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Russian economy: Buckwheat blues

Kathrin Hille Author alerts

After brushing aside concerns over sanctions and oil prices, the rouble fall alarms Russians



In demand: a volunteer in historical uniform hands out portions of boiled buckwheat to passersby during a street event in St Petersburg

“No buckwheat”, said the handwritten sign dangling from an empty shelf at the Dixy market in Murom, a town some 300km east of Moscow. At another supermarket nearby, buckwheat was available, but with a price tag of Rbs90 (\$2) per kg – more than double what it was about a month ago.

News about a poor harvest has sparked panic buying of buckwheat, a favourite staple in Russia, where it is cooked into porridge for breakfast, eaten as a side with meat dishes, put into soups and used to make pancakes.

The sudden shortage prompted some of Russia’s largest grocery retailers to impose quotas. A Lenta supermarket in St Petersburg told customers they could buy no more than five packs a day to prevent black market trading. The Federal Statistics Service said last week the price of buckwheat had jumped by 27.5 per cent from the start of the month.

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There is no threat of serious hardship – shop shelves in Moscow are still filled with a variety of foods. But the buckwheat shortage has left ordinary Russians with the sense that the country’s growing economic problems are starting to hit everyone – not just the Moscow elites who have been deprived of French cheeses and other western foods that were banned in August.

“This is almost like the stories my grandmother told me about the Soviet Union: empty shelves and queueing for grocery shopping,” says Fyodor Zaitsev, a student born in 1998, long after the Soviet Union’s collapse and two years before President Vladimir Putin took power. During his childhood, Mr Putin presided over an oil-fuelled economic boom which left most Russians better off than ever before.

Few in Russia would question the notion that things are better today, even as tumbling oil prices, sanctions over the Ukraine crisis and structural economic problems threaten to push the country into recession. But while Russians have largely taken these problems in their stride, the sharp decline in the rouble’s value over the past month has instilled a palpable sense of anxiety.

“We have to be alert because this behaviour springs from a very real fear. People try to hoard because they don’t feel safe any more,” says a senior official at the Agriculture Ministry. “The currency volatility did this. People worry that things will cost more tomorrow so

it's better to buy today, and actually they're not entirely wrong in this assumption."

Inflation has accelerated to more than 8 per cent and is expected to hit 9 per cent by year-end, in a wide miss of the central bank's target of 5 per cent, says Alexei Ulyukaev, economy minister. According to a draft for his new economic forecast, due to be presented next month, the rout of the rouble is driving inflation, contributing 4 percentage points.

The rouble had been gradually weakening since February 2013. This summer, the slide picked up pace as the Ukraine crisis and lower oil prices started to bite, and the currency has lost 40 per cent of its value against the dollar this year. But over the past month, things threatened to spiral out of control, with a 12 per cent drop against the dollar in one week between October 30 and November 6.

People worry that things will cost more tomorrow so it's better to buy today. They're not entirely wrong

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The central bank's moves to float the rouble and limit short-term loans to Russian banks seem to be succeeding in curbing speculation and ending the wild swings. Over the past week, the currency has rebounded somewhat, and it could get a boost if Opec decides to cut production to push up oil prices.

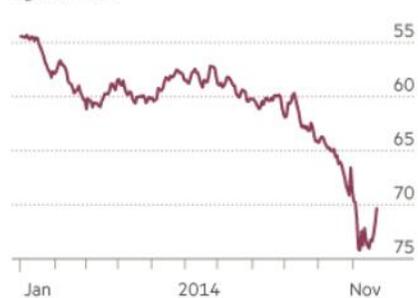
But experts warn that the damage has been done. "Bringing back earlier opportunities with regard to foreign investment and trust in the rouble will take seven to 10 years of growth of our economy," wrote Alexei Kudrin, former finance minister, last week.

While gross domestic product growth is hovering just above zero, the persistent rouble weakness could well tip the economy into recession. "We expect rouble devaluation to continue, although the pace of such devaluation will probably be far more moderate than the one seen lately," says Vladimir Tikhomirov, chief economist at Moscow brokerage BCS Financial. He speaks of a "much bleaker picture of Russia's future economic trajectory" and predicts that the economy will contract by 0.7 per cent next year.

BCS Financial sees fixed investment, which has long been a drag on growth, taking a precipitous dive by 5 per cent this year and 9 per cent in 2015, and forecasts that retail sales, which had still been growing, will start to drop next year as real incomes fall.

Delays in investment are evident everywhere. When Stadler, the Swiss rail carmaker, delivered the first of 25 new double-decker trains to Aeroexpress last week, the company said it would struggle to meet payments for the €380m order.

Rouble
Against the £



Source: Thomson Reuters Datastream

FT

"We have loans in roubles. But now there is a problem," said Alexei Krivoruchko, chief executive of Aeroexpress, which operates trains linking Moscow's airports to the city. Sources close to the two companies said Aeroexpress was expected to back away from an option to buy more trains.

A \$2bn project for a new metro line in the capital is on hold as well. Construction had been scheduled to start next year, but the project's Chinese partners, including the state-owned China Railway Construction Corporation, demanded a renegotiation because the rouble devaluation made imports much more expensive.

Other foreign companies confirm that the weak rouble has become a big challenge. Bilfinger, the German engineering group, says while services provided inside Russia are holding up, its business of building new plants is suffering.

"Where we are feeling it most is in our engineering division, because there are no new foreign direct investment projects any more," says Joerg Syrzisko, managing director at Bilfinger in Russia.

Jens Boehlmann, deputy head of the German chamber of commerce in Russia, says that in the mix of a stagnant economy, sanctions and currency weakness, "the effect of the rouble devaluation is the worst".

Nowhere have things been as catastrophic as in the tourism sector. As households started tightening their belts and the weaker rouble drove up the cost of foreign travel, the country's five largest tour operators, which account for 60 per cent of the packaged tour market, went belly up this year.

Aeroflot created \$79m in reserves to cover the tour operator bankruptcies, erasing all of its first-half earnings. And although the airline receives close to half of its revenues in foreign

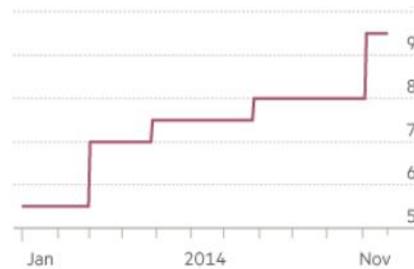
Central bank interest rate
7-day repo (%)

currencies, analysts say it does not benefit from the rouble devaluation the way exporters do. "It would be flying half-empty aircraft without tariff cuts," says Elena Sakhnova, an analyst at VTB Capital.

For the energy and commodities industry, the backbone of Russia's economy, the rouble's fall is a double-edged sword.

It has all but wiped out the profits of some of Russia's largest companies by forcing them to revalue their dollar-denominated debts. Rosneft, the state oil group, reported a 99 per cent drop in net profit in the third quarter, hit by a Rbs95bn accounting loss on its foreign exchange position. Gazprom, the state gas export monopoly, reported a Rbs119bn loss due to foreign currency moves. Despite these accounting losses, the fall in the rouble has brought welcome relief to the resources sector, since export earnings are mainly denominated in dollars while costs are largely in roubles. For example, Rusal, the world's largest aluminium producer, has reported its first positive free cash flow in more than two years.

The weakening of the rouble has gone a long way to offsetting the equally precipitous decline in oil prices in recent months, acting as a safety valve which has helped protect a chunk of the corporate sector as well as the Russian budget from a sudden contraction in revenues.

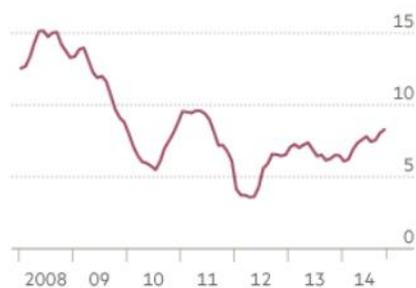


Source: Thomson Reuters Datastream



Inflation

Annual % change in CPI



Source: Thomson Reuters Datastream

"Correlation between oil prices and the rouble rate and the resulting operational 'hedge' of the sector is the largest advantage of the Russian oil and gas companies over international peers," says Mr Karimli.

One of Russian companies' most serious long-term worries is that the rouble slide exacerbates pressures to refinance foreign currency debt, since western sanctions have largely blocked access to fresh dollar and euro funds. As of September, Russian banks and companies had \$614bn in external debt, according to central bank statistics.

Things are particularly complicated for the banking sector, which has largely been cut off from new foreign funding and has little foreign currency earnings. Standard & Poor's, the rating agency, expects that while the sector has enough liquid assets to service its existing foreign currency debt, soaring funding and credit costs will weigh on profits and undermine their capital adequacy over the next year and beyond.

State-owned VTB, Russia's second-largest lender, reported a 90 per cent drop in net earnings for the third quarter because it had to increase provisions for the crisis in Ukraine and deteriorating loan quality at home.

The search for scarce foreign currency funds is driving Russian lenders to compete for corporate dollar deposits. "They are offering rates between 4.5 per cent and 6 per cent," said a banker in Moscow. This compares with 1 per cent interest foreign banks offer Russian corporate clients for dollar deposits.

Other sectors are also vulnerable. VimpelCom and Rostelecom, the telecom operators, are likely to need external funds to repay existing loans, according to Renaissance Capital. Automakers may face a similar problem. And Sistema, the London-listed conglomerate run by recently arrested oligarch Vladimir Yevtushenkov, is "likely to need to borrow to repay", Renaissance said.

So far, Moscow is trying to keep such difficulties out of view. On a website recently launched by state news agency Itar-Tass describing Mr Putin's achievements, the Russian economy is shown in black and white in the 1990s and turning into glorious colour after Mr Putin's arrival.

Echoing this, Vyacheslav Volodin, the president's deputy chief of staff, said last month that Russians understood that "there is no Russia without Putin".

But some among the president's critics think that economic reality could become more important for Russians than the pride Mr Putin instils in them. Among the many buckwheat jokes making the rounds, there is one that puns on Mr Volodin's formula: "There is no Russia without buckwheat."

Additional reporting by Jack Farchy

This is almost like the stories my grandmother told me about the Soviet Union

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Consumers: Leaping on a chance to buy bargain imports

Irina Bychkova, a university student, has little money to spare, but she splashed out on an iPhone last weekend. “I had planned to get one when I visit Munich early next year, but now it’s even cheaper here,” she says.

0.7%

Amount Russia’s economy will contract in 2015, according to BCS Financial

The drop of the rouble, combined with rising inflation, has prompted Muscovites to splurge on durable consumer goods and real estate.

Many foreign vendors have not yet raised prices in Russia to reflect the currency’s recent steep decline, which has made high-end and luxury goods more affordable at home than in Europe for the first time in years.

Russians who often travel to Europe tend to make big purchases there rather than in overpriced Moscow. But Ms Bychkova paid Rbs36,990, or about €648, for her 64GB iPhone 6 – more than €100 below the

retail price in Germany.

Foreign carmakers feel the impact too. While new car sales are falling overall, the rate of decline slowed in October, according to the Association of European Businesses in Russia.

Jörg Schreiber, chairman of AEB’s Automobile Manufacturers’ Committee, says that “the sharp decline of the rouble raising the short-term demand for imported models” is a key reason for the improvement.

Richard Leopold, head of luxury brands at Bentley Russia, estimates the price difference for Bentley cars in Europe and Russia has narrowed from 25 per cent six months ago to less than 10 per cent. “Therefore we see less cross-border trade at the moment.”

But the relief is likely to be temporary. Although retail sales increased by 2.1 per cent last month, experts believe this will drop off as inflation and rouble devaluation eat into disposable incomes.

“From last month, we started feeling that consumers are no longer doing well,” says the Russia head of a European online retailer.

“We have started raising prices, and people try to stick to the brands and quality they prefer but buy less.”

Rbs95bn

The accounting loss on Rosneft’s foreign exchange position in the third quarter

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