

Southern Russia in 2008: Results!



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The Federal State Statistics Service has published the first results for 2008 broken down by region (www.gks.ru). How did southern Russia fare in the pre-crisis year?

Demography: 16.14% of the Russian population live in southern Russia. At a time when the overall population of Russia is falling (-2.6%), the Southern Federal District (SFD) is still the only federal district whose population is increasing (+1.7%).

Income and spending: In 2008 the increase in household income and spending in southern Russia was considerably higher than the national average: real wages increased by 10.4%, nominal wages by 28.4%, household income by 17.1%, and consumer spending by 23.6%. Despite these results, the population of southern Russia still have to tighten their belts: the average per capita income is almost a quarter less than in the rest of the country (76.01%). Thanks to the rise in household income and the greater formalisation and legalisation of trade operations, southern Russia increased its share of total retail trade in Russia (12.8%). However, its share of total wholesale trade in Russia (6.54%) is almost half the national average. The region's service industry also remains underdeveloped (11.47% of the Russian Federation total).

Labour market: Southern Russia accounts for exactly one third of total unemployment in the Russian Federation (24%). The region adapted to high levels of unemployment earlier than other regions. The number of jobseekers in southern Russia (11.15% of all applications in Russia) significantly outstrips employer demand, but the people of the region have already recognised their capacity for self-employment and setting up their own businesses.

Small business: Southern Russia offers real opportunities for small and medium-sized enterprises to flourish, and the region's SMEs are increasingly acting in strict compliance with the law. Southern Russia's share of the total number of registered sole traders in Russia (20.69%) is more than double its share of the total number of businesses in Russia (9.31%). Southern Russia has a long history of private entrepreneurship, demonstrating its sense of responsibility for its legal economic activities. Although many of the region's businesses are relatively small scale, they are now operating on a legal basis.

Finances: The Southern Federal District improved its financial position in 2008, both in terms of public finance (southern Russia accounts for 9.87% of revenue and 9.66% of spending under the consolidated state budgets) and also in terms of private sector financial performance (5.64% of the net financial result of Russia's large and medium-sized enterprises). Companies have started taking a more responsible approach, running their businesses profitably and in compliance with the law. Ahead of the crisis, companies knew it was important to build up "rainy day funds" so that they could survive the difficult times to come.

Investment: The investment boom in southern Russia continued in 2008 (10.33% of total investment in Russia). Krasnodar Krai and the Rostov region proved particularly popular with investors (3.67% and 2.01%, respectively). Investment in southern Russia is typically more dependent on public finance than is the case in other regions: 31% of investment in southern Russia is state investment, primarily from the federal budget (21.2%). However, in those Federation members where

Results 2008. Key financial indicators (IFRS), RUR millions

	01.01.97	01.01.98	01.01.99	01.01.00	01.01.01	01.01.02	01.01.03	01.01.04	01.01.05	01.01.06	01.01.07	01.01.08	01.01.09
Shareholders' equity	14.9	46.1	41.2	82.8	209.5	413.8	678.3	779.1	1,140.8	2,178.6	4,187.8	5,226.7	5,479.1
Assets	97.2	186.1	252.1	524.9	960.3	1,635.3	3,124.0	5,257.3	8,492.6	13,637.2	23,832.6	39,461.1	50,653.4
Loans and Leases	49.3	84.6	133.4	191.3	515.4	891.1	1,928.0	3,127.2	5,323.6	8,202.2	15,819.7	28,723.3	30,710.7
Customer accounts	55.0	104.7	175.5	362.8	690.5	1,072.7	1,750.2	2,904.9	4,858.7	7,727.1	12,361.0	19,245.1	21,251.7
Profit	0.4	5.7	(4.3)	1.6	(6.8)	3.9	14.2	93.5	131.1	305.7	513.3	700.9	307.5

federal finance is insufficient, schemes are being set up to co-finance investment projects using bank loans and regional budgets.

Industry: There are important advantages to the structure of the industrial sector in southern Russia:

- mineral extraction does not play a very significant role (1.58% of the volume of goods shipped, and labour and services in Russia);
- the manufacturing sector (7.70% of the Russian Federation total) is highly diversified;
- the output of infrastructure sectors (8.75% of electric power, gas and water production and distribution) is sufficient to meet the needs not only of industry, but also of other sectors of the economy. Southern Russia provides a model for the future post-crisis economy of the whole of Russia. It was precisely these sectors that were developing more rapidly in the period preceding the localisation of the global crisis in Russia.

Construction: The construction boom in southern Russia continued in 2008 (10.56% of construction-related work in Russia). This was driven by the construction of a large number of small residential properties (15.35% of new housing in Russia) and social infrastructure (16.58% of new capacity for non-specialist educational institutions, 18.5% for preschool educational institutions, and 14.03% for outpatient clinics). Southern Russia is particularly popular with servicemen and women, who after their time in the armed forces prefer to buy a property under the southern sun (16.09% of all flats purchased in Russia). Judging by the area of residential space purchased, they are also buying larger properties (19.59% of the total area of residential space purchased).

Agriculture: The tremendous growth in southern Russia's agricultural sector (+22.1%) was predetermined by performance in 2007, a very dry year (+0.2%). But we are pleased to note that even allowing for the climatic conditions southern Russia is developing its position as the main producer of all types of agricultural products, both crops (+34.9%) and livestock (+1.8%).

Transport: Southern Russia retains its importance as a transit corridor both for rail transport (8.2% of freight handled), and road transport (4.19% of Russian freight lifted and 8.78% of freight moved).

January 2009: First results

January 2009 was the first month when the real situation could not be concealed behind the successes of preceding periods. As half of January is taken up by the New Year and Christmas holidays and weekends, the growth rate can only be compared against January of the previous year.

This comparison shows that:

- Modern food producers in southern Russia that have managed to retool and that are producing competitive goods saw their output increase 100–150%;
- oil, gas and electric power production remained at more or less the same level as in the previous year;
- there was no great change (+/-10%) in output of the goods in which southern Russia specialises (special equipment for the oil industry, ceramic tiles, electric locomotives, cardboard boxes, mineral fertilisers);
- outdated food producers experienced a sharp drop in output (about 20%);
- production of cement, aggregates and coal fell by 30–40%;
- production of cars, combine harvesters, and agricultural equipment fell by more than 40%.

From this first snapshot of the crisis economy we can anticipate that southern Russia's post-crisis economy will have the following advantages:

- demand for food products will be stable, but these products will be produced at modern enterprises;
- the infrastructure will provide for increased production, but demand for raw materials and components will depend on the Russian economic growth rates;
- machine building will require special finance schemes, as investment in machines (cars, tractors, combine harvesters) has a payback period of several years while the salaries of the workers who build these machines have to be paid straightaway.

In the first month of the new year, the contraction in industry in southern Russia (-15.5%) was less pronounced than in Russia as a whole (-16.0%). The most industrialised regions experienced a sharp fall in industrial output: the Volgograd region (-22.5%) and the Rostov region (-23.8%). In almost all of the regions of southern Russia the downturn in manufacturing was also due to the fall in prices for manufactured goods (-5.5%). The price increases in southern Russia for the production and distribution of gas, water and electric power (21.4%) were in line with the national average (21.5%). However, these government-regulated price increases did not prevent a fall in output by these sectors in physical terms (-7% in Russia as a whole and -6.5% in southern Russia).

In January, construction in southern Russia suffered less of a downturn (-7.4%) than the country as a whole (-16.8%). Although residential housing construction had overtaken other types of construction, southern Russia experienced a slightly bigger fall in demand for housing (-5.3%) than the country as a whole (-4.0%). Krasnodar Krai experienced the most significant contraction in residential housing construction: a 13.6% fall in a booming market.

It was a positive sign that in January the **agricultural sector** in southern Russia produced more fodder (10.2 quintals per head of livestock) than in the previous year (7.7 quintals), and also outperformed the national average (8.7 quintals). This fodder supply demonstrates that the national projects in agriculture in southern Russia are working. As well as crop production, livestock farming is recovering: available resources mean that more of the livestock and poultry populations are being preserved rather than being sold for meat (-10.4%). The milk yield of the cattle population has increased significantly (+4.4%). At this time of crisis, poultry factories in southern Russia are using their competitive advantages and showing an increase in egg production (+8.2%) that is considerably higher than the national average (+5.2%).

In January, **retail trade** in southern Russia grew much faster (+8.9%) than in Russia as a whole (+2.4%): amid the crisis, people in southern Russia have been making purchases of imported goods that they had previously deferred. But the downturn in the wholesale sector in southern Russia (-16.7%) was more pronounced than in the country as a whole (-1.6%). Shortcomings in the development of the wholesale sector will lead to a revival of the "shuttle" trade.

Thanks to the overall strengthening of financial discipline in southern Russia, **wage arrears** did not increase dramatically in January 2009 (+11.5% in southern Russia against +49.0% for Russia as a whole).

Changes in the **consumer price indices** in southern Russia in January reflected national trends: the cost of services went up appreciably (+6.6% in southern Russia and +6.3% across the Russian Federation), food prices increased (+1.6% and +1.4%, respectively), and there was a slightly lower increase in the prices of non-food items (+0.7% +0.8%, respectively). Given that there

has been a fairly serious increase in the cost of the basket of basic foodstuffs (+4.2% in southern Russia and +4.6% across the Russian Federation) then even although in southern Russia this basket costs 8% less than the national average, it can be said that demand has shifted towards cheaper products and that this is precisely the segment in which prices have increased. If this trend continues throughout Russia, then southern Russia will continue to benefit: in terms of the price to quality ratio, southern Russia is producing highly competitive goods for the crisis economy. It is important that southern Russia takes advantage of this opportunity to build up its reserves and construct a post-crisis economy.

A particular feature of the structure of industry in southern Russia is that it consists mainly of production (versus services) and energy, gas and water distribution (the prices for which have increased during the crisis), and this has resulted in regional price increases for industrial output (+0.2%). At the same time, prices in this sector fell in Russia as a whole (-2.7%). In January 2009, prices for agricultural products and construction fell more rapidly in southern Russia than in the country as a whole (-2.0% and -0.5%, respectively, for agriculture, and -1.8% and -0.6% for construction). After several years of price freezes, regulated charges for passenger and freight carriage in southern Russia had to be increased (+29.1%).

The Russian government's anti-crisis measures: focus for southern Russia

The programme of anti-crisis measures for 2009 adopted by the Government of the Russian Federation allows us to assess opportunities to use southern Russia's potential as the crisis continues.

Recently, southern Russia's rate of development has been higher than the national average, and it can be hoped that the economy of southern Russia will be less affected by the general downturn than other regions: the experience of the 1990s has not been forgotten, and at a time of general recession, concerted efforts by the business community and the regional authorities, and cooperation with large federal bodies, will enable the south to retain its potential.

The economy of southern Russia is more diversified than the economy of Russia as a whole. The south is less dependent on oil and gas exports, and in terms of the price to quality ratio, goods produced in the south are particularly competitive during times of economic crisis. In the last few years, the government has provided money for investment to compensate for the insufficient funds coming from southern Russia's underdeveloped banking system and financial market. The new economic environment will require broader application of the practice of co-financing projects by attracting government and private sector investment.

In the light of the anti-crisis programme published by the government, what measures must be undertaken in southern Russia? This is an especially important question as "the package of anti-crisis measures will not only mitigate the negative impact of the crisis, but will also stimulate progressive structural and institutional improvements and promote the renewal of the Russian economy and society".

Social obligations and investment in people. The government has confirmed that it will meet all the obligations that it assumed before the crisis: indexing state benefits, raising pensions, and increasing control over the quality and prices of medicines. But simply having a healthy lifestyle and producing affordable, good quality, safe medicines is just as important. Southern Russia offers unique opportunities for healthy living and for the Russian pharmaceutical industry to become more competitive at an international level.

In anticipation of redundancies, the government is planning training, retraining and professional development for the workforce. This will partly be within the context of developing enterprise and self-employment. The education infrastructure in southern Russia is excellent at all levels. The region has a long tradition of self-employment, and the SME sector in southern Russia is developing rapidly. In addition, it would be wise to make the following training mandatory: all students should be trained in basic skills for entrepreneurs and together with their degree certificate they should receive a registration certificate for their own business. Also, people who are temporarily out of work should receive training in basic computer and Internet skills. This will be particularly useful given that vacancy lists are to be updated weekly via the Jobs in Russia portal.

Southern Russia has a particular appeal for ex-servicemen and women. With considerable life experience behind them, these people could help drive reform in many spheres of the economy of southern Russia, including in the public utilities and municipal services sectors. Center-Invest Bank's experience of financing projects in this sector shows that operating expenses can be reduced by at least 30%.

Retaining and developing industrial potential. Southern Russia does not account for a very large share of Russia's industrial output (6.18%). However, companies that have managed to upgrade their technological capabilities will retain their competitiveness not only in the crisis economy but in the post-crisis economy as well. Agricultural products, southern Russia's main specialisation (24.67% of total Russian production), must be more heavily processed. Special solutions are required for mechanisms to finance machine building in southern Russia (combine harvesters, tractors, hydroplanes, helicopters, electric locomotives, river boats and cars). If the performance of the machine building sector as a whole is to improve, the machine-tool industry must be developed. To this end, international cooperation between equipment suppliers and consumers, and foreign and regional banks will be important. Reduced business taxation, amending budget legislation to permit the use of leasing schemes for state procurement, advance payments under government contracts, and subsidised interest rates will only prove effective if these mechanisms are introduced without delay.

Reducing administrative barriers. Thanks to the crisis, many issues on which discussion had previously reached stalemate have now been resolved:

- the notification principle for starting up a business has been extended to 13 types of business;
- limits have been introduced on the frequency of inspections of small companies;
- tariffs for connecting small companies to power grids have been reduced;
- an obligatory state contracts quota for small businesses has been introduced for both state and municipal institutions;
- funding for regional programmes to support small businesses has been increased.

The effectiveness of these measures can be increased by publicly announcing planned investments to develop a region's social and production infrastructure. Making this information accessible and transparent will force local businesses to revise their plans, be more proactive in generating new ideas, and operate as cost-efficiently as possible. The numerous federal agencies working in the regions should not just be issuing inspection reports; they should also be putting forward proposals for the development of enterprise in the region.

Making the national financial system more stable. Ultimately, this crisis will radically change the existing model of global and national finance. The most critical phases of the financial collapse are already behind us, and at this stage it is important that we restore not only individual institutions, but also the financial system itself: money circulation and interbank lending mechanisms. In particular, banks that have received state assistance should make at least 10% of these funds available on the interbank lending market. Lower interest rates on the interbank market will result in lower interest rates and reduced risks when lending to the real sector of the economy in the regions.

Macroeconomic policy. The Russian government's anti-crisis measures should provide social stability, stimulate internal demand, and also support the ruble exchange rate, low inflation and an "acceptable" budget deficit. At the same time, these objectives can be achieved by reducing taxes, cutting public spending, and redistributing resources through the budget. Reduced taxation will allow effective companies to retain working capital instead of this money being used to support ineffective managers and owners. Steps in this direction will be taken as the crisis develops. It is reassuring that the government has postponed non-priority public spending, the ruble exchange rate has already changed "smoothly", and tariffs are to be regulated more carefully. If all these measures have the anticipated effect, southern Russia will be able to fully realise its potential as a food producer; provided that it further develops its transport and logistics infrastructure, the region will be able to satisfy internal demand, proving affordable goods for various social groups, and with minimal pressure on the public purse.

Regional aspect to the anti-crisis measures. Although the federal government is to co-finance anti-crisis measures in the regions, regional authorities must also make the best use of their budgets. It is important that the authorities at different levels are willing to enter into dialogue to agree specific actions to provide employment, support the agricultural, construction and SME sectors, and attract investment. For southern Russia, with respect to developing the region's social and engineering infrastructure, it is especially important that it is "singing from the same hymn sheet" as both the federal authorities and investors.

Southern Federal District as a % of the Total for the Russian Federation	2004	2008	+/-
Population	15,91	16,14	+0,23
Working population	13,07	13,36*	+0,29
Household income	10,08	12,27	+2,19
Household expenditure	10,48	13,67	+3,19
Nominal wages	9,04	9,07*	+0,03
Gross regional product	7,77	7,23*	-0,54
Fixed assets	9,30	8,72*	-0,58
Industrial production	5,06	6,18	+1,08
Agricultural production	22,71	24,67	+1,96
Total area of new housing	14,19	15,35	+1,16
Retail sales	11,05	12,80	+1,75
Net financial result (profits minus losses)	2,64	5,64	+3,00
Loan volumes	4,32	5,60	+1,28
Investment capital	8,74	10,33	+1,59

* 2007

Indices of growth in 2008 as a % of 2007	Russian Federation	Southern Federal District
Industrial output	102,1	103,4
<i>Construction</i>	112,8	112,3
Residential housing	104,5	104,4
Retail sales	113,0	116,5
Service industry	104,9	108,3
Agricultural production	110,8	122,1
Investment in fixed capital	109,8	111,2
Real household income	105,0	110,4
<i>Real wages</i>	110,3	111,6
Number of unemployed	104,4	87,8
Birth rate	106,7	107,2

All this "harmonisation" will require of the local authorities and business community is that they study the government's anti-crisis measures thoroughly and carefully and bring business processes in line with the demands of the new environment.

Macroeconomic policy reflects the priorities of the politicians themselves. Political stability is a development priority for southern Russia, and one to which all the regional leaders are now committed. The federal government obligations listed in the anti-crisis programme do not leave southern Russia any opportunities to maintain social stability, stimulate internal demand, and retain economic growth rates apart from the "innovative scenario" for the development of each economic sector. Therefore, the regional elite should view the Russian government's set of anti-crisis measures as the very minimum that is required to support stability in the region and as a starting point for building the post-crisis economy of southern Russia. While in autumn of last year a fall in demand for goods and services of less than 30% was considered a success, in the post-crisis economy the only businesses that will survive will be those that reduce their costs by at least 30%.

Complete list of Dr. Vysokov's publications: www.centriinvest.ru/ru/pub.html



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