Russia's new dawn

Growing construction activity, a recovering economy and stabilising cement production - 2017 marks something of a turn-around year for Russia after years of recession. But the situation is still fragile with much of the economic growth fuelled by oil prices, which remain volatile, and construction increasing in less obvious sectors such as agriculture and healthcare.

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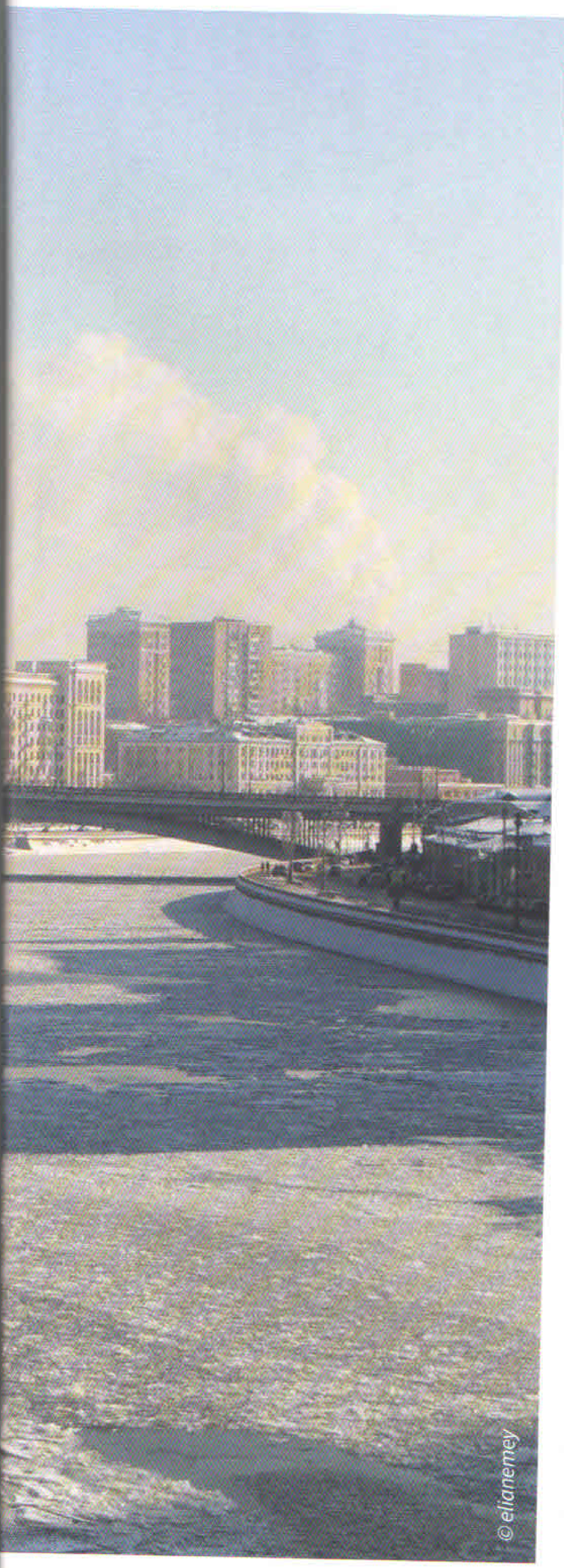
Russia's economic recovery and increase in construction activity could mean a brighter future for the country's cement industry

Following several years of recession, the Russian economy finally stabilised in 2017 with GDP growth of 1.5 per cent, according to the Federal Statistics Service (see Table 1). This compares to a contraction of 0.2 per cent in 2016 and a fall of 2.8 per cent in the previous year. Although the 2017 figure was in line with the Ministry of Economic Development's forecast of 1.4-1.8 per cent, it fell below predictions of 1.7-2.2 per cent growth made by the country's central bank.

Much of the recovery is due to a rise in oil prices, along with an improvement in the country's agricultural and mining industries. The ministry is forecasting the economy to expand by 2.2 per cent in 2018, rising to a possible three per cent by 2020.



Recovering construction sector

Construction output is also showing signs of recovery. After a fall in output of 2.3 and 4.8 per cent YoY in 2014 and 2015, respectively, the rate of contraction is slowing. In 2016 output declined by 4.3 per cent and last year the figure slipped by 1.4 per cent. This will come as welcome news to Russia's cement sector, which has seen consumption slide from 70Mt in 2014 to an estimated 55Mt in 2016, according to The Global Cement Report 12th Edition (GCR12).

Construction output is showing signs of recovery as the economy expands

While total non-residential construction edged up, office building slipped in 2017

Eurocement is Russia's leading cement producer with 16 plants, including its 3Mta Podgorensky works

Non-residential construction

Due to the general economic downturn and decline in investment and business activity, the volume of non-residential building construction began to fall in 2015, noting a decline of 2.9 per cent YoY. This decrease accelerated to 13.9 per cent the following year when the trend troughed as the volume of newly-commissioned office buildings dropped by 28 per cent YoY, shopping centres declined by 19 per cent, and warehouses and industrial buildings contracted by 15 per cent.

2017 recorded a 3.5 per cent increase in overall construction volumes, fuelled by significant growth in the building of agricultural facilities, which rose by 42 per cent YoY, and medical and healthcare facilities, up 10 per cent YoY. However, last year also saw the commissioning of commercial real estate continue to decline, with new office buildings seeing a five per cent drop, while shopping centres fell by 13 per cent.

Residential construction

The decline in residential construction in Russia only began in 2016 with a 6.5 per cent YoY drop but continued into the following year. Last year saw the surface area of residential building construction fall by 2.1 per cent to 78.6Mm^2.

Figure 1 shows a YoY comparison in total residential construction, individual houses (single-flat units) and multi-flat units. The volume of single-flat units began to fall in 2015, a trend which accelerated sharply the following year. By 2016 they accounted for less than 40 per cent of new housing construction, compared to 43 per cent in 2010-14. Last year, however, saw signs of growth in this segment, while construction of multi-flat units continued to decline.

According to the Russian Ministry of Construction, the volume of residential construction is expected to reach 80Mm^2 in 2018 before rising to 120Mm^2 by 2025.

Financing the construction sector

Traditionally, the construction sector in Russia is mainly financed through borrowings. However, the volume of bank loans issued to construction companies declined steadily in 2014 and 2015 by 19 and 33 per cent YoY, respectively, as the central bank rate soared to 17.5 per

Table 1: main indicators of socio-economic development forecast of the Russian Federation, 2018-20

Scenarios used:
'basic' = conservative forecast, 'basic+' = favourable conditions, 'target' = achievement of social and economic targets

Indicator	2016	2017	2018F	2019F	2020F
Urals crude oil (US$/barrel)					
Basic			43.80	41.60	42.40
Basic+	41.70	53.00	43.80	41.60	42.40
Target			36.80	35.00	35.00
GDP YoY change (%)					
Basic			2.1	2.2	2.3
Basic+	-0.2	1.5	2.2	2.6	3.0
Target			0.8	0.9	1.5
Fixed capital investment YoY change (%)					
Basic			4.7	5.6	5.7
Basic+	-0.9	+4.5*	5.7	6.7	8.6
Target			-0.5	1.5	1.5
Industrial production YoY change (%)					
Basic			2.5	2.5	2.5
Basic+	1.3	1.0	2.7	2.9	3.2
Target			1.3	1.5	1.6
Real incomes of population YoY change (%)					
Basic			2.1	1.1	1.2
Basic+	-5.1	-1.7	2.3	1.4	1.7
Target			1.4	0.2	0.6

** Data for 9M17*

cent. By 2016-17 bank credits for the construction industry had risen by 11 per cent annually with the sector attracting bank loans to the tune of RUB1554bn (US$27.4bn) last year alone.

Mortgage loans are seen as another effective source of finance for the Russian construction sector but 2015 saw the value of these tumble by 34 per cent YoY from RUB1.753trn in 2014 to RUB1.158trn following the devaluation of the ruble, rising bank rates and falling incomes. However, 2016 marked a recovery in the mortgage market, supported by a government subsidy programme. As a result, the volume of mortgage loans grew by 27 per cent YoY to RUB1.47trn in 2016. Further growth last year fuelled a steady decline in mortgage rates, which fell from 12.5 per cent in January to 9.8 per cent in December, leading to a 37 per cent advance in the volume of mortgage loans in 2017, exceeding a record RUB2.021trn.

Figure 1: YoY change in the residential construction sector, 2015-17

Cement consumption picks up

Cement consumption in Russia was approximately 55.2Mt in 2017, down 1.3 per cent compared to the previous year (see Figure 2). However, by the 4Q17 significant growth in consumption was seen.

For 2018 consumption of 55-55.5Mt is predicted. The leading cement-consuming segments of Russia's building materials industry demonstrated varying dynamics in 2017 with ready-mixed concrete production's share increasing by 1.5 per cent, dry mortar improving by five per cent, but reinforced concrete products fell by 4.3 per cent. The Ministry of Economic Development expects the building materials industry to see steady growth in production volumes of 2.7-2.9 per cent per year in 2018-20.

Figure 2: change in Russian quarterly and annual cement demand, 2017

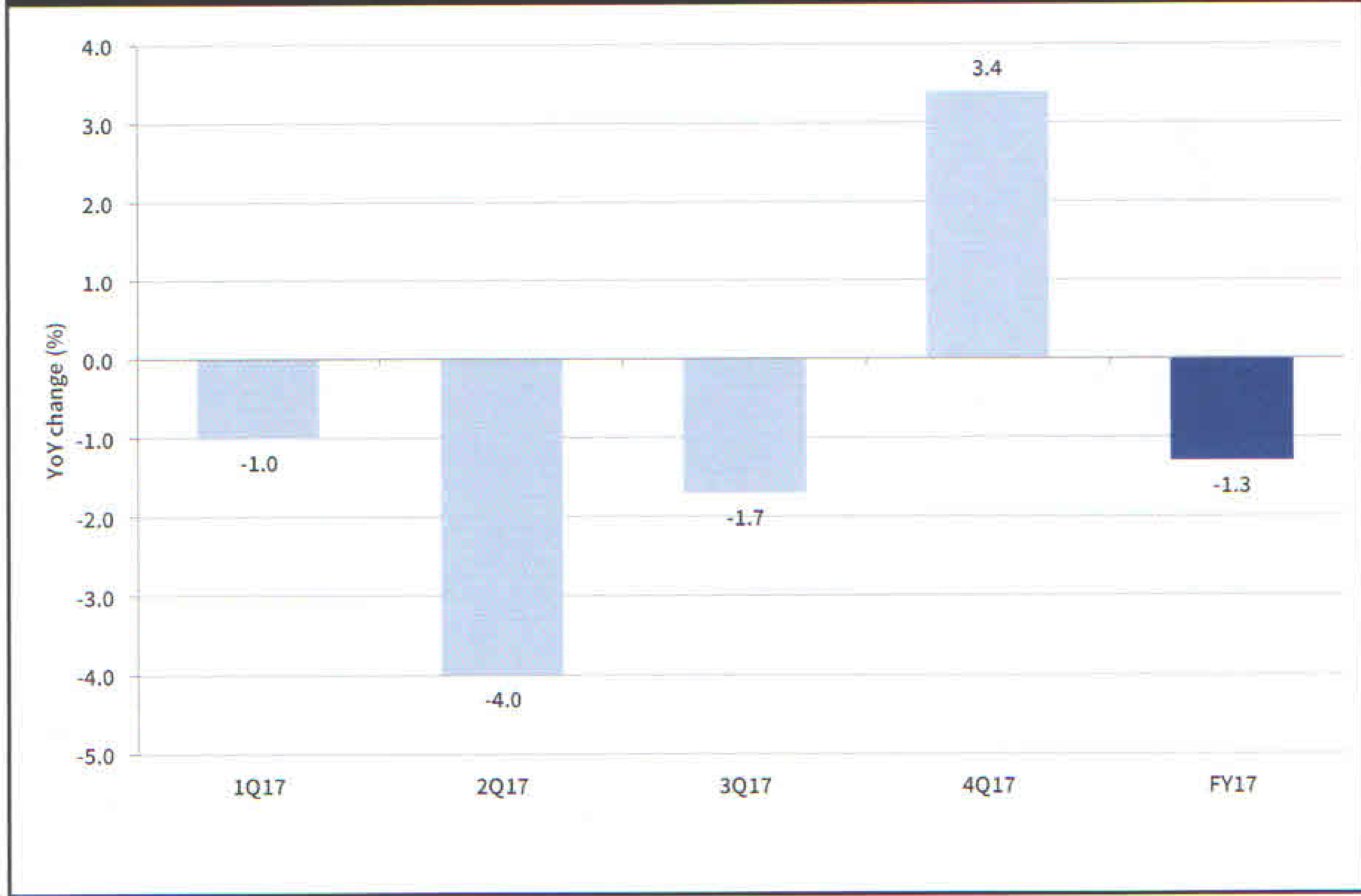


Figure 3: Russian monthly cement production, 2016-17

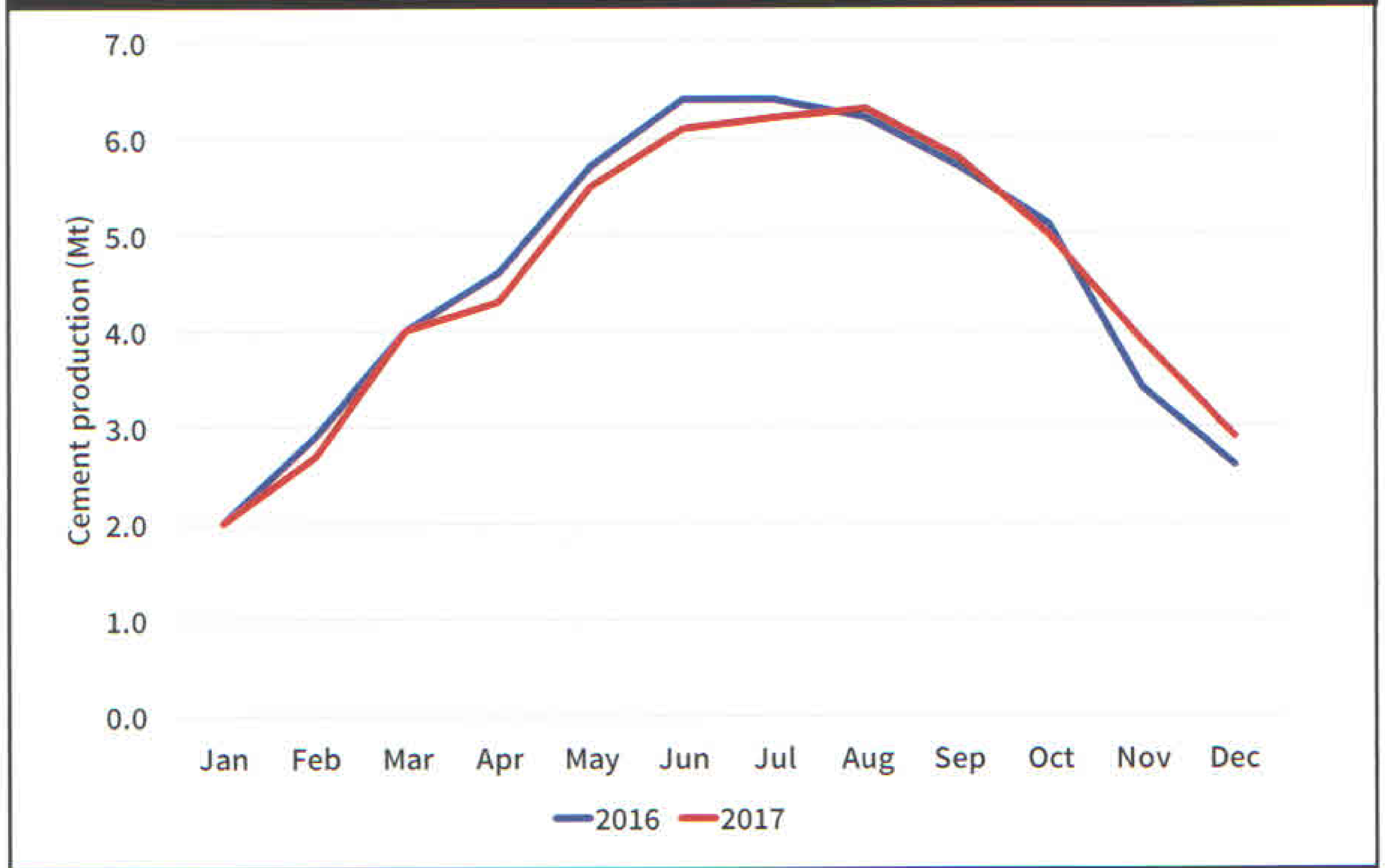
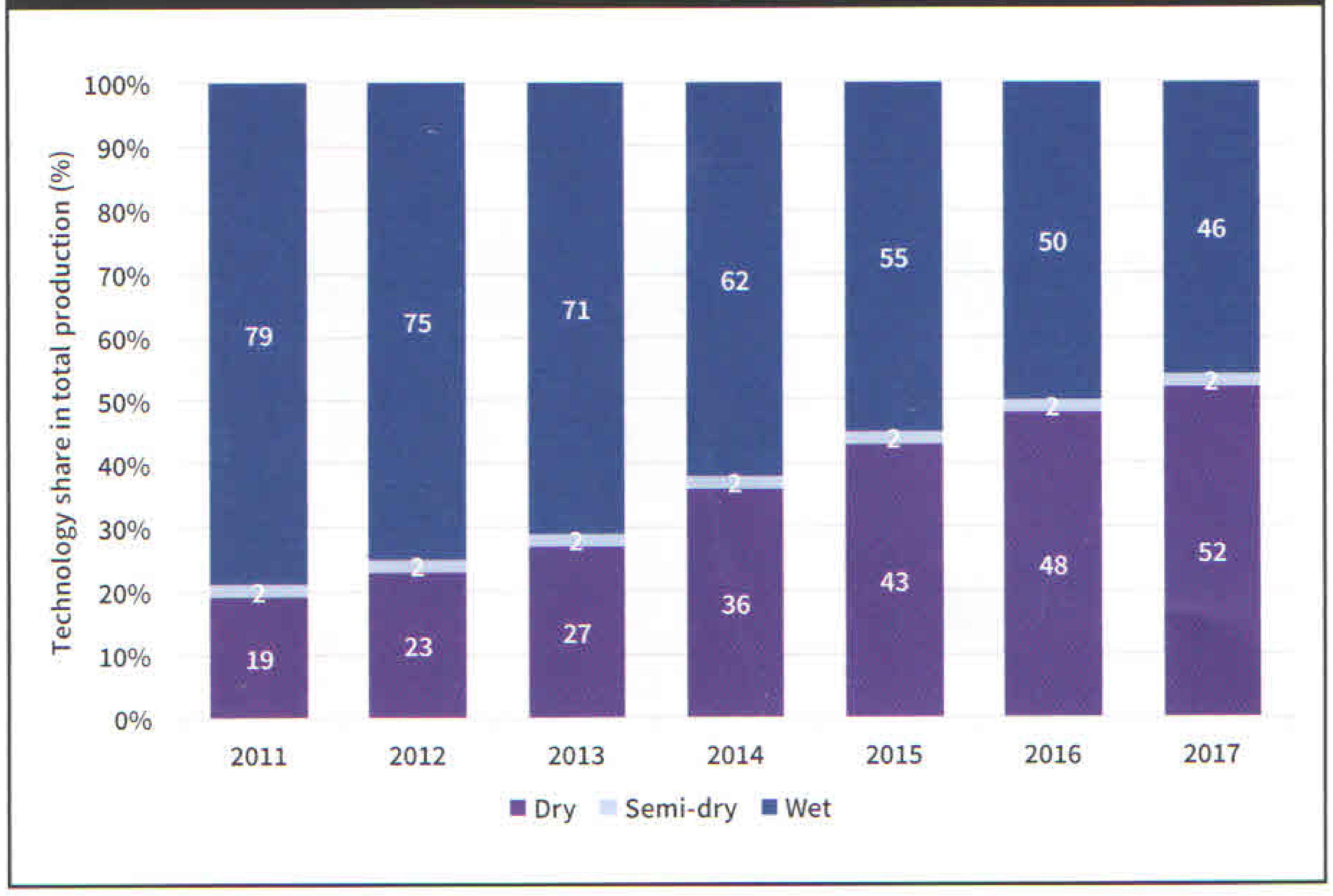


Figure 4: share of cement production by technology type, 2011-17



Cement production stabilises

Following three years of declining production, Russia's cement sector began to stabilise in 2017 with output of around 54.7Mt, down just 0.3 per cent on the previous year (see Figure 3).

However, utilisation rates remain low at around 50 per cent. According to GCR12, Russia is home to 63 cement plants with a combined cement capacity of 108Mta.

Production is dominated by Eurocement, which operates 16 plants with a total capacity of more than 40Mta, accounting for an estimated 40 per cent of the country's total. Other key players include LafargeHolcim, HeidelbergCement and Buzzi Unicem, via its Dyckerhoff subsidiary.

2017 is considered something of a historic year for the sector as it also marks the first time that over half of cement output was produced by dry-process lines. Figure 4 shows the share of cement produced by dry, semi-dry and wet-process technology between 2011-17.

According to the Ministry of Economic Development, Russian cement output is expected to rise by three per cent YoY in 2018 and by as much as 6.2 per cent by 2020.

Declining trade

Russia is also an importer and exporter of cement and clinker, although trading volumes have dropped dramatically in recent years. Imports have declined from 5Mt in 2014 to around 1.7Mt in 2017 as the domestic construction market contracted.

Exports have decreased from around 2.5Mt in 2014 to an estimated 0.8Mt in 2017 as capacity build-up in key markets such as Georgia and Kazakhstan have reduced the need for cement imports by these countries. In addition, Kazakhstan also saw its cement demand fall by over seven per cent in 2016.

Conclusion

While the Russian economy is showing improving signs of stability, much of this is reliant on oil prices. Growing confidence is fuelling an uptick in construction activity although cement consumption growth remains fragile as some sectors, both in the residential and non-residential markets, continue to decline.

In terms of exports, the commissioning of new capacity in Russia's key export markets has reduced opportunities for export growth for Russian cement producers unless they are able to find and tap into new markets. ■