2016	2015/2016 YTD; % Change
	2012	2013	2014	2015			
World	449,382	465,861	349,416	216,062	117,199	132,633	13.2%
Belarus*	133,394	136,187	164,025	175,415	96,792	116,322	20.2%
Argentina	7,968	7,372	18,562	10,254	5,044	5,062	0.4%
Serbia	3,630	5,055	7,453	8,077	3,933	4,807	22.2%
Armenia	868	1,576	1,535	6,103	3,104	1,792	-42.3%
Ukraine	55,421	50,055	11,334	2,767	0	0	0.0%
Chile	0	25	92	1,444	1,323	269	-79.7%
Uruguay	0	345	5,144	2,619	1,069	1,842	72.3%
Switzerland	409	462	1,371	1,471	746	756	1.3%
Kyrgyzstan	0	0	0	0	0	696	0.0%
Kazakhstan	0	419	583	1,409	928	564	-39.2%
EU-28	244,578	261,504	137,117	4,314	4,016	0	-100.0%
Others	3,114	2,861	2,200	2,189	244	523	114.3%

Source: Federal Customs Service of Russia; *Belstat

Table 7. Russian Imports of Butter (HS Codes 040510; 040590) Annual Series: 2012 - 2015 & Year To Date: 07/2015 & 07/2016 Quantity (MT); Major Suppliers

Partner Country	Calendar Year				Jan-Jul 2015	Jan-Jul 2016	YTD% Change
	2012	2013	2014	2015			
World	117,472	138,173	134,386	89,593	52,064	54,008	3.7%
Belarus*	49,478	46,068	53,642	68,134	41,836	43,539	4.1%
New Zealand	21,715	24,824	18,115	6,113	2,063	4,179	102.6%
Uruguay	12,350	16,505	18,198	9,875	4,725	4,280	-9.4%
Argentina	6,361	10,656	10,402	3,341	2,318	1,160	-50.0%
Brazil	0	0	445	365	365	36	-90.1%
Kazakhstan	0	152	209	1,338	692	159	-77.0%
Moldova	40	320	140	325	40	560	1300.0%
Chile	225	400	250	25	25	0	-100.0%
Australia	4,348	9,821	14,588	0	0	0	0.0%
EU-28	22,546	28,932	17,440	0	0	0	0.0%
Others	409	495	957	77	0	95	N/A

Source: Federal Customs Service of Russia; *Belstat

Table 8. Russian Imports of SMP (HS 040210) Annual Series: 2012 - 2015, & Year To Date: 07/2015 & 07/2016 Quantity (MT); Major Suppliers.

Partner Country	Calendar Year						
	2012	2013	2014	2015	2015 Jan-Jul	2016 Jan-Jul	YTD% Change
World	95,835	131,390	102,952	120,562	71,395	71,281	-0.2%
Belarus*	69,140	92,125	87,106	114,504	69,119	60,332	-12.7%
Turkey	0	0	0	0	0	3,311	∞
New Zealand	0	0	0	1,713	0	216	∞
Argentina	1,260	8,313	2,692	1,658	1,104	3,239	193.4%
Ukraine	10,745	5,619	1,710	20	0	0	0.0%
Uruguay	2,000	4,050	2,325	948	0	925	∞
Switzerland	375	705	1,707	1,459	813	2,676	229.2%
EU-28	11,797	20,136	6,813	0	0	0	0.0%
Others	518	442	599	260	359	582	62.1%

Source: Source: Federal Customs Service of Russia; *Belstat

Table 9. Russian Imports of WMP (HS Codes 040221, 040229) Annual Series: 2012 - 2015, & Year To Date: 07/2015 & 07/2016 Quantity (MT); Major Suppliers.

Partner Country	Calendar Year						
	2012	2013	2014	2015	Jan-Jul 2015	Jan-Jul 2016	YTD% Change
World	27,315	43,599	36,386	38,757	20,229	23,769	17.5%
Belarus*	25,005	39,987	29,702	37,232	19,369	17,898	-7.6%
Argentina	503	390	3,488	550	550	3,633	560.5%
Uruguay	0	650	598	550	150	1,613	975.3%
Kazakhstan	0	0	94	223	114	599	425.4%
Ukraine	417	5	138	0	0	0	0.0%
EU-28	807	2,107	1,744	0	0	0	0.0%
Others	583	460	622	202	46	26	-43.5%

Source: Source: Federal Customs Service of Russia; *Belstat