

USDA Foreign Agricultural Service

GAIN Report

Global Agricultural Information Network

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Drought and Heat Hit Food Prices

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Agricultural Situation

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Report Highlights:

Continuous drought and abnormal heat in European Russia may stimulate an increase in the inflation rate by 2-3 percent over the planned 6 percent increase for CY 2010. Experts estimate that food prices may increase by 10-15 percent on a yearly basis due to a 30-35 percent; drought caused decrease in grain production, compared to the previous year. The heat has contributed to a decrease in potato and vegetable crops, productivity of livestock and poultry, increased storing expenses for wholesalers and retailers, handling and delivery of perishable products, and overall higher levels of food loss.

General Information:

The Russian Ministry of Agriculture has decreased its grain production forecast from “below 85 MMT” to “not more than 60 MMT.” Independent experts estimate the possible increase in food prices by 10-15 percent on a yearly basis. These estimates are based primarily on the grain crop damage. However, the drought is likely to decrease the production of potatoes, vegetables, sugar beets, livestock and poultry productivity, increase expenses of wholesalers and retailers for transporting, storing, handling, selling perishable food products, and direct heat-caused food losses are factored into the estimates.

Grain crop forecast goes down, and grain prices go up

Continuous drought and high air temperatures in European Russia and some other parts of Russia have affected the production of grain and other crops (grasses, fodder crops, potato, fruits, berries, vegetables) in 27 Russian provinces, which represent approximately 48 percent of all area planted to agricultural crops^[i], and produce approximately 44 percent of Russian agricultural products (in value terms). Some provinces have had no rains since mid April, and the average air temperature has not dropped below 30 degrees Centigrade since June and the weather forecast is just started to cool in mid-August. The Russian Ministry of Agriculture has been steadily decreasing their grain production forecast from “85 million metric tons or below” in mid July to 70-75 million metric tons (MMT) on August 3, 2010, and now to 60-65 MMT on August 9, 2010. On August 11th, Agricultural Minister reported to the Prime Minister, that the Russian grain crop most likely will not exceed 60 MMT. Grain and wholesale prices for grain products have followed the changes in the crop forecasts (Graphs 1 and 2).

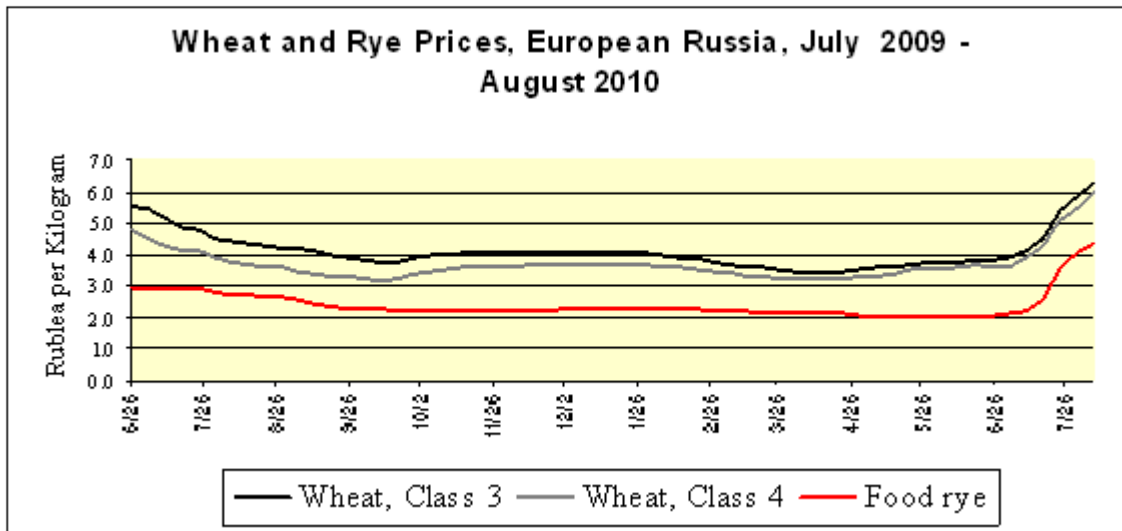
Experts estimated that in the consumer food basket, used by the Russian State Statistical Service (Rosstat) for calculation of inflation, the share of grain-based food comprises 24 percent^[ii]. The Rosstat reported that consumer prices in the first week of August increased by 0.2 percent, while in May – July it was approximately 0.1 percent a week. Food prices started increasing in the end of July. The major reasons for increased inflation: buckwheat cereal prices increased by 7 percent in the first week of August (in the end of July prices already increased by 5.5 percent), wheat flour prices increased by 2.4 percent (1.7 percent growth over the previous week), and bread prices grew by 0.3-0.4 percent (0.1 – 0.2 percent over the previous week). The newspaper Izvestia, published information on the changes in retail prices for some Russian staple products from grain milling since May 2010: buckwheat cereal (grechka) prices increased by 50-150 percent; barley cereal (perlovka) price increased by 90 percent, price of millet cereal (psheno) increased by 86 percent, wheat flour increased by 60-80 percent, and rice increased by 30 percent. Experts attribute the increases in buckwheat, millet and barley cereals prices due to the historically low production expected for these Russian staple food crops. Contrary to the increase in the price for rice, as it is driven by speculators, because the Russian rice crop has not suffered from drought this year; and imports are expected to be at the same level as last year. Recently, mass media has reported that rice prices began decreasing. The increase in wheat flour prices are caused by low wheat and rye crop forecasts and increasing grain prices. However, experts believe that despite the drought, the supply of milling quality wheat (production and stocks) will be more than enough to meet domestic demand.

Consumers in provinces across the country report that bread prices have began increasing due to the increased flour prices. In Moscow and the Moscow oblast alone, the bread price has increased in the

last two weeks by 12-15 percent; some varieties and pastries have increased by 30 percent. Bakers and retailers say these product price increases are caused by 95-110 percent increase in flour prices. Millers attribute the growth in flour prices because of the grain price increase coupled with the increased expenses for grain transportation and storing (grain price comprises 85 percent of flour price).

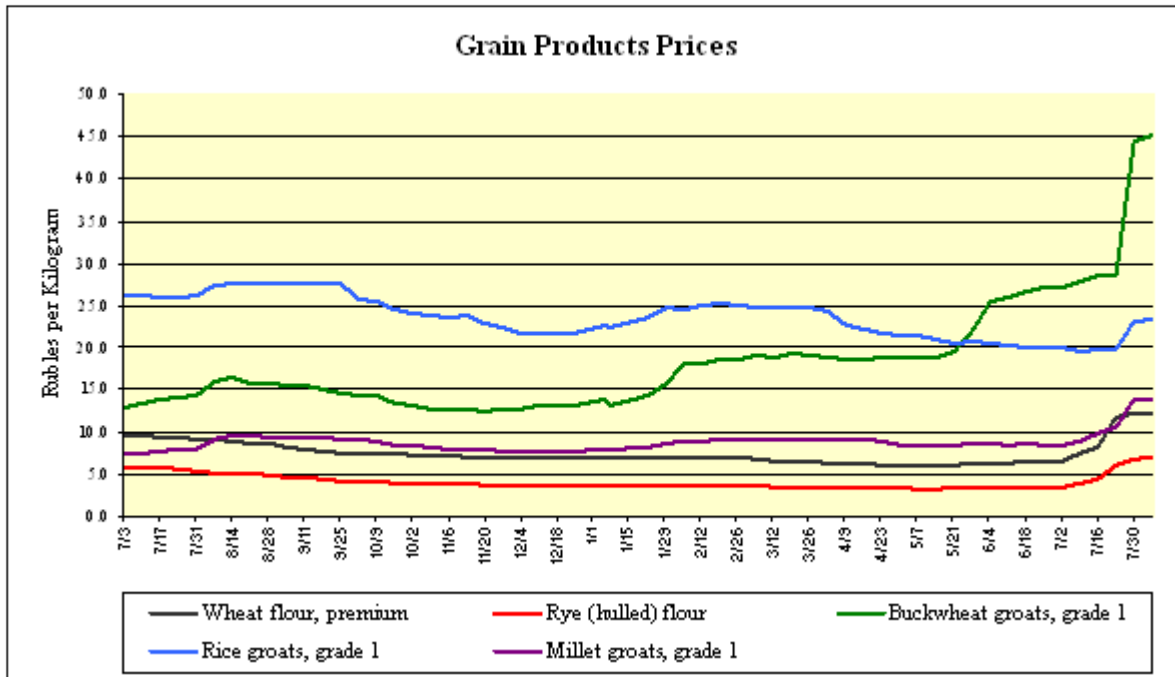
Most experts consider that the 15 percent increase in wheat flour and bread prices is driven by market speculation, as there is not a shortage for milling quality grain in Russia. These speculative expectations have also affected vodka prices, which started increasing in some provinces on the assumption that grain prices will increase. Grain based alcohol products comprise less than 10 percent of the retail price for vodka. Izvestia also reported that the price of salt has increased since May 2010 by 30 percent; this increase has absolutely no grounds.

Graph 1. Grain Prices in European Russia, EXW, Rubles per Kilogram, July 2009 – August 2010



Source: ProZerno

Graph 2. Wholesale Prices of Grain Products in European Russia, Rubles per Kilogram, July 2009 – August 2010

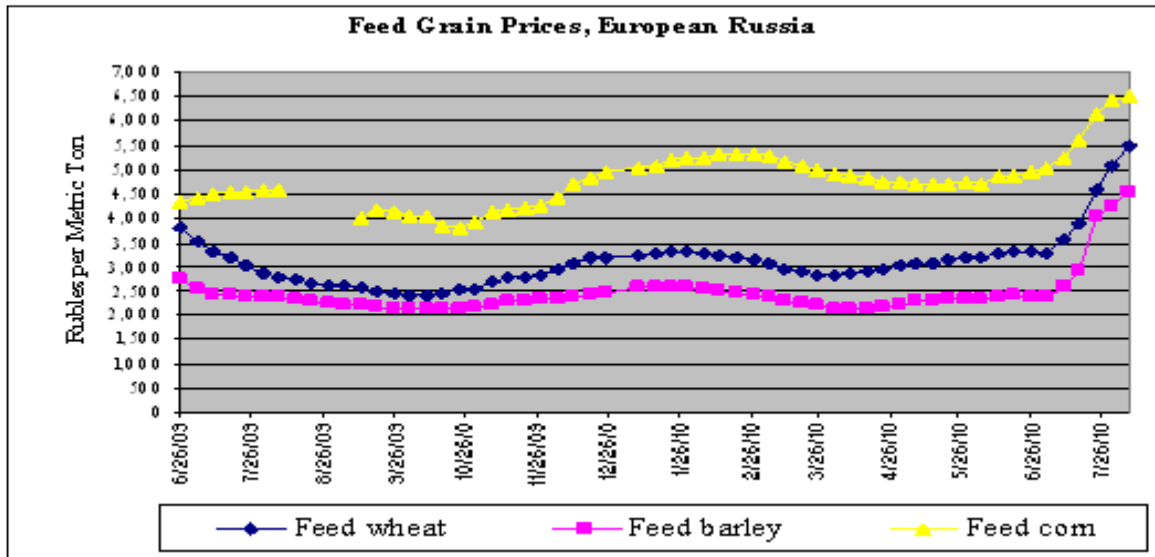


Source: ProZerno

Losses of livestock producers

Feed grain prices increased by 30 percent (corn) to 91 percent (feed barley) in the last month (Graph 3) due to significant losses in feed grain and in other fodder crops such as grass and pasture crops in the drought affected provinces. The Agricultural Minister reported that farmers in the drought affected provinces will be short 7 million metric tons of feeds (including feed grain and other fodder crops). The drought drastically decreased grasses, fodder and feed grain crops in regions with high milk and meat (cattle) production.

Graph 3. Feed Grain Prices in European Russia, EXW, Rubles per Metric Ton July 2009 – August 2010



Source: ProZerno

Some experts forecast that individual entrepreneurs, who are short on feed supplies, will increase cattle slaughter this fall, decreasing the future meat prices. Rosstat reported that in the first week of August, the retail price for milk increased by 1.2 percent compared with 0.1 percent a week earlier. The production costs for products of animal origin is expected to increase by 10-12 percent by the end of 2010 (some experts believe); inevitably raising the retail prices for a number of products. However, specialists feel that the effect of high feed prices on consumer prices, might not be felt until late fall. Considering that in early fall, small farmers will most likely start slaughtering cattle, increasing the supply of meat will, moving meat prices down. With milk, it is more complicated. Large dairy herds are concentrated in the drought affected provinces, such as the Tatarstan Republic, Lipetsk oblast, Bashkortostan Republic. In 2010 the grain and fodder supply will be very short, and large livestock farms will have to ship grains in from the distant provinces. Feed costs will increase due to higher transportation expenses and increased grain prices. The Duma Deputy, Airat Khairullin, reported that in 2010, the drought has affected provinces that produce over half of Russia's milk. Besides grain and fodder shortage, according to specialists, the cow's productivity has also decreased because of the heat. Specialists estimate that when temperatures are 30-40 degrees Centigrade, cows decrease their production by 10 percent.

Losses of vegetables and potato producers

Farmers in the drought and heat affected provinces report that vegetable and potato crops suffer from heat and soil dryness, and production will be lower than predicted. Some farmers expect that they will hardly produce enough potatoes for the next year planting (most farms use saved potato as seed material). A few prosperous farmers with expensive foreign systems (usually purchased on credit terms or leasing) for irrigating vegetable and potato fields, feel very comfortable. However, these farmers may capitalize on increased prices in order to repay the loans or purchase another piece of irrigation equipment. The Ministry of Agriculture has preliminary estimated potato production losses at 20-30 percent from the planned crop. However, most experts believe that potato losses will be as high as 50 percent. According to Rosstat, the total 2010 potato sowing area in Russia was 2.2 million hectares. So

far, the expected decrease in the Russian potato and vegetable production has not been reflected in consumer prices. Currently, the wholesale price for new potatoes is 12 Ru/kilo. Experts expect that wholesale prices for potatoes in September to increase by 10 Ru/kilo. Retail prices for potatoes this fall are expected at 25-30 Ru/kilo.

Heat in the metropolitan area of European Russia

Heat in the cities has primarily affected the food distribution chain; due to the increased cost for delivery, storing and sale of raw and most of processed agricultural food products. The following factors may stimulate the inflation of food prices, during and after the heat period:

- Russia is lagging far behind developed countries in development of a “cold-chain” delivery for food products from the farm to the consumer. High heat and coupled with the shortage of refrigeration (trucks, storage, air- conditioned retail centers, etc.); has significantly increased the product spoilage rate and/or the cost of this delivery if refrigeration is indeed available. Retailers and wholesalers have increased their expenditures for cold storage and refrigeration more this summer than any other previous summers.
- Consumer demand for products with a long shelf-life (without refrigeration), such as cereal (groats), flour, even bread, might temporary increase; causing a price increase for these products and possibly creating a short supply for these products in some areas.
- Demand for soft drinks, water, ice cream has increased, and may cause an increase in the retail price.
- There has been an increase in dinning out at locations which are air-conditions. While street outlet (hot-dogs, pizza, etc.) consumer demand has possibly decreased. The effect of these trends is not obvious, but it has distorted the traditional price balance for retail food products.

As for the current consumer prices, the heat in the major cities of Russia, Moscow and St. Petersburg, have already seen an increase in the prices of soft drinks, water, ice-cream, and fruits and vegetables.

Water and soft drinks companies have benefited the most from the heat. The traditional Russian drink, kvass, (based on fermentation of bread) is the most popular within consumers. According to the Ochakovo Company, one of the leading Russian soft and alcoholic drink producers, the sale of kvass has increased by 25 percent (estimated 14.4 million deciliters) in the first half of 2010 compared to the same period of 2009. In July alone, the sale of kvass was twice that of June. Bottled water sales have almost doubled in June-July compared to the same time last year. Trade sources report a 15 percent increase in ice cream consumption this year. Beer consumption has also more than doubled since the beginning of July 2010.

Trade sources have already reported a 10-15 percent increase in the price for water and soft drinks. The tendencies in restaurants are similar to those in this trade sector: consumption of soft drinks is going up, while consumption of alcoholic beverages is decreasing. Most popular dishes are light deserts and cold appetizers, including ice-cream.

Federal Government Measures

The measures that the Russian government adopts or going to adopt in order to support agricultural producers and to curb price increase are the following:

1. In the sphere of the agriculture government is planning to

- apply direct subsidies to farms and provinces that were mostly affected by the drought
 - re-schedule loans
 - sell grain from intervention funds at the price grain was procured some years ago
 - curb fuel prices for farmers
 - The Chairman of the Government, Vladimir Putin, also cautioned province authorities with abundant grain, against administrative restrictions on selling their grain to other provinces.
2. In the sphere of consumer price control: The Government has enacted Resolution No 530 on price control, which was prepared several months ago in accordance with the Federal Law on Retail Trade. This was a timely adoption by the Government in July to caution retailers on the price increase. For more information see GAIN report RS1038 Government to Control Prices for Socially Important Food _ Moscow _ Russian Federation _ 7-30-2010.
 3. Government imposed a ban on grain and flour export from August 15 to December 31, 2010 (For more information see GAIN RS1039 Ban on Grain Export from Russia Comes to Force on August 15 _ Moscow _ Russian Federation _ 8-6-2010).

Comments

Retail prices for food products might have increased faster than the Russian government anticipated in the beginning of 2010. However, this increase is due to hot weather in the cities, rumors, price increases for fuel, storage, transportation, and the overall sale of food products. The decrease in grain production is the least significant of all these factors, but the most acceptable by traders. It is also necessary to keep in mind, that the Russian government can curb the retail price increase for socially important food products through administrative means (Federal Law on Retail Trade, and approved list of socially important food products). Thus, retailers are using the drought as justification to increase the price of food.

Government intervention may not stabilize the situation fast enough and to silence the spreading of rumors. An increase in food prices by 10-15 percent in 2010 is possible attributing to an average rate of inflation in the country by 2-3 percent or as much as 8-9 percent a year.

^[i] Calculations are based on the Rosstat data for 2008

^[ii] Source; Vedomosti, August 9, 2010