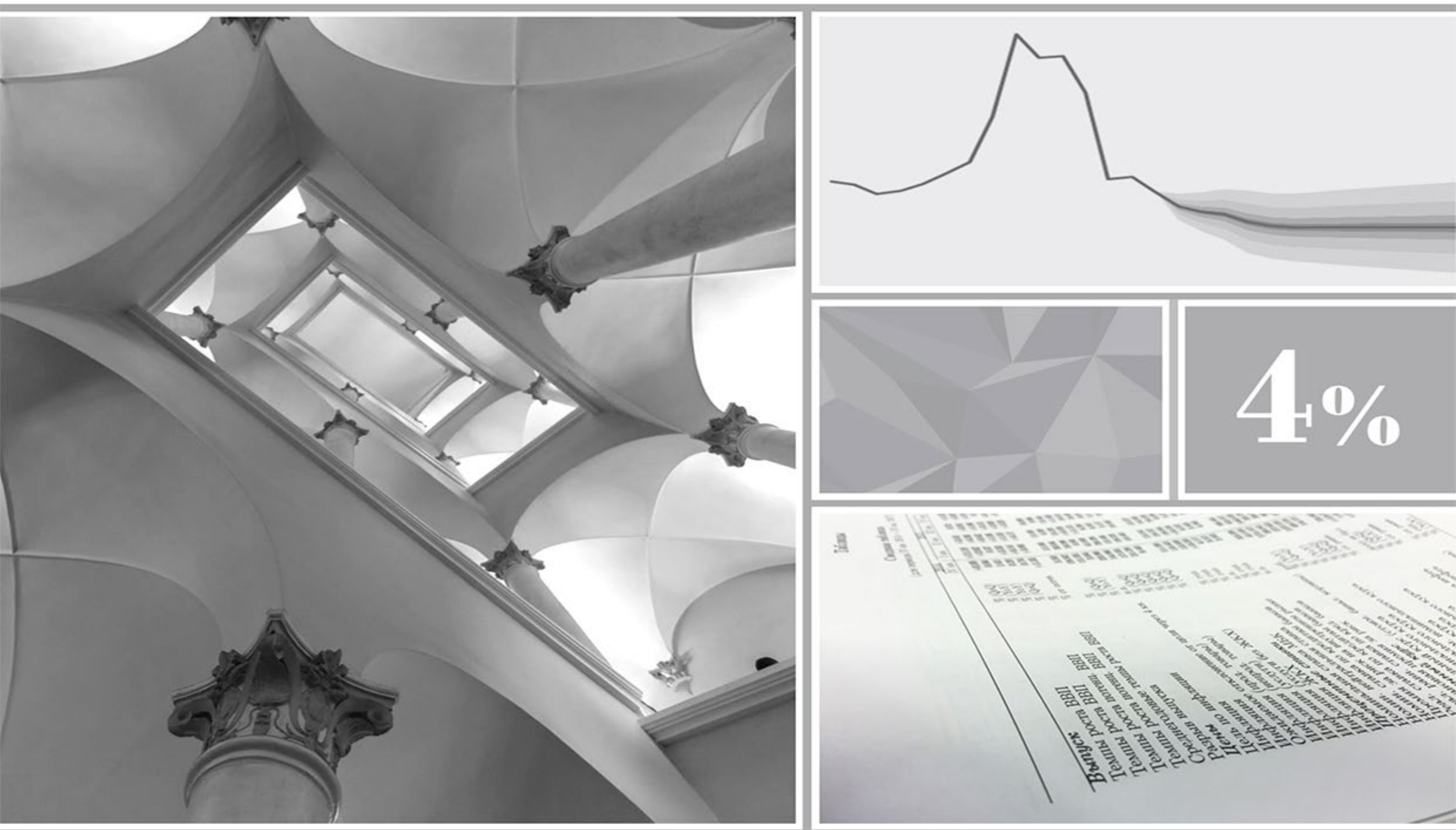
Bank of Russia
The Central Bank of the Russian Federation



No. 3
SEPTEMBER 2018

MONETARY POLICY REPORT

Moscow

DEAR READERS,

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

1. Do you consider there to be an optimal level of detail in the material presented?

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

3. Do you have any other comments or suggestions regarding the report?

4. What is your professional field of interest?

Many thanks in advance for your assistance.

The report has been prepared based on statistics as of 10 September 2018.
Data cut-off date for forecast calculations is 10 September 2018 (if statistics and other information relevant for decision-making appear after the data cut-off date, they are included in the text of the Report and may be used for the adjustment of the mid-term forecast).

Electronic version of the information and analytical compendium is published in the section '*Publications / Monetary Policy Report*' of Bank of Russia's official site.

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

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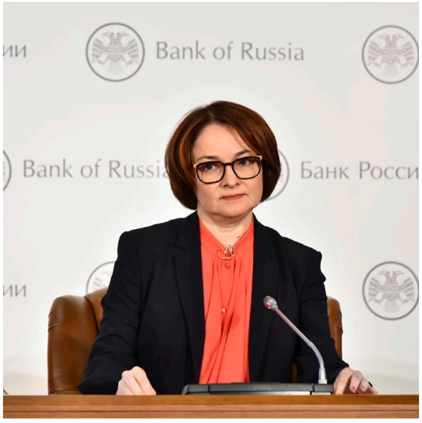
STATEMENT BY BANK OF RUSSIA GOVERNOR ELVIRA NABIULLINA

in follow-up to Board of Directors meeting 14 September 2018



The past few months have seen substantially changed external conditions, triggering a strengthening in inflation risks. In an effort to curb the impact of these factors on price and financial stability, the Bank of Russia has made two decisions today.

First. The Bank of Russia Board of Directors decided to raise the key rate by 0.25 pp to 7.50% per annum in order to check inflation risks. I refer to the risks of mounting inflation and inflation expectations in response to exchange rate volatility. We should also keep in mind the forthcoming VAT rise. Moving forward, we will look into how feasible a further increase in the key rate will be, taking into account inflation movements and economic performance against the forecast, as well as external environment-side risks and financial markets' response.

The second decision is intended to stabilise the financial market. We have decided that foreign exchange purchases in the domestic market, currently being made as part of the fiscal rule, will be suspended through the end of the year. Going forward, we will determine on the need for resumed regular purchases based on our assessment of actual developments in financial markets.

Once such regular purchases have resumed, we will explore the option of relaunching this year's postponed foreign exchange purchases. Having said this, the start of regular purchases may not necessarily be concurrent with the relaunch of deferred purchases. We estimate that the deferred purchases may take longer than one year to follow through.

The suspension of purchases will undoubtedly affect the balance of payments and exchange rate dynamics. We took it into account in our forecast and key rate decision.

The present oil prices are set to take current account revenue to roughly $30 billion before the end of the year, which is double the amount of anticipated external debt payments ($15 billion). That said, at least a half of them are highly likely to be refinanced. Thus, we enjoy the solid safety margin of our current account. In this context, the suspension decision will serve to curtail exchange rate volatility alongside its influence on inflation over the next few quarters.

I will now proceed to elaborate on the factors the Board considered in making the key rate increase decision.

First, inflation risks related to external factors have materialised. This entailed an upgrade in inflation forecast, even with today's decisions factored in. We expect inflation to range within 3.8-4.2% by the end of 2018 and 5-5.5% by the end of 2019; it is then expected to return to 4% in the course of 2020.

There are a number of reasons behind the deterioration in the external environment. This August saw a change in geopolitical factors, with uncertainty growing over sanctions against Russia. The strengthened geopolitical risks were coupled with capital outflow from emerging markets. Over the course of spring and summer, multiple emerging market economies saw the materialisation of previously accumulated *imbalances; this weighed on their financial markets, exchange rates and key macroeconomic indicators. This sequence of events – when more than one country becomes affected – reduces international investor risk appetite and triggers capital outflow from emerging markets in general. This is further aggravated by increased interest rates in advanced economies.*

The ruble's depreciation in August and early September entails a rise in prices of goods and services. The Bank of Russia's estimate of the exchange rate pass-through effect on annual inflation have remained unchanged at roughly 0.1 (one tenth), that is, a 10% drop in the nominal effective exchange rate adds 1 pp to annual inflation over a three- to six-month horizon. According to our calculations, the nominal effective exchange rate declined by roughly 9% year-to-date and is poised to contribute approximately 0.9 pp to annual inflation.

The Bank of Russia's forecast suggests that annual inflation will go up from 3.1% in August to 3.8-4.2% by year-end. It will accelerate in the first half of 2019, when the main effect of the VAT rise manifests itself, to be followed by a decline in price growth rates.

The key rate decision, coupled with the suspension of foreign currency purchases in the domestic market, allows restricting a surge in annual inflation in 2019 by 5-5.5%. Inflation is poised to return to 4% in the first half of 2020, when the effects of the VAT rise and those of exchange rate movements are exhausted.

The second factor we took into account is a rise in inflation expectations and high uncertainty over their future movements.

Households' inflation expectations surged in May and remained elevated throughout summer months, while those of businesses continued to mount. The ruble's depreciation seen in August may push inflation expectations further upwards.

At the end of the year, inflation expectations are also highly likely to respond to the forthcoming VAT rise. Surveys suggest that households have yet to take it into account. Meanwhile, businesses have already factored in the VAT rise in their expectations along with exchange rate movements.

The situation when multiple, rather than just one, proinflationary events are in place – the weakening in the ruble in April and August followed by the VAT hike – may provoke a stronger and more protracted response of inflation expectations. Especially in the situation when inflation expectation are still unanchored.

The third factor we focused on is monetary conditions.

Monetary conditions in the Russian economy tightened somewhat under the influence of external factors, in the first place. The government bond yield curve shifted considerably upwards. Some banks started raising their interest rates on loans and deposits. Financial markets have already prepared for a key rate hike. The key rate hike will, on the one hand, enable deposit rates to hold above the inflation rate, thus supporting the propensity to save and balanced growth in consumption. On the other hand, the prompt response of monetary policy will allow us mitigate inflation risks and, all else being equal, resume the rate cut cycle earlier than expected.

An important factor we took into account is the state of the economy. The developments were in line with our expectations. The 2018 GDP growth forecast has remained unchanged at 1.5-2%. We updated our medium-term forecast, factoring in the announced structural and fiscal measures, as well as the changing external conditions.

The 2019 GDP growth rate is forecast to range within 1.2-1.7%. According to our estimates, the VAT rise will only have a modest constraining effect on economic growth rates, given that extra tax revenues are projected to be used within the same year to underpin economic growth.

The GDP growth forecast is raised to 1.8-2.3% for 2020. Economic growth might accelerate over the next few years provided that structural changes are successfully implemented. This will be conducive to *the increase of current GDP growth rates, as well as its potential ones. Therefore, economic growth pick-up will come without greater inflationary pressure.*

We have slightly adjusted upwards the oil price path, given the current supply and demand balance. The baseline scenario implies a gradual descent of the oil price from its current high levels to $55 per barrel in 2020-2021. This will be assisted by an expansion in shale oil production and a steady relaxation of oil production curbs under the agreement between oil exporting countries. The first steps in this direction were made in June this year. However, all this does not rule out a chance that oil prices may linger close to current levels for quite a long time under the impact of various geopolitical factors, among other things. At the same time, oil price movements will not produce considerable pressure on economic growth and its structure, given the fiscal rule effect. It works to smooth out the drag from the energy commodities market on the domestic economic environment and public finance.

The forecast current account balance is revised upwards from $85 billion to $98 billion for 2018 (approximated 6% of GDP). It will be around $75 billion in 2019 and $45-50 billion, or about 3% of GDP, in 2020-2021. We revised upwards our estimates for the private sector's negative financial account balance in 2018 from $30 to $55 billion. As we go forward, our forecasts suggest the financial account balance of the private sector will drop markedly to $27 billion in 2019 and to roughly $18 billion in 2020-2021. Current account revenues considerably exceed the demand for funds to repay external debts. Therefore, the existing balance of payments does not pose any risks to exchange rate dynamics and macroeconomic stability over the forecast horizon.

***And to sum up**, I would like to say that our decisions today serve to respond to the increase in inflation risks. At the same time, the Bank of Russia believes that the prompt response of monetary policy will keep the growth of inflation risks in check in the future and lay the groundwork for monetary policy easing between late 2019 and the first half of 2020.*

Bank of Russia Governor *Elvira Nabiullina*

1. MACROECONOMIC CONDITIONS

Over the period from mid-June to mid-September, that is, since the preparation of the June Monetary Policy Report, external conditions have deteriorated. This has been taken into account in forecasting and monetary policy decision-making.

Annual inflation is returning to 4% faster than previously anticipated. Consumer price growth increased from 2.3% in June to 3.1% in August. This was largely down to a faster annual food price growth amid the ongoing depletion of the excess supply across certain food markets, which will continue until the end of 2018. Moreover, the deterioration in external conditions gave rise to higher inflation risks and led to a revised inflation forecast, according to which annual consumer price growth will be 3.8–4.2% by the end of 2018.

Over the coming months, goods and services prices and inflation expectations will continue to adjust to the weakening of the ruble observed since the start of the year and the forthcoming VAT increase.

The weakening of the ruble was a reaction to a shrinking demand for EMEs' assets and heightened sanctions rhetoric towards Russia. This weakening was kept in check somewhat by relatively high oil prices.

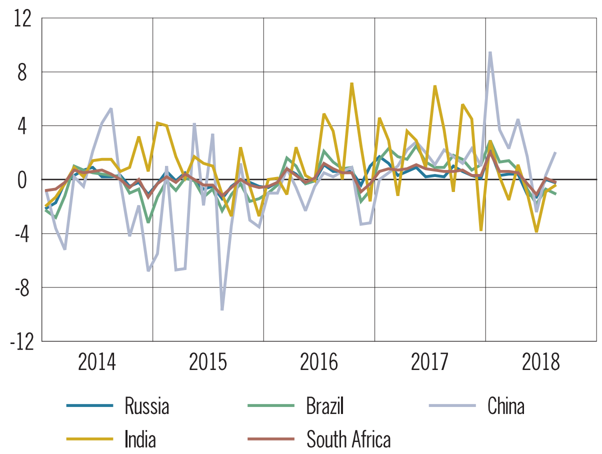
The decline in investors' risk appetite in the financial markets was shaped by a number of factors. Amid the destabilisation of the situation in Turkey and Argentina and tightening of foreign trade restrictions, fears of the deterioration of situation in other countries emerged and economic growth outlook was revised for EMEs. These events resulted in a capital outflow from EMEs, including from Russia. In addition, another factor affecting the risk premium for Russia was the intensifying Russia sanctions rhetoric at the end of July – early August. This led investors to sell Russian securities and caused a noticeable weakening of the ruble in August – early September.

In the context of heightened volatility in the foreign exchange market, the Bank of Russia decided against purchasing foreign currency in the FX market as part of the implementation of the fiscal rule up to the end of 2018. A decision on renewing regular purchases of foreign currency in the domestic market will be taken with due regard to actual conditions in the financial markets. A decision on the foreign currency purchases in the domestic market that were postponed in 2018 will be taken after regular purchases resume. The deferred purchases may be carried out in 2019 and in subsequent years.

The weakening of the ruble was constrained slightly by oil price dynamics during the period under consideration. Energy prices remained higher than the levels set out in the baseline and alternative scenarios in the June Monetary Policy Report. This was conditioned both on growth in the global demand and on supply-side factors. The oil production by countries participating in the OPEC+ agreement increased far less than assumed in the arrangement made in June. According to this arrangement, compliance rate with the agreement was due to be cut from 147% in May to 100% beginning in July, which should have led to a further increase in production by roughly 1 million barrels per day. The growth in oil supplies from a number of countries belonging to the agreement (Saudi Arabia, Russia, Kuwait, Iraq and the UAE) was offset in part by a reduction in oil supply from Venezuela given the ongoing economic crisis and from Iran amid geopolitical tensions. In addition, following a substantial growth in the number of drilling sites and in oil production in the US since the start of the year, in June-August these readings stabilised, mainly due to infrastructure restrictions in the industry, which also fed through to the situation in the oil market. Given the higher oil prices in Q3, the Bank of Russia revised its oil price assumptions in the baseline scenario through the end of 2018. In the medium term, as part of a conservative approach to making scenario assumptions, oil prices are still expected to reduce gradually.

Chart 1.1

Most BRICS nations saw foreign portfolio investment outflow
(billions of US dollars)



Source: EPFR Global.

Chart 1.2

External sanctions led to an increase in the risk premium for Russia
(bp)

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

Taking these oil price dynamics into account, the current account balance will remain high due to stable prices for Russian exported goods and will significantly exceed external debt repayments over the coming months (see Annex 'Balance of payments forecast for 2019–2021'). In these conditions, the Bank of Russia's decision to suspend foreign currency purchases in the domestic market as part of the fiscal rule mechanism will limit exchange rate volatility and its pass-through on inflation dynamics over the coming quarters.

While in April-June, high oil prices combined with the weakening ruble resulted in the significant acceleration of price growth for oil products in the domestic market, in July-August, prices for oil products firmed up. This was aided by measures adopted by the Russian Government to reduce excise taxes on petrol and diesel fuel with effect from 1 June 2018, the growth in exchange sales volumes, and major oil companies' compliance with the price freeze agreement. Taking these factors into account, together with the baseline forecast assumptions regarding a gradual adjustment in oil prices, petrol and diesel fuel price growth is not expected to increase perceptibly in the domestic market till the end of 2018.

Monetary policy conditions tightened slightly, mainly due to the deterioration in external conditions. The government bond yield curve demonstrated a significant upward shift. Interest rates on banking operations started to grow. The increase in the Bank of Russia key rate will help to maintain positive real interest rates on deposits, which will buoy the appeal of savings and balanced growth in consumption.

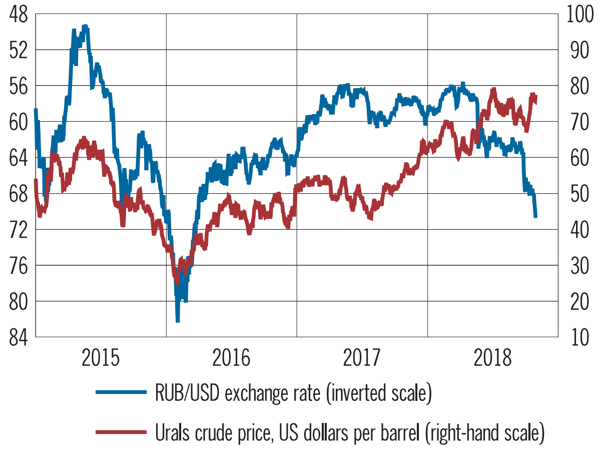
Over the previous period, the yield curve in the financial market shifted significantly upwards under the influence of external factors. The outflow of foreign investors' funds from the OFZ market was a response to the reassessment of investment risks in EMEs and the intensifying Russia sanctions rhetoric.

In Q2, banks still pursued a cautious lending policy, especially in the corporate lending segment. The rather strict borrower requirements observed in previous periods remained in effect, and other non-price lending conditions were also unchanged. The only exception was the consumer lending segment, where a number of banks increased their maximum loan amount and expanded their range of credit products offered to borrowers. One of the reasons for this lending policy by banks may be the persistent competition for the most reliable individual borrowers and the stricter lending conditions in the consumer lending market compared with the mortgage lending market, which provides a certain 'safety margin' for the easing of lending conditions. Since an increase in interest rates can be expected in the near term, lending conditions may tighten over the coming months, which will held back growth in lending activity somewhat.

Against the backdrop of growing consumer demand and incomes, retail lending expanded steadily. The annual growth in the banking system's claims on households at the end of the year will be 19–22%, according to estimates in the Bank

Chart 1.3

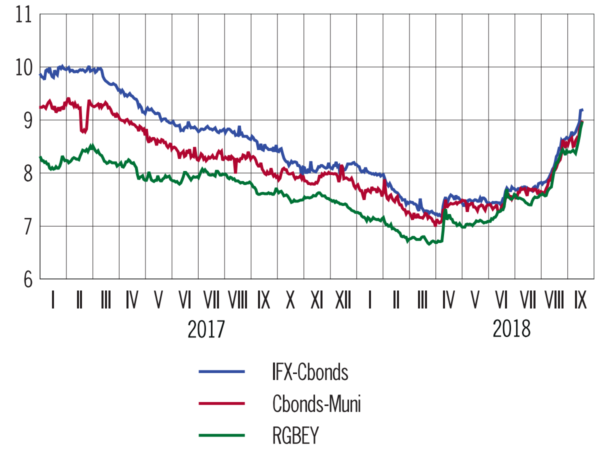
Oil prices held at a high level



Sources: Thomson Reuters, Bloomberg.

Chart 1.5

Higher yields in the bond market are linked to external conditions and tightening sanctions

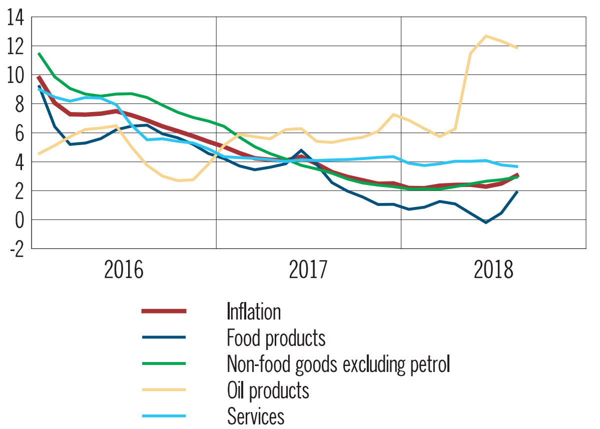


Sources: Cbonds, Moscow Exchange.

Chart 1.4

Price growth accelerated for food products and slowed down for oil products, as expected

(per cent change on corresponding month of previous year)

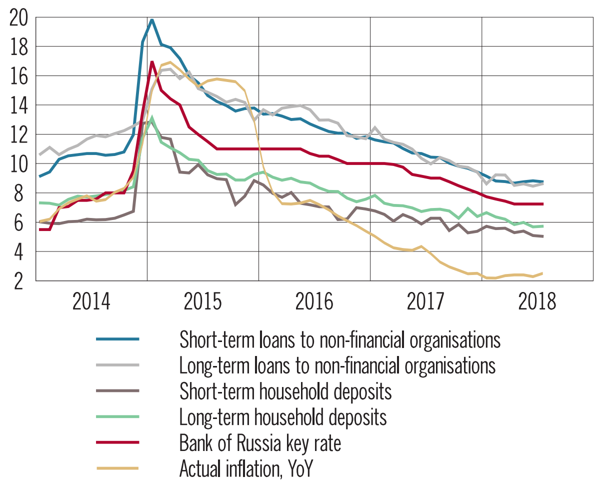


Sources: Rosstat, Bank of Russia calculations.

Chart 1.6

Interest rates started to increase

(% p.a.)



Source: Bank of Russia.

of Russia's baseline scenario. It will be buoyed by income dynamics and a gradual build up in the debt burden[1].

The annual growth in household deposits in June-July, given the relatively high deposit rates compared with current inflation, was still stable. As a result of the observed dynamics of lending and deposits in the retail segment, the change in households' net financial position entered positive territory in June-August, meaning that banks' annual household lending volumes exceeded annual deposit growth.

However, the increase in the corporate loan portfolio was moderate, mainly on account of large borrowers amid banks' persistently cautious approach to customer selection and the slow easing of non-price lending conditions. In the context of a pickup in consumer activity, banks started to lend more actively to wholesale and retail trade companies. In 2018, claims on organisations will increase by 8–10% in the baseline scenario. Unlike households, the corporate debt burden is not expected to grow, in part due to the relatively slow easing of banks' non-price lending conditions in the corporate segment.

During the observed period, lending activity dynamics were largely shaped by the previously effected interest rate cuts in the lending market.

[1] *Here and elsewhere, the debt service ratio is used as an indicator of the debt burden. This indicator is the ratio of payments on accumulated debt (including both the principal and interest) to current income value.*

This was broadly in line with Bank of Russia expectations and did not exert any significant pro-inflationary pressure. Considering the above factors of lending activity dynamics in the corporate and retail segments, in 2018, claims on the economy will grow by 11–13% in the baseline scenario. In the retail segment of the market, another factor that may constrain lending growth is the revision of the scale of enhanced consumer lending risk ratios used to calculate capital adequacy ratios, starting 1 September.

In 2018 Q2, as previously, growth in lending to the economy made the main positive contribution to the growth in money supply, according to the national definition. The structure of other sources of money supply growth was virtually unchanged and, according to Bank of Russia estimates, will remain as such till the end of 2018. Under the baseline forecast, annual growth in money supply in the national definition will be close to the growth in claims on the economy, at 9–12%.

Rosstat's revision of industry data from 2016 to 2018 Q1 does not change the Bank of Russia's perception of the impact of business activity on inflation, both retrospectively and over the forecast period. During the period under consideration, consumer activity continued to expand without overshooting the supply potential or creating excessive pro-inflationary pressure.

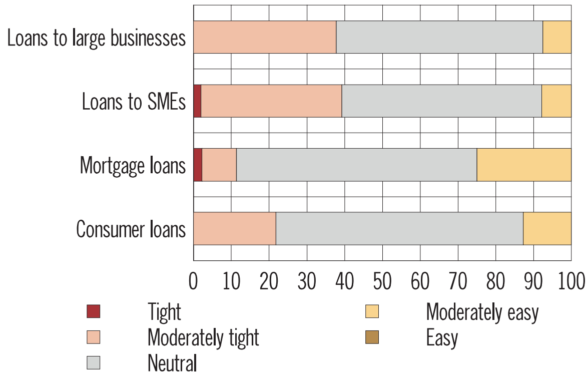
The revision of industry data allowed the Bank of Russia to improve its GDP dynamics estimate[2]. However, given that the data revision mostly affected the production of investment goods, as opposed to consumer demand, the Bank of Russia's view about business activity as a factor affecting inflation dynamics remained unchanged.

The annual rate of GDP growth in Q2 was 1.9%, which is 1.1–1.6% higher than the Bank of Russia's forecast published in the previous MPR and, therefore, not factoring in the revised data at that time. However, the revision of statistics is the main reason for the actual figures being higher than the forecast: GDP growth rates in Q2 are in line with the Bank of Russia's estimated economic activity during this period taking into account the new industry data. Furthermore, taking this revision into account, the Bank of Russia adjusted its annual GDP growth estimate for Q3 from 1.1–1.6% to 1.5–2.0%. The GDP forecast for 2018 has been kept within the range of 1.5–2.0%, which is in line with potential economic growth rates.

Chart 1.7

The majority of banks assess lending conditions as neutral or moderately tight

(banks' assessment of long-term lending tightness in 2018 Q2*, %)



** Characterised by the proportion of banks which chose certain degree of lending condition tightness in the total number of credit institutions polled.*

Source: Bank of Russia.

The growth in final consumption expenditure in Q2 is estimated at 3.0–3.5% and growth in gross fixed capital formation is estimated at 2.5–3.5%. The expansion in external demand made a noticeable contribution to GDP growth rates. Taking the revision of data into account, there are signs of higher growth in exports, mostly due to investment goods. The FIFA World Cup made a further contribution to exports growth, with the growth in turnover for catering and certain types of transport and hotel services accelerating considerably during the event. Against this backdrop, June saw a pick up in price growth for passenger transportation services (air and railway), hotels, and domestic tourism, while July witnessed the expected adjustment. Another factor affecting the prices of services was the lower than previously expected increase in utility prices.

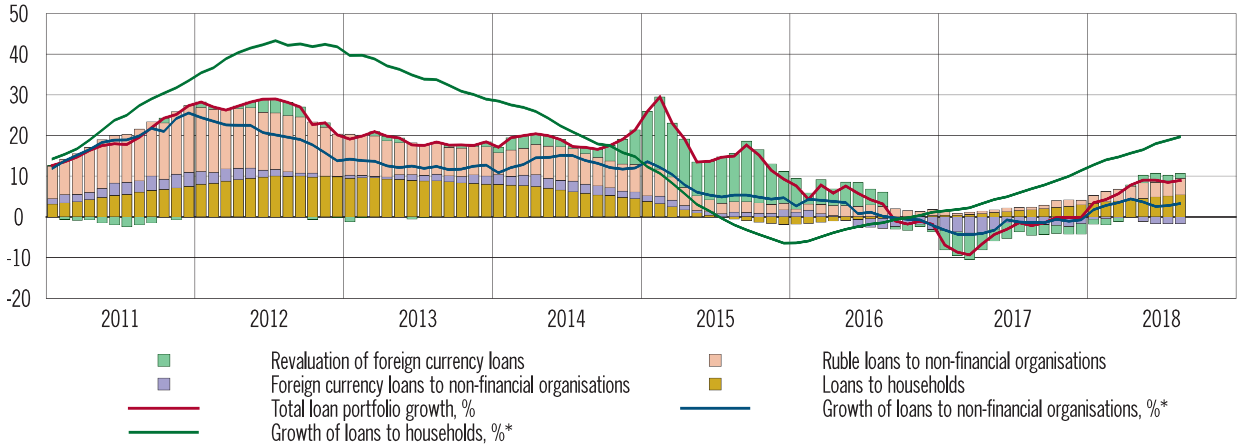
Both the data for Q2 and the operative statistics for July point to consumer activity growth being moderate without outpacing the economy's production potential. As before, the increase in demand was buoyed by recovering household incomes, mostly due to growth in real wages and in consumer lending. The seasonally-adjusted unemployment rate remained close to its natural level, that is, it did not create any additional pro-inflationary risks. Savings rate dynamics also

[2] *Rosstat's retrospective revision of annual GDP dynamics for 2016–2017 will take place on 30 December 2018, with the quarterly data being revised at the end of March – early April.*

Chart 1.8

Growth in lending does not pose any risks for inflation and financial stability

(contribution of components to the annual growth rates of bank's credit portfolio, pp)

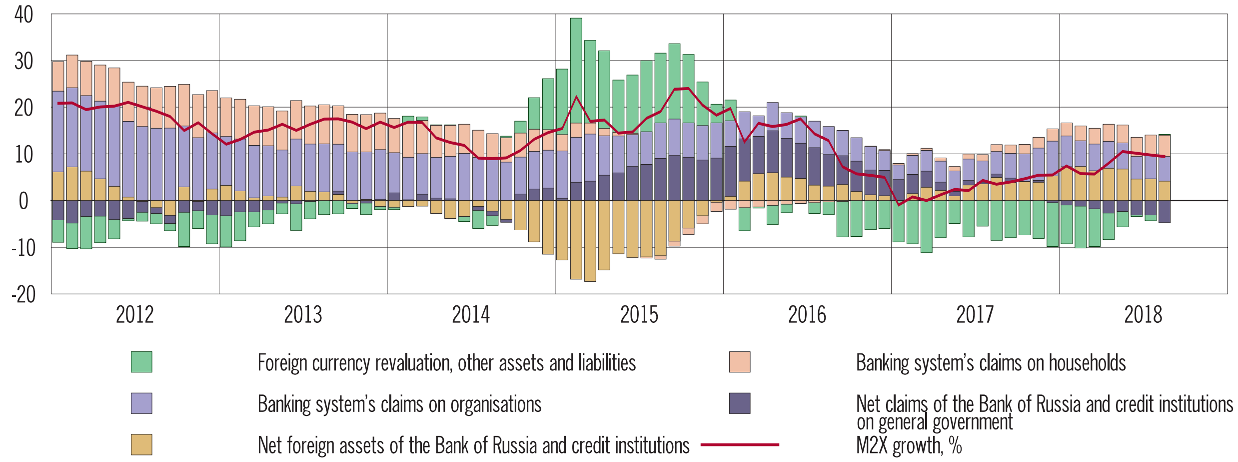


** Adjusted for foreign currency revaluation.*
Source: Bank of Russia.

Chart 1.9

Growth in broad money supply was mainly fuelled by credit*

(contribution to M2X annual growth, pp)



** From 1 January 2015, monetary indicators are calculated on the basis of new statistical methodology.*
Source: Bank of Russia.

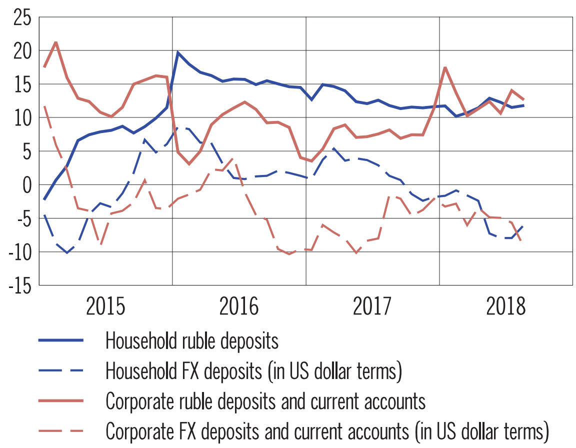
point to the moderate growth of demand, having recovered to levels specific for 2013–2014 after a short-term slump in April amid increased exchange rate volatility.

The growth in demand is also reflected in retail turnover dynamics, with the main contribution to annual growth in July coming from non-food goods, which may in part be associated with active sales of souvenir products during the FIFA World Cup and the gradual increase in demand for non-food goods overall. According to the inFOM survey[3], in June-August, estimates of the favourability of major purchases improved. Against this backdrop, seasonally-adjusted month-on-month prices for non-food goods, excluding petrol, continued to

Chart 1.10

Growth in bank deposits remains stable

(annual growth, %)



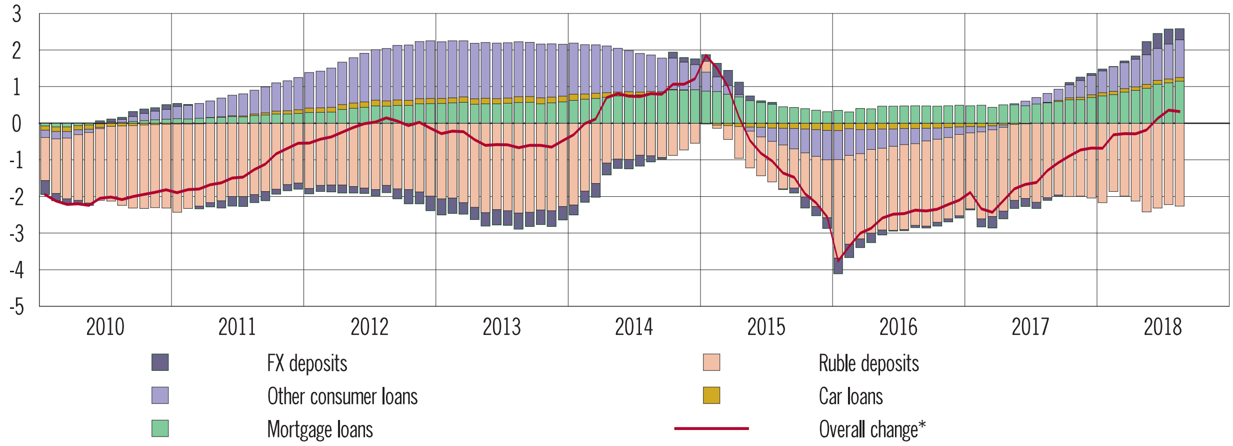
Source: Bank of Russia.

[3] *http://www.cbr.ru/DKP/surveys/inflation.*

Chart 1.11

Change in households' net financial position entered positive territory due to credit

(annual change in retail bank operations, trillions of rubles)



* Positive values mean increase in net banking claims on households..

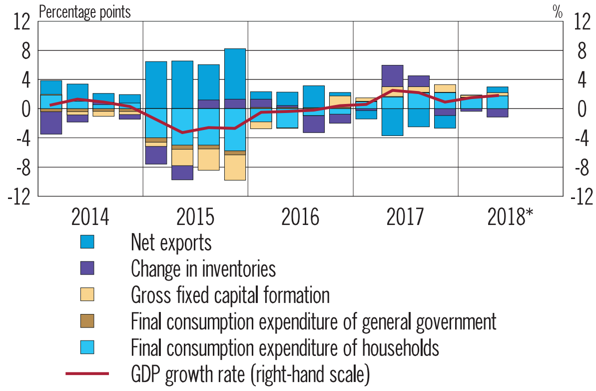
Note: To improve the visualisation of financial flows between banks and households changes in household FX and ruble deposits with banks are shown with the opposite sign.

Source: Bank of Russia.

Chart 1.12

Higher than expected GDP growth in Q2 is linked to the revised industrial data

(GDP growth structure by expenditure, on corresponding period of previous year)



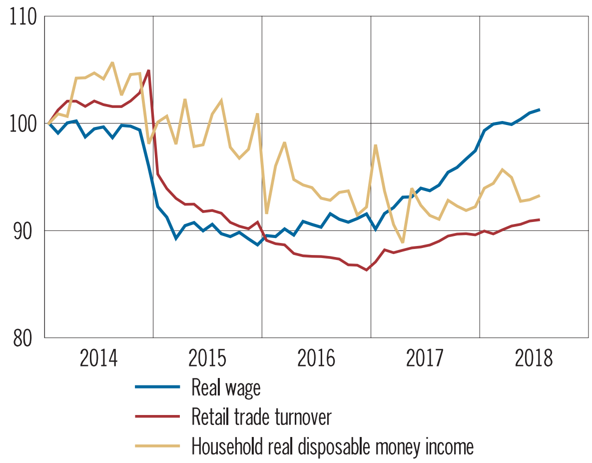
* Data for 2016 – 2018 Q1 – Bank of Russia estimate, given the revised industrial data.

Sources: Rosstat, Bank of Russia calculations.

Chart 1.13

Demand expands moderately amid income recovery and wage growth

(per cent change on January 2014, seasonally adjusted)



Sources: Rosstat, Bank of Russia calculations.

demonstrate a robust growth. However, the reaction of prices of this group of goods to the depreciation of the ruble in April remained muted.

Amid expanding consumer demand, consumer goods production grew at a modest pace. As for other industry sectors, output dynamics continued to fluctuate in June-July. After a significant downturn in June, output in the non-ferrous metallurgy recovered in July. At the same time, machinery manufacturing underwent a slump in July, which the Bank of Russia is currently putting down to short-term factors. However, the possibility that it was connected with longer-term factors cannot be ruled out: the results of various surveys (the Purchasing Managers' Index survey and the Rosstat survey) show weak business sentiment levels, in part due to the fact that demand dynamics do not match the expectations of businesses.

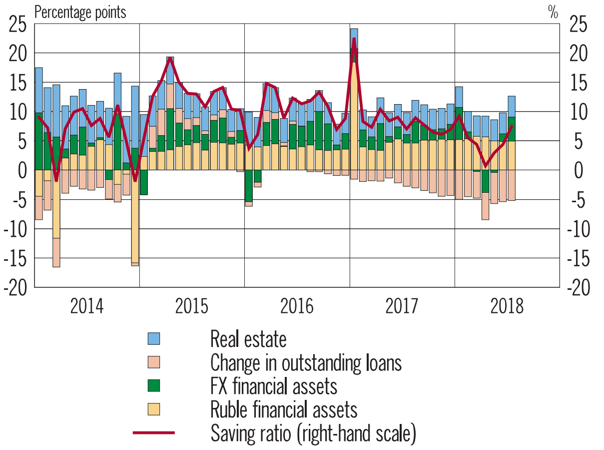
A variety of opposing factors are influencing the production dynamics of construction materials. On the one hand, the growth in output was buoyed by external demand and, on the other hand, the stagnation in construction creates uncertainty surrounding the future dynamics of construction materials production. However, the weak construction dynamics, slump in machinery manufacturing and fall in machinery and equipment imports point to a possible weakening of investment activity.

A more accurate estimate of the nature of the factors affecting economic activity may be derived as new data are released. The Bank of Russia will

Chart 1.14

Saving ratio has recovered to its 2013-2014 levels

(contribution to saving ratio, seasonally adjusted)

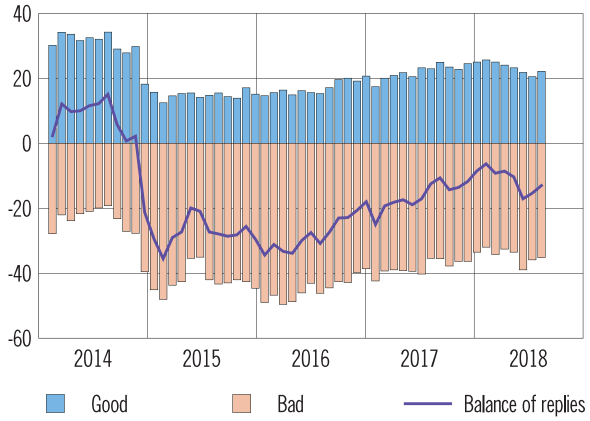


Source: Bank of Russia calculations.

Chart 1.16

Improvement in the assessment of this period of time as favourable for large purchases*

(as % of total respondents)



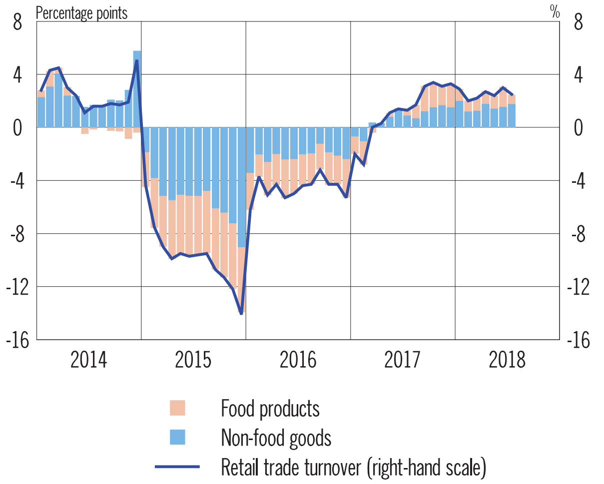
* *In general, speaking about large household purchases, what is your perception of this period of time?*

Source: InFOM.

Chart 1.15

Retail trade turnover grows at a moderate pace

(contribution to growth rate, on corresponding period of previous year)

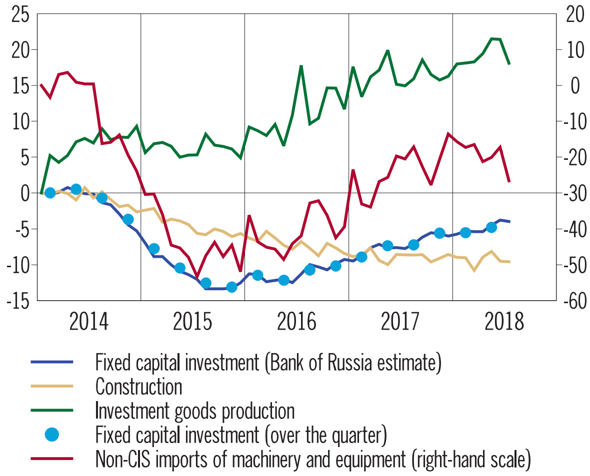


Sources: Rosstat, Bank of Russia calculations.

Chart 1.17

Investment activity in June-July was not high

(growth as % on January 2014, seasonally adjusted)



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

continue to closely monitor developments in the situation and, where necessary, adjust its forecast to take into account changes in monetary conditions.

After a prolonged period of relatively low price growth across various food markets, price dynamics are gradually normalising, as expected, due to the ongoing depletion of excess meat and dairy supplies, decrease in the grain harvest, and the arrival of vegetable harvest that is more uniform than the previous year.

The depreciation of the ruble is a significant factor in food price dynamics; it will exert an upward pressure on food prices over the coming quarters.

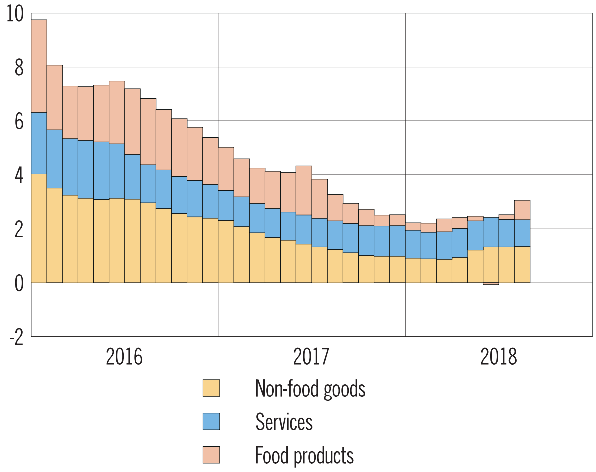
The balance of supply and demand will continue to level out in the meat and dairy markets. While in previous years, production grew quickly in these markets, this year production is slowing, taking demand dynamics into account. The unfavourable epizootic situation in the pig farming made a further contribution to the surge in meat prices. In addition, the increase in prices for imported fodder and fodder components amid the weakening of the ruble is exerting additional pressure on meat prices.

In 2018, the grain harvest is expected to be the average of the last five years, below the record harvest of last year. However, despite the growth in grain prices, the situation in the consumer market for grain-based products remains calm, aided

Chart 1.18

Annual inflation is up due to food price dynamics

(contribution to annual inflation on corresponding period of previous year, pp)

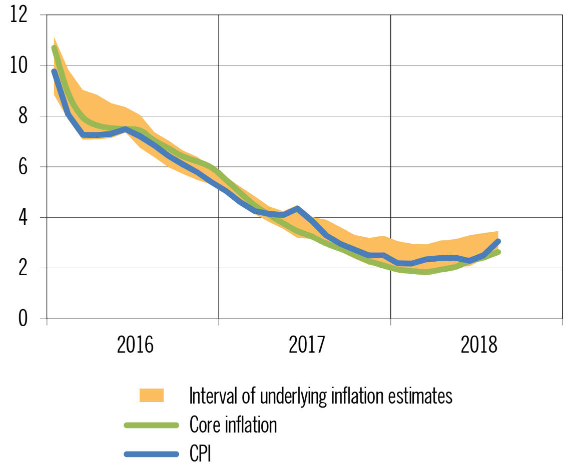


Sources: Rosstat, Bank of Russia calculations.

Chart 1.19

Underlying inflation readings began to grow

(per cent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

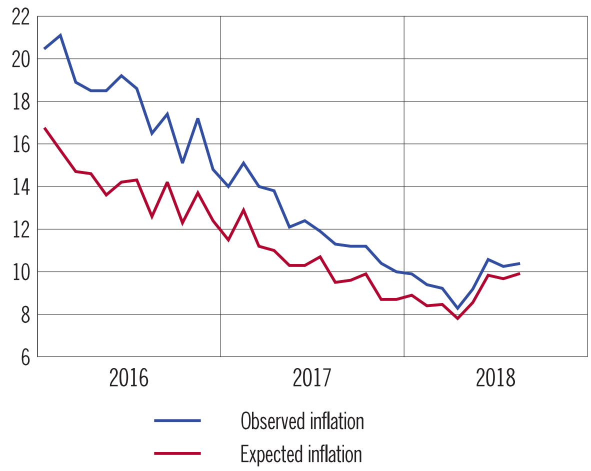
by the high accumulated stocks and typically low sensitivity of prices in this segment of the consumer market to producer price fluctuations.

This year, the monthly price growth for fruit and vegetables in June-August was broadly in line with seasonal trends. This is due to the fact that the new harvest is arriving in the market in the usual timeframes, and its volumes[4] and quality correspond to standard levels. In contrast to this year, June last year witnessed a situation where stocks from the old harvest, which were of poor quality, were quickly sold off, while the new harvest had not reached the market due to the delay of harvesting periods amid the unfavourable weather conditions. This led to a sharp price hike for fruit and vegetables in June followed by a more rapid subsequent drop in prices in July-August. As a result, this summer, the annual dynamics of fruit and vegetable price growth were largely related to the base effect. June witnessed a significant reduction in fruit and vegetable prices year-on-year, and the following two months saw a gradual waning of this effect with annual price growth in August moving out of the negative and remaining in the positive. In addition, in 2017, the quality of the new harvest of a number of vegetables was inadequate, which in autumn led to their quick sale and lower price dynamics. This year, the arrival of fruit and vegetables from the new harvest in the market is

Chart 1.20

Household inflation expectations have firmed up

(median estimate, %)



Source: InFOM.

expected to be more uniform, and the annual price growth for these products is expected to increase, in part due to the base effect. However, the ongoing active development of greenhouse farming in 2018, which will lead to a stable supply of vegetables, especially tomatoes and cucumbers, during the entire year and reduced dependency on imports, will help to moderate growth in fruit and vegetable prices. As of 12 September 2018, the gross harvest of protected-soil vegetables for the country as a whole had increased by 20.4% compared with the same period last year.

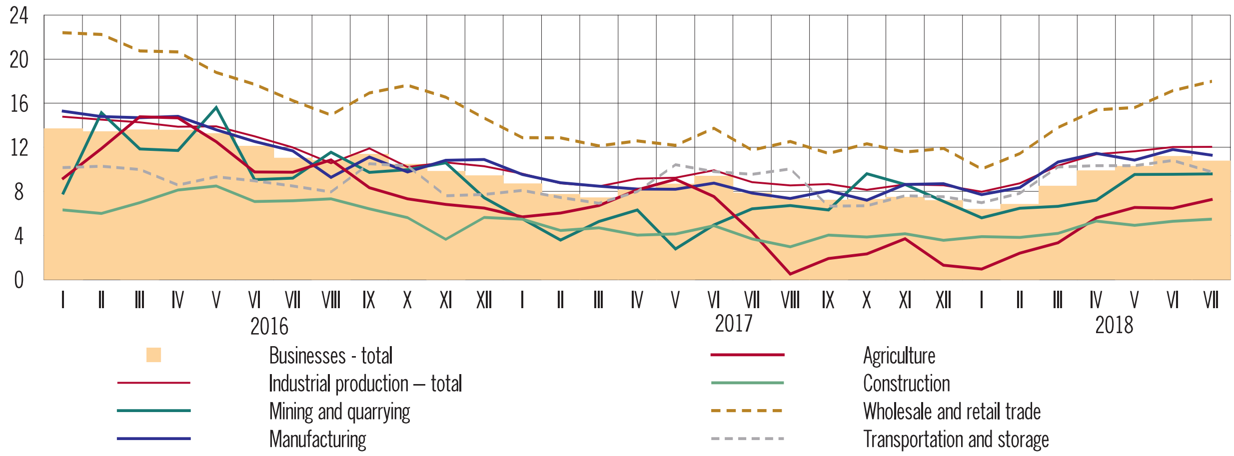
Influenced by these factors, the annual growth in food prices will gradually accelerate. In addition, taking into account producer price dynamics,

[4] Exceptions may be white cabbage and beetroot, the harvest volumes of which are still lagging behind last year's readings, which may be due to the effects of the dry summer.

Chart 1.21

Pro-inflationary risks hamper decline in business price expectations

Balance of replies (seasonally adjusted), %



Source: Bank of Russia calculations.

underlying inflation indicators, which are at a relatively low level, will also continue to increase gradually.

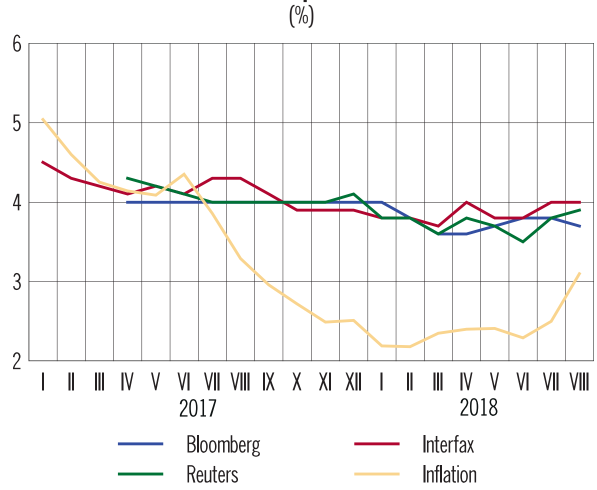
The spring growth in oil product prices, the depreciation of the ruble and the decision to raise VAT from the start of 2019 had an impact on the inflation expectations of households, businesses and the professional community to varying degrees. In the short term, uncertainty surrounding the scale of the response of inflation expectations to these pro-inflationary factors will remain, which will be taken into account by the Bank of Russia in pursuing its monetary policy.

According to surveys by the Public Opinion Foundation Institute (inFOM), household expectations reacted primarily to the change in petrol prices in May-June. 40% of respondents mentioned this as a significant factor in price dynamics in August, compared with 48% in July and 57% in June. In July-August, household expectations firmed amid the slowdown in petrol and diesel fuel price growth. Only a small number of respondents mentioned VAT as a possible reason for the expected acceleration in inflation. Taking into account the adaptive nature of household expectations, they are highly likely to be influenced by the actual increase in VAT at the start of 2019. The increase in meat and poultry prices, noted by respondents in the last survey and recorded by Rosstat since June, could also support the growth in household inflation expectations.

Chart 1.22

Professional analysts factored in the planned VAT rise in their expectations

(%)



Sources: Rosstat, Interfax, Bloomberg, Thomson Reuters.

External conditions are also having a significant impact on the expectations of economic agents. The reaction of household expectations to the ruble depreciation in April was moderate, whereas the impact of the August depreciation episode can only be judged from the data from the most recent survey[5]. However, businesses, as well professional analysts and market participants, have already started to take the deterioration in external conditions into account in their future inflation estimates.

The combination of these pro-inflationary factors, which will feed through to prices over

[5] *The most recent survey was carried out on 6–13 August, so not all of the respondents were able to react to the increase in exchange rate volatility.*

the period through the end of 2018, could weigh negatively on inflation expectation dynamics and keep expectations elevated for a longer time, especially given their ongoing sensitivity to actual price fluctuations for certain goods and services.

As a result, in order to mitigate the growing inflation risks, the Bank of Russia Board of Directors decided on 14 September 2018 to increase the key rate by 0.25 percentage points to 7.50% p.a.

According to the Bank of Russia's forecast, which takes into account decisions made on the key rate and the suspension of foreign currency purchases under the fiscal rule, consumer price growth will be 3.8–4.2% by the end of 2018.

2. ECONOMIC OUTLOOK

The Bank of Russia has considered two main scenarios for its medium-term economic development forecast: a baseline scenario and an unchanged oil price scenario. These scenarios differ primarily in their external conditions for the Russian economy, as the highest levels of uncertainty are associated with external conditions in the medium term. In addition, the Bank of Russia has considered a risk scenario which assumes a more pronounced deterioration in external conditions.

Bank of Russia forecast scenarios have been based on assumptions regarding not only external conditions, but also a number of internal conditions. These are factors that will produce a marked impact on the economy and inflation over the coming years and, in turn, will establish the objective conditions in which monetary policy will be implemented. The majority of these conditions are common to all scenarios. However, the strength and specificity of their pass-through to the economy and inflation may differ somewhat depending on the scenario, which is discussed in more detail below.

Internal conditions

First, structural factors are included in internal monetary policy conditions. These are the current structure of the Russian economy, the specifics shaping the expectations and preferences of Russian households, and the limitations associated with the dynamics of production resources, and in particular labour resources, as they are to a large degree conditioned on demographic trends. These features may change, but this typically takes a considerable amount of time (going beyond the medium-term horizon), and monetary policy cannot directly influence changes in these features.

Second, internal monetary policy conditions can be influenced by measures under other types of economic policy. The implementation of such measures can produce a considerable impact on inflation, current and potential rates of economic growth, and its structure, and can create additional incentives for different types of behaviour by households and businesses, which needs to be taken into account in monetary policy.

Over the three-year horizon and beyond – in the period up to 2024 – a range of fiscal policy measures and reforms have been envisaged[1], these are aimed at easing existing structural limitations for the development of the Russian economy (the Bank of Russia discussed these limitations in its Monetary Policy Guidelines for 2018–2020). These measures are due to be funded by ₽1.2–1.5 trillion, or roughly 1% of GDP, per year over the entire forecast period, according to the Fiscal and Customs Policy Guidelines for 2019 and the Plan Period of 2020 and 2021. The main areas of additional spending include, in particular, health care, education, demography and social policy, science and culture, the development of non-commodity exports, and the funding of infrastructure investment.

First, the effective implementation of these measures may increase potential growth rates in the Russian economy. Improvements in the investment climate, increases in human capital and labour productivity, improvements in management quality across all levels, both in the public and private sectors, the incentivisation of investment activity and the transition to an investment-oriented model of economic growth could all contribute to the mentioned increase in the potential growth rates of the Russian economy. **Second, the concurrent and successful implementation of structural measures could slightly reduce the sensitivity of inflation to certain external and internal factors.** In particular, this may evolve as a result of the Russian economy's reduced dependency on energy exports, improved competition, and the development of transport and logistics infrastructure. **Third, the planned measures could produce**

[1] *Socio-economic measures to be implemented in line with Russian Presidential Decree No. 204, dated 7 May 2018.*

a certain effect on the structure of economic growth. They will in part by aimed at accelerating growth in investment and gradually increasing the share of investment in the structure of aggregate output, in particular by establishing and using an Infrastructure Investment Fund (totalling roughly 0.5% of GDP per year over the forecast horizon). In addition, the liquid part of the National Wealth Fund, accumulated through additional budget income from oil prices exceeding the baseline price set forth in the fiscal rule, may be used to fund self-supporting infrastructure projects in the Russian economy, in line with current fiscal policy principles. This is possible after such funds have reached a specific level (7% of GDP).

At the same time, the specified measures, by their nature, have relatively long return horizons: the completion of such projects in itself, as a rule, takes quite a long time, and the focus of their impact – the institutional and structural characteristics of the economy and demographic trends – change slowly. **In connection with this, the Bank of Russia assumes that the planned fiscal and structural measures will start to have a meaningful impact on the rate and structure of Russian economic growth by the end of the three-year forecast horizon – mostly in 2021.** This impact will then continue and may prove most influential beyond the forecast period. The Bank of Russia suggests that the positive contribution of these planned government policy measures to increasing economic growth rates will not be accompanied by additional upward inflationary pressure if the production potential of the Russian economy increases accordingly. However, a specific quantitative estimate of the scale and duration of the impact of this package of measures on economic growth and inflation is currently characterised by a high degree of uncertainty, as the parameters of the pass-through effect will depend on the speed and efficiency with which these measures are implemented. This estimate will be clarified as the spending structure, along with a range of measures and projects in specific areas are set out in more detail and as the measures are implemented. As a result, the Bank of Russia has provided a relatively wide range for its economic growth forecast in 2021.

The planned increase in the retirement age could have an earlier and a more definite impact, in terms of its scale, on economic growth rates over the forecast horizon. The consequence of this reform should be a further annual increase in the number of persons employed in the economy and, in turn, an increase in GDP growth, all things being equal, that is, compared with the scenario assuming no increase in the retirement age, without leading to any pro-inflationary consequences. Moreover, this will have a moderating effect on potential pro-inflationary risks from wage dynamics. Together with measures to increase human capital and labour resource mobility, the pension reform could alleviate the problem of the labour force shortage caused by the unfavourable demographic trends, which may ensure that wage growth consistently exceeds labour productivity growth. Considering the age structure of the Russian population, the current proportion of working retirees, and the labour productivity dynamics of workers of various ages, the increase in the retirement age, according to Bank of Russia estimates, will make an additional contribution to increasing GDP growth of roughly 0.1 pp in 2019 and 0.2–0.3pp in 2020–2021.

The continuation of the policy of indexing administered tariffs and prices at a rate close to 4% over the forecast period will be of considerable importance for keeping inflation and inflation expectations at target levels and maintaining moderate cost-side pressure on prices. In this regard, the consistent implementation of these principles both on federal and regional levels is viewed as important.

Over the forecast horizon, the fiscal policy will continue to be conducted in accordance with the fiscal rule. This will smooth over the reaction of fiscal policy parameters, exchange rate, economy and inflation to fluctuations in global oil prices: their sensitivity to changes in oil prices will continue to be at the low levels reached in 2017–2018. The Bank of Russia has taken this into account when drafting its medium-term forecast. At the same time, in the event of a significant change in external conditions, in particular, a slump in oil prices to below the level set out in the fiscal rule, the parameters of the accommodative fiscal measures indicated above and their funding sources could change somewhat, which is taken into account in the risk scenario.

In its forecast, the Bank of Russia takes into account not only the direct effects, but also the indirect effects of planned socio-economic measures. These effects are related in part to the fact that funding for reform assumes both the creation of additional incentives to attract private investment, and an increase in government spending in certain areas. Funding the additional budget spending (roughly ₽8 trillion over six years) will require an increase in public debt placements and an increase in the income basis through an increase in value added tax (see the draft Fiscal and Customs Policy Guidelines for 2019 and the Plan Period of 2020 and 2021). **The 2-percentage point increase in the main VAT rate with effect from 1 January 2019 will produce a meaningful impact on inflation and inflation expectations over the forecast horizon.** The scale of the change in inflation, however, will be less than the proposed tax increase. When calculating it, the Bank of Russia takes into account, among other things, VAT's weight in the retail price structure, the number of goods and services in the consumer basket taxed at reduced VAT rates that will not be increased, and the proportion of businesses exempt from VAT payments due to the use of the simplified taxation system. According to Bank of Russia estimates, based in part on studying similar episodes from Russia and other countries, and based on the results of a survey of a broad sample of Russian businesses in July 2018, the reaction of prices to the increase in VAT will be felt in the first few months of 2019.

The initial pass-through of the VAT increase to prices will be one-off in nature, that is, it will lead to a single increase in price levels. This effect will be reflected in annual inflation over the course of a year, but current price growth rates (monthly, quarterly) will increase meaningfully only in the short term – in the first few months of 2019 – before reducing again. **At the same time, the overall scale of the pass-through of the VAT increase to inflation will depend on the scale of the secondary effects of this event, i.e., on how pronounced and stable the increase in inflation expectations is, and the extent to which producers and trade organisations are prepared to cover the cost of some of the tax increase and not pass on the increase in full to prices.** The moderate consumer demand dynamics may limit the extent to which the VAT increase is passed on to prices, as the increase in household tax burden will have a slightly negative effect on household consumer activity dynamics, predominantly in early 2019. Considering the above mentioned effects, the Bank of Russia has estimated the contribution of the VAT increase to annual inflation in 2019 at roughly 1 pp (see the report Estimate of the Pass-through of Increase in the Main VAT Rate on Inflation, August 2018).

The Bank of Russia's efforts seeking to develop financial market and convert household savings into long-term domestic investment will provide additional support for creating favourable conditions to increase investment and economic activity over the forecast horizon. These include measures to develop incentive-based regulation for the banking sector, develop the long-term investment segment, improve the quality of corporate governance, and develop the insurance sector and the fiduciary management and collective investment sector (see the draft Guidelines for the Development of the Russian Financial Market in 2019–2021). The Bank of Russia believes that these measures are likely to have a pronounced impact on economic growth rates only in combination with measures aimed at other aspects of economic policy and are also characterised by long-term economic returns. Bank of Russia efforts to improve households' financial inclusion and financial literacy (see the draft Guidelines for the Development of the Russian Financial Market in 2019–2021) could help to increase the proportion of citizens making active use of financial products and services, thereby contributing more effectively to the conversion of domestic savings into domestic investments. Over the forecast period, this could help to boost the effectiveness of the monetary policy transmission mechanism and somewhat alleviate the impact of those structural peculiarities of the Russian economy that restrict the pass-through of interest rates to household behaviour, such as high income differentiation and the relatively low proportion of middle class in Russia (see the Monetary Policy Guidelines for 2018–2020).

As the accessibility of market funding increases, the Bank of Russia plans to continue its strategy to withdraw specialised refinancing instruments. This process will be phased, and its speed will depend on the further improvement in the accessibility of market sources of finance and, in general, changes in external and internal conditions affecting lending, investment and economic activity. Non-deterioration of conditions of previously issued loans will be one of the key principles of the strategy.

The Bank of Russia assumes that inflation expectations over the forecast horizon will continue to be sensitive to one-off events affecting inflation. To a large degree, this concerns household expectations. These are typically characterised by the highest levels of inertia, that is, they tend to be guided by previous values, and they continue to experience the effects of the long period of higher and more volatile inflation which had existed before the Bank of Russia switched to inflation targeting at 4%. The reaction of inflation expectations to episodes of price growth acceleration may be particularly pronounced, while they may react to lower inflation less so or with a longer delay. Changes in expectations can be caused both by spikes in inflation overall (under the influence of factors such as exchange rate dynamics or government regulatory measures) and by the price dynamics of certain high-demand goods, under the influence of transitory factors affecting only certain markets. In this regard, the Bank of Russia assumes that, over the forecast horizon, and in particular at the start of this period, even one-off pro-inflationary events, including those caused by supply-side factors, will continue to generate secondary effects and, accordingly, will need to be taken into account in monetary policy. With inflation being kept close to 4%, and the Bank of Russia's active information policy, together with measures aimed at improving financial literacy (see the draft Guidelines for the Development of the Russian Financial Market in 2019–2021), in the medium term, the expectations of all groups of economic agents will gradually settle close to 4% and exhibit reduced sensitivity to one-off price fluctuations.

External conditions

Over the forecast period, external conditions will be characterised by relatively high levels of uncertainty, both in terms of global economic growth prospects and the structure of economic growth, and in terms of the economic policy of key economies, including monetary, fiscal and foreign trade policies. These factors may influence capital flows, international trade volumes, and prices in global commodities and financial markets. High levels of uncertainty, which make the markets more sensitive to changes in participants' sentiment and expectations, can lead to short-term spikes in volatility in the global financial markets over the forecast horizon.

The Bank of Russia assumes that external conditions will be generally constraining or neutral for the Russian economy in the medium term, depending on the scenario. However, their pass-through to internal economic conditions, output growth and inflation will be smoothed over by government macro-economic policy measures, including the fiscal rule and the Bank of Russia's policy as part of its inflation targeting regime. Maintaining macro-economic and financial stability and sustainable public finances will ensure that the Russian economy is less vulnerable to fluctuations in the global financial markets compared with many other EMEs.

The effects of external factors on monetary policy conditions will be passed over through several channels. Inflationary pressure in Russia's main trading partners, which is expected to remain low over the entire forecast period, will be translated into internal price dynamics through the cost of imports. Global economic growth rates will be one of the key factors underlying the pace of growth of Russian exports.

The dynamics of external interest rates over the forecast period will be broadly shaped by the processes of monetary policy normalisation in developed economies. A change in external rates combined with a change in the risk premium for investments in Russian assets will influence cross-border capital flows and, in turn, the ruble's exchange rate. Sustainable changes to external rates and risk premia in the long term will also be taken into account by the Bank of Russia in its estimates of the neutral interest rate. However, risk premia will be influenced by factors that are common to EMEs, such as the risk appetite of international investors and the growth outlook of developed and developing economies, and factors that are specific to Russia, including geopolitical factors. The Bank of Russia assumes that the international sanctions imposed against Russia in 2014–2018 will remain over the entire forecast horizon.

The situation in the global energy market will continue to produce a meaningful effect on the Russian economy, given that energy commodities continue to account for a relatively large proportion in Russian exports. The effect will be both direct, through export volumes, and indirect, through capital flow dynamics, as oil price dynamics have considerable influence over foreign investors' assessment of the Russian economy's growth outlook and, therefore, the appeal of investments in Russian assets and their risk premia.

The situation in the global energy market will be shaped by the interplay between demand-side factors, including growth rates for key economies and the global economy as a whole, and supply-side factors, which are largely conditioned on the decisions of the main energy exporting countries, and will also be subject to the influence of geopolitical factors. The combination of these factors will give rise to high levels of uncertainty in the global oil market.

Taking into account the continued heightened uncertainty surrounding changes in the external economic climate over the forecast period, the Bank of Russia has considered two main development scenarios for external conditions and an additional risk scenario, which specifically differ in terms of the assumptions regarding the path of global oil prices.

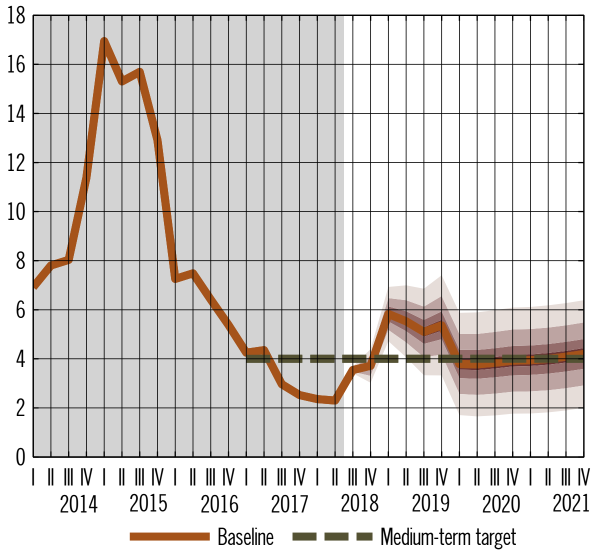
Baseline scenario

In the baseline scenario, maintaining a conservative approach to its assumptions and basing them on the estimates of the most likely course of events, the Bank of Russia assumes stable economic growth in Russia's trading partners, a gradual normalisation of monetary policy in advanced economies and a gradual reduction in oil prices from their current level above $70 per barrel to $55 per barrel in 2020–2021. This oil price trajectory may result from the gradual withdrawal from the arrangements between energy exporting countries to restrict oil production, the parameters of which already started to be relaxed midway through this year, and sustained expansion in shale oil supplies. However, the implementation of the fiscal rule means that the effect of reduction in oil prices will be of limited nature for the economy.

In 2019, the greatest effect on price dynamics will come from the VAT increase. The depreciation of the ruble in 2018 will also continue to feed through to year-on-year inflation levels in the first half of the year. The continued sensitivity of inflation expectations to one-off factors could intensify the effect of exchange rate dynamics and the VAT increase on price growth. Under the influence of these factors, in 2019, annual inflation will temporarily overshoot 4%, peaking in Q1. Beginning in 2019 Q2, the impact of these factors on current price dynamics will start to wane, and by the second half of the year, quarterly annualised inflation rates will come close to 4%. **However, annual inflation will reduce over the year more slowly due to the effects of the VAT increase. By the end of 2019, it will be 5.0–5.5%.** In order to restrict the scale and duration of the secondary effects of the VAT increase and exchange rate dynamics, and to ensure that inflation anchors close to 4% in the medium term, the Bank of Russia will need to implement a tighter monetary policy than previously estimated.

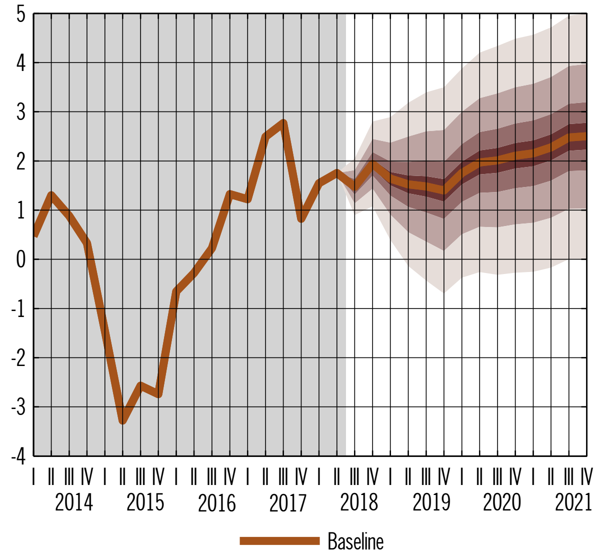
In 2019, demand dynamics will not exert any upward pressure on inflation. Over the year, predominantly in the first six months, a number of factors will have a slight constraining effect on growth in internal demand. These include the VAT increase, slowing growth in exports income in the economy due to the gradual decline in oil prices, and a slight slowdown in lending growth amid the continuation of the Bank of Russia's moderately tight monetary policy and revised market expectations surrounding the speed of the transition to a neutral policy. In these conditions, according to Bank of Russia estimates, growth in the final consumption of households will slow to 1.3–1.8% in 2019. The constraining effect of the VAT increase on investment activity will be rather short-lived and, by 2019, it will be offset by growth in investment demand from the public sector. As a result, according to Bank of Russia estimates, annual growth in gross fixed capital formation will be higher in 2019 than in 2018, at 2.3–2.8%. The gradual phasing out of energy exporters' arrangements to limit oil production will provide additional support to growth in exports in

Inflation
(per cent change on corresponding period of previous year)



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

GDP growth rate
(per cent change on corresponding period of previous year)



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

real terms, which will be in the range of 2.5–3.0% at the end of 2019, according to Bank of Russia estimates. The dynamics of demand for imported goods will be broadly in line with the dynamics of internal consumer demand and investment activity, with demand growth rates slowing to 3.0–3.5% in 2019.

Under the influence of all of these factors, economic growth at the end of 2019 will be 1.2–1.7%, staying close to potential levels.

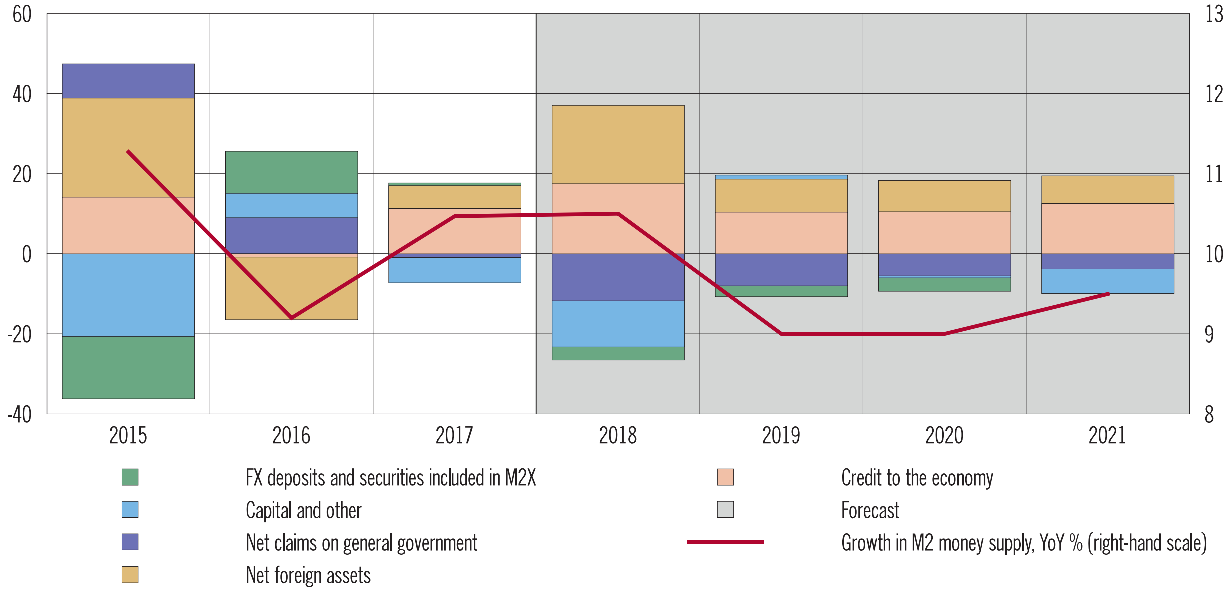
In the first half of 2020, as the pro-inflationary effects of the VAT increase and exchange rate dynamics come to an end, which will have influenced inflation and inflation expectations in 2019, annualised consumer price growth will return to 4%. The expected dynamics of inflation and inflation expectations will create the conditions for the easing of monetary policy at the end of 2019 – early 2020.

In 2020–2021, inflation will be near 4%, with the external economic climate stabilising and economic growth remaining close to potential levels, which will not create additional demand-side pressure for prices.

The gradual easing of monetary policy and positive effect of the increase in the retirement age on the dynamics of the number of those employed in the economy and the gradual accumulation of the positive effect of fiscal policy measures in 2020–2021 will provide additional support to growth in internal demand, in particular investment demand. Combined with the positive effect of the stabilising external conditions on business expectations and sentiment, this will contribute to an acceleration in investment activity growth, resulting in the annual growth in gross fixed capital formation at 3.0–3.5% in 2020 and 3.5–4.5% in 2021. The annual growth in household final consumption expenditure during this period will also increase to 2.0–2.5% in 2020 and 2.5–3.0% in 2021. Robust growth in internal demand will also cause growth in imports by 3.9–4.4% in 2020 and 4.3–4.8% in 2021. Measures designed to stimulate investment could further intensify demand for the imports of investment goods. Growth in export quantities by 2.3–2.8% in 2020–2021 amid the continuation of sustained positive growth in demand demonstrated by Russia's trading partners will continue to provide considerable support for economic growth in 2020–2021. At the same time, the gradual implementation of a range of fiscal policy measures in the period through 2024 will also contribute to growth in the non-commodity segment of exports, in part due to the exports of high-tech goods.

As a result, the growth in aggregate output will have gradually increased by the end of the forecast horizon to 1.8–2.3% in 2020 and 2–3% in 2021. In the baseline scenario, the Bank of

Decomposition in money supply growth in national definition
(contribution of components to money supply growth rates in national definition*, pp)

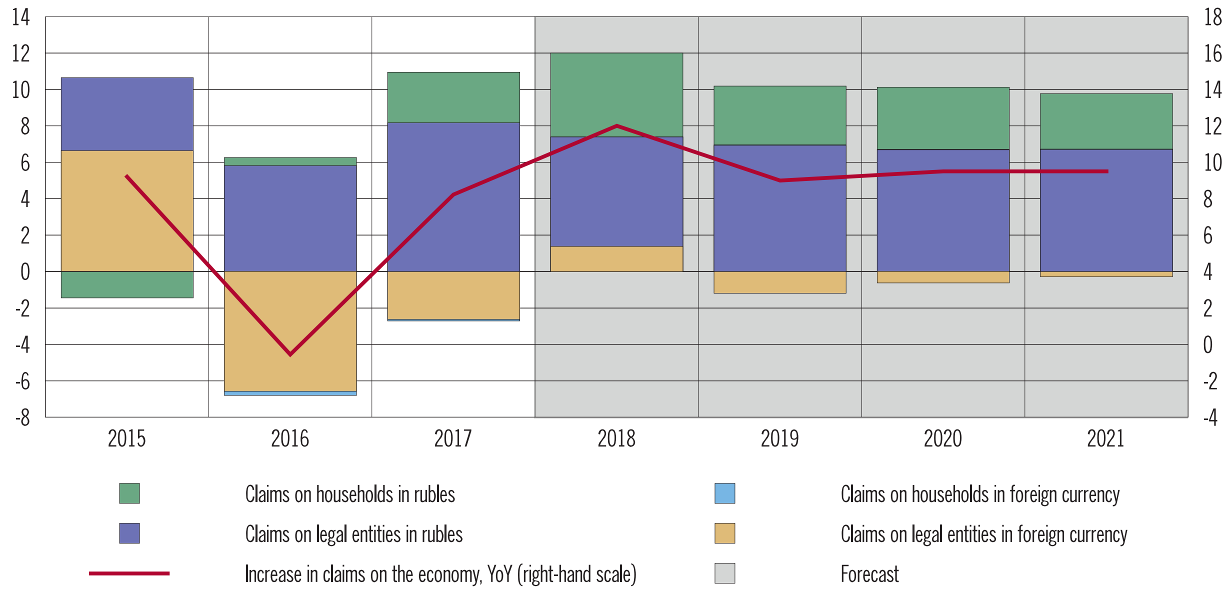


** In the forecast, decomposition is shown for the increase in M2 in the national definition corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations.

Russia expects that, with support coming from the effective implementation of fiscal policy measures and structural reforms, growth will be accelerated primarily on account of improvements in the production potential of the Russian economy. Hence, the expansion of internal demand will not exert additional pro-inflationary pressure and will not require any adjustments in the monetary policy.

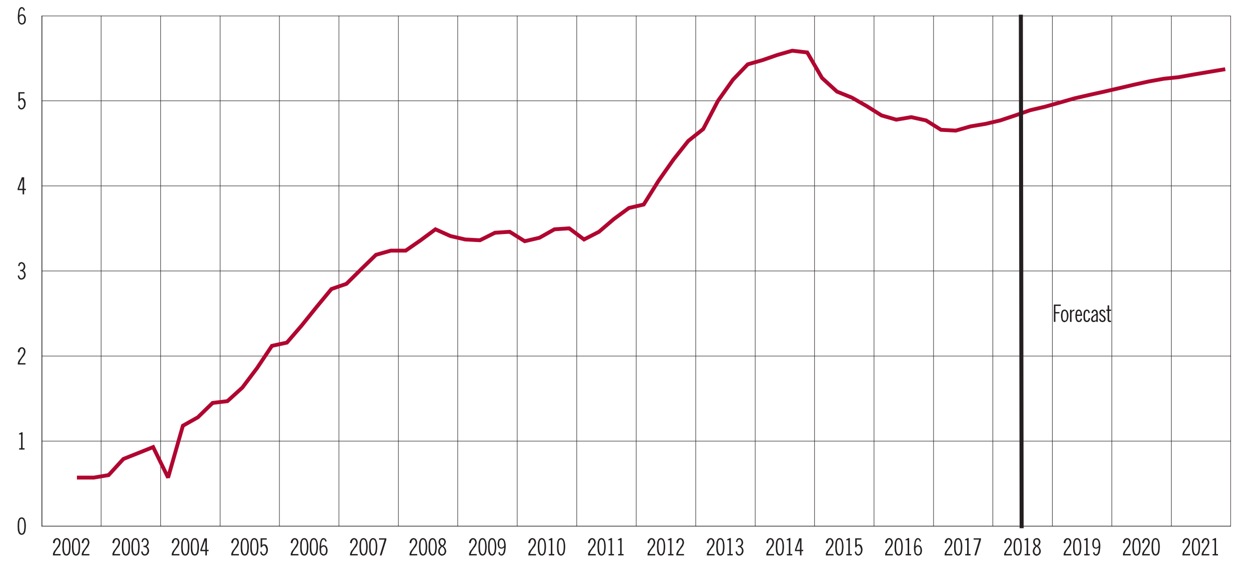
At the same time, if developments in the situation in 2020–2021 differ from the Bank of Russia's assumptions and the upward pressure from increasing government spending on consumer demand significantly outstrips the impact on production capacity, the acceleration of economic growth may be accompanied by an upward pressure on inflation. The Bank of Russia will pay significant

Decomposition in increase in claims on the economy
(contribution to increase in claims* on the economy, pp)



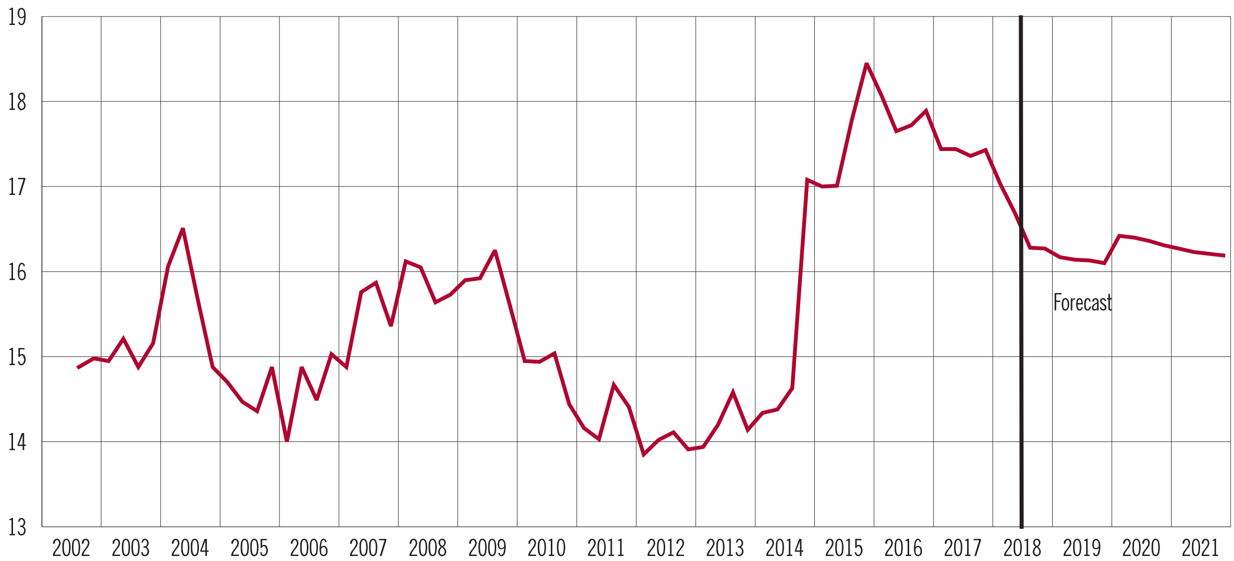
** In the forecast, decomposition is shown for the increase in claims on the economy corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations.

Household debt burden*
(debt service ratio, as % of GDP)



** In the forecast, household debt burden is calculated for the claims corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations based on bank reporting templates, Rosstat.

Corporate debt burden*
(debt service ratio, as % of GDP)



** In the forecast, corporate debt burden is calculated for the claims corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations based on bank reporting templates, Rosstat.

attention to estimating the short-term and long-term effects of planned fiscal measures, by clarifying the scale and nature of their impact on the economy and inflation as more details become available and as they are implemented.

With regard to the dynamics of monetary and credit aggregates over the forecast horizon, these will continue to buoy economic activity, exerting no additional pro-inflationary pressure on the economy. Lending activity will continue to expand at rates in line with the increase in effective demand and will not pose any risks to price or financial stability. Non-price lending conditions will relax gradually, reflecting the continuation of banks' conservative approach to borrower assessment and risk appetite. Lending will continue to be the main driver of change in money supply. The interval between growth in money supply and lending to the economy will narrow in the medium term, in part as the budget surplus shrinks over the forecast

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

	2017 (actual/estimate)	2018		2019		2020		2021	
		baseline	unchanged oil price	baseline	unchanged oil price	baseline	unchanged oil price	baseline	unchanged oil price
Urals price, average for the year, US dollars per barrel	53	69	70	60	70	55	70	55	70
Inflation, as % in December year-on-year	2.5	3.8-4.2	3.8-4.2	5.0-5.5	5.0-5.5	4.0	4.0	4.0	4.0
Inflation, average for the year, as % year-on-year	3.5	2.9-3.1	2.9-3.1	5.0-5.5	5.0-5.5	4.0	4.0	4.0	4.0
Gross domestic product[1]	1.8	1.5-2.0	1.5-2.0	1.2-1.7	1.5-2.0	1.8-2.3	1.8-2.3	2.0-3.0	2.0-3.0
Final consumption expenditure	2.5	2.0-2.5	2.0-2.5	1.2-1.7	1.2-1.7	1.5-2.0	1.8-2.3	2.0-2.5	2.0-2.5
– households	*3.4*	*2.5-3.0*	*2.5-3.0*	*1.3-1.8*	*1.3-1.8*	*2.0-2.5*	*2.0-2.5*	*2.5-3.0*	*2.5-3.0*
Gross capital formation	9.3	(-1.0)-0.0	(-1.0)-0.0	2.0-3.0	2.5-3.5	2.5-3.5	3.0-4.0	3.5-4.5	3.5-4.5
– gross fixed capital formation	*4.9*	*1.5-2.0*	*1.5-2.0*	*2.3-2.8*	*2.5-3.0*	*3.0-3.5*	*3.0-3.5*	*3.5-4.5*	*3.5-4.5*
Exports	6.0	5.2-5.7	5.2-5.7	2.5-3.0	2.5-3.0	2.3-2.8	2.3-2.8	2.3-2.8	2.3-2.8
Imports	17.4	5.2-5.7	5.2-5.7	3.0-3.5	3.2-3.7	3.9-4.4	4.5-5.0	4.3-4.8	4.3-4.8
Money supply in national definition	10.5	9-12	9-12	7-11	8-12	7-12	7-11	7-12	7-12
Lending to the economy (businesses and households) in rubles and foreign currency[2]	8.2	11-13	11-13	7-11	8-12	7-12	7-12	7-12	7-12
– lending to non-financial and financial organisations in rubles and foreign currency, growth as % over year	*7.1*	*8-10*	*9-11*	*6-9*	*7-10*	*6-10*	*6-10*	*6-10*	*6-10*
– lending to households in rubles and foreign currency, growth as % over year	*12*	*19-22*	*19-22*	*12-17*	*13-18*	*10-15*	*11-16*	*10-15*	*10-15*

[1] 2017 data – the Bank of Russia's estimate with Rosstat-revised industrial production data factored in.
[2] Banking sector lending to the economy means all of the banking sector's claims on non-financial and financial institutions and households in the currency of the Russian Federation, a foreign currency and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investments in debt and equity securities and promissory notes, as well as other forms of equity interests in non-financial and financial institutions, and other accounts receivable from settlement operations involving non-financial and financial institutions and households.

Source: Bank of Russia.

Russia's balance of payments indicators*
(billions of US dollars)

	2017 (estimate)	2018		2019		2020		2021	
		Baseline	Unchanged oil price	Baseline	Unchanged oil price	Baseline	Unchanged oil price	Baseline	Unchanged oil price
Current account	**35**	**98**	**99**	**74**	**104**	**50**	**97**	**45**	**94**
Balance of trade	115	181	182	157	189	137	188	134	188
Exports	*354*	*435*	*440*	*411*	*454*	*403*	*471*	*414*	*488*
Imports	*-238*	*-253*	*-258*	*-254*	*-265*	*-266*	*-283*	*-281*	*-300*
Balance of services	-31	-32	-32	-32	-32	-33	-36	-34	-37
Exports	*58*	*65*	*65*	*66*	*68*	*68*	*71*	*70*	*74*
Imports	*-89*	*-97*	*-97*	*-98*	*-100*	*-100*	*-106*	*-104*	*-111*
Primary and secondary income balance	-49	-51	-51	-52	-53	-54	-55	-55	-56
Capital account	0	0	0	0	0	0	0	0	0
Current and capital accounts balance	**35**	**98**	**99**	**74**	**104**	**50**	**97**	**45**	**94**
Financial account (excluding reserve assets)	**-16**	**-59**	**-60**	**-25**	**-36**	**-16**	**-32**	**-14**	**-34**
General government and the central bank	*15*	*-4*	*-4*	*3*	*3*	*3*	*4*	*3*	*5*
Private sector	*-31*	*-55*	*-56*	*-27*	*-38*	*-18*	*-36*	*-18*	*-39*
Net errors and omissions	**4**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Change in FX reserves ('+' – decrease, '-' – increase)	**-23**	**-39**	**-39**	**-49**	**-68**	**-34**	**-65**	**-31**	**-60**

** Signs according to BPM5.*
Note: Due to rounding total results may differ from the sum of respective values.
Source: Bank of Russia.

horizon amid declining oil prices. In 2019–2021, claims on the economy and money supply will grow at the annual rate of 7–12%.

Ruble-denominated loans to organisations will still account for the majority of the claims structure. In 2019–2021, the growth in claims on organisations will be 6–10%. The slowdown in their growth over the forecast period will be caused by the limited potential for the easing of monetary conditions because of their being close to neutral levels, and the gradual deleveraging of corporate balance sheets, including foreign-currency denominated credit facilities and loans. Due to the moderate growth in lending activity, the debt burden in the corporate segment will stabilise over the forecast horizon close to the relatively stable levels around 16% of GDP without posing a threat to financial stability in the economy.

Conversely, the household debt burden will gradually grow, returning to levels consistent with the stable upward trajectory that has evolved in the long term. The growth in claims on households will gradually slow in future, to 12–17% in 2019 and 10–15% in the medium term. The growth in the household debt burden will be in line with the increase in real incomes and will not, therefore, be accompanied by the accumulation of risks to financial stability in the economy. By the end of the forecast period, the household debt burden will be 5.0–5.5% of GDP. If imbalances occur in certain segments of the credit market, the Bank of Russia will offset them by using macroprudential policy measures.

These trends in internal and external demand dynamics combined with the change in prices in global commodity markets will be reflected in the corresponding dynamics of balance of payments indicators in 2019–2021. Amid the gradual decline in oil prices in the baseline scenario, the current account balance will remain consistently positive over the entire period. However, it is expected that due to the contraction in exports volume amid the fall in oil prices, the current account surplus will reduce to roughly 3% of GDP in 2020–2021 after 6% of GDP in 2018. The financial account balance for the private sector will also fall from 4% of GDP in 2018 to 1% of GDP in 2020–2021 amid a reduction in Russian private sector's external debt repayments and a slight decrease in opportunities for Russian companies to build up their foreign liabilities in view of the reduced prices for key Russian export goods.

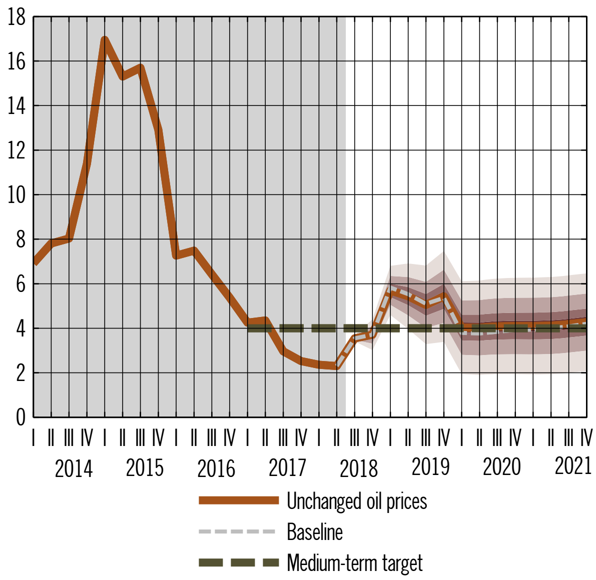
Unchanged oil price scenario

The scenario assuming no change in oil prices is broadly similar to the baseline scenario, in part due to the fact that the impact of oil price dynamics on the Russian economy over the forecast horizon will continue to be smoothed out by the implementation of the fiscal rule.

The main difference between this scenario and the baseline scenario is conditioned on the factors shaping the economic picture in 2019. If oil prices remain unchanged this will lead to a higher ruble exchange rate than in the baseline scenario. On the one hand, this will exert a downward pressure on inflation via the exchange rate pass-through effect. On the other hand, it will lead to a reduction in the cost of imports, thereby buoying consumer and investment demand. The faster, than in the baseline scenario, growth in internal demand for both households and firms will exert some upward pressure on inflation, with this being offset almost entirely by the downward pressure from the exchange rate pass-through effect. **As a result, in 2019, consumer price growth will be close to the levels implied by the Bank of Russia's baseline scenario. In these conditions, monetary policy**

Inflation

(per cent change on corresponding period of previous year)



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

will also be close to the policy conducted under the baseline scenario. In 2019, GDP growth will be slightly above the baseline scenario, at 1.5–2.0%.

After that, over the forecast period, both inflation dynamics and economic activity dynamics will coincide with the estimates of the baseline scenario. Higher growth in economic activity in the second half of the forecast period is possible in the event of faster and more effective structural transformations in the Russian economy compared with the estimates of the baseline scenario. The effect of the fiscal rule and global oil prices consistently exceeding the baseline level will contribute to a budget surplus in 2018 and over the entire forecast horizon.

The dynamics of credit and monetary aggregates will also not undergo any significant changes compared with the baseline scenario. The growth in lending to the economy and, in turn, money supply, will be close to the estimates of the baseline scenario at 8–12% in 2019 and 7–12% in the medium term. The most significant difference is the longer, than in the baseline scenario, persistence of relatively high growth in claims on households over the forecast horizon. Similar to the baseline scenario, household lending activity will be predominantly supported by income dynamics. This will help to maintain effective demand for loans and a debt burden level that does not create any risks to financial stability.

Global oil prices remaining higher than in the baseline scenario will further buoy export volume dynamics, while import dynamics will be close to the baseline scenario. As a result, in 2019–2021, the current account balance will exceed the levels implied in the baseline scenario at 5–6% of GDP over the entire forecast period. The private sector financial account balance will also be higher than in the baseline scenario at roughly 2% of GDP in 2019–2021. This will be aided by a somewhat greater expansion in Russian companies' and banks' foreign assets amid a significant growth in export incomes fuelled by persistently high oil prices.

Risk scenario

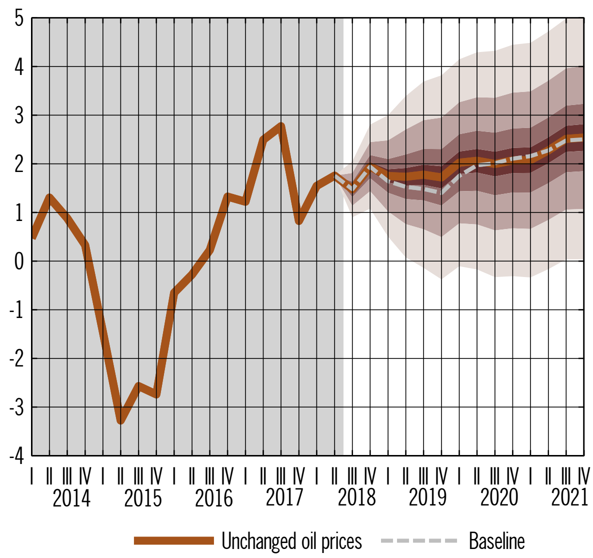
The risk scenario assumes that external conditions will deteriorate considerably for the Russian economy and that global economic growth dynamics and international trade dynamics will be weaker than in the baseline scenario. This may be due to a range of unfavourable events that could occur in varying combinations. These include a significant expansion of foreign trade restrictions, a deterioration in the macro-economic situation in EMEs, an increase in the capital outflow from these countries, and risks of a further expansion of international sanctions against Russia.

The slowing growth of the global economy could lead to a structurally weaker global demand for energy than in the baseline scenario. The risk scenario expects oil prices to fall to $35 per barrel in 2019 and remain at this level going forward, which implies that energy exporting countries are unable to comply with the production restriction arrangements.

These events could moderately lead to a significant growth in risk premia for Russian assets and a faster capital outflow in 2019. The intensifying capital outflow coupled by the pressure on the current account from the deterioration in trading conditions could lead to a short-term contraction in internal demand, depreciation of the ruble, and growth in exchange rate and inflation expectations. The inflation risks will bring about a need to tighten monetary policy in order to limit growth in inflation expectations and to stabilise the financial markets. In addition to changes to the key rate, the Bank of

GDP growth rate

(per cent change on corresponding period of previous year)



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

Russia may also use other instruments to alleviate the consequences of a stronger capital outflow and stabilise the situation in the financial markets. In 2019, if the risk scenario should occur, there will likely be a faster price growth than in the baseline scenario and GDP growth will move into negative territory. However, the effect of the fiscal rule will smooth over the pass-through from deterioration in trading conditions to the economy. In future, over the forecast horizon, as the economy adapts to the changed macro-economic conditions, output growth is expected to return to positive territory in 2020, and by the end of the forecast period – in 2021 – it willbe close to baseline scenario levels. Moreover, inflation will be close to the Bank of Russia's target level by the end of 2020.

In terms of the fiscal policy, the risk scenario exhibits some uncertainty over the implementation of plans to finance the deficit, including market sources of finance, which is conditioned on the limited opportunities to place OFZs and Eurobonds in the planned quantities. But despite the stabilising effect of the fiscal rule with respect to offsetting the shortfall in oil and gas revenues from the National Wealth Fund, overall fiscal policy will have a moderately constraining effect on internal demand.

Should the risk scenario materialise, the Bank of Russia will carefully monitor the levels of risk to financial stability, which may be linked to the elevated volatility in the financial market, and will be ready, if necessary, to use all available instruments to limit such risks.

ANNEXES

Dynamics of major items in the Russian balance of payments in 2018 Q2

According to preliminary estimates, in 2018 Q2, the current account surplus expanded by $20 billion[1] to $22 billion due to a two-fold increase in the external trade balance surplus.

Growth in the goods and services exports volume accelerated from 22% in Q1 to 29% in Q2, mainly due to energy commodities. The expansion of exports was predominantly down to price growth. According to the FCS, the increase in export quantities by an average of 6.5% also made a noticeable contribution to the growth in revenues from Russian external trade in Q2. However, the dynamics of energy export quantities were mixed.

Russian supplies of oil and oil products abroad contracted by 2% in Q2. Growing exports to China under the intergovernmental agreement only partially offset the reduction in supplies to the EU. At the same time, the growth in oil production in Russia in July due to the revision of arrangements has increased opportunities to expand energy exports.

In Q2, export quantities of natural gas rose by 10% amid the increase in gas production in Russia. The growth in export supplies was entirely down to Europe amid increased consumption and reduced production in the EU in January-May 2018. However, roughly half of Russian gas supplied to Europe in 2017 transited through the Ukrainian territory. The expiry of the transit agreement at the end of next year and the uncertainty surrounding the alternative 'Nord Stream–2' pipeline will create risks for natural gas exports in future.

In turn, non-oil and gas goods exports continued to exhibit solid growth, with their volume increasing by more than 20% in both Q1 and Q2. Supplies of wheat grew significantly amid higher reserves following last year's record harvest. The export quantities of ferrous and non-ferrous metals increased.

The additional US duties did not have a meaningful impact on Russian exports. In 2018 Q2, export quantities of iron- and steel-based products affected by these measures from Russia to the US rose both quarter on quarter and year on year. Russian exporters covered the increase in duties by raising prices. The exports of aluminium and aluminium-based products affected by the US duties have been redirected from the US to European countries, primarily Switzerland. As a result, the export quantities of aluminium from Russia to all countries have increased by roughly 20%, despite falling by almost 70% to the US.

The FIFA World Cup also contributed to the growth in exports. Services exports under the *Trips* item increased by 43% in Q2. At the same time, the increase in this indicator in dollar terms was not significant, it was up only by $1 billion to $3.3 billion, accounting for merely 3% of the overall growth in goods and services exports in Q2.

Unlike exports, the growth in the volume of goods and services imports slowed from 19% in Q1 to 9% in Q2 amid the decline in the ruble exchange rate, weakening business activity in industry in Russia and the low base effect coming to an end. Compared with the same period in 2017, in 2018 Q2, the real effective ruble exchange rate against foreign currencies reduced by 11% (6% in Q1). According to the FCS, annual growth in goods import quantities fell from 9% in Q1 to 1% in Q2. Although average prices for imported goods rose by 6.6% in Q2, average export prices grew by far more, by 22%. In turn, external trade conditions improved. The balance of non-tradable current account components remained virtually unchanged in 2018 Q2 (Chart 1).

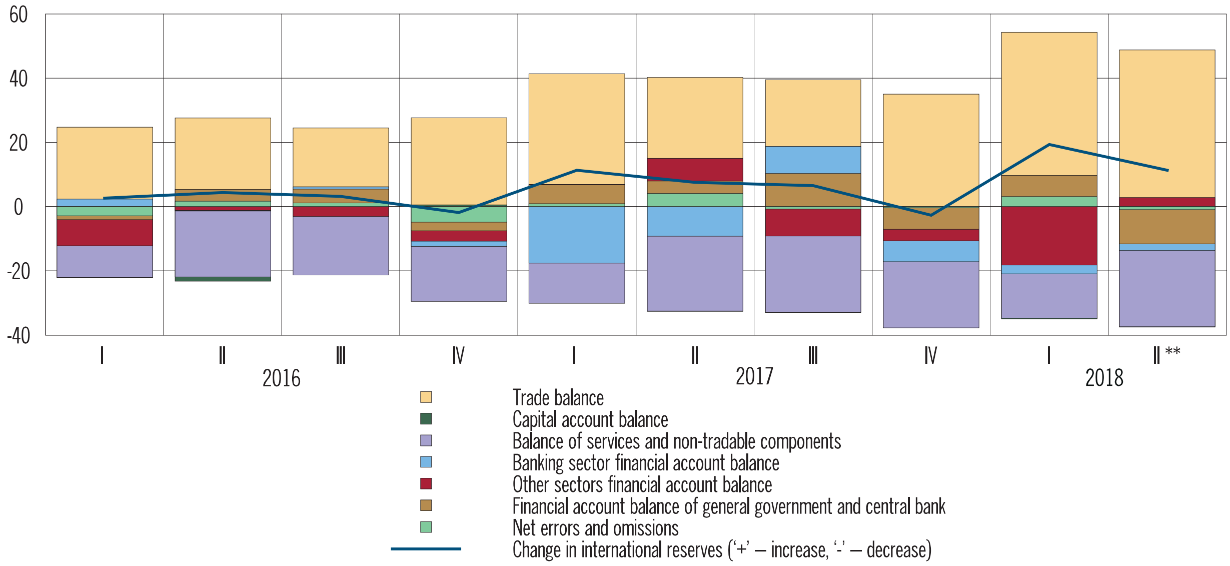
In the context of higher oil prices, the purchases of foreign currency under the fiscal rule expanded. This was reflected in the greater increase in

[1] *Here and below, changes are relative to the corresponding period of the previous year, unless otherwise indicated.*

Chart 1

Major balance of payments components*

(billions of US dollars)



** Signs according to BPM5.*
*** Estimate.*
Source: Bank of Russia.

reserves in 2018 Q2 (by $11 billion) compared with 2017 Q2 (by $7.5 billion).

At the same time, amid fears of stronger sanctions against Russia and weakening demand for risky EME assets coupled by trade disputes and stricter US monetary policy, non-residents were selling Russian government bonds in the secondary market in 2018 Q2. This exerted a downward pressure on the ruble exchange rate. As a result, in 2018 Q2, the net inflow of foreign capital into the general government segment witnessed over the past five quarters in a row was replaced by a net outflow of $7 billion.

The private sector financial account balance was roughly zero in 2018 Q2. Banks continued to repay external debts: their foreign liabilities reduced by $9.5 billion in Q2 according to preliminary estimates. The schedule assumed that banks would repay $10 billion of their external debt over this period. However, the external debt repayments were accompanied by a contraction in banks' foreign assets. Other sectors were able to increase their foreign liabilities. At the same time, the amount of foreign investment attracted by companies remained limited, in part due to the continuation of the EU's financial sanctions. Their demand for foreign assets also shrank.

The economic situation in Russian regions

In August, inflation accelerated in most regions. The regional uniformity of inflation remained virtually unchanged (Chart 1) following significant growth in July. In July-August, this uniformity strengthened due to accelerating year-on-year inflation across many regions specialising in agriculture (the Republic of Crimea, the Republic of Daghestan, the Chuvash Republic, the Stavropol Territory, and the Lipetsk and Rostov Regions, among others), where inflation has been typically below the Russian average in recent years.

The main reason for this growth in regional uniformity in July-August was the acceleration in year-on-year food inflation, the extent of which was generally in line with expectations (Chart 2). This was caused by the low base of July-August last year, when the disinflationary effects from the increase in food supply resulting from the good harvest of 2017 started to manifest themselves. An acceleration in annual food price growth has been observed in the majority of regions, but especially in regions specialising in agriculture.

Similar regional inflation dynamics were also observed in February-March this year, when regional diversity diminished due to the increase in inflation in the regions which had been previously characterised by lower readings. Following this, year-on-year inflation accelerated across all regions and for Russia as a whole. In September-October, we can expect average year-on-year inflation levels for Russia as a whole to grow amid increasing regional diversity: the increase in inflation in major regions with a higher proportion of imports in consumption will be more perceptible due to the pass-through of the ruble's depreciation to prices.

Businesses' price expectations also point to the likelihood of a continued growth in inflation. Even though, for the economy as a whole, inflation expectations abated slightly in July (for the first time since February 2018), retail and wholesale businesses' expectations, which typically most closely reflect actual price change prospects, continued to grow (Chart 3).

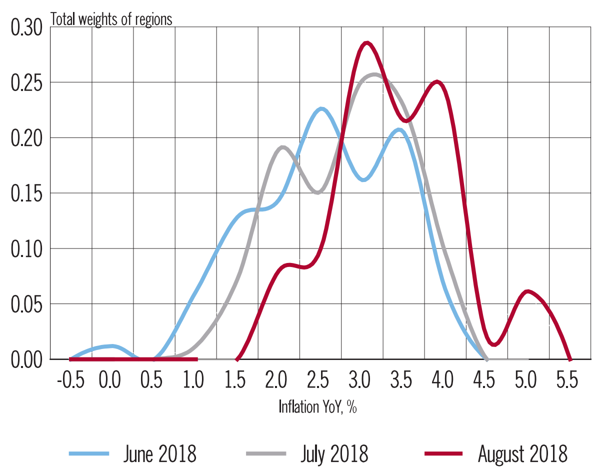
The growth in inflation expectations has primarily been shaped by supply-side factors – the pass-through of previous changes in the exchange rate to prices, growth in agricultural prices, and the expected VAT increase. At the same time, demand dynamics are still not a pro-inflationary factor. The turnover dynamics of retail trade and paid services are not accelerating, with businesses still taking a cautious view of a potential increase in internal demand for their products (Chart 4). Consumer demand growth will continue to be moderate, despite the on-going recovery in household income and improvements in consumer lending activity.

Positive consumer lending dynamics were observed across all regions in 2018 Q2. Higher than average growth rates were predominantly registered in the Central, Volga and Southern Federal Districts. This can be explained in part by the low base effect. The North-Western Federal District occupied a leading position by the share of consumer lending in retail trade turnover in the first half of 2018 (36.1%, compared with 28.9% for Russia as a whole). However, the related pro-inflationary risks were not pronounced: since February 2018, retail trade turnover in this district has not accelerated, and has remained below the Russian average (besides, since May, the district has seen its household incomes shrink). Together with growth in consumer lending across Russia and by region, household deposits have built up steadily, reflecting households' on-going balanced approach to savings and consumption.

Lending to trading companies witnessed a revival in the first half of 2018 (year-on-year). However, cautious estimates by businesses regarding a future expansion in the internal demand for their

Chart 1

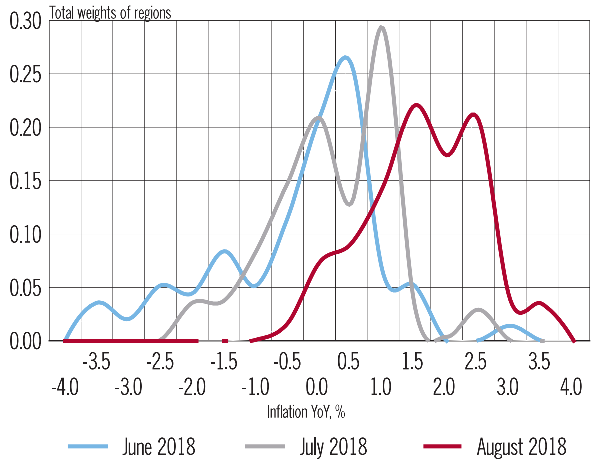
Distribution of regions by contribution to annual inflation



Sources: Rosstat, Bank of Russia calculations.

Chart 2

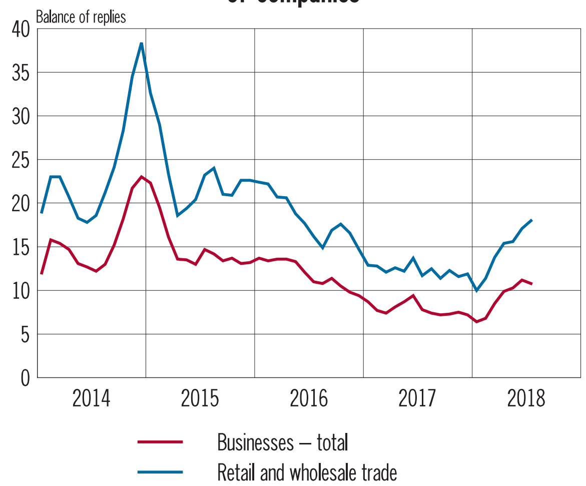
Distribution of regions by contribution to annual inflation



Sources: Rosstat, Bank of Russia calculations.

Chart 3

Price expectations of companies



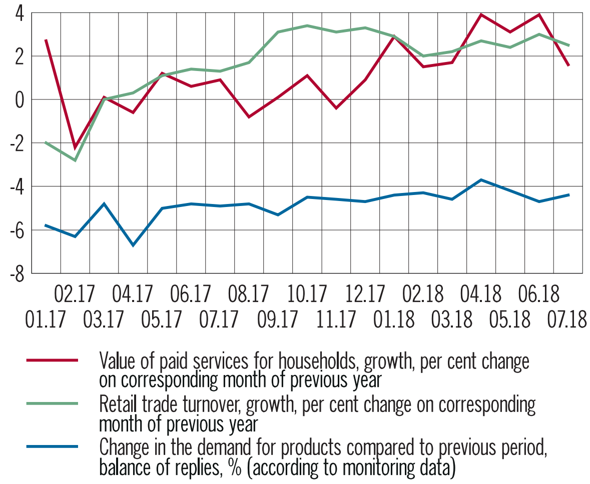
Source: Bank of Russia.

products continue to be a constraining factor for growth in this segment in most regions.

In June, economic growth (year-on-year) continued in almost all districts, but the situation was persistently mixed when broken down by region (Charts 5 and 6). Growth in industrial production was highest in the Volga and Ural Federal Districts. In the Ural Federal District, the growth came mainly from mining and quarrying (significant growth in the Yamalo-Nenets Autonomous Area and the Tyumen Region excluding the autonomous area), and in the Volga Federal District from manufacturing (the highest growth was recorded in the Orenburg Region and the Republic of Bashkortostan). The highest levels of volatility remained in districts with smaller economies – the Far Eastern and North

Chart 4

Paid services, retail trade turnover (YoY) and demand for products of enterprises



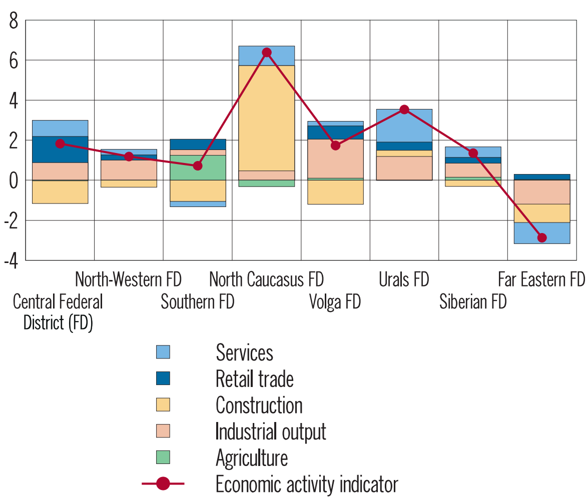
Sources: Rosstat, Bank of Russia.

Caucasus Federal Districts, where dynamics are shaped mainly by short-term local factors. In the Far East, industry made the greatest contribution to the economic slump. The fall in industrial production in the Far Eastern Federal District was mainly due to reduced output volumes at one of the largest aviation companies – the Y. A. Gagarin Komsomolsk-on-Amur Aircraft Plant in the Khabarovsk Territory – due to the completion of work under key contracts. In the North Caucasus district, the positive economic activity dynamics were shaped by growth in the construction industry, due to the completion of few projects (industrial and residential real estate) which are relatively large for the economy of this territory. Significant volatility in the economic dynamics of the North Caucasus and

Chart 5

Economic activity indicator in June 2018

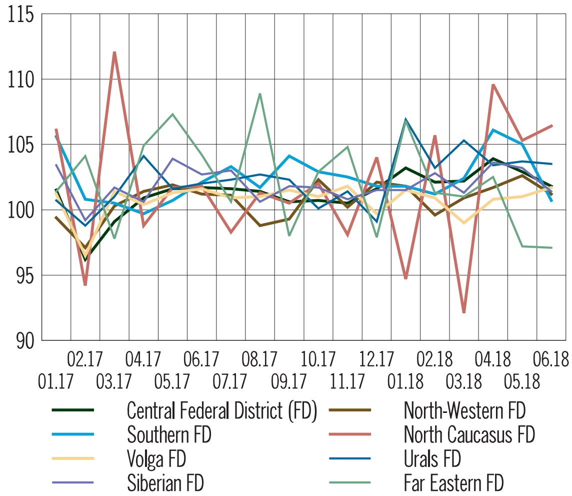
(%)



Sources: Rosstat, Bank of Russia.

Chart 6

Economic activity indicator*, January 2017 – June 2018 (YoY)
(%)



** Economic activity indicators are calculated as the average weighted rate of activity type for: mining and quarrying, manufacturing, electricity, gas and wather production and distribution, agriculture, construction, paid services for households and trade. Weights of respective activity types in the gross regional product (GRP) structure are taken as weights for the calculation of the average value.*
Sources: Rosstat, Bank of Russia.

Far Eastern Federal Districts has been consistently observed over the past few years and is associated with the small scale of their economies, which means that local events in certain regions can produce a meaningful effect on the indicators of the entire district.

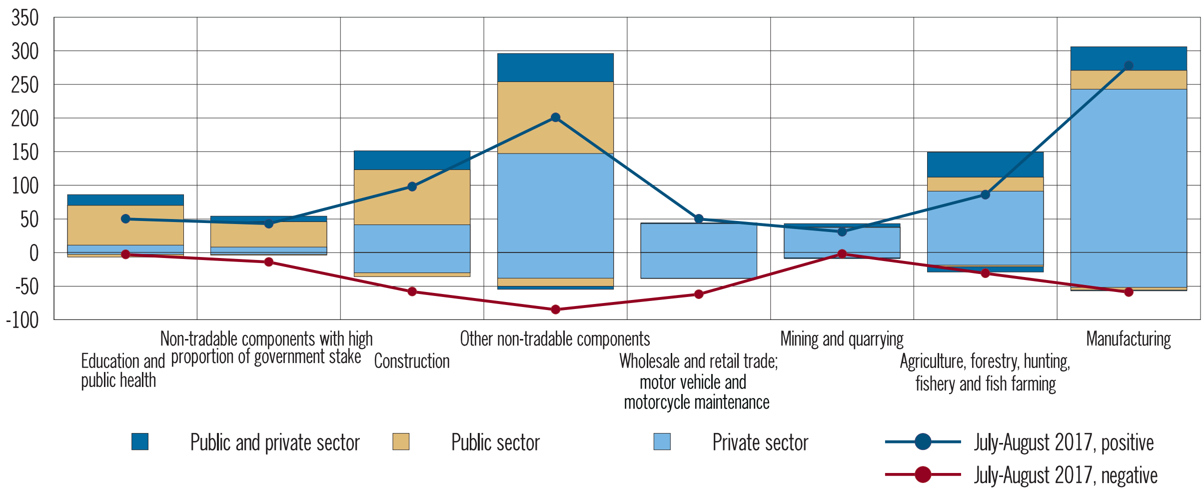
On a national scale, the growth in disposable income witnessed in 2018 and increase in mortgage lending activity, which was observed across all regions, have not yet led to a significant growth in household demand for real estate. Overall, moderate investment activity and existing relatively high levels of supply continue to be constraining factors for the construction industry. The banking sector's credit support for construction organisations in the Russian regions exhibited unstable dynamics in 2018 Q2. But in the regions of the Central and Southern Federal Districts, lending dynamics for the construction industry far exceeded the Russian average. This is in part explained by expected changes in the federal legislation regulating shared-equity construction and government support measures (including in the Southern Federal District).

The improvement in the media coverage of investment in the construction industry is also linked to the implementation of government-funded projects (Chart 7). Noticeable and positive dynamics of investment signals have also been observed in manufacturing industries and agriculture, where a large proportion of positive signals come from private projects.

Since the second half of 2016, business sentiment dynamics have not exhibited any clear positive or negative trends (Chart 8). The Business Climate Index (BCI), calculated on the basis of the Bank of Russia's business monitoring data[2],

Chart 7

Number of investment signals at the main funding source in July-August 2018
(in the negative part – negative signals, in the positive part – positive signals)

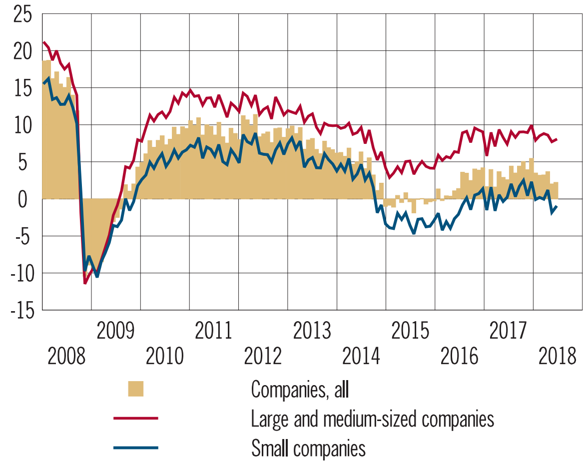


Source: Bank of Russia.

[2] *The Business Climate Index (BCI) reflects the business confidence of both large and small businesses, based on actual and expected changes in production and demand for the industry's products.*

Chart 8

Business climate indicator
(%)



Source: Bank of Russia.

edged up slightly in July following some reduction the previous month. However, large and medium-sized businesses are still assessing the economic situation more optimistically than small businesses; for large and medium-sized businesses, the BCI is close to pre-crisis levels. An expansion in lending activity could bolster small business sentiment in future: in 2018 Q2, positive corporate lending dynamics (year-on-year) for SMEs were recorded in 61 regions, while for large businesses, they were only observed in 41. Since early 2018, the Russian Ministry for Economic Development has been implementing a concessional lending programme for SMEs to support projects in priority industries, and this programme, among others factors, has had a positive impact on the dynamics of lending to SMEs.

Balance of payments forecast for 2018–2021

Compared with the previous MPR, the trajectory of oil prices in the baseline scenario has been revised upwards over the entire forecast horizon. This change and the adjustment of forecast parameters for a number of macroeconomic indicators have had a significant influence on the forecast dynamics of balance of payments items.

In the baseline scenario, in 2018, oil prices are now expected to be higher ($69 per barrel on average) than in the previous MPR ($67 per barrel). This revision is due to a more significant cut in oil production in Venezuela and a faster decrease in production and exports in Iran than previously expected. The lower oil supplies from Libya and Canada also contributed to the higher oil prices. However, oil prices are still expected to decline amid the relaxation of the production restrictions under OPEC and non-OPEC arrangements and the increased supply from countries that are not party to the agreement. Average oil prices are expected to fall to $55 per barrel in 2020 before stabilising at this level, which is slightly higher than in the June MPR ($50 per barrel in 2020).

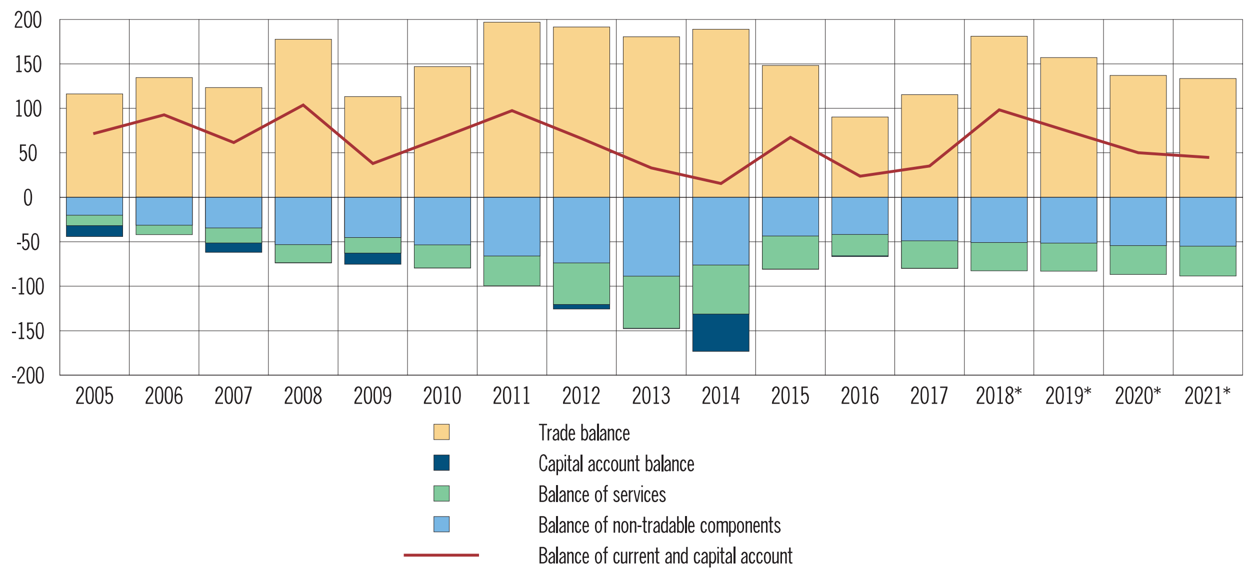
Given the assumption that oil prices will be higher than in the baseline scenario of the previous MPR, the exports and current account surplus forecasts have been revised upwards over the entire forecast period. At the same time, following growth in 2018 amid higher global commodity prices and the FIFA World Cup, the volume of goods and services exports is expected to decline in 2019–2020. The fall in oil prices will only be partially offset by higher export quantities of energy commodities amid growing production in Russia and stronger external demand. In 2021, as oil prices stabilise, the volume of goods and services exports is once again expected to grow due to increases in export quantities. Government measures to develop non-commodity exports could also help to buoy exports.

The imports forecast has been downgraded as a result of the ruble depreciation and the ban on exports of a number of items from the US to Russia. Taking these factors into account and with the low base effect coming to an end, the growth in imports is expected to slow down in 2018–2019. In future, the expansion of imports will accelerate on the back of growth in the Russian economy and government measures aimed to increase investment, which could intensify demand for investment goods, including the imported ones.

In 2018–2021, the deficit of non-tradable current account components will increase on account of payments associated with incoming foreign investment. However, it will remain low as a result of the marked reduction in external debt and

Chart 1

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

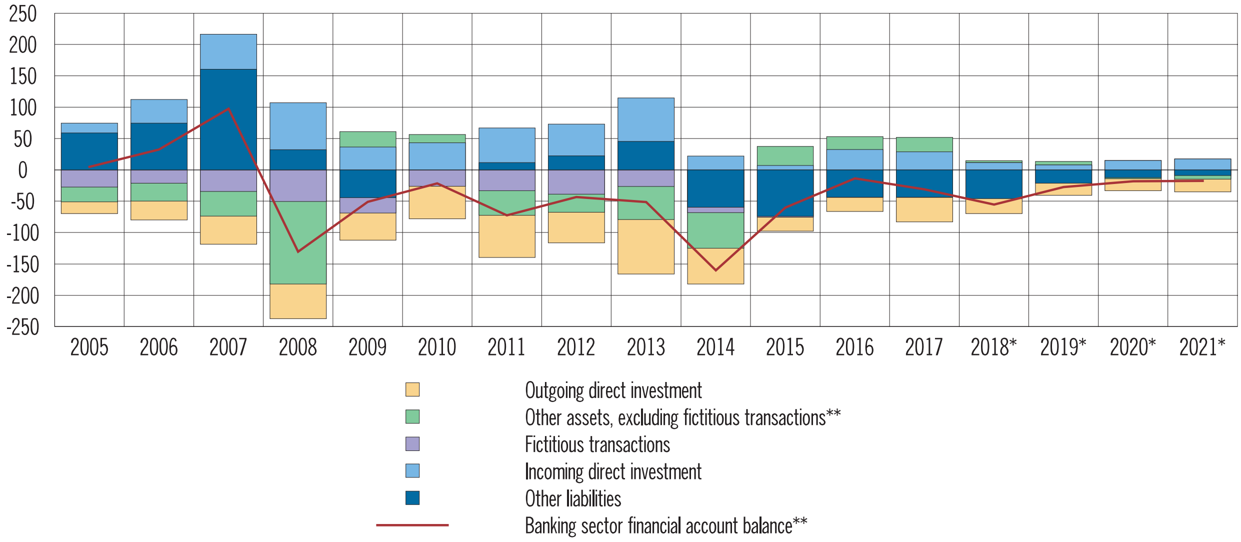


** Baseline scenario forecast.*
Source: Bank of Russia.

Chart 2

Major private sector financial account components*

(billions of US dollars)



** Baseline scenario forecast. Signs according to BPM5.*
*** Excluding debt on deliveries under intergovernmental agreements.*
Source: Bank of Russia.

expenditure on servicing this debt compared with 2014.

Following the growth to 6% of GDP in 2018, the current account surplus will reduce to 3% of GDP in 2020 due to the volume of exports shrinking as oil prices will decline. In 2021, the surplus will continue to reduce mainly due to the growth in imports outstripping exports (Chart 1).

The Russian private sector's net lending to the rest of the world will also reduce from 3% of GDP in 2018 to 1% of GDP in 2020 on account of the other sectors' weakening demand for foreign assets amid the drop in oil prices. In future, the private sector financial account balance will stabilise at roughly 1% of GDP. Even though demand for foreign assets will intensify given the increase in corporate incomes amid growth in the Russian economy, it will remain moderate.

In 2019, a noticeable reduction in the private sector financial account balance is forecast, in part due to a smaller reduction in banks' foreign liabilities. This view is supported by the lower amount of forthcoming external debt repayments according to the schedule. In 2020–2021, the private sector's foreign liabilities are expected to grow insignificantly.

However, with tougher sanctions rhetoric affecting investor sentiment, companies are now expected to attract less foreign investment and banks are expected to further reduce their foreign liabilities, compared with the baseline scenario in the June MPR. This in turn has been reflected in the higher expected private sector financial account balance, compared with the previous MPR.

The forecast has also been adjusted for the government sector, mostly for 2018. Investors' interest in EME assets has weakened amid the stricter monetary policy of the US, the unfavourable situation in a number of countries and growing mutual restrictions in international trade. In addition, fears of further sanctions against Russia have also intensified. Against this backdrop, in Q2, non-residents sold Russian sovereign securities in the secondary market. Taking this into account, in 2018, a small financial account deficit[3] for the government sector is expected together with a weak inflow of foreign capital in subsequent years.

The forecast growth in reserves has been reduced for 2018 compared with the previous MPR, as the foreign currency purchases in the domestic market under the fiscal rule have been suspended until the end of 2018. However, the forecast increase in reserves has been raised for 2019–2021due to larger regular purchases of foreign currency for the Russian Ministry of Finance amid higher oil prices. Given the reduction in oil prices, the growth in reserves is expected to slow.

[3] *Signs according to BPM5.*

In the unchanged oil price scenario, the average annual oil price is assumed to be roughly $70 per barrel over the entire forecast period. Due to the higher oil prices and stronger external demand, the exports volume is expected to be higher than in the baseline scenario. Besides, the slightly faster growth in internal demand and stronger ruble will lead to higher growth in imports. Due to the faster increase in exports compared with imports, the positive trade balance and current account surplus will increase in 2018 and stabilise at higher levels until 2021 compared with the baseline scenario.

At the same time, the Russian private sector's net lending to the rest of the world is expected to be higher than in the baseline scenario due to a higher demand for foreign assets from the Russian private sector. Given higher revenues from foreign trade, the private sector will have more funds to expand its foreign assets. However, amid the higher oil prices and faster economic growth of the Russian economy, the investment appeal of Russian assets will improve. This will contribute to an increase in incoming external finance. With the growth in foreign assets outstripping the growth in liabilities, the Russian private sector's net lending to the rest of the world is expected to grow by 2021.

The increase in reserves under the scenario assuming higher oil prices is forecast to be more pronounced than in the baseline scenario, due to greater purchases of foreign currency for the Russian Ministry of Finance under the fiscal rule.

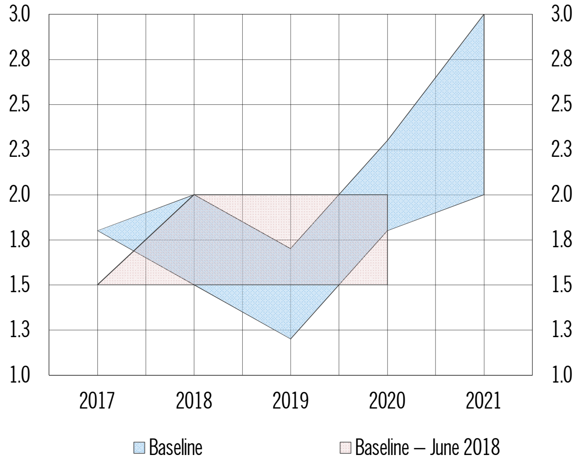
Revision of September baseline forecast parameters against June parameters

GDP growth, including by expenditure

Chart 1

GDP

(%)

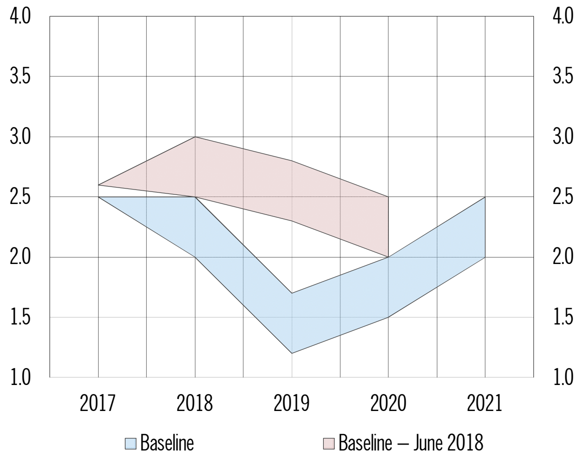


Source: Bank of Russia.

Chart 2

Final consumption

(%)

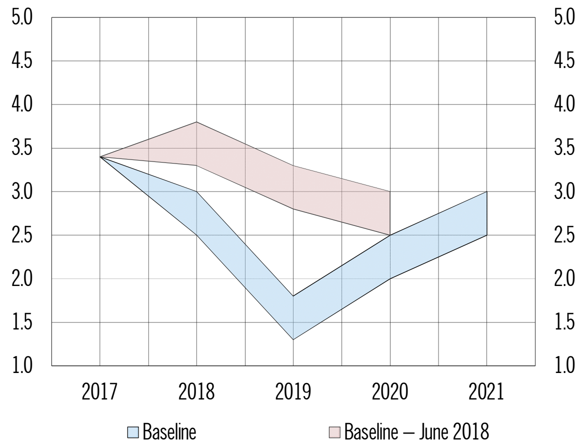


Source: Bank of Russia.

Chart 3

Final consumption expenditure of households

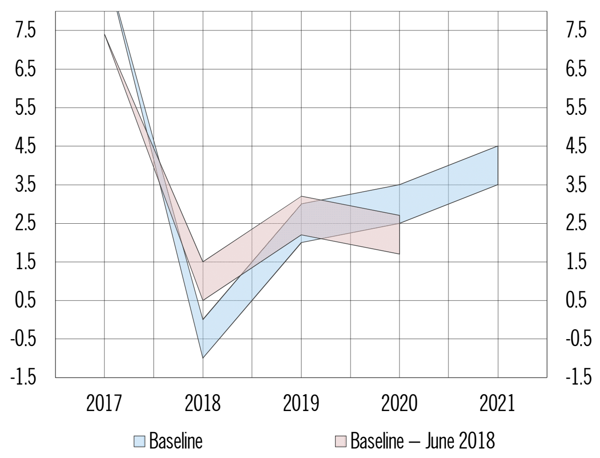
(%)



Source: Bank of Russia.

Chart 4

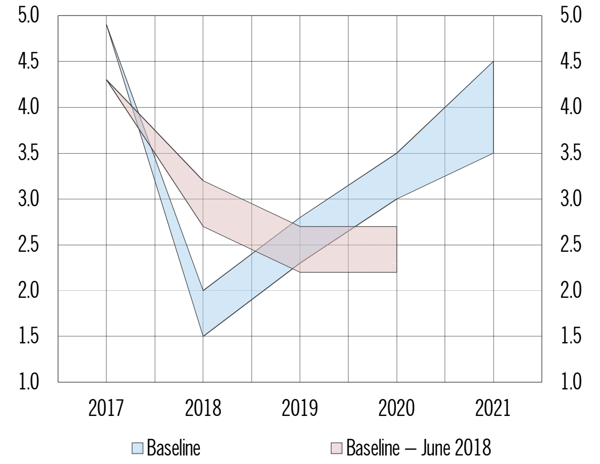
Gross capital formation
(%)



Source: Bank of Russia.

Chart 5

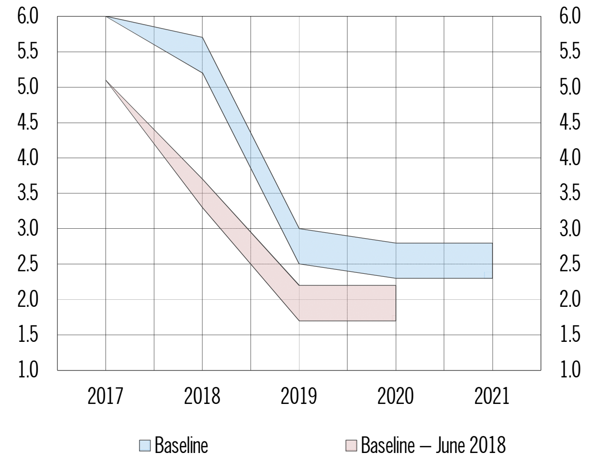
Gross fixed capital formation
(%)



Source: Bank of Russia.

Chart 6

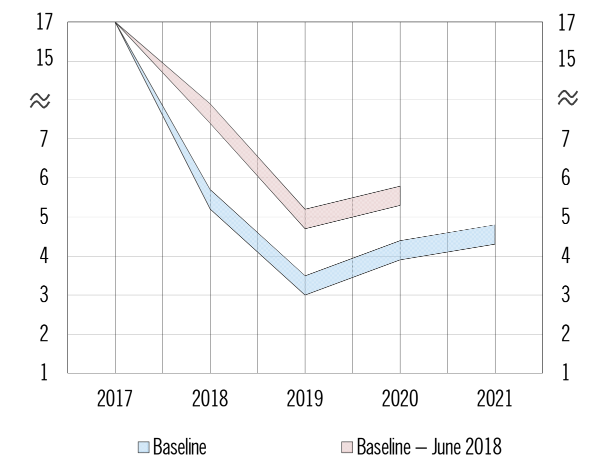
Exports
(%)



Source: Bank of Russia.

Chart 7

Imports
(%)

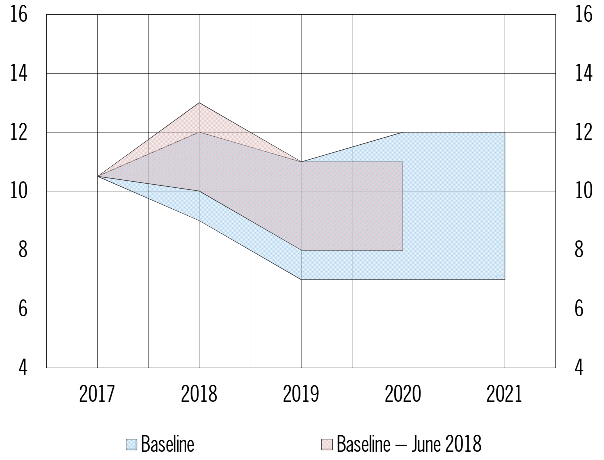


Source: Bank of Russia.

Dynamics of monetary indicators

Chart 8

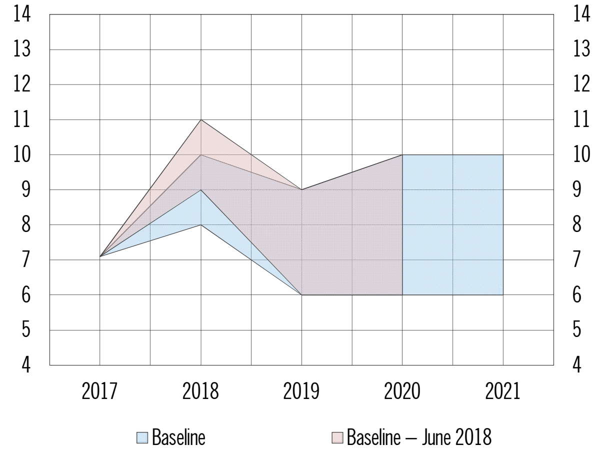
Money supply
(%)



Source: Bank of Russia.

Chart 10

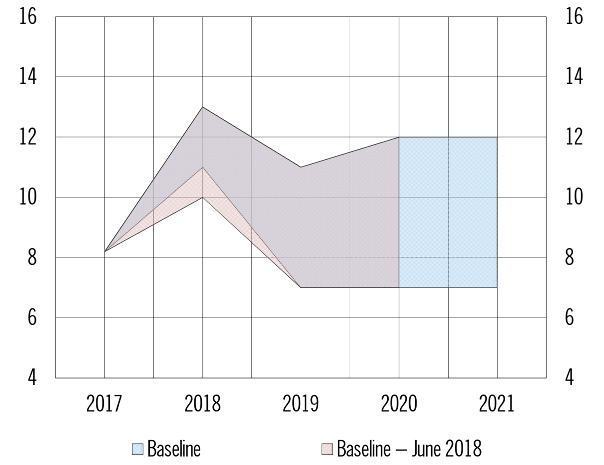
Claims on organisations
(%)



Source: Bank of Russia.

Chart 9

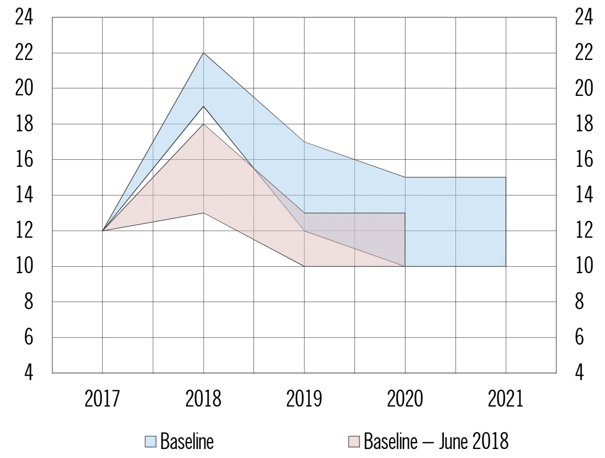
Claims on the economy
(%)



Source: Bank of Russia.

Chart 11

Claims on households
(%)



Source: Bank of Russia.

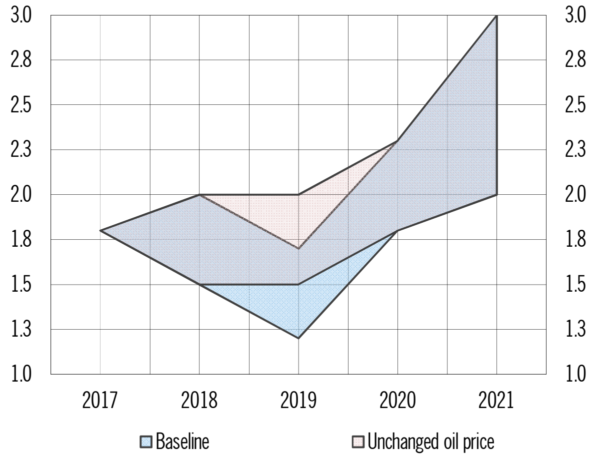
Comparison of forecast parameters in the baseline scenario and in the unchanged oil price scenario

GDP growth, including by expenditure

Chart 1

GDP

(%)

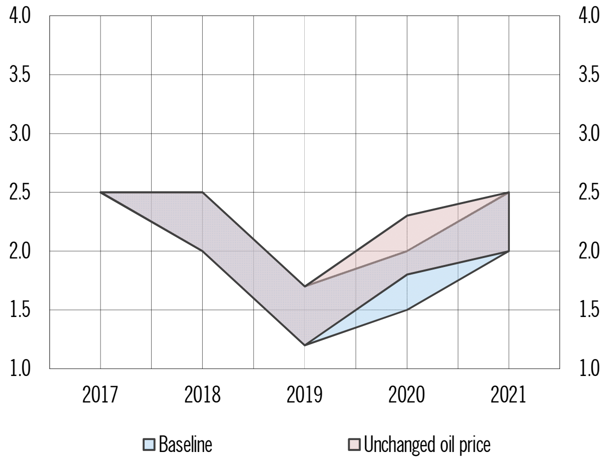


Source: Bank of Russia.

Chart 2

Final consumption

(%)

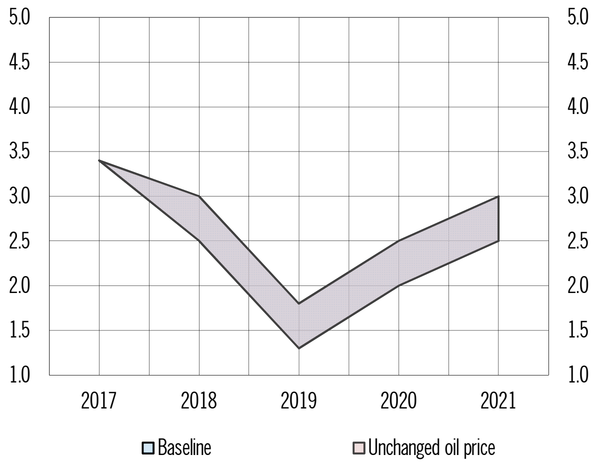


Source: Bank of Russia.

Chart 3

Final consumption expenditure of households

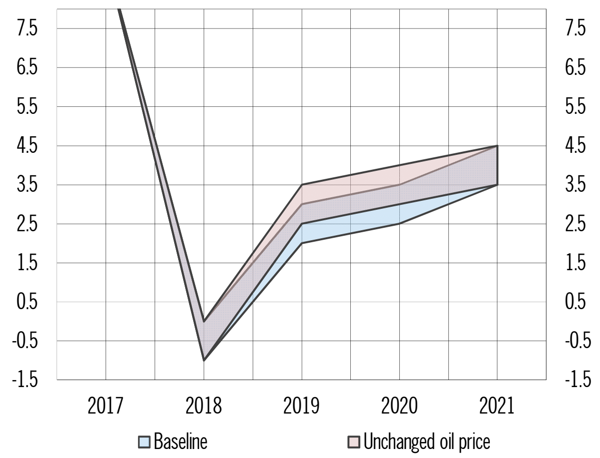
(%)



Source: Bank of Russia.

Chart 4

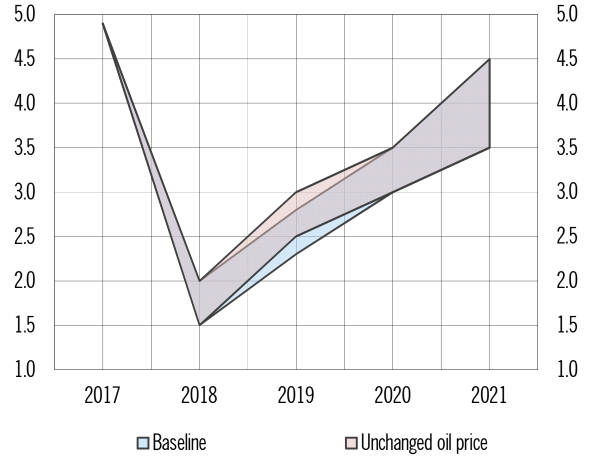
Gross capital formation
(%)



Source: Bank of Russia.

Chart 5

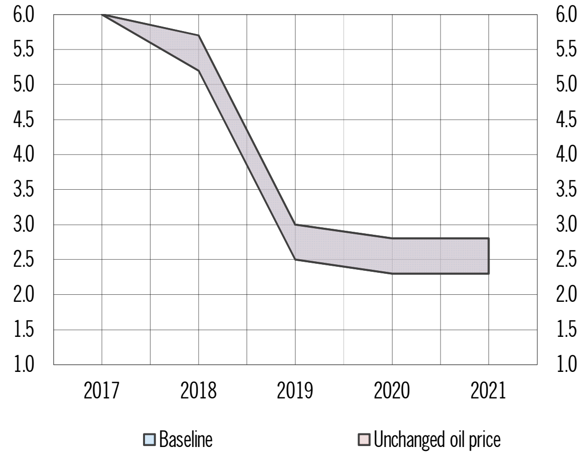
Gross fixed capital formation
(%)



Source: Bank of Russia.

Chart 6

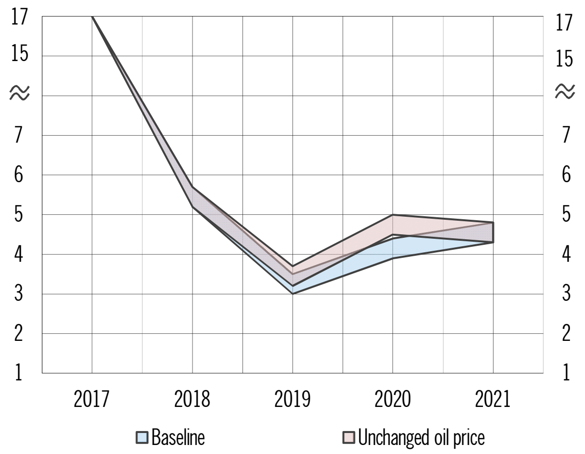
Exports
(%)



Source: Bank of Russia.

Chart 7

Imports
(%)

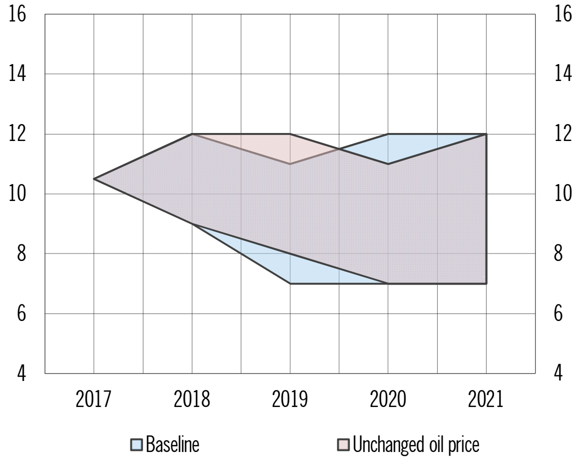


Source: Bank of Russia.

Dynamics of monetary indicators

Chart 8

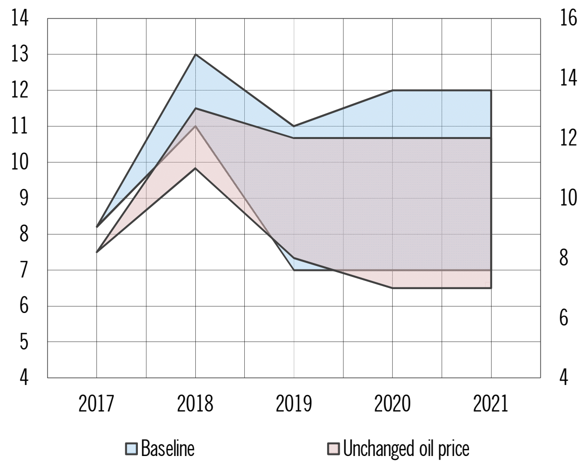
Money supply
(%)



Source: Bank of Russia.

Chart 9

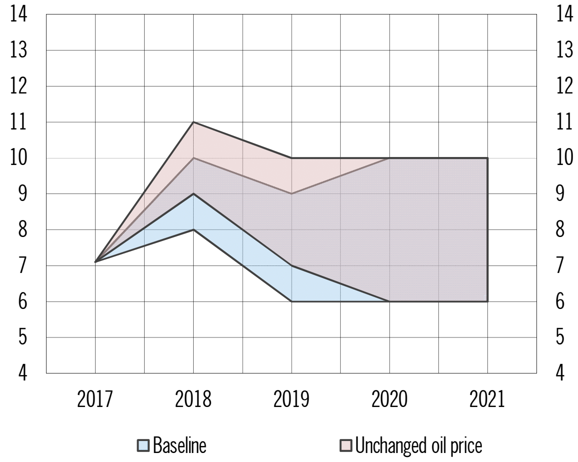
Claims on the economy
(%)



Source: Bank of Russia.

Chart 10

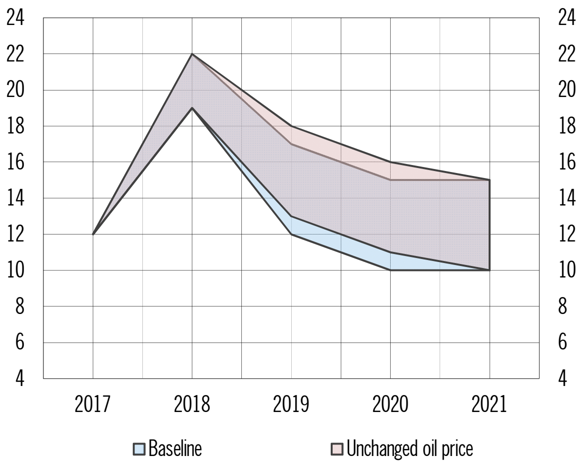
Claims on organisations
(%)



Source: Bank of Russia.

Chart 11

Claims on households
(%)



Source: Bank of Russia.

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

Table 1

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

The time limits for settlements under Bank of Russia operations have been changed	From 16 July 2018, the Bank of Russia shall make deposit operation repayments till 9:00 local time (the operating hours of the Bank of Russia Main Branch that manages corresponding account of a credit institution). From 16 July 2018, credit institutions have been given extra time in addition to the main time to repay Bank of Russia loans (from 16:00 to 17:00 local time). If a credit institution wants to use the released collateral to obtain a new loan the same day, the loan repayment at the request of the credit institution might be carried out from 10:00 till 11:00 local time (based on the credit institution's request forwarded to the Bank of Russia on a day preceding the date of loan repayment)
The Bank of Russia cancelled the acceptance of non-competitive bids at its deposit auctions	From 26 July 2018, credit institutions' bids without indicated interest rate (non-competitive bids) will not be accepted for deposit auctions. The decision is of technical nature; it is aimed at facilitating collection and fulfilment of bids in the deposit auctions
Required reserve ratios have been increased	On 1 August 2018, the Bank of Russia increased the required reserves ratios on FX liabilities of credit institutions by 1 pp: on liabilities to households – to 7.00%; on liabilities to non-resident legal entities and on other liabilities – to 8.0%. This measure is intended to discourage the growth of FX-denominated liabilities in credit institutions' liability structure
New Bank of Russia lending regulations have been approved	From 1 October 2018, to optimise the procedure for bank refinancing Ordinance No. 4801-U on secured lending and Terms and Conditions for the Issue and Repayment of Loans Backed by Securities or Credit Claims will become effective. From the said date, Regulations No. 236-P and 312-P will no longer govern the issue of Bank of Russia loans
The Bank of Russia Lombard List has been expanded	According to the Bank of Russia Board of Directors' decisions of 20 June, 25 July and 29 August 2018, 17 additional securities issues have been added to the Bank of Russia Lombard List

Table 2

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

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.2018	From 12.02.2018	From 26.03.2018	From 4.06.2018[1]	From 17.09.2018[1]
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[2]; repos	1 day	daily	8.75	8.50	8.25	key rate + 1.00	key rate + 1.00
		Loans secured by non-marketable assets[3]	from 2 to 549 days		9.50	9.25	9.00	key rate + 1.75	key rate + 1.75
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets[3]	3 months	monthly[4]	8.00	7.75	7.50	key rate + 0.25	key rate + 0.25
		Repo auctions	1 week	weekly[5]	7.75 (key rate)	7.50 (key rate)	7.25 (key rate)	7.25 (key rate)	7.50 (key rate)
			from 1 to 6 days	occasionally[6]					
		FX swap auctions (ruble leg)[2]	from 1 to 2 days						
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days						
			1 week	weekly[6]					
		OBR bond placement (additional placement) auctions[2]	3 months	occasionally					
	Standing facilities	Deposit operations	1 day[7]	daily	6.75	6.50	6.25	key rate – 1.00	key rate – 1.00

[1] *From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set as key rate spreads.*
[2] *From 23 December 2016, interest rates on the foreign currency leg equal LIBOR on overnight loans in US dollars or euros (depending on the currency of the transaction).*
[3] *Operations conducted at a floating interest rate linked to the Bank of Russia key rate.*
[4] *Operations have been discontinued since April 2016.*
[5] *Either a repo or a deposit auction is held depending on the situation with liquidity. See press-release http://www.cbr.ru/press/PR.aspx?file=19012015_154523if2015-01-19T15_41_11.htm.*
[6] *Fine-tuning operations.*
[7] *Before 16 May 2018, also call operations. From 17 May 2018, the Bank of Russia conducts only overnight deposit operations with credit institutions.*

Memo item: from 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date.

Source: Bank of Russia.

Table 3

Interest rates on specialised refinancing facilities[1]

(% p.a.)

Purpose of indirect bank lending	Maturity	Collateral	As of 1.01.18	From 12.02.18	From 26.03.18	From 4.06.18[2]
Large-scale investment projects[3]	Up to 3 years	Credit claims on bank loans issued for the implementation of investment projects, whose performance is secured by the Russian Federation state guarantees	6.75	6.50	6.25	The lower of the two values: 9.00% p.a. or the Bank of Russia key rate less 1.00 pp.
		Bonds placed to finance investment projects and included in the Bank of Russia Lombard List				
Leasing	Up to 3 years	Claims on loans to leasing companies	6.75	6.50	6.50	The lower of the two values: 6.50% p.a. or the Bank of Russia key rate
Non-commodity exports	Up to 3 years	Credit claims under loan agreements secured by the insurance contracts of JSC EXIAR	6.50	6.50	6.50	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[4]	6.50	6.50	6.50	
		Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises				
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	7.75	7.50	7.25	Bank of Russia key rate

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

[2] From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set at key rate spreads.

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

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

Source: Bank of Russia.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments and obligations on liquidity absorption instruments, billions of rubles				
					As of 1.01.17	As of 01.01.18	As of 1.04.18	As of 1.07.18	As of 1.09.18
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	0.0	0.8	14.6	14.4
		Lombard loans			0.6	0.0	0.0	0.0	0.0
		FX swaps			37.8	0.0	0.0	0.0	0.0
		Repos			593.9	3.6	6.5	2.4	3.3
		Loans secured by non-marketable assets	from 1 to 549 days		626.3	5.5	30.1	5.4	9.5
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly[1]	215.6	0.0	0.0	0.0	0.0
			18 months	occasionally[2]					
		Repo auctions	1 week	weekly[3]	0.0	0.0	0.0	0.0	0.0
			from 1 to 6 days	occasionally[4]					
		FX swap auctions	from 1 to 2 days		0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days		396.9	2,124.9	2,520.6	2,389.1	2,066.2
			1 week	weekly[3]					
		OBR bond placement (additional placement) auctions[5]	3 months	occasionally	-	357.0	1,139.1	1,123.0	1,416.2
	Standing facilities	Deposit operations	1 day[6]	daily	388.3	246.8	264.6	329.1	261.8

[1] Operations have been discontinued since April 2016.
[2] Operations have been suspended since 1 July 2016.
[3] Either a repo or a deposit auction is held depending on the situation with liquidity.
[4] Fine-tuning operations.
[5] If a reporting day falls on a week-end or holiday, the volume of OBR in circulation is indicated inclusive of the coupon yield as of the first business day following the reporting date.
[6] Before 16 May 2018, also call operations. From 17 May 2018, the Bank of Russia conducts only overnight deposit operations with credit institutions.

Source: Bank of Russia.

Table 2

Required reserve ratios

(%)

Liability type	Validity dates		
	1.01.17–30.11.17	1.12.17–31.07.18	From 1.08.18
Banks and non-bank credit institutions			
To households in the currency of the Russian Federation	5.00	x	x
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation			
To households in foreign currency	6.00	x	x
To non-resident legal entities in foreign currency	7.00	x	x
Other liabilities in foreign currency			
Banks with a universal licence and non-bank credit institutions			
To households in the currency of the Russian Federation	x	5.00	5.00
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation			
To households in foreign currency	x	6.00	7.00
To non-resident legal entities in foreign currency	x	7.00	8.00
Other liabilities in foreign currency			
Banks with a basic licence			
To households in the currency of the Russian Federation	x	1.00	1.00
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation		5.00	5.00
To households in foreign currency	x	6.00	7.00
To non-resident legal entities in foreign currency	x	7.00	8.00
Other liabilities in foreign currency			

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

Types of credit institutions	
Banks with a universal licence, with a basic licence	0.8
Non-bank credit institutions	1.0

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

Instrument	Term	Frequency[1]	Minimum auction rate as spread to LIBOR[2], pp; fixed rate for FX swaps[3], % p.a.	Bank of Russia claims, millions of US dollars[4]				
			From 23.12.2016	As of 1.01.17	As of 01.01.18	As of 1.04.18	As of 1.07.18	As of 1.09.18
Repo auctions	1 week	weekly	2.00	2,635.2	0.0	0.0	0.0	0.0
	28 days			8,719.9	0.0	0.0	0.0	0.0
	12 months		3.00	26.2	0.0	0.0	0.0	0.0
Loan auctions	28 days	monthly	2.25	0.0	0.0	0.0	0.0	0.0
	365 days		3.25	0.0	0.0	0.0	0.0	0.0
USD/RUB sell/buy FX swaps	1 day	daily	1.50	1,000.0	2,490.7	0.0	229.0	0.0

[1] No 12-month loan or repo auctions were held in 2017 and January-August 2018; regular one-week and 28-day repo auctions have been discontinued since 11 September 2017.
[2] In respective currencies and for respective terms.
[3] The rate for ruble leg is equal to the Bank of Russia key rate less 1 pp.
[4] For repos – claims on credit institutions under the second leg of repos.

Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities[1]

<table>
<tr><th rowspan="2">Purpose of indirect bank lending</th><th rowspan="2">Maturity</th><th rowspan="2">Collateral</th><th colspan="5">Bank of Russia claims on credit institutions, billions of rubles</th><th rowspan="2">Limit as of 1.09.18, billions of rubles</th></tr>
<tr><th>As of 1.01.17</th><th>As of 01.01.18</th><th>As of 1.04.18</th><th>As of 1.07.18</th><th>As of 1.09.18</th></tr>
<tr><td>Non-commodity exports</td><td>Up to 3 years</td><td>Claims under loan agreements secured by the insurance contracts of JSC EXIAR</td><td>43.4</td><td>47.4</td><td>46.4</td><td>48.8</td><td>49.5</td><td>75.00</td></tr>
<tr><td rowspan="2">Large-scale investment projects[2]</td><td rowspan="2">Up to 3 years</td><td>Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation</td><td>112.6</td><td>108.3</td><td>104.7</td><td>105.7</td><td>104.2</td><td rowspan="2">150.00</td></tr>
<tr><td>Bonds placed to finance investment projects and included in the Bank of Russia Lombard List</td><td>0.6</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td rowspan="2">Small and medium-sized enterprises</td><td rowspan="2">Up to 3 years</td><td>Claims under loan agreements of JSC SME Bank[3]</td><td>43.1</td><td>18.3</td><td>14.7</td><td>12.2</td><td>9.8</td><td rowspan="2">175.00</td></tr>
<tr><td>Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises</td><td>48.2</td><td>81.5</td><td>81.4</td><td>78.7</td><td>76.4</td></tr>
<tr><td>Leasing</td><td>Up to 3 years</td><td>Claims on loans to leasing companies</td><td>0.0</td><td>0.2</td><td>0.2</td><td>0.2</td><td>0.2</td><td>10.00</td></tr>
<tr><td>Military mortgage</td><td>Up to 3 years</td><td>Mortgages issued under the Military Mortgage programme</td><td>29.3</td><td>29.3</td><td>21.9</td><td>21.7</td><td>9.7</td><td>30.0</td></tr>
</table>

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

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

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

Source: Bank of Russia.

Table 6

Monetary policy rates in various countries

Country	Policy rate	Current level	Latest revision	Previous level	Change	Number of rate revisions over the past 12 months	Inflation	
							Current level, %	12-month change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	0	2.0	0.20
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	0	3.4	1.30
Czech Republic	repo rate (14 days)	1.25	02.08.2018	1.00	0.25	4	2.3	-0.20
Romania	base rate	2.50	07.05.2018	2.25	0.25	3	4.6	3.14
Bulgaria	base rate	0.00	01.02.2016	0.01	-0.01	0	3.5	2.20
Serbia	key policy rate	3.00	12.04.2018	3.25	-0.25	4	2.4	-0.80
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	0	1.4	2.10
Brazil	target rate	6.50	21.03.2018	6.75	-0.25	4	4.2	1.73
Chile	monetary policy rate	2.50	18.05.2017	2.75	-0.25	0	2.7	1.00
China	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	0	2.1	0.70
	deposit rate (12 months)	1.50	26.10.2015	1.75	-0.25	0		
	required reserve rate	15.50	05.07.2018	16.00	-0.50	2		
India	reverse repo rate	6.50	01.08.2018	6.25	0.25	2	4.2	1.81
	repo rate	6.25	01.08.2018	6.00	0.25	2		
Indonesia	target rate	6.50	16.06.2016	6.75	-0.25	0	3.2	-0.62
Korea, Republic of	base rate	1.50	30.11.2017	1.25	0.25	1	1.4	-1.20
Malaysia	target overnight rate	3.25	25.01.2018	3.00	0.25	1	0.9	-2.30
Mexico	target rate	7.75	21.06.2018	7.50	0.25	3	4.8	-1.63
Philippines	monetary policy rate	4.00	10.08.2018	3.50	0.50	3	6.4	3.80
Russia	repo auction rate (7 days)	7.25	26.03.2018	7.50	-0.25	5	3.1	-0.20
South Africa	repo rate	6.50	28.03.2018	6.75	-0.25	1	5.1	0.50
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0	1.6	1.30
Turkey	repo rate (7 days)	24.00	13.09.2018	17.75	6.25	3	17.9	7.22
United States	federal funds rate (upper bound)	2.00	13.06.2018	1.75	0.25	3	2.9	1.20
Euro area	refinancing rate	0.00	16.03.2016	0.05	-0.05	0	2.0	0.50
United Kingdom	base rate	0.75	02.08.2018	0.50	0.25	2	2.5	-0.10
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0	0.9	0.50
Canada	target overnight rate	1.50	11.07.2018	1.25	0.25	2	3.0	1.80
Australia	overnight rate	1.50	02.08.2016	1.75	-0.25	0	2.1	0.20
New Zealand	overnight rate	1.75	10.11.2016	2.00	-0.25	0	1.5	-0.20
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0	0.9	-0.60
	New Zealand	-0.65	08.01.2016	-0.75	0.10	0		
Switzerland	3m LIBOR – min	-1.25	15.01.2015	-0.75	-0.50	0	1.2	0.70
	3m LIBOR – max	-0.25	15.01.2015	0.25	-0.50	0		
Sweden	repo rate	-0.50	11.02.2016	-0.35	-0.15	0	2.2	-0.14
Norway	key deposit rate	0.50	17.03.2016	0.75	-0.25	0	3.0	1.50

Note: as of 7 September 2018, changes occurred from the compilation time of the previous Monetary Policy Report issue (5 June 2018) are put in colour.

Source: Bloomberg.

GLOSSARY

Adaptive expectations

Expectations that depend on past inflation readings to a bigger extent than on factors influencing its future dynamics. Given a stable decrease in inflation, its adaptive expectations will exceed its actual level.

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 in the currency of the Russian Federation 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: (the share of banks reporting a significant tightening of lending conditions, %) + 0.5 x (the share of banks reporting a moderate tightening of lending conditions, %) – 0.5 x (the share of banks reporting a moderate easing of lending conditions, %) – (the share of banks reporting a significant easing of lending conditions, %). 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

It corresponds to the minimum interest rate at Bank of Russia 1-week repo auctions and the maximum interest rate at Bank of Russia 1-week deposit auctions. 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.

Broad money (M2X monetary aggregate)

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

Carry trade

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

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 a ratio of the value of a fixed set of goods and services in current prices to the value of the same set of goods and services in the previous (reference) period's prices. The CPI is calculated on the basis of data on the actual structure of consumer spending, being therefore one of the key indicators of living costs.

Core inflation

Inflation 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).

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 become insured against a certain credit event of the reference obligation issuer by paying an annuity premium (CDS spread) to the insurance seller.

Current liquidity deficit/surplus

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

Dollarisation of deposits

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

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.

Financial stability

A financial system characterised by the absence of systemic risks which, once they have evolved, may impact negatively on the process of transforming savings into investment and the real economy. In the event of financial stability, the economy demonstrates better resilience to external shocks.

Floating exchange rate regime

According to the IMF classification, under a 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 sell it should threats to financial stability arise.

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.

Funds in general government's accounts with the Bank of Russia

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 those 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).

Import substitution

Substitution of imported goods by domestically-produced ones, which leads to an increased proportion of domestic goods in the domestic market.

Inflation expectations

Implied, forecast and expected inflation levels which form the basis for economic decisions and future plans of households, firms and financial market participants (including about consumption, savings, borrowings, investment and loan/deposit rates).

Inflation risks

The risks that price growth may cause the decline in value of assets or incomes.

Inflation targeting regime

A monetary policy framework setting that the final target of the central bank is to ensure price stability, i.e. achieving and maintaining sustainably low inflation. 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.

M1 monetary aggregate

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

Macro Risk Index

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

Monetary policy transmission mechanism

The process of transferring the impulse of monetary policy decisions to the economy as a whole and to price dynamics, in particular. The process of transmitting the central bank's signal about a/no change in the key rate and its future path, from financial market segments to the real sector and as a result to inflation. The key rate changes are translated into the economy through the following major channels: interest rate, credit, foreign currency and asset price channels.

Money supply

Total amount of funds of Russian Federation residents (excluding general government and credit institutions). For the purposes of economic analysis, various monetary aggregates are calculated (see 'M1 monetary aggregate', 'Money supply in the national definition (M2 monetary aggregate)', 'Cash in circulation outside the banking system (M0 monetary aggregate)' and 'Broad money (M2X monetary aggregate)'.

Money supply in the national definition (M2 monetary aggregate)

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

MSCI indices

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

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.

Non-price bank lending conditions

Bank lending conditions, which include loan maturity and its amount, solvency rules, collateral requirements, additional fees, and the range of lending purposes. They are assessed on the basis of surveys of credit institutions by the Bank of Russia.

Non-tradable sector of the economy

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

Open market operations

Bank of Russia operations to regulate banking sector liquidity. They include operations on a reverse basis other than standing facilities, which are carried out with the Bank of Russia making a specific offer (usually auction-based), as well as all operations to purchase/sell securities, foreign currency and gold.

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).

PMI indices

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

Relative price

Price of a commodity (commodity group) in terms of the price of another commodity (commodity group) assumed to equal one.

Repo operation

A deal which consists of two legs: one party to the deal 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 fulfil reserve requirements. The latter comprise required reserve ratios and a required reserve averaging ratio.

Ruble nominal effective exchange rate index

The ruble nominal effective 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 against the currencies of these countries. The weights are determined according to the foreign trade turnover share of Russia with each country in the total foreign trade turnover of Russia with its main trading partners.

Ruble real effective exchange rate index

It is calculated as the weighted average change in the real exchange rate 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/surplus

A structural deficit is the state of the banking sector characterised by stable demand of credit institutions for Bank of Russia liquidity. A structural surplus is characterised by a stable surplus in credit institutions' liquidity and the need for the Bank of Russia to conduct liquidity-absorbing operations. The level of a structural liquidity deficit/surplus is a difference between the outstanding amount on refinancing operations and Bank of Russia liabilities on operations to absorb excess liquidity.

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.

Structural transformations

Transformation leading to changes in the economy structure and growth factors, and also to increases in labour productivity and implementation of new technology.

Terms of foreign trade

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

Tradable sector of economy

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

Underlying inflation

Underlying inflation indicators are estimated indicators reflecting movements in prices for the majority of goods and services in the basket used for the calculation of the consumer price index. Being shaped by general economic factors, these are free from one-off effects. The indicators of the core inflation published by Rosstat and the underlying inflation published by the Bank of Russia since 2015 (trend inflation) may be categorised under this group of indicators.

Underlying inflation published since 2015 (trend inflation)

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

VIX

Calculated by Chicago Board Options Exchange index of expected volatility of S&P 500 stock index over the next 30 day period. VIX is constructed as a weighted average of premiums of a wide range of prices of put and call options on the S&P 500 index.

ABBREVIATIONS

AHML – Agency for Housing Mortgage Lending

BLC – bank lending conditions

bp – basis point (0.01 pp)

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

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

Cbonds IFX-Cbonds – corporate bond total return index

Cbonds-Muni – municipal bond index calculated by Cbonds

CCPI – core consumer price index

CPI – consumer price index

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

ECB – European Central Bank

EME – emerging market economies

EU – European Union

FAO – Food and Agriculture Organization of the United Nations

FCS – Federal Customs Service

Fed – US Federal Reserve System

FGUP – federal state unitary enterprise

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

GRP – gross regional product

IBL – interbank loans

IEA – International Energy Agency

Industrial PPI – industrial producer price index

inFOM – Institute of the Public Opinion Foundation

MC – management company

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

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

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

MIC – military-industrial complex

MICEX SE – MICEX Stock Exchange

MPD – Monetary Policy Department of the Bank of Russia

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

NPF – non-governmental pension fund

NPISH – non-profit institutions serving households

OBR – Bank of Russia bonds

OECD – Organisation for Economic Cooperation and Development

OFZ – federal government bonds

OFZ-IN – inflation-indexed federal government bonds

OFZ-PD – permanent coupon-income federal government bonds

OFZ-PK – variable coupon-income federal government bonds

OJSC – open joint-stock company

OPEC – Organization of the Petroleum Exporting Countries

PJSC – public joint-stock company

PMI – Purchasing Managers' Index

pp – percentage point

PPI – producer price index

QPM – quarterly projection model of the Bank of Russia

REB – Russian Economic Barometer, monthly bulletin

RGBEY – Russian Government Bonds Effective Yield until Redemption (calculated by the Moscow Exchange)

RUONIA – Ruble OverNight Index Average (reference weighted rate of overnight ruble deposits in the Russian interbank bond market, calculated by Cbonds)

SME – small and medium-sized enterprises

SNA – system of national accounts

TCC – total cost of credit

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

VAT – value added tax

VCIOM – Russian Public Opinion Research Centre

VEB – Vnesheconombank

VECM – Vector Error Correction Model