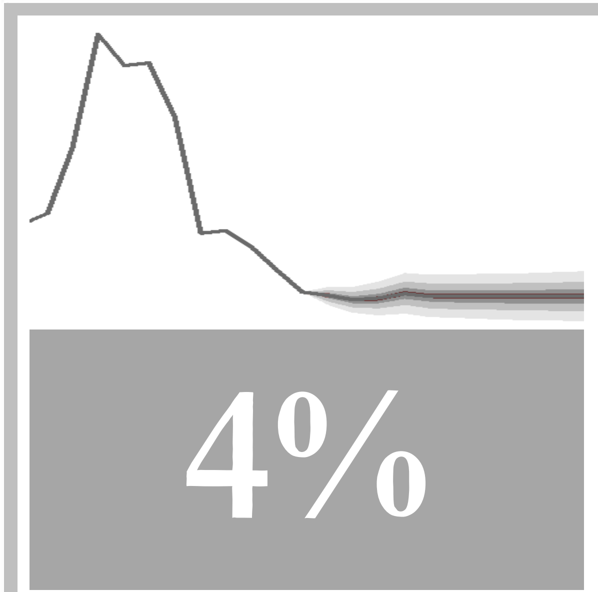
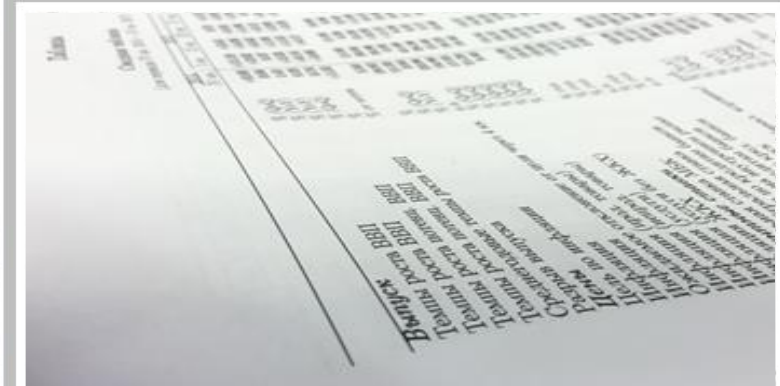
Bank of Russia
The Central Bank of the Russian Federation





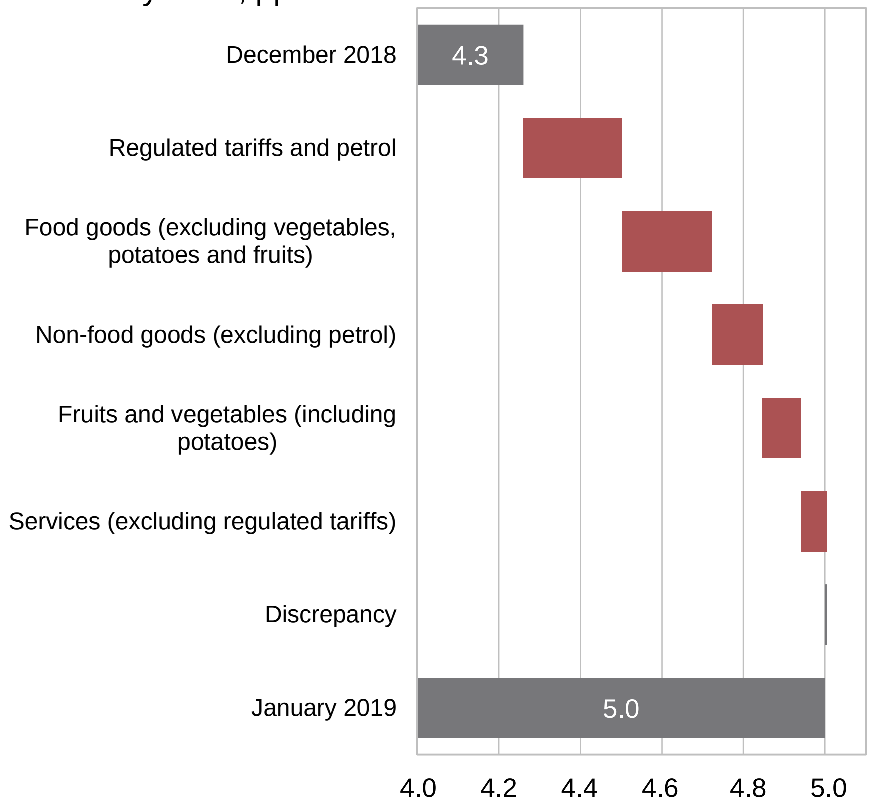
RUSSIA'S ECONOMIC OUTLOOK AND MONETARY POLICY

February 2019

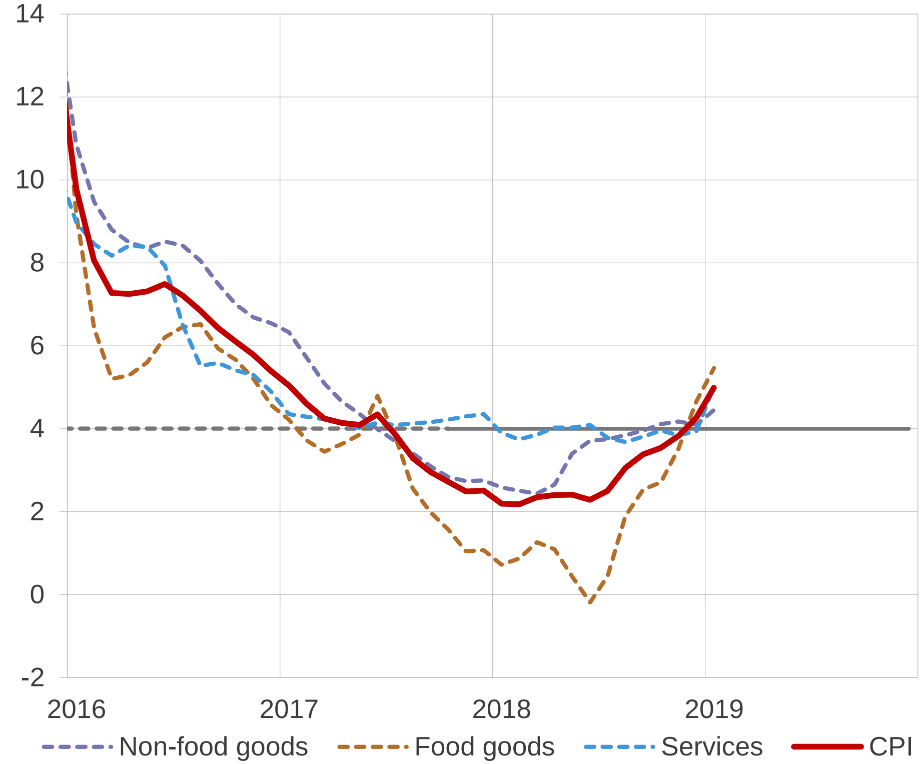
Consumer prices

In January 2019, annual inflation held at the lower bound of the Bank of Russia expectations (5.0% YoY). Faster growth of food prices to 5.5% (vs 4.7% in December 2018) played a significant role in the inflation rise. The contribution of the VAT increase to annual consumer price growth in January was moderate. Prices are completing their adjustment to the ruble’s weakening of the second half of 2018

Contribution of **components** to the change in annual inflation in January 2018, ppts



CPI components, % YoY



Sources: Rosstat, Bank of Russia

Inflation expectations – summary

		2017				2018												2019
	Horizon	I	II	III	IV	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Inflation expectations (absolute numbers), %																		
Households																		
FOM	Next 12 months	11.2	10.3	9.6	8.7	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	10.1	9.3	9.8	10.2	10.4
FOM (observed inflation)	Prev. 12 months	14.0	12.4	11.2	10.0	9.9	9.4	9.2	8.3	9.2	10.6	10.3	10.4	10.2	10.1	10.1	10.2	10.1
FOM (Bank of Russia calculations)	Next 12 months	4.0	4.0	2.8	2.5	2.1	2.1	2.2	2.2	2.2	2.6	2.8	3.5	3.8	3.8	4.4	5.4	6.7
Professional analysts																		
Bloomberg	2019									4.0	4.0	4.2	4.4	4.7	4.5	4.6	4.5	4.7
Interfax	2019					3.6	3.7	3.8	4.1	4.0	4.1	4.3	4.4	4.3	4.2	4.4	4.7	
Reuters	2019								3.9	3.9	4.0	4.3	4.5	4.5	4.5	4.7	5.0	
Financial markets																		
OFZ IN (option not subtracted)	Next 5 years	4.9	4.6	4.2	5.1	4.0	3.9	3.8	4.1	4.2	4.5	4.6	5.2	5.3	5.1	5.1	5.1	5.1
OFZ IN (option not subtracted)	Next 10 years									4.3	4.6	4.6	5.0	5.4	5.2	5.2	5.1	4.9
Inflation expectations (balanced index*)																		
Households																		
FOM	Next 12 months	-1.1	-1.3	-5.1	-4.9	-4.8	-0.9	-1.6	0.8	3.7	9.9	7.8	10.3	6.7	9.5	12.2	15.1	15.2
FOM	Next month	-12.5	-13.2	-15.6	-15.0	-19.1	-18.7	-16.5	-16.6	-13.2	-7.4	-9.6	-5.6	-5.1	-2.7	-2.3	0.0	6.3
Businesses																		
Bank of Russia monitoring	Next 3 months	7.4	9.1	7.4	7.0	6.4	6.9	8.5	9.7	10.0	10.8	11.1	12.5	13.2	14.1	16.7	18.9	
PMI input prices	Next month	7.8	9.0	12.2	10.6	9.2	11.4	12.2	27.4	27.2	28.4	21.6	22.8	24.2	23.4	22.6	22.0	
PMI output prices	Next month	1.0	3.4	6.8	3.0	2.8	2.8	4.0	13.6	6.4	6.6	8.2	6.6	5.8	7.6	7.6	5.6	
Retail prices (Rosstat)	Next quarter	27	24	24	22	-	-	20	-	-	20	-	-	20	-	-	-	
Tariffs (Rosstat)	Next quarter	4	3	0	0	-	-	5	-	-	5	-	-	0	-	-	-	

Change:

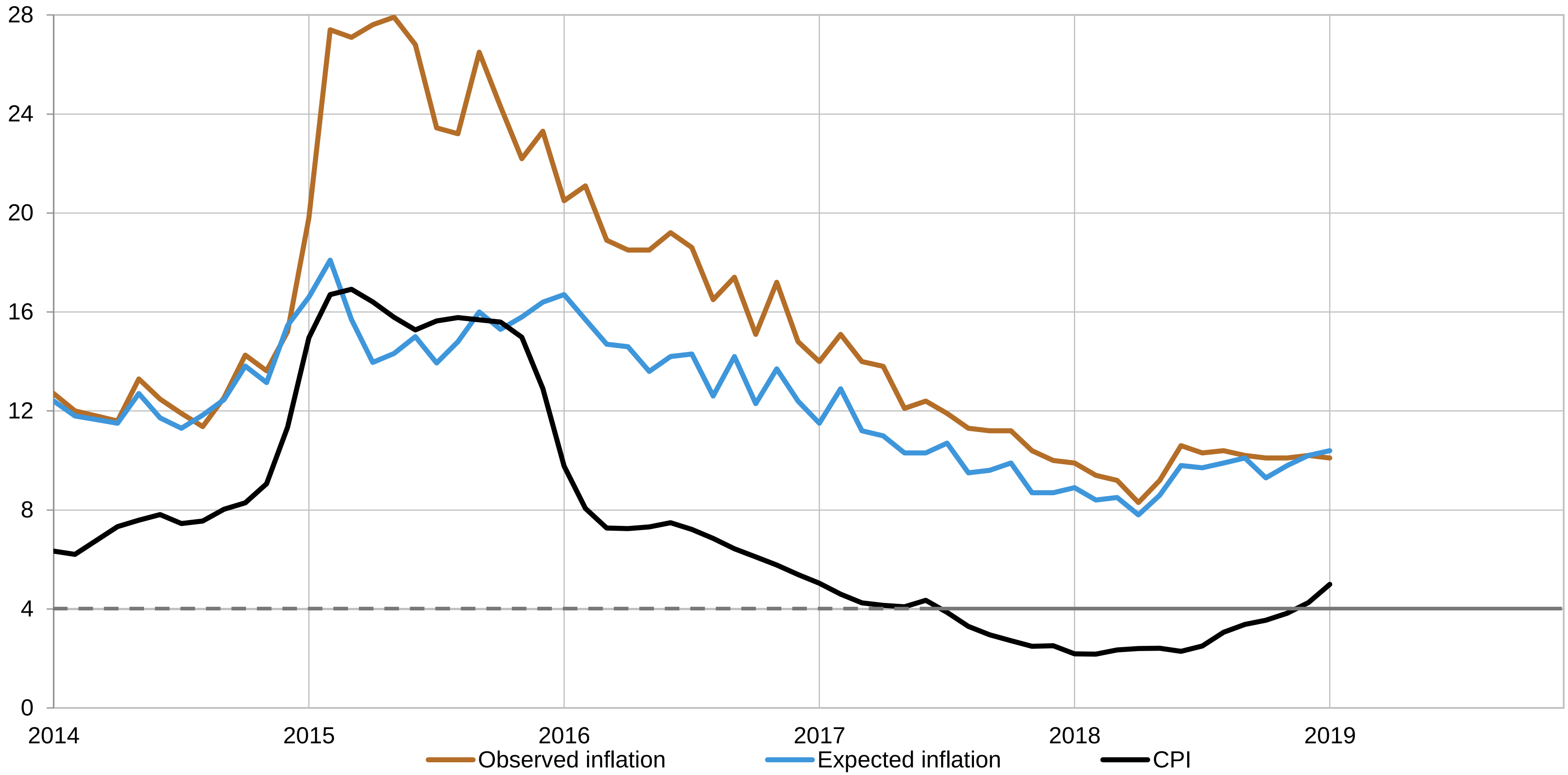
- Inflation expectations become better (more than 1 standard deviation)
- Inflation expectations become better (less than 1 standard deviation)
- Inflation expectations unchanged (±0,2 standard deviations)
- Inflation expectations become worse (less than 1 standard deviation)
- Inflation expectations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

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

Sources: FOM, Rosstat, Bloomberg, Interfax, Thompson Reuters, Bank of Russia

Inflation expectations – households

In January, household inflation expectations rose only slightly (by only +0.2 ppts compared to December)

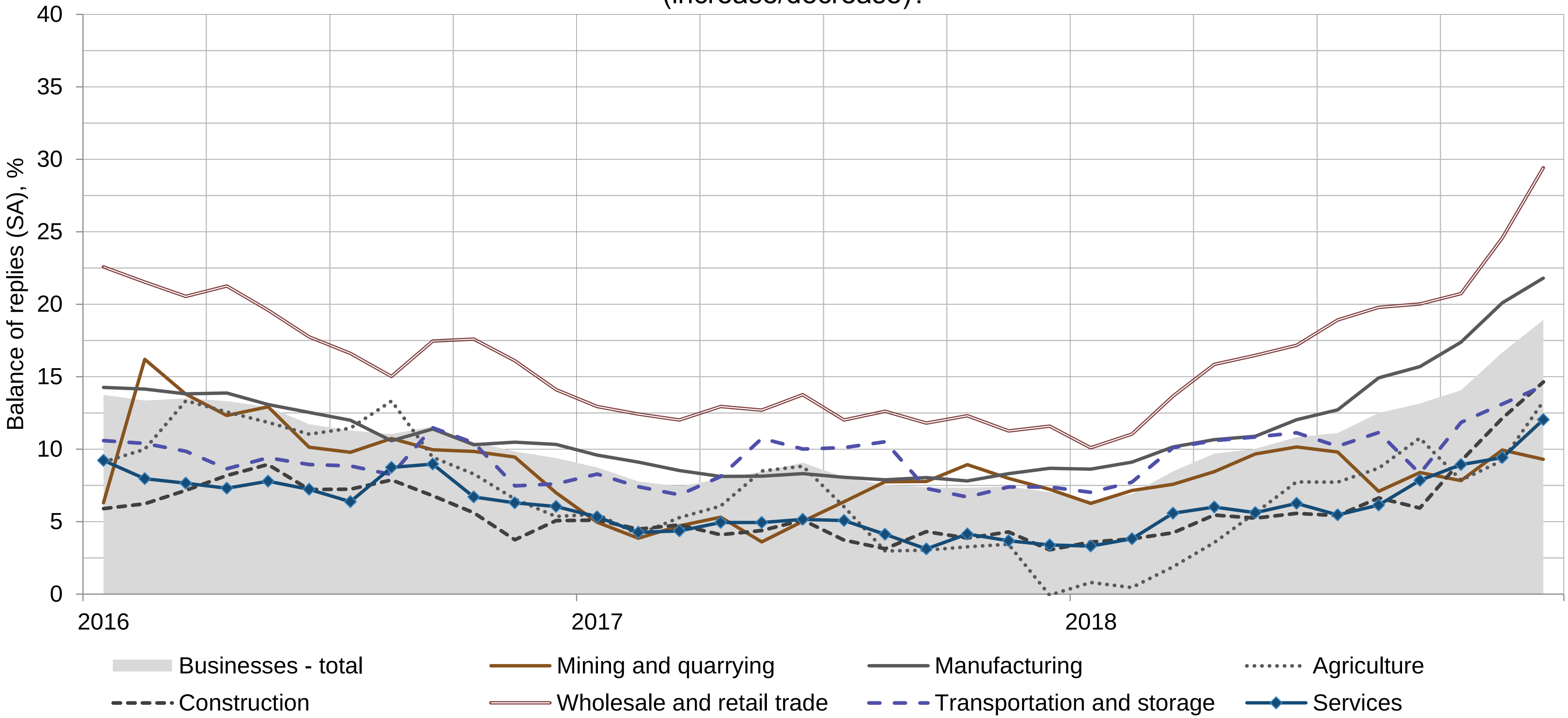


Source: LLC “inFOM”

Inflation expectations – businesses

In January, price expectations of businesses increased on the back of the earlier weakening of the ruble and the VAT increase

Replies of firms to the question: “How will the prices of final goods change in the upcoming 3 months (increase/decrease)?”

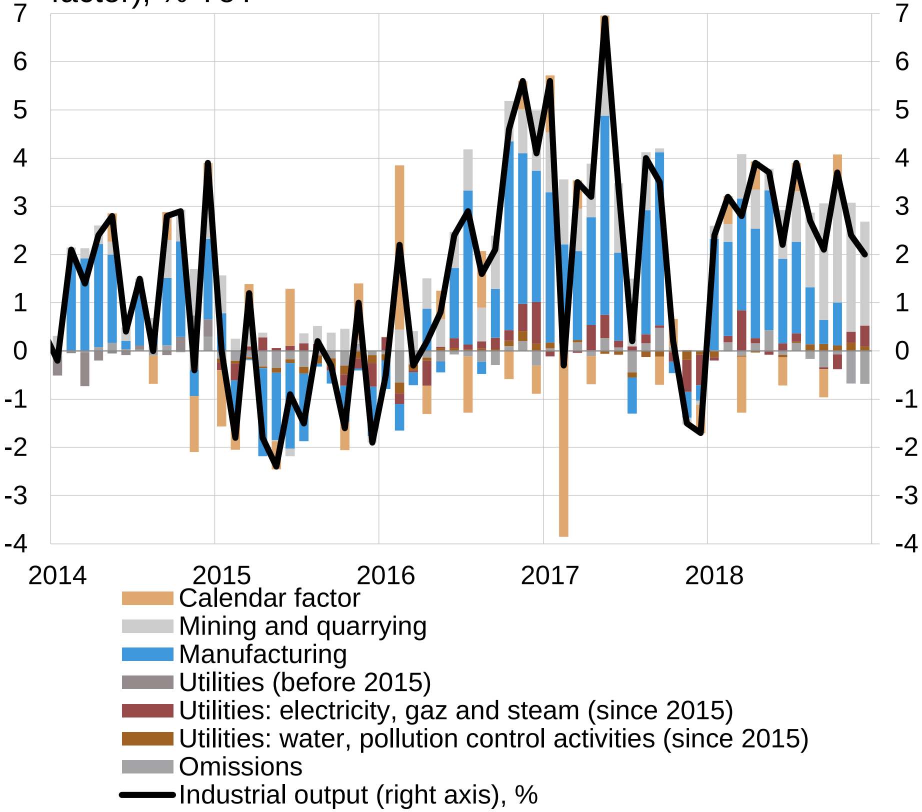


Sources: Bank of Russia’s monitoring of businesses survey

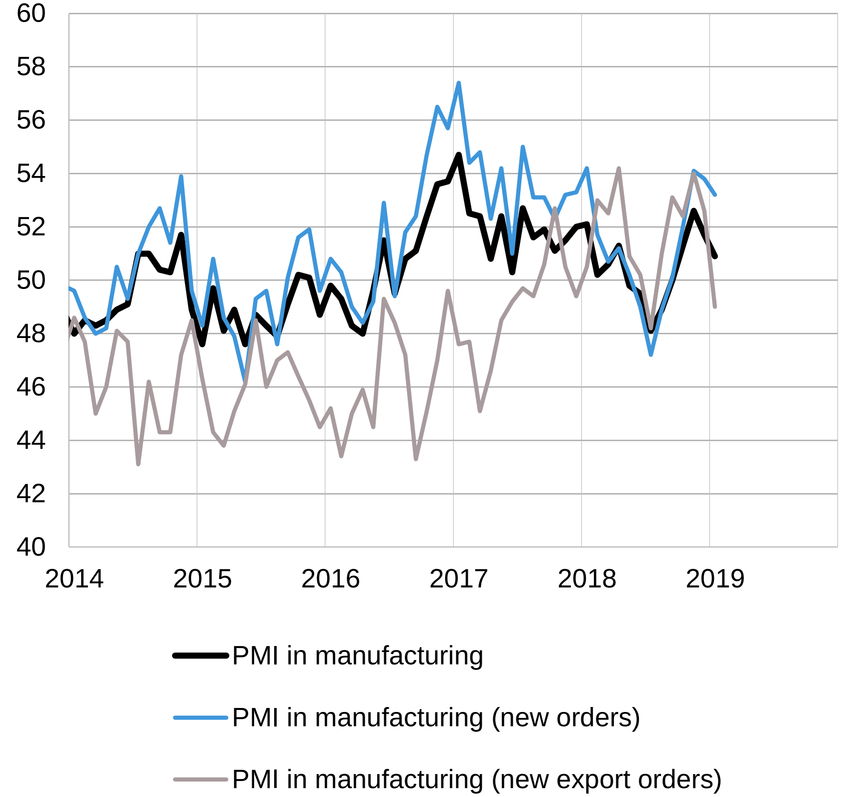
Economic activity – GDP growth and industrial production

Rosstat's flash estimate shows that 2018 GDP growth totalled 2.3%, which exceeds the Bank of Russia's forecast of 1.5-2%. However, recent months have seen slower growth in economic activity

Industrial production with contributions (adjusted for calendar factor), % YoY



PMI indicators

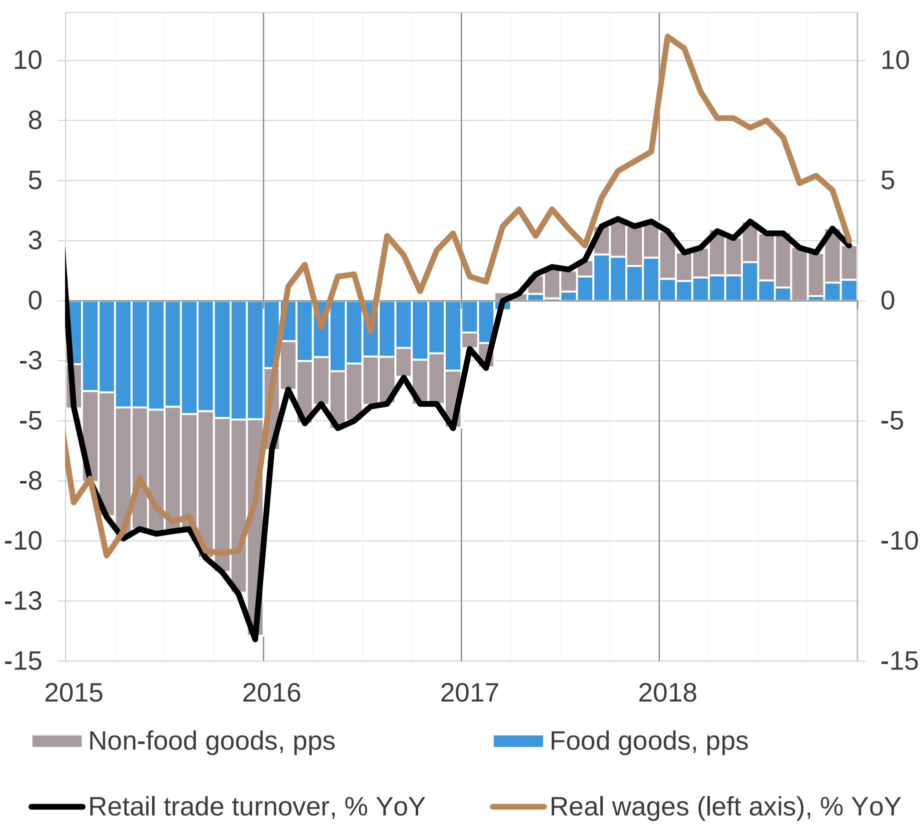


Sources: Rosstat, Bank of Russia

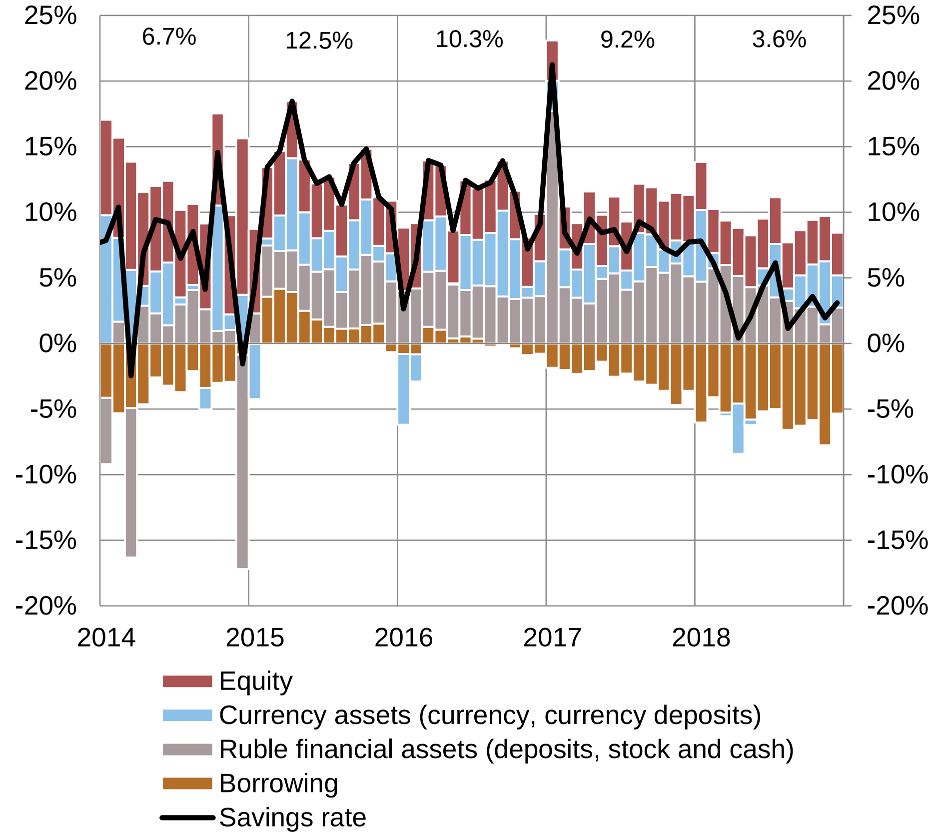
Retail sales and savings rate

Consumer demand growth is moderating with retail sales at +2.3% YoY in December, still mostly driven by non-food sales. Savings rate grew to 3% in December, which is still well below 2015-2017 averages

Retail trade turnover and real wages dynamics



Contributions to the savings rate (seasonally adjusted), ppts

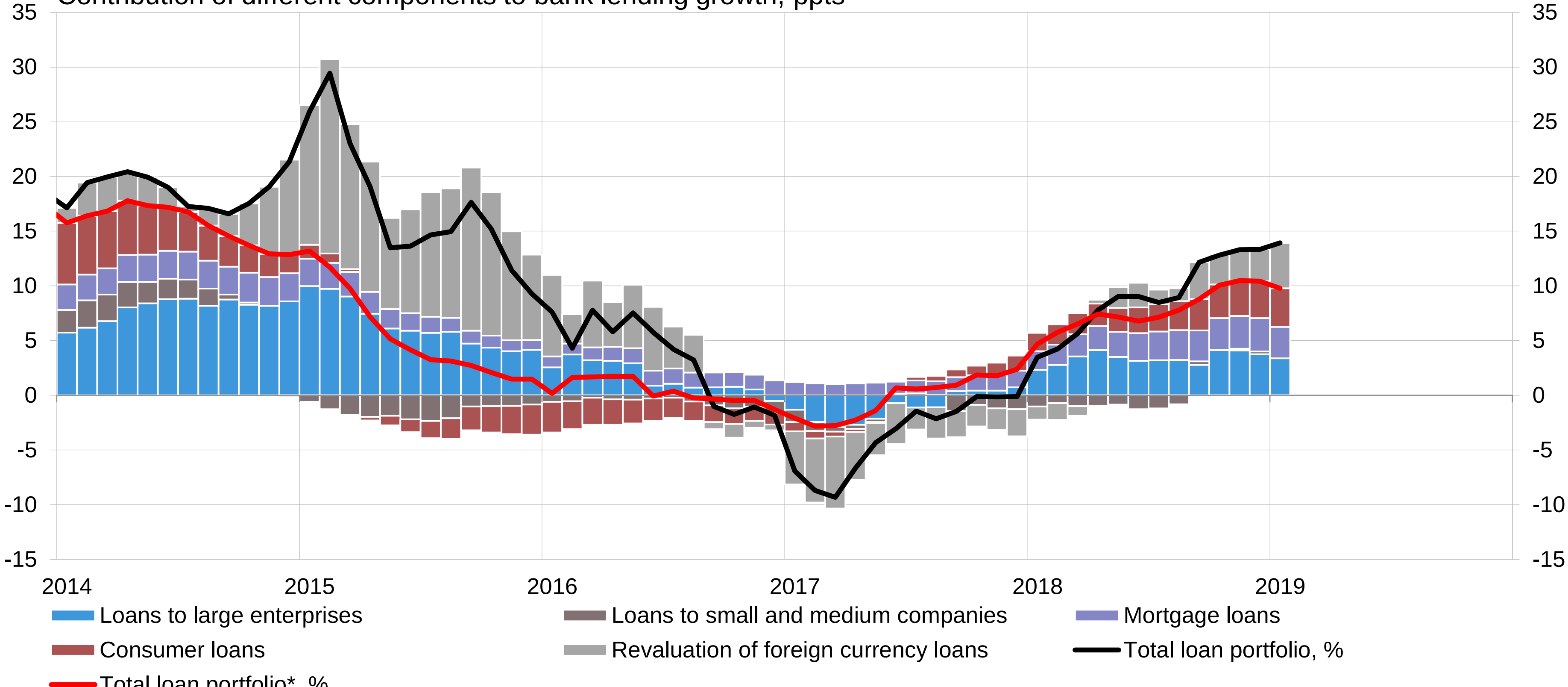


Sources: Rosstat, Bank of Russia etc.

Deposit and credit market – lending

Lending growth is still ongoing, both for retail and corporate lending. Though the growth rate has somewhat slowed down amid rising interest rates

Contribution of different components to bank lending growth, ppts



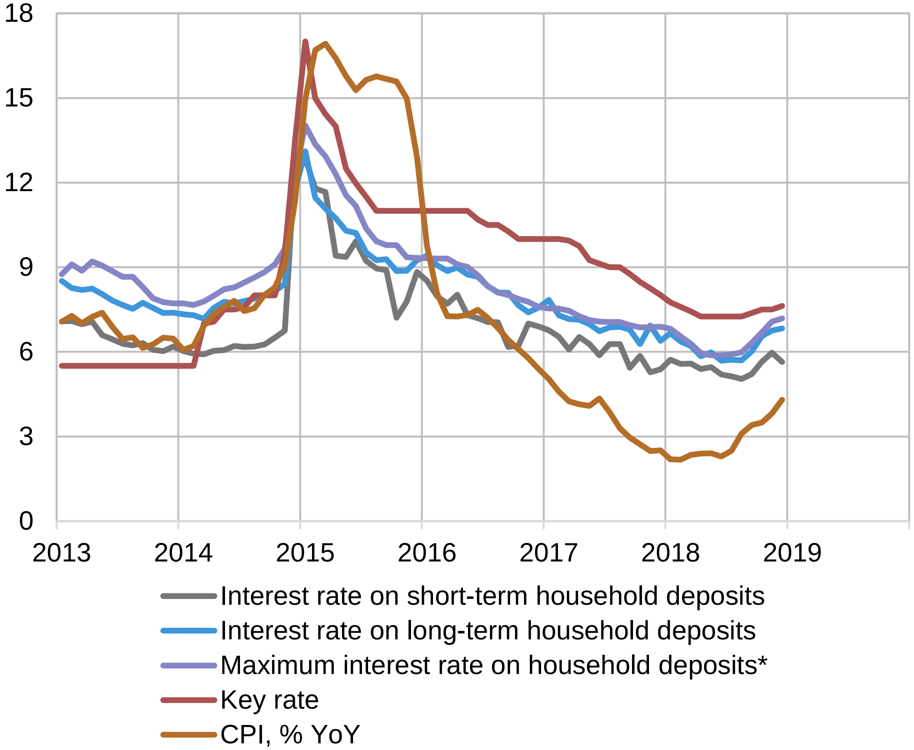
** Excluding foreign currency revaluation*

Source: Bank of Russia

Deposit and credit market – interest rates

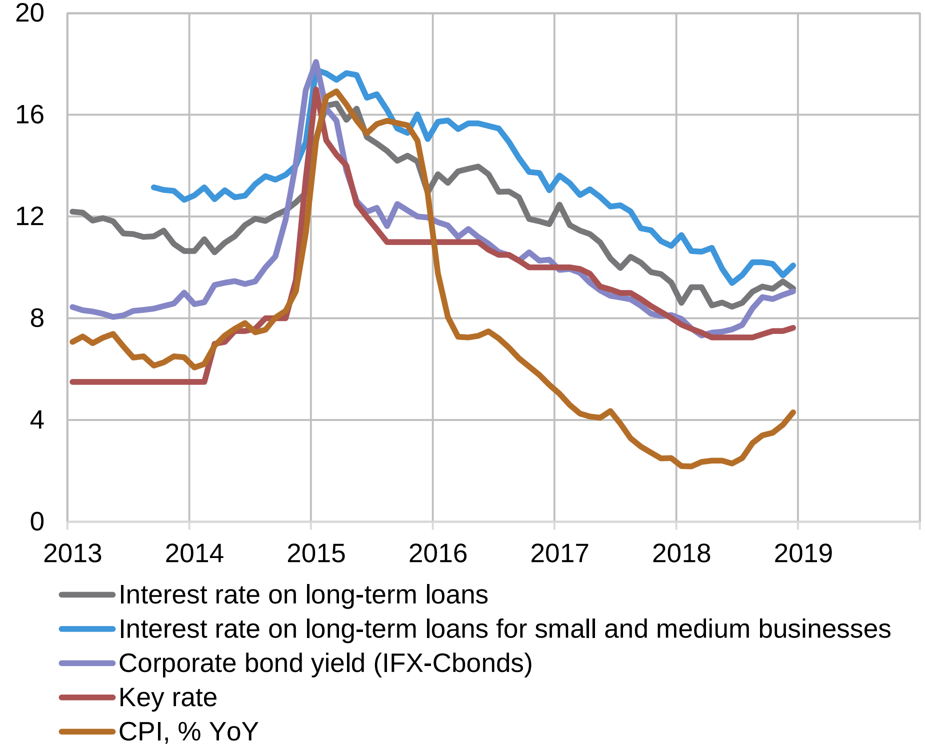
Interest rates in the deposit and credit market have risen slightly. Sustained positive real interest rates are set to support the attractiveness of bank deposits and bonds and balanced growth in consumption

The dynamics of interest rates on household ruble deposits, % per annum



** Monetary policy department calculations*

The dynamics of interest rates on corporate loans in rubles, % per annum

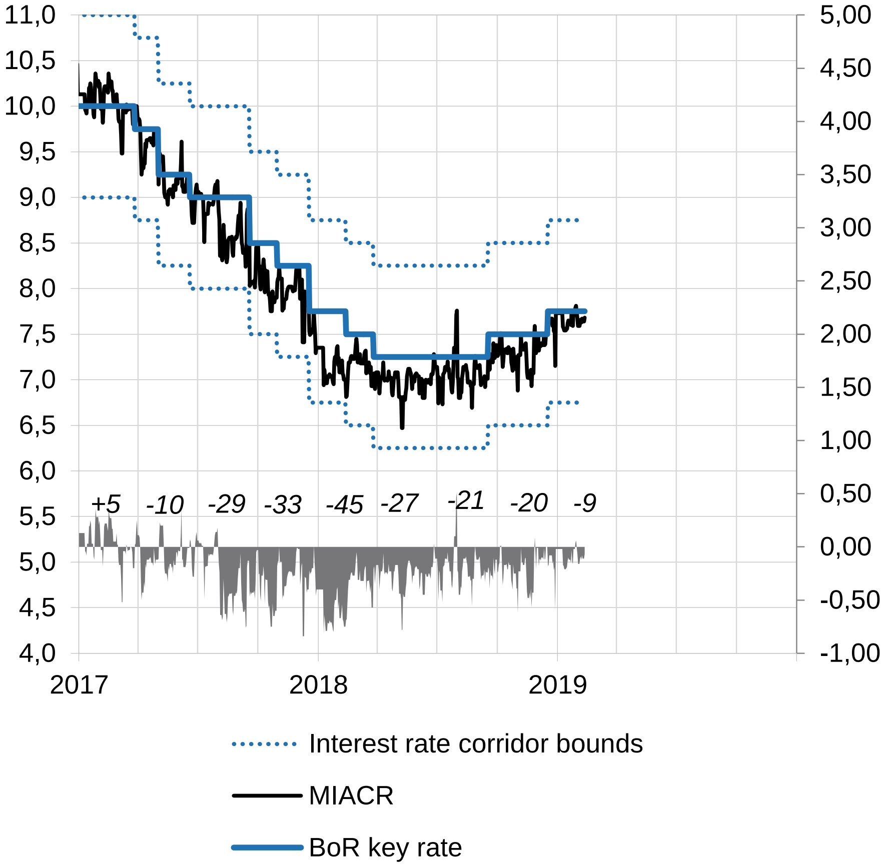


Source: Bank of Russia

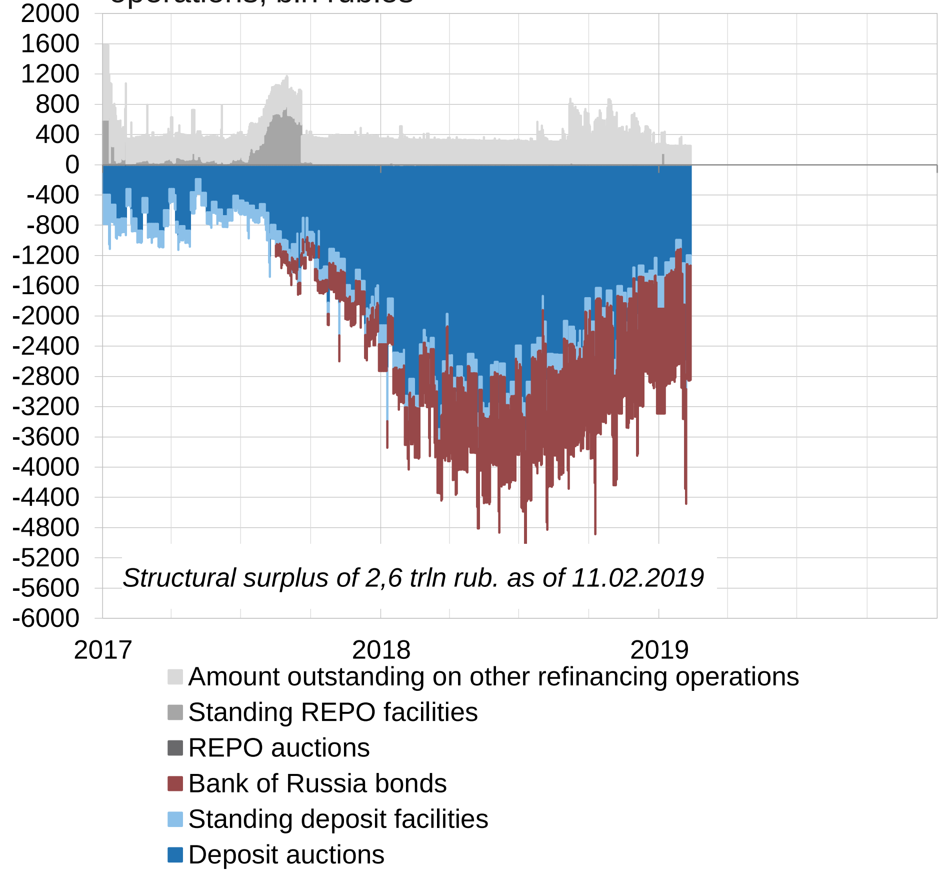
Money market conditions

In the light of the persistent structural surplus MIACR remains moderately below the key rate. In Q4 2018 the spread averaged at -20 bps. In Q1 2019 the average spread so far is -9 bps, which is the least deviation from the key rate since Q2 2017

The dynamics of the key rate and MIACR, % p.a.



The structure of Bank of Russia's liquidity management operations, bln rubles



Source: Bank of Russia

Monetary policy and inflation around the globe (1)

Analysts are expecting policy rate cuts in particular EM (Mexico, Turkey). Inflationary pressure in DM has fallen due to lower oil prices

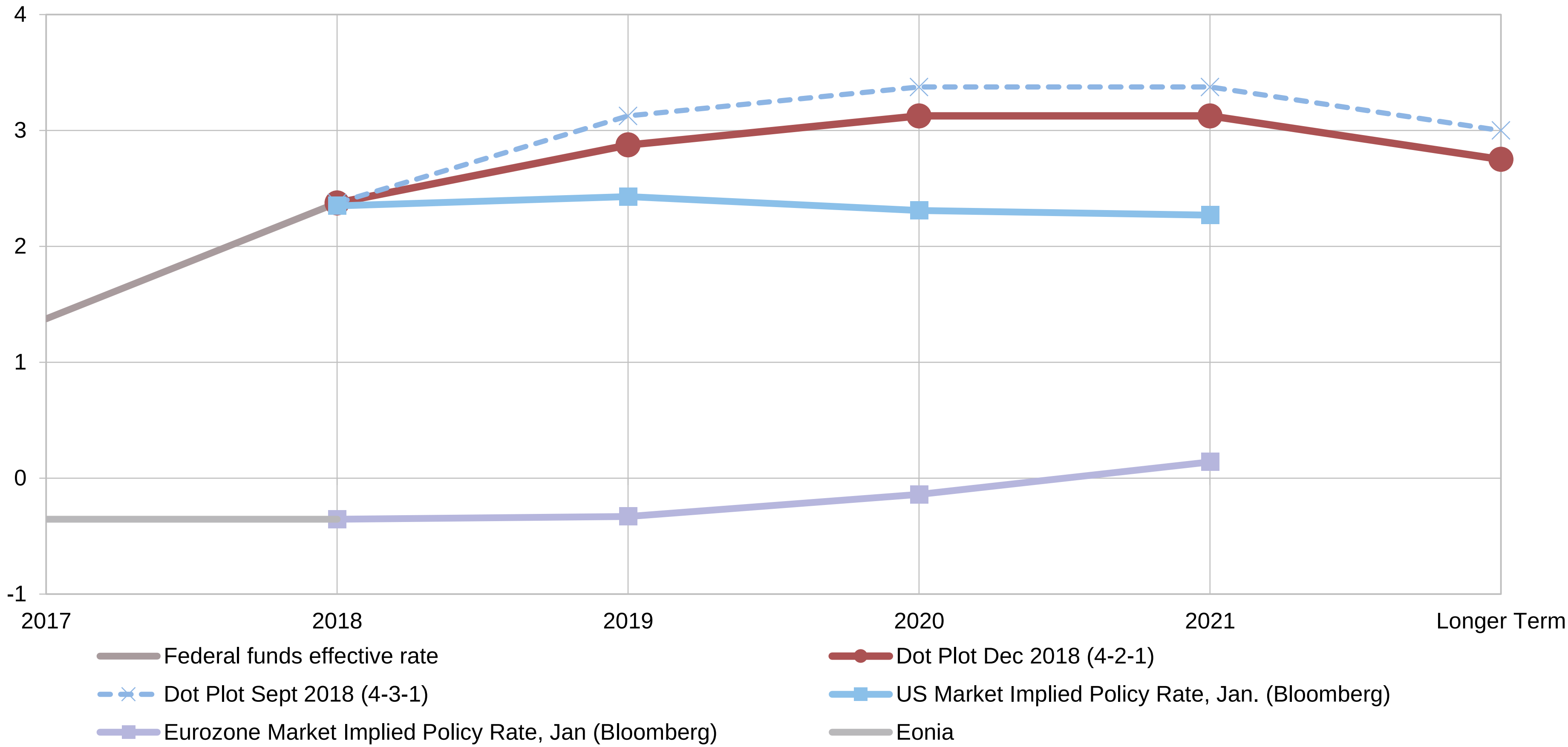
	Current situation				Analysts' expectations				
	21.01.2019	Δ 6M (bps)	**Dec.2018**	Δ 6M (ppts)	**Q1 2020**	Δ to the current rate (bps)	**Q1 2020**	Δ to current inflation (ppts)	Rise is expected (↑) / Reduction is expected (↓)
	Interest rate		***Inflation (YoY)***		**Interest rate**		***Inflation (YoY)***		
Developed economies									
USA (upper bound)	**2.50%**	**(+50)**	1.9%	(-100)	**2.90%**	**(+40)**	2.3%	(+40)	↑
Canada	**1.75%**	**(+25)**	2.0%	(-50)	**2.25%**	**(+50)**	2.2%	(-20)	↑
United Kingdom	**0.75%**	**(+25)**	2.1%	(-30)	**1.20%**	**(+45)**	2.0%	(-10)	↑
Norway (Deposit Rate)	**0.75%**	**(+25)**	3.5%	(+90)	**1.40%**	**(+65)**	2.1%	(-140)	↑
Eurozone (Main refinancing rate)	**0.00%**	**(-)**	1.6%	(-40)	**0.20%**	**(+20)**	1.5%	(-10)	↑
Japan (Target rate)	**-0.10%**	**(-)**	0.3%	(-40)	**0.00%**	**(+10)**	1.9%	(+160)	↑
Australia	**1.50%**	**(-)**	1.9%	(-)	**1.65%**	**(+15)**	2.3%	(+40)	↑
Switzerland	**-0.75%**	**(-)**	0.7%	(-40)	**-0.45%**	**(+30)**	1.0%	(+30)	↑
Developing economies									
Аргентина (LELIQ 7-D Notes Rate)	**57,25%**	**(+1725)**	47,6%	(+1813)	**31,35%**	**(-2590)**	24,9%	(-2270)	↓
Турция	**24,00%**	**(+625)**	20,3%	(+491)	**18,15%**	**(-585)**	13,9%	(-640)	↓
Индонезия	**6,00%**	**(+75)**	3,1%	(-)	**6,35%**	**(+35)**	3,9%	(+80)	↑
Мексика	**8,25%**	**(+50)**	4,8%	(+20)	**7,75%**	**(-50)**	3,8%	(-100)	↓
Индия (Repo Rate)	**6,50%**	**(+25)**	2,2%	(-270)	**6,55%**	**(+05)**	4,6%	(+240)	↑
ЮАР	**6,75%**	**(+25)**	5,2%	(+80)	**7,05%**	**(+30)**	5,4%	(+20)	↑
Чили	**2,75%**	**(+25)**	2,8%	(+80)	**3,80%**	**(+95)**	2,9%	(+10)	↑
Южная Корея	**1,75%**	**(+25)**	2,0%	(+50)	**1,90%**	**(+15)**	1,8%	(-20)	↑
Китай (Lending Rate)	**4,35%**	**(-)**	2,2%	(+40)	**4,30%**	**(-05)**	2,4%	(+20)	↓
Бразилия	**6,50%**	**(-)**	4,1%	(+120)	**7,55%**	**(+105)**	4,1%	(-)	↑
Польша	**1,50%**	**(-)**	1,3%	(-40)	**1,65%**	**(+15)**	2,4%	(+110)	↑
Тайвань	**1,38%**	**(-)**	0,3%	(-144)	**1,40%**	**(+02)**	1,2%	(+90)	↑

Inflation data for South Africa, Chile, South Korea, China, Brazil and Poland is as of November 2018. For Australia – as of Q3 2018.

Source: Bloomberg

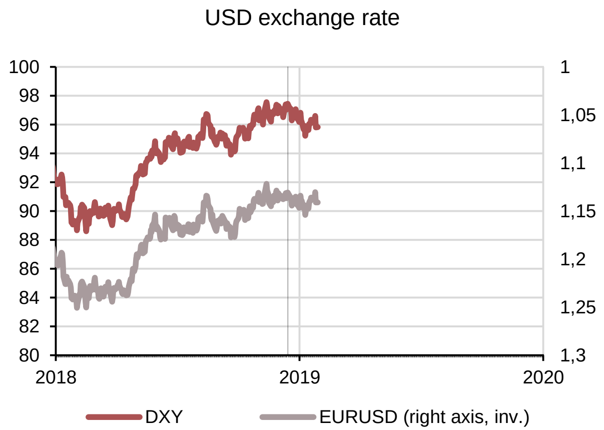
Monetary policy and inflation around the globe (2)

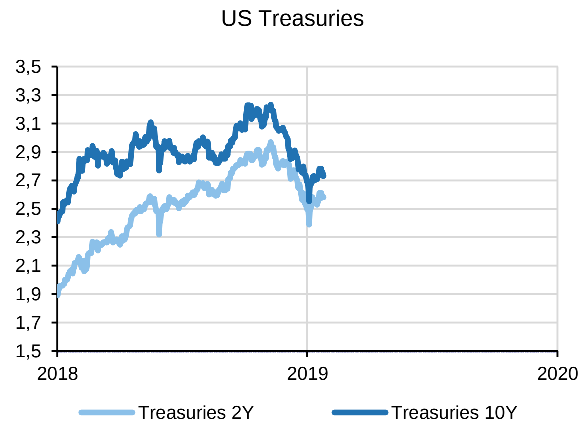
The revisions of the expected paths of monetary policy tightening by the US Federal Reserve and other central banks in developed markets reduce the risks of persistent capital outflows from emerging markets

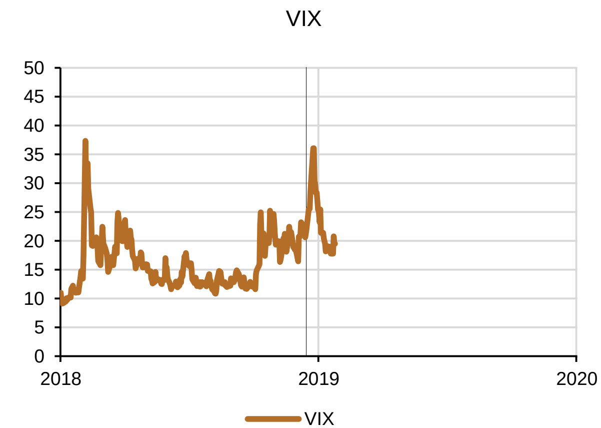


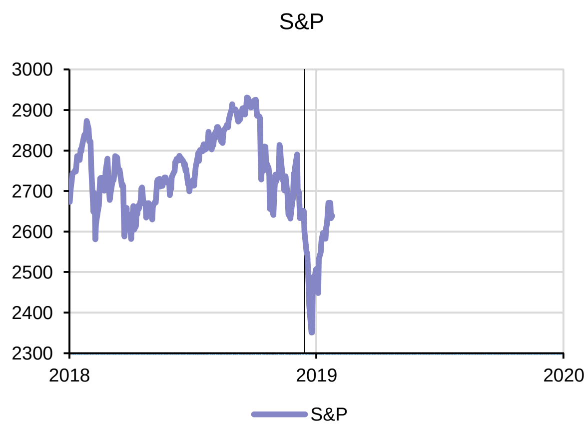
Financial markets – global

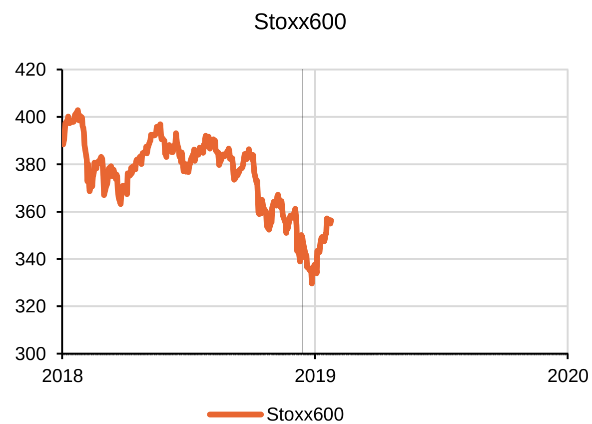
Equity market volatility has abated, which has restored the global demand for risk











Source: Reuters

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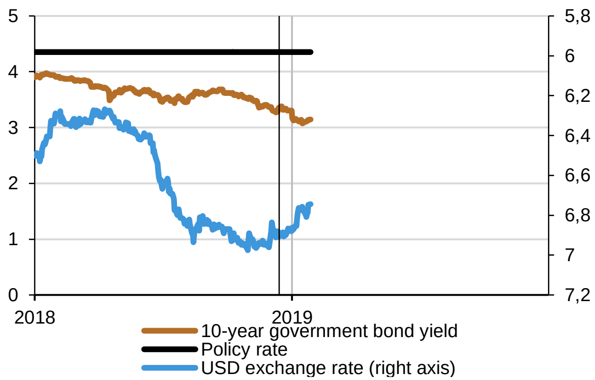
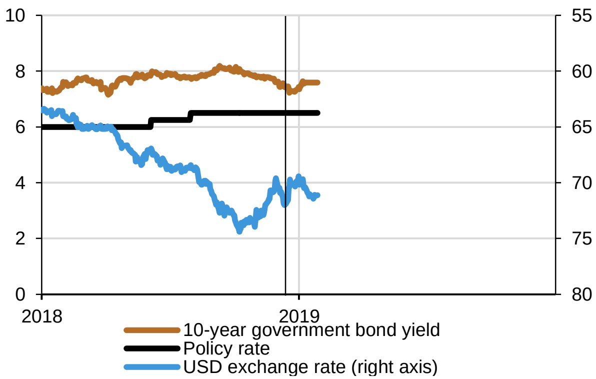
Financial markets – selected EM countries

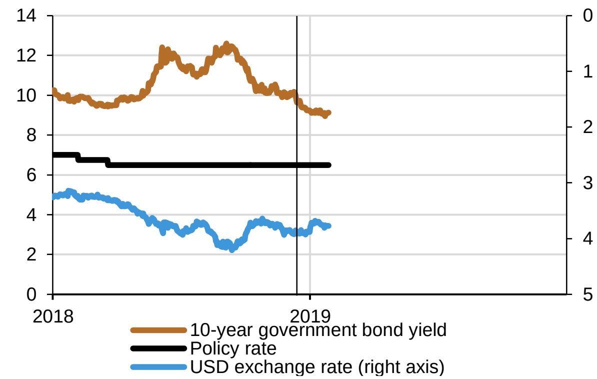
China



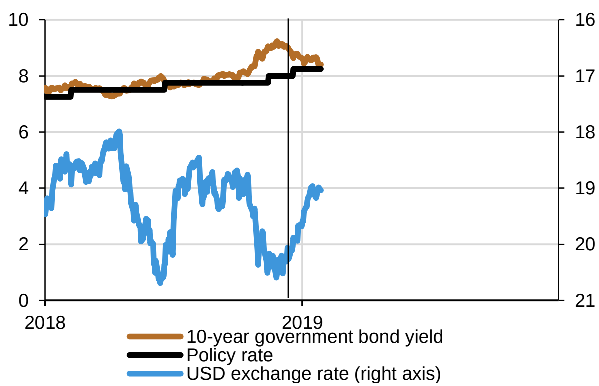
India



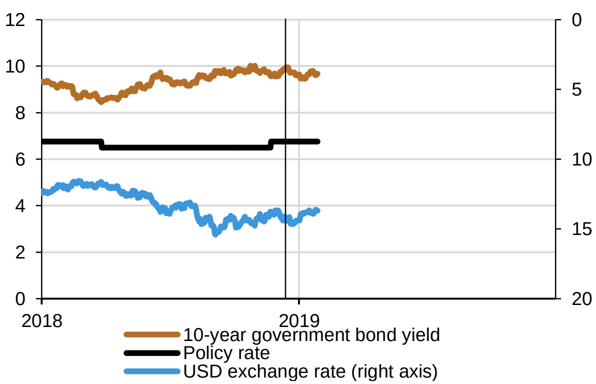
Brazil



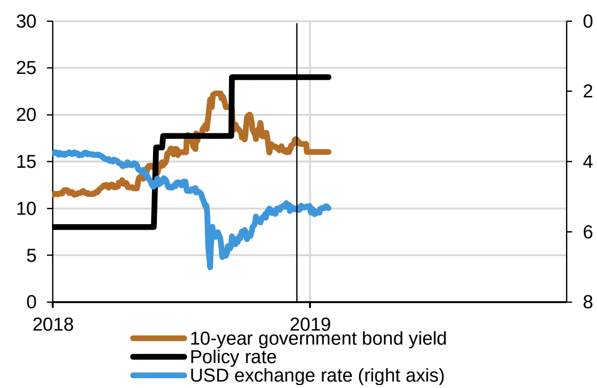
Mexico



South Africa



Turkey



Source: Bloomberg

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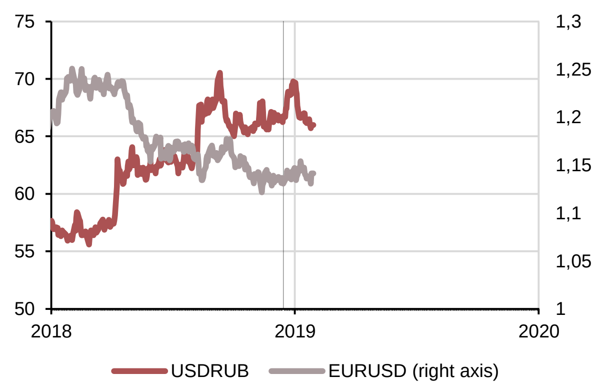
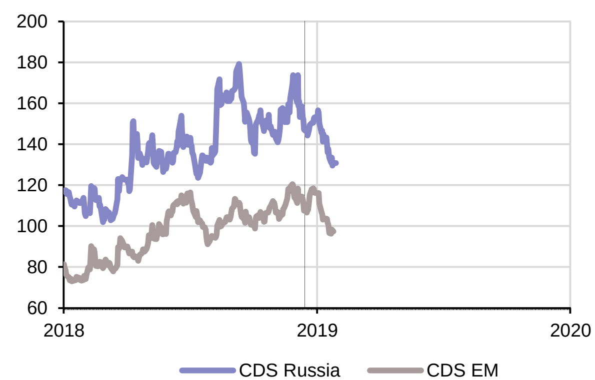
Oil and Russian financial markets

Improved risk appetite and oil price growth have contributed to a decrease in CDS, ruble strengthening and stock market growth

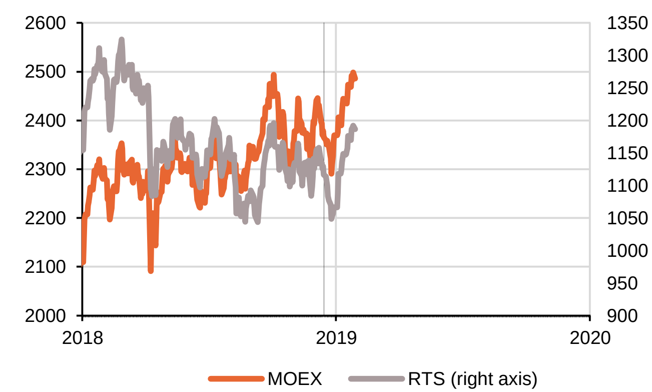
Exchange rate



CDS

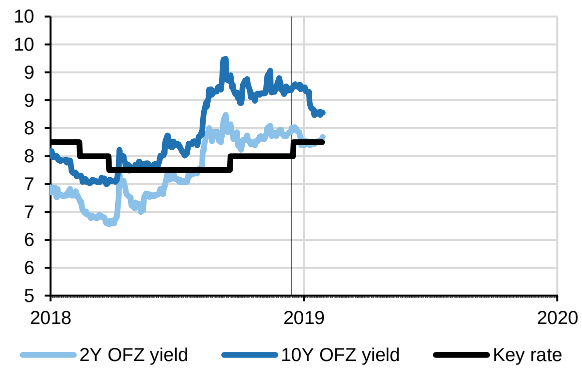


Equity indexes

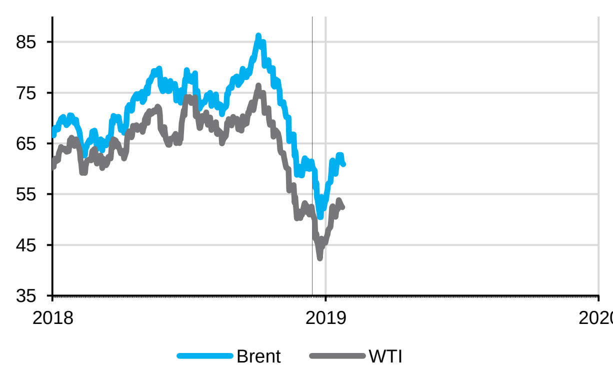


3M ruble volatility

OFZ yields



Oil price

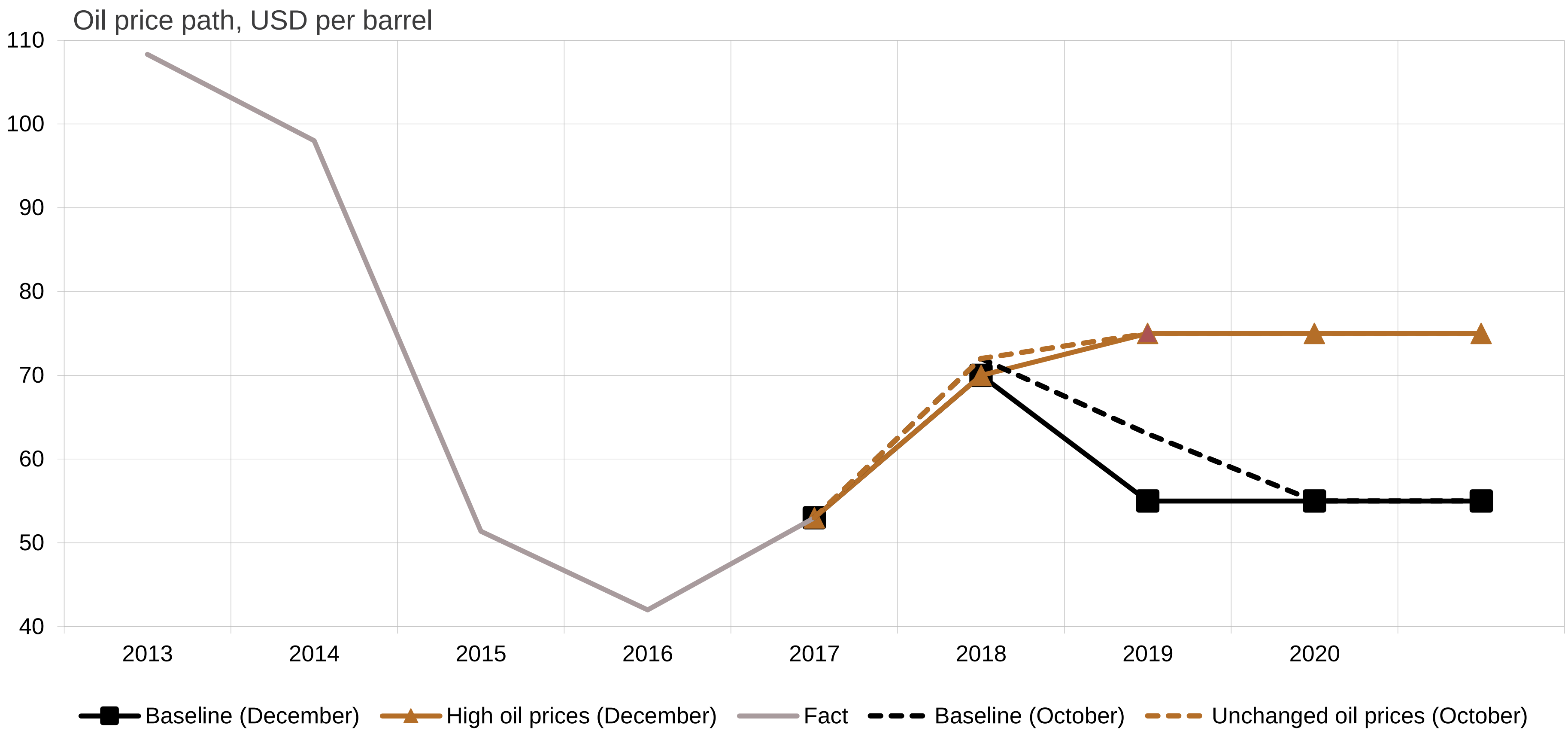


Sources: Reuters, Bloomberg, Bank of Russia calculations

| *- 14.12.18 Bank of Russia's Board meeting*

Oil price assumptions

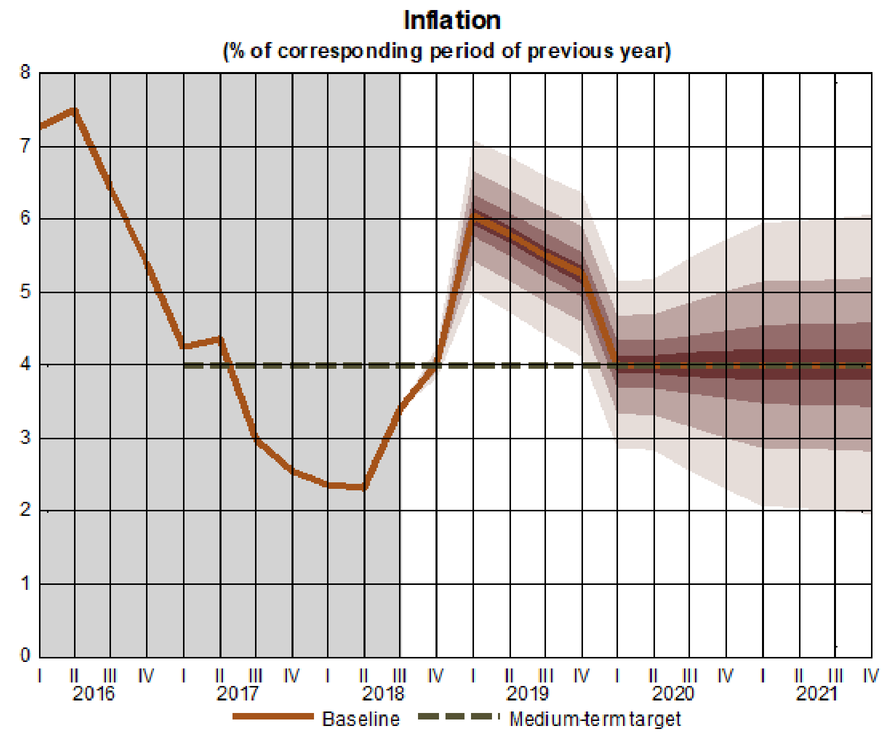
The baseline projection assumes faster convergence to the longer-term steadystate; now at $55/bbl for Urals in 2019 and onwards (October forecast: 63-55-55)



Source: Monetary policy report №4 (December 2018)

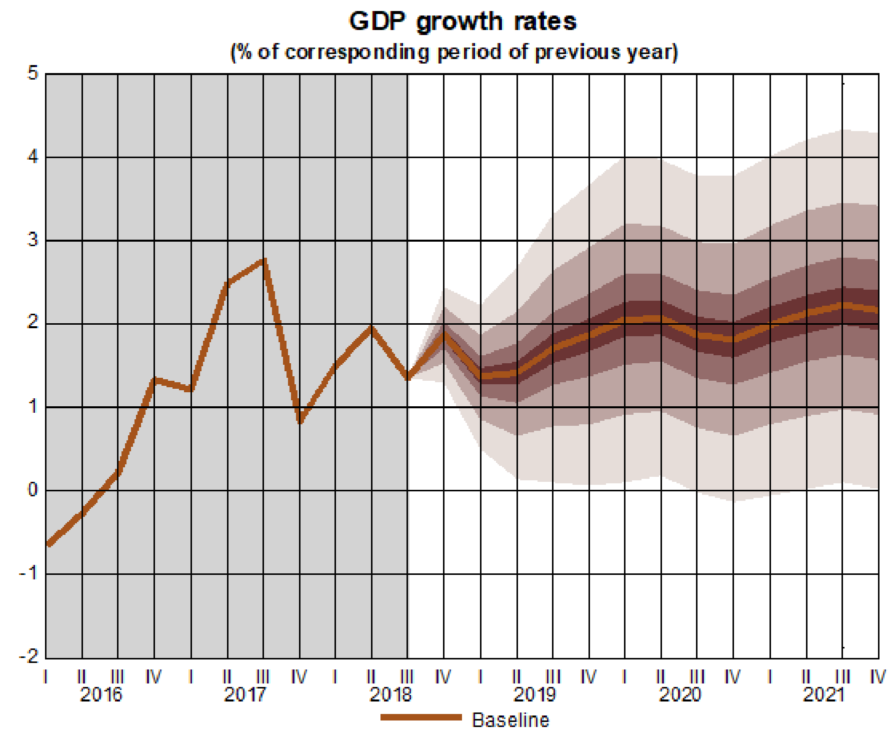
Bank of Russia's baseline scenario (December 2018)

Annual inflation will slow down to 4% in the first half of 2020 when the effects of the ruble's weakening and the VAT rise peter out



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

Higher potential growth rates in 2020-2021 if the planned fiscal and structural measures are successfully implemented



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

Source: Monetary policy report №4 (December 2018)

Bank of Russia's baseline scenario (December 2018) – details

Increase compared to the previous period in % (unless noted otherwise)	2017 (fact/ estimate)	2018	2019	2020	2021
		Baseline*			
Urals price (average for year), USD per barrel	53	70	55	55	55
Inflation in December compared to previous December, %	2.5	3.9-4.2	5.0-5.5	4.0	4.0
Inflation (average for year) compared to the previous year, %	3.5	2.8-2.9	5.0-5.5	4.0	4.0
GDP**	1.8	1.5-2.0	1.2-1.7	1.8-2.3	2.0-3.0
Final consumption expenditures	2.5	2.0-2.5	1.0-1.5	1.5-2.0	*2.0-2.5*
- of households	*3.3*	*2.5-3.0*	*1.0-1.5*	*1.5-2.0*	*2.5-3.0*
Gross capital formation	9.3	(-1.5-0.5)	1.5-2.5	2.5-3.5	*3.5-4.5*
- gross fixed capital formation	*4.9*	*1.5-2.0*	*1.8-2.3*	*3.0-3.5*	*3.5-4.5*
Exports	6.0	5.5-6.0	3.2-3.7	2.7-3.2	2.7-3.2
Imports	17.4	4.0-4.5	2.5-3.0	3.5-4.0	4.5-5.0
Money supply (using the national definition)	10.5	11-14	7-11	7-12	7-12
Lending to non-financial organisations and households, in roubles and foreign currencies***	8.2	12-14	7-11	7-12	*7-12*
- Lending to non-financial and financial organisations, in rubles and foreign currencies	*7.1*	*9-11*	*7-10*	*6-10*	*6-10*
- Lending to households, in rubles and foreign currencies	*12*	*21-24*	*12-17*	*10-15*	*10-15*

** Published in Monetary policy report №4 (December 2018)*
*** 2017 data – Bank of Russia estimate with Rosstat-revised industrial production data factored in*
**** Banking sector's lending to the economy is defined as all the claims of the banking sector to financial and non-financial organisations as well as households in Russian or foreign currency and precious metals, including loans provided (with overdue debt counting as well), overdue interest on loans, credit institutions' investment in equity and debt securities and promissory notes, any forms of participating in the equity of financial and non-financial organisations, and any other receivables for settlements with financial and non-financial organisations and households*

Bank of Russia's baseline scenario (December 2018) – balance of payments

USD billions	2017 (estimate)	Baseline*			
		2018	2019	2020	2021
Current account	**33**	**112**	**71**	**55**	**48**
Trade balance	115	191	154	143	139
Export	*354*	*441*	*400*	*405*	*416*
Import	*-238*	*-250*	*-246*	*-262*	*-277*
Balance of services	*-31*	-31	-33	-34	-36
Export	*58*	*65*	*61*	*62*	*64*
Import	*-89*	*-96*	*-94*	*-97*	*-100*
Balance of primary and secondary income	-51	-49	-51	-53	-55
Capital account	0	0	0	0	0
Financial transactions account (reserve assets excluded)	**-14**	**-72**	**-19**	**-11**	*-8*
Public administration and central banks	*13*	*-5*	*1*	*2*	*3*
Private sector	*-28*	*-67*	*-20*	*-13*	*-11*
Net errors and omissions	**4**	**0**	**0**	**0**	**0**
Change in FX reserves (+ is for decrease, - is for growth)	**-23**	**-39**	**-52**	**-44**	**-40**

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

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Monetary policy decision, 08 February 2019

Inflation and inflation expectations

- In January 2019, annual inflation held at the lower bound of the Bank of Russia expectations
- The contribution of the VAT increase to annual consumer price growth in January was moderate. The effect of the VAT increase on inflation can be fully captured no sooner than this April
- Prices are completing their adjustment to the ruble's weakening of the second half of 2018
- In January, price expectations of businesses increased on the back of the earlier weakening of the ruble and the VAT increase. Household inflation expectations rose only slightly
- The Bank of Russia forecasts annual inflation to range between 5.0 and 5.5% by the end of 2019 and return to 4% in the first half of 2020 when the effects of the ruble's weakening and the VAT rise peter out

Monetary conditions have seen no significant changes since the last Board meeting

Economic activity

- Rosstat's flash estimate shows that 2018 GDP growth totalled 2.3%, which exceeds the Bank of Russia's forecast of 1.5-2%
- However, recent months have seen slower growth in economic activity
- The Bank of Russia maintains its 2019 GDP growth forecast in the range of 1.2-1.7%.
- The newly received budgetary funds will be used to raise government spending including investment as early as 2019. Subsequent years might see higher economic growth rates as the planned structural measures are implemented.

The balance of risks remains skewed towards pro-inflationary risks, especially over a short-term horizon

- **The main risks**: (1) the effects of the VAT increase, (2) price movement in individual food products, (3) continuing uncertainty over future external conditions and their impact on financial asset prices, (4) high risks of supply exceeding demand in the oil market in 2019
- **Moderate risks** – estimates are mostly unchanged: (5) wage movements, (6) possible changes in consumer behavior, (7) budget expenditures

Decision

The Bank of Russia **keeps the key rate** at 7.75% p.a.

Signal

"…In its key rate decision-making, the Bank of Russia will determine if the increases of the key rate in September and December 2018 were sufficient to bring annual inflation back to the target in 2020, taking into account inflation and economic performance against the forecast, as well as the risks associated with external conditions and financial markets' response to them…"

Bank of Russia's FX operations related to the fiscal rule

On 14 December 2018 the Bank of Russia decided to **resume regular foreign currency purchases** in the domestic market as part of fiscal rule implementation **from 15 January 2019**.

The decision was made given the **stabilisation** in the domestic financial market.

On 25 January 2019 the Bank of Russia decided to commence **from 1 February 2019** the foreign currency purchases in the domestic market **that were postponed in 2018** as part of fiscal rule implementation.

The postponed purchases will be carried out **gradually in the 36 months since the launch of these operations**.

These operations will increase the daily amount of foreign currency purchases in the domestic market under the fiscal rule **by 2.8 billion rubles**.

The Bank of Russia reserves the right to suspend foreign currency purchases in the domestic market under the fiscal rule **in the event of financial stability threats**.

Source: Press release «On fiscal rule-based operations» as of 14.12.2018 and «On postponed foreign currency purchases under the fiscal rule» as of 25.01.2019