

Russia, a promising land for Agrifood

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Executive summary

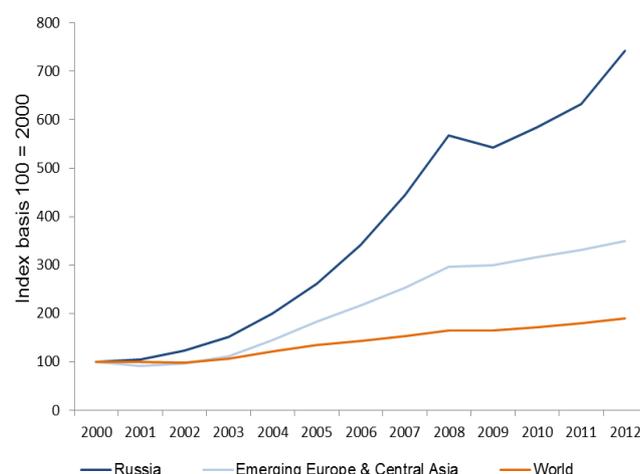
- Sound economic expansion has spurred a rapidly growing Russian middle class since 2000. The trend is likely to continue in the next years, albeit at a somewhat slower pace.
- The broadening of the domestic market has resulted primarily in a steady rise in Russian imports of agrifood products and a high level of investments in F&B industry.
- The F&B industry has followed a solid growing path for the last years and is likely to help boost the Russian economy in mid term.
- Russian Agrifood exports have shored up strongholds in the Middle East and in Africa. Nevertheless, since they are mainly comprised of agricultural commodities, they have remained exposed to price variations in worldwide markets.

The Russian economy has slowed down recently but robust household consumption suggests limited impact on the middle class

Real GDP growth decelerated to +1.5% y/y in H1 2013 from +3.4% in full year 2012 as the ongoing subdued global economy has kept external demand weak and caused a decline in investment activity. Business sentiment indicators have remained soft. However, household consumption maintained robust growth of +6.1% y/y in Q1 and consumer confidence improved in Q2. EH expects full year GDP growth of +2% in 2013 and +3.5% in 2014 (this compares to an average annual +5.2% in 2000-2012). Consumer spending is forecast to moderate slightly owing to higher inflation, slower wage growth and higher unemployment, but should still rise by +5% annually in 2013-2014.

A view on longer term developments shows that Gross National Income (GNI) per capita has surged by about +640% over the past 12 years in Russia, clearly outpacing the global average as well as the average of

Chart 1: GNI per capita



Source: World Bank



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the Emerging Europe & Central Asia region (chart 1). The Russian middle class has benefited particularly from this development as it has become larger and wealthier. The trend is expected to continue in the next years, albeit at a somewhat slower pace. Russia's large population, at 143 million currently, still provides large potential for a further growing middle class.

The higher purchasing power and the new dietary habits of the growing middle class have been fuelling Russian agrifood imports

Agrifood product imports (chart 5) have increased steadily since 2000 (+3.5% to \$39.2bn in 2012), keeping pace with the mounting and changing needs of the Russian middle class. In 2012, the bulk of Russian agrifood imports was comprised of meat products (19% of agrifood product imports), fruits and nuts (16%), dairy products (8%) and beverages/spirits (8%). Except for fruits and nuts (+1%), these heavyweights in Russian agrifood imports recorded double-digit increases last year. Dairy products imports even jumped by +50% versus 2011. It should be noted that agrifood imports can be subject to disruptions caused by sanitary measures (temporary ban of US meat imports starting in February 2013). The recent admission of Russia as a member of the World Trade Organization (WTO) is also likely to open an area of regulatory adjustments as Russia now has to comply with the WTO Sanitary and Phytosanitary Agreement.

In 2012 the European Union remained the chief exporter of agrifood products to the Russian market (36% of Russian agrifood imports, with around 5% from the Eastern European countries), followed by Asia (19%), the other members of the Commonwealth of Independent States (13%), MERCOSUR countries (12%) and NAFTA countries (8%).

The mounting domestic market have spurred strong investments in the Russian F&B industry

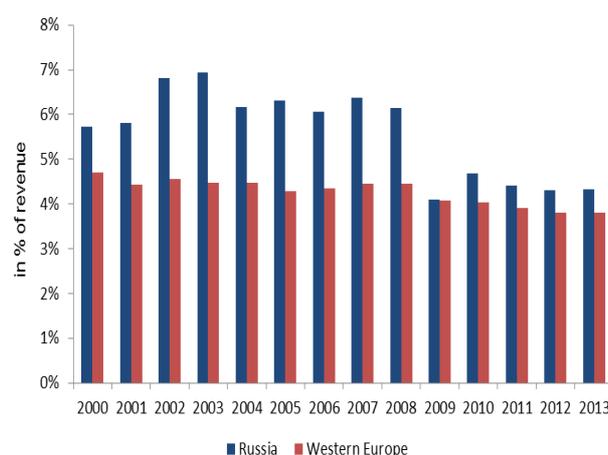
In the early 2000s, the Russian F&B industry made dramatic efforts in capital expenditures to expand and modernize production capacities in response to the growing demand. During this period, the intensity of the investments in the Russian F&B sector (measured as a share of sector revenue) outpaced that of its Western European counterparts (chart 2). It has slowed down since the 2008-09 global recession but has stabilized at a level similar to that of Western Europe. During the same period, the growing Russian market has also gained traction with Western F&B companies eager to tap this potential growth driver. The stock of foreign investments in

Table 1: Major Russian Agrifood import routes : region/country - product

Imports Value	From	Products
\$2.7bn	Mercosur (of which Brazil - \$1.7bn)	Meat products (of which, frozen beef - \$2.0bn, pork - \$0.4bn)
\$2.1bn	European Union (of which France - \$0.6bn, Italy - \$0.4bn, UK - \$0.4bn)	Beverages and spirits (of which spirits, liqueurs and other spirit beverages, alcoholic preparations - around \$1bn, Wine - \$0.7bn)
\$2.0bn	European Union (of which Germany - \$0.6bn, Spain - \$0.4bn, Denmark - \$0.3bn)	Meat products (of which pork - \$1.0bn, pork and poultry fat - \$0.4bn)
\$2.0bn	Asia (of which Turkey - \$0.8bn, China - \$0.3bn)	Fruit and nuts (of which citrus fruit - \$0.7bn, grapes - \$0.4bn)
\$1.7bn	NAFTA (of which US - \$0.9bn, Canada - \$0.6bn)	Meat products (of which pork - \$0.9bn, beef - \$0.3bn, poultry - \$0.3bn)
\$1.7bn	European Union (of which Poland - \$0.4bn, Spain - \$0.4bn)	Fruit and nuts (of which apples, pears and quinces - \$0.8bn, Apricots, cherries, peaches, nectarines - \$0.4bn)
\$1.6bn	European Union (of which Germany - \$0.4bn, Finland - \$0.3bn, Netherlands - \$0.2bn)	Dairy products (of which cheese and curd - \$1.1bn)

Source: International Trade Centre

Chart 2: Intensity of capital expenditures in F&B industry



Sources: IHS Global Insight, Euler Hermes estimates

the Russian F&B industry amounted to \$6.3bn in 2010 (\$1.9bn in agriculture and hunting), three times that of the machinery/equipment sector and 63% higher than in the automotive industry. Two high-profile acquisitions of Russian players highlight the ambitions of the Western companies in this market: Unimilk by Danone in 2010 and Wimm-Bill-Dann by Pepsico in 2011.

After all, Russian F&B industry in continued growth mode

Since 2000, F&B industry output has correlated with the increase in domestic purchasing power. This parallel growth has been the hallmark of most emerging countries. Russian F&B output expanded more than +30% between 2000 and 2012 and should keep growing in 2013 (more than +3%). The revenue of Russian F&B industry should reach roughly \$154bn in 2013, growing more than +8% from 2012.

The significant weight of F&B industry in Russian manufacturing

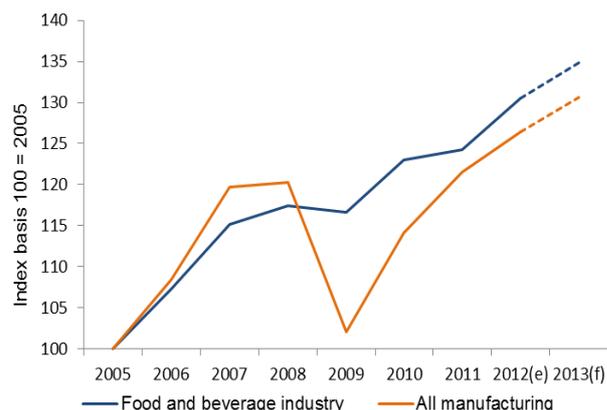
The F&B industry plays a pivotal role in the Russian manufacturing sector as it makes up roughly 16% of real value added in the sector (compared to a global average of 12%). Its annual contribution to domestic GDP grew more than +20% between 2005 and 2012 (overall Russian manufacturing value added increased by +5.5% during the same period). The F&B industry helped absorb the adverse effects of the 2008-09 global recession as it remained steady during the economic hardship (chart 4). In 2013, the value added generated by the F&B sector is expected to increase at the same pace as overall Russian manufacturing (+3.3% versus 2012).

The flip side of the coin: a persistent trade deficit in agrifood products

Russian exports of Agrifood products (chart 5) bounced back dramatically in 2011 (+51%) and continued to soar in 2012 (+47%) to reach \$10.9bn and \$16bn, respectively, on the back of the dramatic rise in the exports of cereals. These two years of growth helped reduce the sector trade deficit (-\$23.2bn in 2012).

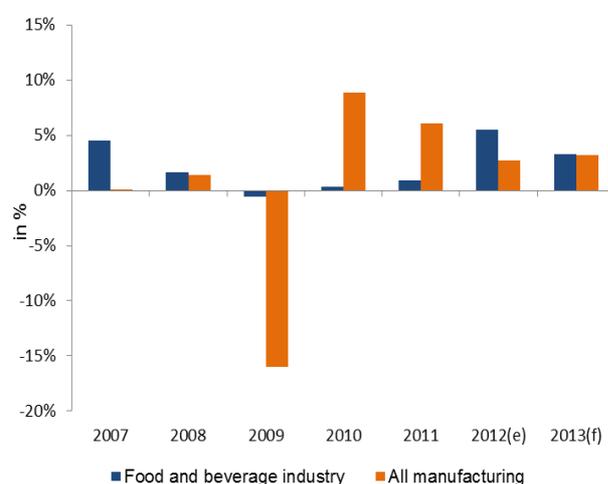
In 2013, the narrowing of the sector trade deficit is anticipated to pause as growth of Russian Agrifood exports is forecast to slow down due to a less buoyant global cereal market, while Agrifood imports should grow at the same pace as in previous years.

Chart 3: Output index in Russia



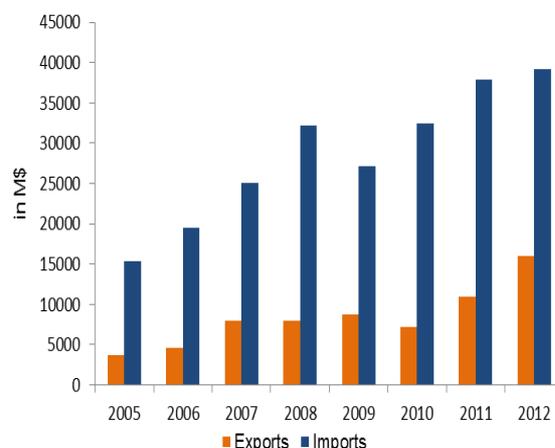
Sources: IHS Global Insight, Euler Hermes estimates

Chart 4: Annual change in real value added in Russia



Sources: IHS Global Insight, Euler Hermes estimates

Chart 5: Annual Russian agrifood trade



Sources: Eurostat, Euler Hermes

Russian Agrifood exports are concentrated on low value added products

The share of agricultural and low-processed food products in Russian Agrifood exports, at around 80% in 2012, indicates a poor competitiveness of the Russian food industry. The combination of the exports of cereals (\$6.2bn), fish/crustaceans (\$2.5bn) and animal or vegetable fats/oils (\$2.2bn) accounted for nearly 70% of overall Russian Agrifood exports last year. Russian exports were mainly concentrated in the Middle East (26% of Agrifood exports last year), to the other members of the Commonwealth of independent States (25%), to Africa (16%, including 3% to Maghreb) and to the European Union (14%). Agrifood exports have shaped the Russian trade relationships with certain partners/regions as, for instance, they made up 36% of overall Russian exports to Africa and 19% to the Middle East in 2012.

Table 2: Major Russian Agrifood export routes : region/country - product

Exports Value	To	Products
\$2.9bn	Middle East (of which Turkey - \$0.9bn, Saudi Arabia - \$0.5bn)	Cereals (of which wheat - \$1.7bn, barley - \$0.8bn)
\$2.2bn	Asia (of which Republic of Korea - \$1.0bn, China - \$0.9bn)	Fish, crustaceans, molluscs (of which fish frozen, whole - \$1.9bn, crustaceans - \$0.3bn)
\$2.2bn	Africa (of which Egypt - \$1.5bn)	Cereals (of which wheat - \$2.1bn)
\$0.7bn	Middle East (of which Turkey - \$0.6bn)	Animal or vegetal fats and oils (safflower, sunflower-seed or cotton-seed - \$0.7bn)
\$0.6bn	Commonwealth of Independent States	Animal or vegetal fats and oils (of which safflower, sunflower-seed or cotton-seed oil - \$0.4bn, margarine - \$0.2bn)
\$0.6bn	European Union (Spain - \$0.2bn, Italy - \$0.1bn)	Cereals (of which wheat - \$0.2bn, corn - \$0.2bn)

Source: International Trade Centre

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