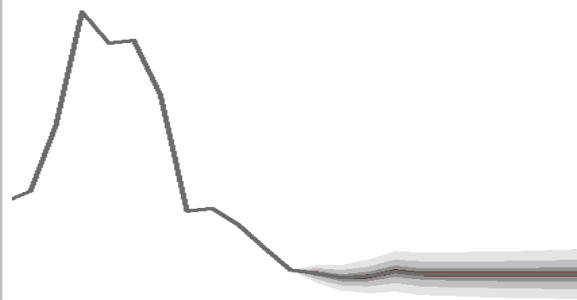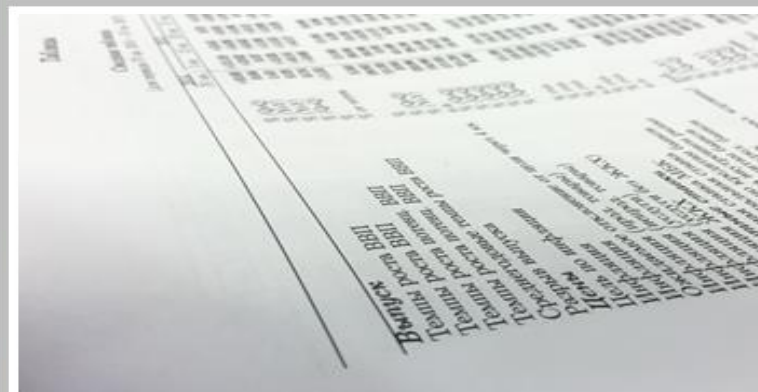Bank of Russia
The Central Bank of the Russian Federation

4%

RUSSIAN ECONOMIC OUTLOOK AND MONETARY POLICY CHALLENGES
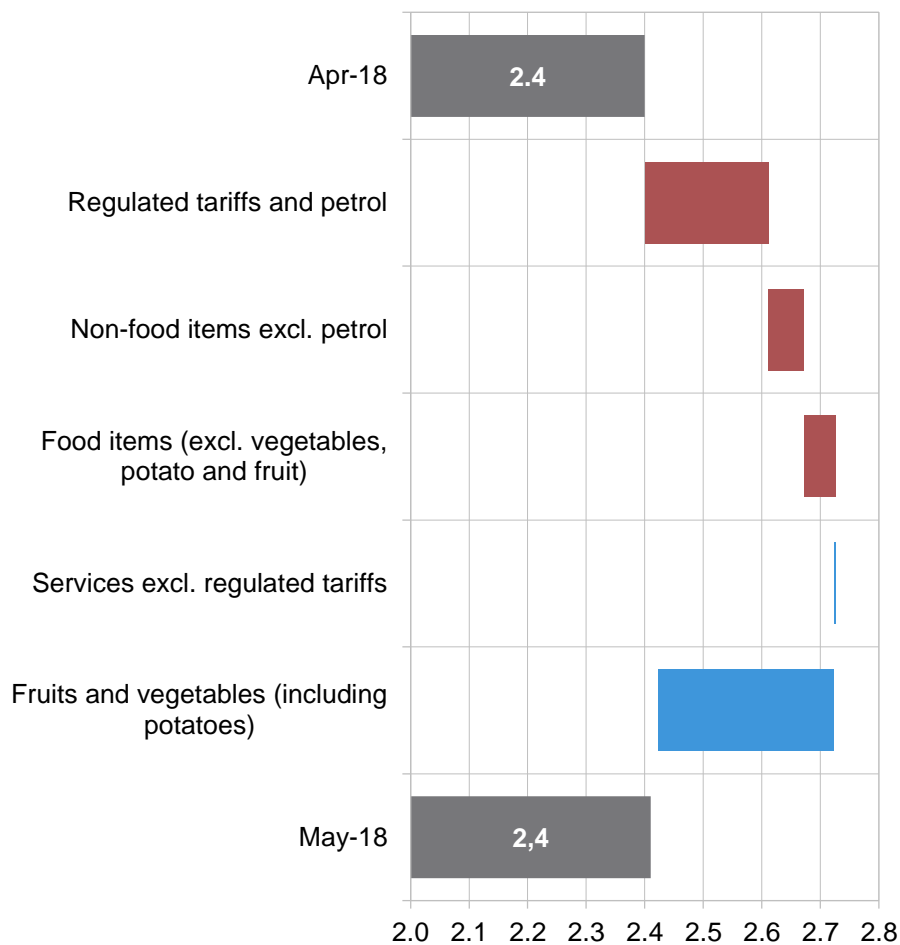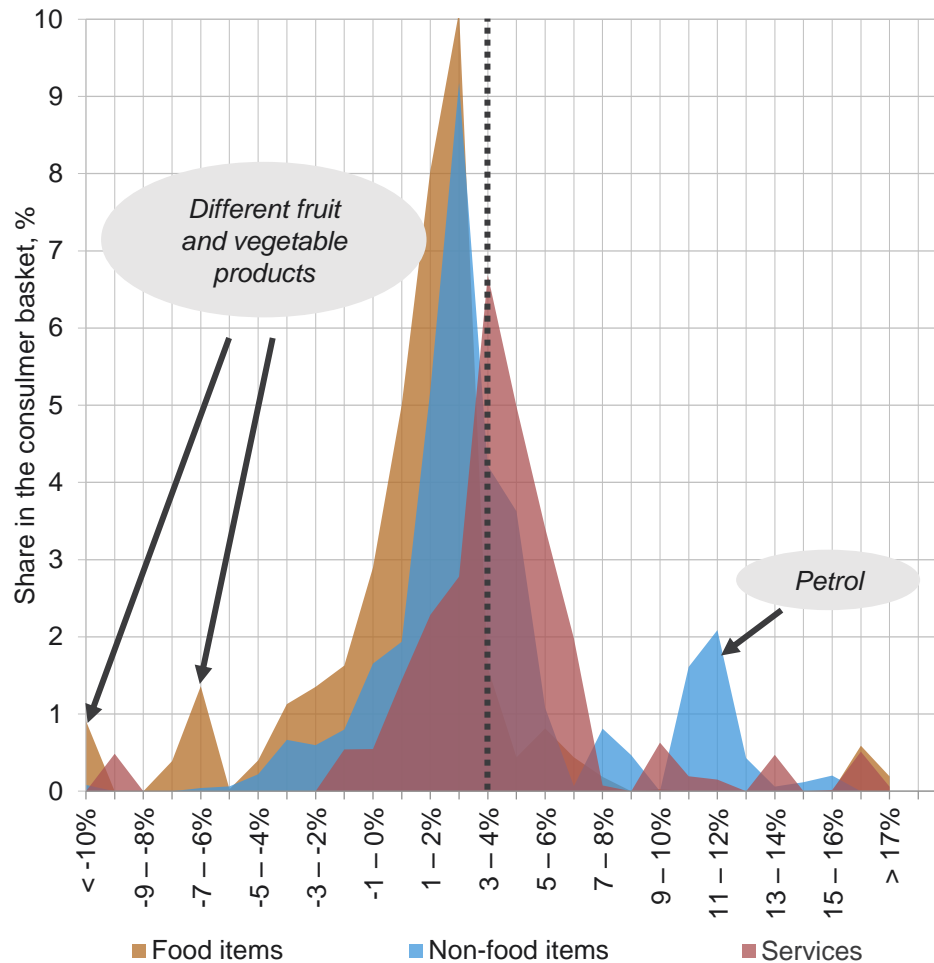
Bank of Russia   June 2018

Annual Inflation Remains Low and in General Corresponds to the Bank of Russia's Expectations. Inflation for Main Consumer Basket Product Groups Shows Mixed Dynamics

Contributions to the change in annual inflation in May 2018, ppts

Annual CPI distribution in May 2018

Apr-18	2.4
Regulated tariffs and petrol	
Non-food items excl. petrol	
Food items (excl. vegetables, potato and fruit)	
Services excl. regulated tariffs	
Fruits and vegetables (including potatoes)	
May-18	2,4

2.0 2.1 2.2 2.3 2.4 2.5 2.6 2.7 2.8

Sources: Rosstat, Bank of Russia

Different fruit and vegetable products

Petrol

Share in the consumer basket, %

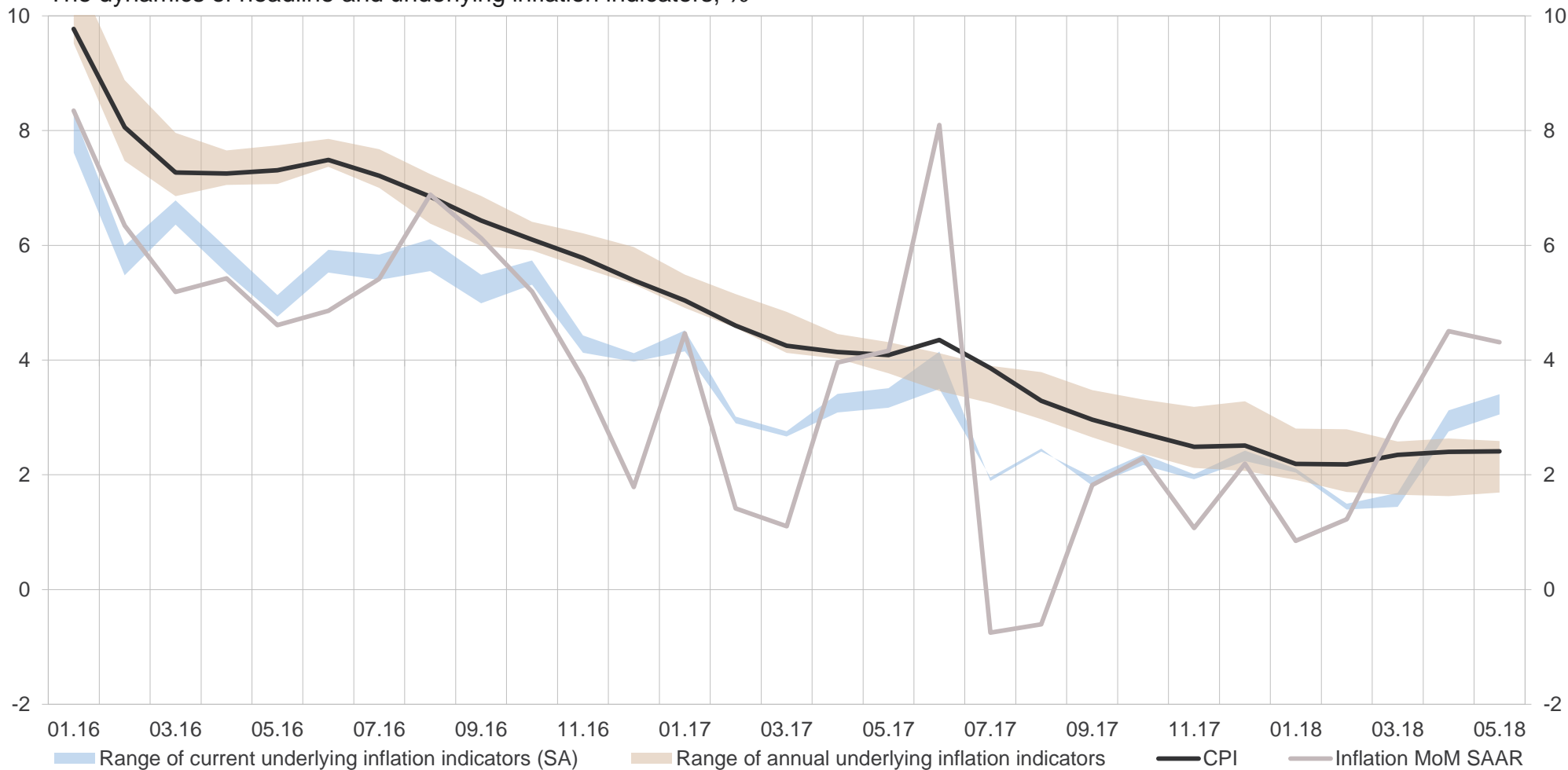Food items   Non-food items   Services

Sources: Rosstat, Bank of Russia

Underlying Inflation Indicators Have Stopped Slowing Down

The dynamics of headline and underlying inflation indicators, %

Range of current underlying inflation indicators (SA) Range of annual underlying inflation indicators CPI Inflation MoM SAAR

Sources: Rosstat, Bank of Russia

Accelerated Growth in Yields in Developed Markets and Geopolitical Factors Influenced the Dynamics of the Ruble Exchange Rate, Which Has a Moderate Effect on Inflation

Emerging markets CDS and VIX*

Decomposition of changes in the USDRUB exchange rate, %

Emerging markets CDS   Russia CDS 5Y   VIX (right axis)

Other factors
Carry trade attractiveness
CDS Russia
Oil price
EM currencies basket
Inertia
Change in the USDRUB exchange rate
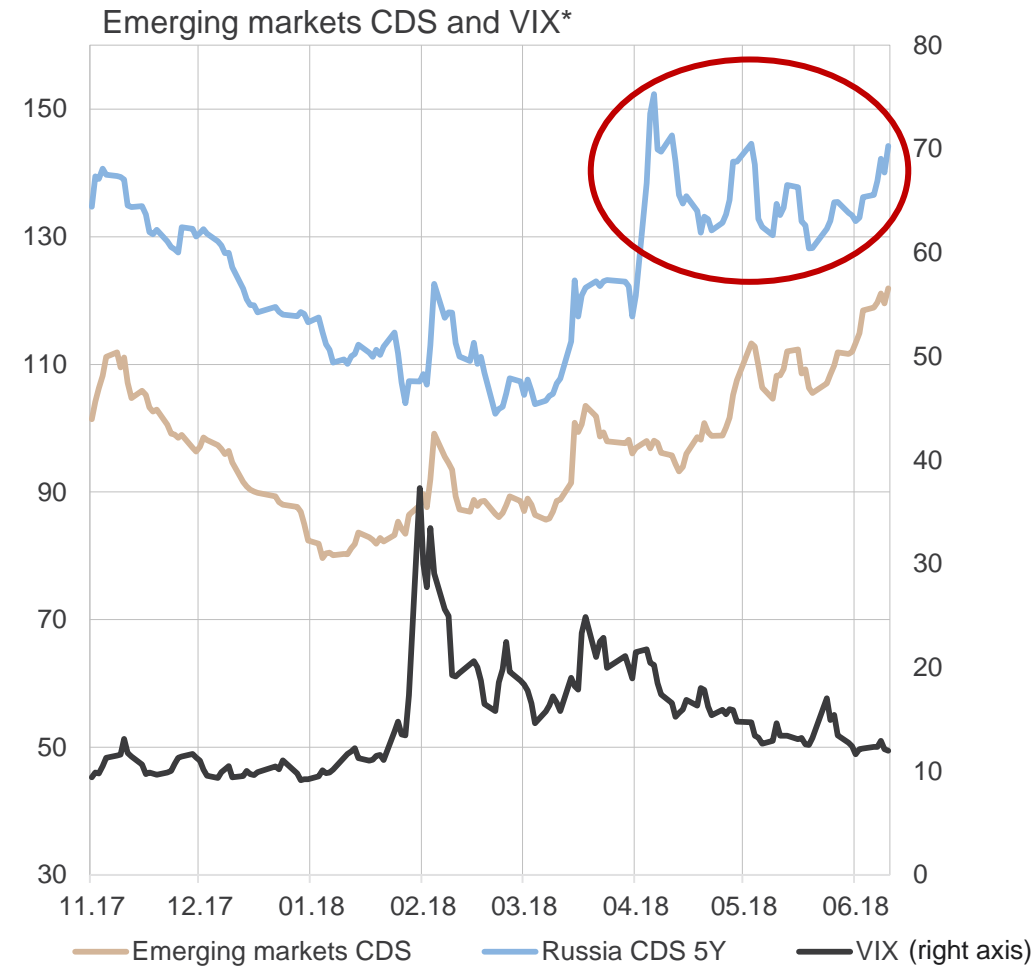
VIX – volatility index

Source: Bank of Russia
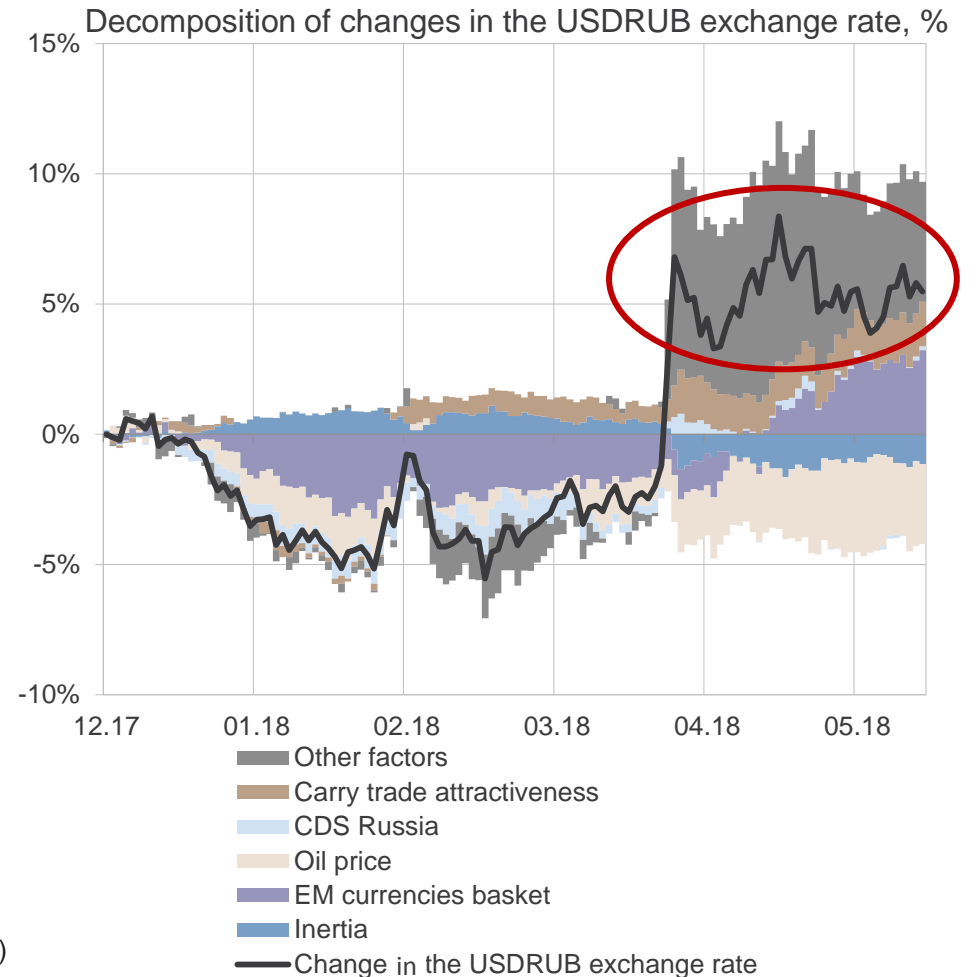
Source: Bank of Russia

Inflation Expectations of Households and Businesses Saw a Slight Increase, Which is Primarily Related to Higher Petrol Prices

	Expectations horizon	I. 2016	II.2016	III.2016	IV.2016	I.2017	II.2017	III.2017	IV.2017	Jan-18	Feb-18	Mar-18	Apr-18	May-18
Inflation expectations (absolute value), %														
Households														
FOM	Next 12 months	14.7	14.2	14.2	12.4	11.2	10.3	9.6	8.7	8.9	8.4	8.5	7.8	8.6
FOM (Bank of Russia calculations)	Next 12 months	7.4	6.7	5.9	5.1	4.0	4.0	2.8	2.4	2.1	2.1	2.2	2.2	2.3
Professional analysts														
Bloomberg	2018						4.0	4.0	4,0	4.0	3.8	3.6	3.6	3.6
Interfax	2018					4.2	4.1	4.1	3.9	3.8	3.8	3.7	4.0	3.8
Reuters	2018						4.1	4.0	4.1	3.8	3.8	3.6	3.8	3.7
Financial markets														
OFZ IN	Next 6 years	5.4	4.6	4.5	4.6	4.5	4.3	3.9	3.7	3.7	3.6	3.5	3.7	3.8
OFZ IN (option not substracted)	Next 6 years	6.9	6.0	5.3	5.4	4.9	4.7	4.3	4.1	4.1	4.0	3.9	4.2	4.3
Bond market	Next quarter	12.0	6.9	7.2	6.6	5.2	4.4	4.5	3.1	-	-	2.7		
Interbank market	Next quarter	9.9	5.3	5.4	5.6	4.6	3.7	3.4	2.5	-	-			
Inflation expectations (balanced index*)														
Households														
FOM	Next 12 months	84	78	82	80	79	80	82	78	78	75	74	76	76
FOM	Next month	72	68	70	76	68	68	73	73	69	61	62	63	63
Businesses														
REB	Next 3 months	14	38	36	46	22	20	14	52	22	24			
Bank of Russia	Next 3 months	13.1	11.9	11.6	9.2	7.4	9.3	7.3	6.9	6.0	6.5	8.3	9.4	
Retail prices (Rosstat)	Next quarter	32	29	28	27	27	24	24	22	-	-	20		
Tariffs (Rosstat)	Next quarter	5	5	0	0	4	3	0	0	-	-	5		

Changes against 3MMA:

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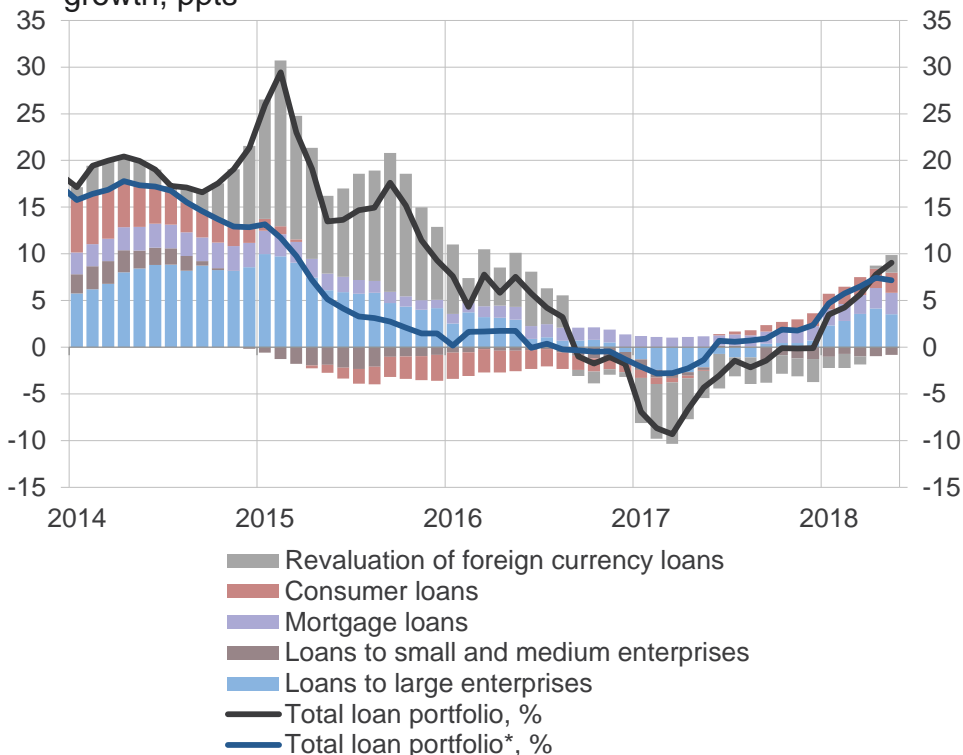- Inflation expectations become worse (more than 1 standard deviation)

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

Sources: FOM, Bank of Russia

Monetary Conditions Are Close to Neutral and Are Already Causing Almost No Constraining Impact on Lending, Demand and Inflation Dynamics
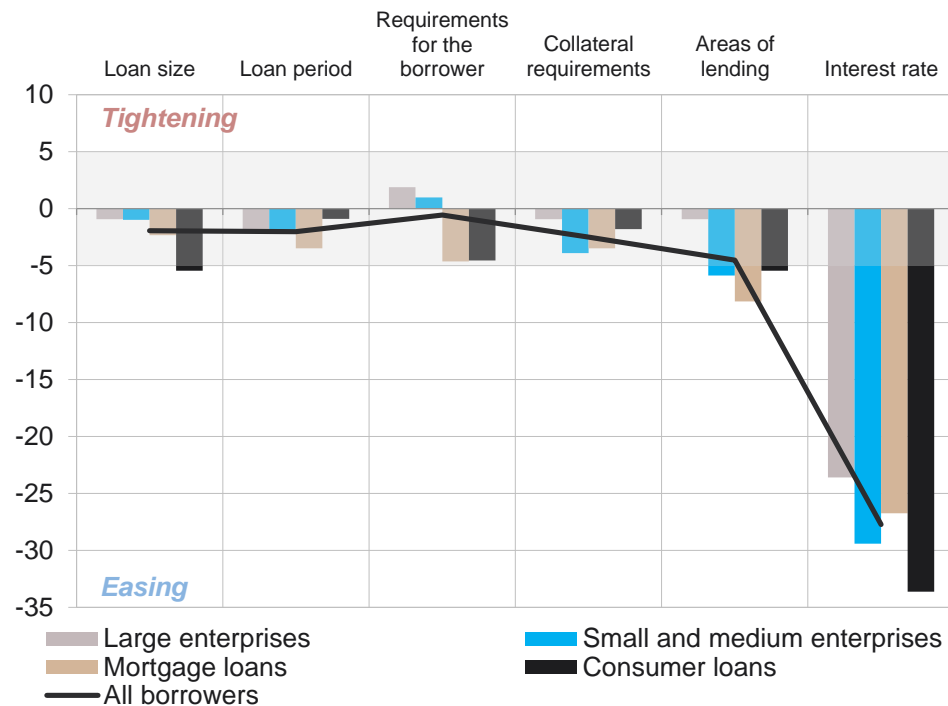
Contribution of different components to the bank lending growth, ppts

Indexes of changes in certain lending condition in 1Q2018, ppts

Legend (left chart):
- Revaluation of foreign currency loans
- Consumer loans
- Mortgage loans
- Loans to small and medium enterprises
- Loans to large enterprises
- Total loan portfolio, %
- Total loan portfolio*, %

*Excluding foreign currency revaluation.   Source: Bank of Russia

Legend (right chart):
- Large enterprises
- Mortgage loans
- All borrowers
- Small and medium enterprises
- Consumer loans

Grey is the zone of insignificant changes of lending conditions

Source: Bank of Russia

Dollarisation of loan portfolio (%)					
	1.02.17	1.03.18	1.04.18	1.05.18	1.06.18
Loans to non-financial organisations	29.0	28.1	28.3	29.0	28.8
Loans to households	0.8	0.8	0.8	0.8	0.8
Total	20.9	20.1	20.3	20.9	20.5

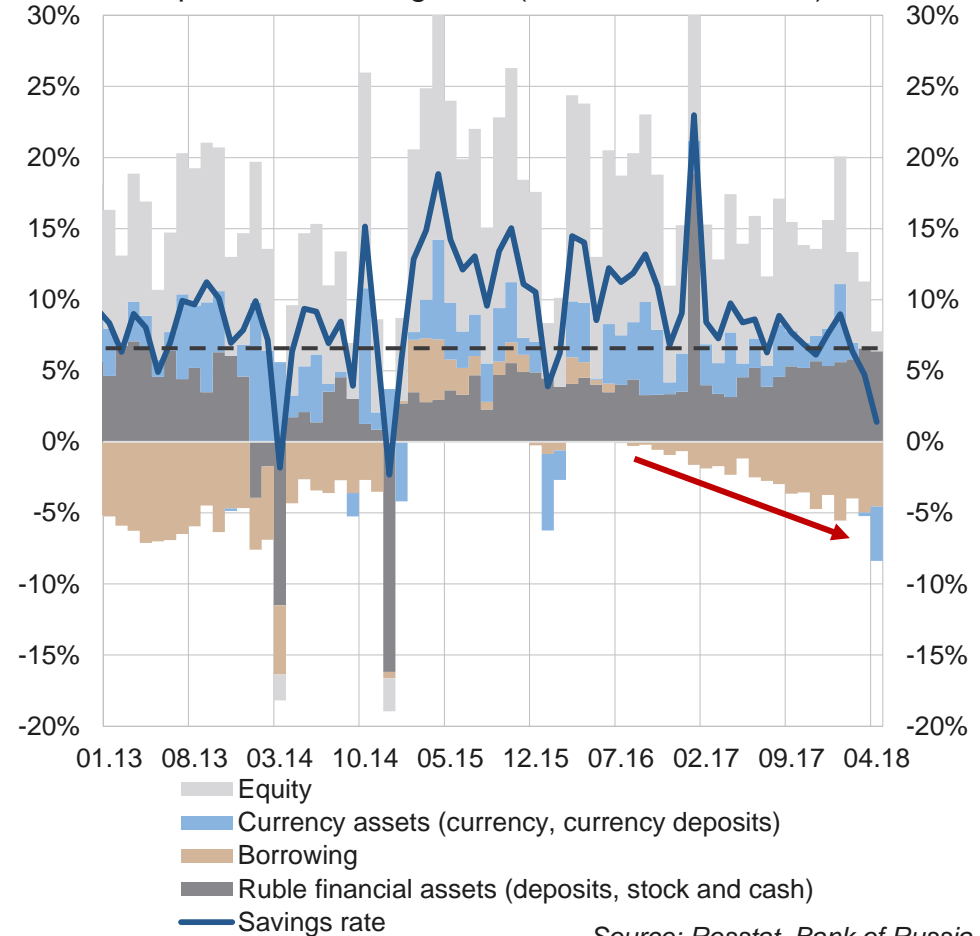| Dollarisation of Deposits (%)					
	1.02.17	1.03.18	1.04.18	1.05.18	1.06.18
Household deposits	20.7	20.2	20.2	20.6	20.5
Corporate deposits and current accounts	34.9	33.7	34.5	35.1	35.2
Total	28.1	27.1	27.6	28.0	28.0

The Increase in Real Wages and the Expansion of Retail Lending Support the Recovery of Consumer Demand

Retail trade turnover and real wages dynamics (YoY)
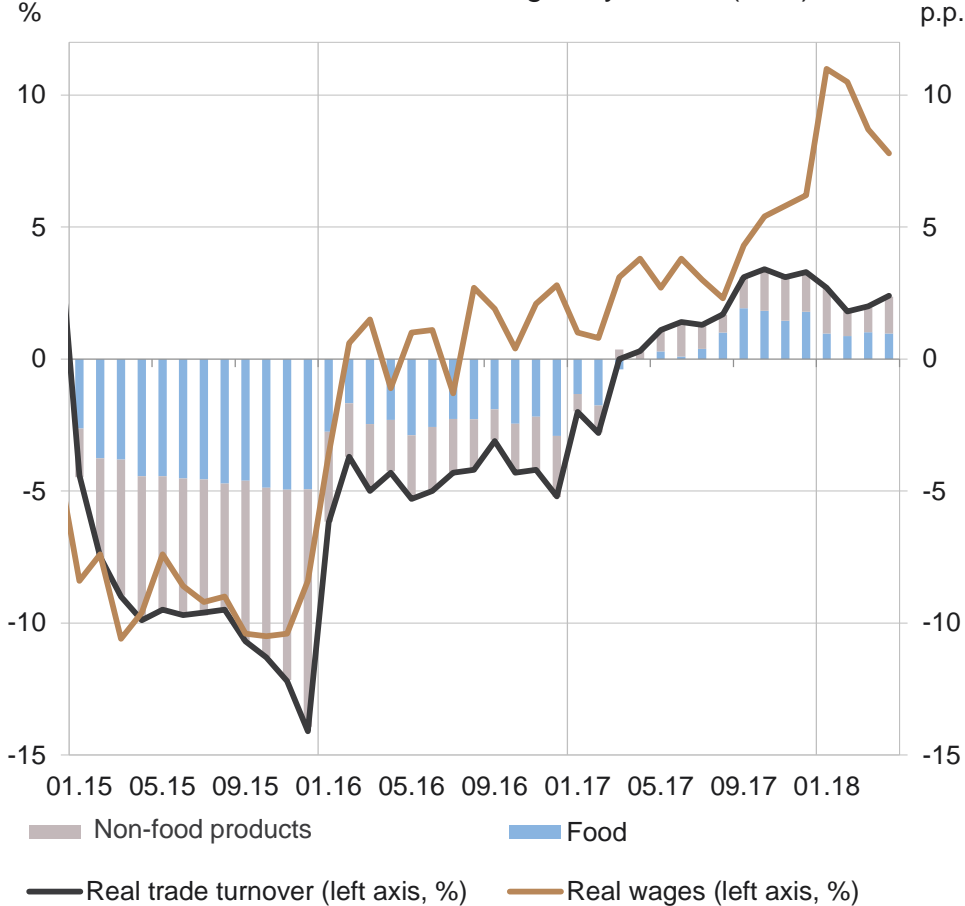
Components of savings rate (share of income, SA)

Non-food products

Food

Real trade turnover (left axis, %)

Real wages (left axis, %)

Equity

Currency assets (currency, currency deposits)

Borrowing

Ruble financial assets (deposits, stock and cash)

Savings rate

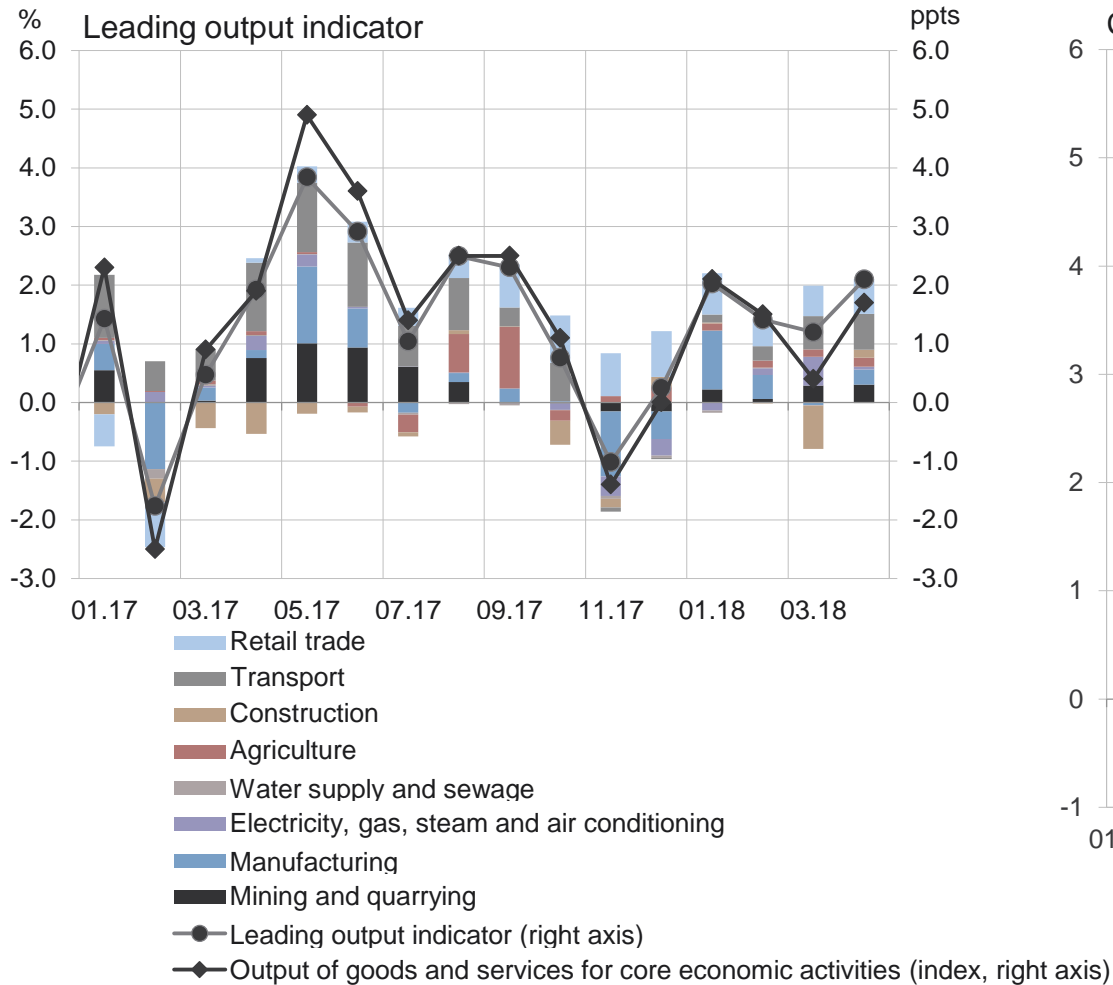*Sources: Rosstat, Bank of Russia*

Source: Rosstat, Bank of Russia

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

Industrial and Investment Activity Improved After a Temporary Slowdown in March 2018

Leading output indicator

%

- Retail trade
- Transport
- Construction
- Agriculture
- Water supply and sewage
- Electricity, gas, steam and air conditioning
- Manufacturing
- Mining and quarrying
- ●— Leading output indicator (right axis)
- ◆— Output of goods and services for core economic activities (index, right axis)

Sources: Rosstat, Bank of Russia

Contribution to industrial output dynamics, % to 2013 (SA)

- —— Raw materials and intermediate goods
- —— Consumer goods
- —— Investment goods
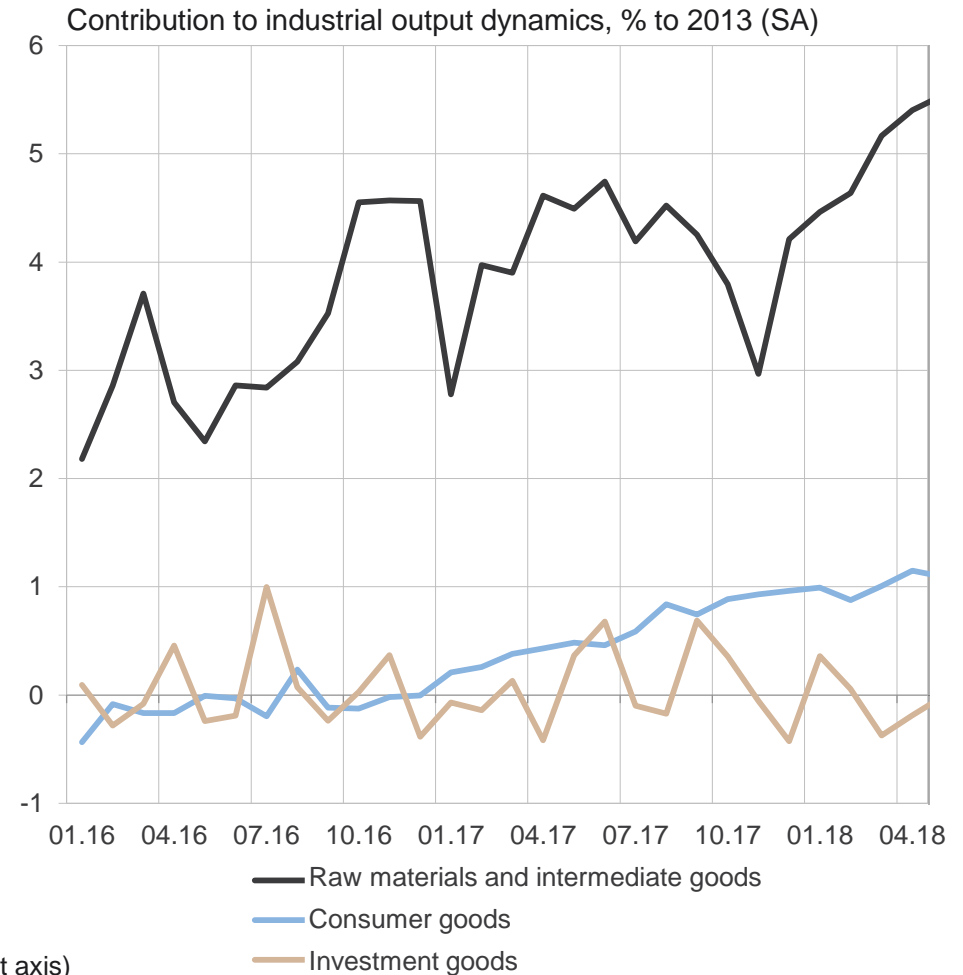
Sources: Rosstat, Bank of Russia

Fiscal Policy: Planned Tax Revisions Will Make About a 1 Percentage Point Contribution to Inflation. Partially This Effect May Take Place This Year

Implementation of the package of measures within the framework of inaugural decrees:
In 2019-2024 the government will incur additional expenses of 8 trillion rubles, also from the intrabudgetary fund of infrastructure investments (3 trillion rubles for 6 years = 0.5 trillion rubles per year), and allocations for the development of human capital: education, infrastructure, environment and technological development.
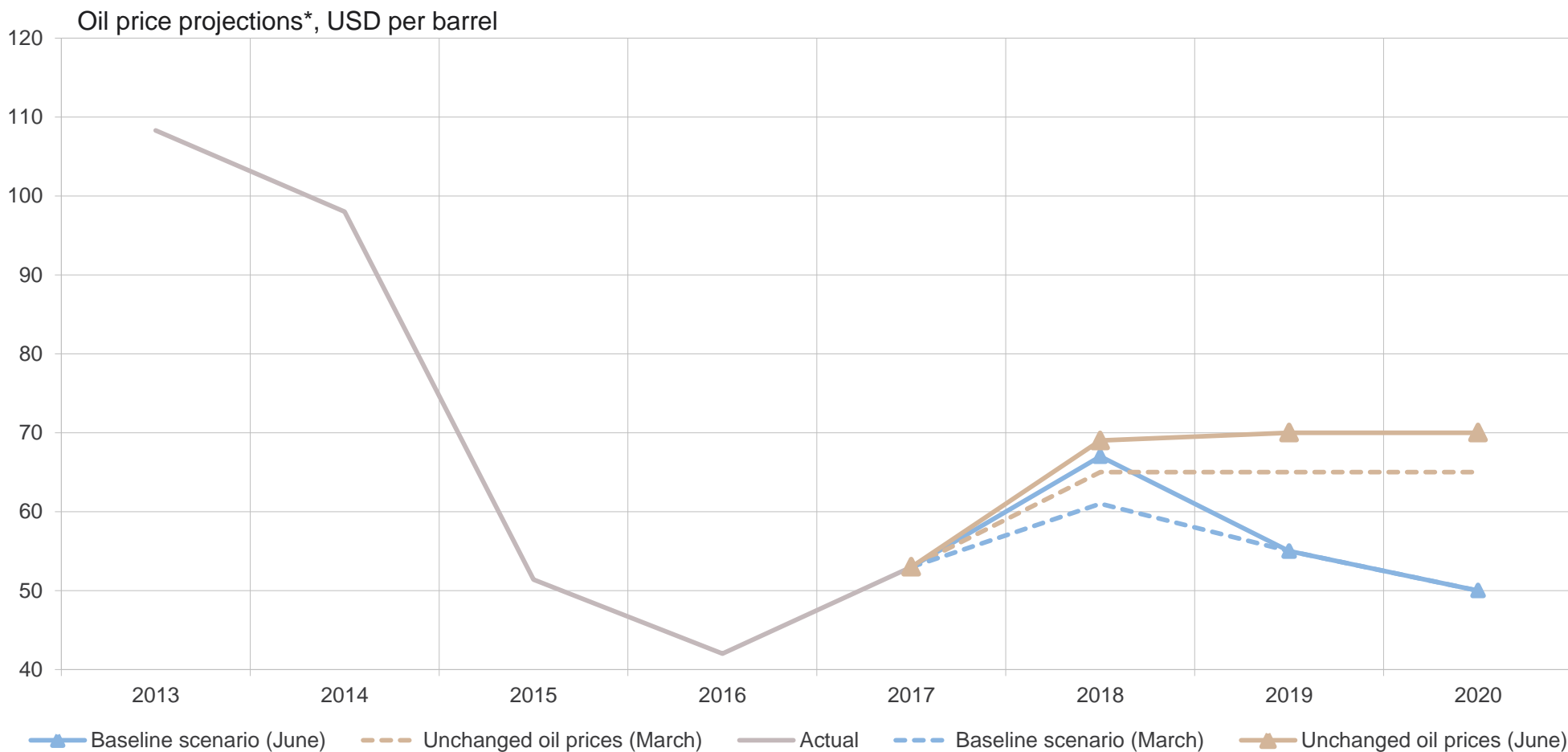
Sources of new expenditures financing:
- To implement new expenditures, the Ministry of Finance of Russia proposes **the adjustment of the budget rule** – an increase in the marginal cost volume of a surcharge of 0.5% of GDP for the implementation of infrastructure fund allocations. This measures **will be financed by new** OFZ borrowings (0.25-0.5 trillion rubles), the use of fund balances in the accounts of the budget in the banking system, as well as measures to optimize taxation and improve the administration of fees. Thus, gross allocations may exceed 2 trillion rubles in 2020.
- The government proposes **to raise the main VAT rate from 18% to 20%**. That could lead to increased revenues by 400-550 billion rubles (0.4-0.5% of GDP) annually, or by 2-2.5 trillion rubles for 6 years. The Increase of the basic VAT rate could promote a one-time acceleration of inflation by 0.6-1.0 percentage points within 2019 (the share of goods and services at the basic rate of VAT in the consumer basket is 70-80%).
- The government proposes **to increase the retirement age** from 2019 - annually by 0.5 years - for men to 65 years (by 2028) and for women to 63 years (until 2034). This measure can increase the potential output and accelerate economic growth in the range of +0.3 percentage points, as well as give additional income for social insurance contributions to 100 billion rubles annually.

Main Indicators of the Federal Budget

Federal Budget	01.06.2018 – 12 months indicators (MoF preliminary estimates)	2018 (Bank of Russia estimates in the baseline scenario – Urals $67/barrel)
Revenues, % of GDP	17.1	18.2
Expenditures, % of GDP	17.4	17.1
Deficit, % of GDP	-0.3	1.1
Transfer from sovereign funds (National Wealth Fund) in 2018, ₽ trln	0	1.1

Under the Current Oil Market Environment the Oil Price Projection for 2018 Has Been Updated in the Bank of Russia's Baseline Scenario. The Medium-Term Outlook Remains Unchanged

Oil price projections*, USD per barrel

— Baseline scenario (June)   - - - Unchanged oil prices (March)   — Actual   - - - Baseline scenario (March)   — Unchanged oil prices (June)

Based on Monetary Policy Report No.2 (June 2018)

Source: Bank of Russia

Baseline Scenario*: GDP Growth Rate Close to Potential, Inflation – 3.5–4% in Late 2018 With a Short-Term Increase to 4–4.5% in 2019 and a Return to 4% in Early 2020
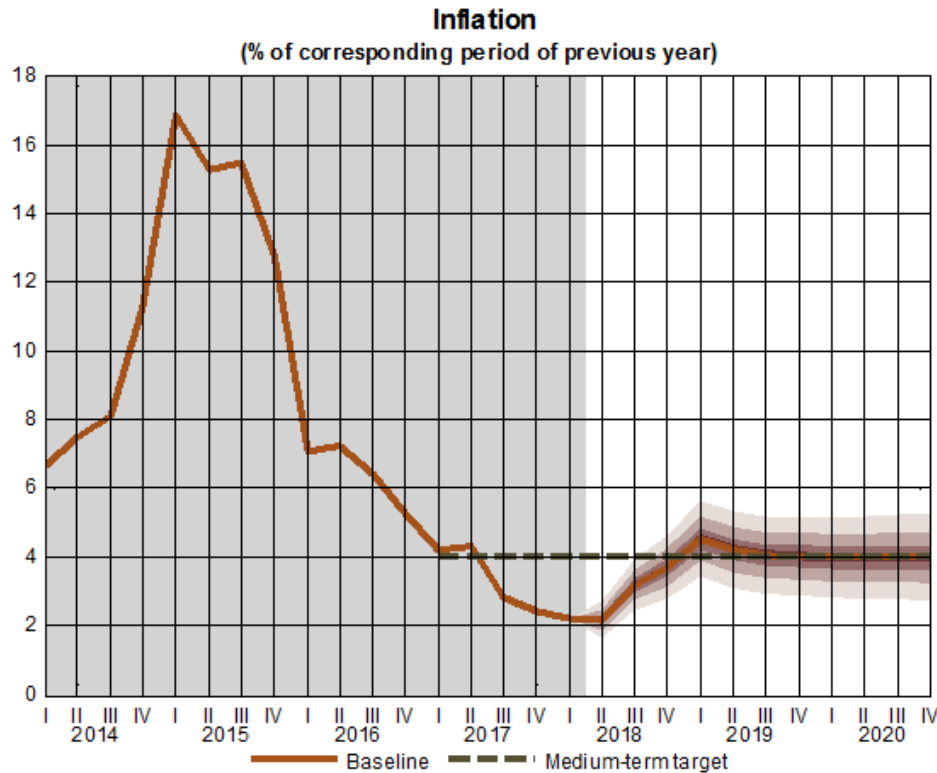
Inflation
(% of corresponding period of previous year)

Baseline — — Medium-term target

Note: shaded areas on the forecast horizon show the probability of different inflation values.
Colour gradation reflects probability
Source: Bank of Russia calculations.

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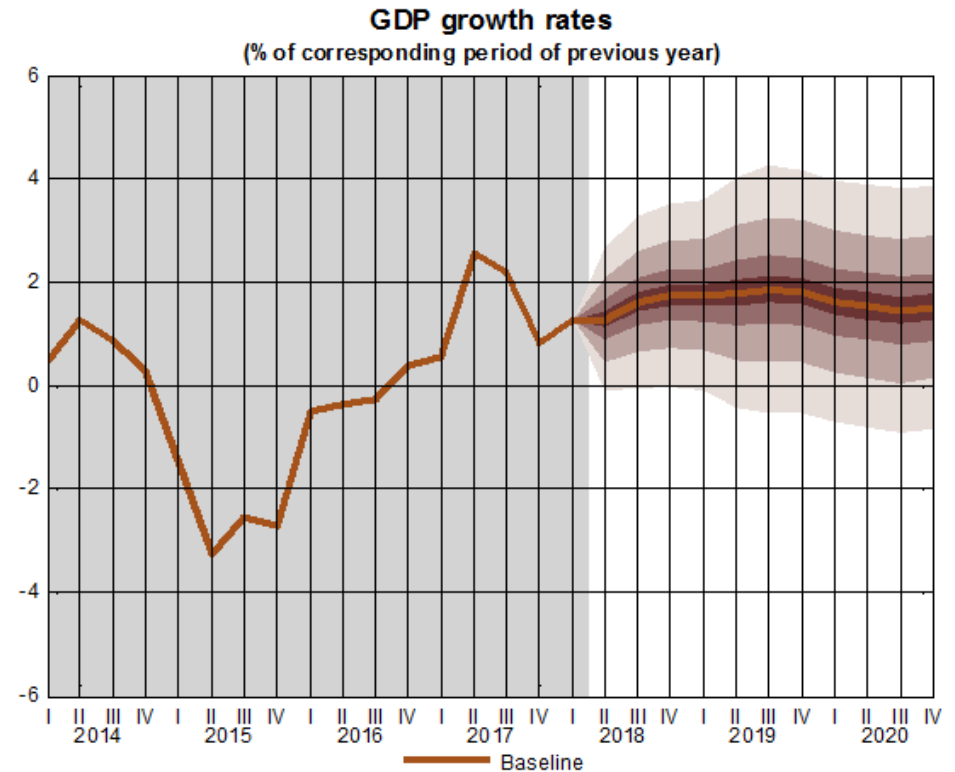
Baseline

Note: shaded areas on the forecast horizon show the probability of different inflation values.
Colour gradation reflects probability
Source: Bank of Russia calculations.

*As presented in Monetary Policy Report №2 (June 2018)

Baseline Scenario: Key Projection Parameters

Increase compared to the previous period in % (unless noted otherwise)	2017 (actual)	2018	2019	2020
		Baseline*		
Urals price (average for year), USD per barrel	53	67	55	50
Inflation in December compared to previous December, %	2.5	3.5-4.0	4.0-4.5	4.0
Inflation (average for year) compared to the previous year, %	3.5	2.5-3.5	4.0-4.5	4.0
GDP	1.5	1.5-2.0	1.5-2.0	1.5-2.0
Final consumption expenditures	2.6	2.5-3.0	2.3-2.8	2.0-2.5
- of households	*3.4*	*3.3-3.8*	*2.8-3.3*	*2.5-3.0*
Gross formation	7.4	0.5-1.5	2.2-3.2	1.7-2.7
- gross fixed capital formation	*4.3*	*2.7-3.2*	*2.2-2.7*	*2.2-2.7*
Exports	5.1	3.3-3.7	1.7-2.2	1.7-2.2
Imports	17.4	7.4-7.9	4.7-5.2	5.3-5.8
Money supply (using the national definition)	10.5	10-13	8-11	8-11
Lending to non-financial organisations and households, in roubles and foreign currencies**	8.2	10-13	7-11	7-12
- Lending to non-financial and financial organisations, in rubles and foreign currencies	*7.1*	*9-11*	*6-9*	*6-10*
- Lending to households, in rubles and foreign currencies	*12*	*13-18*	*10-13*	*10-13*

* Published in Monetary Policy Report No.2 (June 2018)
** Banking sector's lending to the economy is defined as all the claims of the banking sector to financial and non-financial organisations as well as households in Russian or foreign currency and precious metals, including loans provided (with overdue debt counting as well), overdue interest on loans, credit institutions' investment in equity and debt securities and promissory notes, any forms of participating in the equity of financial and non-financial organisations, and any other receivables for settlements with financial and non-financial organisations and households

Source: Bank of Russia

Baseline Scenario: Projections for the Balance of Payments

USD billions	2017 (estimate)	Baseline*		
		2018	2019	2020
Current account:	**35**	**85**	**47**	**32**
Trade balance	115	166	129	115
Exports	*353*	*425*	*390*	*384*
Imports	*-238*	*-259*	*-261*	*-269*
Balance of services	-31	-31	-31	-31
Exports	*58*	*65*	*66*	*69*
Imports	*-89*	*-96*	*-97*	*-100*
Balance of primary and secondary income	-49	-50	-51	-52
Capital account	0	0	0	0
Current account and capital account surplus	**35**	**85**	**47**	**32**
Financial transactions account (reserve assets excluded)	**-16**	**-26**	**-12**	**-8**
Public administration and central banks	*13*	*4*	*3*	*4*
Private sector (net errors and omissions included)	*-29*	*-30*	*-16*	*-12*
Net errors and omissions	**4**	**0**	**0**	**0**
Change in FX reserves (+ is for decrease, - is for growth)	**-23**	**-60**	**-35**	**-24**

*Using BPM 5 methodology. Due to rounding total results may differ from the sum of respective values

Source: Bank of Russia, Monetary Policy Report No. 2 (June 2018)

Monetary Policy of the Bank of Russia in June 2018

Inflation and inflation expectations

- Annual inflation remains low and in general corresponds to the Bank of Russia's expectations, but showed mixed dynamics for main consumer basket products (petrol ↑, food goods ↓)
- Inflation expectations of households and businesses saw a slight increase, which is primarily related to higher petrol prices
- The weakening of the ruble exchange rate in April moderately affects the dynamics of inflation and inflation expectations
- Planned tax revisions will make about a 1 percentage point contribution to inflation

Monetary conditions are close to neutral

Economic activity

- Industrial and Investment Activity Improved After a Temporary Slowdown in March 2018
- Medium-term outlook on economic growth is at large the same, but might be further updated to reflect a detailed estimate of influence of the set of the proposed fiscal measures

Inflation risks

- The main risks: (1) **tax policy measures (the risk has increased)**, (2) external factors.

- Moderate risks – estimates are mostly unchanged: (3) consumer and oil price volatility, (4) wage movements, (5) possible changes in consumer behaviour.

Decision

The Bank of Russia keeps the key rate

at 7.25% p.a.

Signal

the Bank of Russia will explore the necessity of key rate changes by assessing inflation risks, inflation dynamics and economic developments against the forecast
[…]
The monetary policy stance needs to remain somewhat tight to limit the scale of secondary effects of fiscal measures and to maintain the annual consumer prices growth rate around 4%.

APPENDIX

Underlying Inflation Indicators have Stopped Slowing Down (2)

	Jan.17	Feb.17	Mar.17	Apr.17	May.17	Jun.17	Jul.17	Aug.17	Sen.17	Oct.17	Nov.17	Dec.17	Jan.18	Feb.18	Mar.18	Apr.18	May.18
Annual inflation, %																	
All goods and services	5.0	4.6	4.3	4.1	4.1	4.4	3.9	3.3	3.0	2.7	2.5	2.5	2.2	2.2	2.4	2.4	2.4
Trimmed inflation indicators																	
CPI without 20%	5.5	5.1	4.8	4.4	4.1	4.0	3.8	3.6	3.3	3.0	2.9	2.9	2.7	2.6	2.4	2.5	2.5
CPI without 40%	5.5	5.3	4.8	4.4	4.2	4.0	3.8	3.6	3.4	3.1	3.0	3.0	2.8	2.7	2.5	2.5	2.5
CPI without 60%	5.4	5.2	4.8	4.5	4.2	4.0	3.8	3.6	3.4	3.2	3.1	3.0	2.8	2.7	2.5	2.5	2.4
CPI without 80%	5.3	5.3	4.8	4.5	4.2	4.0	3.8	3.7	3.4	3.2	3.2	3.1	2.8	2.8	2.6	2.5	2.5
Median (CPI without 100%)	5.2	5.1	4.8	4.4	4.0	3.9	3.9	3.7	3.5	3.3	3.2	3.3	2.8	2.8	2.6	2.5	2.5
CPI without volatile (for 3 months) components																	
CPI without 10%	5.1	4.8	4.3	4.1	4.0	4.1	3.7	3.4	3.0	2.8	2.3	2.3	2.3	2.3	2.3	2.3	2.4
CPI without 20%	5.2	4.7	4.2	4.0	4.0	4.0	3.6	3.3	3.0	2.7	2.3	2.2	2.2	2.2	2.3	2.3	2.3
CPI without volatile (for 24 months) components																	
CPI without 10%	5.2	4.8	4.3	4.2	4.1	4.2	3.9	3.4	3.0	2.7	2.4	2.5	2.4	2.4	2.5	2.5	2.6
CPI without 20%	5.0	4.6	4.1	4.0	3.8	4.0	3.6	3.1	2.7	2.4	2.1	2.3	2.3	2.4	2.6	2.6	2.6
CPI with different weights (more volatility – less weight)																	
Only volatility	5.1	4.8	4.6	4.4	4.3	4.5	4.0	3.9	3.6	3.3	3.1	3.2	2.8	2.6	2.7	2.7	2.7
Volatility and persistency	4.9	5.1	4.6	4.5	4.3	4.1	3.9	3.8	3.5	3.2	2.3	2.1	1.9	1.7	1.7	1.6	1.7
CPI without various components																	
Core inflation	5.5	5.0	4.5	4.1	3.8	3.5	3.3	3.0	2.8	2.5	2.3	2.1	1.9	1.9	1.8	1.9	2.0
Core inflation without food goods	5.3	4.6	4.2	3.8	3.5	3.2	3.2	3.0	3.1	3.0	3.0	3.1	3.0	3.0	2.9	3.1	3.1
CPI without housing and communal services	5.0	4.5	4.1	4.0	4.0	4.3	3.8	3.1	2.8	2.5	2.3	2.3	2.0	2.0	2.2	2.2	2.2
CPI without fruits and vegetables	5.6	5.2	4.8	4.4	4.1	4.0	3.7	3.5	3.2	2.9	2.7	2.6	2.3	2.2	2.2	2.3	2.7
CPI without "volatile" regions																	
Without 10%	5.0	4.6	4.3	4.2	4.2	4.4	3.9	3.4	3.0	2.8	2.6	2.6	2.3	2.3	2.4	2.5	2.5
Without 20%	5.1	4.7	4.3	4.2	4.2	4.5	4.0	3.4	3.1	2.9	2.7	2.7	2.4	2.3	2.5	2.6	2.6
Alternative inflation indicators																	
Inflation without exchange rate influence (DRF)	6.2	6.6	7.2	7.4	7.0	6.7	5.8	4.7	4.0	3.5	3.3	3.1	2.7	2.3	2.2	2.0	1.5

- lower than 4% (more than 0.3 st. dev.)
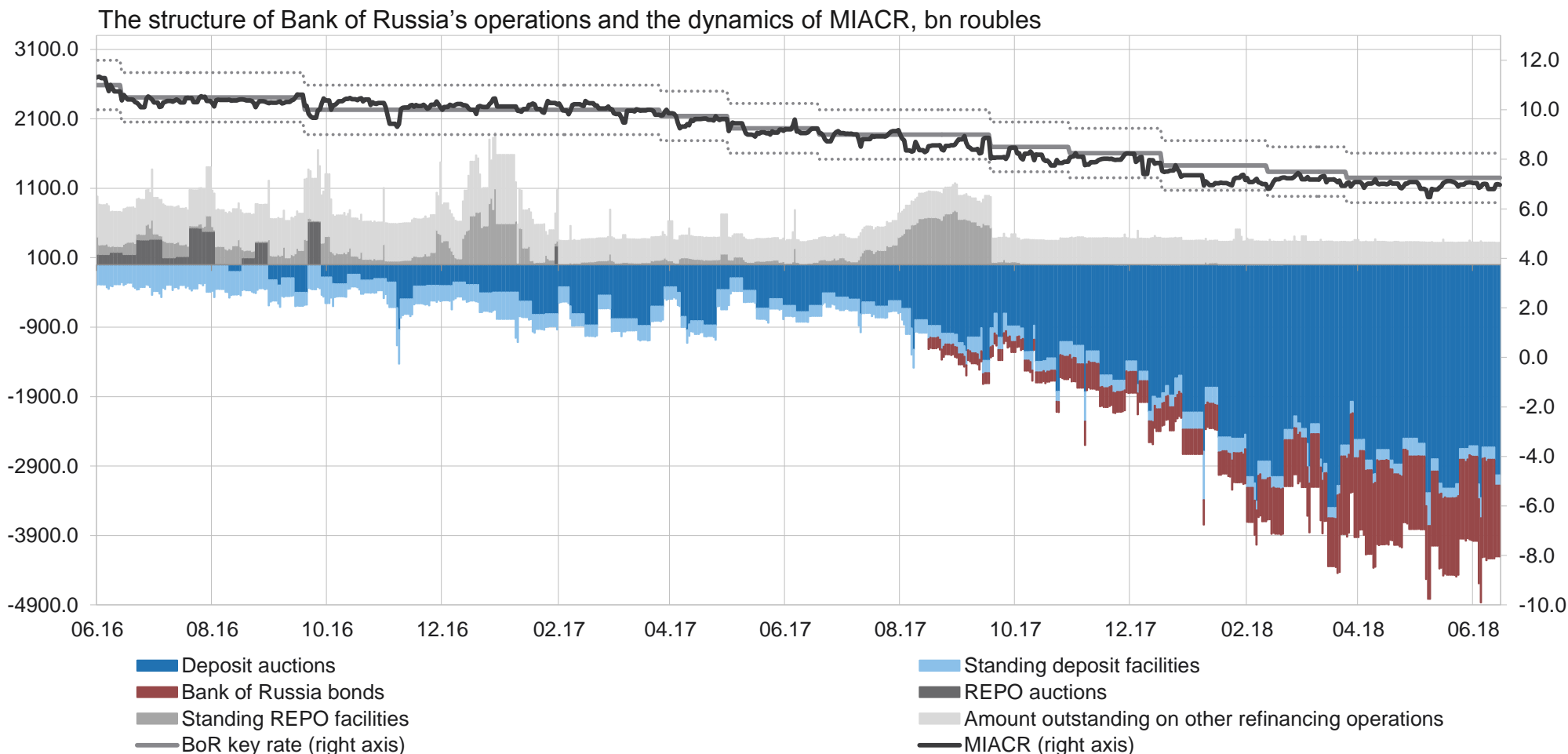- close to 4% (±0.3 st. dev.)
- higher than 4% (more than 0.3 st, dev.)

Sources: Rosstat, Bank of Russia

Underlying Inflation Indicators have Stopped Slowing Down (3)

	Jan.17	Feb.17	Mar.17	Apr.17	May.17	Jun.17	Jul.17	Aug.17	Sen.17	Oct.17	Nov.17	Dec.17	Jan.18	Feb.18	Mar.18	Apr.18	May.18
Monthly inflation (seasonally adjusted, annualised), %																	
All goods and services	4.5	1.4	1.1	4.0	4.2	8.1	-0.8	-0.6	1.8	2.3	1.1	2.2	0.8	1.2	3.0	4.5	4.3
Trimmed inflation indicators																	
CPI without 20%	4.8	2.9	2.7	3.2	3.3	3.5	2.0	2.6	1.8	2.2	1.9	2.2	2.0	1.4	1.9	3.6	3.3
CPI without 40%	4.7	3.1	3.1	3.1	3.1	3.4	2.1	2.7	2.0	2.3	2.4	2.3	2.3	1.4	1.9	3.1	3.1
CPI without 60%	4.4	3.2	3.3	3.3	3.2	3.6	2.2	2.8	2.0	2.3	2.4	2.4	2.2	1.5	1.7	3.0	3.2
CPI without 80%	4.3	3.2	3.3	3.3	3.2	3.7	2.3	2.9	2.0	2.3	2.4	2.4	2.2	1.6	1.6	2.9	3.1
Median (CPI without 100%)	4.2	3.4	3.0	3.1	3.2	3.8	2.3	2.5	1.9	2.3	2.4	2.3	2.4	1.6	1.4	2.8	3.1
CPI without volatile (for 3 months) components																	
CPI without 10%	3.9	1.3	0.9	4.2	4.1	7.4	-0.4	0.2	1.7	2.4	1.2	2.1	0.4	1.2	2.9	4.2	4.4
CPI without 20%	3.9	0.9	0.5	4.2	4.2	7.9	-0.9	0.1	1.9	2.4	1.1	2.1	-0.2	0.7	2.8	4.3	4.5
CPI without volatile (for 24 months) components																	
CPI without 10%	4.2	1.4	1.0	4.0	4.0	8.0	-0.7	0.2	1.7	2.2	1.0	2.4	0.6	1.0	2.9	4.2	4.6
CPI without 20%	3.9	1.1	0.5	4.0	4.0	8.6	-1.2	-0.6	1.6	2.0	0.6	2.2	0.1	0.6	2.8	4.3	4.6
CPI with different weights (more volatility – less weight)																	
Only volatility	5.1	3.2	3.0	3.0	3.0	3.7	2.2	2.8	3.9	2.1	2.1	2.5	2.1	1.7	1.3	2.7	3.5
Volatility and persistency	4.9	3.5	3.1	3.1	3.2	3.2	2.5	3.2	1.5	1.9	1.7	2.0	2.1	1.5	0.7	1.9	2.6
CPI without various components																	
Core inflation	3.2	2.2	1.6	1.3	1.6	2.0	2.7	2.6	2.3	1.8	2.0	2.2	1.6	1.5	1.4	2.1	2.4
CPI without housing and communal services	4.0	1.0	0.7	3.9	4.1	8.5	-0.7	-1.5	1.7	2.0	0.7	2.0	0.4	0.8	2.8	4.5	4.2
CPI without fruits and vegetables	5.2	2.8	1.9	2.3	2.4	3.4	2.2	2.5	2.3	1.7	1.6	2.3	2.0	1.4	1.9	4.0	6.4
Alternative inflation indicators																	
"Core inflation" (trimming method)	4.3	2.7	2.4	2.7	2.8	2.8	1.6	2.2	1.7	1.9	1.9	2.0	1.9	1.3	1.6	2.7	2.7
"Core inflation" (without volatile components)	4.2	3.0	2.7	3.0	3.0	3.2	1.8	2.5	1.8	1.7	2.1	2.1	1.9	1.6	1.4	2.4	2.4
Inertia measures of inflation, %																	
Trend inflation	7.2	7.0	6.8	6.6	6.5	6.4	6.2	6.0	5.9	5.6	5.5	5.4	5.3	5.2	5.1	5.2	5.2
12MMA	6.7	6.4	6.1	5.9	5.6	5.3	5.1	4.8	4.5	4.2	3.9	3.7	3.5	3.2	3.1	2.9	2.8
24MMA	10.8	10.3	9.8	9.3	8.8	8.3	7.9	7.3	6.8	6.3	5.8	5.4	5.1	4.8	4.6	4.4	4.2
Balance indicators of inflation, % (difference of shares of components with accelerating and decelerating inflation)																	
Annual inflation	-34.2	-37.2	-44.5	-41.9	-35.1	-37.6	-43.2	-42.2	-50.2	-38.8	-33.4	-30.2	-40.2	-19.8	-30.0	-1.7	14.9
Monthly inflation (annualised)	-6.3	-49.7	-3.8	-13.0	-3.7	25.9	-9.8	-29.0	-20.1	1.3	-7.6	11.7	3.0	-25.6	-10.7	34.2	28.9

■ - lower than 4% (more than 0.3 st. dev.)
▢ - close to 4% (±0.3 st. dev.)
■ - higher than 4% (more than 0.3 st, dev.)

Sources: Rosstat, Bank of Russia

Amid Structural Liquidity Surplus the Bank of Russia Mostly Conducts Deposit Auctions, With Bank of Russia Bonds (OBR) Being Issued Since August 2017

The structure of Bank of Russia's operations and the dynamics of MIACR, bn roubles

Legend:
- Deposit auctions
- Standing deposit facilities
- Bank of Russia bonds
- REPO auctions
- Standing REPO facilities
- Amount outstanding on other refinancing operations
- BoR key rate (right axis)
- MIACR (right axis)

Source: Bank of Russia