Bank of Russia

DECEMBER 2019

MONETARY POLICY REPORT

23 December 2019

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This publication has been prepared by the Monetary Policy Department.

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STATEMENT BY BANK OF RUSSIA GOVERNOR ELVIRA NABIULLINA

IN FOLLOW-UP TO BOARD OF DIRECTORS MEETING 13 DECEMBER 2019

Today, the Board of Directors has decided to cut the key rate by 25 bp down to 6.25% per annum.

We will consider the necessity of further key rate reduction in the first half of 2020.

Let me dwell on the main factors behind the decision.

First. Annual inflation continues to decline faster than we expected. *Our revised inflation forecast for the end of this year is 2.9–3.2%. Meanwhile, average 2019 inflation will stand at 4.5%, which reflects the high price growth rate in late 2018 and the first months of 2019.*

This significant slowdown in inflation in the second half of the year was caused by a joint action of a number of disinflationary factors, both temporary and more persistent. These factors include an increased supply of individual food products due to a bumper harvest. Also, price growth of imported goods is still limited due to the ruble appreciation and inflation deceleration amongst Russia's trading partners. At the same time, moderate demand, both external and internal, is a more persistent factor. The proportion of temporary and persistent factors has yet to be estimated.

Most indicators that we analyse reflect low inflationary pressure. Annual core inflation is declining at the same rate as the headline consumer price index. Both indicators were registered at 3.5% in November. Seasonally adjusted monthly price growth has been around 0.2% since June.For food products, this indicator came in even lower in October and November. If we transform these monthly indicators into annualised form, the result will be lower than 4%.

However, looking at the key product groups, while annual food and non-food price growth keeps falling, services prices increased slightly faster in November with their growth rate reaching 3.9%. This was mainly owing to the market services segment, which could be an early sign of a potential revival of demand. Survey results also indicate an improvement in consumer sentiment.

As to the next year, our inflation forecast for the first quarter is below 3%. This decrease will be temporary. It is in line with our expectations and is explained by the fact that the effect of the VAT rate increase will be factored out from the calculation of annual inflation. In the second half of the year, inflation will be returning to around 4%. This will be helped by the monetary policy easing that the Bank of Russia has implemented this year. I would like to reiterate that monetary policy measures influence the economy and inflation in a gradual manner. The accumulated effect of the *earlier key rate decisions will manifest itself throughout 2020. Therefore, it may take some time to assess the necessity for a further key rate reduction.*

Taking into account the key rate decisions and other assumptions of our baseline forecast, we expect inflation to range within 3.5–4.0% by the end of 2020. Moving forward, the monetary policy pursued will keep annual inflation close to 4%.

Second. Household inflation expectations decline but stay above the lows registered in April 2018. *However, the perception of inflation by households is gradually changing. We see that inflation expectations are forming now at the level that is lower than the one observed amid comparable price dynamics in late 2017 – early 2018. This is largely associated with the recent trend for average inflation to be much lower than before. The inflation volatility range has also narrowed. However, inflation expectations remain sensitive to changing prices of individual goods and to one-off events. In our policy, we take into account the fact that we need more time to fully anchor inflation expectations.*

Business price expectations decreased in the first half of the year and have remained generally stable during the last few months. Mid-term inflation expectations of analysts and professional market participants are close to 4%.

Third. Monetary conditions are easing and this process will continue mainly due to the earlier key rate decisions.

OFZ yields stay at their lowest levels for the last few years after the October key rate decision. Interest rates in the deposit and credit market are going down. I would like to specifically point out that the interest rate on housing mortgage loans extended in October fell to 9.4% vs 10.6% in May. At the same time, real deposit rates remain positive taking into account inflation forecast, which supports the attractiveness of savings.

Our estimates suggest that there is still a certain potential for a further decrease in loan interest rates. We will assess further adjustment of monetary conditions, in particular, gradual changes in interest rates in various market segments as well as monetary indicators. Their further effect on economic indicators and price dynamics. This is a lengthy and gradual process. Our further monetary policy decisions will depend on its development and consistency with our expectations.

The most important factor that we analysed today is the situation in the economy. We expect that GDP growth rates will be closer to the upper bound of our forecast range of 0.8–1.3%.

The Q3 results show that economic growth accelerated to 1.7%. Industrial output keeps growing. In October, after a prolonged slowdown, we saw an increase in annual retail sales growth. This was supported by an acceleration in real wage growth largely due to inflation slowdown amid relatively unchanged nominal wage growth.

Starting in September, we have observed a notable increase in budget spending on national projects. In the second half of the year, government investment started to support economic growth.

At the same time, we have yet to estimate the stability of higher economic growth rates. Demand remains contained in general. Various investment activity and business sentiment indicators show mixed dynamics. In particular, new (especially, export) order expectations in industry remain low. This reflects a slowdown in global economic growth, continuing global trade tensions and geopolitical risks. These are all restraining factors for our economy.

Regarding the three-year forecast horizon, our expectations here have not changed overall since October. *We expect that the GDP growth rate will gradually increase to 1.5–2.0% in 2020 and to 2–3% in 2022. Successful implementation of national projects should provide the largest contribution to the increase in growth rates. This will support internal demand while external conditions remain a factor of uncertainty in the forecast.*

As regards oil prices. Last week, the OPEC+ countries reached a deal to extend oil production cuts until the end of March 2020. As of now, we stick to a conservative assumption for oil prices in *our forecast: their reduction to 55 US dollars per barrel in 2020 and to 50 US dollars per barrel in 2021 and further on. We will adjust this opinion depending on, among other factors, future changes in the OPEC+ agreements and global demand for energy commodities.*

As to the balance of payments, we have slightly adjusted some indicators for this year, taking into account the actual data available. Let me remind you that the current account balance will gradually decrease over the forecast horizon remaining sustainably positive: approximately to 3% of GDP in 2020 and to 1–2% of GDP in 2021. This is associated with oil price trends and external demand. The financial account balance of the private sector will shrink to about 1% of GDP in 2020–2022.

As usual, making our decisions, we also factored in risks. We are currently talking a lot about disinflationary factors, and they do prevail for the moment. However, there are also proinflationary risks over the forecast horizon.

First, such risks are associated with external factors, which include the world economy and global financial markets.

Second, it is hard to exactly assess the extent to which the inflation slowdown in the food market is caused by temporary factors, the timing and the likelihood of the turnaround in their dynamics and the intensity of balancing changes in food prices given the current low base.

Third, as we have noted, the aggregate effect of five earlier key rate cuts will be gradual and its estimation will take time.

As for the fiscal policy, the situation seems more balanced in terms of its effect on inflation in 2020, given that budget spending, including into the national projects, will be distributed over time.

Let me remind you that the next policy meeting of the Board of Directors will also be a core one, same as today. *This is associated with the changes in the schedule of the Board of Directors' policy meetings. We are going to sum up the results of 2019 at our next meeting. We will then have detailed data on GDP for the third quarter, preliminary data on the balance of payments for the entire 2019, as well as current economic statistics for December and first data on inflation in January. We will adjust our mid-term forecast based on this information.*

Winding up, I would like to get back to the signal of our future actions. *We have said today that we will consider the necessity of a further key rate reduction in the first half of 2020. Noting that, after similar signals in the past, it was twice that we cut the key rate already at the next meeting, namely in October and today, and anticipating your clarifying questions, I would like to point out the following. This wording means that we still see room for a slight decrease in the key rate. But both in February and at the next meetings we will comprehensively assess the reasonableness and relevance of such a decision taking into account the entire range of new data that will be available by that time. Our signal does not imply that we will necessarily lower the key rate in February or in the first half of 2020. A further key rate cut will become possible only if our analysis confirms that this is needed to bring inflation back to the Bank of Russia's 4% target.*

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

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

IN THE FOLLOW-UP TO THE BOARD OF DIRECTORS KEY RATE MEETING ON 13 DECEMBER 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	64	55	50	50
Inflation, as % in December year-on-year	4.3	2.9–3.2	3.5–4.0	4.0	4.0
Inflation, average for the year, as % year-on-year	2.9	4.5	3.0–3.4	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	1.3–1.8	1.5–2.0	1.5–2.0	1.8–2.3
– households	*2.3*	*1.5–2.0*	*2.0–2.5*	*2.0–2.5*	*2.0–2.5*
Gross capital formation	0.8	0.5–1.5	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	-(1.3–1.8)	2.0–2.5	2.0–2.5	2.5–3.0
Imports	2.7	0.0–0.5	3.0–3.5	3.5–4.0	2.5–3.0
Money supply in national definition	11.0	8–11	7–12	7–12	7–12
Banking system claims on the economy in rubles and foreign currency*	11.5	8–11	7–12	7–12	7–12
– corporates, annual growth, %	*8.4*	*5–8*	*6–10*	*6–10*	*6–10*
– households, annual growth, %	*22.0*	*17–20*	*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**	**79**	**52**	**34**	**23**
Balance of trade	194	164	138	122	116
Exports	*443*	*414*	*392*	*385*	*392*
Imports	*249*	*250*	*254*	*263*	*277*
Balance of services	-30	-33	-35	-37	-40
Exports	*65*	*64*	*63*	*65*	*67*
Imports	*95*	*97*	*98*	*101*	*107*
Primary and secondary income account	-51	-52	-51	-52	-53
Current and capital account balance	**112**	**78**	**52**	**34**	**23**
Financial account (net of reserve assets)	**77**	**17**	**14**	**9**	**9**
General government and the central bank	9	-24	-6	-6	-6
Private sector	68	40	20	15	15
Net errors and omissions	**2**	**3**	**0**	**0**	**0**
Change in FX reserves ('+' is increase, '-' is decrease)	**38**	**64**	**38**	**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 prices and risk) were published in the Monetary Policy Guidelines for 2020-2022 on 25.10.2019, www.cbr.ru/Content/Document/File/79959/on_2020_eng.pdf.*

1. ECONOMIC OUTLOOK

In the baseline scenario, the Bank of Russia assumes a gradual slowdown in the world economy and a downturn in global oil prices over the mid-term forecast horizon which is in line with the assumptions of the baseline scenario published in October in the Monetary Policy Guidelines for 2020–2022 (hereinafter, the MPG 2020–2022). The perceived further development of external conditions was largely associated with the deterioration of the situation in key world economies amid persistent expectations of a further tightening of global 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 October figures. According to the updated scenario, annual inflation will be 2.9–3.2% in 2019 and 3.5–4.0% in 2020 and will remain near 4% in the future, taking into account monetary policy pursued by the Bank of Russia. During 2020, the exhaustion of the effect of a number of one-off disinflationary factors in the food market, the easing of fiscal policy and the revival of consumer demand will also facilitate the gradual rise of inflation from the low levels of the beginning of the year to 4%.

In 2019, the GDP growth rate will likely be close to the upper bound of the forecast range of 0.8–1.3% published in the MPG 2020–2022. This is primarily due to the higher-than-expected annual GDP growth rate in Q3, which amounted to 1.7%. We have yet to estimate the stability of the current higher economic growth rates.

The Bank of Russia's general views on the Russian economy's growth in 2020–2022 have remained unchanged. The GDP growth rate will gradually increase to 2–3% in 2022. This will be possible as the Government implements measures for overcoming structural constraints in the Russian economy, including the implementation of national projects. However, the global economic slowdown expected over the forecast horizon will continue to contain growth of the Russian economy.

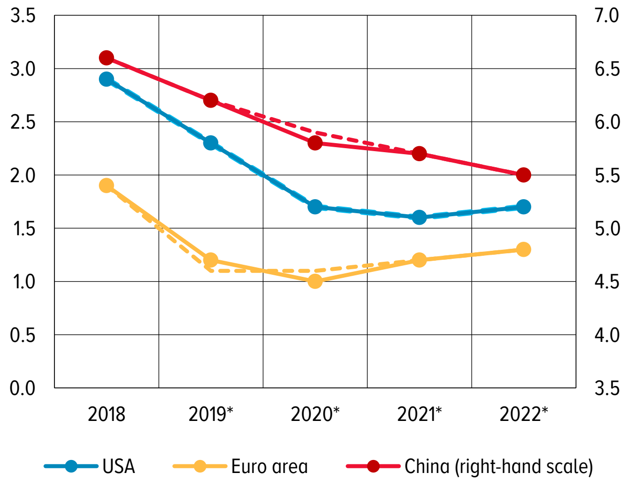
The main uncertainties in the baseline scenario over the forecast horizon involve both external and internal factors. According to Bank of Russia estimates, disinflationary risks still prevail over proinflationary ones in the short term. This is primarily related to the state of domestic and external demand. Disinflationary risks associated with movements in prices of certain food products remain, including on the back of a rising supply of farm produce. Risks posed by budget expenditure growth in 2020 remain low because the rise in expenditure is likely to be distributed over time.

At the same time, a number of proinflationary factors remain significant over the forecast horizon. In particular, the risks of a trend turnaround in the food market cannot be ruled out given that the proportion of temporary and persistent factors in this market is difficult to estimate. In addition, the implemented easing of the monetary policy may place a more significant upward pressure on inflation than the Bank of Russia estimates. Additionally, should the global economic slowdown be more pronounced, including due to tightening global trade restrictions and other geopolitical factors, this may intensify volatility in global commodity and financial markets, affecting exchange rate and inflation expectations.

Over a longer horizon, elevated and unanchored inflation expectations remain a significant domestic proinflationary risk. Mid-term inflation dynamics may also be affected by fiscal policy parameters, including decisions on the use of the liquid part of the National Wealth Fund in excess of the threshold level set at 7% of GDP.

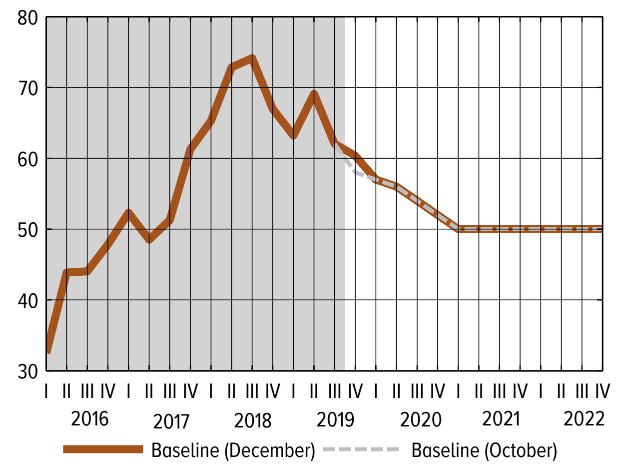
The Bank of Russia leaves mostly unchanged its estimates of risks associated with wage movements and possible changes in consumer behaviour. These risks are still moderate.

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



** Forecast. Dotted line shows the previous forecast (October 2019).*
Source: Bank of Russia calculations.

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



** Nominal Urals crude price.*
Source: Bank of Russia calculations.

1.1. BASELINE SCENARIO

FORECAST ASSUMPTIONS

Global economic growth. As in the MPG 2020–2022, 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 in 2019–2022 will be mainly linked to continuing expectations of the further tightening of global 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 US, the preservation of moderate economic activity in the euro area and a smooth slowdown in China's economy that will in part be structural in nature.

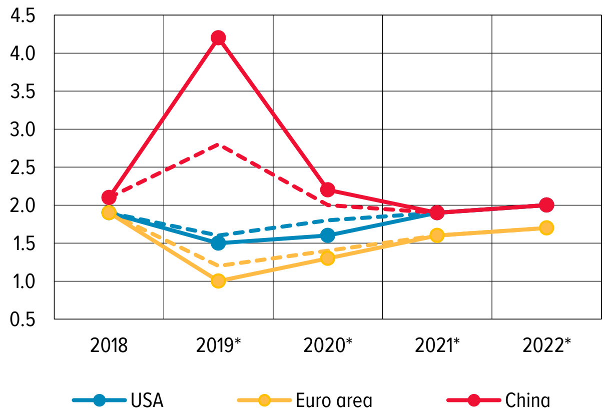
Oil prices. As before, the Bank of Russia's baseline scenario assumes that the Urals crude price will gradually decline to $50 per barrel by the beginning of 2021 and remain near this level further on (Chart 1.1.2). At the same time, the Bank of Russia has adjusted its estimate of the average annual oil price in 2019 to $64 per barrel due to its actual dynamics since the beginning of this year. The average annual oil price in the baseline scenario will fall to $55 per barrel in 2020 to remain at $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 starting in 2020, 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 OPEC+ agreement on crude oil production cuts until March 2020.

Inflation abroad. In its baseline scenario, as in October, the Bank of Russia assumes a gradual increase in inflation in advanced economies in 2020–2022 after its slowdown in 2019 (Chart 1.1.3). 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 US and the euro area closer to their targets. However, given the fact that the growth rate of the economy of the US and the euro area will be generally moderate in 2020–2021 in the baseline scenario, and a decline in oil prices will contribute to low inflationary pressures, inflation in the US and the euro area in this period will remain below their targets. 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). At the same time, in 2019, a greater than previously expected increase in inflation in China in the baseline scenario is largely due to one-off supply-side factors in the food market (see Section 3.1 for more details).

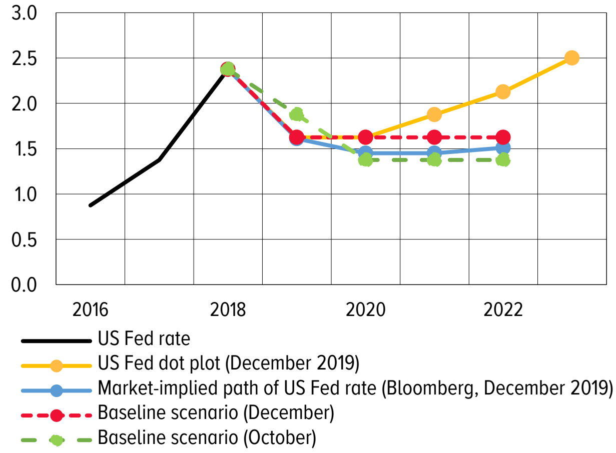
Monetary policies of foreign central banks. In its baseline scenario, the Bank of Russia continues to proceed from the assumption that the accommodative monetary policy in the US and the euro area will be maintained throughout the entire forecast horizon. At the same time, compared with MPG 2020–2022, the Bank of Russia has updated its mid-term view of the dynamics of interest rates in the US and the euro area. For example, the Bank of Russia's baseline scenario factors in one reduction of the ECB deposit rate in the first half of 2020 and its subsequent staying at that level (Chart 1.1.5). In its baseline scenario, the Bank of Russia also takes into account asset purchases by the ECB as part of the quantitative easing programme from 1 November 2019, which will intensify the accommodative nature of the monetary policy in the euro area. As for the monetary policy of the US Fed, the Bank of Russia's baseline scenario now expects the US Fed base rate to remain at the current level throughout the entire forecast horizon (Chart 1.1.4). This interest rate path in the US and the euro area factors in the current year reduction of the US Fed base rate (in July, September and October) and the ECB deposit rate (in September) as well as the US Fed's and the ECB's latest rhetoric on monetary policy prospects in the context of the ongoing global economic slowdown (see Section 3.1 for more

INFLATION INDICATORS IN MAJOR ECONOMIES IN THE BASELINE SCENARIO *Chart 1.1.3*
(% change YoY, average for Q4 in each period)



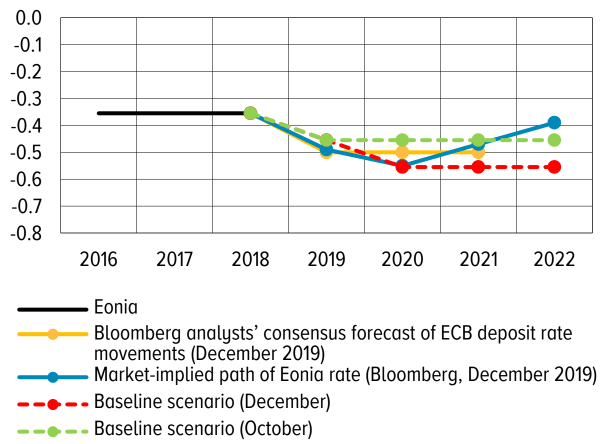
** Forecast. Dotted line shows the previous forecast (October 2019).*
Note : PCE Price Index is forecast for the USA, HICP – for the euro area, and CPI – for China.
Sources: Bank of Russia calculations, Bloomberg.

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



Note: values are given as of the end of each period. Dotted line shows the previous forecast (October 2019).
Sources: Bank of Russia calculations, 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. Baseline scenario: Eonia rate path. Dotted line shows the previous forecast (October 2019).
Sources: Bank of Russia calculations, Bloomberg.

details); also, it is overall consistent with market participants' expectations.

Global financial markets. As in October, 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 correlation between interest rate trajectories in the US and the euro area forecast by the Bank of Russia in the baseline scenario. At the same time, the easing of monetary conditions in 2020 and their further maintenance in advanced economies will limit the risks of steady capital outflows from emerging market economies (EMEs).

In the baseline scenario, the Bank of Russia also maintains equilibrium country risk premiums for EMEs in general and Russia in particular at the same level as in the baseline scenario of the MPG 2020–2022. Equilibrium country risk premiums take into account the actual dynamics of risk premiums over the past few years, and the totality of assumptions regarding the external environment.

Geopolitical factors. As before, 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 an equilibrium country risk premium for Russia at a slightly higher level than if there were no 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. At the same time, the baseline scenario assumes that the funds flowing into the NWF under the fiscal rule will continue to be invested in liquid low-risk FX instruments. In addition to the fiscal rule, the following measures of the Government of the Russian Federation will also influence monetary policy conditions in 2020–2022[1]: planned changes in the tax system and a set of measures aimed at overcoming the structural constraints in the Russian economy, including the implementation of national projects.

Among the key tax policy measures, the Bank of Russia assumes changes in excise duties for certain products in the consumer basket[2] and the oil and gas tax manoeuvre to take place in 2019–2024. According to Bank of Russia estimates, the latter will have a nearly zero contribution to annual inflation in 2019–2022.

The Bank of Russia also maintains its estimates[3] of the impact on the Russian economy of Russian Government measures[4] aimed at alleviating the existing structural constraints in the Russian economy and accelerating its potential growth rates. Such measures include a phased increase in the retirement age as well as additional investment expenditure and expenses for human capital development in 2019–2024.

MEDIUM-TERM FORECAST

Inflation. Taking into account the actual dynamics of inflation, the Bank of Russia lowered its end-of-year annual inflation forecast for 2019 from 3.2–3.7% in the MPG 2020–2022 to 2.9–3.2%. Annual inflation will be slightly below 3% in 2020 Q1 when the effect of the VAT rate increase in 2019 is factored out from its calculation. At the end of 2020, annual inflation will be 3.5–4.0% and will remain near 4% in the future (Chart 1.1.6), which is in line with the baseline forecast published in October.

Inflation will hold steadily close to 4% over the mid-term forecast horizon primarily due to the Bank of Russia's monetary policy. During 2020, the exhaustion of the effect of one-off disinflationary factors in the food market (see

[1] *Pursuant to the Fiscal and Customs Policy Guidelines for 2020 and the Plan Period of 2021 and 2022 and the Tax Code of the Russian Federation.*

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

[3] *Estimates published in the baseline scenario in October 2019 in the MPG 2020–2022.*

[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.*

Section 2 for more details), gradual easing of fiscal policy and a pick-up in consumer demand will also facilitate the gradual approach of inflation to 4% from the low levels of the beginning of the year.

Overall, inflationary pressure will be moderate over the mid-term forecast horizon amid slowing external demand and balanced dynamics of domestic demand. The baseline forecast accounts for the indexation of administered prices and tariffs by an inflation rate close to 4%, which implies that this factor will not exert an excessive upward pressure on prices. In turn, Government measures aimed at increasing the rate of economic growth in accordance with the assumptions of the baseline scenario will not have a significant proinflationary effect over the mid-term horizon.

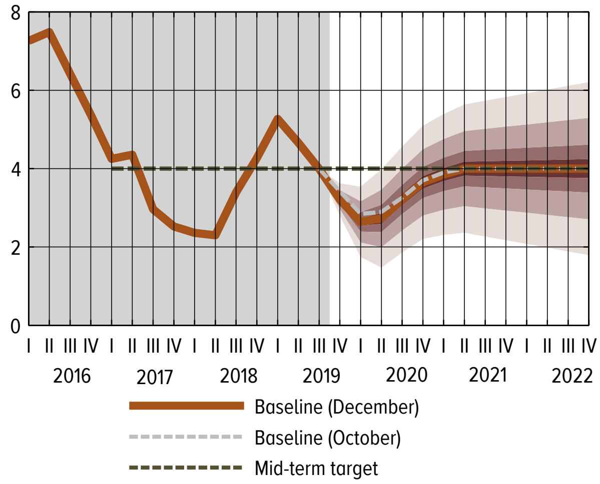
Taking into account the updated forecast path of annual inflation, the average annual inflation for 2020 will be 3.0–3.5% (in October, 3.1–3.5%). In 2021–2022, it will stabilise near 4%.

Economy. In 2019, GDP growth rate may be closer to the upper bound of the forecast range of 0.8–1.3% published in the MPG 2020–2022. This is primarily due to the higher-than-expected annual GDP growth rate in Q3 (see Section 3.3 for more details).

In terms of the structure of GDP growth in 2019, as previously expected, a number of factors will have a restraining effect on the growth of the Russian economy. For example, the ongoing slowdown in the global economy as well as the OPEC+ agreement on oil production cuts will cause a 1.3–1.8% reduction in export quantities in annual terms. In turn, the growth rate of gross fixed capital formation 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, in 2019, the annual growth rate of import quantities will slow down to 0.0–0.5% amid reducing investment imports.

The Bank of Russia has maintained unchanged its view of the growth of the Russian economy in 2020–2022. In the baseline scenario, the Bank of Russia still predicts that in 2020 the growth

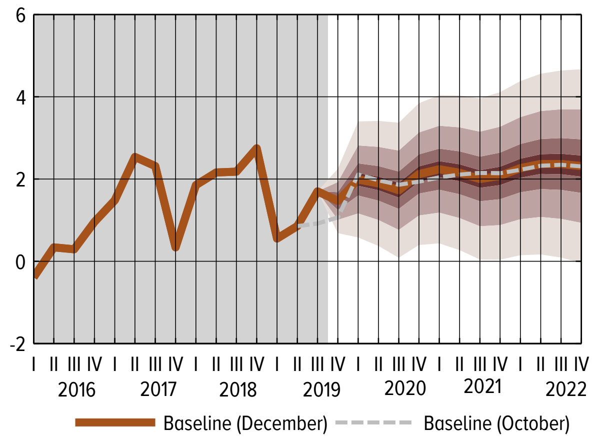
INFLATION TRAJECTORY IN BASELINE SCENARIO *Chart 1.1.6*
(% change on the same period of the previous year)



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

GDP GROWTH TRAJECTORY IN 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.

of the Russian economy will pick up 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 accelerate to 3.5–4.5% in 2020. This will also affect the dynamics of import quantities, the annual growth rate of which will increase to 3.0–3.5%. The growth of the economy in 2020 will be also helped by a certain revival of consumer demand amid improving household income dynamics, including through the growth of real wages (both in the private and in the public sectors). This will manifest in an increase in the annual growth rate of households final consumption expenditure to 2.0–2.5% (in 2019, 1.5–2.0%). However, the slowdown in the global economy assumed in the baseline scenario will limit the growth of Russian exports over the forecast horizon. Government measures to stimulate non-commodity exports in the framework of the International Cooperation and Exports national project will help mitigate this impact. In these circumstances, 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 primarily driven by a gradual accumulation of the positive effect of the planned fiscal policy measures and national projects, provided they are implemented successfully. At the same time, the growth rates of export quantities will not exceed 2.0–2.5% in 2021 and 2.5–3.0% in 2022. Taking into account the implementation of Government plans to reduce the non-oil and gas deficit of the federal budget[5] which is expected over the mid-term forecast horizon, the growth rate of gross fixed capital formation will slow down to 2.5–3.5% in 2022 (in 2020–2021, 3.5–4.5%). This will lead, among other things, to a decline in the growth rate of import quantities to 2.5–3.0% in 2022 (in 2020, 3.0–3.5%, and in 2021, 3.5–4.0%).

[5] In accordance with the budget forecast of the Russian Federation for the period up to 2036 (Ministry of Finance of Russia).

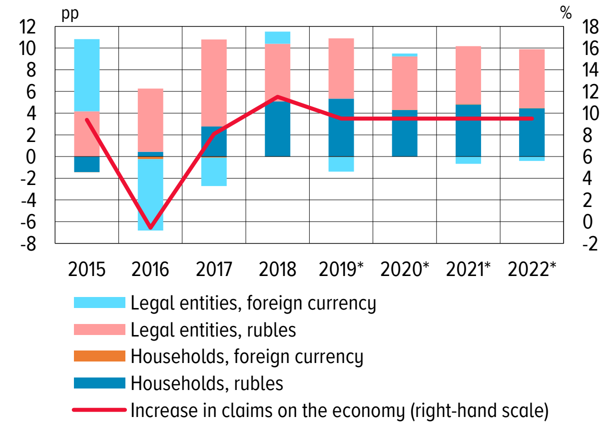
Monetary indicators. As previously predicted, according to the Bank of Russia's baseline scenario, monetary conditions in the Russian economy will continue to gradually soften and will be generally neutral over the forecast horizon. This will be associated mainly with the completion of the adjustment of credit and deposit rates in the economy to the 2019 key rate decrease and the easing of non-price bank lending conditions.

Banking system claims on the economy in 2020–2022 in the baseline scenario will sustainably grow because 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 banking system claims on households in 2019, the baseline scenario of monetary indicators accounts for 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 the debt burden of households in general and of certain categories of borrowers in particular, as well as due to the saturation of the retail credit market. In turn, the gradual easing of price lending conditions 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 continue to grow overall in 2020–2022 at a pace corresponding to the increase in effective demand and posing no risks to price stability (Chart 1.1.8). The debt burden of the economy will rise smoothly, forming at levels that do not threaten financial stability in the economy (Charts 1.1.9 and 1.1.10). Lending will remain the key driver of money supply movements, and in these conditions, money supply growth will be close to the growth of claims on the economy (Chart 1.1.11).

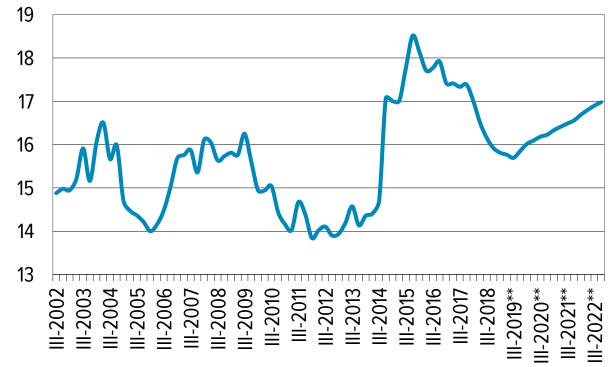
Balance of payments. Compared to MPG 2020–2022, the baseline scenario includes an adjusted forecast of the balance of payments indicators for 2019, which is mainly due to a

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



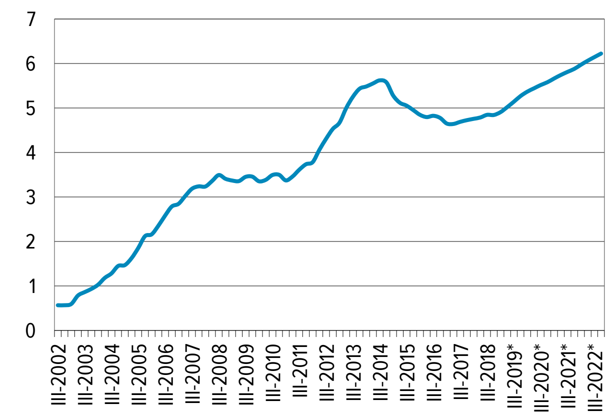
** Forecast. Decomposition is shown for the increase in claims on the economy corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

CORPORATE DEBT BURDEN *Chart 1.1.9*
(debt service ratio*, % of GDP)



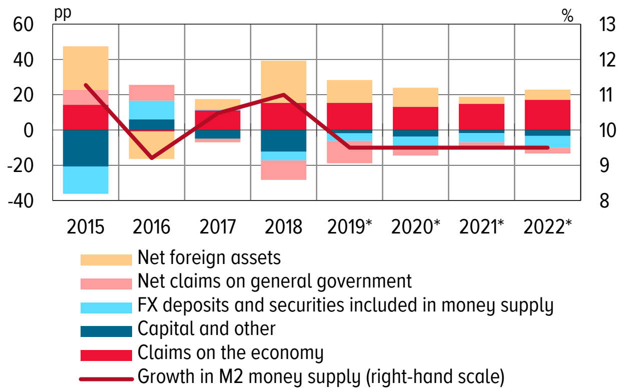
** The debt service ratio was calculated based on the methodology described by S.A. Donets, A.A. Ponomarenko. Debt burden indicators. Money and Credit No. 4, 2017. 2019 Q3 value is the Bank of Russia's estimate.*
*** Forecast. Debt burden is calculated for the level of claims corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

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



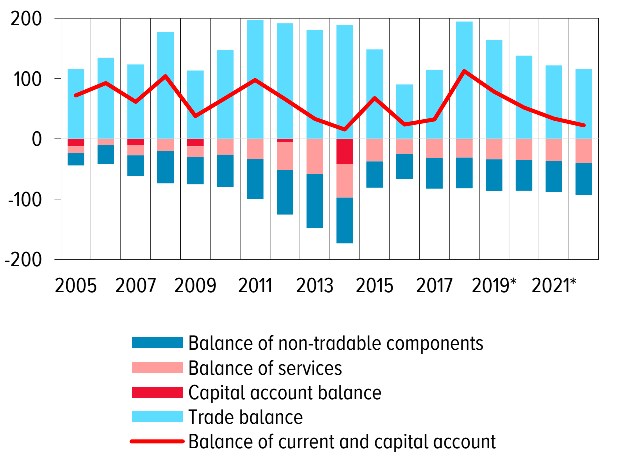
** Forecast. Debt burden is calculated for the level of claims corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

DECOMPOSITION OF MONEY SUPPLY GROWTH IN THE NATIONAL DEFINITION IN THE BASELINE SCENARIO BY SOURCE *Chart 1.1.11*
(contribution to annual growth)



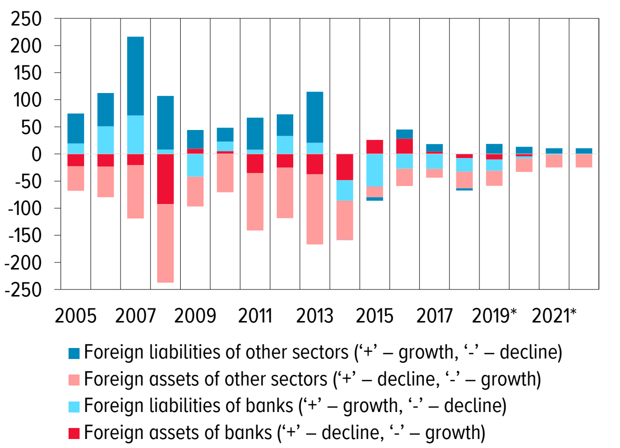
** Forecast. Decomposition is shown for the money supply growth in the national definition corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

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.

slight increase in the average annual oil price in 2019. Thus, the forecast current account balance has increased from $75 to $79 billion. The private sector financial account balance has also increased from $37 billion to $40 billion. Given the actual inflow of foreign investor funds to the OFZ market year-to-date and the successful placement of Russian Eurobonds, the public sector financial account deficit (signs according to BPM6, i.e. net capital inflow) has been revised from $23 to $24 billion.

The forecast balance of payments indicators for 2020–2022 remained unchanged. Over the mid-term forecast horizon, amid 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 will gradually decline but will remain consistently positive: roughly 3% of GDP in 2020 and 1–2% of GDP in 2021–2022 (in 2019, roughly 4.5% of GDP). Government measures aimed at stimulating non-commodity exports will support growth in export quantities, which will smooth out the effects of the expected oil price decline and global economic slowdown (Chart 1.1.12).

The private sector financial account balance will shrink from roughly 2% of GDP in 2019 to roughly 1% of GDP in 2020–2022 against the backdrop of reduced external debt payments and somewhat limited possibilities of Russian business to accumulate foreign assets amid lower prices for core Russian exports (Chart 1.1.13).

In 2019–2022, the Bank of Russia will continue to replenish international reserves under the fiscal rule. Its forecast factors in, among other things, foreign currency purchases in the domestic market that were postponed in 2018 and that should be completed in early 2022.

1.2. FORECAST UNCERTAINTY FACTORS

External conditions. Since October 2019, proinflationary risks associated with specific external factors have remained low. For example, the downward revision of expected interest rate paths in the US and the euro area at the beginning of the year, the reduction of the US Fed base rate (in July, September and October) and the ECB deposit rate (in September), along with the resumption of quantitative easing in the euro area and the general 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 ongoing risks that the slowdown of economic growth observed in most key economies worldwide may last longer 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 US and their key trade partners (first of all, China). The imposition of new foreign trade restrictions, primarily between China and the US, may drag negatively on advanced economies and EMEs, including Russia, both due to the 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. Deteriorating conditions in the EME financial markets in the short term may create proinflationary risks through the dynamics of national currencies and exchange rate expectations. However, in the medium term, a slowdown of the global economy due to potential deepening of trade tensions may generally have a disinflationary effect for most economies, including EMEs.

The future movements of oil prices remain a source of uncertainty. Under the influence of supply-side factors for the most part, their increased volatility may persist. As a result, oil prices over the forecast horizon may move below or above the baseline scenario levels.

In these circumstances, the Bank of Russia maintains a conservative approach when formulating its baseline scenario assumptions related to external factors.

Inflation expectations. Inflation expectations are highly sensitive to increases in prices for individual goods and services, and they are not anchored. This continues to pose significant risks of an upward deviation of inflation 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. The impact of non-monetary factors can lead to both upward and downward deviations of inflation from the forecast path of the baseline scenario. While having a significant impact on inflation movements, non-monetary factors are outside the scope of monetary policy. In these circumstances, the Bank of Russia will continue to take the peculiarities of pricing in the markets of certain goods and services into account in its monetary policy.

Economic policy measures of the Russian Government. The scope and the influence of the complex of fiscal 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 (if it deviates from the assumptions of the baseline scenario) may have a substantial impact both on short- and mid-term inflation dynamics. In particular, more intensive spending of funds (compared to the levels assumed in the baseline scenario) planned by the Government on the implementation of national projects may have a positive effect on consumer demand through change in the dynamics of household income. This will create conditions under which the expansion of demand in the economy will outpace the expansion of production capacity and create additional inflationary pressure. If the rise in the economic growth rate in 2020–2022 driven by the increase in public spending continues to significantly outpace production capacity, the upward pressure on inflation may hold over the entire mid-term forecast horizon. However, if investment project funding is delayed in future, domestic demand will grow at a slower rate than the baseline scenario assumes, thereby intensifying disinflationary pressure in the economy.

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

An additional uncertainty factor over the forecast horizon is the structure and specific timeframe of investment of the liquid portion of NWF funds exceeding 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.

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

Demographic trends. The expected demographic trends may influence mid-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 may affect the dynamics of wages and household consumption and exert an upward pressure on inflation. However, 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 by 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 in the absence of a pronounced influence from the demographic factor as well as possible changes in consumer behaviour remain moderate over the forecast horizon.

2. INFLATION AND INFLATION EXPECTATIONS

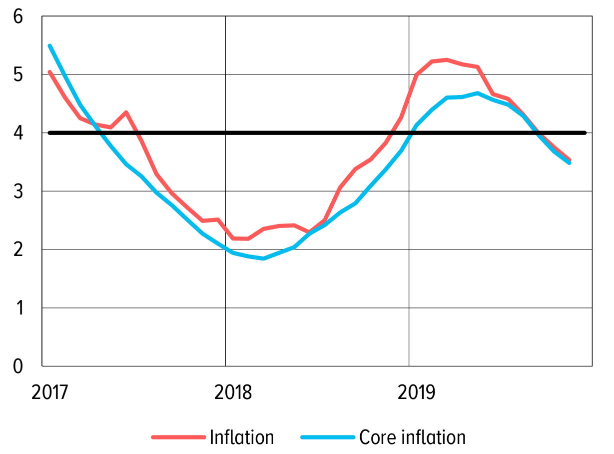
In September–November 2019, annual inflation decreased and amounted to 3.5% in view of a slowdown in the growth of prices for all basic components of the consumer basket. Monthly increases in the prices of goods (seasonally adjusted) mostly corresponded to the lower bound of the range typical for the previous months of the year. The indicators reflecting stable trends in price dynamics decreased. Following the slowdown in inflation, household inflation expectations improved. Business price expectations remained generally stable. Mid-term inflation expectations of professional analysts remained anchored to the Bank of Russia's target (near 4%).

Inflation decelerated faster than forecast by the Bank of Russia. This was produced by a combination of disinflationary factors amid unmaterialised proinflationary risks. Inflation was restrained by both one-off factors (more favourable than expected food market conditions, appreciation of the ruble since the beginning of the year) and more stable factors (increase in demand was less than predicted).

Taking into account the analysis of the current situation and risks, the Bank of Russia revised the inflation forecast and eased its monetary policy. The Bank of Russia forecasts that inflation will come in at 2.9–3.2% by the end of 2019. In 2020 Q1, annual inflation will drop below 3% when the effect of the VAT rate hike is factored out from its calculation. Given the current monetary policy, annual inflation will come in at 3.5–4.0% in 2020 and will stay close to 4% in future.

INFLATION AND CORE INFLATION — Chart 2.1

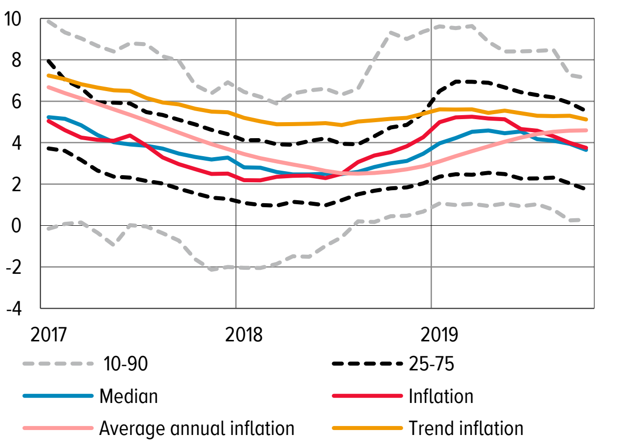
(% change on the same month of the previous year)



Source: Rosstat.

INFLATION AND GROWTH IN PRICES OF GOODS AND SERVICES — Chart 2.2

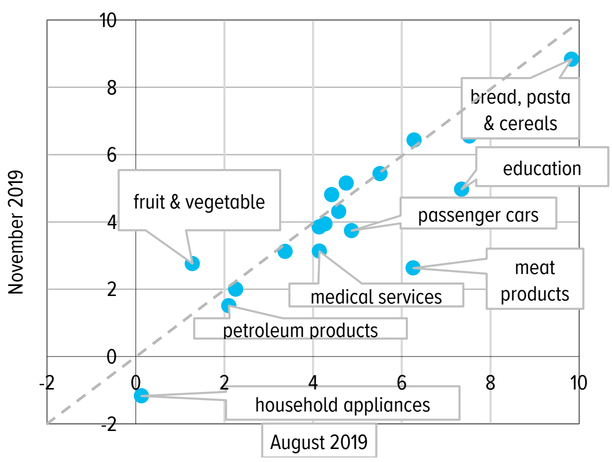
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

GROWTH IN PRICES OF INDIVIDUAL GOODS AND SERVICES — Chart 2.3

(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

In September–November 2019, annual inflation continued to decline and amounted to 3.5% (Chart 2.1). This is lower than the Bank of Russia's forecast.[1] Inflation was shaped by a combination of disinflationary factors amid unmaterialised proinflationary risks. These include a number of temporary factors. Primarily, the supply of food expanded at a pace faster than the dynamics of demand, thus restraining food inflation. At the same time, the risk of an earlier (compared to the usual seasonality) increase in vegetable prices at the end of the harvesting period expected due to earlier sowing and harvesting did not materialise.

The growth of prices was also restrained by the ruble appreciation since the beginning of the year. Exchange rate dynamics influence the import prices of various categories of goods and services with different time lags; and it takes the longest to influence the prices of non-food goods.

Demand dynamics were a more stable factor holding back inflation. Its growth rate during the year was lower than expected by the Bank of Russia. This was in part due to the continued commitment of households to the saving behaviour model (searching for discounts, delaying large purchases). To some extent, income and demand were affected by the budget expenditure lagging behind previously announced plans, including spending on national projects.

The indicators characterising stable price trends dropped (Chart 2.2). In November 2019, core inflation and the median distribution of annual price increases were 3.5% (respectively, 0.8 and 0.6 pp lower than in August). Trend inflation[2] slowed down. The moving average annual inflation, which had been rising since October 2018, stabilised at 4.6% in October–November 2019.

Annual growth in prices continued to go down mainly for the basic groups of goods and services (Chart 2.3).

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[1] *Monetary Policy Report 3/19, www.cbr.ru/Collection/Collection/File/23678/2019_03_ddcp.pdf.*

[2] *For more information on trend inflation, see Macroeconomic Bulletins in the Research section of the Bank of Russia website.*

The monthly growth rate of consumer prices (seasonally adjusted, hereinafter, SA) in August–November was estimated at 0.2% (Chart 2.4). The growth rate of prices for goods and services exclusive of the main volatile or regulated components remained at the same level. This is markedly below the level corresponding to annual inflation near 4%.

The average monthly price growth rate (SA) for September–November for the basic groups of goods and services was generally lower than the average readings for June–August (Chart 2.5).

Taking into account the observed price dynamics, the Bank of Russia forecasts that inflation will come in at 2.9–3.2% by the end of 2019. In 2020 Q1, annual inflation will drop below 3% when the effect of the VAT rate hike is factored out from its calculation.

FOOD PRODUCTS

The dynamics of food prices evolved under more favourable market conditions than the Bank of Russia had forecast. The Bank of Russia traditionally adheres to conservative scenarios, especially concerning the development of the situation in the food markets, which are affected by factors of various nature, primarily non-monetary ones (external and internal).

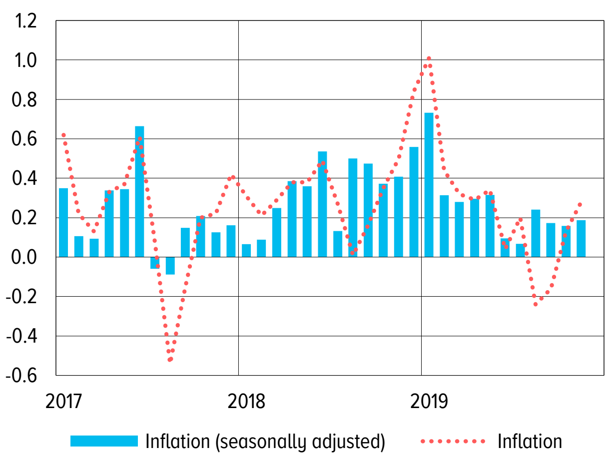
At the same time, this year's harvest of main cereals, oil crops, sugar beet, fruit and vegetables exceeded last year's levels. The supply of animal products expanded steadily, including as a result of modernisation of the industry. In certain meat product markets, the rate of this expansion outpaced demand dynamics. All this conditioned a slowdown in price dynamics across many food markets which was more rapid and significant than forecast.

The monthly growth of food prices (SA) in September–October decreased compared to July–August, being close to zero in October (Chart 2.6). In November, it rose to 0.1%. Annual food inflation came in at 3.7% in November (1.3 pp lower than in August, Chart 2.7).

Animal products. The decline in the growth of meat product prices (the share in the CPI is 9.54%), observed starting June 2019, continued to be the main reason behind the slowdown in annual food inflation. In November, meat

INFLATION
(per cent change on previous month)

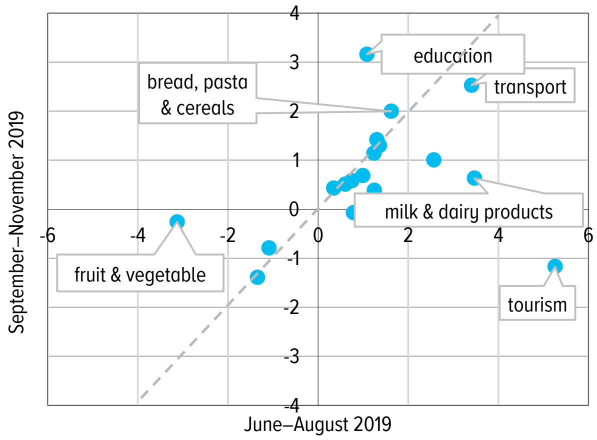
Chart 2.4



Sources: Rosstat, Bank of Russia calculations.

GROWTH IN PRICES OF INDIVIDUAL GOODS AND SERVICES
(average growth for 3 months, %, SA)

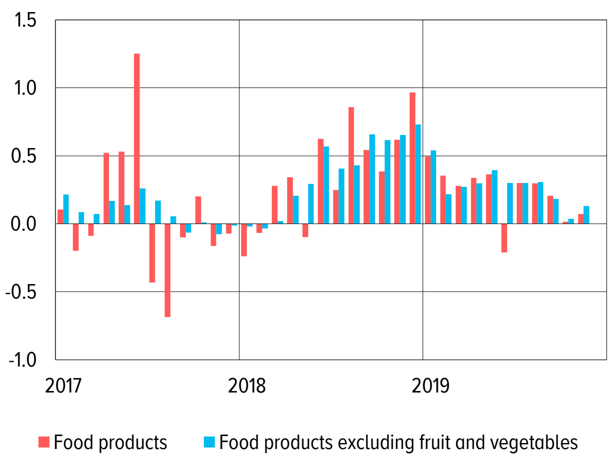
Chart 2.5



Sources: Rosstat, Bank of Russia calculations.

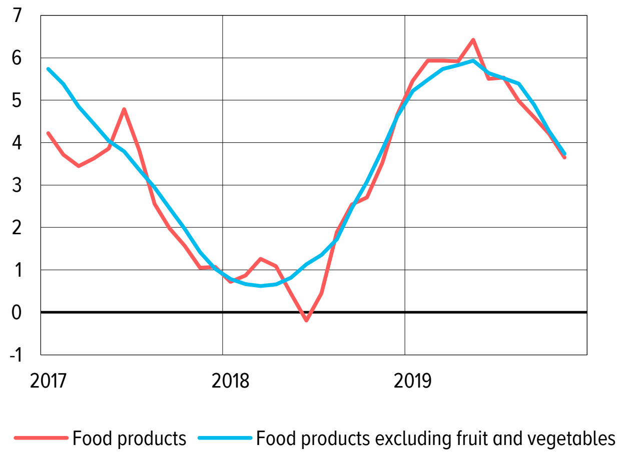
GROWTH IN FOOD PRICES
(% change month-on-month, seasonally adjusted)

Chart 2.6



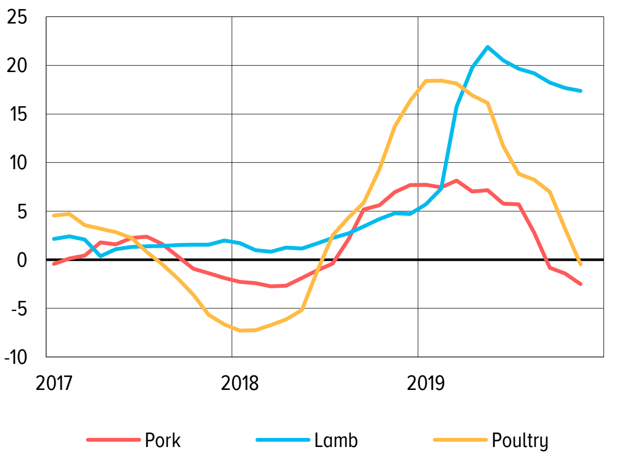
Sources: Rosstat, Bank of Russia calculations.

FOOD PRICES
(% change month on month, SA)
Chart 2.7



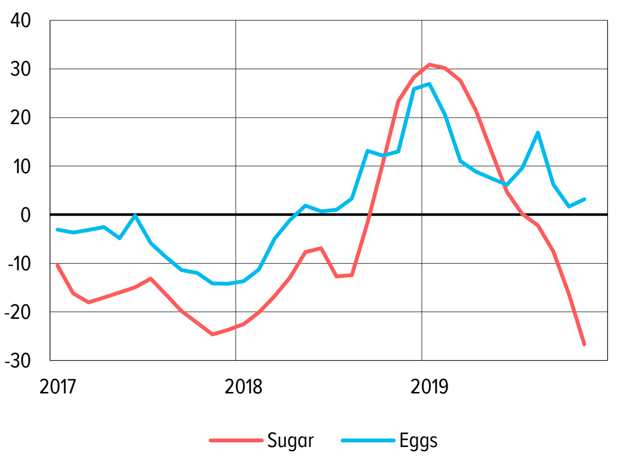
Source: Rosstat.

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



Source: Rosstat.

SUGAR AND EGG PRICES
(% change on the same month of the previous year)
Chart 2.9



Source: Rosstat.

products were 2.6% more expensive than in the previous year (6.3% in August). The price indices for poultry and pork dropped the most (Chart 2.8). A significant contribution to the slowdown in annual food inflation was also made by a decrease in the egg price growth (the share in the CPI is 0.51%) (Chart 2.9).

In October–November 2019, for the first time since July 2018, the annual growth of prices for milk and many types of dairy produce slowed down (the share in the CPI is 5.03%) (Chart 2.10). In November, the annual growth of butter prices stabilised, and the annual growth of cheese prices decreased (in the previous months of the year, it was increasing). This suggests the exhaustion of the transfer of producer costs to the prices of final products in the dairy industry.

Sugar (the share in the CPI is 0.43%). A contribution comparable to the impact of egg price dynamics was made by the drop in the sugar price observed since February 2019. In September–November, its rate accelerated due to a bumper harvest of sugar beet, with its processing volumes hitting all-time high. In November 2019, sugar was 26.7% cheaper in the consumer market than in November of the previous year.

Processed cereal and oil crop products.[3] The increased harvest determined the dynamics of prices for major cereals and oil crops and processed cereal and oil crop products in the Russian markets (Chart 2.11). Since September, the annual growth of prices for bread, bakery products and pasta, certain types of cereals (including millet, which was the leader in terms of price growth in January–August) began to slow down. The growth rate of prices for vegetable fats continued to decline or slow down. At the same time, a lower buckwheat harvest led to an increase in the growth rate of buckwheat prices. Nevertheless, in November, it was 27.2% cheaper than in December 2016.

In general, in the coming months, bumper harvest of cereals (including fodder grains) and oil crops as well as their quality will limit the growth of prices for the products of their processing and associated livestock products.

[3] The total share of bread, bakery products, confectionery, pasta, cereals and vegetable fats in the CPI is 5.45%.

Fruit and vegetables (the share in the CPI is 4.0%). Growth in fruit and vegetable prices in September slowed to 0.1% (SA) after accelerating in July–August. In October–November, they dropped by 0.1–0.2% (SA). The price path was lower than expected by the Bank of Russia, taking into account the earlier harvesting of first open-field vegetables. The growth of prices for fruit and vegetables was restrained by the high volume of supply throughout the season. In November, vegetables of the 'borsch basket' were 1.0% cheaper than a year earlier (Chart 2.12).

Nevertheless, in September–October 2019, the monthly indices of fruit and vegetable prices were generally higher than in the same period of 2018. As a result, the annual price growth rate for this group of food products increased and came in at 2.8% in November (1.5 pp higher than the minimum value registered in August 2019).

Fish products (the share in the CPI is 2.16%). Fish products were one of the few food groups with accelerated annual price growth. This was due to a reduced catch of salmon after record figures of the previous year and preparation for the entry into force of new EAEU technical regulations containing more strict requirements for the safety of fish products. From August through November, the price growth rate increased by 0.4 pp (to 5.2%).

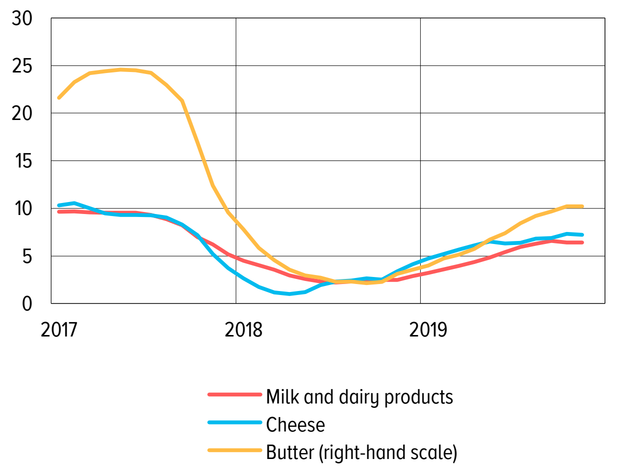
NON-FOOD GOODS

In September–November 2019, the monthly price growth rate of non-food goods (SA) was estimated at 0.1–0.2% (in February–August, 0.2–0.3%), influenced by the ruble appreciation in the current year, demand constraints and the efficient operation of the reverse excise duty mechanism (with the damping component) in the oil market (Chart 2.13).

Annual growth of prices for non-food goods decreased and amounted to 3.1% in November 2019 (0.4 pp lower than in August, Chart 2.14). It should be noted that, while the slowdown in April–August was mainly due to the base effect in the dynamics of motor fuel prices, in recent months the predominant influence came from the decline in the growth rate of prices for durable goods evolving against the background of the weak dynamics of consumer demand (see

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

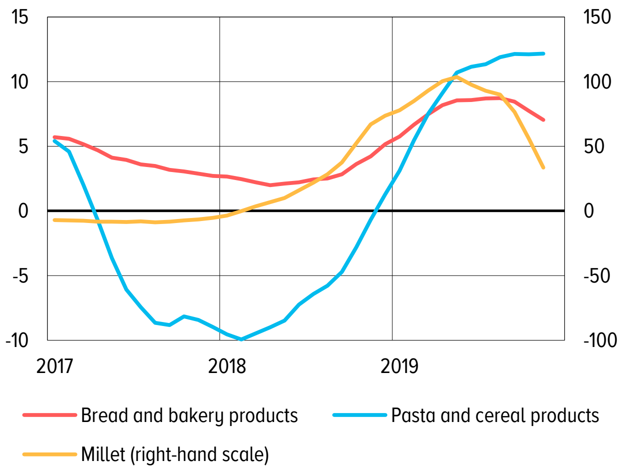
Chart 2.10



Source: Rosstat.

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

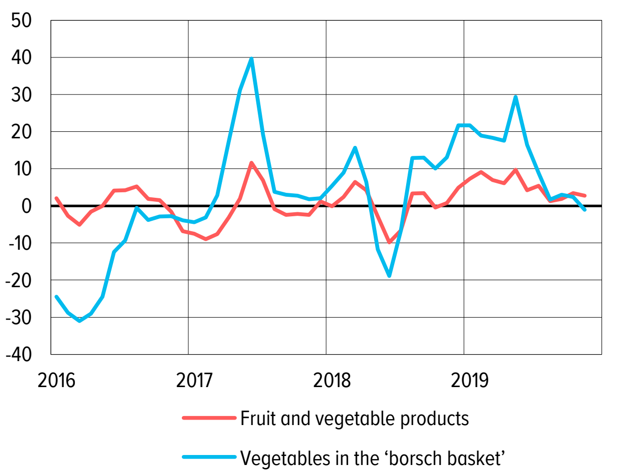
Chart 2.11



Source: Rosstat.

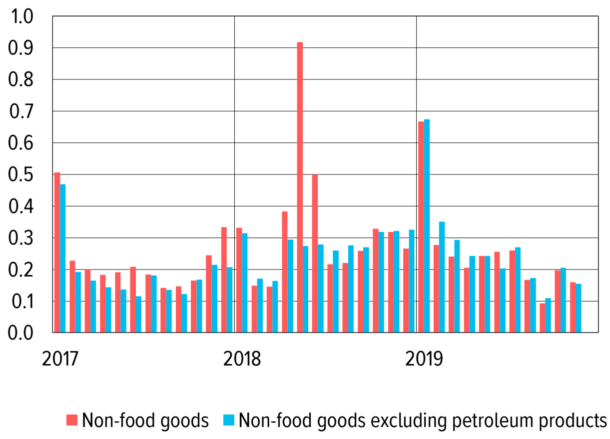
FRUIT AND VEGETABLE PRICES
(% change on the same month of the previous year)

Chart 2.12



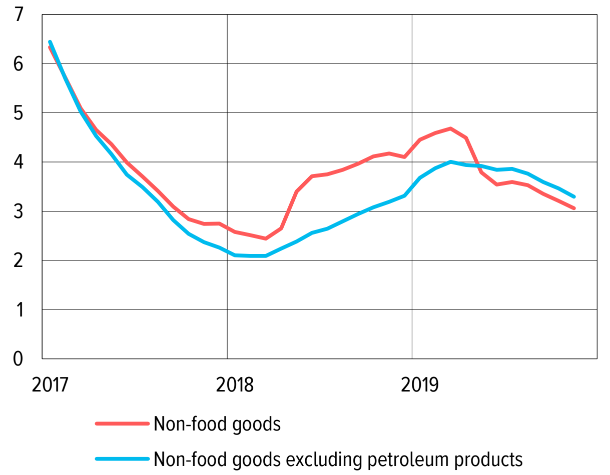
Source: Rosstat.

NON-FOOD GOODS PRICES *Chart 2.13*
(% change month-on-month, seasonally adjusted)



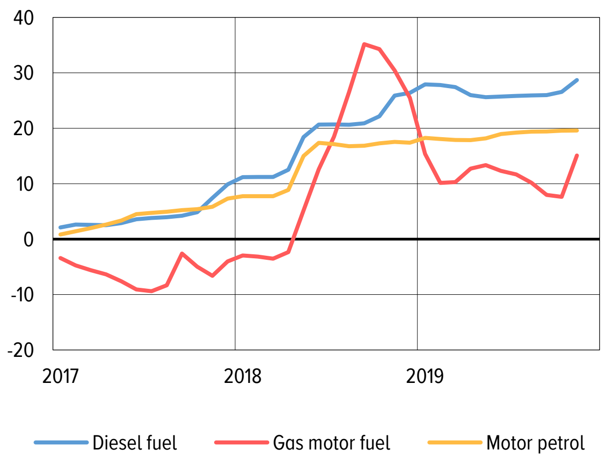
Sources: Rosstat, Bank of Russia calculations.

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



Sources: Rosstat, Bank of Russia calculations.

PETROLEUM PRODUCT PRICES *Chart 2.15*
(% change on December 2016)



Sources: Rosstat, Bank of Russia calculations.

Section 3.3). The annual growth rate of prices for non-food goods (excluding oil products) decreased from September and amounted to 3.3% in November (0.5 pp lower than in August). In September–November, the monthly growth rate of prices for this commodity group (SA) was 0.1–0.2% (in March–August, 0.2–0.3%).

Petroleum products (the share in the CPI is 4.36%). In the second half of the year, consumer prices for petrol were almost stable, while the rise in the price of diesel fuel was seasonal by nature (Chart 2.15). Gas motor fuel prices (characterised by greater volatility) grew but remained lower than in November 2018.

The effect of fluctuations in world oil prices on the prices of petroleum products was offset by the reverse excise duty mechanism with the damping component (Chart 2.16). Overall, the price growth rate for motor fuel fell by 0.6 pp to 1.5% due to the base effect.

Durable goods.[4] The biggest contribution to the slowdown in the annual growth rate of the price for non-food products was made by a decrease in the annual growth rate of prices for passenger cars by 1.1 pp to 3.7% compared to August because of the continued decline in sales.

The decrease in annual growth rates of prices for durable goods such as household appliances and furniture also made a significant contribution to the slowdown in the growth rate.

Overall, the growth of prices for the majority of basic groups of non-food goods slowed down (Chart 2.17).

SERVICES

In September–November 2019, the monthly growth rate of prices for services (SA) was up from 0.2% to 0.4%, which is the highest value since February 2019 (Chart 2.18).

The annual growth rate of services prices slowed to 3.9% in November (0.5 pp lower than in August) partly due to the dynamics of demand and the exchange rate, and partly due to the base effect on price changes in the regulated segment (Chart 2.19).

[4] The total share of furniture, household appliances and electronics, building materials and cars in the CPI is 11.66%.

The November acceleration of inflation in the market segment of the services sector may be a sign of a revival in consumer demand.

Housing and utility services (the share in the CPI is 9.99%). In September–November, tariffs for housing and utility services remained virtually unchanged, which is in line with the usual seasonality. In November, housing and utility services were 4.3% more expensive than in the previous year (0.3 pp less than in August–September). The slowdown in the growth rate was mainly driven by the base effect in the indexation of payments for major repairs: in October 2019, contribution rates fell by 0.6%, while a year earlier they grew by 1.3% (mainly due to a significant (38%) increase in the Rostov Region).

Education services (the share in the CPI is 2.03%). The biggest contribution to the slowdown in annual inflation in the services market was made by a decline in the growth rate of prices for educational services (to 5.0% in November compared to 7.4% in August). The slowdown was in part due to the fact that at the beginning of the new academic year prices for higher education services increased to a lesser extent than in 2018. This was associated with, among other factors, the parameters of changes to the standards of financing for students' education established by the Ministry of Education and Science of Russia.

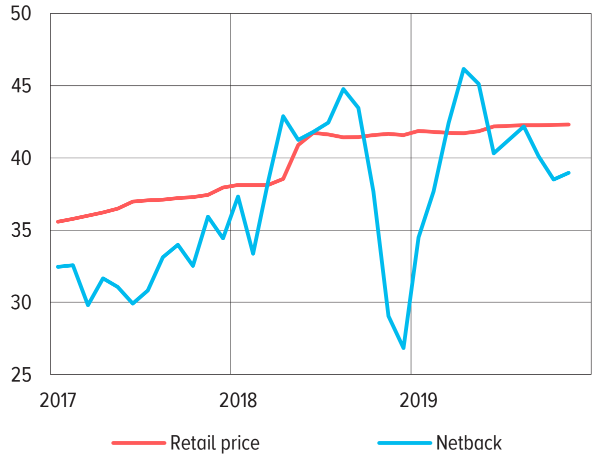
Services with predominantly market pricing.[5] Apart from educational services, the position that exerted the most noticeable effect on the slowdown in the growth of services prices was the interest rate[6] for the use of consumer loans. Its decrease in October–November (compared to the corresponding indicators for the previous year) reflected the easing of lending conditions offered by banks.

In November, growth rates (SA) of services prices accelerated in such segments as culture, overseas tourism and health resort services. Their dynamics could in part be driven by one-off factors, including the introduction of new

[5] *The total share of personal, medical and financial services and services of cultural organisations, air transport and tourism in the CPI is 9.71%.*

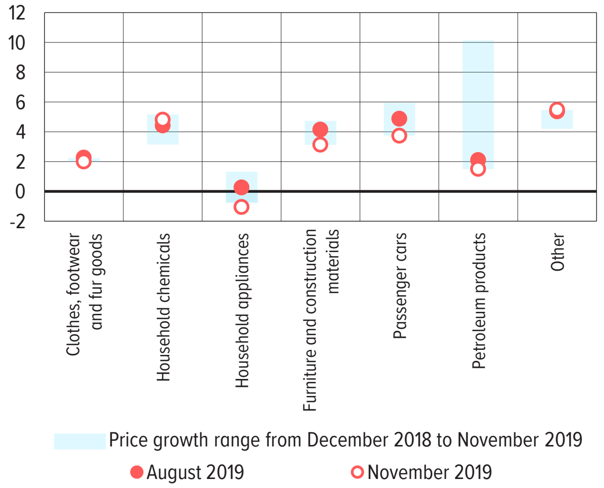
[6] *In value terms.*

AI-92 PETROL PRICES *Chart 2.16*
(rubles per litre)



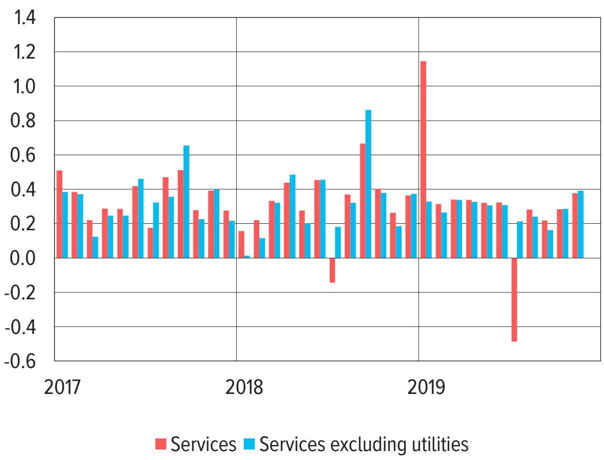
Sources: Rosstat, SPIMEX, Bank of Russia calculations.

PRICES FOR KEY NON-FOOD GOODS GROUPS *Chart 2.17*
(% change on the same month of the previous year)



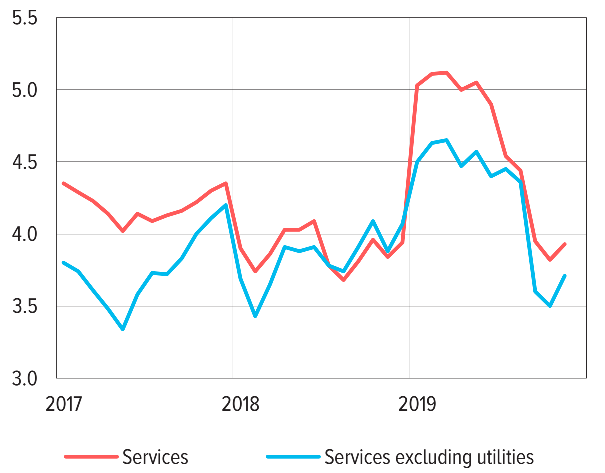
Sources: Rosstat, Bank of Russia calculations.

SERVICES PRICES *Chart 2.18*
(% change month-on-month, SA)



Sources: Rosstat, Bank of Russia calculations.

SERVICES PRICES *Chart 2.19*
(% change on the same month of the previous year)

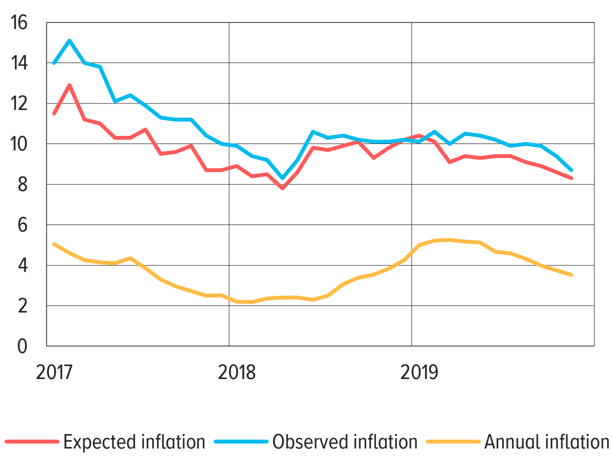


Sources: Rosstat, Bank of Russia calculations.

PRICES FOR KEY SERVICES GROUPS *Chart 2.20*
(% change on the same month of the previous year)

Sources: Rosstat, Bank of Russia calculations.

ANNUAL INFLATION, AND INFLATION OBSERVED AND EXPECTED BY HOUSEHOLDS *Chart 2.21*
(median estimate, %)



Sources: Rosstat, inFOM.

rules for selling tickets on 1 September, which may cause an increase in cultural organisations' costs. The transportation component continued to materially influence prices for tourism travel (especially long-distance trips). That said, a higher growth rate of prices for such optional services suggests that businesses have more opportunities to pass their higher costs on to customers. Considering that prices for market services have less inertial dynamics than non-food goods, their movement may be a sign of a gradual increase in consumer demand following a rise in consumer optimism.

The overall nature of price changes for individual groups of services varied (Chart 2.20). The annual increase in prices for personal and paid medical services as well as their fluctuations was low, forming under the influence of exchange rate dynamics and high competition. The growth rate of prices for air transport services was the highest primarily due to the lag effect of the increase in fuel prices of the previous year.

INFLATION EXPECTATIONS

In September–November 2019, inflation expectations of economic agents mainly decreased, including under the influence of the current inflation slowdown.

Household inflation expectations. According to the inFOM surveys commissioned by the Bank of Russia, in September–November 2019, the median estimate of inflation observed by households over the past 12 months was lower and amounted to 8.7%. The median estimate of inflation expected in the next 12 months decreased as well, reaching 8.3% in November. These are the lowest levels on record, except for last April when the observed and expected inflation estimates were below the current figures (Chart 2.21).

As before, the dynamics of responses to the questions about the estimates of future inflation point to the largely adaptive nature of inflation expectations. Primarily, respondents note the slowdown of current inflation, which they expect to continue in future periods. That said, in November, respondents more rarely mentioned a significant increase in prices for housing and utility services, quite a number of food products (cheese, sausages, fish, seafood, sugar) and petrol.

The estimate of household inflation expectations for the next 12 months calculated by the Bank of Russia using the inFOM survey data continued to go down and came in at 3.7% (in October, 4.1%).[7]

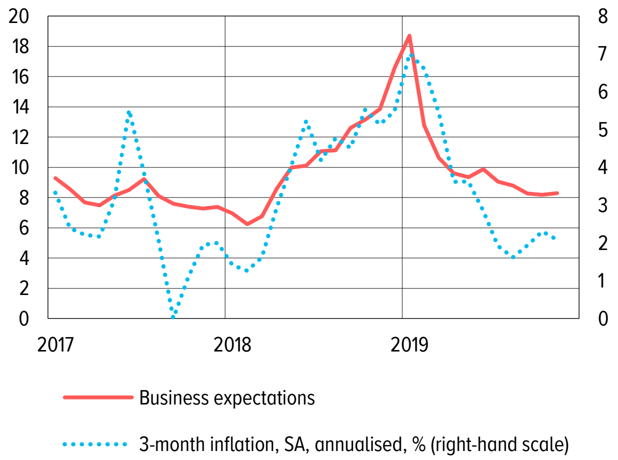
In general, household perception of price dynamics is improving while remaining dependent on current inflation.

Business price expectations. According to business surveys carried out by the Bank of Russia,[8] in September–November 2019, business price expectations for three months ahead remained generally stable (Chart 2.22).

The dynamics of price expectations were mixed across sectors. For example, companies in the mining and quarrying sector, in particular, gas and coal producers, demonstrated the most significant decline in their price expectations, which was associated with a drop in world prices amid weak demand. Price expectations rose in agriculture, driven by a poor harvest of buckwheat and rye. Price expectations in retail trade remained stable.

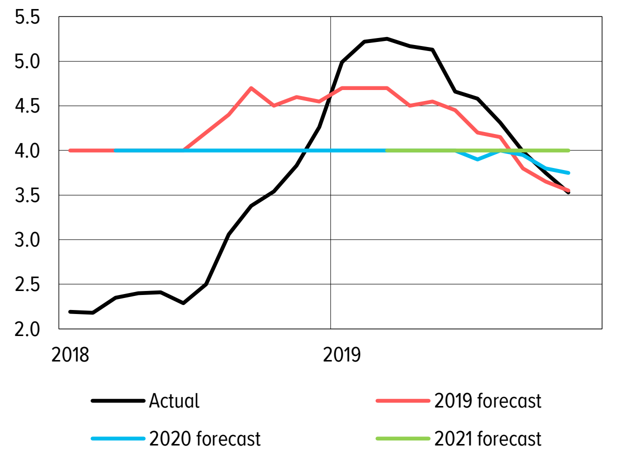
Analysts' inflation expectations. Professional analysts continued to gradually lower their inflation forecasts for the end of December 2019.[9] The expected level in November was 3.2–3.5% (Chart 2.23). Analysts' mid-term inflation expectations remain anchored to the Bank of Russia's target near 4%.

BUSINESS PRICE EXPECTATIONS *Chart 2.22*
(balance of responses, pp)



Sources: Rosstat, Bank of Russia calculations.

ANALYST INFLATION FORECASTS *Chart 2.23*
(% change on the same month of the previous year)



Sources: Bloomberg, Rosstat.

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[7] *When calculating this indicator, the Bank of Russia takes qualitative responses ('inflation will rise / fall') into account rather than quantitative ones and compares them with current inflation. For more details, see www.cbr.ru/Content/Document/File/59815/Inflation_expectations_guide.pdf.*

[8] *For more details on the methodology of the surveys, see the methodological review 'Analysis of Business Price Expectations', December 2018, www.cbr.ru/Content/Document/File/62829/analysis_18-12.pdf.*

[9] *Surveys by Interfax, Bloomberg and Thomson Reuters.*

3. MACROECONOMIC CONDITIONS

Q3 saw a slowdown in global economic growth and a softening in monetary policy by global central banks and, accordingly, restrained price growth in trading partners. In December, the US Fed left the federal funds rate unchanged after three consecutive cuts. Members of the US Federal Open Market Committee expect the rate to remain unchanged throughout 2020. At the same time, in December, a number of other central banks (Brazil, Mexico, and Turkey) continued to reduce their key rates. Country risk premiums declined. In September–November, the world oil price showed varied trends, remaining on average slightly lower than in June–August, but in December, after OPEC+ announced its intentions to maintain production at the current actual level during 2020 Q1, it rose to the highs of July.

The ruble exchange rate against the US dollar remained stable in September–November. In Q3, the current account surplus decreased, while export quantities of oil and oil products grew. After a decline in the second quarter, the volume of imports showed an increase in comparison with the same period of the previous year, and the private sector capital outflow slowed markedly.

Short-term IBL rates were still formed mainly in the lower half of the interest rate corridor. Long-term money market rates were going down. Non-residents increased investment in OFZs. The Russian stock market continued to grow and once again reached its historical maximum in December. Following the dynamics of the key rate and decline in OFZ yield curve, deposit and loan rates continue to decline. The corporate loan portfolio grew due to the ruble component, while the foreign currency component decreased. The growth of household consumer and mortgage loans continued to slow down.

The increase in GDP growth in Q3 is due to the growth of agriculture production, an increase in wholesale trade turnover and acceleration in the manufacturing industry. In August–October, the output in mining and quarrying reached its historical high. The output of investment and consumer goods continues to increase. However, business sentiment in manufacturing is at a 10-year low, and volume of export orders is falling due to a slowdown in the global economy. There was a decrease in the rail freight turnover. The pace of investment growth accelerated slightly due in part to an increase in the capital expenditure of the budget system. Since Q3, fiscal policy has had a stimulating effect on domestic demand. Since August, there has been an acceleration in the execution of budget expenditure on national infrastructure projects.

The retail trade turnover dynamics suggest a slowdown in household consumption growth in Q3 and its recovery in October–November in part due to inflation slowdown. Q3 saw the biggest growth in real household disposable income since 2014. In Q3, there was a decrease in the financial results of large- and medium-sized businesses and a pick-up in the growth of banking sector claims on legal entities.

Compared to the highs registered in Q3, Q4 expects a slight slowdown in annual GDP growth. After that, in 2020 Q1, GDP growth rate will accelerate on the back of increase in gross capital formation and exports as well as the low base of the first half of 2019.

3.1. EXTERNAL CONDITIONS AND BALANCE OF PAYMENTS

GLOBAL ECONOMY

In the period under review, the most noticeable changes in external conditions were the slowdown in global GDP, the low level of inflation in many major economies and the trend toward the easing of monetary policy by a number of world central banks (including most G20 countries) in July–October.

Economic growth worldwide. 2019 Q3 saw the continuation of the trend toward a slowdown in economic activity due to trade tensions; however, there were also signs of stabilisation amid monetary policy easing in a number of countries.

In the euro area (Chart 3.1.1), the annual growth rate remained at the level of Q2 (1.2%), while Germany managed to avoid a technical recession: the growth rate was 0.1% quarter-on-quarter (although the previous quarter's estimate was downgraded from -0.1% to -0.2%), and annual growth picked up from 0.3% to 0.5%.

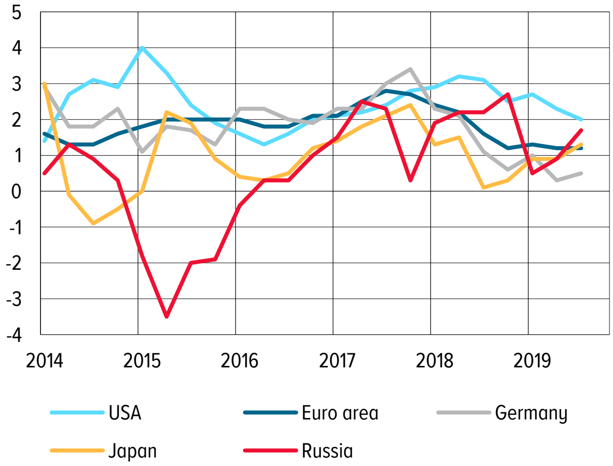
In the US, annual GDP growth was 2.1% (in Q2, 2.3%). Despite the exhaustion of the fiscal effect, the late phase of the cycle and the trade wars, the US economy is slowing down only to its potential growth rate.

In China, annual growth slowed down from 6.2% to 6.0% in Q3 (Chart 3.1.2), but overall the available statistics are in line with the forecasts of a gradual slowdown in the Chinese economy.

There still remain risks of a global economic slowdown primarily related to trade controversies, although these risks have abated somewhat. The US and China are negotiating the first phase of the trade agreement; so far, the introduction of new tariffs between the countries is not expected. Against this backdrop, from early September to early December, the yuan strengthened slightly, from 7.17 to 7.04 yuan to 1 US dollar. In addition, the US administration has postponed the introduction of tariffs on the European automotive industry. The probability of a no-deal Brexit has also subsided.

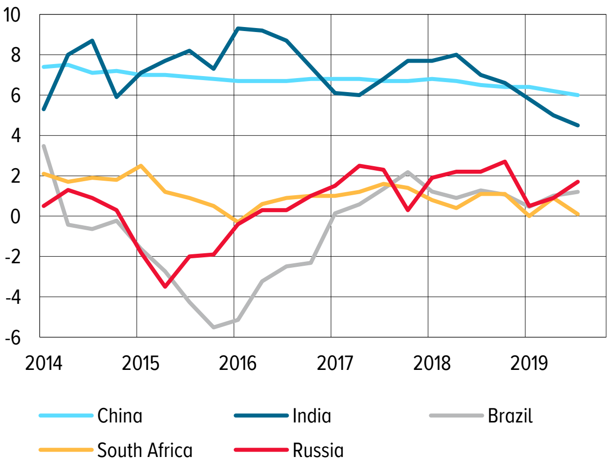
PMIs (Chart 3.1.3) and other statistical data suggest that in October–November the situation in major world economies remained

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



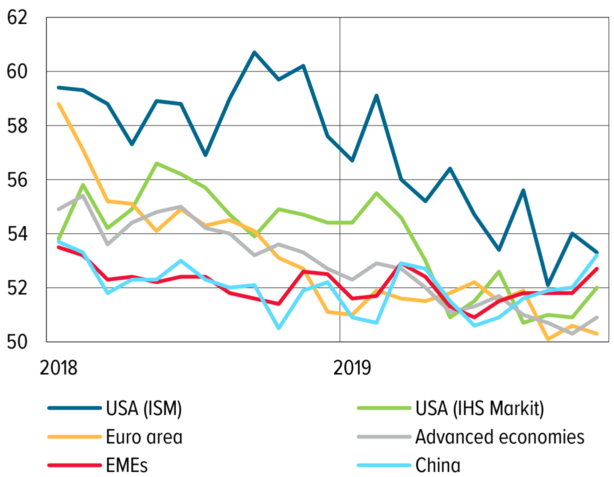
Source: Bloomberg.

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



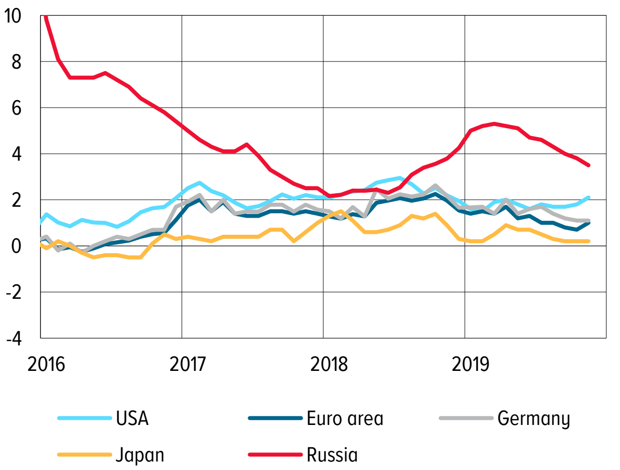
Source: Bloomberg.

DYNAMICS OF PMI COMPOSITE *Chart 3.1.3*
(points)



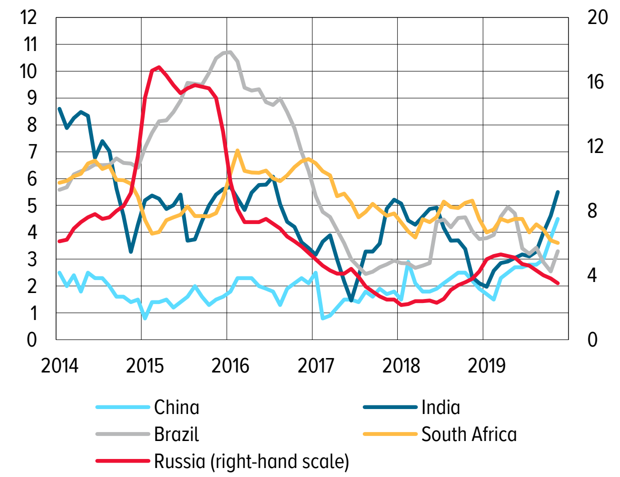
Source: Bloomberg.

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.

controversial, although showing some signs of stabilisation. The manufacturing PMI has paused its decline and is showing some growth in certain countries, but the decline in activity is now more likely to spread to the services sector.

In China, the Caixin manufacturing PMI rose to 51.7 in October and 51.8 in November, and an increase in new export orders has been noted, given that a number of goods have been excluded by the US from its tariffs. In November, the official PMI calculated by the National Bureau of Statistics also rose and left the recession zone (50.2). At the beginning of Q4, the Chinese economy is improving after relatively weak performance in Q3.

In the euro area, there is a moderate improvement in manufacturing: from 45.9 (October) to 46.9 (November), but economic activity is no longer supported by the services sector, and, as a result, the composite PMI remained at the October level of 50.6. In the US, the situation in economic activity remains stable. In November, the IHS Markit composite indicator grew to 52 from 50.9, and the ISM composite PMI fell from 54 to 53.3.

Inflation worldwide. In the context of a slowdown in the major economies, external price pressures remained low during the first three quarters of the year (Charts 3.1.4 and 3.1.5). In the first two months of Q4, inflation picked up slightly in some economies mostly due to local reasons.

In the US, in October and November, annual inflation was 1.8% and 2.1%, and core inflation remains at 2.3%. At the same time, the Core PCE index, used by the US Fed, amounted to 1.6% in October (in September, 1.7%). In November, wage growth slowed from 3.2% YoY and 0.4% month-on-month (SA) in October to 3.0% and 0.2% respectively.

In the euro area, annual inflation stood at 0.7% in October and 1.0% in November. In China, in October and November, inflation accelerated to 3.8% and 4.5% (from 2.7–2.8% in June–August) under the impact of food inflation caused by the swine flu epidemic. However, core inflation remains at a low level (1.5% and 1.4% respectively). In India, in October and November, the price growth rate was 4.6% and 5.5% respectively, also due to the pick-up in food inflation because of rains. In Brazil, annual inflation was at 3.2% in November.

MONETARY POLICIES OF FOREIGN CENTRAL BANKS

This year, in response to reduced inflationary pressures, a slowdown in growth rates and a decrease in GDP 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 and 3.1.7).

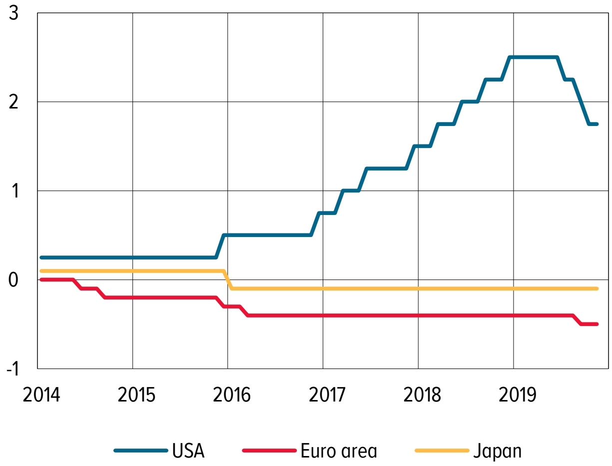
Monetary policies in the US and the euro area. After the meeting on 30 October, the US Fed cut the rate for the third time by 25 bp to 1.5–1.75%; after the meeting on 11 December, it did not change the rate and announced a pause in further rate cuts. The US Fed's updated December macro forecast assumes that the rate will remain unchanged throughout 2020. Now, further reduction may not be necessary partly because of a programme for buying short-term treasury bills worth $60 billion per month from 15 October 2019 through 2020 Q2 in order to increase liquidity for technical purposes to stabilise the repo market.

Low price pressure in the euro area continues to shape the conditions for the accommodative policy of the ECB. After the meeting on 12 September, the ECB cut the deposit rate by 10 bp to - 0.5%; after the meeting on 12 December, it kept the rate unchanged, admitting that the rate may be held at the current level or may be lowered. In addition, the bank introduced a two-tier deposit rate system, launched a new round of quarterly targeted long-term refinancing operations (TLTRO III) and resumed from 1 November an asset purchase programme worth 20 billion euro per month.

Against the backdrop of the resignation of the German voting director and divergent views of the Governing Council of the ECB regarding incentives, the new President of the ECB C. Lagarde called on Germany and the Netherlands, being the countries with a stable surplus, to increase government expenditure to stimulate their national economies as drivers of the European economy.

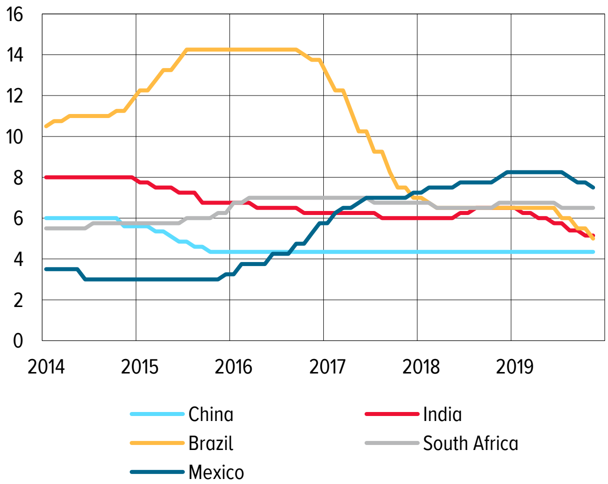
Monetary policies in other countries. Low inflation in many countries and the easing of

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



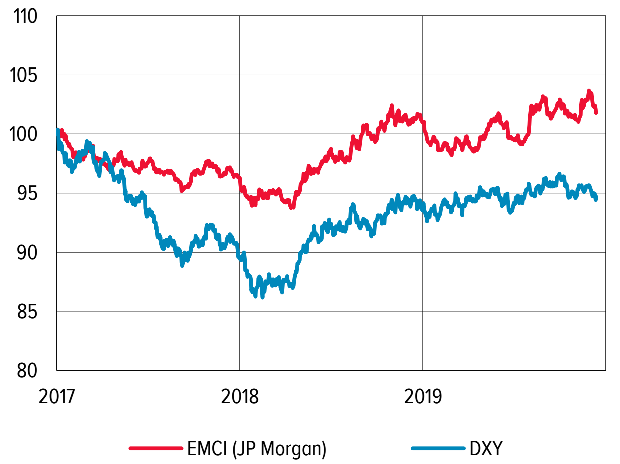
Source: Bloomberg.

POLICY RATES, EMES *Chart 3.1.7*
(%)



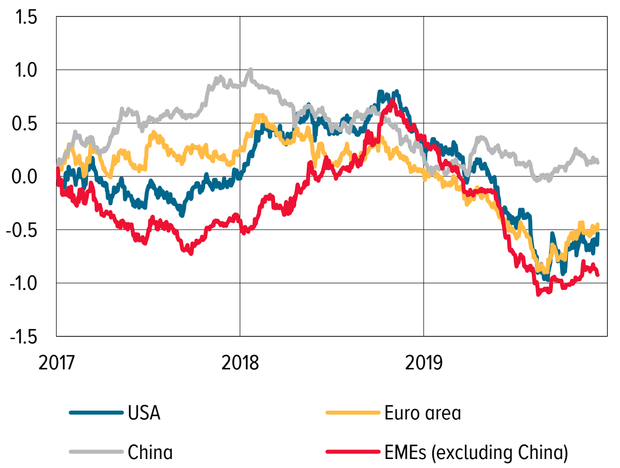
Source: Bloomberg.

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.

monetary policy by the US Fed allowed a number of other central banks to cut rates as well.

In particular, in September–October, the policy rates were lowered in India (by 25 bp to 5.15%), Brazil (by 100 bp to 5%), Indonesia (by 50 bp to 5%), South Korea (by 25 bp to 1.25%), Australia (by 25 bp to 0.75%), and Chile (by 25 bp to 1.75%). In China, the rate on new one-year loans offered to prime borrowers was reduced (LPR, by 5 bp in September and November to 4.15%), as was the rate on the medium-term lending facility (MLF, by 5 bp in November to 3.25%).

November saw the rate cut in Mexico (by 25 bp to 7.5%); in December, the rate was cut in Brazil (-50 bp to 4.5%) and Turkey (-200 bp to 12%).

GLOBAL FINANCIAL MARKETS

Currencies. In September–the first half of December, the dynamics of world markets were shaped by progress in trade negotiations between the US and China. After a temporary depreciation of most currencies against the US dollar in August, since September, as positive news about progress in negotiations came in, most currencies were able to recover their positions. The JP Morgan EME currency index rose by 1.8% during the period under review (Chart 3.1.8). The Russian ruble strengthened the most among EME currencies (+6.3%) (see Subsection 'Foreign exchange market'). Only the currency of Chile has significantly depreciated (by more than 6%) due to political and economic instability in the country. Currencies of advanced economies mostly strengthened slightly against the US dollar, the British pound appreciated most significantly (+8.3%) amid growing investor optimism about Brexit deal.

Interest rates. Since September, the decline in yields in developed countries has stopped on both the long and short ends of the curve. This was due to market participants' expectations related to agreements between the US and China as well as more restrained rhetoric of the US Fed after the rate cut in October. As a result, in advanced economies, yields on 2-year government bonds rose by 10–30 bp, and on 10-year bonds – by 20–45 bp (Charts 3.1.9 and 3.1.10). The growth of yields has led to the normalisation of the curve in the US, and since October, the 10-year and 3-month yield spread has again become positive.

At the same time, the return of investor interest in higher-yield assets as signs of a resolution of geopolitical tensions emerge has contributed to lower yields on the long end of the curve in most EMEs.

Country risk premiums. The recovery of risk appetite has generally contributed to a decline in country risk premiums. Despite occasional volatility hikes, the cost of CDSs reduced in most countries in September–November (Chart 3.1.11). For example, in advanced economies, there was a decrease in the value of a 5-year contract in Italy (by more than 35 bp) and in the UK (by more than 10 bp) due to efforts aimed at reducing the likelihood of a 'no-deal Brexit' and political agreements.

In EMEs, despite some periods of volatility in October, the value of a 5-year contract also fell by an average of 30 bp. Among the largest countries of the group, a significant increase in the cost of insurance against default was recorded only in Chile due to the escalation of domestic political risks.

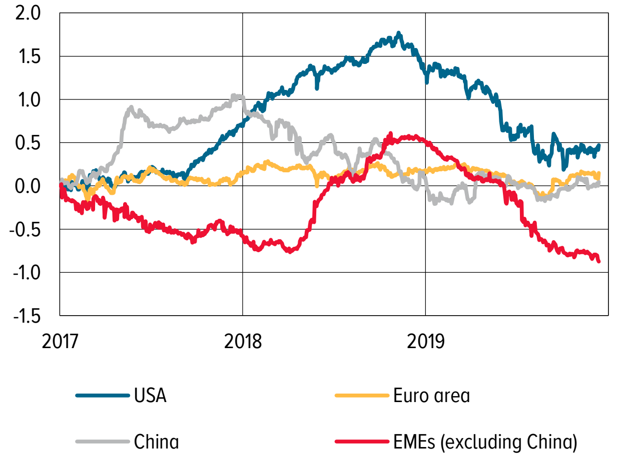
Stocks. Since September, the stock markets in most countries have been buoyed by positive news on the progress of trade negotiations and rate cuts by most central banks. The recovery in investor interest in risky assets has boosted demand for stocks in most advanced and emerging market economies alike. For example, in September–December, the stock indices of EMEs and advanced economies gained an average of 9–15% (Chart 3.1.12).

GLOBAL COMMODITY MARKETS

Oil – price. In September–early December, the trends in world prices for oil, Russia's key export commodity, were mixed. In mid-September, the Urals crude price rose to $68 per barrel due oil output slump in Saudi Arabia after the drone attack. However, amid a rapid recovery in its production and fears of a slowdown in the global economy, the price fell to $57 per barrel in early October. In late November, the price recovered to $65 per barrel amid hopes for the settlement of US–China trade disputes. On average, in September–November, the Urals crude price

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

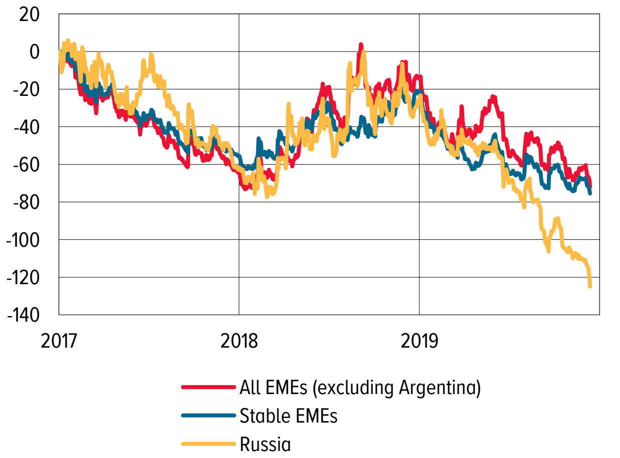
Chart 3.1.10



Sources: Reuters, Bank of Russia calculations.

CDS OF EMES
(change on 02.01.2017, bp)

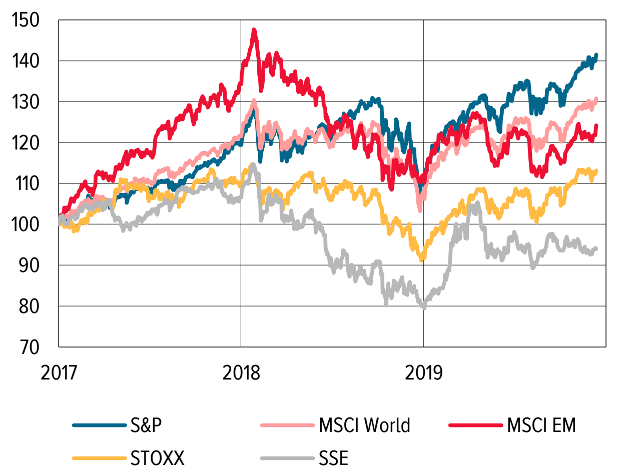
Chart 3.1.11



Source: Reuters.

STOCK INDICES
(100 = 02.01.2017)

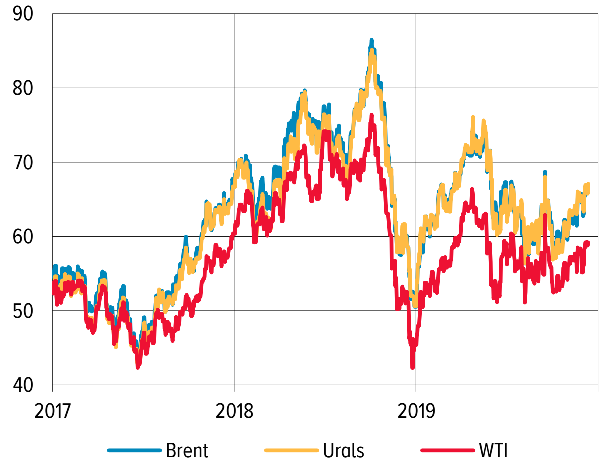
Chart 3.1.12



Sources: Reuters, Bank of Russia calculations.

OIL PRICES
(US dollars per barrel)

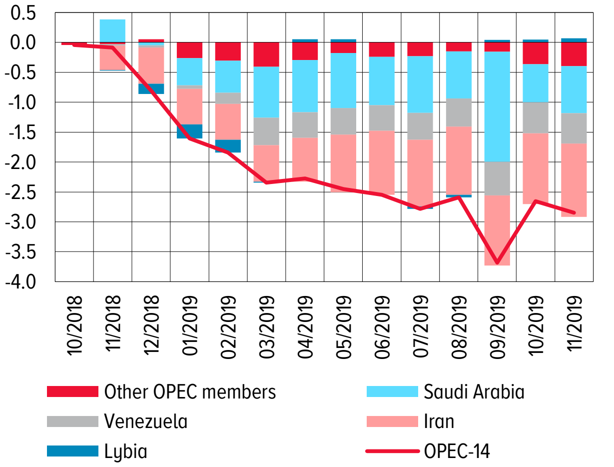
Chart 3.1.13



Sources: Thomson Reuters, Bloomberg.

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

Chart 3.1.14



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

averaged $62 per barrel (Chart 3.1.13). A price increase to $67 in early December was supported by the OPEC+ decision to further reduce oil production in 2020.

Oil – global demand. The IEA estimates that in 2019 Q3 growth in global demand for oil picked up to about 1 million barrels per day (in Q2, 0.4 million barrels per day)[1]. However, according to the December forecast, the IEA expects global demand to increase by only 1.0 million barrels per day overall in 2019. Downward revision of the forecast by 400,000 barrels per day compared to the beginning of the year occurred against the backdrop of deteriorating world economic outlook. In October, the IMF once again lowered its forecast for global GDP growth in 2019 to 3.0%, the lowest figure since 2008–2009.

Oil – OPEC+. At the meeting on 6 December, the OPEC countries and several non-OPEC countries agreed to further reduce production by 500,000 barrels per day from 1 January 2020. This will lead to a total reduction of 1.7 million barrels per day compared to October 2018 under the OPEC+ agreement. With additional voluntary oil output cuts (mainly by Saudi Arabia), its production is expected to decrease by more than 2.1 million barrels per day. In autumn 2019, over-fulfilment of the OPEC+ agreements continued (Chart 3.1.14). According to calculations based on data from secondary OPEC sources, in September, OPEC members exceeded a 240% compliance rate. This was due to the decrease in Saudi Arabia's production by 1 million barrels per day to multi-year low. However, in October, it fully recovered from the September drop. The rate of compliance with OPEC arrangements abated but held at a fairly high level and came in at about 150% in November. Production in Saudi Arabia remained 0.8 million barrels per day below the October 2018 level. That is, it was reduced by 460,000 barrels per day more than the agreement called for. Angola, Kuwait and some other countries also over-fulfilled their obligations. Non-OPEC countries, including Russia, also cut production by about 0.2 million barrels per day compared to October 2018. Due to the adjustment of

[1] *Increase on the same period of the previous year.*

the agreement, in 2020 Q1, Russia will cut production by further 70,000 barrels per day to reach 300,000 barrels per day.

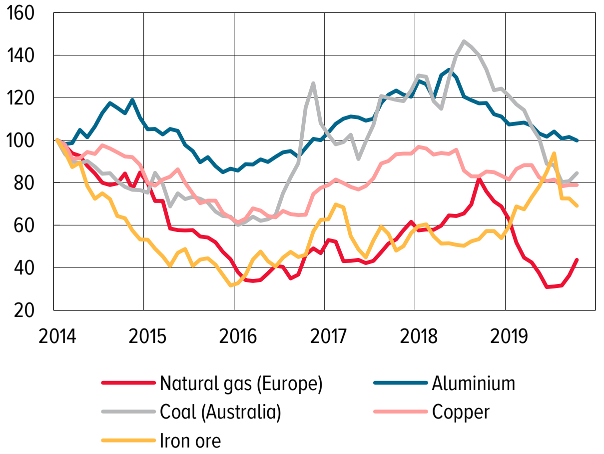
Oil – supply from Iran and Venezuela. In Iran, oil production continued to decline during the autumn of 2019, falling to 2.1 million barrels per day in November. According to secondary OPEC sources, the production volume decreased by 1.2 million barrels per day compared to October 2018—that is, by more than a third. This happened in the context of a decline in Iran's exports by 1.5 million barrels per day since October and by 2.4 million barrels per day since April 2018 amid US sanctions. In Venezuela, production stabilised at about 0.7 million barrels per day (a more than 15-year low). Since October 2018, the production volume has been nearly halved, having decreased by about 0.5 million barrels per day. Downward pressure on production was exerted by US sanctions, the poor state of oil infrastructure and power outages.

Oil – non-OPEC+ production. The growth of oil production in the US slowed compared to the previous year due to a decrease in drilling activity. Overall, however, US production is expected to increase by 1.7 million barrels per day in 2019, according to the US Energy Information Administration. Its growth will continue to make a major contribution to the expansion of the supply of oil and other liquid fuels outside OPEC. Combined with a notable increase in production in Brazil, Norway and Canada, this offsets the production slump of OPEC+ countries, Iran and Venezuela.

Situation in other commodity markets. In autumn, world prices for other energy commodities grew but remained significantly lower than in September–November 2018 due to the full utilisation of gas storage facilities in Europe and competition with other energy sources (Chart 3.1.15). Fears of possible decommissioning of nuclear power plants in France, restrictions on Gazprom's access to OPAL pipeline capacity, earlier-than-expected closure of the Groningen field (in 2022 instead of 2030) and lower supplies from Norway contributed to the autumn increase in the price of natural gas in Europe. In autumn 2019, global coal prices were supported by an increase in imports by China. Global metal prices showed

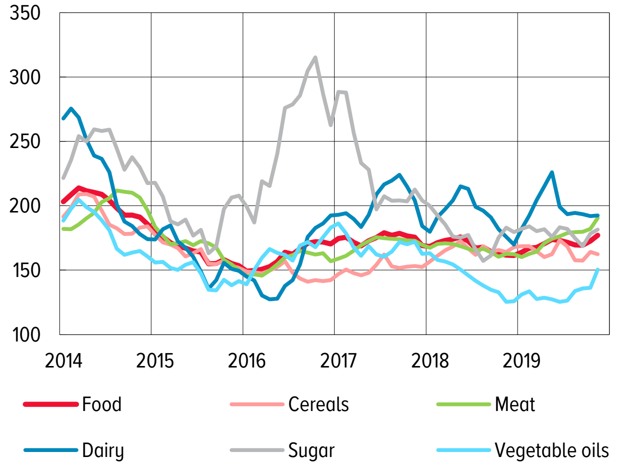
GLOBAL PRICES FOR KEY RUSSIAN EXPORT COMMODITIES
(January 2014 = 100%)

Chart 3.1.15



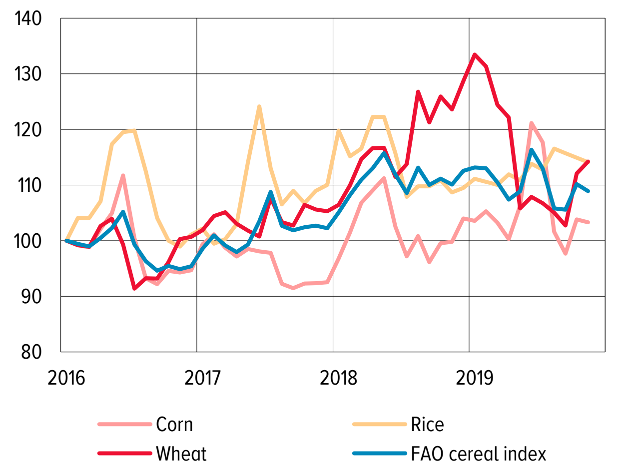
Source: World Bank.

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



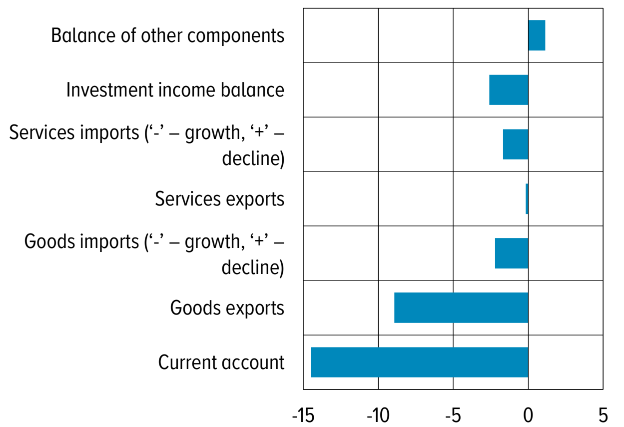
Source: UN Food and Agriculture Organization (FAO).

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 Q3* *Chart 3.1.18*
(billions of US dollars on the same quarter of the previous year)



* *Assessment for 2019 Q3.*
Source: Bank of Russia.

mixed dynamics. Prices were favourably affected by improved sentiment in the financial markets amid lower US interest rates and de-escalation of US–China trade disputes. Downward pressure was exerted by low business activity in global manufacturing industry.

Food products. In January–November 2019, global food prices increased by 1% compared to the same period in 2018 (Chart 3.1.16). The main contribution was made by an increase in meat prices against the backdrop of limited supply and solid demand, especially from China. Sugar prices grew due to expectations of reduced production because of a decrease in sugar cane crop areas in India and a drought in Thailand. Global cereals prices remained below last year figures amid general expectations of good harvests in 2019 (Chart 3.1.17).

BALANCE OF PAYMENTS

Current account. According to the preliminary estimate, the current account surplus in 2019 Q3 fell by $14.5 billion to $12.9 billion[2] mainly due to a one-third reduction in the balance of foreign trade in goods and services (Chart 3.1.18). In January–November 2019, it fell by $30.6 billion to $71.6 billion.

Exports. Decline in the volume of goods and services exports accelerated from 5.9% in 2019 Q2 to 7.1% in 2019 Q3, following a drop in global prices for energy commodities. A decrease in the exports of a number of goods has also had its effect, reflecting the weakening of external demand against the backdrop of the global economic slowdown. At the same time, according to the FCS, a price downturn (-6.3%) made the biggest contribution to the decrease in goods exports than a drop in export quantities (-1.7%).

Oil exports. According to the FCS of Russia, in 2019 Q3, export quantities of crude oil and oil products rose by 1.8% year-on-year and by 10.2% quarter-on-quarter. Exports were supported by the full resumption of supplies through the Druzhba pipeline. At the same time, the decline in oil production in Russia due to the OPEC+ agreement continued to

[2] *Hereinafter, changes are relative to the corresponding period of the previous year, unless otherwise indicated.*

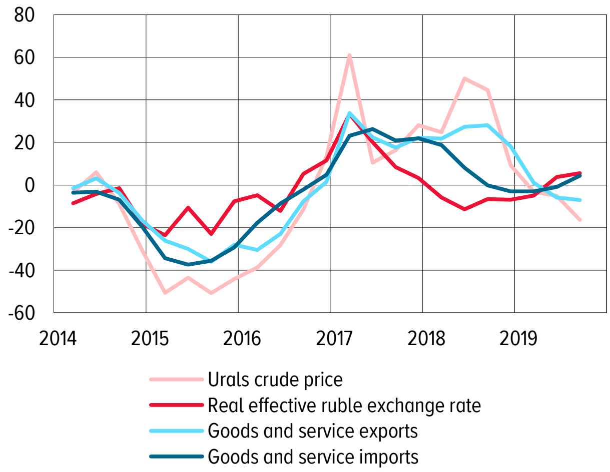
exert a downward pressure. Russia's position in the main (European) market remained stable. According to Eurostat, its share in the imports of oil and oil products in the European Union remained at about 30%. However, competition from the US (whose share rose to 8% compared to 5% in 2018 Q3), Libya and Nigeria increased following an increase in their production. The expansion of supplies from these countries has more than offset the decline in EU oil imports from Iran.

Gas exports. Russian gas export quantities fell by 5.6% from the high level of 2018 Q3. The drop in gas exports to Turkey was caused by a decrease in consumption in an unfavourable economic situation and an increase in LNG imports from other countries. In addition to the weather factor, the downward pressure on Russian gas exports to the EU was a result of competition, renewable energy sources and restrictions on Gazprom's access to the facilities of the OPAL pipeline of Nord Stream since September. At the same time, this year, Russian gas export quantities still exceeded the 2017 quantities and the average measure for the last five years. This was facilitated by the continued decline in gas production in the EU in 2019.

Non-oil and gas exports. The volume of non-oil and gas exports of goods rose in 2019 Q3 by 6.5% (in 2019 Q2, -2.4%). Its dynamics were mixed by commodity group. On the one hand, Russia expanded its exports of a number of engineering products (radar and navigation equipment, turbojet engines) and some other commodities (iron ore, raw aluminium, gold). On the other hand, Russian exports of ferrous metals continue to decline both in volume and quantities. Wheat export volumes, despite a seasonal increase compared to 2019 Q2, remained below the record high of 2018 Q3. Services exports remained largely unchanged in 2019 Q3. The decline in the travel component was almost offset by the expansion of transportation services exports.

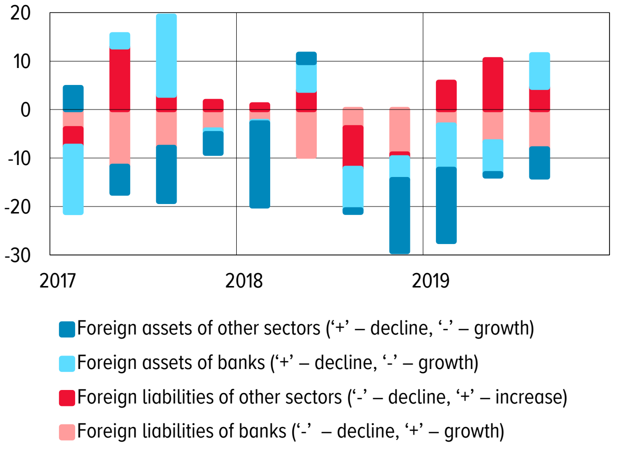
Imports. The volume of goods and services imports in 2019 Q3 rose by 4.4% (in 2019 Q2, -0.9%) (Chart 3.1.19). According to the FCS, the growth of goods imports was mainly due to a 3.6% increase in its quantities. The

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



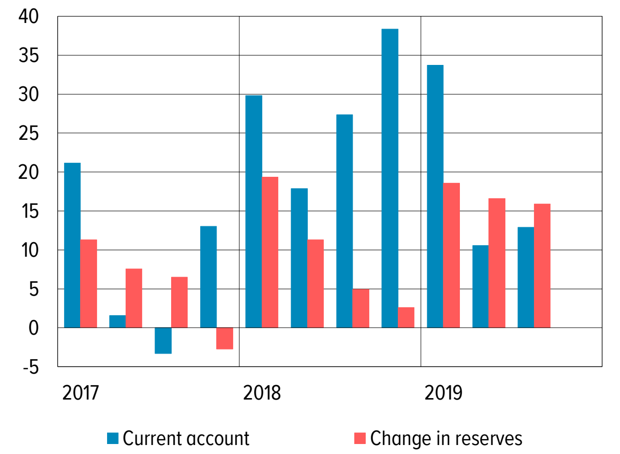
** Assessment of exports and imports for 2019 Q3.*
Sources: Bank of Russia, Thomson Reuters.

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



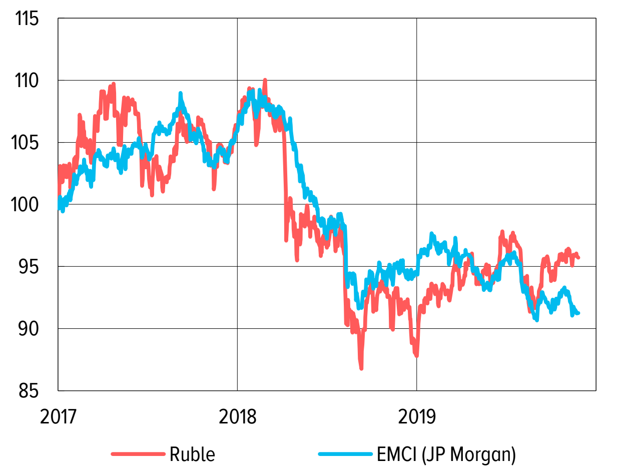
** Assessment for 2019 Q3.*
Source: Bank of Russia.

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



** Assessment of the current account for 2019 Q3.*
Source: Bank of Russia.

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



Source: Thomson Reuters.

expansion of imports was supported by a 5.6% rise in the real effective ruble exchange rate against 2018 Q3. Imports of a number of both consumer goods (medicines, passenger cars) and investment goods (power generating units, electric transducers and medical equipment) increased. The Travel item was the main driver of the growth in the volume of services imports in 2019 Q3.

Financial account – private sector. In 2019 Q3, net lending by the Russian private sector to the rest of the world amounted to $1.4 billion (in 2018 Q1, $18.8 billion). Financial flows of both banks and other sectors were more balanced in Q3 of this year than a year earlier. Unlike in the previous year, banks' repayment of foreign debts was offset by a decline in foreign assets. In 2018 Q3, they grew amid the suspension of fiscal rule-based foreign currency purchases. Other sectors increased their foreign assets as well as their foreign liabilities in 2019 Q3. Overall, in 2019, the balance of private sector financial operations followed a path similar to that seen in 2017 (Chart 3.1.20).

Financial account – public sector. In Q3, the inflow of foreign capital to the public sector declined. The volume of non-resident purchases of Russian government bonds in the secondary market fell to $1.1 billion (in Q2, $10.5 billion). The balance of public sector financial transactions suffered a less prominent drop to $4.5 billion (in Q2, $5.9 billion) due to a $3.1 billion decline in assets after a $1.2 billion increase in Q2.

Foreign currency reserves. In 2019 Q3, reserves increased by $15.9 billion mainly owing to fiscal rule-based foreign currency purchases (Chart 3.1.21). More significant growth compared to 2018 Q3 (+$5.0 billion) is due to the temporary suspension of foreign currency purchases in August 2018. Operations reflected in the balance of payments, revaluation and other changes increased Russia's foreign currency reserves in 2019 Q3 by $12.6 billion to $530.9 billion.

FOREIGN EXCHANGE MARKET

Ruble exchange rate. In September–the first half of December, the ruble exchange rate remained relatively stable (Chart 3.1.22). After strengthening in the first week after the September Bank of Russia Board of Directors' meeting from ₽65.7 to ₽64 per $1, the ruble remained mostly stable until December. As a result, the indicators of three-month historical and implied volatility have reached their lowest values since the end of 2013. The main factors determining the exchange rate dynamics in the period under review were risk appetite in global markets and the easing of monetary policy by the Bank of Russia, resulting in the stronger appreciation of the ruble compared to other EME currencies. Long ruble positions demonstrated moderate growth in the FX swap segment.

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). The average spread stood at -14 bp in September–December (in Q3, -21 bp) and fluctuated in the range from -46 to 26 bp (in Q2, from -51 to 16 bp). The formation of IBL rates and the liquidity situation is discussed in more detail in Section 4.2 'The system of monetary policy instruments and other monetary policy measures.'

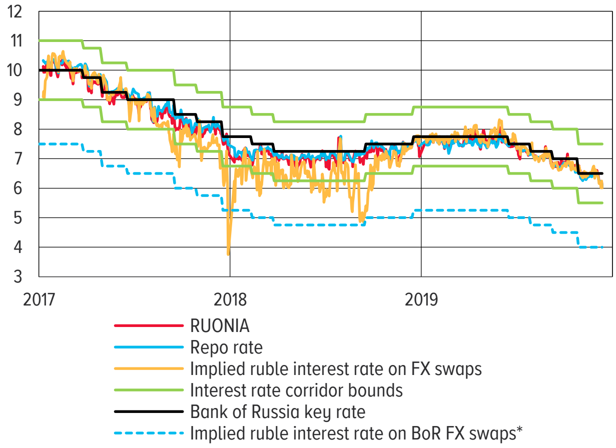
Foreign currency liquidity. Interest rate spreads in the FX swap and IBL segments did not change, amounting to 0 bp in September–December (in Q3, +3 bp) (Chart 3.2.2). The low cost of foreign currency borrowings in the Russian market is supported by the availability of reserves of foreign currency liquidity accumulated in banks in 2018 H2–2019 H1.

Long-term rates. Money market rates for maturities of more than 1 day continued to fall, with long-term rates falling more than short-term rates (1 week ROISFIX fell by 69 bp to 6.29% by 12 December; 1 year ROISFIX fell by 78 bp to 6.18%). This was due to the adjustment of the market expectations of the key rate path (Charts 3.2.3 and 3.2.4) owing to a decrease in actual inflation and inflation expectations. Based on money market curves, market participants expect the key rate to be cut to 6% in 2020.

STOCK MARKET

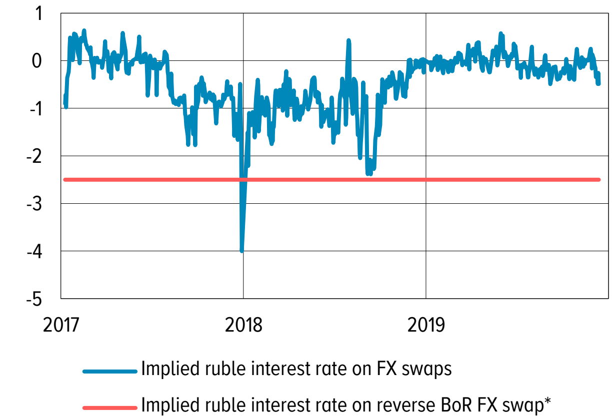
The situation in the Russian stock market was mostly positive in September–December. Most segments of the market showed a rise in quotes

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



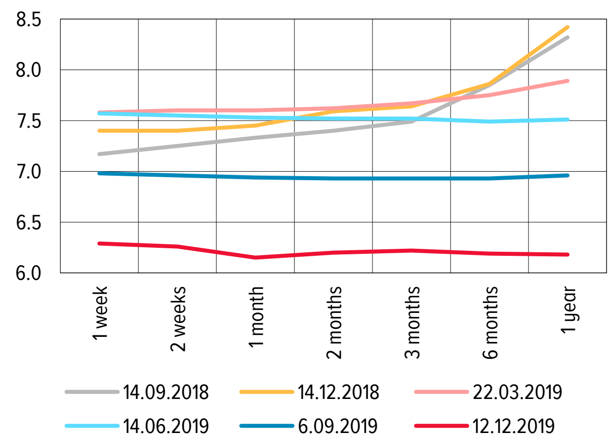
** Implied rate on BoR reverse FX swap = ruble lending rate – FX borrowing rate + LIBOR (since 19.12.2016: key rate – 1 pp - (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).*
Source: Bank of Russia calculations.

SPREAD OF INTEREST RATE IN FX SWAP SEGMENT TO KEY RATE *Chart 3.2.2*
(pp)



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

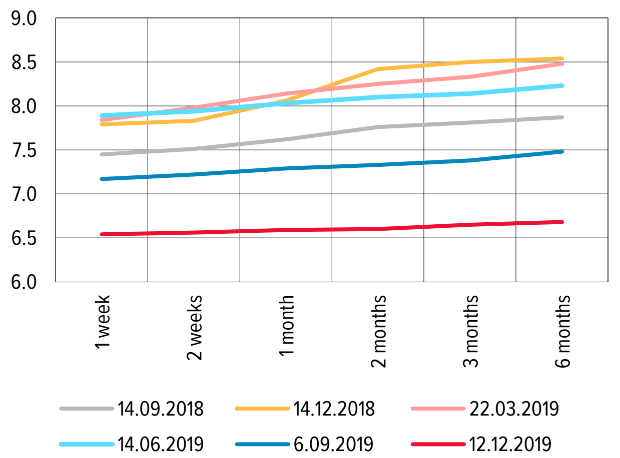
ROISFIX CURVE *Chart 3.2.3*
(% p.a.)



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

MOSPRIME CURVE (% p.a.)

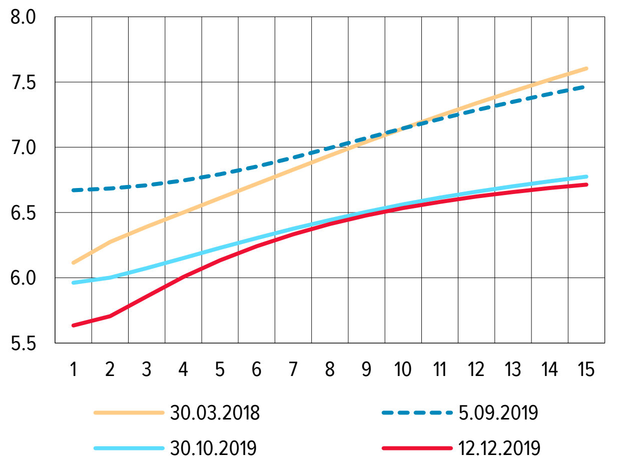
Chart 3.2.4



Source: SRO NFA.

OFZ ZERO COUPON YIELD CURVE (% p.a.)

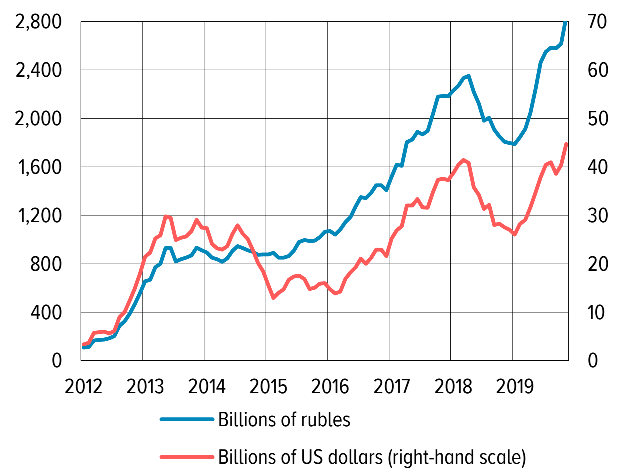
Chart 3.2.5



Source: Moscow Exchange.

NOMINAL VALUE OF OFZ HELD BY NON-RESIDENTS

Chart 3.2.6



Source: National Settlement Depository.

caused by both external and domestic factors. Primarily, these are the growth of demand for risky assets in global markets and the easing of monetary policy by the Bank of Russia.

Government bond market. Expectations of monetary policy easing and the actual reduction of the key rate by the Bank of Russia contributed to a further decline in government bond yields. OFZ zero coupon yield curve shifted down by 60–90 bp depending on maturity, thereby falling across all maturity buckets below the level of early April 2018, when another round of anti-Russian sanctions was imposed (Chart 3.2.5). Moreover, the yield of 2-year OFZs hit its lowest since 2010, and that of 10-year OFZs – since 2007. The decline in yields was accompanied by the resumption of active OFZ purchases by foreign investors; they peaked in October when expectations of monetary policy easing increased significantly against the backdrop of slowing inflation. From September to November, non-residents stepped up their investment in OFZs by ₽271 billion, including by ₽220 billion in October. Thus, the monthly increase in investment in October was comparable to the all-time highs of April–May 2019, when non-residents increased their investment by ₽196 and ₽220 billion respectively. Despite the record demand of non-residents, the volume of auction-based OFZ placements increased, though not as significantly. The largest volume of securities worth ₽190 billion was placed in October, which was half the average monthly volume of placements made in April–May, when the Ministry of Finance of Russia placed securities worth ₽403.8 and ₽375.8 billion. This was due to noticeably lower demand from local investors, in particular, systemically important banks, which, in the face of declining yields, began to purchase corporate bonds with higher yields.

Corporate bond market. Following the government bond market, the yields in corporate bond market continued to decline (Chart 3.2.9). The IFX-Cbonds corporate bond yield index fell by 50 bp to 7.04% p.a. and hit its new low since 2011. As the cost of borrowing decreased, the issuance activity of Russian companies and banks continued to recover. In September–November, their bond placement amounted to ₽779 billion—that is, 2–3 times more than during the same period of 2018. Local investors remained the main buyers. At the same time, the share of purchases by systemically important banks increased (from 24% to 38%); they began to acquire higher-yielding corporate securities amid declining yields in the OFZ market.

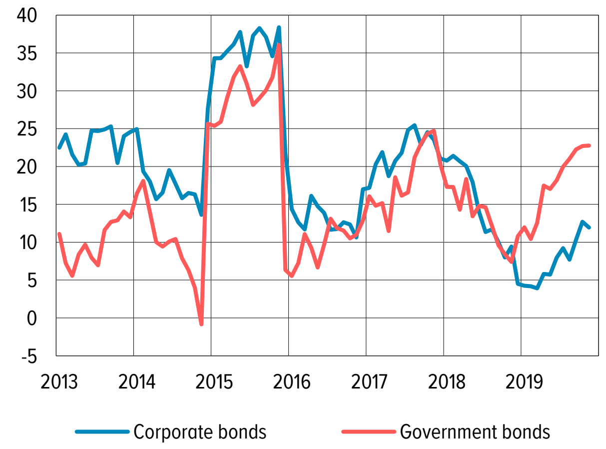
Equity market. During the period under review, the Russian equity market continued to grow. The MOEX index grew by 6.3% (since the beginning of the year, +25.9%), reaching its historical high (Chart 3.2.10). The RTS index was up 11.8% (since the beginning of the year, +33.9%), reversing to its 2013 readings. The indices in the period under review were mostly affected by the dynamics of oil prices and investor sentiment in global markets. For example, until mid-October, the indices mostly declined, following oil price, which by the beginning of October had fallen to $57 per barrel (Brent). But after that, as oil prices recovered, and demand for risky assets increased amid optimism about the prospects for Brexit and US–China trade negotiations, the indices rebounded from the September drop and reached new historical or local highs. The MOEX index hit a historical high of 3,000 points in early November.

DEPOSIT AND LOAN MARKET

Deposit rates. The downward trend in deposit rates that evolved in 2019 Q2 remained in the second half of the year. This was facilitated by the key rate reduction and expectations about its path that manifested in the dynamics of bond yields even before the decision of the Bank of Russia (Chart 3.2.11). In October, the rate of short-term deposits was 5.0% p.a., down 0.8 pp compared to June. The rate of long-term deposits for the same period decreased by 0.6 pp to 6.2% p.a. In November and December, the largest banks in the deposit market mainly reduced deposit rates. Some potential for cutting deposit rates remains in the short term, but competition between banks will constrain it.

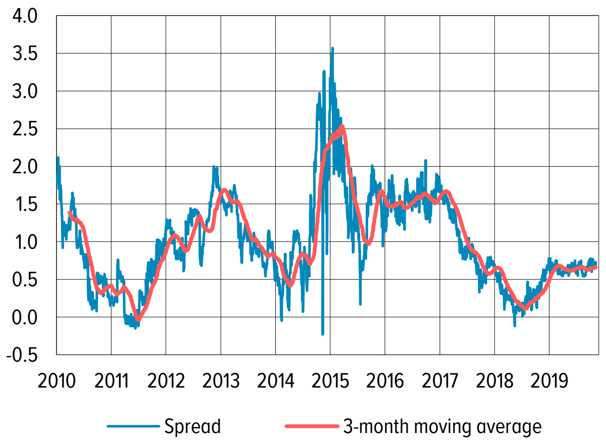
Deposit operations. In July–October, deposit rates declined at a rate comparable to the decline in inflation. As a result, real deposit rates stayed positive and remained attractive to depositors. In early November, annual growth

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



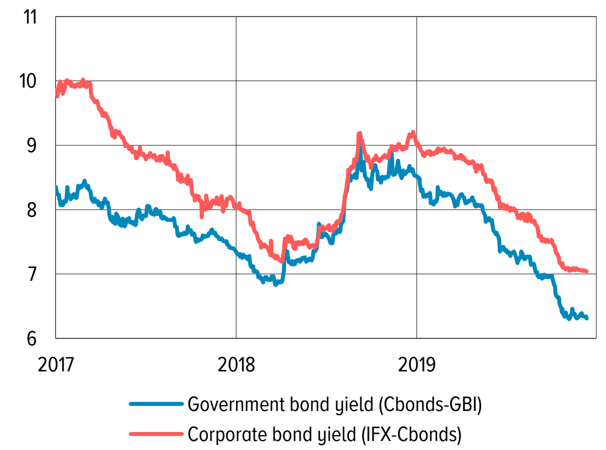
Source: Cbonds.ru

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



Source: Cbonds.ru

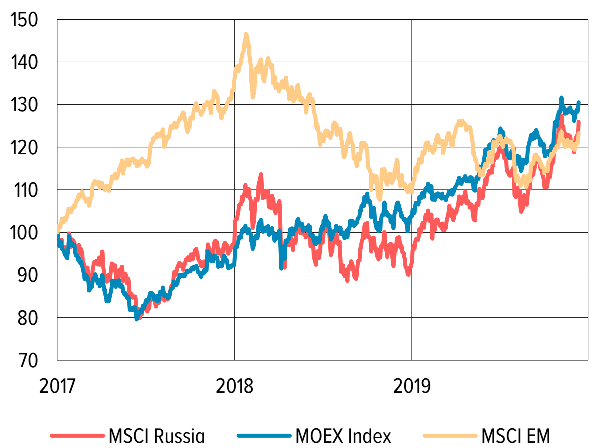
YIELD INDICES OF CORPORATE AND GOVERNMENT BONDS *Chart 3.2.9*
(% p.a.)



Sources: Cbonds.ru

STOCK INDICES
(100 = 03.01.2017)

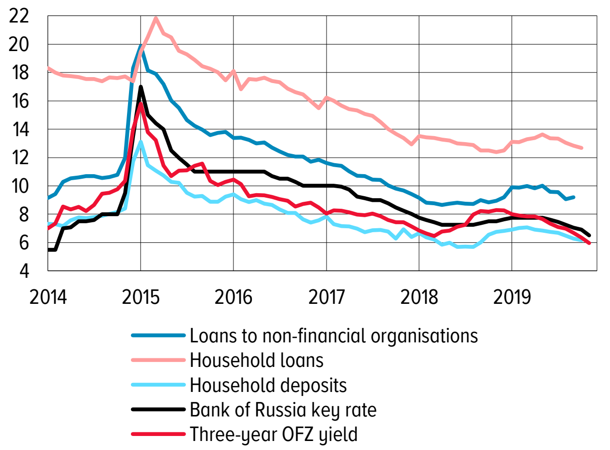
Chart 3.2.10



Source: Bloomberg

INTEREST RATES ON LONG-TERM RUBLE OPERATIONS IN THE RUSSIAN MARKET
(% p.a.)

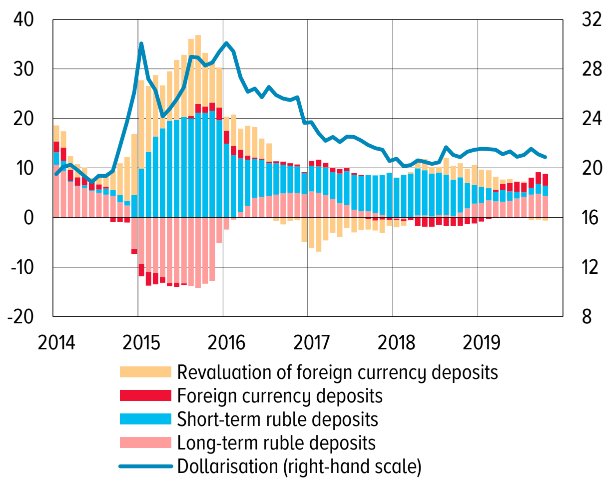
Chart 3.2.11



Source: Bank of Russia.

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

Chart 3.2.12



Source: Bank of Russia.

in household deposits[3] reached 9.2% (in early August, 7.1%).

As in previous months, ruble operations (mainly long-term ones) contributed the most to the growth of deposits (Chart 3.2.12). The slower decline in long-term deposit rates combined with the desire of depositors to lock in the yield on deposits before it is further reduced may have contributed to supporting interest in long-term deposits. By the beginning of November, the annual growth rate of the portfolio of ruble deposits with over-1-year maturities reached 15.3%, while the same figure for deposits with up-to-1-year maturities was 4.2%.

The inflow of funds to foreign currency deposits observed starting the first half of the year stopped. In August–October 2019, the balances on household foreign currency deposits decreased by $0.6 billion. However, during the same months of the previous year, the reduction was more significant, and the annual growth in foreign currency deposits increased slightly.

Lending rates. By mid-2019, the lending market has developed a tendency toward reduced rates supported by cheaper bank funding and banks' competition for prime borrowers (Chart 3.2.11). In September, the average market rate on long-term loans to non-financial organisations was 9.2% p.a., 0.4 pp lower than in June. The rate on short-term loans during the same period fell from 9.1% to 8.3% p.a. In July–October, the rate on new mortgage loans dropped by 0.9 pp, reaching a new historical low for the Russian mortgage market (9.4% p.a.). In 2019 Q4, banks continued to reduce rates on standard credit products, which suggests a further reduction in average market rates.

Corporate lending. In the second half of 2019, banks stepped up corporate lending more slowly than in the second half of 2018 (Chart 3.2.13): in August–October 2019, the portfolio

[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 dollars. To analyse the flows of funds between banks and their customers, when calculating the growth of balance sheet indicators which include FX and ruble components, the growth of the FX component is converted into rubles using the period average exchange rate.

of ruble loans to non-financial organisations increased by ₽590 billion (in August–October 2018, by ₽721 billion), while the portfolio of foreign currency loans decreased by $1.0 billion (vs a $3.8 billion increase in the same period of 2018). As a result, the annual growth rate of corporate lending slowed from 5.7% in early August to 4.1% in early November, while the predominance of foreign currency in the loan portfolio continues to decrease.

Retail lending. In the second half of 2019, the annual growth of retail lending continued to slow down and in early November amounted to 19.7% against 21.9% three months earlier, with mortgage and consumer lending making a comparable contribution to the mentioned slowdown (Chart 3.2.14). In the mortgage lending segment, the slowdown was partly technical in nature and was due to the growing volume of mortgage securitisation. In the consumer lending segment, the slowdown was facilitated both by the exhaustion of the potential for recovery growth in retail lending and by Bank of Russia measures aimed at curbing excessive growth in certain segments of the retail lending market. In the short term, we can expect a further slowdown in the growth of retail lending with a faster contraction of the contribution of consumer lending to this growth.

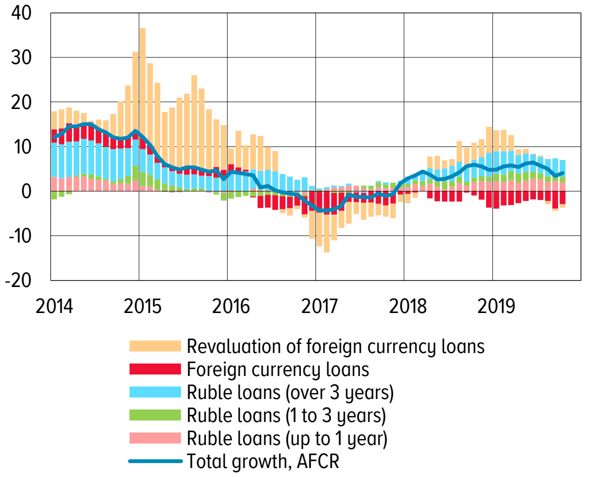
3.3. ECONOMIC ACTIVITY

GROSS DOMESTIC PRODUCT

Annual GDP growth in 2019 Q3 sped up to 1.7% (in 2019 Q2, 0.9%) (Chart 3.3.1). This was higher than the Bank of Russia's estimate published in MPR 3/19 (0.8–1.3%). The Bank of Russia conjectured a possible acceleration of economic growth in the September issue of the information and analytical commentary Economics No. 9 (45).

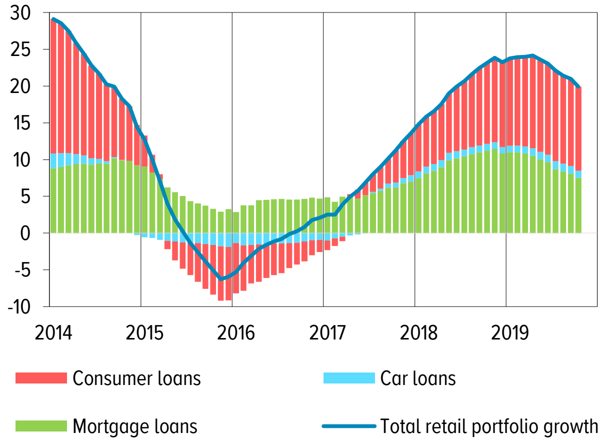
The acceleration of growth was due, first, to the dynamics of wholesale trade, with its turnover increasing significantly in Q3 (by 4.1% YoY after a drop of 1.9% in 2019 Q2). Second, it is due to higher and relatively more sustainable growth in agriculture output than was previously anticipated (see Subsection 'Agriculture'), as

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



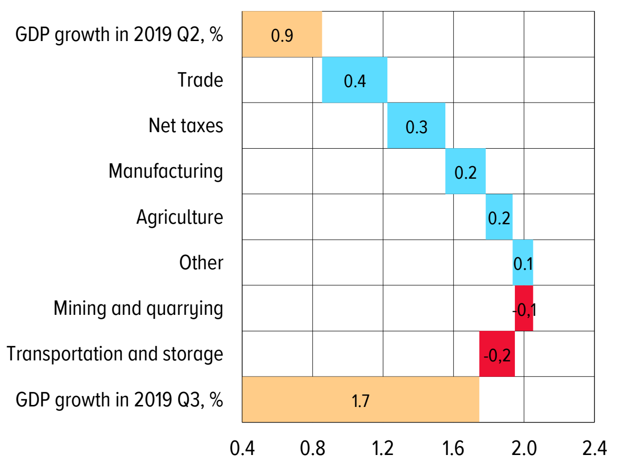
Source: Bank of Russia.

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



Source: Bank of Russia.

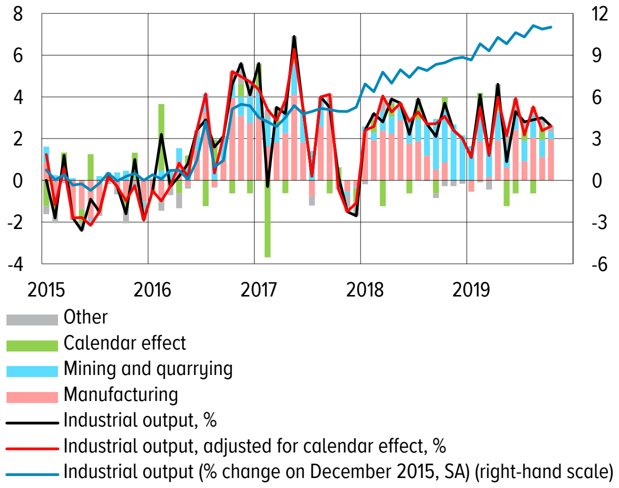
DECOMPOSITION OF ANNUAL GDP GROWTH *Chart 3.3.1*
(pp)



Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL OUTPUT
(contribution to annual growth, pp)

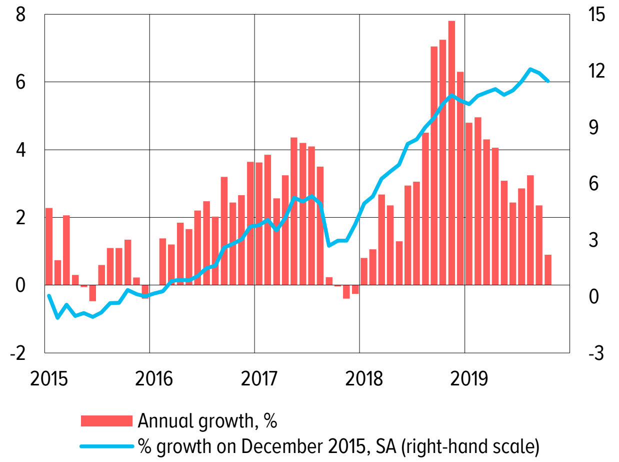
Chart 3.3.2



Sources: Rosstat, Bank of Russia calculations.

RAW MATERIALS

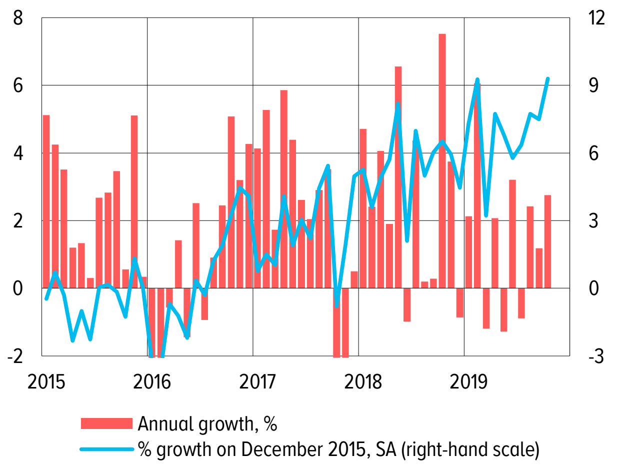
Chart 3.3.3



Sources: Rosstat, Bank of Russia calculations.

INTERMEDIATE GOODS

Chart 3.3.4



Sources: Rosstat, Bank of Russia calculations.

well as to the acceleration of manufacturing growth (see Subsection 'Production activity').

The expansion of production amid slower growth of domestic demand could speed up inventory accumulation in 2019 Q3. Exports showed slightly better dynamics after a noticeable reduction in the previous quarter. However, the slowdown in the global economy continues to hinder its further recovery. It is estimated that in 2019 GDP growth will form closer to the upper bound of the 0.8–1.3% range.

PRODUCTION ACTIVITY

In August–October 2019, the upward trend in industrial output persisted (Chart 3.3.2). The annual growth rate of industrial production increased compared to May–July and averaged at 2.8% over this period. The growth of production activity was due to the expansion of output in a wide range of sectors.

Raw material production. In August–October, mining and quarrying outputs (SA) reached a historical high (Chart 3.3.3). Its growth was due to the expansion of oil production and other (non-energy producing) materials. An increase in oil production was observed in August 2019 due to recovery from the consequences of the Druzhba pipeline incident, followed by its decline as part of the execution of the OPEC+ agreement. On the other hand, gas output continued to shrink. This is explained by weak demand in Europe associated with record large gas volumes accumulated in gas storage facilities.

The production of other minerals increased. The output of marble and gravel was up as the urban improvement works continued in the country's major cities.

Intermediate goods production. In August–October 2019, the output of intermediate goods, as the output of raw materials, increased compared to May–July (SA) (Chart 3.3.4). Thus, the upward trend in the production of these goods observed since 2018 continued. The dynamics of the indicator were mainly supported by an increase in the output of oil products and related products, including chemicals and plastics. Output was also supported by the non-ferrous metal industry in the context of continued expansion of external demand for Russian non-ferrous metals.[4] In contrast, output in the iron and steel industry declined, which could be caused by a decrease in external demand as well as weak domestic demand. The dynamics of other intermediate goods fluctuated near the levels of May–July 2019 (SA).

Production of investment goods. In August–October, the trend toward growth in investment goods output observed in 2019 persisted. During this period, their production (SA) increased primarily owing to engineering products (Chart 3.3.5). The output of electrical equipment increased significantly, possibly supported by the weakening of the ruble in August, which improved the price competitiveness of domestic products compared to imported analogues.

In August–October 2019, the production of construction materials shrank mainly due to the sectors focused on the domestic market.

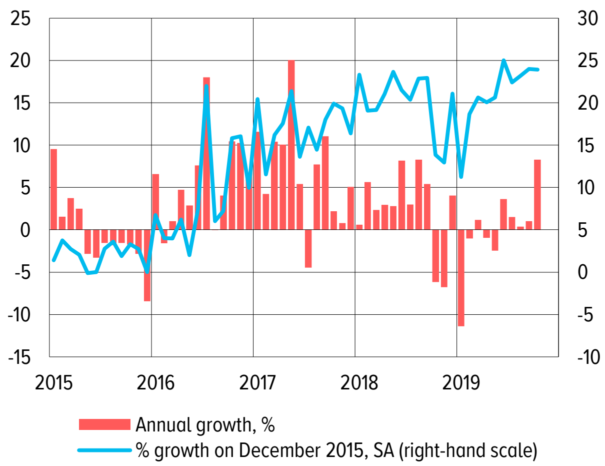
Production of consumer goods. The upward trend in consumer goods output (SA) continued in August–October 2019 (Chart 3.3.6). It was driven by the output of food products, primarily in the animal products processing sector. There was an increase in the output of meat products (pork, sausages and canned meat) and dairy products (cheese). The expansion of food supply restrained the growth of prices in this product category (see Section 2). The production of non-food consumer goods hovered near May–July figures (SA). Its growth was restrained by the dynamics of consumer demand (see Subsection 'Consumption and savings'). Light industry and the pharmaceutical industry demonstrated positive dynamics.

Business surveys. In August–November, the deterioration of business sentiment in the industry continued. The IHS Markit PMI[5] was below 50, signalling a deterioration in market conditions, and in November 2019 it fell to a 10-year low (SA) (Chart 3.3.7). New orders, both export and domestic, declined markedly. The decline in export orders to a 10-year low could

[4] In January–September 2019, the exports of copper and copper products increased by 3.3%, nickel and nickel products – by 28.3%, and aluminium and aluminium products – by 0.7%.

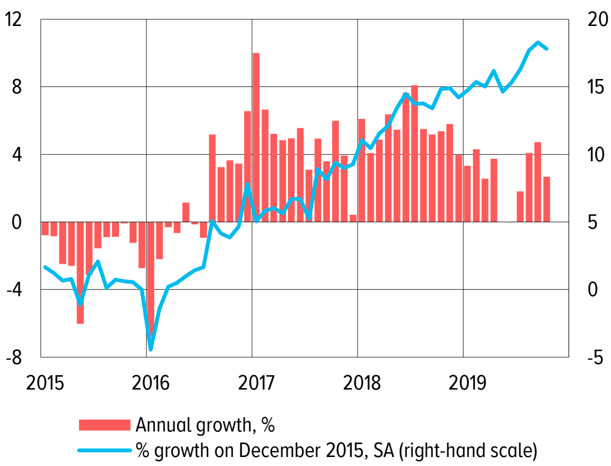
[5] Purchasing Managers' Index. For more details see: www.markiteconomics.com/public.

INVESTMENT GOODS *Chart 3.3.5*



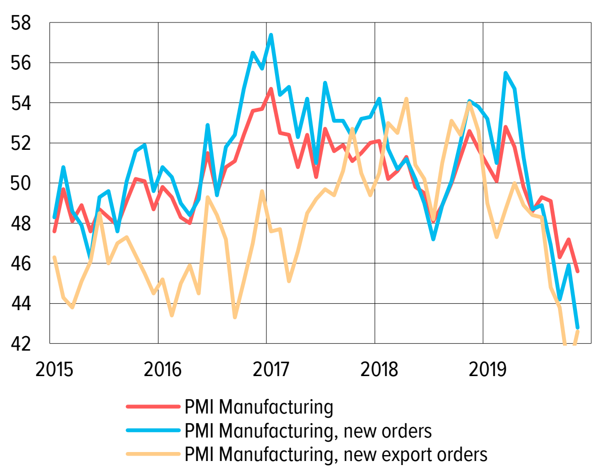
Sources: Rosstat, Bank of Russia calculations.

CONSUMER GOODS *Chart 3.3.6*



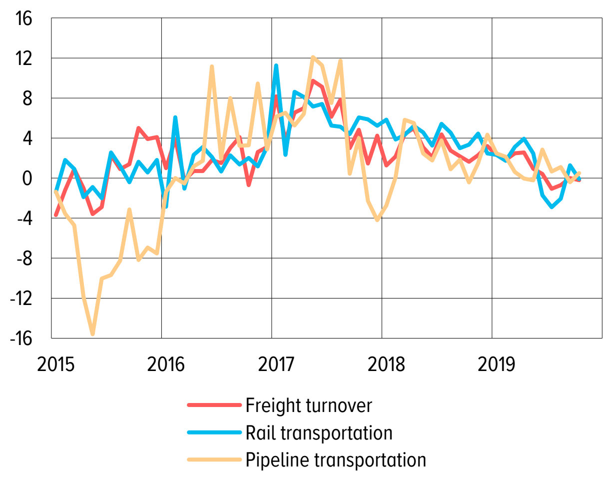
Sources: Rosstat, Bank of Russia calculations.

COMPANIES' ESTIMATES OF DEMAND FOR THEIR PRODUCTS (SA) *Chart 3.3.7*



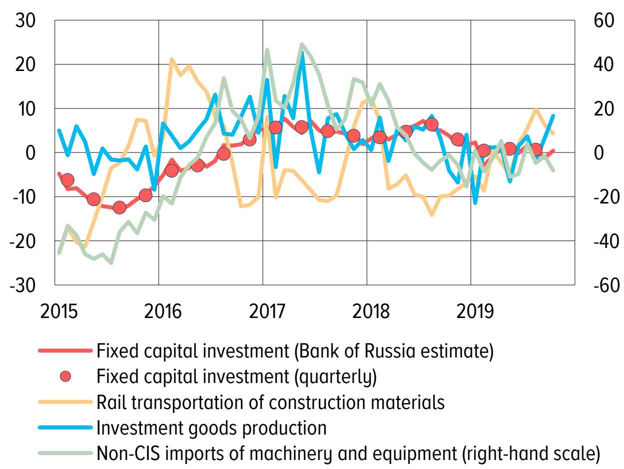
Source: IHS Markit.

FREIGHT TURNOVER *Chart 3.3.8*
(% growth on the same month of the previous year)



Source: Rosstat.

INVESTMENT ACTIVITY INDICATORS *Chart 3.3.9*
(% growth on the same period of the previous year)



Sources: Rosstat, FCS, Bank of Russia calculations.

be caused by a slowdown in the global economy. In this situation, businesses revised downwards their plans for finished-product output, hiring new staff and raw material procurement.

The findings of other surveys in August–November were more positive. The IHS Markit PMI in the services sector in the period was above 50. Rosstat's business confidence indices (SA) in August–November approached the average level of May–July 2019. Companies noted insufficient demand for their products in the domestic market, high taxes and economic uncertainties among the factors limiting production growth.

Transport. In 2019 Q3, freight turnover in annual terms fell by 0.6% (in Q2, 1.3%) (Chart 3.3.8). After a significant drop in July, the decline in freight turnover slowed in August–October. The dynamics of freight turnover were mainly due to weak growth of railway handling operations associated with the downward dynamics of world prices for a number of Russian export commodities (coal, ferrous metals) during almost all months of the year. At the same time, recovery in the exports of oil products after the Druzhba pipeline incident led to an increase in the turnover of pipeline transport.

Agriculture. The annual growth rate of agricultural output in 2019 Q3 increased to 5.1% (the highest since 2017 Q4) and was higher than expected by the Bank of Russia. MPR 3/19 assumed that the acceleration of agricultural output growth in July was largely driven by a one-off factor, i.e. a shift in harvesting timing. According to current expert estimates, the total 2019 output of various crops, including cereals, sunflower seeds, sugar beet and greenhouse vegetables, is expected to increase. The output of meat products (primarily, pork products) also continues to grow. In October 2019, the growth of agricultural output continued.

INVESTMENT ACTIVITY

In 2019 Q3, annual growth in fixed capital investment was at 0.8% (in 2019 Q2, 0.6%) (Chart 3.3.9).

The growth of fixed capital investment has slightly accelerated in part due to the dynamics of investment budget spending. That said, in Q3, the annual growth rate of capital spending of the budget system increased to 3.7% in nominal terms (in 2019 Q2, -4.5%). The positive contribution of public investment to the annual growth of fixed capital investment in 2019 Q3 amounted to 0.3 pp (Chart 3.3.10). At the same time, private sector investment was declining. Investment activity of enterprises was constrained by both general macroeconomic uncertainty and a continuing slowdown in consumer demand growth. Fixed capital investment of the private sector (SA) returned to the level of the beginning of 2018 (Chart 3.3.11).

At the same time, infrastructure investment growth continued in 2019 Q3. 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 investment to the annual growth of fixed capital investment amounted to 0.7 pp in 2019 Q3 (Chart 3.3.10).

Investment activity indicators showed diverse dynamics in October. On the one hand, contraction in investment imports continued, and growth of construction material transportation slowed (Chart 3.3.9). On the other hand, the output of investment goods maintained its upward trend. In these circumstances, according to estimates, the growth rate of fixed capital investment in October remained low.

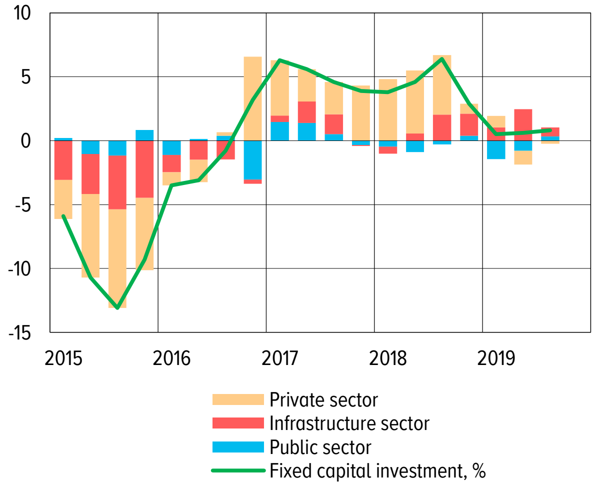
According to Federal Treasury data, budget expenditure accelerated in October 2019, which was in part due to the implementation of national projects. Under these conditions, accelerated growth in investment activity is expected in 2019 Q4. Gross fixed capital formation is to increase by estimated 2.0–2.5% over the year.

CONSUMPTION AND SAVINGS

Final consumption expenditure of households. In 2019 Q2, the growth of household final consumption expenditure accelerated markedly (2.8% after 1.6% in annual terms in Q1), exceeding the estimates of the Bank of Russia.[6] However, this acceleration may

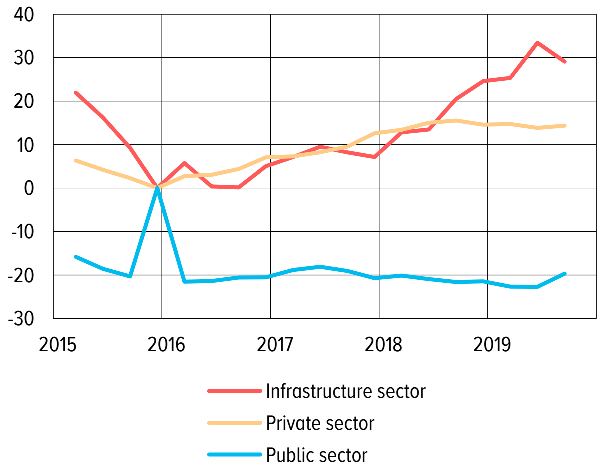
[6] In MPR 3/19, the annual growth rate of the indicator in 2019 Q2 was estimated at 1.5–2.0%.

FIXED CAPITAL INVESTMENT *Chart 3.3.10*
(contribution to annual growth, pp)



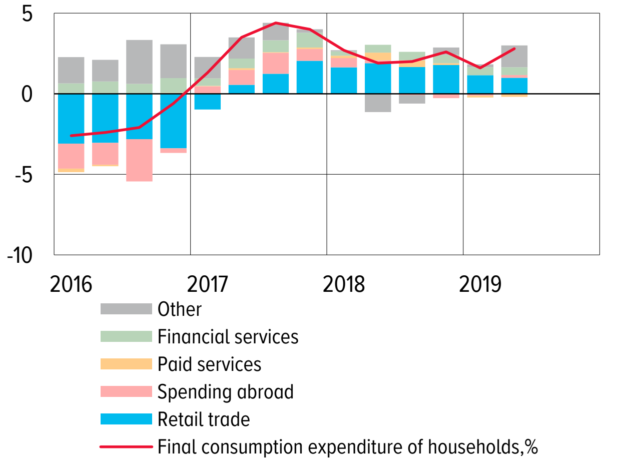
Sources: Rosstat, Bank of Russia calculations.

FIXED CAPITAL INVESTMENT *Chart 3.3.11*
(% growth on 2015 Q4, SA)



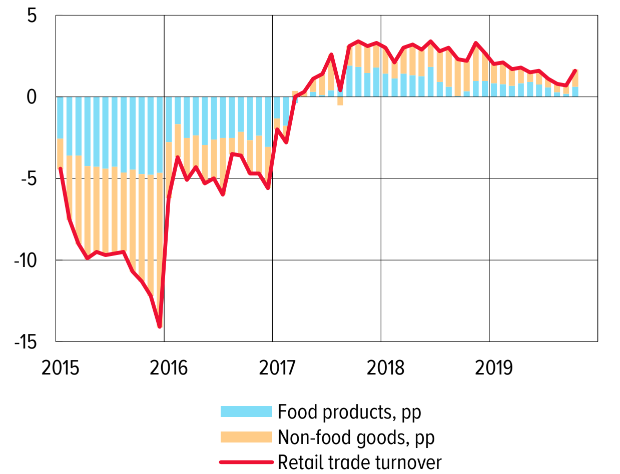
Sources: Rosstat, Bank of Russia calculations.

FINAL CONSUMPTION EXPENDITURE OF HOUSEHOLDS
(contribution to annual growth, pp)
Chart 3.3.12



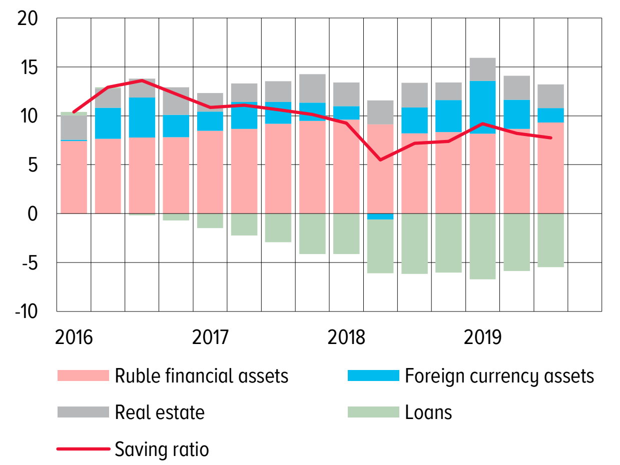
Sources: Rosstat, Bank of Russia calculations.

RETAIL TURNOVER
(% growth on the same month of the previous year)
Chart 3.3.13



Sources: Rosstat, Bank of Russia calculations.

SAVING RATIO
(as per cent of household disposable income, SA)
Chart 3.3.14



Sources: Rosstat, Bank of Russia calculations.

be temporary. This is evidenced by moderate growth of the key consumer demand indicators: retail trade turnover, the value of paid services and financial sector services, and the spending of the population abroad and in foreign online stores (Chart 3.3.12). Under these conditions, the annual growth rate of household final consumption expenditure is expected to slow down to 2.0–2.5% in 2019 Q3.

Retail trade turnover. The growth of consumer demand remained subdued in August–September. Annual growth in retail trade turnover was 0.7–0.8%, the lowest value since September 2017 (Chart 3.3.13). In October, growth accelerated to 1.6%[7] due to the low base of the previous year and, to some extent, deferred effect of income growth (see Subsection 'Labour market and incomes').

In general, consumer demand was formed under the influence of mixed factors. On the one hand, household incomes grew. On the other hand, households followed a savings behaviour model (see Subsection 'Savings ratio'), which limited the expansion of consumer demand.

Consumer sentiment. In the context of rising household money income and slowing price growth, consumer sentiment generally improved in Q3. Rosstat's Consumer Confidence Index continued to grow. Respondents noted positive changes both in their personal financial standing and in the overall economic situation in Russia. The results of the inFOM survey commissioned by the Bank of Russia[8] also suggest an improvement in consumer sentiment. In November, the consumer sentiment index reached its highest level since June 2018. Among its components, the assessment of the country's development prospects in the coming year and changes in the current financial standing improved, as did the attitude of respondents toward large purchases.

Savings ratio. The expansion of consumer demand was restrained mainly by the fact that households adhered to the savings behaviour model. In September, the growth of consumer lending slowed down, while the inflow of

[7] *On 18 December 2019, Rosstat revised the annual growth rate of retail trade turnover in October 2019 to 1.7%.*

[8] *Analytical report on the eleventh survey Measuring Inflation Expectations and Consumer Sentiment based on Population Surveys (November 2019).*

household deposits remained stable.[9] In these conditions, the savings ratio in 2019 Q3 was above the level recorded in the same period of the previous year (Chart 3.3.14).

LABOUR MARKET AND INCOMES

Unemployment rate. In August–October 2019, there was a slight increase in the unemployment rate (to 4.6–4.7% SA) (Chart 3.3.15) amid a faster reduction in the employed population compared to the unemployed. In this context, the workforce in general continued to decrease. In 2019, labour resources may decrease by an estimated 1–1.5%, which may constrain the growth of economic activity.

The decline in labour demand was noted by manufacturing companies surveyed by IHS Markit (PMI Employment). However, the survey shows that the employment rate has stopped going down in the services sector and the economy in general.

Wages. In August–September, the growth of labour compensations continued. The annual growth rate of nominal wages in August–September 2019 was on average close to the values of May–July (Chart 3.3.16). The dynamics of annual wage growth in the public sector was negatively affected by the base effect: in August 2018, there was an increase in the wages of social and cultural workers under the May Decrees of the President of Russia.

With annual inflation falling, real wages increased. In Q3, they went up 3%, corresponding to the forecast of the Bank of Russia.[10] The growth of the indicator in 2019 is estimated at 2.5–3.0%.

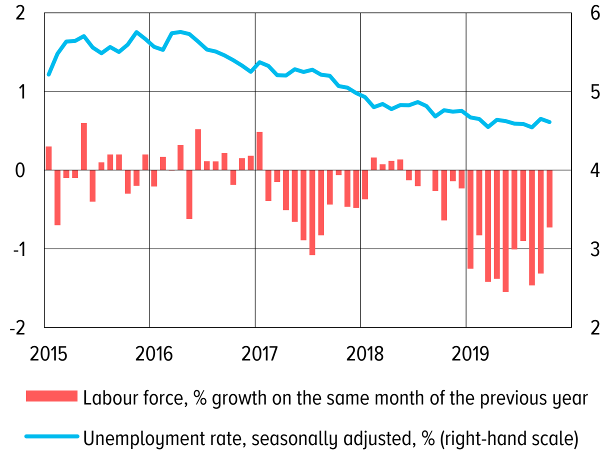
Household incomes. In 2019 Q3, real household disposable money income increased by 3.0%[11] YoY, the greatest increase since 2014 (Chart 3.3.17). This was mainly in response to a marked acceleration in the growth of wages of employees, including those employed by

[9] *Information and analytical material Russian Banking Sector Developments in January–September 2019.*

[10] *In MPR 3/19, the expected growth rate was at 3–3.5%.*

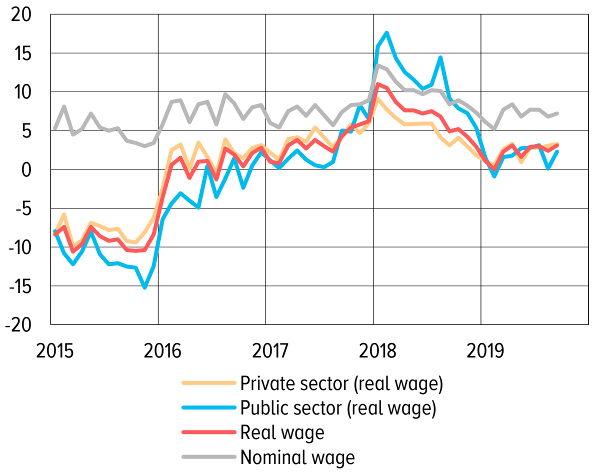
[11] *On 19 December 2019, Rosstat revised the quarterly dynamics of real disposable household income for 2018–2019. According to the updated data, in 2019 Q3, the annual growth rate was 3.3%.*

UNEMPLOYMENT RATE AND LABOUR FORCE *Chart 3.3.15*



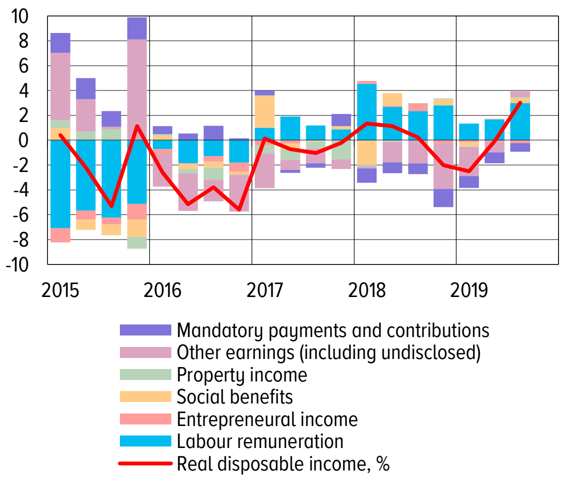
** For comparability purposes, the statistics on annual labour force growth in 2015 are given excluding the Republic of Crimea and Sevastopol.*
Sources: Rosstat, Bank of Russia calculations.

WAGE *Chart 3.3.16*
(% growth on the same month of the previous year)



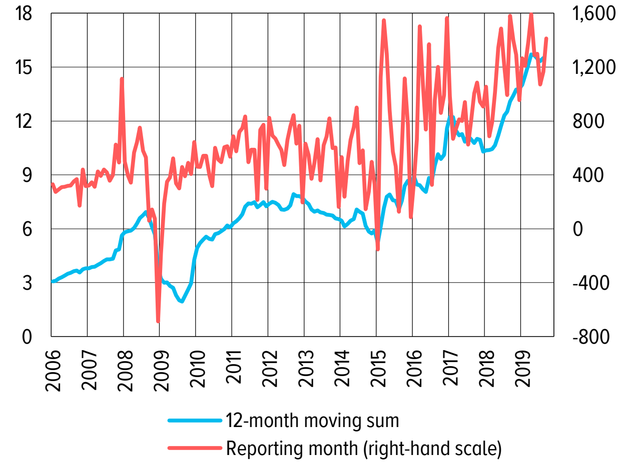
Sources: Rosstat, Bank of Russia calculations.

REAL HOUSEHOLD DISPOSABLE MONEY INCOME *Chart 3.3.17*
(contribution to annual growth, pp)



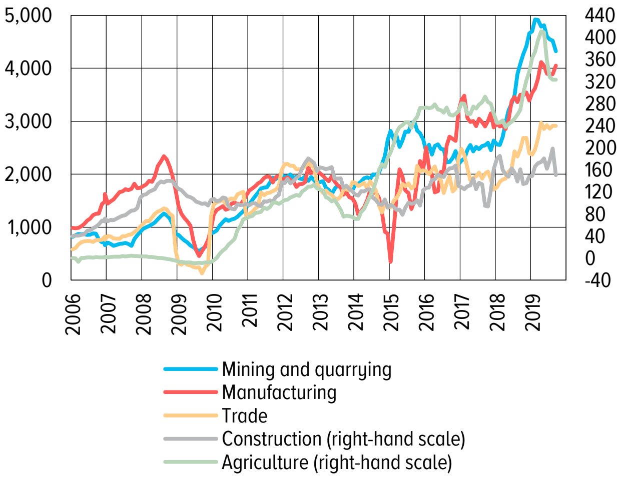
Sources: Rosstat, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX, NET OF LOSSES *Chart 3.3.18*
(trillions of rubles / billions of rubles)



Sources: Rosstat, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX BY INDUSTRY, NET OF LOSSES *Chart 3.3.19*
(12-month moving sum, billions of rubles)



Sources: Rosstat, Bank of Russia calculations.

individual entrepreneurs, as well as other cash receipts (including hidden income).

FINANCIAL STANDING OF ENTERPRISES

Financial result. According to Rosstat's latest updates, the net financial result of large- and medium-sized enterprises for a moving year remains at a 12-year high. The peak financial result for a moving year was achieved in April and amounted to ₽15.7 trillion. In May–July, it declined, reflecting a slower increase in financial result in all major sectors—that is, manufacturing, mining and quarrying, trade and agriculture.[12] These dynamics resulted from weaker demand, both domestic and foreign, as well as lower oil production in connection with the OPEC agreement and the Druzhba pipeline issues. In addition, the price downturn for the main export commodities and exchange rate dynamics played a role (Chart 3.3.18). In August, the financial result grew slightly again but in September it returned to the level of July, ₽15.3 trillion.

The growth rate of the net financial result for January–September 2019 compared to the same period last year was 11.6%. That said, the growth in trade amounted to 35.2%, in construction it amounted to 22.7%, in manufacturing it amounted to 18.7%, while in mining and quarrying and in agriculture the financial result dropped by 15.3% and 12.1% respectively (Chart 3.3.19).

In trade, the growth was mainly supported by the 'Wholesale trade in solid, liquid and gaseous fuels and similar products' sector (1.4-fold growth). The downward dynamics of the 'Production of crude oil and natural gas' segment (a drop of 21.4%) determined the result in the mining and quarrying sector.

In manufacturing, the dynamics were largely shaped by the 'Production of chemicals and chemical products' sector (2.4-fold growth), where the largest increase in the financial result was shown by fertilisers and nitrogen compounds (19.8-fold growth), which is most likely a one-off factor. In addition, the 'Production of major precious metals and other non-ferrous metals,

[12] *Hereinafter, agriculture refers to section A 'Agriculture, forestry, hunting, fishing, fish farming' of the OKVED-2 (Russian National Classifier of Economic Activities).*

production of nuclear fuel' sector posted a noticeable growth (2.1-fold growth).

In agriculture, the prevailing dynamics can be attributed to the 'Crops, livestock, hunting and related services' sector, which fell by 31%.

The total loss of enterprises for January–September 2019 amounted to ₽1.5 trillion, dropping by 17.4% YoY. The sectoral distribution of loss-making companies has changed. While in January–September 2018, the annual increase in losses was observed in almost all sectors, in January–September 2019, the main increase in losses was registered in agriculture (2.5 times), transportation and storage (1.2 times) and construction (1.4 times).

The structure of the sectoral contribution to the net financial result has not changed for several years: on average for 2015–2018, the contribution of the mining and quarrying is approximately 28%; manufacturing, 27%; trade, 16%; transportation and storage, 9%; agriculture, 3%; and construction, 1%.

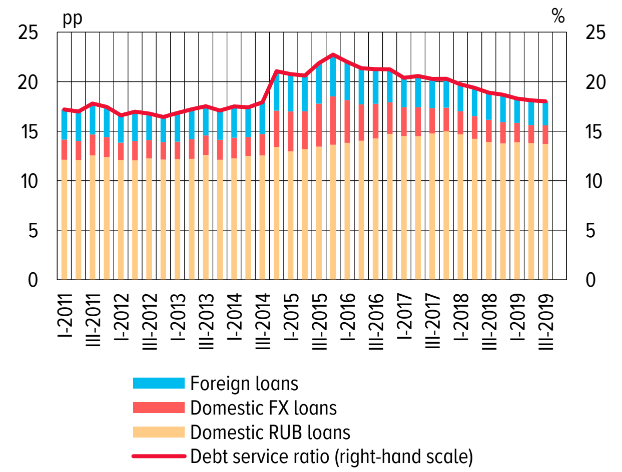
Debt. The volume of claims of the banking sector on legal entities,[13] including financial institutions, in rubles and foreign currency grew in 2019 Q3 by 1.9% (after 0.2% growth in the previous quarter). The acceleration of the growth rate was supported by the dynamics of ruble claims, which showed an increase of 1.6% in July–September 2019 (in 2019 Q2, 1.4%), which can be attributed to the growth of demand for loans. Foreign currency claims grew by 3.4% in ruble terms during the same period (after a 5.9% drop in the previous quarter). The growth of the banking system's claims on the economy in 2019 Q3 amounted to 6.2% year-on-year (in 2018 Q3, 8.0%). The debt burden remained virtually unchanged (Charts 3.3.20 and 3.3.21) amid comparable quarterly growth rates of incomes (moving annual nominal GDP).

3.4. PUBLIC FINANCES

In the middle of 2019 Q3, the nature of the fiscal policy changed from restraining to accommodative. In August–October, federal budget expenditure on national projects

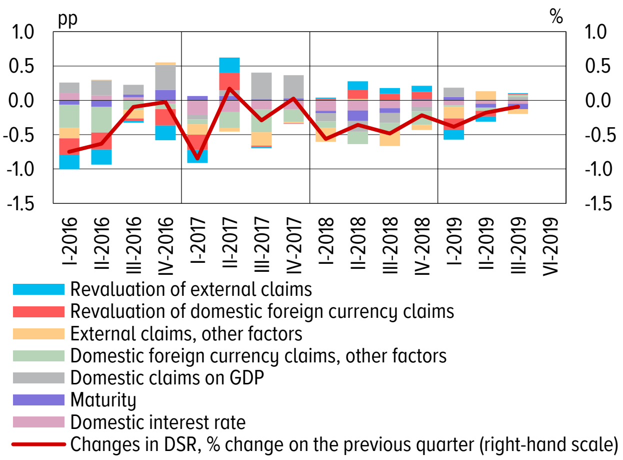
[13] *Includes loans and borrowings, debt securities and other claims.*

NON-FINANCIAL CORPORATIONS TOTAL DEBT BURDEN *Chart 3.3.20*
(debt service ratio and its components, % of GDP)



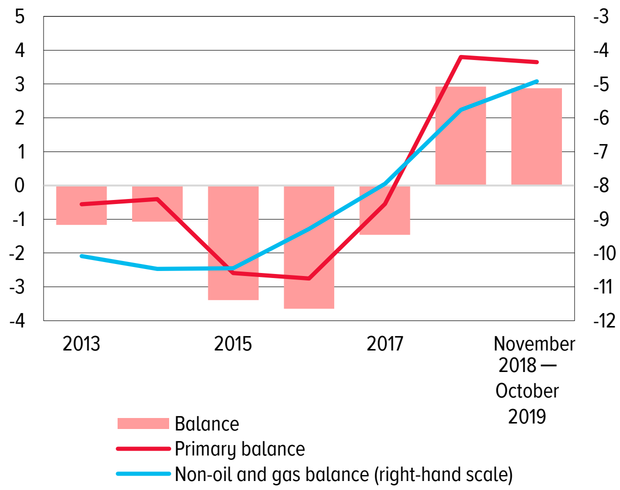
Source: Bank of Russia calculations.

DECOMPOSITION OF CORPORATE DEBT BURDEN DYNAMICS *Chart 3.3.21*
(debt service ratio (DSR) and contributions of its components, % of GDP)



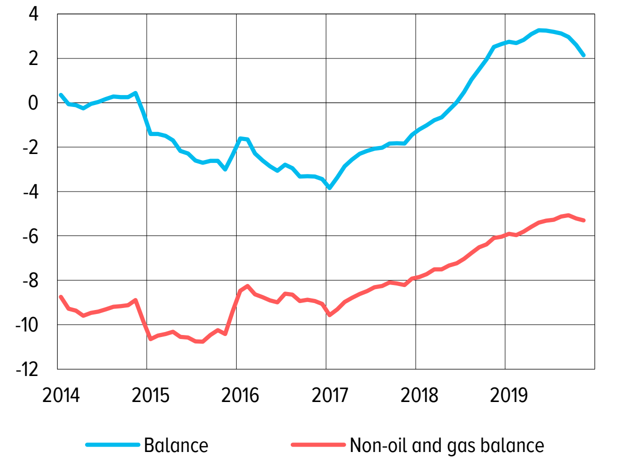
Source: Bank of Russia calculations.

BUDGET SYSTEM BALANCE *Chart 3.4.1*
(% of GDP)



Sources: Federal Treasury, Bank of Russia calculations.

FEDERAL BUDGET BALANCE *Chart 3.4.2*
(12-month moving sum, % GDP)



Sources: Federal Treasury, Bank of Russia calculations.

BUDGET SYSTEM PARAMETERS *Table 3.4.1*
(12-month moving sum, % GDP)

	2017	2018	Oct 2019	Nov* 2019
General government				
Revenue	33.7	35.9	36.3	
Spending	35.2	33.0	33.4	
Balance	-1.5	2.9	2.9	
Central government				
Revenue	16.4	18.7	18.7	18.4
Oil and gas revenue	6.5	8.7	7.8	7.4
Extra oil and gas revenue (excess revenue)	0.9	4.1	3.2	2.8
Non-oil and gas revenue	9.9	10.0	10.9	10.9
Spending	17.8	16.1	16.1	16.2
Balance	-1.4	2.6	2.6	2.1

** Preliminary estimate for budget execution in January-November 2019.*
Sources: Federal Treasury, Bank of Russia calculations.

accelerated. In October, there was an increase in investment spending and labour costs, including regional budget expenditure.

Macroeconomic effects of fiscal policy. In September–November, the fiscal momentum stayed in positive territory. The growth of the general government's accumulated investment spending[14] since the beginning of the year accelerated significantly in October 2019 and amounted to 14.4% in annual terms (after 3.7% in September and -0.8% in August). Due to the September–October indexation of wages in the public sector, the growth of accumulated budget spending on wages since the beginning of the year accelerated, amounting to 4.6% at the end of October (after 4.2% in September and 3.9% in August). In December 2019, fiscal policy will continue to stimulate economic activity. In 2020, the fiscal momentum will stay in positive territory.

Federal budget. The preliminary assessment of federal budget execution in November 2019[15] suggests that the nature of the fiscal policy has remained accommodative since September. In November, the non-oil and gas deficit for the moving year widened to 5.3% of GDP (in October, 5.2% of GDP, Chart 3.4.2). The federal budget surplus for the moving year at the end of November 2019 was at 2.1% of GDP (at the end of October 2019, 2.6% of GDP) (Table 3.4.1). The reduction in the surplus was due to slower revenue growth and faster execution of expenditure. In January–November, the annual growth of expenditure (+7.0%) was higher than the growth of revenue (+3.3%). The slower revenue dynamics were explained by falling oil and gas revenue (to -11.2% YoY because of lower oil prices) and a slowdown in non-oil and gas revenue (in particular, the growth of VAT receipts to 15.7% and profit tax receipts to 18.2%). The annual growth rate of expenditure for January–November 2019 was particularly noticeable in 'Education and healthcare' (+21.9%) and 'National economy' (+9.4%). The growth rate of non-interest expenditure was at 8.0%. The

[14] *Capital investment in government (municipal) property.*

[15] *Information of the Ministry of Finance of Russia www.minfin.ru/ru/press-center/?id_4=36898-informatsionnoe_soobshchenie.*

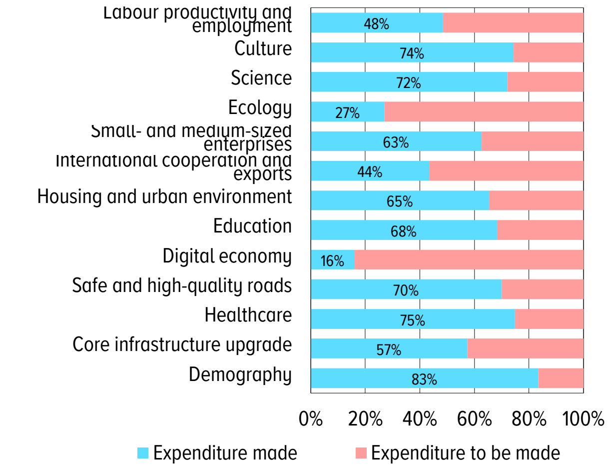
execution of expenditure on national projects also accelerated: in January–October, 65% of the annual plan was executed. In October, the federal budget allocated ₽232 billion for national projects, the highest figure for 2019. In the first 10 months of 2019, the highest execution percentage was demonstrated by the projects 'Demography' (83%), 'Healthcare' (75%) and 'Culture' (74%). The 'Digital Economy' (16%) and 'Ecology' (27%) projects had the lowest percentage of execution (Chart 3.4.3). The pace of the following infrastructure projects continued to increase: 'Safe and high-quality roads' and 'Comprehensive plan for core infrastructure upgrade' (at the end of October 2019, the execution of expenditures for each of them amounted to 70% and 57% respectively).

General government budget. According to the Federal Treasury,[16] in October 2019, the budget system surplus for moving year fell to 2.9% of GDP (Chart 3.4.1) (in September 2019, 3.3% GDP). It was driven by a reduction in the regional budget surplus, among other factors. In October, this figure continued to decline to 0.3% of GDP from the April high of 0.9% of GDP. In the first 10 months of 2019, the growth rate of the general budget expenditure accelerated to 7.9% in annual terms, surpassing the dynamics of revenue (7.1%). The slower growth of income tax receipts (to 13.5%) and personal income tax receipts (to 8.4%) led to a slowdown in the growth of non-oil and gas revenue (to 11.7%) in the first 10 months of 2019 (Chart 3.4.4). Acceleration of non-interest expenditure (+8.5% in October YoY) occurred both at the federal and regional levels.

Balances of funds in budget accounts with the banking system. Despite the observed acceleration of budget expenditure, budget balances in the banking system continued to increase (Chart 3.4.6). The amount of funds placed by the Federal Treasury with banks did not change significantly, while in anticipation of large budget expenditures at the end of the year the Federal Treasury gradually reduced the maturity of its operations (see Subsection 4.2).

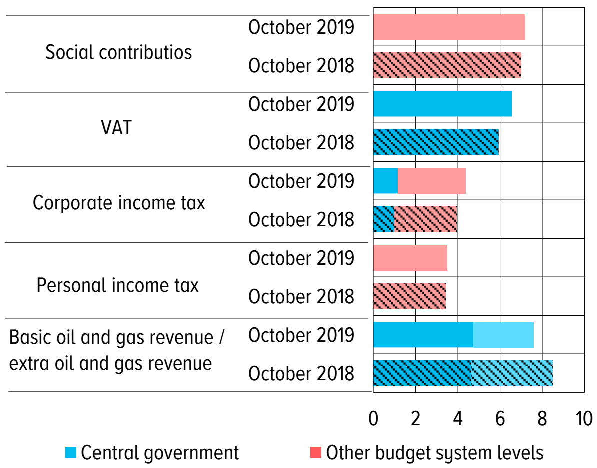
[16] *The monthly report of the Federal Treasury 'On execution of the consolidated budget of the Russian Federation and budgets of state extra-budgetary funds of the Russian Federation' as of 1 November 2019.*

FEDERAL BUDGET SPENDING ON NATIONAL PROJECTS IN JANUARY–OCTOBER 2019 *Chart 3.4.3*
(%)



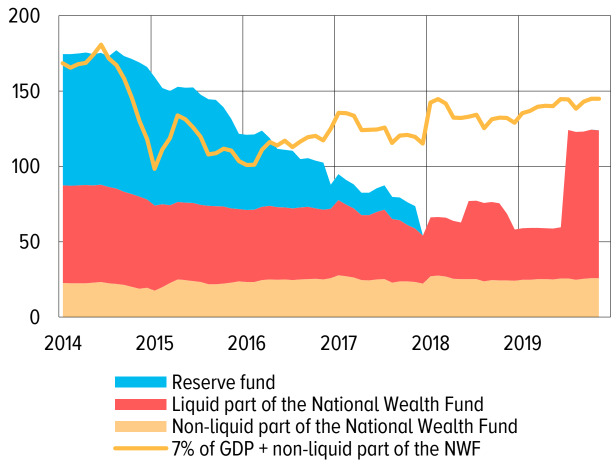
Sources: Federal Treasury, Ministry of Finance, Bank of Russia calculations.

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



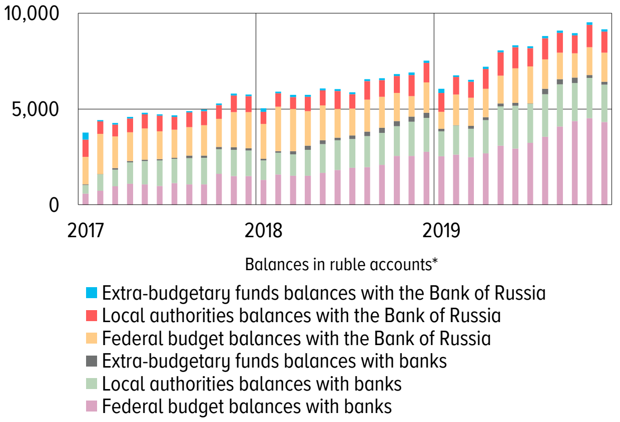
Sources: Federal Treasury, Ministry of Finance, Bank of Russia calculations.

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



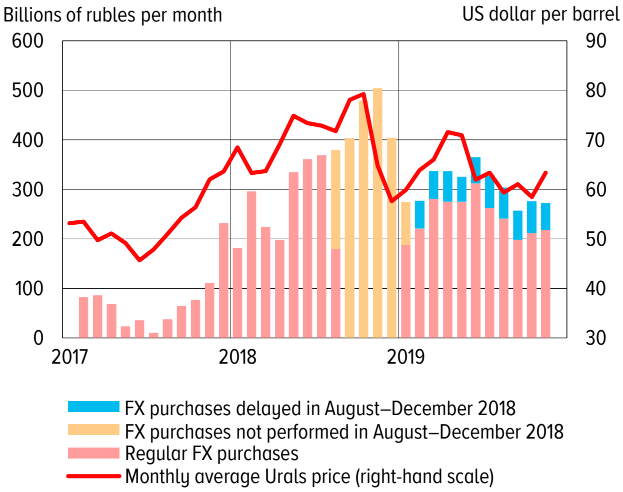
Sources: Ministry of Finance, Bank of Russia calculations.

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



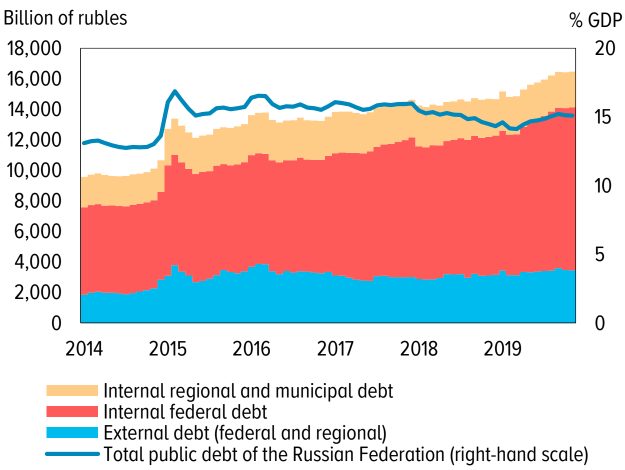
** According to banking reporting form 0409301 'Indicators characterising the performance of a credit institution' of the Bank of Russia's balance sheet.*
Source: Bank of Russia.

OPEN MARKET OPERATIONS TO REPLENISH THE NATIONAL WEALTH FUND *Chart 3.4.7*



Sources: Ministry of Finance, Bank of Russia.

PUBLIC DEBT OF THE RUSSIAN FEDERATION *Chart 3.4.8*



Source: Ministry of Finance.

National Wealth Fund. The volume of the National Wealth Fund as of 1 December 2019 totalled \$124.0 billion (7.3% of GDP), including the liquid part, \$98.1 billion (5.8% of GDP, Chart 3.4.5). As of 1 December 2019, the special foreign currency account of the federal budget accumulated \$42.9 billion (2.5% of GDP) received from the January–November fiscal rule-based purchases of foreign currency in the amount of extra oil and gas revenue of 2019 (Chart 3.4.7). The Bank of Russia estimates that at the end of 2019 the accumulated amount of foreign currency purchased under the fiscal rule will total \$46.1 billion (2.7% of GDP). After the transfer of this amount to the NWF (in mid-2020), the liquid part of the Fund will exceed the threshold of 7% of GDP, thus making it possible to invest NWF funds in other eligible financial assets in accordance with the Budget Code. Areas and mechanisms of investment are currently under development and discussion.

Public debt. According to the Ministry of Finance of Russia, the volume of the aggregate public and municipal debt of the Russian Federation continued to grow and amounted to 15.1% of GDP as of 1 November 2019, which is higher by 0.3 pp of GDP than at the end of the first half of 2019 and by 0.6 pp of GDP than a year ago (Chart 3.4.8). The aggregate public and municipal debt grew mainly due to the growth of domestic federal debt (by 5.3% compared to the end of the first half of the year and by 17.4% in annual terms). In contrast, the internal debt of the constituent territories and municipalities decreased (by 2.1% compared to the end of the first half of 2019 and by 5.6% in annual terms).

In 2019 Q3, OFZ placement was less active than in the first half of 2019. The actual placement of OFZs in 2019 Q3 amounted to ₽302 billion. In January–November 2019, OFZ placements by the Ministry of Finance of Russia were worth ₽1.96 trillion (94% of the updated annual plan of the Ministry of Finance[17]). In 2019 Q4, the Ministry of Finance planned placement worth ₽420 billion. Taking into account OFZ placements worth ₽295 billion in October–November, the plan for December is ₽125 billion.

[17] Federal Law No. 459-FZ, dated 29 November 2018, 'On the Federal Budget for 2019 and the Plan Period of 2020 and 2021' (as amended on 2 December 2019).

4. BANK OF RUSSIA'S MONETARY POLICY

4.1. KEY RATE DECISIONS

Key rate decisions. On 25 October and 13 December, the Bank of Russia Board of Directors decided to reduce the key rate by 75 bps in total to 6.25% p.a.

Since the Board of Directors meeting on 6 September, annual inflation has slowed faster than expected. According to Bank of Russia estimates, inflation indicators reflecting the most sustainable price dynamics in this period were close to or below 4%. Against the backdrop of slowing annual inflation, household inflation expectations decreased, although they remained at an elevated level. Business price expectations remained unchanged overall. However, according to Bank of Russia estimates, disinflationary risks outweighed proinflationary ones over the short-term horizon, primarily due to the dynamics of domestic and external demand. In these circumstances, in line with the monetary policy pursued, in October the Bank of Russia lowered its annual inflation forecast for 2019 to 3.2–3.7% and for 2020 to 3.5–4.0%. In December, the annual inflation forecast for 2019 was lowered to 2.9–3.2%.

At the same time, since September, when making its key rate decisions, the Bank of Russia has taken into account possible proinflationary risks associated with trends in the food market, as well as the impact on inflation of the monetary policy easing in 2019.

In October-November, monetary conditions continued to ease, which was in part facilitated by the Board of Directors' decisions to reduce the key rate in September and October, as well as by signals with regard to the future monetary policy stance. OFZ yields, as well as deposit and loan interest rates, declined.

The growth rate of the Russian economy since the September meeting of the Board of Directors has increased, and Q3–Q4 demonstrated a slight improvement in the dynamics of domestic demand. The fiscal policy started supporting economic growth in the second half of 2019. This was associated with, among other factors, the implementation of the national projects planned by the Government. At the same time, the decline in external demand for Russian export commodities in the context of slowing global economy continued to restrain economic activity. In these circumstances, in October and December, the Bank of Russia kept the forecast of GDP growth for 2019-2022 generally unchanged.

Monetary policy over a medium-term horizon. Taking into account the decisions adopted in October and December, the key rate is within 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%). If the situation develops in line with the baseline forecast, the Bank of Russia will consider the necessity of further key rate reduction in the first half of 2020. The Bank of Russia will make key rate decisions taking into account the actual and expected dynamics of inflation with respect to the target, economic development over the forecast horizon, and assessing risks from the domestic and external environment, as well as the response of the financial markets to them.

Throughout the forecast horizon, the Bank of Russia will pursue monetary policy in such a way as to ensure inflation stabilisation close to 4%.

The effect of the key rate decisions on expectations. Since the publication of MPR 3/19, market expectations for the key rate have mainly adjusted downward. After the September meeting of the Board of Directors, analysts and financial market participants mostly expected a further smooth reduction in the key rate in late 2019–early 2020: to 6.75% p.a. in December 2019 and 6.50% p.a. in March 2020 (according to the consensus forecasts of analysts). At the same time, closer to the October meeting of the Board of Directors, the Bank of Russia admitted the possibility of a more significant reduction of the key rate in the context of a faster slowdown in annual inflation than predicted in MPR 3/19. After that, a significant share of financial market participants began to expect a reduction in the key rate to 6.50% in October 2019.

Following the October meeting of the Board of Directors where the key rate was reduced to 6.50% p.a., the Bank of Russia still signalled that it would assess the feasibility of further reduction of the key rate, and pointed to the prevalence of disinflationary risks over proinflationary ones over the short-term horizon. As a result, key rate expectations of financial market participants continued to gradually adjust downwards. For example, in late October–November, most analysts expected a reduction in the key rate to 6.25% p.a. by the end of 2019 and 6.00% p.a. by March 2020. These expectations strengthened as new data on inflation and economic activity were released. 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).

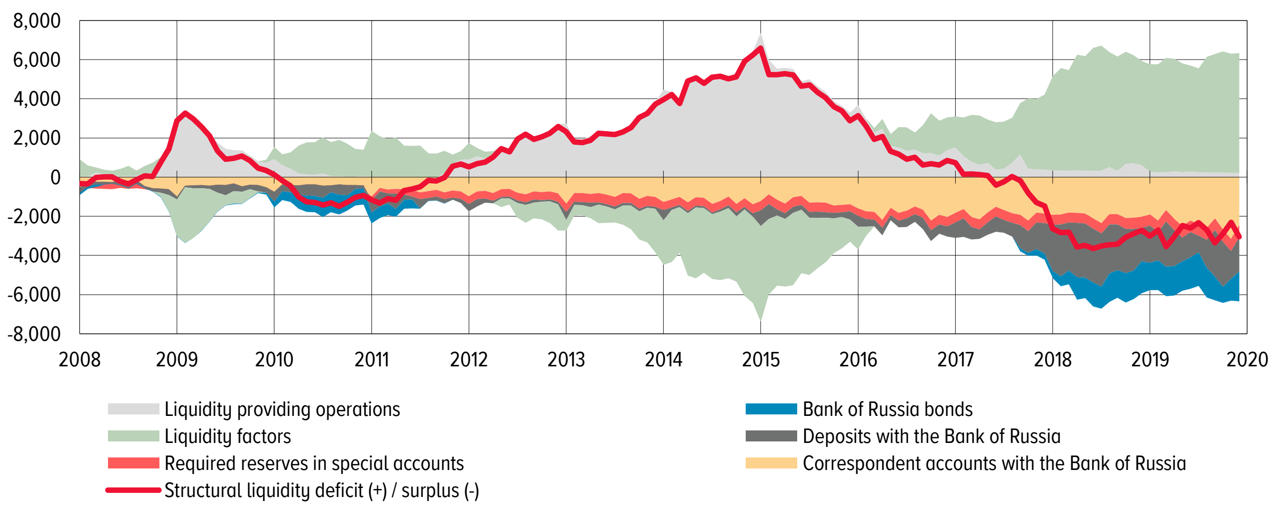
4.2. THE SYSTEM OF MONETARY POLICY INSTRUMENTS AND OTHER MONETARY POLICY MEASURES

Banking sector liquidity. The structural liquidity surplus increased in September-November 2019 from ₽2.6 trillion to ₽3.0 trillion (Chart 4.2.1, Table 4.2.1). The inflow of liquidity to banks was facilitated by the placement of budgetary funds in September to the accounts of individual credit institutions and the seasonal increase in budget expenditure in November. Further placement of OFZ by the Ministry of Finance of Russia and payment of large sums of taxes by banks' clients somewhat compensated the formed inflows of liquidity.

In general, September-October saw a moderate liquidity outflow through the budget channel due to large quarterly tax payments that were not fully offset by a rise in budget expenditure and budgetary fund balances with banks. In November, the impact of the budget factor was close to neutral. The expansion in budget expenditure and large tax repayments

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

Chart 4.2.1



Source: Bank of Russia calculations.

STRUCTURAL LIQUIDITY SURPLUS AND LIQUIDITY FACTORS
(trillions of rubles)

Table 4.2.1

	September 2019	October 2019	November 2019
1. Liquidity factors	**0.1**	**-0.1**	**0.0**
– change in the balances of general government accounts with the Bank of Russia, and other operations*	0.1	-0.2	0.0
– change in cash in circulation	0.0	0.1	0.0
– 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)	**0.6**	**0.5**	**-0.7**
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	**-0.5**	**-0.6**	**0.7**
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)	**-2.9**	**-2.3**	**-3.0**

** 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.

to certain companies were offset by a decline in banks' debt under Federal Treasury operations and tax payments by banks' clients, which slightly decreased amid the oil price downturn. In September-November, the volume of cash in circulation did not change significantly, which is generally consistent with the dynamics of similar periods of the previous years.

The Bank of Russia has resumed a gradual increase in the volume of coupon bonds (coupon OBRs) placements in order to absorb a stable part of the structural surplus of the banking sector liquidity. In September-November, banks stepped up their investment in coupon OBRs by ₽300 billion. The limits on weekly deposit auctions of the Bank of Russia were reduced accordingly.

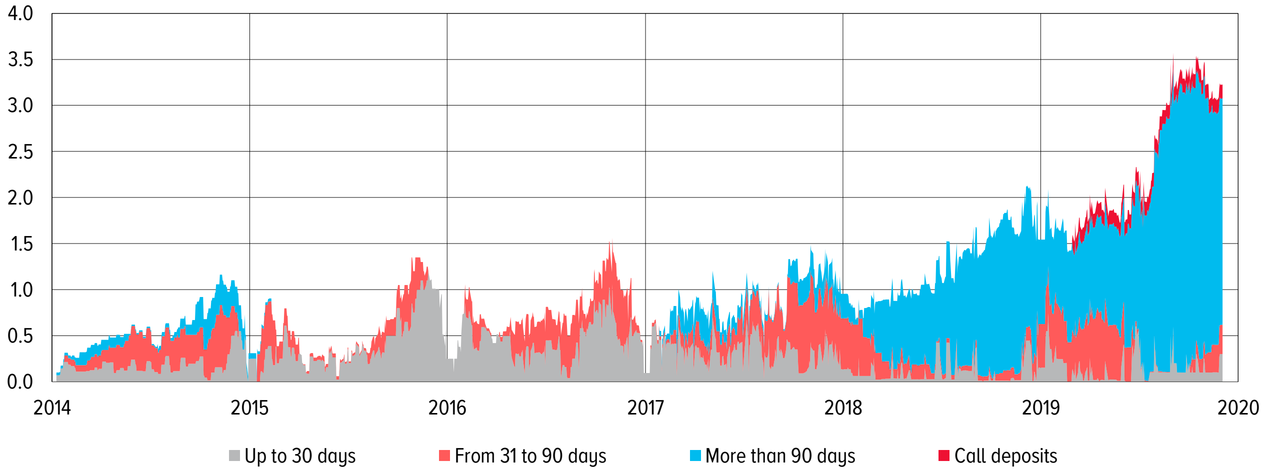
The structural liquidity surplus at the end of 2019 is forecast at ₽3.6-3.9 trillion. Compared to the previous release of the report, this revision was associated with the placement of budgetary funds in accounts of individual credit institutions. Volatility and the ensuing uncertainty with regard to the dynamics of autonomous liquidity factors are traditionally expected to rise in December. The Bank of Russia forecast factors in the current plans of the Russian Ministry of Finance to finance budget expenditure. Moreover, one of the forecast assumptions is the implication of an even required reserves averaging by banks. It means that end-year balances of funds in banks' correspondent accounts with the Bank of Russia are expected to be close to ₽2.3-2.4 trillion.

In 2020-2021, as before, certain growth of the surplus related to the further execution of postponed in 2018 foreign currency purchases in the domestic market under the fiscal rule is expected.

Federal Treasury operations for the administration of temporarily available budgetary funds. In September-November 2019, the debt of credit institutions under long-term operations of the Federal Treasury stopped its growth (Chart 4.2.2). At the same time, the Federal Treasury proposed to place part of the budgetary funds for shorter terms with maturity in 2019. For example, during the period under review, banks' debt on more than 90-day operations decreased by ₽0.4 trillion, and on 31 to 90- day operations, by contrast, increased by ₽0.3 trillion. As of mid-December (16.12.2019), the debt of credit institutions under Federal Treasury operations to be repaid in 2020 is ₽1.5 trillion (as of the end of 2018, banks' debt was ₽1.5 trillion). Should part of the 2019 planned budget expenditure be transferred to 2020, the Federal Treasury will be able to expand the volume of funds to be deposited with banks.

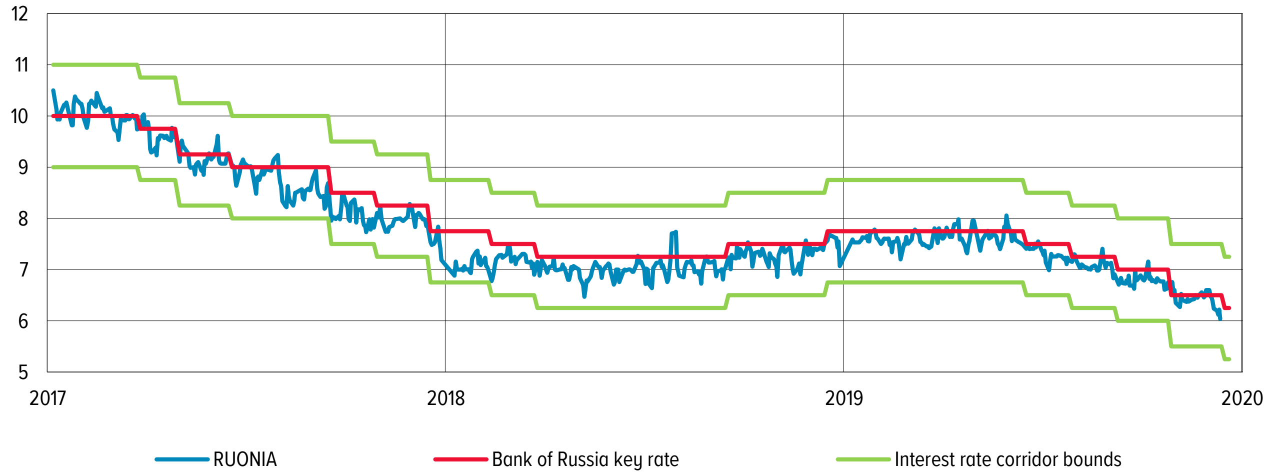
The outflow of liquidity from banks in October was facilitated by their return of deposits of the Social Insurance Fund of the Russian Federation. Later, the mandate of the Social Insurance Fund for placing a reserve of funds

BANKS' OUTSTANDING AMOUNTS ON FEDERAL TREASURY DEPOSITS, REPOS AND SWAPS *Chart 4.2.2*
(trillions of rubles)



Sources: Federal Treasury, Bank of Russia calculations.

RUONIA AND BANK OF RUSSIA INTEREST RATE CORRIDOR *Chart 4.2.3*
(% p.a.)



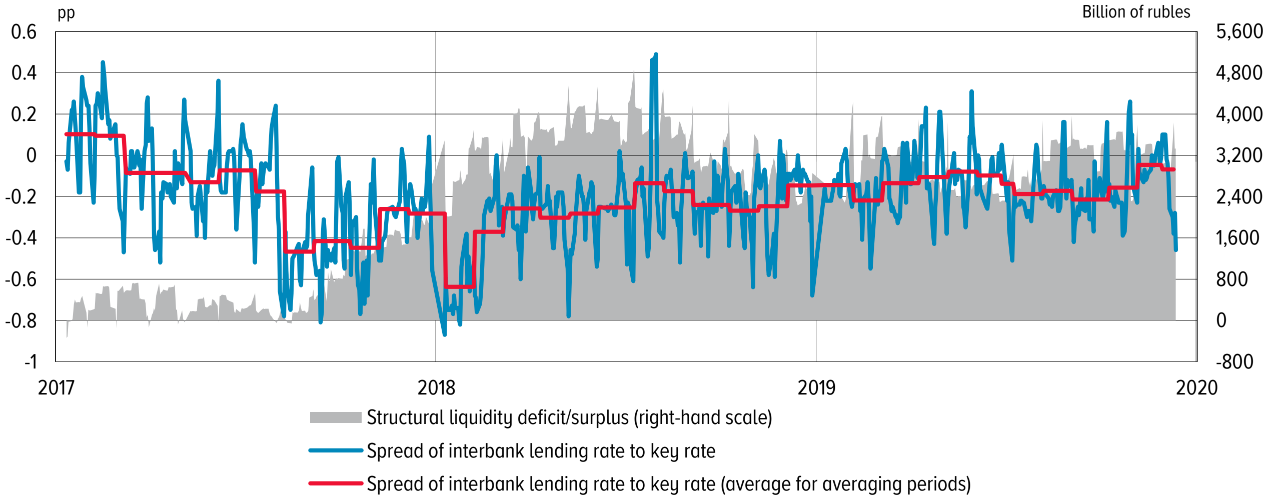
Source: Bank of Russia.

for the implementation of compulsory social insurance against industrial accidents and occupational diseases was transferred to the Federal Treasury. This means that in addition to temporarily free funds of the federal budget, the Federal Treasury will be able to place the funds of the Social Insurance Fund in credit institutions. In general, these organisational changes will not have a significant impact on the banking sector liquidity.

Achieving the operational objective of the monetary policy. Short-term IBL rates in the money market stayed in the lower half of the interest rate corridor close to the Bank of Russia key rate (Chart 4.2.3). The average spread stood at -14 bp in September–early December (in Q3, -21 bp) and fluctuated in the range from -46 to 26 bp (in Q3, from -51 to 16 bp).

As in the previous quarter, the widening of the spread in some periods was due, among other things, to market participants' expectations of a key rate cut (Chart 4.2.4). As in June-July 2019, before the meetings of the Board of Directors of the Bank of Russia in September and October, expecting a reduction in the key rate, banks formed an increased supply of funds at deposit auctions of the Bank of Russia at the beginning of required reserves averaging periods. In this

STRUCTURAL LIQUIDITY SURPLUS AND MONEY MARKET RATES *Chart 4.2.4*



Source: Bank of Russia calculations.

context, those banks, which could not make placements at the deposit auctions due to the above, placed their funds in the interbank market, thereby exerting downward pressure on the rates. After the approval of the key rate decision, banks increased their correspondent account balances again, which slightly reduced the liquidity surplus in the second half of the averaging periods. This strategy has led to a temporary increase in the volatility of money market rates. In November, market interest rates again held close to the Bank of Russia key rate.

BOX

PRACTICE OF INFLATION TARGETING AND CONSUMER PRICE FLUCTUATIONS

Today, many central banks have adopted inflation targeting policies, using monetary policy to control inflation. That said, inflation may fluctuate, as it is formed within the economic system on the basis of a large number of factors. The very format of setting an inflation target often reflects its exposure to fluctuations. For example, a number of central banks targeting inflation, in addition to the target level, also set a range of permissible deviations. The range varies from ±1% (New Zealand, Canada, Czech Republic, Hungary, Poland, Chile, etc.) to ±3% (Uganda), due, among other things, to the sensitivity of inflation to various factors and the duration of the inflation targeting period. Changes in central banks' policy rates affect inflation with a certain lag. In this regard, a central bank makes a decision on the policy rate based on the forecast factoring in all the information available at the time. However, unexpected events that occur in the economy can have a significant impact on inflation and lead to its temporary deviation from the target. The task of the central bank in this case is to use monetary policy measures in order to return it to the target value. International experience shows that central banks that consistently employ inflation targeting policies successfully address this challenge. Further, we consider in more detail the most common factors that may cause inflation to deviate from the target and the measures taken by central banks using examples of different countries.

In commodity-importing countries, fluctuations in energy prices can have an impact on the costs of production of goods and services, and thus on the growth rate of consumer prices. Such changes were observed in many countries in 2015 after a sharp fall in oil prices, which increased the deflationary effect of the negative output gap opened after the global financial crisis (the US, the euro area,[1] Japan, the UK, Czech Republic, Poland, etc.). The strongest deviation of inflation from the target was observed in Poland, where the growth rate of consumer prices was negative even before the drop in oil prices. However, in Poland and in other above-mentioned countries, at the time of inflation deviation from the target the central banks had already applied stimulating monetary policy, including non-traditional measures (QE, CE, etc.). As a result, inflation has left negative territory in most countries (Charts 1–6).

Exchange rate fluctuations affect inflation through changes in the prices of imported goods. The higher is a share of these goods in the consumer basket and sensitivity of inflation expectations to fluctuations in the exchange rate, the greater is the influence of this factor. For example, the weakening of the national currency may lead to the significant deviation of inflation above the target value (Czech Republic and Iceland (2008); Mexico (2017), etc.). Inflation in Mexico was more severely affected by the considerable weakening of its national currency against the backdrop of trade controversies with the US (Chart 7). However, the timely tightening of the monetary policy helped to slow down inflation to the target value and created conditions for further policy rate cuts.

Changes to fiscal policy may cause inflation to deviate from the target. There is a high probability of accelerating inflation when stimulating fiscal policy leads to an excess of demand over supply. For example, inflation deviated from the target after fiscal policy was changed in Brazil in 2015-2016 (Chart 8). However, by the beginning of 2017, the Bank of Brazil managed to bring inflation back to the target by tightening the monetary policy and to significantly reduce the policy rate afterwards.

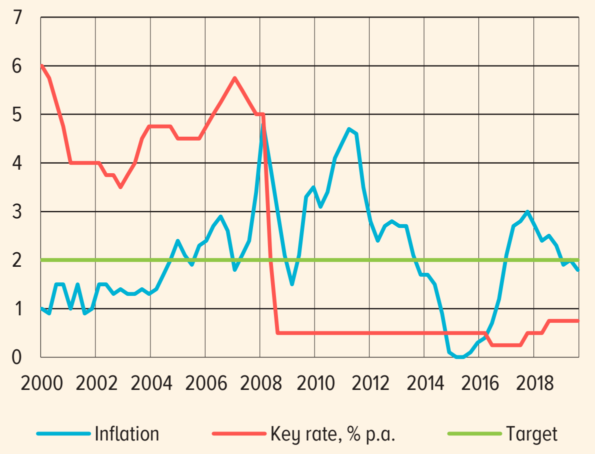
The volume of agricultural production also has a noticeable impact on inflation dynamics. For example, high harvests due to weather conditions and, as a consequence, high supply of agricultural products contribute to a price downturn for food products forming a significant part of the consumer basket. The slowdown in inflation in India in 2014 (Chart 9) and in South Korea in early 2019 (Chart 10) are examples of such situations. In South Korea, the high harvest increased deflationary pressures caused by a number of factors, primarily lower demand and slowing economic activity amid trade controversies. The Bank of Korea took action by

[1] *Officially, the ECB and the US Fed do not employ any inflation targeting policies, but the level of inflation is one of the key parameters of their monetary policies.*

cutting the rate by a combined 50 basis points. Taking into account the adopted decisions, the Bank of Korea expects that, as the influence of temporary factors, among other things, is exhausted, inflation will approach the target and will reach 1.6% by the end of 2020. Analysts' forecasts generally coincide with the forecast of central banks.

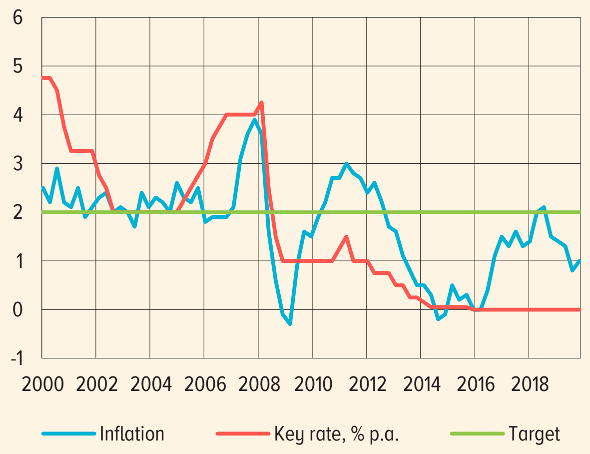
Thus, fluctuations in inflation can be caused by both external and domestic factors. As a rule, in case of deviation of inflation, central banks use monetary policy measures to bring it back to the target. Depending on the nature of the factors and the scale of their impact, the return of inflation to the target can take from 4 to 8 quarters, and sometimes even longer.

INFLATION IN THE UK *Chart 1*
(% growth on the same month of the previous year)



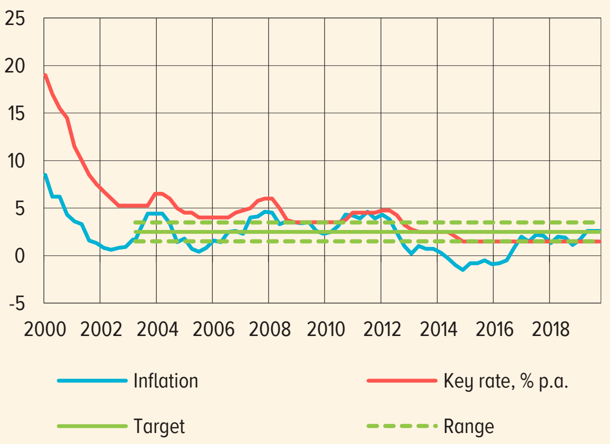
Source: Bloomberg.

INFLATION IN THE EURO AREA *Chart 2*
(% growth on the same month of the previous year)



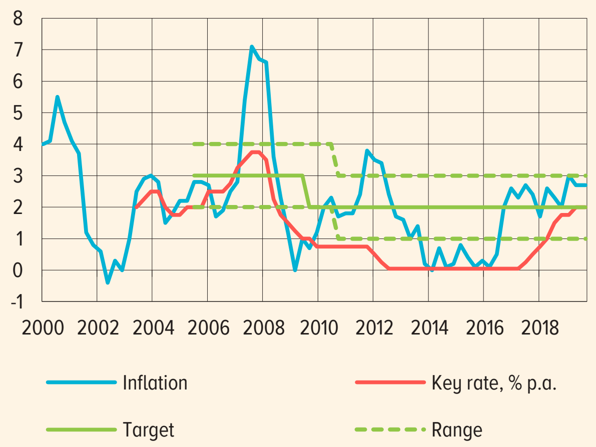
Source: Bloomberg.

INFLATION IN POLAND *Chart 3*
(% growth on the same month of the previous year)



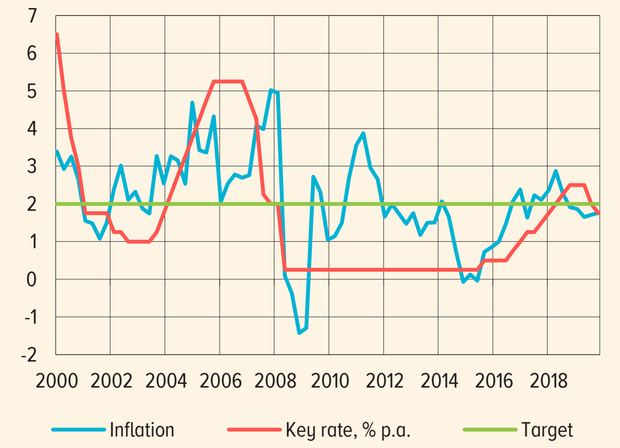
Source: Bloomberg.

INFLATION IN THE CZECH REPUBLIC *Chart 4*
(% growth on the same month of the previous year)



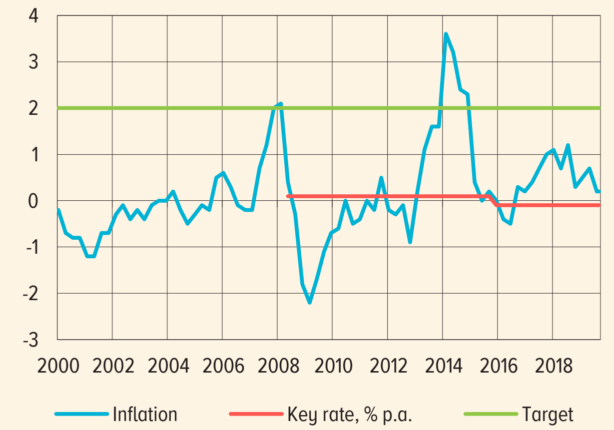
Source: Bloomberg.

INFLATION IN THE USA *Chart 5*
(% growth on the same month of the previous year)



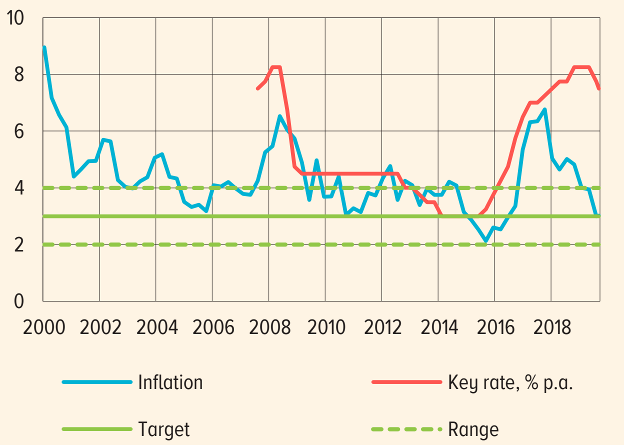
Source: Bloomberg.

INFLATION IN JAPAN *Chart 6*
(% growth on the same month of the previous year)



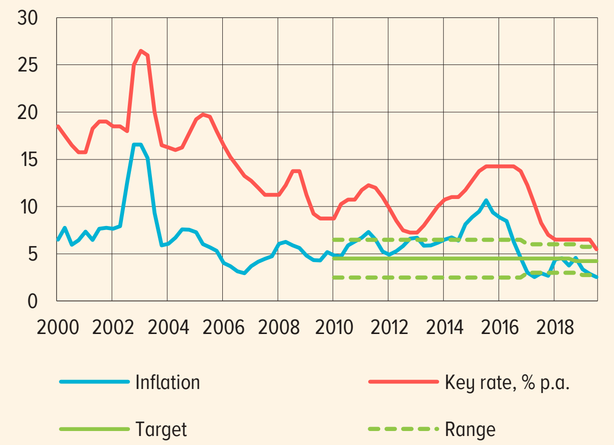
Source: Bloomberg.

INFLATION IN MEXICO *Chart 7*
(% growth on the same month of the previous year)



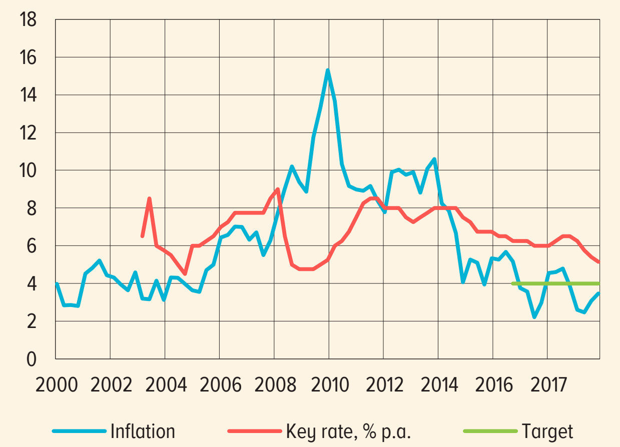
Source: Bloomberg.

INFLATION IN BRAZIL *Chart 8*
(% growth on the same month of the previous year)



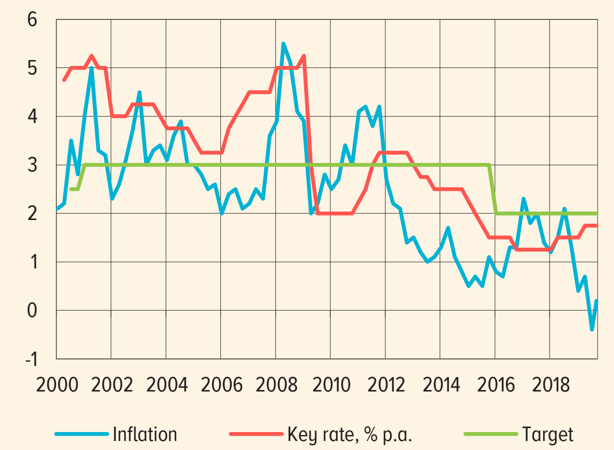
Source: Bloomberg.

INFLATION IN INDIA *Chart 9*
(% growth on the same month of the previous year)



Source: Bloomberg.

INFLATION IN SOUTH KOREA *Chart 10*
(% growth on the same month of the previous year)



Source: Bloomberg.

ANNEXES

ECONOMIC SITUATION IN RUSSIAN REGIONS

In August-November 2019, inflation continued to slow down in most regions. It was accompanied by a decrease in the regional heterogeneity of price dynamics due to the unidirectional influence of countrywide factors. The dynamics of economic activity remained relatively uniform with a decrease in the number of regions with positive growth rates. At the same time, the growth rate of real wages somewhat accelerated in most regions, contributing to a slight improvement in the dynamics of retail trade. However, in general, the dynamics of consumer demand in most regions remained low against the backdrop of a uniform slowdown in consumer lending in all federal districts.

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 (November)	3.6	3.4	3.3	3.9	3.2	3.5	4.0	4.0
Economic activity indicator (YoY, October)	1.8	0.0	0.4	1.5	0.8	-2.3	-1.4	-1.2
Industrial output (YoY, October)	3.4	3.5	2.7	-1	2.1	0	-0.1	1.4
Retail trade turnover (YoY, October)	2.3	0.3	2.2	1.9	0.6	0.5	2.4	4
Volume of paid services (YoY, October)	1.3	-1	1.5	0.8	-0.8	-0.2	-3.3	-6.3
Volume of construction works (YoY, October)	-7.5	-14.0	-24.9	14.8	-3.3	-20.0	-8.4	17.4
Growth in outstanding amounts on household loans (YoY, October)	22.2	20.7	20.6	19.8	17.9	16.2	16.5	17.7
Growth in outstanding amounts on corporate loans (YoY, September)	4.2	5.3	-0.1	10.2	-3.0	0.3	3.1	22.8
Real wage (YoY, September)	3.9	1.0	3.6	3.1	3.0	2.0	2.0	3.5
Unemployment rate (Q3)	2.7	3.4	5.1	10.5	4.1	4.3	5.6	5.7

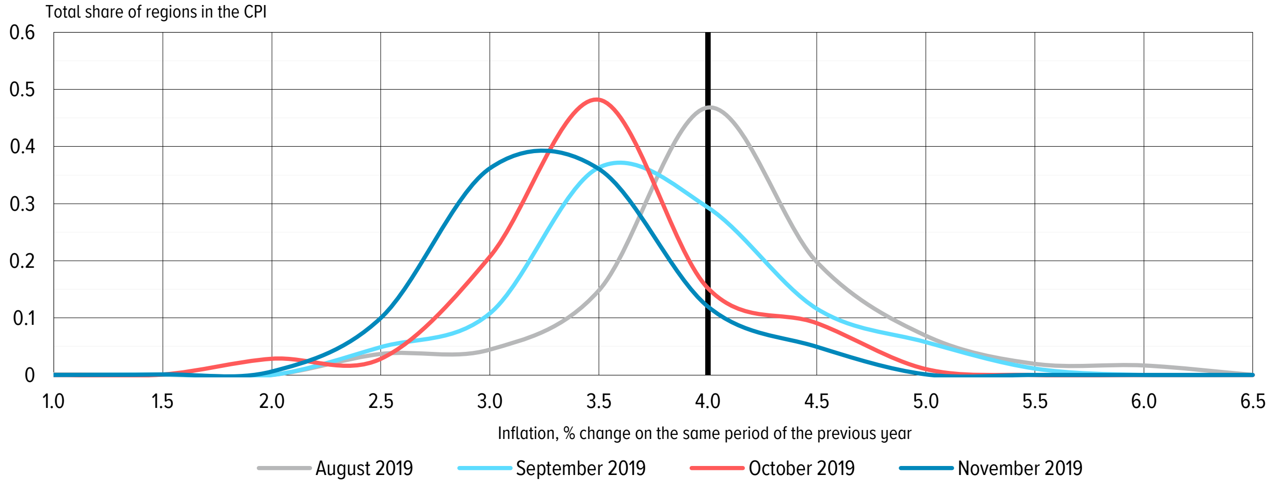
Sources: Rosstat, Bank of Russia.

INFLATION AND PRICE EXPECTATIONS

DISTRIBUTION OF REGIONS BY INFLATION LEVEL

In August-November, inflation continued to slow down in most regions (83 out of 85). The strongest slowdown was observed in the Southern Federal District, where the main contribution to the decrease in the rate of price growth was made by food inflation (during 3 months, the slowdown was more than 2.7 pp). Inflation slightly accelerated only in the Republic of Ingushetia and the Nenets Autonomous District, mainly due to food price dynamics. In general, the countrywide slowdown in inflation was accompanied by a decrease in regional heterogeneity. The values of annual inflation in the regions were in the range from 1.0% (the Yamalo-Nenets Autonomous District) to 5.0% (the Jewish Autonomous Region), with a countrywide average value of 3.5%. In the regional distribution of inflation, almost all regions have moved to the main group with the values of annual price growth in the range from 2% to 4% (Chart 1). Higher inflation was observed mainly in the regions of the Far East and Siberia (Chart 3), where the annual inflation rate continues to be influenced by short-term factors in the food and services markets that were realised in the first half of the year. In addition, in the Far East, the slowdown in the dynamics of food prices began later than in other districts, and was less pronounced because of the remoteness of the district from the main agricultural regions of the country. Inflation also remains relatively high in some regions of Central Russia, where this

DISTRIBUTION OF REGIONS BY ANNUAL INFLATION* *Chart 1*



** Data for Tyumen and Arkhangelsk Regions incorporate data for autonomous areas.*
Sources: Rosstat, Bank of Russia calculations.

deviation is stable and is due to permanent factors,[1] and in some republics of the North Caucasus, where increased rates of price growth are associated with local non-monetary factors in the markets of certain food products and services. Inflation remains steadily below the national average in the autonomous districts of the Tyumen Region and in the Altai Republic.

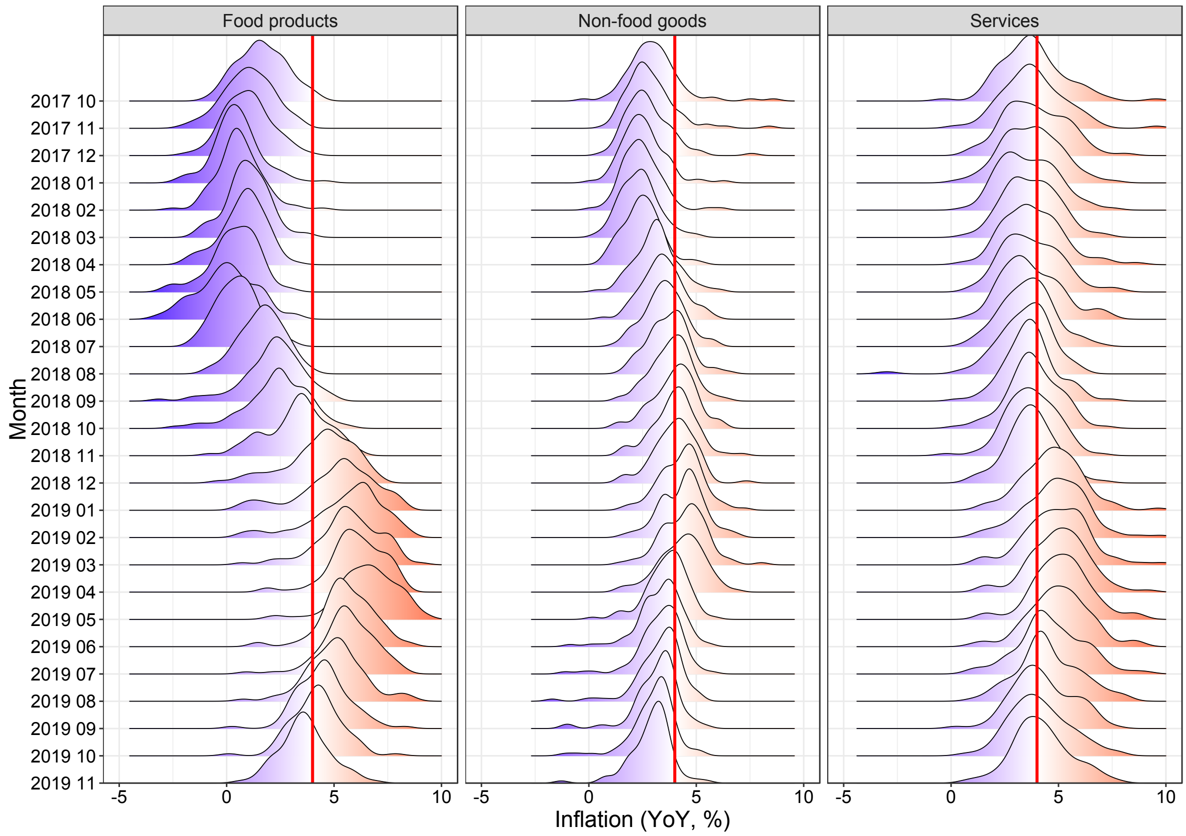
FOOD INFLATION

After a certain pick-up in August, regional heterogeneity of food inflation continued to decline in September-November (Chart 2). In November, annual growth rates of food prices in the regions were in the range from 0.7% (the Yamalo-Nenets Autonomous District) to 6.9% (the Chukotka Autonomous District) with the national average of 3.7%. The values for most regions (70 out of 85) ranged from 2.1% (the Penza Region) to 5% (the Kostroma Region). The slowdown in food inflation in most regions in August–November was the main contributor to the overall slowdown in price dynamics. The most significant drop in food inflation was observed in the regions of the European part of Russia, primarily in the Central, Southern and North-Western Federal Districts. This was mainly supported by the dynamics of prices for meat products, sugar and fruit and vegetables, which significantly slowed down against the backdrop of the increased supply. In August–November, food inflation accelerated only in three regions: the Nenets Autonomous District, the Tyumen Region and the Republic of Ingushetia. In the first two, the overall acceleration of the food prices growth could be attributed to the growth of prices for fruit and vegetables (in the Nenets Autonomous District, due to the peculiarities of food deliveries and the low base of last year, and in the Tyumen Region, due to the fact that the potato harvest in this region, as well as in the neighbouring regions, was worse than in the previous year). In the Republic of Ingushetia, the growth of prices for milk and meat products has accelerated. This acceleration, which was also observed in some other republics of the North Caucasus, was associated with an outbreak of cattle diseases.

[1] *For more details, see Box 'Regional heterogeneity factors and structural inflation rates in Russian regions' in MPR 3/19, www.cbr.ru/Collection/Collection/File/23678/2019_03_ddcp.pdf.*

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..

NON-FOOD INFLATION

The regional heterogeneity of non-food inflation declined in August–November, traditionally remaining lower than the heterogeneity of services and food inflation (Chart 2). For most regions (77 out of 85), the values of non-food inflation in November ranged from 1.4% (the Khanty-Mansiysk Autonomous District) to 4.1% (the Stavropol Territory). In the Republic of Altai, there has been a deflation (in annual terms) of non-food products since June. In July–October, deflation was also observed in the Chechen Republic. In both republics, it was mainly due to a downturn in prices for clothing and shoes. Non-food inflation accelerated in 19 constituent territories amid the countrywide ongoing slowdown in August–November. The acceleration was most significant in the Southern (the Kabardino-Balkarian Republic, the Stavropol Territory, the Chechen Republic, the Republic of Ingushetia), Far Eastern and Northern (the Jewish Autonomous Region, the Sakhalin Region, the Kamchatka and Khabarovsk Territories, and the Yamalo-Nenets Autonomous Region) regions. In most of these constituent territories, main contributors to the increase in non-food goods prices were medical goods, shoes and clothing. The strongest slowdown in non-food inflation occurred in many regions of the Asian part of the country (the Chukotka Autonomous Region; the Magadan, Novosibirsk and Kemerovo Regions; the Republics of Khakassia and Buryatia), as well as in some republics of the Volga Federal District (the Tatarstan, Bashkortostan and Mari El Republics), where the price dynamics slowdown affected a wide range of non-food goods.

INFLATION IN THE SERVICES SECTOR

In November, services inflation in the regions was in the range from 0.7% (the Kamchatka Territory) to 7.7% (the Nenets Autonomous District). Compared to June-July, regional heterogeneity

INFLATION IN REGIONS IN NOVEMBER 2019 *Chart 3*

Sources: Rosstat, Bank of Russia.

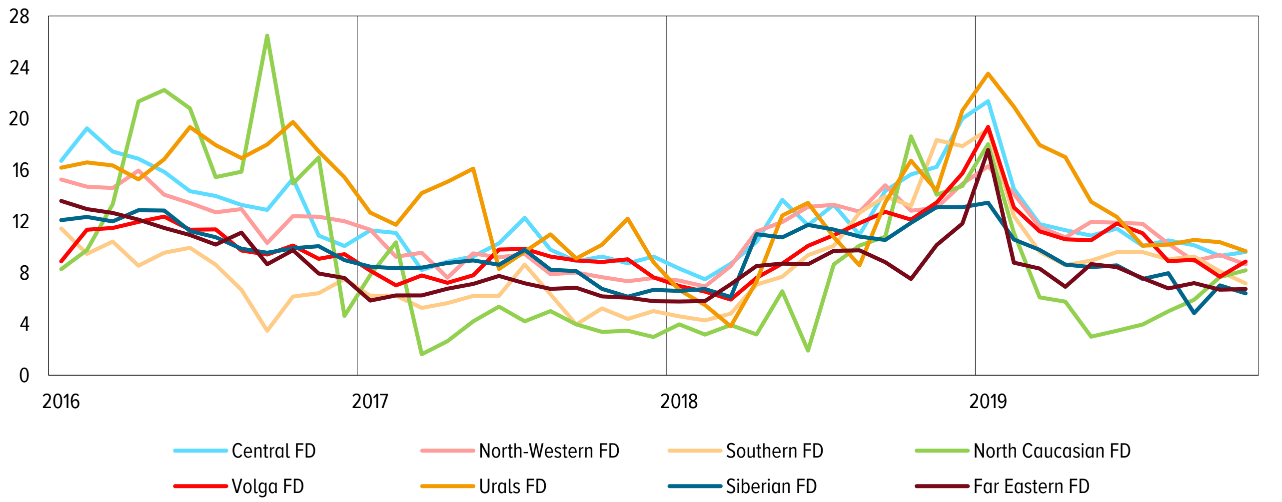
and variation decreased. For most regions (78 out of 85), annual services inflation rates ranged from 2.3% (the Sakhalin Region) to 6.6% (the Tomsk Region). In August-October, with a slowdown in the country as a whole, the dynamics of services inflation were multi-directional at the regional level. In 22 constituent territories, it accelerated. The acceleration was most pronounced in some Siberian regions (the Kemerovo, Novosibirsk and Tomsk Regions) and the republics of the South of the European part of the country (the Republics of Dagestan and Kalmykia). Passenger transport services made a significant contribution to the acceleration of services inflation in all these regions, while housing prices also significantly grew in the Kemerovo Region, as well as prices for communications services in the Novosibirsk Region. In November, services inflation accelerated in most (50 out of 85) regions. It was mainly associated with an increase in the growth rate of prices for communication services (in 61 constituent territories, most significantly in the Tyumen Region, the Khanty-Mansiysk and Yamalo-Nenets Autonomous Regions), foreign tourism services (69 constituent territories). In some regions, air transport significantly contributed to the accelerating services inflation: amid the countrywide slowdown in the inflation of the air transport prices, in November it accelerated in 33 regions, in 12 of them by more than 10 pp, in 4 of them by more than 30 pp (Sevastopol, the Altai Territory, the Astrakhan and Tomsk Regions). This acceleration was due to the delayed increase in fuel charges included in the cost of air tickets by some airlines.

PRICE EXPECTATIONS

In September-November, business price expectations for three months ahead continued to slightly decline in most federal districts (Chart 4). At the same time, November saw a slight increase in half of the districts (the Central FD, the North Caucasian FD, the Volga FD, and the Far Eastern FD), mainly due to higher expectations of transportation and storage enterprises, as well as agricultural enterprises. Transportation and storage enterprises in a number of regions expect

BUSINESS PRICE EXPECTATIONS
(balance of responses, pp)

Chart 4



Source: Bank of Russia.

increased indexation of tariffs for passenger transport services. The increase in expectations in agriculture is mainly due to the rise in prices for buckwheat and rye due to the low harvest. In general, only the North Caucasus saw a slight increase in expectations during the three months, after a stronger decline in March-June compared to the rest of the federal districts.

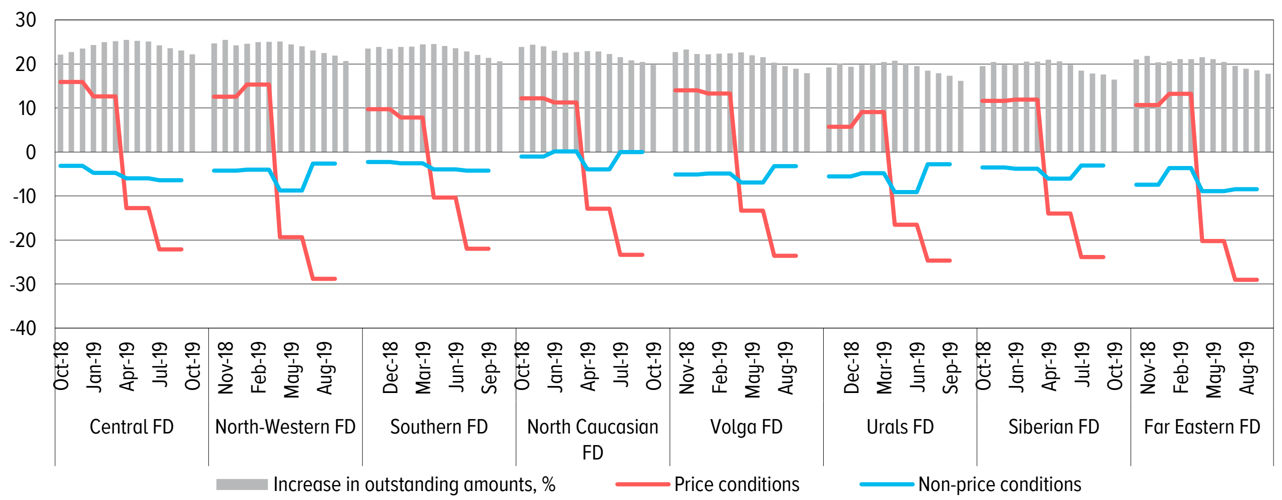
MONETARY CONDITIONS

HOUSEHOLD LENDING

In 2019 Q3, in all federal districts, there was a significant easing of price lending conditions of banks (BLC) for households[2] (Chart 5). This easing, which began in 2019 Q2, continued amid a slowdown in inflation, a reduction in the Bank of Russia key rate and a decrease in inflation

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.

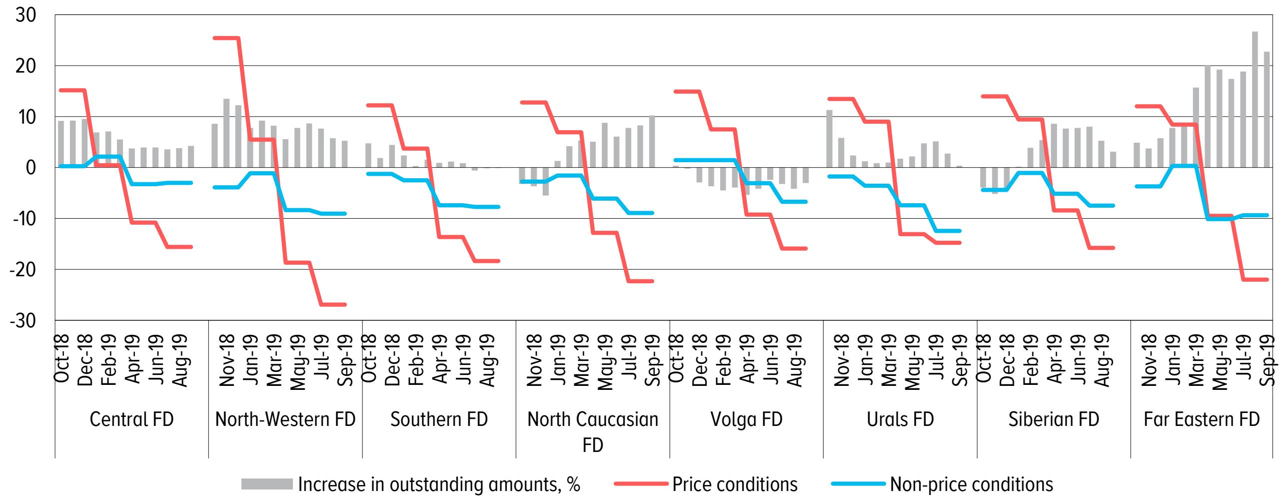
[2] *Pursuant to the data of a quarterly survey of major banks by the Bank of Russia. BLCs are assessed on the basis of the diffusion index, which reflects the balance of the responses of credit institutions assessing the change in conditions as tightening or easing.*

expectations. There was little change in the assessment of non-price BLC for households, although certain easing was observed in all districts, except for the North Caucasus. In general, assessments of household lending conditions in half the regions were within the neutral zone (in 35 out of 68, where the survey was conducted). Compared to Q2, the number of constituent territories where bank lending conditions were assessed as loose increased markedly (from 21 to 29), and the number of constituent territories where banks described conditions as tight decreased (from 13 to 4). At the same time, despite the easing of BLC, the growth of retail lending in August–October continued to slow down in all federal districts and in the majority of regions (83 out of 85), most significantly in the North-Western and Volga Federal Districts due to the higher debt burden in many regions of these federal districts). The countrywide slowdown in household lending is associated with the end of the period of recovery growth of 2017 – early 2019, as well as with the introduction of new macroprudential measures, including in terms of the debt burden of borrowers. In the mortgage market, the most noticeable slowdown occurred in the Siberian, Volga and Southern Federal Districts due to a weaker demand.

CORPORATE LENDING

The bank lending conditions for corporate borrowers in 2019 Q3 also continued to soften in all federal districts, most significantly in the North-Western, North Caucasus and Far Eastern Federal Districts (Chart 6). The easing of non-price conditions was less pronounced, but it was observed in all districts. Nevertheless, legal entities viewed BLC as tight in all federal districts, except for the Urals and Siberian Federal Districts, where they remained in the neutral zone. The dynamics of corporate lending (YoY) by district remained multi-directional: in the Southern and Volga Federal Districts the loan portfolio continued to shrank, in other federal districts there was an increase, with the most significant growth registered in the Far East. In most federal districts, the positive dynamics of the corporate loan portfolio was conditioned on to the implementation of investment projects or the issuance of loans to several large businesses to finance their current activities. In the Far East, a noticeable increase in corporate loans was facilitated by the implementation of large investment projects in mining and quarrying (the Jewish Autonomous Region and the Kamchatka Territory), as well as expanded borrowing by construction companies. The most significant increase in lending by industry occurred in agriculture and construction. In agriculture, there was a noticeable increase in lending in the agricultural regions of Southern and Central Russia (resumption of construction work on large investment projects of agricultural holdings, purchase of agricultural machinery and equipment). In construction, the most noticeable increase in lending was observed in Moscow,

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.

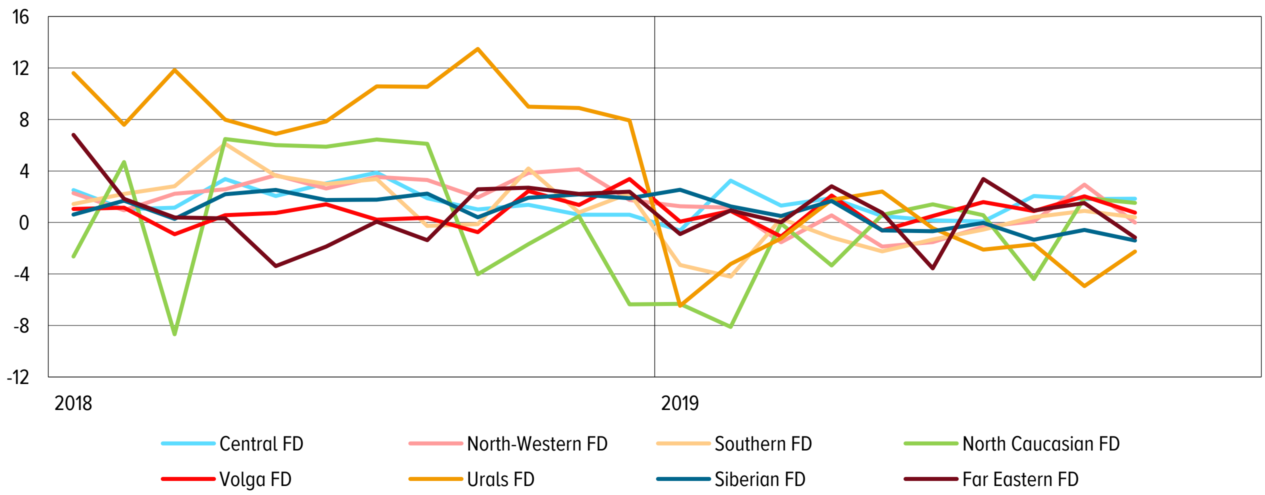
St Petersburg, the Khabarovsk Territory, the Rostov Region, as well as in the regions of the Volga FD. In general, this may suggest a faster transition of the construction industry of the mentioned regions to using escrow accounts. Almost all of these regions were included in the top 20 regions for the balance of funds in escrow accounts for settlements under equity construction contracts. The share of overdue debt of corporate borrowers in August-September remained relatively low and decreased in most (63 out of 85) regions. At the same time, its marked (by more than 1 pp) growth was observed in many republics of the North Caucasus (the Dagestan, Karachay-Cherkessia, North Ossetia, and Chechen Republics), where the share of overdue debt was traditionally higher than the countrywide average.

PRODUCTION AND INVESTMENT ACTIVITY

ECONOMIC ACTIVITY INDICATOR

Same as in the previous months, regional heterogeneity of the economic activity dynamics in August-October remained relatively low. At the same time, the number of regions with positive dynamics of economic activity indicator[3] significantly decreased by October compared to July (from 51 to 42). In the districts of the European part of Russia, output dynamics remained mainly positive; in the Urals, in Siberia, and since October in the Far East, they were negative (Chart 7). In the Urals, the decline in economic activity in recent months can be mainly attributed to construction (largely due to the high base of the previous year). In Siberia and the Far East, the services sector was the main contributor to the decline. In these districts, there is a discrepancy in the dynamics of two indicators reflecting consumer demand: with a significant drop in the volume of paid services, the growth rate of retail trade turnover increased. The highest growth rates of economic activity in October were observed in the Central (growth in all sectors except construction) and the North Caucasus (growth in construction, trade and services) Federal Districts. Industrial production made a positive contribution to the dynamics of economic activity in most federal districts, except for the North Caucasus and Siberia, where in October there was a slight decline in industrial production (-1 and -0.1% respectively). In the North Caucasus, the decline in industrial production was mainly

ECONOMIC ACTIVITY INDICATOR (JANUARY 2018–OCTOBER 2019) *Chart 7*
(YoY, %)



Sources: Rosstat, Bank of Russia calculations.

[3] *The economic activity indicator is calculated as the weighted average rate of the main economic activities: mining and quarrying, manufacturing, power, 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.*

due to a drop in the production of chemicals in the Stavropol Territory. In Siberia, there was a decrease in oil refining output associated with the modernisation of the largest enterprise in the industry (Omsk Oil Refinery); low growth rates were observed in mining and quarrying, one of the traditional industries the district specialises in, against the backdrop of a weak external demand. In most federal districts, agriculture also showed positive dynamics due to the good harvest in the main agricultural regions (the largest growth occurred in the Central, Southern and North-Western Federal Districts).

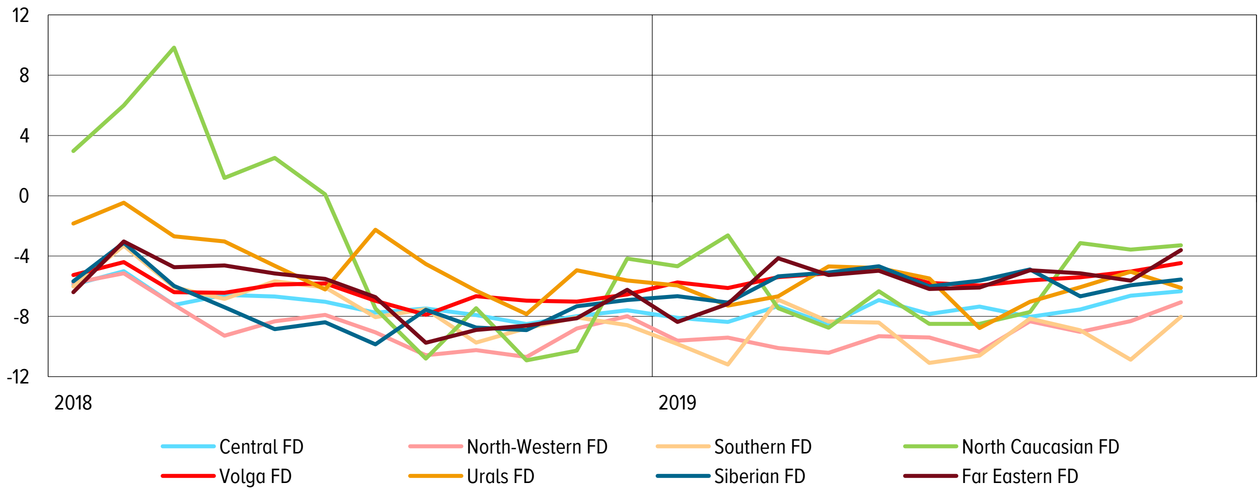
BUSINESS SENTIMENT

Assessments of the economic environment by enterprises that participate in Bank of Russia monitoring improved slightly in September-November in most federal districts, remaining, in general, near the average values of the previous two years (Chart 8). The continued easing of lending conditions and a slight positive change in demand contributed to the improvement in assessments. However, weak demand for products of enterprises continues to weigh down on business sentiment in all districts. In 2019 Q3, on average in Russia, insufficient demand remained a factor limiting the growth of production for almost half (46%) of the surveyed enterprises. In the context of individual industries, the most noticeable improvement in the assessments of market conditions occurred in agriculture and construction against the backdrop of the good harvest and the completed transition to new funding rules of equity construction, which began in 2018. The deterioration in business sentiment was noted in mining and quarrying and was associated with a significant weakening in demand.

INVESTMENT

In 2019 Q3, for the first time since the beginning of the year, survey data in the regions showed an improvement in investment activity. Enterprises participating in Bank of Russia monitoring noted an increase in investment activity in most (5 out of 8) federal districts. The strongest growth in assessments occurred in Siberia, where in January-September there were also the highest annual growth rates of fixed capital investment (13%), due mainly to the implementation of major projects in mining and quarrying, metallurgy and oil refining. Similarly high (8%) investment growth rates were posted in the Central and North Caucasus FDs, mainly due to investment in the construction of transport infrastructure, housing construction (Moscow and the Moscow Region), energy and utilities infrastructure in the North Caucasus. The most significant decline in fixed capital investment (-19%

ASSESSMENT OF CHANGES IN ECONOMIC SITUATION BY BUSINESSES *Chart 8*
(balance of responses, pp)



Source: Bank of Russia.

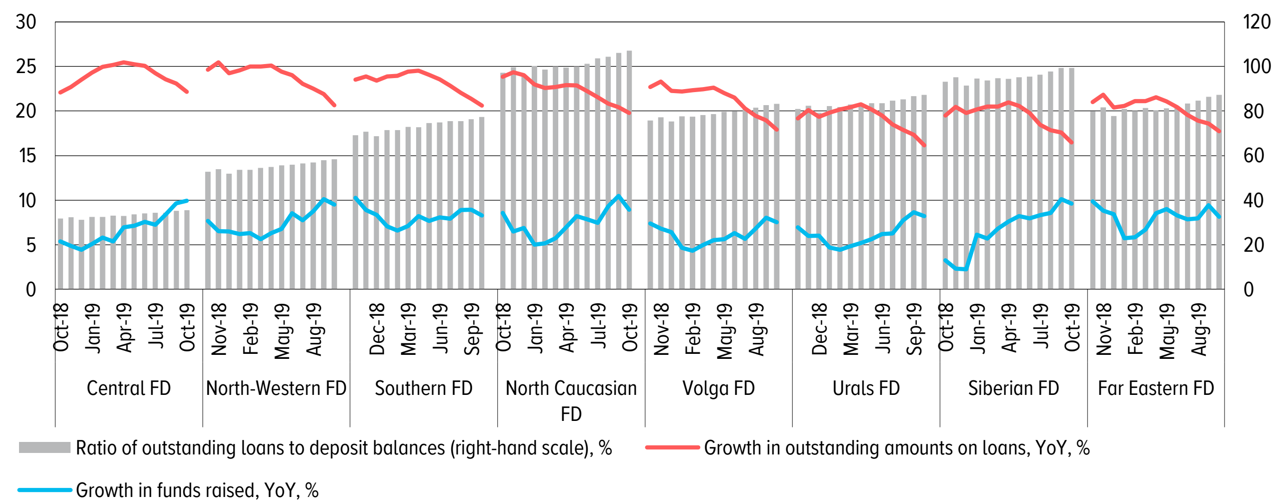
YoY in January-September 2019) occurred in the Southern FD (reduction of investment in transport facilities in Crimea and the Krasnodar Territory (in part due to the base effect, i.e. the completion of a number of construction works on the Crimean Bridge and related infrastructure facilities), in mining and quarrying in the Astrakhan Region).

CONSUMER DEMAND AND SAVINGS

REGIONAL CONSUMPTION PECULIARITIES

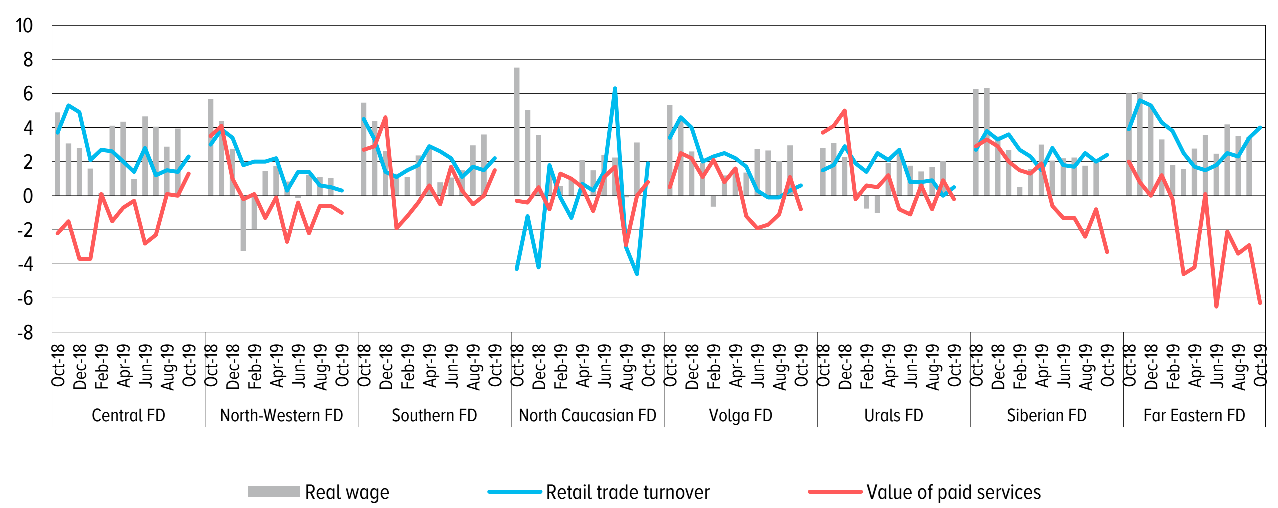
In August-October, the dynamics of consumer activity in the regions remained restrained (Chart 10) against the backdrop of slowing consumer lending and continuing low growth rates of real wages in a significant part of the regions. August-September saw accelerated growth of household deposits, which in most federal districts (with the exception of the Central FD) gave way to some slowdown (Chart 9). In most regions, the annual dynamics of real wages accelerated slightly in July-September. In September, it was positive in 78 constituent territories (in June, 67). At the

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



** The outlier in the deposit growth dynamics for the Siberian Federal District in early 2019 is related to changes in the statistical accounting by branches in a bank of the Novosibirsk Region.*
Source: Bank of Russia.

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



Source: Rosstat.

level of the federal districts, the growth rate of real wages in September was in the range from 1.0% (the North-Western FD) to 3.9% (the Central FD). Certain improvement in income dynamics in the regions contributed to an increase in the number of constituent territories demonstrating an increase in retail trade turnover: in October, 60 such regions, in June, 52 (a new low since April 2017). The growth of retail trade turnover in October was observed in all federal districts, the growth rates (YoY) ranged from 0.3% (the North-Western FD) to 4.0% (the Far Eastern FD). At the same time, annual growth rates of paid services since May remain negative in most regions (in October, in 51 out of 85) and federal districts (in October, in the North-Western, Volga, Urals, Siberian and Far Eastern FDs).

STATISTICAL TABLES

INTEREST RATES 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>From 28.10.2019</th><th>From 16.12.2019</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>7.50</td><td>7.25</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>8.25</td><td>8.00</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>6.75</td><td>6.50</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">6.50 (key rate)</td><td rowspan="5">6.25 (key rate)</td><td rowspan="5">Key rate</td></tr>
<tr><td>From 1 to 6 days</td><td rowspan="3">Occasio-nally[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[7]</td><td>1 day</td><td>Daily</td><td>6.75</td><td>6.50</td><td>6.25</td><td>6.00</td><td>5.50</td><td>5.25</td><td>Key rate – 1.00</td></tr>
</table>

[1] From 4 June 2018, interest rates on Bank of Russia operations with credit institutions have been set as key rate spreads. See 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 transactions).
[3] Operations conducted at a floating interest rate linked to the Bank of Russia key rate.
[4] Operations have been discontinued since April 2016.
[5] Either a repo or a deposit auction is held depending on the situation with liquidity.
[6] Fine-tuning operations.
[7] Before 16 May 2018, also demand deposits. 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's claims under liquidity provision instruments and liabilities under liquidity absorption instruments					
					As of 01.01.18	As of 01.01.19	As of 01.04.19	As of 01.07.19	As of 01.10.19	As of 01.12.19
Liquidity provision	Standing facilities	Overnight loans	1 day	Daily	0.0	8.1	0.0	1.1	0.0	0.0
		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	0.0	0.1
		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	Weekly[2]	0.0	0.0	0.0	0.0	0.0	0.0
			From 1 to 6 days	Occasionally[3]						
		FX swap auctions	From 1 to 2 days		0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	From 1 to 6 days		2,124.9	1,478.2	1,680.0	704.4	2,180.0	1,630.0
			1 week	Weekly[2]						
		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	808.2	1,510.8
	Standing facilities	Deposit operations	1 day[5]	Daily	246.8	423.8	136.4	152.8	135.1	122.3

[1] Operations have been 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 BoR coupon bonds includes the accrued coupon interest as of the first working day following the reporting date.
[5] Before 16 May 2018, also demand deposits. Since 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 the currency of the Russian Federation Other liabilities in the currency of the Russian Federation To non-resident legal entities in the currency of the Russian Federation	5.00	5.00	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 the currency of the Russian Federation Other liabilities in the currency of the Russian Federation	1.00	1.00	1.00	1.00
To non-resident legal entities in the currency of the Russian Federation	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 reserve 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	2,490	2,430	620
09.10.2019 – 05.11.2019	28	September 2019	14.10.2019 – 16.10.2019	2,489	2,430	619
06.11.2019 – 10.12.2019	35	October 2019	15.11.2019 – 19.11.2019	2,499	2,436	619
11.12.2019 – 14.01.2020	35	November 2019	13.12.2019 – 17.12.2019	-	-	-

KEY ECONOMIC AND FINANCIAL INDICATORS *Table 6*

		11.18	12.18	01.19	02.19	03.19	04.19	05.19	06.19	07.19	08.19	09.19	10.19	11.19
Real sector														
Inflation	% YoY	3.8	4.3	5.0	5.2	5.3	5.2	5.1	4.7	4.6	4.3	4.0	3.8	3.5
GDP[1]	% YoY		2.7			0.5			0.9			1.7		
GDP in current prices[1]	trillions of rubles		29.5			24.5			26.2			28.0		
Output by key activity types	% YoY	1.8	2.1	0.3	2.3	0.2	3.1	0.0	2.1	2.5	2.4	3.1	3.1	
Industrial production	% YoY	2.4	2.0	1.1	4.1	1.2	4.6	0.9	3.3	2.8	2.9	3.0	2.6	
Agricultural output	% YoY	-5.5	0.5	0.7	1.0	1.5	1.4	1.0	1.1	6.2	3.4	5.6	5.2	
Construction	% YoY	4.3	2.6	0.1	0.3	0.2	0.0	0.2	0.1	0.2	0.3	0.8	1.0	
Fixed capital investment[1]	% YoY		2.9			0.5			0.6			0.8		
Freight turnover	% YoY	2.3	3.2	2.3	1.8	2.5	2.6	0.9	0.4	-1.1	-0.7	0.0	-0.2	
PMI Composite Index	% SA	55.0	53.9	53.6	54.1	54.6	53.0	51.5	49.2	50.2	51.5	51.4	53.3	52.9
Retail trade turnover	% YoY	3.3	2.7	2.0	2.1	1.7	1.8	1.5	1.6	1.1	0.8	0.7	1.6	
Real disposable money income[1]	% YoY		-2.0			-2.5			-0.1			3.0		
Real wage	% YoY	4.2	2.9	1.1	0.0	2.3	3.1	1.6	2.9	3.0	2.4	3.1		
Nominal wage	% YoY	8.2	7.3	6.1	5.2	7.7	8.4	6.8	7.7	7.7	6.8	7.2		
Unemployment rate	% SA	4.7	4.8	4.7	4.6	4.5	4.6	4.6	4.6	4.6	4.5	4.7	4.6	
Banking sector														
Broad money supply	% YoY, AFCR	7.9	7.9	6.5	7.9	7.0	6.6	6.7	6.4	7.0	7.3	8.0	7.9	
Money supply (M2)	% YoY	11.9	11.0	9.9	9.9	8.9	7.7	8.0	7.3	7.8	7.2	9.1	8.7	
Household deposits	% YoY, AFCR	5.7	5.4	5.4	5.7	5.6	6.8	7.0	7.3	7.1	8.2	9.4	9.2	
in rubles	% YoY	8.9	8.3	7.8	7.5	6.6	7.0	6.7	6.6	6.5	7.8	8.9	8.6	
in foreign currency	% YoY	-5.6	-5.2	-3.6	-1.2	1.6	5.8	8.1	9.9	9.5	9.6	11.3	11.7	
dollarisation	%	21.3	21.5	21.5	21.5	21.5	21.1	21.3	20.9	21.1	21.5	21.1	20.9	
Loans to non-financial organisations	% YoY, AFCR	5.6	4.7	4.8	5.6	5.7	5.4	6.2	6.4	5.7	5.0	3.4	4.1	
short-term (less than 1 year)	% YoY, AFCR	3.7	3.8	-0.6	-2.0	2.7	-1.0	1.3	4.7	4.9	2.1	1.2	1.3	
long-term (more than 1 year)	% YoY, AFCR	6.0	5.4	4.9	6.1	5.2	5.8	5.9	5.4	4.3	4.0	2.1	3.0	
overdue loans	%	6.6	6.3	7.8	7.9	7.9	7.8	7.9	7.9	8.1	8.0	8.0	8.0	
Loans to households	% YoY, AFCR	22.6	22.2	23.0	23.4	23.5	23.8	23.3	22.8	21.9	21.2	20.7	19.7	
housing mortgage loans	% YoY, AFCR	25.5	23.4	24.7	24.8	24.2	23.5	22.7	21.6	19.8	19.0	18.3	17.3	
unsecured consumer loans	% YoY	22.5	22.7	23.4	23.7	24.2	25.2	24.9	24.6	24.4	23.7	23.4	22.6	
overdue loans	%	5.5	5.1	5.4	5.3	5.1	5.1	5.0	4.9	4.9	4.8	4.7	4.6	

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	2019 Q3[1]
Balance of payments[2]								
Urals crude price	% YoY	24.8	50.1	44.6	9.3	-3.2	-5.2	-16.3
USD/RUB exchange rate ('+' – ruble's strengthening, '-' – ruble's weakening)	% YoY	3.4	-7.5	-9.9	-12.1	-14.0	-4.3	1.4
Goods and services exports	% YoY	21.7	27.3	28.2	18.2	1.1	-5.9	-7.1
Goods and services imports	% YoY	18.8	8.2	-0.2	-3.0	-3.0	-0.9	4.4
Current account	**billions of US dollars**	29.8	17.9	27.4	38.4	33.7	10.6	12.9
Balance of trade	billions of US dollars	44.1	45.4	47.8	57.2	46.9	39.5	36.6
Exports	billions of US dollars	101.5	108.8	110.4	122.4	102.5	101.7	101.5
Imports	billions of US dollars	57.4	63.4	62.7	65.2	55.6	62.1	64.9
Balance of services	billions of US dollars	-6.6	-7.7	-8.8	-6.9	-5.8	-8.4	-10.5
Exports	billions of US dollars	13.9	16.7	17.4	16.7	14.2	16.4	17.2
Imports	billions of US dollars	20.5	24.3	26.1	23.6	20.0	24.8	27.8
Balance of primary and secondary income	billions of US dollars	-7.7	-19.8	-11.6	-11.9	-7.4	-20.6	-13.1
Current and capital account balance	billions of US dollars	29.6	17.7	27.4	37.7	33.7	10.3	12.8
Financial account excluding reserve assets (net lending (+) / net borrowing (-)	**billions of US dollars**	12.4	9.3	24.1	30.8	12.6	-2.5	-1.8
Public sector	billions of US dollars	-6.5	11.1	2.9	1.5	-9.0	-5.9	-4.5
Private sector	billions of US dollars	18.9	-1.8	21.2	29.3	21.6	3.4	2.6
Net errors and omissions	billions of US dollars	2.1	2.9	1.7	-4.3	-2.6	3.8	1.3
Change in reserve assets ('+' – increase, '-' – decrease)	**billions of US dollars**	19.3	11.3	5.0	2.6	18.6	16.6	15.9

[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 enhanced 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 sight 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
- EMEs – 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
- IFX-Cbonds – corporate bond return index
- Industrial PPI – industrial producer price index
- inFOM – Institute of the Public Opinion Foundation
- MC – management company
- MIACR – Moscow Interbank Actual Credit Rate (weighted average rate on interbank loans provided)
- MIACR-B – Moscow Interbank Actual Credit Rate-B-Grade (weighted average rate on interbank loans provided to banks with speculative credit rating)
- MIACR-IG – Moscow Interbank Actual Credit Rate-Investment Grade (weighted average rate on interbank loans provided to banks with investment-grade rating)
- MIC – military-industrial complex
- MICEX SE – MICEX Stock Exchange

- MPD – Monetary Policy Department of the Bank of Russia
- MPG 2020-2022 – Monetary Policy Guidelines for 2020-2020 (approved by the Bank of Russia Board of Directors on 25 October 2019)
- MPR – Monetary Policy Report (mentioned in the text as 2/19 – No. 2 2019; 3/19 – No. 3 2019)
- MTVECM, TVECM – Momentum Threshold Vector Error Correction Model, Threshold Vector Error Correction Model
- NPF – non-governmental pension fund
- NPISH – non-profit institutions serving households
- NWF – National Wealth Fund
- 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 market)
- 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