Bank of Russia

JULY 2020

MONETARY POLICY REPORT

3 August 2020

The report has been prepared based on statistics as of 23 July 2020.

The data cut-off date for forecast calculations is 17 July 2020 (if statistics or other information relevant for decision-making come in after the data cut-off date, they are included in the text of the Report and may be used to adjust the mid-term forecast).

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STATEMENT BY BANK OF RUSSIA GOVERNOR ELVIRA NABIULLINA

IN FOLLOW-UP TO BOARD OF DIRECTORS MEETING ON 24 JULY 2020

Today, the Bank of Russia Board of Directors made the decision to reduce the key rate by 25 bp down to 4.25% per annum. At the upcoming meetings, we will consider the necessity of further key rate reduction.

We have continued to ease monetary policy, primarily taking into account that the risks of the downward deviation of inflation from the 4% target in 2021 remain. *These risks result from the slump in economic activity and the decline in domestic and external demand. According to our estimates, the recovery will take over 1.5 years, which will have a restraining effect on prices.*

I would like to stress that the specifics of the current moment is that the situation associated with the pandemic and the easing of the restrictions both in Russia and abroad, in various regions and sectors, is unfolding very non-uniformly. *In June — the first half of July, when Russia started to ease its lockdown requirements, economic processes in the country were reviving, which included the recovery of power consumption, rebounding consumer and investment demand, the expansion of construction and consumer goods output, and a slower annual decline in freight turnover and industrial output. However, although businesses' and households' sentiment was improving, overall they remained cautious amid the persisting high uncertainty about how the situation might be unfolding further on.*

In June, the current monthly growth rates of consumer prices were significantly varying across different product and service groups due to the diverse impact of demand- and supply-side factors in individual markets. Nevertheless, overall inflationary pressure is weakening, after the increase in March — April, which is evidenced by stable inflation indicators, adjusted for one-off factors. Households' and businesses' inflation expectations have stabilised overall after the decrease in May—June. Professional analysts have lowered their inflation expectations for the next year beneath 4%.

We expect that the recovery pace in the economy and price dynamics will also remain non-uniform over the next few months, which may slightly obscure the developing trends. ***Nonetheless, in terms of the key rate decision and the prospects of monetary policy, it is more important to focus on the medium-term view on price and economic activity trends with account of sustainable factors. The economy will be returning to its potential progressively, and therefore disinflationary trends will prevail.***

We have adjusted our assumptions of the annual GDP change only slightly, taking into account the influence of divergent factors.

On the one hand, this is a deeper decline in economic activity and in domestic and external demand in the second quarter, which resulted from the longer duration of the restrictions both in Russia and abroad than we had expected in April. According to our estimate, the GDP decrease in the second quarter equals 9–10%.

On the other hand, we have observed a substantial expansion of the budget-funded and other measures supporting the economy, compared to April, which is partially offsetting the decline in incomes, sustaining consumption and investment, and boosting a faster economic rebound. In the updated forecast, we have reflected that fiscal stimulus has increased nearly twice compared to the measures that had been in place when April's forecast estimates were made. Moreover, economic recovery will also be promoted by the easing of monetary conditions owing to the significant reduction in the key rate.

Taking into account these factors, according to our forecast, GDP will decline by 4.5–5.5% this year. Its recovery growth in the next two years is expected at the level of 3.5–4.5% and 2.5–3.5%. These estimates are mostly within the ranges we specified in April. As before, we expect that plummeting external demand, which will reduce exports by 13–15%, will be the key drag on GDP in 2020. We also expect that the shrinkage of investment and consumption will be approximately equivalent this year, ranging from 6% to 8%.

Although we forecast significant recovery growth in 2021, economic activity will remain considerably below its 2019 level and below the potential. This implies that ***the restraining effect of aggregate demand on consumer price trends will persist in the next year****. The reduced current monthly rates of price growth will remain at this level until the end of the year.* ***Inflation will be returning to the 4% target gradually since it will take time for demand to recover, including owing to the easing of monetary policy.*** *We forecast that annual inflation will range from 3.5% to 4.0% in 2021 and will stabilise close to 4% in 2022.*

I would like to remind you that inflation is expected to reach 3.7–4.2% by the end of this year. This is associated with two aspects. Firstly, annual inflation will rise from 3.2% in June mostly because the low readings of the second half of 2019 will be excluded from the inflation calculation, and not as a result of the current price growth rates.Secondly, the expected return of inflation to 4% by the end of the year will be driven by temporary proinflationary factors that impacted inflation in March — April. Without this temporary price growth acceleration, sustained inflationary pressure, as I have already said, stays at a reduced level below 4%.

The reduction in the key rate since April is contributing to the further easing of monetary conditions. *Interest rates in the banking sector are decreasing. However, we take into account that there are factors that may be restraining this process. These factors include increased credit risks and the resulting tightening of requirements for borrowers, as well as external factors that may cause risk premium fluctuations. Furthermore, we take into consideration that the regulatory easing and preferential lending programmes are also contributing to the easing of monetary conditions today.*

Interest rates on deposits exceed the forecast inflation. Ruble-denominated household deposits keep growing. In June, their annual growth rate was 10.9%.

The easing of monetary conditions driven by the actual key rate reduction will support credit growth already this year. We estimate that the credit to the economy will expand by 6–9% in 2020 and by 7–11% over the next two years. This will positively contribute to GDP dynamics.

When making our decision to cut the key rate, we also take into account the announced plans with regard to the fiscal policy, *including the forthcoming budget consolidation in 2021–2022. This year, the Government has increased fiscal expenditures more significantly than it is provided for by the fiscal rule. This has been done to support the economy and people in times of the powerful negative shock. And this is absolutely justified, especially at the initial stage of the crisis. At such a moment, the fiscal policy is able to aid the economy faster and more prominently than the monetary policy, whose influence becomes fully visible over a horizon from 3 to 6 quarters. At the same time, the current monetary policy easing will mainly influence inflation and economy dynamics over the next year, thereby offsetting the effect* *of the forthcoming budget consolidation. I would like to note that the fact that the Government is planning to completely return to the fiscal rule parameters in 2022 is fundamentally important not only for the long-term stability of public finance but also for maintaining stable long-term interest rates in the economy and, therefore, for ensuring efficient operation of the transmission mechanism of the monetary policy.*

Regarding the ***balance of payments****, in 2020–2021, we expect a slight surplus of the current account, around $2–3 billion. This is a significant forecast revision as compared to April when we expected that the current account balance would turn negative. This forecast adjustment is based on the following two factors. First, we have significantly reviewed our oil price assumptions upwards from $27 to $38 per barrel in 2020 and from $35 to $40 per barrel in 2021 on the back of the oil price recovery owing to the OPEC+ deal. This is reflected in higher export forecast. Second, it is a more prolonged decline in services imports, which took place in the second quarter due to closed borders, suspended travel services and the switch to domestic consumption. These restrictions may partially stay in place further on this year.*

The increase in the expected negative balance of the financial account of the private sector is mainly related to the current account forecast revision. The forecast of the balance of payments also takes into account the plans of the Minfin to increase borrowing this year. Compared to the April forecast, we expect a less significant decline in foreign currency reserves in 2020–2021 considering oil price changes and the amount of operations under the fiscal rule.

The forecast of operations under the fiscal rule includes the completion of sale of foreign currency related to the deal with Sberbank shares. The mechanism, under which we sell this currency only if the price of Urals oil is below $25, expires on 30 September. If the current situation in the global oil market remains in August — September, we are planning to offset the balance of unsold foreign currency related to Sberbank shares with the amounts of purchases postponed since 2018 and pre-emptive sales that we conducted in March—April. The net balance is 185 billion rubles in the ruble equivalent. This amount of foreign currency will be evenly sold in addition to regular fiscal rule-based operations over the course of the fourth quarter of 2020.

Speaking about ***forecast risk factors****, uncertainty remains high, both in terms of the nature of the slowdown and recovery processes in the Russian and global economies and in terms of the scale of the effect that the pandemic and restrictive measures could have on the economic growth potential in Russia and abroad. This concerns both the production recovery potential and possible changes in households' consumer and saving preferences. These factors, in turn, can have a considerable effect on the inflation forecast.*

Uncertainty caused by external conditions is further exacerbated by increased tensions between the US and China, which creates risks to both global economic growth and the dynamics of global commodity and financial markets. There remain risks on the part of other geopolitical factors as well.

Besides, at the current stage, with the restrictions still in place, it is difficult to unambiguously estimate how quickly and widely the key rate reduction will translate into the easing of monetary conditions and further on, into the dynamics of economic activity and inflation. As we have noted earlier, in the near future they will be influenced by a wide range of diverse factors.

I would like to point out that at our today's meeting ***we have returned to our standard key rate change pace****, considering that finer tuning of the monetary policy within the baseline forecast is necessary now, as compared to the previous months, when a decisive reaction of the monetary policy to shocks was justified. In the future, we will estimate the nature of changes in monetary conditions, recovery processes in the economy and price dynamics and, based on these factors, consider the necessity to cut the key rate at the upcoming meetings. In general, we believe that there may still be room for monetary policy easing.*

When making our key rate decision, we also discussed the neutral key rate range. At the current stage, ***we have reviewed our real neutral key rate range downwards to 1–2% from 2–3%. This means that the nominal neutral interest rate range declines to 5–6%, taking into account the annual inflation target close to 4%.*** *The adjustment of the neutral interest rate estimate is primarily related to changes in external factors, including the formation of interest rates in the global economy at a lower level. We also took into account the decrease of the country risk premium. That said, I would like to remind you that a neutral rate of interest is basically a virtual indicator, which cannot be directly observed and depends on a very wide range of factors. The estimate of the neutral interest rate range is based on a comprehensive analysis that was provided to us.*

In conclusion, let me reiterate that we make our monetary policy decisions primarily based on our objective to stabilise inflation close to the 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 24 JULY 2020

KEY FORECAST PARAMETERS OF THE BANK OF RUSSIA BASELINE SCENARIO
(growth as % of previous year, if not indicated otherwise)

Table 1

	2019 (actual)	Baseline		
		2020	2021	2022
Urals price, average for the year, US dollars per barrel	64	38	40	45
Inflation, as % in December year-on-year	3	3.7–4.2	3.5–4.0	4
Inflation, average for the year, as % year-on-year	4.5	3.1–3.3	3.3–4.0	4
Gross domestic product	1.3	-(4.5–5.5)	3.5–4.5	2.5–3.5
Final consumption expenditure	2.4	-(3.8–4.8)	3.5–4.5	1.7–2.7
– households	*2.5*	*-(6.2–7.2)*	*4.3–5.3*	*2.0–3.0*
Gross capital formation	3.8	-(9–12)	4.8–6.8	4.2–6.2
– gross fixed capital formation	*1.5*	*-(5.7–7.7)*	*2.5–4.5*	*3.8–5.8*
Export	-2.3	-(13–15)	4.5–6.5	4.5–6.5
Import	3.4	-(18.8–21.8)	7.7–9.7	6.0–8.0
Money supply in national definition	9.7	9–12	7–11	7–11
Claims on organisations and households in rubles and foreign currency*	10.1	6–9	7–11	7–11
– on organizations	*7.1*	*6–9*	*6–10*	*6–10*
– on households	*19*	*6–9*	*10–11*	*10–11*

** Banking sector claims on organisations and households mean all of the banking sector's claims on non-financial and financial institutions and households in rubles, foreign currency and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investment in debt and equity securities and promissory notes, as well as other forms of equity interest in non-financial and financial institutions, and other accounts receivable from settlement operations involving non-financial and financial institutions and households. Claims' growth rates are given with the exclusion of foreign currency revaluation. In order to exclude the effect of foreign currency revaluation the growth of claims in foreign currency and precious metals is converted to rubles using the period average USDRUB exchange rate.*

Source: Bank of Russia.

RUSSIA'S BALANCE OF PAYMENTS INDICATORS IN THE BASELINE SCENARIO*
(bln of US dollars)

Table 2

	2019 (actual)	Baseline		
		2020	2021	2022
Current account	**65**	**2**	**3**	**10**
Balance of trade	165	58	74	96
Export	*420*	*286*	*308*	*350*
Import	*255*	*228*	*234*	*255*
Balance of services	-36	-18	-31	-44
Export	*63*	*46*	*52*	*56*
Import	*99*	*64*	*83*	*100*
Balance of primary and secondary income	-64	-38	-40	-42
Current and capital account balance	**65**	**1**	**3**	**10**
Financial account (excluding reserve assets)	**-4**	**19**	**15**	**7**
Government and the central bank	-23	-6	-9	-8
Private sector	19	25	25	15
Net errors and omissions	**-2**	**-1**	**0**	**0**
Change in reserve assets ('+' – increase, '-' – decrease)	**66**	**-18**	**-13**	**3**

** Using the methodology of the 6th edition of "Balance of Payments and International Investment Position Manual" (BPM6). In the Financial account "+" stands for net lending, "-" – for net borrowing. Due to rounding total results may differ from the sum of respective values.*

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.*

1. ECONOMIC OUTLOOK

In the first half of 2020, most economies in the world were affected by factors associated with the spread of coronavirus infection. Data released since the publication of MPR 2/20 indicate a stronger than previously expected drop in the world economy in Q2. However, the pace of its recovery in the medium term is likely to be moderate, given the persistent spread of coronavirus and the associated continuation of restrictive measures in a number of countries. Therefore, the output gap of Russia's key trading partners will remain negative across the forecast horizon, meaning weak external demand for the Russian economy. In particular, the dynamics of Russian exports will be constrained by the production restrictions limits under the OPEC+ agreement.

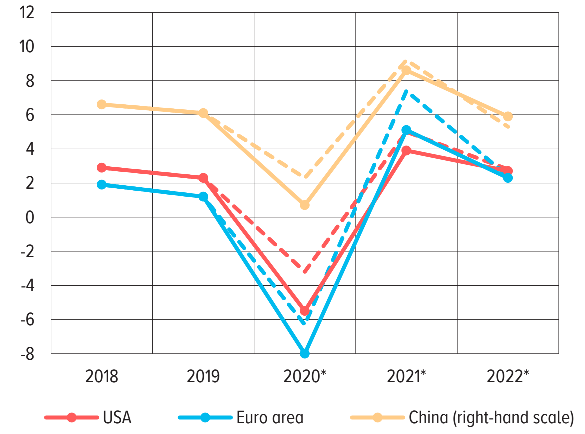
The effects of the coronavirus pandemic and respective restrictions on the Russian economy in the second quarter were also more significant than previously estimated mainly due to the longer duration of the restrictive measures. At the same time, in 2020 Q3-Q4, the GDP will grow at a faster pace than previously expected, both as a result of a more accommodative fiscal policy and due to the slower recovery of imports (especially services imports). In 2020, GDP will decline by 4.5–5.5%, which is overall in line with the forecast in MPR 2/20.

In 2021–2022, the Russian economy will transition to dynamic recovery, which will be facilitated by an accommodative monetary policy and gradual recovery of the world economy. The negative output gap will be closed by mid-2022. At the same time, in 2021, the influence of the fiscal policy will become more restrained, and in 2022 budget expenditure will return to a level consistent with the fiscal rule.

In 2020–2021, the continued negative output gap will contribute to relatively low inflationary pressure, which, given the larger drop in domestic demand in Q2 this year, is reflected in a lower inflation forecast compared to April: the forecast for 2020 was lowered from 3.8–4.8% to 3.7–4.2%. By the end of 2021, inflation will be 3.5–4.0% and thereafter will remain near the 4% target.

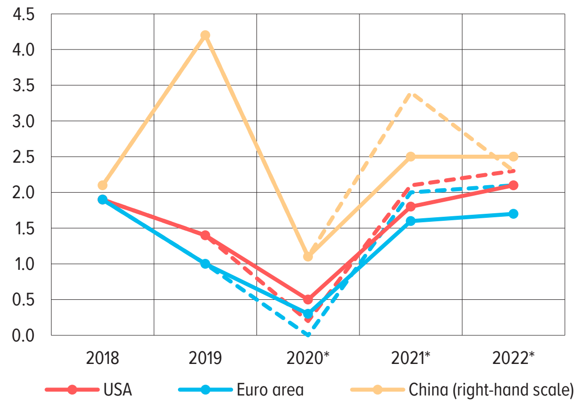
Currently, there is still great uncertainty with regard to the duration and scale of the pandemic, related restrictive measures in various countries, and the consequences for the global and Russian economies. The baseline forecast of the Bank of Russia does not include a second wave of the pandemic. However, this risk was considered when the Bank of Russia Board of Directors discussed its key rate decision at its meeting held on 24 July.

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



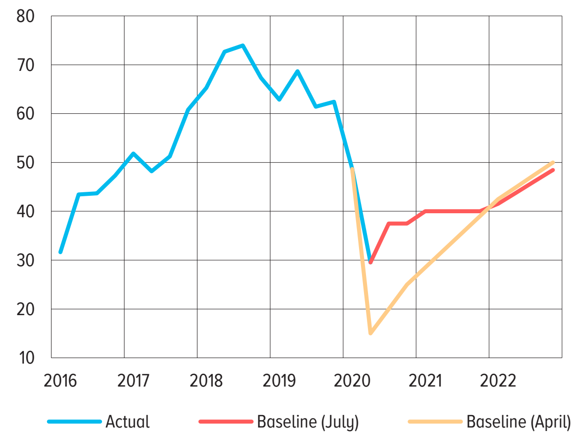
** Forecast. Dotted line shows the previous forecast (April 2020).*
Source: Bank of Russia calculations.

INFLATION INDICATORS IN MAJOR ECONOMIES IN THE BASELINE SCENARIO *Chart 1.1.2*
(% change YoY, average for Q4 in each period)



** Forecast. Dotted line shows the previous forecast (April 2020).*
Note: PCE Price Index is forecast for the USA, HICP – for the euro area, and CPI – for China.
Sources: Bank of Russia calculations, Bloomberg.

OIL PRICE TRAJECTORY* IN THE BASELINE SCENARIO *Chart 1.1.3*
(US dollars per barrel)



** Nominal Urals crude prices (the arithmetic mean of Urals crude price delivered to the Mediterranean and north-western Europe).*
Source: Bank of Russia calculations.

Restrictive measures and uncertainty have led to a deep downturn in the world economy

The rapid spread of the coronavirus infection around the world in the first half of 2020 and the accompanying imposition of restrictive measures have had a very significant impact on most economies. The scenario conditions of the forecast published in MPR 2/20 assumed a decline in global business activity greater in scope than the global financial crisis of 2008–2009. Subsequent economic data suggest that the global economy is slowing down more profoundly than previously expected. As a result, the Bank of Russia's baseline forecast assumes a more significant decline in growth rates in the USA and the euro area in Q2 this year, and a recovery in China, albeit at a somewhat slower pace than expected in MPR 2/20.

Overall, the pace of global economic recovery across the forecast horizon will be moderate, given the continuing spread of the coronavirus infection in a number of countries and the associated restrictive measures. This will be furthered by both a lower potential output path compared to earlier assumptions and a slower cyclical recovery. Therefore, the output gap of the economies of the USA, the euro area and China will continue to be negative across the whole forecast horizon, resulting in lower inflationary pressure. According to the baseline scenario of the Bank of Russia, inflation in the USA and the euro area will be mostly below the US Fed's and the ECB's inflation targets (some episodes where the targets are overshot in 2022 are associated with the rise of oil prices).

A notable easing of central bank policies and fiscal stimulus measures have supported financial markets, but risk premiums will remain elevated until late 2020

The easing of monetary policy and fiscal support measures for businesses and households in many countries helped financial markets recover from a substantial slump in March. For example, in April–June, there was significant growth in the stock market, weakening of the US dollar against the currencies of advanced and developing economies, reduction of volatility and risk premiums, and an inflow of capital to emerging market economies (EMEs).

The observed decrease in the risk premiums for EMEs made it possible to revise estimates of their trajectories to lower levels. However, uncertainty about the speed of recovery in the world economy, the likelihood of renewed tightening of restrictive measures in the world. and the risks of market correction after rapid market growth in recent months lead us to maintain the assumption of elevated levels of risk premiums for EMEs and Russia until the end of 2020. Also, an additional factor for a conservative view is the continued risk of an escalation in the trade conflict between the USA and China.

Subdued inflationary pressure over the forecast horizon will allow the central banks of major economies to continue to implement a loose monetary policy. In 2020, the US Fed and the ECB will continue to expand their balance sheets and maintain the current rates unchanged over the forecast horizon. The speed of balance sheet expansion will largely depend on the process of economic recovery, dynamics of prices on financial assets and the situation with the spread of coronavirus.

The Bank of Russia also continues to proceed from the assumption that the US dollar will gradually weaken against the currencies of advanced economies. A faster weakening of the dollar than previously expected in April–June as well as the clarification of the US Fed's rate path led to a lower forecast for the dollar than the forecast in MPR 2/20.

Signs of shortages have appeared in the world oil market

In spring of 2020, a significant amount of excess supply built up in the oil market as a result of the fall of global demand. Oil consumption remains low due to the depth of the global economic downturn and air transportation shutdowns in several countries. However, compared to April–May, demand is increasing amid easing restrictions and recovery in business activity. These trends have already shifted the balance in the oil market.

Additional voluntary production cuts by Saudi Arabia, the UAE, Kuwait and Oman in June, totalling approximately 1 million barrels per day (million bpd), the extension to July of the record 9.7 million bpd production cut by OPEC+, and the overall high level of compliance with the agreements contributed to the rebalancing of the market and an increase in oil prices. Moreover, countries that failed to fully meet their obligations in May–June will be required to compensate for the unfulfilled production cuts in July–September in addition to the reductions agreed upon for those months. Production cuts outside OPEC+, which were observed amid lower investments in the sector, also made a positive impact on prices.

As a result of the above factors, the price of oil in Q2 was higher than forecast in MPR 2/20. In the baseline scenario, the average annual price of oil was revised upward from $27 to $38 per barrel in 2020 and from $35 to $40 per barrel in 2021, while for 2022 it remained unchanged ($45 per barrel). The price is still expected to rise to $50 per barrel at the end of 2022 and thereafter it will stabilise at that level. The recovery of demand will contribute to the growth of oil prices. However, this growth will be restrained due to the recovery of oil supply outside OPEC+ and the easing of production limits established by the agreements.

The global economic downturn resulted in a large-scale adverse external demand shock for the Russian economy

Restrictive measures imposed around the world led to a significant drop in overall consumption and, in particular, in the consumption of goods and services exported by Russia. Production limits under the OPEC+ agreement were a consequence of these developments.

At the same time, the actual data for 2020 Q2 show that the physical quantities of oil exports declined less than oil production in Russia. This can be explained primarily by lower domestic consumption of energy commodities during the period of self-isolation and substantial external demand for sour oil amid shortages of it as a result of reduced supply within OPEC+.

The fall of non-oil and gas exports was also deeper than expected. Exports of coal, metals and timber decreased due to the recession in the world economy. At the same time, there was an increase in the export sales of gold.

It is expected that external demand will remain at a low level at least until the end of the current year; accordingly, the downturn of Russian exports in real terms will amount to 13–15% in 2020. The current account surplus observed in previous years will go down to almost zero in 2020. At the same time, this is a significant upward revision compared to MPR 2/20, where the current account balance was expected to go to negative territory. The adjustment reflects higher export forecasts at higher oil prices and a more substantial decline in services imports due to prolonged restrictions.

Amid higher current account revenue, foreign assets and net lending by the Russian private sector to the rest of the world are expected to grow more than forecast in MPR 2/20. At the same time, reserves are expected to decrease less substantially due to lower fiscal rule-based foreign currency sales and higher oil prices.

Restrictive measures imposed within Russia caused simultaneous adverse shocks on supply and domestic demand

The lengthy period of non-work days put a halt to the activities of some production facilities and the services sector. Parallel stoppages of production facilities in other countries disrupted global production chains and associated supplies of equipment or components even for operating businesses. Moreover, additional bans on business activities were imposed on a number of sectors, in particular, in the services segment (transport, personal and entertainment services). The prolonged stoppage of production facilities and reduced production activity did not relieve businesses of their fixed costs (such as rent, utility bills, etc.); as a result, some businesses will not be able to recover and will be forced to leave the market.

In Q2, consumer activity remained significantly below the level observed at the beginning of the year despite a surge in household consumption of certain categories of goods in anticipation of restrictive measures. The drop in household income caused by a drop in commercial activities by a number of businesses (especially in the services sector) will hinder a rapid recovery of consumer activity. According to the Bank of Russia's forecast, in 2020, households final consumption expenditure will decline by 6.2–7.2%.

The measures restricting air travel, combined with lower incomes and weakening of the ruble, also led to a deep drop in the consumption of imported goods and, to a much greater extent, the consumption of services in 2020 Q1-Q2. Due to these factors, the recovery of imports will be slower than expected in MPR 2/20, which affected the revision of the GDP growth estimate for 2020. According to the forecast, in 2020, imports will fall by 18.8–21.8% (MPR 2/20 estimated the decline at 5.6–11.6%).

Consumption of investment goods also declined substantially in 2020 Q2. While in Q1 investment activity followed inertial trends based on the plans prepared at the end of last year, in Q2 most companies announced a revision of their investment programmes at least until the end of the year. Oil and gas companies have also revised their investment programmes due to the correction in the balance of supply and demand in the oil market and the accompanying agreement on production limits. In addition, the weakening of the ruble since early 2020 has forced a number of companies to revise their plans to purchase imported equipment.

Over the 2020 forecast horizon, investment activity will be significantly affected by the general uncertainty associated with the further spread of coronavirus and the probability of reimposed or strengthened restrictive measures. Events in early 2020 have already led to a decline in private investment in the Russian economy, and, despite some compensatory effect from the implementation of national projects, gross fixed capital formation will decrease by 5.7–7.7% for the year.

The slowdown in consumer activity of households and investment activity of companies in light of falling incomes will also affect lending dynamics. For the year, the Bank of Russia expects the growth rate of the banking sector's claims on the economy to slow down to 6–9%, which will be largely shaped by the rapid slowdown in the growth of claims on households (especially as regards consumer loans). The dynamics in claims on organisations will remain near the current levels as, despite the general decline in economic activity this year, businesses will demand loans to finance their operating activities amid shrinking revenues. The growth of the money supply will be further supported by the operations of the budget sector and will be at the level of 9–12% for the year.

Inflationary pressure will remain restrained during the year amid weak demand and a gradual recovery in supply.

The weakening of the ruble exchange rate in the first half of the year led to a temporary acceleration of the price growth rate. Currently, the pass-through of the weaker exchange rate to prices has largely materialised, although in certain categories of goods and services its effect may continue on the horizon of Q3-Q4.

Over the forecast horizon of 2020, disinflationary pressure will come primarily from the realised shock of domestic demand and the negative output gap. As a result, the Bank of Russia estimates that by the end of 2020 the price growth rate will be in the range of 3.7–4.2%.

The fiscal and monetary policies will support the Russian economy in 2020

In 2020, both the fiscal and monetary policies are aimed at easing the conditions for the Russian economy.

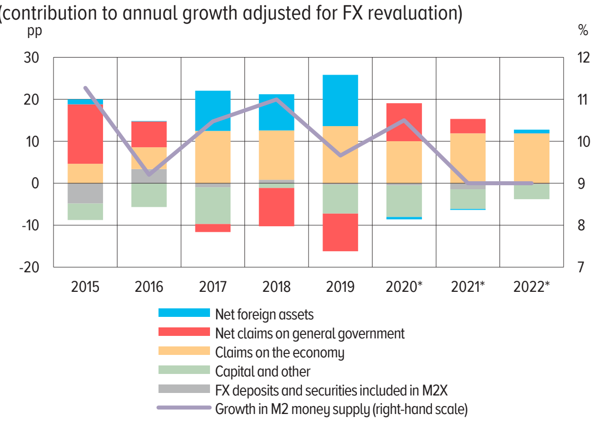
The measures taken by the Government of the Russian Federation have supported households and businesses in the industries most severely affected by the coronavirus restrictions. Household support measures smoothed out the drop in incomes in Q2. Measures aimed at supporting companies will enable the economy to start a dynamic recovery as early as 2020 Q3.

As a result, the baseline scenario forecasts federal budget expenditure and borrowings to be at a higher level compared to MPR 2/20. The federal budget deficit in 2020 will be near 5% of GDP.

The dynamics of the economy and inflation in 2020 will also be affected by the easing of monetary policy undertaken by the Bank of Russia since mid-2019. In June 2019 – July 2020, the key rate was cut by 350 bp. At the same time, the main impact of the decisions taken over the recent months will become

DECOMPOSITION OF MONEY SUPPLY GROWTH IN THE NATIONAL DEFINITION IN THE BASELINE SCENARIO BY SOURCE* *Chart 1.1.4*

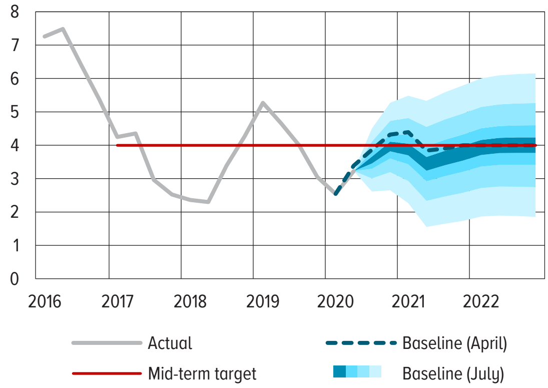
(contribution to annual growth adjusted for FX revaluation)



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

INFLATION TRAJECTORY IN THE BASELINE SCENARIO *Chart 1.1.5*

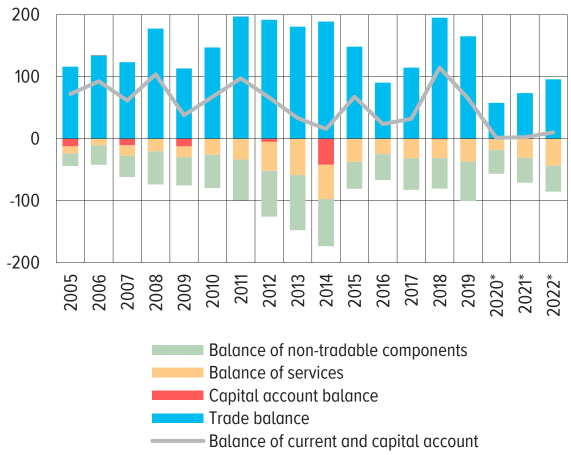
(% change on the same period of the previous year)



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 historical estimates of inflation uncertainty.
Source: Bank of Russia calculations.

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

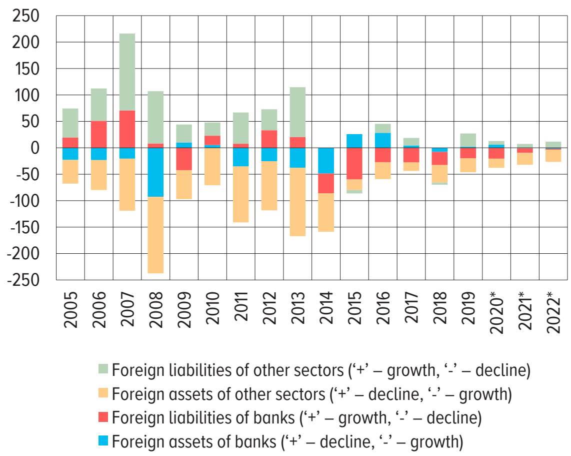
Chart 1.1.6



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

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

Chart 1.1.7



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

apparent in 2021. Given monetary policy lags, the deep economic downturn caused by the effects of the pandemic cannot be instantly offset by loose monetary and fiscal policies. Therefore, the current price growth is likely to remain below 4% in annual terms until the end of 2020.

Recovery of the Russian economy in 2021–2022 will be in sync with the rest of the world

Many countries are making strong efforts to develop a coronavirus vaccine, and clinical protocols are being gradually elaborated. It is expected that in 2021 the restrictions on activities will remain minimal, and the economies of most countries, including Russia, will recover. With the gradual recovery of the world economy and persistently loose monetary policy pursued by advanced economies, risk premiums will decline to long-term equilibrium levels. However, even with the recovery rate moderately exceeding potential growth rate, by the end of the forecast period, global GDP will not reach the level projected before the pandemic.

For the Russian economy, the negative effect of external demand shock will preserve its effect over the entire forecast horizon, and in 2021 the current account balance will remain near zero. In 2022, the current account surplus will increase to 1% of GDP due to rising oil prices. The private sector financial account balance is expected to shrink amid Russia's growing investment attractiveness and accelerated economic growth.

In 2021–2022, the Russian economy will see a recovery in consumer and investment demand: household consumption will increase by an average of 4.3–5.3% in 2021 and by 2–3% in 2022, and gross fixed capital formation will accelerate to 2.5–4.5% and 3.8–5.8% in 2021 and 2022, respectively. The demand for credit will expand against the backdrop of the restored confidence of households and businesses in future income flows. This will be facilitated both by the easing of non-price lending conditions amid reduced uncertainty and by low interest rates reflecting the accumulated effect of the accommodative monetary policy. The growth rate of the banking system's claims on the economy will rise to 7–11% mainly due to the accelerated growth of claims on households (to 10–14%), while claims on organisations will expand less noticeably (to 6–11%). Nonetheless, the negative effects of the domestic demand shock will persist, and domestic demand will reach its pre-crisis levels only by 2022.

The process of fiscal consolidation will begin as the economy recovers. This consolidation will be gradual, and budget expenditure in 2021 will exceed the level implied by the fiscal rule. The effect of fiscal support measures will reach its peak in early 2021, and starting the second half of 2021 the fiscal stimulus will fade as fiscal consolidation measures will be implemented. The 2022 forecast assumes that expenditure will be at the level of parameters established by the fiscal rule.

The above conditions suggest that the Russian economy may experience dynamic recovery growth by 3.5–4.5% in 2021 and by 2.5–3.5% in 2022. At the same time, potential output will grow moderately by 1.0–1.5%. The Bank of Russia estimates that a small negative output gap may persist for most of 2022 due to the incomplete recovery of external demand, continued low capacity utilisation at some enterprises, measures aimed at consolidating expenditure in the fiscal system and continued limits under the OPEC+ agreement.

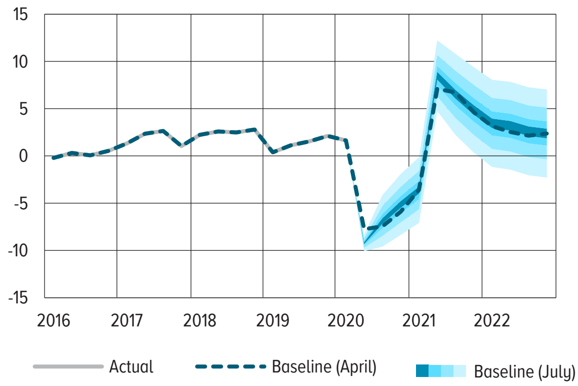
A negative output gap leads to moderate inflation dynamics, which calls for a loose monetary policy in order to bring inflation back to its target level by the end of 2021.

Uncertainty remains high in the baseline scenario

For now, it is very difficult to fully assess the scale of shocks that have already occurred. Apart from the high uncertainty regarding the recovery growth path, additional uncertainty lies in assessing the impact of the pandemic on the path of potential output in Russia and around the world as well as potential changes in the transmission mechanism under current conditions due to the scale and nature of shocks.

Additionally, a more lengthy and extensive spread of coronavirus in Russia and other countries, than expected in the baseline

GDP GROWTH TRAJECTORY IN THE BASELINE SCENARIO *Chart 1.1.8*
(% change on the same period of the previous year)



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

scenario, may lead to the reimposition of some restrictions or prolonged duration of the restrictive measures currently in place in the second half of 2020. In this case, the price of oil may be noticeably lower than the path described in the baseline scenario despite the efforts of OPEC+ to contain excess supply.

Long-term restrictions and expectations of a second wave of the epidemic, combined with uncertainty around the creation of a vaccine and low oil prices, may worsen consumer and business sentiment. Under the influence of persistently weak consumer and investment demand as well as declining oil and gas revenue in the economy, inflation may drop markedly below the level forecast by the baseline scenario. In addition, wages will remain at a lower level for a longer period of time, which will also have a disinflationary effect.

Another material risk for the baseline scenario is uncertainty about the effectiveness and adequacy of economic policy measures adopted worldwide to support companies and households. The recovery of the world economy may be slower than expected in the baseline scenario. While governments will be forced to move toward rapid fiscal consolidation due to the growth of public debt and high budget deficits as early as in 2021, companies and households will still need support, albeit to a less extent.

2. INFLATION AND INFLATION EXPECTATIONS

In 2020 Q2, consumer prices demonstrated mixed dynamics. The first half of the quarter was dominated by temporary inflationary factors associated with measures for containing the spread of the coronavirus pandemic. Inflationary pressure also shaped the weakening of the ruble which occurred at the end of Q1. In addition, social distancing measures (suspension of or restrictions on the sale of goods and services) resulted in increased price volatility.

As the restrictions were lifted, the impact of longer-term disinflationary factors became apparent. The effect of weak demand aggravated by declining household incomes has become more noticeable. In annualised terms, monthly price growth sank below 4%. Nevertheless, the situation with prices continued to be mixed, reflecting differences in the stages established for the removal of restrictions in markets for individual goods and services as well as in the regional context. For example, in May–June, the annualised monthly increase in food prices (excluding fruit and vegetable prices) remained high, while the rates of price change for services most affected by the restrictions showed volatility.

Short-term inflationary expectations of households and businesses rose at the beginning of the quarter. In May–July, they fell but still remained at an elevated level. Household expectations for one year ahead have stabilised. Professional analysts' expectations remain anchored to the inflation target (close to 4%).

The recovery of the global and Russian economies is expected to be gradual, and in the coming quarters the disinflationary influence of the current decline in incomes and demand will be a key factor for price dynamics. Monthly growth rates of consumer prices are projected to be at a low level. At the same time, annual inflation will rise, as the low values of the second half of 2019 are excluded from calculation, and by the end of 2020 will amount to 3.7–4.2%.

With the prevailing impact of weak domestic and external demand, there remains a risk of inflation deviating downward from the target over the forecast horizon. The substantial easing of monetary policy implemented since April is aimed at mitigating this risk and stabilising inflation near 4%. For 2021, annual inflation is forecast at 3.5–4%; thereafter, it will stabilise at 4% in 2022.

CONSUMER PRICES FOR MAIN GROUPS OF GOODS AND SERVICES IN 2020 *Table 2.1*
(% change on previous month, SA)

	January	February	March	April	May	June
Inflation	0.18	0.22	0.48	0.77	0.29	0.25
Food products (excluding fruit and vegetables)	0.05	-0.01	0.64	0.91	0.50	0.47
Non-food goods (excluding petroleum products)	0.27	0.08	0.53	0.57	0.33	0.33
Services (excluding utilities)	-0.15	0.54	0.24	0.22	0.43	-0.40

Sources: Rosstat, Bank of Russia calculations.

CONSUMER PRICES FOR MAIN GROUPS OF GOODS AND SERVICES IN 2020
(% change on the same month of the previous year)

Table 2.2

	January	February	March	April	May	June
Inflation	2.42	2.31	2.54	3.09	3.02	3.21
Food products (excluding fruit and vegetables)	2.54	2.25	2.70	3.40	3.44	3.61
Non-food goods (excluding petroleum products)	2.71	2.42	2.66	2.99	3.08	3.22
Services (excluding utilities)	2.86	3.16	3.10	2.97	3.12	2.37

Source: Rosstat.

CONSUMER PRICES FOR MAIN GROUPS OF GOODS AND SERVICES IN 2020
(% change on previous month, SAAR)

Table 2.3

	January	February	March	April	May	June
Inflation	2.18	2.67	5.91	9.64	3.54	3.04
Food products (excluding fruit and vegetables)	0.59	-0.14	8.00	11.44	6.16	5.75
Non-food goods (excluding petroleum products)	3.24	0.96	6.50	7.06	3.98	4.03
Services (excluding utilities)	-1.78	6.62	2.89	2.66	5.30	-4.73

Sources: Rosstat, Bank of Russia calculations.

INFLATION

Prices had mixed dynamics in 2020 Q2. These dynamics were shaped by the balance of both short-term and longer-term disinflationary and proinflationary factors. **The first half of the quarter was dominated by temporary proinflationary factors**, such as increased demand for certain goods and services due to the spread of the coronavirus epidemic in Russia and the transition of a significant part of the population to the self-isolation regime. We noted an increase in the monthly (estimated, seasonally adjusted, hereinafter, SA) and annual rates of appreciation for some groups of goods, including those whose prices do not usually show high volatility. At the same time, price volatility increased in the services market.

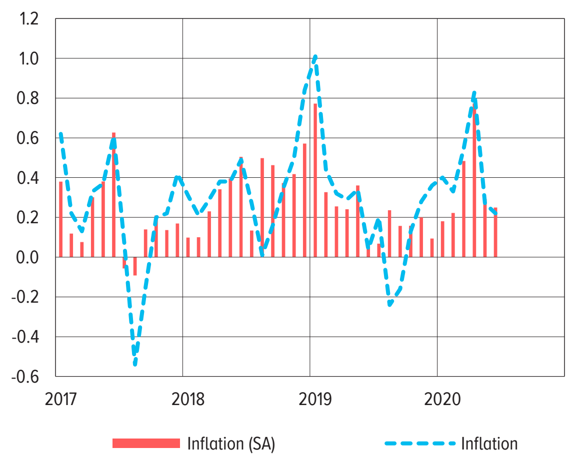
As restrictions were lifted, the impact of longer-term disinflationary factors became apparent; among these, weak demand played a major role. In May–June, the seasonally adjusted annualised rate (SAAR) of the monthly growth of consumer prices returned to readings below 4%. Nevertheless, the situation with inflation remained mixed as it was driven by differences in the stages of easing restrictions both in the markets of individual goods and services and across the regions of Russia. For example, the decline of food inflation, excluding fruit and vegetable prices (the most volatile component), which was under pressure from rising costs, was relatively slow. The dynamics in prices for services, many of which were still subject to restrictions, showed marked fluctuations.[1]

Based on the developments in Q2, the Bank of Russia revised its estimate with regard to the scale of the impact produced by disinflationary factors on prices and downgraded its inflation forecast for 2020 to 3.7–4.2%.

The impact of short-term factors associated with measures for containing the spread of the coronavirus infection

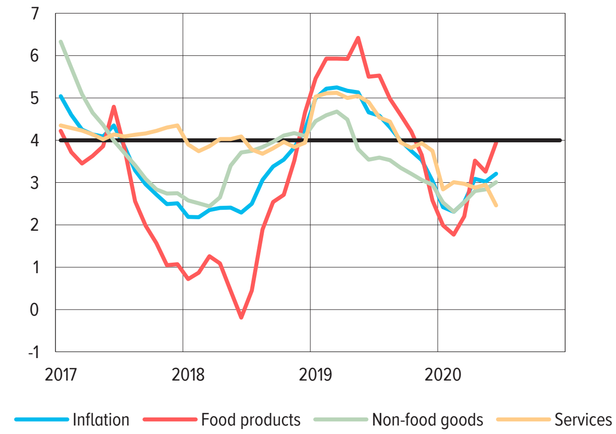
During Q2, price dynamics were shaped by one-time proinflationary factors of a non-monetary nature associated with measures for fighting the spread of the coronavirus pandemic.

INFLATION *Chart 2.1*
(% change on previous month)



Sources: Rosstat, Bank of Russia calculations.

INFLATION AND ITS COMPONENTS *Chart 2.2*
(% change on the same month of the previous year)



Source: Rosstat.

[1] *See the Box. Suspension in provision of certain services and inflation in 2020 Q2.*

FRUIT AND VEGETABLE PRICES IN 2020 *Table 2.4*
(% change on the same month of the previous year)

	January	February	March	April	May	June
Fruit and vegetables	-2.6	-2.2	-1.9	4.0	1.6	6.0
Potatoes	-14.4	-15.1	-11.0	2.1	-2.2	2.1
Lemons	5.7	13.1	22.7	187.5	69.1	16.8

Source: Rosstat.

DURABLE FOOD PRODUCTS PRICES IN 2020 *Table 2.5*
(% change on the same month of the previous year)

	January	February	March	April	May	June
Sugar	-32.4	-32.1	-22.4	-15.9	-14.9	-12.9
Meat and poultry	-0.9	-15.1	-11.0	2.1	-2.2	2.1
Cereals and legumes	13.9	11.9	13.4	20.1	24.1	25.9

Source: Rosstat.

PRICES OF MEDICINES AND HYGIENE ITEMS IN 2020 *Table 2.6*
(% change on the same month of the previous year)

	January	February	March	April	May	June
Medicines	6.6	6.3	7.1	9.8	9.6	8.8
Toilet soap	5.8	4.9	5.4	6.4	6.7	7.5
Toilet paper	4.2	3.3	3.9	4.9	4.9	5.4

Source: Rosstat.

MOBILE SERVICE AND PETROL PRICES IN 2020 *Table 2.7*
(% change on the same month of the previous year)

	January	February	March	April	May	June
Mobile service	3.7	6.1	7.3	7.1	9.9	9.9
Motor petrol	1.4	1.6	1.8	1.7	1.4	1.5

Source: Rosstat.

First of all, it was the introduction of the self-isolation regime in Russian regions. The population's preparations for life in a new environment were accompanied by a surge in demand and prices for certain goods and services (durable food products, folk 'antivirals', essential non-food goods, medicines, and communication services). The proinflationary impact of this factor was already apparent at the end of March. In April 2020, the rate of monthly price growth (SA) increased by 0.3 pp compared to March and amounted to 0.8%, while in June 2019 – February 2020 it was in the range of 0.1–0.2%. In April, annualised inflation increased by 0.6 pp to 3.1%.

The highest acceleration in April was reported for the growth of food prices. The greatest contribution to the increase in food inflation was made by the accelerated growth of fruit and vegetable prices, primarily citrus fruits (a popular folk remedy for the prevention of viral infections), the appreciation of which was further affected by the weakening of the ruble. There was a noticeable increase in the annual rate of appreciation of food products (such as meat and poultry, cereals and sugar) which people purchased to stock up for future use. Price growth also accelerated for medicines and hygiene items.

In May, there was an increase in the annual growth of rates for the services of mobile operators (by 2.8 pp to 9.9%), which was driven by the higher costs of infrastructure development amid increased demand from workers and students who started to work and study from home.

In April, Russian regions completed the introduction of self-isolation regime, and since mid-May some regions have begun to gradually ease them. With the end of panic buying, in May, the monthly increase in consumer prices fell to 0.3% (SA), and annual inflation declined to 3.0%. The annual growth of prices for fruit and vegetables, meat and poultry, and medicines slowed down. In June, the annual growth of rates for mobile communications stopped rising, reflecting the start of the return of workers from remote to regular work arrangements and the end of the academic year for school pupils and students. At the same time, with the recovery of economic activity and renewed mobility of the population, there was a hike in the annual growth rate of motor fuel prices after its decline in April–May. This reflected a rapid expansion of demand outstripping the growth of supply, which slowed down during the period of self-isolation.

Measures aimed at preventing the spread of the epidemic included the suspension of some services, which sharply increased price volatility. This was especially true for air travel and foreign tourism services, whose prices fluctuated widely during the entire quarter.

Further easing of restrictions and recovery of economic activity will be accompanied by the normalisation of demand structure and the reduction of price volatility.

Impact of the dynamics of the ruble exchange rate

Amid a marked decline of the ruble exchange rate at the end of 2020 Q1, there was a significant increase in demand and accelerated growth of prices for household appliances and consumer electronics (see MPR 2/20).

In April, the impact of exchange rate dynamics on prices was distorted by the effect of self-isolation measures (change in the format of retail trade, temporary shift in the structure of household demand in favour of essential goods) and, in addition, had a lower relative importance compared to the contribution of panic buying. However, in May, following the exhaustion of the short-term effects, the weakening of the ruble made a more noticeable contribution to inflation.

First of all, this was reflected in the higher annual growth rate of prices for goods with a notable import component in the price. Another channel for the impact of exchange rate dynamics on inflation was the increase in export parity prices and the build-up of pressure on the domestic prices of grain and grain products. State interventions in the grain market launched in the middle of April and the introduction of quotas on grain exports to non-EAEU states (for the period from 1 April to 30 June) contributed to the stabilisation of the market.

In the coming months, the impact of the weakening of the ruble exchange rate which occurred in Q1 will come to an end.

AIR TRANSPORTATION AND OUTBOUND TOURISM SERVICES PRICES IN 2020 *Table 2.8*
(% change on the same month of the previous year)

	January	February	March	April	May	June
Outbound tourism	0.2	0.3	1.2	1.3	-0.6	-2.5
Air transportation	7.1	8.6	0.0	3.7	6.2	-7.6

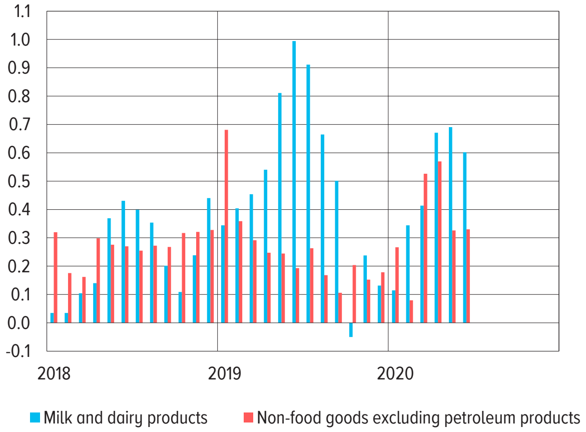
Source: Rosstat.

PRICES FOR CERTAIN GOODS IN 2020 *Table 2.9*
(% change on the same month of the previous year)

	January	February	March	April	May	June
Personal computers	-1.1	-1.5	-0.1	1.1	1.5	1.9
Passenger cars	2.5	2.3	2.3	2.7	3.1	3.4
Household refrigerators	-1.0	-1.3	0.3	1.9	2.2	2.7
Coffee	0.1	-0.3	0.0	0.0	1.0	0.9

Source: Rosstat.

PRICES FOR NON-FOOD PRODUCTS (EXCLUDING PETROLEUM PRODUCTS), MILK AND DAIRY PRODUCTS *Chart 2.3*
(% change on previous month, SA)



Sources: Rosstat, Bank of Russia calculations.

Impact of demand dynamics

As the effect of short-term proinflationary factors wanes, the role of such a longer-term disinflationary factor as weakening demand has become more apparent. It had a significant constraining impact on the growth of prices in the past as well. This year, weak economic activity amid imposed restrictions aimed at preventing the spread of the epidemic has led to a decline in the incomes of economic agents (see Subsection 3.3 'Economic activity'). This will in turn intensify the disinflationary impact of weak demand on inflation.

In May and June, monthly price increases fell to 0.3% and 0.2% (SA), respectively. However, the price dynamics were still mixed and largely reflected the impact of volatile components (in May, prices for fruit and vegetables; in June, prices for airline tickets and tourism services).

The impact of restrained demand could be seen, for example, in the dynamics of prices for non-food goods, excluding motor fuel: in May, their growth slowed down by 0.3 pp to 0.3% (SA) and did not change in June despite the gradual removal of restrictions on retail trade. The growth of milk and dairy prices (SA) was lower than a year earlier and was driven by weak demand amid growing supply.

In June, the annual rate of inflation amounted to 3.2%, which was 0.7 pp higher than in March. Its increase in April was due to the prevailing influence of one-time non-monetary factors, and in June it was driven by the low base effect, mainly in the fruit and vegetable market.

INFLATION EXPECTATIONS

Short-term (over the horizon of up to 1 year) inflation expectations of economic agents increased in Q2, reflecting the observed acceleration of price growth and the general increase in economic uncertainty. ***By the end of the quarter, they had declined somewhat, but their level remained elevated***. Professional analysts downgraded their inflation forecasts for 2020–2021 apparently due to the revision of forecasts toward a greater weakening of economic activity. ***They remained anchored to the Bank of Russia's target*** (near 4%).

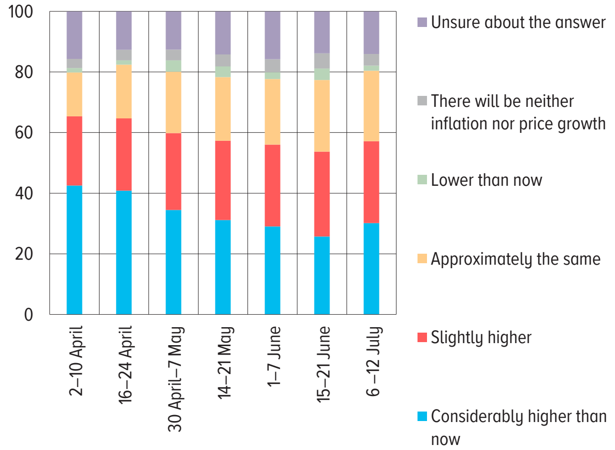
Household inflation expectations. In Q2, the observed acceleration of inflation and increased price volatility had a negative impact on worsening consumer sentiment and growing inflation expectations of households.[2] In early April, most respondents expected a pick up in the growth of prices over the horizon of one month and one year. Moreover, about *two-thirds of respondents* believed that the acceleration would be strong.

Since May, amid slowing inflation, households' perception of price-related processes has begun to improve. In June, the share of respondents describing current price growth as elevated versus the beginning of the year was lower than at the start of the quarter.[3] Inflation expectations for one month ahead showed a downward trend. A certain increase in inflation expectations in early July is traditionally associated with the indexation of tariffs on housing and utility services.

Expectations for price changes over one-year horizon were rising in the first half of the quarter, reflecting high uncertainty with regard to the development of the epidemic and, consequently, the economic situation. By the end of the quarter, the growth had stopped. However, stabilisation occurred at a high level.

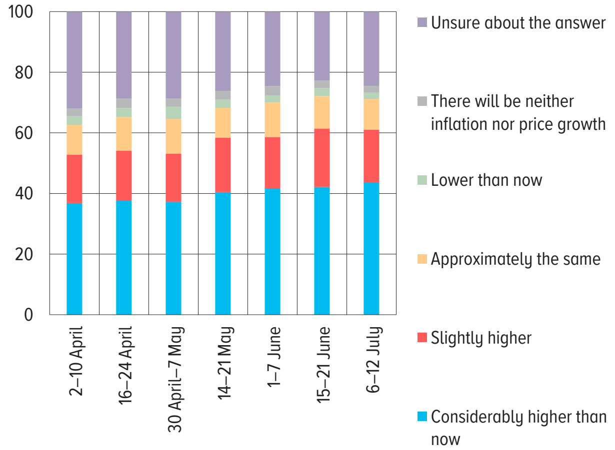
Business price expectations. According to the monitoring of enterprises conducted by the Bank of Russia, changes in business price expectations generally reflected changes in the balance of inflation factors. In April, three-month ahead expectations for price growth remained at the high level which had been reached in February. In May–July, there was a decline in expectations. The most significant decline was observed in the trade sector, where weak demand was mentioned as the main reason. In other sectors, the dynamics of price expectations were unstable and mixed, apparently due to high uncertainty about the development of the epidemic situation and the

HOUSEHOLDS' PRICE GROWTH EXPECTATIONS FOR NEXT MONTH *Chart 2.4*
(share of respondents, %)



Source: InFOM.

HOUSEHOLDS' PRICE GROWTH EXPECTATIONS FOR NEXT YEAR *Chart 2.5*
(share of respondents, %)



Source: InFOM.

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[2] *Since April 2020, inFOM has been conducting representative telephone surveys of households across Russia commissioned by the Bank of Russia. Due to substantial methodological differences, their findings cannot be compared to those obtained in earlier surveys conducted in the form of in-person interviews*

[3] *See Brief analytical report on the sixth telephone survey in 2020.*

removal of related restrictions. For example, in July, amid the gradual removal of restrictions, expectations increased in the transportation and warehousing sectors after the decline observed in June. In the construction and services sectors, price expectations rose as early as in June and remained unchanged in July.

Analysts' inflation expectations. In late March – early April, amid growing pressure of inflationary factors, the inflation forecast for 2020 made by professional analysts was revised upward (to 4.4%). Since May, it was adjusted downwards (to 3.7% in June), apparently based on the projected decrease in incomes and demand.

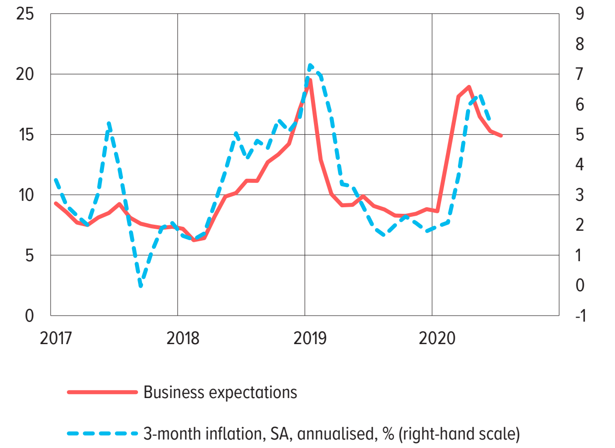
The forecast for 2021 was also lowered and amounted to 3.6% in June. This is in line with the Bank of Russia's target (near 4%).

INFLATION FORECAST FOR 2020

Until the end of this year, the disinflationary impact of lower incomes and demand will be the key factor in price dynamics. Monthly growth rates of consumer prices are projected to be at a low level. Nonetheless, the annual inflation will rise as the low values of the second half of 2019 are excluded from the calculation and **by the end of 2020 will amount to 3.7–4.2%.**

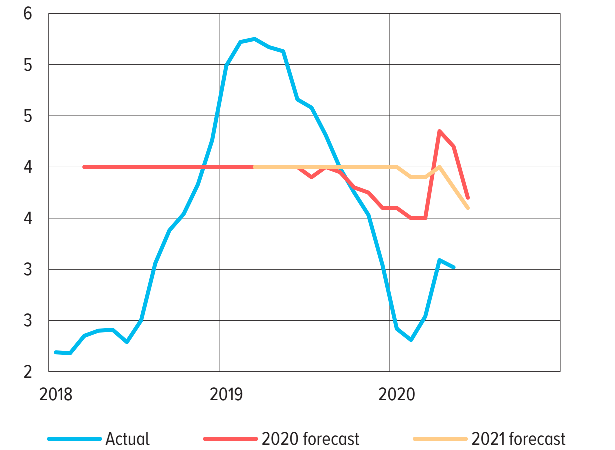
In these conditions, there remains a risk of inflation deviating downward from 4% in 2021. The substantial easing of monetary policy implemented since April is aimed at limiting this risk and stabilising inflation near 4% over the forecast horizon.

BUSINESS PRICE EXPECTATIONS *Chart 2.6*
(balance of responses, pp)



Sources: Bank of Russia, Rosstat.

ANALYST INFLATION FORECASTS *Chart 2.7*
(% change on the same month of the previous year)



Sources: Bloomberg, Rosstat.

3. MACROECONOMIC CONDITIONS[1]

The statistical data on the Russian economy released in April–June affected the Bank of Russia's forecast for GDP components in 2020 Q2. In particular, the data reveal a more significant decrease in household consumption than forecast in MPR 2/20, primarily due to a drop in services imports. The statistics on fixed capital investments indicate that the drop in gross fixed capital formation was smaller than expected in April. Therefore, according to the results of 2020 Q2, the decrease in GDP is estimated at 9–10%. Accommodative fiscal measures expanded significantly after the April meeting of the Board of Directors. Due to that and the easing of monetary policy by the Bank of Russia, we expect that economic activity will recover faster in Q3 and Q4, and the total decline of GDP for 2020 will amount to 4.5–5.5%.

*In May–July 2020, **global economic activity was heterogeneous and was determined by the phases of the coronavirus pandemic and the speed of the removal of related economic restrictions**. Advanced economies saw a peak in the decline in April, and in May–July economic activity started to recover. Most governments and central banks continued to implement measures aimed at mitigating the adverse economic impact of the pandemic and supporting financial stability.*

*In May, **global oil prices rebounded rapidly from April's multi-year lows.** This was facilitated by the implementation of the OPEC+ deal to limit oil production. In June–July, global oil prices continued to recover, albeit at a slower pace. This was due to an increase in demand, oil production cuts in the USA and the extension of stricter production quotas by OPEC+ countries in July.*

***In May–June, the ruble exchange rate continued to appreciate** due to the overall growth of EME currencies, additionally supported by a significant decrease in services imports.*

*Despite the decline in exports, **the current account remained positive in Q2.** This was facilitated by a decrease in goods imports due to lower domestic demand and a significant drop in services imports due to the quarantine restrictions.*

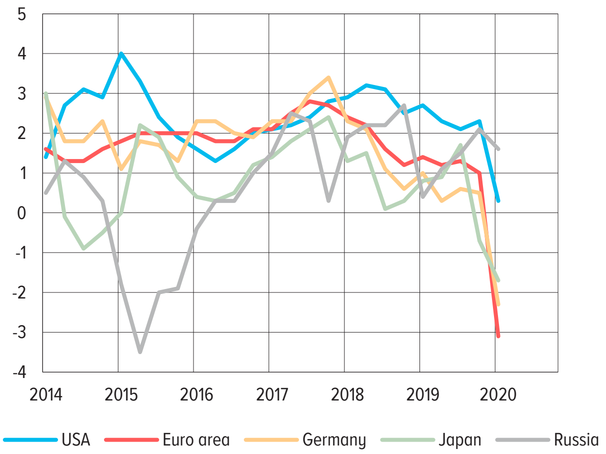
*In April–May, **loan interest rates demonstrated heterogeneous dynamics**: rates on car loans, unsecured consumer loans and long-term corporate loans grew, while mortgage rates dropped to historic lows. April saw a slowdown in retail lending, but it was short-lived; signs of recovery were already visible in May – early June. Growth of corporate lending continued in Q2. Due to the key rate cut and an increase in domestic borrowings by the public sector, **the OFZ yield curve became steeper.***

*April–May 2020 saw the **peak of the decline in industrial production** due to the introduction of non-work days and the start of oil production cuts. The labour market posted an increase in the unemployment rate due to the suspension of activities by businesses and a decline in their capacity utilisation as well as increased allowances paid to workers laid off during the pandemic. Despite support from the budget, household real disposable income dropped significantly in Q2. June data show a gradual recovery in industrial production and consumer activity. Business surveys indicate an improvement in business sentiment in the services and industrial sectors.*

*In 2020 Q2, **fiscal policy contributed significantly to domestic demand** as a result of support measures for households and companies of the affected industries. Expenditures were still being actively executed. The dynamics of non-oil and gas revenues became negative. The Q2 decline in economic activity will drag negatively on budget revenue in 2020 H2. The Ministry of Finance of Russia plans to make up for the shortfall in revenue with increased domestic borrowings. To support recovery of the economy, the Ministry of Finance has announced that federal budget expenditure in 2021 will exceed those implied by the fiscal rule.*

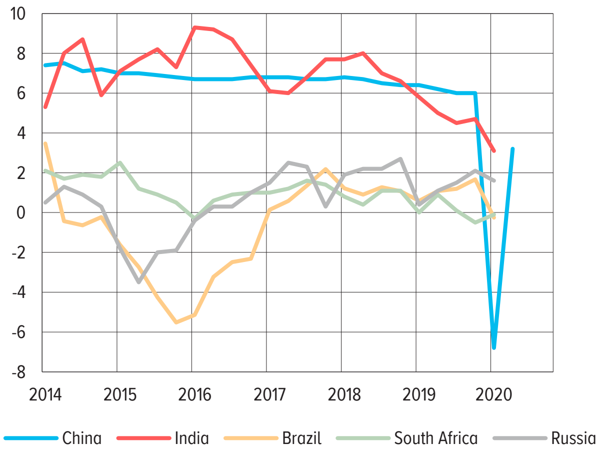
[1] *This section primarily covers the facts obtained by the Bank of Russia Board of Directors before its key rate review meeting on 24 April 2020. Some additional data which became available later but, given their relevance to the assessment of the current situation, have also been included in this section are given in italics and in brackets with the note 'Additionally'.*

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



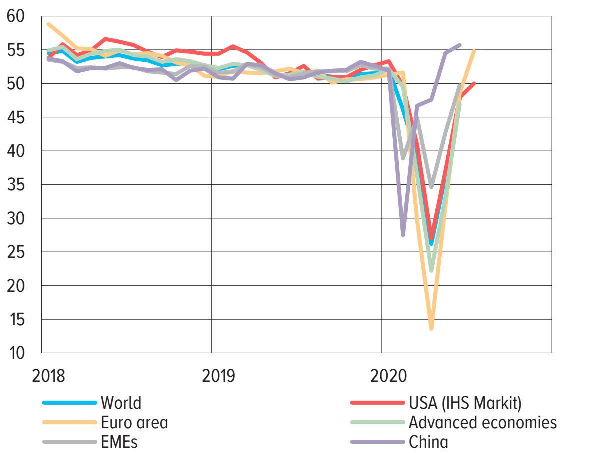
Note: 2020 Q1 statistics are released after the data cut-off date.
Source: Bloomberg.

GDP: EMES AND RUSSIA *Chart 3.1.2*
(growth rate, % change on the same period of the previous year)



Source: Bloomberg.

PMI COMPOSITE *Chart 3.1.3*
(points)



Source: Bloomberg.

3.1. EXTERNAL CONDITIONS AND BALANCE OF PAYMENTS

GLOBAL ECONOMY

Economic growth worldwide. In May–July, the world economy is recovering as restrictions on economic activity are lifted. In most large economies (where the spread of the pandemic followed China with a lag of 1–1.5 months), the bulk of industrial production activity has resumed since mid-May. In the services sector, restrictions are being lifted gradually, and some of them related to social distancing will likely last for months. Industries such as air transportation and tourism are unlikely to return to pre-pandemic levels of activity soon, given that modern communications technology can take the place of business trips and thus eliminate some of the demand for international travel. Leading indicators and official statistics are turning out to be more reliable than forecasts and so far, point to a fairly confident recovery of activity.

China. In May–June, a solid recovery was observed amid the lifting of the lockdown and resumption of production. The Caixin Composite PMI (in June, 55.7) significantly exceeded pre-pandemic levels and reached a record high since November 2010.

Given the continued improvement in May–June, in 2020 Q2, China's GDP grew by 3.2% YoY after a 6.8% drop in Q1. This is quite close to the forecast in the April report. GDP grew by 11.5% QoQ after a 9.8% drop, exceeding pre-pandemic levels.

Europe and the USA. Q1 GDP dynamics in the United States and the euro area were slightly worse than forecast in the April report. Acceleration of PMI indicators in June suggests that Q2 GDP dynamics may show a slight improvement compared to the forecast. In June, the composite PMI of the euro area grew from April's record low of 13.6 to 48.5 (France's PMI was above 50, Germany's was 45.8), while the United States' PMI grew from 27 to 47.9. Still, economic activity remains rather subdued compared to pre-pandemic levels in almost all of the above-mentioned countries.

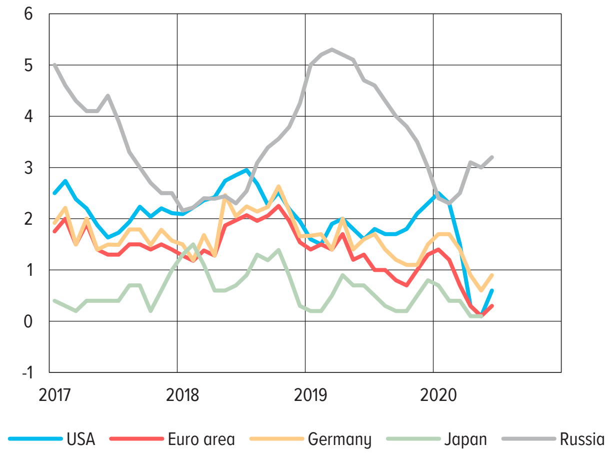
At the same time, in some advanced economies (primarily in the USA, possibly due to social unrest) as well as in a number of large emerging market economies (Brazil, India), the number of new cases of Covid-19 has not yet stabilised. And although the economic authorities of different countries are still reserved in assessing the likelihood of new lockdowns, in general, this situation may possibly lead to a second wave of the pandemic and thus restrict the rapid recovery of economic activity to pre-pandemic levels.

Inflation worldwide. In April–May, inflation in major economies continued to decelerate due to suppressed demand; June saw a moderate increase in prices as prices for energy commodities recovered.

POLICY OF FOREIGN CENTRAL BANKS IN THE SPHERE OF PRICE AND FINANCIAL STABILITY

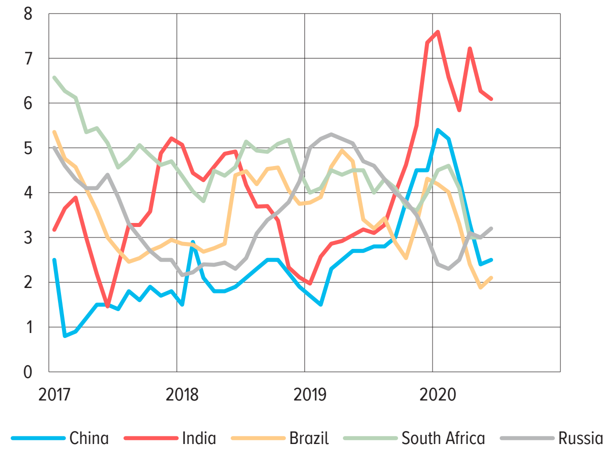
In response to the deterioration of the economic situation and worsening forecasts for economic dynamics in March as well as increasing demand for liquidity and growing volatility in financial markets, in March–April the central banks of major large economies (primarily the US Fed and the ECB as well as other G20 economies) resorted to rapid policy rate cuts and unprecedented expansions of the scale of operations and the lists of financial instruments used. In May–June, these measures persisted, and the central banks of several more countries announced rate cuts (including Norway, Mexico, Brazil, India and South Africa). Some central banks opted for extraordinary measures: the Bank of Australia started targeting sovereign bond yields, while the Bank of Indonesia began to directly buy government bonds in the initial offering. According to the US Fed's minutes, though included in the agenda, the issue of yield curve control was not approved by the majority of FOMC members. At the same time, the pace of expansion of the US Fed's balance sheet has stabilised: the US Fed is still buying treasury and mortgage bonds as well as some corporate bonds through ETFs, but the volume of repos and FX swaps conducted with foreign central banks has significantly decreased.

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



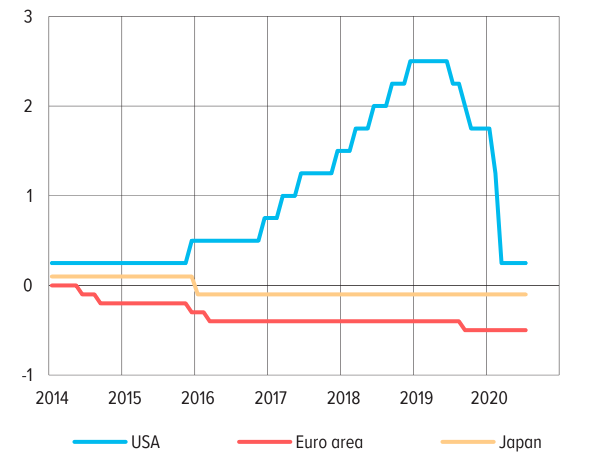
Source: Bloomberg.

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



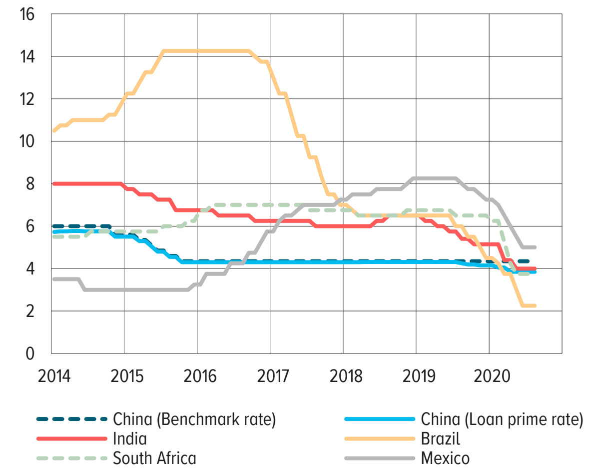
Source: Bloomberg.

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



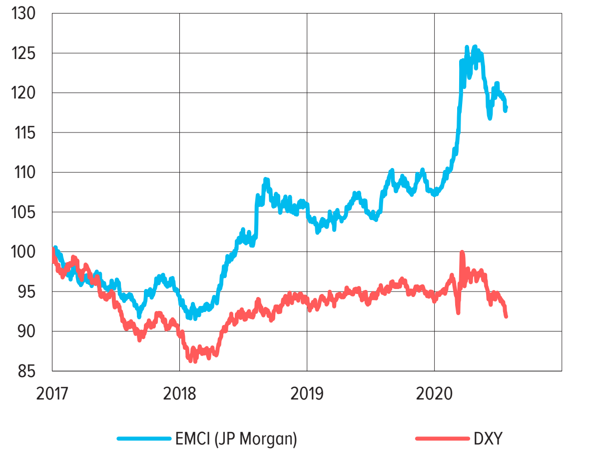
Source: Bloomberg.

POLICY RATES, EMES
(%)
Chart 3.1.7



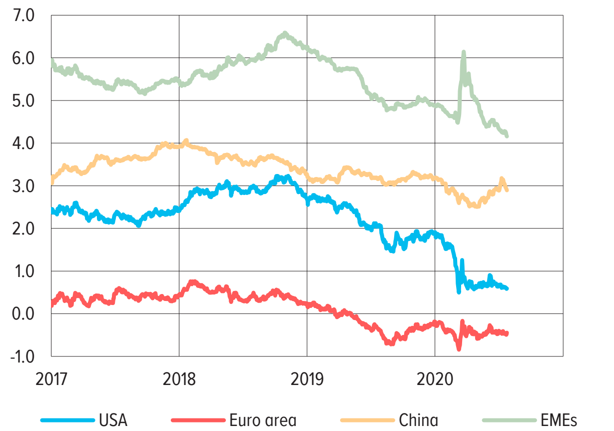
Source: Bloomberg.

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



Sources: Thomson Reuters, Bank of Russia calculations.

YIELDS ON 10-YEAR GOVERNMENT BONDS
(%, p.a.)
Chart 3.1.9



Note: the EME line in the chart represents: Indonesia, Mexico, Malaysia, Panama, the Philippines, Peru, Chile, and Colombia.
Sources: Thomson Reuters, Bank of Russia calculations.

GLOBAL FINANCIAL MARKETS

Currencies. Since the April meeting of the Bank of Russia Board of Directors, the currencies of most countries have appreciated against the US dollar in the context of a gradual recovery in economic activity and measures aimed at supporting the economy. The JP Morgan EM Currency Index has gone up 5.6% since 24 April, slightly more than the Bank of Russia expected. This is due to the faster lifting of quarantine restrictions and the recovery of economic activity. It is worth noting that the second half of June saw fears of a second wave of the coronavirus pandemic mount, leading to a deterioration in market sentiment and a decline in the exchange rates of many currencies.

Interest rates. In most advanced economies, government bond yields did not change significantly, since after the easing of monetary policy in 2020 Q1 the potential for further rate cuts was limited, and regulators did not make any significant steps. At the same time, in EMEs, where rates are on average higher than in advanced economies, many central banks continued the extensive easing of monetary policy, which led to a decline in government bond yields to pre-crisis levels and even lower. The only exception among the major economies is China where economic activity started to rebound earlier, and bond yields partially recovered after the decline.

Country risk premiums. Country risk premiums continued to decrease but still significantly exceeded pre-crisis levels. Despite government bond yields dropping to below pre-crisis levels, spreads between government bonds and US Treasuries remained by 7 bp (Mexico) –120 bp (Indonesia) higher than in January 2020. CDS spreads showed the same dynamics. Their values are currently similar to those of late 2018, and, despite fears of a monetary policy tightening in the USA and a trade war with China, this period cannot be described as a crisis. Thus, investors are generally positive about the future economic situation in EMEs.

GLOBAL COMMODITY MARKETS

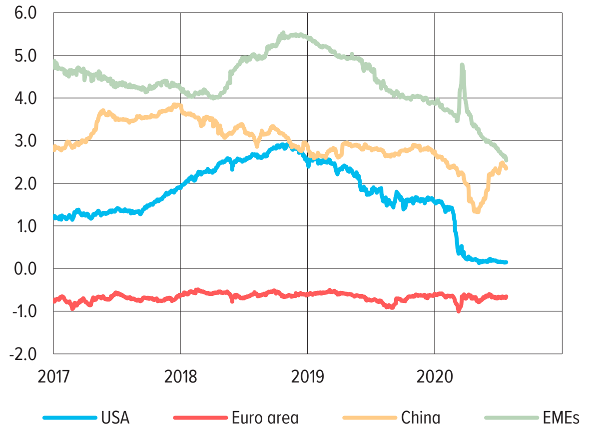
Oil – price. The average price for Urals crude grew from $16 per barrel in April to $30 per barrel in May and to $42 per barrel in June. On 21

April, it dropped to its 1999 low, having declined by more than 80% since the beginning of the year amid a significant contraction in demand as a result of restrictive measures introduced to contain the pandemic as well as an increase in oil supply following the termination of the OPEC+ agreement in April 2020. New agreements on significant production cuts over two years starting from May 2020 were reached in early April. This supported prices on the supply side in combination with additional production cuts in Saudi Arabia, the UAE and Kuwait in June, an extension of stricter production quotas for July and a natural decline in US production. In May–June, demand for oil began to recover, further contributing to the rise in oil prices in recent months. As a result, actual oil prices in 2020 Q2 were higher than expected, and oil price trajectories were revised upward. The upward revision of oil prices, in turn, led to an adjustment in most of the forecast indicators, in particular, higher values of exports and the current account balance and a less significant decrease in reserve assets in the balance of payments.

Oil – global demand. In many countries, the drop in demand for oil due to the coronavirus pandemic spread and related restrictive measures continued in April, but May already saw signs of its recovery that became even more evident in June. Compared to June, in July, international organisations and consulting companies slightly downgraded their estimates for a drop in demand for oil in 2020: the US Energy Information Administration by 0.2 million bpd to 8.2 million bpd; and the International Energy Agency (IEA) also by 0.2 million bpd to 7.9 million bpd.

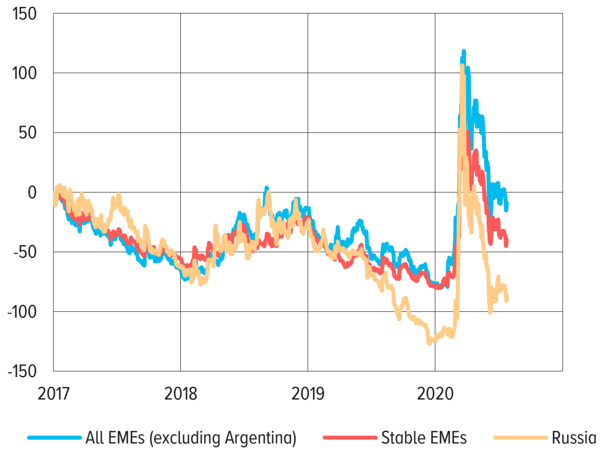
Oil – non-OPEC+ production. Production volumes in non-OPEC+ countries started to decrease as early as in April on the back of a sharp decline in drilling activity as a result of oil prices. According to the US Energy Information Administration, oil production in the USA in April–June decreased by 1.3 million bpd compared to 2020 Q1, and production of liquid hydrocarbons in Canada decreased by 1.1 million bpd. The decline in US crude oil production is expected to continue through mid-2021, while Canadian production will recover to the levels

YIELDS ON 2-YEAR GOVERNMENT BONDS *Chart 3.1.10*
(%, p.a.)



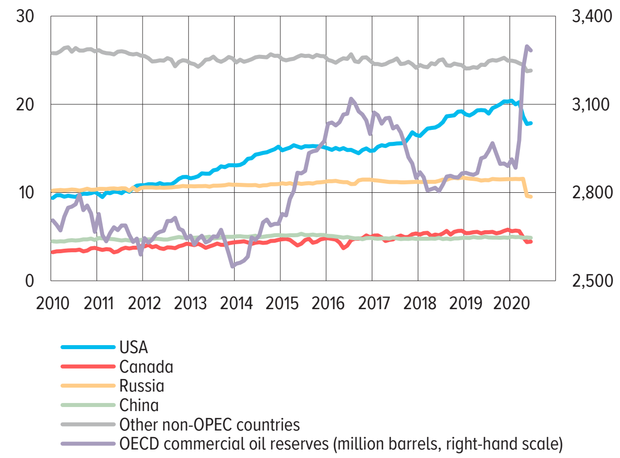
Note: the EME line in the chart represents: Indonesia, Mexico, Malaysia, Panama, the Philippines, Peru, Chile, and Colombia.
Sources: Thomson Reuters, Bank of Russia calculations.

CDS OF EMES *Chart 3.1.11*
(change on 02.01.2017, bp)



Sources: Thomson Reuters, Bank of Russia calculations.

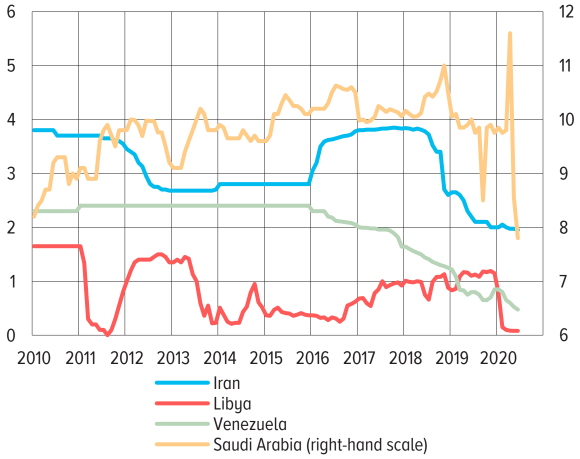
NON-OPEC CRUDE OIL PRODUCTION AND RESERVES *Chart 3.1.12*
(million bpd)



Sources: US Energy Information Administration, MPD calculations.

OPEC CRUDE OIL PRODUCTION
(million bpd)

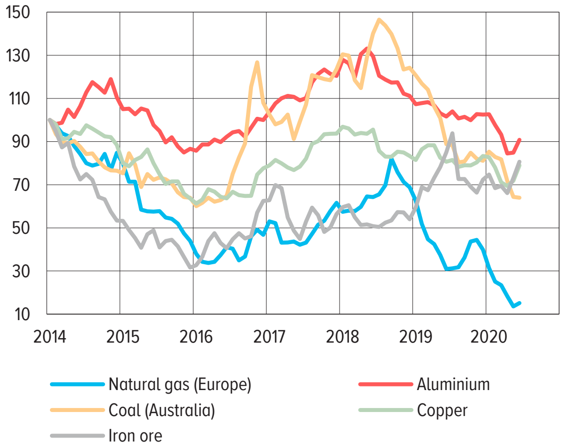
Chart 3.1.13



Source: US Energy Information Administration.

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

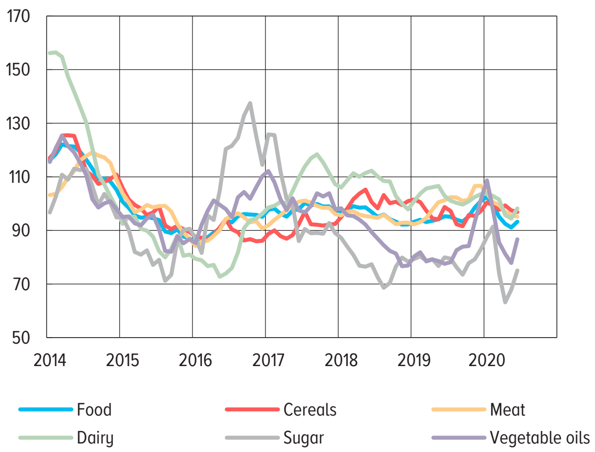
Chart 3.1.14



Source: World Bank.

GLOBAL FOOD PRICES
(2014-2016=100%)

Chart 3.1.15



Source: UN Food and Agriculture Organization (FAO).

observed at the beginning of 2020 no earlier than late 2021.

Oil – OPEC+. After OPEC+ agreements on production cuts were terminated in April, some countries, including Saudi Arabia, increased their production volumes. However, a sharp downturn in oil prices, risks of lack of oil storage capacities and forced production cuts made it possible to enter into a new agreement effective until April 2022. In May, this resulted in significant oil production cuts by OPEC+ countries, including Russia. In June, they were supplemented by voluntary production cuts by Saudi Arabia, the UAE and Kuwait as well as the extension of stricter production quotas for July.

Other commodity markets. In April–June 2020, global coal prices continued to decline amid weak demand, primarily, in China. After dropping to the lowest point in recent decades in May on the back of unprecedented inventories due to the warm winter and significant 2019 imports, gas prices in Europe rose moderately in June following a decline in liquefied natural gas imports from the USA. After the fall in April, prices for most metals recovered in May–June due to the revival of production activity in China.

Food products. In April–May, global food prices continued to fall amid a decline in demand due to the pandemic. In April, the FAO Composite Food Price Index decreased by 3% month on month, and in May, by another 1%. In April, prices for all major commodity groups fell, except for cereals, and in May – except for sugar (the demand for which increased amid growing demand for biofuels). In June, prices for dairy produce, vegetable oils and sugar grew significantly on the back of recovering demand, while cereal prices remained under pressure from expectations for a bumper crop in 2020.

BALANCE OF PAYMENTS

Current account. The current account balance in Q2 was higher than expected in the baseline scenario of MPR 2/20 due to the higher price of oil, Russia's main export commodity. In addition, the situation was characterised by a greater contraction in imports caused by extended coronavirus-related restrictive measures. As a result, according to preliminary estimates, the current account balance in 2020

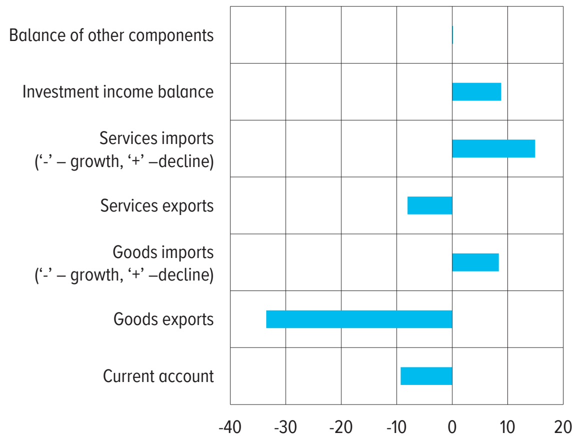
Q2 remained positive. At the same time, its surplus decreased by $9 billion (here and below, changes are relative to the same period of the previous year, unless otherwise indicated) due to the faster drop in exports as compared to imports.

Exports. The decline in the value of goods and services imports in Q2 accelerated to 35% (in 2020 Q1, -13%). The decline in global prices for many commodities intensified, while external demand continued to weaken as a result of the deteriorating situation in the global economy and pandemic-related restrictions. Further pressure on exports was exerted by a 10% reduction in Russian oil production in Q2 due to the new OPEC+ agreements. The contraction of exports was mainly accounted for by oil, petroleum products and gas as their share in the exports of goods and services fell to 37% (in 2019 Q2, 50%). The services exports also dropped significantly mainly on account of transportation services and services under the item ‘Travel’ amid a decrease in the volume of supplies of goods and a suspension of inbound tourist flow.

Imports. In 2020 Q2, goods and services imports dropped by 27% (in 2020 Q1, +1%), in part due to close-to-zero imports of services under the item ‘Travel’ following terminated international passenger traffic and restrictions on outbound tourism. The value of goods imports decreased by 14% due to the contraction of domestic demand in the context of the pandemic and related restrictions as well as the weakening of the ruble. The drop in imports peaked in April (-20%) amid the suspension of production activities and introduction of social distancing measures. On the back of easing restrictions and slowing decline in economic activity, May–June saw a slower decrease in the imports value.

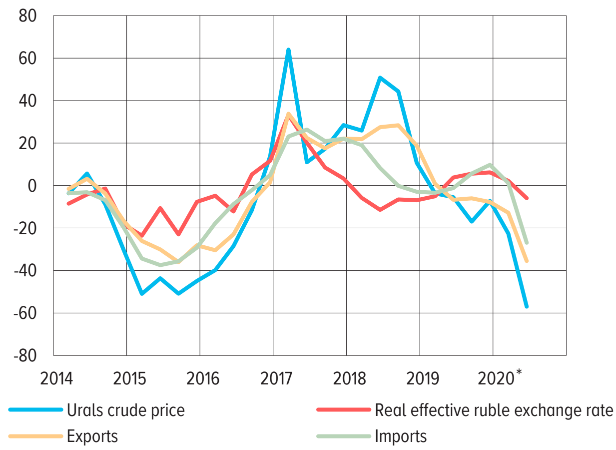
Financial account. In 2020 Q2, net lending by the private sector to the rest of the world was around $12 billion (in 2019 Q2, borrowings of $1 billion). Amid the deteriorating situation in the global economy and risk aversion of investors, net foreign capital borrowing by other sectors dropped, and banks’ liabilities continued to decline at a rate slightly higher than in the same period of the previous year. The increased

GROWTH STRUCTURE OF THE CURRENT ACCOUNT BALANCE IN 2020 Q2* *Chart 3.1.16*
(billions of US dollars on the same quarter of the previous year)



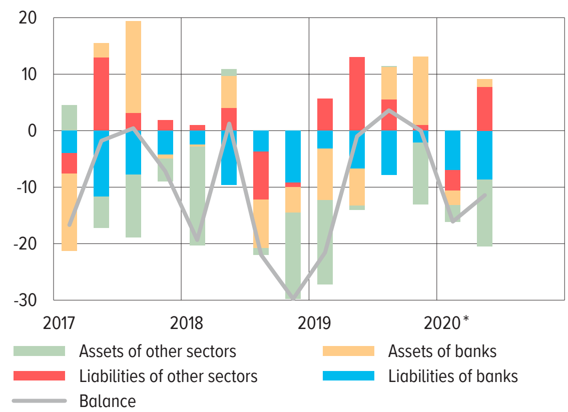
** Assessment for 2020 Q2.*
Source: Bank of Russia.

FOREIGN TRADE *Chart 3.1.17*
(% change on the same quarter of the previous year)



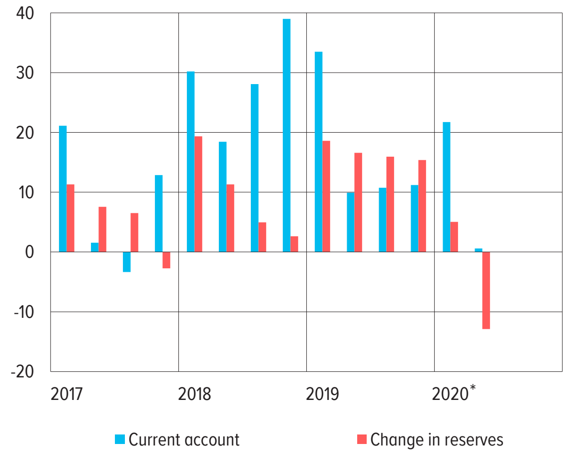
** Assessment of exports and imports for 2020 Q2.*
Sources: Bank of Russia, Thomson Reuters.

MAJOR PRIVATE SECTOR FINANCIAL ACCOUNT COMPONENTS *Chart 3.1.18*
(billions of US dollars)



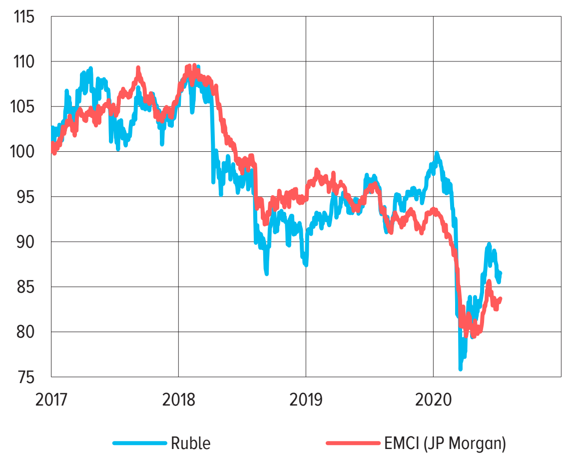
** Assessment for 2020 Q2.*
Note: for assets '+' – decline, '-' – growth; for liabilities '-' – decline, '+' – growth.
Source: Bank of Russia.

DYNAMICS OF RESERVE ASSETS AND CURRENT ACCOUNT *Chart 3.1.19*
(billions of US dollars)



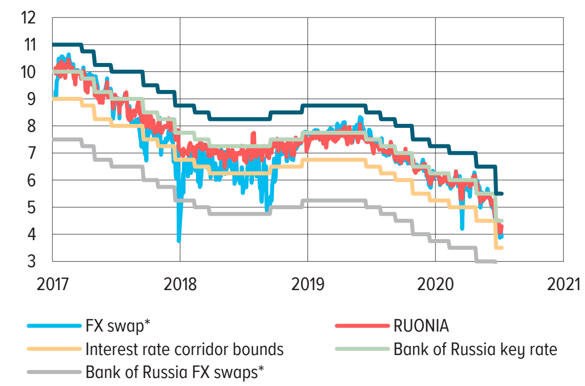
** Assessment of the current account for 2020 Q2.*
Source: Bank of Russia.

DYNAMICS OF RUBLE/US DOLLAR EXCHANGE RATE AND EMCI *Chart 3.1.20*
(100 = 02.01.2017)



Source: Thomson Reuters.

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



** Implied ruble rate is indicated for all types of transactions. 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.

acquisition of foreign assets by other sectors through portfolio investments also had its effect.

International reserves. As a result of transactions recognised in the balance of payments, reserve assets decreased by \$13 billion (in 2019 Q2, +\$17 billion). This was primarily due to fiscal rule-based foreign currency sales, in part in connection with the acquisition of the Sberbank stock by the Government using the money of the National Wealth Fund. At the same time, in Q2, reserves increased by \$5 billion to \$569 billion: the effect of positive revaluation related to the increase in gold prices outweighed the decline due to the conducted transactions.

FOREIGN EXCHANGE MARKET

Ruble exchange rate. During most of the period under review, the ruble exchange rate strengthened, corresponding to the dynamics observed in the markets and the situation in the economy. By the end of July, as compared to 24 April, the ruble grew by 4.2% against the US dollar, while other EME currencies grew by 6.4%, and oil prices almost doubled. The slower growth in the ruble exchange rate compared to other EME currencies was explained by its weakening in July, possibly associated with the conversion of dividends and the sale of OFZs by foreign investors amid elevated geopolitical risks.

3.2. MONETARY CONDITIONS

MONEY MARKET

Short-term IBL rates. Short-term interbank lending rates in the money market were formed in the lower half of the interest rate corridor, close to the Bank of Russia key rate. The average spread stood at -21 bp in April–July (in Q1, -20 bp) and fluctuated in the range from -81 to +39 bp (in Q1, from -70 to +32 bp). The formation of IBL rates and the liquidity situation are discussed in more detail in Section 4.2 'System of monetary policy instruments and other monetary policy measures'.

Foreign currency liquidity. The foreign currency liquidity situation in the Russian financial system remained stable in April–June. Interest rate spreads in the FX swap and interbank segments remained close to zero, amounting to -7 bp in February–April (in Q1, -9 bp). Overall, the cost of foreign currency borrowings remained at low levels in Russia owing to a large reserve of foreign currency liquidity accumulated in 2018–2019.

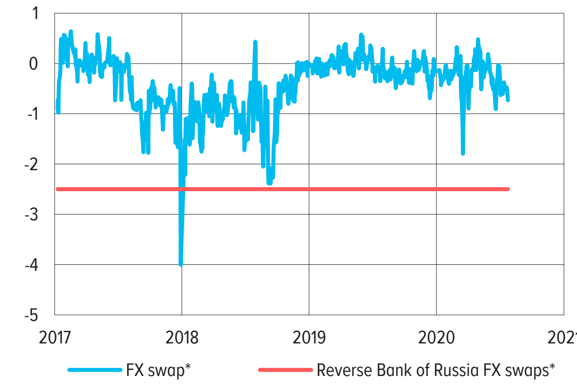
Long-term IBL rates. Money market rates for periods exceeding one day showed a significant drop. The ROISFIX curve went down 140–163 bp, and the MOSPRIME curve went down 189–195 bp. The decrease resulted from the Bank of Russia announcing a faster cut in the key rate than previously assumed. The downward movement of the MOSPRIME curve was also conditioned on the reduction in the risk premium, which was still fairly high in April. At the moment, market rates anticipate a key rate in the range of 4.00–4.25% at the end of the year.

STOCK MARKET

In May–July, the Russian stock market continued to recover on the back of growth in global markets, gradual lifting of quarantine restrictions and implementation of support measures for the economy. However, fears of a second wave of the coronavirus pandemic and geopolitical risks periodically resulted in market corrections.

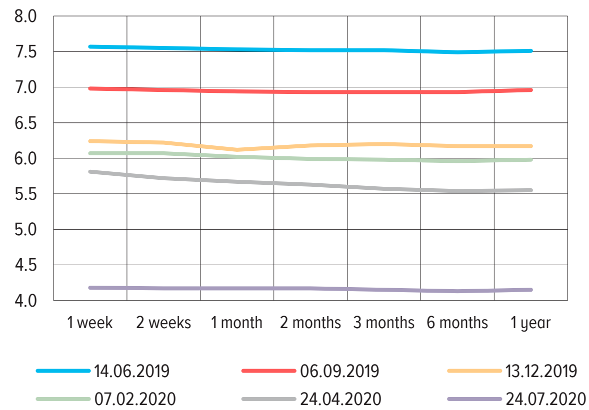
The bond market is the only segment of the Russian financial market that has completely recovered its Q1 losses. This was mainly due to the easing of monetary policy by the Bank of Russia, leading to the OFZ yield curve renewing its historical lows in June: 2-year OFZ yields dropped to 4.42% p.a., and 10-year OFZ yields – to 5.6% p.a. Expecting a decrease in the key rate, investors began extensive purchasing of OFZs, enabling the Ministry of Finance of Russia to resume borrowing and fully execute the borrowing plan for Q2 (see Subsection 3.4 'Public finances'). In addition, the ministry announced plans to step up the placement of OFZs for the second half of the year, and, together with increased geopolitical risks, this led to growing yields on long-term issues and an increase in the slope of the OFZ yield curve to a record high since early 2014.

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



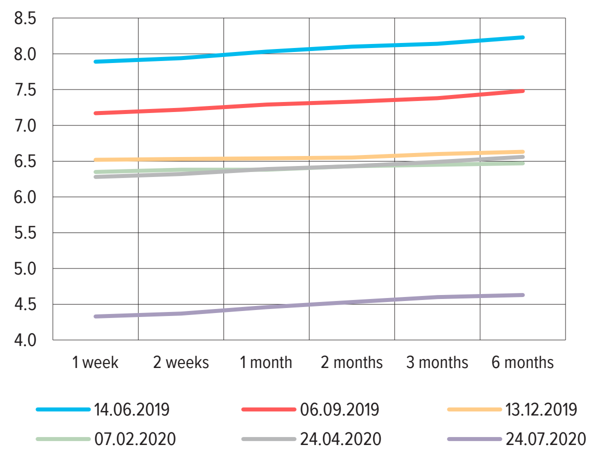
** Implied ruble rate is indicated for all types of transactions. Implied rate on BoR reverse FX swap = ruble lending rate – FX borrowing rate + LIBOR (since 19.12.2016: key rate – 1 pp – (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).*
Source: Bank of Russia calculations.

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.

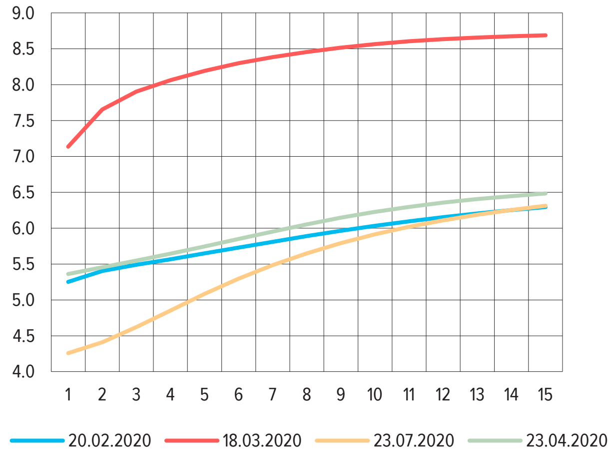
MOSPRIME CURVE *Chart 3.2.4*
(% p.a.)



Source: SRO NFA.

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

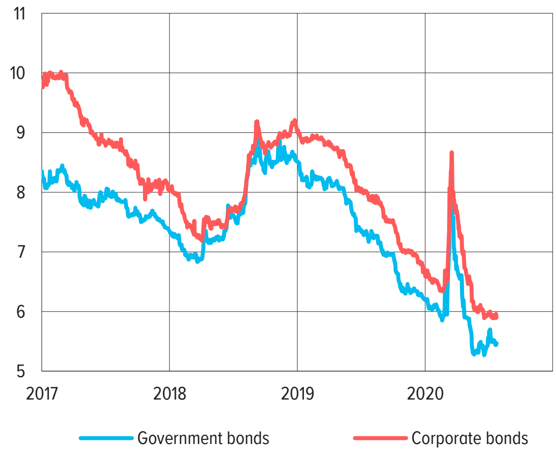
Chart 3.2.5



Source: Moscow Exchange.

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

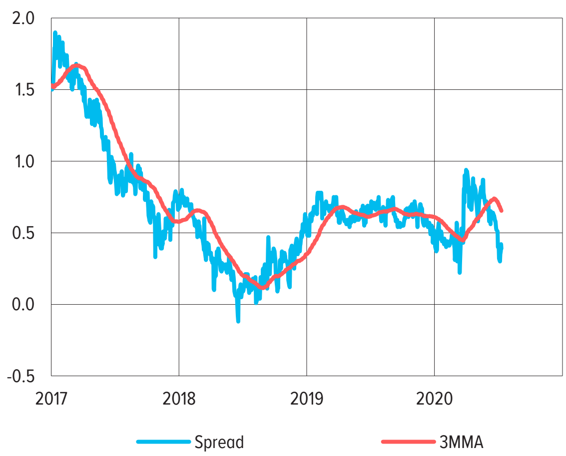
Chart 3.2.6



Source: Cbonds.ru

SPREAD BETWEEN CORPORATE AND GOVERNMENT BOND YIELDS
(pp)

Chart 3.2.7



Source: Cbonds.ru

All other things being equal, this will result in higher-than-expected values of long-term rates in the economy. **Corporate bond yields** also fell below the pre-crisis level following the drop in OFZ yields. In addition, the spread between the yields on corporate and government securities returned to the previous readings. However, this was probably related not to a decrease in the risk premium but to the slower reaction of the bond market to the June sale of OFZs. Issuance activity demonstrated an expected decline, but in June it began to recover following the drop in yields.

DEPOSIT AND LOAN MARKET

Deposit rates. Instability in the financial markets in March led to a sharp increase in bond yields and was reflected in growing average market deposit rates in April. The rate on short-term deposits increased more significantly than on long-term ones, pointing to the expectations of an imminent resumption of rate cuts and the unwillingness of banks to excessively increase the cost of long-term funding.

In May, banks resumed massive reductions in deposit rates, and at the end of the month their weighted average values fully negated the April increase, amounting to 4.1% p.a. in the short-term segment of the market and 4.9% p.a. in the long-term segment. According to the latest updates, in June, credit institutions also mainly cut deposit rates amid the easing of monetary policy.

Deposit operations. In the context of anti-epidemic measures, households sought to procure funds for current expenses, showing an increased demand for cash and building up the balances of current accounts, by using savings from term deposits, among other things. As a result, the annual growth[1] of household deposits dropped from 9.0% in February to 7.2% in June,

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

and the structure of this growth was dominated by short-term transactions.

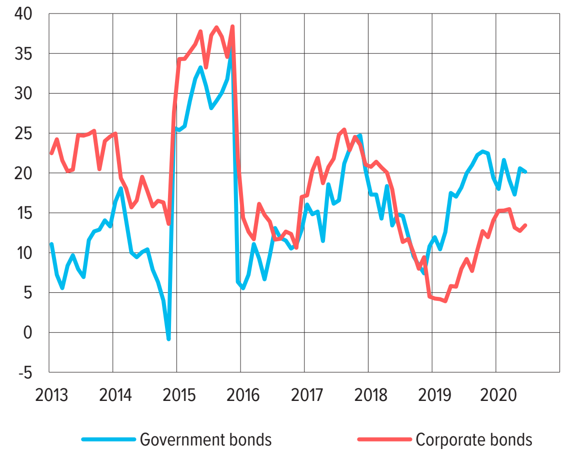
In the context of exchange rate volatility and rates on FX deposits close to historic lows, FX deposits declined or grew more slowly than ruble deposits. Combined with the strengthening of the ruble, this drove a decrease in the share of FX deposits in the market.

Lending rates. In 2020 H1, lending rates demonstrated mixed dynamics as the increased level of uncertainty amid the Covid-19 epidemic and government support programmes for socially significant lending areas had different impacts on individual market segments. Thus, mortgage rates have been steadily declining owing to the low level of mortgage risks and government support programmes. In May, the average market rate on mortgage loans renewed its all-time low of 7.4% p.a., which is 1.3 pp below the same indicator for March. In the segment of consumer loans and car loans, which are characterised by higher risks and a lack of major interest rate subsidy programmes, May saw a significant growth in interest rates compared to March.

The corporate segment of the market also showed no uniform trend of interest rate changes. In May, the interest rate on long-term corporate loans increased slightly compared to March, and the interest rate on short-term loans dropped significantly. The increased sensitivity of credit rates to the level of risk discourages the build-up of riskier assets, contributing to growing stability in the banking system in general and in the credit and deposit markets in particular.

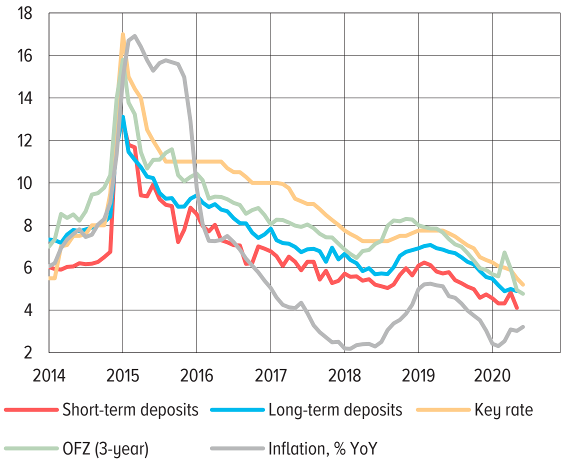
Corporate lending. In Q2, the increased need of businesses to finance current expenses amid unstable dynamics of demand for their products and government support programmes for certain industries and categories of businesses contributed to the revival of corporate lending, mainly short-term one. By the end of June, annual growth in the portfolio of loans to non-financial organisations amounted to 4.4% against 3.6% at the beginning of the quarter. The share of loans with a maturity of up to one year in the corporate portfolio increased from 17.2% at the beginning of April to 17.6% at the end of June. Growing corporate lending mitigates the impact

CORPORATE AND GOVERNMENT SECURITIES PORTFOLIO *Chart 3.2.8*
(% change on the same period of the previous year)



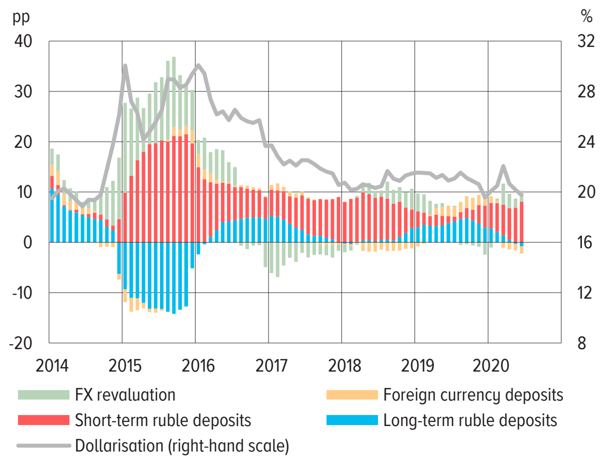
Source: Cbonds.ru

INTEREST RATES ON HOUSEHOLD RUBLE DEPOSITS *Chart 3.2.9*
(% p.a.)



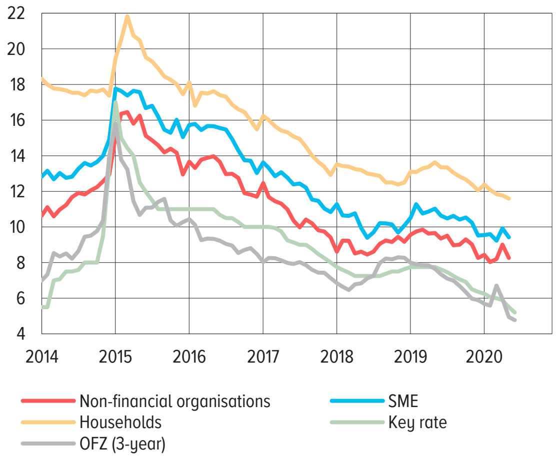
Source: Bank of Russia.

HOUSEHOLD DEPOSITS *Chart 3.2.10*
(contribution to annual growth, pp)



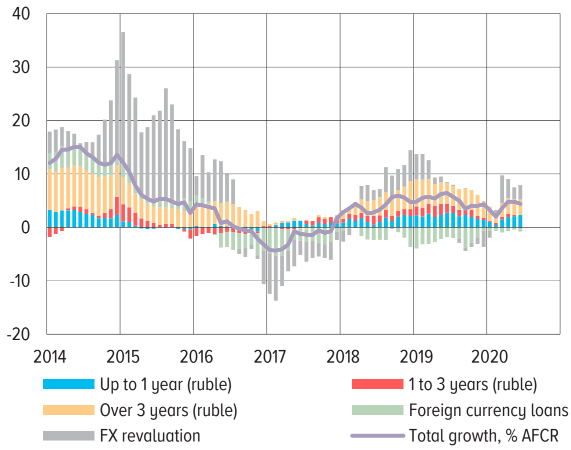
Source: Bank of Russia.

INTEREST RATES ON LONG-TERM RUBLE LENDING TO THE NON-FINANCIAL SECTOR *Chart 3.2.11*
(% p.a.)



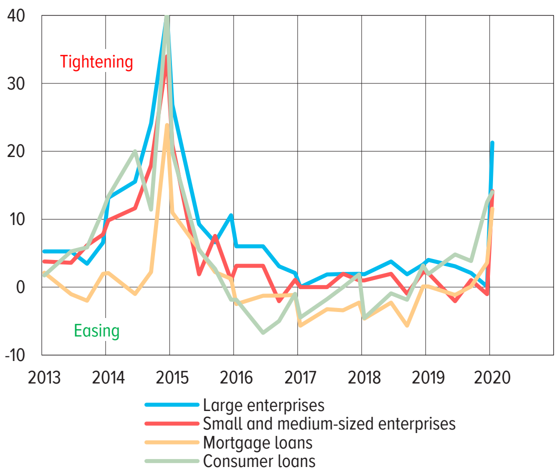
Source: Bank of Russia.

CORPORATE LOAN PORTFOLIO *Chart 3.2.12*
(contribution to annual growth, pp)



Source: Bank of Russia.

INDICES OF CHANGES IN CLAIMS ON BORROWERS *Chart 3.2.13*
(pp)



Source: Bank of Russia.

of lower demand and allows for a smoother recovery in economic activity after the epidemic is over.

The growth of corporate lending was restrained by the tightening of bank lending conditions (BLC), primarily in terms of requirements for borrowers. The prudent lending policy of Russian banks, which manifested as the tightening of non-price lending conditions, made it possible to avoid any significant deterioration in the quality of the corporate loan portfolio. At the end of June, the share of overdue loans in the loan portfolio was 7.7%, exceeding the value of this indicator at the beginning of the quarter by 20 bp.

Retail lending. As expected, Q2 saw a slowdown in the retail segment of the lending market. As of the end of June, the annual growth of the retail loan portfolio amounted to 12.6% against 17.7% at the beginning of April. The slowdown in retail lending was mainly due to the decline in the car and consumer loan portfolio in April–May. Later, these market segments showed a moderate recovery. The faster-than-expected recovery in lending, driven by improved market participants' sentiment, sets the stage for a revival in consumer demand and overall oi.

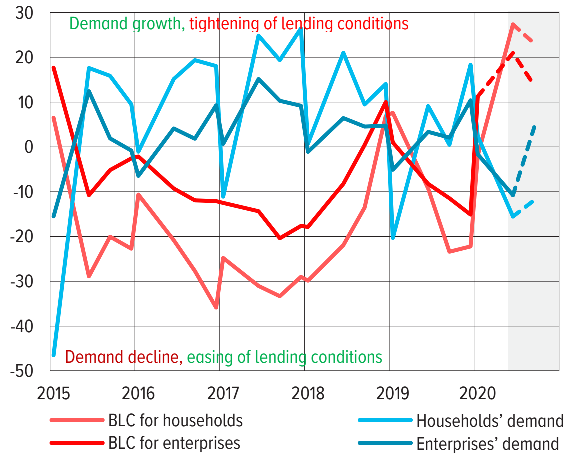
The materialisation of risks in the retail lending market led to a deterioration in the quality of the household loan portfolio. The growth in overdue debt was significantly lower than during the previous periods of instability due in part to the extensive loan restructuring programme. The share of overdue debt in the loan portfolio increased by 0.2 pp in April–June, and this growth was associated exclusively with the segment of car and consumer loans. The share of overdue mortgage loans remained virtually unchanged.

3.3. ECONOMIC ACTIVITY

GDP

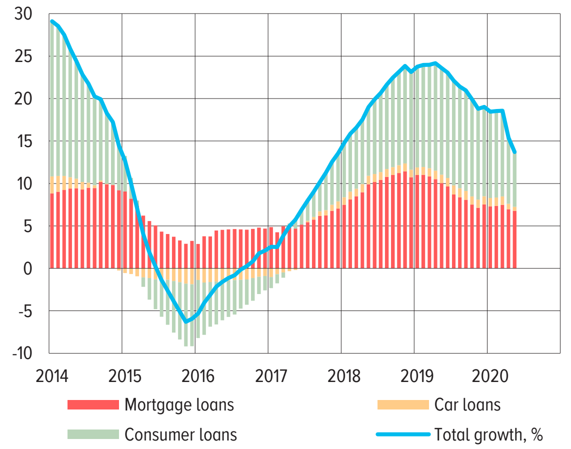
In 2020 Q1, annual GDP growth totalled 1.6%. This is in line with the Bank of Russia's estimate published in *MPR 2/20* (1.5–2.0%). The growth rates of most GDP components by expenditure coincided with the expectations of the Bank of Russia, except for the dynamics of change in

INDICES OF LENDING CONDITIONS AND DEMAND FOR LOANS* Chart 3.2.14
(pp)



* The dashed line shows expectations for 2020 Q2-Q3.
Source: Bank of Russia.

RETAIL LOAN PORTFOLIO Chart 3.2.15
(contribution to annual growth, pp)



Source: Bank of Russia.

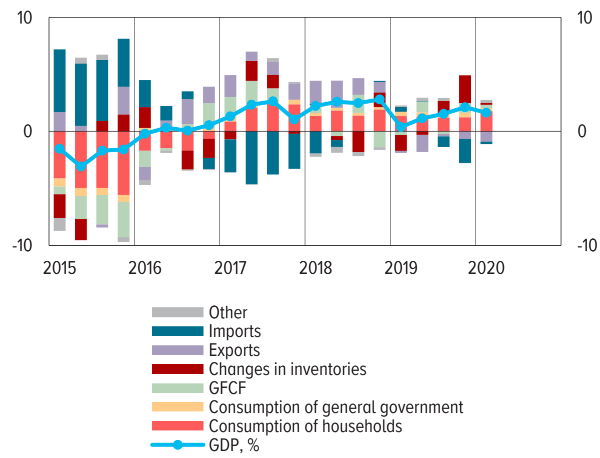
inventories and gross fixed capital formation. The boom in consumer demand of March 2020 and the disruption of global production and supply chains that limited the supply of goods led to a larger-than-expected drop in inventories. At the same time, the decline in investment activity of companies amid increased uncertainty as coronavirus spread and the ruble weakened in 2020 Q1 had no significant impact on the dynamics of GFCF. Its growth in Q1 outstripped the Bank of Russia's estimates. The positive annual growth rates of GFCF were supported, among other things, by a large contribution of public investment (see the part 'Investment activity').

The Bank of Russia estimates that the decline of GDP in Q2 may amount to 9–10% due to a more considerable adverse impact of restrictive measures on economic activity than assumed in *MPR 2/20*, a drop in household consumption (see the part 'Household final consumption expenditure'), deterioration of external conditions and a decrease in oil production and exports under the OPEC+ agreements. Fiscal measures adopted in Q2 will support domestic demand (see the Subsection 'Public finances'). In Q3, the easing of restrictions both in foreign countries and in Russia will facilitate the expansion of economic activity mainly due to the recovery of consumer demand. Despite this, the annual economic growth in H2 will remain negative. The Bank of Russia estimates that in 2020 GDP will decrease by 4.5–5.5%.

PRODUCTION ACTIVITY

Key Industry Index and leading output indicator. After an increase of 1.9% in 2020 Q1, the output of goods and services in key industries significantly decreased in Q2 due to the domestic restrictions on economic activity and a decline in external demand. In April, it amounted to -10%, the lowest for the previous five years according to Bank of Russia estimates. Most industries experienced a decline. The negative contribution of mining and quarrying, transportation, retail trade and investment goods production to output dynamics grew noticeably. In June, amid the easing of self-distancing measures, the negative contribution of retail trade and a significant part of manufacturing

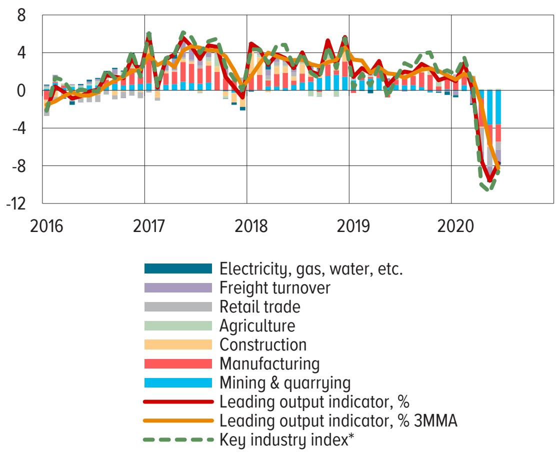
GDP BY EXPENDITURE Chart 3.3.1
(contribution to annual growth, pp)



Source: Rosstat, Bank of Russia calculations.

LEADING OUTPUT INDICATOR
(contribution to annual growth, pp)

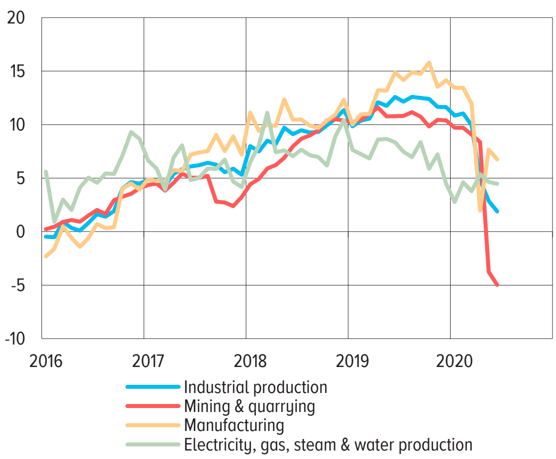
Chart 3.3.2



** Here and onward – 3MMA % change on the same period of the previous year.*
Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL PRODUCTION
(% growth on December 2015, SA)

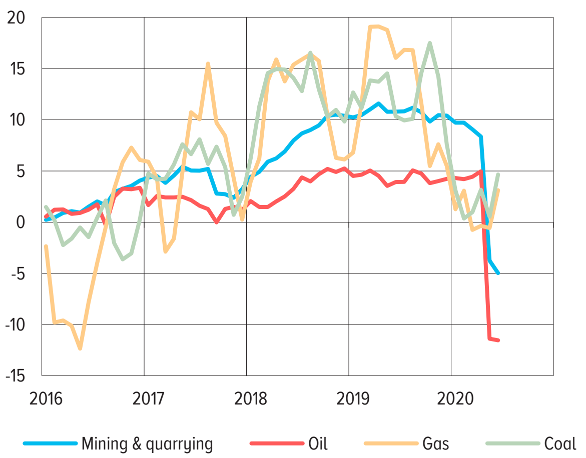
Chart 3.3.3



Sources: Rosstat, Bank of Russia calculations.

MINING AND QUARRYING
(% growth on December 2015, SA)

Chart 3.3.4



Sources: Rosstat, Bank of Russia calculations.

industries to output dynamics declined.[2] July saw a persistent recovery in economic activity. It was gradual and heterogeneous, as evidenced by the data of the weekly monitoring of sectoral financial flows by the Bank of Russia.[3] While in some industries the volumes of incoming payments showed a trend toward normalisation (a number of industries focused on consumer investment demand), in others their level remained markedly low (many segments of the services sector as well as mining and quarrying were primarily focused on external demand). Overall, the dynamics of financial flows remained unstable.

As the anti-epidemic restrictions are further removed, economic activity will revive. But its curve will depend on the speed and scale of the easing of restrictions in Russia and worldwide, delayed effects of the slowdown in economic activity and possible changes in consumer preferences.

Industrial production. In 2020 Q2, industrial output decreased by 6.7% on Q1 (SA). After the near-zero growth in Q1,[4] the Q2 decline amounted to 8.0% in annualised terms, net of the calendar factor.

Amid contraction in external and internal demand, mining and quarrying dropped the most in Q2, by 8.8% (SA). In oil production, the compliance with the OPEC+ deal by Russia became an additional factor. In Q2, production decreased by 10% in annualised terms, net of the calendar factor (in 2020 Q1, -1%).

The output of the manufacturing industry in Q2 decreased by 6.6% on Q1 (SA). Year-on-year, after a 2.1% growth in Q1, the manufacturing industry's output went down by 7.3% in Q2.

In Q2, the biggest output contraction was registered in the production of investment goods – by 12.9% QoQ (SA). This resulted from both the introduction of non-work days and a significant decrease in demand caused by the revision of investment plans by businesses.

[2] *See the information and analytical commentary Economy, No. 6 (54), June 2020.*

[3] *See the analytical materials presenting general information on ruble payments via the National Payment System.*

[4] *See the information and analytical commentary 'Economy' for more details on the dynamics of industrial production and its individual components in Q2.*

In May–June, the lifting of restrictions in a significant number of regions and a gradual recovery of production activity in Russia's trading partner countries led to a partial recovery in output, which nonetheless remained below the level of 2016 H2.

The Bank of Russia estimates that the decline in the output of intermediate goods in Q2 compared to Q1 was less deep and amounted to 3.9% (SA). The most significant decline affected the output of petroleum products, rubber and plastic items as well as products of a number of metallurgical enterprises. At the same time, the industrial output was supported by certain types of chemical enterprises, in particular, the production of fertilisers, including through the expansion of exports in the context of lower prices for Russian products in the global market due to the weakening of the ruble.

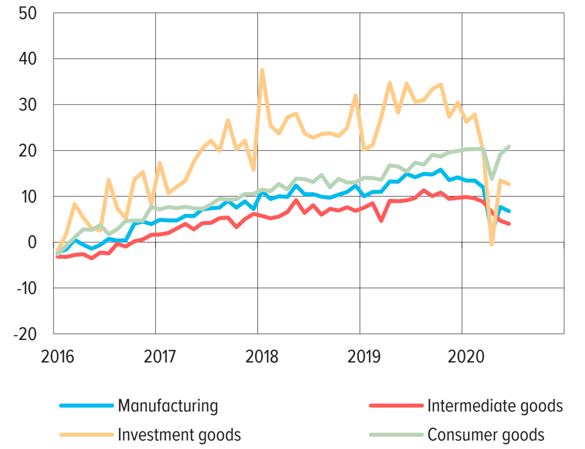
The output of consumer goods in 2020 Q2 declined the least, by 2% on Q1 (SA). The decrease was mainly conditioned on a drop in the production of non-food goods amid the suspension of trade as part of the anti-coronavirus measures. Among food products, decrease was observed for the production in the high-price segment – chilled meats and certain types of dairy products. This was accompanied by a growing output of products with a long shelf life (canned meat, sunflower oil).

Electricity, gas, steam and water production. The production of electricity, gas, steam and water in Q2 saw a slight increase compared to Q1 (SA). The output was supported by colder than normal weather.

Electricity consumption. Electricity consumption is a meaningful indirect indicator of economic activity. In Q2, it decreased by 3.4% YoY amid shutdowns of some businesses and a significant reduction in oil production. The most significant reductions affected the energy systems of the Urals, the mid-Volga region and the South. The first half of July saw an increase in consumption in most regions, pointing to a revival in economic activity.

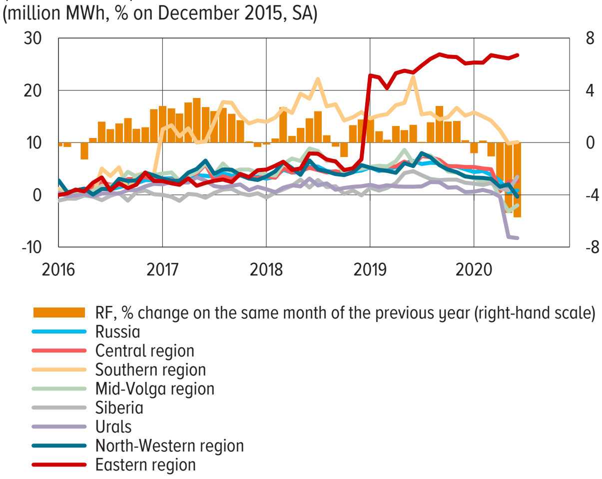
Transport. The decline in production and demand as well as restrictions on the travel by households affected transportation activities. In 2020 Q2, freight turnover dropped by 8.2% in annualised terms compared to a 3.8% decrease

MANUFACTURING
(% growth on December 2015, SA)
Chart 3.3.5



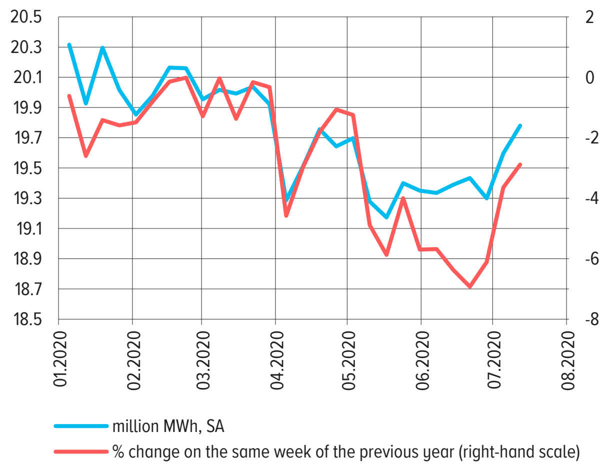
Sources: Rosstat, Bank of Russia calculations.

ELECTRICITY CONSUMPTION ADJUSTED BY CALENDAR AND TEMPERATURE FACTORS (PER MONTH)
(million MWh, % on December 2015, SA)
Chart 3.3.6



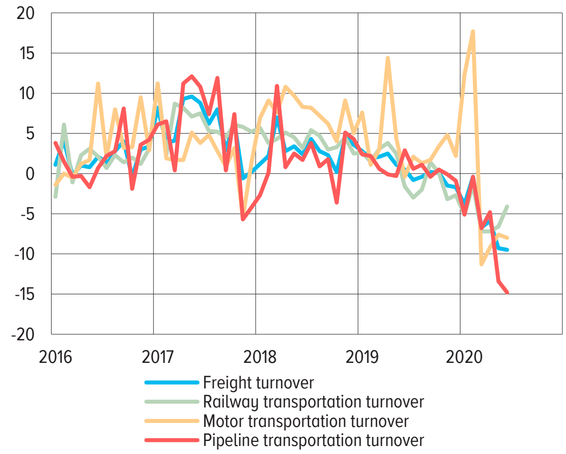
Sources: SO UPS JSC, Bank of Russia calculations.

ELECTRICITY CONSUMPTION ADJUSTED BY CALENDAR AND TEMPERATURE FACTORS IN 2020 (PER WEEK)
Chart 3.3.7



Sources: SO UPS JSC, Bank of Russia calculations.

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



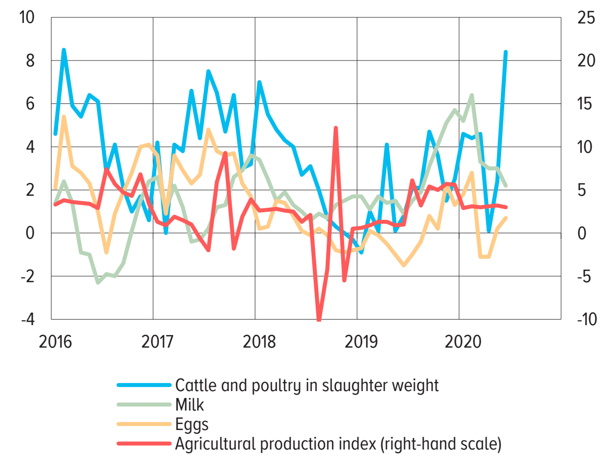
Source: Rosstat.

CARGO AND PASSENGER TRANSPORTATION IN 2020 *Table 3.3.1*
(% change on the same period of the previous year)

	Q1	April	May	June	Q2
Cargo transportation	**1**	**-5.4**	**-5.9**		
railways	-3.8	-5.9	-5.5	-4.4	-5.3
motor transport	3.6	-5.6	-4.4		
sea transport	9.4	7.1	53.7		
inland water transport	18.4	16	9.4		
air transport	4.3	-15.3	-6.2		
pipeline transport	-4.5	-4.6	-16.3		
Passenger transportation	**-4.5**	**-69.7**	**-62.2**		
railways	-1.6	-72.1	-67.5	-46.7	-61.8
motor transport	-4.8	-69.2	-61.2		
sea transport	-2.3	-75.5	-61.2		
inland water transport	41.7	-37.8	-52.7		
air transport	-5.9	-92.1	-91.3		

Sources: Rosstat, Russian Railways.

AGRICULTURE *Chart 3.3.9*
(% change on the same month of the previous year)



Source: Rosstat.

in 2019 Q1. Passenger traffic decreased by 66% YoY (in Q1, -4.5%). The decline affected all types of transport, air travel the most (-91.7%).

In 2020 Q2, pipeline transport demonstrated the most significant decrease in freight turnover, including due to a further reduction in natural gas exports to non-CIS countries. The drop in railway freight turnover accelerated, primarily affecting the transportation of export commodities: oil, ferrous metals and coal. In contrast, railway transportation of grain increased significantly. The growth in the transportation of construction materials also supported the dynamics of railway freight starting in May largely due to the gradual easing of restrictive measures and the resumption of construction work in a number of Russian regions.

Agriculture. Growth in agricultural output in 2020 Q2 continued at 3.1% YoY (in Q1, 3.0%). The main contribution to growth was made by the output of livestock products. Production of greenhouse vegetables also continued to show high growth rates.

The Ministry of Agriculture of Russia estimates that the gross grain harvest in 2020 will exceed the harvest of 2019 by 1.1% and will amount to 122.5 million tonnes. Independent Russian experts forecast even higher values: they expect the second-largest harvest after the 2017 record (123–129 million tonnes). The Bank of Russia estimates that the situation in agriculture does not pose any significant inflationary risks over the 2020 horizon.

Construction. The Bank of Russia estimates that as a result of restrictions on construction in 44 regions of Russia in March–April, a drop in the income of economic agents and an increase in uncertainty, the volume of construction work in Q2 decreased by 0.9% on 2020 Q1 (SA). The housing construction segment shrank even more, by 3.9% (SA).

As restrictions were lifted in the regions of Russia, the volume of construction began to gradually recover starting from June. In June, the volume of construction was 0.1% lower YoY, and the commissioning of housing was 6.4% lower. However, given the gradual recovery of income and persisting tensions in the labour market, this process is expected to be prolonged.

BUSINESS SURVEYS AND FINANCIAL RESULTS

Business surveys. The disruption of global production and supply chains and the anti-coronavirus restriction of economic activity in Russia led to a significant deterioration in businesses' assessments of the current situation in the economy as well as their expectations in 2020 Q2. Most survey indicators suggest that the greatest deterioration in business sentiment occurred in April. Russia's composite PMI fell to an all-time low of 13.9 in that month. A record decline was also observed for the components of the index: the manufacturing PMI amounted to 31.3, while the services sector PMI amounted to 12.2. In May–June, the gradual easing of restrictions on economic activity in Russia and other countries of the world led to an increase in PMI measures, though they are still below 50, indicating a persistent deterioration in business sentiment in both the services sector and the industry.

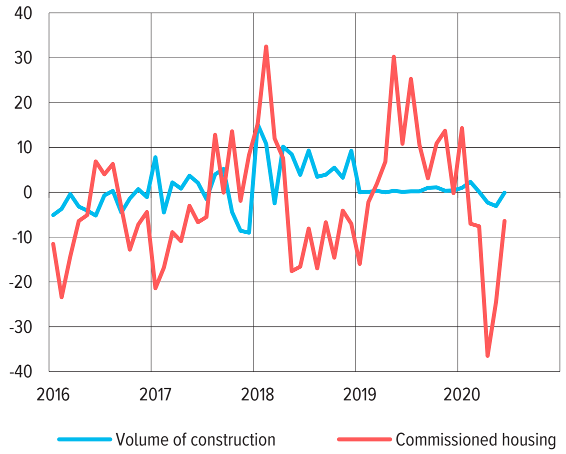
The Rosstat Business Confidence Indices also showed a considerable decline in Q2. Companies reported insufficient demand for their products in the domestic market, economic uncertainty and high taxes among the factors limiting production growth.

According to the results[5] of business monitoring by the Bank of Russia, in May–June, assessments of the current business climate improved in almost all industries. The most significant improvements were observed among retailers that were directly affected by the easing of social distancing measures. In June, a comparable improvement in assessments of the current situation was noted in the manufacturing industries. Nevertheless, currently, the business climate indicator in these industries remains below the levels registered at the beginning of the year.

In May, three-month ahead business expectations showed by far more positive dynamics: for the first time since March 2020 the indicator of expectations was positive,

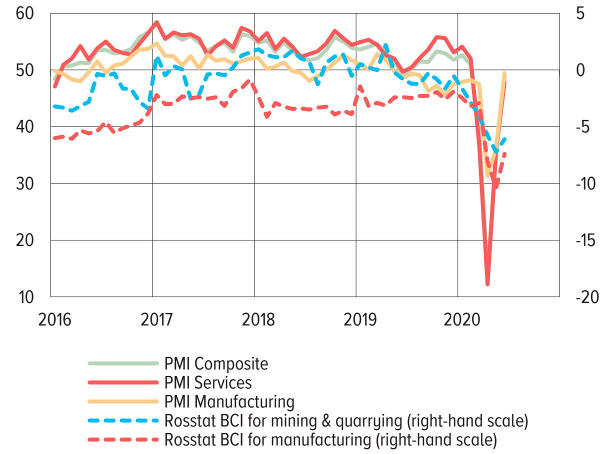
[5] *The Bank of Russia's Business Climate Indicator reflects actual and expected changes in production and demand based on the assessments of businesses participating in the monitoring.*

CONSTRUCTION *Chart 3.3.10*
(% change on the same month of the previous year)



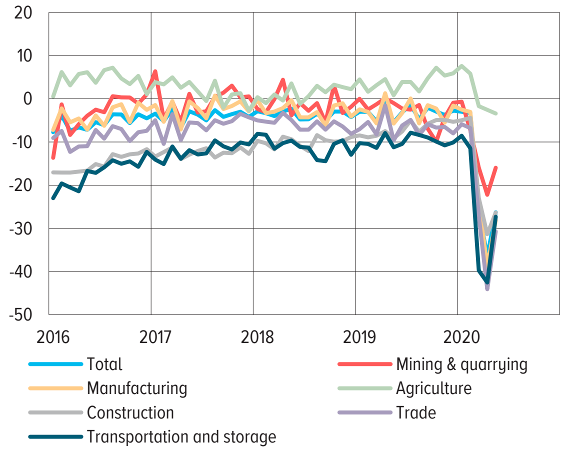
Source: Rosstat.

BUSINESS SURVEYS: PMI AND ROSSTAT BUSINESS CONFIDENCE INDICES (SA) *Chart 3.3.11*



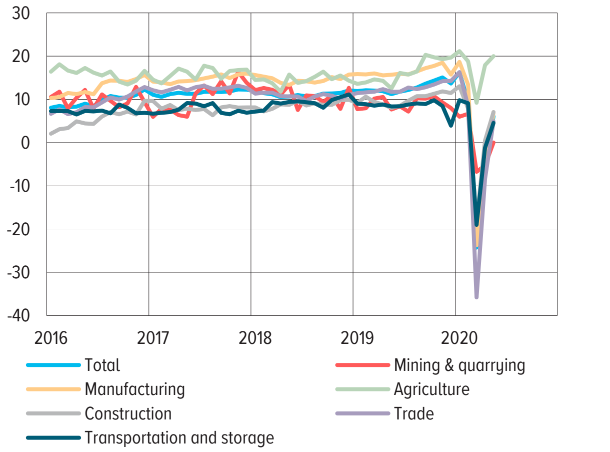
Sources: IHS Markit, Rosstat, Bank of Russia calculations.

BUSINESS CLIMATE INDICATOR OF THE BANK OF RUSSIA: CURRENT STATE *Chart 3.3.12*



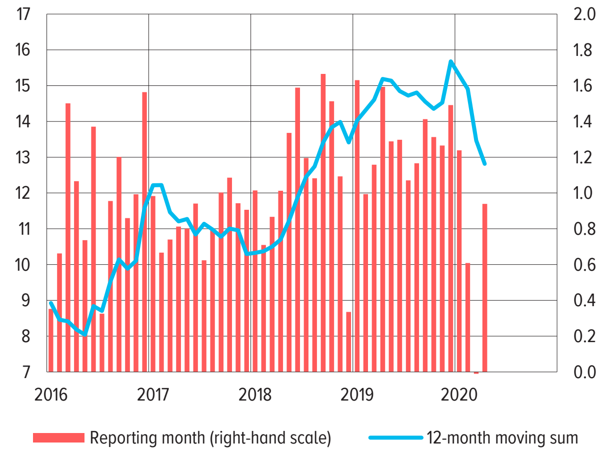
Sources: Monitoring of enterprises of the Banks of Russia, Bank of Russia calculations.

BUSINESS CLIMATE INDICATOR OF THE BANK OF RUSSIA: EXPECTATIONS *Chart 3.3.13*



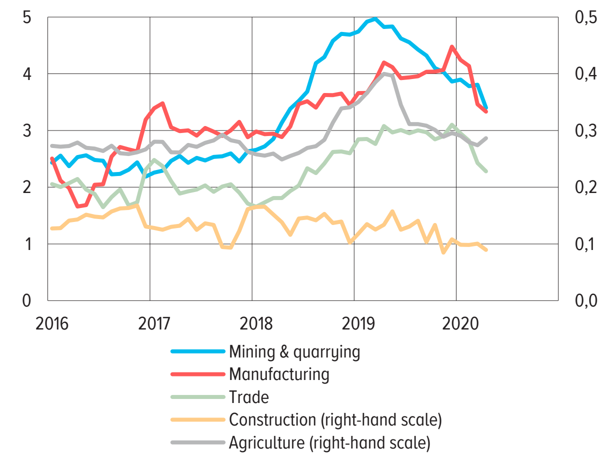
Sources: Monitoring of enterprises of the Bank of Russia, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX, NET OF LOSSES *Chart 3.3.14*
(trillions of rubles)



Sources: Rosstat, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX BY INDUSTRY, NET OF LOSSES *Chart 3.3.15*
(12-month moving sum, trillions of rubles)



Sources: Rosstat, Bank of Russia calculations.

suggesting an improvement in business sentiment across the majority of sectors in the economy. In June, the observed growth of the indicator continued.

Financial performance of businesses.[6] The decrease in the balanced financial result accumulated since the beginning of the year slowed down to 54.4% in April after falling by 58.5% in 2020 Q1. At the same time, the financial result for the moving 12-month period accelerated its decline, from -7.8% in March to -15.6% in April. The breakdown by industry reflects the impact of the main events in January–April: a reduction in prices in world commodity markets and the introduction of restrictive measures. As a result, the most noticeable reduction in the financial result in January–April (both over a moving 12-month period and accumulated since the beginning of the year) is observed in mining and quarrying, manufacturing and trade. In agriculture, the YoY decline continues to consistently shrink (from -25.4% in January–February to -11.5% in January–April), both due to the fact that restrictive measures only slightly affected agricultural enterprises and due to the measures aimed at supporting the industry.

The share of profit-making organisations in January–April decreased very little compared to the same period of the previous year: 63% this year compared to 67% a year ago. The share of profit-making organisations decreased the most in coal mining (46% in 2020 and 65% in 2019) and oil and gas production (47% in 2020 and 76% in 2019).

INVESTMENT ACTIVITY

Rosstat estimates that the annual growth rate of fixed capital investment was 1.2% in 2020 Q1 after 2.3% in the previous quarter. The slowdown in growth was largely due to a noticeable increase in the uncertainty of economic dynamics in March 2020 amid the coronavirus pandemic, both in Russia and worldwide. Downward pressure on investment activity was exerted by the weakening of the ruble reflected in a decrease in engineering imports in March as well as a shortage of imported components.

[6] *Other than credit institutions.*

Indirect indicators of investment demand (production of investment goods and engineering imports) show that April saw the most significant decline in investment. In May–June, as the restrictions were lifted in a number of regions of Russia, the situation began to gradually improve, but high inertia in the dynamics of fixed capital investment prevented its appreciable recovery. The reduction in investment was facilitated both by reduced private investment amid uncertainty caused by the coronavirus pandemic in Russia and worldwide and by lower investment on the part of infrastructure companies (in mining and quarrying) amid a significant drop in global prices for energy commodities.

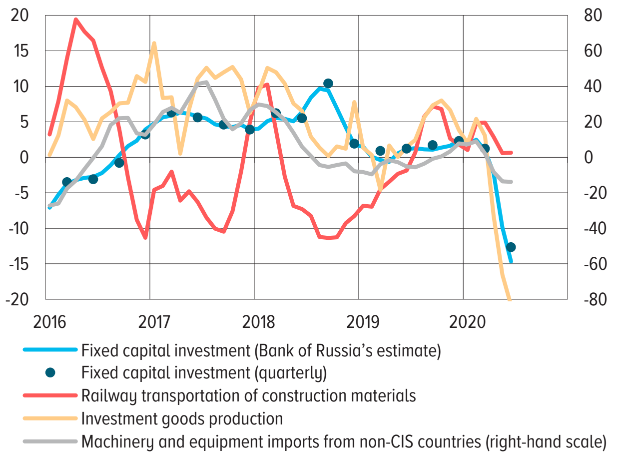
CONSUMPTION AND SAVINGS

Household final consumption expenditure. In 2020 Q2, amid the introduction of restrictive measures and the suspension of the activities of some retail outlets and services sector enterprises, the Bank of Russia estimates that household final consumption expenditure fell by 15–17%, thereby exceeding the April forecast. The maintenance of restrictions for longer than expected led to a greater decline in household income (see the Subsection 'Labour market and income'). Along with the deterioration in consumer sentiment,[7] this led to a greater-than-expected decline in consumption, as indicated by the dynamics of retail trade turnover, the volume of personal services and new early monthly indicators. Households' elevated propensity to save was an additional restraining factor. In the future, as households return to the consumption behaviour model and the realisation of deferred demand, final consumption expenditure will recover.

Retail trade turnover. In Q2, consumer activity declined massively due to the introduction of self-isolation measures. Retail trade turnover decreased by 16.6% YoY. The restrictive measures mostly affected the sales of non-food goods and the consumption of services; during the specified period, they dropped by more than 25%. At the same time, the shift of businesses'

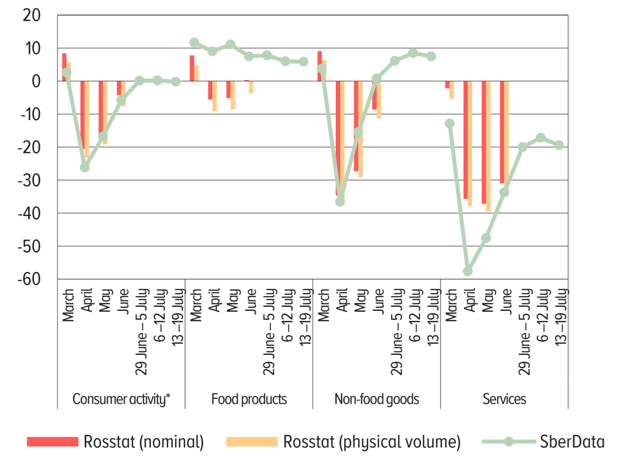
[7] See the information and analytical commentary Economy, No. 5 (53), May 2020.

INVESTMENT ACTIVITY INDICATORS
(% 3MMA)
Chart 3.3.16



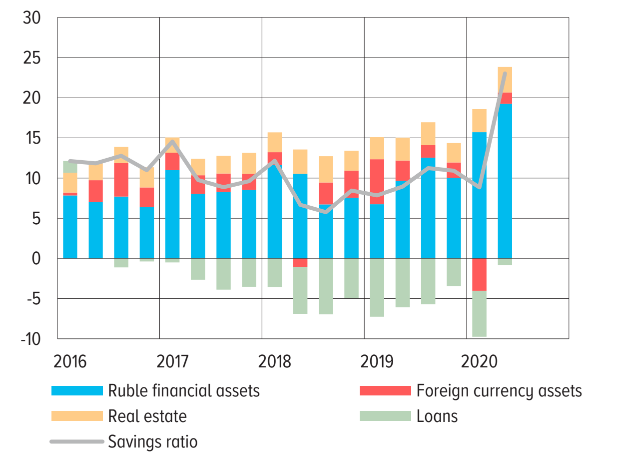
Sources: Rosstat, Federal Customs Service, Russian Railways, Bank of Russia calculations.

CONSUMER ACTIVITY INDICATORS IN 2020
(% change on the same period of the previous year)
Chart 3.3.17



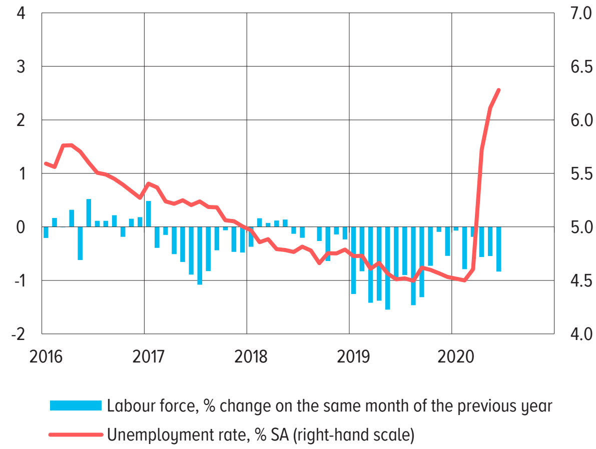
** Retail turnover for Rosstat.*
Sources: Rosstat, SberData Laboratory.

SAVING RATIO
(percentage of household disposable income, SA)
Chart 3.3.18



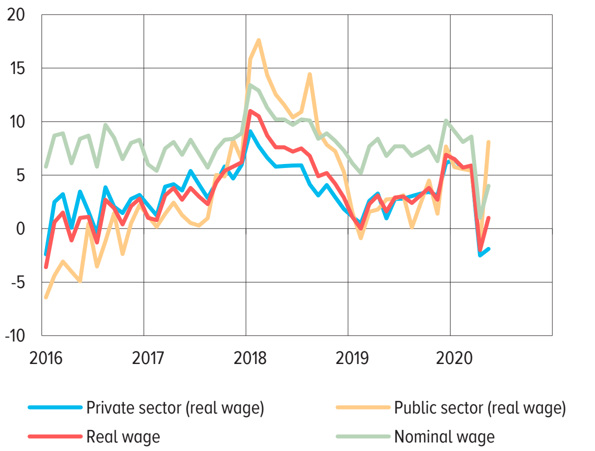
Sources: Rosstat, Bank of Russia, Moscow Exchange, Bank of Russia calculations.

UNEMPLOYMENT RATE AND LABOUR FORCE *Chart 3.3.19*



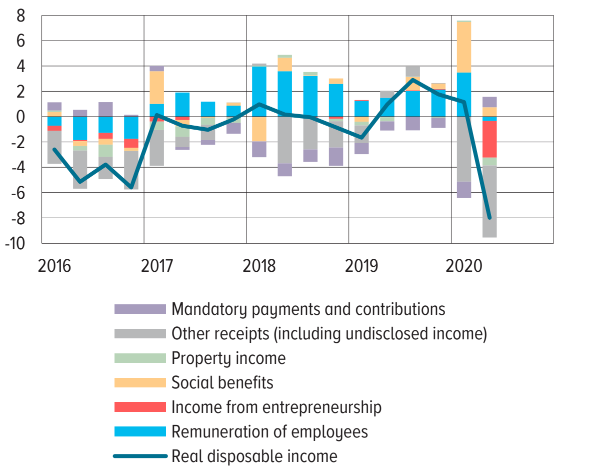
Sources: Rosstat, Bank of Russia calculations.

WAGE *Chart 3.3.20*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

HOUSEHOLD REAL DISPOSABLE INCOME *Chart 3.3.21*
(contribution to annual growth, pp)



Sources: Rosstat, Bank of Russia calculations.

focus to online sales somewhat smoothed out this decline.

New early monthly indicators. In July, key early monthly indicators implied a return of consumption to pre-lockdown growth rates. A significant recovery in sales was noted in the segment of non-food goods: according to the SberData laboratory, consumer activity in this segment demonstrated a YoY increase. At the same time, the recovery of demand for services is proceeding at a slower pace due to the preservation of some of the restrictions in this sector.

Saving ratio. In 2020 Q2, the saving ratio climbed to 23% SA (in Q1, 8.8%), which is associated with an increase in the propensity to save amid limited consumption. Due to growing uncertainty, households demonstrated more demand for cash and short-term deposits, which led to an increase in ruble assets. The consumer and mortgage lending market saw a certain cooling following the March pick-up in demand (see Subsection 3.2 'Monetary conditions'). In addition, the growth of the indicator was conditioned on the decrease in household disposable income (-5.1% YoY; the denominator of the saving ratio).

LABOUR MARKET AND INCOME

Employment. Suspension of activities of some businesses led to a decrease in demand for labour, resulting in a Q2 rise in the unemployment rate to 6.0% SA. The number of unemployed grew by 1.1 million in 3 months. The number of applications for employment services increased even more significantly (by 2 million) partly due to an increase in the cap on unemployment benefits to ₽12,100 (minimum wage), the payment of child allowances[8] and the introduction of a simplified system for verifying information provided by applicants. According to the Ministry of Labour, in July, the weekly growth rate of the number of registered unemployed persons slowed down.

Wages. After high growth rates of nominal wages in February–March (+ 8.1–8.6%), in April–May, amid a decline in economic activity,

[8] *Resolution of the Government of the Russian Federation No. 844, dated 10 June 2020, 'On Amending Certain Regulations of the Government of the Russian Federation'.*

its growth dropped to a historical low of 1.0–4.0% YoY. A sharp decline was observed in the services sectors most affected by the pandemic (hotels and restaurants, culture and sports, air transportation, etc). At the same time, growth of wages was supported by temporary incentive payments to healthcare workers. In real terms, wages fell by 2.0% in April and grew by 1.0% in May.

Household income. In 2020 Q2, household real disposable money income decreased by 8.0% YoY (in Q1, +1.2%). Due to the introduction of restrictive measures, entrepreneurial and other (including hidden) incomes suffered the most. At the same time, for the first time since 2017, mandatory payments made a positive contribution to the dynamics of income due to a decrease in the tax base and a grace period for advance payments for individual entrepreneurs. Incomes were supported by anti-crisis benefits paid from the budget. The Bank of Russia estimates that they amounted to about ₽0.8 trillion, or 6% of total income. Further on, the weak dynamics of household income will remain a significant disinflationary factor.

3.4. PUBLIC FINANCES

In 2020 Q2, fiscal policy incentives intensified, as evidenced by the expansion of the non-oil and gas deficit of the federal budget in moving annualised terms (to 6.6% of GDP after 5.7% in 2020 Q1). In May, for the first time in the past 2 years, the balance of the budget system in moving annualised terms became negative. This was due to growing anti-crisis expenses, on the one hand, and decreasing income, on the other. By the end of the year, the deficit of both the budget system and the federal budget is expected to expand.

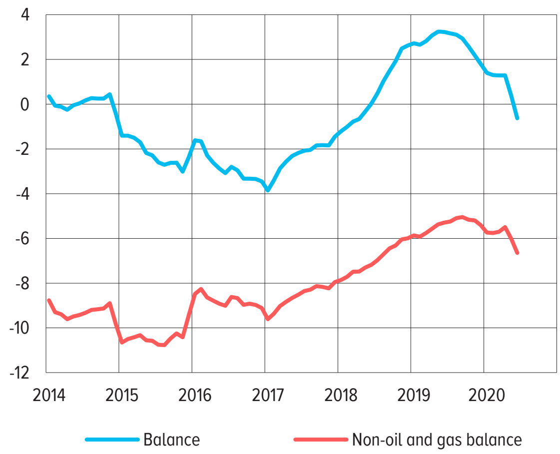
In 2020 Q2, the deteriorated external economic environment cut oil and gas budget revenue by more than a half YoY. Non-oil and gas revenue was appreciably supported by the sale of Sberbank stock. However, receipts from basic taxes fell YoY amid terminated business activity due to the anti-coronavirus restrictive measures and the government anti-crisis easing measures in terms of tax policy and non-tax revenue.

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

	December 2019	March 2020	April 2020	May 2020	June 2020
General government					
Revenue	35.9	36.3	36.6	36.2	
Spending	34.0	35.0	35.6	36.2	
Balance	1.9	1.3	1.1	0.0	
Central government					
Revenue	18.3	18.4	19.0	18.6	18.4
Oil and gas revenue	7.2	7.0	6.8	6.4	6.0
Extra oil and gas revenue	2.7	2.6	2.3	1.8	1.3
Non-oil and gas revenue	11.1	11.4	12.2	12.2	12.3
Spending	16.6	17.1	17.7	18.2	19.0
Balance	1.8	1.3	1.3	0.4	-0.6
Non-oil and gas balance	-5.4	-5.7	-5.5	-6.0	-6.6

Sources: Federal Treasury, Bank of Russia calculations.

FEDERAL BUDGET BALANCE *Chart 3.4.1*
(12-month moving sum, % GDP)



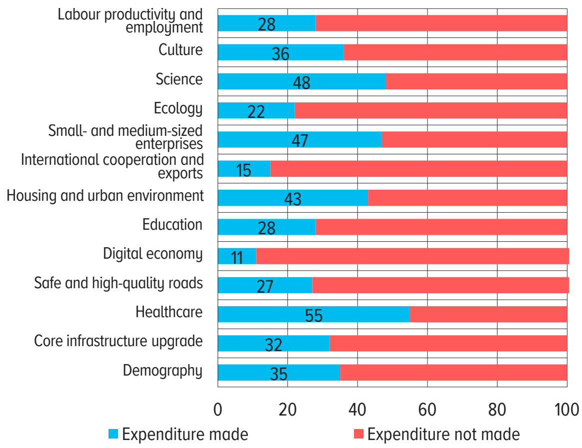
Sources: Federal Treasury, Bank of Russia calculations.

GROWTH OF FEDERAL BUDGET PARAMETERS *Table 3.4.2*
(% change on the same period of the previous year)

	2019 Q1	2019 Q2	2020 Q1	2020 Q2
Revenue	12.6	9	3.1	-12.1
Non-oil and gas revenue	7.2	2.6	-10.3	-59
Non-oil and gas revenue less Sberbank	17.1	14.4	13.3	-14.5
VAT	14.6	20.6	3.4	-4.9
Import VAT	20.8	14.7	0.6	-6.9
Corporate income tax	22.3	32.8	28.6	-36.8
Noninterest expenses	8.6	-2.5	18.1	40.7
Healthcare	95.3	6.4	by a factor of 2.4	76.8
Social policy	16.6	-6.9	5.4	61.2

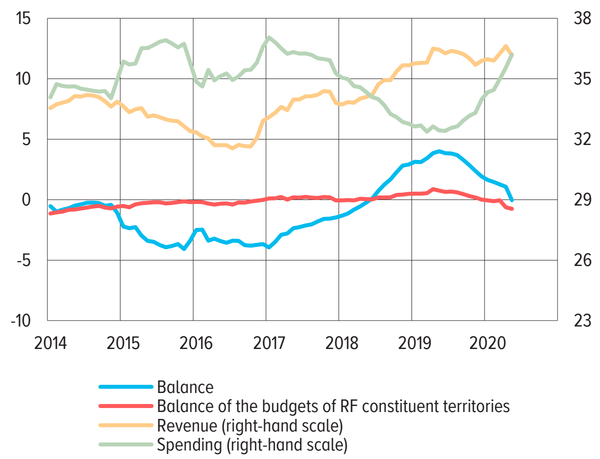
Sources: Federal Treasury, Bank of Russia calculations.

FEDERAL BUDGET SPENDING ON NATIONAL PROJECTS AS AT END-JUNE 2020 (%) *Chart 3.4.2*



Sources: Accounts Chamber, Bank of Russia calculations.

GENERAL GOVERNMENT BALANCE (12-month moving sum, % GDP) *Chart 3.4.3*



Sources: Federal Treasury, Bank of Russia calculations.

The growth of budget expenditure was mainly anti-crisis in nature. The dynamics of household income were positively affected by the temporary increase in the cap on unemployment benefits and sick leave payments, one-time payments for families with children under 16, federal extra payments and bonuses to employees of healthcare, social institutions and law enforcement agencies, as well as subsidies to enterprises engaged in supporting employment. The effected money transfers to households are meant to support their final consumption expenditure in 2020 Q2–Q3. Budget system expenditure on capital investment showed double-digit growth rates compared with the previous year, offsetting the negative effects of the abrupt termination of business activity on the dynamics of fixed capital investment (see Subsection 3.3 ‘Economic activity’).

Measures implemented and planned by the Government to support the economy through budget policy instruments in 2020–2021 are included in the baseline scenario of the Bank of Russia. However, they turned out to be of a larger scale than assumed in the baseline scenario of MPR 2/20. The Bank of Russia estimates that the fiscal impulse will remain positive throughout the whole 2020 due to the implemented anti-crisis measures. The baseline scenario takes into account the fact that federal budget expenditure in 2021 will exceed the level implied by the fiscal rule.

Federal budget. Data on the execution of the federal budget in 2020 Q2 demonstrate significant support for the economy from fiscal policy. Net of the proceeds from the sale of Sberbank stock, the non-oil and gas deficit for the moving year expanded to 7.6% of GDP in June after 5.7% of GDP at the end of 2020 Q1. The balance of the federal budget for the moving year turned out to be negative in June 2020 (-₽0.7 trillion) for the first time since May 2018.

The fall in oil and gas revenue in Q2 amounted to 59.0% in annualised terms due to a downturn in global oil prices and a decrease in oil production under the OPEC+ deal as well as a decrease in oil exports. Net of the proceeds from the sale of Sberbank stock, non-oil and gas revenue in Q2 fell by 14.5% in annualised terms due to business activity restrictions associated with anti-coronavirus measures, the deterioration of the financial performance of companies in 2020 Q1 (see Subsection 3.3 'Economic activity') and the fall in goods imports.

The active growth and intensification of the execution of non-interest federal budget expenditure in Q2 (+40.7% YoY) were facilitated by the anti-crisis measures of the Government and the temporary easing of the rules and procedures for public procurement. Federal budget expenditure for the implementation of national projects in 2020 H1 amounted to 35.1% of the annual volume (2019 H1, 32.4%). High execution indicators (in % of the plan) were observed for the socially focused national projects 'Healthcare' (55.1%), 'Housing and Urban Environment' (42.8%) and 'Demography' (35.3%). However, in capital intensive national projects, execution was weak: 'Safe and High-Quality Roads' (26.5%), 'International Cooperation and Exports' (14.8%) and 'Digital Economy' (10.5%).

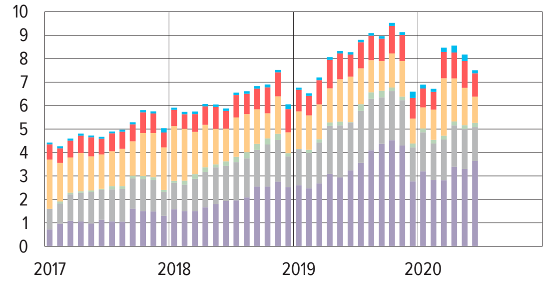
General government budget. As of the end of May 2020, the balance of the budget system for the moving 12-month period turned out negative for the first time in the past two years (-₽47 billion). The easing of fiscal policy took place both at the federal and regional levels. The balance of regional budgets for the moving 12-month period has been in negative territory since the beginning of 2020.

Over five months of 2020, budget system revenue decreased by 1.6% YoY. Net of the proceeds from the sale of Sberbank stock, non-oil and gas revenue decreased by 2.7% mainly due to a YoY fall in income tax (-14.1%). A YoY decrease in revenue was also observed for VAT (-0.9%) and personal income tax (-0.8%). The upward trend in receipts from excise taxes (+8.2% YoY) persisted due to the indexation of rates in 2020 H1.

The growth of budget system expenditure in January–May 2020 amounted to +14.7% YoY, slightly slowing down compared to 2020 Q1 (+16.9%). The most significant contribution to the annual growth in expenditure was made by the items 'Healthcare' (+35.9%) and 'National Economy' (+24.9%).

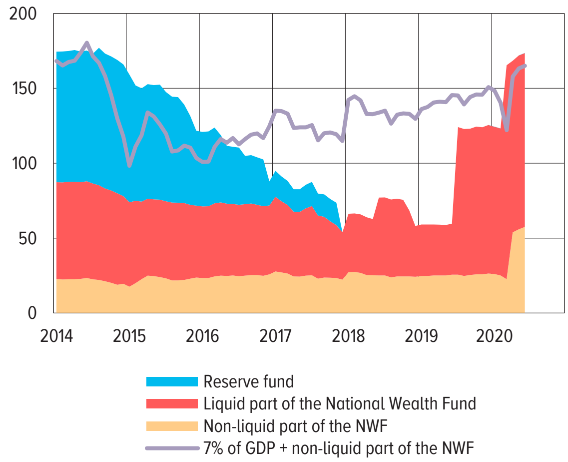
Account balances in the banking system. In April, a part of the profit of the Bank of

BALANCES OF BUDGET SYSTEM FUNDS IN RUBLE ACCOUNTS WITH BANKS AND THE BANK OF RUSSIA *Chart 3.4.4*
(trillions of rubles, end of the period)



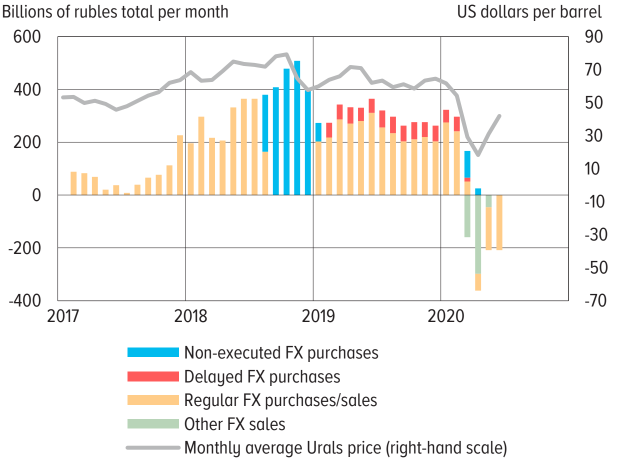
** According to banking reporting form 0409301 'Performance indicators of a credit institution' and the Bank of Russia's balance sheet.*
Source: Bank of Russia.

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



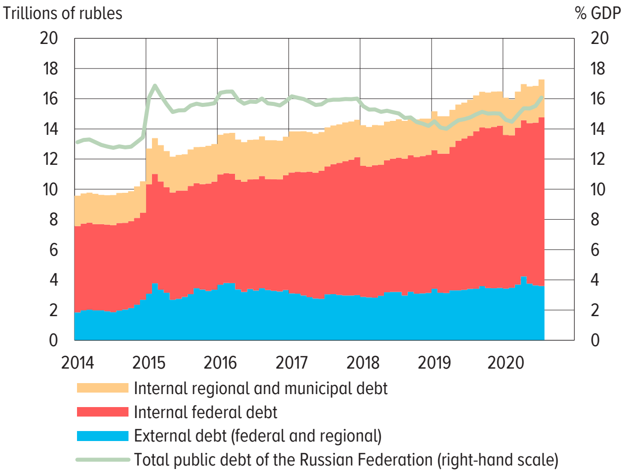
Sources: Ministry of Finance, Bank of Russia calculations.

FISCAL RULE-BASED OPERATIONS IN THE FINANCIAL MARKET *Chart 3.4.6*



Sources: Ministry of Finance, Bank of Russia.

PUBLIC DEBT OF THE RUSSIAN FEDERATION *Chart 3.4.7*
(trillions of rubles)



Source: Ministry of Finance.

Russia from the sale of Sberbank stock in the amount of ₽1.1 trillion was transferred to the single account of the federal budget with the Bank of Russia. In May–June, due to the budget system's expenditure exceeding its revenue, the balances of budgetary funds held with banks and with the Bank of Russia dropped. At the same time, amid a decreased structural surplus and the growth of banks' need for liquidity, the Federal Treasury increased the share of funds deposited in banks (see Subsection 4.2 'System of monetary policy instruments and other monetary policy measures').

National Wealth Fund. The volume of the National Wealth Fund (NWF) as of 1 July 2020 totalled $173.5 billion, including the liquid part of $116.1 billion.

Due to the global oil prices dropping below the base level ($42.4 per barrel), in April–June 2020, the Ministry of Finance of Russia conducted fiscal rule-based sales of foreign currency in the domestic market using funds accumulated in a special payable-through (transit) account. In addition, in March–May, the Government sold foreign currency from the NWF to be used as payment for the Sberbank stock purchase; and fiscal rule-based proactive foreign currency sales were carried out in March–April.

Public debt. According to the Ministry of Finance of Russia, as of the end of June 2020, the total public debt of the Russian Federation amounted to 16.1% of GDP, which was 1.5 pp of GDP higher than its value at the end of 2019. The total federal public debt increased to 12.7% of GDP, which was 1.2 pp of GDP higher than at the end of 2019. In 2020 H2, the public debt is expected to grow due to the expansion of the domestic borrowing programme for 2020 to ₽5 trillion announced by the Ministry of Finance of Russia.

Due to a favourable environment in the OFZ market and expectations of market participants for the easing of monetary policy, in 2020 Q2, the Ministry of Finance of Russia managed to attract a record high volume of funds: ₽1,173.2 billion, almost doubling the quarterly borrowing plan (₽0.6 trillion). In Q3, the Ministry of Finance plans to place OFZs for ₽1 trillion.

4. BANK OF RUSSIA'S MONETARY POLICY

In June and July, the Bank of Russia Board of Directors decided to cut the key rate by 100 and 25 bp, respectively, from 5.50% to 4.25% p.a. The dynamics of inflation in 2020 and 2021 H1 will be largely influenced by a significant drop in domestic and external demand in Q2 that turned out to be deeper than the Bank of Russia anticipated in April. This was due to the protracted effective periods of anti-coronavirus restrictive measures in Russia and worldwide. The impact of short-term proinflationary factors on inflation and inflation expectations was short-lived. In May–June, inflation expectations of households and businesses dropped after growth in March–April. In these conditions, there is a risk of inflation deviating downward from 4% in 2021. The substantial easing of monetary policy implemented since April is aimed at mitigating this risk and stabilising inflation near 4% over the forecast horizon. According to the Bank of Russia's forecast, given the monetary policy being pursued, annual inflation will stand at 3.7–4.2% in 2020, 3.5–4.0% in 2021 and will remain close to 4% thereafter.

If the situation evolves in line with the baseline forecast, the Bank of Russia will consider the necessity of a further key rate reduction at its upcoming meetings. The Bank of Russia will make its key rate decisions with due regard for the actual and expected inflation dynamics relative to the target, economic developments over the forecast horizon as well as risks created by internal and external conditions and how financial markets respond to them.

Short-term interbank lending rates in the money market were mainly formed in the lower half of the interest rate corridor, close to the Bank of Russia key rate. The temporary increase in interest rate volatility in April – early May was due to the growth in banks' need for liquidity during a period of high uncertainty in the financial markets and a decrease in the predictability of operations of bank customers.

In April–June, the banking sector's liquidity surplus decreased. The main factor underlying the outflow of funds was the growing volume of cash in circulation as after the introduction of restrictive measures both households and businesses demonstrated an increased demand for cash. By the end of the year, cash will gradually return to bank accounts, but this process may be slower than previously expected. Due to the above and given the foreign currency sales planned by the Bank of Russia in 2020 Q4 in addition to fiscal rule-based standard operations, the forecast structural liquidity surplus for the end of 2020 has been downgraded from ₽2.2–2.8 trillion to ₽1.4–2.0 trillion.

4.1. KEY RATE DECISIONS

Key rate decisions. In June and July, the Bank of Russia Board of Directors decided to cut the key rate by 100 and 25 bp, respectively, to 4.25% p.a. Thus, in June–July, the key rate continued to decrease.

When making its key rate decisions, the Bank of Russia took the following factors into account.

First, **inflation dynamics** will be largely influenced by a significant drop in domestic and external demand in Q2 that turned out to be deeper than the Bank of Russia expected in April. This is due to the fact that anti-coronavirus restrictive measures remain in place for a longer [than anticipated] period of time in Russia and worldwide. At the same time, the strengthening of the ruble that has been happening since April largely compensated for its weakening in March, thereby limiting the upward influence of the exchange rate on consumer prices.

At the current stage, in the context of the easing of restrictive measures, the dynamics of consumer prices are heterogeneous. This is linked to a gradual and uneven recovery of demand and supply in the goods and services markets. However, current inflationary pressures remain moderate. According to Bank of Russia estimates, indicators of monthly growth of consumer prices reflecting the most stable price movements are close to 4% (annualised). The increase in the annual inflation rate to 3.2% in June and its expected increase in 2020 H2 is largely conditioned on the exclusion of the low rates of price growth in 2019 H2 from calculation.

In May–June, inflation expectations of households and businesses dropped after growth in March–April. In July, they largely stabilised near the levels reached. Thus, the impact of short-term proinflationary factors on inflation expectations was short-lived.

Given the pursued monetary policy, annual inflation is forecast to stay at 3.7–4.2% in 2020, 3.5–4.0% in 2021 and to remain close to 4% further on.

Second, a significant reduction in the key rate is necessary to ensure the easing of **monetary conditions** to support domestic demand and stabilise inflation near 4% over the forecast horizon. This is especially important at the current stage, when a number of factors may slow down the downward movement of interest rates in the financial sector. In particular, these factors include elevated risks leading to tougher requirements for borrowers as well as changing external conditions manifesting as fluctuations in country risk premiums.

The Bank of Russia's decisions also took into account that since May monetary conditions have been easing after some tightening in March–April. This was facilitated by the key rate cut in April as well as the stabilisation of the situation in the external financial and commodity markets. For instance, compared to the April figures, decline was registered for OFZ and corporate bond yields, and also for lending and deposit interest rates. The yield spreads between corporate bonds and OFZs approached the levels of the beginning of the year.

Third, the restrictive measures and the considerable drop in external and domestic demand had a more protracted negative impact on **economic activity** than the Bank of Russia assumed in April. Given the gradual lifting of the restrictive measures, the recovery of the Russian economy is proceeding unevenly across industries and regions, which is evidenced by business and consumer activity indicators in May–June as well as by the operating indicators in July.

The Bank of Russia estimates that the trajectory of further gradual economic recovery may be unstable due to the drop in income, restrained consumer behaviour, cautious business sentiment and external demand constraints.

In this situation, according to the Bank of Russia's forecast, GDP will decrease by 4.5–5.5% in 2020. Thereafter, the recovery growth of the Russian economy is projected by 3.5–4.5% in 2021 and 2.5–3.5% in 2022. The Russian economy will continue to be supported by Government and Bank of Russia measures aimed at containing the economic consequences of the coronavirus pandemic, including the implemented easing of monetary policy and Bank of Russia regulatory measures.

Fourth, the Bank of Russia made its key rate decisions in June–July taking into account the **prevalence of disinflationary risks over proinflationary ones** over the forecast horizon. In the baseline scenario, disinflationary risks are mainly associated with uncertainty about the further development of the coronavirus pandemic situation in Russia and worldwide, the scale of possible anti-coronavirus measures and their impact on economic activity, and also the speed of recovery of the global and Russian economies following the easing of restrictive measures. Inflation dynamics may also be restrained by sustainable changes in the preferences and behaviour of the population as well as a related increase in the propensity to save.

At the same time, over the short-term horizon, the Bank of Russia estimates that a number of factors may exert an upward pressure on prices. These, specifically, include disruption of supply chains amid continuing restrictions as well as additional costs for businesses associated with protective measures for employees and consumers against the spread of coronavirus. Short-term proinflationary risks may be also linked to more significant deferred demand for goods and services than assumed in the baseline scenario. Periods of increased volatility in global markets may affect exchange rate expectations and inflation expectations.

The Bank of Russia also takes into account the fact that mid-term dynamics of inflation will be appreciably influenced by the fiscal policy, in particular, the scale and effectiveness of measures taken by the Government to mitigate the consequences of the coronavirus pandemic and to overcome structural constraints as well as the speed of fiscal consolidation in 2021–2022.

Monetary policy over a medium-term horizon. The decisions to cut the key rate taken by the Bank of Russia in June–July help ease the monetary conditions over the forecast horizon. If the situation evolves in line with the baseline forecast, the Bank of Russia will consider the necessity of a further key rate reduction at its upcoming meetings. The Bank of Russia will make its key rate decisions with due regard for the actual and expected inflation dynamics relative to the target, economic developments over the forecast horizon as well as risks created by internal and external conditions and how financial markets respond to them.

Throughout the forecast horizon, the Bank of Russia will pursue a monetary policy such as to ensure the anchoring of inflation close to 4%. At the same time, given the meaningful disinflationary demand-side factors and the gradual removal of restrictive measures as well as the easing of the monetary policy implemented since April, the key rate path in the baseline scenario is below the path implied in MPR 2/20.

In July, the Bank of Russia also made a downward revision of the estimated range of the real neutral key rate values from 2–3% to 1–2% p.a. This corresponds to the nominal neutral interest rate of 5–6% p.a., taking into account the inflation target of about 4%. The revision of the neutral rate range is due to both lower interest rates in the global economy and a decrease in the country risk premium for Russia.

As the neutral rate in the economy is an unobservable variable and depends on a wide range of both internal and external factors as well as on the monetary policy transmission mechanism, its estimate may change under the influence of these factors. Consequently, the Bank of Russia will continue a comprehensive analysis of the factors influencing the neutral rate.

Effect of the decisions made on key rate expectations. Since the publication of MPR 2/20, market participants' key rate expectations have mainly adjusted downward.

Following the April meeting of the Board of Directors that made a decision to cut the key rate by 50 bp to 5.50% p.a., the Bank of Russia allowed for the possibility of a further decrease in the key rate if the situation develops in accordance with the baseline scenario. At the same time, at the press conference following the meeting of the Board of Directors and at the interim conferences in May–June, it was noted that a reduction by 100 bp at a time had also been considered among the possible options for the key rate cut in April. In this situation, in the run up to the June meeting of the Bank of Russia Board of Directors, analysts and financial market participants generally expected the key rate to be cut to 4.50% p.a. in June already. The market expectations also tended to be in favour of this move as the situation in the global financial and commodity markets improved.

Following the June meeting of the Board of Directors, the Bank of Russia lowered its key rate to 4.50% p.a. and noted in its communications that it would consider the necessity of further key rate cuts at upcoming meetings of the Board of Directors if the situation develops in accordance with the baseline scenario. As a result, analysts and financial market participants continued to adjust their key rate expectations downwards, mainly anticipating a cut in July to 4.00–4.25% p.a. Key rate expectations for the end of 2020 shifted downward to 4.00% p.a. (before the June decision, 4.50% p.a.).

After the key rate cut in July by 25 bp to 4.25% p.a. and continued signals regarding the assessment of the expediency of further key rate cuts at upcoming meetings, the expectations of financial market participants for the key rate path until the end of 2020 did not change significantly, still allowing for the possibility of a key rate cut to 4.00% p.a. in 2020.

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

Banking sector liquidity. The significant liquidity surplus built since 2017 allowed the banking sector to maintain stability during the spread of the coronavirus pandemic in Russia. However, in April – the first half of May, amid growing volatility in financial markets, and also a decrease in the predictability of financial flows of customers and an increase in their demand for cash after the introduction of non-work days, credit institutions' need for liquidity temporarily grew. As the situation in financial markets stabilised, and the anti-crisis package of measures was launched by the Bank of Russia and the Government of the Russian Federation, banks' demand for liquidity provision operations declined.`

In April–June, liquidity surplus decreased.[1] The main factor underlying the outflow of funds was growth in the volume of cash in circulation, which was in part offset by the inflow of funds through the budget channel. The increase in banks' demand for liquidity was also facilitated by the growth of required reserves as a result of the revaluation of the FX liabilities of credit institutions.

Cash in circulation. A significant liquidity outflow from banks was associated with an increase in cash. In April – the first half of July, its volume in circulation increased by ₽1.4 trillion (taking into account funds used to replenish the cash offices and ATMs of credit organisations). Both households and businesses demonstrated an increased demand for cash, which means a proportionate outflow of liquidity from the banking sector. Due to the restrictive measures, the volume of cash received by banks from the collection of proceeds of retail trade businesses also decreased. Since in April–June this decrease was more significant than the drop in retail trade turnover, it can be assumed that payments for goods and services partially transitioned from non-cash to cash.

Demand for cash is expected to gradually return to pre-pandemic levels as the restrictive measures are lifted, and economic activity returns to normal. Accordingly, the volume of cash in circulation will gradually decrease, but this process is likely to be partially extended to 2021 H1. Taking this into account, the forecast changes in the volume of cash in circulation in 2020 have been raised to ₽1.4–1.6 trillion with a subsequent reduction in 2021.

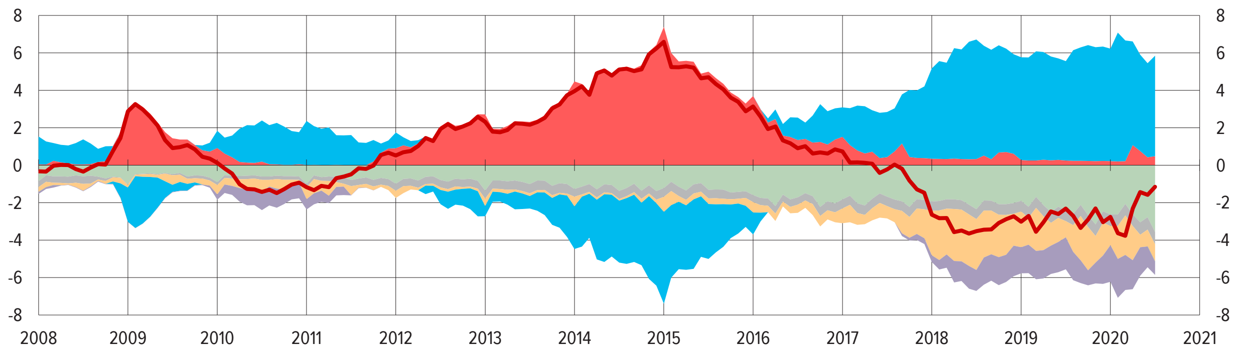
Budget account operations. In April–June, budget system expenditure grew materially, mainly due to transactions in the accounts of extra-budgetary funds — that is, payments to individuals, including to families with children, and healthcare expenses. At the same time, due to the downturn in Urals crude prices, oil and gas budget revenue fell. In addition, the traditionally procyclical profit tax significantly reduced.

The excess of the general government's expenditure over its revenue was financed mainly by reducing the balances of the federal budget and local authorities with the Bank of Russia as well as the growth of domestic borrowings of the Ministry of Finance of Russia, and a decrease in bank deposits of the budgets

[1] *The average liquidity surplus over the averaging periods dropped from ₽2.0 trillion in April–May to ₽1.7 trillion in June–July.*

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

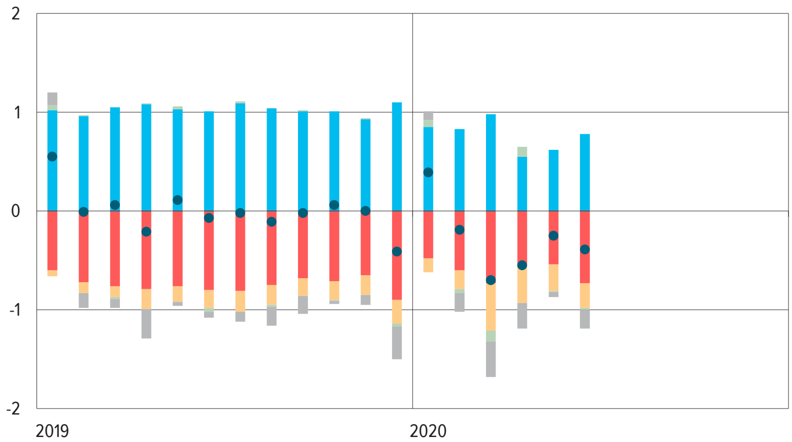
Chart 4.2.1



Source: Bank of Russia calculations.

STRUCTURE OF CASH RECEIPTS BY/WITHDRAWALS FROM CASH DEPARTMENTS OF BANK OF RUSSIA ESTABLISHMENTS AND CREDIT INSTITUTIONS
(trillions of rubles)

Chart 4.2.2



Source: Bank of Russia calculations.

of the constituent territories of the Russian Federation.

At the same time, the Federal Treasury, in contrast, additionally placed around ₽0.6 trillion with credit institutions (taking into account the placements of funds of the Social Insurance Fund).

The aggregate inflow of funds from these budget operations was somewhat offset by the fiscal rule-based sales of foreign currency.

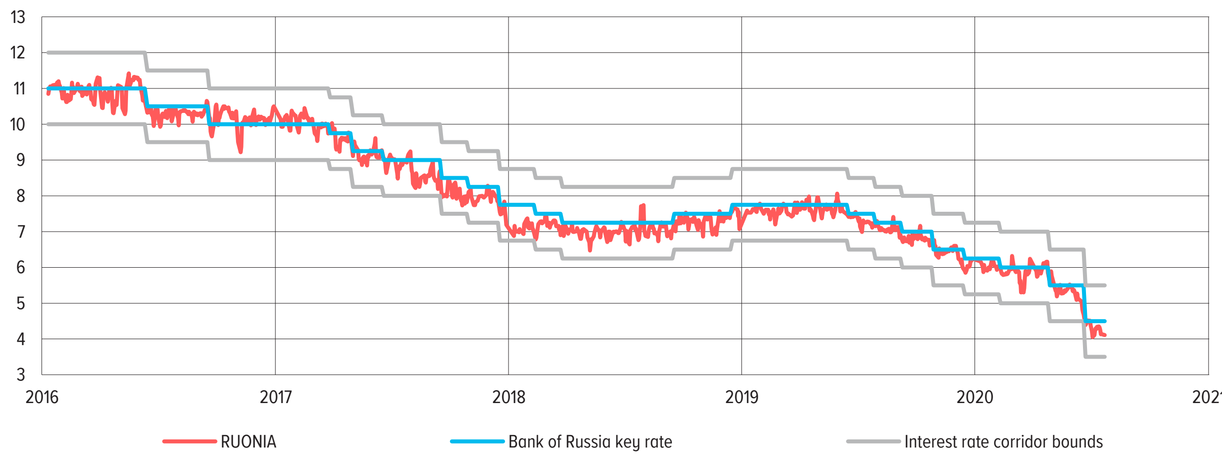
The forecast of the structural liquidity surplus for the end of 2020 was downgraded from ₽2.2–2.8 trillion to ₽1.4–2.0 trillion. This was due to an increase in the estimate of the outflow of cash from banks as well as taking into account additional foreign currency sales[2] planned for October–December 2020. These changes were partially offset by an increase in the forecast of the inflow of funds through the budget channel due to the revision of the macroeconomic forecast of the Bank of Russia.

Monetary policy instruments. In April–May, one of the key goals of the Bank of Russia was to achieve the operational objective of monetary

[2] *The net volume of the specified additional foreign currency sales will amount to ₽185 billion, corresponding to the netting of foreign currency sales associated with the Sberbank stock deal, fiscal rule-based foreign currency purchases postponed in 2018 and March–April 2020 as well as proactive fiscal rule-based foreign currency sales conducted in March–April.*

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

Chart 4.2.3



Source: Bank of Russia.

policy — that is, to maintain money market rates close to the key rate. Despite the fact that the banking sector operated under a structural liquidity surplus throughout this period, the uneven distribution of funds among individual credit institutions could become a source of heightened volatility in the money market. To compensate for the emerging imbalances, the Bank of Russia continued fine-tuning repo auctions with various terms. However, since mid-May, with the beginning of a new averaging period of required reserves and amid the gradual normalisation of the dynamics of liquidity factors and the stabilisation of consumer activity, these operations have become unnecessary.

In addition, given the persisting unfavourable external environment, the Bank of Russia continued to hold one-month fixed-rate repo auctions and one-year floating-rate repo auctions. However, by the time of these operations, credit institutions had largely adapted to the reduced level of the structural surplus. As a result, in May–July, banks did not exhibit any demand for these refinancing operations. The operations launched by the Bank of Russia to support small business remained in demand with SMEs. Outstanding amounts on these operations increased by ₽0.4 trillion by the end of July.

Amid the decrease in the liquidity surplus in the banking sector in March–April, the Bank of Russia reduced the placement of coupon OBRs to provide more flexibility in changing the volume of liquidity absorption by using weekly deposit auctions.[3] As a result, the volume of coupon OBRs in circulation decreased by half, to ₽0.7 trillion.

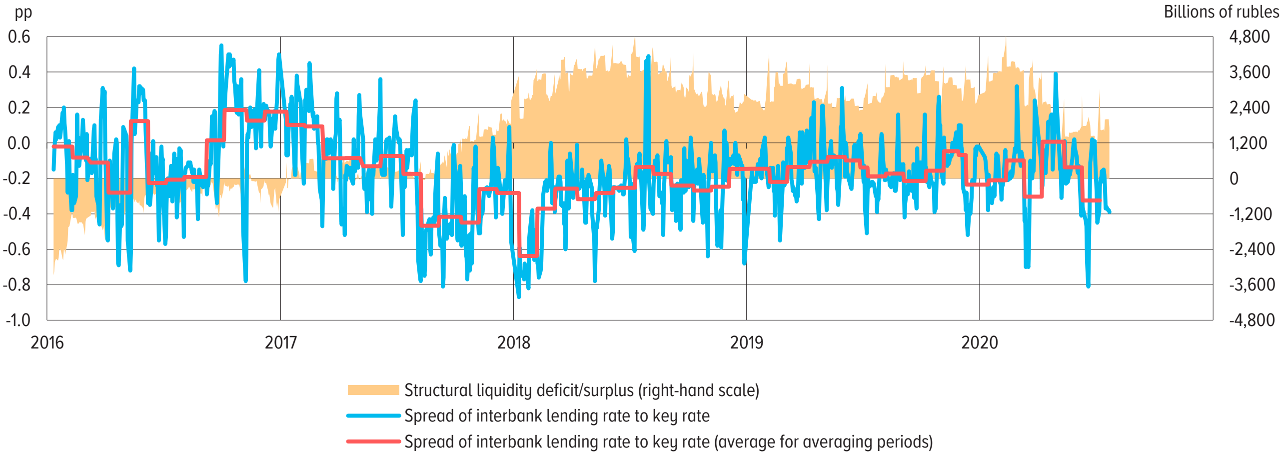
Achieving the operational objective of monetary policy. Short-term interbank lending rates in the money market were formed in the lower half of the interest rate corridor, close to the Bank of Russia key rate. The average spread stood at -21 bp in April–July (in Q1, -20 bp) and fluctuated in the range from -81 to +39 bp (in Q1, from -70 to +32 bp).

In April–July 2020, the dynamics of IBL rates in the money market were heterogeneous. For example, the narrowing of the spread in April was caused by the outflows of liquidity from the banking sector, on some days causing IBL rates to form higher than the key rate. Nevertheless, the Bank of Russia's prompt response to the liquidity situation, including through fine-tuning repo auctions, helped maintain conditions for the formation of rates close to the key rate as well as increase the ability of credit institutions to manage their own liquidity.

In May, the spread returned to predominantly negative territory amid a reduction in the outflow of liquidity from the banking sector and a gradual redistribution of funds between banks. As a result, banks with a high need for liquidity reduced demand for it in the money market, and

[3] *For this purpose, it was decided to skip the auction on 12 May 2020 for the placement of the 33rd issue of coupon OBRs and to place the 32nd and 33rd issues of coupon OBRs in June and July, respectively.*

STRUCTURAL LIQUIDITY SURPLUS AND MONEY MARKET RATES *Chart 4.2.4*



Source: Bank of Russia calculations.

the number of banks willing to lend to other money market participants increased. Moreover, the bid of banks at Bank of Russia deposit auctions was formed close to the established limits, thereby helping to maintain the rates close to the key rate.

In June, the widening of the spread and growing volatility evolved amid expectations for a significant cut in the Bank of Russia key rate. For example, in the first half of the required reserve averaging period, the spread stood at -55 bp on average as banks tried to place funds in deposits with the Bank of Russia or in the money market in anticipation of the key rate cut, postponing the required reserves averaging till the second half of the averaging period. As a result, the offer of funds at deposit auctions significantly exceeded the established limits. After the meeting of the Board of Directors, the excess offer at deposit auctions dropped, and IBL rates started forming close to the Bank of Russia key rate.

STRUCTURAL LIQUIDITY SURPLUS AND LIQUIDITY FACTORS *Table 4.2.1*
(trillions of rubles)

	April 2020	May 2020	June 2020
1. Liquidity factors	**-0.4**	**-0.1**	**0.4**
– change in the balances of general government accounts with the Bank of Russia, and other operations*	0.1	0.1	0.7
– change in cash in circulation	-0.5	-0.2	-0.4
– Bank of Russia interventions in the domestic FX market and monetary gold purchases	0	0	0
– regulation of banks' required reserves with the Bank of Russia	0	0	0
2. Change in free bank reserves (correspondent accounts)	**0.4**	**-0.3**	**0.8**
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	**-1.2**	**-0.2**	**-0.4**
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	**-0.3**	**-0.3**	**0.1**
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	**-1.4**	**-1.6**	**-1.2**

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

BOX

SUSPENSION IN PROVISION OF CERTAIN SERVICES AND INFLATION IN 2020 Q2

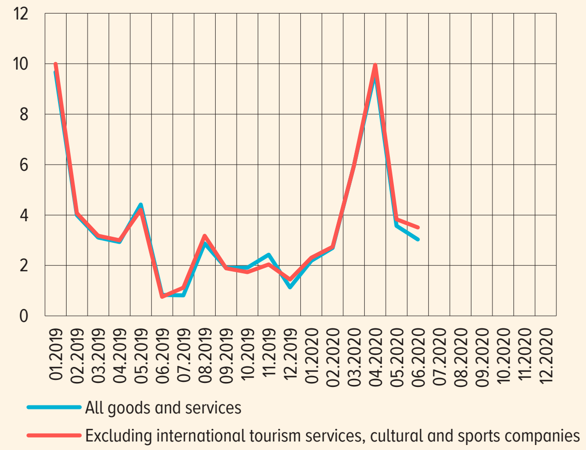
The majority of Russian regions suspended the provision of certain services as part of their social distancing measures to combat the spread of the coronavirus. This impacted inflation indicators since a statistical agency is entitled to duplicate prices for calculating the consumer price index when a product or a service is missing in the market over a reporting period.[1]

In April–June 2020, the cultural sector (theatres, cinemas, and museums), the foreign travel and fitness and sports industries discontinued the provision of services almost completely (only a very small part of them were offered online). Prices were recorded as unchanged in statistics across the majority of localities.

However, the above services only account for approximately 3% in the consumer spending structure applied this year to compute consumer price indices. Therefore, changes in prices for these services do not have any statistically significant effect on inflation. This is confirmed by the difference between the annualised rates of the two indicators – the monthly price growth assessed based on data including and excluding the said items (Table 1; Chart 1).

After the resumption of these services, the contribution to inflation of their price movements may be both positive and negative, depending on the influence of competing factors. On the one hand, deferred demand and the effect of the weakened ruble may cause temporary proinflationary pressure. On the other hand, price growth will be limited because of demand decline induced by decreased household incomes and shifts in consumer behaviour following the overall downturn in economic activity. It is worth reminding of the trend to postpone (rather than cancel) cultural events and travels (including those already paid for) that was widespread over the period of non-work days. Presumably, prices for these services will be close to those offered prior to the postponement. In general, given their percentage in consumer spending, changes in prices for the above services will only have a minor impact on inflation.

INFLATION *Chart 1*
(% change on previous month, SA, annualised)



Sources: Rosstat, Bank of Russia calculations.

INFLATION IN 2020 *Table 1*
(% change on previous month, SA, annualised)

	January	February	March	April	May	June
All goods and services	2.2	2.7	6.0	9.7	3.6	3.0
Excluding international tourism services, cultural and sports companies	2.3	2.7	6.0	10.0	3.8	3.5

Sources: Rosstat, Bank of Russia calculations.

[1] *Clause 4.5.3 of the Official Statistical Methodology for Organising Statistical Monitoring of Consumer Prices for Goods and Services and for Calculating Consumer Price Indices (Order of the Federal State Statistics Service No. 734, dated 30 December 2015).*

ANNEXES

ECONOMIC SITUATION IN RUSSIAN REGIONS

Regional differences in the dynamics of inflation in April–June were mainly determined by the degree and speed of materialisation of country-wide factors in individual regions; local factors did not play any significant role. The decline in economic activity in April–May in the context of anti-coronavirus restrictions affected all federal districts. During this period, better dynamics of economic activities compared to other federal districts was demonstrated by the Far Eastern Federal District (FD), with the least significant impact of the restrictions on the operation of businesses. In June, all regions already showed signs of improvement in the economic situation as the restrictions were gradually lifted amid a significant easing of monetary conditions and the implementation of government support measures. According to the Bank of Russia's survey, businesses in all federal districts expect further improvement in the economic situation and also in output and demand dynamics.

INFLATION AND PRICE EXPECTATIONS

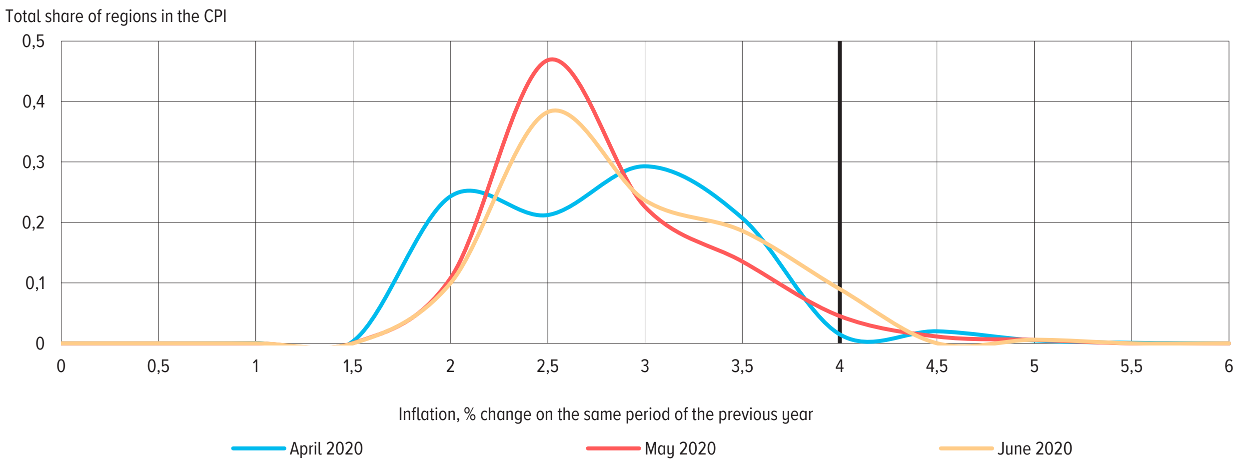
Distribution of regions by inflation level

In April, annual inflation continued to accelerate in most (84 out of 85) constituent territories in line with the trend that began in March. In the distribution of regions by annual inflation in April, two large groups formed (Chart 1). The larger group included regions with inflation values above or close to the country-wide average measures, where the annual inflation accelerated more rapidly. The smaller group consisted of constituent territories where inflation accelerated less rapidly and its values were at lower levels, including the largest ones, Moscow and the Moscow Region. These regions enjoy the most developed and highly competitive retail sector, which had a restraining effect on the growth of prices. The left part of the distribution also included constituent territories where inflation had been low in the previous months, and the April acceleration brought them only slightly closer to the main group of regions.

In May, the acceleration in annual inflation reversed to a slowdown in more than half (55 out of 85) of constituent territories. This was mainly due to the decline in the growth rate of food and services prices. At the same time, the growth of non-food prices continued to accelerate in most (49 out of 85) regions. The group of regions, where annual inflation continued to accelerate in May, included mainly the constituent territories where inflation was largely 'catching up' in the context of lower acceleration rates in April. These are, in particular, many northern, Far Eastern and Siberian regions (Chukotka Autonomous Area, Kamchatka Territory, Amur and Irkutsk Regions, Komi Republic, Khanty-Mansi Autonomous Area) where changes in inflation traditionally occur with a certain lag in relation to the rest of the country, as well as some regions of Central Russia, including Moscow and the Moscow Region, where the pace of acceleration was, however, less significant. In the regional distribution by annual inflation in May, most of the regions once again moved to the main group, with the values of annual price growth from 2% to 3% (Chart 1).

In June, inflation once again accelerated in most regions (70 out of 85). The acceleration was mainly affected by the dynamics of prices for food and non-food goods, while the growth of services prices continued to slow down in more than half of the regions. The most significant acceleration of inflation took place in the Southern and the North Caucasian FDs due to the dynamics of food prices (in the Southern FD, the low base effect from last year's fruit and vegetable prices was more pronounced) and durable non-food goods prices. In the distribution of regions by inflation in June, the main group of regions with annual price growth from 2% to 3% remained unchanged, while the group of regions with inflation ranging from 3% to 4.5% grew slightly (Chart 1). Higher inflation rates

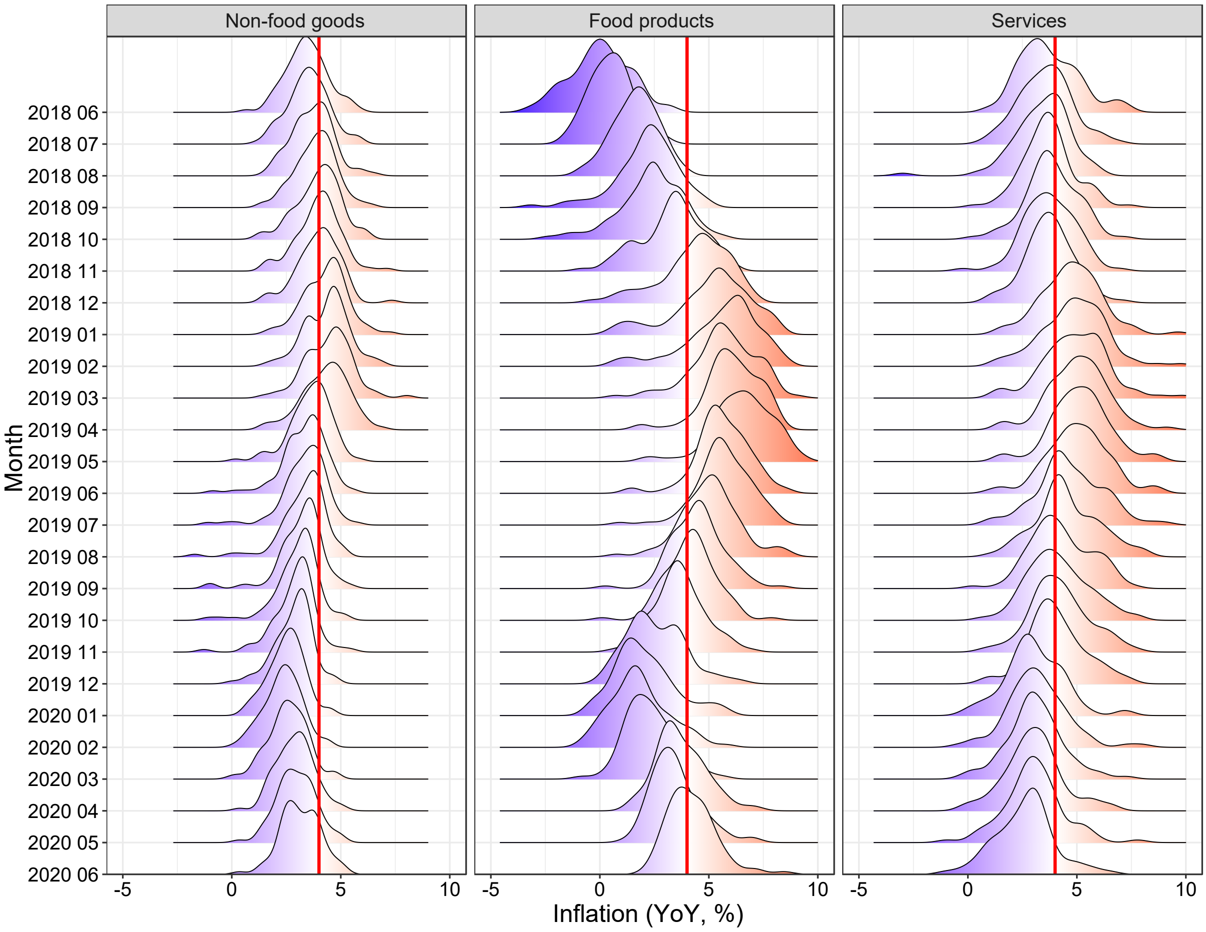
INFLATION, % CHANGE ON THE SAME PERIOD OF THE PREVIOUS YEAR *Chart 1*



Sources: Rosstat, Bank of Russia calculations.

DISTRIBUTION OF REGIONS BY ANNUAL INFLATION OF GOODS (FOOD AND NON-FOOD) 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.

were noted in many regions of the southern part of the Far East[1] and Siberia as well as in a number of regions in the European part of the country (Chart 3).

Food inflation

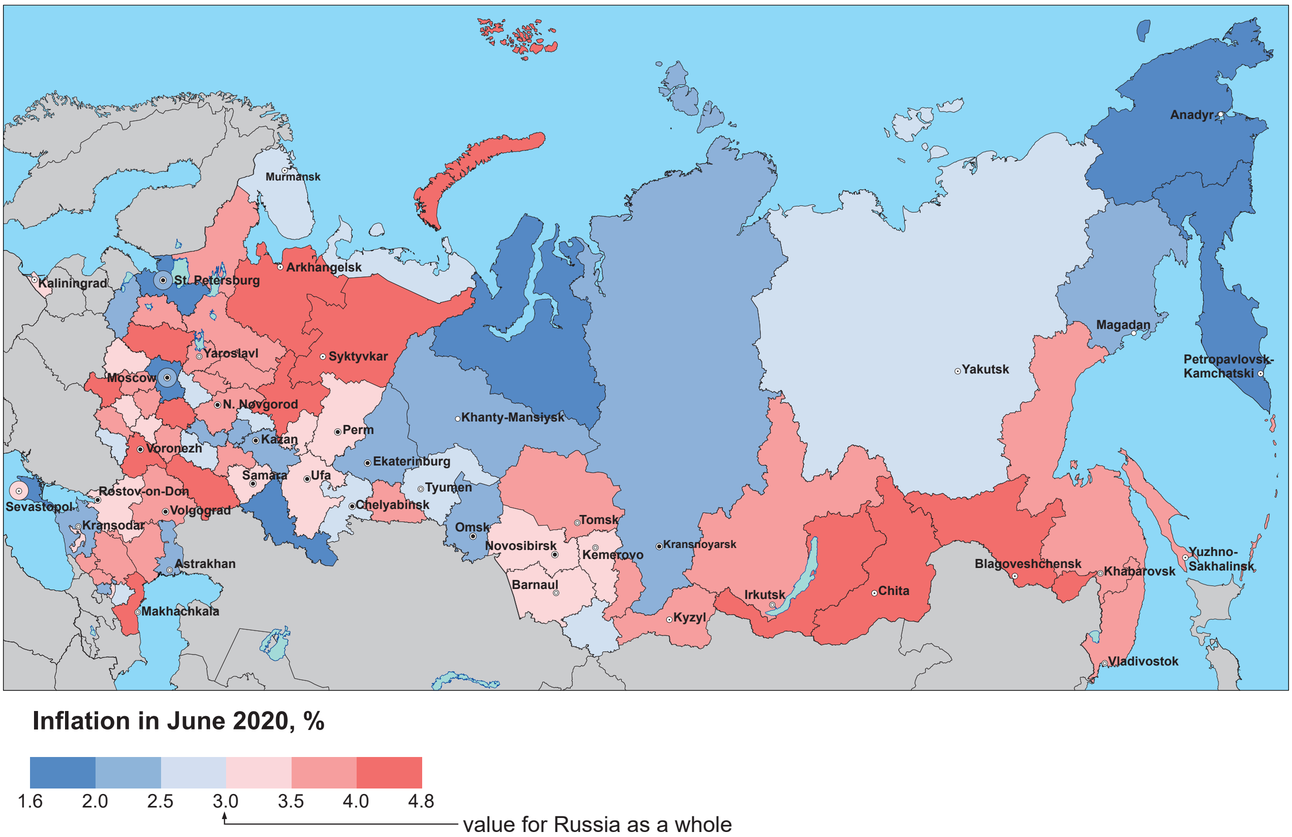
In April–June, amid the countrywide acceleration of food inflation by region, the highest regional inflation rates were observed in the Volga and Southern FDs. In the Volga FD, the acceleration was mainly due to the growth of cereals prices, which, during the April short-term boom in demand, exceeded the countrywide average in many regions of the district. In the Southern FD, deviations from the countrywide dynamics were determined by the faster acceleration of the growth of vegetable and fruit prices largely due to the low base effect of last June, which was more significant in the South than in other federal districts (in June 2019, the early start of harvesting of open field vegetables in the southern regions was the main contributor to the countrywide slowdown in the growth of vegetable prices[2]).

In the Far East, the acceleration of food inflation in April–June was noticeably lower than the countrywide average. In the context of generally more relaxed anti-pandemic restrictions compared to other districts, the regions of the Far Eastern FD saw slower acceleration of cereals price growth

[1] *In the Far East, annual inflation has exceeded countrywide values since June 2019; the reasons for this were indicated in the Annex 'Economic situation in Russian regions' to MPRs 1/20 and 2/20 ('Food inflation' section).*

[2] *See the Annex 'Economic situation in Russian regions' to MPR 3/19, 'Food inflation' section.*

INFLATION IN THE REGIONS IN JUNE 2020 *Chart 3*
(%)



Source: Rosstat.

during the short-term boom in demand. The acceleration in fruit and vegetable price growth in June in the Far Eastern FD was also moderate due to the limited impact of the low base. At the same time, in the Far East, food inflation rates remain the highest, and the risk of accelerated growth of vegetable and fruit prices is high due to a lag in price dynamics given the district's remoteness from the main vegetable producing regions.

Non-food inflation

The growth of non-food goods prices in April–June accelerated in most (77 out of 85) regions, albeit at a slower pace than food inflation (Chart 2). **Non-food inflation accelerated most noticeably in many regions of the Southern and North Caucasian FDs** (Republics of Kalmykia and Crimea, Chechen and Karachay-Cherkess Republics, Sevastopol, Volgograd and Astrakhan Regions). The bulk of the growth occurred in June, which may be associated with a more significant impact of the recovery in consumer demand after the end of the self-isolation regime than in other regions. The accelerated growth of prices in these regions evolved across a wide range of durable goods. In Crimea and Sevastopol, the annual dynamics of petrol prices, which had been negative since September 2019, became positive in June 2020; the change in the annual rate of price growth in April–June amounted to more than 6 pp. The acceleration in the growth of petrol prices on the peninsula is due to higher wholesale prices of suppliers in the context of the prevalence of local small networks of filling stations and the absence of filling stations belonging to federal oil companies. For the same reason, a noticeable, albeit less significant than in Crimea, acceleration in the growth of petrol prices affected many of the North Caucasian republics (Republics of Dagestan, Ingushetia, North Ossetia, Kabardino-Balkarian and Chechen Republics).

In April–June, non-food inflation slowed down in some of the Siberian and Far East regions (Kamchatka and Krasnoyarsk Territories, Sakhalin Region, Republic of Tyva), in Saint Petersburg, the Republic of Ingushetia, the Tyumen and Orenburg Regions. In most of these constituent territories, the slowdown was mainly due to the dynamics of prices for passenger cars (which could be associated with promotion campaigns of individual car dealers in conditions of low demand) and petrol.

Inflation in the services sector

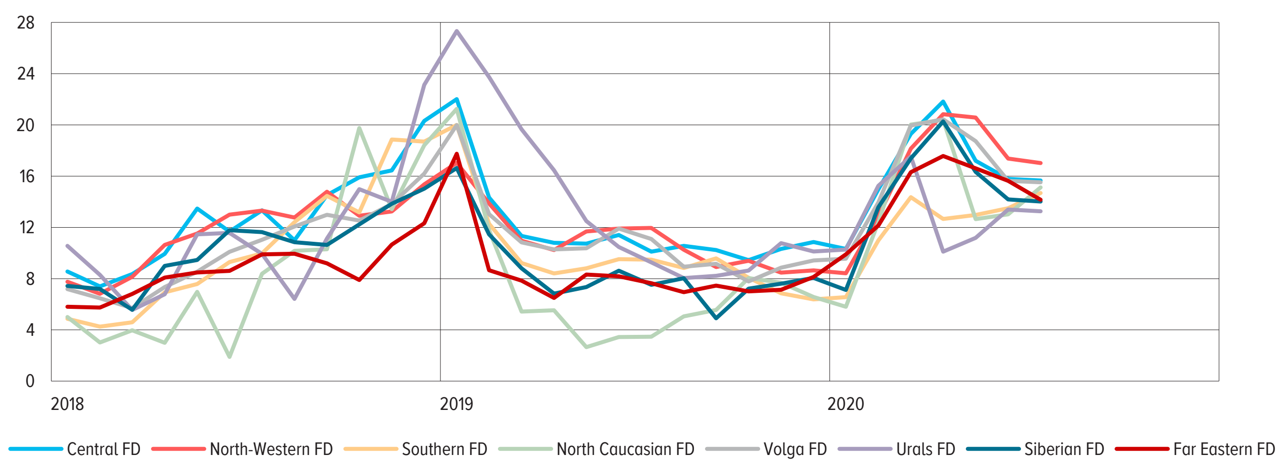
The dynamics of inflation in the services sector in April–June was more heterogeneous than goods inflation. In total, over three months, it slowed down in 62 out of 85 regions. **Passenger transportation services, primarily air transportation, were the main contributors to regional differences in the dynamics of services prices as volatility in this sector was high due to the decrease in passenger traffic.** At the same time, the greatest contribution to both the slowdown and the acceleration of inflation was made by air transportation services in the remote northern, Siberian and Far Eastern regions due to the higher weight of air transportation in the structure of their CPI, explained by the remoteness of these regions from each other and from the constituent territories of the European part of the country. The most significant slowdown in services inflation in April–June was observed in the Yamalo-Nenets Autonomous Area, the Jewish Autonomous Area, the Republic of Buryatia (largely due to air transportation) and the Republic of Crimea (due to slower growth of urban transportation fares and the exclusion of the effect of the fare increase last April from calculation). The greatest acceleration in the growth of services prices during this period occurred in the Chukotka Autonomous Area, the Republic of Sakha (mainly contributed to by air transportation) and the Murmansk, Saratov and Smolensk Regions (mainly due to growth in communication services prices).

Price expectations

Price expectations of businesses participating in the Bank of Russia's monitoring continued to grow in April, but in May–June they began to decline in most federal districts. By July, expectations stabilised in all districts at an elevated level compared to 2019 H2 (Chart 4). As for three-month price expectations by industry, the most noticeable decrease was recorded in trade on the back of the strengthening of the ruble and the return of demand for certain goods to normal after the boom. At the same time, in July, price expectations in trade still remained higher than in other industries. An increase in price expectations in May–July occurred in mining and quarrying due to the resumed growth of global prices for energy commodities. As the restrictions were lifted, some months saw an

BUSINESS PRICE EXPECTATIONS
(balance of responses, %)

Chart 4



Source: monitoring of enterprises conducted by the Banks of Russia.

increase in price expectations in other industries: in June, in construction and services companies following the resumption of construction and residential housing sales in the traditional form[3] and the reopening of services companies; in July, in transportation and storage services. Broken down by federal district, a slight increase in expectations in May–June was observed in the Southern and Urals FDs. However, this increase only partially offset an earlier decline in these districts in April when price expectations continued to grow in the rest of the country. In July, price expectations in the Southern and Urals FDs stabilised at levels close to those in other districts.

CORPORATE LENDING

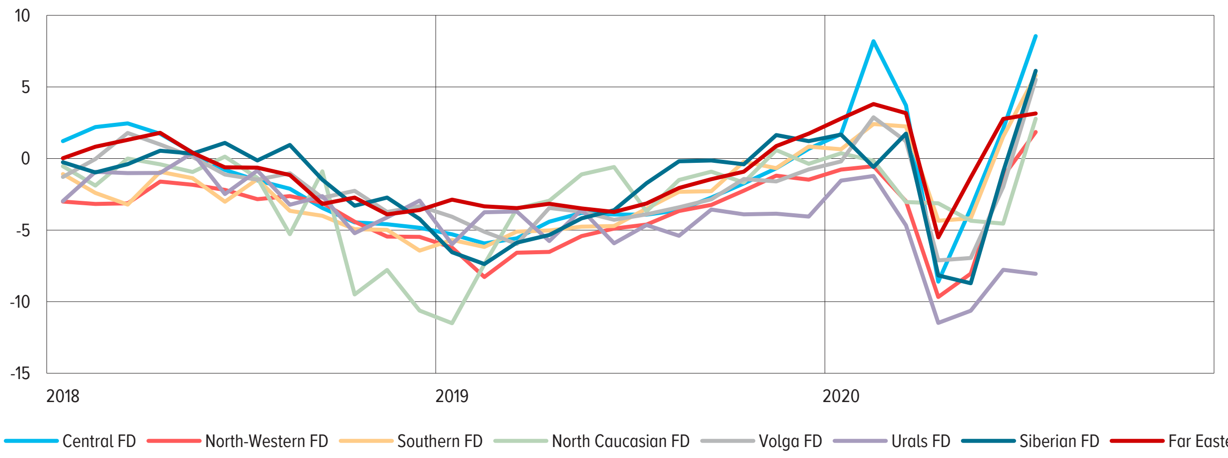
Corporate lending conditions

According to the quarterly survey of credit institutions conducted by the Bank of Russia, in 2020 Q1–Q2, the tightening of non-price lending conditions that began in 2019 Q4 continued in all federal districts. At the same time, in Q2, the price conditions were significantly eased after tightening in Q1. Nevertheless, lending conditions in Q2 were rated as tight in most regions (58 out of 68 regions surveyed) and in all federal districts.

According to the assessment by businesses participating in the Bank of Russia's monitoring, the short-term deterioration in lending conditions that occurred in all federal districts in March–April reversed to a noticeable improvement in May–June; by July, the balance of responses in many FDs returned to the figures of early 2020 or exceeded them (Chart 5). The easing of corporate lending conditions took place in the context of the cut in the Bank of Russia key rate and the implementation of government support programmes for lending to businesses in certain industries and to small- and medium-sized enterprises. Broken down by industry, the greatest improvement in lending conditions was noted by transportation, services and trade enterprises – that is, industries listed as the most affected by the coronavirus pandemic.[4] Businesses in these industries can apply for government support, including concessional lending. In July, a noticeable improvement in lending conditions was also noted by manufacturing enterprises. Broken down by federal district, the Urals FD stood out from the overall positive dynamics in May–July. This may be due to the preservation of tougher non-price lending conditions in the Urals given slower lifting of restrictions and recovery of economic activity compared to other federal districts.

ASSESSMENT OF CHANGES IN LENDING CONDITIONS BY BUSINESSES
(balance of responses, %)

Chart 5



Source: monitoring of enterprises conducted by the Banks of Russia.

[3] *In the period of the self-isolation measures, a significant part of real estate sales transactions was carried out remotely.*

[4] *List of sectors of the Russian economy most affected by the deterioration of the situation resulting from the coronavirus pandemic.*

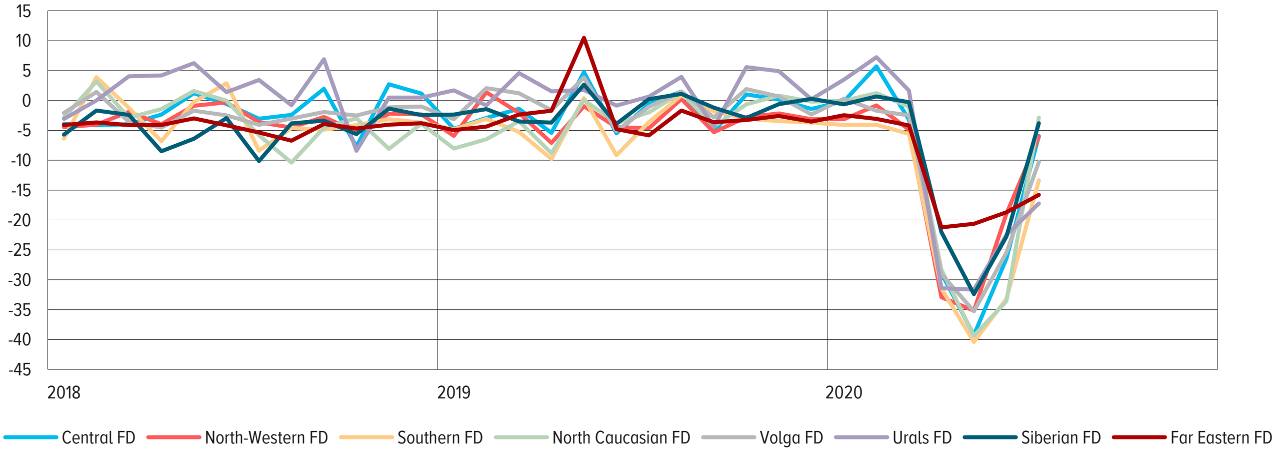
ECONOMIC ACTIVITY

Production activity

In April–May, in all federal districts, businesses participating in the Bank of Russia's monitoring noted a uniform decrease in production activity due to the anti-coronavirus restrictions (Chart 6). Broken down by sector, the greatest decrease in the volume of works performed was noted by businesses in transportation, trade and services. At the same time, the balance of responses of agricultural companies showed almost no deterioration. There was a noticeable difference in the dynamics of output estimates depending on the size of businesses: it was significantly worse for small-sized and micro-enterprises. Small businesses also rated demand and the general economic environment lower. **Broken down by federal district, the least significant decrease in output estimates was noted in the Far East, where they were higher than the national average in almost all sectors. This district also saw an earlier (in May) recovery of production output. In the rest of the federal districts, growth resumed in June**, but everywhere the balance of responses remains negative, well below the levels of the beginning of the year. The less significant decline in the output estimates in the Far East is due to the generally more relaxed restrictive measures: according to

ASSESSMENT OF CHANGES IN OUTPUT VOLUMES BY BUSINESSES
(balance of responses, %)

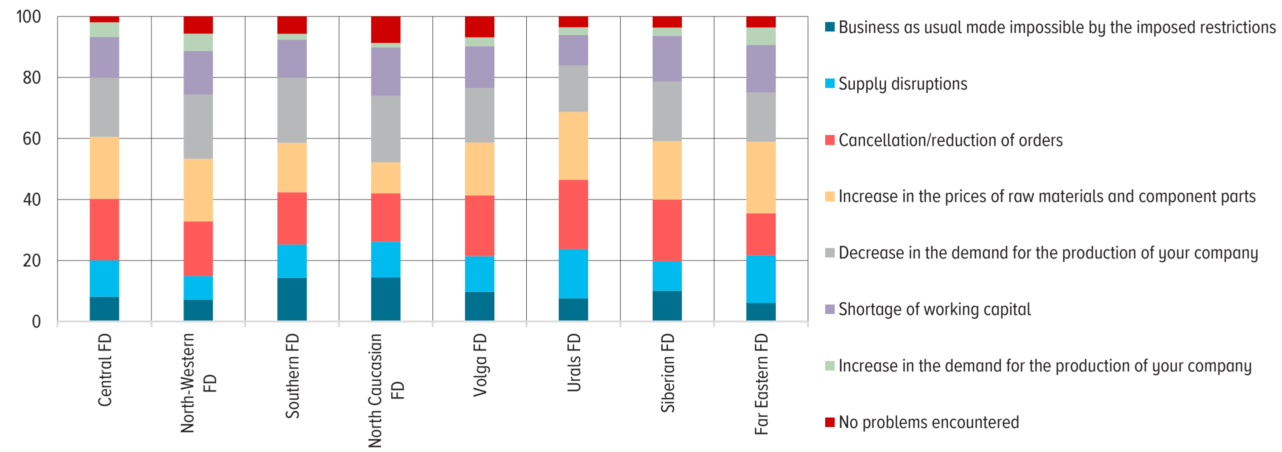
Chart 6



Source: monitoring of enterprises conducted by the Banks of Russia.

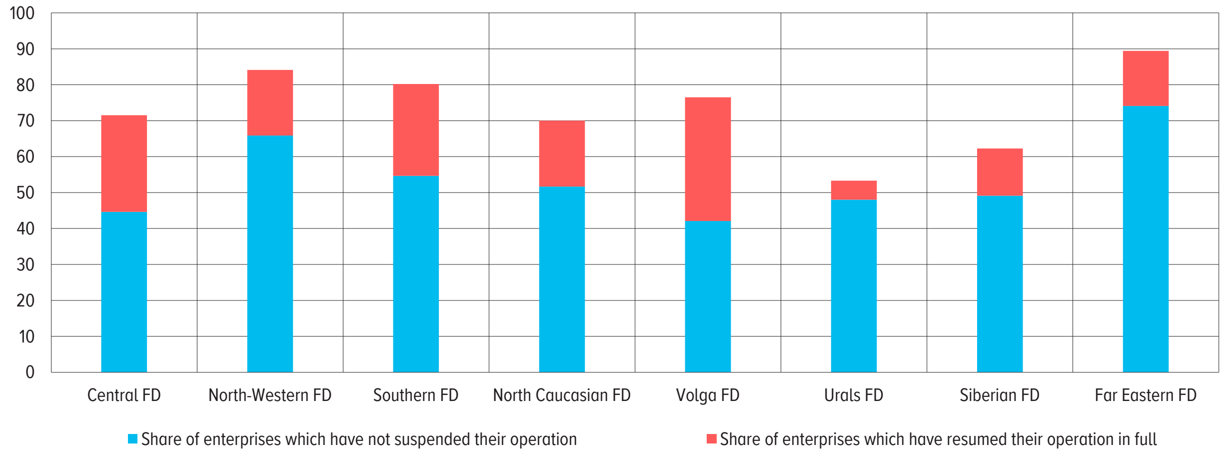
DISTRIBUTION OF RESPONSES TO THE QUESTION 'WHAT WERE THE CONSEQUENCES OF THE PANDEMIC SPREAD FOR YOUR ENTERPRISE?' THERE ARE SEVERAL RESPONSE OPTIONS*
(%)

Chart 7



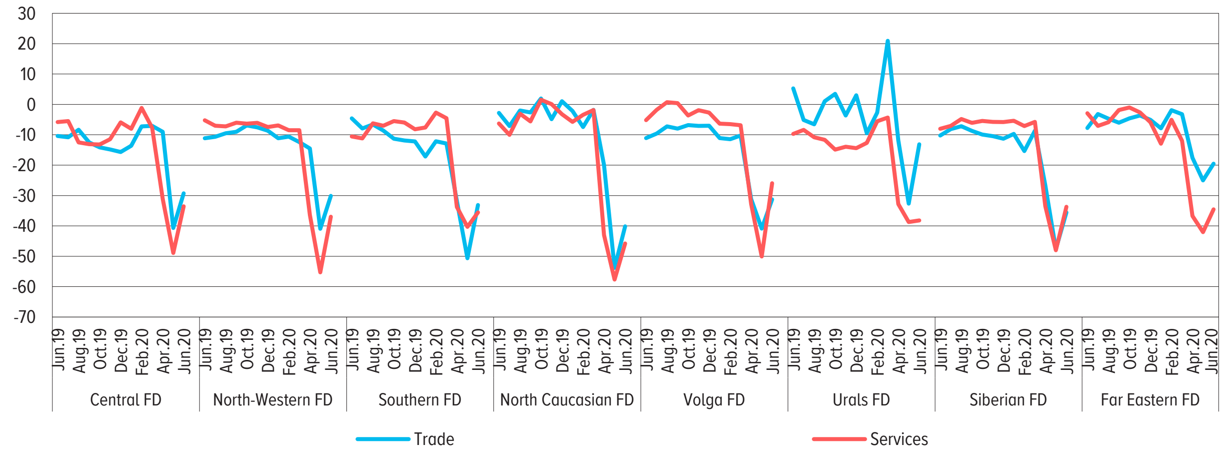
** The survey was conducted on 15 May 2020, when the pandemic hit the maximum values. At that time, the share of enterprises choosing the 'No problems encountered' option was minimal.*
Source: monitoring of enterprises conducted by the Banks of Russia.

DISTRIBUTION OF RESPONSES TO THE QUESTION 'WHAT IS THE CURRENT WORKING MODE OF YOUR ENTERPRISE?'* *Chart 8*
(%)



** The survey was conducted on 26 June 2020.*
Source: monitoring of enterprises conducted by the Banks of Russia.

ASSESSMENTS OF DEMAND BY TRADE AND SERVICES COMPANIES *Chart 9*
(balance of responses, %)



Source: monitoring of enterprises conducted by the Banks of Russia.

the Bank of Russia's survey conducted among certain businesses participating in the monitoring, in the Far Eastern FD at the peak of the epidemic, the share of businesses declaring that business as usual became impossible was the lowest (6% compared to 10% on average for the rest of the districts) (Chart 7), and by the end of June almost 90% of businesses in the Far Eastern FD were back to normal operations (Chart 8). At the same time, in the Far Eastern FD, as in other federal districts, most of the surveyed enterprises faced many negative effects of the restrictions, of which a decrease in demand and reduction in orders for their production, and also increase in the prices of raw materials and component parts were the most common (Chart 7). According to the survey, the most severe restrictions on the operation of enterprises were still in force at the end of June in the Urals and Siberia, where more than a third of enterprises could not operate normally (Chart 8).

By mid-July[5], 18% of surveyed enterprises were able to take advantage of the government support measures, and 10% received concessional loans at 2% p.a. for the resumption of operation. The highest share of businesses that benefited from government support is in the North Caucasus (33%) and the Far East (24%); the lowest is in the Urals (9%).

[5] *The survey was conducted on 26 June.*

After a sharp decline in April, expectations for changes in output and demand in May–July increased noticeably in all federal districts, approaching the levels observed before the introduction of self-isolation. The highest values of the balance of responses concerning expectations for demand and output in June were observed in the North Caucasus. Broken down by sector, agricultural enterprises, which were the least affected by the restrictive measures, have the highest expectations, and the lowest expectations are observed in mining and quarrying, where external demand for raw materials exported by Russia remains weak, and production is restricted under the OPEC+ arrangements.

Consumer activity

According to the Bank of Russia's monitoring of enterprises, a decline in consumer activity in April–May was observed in all federal districts (Chart 9). In the Far East, the decline in consumer demand was less significant as the deterioration in the economic environment was generally the least substantial there. The most significant decline in consumer activity in April–May occurred in the regions of the North Caucasus characterised by the lowest level of household income. **In June, all federal districts demonstrated slightly improved demand estimates. By July, in most districts, demand estimates made by trade companies approached the levels of early 2020. At the same time, demand estimates of companies in the services sector remained below pre-crisis values in all districts.**

Investment activity

According to the quarterly survey of enterprises conducted by the Bank of Russia, in 2020 Q1–Q2, investment activity was down in all federal districts. Broken down by industry, the most significant decline in Q1 occurred in mining and quarrying amid a drop in external demand and downturn in global oil prices. In Q2, investment activity estimates in mining and quarrying improved slightly, although they remained significantly below the 2019 levels. The estimates deteriorated the least in agriculture; investment activity of agricultural enterprises was noticeably higher compared to other industries.

STATISTICAL TABLES

Table 1

INTEREST RATES ON BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY
(% p.a.)

Purpose	Instrument type	Instrument	Term	Frequency	As of 01.01.2019	From 17.06.2019	From 29.07.2019	From 09.09.2019	From 28.10.2019	From 16.12.2019	From 10.02.2020	From 27.04.2020	From 14.05.2020	From 22.06.2020	From 27.07.2020	General approach to rate-setting[1]
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[2]; repos	1 day	Daily	8.75	8.50	8.25	8.00	7.50	7.25	7.00	6.50	6.50	5.50	5.25	Key rate + 1.00
		Loans secured by non-marketable assets[3]	From 2 to 549 days		9.50	9.25	9.00	8.75	8.25	8.00	7.75	7.25	7.25	6.25	6.00	Key rate + 1.75
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets	3 months[3]	Monthly[4]	8.00	7.75	7.50	7.25	6.75	6.50	6.25	5.75	5.75	4.75	4.50	Key rate + 0.25
		Repo auctions	1 year[3]	Monthly	-	-	-	-	-	-	-	-				
			1 month		-	-	-	-	-	-	-	-	5.60	4.60	4.35	Key rate + 0.1
			1 week	Weekly[5]	7.75 (key rate)	7.50 (key rate)	7.25 (key rate)	7.00 (key rate)	6.50 (key rate)	6.25 (key rate)	6.00 (key rate)	5.50 (key rate)	5.50 (key rate)	4.50 (key rate)	4.25 (key rate)	Key rate
			From 1 to 6 days	Occasionally[6]												
		FX swap auctions (ruble leg)[2]	From 1 to 2 days													
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	From 1 to 6 days													
			1 week	Weekly[5]												
	Standing facilities	Deposit operations[7]	1 day	Daily	6.75	6.50	6.25	6.00	5.50	5.25	5.00	4.50	4.50	3.50	3.25	Key rate - 1.00

[1] From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set as key rate spreads. See press release.
[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] Until 16 May 2018, also call 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
(billions of rubles)

Table 2

Purpose	Instrument type	Instrument	Term	Frequency	Bank of Russia claims under liquidity provision instruments and liabilities under liquidity absorption instruments					
					As of 01.01.2019	**As of 01.01.2020**	**As of 01.04.2020**	**As of 01.05.2020**	**As of 01.06.2020**	**As of 01.07.2020**
Liquidity provision	Standing facilities	Overnight loans	1 day	Daily	8.1	0.0	0.0	0.0	0.0	0.0
		Lombard loans			0.0	0.0	0.0	0.0	0.0	0.0
		FX swaps			4.1	12.6	0.0	0.0	0.0	0.0
		Repos			3.6	0.0	16.7	0.0	0.1	0.0
		Loans secured by non-marketable assets	From 1 to 549 days		5.1	5.1	5.1	5.1	5.1	5.1
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months[1]	Monthly	0.0	0.0	0.0	0.0	0.0	0.0
		Repo auctions	1 year		-	-	-	-	-	5.3
			1 month		-	-	-	-	0.0	0.0
			1 week	Weekly[2]	0.0	0.0	0.0	0.0	0.0	0.0
			From 1 to 6 days	Occasionally[3]			854.4	500.5	0.0	0.0
		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		1,478.2	696.6	1,673.5	410.0	770.0	773.4
			1 week	Weekly[2]						
		Auctions for the placement and additional placement of coupon OBRs[4]	Up to 3 months	Occasionally	1,391.3	1,956.3	1,544.2	1,520.3	1,109.7	708.2
	Standing facilities	Deposit operations	1 day[5]	Daily	423.8	329.7	160.5	260.1	126.0	151.3

[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 coupon OBRs includes the accrued coupon interest as of the first working day following the reporting date.
[5] Before 16 May 2018, also demand deposits. From 17 May 2018, the Bank of Russia only conducts overnight deposit operations with credit institutions.
Source: Bank of Russia.

REQUIRED RESERVE RATIOS *Table 3*
(%)

Liability type	Validity dates			
	01.12.2017 – 31.07.2018	01.08.2018 – 31.03.2019	01.04.2019 – 30.06.2019	From 01.07.2019[1]
Banks with a universal licence and non-bank credit institutions				
To households in the currency of the Russian Federation	5.00	5.00	4.75	4.75
Other liabilities in the currency of the Russian Federation				
To non-resident legal entities in the currency of the Russian Federation				
To households in foreign currency	6.00	7.00	7.00	8.00
To non-resident legal entities in foreign currency	7.00	8.00	8.00	8.00
Other liabilities in foreign currency				
Banks with a basic licence				
To households in the currency of the Russian Federation	1.00	1.00	1.00	1.00
Other liabilities in the currency of the Russian Federation				
To non-resident legal entities in the currency of the Russian Federation	5.00	5.00	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	7.00	8.00	8.00	8.00
Other liabilities in foreign currency				

[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 2020 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			
11.12.2019 – 14.01.2020	35	November 2019	13.12.2019 – 17.12.2019	2,526	2,428	617
15.01.2020 – 11.02.2020	28	December 2019	22.01.2020 – 24.01.2020	2,479	2,418	618
12.02.2020 – 10.03.2020	28	January 2020	14.02.2020 – 18.02.2020	2,474	2,398	613
11.03.2020 – 07.04.2020	28	February 2020	16.03.2020 – 18.03.2020	2,536	2,431	622
08.04.2020 – 12.05.2020	35	March 2020	14.04.2020 – 16.04.2020	2,685	2,605	665
13.05.2020 – 09.06.2020	28	April 2020	20.05.2020 – 22.05.2020	2,700	2,635	671
10.06.2020 – 07.07.2020	28	May 2020	15.06.2020 – 17.06.2020	2,636	2,570	656
08.07.2020 – 04.08.2020	28	June 2020	14.07.2020 – 16.07.2020			
05.08.2020 – 08.09.2020	35	July 2020	14.08.2020 – 18.08.2020			
09.09.2020 – 06.10.2020	28	August 2020	14.09.2020 – 16.09.2020			
07.10.2020 – 10.11.2020	35	September 2020	14.10.2020 – 16.10.2020			
11.11.2020 – 08.12.2020	28	October 2020	16.11.2020 – 18.11.2020			
09.12.2020 – 12.01.2021	35	November 2020	14.12.2020 – 16.12.2020			

KEY ECONOMIC AND FINANCIAL INDICATORS

Table 6

		June 2019	July 2019	August 2019	September 2019	October 2019	November 2019	December 2019	January 2019	February 2020	March 2020	April 2020	May 2020	June 2020
Real sector														
Inflation	% YoY	4.7	4.6	4.3	4.0	3.8	3.5	3.0	2.4	2.3	2.5	3.1	3.0	3.2
GDP[1]	% YoY	1.1			1.5			2.1			1.6			
GDP in current prices[1]	trillions of rubles	26.4			28.9			29.8			25.3			
Output by key activity types	% YoY	1.3	2.9	2.5	3.9	4.0	1.8	2.1	1.7	3.5	0.6	-10.0	-10.8	
Industrial production	% YoY	3.3	2.8	2.9	3.0	2.6	0.3	2.1						
Agricultural production	% YoY	1.0	6.1	3.2	5.4	5.0	5.7	5.6	2.9	3.1	3.0	3.1	3.2	3.0
Construction	% YoY	0.1	0.2	0.2	1.0	1.1	0.3	0.4	1.0	2.3	0.1	-2.3	-3.1	-0.1
Fixed capital investment[1]	% YoY	1.2			1.7			2.3			1.2			
Freight turnover	% YoY	0.5	-0.9	-0.3	0.5	0.2	-1.2	-1.3	-3.8	-0.4	-6.7	-5.9	-9.3	-9.5
PMI Composite Index	% SA	49.2	50.2	51.5	51.4	53.3	52.9	51.8	52.6	50.9	39.5	13.9	35.0	48.9
Retail turnover	% YoY	1.8	1.5	1.1	0.9	1.9	2.6	1.8	2.7	4.7	5.7	-23.2	-19.2	-7.7
Real disposable income[1]	% YoY	1.0			2.9			1.8			1.2			-8.0
Real wage	% YoY	2.9	3.0	2.4	3.1	3.8	2.7	6.9	6.5	5.7	5.9	-2.0	1.0	
Nominal wage	% YoY	7.7	7.7	6.8	7.2	7.7	6.3	10.1	9.1	8.1	8.6	1.0	4.0	
Unemployment rate	% SA	4.5	4.5	4.5	4.6	4.6	4.6	4.5	4.5	4.5	4.6	5.7	6.1	6.3
Banking Sector														
Broad money supply	% YoY, AFCR	6.4	7.0	7.3	8.0	7.9	8.3	7.6	8.0	7.9	9.1	9.6	9.3	
Money supply (M2)	% YoY	7.3	7.8	7.2	9.1	8.7	9.6	9.7	10.7	11.0	13.4	14.0	13.6	
Household deposits	% YoY, AFCR	7.3	7.1	8.2	9.4	9.2	9.8	9.8	9.8	9.0	7.3	6.4	6.4	7.2
in rubles	% YoY	6.6	6.5	7.8	8.9	8.6	10.0	9.9	10.8	10.8	10.7	9.9	9.8	10.9
in foreign currency	% YoY	9.9	9.5	9.6	11.3	11.7	9.6	9.8	6.3	2.3	-4.6	-6.2	-5.9	-6.7
dollarisation	%	20.9	21.1	21.5	21.1	20.9	20.6	19.6	20.1	20.5	22.1	20.7	20.2	19.8
Loans to non-financial organisations	% YoY, AFCR	6.4	5.7	5.0	3.4	4.1	4.0	4.3	3.2	2.0	3.6	4.8	4.8	4.4
short-term (less than 1 year)	% YoY, AFCR	4.7	4.9	2.1	1.2	1.3	0.6	0.4	4.9	3.3	9.8	12.4	13.9	15.0
long-term (more than 1 year)	% YoY, AFCR	5.4	4.3	4.0	2.1	3.0	3.1	3.2	2.8	1.9	2.3	3.2	3.1	2.1
overdue loans	%	7.9	8.1	8.0	8.0	8.0	7.9	7.8	7.8	7.6	7.5	7.4	7.5	7.7
Loans to households	% YoY, AFCR	22.8	21.9	21.2	20.7	19.7	18.6	18.5	17.9	17.8	17.7	14.6	13.0	12.6
housing mortgage loans	% YoY, AFCR	21.6	19.8	19.0	18.3	17.3	16.4	16.9	15.6	15.4	15.2	14.1	13.6	13.7
unsecured consumer loans	% YoY	24.6	24.4	23.7	23.4	22.6	21.1	20.8	20.1	20.2	20.0	15.3	12.7	11.2
overdue loans	%	4.9	4.9	4.8	4.7	4.6	4.5	4.3	4.4	4.5	4.5	4.6	4.7	4.7

Legend:
YoY – on the same period of the 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	2019 Q4	2020 Q1	2020 Q2[1]
Balance of payments[2]											
Urals crude price	% YoY	25.9	50.8	44.3	10.7	-3.7	-5.5	-16.9	-7.2	-22.6	-57.0
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	4.3	0.0	-10.7
Goods and services exports	% YoY	21.8	27.4	28.4	18.8	0.8	-6.7	-6.0	-7.7	-12.8	-35.5
Goods and services imports	% YoY	19.0	8.2	-0.1	-2.9	-3.4	-1.2	5.7	9.8	1.1	-26.9
Current account	**billions of US dollars**	**30.2**	**18.4**	**28.1**	**39.0**	**33.5**	**9.9**	**10.7**	**11.2**	**21.7**	**0.6**
Balance of trade	billions of US dollars	44.0	45.5	47.8	57.7	47.0	39.4	37.9	41.0	31.9	14.3
Exports	billions of US dollars	101.6	108.9	110.6	122.9	102.6	101.4	103.3	112.5	88.1	67.9
Imports	billions of US dollars	57.5	63.4	62.7	65.2	55.7	62.0	65.4	71.6	56.2	53.6
Balance of services	billions of US dollars	-6.6	-7.7	-8.8	-6.9	-6.0	-9.0	-11.5	-9.7	-6.7	-2.1
Exports	billions of US dollars	13.9	16.6	17.4	16.7	13.8	15.8	17.0	16.2	13.4	7.7
Imports	billions of US dollars	20.6	24.4	26.1	23.6	19.8	24.7	28.5	26.0	20.1	9.8
Balance of primary and secondary income	billions of US dollars	-7.2	-19.3	-11.0	-11.8	-7.5	-20.5	-15.7	-20.0	-3.5	-11.6
Current and capital account balance	billions of US dollars	30.0	18.2	28.1	38.3	33.5	9.7	10.6	10.8	21.7	0.4
Financial account excluding reserve assets (net lending (+) / net borrowing (-)	**billions of US dollars**	**12.7**	**9.8**	**24.9**	**31.0**	**12.3**	**-5.2**	**-7.2**	**-3.8**	**16.5**	**12.7**
Public sector	billions of US dollars	-6.6	11.1	2.9	1.3	-9.3	-6.2	-3.6	-3.8	0.4	1.2
Private sector	billions of US dollars	19.3	-1.3	22.0	29.8	21.6	1.0	-3.6	0.0	16.1	11.4
Net errors and omissions	billions of US dollars	2.1	2.9	1.8	-4.7	-2.6	1.7	-1.9	0.8	-0.2	-0.6
Change in reserve assets ('+' – increase, '–' – decrease)	**billions of US dollars**	**19.3**	**11.3**	**5.0**	**2.6**	**18.6**	**16.6**	**15.9**	**15.4**	**5.0**	**-12.9**

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

LIST OF PUBLICATIONS

Bank of Russia information and analytical commentaries released after the publication of MPR 2/20 on 6 May 2020[1]:

1. *Consumer price dynamics, No. 4 (52), April 2020 (18 May 2020)*
2. *Consumer price dynamics, No. 5 (53), May 2020 (22 June 2020)*
3. *Consumer price dynamics, No. 6 (54), June 2020 (15 July 2020)*
4. *Inflation expectations and consumer sentiment, No. 5 (41), May 2020 (28 May 2020)*
5. *Inflation expectations and consumer sentiment, No. 6 (42), June 2020 (25 June 2020)*
6. *Inflation expectations and consumer sentiment, No. 7 (43), July 2020 (27 July 2020)*
7. *Economy, No. 3 (51), March 2020 (7 May 2020)*
8. *Economy, No. 4 (52), April 2020 (3 June 2020)*
9. *Economy, No. 5 (53), May 2020 (29 June 2020)*
10. *Economy, No. 6 (54), June 2020 (28 July 2020)*
11. *Banking sector liquidity and financial markets, No. 4 (50), April 2020 (14 May 2020)*
12. *Banking sector liquidity and financial markets, No. 5 (51), May 2020 (10 June 2020)*
13. *Banking sector liquidity and financial markets, No. 6 (52), June 2020 (10 July 2020)*
14. *Russia's balance of payments, No.2 (4), 2020 Q2 (16 July 2020)*

[1] *The date in the brackets is the publication date on the Bank of Russia website.*

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

The principal 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. The rate corresponds to the minimum interest rate at the Bank of Russia's one-week repo auctions and to the maximum interest rate at the Bank of Russia's 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 enabling a buyer to insure against a certain credit event (e.g., default) concerning a third party's financial obligations in exchange for regular payments of premia (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.

LIQUIDITY-ABSORBING OPERATIONS

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

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)

The total amount of cash in circulation outside the banking system and of the balances of Russian residents (non-financial and financial (other than credit) institutions and individuals) in settlement, current and other demand accounts (including in bank card accounts), time deposits, and other raised term funds in the banking system denominated in Russian rubles, as well as 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.

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)

A reference weighted interest rate on overnight ruble-denominated 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

AE – Advanced economies

AEB – Association of European Businesses

AFCR – adjusted for foreign currency revaluation

AHML – Agency for Housing Mortgage Lending

BLC – bank lending conditions

bp – basis point (0.01 percentage points)

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

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

Cbonds-Muni – municipal bond index calculated by Cbonds

CCPI – core consumer price index

CPI – consumer price index

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

ECB – European Central Bank

EME – emerging market economies

EU – European Union

FAO – Food and Agriculture Organization of the United Nations

FCS – **Fed**eral Customs Service

Fed – US **Fed**eral Reserve System

FGUP – federal state unitary enterprise

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

GRP – gross regional product

GVA – gross value added

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 – **MIC**EX Stock Exchange

million bpd – million barrels per day

MPD – Monetary Policy Department of the Bank of Russia

MPG 2020-2022 – Monetary Policy Guidelines for 2020-2022 (a**pp**roved 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; 4/19 – No. 4 2019, 1/20 – No. 1 2020; 2/20 – No. 2 2020)

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

NFI – non-bank financial institution

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

REER – real effective exchange rate

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)

SA – seasonally adjusted

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

3MMA – three-month moving average