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CHANGES IN UKRAINIAN DAIRY INDUSTRY DURING THE YEAR OF WAR

Special information bulletin produced by Infagro analytical agency in the frame of the set of expert discussions for dairy exports support and promotion during the war

General tends

The impact of the war on dairy sector

428 days of Russia's war against Ukraine, of course, left a "dirty" and sometimes even bloody mark on the country's dairy industry. However, thanks to the victories of the Armed Forces and the mobilization of efforts of all dairy industry participants, the situation now looks much better than in the first months of the war.

Agricultural enterprises are increasing the production of milk, and factories are processing it properly. Trade has resumed its activity, there are grounds for the forecasts of an increase in consumption of dairy products in the current year. Domestic logistics have improved, new export routes have been developed. Until recently, export sales were active.

Nevertheless, even with the incredible efforts of all branches, the war caused negative processes in dairy industry, which require a lot of effort and time, maybe even years, to overcome.

Unfortunately, it has not yet been possible to de-occupy the significant territories in the East and South of Ukraine. In these regions, as well as in the de-occupied regions and in the front-line zones, there was a significant reduction in milk production. But at the same time, milk production increased in Central Ukraine and in the West.

After the crisis year of 2022, milk production in agricultural enterprises in the current year may increase to the pre-war level. But households continue to actively get rid of cows and this leads to further overall decline in milk production in the country.

Following the decrease by 16.6% in 2022, in 2023 volumes of milk processing may increase by 10%. Due to a significant drop in consumption of dairy products, last year dairies were forced to reorientate on the production of dairy intended for export and significantly reduced the production of cheese and fresh dairy products.

Due to the forced migration and a decrease in the solvency of Ukrainians who stayed in the country, according to approximate estimated, in 2022 dairy sales decreased by 27% to 2.5 million tons (in terms of the milk). In 2023, consumption is expected to increase, but only because a significant part of the refugees is expected to return to Ukraine. As to the solvency, unfortunately, Ukrainians are not getting richer yet.

Despite the expected increase in consumption and decrease in milk production, milk surplus remains too large. For a normal balance, in 2023 it is necessary to export a lot of dairy as well. According to approximate estimates, up to 20% of the milk offered for industrial processing can be considered as "excess“ milk.

According to analysts' estimates, the export of dairy products in 2022 increased to a level of about 700,000 tons (in milk equivalent). In the current year, this indicator may stay about the same, but the export structure will change: sales of butter and cheese products will decrease most significantly, while the export of skim milk powder will increase.

A significant drop in the import of dairy products last year was beneficial for domestic producers – it weakened competition. According to Infagro's approximate estimates, this indicator has halved to 300,000 tons in milk equivalent. In the current year, there will be no significant increase in imports either.

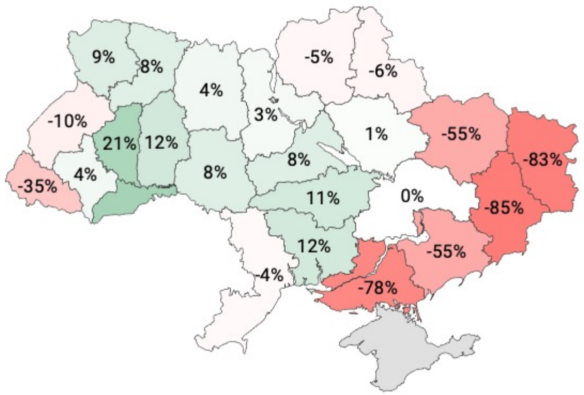
In 2023 a significant drop in global and, as a result, Ukrainian export prices for dairy products are considered to be one of the biggest problems of the dairy industry. Given the current cost of production, foreign sales of a number of products are currently considered unprofitable.

However, leading analysts believe that in the second half of the year the situation on the world dairy markets should improve.

The policy of our European neighbors to limit the import of agricultural products also worries Ukrainian exporters. In particular, Poland, which in 2022 was the largest buyer of Ukrainian dairy products, recently introduced a ban on these products. We hope friendly Poland will recognize the mistake and resumes import in the coming days …

Sources: Institute for the Study of War with American Enterprise Institute’s Critical Threats Project (as of Nov’22)

MILK PRODUCTION DYNAMICS IN AGRI ENTERPRISES (2022 > 2021), %



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Changes in the raw milk supply

Russia's full-scale military aggression caused critical consequences for Ukraine and the dairy industry in particular. Destruction of farms and livestock, damage to logistics, fodder stocks, and producers' property led to a reduction in the supply of raw milk in the country. Last spring a significant stress for the industry was the general optimization of feeding and the reduction of the number of cattle milkings per day.

Nevertheless, in the second half of the year, the situation in the country stabilized. Accordingly, processes in animal husbandry also improved: farmers understood the expediency of "investing" cheap grain in cows; setting of export routes led to an increase in demand and purchase prices of raw milk, which, in turn, also stimulated producers to increase the supply of raw milk.

Due to the steady decline in milk production in rural households, the general indicators for Ukraine show a further reduction in 2023. At the same time, there are hopes for the resuming the decrease of the supply in the category of industrial dairy farms to the level of 2021.

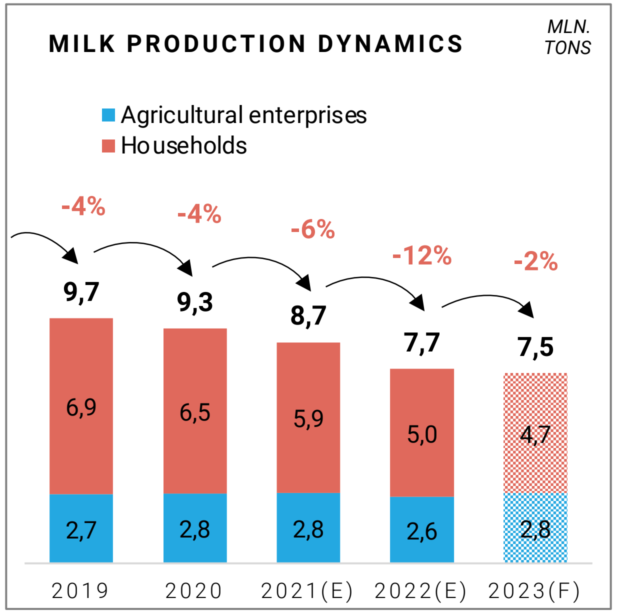
Trends in consumption

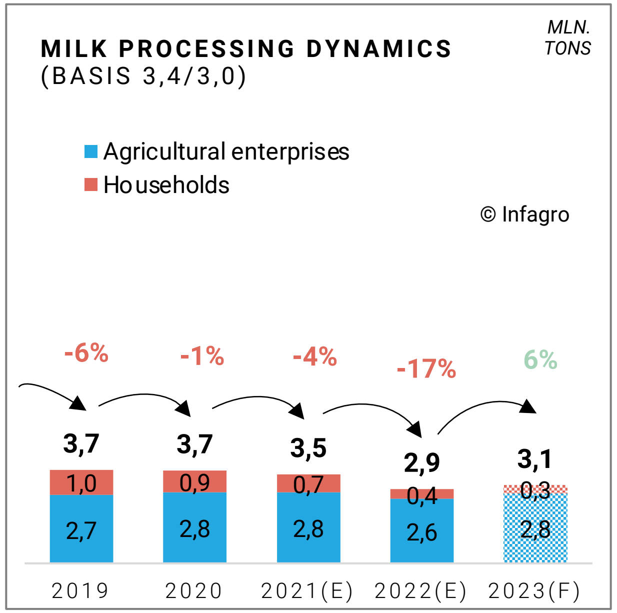
According to the results of the year, we note that the demand for milk and dairy products suffered more significantly than its supply. Thus, compared to 2021, in 2022 the internal demand of the commodity market (in the equivalent of raw milk) fell by 27% compared to the decrease in the volume of processing of raw milk by 17%.

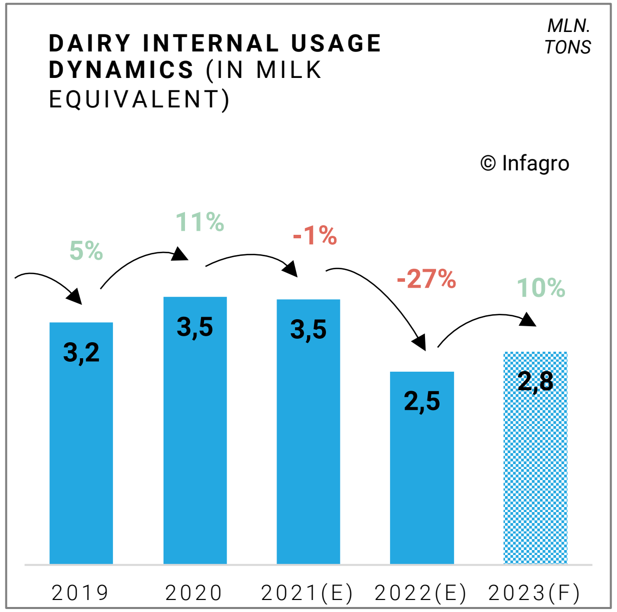
Such terrible dynamics are primarily related to demographic movements caused by the war and the occupation of Ukrainian territories. Economic reasons include a general decrease in the purchasing power of the population and high inflation. But, paradoxically, at the same time the latter supported sales of dairy products compared to other products: the figures show that the annual inflation of wholesale prices in the fresh milk category was significantly lower than the level of general consumer inflation in Ukraine.

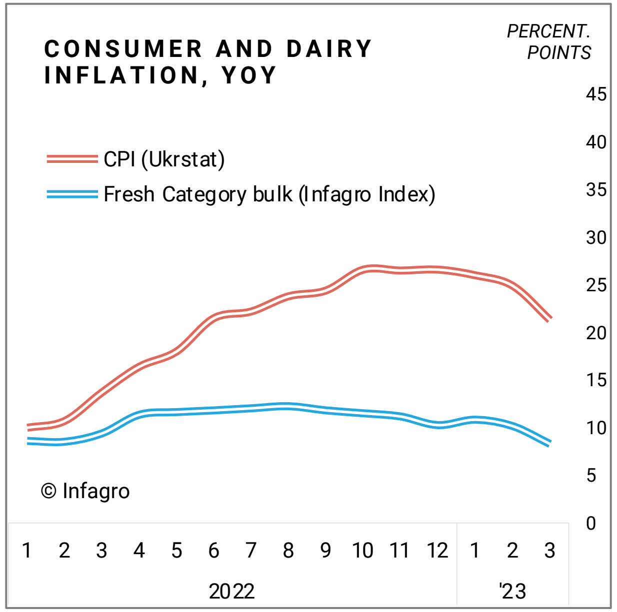
Positive forecasts for 2023 are built on the low base of 2022 and projections of an improvement in the country's demographic situation.

The difference between supply and demand, as it was in the previous year, in 2023 makes it necessary to maintain the appropriate rates of export of dairy products.









Dairy balance

The secure dairy supply and foreign trade

In 2022, unlike in 2021, when Ukraine was balancing domestic demand and supply figures, as well as the trade parity, the balance underwent significant changes due to russian aggression. In the current year, a certain transformation of it is also taking place.

The war in Ukraine caused a general decrease in both milk production and domestic market demand as a whole. There are no official statistics in Ukraine, but according to expert estimates, the supply of raw milk for processing in 2022, compared to the previous year, decreased by approximately 17% to 2.9 million ton (calculated on the basic indicators of fat and protein).

Due to migration processes and the economic decline, last year the domestic market demand (industrial consumption and/or use of milk and dairy products in the equivalent of raw milk) fell by approximately 27%, to 2.5 million tons.

In recent months, there has been a certain recovery in the consumption of dairy products. Seems like Ukrainians are returning home more actively from their forced migration. We assume that in 2023 domestic sales of dairy products may increase by 10% compared to last year's fall to 2.8 million tons.

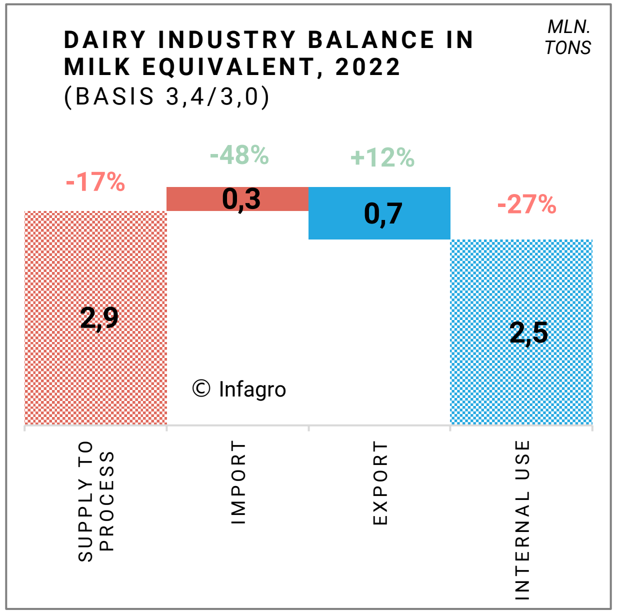
Thus, according to Infagro calculations, the level of self-sufficiency of the dairy market in both 2022 and 2023 is above 100% even if imports are reduced by almost half. That is, the dependence of the industry on exports has significantly increased.

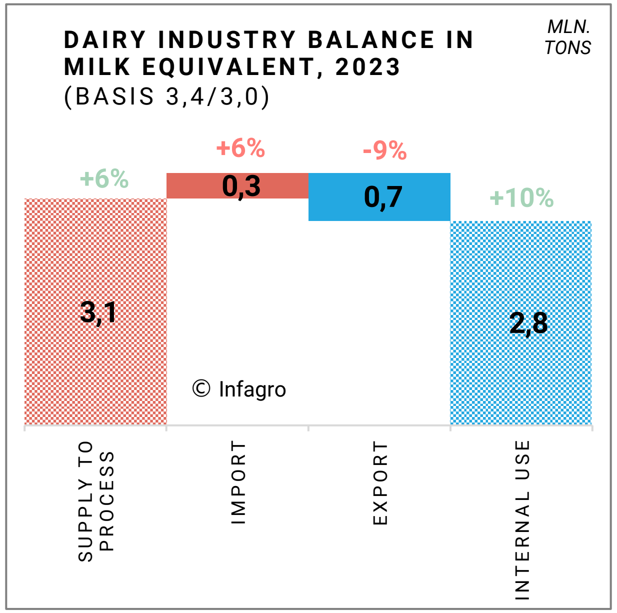
Almost a quarter of the milk received for processing last year had to be exported mostly in the form of butter, dry milk products, and products of the cheese group. Currently, the share of exports in this balance will decrease to approximately 20%.

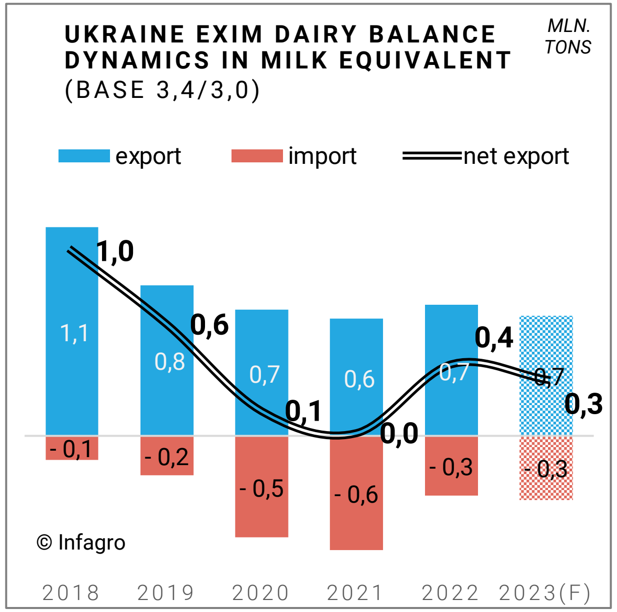
Therefore, the export of dairy products last year increased by 12% in milk equivalent to 0.7 million tons. In the current year, we expect a slight decrease in foreign sales primarily due to the increase in consumption. At the same time, the revenue from exports may decrease by 15% due to significantly lower prices of external demand.

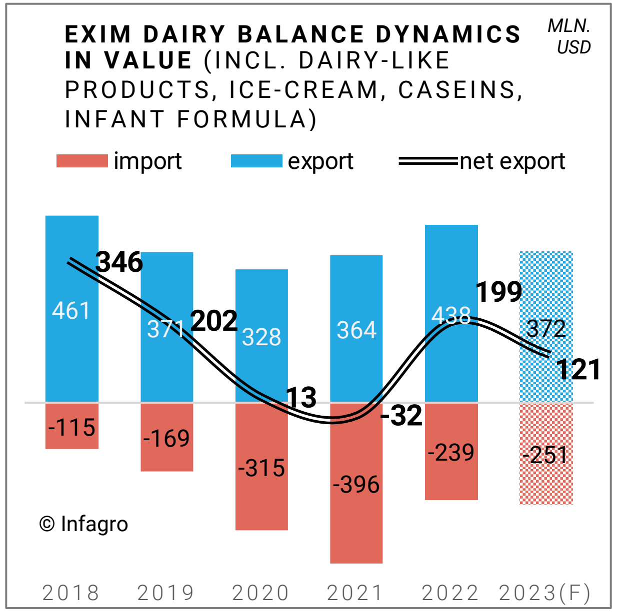
The calculation of the last year's balance sheet shows a net positive assessment of foreign trade almost at the level of 200 million dollars, and in 2023, according to experts' forecasts, net exports will amount to 110-125 million.

No drastic changes in the volume of dairy product imports are expected.









Exports geography and structure

Even before the full-scale invasion of February 24, 2022, with the start of Russia's war against Ukraine in 2014, the structure of exports in terms of types of dairy products and the geography of supplies began to change radically.

10 years ago, Russia and other post-Soviet countries (excluding the Baltic states) accounted for more than 90% of all foreign sales of dairy products. From the point of view of business, it is not surprising, because at that time little attention was paid to the quality of products, and the prices were almost always higher than the world prices.

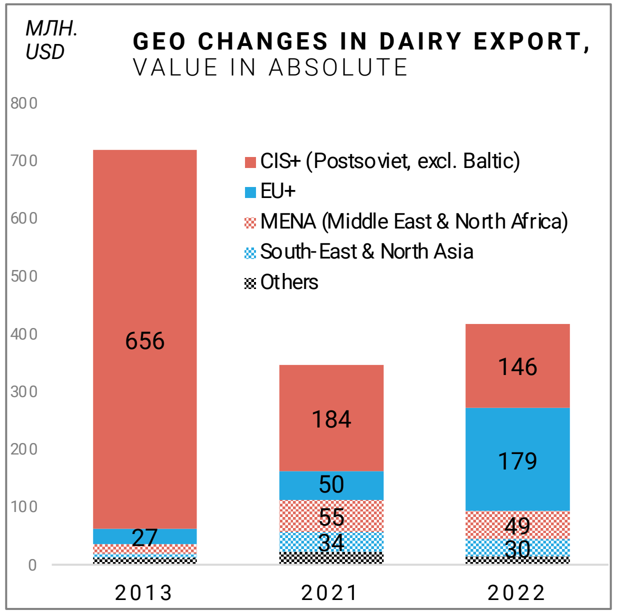
In 2014, the "great friendship" with Russia ended, and trade with this country almost stopped. Later, there appeared certain problems with the transit of Ukrainian products to other CIS countries through the Russian federation. In such conditions, Ukrainian producers were forced to significantly change the range of products (rejecting cheese), and exporters had to look for new sales markets for butter and dry milk products.

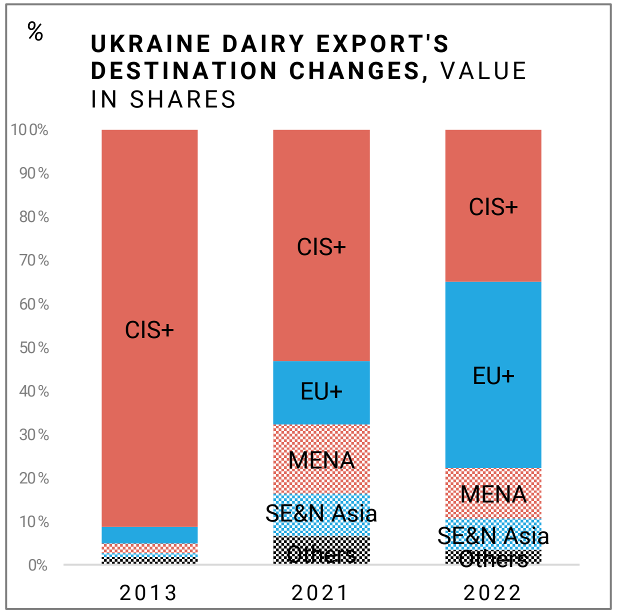
However, as early as 2021, the share of post-Soviet countries in purchases of Ukrainian dairy products accounted for more than half in monetary terms, for 184 million dollars. Deliveries to the countries of MENA, Southeast, and North Asia somewhat increased. Only 50 million dollars worth of products were sold in the EU, and that was mostly due to the supply of technical casein.

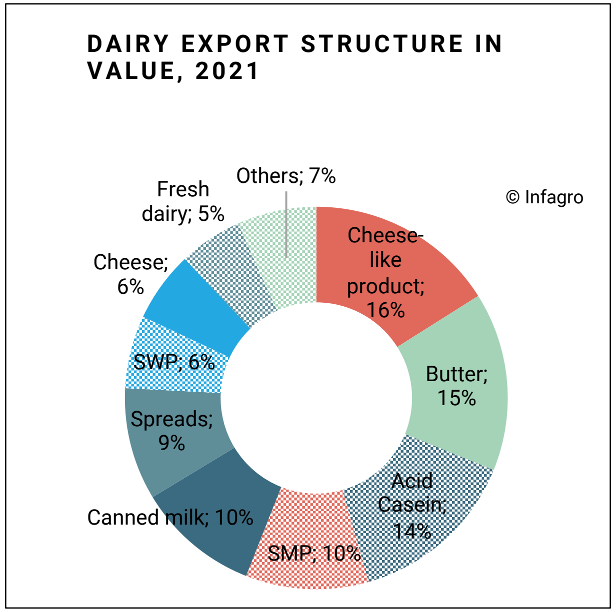
In 2022, with the beginning of a full-scale war, Ukrainian exporters had to once again radically revise the channels of dairy sales. Not only the transit of goods through Russia was lost, but also the regular deliveries through Ukrainian seaports. Export opportunities became extremely limited, the industry was on the verge of collapse.

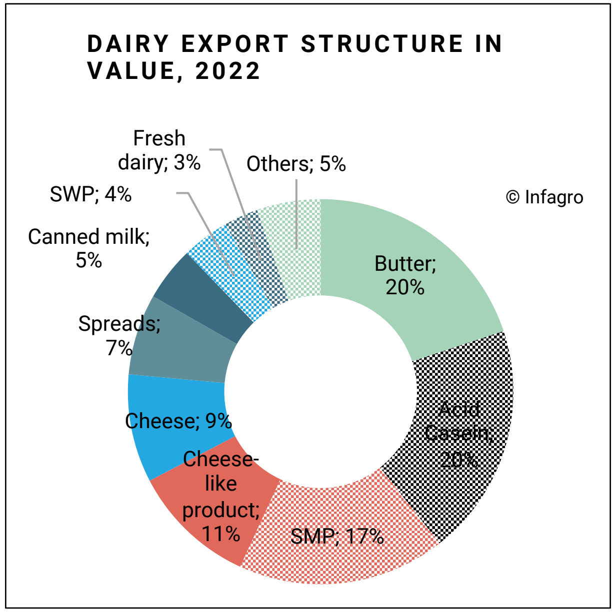
At that time friendly EU countries came to the rescue, greatly simplifying the conditions of transit through their territory and, most importantly, allowing goods to be supplied to Europe without quotas and duties. The number of Ukrainian enterprises with permits to supply products to Europe also increased. As a result, in contrast to previous years, the lion's share of the export of certain goods (butter, milk powder, casein) in 2022 fell to the EU countries.

In order for Europe to remain the main sales market for Ukrainian dairy products in 2023, exporters and government representatives must make a lot of effort. There may be some problems, given the recent events in trade relations with neighboring countries...









Price trends

Price trends

The global price situation last year was the factor that significantly accelerated the establishment of external logistics after the start of the full-scale russian aggression.

While global inflation drove up the prices of stock and consumer goods, including milk, the blockade of Ukrainian seaports by the aggressor and trade restrictions introduced by the EU led to a decrease in the price of raw milk in Ukraine. Even after the EU opened "green corridors" for Ukrainian goods, the devaluation of the hryvnia kept domestic prices at low levels comparatively to European record highs.

It was this difference, which was observed during almost the entire calendar year, that made it possible to increase the export of Ukrainian products, even despite the high cost of logistics and other difficulties.

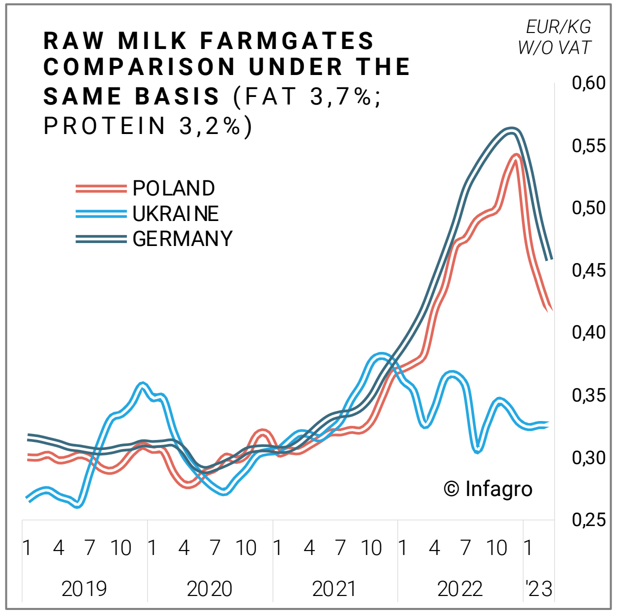
According to the dynamics of the spot prices for raw milk in the EU, we can state that the peak of demand for raw milk and dairy products in the EU fell in September. It was September that became a record month for the export of Ukrainian dairy products (in the equivalent of raw milk). About 100,000 tons of goods were exported, that is, almost 30% of the total volume of raw milk that was processed during this period.

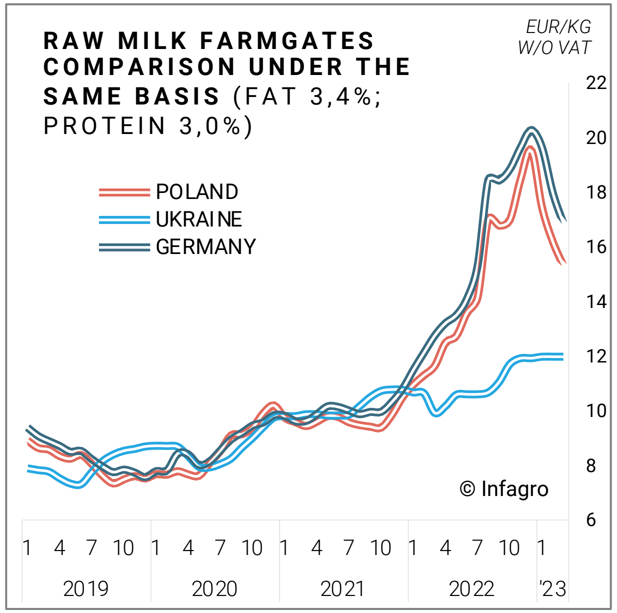
However, the increase in the supply of raw milk in the EU due to the attractiveness of its production (record purchase prices of raw milk) and the decrease in global demand led to a drop in demand in Europe.

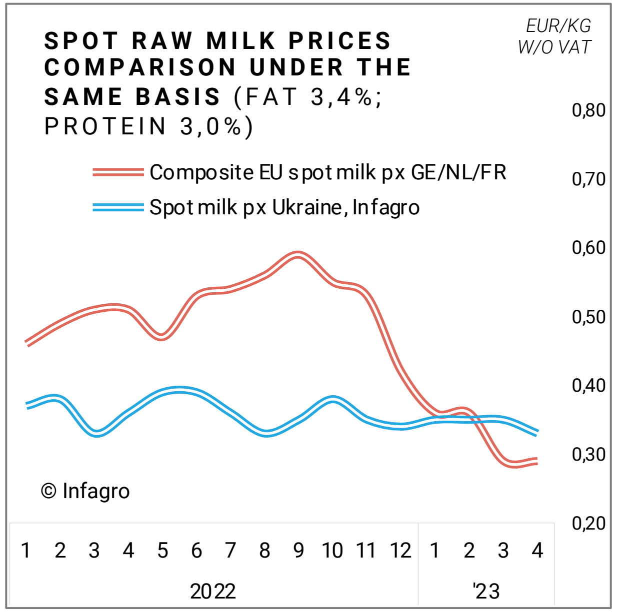
This resulted in a sharp decrease in the purchase prices of raw milk in the EU in the first quarter of 2023. But even taking into account the rapid drop in prices, the price levels of the primary market of raw milk in the EU countries are higher than the corresponding Ukrainian prices.

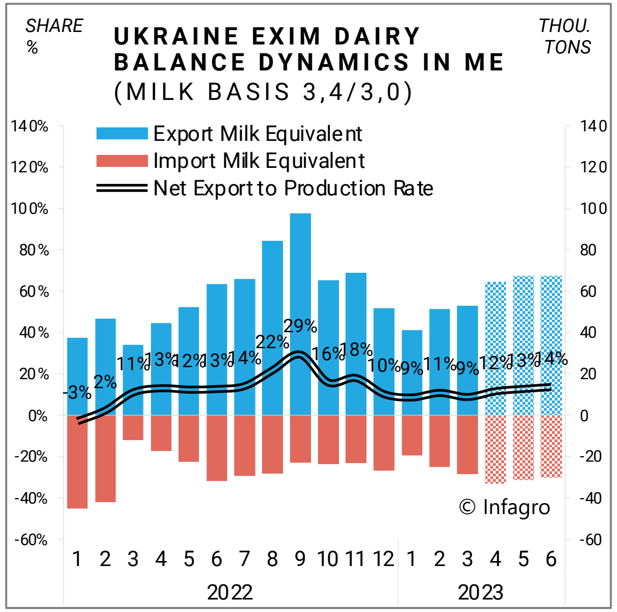
Then why do we record a decline in demand for Ukrainian commodities from Western traders? The fact is that, due to the weak demand, we are currently also observing low prices for commodities in Europe. The trends are confirmed by the trend of the price of raw milk on the secondary market in the EU, the level of which in recent months is even lower than the Ukrainian price. Just from this cheap raw milk the European milk powder and butter are currently produced.

Accordingly, in 2023 Ukrainian exporters have almost stopped the shipment of products to the West (which is why the effect of the current ban on Poles is minimal)/ They are looking for additional ways of selling goods, which are associated mainly with Asia.









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These activities are carried out jointly with the state institution The Entrepreneurship and Export Promotion Office and the analytical agency Infagro within the framework of the Swiss-Ukrainian Program "Higher Value Added Trade from the Organic and Dairy Sector in Ukraine" implemented by the Research Institute of Organic Agriculture (FiBL, Switzerland) in partnership with SAFOSO AG (Switzerland), www.qftp.org.

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