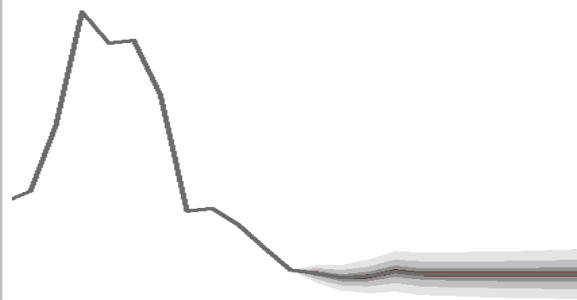
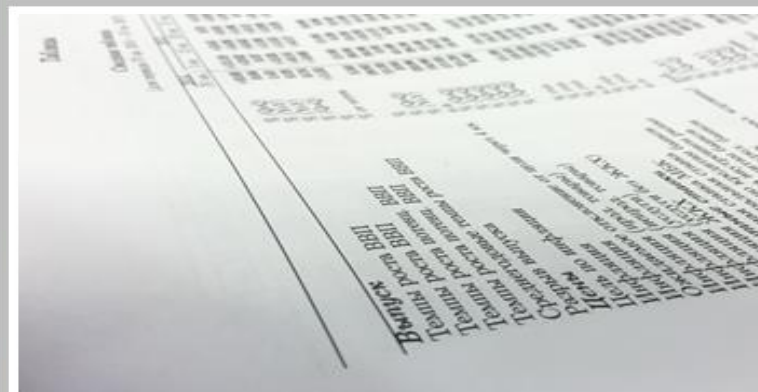




Bank of Russia  
The Central Bank of the Russian Federation



4%



## RUSSIAN ECONOMIC OUTLOOK AND MONETARY POLICY CHALLENGES

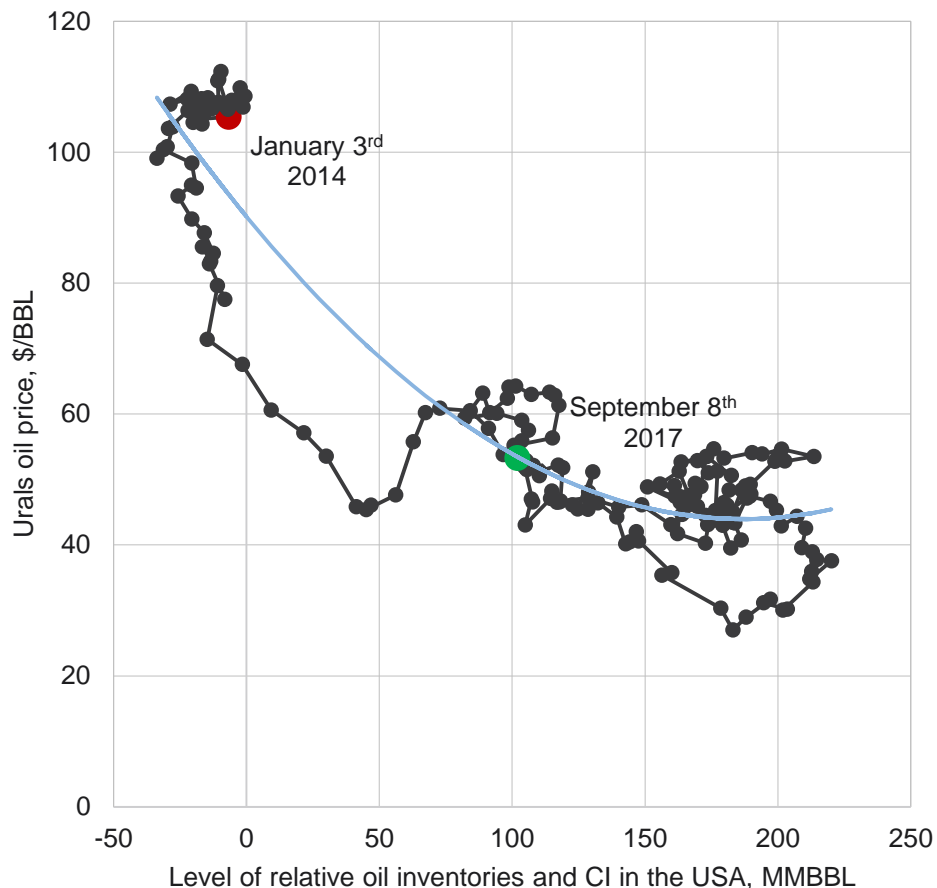
Bank of Russia

September 2017

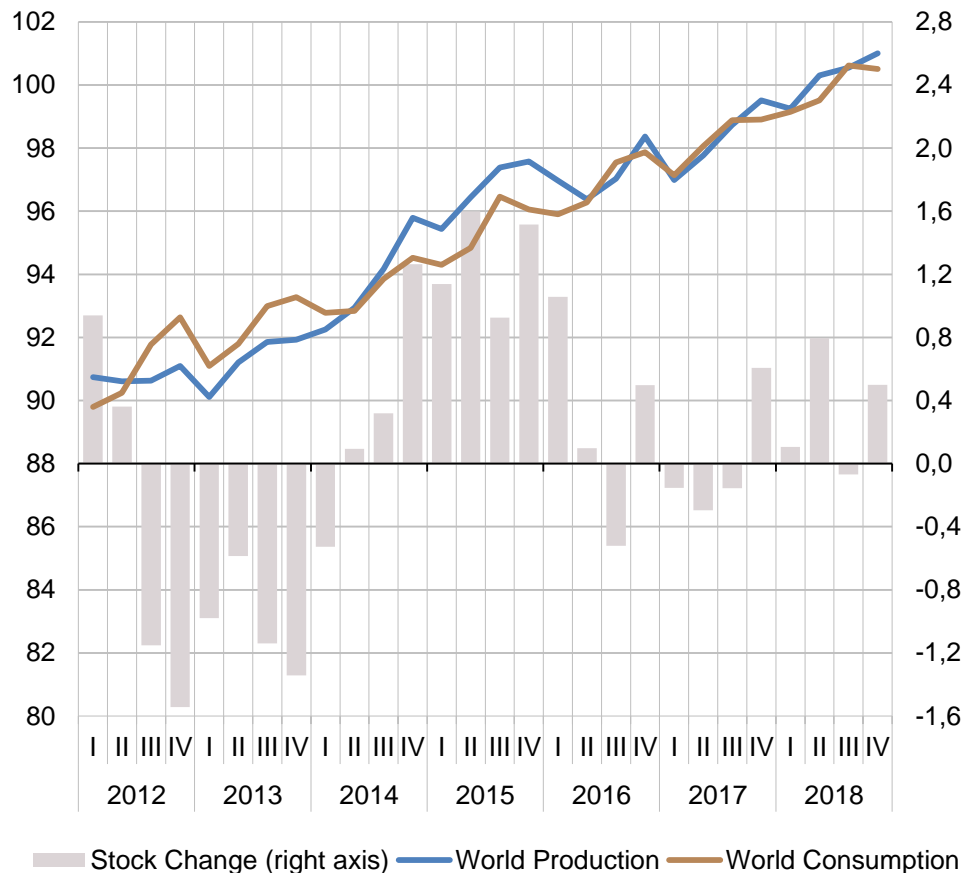


# Given the Implementation of the OPEC+ Agreement and Libya and Nigeria Reaching Their Target Extraction Levels, Oil Prices Will Remain Elevated Until Q3 2018

At the present moment world oil prices match the level of relative oil inventories and CI in the USA



World liquid fuels production and consumption balance, MMb/d

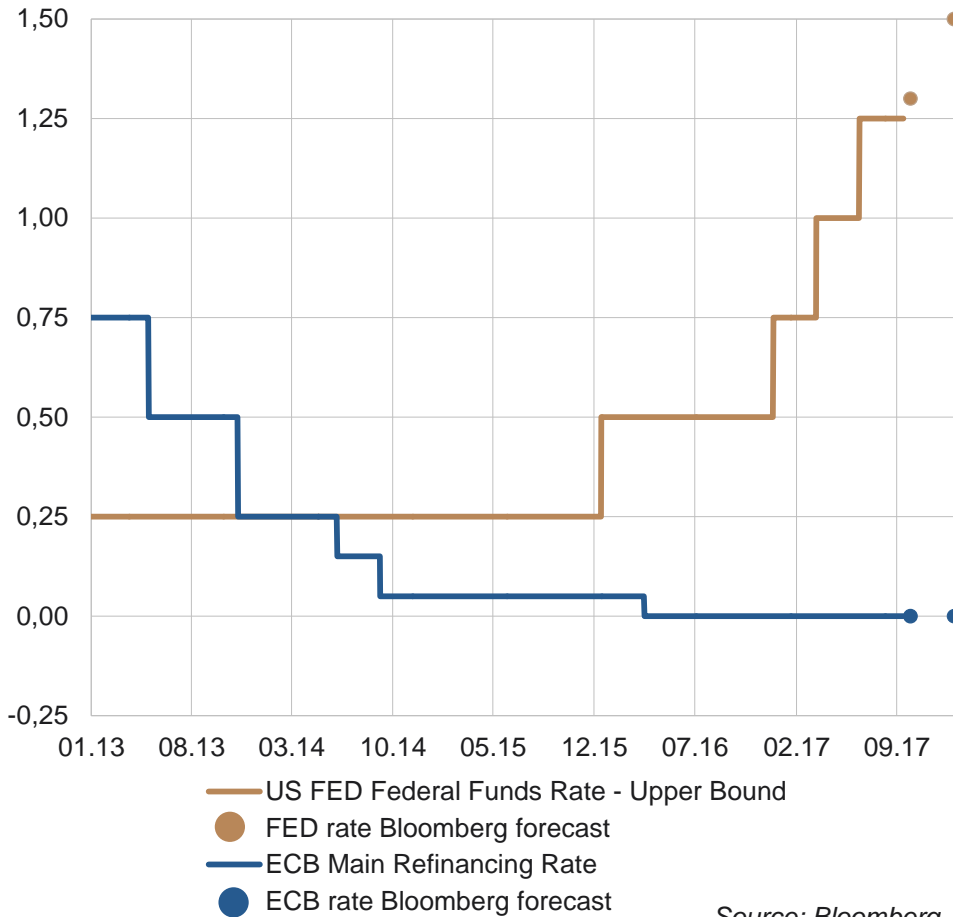


Source: U.S. Energy Information Administration



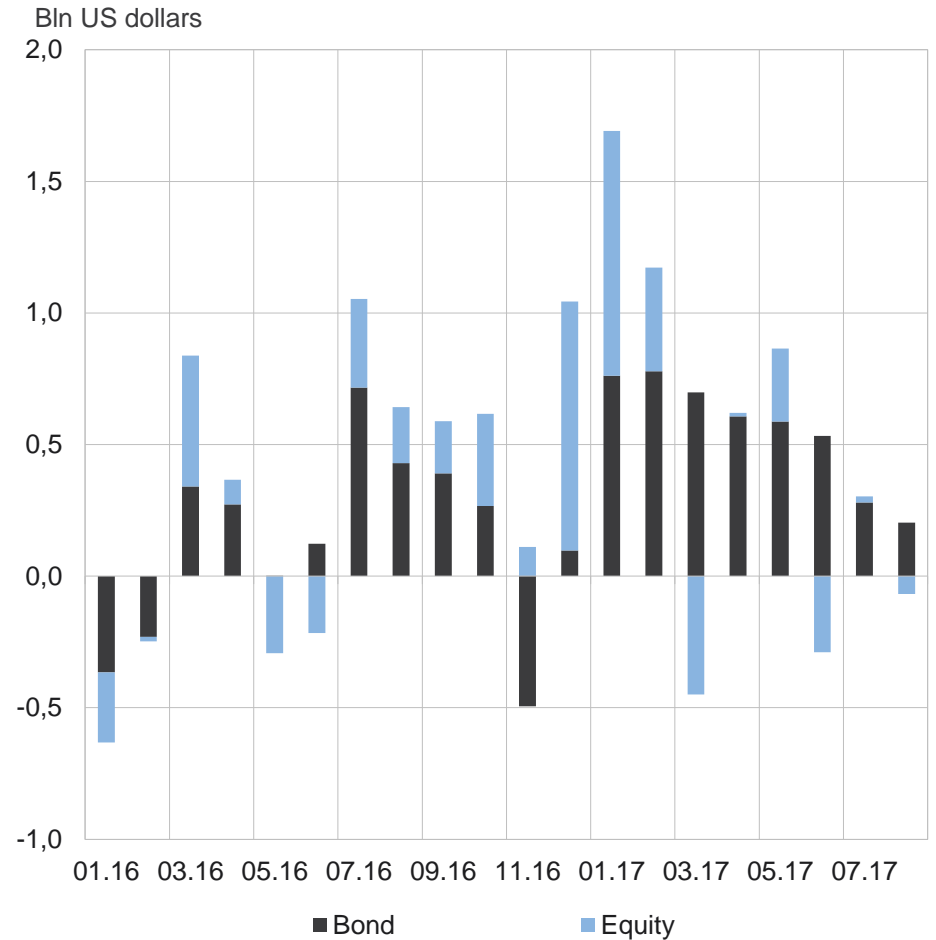
# Given the Gradual Monetary Policy Normalisation in the US, Emerging Markets Continue to Attract Foreign Investment

### Key central bank rates, %



Source: Bloomberg

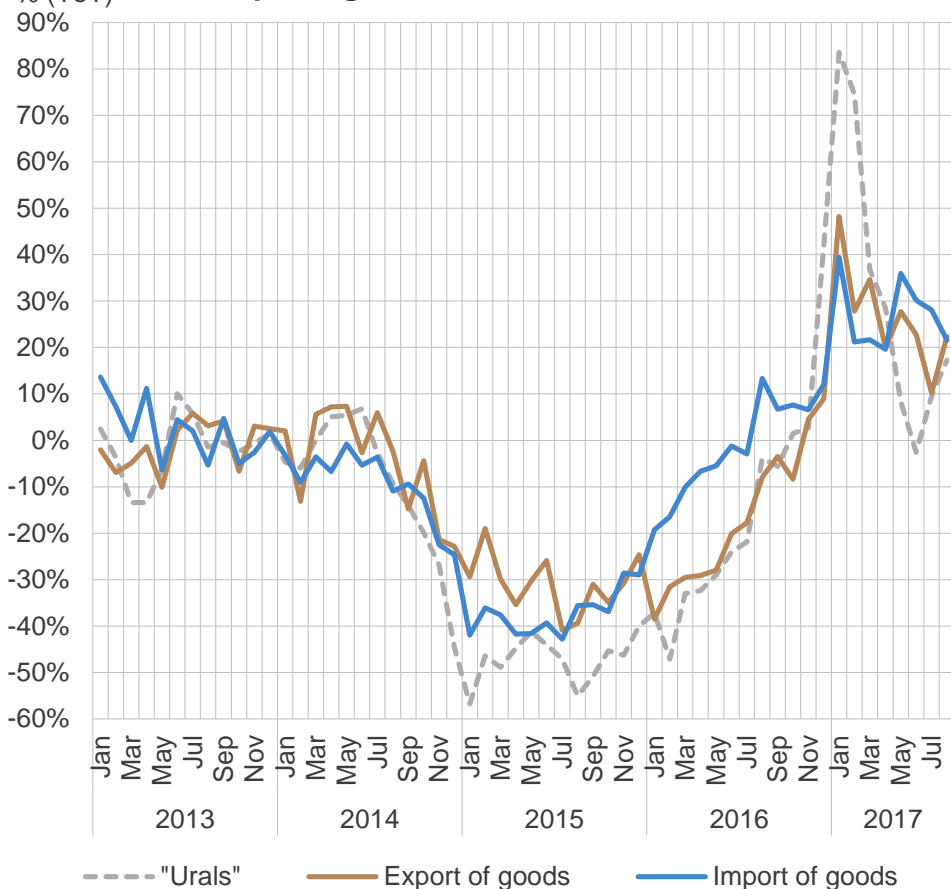
### Portfolio investment inflow to Russia during the latest months took place mostly in the bond market



Source: Bank of Russia

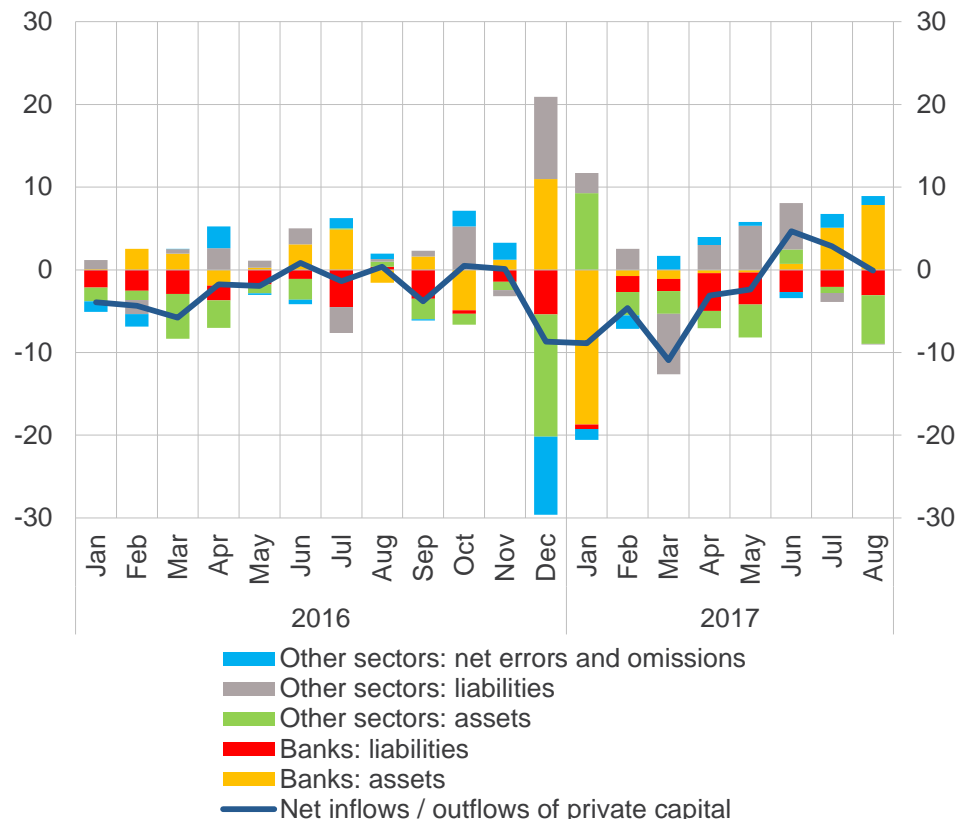
## Seasonal Current Account Deficit in July-August Caused by Higher Import Growth Rates and a Rise in Dividend Payments Was Accompanied by Net Financial Account Inflows

**Faster exports growth led to a trade balance reduction**



Source: Bank of Russia, Reuters

**The structure of inflows and outflows of capital\*, bln US dollars**



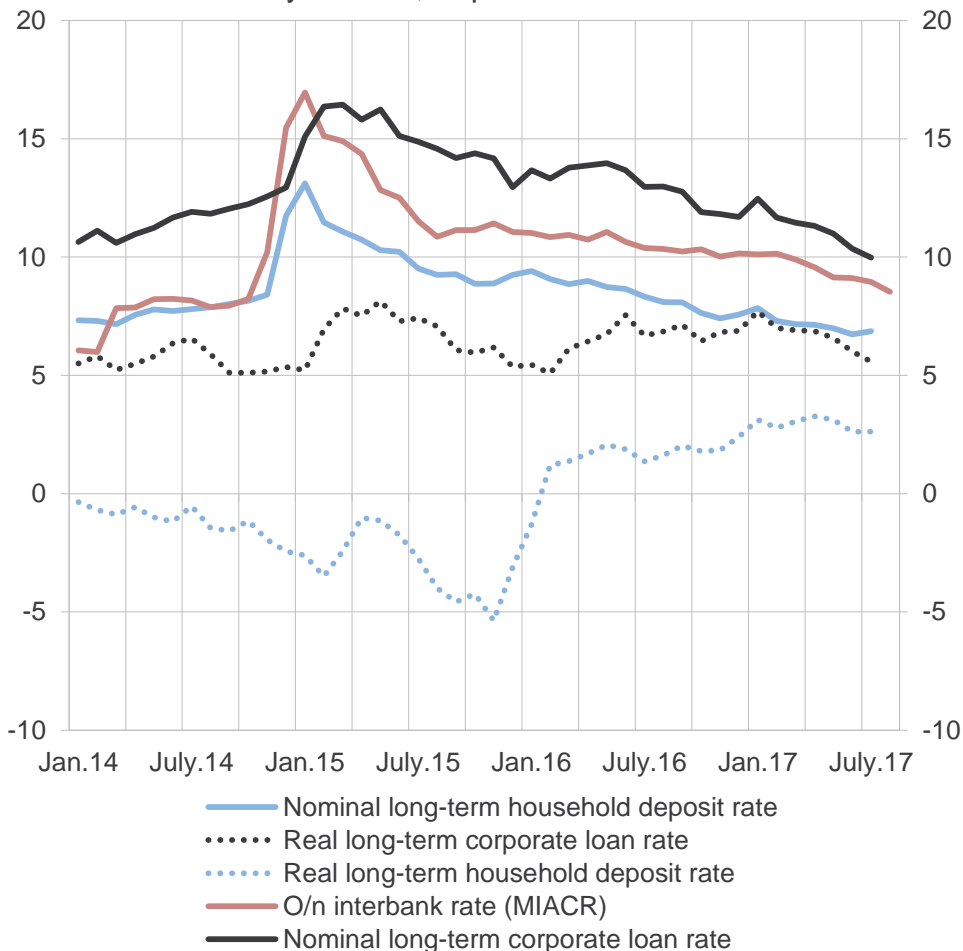
\* Notice: Data is adjusted for the amount of "currency swap" operations, operations with corresponding account balances of credit institutions at the central bank and FX liquidity refinancing operations on a return basis. According to BPM5

Source: Bank of Russia

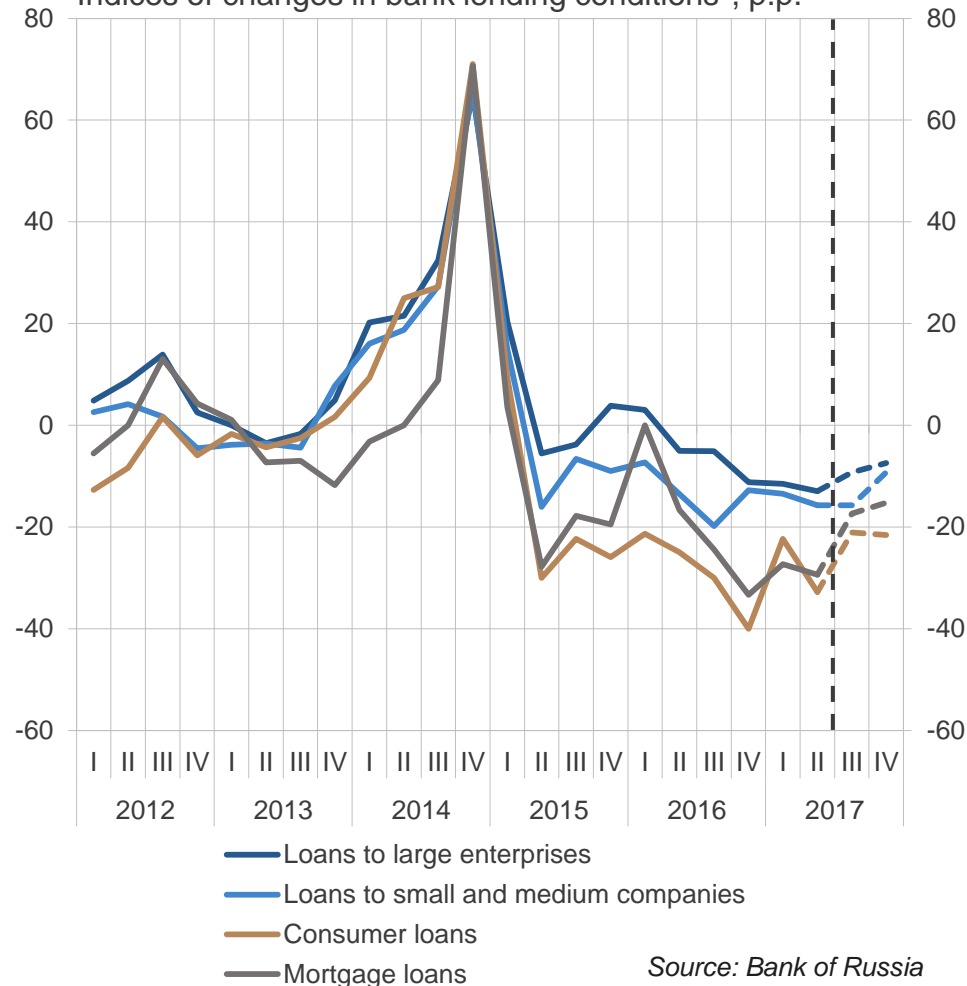


# Monetary Conditions Continue to Ease in Nominal Terms But in Real Terms Remain Moderately Tight

Interest rates dynamics\*, % p.a.



Indices of changes in bank lending conditions\*, p.p.



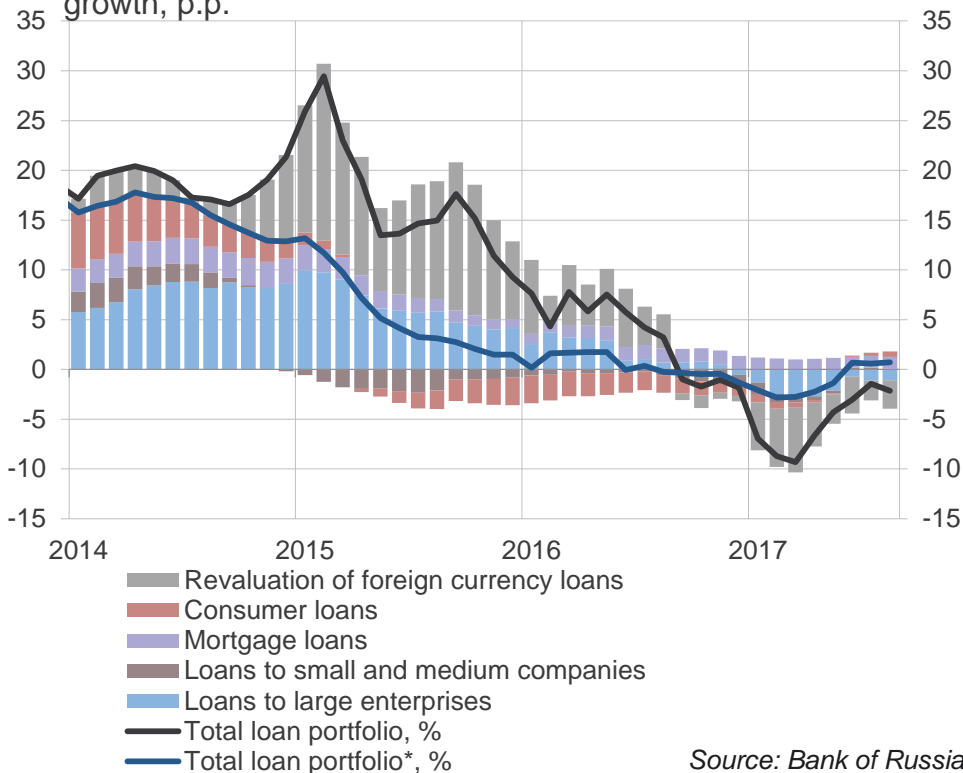
\* - Inflation expectations indicator used: Source: Bank of Russia  
 1) Real long-term corporate loan rate – Bloomberg  
 2) Real long-term household deposit rate – FOM (adjusted by the BoR)

(\*) Preliminary figures for Q3-Q4 2017

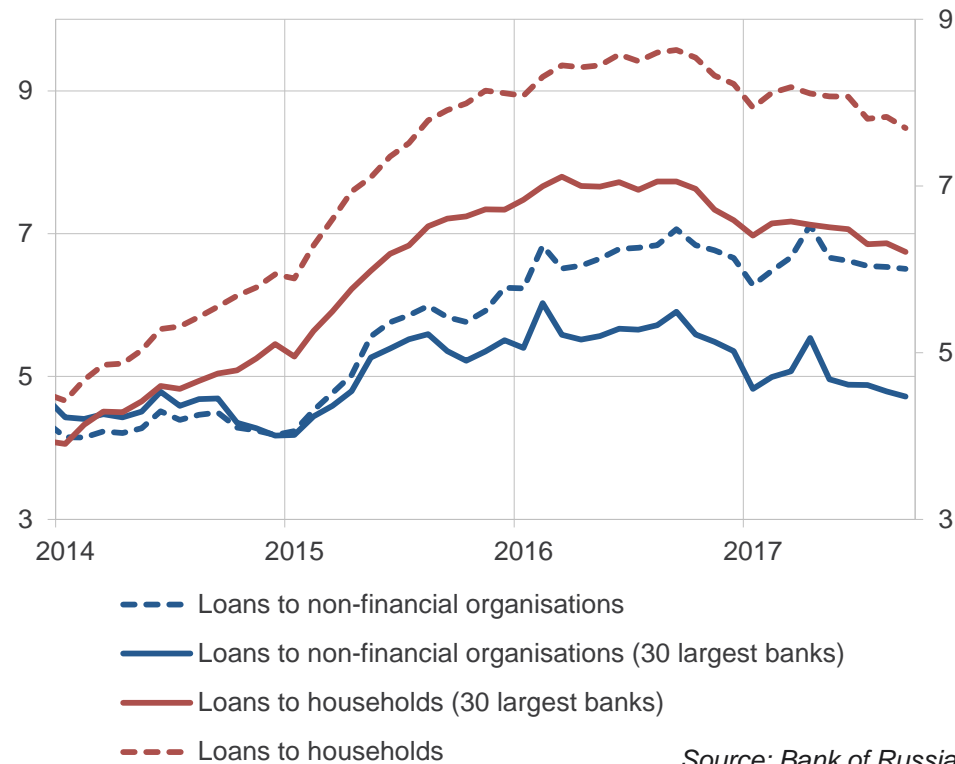
Source: Bank of Russia

## Cautious Behaviour of Banks and Borrowers and Moderately Tight Monetary Conditions Constrain Lending Growth

Contribution of different components to the bank lending growth, p.p.



Overdue loans (as % of loan portfolio)



Dollarisation of Loan Portfolio (%)

	1.01.16	1.05.17	1.06.17	1.07.17	1.08.17
Loans to non-financial organizations	39,8	29,9	29,6	30,4	30,3
Loans to households	2,7	1,2	1,2	1,2	1,2
Total	30,8	22,1	21,9	22,5	22

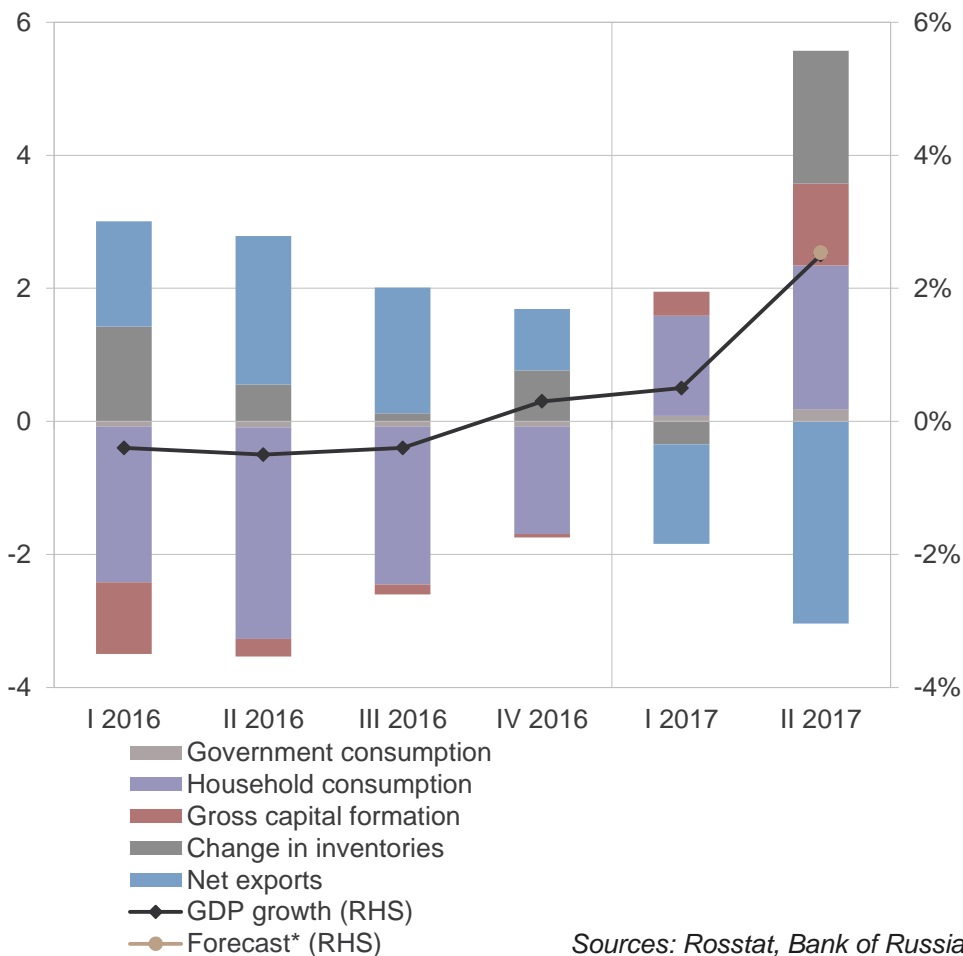
Dollarisation of Deposits (%)

	1.01.16	1.05.17	1.06.17	1.07.17	1.08.17
Household deposits	29,4	22,5	22,1	22,5	22,5
Corporate deposits and current accounts	47,3	37,0	36,3	36,9	37,2
Total	39,2	30,0	29,5	29,9	30,9



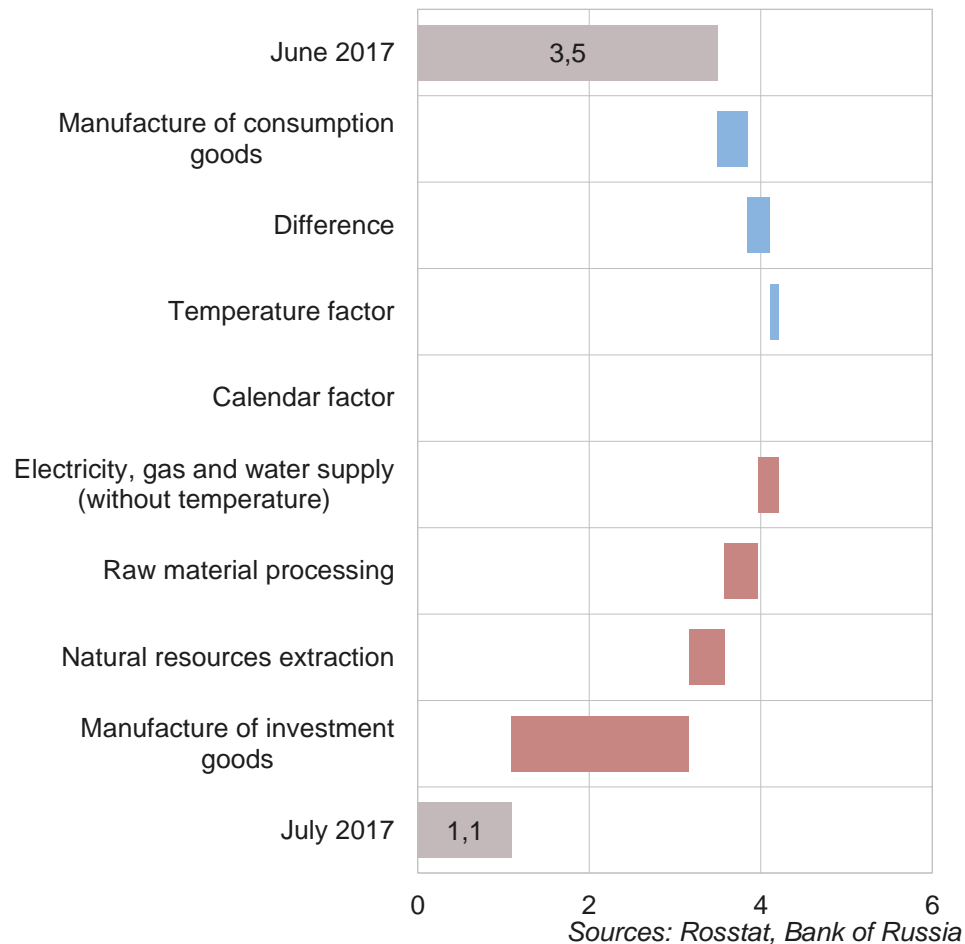
# Though Economic Recovery Has Accelerated in Q2, the Current Dynamics of Industrial Production Show That in Q3 and Q4 2017 GDP Growth Rates Will be Slightly Lower

Structure of elements of GDP use, p.p.



\* Q2 2017 – Bank of Russia estimates regarding the elements of use

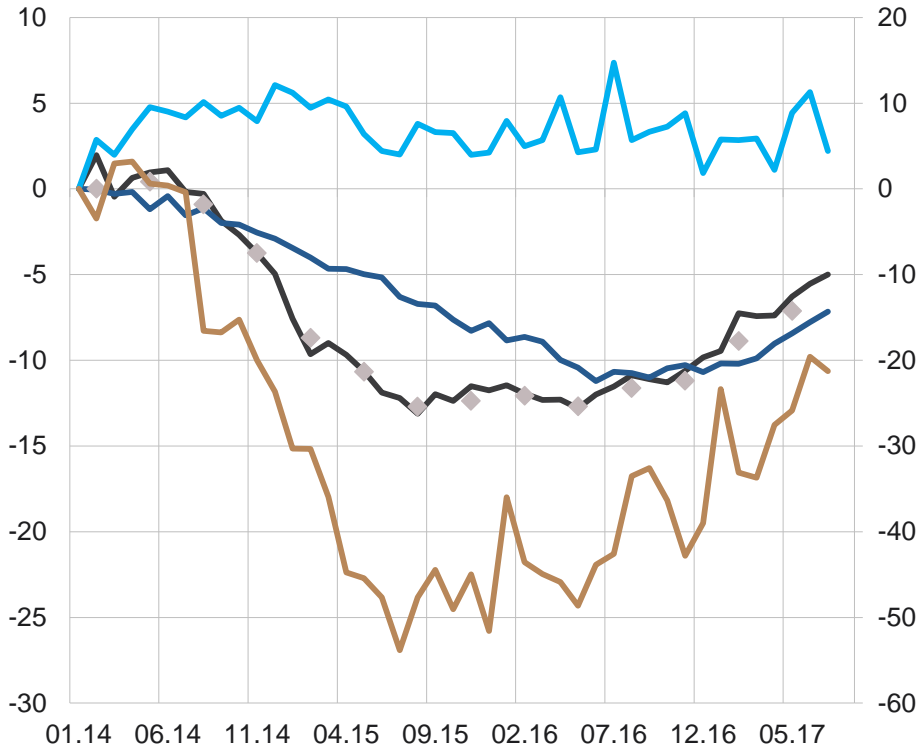
Change in annual growth rate of industrial production, p.p.





# Investment Activity Unevenly Picks Up

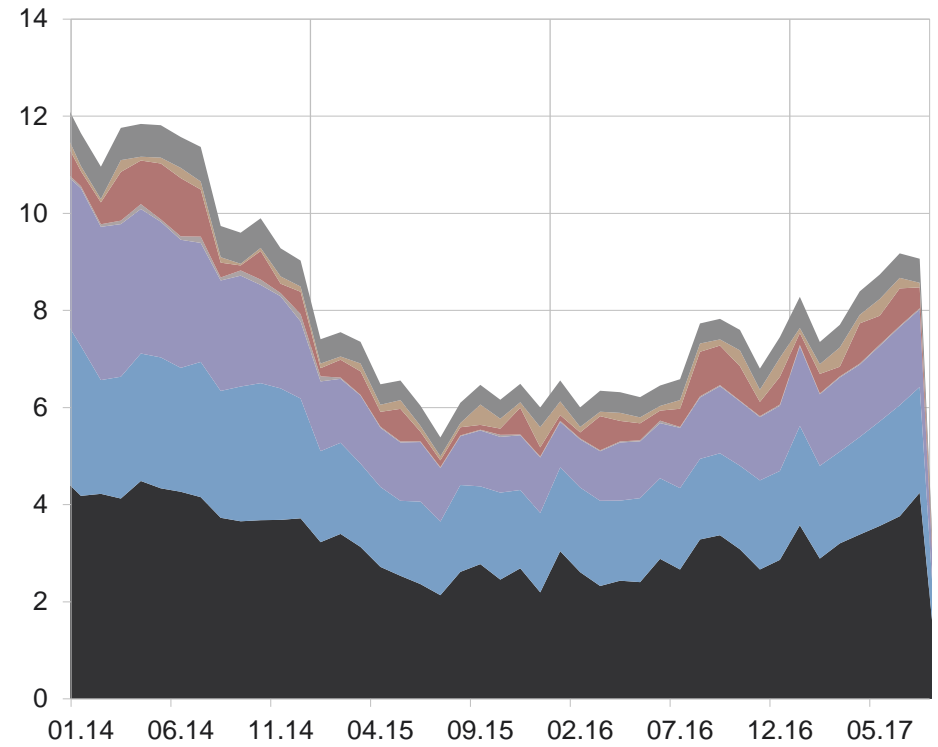
Indicators of investment activity (in % to Jan. 2014, SA)



- Fixed Capital Investment (Bank of Russia Estimate)
- Construction Works
- Investment Goods Manufacturing
- ◆ Fixed Capital Investment (Quarterly)
- Import of Machinery and Equipment from Far-Abroad

Sources: Rosstat, Bank of Russia

Import of machinery from non-CIS countries (SA), bln USD

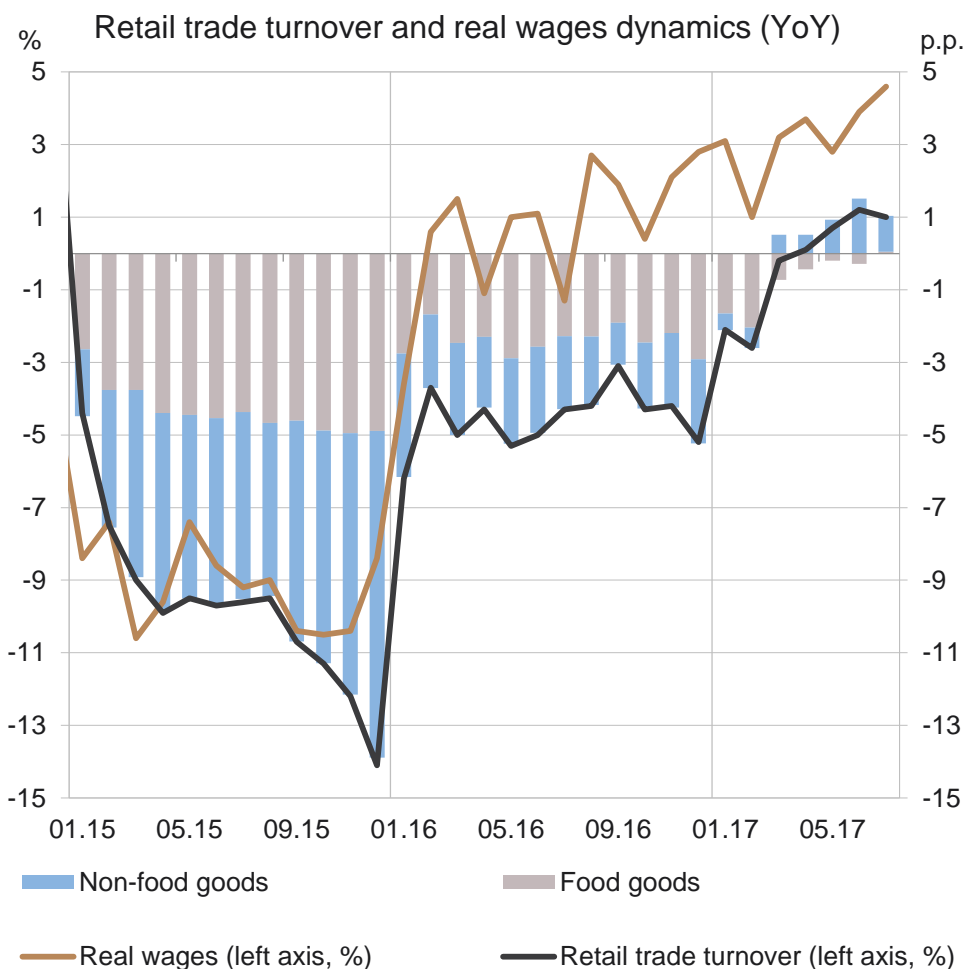


- Optical apparatus and instruments
- Vessels and watercraft
- Air vehicles
- Railway locomotives
- Land vehicles
- Electrical equipment
- Mechanical equipment

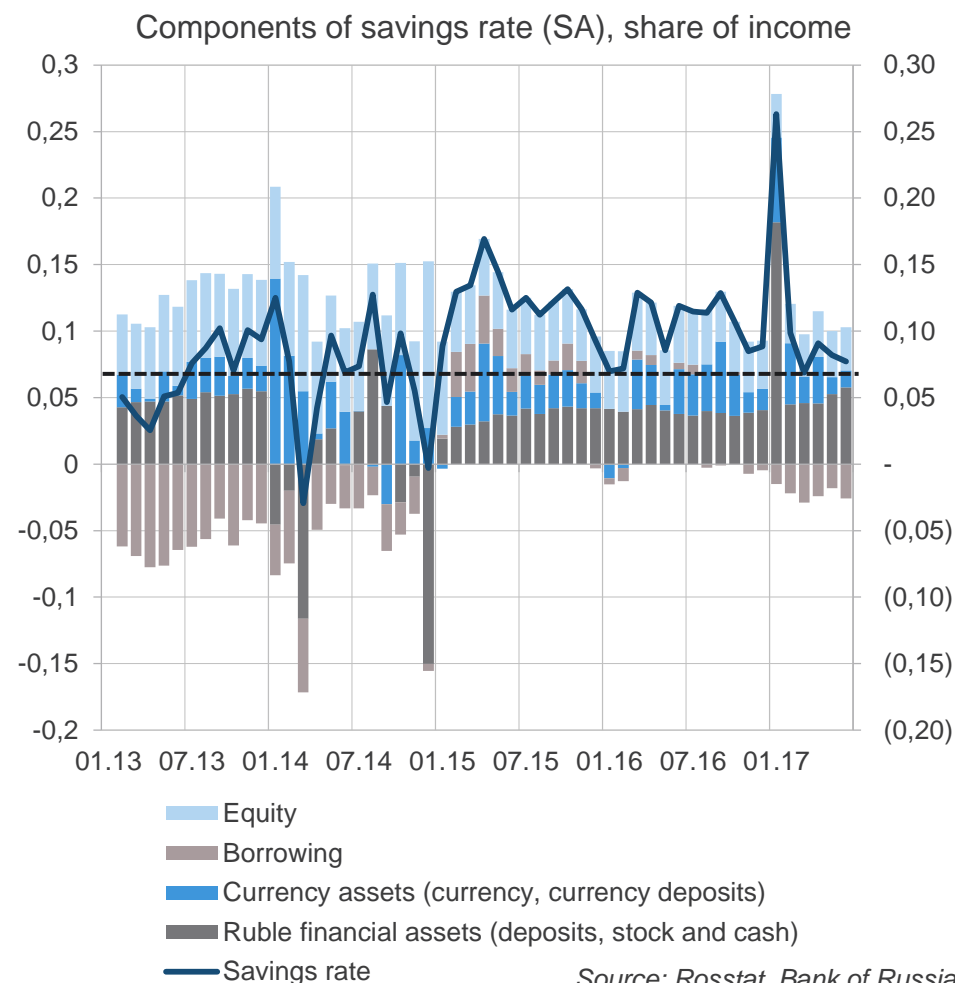
Sources: Rosstat, Bank of Russia



## Consumer Demand is Rebounding Gradually. Nevertheless, Households Still Demonstrate Savings Behaviour Patterns



Sources: Rosstat, Bank of Russia



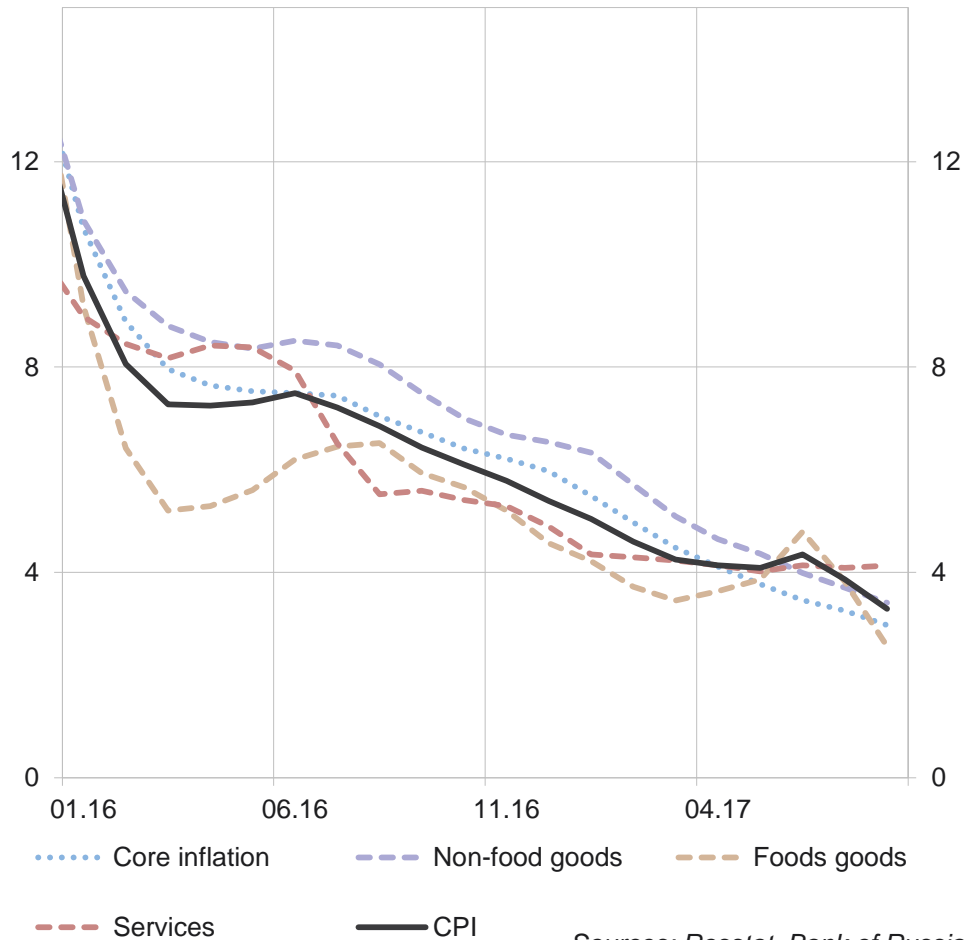
Source: Rosstat, Bank of Russia

\* Average savings rate in 2013-2014 – 0,0665 (horizontal line)



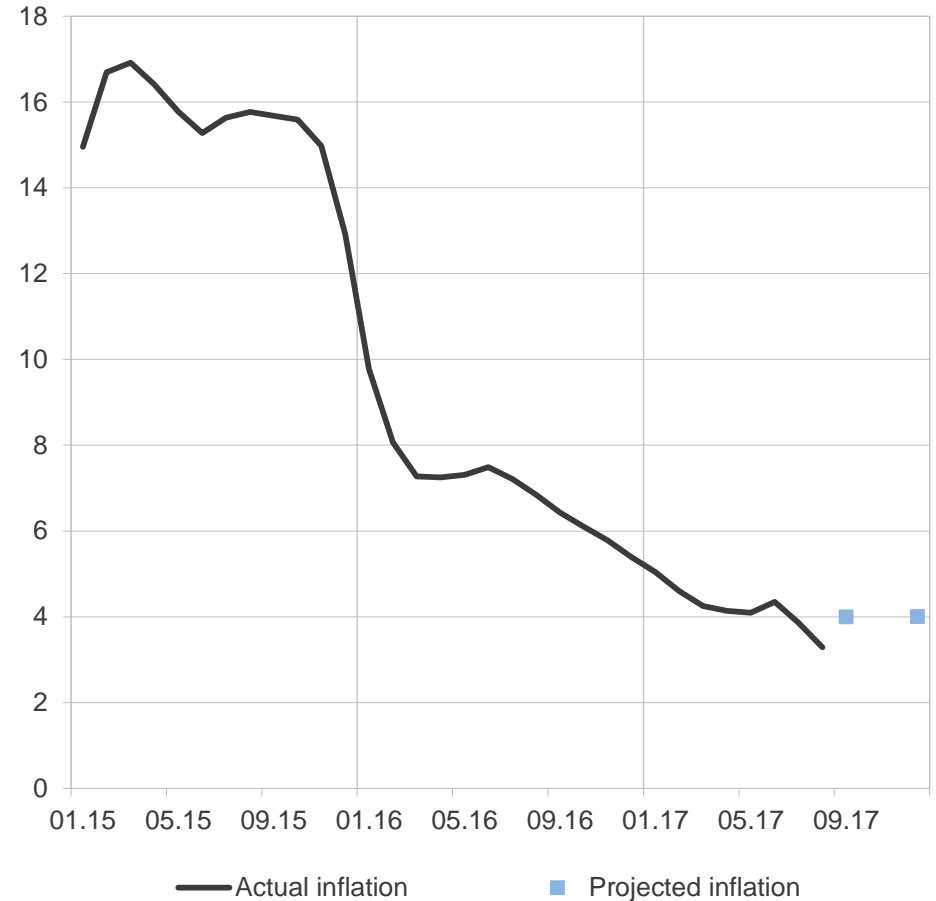
## Annual Inflation Remained Close to the Target in August. A Temporary Shock in the Fruit and Vegetables Market Subsides Faster than Expected

Inflation (YoY), %



Sources: Rosstat, Bank of Russia

Actual and projected inflation (end of quarter, YoY), %



Sources: Rosstat, Bank of Russia



## Inflation Expectations Resumed Their Decline in August

Expectations horizon		I.2016	II.2016	III.2016	IV.2016	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17
<b>Inflation expectations (absolute value), %</b>													
<b>Households</b>													
FOM	Next 12 months	14,7	14,2	14,2	12,4	11,5	12,9	11,2	11,0	10,3	10,3	10,7	9,5
FOM (Bank of Russia calculations)	Next 12 months	7,4	6,7	5,9	5,1	4,6	4,4	4,0	3,7	3,7	4,0	4,1	3,7
<b>Professional analysts</b>													
Bloomberg	2017		4,7	5,2	4,5	4,4	4,3	4,2	4,1	4,1	4,0	4,2	4,0
Interfax	2017	5,7	5,5	4,9	4,7	4,7	4,4	4,2	4,1	4,0	3,9	4,1	4,1
Reuters	2017			5,1	4,6	4,1	4,3	4,1	4,1	4,1	4,0	4,1	4,0
<b>Financial markets</b>													
OFZ IN	Next 7 years	5,4	4,6	4,5	4,6	4,6	4,5	4,5	4,3	4,1	4,3	4,5	4,4
OFZ IN (option not substracted)	Next 7 years	6,9	6,0	5,3	5,4	5,0	4,9	4,9	4,7	4,6	4,7	4,9	4,8
Bond market	Next quarter	12,0	6,9	7,2	6,6	-	-	5,5	-	-	4,7	-	-
Interbank market	Next quarter	9,9	5,3	5,4	5,6	-	-	4,5	-	-	3,6	-	-
<b>Inflation expectations (balanced index*)</b>													
<b>Households</b>													
FOM	Next 12 months	84	78	82	80	80	83	79	80	78	80	82	79
FOM	Next month	72	68	70	76	72	72	68	71	66	68	73	67
<b>Businesses</b>													
REB	Next 3 months	14	38	36	46	42	20	22	14	26	20		
Retail prices (Rosstat)	Next 3 months	32	29	28	27	-	-	27	-	-	24	-	-
Tariffs (Rosstat)	Next quarter	5	5	0	0	-	-	4	-	-	3	-	-

### Change against 3MMA:

- - Inflation expectations become better (more than 1 standard deviation)
- - Inflation expectations become better (less than 1 standard deviation)
- - Inflation expectations unchanged ( $\pm 0,2$  standard deviations)
- - Inflation expectations become worse (less than 1 standard deviation)
- - Inflation expectations become worse (more than 1 standard deviation)

\*Balanced index is the difference between the shares of those who expect prices to rise and fall



## Fiscal Policy: The Ministry of Finance Adheres to Fiscal Consolidation and Plans to Implement Fiscal Rules

### Conservative Fiscal Policy in 2016-2020:

Budget Deficit Reduction from 3.4% of GDP in 2016 to 2.1% of GDP in 2017, 1.6% in 2018 of GDP, 0.9% in 2019 of GDP and 0.8% of GDP in 2020.

### New Fiscal Rules in 2017-2019:

Sterilisation of Extra Oil and Gas Revenues (due to Urals price being above \$40 per barrel) and their Accumulation in the Reserve Fund via the purchases of foreign currency in the domestic FX market. The volume of foreign currency purchases will be ₹ 426,5 bln in February-September while the Reserve Fund is not used to finance the budget deficit.

### Borrowing as a Source of Financing Public Expenditures Instead of the Reserve Fund:

Ministry of finance borrowed \$ 3 bln through eurobonds placement in June 2017. Net Placement of OFZ in 2017-2018 will amount to ₹ 1,05 trln annually.

### Further Implementation of Privatisation Plans:

Privatisation of “VTB” in 2017 has been cancelled. The Government plans to privitise “NCSP” and “SCF” (with revenues around ₹ 40-50 bln)

### Budget Execution Within the Year:

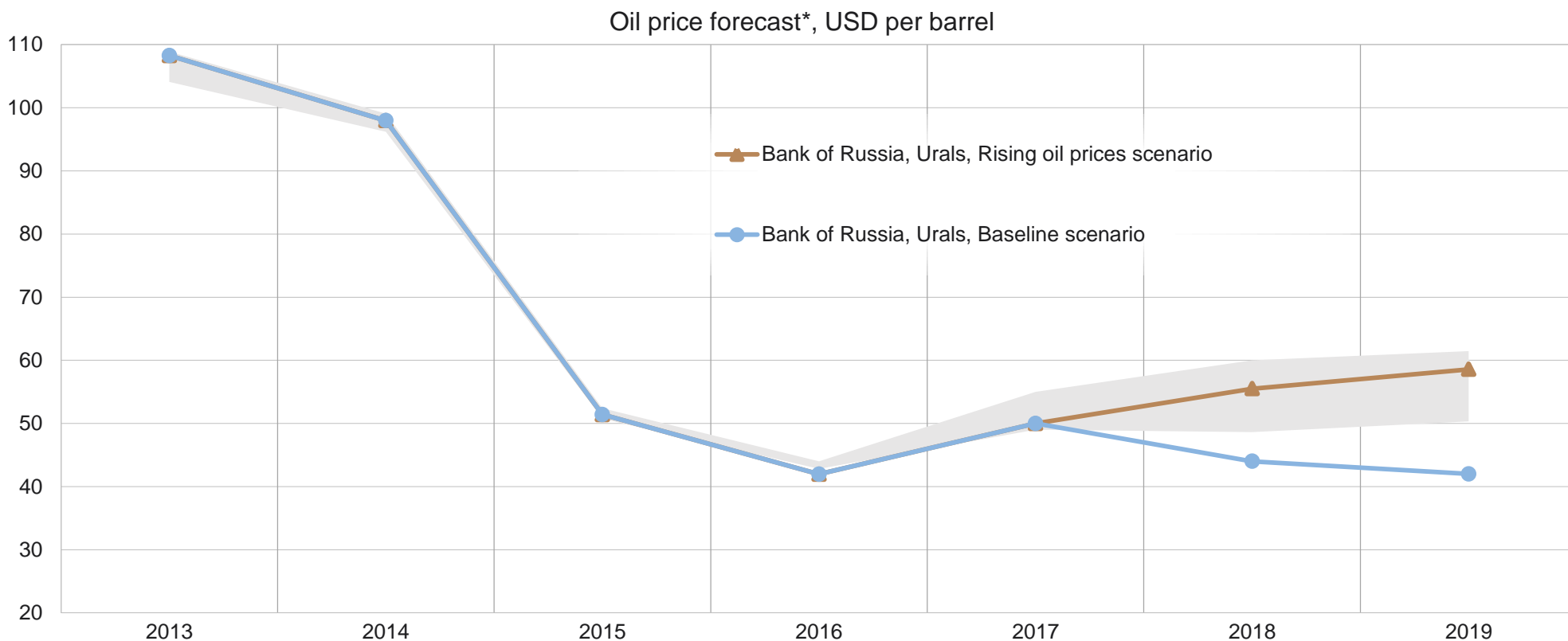
Despite big social expenditures on the one-off payment for pensioners and two indexations of social contributions and pensions at the beginning of the year, budget deficit was reduced from 3.4% GDP in 2016 to 2.2% GDP level in the middle of 2017. It is close to the end-of-the-year Ministry of Finance forecast. Such dynamics is related to the fast paces of economic recovery. The Government can increase expenditures (by about ₹ 0,1-0,2 trln).

### Main Indicators of the Federal Budget

Federal budget	Jan-Jun 2017 (moving average over last 12 months)	2017 (Bank of Russia estimates in baseline scenario – Urals 51\$/brl)
Revenues (without extra oil and gas revenues), % of GDP	17,0	15.6
Expenditures, % of GDP	19,2	18.6
Deficit, % of GDP	-2,2	-3,0
Net using (spending – accumulation) of the Reserve Fund resources, ₹ trln	-0,31	1,21



## The Bank of Russia Remains Conservative Regarding the Oil Price Path in the Key Scenarios



Note: grey area reflects the range of oil price forecasts made by international organizations and independent analysts and oil prices actually observed in previous years. The forecasts are made for oil grades: Brent, Dubai, WTI.

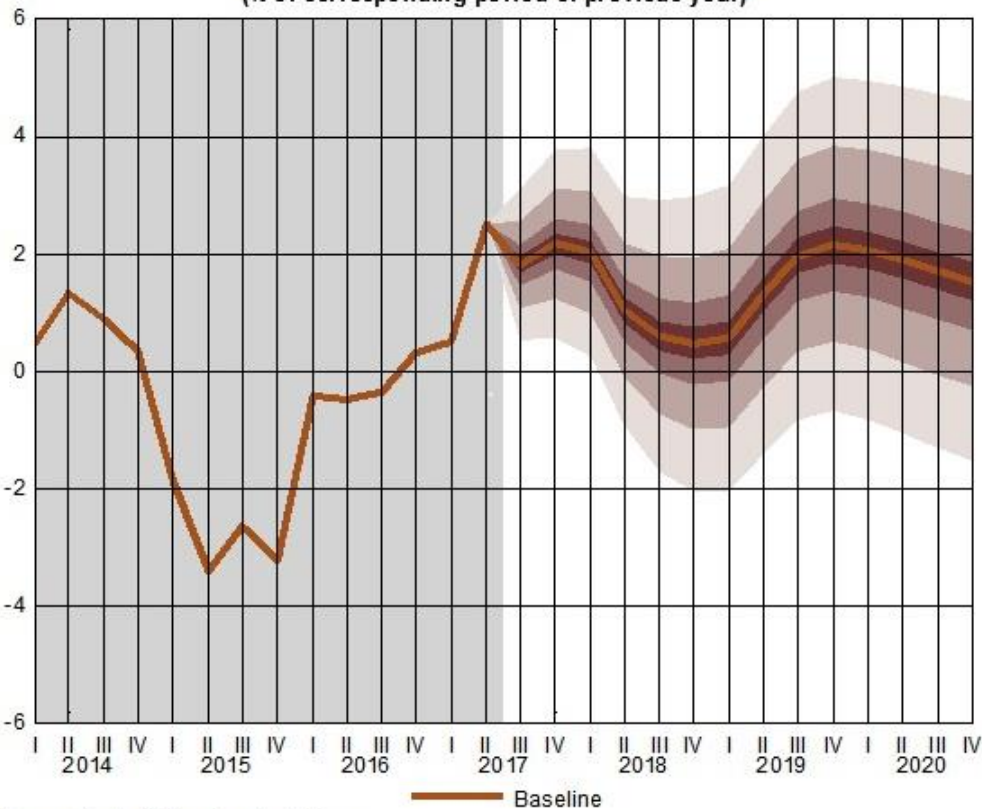
\* As presented in Monetary Policy Report №3 (September 2017)

Sources: Bank of Russia, US Energy Information Administration, World Bank, IMF, The Economist, Consensus Economics, Reuters



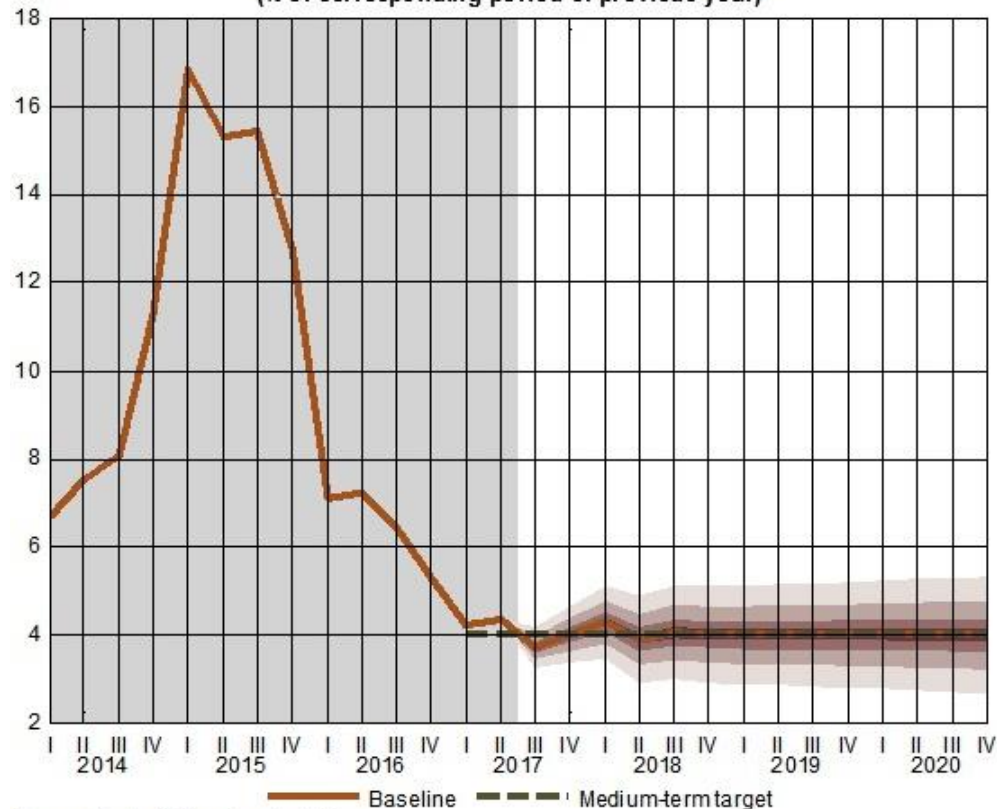
## Baseline Scenario\*: Economic Recovery and Inflation Maintained Close to 4%

**GDP growth rates**  
(% of corresponding period of previous year)



Source: Bank of Russia calculations.

**Inflation**  
(% of corresponding period of previous year)



Source: Bank of Russia calculations.

\*As presented in Monetary Policy Report №3 (September 2017)



## Baseline scenario: The Medium-Term Outlook on the Russian Economy Has Not Changed

as % of previous year (unless indicated otherwise)	2016	2017	2018	2019	2020
	(actual)	Baseline*			
Urals price (annual average), US dollars per barrel	42	50	44	42	42
Inflation, % in December year-on-year	5,4	3,5-3,8	4,0	4,0	4,0
Inflation, yearly average	6,5	4,0	4,0	4,0	4,0
Gross domestic product	-0,2	1,7-2,2	1,0-1,5	1,5-2,0	1,5-2,0
Final Consumption Expenditure	-3,5	2,5-3,0	1,0-1,5	1,5-2,0	2,5-3,0
- households	-4,5	3,0-3,5	1,5-2,0	2,0-2,5	3,0-3,5
Gross formation	1,5	6,0-7,0	1,0-2,0	2,0-3,0	1,5-2,5
- gross fixed capital formation	-1,8	4,0-4,5	1,0-1,5	1,0-1,5	2,3-2,8
Exports	3,1	3,5-4,0	1,5-2,0	1,5-2,0	1,5-2,0
Imports	-3,8	13,0-13,5	2,0-2,5	3,0-3,5	4,0-4,5
Money supply in national definition	9,2	8-11	9-12	9-12	8-11
Money base in narrow definition	-0,6	3-5	5-7	7-10	7-10

\*As presented in Monetary Policy Report №3 (September 2017)

Source: Bank of Russia



## Базовый сценарий: прогноз платёжного баланса

<i>(Billions USD)</i>	2016 (actual)	Baseline*			
		2017	2018	2019	2020
<b>Current account</b>	<b>26</b>	<b>30</b>	<b>12</b>	<b>4</b>	<b>8</b>
Balance of trade	90	102	84	78	80
<i>Exports</i>	282	330	315	313	322
<i>Imports</i>	-192	-228	-231	-235	-242
Balance of services	-24	-28	-28	-28	-29
<i>Exports</i>	51	55	58	60	63
<i>Imports</i>	-74	-84	-86	-89	-92
Primary and secondary income balance	-41	-43	-44	-45	-47
Capital account	-1	0	0	0	0
<b>Balance of current and capital accounts</b>	<b>25</b>	<b>30</b>	<b>12</b>	<b>4</b>	<b>4</b>
<b>Financial account (except reserve assets)</b>	<b>-17</b>	<b>-6</b>	<b>-2</b>	<b>-4</b>	<b>-4</b>
<i>General government and central bank</i>	3	12	7	6	6
<i>Private sector (including net errors and omissions)</i>	-20	-17	-10	-10	-10
<b>Change in reserve assets ('+' - decrease, '-' - increase)</b>	<b>-8</b>	<b>-24</b>	<b>-9</b>	<b>0</b>	<b>0</b>

\*As presented in Monetary Policy Report №3 (September 2017). Signs according to BPM5

Note: owing to rounding the sums of the separate items may differ from the totals shown

Source: Bank of Russia





## Monetary Policy in September 2017

### Inflation and inflation expectations

- Inflation is close to 4%
- Inflation expectations are declining, though are not yet “anchored”

### Economic activity

- The economy keeps growing
- The economy is close to its potential

### Inflation risks

Short-term	Medium-term
<ul style="list-style-type: none"> <li>• Fluctuations of food prices</li> </ul>	<ul style="list-style-type: none"> <li>• Price fluctuations in global commodity markets</li> <li>• Labour productivity growth lagging considerably behind the wage growth</li> <li>• Households' shrinking propensity to save</li> <li>• High sensitivity of inflation expectations</li> </ul>

**Medium-term risks of inflation overshooting 4% dominate over the risk of its steady downward deviation from the target**



### Decision

**The Bank of Russia cuts the key rate by 50 bp to 8.50% p.a.**

### Signal

***During the next two quarters, the Bank of Russia deems it possible to cut the key rate further***



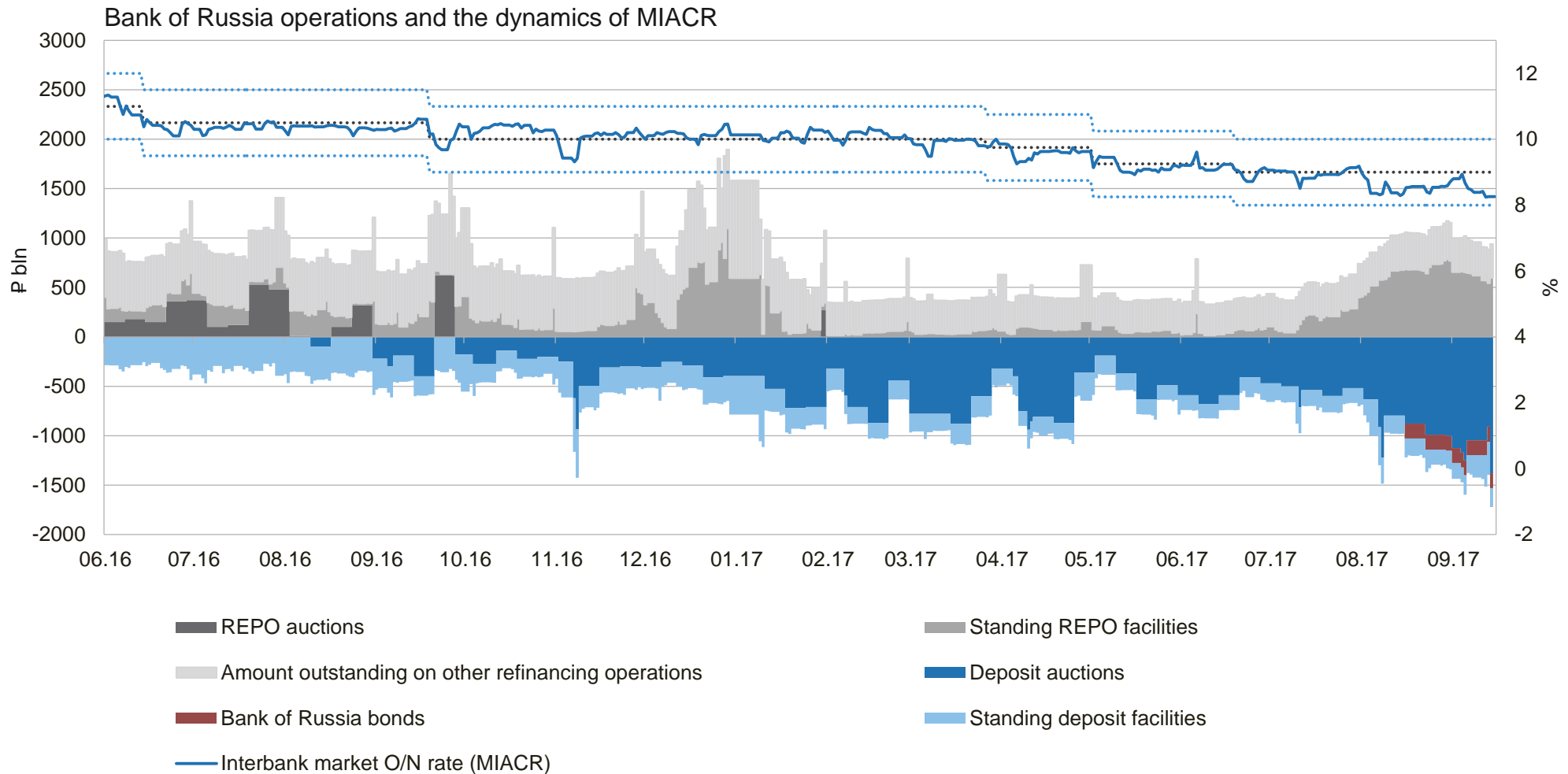
Bank of Russia  
The Central Bank of the Russian Federation



## Appendix



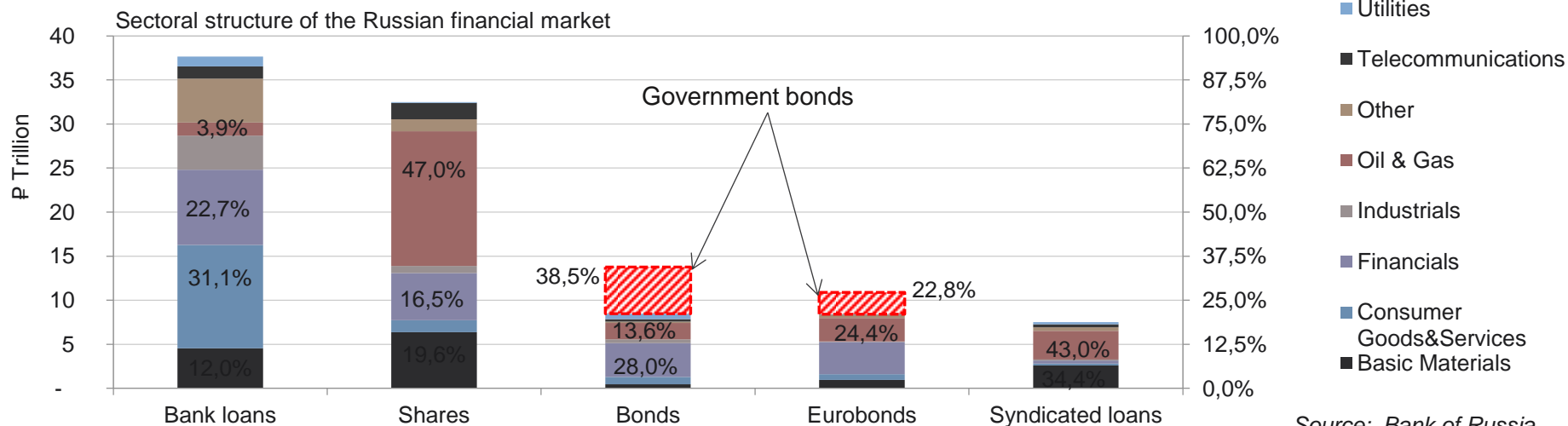
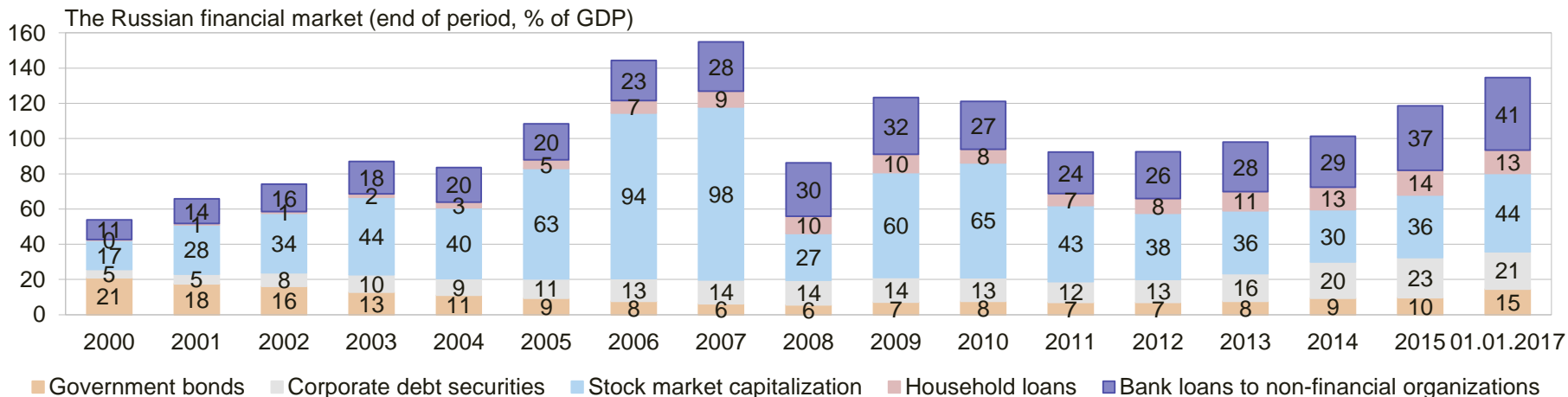
## Performance Under Structural Excess Liquidity Since January 2017. The Bank of Russia Mostly Conducts Deposit Auctions and Has Started Issuing Bonds in August



Source: Bank of Russia



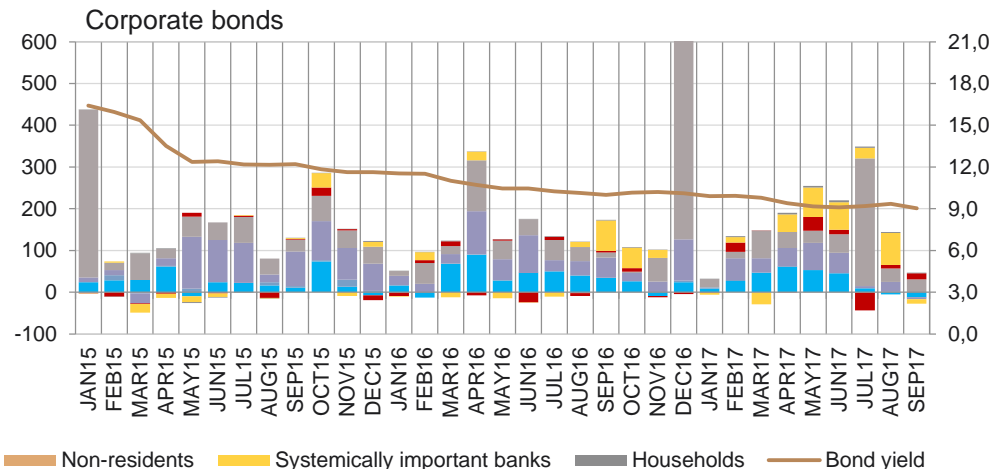
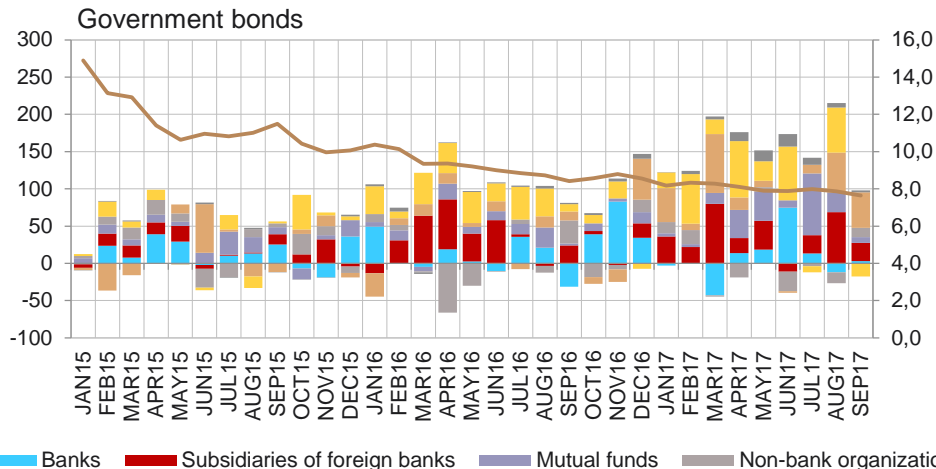
# Bank Loans Are the Main Source of Funding



Source: Bank of Russia

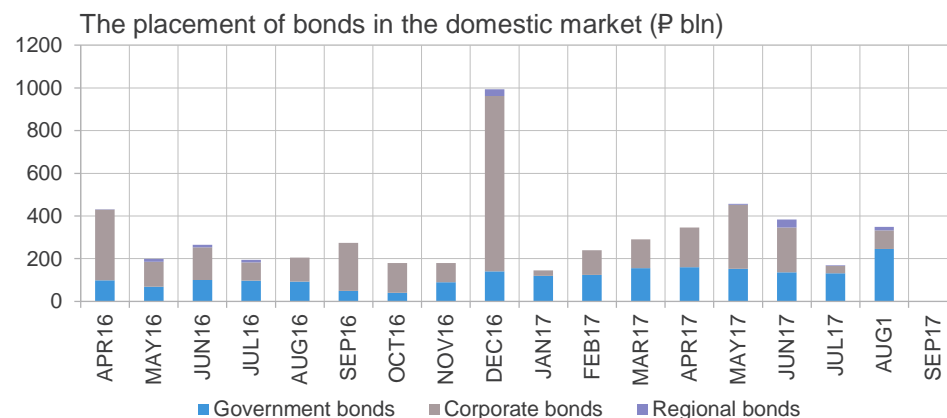


## Non-resident Purchases of OFZ Increased in August



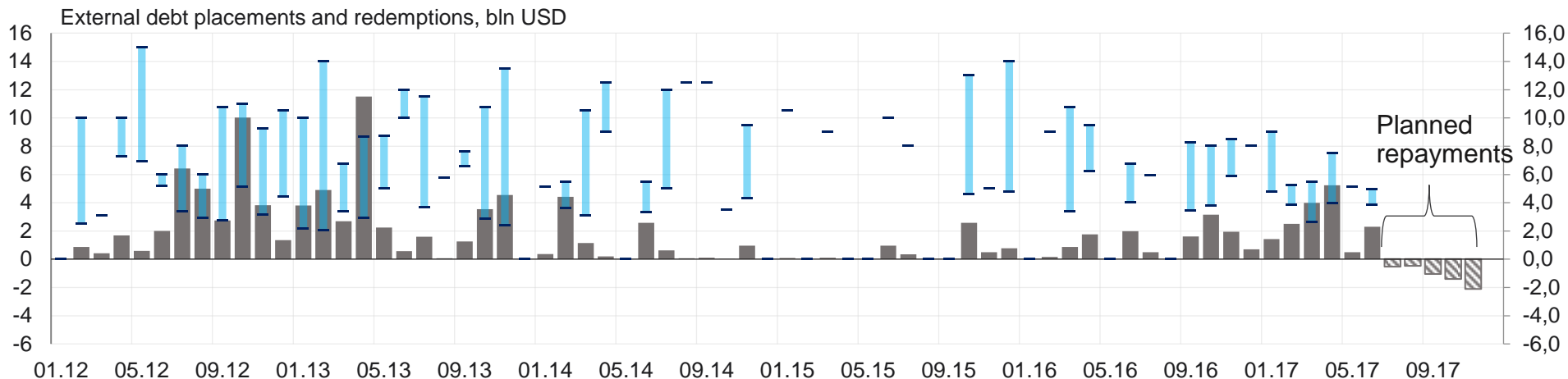
■ Banks 
 ■ Subsidiaries of foreign banks 
 ■ Mutual funds 
 ■ Non-bank organizations 
 ■ Non-residents 
 ■ Systemically important banks 
 ■ Households 
 — Bond yield

Date	Government bonds	Regional bonds	Corporate bonds	Stock market capitalisation
2010	2,054	0,462	2,965	-
2011	2,803	0,424	3,437	-
2012	3,197	0,440	4,166	25,2
2013	3,635	0,499	5,189	25,3
2014	4,593	0,532	6,623	23,2
2015	4,991	0,576	8,068	28,8
2016	5,611	0,634	9,438	37,8
Sep.17	6,392	0,644	10,5	33,0
<b>Change in 2017</b>	<b>+13,9%</b>	<b>+1,5%</b>	<b>+11,3%</b>	<b>-12,7%</b>



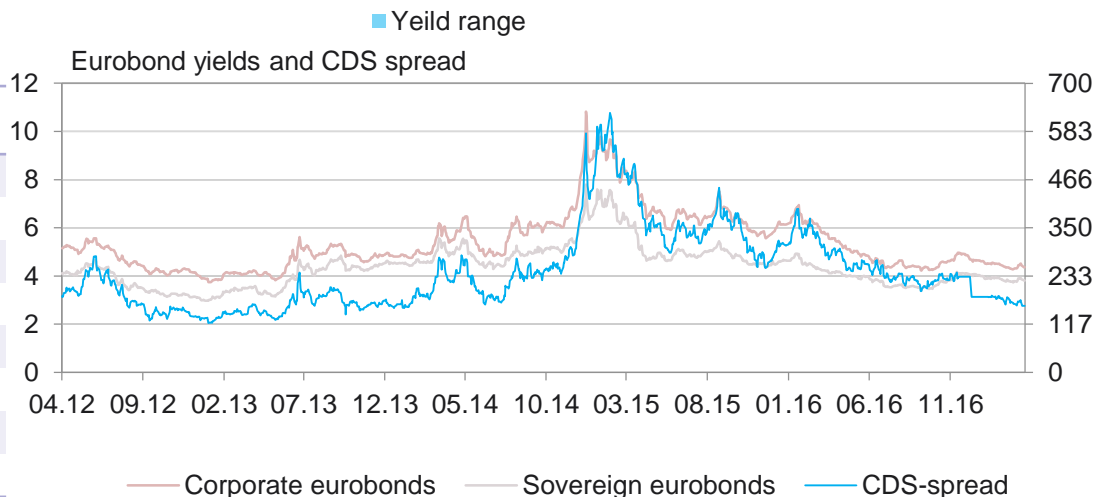


# Issuing Activity in the External Market Has Decreased



■ Eurobond placement

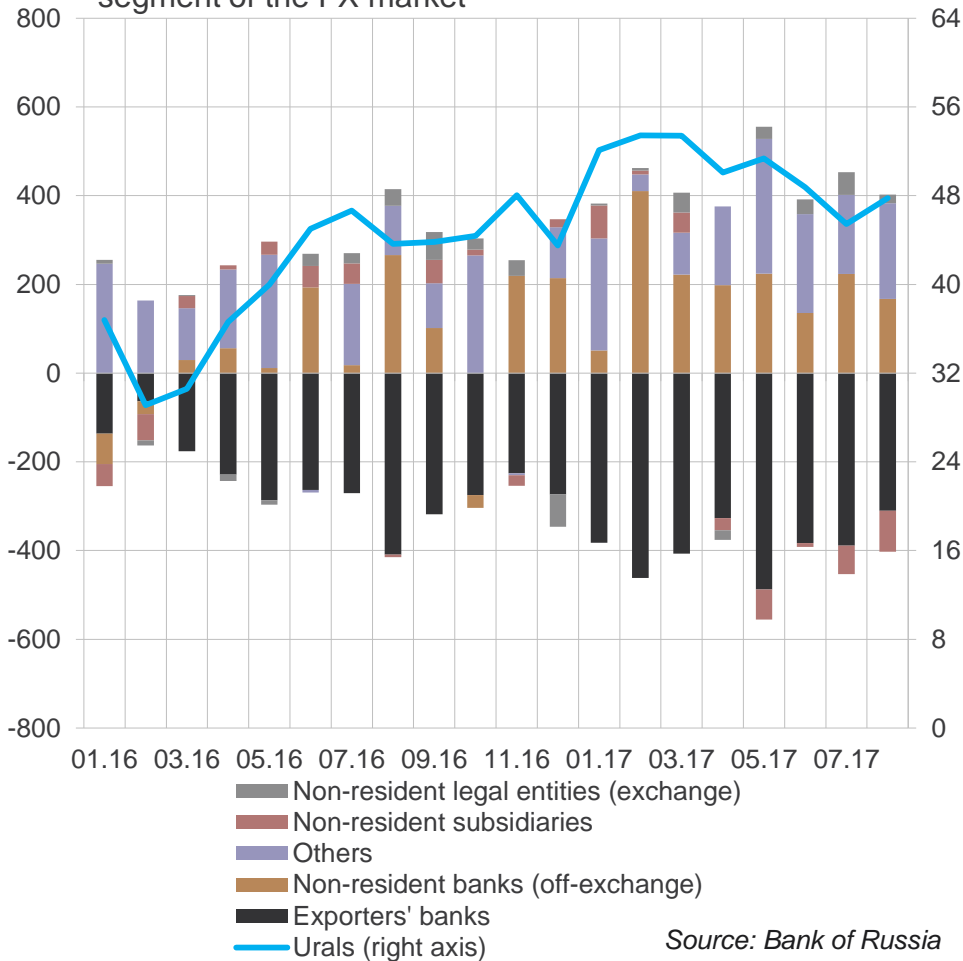
External Bond Market Portfolio, bln USD			
	Sovereign Eurobonds	Regional Eurobonds	Corporate Eurobonds
2010	32,2	1,3	106,6
2011	29,2	0,7	113,9
2012	34,9	0,5	148,9
2013	40,7	0,6	181,8
2014	39,3	0,5	165,9
2015	35,9	0,4	139,1
2016	37,6	0,0	134,5
Jun.17	35,0	0,0	134,1





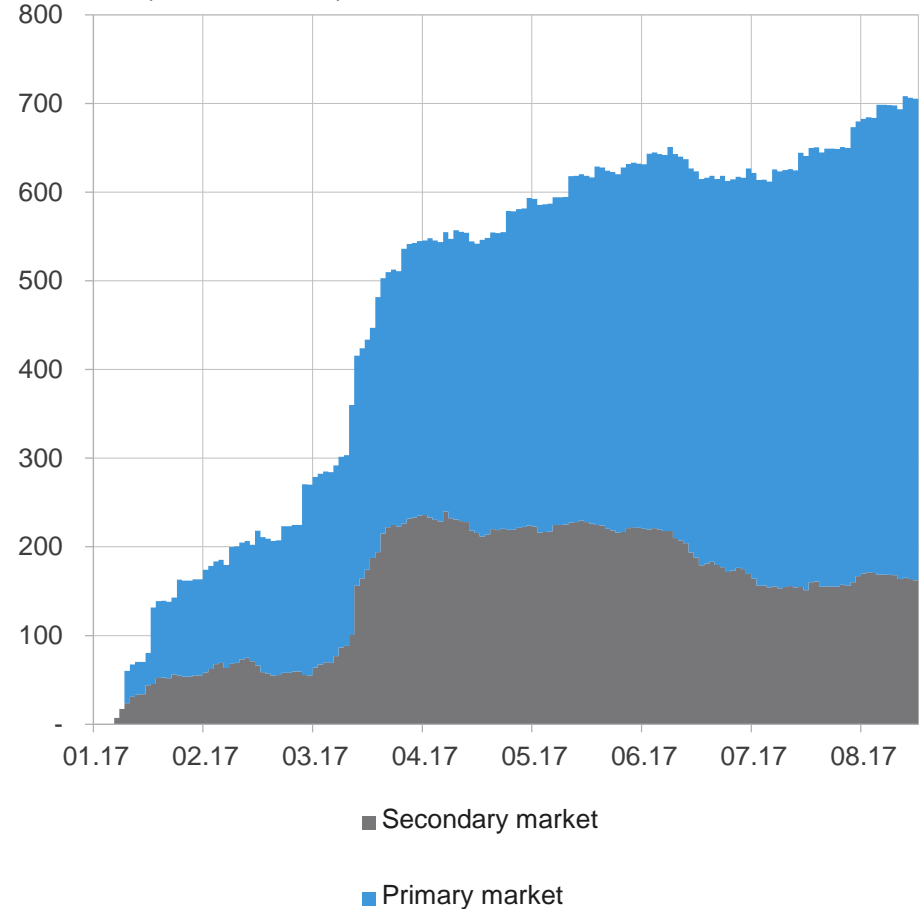
# In August Exporters have Reduced Their FX Supply and Non-Residents Have Resumed OFZ Purchases

Daily average net purchases of USDRUB in the cash segment of the FX market



Source: Bank of Russia

OFZ purchases by foreign investors (accumulated), ₺ bln



Source: Bank of Russia



## Otkritie FC Bank Case: Causes

### **Aggressive Growth Strategy During the Last Several Years:**

- ✓ Otkritie became systemically important after the merger of 3 relatively large banks;
- ✓ The bank acquired the second largest insurer Rosgosstrakh which faced significant financial problems.

### **High Risk Appetite:**

- ✓ Active participation in the FX repo operations in order to purchase the Russia30 Eurobonds.

**Massive Outflow (More Than \$10 bln) of Predominantly Corporate Deposits in July-August 2017**

**Credit Rating Downgrade as a Result of the Outflows**





## Otkritie FC Bank Case: Measures and Consequences

### MEASURES

The appointment of a provisional administration on August 29<sup>th</sup>, 2017

the Bank of Russia will act as the key investor with the funding coming from the Banking Sector Consolidation Fund

No moratorium on payments under creditors' claims is introduced, no bail-in option will be applied

Financial institutions and service providers within the Bank's group will continue their normal operation and provide services to their clients

The measures are being implemented in cooperation with the Bank's current owners and executives, which is set to secure the continuity of its operations in the banking services sector

### CONSEQUENCES

**As a result of the case, the financial system remains quite stable:**

- ✓ No signs of panic among either retail or wholesale bank depositors;
- ✓ Increase in bond yields of the largest private banks is insignificant (by 100-150 basis points);
- ✓ No negative impact on the equity market.