Bank of Russia

The Central Bank of the Russian Federation

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DECEMBER 2018

MONETARY POLICY REPORT

Moscow

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Many thanks in advance for your assistance.

The report has been prepared based on statistics as of 30 November 2018.
Data cut-off date for forecast calculations is 30 November 2018 (if statistics and other information relevant for decision-making appear after the data cut-off date, they are included in the text of the Report and may be used for the adjustment of the mid-term forecast).

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STATEMENT BY BANK OF RUSSIA GOVERNOR ELVIRA NABIULLINA

in follow-up to Board of Directors meeting 14 December 2018

Today the Bank of Russia Board of Directors has decided to raise the key rate by 0.25 pp to 7.75% p.a. This move is aimed at limiting the scale of inflation risks in the coming year. I will subsequently elaborate on the rationale of this decision.

The second decision made today was to resume regular fiscal rule-based foreign currency purchases from 15 January. As we said earlier, the postponed purchases will be made gradually in the course of several years. We will decide on the fiscal rule-based foreign currency purchases postponed in 2018 in due course, after regular purchases are resumed. We have factored in this decision in our forecast.

Let me now proceed to give you the details of the key rate decision. Today's Board meeting took an in-depth look at the reasoning for both keeping the key rate unchanged and revising it upwards.

The main argument in favour of an unchanged key rate is the performance of the domestic demand. It is expanding moderately without posing any inflation risks. This primarily concerns consumption. In October, annual growth of retail sales came in at 1.9%. The heads of Bank of Russia regional branches, who contribute to the key rate decision, have also pointed to low demand and mixed consumption dynamics across regions. Annual wage growth has also slowed considerably after peaking early in the year.

The savings rate has been recovering in the recent months after a considerable drop in the second and third quarters. Household deposits resumed growth driven by interest rates attractive for depositors. In this context, strong growth in retail lending underpins consumer demand without posing inflation risks. The evolution of the household behaviour model meets our expectations.

However, more arguments call for a key rate hike.

What are these arguments? They are associated with both external and domestic factors.

External factors include, first, the state of the global economy as a whole and the situation in emerging markets. Certainly, global financial markets have been less volatile this quarter than they were in August and September. This is partially attributed to the revision of monetary policy projections by major central banks. The next year normalisation may prove slower than expected, thus mitigating the risk of capital outflow from emerging markets. However, it is important that the altered projections of policy revision by key central banks are associated with downgraded next year growth forecasts for major economies. Also, the current standstill in trade disputes may merely prove a temporary truce. These risks are quite tangible for emerging market economies.

Second, we have here the oil glut risk in 2019. This is partially associated with a downward revision of the global demand outlook. However, the main reason is an aggressive expansion of oil production in the US. In early December, OPEC and other oil exporters agreed to cut production in 2019. However, the developments of this year demonstrate that producers can rapidly ramp up shale oil production when prices are high.

Another considerable external factor is geopolitical risks affecting both Russia and other countries and regions.

As far as internal factors are concerned, here we have persistent uncertainty over the price response to the VAT rate hike, the effect of this year's weakening in the ruble on inflation, and its effect on inflation expectations. It means that the uncertainty over price movements is associated with both an estimated direct effect of proinflationary factors and the scale of secondary effects dependent on inflation expectations.

Thus, our baseline scenario assumes that the VAT rise will contribute approximately 1 pp to inflation. However, the possible estimates of this contribution range between 0.6 and 1.5 pp.

The scale of secondary effects is still harder to estimate. Even a temporary acceleration of price growth raises inflation expectations of both households and businesses. We saw it from the surge in petrol prices registered in May-June this year. Petrol prices have been stable in the second half of the year. However, surveys suggest that Russians are highly concerned about the rise in petrol prices.

Inflation expectations remain unanchored. This means that they are highly likely to go up in response to price growth following the VAT rate hike. Therefore, we cannot consider the VAT rate revision as a purely one-off factor.

Elevated inflation expectations may change consumer behaviour and reduce the propensity to save. In these circumstances, firms will have an opportunity to raise retail prices even when the effect of one-off factors is exhausted. If this spiral is set off, inflationary pressure will rise and inflation may hold above the 4% target for a long period of time. This will require a considerable and enduring monetary policy tightening.

The task is to reduce as much as possible the risks of this scenario materialising. In addition, full-year inflation will total about 4% in 2018. This means that we are entering the new year without the inflation buffer we had and with a substantially upgraded inflation forecast for next year. This is why we are raising the key rate. At this moment in time, in the context of strengthened risks, it is crucial that we remain proactive. This approach reflects a key inflation targeting policy principle.

We look to the outrunning response of monetary policy to enable us to constrain the secondary effects and ensure inflation declines after its temporary rise. We admit that between March and April inflation could exceed 5.5% or even peak to 6%. Its acceleration in the first quarter of 2019 is set to precede its subsequent slowdown. Should we take action to curb the secondary effects, beginning from the second to third quarter of 2019, seasonally adjusted quarterly price growth will total 1 pp, that is, it will be consistent with 4% annualised inflation. The residual impact of the one-off factors on annual inflation is set to be entirely gone in one year's time – in the first quarter of 2020.

Now, I will say a few words about the economy and the forecast. Economic growth rates remain close to their potential levels. Unemployment is invariably low and close to its natural rate. Having said that, certain economic activity indicators continue to post a mixed performance.

The forecast remains essentially unchanged. Given the state of the global energy market over recent months, we have downgraded the oil price path somewhat in the baseline scenario. The assumption has been updated to reflect faster declining oil prices in the course of 2019 – based on the calculation that the average oil price will total $55 per barrel (from the previous estimate of $63 a barrel). Moving forward, the average price is set to remain at this level between 2020 and 2021. As before, our approach to oil price assumptions is conservative. The oil price volatility we saw in the fourth quarter (from $85 to $58 a barrel) is an indication of the validity of this approach.

The running fiscal rule will ensure that the impact of changing oil prices on economic growth remains limited. We therefore leave our GDP growth forecast unchanged at 1.2-1.7% for 2018, admitting it may rise to 2-3% in 2021 as the Government implements its structural reforms.

Changing oil price assumptions have stronger implications for our estimated balance of payments. We now predict the current account balance to stand at $71 billion in 2019 (compared to $95 billion assumed in October). We have also made a slight downgrade in the financial account balance of the private sector – to $20 billion, in comparison to $25 billion assumed in October.

Many will ask why next year's private sector financial account balance will make up $20 billion, whereas it is predicted at $67 billion for this year.

Beyond the decline in oil prices, the reason for this is the decision to suspend and subsequently resume fiscal rule-based foreign currency purchases in the market. A positive current account balance is helped by either the buildup of national foreign currency reserves or capital outflow.

This is clearly seen from this year's movements in the balance of payments. In the first year-half, the current account totalled $49 billion, with foreign currency reserves at $31 billion and private sector net capital outflow at $13 billion. In the second half of the year, when we moved to suspend foreign currency purchases under the fiscal rule, this ratio reversed. With the current account running at $63 billion, we expect capital outflow to run at $54 billion and foreign currency reserves to expand by no more than $8 billion.

Private sector capital outflow is either repayment of external liabilities or accumulation of foreign assets including in the form of foreign exchange in foreign bank accounts. Hence, in the second half of the year, when the buildup of government reserves ground to a halt, a considerable part of export revenue, if unspent to reduce external debt, ultimately settled in bank accounts as extra foreign currency liquidity. Incidentally, this is why the response of the foreign exchange rate to the purchase suspension decision was fairly muted. The market essentially continued to expect their resumption and accumulated assets.

Next year, our baseline scenario provides for a return to the 2017-2018 situation, with a significant amount of oil revenues being used to rebuild international reserves and private sector capital outflow declining. Importantly, in this logic we do not foresee a strong response of either the current balance or the foreign currency exchange to resumed purchases.

To conclude, let me reiterate that the Bank of Russia will explore the need for further upgrades to the key rate, taking into account inflation and economic developments against the forecast, as well as the risks of external conditions and the response of financial markets.

In the current context it is crucial that our approach remains conservative as we assess risks and conduct monetary policy. Inflation stays close to 4%. More so, it has never climbed above this figure since the second half of 2017. Although the rise in inflation early next year is set to be driven by transient factors, considering the need to limit their negative effects and ensure a speedy return of inflation to 4%, it is critical that the response of monetary policy is well-timed. A consistently conservative monetary policy stance will enable us to curb both inflation risks and the response of inflation expectations. This will lay the groundwork for looser monetary policy by late 2019 – early 2020, if the situation unfolds consistent with our forecast.

Before I proceed to answer your questions, let me also inform you about the changes we want to introduce beginning in March 2019 as regards our communications related to key rate decisions. First, a key rate press release in the follow-up to our policy Board meeting will include a reforecast. Second, a monetary policy report will be published in a week after a Board meeting. These arrangements will serve to better reflect the logic of the already made decision.

Bank of Russia Governor *Elvira Nabiullina*

1. MACROECONOMIC CONDITIONS

Annual inflation was rising gradually between September and November 2018, moving closer to 4%, which is consistent with the Bank of Russia's target. Acceleration in price growth rates was registered across most regions. Price movements were influenced by changes in supply and demand in individual food markets and the prior ruble weakening alongside the emerging price adjustment to the scheduled standard VAT rate increase due in January 2019. Economic agents' inflation expectations remained heightened, adding pressure on consumer price movements. Consistent with forecasts, inflation by the end of 2018 is set to total 4%.

Domestic financial markets stabilised, following the strong volatility rise episode between August and the first half of September. The ruble strengthened slightly, tracking the performance of exchange rates in emerging market economies (EMEs). Oil prices in the fourth quarter remained above $55 per barrel – the benchmark of the 2019-2021 baseline scenario assumptions. However, they demonstrated strong volatility. Oil production dynamics in the US combined with a certain slowdown in global economic growth strengthened the risks of supply exceeding demand in the 2019 oil market. High uncertainty remains over other future external conditions and their impact on financial asset prices.

A certain tightening in monetary conditions continued. The increase of the Bank of Russia key rate will help maintain positive real interest rates on deposits, which will buoy the appeal of savings and balanced growth in consumption.

Consumer and investment activity remained muted, as incomes grew moderately and external uncertainty persisted. Economic activity was supported by sustainably rising lending to households and businesses. The unemployment rate was close to its equilibrium mark. No inflationary pressure came from overall domestic demand and production activity, helped by the current monetary policy stance. GDP growth in 2018 is predicted to total 1.5-2.0% – consistent with the potential growth estimate for the Russian economy.

1.1. Inflation

Inflation was on an upward path between September and November 2018, returning to the Bank of Russia's 4% target. Annual consumer price growth rates were 3.8% in November relative to the same period last year (in August, 3.1%, Chart 1.1). The Bank of Russia forecasts that annual inflation will be in the 3.9-4.2% range by the end of 2018. A rise was also reported in the inertia parameters of price dynamics: year-on-year inflation was 2.7% in November (0.2 pp higher than in August). It is expected to stand at 2.8-2.9% in late 2018.

The weakening of the ruble, triggered by external conditions, came as a key driver for annual inflation. Although the exchange rate saw marked fluctuations, price sensitivity to exchange rate dynamics sustained close to the late 2017 – early 2018 levels. Growing prices of imports (both final and intermediate products) acted as an exchange rate pass-through channel. The other channel the exchange rate exerted its influence through was increasingly more profitable export operations. Their impact fed through to domestic prices via the export parity price mechanism. The current year's rise in export prices minus the costs of transportation and export duty[1] was also caused by growing prices in global commodity markets (hydrocarbons, grain). The rise in export prices was especially noticeable in oil producers' domestic production and processing prices. This worked to build cost-side pressures in the overall economy.

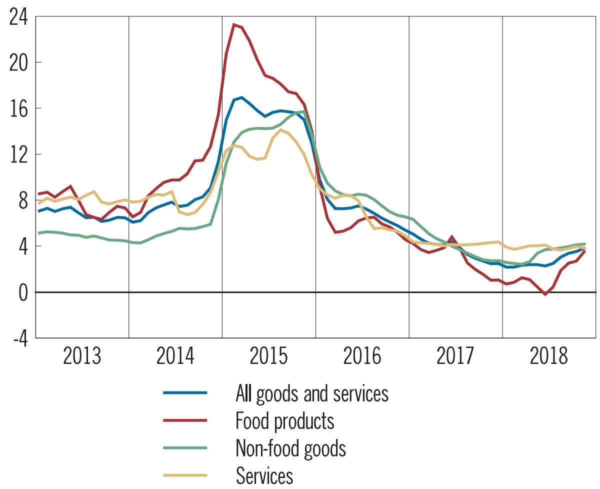
The exchange rate's proinflationary effect was further strengthened by several supply-side factors in food markets.

At the same time, consumer demand growth was muted, adding no substantial proinflationary pressure to product and service prices.

Inflation moved upwards across most Russian regions (see the Annex 'The economic situation in Russian regions'). Regions continued to report highly diverse growth rates for consumer prices. This heterogeneity owes its existence to markedly different consumer baskets across regions, various exchange rate pass-through effects and, as a result, various structural specifics of food markets alongside other drivers of local relevance.

The overall upward price movement is evidenced by a rise in several underlying inflation indicators cleared of one-off effects (Chart 1.2). Rosstat's annual core inflation edged up 0.7 pp to 3.4% from September to November.

Chart 1.1
Inflation
(per cent change on corresponding month of previous year)



Source: Rosstat.

Food products

Annual food inflation, at a historical minimum in the first year-half, grew in the September to November 2018 period, which is in line with the Bank of Russia's September forecast[2] (Chart 1.3). It was 3.5% in November 2018 (1.6 pp higher than in August). Overall proinflationary pressure on food prices came from a weaker ruble. Further pressure came from impactful factors specific to individual markets. Conversely, global prices for core Russian food imports and exports (excluding grain) in the September to October period added no proinflationary pressure (see Section 1.2).

The most noticeable price growth paces were shown by meat products and eggs; these developments were largely the result of a further adjustment in domestic supply to demand. Prices for meat products and eggs were also adversely influenced by the epizootic situation in pig breeding and poultry farming across a number of regions. At the same time, the lifting of the ban on meat imports from Brazil will act as the meat price constraint in the months to come.

[1] *Export price minus the cost of getting the product from the factory (transportation etc.) and export duty – netback.*

[2] *See Monetary Policy Report, No. 3 (23), September 2018 (hereinafter, the Report), http://www.cbr.ru/Collection/Collection/File/7822/2018_03_ddcp.pdf.*

Beyond the increase in energy prices, weighing on the overall price dynamics, further upward pressure on the annual growth rates of producer costs and prices for meat and eggs came from mounting fodder grain prices, occurring in the context of rising global and domestic grain prices.

At the same time, taking into account the previous years' stocks, grain and its products in the Russian market were in abundant supply. Stability in this market was further helped by the state grain interventions in place since June. In these conditions, the growth rates of producer prices for bread, bakery products and confectionery, as well as the increase in their retail prices, proved moderate. Consistent with prior years, retail prices for grain and pulses in November were lower than in the previous year (and in the preceding months since April 2017). Millet emerged as the only exception, with its price growth rates persistently high as the supply of millet shrank against the backdrop of poorer harvest than last year. Nonetheless, its contribution to inflation, taking into account its share in household expenses, was negligible.

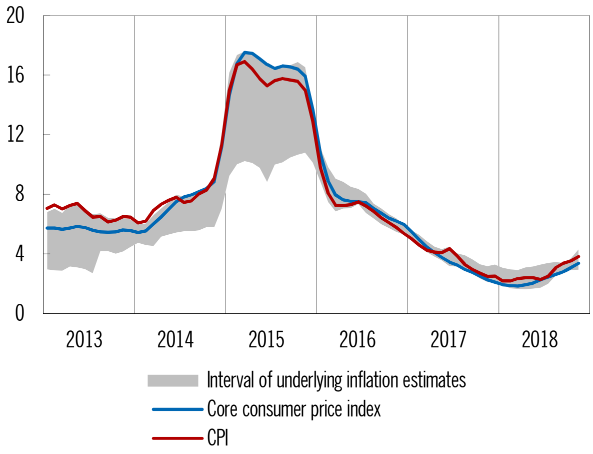
Equally moderate were fruit and vegetable price movements, helped by further growing outputs of greenhouse vegetables. These in the period from early 2018 to early December were rising at 28% against the same period in 2017.

Non-food goods

The September to November 2018 period expectedly saw a rise in annual inflation in the non-food market (by 0.4 pp to 4.2%). Price growth rates picked up across many positions in this consumer market segment, triggered by the weaker ruble and rising cost-side pressures.

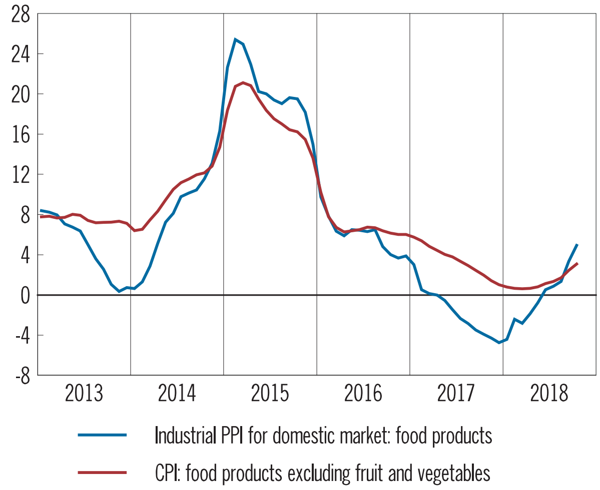
Despite the volatility of global oil prices and the trend towards rising oil producers' domestic prices, the September to November period saw modest monthly growth in consumer petrol prices (Chart 1.4). No substantial changes were seen in its annual growth rates. This socially relevant market was overall steady, thanks to the Government's action. The Government' arrangements with oil majors are set to last through the end of March 2019. Moving forward, a rise in oil product prices will be limited by the reverse excise tax framework as part of the tax manoeuvre in the oil industry (see the Annex 'Assessment of the effect of oil tax manoeuvre on consumer inflation'). The overall

Chart 1.2
Underlying inflation indicators
(per cent change on corresponding month of previous year)



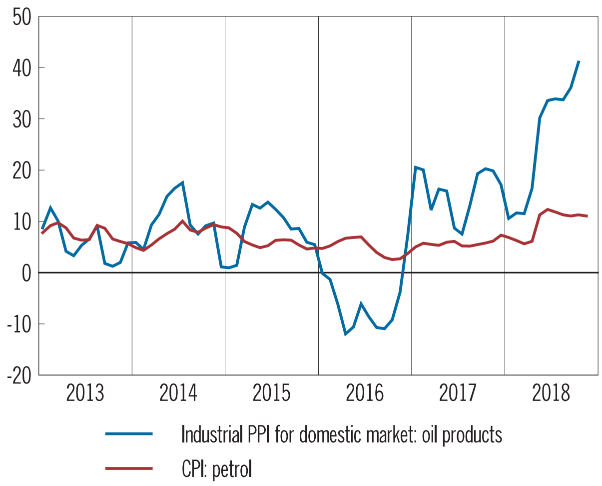
Sources: Rosstat, Bank of Russia calculations.

Chart 1.3
Food prices
(per cent change on corresponding month of previous year)



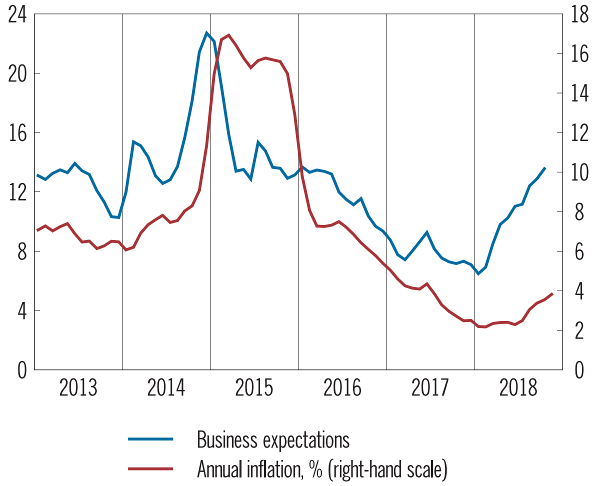
Source: Rosstat.

Chart 1.4
Petrol prices
(per cent change on corresponding month of previous year)



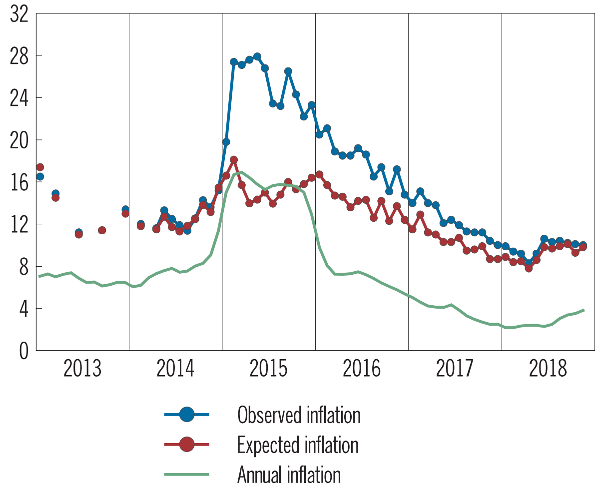
Source: Rosstat.

Chart 1.5
Business inflation expectations
(seasonally adjusted balance of replies, pp)



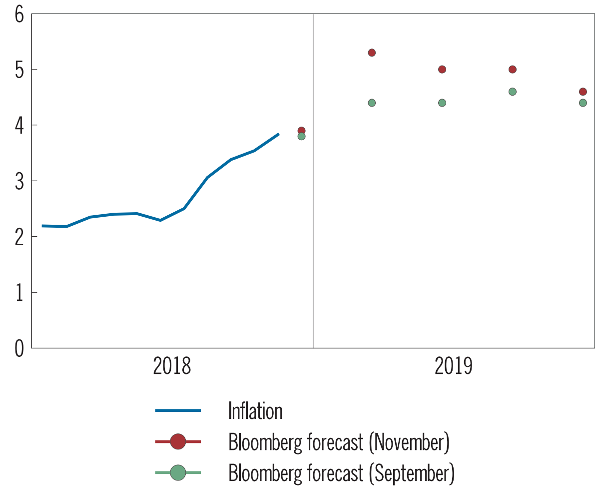
Sources: Rosstat, Bank of Russia.

Chart 1.6
Households' inflation expectations
(median estimate, %)



Sources: Rosstat, inFOM.

Chart 1.7
Professional analysts' inflation expectations
(per cent change on corresponding period of previous year)



Sources: Rosstat, Bloomberg.

impact of the tax manoeuvre on inflation is set to depend on global oil price movements.

Services

Prices grew modestly from September to November: growth rates added 3.8% in November, which is 0.1 pp higher than in August. Prices across services sector segments posted a mixed performance, shaped by local factors including regulatory measures.

Inflation expectations

As growth rates of producer and consumer prices moved upwards, economic agents' inflation expectations, which are essentially adaptive in nature, either moved up or settled at heightened levels.

According to estimates based on Bank of Russia surveys, the period between September and October 2018 saw a continued trend towards rising inflation expectations of businesses for three months ahead. They returned to the levels seen between the second half of 2015 and the first half of 2016 (Chart 1.5). Inflation expectations grew the largest in agriculture and trade, which mainly comes as a result of ruble exchange rate movements, cautious estimates for the harvest volumes of several cultures, concerns over rising prices for fuels and lubricants, and a preliminary adjustment to the VAT rate hike due in January 2019.

Household inflation expectations in the autumn months of the year fluctuated close to levels observed in the May to June 2018 period, when they moved upwards, mainly driven by retail prices for motor fuel (Chart 1.6). They were on the rise in November. At the same time, expected inflation estimates are invariably lower than observed inflation, in a sign of households' uncertainty persisting over future price trends.

The median estimate of annual inflation expected in 2018 Q4 calculated based on the accuracy of Bloomberg surveys increased to 4.1% (in September, 3.8%) (Chart 1.7). In 2019, the professional community expects annual inflation to reach 4.6%, which is to a great degree caused by the hike in the standard VAT rate due from 1 January 2019. The forecasts were revised upwards (from 4.4% in September) – probably based on inflation readings for the autumn months.

1.2. External conditions

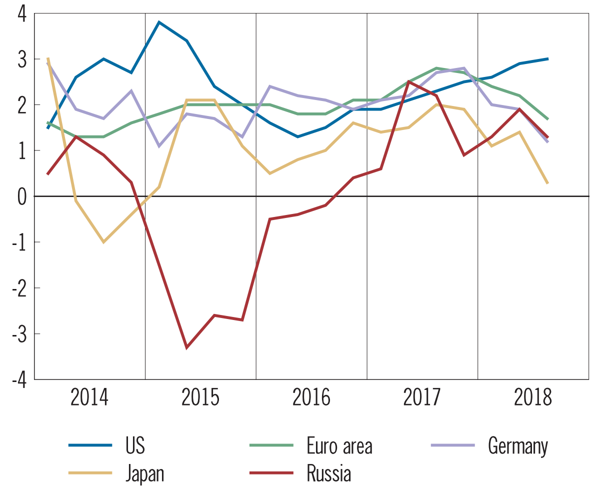
Economic growth and inflation

Between September and November, there was a certain slowdown in economic growth, both in advanced economies (AEs) and EMEs. In the third quarter of the current year, GDP slowdown was recorded in Russia's several trading partners including the euro area (a decline from 2.2 to 1.7%) and China (from 6.7 to 6.5%). Changes to trade agreements, the risks of fresh export tariffs along with a deterioration in economic expectations are mainly weighing on export-focused economies (e.g., China or Germany, the euro area's leading economy which saw its Q3 GDP growth fall from 1.9% to 1.2%). Leading indicators point to a further slowdown in economic activity across most regions: the euro area's composite PMI edged down in November from 53.1 to 52.4 points; China's PMI, calculated by the National Bureau of Statistics, dropped in November from 53.1 to 52.8 points, with its manufacturing PMI having reached the threshold value of 50 points.

The US economy was the only major global economy where annualised economic growth carried on, mainly driven by fiscal stimulus measures. US GDP totalled 3% in 2018 Q3. However, US economic growth is expected to slow as early as 2019 with fiscal stimulus effects drawing to a close, interest rates continuing to rise and the business cycle transitioning into a mature stage.

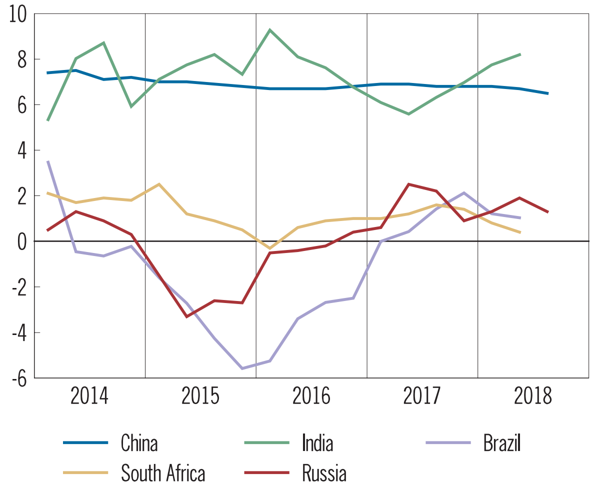
External inflationary pressures from September through October were overall low both in AEs (even in the context of sustainable economic growth) and most EMEs (Charts 1.10 and 1.11). In November, inflation in the US decelerated from 2.5 to 2.2% against the same period of the previous year, from 2.2 to 2.0% in the euro area, and from 2.5 to 2.2% in China. Several EMEs that are Russia's trading partners (e.g. Turkey), after having seen inflation accelerate between September and October, report weaker inflationary pressure in November. As lower energy prices feed through to consumer prices and economic growth slows down across major global economies, inflationary pressure is set to remain muted.

Chart 1.8
GDP growth rate: advanced economies and Russia
(per cent change on corresponding period of previous year)



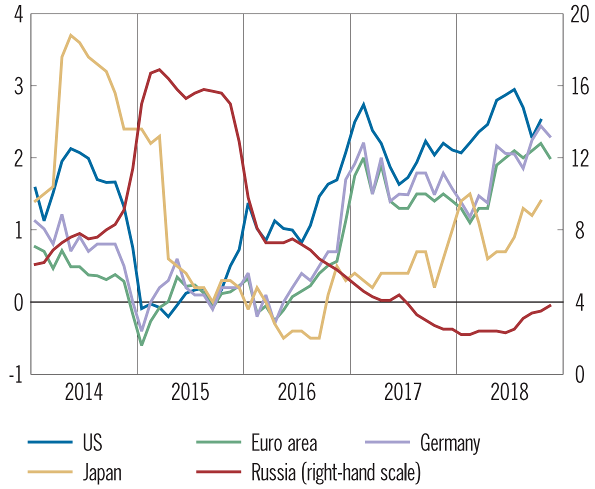
Source: Bloomberg.

Chart 1.9
GDP growth rate: EMEs and Russia
(per cent change on corresponding period of previous year)



Source: Bloomberg.

Chart 1.10
Inflation: advanced economies and Russia
(per cent change on corresponding period of previous year)



Source: Bloomberg.

Foreign central banks' monetary policies

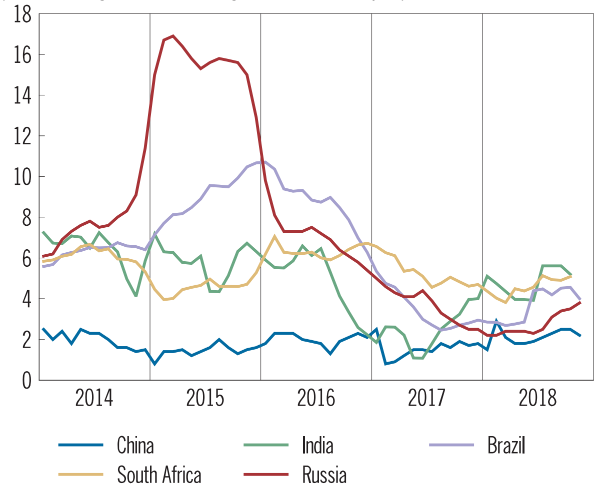
The September to November period of this year saw an overall tightening in most countries' monetary policies. This occurred on the back of ongoing monetary process normalisation in several AEs as a response to excessive volatility in financial markets and capital flows in EMEs.

The US Fed went ahead with its monetary policy normalisation cycle, moving to raise the federal funds rate by 25 bp in September, with another rise slated for this December. The ECB cut down its quantitative easing volumes back in the fourth quarter, from 30 billion to 15 billion euro, in an effort to close the programme by the end of the year. Since November, market players had been revaluating the paces of AE monetary policy tightening expected in 2019; they had been increasingly opting for weaker interest rate hikes as the risks of slower economic growth and higher market volatility emerged.

A number of AEs and EMEs (in particular, Canada, Norway, Korea, Mexico, Turkey, Chile, Philippines and the Republic of South Africa) also raised policy rates between September and November.

In the context of trade tensions and slower economic growth, China is rolling out a suite of accommodative monetary and fiscal measures. Chinese authorities overall see their monetary policy as neutral with some ad hoc support measures which include reduced reserve ratios, expanded lending support programmes, and a number of macroprudential changes.

Chart 1.11
Inflation: EMEs and Russia
(per cent change on corresponding period of previous year)



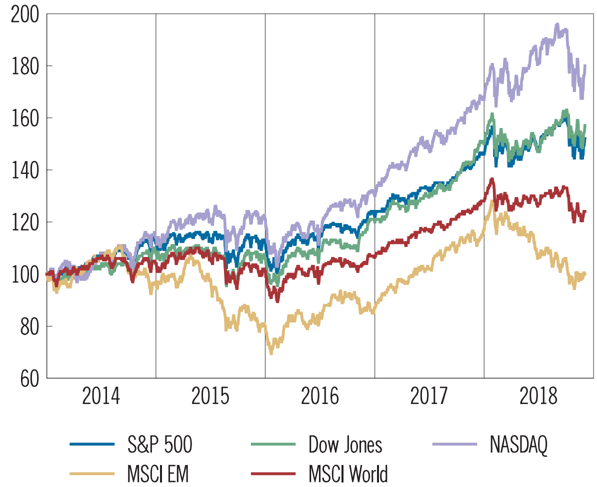
Source: Bloomberg.

Global financial markets

Most segments of global financial markets remained exceedingly volatile through the September to November period. Volatility was at its highest point since March 2018. Both AEs' stock indices, tracking the US, and EMEs' stock indices declined, based on the MSCI indices (Chart 1.12).

US stock indices were beginning to dip into negative territory between October and November, after their historical highs in September. This drop in US stock indices is in part a reflection of investor alarms over a potential slowdown in the growth of the US economy. However, most experts maintain that these developments are nothing more than market adjustment given the overall overvaluation

Chart 1.12
Main global stock indices
(02.01.2014 = 100%)



Source: Bloomberg.

of US companies (in particular, in the high tech sector), a strengthening of the US dollar, as well as the risks of trade wars.

At the same time, US government bond yields in October to early November touched seven years' highs against the fears of a faster US interest rate increase based on the assumptions that the economy was set to accelerate. Nevertheless, the US Fed's relatively soft rhetoric over the federal funds rate approaching its neutral level and the uncertainty over the continuation of quarterly rate increases led to a decline in US government bond yields with their subsequent stabilisation (Chart 1.13).

In FX markets, the US dollar was appreciating against most currencies, helped by the potentially negative impact of increased tariffs on global trade and the world economy combined with growing risks in several euro area countries, in particular, given Italy's budget problems and the uncertainty over Brexit.

Global commodity markets

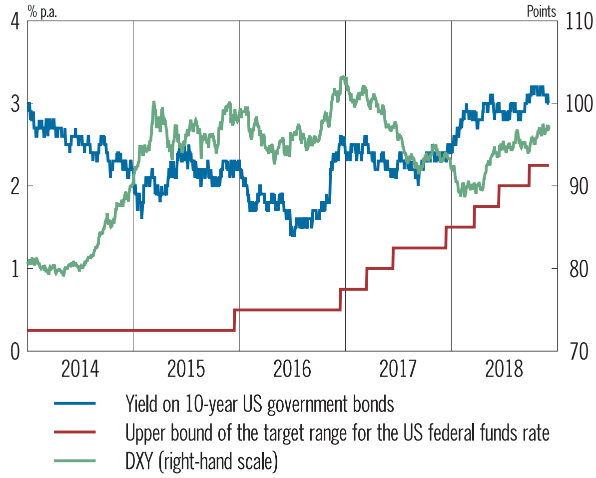
As global economic growth slowed and barriers in global trade strengthened, the demand-driven support for commodity prices grew weaker. In the autumn, global prices for many metals and coal declined (Chart 1.14).

The performance of the price for oil, Russia's key export commodity, was mixed in the period under consideration, driven to a large degree by supply-side factors. In the second half of September – October, Urals prices climbed to the average of $80 per barrel, exceeding the September Report's assumption, against the backdrop of quickly shrinking Iranian exports in anticipation of reinstated US sanctions.

That being said, the oil price dropped below $60 per barrel by late November in the context of softened Iran export restrictions and rapidly rising US outputs. The price came under further downward pressure from expanding outputs in some OPEC countries, which abundantly offset the shortfall in supply caused by Iran and Venezuela.

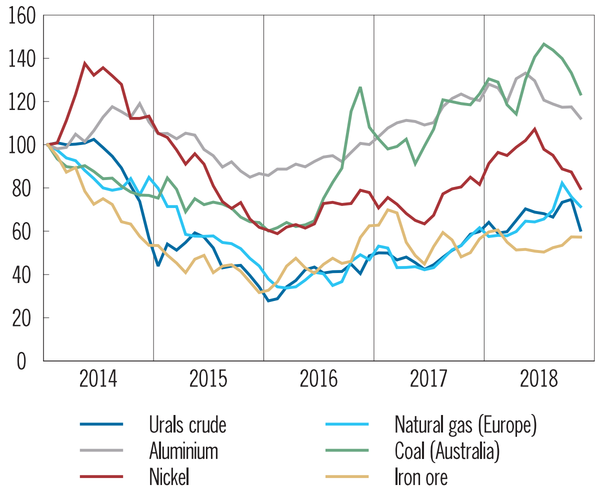
In early December, the crude price saw an upward adjustment as expectations were in place over oil production cuts as part of the OPEC+ deal for 2019, production constraints in Canada, and the US-China arrangements made in November to hold back from further import duties for at least 90 days.

Chart 1.13
Yield on US government bonds, US federal funds rate and US dollar index



Source: Bloomberg.

Chart 1.14
Global prices of Russian principal export commodities (January 2014 = 100%)



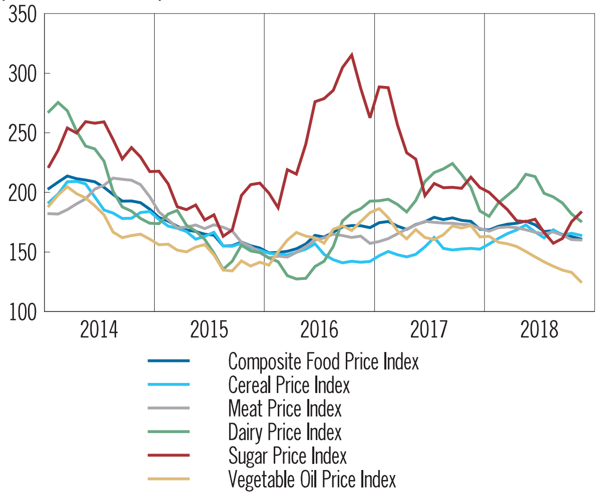
Sources: World Bank, Thomson Reuters..

On 7 December 2018, OPEC members and several non-OPEC countries reached a deal to cut oil production in the first half of 2019 by a total of 1.2 million barrels a day. These arrangements are expected to shore up oil prices. At the same time, oil prices remain pressured by the ongoing extension in the US supply of the energy commodity. In these conditions, against the backdrop of slower demand growth assumed in the baseline scenario, it is still expected that the oil price will drop to $ 55 per barrel in early 2019 from the $60 per barrel crude touched in the first two weeks of December 2018.

The price for natural gas in Europe (Russia's core market) held close to their highest levels since the beginning of 2015 as stocks dropped relative to the past year's levels.

Current global food price movements are creating no meaningful inflationary pressure. In the September to November period, global food prices were overall moving downwards, especially those for meat and milk products (Russian imports) amid abundant supply in the global market (Chart 1.15). The acceleration in meat price growth in Russia, referred to in Section 1.1, was largely conditioned on domestic factors and the ruble exchange rate.

Chart 1.15
Global food prices
(2002–2004 = 100%)



Source: UN Food and Agriculture Organization (FAO).

1.3. Balance of payments

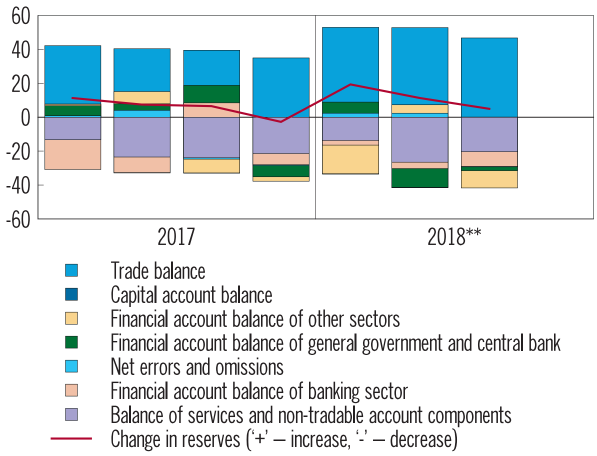
Current account

In 2018 Q3, the current account surplus climbed to the highest mark since 2008 due to the positive foreign trade surplus rising by more than 3.5 times compared to the corresponding period last year[3] (Chart 1.16).

Exports in the third quarter expanded, as they did in the second quarter, on the back of a roughly 30% rise in oil prices in the global market and natural gas prices in the European market (Chart 1.17). Exports were further buoyed by expanded oil production in Russia in the context of easing restrictions under the arrangements reached by OPEC and several non-OPEC members.

According to the Federal Customs Service, Russia increased its crude and oil product imports by 2% in the third quarter. This increase was mainly

Chart 1.16
Major balance of payments components*
(billions of US dollars)



** Signs according to BPM5.*
*** 2018 Q3 estimate..*
Source: Bank of Russia.

[3] *Here and below, changes are relative to the corresponding period of the previous year, unless otherwise indicated.*

generated by the Asian region in the context of the operating intergovernmental agreement with China alongside Korea's replacement of Iranian oil because of the resumed US sanctions.

In 2018 Q3, export quantities of Russia's natural gas continued to grow at high paces (upwards of 10%), chiefly thanks to European customers. Russia's EU-bound gas supplies increased by 19%, as domestic gas production in Europe continued to shrink, European economic growth held and Russia's energy production expanded.

Refocused on other countries, export quantities of Russian metals covered by further US duties held steady.

In value terms, imports of products and services were essentially unchanged in 2018 Q3. On the one hand, imports were buoyed by the ongoing moderate rise in domestic demand. On the other hand, imports were constrained by a 6.5% drop in the ruble's real effective exchange rate against 2017 Q3. Imports by product / service turned in a mixed performance. Noted was a drop in the imports of several products (industrial and laboratory equipment and pharmaceuticals) in value terms. Nonetheless, imports of several other product categories (e.g. handsets) sustained growth in both quantity and value terms, albeit at lower paces.

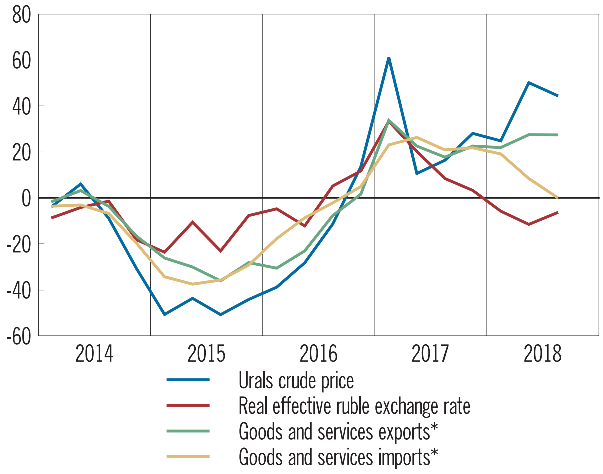
Financial account and change in the reserves

The negative balance of the private sector's[4] financial account in 2018 Q3 expanded due to the growing foreign assets of banks as oil and gas export revenues rose considerably on the back of higher oil prices (Chart 1.18). The increase in banks' foreign assets in comparison with the second quarter is also connected with more massive foreign currency accumulation in their accounts against the backdrop of suspended foreign currency purchases under the fiscal rule, introduced from late August. The move to suspend the purchases was also reflected in the slower build-up of the reserves in the course of the third quarter.

The expansion in the private sector's financial account balance in comparison with 2017 Q3 occurred also in the context of substantially

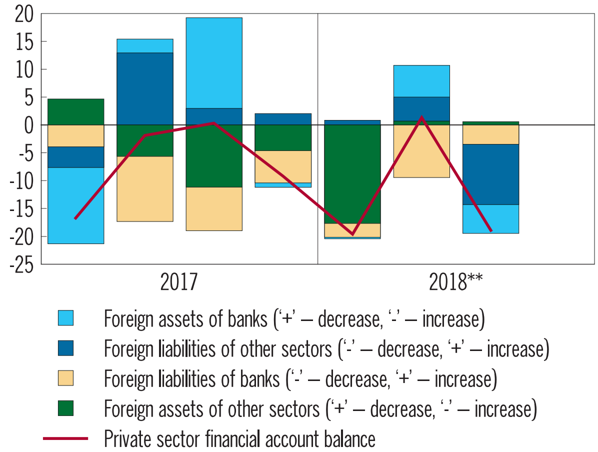
[4] Here and below, signs according to BPM5.

Chart 1.17
Foreign trade:
(per cent change on corresponding quarter of previous year)



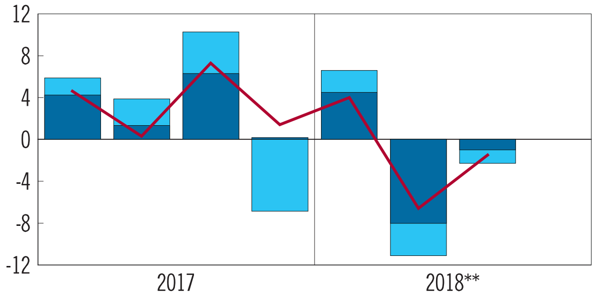
* 2018 Q3 estimate.
Sources: Bank of Russia, Thomson Reuters.

Chart 1.18
Major private sector financial account components*
(billions of US dollars)



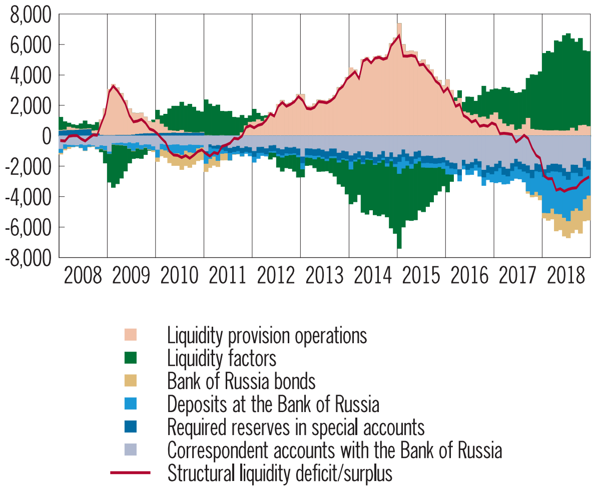
* Signs according to BPM5.
** 2018 Q3 estimate.
Source: Bank of Russia.

Chart 1.19
Public sector financial account components*
(billions of US dollars)



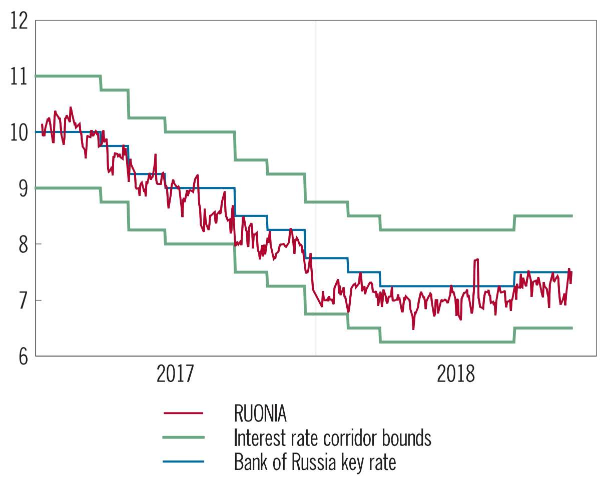
* Signs according to BPM5.
** 2018 Q3 estimate.
Source: Bank of Russia.

Chart 1.20
The Bank of Russia balance sheet and structural liquidity deficit/surplus
(billions of rubles)



Source: Bank of Russia.

Chart 1.21
RUONIA and Bank of Russia interest rate corridor
(% p.a.)



Source: Bank of Russia.

decreased external obligations in other sectors. This was connected with dividend payouts and loan debt repayment in these sectors alongside a reduction in non-residents' investment in Russian securities.

The contraction of banks' foreign obligations was slower in comparison with 2017 Q3, as the observed drop in external debt repayments was consistent with the schedule.

The material net outflow of foreign capital from the public sector in 2018 Q2 decelerated in Q3 of the year, as a result of the decline in non-residents' sales of sovereign securities (Chart 1.19).

1.4. Monetary conditions

Money market

In September-November 2018, the structural liquidity surplus dropped substantially (Chart 1.20). Bank customer tax payments did not fully flow into the banking sector as budget expenditure. Given the temporarily suspended foreign currency purchases in the domestic FX market under the running fiscal rule, the moderate budget expenditure failed to offset the tax-related cash outflow from banks.

The Federal Treasury and other budget system bodies deposited temporarily available funds with banks; however these funds generated only limited demand in presence of the structural liquidity surplus. Aiming to sustain money market rates close to the key rate, the Bank of Russia conducted liquidity-absorbing operations: regular deposit auctions and auctions to place Bank of Russia coupon bonds.

In these conditions, short-term interbank rates remained close to the key rate (Chart 1.21). Since the beginning of the year, the negative spread between interbank lending rates and the key rate narrowed significantly, as the banking sector adjusted to the increased structural liquidity surplus in 2017-2018. In September-November, a modest expansion of the spread occurred, which was connected with a temporary change in the interbank lending market.

Several banks, which previously generated a substantial share of demand for ruble liquidity, reduced market loans under the influence of local factors, replacing them with Bank of Russia loans and attracting financial resources from budget system bodies. Other market players were not quick to adjust to the declining demand of such banks, failing to increase the supply of funds at Bank of Russia deposit auctions. This brought about the onset of a temporary liquidity surplus in the short-term segment of the money market, thereby widening the spread of interbank rates to the BoR key rate.

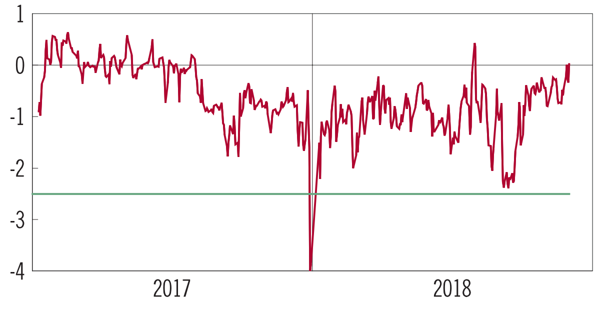
Consistent with expectations, the December 2018 to January 2019 period is set to see increased volatility in autonomous liquidity factors. In certain periods, budget expenditure and cash in circulation shape essential inflows, as well as outflows of funds from banks. Growing turnovers, including those across customer transactions, create considerable uncertainty for banks over their liquidity position. As a result, at the end of the year a potential surplus of funds in correspondent bank accounts may emerge along with a certain reduction in short-term interbank rates. Nevertheless, the Bank of Russia estimates that the average negative spread of market rates to the key rate is set to remain below or equal to 25 basis points in the specified period.

The foreign currency liquidity position in the banking sector remained overall favourable. The temporarily suspended foreign currency purchases under the fiscal rule led to the emergence of a massive inflow of foreign currency in the current account of the balance of payments. This contributed towards the build-up of foreign currency deposits of large banks' customers together with a rise in their foreign currency liquidity buffers. Banks deposited these funds in the money market, which kept the cost of foreign currency loans at fairly low levels and helped preserve ruble rates in the FX swap segment close to interest rates on unsecured interbank loans (Chart 1.22).

Foreign currency market

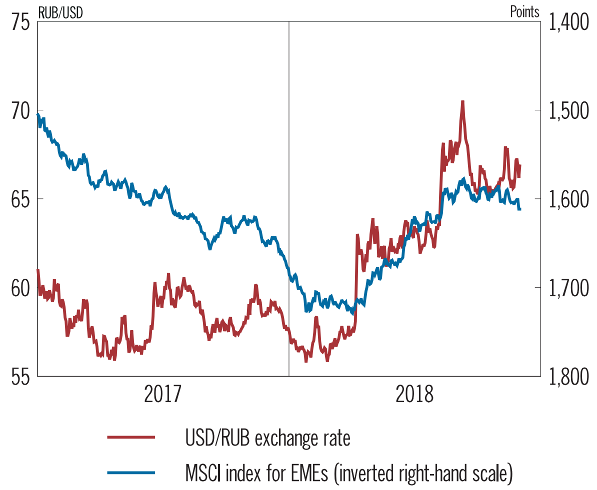
Following this September's Bank of Russia Board meeting, the ruble gained approximately 1.7% vs the US dollar (as of 30.11.2018). The ruble's overall performance was consistent with the movements of other EME currencies (Chart 1.23), but proved stronger than the currencies of oil-producing countries (Mexico, Colombia, Canada and Norway). The strong decline in the global oil price sent these currencies 2-7% lower. The ruble's response was different for several reasons. In the

Chart 1.22
Rates in the segment of FX swap, Bank of Russia key rate spread
(percentage points)



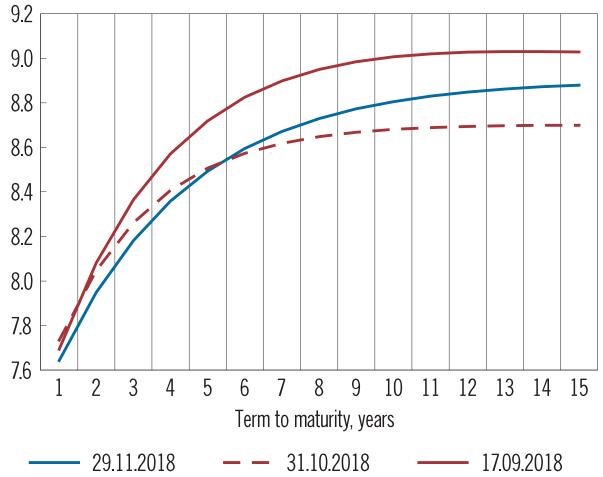
* Implied rate = ruble lending rate – FX borrowing rate + LIBOR (from 19.12.2016: key rate – 1 pp – (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).
Source: Bank of Russia calculations.

Chart 1.23
Ruble and other EME currency exchange rate



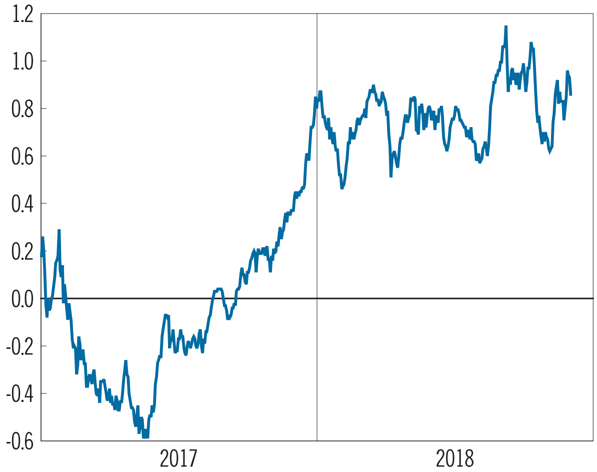
Source: Bloomberg.

Chart 1.24
OFZ zero-coupon yield curve
(% p.a.)



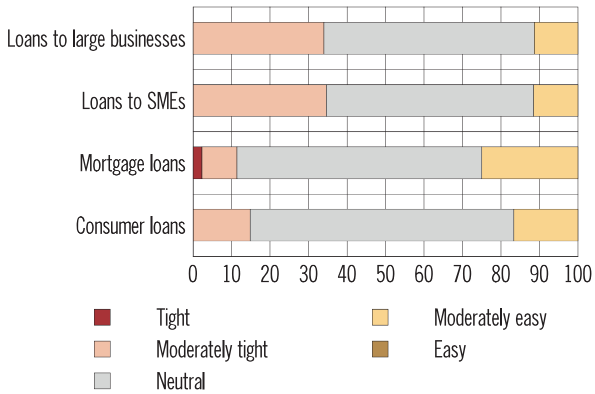
Source: Moscow Exchange.

Chart 1.25
Spread of 10-year OFZ yields to 2-year OFZ yields
(percentage points)



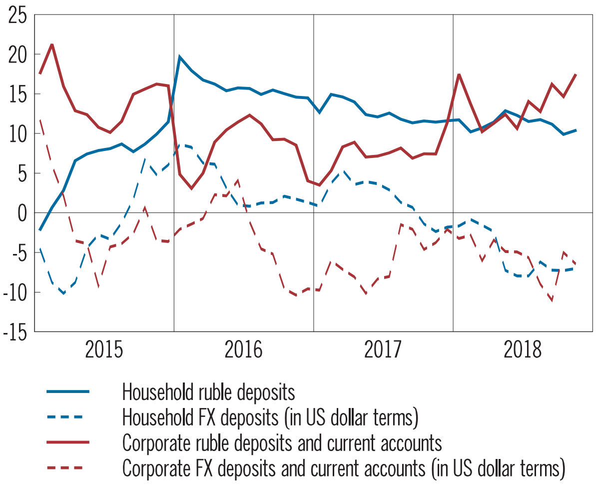
Sources: Moscow Exchange, Bank of Russia calculations.

Chart 1.26
Assessment of the tightness of long-term lending conditions by banks in 2018 Q3*
(%)



** Characterised by the proportion of banks which chose certain degree of lending condition tightness in the total number of polled credit institutions.*
Source: Bank of Russia.

Chart 1.27
Annual growth in bank deposits
(%)



Source: Bank of Russia.

middle of September, the ruble was considerably undervalued on concerns over the rollout of further sanctions against Russia. Market players downgraded their assessment of these risks in October-November. Furthermore, exchange rate volatility was held back by the Bank of Russia's move to suspend fiscal rule-based foreign currency purchases, aimed at limiting financial stability risks. This was also aided by the Bank of Russia's September 2018 decision to increase the key rate. In late November, the ruble gained support from overall improvement in EMEs, with demand rising for risk assets as the US Fed softened its rhetoric over future monetary policy.

Stock market

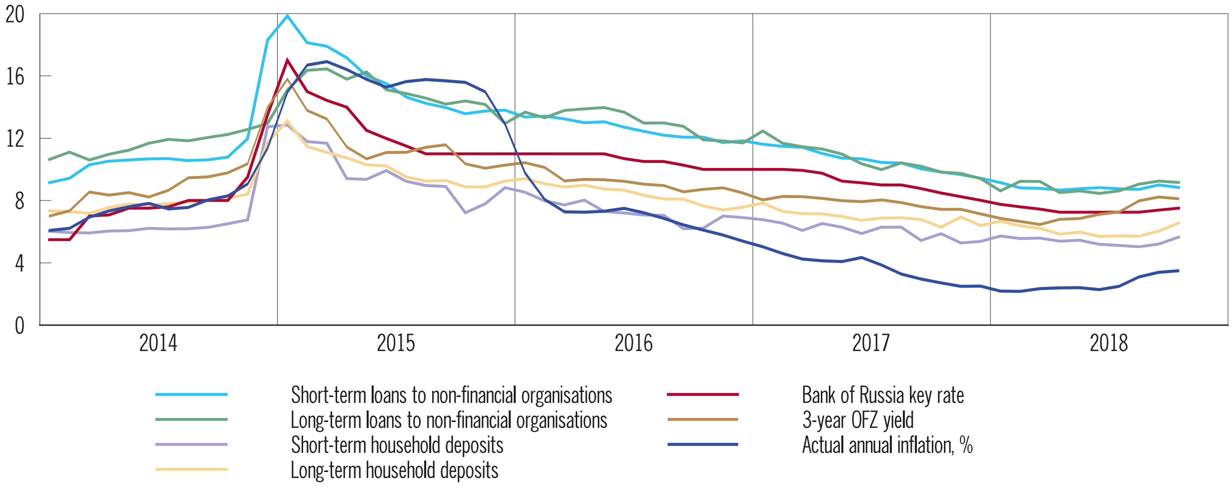
The government bond market saw a stabilisation in the October to November period (Chart 1.25). The Russian Finance Ministry resumed regular OFZ auctions; however the volumes on offer were still markedly below those in the first six months of 2018. The considerable outflow of foreign investors' funds, observed from August through September, was seen to reduce markedly. Although funds continued to outflow from the secondary market, foreign investors increased their purchases in the primary market. At auctions, their share in several issues amounted to 50-70%. Against this background, the long end of the OFZ zero-coupon yield curve dropped by 30 bp since mid-September (Chart 1.24). OFZs saw their curve slope increase at the short end. The spread between 10-year and 2-year OFZs returned to the middle the 2018 range (Chart 1.25).

Deposit and loan market

In August-November, banks continued to raise loan and deposit interest rates. This was driven by the July-August rise in debt security yields and rates on long-term money market operations (Chart 1.28). As before, changes in money and stock market interest rates fed through into banks' interest rates gradually. Preliminary estimates show that by November rates on banking operations grew weaker than bond yields did, in a sign that a moderate growth potential remains in place for loan and deposit interest rates, moving forward.

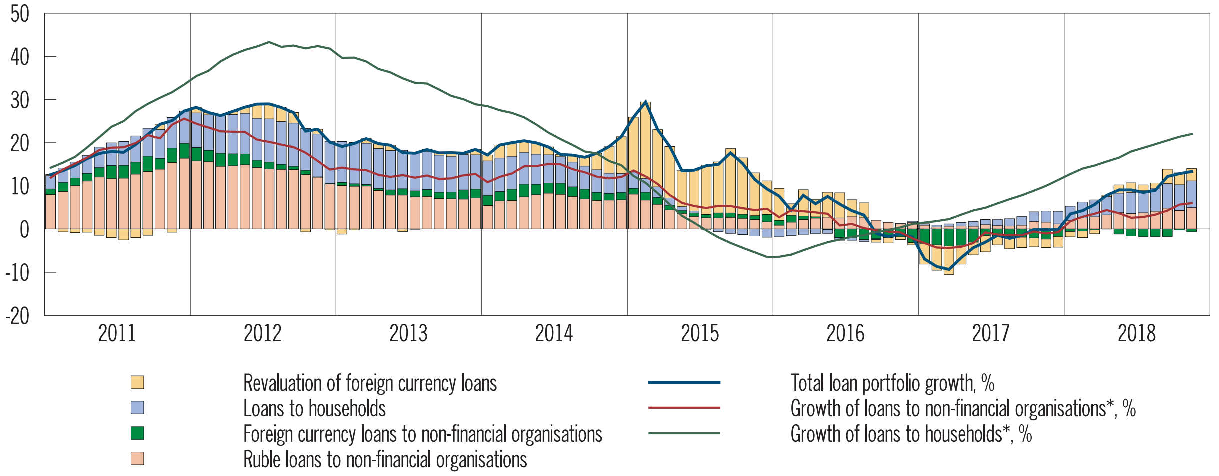
The rise in interest rates on banking operations, observed from August into November, occurred

Chart 1.28
Interest rates on ruble operations in the Russian market
(% p.a.)



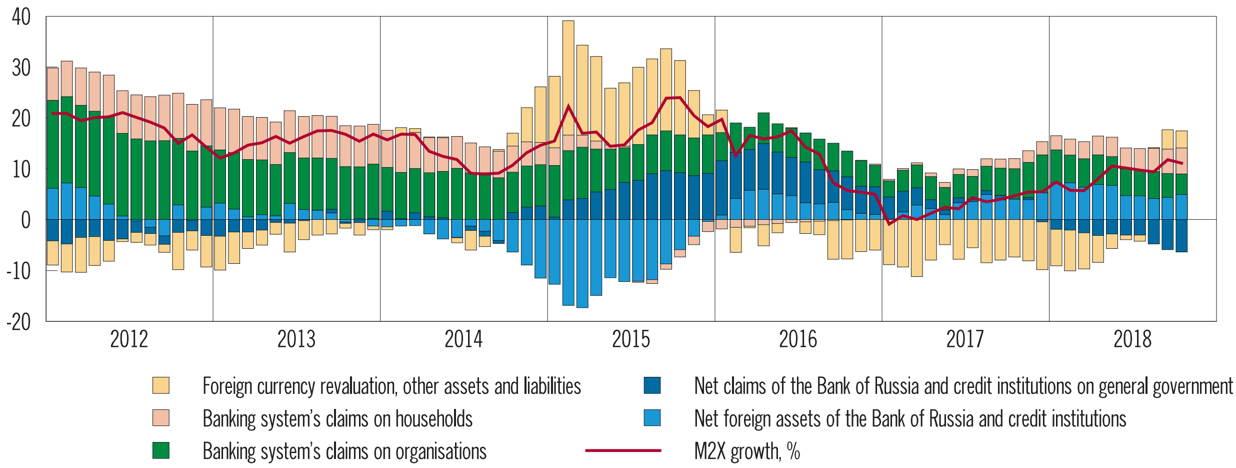
Source: Bank of Russia.

Chart 1.29
Contribution of various components to annual growth of banks' loan portfolio
(percentage points)



** Adjusted for foreign currency revaluation.*
Source: Bank of Russia.

Chart 1.30
Contribution of various sources to annual broad money supply growth*
(percentage points)



** From 1 January 2015, monetary indicators are calculated on the basis of new statistical methodology.*
Source: Bank of Russia.

against the background of mounting actual inflation and inflation expectations commensurate with the increase in nominal rates. As a result, real rates on deposits and loans scarcely grew in the second half of 2018; several market segments saw them decline. These conditions enabled loans to keep their appeal with borrowers, which, combined with the ongoing economic growth, promoted a further ramp-up of banks' credit activities (Chart 1.29). The expansion in lending also made a positive contribution to the increase in consumer demand.

Consistent with previous periods, banks remained interested in retail operations, seeking to grow their volumes. In August-September, interest rates on household loans continued to decline, with growth, which emerged in October, weaker than in the corporate lending segment. As regards retail loan interest rates, the slower growth effects were to a certain degree associated with a lag between the time of loan approval and its formal issue date, a feature of the mortgage market segment. Non-price lending conditions for retail borrowers were softer than those for corporate borrowers (Chart 1.26). In this context, growth in household lending continued to outpace that in corporate lending.

The mortgage market, where credit risks are the lowest, emerged as the segment with the strongest competition for borrowers. Based on annual growth rates, the mortgage market continued to outrun other credit market segments. The expansion in consumer demand combined with higher household incomes to push up demand for consumer loans, enabling the consumer lending segment to post catch-up growth. Over a short-term horizon, the potential for further growth in consumer lending will be limited as the recovery demand for loans fades out gradually along with a further tightening in lending conditions, which first emerged at the end of the year; among other constraints were rising household debt burdens and stricter regulation of this segment. Therefore, rising volumes of consumer lending carry no strong inflation risks in the near term.

The corporate lending segment saw an improvement in mid-2018 in the quality of loan portfolios (except for the banks under resolution, which accounted for over half of bad corporate liabilities).

This combined with the ongoing economic expansion to spur growth in corporate lending. Also on the rise were growth rates in lending to most manufacturing sectors (mainly, chemicals and metallurgy), agriculture and trade. As a result, in some months of the third quarter, corporate lending contributed more to the rise in banks' credit portfolios than retail lending did.

Over a short- and medium-term horizon, the continued lending expansion will shore up consumer and investment demand growth. A further increase in the contribution of corporate lending to domestic lending volumes is not ruled out, driven by both rebounding investment activity and the Bank of Russia's regulatory measures towards curbing retail lending segments associated with higher risks.

In August-October, growth in credit to the economy remained the core source of money supply increase (Chart 1.30). Growing credit activity set off the impact of budget operations on money supply, with the effect that the increase in money supply was commensurate with overall economic expansion and created no inflation risks.

In the deposit market, private investors' activity in recent months remained low (Chart 1.27). The August to September period saw a drop in household deposit balances. The outflow of funds from deposits was triggered by local developments. In October-November, the inflow of funds into household deposits resumed.

The trend towards change in the structure of the deposit market, seen in recent years, continued into the second half of 2018. For the most part of the period, the share of foreign currency in household deposits continued to decline. Households' foreign currency deposits declined both at a time when ruble deposits were growing and at a time when they were shrinking; in the latter case, foreign currency deposits were declining at outrunning paces. As before, private investors opted for short-term deposits; the proportion of long-term deposits in the overall portfolio of retail deposits continued to dwindle. The lower average maturity of deposits could have been another factor in competition between banks in the deposit market, aiding growth in deposit rates.

1.5. Economic activity

GDP dynamics

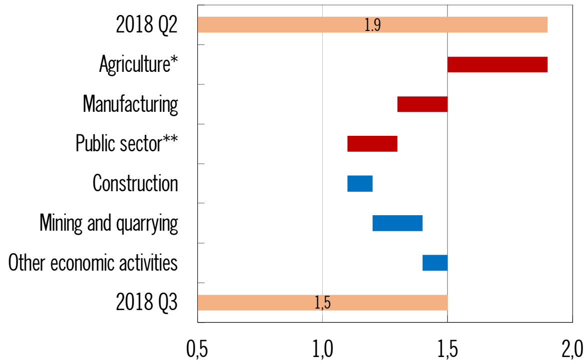
Annual GDP growth in 2018 Q3 slowed to 1.5% (against the previous quarter's 1.9%). This corresponds to the middle of the Bank of Russia's forecast range (1.3-1.7%) presented in the September Report (Chart 1.31). Agricultural outputs emerged as the key negative contributor to economic slowdown on a quarterly basis (0.4 in the previous quarter). In annual terms, the contraction was mainly due to the base effect: the previous year saw record high grain and other culture crops. The base effect fed through into output growth rates in the manufacturing sector, which also undermined annual GDP growth.

GDP growth was to a great extent due to rising external demand for Russian products and services. Commodity exports and exports of investment goods were on the rise. Expansion was seen in the exports of services, supported by the FIFA World Cup. Preliminary estimates show that annual growth in the export quantities of goods and services in 2018 Q3 totalled 4.7-4.8%, which is roughly equal to a 1.2 pp contribution to annual GDP growth. As consumer and investment demand grew modestly, the output of goods and services for the domestic market is estimated to have increased by 0.5%.

Production activity

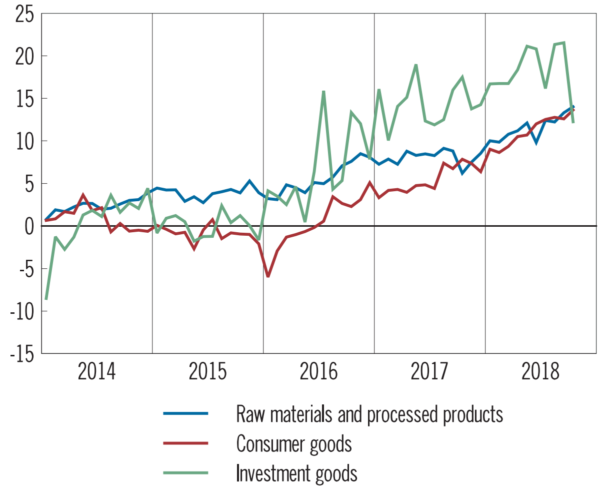
Seasonally adjusted production activity in the third quarter was overall on the rise compared to the previous period. Industrial production expanded both on year-on-year basis and against 2018 Q2 (adjusted for seasonal and calendar factors). Growing mining outputs were the key contributor to these data, along with steadily growing external demand (Chart 1.32). Manufacturing sectors' outputs meanwhile remained unsteady: the moderate expansion in domestic demand for domestically produced products could not offset the adverse effects of one-off factors in several markets, including metals. The output of non-ferrous metals came under pressure from geopolitical events, while the production of ferrous metals was constrained by strengthening protectionism in global trade.

Chart 1.31
Contribution of economic activities to slowdown in GDP growth in 2018 Q3
(percentage points)



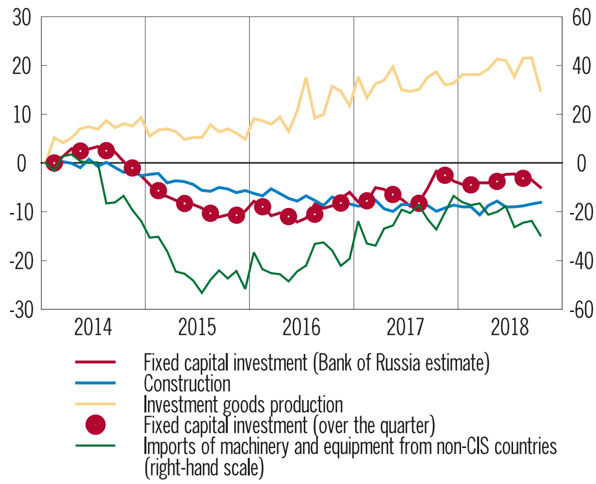
Agriculture implies an activity type made up of 'agriculture, forestry, hunting, fishery and fish farming'.
*** Public sector implies the following activity types 'public administration and military security', 'social security', 'education', 'public health and social services'.*
Sources: Rosstat, Bank of Russia calculations.

Chart 1.32
Industrial production by individual commodity group
(seasonally adjusted, growth as % on 2013)



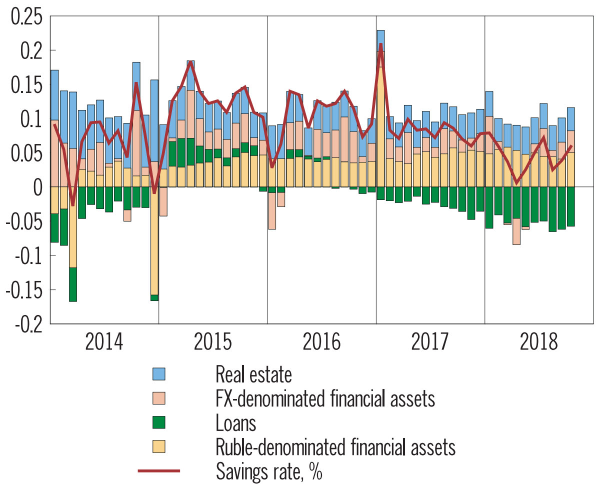
Sources: Rosstat, Bank of Russia calculations.

Chart 1.33
Investment activity indicators
(seasonally adjusted, growth as % on January 2014)



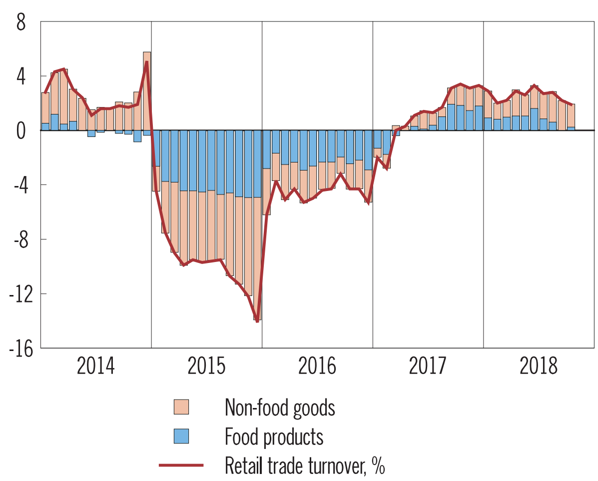
Sources: Rosstat, Federal Customs Service of Russia, Bank of Russia calculations.

Chart 1.34
Decomposition of savings rate
(contribution, percentage points, seasonally adjusted)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.35
Decomposition of growth in retail trade turnover
(contribution to annual growth, percentage points)



Sources: Rosstat, Bank of Russia calculations.

Industrial production is expected to slow in October 2018, according to Bank of Russia estimates. The output of investment goods including transport vehicles was held back by one-off factors.

Although economic activity indicators in October proved somewhat weaker than Bank of Russia expectations, they give no reason for a revision in the short-term forecast of the aggregate output of goods and services. In 2018, GDP growth is forecast at 1.5-2.0%, which accords with the Monetary Policy Guidelines for 2019-2021 released at the end of October.

Investment activity

A variety of indicators offer a mixed view of growth in investment activity (Chart 1.33). On the one hand, gross fixed capital formation rose by 1% in 2018 Q2 year-on-year – well below the Bank of Russia's September Report estimate (2.5-3.5%).

On the other hand, annual growth in fixed capital investment in the period under study totalled 2.8%, including a 4.9% rise in the private sector investment. In this way, the smaller than expected growth in gross fixed capital formation in 2018 Q2 was mainly caused by non-market factors that must have been transient.

The annual rate of fixed capital investment accelerated to 5.2% in the third quarter. At the same time, a further rise in investment activity may be contained by tighter lending conditions, triggered by a deteriorating external climate and growing costs of imported equipment (following the August-September weakening of the ruble). Preliminary estimates point to somewhat weaker investment activity in October 2018. Seasonally adjusted outputs of investment goods slid month-on-month, as did imports of engineering products. The recovery growth in construction volumes, in progress since August 2018, remains weak (see the Annex 'Construction sector'). Despite the volatility of investment activity indicators, their movements are overall in line with a gross fixed capital formation estimate for 2018 (1.5-2.0%) specified in the October Report.

Consumer demand and savings

In 2018 Q2, households final consumption expenditure totalled 2.5% – lower than the Bank of Russia's estimate based on retail sales data presented in the September Report (3.0-3.5%). The likely reason for the divergence is weaker than expected households' spending abroad and higher spending of non-residents during the FIFA World Cup.

Expansion in consumer demand continued in the course of the third quarter. This was aided the weakening in consumers' saving behaviour model. In August-September 2018, the savings rate slid below its 2013-2014 readings, in part due to expanding consumer lending (Chart 1.34). Consumption growth may have been a reflection of higher inflation expectations triggered by the August-September weakening of the ruble. In this environment, retail sales were rising mainly on account of non-food products (Chart 1.35), whereas food sales data were more subdued.

This effect grew weaker in the October of 2018, however, when sales growth slackened. Consumer demand is in for a moderate increase in November and December 2018.

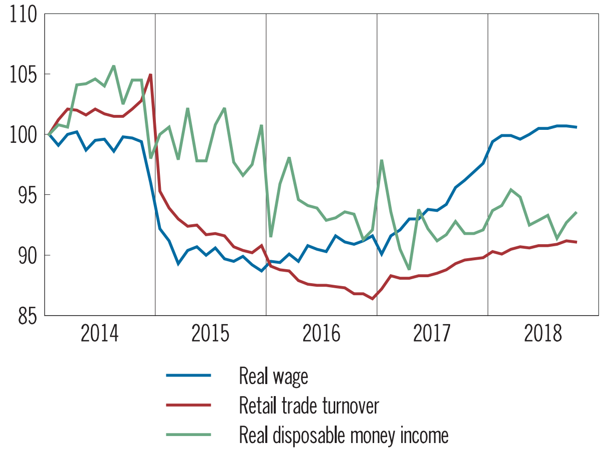
As of year-end 2018, the growth rate of households final consumption expenditure may well be close to the lower bound of the 2.5-3.0% estimate unveiled in October.

Labour market and incomes

The performance of the labour market in the August to October period matched Bank of Russia expectations. The unemployment rate remained close to its natural level and carried no inflation risks.

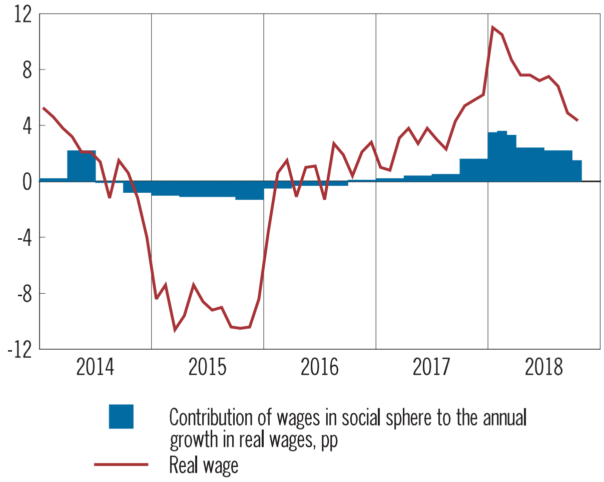
The third quarter's pay rises in the public sector, in pursuance of the Russian President's May decrees, continued to make a positive contribution to wage data (Chart 1.37). Having said that, the magnitude of this contribution dropped, consistent with expectations: real wage growth decelerated. The Bank of Russia estimates real wages to grow by 7-8% for the entire 2018. At the same time, growth in real household disposable money income is estimated to post substantially weaker paces, owing to non-labour incomes and social transfers[5] (Chart 1.36).

Chart 1.36
Real wage, real disposable money income, retail trade turnover
(seasonally adjusted, per cent change on January 2014)



Sources: Rosstat, Bank of Russia calculations.

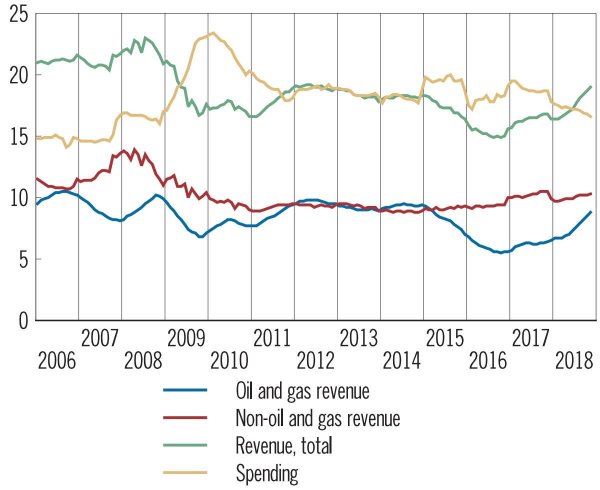
Chart 1.37
Real wage
(per cent change on corresponding month of previous year)



Sources: Rosstat, Bank of Russia calculations.

[5] *These include entrepreneurial income, property income and other types of income which are highly volatile in times of ruble depreciation.*

Chart 1.38
Year-on-year 12-month total budget revenue and spending
(% GDP)



Source: Bank of Russia.

State budget

According to the most recent Finance Ministry estimates[6], the outturn of the budget revenue part is progressing at fast rates. The relatively favourable domestic conditions along with sustained fairly high oil prices in this period helped secure the availability of 92.1% of the entire 2018 budget revenue. The execution of the spending part is overall on track to match Finance Ministry plans and Bank of Russia short-term estimates published in October. As of the end of November, public spending totalled roughly 83.7% of the planned 2018 volume. Public spending is expected to mount in December 2018, compared with previous months, to a degree consistent with traditional seasonality in budget processes. As of late November, revenue from OFZ placement totalled 82.1%[7] of total placements scheduled for 2018[8].

[6] *Information notice 'Preliminary estimate for federal budget execution, January-November 2018' in the section 'Press Center' of the Ministry of Finance website (www.minfin.ru).*

[7] *The actual receipts to total scheduled OFZ placements ratio stood at 89% in January-November 2018.*

[8] *In accordance with Federal Law No. 458FZ, dated 29 November 2018, 'On Amending the Federal Law 'On the Federal Budget for 2018 and the Plan Period of 2019 and 2020'.*

2. ECONOMIC OUTLOOK

Over a mid-term horizon, key uncertainties for the Russian economy come from external conditions. These are, in particular, the uncertainty over the further oil price movements, world economic growth pace, developments in monetary and foreign trade policies of major economies, and sanctions against the Russian economy. The Bank of Russia takes the above factors into account in its two main medium-term forecasts, which differ in external conditions: a baseline scenario and a high oil price scenario. The assumptions and key parameters of these scenarios have virtually remained unchanged compared with the medium-term forecast released in October. The only adjustment was made to the 2019 oil price trajectory in the baseline scenario. It was revised slightly downwards to factor in the observed changes in the balance of supply and demand in the global oil market. However, this revision has left the inflation and economic activity forecasts virtually unaffected, given the smoothing effect of the fiscal rule.

Both the baseline and high oil price scenarios assume that inflation will temporarily accelerate to 5-5.5% by the end of 2019 due to one-off factors, such as a VAT rate hike and a phased pass-through of the 2018 weakening in the ruble to prices. The taken monetary policy decisions, which will help prevent sustainable inflation anchoring at the level significantly exceeding the Bank of Russia's target, will slow down quarterly annualised consumer price growth to 4% as early as 2019 H2. Annual inflation will return to 4% in 2020 H1 to hold close to this level till the end of the forecast horizon. This will lay the groundwork for looser monetary policy by late 2019 – early 2020. Economic growth rates in both scenarios will remain close to potential levels and accelerate smoothly in 2019-2021, as the government-planned fiscal measures are gradually implemented and the retirement age is raised.

In addition, Bank of Russia scenarios include a risk scenario assuming a marked deterioration of external conditions. It will exert an unfavourable effect on both price movements and economic activity: in 2019, inflation may deviate considerably from 4% and GDP growth may hit negative territory. However, this effect will be short-lived, given the increased resilience of the Russian economy to external developments, the smoothing effect of the fiscal rule, and a timely tightening of monetary policy. As early as 2020-2021, key macroeconomic parameters of the risk scenario forecast, as well as the Bank of Russia key rate path will draw close to baseline scenario projections. The Bank of Russia leaves mostly unchanged its estimates of internal inflation risks associated with wage movements, possible changes in consumer behaviour and budget expenditures. These risks remain moderate. At the same time, further dynamics of inflation expectations remain highly uncertain, including the scale and duration of their response to the present and future proinflationary factors.

Overall, the balance of risks remains skewed towards proinflationary risks, especially over a short-term horizon.

The decision to raise the key rate to 7.75% was taken on 14 December 2018 with a view to limiting inflation risks. The Bank of Russia will explore the need for further upgrades to the key rate, taking into account inflation and economic developments against the forecast, as well as the risks of external conditions and the response of financial markets.

2.1. Baseline scenario

Forecast assumptions

The assumptions of the Bank of Russia's baseline scenario remained virtually unchanged compared with the baseline scenario released in October. Its main difference is the updated oil price trajectory over the 2019 horizon (Chart 2.1). It primarily results from the current state of the global oil market (see Section 1.2) and a more sizeable expansion of oil production (mostly in the US) than previously expected over the forecast horizon. Higher-than-expected supply is also associated with the easing of restrictions on Iranian oil imports. These factors will limit oil price support provided by the extended OPEC+ agreement (see Section 1.2). As a result, the Bank of Russia assumes in its baseline scenario that Urals prices will gradually slide to $55 per barrel; however, this drop will prove somewhat faster than expected. In the forecast assumptions, the average oil price has been revised downward from $63 to $55 per barrel for 2019 and retained close to this level for 2020-2021.

Other internal and external assumptions of the baseline scenario remained unchanged compared with the baseline scenario released in October. Along with the oil price path, the Bank of Russia includes in key external assumptions a slight slowdown of economic growth and persistently low inflationary pressure in Russia's main trading partners, gradual monetary policy normalisation in advanced economies, and the retention of international sanctions against Russia imposed in 2014-2018.

In October-November, international organisations downgraded their world economic growth forecasts for the coming years, given the current developments in major economies (see Section 1.2). However, this move failed to cause the Bank of Russia to update its baseline scenario assumptions, because they were initially somewhat more conservative, factoring in, among other things, the persistent risks of tighter trade restrictions. The Bank of Russia assumes that in 2019-2020 the US will raise its policy rate; however, the pace of its upward revision will depend on the balance of proinflationary risks in the economy and in the labour market, as well as disinflation risks which may arise as a result of the slowdown in the global economy and growing volatility in financial markets.

The Bank of Russia assumes in its baseline scenario that the ECB is expected to raise its policy rate no earlier than late 2019 (see Section 1.2), according to its representatives.

The Bank of Russia includes in its key internal assumptions the effect of other economic policy measures on monetary conditions: the rise of the standard VAT rate from 18% to 20% from 1 January 2019; the planned revision of excise taxes on individual goods included in the consumer basket; the oil and gas tax manoeuvre; the phased retirement age increase; the planned implementation of fiscal policy measures aimed at easing the current structural constraints in the Russian economy and the fiscal rule.

Forecast

The 2019-2021 forecast of key macroeconomic indicators under the Bank of Russia baseline scenario remained overall unchanged compared with the baseline scenario released in October. The Bank of Russia's forecast suggests that annual inflation will temporarily speed up to 5.0-5.5% in 2019 from 3.9-4.2% registered in 2018 (Chart 2.2). The increase of the standard VAT rate will have the most tangible effect on consumer price dynamics in 2019 contributing approximately 1 pp to annual inflation, the Bank of Russia estimates. The weakening in the ruble seen in 2018 will also affect inflation, primarily in 2019 H1. The VAT and exchange rate effects will be passed on to annual inflation throughout 2019. That said, quarterly annualised consumer price growth (seasonally adjusted) will slow to 4% as early as 2019 H2. The inertial inflation parameters, including average year-on-year inflation, will post higher readings throughout 2019 compared to 2018.

A relatively faster drop in oil prices, than assumed in the October baseline scenario, resulted in the revision of the contribution of the tax manoeuvre to annual inflation. In 2019, it will come in at -0.1 pp; afterwards, as oil prices stabilise, it will gradually increase to the near-zero level in 2020 and will be slightly positive in 2021 (see Annex 'Assessment of the effect of oil tax manoeuvre on consumer inflation').

Key parameters of the Bank of Russia's forecast scenarios
(growth as % of previous year)

	2017 (actual/estimate)	2018	2019		2020		2021	
		Estimate	Baseline	High oil price	Baseline	High oil price	Baseline	High oil price
Urals price, average for the year, US dollars per barrel	53.0	70	55	75	55	75	55	75
Inflation, as % in December year-on-year	2.5	3.9–4.2	5.0–5.5	5.0–5.5	4.0	4.0	4.0	4.0
Inflation, average for the year, as % year-on-year	3.5	2.8–2.9	5.0–5.5	5.0–5.5	4.0	4.0	4.0	4.0
Gross domestic product[1]	1.8	1.5–2.0	1.2–1.7	1.5–2.0	1.8–2.3	1.8–2.3	2.0–3.0	2.0–3.0
Final consumption expenditure	2.5	2.0–2.5	1.0–1.5	1.2–1.7	1.5–2.0	1.8–2.3	2.0–2.5	2.0–2.5
– households	*3.3*	*2.5–3.0*	*1.0–1.5*	*1.3–1.8*	*1.5–2.0*	*2.0–2.5*	*2.5–3.0*	*2.5–3.0*
Gross capital formation	9.3	-(1.5–0.5)	1.5–2.5	2.0–3.0	2.5–3.5	3.0–4.0	3.5–4.5	3.5–4.5
– gross fixed capital formation	*4.9*	*1.5–2.0*	*1.8–2.3*	*2.0–2.5*	*3.0–3.5*	*3.0–3.5*	*3.5–4.5*	*3.5–4.5*
Exports	6.0	5.5–6.0	3.2–3.7	3.2–3.7	2.7–3.2	2.7–3.2	2.7–3.2	2.7–3.2
Imports	17.4	4.0–4.5	2.5–3.0	3.5–4.0	3.5–4.0	3.5–4.0	4.5–5.0	4.5–5.0
Money supply in national definition	10.5	11–14	7–11	8–12	7–12	9–13	7–12	9–13
Lending to organisations and households in rubles and foreign currency[2]	8.2	12–14	7–11	8–12	7–12	7–12	7–12	7–12
– lending to non-financial and financial organisations in rubles and foreign currency, growth as % over year	*7.1*	*9–11*	*7–10*	*8–11*	*6–10*	*6–10*	*6–10*	*6–10*
– lending to households in rubles and foreign currency, growth as % over year	*12.0*	*21–24*	*12–17*	*13–18*	*10–15*	*11–16*	*10–15*	*10–15*

[1] 2017 data – Bank of Russia estimate with Rosstat-revised industrial production data factored in.
[2] Banking sector lending to the economy means all of the banking sector's claims on non-financial and financial institutions and households in the currency of the Russian Federation, a foreign currency and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investment in debt and equity securities and promissory notes, as well as other forms of equity interest in non-financial and financial institutions, and other accounts receivable from settlement operations involving non-financial and financial institutions and households.
Source: Bank of Russia.

Russia's balance of payments indicators[1]
(billions of US dollars)

	2017	2018	2019		2020		2021	
		Estimate	Baseline	High oil price	Baseline	High oil price	Baseline	High oil price
Current account	**33**	**112**	**71**	**127**	**55**	**122**	**48**	**114**
Balance of trade	115	191	154	210	143	210	139	205
Exports	*354*	*441*	*400*	*465*	*405*	*482*	*416*	*497*
Imports	*-238*	*-250*	*-246*	*-255*	*-262*	*-272*	*-277*	*-292*
Balance of services	-31	-31	-33	-29	-34	-31	-36	-34
Exports	*58*	*65*	*61*	*68*	*62*	*71*	*64*	*73*
Imports	*-89*	*-96*	*-94*	*-97*	*-97*	*-102*	*-100*	*-107*
Balance of primary and secondary income	-51	-49	-51	-54	-53	-56	-55	-57
Current and capital account balance	**33**	**111**	**71**	**127**	**55**	**122**	**48**	**114**
Financial account (excluding reserve assets)	**-14**	**-72**	**-19**	**-34**	**-11**	**-36**	**-8**	**-33**
Government and the central bank	13	-5	1	3	2	4	3	5
Private sector	-28	-67	-20	-37	-13	-40	-11	-38
Net errors and omissions	**4**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Change in reserve assets ('+' – decrease, '-' – increase)	**-23**	**-39**	**-52**	**-92**	**-44**	**-86**	**-40**	**-81**

[1] *Using BPM5 methodology. Due to rounding total results may differ from the sum of respective values.*
Source: Bank of Russia.

The joint contribution to annual inflation of the rise in excise taxes for individual goods included in the consumer basket may come in at roughly 0.3-0.4 pp in 2019 (see Annex 'Impact of changes in excise rates on inflation in 2019'). The Bank of Russia has already factored in this effect in the baseline forecast of 5.0-5.5% inflation for late 2019.

The persistent sensitivity of inflation expectations to one-off factors may amplify the pass-through of exchange rate movements and the VAT increase to consumer prices. In 2019, monetary policy will be aimed at limiting the scale and duration of these secondary effects of the VAT hike and the past ruble depreciation.

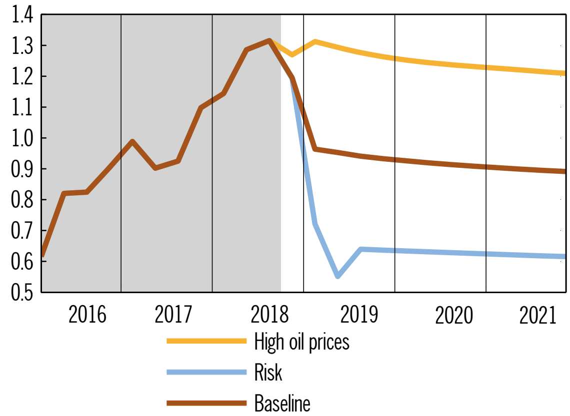
The Bank of Russia will approach its monetary policy in a conservative manner focusing on proinflationary factors and risks. This approach suggests that the Bank of Russia will pursue a tighter monetary policy than in the absence of the effect of the above one-off factors on inflation. Such a conservative approach to monetary policy will allow its easing in late 2019 – early 2020.

According to the Bank of Russia's forecast, given the monetary policy decisions, annual inflation will return to 4% in 2020 H1, when the effect of the past ruble depreciation and the VAT hike are exhausted, to hold near 4% in future (Chart 2.2). The Bank of Russia's monetary policy will help stabilise inflation close to 4%. The Bank of Russia's decision to raise the key rate in December 2018 will help prevent sustainable inflation anchoring at the level significantly exceeding the Bank of Russia's target.

The 2019-2021 forecast of Russia's economic growth and monetary indicators also remained unchanged compared with the baseline scenario released in October. Given the fiscal rule implementation, a faster decline in oil prices will produce a limited effect on the Russian economy. Domestic demand, in turn, will not exert any upward pressure on inflation over the whole forecast horizon.

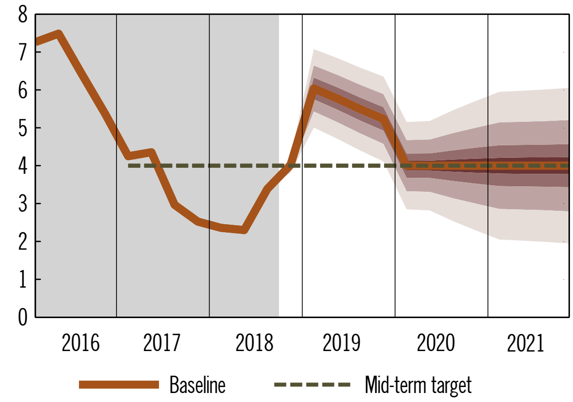
In 2019, the GDP growth rate will decrease somewhat to 1.2-1.7% vs 1.5-2.0% seen in 2018. Over the 2019 horizon, domestic demand will be held back by the VAT hike (primarily at the beginning of the year), slower growth of export revenues due to the drop in oil prices, and slower lending growth amid monetary policy tightening of 2018

Chart 2.1
Terms of trade
(per cent change on corresponding period of previous year)



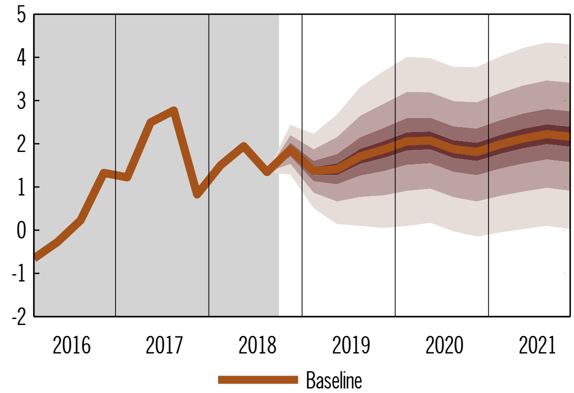
Note: terms of trade are approximated by Urals crude price index in real terms (oil prices adjusted for foreign price index).
Source: Bank of Russia calculations.

Chart 2.2
Inflation
(per cent change on corresponding period of previous year)



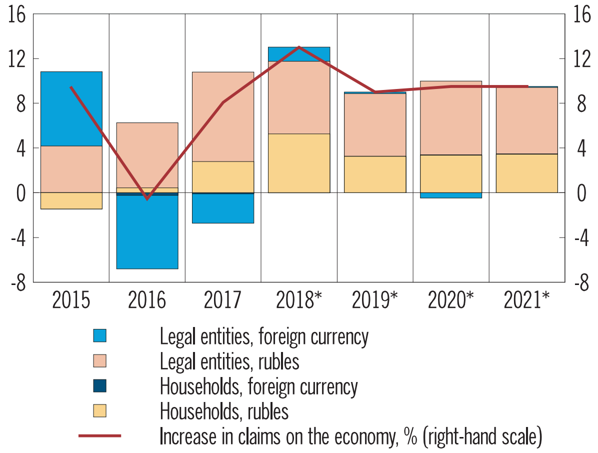
Note: shaded areas on the forecast horizon show the probability of different inflation values. Colour gradation reflects probability intervals.
Confidence intervals are symmetrical and are based on historical estimates of uncertainty of inflation.
Source: Bank of Russia calculations.

Chart 2.3
GDP growth rate
(per cent change on corresponding period of previous year)



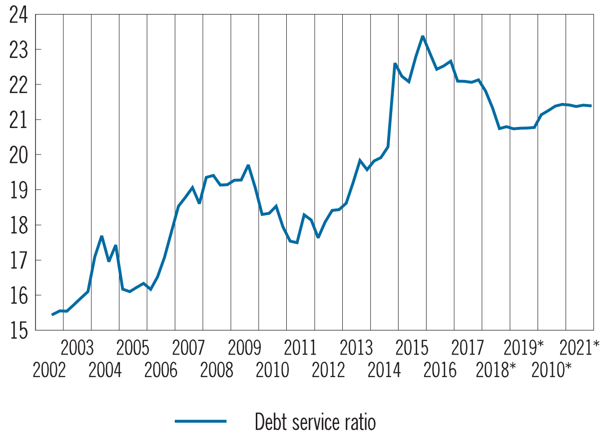
Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals.
Confidence intervals are symmetrical and are based on historical estimates of uncertainty of GDP growth rate.
Source: Bank of Russia calculations.

Chart 2.4
Decomposition in increase in claims on the economy
(contribution to annual growth, percentage points)



*Forecast. Decomposition is shown for the increase in claims on the economy corresponding to the middle of the forecast range in the baseline scenario.
Source: Bank of Russia calculations.

Chart 2.5
Total leverage in the economy
(debt service ratio, as % of GDP)



*Forecast. The debt burden is calculated for the lending corresponding to the middle of the forecast range in the baseline scenario.
Source: Bank of Russia calculations.

H2 on the back of deteriorating external economic environment. At the same time, the constraining effect of the VAT hike will be largely offset in 2019 by growing investment demand triggered by the implementation of the government's fiscal measures and the retirement age increase, which will alleviate the effect of demographic constraints on economic growth.

In 2020-2021, Russia's economic growth will accelerate to 1.8-2.3% and 2.0-3.0% respectively (Chart 2.3). It will be driven by a gradual accumulation of the positive effect of the planned fiscal policy measures and structural reforms, once they are successfully implemented. High growth rates of the Russian economy will not produce any additional demand-side inflationary pressure and hamper inflation anchoring at the target level, as they will be backed by the economy's expanding production capacity.

Lending activity in 2019-2021 will continue to pick up at a pace that is consistent with the increase in effective demand and does not create price and financial stability risks (Charts 2.4 and 2.5). Non-price lending conditions will soften gradually, reflecting the conservative approach of banks to assessing borrowers and taking risks. Lending will continue to be the main driver of changes in the money supply.

Key trends in the 2019-2021 balance of payments forecast associated with domestic and external demand and global oil price movements are overall in line with the trends outlined in the baseline scenario released in October. The Bank of Russia's forecast suggests that, as oil prices gradually decline, the current account balance will remain positive over the forecast horizon (roughly 5% of GDP in 2019 and roughly 3% of GDP in 2020-2021). However, as of the end of 2019, it will be lower than previously assumed due to a faster drop in oil prices to $55 per barrel (Chart 2.6). At the same time, the gradual rollback of the oil production arrangements of energy exporters and the government's measures aimed at encouraging non-commodity exports will underpin growth in export quantities thereby smoothing the effect of oil price drop.

The private sector financial account balance will decrease in 2019-2021 (roughly 1% of GDP in 2019 and slightly below 1% of GDP in 2020–2021) amid declining external debt repayments and somewhat weaker global investment capabilities of Russian companies in the context of lower prices for core Russian exports (Chart 2.7). In 2019-2021, the Bank of Russia will continue to replenish the international reserves under the fiscal rule. The Bank of Russia intends to resume regular foreign currency purchases from 15 January 2019, after their suspension in September. The Bank of Russia will take the decision regarding the foreign currency purchases in the domestic market which were postponed in 2018 after regular purchases are resumed. Exclusively for the purposes of model-based calculations in support of the baseline scenario, the Bank of Russia assumes that foreign currency purchases suspended in 2018 will be implemented evenly over the whole forecast horizon of 2019-2021.

2.2. High oil price scenario

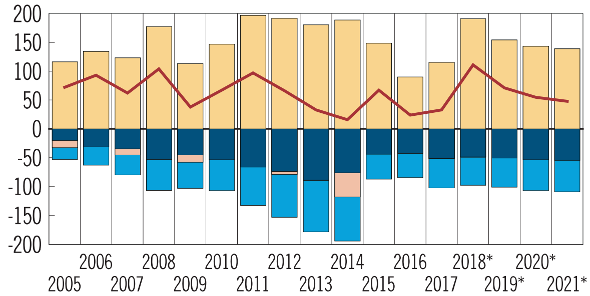
Forecast assumptions

The assumptions of the high oil price scenario coincide with the assumptions made in the unchanged oil price scenario released in October. Its title was revised to reflect the current state of the global oil market (see Section 1.2). This scenario only differs from the baseline scenario in the trajectory of oil prices, which are higher over the whole forecast horizon – about $75 per barrel. These dynamics are mostly determined by energy supply-side factors: the high oil price scenario assumes that production caps under the OPEC+ deal are more considerable beyond 2018 compared with the baseline scenario. Other external and internal assumptions overall coincide with the baseline scenario. The fiscal rule will continue to smooth out the effect of oil price movements on the Russian economy over the forecast horizon.

Forecast

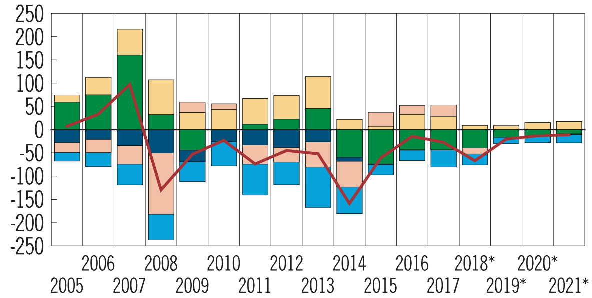
The forecast of key macroeconomic parameters under the high oil price scenario remained overall unchanged compared with the unchanged oil price scenario released in October. It mainly differs from the baseline scenario in the dynamics of economic

Chart 2.6
Major current account components
in the baseline scenario*
(billions of US dollars)



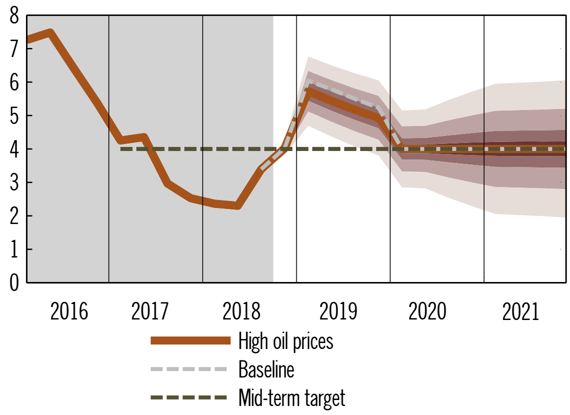
*Forecast. Signs according to BPM5.
Source: Bank of Russia.

Chart 2.7
Major private sector financial account components
in the baseline scenario*
(billions of US dollars)



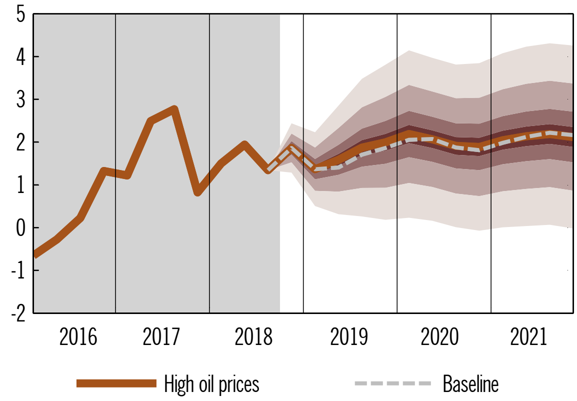
*Forecast. Signs according to BPM5.
Source: Bank of Russia.

Chart 2.8
Inflation
(per cent change on corresponding period of previous year)



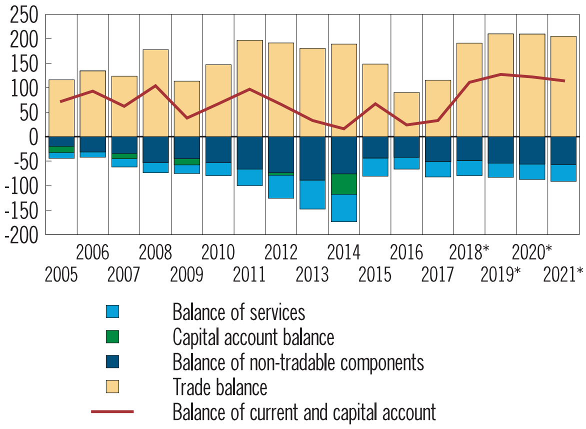
Note: shaded areas on the forecast horizon show the probability of different inflation values. Colour gradation reflects probability intervals.
Confidence intervals are symmetrical and are based on historical estimates of uncertainty of inflation.
Source: Bank of Russia calculations.

Chart 2.9
GDP growth rate
(per cent change on corresponding period of previous year)



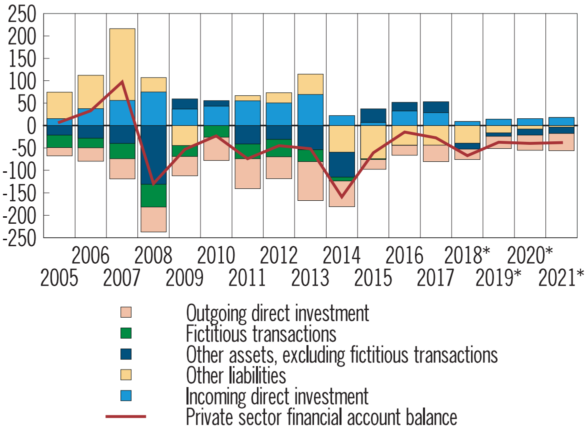
Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals.
Confidence intervals are symmetrical and are based on historical estimates of uncertainty of GDP growth rate.
Source: Bank of Russia calculations.

Chart 2.10
Major current account components
in the high oil price scenario*
(billions of US dollars)



** Forecast. Signs according to BPM5.*
Source: Bank of Russia.

Chart 2.11
Major private sector financial account components
in the high oil price scenario*
(billions of US dollars)



** Forecast. Signs according to BPM5.*
Source: Bank of Russia.

activity in 2019. Amid more favourable external conditions, which will provide additional support to business sentiment, and consumer and investment activity, the 2019 GDP growth will be slightly higher at 1.5-2.0%. A somewhat faster expansion of domestic demand, than in the baseline scenario, will have a slight upward pressure on inflation in 2019. Furthermore, higher oil prices in 2019 (compared to those assumed in the baseline scenario) will result in a positive contribution of the oil and gas tax manoeuvre to annual inflation (0.3 pp). However, the effect of these factors on inflation is offset by the downward pressure through the exchange rate pass-through, because the ruble will prove somewhat stronger than in the baseline scenario, according to Bank of Russia estimates. In 2019, inflation will stand at approximately the baseline scenario level of 5.0-5.5% due to the VAT rate hike and the 2018 ruble depreciation. High sensitivity of inflation expectations to one-off proinflationary factors will bring monetary policy described in this scenario closer to the one implied in the baseline scenario. It will be aimed at containing inflation risks and stabilising inflation near 4%.

In 2020-2021, key parameters dynamics will almost entirely coincide with baseline scenario projections: inflation is supposed to return to the near-4% level and economic growth is expected to hold close to potential levels (Charts 2.8 and 2.9).

The difference in the parameters of the balance of payments from the baseline scenario will be associated with the noticeable positive effect of higher global oil prices on export volumes. This will take the current account balance (Chart 2.10) over the entire forecast horizon above the baseline scenario to 8% of GDP in 2019 and roughly 6-7% of GPP in 2020-2021. The private sector negative financial account balance (Chart 2.11) will also be higher than in the baseline scenario and will amount to 2% of GDP in 2019–2021. This will be facilitated by a slightly greater expansion of foreign assets held by Russian companies and banks amid a more significant increase in export revenues. The high oil price scenario assumes that international reserves will show a more sizeable increase compared with the baseline scenario due to significant fiscal rule-based foreign currency purchases amid higher oil prices.

2.3. Risk assessment

The balance of risks remains skewed towards proinflationary risks, especially over a short-term horizon. High uncertainty over future external conditions and their impact on financial asset prices still remains. Uncertainty over external factors primarily comes from the overall global economic outlook and the developments in emerging markets; they are in part affected by further changes in international trade restrictions and geopolitical factors. In addition, the state of the global energy market exacerbated the risks of oil glut in 2019 (see Section 1.1).

Along with the main scenarios, the Bank of Russia also considers a risk scenario.

Risk scenario assumptions have remained unchanged compared with the scenario released in October. They assume that external conditions may deteriorate considerably due to the simultaneous aggravation of several above-mentioned external factors, which may bring about sizeable growth in risk premium for Russian assets and an increased capital outflow from Russia. The risk scenario also assumes that world oil prices will drop steadily to $35 per barrel as a result of a weaker global demand for energy than estimated in the baseline scenario as the global economy slows down. The fiscal rule will smooth the impact of deteriorating terms of trade on public finance, the economy, and the exchange rate.

The risk scenario has remained overall unchanged compared with the risk scenario released in October. The worsening of external conditions will cause an accelerated capital outflow in 2019, and exert a downward pressure on the current account. This may result in a short-term contraction of domestic demand, ruble weakening, and a rise in exchange rate and inflation expectations. Inflation risks will necessitate a tighter monetary policy to limit the growth of inflation expectations and stabilise financial markets. Should the risk scenario materialise in 2019, inflation will likely accelerate more significantly than the baseline scenario assumes, and GDP growth will dip into negative territory. Moving forward, as the economy adjusts to the new external conditions, total output growth will return to positive territory to approach baseline scenario levels in 2020-2021. Inflation will come close to the Bank of Russia's target by late 2020 to hold near 4% in future.

Should the risk scenario materialise, the Bank of Russia will closely monitor the level of financial stability risks which may be associated with increased financial market volatility and will be ready to use all the available instruments to keep them in check.

The Bank of Russia leaves mostly unchanged its estimates of internal inflation risks associated with wage movements, possible changes in consumer behaviour and budget expenditures. These risks remain moderate.

At the same time, further dynamics of inflation expectations remain highly uncertain, including the scale and duration of their response to the VAT hike in early 2019, and the 2018 ruble depreciation. The inertia of inflation expectations and their sensitivity to one-off proinflationary events may give rise to the secondary effects of such events and enhance the influence of other proinflationary risks should they materialise.

The decision to raise the key rate to 7.75% was taken on 14 December 2018 with a view to limiting inflation risks; it will allow preventing sustainable anchoring of inflation at the level considerably above the Bank of Russia's target. The Bank of Russia will explore the need for further upgrades to the key rate, taking into account inflation and economic developments against the forecast, as well as the risks of external conditions and the response of financial markets.

ANNEXES

The economic situation in Russian regions

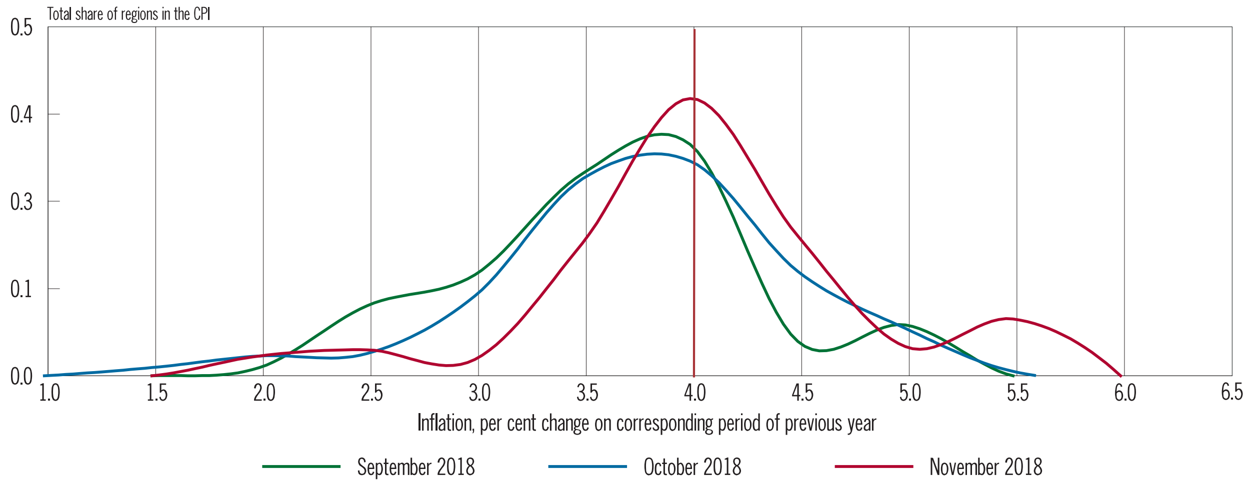
Inflation and price expectations

Inflation varied considerably across regions in September-November 2018 (Chart 1). Persistent factors behind the uneven price increase in Russia included different exchange rate pass-through effects (due to the discrepancies in the structure of the consumer basket and the geography of imported goods suppliers), structural specifics of performance in different sectors of the economy, and varying supply of farm produce (taking into account regions' geography and specialisation). Furthermore, short-term regional inflation deviations from the countrywide trends are triggered by non-monetary factors, such as imperfect competition and market entry barriers, suboptimal tariff regulation, immature logistics infrastructure, and resource limitations in certain segments.

November readings of annual inflation registered in Russian regions varied between 1.6% and 5.4%, whereas the Russian average figure stood at 3.8%. The highest growth rates were registered in most Central and Far Eastern regions, where household incomes are the highest; the Republic of Crimea, where prices rose to the levels seen in other Russian regions; and some south Siberian regions (Chart 2). Regions with the lowest annual price growth are situated in the Urals and west Siberia, where the share of imports in consumption is low; North Caucasus republics and some southern regions with a highly developed agro-industrial complex.

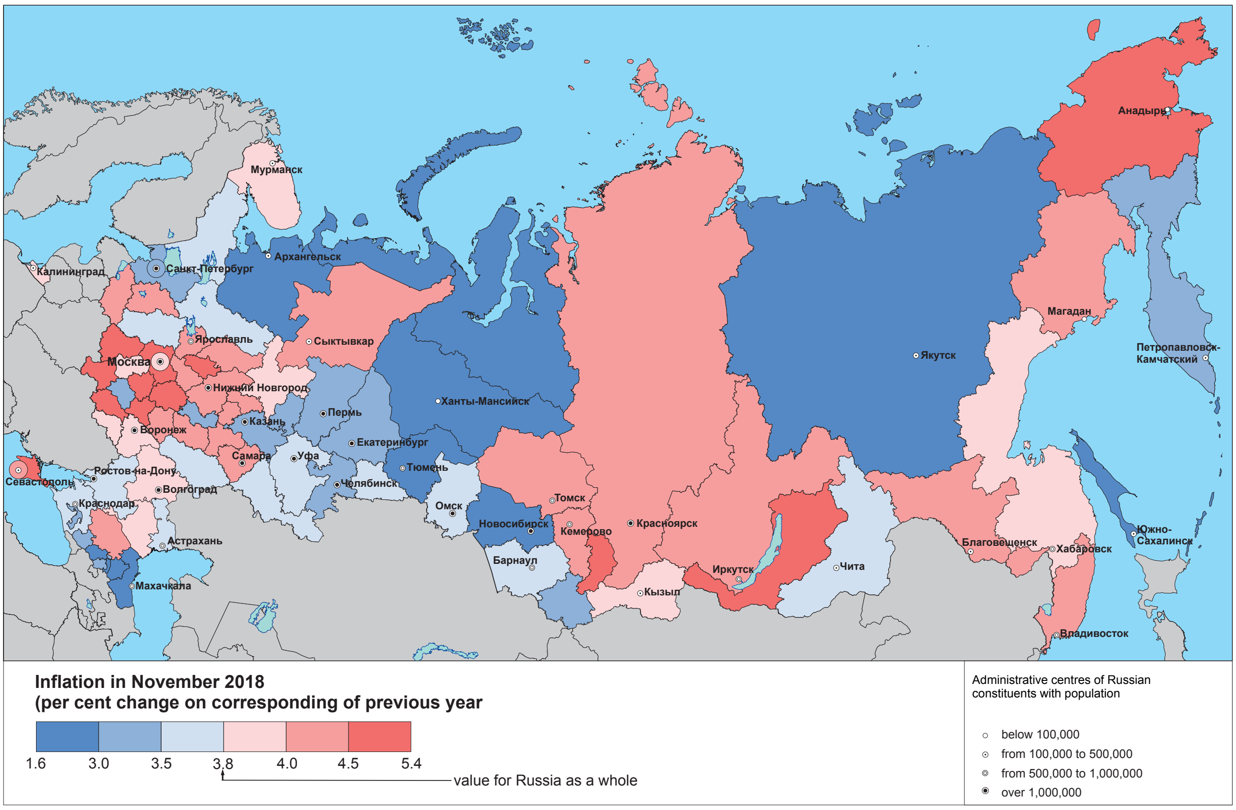
In November, the most considerable regional variations were observed in food inflation dynamics. That said, regional heterogeneity in food inflation declined somewhat compared with the October readings as temporary factors in the North Caucasus were exhausted (in October, annualised prices in the Caucasus regions showed slower growth due to a delayed harvesting of field vegetables). At the same time, the distribution of regions by service and non-food inflation became more even by the October-November period (Chart 3).

Chart 1
Distribution of regions by contribution to annual inflation



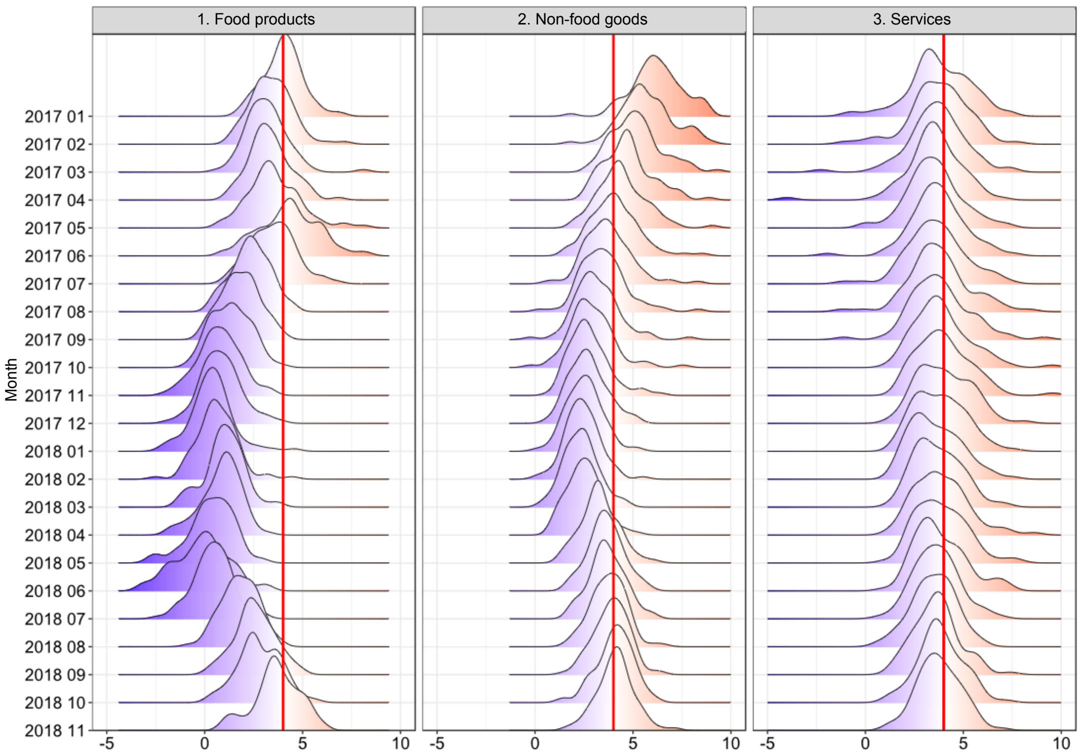
Sources: Rosstat, Bank of Russia calculations.

Chart 2
Inflation in regions in November 2018



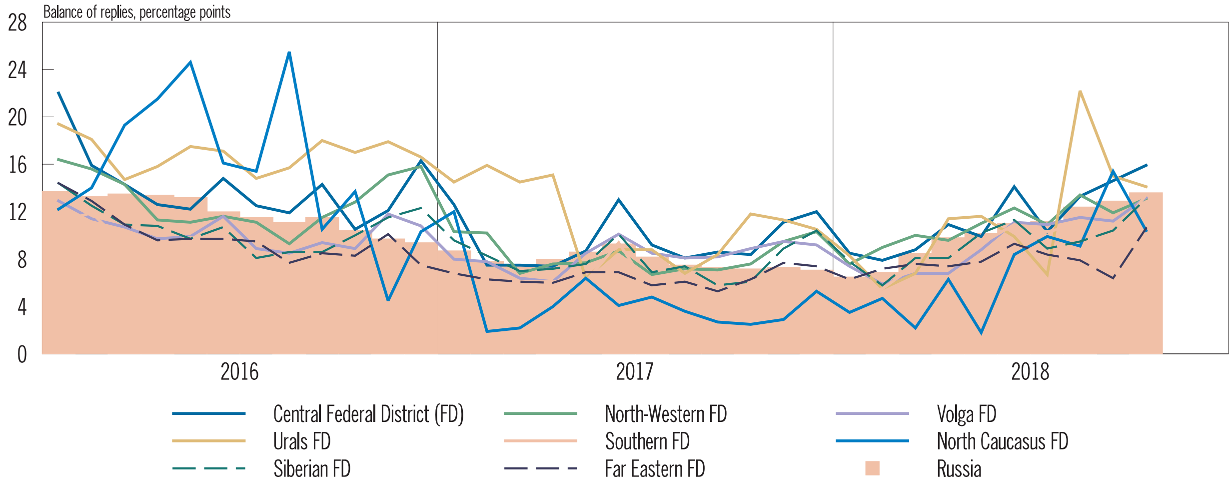
Sources: Rosstat, Bank of Russia.

Chart 3
Distribution of regions by contribution to the annual inflation of goods (food and non-food) and services in 2017-2018



Note: the horizontal axis shows inflation level (annualised, %), the vertical axis shows total weights of regions.
Sources: Rosstat, Bank of Russia calculations.

Chart 4
Business price expectations



Sources: Bank of Russia.

The drag of temporary regional fluctuations in food supplies on prices will gradually decline. Services price dynamics (including prices of medical services, education, and passenger transportation) are also expected to become more even across regions.

At the same time, the effects of a number of factors increasing regional heterogeneity will come to the fore in the months to come. They include the varying pass-through of the past ruble depreciation to prices and the increase in motor fuel prices (the effect of this factor will diminish after the stabilisation of petrol price growth), as well as the expected VAT rate increase. These effects will be most marked in non-food prices. The effect of these factors on inflation will be more pronounced in high-income regions with a lower share of goods taxed at a concessional VAT rate (socially sensitive goods and services) and a higher share of imports in the consumption structure (major regions of the country's European part), as well as in remote regions with a high level of transportation costs (northern and Far Eastern regions).

The above-mentioned nationwide inflation factors have already echoed in changes to short-term price expectations of businesses in most regions, which continued to grow in September-October 2018 (Chart 4). Broken down by sector, elevated expectations were registered in October across all economic activities; and broken down by region – in all federal districts, excluding the Urals and the North-Western FDs, where expectations decreased somewhat compared with the high readings seen in August.

As inflation nears 4% nationwide throughout the year and exceeds this figure in 2019 H1 (the current monthly price growth rates will return to 4% as early as mid-2019) the number of regions where inflation exceeds 5% will grow. At the same time, though rising, inflation may hold below 4% in some regions; primarily in the North Caucasus and the Urals (due to the effect of the above-mentioned sustainable structural factors).

Consumer demand

Demand showed moderate dynamics which failed to exert a considerable proinflationary effect in all federal districts. In the September-October period, slowing annualised growth in demand registered throughout Russia was largely determined by a local slump in North Caucasus regions, whereas most large macroregions registered stabilisation or recovery in retail trade and paid services. Broken down by region, the North Caucasus and the Southern Federal Districts showed the most moderate movements in demand for goods and services. This was determined by negative year-on-year dynamics of household incomes as the economic situation in agricultural regions deteriorated in the third quarter on the back of this year's harvesting campaign (see Subsection 'Economic activity').

Lending

Bank lending conditions in most regions developed co-directionally (Charts 9 and 10). According to the Bank of Russia-conducted survey of bank lending conditions, the third quarter saw further easing of both price and non-price conditions of household lending (mostly mortgage lending). At the same time, the quarter-end registered a stabilisation or a U-turn in the dynamics of interest rates on consumer loans in most federal districts. The segment of lending to large businesses also posted tightening of price lending conditions across regions in the third quarter, which came after a long period of easing. At the same time, regional non-price corporate lending conditions eased. Banks in all Russian regions described overall conditions of corporate lending as neutral. However, the balance of estimates skewed towards tight lending conditions in the central and southern Russia.

In 2018 Q3, household lending growth remained relatively high in all federal districts. Its stabilisation will be further driven by the fading recovery growth and market saturation in terms of borrowers' debt burden. In four middle-income federal districts (North Western FD, Volga FD, Urals FD, and Siberian FD) household credit burden calculated as a ratio of a borrower's monthly loan repayments to their income has already come close to the upper bound of the neutral level of 30-35%.[1] In the Far East and the North Caucasus, the catch-up credit growth may be associated with the low base effect and a lower debt burden. That said, however, household lending in these regions will be contained by persistently high credit risks. In September, the share of loan loss provisions[2] in total household loan liabilities came in at 25% in the North Caucasus FD and 28% in the Far Eastern FD, with the Russian average figure being at 9%.

Corporate lending has shown mixed dynamics across regions throughout this year. Most regions of the central and southern Russia and the Urals have demonstrated sustainable growth of corporate loan portfolio in the past two years. In the third quarter, lending in these regions was mainly boosted by large-scale investment projects and government support programmes. In the Far East and the North West, positive dynamics have been in place since late 2017 – early 2018. In Siberia, corporate lending has been in decline since spring 2017. In the North Caucasus and the Volga FD, corporate lending shows unstable dynamics and has been largely negative in recent months due to temporary factors (loan repayment by a number of large borrowers).

Economic activity

Economic activity indicators[3] and inflation have become more uneven across regions (Charts 5 and 6). Regional differences are determined by regions' economic profile, sectoral dynamics, as well as local and temporary factors. In most federal regions, negative contribution to annual economic activity dynamics came in September from agriculture and construction. Negative growth in agriculture is associated with this year's lower harvest compared with last year's record crops. The decline in construction works has continued in most regions since 2014; it is caused by such objective factors as households' and businesses' persistently cautious approach to real estate investment, and inertia in construction. However, the sector has been recovering nationwide since September 2018. The recovery is mostly driven by the positive construction dynamics in the Tyumen Region (including autonomous areas) and certain North Caucasus republics, as well as growth in individual house construction in most regions.

The Central, North Western, Urals, Siberian and Far Eastern Federal Districts registered growth in economic activity in September; it was mainly driven by industrial production, retail trade and services.

[1] In the banking practice, normal household debt burden calculated as a ratio of a borrower's monthly loan repayments to their income stands within the 30-35% range (data by the United Credit Bureau and the National Bureau of Credit Histories).

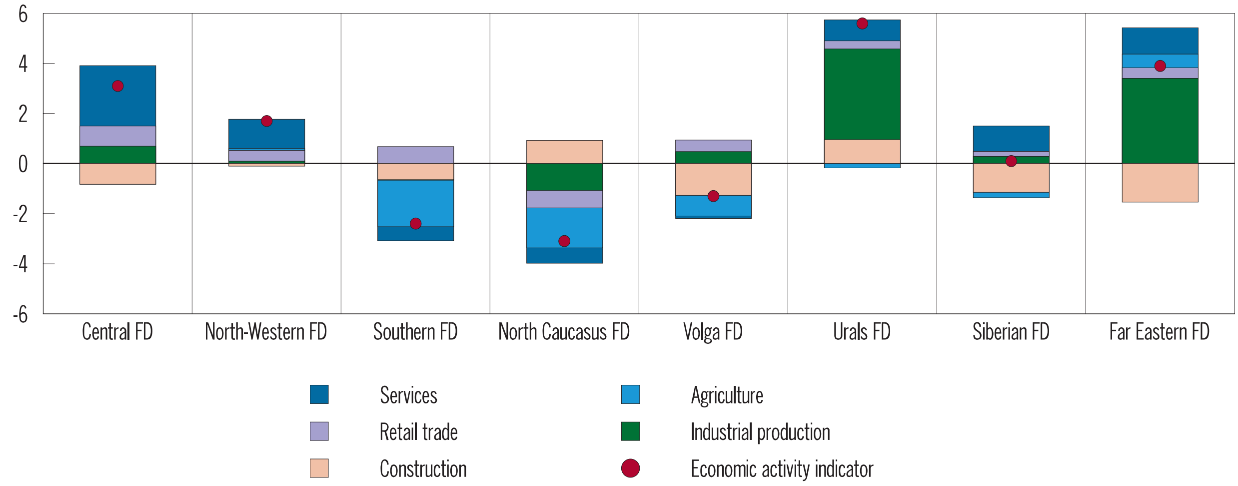
[2] Loan loss provisions (LLP) depend on the quality of a bank's loan portfolio. The lower the quality, the higher is the LLP share in total loan liabilities.

[3] Economic activity estimates are based on economic activity indicators calculated by the Bank of Russia for federal districts. Economic activity indicators are calculated as a weighted average rate of key economic sectors: mining; manufacturing; electricity, gas and water supply; agriculture; construction; paid services provided to households; and trade. Adjusted weights of respective economic activities in the structure of the gross regional product (GRP) are used as weights for the calculation of the weighted average figure.

In the Urals FD, a positive contribution was also made by construction. The most sizeable growth in industrial production was registered in the Far East and the Urals FD (9% and 7% YoY respectively). It was mainly driven by expanding oil and gas production in the Sakhalin Region, Yakutia and Yamal-Nenets Autonomous Area, and production of petrochemicals in the Tyumen Region. Overall industrial production performance varied across regions in the September-October period. However, in October it shifted considerably towards positive territory encouraged by accelerated growth in a number of large regions (the Rostov and Sverdlovsk Regions, Krasnoyarsk Territory, Yakutia, Moscow, etc.), including with the calendar and base effects factored in (Chart 7).

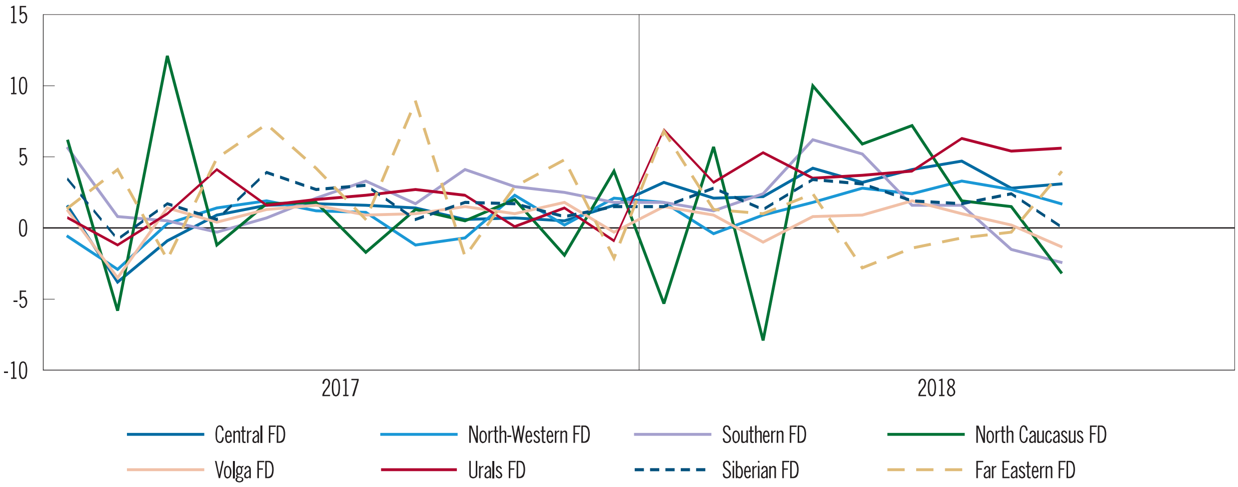
Economic activity declined in September in the North Caucasus and Volga macroregions, while the Southern Federal District saw a continued downward trend. In all the three districts the decline resulted from negative performance in agriculture and services; the Southern FD and the North Caucasus FD also saw a shrinkage in industrial production, while construction contracted in the Southern FD and the Volga FD.

Chart 5
Economic activity indicator* in September 2018
(year on year, %)



** Economic activity indicators are calculated as the weighted average rates of key economic activities: mining, manufacturing, electricity, gas and water supply, agriculture, construction, paid services provided to households and trade. When calculating the average value, weights are determined according to the adjusted weights of corresponding activity types in the GRP structure.*
Sources: Rosstat, Bank of Russia calculations.

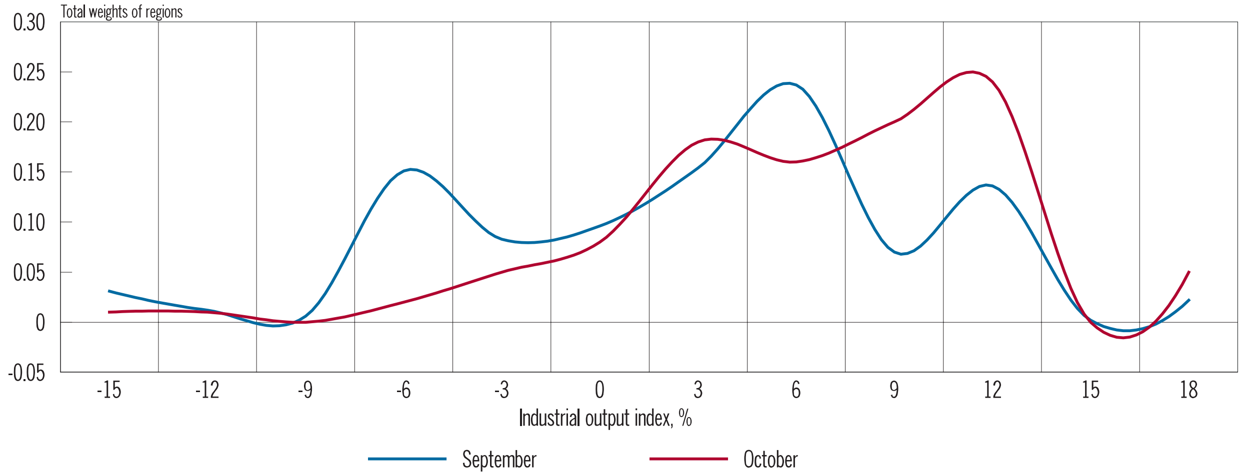
Chart 6
Economic activity indicator in January 2017 – September 2018
(year on year, %)



Sources: Bank of Russia.

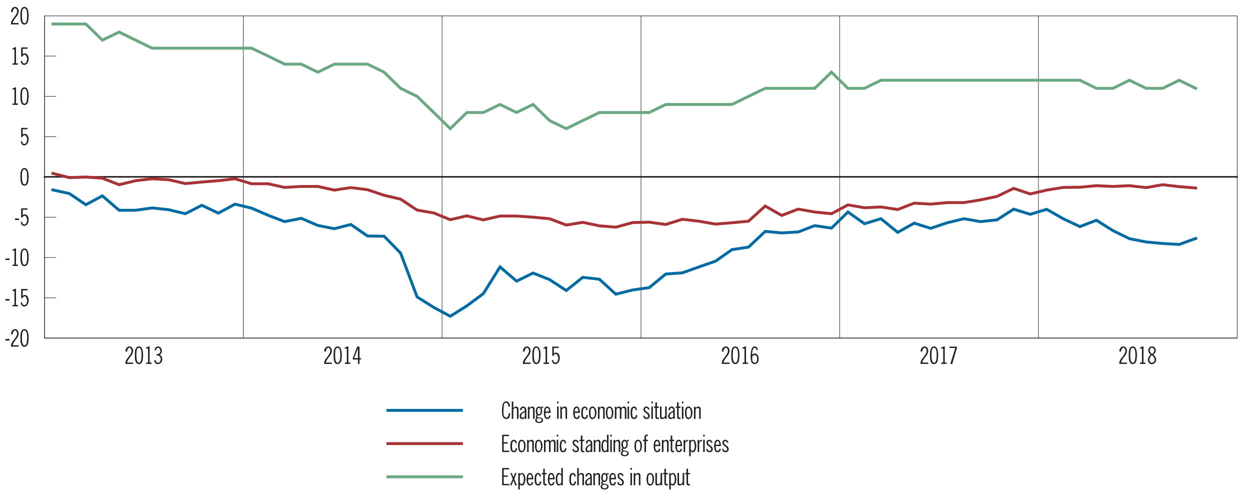
Company surveys supplement statistics on regional economic performance. According to the Bank of Russia's business monitoring data, the economic situation remained negative in October though showing the first signs of improvement after having deteriorated since May (Chart 8). Negative business sentiment stems from slack demand, rising costs, tightening lending conditions, and elevated business risks. At the same time, expectations regarding changes in production volumes held at the past two-year's average level.

Chart 7
Distribution of regions by contribution to industrial output (year on year)



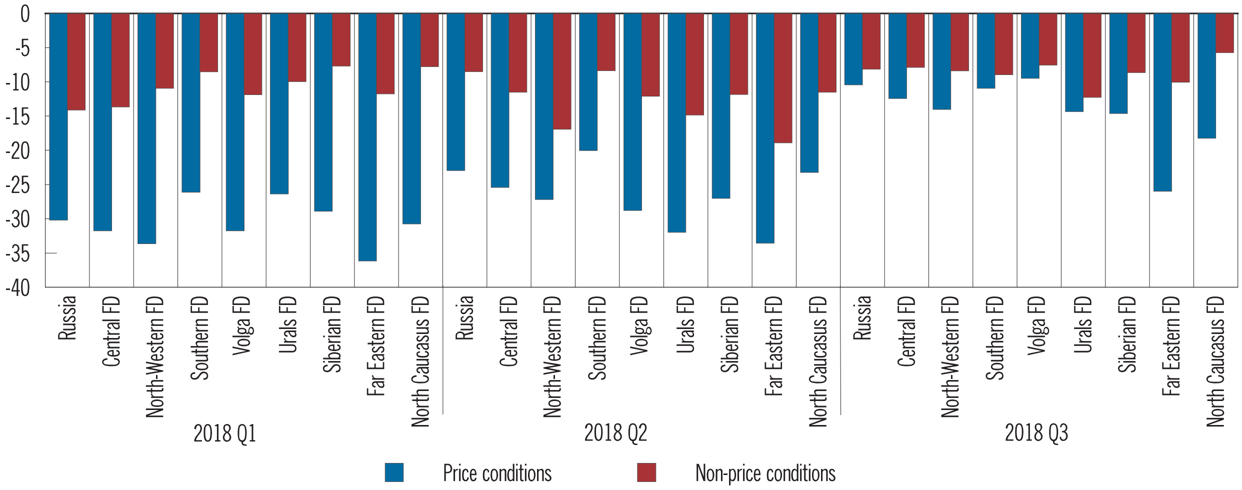
Sources: Rosstat, Bank of Russia calculations.

Chart 8
Assessment by enterprises of changes in economic situation and economic standing, and expected changes in output, according to the monitoring of enterprises by the Bank of Russia
(balance of replies, %)



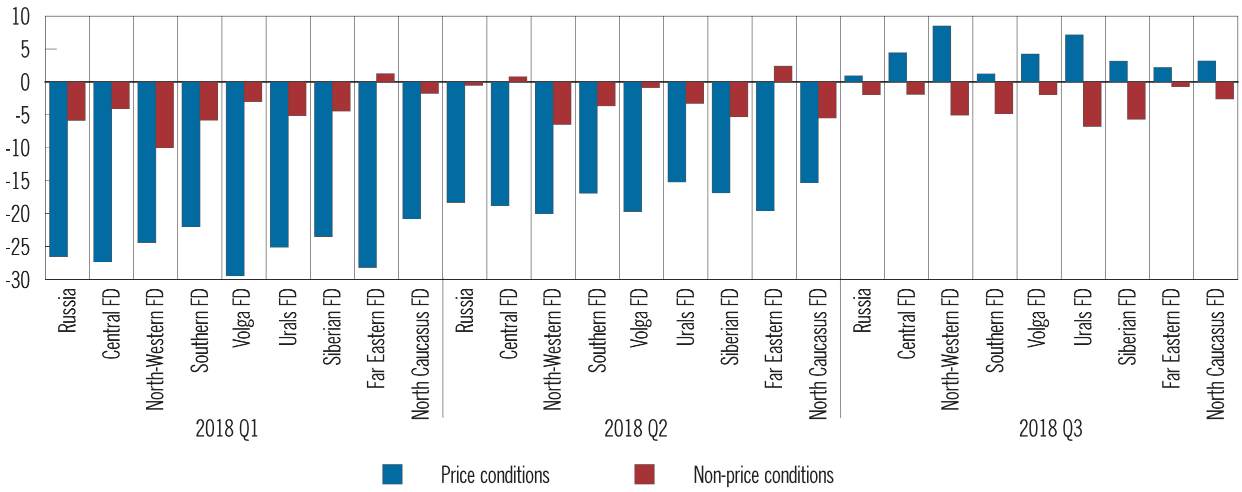
Source: Bank of Russia.

Chart 9
Change in the conditions of bank lending to individuals across federal districts in 2018 (diffusion index*)
(negative zone implies easing, positive zone – tightening)
(percentage points)



** The diffusion index represents the balance of replies by credit institutions when they view changes in conditions as tightening or easing.*
Source: Bank of Russia.

Chart 10
Change in the conditions of corporate bank lending across federal districts in 2018 (diffusion index*)
(negative zone implies easing, positive zone – tightening)
(percentage points)



Source: Bank of Russia.

Assessment of the effect of oil tax manoeuvre on consumer inflation

The tax manoeuvre in the oil and gas industry assumes that the export duty on oil and oil products will be gradually abolished in favour of the mineral tax. This may affect inflation in 2019-2024; however, the scale of this effect will largely depend on global oil price movements. The effect will be made both directly – through the direct contribution of changes in petrol and diesel prices to inflation, and indirectly – through the pass-through of changes in domestic oil and oil product prices to the production costs of goods and services.

1. Tax manoeuvre parameters and its effect on inflation

The tax manoeuvre provides for the following alterations in the taxation of oil and gas industry. Export duties on oil and oil products are expected to be reduced to zero by 2024[1]. At the same time, the mineral extraction tax (hereinafter, the MET) will be gradually raised to offset budget losses from export tax revenues. In addition, an excise tax on crude oil supplied for processing and a deduction from the said excise tax are planned to be gradually introduced between 1 January 2019 and 2024.[2]

The increase in the MET coupled with the reduction of export duties for oil may trigger the growth of its domestic price. The first measure is the rise of production cost. The second one is the contraction of the gap between the export and domestic price of oil. The increase in domestic oil prices will push up the production cost of oil products, thereby exerting an upward pressure on their prices. Furthermore, the tax manoeuvre assumes that export duties on oil products will be reduced; this will also trigger growth in their prices similar to that in the oil market.

In order to mitigate the fallouts from the reduction of export duties and growth of the MET on the domestic prices of oil products, the government is planning to introduce a reverse excise tax. It is supposed to partially compensate producers for the cost of oil supplied for refining. This should in part cover expenses on the supply of oil products to the domestic market and reduce pressure on their prices.

2. Consumer inflation pass-through channels

The Bank of Russia made its baseline estimates with the assumption that the tax manoeuvre mainly influenced inflation through the reduction of oil export duty (Chart 1). The calculations are based on the assumption that domestic oil prices are largely determined by the state of the global market (netback pricing) and transferred completely to production costs and prices of oil products. The calculations also factor in the offsetting effect of reverse excise taxes on motor fuel production costs but factor out the effect of taxation only indirectly associated with the tax manoeuvre (e.g., changes in the excise tax rates for petrol and diesel fuel). The influence of the tax manoeuvre on inflation through other channels shown on the chart below is considered to be less significant.

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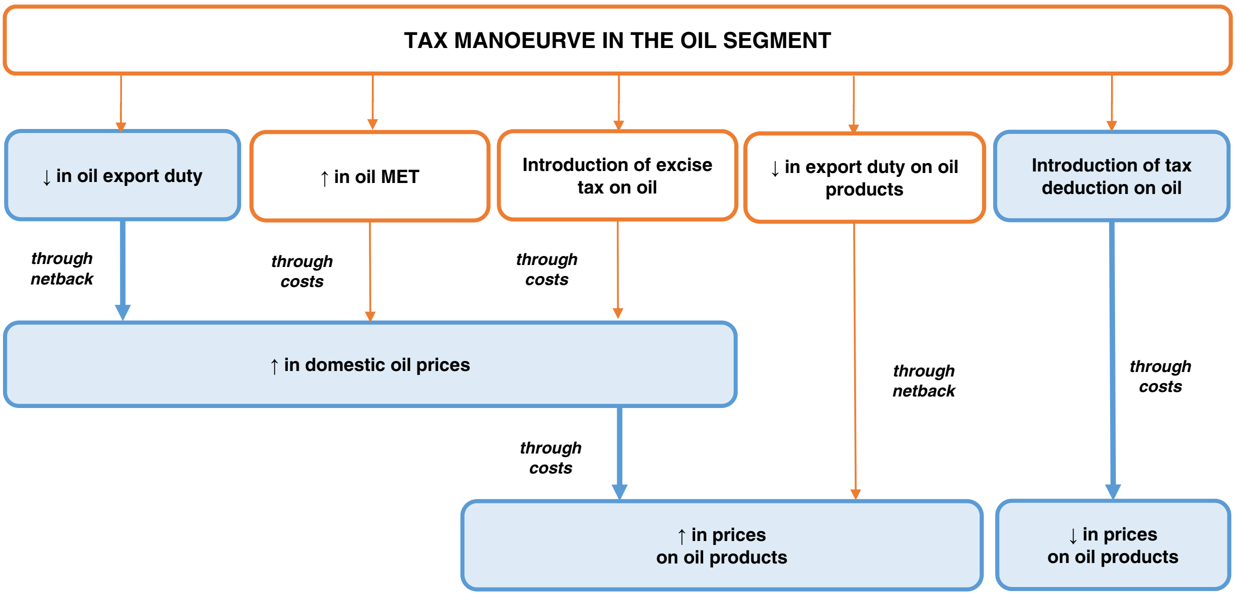
[1] Federal Law No. 305-FZ, dated 3 August 2018, 'On Amending Article 3.1 of the Russian Federation Law 'On Customs Tariffs'.

[2] Federal Law No. 301-FZ, dated 3 August 2018, 'On Amending Part Two of the Tax Code of the Russian Federation'.

Chart 1
Channels through which the tax manoeuvre in the oil segment affects consumer inflation*



** The main channel determining the contribution of the tax manoeuvre to the inflation is shown in the blue colour in the chart..*
Note: the sign «↑» means increase, the sign «↓» means decrease.
Source: Bank of Russia.

3. Assessment of contribution to inflation

We considered two effects to assess the overall impact of the tax manoeuvre on inflation. The direct effect is a direct contribution of the increase in petrol and diesel prices to the consumer price index. The indirect effect is the pass-through of the rise in oil and oil product prices onto the production costs of other consumer goods and services, included in the CPI. According to Bank of Russia estimates, the magnitude of this indirect effect is weaker than the direct one.

Table 1
Estimates of the contribution of the tax manoeuvre to inflation amid different Urals crude prices in 2019

Global Urals price, yearly average, US dollars per barrel	Change in average global oil price in 2019 vs 2108, %	Change in the petrol price in 2019, %	Total contribution to CPI, pp	Of which:	
				direct contribution to CPI (due to increase in petrol and diesel fuel prices)	indirect contribution to CPI (due to increase in oil price)
90	28.6	10.9	0.8	0.5	0.3
85	21.4	9.1	0.6	0.4	0.3
80	14.3	7.3	0.5	0.3	0.2
75	7.1	4.0	0.3	0.2	0.2
70	0.0	3.1	0.2	0.1	0.1
65	-7.1	1.9	0.1	0.1	0.1
60	-14.3	0.1	0.0	0.0	0.0
55	-21.4	-0.7	-0.1	0.0	0.0
50	-28.6	-3.5	-0.3	-0.1	-0.1
45	-35.7	-5.4	-0.4	-0.2	-0.2
40	-42.9	-7.3	-0.5	-0.3	-0.2
35	-50.0	-9.2	-0.7	-0.4	-0.3

** The table contains estimates of the contribution of the tax manoeuvre to the annual inflation in 2019. The estimates largely depend on the scale of changes in global oil prices. Shold exchange rate dynamics are conditioned on factors not linked to oil, the effects of the tax manoeuvre may vary.*
Source: Bank of Russia.

The impact of the tax manoeuvre on inflation depends on global oil price movements. Growing oil prices will take the tax manoeuvre contribution higher, whereas their decline will send it down. Should oil prices slump, it will be negative. The estimates of the total contribution of the tax manoeuvre to 2019 annual inflation ranges between -0.7 pp, if the average annual Urals price stands at $35 per barrel in the global market, and +0.8 pp, if the price is $90 per barrel (see Table 1). In the Bank of Russia's baseline scenario, the contribution of the tax manoeuvre to inflation comes in at -0.1 pp in 2019, 0.0 pp in 2020, and 0.2 pp in 2021. In the high oil price scenario, the contribution to inflation becomes considerably higher in 2019 and stands at a comparable level with the baseline estimates in future: 0.3 pp, 0.1 pp and 0.2 pp in 2019, 2020 and 2021 respectively.

A number of factors may result in both somewhat higher and somewhat lower actual effect of the tax manoeuvre on prices than the below estimates suggest. Thus, should companies reassess growth in their input or transportation costs on the back of the tax manoeuvre, price growth may be more sizeable than Bank of Russia estimates. At the same time, growth in the consumer prices of motor fuel may be contained by the pricing specifics associated with the dominance of vertically integrated oil companies[3] and the government's focus on prices in this socially important segment.

[3] *According to the 2017 Report on Competition Policy Developments in the Russian Federation by FAS (https://fas.gov.ru/documents/654014), such companies hold the main share in all segments of the oil and oil product market: oil production and processing, storage, wholesale and retail sales of oil products.*

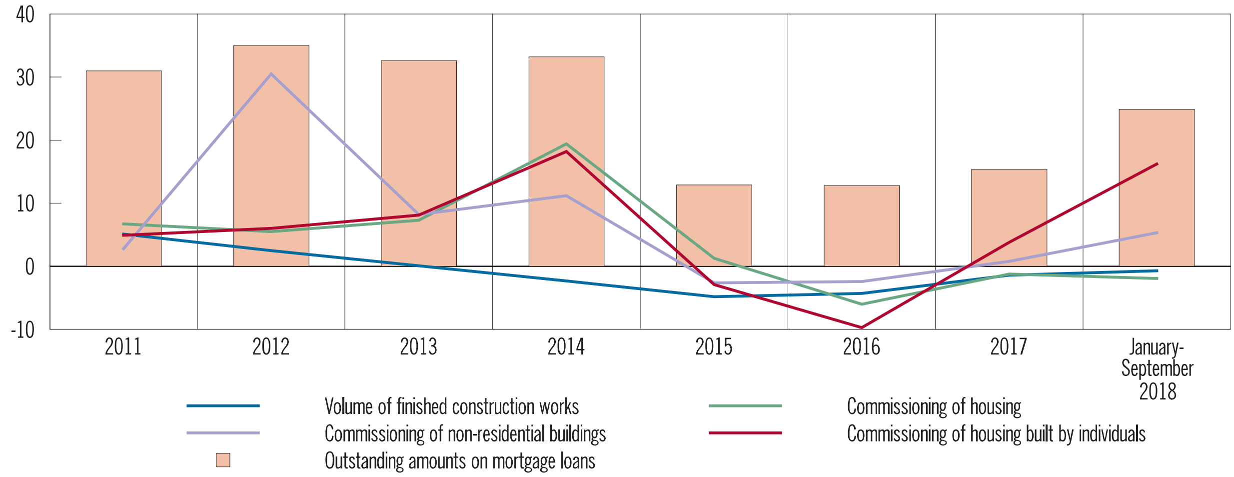
Construction sector

The economic situation in construction has certain specifics. It is marked with high inertia, with recessions and recoveries taking rather long periods of time. Such delays become especially clear during the periods of economic wobbles. As a rule, recession only gives way to a new surge in construction after the economy has recovered and incomes are rising sustainably. That said, it may take another several years for the construction to be completed and facility commissioning indicators to go up. The long slump in construction seen in recent years is associated with objective factors – prudent attitude towards investment in fixed assets by businesses and in real estate by households, given the income and expectation dynamics. At the same time, the current values of buildings and facilities commissioning indicators largely reflect the 2015-2016 drop in investment. However, individual indicators of the construction sector have shown certain improvement in 2018 as household incomes recover and economic activity revives (Chart 1). Next year, the sector will be affected by a number of factors. Construction dynamics will in part depend on the implementation of government-financed projects in housing and infrastructure construction.

Despite the fact that construction growth rates remain overall in negative territory, starting 2017 H2 growth was registered in individual housing and non-residential property construction (Chart 1). Private housing construction responds to the start of recovery in household incomes more promptly than the construction of apartment blocks (Chart 2). Another factor that influenced the private construction in late 2017 – early 2018 was the plan to taper off the *dacha amnesty*[1] from 1 March 2018. Positive dynamics in the construction of non-residential buildings reflect the ongoing recovery in investment activity. Building construction accounts for about 40% of all construction works; however, it also largely determines the situation in other construction sectors: construction of engineering structures (roads and communications) – 40% of total construction works; installation and decoration works (including dismantling and demolition) – 20% of total construction works.

The expansion of individual housing construction in 2017 H2 – early 2018 amid the continued decline in the construction of apartment blocks determined regional differences in overall housing construction dynamics. The size of newly built houses mostly increased in southern Russia where private houses prevail, and in the central and north-western regions where Moscow and Saint Petersburg, the largest cities, are situated.[2]

Chart 1
Construction and mortgage lending
(per cent change on corresponding period of previous year)

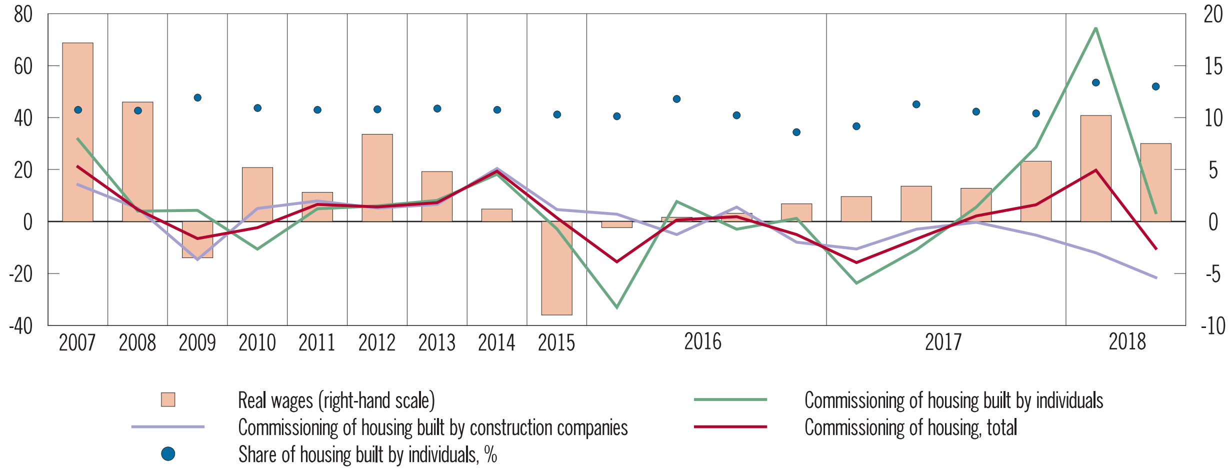


Sources: Rosstat, Bank of Russia.

[1] *The dacha amnesty means a simplified registration of ownership for land plots and buildings meant for individual housing construction, subsidiary farming, gardening and market gardening, and garage building.*

[2] *Though most Russian regions registered a decline in residential construction in 2018 Q2-Q3, the sector's real performance can only be assessed as of the year-end, because most residential housing is commissioned in the fourth quarter.*

Chart 2
Real wages and housing commissioning
(per cent change on corresponding period of previous year)



Source: Rosstat.

Starting 2017 Q3, the resumption of active growth was also registered in mortgage lending due to income recovery and interest rate cuts. In the past 18 months, growth in mortgage lending has been coupled with the levelling of regional heterogeneity by debt burden. Higher rates of debt growth are registered in the regions with a relatively low base of this segment's development: North Caucasus republics, Crimea and Sevastopol, certain regions of south Siberia and the Far East. In urbanised Volga, central, north western and Siberian regions, characterised by higher debt levels, growth rates are lower. In future, mortgage lending may be expected to remain uneven across regions due to changes in the level of debt burden and lending conditions.

In the next one to two years, the situation in residential construction will depend on a variety of mixed factors, including the implementation of government-financed projects. Significant effect will be exerted by construction companies' adjustment to amendments to the equity construction law aimed at mitigating risks in this field. The adopted amendments will change the funding structure of apartment block construction: the money of equity holders will be replaced with bank loans;[3] this will push construction companies' costs upward. However, these changes will not be critical for the majority of large and medium developers, though estimates made by industry experts suggest that certain small construction companies may have a hard time adjusting to the changes. That said, risks are low that the sector may be monopolised because some developers will leave the market: the sector of residential construction is quite competitive in most regions (excluding several small regions where most houses are built by one or two companies). The adjustment to the new requirements may take time.

Construction will be supported by the nascent recovery in household incomes. Its effect will feed through to apartment block construction in one to two years (growth in demand for housing has already translated into the prices of primary residential property market, which resumed growth in 2017 Q2). In the medium term, growth in residential construction should also come from the Housing and Urban Environment national project. The most significant effect of this programme is expected to become evident in 2020-2024 (by 2024, 120 million square meters of new housing should be commissioned vs 80 million square meters registered in 2017) due to more affordable mortgage lending, simplified administrative procedures for developers, government support for infrastructure construction, rehousing of people living in substandard housing, and other measures.

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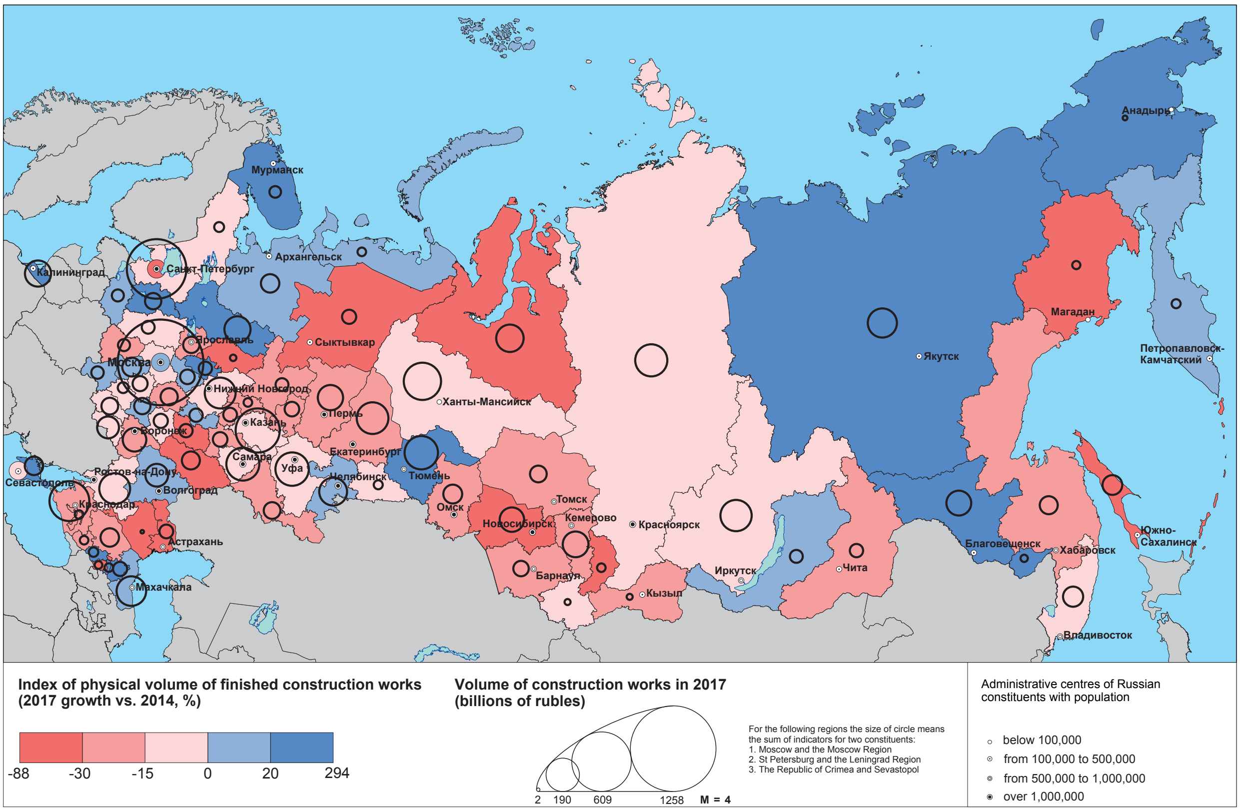
[3] *In accordance with the approved amendments to Federal Law No. 214 FZ, dated 30 December 2004, starting 1 July 2019, flats in newly built houses can only be sold with the use of escrow accounts. In this case customer funds are transferred to an account opened by a developer with an authorised bank, and the developer cannot access this account until the construction is completed. Construction funding comes from a bank loan.*

Chart 3
Construction dynamics and volume of works in 2014–2017



Source: Rosstat.

The performance of the construction sector in 2019-2024 will largely depend on the implementation of the Comprehensive Plan for Upgrading and Expanding Core Infrastructure. The related expenses will exceed ₽6 trillion, including ₽3 trillion of private investment (for comparison, the total cost of construction works in 2017 equalled ₽7.5 trillion). The greatest contribution to the performance of the construction sector from the implementation of the said plan is expected after 2019-2020. The most sizeable expenses on its financing are set to fall on this period. The importance of the plan for the economy, including investment and construction, is higher in individual central and Volga regions (construction and repairs of highways and communal infrastructure), the north of Russia's European part, Siberia, and the Far East (airport and port infrastructure development).

Impact of changes in excise rates on inflation in 2019

The Tax Code of the Russian Federation provides for the annual indexation of excise rates on certain goods in the consumer basket used to calculate the consumer price index. Starting 1 January 2019, excise taxes for petrol, diesel fuel, cigarettes and light vehicles will be raised. Excise rates for alcohol will remain unchanged. However, as the WTO requires that domestic and foreign producers should be on a level playing field, concessional rates of excise duty for wines and champagnes with protected geographical indication shall be abolished (Table 1).

Petrol and diesel fuel are expected to see the most sizeable excise rate hike; however it will not be fully translated into prices of respective fuels. According to the agreements with the government to stabilise the fuel market, major oil companies committed to peg retail fuel prices at the May level throughout 2018. The growth rate of retail prices for oil products should not exceed 1.7% from 1 January till 1 February 2019, and should be in line with the average annual inflation rate forecast for 2019 in the February-March period. The overall increase in prices on motor fuel will come in at no more than 4.6% in 2019.[1] Growth in motor fuel prices consistent with inflation will not trigger undesirable secondary effects from the rise in producer costs. The contribution to annual inflation will be roughly 0.2 pp.

Starting 1 January 2019, excise taxes on light vehicles will increase by 4.0%, which, all things being equal, will cause retail vehicle prices to rise by an average of 0.2%. The increase in excise rates on light vehicles will not have any significant impact on inflation.

Table 1

Excise rate movements and their share in excisable goods prices
(%)

Excisable goods	Excise growth rate in 2019	Excise share in consumer price in 2018
Motor petrol	48.6	15.1
Diesel fuel	50.8	11.5
Light vehicles	4.0	4.3
Alcohol, wine	0.0 / 58.6*	4.4
Tobacco products	9.1	52.2

** With account of cancelled concessional excise taxes on wine and champagne with protected geographical indication.*
Sources: Rosstat, Federal Tax Service, Tax Code of the Russian Federation, Bank of Russia calculations.

Table 2

Excisable goods price movements and their effect on inflation
(%)

Excisable goods	Excise growth rate in 2019, %	Contribution to annual inflation in 2019, percentage points
Motor petrol	7.3 / 4.6*	0.29 / 0.18*
Diesel fuel	5.8 / 4.6*	0.01 / 0.01*
Passenger cars	0.2	0.01
Alcohol, wine	0.0 / 0.9**	0.00 / 0.01**
Tobacco products	4.6	0.06
Cumulative contribution to inflation		0.37 / 0.27***

** Maximum increase in retail fuel prices in 2019 and its contribution to inflation according to the agreement reached by the government and an oil company.*
*** With account of cancelled concessional excise taxes on wine and champagne with protected geographical indication.*
**** Contribution to inflation with account of the state regulation of fuel prices and concessional taxes on wine and champagne with protected geographical indication.*
Sources: Rosstat, Federal Tax Service, Tax Code of the Russian Federation, Bank of Russia calculations.

[1] *All else being equal, a complete pass-through of the excise rate hike to retail prices on motor fuel would bring petrol prices up by 7.3% and diesel prices by 5.8%.*

From the beginning of next year, cigarette excise taxes are also expected to rise by 9.1% triggering a 4.6% surge in cigarette prices. This will contribute less than 0.1 pp to annual inflation.

Alcohol excise rates will remain unchanged in 2019. At the same time, the abolition of the concessional rates of excise duty on Russian wines and champagnes with protected geographical indication is expected to bring average wine prices up by 0.9%. Given the low weight of wine and champagne in the consumer price index, the contribution of the abolition of concessional excise rates will be immaterial (less than 0.01 pp).

The cumulative contribution of the increased excise taxes to annual inflation could reach roughly 0.3-0.4 pp (Table 2).

Changes in the system of monetary policy instruments and other Bank of Russia measures

Table 1

Changes in the system of monetary policy instruments
and other Bank of Russia measures

New Bank of Russia lending regulations have come into force	Starting 1 October 2018, the Bank of Russia issues secured loans in compliance with the terms and conditions of issue and repayment of loans backed by securities or credit claims. Starting the said date, Regulations Nos. 236-P and 312-P no longer govern the issue of Bank of Russia loans
Paper-based document workflow associated with secured loan issue has been reduced	Starting 1 October 2018, when issuing secured loans in compliance with the terms and condition of issue and repayment of Bank of Russia loans backed by securities or credit claims, the Bank of Russia only accepts from credit institutions softcopy documents (in accordance with Bank of Russia Information Letter No. IN-03-20/55, dated 17 August 2018) in accordance with the document exchange agreement
The Bank of Russia Lombard List has been expanded	In accordance with the decisions of the Bank of Russia Board of Directors of 17 October and 28 November 2018, additional 14 securities issues were included in the Bank of Russia Lombard List
Criteria for credit claims to Russian constituents and municipalities have been updated	Starting 1 July 2019, the Bank of Russia will compile the list of Russian constituents and municipalities which can be debtors under loan agreements, claims on which can be included in the pool of collateral on Bank of Russia loans based on the credit rating no lower than A(RU) in the classification of the credit rating agency ACRA (JSC) or ruA in the classification of the credit rating agency JSC Expert RA. The Bank of Russia will take the results of credit quality assessment into account

Table 2

Interest rates on Bank of Russia operations to provide and absorb ruble liquidity

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.2018	From 12.02.2018	From 26.03.2018	From 4.06.2018[1]	From 17.09.2018[1]	From 17.12.2018[1]
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[2]; repos	1 day	daily	8.75	8.50	8.25	key rate + 1.00	key rate + 1.00	key rate + 1.00
		Loans secured by non-marketable assets[3]	from 2 to 549 days		9.50	9.25	9.00	key rate + 1.75	key rate + 1.75	key rate + 1.75
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets[3]	3 months	monthly[4]	8.00	7.75	7.50	key rate + 0.25	key rate + 0.25	key rate + 0.25
		Repo auctions	1 week	weekly[5]	7.75 (key rate)	7.50 (key rate)	7.25 (key rate)	7.25 (key rate)	7.50 (key rate)	7.75 (key rate)
			from 1 to 6 days	occasionally[6]						
		FX swap auctions (ruble leg)[2]	from 1 to 2 days							
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days							
			1 week	weekly[6]						
		OBR bond placement (additional placement) auctions[3]	3 months	occasionally						
	Standing facilities	Deposit operations	1 day[7]	daily	6.75	6.50	6.25	key rate – 1.00	key rate – 1.00	key rate – 1.00

[1] *From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set as key rate spreads.*

[2] *From 23 December 2016, interest rates on the foreign currency leg equal LIBOR on overnight loans in US dollars or euros (depending on the currency of the transaction).*

[3] *Operations conducted at a floating interest rate linked to the Bank of Russia key rate.*

[4] *Operations have been discontinued since April 2016.*

[5] *Either a repo or a deposit auction is held depending on the situation with liquidity. See press release http://www.cbr.ru/press/PR.aspx?file=19012015_154523if2015-01-19T15_41_11.htm.*

[6] *Fine-tuning operations.*

[7] *Before 16 May 2018, also call operations. From 17 May 2018, the Bank of Russia conducts only overnight deposit operations with credit institutions.*

Memo item: from 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date.

Source: Bank of Russia.

Table 3

Interest rates for specialised refinancing facilities[1]

(% p.a.)

Purpose of indirect bank lending	Maturity	Collateral	As of 1.01.2018	From 12.02.2018	From 26.03.2018	From 04.06.2018[2]
Large-scale investment projects[3]	Up to 3 years	Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation	6.75	6.50	6.25	The lower of the two values: 9.00% p.a. or the Bank of Russia key rate less 1.00 pp.
		Bonds placed to finance investment projects and included in the Bank of Russia Lombard List				
Leasing	Up to 3 years	Claims on loans to leasing companies	6.75	6.50	6.50	The lower of the two values: 6.50% p.a. or the Bank of Russia key rate
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by the insurance contracts of JSC EXIAR	6.50	6.50	6.50	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[4]	6.50	6.50	6.50	
		Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises				
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage Programme	7.75	7.50	7.25	Bank of Russia key rate

[1] Specialised refinancing facilities are Bank of Russia instruments aimed at encouraging bank lending to certain segments of the economy whose development is hampered by structural factors. Under these facilities, the Bank of Russia provides funds to credit institutions at lower rates and for longer maturities compared with standard Bank of Russia operations. Specialised refinancing facilities are temporary Bank of Russia instruments, which will be valid until conditions for their replacement with market instruments are created in the financial market. The provision of funds under the specialised facilities is restricted, because their application should not distort the stance of the monetary policy and prevent the achievement of its key objective of ensuring price stability.

[2] From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set at key rate spreads.

[3] Projects are selected in compliance with the rules established by Regulation of the Government of the Russian Federation No. 1016, dated 14 December 2010, 'On Approving the Rules to Select Investment Projects and Principals for the Provision of the Russian Federation State Guarantees on Loans or Bonded Loans Attracted to Carry out Investment Projects' or Regulation of the Government of the Russian Federation No. 1044, dated 11 October 2014, 'On Approving the Programme to Support Investment Projects Implemented in the Russian Federation Based on Project Financing'.

[4] Claims under loans issued to banks and microfinance organisations partnering with JSC SME Bank under the Programme for Financial Support of Small and Medium-sized Enterprises Development for lending to SMEs and claims under loans issued to leasing companies partnering with JSC SME Bank for leasing property to SMEs.

Source: Bank of Russia.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims and obligations, billions of rubles					
					As of 1.01.2017	As of 1.01.2018	As of 1.04.2018	As of 1.07.2018	As of 1.10.2018	As of 1.12.2018
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	0.0	0.8	14.6	0.4	0.0
		Lombard loans			0.6	0.0	0.0	0.0	0.0	0.0
		FX swaps			37.8	0.0	0.0	0.0	0.0	8.2
		Repos			593.9	3.6	6.5	2.4	10.0	9.2
		Loans secured by non-marketable assets	from 1 to 549 days		410.7	5.5	30.1	5.4	377.8	337.3
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly[1]	215.6	0.0	0.0	0.0	0.0	0.0
			18 months	occasionally[2]						
		Repo auctions	1 week	weekly[3]	0.0	0.0	0.0	0.0	0.0	0.0
			from 1 to 6 days	occasionally[4]						
		FX swap auctions	from 1 to 2 days		0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days		396.9	2,124.9	2,520.6	2,389.1	1,761.8	1,547.8
			1 week	weekly[3]						
		Auctions for the placement and additional placement of OBRs[5]	3 months	occasionally	-	357.4	1,139.1	1,123.0	1,502.1	1,638.1
	Standing facilities	Deposit operations	1 day[6]	daily	388.3	246.8	264.6	329.1	499.0	151.4

[1] *Operations have been discontinued since April 2016.*
[2] *Operations have been suspended since 1 July 2016.*
[3] *Either a repo or a deposit auction is held depending on the situation with liquidity.*
[4] *Fine-tuning operations.*
[5] *If a reporting day falls on a week-end or holiday, the volume of OBRs in circulation is indicated inclusive of the coupon yield as of the first business day following the reporting date.*
[6] *Before 16 May 2018, also call operations. From 17 May 2018, the Bank of Russia conducts only overnight deposit operations with credit institutions.*
Source: Bank of Russia.

Table 2

Required reserve ratios

(%)

Liability type	Validity dates		
	1.01.17–30.11.17	1.12.17–31.07.18	From 1.08.18
Banks and non-bank credit institutions			
To households in the currency of the Russian Federation	5.00	x	x
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation			
To households in foreign currency	6.00	x	x
To non-resident legal entities in foreign currency	7.00	x	x
Other liabilities in foreign currency			
Banks with a universal licence and non-bank credit institutions			
To households in the currency of the Russian Federation	x	5.00	5.00
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation			
To households in foreign currency	x	6.00	7.00
To non-resident legal entities in foreign currency	x	7.00	8.00
Other liabilities in foreign currency			
Banks with a basic licence			
To households in the currency of the Russian Federation	x	1.00	1.00
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation		5.00	5.00
To households in foreign currency	x	6.00	7.00
To non-resident legal entities in foreign currency	x	7.00	8.00
Other liabilities in foreign currency			

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

Types of credit institutions	
Banks with a universal licence, with a basic licence	0,8
Non-bank credit institutions	1,0

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

Instrument	Term	Frequency[1]	Minimum auction rate as spread to LIBOR[2], pp; fixed rate for FX swaps[3], % p.a.	Bank of Russia claims, millions of US dollars[4]					
			From 23.12.16	As of 1.01.17	As of 1.01.18	As of 1.04.18	As of 1.07.18	As of 1.10.18	As of 1.12.18
Repo auctions	1 week	weekly	2.00	2,635.2	0.0	0.0	0.0	0.0	0.0
	28 days			8,719.9	0.0	0.0	0.0	0.0	0.0
	12 months		3.00	26.2	0.0	0.0	0.0	0.0	0.0
Loan auctions	28 days	monthly	2.25	0.0	0.0	0.0	0.0	0.0	0.0
	365 days		3.25	0.0	0.0	0.0	0.0	0.0	0.0
USD/RUB sell/buy FX swaps	1 day	daily	1.50	1,000.0	4,490.7	0.0	229.0	0.0	0.0

[1] No 12-month loan or repo auctions were held in 2017 and January-August 2018; regular one-week and 28-day repo auctions have been discontinued since 11 September 2017.
[2] The rate for ruble leg is equal to the Bank of Russia key rate less 1 pp.
[3] In respective currencies and for respective terms.
[4] For repos – claims on credit institutions under the second leg of repos.
Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities[1]

Purpose of indirect bank lending	Maturity	Collateral	Bank of Russia claims on credit institutions, billions of rubles						Limit, billions of rubles
			As of 1.01.17	As of 1.01.18	As of 1.04.18	As of 1.07.18	As of 1.10.18	As of 1.12.18	As of 1.12.18
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by the insurance contracts of JSC EXIAR	43.4	47.4	46.4	48.8	50.0	49.6	75.00
Large-scale investment projects[2]	Up to 3 years	Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation	112.6	108.3	104.7	105.7	105.1	94.3	150.00
		Bonds placed to finance investment projects and included in the Bank of Russia Lombard List	0.6	0.0	0.0	0.0	0.0	0.0	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[3]	43.1	18.3	14.7	12.2	9.1	8.1	175.00
		Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises	48.2	81.5	81.4	78.7	78.1	76.0	
Leasing	Up to 3 years	Claims on loans to leasing companies	0.0	0.2	0.2	0.2	0.2	0.2	10.00
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage Programme	29.3	29.3	21.9	21.7	9.7	9.7	30.0

[1] Specialised refinancing facilities are Bank of Russia instruments aimed at encouraging bank lending to certain segments of the economy whose development is hampered by structural factors. Under these facilities, the Bank of Russia provides funds to credit institutions at lower rates and for longer maturities compared with standard Bank of Russia operations. Specialised refinancing facilities are temporary Bank of Russia instruments, which will be valid until conditions for their replacement with market instruments are created in the financial market. The provision of funds under the specialised facilities is restricted, because their application should not distort the stance of the monetary policy and prevent the achievement of its key objective of ensuring price stability.

[2] Projects are selected in compliance with the rules established by Regulation of the Government of the Russian Federation No. 1016, dated 14 December 2010, 'On Approving the Rules to Select Investment Projects and Principals for the Provision of the Russian Federation State Guarantees on Loans or Bonded Loans Attracted to Carry out Investment Projects' or Regulation of the Government of the Russian Federation No. 1044, dated 11 October 2014, 'On Approving the Programme to Support Investment Projects Implemented in the Russian Federation Based on Project Financing'.

[3] Claims under loans issued to banks and microfinance organisations partnering with JSC SME Bank under the Programme for Financial Support of Small and Medium-sized Enterprises Development for lending to SMEs and claims under loans issued to leasing companies partnering with JSC SME Bank for leasing property to SMEs.

Source: Bank of Russia.

Table 6

Monetary policy rates in various countries

Country	Policy rate	Current level	Latest revision	Previous level	Change	Number of rate revisions over the past 12 months	Inflation	
							Current level, %	12-month change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	0	1.2	-1.30
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	0	3.8	1.60
Czech Republic	repo rate (14 days)	1.75	01.11.2018	1.50	0.25	5	2.2	-0.70
Romania	base rate	2.50	07.05.2018	2.25	0.25	3	4.3	1.62
Bulgaria	base rate	0.00	01.02.2016	0.01	-0.01	0	3.7	1.20
Serbia	key policy rate	3.00	12.04.2018	3.25	-0.25	2	2.2	-0.60
Israel	target overnight rate	0.25	26.11.2018	0.10	0.15	1	1.2	1.00
Brazil	target rate	6.50	21.03.2018	6.75	-0.25	2	4.6	1.86
Chile	monetary policy rate	2.75	18.10.2018	2.50	0.25	1	2.9	1.00
China	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	0	2.5	0.60
	deposit rate (12 months)	1.50	26.10.2015	1.75	-0.25	0		
	required reserve rate	14.50	15.10.2018	15.50	-1.00	3		
India	reverse repo rate	6.50	01.08.2018	6.25	0.25	2	3.3	-0.27
	repo rate	6.25	01.08.2018	6.00	0.25	2		
Indonesia	reverse repo rate (7 days)	6.00	15.11.2016	5.75	0.25	4	3.2	-0.07
Korea, Republic of	base rate	1.75	30.11.2018	1.50	0.25	1	2.0	0.70
Malaysia	target overnight rate	3.25	25.01.2018	3.00	0.25	1	0.6	-3.10
Mexico	target rate	8.00	15.11.2018	7.75	0.25	3	4.9	-1.47
Philippines	monetary policy rate	4.75	16.11.2018	4.50	0.25	5	6.0	3.00
Russia	repo auction rate (7 days)	7.50	17.09.2018	7.25	0.25	4	3.5	0.80
South Africa	repo rate	6.75	23.11.2018	6.50	0.25	2	5.1	0.30
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0	0.9	-0.05
Turkey	repo rate (7 days)	24.00	13.09.2018	17.75	6.25	3	21.6	8.64
United States	federal funds rate (upper bound)	2.25	26.09.2018	2.00	0.25	3	2.5	0.50
Euro area	refinancing rate	0.00	16.03.2016	0.05	-0.05	0	2.0	0.50
United Kingdom	base rate	0.75	02.08.2018	0.50	0.25	1	2.4	-0.60
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0	1.4	1.20
Canada	target overnight rate	1.75	24.10.2018	1.50	0.25	3	2.4	1.00
Australia	overnight rate	1.50	02.08.2016	1.75	-0.25	0	1.9	0.10
New Zealand	overnight rate	1.75	10.11.2016	2.00	-0.25	0	1.9	0.00
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0	0.7	-0.70
	certificate of deposit rate	-0.65	08.01.2016	-0.75	0.10	0		
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	0	0.9	0.10
	3m LIBOR - max	-0.25	15.01.2015	0.25	-0.50	0		
Sweden	repo rate	-0.50	11.02.2016	-0.35	-0.15	0	2.4	0.73
Norway	key deposit rate	0.75	20.09.2018	0.50	0.25	1	3.1	1.90

Note: as of 6 December 2018, changes occurred from the compilation time of the previous Monetary Policy Report issue (21 September 2018) are put in colour.
Source: Bloomberg.

GLOSSARY

Adaptive expectations

Expectations that depend on past inflation readings to a bigger extent than on factors influencing its future dynamics. Given a stable decrease in inflation, its adaptive expectations will exceed its actual level.

Averaging of required reserves

The right of a credit institution to meet reserve requirements set by the Bank of Russia by maintaining a share of required reserves not exceeding the averaging ratio in a correspondent account with the Bank of Russia during a specified period.

Banking sector liquidity

Credit institutions' funds held in correspondent accounts with the Bank of Russia in the currency of the Russian Federation to carry out payment transactions and to comply with the Bank of Russia's reserve requirements.

Bank lending conditions index

A generalised indicator of changes to bank lending conditions, as calculated by the Bank of Russia based on the results of a quarterly survey among leading Russian banks operating in the lending market, as follows: (the share of banks reporting a significant tightening of lending conditions, %) + 0.5 x (the share of banks reporting a moderate tightening of lending conditions, %) – 0.5 x (the share of banks reporting a moderate easing of lending conditions, %) – (the share of banks reporting a significant easing of lending conditions, %). Measured in percentage points (pp).

Bank of Russia interest rate corridor (interest rate corridor)

The basis of the Bank of Russia interest rate system. The centre of the corridor is set by the Bank of Russia key rate; the upper and lower bounds are rates on overnight standing facilities (deposit facilities and refinancing facilities) symmetric to the key rate.

Bank of Russia key rate

It corresponds to the minimum interest rate at Bank of Russia 1-week repo auctions and the maximum interest rate at Bank of Russia 1-week deposit auctions. It is set by the Bank of Russia Board of Directors.

Bank of Russia Lombard List

A list of securities eligible as collateral for Bank of Russia refinancing operations.

Broad money (M2X monetary aggregate)

Total amount of cash in circulation and funds of Russian Federation residents (non-financial and financial organisations (excluding banks) and households) in settlement, current and other on-demand accounts (including bank card accounts), time deposits and other types of deposits in the banking system, denominated in the currency of the Russian Federation, and interest accrued on them.

Carry trade

A strategy in which money is borrowed at a low interest rate in order to invest in higher-yielding assets. This strategy is employed by FX and stock market players to benefit from the positive differentials between active and passive interest rates in different currencies or for different maturities.

CDS spread

Premium paid by the CDS buyer to the seller, usually expressed in basis points of the nominal value of the debt and paid with a certain periodicity.

Consumer price index (CPI)

The CPI measures changes over time in the overall price level of goods and services purchased by households for private consumption. This index is calculated by the Federal State Statistics Service as a ratio of the value of a fixed set of goods and services in current prices to the value of the same set of goods and services in the previous (reference) period's prices. The CPI is calculated on the basis of data on the actual structure of consumer spending, being therefore one of the key indicators of living costs.

Core inflation

Inflation measured as a core consumer price index (CCPI). The difference between the CCPI and the consumer price index (CPI) lies in the CCPI calculation method, which excludes a change in prices for individual goods and services subject to the influence of administrative and seasonal factors (fruit and vegetables, fuel, passenger transportation services, telecommunications services, and the majority of housing and public utility services).

Credit default swap (CDS)

An insurance contract protecting from default on reference obligations (sovereign or corporate securities with fixed yields). It is a credit derivative allowing the buyer of the contract to become insured against a certain credit event of the reference obligation issuer by paying an annuity premium (CDS spread) to the insurance seller.

Current liquidity deficit/surplus

An excess of banking sector demand for liquidity over liquidity supply on the current day. The reverse situation, an excess of liquidity supply over demand on a given day, is the current liquidity surplus.

Dollarisation of deposits

A share of deposits denominated in foreign currency in total banking sector deposits.

Factors of banking sector liquidity

Changes in the central bank balance-sheet items affecting banking sector liquidity, but which do not result from central bank liquidity management operations. These factors include changes in cash in circulation, changes in balances of general government accounts with the Bank of Russia, Bank of Russia operations in the domestic foreign exchange market (excluding operations regulating banking sector liquidity), as well as changes in required reserves deposited by credit institutions in required reserve accounts with the Bank of Russia.

Financial stability

A financial system characterised by the absence of systemic risks which, once they have evolved, may impact negatively on the process of transforming savings into investment and the real economy. In the event of financial stability, the economy demonstrates better resilience to external shocks.

Floating exchange rate regime

According to the IMF classification, under a floating exchange rate regime the central bank does not set targets, including operational ones, for the level of, or changes to, the exchange rate, allowing it to be shaped under the impact of market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to sell it should threats to financial stability arise.

Floating interest rate on Bank of Russia operations

An interest rate tied to the Bank of Russia key rate. If the Bank of Russia Board of Directors decides to change the key rate, the interest rate applied to the loans previously provided at a floating interest rate will be adjusted by the change in the key rate with effect from the corresponding date.

Funds in general government's accounts with the Bank of Russia

Funds in accounts with the Bank of Russia representing funds of the federal budget, the budgets of constituent territories of the Russian Federation, local budgets, government extra-budgetary funds and extra-budgetary funds of constituent territories of the Russian Federation and local authorities.

Generalised (composite) consumer confidence index

Calculated by the Federal State Statistics Service on the basis of quarterly surveys, as an arithmetical mean value of five indices: occurred and expected changes in personal wealth; occurred and expected changes in the economic situation in Russia; and the favourability of conditions for high-value purchases. Partial indices are calculated by drawing up the balance of respondents' estimates (as a percentage). The balance of estimates is the difference between the sum of shares (as a percentage) of decisively positive and 1/2 of the rather positive answers and the sum of shares (as a percentage) of negative and 1/2 of the rather negative answers. Neutral answers are not taken into account.

Gross credit of the Bank of Russia

Includes loans extended by the Bank of Russia to credit institutions (including those with revoked licences), overdue loans and overdue interest on loans, funds provided by the Bank of Russia to credit institutions through repos and FX swaps (USD/RUB and EUR/RUB swaps).

Import substitution

Substitution of imported goods by domestically-produced ones, which leads to an increased proportion of domestic goods in the domestic market.

Inflation expectations

Implied, forecast and expected inflation levels which form the basis for economic decisions and future plans of households, firms and financial market participants (including about consumption, savings, borrowings, investment and loan/deposit rates).

Inflation risks

The risks that price growth may cause the decline in value of assets or incomes.

Inflation targeting regime

A monetary policy framework setting that the final target of the central bank is to ensure price stability, i.e. achieving and maintaining sustainably low inflation. Under this regime a quantitative inflation target is set and announced. The central bank is responsible for achieving this target. Typically, under an inflation targeting regime, the monetary policy affects the economy through interest rates. Decisions are made primarily on the basis of economic forecasts and inflation dynamics. An important feature of this regime is regular explanations to the public of decisions adopted by the central bank, which guarantees its accountability and transparency.

Interest rate corridor

See Bank of Russia interest rate corridor.

M1 monetary aggregate

Total amount of cash in circulation and funds of Russian Federation residents (non-financial and financial organisations (excluding banks) and households) in settlement, current and other on-demand accounts (including bank card accounts) opened in the banking system in the currency of the Russian Federation and interest accrued on them.

Macro Risk Index

An index calculated by Citibank and demonstrating the perception of risk level in the global financial markets by investors. The index is bound between 0 (low risk level) to 1 (high risk level). The index is based on the historical dynamics of emerging market sovereign Eurobond yield spreads to the yield spreads of US treasuries, credit spreads on US corporate bonds, US swap spreads, and implied exchange rate, stock index and interest rate volatility.

Monetary policy transmission mechanism

The process of transferring the impulse of monetary policy decisions to the economy as a whole and to price dynamics, in particular. The process of transmitting the central bank's signal about a/no change in the key rate and its future path, from financial market segments to the real sector and as a result to inflation. The key rate changes are translated into the economy through the following major channels: interest rate, credit, foreign currency and asset price channels.

Money supply

Total amount of funds of Russian Federation residents (excluding general government and credit institutions). For the purposes of economic analysis, various monetary aggregates are calculated (see 'M1 monetary aggregate', 'Money supply in the national definition (M2 monetary aggregate)', 'Cash in circulation outside the banking system (M0 monetary aggregate)' and 'Broad money (M2X monetary aggregate)'.

Money supply in the national definition (M2 monetary aggregate)

Total amount of cash in circulation and funds of Russian Federation residents (non-financial and financial organisations (excluding banks) and households) in settlement, current and other on-demand accounts (including bank card accounts), time deposits and other types of deposits in the banking system, denominated in the currency of the Russian Federation, and interest accrued on them.

MSCI indices

Group of indices calculated by Morgan Stanley Capital International. Calculations are made for indices for individual countries (including Russia), global indices (for various regions, for developed/emerging economies) and 'world' index.

Net credit of the Bank of Russia to credit institutions

Gross credit of the Bank of Russia to credit institutions net of correspondent account balances in the currency of the Russian Federation (including the averaged amount of required reserves) and deposit account balances of credit institutions with the Bank of Russia, investments by credit institutions in Bank of Russia bonds (at prices fixed as of the start of the current year), and credit institutions' claims on the Bank of Russia under the ruble leg of FX swaps (USD/RUB swaps).

Net private capital inflow/outflow

The total balance of private sector operations involving foreign assets and liabilities recorded on the financial account of the balance of payments.

Non-price bank lending conditions

Bank lending conditions, which include loan maturity and its amount, solvency rules, collateral requirements, additional fees, and the range of lending purposes. They are assessed on the basis of surveys of credit institutions by the Bank of Russia.

Non-tradable sector of the economy

Sector of the economy engaged in electricity, gas and water supply, construction, wholesale and retail trade, motor vehicle and motorcycle maintenance, household goods and personal appliance repairs, hotels and restaurants, transport and communications, financial activity, real estate, leasing and services, including other communal, social and personal services.

Open market operations

Bank of Russia operations to regulate banking sector liquidity. They include operations on a reverse basis other than standing facilities, which are carried out with the Bank of Russia making a specific offer (usually auction-based), as well as all operations to purchase/sell securities, foreign currency and gold.

Outstanding amount on Bank of Russia refinancing operations

Outstanding amount on loans extended by the Bank of Russia to credit institutions against the collateral of securities, non-marketable assets, guarantees, gold, repo operations, and FX swaps (USD/RUB and EUR/RUB swaps).

PMI indices

Indicators of business activity based on company surveys in manufacturing and/or services industries. The PMI index series describe dynamics for the following aspects of business climate: output (or business activity for the services industry), new orders, new export orders, backlogs of work, stocks of finished goods, stocks of purchases, quantity of purchases, suppliers' delivery times, employment, output prices (prices charged for the services industry), input prices, and expectations for activity one year ahead (for the services industry). PMI readings over 50 indicate an expansion of business activity, while readings below 50 suggest a decline.

Relative price

Price of a commodity (commodity group) in terms of the price of another commodity (commodity group) assumed to equal one.

Repo operation

A deal which consists of two legs: one party to the deal sells securities to the other party in return for cash, and then, once the deal term has expired, buys them back at a predetermined price. Repos are used by the Bank of Russia to provide credit institutions with liquidity in rubles and foreign currency in exchange for collateral in the form of securities.

Required reserves

Funds maintained by credit institutions in correspondent accounts with the Bank of Russia and accounts to record required reserves in order to fulfil reserve requirements. The latter comprise required reserve ratios and a required reserve averaging ratio.

Ruble nominal effective exchange rate index

The ruble nominal effective exchange rate index reflects changes in the exchange rate of the ruble against the currencies of Russia's main trading partners. It is calculated as the weighted average change in the nominal exchange rates of the ruble against the currencies of these countries. The weights are determined according to the foreign trade turnover share of Russia with each country in the total foreign trade turnover of Russia with its main trading partners.

Ruble real effective exchange rate index

It is calculated as the weighted average change in the real exchange rate of the ruble to the currencies of Russia's main trading partners. The real exchange rate of the ruble to a foreign currency is calculated using the nominal exchange rate of the ruble to the same currency and the ratio of price levels in Russia to those in the corresponding country. When calculating the real effective exchange rate, weights are determined according to the foreign trade turnover share of Russia with each of these countries in the total foreign trade turnover of Russia with its main trading partners. The ruble real effective exchange rate index reflects changes in the competitiveness of Russian goods in comparison to those of Russia's main trading partners.

Shadow banking sector

Financial intermediaries providing credit intermediary services whose activity is not regulated by the banking legislation.

Standing facilities

Operations to provide and absorb liquidity carried out by the Bank of Russia on the initiative of credit institutions.

Structural liquidity deficit/surplus

A structural deficit is the state of the banking sector characterised by stable demand of credit institutions for Bank of Russia liquidity. A structural surplus is characterised by a stable surplus in credit institutions' liquidity and the need for the Bank of Russia to conduct liquidity-absorbing operations. The level of a structural liquidity deficit/surplus is a difference between the outstanding amount on refinancing operations and Bank of Russia liabilities on operations to absorb excess liquidity.

Structural non-oil and gas primary budget deficit

Budget items that are not dependent on the phase of the business cycle and are determined by general government decisions. It is the overall budget deficit, excluding oil and gas revenues, net interest payments, one-off budget revenues, and other items directly dependent on changes in economic activity.

Structural transformations

Transformation leading to changes in the economy structure and growth factors, and also to increases in labour productivity and implementation of new technology.

Terms of foreign trade

Ratio between a country's export price index and import price index.

Tradable sector of economy

Economy sector made up of agriculture, hunting, forestry, fishery, fish farming, mining and quarrying, and manufacturing industries.

Underlying inflation

Underlying inflation indicators are estimated indicators reflecting movements in prices for the majority of goods and services in the basket used for the calculation of the consumer price index. Being shaped by general economic factors, these are free from one-off effects. The indicators of the core inflation published by Rosstat and the underlying inflation published by the Bank of Russia since 2015 (trend inflation) may be categorised under this group of indicators.

Underlying inflation published since 2015 (trend inflation)

Inflation indicator cleared of all shocks which are irrelevant for the monetary policy. The underlying inflation indicator used by the Bank of Russia is calculated on the basis of dynamic factor models.

VIX

Calculated by Chicago Board Options Exchange index of expected volatility of S&P 500 stock index over the next 30 day period. VIX is constructed as a weighted average of premiums of a wide range of prices of put and call options on the S&P 500 index.

ABBREVIATIONS

AHML – Agency for Housing Mortgage Lending

BLC – bank lending conditions

bp – basis point (0.01 pp)

BPM6 – the 6th edition of the IMF's Balance of Payments and International Investment Position Manual

BRICS – a group of five countries: Brazil, Russia, India, China and South Africa

Cbonds IFX-Cbonds – corporate bond total return index

Cbonds-Muni – municipal bond index calculated by Cbonds

CCPI – core consumer price index

CPI – consumer price index

DSR – debt service ratio (the ratio of the cash flow available to pay current debt obligations, including principal and interest, to current income value)

ECB – European Central Bank

EME – emerging market economies

EU – European Union

FAO – Food and Agriculture Organization of the United Nations

FCS – Federal Customs Service

Fed – US Federal Reserve System

FGUP – federal state unitary enterprise

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

GRP – gross regional product

IBL – interbank loans

IEA – International Energy Agency

Industrial PPI – industrial producer price index

inFOM – Institute of the Public Opinion Foundation

MC – management company

MIACR – Moscow Interbank Actual Credit Rate (weighted average rate on interbank loans provided)

MIACR-B – Moscow Interbank Actual Credit Rate-B-Grade (weighted average rate on interbank loans provided to banks with speculative credit rating)

MIACR-IG – Moscow Interbank Actual Credit Rate-Investment Grade (weighted average rate on interbank loans provided to banks with investment-grade rating)

MIC – military-industrial complex

MICEX SE – MICEX Stock Exchange

MPD – Monetary Policy Department of the Bank of Russia

MTVECM, TVECM – Momentum Threshold Vector Error Correction Model, Threshold Vector Error Correction Model

NPF – non-governmental pension fund

NPISH – non-profit institutions serving households

OBR – Bank of Russia bonds

OECD – Organisation for Economic Cooperation and Development

OFZ – federal government bonds

OFZ-IN – inflation-indexed federal government bonds

OFZ-PD – permanent coupon-income federal government bonds

OFZ-PK – variable coupon-income federal government bonds

OJSC – open joint-stock company

OPEC – Organization of the Petroleum Exporting Countries

PJSC – public joint-stock company

PMI – Purchasing Managers' Index

pp – percentage point

PPI – producer price index

QPM – quarterly projection model of the Bank of Russia

REB – Russian Economic Barometer, monthly bulletin

RGBEY – Russian Government Bonds Effective Yield until Redemption (calculated by the Moscow Exchange)

RUONIA – Ruble OverNight Index Average (reference weighted rate of overnight ruble deposits in the Russian interbank bond market, calculated by Cbonds)

SME – small and medium-sized enterprises

SNA – system of national accounts

TCC – total cost of credit

TVP FAVAR – Time-Varying Parameter Factor-Augmented Vector Auto-Regression

VAT – value added tax

VCIOM – Russian Public Opinion Research Centre

VEB – Vnesheconombank

VECM – Vector Error Correction Model