

Structural Challenges To Growth Become Binding



Russia Economic Update
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Russia Economic Report No. 30

1. Recent Economic Developments
2. Outlook and Risks
3. Volatility, Firm-Survival and Diversification in Manufacturing



Main messages



1

Russia's economy lost steam in 2013 on account of weaker demand

- World Bank projects a growth rate of 1.8 percent in 2013.
- External demand: Oil prices retreated and stabilized below US\$ 100/bbl, global trade lost momentum
- Domestic demand: Investment activities tapered sharply, consumption expanded at a much slower pace

2

Russia's growth prospects will increasingly depend on addressing structural constraints

- World Bank projects 3.1 percent growth for 2014.
- Economy growing near current potential; non-tradable sector growth does not compensate anymore for growth weakness in tradable sectors
- Structural challenges become binding

3

Russia's past growth volatility impacted the structure and diversification of the economy

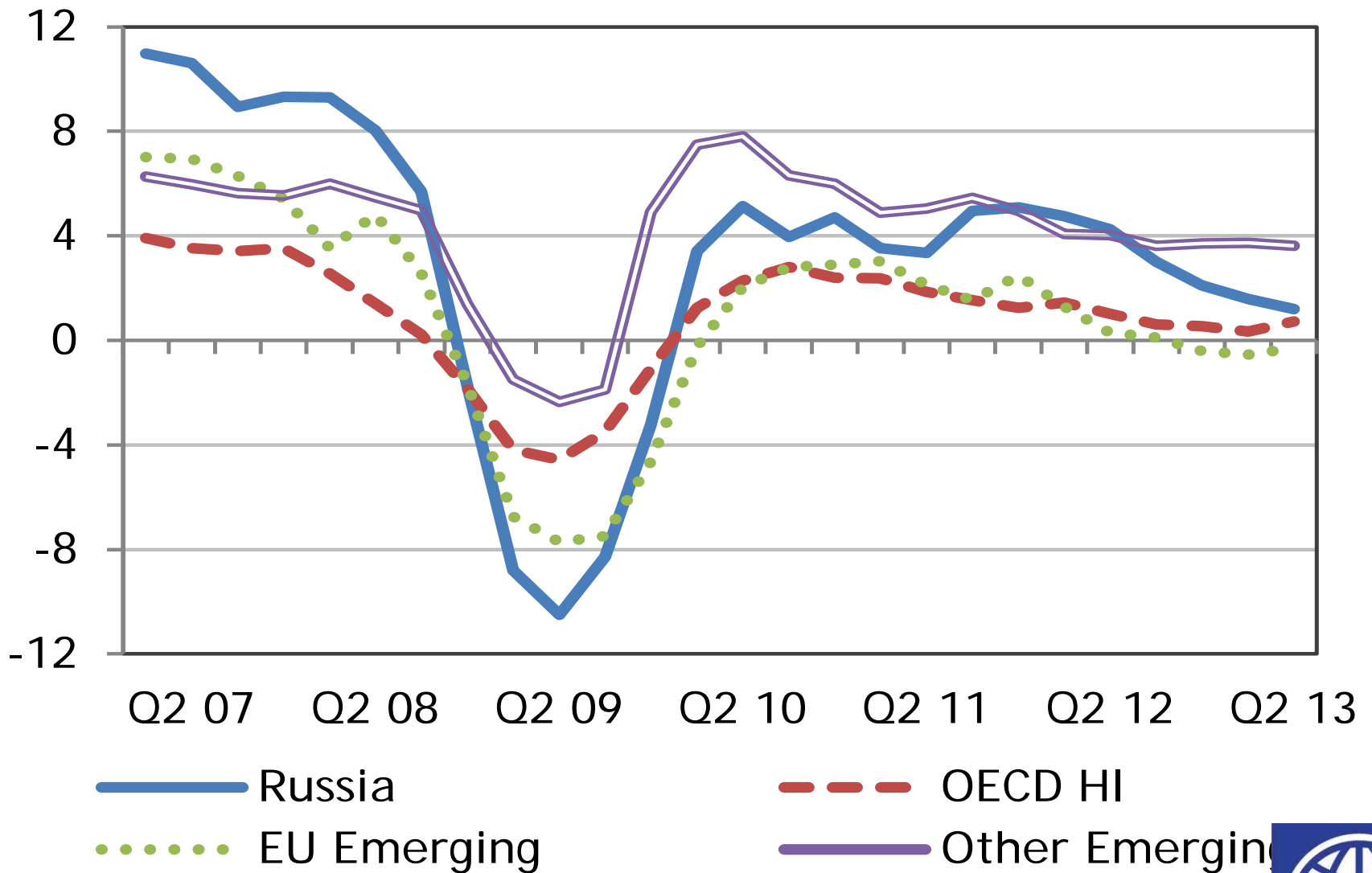
- The structure of manufacturing in Russia is different; volatility in manufacturing output growth is different and slumps are different
- A vicious cycle of concentration and volatility

4

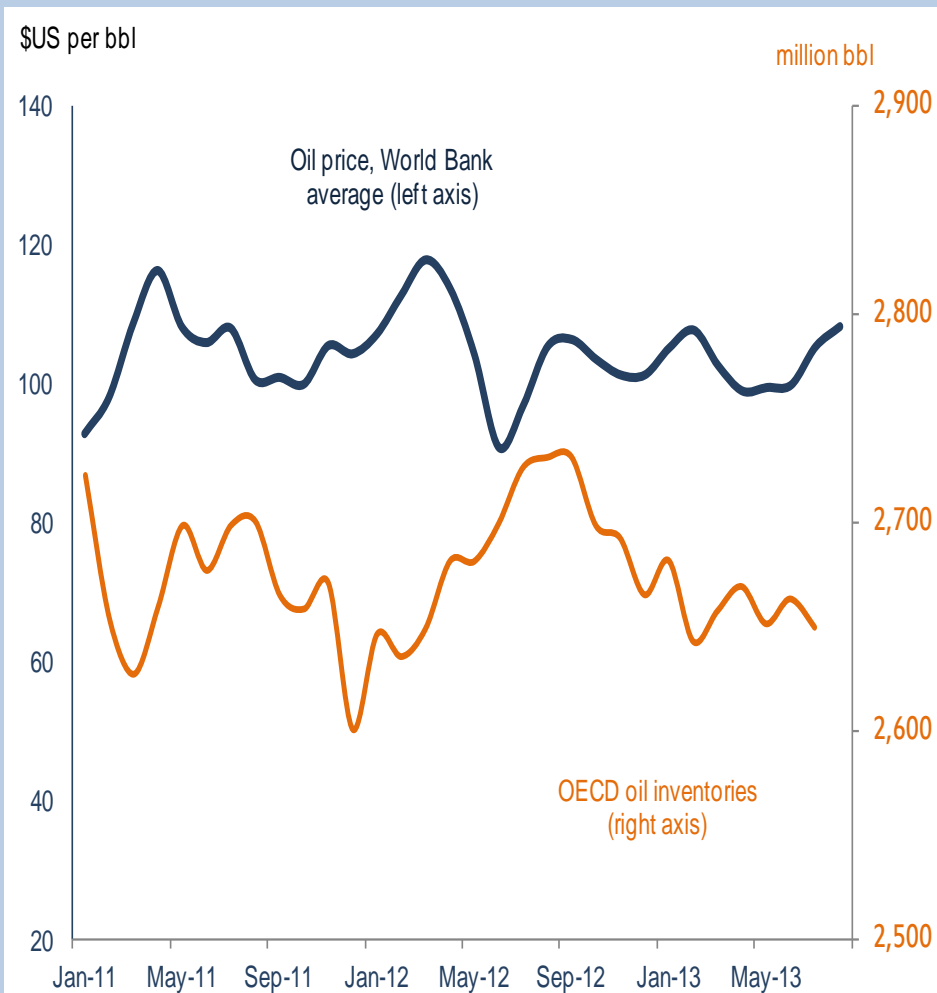
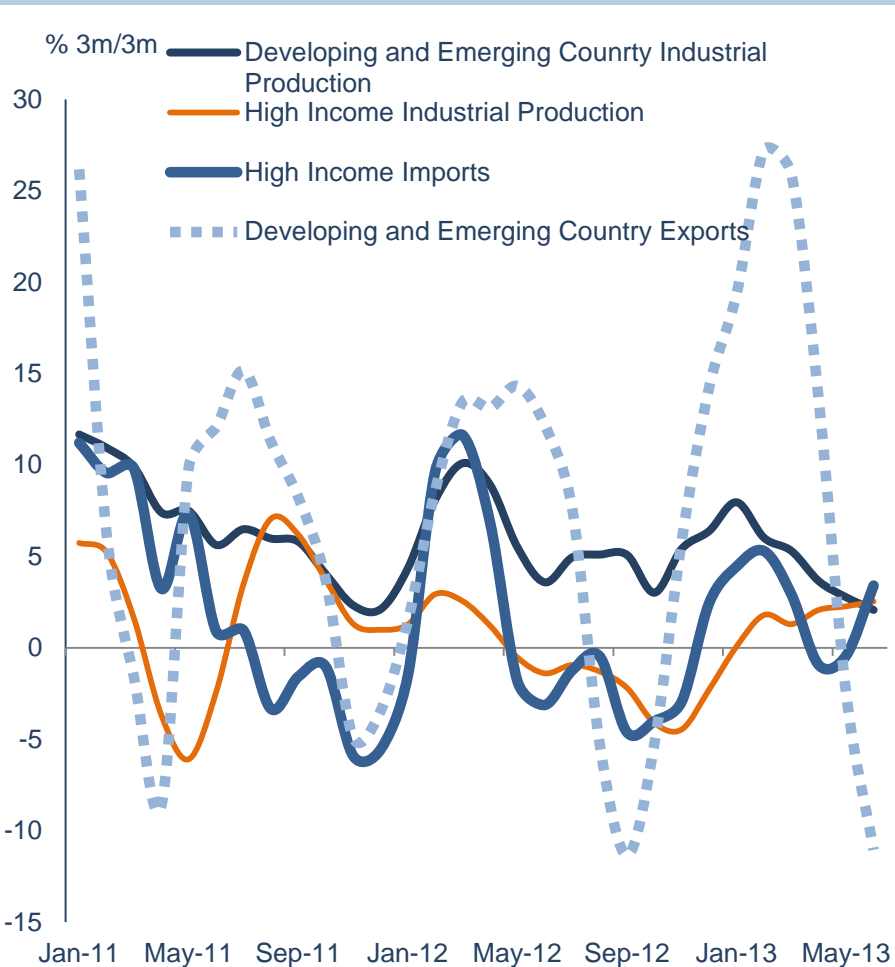
Economic structure and diversification would benefit from more competition

- Do slumps push out less efficient firms in Russia? The old, less efficient and, in concentrated sectors, the unproductive survive.
- Key recommendations: Promote competition to support diversification and better targeting of SME programs

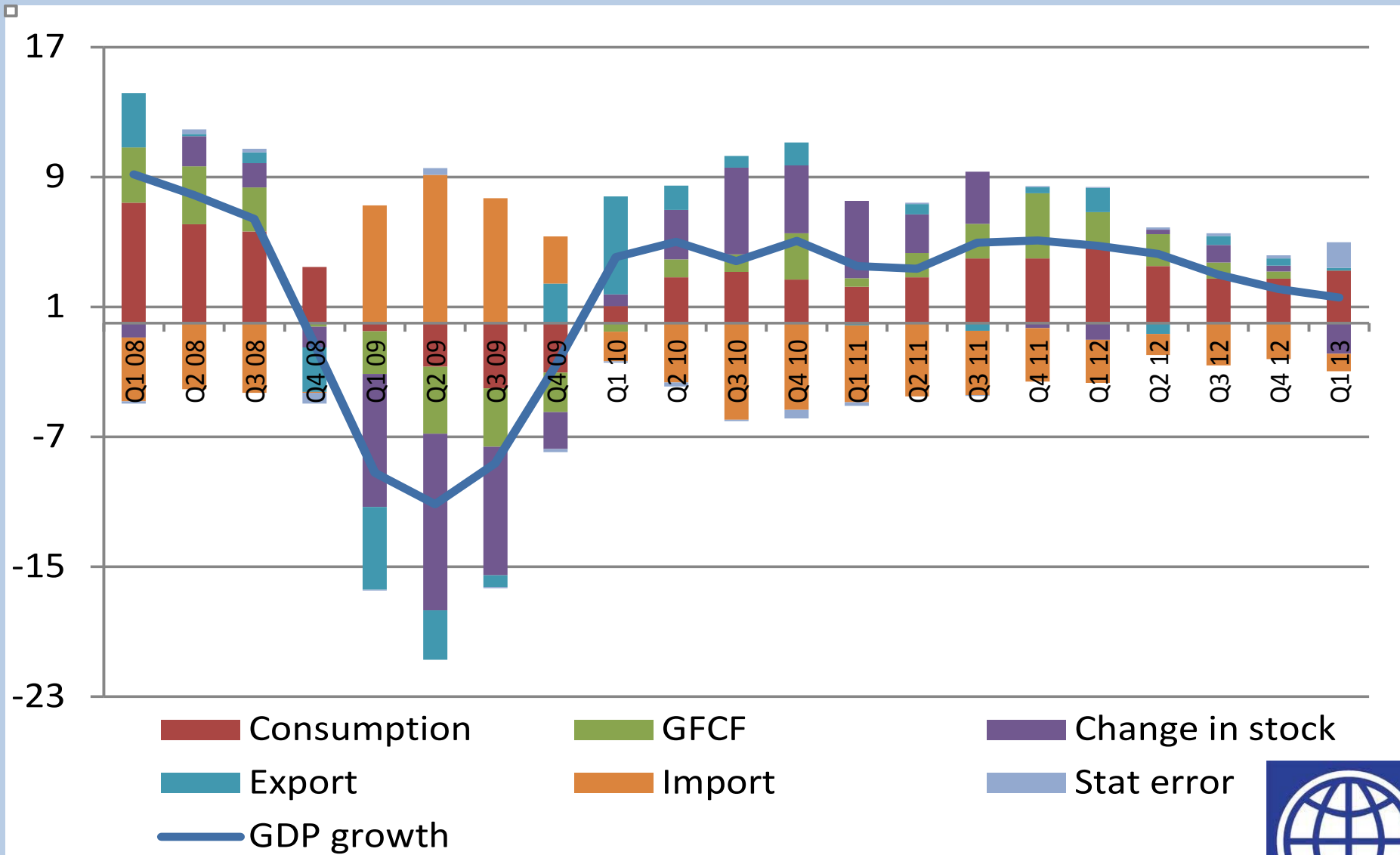
Russia's Growth Slowdown



→ (1) Weak External Demand



→ (2) Stalling Domestic Demand



Fiscal Impact: Pressure to Consolidate

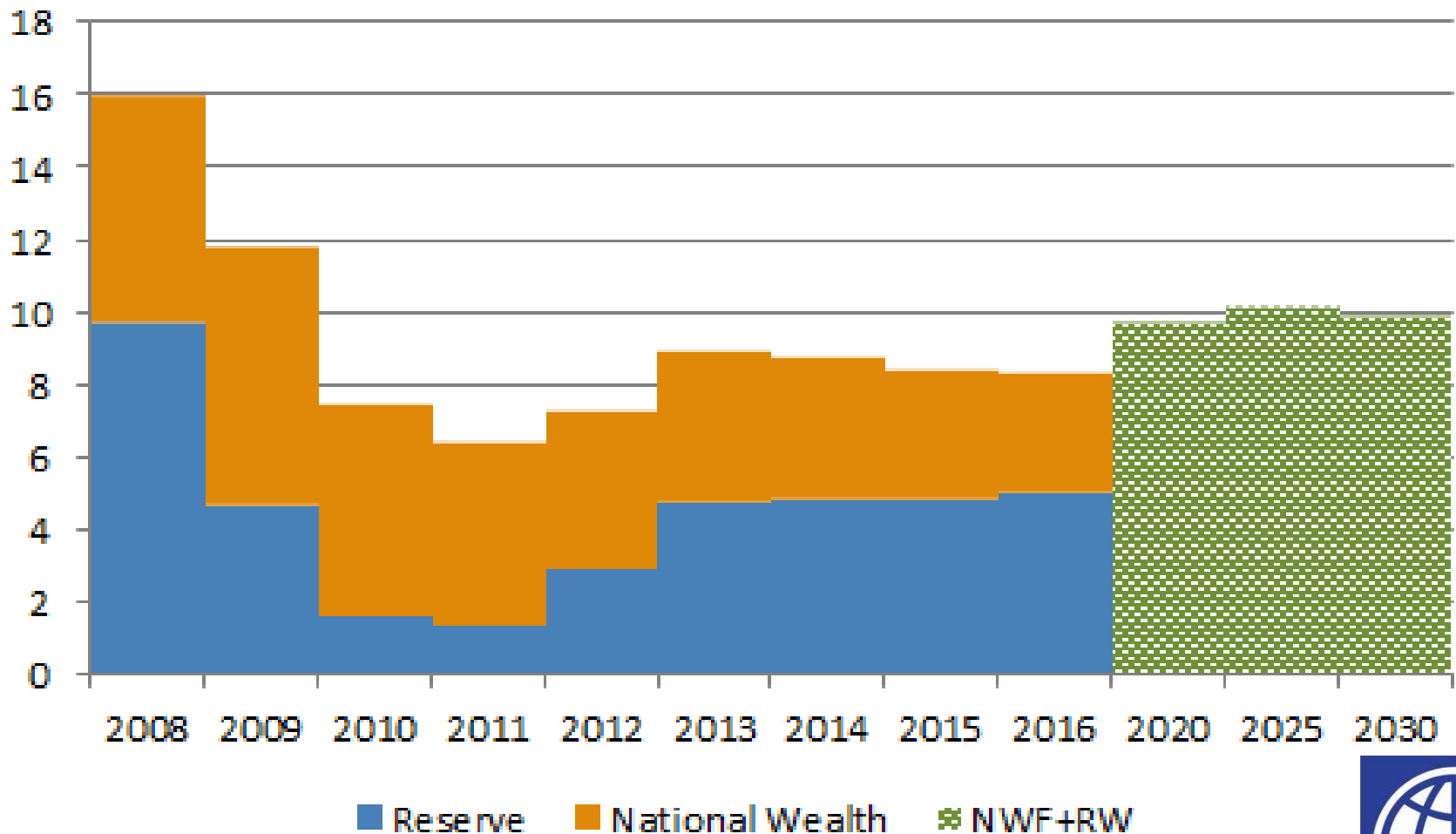
% of GDP	2012	H1 2012	H1 2013*	2013
	Actual	Actual	Actual	Estimate
Federal Budget				
Expenditures	20.6	20.9	19.1	19.8
Revenues	20.5	21.8	19.8	19.3
Balance	-0.1	0.9	0.6	-0.5
Consolidated Budget				
Expenditures	36.6	34.6	34.7	37.6
Revenues	37.0	38.5	36.4	36.9
Balance	0.4	4.0	1.7	-0.7
Consolidated Subnational Budget				
Expenditures	13.3	12.1	11.8	13.0
Revenues	12.9	13.5	11.8	12.7
Balance	-0.4	1.4	0.0	-0.3

* data for January - July



Fiscal Buffers below Pre-crisis Level

Reserve and National Welfare Funds in 2008-2030, % of GDP



Moderately Positive Growth Outlook

What Are Future *Growth Sources* and *Risks*?

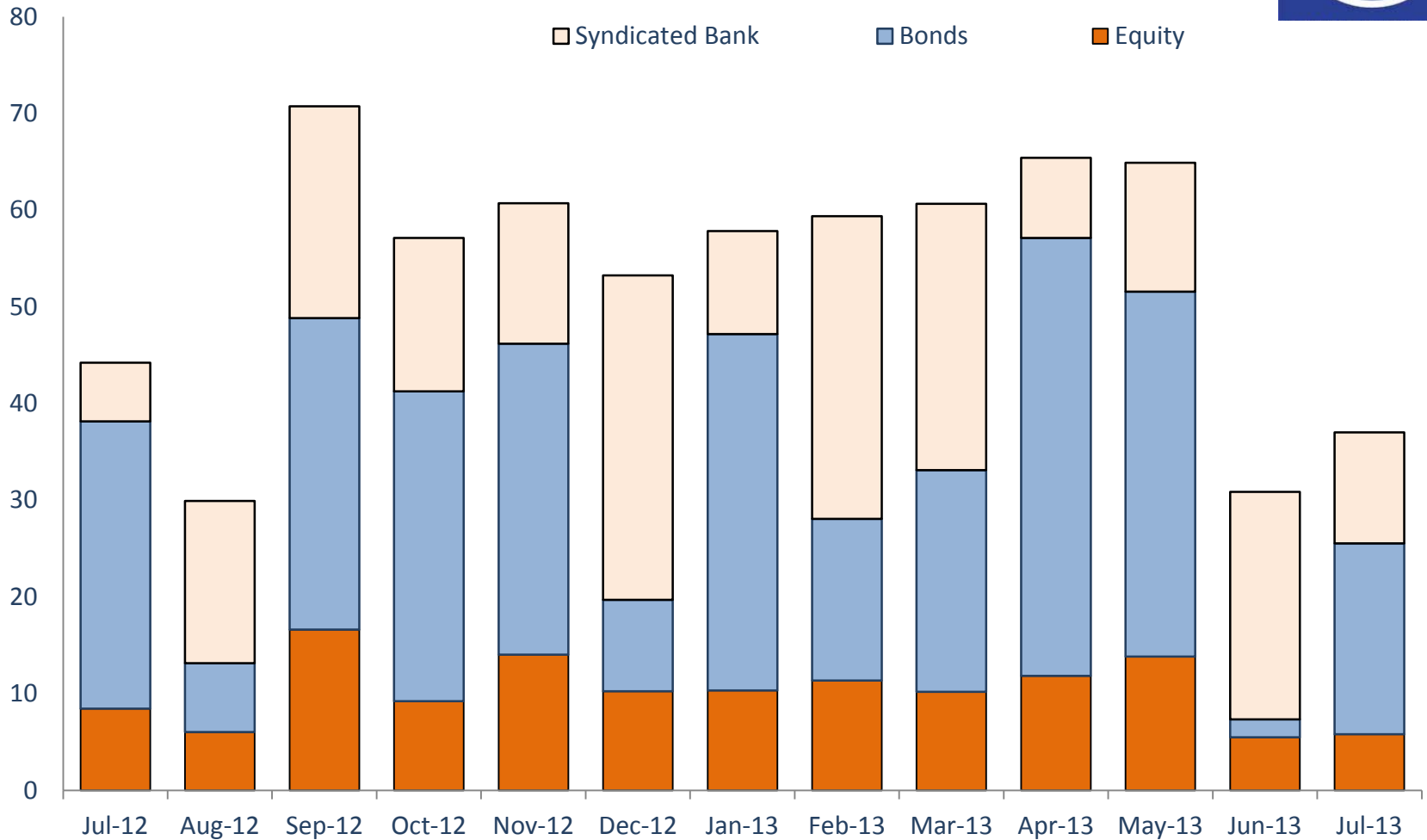
	2008	2009	2010	2011	2012	2013f	2014f
World	1.4	-2.2	3.9	2.8	2.5	2.4	3.2
High Income	0.1	-3.5	2.8	1.7	1.6	1.3	2.1
Developing and Emerging Countries	5.8	1.9	7.3	5.9	4.8	4.9	5.5
Euro Area	0.3	-4.3	1.9	1.5	-0.6	-0.5	0.9
Russian Federation	5.2	-7.8	4.5	4.3	3.4	1.8	3.1



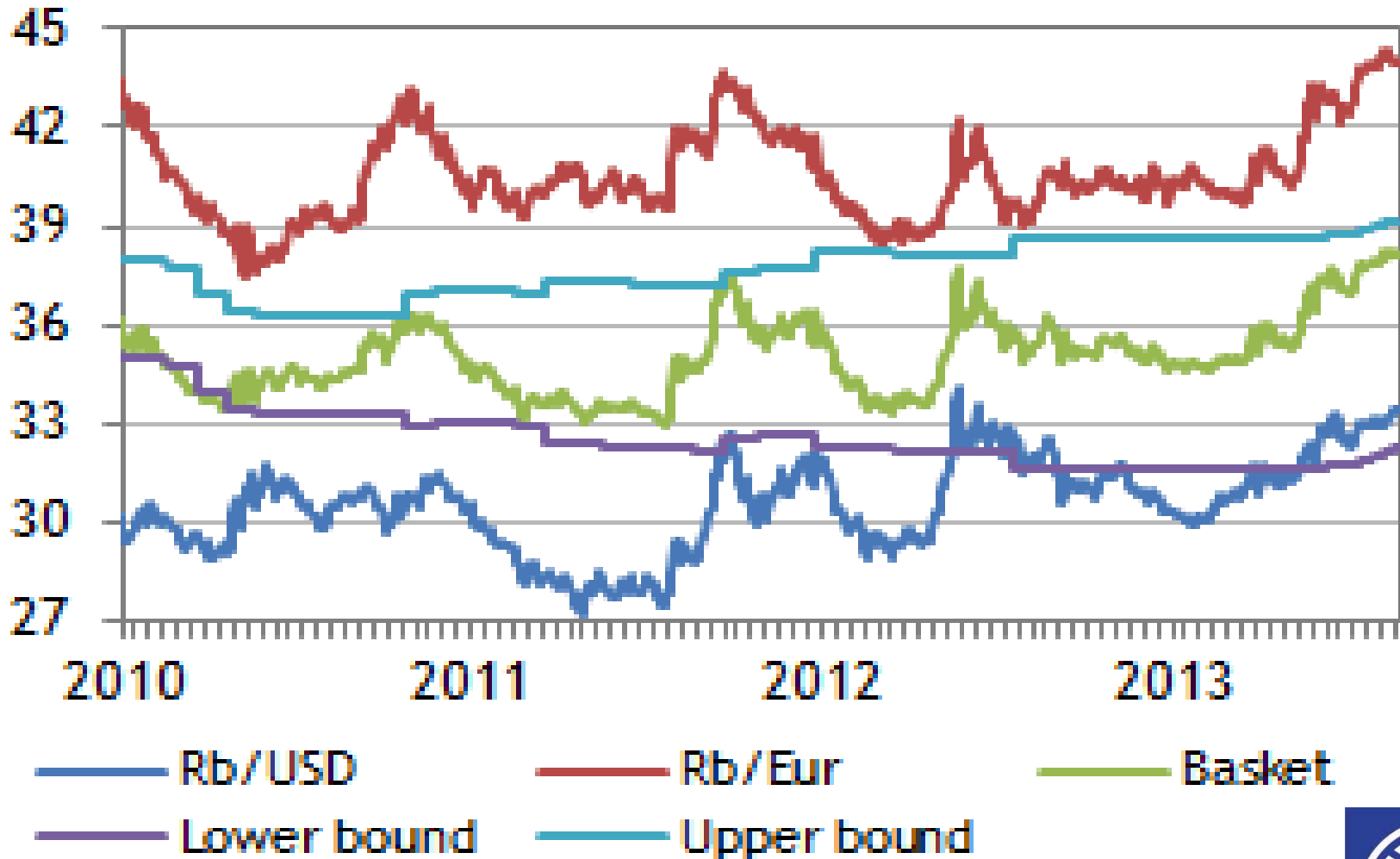
Risks: Tighter Financial Conditions



\$bn Gross capital flows to developing and emerging countries

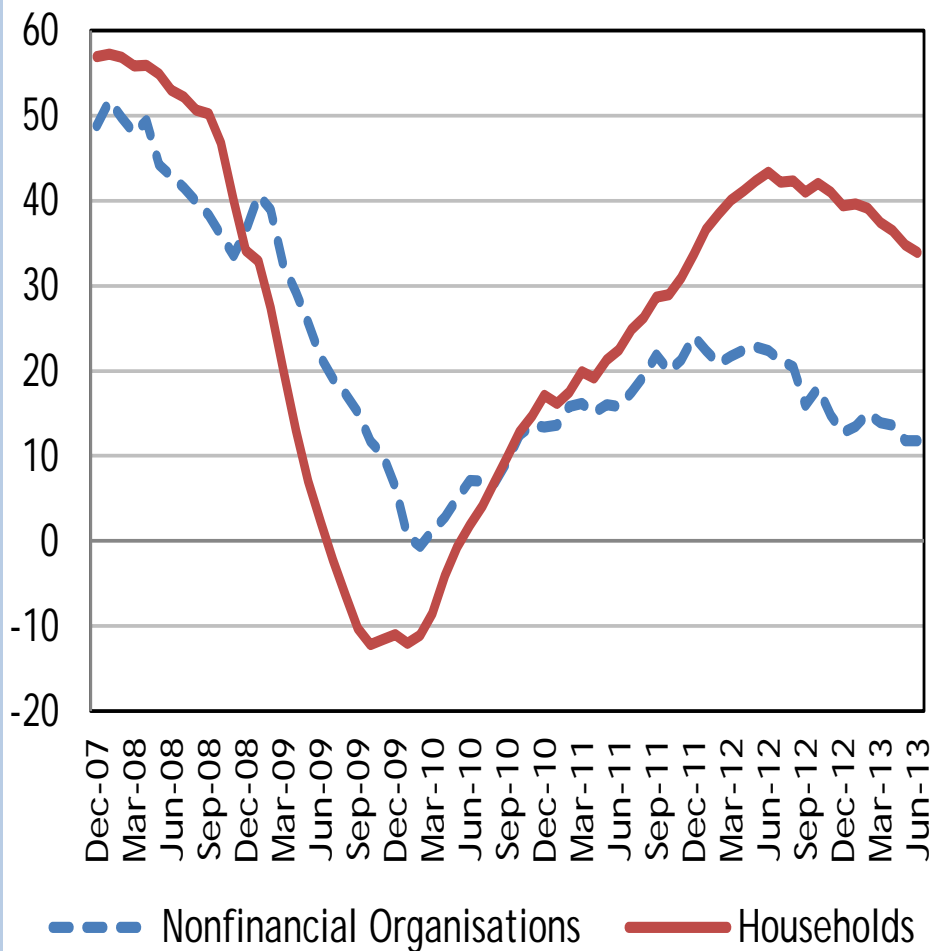


Increased Currency Risk

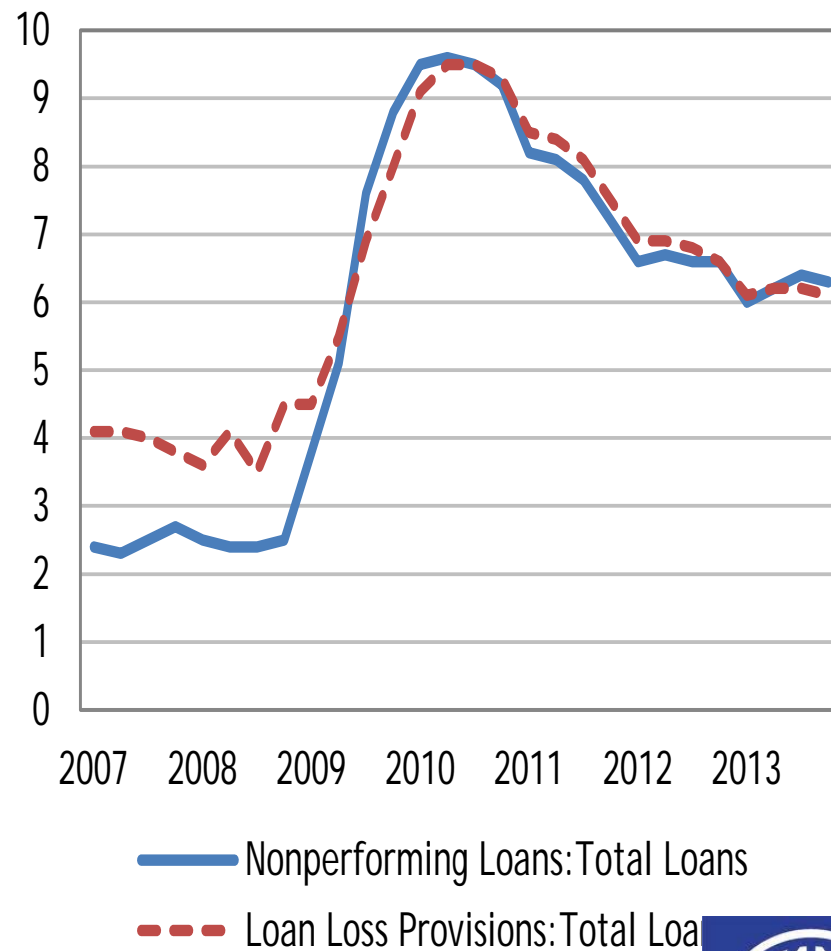


Credit and Increased Market Access Risks

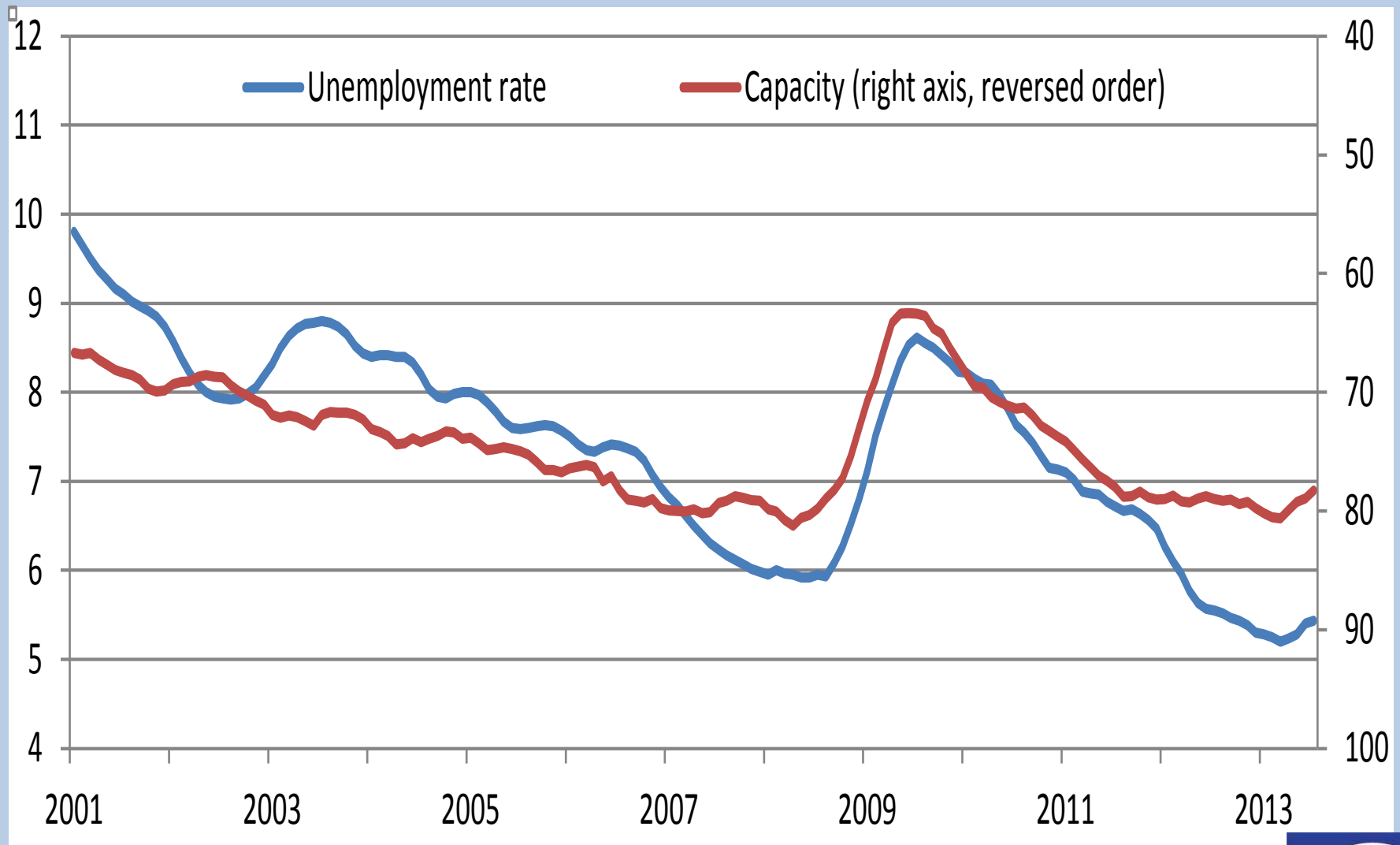
Credit Growth (percent, y-o-y)



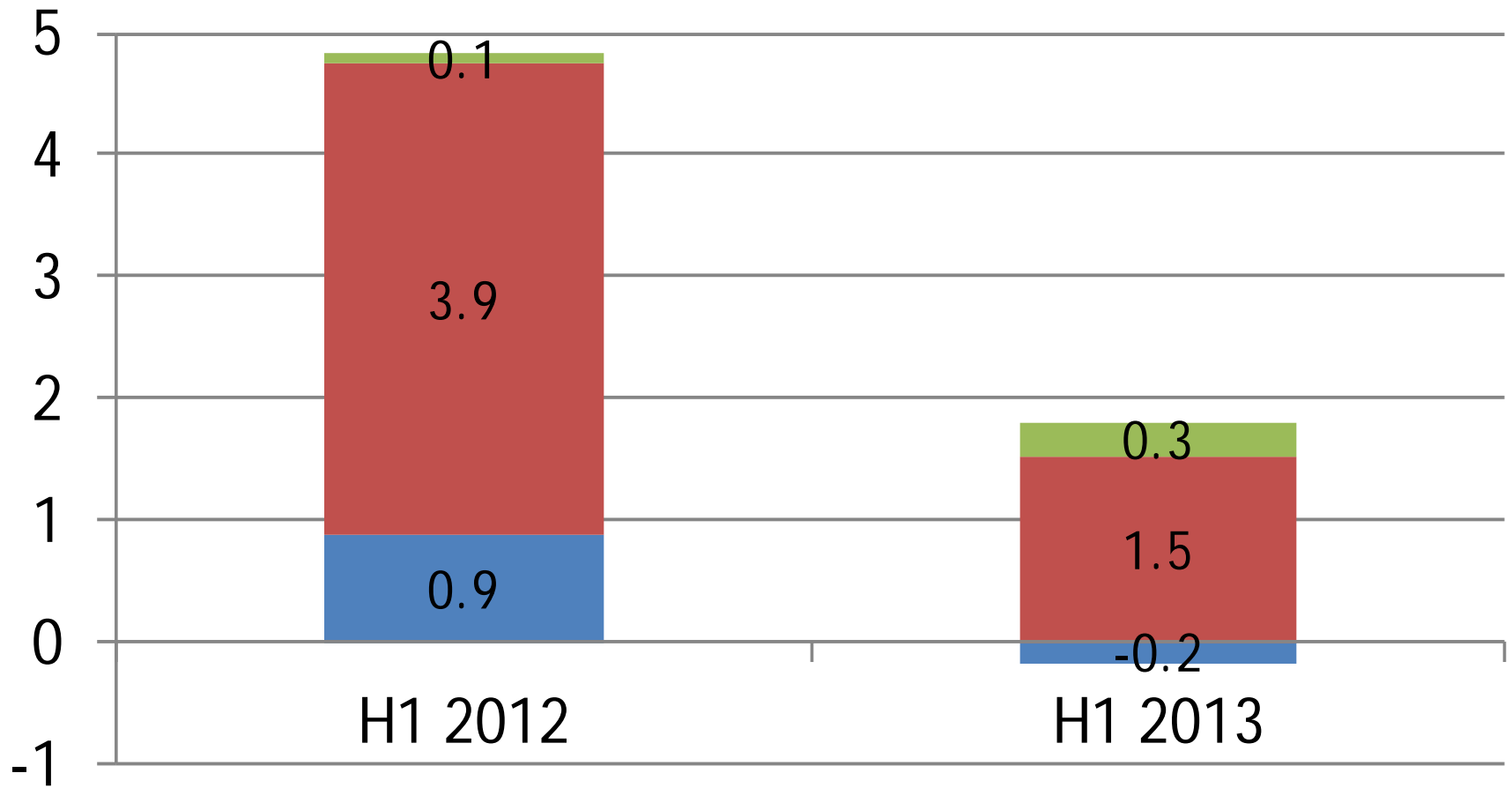
NPLs and loss provisioning (% of loans)



Sources of Growth: Growing at Potential?



Sector Composition of Growth



■ tradable ■ non-tradable ■ public sector



Russia's Future Growth Model?



Past growth model focused at stimulating domestic demand.



Structural challenges become binding constraints.



Overcoming structural challenges would need to constitute an important aspect of growth-stimulating policies to lift Russia's growth potential.

Special Focus Note

Volatility in Russia: Obstacle to Firm Survival and Diversification in Manufacturing





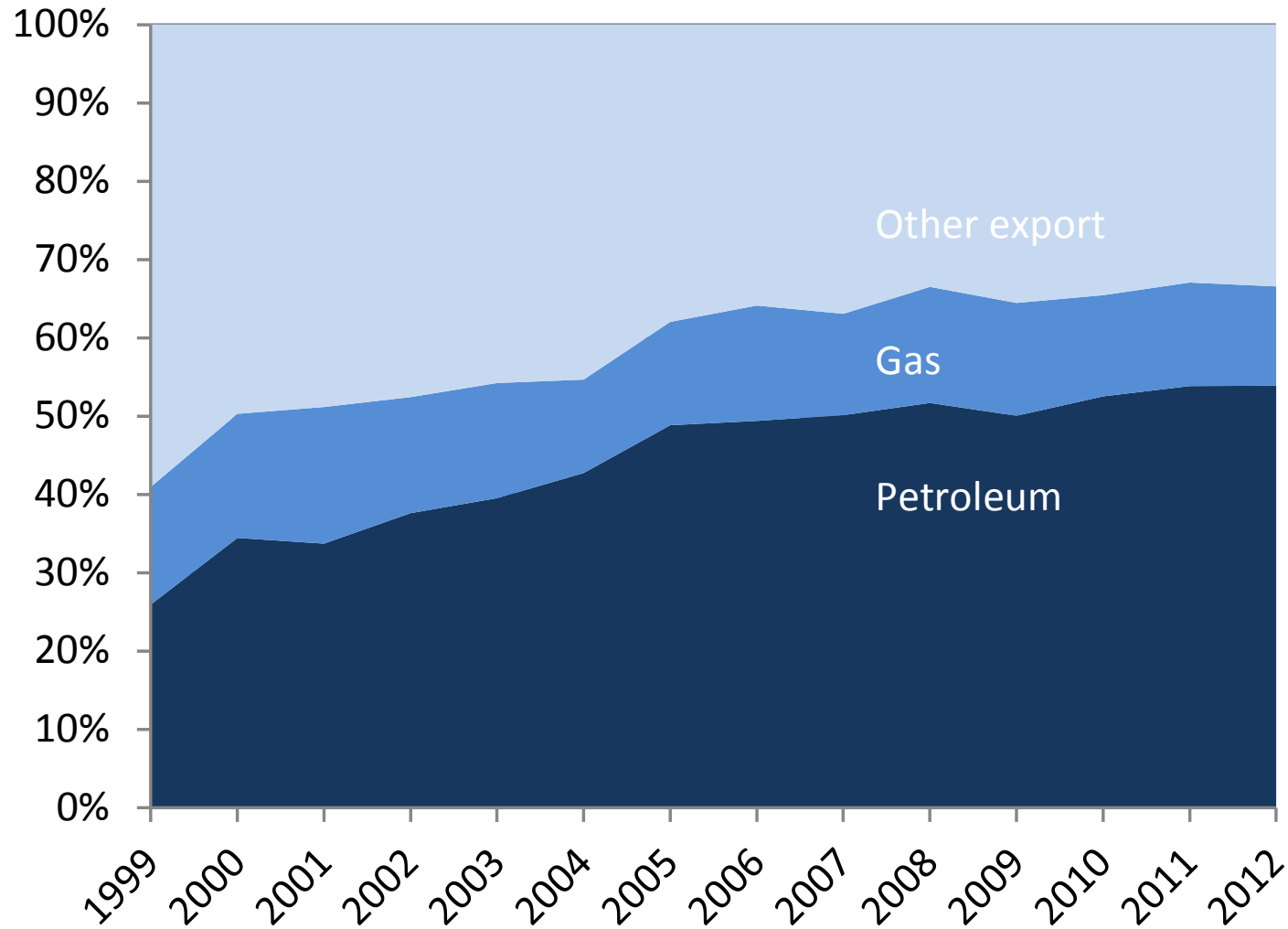
Volatility in Economic Growth and Its Effects

Past economic growth in Russia has been volatile with consequences on the structure and diversification of the economy:

1. The structure of manufacturing in Russia is different.
2. Volatility in manufacturing output growth is different in Russia.
3. Slumps in Russia are different. Surges are not.



Petroleum and gas dominate Russia's exports



Source United Nations, Comtrade, retrieved September 25, 2013



Output is concentrated in a few manufacturing sectors and a few firms in Russia

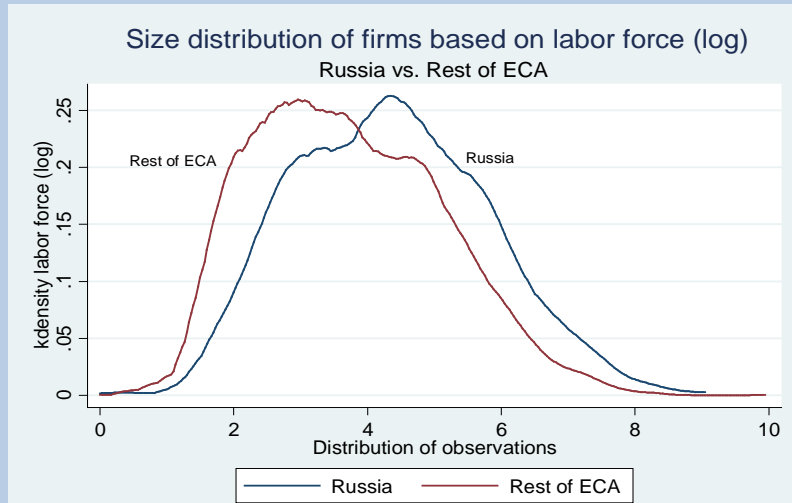
A vicious cycle: Does concentration exacerbate volatility and does volatility induce more concentration?

- The bottom quartile of sectors contribute 0.6 percent of total manufacturing output. The top quartile contributes 80 percent.
- The bottom quartile of firms contribute is 0.06 percent of total manufacturing output. The top quartile contributes 94.7 percent.



The Russian economy is dominated by larger firms

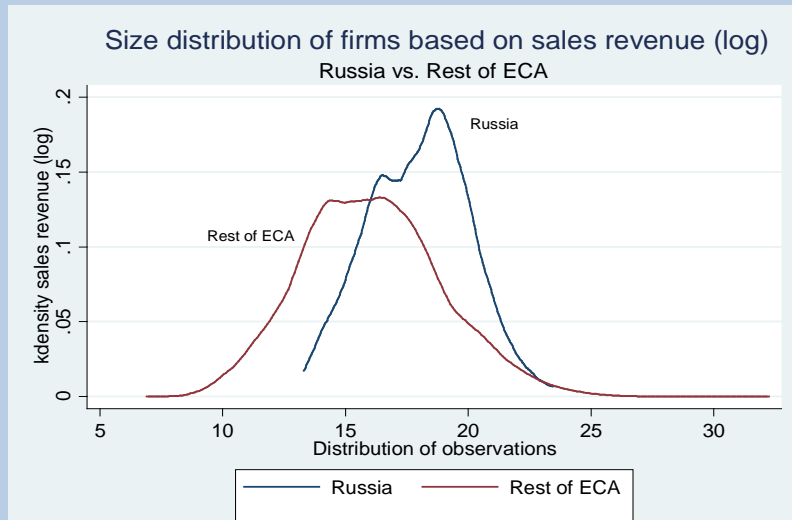
Size distribution of firms by labor force and annual revenue



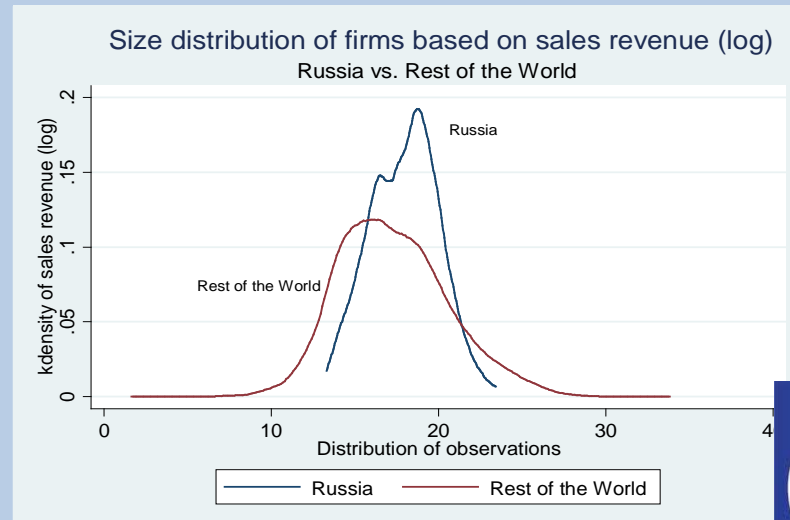
Source: Enterprise Surveys comprehensive dataset (May 2012)



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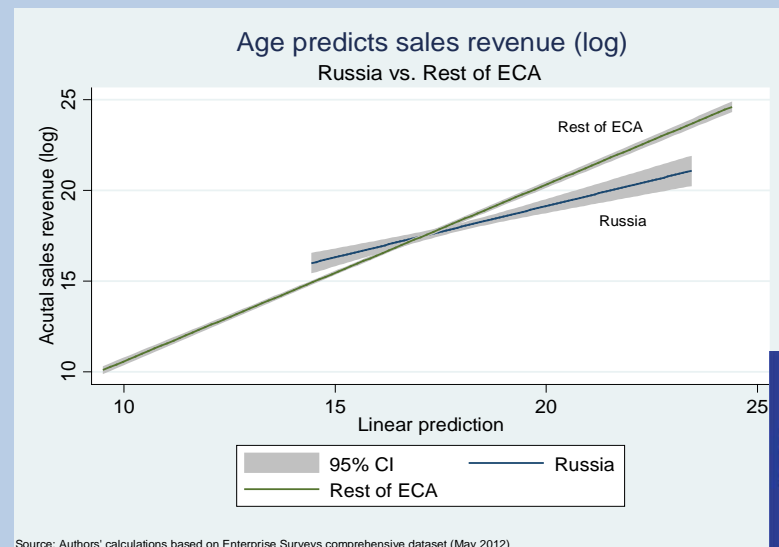
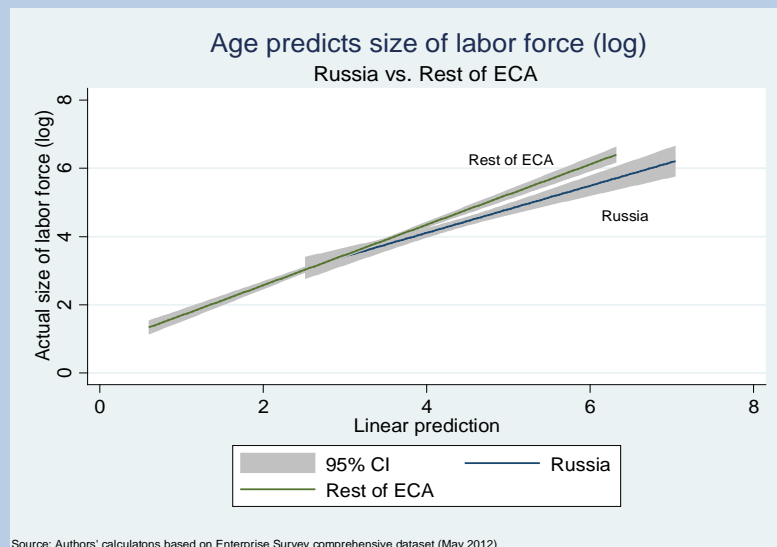
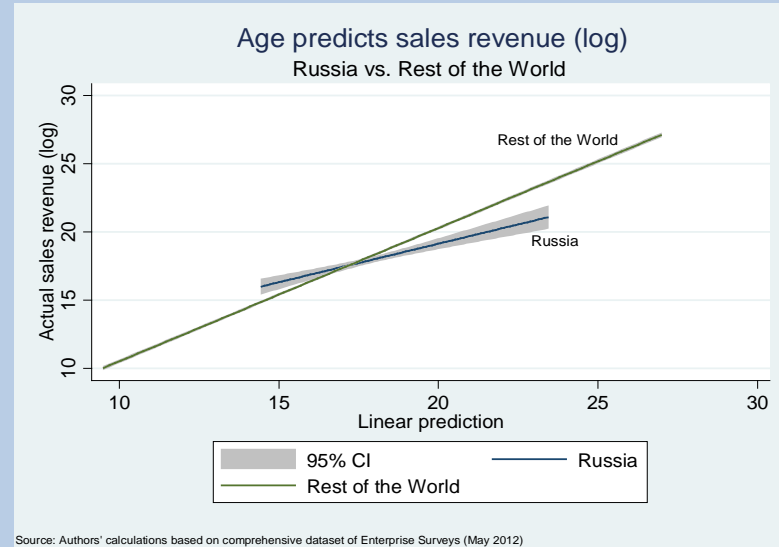
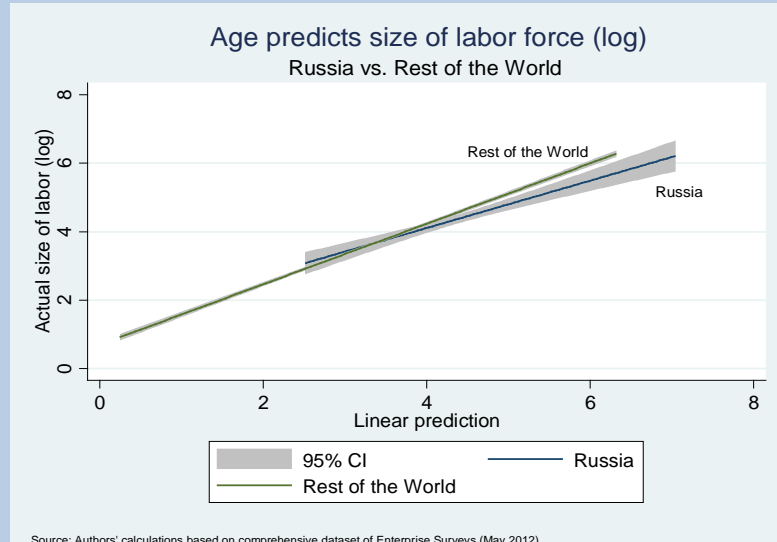


Source: Enterprise Surveys comprehensive dataset (May 2012)



Russian firms grow less after a certain age

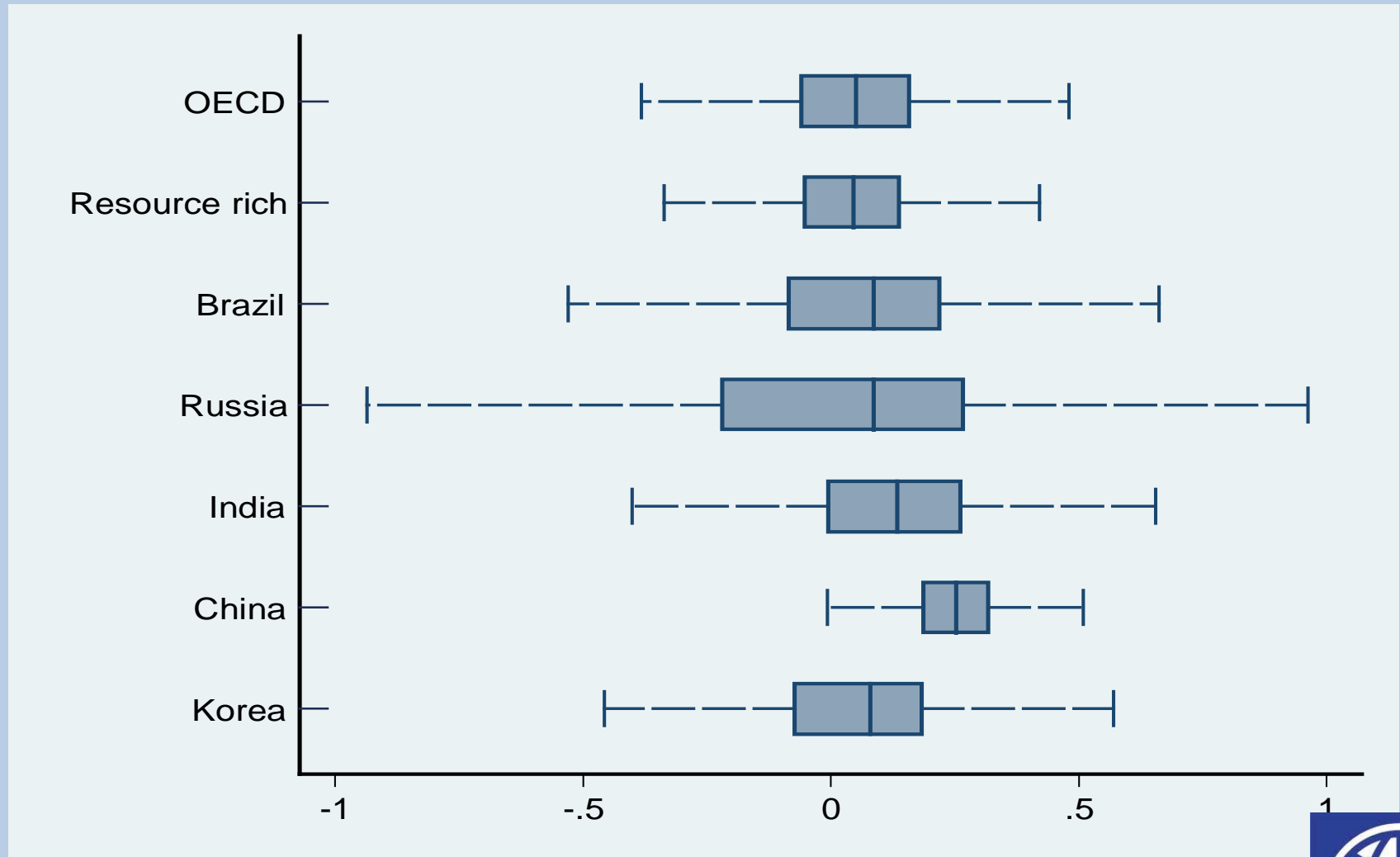
Comparisons of size (labor force and annual revenue) and age



Source: World Bank Enterprise Surveys (data retrieved from www.enterprisesurveys.org on May 2012)

There is more growth volatility in Russia

Annual manufacturing output growth in output (1993-2009)

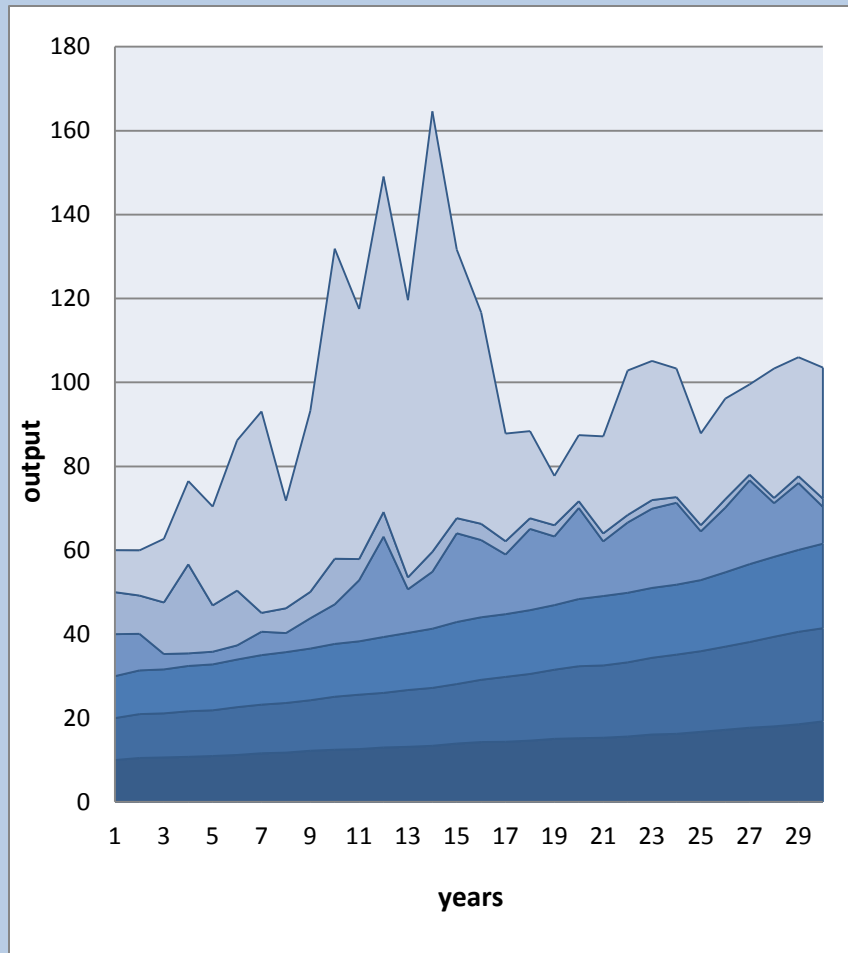


Source: Author's calculation from UNIDO 2011 Industrial Output Data (4-digit NACE)

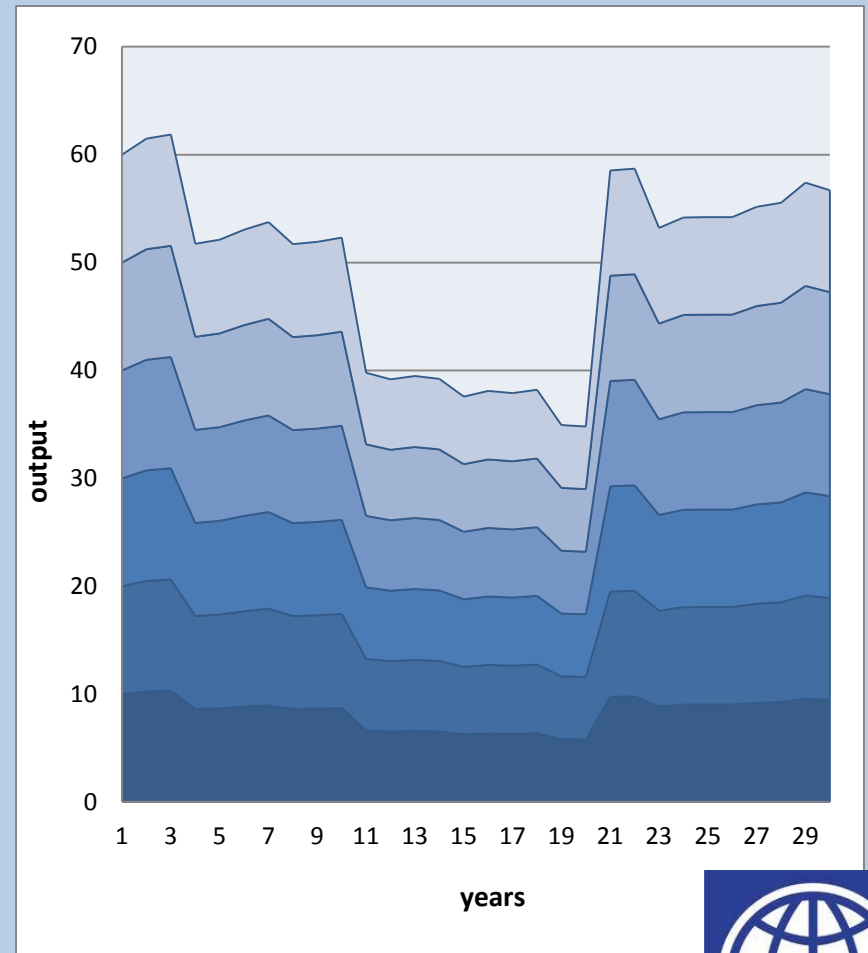


Spillover-Russia's volatility is correlated across time, not sectors

Sector-specific volatility

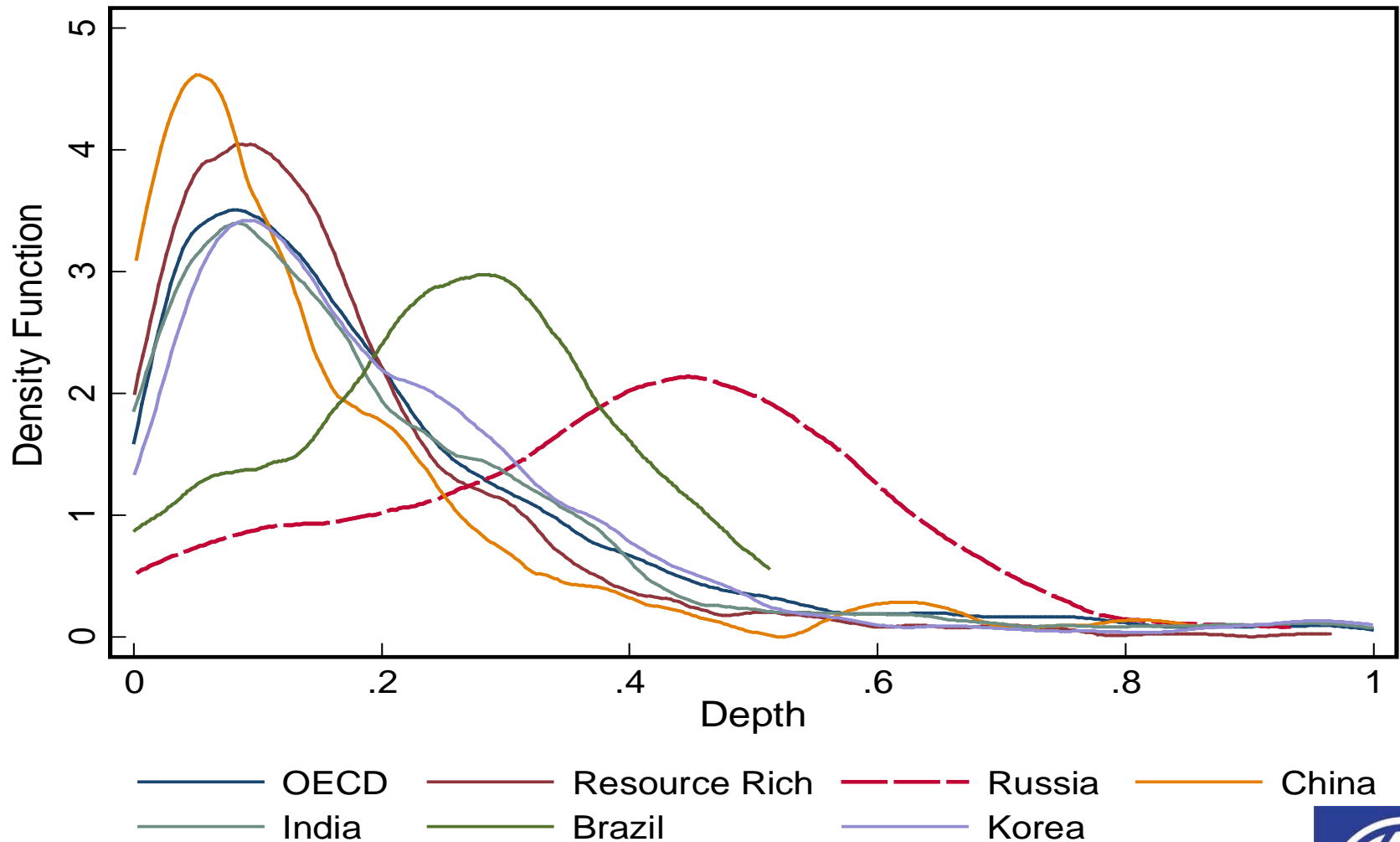


Year-specific volatility



The average slump is deeper in Russia

Frequency of slumps based on their depth (1993-2009)

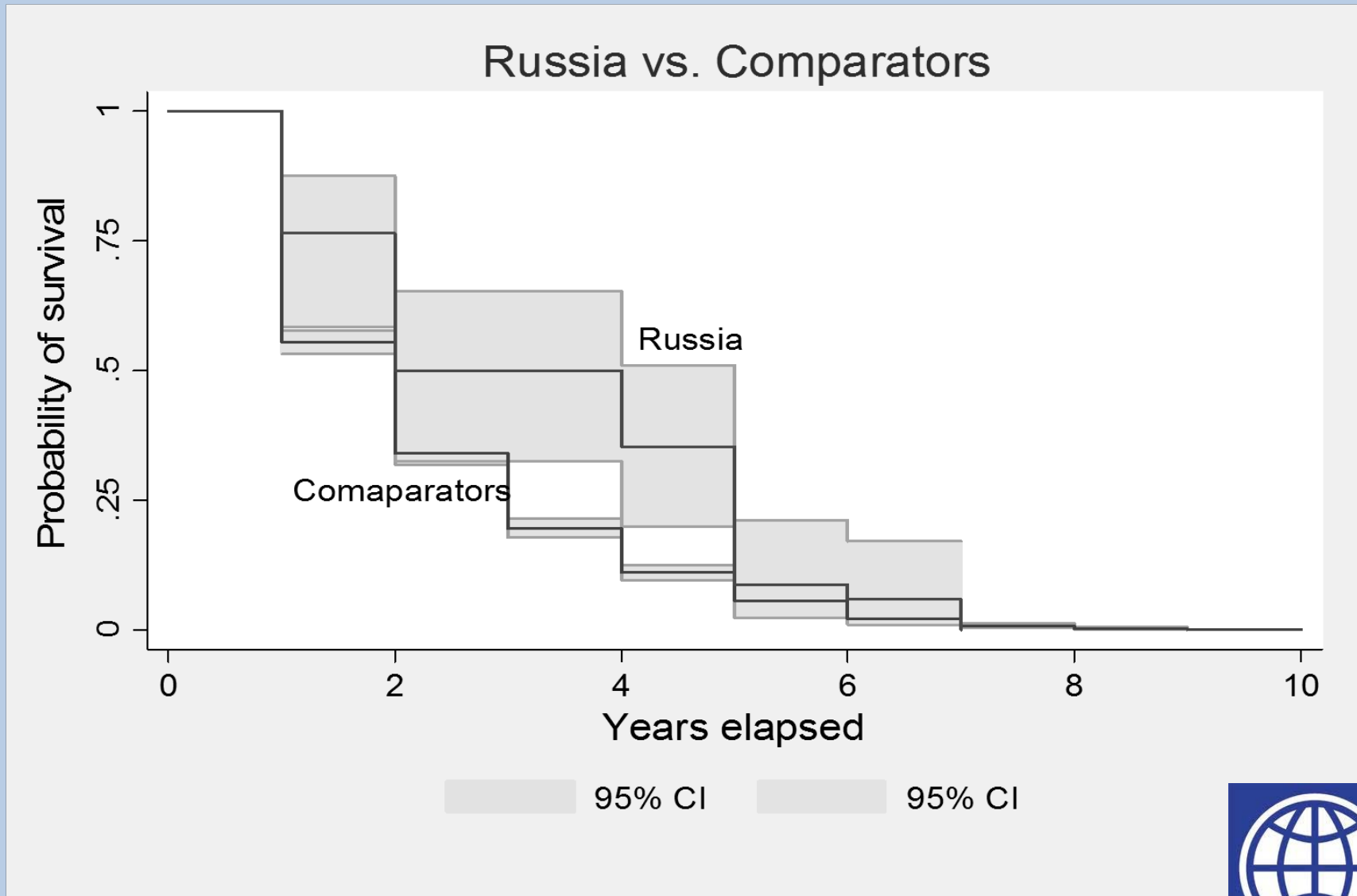


Source: Author's calculation from UNIDO 2011 Industrial Output Data (4-digit NACE)

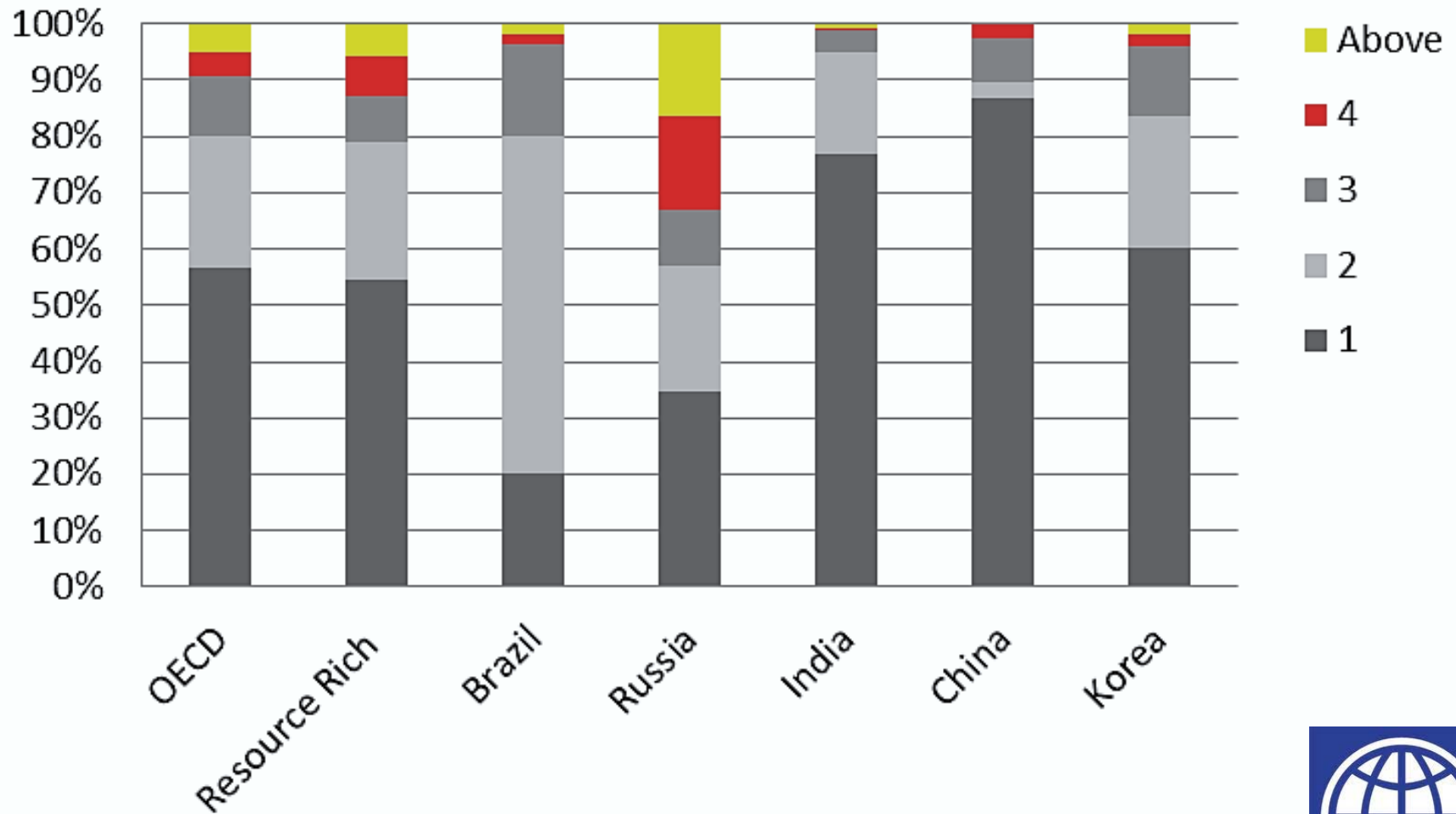


The average slump lasts longer in Russia

Conditional probability of duration of slumps (1993-2009)



The average slump lasts longer in Russia



Do slumps in Russia push out less efficient firms?

In Russia, more efficient firms are relatively less likely to exit than less efficient ones—this is good.

In Russia, older firms are relatively less likely to exit than younger ones—this is not so good.

In Russia, during slumps, less efficient firms become more likely to survive—this is not so good.

In Russia, in sectors with less competition, less efficient firms are less likely to exit—this is not so good.



Volatility is a drag on diversification, so is a lack of competition

1. Overall, the economy does have vibrancy and dynamism, unfortunately, in the recent past, this vibrancy was wiped away with long and deep slumps.
2. The economic structure and diversification can benefit from greater doses of competition.
3. Programs and policies to help small and medium enterprises may be better targeted if they helped young, productive firms.



Thank you!

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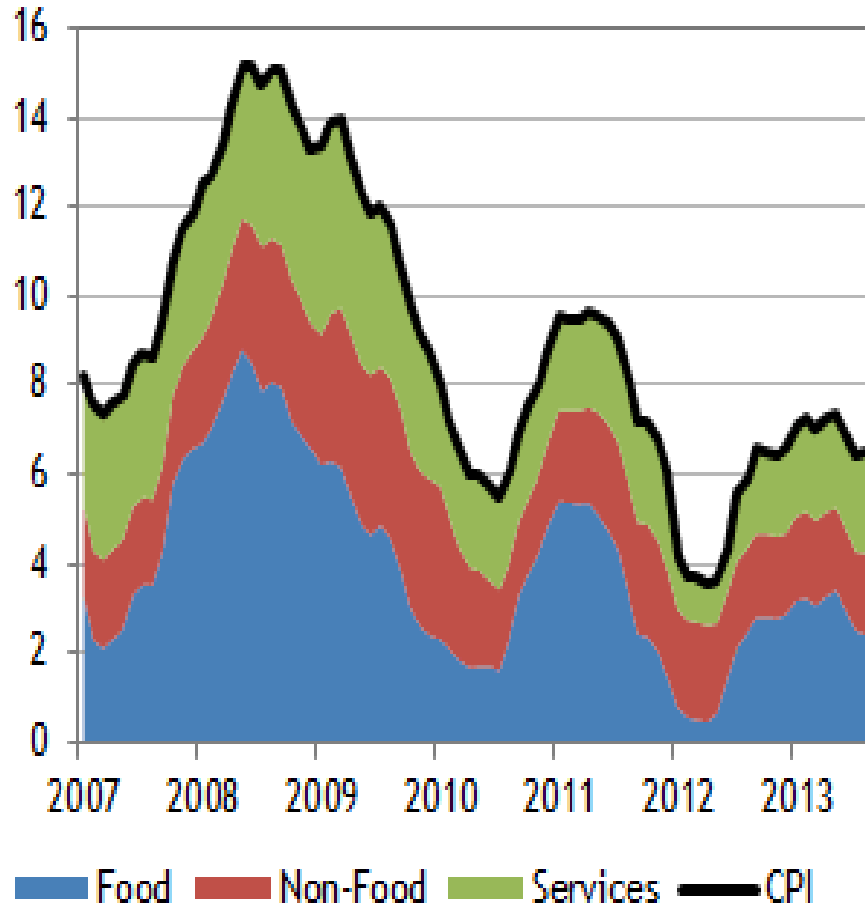
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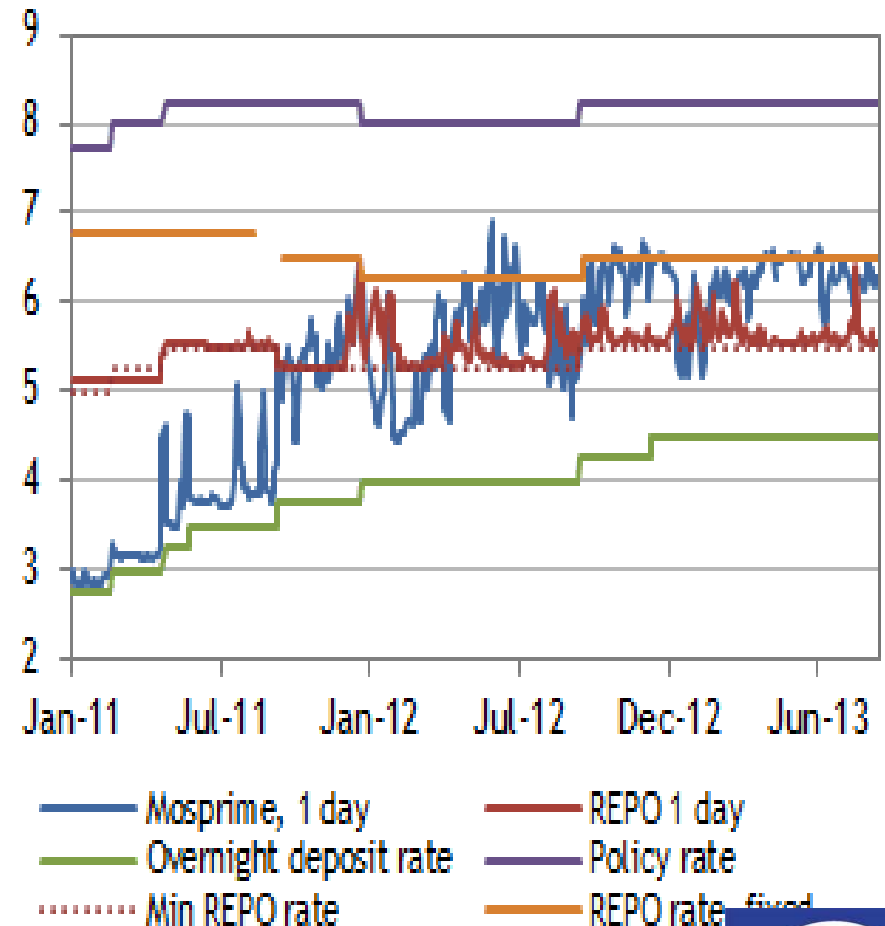
EXTRA SLIDES

Commitment to Inflation Targeting

CPI inflation by component
(percent, y-o-y)

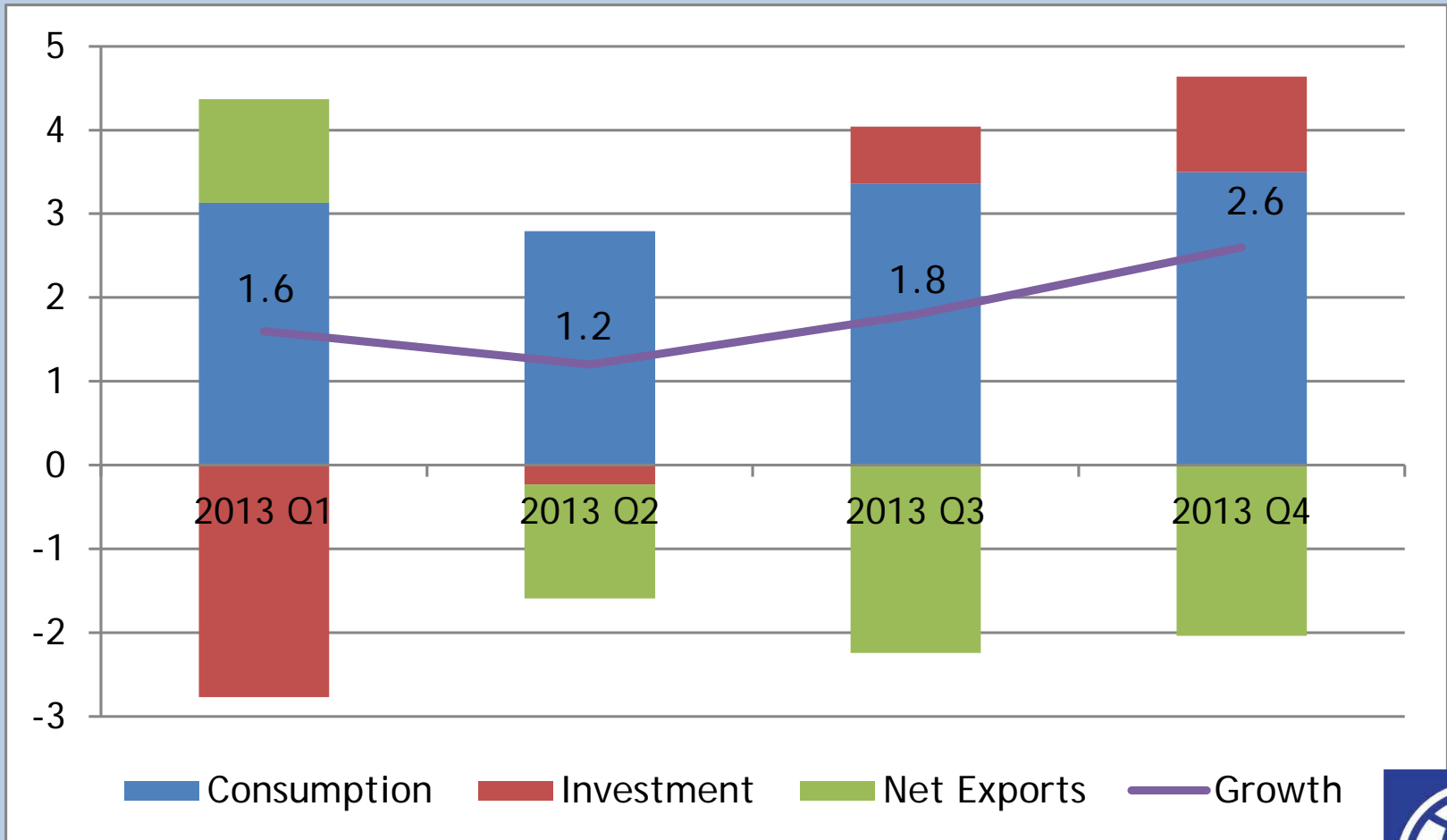


Interest rates (percent)



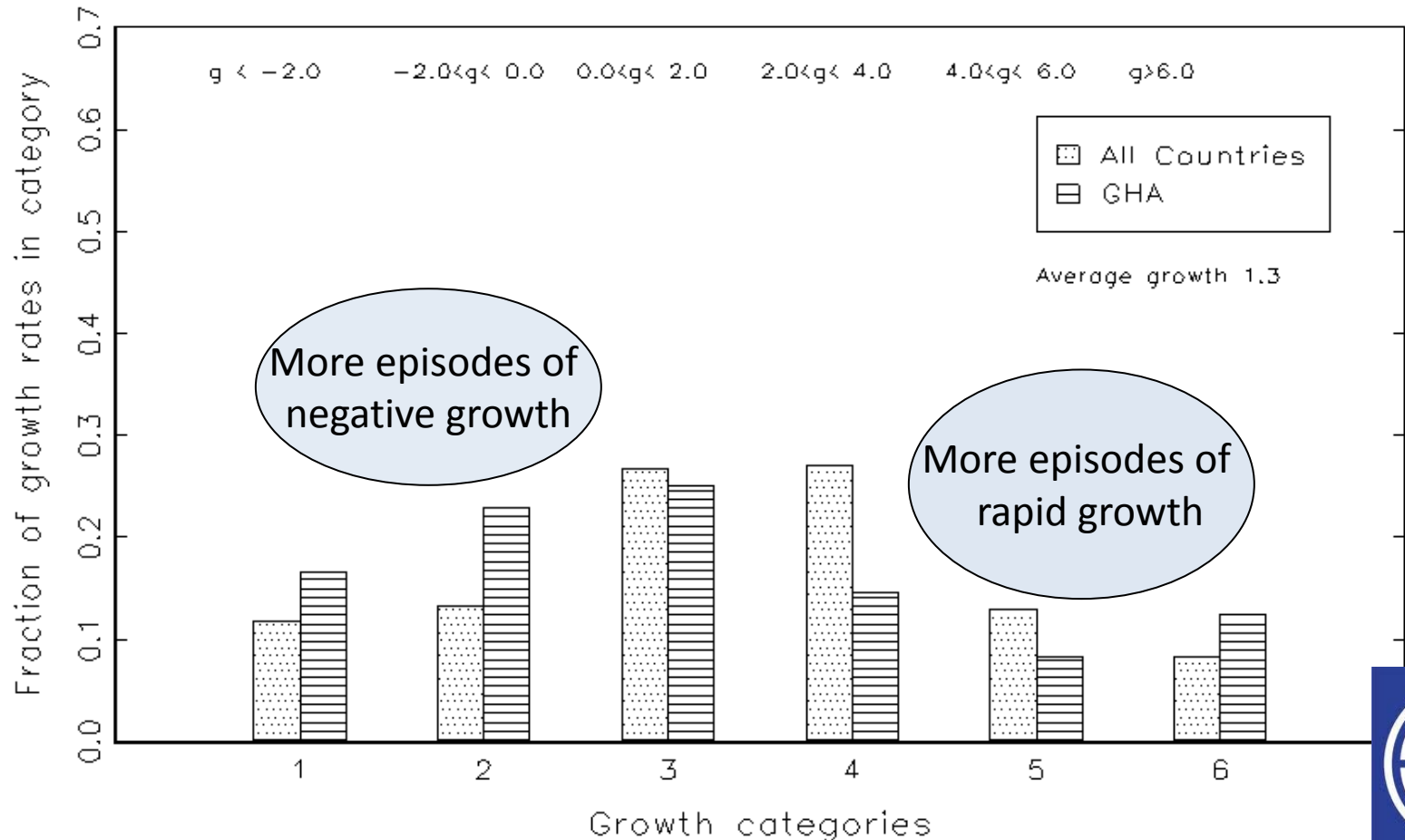
2013 Growth Projection

Projected Sources of Growth by Quarter 2008-2013 (% change, y-o-y)



Ghana tells us one story—high volatility

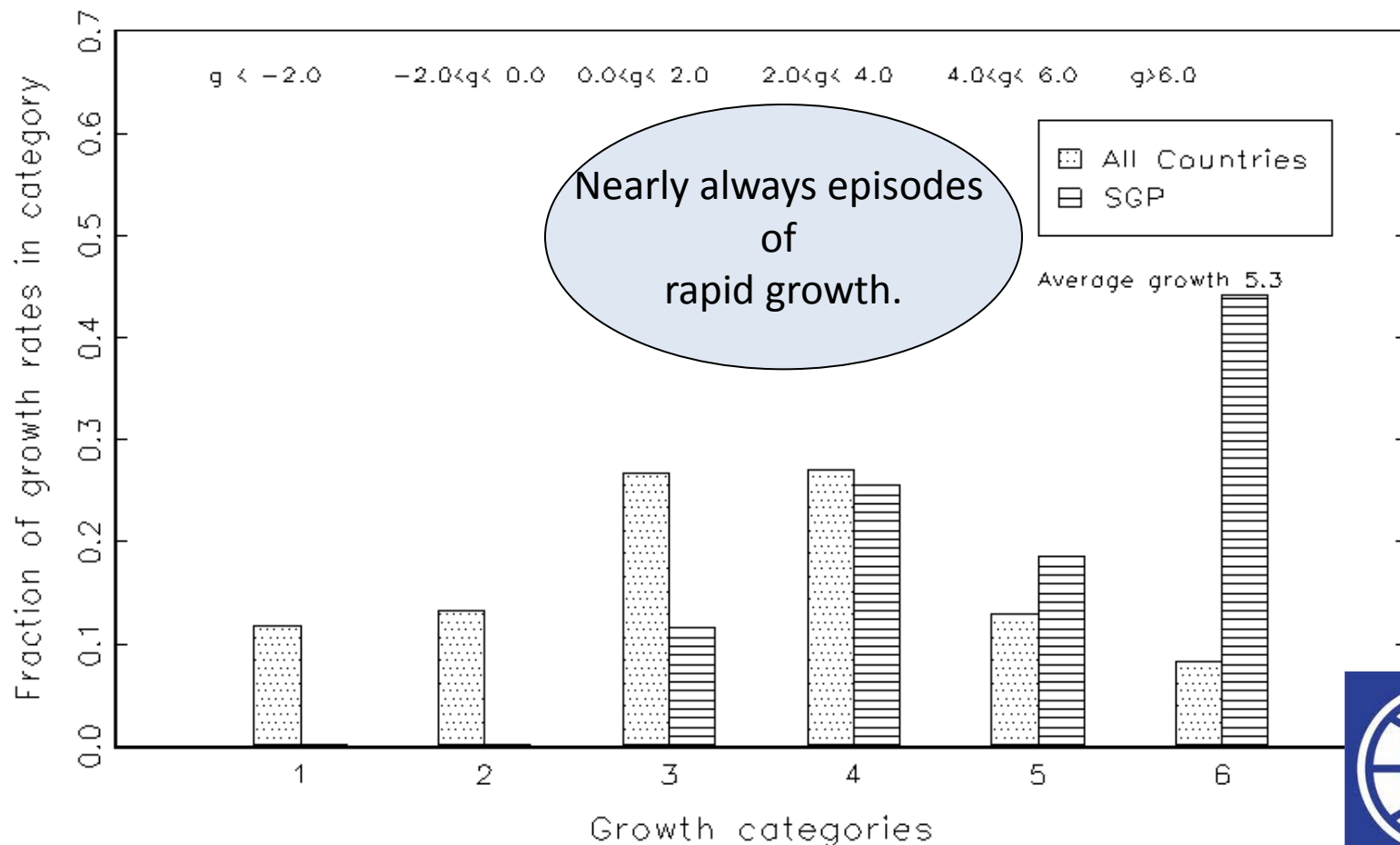
Distribution of growth rates, world versus one country
(growth of 5 (overlapping) year periods)



Source: I. Pritchett (1997) "Divergence Big Time" The Journal of Economic Perspectives, Vol. 11, No. 3. (Summer), pp. 3-17.

Singapore tells the other story—little volatility

Distribution of growth rates, world versus one country
(growth of 5 (overlapping) year periods)



Source: I. Pritchett (1997) "Divergence Big Time" The Journal of Economic Perspectives, Vol. 11, No. 3. (Summer), pp. 3-17.