Bank of Russia
The Central Bank of the Russian Federation

No. 3
September 2015

Information and Analytical Review

MONETARY POLICY REPORT

Moscow

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2. Which subjects, in your opinion, should be illustrated in this report?

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4. What is your professional field of interest?

Many thanks in advance for your assistance.

The report has been prepared on the basis of data as of 4 September 2015.
Data cut-off date for forecast calculations is 4 September 2015.

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Contents

Summary

In July – early September 2015, external economic conditions worsened again despite a slight pick-up in March-June 2015. Slower economic growth and stock market slump in China aroused concerns over the global demand for commodities, pushing their prices down. Persistent excess supply in the oil market exerted additional pressure on prices. Developments in the Chinese economy and the expected normalisation of the US Fed's monetary policy triggered investors' higher risk aversion and slower capital inflow to emerging markets.

These developments pose risks to growth outlook of both the global and Russian economy. Given the situation, the Bank of Russia revised the oil price downwards in all the scenarios of its macroeconomic development forecast. Meanwhile, sanctions restricting the Russian companies' access to external funding and high-tech products imports for investment purposes are expected to remain in place over the entire forecast horizon.

Although key macroeconomic indicators came to a halt in July, the GDP growth in 2015 will be lower than expected due to the oil price fall. The Bank of Russia estimates GDP to contract by 3.9-4.4% in 2015. The baseline scenario suggests no improvement in the external conditions in the years to come. In 2016-2018, oil prices will stay at about $50 per barrel. Demand for Russian exports will show a moderate growth. Foreign trade income will contract and producer costs will rise under unfavourable external trade environment. Domestic sources of economic growth will also be limited amid the likely negative business sentiment and expectations impacting the propensity to invest in the Russian economy. The ongoing structural constraints, including those related to unfavourable demographic trends and low mobility of labour resources, will also contain the Russian economic growth.

The baseline scenario provides for a further decline in fixed capital investment in 2016 against the backdrop of high economic uncertainty, relatively tough lending conditions and limited external funding substitution potential. However, investment activity is expected to recover as corporate debt burden decreases, internal financial conditions ease and international funding sources diversify. Fixed capital investment growth will become positive in 2017. A small rise in nominal wages and consumer lending, as well as households' propensity to save will result in a more protracted consumer demand shrinkage giving way to its growth only in 2018. According to the Bank of Russia forecast, GDP will fall by 0.5-1.0% in 2016 and the economic growth rates are expected to be 0.0-1.0% in 2017 and 2.0-3.0% in 2018.

Slack domestic demand will facilitate inflation reduction in 2015-2017. However, its disinflationary influence will be limited due to the recession being partly of a structural nature. Therefore, given the ruble depreciation in July-August 2015 and the elevated inflation expectations, consumer price growth in 2015 will be higher than expected – 12.0-13.0%. In early 2016, the annual inflation is still expected to decline considerably due to the high base of 2015. Against the backdrop of slower consumer price growth, inflation expectations are anticipated to resume moving downwards. The Bank of Russia forecasts inflation to slide to 5.5-6.5% in late 2016 to reach the 4% target in 2017.

Due to the higher inflation risks amid persistent risks of considerable economy cooling, the Bank of Russia decided to limit its key rate reduction to 50 basis points in July and cut it to 11.00% p.a., in September the Bank of Russia stopped monetary policy easing and left the key rate unchanged. As inflation slows in 2016-2018 in line with the forecast, the Bank of Russia will gradually revise the key rate downwards.

The Bank of Russia's optimistic scenario suggests that the oil price will go up to $70-80 per barrel in 2018. This will trigger a faster economic recovery, inflation slowdown and a possibility to pursue an easier monetary policy than the baseline scenario provides for. Under the risk scenario, the oil price is expected to fall below $40 per barrel as its supply in the market will considerably surpass the demand. Against

this background, the recession will be longer and deeper than in the baseline and optimistic scenarios. At the same time, economic activity cooling will be mostly of a structural nature. Considering this and taking account of significant inflation risks in this scenario, the Bank of Russia will have to pursue tougher monetary policy than assumed in the other scenarios.

All the three scenarios envisage that the Bank of Russia will continue FX refinancing operations to ensure a smooth functioning of the banking sector and the financial market amid restricted access to international capital markets for Russian companies. However, depending on the scenario and credit institutions' and companies' adjustment to the restrictions imposed and their reorientation to other funding sources, the funding volumes under these transactions can be either increased or curtailed. Moreover, provided that the situation in the domestic FX market is favourable, the Bank of Russia will resume foreign currency purchases in the domestic FX market, suspended in late July 2015, to replenish the international reserves.

The situation in the Russian economy in the years to come will largely depend on its ability to adapt to adverse external conditions. The country's economic potential can be enhanced only through extensive structural changes connected with redistribution of production resources from less competitive industries to more competitive ones. This process should be facilitated by the real ruble exchange rate and government policy measures aimed at improving business climate and ensuring higher quality of labour resources and productivity growth.

1. MACROECONOMIC CONDITIONS

I.1 External economic and financial conditions

In June-August 2015, external conditions significantly deteriorated. The volatility of global financial and commodity markets increased considerably and oil prices started to fall again at a rate markedly higher than the Bank of Russia's forecasts. The significant correction in the stock market in China coupled with the renminbi depreciation and exchange rate changes led to a fall in demand for risky assets in the global financial markets, which had a negative impact on currency exchange rates and asset prices in emerging market economies. Finally, a change in investor expectations regarding the timing and pace of the increase in the Fed's interest rate contributed to continuing heightened volatility. Consequently, the country risk premium was substantially higher than forecast by the Bank of Russia and the real effective exchange rate of the ruble was significantly weaker than the equilibrium level, according to Bank of Russia estimates.

Instability in the financial and commodity markets has not yet managed to affect the real sector of the global economy. GDP growth in Russia's main trading partners continues to be weak, however, the prerequisites are still in place for its increase, above all as a result of the improved economic situation in developed countries. The fall in commodity and food prices is helping to reduce inflationary pressure, intensifying the prerequisites for the majority of global central banks to continue the comparatively eased monetary policy. However, the situation in the global financial markets (in particular in China) is increasing the risk of a slowdown in economic growth globally, especially in emerging economies.

Despite the fact that international organisations' forecasts and consensus surveys of analysts and market participants still suggest that the deterioration in external conditions is temporary and oil prices are expected to rally and global economic growth – to accelerate in the medium term, the situation will remain strained over the coming quarters.

In view of recent events, the Bank of Russia has revised its oil price forecast and is expecting lower prices compared with the scenarios published in the previous Monetary Policy Report (hereinafter, the Report), both over the coming quarters and in the medium term. This factor will have an adverse effect on the economy, offsetting the impact of the ongoing recovery in external demand. Furthermore, the risk that instability in the global financial markets will have a negative impact on economic growth in Russia's trading partners is increasing.

Economic activity and inflation abroad

In June-August, the situation in developed economies continued to improve. US GDP increased in Q2 and data for Q1 was revised upwards. The UK economy also accelerated in Q2. The euro area's economy continued to show signs of recovery thanks to the ECB's quantitative easing programme, although Q2 growth was slightly below forecast levels[1].

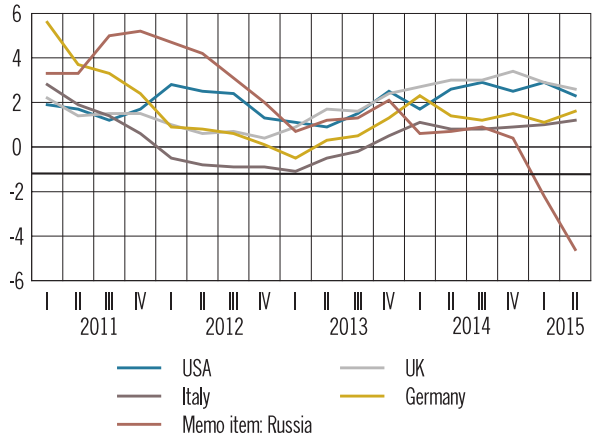
As assumed in the scenarios published in the previous Report, after a temporary slowdown in 2015 Q1, US GDP growth accelerated in Q2, with the GDP growth figure for Q1 this year being revised up into positive territory. The recovery in the US economy is still based on steady growth in consumer spending. The continuation of accommodative policy by the ECB and the euro exchange rate remaining low allowed the euro area's economy to maintain high quarterly growth, and year-on-year growth in 2015 Q2 continued to accelerate. However, out of all the main economies in the euro area, only Germany managed to increase its growth rate, while in France and Italy economic growth slowed. The slowdown in growth

[1] *Here and throughout Section 1.1, seasonally-adjusted growth indicators are given relative to the previous period, unless indicated otherwise.*

Chart 1.1.1

GDP growth rates of Russia's trading partners: developed economies

(as % of corresponding period of previous year)

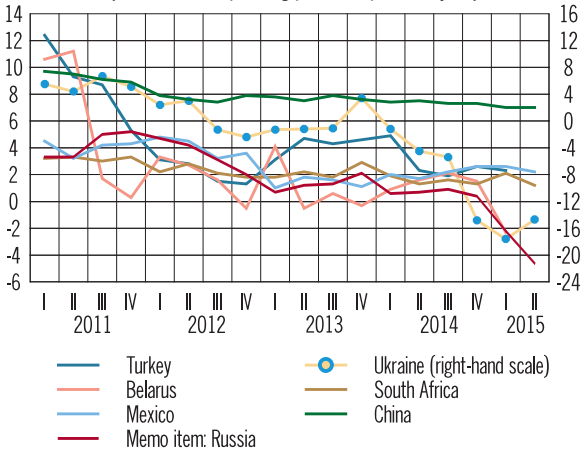


Sources: national statistics agencies, Eurostat.

Chart 1.1.2

GDP growth rates of Russia's trading partners: emerging economies

(as % of corresponding period of previous year)



Sources: national statistics agencies.

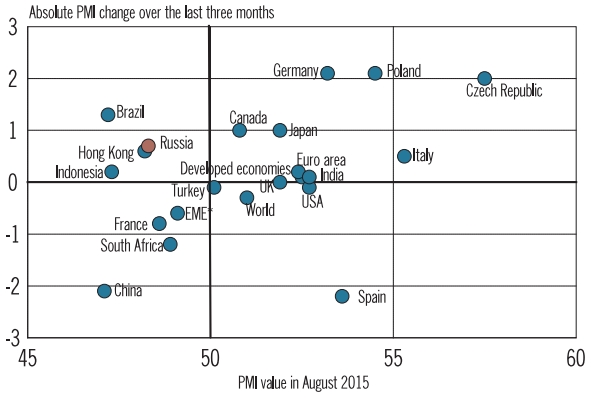
in a number of European countries in Q2 was linked to both the cooling of the Chinese economy, one of the euro area's key trading partners, and the influence of the debt crisis in Greece.

In the second half of 2015, the current economic growth rates are expected to continue or increase slightly in developed countries. Among other things, short-term leading indicators (PMI) suggest that this will be the case, in particular in Germany, France, the US and Japan (Chart 1.1.3). US PMI slowed in July and August, but the index remains above the critical value, pointing to a rise in economic activity. PMI in August remained high in Germany and in the euro area as a whole (although it fell in France), and was also high in Japan. The ongoing easy monetary policy in the euro area and Japan and the relatively smooth path with which monetary policy is normalising in the US and UK will contribute to sustained high rates of growth. The heightened volatility in the global financial markets has not yet had any negative effect on economic growth in developed countries.

Economic growth in the majority of emerging market economies continued to slow in 2015 Q2 (despite the stimulus measures adopted by the central banks in these countries), primarily as a result of the slowdown in the Chinese economy. China's annual GDP in Q2 remained at Q1 levels, but data for July pointed to a slowdown in industrial production and a fall in exports. Furthermore, total lending to the economy (including the shadow banking sector) shrank by almost twofold in July

Chart 1.1.3

Changes in business indicators



Note: PMI indices in manufacturing industries, and PMI of HSBC in China. Data for the world as a whole are calculated by J.P. Morgan based on the data for the USA, Japan, Germany, Spain, Italy, France, BRICS nations, Australia, Mexico, etc.
Sources: Bloomberg, Bank of Russia calculations.

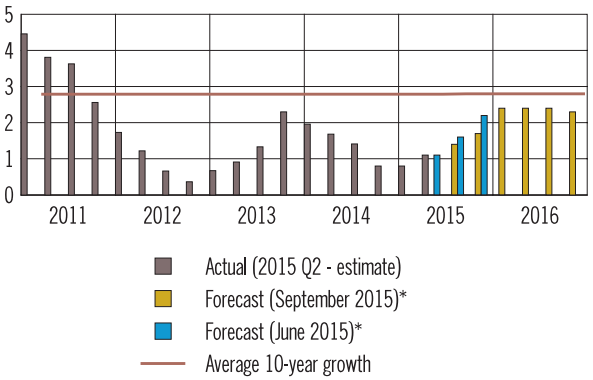
compared with June. In response to the slowing economic growth and the stock market slump, Chinese authorities adopted a number of measures to support the economy. The National Bank of China has reduced interest rates and the reserve ratio. In response to falling exports, the decision was made to depreciate the renminbi and widen the corridor of permitted fluctuations in the national currency's exchange rate.

The problems in the Chinese economy led to a slowdown in other Asian economies (excluding India), and deteriorating expectations regarding Chinese economic growth negatively affected the economies of natural resources exporters (including Brazil and Indonesia) through a decline in raw

Chart 1.1.4

Aggregate GDP of Russia's trading partners

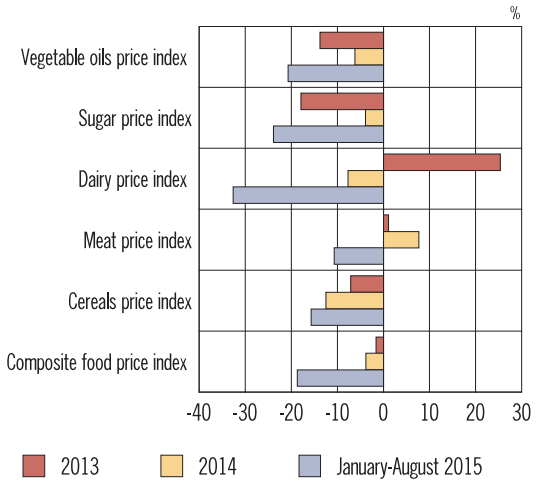
(as % of corresponding period of previous year)



** Bank of Russia forecasts based on forecasts by the IMF, World Bank, OECD, European Commission, Asian Development Bank, national central banks, and consensus forecasts by Consensus Economics, Bloomberg, and Thomson Reuters.*
Sources: national statistics agencies, Eurostat, Bank of Russia calculations and forecasts.

Chart 1.1.5

Global food prices



Source: Food and Agriculture Organisation of the United Nations (FAO).

material prices. Moreover, fears over the Chinese economy along with the expected normalisation of US monetary policy intensified risk-aversion among investors and led to capital outflow from emerging markets as a whole.

In the second half of 2015, the current low (compared with aggregate historical values) economic growth rates are expected to continue. There may even be a further slowdown in growth in many emerging markets. Short-term leading indicators point to a further reduction in economic activity in the majority of emerging markets in 2015 Q3-Q4. In particular, in August the Chinese Manufacturing PMI indicated a reduction in business activity for the sixth consecutive month (the index value itself dropped to 47 points). Among the largest emerging economies, India was the only one to see its Manufacturing PMI above the critical 50 point value. In Brazil, Indonesia and South Africa, business activity continues to fall, in part due to low prices for export goods.

The aggregate GDP growth of Russia's trading partners[2] rose slightly in Q2 compared with 2014 Q4-2015 Q1 (Chart 1.1.4) due to accelerating growth in developed countries (which is largely in line with the Bank of Russia's forecast in the previous Report), but remained low compared with historical values. Economic growth rates in the CIS countries (especially in Ukraine), which were lower in 2015 Q2 than expected by the Bank of Russia, had the largest constraining effect on the indicator dynamics. However, Ukraine's share of Russian foreign trade is shrinking, meaning that this negative effect will grow weaker in future.

The Bank of Russia expects economic growth in Russia's trading partners to gradually increase over the coming quarters. This increase in aggregate GDP growth will be down to higher indicators in developed economies (especially in the euro area). At the same time, aggregate GDP growth will continue to be low compared with historical values: the forecast aggregate output growth in 2015 was lowered slightly (due to the economic recovery in Ukraine starting later than previously assumed) and is still below aggregate GDP growth for 2014. The main risks are linked to the possible deterioration of the situation in China and the corresponding negative impact on Russia's trading partners' growth and commodity market prices. The direct effect of a recovery in Russia's trading partners' GDP on the Russian economy will be limited; instead raw material prices will play a decisive role.

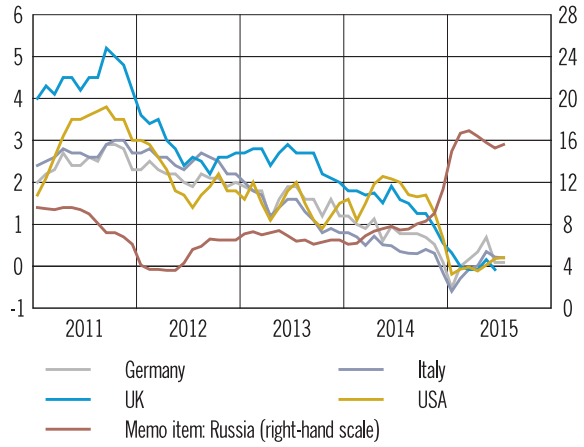
Weak demand kept prices low in the global commodity markets. In June-August 2015, global food prices continued to fall amid excess supply, high levels of reserves, increasing fears over slowing economic growth in China and low fuel costs. The UN Food and Agriculture Organisation's (FAO) food price index for this period fell by 6.9%

[2] *The aggregate GDP growth across the 23 foreign countries – trading partners which account for the largest share of Russian exports (countries whose share of Russian exports in 2008-2012 was at least 0.9% annually; the share of each country is determined based on the structure of goods exported to the main trading-partner countries). See Table 10 in the Annex.*

Chart 1.1.6

Inflation in Russia's trading partners: developed economies

(as % of corresponding period of previous year)

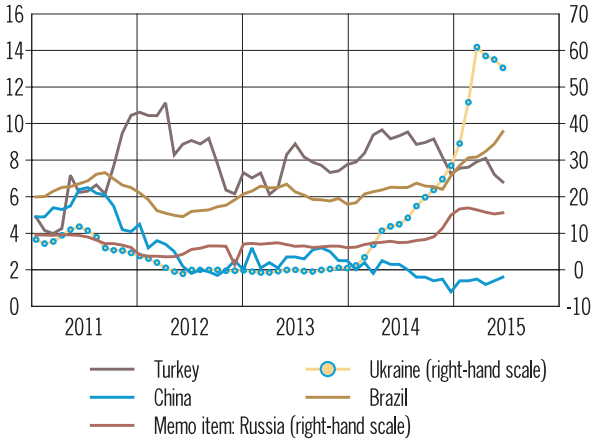


Sources: national statistics agencies, Eurostat.

Chart 1.1.7

Inflation in Russia's trading partners: emerging economies

(as % of corresponding period of previous year)



Sources: national statistics agencies.

to a six-year low. Prices for dairy products suffered the greatest loss. However, compared with March-May 2015, in June-July 2015 the fall in global food prices slowed and a further substantial reduction is unlikely. The significant drop in prices forecast by international organisations for this year has already taken place (Chart 1.1.5).

Over the coming quarters, the high level of reserves and low oil prices will continue to force prices downwards. However, amid the slight revival in global economic growth and the revision of harvest and grain consumption forecasts, the fall in global food prices is highly likely to stabilise or at least slow further.

With low global food prices and the sharp drop in energy prices, inflation continues to be low in the majority of countries around the world compared with historical averages. After a slight acceleration in May, price growth in the majority of developed countries stabilised in June-July and annual inflation remained close to zero. Moderate price growth was seen in Germany, France, Italy, and in the euro area as a whole, as well as in Japan as a result of the ongoing quantitative easing measures adopted by the central banks of these countries. Moreover, after five months of negative or near-zero price growth in the US, in June-July inflation accelerated slightly (Chart 1.1.6). Falling oil prices and low economic growth will help keep consumer prices low or slightly increase them in developed countries over the coming quarters despite the stimulus measures adopted by a number of central banks in developed countries.

In June-July, inflation in emerging market economies remained at March-May levels or slowed slightly. The fall in energy prices led to a reduction in inflationary pressure for the majority of EMEs. Inflation remained low in China and is still low in the Czech Republic and Hungary. Poland continues to see deflation. However, in some regions (primarily the CIS and Latin America) consumer price growth accelerated, largely down to the depreciation of national currencies amid the deterioration in trading conditions and strengthening of the US dollar. Inflation in Ukraine continues to exceed 55%, and Brazil, Turkey and Belarus are witnessing significant price growth (Chart 1.1.7). However, over the coming quarters, the external inflationary pressure from the CIS will abate as the effect of falling national currency exchange rates gradually comes to an end and weak internal demand contributes to a slowdown in inflation.

The continued accelerating inflation in the CIS in Q2 caused higher aggregate price growth in Russia's trading partners compared with headline inflation levels globally. Year-on-year, according to the Bank of Russia's forecasts, price growth in 2015 will be higher than predicted in the previous Report and will cause aggregate inflation indicators to exceed the levels witnessed the year before. However, in the majority of developed countries and a number of EMEs, the fall in prices for oil and industrial metals will have a stronger impact on inflation than the acceleration in economic growth, causing inflation indicators in these countries to remain at current low levels or to increase slightly.

Consequently, amid continuing low inflation in Russia's trading partners and low global food prices, the external inflationary pressure may even intensify slightly over the coming quarters, but will continue to be weak compared with historical averages. At the same time, the ruble depreciation in June-August and the ban on imports of a number of foodstuffs will limit the positive effect of the low external inflation on domestic prices (see Section 1.3 for more details).

External financial conditions

Amid the low inflationary pressure and global economic growth, key banks around the world are on the whole continuing to implement an easy monetary policy. The European Central Bank and Bank of Japan are continuing their asset purchase programmes. Expectations of a faster increase in the US Fed's key rate increased in June-July, but were again adjusted in August amid growing instability in global financial markets and the fall in oil prices. In the first half of 2015 Q3, the majority of analysts expected two interest rate hikes before the end of the year, but by the end of August these assessments had shifted in favour of one increase in October-December 2015.

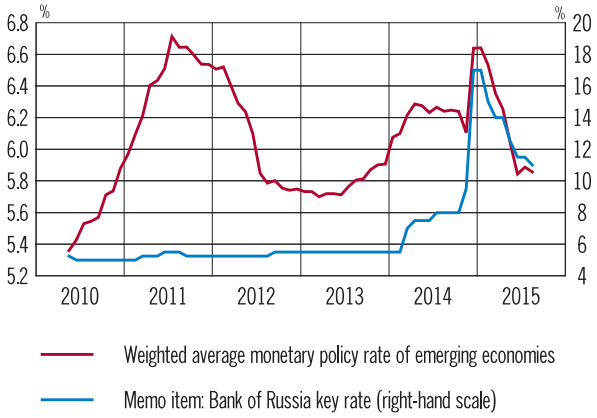
In turn, the slowdown in the Chinese economy and the new wave of sales in the stock market caused a further ease of the People's Bank of China's policy. Rates were also reduced in June-August by other central banks in developed countries and EMEs: Hungary, Canada, South Korea, New Zealand, Norway, Serbia, Sweden and South Africa (Chart 1.1.8). The exception was Brazil, where the key interest rate was raised to curb the high rates of inflation caused by the fall in raw material prices and the depreciation of the Brazilian real's exchange rate.

Loose monetary policy and slowing inflation in developed countries contributed to a reduction in government bond yields in July-August compared with Q2 (Chart 1.1.9). Another factor was the growing demand from international investors for reliable assets which started at the end of July amid the sell-off in the stock market. Furthermore, the settlement of another round of the Greek debt crisis was a reason for the fall in bond yields in Europe.

However, the fall in rates in developed countries' markets did not contribute to increased capital

Chart 1.1.8

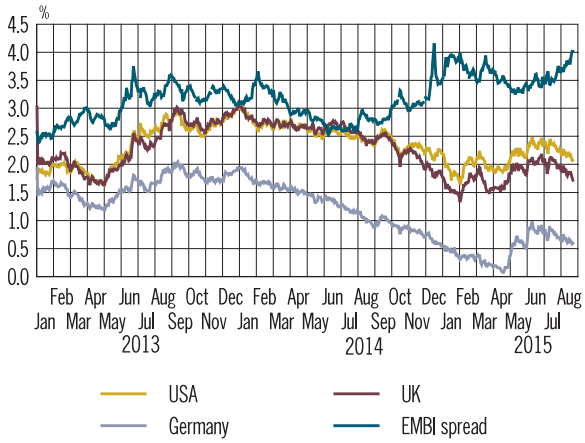
Weighted average monetary policy rate of emerging economies*



** Values of central bank assets were used as weights to calculate the average rate. August data: as of 20 August 2015.*
Sources: Bloomberg, IMF, central banks, Bank of Russia calculations.

Chart 1.1.9

10-year developed economies' government bond yields and emerging markets bond index (EMBI) spread

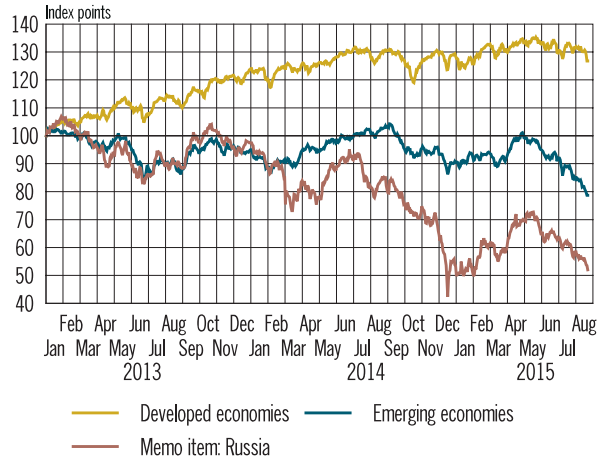


Source: Bloomberg.

inflow into EMEs. On the contrary, July-August saw an outflow from emerging markets due to the slowdown in the Chinese economy, the collapse of the Chinese stock market and growth in investor demand for reliable assets in the US and the euro area. Global stock indices fell in June-August (Chart 1.1.10) primarily due to declines in EMEs' stock indices. Indicators of global investors' risk appetite rose significantly. The first stage of growth was observed at the start of July, during a period when expectations of a Greek exit from the euro area were intensifying. After reaching an agreement on the Greek debt, global market volatility started to fall, but rose again sharply in the second half of August after the decline in the Chinese stock market began to accelerate. Another factor that added to

Chart 1.1.10

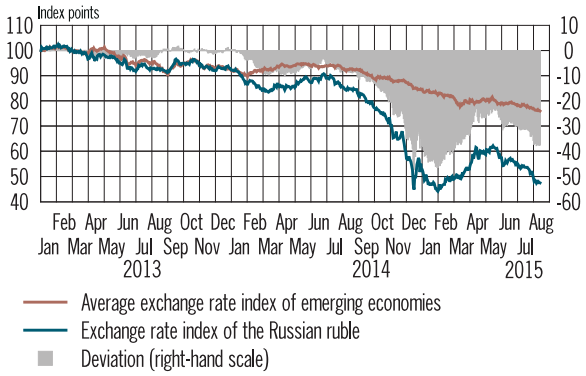
Global stock indices MSCI
(1.01.2013 = 100)



Source: Bloomberg.

Chart 1.1.12

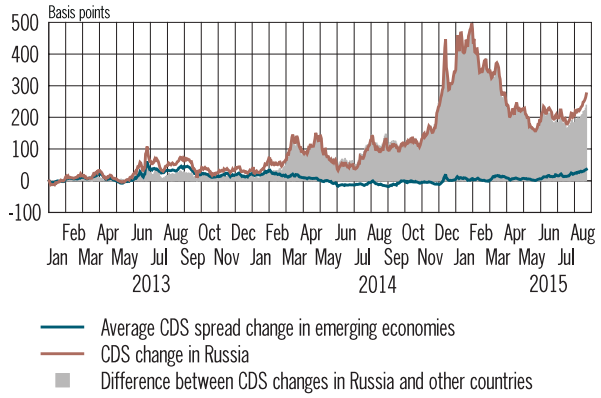
Exchange rate indices against the US dollar*
(1.01.2013 = 100)



** Average exchange rate index of emerging economies is a geometric average of the exchange rates of Hungarian forint, Brazilian real, Turkish lira, Mexican peso, Polish zloty, Romanian leu, Malaysian ringgit, Philippine peso, Indonesian rupiah, and Indian rupee against the US dollar.*
Sources: Bloomberg, Bank of Russia calculations.

Chart 1.1.11

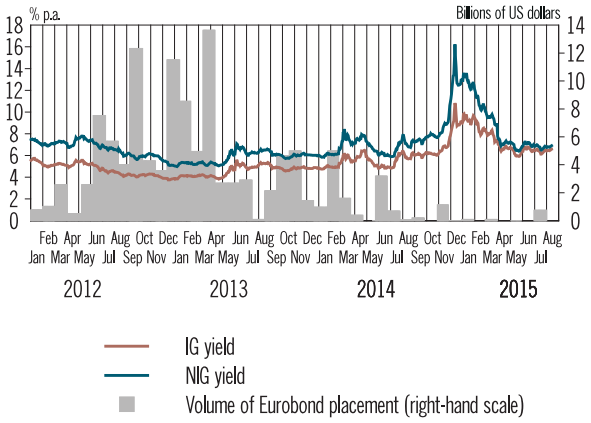
Change of risk premium in Russia and emerging economies* from 1 January 2013



** 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 1.1.13

Effective yield and volume of placement of Russian corporate Eurobonds*



** IG and NIG yield and duration are calculated on the basis of indexed portfolio of Eurobonds with investment-grade and non-investment grade speculative ratings respectively.*
Source: Cbonds.ru news agency.

the capital outflow from exporting nations was low global commodity market prices, in particular for oil.

As a result, the capital outflow from funds investing in Russia was roughly $2.2 billion in June-August. Premiums on Russian 5-year CDS and Russian-issued Eurobond yields remained stable from June to August, but started to increase rapidly from the second half of August 2015 amid the sharp drop in oil prices and the overall decline in investor interest in EME assets. As a result, CDS premiums and Russian-issued Eurobond yields returned to April 2015 levels (Charts 1.1.11, 1.1.13), far exceeding the Bank of Russia's forecasts.

Amid the growth in risk premiums and low investor demand for EME assets, and the ongoing impact of the financial sanctions, external capital markets remained essentially closed to Russian borrowers: the amount of Eurobond placements and loans taken out in June-August was near zero (Chart 1.1.13). Furthermore, net private sector capital outflow continued, mainly due to the forced settlement of liabilities to non-residents by banks and companies amid the Western sanctions against the Russian financial sector.

Volatility in the bond market is likely to continue, because a number of important decisions are expected from monetary authorities in the US and UK in 2015 Q3-Q4. Moreover, market participants' behaviour may be affected by the publication of euro zone statistics showing the effectiveness of

the ECB's policy to combat deflation. High levels of uncertainty still remain regarding the economic situation in China. The Bank of Russia expects yields on long-term instruments to remain roughly at current levels or even fall slightly amid increased demand for risk-free assets and low inflation expectations.

With falling oil prices and growing country risk premiums, the ruble real exchange rate dropped by 6.5% in June and by 2.6% in July (after growth of 2.1% in May). According to the Bank of Russia's preliminary estimates, in August the ruble real effective exchange rate fell by more than 11%. However, according to Bank of Russia estimates, the actual real exchange rate was significantly lower than the equilibrium value: in August the difference was roughly 10%.

The ruble depreciated against the US dollar much more than EME currencies on average. The growth in CDS premiums for Russian assets was also higher. The gap between the ruble exchange rate and the average exchange rate of EME currencies is expected to remain at current levels if there are no significant fluctuations in the commodity markets. CDS premium forecasts were raised compared with the previous forecast, primarily due to the change in expected oil price dynamics.

Trading conditions

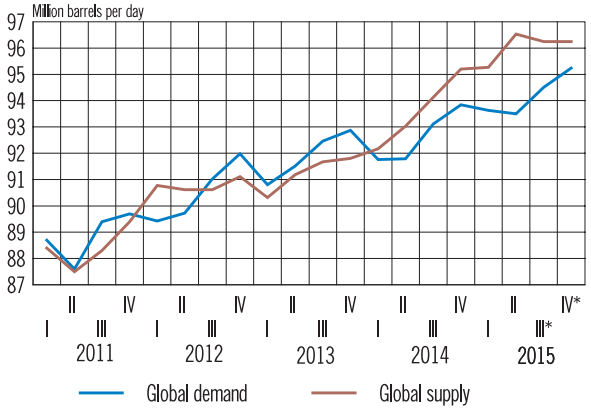
Having recovered in March-May, global oil prices resumed their fall in June-August 2015. Global prices for other key Russian exports continued to drop, leading to a deterioration in trading conditions.

After growing to $58.8 per barrel on average in March-May 2015, the price of Urals crude dropped again to $54.6 per barrel in June-August 2015 with oil prices falling to almost $40 per barrel in August (their lowest since February 2009). The renewed slump was greater than forecast in scenarios 1 and 2 in the previous Report, and was closer to the risk scenario.

Concerns surrounding demand from China, the second largest consumer of oil globally, played a key role in the falling prices. Prices were also under downward pressure from fears of a significant increase in oil supplies from Iran, which intensified after the approval in July of a treaty regarding its nuclear programme, which will allow the restrictions on oil imports from Iran to be lifted. Other factors

Chart 1.1.14

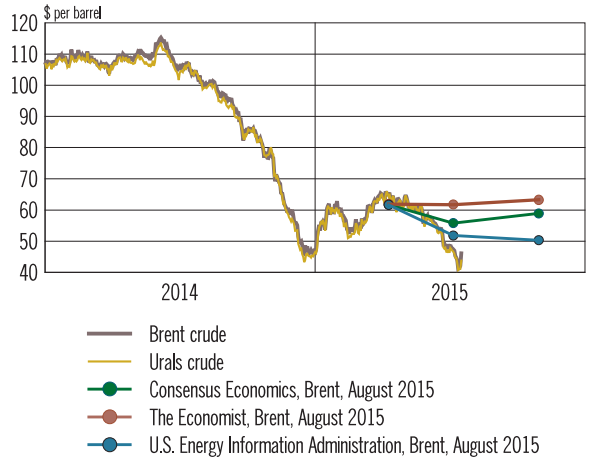
Global oil supply and demand*



* *Forecast for 2015 Q3 and Q4.*
The planned oil production volume by OPEC during the forecast period is 31.7 million barrels per day.
Source: International Energy Agency.

Chart 1.1.15

Global oil prices



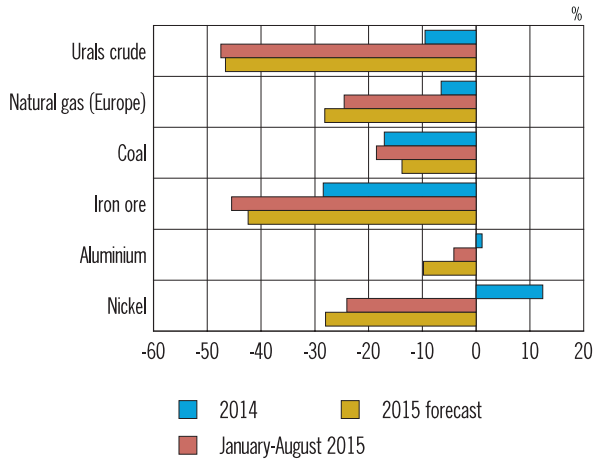
Sources: Thomson Reuters, EIU, EIA, Consensus Economics.

behind the falling oil prices were the strengthening of the US dollar amid the expected increase in the Fed's key rate, high levels of reserves in developed countries and increased production in OPEC member states, in particular in Iraq and Saudi Arabia. However, the drop in oil prices was held in check by reduced oil production in the US and low supplies from Libya amid ongoing geopolitical tension in the country.

The Bank of Russia expects global oil prices to remain close to current levels until the end of 2015, i.e., less than forecast in scenarios 1 and 2 in the previous Report. Risks have shifted towards a further fall in prices. The downward pressure was the result of all of the negative factors playing out simultaneously: the problems in China, the relaxation

Chart 1.1.16

World prices of Russian principal export commodities



Sources: IMF, for oil - Reuters data and Bank of Russia baseline forecast 1.

of sanctions against Iran, and the strengthening of the US dollar. In addition, many market participants did not expect production from unconventional sources in the US to be sustainable. Thanks to advances in technologies used to extract oil from unconventional sources, the cost of extraction at existing shale oil deposits in the US fell considerably (Charts 1.1.14, 1.1.15). Accounting for the factors mentioned above and the recent fall in oil prices, oil price forecasts were revised downwards for the coming years (see Section 2.1 for more details).

The fall in global prices for other Russian key exports, which has taken place over the past few years, continued in June-August 2015. The price of natural gas in the European market fell significantly amid an increase in reserves, weak demand, and the adjustment of contract prices tied to oil prices. Global coal and metal prices continued to fall amid excess supply, slowing growth in demand from China, which accounts for roughly half of global demand for coal and metals, and the strengthening of the US dollar. Over the coming quarters, as the influence of the aforementioned factors persists, gas, coal and metal prices will remain low (Chart 1.1.16).

The fall in global prices in the commodity markets had a negative impact on the Russian economy. In January-July 2015, the decline in prices for oil, oil products, gas, coal, iron ore and nickel led to a reduction in export earnings compared with the same period of the previous year by more than $85 billion, which is comparable with the reduction in aggregate exports. This decrease was only partially offset by the ruble depreciation and the growth in actual supplies of oil and oil products. The fall in commodity prices is also having a negative impact on budget revenues and is leading to a further downturn in Russia's investment appeal.

1.2. Financial conditions

In June-August 2015, interest rates in key segments of the Russian financial market decreased following the reduction of the Bank of Russia key rate. Despite this trend, financial conditions remained moderately tough. Market participants' risk appetite was low. In particular, that was reflected by tighter non-price lending conditions and ongoing substitution of more risky lending with less risky one. Against this backdrop, the growth in credit and monetary aggregates seen in the recent months amid the falling rates was weak failing to bolster the aggregate demand in the economy and creating prerequisites for further inflation slowdown.

Money market and Bank of Russia banking sector liquidity management

In June-August 2015, money market rates continued to fluctuate within the Bank of Russia interest rate corridor. However, changes in the structure of operations of certain money market participants and banking sector liquidity factors during this period caused uneven dynamics in the spread between interbank lending rates and the Bank of Russia key rate.

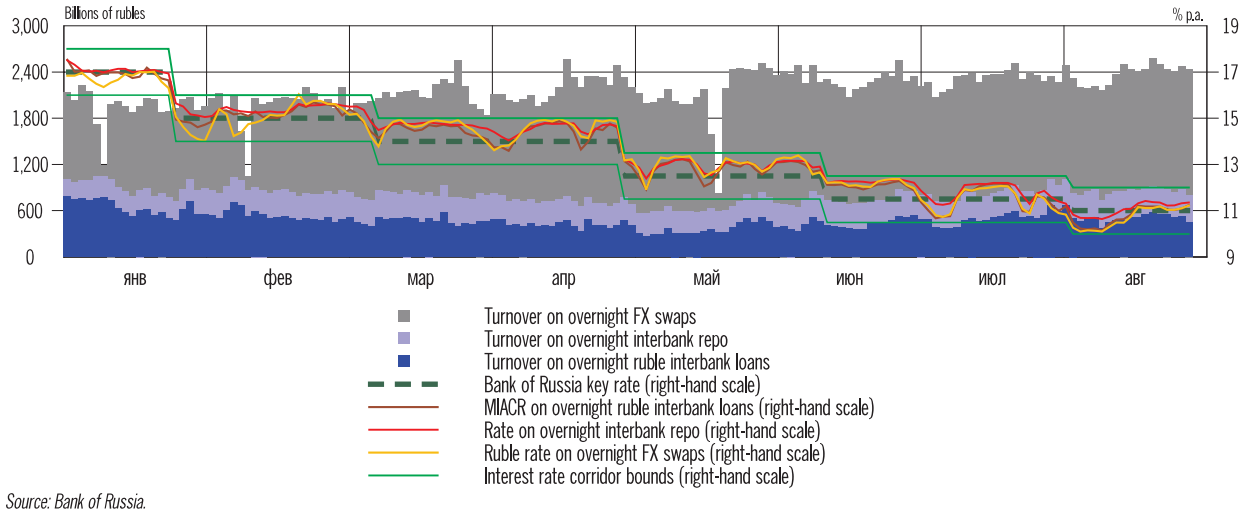
In June and the first half of July, interbank rates were above the Bank of Russia key rate amid the near-zero current liquidity deficit. The positive spread with the key rate averaged about 30 bp. The high demand for ruble liquidity provision through stock exchange FX swaps from certain banks exerted an upward pressure on interbank rates during this period. From the end of July, against the backdrop of sliding demand for liquidity from credit institutions at the end of the required reserves averaging period, banks' demand for funds in the money market, including the FX swap segment, shrank. Combined with the ongoing liquidity inflow through the fiscal channel, it resulted in a decrease in the interbank rates below the Bank of Russia key rate (Chart 1.2.1).

During the second ten days of August, as the new averaging period began and banks' demand for liquidity started to grow, the average interest rates in the overnight segment of the money market returned close to the Bank of Russia key rate. The positive spread of interest rates in the interbank market stabilised at 10-20 bp, which is below the values witnessed in March-June this year. The narrowing of the spread resulted from the gradual reduction in the structural liquidity deficit of the banking sector over the period under consideration.

Amid the inflow of funds into the banking sector driven by liquidity factors (Chart 1.2.2), the Bank of Russia reduced liquidity provision through its weekly repos. Some credit institutions failed to adapt to it quickly enough. In particular, it resulted in the excessive demand for liquidity from certain banks, whose rates usually exceeded those of other market participants. As a result, the weighted average rates at Bank of Russia repo auctions

Chart 1.2.1

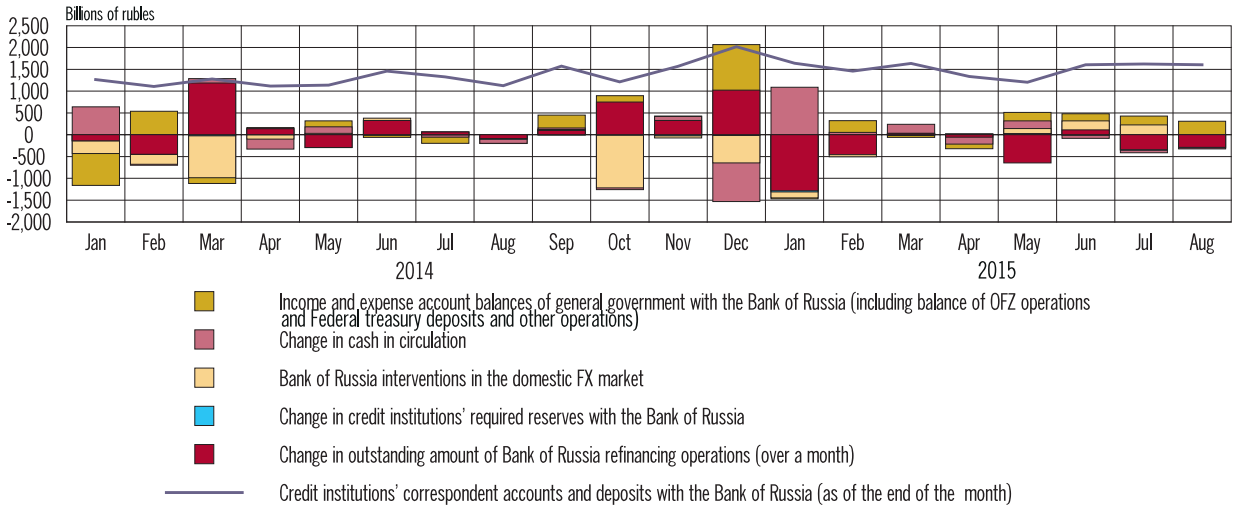
Money market interest rates and turnover in 2015



Source: Bank of Russia.

Chart 1.2.2

Banking sector liquidity and liquidity factors



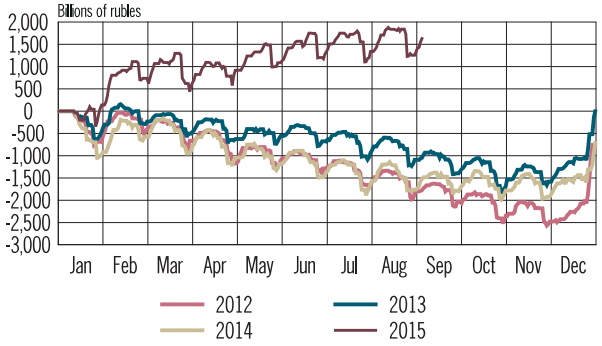
in June-August exceeded the key rate by 50-60 bp (in March-May 2015, 20-30 bp). However, the high weighted average rates resulting from these auctions did not prevent the Bank of Russia from achieving the operational target of the monetary policy: keeping interbank rates close to the Bank of Russia key rate. In the period between one-week repos, funds obtained at Bank of Russia auctions were redistributed between money market participants experiencing deficit or surplus of funds. It did not result in considerable use of Bank of Russia standing facilities and higher interbank rates. All this is indicative of sufficient provision of funds through one-week repo auctions of the Bank of Russia.

The liquidity inflow into the banking sector over the period under consideration largely resulted from higher budget expenditures compared with the dynamics characteristic of the period in previous years (Chart 1.2.3). Thus, funds received by the banking sector through the fiscal channel in June-August as a result of reduction in general government account balances with the Bank of Russia (including other operations) totalled 0.6 trillion rubles. Of these, a liquidity inflow of 0.2 trillion rubles came from Federal Treasury operations to deposit temporary unallocated federal budget funds.

The change in cash in circulation in June-August 2015 took a traditional mid-year path characterised by monthly increases in the amount of cash in the economy. This resulted in a slight liquidity outflow

Chart 1.2.3

Change in general government accounts with the Bank of Russia ('+' decrease, '-' increase)
(year-to-date)*



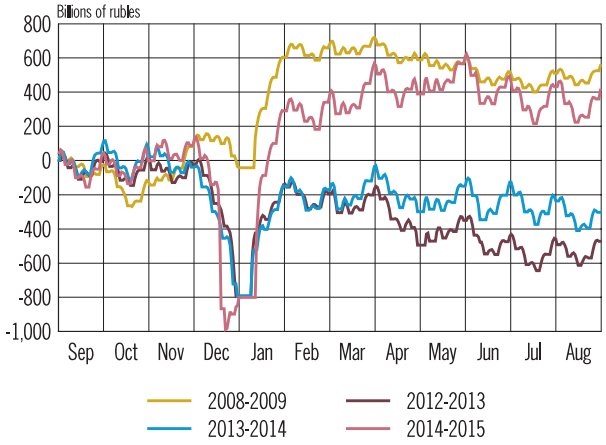
** Excluding Federal treasury deposits with credit institutions, OFZ operations and one-off payments.*
Source: Bank of Russia.

from the banking sector through this channel in the amount of 0.2 trillion rubles (Chart 1.2.4). In June-July 2015, Bank of Russia operations to purchase foreign currency in the domestic market to replenish international reserves contributed to an increase in banking sector liquidity by 0.4 trillion in ruble terms.

These banking sector liquidity factors triggered a decline in credit institutions' debt on Bank of Russia refinancing operations from 4.9 trillion rubles in early June to 4.3 trillion rubles in late August. The debt contracted primarily due to the change in the amount of funds provided through one-week repos, while outstanding loans secured by non-marketable assets or guarantees changed insignificantly (Chart 1.2.5).

Chart 1.2.4

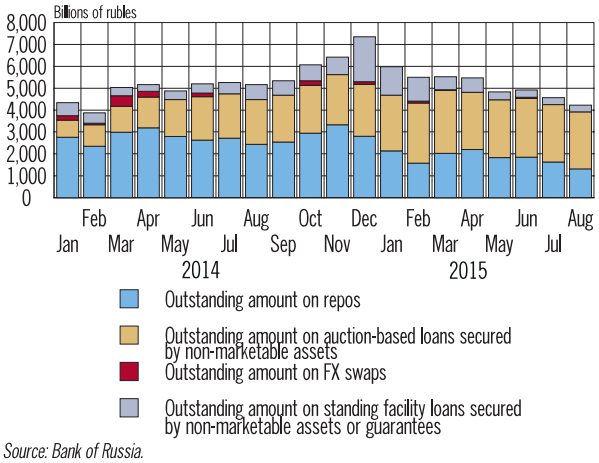
Change in cash in circulation ('+' decrease, '-' increase)
(September-to-date)



Source: Bank of Russia.

Chart 1.2.5

Bank of Russia refinancing operations in 2014 - early 2015
(as of the end of the month)



Source: Bank of Russia.

Table 1.2.1

Forecast of banking sector liquidity factors (trillions of rubles)

		2013	2014	2015[1] (forecast)
Total for liquidity factors	1=2+3+4+5	-1.7	-2.6	[1.9; 2.8]
of which:				
– change in general government accounts with the Bank of Russia and other operations[2]	2	-0.4	0.9	[0.7; 2.1]
– change in cash in circulation	3	-0.5	-0.3	[0; 0.3]
– Bank of Russia interventions in the domestic FX market and purchases of monetary gold[3]	4	-0.9	-3.1	[0.7]
– change in credit institutions' required reserves with the Bank of Russia	5	0	-0.1	[0; 0.2]
Change in free bank reserves[4]	6	0	0.2	[0.1; 0.2]
Change in outstanding amount on Bank of Russia refinancing operations	7 = 6 - 1	1.7	2.8	[-2.7; -1.8]
Memo item: outstanding amount on Bank of Russia refinancing operations (as of year-end)[5]	8	4.5	7.3	[4.6; 5.6]

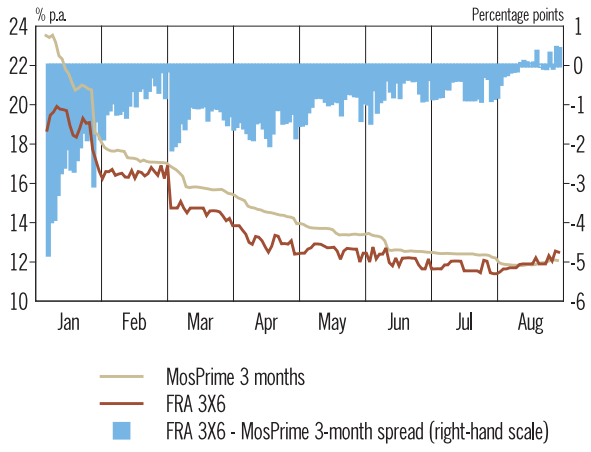
[1] January-August 2015 - actual, September-December - forecast.
[2] Including interest payments on Bank of Russia refinancing operations.
[3] In previous MPR releases these operations were categorised as 'change in general government accounts with the Bank of Russia and other operations'
[4] During the forecast period the demand for free bank reserves is determined on the basis of credit institutions' correspondent account balances with the Bank of Russia (taking into account the average amount of required reserves held in correspondent accounts, banks' need to perform settlements and precautionary motives) and the volume of credit institutions' deposits with the Bank of Russia.
[5] Excluding subordinated loans to Sberbank of Russia and bonds of certain credit institutions in the Bank of Russia portfolio.

Source: Bank of Russia calculations.

Credit institutions' demand for Bank of Russia refinancing operations is expected to increase until late 2015. By the end of December, credit institutions' debt owed to the Bank of Russia can reach 4.6-5.6 trillion rubles, which is in line with the forecast in the previous release of the Monetary Policy Report. The outflow of liquidity will be caused by the dynamics of cash in circulation returning to seasonal trends. Meanwhile, the main factor of uncertainty in the estimates of expected banking sector demand for refinancing continues to be the amount of budget expenditures financed from Reserve Fund resources and the investment of National Wealth Fund resources. Considering the changing demand for liquidity through the end of the year, the Bank of Russia will adjust the amount of funds provided through both repo auctions and auction-based loans secured by non-marketable assets. The Bank of Russia plans to gradually reduce the amount of debt outstanding on such

Chart 1.2.6

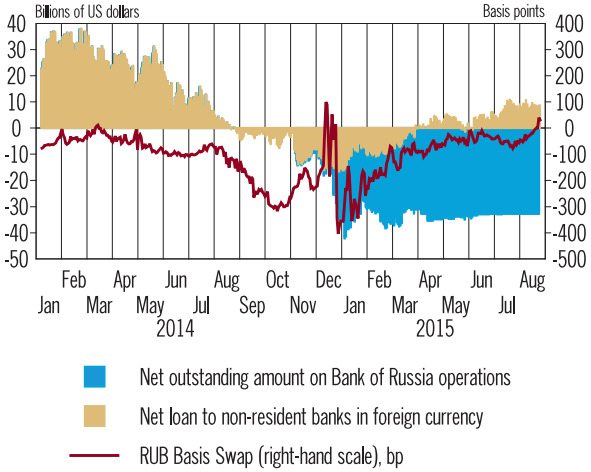
FRA 3X6 - MosPrime 3-month spread in 2015



Sources: Bank of Russia, Thomson Reuters.

Chart 1.2.8

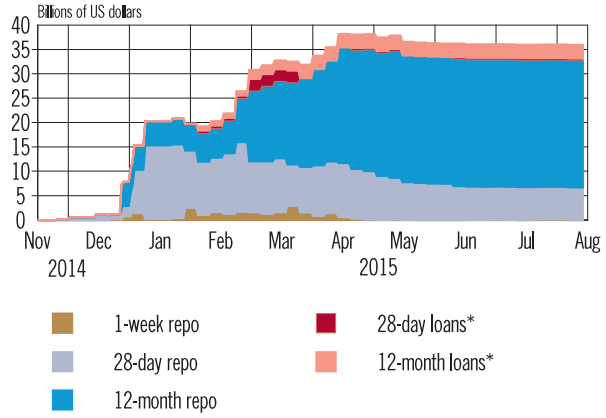
Operations of resident banks with the Bank of Russia and non-resident banks in foreign currency



Source: Bank of Russia

Chart 1.2.7

Credit institutions' debt to the Bank of Russia under refinancing FX instruments



** Bank of Russia US dollar loans secured by the pledge of claim on US dollar loans.*
Source: Bank of Russia.

loans. On the whole, Bank of Russia operations to manage liquidity will be aimed at ensuring conditions for establishing money market rates at a level close to the Bank of Russia key rate.

The expectations of participants of interest rate derivatives market regarding the future dynamics of the Bank of Russia key rate do not suggest any significant changes in the short term.

After the Bank of Russia had reduced the key rate in July, spreads between future contracts on the 3-month MosPrime rate (FRA 3x6 and FRA 6x9) and its current values, which were negative throughout 2015 (reflecting expectations of a further reduction in the Bank of Russia key rate) turned positive and stabilised at about 25 bp (Chart 1.2.6). This, combined with the current slope of the money market interest rate curve (overnight index swap), suggests that market participants consider the potential for reduction in the Bank of Russia key rate in the next two quarters to be exhausted.

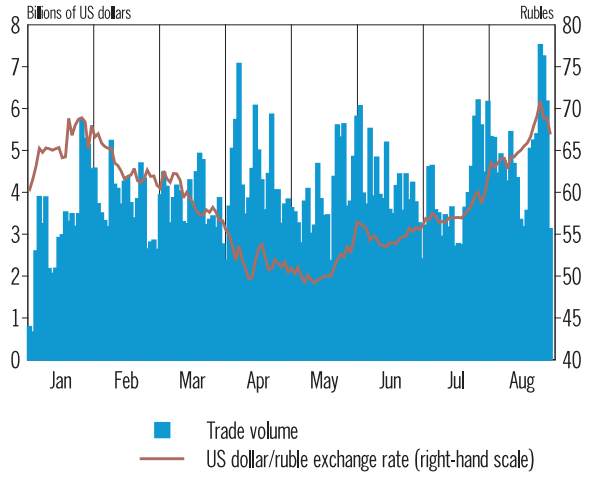
Foreign exchange market and Bank of Russia operations with foreign currency

In June-August 2015, the FX liquidity situation at Russian banks continued to be favourable due to, among other things, the debt on Bank of Russia FX repos and loan auctions persisting at about $36 billion over this period (Chart 1.2.7). In these conditions, Russian banks' net credit to non-resident banks under money market operations remained close to the levels of 2014 Q2, the period before the imposition of sectoral sanctions against Russian organisations. The dynamics of the spread between one-year ruble and cross-currency interest rate swaps also indicated no problems with dollar liquidity; the value at the end of August was close to zero (Chart 1.2.8).

In June-August, the FX market saw considerable ruble depreciation (Chart 1.2.9) that was largely bolstered by changes in oil prices. According to Bank of Russia estimates, the sensitivity of the USD/RUB exchange rate to oil prices increased considerably as they fell. Thus, the 17.4% decline in oil prices in June-August was accompanied by a 22.8% rise in the USD/RUB exchange rate. In addition, negative trends in international financial markets (the slump in stock indices in China and the US and the depreciation of the Chinese renminbi

Chart 1.2.9

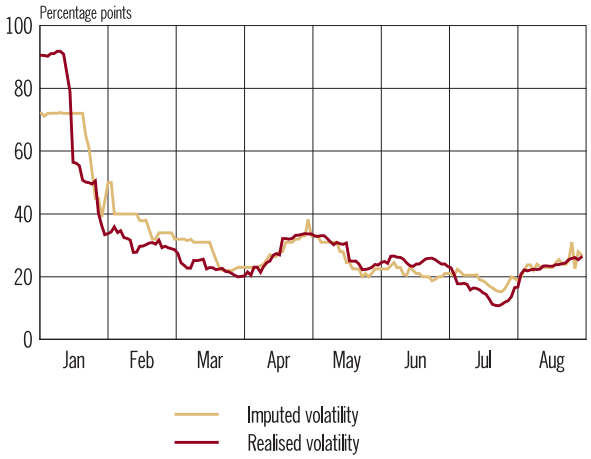
Volume of trade and US dollar/ruble exchange rate at the Moscow Exchange in 2015



Sources: Thomson Reuters.

Chart 1.2.10

Imputed and realised ruble exchange rate volatility in 2015



Source: Bloomberg.

in August 2015) exerted additional pressure on the ruble exchange rate (see Section 1.1).

The observed ruble depreciation did not entail any considerable growth in exchange rate volatility: volatility indicators remained close to the levels seen over most of 2015. However, their growth in the third ten days of June and in August 2015 was largely linked to the falling oil prices. In these conditions, realised and imputed volatility (see Glossary) returned to the range of 20-30 pp year-on-year in August 2015 following a local slump in late June – early July (Chart 1.2.10). Since currently these indicators are largely determined by oil prices, as energy market prices stabilise the volatility of the ruble exchange rate can be expected to reduce slightly.

Taking into account the current climate in the domestic FX market, at the end of July 2015 the Bank of Russia decided to suspend its purchases of foreign currency to replenish the international reserves, because further operations could have intensified the developing exchange rate trend. Furthermore, the ruble continued to receive support from a number of factors that restrained its depreciation amid falling oil prices and growing uncertainty in global financial markets. Household and business demand for foreign currency was persistently moderate showing no speculative motives to purchase foreign currency as in December 2014. In June-August 2015, foreign currency sales by major exporters were significant and more uniform compared with previous months, partially due to the conversion of foreign currency to pay ruble dividends.

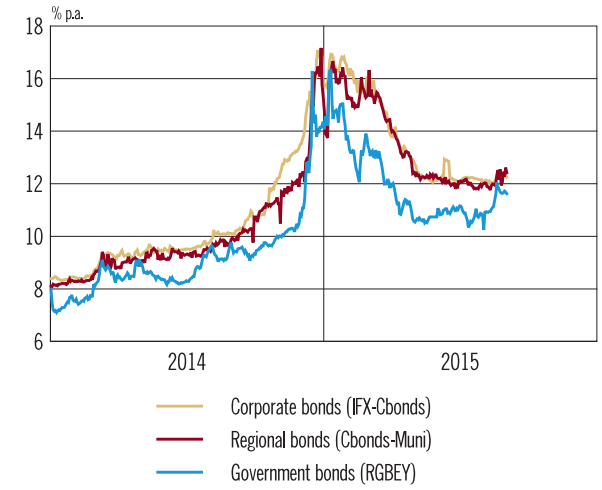
According to Bank of Russia estimates, Russian organisations' operations to settle external debt through the end of 2015 will not exert any considerable pressure on the exchange rate. Net revenues in the balance of payments current account (even taking account of the current oil prices) and the foreign currency assets accumulated by Russian banks and companies will allow them to make uninterrupted external debt payments without showing additional demand for foreign currency in the domestic market. In addition, the Bank of Russia is ready to continue providing FX liquidity through repo auctions. The substantial repayments under 12-month FX repos at the end of 2015 may be refinanced in future. However, the Bank of Russia will be flexible in selecting the forms of refinancing banks' annual foreign currency debts. It considers the possibility of both resuming 12-month FX auctions and increasing monthly and weekly auction limits. Other parameters of FX refinancing operations will be based on further developments in the FX market.

Asset prices and bond market

The deterioration of the situation in the international financial and commodity markets and the associated ruble depreciation, combined with the ongoing slump in economic activity within the country, had a negative impact on the sentiment

Chart 1.2.11

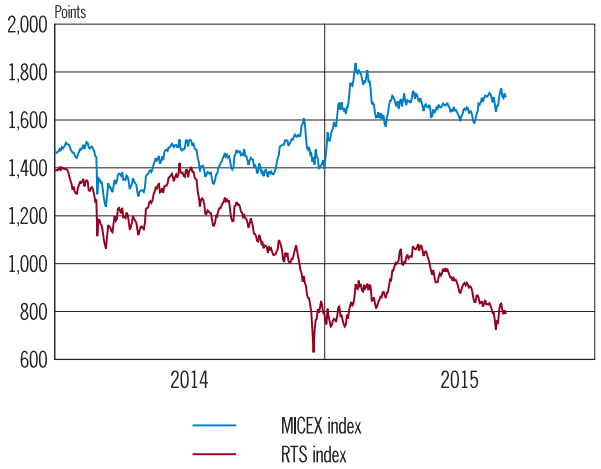
Bond yields



Sources: MICEX SE, Cbonds.ru.

Chart 1.2.12

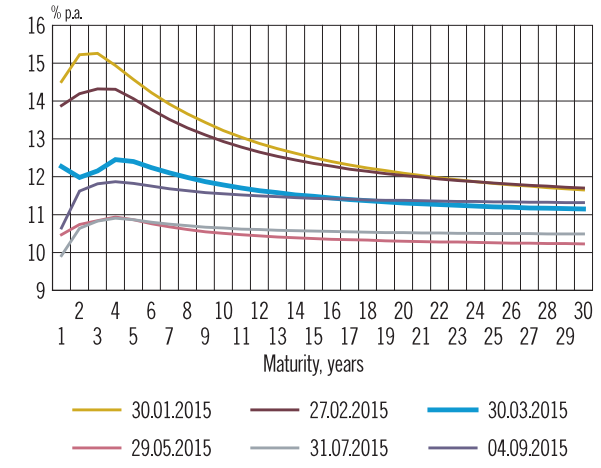
Equity indices



Source: MICEX SE.

Chart 1.2.13

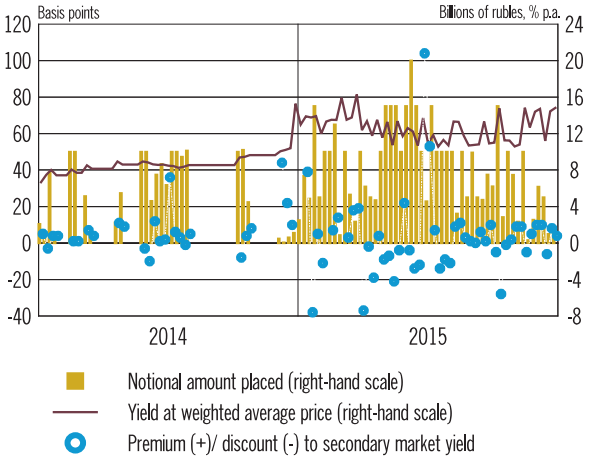
Zero-coupon OFZ yield curve



Sources: MICEX SE, calculated using the method elaborated together with the Bank of Russia.

Chart 1.2.14

Ministry of Finance auctions for OFZ placement/additional placement



Sources: MICEX SE, Bank of Russia calculations.

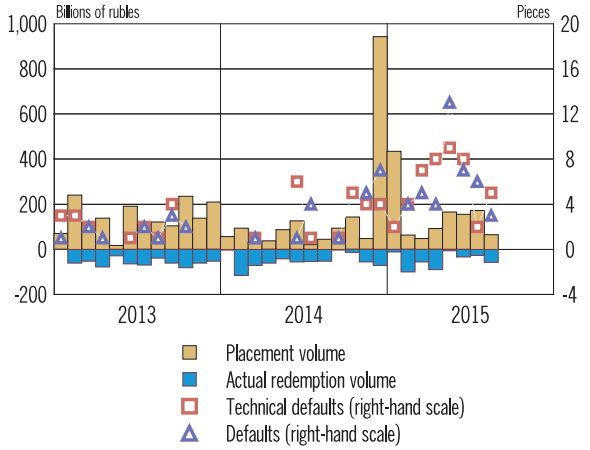
of Russian securities market participants. The recovery of prices for ruble-denominated financial assets witnessed since early 2015 came to an end in June-August (Charts 1.2.11 and 1.2.12). At the same time, further reduction of the Bank of Russia key rate balanced the effects of external and internal shocks, thereby preventing the development of negative trends in the Russian securities market in terms of price and trading dynamics.

In June-August 2015, the yield on all types of bonds and ruble-denominated stock indices fluctuated close to the levels seen at the end of May. Only in the third ten days of August saw a tangible yield growth amid the accelerating decline in global oil prices and the ruble depreciation. However, at the end of August, market expectation indicators (extracted from OFZ prices and yield curves), on the one hand, still showed a reduction in rates in the medium-term, and on the other hand, suggested that the potential to reduce rates through the end of 2015 had been largely exhausted (Chart 1.2.13).

Issuing activity in the domestic bond market remained high in June-August 2015 (Charts 1.2.14 and 1.2.15). Companies and banks increased their domestic bond debt continuing to use the window of opportunities that opened in 2015 after the significant downturn in borrowing conditions in the second half of the previous year. The growing supply of bonds in the domestic market was bolstered by the persistently relatively attractive borrowing costs

Chart 1.2.15

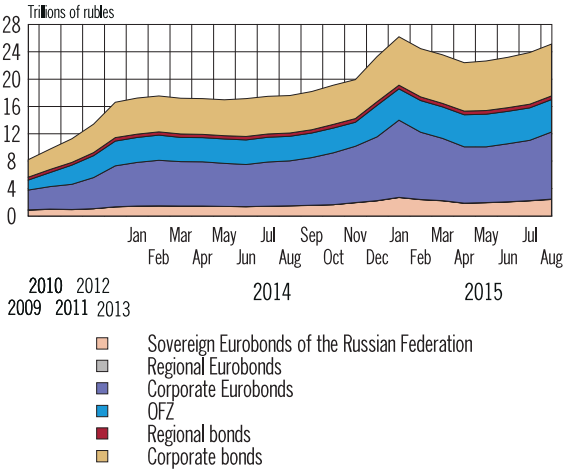
Placement at MICEX SE and redemption of corporate bonds (defaults on bond issues)



Sources: MICEX SE, Cbonds.ru, Bank of Russia calculations.

Chart 1.2.16

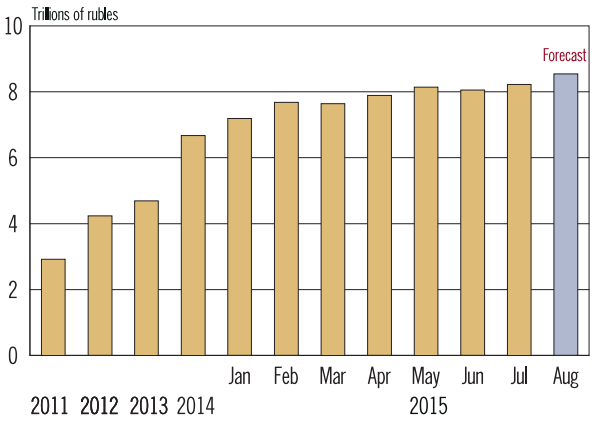
Volume of Russian bonds outstanding
(as of end-period)



Sources: MICEX SE, Cbonds.ru.

Chart 1.2.17

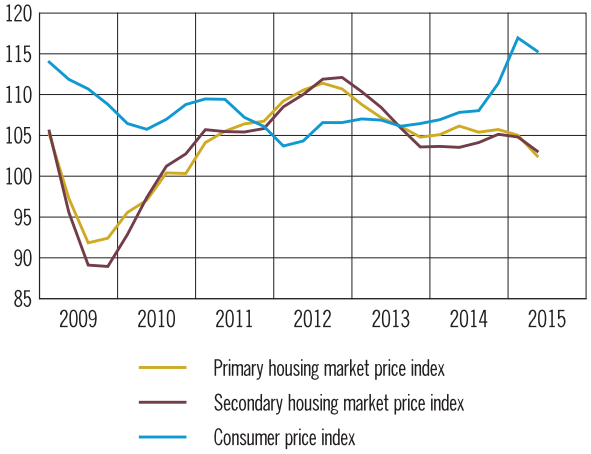
Securities held by banks included in the Bank of Russia Lombard list
(as of end-period)*



** Including securities pledged as collateral under repos.*
Source: Bank of Russia.

Chart 1.2.18

Housing and consumer goods price indices
(as % of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

for issuers, which remained largely unchanged after a decline in January-May 2015, and the restricted access to external funding, which stimulated issues of corporate bonds not only in rubles but also in foreign currencies. As before, substantial demand for new bond issues in the primary market came from credit institutions, which used these assets among other things as marketable collateral in money market operations (in particular, operations with the Bank of Russia), and NPFs, which increased investments in government and corporate bonds in connection with the 'unfreezing' of pension savings. These groups of investors bought more than two thirds of the bond issues placed at the MICEX SE in June-August. The remainder was purchased by non-residents, non-bank organisations and individuals. However, non-residents reduced their investment in ruble-denominated financial assets (see Section 1.1), which resulted in higher volatility in the stock market at some periods. By the end of August 2015 the combined portfolio of corporate bond issues outstanding in the domestic market increased by 2.7% compared with late May (Chart 1.2.16).

Banks' high demand for debt instruments, along with the ongoing programme for additional capitalisation of banks through OFZs and Bank of Russia measures to expand the Lombard List, will facilitate an increase in marketable collateral held by credit institutions from 6.7 trillion rubles on

1 January 2015 to 8.5 trillion rubles by the end of 2015 (Chart 1.2.17).

Given the high uncertainty of Russian securities market participants' pricing expectations, the potential for further price recovery and growth in the portfolio of outstanding securities issues is limited over the coming quarters. The demand for new bond issues is likely to be selective, with investors' interest shifting toward high-quality debt instruments and abandoning risky investments.

Amid the decline in economic activity and reduction in real disposable incomes, households' interest in purchasing residential property has fallen. The average cost of 1 square metre of living space in 2015 Q2 fell by 0.73% compared with the previous quarter. In 2015 Q2, annual growth of price indices in the primary and secondary housing markets fell behind the corresponding figures for 2014 Q2 and continued to be significantly below the inflation (Chart 1.2.18). The easing of mortgage lending price conditions following the decrease in ruble-denominated mortgage lending rates since 2015 Q2 and the government's mortgage rate subsidy programme have prevented a more significant drop in housing prices. However, amid higher economic uncertainty, weak investment activity and falling consumer purchasing power, the housing price growth is very likely to remain negative over the next two quarters.

Bank loan and deposit market

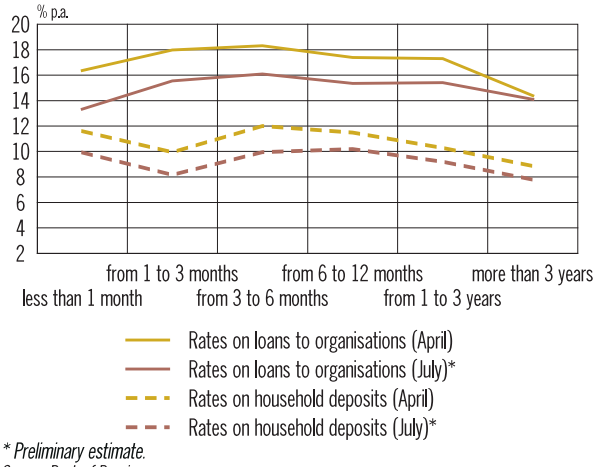
In May-August 2015, amid the ongoing reduction of the Bank of Russia key rate, the key segments of the Russian loan and deposit market saw persistent downward rate dynamics that had started earlier this year (Chart 1.2.19) after the sharp increase in rates (especially short-term) in December 2014-January 2015.

As expected, the rate reduction in different segments of the deposit market was not uniform. According to preliminary estimates, the average rate on short-term ruble deposits in July was 1.7 pp lower than the equivalent figure for April. Long-term deposit rates decreased by 1.1 pp over the same period. Consequently, while short-term deposit rates still exceeded long-term rates, the difference shrank considerably. These deposit rate dynamics were largely shaped by changes in banks' priorities. During the period under analysis, banks in the deposit market primarily focused on establishing sustainable long-term funding rather than attracting short-term liabilities, like in late 2014 amid the tension in the money market.

Overall, household funds continued to flow into bank deposits, although May-July saw a seasonal downturn in average monthly growth of bank deposits. This growth in household deposits was accompanied by anticipated shifts in their structure. Amid the accelerating decline in short-term deposit rates and the increase in household confidence in the banking sector, the inflow of funds into long-term deposits, which had contracted earlier this year, resumed with a simultaneous slowdown in growth of short-term deposits (Chart 1.2.20).

Chart 1.2.19

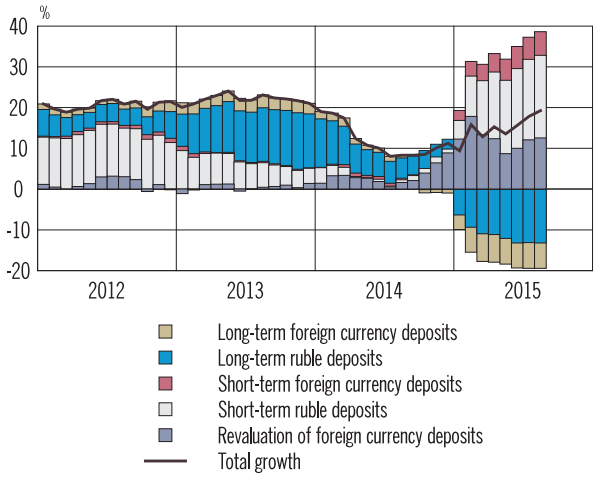
Term structure of interest rates on ruble bank transactions in 2015



** Preliminary estimate.*
Source: Bank of Russia.

Chart 1.2.20

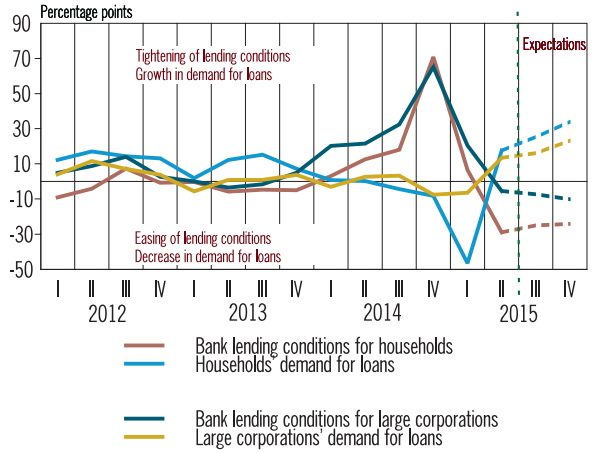
Contributions of various components to the annual growth rates of bank deposits of households



Source: Bank of Russia.

Chart 1.2.21

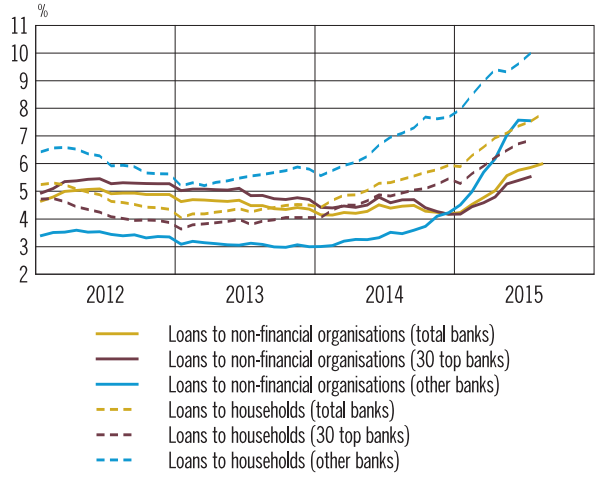
Lending conditions and demand for loans index



Source: Bank of Russia.

Chart 1.2.22

Overdue bank loans



Source: Bank of Russia.

Despite the nominal depreciation of the ruble, in May-July growth in ruble deposits slightly exceeded the equivalent figure for foreign currency deposits. Higher deposit dollarisation during this period resulted only from revaluation of foreign currency deposits.

The trends observed in the middle of the year can be expected to continue through the end of 2015. The leading decline in short-term deposit rates will continue until the maturity structure of deposit rates returns to normal and the growth of long- and short-term deposits starts to equalise (or long-term deposits start to moderately exceed short-term ones). In the absence of significant changes in the situation in the FX market, foreign currency and ruble deposits will show similar growth.

The transition to the system of differentiated contributions to the DIA will help maintain these positive deposit rate dynamics along with the effect of the key rate reduction in January-August 2015. This factor can be expected to result in a faster reduction in the rates on operations by banks conducting the most aggressive pricing policy in the deposit market, and a narrower range of rates on deposit products offered in the Russian market.

As expected, the reduction in the Bank of Russia key rate along with lower cost of bank funding (in part due to the replacement of short-term deposits attracted by banks at high rates in December 2014 and January 2015 with new deposits attracted at significantly lower rates) contributed to a reduction in banks' rates on loans (Chart 1.2.19) (see the Monetary Policy Report, June 2015). However, rates for short-term loans to non-financial organisations slid significantly faster than the equivalent figures for long-term loans (according to preliminary data, the decrease in May-July was 2.5 pp and 0.3 pp respectively). These dynamics reflected slower and weaker growth in long-term rates at the beginning of the year, due to both the expected key rate reduction and the lower elasticity of long-term rates.

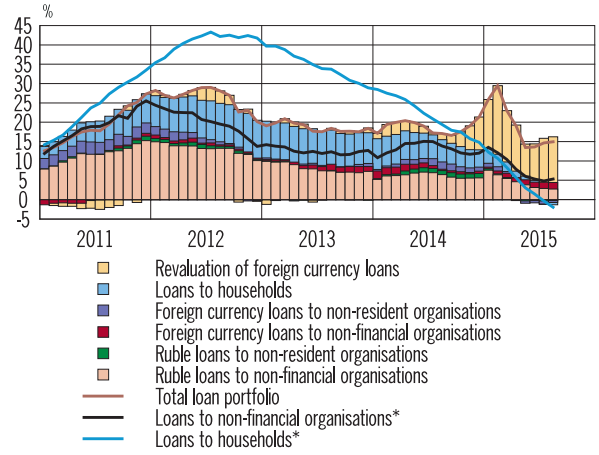
Amid falling loan rates and the accompanying growth in demand for loans[1] (Chart 1.2.21), the loan market experienced a slight revival: average monthly growth in the corporate loan portfolio returned to positive territory in May-July. Retail lending continued to contract, but the contraction rate dropped. However, growth in the corporate loan portfolio was lower than in the corresponding months of the previous year, and annual lending growth declined (Chart 1.2.23).

One of the factors restricting growth in loan portfolios of Russian banks was further deterioration in its quality (Chart 1.2.22). This dictated the continuation of banks' conservative lending policies, which, though relaxing price conditions for lending, maintained or even tightened non-price lending conditions, in particular the requirements to the borrower's financial position and the quality of loan collateral.

[1] *Based on the results of the quarterly survey of bank lending conditions for 2015 Q2 (http://www.cbr.ru/DKP/iubk/iubk_15-2.pdf).*

Chart 1.2.23

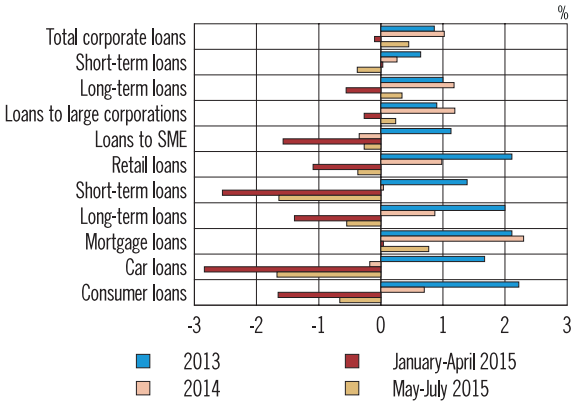
Contributions of various components to the annual growth rates of bank loan portfolio



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

Chart 1.2.24

Average monthly growth of certain components of bank loan portfolio*



** Adjusted for revaluation of foreign currency loans. For mortgage loans, car loans and other consumer loans - average monthly growth not adjusted for revaluation of foreign currency loans.*
Source: Bank of Russia.

The general tightening of non-price lending conditions was aggravated by the increasing deterioration of quality of small and medium-sized banks' loan portfolio, and these banks found themselves most restricted in their ability to expand lending. Larger banks, whose loan portfolios suffered less (Chart 1.2.22), continued to increase their market share in May-June. Since large banks generally adhere to a more conservative lending policy, the consolidation of their positions in the market also held back lending growth.

The tightening of banks' borrower requirements bolstered the trend for replacing more risky lending with less risky one seen in the previous quarters (Chart 1.2.24). In the corporate lending segment, the increase in the loan portfolio resulted exclusively from the growth in lending to large companies. Lending to SMEs continued to contract, albeit at a slower pace than in the previous quarter. Amid the reduction in total household lending, moderate growth in low-risk mortgage lending continued.

Moderate growth in bank lending can be expected to persist at 4-7% up to the end of the year amid a gradual decrease in loan rates. The effect of the key rate reduction has not yet manifested itself fully in the loan market and there is still potential for further rate reductions (due to the key rate reductions implemented by the start of August, long-term corporate loan rates can be expected to reduce by 0.3-0.6 pp before the end of 2015). With loan risks continuing to be relatively high, no significant easing in non-price lending conditions will be observed. On the whole, lending conditions will remain moderately tight, easing only through a gradual reduction in loan rates. Ultimately, despite banks' expectation of higher demand for loans, the potential to increase lending will be limited. Accordingly, the loan market will not have any significant boosting effect on aggregate demand in the Russian economy, especially on consumer demand.

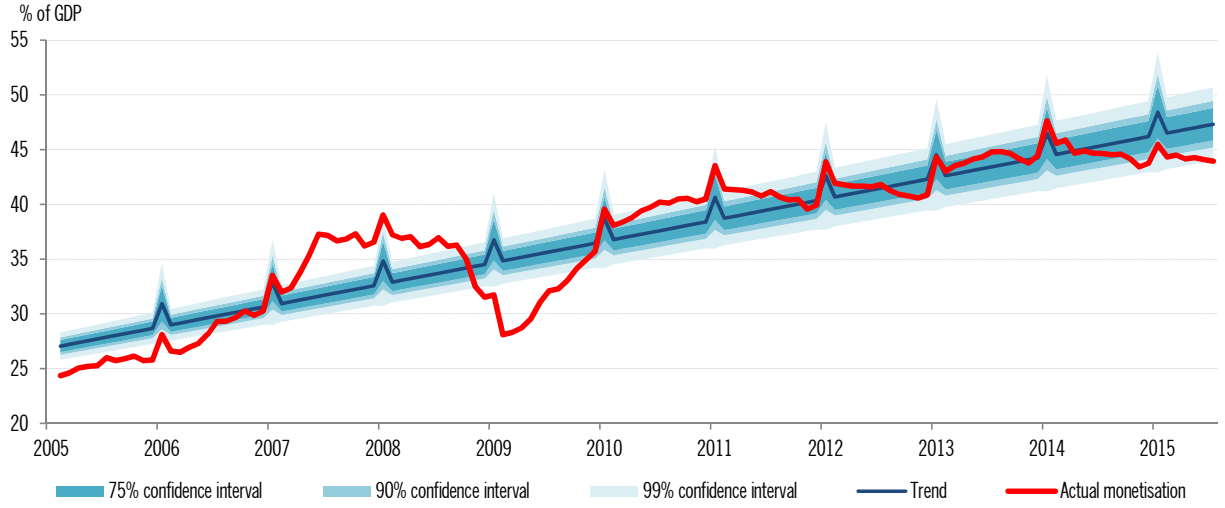
In the longer term, gradual growth in lending can be expected. The recovering inflow of funds into long-term household deposits and the falling cost of funding will help expand banks' opportunities to increase lending. Ongoing structural changes in banks' loan portfolios towards expanding less risky lending will stave off any potential deterioration in the credit quality of bank assets and its negative impact on lending activity.

As assumed in the previous Monetary Policy Report, weak lending activity suppressed growth in money supply. The annual growth in ruble money supply (M2 aggregate) and broad money supply (M2X aggregate), adjusted for foreign exchange revaluation, fluctuated near the local lows formed in early 2015. The main source of money supply growth in the period under consideration continued to be rising budget expenditures (and, accordingly, growth in the banking system's net claims against general government).

On the whole, money supply growth is not expected to accelerate considerably before the end of this year, considering the weak growth in bank

Chart 1.2.25

Monetisation level and its correlation with long-term trend



Source: Bank of Russia.

lending and limited potential to increase budget spending, as well as ongoing uncertainty in the external markets, which is preventing a possible expansion in the banking system's net foreign assets. In current conditions, money supply growth will range from 5% to 8% in 2015, which is in line with the estimates in the previous Monetary Policy Report.

Due to the low growth in monetary aggregates, the money supply to GDP ratio (monetisation) fell below the long-term trend line (Chart 1.2.25). These money supply dynamics do not give grounds for concerns over significant inflation pressure from the money supply in the medium term, which, among other things, was considered by the Bank of Russia when making decisions on changes to its key rate.

1.3. Internal economic conditions

The fall in GDP in 2015 Q2 accelerated to 4.6% amid a stronger downturn in both consumer and investment demand than in the previous quarter. In June-July, certain supply and demand indicators suggested that the recession is slowing. However, deterioration of the external economic climate creates risks of further economy cooling. GDP forecast for the second half of 2015 is revised downward compared with the forecast published in the Monetary Policy Report in June this year. By the end of the year, the fall in output could reach 3.9-4.4%.

In May-June, inflation fell faster than previously forecast amid the intensification of demand-side restrictions, ruble appreciation in March-May, and reduction in inflation expectations. The slight increase in inflation in July resulted from the indexation of utility tariffs. However, in the second half of June the conditions for acceleration of inflation began to form due to the ruble depreciation and deteriorating expectations of economic agents. The second half of August saw a significant intensification of these trends, causing the inflation forecast for 2015 to be revised upwards.

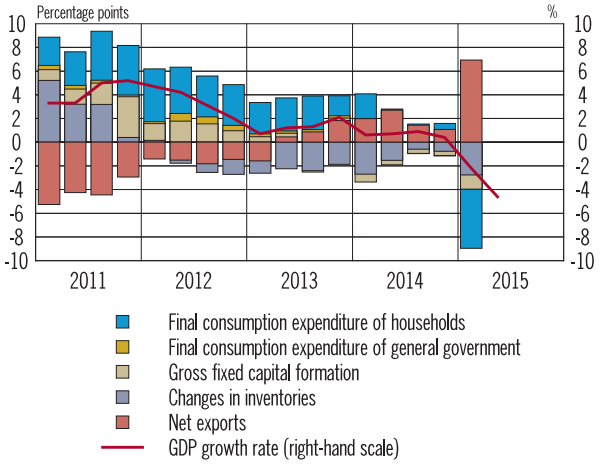
Demand

In 2015 Q2, the economic activity continued to decline. These trends in the Russian economy reflect its adaptation to changing environment (primarily the steady deterioration of trading conditions as compared with the previous year). However, the pace of this adjustment is currently very difficult to determine. The dynamics of some indicators, including the unemployment rate, real wages, labour force utilisation and production capacity, as well as indicators of economic agents' expectations, suggest that the current downturn in economic activity is both structural and cyclical in nature. However, estimates of the depth of the negative output gap and, accordingly, the scale of the reduced economic activity's restraining effect on inflation are currently accompanied by a high level of uncertainty (see Box 'Composite expectation indicator and the output gap').

Chart 1.3.1

GDP growth structure by expenditure

(of corresponding period of previous year, percentage points)



Sources: Rosstat, Bank of Russia calculations.

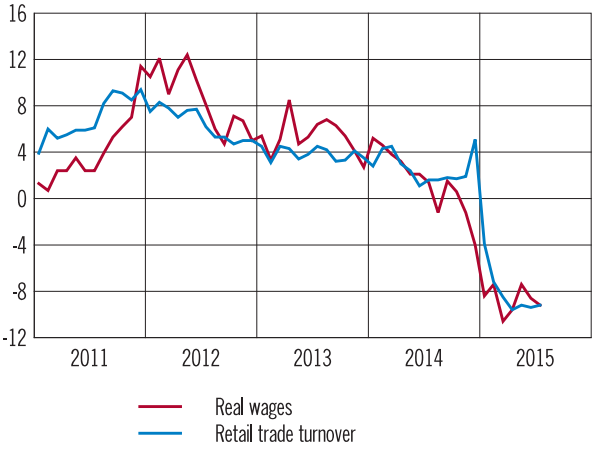
In 2015 Q2, GDP fell by 4.6% year-on-year (Chart I.3.1), which was slightly below the Bank of Russia forecast of June 2015. Both consumer and investment demand reduced more considerably than previously anticipated. More significant than expected fall in output can be explained by the revision of the GDP fall in 2015 Q1 (from 1.9% to 2.2% year-on-year) by Rosstat. However, amid the increased uncertainty, the decline in consumer and investment demand against the previous quarter was also more significant than previously expected.

In 2014 Q2 consumer demand shrinkage intensified. Retail trade turnover in 2015 Q2 contracted by 9.4% year-on-year after falling by 6.4% in Q1 (Chart I.3.2). The acceleration rate

Chart 1.3.2

Real wages and retail trade turnover

(growth as % of corresponding period of previous year)



Source: Rosstat.

Composite expectation indicator and the output gap

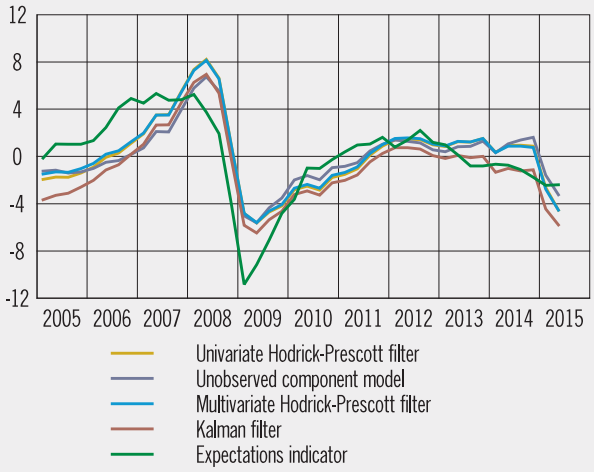
Economic and mathematical methods based on filtering strategies give consistent and plausible answers to questions about which phase of the cycle business activity is in, and whether a particular crisis is cyclical and temporary or reflects structural problems in the economy. Nevertheless, procedures that produce reasonable results for the past dynamics are not always capable of providing an accurate assessment of the current situation: almost all statistical filters are subject to the 'end-point' problem.

Therefore, alternative indicators are used along with standard methods to assess the current output gap. Researchers at the Office for Budget Responsibility[1] used expectations and sentiment, along with other cyclical indicators, to evaluate the output gap. When modelling the impact of the 2008 financial crisis on the US economy, specialists at the IMF[2] used data from surveys of former commercial bank analysts regarding bank lending conditions in the GPM model. The indicator obtained through this elementary aggregation of responses served as a good approximation of the output gap indicator during the financial shock, and when added to the model, significantly improved its forecasting properties.

To build an expectation indicator, we used information on economic agents' assessments of the current situation and their expectations (29 indicators[3]). Using these monthly indicators from January 2002 to April 2015, we developed a FAVAR model and used the first factor, which accounts for roughly 40% of the variance of the indicators in the system, as the composite expectation indicator.

It is notable that this model did not use information on output or unemployment dynamics, but instead considered only subjective assessments of the extent to which the current economic situation differed from 'normal'. On the whole, the dynamics of the expectation indicator demonstrate the same trends as the dynamics of output gap estimates (see the chart). However, in the first half of 2015, its value is higher, which shows that the observed slump is both cyclical and structural in nature.

Output gap estimates
(as % of potential output)



Source: Bank of Russia calculations.

[1] *Briefing paper #2 'Estimating Output Gap', April 2011, Office for Budget Responsibility, UK.*

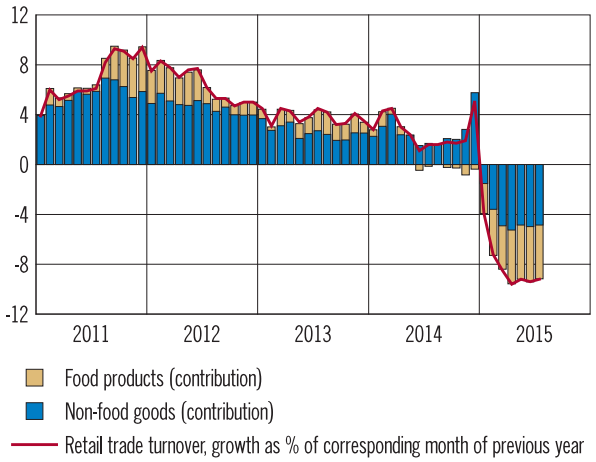
[2] *Ioan Carabenciov, Igor Ermolaev, Charles Freedman, Michel Juillard, Ondra Kamenik, Dmitry Korshunov and Douglas Laxton, 2008 'A Small Quarterly Projection Model of the US Economy', IMF Working Paper 08/278 (December).*

[3] *Employment diffusion index (expected change); wages diffusion index (expected change); order portfolio diffusion index (expected change); output product price diffusion index (expected change); purchased product price diffusion index (expected change); output diffusion index (expected change); equipment purchases diffusion index (expected change); financial position diffusion index (expected change); bank debt diffusion index (expected change); output product price diffusion index (actual change); purchased product price diffusion index (actual change); wages diffusion index (actual change); employment diffusion index (actual change); output diffusion index (actual change); order portfolio diffusion index (actual change); finished goods inventories diffusion index (actual change); diffusion index of output and purchased product price ratio (actual change); equipment purchases diffusion index (actual change); capacity utilisation (normal monthly level = 100); labour force utilisation (normal monthly level = 100); finished goods inventories (normal monthly level = 100); order portfolio (normal monthly level = 100); bank debt (normal monthly level = 100); proportion of businesses in a 'good' or 'normal' financial position; proportion of businesses not buying equipment for two or more consecutive months; interest rates on bank loans (in rubles) to be raised in the next three months; proportion of businesses with no bank debt and not expecting any debt in the coming three months; proportion of businesses not intending to take out new loans from banks in the next three months; and proportion of cash sales in manufacturing.*

of drop in consumer spending and deterioration of consumer confidence amid the continuing decline in real wages was comparable with levels in Q1. Consumer demand was also held back by retail lending dynamics (see Sub-section 1.2). In addition, despite a slight reduction in the household debt burden, the need to service previous loans had persistently negative impact on disposable

Chart 1.3.3

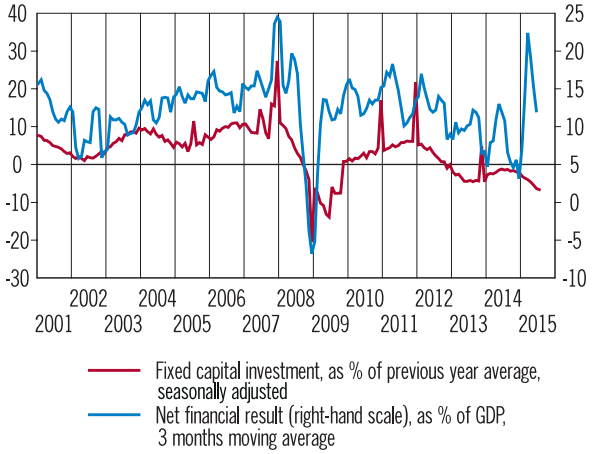
Retail trade turnover
(as % of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.3.4

Fixed capital investment and net financial result



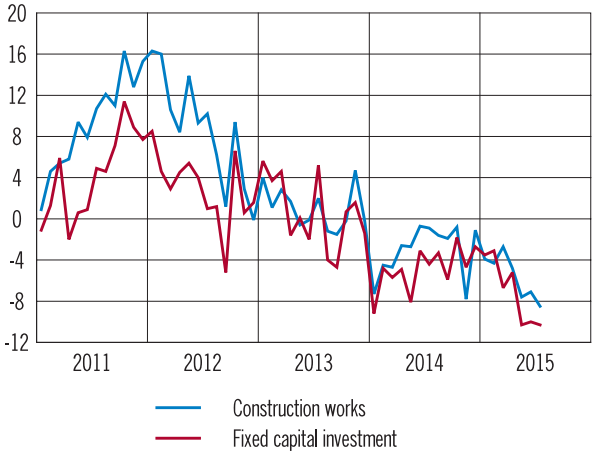
Sources: Rosstat, Bank of Russia calculations.

income and, accordingly, consumer demand. According to estimates, household spending on final consumption fell by about 9% in Q2.

In July 2015, the drop in retail trade turnover slowed slightly (9.2% compared with the corresponding period of the previous year) despite the accelerating decline in real wages, which served as the main mechanism for the labour market to adjust to the downturn in the economic situation (Chart I.3.3). Slower decline was more evident in the non-food segment compared with the previous month. This can be explained by households' propensity to slightly increase consumption 'for future use', which emerged amid households' increased inflation expectations following the depreciation of the ruble

Chart 1.3.5

Fixed capital investment and construction works
(growth as % of corresponding period of previous year)



Source: Rosstat.

(see Section 'Inflation and inflation expectations'). However, this growth in consumption may be only a short-term one. With persistent reduction in real household incomes, consumer demand is expected to fall further. According to estimates, in 2015 Q3 household spending will shrink by 8.5-9% year-on-year, and in Q4 spending may fall by up to 10% due to the high base from the previous year (as a result of panic buying in December 2014).

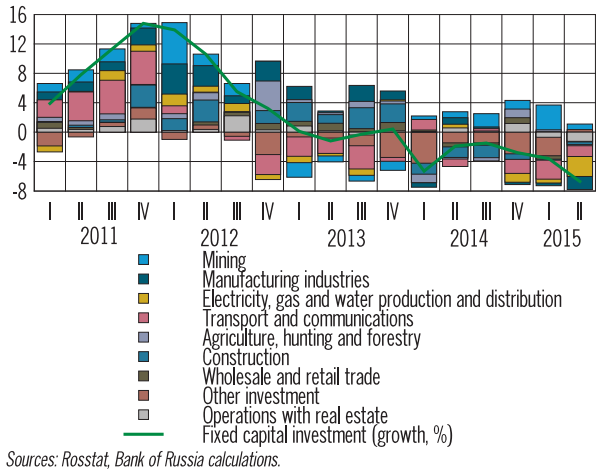
The fall in investment activity also accelerated. With high economic uncertainty and persistently negative sentiment among manufacturers, the annual decline in fixed capital investment was 6.7% in 2015 Q2 after 3.6% in Q1. In July, investment continued to slump. The temporary improvement in companies' financial performance in the first half of this year failed to bolster investment activity (Chart I.3.4). Companies were likely to use the additional profits mainly to settle overdue loans and normalise their debt burden, which rose significantly in 2015 due to the exchange rate revaluation of FX liabilities amid the depreciation of the ruble, deterioration of external financial conditions and increase in domestic interest rates.

Construction output dynamics made a significant contribution to the fall in fixed capital investment (Chart I.3.5). Starting June 2015, against the backdrop of stagnation in the real estate market after 18 months of uninterrupted growth, housing construction started to contract. In the first few months of this year, the financial resources accumulated by construction companies

Chart 1.3.6

Fixed capital investment by activity type

(of corresponding period of previous year, contribution in percentage points)

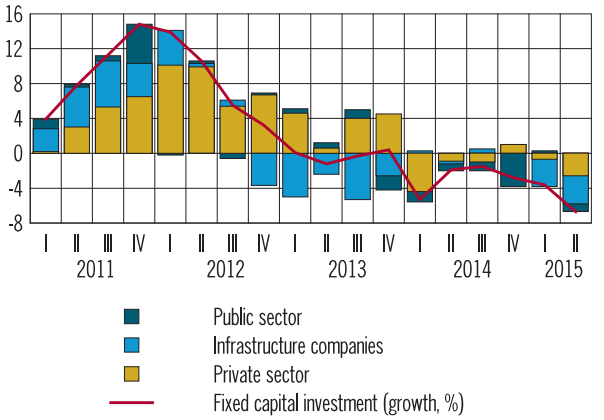


Sources: Rosstat, Bank of Russia calculations.

Chart 1.3.7

Fixed capital investment by public, private sector and infrastructure companies

(of corresponding period of previous year, contribution in percentage points)



Sources: Rosstat, Bank of Russia calculations.

amid heightened purchasing activity at the end of the previous year allowed them to complete ongoing projects and delay the slump in housing construction. However, since summer the dominant effect has been the squeeze on demand for housing following the reduction in real household incomes amid high weighted-average rates on ruble mortgages (see Sub-section 1.2). Besides, higher risk of incomplete and protracted construction projects in crisis environment and low growth in housing prices contribute to investor demand reduction. In the short term the falling demand is expected to have a persistently negative impact on housing construction due to the reluctance to start new projects, and the housing construction growth will remain in negative.

In 2015 Q2, most economic activities saw a reduction in fixed capital investment (Chart I.3.6). According to preliminary estimates, production and distribution of electricity, gas and water; manufacturing; transport and communications had considerable negative impact on investment activity. It was bolstered by the positive capital investment dynamics in the mining sector, least affected in the current crisis.

According to estimates, the slump in investment activity in 2015 Q2 was seen across all sectors of the economy: public (the fall in investment was 8.6% compared with the corresponding period in 2014), private (3.6%) and infrastructure (18.6%). The infrastructure and private sectors contributed the most to the investment decrease (Chart I.3.7).

On the whole, investment activity will continue to fall over the coming quarters. Meanwhile, the reduction in oil prices witnessed in July-August is likely to have an additional negative impact on investment activity as a result of decreased export income and further deterioration of manufacturers' sentiment. In 2015 Q3-Q4 gross fixed capital formation will fall by 8-9% year-on-year. Inventories will also continue to decline, albeit slower than in the first half of 2015: inventory optimisation started back in 2013 and currently their levels are fairly low.

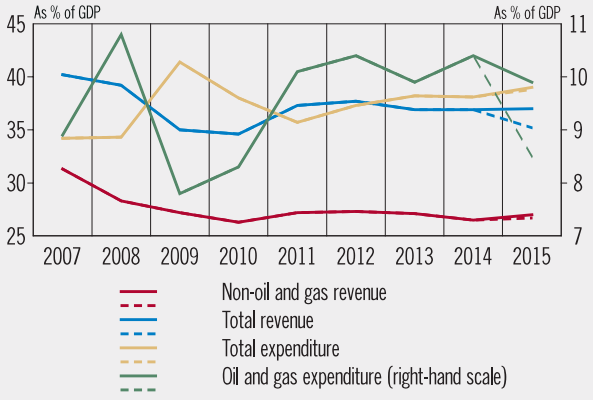
Despite the slow growth in external demand, in 2015 Q1 actual exports grew by 4.5% compared with the corresponding period of the previous year. In Q2 the growth is estimated at roughly 2% and is expected to persist at this level until the end of the year. One of the reasons behind this trend is that considerable depreciation of the ruble in real terms in late 2014 – early 2015 provided some support for export-oriented sectors of the Russian economy – especially the oil sector and metallurgy – partially compensating businesses for losses resulting from the fall in prices in global commodity markets. Thus, in January-June exports of oil rose by 9.8%, oil products by 16.5%, and metals by 9.6% compared with the corresponding period of the previous year. At the same time, the first half of the year saw a reduction in natural gas exports (by 10.3%), mostly due to the fall in gas exports to Ukraine and other European countries (because of the lower demand and high accumulated reserves).

Fiscal policy

According to the Federal Treasury, in the first half of 2015 budgetary expenditures of the Russian Federation amounted to 39.6% of GDP, which is 5.3 pp higher than the same indicators for the first half of 2014 (see the chart). The reason behind the increased expenditures in the first six months is that spending set forth in the draft budget for 2015, including spending on national defence and social policy, is ahead of schedule.

The first six months of the year saw budget income fall by 0.5 pp to 37.0% of GDP. Oil and gas income shrank by 2.4 pp year-on-year to 8.6% of GDP or, in nominal terms, by 19.6% to 2,976.0 billion rubles. The 47% fall in oil prices could have led to a comparable reduction in oil and gas income in nominal terms, but the impact of this factor was largely offset by the ruble depreciation and to a certain degree by growth in oil production and exports and the completion of the tax manoeuvre in the oil and gas industry. Non-oil and gas income rose by 1.8 pp to 28.4% of GDP compared with 26.6% of GDP in the first six months of 2014 against the backdrop of positive profit tax and VAT revenue dynamics. In these conditions, the budget deficit was 2.6% of GDP (in the first six months of 2014 there was a surplus amounting to 3.2% of GDP) and the non-oil and gas deficit increased by 3.5 pp to 11.2% of GDP.

Budget system indicators in 2007-2015*



** Solid line - actual and forecast based on the Budget Policy Guidelines, dash line - Bank of Russia baseline forecast.*
Sources: Russia's Ministry of Finance, Bank of Russia calculations.

According to Bank of Russia estimates, in 2015 the budget income of the Russian Federation will contract relative to GDP by 1.6 pp compared with 2014 (due to lower oil and gas revenues) to 35.3% of GDP. Based on the draft Budget Policy Guidelines for 2016 and the Planned Period of 2017-2018, budget expenditures can rise by 0.8 pp relative to GDP to 38.9% of GDP. Thus, the consolidated budget deficit in 2015 can increase compared with 2014 by 2.5 pp to 3.7% of GDP, which will require spending about 2.3 trillion rubles from the Reserve Fund to cover this deficit.

In view of the increased budget deficit from the implementation of anti-recession budgetary policy measures and the investment of National Wealth Fund resources to support infrastructure projects, the public sector is expected to have a positive impact on the aggregate demand in 2015.

Amid domestic demand shrinkage, goods and services imports continued to fall in real terms in 2015 Q2 and, accordingly, their contribution to the GDP growth continued to be positive.

Supply

In April-July 2015, the decline in industrial production accelerated. In Q2, it fell by 4.9% year-on-year (after 0.4% in Q1) and remained at virtually the same level in July (4.7%).

Manufacturing industries contributed the most to the contraction in industrial output. Most of their output is oriented on domestic consumer and investment demand, which also slumped in the first half of the year (Chart I.3.8). Output shrinkage also resulted from higher cost of intermediate imports[1].

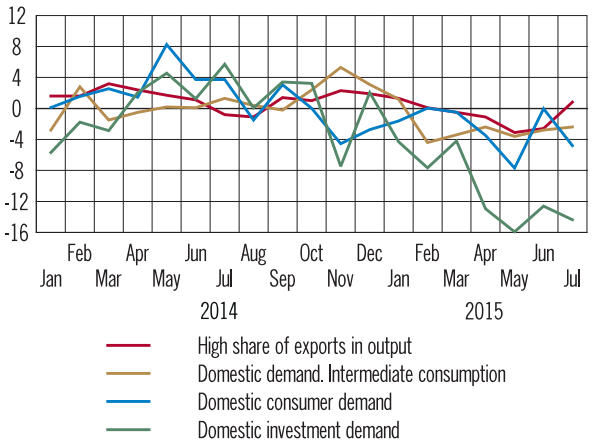
Output in manufacturing sectors such as furniture, other goods, textiles, leather goods, motor cars, and the food industry is chiefly dependent on domestic consumer demand. For example, the food industry, which has the highest gross value added of the industries listed above, sends 97% of its output to the domestic market[2]. In April-July 2015, amid consumer demand contraction, most of these industries saw output fall.

[1] *According to estimates, manufacturing sectors such as food products, textiles and sewing, leather goods, other consumer goods, machinery and equipment, electrical equipment and vehicles are the most sensitive to this factor.*

[2] *The estimate for 2012-2014 is based on the index of actual production and exports volumes at 2012 domestic prices.*

Chart 1.3.8

Output by production sector
(as % of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Import substitution helped sustain output in consumer demand-oriented industries. In particular, the substitution bolstered production of certain food products (in view of the food embargo) and certain sectors of the chemical industry (pharmaceuticals, detergents, cosmetics). The significant growth in the financial performance of research and development activities (a three-fold increase as against the previous year) in the first six months of 2015 implies the development of import substitution.

However, in consumer demand-oriented industries, the trend for output contraction will continue over the coming quarters. It can be partially suppressed by switching some of the output from certain competitive industries over to external markets: in particular, in August several foreign automakers' assembly plants announced plans to start export operations.

In the first six months of 2015, the most substantial drop in output (of all the industry classes) was seen in construction materials, machinery, equipment, electronics, and transport (excluding motor cars), which make up the capital goods production index. According to survey data, in April-July 2015, the impact of factors hampering the increase in output intensified: higher economic uncertainty, insufficiency of domestic demand, and interest expenditures were observed. Spending on import components and fixed assets was up compared to the corresponding period of the previous year.

In view of the limited competitiveness of capital good exports, production dynamics among this group of industries will be shaped by the continuing fall in investment demand in the near future. Import substitution does offer some potential to support the production of capital goods, but the scale of this effect will be minor over the coming quarters.

Output in fields with high proportion of exports (such as mining, metallurgy, timber, fertiliser, and oil and gas production) was, as predicted amid the depreciation of the national currency,

Financial position of enterprises

According to current data from Rosstat, in the first six months of 2015, the net financial result (profit less loss) of enterprises[1] exceeded the comparable indicator for 2014 by 42.6%. Among key activities, the manufacturing industry saw the largest (two-fold) growth in its profit and loss balance. The improvement in businesses' financial positions amid a fall in production was due to temporary factors, primarily higher profitability of sales in certain industries (due to growing yields from exports, cost optimisation, import substitution) and a reduction in the deficit on non-operational income and expenses (due to the impact of the ruble appreciation on foreign currency revaluations).

However, April-June saw a subsequent reduction in growth in profit and loss balances (accrued year-to-date) from 90.4% in 2015 Q1 relative to 2014 Q1 for the economy as a whole, as the impact of one-off factors started to exhaust. The slowing growth of net profits was primarily contributed by the manufacturing industries (in Q1 net profits grew 12.7-fold; at the end of the first six months they grew two-fold; in other key activities, profit growth for the first six months was comparable with Q1). Data on companies' financial results for January-June is currently not available. However, we can assume that further reduction in demand, intensified competition, and levelling out of the 'discrepancies' between the growing prices for marketable products and higher costs may have hampered profitability increase and sales income, while the end of the ruble appreciation in Q2 slowed the reduction in non-operational losses.

With the external economic climate expected to be weak and amid low domestic demand, the surplus of profit and loss balance over that for the previous year will shrink before the end of the year.

[1] *Excluding small businesses, banks, insurance companies and state-financed organisations.*

Bankruptcy dynamics

The number of troubled businesses is a key indicator of the corporate sector's stability in the face of external shocks. Literature offers various approaches[1] to the issue of the most accurate determining of the troubled companies, but in most cases preference is given to analysing corporate bankruptcy dynamics (e.g., see [Karels, Prakash, 1987][2], [Platt, Platt, 2008][3]).

A company (legal entity) becomes involved (as a respondent) in a bankruptcy case if it systematically fails to honour its obligations to creditors over a certain period of time[4]. In Russia, the bankruptcy proceeding involves several stages, during which the conditions to restore the company's solvency[5] are created (excluding a special bankruptcy process known as the simplified procedure[6]). If this is not possible, legal steps are taken to sell off the company's assets at auction and honour its obligations to creditors in order of priority.

Key facts and trends in bankruptcy dynamics[7] in the Russian corporate sector in 2007 – early 2015 (see the chart):

- Taking account of the shift resulting from the difference in calendar periods, the number of bankruptcies in the Russian corporate sector grew steadily from 2013 Q3 to 2014 Q4. As a result, the total number of bankruptcies in 2014 essentially reached the peak levels of the 2010 crisis;
- In 2015 Q1, the number of bankruptcies was comparable with the levels seen in the 2009 crisis. However, from April the situation started to improve significantly – bankruptcies fell by almost 18% over Q2;
- Over 95% of all companies involved in bankruptcy proceedings are small and micro-businesses (companies whose revenues do not exceed 800 million rubles per year)[8];
- Estimates based on a restricted sample (only companies in industry and agriculture whose annual revenues exceeded 80 million rubles at least once over the period) show that[9]:
  - Since 2011, 'hopeless bankrupts' (cases for the simplified procedure) have grown systematically as a percentage of the total number of legal entities in bankruptcy;
  - the relatively high (about 25% per year[10]) proportion of companies that regain solvency through the procedure persists;

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[1] Widespread alternatives are a default on company's obligations (often used in the analysis of public companies), the actual time of liquidation, ceasing production, and lack of dividend payments.

[2] Karels G., Prakash A. (1987). Multivariate Normality and Forecasting of Business Bankruptcy//Journal of Business Finance & Accounting. No.14 (4). pp.573-593.

[3] Platt H. D., Platt M. B. (2008). Financial Distress Comparison Across Three Global Regions//Journal of Risk and Financial Management. No.1 (1). pp.129-162.

[4] According to the Russian legislation (Federal Law No. 127-FZ, dated 26 October 2002, 'On Insolvency (Bankruptcy)', as amended on 13 July 2015), bankruptcy proceedings can be initiated against a legal entity if the amount of claims against it is at least 300,000 rubles and obligations have not been fulfilled for at least 3 months.

[5] When bankruptcy proceedings are initiated the debtor loses a number of powers to carry out property transactions and manage debt owed to creditors, and has to comply with decisions made by a board of creditors/administrative manager. Moreover, a number of creditors' claims and administrative measures against the company (e.g., sequestration) are 'frozen', and the company itself continues to function.

[6] The simplified bankruptcy procedure can be initiated against a company in the liquidation stage (bankruptcy of the liquidated debtor, Article 224 of the Federal Law on Bankruptcy) or a company which has actually ceased operating (bankruptcy of the absent debtor, Article 227 of the Federal Law on Bankruptcy) if the relevant criteria are met, and against specialised associations and mortgage agents (Articles 230.1 and 230.5 of the Federal Law on Bankruptcy). Unlike standard bankruptcy proceedings, under the simplified procedure the process of selling off the company's assets starts immediately in order to satisfy the creditors' claims.

[7] The presented conclusions and assessments are based on data from the BIR-Analitik system and the information resource IT-Audit 'Business Bankruptcy'. The company's bankruptcy date refers to the date on which it was first noted that the company was involved in bankruptcy proceedings in the media (Rossiyskaya Gazeta and Kommersant) or the date on which the corresponding entry was made in the Unified Federal Register of Bankruptcy Information.

[8] The criterion regarding revenue corresponds to the threshold for annual small business revenue set in Resolution of the Government of the Russian Federation No. 702, dated 13 July 2015.

[9] For more information on bankruptcy trends, including an analysis by activity type, form of ownership, and company structure, see Mogilat A. N., 'Bankruptcy of Real Sector Companies in Russia: Main Trends and Financial 'Portrait' of a Typical Bankruptcy' // Treatise: Institute of Economic Forecasting, Russian Academy of Sciences, 2015 (in print).

[10] The estimate represents the 'survivors' as a percentage of the total number of companies undergoing the standard bankruptcy procedure.

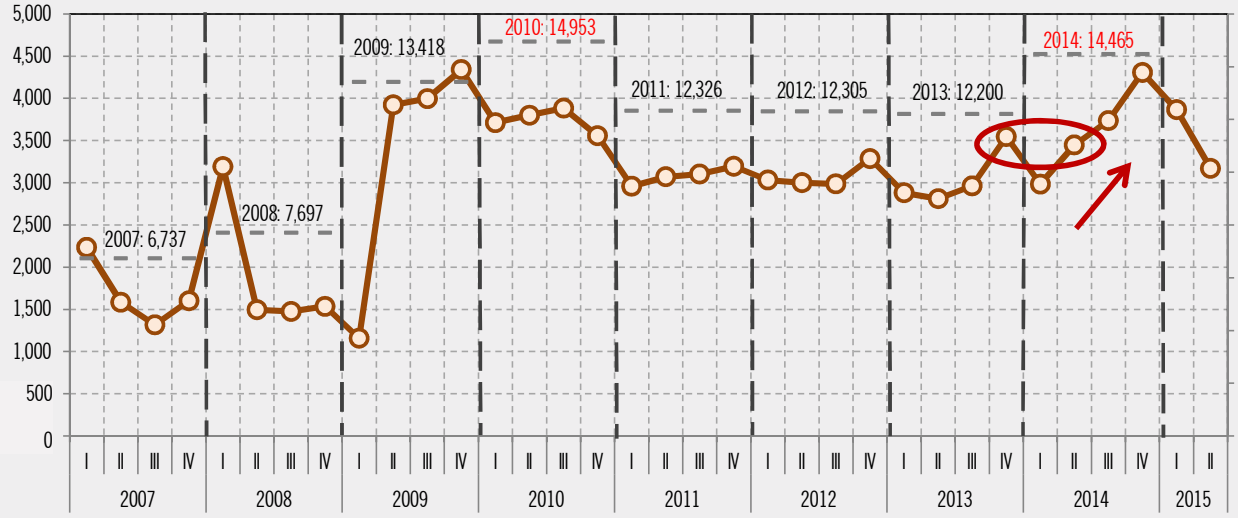
- Most bankrupt companies are seen among trading and construction companies, as well as in the transport and communications sector; among industrial activities, the most alarming situation is in the food and metallurgical industries and in certain machine building sectors;
- Analysis of microdata shows that the first signs of bankruptcy emerge in companies long before bankruptcy proceedings are initiated (1-2 years before) and generally manifest themselves through a significant reduction in output and profits, the accumulation of low liquid inventories, and rapid growth in the debt burden (mostly net accounts payable).

This analysis suggests that the current economic situation impacts the smallest businesses most negatively. However, the situation is not critical:

– First, on the scale of the small and micro-business segment, the number of bankruptcy proceedings is low: in early 2014, roughly 2 million small and micro-businesses were registered in Russia;

– Second, no negative trends have been noted in net creation of legal entities: in January-April 2015, net creation of businesses in non-trading sectors which, judging by bankruptcy statistics, are the most vulnerable in the current situation, started to step up and, according to estimates, this is not linked to any obvious technical factors such as tax benefits, changes in legislation and tax administration practices, or the registration of businesses in the Crimean Federal District in compliance with the Russian legislation.

Number of companies recognised as bankrupt
(quarterly and annually)



Sources: Rosstat, Prime BusinessInfoResource, IT-audit, Bank of Russia calculations.

the most stable: production volumes in April-July 2015 dropped the least of all production classes, and during this period the trend for improvement was observed. This was due to the increase in the physical volume of exports by most producers in this group. On the whole, the negative output dynamics were caused by two factors: first, lower internal demand, and second, restricted growth in the production of export goods due to industry-specific factors. The gas industry saw reduced demand for natural gas from European countries (amid the expected drop in contract prices for supplies and the use of accumulated reserves) and the ferrous metals and coal industries saw growing production of export goods restricted by the high ratio of competitive products in the external market, weak external demand, and partly by protectionist measures implemented by importer-countries in certain markets.

As expected, the production of intermediate raw materials (pulp and paper industry, certain activities in the chemical industry, including the production of rubber and plastic products) decreased on the whole more than the production of goods designed to meet consumer demand, due to the significant reduction in demand from investment-oriented

industries. However, exports supported the output: in April-June, exports of key chemicals, non-fuel petrochemical products, fertilisers and timber products continued to grow. Further production of intermediate goods will be shaped by changes in investment and consumer demand.

Business sentiment analyses show signs of stabilisation and even deceleration of reduction in industrial production. However, with the deterioration in the external economic climate and weaker demand in industry forecast for the coming quarters, production volumes are expected to further decline.

Agricultural output in April-July 2015 made a positive contribution to economic dynamics. In the first six months of the year, growth in agricultural output tended to slow; in July production volumes fell (relative to July 2014). These dynamics resulted from a number of different factors. The production growth was boosted by the food embargo, under which import substitution started to take hold as the government's support for agricultural producers in plant cultivation and livestock rearing increased. According to estimates, livestock rearing showed stable positive dynamics in April-July. Lower output in plant cultivation was expected after the good harvest in 2014. Production dynamics restrained by, among other things, persistent structural problems that cause limited productivity and are primarily a result of insufficient investment in fixed assets and human capital. This agricultural year, the trends of growing production volumes are expected to persist in livestock rearing, while plant cultivation is expected to see a slight drop in production volumes.

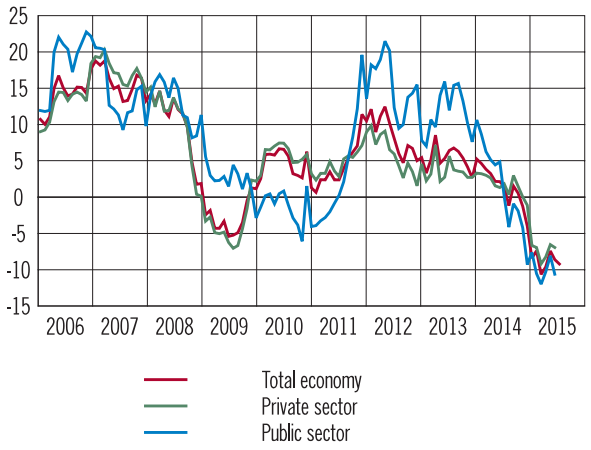
Collectively, supply and demand indicators in June-July suggest that the fall in goods and services output during this period has slowed down. However, current oil prices and their downward revision through the end of the year are causing the forecast reduction in GDP to be lower for 2015 Q3 (to 4.5-5.0% respectively). According to estimates, in 2015 GDP will contract by 3.9-4.4%.

Labour market

In 2015 Q2 the dynamics of key labour market indicators point to the market's ongoing adaptation to lower economic activity. The main channel for this adaptation was reduced labour costs. However, no stable trends have yet formed in the dynamics

Chart 1.3.9

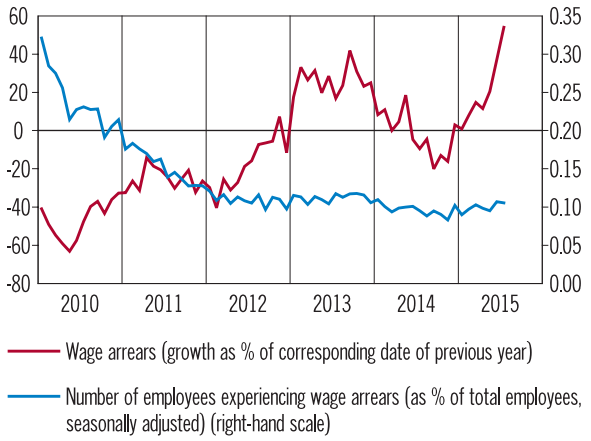
Real wage growth rates
(as % of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.3.10

Wage arrears



Source: Rosstat.

of employment and unemployment indicators. The falling number of economically active population, on the one hand, and the growth in economic activity, on the other hand, affected the labour supply. The economic recession had a negative impact on the demand for labour resources, but the fall in real wages and businesses' propensity to hold on to their qualified employees bolstered the demand.

Following the decrease in April-May 2015 the annual fall in real wages rose in June-July to 8.6% and 9.2% respectively (Chart I.3.9), due to the slower growth in nominal wages and the slightly higher inflation (in July). Meanwhile, with the indexation of wages of public sector employees being frozen, the rate of wage decrease in the

Table 1.3.1

Labour market

Indicators	2014				2015	
	I	II	III	IV	I	II
Employment and unemployment (seasonally adjusted)						
Unemployment rate, %	5.0	5.2	5.2	5.2	5.2	5.8
Employed to unemployed ratio	18.7	18.2	18.3	18.3	18.0	16.3
Aggregate labour market indicator	5.0	4.5	4.1	4.3	5.2	6.1
PMI Composite Employment Index	48.2	47.4	48.2	46.6	44.8	46.0
Wages (year-on-year)						
Nominal wages	11.1	10.2	8.3	7.7	5.7	6.4
Real wages	4.4	2.4	0.6	-1.7	-9.0	-8.1
Wage arrears	6.2	5.7	-11.9	-10.2	7.9	22.6
Part-time employment						
Number of part-time employees, as % of previous period (seasonally adjusted)						
Total	-2.1	0.5	1.2	1.0	1.5	4.5
Part-time employment	7.8	-4.2	-3.4	4.6	11.9	2.7
Part-time employment at employer's initiative	15.6	-0.5	-8.3	10.0	19.1	24.2
Part-time employment upon mutual agreement	-1.4	2.6	0.5	1.4	3.1	2.8
Idle employees	4.9	3.6	2.8	1.3	2.1	2.8
Unpaid leave	-0.4	0.6	-0.7	1.6	1.2	3.5
Part-time employees, as % of headcount						
Total	9.0	9.5	10.4	10.0	9.4	10.4
Part-time employment	2.2	2.1	2.0	1.9	2.4	2.5
Part-time employment at employer's initiative	0.3	0.3	0.2	0.0	0.4	0.4
Part-time employment upon mutual agreement	1.9	1.8	1.8	1.9	2.0	2.1
Idle employees	0.7	0.6	0.6	0.8	0.8	0.7
Unpaid leave	6.1	6.8	7.8	7.3	6.2	7.2
Alternative indicators of part-time employment						
Working hours per employee (year-on-year)	0.3	0.4	0.2	-0.1	-0.3	-0.4
Labour force utilisation in industrial production (normal level=100)	88	87	89	86	82	87

– situation improved
– situation remains unchanged
– situation deteriorated

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

public sector continued to outstrip falling wages in the private sector.

Since early 2015, overdue wages increased (Chart I.3.10) and at the end of July, the growth rate reached a five-year high (+54% compared with the corresponding period of the previous year). Besides, the number of employees experiencing wage arrears is still low: 0.1% of the total number in employment in July.

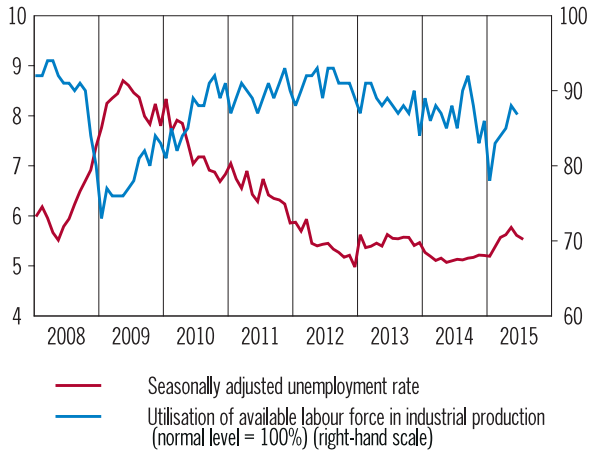
With no noticeable wage indexation in the public and private sectors through the end of 2015, real wages are expected to fall further. In Q3, wages may fall more rapidly due to the rising inflation.

Unemployment and employment indicators give mixed signals regarding the ongoing processes (Table I.3.1). After the spike to 5.7%[3] in May, in June seasonally-adjusted unemployment rate returned to April's levels (5.6%) and continues to fall (5.5% in July) (Chart I.3.11). With the deterioration in the economic situation, these dynamics can

[3] *To ensure that the time series are compatible, this indicator excludes data on the Republic of Crimea and the city of Sevastopol.*

Chart 1.3.11

Unemployment and labour force utilisation (%)

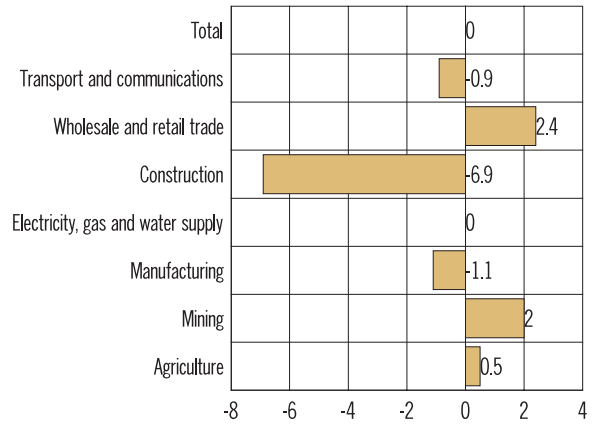


Sources: Rosstat, Bank of Russia calculations, Russian Economic Barometer.

Chart 1.3.12

Annual growth in filled vacancies in June 2015

(as % of average growth in all activities)



Sources: Rosstat, Bank of Russia calculations.

be connected with the fact that, given the lower cost of labour, businesses prefer to transfer their employees to part-time employment with a view to future economic growth rather than lay them off. Furthermore, the trend of increasing economic activity among the population remained, resulting both from the long-term trend of falling labour supply (due to demographic factors) and the increased need for wages due to the lower monetary incomes. However, large and medium organisations saw a reduction in employee numbers in June-July (compared with the corresponding month of the previous year).

In 2015 Q2, labour resources continued to flow from the manufacturing industry and construction into trade and materials sector (Chart I.3.12). The increase in the number of filled vacancies in trade could be linked to the low barriers to moving into this field due to the low requirements for professional training of employees. The positive dynamics in the mining sector could result from the rapid growth in wages in export-oriented industries (due to the positive impact of the ruble depreciation) compared with wages in non-trading industries.

In the second half of 2015, unemployment is expected to grow as a result of weak economic performance.

Inflation

May-June saw inflation reduction (to 15.3% compared with the corresponding month in 2014). Inflation fell faster than previously forecast amid the intensification of demand-side restrictions, ruble appreciation in March-May, and lower inflation expectations (Charts I.3.13 and I.3.14). In July, annual consumer price growth rose, primarily due to greater indexation of utility tariffs than in the previous year.

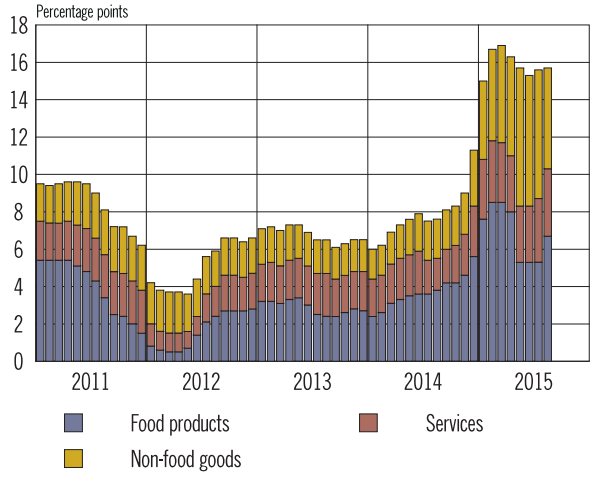
Inflation excluding prices and tariffs for housing and utilities continued to fall. In August 2015, inflation continued to rise (to 15.8%) triggered by the accelerating depreciation of the ruble. According to estimates, the contribution of exchange rate dynamics to annual inflation in August was roughly 7 pp and lower demand reduced inflation by about 1 pp.

In March-August, the food price growth slowed. Over this period, food inflation reduced by 5.6 pp (to 18.1% relative to August 2014) and price growth for fruit and vegetables shrank by 14.4 pp (to 29.1%). Reduction of food inflation after a jump in late 2014 – early 2015 resulted mainly from the ruble appreciation in March-May and contracting demand. Besides, according to estimates, in 2015 Q2, the embargo introduced in 2014 no longer had a significant impact on food prices: producers and suppliers had adapted to the new conditions. Although Russia extended the list of countries the food embargo applied to in August of this year[4], the impact of this factor is estimated to be negligible. Another factor promoting security in the domestic

[4] *Resolution of the Government of the Russian Federation No. 842, dated 13 August 2015.*

Chart 1.3.13

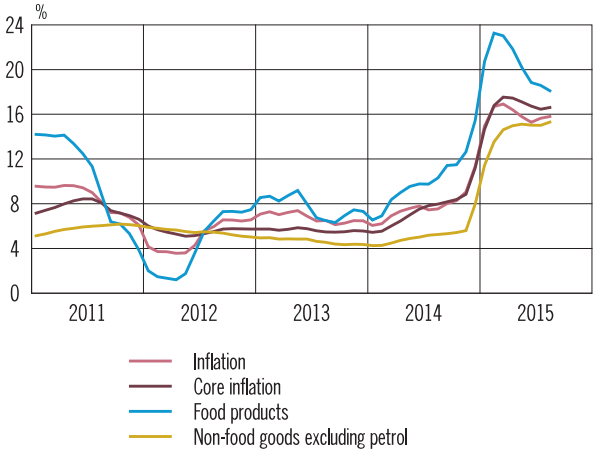
Contribution to inflation
(of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.3.14

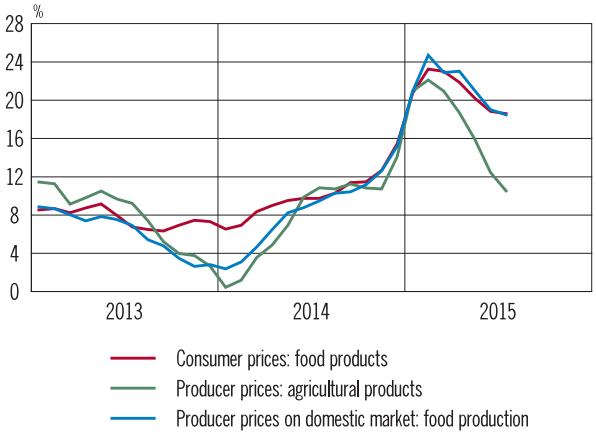
Prices of consumer goods and services
(month of corresponding month of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.3.15

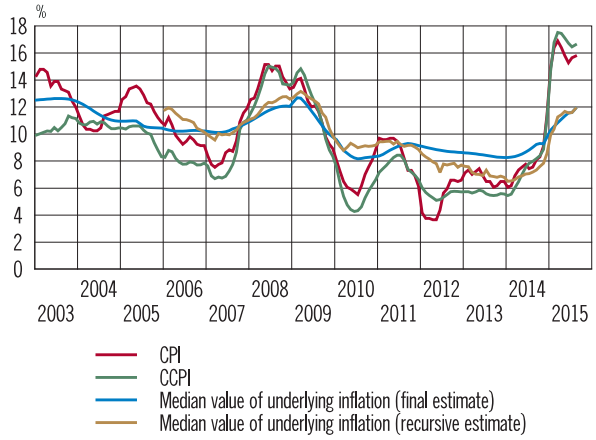
Growth in producer and consumer prices for food products
(of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.3.16

CPI, CCPI and underlying inflation*
(of corresponding month of previous year)



** Bank of Russia estimate.*
Sources: Rosstat, Bank of Russia calculations.

market for grain and products derived from grain was the launch of the export duties mechanism on 1 July 2015.

The fall in food inflation in the consumer market was in line with the slowdown in the growth of producers' prices for food product, including beverages and tobacco from 23.0% in April to 18.5% in July (Chart I.3.15).

However, over the last 12 months, food products increased in price more than other key components of the consumer basket. Pasta and cereals, tea, coffee, seafood, sugar, and fruit and vegetables saw the highest rise in prices, mostly due to the direct and indirect effects of the depreciation of the ruble.

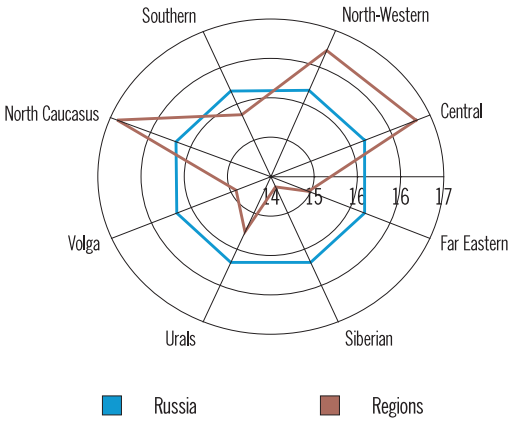
Non-food prices grew by 14.2-14.3% in April-July 2015 (against the corresponding month in 2014). In August they rose again (to 14.6%), reflecting the impact of exchange rate dynamics. From April the growth in prices for services (excluding housing and utilities) was lower than in the first months of the year; June-August saw prices increase (to 14.2%), largely due to the dynamics of prices for foreign tourism services in response to the depreciation of the ruble.

The annual growth in consumer prices for market services and non-food goods that had occurred by July was on the whole in line with the scale of the year's increase in producers' prices in the economy (excluding prices for agricultural products). The

Chart 1.3.17

Inflation by federal district and in Russia as a whole, August 2015

(month to corresponding period of previous year, %)

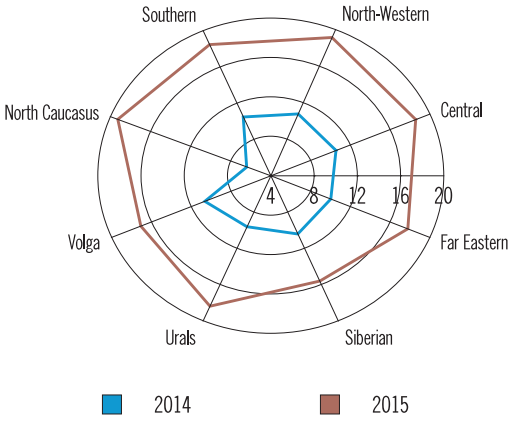


Source: Rosstat.

Chart 1.3.18

Food inflation by regions

(August to August of previous year, %)

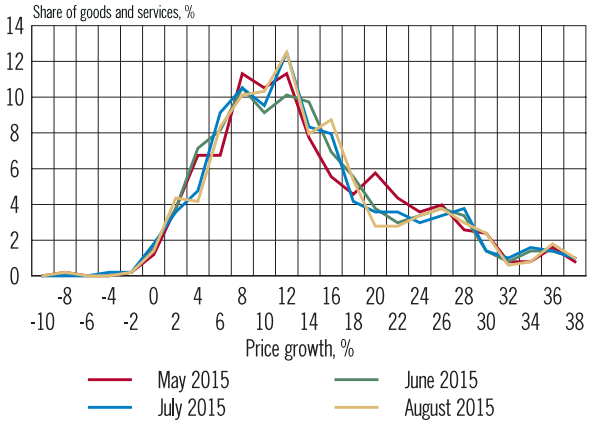


Source: Rosstat.

Chart 1.3.19

Distribution of price growth for all goods and services adjusted for weights in consumer basket

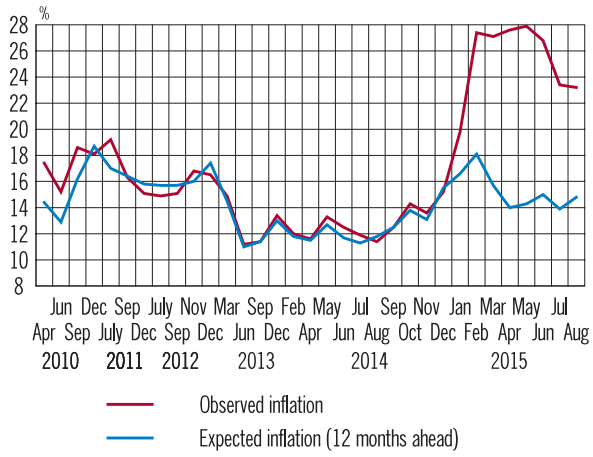
(month to corresponding period of previous year)



Source: Bank of Russia calculations.

Chart 1.3.20

Direct inflation estimates: median values



Source: Public Opinion Foundation survey results.

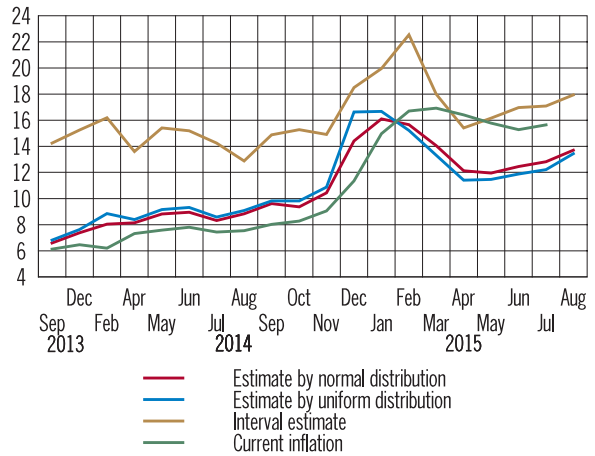
annual growth in producers' prices in industry did not exceed 13.4% in May-July and the growth in freight shipping tariffs has been roughly 10-11% since the start of the year, rising to 14.1% in July.

Overall, the proximity of the growth in producers' prices for goods supplied to the domestic market and inflation (as the aggregate change in consumer prices for domestic and imported goods) suggests, on the one hand, that price dynamics in the economy as a whole have been shaped by the dominating influence of one common factor – the ruble exchange rate, and, on the other hand, that producers' prices, and therefore expenses, played a significant role in price formation for domestic consumer goods. In these conditions, any further drop in inflation will noticeably depend on the dynamics of producers' prices. In turn, the dynamics of indicators such as global energy prices, the ruble exchange rate and aggregate demand will also have an impact on inflation.

After having declined in May-June, core inflation climbed again in August (to 16.6% relative to August 2014). The core consumer price index (core CPI) remained above the CPI, a situation characteristic of relative price shocks in which the ruble depreciation causes prices for tradable goods to jump while non-tradable goods and services become relatively cheap and overall inflation grows. The CPI, unlike core CPI, includes prices for non-tradable goods and services – utilities, some transport services, oil

Chart 1.3.21

Quantified inflation expectations (%)

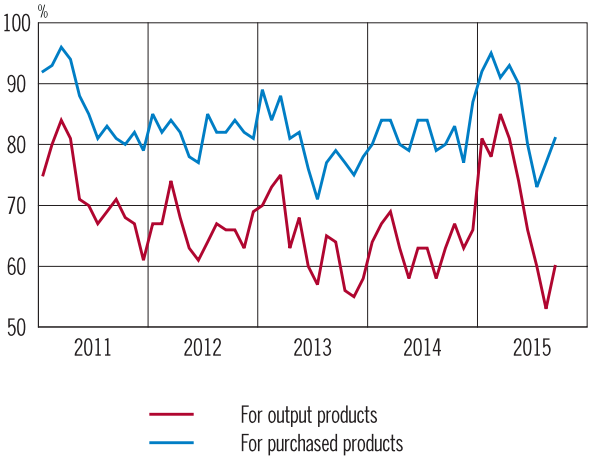


Sources: Public Opinion Foundation survey results, Bank of Russia calculations.

Chart 1.3.22

Diffusion price index for industrial production, expected changes

(share of enterprises showing higher rates over three months)

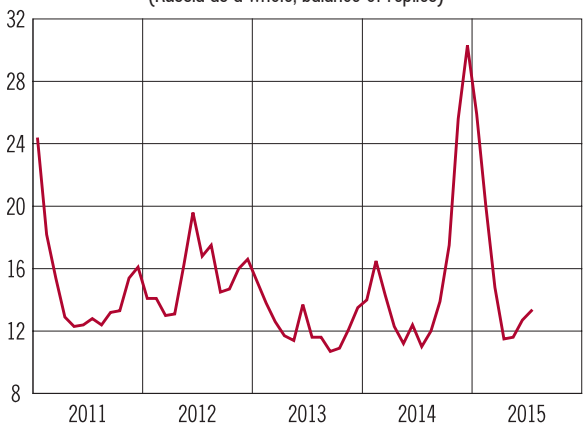


Source: Russian Economic Barometer survey results.

Chart 1.3.23

Expected changes in prices (tariffs, sale prices) for finished goods (services) of enterprises in the next three months

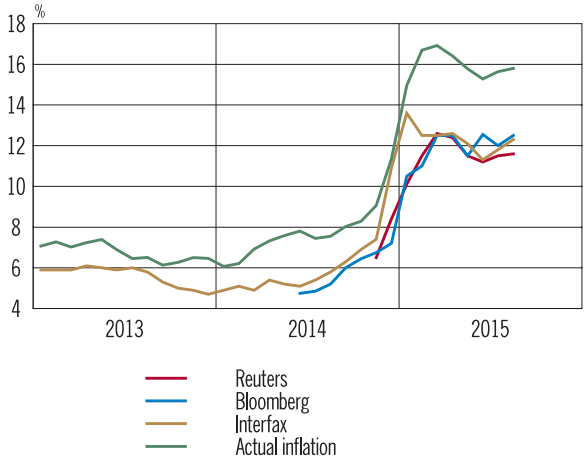
(Russia as a whole, balance of replies)



Source: Bank of Russia.

Chart 1.3.24

Professional analysts' consensus-forecasts of consumer price inflation in 2015



Source: Bank of Russia.

products. Prices for these goods were lower in the last 12 months than prices for goods and services that comprise core inflation.

Estimates of annual rates of trend inflation in August 2015 remained stable at 11.5-12% (Chart I.3.16). This indicates that inflationary pressure in early 2015 did not fully translate into a subsequent acceleration in price growth for a broad range of goods and services. If these price and monetary aggregate trends continue, we can assume that current trend inflation estimates are peaks and expect them to fall gradually.

Signs of growing inflationary pressure, evidently linked to increased depreciation risks, started to appear back in June-July. Thus, the analysis of price dynamics across the complete list of consumer goods and services suggests that the shape of the year-on-year price growth distribution characteristic of recent months in 2015 was preserved in August 2015 (Chart I.3.19). However, it is important to note the increase (to 44.8%) in the share of goods and services showing high price growth – from 10% to 20% relative to the corresponding month of the previous year. The previous year only 14.3% of all goods and services fell under this bracket, while in April 2015 the figure was 38.1%.

Furthermore, the inflation expectations of economic agents started to deteriorate in June (Table I.3.2). According to Russian Economic Barometer, in June more industry managers

Table 1.3.2

Inflation expectations of economic agents

Survey	Expectation horizon	2014				2015							
		I	II	III	IV	January	February	March	April	May	June	July	August
Inflation expectations (absolute), %													
Households													
Public Opinion Foundation	next 12 months	11.8	11.7	12.5	15.5	16.6	18.1	15.7	14.0	14.3	15.0	13.9	14.8
Public Opinion Foundation (Bank of Russia calculations)	next 12 months	8.1	9.0	9.6	14.4	16.1	15.7	14.1	12.1	11.9	12.4	12.8	13.7
Professional analysts													
Bloomberg	2015	4.6	4.8	6.0	7.2	10.5	11.0	12.5	12.5	11.5	12.6	12.0	12.5
Interfax	2015	4.9	5.1	6.3	10.9	13.6	12.5	12.5	12.6	12.1	11.3	11.8	12.3
Thomson Reuters	2015				8.4	10.1	11.5	12.6	12.4	11.5	11.2	11.5	11.6
Financial markets													
Bond market	next quarter	7.1	7.2	8.1	8.7			11.4			16.1		
Interbank market	next quarter	7.2	8.2	8.6	10.0			13.9			18.1		
Inflation expectations (balance of replies*)													
Население Households													
Public Opinion Foundation	next 12 months	84	85	84	83	84	78	76	74	70	72	74	73
Public Opinion Foundation	next month	79	82	76	77	75	71	68	62	59	60	63	67
Enterprises													
Russian Economic Barometer	next 3 months	26	26	32	70	62	48	32	20	6	20		
Bank of Russia	next 3 months	14.3	12.4	13.9	30.3	25.9	20.2	14.8	11.5	11.6	12.7	13.3	
Retail prices (Rosstat)	next quarter	42	41	41	43			31			28		30**
Tariffs (Rosstat)	next quarter	6	5	2	5			7			6		

– inflation expectations improved
– inflation expectations remain the same
– inflation expectations deteriorated

** 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.*
*** September.*

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

expected prices for output and purchased goods to increase (Charts I.3.22 and I.3.23). According to surveys conducted by inFOM, the inflation expected by households in one month- and one year-period increased in August; current monthly inflation perceptions deteriorated (Charts I.3.20 and I.3.21).

A survey by Levada Centre carried out at the end of August showed that the main problem concerning Russians is price growth. Consensus forecasts of inflation levels by professional analysts in 2015 (Chart I.3.24) are still moderate: 11.6% (Thomson Reuters), 12.3% (Interfax), and 12.5% (Bloomberg).

2. ECONOMIC OUTLOOK AND KEY RATE DECISION

2.1. Economic outlook

In this Monetary Policy Report, the Bank of Russia considered three development scenarios for the Russian economy. The key difference between these scenarios is the assumption made about oil price dynamics. The baseline scenario assumes that oil prices will stabilise around $50 per barrel in 2016-2018. The optimistic scenario is based on the premise that oil prices will grow to $75 per barrel by the end of 2018. The risk scenario expects Urals crude prices to fall below $40 per barrel and to remain low in the medium term.

The depth and duration of GDP reduction in these scenarios will be determined to a large extent by the path of trading conditions. Under the baseline and optimistic scenarios, inflation is forecast to fall to the target in 2017, if there is a definite potential for monetary policy easing at varying paces.

Significant inflation risks could also cause changes in fiscal and tariff policy. If these risks materialise, the Bank of Russia will take measures aimed at reducing their inflationary aftermath with due account of Russian economic potential.

In the previous Monetary Policy Report (June 2015), the Bank of Russia considered two economic development scenarios to be equally possible: (1) a gradual recovery of oil prices to $80 per barrel by the end of 2018 and (2) oil prices remaining close to $60 per barrel[1] in 2016-2018. However, the change in the situation in the global economy and in the oil market in June-August 2015 served as the basis for a downward revision of assumptions about oil price dynamics both for the remaining months in 2015 and in the medium term.

The decline in EME growth forecasts suggests that global demand for oil will grow at a slower rate than previously assumed. According to International Energy Agency estimates, in 2015-2016 roughly 80% of growth in global demand for oil will come from non-OECD countries (of which China will account for roughly 25%). The Chinese stock market selloff and the resulting wave of investors fleeing risky assets have already contributed to a drastic fall in oil prices in August 2015 and the revision of forecasts through the end of the year. If problems in the financial market and accumulated imbalances lead to a slowdown in the Chinese economy (and other EMEs with close economic ties with China), global demand for oil will grow slower than previously forecast.

In turn, the prerequisites for higher-than-expected supply in the oil market are intensifying. Shale oil production in the US is contracting slower than many market participants anticipated. Thanks to advances in technologies used to extract oil from unconventional sources, the cost of extraction at existing shale oil deposits in the US fell considerably. According to estimates from international analytical agencies, production will remain profitable even if oil prices fall to $30 per barrel. Furthermore, the treaty regarding Iran's nuclear programme concluded in July 2015 will cause restrictions on Iranian oil exports to be lifted in 2016 and, consequently, produce a rise in oil supply in the global market.

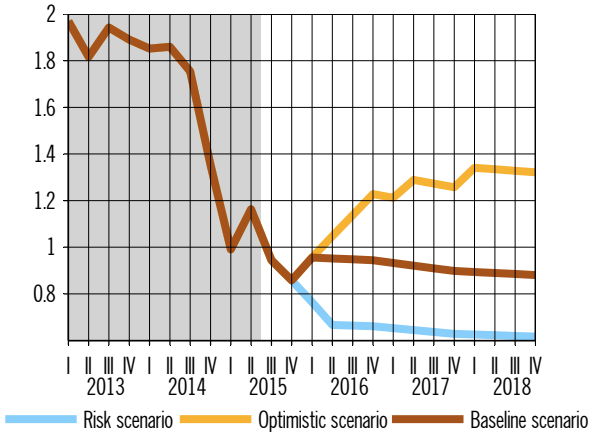
In view of these factors, the Bank of Russia reduced its Urals crude price forecasts (Chart 2.1.1). In 2015 Q3-Q4, prices are expected to fluctuate between $45 and $50 per barrel with the annual average price at roughly $52 per barrel. Going forward, the Bank of Russia is considering the following scenarios for the global energy market developments.

Under the baseline scenario, oil prices will stabilise around $50 per barrel in 2016-2018 due to a further reduction in the cost of oil as a result of improvements to technologies used to produce oil from unconventional sources, increased supply from OPEC countries (especially Iran), and moderate growth in oil demand. The optimistic scenario assumes that the increasing global demand for oil and the decreasing supply in the oil market in the medium term will contribute to a gradual rise

[1] *The expected average oil price in 2015 was the same at the time of publishing the previous Report.*

Chart 2.1.1

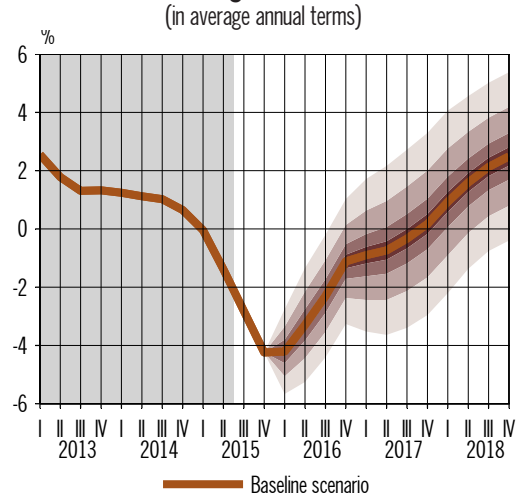
Terms of trade



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

Chart 2.1.2

GDP growth rate
(in average annual terms)



Source: Bank of Russia calculations.

in oil prices to $75 per barrel by the end of 2018. Finally, the risk scenario was calculated based on the assumption that supply in the oil market will significantly exceed demand, causing oil prices to fall below $40 per barrel in 2016 and remain low in the long term.

External financial conditions in all of the scenarios will constrain the growth of the Russian economy over the course of the entire forecast period. As a result of the financial sanctions imposed against Russia, companies' and banks' access to world capital markets will remain limited. With reduced demand for Russian assets, Russian banks and other sectors will be forced to repay loans received earlier, as was the case in 2014 Q4–2015 Q2. According to estimates, in September-December 2015, net payments by banks and other sectors on external debts will be roughly $30 billion, and roughly $40 billion for 2016 as a whole.

The constraining influence of external financial restrictions, according to estimates, will gradually decrease with the diversification of international funding sources. Under the optimistic scenario, this influence is expected to abate faster: as oil prices recover, the Russian economy will become more attractive to international investors.

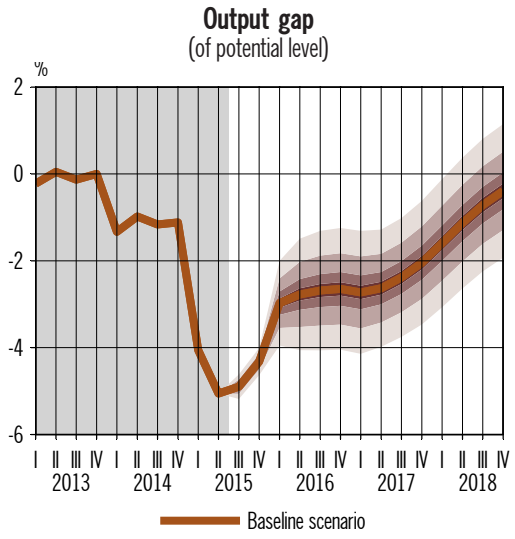
Under the baseline scenario, persistence of negative external economic and financial conditions in the long term will be a significant factor holding back economic recovery (Chart 2.1.2). Furthermore, internal sources for economic growth will also be limited with negative business sentiment and expectations likely to continue to affect the propensity to invest in the Russian economy. Accordingly, in 2016 GDP is expected to continue to fall to 0.5-1.0%.

The negative growth in output will in part be down to the economy's structural adjustment to changing external economic conditions, which will be accompanied by a flow of labour and capital resources into more productive sectors, primarily export-oriented sectors, and industries serving domestic demand and manufacturing competitive goods. Given a fall in income from foreign trade operations compared with previous years and considering that economic agents are not expecting any significant improvement in external economic conditions over the forecast horizon, the decrease in GDP will be largely of structural nature, meaning that there will be a relatively small negative output gap in 2016 (Chart 2.1.3).

Breaking down the components by use, the fall in GDP in 2016 will be caused by a further squeeze on both consumer and investment demand. The main factor behind the continuing contraction in consumer demand is still the low rate of indexation of nominal wages in the public and private sectors amid falling demand for labour from businesses and limited opportunities to fund the budget deficit. The reduction in household spending on final consumption is forecast to be between 1.0% and 2.0% in 2016.

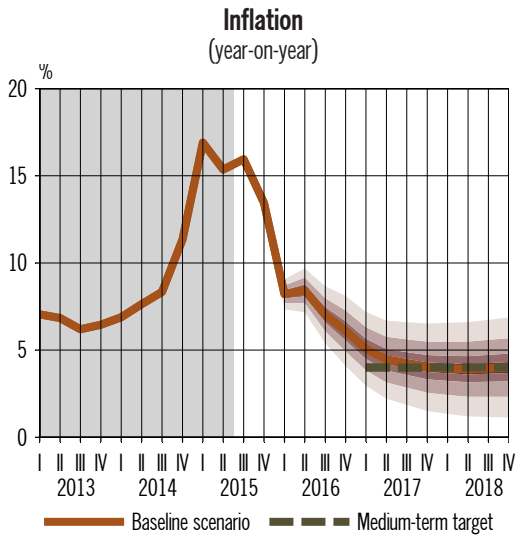
Gross capital formation will also continue to make a negative contribution to GDP growth in

Chart 2.1.3



Source: Bank of Russia calculations.

Chart 2.1.4



Source: Bank of Russia calculations.

2016 both due to a reduction in gross fixed capital formation and as a result of the ongoing adjustment of inventories (albeit more slowly than in 2015). The main factors holding back investment activity will remain the economic agents' persistent negative expectations regarding Russia's economic outlook, low export earnings, and relatively tight external and internal financial conditions.

Export growth in real terms is not expected to exceed 1% in 2016 amid relatively weak external demand. Import volumes will continue to shrink, albeit far more slowly than in 2015, amid the slowing fall in investment and consumer spending. As such, the contribution of net exports will remain positive.

In 2017, decreasing uncertainty amid stabilising oil prices will have a positive effect on the economic agents' sentiments. The reduction in the debt burden of non-financial organisations and households after two years of low growth in lending to households and non-bank institutions and the consistent settlement of external debts will increase economic agents' opportunities to borrow, which will also be supported by the easing of domestic financial conditions. These trends will create the necessary conditions for investment activity to step up. In 2017, gross capital formation growth is expected to be slightly positive, and in 2018 could exceed 5.5%, according to estimates.

Consumer demand will recover slowly and will be conditioned upon a gradual increase in demand for labour and thus an acceleration of wage growth: growth in household spending on final consumption will only break into consistently positive territory in 2018.

As the global economy recovers and the competitiveness of Russian exports increases (both primary and non-primary exports), growth in export volumes is expected to gradually increase in 2017-2018. In addition, growth in import volumes is forecast to enter consistently positive territory in 2018.

Considering these dynamics in the growth rates of exports and imports and stable oil prices, the current account surplus is expected to consistently fall in 2016-2018 (see Annex 'Balance of payments'). At the same time, the reduction in external debt payments (which is expected, on the one hand, in accordance with the official repayment schedule and, on the other hand, as a result of increased opportunities to refinance) will cause a gradual contraction in capital outflow. In these conditions, banks will not need to increase their debt under Bank of Russia foreign currency refinancing facilities in 2016-2018.

Inflation is expected to fall gradually over the forecast period. The exhaustion of the effect from the ruble depreciation in June-August 2015 will cause a gradual slowdown in quarterly inflation from 2016 Q1following its acceleration in 2015 Q3-Q4. In December 2015, annual inflation is forecast to be between 12% and 13%, and from January 2016 it will start to decline, partly due to the high base in 2015 (Chart 2.1.4).

Table 2.1.1

Main parameters of Bank of Russia forecast
(as % of previous year, unless indicated otherwise)

	2014 (actual)	2015		2016				2017				2018			
		September	June	September	June	September	June	September	June	September	June	September	June	September	June
		estimate	scenario 1/ scenario 2	baseline	scenario 2	optimistic	scenario 1	baseline	scenario 2	optimistic	scenario 1	baseline	scenario 2	optimistic	scenario 1
Urals crude price, annual average, $ per barrel	98	52	60	50	60	60	70	50	60	70	75	50	60	75	80
Inflation, December on December of previous year, %	11.4	12.0-13.0	10.8	5.5-6.5	4.5	5.5-6.5	5.1	4.0	4.0	4.0	4.2	4.0	4.0	4.0	4.0
Gross domestic product, year-on-year, %	0.6	-(3.9-4.4)	-3.2	-(0.5-1.0)	-1.2	0.0-0.5	0.7	0.0-1.0	0.0	1.0-2.0	2.4	2.0-3.0	1.7	2.5-3.5	1.7
Final consumption expenditure	0.9	-(6.1-6.9)	-5.6	-(1.0-1.4)	-2.0	0.0-0.3	-0.4	(-0.7)-0.3	-0.8	0.8-1.5	2.9	1.5-2.5	2.9	2.0-3.0	2.4
– by households	1.3	-(9.0-9.5)	-5.9	-(1.0-2.0)	-2.1	0.0-0.6	-1.2	(-0.9)-0.0	-1.9	1.1-1.7	3.5	1.8-2.9	3.2	2.5-3.5	2.9
Gross capital formation	-7.3	-(21.0-26.0)	-22.0	-(3.2-6.6)	-4.1	1.1-3.2	4.9	(-0.5)-2.5	4.3	4.7-7.7	6.1	5.5-7.2	1.5	11.5-14.0	0.3
– gross fixed capital formation	-2.0	-(8.0-8.9)	-4.9	-(2.8-3.8)	-1.1	0.6-1.6	1.1	(-0.5)-0.5	1.3	3.0-4.0	6.4	4.0-5.0	3.2	5.0-6.0	1.6
Net exports	29.8	74.5-76.5	73.3	8.5-10.5	15.4	-(1.5-3.5)	0.9	8.5-10.5	-2.3	-(1.5-3.5)	-13.1	-(5.0-7.0)	-10.1	-(14.5-16.5)	-2.3
– exports	-0.1	1.5-4.0	0.9	0.0-1.0	1.0	0.4-1.4	2.2	1.0-2.0	1.3	1.6-2.6	2.0	1.9-2.8	1.8	1.9-2.8	1.6
– imports	-7.9	-(18.0-21.5)	-21.7	-(1.5-2.5)	-3.5	0.5-2.6	2.6	(-1.0)-0.5	2.4	3.1-4.0	6.7	4.5-6.0	5.5	7.0-9.0	2.8
Money supply in national definition, annual growth, %	2.2	5-8	2-7	4-7	0-5	8-10	4-9	8-11	2-7	13-16	10-15	13-16	7-11	13-16	8-13
Monetary base in narrow definition, annual growth, %	2.7	0-3	0-2	1-4	(-2)-2	5-8	2-4	2-5	(-1)-3	5-8	9-11	5-8	4-8	5-8	7-9
Lending to non-financial organisations and households in rubles and foreign currency, annual growth, %	25.9	4-7	2-7	4-7	0-5	7-9	4-9	8-11	2-7	13-16	10-15	13-16	7-11	13-16	8-13

Table 2.1.2

Russian balance of payments indicators
(billions of US dollars)

	2014 (actual)	2015		2016				2017				2018			
		September	June	September	June	September	June	September	June	September	June	September	June	September	June
		baseline/ optimistic	scenario 1/ scenario 2	baseline	scenario 2	optimistic	scenario 1	baseline	scenario 2	optimistic	scenario 1	baseline	scenario 2	optimistic	scenario 1
Current account	59	73	93	58	101	83	104	56	81	79	117	51	72	76	121
Trade balance	190	156	187	138	186	165	185	131	169	162	206	126	158	164	212
Exports	*498*	*344*	*411*	*335*	*415*	*374*	*440*	*336*	*414*	*430*	*490*	*346*	*418*	*486*	*538*
Imports	*-308*	*-187*	*-223*	*-198*	*-228*	*-210*	*-255*	*-205*	*-244*	*-267*	*-284*	*-220*	*-260*	*-322*	*-326*
Balance of services	-55	-33	-43	-35	-40	-35	-36	-36	-41	-43	-39	-39	-43	-50	-38
Exports	*66*	*53*	*52*	*54*	*53*	*56*	*58*	*55*	*55*	*59*	*59*	*58*	*55*	*64*	*63*
Imports	*-121*	*-87*	*-96*	*-90*	*-93*	*-92*	*-94*	*-91*	*-96*	*-102*	*-98*	*-96*	*-98*	*-114*	*-101*
Balance of primary and secondary income	-75	-50	-51	-44	-46	-46	-45	-39	-47	-40	-51	-37	-43	-38	-53
Capital account	-42	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Balance from current and capital account	**17**	**73**	**93**	**58**	**101**	**83**	**104**	**56**	**81**	**79**	**117**	**51**	**72**	**76**	**121**
Financial account (excluding reserve assets)	**-134**	**-88**	**-93**	**-59**	**-78**	**-68**	**-78**	**-56**	**-68**	**-64**	**-74**	**-50**	**-58**	**-61**	**-68**
General government and central bank	*29*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*
Private sector (including net errors and omissions)	*-154*	*-85*	*-90*	*-56*	*-75*	*-65*	*-75*	*-53*	*-65*	*-61*	*-71*	*-47*	*-55*	*-58*	*-65*
Change in FX reserve assets ('+' - decrease, '-' - increase)	**108**	**15**	**0**	**0**	**-23**	**-15**	**-26**	**0**	**-13**	**-15**	**-43**	**0**	**-14**	**-15**	**-53**

The economic cool-down will have a limited disinflationary effect as it will in part be down to structural factors. The economy's adaptation to changing external economic conditions may be accompanied by an increase in producer costs linked, in particular, to a fall in productivity.

Thus, the potential for monetary policy easing is significantly restricted, which caused the Bank of Russia to keep its key rate unchanged (at 11% p.a.) on 11 September 2015. Taking into account the increase in the inflation forecast for the end of 2015 – start of 2016, and the expected gradual slowdown of falling aggregate output in the first six months of 2016, the balance of risks will not undergo any significant change. As inflation slows further in accordance with the forecast and inflation expectations fall, the Bank of Russia will be ready to reduce the key rate.

Any change in interest rate policy will be gradual, and monetary policy will remain reasonably tough until inflation is persistently stable around the 4% target. This is necessary not only to ensure a reduction in inflation and inflation expectations but also to support financial stability. The main internal source of risk to the latter may be excessive acceleration in the growth of the credit burden disproportionate to income trends in the economy, which is possible in the event of excessive easing of financial conditions.

Under the optimistic scenario, the restraining influence of external factors on the economy will be less pronounced and the Russian economy is expected to return to positive growth as early as 2016.

The demand for Russian exports – both primary and non-primary exports – will turn out to be higher than under the baseline scenario. The growth in import quantities will in turn be determined by the increase in investment demand and then by the recovery of consumer activity. Despite the somewhat faster growth in imports in real terms relative to exports, the USD equivalent of the current account balance will remain at a comparatively higher level, exceeding the figures set out in the baseline scenario. However, the financial account deficit is forecast to be slightly above the baseline scenario, due to the more dynamic recovery of income growth in the economy and larger flow of funds into the current account. The net private capital outflow will be in the range of $60-70 billion per year. The state of Russia's balance of payments and the situation in the foreign exchange market under this scenario will enable the Bank of Russia to gradually build up its foreign currency reserves throughout the forecast period due to banks settling debts owed under Bank of Russia foreign currency refinancing facilities.

This scenario also assumes that a recovery in trading conditions is also expected by most economic agents in the medium term, meaning that the economic cooling in 2015-2016 will be largely of a cyclical nature (compared with the baseline scenario). A deeper negative output gap (even against the backdrop of the more favourable economic growth forecast) than in the baseline scenario will cause demand to have a more pronounced constraining impact on inflation. This in turn will create potential for a faster reduction in the Bank of Russia key rate than in the baseline scenario.

2.2. Risk assessment

Under the risk scenario, the more unfavourable development of the external situation in comparison with the baseline and optimistic scenarios will bring about a stronger and longer-lasting recession. The adverse impact of the foreign economic situation on the Russian economy will take the form of a drop in income from exports, a decrease in the solvency of borrowers who have outstanding debt in foreign currency, a decline in the attractiveness of investment in the Russian economy for Russian and foreign investors, and a squeeze on the ability to finance public expenditures. Under these conditions, GDP could fall by more than 5% in 2016.

Given the increased uncertainty over the development of the external and domestic situation, volatility in the financial markets may rise under this scenario. Under these conditions, exchange rate and inflation expectations may deteriorate sharply, which significantly increase inflation risks and risks to financial stability. In order to prevent these risks from snowballing, the Bank of Russia can use either interest rate policy measures or other instruments, including operations in the domestic FX market (through both reverse transactions and direct sales of foreign currency in the open market).

Under the risk scenario, inflation will be higher than in the baseline and optimistic scenarios at 8-9% in 2016. The Bank of Russia key rate will remain for a protracted period at a higher level than under the baseline and optimistic scenarios.

In all of these scenarios, there is a possibility of further risks which could impact inflation dynamics. At the current stage, the Bank of Russia believes that risks are distributed asymmetrically across price dynamics and are largely lean towards the pro-inflationary ones, which makes it necessary to take a relatively conservative approach to monetary policy-making. One risk for the inflation forecast is the fluctuation of traditionally volatile food prices depending on the harvest of particular crops. Changes in fiscal and tariff policies that were not built into the scenarios considered could also have an inflationary effect. External risks from geopolitical factors still persist and may affect price dynamics through exchange rate changes.

The acceleration of annual inflation rates under the influence of the above factors is usually short-lived, i.e., as the influence is exhausted after 12-18 months, inflation begins to slow down. In this case, inflation will return to a path that is consistent with meeting the 4% target in the medium term, without any additional change in monetary policy. If, however, such factors begin to influence the price dynamics for a wide range of goods and services and if inflation expectations begin to rise, the Bank of Russia will pursue tougher monetary policy.

ANNEX

Dynamics of major balance of payments items in 2015 Q2

The renewed slump in global oil prices in mid-May caused the annual rate of export decline to stay high. As a result, despite the greater than expected fall in imports in 2015 Q2, the current account balance was significantly below forecast levels. The balance of trade surplus decreased by 15%[1], while the current account surplus in 2015 Q2 increased compared with 2014 Q2. The fall in the balance of trade was fully offset by a reduction in the negative contribution of non-tradable components and the balance of services (Chart 1).

The value of exports fell by 30%, mainly due to reduced prices for commodities. The growth in export volumes of crude oil and oil products by 7% and 10% respectively was not enough to offset the effect of the falling prices. The export volumes of Russian natural gas fell by 4% due to a reduction in supplies to the EU and Ukraine. As a result, exports of crude oil, oil products, and natural gas fell by 38% and exports of other products only fell by 14% owing to the ruble depreciation.

The 40% reduction in imports of goods in Q2 was due to reduced consumer activity. The main contribution to the decrease in imports came from machinery, equipment and vehicles. The food embargo introduced by Russia in 2014 did not have a significant effect on imports: the fall in imports of foodstuffs affected by the embargo accounted for only 6% of the total decrease in imports.

The deficit of the non-tradable components' balance decreased mainly due to the fall in investment income payable. As debt was repaid, the reduction in the total volume of obligations to non-residents contributed to the reduction in the volume of interest payments.

In turn, the financial account's balance was close to the predicted level, despite the extremely volatile and heterogeneous dynamics of its certain components. Net private sector capital outflow in 2015 Q2 shrank by 3% compared with the same period in 2014 and by 35% compared with the outflow in the previous quarter. Unlike previous years, when the private sector capital outflow was mainly the result of asset growth, in 2015 Q2 it was the result of both reduced external obligations and increased foreign assets.

The reduction in private sector foreign obligations by $11.5 billion was mostly due to banks settling external debt amid shrinking opportunities to refinance debt due to the financial sanctions. In 2015 Q2, private sector external debt remained virtually unchanged (Chart 2). The reduction in banking sector debt was offset by growth in the debt of other sectors. However, banks reduced foreign obligations faster than had been assumed by the forecasts, which were based on the external debt repayment schedule, while other sectors did so more slowly. Despite the impact of negative external factors, a small inflow of capital was recorded in 2015 Q2 with respect to other sectors' obligations.

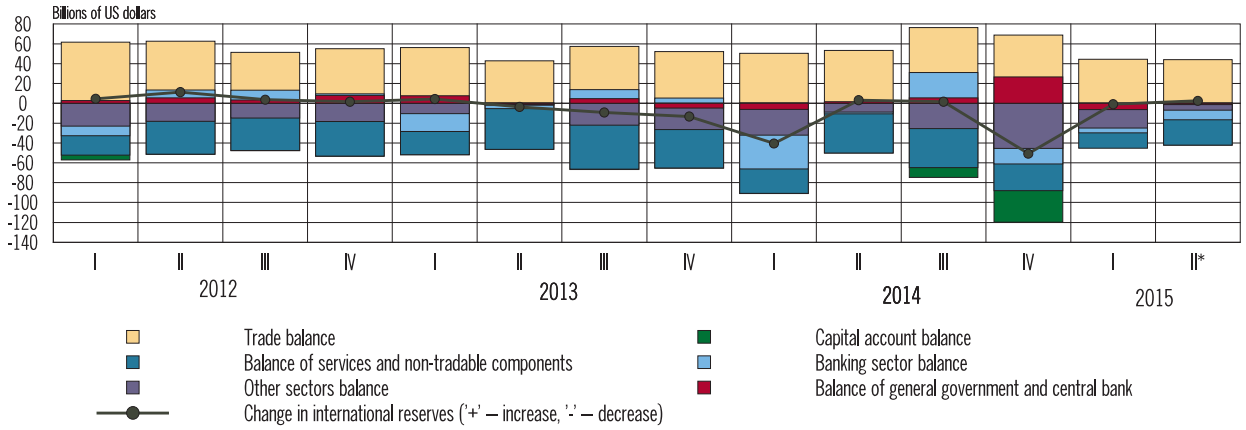
Banks repaid their external debts along with the purchases of foreign assets, which increased by $3.7 billion. Other sectors also built up their foreign assets by $7.1 billion, mainly through direct investment. Companies managed to secure a net direct investment of $4.7 billion.

Moreover, in comparison with the previous quarter, the value of external debt payments decreased and the household demand for foreign currency fell. Other sectors' foreign assets in foreign currency cash fell by $2.8 billion in 2015 Q2, as in the previous quarter. All this contributed to reduced capital outflow. Net private sector capital outflow adjusted to the volume of foreign currency liquidity provided to credit institutions on a repayable basis

[1] *Here and below in the Balance of Payments Section, changes in indicators are shown on a year-on-year basis, unless indicated otherwise.*

Chart 1

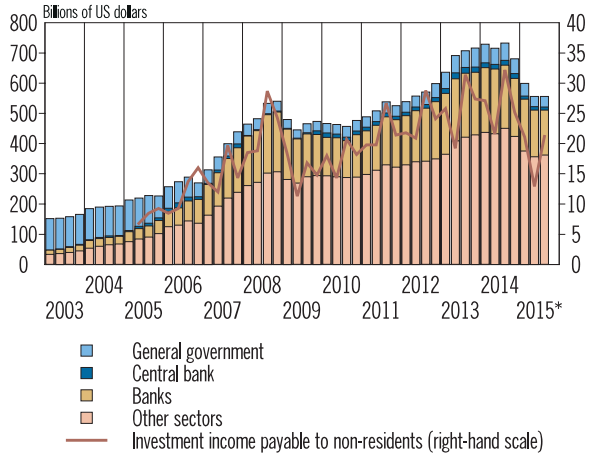
Major balance of payments components



** Items 'Banking sector balance' and 'Change in international reserves' are adjusted by the amount of FX swaps of the Bank of Russia with resident banks and operations on resident banks' correspondent accounts with the Bank of Russia; item 'Other sectors balance' includes item 'Net errors and omissions'. The use of signs corresponds to BPM5.*
*** Estimate.*
Source: Bank of Russia.

Chart 2

External debt of the Russian Federation



** As of 1.07.2015 - estimate.*
Source: Bank of Russia.

and other Bank of Russia operations[2] fell from $23.3 billion in 2015 Q1 to $16.4 billion in 2015 Q2.

Balance of payments forecast for 2015-2018

The Bank of Russia is considering three macroeconomic development scenarios which differ in their assumptions about oil price dynamics and forecasts of other key macroeconomic indicators. Under the baseline and optimistic scenarios, oil prices are assumed to remain between $45 and $50 per barrel in 2015. The baseline scenario assumes that oil prices over the period will fluctuate at roughly $50 per barrel, while in the optimistic scenario oil prices will grow steadily to $75 per barrel in 2018. The risk scenario assumes oil prices will fall below $40 per barrel by the start of 2016 and remain below $40 per barrel until the end of 2018.

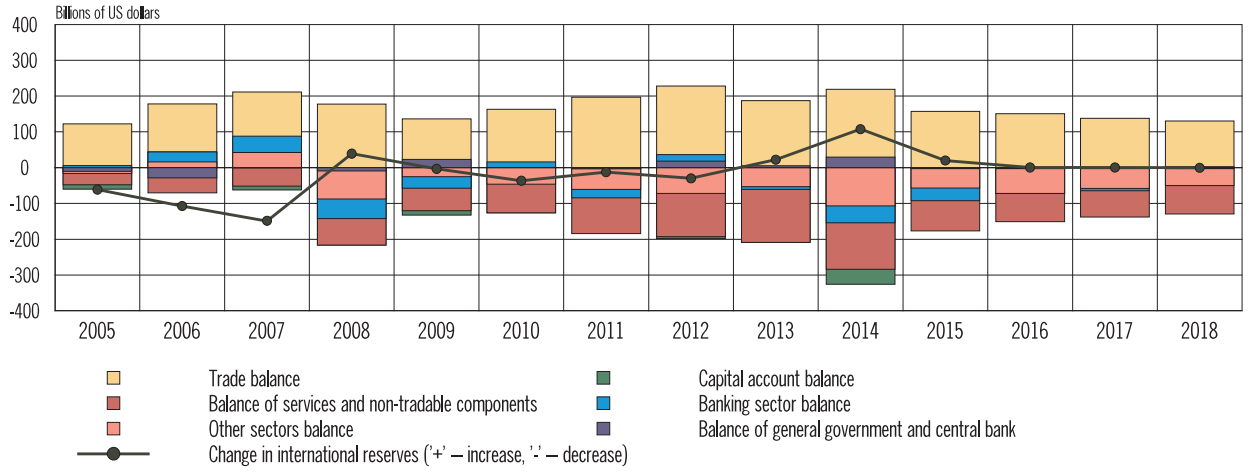
2.1. Current account and capital account

A significant fall in the price of oil in 2015 in comparison with 2014 in all of the considered scenarios will exert a strong downward pressure on exports. The impact of the ruble exchange rate dynamics will be insufficient to offset this pressure. This will cause exports to fall by 30% in US dollar terms. However, the import quantities will contract even faster under the influence of slowing economic growth and the weakened ruble, and also under the influence of international financial and trade sanctions. As a result, the balance of trade surplus will contract considerably compared with the last year's level, but the current account as a whole will rise from $60 billion to $73 billion due to an improvement in the balance of services and the balance of non-tradable components, primarily a reduction in investment income payable.

[2] *Adjusted to the volume of foreign currency liquidity provided by the Bank of Russia to credit institutions on a repayable basis, to the amount of operations in resident banks' correspondent accounts with the Bank of Russia, and also to the amount of foreign currency funds received by the Bank of Russia as part of FX swap operations.*

Chart 3

Major balance of payments components
(baseline scenario forecast)



Source: Bank of Russia.

Compared with the previous forecast published in the June Monetary Policy Report, in 2015 estimates of average annual oil prices and economic growth rates have been revised downwards. Accordingly, estimates of both exports and imports have been reduced significantly, but the revision of exports was more pronounced. As a result, the balance of trade and current account balance will be lower overall in 2015 than assumed in the previous forecast.

In 2016-2018, under the baseline scenario, oil prices will stabilise at a lower level than the average annual price for 2015. As a result, exports of goods and services will decline slightly in 2016 and are not expected to grow significantly in the future. In turn, imports of goods and services will start to grow steadily as domestic demand recovers. External debt repayment will lead to a reduced number of debt payments. As a result, the deficit of the non-tradable components' balance will steadily decline over the entire period under review. Consequently, in 2016 the current account surplus will shrink, but it will then stabilise at roughly $50-60 billion (about 4% of GDP) in 2016-2018. Compared with Scenario 2 published in the previous Report (which also assumed oil prices would remain stable in 2016-2018, but at a higher level), the lower oil prices mean lesser export volumes, which result in a lower current account balance.

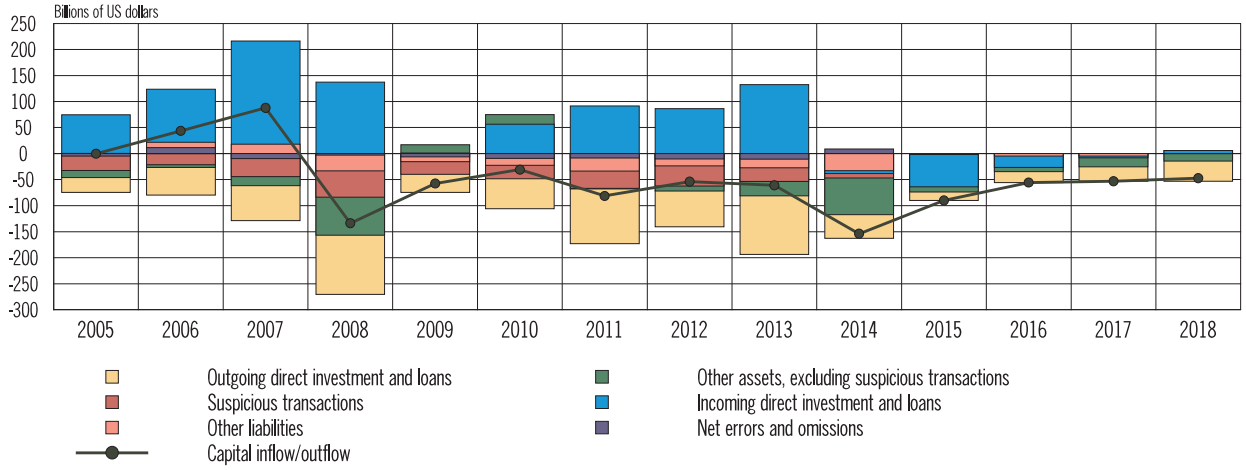
Under the optimistic scenario, in 2016-2018 the increase in oil prices and economic recovery of Russia's trading partners will promote growth in exports. However, imports will grow at a faster rate as internal demand recovers. As a result, after a slight increase in 2016, the balance of trade will remain virtually unchanged, and the balance of services will gradually worsen: services exports have a far weaker connection with oil prices than goods exports, while services imports will grow following GDP growth. As in the baseline scenario, the deficit in the balance of non-tradable components will steadily decline over the entire period under review amid the reduction in total debt. As a result, the current account surplus will reach its maximum over the forecast period in 2016 and will steadily fall thereafter, staying, however, at historically high levels (roughly $75-85 billion, or 5-6% of GDP). Compared with the forecast published in the Monetary Policy Report in June 2015 under Scenario 1 (which also assumed growth in oil prices in 2016-2018), estimates of the current account surplus have been lowered. The reduction in the imports forecast as a result of the low expected GDP growth was not enough to offset the fall in exports due to the downward revision of the oil price forecast.

2.2. Financial account and change in international reserves

In all of the scenarios, in 2015 the Bank of Russia expects the capital outflow to remain relatively high by historical standards, but in 2016-

Chart 4

Capital outflow
(baseline scenario forecast)



Source: Bank of Russia.

2018 the structure of the capital outflow will change, contributing to a reduction in the aggregate capital outflow.

Limited access to external lending sources means that, unlike in previous years, companies will not be able to refinance a significant portion of their external debts due in the remaining months of 2015 and in 2016-2018. Taking into account the portion of debt owed by residents to non-residents which are part of groups of companies (intragroup loans) and the portion of debt that companies can refinance, according to Bank of Russia estimates, in 2015 the share of the net reduction in external debt will be roughly 60% of the total debt due for repayment. In September-December 2015, banks and non-financial companies will have to pay about $50 billion on external debts. Thus, the capital outflow in the form of net reductions in liabilities to non-residents will be roughly $30 billion. It is worth noting that, according to the external debt repayment schedule, the peak of payments came in 2015 Q1 and passed relatively calmly. According to balance of payments data for 2015 Q1-Q2, banks and other sectors reduced their foreign liabilities by more than $40 billion.

This 'forced' reduction of liabilities to non-residents will make the biggest contribution to aggregate capital outflow in 2015-2016 and subsequently abate as companies find external funding sources unaffected by the sanctions (for example, in Asian markets) and due to the reduction in total debt. However, the reduction in external obligations as the debt is repaid will be a significant factor in the capital outflow in subsequent years, too. According to Bank of Russia estimates, under the baseline scenario the total amount of net external debt repayments by the private sector could reach up to $70 billion in 2015, $40 billion in 2016, and $20 billion or less in 2017 and 2018. Under the optimistic scenario, the amount of net external debt repayments in 2016-2018 could be $5-15 billion less due to the fact that if oil prices increase and Russian economic growth accelerates, companies will find it slightly easier to obtain new loans and refinance old ones. Estimates of net debt repayments have not changed from the previous Report.

In 2017-2018, as the economic situation normalises and the income of economic agents rises, the accumulation of foreign assets will again come to the fore among the capital outflow factors in all of the scenarios. Since the rate of economic recovery (and the recovery of economic agents' incomes) will be relatively low, even under the optimistic scenario the growth in demand for foreign assets will only reach a level comparable with 2014 by 2018. Compared with the previous forecast, in both scenarios the expected demand for foreign assets from residents was revised downwards, following the lower Russian GDP growth estimates.

As a result, the net capital outflow will be about $85 billion in 2015 and will then decline, because the reduction in outflow in the form of repayment of obligations will be faster than the growth in capital outflow in the form of foreign asset accumulation.

Under the optimistic scenario, the net aggregate capital outflow is forecast to be at a higher level than in the baseline scenario due to the higher demand for foreign assets (amid rapid growth in GDP and economic agents' incomes). The difference in the demand for foreign assets more than compensates for the lower capital outflow in the form of a reduction in foreign liabilities in the optimistic scenario. By 2018, the amount of capital outflow will shrink to less than $50 billion in the baseline scenario and less than $60 billion in the optimistic scenario.

To ensure a possibility to repay external debt in 2015 and make other payments to non-residents without the risk of destabilising the domestic FX market, a slight increase in the Bank of Russia's balance of operations to provide funds on a repayable basis (taking account of the amount already provided) may be needed. Going forward, the Bank of Russia will, to the extent possible, strive to gradually reduce the amount of foreign currency refinancing. However, under the baseline forecast, in 2016-2018 the current and financial account ratio will more likely only make it possible not to further increase the amount of foreign currency provided to credit institutions through FX repos. Only under the optimistic scenario will the Bank of Russia be able to begin reducing the volume of foreign currency provided to credit institutions through FX repos and gradually increase the volume of foreign currency reserves by purchasing foreign exchange in the open market up to a comfortable level of $500 billion.

Forecast risks

Under the risk scenario, which assumes oil prices will fall below $40 per barrel by the start of 2016 and remain low until the end of 2018, GDP is expected to fall significantly further and for longer than in the baseline scenario. Under the influence of this factor, the reduction in imports in relative terms will be even more significant than the reduction in exports due to the falling oil prices. Consequently, the balance of trade under the risk scenario will be slightly higher in 2016 than in the baseline scenario.

The fall in oil prices in 2016 below $40 per barrel will be accompanied by increased instability in the foreign exchange market and in the economy as a whole, which could lead to growth in capital outflow in 2016 in the form of investments in foreign assets as a precaution. Moreover, stabilisation of oil prices at a low level will encourage non-residents to reconsider the attractiveness of investing in the Russian economy, and will bring further reduction in foreign investment. As a result, the capital outflow in 2016 under the risk scenario will be far higher than in the baseline and optimistic scenarios. In these circumstances, under the risk scenario, to ensure a possibility to repay external debt in 2016 and make other payments to non-residents within foreign economic activity without the risk of destabilising the domestic FX market, a significant increase in the volume of Bank of Russia operations to provide foreign currency on a repayable basis may be required.

ANNEX

Changes in the system of instruments and other monetary policy measures

Table 1

Changes in the system of instruments and other monetary policy measures

Introduction of fine-tuning FX swap auctions for 1 to 2 days	From 16 June 2015, the Bank of Russia supplemented monetary policy instruments with USD/RUB and EUR/RUB buy/sell fine-tuning FX swap auctions for 1 to 2 days. If the Bank of Russia holds fine-tuning repo auction for 1 to 2 days, it will decide on the necessity of fine-tuning FX swap auction for similar terms depending on the situation in the money market, including the use of marketable collateral by credit institutions. The common maximum allotment amount will be set for fine-tuning repo and FX swap auctions. The minimum interest rate for the ruble leg of FX swaps is equal to the Bank of Russia key rate, the interest rate on the FX leg is equal to zero. The common cut-off rate will be determined as a result of the auctions. This measure is aimed at expanding credit institutions' ability to manage their ruble liquidity and assets eligible as collateral for Bank of Russia refinancing operations. The employment of fine-tuning FX swap auctions by the Bank of Russia during local increases in credit institutions' demand for Bank of Russia refinancing will facilitate lower demand for FX swap standing facilities, lower volatility of short-term money market interest rates, their convergence with the Bank of Russia key rate, and consequently higher efficiency of the interest rate channel of the monetary policy transmission mechanism.
Suspension of operations to replenish international reserves	The Bank of Russia decided to suspend operations to replenish international reserves from 28 July 2015 due to the increased volatility in the domestic FX market.
Expansion of the Bank of Russia Lombard List	In order to increase the amount of marketable collateral held by credit institutions, the Bank of Russia took three decisions to expand the Lombard List in June-August 2015 (4 June 2015, 3 July 2015 and 22 July 2015). The total of 45 bond issues worth 325.1 billion rubles were included in the Bank of Russia Lombard List during this period. The Bank of Russia also cut discounts on certain securities and raised correction ratios used to adjust the value of assets eligible as collateral.

Interest rates on Bank of Russia operations to provide and absorb ruble liquidity in 2015 (% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	From the beginning of the year	From 2.02.2015	From 16.03.2015	From 5.05.2015	From 16.06.2015	From 3.08.2015
Liquidity provision	Standing facilities	Overnight loans; FX swaps (ruble leg); Lombard loans; repos	1 day	daily	18.00	16.00	15.00	13.50	12.50	12.00
		Loans secured by gold	1 day		18.00	16.00	15.00	13.50	12.50	12.00
			from 2 to 549 days[1]		18.50	16.50	15.50	14.00	13.00	12.50
		Loans secured by non-marketable assets or guarantees	1 day		18.00	16.00	15.00	13.50	12.50	12.00
			from 2 to 549 days[1]		18.75	16.75	15.75	14.25	13.25	12.75
	Open market operations (minimum interest rates)	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
			3 months[1]	monthly						
			18 months[1]	occasionally						
		Lombard loan auctions	36 months[1]		17.25	15.25	14.25	12.75	11.75	11.25
		Repo auctions	1 week	weekly	17.00 (key rate)	15.00 (key rate)	14.00 (key rate)	12.50 (key rate)	11.50 (key rate)	11.00 (key rate)
			from 1 to 6 days[2]	occasionally						
		FX swap auctions	from 1 to 2 days[2]							
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days[2]							
			1 week[3]	weekly						
	Standing facilities	Deposit operations	1 day, call	daily	16.00	14.00	13.00	11.50	10.50	10.00
Memo item										
Refinancing rate					8.25	8.25	8.25	8.25	8.25	8.25

[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_154523if2015-01-19T15_41_11.htm.
Source: Bank of Russia.

Statistical tables

Table 1

Operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments, Bank of Russia obligations on liquidity absorption instruments, billions of rubles			
					1.01.15	1.04.15	1.07.15	1.09.15
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	1.2	4.0	0.0
		USD/RUB and EUR/RUB buy/sell FX swaps			121.6	16.6	49.9	0.0
		Lombard loans			3.7	4.1	4.0	4.0
		Repo			96.2	107.0	275.9	87.4
		Loans secured by gold	1 day		1.2	0.6	0.5	0.6
			from 2 to 549 days					
		Loans secured by non-marketable assets or guarantees	1 day		2055.9	598.0	335.1	310.4
			from 2 to 549 days					
	Open market operations	Auctions to provide loans secured by non-marketable assets	from 1 to 3 weeks	occasionally	2,370.9	2,892.0	2,685.0	2,598.8
			3 months	monthly				
			12 and 18 months	occasionally				
		Lombard loan auctions	36 months	occasionally	-	-	-	-
		Repo auctions	1 week	weekly	2,727.6	1,910.8	1,572.3	1,226.8
			from 1 to 6 days	occasionally[1]				
		FX swap auctions	from 1 to 2 days		-	-	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days		0.0	0.0	0.0	0.0
			1 week	weekly[2]				
	Standing facilities	Deposit operations	1 day, call	daily	804.6	292.2	293.1	291.0

[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	Ratio, %
To non-resident legal entities	4.25
To households	
Other liabilities	

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

Type of credit institutions	As of beginning of 2015	From 10.09.2015
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

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			
			Beginning of 2015	From 30.03.15	From 13.04.15	From 21.04.15	As of 1.01.15	As of 1.04.15	As of 1.07.15	As of 1.09.15
Repo auctions	1 week	weekly	0.50	1.00	1.50	2.00	209.7	1565.6	18.3	4.9
	28 days						15,075.1	9,298.3	6,832.6	7,001.2
	12 months[3]		0.50	1.00	1.75	2.50	4,960.0	18,222.7	25,978.1	25,978.1
Loan auctions	28 days	monthly	0.75	1.25	1.75	2.25	-	-	441.0	443.0
	365 days		0.75	1.25	2.00	2.75	-	2,766.8	2,766.8	2,766.8
USD/RUB buy/sell FX swaps	1 day	daily	1.50	1.50	1.50	1.50	1,600.0	0.0	0.0	0.0

[1] In respective currencies and for respective terms.
[2] For dollar leg; ruble leg rate corresponds to the key rate less 1 pp.
[3] FX repo auctions for 12 months are suspended from 1 June 2015.

Source: Bank of Russia.

Table 5

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
2013								
January	1.0	0.5	1.8	1.2	7.4	0.4	0.4	0.6
February	0.6	0.4	0.8	0.6	2.8	0.4	0.4	0.4
March	0.3	0.4	0.4	0.5	0.1	0.4	0.4	0.2
April	0.5	0.4	0.7	0.4	3.6	0.4	0.4	0.5
May	0.7	0.3	1.0	0.3	6.5	0.3	0.3	0.8
June	0.4	0.3	0.5	0.2	3.0	0.2	0.2	0.6
July	0.8	0.3	0.0	0.4	-3.0	0.1	0.1	3.1
August	0.1	0.5	-0.7	0.6	-11.3	0.5	0.3	0.9
September	0.2	0.7	0.0	0.8	-7.6	0.5	0.4	0.1
October	0.6	0.6	1.1	0.9	3.6	0.5	0.5	-0.1
November	0.6	0.6	0.9	0.7	3.0	0.4	0.5	0.2
December	0.5	0.4	0.8	0.5	2.8	0.2	0.3	0.6
Total for the year (December on December)	6.5	5.6	7.3	7.1	9.3	4.5	4.4	8.0
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

[1] *Excluding vegetables and fruit.*
[2] *Bank of Russia estimate.*

Sources: Rosstat, Bank of Russia calculations.

Table 6

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 excluding petrol[2]	Services
2013								
January	7.1	5.7	8.6	7.8	16.1	5.1	4.9	7.8
February	7.3	5.7	8.7	7.8	16.8	5.3	5.0	8.2
March	7.0	5.6	8.3	7.7	13.8	5.2	4.9	7.9
April	7.2	5.7	8.8	7.7	18.3	5.1	4.9	8.1
May	7.4	5.9	9.2	8.0	19.1	5.0	4.8	8.3
June	6.9	5.8	8.0	7.9	8.2	4.9	4.9	8.1
July	6.5	5.6	6.8	7.4	1.3	4.8	4.6	8.4
August	6.5	5.5	6.5	7.2	0.8	4.9	4.6	8.7
September	6.1	5.5	6.3	7.2	-1.4	4.7	4.4	7.8
October	6.3	5.5	6.9	7.2	4.4	4.5	4.3	7.7
November	6.5	5.6	7.5	7.3	8.9	4.5	4.4	7.9
December	6.5	5.6	7.3	7.1	9.3	4.5	4.4	8.0
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

[1] Excluding vegetables and fruit.
[2] Bank of Russia estimate.

Sources: Rosstat, Bank of Russia calculations.

Table 7

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

	Industrial production[1]	Agriculture	Construction	Freight turnover	Retail trade turnover	Fixed capital investment	Consumer expenditure	Output index of goods and services by key industries	GDP[2]
2013									
January	-1.1	-2.7	3.1	-1.1	0.4	-1.8	0.4	0.0	
February	-1.0	0.8	-1.5	0.1	-0.1	-1.2	0.5	-0.3	
March	1.0	0.0	1.0	-0.3	0.5	0.5	0.3	0.7	0.2
April	0.3	0.0	-1.9	1.1	0.4	-1.7	0.6	0.0	
May	-0.3	0.3	2.6	-0.5	0.2	-0.6	0.2	-0.3	
June	1.4	0.6	-2.9	-0.9	0.5	0.0	0.3	0.9	0.7
July	-0.3	-0.6	2.3	0.5	0.2	-0.5	0.3	-0.5	
August	0.4	3.8	-2.0	1.4	0.2	-0.8	0.1	0.0	
September	-0.5	-2.9	1.3	1.6	0.2	-0.5	-0.1	-0.6	0.3
October	0.2	1.1	-2.7	1.4	0.3	-0.4	0.1	1.1	
November	1.9	3.2	2.3	-3.1	0.3	2.7	0.0	0.3	
December	-2.1	-2.3	-2.0	2.1	0.4	-3.4	-0.2	-1.2	0.6
2014									
January	0.3	1.3	-2.0	-0.1	0.3	0.1	-0.3	-0.1	
February	1.1	0.3	0.9	-1.9	0.7	0.7	2.4	1.3	
March	-0.2	0.2	0.3	-1.0	0.2	-0.7	0.0	-0.4	-0.9
April	1.5	0.7	-0.9	0.2	0.0	0.3	-0.2	0.7	
May	0.2	0.4	-0.1	1.5	-0.2	0.2	-0.2	0.2	
June	-0.8	0.0	0.6	0.2	-0.3	-0.1	-0.1	-0.6	0.8
July	0.3	1.9	-0.9	-2.3	-0.2	-0.1	-0.1	0.1	
August	-0.9	-1.2	-0.1	0.1	-0.3	-0.4	0.0	-0.6	
September	1.3	2.4	-1.5	1.2	-0.5	-1.1	0.1	0.5	0.3
October	0.1	-19.1	0.6	0.1	-0.5	0.4	0.0	-0.8	
November	-1.4	21.3	-1.3	-0.2	-0.5	-2.2	0.0	-0.3	
December	1.7	1.1	-0.5	-0.7	4.5	0.7	0.2	0.0	0.1
2015									
January	-2.1	-0.3	-0.6	-0.8	-6.1	-0.8	-8.1	-1.4	
February	-0.9	0.1	-0.7	0.4	-1.1	-0.9	0.0	-1.0	
March	0.3	0.2	-1.7	0.9	-0.9	-0.4	0.0	-0.4	-3.3
April	-1.7	-0.1	0.0	-1.4	-1.0	-0.9	0.1	-1.4	
May	-0.6	0.0	-1.8	-1.0	-0.7	-1.1	0.1	-0.5	
June	-0.2	0.0	-0.9	0.8	-0.8	-1.0	0.1	-0.6	-1.8
July	0.0	-0.5	-0.7	2.6	-0.7	-0.7	0.2	0.1	

[1] *Rosstat estimate.*
[2] *Quarterly data.*

Sources: Rosstat, Bank of Russia calculations.

Table 8

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

	2014	2015								Memo item: 2014
	Total	January	February	March	April	May	June	July	January-July	January-July
Output of goods and services by key industries	0.5	-1.1	-3.1	-2.8	-5.8	-6.8	-6.1	-5.9	-4.6	0.4
Industrial output	1.7	0.9	-1.6	-0.6	-4.5	-5.5	-4.8	-4.7	-3.0	1.5
Agricultural output	3.7	2.8	3.2	4.2	3.3	2.7	1.6	-1.9	1.6	4.4
Fixed capital investment	-2.7	-3.9	-4.3	-2.7	-4.8	-7.6	-7.1	-8.5	-5.9	-2.8
Construction	-4.5	-3.5	-3.1	-6.7	-5.2	-10.3	-10.0	-10.3	-7.7	-5.4
Retail trade turnover	2.7	-3.6	-7.0	-8.5	-9.6	-9.2	-9.4	-9.2	-8.1	2.7
Household real disposable money income	-0.7	-0.7	-1.6	-1.6	-3.9	-6.5	-3.1	-2.0	-2.9	-0.4
Real wage	1.3	-8.4	-7.4	-10.6	-9.6	-7.4	-8.6	-9.2	-8.8	3.1
Number of unemployed	-6.0	-2.1	1.5	8.7	8.8	13.5	8.6	7.9	6.5	-6.0
Unemployment (as % of economically active population)	5.2	5.5	5.8	5.9	5.8	5.6	5.4	5.3	5.3	4.9

Sources: Rosstat, Bank of Russia calculations.

Table 9

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

		Forecast of GDP growth in 2015, %		Memo item: country's share in aggregate GDP of trading partners
		August 2015	May 2015	
Total		1.3	1.4	100
1	The Netherlands	1.9	1.5	15.7
2	Italy	0.6	0.5	8.7
3	Germany	1.6	1.7	8.0
4	China	7.0	7.0	7.0
5	Ukraine	-9.5	-7.9	6.5
6	Turkey	2.7	2.9	6.4
7	Belarus	-2.7	-2.0	5.9
8	Poland	3.5	3.4	4.9
9	United Kingdom	2.6	2.5	3.5
10	United States	2.6	3.1	3.5
11	Finland	0.2	0.4	3.4
12	Kazakhstan	1.7	1.6	3.4
13	Japan	1.1	1.1	3.3
14	France	1.2	1.1	3.2
15	Korea, Republic of	2.7	3.1	2.8
16	Switzerland	0.6	0.7	2.6
17	Latvia	2.3	2.4	1.9
18	Hungary	2.9	2.6	1.8
19	India	7.6	7.5	1.7
20	Belgium	1.2	1.1	1.5
21	Czech Republic	3.1	2.4	1.5
22	Slovakia	3.0	2.9	1.5
23	Spain	2.9	2.6	1.3

Source: Bank of Russia.

Table 10

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	04.03.2015	2.00	-0.50	2		-0.7	-0.50
Hungary	base rate	1.35	21.07.2015	1.50	-0.15	5		0.4	0.30
Czech Republic	repo rate (14 days)	0.05	01.11.2012	0.25	-0.20	0		0.5	0.00
Romania	base rate	1.75	06.05.2015	2.00	-0.25	6		-1.7	-2.62
Bulgaria	base rate	0.02	00.01.1900	0.02	0.00	6		-0.2	0.80
Serbia	key policy rate	5.50	13.08.2015	6.00	-0.50	6		1.0	-1.10
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	2		-0.3	-0.59
Brazil	target rate	14.25	29.07.2015	13.75	0.50	7		9.6	3.06
Chile	monetary policy rate	3.00	16.10.2014	3.25	-0.25	2		4.6	0.10
China	lending rate (12 months)	4.85	29.06.2015	5.10	-0.25	4		1.6	-0.70
	deposit rate (12 months)	2.00	29.06.2015	2.25	-0.25	4			
	required reserve rate	18.50	20.04.2015	19.50	-1.00	2			
India	reverse repo rate	7.25	02.06.2015	7.50	-0.25	3		3.8	-3.61
	repo rate	6.25	02.06.2015	6.50	-0.25	3			
Indonesia	target rate	7.50	17.02.2015	7.75	-0.25	2		7.3	2.73
Korea, Republic of	base rate	1.50	11.06.2015	1.75	-0.25	3		0.7	-0.90
Malaysia	target overnight rate	3.25	10.07.2014	3.00	0.25	0		3.3	0.10
Mexico	target rate	3.00	06.06.2014	3.50	-0.50	0		2.7	-1.33
Philippines	monetary policy rate	4.00	12.09.2014	3.75	0.25	1		0.8	-4.10
Russia	repo auction rate (1-6 days)	11.00	03.08.2015	11.50	-0.50	8		15.6	8.10
South Africa	repo rate	6.00	23.07.2015	5.75	0.25	1		5.0	-1.30
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	2		-1.1	-3.21
Turkey	repo rate (7 days)	7.50	24.02.2015	7.75	-0.25	2		6.8	-2.51
United States	federal funds rate (upper bound)	0.25	16.12.2008	1.00	-0.75	0		0.2	-1.80
Euro area	refinancing rate	0.05	04.09.2014	0.15	-0.10	1		0.2	-0.20
United Kingdom	base rate	0.50	05.03.2009	1.00	-0.50	0		0.1	-1.50
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0		0.4	-3.20
Canada	target overnight rate	0.50	15.07.2015	0.75	-0.25	2		1.0	-1.40
Australia	overnight rate	2.00	05.05.2015	2.25	-0.25	2		1.5	-1.50
New Zealand	overnight rate	3.00	23.07.2015	3.25	-0.25	2		0.3	-1.30
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	1		0.5	0.00
	certificate of deposit rate	-0.75	06.02.2015	-0.50	-0.25	5			
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	2		-1.3	-1.30
	3m LIBOR - max	-0.25	15.01.2015	0.25	-0.50	1			
Sweden	repo rate	-0.35	02.07.2015	-0.25	-0.10	4		0.8	0.40
Norway	key deposit rate	1.00	18.06.2015	1.25	-0.25	2		1.8	-0.40

Note: Changes occurred from the release of the previous Monetary Policy Report issue are put in colour.
Source: Bloomberg.

Table 11

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

	2013					2014					2015	
	I	II	III	IV	Total	I	II	III	IV	Total	I[1]	II
Current account	25.0	1.8	-0.7	8.0	34.1	25.9	12.2	6.0	15.4	59.5	28.9	18.6
Current account, YoY, %	*-36.4*	*-88.8*	*-87.3*	*-23.0*	*-52.2*	*3.4*	*577.6*	*-959.9*	*92.4*	*74.5*	*12.0*	*52.2*
Trade balance	48.6	42.8	43.7	46.8	181.9	50.5	51.7	45.3	42.3	189.7	44.4	44.1
Trade balance, YoY, %	*-17.3*	*-13.1*	*14.5*	*3.1*	*-5.1*	*3.9*	*20.8*	*3.6*	*-9.7*	*4.3*	*-12.0*	*-14.6*
Exports of goods	125.2	127.3	131.0	139.8	523.3	123.0	132.3	125.7	116.7	497.8	89.9	92.7
Exports of goods, YoY, %	*-4.5*	*-3.0*	*4.6*	*-0.2*	*-0.8*	*-1.7*	*3.9*	*-4.0*	*-16.5*	*-4.9*	*-26.9*	*-30.0*
crude oil	43.2	40.7	44.0	45.7	173.7	38.8	42.3	40.3	32.5	153.9	22.9	25.5
crude oil, YoY, %	*-6.4*	*-10.5*	*3.1*	*-2.0*	*-4.0*	*-10.1*	*3.8*	*-8.4*	*-28.9*	*-11.4*	*-41.0*	*-39.7*
oil products	25.5	29.3	27.1	27.4	109.3	27.5	30.6	31.8	26.0	115.9	19.1	19.3
oil products, YoY, %	*-0.5*	*10.9*	*7.5*	*3.9*	*5.5*	*8.0*	*4.3*	*17.4*	*-5.2*	*6.0*	*-30.6*	*-36.8*
natural gas	18.1	13.9	16.4	18.8	67.2	17.7	16.3	9.9	11.4	55.2	10.8	10.8
natural gas, YoY, %	*-1.8*	*3.4*	*22.9*	*10.3*	*7.9*	*-2.4*	*17.5*	*-39.7*	*-39.6*	*-17.9*	*-38.9*	*-33.9*
other	38.3	43.3	43.6	47.9	173.0	39.0	43.2	43.7	46.8	172.8	33.8	37.1
other, YoY, %	*-6.2*	*-5.6*	*-0.8*	*-4.1*	*-4.2*	*1.8*	*-0.3*	*0.3*	*-2.2*	*-0.1*	*-13.3*	*-14.1*
Imports of goods	-76.6	-84.5	-87.3	-93.0	-341.3	-72.5	-80.6	-80.5	-74.4	-308.0	-45.4	-48.5
Imports of goods, YoY, %	*6.0*	*3.2*	*0.3*	*-1.7*	*1.6*	*-5.3*	*-4.6*	*-7.8*	*-20.0*	*-9.8*	*-37.3*	*-39.8*
Balance of services	-10.5	-13.7	-19.8	-14.4	-58.3	-11.1	-14.4	-18.6	-11.2	-55.2	-8.4	-9.2
Balance of services, YoY, %	*26.4*	*34.5*	*28.8*	*13.2*	*25.1*	*5.4*	*4.9*	*-6.1*	*-22.2*	*-5.3*	*-23.8*	*-35.8*
Exports of services	15.2	17.9	18.4	18.6	70.1	15.1	17.3	17.8	15.5	65.8	11.8	13.4
Exports of services, YoY, %	*15.8*	*13.8*	*12.6*	*8.6*	*12.4*	*-0.7*	*-3.1*	*-3.0*	*-16.6*	*-6.1*	*-21.7*	*-23.0*
Imports of services	-25.7	-31.5	-38.2	-33.0	-128.4	-26.2	-31.7	-36.4	-26.7	-121.0	-20.3	-22.6
Imports of services, YoY, %	*19.9*	*21.5*	*20.4*	*10.5*	*17.9*	*1.8*	*0.7*	*-4.6*	*-19.0*	*-5.8*	*-22.6*	*-28.8*
Compensation of employees	-2.9	-2.9	-3.6	-3.9	-13.2	-2.7	-2.6	-2.7	-2.1	-10.1	-1.4	-1.1
Investment income	-8.7	-23.2	-17.8	-17.5	-67.2	-9.1	-21.8	-14.5	-11.8	-57.2	-4.6	-14.3
Receivable	10.5	8.2	9.5	9.6	37.9	12.5	10.8	11.0	8.3	42.6	8.3	6.9
Payable	-19.2	-31.4	-27.4	-27.1	-105.1	-21.6	-32.6	-25.5	-20.2	-99.8	-12.9	-21.2
Rent	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.1	0.0	0.0
Secondary income	-1.5	-1.3	-3.3	-3.1	-9.3	-1.8	-0.7	-3.6	-1.7	-7.9	-1.1	-0.9
Non-tradable components	**-13.1**	**-27.4**	**-24.7**	**-24.5**	**-89.6**	**-13.6**	**-25.1**	**-20.7**	**-15.7**	**-75.0**	**-7.0**	**-16.3**
Non-tradable components, YoY, %	***17.0***	***19.1***	***42.9***	***9.9***	***21.4***	***3.7***	***-8.3***	***-16.3***	***-36.0***	***-16.3***	***-48.1***	***-35.0***
Capital account	**0.0**	**0.0**	**-0.2**	**-0.1**	**-0.4**	**-0.2**	**-0.1**	**-10.0**	**-31.8**	**-42.0**	**0.0**	**0.0**
Balance from current and capital account	**25.0**	**1.8**	**-0.9**	**7.9**	**33.7**	**25.7**	**12.1**	**-4.0**	**-16.4**	**17.4**	**29.0**	**18.6**
Financial account (excluding reserve assets)	**-13.3**	**-7.8**	**-4.5**	**-19.3**	**-45.0**	**-47.2**	**-27.8**	**-6.0**	**-52.9**	**-133.8**	**-37.3**	**-21.9**
Net incurrence of liabilities ('+' – increase, '–' – decrease)	**86.2**	**19.1**	**8.0**	**12.5**	**125.8**	**2.6**	**7.8**	**-23.1**	**-38.0**	**-50.7**	**-38.7**	**-10.9**
Federal government, local government, and central bank	8.0	-0.2	4.1	-2.2	9.7	-6.5	2.2	-3.4	-4.4	-12.2	-6.2	0.6
Banks and other sectors	78.2	19.4	3.8	14.8	116.0	9.2	5.6	-19.7	-33.6	-38.5	-32.5	-11.5
Net acquisition of financial assets, excluding reserve assets ('+' – decrease, '–' – increase)	**-99.5**	**-27.0**	**-12.5**	**-31.8**	**-170.8**	**-49.8**	**-35.6**	**17.1**	**-14.8**	**-83.1**	**1.4**	**-11.0**
General government and central bank	-0.3	-1.2	0.6	-2.6	-3.6	0.5	-0.5	8.8	31.2	40.0	-0.2	-0.2
Banks and other sectors	-99.2	-25.8	-13.0	-29.3	-167.3	-50.3	-35.0	8.3	-46.1	-123.1	1.5	-10.8
Net errors and omissions	**-6.8**	**1.6**	**-1.9**	**-3.8**	**-10.8**	**-5.9**	**5.3**	**4.2**	**5.1**	**8.8**	**-1.7**	**1.2**
Change in FX reserve assets ('+' – decrease, '–' – increase)	**-4.9**	**4.4**	**7.4**	**15.2**	**22.1**	**27.4**	**10.3**	**5.7**	**64.2**	**107.5**	**10.1**	**2.2**
Net capital inflow/outflow into/from banks and enterprises	**-28.2**	**-5.5**	**-10.4**	**-16.9**	**-61.0**	**-47.7**	**-21.9**	**-7.2**	**-77.4**	**-154.1**	**-32.5**	**-21.1**
Certain indicators adjusted by the amount of FX swaps between the Bank of Russia and resident banks, the amount of FX funds provided by the Bank of Russia to resident banks on a reverse basis, as well as funds in resident banks' correspondent accounts with the Bank of Russia												
Change in FX reserve assets ('+' – decrease, '–' – increase)	**-4.3**	**3.6**	**9.2**	**13.3**	**21.8**	**40.5**	**-3.2**	**-1.6**	**50.8**	**86.5**	**0.9**	**-2.5**
Net capital inflow/outflow into/from banks and enterprises	**-28.9**	**-4.6**	**-12.2**	**-15.0**	**-60.7**	**-60.8**	**-8.4**	**0.1**	**-64.0**	**-133.1**	**-23.3**	**-16.4**

[1] *Estimate. The use of signs corresponds to BPM5.*

Source: Bank of Russia.

LIST OF BOXES

GLOSSARY

Asset-backed securities (ABS)

Bonds or other securities backed by pooled assets which usually generate predicable 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*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.

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.

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 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.

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

MICEX index is the 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 (excluding credit) organisations 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 held by residents of the Russian Federation (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 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.

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 index

An indicator of business activity based on company surveys. A PMI of more than 50 represents an expansion of business activity, a reading under 50 represents a contraction.

Potential output

The aggregate level of output in the economy achieved under normal utilisation of production factors with existing resource and institutional constraints. Reflects the volume of products that may be produced and sold without creating prerequisites to a change in price growth rates. The level of potential output is not linked to a certain level of inflation; it merely indicates the presence or absence of conditions for the inflation acceleration or deceleration.

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.

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 until 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

RTS index is the 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.

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).

Volatility smile

Implied volatility dependence on the option strike price. Each strike price has a respective option delta which is equal to the first option value derived from the underlying asset price and which reflects an approximated probability, relative to the risk neutral measure, of at-the-money option.

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

CPI — consumer price index

DIA – Deposit Insurance Agency

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

Fed – US Federal Reserve System

FOM — Public Opinion Foundation

FPG — fiscal policy guidelines

GDP — gross domestic product

GFCF — gross fixed capital formation

IBL — interbank loans

IFX-Cbonds — corporate bond index

MC— management company

MIACR — Moscow Interbank Actual Credit Rate (weighted average rate on interbank loans provided)

MIACR-B — Moscow Interbank Actual Credit Rate-B-Grade (weighted average rate on interbank loans provided to banks with speculative credit rating)

MIACR-IG — Moscow Interbank Actual Credit Rate-Investment Grade (weighted average rate on interbank loans provided to banks with investment-grade rating)

MICEX SE — MICEX Stock Exchange

MPD — Monetary Policy Department of the Bank of Russia

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

NPF — non-governmental pension fund

OFZ — federal government bonds

OFZ-PD — permanent coupon-income federal government bonds

OFZ-PK — variable coupon-income federal government bonds

OJSC — open joint-stock company

OPEC — Organisation of the Petroleum Exporting Countries

PJSC — public joint-stock company

PMI — Purchasing Managers' Index

QPM — quarterly projection model of the Bank of Russia

REB — Russian Economic Barometer

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

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