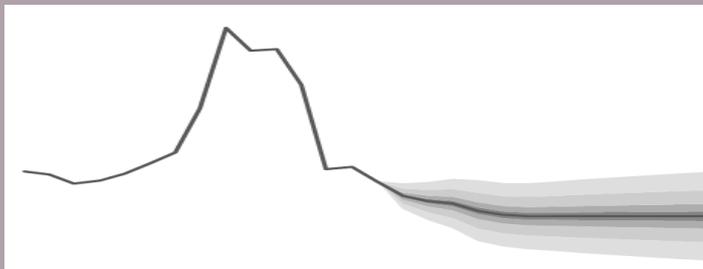




Bank of Russia

The Central Bank of the Russian Federation



4%

No. 2
June 2016

Information
and Analytical
Review

MONETARY POLICY REPORT

Moscow

DEAR READERS,

In order to improve the effectiveness of the Bank of Russia's information policy with regard to its monetary policy and to assess the relevance of and demand for the materials published, we would be grateful if you could answer the following questions.

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- 2. Which subjects, in your opinion, should be illustrated in this report?*
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Many thanks in advance for your assistance.

The report has been prepared on the basis of data as of 1 June 2016.
Data cut-off date for forecast calculations is 1 June 2016.

An electronic version of the information and analytical review can be found on the Bank of Russia website at <http://www.cbr.ru/publ/>.

Please send your suggestions and comments to monetarypolicyreport@mail.cbr.ru.

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SUMMARY

In the context of improved external economic developments in March-May 2016, the Russian economy faced a more favourable situation than anticipated earlier (in the Monetary Policy Report issued in March). GDP decline slowed significantly, and there were signs of an imminent economic recovery phase. Such output dynamics occurred on the back of slowing inflation. In March, annual inflation decelerated to 7.3% and stabilised at that level in April-May despite some forecast acceleration. Inflation risks shaped by the dynamics of budget expenditures, inflation expectations and oil prices were subdued. Certain advances in nominal wage growth did not drag on inflation. Those positive price dynamics installed more confidence, allowing for further expectations of a sustainable inflation reduction to the 4% target in 2017. Under these circumstances, in June the Bank of Russia decided to reduce the key rate by 50 basis points to 10.50% p.a. from 11.00 in April.

Data on GDP dynamics in 2016 Q1, as well as macroeconomic indicators in April point to a gradual decrease in the economy's dependence on oil price dynamics and to the increase in its resilience to changes in external environment. New points signalling recovery emerge in the manufacturing sectors, partly prompted by the expansion in import substitution and non-commodity exports. However, production activity indicators improve unevenly by sector, which does not lead to the recovery in consumer and investment demand. Therefore, current economic revival does not exert additional inflationary pressure. In contrast, weak domestic demand restricts price growth. Inflation slowdown and its subsequent stabilisation are also helped by temporal factors, i.e. ruble appreciation amid oil price growth and stability in the global food market. Deceleration in consumer price growth is accompanied by a fall in inflation expectations.

Given a noticeable change in the trade-off between demand and supply in the oil market, the oil price path was adjusted upwards in the baseline scenario of the forecast. At the same time, as the observed growth in oil prices was mainly driven by temporal factors, the Bank of Russia retained a conservative approach to formulating its oil price assumptions in the forecast. The baseline scenario suggests adjusting the average Urals price to \$40 per barrel in 2016 H2 and preserving it as such in 2017-2018. The witnessed positive trends in the economy are expected to continue. Manufacturing will be assisted by a stable external demand, and later on – by the domestic demand, whose expansion will start in 2017. Investment growth will be facilitated by a gradual reduction in uncertainty, improved business sentiment, monetary conditions easing and an alleviation of the debt burden. Consumer demand will also see a gradual recovery. However, household propensity to save will decline slowly amid a slow decrease in real rates, and demand growth will not drag significantly on inflation. According to Bank of Russia forecasts, in 2016 GDP will drop by 0.3 – 0.7%, output will grow by 1.1 – 1.4% in 2017, and by 1.6-2.0% in 2018.

Amid stabilising energy prices and a gradual recovery in imports, the current account surplus will be steadily contracting over the forecast period. Within the same time-span, the net private capital outflow will stay subdued, prompted by a steady reduction in external debt payments and increased capacity of its restructuring prior to end-2017. Current account receipts will be sufficient to repay the external debt, and banks will be able to fully repay their outstanding amounts on FX refinancing instruments to the Bank of Russia.

Annual inflation will stay on the downward track. Administered prices and tariffs will be indexed in July in line with the announced plans and to a lesser extent than a year ago, helping to reduce inflation. Conservative consumer behaviour patterns coupled by households' propensity to save will keep price growth in check. Inflation slowdown will be also facilitated by a further optimisation of the costs by producers and a decline in inflation expectations. According to Bank of Russia forecasts, inflation will go down to 5-6% by end-2016 and to the 4% target by end-2017.

Despite the fact that oil-price driven risks have not materialised during the previous period, uncertainty with regard to future oil quotations remains. Therefore, apart from the baseline scenario the Bank of Russia has considered optimistic and risk scenarios. Under the optimistic scenario, in the context of a more vigorous revival of the global economy, oil price growth is expected to continue its upward movement. This will lead to a faster pick-up in the Russian economic recovery given the decline in price growth, comparable with the baseline scenario. The risk scenario assumes that a considerable slack in Chinese economic growth, accelerated normalisation of the Fed's monetary policy or expanded supply in the oil market will all lead to a material drop in oil prices. In such settings, the recession of the Russian economy will be more protracted, and prices will decline slower, therefore threatening to overshoot the 4% inflation target in 2017.

Apart from external risks, domestic inflation risks will remain elevated. No final decisions have been made yet on the parameters of wage and pension indexing, as well as the further fiscal consolidation strategy. A year-from-now inflation, as expected by households and businesses, remains rather high. One should not rule out an accelerated reduction in household propensity to save. This, alongside with growing wages, may set grounds for consumption to outpace output, thus exerting a downward pressure on prices.

The Bank of Russia will consider the possibility of a further key rate cut based on estimates for inflation risks and alignment of inflation decline with the forecast trajectory.

1. MACROECONOMIC CONDITIONS

In March-May 2016, the situation in the Russian economy developed amid more positive trends in the global economy and global financial and commodity markets than were previously expected (Monetary Policy Report No. 1 (13), March 2016¹).

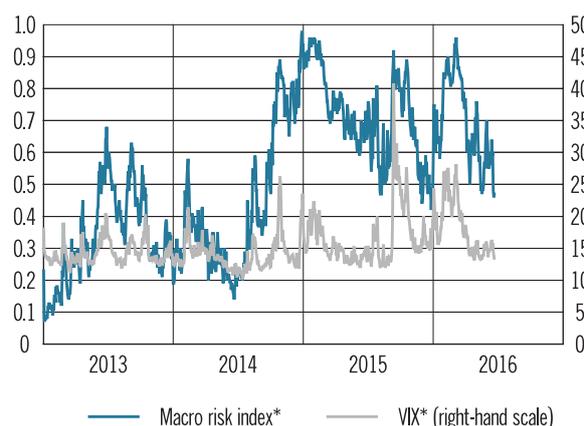
Overall, the Russian economy showed stable dynamics in key indicators of economic activity with stronger signs of renewed growth in production across certain sectors. These dynamics were buoyed in part by external demand and the continuation of import substitution processes. In addition to the improvement in external conditions, the persistently stable situation in the financial sphere helped create a favourable backdrop for this. However, during the period under review, supply and demand indicators moved in different directions with even greater intensity in the Russian economy. With sufficiently positive trends observed in industry, internal consumer and investment demand remained relatively weak. This had a restraining effect on inflation, which continued to slow ahead of the Bank of Russia's forecasts.

External economic conditions in March-May 2016 improved slightly for Russia compared to the start of 2016. During this period, the optimism of global financial and commodity market participants intensified and risk perception indicators remained subdued (Chart 1.1). This was shaped in part by the revised expectations regarding the US Fed's policy, the publication of a number of relatively positive statistics on the Chinese economy, and slight improvement in business indicators in key developed countries (Chart 1.2). However, the improvement in investor sentiment in the global markets to a certain degree outstripped the changes in economic fundamentals reflecting the real growth prospects of the global economy. In view of this, any further intensification of these upside trends in the global financial and commodity markets seems unlikely; and the likelihood that they will be slightly adjusted is growing. Some signs of stabilising investor sentiment have already been observed, in

particular, in the dynamics of global stock indices (Chart 1.3).

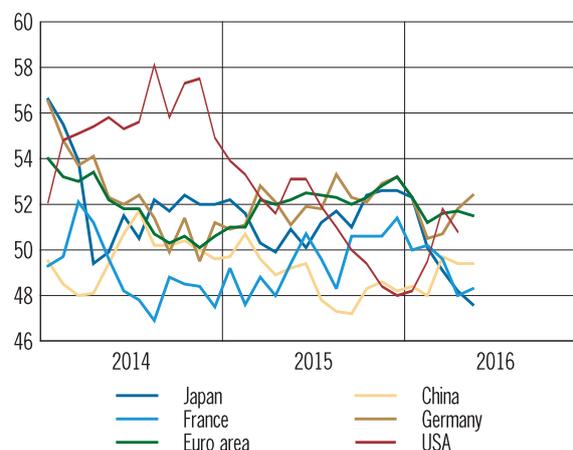
In March-May 2016, global oil prices, which are one of the key external factors weighing on the Russian economy, were higher than the level assumed in the baseline scenario of the forecast presented in the previous Report. Over this period, the average price of Urals crude was \$40.5 per barrel. The improvement in the price situation

Chart 1.1
Indices of volatility and global financial market risk perception by investors



* See the Glossary.
Source: Bloomberg.

Chart 1.2
Business activity indices (PMI)
in industry abroad
(points)

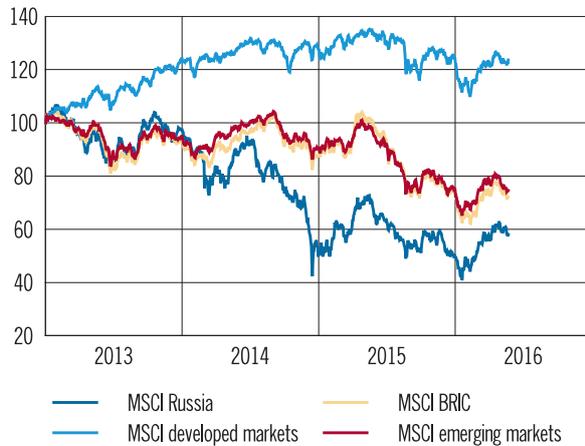


Source: Bloomberg.

¹ Hereinafter, the Report.

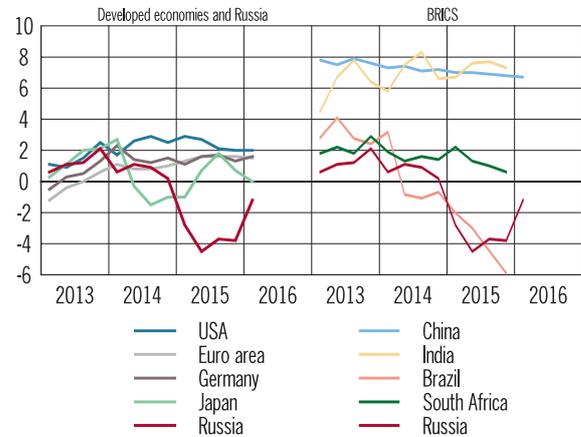
Global stock indices
(1.01.2013 = 100%)

Chart 1.3



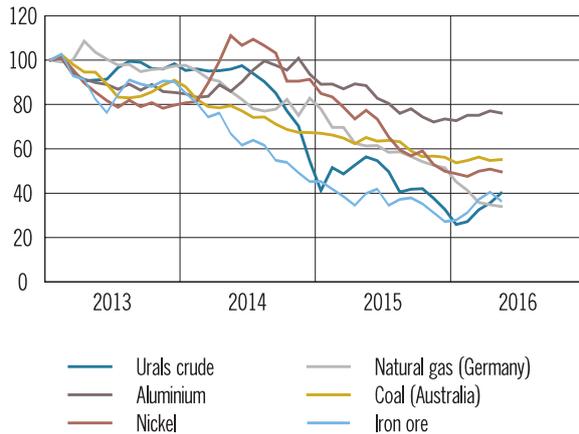
GDP growth rates of key developed and emerging economies
(percent change on corresponding period of previous year)

Chart 1.5



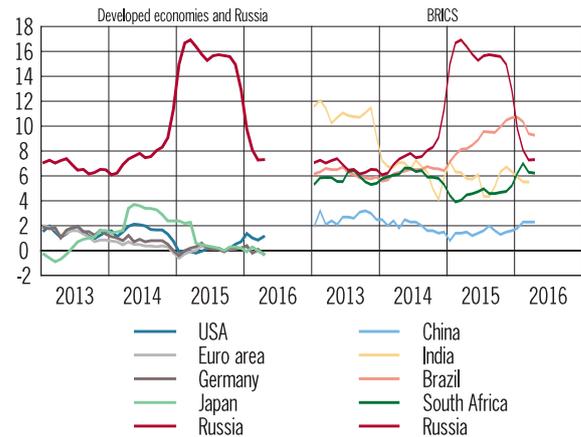
World prices of Russian principal export commodities
(January 2013 = 100%)

Chart 1.4



Inflation in key developed and emerging economies
(percent change on corresponding period of previous year)

Chart 1.6



in the global oil market was buoyed, on the one hand, by growing optimism among global investors and, on the other hand, by a slowdown in supply growth, in particular due to local factors (including interruptions to supplies in Libya and Nigeria and lower production in Canada as a result of spreading forest fires).

Against this background, global experts' assessments somewhat changed with respect to the balance of key oil supply and demand factors. The oil glut in the global market is expected to reduce to near-zero values faster than assumed, this year already. However, present risks linked primarily to the slowing Chinese economy in view of a stable growth in supply, including from OPEC

members, and stocks remaining high are limiting the potential for further growth in oil prices. Global prices for other commodities exported by Russia have for the most part remained stable or increased in recent months, albeit more moderately than oil prices (Chart 1.4).

Given the current external climate and the impact of aforementioned relationship between supply and demand factors in the global oil market, the Bank of Russia revised its oil price forecasts upward. The baseline Urals crude price forecast was raised to \$40 per barrel for 2016 Q2–Q4. As a result, the average value for 2016 is assumed to be \$38 per barrel (\$30 per barrel in the previous Report). More active growth in oil supply in the global market,

Chart 1.7

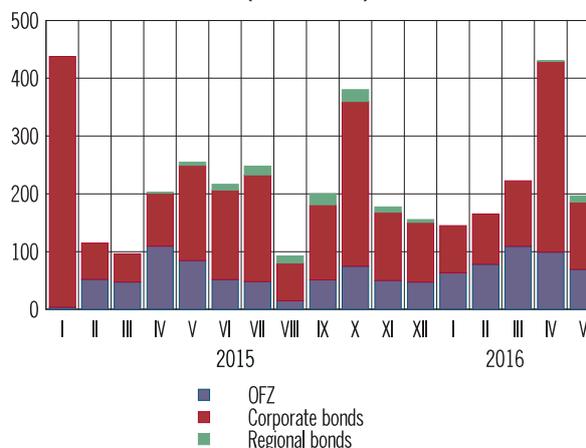
Change of risk premium in Russia and emerging economies* (basis points)



* Average CDS spread for emerging economies is based on the data for Brazil, China, Turkey, Mexico, Malaysia, Poland, Hungary, etc.
Sources: Bloomberg, Bank of Russia calculations.

Chart 1.9

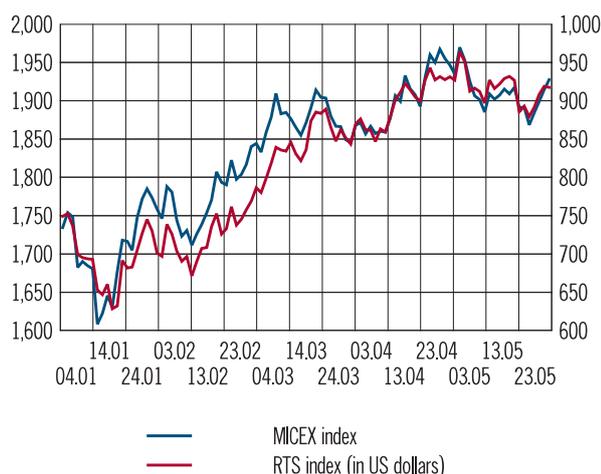
Volume of bond issue in the domestic market (billions of rubles)



Sources: MICEX SE, Bank of Russia.

Chart 1.8

MICEX and RTS indices (points)



Source: MICEX SE.

primarily from Iraq and Libya, a drastic downturn in the situation in China and the Fed's monetary policy normalising faster than expected by the market could all pose a risk to this forecast. The Bank of Russia considers the likelihood of these risks materialisation to be relatively low.

No significant changes occurred in economic activity indicators for the global economy in March-May 2016. The varied situation in developed and emerging market economies remained, but the overall picture was stable (Chart 1.5).

Aggregate growth in Russia's trading partners is expected to remain close to 2015 levels throughout 2016 (at roughly 2% per year, according to Bank of Russia estimates). This forecast is based

on relatively conservative assumptions on the economic growth prospects of China² and a number of EMEs³.

Against the backdrop of moderate economic activity dynamics, inflation in most of Russia's trading partners remained relatively low in March-May 2016 (Chart 1.6). Global food prices rose slightly in recent months compared with the lows reached at the start of 2016. This trend was sustained by the increase in global oil prices and unfavourable weather conditions linked to El Niño⁴ effect. It is expected that this climatic factor will be exhausted in the short run, which, together with the relatively high commodity inventories, should curb further growth in global food prices. In this context, moderate external inflation dynamics are still forecast for this year.

Amid persistently low inflationary pressure, the majority of central banks around the world continued to implement a relatively accommodative monetary policy (Annex, table 'Monetary policy rates in various countries'). Investors in global markets changed their expectations regarding the pace of the Fed's monetary policy normalisation, shifting

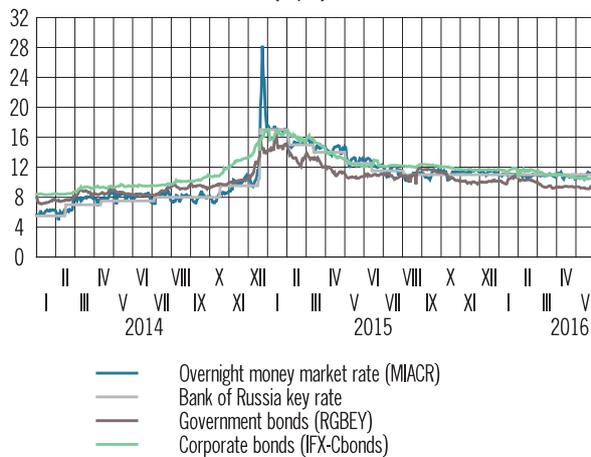
² China's economic growth is expected to be roughly 6.5% in 2016, which is far below the aggregate consensus forecast of market participants.

³ See the Abbreviations.

⁴ A natural phenomenon associated with fluctuations in water surface temperatures in the equatorial Pacific. According to FAO estimates, this phenomenon, which has a perceptible influence on climate, remained very active in the first half of 2016.

Chart 1.10

Bond market yields, Bank of Russia key rate and MIACR (% p.a.)



Sources: MICEX SE, Bank of Russia.

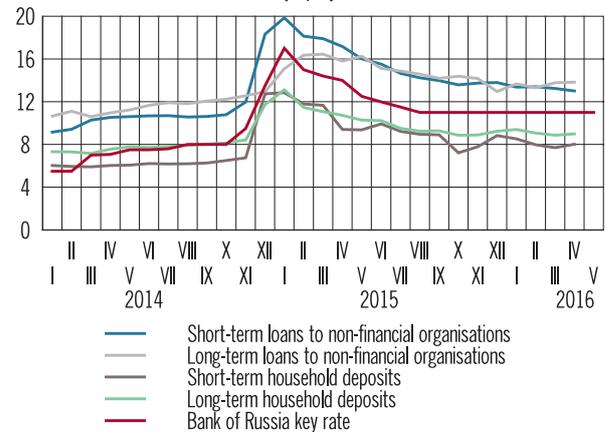
towards a slower increase in rates. However, in view of the relatively favourable statistics released for the US and recent statements by the members of the Fed's Open Market Committee, market participants' optimistic assessments are perhaps exaggerated. This may be a factor causing a moderate adjustment in sentiment in the global financial markets over the coming months. The Bank of Russia is working on the assumption that the Fed will continue the normalisation of monetary policy at a pace generally in line with its current statements (one-two percentage point increase before the end of 2016).

The improvement in the global financial market climate in March-April against the background of an accommodative monetary policy in many countries, growing investor optimism and generally persistent stability in the Russian economy, weighed both on external borrowing conditions for Russian borrowers and the situation in the domestic financial markets. As before, opportunities for Russian companies and banks to access external lending were limited by international financial sanctions. However, in March-April the Russian corporate sector was seen to attract funds in foreign markets in the form of Eurobond placements and received subordinated loans; risk premium for Russia was consistently reduced relative to the start of 2016 (Chart 1.7).

There was also a revival in the domestic markets. In March-April, stock indices increased at a moderate pace and a noticeable activity growth was registered in the domestic bond market. Some issuers, who had previously postponed investments,

Chart 1.11

Interest rates on bank ruble operations and Bank of Russia key rate* (% p.a.)



* Interest rates on bank ruble operations as of April 2016 - preliminary estimate.
Source: Bank of Russia.

sought to take advantage of this favourable period of increased demand from market participants. The ruble rallied by 6.2% in real terms⁵ at end-May on December 2015, according to preliminary estimates.

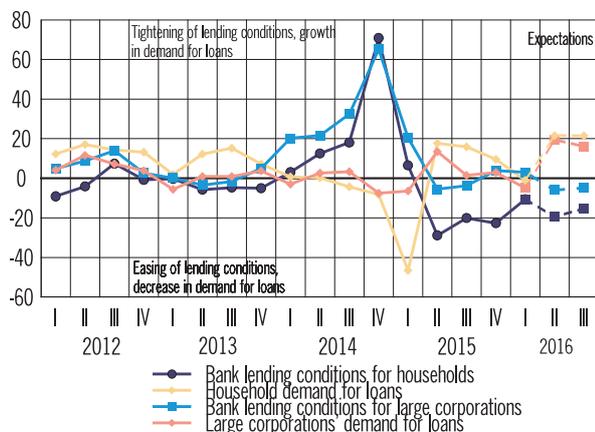
In the second half of April–May, investor sentiment shifted slightly both in external and domestic markets. In May, the inflow of funds from international investment funds into emerging markets, including Russia, gave way to an outflow, while activity dropped in the Russian stock market (Charts 1.8, 1.9), and the ruble exchange rate against key currencies stabilised at mid-April levels.

In its baseline scenario, the Bank of Russia considers a further moderate shift in global financial and commodity markets to be likely. In view of this, the transitory improvement in external economic conditions with the key rate decision in April 2016 was not a factor behind the monetary policy easing. However, external conditions are generally expected to be more favourable than previously forecast in 2016. This will weigh on both the sentiment and expectations of economic agents (and, in turn, the level of economic activity) and inflation dynamics due to the rallying ruble.

With the monetary policy stance remaining unchanged, interest rates on banking sector credit operations remained close to January-February 2016 levels, while rates on deposit operations mostly fell slightly. The dynamics of bank interest

⁵ Based on the real effective exchange rate index of the ruble against foreign currencies.

Chart 1.12
Lending conditions and demand for loans indices
(percentage points)



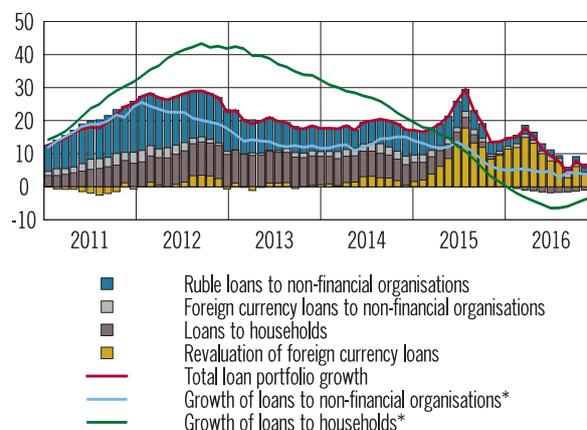
Source: Bank of Russia.

rates in part reflected the drag from the slight decrease in short-term money market rates at the start of the year amid the shrinking banking sector liquidity deficit and market participants' expectations regarding the future path of changes to inflation and the Bank of Russia's monetary policy.

Bond market yields fell more than bank interest rates, due to the aforementioned surge in demand for financial assets (Charts 1.10, 1.11). Other factors behind the fall in interest rates (especially on deposit operations) over the year will likely be the further use of the Reserve Fund to finance the budget deficit and growth in liquidity surplus experienced by certain banks. Thus, in its monetary policy decision-making, the Bank of Russia took into account the fact that monetary policy conditions could be softened even with the key rate remaining unchanged, though the scale of such softening is limited.

Non-price bank lending conditions, assessed on the basis of the survey of credit institutions by the Bank of Russia, preserved mixed dynamics in 2016 Q1. Household and SME lending conditions continued to ease, while the corporate sector witnessed a slight tightening of conditions for the second consecutive quarter (Chart 1.12). The divergent trends observed for different lending types can be explained by differing bank assessments of credit risks and the financial position of borrowers across various segments. The shrinking retail lending and SME lending activity, witnessed in 2015, has already caused a reduction in the debt burden of borrowers and an improvement in their

Chart 1.13
Contribution of various components to the annual growth rate of banks' loan portfolio
(%)



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

Chart 1.14
Sources of money supply
(national definition)
(annual growth, %)



Source: Bank of Russia.

balance sheets. In the corporate segment, this process was less pronounced, and the situation was aggravated by the revaluation of outstanding amounts on foreign currency loans (which account for a high proportion of corporate sector debt) amid the depreciation of the ruble. This factor restricted the easing of price and non-price lending conditions by banks.

The still relatively high debt burden and moderate-to-tight credit conditions continued to hold back real sector demand for loans at the end of Q1–start of Q2 2016. Monthly and annual growth in corporate and retail lending remained relatively low (Chart 1.13). However, given the tentative stabilisation of overdue outstanding amounts and stronger positive trends in economic activity, banks

Fiscal policy

According to Russian Federal Treasury data, the budget system deficit of the Russian Federation in January-April 2016 was 0.7 trillion rubles or 2.7% of GDP¹ (3.7% of GDP in January-April 2015). The federal budget deficit was 1.1 trillion rubles (4.3% of GDP), an increase of 0.2 trillion rubles year on year.

The budget system income for January-April 2016 reduced by 4.3% year on year to 8.3 trillion rubles (31.7% of GDP) and the federal budget income reduced by 14.1% to 3.9 trillion rubles (14.9% of GDP). The main factor behind this reduction in income was the fall in oil and gas revenue. At the same time, the level of non-oil and gas revenue remained stable. The largest increase in the income structure came from excise duty receipts, which grew (by 19.5% year on year) on the back of the increase in petrol and diesel excise duties in January and April 2016.

The budget system expenditures decreased by 5.3% year on year to 9.0 trillion rubles (34.4% of GDP) and federal budget expenditures decreased by 7.5% to 5.0 trillion rubles (19.2% of GDP). In the expenditure structure, a decrease relative to the same period the previous year was seen in the 'National economy' and 'National defence and security' items at the same time as increased social expenditure. After a relatively conservative execution of the budget in January-February, which is characteristic of seasonal trends in recent years (excluding 2015), expenditure intensified in March-April. This led to a significant increase in the budget deficit, which was primarily funded by reducing federal budget account balances, including the Reserve Fund (780 billion rubles were transferred in April-May), and through internal borrowing.

The Russian Ministry of Finance is successfully implementing its government borrowing programme. Net placement of its OFZ portfolio stood at 185.5 billion rubles in January-April 2016. At end-May, the Russian Ministry of Finance also attracted \$1.75 billion from the placement of 10-year Eurobonds. The total public debt as of 1 April 2016 was 13.3 trillion rubles, a slight decrease on the start of the year due to the foreign exchange revaluation of the external debt.

According to recent announcements, in 2016 the Russian Ministry of Finance is going to achieve a federal budget deficit of 3% (given an average Urals crude price of \$40 per barrel in 2016) and to undertake further fiscal consolidation to reduce the budget deficit by 1 percentage point per year in 2017-2019. In 2016, as usual, the budget parameters may be reviewed against the parameters set out in Federal Law No. 359-FZ, dated 14 December 2015, 'On the Federal Budget for 2016'. The changes could touch upon reducing and rebalancing budget expenditure. The risks of an increase in the budget deficit announced by the Russian Ministry of Finance could include a fall in oil prices and a slower recovery in economic activity than factored in the calculation of the budget parameters. Additional risks could also be linked to a shortfall in revenue from the planned sale of a stake in Rosneft.

According to Bank of Russia estimates, in 2016 the total contribution of the fiscal policy to domestic economic activity dynamics will more than likely be near zero. However, the persistently conservative public-sector wage and social security indexation policy should have a moderating impact on inflation expectations, reducing the potential inflationary drag from the growing budget deficit.

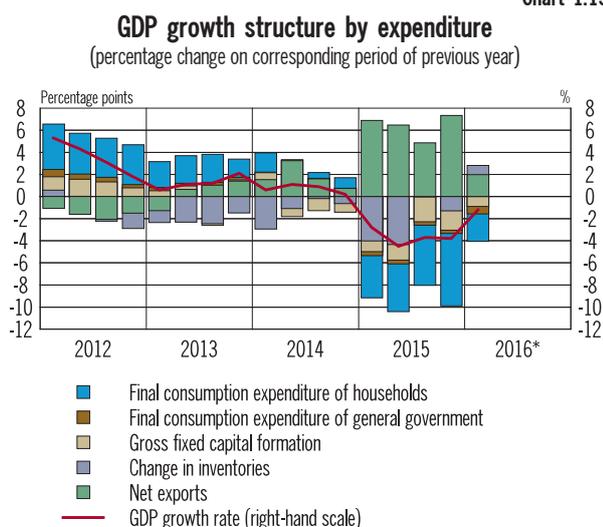
¹ Here and throughout, GDP is based on the Russian Ministry of Finance's preliminary estimates using the SNA-1993 methodology.

expect a revival in borrower demand for loans and have indicated their willingness to slightly ease bank lending conditions across all segments. Bank recapitalisation and state programmes to support certain areas of lending (SMEs, mortgages) will also continue to have a moderate stimulatory effect on lending activity. Taking these factors into account, together with the upward revisions of expected economic activity dynamics (see below in this section), the forecast for growth in lending to the economy by the banking sector has been upgraded to 5–8% by the end of 2016 (3–6% in the previous Report). We can expect the contraction in household lending to give way to growth by the

end of the year, at a pace close to that of corporate lending activity.

Monetary aggregate dynamics were largely shaped by credit activity in the banking sector and were generally in line with previous forecasts (Chart 1.14). The increase in net general government borrowing from the banking system through the use of the Reserve Fund to finance the budget deficit (see Box 'Fiscal policy') made a further positive contribution to money supply growth. As expected, growth in money supply (according to the national definition) at the end of 2016 will remain close to the levels observed at the end of 2015–start of 2016 at 10–13%.

Chart 1.15



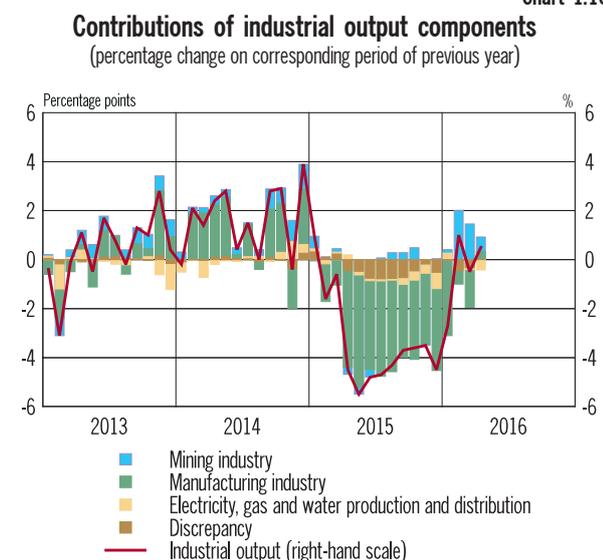
* 2016 Q1 - Bank of Russia estimate.
Sources: Rosstat, Bank of Russia calculations.

Chart 1.17



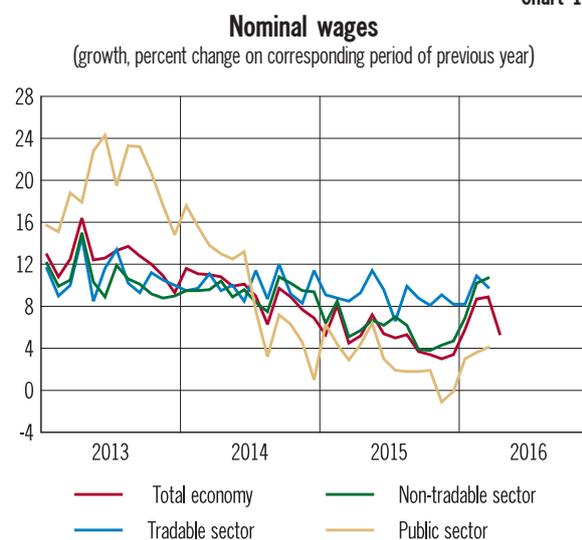
Source: Rosstat.

Chart 1.16



Sources: Rosstat, Bank of Russia calculations.

Chart 1.18



Sources: Rosstat, Bank of Russia calculations.

The slight improvement in external conditions and the domestic financial market climate had a favourable impact on business sentiment in the Russian economy compared to the start of 2016 and maintained conditions for a further slowdown in the recession.

According to Rosstat data, in 2016 Q1, the fall in GDP relative to the corresponding quarter of the previous year was 1.2% after 3.8% the previous quarter (Chart 1.15). This was better than experts' expectations and the Bank of Russia's assessments presented in the previous Report. According to estimates, in 2016 Q1, seasonally adjusted GDP growth on the previous quarter was near zero, despite the significant downturn in the terms of trade witnessed in the first few months of 2016. This

suggests a gradual reduction in the dependence of economic activity on oil price dynamics.

The trends observed in the dynamics and structure of industrial production point to similar conclusions. Annual growth in industrial production continued to improve and, in April 2016, once again turned positive (mainly due to the low base effect) (Chart 1.16). In March-April, industrial production (seasonally adjusted) remained at the same level as during the second half of 2015—first few months of 2016. At the same time, seasonally adjusted average manufacturing output has shown growth since the start of the year compared with the previous month (the most pronounced growth was recorded in March). Areas of the manufacturing industry demonstrating recovering growth in the

Table 1.1

Labour market

Indicators	2014				2015				2016
	I	II	III	IV	I	II	III	IV	I
Employment and unemployment (seasonally adjusted)									
Unemployment rate, %	5.0	5.2	5.2	5.2	5.2	5.8	5.6	5.7	5.4
Employed to unemployed ratio	18.6	18.2	18.3	18.4	17.9	16.4	16.9	16.7	17.4
PMI Composite Employment Index, points	48.2	47.4	48.2	46.6	44.8	46.0	47.4	45.9	46.5
Wages (as %, year-on-year)									
Nominal wages	11.1	10.2	8.3	7.7	5.7	5.9	4.7	3.3	7.7
Real wages	4.4	2.4	0.6	-1.7	-9.0	-8.5	-9.5	-9.8	-0.6
Wage arrears	6.2	5.7	-11.9	-10.2	7.9	22.6	38.6	55.9	45.4
Part-time employment									
Number of part-time employees (as % of previous period, seasonally adjusted)									
Total	-1.2	-0.1	2.2	0.1	1.2	2.3	0.3	1.5	1.0
Part-time employment	7.8	-4.2	-3.4	4.6	11.9	2.7	-3.5	3.8	9.8
Part-time employment on employer's initiative	14.8	-1.2	-8.5	11.8	18.2	23.3	-3.9	-7.0	-0.6
Part-time employment upon mutual agreement	-1.3	1.2	2.7	0.1	2.4	5.7	2.3	1.9	3.1
Idle employees	0.3	-1.0	12.5	-11.3	10.0	-1.8	-4.9	1.9	-7.7
Unpaid leave	0.1	-1.3	2.9	-0.2	-1.2	3.4	-0.2	-0.1	0.5
Part-time employees, as % of headcount									
Total	9.0	9.5	10.4	10.3	9.4	10.4	11.0	11.0	13.6
Part-time employment	2.2	2.1	2.0	2.2	2.4	2.5	2.4	2.5	6.4
Part-time employment on employer's initiative	0.3	0.3	0.2	0.3	0.4	0.4	0.4	0.4	4.0
Part-time employment upon mutual agreement	1.9	1.8	1.8	1.9	2.0	2.1	2.0	2.1	2.4
Idle employees	0.7	0.6	0.6	0.8	0.8	0.7	0.5	0.9	0.7
Unpaid leave	6.1	6.8	7.8	7.3	6.2	7.2	8.1	7.6	6.5
Alternative indicators of part-time employment									
Average working hours per employee (year-on-year)	0.3	0.4	0.2	-0.1	-0.3	-0.4	-0.5	-0.1	-0.3
Labour force utilisation in industrial production (normal level = 100)	87.7	86.7	89.0	85.7	81.7	86.7	87.7	88.0	83.7

Change compared with previous 12 months:

- – situation improved (more than 1 standard deviation)
- – situation improved (less than 1 standard deviation)
- – situation remains unchanged (± 0.15 standard deviations)
- – situation deteriorated (less than 1 standard deviation)
- – situation deteriorated (more than 1 standard deviation)

Sources: Rosstat, Bank of Russia calculations, Russian Economic Barometer, Markit Economics.

past continued to do so and new areas of growth emerged. These include clothing, leather goods and furniture production. Output in these sectors was buoyed both by import substitution and increased supply of products for export.

As in previous periods, the food and chemical industries (including industrial chemicals, household chemicals and pharmaceuticals) continued to show robust dynamics. Overall, production of rubber and plastic goods and wooden structures was stable. Another positive trend was the end of the fall in vehicle production. Positive dynamics persisted in the mining industry, supported by stable external demand.

However, the improvement in production activity indicators was not accompanied by a recovery in internal demand dynamics. Consumer activity

remained modest in March-April 2016. Retail trade turnover continued to decline (based on seasonally adjusted data), while the slowdown in the year-on-year decline was exclusively down to the low base effect of the previous year (Chart 1.17). Relatively weak dynamics also persisted in the value of paid services provided to households. This reserved consumer behaviour was largely due to savings rates remaining high amid the on-going appeal of ruble-denominated deposits and the drag from precautionary motives.

Changes in labour market indicators, which also had an impact on domestic demand, continued to be mixed (Table 1.1). In March-April 2016, unemployment (seasonally adjusted) increased slightly compared to the start of the year (from 5.5% to 5.7%, according to Bank of Russia

The financial standing of real sector organisations in 2016 Q1

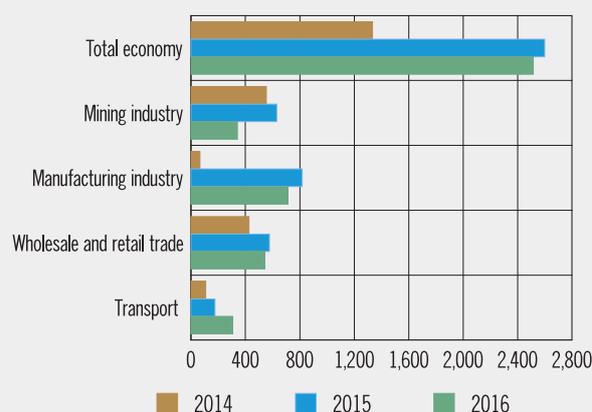
The total positive financial result of organisations¹ in 2016 Q1 remained relatively high, falling by 3.2% compared with 2015 Q1, largely due to the high base effect of the previous year. A slight growth in profits was seen (by 0.7%) together with a more perceptible increase in losses (by 15.8%).

However, the profit and loss dynamics varied across different types of economic activity (Chart 1.19). An increase in net profits was observed in key areas of the services sector (including regulated segments), in transport and communications, in energy, gas and water production and distribution, real estate, leasing and services. At the same time, these areas also registered growth in the incomes of profitable companies and reduction in the losses of companies reporting negative financial results. In terms of trading volumes, profits also rose, but the greater increase in the losses incurred by some companies led to a reduction in the total financial result in this sector.

In manufacturing, the fall in the balance of profit and losses was largely due to the high base effect in early 2015. At the end of January-March this year, manufacturing was the leader by the size of its balance of profit and losses, as in the previous year. Manufacturing accounted for 28.3% of the total profit of the economy.

Amid the fall in global commodity prices at the start of the year, the total profit fell considerably in the mining industry (by 45.7%), with profit shrinking (by 29.3%) and losses increasing (by 76.8%).

Chart 1.19
Net financial result (profit less loss) in Q1 2014-2016
of large and medium Russian companies
(billions of rubles)



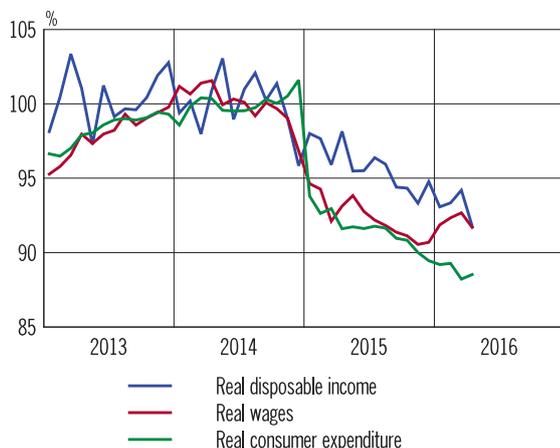
Source: Rosstat.

¹ Excluding small businesses, banks, insurance companies and budget-financed organisations.

estimates), returning to levels of the second half of 2015. However, the growth in nominal wages in March 2016 was notably higher than experts' expectations. Improved dynamics were observed in

Chart 1.20

Real wages, real disposable income and consumer expenditure (seasonally adjusted, 2014=100%)



Sources: Rosstat, Bank of Russia calculations.

most sectors, and the gap in wage growth shrank across various industries (Chart 1.18). The annual wage growth acceleration in February-March to a little less than 9% can in part be explained by the calendar effect (leap year) and the shifting of the time for the payment of annual bonuses compared with 2015. In April, nominal wage growth slowed to 5.4% year on year.

At the same time, seasonally adjusted nominal wages reduced only slightly month on month (by 0.4% following stable growth by an average of 1.2% in January-March 2016). These dynamics could point to the fact that many companies have already started to index workers' wages. The slight improvement in the assessments of the economy's growth outlook amid the build-up of evidence of recovering growth in production and relatively favourable dynamics in the financial results of companies across certain sectors (see Box 'The financial standing of real sector organisations in

Assessment of current investment dynamics using indirect indicators

In the previous Report, the Bank of Russia analysed investment demand dynamics¹ using alternative indicators: the amount of work carried out in 'Construction' and the investment goods production index. Statistical methods of analysis have been applied to dynamic series of fixed capital investments, construction works, the production of electrical machinery and equipment, and imports of machinery products² to improve the accuracy of investment demand assessments. Given the fact that models built on monthly data can no longer be reassessed, quarterly data on fixed capital investment were also interpolated using the Kalman³ filter.

Considering the long-term dependence between the variables under examination, it is assumed that the equation for investments is in line with the error correction model. The equation further takes into account a shift in the structure of fixed capital investment: beginning from 2014, the share of machinery, equipment and vehicles has fallen, while the share of buildings and structures has increased.

Table 1.2 shows the assessments of annual growth rates in fixed capital investment for January-March 2016, obtained both with and without the use of information on the growth rate in fixed capital investment in Q1.

The model thus constructed gives satisfactory results both from the perspective of forecasting a quarterly series of investment, and from the perspective of assessing monthly dynamics, which makes it possible to improve the future quality of analysis of the current economic situation in the absence of monthly reporting data on investment.

Chart 1.21

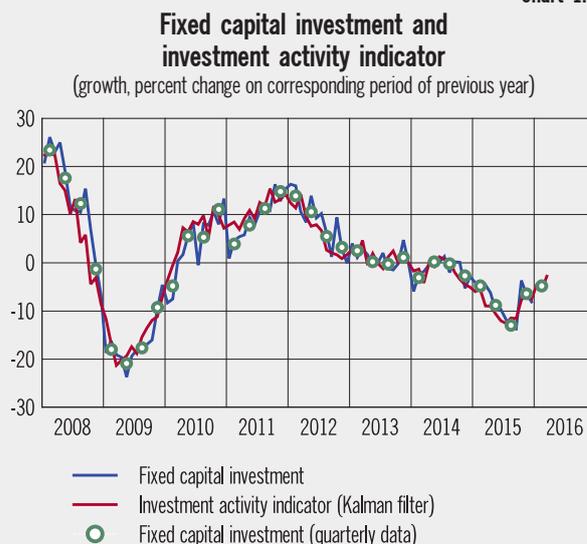


Table 1.2

Estimates of annual growth in fixed capital investment, January-March 2016
(percent change on corresponding period of previous year)

	January	February	March	2016 Q1
Kalman filter				
– incl. 2016 Q1	–4.6	–5.5	–2.8	–4.8*
– excl. 2016 Q1	–4.9	–6.1	–3.7	–4.9

* Actual growth in 2016 Q1.
Source: Bank of Russia calculations.

¹ From 1 January 2016, Rosstat stopped publishing monthly data on fixed capital investment.

² The addition of production dynamics and imports of other investment goods to the model did not result in any significant improvement.

³ Monthly investment in fixed capital serves as an unobservable variable. The equation for the observations combines available quarterly data on fixed capital investment with unobservable monthly series.

2016 Q1') have created the necessary conditions for an increase in wages.

The strong growth in nominal wages in the context of stable inflation dynamics helped real wages to remain significantly above the levels observed at the end of 2015. However, household

real disposable money income continued to fall (Chart 1.20). This can be explained by the fact that the change in income from other sources, including social transfer payments (e.g. pensions) and income from entrepreneurial activity has been more moderate than wage dynamics.

Structural changes in inventories as economic activity indicator

In 2015, inventories shrank, making a perceptible negative contribution to aggregate output dynamics. A similar situation was observed when GDP fell in 2008-2009. The changes in inventories developed as a result of the dynamics of their qualitatively different components, which demonstrate different reactions to the downturn in economic activity. During a crisis, a fall in demand stimulates business to use existing raw materials and component parts instead of buying new ones, which decreases their stocks. However, inertia in the production process does not allow for a quick reduction in output, therefore the share of stocks of finished products for which there is no demand increases in the structure of inventories.

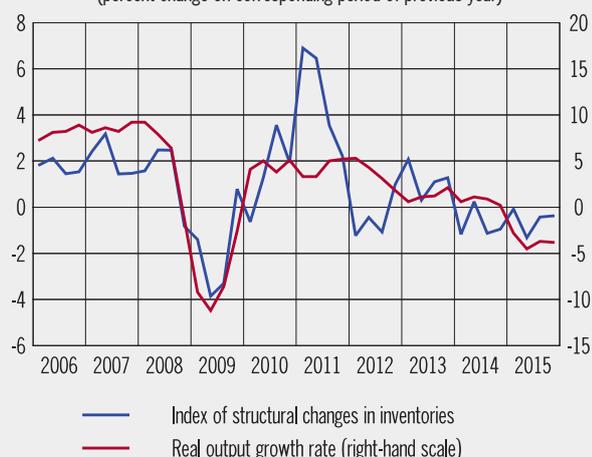
The figure reflecting changes in inventories in itself is an ambiguous indicator of economic dynamics. A decrease in inventories can be caused both by an anticipated fall in demand below current levels and an actual growth in demand. Therefore, when analysing inventories, changes in the inventory structure driven by the various dynamics of components can play an important role.

In order to identify the nature of processes shaping inventory dynamics, an 'index of structural changes in inventories' was developed. The first stage involved an analysis of paired correlations between growth in real GDP and the dynamics of the shares of components making up the inventories, which made it possible to determine whether key components are procyclical or acyclical in nature. According to these results, stocks of raw materials, component parts and goods for resale have a statistically significant positive correlation with output, while stocks of work in progress and finished products have a negative correlation¹.

The index was then constructed so as to take into account the dynamics of each component of inventories according to its weight in the inventories at the time. Annual growth in the share of the procyclical component was included in the index as a positive value, while the acyclical component was included as a negative value. This approach makes it possible to take account of mixed changes to different inventory components in response to a general shock and, consequently, provides more specific characteristics of inventory dynamics (Chart 1.22).

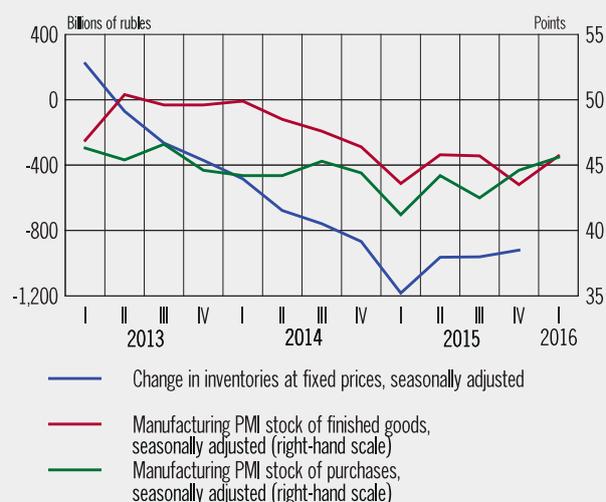
If there are no changes in the inventory structure, the index returns to a near-zero value. If the index remains in the positive territory for a long time, this points to an ever growing share of raw materials and/or falling share of finished products in the inventories, which can suggest that the economy is overheating. During periods of falling output, the index starts to turn negative, due to the decreasing share of production supplies and growing share of finished products for which there is no demand.

Chart 1.22
Index of structural changes in inventories
and real output growth rate
(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.23
Change in inventories and PMI



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

¹ Since national account statistics do not contain data on the inventory structure, the calculations used data from Rosstat's statistical form No. P-3 'Information on the Financial Standing of Organisations' for 2006-2015. This source reports inventories at their actual purchase price and does not include data from small businesses, budget-financed organisations and financial institutions.

In the current economic situation, the fall in the index was less severe, but more protracted than during the 2008-2009 crisis. The index of structural changes in inventories turned negative at the start of 2014 and is still in the negative territory now, pointing to a prolonged stagnation. Nonetheless, the index moved closed to zero in the second half of 2015, which may be a sign of the economic situation stabilising somewhat.

It is important to note that current changes in PMI subindices for stocks of raw materials and finished products, which traditionally serve as leading indicators of the state of inventories², also point to a possible slowdown in their further fall (Chart 1.23). Improvements in PMI dynamics at end-2015–early 2016 indicate that the index may turn positive this year.

² Zamaraev B., Nazarova A. *Inventory management in the Russian economy: crisis and post-crisis adjustments // Voprosy Ekonomiki. – 2013, No. 3.*

Tentative improvements in income dynamics and persistently high savings rates, which can take time to adjust, as shown by previous crises, will continue to exert a moderating drag on consumer demand dynamics. However, this slump is expected to continue to slow, in part due to the low base effect. According to the baseline forecast, in Q2 and Q3 2016, the annualised rate of decline in household final consumption expenditure will slow to 3–3.5% following 4.5% in 2016 Q1 (according to Bank of Russia preliminary estimates). Shrinking general government final consumption expenditure amid the planned continuation of a conservative policy of budget spending this year will go on to make a small negative contribution to GDP dynamics.

Investment demand, like consumer demand, remained relatively weak. At the end of 2016 Q1, fixed capital investment fell by 4.8% year on year, compared with 6.4% in the previous quarter, which was in line with the forecasts (4–5% in the previous Report). However, the improvement in annual investment dynamics was mostly shaped by the base effect, while they continued to fall relative to the previous quarter. The same trends were observed in monthly investment activity dynamics, which the Bank of Russia assesses using indirect indicators: the amount of construction works and the investment good production index (see Box ‘Assessment of current investment dynamics using indirect indicators’). The on-going demand-side restrictions, moderate-to-tight lending conditions, and high debt burden among many companies will continue to hold back investment activity. Fixed capital investment is expected to fall by 3–4% in Q2 and Q3 2016.

Based on a preliminary analysis of the GDP structure decomposition for 2016 Q1, gross

capital formation dynamics generally improved more than fixed capital investment dynamics, due to favourable inventory dynamics. The cycle of inventories depletion after a long adjustment period is expected to end. The slight improvement on previous forecasts can be attributed to the relatively favourable sentiment and expectation dynamics among producers and suppliers, which can in part be explained by the improvement in external factors (see Box ‘Structural changes in inventories as economic activity indicator’). The positive contribution to annual GDP growth in 2016 Q1 made by the change in inventories was 0.8 percentage points, according to preliminary estimates, while in 2016 Q2 it is expected to be 0.5–0.7 percentage points.

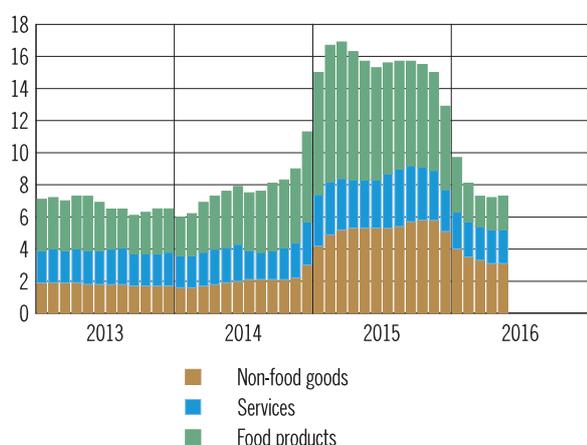
With internal consumer and investment demand dynamics still restrained, domestic production was supported by external demand. In 2016 Q1, net exports continued to show stable dynamics and to make a positive contribution to GDP. Annual growth in exports in real terms slowed, mostly due to the high base effect of the previous year. In 2016 Q2 and Q3, exports are expected to recover to average values seen in 2015: 3–4% relative to the corresponding quarters of the previous year.

At the same time, against the backdrop of the slowing decline in demand and ruble appreciation, the export contraction slowed. This, together with the unfavourable price situation for Russian export commodities, meant that Russia’s current account balance in March–April remained far lower than in the same period of the previous year. However, there was a proportionate reduction in the capital outflow, in part due to decreased repayments of external debts. This helped maintain a stable situation in the foreign exchange market and allowed banks

Chart 1.24

Contribution to inflation

(of corresponding period of previous year, percentage points)

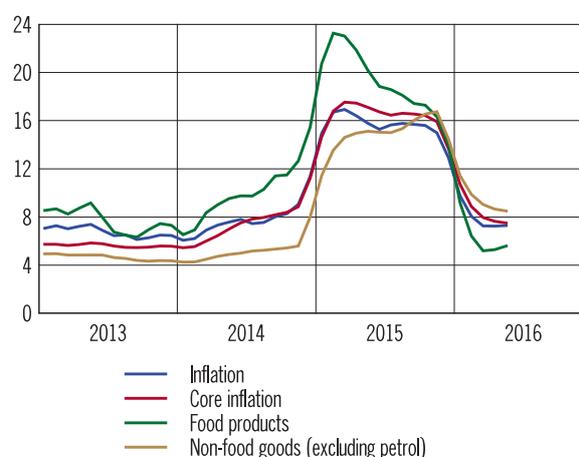


Sources: Rosstat, Bank of Russia calculations.

Chart 1.25

Prices of consumer goods and services

(as % of corresponding period of previous year)

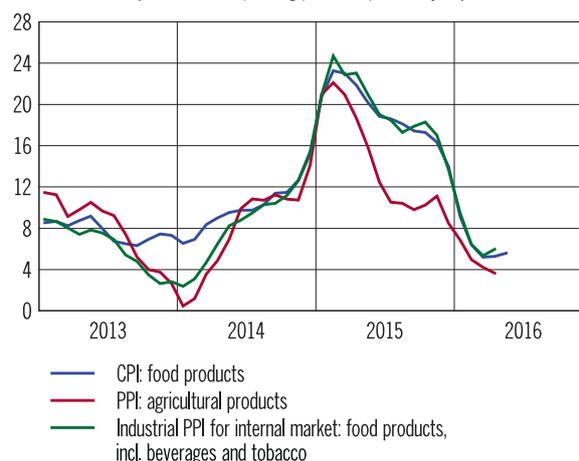


Sources: Rosstat, Bank of Russia calculations.

Chart 1.26

Growth in producer and consumer prices for food products

(as % of corresponding period of previous year)



Source: Rosstat.

to continue repaying debts on Bank of Russia FX liquidity provisions operations conducted on a reverse basis (see Annex 'Balance of Payments of the Russian Federation' in 2016 Q1).

Overall, taking into account the slight improvement in current dynamics for key economic activity indicators and the prerequisites for a change in external conditions (chiefly, adjustments to expected oil prices), the Bank of Russia revised the forecast decrease in GDP in 2016 Q2 towards the upper bounds of the previous assessment: to 0.2–0.5% relative to the corresponding period of the previous year (0.3–1.8% in the previous Report). In 2016 Q3, quarterly and annual GDP growth measures are expected to remain at a comparable level. In Q4, annual GDP growth may turn positive.

In early 2016, economic conditions caused inflation to decline a little faster than previously expected. In March, annual inflation reduced to 7.3% compared with the previous forecasts of 7.4–7.6%. In April–May, it stabilised at this level (Charts 1.24, 1.25). Core inflation decreased from 8.9% in February compared to the corresponding period of the previous year to 7.5% in May. However, seasonally adjusted price growth compared with the previous month stabilised at relatively low levels.

The persistently weak consumer demand, which was shaped by the on-going shrinking of real household incomes and continued relatively high savings rates, was a significant factor behind the low inflationary pressure. Demand-side restrictions' negative contribution to annual inflation was

estimated to be roughly 2–3 percentage points in May 2016.

The fact that ruble deposits remain attractive to households despite the fall in deposit interest rates can be viewed as indirect evidence in favour of a slight reduction, calculated using probabilistic methods by the Bank of Russia. The interest rate decline was also evidenced by both the path of the median estimated one year ahead inflation expectations calculated by inFOM, and inflation expectation measures calculated by the Bank of Russia using probabilistic methods (Table 1.3). These trends suggest that there is currently no upward drag on inflation from this factor.

Table 1.3

Inflation expectations of economic agents

Survey	Expectation horizon	2014				2015				2016								
		I	II	III	IV	I	II	July	August	September	October	November	December	January	February	March	April	May
Inflation expectations (absolute), %																		
Households																		
Public Opinion Foundation	next 12 months	11.8	11.7	12.5	15.5	15.7	15.0	13.9	14.8	16.0	15.3	15.8	16.4	16.7	15.7	14.7	14.6	13.6
Public Opinion Foundation (Bank of Russia calculations)	next 12 months	8.1	9.0	9.6	14.4	13.8	12.2	12.6	13.8	14.5	13.7	15.1	12.8	10.8	7.8	7.4	7.2	6.6
Professional analysts																		
Bloomberg	2016						6.7	6.8	6.9	7.0	7.3	7.5	7.2	8.0	8.3	7.9	7.4	7.2
Interfax	2016					7.0	6.7	6.1	6.4	7.4	7.2	7.2	7.6	8.5	8.3	7.6	7.4	7.3
Thomson Reuters	2016										7.7	7.0	7.5	8.1	7.9	7.4	7.1	7.0
Financial markets																		
OFZ-IN	next 8 years							5.8	6.5	6.4	5.8	5.6	5.8	6.2	6.1	5.4	5.2	5.0
OFZ-IN (without option adjustment)	next 8 years							7.4	8.0	8.1	7.3	7.1	7.3	7.7	7.6	6.9	6.7	6.5
Bond market	next quarter	7.1	7.2	7.9	8.4	10.7	15.1	-	-	14.2	-	-	14.1	-	-	12.4		
Interbank market	next quarter	7.2	8.1	8.9	9.7	13.0	18.4	-	-	15.2	-	-	12.4	-	-	10.2		
Inflation expectations (balance of replies)*																		
Households																		
Public Opinion Foundation	next 12 months	84	85	84	83	76	72	74	73	80	80	82	83	85	82	84	83	81
Public Opinion Foundation	next month	79	82	76	77	68	60	63	67	71	73	79	78	80	76	72	74	70
Enterprises																		
Russian Economic Barometer	next 3 months	26	26	32	70	32	20	14	30	28	46	38	48	46	22	14		
Bank of Russia (Banking Supervision Department)	next 3 months	14.3	12.4	13.9	30.3	14.8	12.7	13.3	13	12.1	13.2	15.4	17.3	15.6	13.6	12.4	11.5	
Retail prices (Rosstat)	next quarter	42	41	41	43	31	28	-	-	30	-	-	29	-	-	32		
Tariffs (Rosstat)	next quarter	6	5	2	5	7	6	-	-	2	-	-	2	-	-	5		

Change compared with previous 3 months:

- inflation expectations improved (more than 1 standard deviation)
- inflation expectations improved (less than 1 standard deviation)
- inflation expectations remain unchanged (± 0.2 standard deviations)
- inflation expectations deteriorated (less than 1 standard deviation)
- inflation expectations deteriorated (more than 1 standard deviation)

* Balance of replies is a difference in the share of replies of the respondents, who expect that prices will increase and that prices will decrease.

Sources: Public Opinion Foundation survey results, Rosstat, Interfax, Bloomberg, Thomson Reuters, Bank of Russia calculations, Russian Economic Barometer.

Fruit and vegetable price dynamics in 2016

The consistent decline in annual inflation in January-March 2016 was to a large degree linked to the dynamics of fruit and vegetable prices. In March, the fall in prices for this category of goods accelerated to 5.1% against the corresponding period of the previous year (with the March negative price growth compared to the previous month registered for the first time in the history of observations), after a 2.7% fall in February. In April, the fall in fruit and vegetable prices continued both year on year and month on month (seasonally adjusted), albeit at a slower pace.

The downturn in fruit and vegetable prices (year on year) was caused by a fall in prices for two of the three main components: vegetables and potatoes (Chart 1.27). Potato prices were 39.8% lower in April than in April 2015 and prices for vegetables were 7.6% lower.

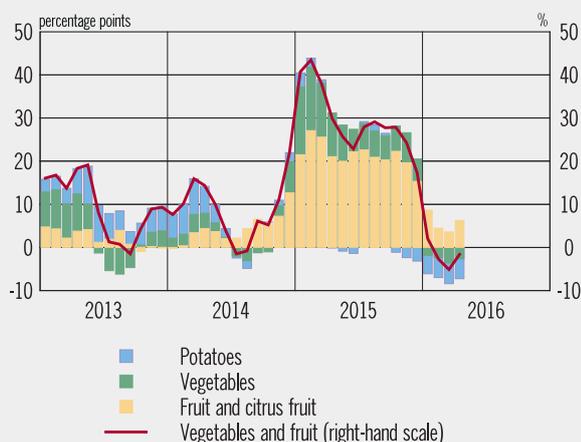
The fall in potato and vegetable prices occurred amid growth in demand, which reflected a shift in household demand towards cheaper goods prompted by the drop in the purchasing power of income. In 2016 Q1, retail sales of potatoes were 28.0% higher than in 2015 Q1 and those of fresh vegetables were 5.9% higher. At the same time,

however, the supply of root vegetables rose in the retail trade, buoyed by the good harvest of the previous year and the inadequate infrastructure for long-term storage. As a result, in the first few months of 2016, the level of fruit and vegetable supply exceeded demand, and stocks of these food goods rose sharply at retail organisations. As of 1 April 2016, potato stocks were 26.0% higher than in the previous year (while on 1 January, these stocks were 0.3% lower) and fresh vegetable stocks were 15.8% higher (8.4% lower).

According to estimates, the imbalance between supply and demand is linked to roughly one fifth of the annual fall in vegetable prices (Chart 1.28) and to roughly one quarter of the fall in potato prices (Chart 1.29).

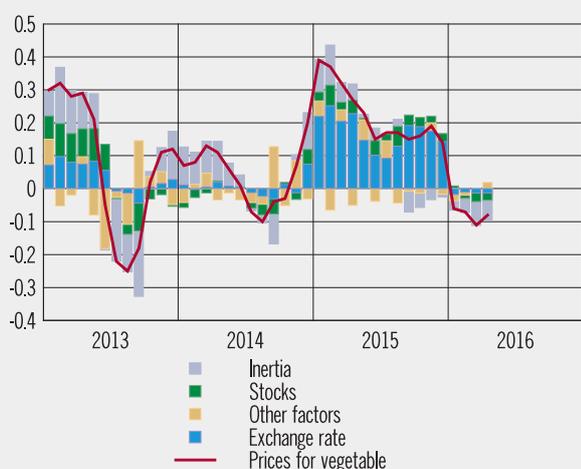
In addition, the appreciation of the ruble supported the decline in vegetable prices in the first few months this year (relative to the comparable months of 2015), contributing about 10% in April. While on average over the year, the share of imports in the supply of vegetables¹

Chart 1.27
Decomposition of vegetables and fruit price growth rate
(of corresponding period of previous year)



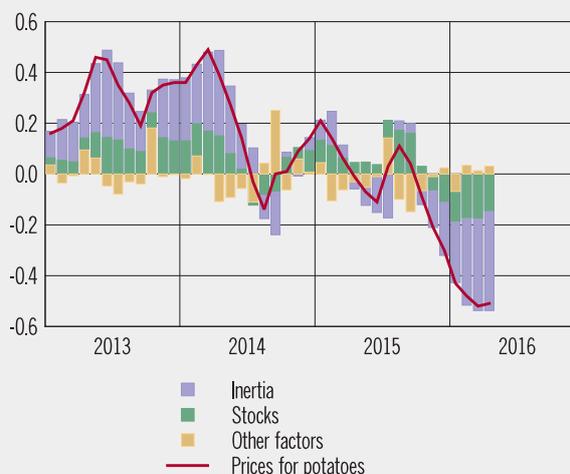
Sources: Rosstat, Bank of Russia calculations.

Chart 1.28
Logarithm of vegetables consumer prices annual change decomposition



Sources: Rosstat, Bank of Russia calculations.

Chart 1.29
Logarithm of potatoes consumer prices annual change decomposition



Sources: Rosstat, Bank of Russia calculations.

¹ The share of imports in the total of domestic production and imports.

in the Russian market was relatively low (10–13%), most products sold in the off-season are imported (for some types of vegetables more than a half, according to experts), and the dynamics of the ruble exchange rate have a significant impact on prices. The share of imports in the supply of potatoes is low (in lean years up to 5%) and the influence of exchange rate dynamics is negligible.

The persistently low growth in producer costs also continues to play an important role in curbing price dynamics (Chart 1.26). In particular, the year-on-year fall in global energy prices influenced internal producer prices in the mining industry, causing a 7.2% drop in April 2016 compared with April 2015. Overall, the annual growth in industrial producer prices was low in April (0.9%).

In addition, the improvement in inflation dynamics was linked to the more favourable external economic climate. Taking into account the March-April ruble appreciation, the contribution of the ruble exchange rate's dynamics to annual inflation reduced by more than twofold since December 2015, to roughly 2 percentage points in May. Another external factor exerting a downward pressure on inflation was the stability in the global food market.

To a certain extent, inflation slowdown was assisted by several factors that are likely to be short-term in nature. This primarily concerns fruit and vegetable price dynamics (see Box 'Fruit and vegetable price dynamics in 2016'). In its inflation forecast, the Bank of Russia proceeded from a relatively conservative assumption that the fall in fruit and vegetable prices in the first few months of the year would be accompanied by a change in seasonal dynamics. The scale of the depreciation of fruit and vegetables, which traditionally occurs in the summer months, may be less than usual, which will slightly slow the fall in consumer price inflation in 2016 Q3.

It is expected that muted demand dynamics, which will be shaped, among other things, by the moderate-to-tight monetary policy and relatively conservative fiscal policy, generally positive harvest outlooks in Russia and globally, moderate price and tariff indexation parameters for infrastructure company products (services) will have a consistently constraining effect on inflation. However, the actual improvement in current and expected external conditions shall be rather viewed as a factor behind the reduction in the inflation forecast up to the end of 2016. The positive contribution to the inflation forecast from a slight upward revision in the GDP forecast, given the expected reserved demand dynamics (with a persistently elevated savings rate), will be more than offset by the moderating influence of rather favourable exchange rate dynamics on inflation.

The fall in annual inflation will continue from July. In September 2016, inflation is forecast to be in the range 6.2–6.4% year on year, and 5–6% at the end of 2016.

The main pro-inflationary risks are linked to persistently high inflation expectations among economic agents⁶, the potential for a faster recovery in demand prompted by growing wages and changes in consumer savings patterns, high uncertainty surrounding external economic and exchange rate dynamics, and also potential fiscal policy decisions. These risks were the main impediment to reducing the key rate in April 2016.

⁶ Values of households' one-year-ahead inflation expectations consistently exceed Bank of Russia estimates published in press releases on the key rate.

2. ECONOMIC OUTLOOK AND KEY RATE DECISION

In April-May 2016, the situation in the global financial and commodity markets was more favourable than assumed in the baseline scenario for Russian economic growth presented in the previous Report. In particular, despite that fact that the scenario assumed Urals crude price of \$30 per barrel in 2016 Q2, in April-May it averaged \$42.6 per barrel, and beginning mid-May it consistently exceeded \$45 per barrel.

The current Urals crude price considered by the Bank of Russia slightly exceeds its fundamental levels for a number of reasons. First, the growth in oil prices which began in March 2016 was in many ways caused by supply-side factors, which are short-lived in nature (in particular, the forest fires in Canada, energy supply problems in Venezuela, the closure of the oil pipeline in Nigeria for repairs, and geopolitical problems in Libya). Second, the growth in oil prices also occurred amid increasing optimism in the global financial and commodity markets due to the Fed's soft rhetoric and international investors misjudging the potential speed of the monetary policy normalisation in the USA.

That said, the change in the balance of supply and demand in the energy market as a result of the aforementioned non-fundamental factors was rather significant. As a result, international analytical agencies have brought their forecasts regarding the recovery of the balance of oil supply and demand forward from the second half of 2017 to the end of 2016 – first half of 2017. This suggests that a sustainable long-term oil price will emerge in global energy markets slightly earlier.

Thus, the Bank of Russia revised the oil price path in its baseline scenario upwards, but considers it more likely that Urals crude prices will shift from current levels (roughly \$48 per barrel) to around \$40 per barrel in 2016 Q3 and average oil prices will remain near this level in 2017–2018.

The current data on economic activity in developed and emerging economies do not require any changes to the assumptions for external demand. According to the most recent actual data

from the IMF, in April 2016 the global economic growth forecast was adjusted slightly downwards (to 3.2% in 2016 and 3.5% in 2017). Taking into account Russia's foreign trade relations, as before, the baseline scenario assumes that GDP growth in Russia's trading partners will be roughly 2% p.a. in 2016–2018 and will continue to provide some support for the Russian economy.

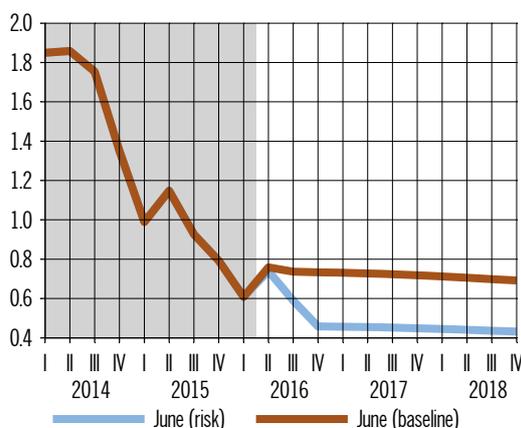
The monetary policy of most global central banks will remain accommodative, which will help to keep interest rates low in global financial markets. Central banks of developed countries (primarily, the Fed) will raise interest rates gradually in view of the pace of economic recovery in these countries and existing risks to economic growth and financial stability from EMEs.

The baseline scenario also assumes that the country risk premium for Russia will remain low (in line with the level for April-May 2016) with oil prices stabilising and international investors demonstrating rather calm risk perception.

As the results of 2016 Q1 showed, EU and US financial and economic sanctions had a limited effect on Russian companies' ability to attract capital in international markets: the corporate sector has successfully refinanced a weighty proportion of its external debt and reduced its foreign liabilities to a far smaller extent than stipulated in the external debt repayment schedule. This fact means that we can assume the financial and economic sanctions will not have such a strong drag on the Russian economy as previously anticipated.

As noted above (see Section 1), the Russian economy has proven itself relative immune to the latest round of oil price reductions at the start of 2016, contracting significantly less than forecast earlier.

The industry structure showed several positive changes, notably the growth in light industry (in particular, consumer goods) at a pace outstripping the aggregate industrial production index. This is down to both export quantities and import substitution processes. If these trends persist in

Chart 2.1
Terms of trade

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

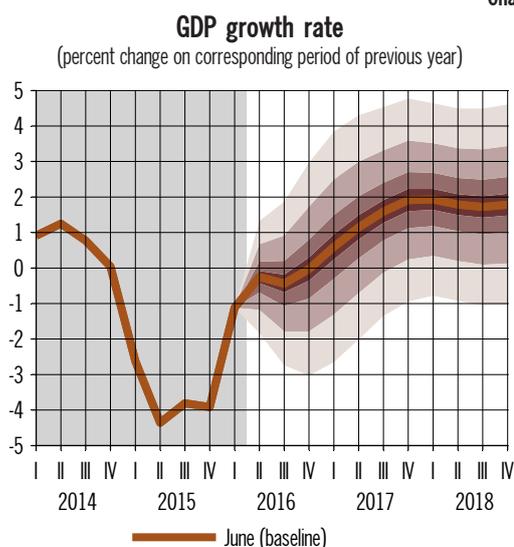
the medium term, this will spell a gradual reduction in the Russian economy's sensitivity to oil price fluctuations. The risks threatening the sustainability of recovery processes are linked to the stagnation observed in quite a wide range of industries, including industries that typically act as the drivers of growth in the Russian economy.

Taking into account the improved prerequisites regarding external conditions and the more positive data for January-April than previously expected, the GDP growth forecast for 2016–2017 was revised upward. GDP is expected to fall by 0.3–0.7% in 2016 compared with the decrease of 1.3–1.5% previously forecast (Table 2.1); that said, positive quarterly seasonally-adjusted GDP growth is likely to be registered in the second half of the year. In 2017, GDP is estimated to grow by 1.1–1.4% (compared with near-zero growth forecast in March). In 2018, GDP growth will follow a relatively stable trajectory of growth at 1.6–2.0% per year.

The increased economic activity will be supported by stable external demand (including through higher non-commodity exports), further growth in import substitution and, subsequently, the production of goods and services geared towards internal demand as uncertainty decreases and economic growth prospects are revised by Russian economic agents.

The recovery in economic growth in 2016–2018 will be also assisted by the gradual relaxation of monetary conditions, primarily due to the decrease in the Bank of Russia key rate as inflation slows in line with forecasts, inflation expectations fall and inflation risks subside. However, according

Chart 2.2



Source: Bank of Russia calculations.

to estimates, monetary conditions will remain moderate-to-strict.

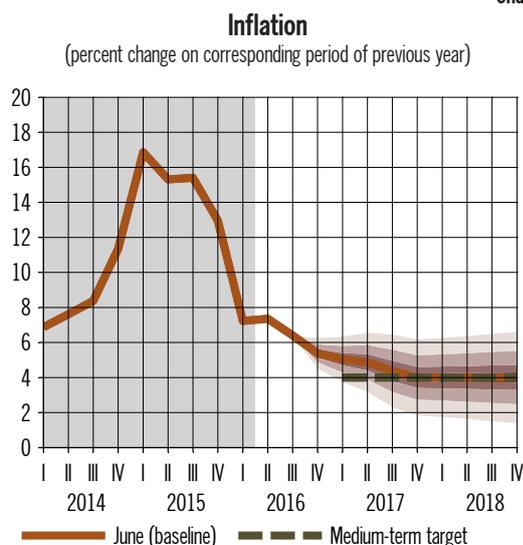
As expected, non-price lending conditions will also gradually ease as the overall economic situation improves, which will allow banks to soften their requirements for borrowers and collateral, and to gradually expand the range of lending on offer. Another factor behind the decline in interest rates on bank operations will also be the gradual transition of the banking sector to a structural liquidity surplus which will likely produce the greatest downward effect on deposit rates.

The recovery in lending activity will be gradual. In 2016, the growth in lending to the real sector of the economy will be held back by the high overall debt burden, in addition to the relatively tight price and non-price lending conditions. However, the forecast growth in lending for 2016 has been upgraded slightly, primarily due to expectations among economic agents that the overall economic situation will improve. According to estimates, lending to non-financial organisations and households in rubles and foreign currencies will increase in 2016 by 5–8% (it was previously forecast to grow by 3–6%).

A further easing of monetary conditions in 2017–2018, gradual recovery of economic agents' income and normalisation of the debt burden will all give rise to an increase in demand for borrowed funds. Lending growth will accelerate to 6–9% in 2017–2018.

Growth in money supply will still outstrip the increase in lending to the economy due to the contribution of banking system's net lending to the government. According to estimates, money

Chart 2.3



Source: Bank of Russia calculations.

supply growth rates in 2016 will be 10–13% and will subsequently be in the 7–11% range. Money supply dynamics could be a source of inflation risks over the forecast horizon.

At the same time, the improvement in the economic growth forecast will create more favourable settings for achieving the federal budget deficit target over the forecast horizon (roughly 3% of GDP in 2016 with a subsequent decrease of 1 percentage point of GDP in 2017–2018) on condition of implementing appropriate fiscal consolidation measures.

According to Bank of Russia estimates, this will lead to the slower spending of sovereign funds than expected earlier during the forecast period, which will reduce the contribution of this factor to the forecast money supply growth rates in 2016–2018. During consolidation, fiscal policy will have a moderately constraining influence on economic growth, which will be taken into account in monetary policy.

The banking sector's final transition to the structural liquidity surplus is forecast for the start of 2017, whereas some time ago this transition was expected to occur at the end of 2016. Consequently, the possible easing of monetary conditions driven by the release of sovereign funds during the forecast period may turn out less in scope.

The economic recovery is forecast to be relatively even across all components of aggregate demand. The recovery in economic activity is expected to be followed by an increase in wages amid the labour deficit (this situation was observed in February–April

2016). At the same time, the recovery in private consumption will be limited by the slow decline in households' propensity to save, which will be caused by the relatively moderate reduction in real interest rates (with the actual inflation followed by reduction in inflation expectations). Taking this into account, after a fall of roughly 3% in 2016, household final consumption expenditure will start to grow again in 2017 (by 1.4–1.8%) and will keep on growing at roughly 2.5–3%.

Simultaneously, more favourable terms of trade and a corresponding revision of expected ruble exchange rate dynamics will set up necessary conditions for a recovery in investment both in terms of expanding companies' opportunities to acquire imported equipment and improving their assessments of the Russian economy's growth prospects. Gross fixed capital formation growth is forecast to be roughly 2% in 2017–2018 after falling by 1.5–1.8% in 2016.

Considering the slow increase in external demand, growth in exports will remain low (roughly 1.5% in 2016–2018). At the same time, the amount of imports will gradually expand amid the recovery in internal demand and relatively stable ruble exchange rate dynamics. As a result, the positive contribution of net exports to GDP will be significantly lower in 2017 (compared with 2016) and will turn negative in 2018.

Given these dynamics in the export and import quantities of goods and services, and taking into account the stabilisation of energy prices, the current account surplus over the forecast period will gradually shrink (Table 2.2). However, the net outflow of private capital over the forecast period is also expected to remain subdued, not exceeding 2% of GDP. The low level of capital outflow will be caused both by the gradual reduction in external debt payments according to the repayment schedule, and the expanded opportunities to refinance external debt. The positive real interest rates in the economy, buoyed by the appeal of investing in ruble-denominated financial assets, will also help to maintain low rates of capital outflow. In addition, as economic activity recovers, the capital outflow will be largely shaped by the increase in the foreign assets of other sectors, which, however, will be significantly lower compared with the levels observed in 2010–2014.

Considering the moderate demand for foreign assets in 2016–2017, current account receipts will be more than sufficient to repay external debts. As a result, if the baseline scenario is realised, banks will be able to fully repay their debts on foreign currency refinancing instruments to the Bank of Russia by the end of 2017.

Annual inflation will reduce over the second half of 2016 and further into 2017. An increase in quarterly price growth (seasonally adjusted) is possible in 2016 Q3. This may be linked to adjusted prices for food and especially for fruit and vegetables, which have seen abnormally low price growth in February–April 2016 that cannot be explained by seasonal factors. In future, inflation will continue to fall both in quarterly terms and year on year, chiefly due to the moderate demand amid stable foreign exchange dynamics. An additional moderating drag on consumer price growth will come from low producer costs. This will chiefly be the result of persistently low energy prices in the absence of significant exchange rate fluctuations. The quarterly annualised consumer price growth is expected to stabilise at roughly 4% as early as 2017 Q2. This said, the annual inflation will gradually fall from 5.0–6.0% in December 2016 to 4% at the end of 2017. This downward inflation path in the event of the baseline scenario materialisation will be possible on condition of a significant reduction in nominal interest rates by the end of 2017.

At the same time, a number of internal risks could have an impact on how the situation evolves in the Russian economy. These risks are primarily linked to uncertainty surrounding fiscal policy, the possible retention of high inflation expectations in the long term, and changes in household savings behaviour (growth in household propensity to consume).

The main area of uncertainty remains the implementation of fiscal policy in 2016–2018. The absence of active consolidation measures could be a source of additional inflation risks over the forecast period and, at the same time, install conditions for a slack in economic growth over the longer term horizon.

Amid the shortage of labour resources, active indexing of wages in budget-financed sectors could generate additional upward pressure on wages in the private sector, which could produce a further

influence on inflation, including through secondary effects such as enhanced inflation expectations.

In this situation, by 2018, taking into account the on-going financial and economic sanctions and depletion of sovereign funds, the main source of funding for the budget deficit will become borrowing in the domestic market. Active placement of government bonds with standard maturities until redemption taking into account the limited capacity of the domestic financial market will lead to growth in interest rates on the long end of the yield curve (i.e., a significant increase in maturity premiums), which, in the medium term, will have a negative impact on economic growth primarily through a reduction in investment activity. At the same time, funding the budget deficit by issuing short-term debt liabilities, which do not exert such significant influence on medium- and long-term interest rates, will more than likely require a tightening of the monetary policy to contain inflation risks, which will also have a negative impact on investment activity in the medium run.

Moreover, apart from the general problems that arise when public debt grows (increase in the budget deficit driven by interest expenditure, displacement of private borrowers), the high capital flow volatility that is characteristic of the Russian economy could pose further risks to financial stability and economic growth.

A potential appreciable downturn in household propensity to save, which has also been noted as one of the main inherent economic risks, could lead to an increase in household final consumption expenditure that will create the conditions for inflation acceleration. At the same time, an increase in economic activity spurred by these reasons will hardly be stable in the long term. First, it sets grounds for inflation to remain high and volatile, which will reduce incentives for investment. Second, in the absence of conditions for import substitution, growth in consumer demand will ultimately lead to increased exports, which will make a negative contribution to economic growth rates. Thus, if signs of these risks emerge, the Bank of Russia will have to implement a tighter monetary policy than prescribed in the baseline scenario. Persistently high inflation expectations, which are possible in view of the high degree of inertia, would call for a similar monetary policy response.

Table 2.1

**Key parameters of the Bank of Russia's baseline forecast
(as % of previous year, unless indicated otherwise)**

	2015 (actual)	2016	2017	2018
Urals price, average for the year, US dollars per barrel	52	38	40	40
Inflation, % in December year-on-year	12.9	5.0-6.0	4.0	4.0
Gross domestic product	-3.7	-(0.7-0.3)	1.1-1.4	1.6-2.0
Final consumption expenditure	-7.5	-(3.2-2.8)	1.3-1.7	2.0-2.4
– households	-9.6	-(3.6-3.2)	1.4-1.8	2.4-2.8
Gross formation	-18.7	-(1.7-1.3)	0.7-1.1	1.9-2.3
– gross fixed capital formation	-7.6	-(1.8-1.5)	1.9-2.3	1.8-2.2
Net exports	96.0	22.9-25.4	0.5-3.0	-(3.3-0.8)
– exports	3.6	1.8-2.2	1.3-1.7	1.3-1.7
– imports	-25.7	-(6.9-6.5)	1.2-1.6	2.7-3.1
Money supply in national definition	11.4	10-13	9-11	7-9
Monetary base in narrow definition	-4.3	2-4	4-6	4-6
Loans to non-financial organisations and households in rubles and foreign currency	7.1	5-8	6-8	7-9

Table 2.2

Russia's balance of payment indicators – baseline scenario (billions of US dollars)

	2015 (actual)	2016	2017	2018
Current account	70	40	32	29
Balance of trade	149	114	106	105
Exports	341	291	304	317
Imports	-193	-177	-197	-212
Balance of services	-37	-33	-32	-33
Exports	52	44	46	49
Imports	-88	-77	-79	-82
Primary and secondary income balance	-42	-41	-42	-43
Capital account	0	0	0	0
Current and capital account balance	69	40	32	29
Financial account (net of reserve assets)	-73	-25	-25	-29
General government and the central bank	-9	0	0	0
Net private capital outflow	-63	-25	-25	-29
Net errors and omission	5	0	0	0
Change in FX reserves ('+' - decrease, '-' - increase)	-2	-15	-7	0

The uncertainty regarding the development trajectory in the global economy and in the global financial and commodity markets during the period since the publication of the previous Report has not diminished. As a result, the Bank of Russia also considers an optimistic scenario and a risk scenario, alongside the baseline scenario.

The risk scenario assumes oil prices will fall to \$25 per barrel at end-2016 and remain roughly close to this level until the end of 2018. Such a fall in oil prices could occur either if the Chinese economy experiences a drastic slowdown or if the

Fed accelerates the normalisation of its monetary policy, or if supplies recover quickly from Canada, Nigeria and Libya and there is significant growth in supply from other oil exporting countries (primarily Iran and Iraq).

Under the risk scenario, the external situation will develop unfavourably, causing a stronger economic decline in 2016–2017 than under the baseline scenario. The adverse impact of the foreign economic situation on the Russian economy will take the form of a drop in exports earnings, a decrease in the solvency of borrowers who have

outstanding debt in foreign currency, a deterioration in expectations regarding the Russian economic outlook, and a significant decline in the attractiveness of investment in the Russian economy for Russian and external investors. In addition, it will become necessary to further reduce budget spending compared with the baseline scenario given a fall in income and limited opportunities to fund the budget deficit. But even if spending is reduced, the federal budget deficit will be significantly higher over the entire forecast period than anticipated in the baseline scenario. These factors will cause GDP to shrink by 0.9–1.2% in 2016–2017.

At the same time, the possible increased volatility in the global and Russian financial markets assumed by this scenario will lead to a sharp deterioration in exchange rate and inflation expectations, which will significantly increase inflation risks and risks to financial stability. In these conditions, inflation will be higher than in the baseline scenario and, according to estimates, will be 6.5–7.0% by the end of 2016, possibly exceeding 4% in 2017. In order to prevent these risks from snowballing, the Bank of Russia can use either interest rate policy measures or other instruments.

If this scenario is realised, the Bank of Russia will implement a tighter policy than in the baseline scenario. In addition, if a threat arises to financial stability, the Bank of Russia will be ready to significantly increase the amount of foreign exchange refinancing operations and, where necessary, to carry out foreign exchange interventions.

The optimistic scenario assumes that Urals crude prices will remain at roughly \$50 per barrel until the end of the forecast period. This trajectory of the terms of trade could occur if the global economy experiences a faster recovery, but will not be accompanied by significantly faster increases (compared with the baseline scenario) in interest rates by central banks around the world (primarily the Fed).

If the prerequisites are in place for the optimistic scenario, economic activity is expected to recover more confidently than under the baseline scenario. In 2016, GDP growth is forecast to be near zero, and in 2017–2018, GDP growth is expected to be in the range of 1.5–2%. Apart from improvements in terms of trade, economic growth will also be buoyed by economic agents' revised expectations regarding the Russian economic outlook.

The impact of improvements in the terms of trade on inflation will be mixed. On the one hand, the ruble appreciation amid the expected rise in oil prices in the second half of 2017 will have a moderating effect on inflation. On the other hand, economic agents' increased earnings and reduced uncertainty will contribute to growth in consumer expenditure, which will have a pro-inflationary effect. However, according to estimates, the exchange rate's moderating drag on inflation will take hold faster and will be more significant, which will create further opportunities (compared with the baseline scenario) to ease monetary policy if events evolve according to the optimistic scenario.

Under this scenario, as in the baseline one, credit institutions are expected to repay their debts on Bank of Russia FX refinancing instruments by the end of 2017. Further down the line, amid the more favourable external climate and growth in earnings from foreign trade operations, the Bank of Russia does not rule out purchasing foreign currency with a view to increasing its international reserves. The current account balance to GDP ratio and net capital outflow to GDP ratio will be higher than in the baseline scenario. The higher current account balance over 2016–2018 can be explained primarily by higher oil prices, while higher capital outflow will result from a stronger demand for foreign assets by the private sector with the ruble stronger than in the baseline scenario.

The Bank of Russia views the slowdown in inflation to be slightly faster than the previous forecast compiled amid signs of the economy soon entering a phase of recovering growth. The expected inflation level over the six month–one year horizon in the baseline scenario has been revised downwards, trends of lower inflation expectations have occurred, and inflation risks have decreased. Taking these factors into account, on 10 June 2016 the Bank of Russia decided to reduce its key rate to 10.50% p.a. A slowdown in inflation processes will make it possible to more confidently expect a fall in inflation to the target level of 4% at the end of 2017 taking into account the above decision and the continuation of a moderate-to-strict monetary policy. The Bank of Russia will consider the possibility of a further key rate cut based on estimates for inflation risks and alignment of inflation decline with the forecast trajectory.

ANNEX

Dynamics of major items in the Russian balance of payments in 2016 Q1

In 2016 Q1, the current account surplus fell to its lowest value for Q1 since 2009. The twofold¹ reduction in the positive trade balance was only partly offset by the decreased negative contribution of the deficit from the balance of services and non-tradable components.

The decline in goods exports intensified from 30% in 2015 Q4 to 34% in 2016 Q1 amid the fall in global commodity prices to their lowest values in years. Prices for Urals crude sank by 39% and for natural gas in the European market – by 44%. However, in February-March, global oil prices rose amid the reduction in energy production in the USA and the anticipation of joint measures to limit supplies from major producing countries.

Despite the significant drop in oil prices in 2016 Q1, the export quantities of oil rose by 4% (according to data from the Russian Federal Customs Service (FCS), aided by the reduction in export duties and the highest Russian oil production figures in the post-Soviet era. The increase in oil supplies mainly occurred due to China. However, Russia's position strengthened both in the Chinese market and in the European market (Russia's primary market). Unlike crude oil exports, Russian export quantities of oil products shrank by 16% due to the high base of the same period in 2015 and companies' re-orientation from oil product exports to crude oil exports as part of a 'tax manoeuvre'. The 18% growth in natural gas supplies year on year was down to the low base effect. That said, the risks associated with Ukraine, the main transit country for Russian gas, remained. Ukraine ceased purchases of Russian gas in November 2015.

In contrast to exports, the annual decline in Russian imports reduced overall from 32% in 2015

Q4 to 15% in 2016 Q1; the same was true for all major product groups. The less significant reduction in imports in Q1 was caused by the slowdown in the ruble depreciation and the economic recession in Russia. Improvements in consumer activity also provided support to imports: the annual reduction rates in retail sales decreased. According to FCS data, in 2016 Q1 imports contracted by 54% on account of machinery, equipment, and vehicles. The imports of this major product group reduced more than total imports (by 17%). As a result, the share of this group in the total value of goods imports fell from 48% in 2014 to 45% in 2015 and to 43% in 2016 Q1. The contribution of food goods, falling under the restrictions introduced by Russia in 2014 against the EU, the USA, Canada, Australia, and Norway and expanded further to include Albania, Montenegro, Iceland and Liechtenstein (August 2015), and Ukraine (beginning 1 January 2016), to the reduction in aggregate imports in 2016 Q1 dropped to 1%. Imports from Turkey reduced by \$209 million in Q1 (a 3% reduction in goods imports), primarily due to a reduction in tomato imports, as a result of the ban on importing certain categories of agricultural produce, raw materials and food goods into Russia from 1 January 2016.

The largest reduction in services was seen in tourism services amid the fall in real wages and suspension of flights to and from Egypt and Turkey. Out of non-tradable current account components, the balance of investment income deficit saw the greatest reduction in the face of the external debt repayments by the private sector.

In 2016 Q1, net private capital outflow shrank by almost twofold compared with 2015 Q1, to \$12 billion², amid lower external debt repayments. With the limited access to Western capital markets in 2016 Q1 due to sanctions, as in the previous

¹ Here and hereinafter, changes are relative to the corresponding period of the previous year, unless otherwise indicated.

² Adjusted by the amount of foreign currency liquidity provided by the Bank of Russia to credit organisations on a reverse basis, by the amount of operations in resident banks' correspondent accounts with the Bank of Russia, and also by the amount of funds in foreign currency received by the Bank of Russia as part of FX swaps.

Russia's position in key oil markets

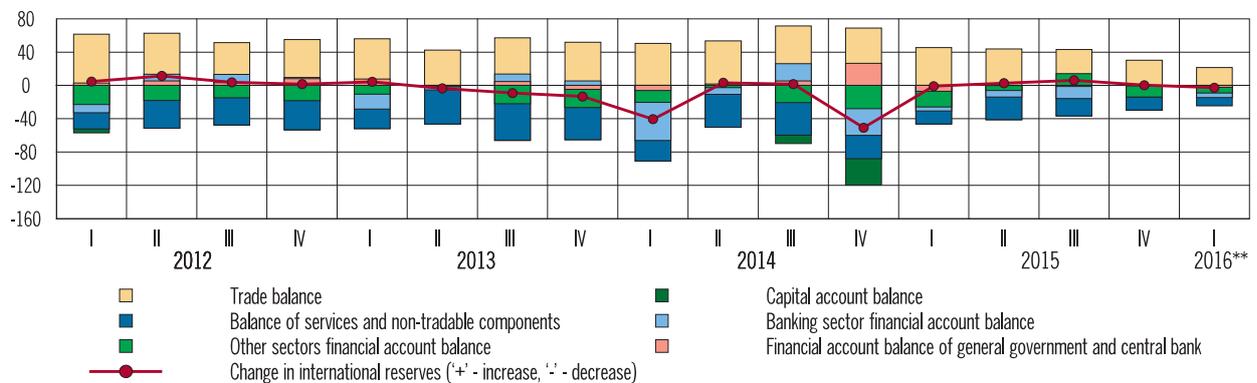
The European market is still Russia's main market: according to FCS data, the EU's share in Russian oil exports is still roughly 60%. According to Eurostat data, Russia's share in EU crude oil imports increased from 28% in 2015 Q1 to 32% in 2016 Q1.

China's importance to Russia has increased significantly recently: China's share in Russian oil exports grew to 19% in 2016 Q1 (14% in 2015 Q1). Russia's position in the Chinese market (the fastest growing market) also became stronger. According to data from China's General Administration of Customs (GACC), Russia occupied the first place by the value of imports to China in March-April 2016, outstripping Saudi Arabia. Russia's share in Chinese crude oil imports increased from 11% in 2015 Q1 to 13% in 2016 Q1 and 15% in April 2016.

At the same time, the outlook for Russian energy supplies to key markets is unfavourable. Following the lifting of sanctions against Iran at the start of the year, Iranian crude oil supplies to China have increased from 410,000 barrels per day in January to 675,000 barrels per day in April 2016, according to GACC data. The quantity of oil shipped from Iran to Europe after the lifting of the embargo rose to 500,000 barrels per day according to the International Energy Agency (April 2016). Before the ban was imposed, according to Eurostat data, in 2011 the EU had imported roughly 600,000 barrels per day of crude oil from Iran (3.5 million barrels per day were imported from Russia in 2011 and 3 million barrels per day – in 2015). The competition could turn more intense with the resumption of supplies from Libya (imports by the 28 EU member states totalled 1 million barrels per day in 2010 and 266,000 barrels per day in 2015).

Chart 1

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



* Items 'Banking sector balance' and 'Change in international reserves' are adjusted by the amount of foreign currency liquidity provided by the Bank of Russia to credit institutions on a reverse basis, operations in resident banks' correspondent accounts with the Bank of Russia, and foreign currency received by the Bank of Russia in FX swaps. Item 'Other sectors balance' includes item 'Net errors and omissions' (according to BPM5).

** 2016 Q1 - estimate.
Source: Bank of Russia.

year, the outflow was largely influenced by the fall in external liabilities in the private sector. Banks accounted for the vast majority of the reduction in foreign liabilities. In 2016 Q1, banks repaid their external debt amid reduced amounts of foreign currency liquidity provided by the Bank of Russia to credit institutions on a reverse basis, whereas

in 2015 Q1 banks showed significant demand for foreign currency refinancing. Despite the EU and US financial sanctions, other sectors successfully refinanced a significant proportion of their external debt and reduced FX liabilities to a level far lower than that suggested by the external debt repayment schedule.

Balance of payments forecast for 2016–2018

Compared with the forecasts in the previous Report, the baseline scenario assumptions for oil prices in the short- and medium-term were revised upwards, and the forecasts of a number of other key macroeconomic indicators¹ over the period under consideration were also improved considerably. This has a massive impact on the forecast dynamics of balance of payments items.

In the context of the faster than expected reduction in oil supply glut in the global market², the baseline scenario assumes that oil prices will stabilise at \$40 per barrel in 2016 Q3 and remain close to this level on average until 2018. Higher oil prices in 2016–2017 will entail a higher volume of exports during this period than suggested in the previous Report. As a result, the value of exports in 2016 will fall to a lesser degree in the baseline scenario – by 15–20% (compared with a fall of almost 30% in the previous forecast). In 2017–2018, amid stable oil prices, a slight increase in exports is expected, primarily due to a gradual build up in external demand.

At the same time, the improved estimates of Russia's GDP dynamics compared with the forecasts published in the previous Report and the drag from the strengthening ruble in March–April will result in higher imports than anticipated. In 2016, the value of imports will reduce by less than 10% (compared with more than 20% in the previous forecast) and in subsequent years it will grow as demand recovers in line with growth in the Russian economy.

The negative balance of non-tradable components will remain low as a result of the fall in external liabilities and the consequent decline in investment income payable. However, given the stabilising external debt, it is not expected to fall further.

As a result (with the rapid growth in imports compared with exports and the stable balance of non-tradable components), in 2016 the current account balance will drop to \$40 billion (3.5% of

GDP) and will then decrease further to roughly \$30 billion (2.2% of GDP) in 2018.

The main component of capital outflow in 2016 will be the forced (amid ongoing international sanctions) settlement of external liabilities by Russian companies and banks. According to the external debt repayment schedule, total payments by banks and other sectors in 2016 will amount to roughly \$90 billion. However, taking into account the continuing growth in the liability items of direct investment³, intra-group loans and borrowing, and partial refinancing of debts, the actual reduction in private sector liabilities will be roughly \$15–20 billion. This estimate has been revised downwards compared with the previous Report (\$30 billion) taking into account updated forecasts for key macroeconomic indicators and actual data for 2016 Q1. In future (under the baseline scenario), as the economic situation improves and as Russia's appeal increases consequently in the eyes of foreign investors, companies' opportunities to use sources not affected by the sanctions will expand. Thus, the scale of capital outflow associated with net reduction in liabilities will abate, and 2018 is expected to see a slight net increase in liabilities to the external sector.

In turn, in 2016, the value of capital outflow associated with the net demand for foreign assets, despite growing (compared with 2015 when there was a net reduction in foreign liabilities) will be small by historical standards. The financial standing of economic agents will not improve to the extent that they can significantly increase the amount of their funds used to acquire foreign assets. Moreover, some liquid foreign assets will be used to fund payments on liabilities, including the repayments of banks' outstanding amounts on Bank of Russia FX repos. In future, as GDP recovers (and economic agents' incomes recover), demand for foreign assets will also increase. However, in view of the low forecast economic growth rates, this process will be fairly slow and demand for foreign assets will remain comparatively low by historical standards. Thus, according to Bank of Russia estimates, capital outflow associated with net demand for foreign assets will increase under the baseline scenario from less than \$10 billion in 2016 to \$30

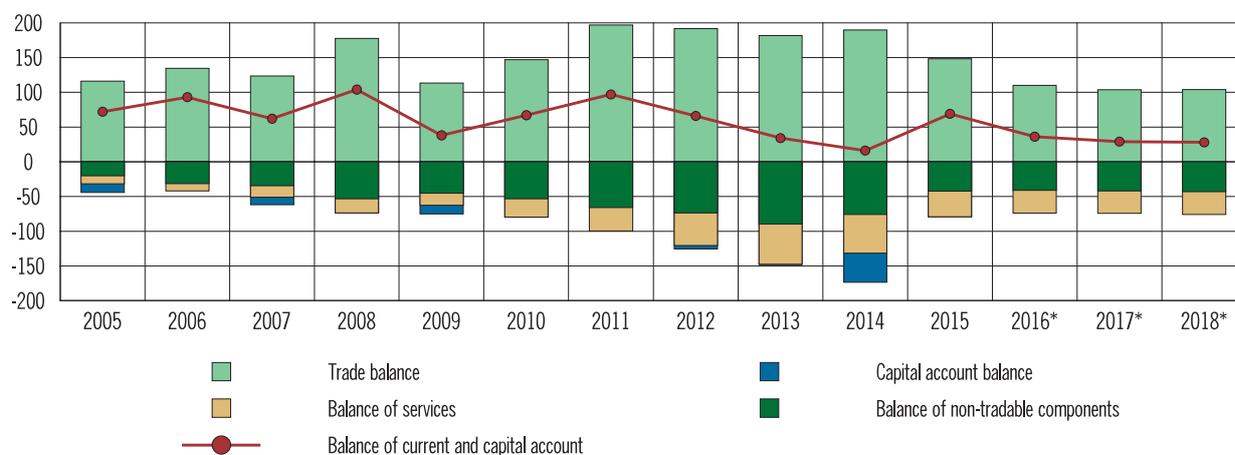
¹ See Section 2 'Economic outlook and key rate decision'.

² See Section 1 'Macroeconomic conditions'.

³ Including liabilities not associated with debt accumulation, for example, equity holdings in affiliated and subsidiary companies.

Chart 2

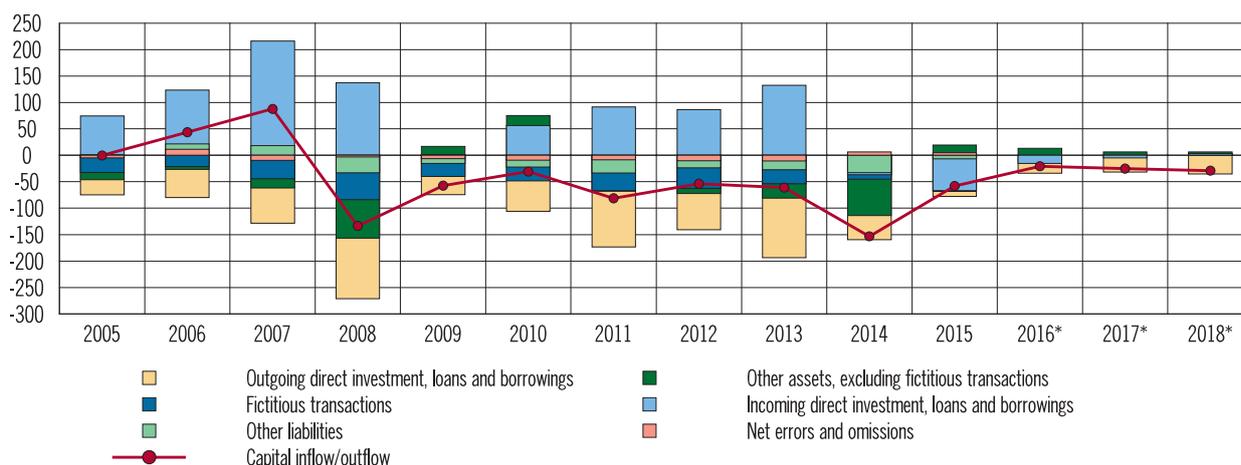
Major current account components (billions of US dollars)



* Baseline scenario forecast.
Source: Bank of Russia.

Chart 3

Capital outflow* (billions of US dollars)



* Baseline scenario forecast.
Source: Bank of Russia.

billion in 2018, and from 2017 onwards it will again become the main component of the aggregate private capital outflow.

Current account and financial account balance dynamics, as forecast in the baseline scenario, will therefore not create the preconditions for an increase in international reserves through repayment of credit institutions' outstanding amounts on Bank of Russia FX repos in 2016–2017.

The main risks to the balance of payments forecast stem from oil price dynamics. The Bank of Russia's risk scenario expects oil prices to fall to \$25 per barrel by end-2016 and stabilise at this level over the longer period. In this case, export earnings will be significantly lower than under the

baseline scenario. Lower economic growth rates will also shape lower overall imports compared with the baseline scenario. However, the fall in export earnings will be larger than the fall in imports. Moreover, after a fall in 2016–2017, export earnings will remain at roughly the same level over the entire forecast period. Imports, in turn, will stabilise in 2018 and then will start to gradually rise as economic activity recovers. As a result, a sharp decrease in the current account balance is forecast in 2016 (to less than \$25 billion, i.e. by a factor of roughly 1.5 compared with the baseline scenario) and is expected to gradually decline in future.

Capital outflow under the risk scenario will also be less than under the baseline scenario. The net

reduction in liabilities will grow somewhat – projects in Russia are becoming less appealing to foreign investors. As compared with the baseline scenario, it will be more difficult to refinance existing borrowing and to obtain new credit. However, this will be offset by a rapid contraction in demand for foreign assets (in dollar terms, the share of income that residents may spend on foreign assets will be less than in the baseline scenario).

At the same time, the reduction in capital outflow will not be as pronounced as the reduction in the current account balance. Moreover, if the risk scenario is realised, the likelihood of a further increase in capital outflow will grow. Driven by a new fall in oil prices, volatility in the foreign exchange market may increase and demand for foreign assets among residents may rise. As a result, in 2017 companies and banks might once again start to experience difficulties in funding their external debt payments. In this case, the Bank of Russia might expand its FX liquidity provision operations on a reverse basis or, if necessary, resort to direct interventions in the foreign exchange market in order to avert risks to financial stability.

On the other hand, if global economic growth and demand for risky assets in the global financial markets are relatively high in future, and supply in the oil market does not grow rapidly, the situation could evolve better than under the baseline scenario. In the optimistic scenario considered by the Bank of

Russia, the combination of these factors will lead to oil prices stabilising at roughly \$50 per barrel until the end of the period under review. In this case, export earnings in 2017–2018 will be significantly higher than in the baseline scenario. However, a faster economic revival and higher ruble exchange rate compared with the baseline scenario will speed up growth in imports. As a result, the current account balance will be slightly higher than under the baseline scenario in these years (roughly \$35–40 billion compared with \$25–30 billion).

The amount of capital outflow under the optimistic scenario will also slightly exceed the corresponding figure under the baseline scenario. With the higher demand for risky assets in the international financial markets and improved Russian economic outlook, Russian companies will find it easier to attract foreign liabilities. However, this will be offset by growth in economic agents' demand for foreign assets supported by the increase in their incomes. As in the baseline scenario, in 2016–2017 credit institutions will be able to repay outstanding amounts on Bank of Russia FX repos, which will lead to growth in international reserves. Further down the line, amid the more favourable external climate and growth in earnings from foreign trade operations, the Bank of Russia does not rule out purchasing foreign currency with a view to increasing its international reserves.

Economic situation in Russian regions

Despite the downturn in the external situation at the start of 2016, in Q1 the fall in goods and services output slowed. The Russian economy was adapting to the low oil prices. The adaptation of Russian regions to the new economic reality was uneven. The patterns of their distribution by key macroeconomic indicators changed slightly compared with the previous year.

Overall, favourable trends dominated in production activity dynamics. The regions demonstrated increased variation¹ (Chart 1), which in this case can be viewed as a positive sign confirming the emergence of new points of growth in economic activity. In 2016 Q1, the number of regions with contracting industrial production fell to 41 (48 in 2015 Q1). As noted in Section 1 of the Report, the situation improved in certain manufacturing sectors, including the production of food, plastic and rubber products, and leather goods and shoes. In 2016 Q1, the growth in industrial production in regions where these industries are well-developed was higher than the national average indicator. Furthermore, state orders have provided support for manufacturing industries. In contrast, regions with developed motor vehicle and aviation industries posted deeper declines.

The distribution of regions by annual growth in retail trade turnover changed significantly (Chart 2). The share of regions, where retail trade turnover reduced by more than 10%, shrank considerably. Conversely, the number of regions in which retail trade turnover increased compared with the corresponding period of the previous year grew (to 17). The regions' heterogeneity by consumer activity dynamics broadly reduced². However, the situation in the majority of regions lagging behind in terms of growth in 2015 continued to be unfavourable at the start of 2016³.

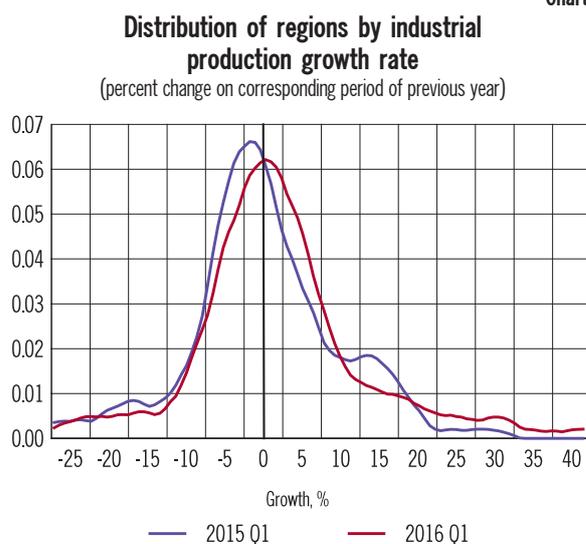
¹ The standard deviation of the distribution of annual growth in industrial production rose by more than 1 percentage point.

² The standard deviation of the distribution of annual growth in retail trade turnover decreased from 6.1 to 4.7 percentage points.

³ An analysis of the joint distribution of growth in 2015 Q1 and 2016 suggests that in regions with lower growth figures in 2015 Q1 retail trade turnover was also more likely to fall in Q1 this year.

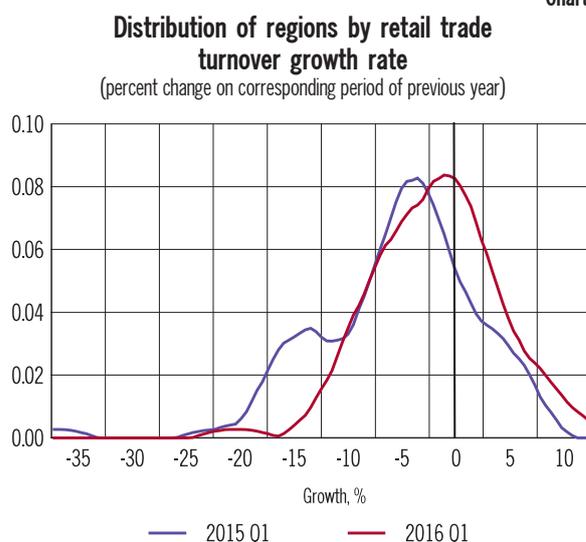
The distribution of growth in fixed capital investment became more uneven (Chart 3⁴). Despite the fact that the annual growth of fixed capital investment in Russia as a whole remained unchanged in 2016 Q1 compared with the same period in 2015 (-4.8%), the mean and median measures of this indicator by region decreased, and the number of regions registering a negative investment growth increased from 44 to 49. All

Chart 1



Source: Bank of Russia calculations.

Chart 2



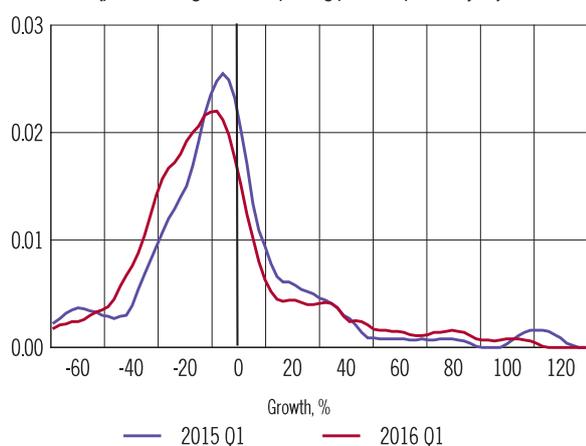
Source: Bank of Russia calculations.

⁴ Chart 3 does not show growth in fixed capital investment in 2015 Q1 in the Magadan Oblast (143.9% relative to the corresponding period of the previous year). Likewise, the Republic of Crimea and city of Sevastopol are not included in the list of regions analysed in terms of the 'Inflation' and 'Fixed capital investment' indicators due to the lack of data for 2015 Q1.

Chart 3

Distribution of regions by fixed capital investment growth rate

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

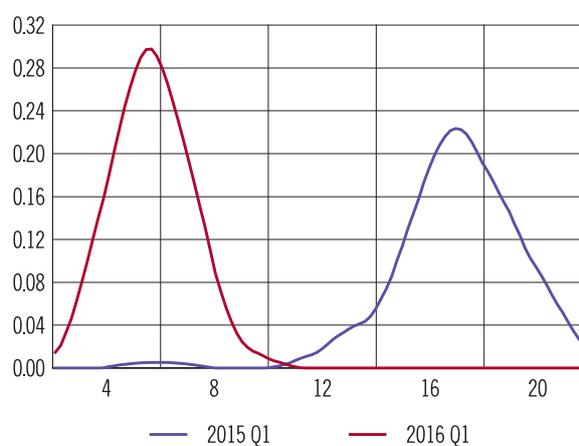
these findings confirm the persistence of the negative trends in investment demand dynamics, which could be constrained even more by the further downturn in external conditions at the end of 2015–start of 2016.

In March 2016, overall annual inflation in Russia reduced to 7.3%. The decrease was caused by a fall in demand, the ruble appreciation, high supply of

Chart 4

Distribution of regions by annual inflation rate

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

agricultural products, and the favourable situation in the global agricultural markets. It is important to note that compared with March 2015, regional inflation has broadly converged (the standard deviation reduced from 2 to 1.1 percentage points) (Chart 4). This could suggest the sustainable character of disinflationary trends observed in several recent quarters.

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

Table 1

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

Suspension of 12-month FX repo auctions	From 1 April 2016, the Bank of Russia suspends 12-month FX repo auctions because of the lack of demand for these facilities from Russian credit institutions and the shift in their demand to 28-day FX repos.
Start of OFZ sales from the Bank of Russia's portfolio	In April 2016, the Bank of Russia began selling federal government bonds (OFZ) from its portfolio. These OFZ sales help partly to absorb the liquidity inflow originated by the use of the Reserve Fund for financing the federal budget deficit. Moreover, the OFZ sales may increase liquidity and the depth of the secondary market of government securities. The Bank of Russia sells OFZ issues through on-exchange trades at MICEX SE. In doing so, the Bank of Russia seeks to minimise the impact of these sales on the situation in the OFZ market.
Expansion of the Bank of Russia Lombard List	According to the decisions of the Bank of Russia Board of Directors of 4 April, 25 April and 26 May 2016, 33 securities issues were added to the Lombard List.
Introduction of increased risk weights on FX operations for the calculation of capital adequacy ratios of banks	To set up additional capital coverage for foreign currency risks in the banking sector, from 1 May 2016 the Bank of Russia raised risk weights on corporate lending and operations with FX securities (110%, 130% and 150% depending on a transaction type/ investment object/ quality of a depository certifying the title to securities) for the calculation of the capital adequacy ratios of banks.

Table 2

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

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.15	From 2.02.15	From 16.03.15	From 5.05.15	From 16.06.15	From 3.08.15	From 14.06.16	
Liquidity provision	Standing facilities	Overnight loans; Lombard loans; loans secured by gold, non-marketable assets or guarantees; FX swaps (ruble leg); repos	1 day	daily	18.00	16.00	15.00	13.50	12.50	12.00	11.50	
		Loans secured by gold	from 2 to 549 days ¹		18.50	16.50	15.50	14.00	13.00	12.50	12.00	
	Open market operations (minimum interest rates)	Loans secured by non-marketable assets or guarantees	3 months ¹	monthly								
		Auctions to provide loans secured by non-marketable assets	from 1 to 3 weeks	occasionally	17.25	15.25	14.25	12.75	11.75	11.25	10.75	
Liquidity absorption	Open market operations (maximum interest rates)	Lombard loan auctions	18 months ¹									
		Repo auctions	36 months ¹	weekly								
	Standing facilities daily	FX swap auctions	1 week	weekly								
		Deposit auctions	from 1 to 6 days ²	occasionally	17.00 (key rate)	15.00 (key rate)	14.00 (key rate)	12.50 (key rate)	11.50 (key rate)	11.00 (key rate)	10.50 (key rate)	
Refinancing rate ⁴		Deposit operations	from 1 to 6 days ²	weekly								
			1 day, call	daily	16.00	14.00	13.00	11.50	10.50	10.00	9.50	
Memo item												

¹ Loans provided at a floating interest rate linked to the Bank of Russia key rate.

² Fine-tuning operations.

³ Faced by structural liquidity deficit, the Bank of Russia holds repo auctions. See press release at http://www.cbr.ru/press/PR.aspx?file=19012015_154523/2015-01-19T15_41_11.htm.

⁴ In 2015, the Bank of Russia refinancing rate was 8.25%. From 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date. From 1 January 2016, no individual values are set for the refinancing rate.

Source: Bank of Russia.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity in 2015-2016

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments and obligations on liquidity absorption instruments, billions of rubles							
					1.01.15	1.04.15	1.07.15	1.10.15	1.01.16	1.04.16	1.05.16	1.06.16
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	1.2	4.0	0.0	0.0	0.0	0.0	2.9
		Lombard loans			3.7	4.1	4.0	4.1	2.9	3.2	1.3	0.6
		FX swaps			121.6	16.6	49.9	0.0	14.9	0.0	0.0	0.0
		Repos	96.2		107.0	275.9	289.3	264.9	192.6	215.5	75.2	
		Loans secured by gold	1.2		0.6	0.5	0.6	0.5	0.6	0.0	0.0	
		Loans secured by non-marketable assets or guarantees	2,055.9		598.0	335.1	122.7	234.8	637.3	127.9	280.3	
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly	2,370.9	2,892.0	2,685.0	2,438.8	1,553.8	744.9	573.4	296.6
			from 1 to 3 weeks, 18 months	occasionally								
		Repo auctions	1 week	weekly	2,727.6	1,910.8	1,572.3	912.0	1,448.5	650.3	429.0	605.0
		FX swap auctions	from 1 to 2 days	occasionally ¹	-	-	0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days	weekly ²	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Standing facilities	Deposit operations	1 day, call	daily	804.5	292.2	293.1	280.5	557.8	400.9	257.2	340.3

¹ Fine-tuning operations.² Faced by structural liquidity deficit, the Bank of Russia holds repo auctions. See press release at http://www.cbr.ru/press/PR.aspx?file=19012015_154523if2015-01-19T15_41_11.htm.

Source: Bank of Russia.

Table 2

Required reserve ratios
(%)

Liability type	Periods		
	From 1.01.15 to 31.03.16	From 1.04.15	From 1.07.16
To non-resident legal entities in rubles	4.25	4.25	4.25
To households in rubles and foreign currency			5.25
Other liabilities in rubles		6.25	
To non-resident legal entities in foreign currency			
Other liabilities in foreign currency			

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

Types of credit institutions	As of 1.01.15	From 10.09.15
Banks	0.7	0.8
Settlement non-bank credit institutions and non-bank credit institutions entitled to transfer funds without opening bank accounts and to conduct other related bank operations	1.0	1.0
Non-bank credit institutions performing deposit and lending operations	0.7	1.0

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

Instrument	Term	Frequency	Minimum auction rate as spread to LIBOR ¹ , pp; fixed interest rate for FX swaps ² , % p.a.					Bank of Russia claims, millions of US dollars					
			As of 1.01.15	From 30.03.15	From 13.04.15	From 21.04.15	From 14.12.15	As of 1.01.15	As of 1.04.15	As of 1.01.16	As of 1.04.16	As of 1.05.16	As of 1.06.16
Repo auctions ³	1 week	weekly	0.50	1.00	1.50	2.00	2.00	209.8	1,556.1	100.1	100.0	2.1	9.3
	28 days							14,900.8	9,287.3	5,016.7	12,109.5	15,572.4	14,351.0
	12 months ⁴							4,737.3	17,035.8	15,550.0	4,346.6	279.0	173.5
Loan auctions	28 days	monthly	0.75	1.25	1.75	2.25	2.25	-	0.0	-	0.0	0.0	0.0
	365 days		0.75	1.25	2.00	2.75	3.25	-	2,526.8	1,494.7	0.0	0.0	0.0
USD/RUB sell/buy FX swaps	1 day	daily	1.50	1.50	1.50	1.50	1.50	1,600.0	0.0	0.0	0.0	0.0	0.0

¹ In respective currencies and for respective terms.

² For dollar leg; the rate for ruble leg is equal to the Bank of Russia key rate less 1 pp.

³ Credit institutions' outstanding amounts under the first leg of repos.

⁴ From 1 June through 14 December 2015 and from 1 April 2016, 12-month FX repo auctions were suspended.

Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities¹

Purpose of indirect bank lending	Maturity	Collateral	Interest rate, % p.a. ²		Bank of Russia claims on credit institutions, billions of rubles					Limit as of 1 June 2016, billions of rubles
			As of 1.01.16	From 14.06.16	As of 1.01.2015	As of 1.01.2016	As of 1.04.2016	As of 1.05.2016	As of 1.06.2016	
Non-commodity exports	Up to 3 years ³	Claims under loan agreements secured by contracts of insurance of JSC EXIAR	9.00	9.00	—	39.66	51.01	49.64	50.63	75.00
Large-scale investment projects ⁴	Up to 3 years	Claims under bank loans for investment projects secured by the government guarantees of the Russian Federation	9.00	9.00	—	53.44	74.16	83.33	87.57	100.00
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List	9.00	9.00	2.85	2.85	2.85	0.94	0.24	
Small and medium-sized enterprises	Up to 3 years ³	Claims under loan agreements of JSC SME Bank ⁵	6.50	6.50	23.26	40.10	41.24	41.81	43.73	75.00
	Up to 3 years	Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises ⁶			—	0.08	1.10	2.53	5.03	
Leasing	Up to 3 years	Claims on loans to leasing companies ⁷	9.00	9.00	—	0.00	0.00	0.00	0.00	10.00
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	10.75	10.50	—	21.01	21.01	21.01	21.63	30.00

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

² For more information on the interest rates on the Bank of Russia's specialised instruments see the section Monetary Policy on the Bank of Russia's website.

³ Until 1 June 2015, the maturity of Bank of Russia loans was one to 365 days. From 1 June 2015, the maturity of Bank of Russia loans was extended to three years.

⁴ Projects are selected in compliance with the rules established by Regulation of the Government of the Russian Federation No. 1016, dated 14 December 2010, 'On Approving the Rules to Select Investment Projects and Principals for the Provision of Government Guarantees of the Russian Federation for Loans or Bonded Loans Attracted to Implement Investment Projects' or Regulation of the Government of the Russian Federation No. 1044, dated 11 October 2014, 'On Approving the Programme to Support Investment Projects Implemented in the Russian Federation on the Basis of Project Financing'.

⁵ Claims under loans issued to banks and microfinance organisations partnering with JSC SME Bank under the Programme for Financial Support of Small and Medium-sized Enterprises Development for lending to SMEs and claims under loans issued to leasing companies partnering with JSC SME Bank for leasing property to SMEs.

⁶ The instrument was introduced in June 2015.

⁷ The instrument was introduced in December 2015.

Source: Bank of Russia.

Table 6

Consumer prices by group of goods and services
(month on previous month, %)

	Inflation	Core inflation	Food	Food ¹	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol ²	Services
2014								
January	0.6	0.4	1.0	0.5	5.8	0.3	0.3	0.5
February	0.7	0.5	1.2	0.7	5.1	0.4	0.4	0.4
March	1.0	0.8	1.8	1.3	5.3	0.7	0.6	0.5
April	0.9	0.9	1.3	1.2	2.3	0.6	0.6	0.7
May	0.9	0.9	1.5	1.3	2.4	0.5	0.5	0.8
June	0.6	0.8	0.7	1.1	-2.8	0.4	0.4	0.9
July	0.5	0.6	-0.1	1.0	-8.1	0.4	0.3	1.4
August	0.2	0.6	-0.3	0.9	-10.7	0.5	0.4	0.7
September	0.7	0.9	1.0	1.2	-1.2	0.6	0.5	0.3
October	0.8	0.8	1.2	1.0	2.8	0.6	0.6	0.6
November	1.3	1.0	2.0	1.3	8.7	0.6	0.6	1.2
December	2.6	2.6	3.3	2.2	12.9	2.3	2.5	2.2
Total for the year (December on December)	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	3.9	3.5	5.7	3.7	22.1	3.2	3.5	2.2
February	2.2	2.4	3.3	2.7	7.2	2.1	2.3	0.8
March	1.2	1.5	1.6	1.6	1.2	1.4	1.6	0.3
April	0.5	0.8	0.3	0.9	-3.7	0.9	0.9	0.0
May	0.4	0.6	0.1	0.2	-1.0	0.5	0.6	0.5
June	0.2	0.4	-0.4	0.2	-5.0	0.3	0.3	1.0
July	0.8	0.4	-0.3	0.3	-4.2	0.5	0.3	3.0
August	0.4	0.8	-0.7	0.5	-9.8	0.8	0.7	1.3
September	0.6	0.8	0.4	0.7	-2.3	1.1	1.1	0.0
October	0.7	0.7	1.0	0.8	2.9	1.0	1.1	-0.1
November	0.8	0.6	1.2	0.7	5.6	0.7	0.8	0.2
December	0.8	0.6	1.2	0.6	6.6	0.4	0.5	0.7
Total for the year (December on December)	12.9	13.7	14.0	13.6	17.4	13.7	14.5	10.2
2016								
January	1.0	0.8	1.2	0.6	6.2	0.7	0.8	1.0
February	0.6	0.7	0.7	0.5	2.3	0.8	0.9	0.3
March	0.5	0.6	0.4	0.6	-1.3	0.8	0.8	0.1
April	0.4	0.5	0.4	0.5	-0.1	0.6	0.6	0.3
May	0.4	0.5	0.4	0.3	0.6	0.4	0.4	0.5

¹ Excluding vegetables and fruit.

² Bank of Russia estimate.

Sources: Rosstat, Bank of Russia calculations.

Table 7

Consumer prices by group of goods and services
(month on corresponding month of previous year, %)

	Inflation	Core inflation	Food	Food ¹	Vegetables and fruit	Non-food goods	Non-food goods ²	Services
2014								
January	6.1	5.5	6.5	6.4	7.7	4.3	4.3	7.8
February	6.2	5.6	6.9	6.5	10.1	4.3	4.3	7.9
March	6.9	6.0	8.4	7.5	15.9	4.6	4.5	8.2
April	7.3	6.5	9.0	8.3	14.4	4.9	4.7	8.5
May	7.6	7.0	9.5	9.5	10.1	5.1	4.9	8.4
June	7.8	7.5	9.8	10.5	3.9	5.3	5.0	8.7
July	7.5	7.8	9.8	11.2	-1.5	5.6	5.2	7.0
August	7.6	8.0	10.3	11.5	-0.8	5.5	5.3	6.7
September	8.0	8.2	11.4	12.0	6.1	5.5	5.3	6.9
October	8.3	8.4	11.5	12.1	5.3	5.7	5.4	7.6
November	9.1	8.9	12.6	12.8	11.1	5.9	5.6	8.7
December	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	15.0	14.7	20.7	18.4	40.7	11.2	11.4	12.3
February	16.7	16.8	23.3	20.8	43.5	13.0	13.5	12.8
March	16.9	17.5	23.0	21.1	38.0	13.9	14.6	12.6
April	16.4	17.5	21.9	20.8	30.0	14.2	15.0	11.8
May	15.8	17.1	20.2	19.5	25.7	14.3	15.1	11.6
June	15.3	16.7	18.8	18.4	22.8	14.2	15.0	11.7
July	15.6	16.5	18.6	17.5	27.9	14.3	15.0	13.4
August	15.8	16.6	18.1	17.0	29.1	14.6	15.3	14.1
September	15.7	16.6	17.4	16.4	27.7	15.2	16.0	13.8
October	15.6	16.4	17.3	16.2	27.9	15.6	16.6	13.1
November	15.0	15.9	16.3	15.5	24.3	15.7	16.7	11.9
December	12.9	13.7	14.0	13.6	17.4	13.7	14.5	10.2
2016								
January	9.8	10.7	9.2	10.2	2.0	10.9	11.4	9.0
February	8.1	8.9	6.4	7.8	-2.7	9.5	9.9	8.5
March	7.3	8.0	5.2	6.7	-5.1	8.8	9.1	8.2
April	7.3	7.6	5.3	6.3	-1.6	8.5	8.7	8.4
May	7.3	7.5	5.6	6.4	0.0	8.4	8.5	8.4

¹ Excluding vegetables and fruit.

² Bank of Russia estimate.

Sources: Rosstat, Bank of Russia calculations.

Table 8

Macroeconomic indicators
(seasonally adjusted, growth as % of previous period)

	Industrial production ¹	Agriculture	Construction	Freight turnover	Retail trade turnover	Consumer expenditure	Output index of goods and services by key industries	GDP ²
2014								
January	0.4	1.0	0.1	0.5	0.1	-0.7	0.5	
February	1.1	0.3	-0.4	-1.8	0.7	1.3	1.3	
March	-0.2	0.1	0.2	-0.9	0.2	0.6	-0.8	-0.3
April	1.5	0.6	0.2	0.2	0.0	0.0	1.1	
May	0.2	0.3	-0.8	1.4	0.0	-0.8	-0.1	
June	-0.8	0.1	0.5	0.2	-0.1	-0.1	-0.4	0.9
July	0.3	2.2	-0.3	-2.3	0.1	0.0	-0.1	
August	-0.7	-1.8	0.0	0.2	-0.1	0.2	-0.4	
September	0.8	2.6	-1.4	0.5	0.1	0.6	-0.3	-0.4
October	0.0	-12.1	0.0	-0.8	-0.1	-0.3	-0.2	
November	-1.1	11.3	-1.4	0.2	0.0	0.5	-0.2	
December	1.7	0.8	-0.7	-0.7	2.7	1.1	0.3	-0.2
2015								
January	-3.2	0.1	-1.1	0.0	-8.5	-7.7	-1.2	
February	-0.8	0.1	-0.7	0.5	-1.4	-1.2	-1.2	
March	-0.2	0.5	-0.4	1.0	-0.4	0.3	0.3	-2.9
April	-1.4	0.0	-0.2	-1.3	-0.9	-1.5	-1.4	
May	-0.3	0.1	-1.0	-1.1	-0.4	0.1	0.1	
June	-0.2	0.1	-0.2	0.6	-0.5	-0.1	-0.7	-0.9
July	0.1	-0.6	-1.2	2.6	-0.4	0.2	0.4	
August	-0.1	1.2	-0.2	-0.9	-0.3	-0.1	-0.2	
September	0.5	0.5	0.2	0.9	-0.6	-0.8	0.8	0.2
October	0.0	-1.5	-0.6	2.2	-0.3	-0.1	-0.3	
November	-0.6	1.6	0.5	-0.9	-0.5	-0.9	-4.2	
December	0.8	0.4	0.2	-0.2	-0.2	-0.6	1.0	-0.3
2016								
January	-0.2	-0.1	-0.9	-2.1	-0.4	-0.3	0.4	
February	0.1	0.4	0.6	0.3	-0.1	0.1	0.5	
March	0.3	0.1	-0.8	-0.2	-0.7	-1.2	0.4	-0.1
April	0.0	0.2	-0.9	-0.1	-0.1	0.3	0.0	

¹ Rosstat estimate.

² Quarterly data.

Sources: Rosstat, Bank of Russia calculations.

Table 9

Macroeconomic indicators
(as % of corresponding period of previous year)

	2015	2016					Memo item: 2015
	Total	January	February	March	April	January- April	January- April
Output of goods and services by key industries	-4.1	-3.5	0.6	-0.5	-0.4	-0.9	-3.3
Industrial output	-3.4	-2.7	1.0	-0.5	0.5	-0.1	-1.5
Agricultural output	3.0	2.5	3.1	2.7	2.7	2.8	3.5
Construction	-7.0	-4.2	0.4	-1.4	-5.9	-3.3	-5.7
Retail trade turnover	-10.0	-6.0	-4.3	-5.8	-4.8	-5.2	-7.7
Household real disposable money income	-4.3	-5.5	-4.5	-1.2	-7.1	-4.7	-2.4
Real wage	-9.3	-3.6	0.6	1.5	-1.7	-0.9	-9.2
Number of unemployed	7.4	6.2	0.4	1.4	2.3	2.5	4.1
Unemployment (as % of economically active population)	5.6	5.8	5.8	6.0	5.9	5.9	5.8

Sources: Rosstat, Bank of Russia calculations.

Table 10

**Change in Bank of Russia forecasts of GDP¹
growth of Russia's trading partners (%)**
(%)

	Forecast of GDP growth in 2016, %		Memo item: country's share in aggregate GDP of trading partners
	February 2016	May 2016	
Total	2.1	2.0	100.0
1 Germany	1.4	1.3	13.67
2 Italy	1.1	0.8	8.95
3 China	6.3	6.3	8.93
4 The Netherlands	1.6	1.5	6.72
5 Turkey	2.7	3.2	6.62
6 Poland	3.3	3.7	4.92
7 Belarus	-1.0	-1.5	4.84
8 Belgium	1.1	1.1	4.50
9 Japan	1.0	0.6	4.42
10 United States	2.6	2.2	4.08
11 France	1.1	1.1	3.89
12 Korea, Republic of	2.6	2.5	3.79
13 United Kingdom	2.1	1.9	3.65
14 Kazakhstan	1.6	0.5	3.58
15 Finland	0.2	0.5	3.33
16 Switzerland	0.9	0.9	2.48
17 Latvia	2.8	2.4	2.44
18 Hungary	2.1	2.2	1.68
19 India	7.5	7.3	1.67
20 Slovakia	2.8	3.1	1.54
21 Czech Republic	2.2	2.0	1.44
22 Lithuania	2.5	2.3	1.44
23 Spain	2.5	2.5	1.42
24 Ukraine	1.4	1.3	0.00

¹ The aggregate GDP growth rate is calculated based on 24 Russia's trading partners which account for more than 1% of Russian exports on average for 5 years (from 2010 to 2014). Previously, the calculation for 2008-2012 was based on 23 countries. The share of each country was determined based on the exports to major trading partners. In this report, the aggregate GDP forecast excludes the economy of Ukraine and includes the re-exports of Russian energy commodities from the Netherlands.

Source: Bank of Russia.

Table 11

Monetary policy rates in various countries

Country	Policy rate	Current level	Date of latest change	Previous level	Change	Number of rate changes over the past 12 months	Inflation	Current level, %	12-month change, pp
Poland	target rate	1.50	4.03.2015	2.00	-0.50	0		-1.0	0
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	5		-0.2	-0.70
Czech Republic	repo rate (14 days)	0.05	1.11.2012	0.25	-0.20	0		0.6	0.10
Romania	base rate	1.75	6.05.2015	2.00	-0.25	0		-3.3	-3.90
Bulgaria	base rate	0.00	1.02.2016	0.01	-0.01	3		-2.2	-2.70
Serbia	key policy rate	4.25	11.02.2016	4.50	-0.25	5		0.4	-1.40
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	0		-0.9	-0.40
Brazil	target rate	14.25	29.07.2015	13.75	0.50	1		9.3	0.85
Chile	monetary policy rate	3.50	17.12.2015	3.25	0.25	2		4.2	0.20
	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	3		2.3	0.80
China	deposit rate (12 months)	1.50	26.10.2015	1.75	-0.25	3			
	required reserve rate	17.00	1.03.2016	17.50	-0.50	3			
	reverse repo rate	6.50	5.04.2016	6.75	-0.25	2		5.4	0.52
India	repo rate	6.00	5.04.2016	5.75	0.25	4			
Indonesia	target rate	6.75	17.03.2016	7.00	-0.25	3		3.3	-3.82
Korea, Republic of	base rate	1.50	11.06.2015	1.75	-0.25	1		0.8	0.30
Malaysia	target overnight rate	3.25	10.07.2014	3.00	0.25	0		2.1	0.30
Mexico	target rate	3.75	17.02.2016	3.25	0.50	2		2.5	-0.52
Philippines	monetary policy rate	0.00	6.06.2016	3.00	-3.00	2		1.6	0.00
Russia	repo auction rate (7 days)	11.00	3.08.2015	11.50	-0.50	2		7.3	-8.50
South Africa	repo rate	7.00	17.03.2016	6.75	0.25	4		6.2	1.70
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0		0.5	1.73
Turkey	repo rate (7 days)	7.50	24.02.2015	7.75	-0.25	0		6.6	-1.51
United States	federal funds rate (upper bound)	0.50	16.12.2015	0.25	0.25	1		1.1	1.30
Euro area	refinancing rate	0.00	10.03.2016	0.05	-0.05	1		-0.1	-0.40
United Kingdom	base rate	0.50	5.03.2009	1.00	-0.50	0		0.3	0.40
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0		-0.3	-0.90
Canada	target overnight rate	0.50	15.07.2015	0.75	-0.25	1		1.7	0.90
Australia	overnight rate	1.75	3.05.2016	2.00	-0.25	1		1.3	0.00
New Zealand	overnight rate	2.25	10.03.2016	2.50	-0.25	5		0.4	0.10
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0		-0.3	-0.70
	certificate of deposit rate	-0.65	8.01.2016	-0.75	0.10	1			
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	0		-0.4	0.80
	3m LIBOR - max	-0.25	15.01.2015	0.25	-0.50	0			
Sweden	repo rate	-0.50	11.02.2016	-0.35	-0.15	2		1.0	0.49
Norway	key deposit rate	0.50	17.03.2016	0.75	-0.25	3		3.2	1.20

Note: As of 8 June 2016, changes occurred from the compilation time of the previous Monetary Policy Report issue (17 March 2016) are put in colour.

Source: Bloomberg.

Table 12

Balance of payments of the Russian Federation¹
(billions of US dollars)

	2015					2016
	I	II	III	IV	Year	I ²
Current account	30.0	16.6	8.0	15.0	69.6	11.7
Trade balance	45.5	43.7	28.9	30.3	148.5	21.6
<i>Trade balance, YoY, %</i>	-9.9	-15.4	-36.1	-28.3	-21.7	-52.6
Exports of goods	90.2	91.4	78.8	81.1	341.5	59.3
<i>Exports of goods, YoY, %</i>	-26.7	-30.9	-37.4	-30.5	-31.4	-34.2
crude oil	22.7	25.4	21.5	20.0	89.6	14.0
<i>crude oil, YoY, %</i>	-41.5	-39.9	-46.7	-38.5	-41.8	-38.4
oil products	20.0	19.1	14.9	13.4	67.5	9.6
<i>oil products, YoY, %</i>	-27.3	-37.5	-53.1	-48.3	-41.8	-52.1
natural gas	11.4	10.4	9.4	10.6	41.8	7.9
<i>natural gas, YoY, %</i>	-35.7	-36.0	-4.5	-6.8	-24.3	-30.5
other	36.1	36.5	32.9	37.1	142.6	27.9
<i>other, YoY, %</i>	-7.5	-15.5	-24.7	-20.8	-17.5	-22.6
Imports of goods	44.7	47.7	49.8	50.8	193.0	37.8
<i>Imports of goods, YoY, %</i>	-38.4	-40.9	-38.1	-31.7	-37.4	-15.3
Balance of services	-8.3	-9.5	-12.0	-6.8	-36.6	-4.7
<i>Balance of services, YoY, %</i>	-25.1	-34.1	-35.3	-39.3	-33.8	-43.3
Exports of services	11.7	13.1	13.2	13.7	51.8	9.5
<i>Exports of services, YoY, %</i>	-22.2	-24.4	-25.9	-11.4	-21.2	-19.1
Imports of services	20.0	22.6	25.3	20.5	88.4	14.3
<i>Imports of services, YoY, %</i>	-23.4	-28.8	-30.7	-23.1	-27.0	-28.6
Compensation of employees	-1.5	-1.5	-1.1	-1.1	-5.1	-0.8
Investment income	-4.8	-14.9	-6.0	-5.9	-31.6	-3.4
Receivable	8.8	7.0	9.1	8.8	33.6	6.7
Payable	13.5	21.9	15.1	14.7	65.2	10.1
Rent	0.0	0.0	0.0	0.0	0.0	0.0
Secondary income	-1.0	-1.2	-1.9	-1.5	-5.6	-0.9
Non-tradable components	-7.2	-17.6	-8.9	-8.5	-42.3	-5.2
<i>Non-tradable components, YoY, %</i>	-47.0	-30.0	-56.5	-49.1	-44.4	-28.1
Capital account	0.0	-0.2	0.0	-0.2	-0.3	0.0
Balance of current and capital accounts	30.0	16.5	8.0	14.8	69.2	11.8
Financial account (except reserve assets)	37.5	19.4	2.6	13.0	72.6	7.5
Net incurrence of liabilities ('+' - increase, '-' - decrease)	-38.7	-11.6	-7.4	-15.7	-73.4	-11.8
Federal government, local governments, and central bank	-6.9	0.7	-1.3	1.1	-6.4	-2.5
Banks and other sectors	-31.8	-12.3	-6.1	-16.7	-67.0	-9.3
Net acquisition of financial assets, excluding reserve assets ('+' - decrease, '-' - increase)	-1.2	7.8	-4.8	-2.7	-0.8	-4.3
General government and central bank	0.2	0.7	0.1	1.6	2.6	-0.3
Banks and other sectors	-1.3	7.1	-4.9	-4.3	-3.4	-4.0
Net errors and omissions	-2.6	0.8	4.4	2.5	5.0	-1.7
Change in FX reserves ('+' - decrease, '-' - increase)	-10.1	-2.2	9.7	4.3	1.7	2.6
Net capital inflow/outflow by banks and enterprises	32.9	18.7	-3.3	9.7	58.1	7.0
Certain indicators adjusted by the amount of FX swaps between the Bank of Russia and resident banks, FX liquidity provided by the Bank of Russia to credit institutions on a reverse basis, and funds in resident banks' correspondent accounts with the Bank of Russia						
Change in FX reserve assets ('+' - decrease, '-' - increase)	-0.9	2.6	6.2	0.3	8.2	-2.7
Net capital inflow/outflow by banks and enterprises	23.7	13.9	0.3	13.7	51.6	12.4

¹ According to BPM6.² Estimate.

Source: Bank of Russia.

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GLOSSARY

Asset-backed securities (ABS)

Bonds or other securities backed by pooled assets which usually generate predictable cash flows and which are formed by banks or other credit institutions.

Averaging of required reserves

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

Banking sector liquidity

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

Bank lending conditions index

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

Bank of Russia interest rate corridor (interest rate corridor)

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

Bank of Russia key rate

Interest rate on main operations of the Bank of Russia to manage banking sector liquidity. A key indicator for the monetary policy stance. It is set by the Bank of Russia Board of Directors.

Bank of Russia Lombard List

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

Basis point

One hundredth of a percentage point.

Broad money (monetary aggregate M2X)

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

Butterfly

An option position including options with the same maturity, whose quotation is calculated according to the formula: $BF = (CALL + PUT - 2 \cdot ATM) / 2$, where CALL and PUT are implied volatility values for call and put options with the respective deltas, and ATM is an implied volatility value for at-the-money option. This quotation means that the implied distribution of expectations of future exchange rate fluctuations has fatter tails relative to the risk neutral measure.

Carry trade

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

CBOE crude oil volatility index

The Chicago Board Options Exchange (CBOE) index calculated by applying the VIX methodology and reflecting the market's expectations of 30-day volatility of crude oil prices.

CDS spread

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

Consumer price index (CPI)

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

Core inflation

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

Countercyclical currency

A currency which normally faces appreciation in periods of instability in global markets and/or recession in the global economy. Specifically, this type of currencies includes the US dollar, Japanese yen, and Swiss franc.

Covered bonds

Bonds secured by payments on mortgage loans or government debt obligations. The difference between covered bonds and asset backed securities lies in the fact that covered bonds remain on the issuer's balance sheet after the issue, therefore making the issuer liable for the credit risk on the assets which back the bonds.

Credit default swap (CDS)

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

Cross-currency basis swap

Currency interest rate swap which implies an exchange of nominal values and interest payments in different currencies. The price of this swap reflects the premium to one of the floating rates.

Current liquidity deficit

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

Dollarisation of deposits

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

Dual-currency basket

Ruble exchange rate index calculated as the sum of 0.55 US dollars and 0.45 euros in rubles.

Factors of banking sector liquidity

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

Fiscal stress index

Conceptual approach developed by IMF experts proposes an aggregate index which provides early warning signals of risks. The index is calculated on the basis of the study of the signals produced by three complementary sets of variables: basic fiscal variables, long-term fiscal trends, and asset and liability management (the total of 12 variables). Thresholds are calculated for all variables. By exceeding its threshold, the variable signals an upcoming crisis in the following year. Besides, each variable is assigned signaling power which shows its weight in the fiscal stress index. For more information on the approach see Baldacci E., McHugh J., Petrova I. *Measuring Fiscal Vulnerability and Fiscal Stress: A Proposed Set of Indicators*. IMF Working Paper, No. 94, 2011 and Baldacci E., Petrova I., Belhocine N., Dobrescu G., Mazraani S. *Assessing Fiscal Stress*. IMF Working Paper, No. 100, 2011.

Floating exchange rate regime

According to the IMF classification, under the floating exchange rate regime the central bank does not set targets, including operational ones, for the level of, or changes to, the exchange rate, allowing it to be shaped under the impact of market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to influence the domestic FX market occasionally to smooth out the ruble's exchange rate volatility and prevent its excessive deviations.

Floating interest rate on Bank of Russia operations

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

Foreign exchange swap

A deal which consists of two legs: one party of the deal initially exchanges a certain amount in domestic or foreign currency for an equivalent amount in another currency provided by the second party of the deal. Then, once the deal term has expired, the parties make a reverse transaction (in the corresponding volumes) at a predetermined rate. Foreign exchange swaps are used by the Bank of Russia to provide credit institutions with refinancing in rubles and foreign currency (US dollars).

Forward rate agreement (FRA)

A forward interest rate agreement on a certain future obligation, according to which the parties are bound, as of the effective date, to compensate for the differences in the amount of interest payments calculated on the basis of the agreed and actual rates and the agreed nominal value.

Funds in general government's accounts

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

Generalised (composite) consumer confidence index

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

Gross credit of the Bank of Russia

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

Implied volatility

A measure of exchange rate volatility that reflects current market prices of FX options under Black-Scholes model (as a rule, at-the-money).

Inflation-neutral output

Total output in economy which may be produced and allocated without setting grounds for changing the price growth rate. Besides, the volume of inflation-neutral output is not linked to any specific level of inflation, it only signals the existence/absence of conditions for its acceleration/deceleration.

Inflation targeting regime

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

Interest rate corridor

See Bank of Russia interest rate corridor.

Macro risk index

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

Managed floating exchange rate regime

Under the managed floating exchange rate regime the central bank does not interfere in the trends of ruble dynamics which are shaped by fundamental macroeconomic factors. No fixed limits or targets are set for the ruble rate, with the central bank seeking to smooth out exchange rate fluctuations in order to support economic agents' gradual adaptation to changes in external economic environment.

MICEX index

Composite index of the Russian stock market calculated by CJSC MICEX Stock Exchange (hereinafter, the Exchange) based on the ruble prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

MSCI indices

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

Monetary aggregate M1

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

Monetary policy stance

The characteristics of a monetary policy's impact on the economy. Tight stance suggests the restraining effect of the monetary policy on economic activity in order to reduce inflationary pressures, whereas a loose monetary policy stance implies economic stimulation with possible upward pressure on inflation.

Monetary policy transmission mechanism

The process of transferring the impulse of monetary policy decisions (i.e. decisions made by a central bank in relation to changes to interest rates on its operations) to the economy as a whole and to price dynamics, in particular. The most important channel of monetary policy transmission is the interest rate channel. The impact of the latter is based on the influence of a central bank policy on changes to the interest rates at which economic agents may deposit and raise funds, and, as a result, on decisions regarding consumption, saving and investment and, thereby, on the aggregate demand, economic activity and inflation.

Money supply

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

Money supply in the national definition (monetary aggregate M2)

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

Net credit of the Bank of Russia to credit institutions

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

Net private capital inflow/outflow

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

Nominal effective ruble exchange rate index

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

Non-marketable assets eligible as collateral for Bank of Russia loans

Promissory notes and credit claims eligible as collateral for Bank of Russia loans in accordance with Bank of Russia Regulation No. 312-P, dated 12 November 2007, 'On the Procedure for Extending Bank of Russia Loans Secured with Assets or Guarantees to Credit Institutions'.

Non-price bank lending conditions

Bank lending conditions aside from the cost of a loan to the borrower, such as maximum loan amount and lending term, requirements for collateral and the financial standing of the borrower.

Non-tradable sector of the economy

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

Open market operations

Operations carried out on the initiative of a central bank. They include auction-based refinancing and liquidity-absorbing operations (repo auctions, deposit auctions, etc.), as well as purchases and sales of financial assets (government securities, foreign currency, and gold).

Output gap

Deviation of GDP from potential output, expressed as a percentage. Characterises the balance between demand and supply and may be regarded as an aggregate indicator of the effect which the demand factors have on inflation. If the actual output is larger than the potential output (positive output gap), all else equal, inflation is expected to accelerate. A negative output gap is an indicator of an expected slowdown in price growth. Output fluctuations around the potential level are called cyclical fluctuations.

Outstanding amount on Bank of Russia refinancing operations

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

Overnight index swap (OIS)

An interest rate swap where fixed-rate payments are swapped for floating-rate payments set on the basis of overnight money market rates over a respective period of time.

PMI indices

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

Procyclical currency

A currency which normally appreciates in periods of global economic growth. Specifically, this category of currencies includes the euro, the Canadian dollar, and the Australian dollar.

Realised volatility

Exchange rate volatility measure calculated on the basis of historical data taken for a given period of time. As a rule, a mean-square deviation of daily logarithmic returns of the exchange rate is assumed to be its realised volatility.

Relative prices

A ratio between CPI subindex and CPI.

Repo operation

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

Required reserves

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

RGBEY index

RGBEY (Russian Government Bond Effective Yield to Redemption) index reflects an effective yield to redemption of Russian government bonds calculated as an average gross yield to redemption without accounting for bond issue duration.

Risk-neutral measure

A theoretical measure of probability derived from the assumption that the current value of an option is equal to the mathematical expectation of its future payoff discounted at the risk-free rate.

Risk premium on market securities portfolio

Calculated in accordance with the capital asset pricing model as the difference between the yield of a market securities portfolio and the yield of a risk-free asset. The yield of a risk-free asset is, as a rule, taken to be the yield of government securities (for example, OFZ – federal government bonds). Measured in percentage points (pp).

Risk reversal

An option position, whose quotation is calculated as a difference between implied volatility values for call and put options with the respective deltas and same maturities (an option delta is roughly equal to the market participants' estimate of at-the-money option probability). This quotation reflects an asymmetric distribution of expectations of future exchange rate fluctuations relative to the risk-neutral measure.

RTS index

Composite index of the Russian stock market calculated by the Exchange based on the US dollar prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

Ruble real effective exchange rate index

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

Shadow banking sector

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

Standing facilities

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

Structural liquidity deficit

The state of the banking sector characterised by a stable demand by credit institutions for Bank of Russia liquidity provision operations. The reverse situation, characterised by a stable demand by credit institutions to deposit funds with the Bank of Russia, is a structural liquidity surplus. A calculated level of structural liquidity deficit/surplus is a difference between amounts outstanding on Bank of Russia refinancing and liquidity-absorbing operations.

Structural non-oil and gas primary budget deficit

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

Terms of foreign trade

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

Tradable sector of economy

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

Underlying inflation

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

US dollar index (DXY)

The DXY is a weighted geometric mean of the US dollar's value relative to a basket of six foreign currencies (EUR, JPY, GBP, CAD, SEK, CHF).

VIX

Index of expected volatility of S&P 500 stock index calculated by Chicago Board Options Exchange over the next 30-day period. VIX measures implied volatility by averaging the weighted premiums of a wide range of prices of put and call options on the S&P 500.

ABBREVIATIONS

AHML – Agency for Housing Mortgage Lending

BLC — bank lending conditions

bp – basis points (0.01 pp)

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

Cbonds-Muni —municipal bond index calculated by Cbonds

CCPI — core consumer price index

CIS — Commonwealth of Independent States

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 Organisation of the United Nations

FCS – Federal Customs Service

Fed — US Federal Reserve System

FPG — fiscal policy guidelines

GDP — gross domestic product

GFCF — gross fixed capital formation

IBL — interbank loans

IEA – International Energy Agency

IFX-Cbonds — corporate bond index

Industrial PPI – Industrial Producer Price Index

inFOM – Institute of the Public Opinion Foundation institute

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)

MICEX SE — MICEX Stock Exchange

MPD — Monetary Policy Department of the Bank of Russia

MTVECM, TVECM — Momentum Threshold Vector Error Correction Model, Threshold Vector Error Correction Mode

NPF — non-governmental pension fund

OFZ — federal government bonds

OFZ-IN — federal government bonds with inflation-indexed nominal value

OFZ-PD — permanent coupon-income federal government bonds

OFZ-PK — variable coupon-income federal government bonds

OJSC — open joint-stock company

OPEC — Organisation of the Petroleum Exporting Countries

PJSC — public joint-stock company

PMI — Purchasing Managers' Index

PPI — Producer Price Index

QPM — quarterly projection model of the Bank of Russia

REB — Russian Economic Barometer, monthly release

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 on the Russian interbank bond market, calculated by Cbonds)

SMB — small and medium-sized businesses

SNA — System of National Accounts

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

USA — United States of America

VCIOM — Russian Public Opinion Research Centre

VEB — Vnesheconombank

VECM — Vector Error Correction Model

