



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.09

Voluntary Report - Public distribution

Date: 2/24/2009

GAIN Report Number: RS9008

Russian Federation

Agricultural Situation

Economic Crisis Update

2009

Approved by:
Scott Reynolds
U.S. Embassy

Prepared by:
Staff

Report Highlights:

The global financial crisis has had a significant impact on Russian agribusiness and agriculture. Declining oil revenues and slumping confidence in the Russian economy have led to strong downward pressures on the ruble. The weak currency coupled with a decrease in purchasing power will pose significant challenges for U.S. agricultural exports in 2009.

Includes PSD Changes: No
Includes Trade Matrix: No
Annual Report
Moscow [RS1]
[RS]

OVERVIEW

The global financial crisis has had a significant, negative impact on Russian agribusiness and agricultural production. Declining oil revenues and slumping confidence in the Russian economy have led to strong downward pressures on the ruble. In 2008 inflation was 13.8 percent and given the weakened ruble, inflation is likely to remain in double digits throughout the 2009. The global crisis spurred a liquidity crisis in the Russian financial markets as foreign investors left in mass and foreign banks dissolved Russian credit lines. With forty percent of investments in Russian agriculture dependant on credits and several banks denying financing for new agricultural projects, agriculture is among the most vulnerable sectors. Short term credits for working capital is scarce and experts opine that by spring 2009, 20 percent of Russian agricultural enterprises may go bankrupt; primarily small producers of crops and dairy products.

The impact of the crisis on U.S. agricultural exports began to be felt in the fourth quarter of 2008 as U.S. exports declined sharply led by a drastic decline in meat and poultry imports. The weak currency coupled with a decrease in purchasing power will pose significant challenges for U.S. agricultural exports in 2009 as well.

IMPACT ON IMPORTS

Despite the economic crisis, U.S. agricultural exports to Russia hit a record high in 2008. Exports were more than \$1.8 billion, 39 percent over last year's total. The final quarter failed to deliver the explosive growth of the previous three quarters. However, it is difficult to ascertain how much of the decrease resulted from regulatory barriers verses the financial crisis and devaluation of the ruble.

	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec
2007	53 530	72 735	78 399	103 396	93 248	108 278	121 005	143 236	120 574	157 012	170 159	106 965
2008	111 686	146 981	154 941	155 419	174 627	142 612	196 034	200 792	160 847	197 811	143 494	52 961
Change	108.64%	102.08%	97.63%	50.31%	87.27%	31.71%	62.00%	40.18%	33.40%	25.98%	-15.67%	-102%

Source: Department of Commerce, U.S. Census Bureau

Since August the ruble has lost almost half of its value against the dollar. Given this sharp decline, it is certain that U.S. exports will continue the downward trend during the first half of 2009. The dramatic deterioration of the ruble which occurred in December and January will begin to be felt by the consumer in February as retail prices adjust to reflect the increased costs associated with imported inventory and increased liquidity costs. The ruble dollar exchange rate in the beginning of August was 24:1, in the beginning of December 27:1 and in the beginning of February 36:1.

At the end of January, the Russian interbank lending rates hit a historical high and commercial rates followed. Commercial interest rates in February were reportedly around 30 percent whereas in the first half of January it was still possible to secure trade financing at rates of 15-20 percent.

RETAIL SECTOR

The Russian food retail sector is scrambling to cope with changes in the market in the wake of the world economic crisis and the declining ruble. According to Rosstat, inflation in 2008 reached 13.3 percent, far exceeding the Russian government's forecast of 7 percent (which was adjusted upward several times throughout the year). In 2008, food prices increased 17.6 percent. In 2008, moreover, the largest increases were seen in basic foodstuff commodities, including a 33.8 percent jump in pasta prices, more than 25 percent rises for bread and baked products, groats and legumes, and more than 20 percent increases for meat, poultry, and vegetable oils.

According to mass media in 2009 volumes of retail trade may increase only by 3.4 percent, versus 13.6 percent in 2008 (Torgovaya Gazeta). Most chains have had to cut overhead costs and cancel expansion plans. Retailers are reporting almost an across-the-board freeze of development projects, reductions in workforce of 10-30 percent on average, and are aggressively renegotiating leases. There is increased pressure on suppliers to extend credit terms beyond the traditional 30 days to 90 days or more. In some cases, suppliers are refusing to deliver products to slow-paying retailers, even in the high-end segment of food retail which was initially believed to be insulated from the crisis because their profit margins are higher and their customers were believed to be less impacted by the crisis. While the pace of retail expansion will not be as steep in the past, some analysts believe there will be increased demand for imported food as credit is scarce for domestic agricultural development projects.

As for food products, it is anticipated that retailers will switch to buying cheaper food products, and the assortment of products will decrease. Some experts consider that consumers may begin buying more in traditional food markets than in the supermarkets. In view of the economic crisis the Moscow city government decided to suspend its program targeted on decreasing the number of kiosks, booths, stands and truck-bed kiosks. Originally they planned to close 1,500 trade kiosks in 2009, or 20 percent of the total number. In 2008 the number of these retail outlets already decreased by 3,000.

MEAT

Imports of meat and poultry suffered steep declines in the fourth quarter with December sales falling to a fraction of historic averages. The majority of declines can be attributed to the canceling of contracts due to importers' inability to obtain credit and the plummeting ruble which has made imports significantly more expensive.

According to the Russian Federal Statistics Service, retail prices for meat and poultry increased in Russia by more than 23 percent in 2008. Despite the crisis, Russian importers believe imports of the U.S. chicken leg quarters will be limited more by the new quota volume and a stronger dollar rather than credit issues. While price increases are expected, demand should remain strong as poultry continues to be the cheapest source of animal protein. Russian consumers, coping with lower disposable income and higher prices, are expected to reduce meat consumption or substitute products (i.e. beef for pork, pork for poultry).

Pork trade has suffered the most drastic declines with softer demand and lower prices. Russian pork importers are beginning to shift away from traditional cuts in favor of cheaper pork offals. Pork and pork variety meats continued sharply downward in December 2008 for the second straight month. Lower December shipments are expected due to seasonality, however, U.S. monthly pork export volumes have not been this low

since December 2006. While seasonality of trade similar to that of pork was expected for broiler meat, the volume of U.S. shipments crashed in December to its lowest level since April 2002. Out of the three meat products, beef trade has been the most negatively impacted by the global financial crisis. Since late 2008, demand for higher quality beef cuts has fallen dramatically again in favor of cheaper offals.

New investment in poultry, swine, and beef production in Russia has slowed due to the lack of available credit from commercial banks. While businesses continue projects which are close to completion, new projects are being postponed or abandoned. Nevertheless, domestic poultry and pork producers asserted that they will increase production in 2009 benefitting from pre-crisis investment in these sectors, more large government subsidies, and the availability of cheaper animal feed.

Nuts

Since 2005, nut consumption in Russia has increased driven largely by rising incomes. In 2008, U.S. tree nut exports to Russia totaled \$77 million, an increase of 200% since 2006. 2008 data does not reflect the impact of the economic crisis, as the time lag in contracts and shipping is approximately three months. However, according to the trade contacts, almond imports may decrease by at least 30% in 2009, if the economic situation in the country does not stabilize in near future months and the ruble does not appreciate. The confectionary and snack industries, the main consumer of the California almonds are currently ordering at least 40% less. One of the major importers of almonds in Russia who averaged 12 containers per month last year, received seven containers in December and anticipates ordering on three to four containers per month in 2009 due to decreased demand. Some companies are beginning the transition to less expensive ingredients (primarily peanuts) to produce more affordable products for consumers.

Food industry experts believe that imports of U.S. pistachios will not decrease so severely in 2009. In 2008, the U.S. became the second largest supplier of the pistachios to Russia after Iran, securing a 24 percent market share. As of January 2009, according to the biggest importer of California pistachios consumption of pistachios is stable; however, at least one large importer has put contract negotiations for California pistachios on hold because of the current economic situation.

Fresh Fruits

Russia's imports of American fruits are forecast to decrease 30 percent due to decreasing incomes and customers moving to the less expensive varieties. The drastic appreciation of the dollar versus the rubles makes Washington Apples and other American fruits less competitive on the market compared with more affordable Polish and Chinese fruits. As contracts are in dollars, the instability of the ruble coupled with the two month delivery time leave importers overexposed.

One of the top three Russian fresh produce importers – Sorus Co. was declared bankrupt on December 4, 2008. Also during December three of five Russian major fresh fruit importers, as well as smaller companies, stopped purchasing Washington apples and the remaining importers significantly decreased orders. Furthermore, a good crop in Poland and the recent lifting of the ban on Polish produce resulted in market domination by Polish apples. Chinese, Serbian and Moldovan apples are also moving rather fast, while more expensive apples from France and Italy have rather low demand.

Commercial production of apples in Russia has been increasing since 2005 in response to the growing demand for local product from the processing industry and consumers. Official

statistics reported that Russia produced 2 million metric tons (MMT) of apples in 2007, 40 percent over the 2006 level. However, the shortage of available credit will undoubtedly negatively impact new apple orchard projects so production is likely to level-off.

In 2008, the sales of U.S. pears to Russia started early and importers shipped substantial volumes of product before the Russian fruit market felt the impacts of the crisis. The Chinese pear is expected to become a stronger player in 2009 benefiting from its price advantage and newly sensitized consumers.

FISH

The analytical arm of Rosrybolovstvo (the Russian Fishermen's Union) estimates that the fishery sector's profitability has declined 4.7 percent from 2007 to 2008. The sector was negatively impacted in the last quarter of the year by the global economic crisis and the lack of credit which followed. According to U.S. Bureau of Census Statistics exports of fish and seafood from the U.S. to Russia decreased by 19 percent in value, and estimated at \$34.6 million in 2008 versus \$46.4 million in 2007. The sharper decline in exports occurred following the onset of the crisis in November and December, specifically in whiting and hake, pacific salmon, and scallops.

Russia's fishery sector suffered from the impact of new onerous regulations requiring 10-year quota allocations and insisting that companies have their own fleet in order to obtain this quota. The outlook for 2009 calls for mergers in the sector as small fishery companies will not have the means to compete in the current economic and regulatory climate. According to Rosstat retail prices for fish and seafood in Russia have increased by 12 percent in the past 12 months.

As of January 2009, credit lines have slowly returned to the sector but at higher rates. Traders have also observed a shift in the consumption pattern from value-added fish products to fish in the lower priced segments such as herring, hake and perch, especially outside the city center in the regions. Most companies have attributed this change to the current economic slowdown and decreasing purchasing power of middle class. Local analysts expect that the middle class will spend less on food and, as a result, consumers will continue to purchase low-priced, domestic products and raw food products instead of ready-to-cook products. According to sources in the trade, the sales of groundfish increased in the regions by almost 30 percent while demand for salmon, syomga and trout, decreased by 5 percent. The head Rosrybolovstvo, believes that Russian export-oriented companies may face some difficulties due to the drop in fish prices worldwide. Reports indicate that cod fish prices dropped from \$4.5 per kilo to as low as \$1.7 per kilo. The head of the agency foresees that Russian companies will likely re-orient their catch for cheaper fish species that are traditional and more popular for Russian consumers, such as pollock, mackerel, and herring.

Oilseeds

Russia has relatively modern oilseeds crushing industry which can process practically all of this year's unusually large oilseeds harvest (over 8.0 MMT in 2008). Given this industry does not have any direct government support, and the financial crisis will certainly stymie further modernization of this industry. However, this sector had an influx of investment in 2006-2008 and significant upgrades were made. Domestic prices of vegetable oil and other oilseed products are decreasing, and this stimulates both domestic demand and vegetable oil exports. In October- November 2009 (two months of MY 2008) Russia exported over 150,000 metric tons of vegetable oil, or almost half of all vegetable oil exports in MY 2007. Exports in December – January have been supported by the devaluated ruble, although data for these months are not available yet.

Vegetable oil falls in the segment of cheap food products, and domestic demand for this oil and oil products will be stable and may even increase in course of economic crisis. Thus, in general, in spite of decreasing revenues and financial constrains, which push many small scale crushers from the business, oilseeds crushing industry is in relatively better shape than many other industries. Stable and increasing domestic demand for relatively cheap vegetable oil, as well as good prospects for vegetable oil exports will support oilseeds crushing industry in 2009. Thus, demand for oilseeds will not decrease, although oilseeds procurement prices will be relatively low. In MY 2009 Russian farmers may increase oilseeds production, and Russia's exports of vegetable oil will continue to grow.

GRAIN

Russia's record grain harvest in 2008 has put downward pressure on prices and grain farmers' who could not afford to hold their grain suffered from the 30-40 percent decline in the grain prices in the fall 2008. However, the situation in the grain sector improved by the end of 2008 after the government increased purchases of grain into intervention fund at higher than market price and allocated additional funds for these purchases. By the end of January 2009 the government spent more than 31 billion rubles (approximately \$1 billion) to withdraw from the market 6.6 million metric tons of grain.

It is unlikely that commercial grain exports in MY 2008 will surpass 16 MMT (by the end of January Russia had exported approximately 13 MMT of grain). At the end of the 2008 MY Russia found itself burdened by huge carry-over stocks of poorly stored grain. Additionally, problems with the development of livestock and poultry sectors may decrease domestic feed grain demand in 2009. In spite of announced government support of the farming sector including subsidized seeds, and decreased prices of fertilizer and fuel, farmers will decrease production of grain in 2009, the export potential for Russia's grain may be lower in MY 2009.

GOVERNMENT ACTION

On January 22, 2009, the Russian central bank announced the end of the policy of gradual ruble devaluation in favor of a managed float with a reported floor of 36 RUR to 1 USD. Since August the ruble lost half of its value against the dollar, tumbling from 24:1 to 36:1. Defending the ruble has proven to be an expensive affair with the government reserves falling \$200 billion since August and now dipping below \$400 billion for the first time since 2004.

While Prime Minister Putin has cautioned that state aid is exhaustible, the Russian federal government has indicated priority industries in need of assistance because of the liquidity crisis – including the retail sector and agribusiness. Recognizing that the disruption in the supply of agricultural or food products will have dramatic effect on the economic and social stability of the country, in November 2008, the government provided 50 billion rubles to the state controlled banks to provide financing to the top 10 largest nationwide food retailers.

The retailers chosen to receive the state-backed credit terms are Sedmoy Continent, Magnit, X5 Retail Group, Dixie, Mosmart, Victoria, Kopeyka, Lenta, Holiday, and O'Key. The "easy" credit terms carry 15% to 18% interest rates and must still be collateralized by a share of the business or real estate holdings. In exchange for the assistance, retailers pledged to pay their suppliers more quickly and to keep prices steady on staples. Retailers' over reliance on credit for operating expenses has put tremendous pressure on suppliers to extend credit terms beyond the traditional 20 to 45 days to 60 to 90 days. The devaluation of the ruble is

causing many suppliers of imported products to raise prices. X5 Retail Group has said that it would delay payments to suppliers seeking price increases by an average of 20 days.

In efforts to restore confidence among agricultural producers, Agriculture Minister Gordeyev took charge of a working group consisting of the six largest banks financing the agriculture sector. There is an agreement that banks will reduce funding, but priority projects and funds to support production will continue. The group will define priority measures to stabilize the funding of agricultural producers. However, only in the middle of February 2009, when the Russian Prime Minister Vladimir Putin was involved in the negotiations with the banks, the two major Russian state non-agricultural banks Sberbank and Vnesheconombank (VEB) submitted their plans to finance agriculture.

The government has pledged that credit resources for agriculture in 2009 shall be 866 billion rubles (approximately \$31 billion), including 520 billion rubles' loans (\$18.6 billion)^[1] will be offered to agricultural producers in priority industries on the terms of subsidized interest rates (dairy and meat producers will receive 100 percent compensation of interest rate). The Government allocated additional funds to increase the Charter Capitals of Rosselkhozbank and Rosagroleasing. This 866 billion rubles (\$25 billion) amount of agricultural financing was announced in the middle of December.

It is anticipated that in 2009 the level of control of the Russian Government over its grain market may increase as the Ministry of Agriculture looks to support grain prices through up to 20 MMT in intervention purchases. First Deputy Prime Minister Viktor Zubkov has also revived discussion on establishing a grain export company which could control more than 50 percent of the Russian grain market.

As before the crisis, farm mortgages continue to be almost nonexistent due to continued land-ownership confusion that limits the ability to use land as collateral, as well as shortages of professional appraisers and assessors. In addition, commercial banks are still reluctant to invest in production agriculture. Limited participation by commercial credit institutions will likely perpetuate ongoing Russian government programs to finance agriculture for the foreseeable future.

APPENDIX

Russia's Central Bank's exchange rate of \$US1 to Ruble from

Week Ending	Avg RU/\$
14.02.2009	35,45
07.02.2009	36,20
31.01.2009	33,84
24.01.2009	32,93
17.01.2009	31,71
27.12.2008	28,58
20.12.2008	27,66
13.12.2008	27,92
06.12.2008	27,99
29.11.2008	27,49
22.11.2008	27,49
15.11.2008	27,36
02.11.2008	27,02
25.10.2008	26,69
18.10.2008	26,19
11.10.2008	26,16
04.10.2008	25,59
27.09.2008	25,05
20.09.2008	25,47
13.09.2008	25,58
06.09.2008	24,99
30.08.2008	24,55
23.08.2008	24,41
16.08.2008	24,37
09.08.2008	23,56

Source: <http://www.finmarket.ru/z/vlk/valdetails.asp?val=840>

