Bank of Russia

SEPTEMBER 2019

MONETARY POLICY REPORT

16 September 2019

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STATEMENT BY BANK OF RUSSIA GOVERNOR ELVIRA NABIULLINA

in follow-up to Board of Directors meeting 6 September 2019

Today, the Board of Directors has decided to reduce the key rate to 7% p.a.

If economic conditions are in line with our forecast, we will look into further key rate reduction at one of the upcoming meetings.

Let me dwell on the main factors behind the decision.

First. *Annual inflation has already approached 4%. Our estimates suggest that as of the year-end it will fall within the range of 4.0-4.5%. Meanwhile, inflation is forecast to stand at 3.5-4.0% in the opening months of next year. This is largely associated with the fact that the VAT rate increase will be factored out from the calculation of annual inflation. This may be considered as a purely technical factor. Sustainable trends point to inflation of about 4%.*

Second. *Inflation expectations of households and businesses remain elevated. Therefore, we stay focused on their dynamics.*

Right now, I will not highlight the figures we released last week. However, I would like to note that previously we abstained from posting the results of surveys on household inflation expectations during 'the week of silence'. We have discussed this issue and from now on we will publish these data as soon as they are released. It is essential that the market promptly receives the information which the Board of Directors consults when making its decision. The Bank of Russia will continue to publish its analytical commentary that summarises and estimates expectations of households, businesses and analysts, after 'the week of silence'.

Third. *Monetary conditions are continuing to loosen. We expect that both previous and today's key rate decisions will underpin this trend.*

Market expectations for interest rates shifted downwards on the back of the signals in the follow-up to the Board meetings in June and July. This was also driven by the shifting expectations for monetary policies of the US Fed and the ECB as the economic growth outlook for the US and euro area deteriorated.

The decline in interest rates comes with an easing of non-price lending conditions in terms of maturities and volumes. The easing of both price and non-price monetary conditions *contributes to expansion in lending. According to our estimates, corporate lending will rise by 7-10% while retail lending will increase by 15-20% this year.*

Fourth. *Economic activity undershot the Bank of Russia's expectations in the second and early third quarters. This results from internal and external factors. This made us revise our 2019 GDP growth forecast from 1.0-1.5% to 0.8-1.3%.*

An important external factor is a slowdown in growth of the global economy, which has proven more tangible than expected due to, among other things, the growing contradictions in international trade. A weakening in domestic demand already reduced export quantities in the first half of the year, and we forecast that they will contract for a wide range of goods as of the year-end.

The deterioration in the global growth outlook also affects investment plans. Though, certainly, business sentiment depends not only on external factors but also on the business environment as a whole. In the first half of the year, growth in fixed capital investment slowed considerably, which is associated with, among other things, a rather sizeable drop in public investment. According to our estimates, even with a revival in national project expenditures in the second half of the year factored in, total growth of gross fixed capital formation will come in at no higher than 1% as of the year-end.

Consumer demand continues to make a positive contribution to GDP growth. This year, the expansion of lending continues to offer strong support to consumption growth. Loans, however, cannot be the main driver of growth in demand. Consumption growth will remain slack as household incomes stagnate. This year, we expect it to come in at 1-1.5% range.

We have also updated our medium-term baseline forecast. Now, we expect the dynamics of domestic and external demand to be more moderate in 2020-2021. The most notable revision has been made for export growth rates. This reflects the deteriorated world economic outlook amid rising trade tensions.

As a result, we may only expect GDP growth to accelerate to 2-3% by the end of 2022, rather than in 2021. A higher economic growth rate should primarily be driven by the shift to a more extensive implementation of national projects and other governmental measures aimed at removing structural constraints. This will promote an increase in investment demand and a quicker rise in labour productivity, household income and, accordingly, consumption.

Lending will sustainably expand over the entire forecast horizon supporting economic growth. Corporate lending will annually increase at a pace of 6-10%, and household lending will grow by 10-15% each year. Mortgage loans will account for the bulk of household lending growth. Meanwhile, macroprudential measures will gradually reduce the growth pace of consumer lending.

We have updated the balance of payments to factor in the world economy dynamics, prices for oil and other Russian exports. We assume a gradual decline in oil prices to 50 US dollars per barrel in 2021 (as compared to 55 US dollars considered earlier). If external demand weakens, prices for other Russian exports will drop, too. In such conditions, the current account balance will shrink from 83 billion US dollars (5% of GDP) this year to 28 billion US dollars (which is about 2% of GDP) in 2022.

Given the actual dynamics observed since the beginning of the year, we have also slightly lowered the 2019 forecast for the private sector's financial account balance from 50 to 40 billion US dollars. Later on, it is expected to gradually reduce to 20 billion US dollars by the end of 2022. I would like to emphasise once again that the fiscal rule mechanism smooths *out the impact of a decrease in the current account balance on the domestic economic environment. However, it only pertains to oil price fluctuations.*

I would like to stress that we have slightly changed our approach to publishing forecast scenarios. The key rate decision relies on our baseline macroeconomic forecast and the analysis of uncertainties and risks for the baseline forecast. This is the reason why we will continue to publish the baseline scenario four times a year in our press releases and Monetary Policy Report following core meetings.

We will release our supplementary scenarios – the high oil price scenario and the risk scenario that assumes that prices will plunge – in the same manner as the baseline scenario but once a year, in the Monetary Policy Guidelines. It is determined by the essence of these scenarios that remains almost unchanged across the meetings. The 2020-2022 Guidelines will be published on Monday.[1]

Winding up, I would like to comment on monetary policy prospects.

After the five years of the evolution from tight to moderately tight and then to neutral monetary policy, we have finally entered the key rate range we consider as a probable neutral interval. Given today's decision, the key rate is at the top of this range equalling from 6% to 7% in nominal terms, or from 2% to 3% in real terms, which is the same, with inflation expected to reach 4%.

In this regard, it is of note that the neutral key rate estimate is not 'a point', but a range of values. It depends on various domestic and global drivers, as well as the monetary policy transmission mechanism, and may alter, being affected by them. It will therefore take time to 'feel' the thresholds of this 'neutral range' and make sure that they are in line with our current estimates. If necessary, we will adjust these estimates.

A sustainable inflation rate close to the 4% target will be the key criterion suggesting that we are right in our estimates of this range.

Bank of Russia Governor ***Elvira Nabiullina***

[1] *The draft of the Monetary Policy Guidelines for 2020-2022 as of 06.09.2019 was published on the official web-site of the Bank of Russia on 9 September, 2019. The draft as of 27.09.2019 is available at http://cbr.ru/Content/Document/File/79959/on_2020_eng.pdf.*

BANK OF RUSSIA'S MEDIUM-TERM FORECAST[1]

IN THE FOLLOW-UP TO THE BOARD OF DIRECTORS KEY RATE MEETING ON 6 SEPTEMBER 2019

KEY PARAMETERS OF THE BANK OF RUSSIA'S FORECAST UNDER THE BASELINE SCENARIO *Table 1*
(growth as % of previous year, unless indicated otherwise)

	2018 (actual)	Baseline			
		2019	2020	2021	2022
Urals price, average for the year, US dollars per barrel	69.8	63	55	50	50
Inflation, as % in December year-on-year	4.3	4.0–4.5	4.0	4.0	4.0
Inflation, average for the year, as % year-on-year	2.9	4.6–4.8	4.0	4.0	4.0
Gross domestic product	2.3	0.8–1.3	1.5–2.0	1.5–2.5	2.0–3.0
Final consumption expenditure	1.8	1.0–1.5	1.5–2.0	1.5–2.0	1.8–2.3
– households	*2.3*	*1.0–1.5*	*2.0–2.5*	*2.0–2.5*	*2.0–2.5*
Gross capital formation	0.8	0.0–1.0	3.5–4.5	3.5–4.5	2.5–3.5
– gross fixed capital formation	*2.9*	*0.0–1.0*	*3.5–4.5*	*3.5–4.5*	*2.5–3.5*
Exports	5.5	-(0.3–0.8)	2.0–2.5	2.0–2.5	2.5–3.0
Imports	2.7	-(0.3) – 0.2	3.0–3.5	3.5–4.0	2.5–3.0
Money supply in national definition	11.0	8–12	7–12	7–12	7–12
Banking system claims on the economy in rubles and foreign currency*	11.5	8–12	7–12	7–12	7–12
– corporates, annual growth, %	*8.4*	*7–10*	*6–10*	*6–10*	*6–10*
– households, annual growth, %	*22.0*	*15–20*	*10–15*	*10–15*	*10–15*

* *Banking sector claims on the economy mean all claims of the banking system on non-financial organisations and financial institutions and households in the currency of the Russian Federation, foreign currency, and precious metals, including loans extended (including overdue loans), overdue interest on loans, investments of credit institutions in debt and equity securities and promissory notes, other forms of stakeholding in the capital of non-financial organisations and financial institutions, and other receivables under settlement operations with non-financial organisations and financial institutions and households.*
Source: Bank of Russia.

RUSSIA'S BALANCE OF PAYMENTS INDICATORS UNDER THE BASELINE SCENARIO* *Table 2*
(billions of US dollars)

	2018 (actual)	Baseline			
		2019	2020	2021	2022
Current account	**113**	**83**	**56**	**39**	**28**
Balance of trade	194	166	141	126	120
Exports	*443*	*415*	*395*	*389*	*396*
Imports	*249*	*249*	*254*	*263*	*276*
Balance of services	-30	-31	-34	-36	-39
Exports	*65*	*64*	*63*	*65*	*67*
Imports	*95*	*95*	*97*	*101*	*106*
Primary and secondary income account	-51	-52	-51	-52	-53
Current and capital account balance	**112**	**83**	**56**	**39**	**28**
Financial account (net of reserve assets)	**77**	**20**	**19**	**14**	**14**
General government and the central bank	9	-20	-6	-6	-6
Private sector	68	40	25	20	20
Net errors and omissions	**2**	**-3**	**0**	**0**	**0**
Change in FX reserves ('+' is increase, '-' is decrease)	**38**	**60**	**37**	**25**	**14**

* *As per the 6th edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6). In financial account, '+' denotes net lending and '-' denotes net borrowing. Final values may differ from the total of the respective values due to rounding.*
Source: Bank of Russia.

[1] *The Bank of Russia's forecast under the supplementary scenarios (high oil price and risk) were published in the Monetary Policy Guidelines for 2020-2022 (draft as of 06.09.2019), http://www.cbr.ru/Content/Document/File/79959/on_2020_eng.pdf.*

1. ECONOMIC OUTLOOK

In the baseline scenario, the Bank of Russia has revised downwards its assumptions regarding world economy growth rates and global oil price paths over the mid-term forecast horizon as compared to the Monetary Policy Report published on 24 June 2019. This was largely associated with the deterioration of the situation in the global economy and increasing expectations of a further tightening of the foreign trade restrictions affecting business, investment and consumer sentiment worldwide.

Given the current situation in the Russian economy, including domestic consumer price dynamics, the Bank of Russia has lowered its annual inflation forecast for the end of 2019 in the baseline scenario as compared to the June figures. Under the baseline scenario, annual inflation is expected to be 4.0–4.5% as of the end of 2019 and will stay close to 4% later on. This will be primarily facilitated by the Bank of Russia's monetary policy.

The Bank of Russia has also decreased its GDP growth forecast for 2019–2021. Taking into account the weak economic activity observed since the beginning of this year, growth of the Russian economy will come in at 0.8–1.3% in 2019. Economic activity dynamics in 2019 will be restrained by a weak external demand and a slower than expected implementation of a range of national projects planned by the Russian Government. The 2020–2021 forecast of the Russian economy growth rates has been revised downwards due to a greater slowdown in the world economy than it was earlier assumed in the baseline scenario. However, economic growth in 2020–2022 will be supported by a positive effect gradually accumulating as a result of the measures implemented by the Government to overcome the structural constraints in the Russian economy, including owing to the successful completion of national projects. As a result, GDP growth will gradually speed up to 2.0–3.0% by 2022. The Bank of Russia assumes that the positive contribution of the planned state policy measures to economic growth acceleration will not be accompanied by additional pressure on inflation if there is an adequate expansion in the production capacity of the Russian economy.

The main uncertainties in the baseline scenario over the forecast horizon involve both external and internal factors. The Bank of Russia estimates that there is a balance between disinflationary and pro-inflationary risks until the end of 2019. Disinflationary factors are primarily related to the weak dynamics of domestic and external demand. However, in case of a more significant slowdown in the world economy, including due to the tightening foreign trade restrictions and other geopolitical factors, volatility in global commodity and financial markets may increase, affecting exchange rate and inflation expectations.

As to internal factors, a considerable risk is posed by elevated and unanchored inflation expectations. Mid-term inflation dynamics may also be affected by the fiscal policy parameters, including the Government's decisions on the use of the liquid part of the National Wealth Fund in excess of the threshold level set at 7% of GDP.

The Bank of Russia's estimates of risks related to dynamics of wages and prices for individual food products and possible changes in consumer behaviour remained almost unchanged. These risks are still moderate.

1.1. BASELINE SCENARIO1

FORECAST ASSUMPTIONS

Global economic growth. Given the slowdown in the global economy observed since the second half of 2018, the Bank of Russia assumes in its baseline scenario that global economic growth will continue to decelerate over the medium-term forecast horizon (Chart 1.1.1). The forecast suggests that the slowdown in the global economy during the period of 2019–2022 will be mainly related to the continuing expectations of further tightening of the foreign trade restrictions, which affect business, investment and consumer sentiment worldwide. Against this background, the baseline scenario assumes a transition to a later phase of the economic cycle in the USA, the preservation of moderate economic activity in the euro area, and a smooth slowdown in China's economy that will be mainly structural in nature.

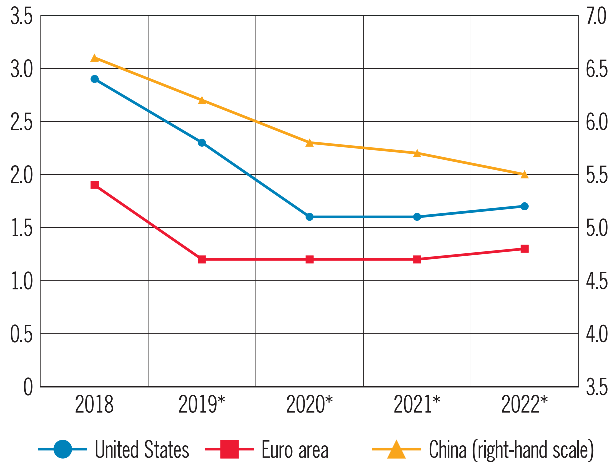
Oil prices. The Bank of Russia's baseline scenario assumes that the Urals crude oil price will gradually drop to $50 per barrel by early 2021 and remain close to this level further on (Chart 1.1.2). Thus, the average oil price in the baseline scenario will amount to $63 per barrel in 2019, will decline to $55 per barrel in 2020 and stay at the level of $50 per barrel in 2021–2022.

This trajectory is based on the assumptions that global economic growth will gradually slow down and that supply in the oil market will be slightly above demand throughout the forecast horizon, including due to a significant increase in oil production outside OPEC+ countries. Yet, oil prices in 2019–2020 will be supported by the continuing expectations of a decrease in oil production and exports from Iran and Venezuela amid political tensions and by the extension of the OPEC+ agreement on crude oil production cuts until March 2020.

Inflation abroad. In its baseline scenario, the Bank of Russia assumes a gradual increase in

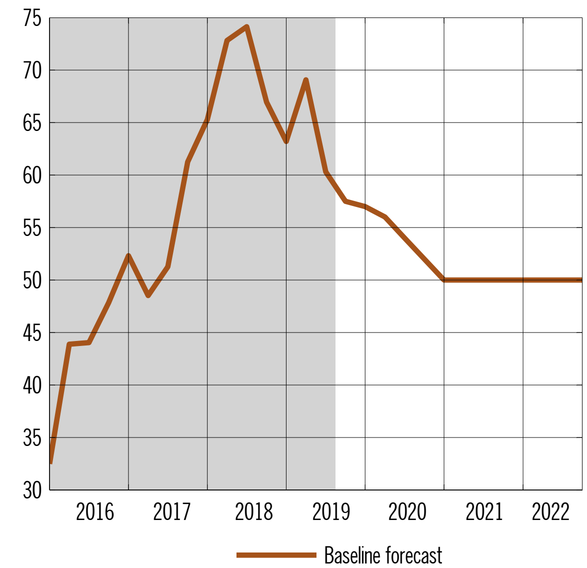
[1] *The description of the baseline scenario provided in this Monetary Policy Report is the same as the one published on 9 September 2019 in the draft Monetary Policy Guidelines for 2020–2022, except for the subsection on monetary policy that is, as before, included into Section 4 'Bank of Russia's Monetary Policy'.*

GDP GROWTH IN MAJOR ECONOMIES IN THE BASELINE SCENARIO *Chart 1.1.1*
(% growth, YoY)



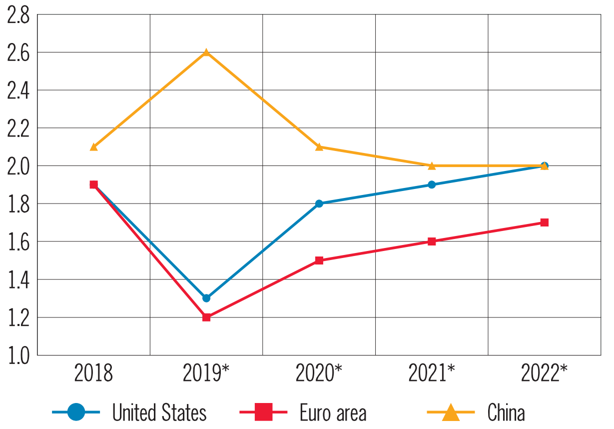
** Forecast.*
Source: Bank of Russia calculations.

OIL PRICE MOVEMENTS IN THE BASELINE SCENARIO *Chart 1.1.2*
(US dollars per barrel)



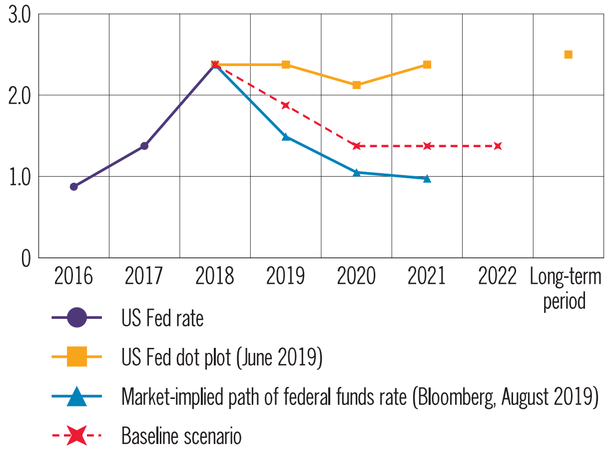
** Nominal prices for Urals crude oil.*
Source: Bank of Russia calculations.

INFLATION INDICATORS IN MAJOR ECONOMIES IN THE BASELINE SCENARIO *Chart 1.1.3*
(% change YoY, as of the end of the period)



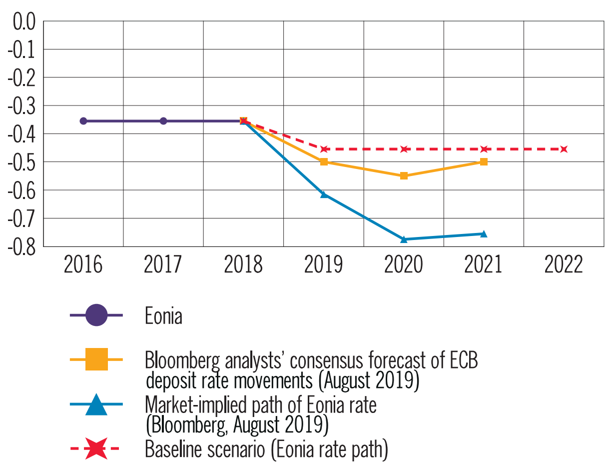
** Forecast.*
Note: PCE Price Index is forecast for the US, HICP – for the euro area, and CPI – for China.
Sources: Bank of Russia calculations, Bloomberg.

EXPECTED MOVEMENTS OF US FEDERAL FUNDS RATE *Chart 1.1.4*
(% p.a.)



Note: values are given as of the end of each period.
Sources: Bank of Russia calculations, the US Fed, Bloomberg.

EXPECTED PATHS OF INTEREST RATES IN THE EURO AREA *Chart 1.1.5*
(% p.a.)



Note: values are given as of the end of each period.
Sources: Bank of Russia calculations, Bloomberg.

inflation in advanced economies in 2020–2022 after its slowdown in 2019. Monetary policy of the US Fed and the ECB amid a slower growth of the global economy and declining oil prices will gradually bring inflation in the USA and the euro area closer to their targets. However, inflation in the USA and the euro area during this period will remain below the targets, given that in the baseline scenario the economic growth rates in the USA and the euro area will stay below potential in 2020–2021 and a decline in oil prices will contribute to a low inflationary pressure. In turn, the expected deceleration of China's economy in the baseline scenario will result in a gradual decrease of inflation in China and its stabilisation at a low level by the end of the forecast horizon (Chart 1.1.3).

Foreign central banks' monetary policies. In its baseline scenario, the Bank of Russia assumes that monetary policy in the USA and the euro area will loosen in 2019–2020 and that accommodative monetary policy will be pursued further on over the forecast horizon. Such interest rate path in the USA and the euro area factors in the July reduction of the US Fed base rate and the softening of the US Fed's and the ECB's rhetoric on monetary policy prospects in the context of the ongoing global economic slowdown; also, it is overall consistent with market participants' expectations. The Bank of Russia's baseline scenario provides for another reduction of the US Fed base rate by the end of 2019, two cuts in 2020 and its maintenance at a constant level in 2021–2022 (Chart 1.1.4). As for the interest rate path in the euro area, in its baseline scenario the Bank of Russia expects it to slightly decline in 2019 and hold in the future at the level achieved (Chart 1.1.5).

Global financial markets. In its baseline scenario, the Bank of Russia assumes that the US dollar will gradually weaken against the euro over the forecast horizon. Such dynamics of the US dollar against the euro reflect mainly the ratio of interest rate trajectories in the USA and the euro area forecast by the Bank of Russia in the baseline scenario. The easing of monetary conditions in 2019–2020 and their further maintenance in advanced economies will limit the risks of steady capital outflows from emerging market economies (EMEs).

The equilibrium country risk premium conjectured in the Bank of Russia's baseline scenario for EMEs in general and Russia in particular takes into account the actual dynamics of risk premiums since early 2019 and the assumptions regarding the external environment. The equilibrium risk premium for Russia is supposed to be slightly higher than for EMEs in general, primarily due to geopolitical factors.

Geopolitical factors. In its baseline scenario, the Bank of Russia expects that the international sanctions imposed on Russia in 2014–2019 will hold over the entire forecast horizon. This involves instituting a country risk premium for Russia at a slightly higher level than in a situation without any sanction restrictions. Relying on the conservative risk premium assumptions, the Bank of Russia's baseline scenario takes into account potential volatility in financial markets in case of short-term increases in geopolitical tensions.

Economic policy of the Russian Government. Among the key internal assumptions, the Bank of Russia takes into account the effect of the fiscal rule over the entire forecast horizon that smooths out the impact of oil price dynamics on the domestic economic environment. The forecast also assumes that funds of the National Wealth Fund will be invested in liquid low-risk FX instruments. In addition to the fiscal rule, the following measures of the Russian Government will also influence monetary policy conditions in 2019–2022: the actual and expected changes in the tax system; a complex of measures aiming at elimination of the structural constraints in the Russian economy, including the implementation of national projects; measures of the federal and regional authorities intended to mitigate the impact of non-monetary factors on inflation and carried out with the engagement of the Bank of Russia.[2]

Among the key tax policy measures, the Bank of Russia assumes changes in excise duties for certain products in the consumer basket[3] and the oil and gas tax manoeuvre to take place in 2019–2024. According to the Bank of Russia's estimates, the latter will have a nearly zero contribution to annual inflation in 2019–2022.

The range of the government measures taken into account by the Bank of Russia in its baseline scenario primarily includes additional investment spending and expenses for human capital development within national projects.[4] These measures are aimed at alleviating the existing structural constraints in the Russian economy. If implemented successfully, they will help accelerate potential economic growth. These measures may influence potential growth through renewal of fixed assets and infrastructure, investment climate improvement, human capital and labour productivity increase, better quality of management at all levels (both in the public and private sectors), diversification of the Russian economy, and reduction of its commodity dependence.

The implementation of the above measures basically requires a long time, while their targets, including the institutional and structural parameters of the economy and the demographic trends, change slowly. In this regard, the Bank of Russia assumes that the scheduled fiscal and structural measures will have a significant impact on the growth rates and structure of the Russian economy only towards the end of the forecast horizon. These measures will have the greatest effect beyond the forecast period.

The Bank of Russia assumes that the positive contribution of the planned state policy measures to economic growth acceleration will not be accompanied by additional upward pressure on inflation if there is an adequate expansion in the production capacity of the Russian economy.

In its baseline scenario, the Bank of Russia also takes into account the phased increase in the retirement age planned by the Government and preserves its estimates regarding the impact

[2] *Pursuant to the Guidelines for the Fiscal, Tax, and Customs and Tariff Policy for 2019 and the 2020–2021 Planning Period and the Tax Code of the Russian Federation.*

[3] *Alcohol and alcohol-containing products, main types of motor fuel, tobacco, and other types of products.*

[4] *Social and economic measures under Decree of the President of the Russian Federation No. 204, dated 7 May 2018, scheduled for implementation in 2019–2024. This package of measures is to receive extra budget funding in the amount of about 1% of GDP annually throughout the forecast horizon (overall, nearly ₽8 trillion in 2019–2024; the total amount, including the previously allocated funds, will approximate ₽13 trillion).*

of this increase on potential economic growth rates: about 0.1 pp in 2019 and about 0.2–0.3 pp in 2020–2022.[5]

Other types of the Bank of Russia's policy. The Bank of Russia's measures aimed at a balanced development of the financial market, minimisation of the probability of systemic risks in it, and efficient transformation of household savings into long-term domestic investment will facilitate the creation of favourable conditions driving higher investment and economic activity over the forecast horizon. These measures comprise the launch and enhancement of incentive-based regulation in the banking sector, boosting competition in the financial market, development of the long-term financial resource segment, improving the quality of corporate governance, better investor protection, and development of the insurance sector and the trust management and collective investment segment, as well as macroprudential policy measures.[6] The Bank of Russia reckons that these measures are both cyclical and structural.

The Bank of Russia's efforts to improve financial inclusion and financial literacy[6] can help increase the share of households extensively using financial products and services, thereby contributing to a more efficient transformation of domestic savings into domestic investment. This also enhances the efficiency of the monetary policy transmission mechanism.

MEDIUM-TERM FORECAST

Inflation. In its baseline scenario, the Bank of Russia forecasts that annual inflation will range from 4.0% to 4.5% by the end of 2019 and will stay close to 4% in the future (Chart 1.1.6). This will be primarily facilitated by monetary policy pursued by the Bank of Russia. Inflation pressure will be moderate amid decelerating external demand and balanced domestic demand dynamics. The forecast takes into account the indexation of administered prices and tariffs by the inflation rate close to 4%, which implies that this factor will not exert excessive upward pressure on prices. The assumption regarding higher investments as a main goal of the Government's measures for economic growth acceleration implies that investments are not expected to have notable pro-inflationary effects over the mid-term horizon. However, the Bank of Russia takes into account that a positive influence on consumer demand through income dynamics may surpass an expansion of the production capacity at initial stages of investment projects.

Given that annual inflation is expected to keep close to 4% in 2020–2022, the rolling yearly average inflation rate will also stabilise close to 4% during this period after its increase in 2019, being affected by temporary pro-inflationary factors.

Economy. According to the Bank of Russia's baseline scenario, growth of the Russian economy will come in at 0.8–1.3% in 2019 (vs 2.3% in 2018), given the weak economic activity observed since the beginning of this year. Economic growth in 2019 will be restrained by a number of factors. Thus, the ongoing slowdown in the global economy, as well as the OPEC+ agreement on oil production cuts will cause a 0.3–0.8% reduction in export quantities in annual terms after their 5.5% increase in 2018. The growth rate of gross fixed capital formation, which totalled 2.9% in 2018 being supported by a range of large-scale infrastructure projects, including state-supported ones, will decrease to 0.0–1.0% in 2019 as the implementation of a number of national projects planned by the Government is slower than expected. In addition, annual growth of import quantities will slow down from 2.7% in 2018 to (-0.3%)–0.2% in 2019 amid reducing investment imports.

The Bank of Russia forecasts that in 2020 growth of the Russian economy will accelerate to 1.5–2.0%. An increase in public investment spending explained by the transition to the active stage of the implementation of national projects will be the major contributor to higher economic growth rates. In this context, annual growth of gross fixed capital formation will speed up to 3.5–4.5% in 2020. This will also

[5] *Estimates published in the baseline forecast in the Monetary Policy Guidelines for 2019–2021.*

[6] *For more details about the financial market development measures planned by the Bank of Russia, refer to the Guidelines for the Development of the Russian Financial Market in 2019–2021, www.cbr.ru/Content/Document/File/71220/main_directions.pdf.*

impact the dynamics of import quantities: their annual growth rate will increase to 3.0–3.5%. Economic growth in 2020 will also be supported by a slight consumer demand expansion owing to better household income dynamics and the exhaustion of the restraining effect of the VAT increase. This will speed up annual growth of households' final consumption expenditure to 2.0–2.5% (vs 1.0–1.5% in 2019). However, the slowdown in the global economy assumed in the baseline scenario will limit the growth of Russian exports over the forecast horizon. The Government's measures to stimulate non-commodity exports within the International Cooperation and Exports national project will help mitigate this impact. As a result, annual export growth in the baseline scenario will only increase to 2.0–2.5% in 2020.

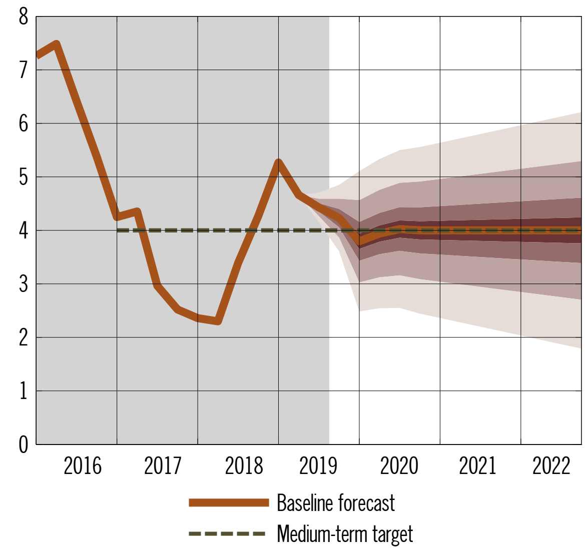
The baseline scenario assumes that in 2021–2022 growth of the Russian economy will accelerate to 1.5–2.5% and 2.0–3.0% respectively (Chart 1.1.7). This will be driven by a gradual accumulation of the positive effect of the planned fiscal policy measures and national projects, provided they are implemented successfully, as well as the consumption dynamics. Yet, the growth rates of export quantities will not exceed 2.0–2.5% in 2021 and 2.5–3.0% in 2022. The Government plans to reduce the non-oil-and-gas deficit of the federal budget over the mid-term forecast horizon.[7] In this regard, growth of gross fixed capital formation is expected to slow down to 2.5–3.5% in 2022 (vs 3.5–4.5% in 2020–2021). This will result in, among other things, a lower growth rate of import quantities: it will fall to 2.5–3.0% in 2022 (vs 3.0–3.5% in 2020 and 3.5–4.0% in 2021).

Monetary indicators. According to the Bank of Russia's baseline forecast, monetary conditions in the Russian economy will continue to gradually moderate and will get generally neutral over the forecast horizon. This will be mainly facilitated by the completion of the adjustment of credit and deposit rates in the economy to the 2019 key rate decrease and by the easing of non-price bank lending conditions.

[7] *In accordance with the budget forecast of the Russian Federation for the period until 2036 (Ministry of Finance).*

INFLATION PATH
IN THE BASELINE SCENARIO
(% change on the same period of the previous year)

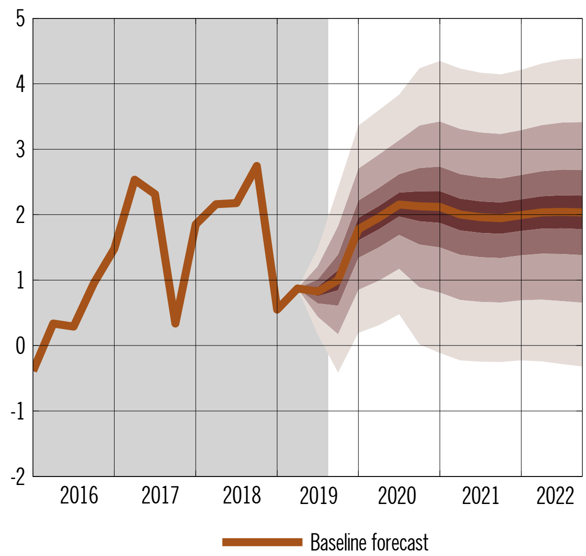
Chart 1.1.6



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

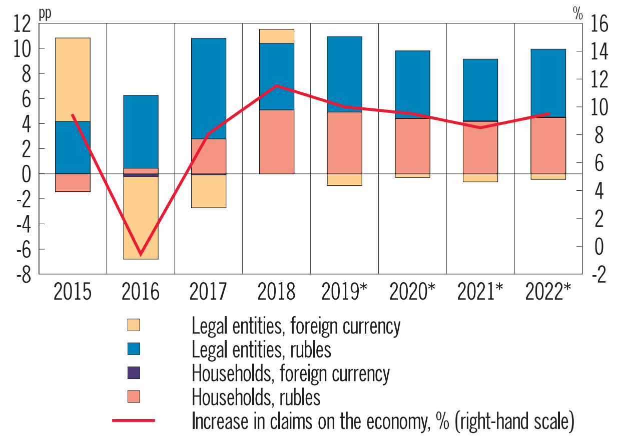
GDP GROWTH PATH IN THE BASELINE SCENARIO
(% change on the same period of the previous year)

Chart 1.1.7



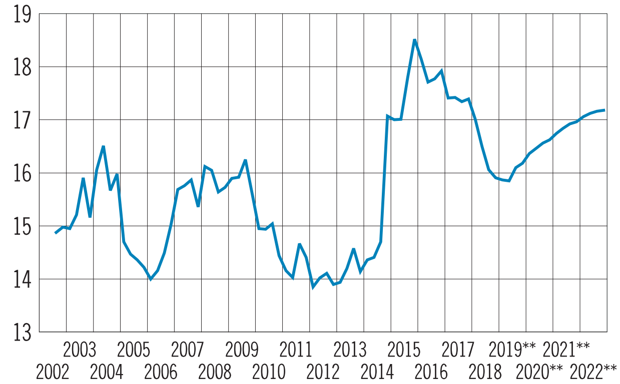
Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on historical estimates of GDP growth uncertainty.
Source: Bank of Russia calculations.

DECOMPOSITION OF THE INCREASE IN CLAIMS ON THE ECONOMY IN THE BASELINE SCENARIO *Chart 1.1.8*
(contribution to annual growth, pp)



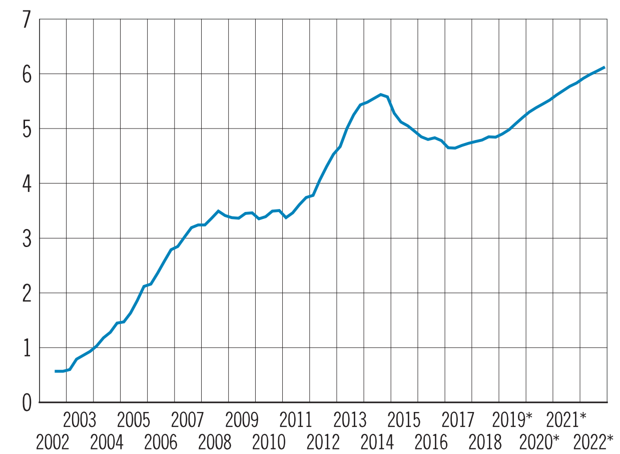
* Forecast. Decomposition is shown for the increase in claims on the economy corresponding to the middle of the forecast range in the baseline scenario.
Source: Bank of Russia calculations.

NON-FINANCIAL CORPORATIONS DOMESTIC DEBT BURDEN *Chart 1.1.9*
(debt service ratio*, % of GDP)



* The debt service ratio was calculated based on the methodology described in S.A. Donets, A.A. Ponomarenko Debt burden indicators. Russian Journal of Money and Finance. No. 4, 2017 2019. Q1 value – Bank of Russia estimate.
** Forecast. Calculations were based on the level of the credit corresponding to the middle of the forecast range of the baseline scenario.
Source: Bank of Russia calculations.

HOUSEHOLD DEBT BURDEN *Chart 1.1.10*
(debt service ratio, % of GDP)



* Forecast. Calculations were based on the level of credit corresponding to the middle of the forecast range of the baseline scenario.
Source: Bank of Russia calculations.

The banking system's claims on the economy in 2020–2022 in the baseline scenario will sustainably grow as a result of a gradual economic growth acceleration and better household income dynamics, as well as under the influence of monetary conditions forming over the forecast horizon. As regards the banking system's claims on households for 2019, the baseline scenario of monetary indicators takes into account a faster growth of these claims at the beginning of the year with its gradual slowdown from the middle of this year. Moving forward, the Bank of Russia expects a smooth deceleration of retail lending growth, including due to the measures aimed at limiting the increase in debt burden of households in general and of particular borrowers, as well as due to the saturation of the retail credit market. In turn, the gradual easing of price lending conditions as a result of the key rate cut will support stable growth in corporate and mortgage lending. Non-price lending conditions will slowly moderate, reflecting banks' conservative approach to borrower assessment and risk acceptance.

Given the impact of all the above factors, lending activity will generally continue to grow in 2020–2022 at a pace corresponding to the effective demand increase and posing no risks to price stability (Chart 1.1.8). The debt burden of the economy will maintain at levels that do not threaten financial stability in the economy, while increasing smoothly (Charts 1.1.9, 1.1.10). Lending will remain the key driver of money supply movements, and in these conditions, money supply increase will be close to the growth rates of claims on the economy (Chart 1.1.11).

Balance of payments. The forecast of the balance of payments indicators takes into account the actual data on the main components of the balance of payments since the beginning of this year and the expected trajectory of oil prices and GDP growth rates in 2019–2022. The Bank of Russia forecasts a decrease in the current account surplus to $83 billion in 2019 (vs $113 billion in 2018) and a reduction in the financial account balance of the private sector to $40 billion (vs $68 billion in 2018). Given the actual inflow of foreign investor funds to the OFZ market year-to-date and the successful placements of Russian eurobonds, the financial account deficit of the public sector (in BPM6 signs, i.e. net capital inflow) will total $20 billion in 2019, after the net capital outflow in 2018 in the amount of $9 billion.

Over the mid-term forecast horizon, despite a gradual decline in oil prices and a generally small increase in export quantities against the backdrop of a slowdown in the global economy, the current account balance of the balance of payments will be steadily positive: 3% of GDP in 2020 and about 1.5–2.0% of GDP in 2021–2022 (vs 5% of GDP in 2019). The Government's measures aimed at stimulating non-commodity exports will support growth of export quantities, which will smooth out the effects of the expected oil price drop and global economy slowdown (Chart 1.1.12).

The financial account balance in the private sector will decrease from 2.5% of GDP in 2019 to approximately 1.0–1.5% of GDP in 2020–2022 (vs 4% of GDP in 2018) on the backdrop of reducing external debt payments and a slight reduction of the possibilities for Russian companies to accumulate foreign assets amid a downturn in prices for core Russian exports (Chart 1.1.13).

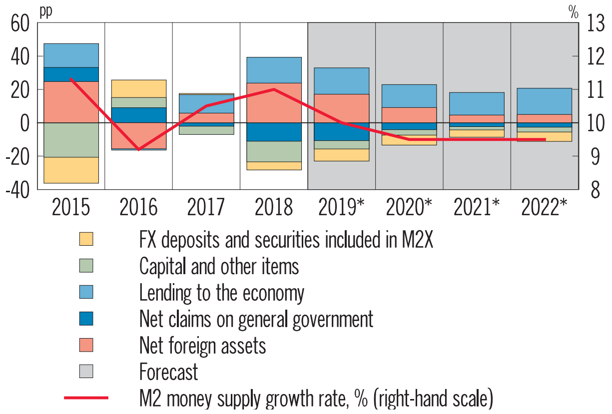
In 2019–2022, the Bank of Russia will continue to replenish the international reserves under the fiscal rule. The forecast also factors in foreign currency purchases in the domestic market suspended in 2018 that should be completed in early 2022.

1.2. FACTORS OF UNCERTAINTY IN THE FORECAST

External conditions. Since the beginning of 2019, pro-inflationary risks associated with specific external factors have been decreasing. Thus, the downward revision of the expected interest rate paths in the USA and the euro area at the beginning of the year and the reduction of the US Fed base rate in July, along with the softening in the rhetoric of the US Fed and the ECB, mitigate the risks of a substantial capital outflow from emerging market economies.

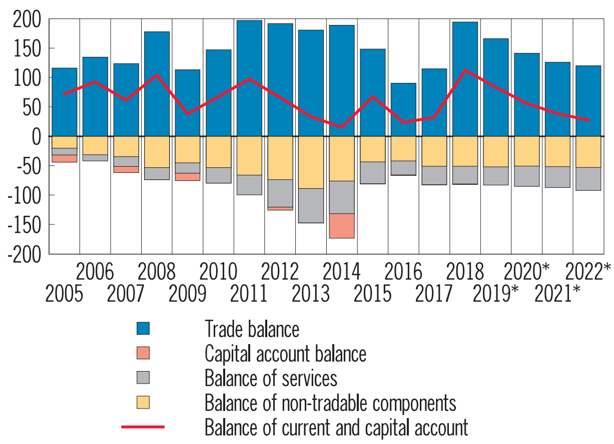
However, other external risks remain significant. In particular, there are continuing

DECOMPOSITION OF THE MONEY SUPPLY GROWTH ACCORDING TO THE NATIONAL DEFINITION, BASELINE SCENARIO *Chart 1.1.11*
(contribution to annual growth, pp)



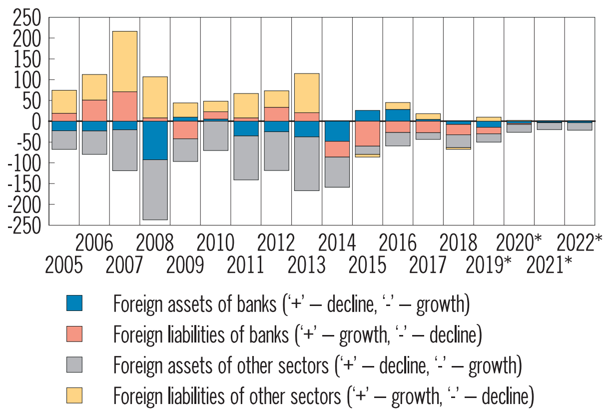
** Forecast. Money supply is calculated according to the national statistical definition and corresponds to the middle of the forecast range of the baseline scenario.*
Source: Bank of Russia calculations.

MAIN CURRENT ACCOUNT COMPONENTS IN THE BASELINE SCENARIO *Chart 1.1.12*
(billions of US dollars)



** Forecast.*
Source: Bank of Russia calculations.

MAIN COMPONENTS OF THE PRIVATE SECTOR'S FINANCIAL ACCOUNT IN THE BASELINE SCENARIO *Chart 1.1.13*
(billions of US dollars)



** Forecast.*
Source: Bank of Russia calculations.

risks that the economic growth slowdown observed in most key economies since mid-2018 may persist for a longer period and turn out to be steadier than assumed in the baseline scenario. Global economy growth may be adversely affected by unfavourable developments related to a range of geopolitical factors, including the potential Brexit parameters and outcomes, as well as further tightening of the mutual foreign trade restrictions between the USA and America's key trade partners (first of all, China). Thus, the imposition of new foreign trade restrictions, primarily between China and the USA, may negatively affect advanced economies and EMEs, including Russia, both as a result of deterioration of the economic growth outlook because of shrinking external demand and due to declining demand for high-risk assets and increasing risk premiums amid rising volatility in financial markets. In the short run, the deteriorating environment in financial markets of emerging economies may cause pro-inflationary risks through the dynamics of national currencies and exchange rate expectations. However, in the mid-run, a slower growth of the global economy due to the escalation of trade tensions may generally have a disinflationary effect for most economies, including EMEs.

Future movements of oil prices remain a source of uncertainty. Being affected by mostly supply-side factors, their increased volatility may persist. As a result, oil prices over the forecast horizon may move below or above the baseline scenario level.

In this context, the Bank of Russia sticks to the conservative approach when forming its baseline scenario assumptions related to external factors. In addition, the Bank of Russia also considers the high oil price scenario and the risk scenario that assumes a combination of adverse external events.

Inflation expectations. Inflation expectations are highly sensitive to increases in prices for certain goods and services and are not anchored. This continues to pose significant risks of an upward deviation of inflation away from the baseline forecast.

Non-monetary inflation factors. Inflation dynamics over the forecast horizon may also be affected by non-monetary factors, including those influencing food and motor fuel prices. While having a significant impact on inflation movements, non-monetary factors are outside the scope of monetary policy.

The Bank of Russia will take into account the specifics of pricing for certain goods and services and will closely communicate at the expert level with the Russian Government in order to devise and implement measures helping reduce the sensitivity of price dynamics to non-monetary factors.

Economic policy measures of the Russian Government. The scope and influence of the complex of budgetary and structural policy measures planned by the Government are a factor of uncertainty for the economic growth outlook over the forecast horizon, primarily starting from 2020. They will depend on the pace and efficiency of implementation of the planned changes.

Fiscal policy may have a substantial impact both on short- and mid-term inflation dynamics. The delayed implementation of a number of national projects amid the seasonal increase in budget spending in the second half of this year may have a pro-inflationary effect in late 2019–early 2020.

An additional factor of uncertainty is the structure of investment of the liquid portion of NWF funds above the threshold amount set at 7% of GDP in the Budget Code. According to the Bank of Russia's baseline scenario, this threshold will be reached in 2020.

If developments in 2020–2022 differ from the Bank of Russia's assumptions in the baseline scenario and an upward influence of increasing government spending on consumer demand substantially outpace an impact on production potential, economic growth acceleration may be accompanied by an upward pressure on inflation dynamics.

A gradual elimination of the structural constraints in the Russian economy may simultaneously reduce the sensitivity of domestic prices to particular external and internal factors and have a downward effect on inflation in case of a faster-than-expected growth of the Russian economy. This may occur as a result of reduced dependence of the Russian economy on exports of energy resources, increased competition, and the development of transport and logistics infrastructure.

The Bank of Russia will pay great attention to assessing the short- and long-term effects of the planned fiscal measures by clarifying their scope and how they impact the economy and inflation as they are elaborated in greater detail and implemented.

Demographic trends. The expected demographic trends may influence the medium-term inflation dynamics and economic growth. Due to the current age structure of the population, the economically active population will continue to decrease in the near future. This will remain a factor limiting potential economic growth in 2020–2022, even with account of the positive contribution of the retirement age increase. Insufficient supply in the labour market can affect the dynamics of wages and household consumption and put an upward pressure on inflation. Yet, the impact of the demographic factor on potential output and inflation can be mitigated if the decrease in Russia's economically active population is substantially offset owing to a higher labour market flexibility, reduction of non-productive jobs and migration from other countries. Migration flows will depend not only on the Government's migration policy, but also on the overall attractiveness of the Russian economy for foreign labour force as compared with other states.

Other factors. According to the Bank of Russia's estimate, risks associated with the dynamics of wages and prices for certain food products, as well as possible changes in consumer behaviour remain moderate over the forecast horizon.

2. INFLATION AND INFLATION EXPECTATIONS[1]

Annual inflation continued to slow down in June–August 2019. It stood at 4.3% in August. Annual core inflation and the median distribution of annual consumer price increases reflecting sustainable trends in price dynamics also declined. The slowdown in annual inflation was influenced by moderate demand, appreciation of the ruble in the first half of the year and one-off factors, primarily, the July indexation of utility tariffs, which was lower than a year earlier and is being carried out in two stages this year.

After dropping in June–July under the influence of temporary factors, consumer price growth in August (seasonally adjusted) returned to 0.3% in annualised terms, which corresponds to the Bank of Russia's target of around 4%. The monthly growth rates of prices for goods and services, excluding the most volatile or regulated components (core inflation, inflation excluding fruit and vegetables, petroleum products and utilities), amounted to 0.2–0.3% (seasonally adjusted).

In June–August 2019, the price expectations of businesses for the next three months continued to decline. Experts predict that inflation will return to the Bank of Russia's target by the end of 2019 and stabilise subsequently. However, household inflation expectations for the year ahead remain elevated.

The Bank of Russia forecasts that inflation will come in at 4.0–4.5% by the end of 2019. Moving forward, the monetary policy pursued will keep annual inflation close to 4%.

[1] *The section takes into account the statistics on the dynamics of prices for goods and services in August published on 9 September 2019 (after the September meeting of the Bank of Russia Board of Directors).*

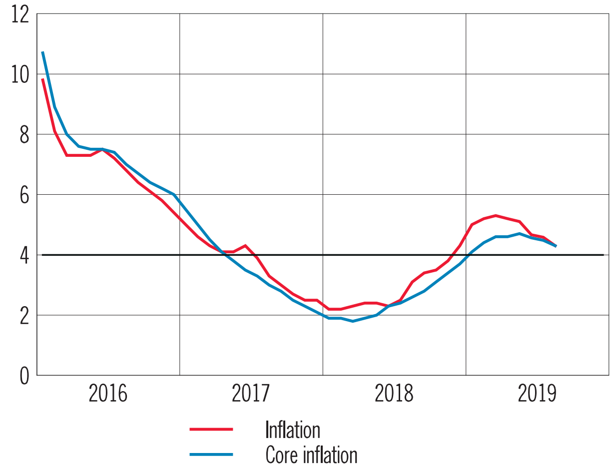
In June–August 2019, annual inflation continued to decline after a local peak in March (Chart 2.1), which corresponds to the Bank of Russia's forecast.[2] It stood at 4.3% in August. The main factors behind the inflation slowdown were the exhaustion of the effect of the VAT hike at the beginning of the year, the strengthening of the ruble in the first half of 2019, and moderate demand. A certain role was also played by one-off factors, such as the specifics of regulation in the markets of utilities and petroleum products and the early harvest of vegetables.

The indicators characterising sustainable trends in the dynamics of prices declined. Thus, annual core inflation slowed down in June–August after increasing from March 2018 through May 2019. It was equal to 4.3% in August. The median distribution of annual price increases in August fell to 4.1% (Chart 2.2).

The monthly growth rate of consumer prices (seasonally adjusted, hereinafter, 'SA') slowed to 0.1–0.2% in June–July under the impact of one-off factors, primarily in the dynamics of prices for fruit and vegetables and utilities (Chart 2.3). In August, it returned to 0.3%, which corresponds to the Bank of Russia's target of around 4% in annualised terms. Monthly increases in prices for goods and services, excluding the most volatile or regulated components (core inflation, price increases for goods and services, excluding fruit and vegetables, petroleum products and utilities) are estimated in June–August to have been in the range of 0.2–0.3% (SA).

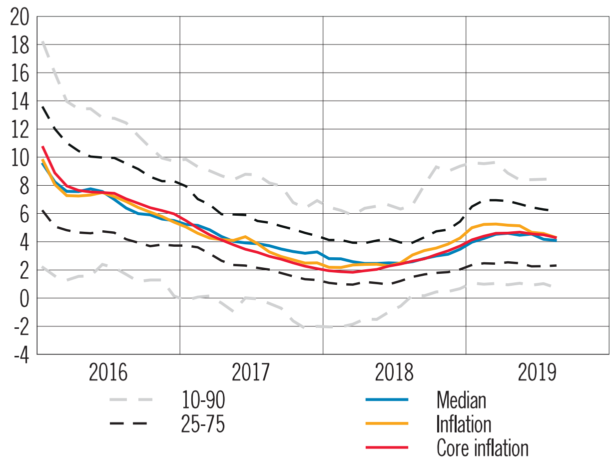
The Bank of Russia forecasts that inflation will come in at 4.0–4.5% by the end of 2019. Moving forward, the monetary policy pursued will keep annual inflation close to 4%.

INFLATION AND CORE INFLATION *Chart 2.1*
(% change on the same month of the previous year)



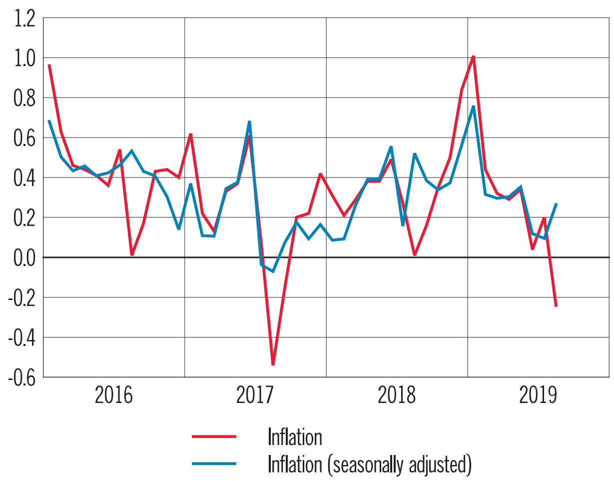
Source: Rosstat.

GROWTH IN PRICES OF GOODS AND SERVICES *Chart 2.2*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

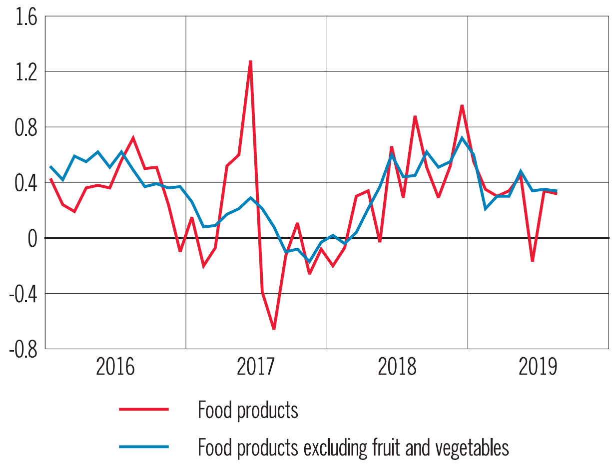
INFLATION *Chart 2.3*
(% change month-on-month)



Sources: Rosstat, Bank of Russia calculations.

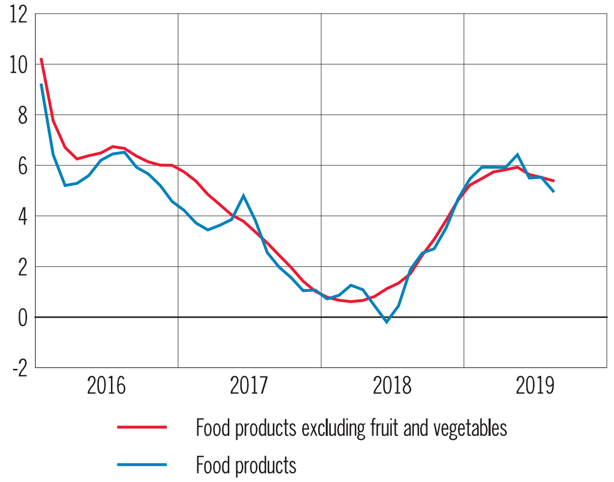
[2] *Monetary Policy Report 1/19, www.cbr.ru/Collection/Collection/File/18969/ 2019_01_ddcp.pdf; Monetary Policy Report 2/19, www.cbr.ru/Collection/Collection/File/19993/2019_02_ddcp.pdf.*

FOOD PRICES *Chart 2.4*
(% change month-on-month, seasonally adjusted)



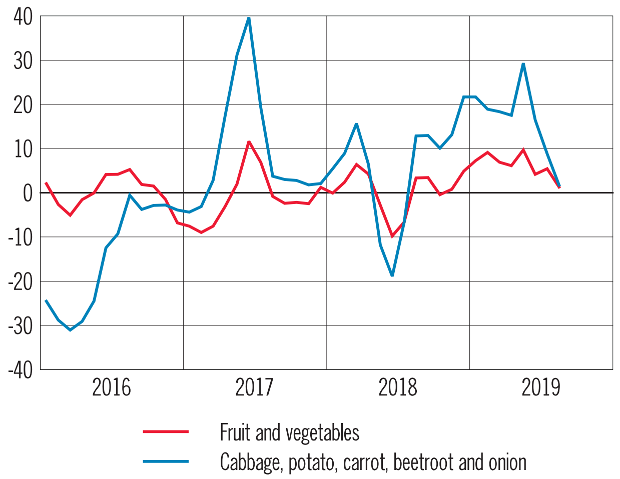
Sources: Rosstat, Bank of Russia calculations.

FOOD PRICES *Chart 2.5*
(% change on the same month of the previous year)



Sources: Rosstat.

FRUIT AND VEGETABLE PRICES *Chart 2.6*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

FOOD PRODUCTS

In June 2019, food prices declined (SA), offsetting a temporary acceleration of their growth in May. During these two months, food prices rose by 0.1% on average. The main source of volatility was the dynamics of prices for fruit and vegetables, while the rate of change in prices for other food groups was fairly stable (Chart 2.4). In July–August, food prices rose by 0.3% monthly (SA).

Annual food inflation in August was 5.0% or 1.4 pp lower than in May when it reached a local peak (Chart 2.5).

Fruit and vegetable products. Prices for fruit and vegetables fell by 3.8% (SA) in June due to the early new harvest owing to favourable weather conditions in the European Russia. In July, prices for borscht vegetables continued to drop, however, growth of prices for tomatoes and cucumbers accelerated due to the adverse impact of the rainy and cool weather in the European part of the country. As a result, fruit and vegetable prices rose during the month by 0.7% (SA) on average. In August, their prices grew by 0.8% (SA) largely due to rising prices for cabbage. These dynamics in the summer months were influenced by an earlier harvest date.

Differences in weather conditions and dates of the harvest of vegetables and fruit in the current and previous years were reflected in the fluctuations of annual growth in prices. In June–August, it was in the range of 1.3–5.4% (Chart 2.6). In particular, the dynamics of tomato prices showed high volatility (from their decrease of 2.8% in June to an increase of 31.3% in July). Due to the base effect, annual growth of cabbage prices fell to 5.5% in June (in previous months of the year, it was about twice as expensive as in the same months of 2018), and in July–August it rose again to 13.3%. Overall, the annual increase in prices for borscht vegetables dropped to 1.7% in August from 29.4% in May.

FOOD PRODUCTS (EXCLUDING FRUIT AND VEGETABLES)

The monthly increase in food prices (excluding fruit and vegetables) was stable in June–August and is estimated at 0.3% (SA), the same as in March–April.

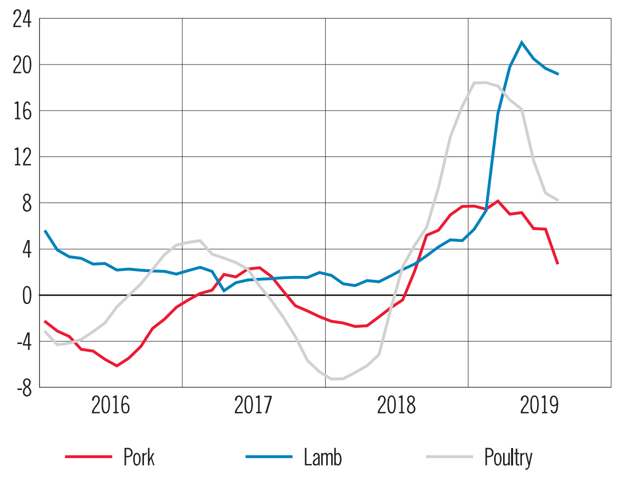
Annual growth of prices for this commodity group slowed to 5.4% in August after a local high in May (5.9%). Prices for various food groups showed mixed dynamics.

In June–August, annual growth of prices for meat products decelerated (Chart 2.7). The slowing growth in poultry prices (from 16.1% in May to 8.2% in August), which had occurred in March and reflected the completion of the supply-to-demand adjustment (acceleration of price dynamics had been observed from the second half of 2018), was particularly noticeable. With due account of the weight in the consumer basket, this made the greatest contribution to the slowdown in growth of prices in the reviewed segment of the food market. One should note a decrease in growth of lamb prices promoted by the expansion of production (a sharp rise in lamb prices occurred in March–May and was caused by a rapid increase in exports).

Sugar became cheaper in August than in the same month of 2018 (early this year, the price increased by 30%) due to growth in its production coupled with a large harvest of sugar beets.

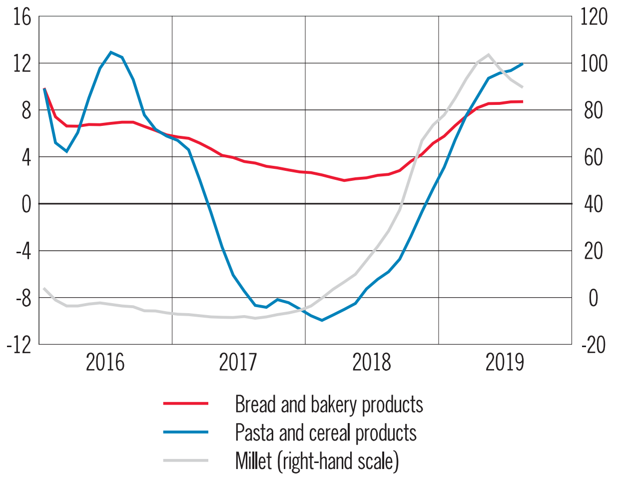
Annual growth of prices for bread and bakery products remained at the previous month's level for the first time since May 2018 when it began to grow (Chart 2.8). The expected heavy crops in Russia and worldwide and the continuing downward trend in global prices form the basis for stabilisation of consumer prices for grain products. Nevertheless, annual growth in prices for grains and legumes as well as pasta still continued to increase in August, reflecting the deferred effects of higher grain prices in the second half of 2018. Growth of prices for millet, which remains the leader in price growth not only among food products but

MEAT PRODUCT PRICES *Chart 2.7*
(% change on the same month of the previous year)



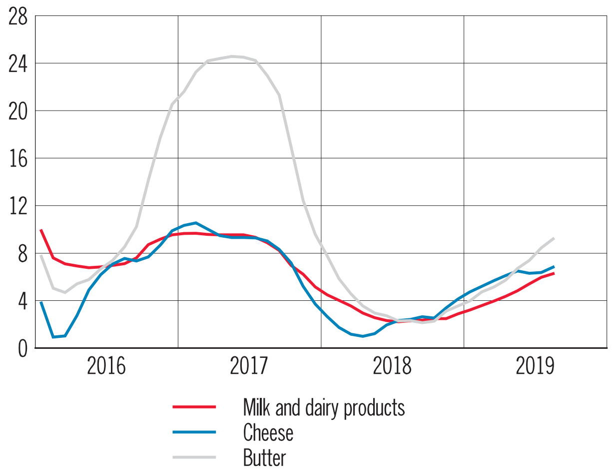
Sources: Rosstat, Bank of Russia calculations.

GRAIN PRODUCT PRICES *Chart 2.8*
(% change on the same month of the previous year)



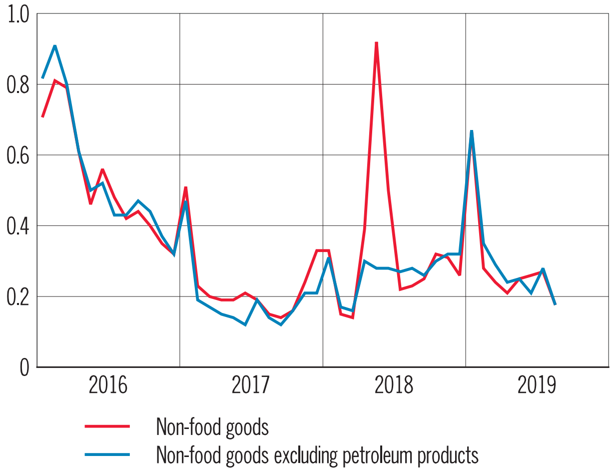
Sources: Rosstat, Bank of Russia calculations.

DAIRY PRODUCT PRICES *Chart 2.9*
(% change on the same month of the previous year)



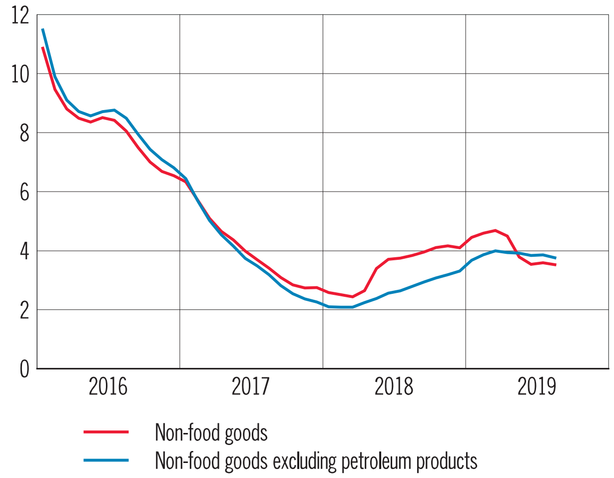
Sources: Rosstat, Bank of Russia calculations.

NON-FOOD GOODS PRICES *Chart 2.10*
(% change month-on-month, seasonally adjusted)



Sources: Rosstat, Bank of Russia calculations.

NON-FOOD GOODS PRICES *Chart 2.11*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

also among consumer goods and services (in August, it was almost twice as expensive as a year earlier), slowed down somewhat.

The Russian Ministry of Agriculture and independent experts expect a higher grain harvest than a year earlier, although experts have lowered their forecasts taking weather conditions into account. In addition, according to the FAO, the dynamics of global grain prices are restrained by significant reserves and continuing expectations of a record high production level in the world, despite lowered forecasts for the wheat harvest in a number of countries. All this is creating the conditions for slower growth of grain prices in the domestic market and consumer prices for grain products.

The trend towards increasing annual growth of prices for dairy products persisted (Chart 2.9). This indicates a further reorganisation of the market aimed at restoring the profitability of business. Accelerated growth of raw milk production this year projected by the National Union of Milk Producers will restrain price growth.[3] In addition, the pressure on butter prices from global market prices has eased. Overall, milk and dairy products in August were 6.3% more expensive on average than in August 2018, butter – 9.2% and cheese – 6.8%.

In the coming months, the difference in the time of ripening and harvesting of fruit and vegetables, as compared with the last year, may cause fluctuations in annual food inflation. Nevertheless, the overall high availability of agricultural raw materials and food in the Russian market creates the conditions for a moderate increase in the prices of food products at a pace corresponding to price stability.

NON-FOOD GOODS

In June–August 2019, monthly growth of prices for non-food products (SA) was estimated at 0.2–0.3% (Chart 2.10).

Annual growth of prices for non-food products came in at 3.5% in August, which is 0.3 pp lower than in May (Chart 2.11). The decline observed since April was due to the base effect in the petroleum products price

[3] *www.agroinvestor.ru/analytics/news/32328-tempy-rosta-proizvodstva-tovarnogo-moloka/full/*.

trend. Growth of prices for non-food products excluding petroleum products was in the range of 3.8–3.9%.

Motor fuel. Before 1 July 2019, growth in prices for key types of motor fuel was limited by agreements between the Government of the Russian Federation and major oil companies. Under these conditions, the monthly growth rate of prices for petroleum products in the consumer market in April–June lagged significantly behind the values of the comparable months last year, when they accelerated, and the annual rate decreased (Chart 2.12). This lag was particularly noticeable in May 2019 (the major rise in motor fuel prices occurred in May 2018). Annual growth in prices for petroleum products fell by 5.5 pp to 3.0%. June saw the decline continue (to 1.5%).

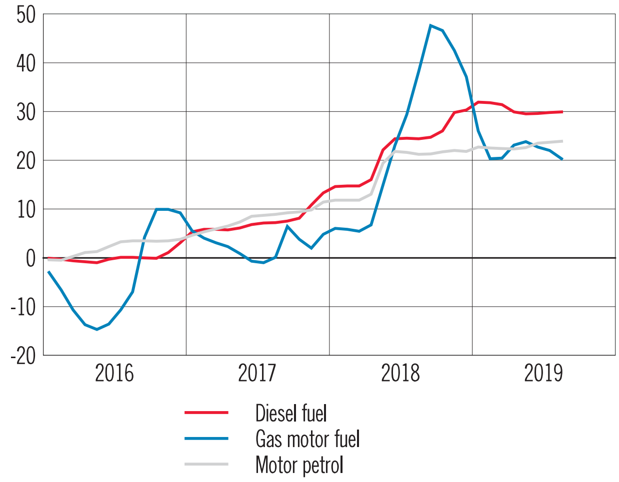
Since last July, prices in the petroleum products market are formed under the impact of implicit mechanisms, including reverse excise duty with a damping component. A moderate increase in consumer prices for motor fuel in July–August was estimated at 0.1–0.2% (SA), which was facilitated by the export parity dynamics (Chart 2.13). The annual growth rate increased slightly (to 2.1%) due to the base effect (in the comparable months of 2018, prices were formed under the impact of regulatory measures).

Other non-food goods. The monthly growth rate of prices for non-food products excluding petroleum products (SA) in June–August remained in the range typical of March–May (0.2–0.3%). Moderate rates of price growth were influenced by moderate demand and the strengthening of the ruble in the first half of 2019.

Since last April, the annual growth rate of prices for this group of non-food products has been stable, in the range of 3.8–3.9%.

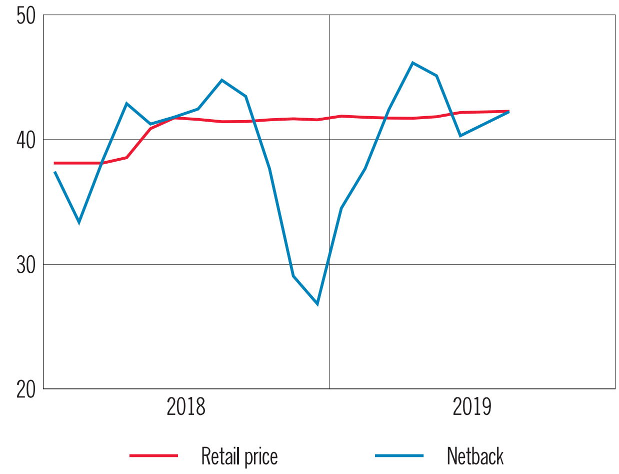
Prices for certain product groups showed mixed dynamics, reflecting the influence of factors typical of the given markets. Thus, the price indices for household appliances and electronics (except computers) continued to decline. Annual growth rates of prices for tobacco products, computers and footwear increased slightly (Chart 2.14).

PETROLEUM PRODUCT PRICES
(% change on December 2015)
Chart 2.12



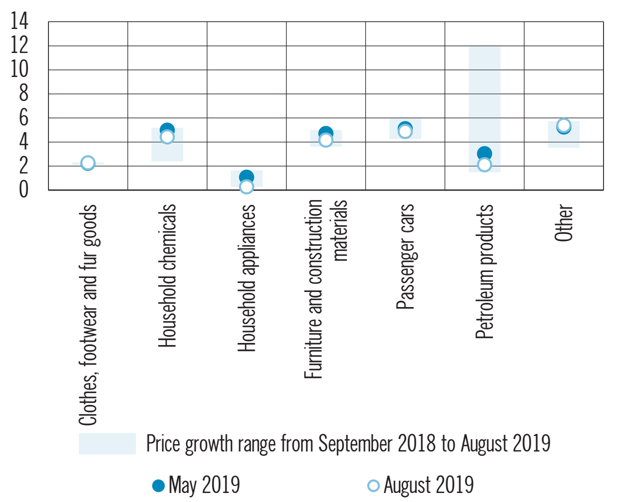
Sources: Rosstat, Bank of Russia calculations.

AI-92 PETROL PRICES
(rubles per litre)
Chart 2.13



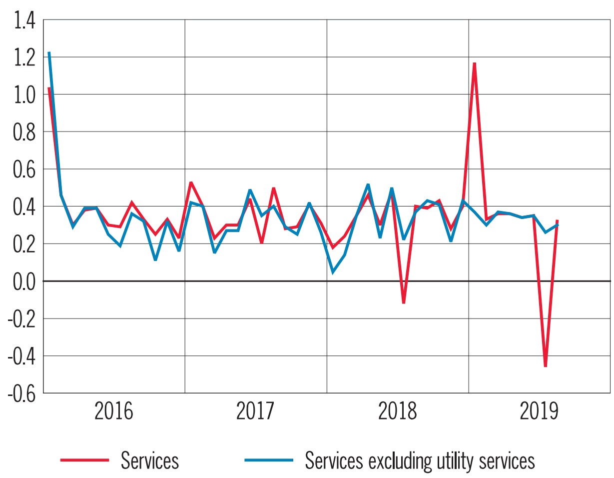
Sources: Rosstat, SPIMEX, Bank of Russia calculations.

PRICES OF KEY NON-FOOD GOODS
(% change on the same month of the previous year)
Chart 2.14



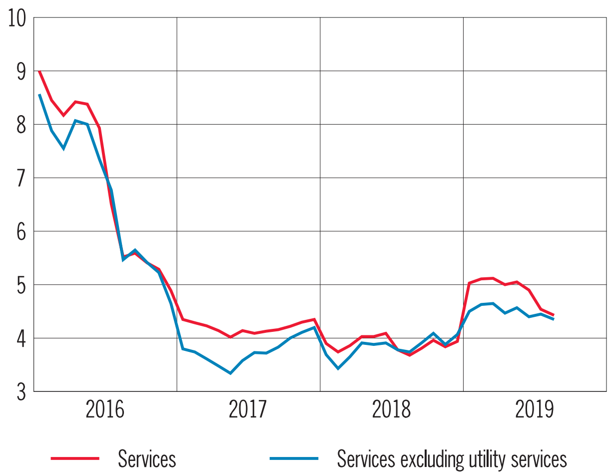
Sources: Rosstat, Bank of Russia calculations.

SERVICE PRICES
(% change month-on-month, seasonally adjusted)
Chart 2.15



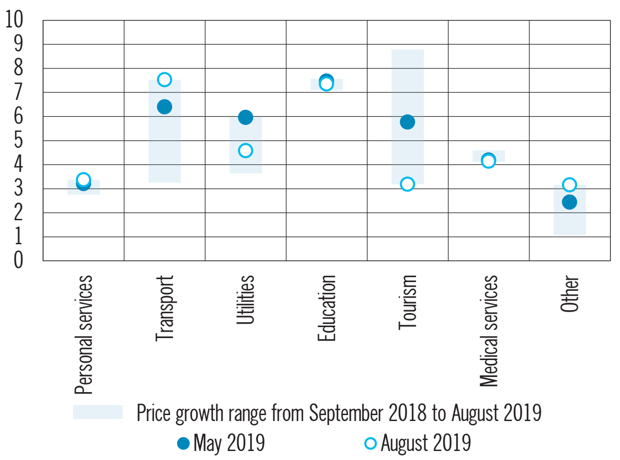
Sources: Rosstat, Bank of Russia calculations.

SERVICE PRICES
(% change on the same month of the previous year)
Chart 2.16



Sources: Rosstat, Bank of Russia calculations.

SERVICE PRICES
(% change on the same month of the previous year)
Chart 2.17



Sources: Rosstat, Bank of Russia calculations.

SERVICES

In June–August 2019, the monthly growth rate of prices for services (SA) fluctuated mainly due to the dynamics of administered prices and tariffs (transport and utilities, Chart 2.15). The annual growth rate of prices for services fell to 4.4% in August largely due to a smaller than a year before indexation of utilities tariffs (Chart 2.16).

Prices for **utilities** rose by 0.4% in June 2019, just like in May (SA). July saw an estimated decrease (SA) in utilities tariffs due to their smaller-than-usual increase. Utilities tariffs rose by 2.5%, in line with expectations. This was the second stage of the indexation. The first one was held in January and was associated with the VAT rate hike.

As expected, the annual growth rate of utilities prices in July decreased significantly due to a smaller than a year before indexation of utilities tariffs. It stood at 4.7%, and 4.6% in August (1.3 pp lower than in May).

Services (excluding utilities). The monthly growth rate of prices for services excluding utilities is estimated at 0.3–0.4% in June–August, the same as in the previous months of the year (SA). The annual growth rate of prices for this group of services was 4.4% during the summer months (4.5–4.7% in January–May).

The nature of price changes for individual groups of services varied (Chart 2.17). In particular, the monthly and annual growth rates of prices for transport services fluctuated as usual due to differences in the scheme of increasing railway transportation fares in 2019 and 2018. Airfares increased significantly reflecting the deferred effects of fuel price growth. The strengthening of the ruble since the beginning of 2019 affected the slowdown in growth of prices for tourism and medical services.

INFLATION EXPECTATIONS

Inflation expectations of economic agents in June–August 2019 did not change or decreased after an increase at the beginning of the year associated, inter alia, with the VAT rate hike. Going forward, economic agents expect an inflation slowdown.

Inflation expectations of households. According to the inFOM surveys commissioned by the Bank of Russia, in June–August 2019, the median estimate of inflation observed by the population over the past 12 months was 9.9–10.2%. This is close to the values that prevailed in the second half of 2018 (Chart 2.18).

The median estimate of inflation expected in the next 12 months was unchanged in June–July and slightly decreased in August. It also remains high (9.1%).

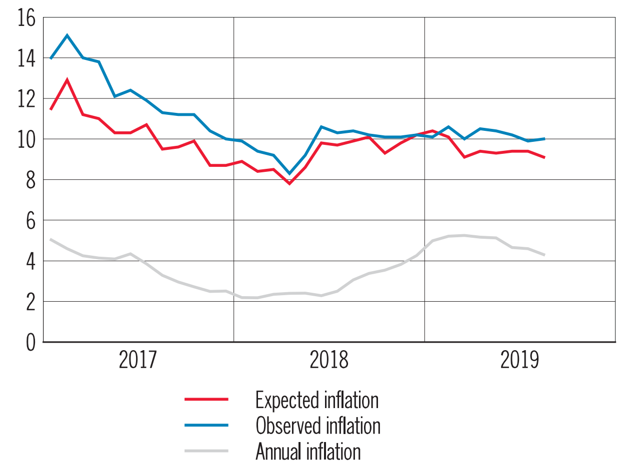
Inflation expectations of households are significantly influenced by the current dynamics of prices for frequently purchased goods and services as well as the news context. Thus, in June, respondents were extremely concerned about a possible increase in petrol prices on the eve of the termination of the agreements between the Government and major oil companies on restrictions on motor fuel price growth from 1 July, which had been widely discussed in the media. In July–August, respondents were less likely to perceive any increase in prices for fruit and vegetables (against the background of their seasonal price drop) as significant but were more concerned about growth of utility tariffs after their planned indexation.

The high sensitivity to current events indicates that inflation expectations of households are still unanchored to the Bank of Russia's targets. At least half of respondents believe that inflation in 2019 and over the three-year horizon will be above 4%.

Price expectations of companies. According to surveys of businesses conducted by the Bank of Russia[4], in June–August 2019, the trend towards reduced price expectations of businesses for three months ahead persisted on the whole. Their slight increase in June was influenced by one-off factors (the situation in global commodity markets, changes in the mechanism of construction project financing) and was offset in July. The decrease in expectations affected all types of economic activity, except for the mining and quarrying

[4] For more details on the survey methodology, see the methodological review 'Analysis of Price Expectations of Businesses', August 2018, www.cbr.ru/Content/Document/File/62 829/analysis_18-12.pdf.

ANNUAL INFLATION OBSERVED AND EXPECTED BY HOUSEHOLDS *Chart 2.18*
(median estimate, %)

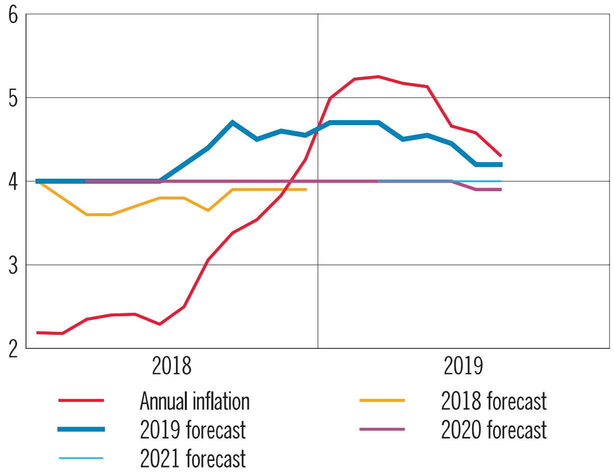


Sources: Rosstat, inFOM.

BUSINESS PRICE EXPECTATIONS *Chart 2.19*
(balance of responses, pp)

Sources: Rosstat, Bank of Russia calculations.

ANALYST INFLATION FORECASTS *Chart 2.20*
(% change on the same month of the previous year)



Sources: Bloomberg, Rosstat.

sector, where enterprises pointed out the global expansion of metal ore prices and the OPEC+ deal extension.

Price expectations remained virtually unchanged in August. Respondents noted weak demand and the strengthening of the ruble as factors in upcoming price dynamics (Chart 2.19).

Inflation expectations of professional analysts. In July–August, the range of professional analysts' inflation forecasts for December 2019 decreased slightly to 4.1–4.3% (Chart 2.20). Analysts' mid-term inflation expectations remain anchored to the Bank of Russia's targets.

3. MACROECONOMIC CONDITIONS

In June–July 2019, the external conditions were favourable for the development of the Russian economy. However, they began to deteriorate in late July and early August. Oil prices went down. Following the results of June–August 2019, the downturn in the global economy persisted. The trade controversies between the USA and China aggravated. Many countries eased their monetary policies. In most countries (except for the USA), inflation expectations declined.

In June–July, the ruble, as the currencies of most emerging market economies, strengthened against the US dollar amid the easing of financial conditions in advanced economies. However, since the beginning of August, EME currencies started weakening against the US dollar on the back of the growing uncertainty in foreign trade and extra risks to global economic growth. August saw an increase in country risk premiums in many EMEs.

The Russian securities market enjoyed stability in June–August: there was a rise in quotes in the bond segment, while stock market indices slightly declined.

Short-term money market rates stayed in the lower half of the interest rate corridor close to the Bank of Russia key rate. Rates with a maturity of more than 1 day continued to fall.

In 2019 Q2, a steady downward trend in deposit rates formed. In May, interest rates on loans, including mortgages, began to decrease. 2019 Q2 saw an acceleration of the corporate lending growth rate. Retail lending growth has been slowing down since May 2019.

According to Rosstat's preliminary estimates, GDP growth sped up in Q2. Pursuant to the Bank of Russia's assessments, consumer demand remained the main growth driver. The GDP data for Q1 evidence a decline in gross fixed capital formation and exports. The drop in imports in Q1 had a positive effect on the GDP dynamics.

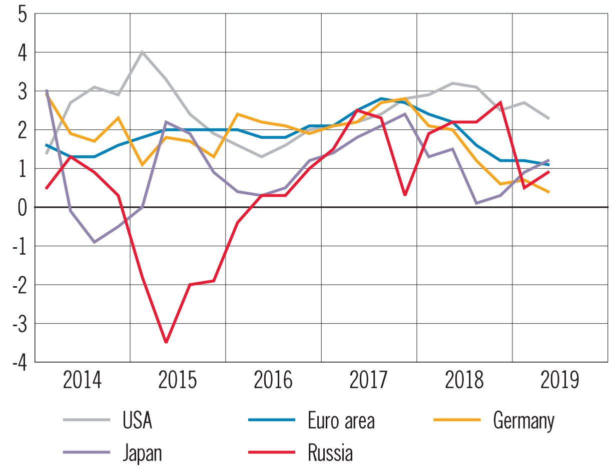
In May–July, the industrial output growth rate was the same as in March–April. The output of investment goods increased. The consumer goods output reduced. Business sentiment in the manufacturing industry deteriorated. Q2 saw a slight increase in investment activity. The growth of consumer demand remained subdued in May–July. Unemployment was at minimum levels, and there was a decrease in the workforce. In Q2, the decline in real household disposable money income slowed down.

As of the end of 2019 H1, financial performance of large- and medium-sized companies was at its highest level for the last 12 years.

In May–July, fiscal policy continued to restrain domestic demand due to a significant increase in non-oil-and-gas revenue and a slow execution of expenditures. The contribution of fiscal policy to the total output accumulated since the beginning of the year is in the negative area.

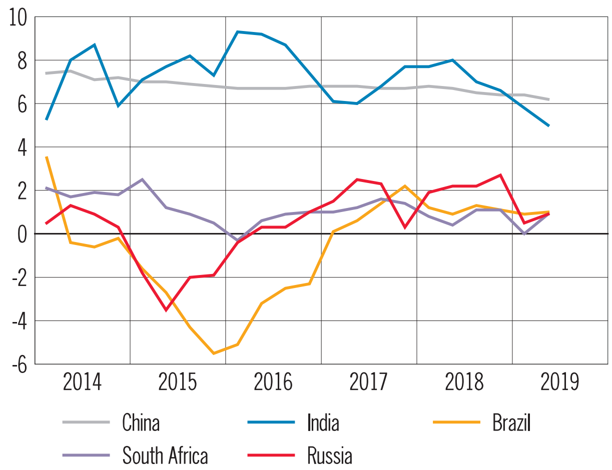
GDP growth is expected to slightly accelerate in Q3–Q4 owing to a rise in public investment, associated with the execution of expenditures for national infrastructure projects, and the continuing trend of a steady increase in households' final consumption expenditure.

GDP GROWTH RATES: ADVANCED ECONOMIES AND RUSSIA *Chart 3.1.1*
(% change on the same period of the previous year)



Source: Bloomberg.

GDP GROWTH RATES: EMES AND RUSSIA *Chart 3.1.2*
(% change on the same period of the previous year)



Source: Bloomberg.

3.1. EXTERNAL CONDITIONS AND BALANCE OF PAYMENTS

GLOBAL ECONOMY

Economic growth worldwide. In 2019 Q2, economic activity in major economies preserved a downward trend amid the continuing trade controversies and a slight easing of monetary policy in a number of countries (Chart 3.1.1).

In China, annual growth slowed down from 6.4% to 6.2% in 2019 Q2. Although this is a 27-year low, it is basically in line with the forecasts of a gradual slowdown in the Chinese economy.

Annual growth in the euro area came in at 1.1% as compared to 1.2% in the previous quarter on the back of its slowdown in Germany from 0.9% to 0.4% (the German economy shrank by 0.1% quarter-on-quarter).

Annual GDP growth in the USA slowed down from 2.7% to 2.3%. Moreover, the revision of the statistics for 2014 Q1–2019 Q1 showed that the US economy had demonstrated higher growth rates in 2017 H2–2018 H1 and lower growth rates in late 2018–early 2019. The peak of annual growth (3.2%) now falls on 2018 Q2, and not on 2019 Q1. Therefore, the fiscal stimulus had the maximum effect in mid-2018, and not in early 2019 as previously assumed.

Among other large economies (Chart 3.1.2), annual growth slowed in India (to 5% vs 5.8% in Q1), Mexico (to -0.8% vs 1.2%), and Australia (to 1.4% vs 1.7%). In contrast, growth sped up in Japan (to 1.2% vs 1.0%), Brazil, South Africa, and South Korea (to 2.1% vs 1.7%). The acceleration of growth in Korea was associated with an increase in government spending in the context of declining exports.

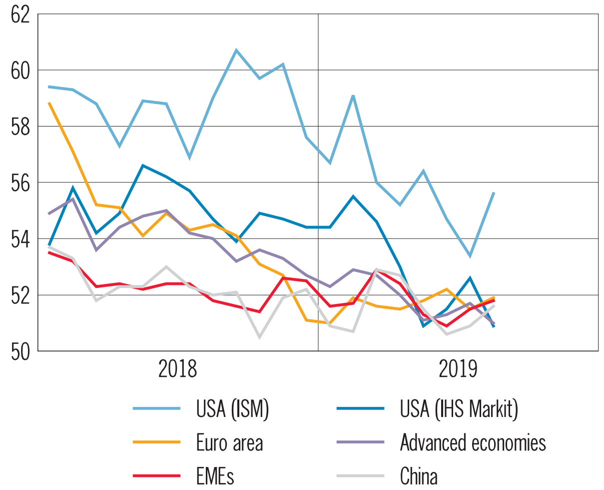
There are still risks of a global economic slowdown, primarily related to the trade controversies. The USA is imposing new 15% duties on Chinese goods in the amount of $300 billion in stages, starting from 1 September and 15 December. In response, China is raising tariffs on goods from the USA in the amount of $75 billion by 5–10% on the same dates. An increase from 25% to 30% in the earlier imposed duties on goods from China worth $250 billion has been postponed from 1 to 15 October. The situation may improve in case of a new round of trade negotiations scheduled for early October. Amid the deepening trade controversies, the exchange rate fell to RMB 7.15 to the US dollar.

PMIs (Chart 3.1.3) and other statistical data indicate that the situation in major world economies remained controversial in July–August. In China, the Caixin Composite PMI rose to 51.6 in August as compared to 50.9 in July, but it remains close to its 2018–2019 lows. The Caixin Manufacturing PMI increased above 50 in August, but a similar index calculated by the National Bureau of Statistics remains in the recession zone (below 50) for the fourth consecutive month. Economic activity in the euro area is supported by the services sector. The composite PMI rose to 51.9 in August from 51.5 in July, while the manufacturing PMI remains below 50 for the seventh consecutive month, although its slowdown slightly decelerated in August. In Germany, the manufacturing PMI in July–August was just above 43 (the lowest since July 2012). In the USA, where the effect of the fiscal stimulus is being gradually exhausted, economic activity stabilized in July–August. The composite IHS Markit index fell to 50.7 from 52.6 in July, while the ISM PMI rose to 55.6 from 53.4. The job creation rate remains high (above 100,000), but is showing a downturn trend: 193,000 in June; 159,000 in July; and 130,000 in August.

Inflation worldwide. Although external inflationary pressure slightly increased in July–August, it generally remained quite low, both in AEs and in most EMEs (Charts 3.1.4, 3.1.5). Amid the slowdown of growth in major economies, inflation expectations have been decreasing in most countries. In the USA, annual inflation rose to 1.8% in July as compared to 1.6% in May. Core inflation was 2.2% (vs 2.1% in June). Wage growth in August also remained high – 3.2% year-on-year and 0.4% month-on-month (as compared to 3.3% and 0.3% in July, respectively).

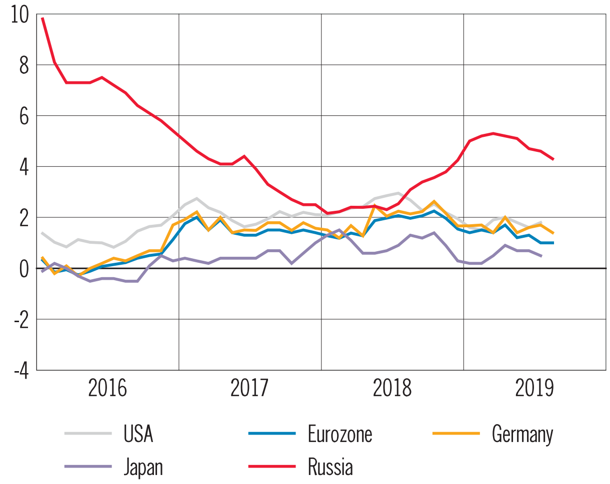
In the euro area, inflation slowed down from 1.3% in June to 1.0% in July and August. Annual inflation in Japan fell from 0.7% in May–June to 0.5% in July. As for large EMEs, in July, inflation in China was 2.8% (vs 2.7% in June), while in India it was 3.1% (vs 3.2% in June). In Brazil and South Africa, annual inflation decreased to 3.2% and 4%, respectively.

DYNAMICS OF PMI COMPOSITE *Chart 3.1.3*
(points)



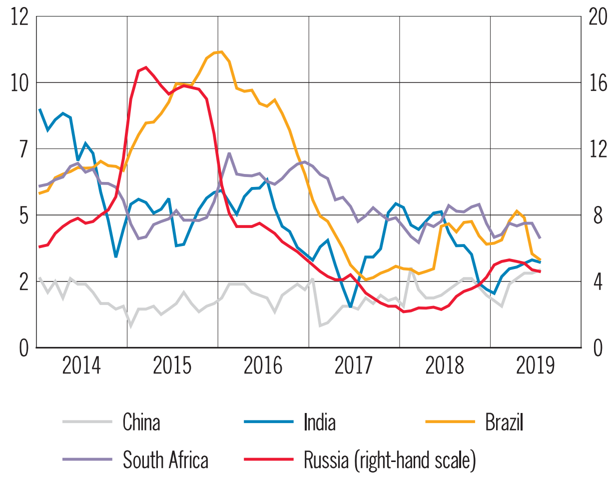
Source: Bloomberg.

INFLATION: ADVANCED ECONOMIES AND RUSSIA *Chart 3.1.4*
(% change on the same period of the previous year)



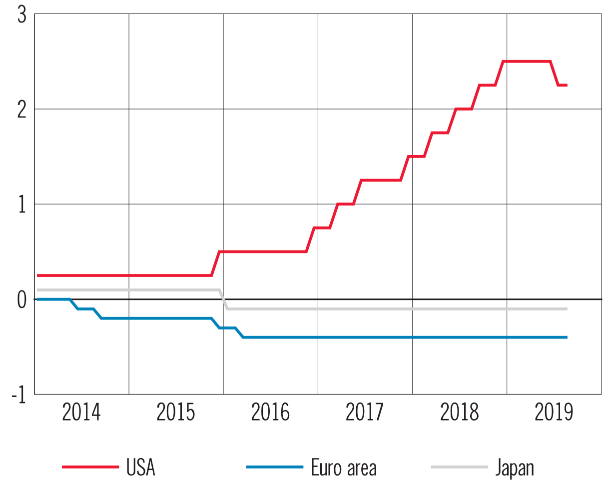
Source: Bloomberg.

INFLATION: EMES AND RUSSIA *Chart 3.1.5*
(% change on the same period of the previous year)



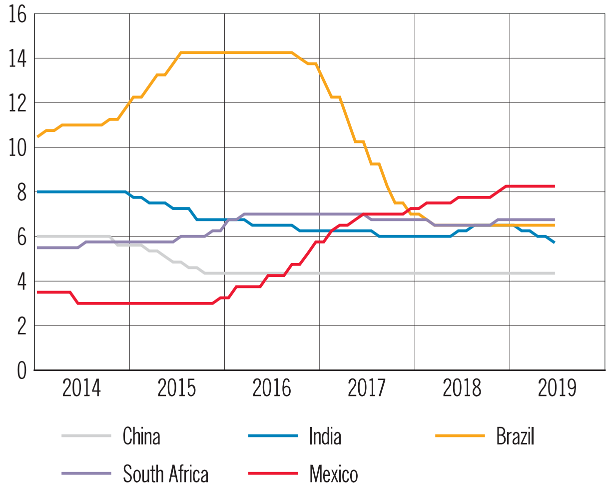
Source: Bloomberg.

POLICY RATES, ADVANCED ECONOMIES *Chart 3.1.6*
(%)



Source: Bloomberg.

POLICY RATES, EMES *Chart 3.1.7*
(%)



Source: Bloomberg.

MONETARY POLICIES OF FOREIGN CENTRAL BANKS

In the first half of this year, in response to a slowdown in growth rates and a decrease in growth forecasts for 2019–2020, the monetary authorities of most countries suspended the normalisation of monetary policy or even eased it (Charts 3.1.6, 3.1.7).

Monetary policies in the USA and the euro area. Following its meeting on 31 July, the US Fed reduced the rate by 25 basis points. However, the US Fed's representatives noted that this decline did not imply the beginning of a monetary policy easing cycle. Yet, market participants expect at least one more rate cut in 2019.

In August 2019, the US Fed announced an early end to the quantitative tightening programme (balance sheet reduction). It had been previously assumed that this would happen in September. The early termination of the programme was possibly associated with the US Treasury's plan to increase borrowings in the market in Q3 by $274 billion to total $433 billion.

Low price pressure in the euro area creates the conditions for a more accommodative policy of the ECB that preserved the monetary policy parameters unchanged following its meeting on 25 July, while having noted that the rate might stay at the current level or decrease. In 2019 H2, auctions will be held within TLTRO III (targeted longer-term refinancing operations) to provide long-term liquidity to the euro area's banking sector.

Monetary policies in other countries. In other regions, amid a pause in the normalisation of monetary policy and its slight easing in the world's leading economies, many central banks have also loosened monetary conditions. In particular, in June–August, the policy rates were lowered in India (to 5.4%), Brazil (to 6%), South Africa (to 6.5%), Indonesia (to 5.5%), South Korea (to 1.5%), Australia (to 1.0%), Mexico (to 8%), New Zealand (to 1%), and Chile (to 2%). China decreased the mandatory reserve requirements for banks by 50 bp to 13%.

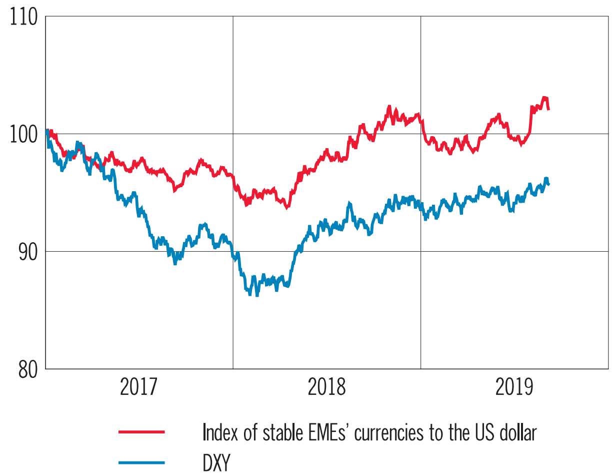
GLOBAL FINANCIAL MARKETS

Currencies. In June–July, the global FX market demonstrated diverse trends. The currencies of most advanced economies weakened against the US dollar by around 2% due to the rising expectations of monetary policy easing in most G10 countries (Chart 3.1.8). The British pound fell more significantly against the US dollar because of the new Prime Minister's rigid position regarding Brexit. In contrast, the currencies of most EMEs strengthened against the US dollar by 1–5% amid the expectations of the easing of financial conditions in advanced economies.

Due to the escalating trade controversies between the USA and China, volatility in financial markets has been intensifying since the beginning of August. As uncertainty in foreign trade and additional risks to global economic growth increased, most emerging market currencies weakened against the US dollar by 1–6%. In Argentina, rising political uncertainty increased fears of default and led to depreciation of the national currency by more than 20%, following which the government was forced to impose capital controls and seek help from the IMF. The dynamics of advanced economies' currencies against the US dollar were diverse: safe haven currencies, such as the Swiss franc and the Japanese yen, primarily strengthened, and the British pound appreciated by 1.5%, having slightly offset the July fall. The New Zealand dollar and the Norwegian krone declined by 1–2%.

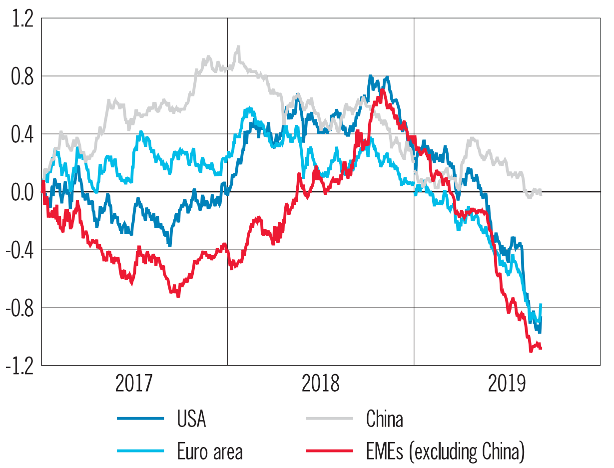
Interest rates. In June–August, short-term interest rates on government debt decreased in all major advanced economies due to persistently low inflationary pressure with an expected further slowdown of economic growth in most regions. As a result, the softened rhetoric of advanced economies' central banks boosted market expectations of further monetary policy easing. Yields on 2-year securities declined in the USA by over 45 bp, in Germany by more than 20 bp, in Japan by over 10 bp, and in the UK by more than 20 bp (Chart 3.1.10). Even in Italy, despite the political crisis aggravation

US DOLLAR EXCHANGE RATE AGAINST ADVANCED ECONOMIES' AND EMES' CURRENCIES *Chart 3.1.8*
(100 = 02.01.2017)



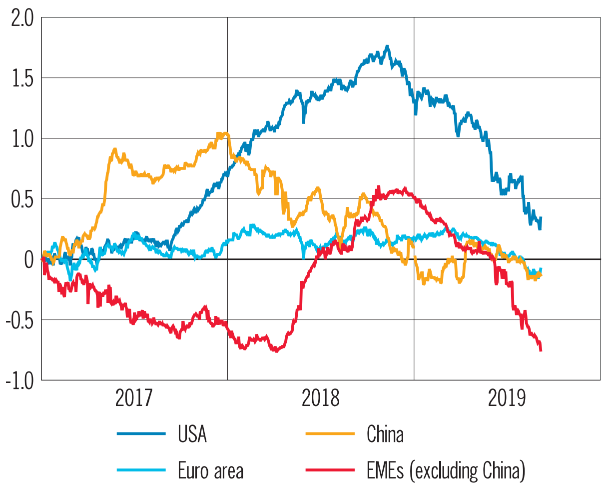
Sources: Reuters, Bank of Russia calculations.

YIELDS ON 10-YEAR GOVERNMENT BONDS *Chart 3.1.9*
(change on 02.01.2017, pp)



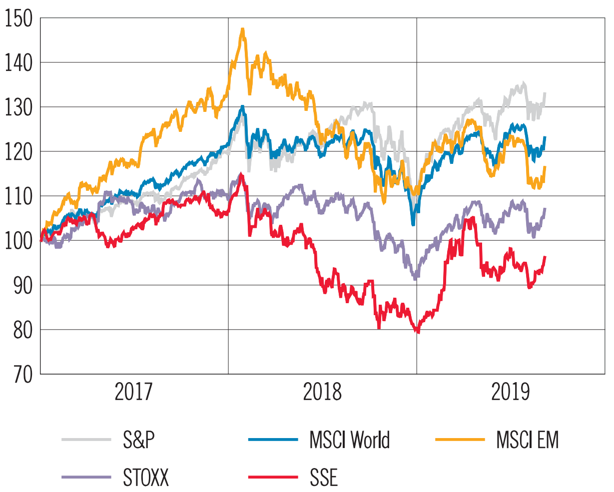
Sources: Reuters, Bank of Russia calculations.

YIELDS ON 2-YEAR GOVERNMENT BONDS *Chart 3.1.10*
(change on 02.01.2017, pp)



Sources: Reuters, Bank of Russia calculations.

STOCK INDICES *Chart 3.1.11*
(100 = 02.01.2017)



Source: Reuters.

and the yield growth in certain periods, 2-year government bonds had negative yields again in August (for the first time since May 2018).

Expected further rate cuts in most regions and the likely resumption of quantitative easing in the euro area contributed to the revision of long-term rate expectations. This also had a downward impact on long-term bond yields. In advanced economies, 10-year government bond yields fell by 15–180 bp during the period under review, with the greatest decline recorded in Italy due to the hopes for the formation of a new government (Chart 3.1.9).

Dynamics of advanced economies' government debt curve were diverse in June–July. However, after the risk of new US trade duties emerged, the US state debt curve began to approach inversion. The yield spread between 2-year and 10-year securities became negative for the first time since 2007, and the yield spread between 3-month and 10-year securities had been in the negative area since May and fell below -45 points in August. In Germany, the spread for the 3–10 year interval has also continued to decline and remains the lowest since 2007.

Lower yields in advanced economies and risks of a slowdown in the global economy contributed to a downward revision of expectations for central banks' policy rates in most stable EMEs.

Yields on largest EMEs' 10-year government bonds declined by 50–120 points. In Turkey, long-term rates decreased by more than 330 points due to a 425-point rate reduction by the central bank, which exceeded analysts' expectations.

Country risk premiums. In June–August, the value of contracts in the credit default swap market changed only slightly in advanced economies. The value of a 5-year contract in the UK increased a little (by no more than 5 points) under the influence of a growing probability of a no-deal Brexit. The market of insurance against Italian default remained volatile, but by the end of August, as the country's debt market stabilised, the risk premium fell below 150 points, which is the lowest since May 2018.

In June–July, the cost of credit default swaps of most EMEs declined, being affected by the expectations of monetary policy easing

(Chart 3.1.12). After the escalation of the trade controversies and market volatility increase, August saw a surge of CDS in most countries. However, the cost of contracts in most countries remained below the values recorded in early summer, when the USA announced the previous increase in the trade duties. The value of contracts in largest EMEs remains 30–180 points below the peak values of 2018 Q3–Q4.

Stocks. In June–July, most stock markets of both advanced and emerging market economies grew by 5–10% amid the rising expectations of easing financial conditions in most countries and the expectations of a resumption of quantitative easing in individual regions (Chart 3.1.11). However, after a new round of the US trade duties and a potential response of China to them were announced in August, there was a market adjustment that completed in the middle of the month.

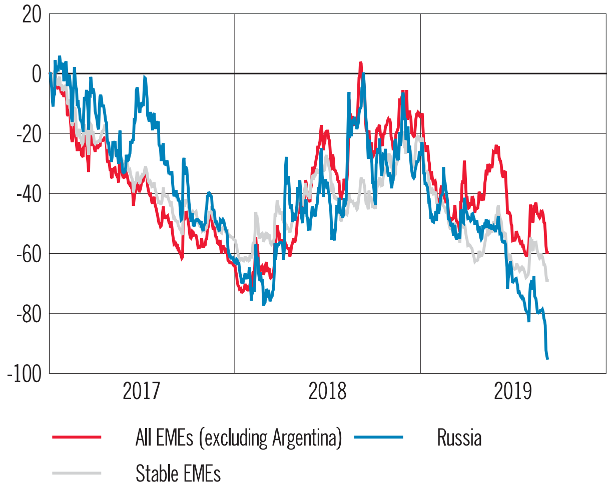
As a result, in June–August, the indices of the major advanced economies remained above their early summer levels by 2–5%, while the indices of EMEs demonstrated diverse dynamics. The most significant decline in the stock market is observed in Argentina (by over 30%) due to the debt crisis.

GLOBAL COMMODITY MARKETS

Oil. After rising in January–May, global prices for oil, Russia's key export commodity, dropped in June–August (Chart 3.1.13). On 7 August, the price for Urals crude oil fell to $56 per barrel, its lowest level since January. In June–August, the Urals crude oil price averaged $62 per barrel. The price decline was caused by increasing concerns about global demand amid the deterioration of the trade relations between the USA and China, the largest oil consumers. The decrease in prices was restrained by the over-fulfilment of the OPEC+ agreement and the continuing production cuts in Iran and Venezuela (Chart 3.1.14).

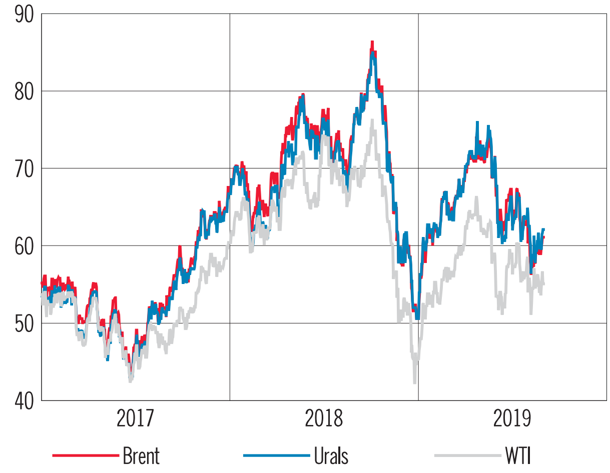
Oil – global demand. According to the International Energy Agency's assessments provided in August, growth of global demand for oil in January–May 2019 was the slowest since 2008. The IEA expects that on average it will increase in 2019 by as little as 1.1 million

CDS OF EMES
(change on 02.01.2017, bp)
Chart 3.1.12



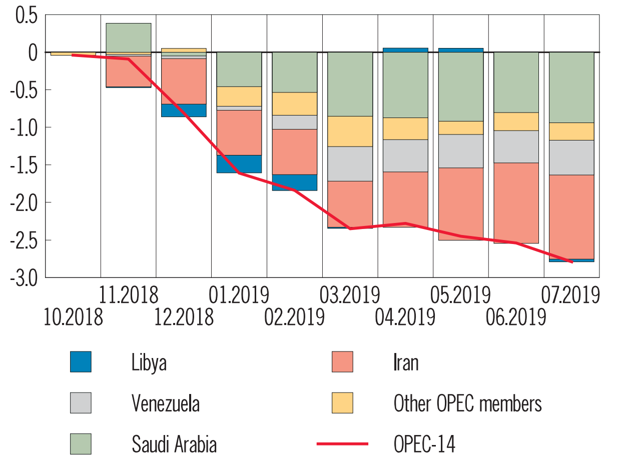
Sources: Reuters, Bank of Russia calculations.

OIL PRICES
(US dollars per barrel)
Chart 3.1.13



Sources: Thomson Reuters, Bloomberg.

CHANGE IN OPEC CRUDE OIL PRODUCTION SINCE OCTOBER 2018* *Chart 3.1.14*
(million barrels per day)



** For Kuwait – since September 2018.*
Source: calculations based on OPEC secondary source data.

barrels per day. In January, the August forecast was revised downwards by 300,000 barrels per day on the back of a deteriorating global economy growth outlook. In summer, the World Bank and the IMF considerably lowered their forecasts for global GDP growth due to rising barriers in international trade.

Oil – OPEC+. The production limiting agreements were extended for 9 months, until the end of March 2020. To support oil prices, a number of countries continue to exceed their commitments. The largest contributor is Saudi Arabia: it has reduced production in July 2019 by over 900,000 barrels per day compared to October 2018, i.e. by 600,000 barrels above its commitments. Angola, Kuwait, and other countries have also cut the production by more than required by the agreement. The production cut by the non-OPEC members who joined the deal also continued to support oil prices. In May–July, Russia exceeded its commitments. At the same time, the resumption of supplies via the Druzhba pipeline contributed to the recovery of oil production in Russia.

Oil – supply from Iran and Venezuela. In July 2019, oil production in Iran dropped to a 30-year low. According to OPEC's secondary sources, production has decreased by 1.1 million barrels per day since October and by 1.5 million barrels per day since July 2018. This happened on the back of the reduction in Iran's exports due to the termination in May of the US concessions for Iranian oil importers. Oil production in Venezuela also significantly declined – by 0.5 million barrels per day since October 2018. This was caused by the US sanctions and the poor state of the oil production infrastructure.

Oil – non-OPEC+ production. According to the US Department of Energy, oil production in the USA fell in July by 300,000 barrels per day as compared to June. This occurred due to the suspension of works on the Gulf of Mexico platforms ahead of Hurricane Barry. However, in late July–early August, oil production in the USA recovered. In July 2019, the supply of oil and other liquid fuels in the USA increased by 1.3 million barrels per day as compared to July 2018 and by more than 0.5 million barrels per day since October. As a result, the expansion of production by non-OPEC countries not participating in the agreements by 1 million barrels per day since October and by 1.7 million barrels per day since July 2018 partially offset the decrease in production by the OPEC+ members, Iran and Venezuela.

Situation in other commodity markets. In summer, global prices for other energy commodities remained close to their long-term lows (Chart 3.1.15): for natural gas in Europe – since 2003; for coal – since 2016. The drop in production had a negative impact on world coal prices. Global metal markets demonstrated diverse dynamics. In June–August, prices for aluminium and copper fell both compared to the same period of 2018 and early 2019 amid the slowdown of economic growth in China, the largest consumer. At the same time, in July 2019, world iron ore prices were the highest since 2014 amid the supply-side constraints. However, in August, iron ore prices dropped due to the rising tension in international trade and an increase in Brazil's exports after the resumption of work at one of the country's largest mines.

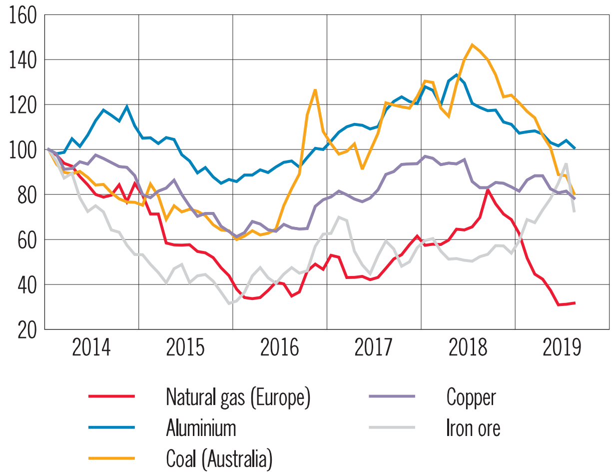
Food. In June–August 2019, global food prices increased by 1% compared to the same period in 2018 (Chart 3.1.16). Meat prices rose due to significant imports to Asian countries. Sugar prices were up due to the deterioration of the estimates regarding its manufacture in the central part of Brazil, the largest sugar exporter. Global prices for cereals have changed only slightly (Chart 3.1.17): good harvests are expected in 2019. Generally, after the increase in January–May 2019, global food prices dropped in June–August as compared to the previous months.

BALANCE OF PAYMENTS

Current account. According to the preliminary estimate, the current account balance decreased in 2019 Q2 by \$6 billion to \$12 billion.[1] This was due to a 6% decline in goods and service exports amid the decrease in world commodity prices and lower supplies (Charts 3.1.18, 3.1.19). In the first half of 2019, the current account surplus reduced by \$2 billion to \$46 billion.

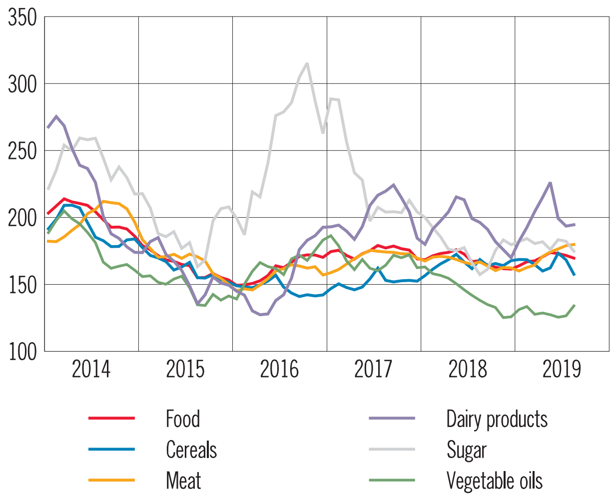
[1] *Hereinafter, changes are given as compared to the same period of the previous year, unless specified otherwise.*

GLOBAL PRICES FOR KEY RUSSIAN EXPORT COMMODITIES *Chart 3.1.15*
(January 2014 = 100%)



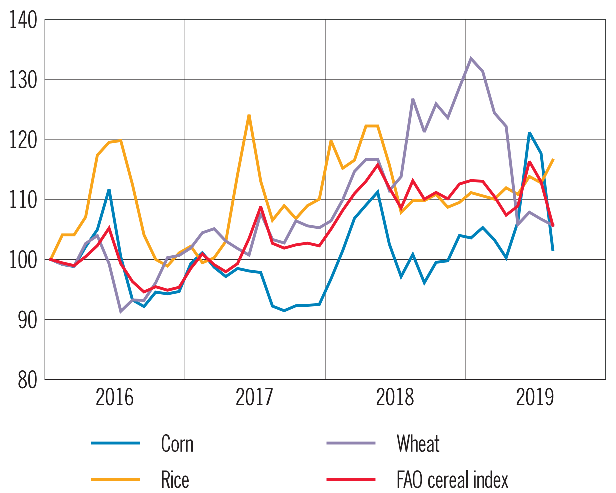
Source: World Bank.

GLOBAL FOOD PRICES *Chart 3.1.16*
(2002–2004=100%)



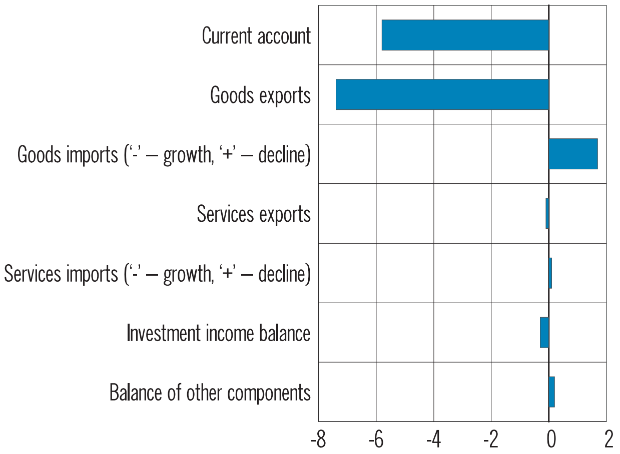
Source: UN Food and Agriculture Organization (FAO).

GLOBAL PRICES FOR CEREALS *Chart 3.1.17*
(January 2016 = 100%)



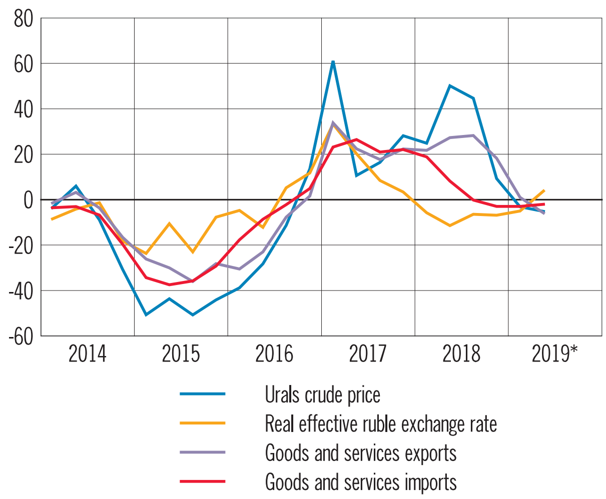
Sources: World Bank, Bloomberg, UN Food and Agriculture Organization (FAO).

GROWTH STRUCTURE OF THE CURRENT ACCOUNT BALANCE IN 2019 Q2 *Chart 3.1.18*
(billions of US dollars on the same quarter of the previous year)



** Assessment for 2019 Q2.*
Source: Bank of Russia.

FOREIGN TRADE *Chart 3.1.19*
(% change on the same quarter of the previous year)



** Assessment of exports and imports for 2019 Q2.*
Sources: Bank of Russia, Thomson Reuters.

Oil exports. Oil exports decreased due to the contamination of the Druzhba pipeline. In May, Russian oil supplies via this pipeline dropped by about 900,000 barrels per day compared to Q1. The supply decline most significantly affected Belarus, Poland and Germany. At the same time, it was largely offset by the expansion of oil and petroleum product exports along other routes and to other destinations. In addition, thanks to the measures taken to decontaminate the oil and the pipeline system, supplies via Druzhba gradually restored. In June, oil exports via this pipeline increased by more than 400,000 barrels per day as compared to May. Since July, supplies via the Druzhba pipeline have been resumed in full.

Gas exports. Supplies of Russian natural gas in the gaseous state also declined. Supplies to Turkey have been shrinking since 2018 due to falling consumption amid unfavourable economic conditions and an increase in LNG purchases from Qatar and gas imports from Azerbaijan. The decline in gas exports to Germany in 2019 was caused by weather conditions. At the same time, Russian gas supplies to the Netherlands increased owing to the Dutch government's plans to accelerate production cuts at the Groningen field due to earthquakes. In addition, Russian LNG exports are rapidly growing, having increased by 90% in 2019 Q2. The share of LNG in the value of exports doubled in 2019 Q2 and amounted to 2%.

Non-oil-and-gas exports. In Q2, the total value of exports decreased by 5%. This was caused by a decline in the quantities of ferrous metal exports to Turkey amid a low production activity and to the USA due to the increase in duties in 2018. Supplies of Russian wheat (mainly to Egypt) considerably reduced. At the same time, the FAO expects that in 2019/2020 wheat supplies from Russia will exceed the average volume for the past 5 years by about 20% owing to good harvest prospects and high demand for Russian grain.

Imports. The decline in the value of goods and service imports in Q2 slowed to 2% from 3% in Q1, supported by the appreciation of the ruble. In Q2, the real effective ruble exchange rate increased by 4%. But the demandside support weakened. Retail sales growth slowed down. Business activity was weak. As a result, both the import value and quantities of machinery and industrial and laboratory equipment dropped. Imports of computers and telephones decreased.

In addition, imports of individual goods were affected by industry factors. Import quantities of tractors in 2019 decreased owing to the expansion of their production in Russia. This was facilitated by the 60% increase in subsidies allocated to domestic agricultural equipment manufacturers in 2019 within Programme No. 1432.[2]

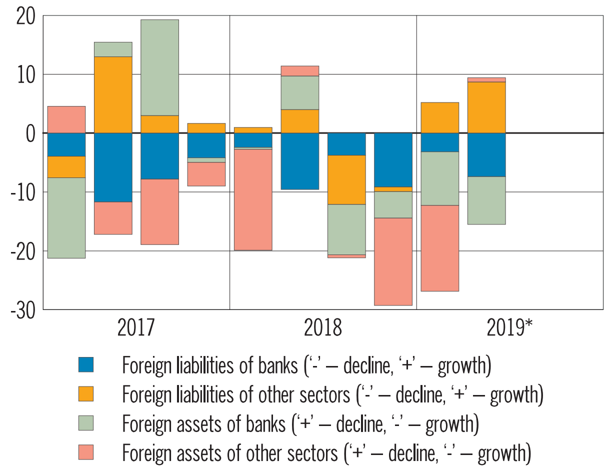
Financial account – private sector. According to the preliminary estimate, net lending by the Russian private sector to the rest of the world dropped from $24 billion in 2019 Q1 to $3 billion in 2019 Q2 due to a slowdown in the growth of foreign assets caused by lower revenues from foreign economic activity (Chart 3.1.20). However, the situation differs from the previous years when banks reduced foreign assets along with the repayment of external debt. This was also typical for 2018 Q2 when there was an inflow of private capital in the amount of $5 billion. In 2019 Q2, banks continued to reduce foreign liabilities, but to a lesser extent than in the previous year. Other sectors managed to increase their external liabilities more significantly than in 2018 Q2, although their access to the Western capital market was limited.

Financial account – public sector. Foreign investors' interest in public debt also increased. As in 2019 Q1, there was a significant foreign capital inflow into the public sector in Q2 totalling $8 billion. In the secondary market, non-residents purchased Russian government bonds in the amount of over $10 billion.

Foreign currency reserves. In 2019 Q2, reserves increased by $17 billion mainly owing to fiscal rule-based foreign currency purchases (Chart 3.1.21). As a result, by mid-2019 Russia's foreign currency reserves exceeded $500 billion and became sufficient to finance imports during 18 months.

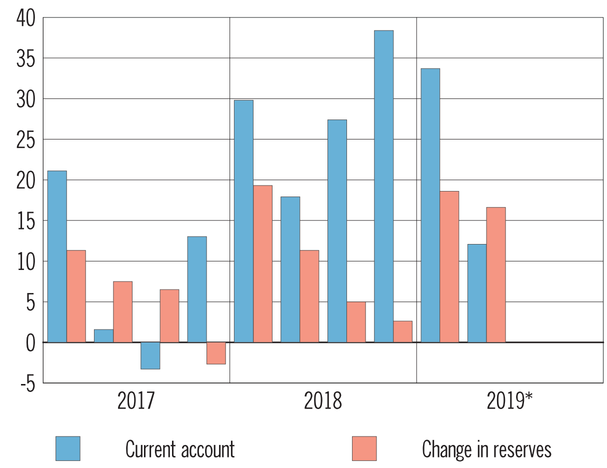
[2] *According to Resolution of the Government of the Russian Federation No. 8, dated 18 January 2019, 'On Amending the Regulations for the Allocation of Subsidies to Farming Equipment Manufacturers'.*

MAJOR PRIVATE SECTOR FINANCIAL ACCOUNT COMPONENTS *Chart 3.1.20*
(billions of US dollars)



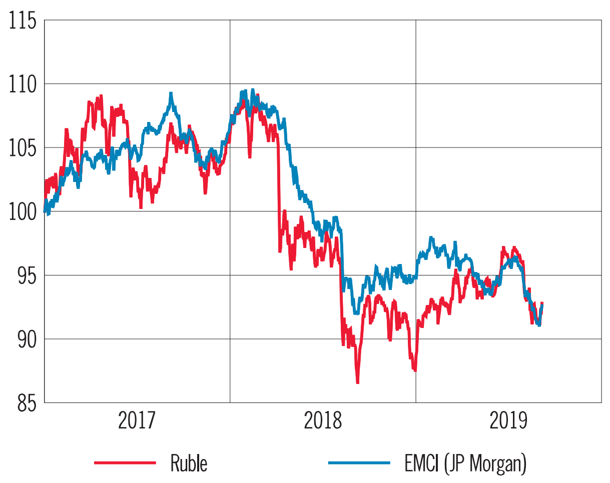
** Assessment for 2019 Q2.*
Source: Bank of Russia.

RESERVE ASSETS AND CURRENT ACCOUNT *Chart 3.1.21*
(billions of US dollars)



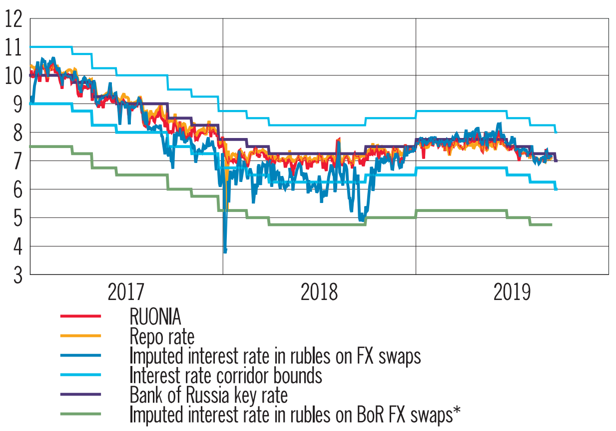
** Assessment of the current account for 2019 Q2.*
Source: Bank of Russia.

RUBLE/US DOLLAR EXCHANGE RATE AND EMCI *Chart 3.1.22*
(100 = 02.01.2017)



Source: Thomson Reuters.

MONEY MARKET RATES *Chart 3.2.1*
(% p.a.)



** Imputed rate on BoR reverse FX swap = ruble lending rate – foreign currency 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.

FOREIGN EXCHANGE MARKET

Ruble exchange rate. In June–August, the ruble exchange rate was impacted primarily by external factors (Chart 3.1.22). Accordingly, its dynamics largely coincided with the path of other EME currencies (during the period under review, the index of EME currencies dropped by 1.7%). In the second half of June, EME currencies, including the ruble, mainly strengthened amid the rising expectations for the easing of monetary policy by the US Fed. However, market participants somewhat overestimated the pace of such easing, and after a number of statements from the US Fed's representatives about a possibly slower rate reduction, EME currencies began to weaken. In early August, the decline sped up due to concerns about escalation of the trade war between the USA and China. The ruble exchange rate was also adversely affected by the imposition of the new anti-Russian sanctions. However, according to the model estimates, their impact was quite moderate and did not exceed 0.5%. Dividend payouts did not have a significant influence on the ruble exchange rate dynamics and, according to the estimates, could resulted in an additional 1% rise of the ruble in June, which was offset in July by the reverse conversion of payouts.

3.2. MONETARY CONDITIONS

MONEY MARKET

Short-term rates. Short-term interbank lending rates in the money market stayed in the lower half of the interest rate corridor close to the Bank of Russia key rate (Chart 3.2.1). From the beginning of June through 5 September, the spread averaged -17 bp (vs -8 bp in Q2). The spread ranged from -51 to 16 bp (as compared to the range of -43 to 31 bp in Q2). More information on the formation of interbank lending rates and regarding liquidity is provided in Section 4.2 'System of monetary policy instruments and other monetary policy measures'.

Foreign currency liquidity. The interest rate spread in the FX swap and interbank lending segments decreased, reflecting a slight increase in the cost of foreign currency borrowings in the Russian money market (Chart 3.2.2). In June–August, the spread of short-term interest rates in the FX swap and interbank lending segments averaged +8 bp (vs +23 bp in Q2). The spread reduced amid the seasonal decline in the foreign currency inflow in the current account of the balance of payments in the context of significant fiscal rule-based foreign currency purchases and lower oil prices.

Long-term rates. Money market rates for tenors of more than 1 day continued to fall (by the beginning of September, the 6-month Mosprime rate dropped to 7.53% as compared to 8.23% on 14 June) as a result of the declining trajectory of short-term money market rates expected by the market (Charts 3.2.3, 3.2.4). Expectations changed on the back of inflation deceleration and the Bank of Russia's comments on potential further easing of monetary policy. In these circumstances, the decisions to reduce the key rate approved at the meetings of the Board of Directors in July and September were largely already reflected in the money market rates.

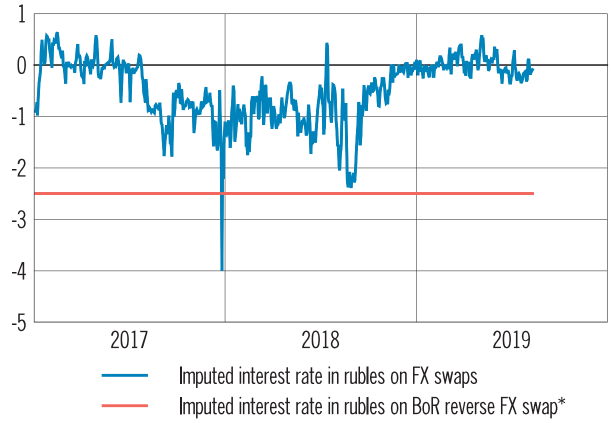
STOCK MARKET

The situation in the Russian stock market remained generally stable in June–September. However, during the largest part of this period global markets saw a declining interest in assets of emerging market economies, including Russia, due to concerns about escalation of trade wars and a slowdown in the world economy. Yet, in late August and early September, after the news about the USA and China planning to continue their trade negotiations, investor interest in high-risk assets rose again, thus enabling markets to partially offset the decline.

Government bond market. In the government bond segment, the situation was more positive. Yields on federal government bonds (OFZs) decreased by 40–70 bp depending on maturities (Chart 3.2.5). The adverse impact of external factors was offset owing to the easing of monetary policy by the Bank of Russia and expectations of a further reduction of the key rate. The growth of bond quotes was also driven by a decrease in the securities supply

INTEREST RATE SPREAD
IN THE FX SWAP SEGMENT TO THE KEY RATE
(pp)

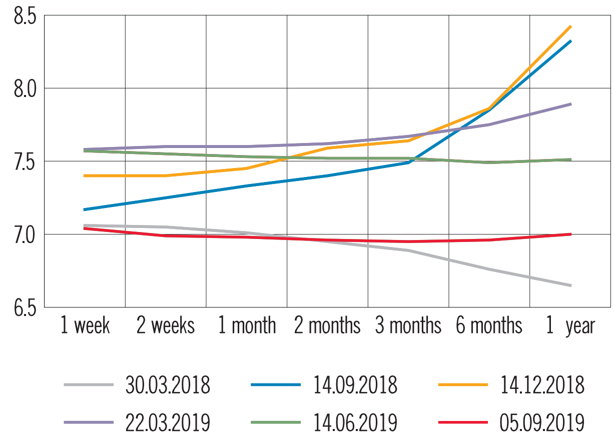
Chart 3.2.2



** Imputed rate = ruble lending rate – foreign currency 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.

ROISFIX CURVE
(% p.a.)

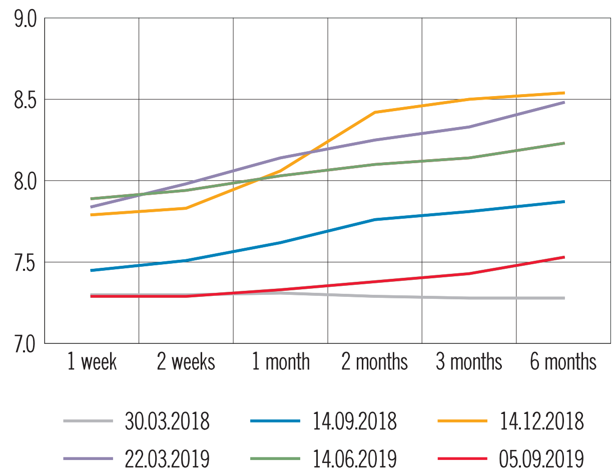
Chart 3.2.3



Note: ROISFIX (RUONIA Overnight Interest Rate Swap) is an indicative rate (fixing) for RUONIA interest swap transactions. It reflects the expected average RUONIA rate over a horizon from 1 week to 1 year.
Source: SRO NFA.

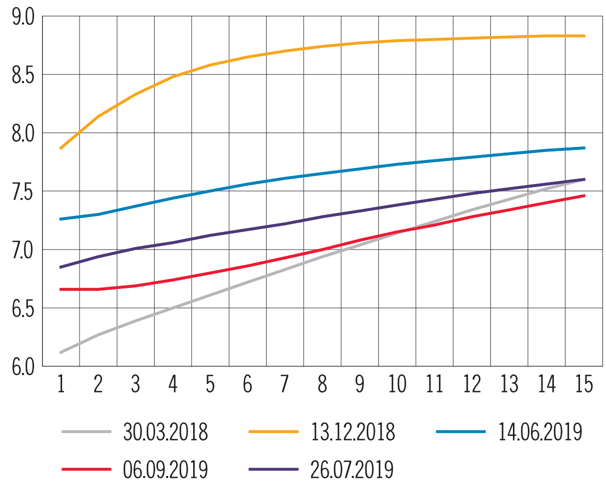
MOSPRIME CURVE
(% p.a.)

Chart 3.2.4



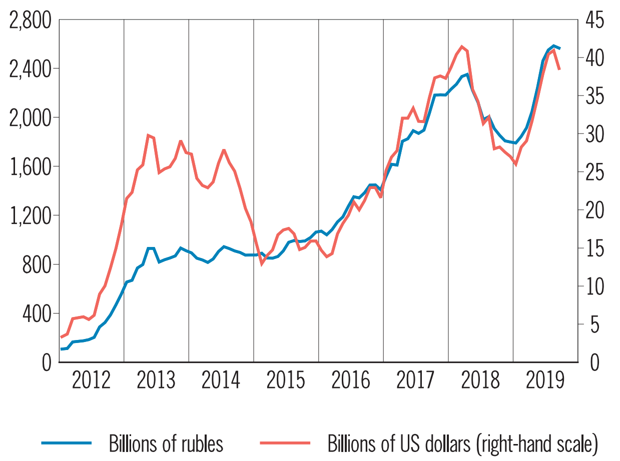
Source: SRO NFA.

OFZ ZERO COUPON YIELD CURVE *Chart 3.2.5*
(% p.a.)



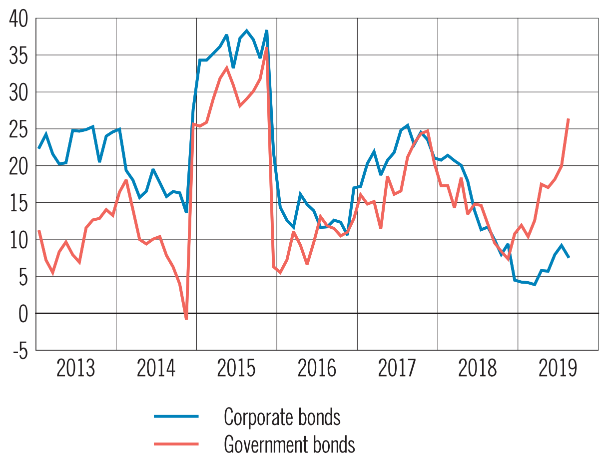
Source: Moscow Exchange.

NOMINAL VALUE OF OFZS HELD BY NON-RESIDENTS *Chart 3.2.6*



Source: National Settlement Depository.

CORPORATE AND GOVERNMENT SECURITIES PORTFOLIO *Chart 3.2.7*
(% growth on the same period of the previous year)



Source: Cbonds.ru

on the part of Russia's Ministry of Finance. In June, after the excessive offering in Q1 and Q2, the Ministry resumed auctions with an offer limit. As a result, in June–July, some investors, including a significant portion of non-residents among them, actively purchased securities in the secondary market. In August, foreign investments in OFZs slightly decreased (by ₽18 billion), which was mainly caused by a general decline in demand for high-risk assets in global markets (Chart 3.2.6). The imposition of the new anti-Russian sanctions only had a short-term negative impact. After the first news, foreign investors sold securities worth ₽17 billion. However, when it had become clear that the sanctions did not affect OFZs, the securities were bought back within a few days, and the yields returned to their previous level.

Corporate bond market. In the corporate bond market, yields continued to decline following the government bond market (Chart 3.2.9). The spread between them remained stable throughout the period under review, ranging from 60 to 75 bp (Chart 3.2.8). As yields declined, companies increased their issues, and the annual growth rate of the portfolio of traded corporate bonds recovered to 8% (Chart 3.2.7). During June–August, companies placed bonds in the amount of ₽560 billion, of which ₽413 billion were in the market (according to Cbonds.ru), i.e. they were offered to a broad circle of investors. This is comparable to the same period in 2017 when companies placed securities worth ₽688 billion, including market securities accounting for ₽266 billion (the total issue in 2018 was significantly smaller due to concerns about tightening of the sanctions). Corporate securities were demanded among all groups of local investors, namely 42% were bought by banks, 25% by collective investors, 16% by individuals, 13% by non-bank organizations, and the rest by non-residents.

Equity market. The Russian equity market, as the FX market, largely followed the dynamics of other emerging economies' markets. The MOEX index reached its historical high amid the general growth of risk appetite and then began to gradually decrease (Chart 3.2.10). The situation in the oil market and the end of the dividend period had an additional negative impact. In late August–early September, amid the recovery of demand for high-risk assets in global markets, the Russian market partially offset the decline, and the MOEX index rose by 2% by the end of the period under review.

DEPOSIT AND LOAN MARKET

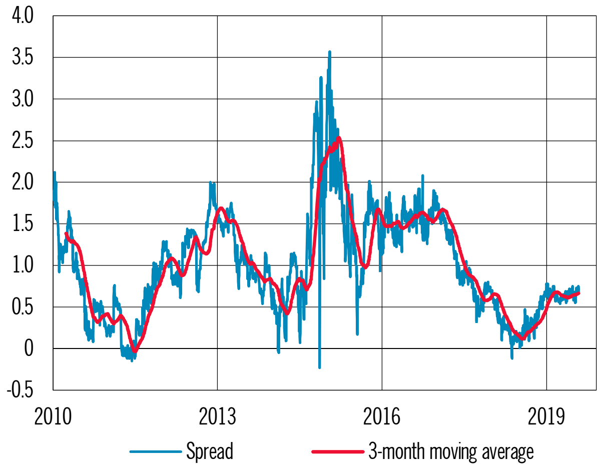
Deposit rates. In 2019 Q2, a steady downward trend in deposit rates took shape. The key rate cut as well as expectations as regards this cut, which manifested in the dynamics of bond yields, were reflected in the change in deposit rates. In June, interest rates on both short-term and long-term deposits decreased by 0.3 pp compared to March (Chart 3.2.11). In July–August, the banks that are the main participants of the deposit market continued to reduce deposit rates. As inflation returns to the target and long-term money market rates and bond yields adjust accordingly, we can expect, in the short term, a further reduction of average market deposit rates.

Deposit operations. The decline in deposit rates in April–June was comparable to the decline in inflation. Real deposit rates remained positive and attractive to depositors. In these conditions, the inflow of household funds to deposits continued. As of early August, the annual growth of household deposits[3] amounted to 7.1% vs 6.8% as of the beginning of May.

Ruble operations, mainly long-term ones, still dominated the inflow of household funds to bank deposits (Chart 3.2.12). The desire of depositors to fix the current yield on deposits coupled with declining deposit rates contributed to the increased attractiveness of long-term ruble deposits. The annual growth rate of the portfolio of ruble deposits up to 1 year by the beginning of August decreased to 1.8%, while the same rate for deposits with maturity of over 1 year increased to 14.9%.

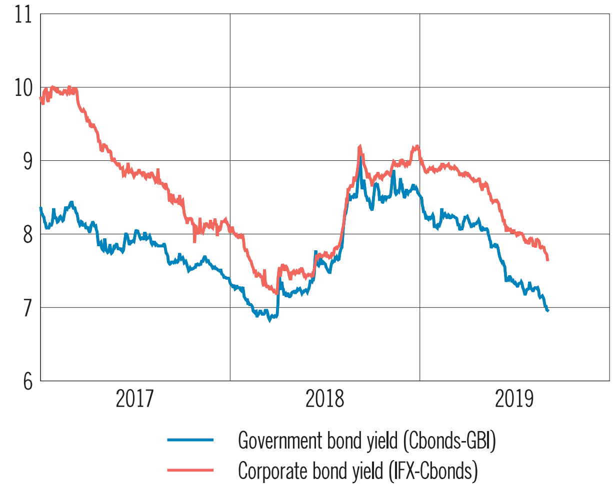
[3] *Hereinafter, increases in banks' balance sheet indicators are calculated based on reporting data of operating credit institutions recorded in the State Register as of the relevant reporting date. Increases in foreign currency claims and liabilities are calculated in US dollar terms. For the analysis of flows of funds between banks and their customers, the growth of the foreign currency component is converted into rubles using the period average exchange rate when calculating increases in balance sheet indicators comprising foreign currency and ruble components.*

SPREAD BETWEEN CORPORATE AND GOVERNMENT BOND YIELDS
(pp)
Chart 3.2.8



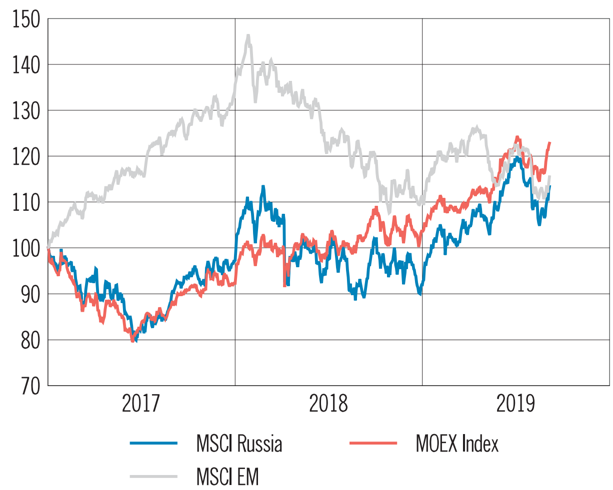
Source: Cbonds.ru

YIELD INDICES OF CORPORATE AND GOVERNMENT BONDS
(% p.a.)
Chart 3.2.9



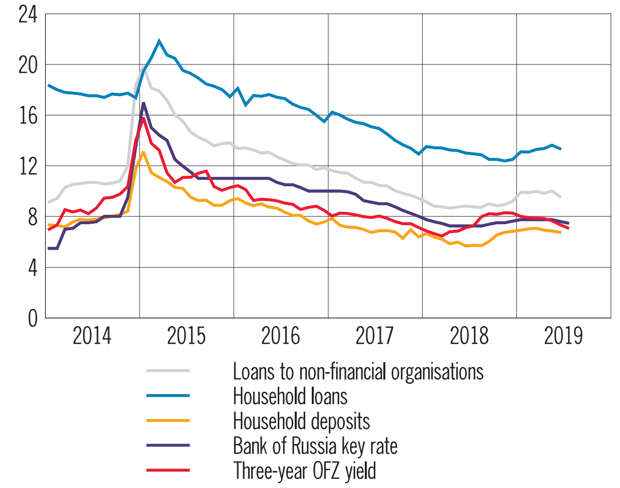
Source: Cbonds.ru

STOCK INDICES
(100 = 03.01.2017)
Chart 3.2.10



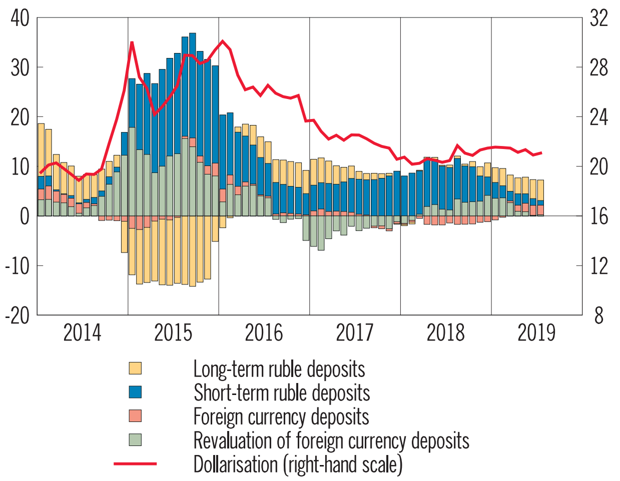
Source: Bloomberg.

INTEREST RATES ON LONG-TERM RUBLE TRANSACTIONS IN THE RUSSIAN MARKET *Chart 3.2.11*
(% p.a.)



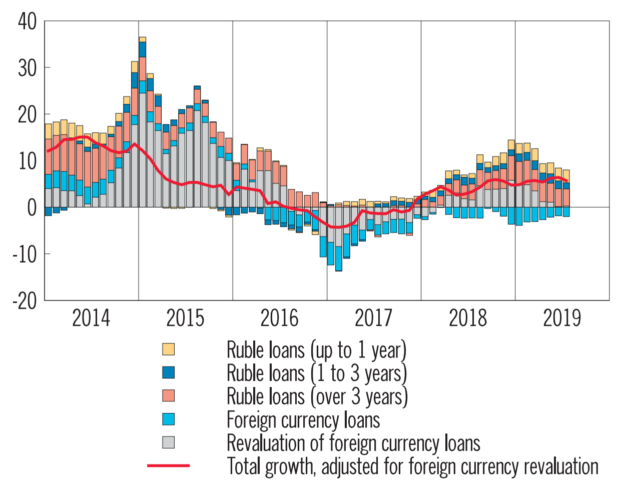
Source: Bank of Russia.

ANNUAL GROWTH OF HOUSEHOLD DEPOSITS *Chart 3.2.12*
(contribution of individual components, pp)



Source: Bank of Russia.

ANNUAL GROWTH OF CORPORATE LOAN PORTFOLIO *Chart 3.2.13*
(contribution of individual components, pp)



Source: Bank of Russia.

The inflow of funds to foreign currency deposits in May–July was less than in the first months of the year but remained positive. As a result, the contribution of foreign currency deposits to the total annual growth of household deposits continued to grow.

Lending rates. By April, the upward trend in lending rates in the second half of 2018 had come to a halt (Chart 3.2.11). In the mortgage segment of the market, where rates grew faster in the first half of 2018, we saw their decline emerging from early May. In July 2019, the average market rate on new mortgage loans was 10.2% per annum, down 0.3 pp from the local maximum in April. In July–August, a number of major market participants lowered rates for mortgage products, which will also contribute to a further decrease in the average market rates. In other market segments, the dynamics of lending rates were less pronounced, and only by June did we see a steady downward trend.

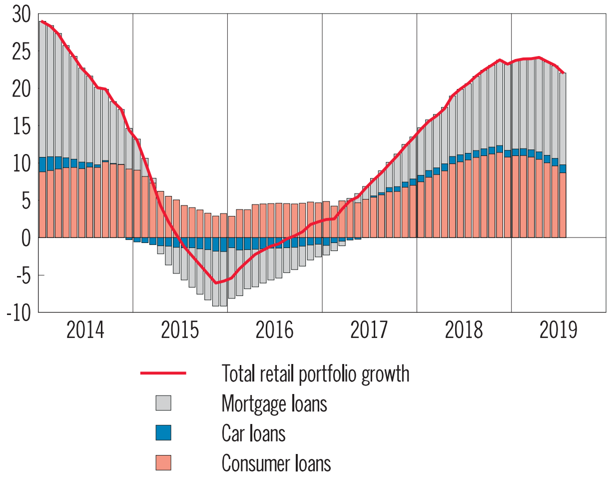
As the cost of bank funding and the yield of alternative financial instruments decrease through the end of 2019, we can expect a steady trend towards reduction in lending rates, supported by competition for top-grade borrowers among banks.

Corporate lending. In mid-2019, the growth rate of corporate lending accelerated slightly, amounting to 5.7% at the beginning of August against 5.4% seen three months earlier. The trend towards s a reduction of foreign currency predominance in corporate loans seen in recent years continued (Chart 3.2.13): by the beginning of August, the annual growth of ruble loans to non-financial organisations was 10.7%, while foreign currency loans dropped 7.1%.

In the short run, we expect further gradual growth of corporate lending with continued dedollarisation in this market segment.

Retail lending. The acceleration in retail lending growth observed since early 2016 had ceased by May 2019. The annual increase in household lending by the beginning of August was 21.9% against 23.8% at the beginning of May. This slowdown was triggered by both the exhaustion of the potential for recovery growth in retail lending and by the Bank of Russia's measures towards curbing excessive growth in certain segments of the retail lending market. Mortgage lending growth has slowed more than consumer lending growth (Chart 3.2.14). This could be affected by, among other things, the faster-than-expected growth of mortgage rates in late 2018 – early 2019 and the increased sensitivity of mortgage loans to the rate level. Due to the emerging trend towards lower mortgage rates and tighter regulation of consumer lending, we can expect a resumption of mortgage lending growth in the share of the retail loan portfolio by the end of the year, coupled with a further slowdown in household lending.

ANNUAL GROWTH OF RETAIL LOAN PORTFOLIO (contribution of individual components, pp) *Chart 3.2.14*



Source: Bank of Russia.

3.3. ECONOMIC ACTIVITY

GROSS DOMESTIC PRODUCT

Annual GDP growth rose to 0.9% in 2019 Q2 (it was 0.5% in 2019 Q1) (Chart 3.3.1).[4] Estimates suggest that consumer demand remained the key growth driver. The increase in GDP growth was due to a smaller reduction in gross fixed capital formation (GFCF) compared to the previous quarter of 2019 (Table 3.3.1).

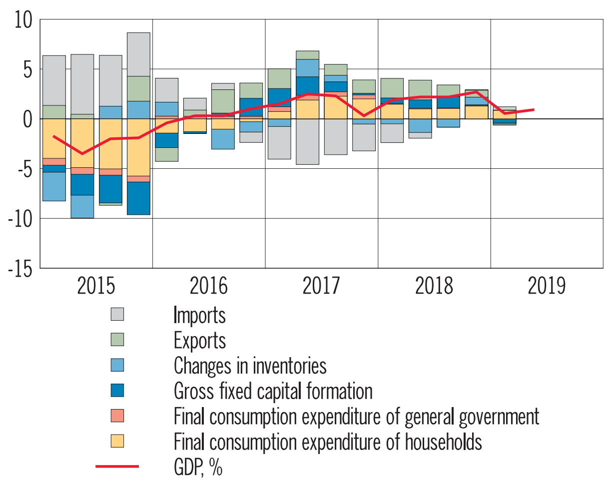
According to Bank of Russia estimates, GFCF shrank by 0.5–1.0% YoY. The fact that the indicator decreased less than in the previous quarter may be attributed to the dynamics of GFCF components included in the calculation of fixed capital investment. Investments in these non-financial assets dropped pronouncedly in 2019 Q1. Estimates suggest that in 2019 Q2 the constraining effect of these components on GFCF growth eased.

The annual growth of other GDP components, according to the Bank of Russia, has not changed significantly compared to 2019 Q1 (Table 3.3.1).

Estimates suggest that the implementation of national projects and the increase in public investment will lead to an increase in the GFCF growth rate to 0.5–1.0% in 2019 Q3. The growth rate of household final consumption expenditure will remain low at 1.2–1.7%. Economic growth will accelerate to 0.8–1.3% amid increased

[4] *Statistics on GDP production in 2019 Q2 published on 9 September 2019 (after the September meeting of the Bank of Russia Board of Directors) confirmed Rosstat's preliminary estimate for the annual GDP growth rate.*

DECOMPOSITION OF ANNUAL GDP GROWTH (pp) *Chart 3.3.1*



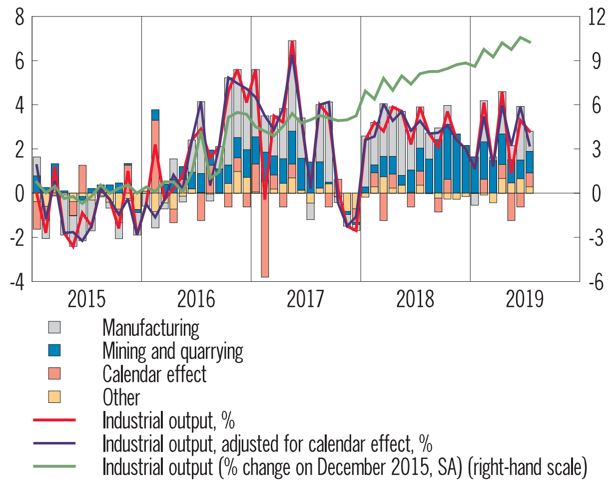
Sources: Rosstat, Bank of Russia calculations.

GROWTH OF GDP COMPONENTS BY EXPENDITURE (% change on the same quarter of the previous year) *Table 3.3.1*

	2018	2019 Q1	2019 Q2
GDP	2.3	0.5	0.9
Final consumption expenditure	1.8	1.2	1.0–1.5*
– households	2.3	1.6	1.5–2.0*
Gross capital formation	0.8	-3.1	-(0.0–0.5)*
– Tier 1 capital	2.9	-2.6	-(0.5–1.0)*
Exports	5.5	-0.4	-(0.3–0.8)*
Imports	2.7	-1.6	-(1.0–1.5)*

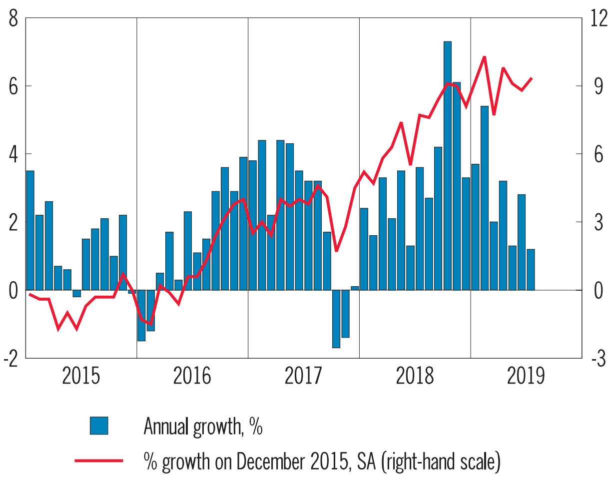
** Bank of Russia's estimate.*
Source: Rosstat, Bank of Russia's estimates.

INDUSTRIAL OUTPUT *Chart 3.3.2*
(contribution to annual growth, pp)



Sources: Rosstat, Bank of Russia calculations.

RAW AND INTERMEDIATE GOODS PRODUCTION *Chart 3.3.3*



Sources: Rosstat, Bank of Russia calculations.

investment activity. Overall, in 2019, the GDP growth rate will amount to 0.8–1.3% (see Section 1 and Table 1).

PRODUCTION ACTIVITY

In May–July 2019, the annual growth rate of industrial production remained close to March–April levels and averaged 2.3% over the period (Chart 3.3.2). The dynamics of output were heterogeneous for different product groups. The increase in industrial production in June 2019 was mainly owing to a significant increase in the production of engineering products, which could be associated with the execution of large orders, including exports. In July 2019, a partial adjustment in the output of engineering products led to a reduction in industrial production month-on-month (SA). The trend towards a gradual increase in industrial production has continued despite volatility.

Raw material production. In May–July, there was slight growth (SA) in mining (Chart 3.3.3). Oil production was constrained primarily by the decline in oil exports due to the contamination of the Druzhba pipeline as well as the implementation of agreements between oil-exporting countries. Gas production fluctuated near average March–April (SA) levels amid high gas storage levels in Europe. Production of liquefied gas increased significantly. At the same time, demand from European consumers continued to switch from coal to gas fuel. This supported exports of gas and negatively impacted the dynamics of coal production.

Production of intermediate goods. In May–July 2019, the production of intermediate goods decreased vs March–April (SA). The main contribution to the decrease was made by a drop in the output of petroleum products, which occurred in connection with the suspension of the operation of the Antipinsky oil refinery in April 2019 as well as planned repairs at other refineries. This also contributed in part to a halt in growth of the output of petrochemicals and plastics. Output in metallurgy remained low due to the contraction of external demand for Russian metals. In these conditions, exports and production of non-ferrous metals in May–July decreased.

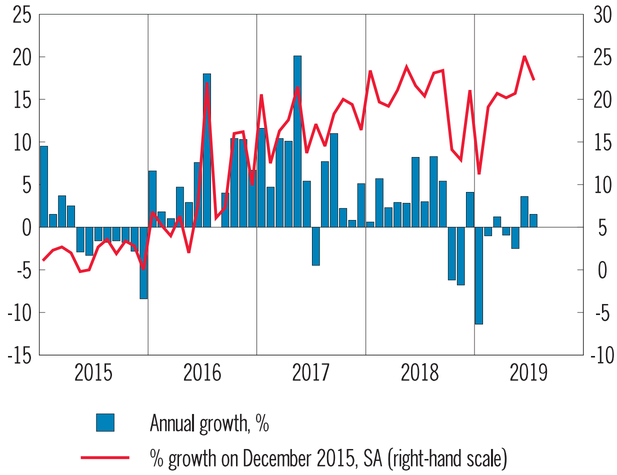
Production of investment goods. In May–July 2019, the output of investment goods increased markedly compared to March–April (SA) (Chart 3.3.4). In June 2019, it reached a historical high. This was mainly due to the output of engineering products, which could be associated with the execution of large orders, including exports. Such orders may not be regular, so the growth of the output of investment goods remains unstable. In July 2019, their output adjusted downwards as expected.

Production of consumer goods. In May–July 2019, the output of consumer goods decreased (compared to March–April SA, Chart 3.3.5). The output of food products did not change but was volatile, which was due to the end of the cycle of processing of vegetable raw materials of the 2018 harvest and the beginning of processing of the new harvest. The meat and dairy industry showed moderate output growth. A noticeable increase in fish processing production was associated with a record catch of Pacific salmon in July. The reduction in the output of non-food products was due to decreased production of the light industry (leather goods) as well as furniture and other finished products. The output of selected consumer durable goods, including cars and appliances, was unstable in the face of slow growth in consumer demand (see 'Consumption' in Subsection 3.3).

Business survey. In May–July, there was a significant deterioration in business sentiment in the manufacturing industry. The IHS Markit PMI was below 50 points, indicating a deterioration in the market during all three months (Chart 3.3.6). New orders – both export and domestic – declined markedly. Amid slowing economic growth in trading partner countries, enterprises revised their plans for outputs of finished products downwards. The decline in demand was observed mainly in the sectors producing intermediate and investment goods.

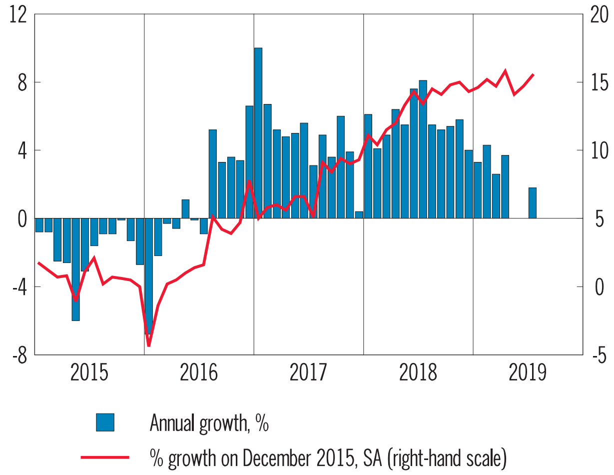
Transport. The growth of rail freight turnover in 2019 Q2 slowed to 1.6% year-on-year (2.4% in Q1). In July, this figure fell by 3.1% (Chart 3.3.7). The main contribution to the year-on-year contraction of railway transportation came from a decline in coal and ferrous metal exports (due to slack external demand). However,

INVESTMENT GOODS *Chart 3.3.4*



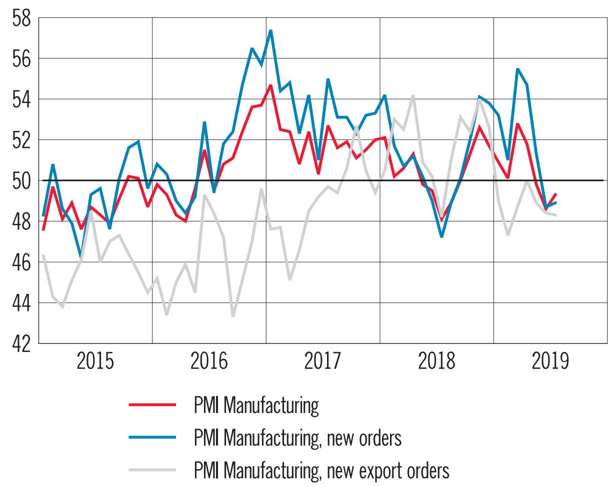
Sources: Rosstat, Bank of Russia calculations.

CONSUMER GOODS *Chart 3.3.5*



Sources: Rosstat, Bank of Russia calculations.

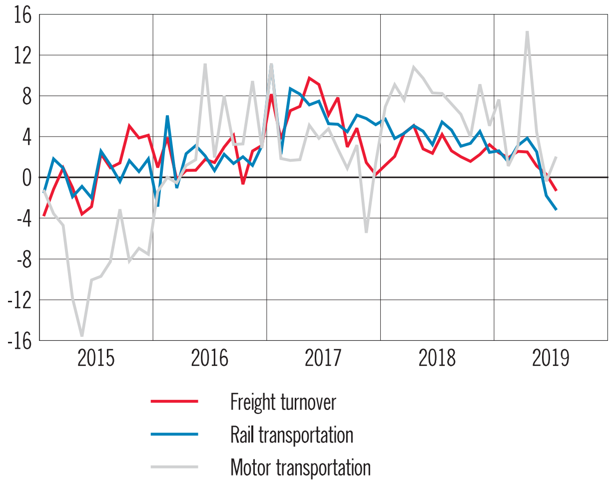
COMPANIES' ESTIMATES OF DEMAND FOR THEIR PRODUCTS (SA) *Chart 3.3.6*
(points)



Source: IHS Markit.

FREIGHT TURNOVER
(% growth on the same month of the previous year)

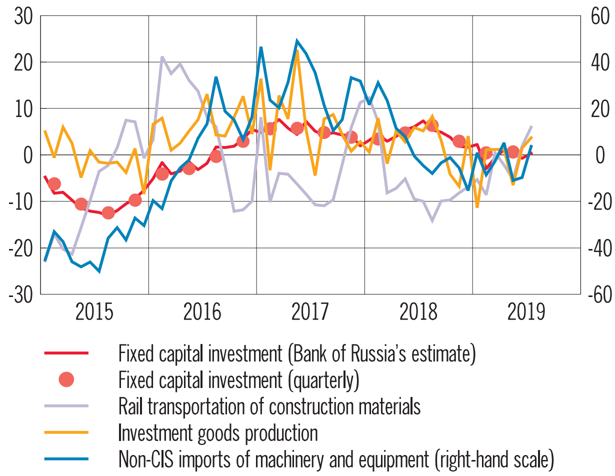
Chart 3.3.7



Source: Rosstat.

INVESTMENT ACTIVITY INDICATORS
(% growth on the same month of the previous year)

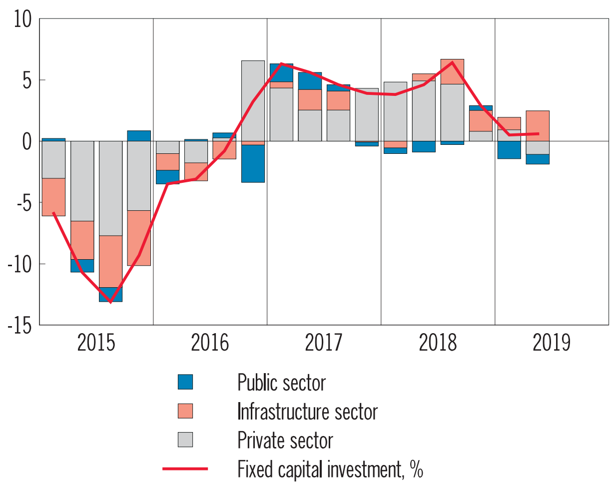
Chart 3.3.8



Sources: Rosstat, FCS, Bank of Russia calculations.

FIXED CAPITAL INVESTMENT
(contribution to annual growth, pp)

Chart 3.3.9



Sources: Rosstat, Bank of Russia calculations.

the transportation of construction materials increased. The turnover of pipeline transport decreased significantly due to a reduction in exports of petroleum products because of the Druzhba pipeline incident. As a result, the annual growth rate of transport turnover as a whole slowed to 1.3% in Q2, and in July 2019 it decreased by 1.2% (the lowest since July 2015).

Agriculture. The annual growth rate of agricultural output in 2019 Q2 remained the same as in the previous quarter and amounted to 1.2%. Livestock and crop outputs increased. In July 2019, agricultural output growth accelerated to 5.9% (1% in May–June). Estimates suggest that earlier harvesting in 2019 made a considerable contribution to annual growth in the production of farm produce; the harvesting of grains and legumes in most parts of Russia's territory started earlier than in the previous year, and by 1 August 2019 the grain harvest was 17% larger than on the same day last year. That said, the contemporaneous data of Russia's Ministry of Agriculture suggest that by mid-August grain output had nearly returned to that of last year's figure. According to estimates, growth in the output of agricultural produce will slow down in the upcoming months.

INVESTMENT ACTIVITY

Annual growth in fixed capital investment came in at 0.6% in 2019 Q2 (0.5% in 2019 Q1) (Chart 3.3.8). This exceeded the Bank of Russia's previous estimate, according to which Q2 fixed capital investment dropped by 1.3–1.8%.[5] This estimate was largely based on the dynamics of engineering imports, which contracted considerably in the period under review. Q2 investment demand may largely have been satisfied by domestically produced items.

At the same time, growth in investment activity remained low largely due to a decline in public investment. The annual rate of contraction in capital expenditures of the budget system came in at 6.5% in nominal terms in 2019 Q2. In these circumstances, the negative contribution of public investment to the annual growth of fixed capital investment in 2019 Q2 amounted to

[5] *See the information and analytical commentary Economy, No. 6 (42), June 2019.*

0.08 pp (Chart 3.3.9). Private sector investment also declined. The investment activity of enterprises was constrained by both general macroeconomic uncertainty and the slowdown in consumer demand growth, including due to the VAT increase. Fixed capital investment of the private sector (SA) returned to the level of the beginning of 2018 (Chart 3.3.10).

At the same time, infrastructure investment growth accelerated in 2019 Q2. It was supported by the implementation of major projects in the field of production and development of natural gas fields as well as transport infrastructure, including the modernisation of the Baikal-Amur and Trans-Siberian Railways. The contribution of infrastructure investments to the annual growth of fixed capital investments in 2019 Q2 amounted to 2.5 pp (Chart 3.3.9).

July 2019 saw a rise in investment activity indicators (Chart 3.3.8). The production and imports of investment goods grew year on year. However, growth in construction works in January–July 2019 remained close to zero compared to the same period of the previous year, which may be attributed to statistical specifics.[6]

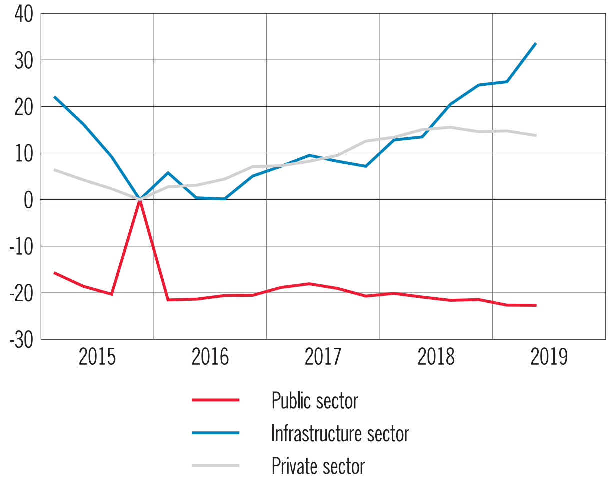
CONSUMPTION

Retail sales. Consumer demand posted muted growth between May and July. This was largely due to the stagnation of real disposable household incomes. Annual growth in retail sales slowed down to 1–1.4%, the lowest figure since September 2017 (Chart 3.3.11). At the same time, average monthly sales (SA) in May–July 2019 were higher than those in March–April (Chart 3.3.12). Retail sales of food and non-food products, including durable goods, increased. For example, sales of washing machines in July 2019 increased by 9.0% year-on-year, while sales of furniture increased by 8.5%.

Consumer sentiment. The somewhat improved consumer sentiment made a positive impact on household demand for goods and

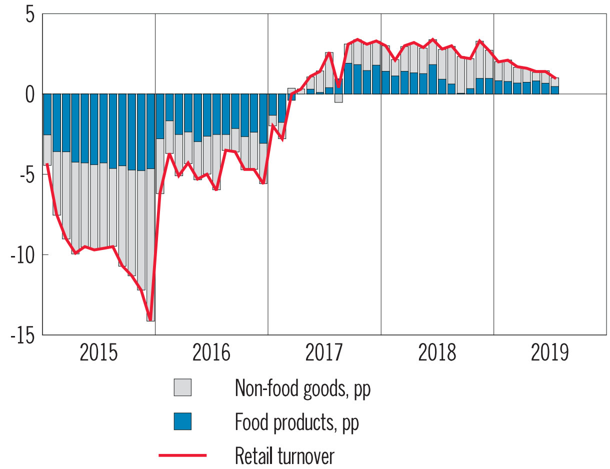
[6] *The initial Rosstat's data on construction works may differ from the final estimate because contractors usually provide inaccurate (usually understated) statistics and adjust them throughout the calendar year. Hereinafter, data on production and railway transportation of construction materials will be used instead of construction works to estimate monthly investment dynamics.*

FIXED CAPITAL INVESTMENT
(% growth on 2015 Q4, SA)
Chart 3.3.10



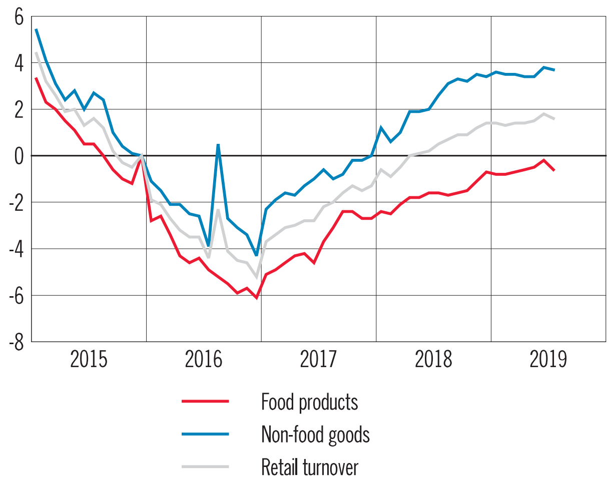
Sources: Rosstat, Bank of Russia calculations.

RETAIL TURNOVER
(% growth on the same month of the previous year)
Chart 3.3.11



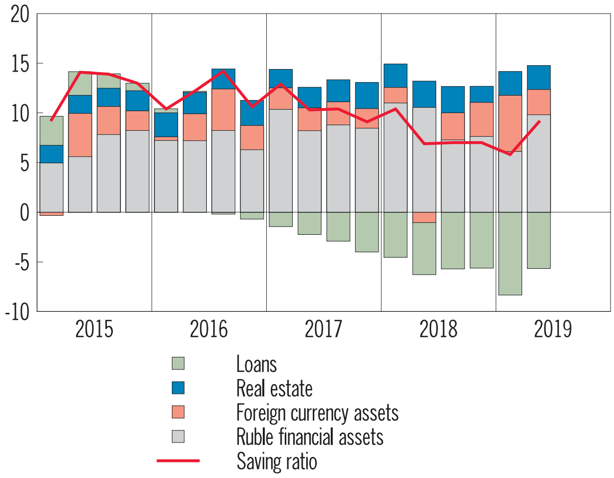
Sources: Rosstat, Bank of Russia calculations.

RETAIL TURNOVER
(% growth on December 2015, seasonally adjusted)
Chart 3.3.12



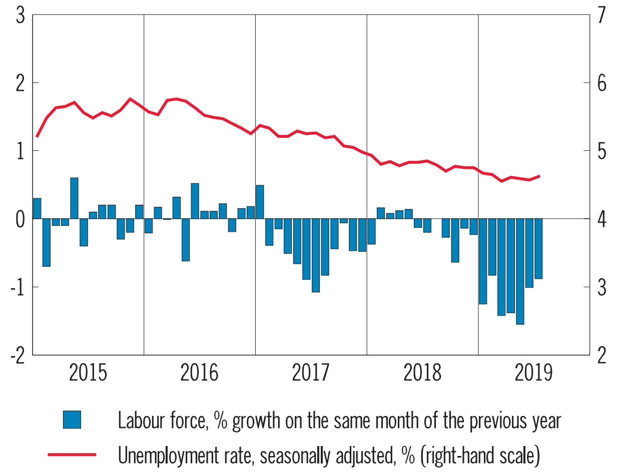
Sources: Rosstat, Bank of Russia calculations.

SAVING RATIO *Chart 3.3.13*
(as per cent of household disposable income, SA)



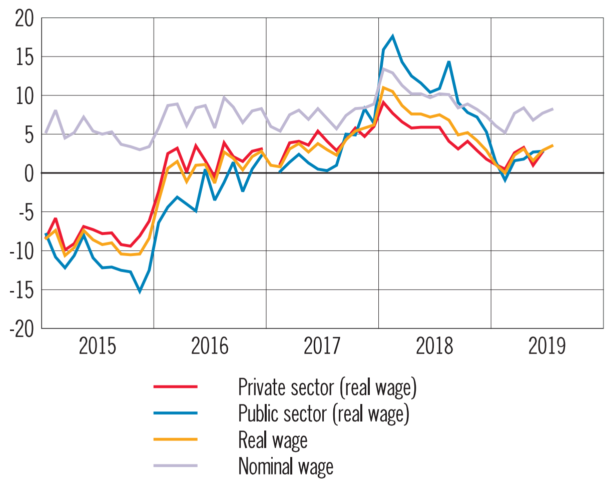
Sources: Rosstat, Bank of Russia calculations.

UNEMPLOYMENT RATE AND LABOUR FORCE *Chart 3.3.14*



** For comparability purposes, the statistics on annual labour force growth in 2015 are given excluding the Republic of Crimea and Sevastopol.*
Sources: Rosstat, Bank of Russia calculations.

WAGE *Chart 3.3.15*
(% growth on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

services between May and June 2019. For example, according to Rosstat, the consumer confidence index in 2019 Q2 continued to grow. This may have been due to a slowdown in inflation after its temporary increase at the beginning of the year, caused by a rise in the VAT rate. At the same time, the inFOM consumer sentiment index[7] dropped mainly due to the deterioration of respondents' assessment of the country's development prospects. In these circumstances, it is too early to suggest a sustainable recovery in consumer demand.

Savings rate. In 2019 Q2, the savings rate (SA) increased (Chart 3.3.13) partly due to the high attractiveness of deposits (see 'Deposit and credit market' in Subsection 3.2). At the same time, it stayed below the average for 2015–2017, in a sign that the population sought to set off dropping incomes with an increased propensity to consume, including through growing demand for loans.

In 2019 Q3, annual growth in retail sales is forecast to stand at 1.2–1.7%.

LABOUR MARKET AND INCOMES

Unemployment rate. In May–July 2019, the unemployment rate was near its historical lows (4.6% SA, Chart 3.3.14). This was accompanied by a reduction in labour resources (YoY) mainly due to demographic factors. The additional expansion of labour resources owing to individuals who were affected by the pension reform was insufficient to compensate for this. In 2019, overall labour resources are set to decrease by an estimated 1–1.5%, which may constrain economic growth.

Wages. In May–July 2019, the annual growth rate of nominal wages remained close to the values of March–April, amounting to 6.8–8.2% (Chart 3.3.15). At the same time, during this period, the dynamics of labour compensation were volatile due to the postponement of one-time payments in the oil and gas sector.

With annual inflation falling, real wages also increased. In Q2, their growth amounted to 2.6%, which slightly exceeded Bank of Russia

[7] *See the information and analytical comments 'Inflation expectations and consumer sentiment'.*

estimates.[8] In the second half of 2019, the growth of real wages will continue and will amount to 3–3.5% year-on-year.

Household incomes. In 2019 Q2, the annual rate of decline in real disposable household income slowed to 0.2% (2.5% in Q1, Chart 3.3.16). This was due to the increase of pension payments to regional subsistence minimums, as a result of which the contribution of social payments to annual income growth became positive. Another significant factor in improving income dynamics was the slowing decline in other cash receipts.

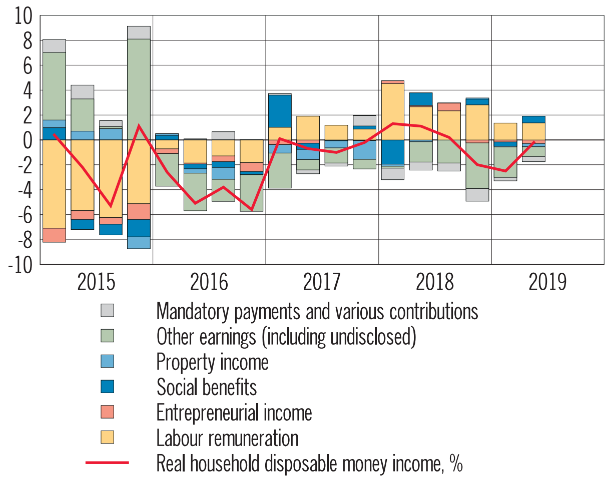
FINANCIAL POSITION OF ORGANISATIONS

Financial result. According to Rosstat's operational data, the balanced financial result of large- and medium-sized businesses for the first half of 2019 was at a 12-year high. However, in May, this figure for a rolling year dropped by 0.3% to ₽15.7 trillion (Chart 3.3.17), while the month-on-month decrease was 19%, sending this indicator down to ₽1,289 billion. In June, the decline in the financial result for a rolling year continued, amounting to 1.2% by May. The decrease in the balance of profit and loss for a rolling year in June compared to May was observed in mining, manufacturing and construction (Chart 3.3.18); June saw an increase in this indicator in the trade sector.

The growth rate of the net financial result in the first half of 2019 compared to the same period last year was 23.2%. In construction, this figure increased 2.2-fold. In the manufacturing sector, high growth rates of the balance of profits and losses are observed amid favourable dynamics in industrial production (22.0%) as well as in trade (62.1%). In the mining and quarrying sector, the financial result decreased by 11.2% mainly due to a decrease in oil production under the agreement with OPEC countries (see Subsection 3.1) and the issues with the Druzhba pipeline. The total loss of organisations, according to Rosstat's operational data, for the first half of 2019 amounted to ₽1.2 trillion, a drop of 11.1% on the same period last year. The size of the

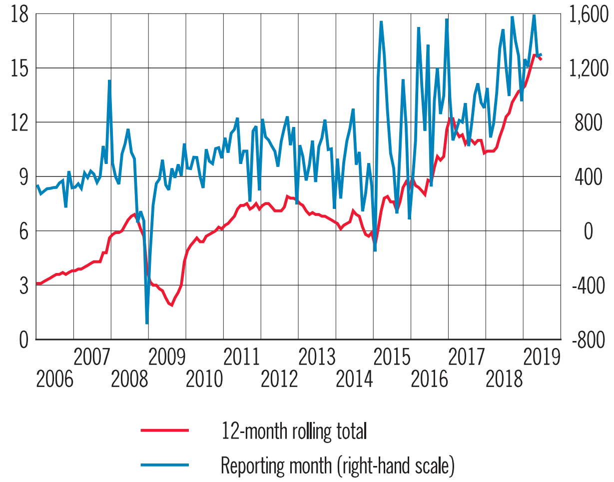
[8] *In Monetary Policy Report 2/19, the projected growth rate was about 2%.*

REAL HOUSEHOLD DISPOSABLE MONEY INCOME *Chart 3.3.16*
(contribution to annual growth, pp)



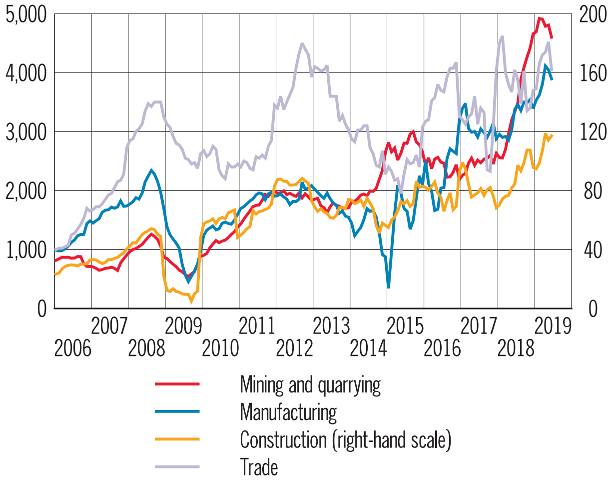
Sources: Rosstat, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX, NET OF LOSSES *Chart 3.3.17*
(trillions of rubles / billions of rubles)



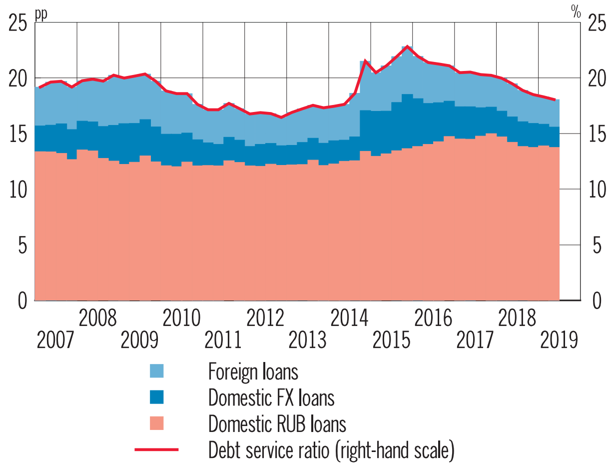
Sources: Rosstat, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX BY INDUSTRY, NET OF LOSSES *Chart 3.3.18*
(12-month rolling total, billions of rubles)



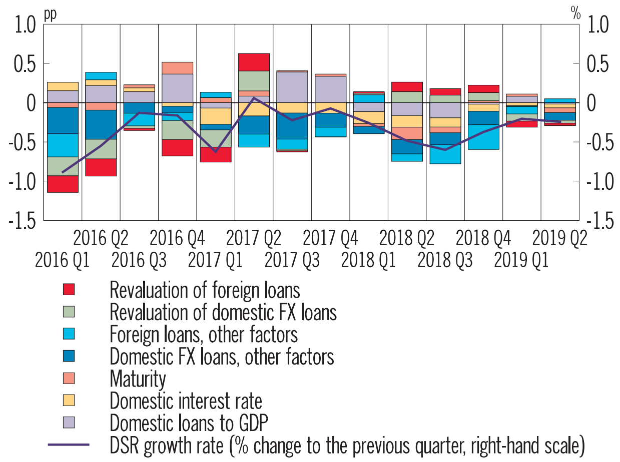
Sources: Rosstat, Bank of Russia calculations.

NON-FINANCIAL CORPORATIONS TOTAL DEBT BURDEN *Chart 3.3.19*
(debt service ratio and its components, % of GDP)



Source: Bank of Russia calculations.

DECOMPOSITION OF CORPORATE DEBT BURDEN DYNAMICS *Chart 3.3.20*
(debt service ratio (DSR) and contribution of its components, % of GDP)



Source: Bank of Russia calculations.

BUDGET SYSTEM PARAMETERS *Table 3.4.1*
(12-month rolling total, % of GDP)

	2017	2018	June 2019	July 2019
Consolidated budget				
Revenue	33.7	35.9	36.4	36.5
Expenditure	35.2	33.0	32.5	32.7
Balance	-1.5	2.9	3.9	3.8
Federal budget				
Revenue	16.4	18.7	18.9	18.9
Oil and gas revenue	6.5	8.7	8.6	8.4
Additional oil and gas revenue (excess revenue)	0.9	4.1	3.9	3.8
Non-oil-and-gas revenue	9.9	10.0	10.4	10.5
Expenditure	17.8	16.1	15.7	15.7
Balance	-1.4	2.6	3.2	3.2

Sources: Federal Treasury, Bank of Russia calculations.

segment of loss-making companies did not significantly change.

Debt. According to Bank of Russia estimates, the volume of the banking sector's claims on legal entities, including financial institutions, in rubles and foreign currency grew in 2019 Q1 by 0.2% (after 1.4% growth in the previous quarter), while the volume of claims over the year grew by 6.8% (7.5% in 2018 Q2). The slowdown was due to the dynamics of foreign currency claims, which for the April to June 2019 period decreased by 5.9% in ruble terms, including due to a strengthening in the ruble (Charts 3.3.19, 3.3.20). Claims in rubles during that period grew by 1.4% (3.2% in 2019 Q1). The debt burden[9] remained practically unchanged amid comparable quarterly growth rates of claims and incomes (nominal GDP).

3.4. PUBLIC FINANCES[10]

The budget surplus of the enlarged government[11] for 7 months of 2019 increased by ₽1.1 trillion compared to the same period last year. Its formation was due to faster growth in revenues (10.3% up against the same period last year) compared to the increase in spending (5.6%). There was a significant increase (12.7%) in non-oil-and-gas revenue due to the increase in the base VAT rate and high profits of commercial organisations. There was a small (2.1%) increase in oil and gas revenues. The twelve-month rolling non-oil-and-gas deficit in July 2019 fell to 4.6% of GDP (5.8% at the end of 2018) (Chart 3.4.1).

Macroeconomic effects of the fiscal policy. The fiscal policy in the January to July 2019 period made a negative contribution to the dynamics of output. Investment expenditures[12] of the enlarged government between January

[9] *The debt service ratio was calculated based on the methodology described by S.A. Donets and A.A. Ponomarenko. Debt burden indicators. Money and Credit, No. 4, 2017. The value for 2019 Q1 is calculated based on the Bank of Russia's GDP forecast.*

[10] *The section takes into account the statistics on the budget system in July and revised data on federal budget expenditures published on 6 September 2019 (after the September meeting of the Bank of Russia Board of Directors).*

[11] *Here and below, the concept of the enlarged government includes the consolidated budget of the federal centre, the constituent territories of the Russian Federation and government extra-budgetary funds.*

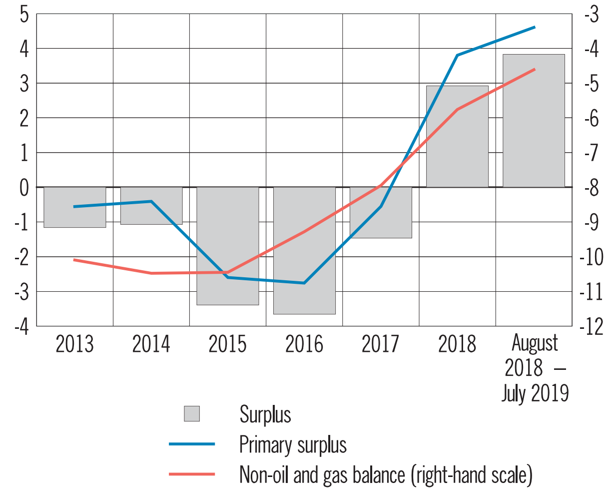
[12] *Capital investments in government (municipal) property.*

and July 2019 fell in nominal terms by 0.6% as compared to the corresponding period of the previous year. In the remaining months of 2019, fiscal policy is expected to soften due to the seasonality of budget expenditures. According to the Bank of Russia, in 2020, the fiscal boost will shift into the positive area, including through more active implementation of national projects.

Federal budget. Data on the execution of the federal budget for the first seven months of 2019[13] indicate a slowdown in the growth of the surplus for the rolling year and the continued reduction of the non-oil-and-gas deficit (Chart 3.4.2). The federal budget surplus for the rolling year as at the end of July 2019 amounted to 3.2% of GDP (2.6% of GDP at the end of 2018) (Table 3.4.1). The growth of the surplus was due to both slower execution of expenditures and increased revenues. Revenue growth (9.3% compared to the same period last year) was mainly due to the non-oil-and-gas component (+15.1%): VAT revenues in January–July 2019 increased by 17.6% to 6.7% of GDP (6.1% of GDP at the end of 2018) (Chart 3.4.4). The growth of expenditures in January–July (3.2% compared to the same period last year) was below inflation, while non-interest expenditure increased at a rate close to the growth of prices (4.2%). As of 1 August 2019, the execution of expenditures was at its lowest in recent years and totalled 49% of the amount in the consolidated budget roster. The execution degree of expenditures on national projects was low. The 'Demographics' (59%), 'Health' (58%) and 'Science' (46%) projects had the highest percentage of implementation. The 'Digital Economy' (9%) and 'Ecology' (14%) projects had the lowest percentage of implementation (Chart 3.4.3). The June to July period saw accelerated execution of expenditures on the 'Safe and High-Quality Roads' and 'Comprehensive Plan for Modernisation and Expansion of the Main Infrastructure up to 2024' infrastructure projects. As of 1 August 2019, the execution on these national projects amounted to 24% and 27% respectively.

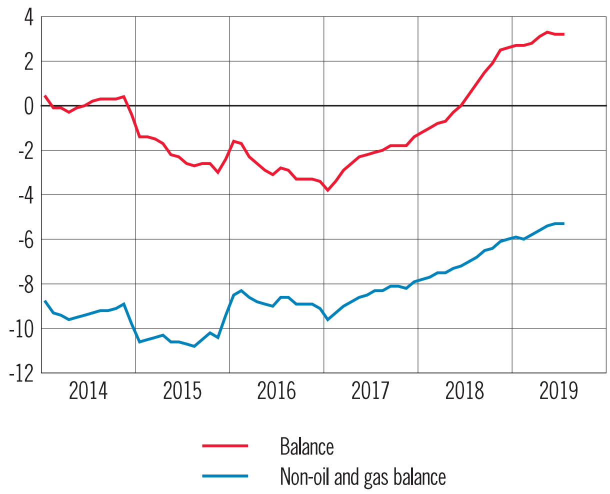
[13] See the Federal Treasury Report 'On Execution of the Federal Budget' dated 1 August 2019.

BUDGET SYSTEM SURPLUS
(% of GDP)
Chart 3.4.1



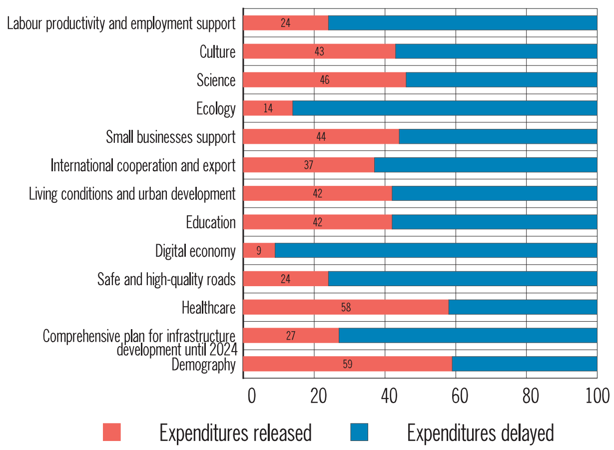
Sources: Federal Treasury, Bank of Russia calculations.

FEDERAL BUDGET BALANCE
(12-month rolling total, % of GDP)
Chart 3.4.2



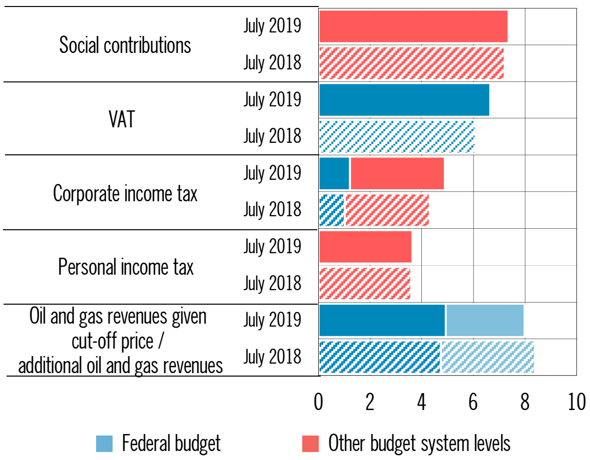
Sources: Federal Treasury, Bank of Russia calculations.

FEDERAL BUDGET EXPENDITURES ON NATIONAL PROJECTS, JANUARY–JULY 2019
(%)
Chart 3.4.3



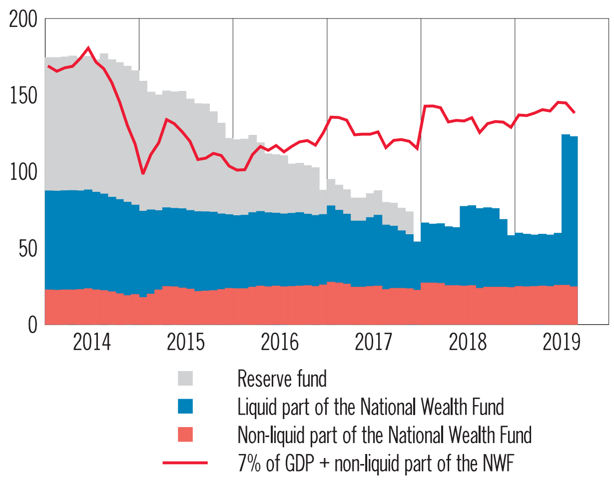
Sources: Federal Treasury, Ministry of Finance; Bank of Russia calculations.

BUDGET REVENUE COMPOSITION, MAJOR TAXES *Chart 3.4.4*
(January-July, % of GDP)



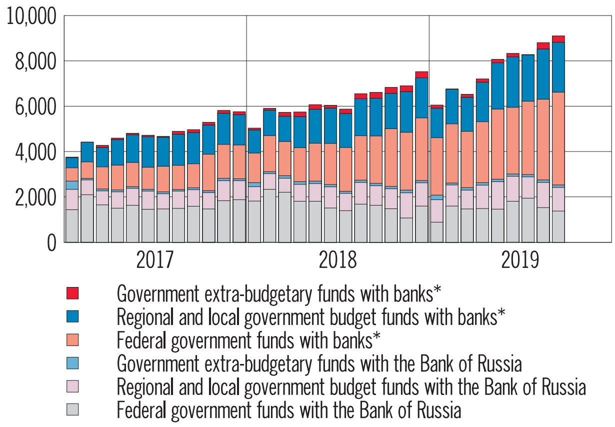
Sources: Federal Treasury, Ministry of Finance, Bank of Russia calculations.

SOVEREIGN FUNDS OF THE RUSSIAN FEDERATION *Chart 3.4.5*
(billions of US dollars)



Sources: Ministry of Finance; Bank of Russia calculations.

BUDGET SYSTEM FUNDS IN RUBLE ACCOUNTS WITH COMMERCIAL BANKS AND THE BANK OF RUSSIA *Chart 3.4.6*
(billions of rubles)



** According to banking reporting form 0409301 'Performance indicators of a credit institution', the Bank of Russia's balance sheet data.*
Source: Bank of Russia.

Budget of the enlarged government. According to Federal Treasury data,[14] in January–July 2019, the budget surplus for the rolling year increased, amounting to 3.8% of GDP (2.9% of GDP at the end of 2018) (Chart 3.4.1). The growth of the surplus was due to a decrease in the share of budget expenditures at all levels in GDP of 0.3 pp and an increase in revenues of 0.6 pp, including non-oil-and-gas revenues of 0.9 pp (Table 3.4.1). In particular, in January–July, there was an increase in income tax revenues (22.0%) and insurance premiums for compulsory social insurance (9.7%) compared to the same period last year. As a result, in January–July, the share of income from these taxes in GDP increased to 4.9% and 7.4% respectively, compared with 4.3% and 7.2% in January–July 2018 (Chart 3.4.4). During the first seven months of 2019, compared to the same period last year, expenditures under the item 'National Economy' increased by 6%, while expenditures under the heading 'National Defence' became lower by 4.7% in nominal terms.

Balances of funds in budget accounts with the banking system. Faster growth of budget system revenues in comparison with its expenditures sent budget balances in the banking system higher (Chart 3.4.6). In June–August, the Federal Treasury increased the tenor of its operations to place temporarily free budgetary funds on bank deposits as well as the number of auctions held at a fixed rate. Along with the resumption of FX swap operations, this allowed the Federal Treasury to significantly increase the amount of funds placed in the banking sector (see Subsection 4.2).

National Wealth Fund. In July 2019, the $65.2 billion of additional oil and gas revenues received in 2018 were transferred to the NWF. As a result, the National Wealth Fund totalled $122.9 billion as of 1 September 2019. (7.5% of GDP), including the liquid part, $98.1 billion (6.0% of GDP) (Chart 3.4.5). Due to the downturn in oil prices, the value of foreign exchange operations to purchase foreign currencies for the Ministry of Finance of the Russian Federation under

[14] See the Federal Treasury's monthly report 'On the execution of the consolidated budget of the Russian Federation and the budgets of state extra-budgetary funds of the Russian Federation' as of 1 August 2019.

the fiscal rule decreased in July–August 2019 (Chart 3.4.7).

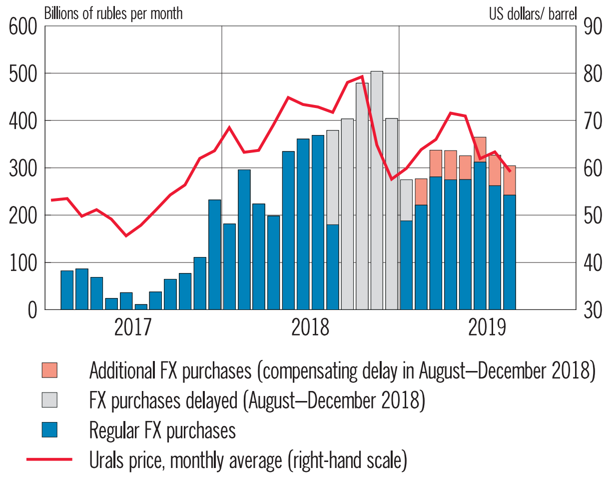
Public debt. According to the Ministry of Finance of Russia, aggregate public and municipal debt of the Russian Federation totalled 14.9% of GDP as of 1 August 2019, which is 0.2 pp lower than last year's level (Chart 3.4.8).

The total state and municipal debt in nominal terms increased owing to the internal federal debt. A favourable market environment and a new format of OFZ placement auctions (without a pre-announced placement volume) enabled the placement of federal government bonds at an accelerated pace. In the first half of 2019, the Ministry of Finance placed OFZs for ₽1.4 trillion, exceeding the planned volume for the period by 31%.

At the end of July, a closed auction for the placement of OFZs was held for Vnesheconombank, resulting in the Ministry of Finance's revenue of ₽39.2 billion. For 2019 Q3, the Ministry of Finance of Russian Federation planned to place OFZs for ₽300 billion.

OPEN MARKET OPERATIONS TO REPLENISH THE NATIONAL WEALTH FUND

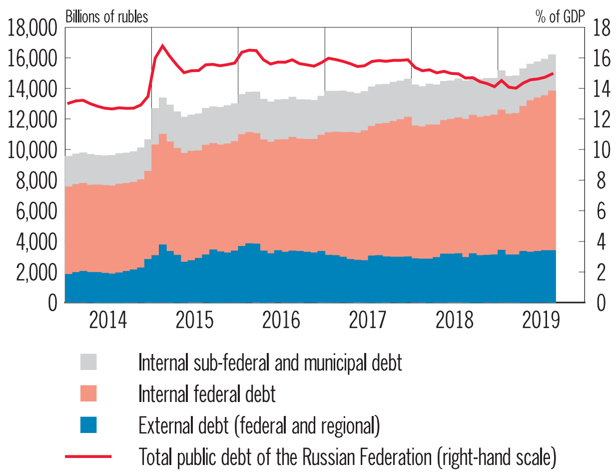
Chart 3.4.7



Source: Ministry of Finance, Bank of Russia.

TOTAL PUBLIC DEBT OF THE RUSSIAN FEDERATION

Chart 3.4.8



Source: Ministry of Finance.

4. MONETARY POLICY OF THE BANK OF RUSSIA

4.1. KEY RATE DECISIONS

Key rate decisions. On 26 July and 6 September, the Bank of Russia Board of Directors decided to reduce the key rate by 50 bp in total to 7.00% p.a.

Annual inflation continued to slow down since the Board meeting on 14 June, and steady trends indicated inflation was forming around 4%. The slowdown in annual inflation contributed to a reduction in inflation expectations, which remained at an elevated level in July–August. At the same time, disinflationary risks remained significant in the short term primarily due to the dynamics of domestic and external demand. In these circumstances, in line with the monetary policy pursued, the Bank of Russia has lowered its end-of-year annual inflation forecast for 2019 to 4.0-4.5%.

In July–August, monetary conditions continued to ease, which was facilitated, among other things, by the Board of Directors' decisions to reduce the key rate in June and July as well as by signals with regard to the future monetary policy stance.

The growth rate of the Russian economy in the period since the June meeting of the Board of Directors remained below the Bank of Russia's expectations, which was primarily related to a decrease in external demand for Russian exports on the back of global economy slowdown and weak domestic demand, including due to slower-than-expected implementation of a number of national projects planned by the Government. At the same time, risks of a significant slowdown in the global economy due to deepening international trade tensions increased. In these circumstances, in September, the Bank of Russia lowered its forecast of Russia's economic growth in 2019-2021.

In August, the deterioration in global economic growth outlook was also accompanied by increased volatility in global commodity and financial markets, which somewhat increased proinflationary risks. In general, according to the Bank of Russia's estimates, proinflationary and disinflationary risks are balanced until the end of 2019.

Monetary policy over a medium-term horizon. Taking into account the decision adopted by the Board of Directors on 6 September, the key rate has reached the upper bound of the Bank of Russia's range of neutral rate values: 2-3% p.a. in real terms, 6-7% p.a. in nominal terms (taking into account the inflation target of near 4%). As the neutral rate in the economy depends on a wide range of both internal and external factors as well as on the monetary policy transmission mechanism, its estimate may change under the influence of these factors. In the future, the Bank of Russia may need time to determine the bounds of the neutral range and to make sure that they are in line with the current estimates.

If the situation develops in line with the baseline forecast, the Bank of Russia will consider the necessity of further key rate reduction. In its key rate decision-making, the Bank of Russia will take into account actual and expected inflation dynamics relative to the target and economic developments over the forecast period, as well as risks posed by domestic and external conditions and the reaction of financial markets. Throughout the entire forecast horizon, the Bank of Russia will pursue monetary policy in such a way as to ensure the stabilisation of inflation near 4%.

The effect of the key rate decisions on expectations. Since the publication of Monetary Policy Report 2/19, market expectations for the key rate have mainly adjusted downward. After the June meeting of the Board of Directors, analysts and financial market participants mostly expected a slight reduction in the key rate (by 25 bp according to the consensus forecasts of analysts) in 2019 Q3. Following the meeting of the Board of Directors on 26 July, the Bank of Russia communicated the possibility of a further reduction of the key rate and pointed to the predominance of disinflationary risks over proinflationary risks over the short-term horizon, and expectations continued to gradually adjust downwards. For example, in late July and August, most analysts expected the key rate to be reduced to 7.00% by the end of Q3 and to remain at that level until the end of 2019. These expectations strengthened as new data on inflation and economic activity were released. The share of experts and market participants expecting further easing of monetary policy in 2020 also grew. The downward revision of financial market participants' expectations regarding the path of the Bank of Russia key rate was reflected in the dynamics of money and stock market rates, including OFZs and corporate bonds (see Subsection 3.2 for more details).

4.2. SYSTEM OF MONETARY POLICY INSTRUMENTS AND OTHER MONETARY POLICY MEASURES

Banking sector liquidity. The structural liquidity surplus increased in June–August 2019 from ₽2.6 trillion to ₽3.3 trillion. The growth of banks' debt under Federal Treasury transactions caused a significant inflow of funds. In addition, the volume of extra-budgetary funds (in particular, the Social Insurance Fund) in bank deposits increased. The banking sector also received funds as a result of measures to improve the financial stability of individual credit institutions. The liquidity inflows were partially set off because large public corporations transferred dividend payouts into the budget accounts with the Bank of Russia, banks made clients' tax payments, and Russia's Ministry of Finance continued to offer federal government bonds (OFZs), with budget expenditure remaining seasonally moderate.

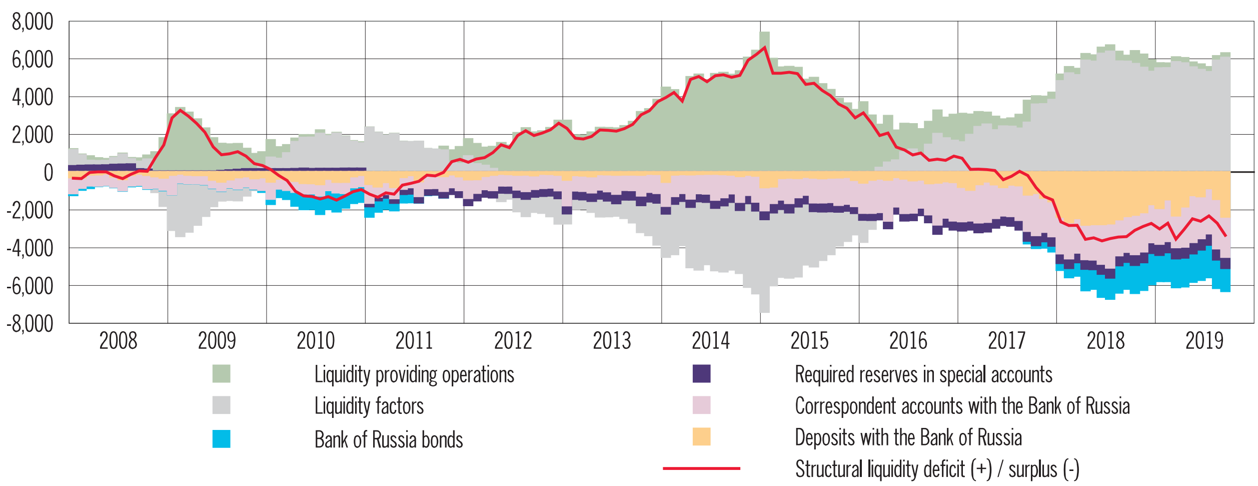
The volume of cash in circulation increased by ₽0.2 trillion, which is slightly less than in the same period last year. In general, since the beginning of the year, the decline in the growth rate of this indicator has been primarily due to the growth of non-cash payments and the gradual reduction of cash funds of credit institutions.

In July 2019, the Bank of Russia's decision to increase required reserve ratios for foreign currency liabilities to individuals for banks with a universal licence, banks with a basic licence and non-bank credit institutions by 1 pp to 8.00% came into effect. This measure was intended to discourage growth of foreign currency-denominated liabilities in credit institutions' liability structure. As a result, the aggregate volume of required reserves of credit institutions (including funds in special-purpose accounts for required reserves) increased by ₽35 billion.

In June–August 2019, the structural liquidity surplus exceeded the Bank of Russia's forecast due to the growth of banks' demand for Federal Treasury deposits. Expecting less need to absorb a stable portion of the liquidity surplus, the Bank of Russia has been reducing the volume of coupon bond offerings (Coupon OBRs) and raising limits at deposit auctions since July 2019. However, starting from October 2019, a gradual increase in the volume of Coupon OBR placements in proportion to the growth of the liquidity surplus is

BANK OF RUSSIA BALANCE SHEET
(start of business, billions of rubles)

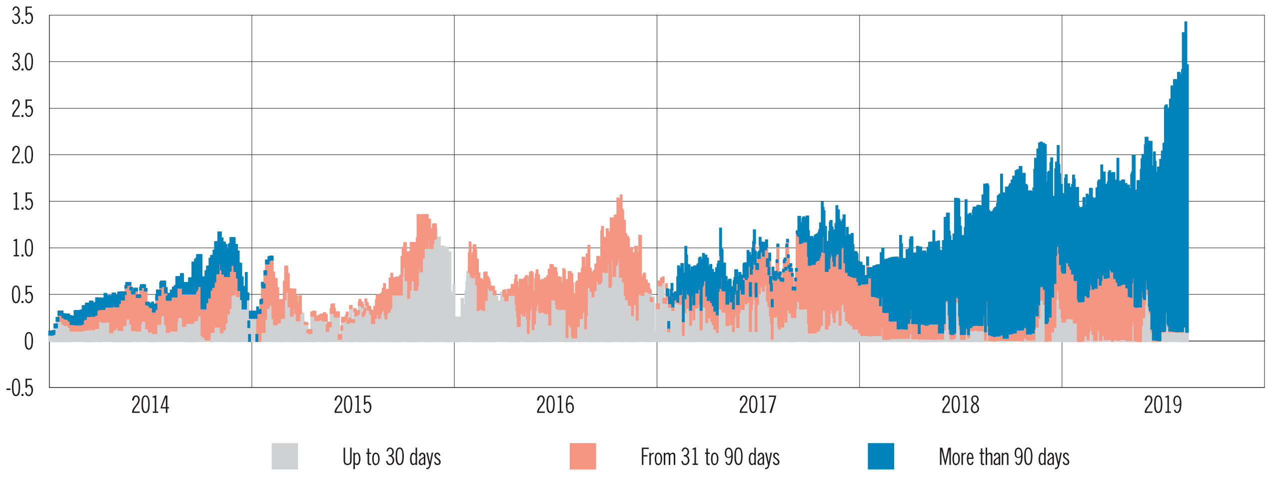
Chart 4.2.1



Source: Bank of Russia calculations.

BANKS' OUTSTANDING AMOUNTS ON FEDERAL TREASURY DEPOSITS, REPOS AND SWAPS
(trillions of rubles)

Chart 4.2.2



Sources: Federal Treasury, Bank of Russia calculations.

planned. The structural liquidity surplus at the end of 2019 is expected to amount to ₽3.4-3.7 trillion. In 2020-2021, as before, certain growth of the structural liquidity surplus related to further execution of foreign currency purchases in the domestic market under the fiscal rule postponed in 2018 is expected.

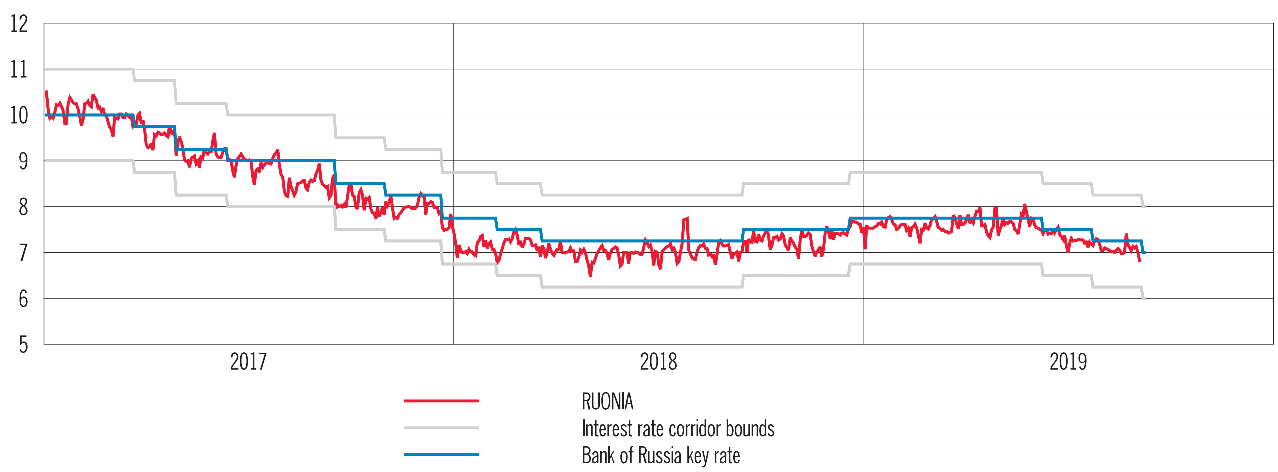
Federal Treasury operations for the administration of temporarily available budgetary funds. In June–August 2019, banks raised about ₽1.2 trillion through Federal Treasury operations. The bulk of funds was placed with banks for long terms (over 90 days), and the share of fixed interest rate operations increased.

The reduction in temporarily available balances of funds in the single account of the federal budget with the Bank of Russia and increasing amounts of funds deposited with credit institutions contribute to smoothing out the impact of fiscal flows on the banking sector's need for liquidity. For example, if during the year the Federal Treasury maintains a high volume of funds placed in bank deposits, then at the end of the year it can withdraw them from banks for budget expenditures. In general, these transactions will be neutral for banking sector liquidity. However, the growth of banks' liabilities on Federal Treasury operations with moderate budget expenditures, as in June–August, leads to an increase in the liquidity surplus.

Achieving the operational goal of the monetary policy. Short-term rates in the interbank lending segment of the money market were formed

RUONIA AND BANK OF RUSSIA INTEREST RATE CORRIDOR
(% p.a.)

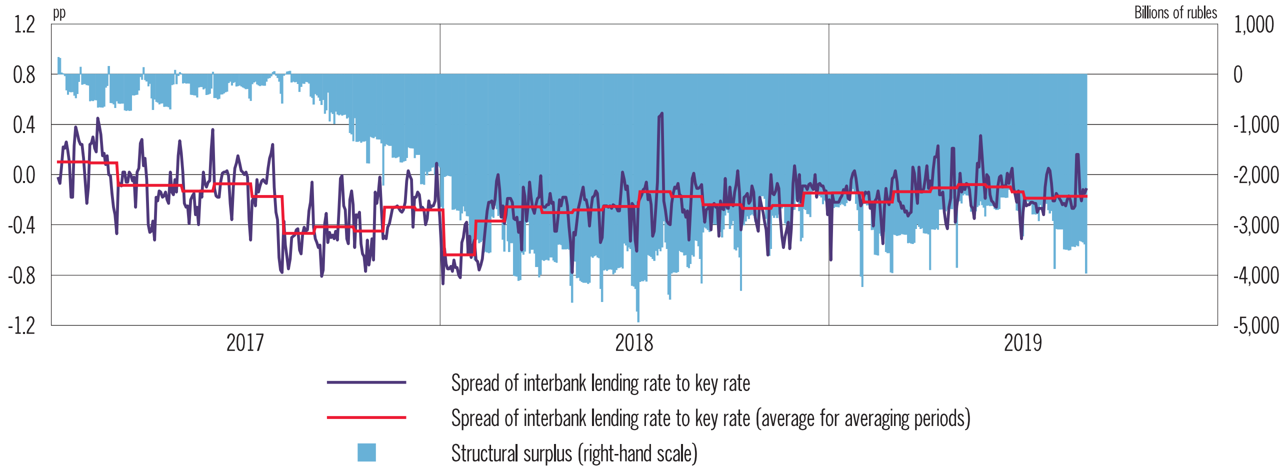
Chart 4.2.3



Source: Bank of Russia.

STRUCTURAL LIQUIDITY SURPLUS AND MONEY MARKET RATES

Chart 4.2.4



Source: Bank of Russia calculations.

in the lower half of the interest rate corridor close to the Bank of Russia key rate. The average spread from the end of June through 5 September was -17 bp (in Q2, -8 bp) and fluctuated in the range from -51 to 16 bp (in Q2, in the range of -43 to 31 bp).

The widening of the spread in some periods was due, among other things, to market participants' expectations of a key rate cut. For example, before the meetings of the Bank of Russia Board of Directors in June and July, banks sought to postpone the required reserves averaging to the second half of the averaging periods. For this reason, banks formed a high supply of funds at deposit auctions of the Bank of Russia in the first half of the averaging periods, reducing the balances of their correspondent accounts with the Bank of Russia as much as possible. After the key rate decision, banks, on the contrary, increased balances of their correspondent accounts and reduced deposits with the Bank of Russia. This somewhat restrained the redistribution of funds between banks in the money market, including those received under Federal Treasury operations and as a result of measures aimed at improving the financial stability of individual credit institutions. Subsequently, the situation normalised, and market rates approached the Bank of Russia key rate.

STRUCTURAL LIQUIDITY SURPLUS AND LIQUIDITY FACTORS
(trillions of rubles)

Table 4.2.1

	June 2019	July 2019	August 2019
1. Liquidity factors	**-0.1**	**0.6**	**0.1**
– change in the balances of general government accounts with the Bank of Russia, and other operations*	-0.1	0.6	0.2
– change in the amount of cash in circulation	-0.1	0.0	-0.1
– Bank of Russia interventions in the domestic FX market and monetary gold purchases	0.0	0.0	0.0
– regulation of banks' required reserves with the Bank of Russia	0.0	0.0	0.0
2. Change in free bank reserves (correspondent accounts)	**0.2**	**0.2**	**-0.5**
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	**-0.3**	**0.4**	**0.6**
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	**0.0**	**0.0**	**0.0**
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	**-2.3**	**-2.7**	**-3.3**

* *Including fiscal rule-based operations to buy (sell) foreign currency in the domestic FX market, settlements on Bank of Russia USD/RUB FX swaps, and other operations.*

Source: Bank of Russia calculations.

BOX

ESTIMATING THE EXCHANGE RATE PASS-THROUGH TO INFLATION[1]

In recent years, the conditions in which exchange rate movements are passed through into price dynamics have changed considerably.

The shift to inflation targeting in 2015 was accompanied by a transition to a floating exchange rate regime and changes in the mechanisms of rapid economic adjustment to exchange rate fluctuations. In addition, the drop in prices for Russian exports and the imposition of financial and economic sanctions against Russia led to a sizeable depreciation of the ruble in 2014-2016. The latter sped up the adjustment of economic agents to the new institutional conditions and fostered import substitution as a means of reducing the economy's sensitivity to external shocks.

The introduction of a new fiscal rule in 2018 became another important mechanism that mitigates the impact of fluctuations in the oil market, the core global market for Russia, on the Russian economy and, in particular, on the FX market.

Exchange rate movements are passed through into inflation through prices for imported and exported goods. For example, the depreciation of the ruble creates proinflationary influence. Risks of inflation acceleration are amplified by the asymmetry of exchange rate pass-through to prices in the short-term (that is, a stronger reaction of prices to depreciation than to appreciation) based on nominal rigidities (primarily of wages and prices of goods and services of natural monopolies).

It should also be noted that the pass-through can be non-linear, since the extent to which a currency weakens (or strengthens) can affect the behaviour of producers and consumers. Non-linearity means such a reaction of prices to exchange rate fluctuations where prices change disproportionately to changes in the exchange rate.

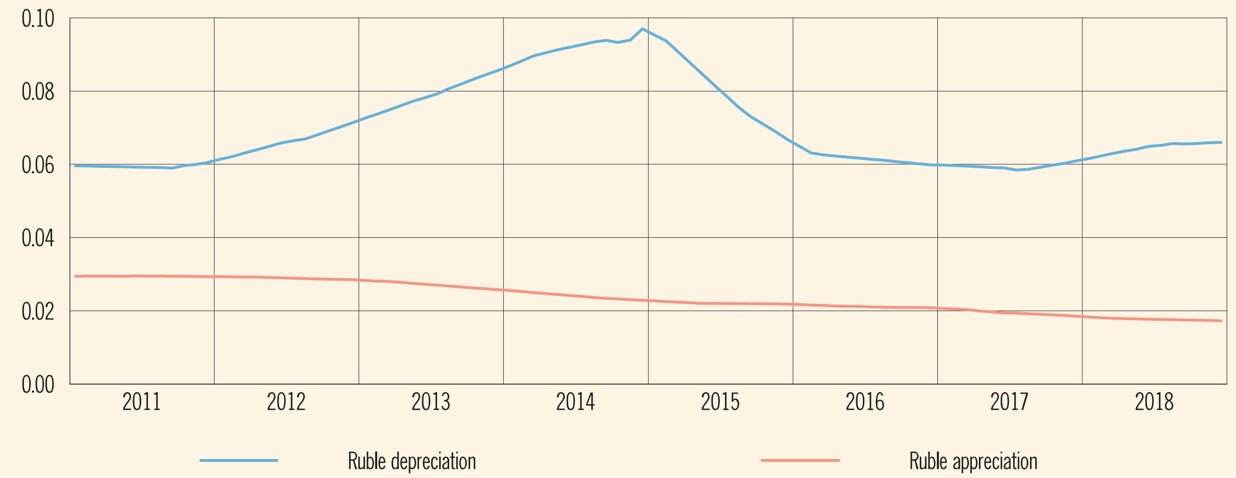
To clarify the estimates of the short-term elasticity of consumer prices to exchange rate dynamics, a model was developed incorporating the following variables as factors: ruble exchange rate fluctuations, indicators of economic activity and inflation expectations net of exchange rate effects. It is assumed that the pass-through may be asymmetrical and may vary over time. Only the impact of exchange rate fluctuations on prices manifested in the short term is considered; dependencies with a long lag are not taken into account in the calculations. Factors of economic activity (and inflation expectations) are based on the principle of dynamic factor models, which makes it possible to identify the overall dynamics characteristic of various indicators of economic activity (inflation expectations) not associated with exchange rate fluctuations.

The issue of using a particular indicator of exchange rate dynamics (the nominal effective exchange rate of the ruble or the US dollar) in models for short-term inflation forecasting is debatable, given potential discrepancies between the currency of the import contract (transaction) and the currency of payment under it and the impact of various mechanisms of import price formation in the domestic market. The analysis showed that any differences in the estimates of the pass-through made using different indicators of exchange rate dynamics are statistically insignificant. This is true of both inflation as a whole and its major components.

The simulation results confirmed the asymmetry of pass-through in the short term: consumer prices are less sensitive to the ruble strengthening than to its weakening (Chart 1). At the same time, the asymmetry of exchange rate pass-through in the short term does not mean asymmetry in the long term. For example, assuming that asymmetry is present in the short-term pass-through and absent in the long-term, the estimated dynamics and scale of the impact of exchange rate pass-through on inflation in the short term remain comparable to the original calculations.

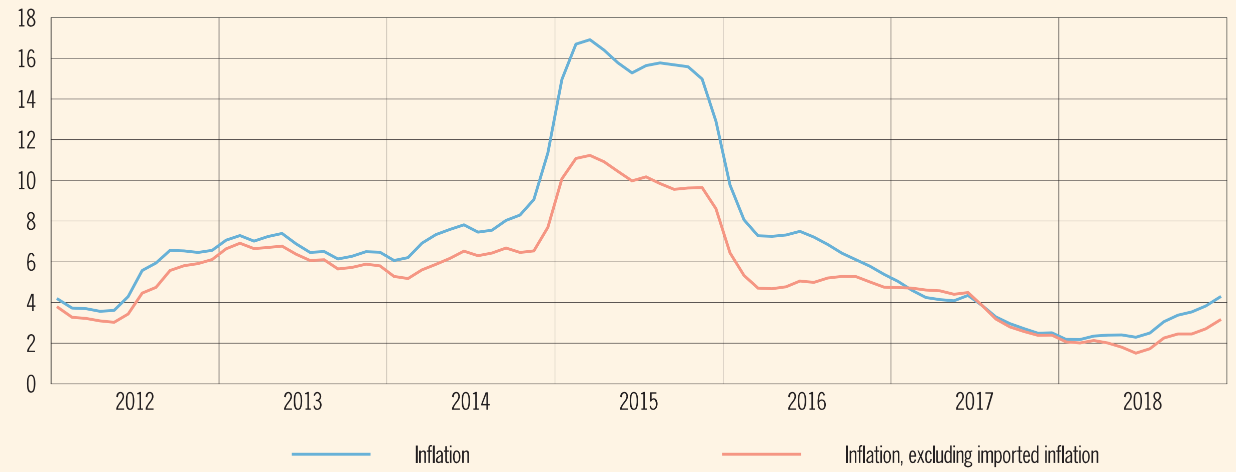
[1] *For more details see: Analysis of Asymmetry and Non-linearity of Exchange Rate Pass-Through. Working Paper Series A. Andreev. No. 45. September 2019; www.cbr.ru/Content/Document/File/79935/wp_45.pdf.*

SEMI-ELASTICITY OF CONSUMER PRICES AT THE EXCHANGE RATE IN THE SHORT RUN *Chart 1*
(pp)



Source: Bank of Russia calculations.

ANNUAL INFLATION AND INFLATION ADJUSTED FOR FX EFFECTS *Chart 2*
(% growth on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

The maximum (in absolute terms) short-term semi-elasticity[2] of inflation with respect to ruble depreciation was registered in late 2014 – early 2015, the period of increased exchange rate volatility, which is in line with previous estimates.[3] In 2016-2018, as the economy adjusted to new conditions, inflation became considerably less sensitive to ruble weakening. However, starting from the second half of 2017, the elasticity of prices with respect to the exchange rate rose somewhat; this may be connected with an increasing sanction pressure and overall high external economic uncertainty.

Note that the assessment of the pass-through in the inflation model makes it possible to estimate the inflation rate corresponding to constant exchange rate dynamics. It can be used in a set of indicators of basic inflation, that is, inflation net of shocks that are not relevant to monetary policy. Annual inflation net of the impact of import prices in 2018 was lower than the actual inflation: exchange rate dynamics in 2018 were proinflationary (Chart 2).

[2] *Semi-elasticity shows by how many percentage points inflation will change in the case of a 1% movement in the ruble exchange rate.*

[3] *Monetary Policy Report 1/16, www.cbr.ru/Collection/Collection/File/7839/2016_01_ddcp.pdf.*

REGIONAL HETEROGENEITY FACTORS AND STRUCTURAL INFLATION RATES IN RUSSIAN REGIONS

When preparing its monetary policy decisions, the Bank of Russia makes extensive use of regional data and examines the situation at the local level. In terms of regional disaggregation, nationwide inflation is a region-weighted average: when the national target for inflation is reached, there will always be regions where the price growth rate is lower or higher than the target.

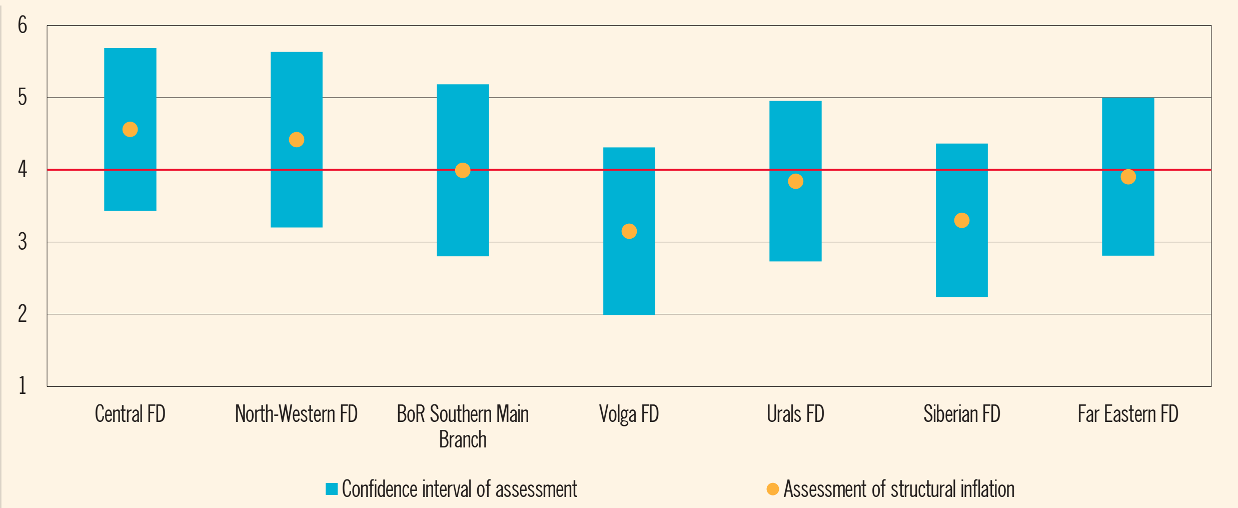
The analysis of regional heterogeneity of prices is currently a very topical subject in the academic literature. Differences in regional inflation rates are explained by both temporary and structural factors of the region's economy. In most studies, price convergence and structural features of regions are identified as factors of regional inflation rates as well as differences in terms of trade, exchange rates and income. As for studies by Russian researchers, there are no similar estimates for the regions, but a significant number of papers exist on the effects of convergence of regional prices and identification of factors of regional inflation heterogeneity.

The assessment of the structural levels of inflation by regions[1] included analysis of statistical data on regional inflation dynamics, identification of heterogeneity factors and calculation of regional inflation rates upon the achievement of national inflation target. Historically, Russia has had a wide spread of regional inflation rates, but since 2014 it has shrunk noticeably. Regions and entire federal districts have been identified where inflation rates have been consistently higher or lower than the national average since 2014, which most likely can be explained by structural features of regional economies, a heterogeneous response to shocks and differences in the regional structure of the consumer basket.

The econometric approach in the study was based on the Balassa-Samuelson theory and subsequent works, from which the dependence of differences in regional price growth rates on such factors as the difference in productivity in the tradable and non-tradable sectors, exchange rate dynamics, etc. was inferred.[2] Based on the obtained estimates and subject to achieving the national target inflation rate (4%), 'structural' inflation for each federal district was calculated, and a confidence interval was built.

The results showed that the structural features of regions, the relative depreciation of effective exchange rates and the dynamics of revenues and stocks of products can determine a stable deviation of the regional inflation rate from the national average. In addition, regional variations in the composition of the consumer

ASSESSMENT OF STRUCTURAL INFLATION BY FEDERAL DISTRICT* *Chart 1*
(%)



** Bank of Russia Southern Main Branch for the regions of the Southern and North Caucasian Federal Districts.*
Source: M. Zhemkov. Regional effects of inflation targeting in Russia: factors of heterogeneity and structural inflation rates. Voprosy Ekonomiki. No. 9. 2019. Pages 70–89.

[1] *M. Zhemkov. Regional effects of inflation targeting in Russia: heterogeneity factors and structural levels of inflation. Voprosy Ekonomiki. No. 9. 2019. Pages 70-89.*

[2] *M. Zhemkov. Regional effects of inflation targeting in Russia: heterogeneity factors and structural levels of inflation. Voprosy Ekonomiki. No. 9. 2019. Pages 70-89.*

basket may contribute to regional inflation heterogeneity. Regions with high inflation (the Central and North-Western Federal Districts) stand out, which can be explained by high average incomes and high-paying demand. At the same time, in the Volga Federal District, the Urals Federal District and the Siberian Federal District, inflation has traditionally been below the national average since 2014. The value of 'structural' inflation in the southern regions of the European part of Russia at the level of 4% with a symmetrical deviation in both directions can be explained by a strong reaction to farm produce supply shocks, which can lead both to a significant acceleration of inflation in the macro-region (summer 2017) and to its significant slowdown (a good harvest and a slowdown in food inflation in 2018).

ANNEXES

ECONOMIC SITUATION IN RUSSIAN REGIONS

In June and July, inflation continued to slow down in most regions, accompanied by a slight increase in its heterogeneity. The indexation of regulated tariffs for housing and public utility services, which significantly differed in scale by regions, and heterogeneous inflation of air transport services were the main contributors to the increase in the regional spread of price dynamics. The dynamics of economic activity in July returned to the positive area in most regions after some deterioration in May–June. Its regional variation remains low, with economic dynamics indicators close to zero in all federal districts. In May–July, most regions saw a certain growth in consumer activity and real wages amid slowing inflation.

PRINCIPAL ECONOMIC AND INFLATION INDICATORS BY FEDERAL DISTRICT *Table 1*
(%)

	Central FD	North-Western FD	Southern FD	North Caucasian FD	Volga FD	Urals FD	Siberian FD	Far Eastern FD
Inflation (July)	4.7	4.5	4.8	4.4	4.3	4.1	5.1	4.9
Economic activity indicator (YoY, July)	-1.3	-0.8	-1.2	0.9	1.5	-1.9	-0.3	3.3
Industrial output (YoY, July)	4.5	5.4	0.7	0	4.6	0	0.5	7.1
Retail turnover (YoY, July)	1.2	1.3	0.8	6.2	-0.3	0.6	1.1	2.5
Volume of paid services (YoY, July)	-4.9	-2.7	-0.1	1.4	-1.7	1.2	-1.5	-3.6
Volume of construction works (YoY, July)	-8.9	-24.3	-23.0	-5.2	-0.8	-20.1	-0.4	27.6
Growth in outstanding amounts on household loans (YoY, July)	24.2	23.1	22.8	21.5	20.3	18.5	18.5	19.6
Growth in outstanding amounts on corporate loans (YoY, June)	4.0	8.7	0.8	6.1	-2.4	4.7	7.8	17.4
Real wage (YoY, June)	4.7	-0.1	1.1	2.4	2.7	1.8	2.2	2.5
Unemployment rate (Q2)	2.9	3.5	5.3	11.1	4.2	4.3	5.8	6.0

Sources: Rosstat, Bank of Russia.

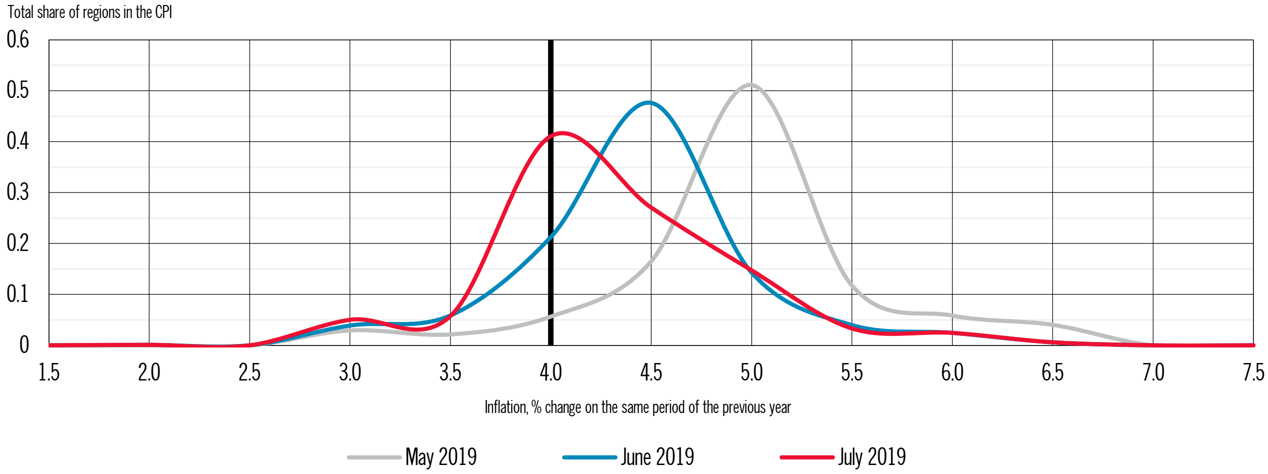
INFLATION AND PRICE EXPECTATIONS

DISTRIBUTION OF REGIONS BY INFLATION LEVEL

In June–July, regional inflation dynamics were fairly unidirectional: inflation slowdown was observed in most regions (77 out of 85). Inflation slowed down most significantly in the European part of Russia, primarily in the Southern and Central Federal Districts, while the acceleration of price growth occurred in some Siberian and Far Eastern regions (Republic of Sakha (Yakutia), Trans-Baikal Territory, Sakhalin and Irkutsk Regions). In general, inflation slowdown in the regions was not homogeneous: in June–July, its variation increased due to differences in the indexation of regulated tariffs for utility and passenger transport services as well as in the dynamics of fruit and vegetable prices. Annual inflation values in the regions varied in July from 1.1% to 6.6%, with the countrywide average value of 4.6%. Despite some growth in heterogeneity, the regional distribution of inflation generally retained its shape, and the main peak of the distribution in July moved to 4% (Chart 1). At the same time, a significant group of regions with inflation above 5% remains, consisting mainly of the regions of the Central Russia and Siberia. Regions with the lowest (1-3.5%) inflation since the beginning of the year include the Khanty-Mansi and Yamalo-Nenets Autonomous Areas and the Altai and Ingushetia Republics; in June–July, this group also included the Udmurt Republic, the Kirov Region and the Kamchatka Territory (Chart 3).

DISTRIBUTIONS OF REGIONS BY ANNUAL INFLATION

Chart 1



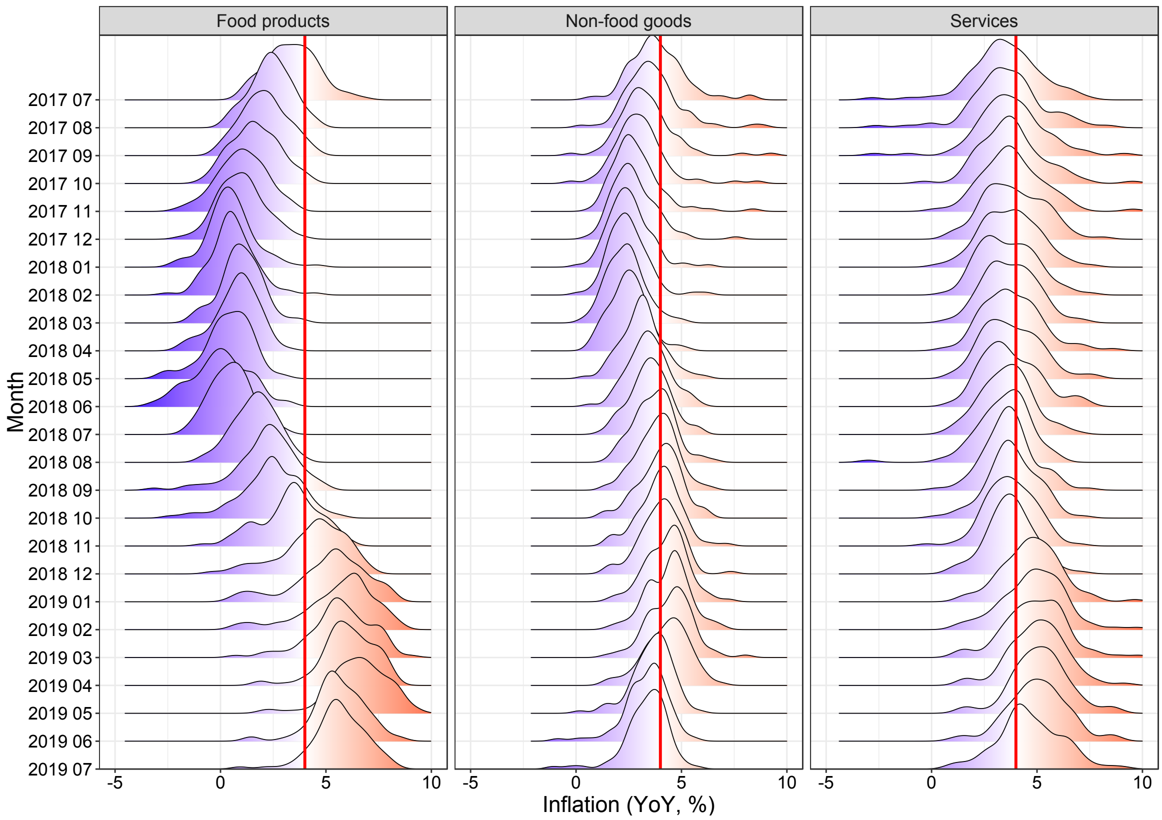
Sources: Rosstat, Bank of Russia calculations.

FOOD INFLATION

In June–July, the regional heterogeneity of food inflation significantly decreased amid a countrywide slowdown in price growth (Chart 2). The values of food inflation in the regions in July varied from 0.9% (the Yamalo-Nenets Autonomous Area) to 8.2% (the Irkutsk Region), whereas the values for the main group of regions (72 out of 85 constituent territories) ranged from 4.0% (the Vologda Region) to 7.5% (the Chukotka Autonomous Area). In June–July, fluctuations in food inflation in the regions

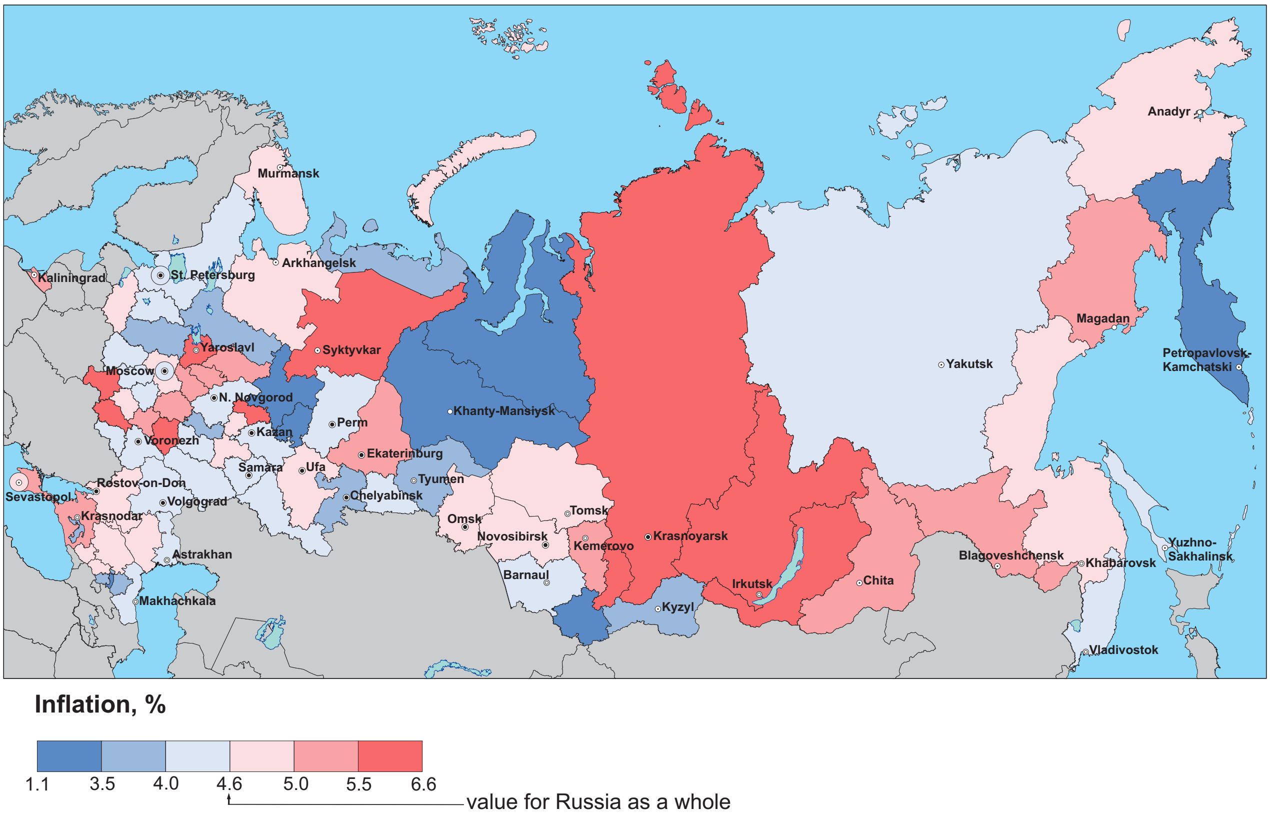
BREAKDOWN OF REGIONS BY ANNUAL INFLATION OF GOODS AND SERVICES

Chart 2



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

INFLATION IN REGIONS IN JULY 2019 *Chart 3*



Sources: Rosstat, Bank of Russia.

were determined mainly by the dynamics of prices for fruit and vegetables. Traditionally volatile, in June they were the major contributors to the slowdown in food inflation in most regions, and in July, to its acceleration in more than a half of the regions. The slowdown in inflation of fruit and vegetables in June in most constituent territories was caused by an earlier (compared to last year) new ground vegetables harvest in the main producing regions in the South of the country. In July, in many regions, the growth of prices for fruit and vegetables accelerated due to a cold and rainy weather in a large part of the European territory of Russia, which was unfavourable for the harvest. However, this acceleration in the regions was mostly insignificant, and in general, by the end of June–July, annual inflation of fruit and vegetables had decreased in most regions. In June–July, acceleration of food inflation occurred in many remote regions of the Far East, where it was associated with a slow response to the acceleration of price dynamics in large food-producing regions in the previous months due to the peculiarities of the import of products. At the same time, most regions saw a slowdown in the inflation of meat products due to the continuing growth in the supply of domestic meat as well as the cessation of certain non-monetary factors in the markets of lamb and poultry in the North Caucasian regions.[1] At the same time, the regional heterogeneity of meat inflation decreased, which made a major contribution to reducing the heterogeneity of overall food inflation.

NON-FOOD INFLATION

Inflation of non-food goods in July remained the most homogeneous across regions compared to inflation of food products and services: indicator values for the main group of regions (76 constituent territories with a total weight in the country CPI of over 95%) varied from 2% (the Sakhalin Region)

[1] *For more details, see 'Economic Situation in Russian Regions' in Monetary Policy Report 2/19, www.cbr.ru/Collection/Collection/File/19993/2019_02_ddcp.pdf.*

INFLATION IN THE FEDERAL DISTRICTS BY INDIVIDUAL SUBCOMPONENTS *Table 2*

	Share in the CPI								Inflation (%, July)							
	Central FD	North-Western FD	Southern FD	North Caucasian FD	Volga FD	Urals FD	Siberian FD	Far Eastern FD	Central FD	North-Western FD	Southern FD	North Caucasian FD	Volga FD	Urals FD	Siberian FD	Far Eastern FD
All goods and services	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	4.7	4.5	4.8	4.4	4.3	4.1	5.1	4.9
Food products	36.2	37.2	40.4	45.2	37.4	36.5	37.8	37.4	5.8	5.4	6.0	5.4	4.9	5.0	5.9	6.3
– excluding fruit and vegetables	32.5	32.9	35.6	38.8	33.8	32.8	34.0	33.1	5.9	5.0	6.1	5.5	5.1	4.6	6.3	5.9
Meat products	10.1	8.5	10.0	12.8	8.9	8.5	9.3	8.5	7.2	6.3	7.2	7.7	6.1	5.2	8.2	8.6
Milk and dairy products	2.9	3.5	3.2	3.2	3.2	3.3	3.4	3.1	6.1	5.9	6.5	6.2	4.2	6.7	7.0	5.5
Fruit and vegetables	3.6	4.3	4.7	6.5	3.5	3.8	3.8	4.3	5.1	8.4	5.6	5.2	3.3	8.7	3.1	9.4
Bread, pasta and cereals	2.2	2.4	2.9	3.4	2.7	2.4	2.6	2.3	12.1	6.4	11.4	6.2	11.9	9.1	11.0	9.4
Fish products	2.8	1.7	2.1	2.1	1.8	1.7	1.9	1.8	4.6	5.4	4.5	4.8	5.9	4.5	4.6	0.8
Oils and fats	1.0	1.1	1.4	2.2	1.2	1.0	1.2	1.0	5.3	4.4	5.8	8.2	6.0	3.3	4.4	4.8
Eggs	0.5	0.5	0.6	0.6	0.5	0.5	0.5	0.6	10.1	7.2	8.2	9.4	6.5	6.3	15.9	12.7
Sugar	0.3	0.3	0.5	1.3	0.5	0.4	0.6	0.4	0.0	-1.1	-1.5	4.1	-2.2	-1.2	-0.8	3.9
Other	11.0	12.6	11.9	9.4	12.7	12.5	12.0	12.8	3.6	3.3	4.0	3.0	2.9	2.9	4.4	4.1
Non-food goods	34.4	34.0	34.9	32.9	35.6	35.1	36.7	34.2	4.1	3.5	3.3	2.3	3.7	2.9	3.8	3.0
– excluding petrol	30.0	29.5	31.1	28.6	31.3	30.4	32.0	29.8	4.5	3.6	3.6	2.8	3.8	3.0	3.9	3.0
Clothes, footwear and fur goods	7.4	6.7	7.3	8.1	7.5	6.3	6.9	7.3	2.6	2.3	2.0	1.5	2.1	1.2	1.8	1.9
Cars	6.3	5.6	5.3	2.5	6.4	7.6	6.2	4.4	6.1	4.7	4.3	3.9	5.1	4.2	4.3	2.2
Petroleum products	4.4	4.5	3.7	4.3	4.3	4.7	4.7	4.4	1.2	2.7	1.2	-1.1	2.7	2.1	2.5	2.9
Household appliances	2.7	2.4	3.3	2.7	2.8	2.5	2.6	2.6	1.3	-1.8	1.4	-0.3	0.1	-0.2	-0.5	0.1
Furniture and construction materials	2.8	2.5	3.3	3.2	3.3	2.5	2.9	2.9	4.9	4.2	3.4	4.0	4.6	3.5	4.8	3.3
Household chemicals	0.7	0.8	0.9	1.1	0.9	0.7	0.9	0.9	6.5	6.0	4.1	5.5	4.7	2.6	4.8	7.7
Other	10.1	11.5	11.0	10.9	10.6	10.7	12.5	11.7	5.6	4.9	5.0	3.7	4.9	4.0	5.6	4.2
Services	29.4	28.8	24.8	21.9	27.0	28.4	25.5	28.4	4.0	4.4	5.0	5.5	4.4	4.5	5.6	5.6
– excluding utilities	19.7	18.9	14.4	12.6	16.9	18.0	16.0	17.0	3.6	4.7	4.9	5.6	4.4	5.2	5.3	6.5
Utilities	9.8	9.9	10.4	9.3	10.1	10.4	9.5	11.4	4.9	4.0	5.1	5.4	4.4	3.4	6.0	4.2
Personal services	3.5	3.8	3.3	2.8	3.1	3.1	2.7	3.2	2.8	3.6	4.2	3.4	3.6	2.8	4.1	4.0
Passenger transport	2.5	3.0	1.8	1.9	2.1	2.2	2.4	3.1	4.5	7.9	8.9	12.4	5.0	9.5	10.7	11.2
Tourism services	3.3	2.2	0.7	0.4	1.5	2.9	0.9	1.1	3.3	5.7	4.1	5.7	4.5	6.5	6.1	8.2
Education services	2.3	1.7	2.1	1.3	2.1	1.8	1.7	2.1	7.5	7.0	6.3	7.1	6.9	6.3	7.0	13.9
Medical services	1.7	1.5	1.4	1.2	1.6	1.4	1.2	1.4	3.1	4.3	4.0	4.3	5.4	4.1	5.3	5.0
Other	6.8	7.5	5.5	5.1	6.9	6.8	7.3	6.4	2.4	3.4	3.5	4.4	2.8	3.6	3.7	2.7

– *maximum values (share and inflation) across all federal districts*

– *minimum values for each subcomponent*

Sources: Rosstat, Bank of Russia.

to 4.8% (the Tambov Region). Slowing somewhat at the national level, the dynamics of non-food inflation in the regions were multi-directional in June–July. Regional differences were largely due to the dynamics of motor fuel prices associated with the base effect: the implementation of administrative measures to curb oil product prices began in July 2018. At the same time, in some regions, the base effect was less pronounced, and the slowdown in the growth of motor fuel prices continued mainly due to the predominance in these regions of independent gas stations less affected by measures aimed at stabilising petrol prices in 2018. In July, the market of motor fuel in some of these regions (the Republics of Ingushetia, Dagestan, Crimea, Altai and Chechnya; the Bryansk, Oryol and Kursk Regions; and Sevastopol) saw deflation compared to the last year. In general, the change in the dynamics of prices for non-food products in June–July in most regions was insignificant (in 64 regions, the acceleration or slowdown was less than 0.5 pp) and made a limited contribution to the overall dynamics of inflation.

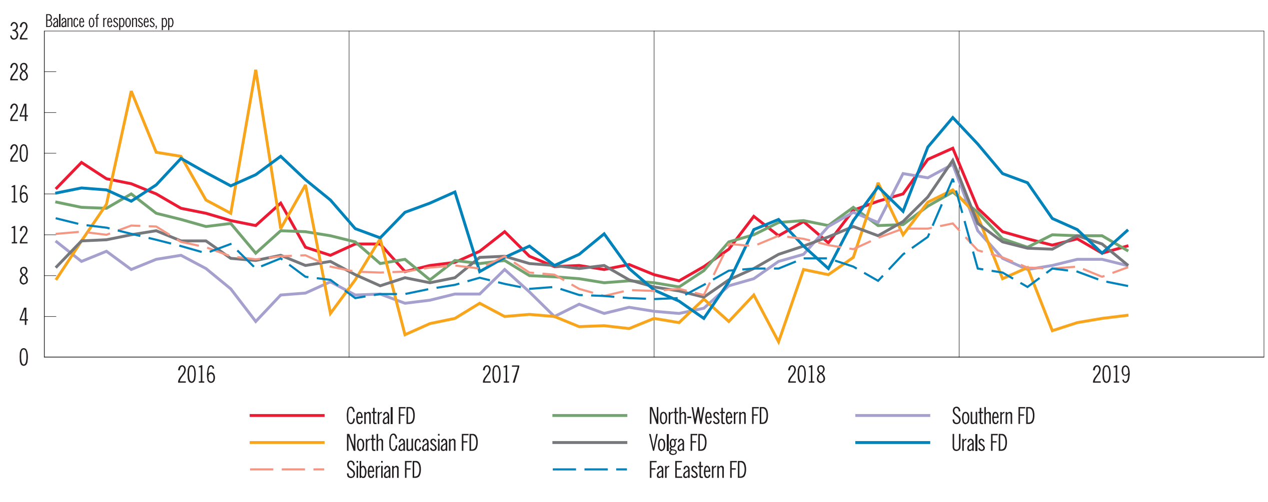
INFLATION IN THE SERVICES SECTOR

In July, service inflation made the main contribution to the increase in the regional heterogeneity of price dynamics. Indicator values ranged from 0.9% (the Kamchatka Territory) to 9% (the Komi Republic), while for the main group of regions (75 constituent territories with a total weight in the country CPI of over 95%) they ranged from 2.5% (the Republic of Kalmykia) to 6.8% (the Mari El Republic, the Republic of Dagestan). The growth of heterogeneity in the dynamics of prices for services in June–July was mainly due to inflation of passenger transportation services. Some Northern and Siberian regions saw a significant (over 6-7 pp) acceleration caused by a delayed increase in prices for air travel following the losses of 2018 and the pass-through of last year's rise in fuel prices to the cost of tickets. In the regions where there was a significant slowdown in inflation on passenger transportation services (the Republic of Mordovia, the Astrakhan, Magadan and Novgorod Regions, and the Khanty-Mansi and Yamalo-Nenets Autonomous Areas, by more than 8 pp), it was due to the postponement of the increase in urban transport fares and fuel surcharges included in the cost of air tickets by some airlines. In July, most regions saw a slowdown in service inflation, the most significant contribution to which was made by the dynamics of tariffs for utility services: their indexation in July was lower than a year earlier, as in 2019 it was carried out in two stages.

PRICE EXPECTATIONS

In July–August, price expectations of businesses for the three months ahead stabilised in most federal districts, remaining on average at the levels of the previous months (Chart 4). Price expectations in the North Caucasus are at their lowest levels since May mainly due to assessments of manufacturing, transportation and storage companies. The expectations of the latter could have been influenced by the dynamics of motor fuel prices, which in June–July in the North Caucasian FD slowed down the most in comparison with other FDs, and some regions of the district experienced deflation in this commodity group. In the sectoral context, most regions saw a decrease in expectations in construction in July. The increased expectations of enterprises in this industry at the beginning of the year persisted on the eve of the transition to the new rules of equity housing construction and the introduction of escrow accounts effective from 1 July. In August, price expectations in agriculture increased in most federal districts. This growth is due to some downward adjustments in harvest expectations (primarily grain).

COMPANIES' PRICE EXPECTATIONS *Chart 4*



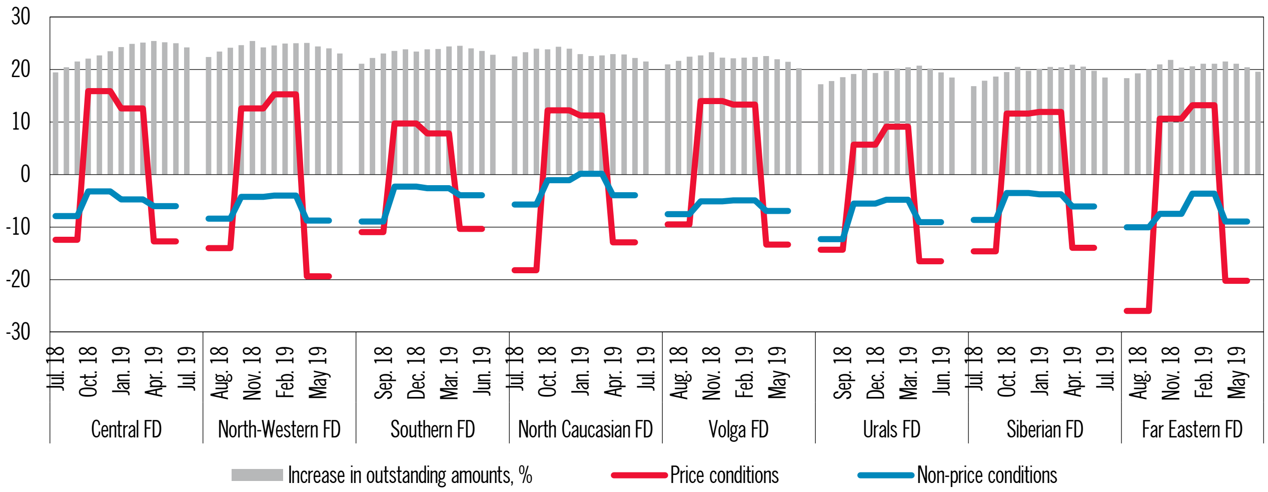
Source: Bank of Russia.

MONETARY CONDITIONS

HOUSEHOLD LENDING

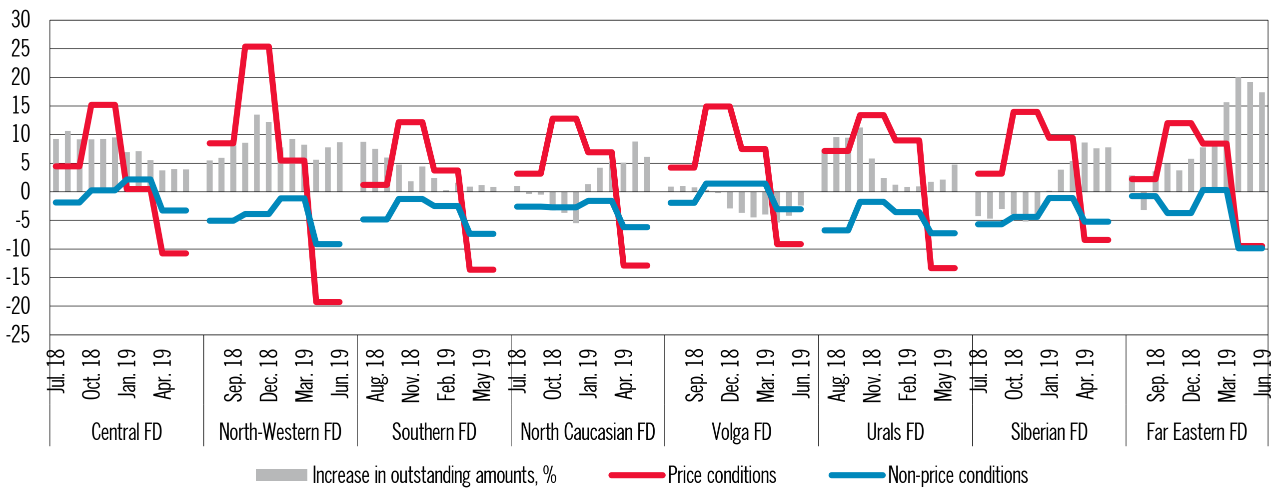
In 2019 Q2, in all federal districts, there was a significant easing of bank household lending conditions[2] (Chart 5). The easing of price conditions, which was noted by respondents for the first time in the last three quarters, occurred on the back of decreasing inflation expectations, slowing inflation and Bank of Russia key rate cuts. There was little change in the assessment of non-price lending terms for households, although certain easing was observed in all districts. In general, assessments of lending conditions in half of the regions remained in the neutral zone (in 34 regions out of the 68 regions where the survey was conducted), while they were rated as tight in 13 regions and as loose in 21 regions. At the same time, despite the easing of bank lending conditions, the growth rate of retail lending in May–July slowed in all federal districts, most significantly in the Volga, Urals and Siberian

CHANGES IN BANK LENDING CONDITIONS (NEGATIVE ZONE – EASING, POSITIVE ZONE – TIGHTENING) AND INCREASE IN OUTSTANDING AMOUNTS ON HOUSEHOLD LOANS (YOY) *Chart 5*



Source: Bank of Russia.

CHANGES IN BANK LENDING CONDITIONS (NEGATIVE ZONE – EASING, POSITIVE ZONE – TIGHTENING) AND INCREASE IN OUTSTANDING AMOUNTS ON CORPORATE LOANS (YOY) *Chart 6*



Source: Bank of Russia.

[2] Pursuant to the data of a quarterly survey of major banks. BLCs are assessed on the basis of the diffusion index, which reflects the balance of the responses of credit institutions assessing the change in conditions as tightening or easing.

Federal Districts. The growth of household lending is constrained by the high credit burden, which in 75% of the regions has already exceeded the peak of 2013-2014. At the level of individual regions, growth of the household loan portfolio (YoY) in July in most constituent territories ranged from 15% (the Vologda Region) to 27-28% (the Chukotka Autonomous Area, the Tyva Republic, the Republic of Dagestan, the Leningrad Region). In Crimea and Sevastopol, despite a noticeable (compared to March–April) slowdown, growth rates remain significantly higher (65% and 81%, accordingly), which is caused by the catch-up growth of consumer lending in those regions.

CORPORATE LENDING

Bank lending conditions for corporate borrowers in 2019 Q2 were also eased in all federal districts (Chart 6). Nevertheless, legal entities see bank lending conditions as tight in all districts, with the exception of the Urals FD, where they remain in the neutral zone. Amid easing of lending conditions, in May–June, the growth rate of the loan portfolio of businesses accelerated in most regions and federal districts. The highest growth rates were observed in the regions of the Far East, where the level of debt burden[3] of businesses (19%) remains significantly below the average Russian value (29%), with a low share of overdue debt (5.7% compared to 7.4% for the Russian Federation). The reduction of the loan portfolio of corporate borrowers occurred only in the Volga Federal District, where negative dynamics of corporate lending have persisted since November 2018. Here, the debt of the manufacturing industry, construction and trade enterprises decreased. In five federal districts (Central, Southern, North Caucasian, Volga and Urals), in May–June, there was an increase in the share of overdue debts of corporate borrowers.

PRODUCTION AND INVESTMENT ACTIVITY

ECONOMIC ACTIVITY INDICATOR

In May–July, the regional heterogeneity of the dynamics of economic activity remained relatively low, and the values of the economic activity indicator (EAI)[4] for all federal districts stayed in a narrow range near zero (Chart 7). In July, the number of regions with positive EAI dynamics increased significantly (to 51) after a decline that had continued since April (in April, there were 53 such regions; in June, there were 38). At the federal district level, the North Caucasian, the Far Eastern and the Volga FDs saw growth in economic activity in July. In the NCFD, the main contribution to EAI dynamics was from retail trade and services, while in the Volga FD and Far Eastern FD, it came from the manufacturing industry. In addition, the Far Eastern was the only district where there was an increase in the volume of construction works. This growth was due, among other things, to the completion in July of certain works on major projects (for example, this month the Power of Siberia gas pipeline was joined with the Chinese section). In other federal districts, the dynamics of construction contributed to the decline in economic activity (an especially strong decline was observed in the Southern and the Urals FDs), while almost everywhere there was an increase in the manufacturing industry (the only exception being the Urals and North Caucasian Federal Districts where the dynamics were zero). Despite some improvement in economic activity in a number of regions in July, the overall impact of a number of constraints remains: the increase of VAT on producer costs and consumer demand, fiscal policy, the weakening of external demand for export products and weak dynamics of investment activity.

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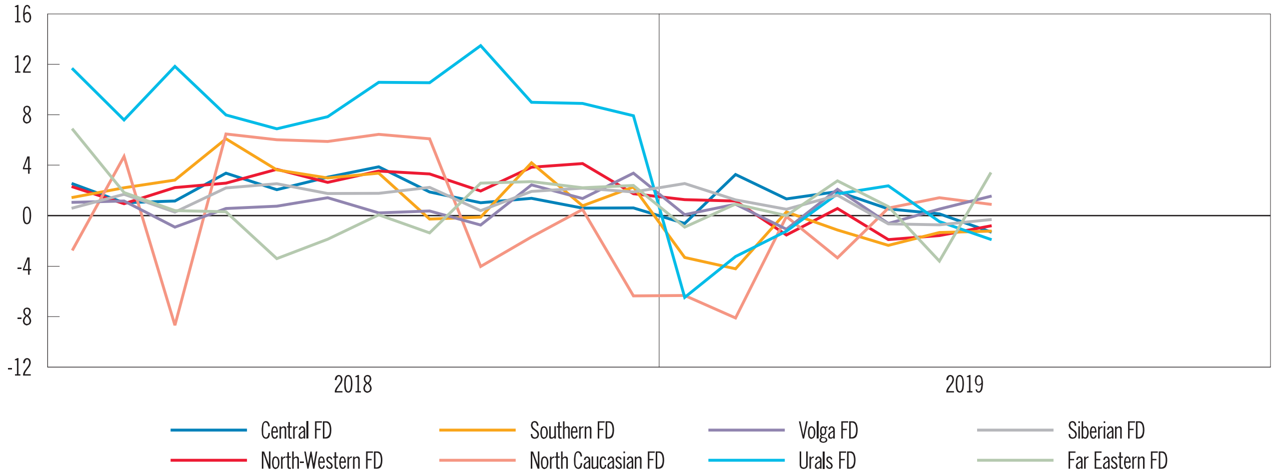
[3] *The debt burden of corporate borrowers by region (federal district) was calculated as the ratio of outstanding corporate loans to the volume of goods shipped and works and services performed (12-month rolling total).*

[4] *The economic activity indicator is calculated as the weighted average rate of the main economic activities: mining and quarrying, manufacturing, electricity, gas and steam supply, water supply, sewerage, waste collection and disposal, agriculture, construction, paid services provided to households and trade. The weights of the respective economic activities in the structure of the gross regional product (GRP) are used as weights for calculating the average figure. The EAI is the regional equivalent of the key industry index published by Rosstat.*

ECONOMIC ACTIVITY INDICATOR (JANUARY 2018–JULY 2019)
(YoY, %)

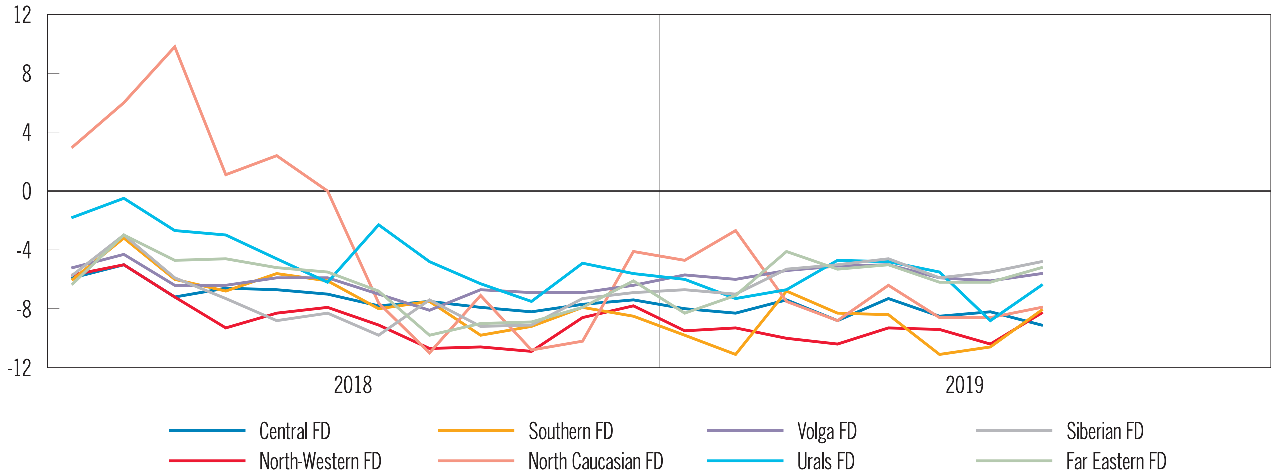
Chart 7



Sources: Rosstat, Bank of Russia calculations

COMPANIES' ASSESSMENT OF ECONOMIC SITUATION CHANGES
(balance of responses, pp)

Chart 8



Source: Bank of Russia.

BUSINESS SENTIMENT

Assessments of the economic environment by enterprises participating in Bank of Russia monitoring improved slightly in August after a slight deterioration in June and July in most federal districts (Chart 8). This was facilitated by the easing of lending conditions observed by businesses. In general, with minor changes, business sentiment in the federal districts remains at the levels of late 2018 – early 2019. Weak demand for products of enterprises continues to weigh down on business sentiment: its estimates remain at low levels near the averages of the past two years. Enterprises do not expect a significant increase in demand in the next three months: the balance of responses remains at the level of the first half of 2019.

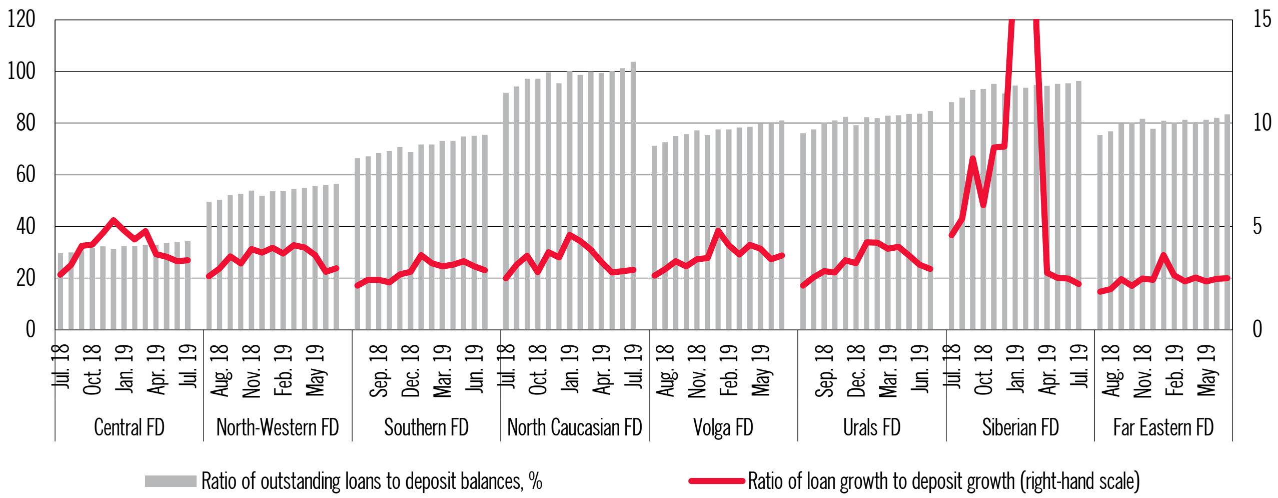
INVESTMENT

According to the results of the first half of 2019, the growth of fixed capital investments was maintained in four of the eight federal districts (Central, North Caucasian, Urals, and Siberian FDs). The highest annual growth rates remain in the Central and Siberian FDs (11% and 13% respectively), which is largely due to the ongoing implementation of major projects in Moscow (housing, transport), the Irkutsk Region and the Krasnoyarsk Territory (mining, metallurgy, chemical industry). In 2019 Q2, assessments of investment activity by businesses participating in the monitoring of the Bank of Russia in most federal districts continued to deteriorate but remained close to the average values of the previous three years. A slight increase in investment activity was noted by the businesses of the Siberian, Volga and North Caucasian districts.

CONSUMER DEMAND AND SAVINGS

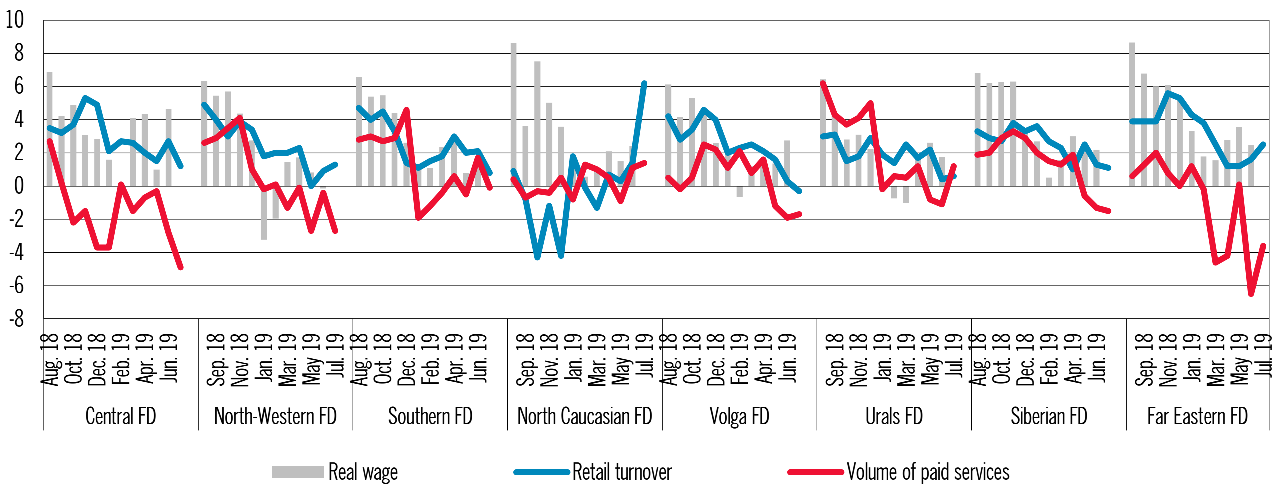
In May–July, the dynamics of consumer activity in the regions remained restrained amid low growth rates of real wages. In most regions, demand is also constrained by a slowdown in retail lending, which in many regions is accompanied by a slight acceleration in the growth of household deposits (Chart 9). Although in July the growth of retail trade turnover continued in most regions and federal districts (Chart 10), the number of regions with positive dynamics has continued to decrease since the beginning of the year (in July, there were 53 such regions, in April there were 68, and in January there were 72). Strong acceleration of retail trade turnover growth in the North Caucasus in July was

HOUSEHOLD LOANS AND DEPOSITS IN THE FEDERAL DISTRICTS* *Chart 9*



** The outlier in the deposit growth dynamics for the Siberian Federal District is related to changes in the statistical accounting by branches in a bank of the Novosibirsk Region.*
Source: Bank of Russia.

REAL WAGE, RETAIL TURNOVER AND VALUE OF PAID SERVICES *Chart 10*
(YoY, %)



Source: Rosstat.

due to a significant increase in one region, the Republic of Dagestan, where the dynamics of trade are traditionally volatile. In May–July, the annual dynamics of paid services in the regions were worse than in the previous months. For the first time since the beginning of the year, most regions saw a decrease in their volume, which was the strongest in the Central and Far Eastern FDs.

LABOUR MARKET AND INCOMES

In 2019 Q2, employment[5] (adjusted for seasonality) continued to decline in most regions and in all federal districts. In some regions, the level of employment ranged from 48% (the Republic of Tyva) to 78% (the Chukotka Autonomous Area), with an average national value of 64.6%. In May–June, the dynamics of real wages (YoY) in most regions slowed somewhat after growth in April but remained in the positive zone in all federal districts, except for the North-Western Federal District, and in most regions (in June, in 67 out of 85). The continued slowdown in inflation supports the growth of real wages in the regions. The unemployment rate in 2019 Q2 (seasonally adjusted) continued to decrease in most regions. At the same time, certain growth continues in several regions of the North Caucasus (the Dagestan, Ingushetia, Karachay-Cherkess and Kabardino-Balkar Republics) and Southern Siberia (the Republics of Altai and Buryatia), where the unemployment rate traditionally exceeds the national average. This contributed to the preservation of significant regional heterogeneity of the indicator: the unemployment rate in the regions in April–June 2019 ranged from 1.3-1.4% (Moscow, Saint Petersburg) to 26.6% (the Republic of Ingushetia).

[5] *For the population aged 15 to 72.*

STATISTICAL TABLES

INTERESTRATES ON BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY *Table 1*

(% p.a.)

<table>
<tr><th>Purpose</th><th>Type of instrument</th><th>Instrument</th><th>Term</th><th>Frequency</th><th>As of 01.01.2019</th><th>From 17.06.2019</th><th>From 29.07.2019</th><th>From 09.09.2019</th><th>General approach to rate-setting[1]</th></tr>
<tr><td rowspan="6">Liquidity provision</td><td rowspan="2">Standing facilities</td><td>Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[2]; repos</td><td>1 day</td><td rowspan="2">Daily</td><td>8.75</td><td>8.50</td><td>8.25</td><td>8.00</td><td>Key rate + 1.00</td></tr>
<tr><td>Loans secured by non-marketable assets[3]</td><td>From 2 to 549 days</td><td>9.50</td><td>9.25</td><td>9.00</td><td>8.75</td><td>Key rate + 1.75</td></tr>
<tr><td rowspan="4">Open market operations (minimum interest rates)</td><td>Auctions to provide loans secured by non-marketable assets[3]</td><td>3 months</td><td>Monthly[4]</td><td>8.00</td><td>7.75</td><td>7.50</td><td>7.25</td><td>Key rate + 0.25</td></tr>
<tr><td rowspan="2">Repo auctions</td><td>1 week</td><td>Weekly[5]</td><td rowspan="5">7.75 (key rate)</td><td rowspan="5">7.50 (key rate)</td><td rowspan="5">7.25 (key rate)</td><td rowspan="5">7.00 (key rate)</td><td rowspan="5">Key rate</td></tr>
<tr><td>From 1 to 6 days</td><td rowspan="3">Occasionally[6]</td></tr>
<tr><td>FX swap auctions (ruble leg)[2]</td><td>From 1 to 2 days</td></tr>
<tr><td rowspan="3">Liquidity absorption</td><td rowspan="2">Open market operations (maximum interest rates)</td><td rowspan="2">Deposit auctions</td><td>From 1 to 6 days</td></tr>
<tr><td>1 week</td><td>Weekly[5]</td></tr>
<tr><td>Standing facilities</td><td>Deposit operations</td><td>1 day[7]</td><td>Daily</td><td>6.75</td><td>6.50</td><td>6.25</td><td>6.00</td><td>Key rate - 1.00</td></tr>
</table>

[1] *From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set as key rate spreads. See the press release www.cbr.ru/press/pr/?file=01062018_180510dkp2018-06-01T18_04_36.htm.*

[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 discontinued since April 2016.*

[5] *Either a repo or a deposit auction is held depending on the situation with liquidity.*

[6] *Fine-tuning operations.*

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

BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY *Table 2*
(billions of rubles)

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims and liabilities					
					As of 01.01.2018	As of 01.01.2019	As of 01.04.2019	As of 01.07.2019	As of 01.08.2019	As of 01.09.2019
Liquidity provision	Standing facilities	Overnight loans	1 day	Daily	0.0	8.1	0.0	1.1	0.6	0.4
		Lombard loans			0.0	0.0	0.0	0.0	0.0	0.0
		FX swaps			0.0	4.1	32.8	3.6	0.0	0.0
		Repos			3.6	3.6	2.6	1.4	0.7	0.9
		Loans secured by non-marketable assets	From 1 to 549 days		5.5	5.1	8.1	5.1	5.1	5.1
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	Monthly[1]	0.0	0.0	0.0	0.0	0.0	0.0
		Repo auctions	1 week From 1 to 6 days	Weekly[2] Occasionally[3]	0.0	0.0	0.0	0.0	0.0	0.0
		FX swap auctions	From 1 to 2 days	Occasionally[3]	0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	From 1 to 6 days 1 week	Occasionally[3] Weekly[2]	2,124.9	1,478.2	1,680.0	704.4	1,299.5	2,215.0
		Auctions for the placement and additional placement of coupon OBRs[4]	Up to 3 months	Occasionally	357.4	1,391.3	1,515.3	1,716.6	1,517.1	1,214.2
	Standing facilities	Deposit operations	1 day[5]	Daily	246.8	423.8	136.4	152.8	126.0	149.8

[1] *Operations discontinued since April 2016.*
[2] *Either a repo or a deposit auction is held depending on the situation with liquidity.*
[3] *Fine-tuning operations.*
[4] *If the reporting date falls on a weekend or holiday, the indicated amount of outstanding Bank of Russia coupon OBRs includes the accrued coupon interest as of the first working day following the reporting date.*
[5] *Before 16 May 2018, also call operations. From 17 May 2018, the Bank of Russia only conducts overnight deposit operations with credit institutions.*
Source: Bank of Russia.

REQUIRED RESERVE RATIOS *Table 3*
(%)

Liability type	Validity dates			
	01.12.17–31.07.18	01.08.18–31.03.19	01.04.19–30.06.19	From 01.07.19[1]
Banks with a universal licence and non-bank credit institutions				
To households in rubles Other liabilities in rubles To non-resident legal entities in rubles	5.00	5.00	4.75	4.75
To households in foreign currency	6.00	7.00	7.00	8.00
To non-resident legal entities in foreign currency Other liabilities in foreign currency	7.00	8.00	8.00	8.00
Banks with a basic licence				
To households in rubles Other liabilities in rubles	1.00	1.00	1.00	1.00
To non-resident legal entities in rubles	5.00	5.00	4.75	4.75
To households in foreign currency	6.00	7.00	7.00	8.00
To non-resident legal entities in foreign currency Other liabilities in foreign currency	7.00	8.00	8.00	8.00

[1] Bank of Russia Ordinance No. 5158-U, dated 31 May 2019. See the press release published on the Bank of Russia website on 31 May 2019.
Source: Bank of Russia.

REQUIRED RESERVE AVERAGING RATIO *Table 4*

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.

REQUIRED RESERVES AVERAGING SCHEDULE FOR 2019 AND INFORMATION ON CREDIT INSTITUTIONS' COMPLIANCE WITH RESERVE REQUIREMENTS *Table 5*

Averaging period to calculate a required reserves amount for a respective reporting period	Averaging period duration (days)	Memo item:		Actual average daily balances in correspondent accounts	Required reserves to be averaged in correspondent accounts	Required reserves recorded to their respective accounts
		Reporting period	Required reserves regulation period			
09.01.2019 – 05.02.2019	28	December 2018	22.01.2019 – 24.01.2019	2,329	2,258	586
06.02.2019 – 05.03.2019	28	January 2019	14.02.2019 – 18.02.2019	2,368	2,273	588
06.03.2019 – 09.04.2019	35	February 2019	15.03.2019 – 19.03.2019	2,346	2,279	587
10.04.2019 – 07.05.2019	28	March 2019	12.04.2019 – 16.04.2019	2,376	2,294	589
08.05.2019 – 04.06.2019	28	April 2019	21.05.2019 – 23.05.2019	2,389	2,324	593
05.06.2019 – 09.07.2019	35	May 2019	17.06.2019 – 19.06.2019	2,394	2,334	596
10.07.2019 – 06.08.2019	28	June 2019	12.07.2019 – 16.07.2019	2,404	2,335	597
07.08.2019 – 03.09.2019	28	July 2019	14.08.2019 – 16.08.2019	2,424	2,363	604
04.09.2019 – 08.10.2019	35	August 2019	13.09.2019 – 17.09.2019	-	-	-
09.10.2019 – 05.11.2019	28	September 2019	14.10.2019 – 16.10.2019	-	-	-
06.11.2019 – 03.12.2019	28	October 2019	15.11.2019 – 19.11.2019	-	-	-
04.12.2019 – 07.01.2020	35	November 2019	13.12.2019 – 17.12.2019	-	-	-

KEY ECONOMIC AND FINANCIAL INDICATORS *Table 6*

		08.18	09.18	10.18	11.18	12.18	01.19	02.19	03.19	04.19	05.19	06.19	07.19	08.19
Real sector														
Inflation	% YoY	3.1	3.4	3.5	3.8	4.3	5.0	5.2	5.3	5.2	5.1	4.7	4.6	4.3
GDP[1]	% YoY		2.2			2.7			0.5			0.9		
GDP in current prices[1]	trillions of rubles		27.1			29.5			24.5			26.2		
Output by key activity types	% YoY	2.0	1.6	3.8	1.8	2.1	0.3	2.3	0.2	2.9	-0.3	2.0	2.6	
Industrial production	% YoY	2.7	2.1	3.7	2.4	2.0	1.1	4.1	1.2	4.6	0.9	3.3	2.8	
Agricultural output	% YoY	-10.6	-4.7	12.1	-5.9	0.1	0.7	1.0	1.5	1.4	1.0	1.1	5.9	
Construction	% YoY	3.3	5.9	5.7	4.3	2.6	0.1	0.3	0.2	0.0	0.2	0.1	0.2	
Fixed capital investment[1]	% YoY		6.4			2.9			0.5			0.6		
Freight turnover	% YoY	2.8	2.2	1.6	2.3	3.2	2.3	1.8	2.5	2.6	0.9	0.4	-1.2	
PMI Composite Index	% SA	52.1	53.5	55.8	55.0	53.9	53.6	54.1	54.6	53.0	51.5	49.2	50.2	51.5
Retail trade turnover	% YoY	3.0	2.3	2.2	3.3	2.7	2.0	2.1	1.7	1.6	1.4	1.4	1.0	
Real disposable money income[1]	% YoY		0.2			-2.0			-2.5			-0.2		
Real wage	% YoY	6.8	4.9	5.2	4.2	2.9	1.1	0.0	2.3	3.1	1.6	2.9	3.5	
Nominal wage	% YoY	10.1	8.4	8.9	8.2	7.3	6.1	5.2	7.7	8.4	6.8	7.7	8.2	
Unemployment rate	% SA	4.8	4.7	4.8	4.7	4.8	4.7	4.7	4.6	4.6	4.6	4.6	4.6	
Banking sector														
Broad money supply	% YoY, AFCR	8.2	8.2	7.9	7.9	7.9	6.5	7.9	7.0	6.6	6.7	6.4	7.0	
Money supply (M2)	% YoY	12.6	11.8	11.5	11.9	11.0	9.9	9.9	8.9	7.7	8.0	7.3	7.8	
Household deposits	% YoY, AFCR	7.0	6.0	6.5	5.7	5.4	5.4	5.7	5.6	6.8	7.0	7.3	7.1	
in rubles	% YoY	11.2	9.9	10.4	8.9	8.3	7.8	7.5	6.6	7.0	6.7	6.6	6.5	
in foreign currency	% YoY	-7.2	-7.3	-7.0	-5.6	-5.2	-3.6	-1.2	1.6	5.8	8.1	9.9	9.5	
dollarisation	%	21.7	21.1	20.9	21.3	21.5	21.5	21.5	21.5	21.1	21.3	20.9	21.1	
Loans to non-financial organisations	% YoY, AFCR	4.3	5.7	6.0	5.6	4.7	4.8	5.6	5.7	5.4	6.2	6.4	5.7	
short-term (up to 1 year)	% YoY, AFCR	-0.5	-1.3	2.2	3.7	3.8	-0.6	-2.0	2.7	-1.0	1.3	4.7	4.9	
long-term (more than 1 year)	% YoY, AFCR	4.9	7.2	6.9	6.0	5.4	4.9	6.1	5.2	5.8	5.9	5.4	4.3	
overdue loans	%	6.7	6.6	6.7	6.6	6.3	7.8	7.9	7.9	7.8	7.9	7.9	8.1	
Loans to households	% YoY, AFCR	20.5	21.4	22.0	22.6	22.2	23.0	23.4	23.5	23.8	23.3	22.8	21.9	
housing mortgage loans	% YoY, AFCR	24.5	24.8	25.3	25.5	23.4	24.7	24.8	24.2	23.5	22.7	21.6	19.8	
unsecured consumer loans	% YoY	19.3	20.5	21.4	22.5	22.7	23.4	23.7	24.2	25.2	24.9	24.6	24.4	
overdue loans	%	5.9	5.8	5.6	5.5	5.1	5.4	5.3	5.1	5.1	5.0	4.9	4.9	

Legend:
YoY – on corresponding period of previous year;
SA – seasonally adjusted;
AFCR – adjusted for foreign currency revaluation.
[1] Quarterly data.
Sources: Rosstat, IHS Markit, Bank of Russia calculations.

KEY ECONOMIC AND FINANCIAL INDICATORS: BALANCE OF PAYMENTS

Table 7

		2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2[1]
Balance of payments[2]							
Urals crude price	% YoY	24.8	50.1	44.6	9.3	-3.2	-5.2
USD/RUB exchange rate ('+' – ruble appreciation, '-' – ruble depreciation)	% YoY	3.4	-7.5	-9.9	-12.1	-14.0	-4.3
Goods and services exports	% YoY	21.7	27.3	28.2	18.2	1.0	-5.9
Goods and services imports	% YoY	18.8	8.2	-0.2	-3.0	-3.0	-2.1
Current account	**billions of US dollars**	**29.8**	**17.9**	**27.4**	**38.4**	**33.7**	**12.1**
Balance of trade	billions of US dollars	44.1	45.4	47.8	57.2	46.8	39.7
Exports	billions of US dollars	101.5	108.8	110.4	122.4	102.4	101.4
Imports	billions of US dollars	57.4	63.4	62.7	65.2	55.6	61.7
Balance of services	billions of US dollars	-6.6	-7.7	-8.8	-6.9	-5.9	-7.6
Exports	billions of US dollars	13.9	16.7	17.4	16.7	14.2	16.6
Imports	billions of US dollars	20.5	24.3	26.1	23.6	20.1	24.2
Balance of primary and secondary income	billions of US dollars	-7.7	-19.8	-11.6	-11.9	-7.3	-20.0
Current and capital account balance	billions of US dollars	29.6	17.7	27.4	37.7	33.7	12.0
Financial account excluding reserve assets (net lending (+) / net borrowing (-)	**billions of US dollars**	**12.4**	**9.3**	**24.1**	**30.8**	**12.7**	**-1.9**
Public sector	billions of US dollars	-6.5	11.1	2.9	1.5	-9.0	-8.0
Private sector	billions of US dollars	18.9	-1.8	21.2	29.3	21.7	6.1
Net errors and omissions	billions of US dollars	2.1	2.9	1.7	-4.3	-2.4	2.7
Change in reserve assets ('+' – increase, '–' – decrease)	**billions of US dollars**	**19.3**	**11.3**	**5.0**	**2.6**	**18.6**	**16.6**

[1] *Estimate.*
[2] *Signs according to BPM6.*

GLOSSARY

BALANCE OF PAYMENTS OF THE RUSSIAN FEDERATION

A statistical system reflecting all economic transactions between residents and non-residents of the Russian Federation, which occurred during the reporting period.

BANKING SECTOR LIQUIDITY

Credit institutions' funds held in correspondent accounts with the Bank of Russia in the currency of the Russian Federation, mainly to carry out payments through the Bank of Russia payment system and to comply with obligatory reserve requirements.

BANK OF RUSSIA KEY RATE

A main instrument of the Bank of Russia's monetary policy. The Bank of Russia Board of Directors sets the rate eight times a year. Key rate changes influence lending and economic activities and make it possible to achieve the primary objective of the monetary policy. It corresponds to the minimum interest rate at Bank of Russia one-week repo rate auctions and the maximum interest rate at Bank of Russia one-week deposit auctions.

CONSUMER PRICE INDEX (CPI)

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. This index is calculated by the Federal State Statistics Service. The CPI shows changes over time in the overall price level of goods and services purchased by households for private consumption. 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. Additionally, the CPI possesses a number of properties facilitating its wide-spread application: simple and clear construction methods, calculation on a monthly basis and publication in a timely manner.

CORE INFLATION

An inflation indicator characterising its most stable part. Core inflation is measured using the core consumer price index (CCPI). The difference between the CCPI and the consumer price index (CPI) lies in the CCPI calculation method, which excludes the change in prices for individual goods and services subject to the influence of administrative and seasonal factors (certain types of fruit and vegetables, passenger transportation services, telecommunication services, housing and public utility services, motor fuel, etc.).

CREDIT DEFAULT SWAP (CDS)

A financial instrument which allows a CDS buyer to insure against a certain credit event (e.g., default) under financial obligations of a third party in exchange for regular payment of a premium (CDS spread) to the CDS seller. The higher the paid premium, the more risky the obligations which served as the subject matter of the credit default swap.

DOLLARISATION OF BANK DEPOSITS (LOANS)

The share of deposits (loans) denominated in foreign currency in total banking sector deposits (loans).

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

An exchange rate regime, under which the central bank does not set targets, including operational ones, for the level of or changes to the exchange rate, allowing it to be influenced by 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.

INFLATION

A sustained increase in the overall price level of goods and services in the economy. Inflation is generally associated with changes over time in the cost of a consumer basket, i.e. a set of food products, non-food goods and services consumed by an average household (see also 'Consumer price index').

INFLATION EXPECTATIONS

Economic agents' expectations about future price growth. Inflation expectations can be given by businesses, households, financial markets and professional analysts. Driven by expectations, economic agents make their economic decisions and future plans, which include consumption, savings, borrowings, investment and loan/deposit rates. Capable of producing a certain effect on inflation, inflation expectations constitute an important indicator for the monetary policy decision-making process.

INFLATION TARGETING

A monetary policy strategy governed by the following principles: the main objective of monetary policy is price stability; the inflation target is specified and declared; monetary policy influences the economy largely through interest rates under a floating exchange rate regime; monetary policy decisions are taken based on the analysis of a wide range of macroeconomic indicators and their forecast. The Bank of Russia seeks to set clear benchmarks for households and businesses, including through increased information transparency.

MONETARY BASE

Total amount of certain cash components and credit institutions' funds in Bank of Russia accounts and bonds denominated in the currency of the Russian Federation. The monetary base in a narrow definition includes cash in circulation (outside of the Bank of Russia) and credit institutions' funds in accounts recording required reserves on funds attracted by credit institutions in the currency of the Russian Federation. The broad monetary base includes cash in circulation (outside of the Bank of Russia) and the total funds of credit institutions in Bank of Russia accounts and bonds.

MONEY SUPPLY

Total Russian Federation residents' funds (excluding general government's and credit institutions' funds). For the purposes of economic analysis, various monetary aggregates are calculated (M0, M1, M2, M2X).

MONEY SUPPLY IN THE NATIONAL DEFINITION (M2 MONETARY AGGREGATE)

Total amount of cash in circulation outside the banking system 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

A 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 advanced/emerging economies) and the 'world' index.

NEUTRAL RATE

The level of the key rate when monetary policy neither slows down nor spurs inflation.

OPERATIONS TO ABSORB LIQUIDITY

Bank of Russia reverse operations to absorb liquidity from credit institutions. These are operations either to attract deposits or place Bank of Russia bonds.

REFINANCING OPERATIONS

Bank of Russia reverse operations to provide credit institutions with liquidity. They may be in the form of loans, repos or FX swaps.

REQUIRED RESERVE RATIOS

Ratios ranging from 0% to 20% are applied to reservable liabilities of credit institutions to calculate the standard value of required reserves. They are set by the Bank of Russia Board of Directors.

RUONIA (RUBLE OVERNIGHT INDEX AVERAGE)

Reference weighted rate of overnight ruble deposits in the Russian interbank market. It reflects the cost of unsecured loans of banks with minimum credit risk. To calculate RUONIA, the Bank of Russia applies the method elaborated by the National Finance Association in cooperation with the Bank of Russia based on the information on deposit transactions made between member-banks. The list of RUONIA member banks is compiled by the National Finance Association and concurred with the Bank of Russia.

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.

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. Changes in the key rate are translated into the economy through different channels (interest rate, credit, foreign exchange, balance sheet, inflation expectations and other channels).

ABBREVIATIONS

- AFCR – adjusted for foreign currency revaluation
- AHML – Agency for Housing Mortgage Lending
- BLC – bank lending conditions
- bp – basis point (0.01 percentage points)
- 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-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
- IFX-Cbonds – corporate bond return index
- 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