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**Prepared By:**

**Approved By:** Stanley Phillips

**Report Highlights:**

A growing supply of milk from industrialized farms is leading to quality improvements. Despite reduced purchasing power, consumers have responded positively to improved quality and steps taken to ensure consumer confidence in labeling of dairy products. Firm demand for cheese and butter is anchoring the industry as it faces COVID-19 related economic difficulties in retail and growing operational expenses due to ruble depreciation. Production of cheese, butter, and powders is expected to grow in 2021 and offset some imports. Exports remain insignificant reflecting less competitive prices for raw milk in Russia as compared to world markets.

## Executive Summary

Despite the expected decline of cow inventories to 6.5 million head in 2021, milk production is forecast to grow to 31.8 million metric tons (MMT) because of the improving productivity. Large, industrialized farms are the main contributors to the positive dynamics as they invest in better genetics and equipment. Productivity is expected to grow gradually along with expansion of leading companies to new regions. An improved investment climate in the milk sector will encourage the consolidation process. Growth opportunities are constrained, however, by weak consumer purchasing power and operational expenses driven higher by depreciation of the Ruble.

The growing supply of raw milk is occurring in tandem with quality improvement in the increasingly transparent market. Quality advances are, in part, a result of Russian government initiatives to trace and remove products that do not comply with regulatory requirements from the market. Notably, the “Mercury” system of national electronic veterinary certification has become obligatory for registering all movements of dairy products from farm to table. As a result of more transparency, consumers have more confidence in dairy products and demand for raw milk from processing plants increased. Producer prices for raw milk were reaching historical maximums even as the worrying economic environment triggered by the COVID-19 developed.

The unexpectedly positive response of consumers in the business-to-consumer (B2C) segment to improved quality of cheese and butter helped the industry cope with COVID-19 related economic difficulties. Cheese and butter consumption are forecast to grow 5.6 and 2.86 percent in 2020, respectively. Driven by firm demand, cheese and butter production are forecast at 1.05 MMT and 280,000 MT, respectively in 2021.

Unlike B2C, Covid-19 containment measures have hit the business-to-business (B2B) sector strongly. During the January-July 2020 period, the restaurant and catering market declined by 24.5 percent compared to 2019. Consumption patterns have shifted to traditional dairy products used for in-home consumption and meal preparation. In contrast, the robust supply of milk powder in the first quarter of 2020 faced a weak demand from the food processing industry because of COVID-related closures. The forecast of 92,000 MT skimmed milk powder (SMP) and 65,000 MT of whole milk powder (WMP) production in 2021 is based on expectations of a moderate recovery in demand from the B2B component of the food sector.

The Russian dairy industry’s production of milk fat is augmented by imports accounting for approximately one-third of the country’s milk fat consumption. The long-term goal of national import substitution policies is to reduce this dependence. Imports are forecast to decline in 2021 due to intensifying competition from domestic plants compounded by reduced competitiveness of imported product caused by Ruble depreciation. Cheese imports are forecast to decline to 280,000 MT in 2021, butter to 118,000 MT and WMP to 36,000 MT. SMP imports are forecast at 60,000 MT in 2021; a minor recovery reflecting expectations of improved demand from the HRI segment. Belarus will most likely remain the key supplier of imported dairy products. Exports remain insignificant because average prices of raw milk in Russia remain higher than prices of the key world exporters.

Trade Restrictions: Counter-sanctions introduced in 2014 continue to influence fluid milk, cheese, butter and milk powder trade with a number of countries, including the United States. As of the date of the report, counter-sanctions are scheduled to remain in effect through December 31, 2020. The Government of Russia (GOR) has not extended the counter-sanctions through 2021 but there have been no announcements of any intentions to lift the restrictions. Purebred breeding cows and heifers are excluded from the counter-sanctions.

### Fluid Milk

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

Dairy, Milk, Fluid Market Begin Year Russia	2019		2020		2021	
	Jan 2019		Jan 2020		Jan 2021	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
<b>Cows In Milk</b>	6,655	6,711	6,580	6,580	0	6,500
<b>Cows Milk Production</b>	30,560	31,154	31,000	31,650	0	31,800
<b>Other Milk Production</b>	0	0	0	0	0	0
<b>Total Production</b>	30,560	31,154	31,000	31,650	0	31,800
<b>Imports</b>	200	250	200	270	0	250
<b>Total Supply</b>	30,760	31,404	31,200	31,920	0	32,050
<b>Exports</b>	30	27	30	30	0	30
<b>Fluid Use Dom. Consum.</b>	7,215	7,270	7,200	7,200	0	7,115
<b>Factory Use Consum.</b>	21,580	22,150	22,050	22,760	0	22,995
<b>Feed Use Dom. Consum.</b>	1,935	1,957	1,920	1,930	0	1,910
<b>Total Dom. Consumption</b>	30,730	31,377	31,170	31,890	0	32,020
<b>Total Distribution</b>	30,760	31,404	31,200	31,920	0	32,050
(1000 HEAD, 1000 MT)						

NOTE: Not Official USDA data;

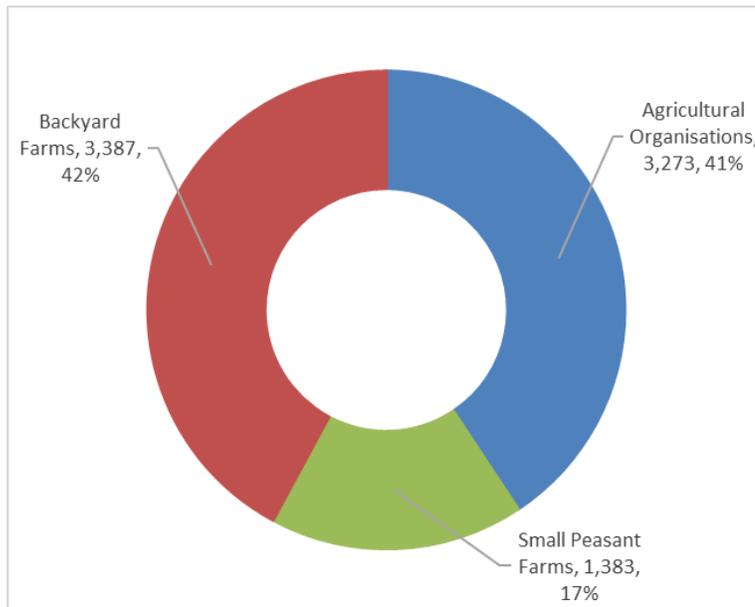
Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

### Cows-in-milk

Cows-in-milk inventories are forecast to decline to 6.5 million head in 2021. The inventory component represented by backyard farms has been shrinking for decades due to declining rural population and this long-term trend is expected to continue in 2021. Cow numbers at commercial farms are also declining as dairy businesses replace “dual purpose milk and meat” cattle of local selection with modern highly productive dairy breeds.

Milk farming remains the least industrialized and the least consolidated agricultural subsector in Russia. Rosstat reported 8.043 million head of cows in the country as of July 1, 2020 with 42 percent of the herd represented by backyard farms. Backyard farm do not contribute to industrial processing supply chains. Most dairy produced on backyard farms is used for on farm consumption with the exception of irregular nondocumented sales at small local farmers’ markets.

Chart 1. Distribution of Cows\* by types of farms on July 1, 2020; 1,000 head.



Source: Rosstat

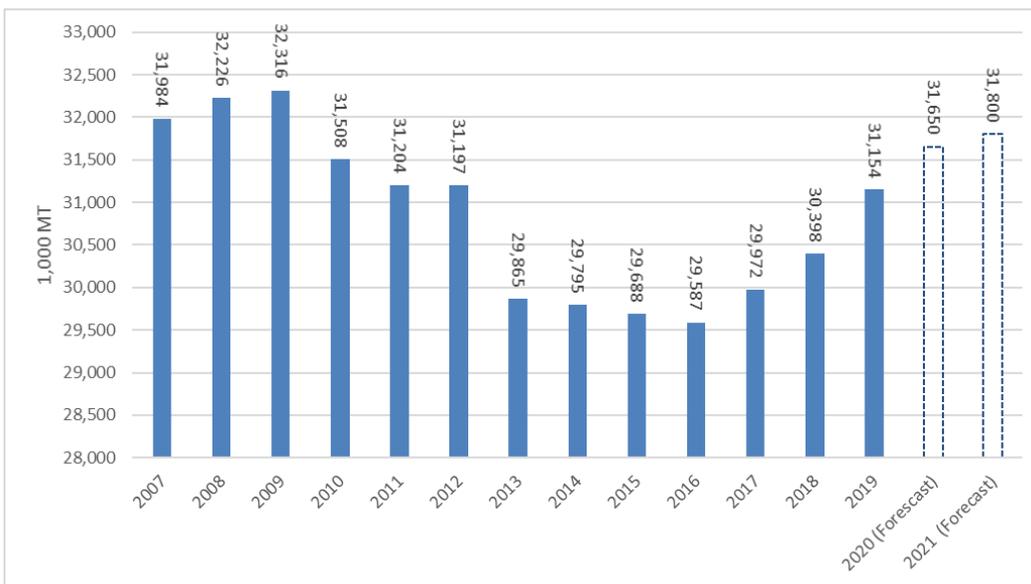
\*Rosstat calculates “cows” as including all forage cows, beef and dairy. Official USDA data for cows-in -milk is available at <http://apps.fas.usda.gov/psdonline/>

Large, industrialized farms account for 41 percent of cow inventories. Small peasant farms account for 17 percent. These two types of businesses supply milk for factory processing, which is forecast to increase to 22.760 MMT in 2020 and 22.995 MMT in 2021.

### Fluid Milk Production

Despite the expected decline of cow numbers, milk production is forecast to grow to 31.8 MMT in 2021 because of the improving per cow productivity. The average per cow yield at all types of farms was 4.642 MT in 2019, a 3.4 percent improvement year-on-year. Positive changes in the average productivity are expected to continue in 2020-2021 at a comparable pace. Large, industrialized farms are the main contributors to the positive dynamics as they invest in better genetics and equipment. Rosstat reported a 6.4 percent increase in per-cow yields at large industrialized farms in January-August 2020.

Chart 2. Russia: Cow milk production by all types of farms in 2007-2019 and forecast 2020 and 2021 (1,000 MT)



Source: Rosstat<sup>1</sup>

<sup>1</sup> Data Revision. Rosstat has revised livestock inventories and milk production data for the years 2007-2017. The revision of cows-in milk inventories and milk production was based on the results of the 2016 Agricultural Census. FAS/Moscow has adjusted cows-in-milk inventories and fluid milk production data in accordance with available official Rosstat’s data.

There is good potential for further growth in productivity because the industry is not equally developed throughout the country. The average yields per cow vary from as low as 1.802 MT per cow per year to as high as 8.591 MT. Productivity is expected to grow gradually along with expansion of the leading companies to new regions.

According to the National Union of Milk Producers “Souzmoloko”, the 30 biggest companies<sup>2</sup> produced 3.176 MMT of milk in 2019 accounting for less than ten percent of total production. For decades, milk production has been characterized by financial struggles and heavy subsidies. The sector was the least attractive for investors compared to other Russian food industries. Now, investors are turning towards milk production as other sectors are showing signs of oversupply and lower margins. At the same time the cost of capital has decreased. As of the date of this report, the key interest rate of the Central Bank of the Russian Federation (CBR) was 4.25 percent, a record low in the history of modern Russia. With improving investment, the consolidation process in the milk production sector has started. Industry leaders have started expanding into new regions by taking over the farms of their weaker competitors. The market share of the leaders is expected to grow gradually in the future. However, the increase in 2021 will be marginal due to COVID-19 related economic difficulties of 2020. Weak consumer purchasing power and growing operational expenses will have a negative impact on producer margins and most likely constrain faster growth. For example, “Ekoniva”, the largest Russian producer of raw milk<sup>3</sup>, has already revised its plan for 2020. The company has reduced its expected raw milk output for 2020 from 1 MMT to about 900,000-940,000 MT. The company’s dairy herd will reach 105,000 cows instead of the previously planned 110,000 head.

According to “Souzmoloko” analysis of production costs, the average operational expenses of milk producers increased 10 percent in August 2020 compared to 2019. The growth of feed prices and the devaluation of the national currency were the main reasons behind the increase of production costs.

The devaluation of the national currency in March 2020<sup>4</sup> resulted in an increase of ruble prices for imported inputs like veterinary medicines, disinfectants and equipment. Weakening of the ruble will further impact production costs in the last quarter of 2020 with raw milk prices expected to grow in the mid-term.

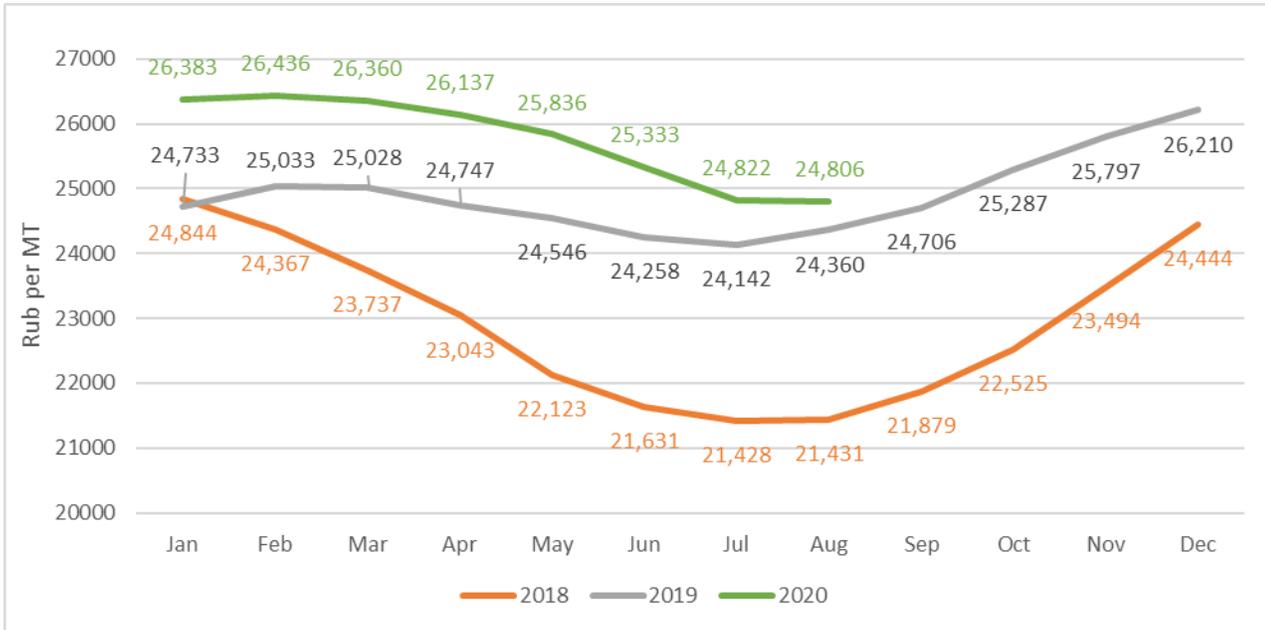
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<sup>2</sup> Source: [https://milknews.ru/analitika-rinka-moloka/reitingi/reitingi\\_55267.html](https://milknews.ru/analitika-rinka-moloka/reitingi/reitingi_55267.html)

<sup>3</sup> EkoNiva produced .758 MMT of milk in 2019 and the company’s revenue exceeded 400 million Euros; a 60 percent increase from 2018. As of July 1, 2020, all EkoNiva farms produced more than 2.5 thousand tons of milk per day. The company currently operates farms in Voronezh, Kursk, Novosibirsk, Kaluga, Ryazan, Moscow, Tyumen, Orenburg, Leningrad, Samara regions, the republics of Tatarstan and Bashkortostan, Altaiskiy Krai. The company controls more than 600 thousand hectares of land and has a herd of 188.6 thousand head, including 101.6 thousand dairy cows.

<sup>4</sup> The Ruble depreciated 13.9 percent against the U.S. dollar in March 2020 from 66.99 on 03.01.20 to 77.73 rubles per dollar on 04.01.20 Source: <https://www.cbr.ru/>

Chart 3. Russian Average Farmgate Prices for Milk, 2018 - 2020 (Rubles/MT)



Data Sources: Rosstat

Chart 4. Russia: Average Farmgate Prices for Milk, 2019-2020 (USD/MT)



Data Sources: Rosstat, Central Bank of Russia

### Government support.

According to media releases on the draft Federal Budget, 257.5 billion rubles (USD 3.4 billion) have been allocated for the state program of Agricultural Development in 2021. The amount is 33.7 billion rubles (USD 455 million) less than the previous version of the budget had planned for agricultural sector support in 2021. The cut is related to redistribution of funds to address the impact of COVID-19. Unlike other impacted industries, the agricultural sector is expected to grow approximately one percent in 2020, so the funds will be redirected to other urgent needs. Dairy industry representatives are concerned about possible cuts to dairy programs. Ministry of Agriculture officials reassured them that access to preferential credit and subsidies to promote increased dairy cattle productivity will remain in place. No return to past direct subsidies provided for each kilo of milk sold for processing are envisioned. However, the government might stop reimbursing pre-selected companies for capital expenditures on construction and modernization of dairy farms. As of the date of the report, it is not clear what amounts will be actually allocated for specific dairy industry support programs.

### Fluid Milk Consumption

*Improved Market transparency became the big positive factor in 2020.*

After the import ban was introduced in 2014, a flood of illegitimate “dairy” products<sup>5</sup> appeared on the market. For example, products marketed as “dairy” often were produced from non-dairy ingredients like palm oil in illegal operations across the country. Illegitimate “dairy” products remained the biggest issue for the Russian dairy industry in the ensuing years. Research conducted by Federal Veterinary and Phytosanitary Surveillance Service (VPSS) in 2019 found that 24 percent of dairy products were counterfeit with actual ingredients different from what was printed on the labels. According to the research conducted by “Souzmolko” in 2019, the share of dairy products with false ingredients on their labels was 39 percent. Both studies showed that the most frequent violations stemmed from products like cheese, butter and sour cream (“smetana” labeled as produced from genuine milk fats but actually produced using palm oil). The Russian government introduced a series of practical and legislative measures to trace and remove the fraudulent products from the market. The efforts were focused on improving the transparency of supply chains and distribution channels. New labeling and marking rules for products with non-dairy components, an obligatory electronic veterinary certification and a VAT increase on palm oil from 10 to 20 percent were among of the regulatory changes which addressed the problem and restored demand in 2019 and 2020 for milk and milk fat in particular.

Despite of some initial disagreement between the dairy industry and the government about veterinary certification of processed dairy products, the “Mercury” system of national electronic veterinary certification is now used for all dairy products. According to VPSS the system successfully detects and guards against placement of illegitimately labelled “dairy” products on the market.

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<sup>5</sup> Products labeled as “dairy” but illegally made without milk.

The “Mercury” system has been developed and is monitored by the VPSS. Starting from November 1, 2019, electronic certification in the “Mercury” system is obligatory for fluid milk and all processed dairy products. According to VPSS, the system is capable of tracing all the movements of products from dairy farms to final consumers. “Mercury” also generates data showing discrepancies between the amount of raw milk purchased for processing and the final output of dairy products at each plant. For example, according to Sergey Dankvert, the head of VPSS, the system identified a producer who somehow converted 10 liters of fluid raw milk to 10 MT of cheese. The analysis of this data helped to identify and close 489 companies producing falsified dairy products between January and August 2020. Industry representatives confirm that electronic certification became an effective tool for removal of the fake products from the market. According to “Souzmoloko”, the most recent audits detect less than one percent of fake dairy in the samples.

As a result of better market transparency, the demand for raw milk from processing plants is increasing and supporting milk prices. According to Rosstat, in August 2020 the price for a liter of milk reached 24.8 rubles per kg (excluding VAT), a historical high for August despite the COVID-19 related economic difficulties.

#### *Influence of COVID-19 containment measures on milk consumption.*

Key negative factors influencing the current market are the deteriorating purchasing power of Russian consumers and ongoing problems in the Hotel, Restaurant and Institutional (HRI) sector since the first shutdown in early 2020. During the January-July 2020 period, the restaurant and catering market declined by 24.5 percent compared to 2019. Real Disposable incomes are forecast to decline 3 percent in 2020, with recovery to pre-COVID levels anticipated by the end of 2021. Consumption patterns initially have shifted to traditional products used in home consumption and meal preparation due to COVID-19 containment measures, and then to less expensive SKUs due to loss of incomes.

The leading retail chains reported 20-30 percent growth of sales of cheese, butter and UHT milk at the end of March and beginning of April 2020, when households were purchasing additional food supplies with a long shelf-life after the government had announced quarantine measures due to COVID-19. Then, real disposable incomes suffered a steep fall during the second quarter of 2020, plunging a record 8 percent. As a result, consumer demand shifted to the least expensive traditional dairy products<sup>6</sup>, family size packages and cheap dairy alternatives. Dairy sales stabilized during the summer months when the quarantine measures were eased, but the ban on international travel due to COVID-19 remained in place. Families who typically spend summer

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<sup>6</sup> Approximately 55 percent of all industrially processed milk in Russia is used to produce fluid milk in consumer packages and traditional fluid dairy products based on fermented milk. This product group is classified in Russia under the “whole milk dairy products excluding tvorog” category, and includes “kefir”, “ryazhenka”, “prostokvasha”, “smetana”, “yogurt”, and other traditional dairy. Traditional dairy products are a “super fresh” retail category with temperature requirement below 6°C and shelf life between 3 and 30 days depending on the type of product. Post PSDs include these products in “Factory use consumption”.

vacations outside the country stayed home or traveled inside the country and unutilized travel budgets were used for buying local food products, including dairy.

Cheese and Curd (HS 0406)

Important Note: PSD category “Cheese” (HS Code 0406) covers two different markets: “Cheese” that accounts for approximately 52 percent of consumption, and “Tvorog” which accounts for the remaining 48 percent of consumption. “Tvorog” is a popular traditional fermented milk product, similar to cottage cheese or quark, with a shelf-life from three to thirty days depending on the type. Popular types of “Tvorog” may contain from 0.1 to 11 percent of milk fat. Prices for “Tvorog” are on average lower than prices for cheese (Please refer to Charts 6 and 7 for details). Unlike “Cheese”, “Tvorog” is considered a low marginal product by processors. Detailed information about the brands and characteristics of “tvorog” products is available here (in Russian):

[https://roscontrol.com/category/produkti/molochnie\\_produkty/tvorog/#](https://roscontrol.com/category/produkti/molochnie_produkty/tvorog/#)

Table 2. Russia: Cheese and Curd (HS 0406) Supply and Distribution, 1,000 MT

Dairy, Cheese	2019		2020		2021	
	Jan 2019		Jan 2020		Jan 2021	
Russia	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	36	36	40	35	0	32
Production	970	983	1,000	1,035	0	1,050
Imports	273	273	275	290	0	280
Total Supply	1,279	1,292	1,315	1,360	0	1,362
Exports	24	26	20	28	0	30
Domestic Consumption	1,215	1,231	1,255	1,300	0	1,300
Total Use	1,239	1,257	1,275	1,328	0	1,330
Ending Stocks	40	35	40	32	0	32
Total Distribution	1,279	1,292	1,315	1,360	0	1,362

(1000 MT)

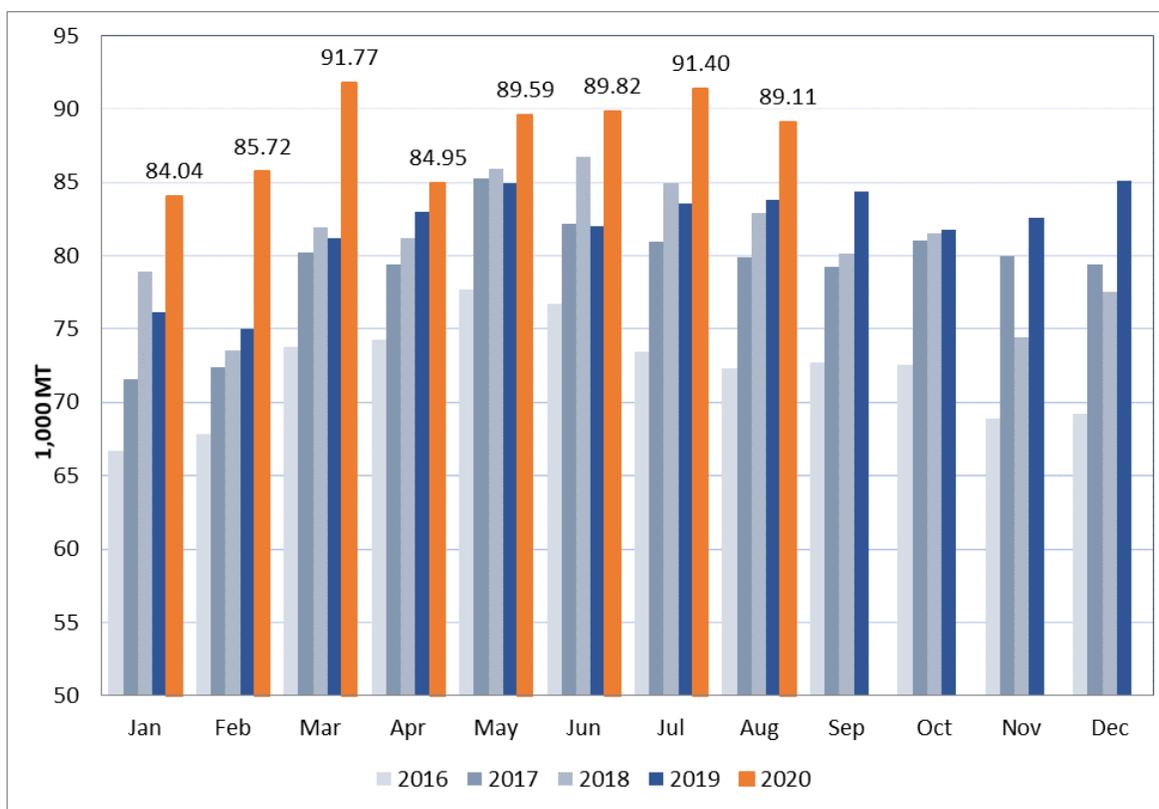
NOTE: Not Official USDA data; Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

### Cheese and curd (“tvorog”) production.

Cheese and curd production is forecast to reach 1.05 MMT in 2021 because of the growing domestic supply of raw milk and positive response of Russian consumers to the improved quality of locally made cheese. Local products are expected to increasingly substitute for imports.

The dairy industry produced 706,399 MT of cheese and curd in January - August 2020, up 8.7 percent from the same months in 2019. Total production includes 377,230 MT of hard and semi-hard cheese and 329,168 MT of curd (“tvorog”). Despite the ongoing economic crisis and decline in purchasing power of Russian consumers, firm demand for quality cheese encouraged production. The more expensive category “cheese” has been growing faster than less expensive “tvorog”.

Chart 5. Russia: Monthly Production of Cheese & Curd (“Tvorog”) (HS Codes 040510, 040590) in 2016–Aug 2020; 1,000 MT



Source: Rosstat

### *Cheese and curd ("tvorog") consumption.*

The demand for cheese improved significantly in 2020 mostly because of new labeling requirements and removal of fraudulent cheese from the market. Effective July 1, 2019, cheese became subject to obligatory electronic certification in the "Mercury" system. In addition, amendments to the technical regulations of the Customs Union on Safety of Milk and Dairy obliged producers to inform buyers about the presence of vegetable fats in products. Starting from July 2019, the words "milk-containing products with milk fat substitute" must be printed on the labels of products with palm oil. The information must be printed in contrast bold type at least 2.5mm thick on the front side of the label. There also must be at least a 3mm thick inscription "contains vegetable oils" on the label.

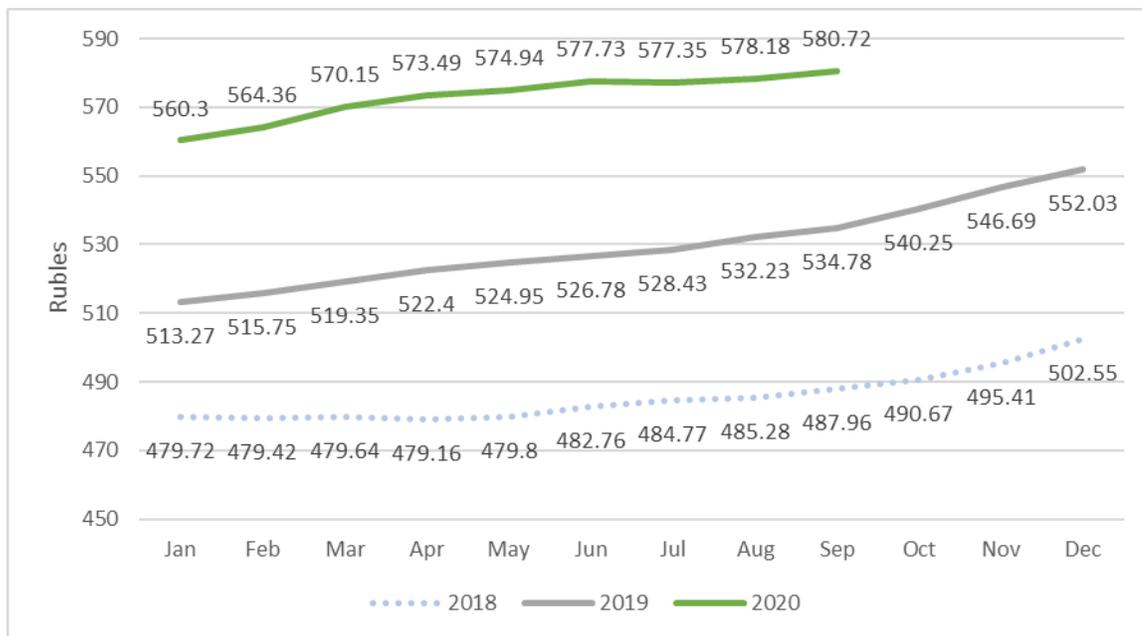
Additionally, new regulations for retail dairy products in Russian stores require that they must be displayed on the shelves in accordance with the ingredients used for their production. For example, dairy products must be placed in a way that consumers can easily visually differentiate them from similar products containing vegetable fats. Price tags with words "Products without milk fat substitutes" must be displayed on relevant dairy shelves. Milk containing products with non-dairy components must be accompanied with price tags stating the, "Product contains milk fat substitute".

As soon as buyers could easily differentiate cheese from cheese-like products, cheese sales started growing. According to the analytical center Milknews<sup>7</sup>, in January-July 2020, consumption of cheese in Russia increased by 9.7 percent compared to the same period of the previous year. At the same time, consumption of cheese products containing plant-based components fell by 17 percent. However, due to the sharp contraction of the HRI segment, the monthly growth rate of cheese consumption has slowed down. Experts predict some shift in consumer demand back to less expensive cheese alternatives due to rising raw milk prices and falling incomes.

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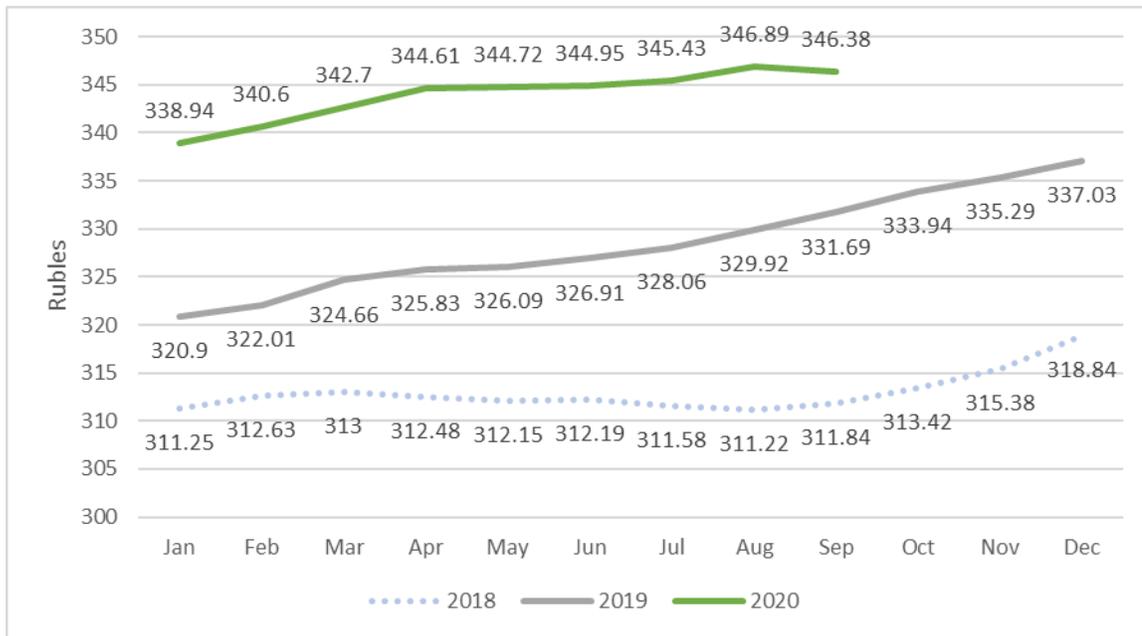
<sup>7</sup> Source: <https://milknews.ru/analitika-rinka-moloka/rinok-moloka-v-Rossii/potreblenie-molochnoj-produkcii-iyul.html>

Chart 6. Russia: Average Consumer prices for hard and semi-hard cheese in 2018-August 2020; Rubles per kg (including VAT)



Source: Rosstat

Chart 7. Russia: Average Consumer prices for curd ("Tvorog") in 2018-August 2020; Rubles per kg (including VAT, excluding fat-free curd)



Source: Rosstat

Cheese and curd consumption is forecast at 1.3 MMT in 2020, a 5.6 percent annual growth. The positive effect of the improved market transparency most likely will be exhausted by the end of the year. Consequently, cheese consumption in 2021 is forecast flat.

#### *Cheese and Curd Trade (HS Code 0406)*

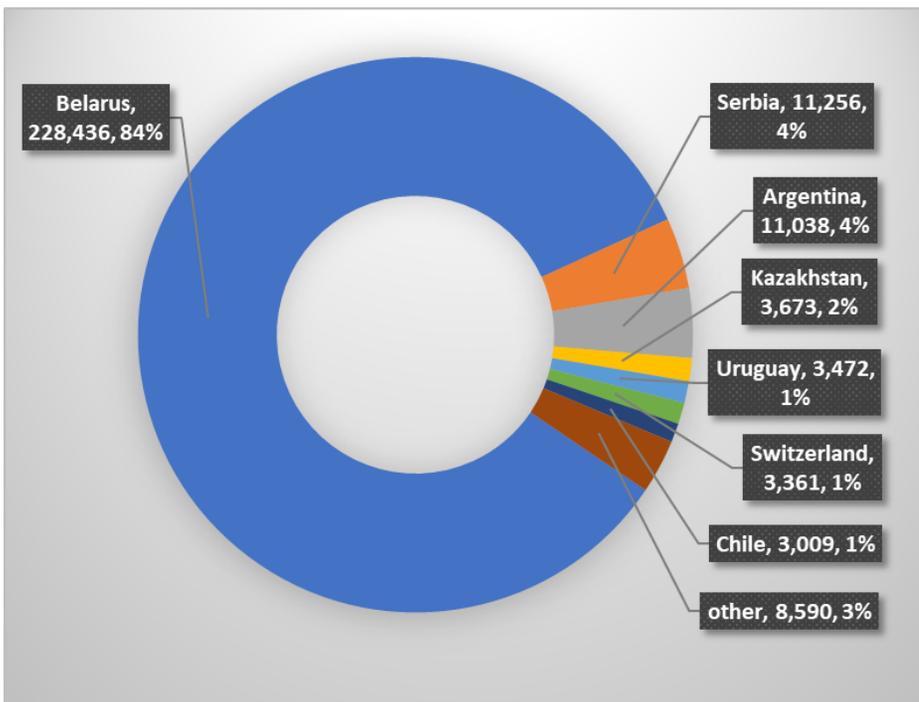
Imports of Cheese and Curd (HS Code 0406) are forecast to decline to 280,000 MT in 2021 due to intensifying competition with cheese from domestic plants and reduced competitiveness of imported products due to Ruble depreciation.

The 2020 forecast has been revised higher based on better than expected demand for quality imported cheese as the “Mercury” system created better transparency in distribution channels for imported dairy products. At the same time, the system improved the accuracy of statistics on border crossings of dairy products which, in turn, supported an increase in estimated imports in 2020. Relatively high prices for raw milk inside Russia also contributed to larger than expected cheese imports. As a result of joint influence of these factors, cheese and curd imports in 2020 may reach the highest level since the introduction of anti-sanctions trade restrictions in 2014.

Russia imported 272,835 MT of Cheese and Curd HS Code 0406 in 2019, including 184,735 MT of hard and semi-hard cheeses, 81,755 MT of fresh cheese and curd (“tvorog”), and 6,345 MT of other types of cheese. Total value of these imports was 1.14 billion USD. Hard and Semi-Hard Cheeses, including Cheddar and Colby (HS Code 040690) accounted for 67.7 percent of the total volume. Fresh Cheese and Curd (HS Code 040610) accounted for 30 percent of the imports.

Imports of Cheese and Curd (HS 0406) in January-July 2020 amounted to 168,295MT, a 9.1 percent increase in volume with a commensurate 8.1 percent value increase, i.e., imports of USD 678.2 billion for the period. Imports of fresh cheese increased 9 percent to 52,412 MT during the first seven months of 2020 while imports of hard and semi-hard cheese grew 10.1 percent 112,809 MT for the same period.

*Chart 8. Russia: Imports of Cheese and Curd (HS Code 0406) in 2019; Major Suppliers; Quantity (MT), share %*



*Source: Trade Data Monitor*

Belarus is the biggest supplier of cheese and curd to Russia, it accounted for 84 percent of imports in 2019, and maintains its leadership position with an 85 percent share in 2020. Belarus shipped 142,679 MT of cheese in January-July 2020, a 9.4 percent increase in volume from the same period in the previous year. Other suppliers also shipping cheese to Russia include Serbia, Argentina, Kazakhstan, Uruguay, Switzerland, and Chile. The same players are expected to remain in the market in 2021 with comparable shares.

Cheese and curd exports are forecast to grow to 30,000 MT in 2021. The expected surplus of raw milk will be partially processed into products with a longer shelf life, in particular cheese. Accumulated unsold stocks should strengthen exports to neighboring markets, mostly to the EAEU, Caucasus, and Central Asia. Russia exported 26,239 MT of Cheese and Curd in 2019 (+9.3% year-on-year); and 15,736 MT in January-July 2020 (+9.7 % YTD).

Butter and Anhydrous Milkfat

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

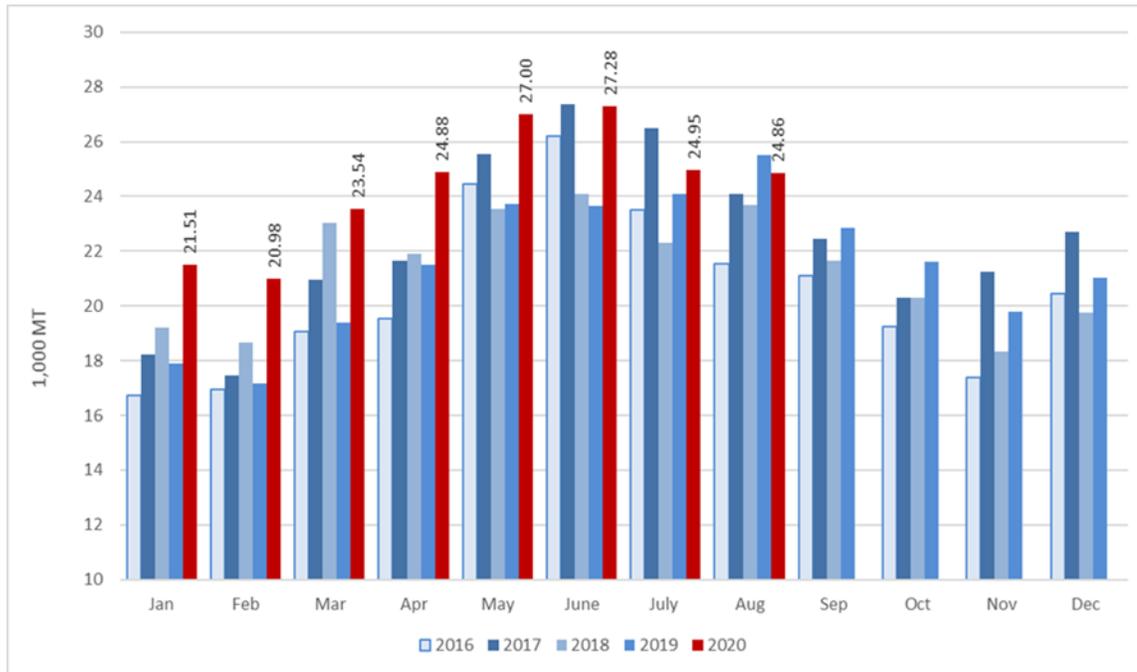
Dairy, Butter	2019		2020		2021	
	Jan 2019		Jan 2020		Jan 2021	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Market Begin Year						
Russia						
Beginning Stocks	15	15	15	14	0	18
Production	254	268	260	278	0	280
Imports	117	117	135	125	0	118
Total Supply	386	400	410	417	0	416
Exports	2	2	2	4	0	4
Domestic Consumption	369	384	388	395	0	395
Total Use	371	386	390	399	0	399
Ending Stocks	15	14	20	18	0	17
Total Distribution	386	400	410	417	0	416
(1000 MT)						

NOTE: Not Official USDA data;

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

Butter and Anhydrous Milkfat production

Chart 9. Russia: Monthly Production of Butter in 2016–Aug 2020



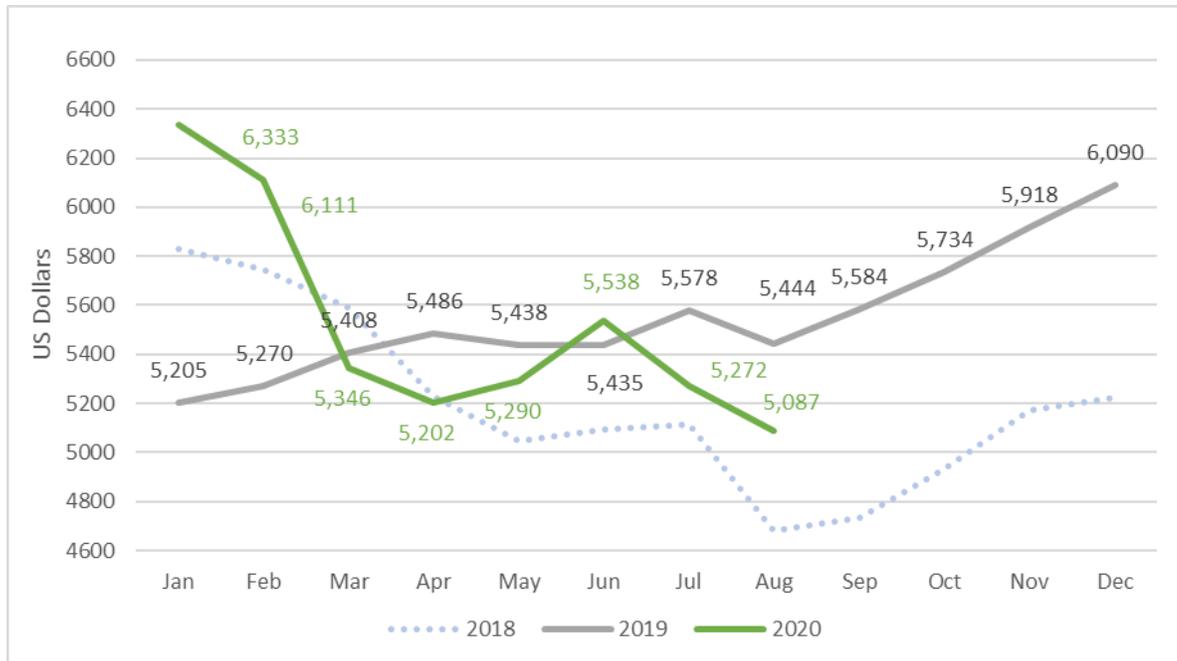
Source: Rosstat

Butter production is forecast to reach 280,000 MT in 2021, essentially flat (0.7 percent) annual growth following a forecast 3.7 percent increase in 2020. Improving supply of raw milk from industrial farms is the key driver of the growth. The Russian dairy industry is gearing up to produce more milk fat to butter imports which currently account for approximately one third of the country’s consumption. The long-term goal of the state import substitution policies is to reduce this dependence. Russian production is expected to continue growing at the expense of reduced imports.

2020 production exceeded previous expectations because transparency of the market improved and fake products with milk fat substitutes were successfully removed from dairy shelves. (Please refer to “Fluid Milk production” and “Cheese & Curd consumption” chapters of this report for detailed explanations. The same factors influenced the butter segment.).

According to Rosstat, butter production reached 195,000 MT in January-August 2020, which is a 6.5 percent increase compared to the same months of 2019. The pace of production growth will likely slow down in the last quarter of the year due to accumulation of unsold stocks, and the negative impact ruble depreciation has on profitability of butter sales. Wholesale butter prices (calculated in U.S. dollars) have fallen 19.6 percent between January and August 2020, meanwhile production costs increased.

Chart 10. Average producer prices for dairy butter in Russia in 2018-August 2020; US Dollars per MT (including VAT)



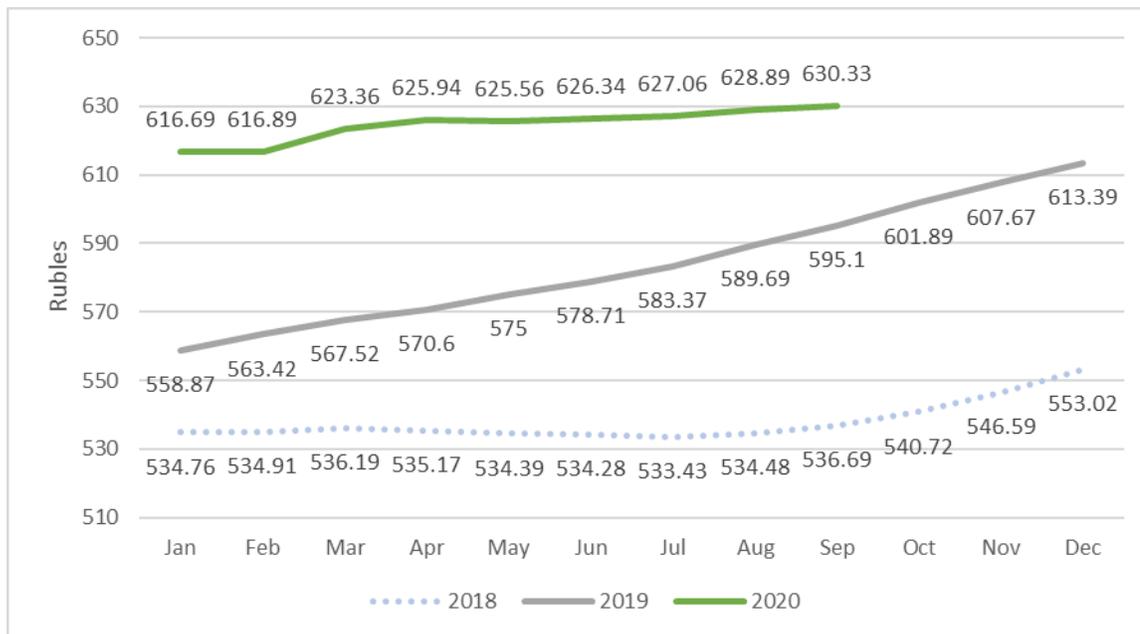
### Butter and Anhydrous Milkfat consumption

Butter consumption in 2021 is forecast 395,000 MT, unchanged from 2020. The market is anticipated to stabilize after significant growth 7.87 percent in 2019 and 2.86 percent in 2020.

New requirements for labels and separate shelves for products with milk fat substitutes resulted in boost of butter sales at the expense of the declining sales of plant-based oils and spreads. When Russian consumers could differentiate real butter from its substitutes, they preferred butter.

Consumer prices for butter increased 9.8 percent last year from 558.87 Rub/kg in January 2019 to 613.39 Rub/kg in December. The price growth reflected increased consumer interest in butter. The consumer prices continued growing in 2020 at a smaller pace. The average consumer prices increased 2.2 percent between January and August 2020. The effects from introduction of the new shelving rules, labeling and veterinary certification will most likely be exhausted by the end of 2020. Considering the on-going decline of consumers' incomes and the anticipated increase of prices due to growing production costs, growth of butter consumption in 2021 is unlikely.

Chart 11. Consumer prices for dairy butter in Russia in 2018-August 2020; Rubles per kg (including VAT)



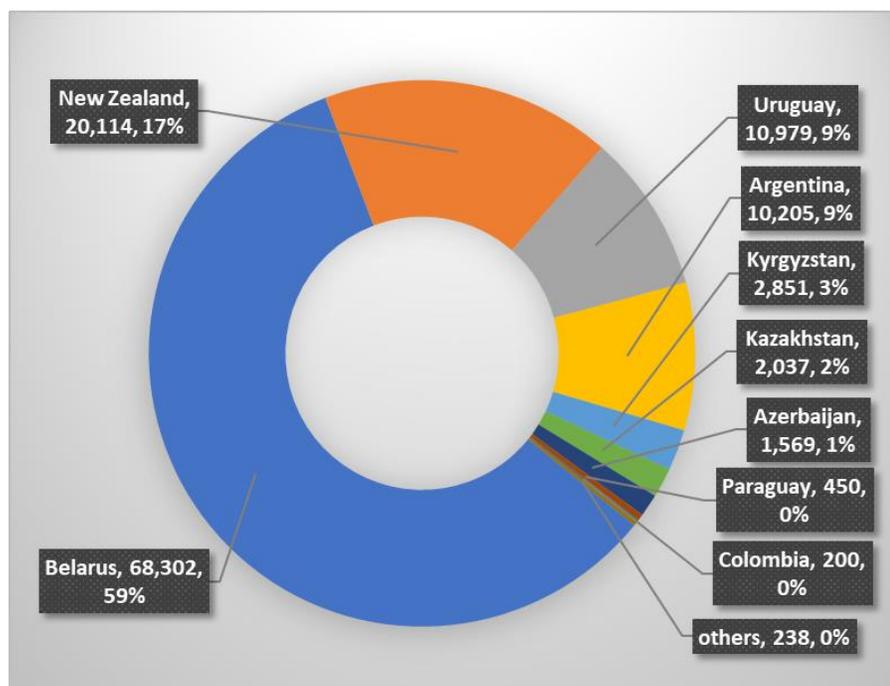
Source: Rosstat

### Butter and Anhydrous Milkfat trade

Imports of *Butter and Anhydrous Milkfat* are forecast to decline to 118,000 MT in 2021 due to growing supply of butter from Russian plants and ruble depreciation, that creates unfavorable price outlook for imports. The 2020 forecast has been corrected to a bigger number because of relatively low world prices on milk fat and a better than expected demand inside Russia in the first half of the year.

Russia imported 116,945 MT of *Butter and Anhydrous Milkfat* in 2019. Butter (HS Code 040510) accounted for 90 percent, milkfat (HS Code 040590) for 10 of the shipments. Total value of these imports was 613.725 million USD. Quantity of imports grew 11.6 percent year-to-date in January-July 2020, to 74,917 MT; meanwhile the total value of the trade year-to-date remained 345 million USD, unchanged from the same period in the previous year.

Chart 12. Russia: Imports of Butter and Anhydrous Milkfat\_(HS Codes 040510 and 040590) in 2019; Major Suppliers; Quantity (MT Butter Equivalent), share (%)



Source: Source: Trade Data Monitor

Belarus is the biggest supplier of butter to Russia, it accounted for 59 percent of imports in 2019, and maintains its leadership with the 55 percent share in January-July 2020. Belarus shipped 41,092 MT of butter in January-July 2020, supply declined 5.3 percent (-2,300 MT) in volume year-to-date. During the same period, New Zealand, the second largest supplier increased its shipments by 80.4 percent (+8,883 MT). Argentina also increased butter shipments to Russia by 4,543 MT year-to-date. Russian market remains closed for other key suppliers, so the same players are expected maintain their shares in 2021 with minor fluctuations.

Butter exports are forecast at 4,000 MT in 2021, unchanged from 2020. Exports remain insignificant because average prices on milkfat in Russia remain 10-15 percent higher than average world prices. Russia exported 1,690 MT in January-July 2020 to its traditional markets of the EAEU, CIS, Eastern Ukraine.

SMP

Table 4. Russia: Skimmed Milk Powder (SMP) Supply and Distribution, 1,000 MT

Dairy, Milk, Nonfat Dry	2019		2020		2021	
	Jan 2019		Jan 2020		Jan 2021	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	8	8	9	7	0	7
Production	82	88	85	90	0	92
Imports	88	88	60	58	0	60
Total Supply	178	184	154	155	0	159
Exports	1	1	2	2	0	3
Domestic Consumption	168	176	143	146	0	150
Total Use	169	177	145	148	0	153
Ending Stocks	9	7	9	7	0	7
Total Distribution	178	184	154	155	0	160
(1000 MT)						

NOTE: Not Official USDA data;

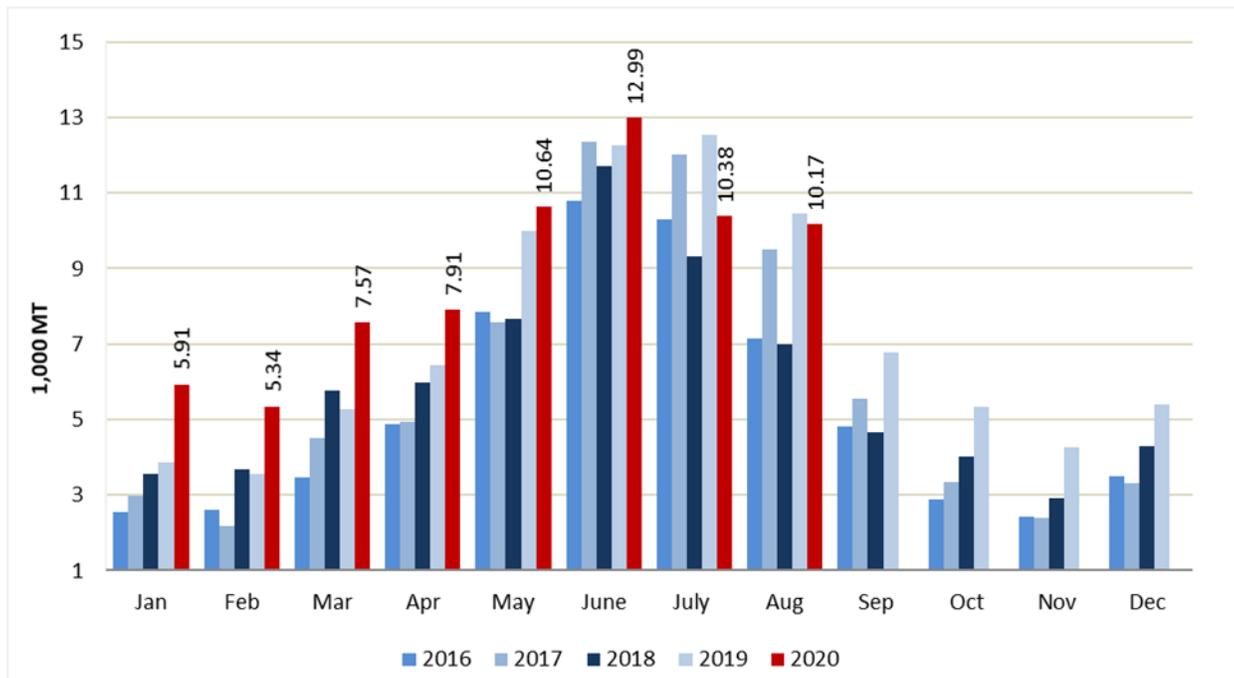
Official USDA data is available at <http://apps.fas.usda.gov/psdonline/>

SMP Production

Despite the record low demand for SMP due to COVID-19 related difficulties in food sector, SMP production is forecast to grow to 90,000 MT in 2020. Reduced imports resulted in a 15 percent decline of total SMP supply, creating favorable conditions for the growth of domestic production. The forecast of 92,000 MT SMP

production in 2021 is based on expectations of a moderate recovery of demand from the b2b element of the food sector and an optimistic butter production forecast<sup>8</sup>.

Chart 13. Russia: Monthly Production of SMP (HS Code 040210) in 2016 – Aug2020



Source: Rosstat

The Russian industry produces the largest part of the annual volume of Skimmed Milk Powder during the “high milk season” between May and August. The output seasonally increased in 2020, as usual. The monthly output in the first quarter of 2020 was noticeably higher than in 2019, mostly due to improved supply of raw milk and robust butter production. The strong supply in the first quarter faced a very weak demand from the food processing industry impacted by COVID-related closures. Ruble prices for SMP declined 10 percent between March and July 2020. If calculated in dollars, the decline in prices was even stronger at 18.7 percent, due to Ruble depreciation. This combination of factors created a rare situation, when Russian SMP prices fell below world levels, making imports not profitable.

Reduced imports resulted in relatively low SMP stocks accumulated by the end of the “high milk season”. Rosstat reported only 13,828 MT of SMP in stocks by the end of August 2020, the lowest quantity in five years. The pace of butter production slowed down in the second part of the year, resulting in slowdown of SMP

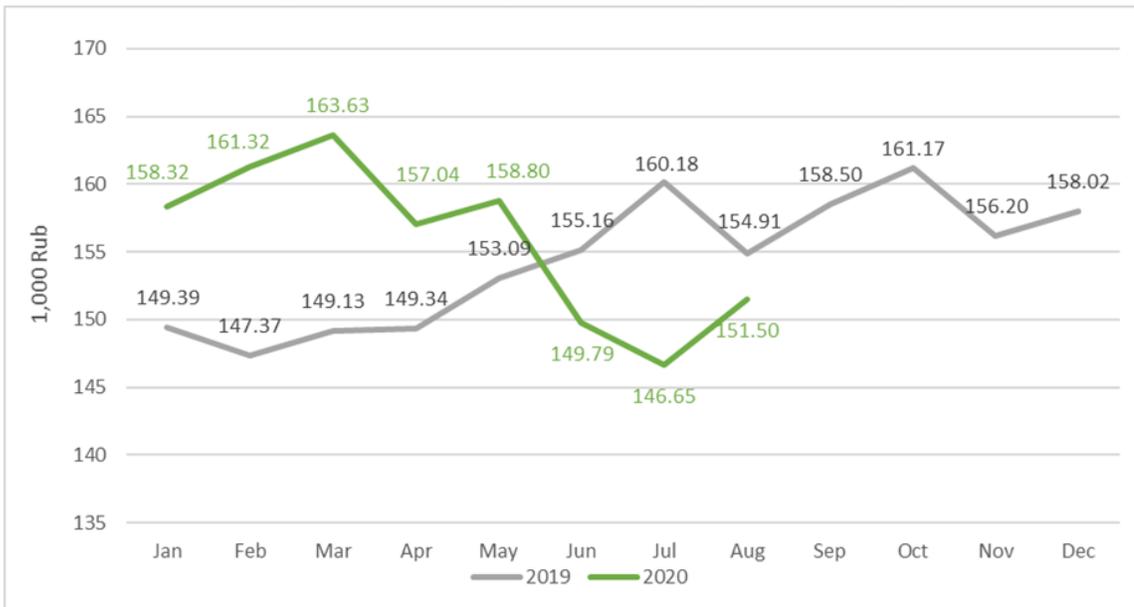
<sup>8</sup> Butter and SMP are produced at the same plants in Russia, and the output of both products is correlated. However, there is not always a strong linear correlation between SMP and butter production in Russia. According to Rosstat butter production increased 6.5 percent in January-August 2020 while SMP increased 9.67 percent.

output. The stocks will most likely remain low through the beginning of 2021 which may become an additional factor motivating continued production growth in the next season.

SMP Consumption

The COVID-19 related crisis hit demand for SMP stronger than other dairy products. Demand from producers of dairy ingredients for the Hotel, Restaurant and Institutional (HRI) sector dramatically declined in the first half of the year due to Covid-19 containment measures. As a result, total consumption of SMP is expected to decline to 146,000 MT in 2020, a 17 percent reduction from 2019. The forecast consumption of 150,000 MT SMP in 2021 is based on the anticipated recovery of demand from the b2b sector, which is adjusting to the pandemic realities.

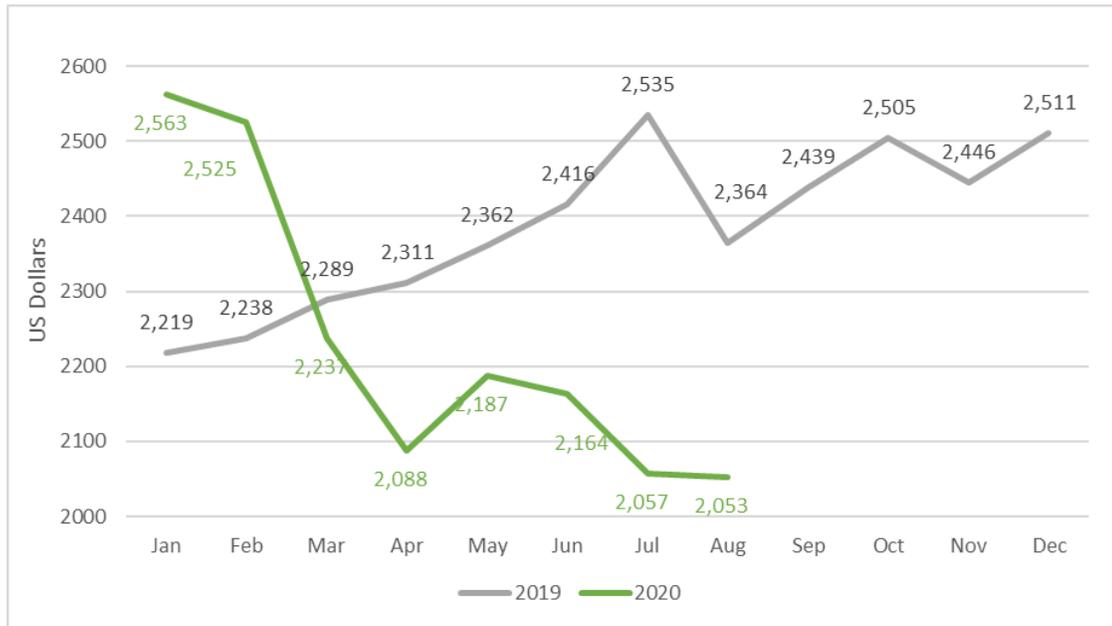
Chart 14. Russia: Average Producer Prices for SMP; Rubles per MT (Including VAT)



Source: Rosstat

SMP prices demonstrated the strongest decline year-on-year relative to all other dairy products. The Average Producer price for SMP was 151,500 Rubles per MT (USD 2,053) in August 2020. SMP prices in Rubles declined by 3,410 Rubles year-on-year, (about USD 311). Unlike all other dairy products, Ruble prices for SMP dropped below 2019 levels in the third quarter of 2020. The dramatic decline of prices reflects both the downward trends of world SMP prices in the first half of 2020 and the weak demand for SMP from the Russian food processing sector.

Chart 15. Russia: Average Producer Prices for SMP; US Dollars per MT (Including VAT)

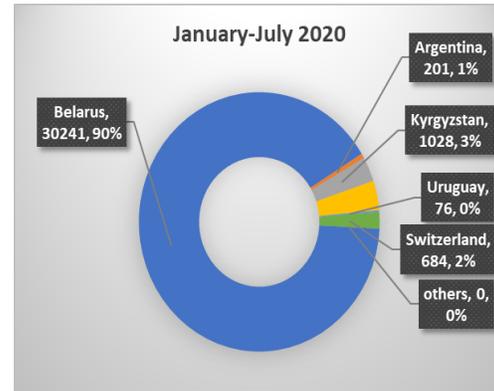
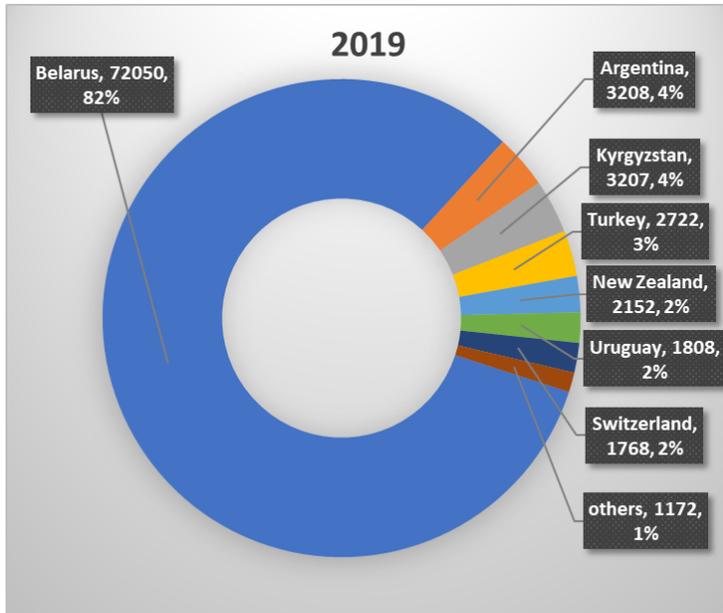


Source: Rosstat, CBR

### SMP Trade

SMP imports are forecast at 60,000 MT in 2021, a minor recovery from 58,000 MT anticipated in 2020. The volume of SMP imports in January-Aug 2020 fell 39.7 percent to 34,595 MT compared to the previous year while the value of imports declined 35.5 percent. Shipments declined from all the suppliers due to low SMP prices in Russia. In 2020 there was an unusual case, when Russian SMP prices were below world's average. The minor recovery of trade in 2021 is based on the expectations of improved demand from the food processing sector.

Chart 16. Russia: Imports of SMP (HS Code 040210) in 2019 and January-July 2020, Major Suppliers. MT; %

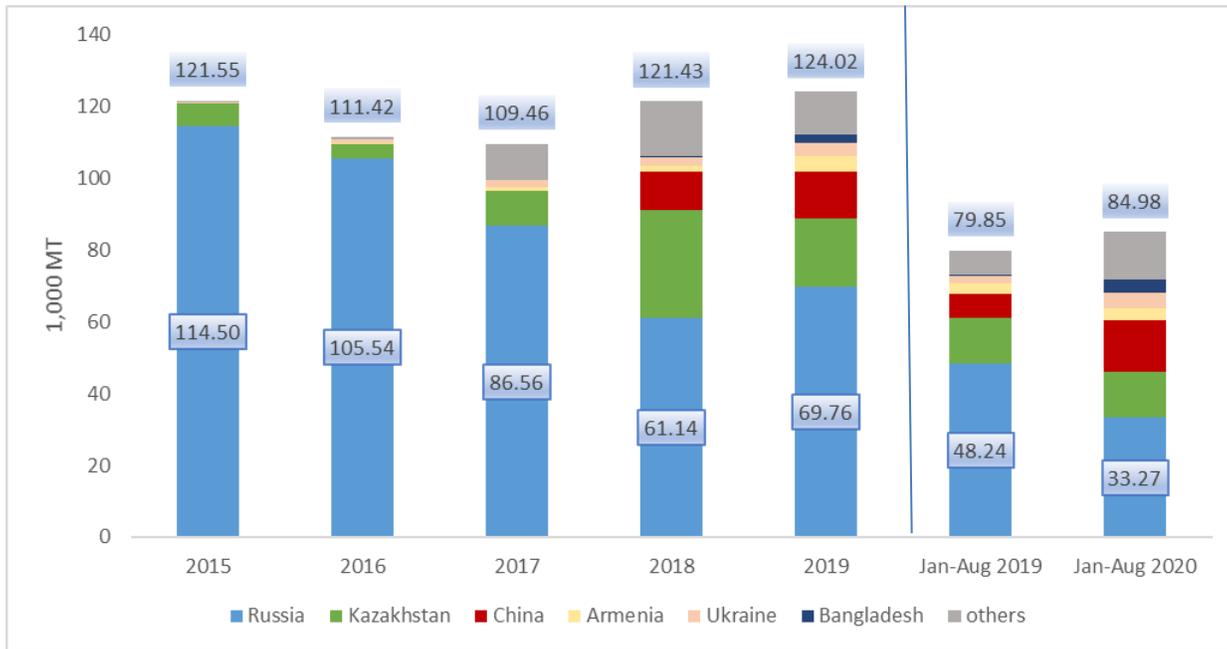


Source: Trade Data Monitor

Belarus remains the largest supplier of SMP to Russia, accounting for 87 percent of all SMP imports, but the quantity of the shipments from Belarus declined significantly. Russia imported 30,241 MT of SMP from Belarus in January-August 2020 (34 percent less) compared to the same months of 2019.

Russia used to be the main destination for SMP exports from Belarus; SMP shipments to Russia exceeded 80 percent of Belarussian exports until 2018. Belarus pricing policies had a strong, often negative influence on SMP prices in Russia. Russian producers complained that they were losing market share Belarus due to lower prices on fluid milk in Belarus, where milk production is heavily subsidized and controlled by the state. That resulted in a series of disputes and restrictions on dairy trade between the two neighboring countries. For example, VPSS banned all dairy imports from Belarus in industrial packages, including SMP, between June 2018 and May 2019 due to “violations of sanitary requirements”. In January-August 2020, SMP exports to Russia accounted for only 39 percent of Belarussian exports.

Chart 17. Belarus: SMP exports from Belarus. Major destinations. 1,000 MT



Source: Belarus National Statistical Committee

WMP

Table 5. Russia: Whole Milk Powder Supply and Distribution, 1,000 MT

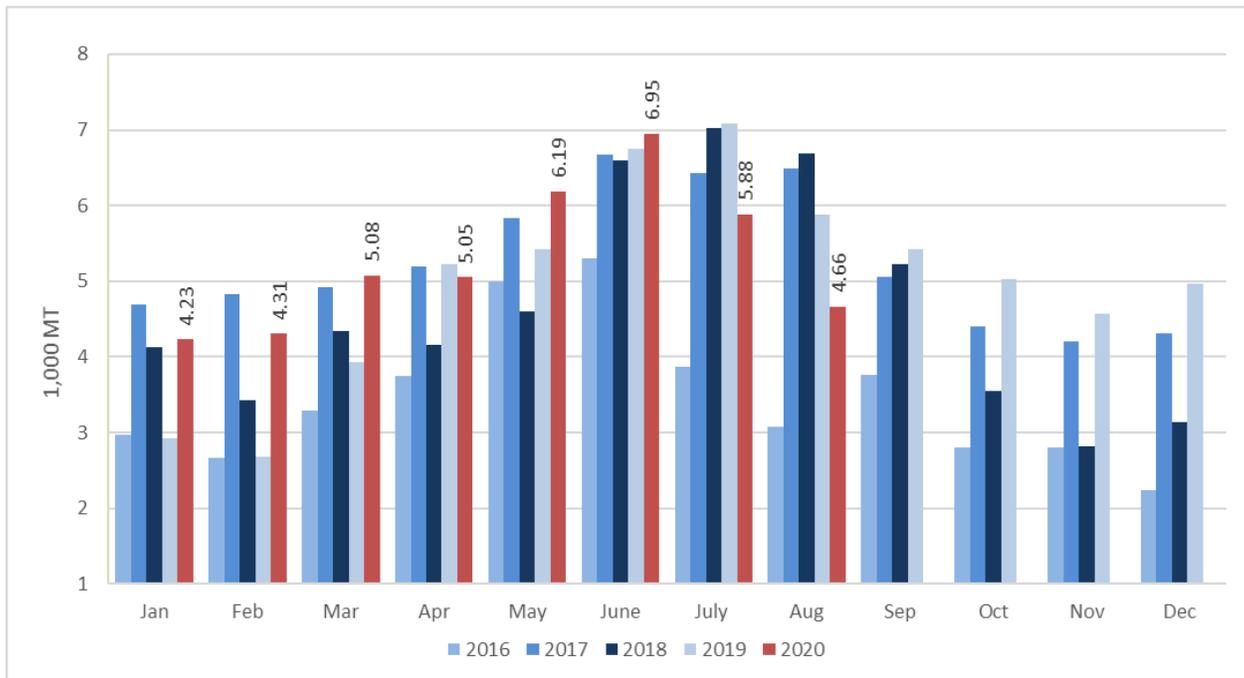
Dairy, Dry Whole Milk Powder	2019		2020		2021	
Market Begin Year	Jan 2019		Jan 2020		Jan 2021	
Russia	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	23	10	25	4	0	5
Production	56	65	60	65	0	65
Imports	46	46	40	40	0	36
Total Supply	125	121	125	109	0	106
Exports	0	0	0	1	0	1
Domestic Consumption					0	
	100	117	101	103		100
Total Use	100	117	101	104	0	101
Ending Stocks	25	4	24	5	0	5
Total Distribution	125	121	125	109	0	106
(1000 MT)						

NOTE: Not Official USDA data;

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

WMP Production

Chart 18. Russia: Monthly Production of WMP; 2016 through August 2020



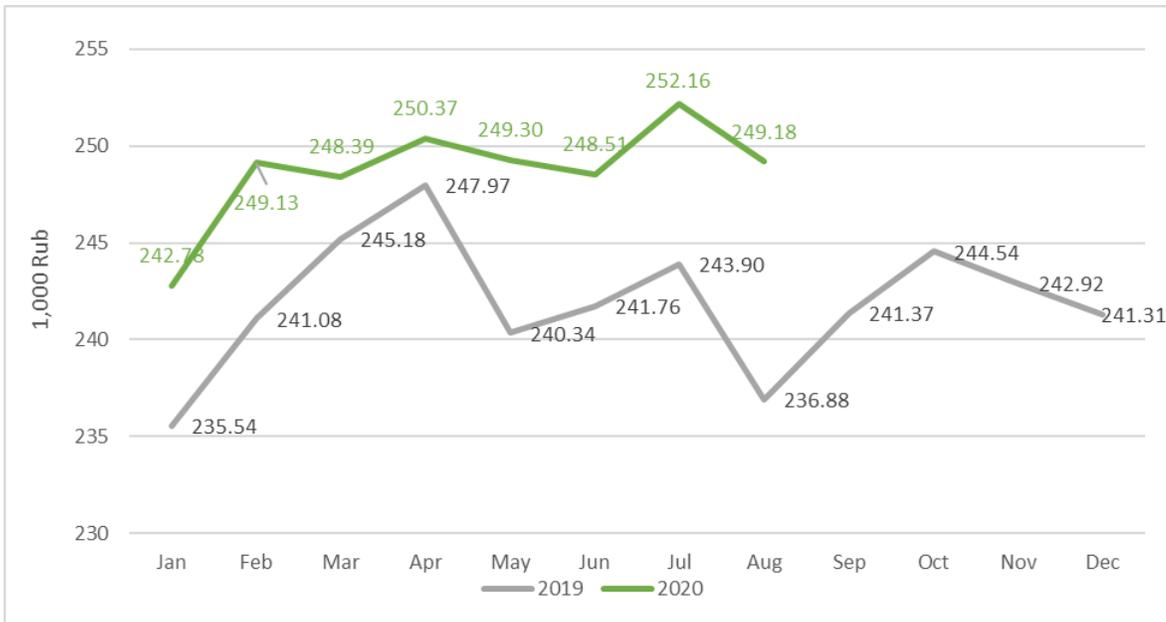
Source: Rosstat

Whole Milk Powder (WMP) production was growing in the first part of 2020, reflecting the growing surplus of raw milk available for processing. However, accumulated stocks of unsold WMP and Ruble depreciation created an unfavorable environment for production growth at the same pace in the second half of the year. FAS/Moscow forecasts WMP production at 65,000 MT in 2020 and expects it to remain at the same level in 2021. Producers expect better profits from complementary production of butter/SMP than WMP. Accordingly, the industry is expected to continue processing a large portion raw milk supplies into butter/SMP and cheese, rather than use it for WMP.

According to Rosstat, WMP production amounted to 42,349 MT in January-August 2020; a 6 percent increase from the same months in 2019. Declining WMP imports, relatively stable Ruble prices, and rising stocks suggest that the WMP supply is sufficient or even exceeds demand in the current market.

Ongoing Ruble depreciation presses on the margins for WMP sales, discouraging further growth of its production. If calculated in U.S. dollars, the WMP price declined to USD 3,376 in August 2020, 6.6 percent down from August 2019.

Chart 19. Russia: Producer Prices for WMP; Rubles per MT (including VAT)



Source: Rosstat

Chart 20. Russia: Producer prices for WMP; US Dollars per MT (Including VAT)



Source: Rosstat; CBR

### *WMP Consumption*

Producers of the Russian traditional dairy assortment “drinkable milk”, “kefir”, “smetana”, “tvorog”, and “ryazhenka” use WMP as a substitute for raw fluid milk in their recipes. Industrial use of WMP usually increases during the “low milk season” between October and April each year. However, the seasonal volatility has been decreasing in recent years because of the growing seasonally stable supply of milk from industrialized farms. Transition from WMP to raw fluid milk of local origin for industrial use will most likely become the mid-term trend. A three percent decline of WMP consumption to 100,000 MT is forecast in 2021 as growing supplies of fluid milk from Russian dairy farms gradually replace imported WMP.

### *WMP Trade*

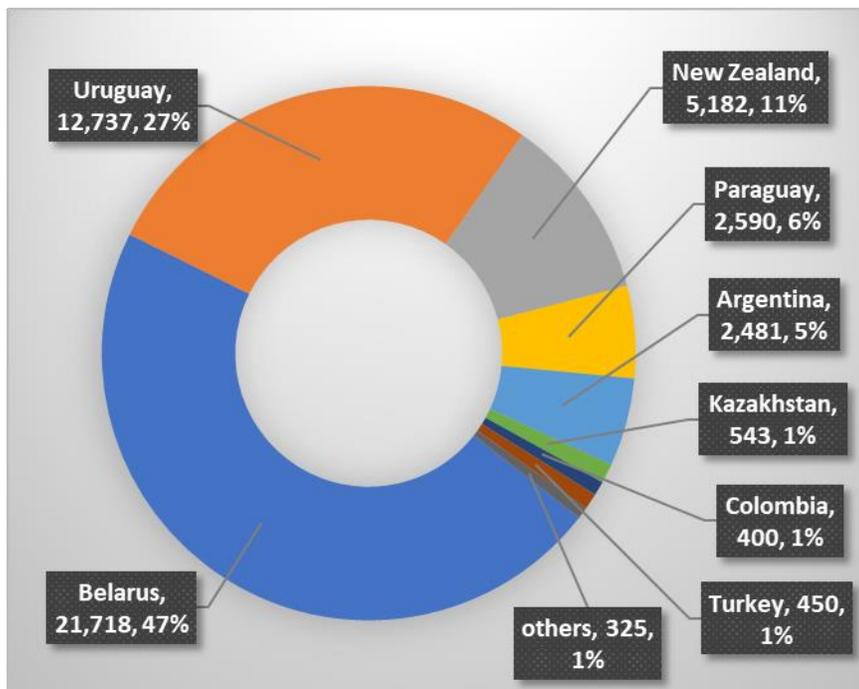
Imports of Whole Milk Powder are forecast at 36,000 MT in 2021, a 10 percent annual reduction following a 13 percent decline anticipated in 2020. Import of WMP is expected to decline because the demand for the commodity is shrinking due to growing supply of raw milk from local industrialized farms. Developing domestic milk production will press both on consumption of WMP and on the quantity of the imports in the midterm. Russia imported 39.3 percent of whole milk powder it consumed in 2019, the share of imports in consumption is expected to decline to 33 percent in 2021.

Depreciated Ruble values make prices of local products more competitive with imports. According to Federal Customs Service of Russia the average price for imported WMP was USD 3,264 per MT in January-July 2020, a 10.6 percent increase from 2019<sup>9</sup>. Meanwhile, the Average Producer Price for WMP inside Russia declined 6.6 percent to USD 3,376 (including VAT). WMP imports decreased 31 percent during January-July 2020 to 20,088 MT compared to the same period during the previous year. Shipments decreased from all key suppliers except Paraguay and Argentina.

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<sup>9</sup> Compare to USD 3,218 GDT Index price for WMP in July 2020; 8 percent increase from July 2019.  
<https://www.globaldairytrade.info/en/product-results/whole-milk-powder/>

Chart 21. Russia: Imports of WMP (HS Codes 040221; 040229) in 2019; Major Suppliers; Quantity (MT), share %



Source: Source: Trade Data Monitor

In 2019 Belarus supplied 21,718 MT of WMP, Uruguay 12,737 MT; New Zealand 5,182 MT; Paraguay 2,590 MT; Argentina 2,481 MT. As the market remains closed for other players due to sanctions, the same suppliers are expected to remain in the market in 2021.

WMP exports from Russia remain insignificant mostly due to inconsistent quality offered by Russian dryers and expensive logistics. Russia exported 457 MT of whole milk powders in 2019, mostly to Belarus, Kazakhstan, and the eastern regions of Ukraine. Even though Russian WMP producers gained access to Chinese market in 2019, the quantity of WMP exports remained low. WMP exports in January-July 2020 totaled 377 MT, with no reported shipments to China. WMP exports are forecast at 1,000 MT in 2020 and 2021.

#### Attachments:

No Attachments