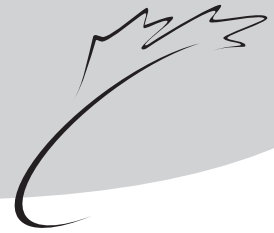




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RUSSIA AND UKRAINE: WHEAT

Wheat exports from Russia and Ukraine have been increasing for the past two years, due to increased production. Total exports in 2002-2003 are forecast at a record 18.5 million tonnes (Mt), compared to less than 1 Mt just two years ago. Russia and Ukraine are projected to be the world's third and sixth largest wheat exporters in 2002-2003. Despite high market transaction costs, Russian and Ukrainian wheat is competitive due to low production costs. The increased exports have pressured world wheat markets, as the Black Sea wheat entered the European Union (EU), as well as traditional markets of the major exporters. As a result, world wheat prices have declined sharply since they reached a seven year high in the fall of 2002 due to the drought in the United States (US), Canada and Australia. For 2003-2004, however, Russian and Ukrainian wheat production is expected to decline. Exports are therefore forecast to fall sharply, but remain at an historically high level. The continued competitiveness of Russian and Ukrainian wheat on world markets will largely depend on their governments' evolving grain policy.

Russian Wheat Policy

The Russian government remains committed to increasing wheat production by increasing credit and subsidizing crop inputs, as well as offering a special machinery leasing fund. However, implementation of these programs depends upon the federal budget allocation to agriculture. The Russian Ministry of Agriculture moved towards controlling the wheat market through intervention which

began in November 2001 for feed wheat. For 2002-2003, state procurement intervention prices are 2,300 rubles per tonne (/t) (CAN\$110/t) for No.3 wheat and 1,800 rubles/t (CAN\$86/t) for No.4 wheat. Russia applied for accession to the World Trade Organization (WTO) in 1995 and negotiations are currently in progress.

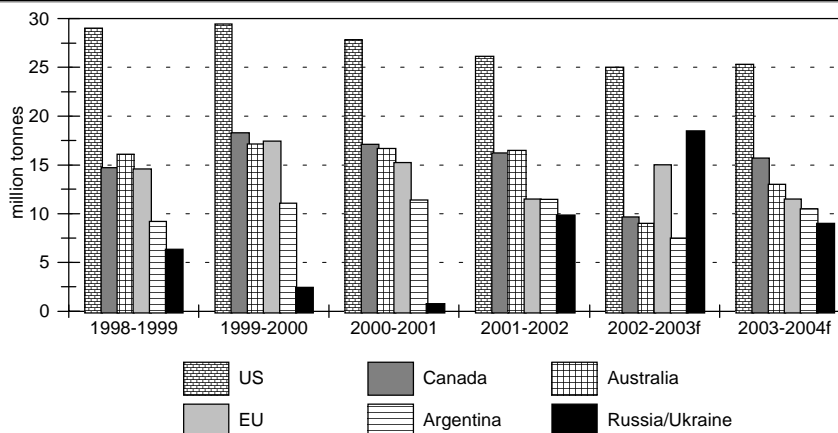
Ukrainian Wheat Policy

Agriculture accounts for about 20% of Ukraine's gross domestic product. However, despite its potential, the agriculture sector continues to suffer from inefficiency and non-competitiveness. These factors contribute to the need for reform of Ukrainian agriculture.

Since Ukraine began its transition to a market based economy following its independence in 1991, reforms in the sector have been slow and problems remain unsolved. After 1992, prices were liberalized for most commodities, however, many agricultural subsidies continued, contributing to growing budget deficits and inflation. After the rate of inflation grew substantially in 1993 and 1994, a monetary policy was put in place, which helped stabilize Ukraine's currency, the grivna.

The strengths of Ukraine are its rich soils, favourable growing conditions, geographic location and its year round access to the Black Sea. The weaknesses are low crop productivity, a lack of proper inputs such as chemicals and machinery, and a lack of experience in profitable farm management.

WORLD: WHEAT EXPORTS BY MAJOR EXPORTERS



f: forecast, USDA: 2002-2003; AAFC 2003-2004
Source: USDA, AAFC

Areas where improvement is needed include state policy development and implementation, farm restructuring, land reform and rural financing.

Ukraine formally applied for accession to the WTO in 1993. Talks stalled from 1998 to 2000, but have resumed. Specific terms are currently in negotiation.

SITUATION

Production

Wheat can be classified into winter wheat and spring wheat. Winter wheat is the main type grown in Russia and Ukraine. In Ukraine, winter wheat represented 97% of the total harvested wheat area over the last five years. In contrast, the 5-year average for Russian harvested area has been approximately 35% winter wheat and 65% spring wheat. However, the split between winter and spring wheat production is about 50% each. The main wheat producing area in Russia is in the western portion of the country around Moscow, north of the Black Sea. This area accounts for about 35% of the total wheat produced. Beginning in August and running through the first of October, winter wheat is planted. The wheat begins heading in May, and harvest begins in July and continues through the end of August. As for Ukraine, major production areas of winter wheat exist throughout the entire country, except the northern region, which is classified as a minor growing area.

For 2002-2003, **Russian** harvested wheat area is estimated at 25.7 Mha, up 8% from 2001-2002. Prior to this, harvested area had been flat as the Russian economy

experienced the effects of a financial crisis in 1998. Russian producers had been limited by a continuing shortage of cash on-farm, making it difficult to buy high priced crop inputs such as fuel and fertilizer and to repair inferior machinery. In the last two years, fuel and seed supplies for agriculture have improved, while access to better farm equipment has improved only marginally. As a result, 2002-2003 Russian wheat yields are estimated to be about 2.0 tonnes per hectare (t/ha), similar to last year, but up about 0.5 t/ha from 2000-2001.

For 2002-2003, Russian wheat production is estimated at 50.6 Mt, up 8% from last year and the highest since 1990-1991. This is largely due to excellent weather conditions for winter wheat development in the central and southern part of European Russia. Spring wheat production in the Urals and Siberia is estimated to be similar to last year at 32.0 Mt, slightly above the 5-year average.

For 2002-2003, **Ukrainian** harvested wheat area is estimated at 6.8 million hectares (Mha), marginally lower than 2001-2002. From 1998 to 2000, harvested area had averaged 5.7 Mha, due to deteriorating farm equipment, declining use of fertilizer and herbicides and poor weather conditions. In 2001-2002, the supply of agricultural inputs improved due to the increase in farm income as a result of high domestic wheat prices in 2000-2001 and an improvement in loan guarantees by financial institutions. For 2002-2003, Ukrainian wheat yields are estimated at 3.1 t/ha, similar to last year, but over 50% higher than 2000-2001.

For 2002-2003, Ukrainian wheat production is

estimated at 20.6 Mt, down marginally from 2001-2002, however, more than double the output of two years ago. The unusually cold weather in December of 2002 combined with less than adequate snow cover has resulted in an increase in winterkill compared to last year.

Consumption

In both **Russia and Ukraine**, about 40% to 50% of wheat consumption is in the form of human food, followed by feed use (30% to 35%) and seed use (5% to 10%). About 80% of the winter wheat crop is graded No. 4 (10% protein) and is utilized for blending in bread production and animal feed. The remaining 20% of the winter wheat crop averages a No. 3 and is considered to be milling quality. Annual per capita consumption of wheat in Russia and Ukraine is about 130 kilograms (kg) compared to 90 kg in Canada.

For 2002-2003, Russian and Ukrainian feed use is expected to increase to 17.5 Mt and 3.0 Mt respectively, up 30% from last year. With high wheat production in both countries during the last two years, domestic feed wheat prices have fallen sharply. This has resulted in rapid growth in pork production, which is expected to more than offset decreasing beef production.

Traditionally, **Ukrainian** wheat producers have used their own seed for planting and seed use has averaged about 1.3 Mt per year. Producers are hesitant to store grain at local elevators because Ukraine lacks new facilities. Instead, producers prefer flat on-farm storage. For this reason, storage and marketing losses are as high as 4% of total wheat production.

RUSSIA: WHEAT SUPPLY AND DISPOSITION					
July-June crop year	1999 -2000	2000 -2001	2001 -2002e	2002 -2003f	2003 -2004f
thousand tonnes.....				
Carry-in Stocks	1.0	1.2	1.4	6.4	6.7
Production	31.0	34.5	46.9	50.6	42.0
Imports	<u>5.1</u>	<u>1.6</u>	<u>0.6</u>	<u>0.3</u>	<u>0.5</u>
Total Supply	37.1	37.3	48.9	57.3	49.2
Domestic Use	35.4	35.2	38.1	40.6	40.0
Exports	<u>0.5</u>	<u>0.7</u>	<u>4.4</u>	<u>10.0</u>	<u>4.5</u>
Total Use	35.9	35.9	42.5	50.6	44.5
Carry-out Stocks	1.2	1.4	6.4	6.7	4.7

e: estimate, USDA: 2001-2002; f: forecast, AAFC: 2002-2003 and 2003-2004
Source: USDA

UKRAINE: WHEAT SUPPLY AND DISPOSITION					
July-June crop year	1999 -2000	2000 -2001	2001 -2002e	2002 -2003f	2003 -2004f
thousand tonnes.....				
Carry-in Stocks	1.9	1.8	0.5	3.7	2.4
Production	13.6	10.2	21.3	20.6	18.0
Imports	<u>0.4</u>	<u>0.7</u>	<u>0.0</u>	<u>0.2</u>	<u>0.0</u>
Total Supply	15.9	12.7	21.8	24.5	20.4
Domestic Use	12.2	12.2	12.6	13.6	13.5
Exports	<u>2.0</u>	<u>0.1</u>	<u>5.5</u>	<u>8.5</u>	<u>4.5</u>
Total Use	14.1	12.2	18.1	22.1	18.0
Carry-out Stocks	1.8	0.5	3.7	2.4	2.4

e: estimate, USDA: 2001-2002; f: forecast, AAFC: 2002-2003 and 2003-2004
Source: USDA

Infrastructure

Russian port facilities are limited although improvements are underway and expansion is expected to be completed in the next 2-3 years. This includes the ports of Taganrog and Yeysk, located on the Sea of Azov and connected with the Black Sea by the Kerch Strait. Improvements to the Black Sea port of Novorossiysk and the port of Vladivostok, located on the Sea of Japan are also underway. However, overall Russian port capacity will continue to be restricted by shallow drafts and a lack of land for development around ports. Total Russian port throughput capacity is 15 Mt, however, deep sea port capacity is only 10 Mt. Wheat and other grains are often in competition for facility storage with other high value products. In January 2003, construction of two grain terminals began near Astrakhan's river and seaport. The two facilities are expected to begin shipping grain this year. Projections are in place to increase throughput capacity to 1 Mt by 2010. In response to limited capacity at Russian deep sea ports, Russian exporters have used facilities in western Europe and Ukraine to reduce pooling and consolidation costs.

Ukrainian port storage capacity is 340,000 t with a throughput of about 16.0 Mt a year. About 7 % of the grain shipped through Ukrainian ports is of Russian origin. Ukraine's competitive position in wheat exports will be enhanced as improvements continue to be made in port infrastructure through private investment. The Ukrainian ports of Illichesk, Odessa, Nickolayev, Khersonk, and Berdyansk are undergoing upgrades which will enable these ports to increase their throughput by a combined 2-3 Mt a year.

TRADE

Exports

Russia and Ukraine were mainly net wheat importers when they were members of the Former Soviet Union (FSU). Before the break-up of the Soviet Union, Ukraine largely exported wheat to Russia and other countries of the FSU. They were responsible for supplying feed grains to the large dairy, livestock and poultry operations in the Soviet Union. Following the break-up of the FSU in 1991, both the Russian and Ukrainian agricultural sectors entered a decade of

decline. FSU farm subsidies for fuel and protein feed were abolished, and as a result livestock numbers decreased. The reduction in livestock inventories left a surplus of feed wheat. However, wheat exports were limited until 1994 when state price controls were reduced and restrictions on export licences and quotas were removed.

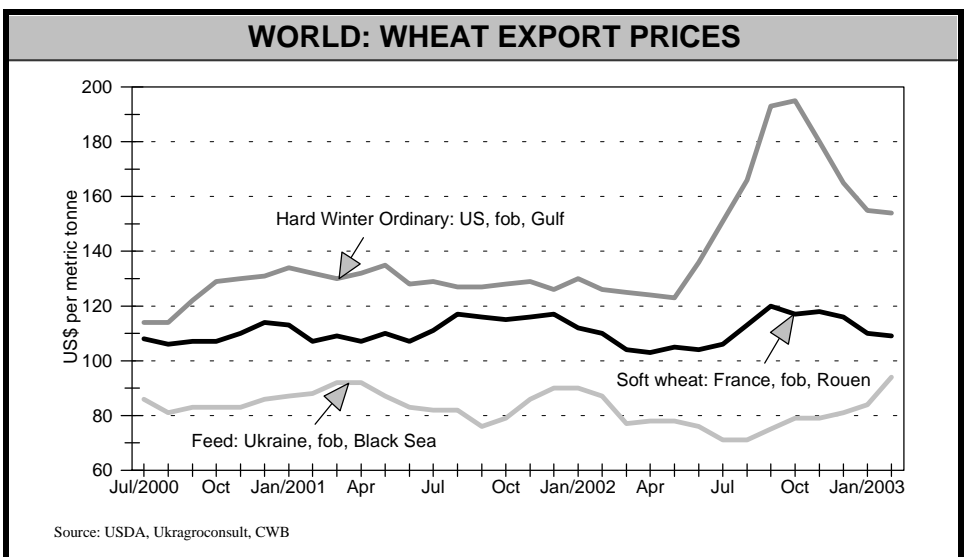
Ukraine's livestock and poultry sectors were designed by the FSU to function in a centrally planned economy. Following independence, the Ukrainian government tried to maintain inventories by increasing corn imports in 1991 and 1992. Nevertheless, with the elimination of farm input and feed subsidies, increased competition from imported livestock and poultry products and a decrease in consumer disposable income, Ukrainian producers reduced livestock and poultry inventories.

Both **Russia and Ukraine** have been minor wheat exporters, with exports averaging a combined 2.8 Mt from 1996 to 2000. In 2001-2002, however, Russia and Ukraine exported 4.4 and 5.5 Mt, versus 0.7 and 0.1 Mt, respectively in 2000-2001. With a second consecutive bumper wheat crop in 2002-2003, Russia and Ukraine are forecast to export a record 10.0 and 8.5 Mt, respectively. These two countries collectively are the second largest exporter after the US for 2002-2003. Early crop year exports of low priced wheat have been exceptionally large due to tight supplies and high prices in the five major exporting countries. Less competition from Canada and Australia has provided opportunities for milling wheat exports to North Africa and the Middle East. The proximity to these markets gave Russia and

Ukraine a freight advantage over many exporters, along with their flexibility in offering smaller vessels to private importers in the Mediterranean. Feed quality wheat exports to South Korea and Israel have been very competitive with US corn. Due to limited Canadian wheat supplies as a result of drought conditions, Ukraine feed wheat exports to eastern Canada, largely Quebec, totalled 73,000 t in 2001-2002 and are forecast at 100,000 t in 2002-2003. The EU had been the largest market for Russian and Ukrainian wheat exports, largely due to the lack of an import duty, which allowed wheat exports into the EU at prices lower than domestic EU wheat prices. For 2002-2003, Italy, Greece, and Spain are the largest EU importers to-date of Russian and Ukrainian wheat. However, on January 1, 2003, the EU limited wheat imports of low and medium protein wheat with a quota of less than 3.0 Mt at a €12/t (CAN\$19/t) tariff. The after quota tariff was set at €95/t (CAN\$149/t). The frequency of Russian and Ukrainian wheat exports has diminished recently, after record shipments in the first half of the crop year. Feed wheat availability has been sharply reduced in Russia and Ukraine. Ukrainian feed wheat export quotes have increased to nearly US\$100/t in February. This may lead to a downward revision of both the 2002-2003 Russian and Ukrainian wheat exports forecasts.

Imports

For 2002-2003, **Russian** wheat imports are forecast at 0.3 Mt, down from 0.6 Mt the previous year. These imports are from Kazakhstan. Russia has a 5% import tariff on No.3 wheat in an attempt to protect the



domestic market, but the majority of imports come unregistered from Kazakhstan, due to the large unenforced common border.

For 2002-2003, **Ukrainian** wheat imports are forecast at 0.2 Mt, slightly above last year, but below the 5-year average of 0.3 Mt, due to ample wheat supplies. These imports are expected to originate from Kazakhstan, which faces zero duty under the current free trade agreement between the countries.

OUTLOOK

In **Russia**, 2003-2004 wheat seeded area is forecast to fall over 10% due to low domestic prices and unfavourable weather. The general condition of the wheat crop is reported to be worse than 2002-2003 after frost damaged crops in areas unprotected by snow. For 2003-2004, Russian wheat production is forecast at 42.0 Mt, down 17% from 2002-2003. Consequently, Russian wheat supplies are projected at 49.2 Mt, down 14% from this year. However, domestic use is forecast to remain relatively unchanged at 40.0 Mt. Russian wheat exports are forecast to fall by 55% to 4.5 Mt due to reduced exportable wheat supplies. Carry-out stocks are expected to decrease to 4.7 Mt, with a stocks-to-use ratio of 11% versus 13% this year.

For 2003-2004, heavy frosts in **Ukraine** in December of 2002 are very likely to have killed the less developed winter wheat. Preliminary forecasts show that over 2.0 Mha may need to be reseeded in the spring, much higher than in 2002-2003. Yields may also be lowered due to late seeding and poorly established winter wheat as a result of the dry weather in the fall of 2002. Ukrainian wheat production is forecast at 18.0 Mt, down 13% from 2002-2003. With this decrease in projected production, Ukrainian wheat supplies are expected to fall by 17% to 20.4 Mt, with domestic use expected to remain relatively unchanged at 13.5 Mt. Livestock and poultry inventories have been increasing since 2001, but are not expected to reach the high levels of the early 1990s for quite some time. The major limiting factor is that Ukrainian livestock and poultry producers are now in competition with wheat

exporters for feed supplies. Feed demand is expected to play a lesser role in price formation with export demand being the larger determining factor. For 2003-2004, Ukrainian wheat exports are forecast at 4.5 Mt, down 47% from this year. Carry-out stocks are expected to remain unchanged at 2.4 Mt, with a stocks-to-use ratio of 13% compared to 11% in 2002-2003.

Despite high market transaction costs, **Russian and Ukrainian** wheat is competitive largely due to low production costs. Low production costs enable wheat exporters to offset existing high costs of storage and transportation and offer lower export prices. The continued competitiveness of Russian and Ukrainian wheat on world markets will largely depend on their governments' evolving grain policy. Costs of production are expected to rise in 2003-2004. Another factor that may result in a decrease in wheat profitability, is the **Ukrainian** government's reluctance to refund the value-added tax to wheat exporters. To-date, there are indications that Ukraine's domestic wheat supplies are limited, especially milling wheat, which has already resulted in an increase in domestic wheat prices. Lower supplies may undermine Ukraine's position on the world wheat market, and raise the interest of Ukrainian ports in handling transfer wheat exports from Russia and Kazakhstan as alternatives.

In the long-term, **Russian and Ukrainian** wheat export competitiveness will depend on government policy decisions and reductions in logistics costs. Currently, it costs approximately US\$18-25/t to move grain from an inland elevator to ocean vessel. It is expected that with port facility upgrades in Russia and Ukraine, such costs may be reduced thereby increasing the profitability of wheat, while reducing congestion at Ukrainian ports. Future wheat exports from **Russia** will also depend on income growth and the demand for livestock and poultry products. Increased domestic livestock and poultry production will require more wheat for feed thereby reducing wheat exports.

UKRAINE AND CANADA: 2001-2002 WHEAT CROP BUDGET COMPARISON

	Ukraine	Canada*
Variable CostsCAN\$ per hectare.....	
Seed (inc. treatment)	8.48	16.62
Fertilizer	27.18	46.19
Chemicals	13.22	45.99
Fuel	8.37	24.70
Repairs	3.69	14.82
Other	<u>13.67</u>	<u>6.35</u>
Total Variable Costs	74.61	154.67

*Saskatchewan Brown soil zone spring wheat budget with interest and crop insurance removed

Source: USDA-Ukraine; AAFC-Canada

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