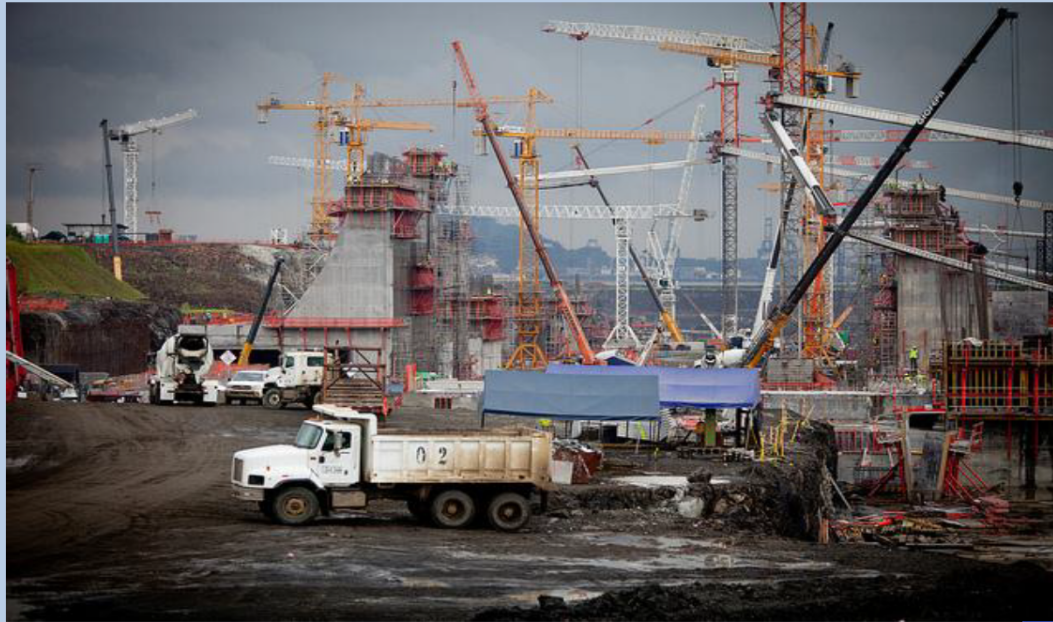


Structural Challenges To Growth Become Binding



Russia Economic Update
September 2013 | Edition No. 30



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 growth rate at 1.3 percent in 2013.
- External demand: Oil prices retreated to under US\$ 100/bbl in H12013. Global trade lost momentum in H12013.
- 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 2.2 percent growth for 2014.
- Economy growing near 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

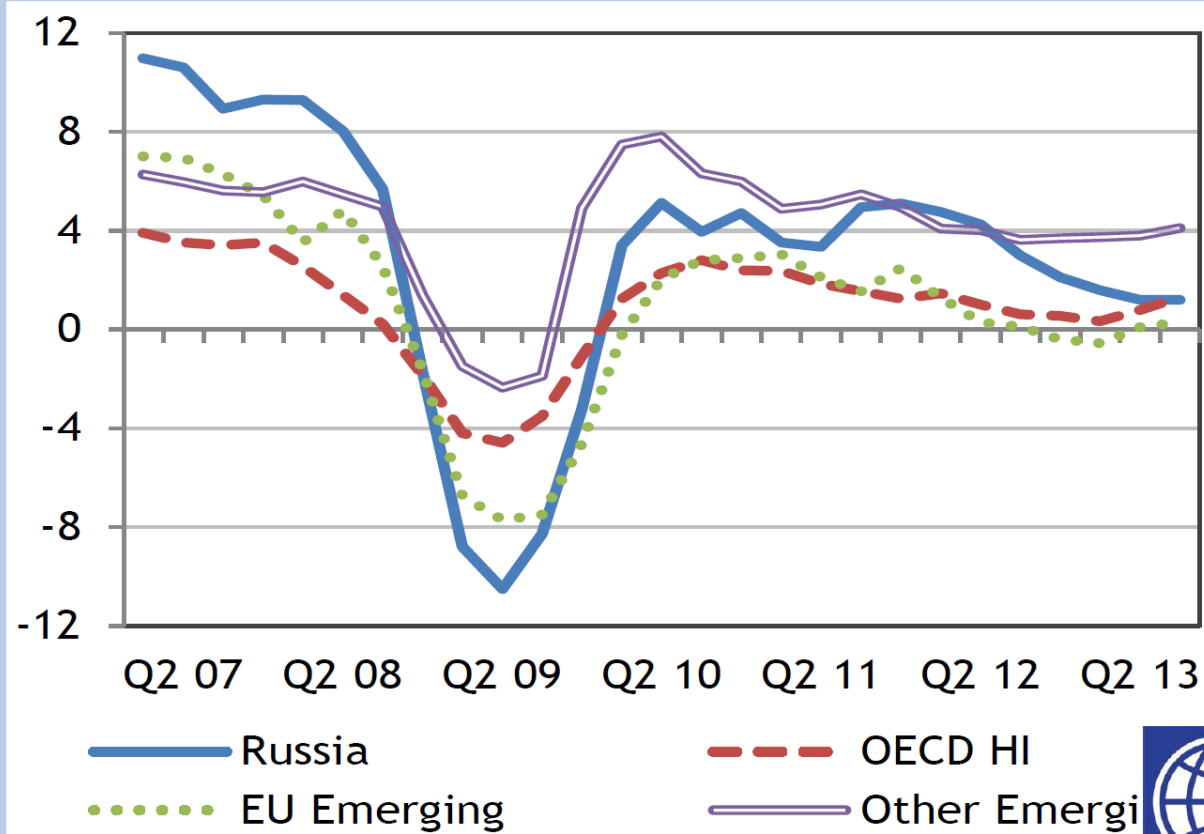
- The structure of manufacturing in Russia is different; volatility in manufacturing output growth is different and slumps are different
- A vicious cycle of concentration and volatility

4

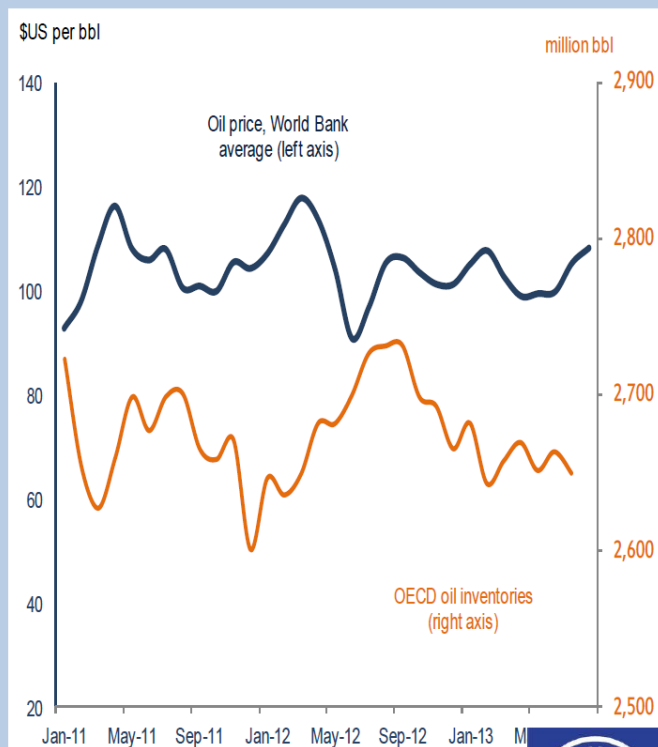
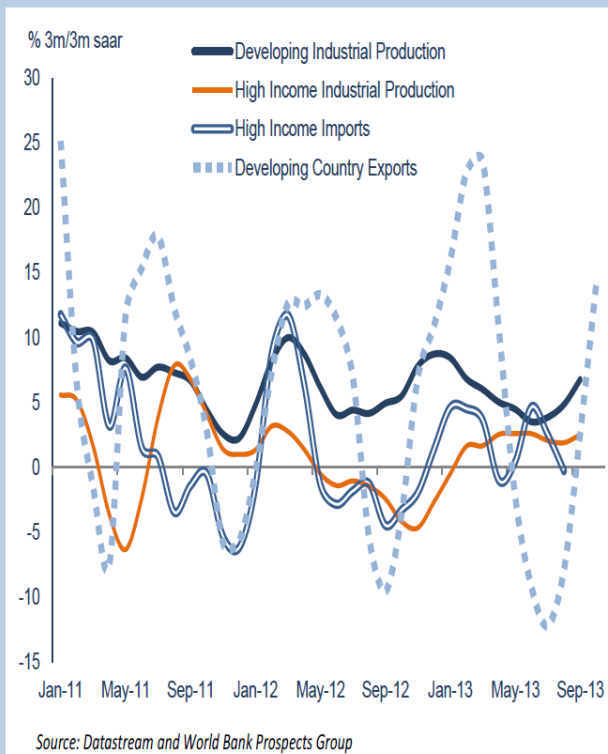
Economic structure and diversification would benefit from more competition

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

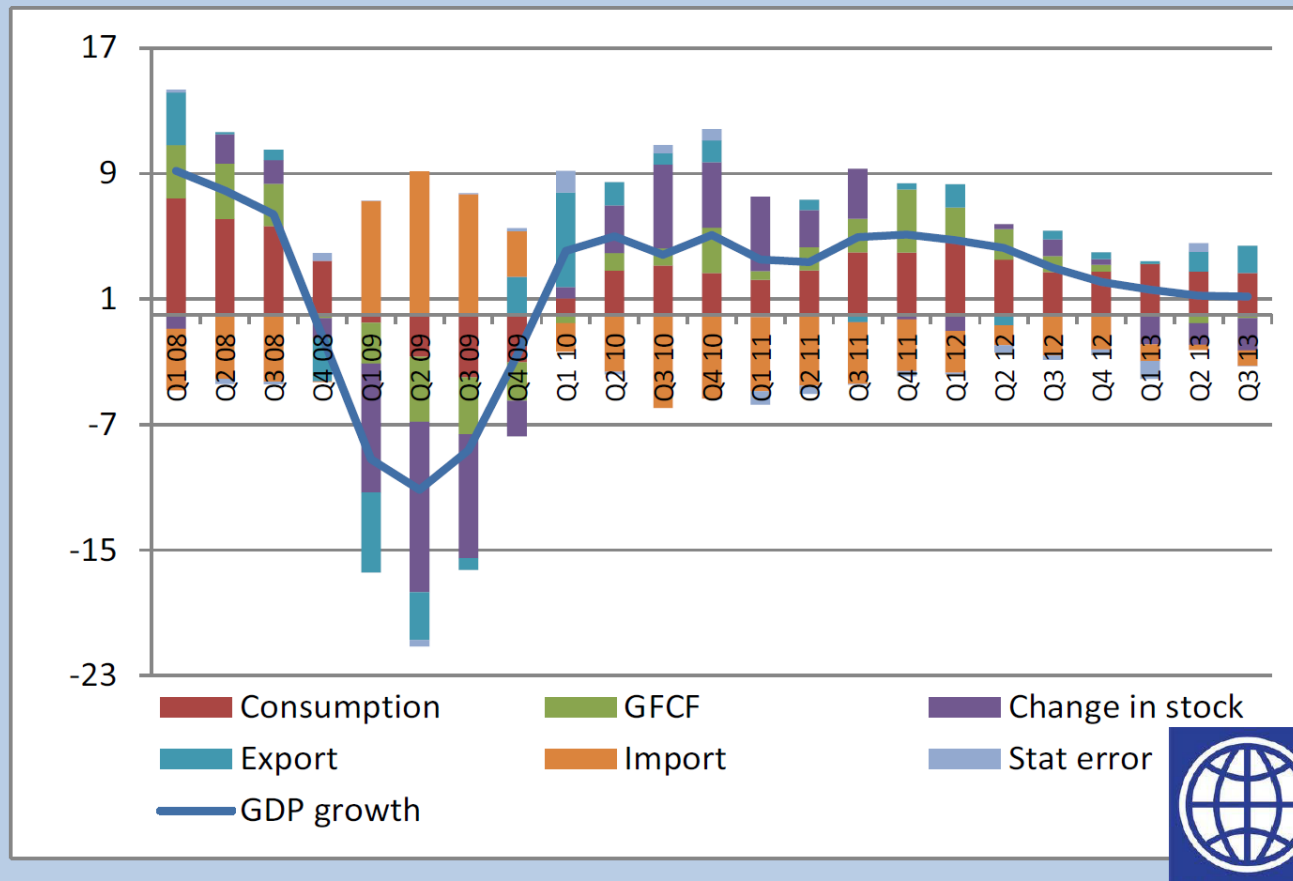
Russia's Growth Slowdown



→ (1) Weak External Demand



→ (2) Stalling Domestic Demand



Fiscal Impact: Pressure to Consolidate

percent of GDP	2012	H1 2012	H1 2013	2013
	Actual	Actual*	Actual*	Preliminary/ Estimate**
Federal Budget				
Expenditures	20.6	20.9	19.1	21.5
Revenues	20.5	21.8	19.8	21.0
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

* Federal budget data covers January - July

** Federal budget data is preliminary, consolidated and consolidated subnational budget data is still estimate of the Ministry of Finance



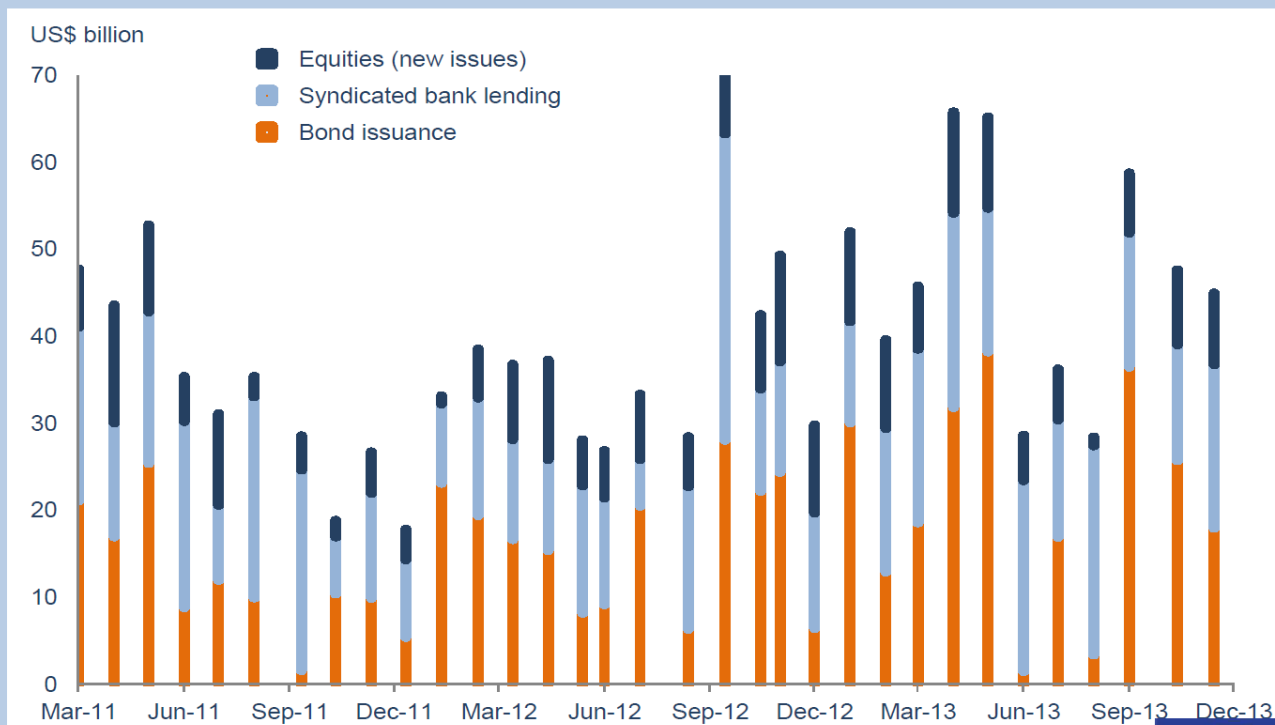
Moderately Positive Growth Outlook

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	1.5	1.3	2.2
Developing and Emerging Countries	5.8	1.9	7.3	5.9	4.8	4.8	5.3
Euro Area	0.3	-4.3	1.9	1.5	-0.6	-0.4	1.1
Russia	5.2	-7.8	4.5	4.3	3.4	1.3	2.2

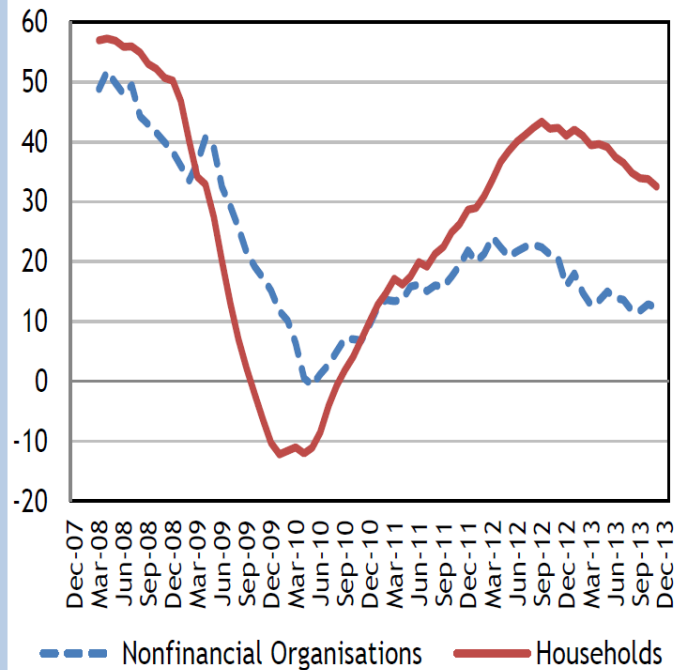


Risks: Tighter Financial Conditions

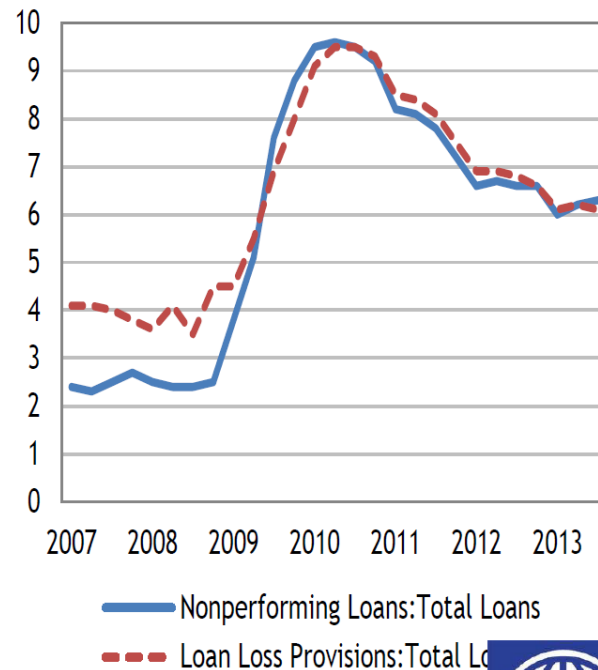


Credit and Increased Market Access Risks

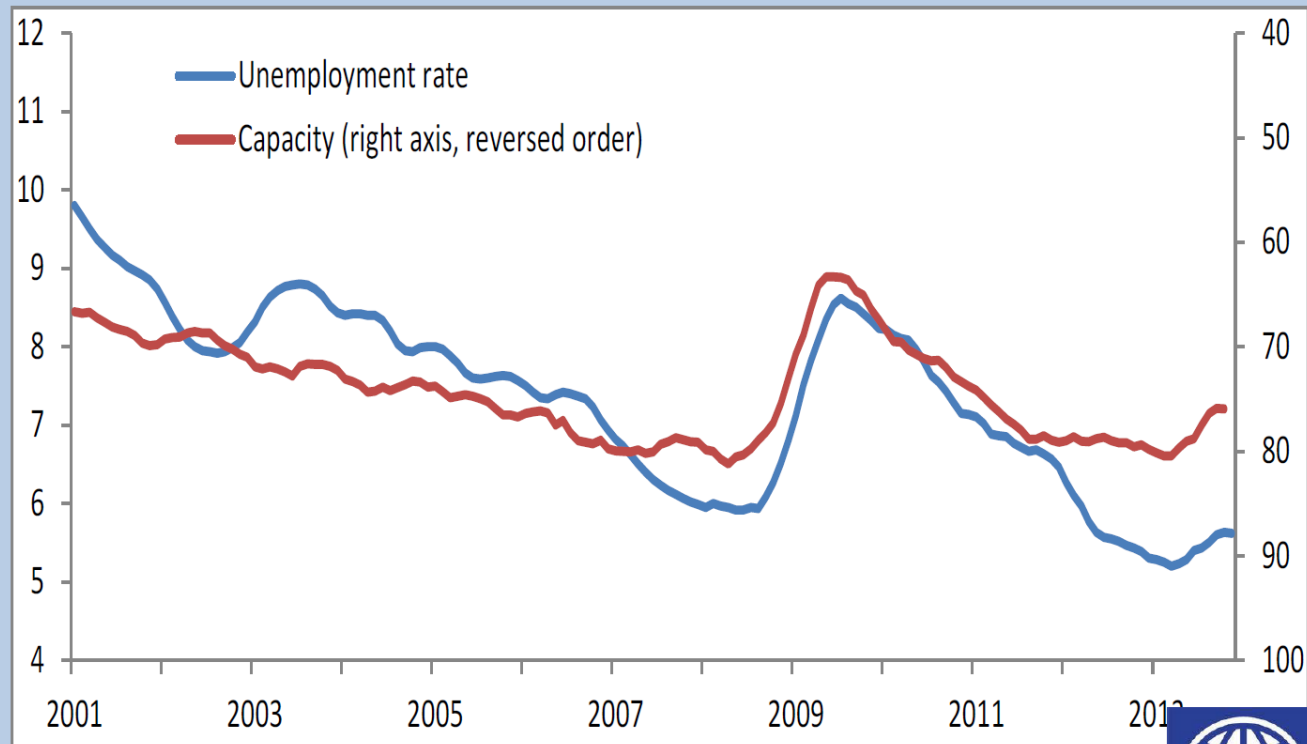
Credit Growth (percent, y-o-y)



NPLs and loss provisioning (% of loans)



Sources of Growth: Growing at Potential?



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.



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

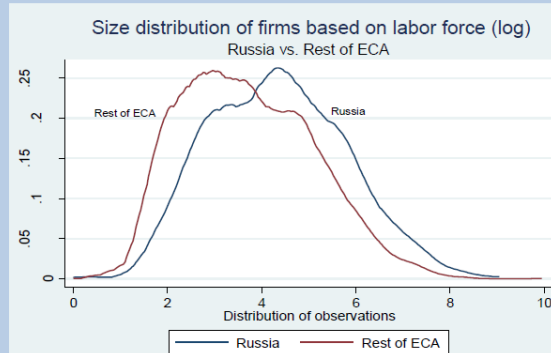
A vicious cycle: Does concentration exacerbate volatility and does volatility induce more concentration?

- 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)



Source: Enterprise Surveys comprehensive dataset (May 2012)



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Source: Enterprise Surveys comprehensive dataset (May 2012)



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

Russian firms grow less after a certain age

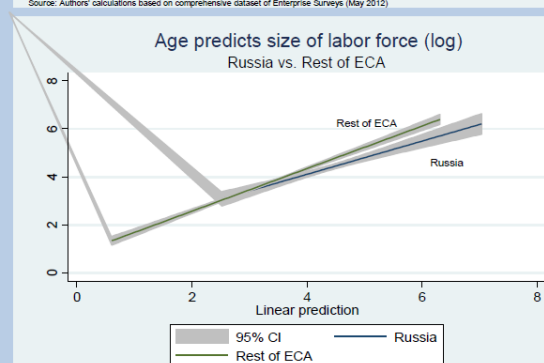
Comparisons of size (labor force and annual revenue) and age



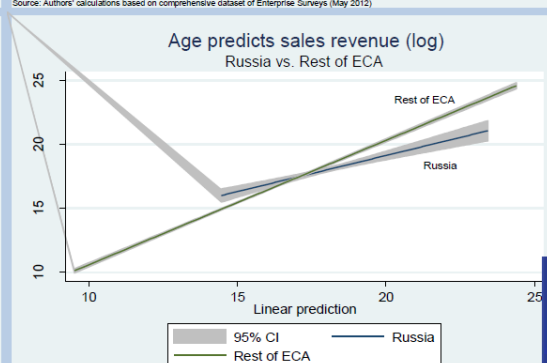
Source: Authors' calculations based on comprehensive dataset of Enterprise Surveys (May 2012)



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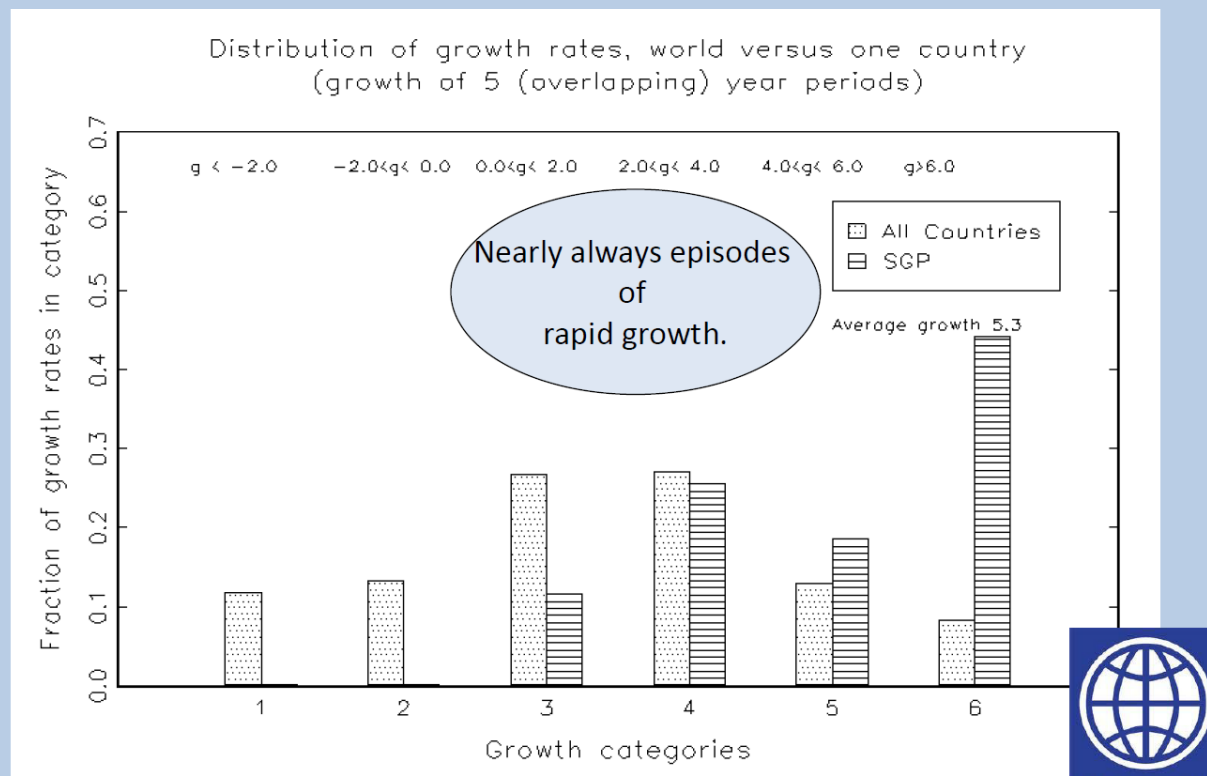


Source: Authors' calculations based on Enterprise Surveys comprehensive dataset (May 2012)



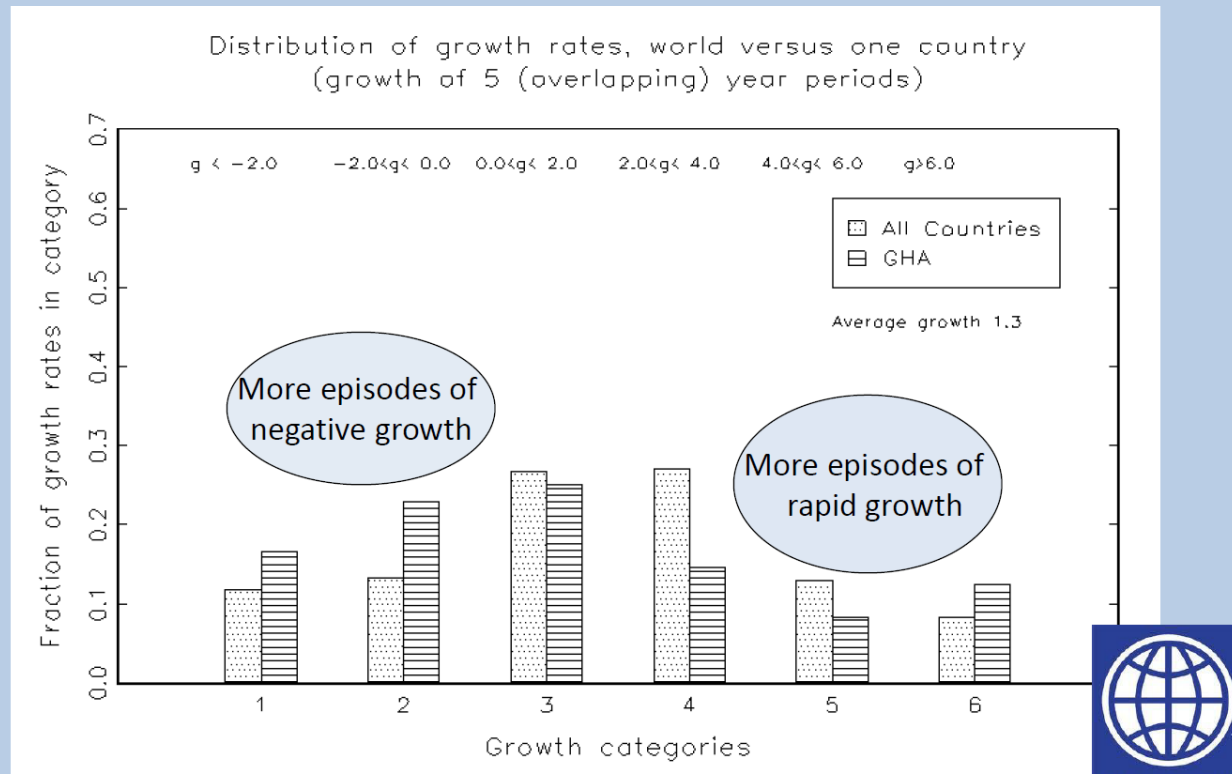
Source: World Bank Enterprise Surveys (data retrieved from www.enterprisesurveys.org on May 2012)

Singapore tells the other story—little volatility



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

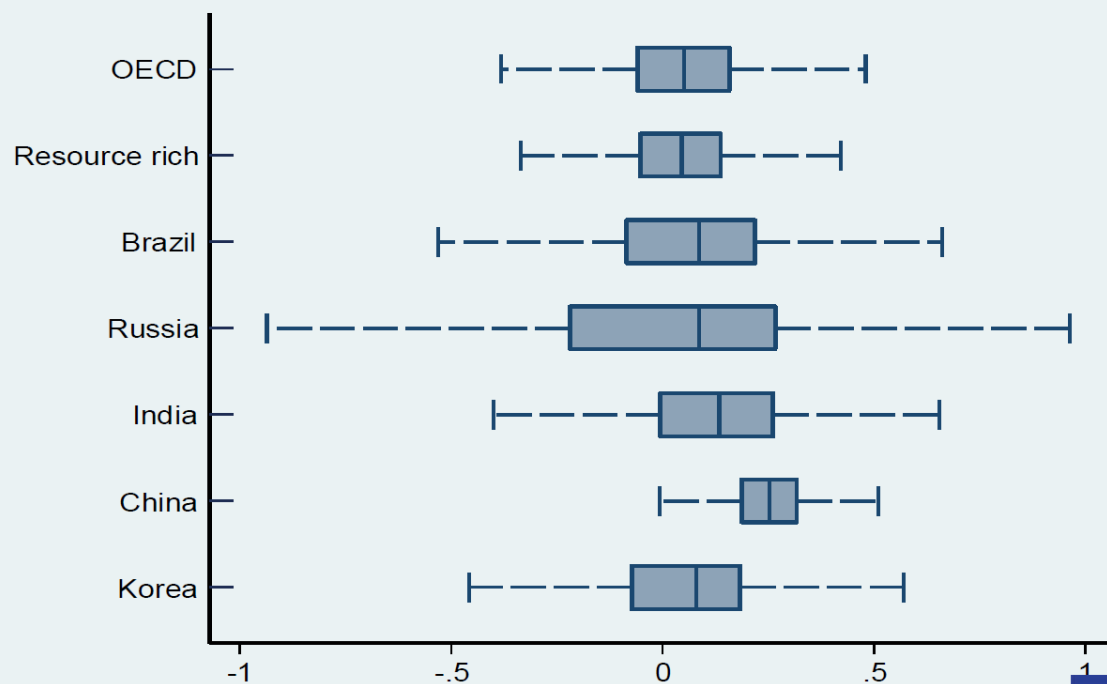
Ghana tells us one story—high volatility



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

There is more growth volatility in Russia

Annual manufacturing output growth in output (1993-2009)

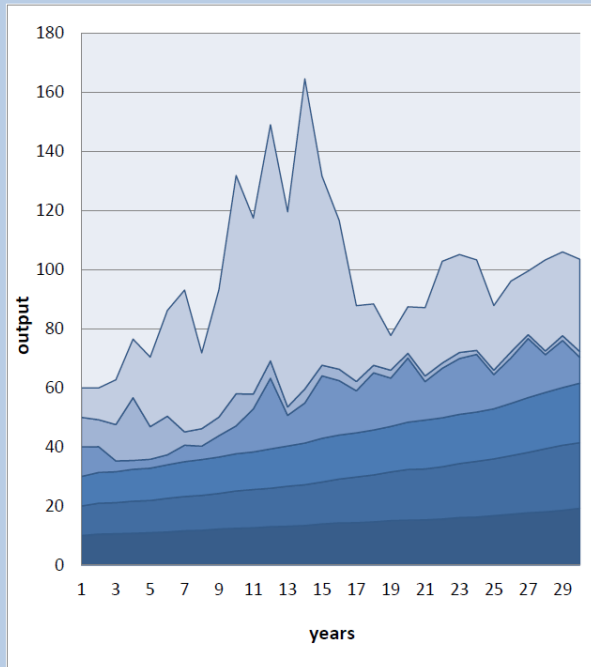


Source: Author's calculation from UNIDO 2011 Industrial Output Data (4-digit NACE)

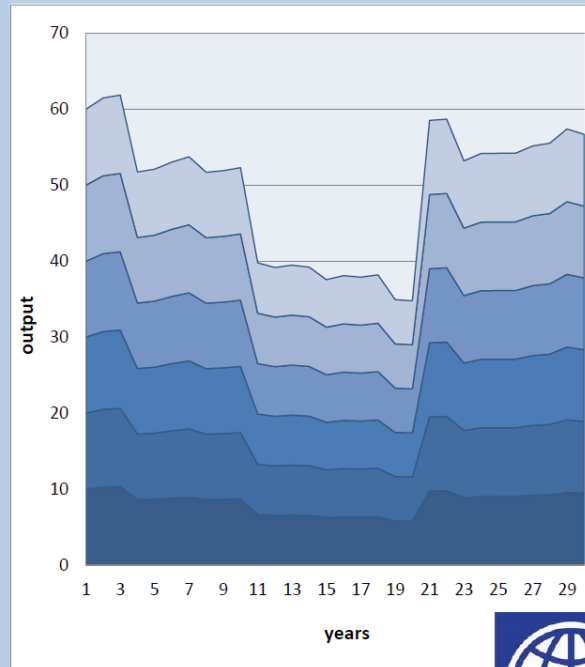


Spillover-Russia's volatility is correlated across time, not sectors

Sector-specific volatility

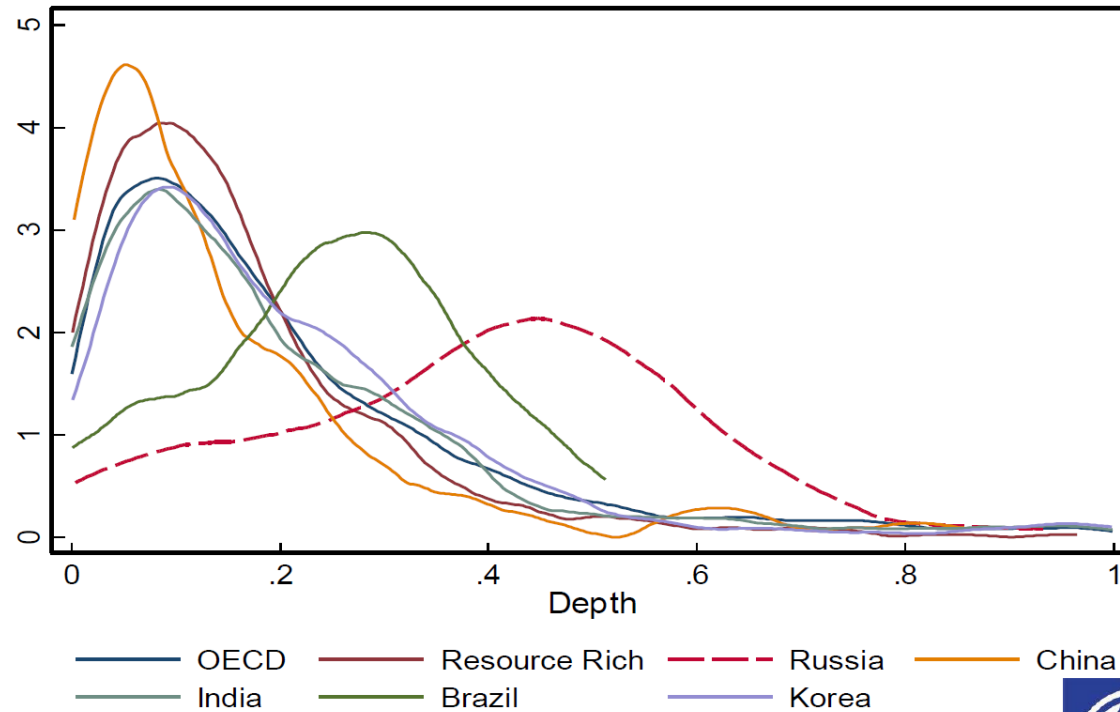


Year-specific volatility



The average slump is deeper in Russia

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

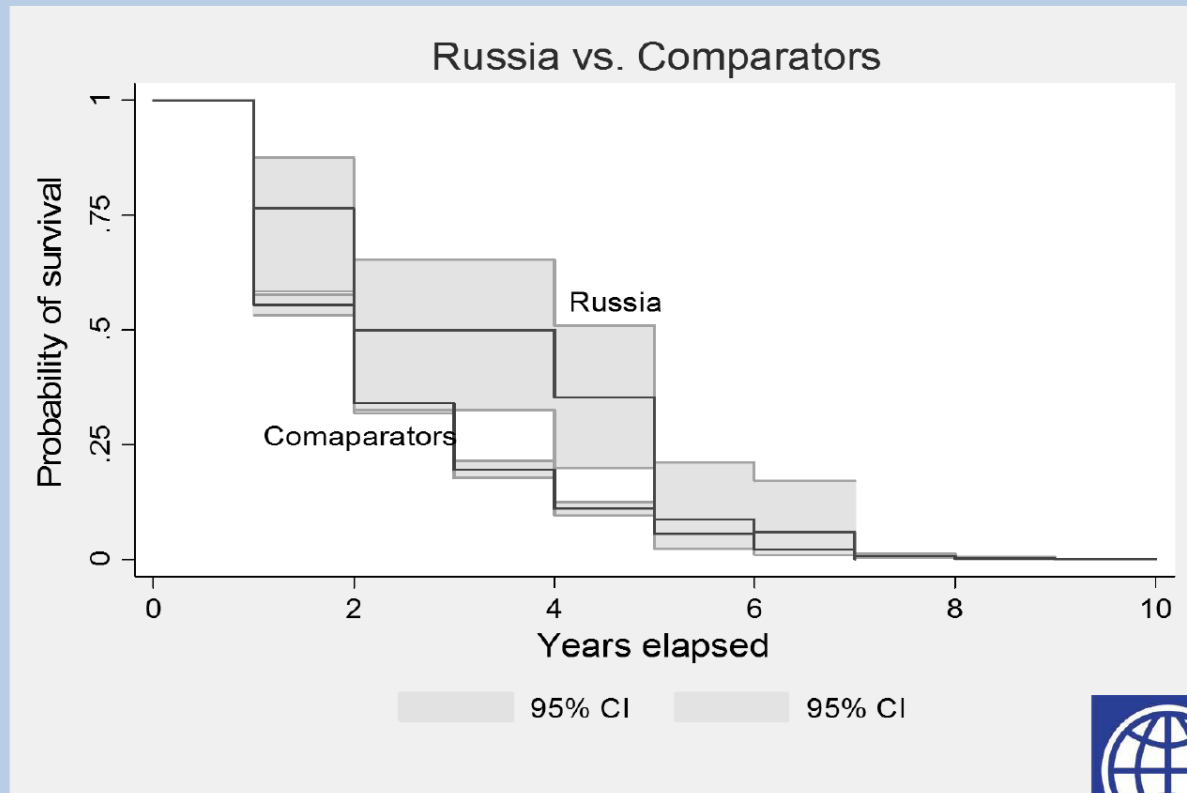


Source: Author's calculation from UNIDO 2011 Industrial Output Data (4-digit NACE)



The average slump lasts longer in Russia

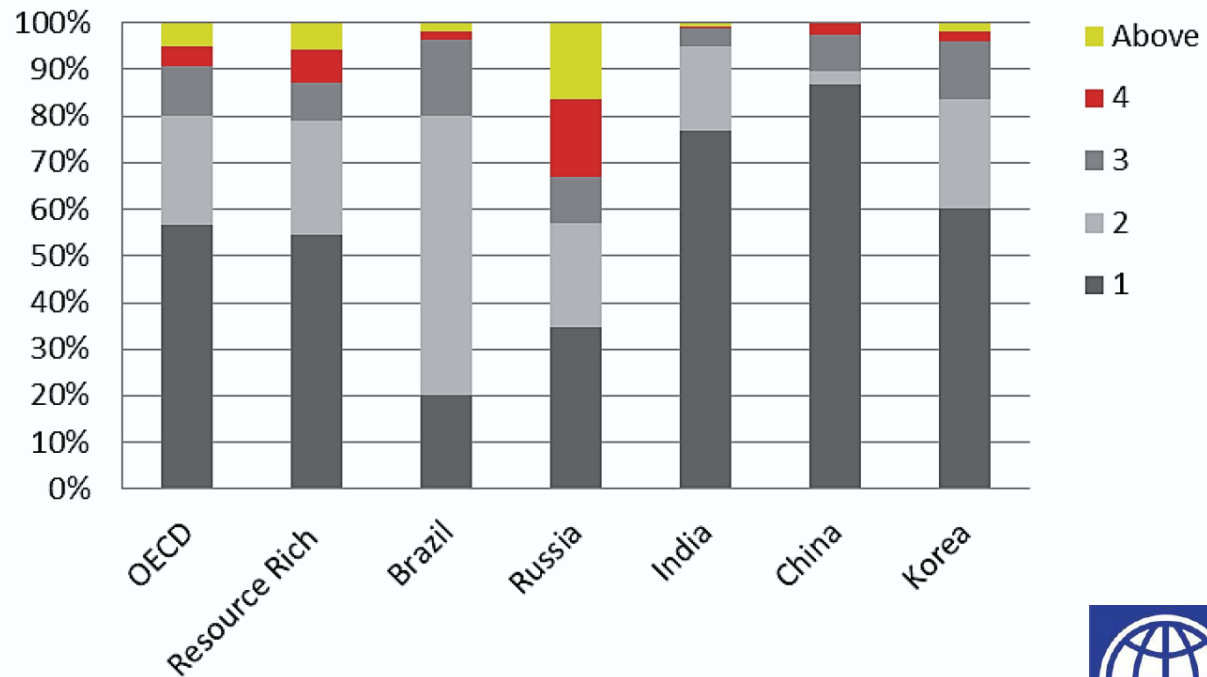
Conditional probability of duration of slumps (1993-2009)



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



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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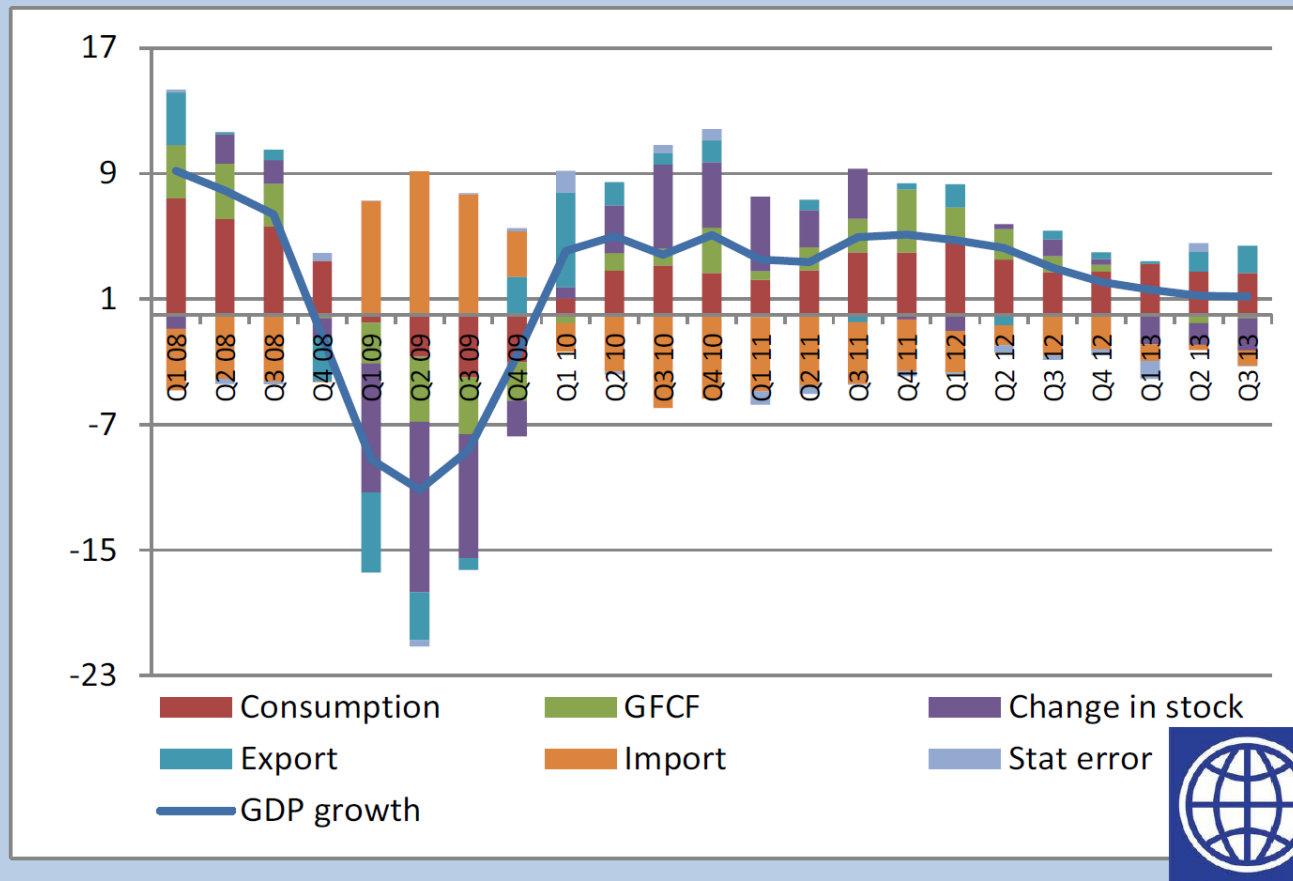
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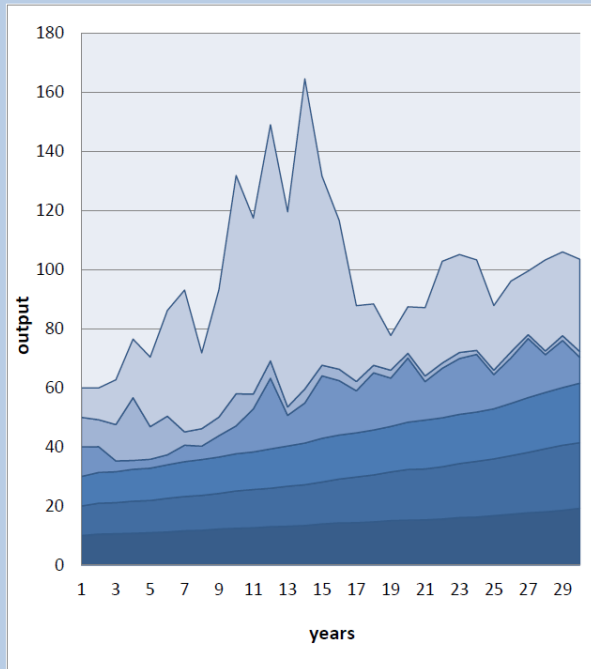


→ (2) Stalling Domestic Demand



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