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Ukraine's dairy industry lost access to its largest export market

From January 20, 2006 Russia banned import of Ukrainian livestock products. This decision, first of all, harmed Ukraine's dairy production, inflicting significant losses to both dairy industry and raw milk producers. At the same time, domestic consumers are likely to gain, as excess supply of dairy products on domestic market should reduce prices.

The formal reason for banning livestock products' exports was violations of Russian veterinary legislation by Ukrainian meat exporters. This ban was based on several cases when Ukraine's meat exporters did not react timely and completely on Russian enquiries. However, why this ban also concerns dairy products instead of tackling meat products directly remains unclear, as no complaints on dairy products were filed.

The dairy industry is one of the most fast growing branches of the Ukrainian agro-food sector, with a sufficient degree of competition in a industry. Despite gradual concentration of production, so far none of the companies possesses more than 15% of the market share. Although most of domestically produced dairy products are sold on internal market, approximately one-third of the raw milk processed by dairy plants is exported in the form of cheese, butter, skimmed milk powder etc. In 2005 dairy export was valued at about USD 700 m, with cheese accounting for 50% of the whole export revenues.

Russia was traditionally the largest export market for Ukraine's dairy, accounting for 64% of the whole Ukraine's dairy export in 2005. Moreover, Russia was the dominant consumer of Ukrainian cheese, importing 95% of total export volume of this product. That allowed Ukraine to have nearly 50% of Russian cheese market.

Low quality of raw milk supplied to dairy plants and incompliance of Ukrainian standards with international ones hampers dairy exports to Western countries. At present Ukraine's dairy exports to Europe consist mostly of non-fat and skimmed milk powders used as feedstuff or as additives to better quality milk powder.

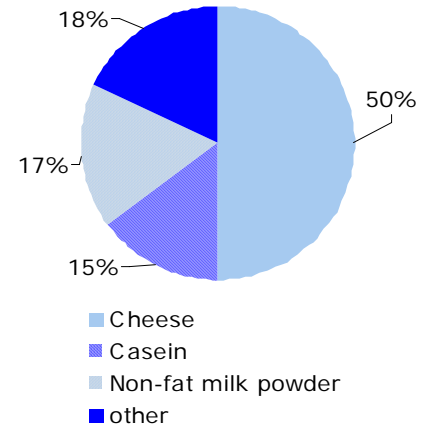
The banned access to the biggest export market imposed significant losses on dairy producers estimated at about USD 2 m per day. To offset losses, dairy enterprises reduced employed capacities of dairy plants and decreased procurement prices for raw milk by approximately 40% (i.e. to about UAH 0.8 per litre), thus partly transferring the burden to raw milk producers. In turn, the latter get fewer incentives to produce and supply raw milk to dairy plants. If the conflict lasts for considerable time span, it might lead to reduction of milk cows stock, since this business would become less profitable. It might also have repercussions to meat production as profitability of livestock farms declines.

In the short-run, consumers should expect lower prices for such goods as cheese, butter and before heavily exported to Russia. However, if the supply of raw milk significantly reduces, the prices will grow. Also, negative spillovers on meat production could push prices for meat further upwards in the medium-term horizon.

Despite clear negative consequences for dairy industry, the conflict should provide impetus for improving industry's efficiency and competitiveness. Diversification of export markets could prevent significant losses in such situations. For dairy industry, the penetration in other – first of all, European – markets means first of all introduction of standards that are compliant with international requirements, thus improving the quality.

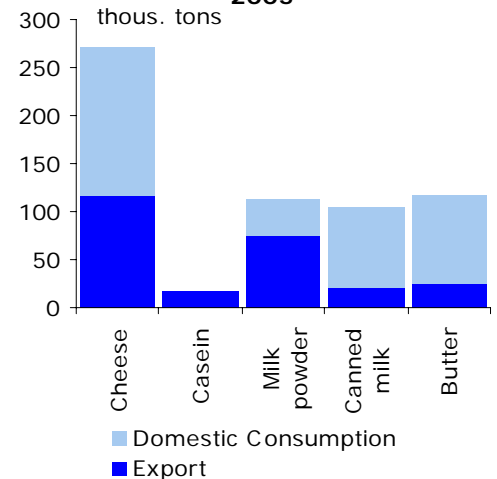
Also, this conflict emphasized important benefits of WTO membership. This international organisation helps to converge standards and provides members with an access to trade conflict resolution mechanisms, making it more open and transparent.

Dairy Export Value Structure in 2005



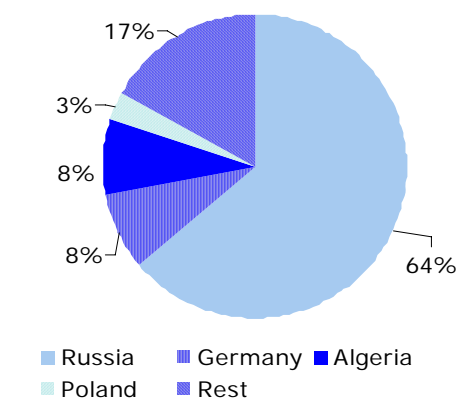
Source: Agrarika

Dairy Production/Export ratio in 2005



Source: Agrarika

Dairy Export Geography in 2005



Source: Agrarika

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Quarterly Trends

National accounts **		Q3 02	Q2 03	Q3 03	Q4 03	Q1 04	Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Q4 05
GDP	UAH bn	64.1	60.0	75.6	77.1	64.7	100.5	100.6	82.5	95.0	120.0	...
GDP (real)	% yoy	4.3	10.0	6.8	12.1	12.7	14.0	8.5	5.0	3.2	1.2	...
Households consumption (real)	% yoy	8.9	14.4	11.2	13.6	14.6	13.1	16.2	16.4	14.6	19.4	...
State consumption (real)	% yoy	-18.8	17.8	19.2	9.0	3.3	5.0	10.1	5.2	2.2	2.3	...
Gross fixed capital formation (real)	% yoy	3.8	20.4	24.3	9.0	18.4	4.6	12.9	-2.6	-0.9	-0.1	...
Exports of goods and services (real)	% yoy	15.3	9.8	9.8	11.6	18.1	10.5	8.6	0.1	-2.5	-17.9	...
Imports of goods and services (real)	% yoy	10.4	16.2	17.4	17.7	13.8	6.7	7.8	6.6	2.1	1.7	...
Agriculture, hunting, forestry (real)*	% yoy	2.1	-13.7	-22.5	6.7	-4.4	35.7	9.9	5.9	8.5	2.2	...
Manufacturing industry (real)*	% yoy	8.0	15.4	23.0	20.1	23.9	12.5	9.4	7.8	3.2	0.2	...
Construction (real)*	% yoy	-1.2	24.8	30.9	16.9	29.9	16.4	3.9	-5.9	-9.0	-6.3	...
Trade, repair services (real)*	% yoy	8.8	15.1	22.6	29.6	23.6	2.7	13.7	-1.5	-3.2	-6.2	...
Transport (real)*	% yoy	7.9	11.5	15.9	11.7	10.1	12.3	10.5	7.3	6.8	4.7	...
Balance of payments												
Current account balance	USD bn	0.8	0.7	0.7	0.4	1.6	1.7	1.2	1.7	0.6	-0.2	...
Current account balance	% of GDP	6.4	7.0	5.0	3.0	13.5	8.8	6.2	10.8	3.2	-0.8	...
Trade balance in goods	USD m	155	-42	-155	-381	933	774	482	1051	-228	-1017	...
Trade balance in services	USD m	247	399	362	409	332	377	270	257	355	321	...
Current transfers	USD m	517	526	574	584	475	720	623	624	692	741	...
Direct investment (FDI)	USD m	156	454	390	329	334	422	345	231	355	445	...
Portfolio investments	USD m	-592	640	-444	-293	60	781	-511	-114	-86	-1253	...
Gross international reserves	USD bn	4.1	6.2	6.7	6.9	7.9	12.1	9.5	12.0	13.1	14.3	...
Fiscal indicators												
Consolidated fiscal revenues	% of GDP	28.2	31.7	30.1	28.6	27.2	26.3	25.9	32.1	35.1	31.5	31.0
Personal income tax	% of GDP	4.9	5.7	5.3	5.1	4.4	3.8	3.8	4.3	4.4	3.9	4.2
Enterprise profits tax	% of GDP	4.1	5.1	4.8	5.0	3.9	4.1	6.1	4.8	5.9	5.3	6.3
Value-added tax	% of GDP	6.4	6.3	5.8	4.8	6.2	5.1	4.1	8.6	9.2	7.9	7.3
Excise tax	% of GDP	1.9	2.2	2.1	2.0	2.1	2.0	1.8	2.0	2.0	2.0	1.7
Consolidated fiscal expenditures	% of GDP	26.4	29.2	27.9	28.8	25.3	26.8	35.2	28.3	36.4	28.1	41.7
Current expenditures	% of GDP	na	26.3	24.2	24.3	22.4	21.7	27.2	26.5	33.6	24.0	34.2
Capital expenditures	% of GDP	na	3.0	3.7	4.4	2.9	5.1	8.0	1.8	2.7	4.1	7.5
Consolidated fiscal balance	% of GDP	1.7	2.5	2.2	-0.2	1.9	-0.5	-9.3	3.7	1.0	-5.0	6.2
Privatisation receipts	% of GDP	0.3	1.0	1.0	0.8	1.5	3.5	1.0	0.2	0.6	0.6	16.0
Labour market												
Average wage (real)	% yoy	21.2	19.1	19.9	14.9	19.9	14.7	15.4	15.0	19.0	19.6	26.4
Household income (real)	% yoy	100.8	8.6	10.0	8.7	11.7	11.3	16.6	24.0	28.0	19.4	18.9
Unemployment rate (ILO methodology)	%	9.2	8.8	9.2	9.0	9.3	8.1	8.7	8.7	7.0	5.2	...
Banking system												
Monetary aggregate M0	% yoy cum	46.0	37.0	30.5	25.3	29.1	37.1	27.9	28.2	39.1	31.1	42.2
Monetary aggregate M2	% yoy cum	46.5	54.6	49.9	47.6	45.4	51.5	32.3	38.9	37.4	31.3	53.9
Household deposits in national currency	% yoy cum	103.6	74.7	65.0	66.1	69.4	67.9	26.2	28.3	31.6
Household deposits in foreign currency	% yoy cum	55.1	70.2	70.4	77.5	67.0	55.2	54.3	51.8	45.4
Com. bank credits in national currency	% yoy cum	42.3	71.2	73.0	61.7	56.8	44.3	29.4	28.3	32.6	43.4	58.7
Com. bank credits in foreign currency	% yoy cum	37.3	48.4	57.7	60.9	63.6	43.5	32.2	33.1	36.8	47.1	66.3
Long-term com. bank credits	% yoy cum	85.8	156.4	164.0	157.9	141.7	82.7	57.1	49.5	53.0	70.1	84.6
Long-term com. bank credits	% of total	25.3	37.4	40.1	45.0	47.4	50.9	54.2	54.4	56.1	59.7	61.8
Average lending rate on national cur. credits	% p.a.	23.5	17.2	17.2	17.7	17.2	17.0	17.6	17.0	15.4	15.4	16.4
Average lending rate on foreign cur. credits	% p.a.	11.9	12.6	11.7	10.9	12.2	12.6	12.2	12.1	11.0	11.3	11.7

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

* change in value added

** preliminary

Notes:

yoy year on year change

p.a. per annum