Bank of Russia

MARCH 2019

MONETARY POLICY REPORT

1 April 2019

The report has been prepared based on statistics as of 22 March 2019.
The data cut-off date for forecast calculations is 15 March 2019 (if statistics or other information relevant for decision-making come in after the data cut-off date, they are included in the text of the Report and may be used to adjust the mid-term forecast).

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This publication has been prepared by the Monetary Policy Department.

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Statement by Bank of Russia Governor Elvira Nabiullina

in follow-up to Board of Directors meeting 22 March 2019

Today, the Bank of Russia Board of Directors decided to keep the key rate at 7.75% p.a.

We have every reason to believe that the decisions to raise the key rate made last year are most likely to be sufficient to bring annual inflation back to the near 4% target in the first half of 2020. Some indicators have performed better than we expected in December: foreign financial and commodity markets have stabilised, the VAT pass-through to prices is quite moderate, and inflation expectations have turned to decline. In these circumstances, inflation stands somewhat below our December forecast, while short-term proinflationary risks have softened.

Given these trends, we expect end-2019 inflation to come in at a lower level of 4.7-5.2% instead of the 5-5.5% range forecast earlier.

Let me set out in further detail the factors that were central to our decision.

First, as I have mentioned, annual inflation in January-February proved somewhat lower than we expected at the end of last year. In February, it came in at 5.2%. Monthly price growth rates have already been going down. Annual inflation will pass its peak in March-April on the back of the base effect. Our updated estimates suggest that at its highest point inflation may surge to approx. 5.5%. You will recall that in December we did not rule out that inflation might considerably exceed this level.

There are several reasons for such inflation dynamics.

First of all, the contribution of the VAT hike to annual inflation currently stands at approx. 0.6-0.7 pp, which is close to the lower bound of our expectations. According to our estimates, the VAT pass-through to prices has already largely materialised. This is suggested by the analysis of prices of goods and services for which the VAT was raised. These are mostly non-food goods and services. Annual price growth in most of them has accelerated only moderately. In monthly terms, it returned in February to the growth pace seen in September-December last year (seasonally adjusted); however, it still holds somewhat above 4% in annual terms. Weekly inflation estimates suggest similar developments. After a surge in the first two weeks of this year, they have dropped in recent weeks, though holding somewhat above the path that corresponds to our inflation target. Moreover, we do not rule out that the deferred effects of the VAT hike may manifest themselves in the months to come. It is also of note that in February, both monthly core inflation and most other indicators adjusted for volatile components and seasonality exceeded 4% in annual terms.

There is evidence that risks that prices of certain food products may grow at an elevated pace have decreased. In February, a decline was registered in prices of a number of products which had made a considerable contribution to acceleration of food inflation. Furthermore, both domestic and external prices of main crops stopped growing in recent months. Current harvest expectations for this year are favourable, which also limits risks in this part.

Petrol and diesel prices were comparatively stable in December-February, and even drifted down slightly in February. This constrained inflation acceleration. Furthermore, the ruble appreciated in the opening months of the year; this had a favourable effect on prices and inflation expectations.

Inflation expectations is the second factor we closely monitor. We had concerns about their possible response to inflation acceleration. Expectations of professional analysts remain anchored. Analysts understand the temporary nature of this year's inflation acceleration associated with one-off factors, in particular, the VAT. Therefore, as the Bank of Russia, they forecast a moderate increase in inflation in 2019 and expect inflation to come in at 4% from next year onwards.

Households and businesses responded to inflation acceleration more pronouncedly. Expectations of households rose from a historic low of 7.8% seen last April to 10.4% in January, that is returned to their mid-2017 readings. Businesses' price expectations also jumped considerably. However, household inflation expectations dropped to 9.1% as early as March. Price expectations of businesses also declined. However, they both remain elevated. It is of special note that inflation expectations of households and businesses demonstrated last year that they remained unanchored. They follow current changes in prices, primarily petrol and food prices, and ruble exchange rate fluctuations.

The third important factor we took into account is consumer demand. Lending underpins consumption but slowing wage growth constrains a rise in demand. Consumption growth slowed down after a short-term acceleration in November, which was likely associated with preemptive purchases of non-food goods in the run-up to the VAT hike. We can see it from retail sales figures. The rise in consumer activity does not exert pressure on prices. This, among other things, is an important reason of a moderate VAT pass-through to prices.

The fourth factor is external conditions. A number of changes which only started to emerge in December, intensified at the beginning of this year. The US Fed and the European Central Bank eased their rhetoric as regards the monetary policy outlook. Improvements were seen in markets' expectations regarding the negotiations of international trade restrictions. These factors supported emerging market currencies and reduced their risk premiums. We may say that external risks declined in this part. At the same time, geopolitical risks remain in place.

Oil prices in the first quarter were higher than projected in the baseline scenario. However, risks are high that oil production will exceed consumption this year.

Finally, overall monetary conditions have changed little if at all since the start of the year. Deposit rates have edged higher, while loan rates have stabilised. OFZ yields dipped on the back of improving conditions in global financial markets, as well as a result of reviewed expectations of market participants as to the future key rate path. These OFZ yield movements, while working to constrain the potential of loan and deposit rate growth, are laying the groundwork for their subsequent decrease.

With due account for the totality of factors I have mentioned, we have downgraded our inflation forecast for the end of this year to 4.7-5.2%. At this point in time, it is with a certain degree of confidence that we can say: provided that the situation unfolds according to our baseline scenario, the preventive steps we have made so far to increase the key rate last year are most likely to be sufficient to ensure annual inflation returns to 4% in the first half of 2020.

I will now proceed to speak on the risks, as usual. Despite the reduction in short-term risks, the overall balance of medium-term risks remains tilted towards proinflationary ones. As before, we should approach the assessment of external conditions with great caution. The risks related to geopolitical factors remain high. We continue to observe manifold sources of uncertainly in the global economic outlook. Investor sentiment is subject to rapid change in this environment, which is set to impact on OFZ yields and the exchange rate. Certainly, elevated and unanchored inflation expectations, as I have said, also remain a material risk.

Moreover, it is premature at this stage to make a precise estimate for the ultimate impact of the VAT increase on prices and inflation expectations. At the present time, producers and retailers are essentially compromising part of their margins to ensure customer retention. The muted demand and competition for market share both work to prevent them quickly passing the tax change on to higher prices. This is why they proceed on a piecemeal basis, each time they are able to do so. Moreover, there are still stocks built up before the VAT hike. As contracts are renewed, goods taxable at the new rate will come into the market. Taking into account these factors, we do not rule out that the VAT change pass-through to prices could be protracted. Having said this, our baseline scenario suggests that the VAT pass-through to consumer prices is mostly complete.

As regards the main changes to our medium-term forecast, beginning from today, it will be published as part of the key rate press release. You have had the opportunity to read it.

The principal change in the forecast is a downward revision of inflation projections for this year. Furthermore, we have refined the average level of oil prices for this year based on their actual movements at the start of the year. The baseline scenario has been revised upwards from $55 to $60 a barrel; the high oil price scenario has been revised downwards from $75 to $70. Our oil price forecast for 2020-2021 remains unchanged. These adjustments have made no major impact on expected economic growth indicators in the context of the operating fiscal rule.

Finalised data suggest GDP growth was 2.3% last year, above our expectations. Our estimates suggest that the accomplishment of major investment projects emerged as key enablers of this growth. With due regard for this, we, first, reconfirm our assessment of the nature of economic growth: the economy is close to its potential; its expansion does not create additional proinflationary pressure. Second, we keep our GDP growth estimate in the baseline scenario at 1.2-1.7% for this year. The growth rates will accelerate to 1.8-2.3% in 2020 and 2-3% in 2021 as the positive effect of national projects and structural reforms provided that these deliver.

The oil price adjustments in the forecast carry implications for balance of payments indicators. In the baseline scenario, the forecast current account balance for this year has been upgraded from $71 billion to $88 billion, chiefly on the back of a higher value of oil and gas exports. The balance

of the financial account of the private sector has also been raised from with $20 billion to $35 billion. This is based on the actual data for the first two months of the year along with greater opportunities for the buildup of foreign assets given the higher export revenues. Over a medium-term horizon, balance of payments trends remain unchanged.

This year's revision of the estimate for foreign currency reserves from $52 billion to $59 billion comes a result of higher foreign currency purchase volumes based on the fiscal rule in the context of higher oil prices.

In conclusion, I would like to make the following comment. Should the situation unfold according to our baseline forecast, we hold open the prospect of a key rate reduction somewhat sooner than we assumed back in December last year. We do not rule out that this may occur in 2019. The Bank of Russia will make its key rate decisions, as it always does, taking into account inflation and economic dynamics against the forecast as well as risks posed by external conditions and the reaction of financial markets.

Bank of Russia Governor *Elvira Nabiullina*

Bank of Russia's medium-term forecast

following the Board of Directors' key rate meeting on 22 March 2019

KEY PARAMETERS OF THE BANK OF RUSSIA'S FORECAST SCENARIOS *Table 1*
(GROWTH AS % OF PREVIOUS YEAR, IF NOT INDICATED OTHERWISE

	2018 (actual)	BASELINE			HIGH OIL PRICES		
		2019	2020	2021	2019	2020	2021
Urals price, average for the year, US dollars per barrel	69.8	60	55	55	70	75	75
Inflation, as % in December year-on-year	4.3	4.7-5.2	4.0	4.0	4.7-5.2	4.0	4.0
Inflation, average for the year, as % year-on-year	2.9	5.1-5.4	4.0	4.0	5.1-5.4	4.0	4.0
Gross domestic product	2.3	1.2-1.7	1.8-2.3	2.0-3.0	1.2-1.7	2.0-2.5	2.0-3.0
Final consumption expenditure	1.9	1.0-1.5	1.8-2.3	2.0-2.5	1.0-1.5	2.0-2.5	2.0-2.5
– households	*2.2*	*1.0-1.5*	*1.8-2.3*	*2.5-3.0*	*1.0-1.5*	*2.3-2.8*	*2.5-3.0*
Gross capital formation	1.5	1.0-2.0	3.5-4.5	3.5-4.5	1.0-2.0	3.5-4.5	3.5-4.5
– gross fixed capital formation	*2.3*	*1.0-2.0*	*3.5-4.5*	*3.5-4.5*	*1.0-2.0*	*3.5-4.5*	*3.5-4.5*
Exports	6.3	2.5-3.0	2.7-3.2	2.7-3.2	2.5-3.0	2.7-3.2	2.7-3.2
Imports	3.8	1.0-1.5	3.8-4.2	4.5-5.0	1.0-1.5	4.0-4.5	4.5-5.0
Money supply in national definition	11.0	7-11	7-12	7–12	8-12	9-13	9-13
Lending to organisations and households in rubles and foreign currency*	11.5	7-11	7-12	7–12	8-12	7-12	7-12
– lending to non-financial and financial institutions in rubles and foreign currency, growth as % over year	*8.4*	*7-10*	*6-10*	*6–10*	*8-11*	*6-10*	*6-10*
– lending to households in rubles and foreign currency, growth as % over year	*22.0*	*12-17*	*10-15*	*10–15*	*13-18*	*11-16*	*10-15*

** 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' investment in debt and equity securities and promissory notes, as well as other forms of equity interest in non-financial and financial institutions, and other accounts receivable from settlement operations involving non-financial and financial institutions and households.*

Source: Bank of Russia.

RUSSIA'S BALANCE OF PAYMENTS INDICATORS* *Table 2*
(BILLIONS OF US DOLLARS)

	2018** (actual)	BASELINE			HIGH OIL PRICES		
		2019	2020	2021	2019	2020	2021
Current account	**114**	**88**	**58**	**50**	**106**	**114**	**104**
Balance of trade	194	170	146	141	191	204	200
Exports	*443*	*420*	*410*	*421*	*448*	*481*	*497*
Imports	*249*	*250*	*264*	*280*	*257*	*277*	*297*
Balance of services	-30	-33	-37	-39	-33	-36	-41
Exports	*65*	*62*	*63*	*65*	*66*	*70*	*73*
Imports	*95*	*95*	*100*	*104*	*99*	*106*	*114*
Balance of primary and secondary income	-51	-49	-51	-52	-52	-54	-55
Current and capital account balance	**113**	**88**	**58**	**50**	**106**	**114**	**104**
Financial account (excluding reserve assets)	**77**	**29**	**13**	**9**	**31**	**31**	**25**
Government and the central bank	9	-6	-4	-4	-6	-6	-7
Private sector	68	35	17	13	37	37	32
Net errors and omissions	**3**	**0**	**0**	**0**	**0**	**0**	**0**
Change in reserve assets ('+' – increase, '-' – decrease)	**38**	**59**	**45**	**41**	**75**	**83**	**79**

** Using the methodology of the 6th edition of 'Balance of Payments and International Investment Position Manual' (BPM6). In the Financial account '+' stands for net lending, '-' – for net borrowing. Net errors and omissions = Financial account (including reserve assets) – Current and capital account balance. Due to rounding total results may differ from the sum of respective values.*

*** The 2018 figures were updated according to the Balance of Payments data published by the Bank of Russia on 1 April 2019.*

Source: Bank of Russia.

1. ECONOMIC OUTLOOK

In the context of current global and Russian economic developments and domestic consumer price dynamics, the Bank of Russia has lowered its annual inflation forecast for the end of 2019 in the baseline scenario as compared to its Monetary Policy Report published on 14 December 2018. Under the baseline scenario, annual inflation is expected to stay within 4.7–5.2% at the end of 2019. This revision is due largely to a moderate response of prices and inflation expectations to the VAT increase seen since the beginning of the year on the back of muted domestic demand. The increase in VAT has generally made its contribution to the annual growth of consumer prices; but delayed effects may come out in the next few months. An accurate assessment of the VAT revision effect on inflation is not expected until the second quarter of the current year.

Quarterly year-on-year consumer price growth is set to decelerate to 4% as early as the second half 2019. Annual inflation will return to 4% in the first half 2020, when the effects of the ruble's weakening in 2018 and the VAT rise peter out, and will continue to remain around this level.

The paces of economic growth in the baseline scenario will remain close to potential; after a slight slowdown in 2019, they will gradually accelerate in 2020–2021, as the positive effects of the fiscal policy measures planned by the Government and national projects accumulate, subject to their successful implementation.

The key uncertainty factor for the Russian economy in 2019–2021 is further global economic developments. In this respect, in addition to the baseline scenario, the Bank of Russia continues considering the high oil price scenario and the risk scenario.

In the scenario with high oil prices at $75 per barrel in 2020–2021, economic growth in 2020 will be better than in the baseline scenario due to additional support of business sentiment, as well as consumer and investment activities in the context of improved trade conditions. Inflation will sustain at the level of the baseline scenario over the entire forecast horizon, as the Bank of Russia will implement its monetary policy taking into account the slightly higher pressure on it, resulting from changes in demand or the effect of oil and gas tax manoeuvre.

The risk scenario parameters have generally remained the same as compared to the December report. A significant deterioration of external conditions may cause a temporary inflation acceleration of over 4% and a downturn in the economy. However, this effect will be short-lived, given the increased resilience of the Russian economy to external developments, the smoothing effect of the fiscal rule, and a timely response of monetary policy. In the second half of the forecast horizon, the key forecast parameters under the risk scenario will draw closer to the baseline scenario.

In addition to further external developments, including the risks of a slowdown in the global economy and geopolitical factors, the future dynamics of inflation expectations will remain an additional uncertainty factor for the baseline scenario. In such conditions, the balance of medium-term inflation risks remains shifted towards proinflationary ones.

At the same time, Bank of Russia estimates suggest that short-term proinflationary risks have abated. With regard to internal conditions, secondary effects of the VAT increase and price movements in certain food products became less of a risk. As for external conditions, the revision of interest rate path by the US Fed and other central banks in advanced economies reduces the risks of persistent capital outflows from EMEs.

The Bank of Russia leaves mostly unchanged its assessment of risks associated with wage movements, possible changes in consumer behaviour and budget expenditures. These risks remain moderate.

1.1. BASELINE SCENARIO AND FORECAST UNCERTAINTY FACTORS

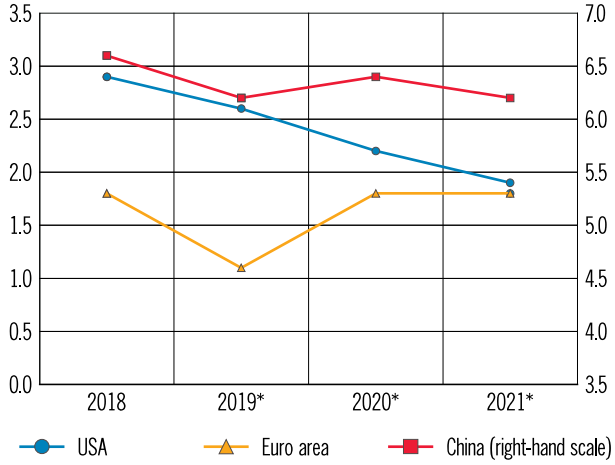
FORECAST ASSUMPTIONS

Global economic growth. In its baseline scenario, the Bank of Russia assumes a somewhat greater slowdown in the global economy in 2019–2021 than expected in the Monetary Policy Report published on 14 December 2018 (hereinafter, Monetary Policy Report 4/18) (Chart 1.1.1). The expected slowdown in the global economy is largely due to weak economic activity in euro area countries and a number of other advanced economies, the gradual exhaustion of the effect from the fiscal impulse, the shift in the US to a late-cycle phase, and a gentle slowdown in China's economy (see Section 3.1). There are still concerns about the further tightening of international trade restrictions. At the same time, despite the gradual slowdown, US economic growth rates in the baseline scenario will remain higher than potential ones. The Bank of Russia's outlook on global economic growth is generally close to the expectations of market participants and international organisations.

Oil prices. In the baseline scenario, the Bank of Russia proceeds from a gradual price drop in Urals crude to $55 per barrel and maintaining it near this level in 2020–2021 (Chart 1.1.2). The path for 2019 is adjusted for actual indicators as of the beginning of 2019 and revised expectations for OPEC+ actions. Thus, for 2019, the average annual Urals crude price has been increased in the baseline scenario from $55 per barrel to $60 per barrel. This takes into account the OPEC+ agreement on oil production cuts in the first half of 2019 and provides for its extension for the other six months, while assuming a potential slowdown in the global economy and a high probability of an oil glut over the forecast horizon due to continuing substantial growth in production outside OPEC+ countries.

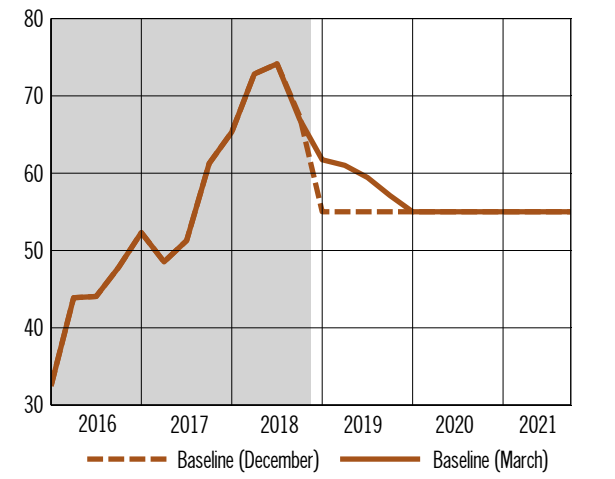
Inflation abroad. As in December, the Bank of Russia's baseline scenario provides for weaker inflationary pressure in Russia's key trading partners in 2019–2021. This will be largely due to a gradual downturn in oil prices and a global

GROWTH INDICATORS OF LARGEST GLOBAL ECONOMIES IN BASELINE SCENARIO *Chart 1.1.1*
(PER CENT CHANGE ON PREVIOUS YEAR)



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

OIL PRICE TRAJECTORY IN BASELINE SCENARIO *Chart 1.1.2*
(PER CENT CHANGE ON PREVIOUS YEAR)



Note: Urals crude nominal prices.
Source: Bank of Russia calculations.

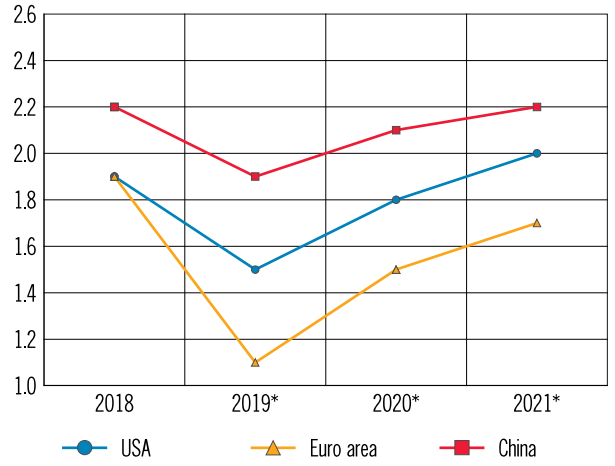
economic slowdown. At the same time, given the revised medium-term forecast for global economic growth, the Bank of Russia has somewhat reduced its assumption about growth in consumer prices over the forecast horizon in the US, euro area and China as compared to Monetary Policy Report 4/18 (Chart 1.1.3).

Monetary policies of foreign central banks. In 2019–2020, the Bank of Russia expects further tightening of monetary policies by the central banks of advanced economies. The Bank of Russia has also revised its assumptions about the growth of rates in the US and euro area in 2019–2021 on the back of the latest communications from the US Fed and the European Central Bank (see Section 3.1), which affected the expectations of market participants (Charts 1.1.4 and 1.1.5), as well as based on a deteriorating medium-term outlook for the global economy and reduced inflationary pressure in advanced economies. In its baseline scenario, the Bank of Russia factors in only one increase in the US Federal Reserve base rate over the forecast horizon, which will occur in 2020. An increase in the key rate of the ECB is now expected in 2020.

Global financial markets. Compared to December, in its current baseline scenario, the Bank of Russia proceeds from a stronger US dollar against the euro in 2019–2021. Weaker euro dynamics are conditioned on poorer economic outlook in the euro area and delayed stabilisation of the situation on the EU periphery (Portugal, Italy, Greece and Spain), which will result in a slower risk premium decline for the euro area than previously assumed. At the same time, the softer-than-expected monetary stance in advanced economies will mitigate the risk of a steady capital outflow from EMEs.

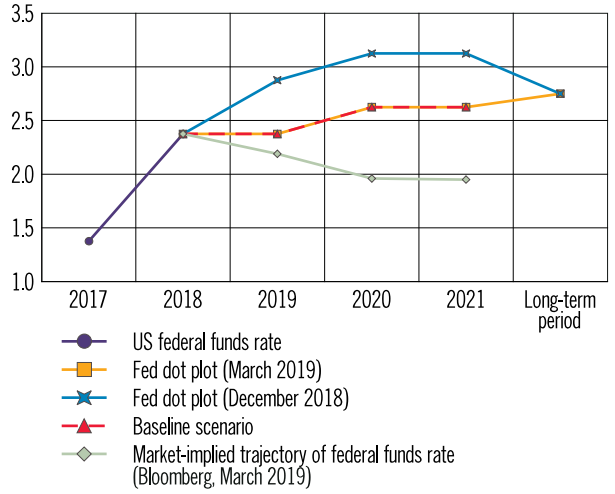
Geopolitical factors. As before, in its baseline scenario the Bank of Russia proceeds from the retention of international sanctions imposed on Russia in 2014–2018 over the entire forecast horizon. This involves instituting a country risk premium for Russia at a slightly higher level than if there were no sanction restrictions. Relying on conservative risk premium assumptions, the Bank of Russia takes into account the potential volatility of financial markets in case of the emergence of short-term episodes of elevated geopolitical tension.

INFLATION INDICATORS OF LARGEST GLOBAL ECONOMIES IN BASELINE SCENARIO *Chart 1.1.3*
(PER CENT CHANGE Y.O.Y AS OF THE PERIOD-END)



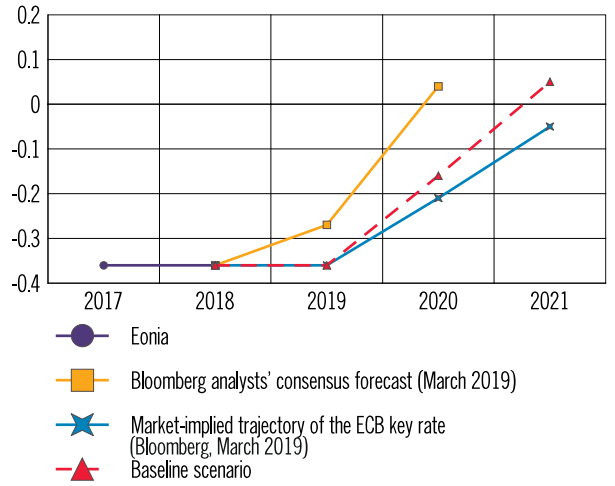
** Forecast.*
Note: PCE Price Index is forecast for the US, HICP – for the euro area, and CPI – for China.
Source: Bank of Russia calculations.

EXPECTED TRAJECTORIES OF FEDERAL FUNDS RATE *Chart 1.1.4*
(% P.A.)



Note: values are given as of the end of each period.
Sources: Bank of Russia calculations, the US Fed, Bloomberg.

EXPECTED TRAJECTORIES OF ECB KEY RATE *Chart 1.1.5*
(% P.A.)



Note: values are given as of the end of each period.
Sources: Bank of Russia calculations, the US Fed, Bloomberg.

Other measures of Russia's state policy. In terms of key internal assumptions, in its monetary policy for 2019–2021, the Bank of Russia factors in the past and expected changes in taxation, the Government's measures for overcoming the structural constraints of the Russian economy, including national projects, and the effect of the fiscal rule.

The key changes provided for by the Bank of Russia in the taxation policy primarily include an increase in the standard VAT rate from 18 to 20% starting 1 January 2019, which, according to the bank's forecast, will have a slight constraining effect on GDP dynamics in 2019. Considering the price dynamics since the beginning of the current year, the increased VAT is currently estimated to have contributed to annual inflation roughly 0.6–0.7 pp. At the same time, the Bank of Russia assumes that individual delayed effects of the VAT hike may be seen in the coming months. The Bank of Russia also takes into account the expected changes in excise taxes on individual products included in the consumer basket and the oil and gas manoeuvre, whose contribution to annual inflation in 2019–2021 has not changed substantially as compared to the December forecast. Thus, in 2019–2020, the contribution of the tax manoeuvre to annual inflation will be around zero, while in 2021 it may reach 0.2 pp.

The Bank of Russia also maintains its assessments of the effect that the Government's measures aimed at mitigating the existing structural constraints in the Russian economy and increasing its potential growth rates at the level of those published in October 2018 (in the Monetary Policy Guidelines for 2019-2021) may have on the Russian economy. These measures include a phased increase in the retirement age, as well as additional investment expenses and expenses for the development of human capital in 2019–2024.

MEDIUM-TERM FORECAST

Inflation. The inflation forecast for 2019 has been revised from 5.0–5.5% in Monetary Policy Report 4/18 to 4.7–5.2%. The revised forecast reflects the reduced assessments of possible effects from the VAT increase, as well as the ruble's strengthening in the first months of the year against the backdrop of favourable external conditions (see Sections 3.1–3.2).

In view of the monetary policy decisions and the exhaustion of the VAT hike and the 2018-ruble's weakening pass-through effects on the current price dynamics, the quarterly annualised growth rates of consumer prices (seasonally adjusted) will slow to 4% in the second half of 2019. Upon returning to 4% in the first half of 2020, annual inflation will remain around 4% through the end of the forecast horizon (Chart 1.1.6). Inertia inflation factors, including the moving average annual inflation, will remain higher during the whole 2019 than in 2018, but in 2020–2021, they will also be around 4%.

Economy. The forecast economic growth over the entire horizon remained unchanged as compared to Monetary Policy Report 4/18 (Chart 1.1.7). The GDP growth rate will drop to 1.2–1.7% in 2019 (versus 2.3% at the end of 2018). This slowdown suggests that some of the factors that supported output dynamics in 2018 were one-off only, as estimated by the Bank of Russia (see Section 3.3). In 2019, domestic demand will be constrained by a slower growth in export revenues due to a drop in oil prices and slower lending growth amid monetary policy tightening in the second half of 2018. The estimated growth in investment, exports and imports in 2019 was somewhat lower considering the actual indicators for 2018 and the first months of 2019 (see Section 3.3) and the revised forecast assumptions about external conditions. Investment will demonstrate faster growth in the second half of the year as the Government starts to implement its planned investment projects.

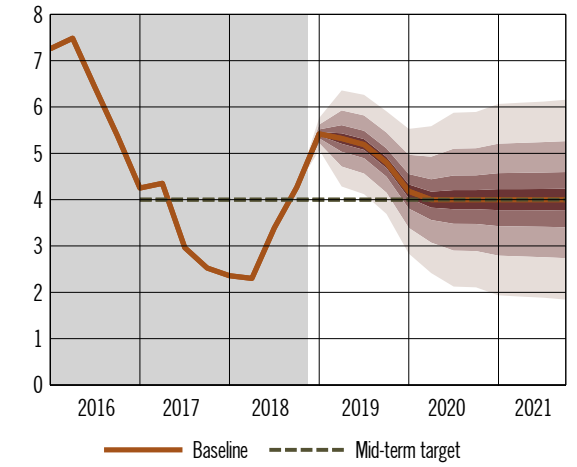
The Bank of Russia continues to forecast that the Russian economy's accelerated growth in 2020 and 2021 will reach 1.8–2.3% and 2.0–3.0% respectively (Chart 1.1.7). This will be driven by a gradual accumulation of the positive pass-through of the planned fiscal policy measures and national projects once they are successfully implemented. In its baseline scenario, the Bank of Russia assumes that higher growth rates in the Russian economy will not create significant demand-side inflationary pressure, as it will result in the expanded production capacity of the economy.

Monetary indicators. The forecast for monetary indicators remained unchanged as compared to the forecast published in Monetary Policy Report 4/18 (Chart 1.1.8). The Bank of Russia expects slower growth in household loans as compared to its high level in 2018 (22.0% at year-end), which is in part due to measures intended to restrict an increase in the debt burden of the population in general and of individual borrowers in particular. At the same time, the gradual easing of price lending conditions that will evolve in part due to the reduced key rate in the baseline scenario (see Section 4.1) will facilitate lending growth primarily for corporate and mortgage loans. Non-price lending conditions will soften gradually, reflecting banks' conservative approach to assessing borrowers and taking risks. Given the effect of all of the above factors, lending activities will generally continue to grow in 2019–2021 at a stable pace that corresponds to the increasing effective demand and does not pose any risks to price stability. The overall debt burden of the economy will remain at levels that do not create any threats to the financial stability of the economy and will mainly increase due to households' debt burden (Charts 1.1.9 and 1.1.10). Macroprudential measures make it possible to alleviate risks in individual lending segments. Credit will remain the key driver of changes in the money supply, and the money supply growth rates in such conditions will be close to the growth rates of credit in the economy (Chart 1.1.11).

Balance of payments. The forecast for the balance of payment indicators has been updated with regard to the revised oil prices for 2019 and the actual indicators as of the start of the year. Thus, the forecast current account balance has been raised from 71 to 88 billion US dollars. The private sector financial account balance has also been raised from 20 to 35 billion US dollars. At the same time, taking into account the inflow of foreign investor funds to the OFZ market and successful placements of Russian Eurobonds, the public sector financial account deficit (signs according to BPM6, i.e. net capital inflow) has been revised for 2019 from 1 to 6 billion US dollars.

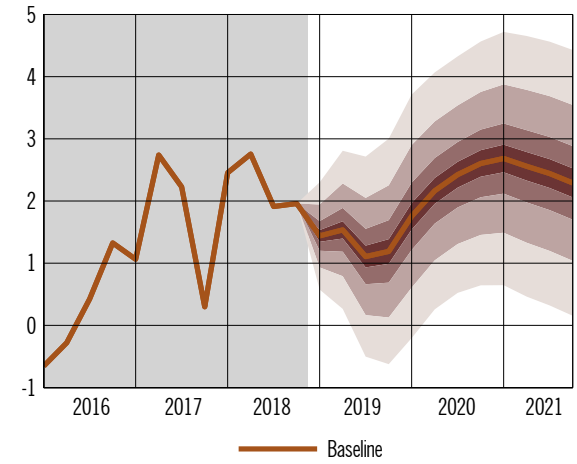
In the medium term, despite a gradual downturn in oil prices, the current account balance will remain positive over the entire forecast horizon (roughly 5% of GDP in 2019 and roughly 3% of

INFLATION *Chart 1.1.6*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



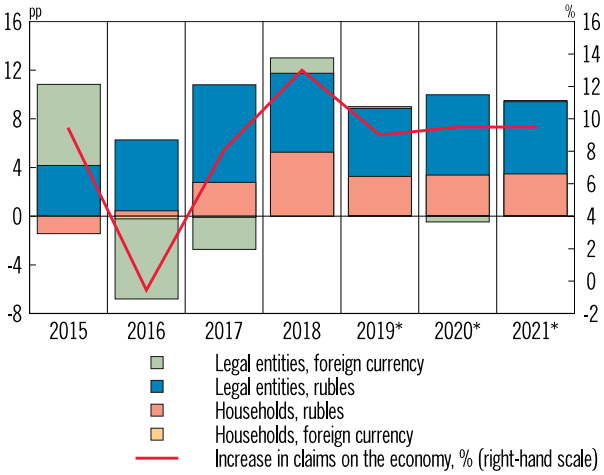
Note: shaded areas on the forecast horizon show the probability of different inflation values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on the historical estimates of inflation uncertainty.
Source: Bank of Russia calculations.

GDP GROWTH RATE *Chart 1.1.7*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



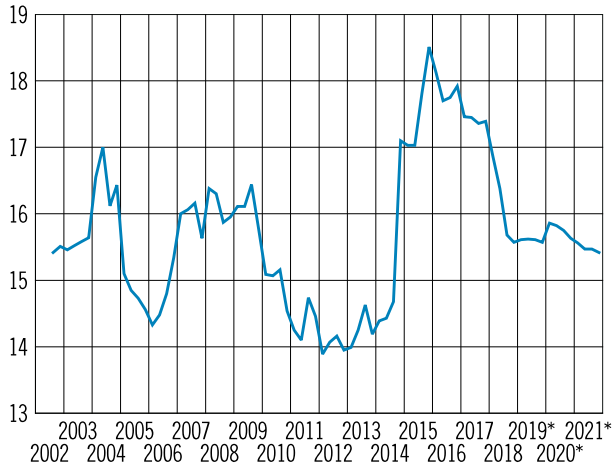
Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on the historical estimates of GDP growth rate uncertainty.
Source: Bank of Russia calculations.

DECOMPOSITION OF INCREASE IN CLAIMS ON ECONOMY *Chart 1.1.8*
(CONTRIBUTION TO ANNUAL GROWTH)



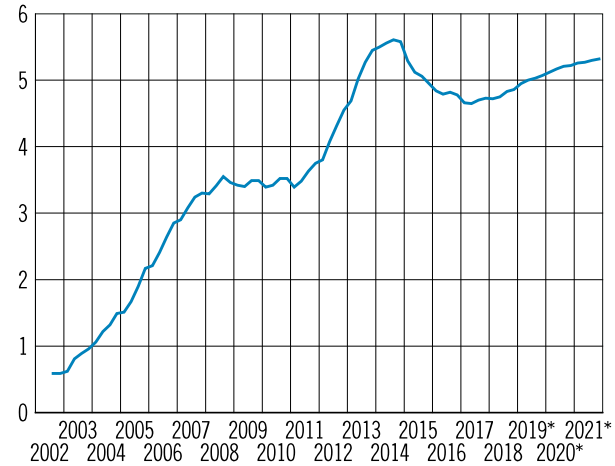
** Forecast. Decomposition is shown for the increase in claims on the economy corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

CORPORATE DEBT BURDEN
(DEBT SERVICE RATIO, AS % OF GDP)
Chart 1.1.9



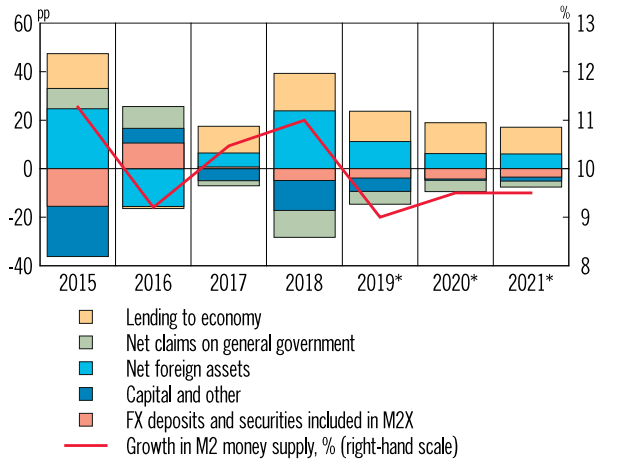
** Forecast. Debt burden is calculated for the credit corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations.

HOUSEHOLD DEBT BURDEN
(DEBT SERVICE RATIO, AS % OF GDP)
Chart 1.1.10



** Forecast. Debt burden is calculated for the credit corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations.

DECOMPOSITION OF GROWTH IN MONEY SUPPLY IN NATIONAL DEFINITION IN BASELINE SCENARIO
(CONTRIBUTION TO ANNUAL GROWTH, PP)
Chart 1.1.11



** 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.

GDP in 2020–2021 vs 7% of GDP in 2018). The effect of the expected decline in oil prices will be mitigated by the growth in export quantities, which will be in part supported by the Government's measures aimed at stimulating non-commodity exports (Chart 1.1.12).

The private sector financial account balance will shrink in 2019–2021 (roughly 2% of GDP in 2019 and roughly 1% of GDP in 2020–2021 vs 4% of GDP in 2018) against the backdrop of reduced external debt payments and somewhat limited possibilities of Russian companies to accumulate foreign assets in the context of lower prices for core Russian exports (Chart 1.1.13).

In 2019–2021, the Bank of Russia will also continue to replenish international reserves under the fiscal rule. Its forecast takes into account, among other things, domestic market foreign currency purchases postponed in 2018.

FORECAST UNCERTAINTY FACTORS

External conditions. The balance of risks associated with external factors remains shifted towards proinflationary risks. However, these risks have somewhat decreased as compared to the end of 2018. In late 2018 – early 2019, the revised expected pace of monetary policy tightening by the US Fed and other central banks in advanced economies reduced the risks of steady capital outflows from EMEs. There is visible progress in negotiations between the US and China regarding the international restrictions in foreign trade, which had a positive effect on EME risk premiums (see Section 3.1).

Further oil price dynamics remain the source of uncertainty. Influenced by supply-side factors, oil prices may be either lower or higher than the baseline scenario. Geopolitical risks remain elevated.

In such conditions, the Bank of Russia maintains a conservative approach to forming assumptions in the baseline scenario, while not excluding the high oil price scenario and the risk scenario, which assume a combination of adverse external factors.

Inflation expectations. The inertia of inflation expectations, their sensitivity to price increases for individual goods and services, as well as their unanchored character remain a significant risk

for inflation's upward deviation from the baseline forecast.

VAT. The Bank of Russia's baseline scenario suggests that the VAT pass-through to consumer prices is mostly complete. However, there is still a risk that it will be stretched out over time due to the phased renegotiation of contracts between manufacturers and trade organisations. The pass-through of the VAT to inflation in 2019 can be fully assessed only at the end of the second quarter.

Other factors. The Bank of Russia's assessment of inflation risks associated with wage movements, possible changes in consumer behaviour and budget expenditure has remained mostly unchanged. These risks remain moderate.

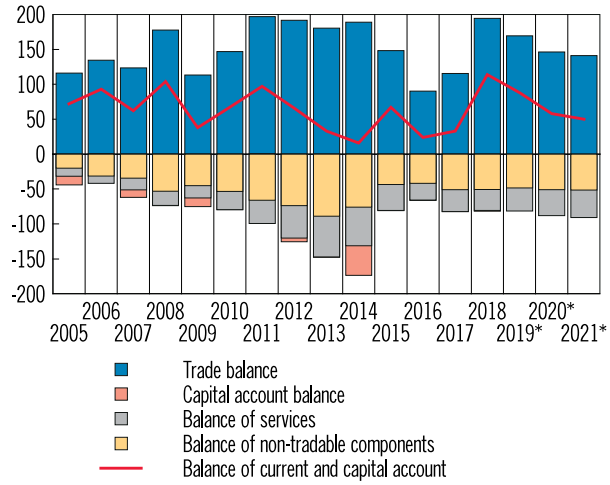
1.2. HIGH OIL PRICE SCENARIO

FORECAST ASSUMPTIONS

Oil price. The key difference between the high oil price scenario and the baseline scenario is the oil price path of $75 per barrel over the forecast horizon. This path may be primarily conditioned on energy supply-side factors. These include tougher restrictions in production under OPEC+ agreements as compared to the baseline scenario, a greater decline in production in Iran because of renewed sanctions, as well as a more substantial and prolonged drop in oil production in Venezuela in the context of the ongoing domestic economic and political crisis. At the same time, given the actual oil price dynamics since the beginning of this year, the annual average oil price for 2019 in the high oil price scenario was adjusted from $75 per barrel to $70 per barrel.

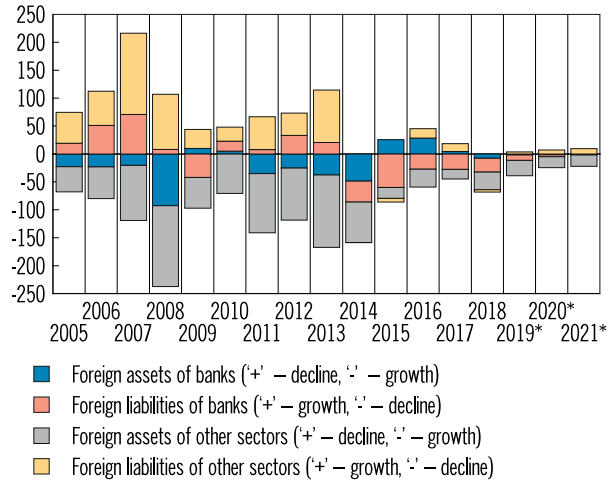
Other assumptions. Other external and internal assumptions in the high oil price scenario mostly coincide with the baseline scenario. However, higher oil prices bring about stronger inflationary pressure caused by expenditures in the real economy sector of oil exporters, which may lead to somewhat faster tightening of the monetary policy in advanced economies than in the baseline scenario. Nevertheless, the scale of this tightening will be less pronounced than the one assumed in Monetary Policy Report 4/18, which is primarily due to the revision of the world economic outlook similar to the baseline scenario.

MAJOR CURRENT ACCOUNT COMPONENTS IN BASELINE SCENARIO *Chart 1.1.12*
(BILLIONS OF US DOLLARS)



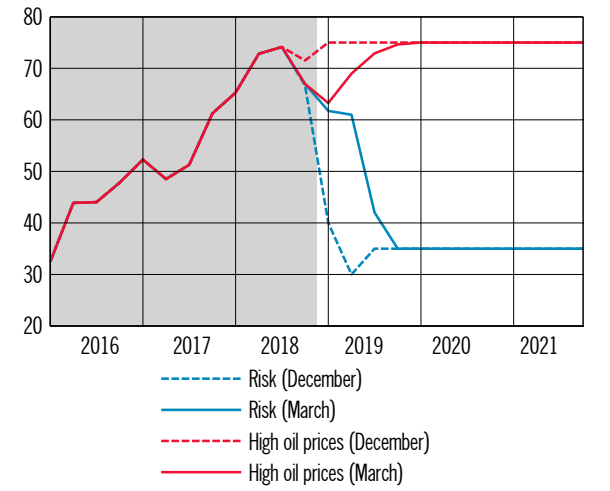
** Forecast in signs according to BPM6.*
Source: Bank of Russia.

MAJOR PRIVATE SECTOR FINANCIAL ACCOUNT COMPONENTS IN BASELINE SCENARIO *Chart 1.1.13*
(BILLIONS OF US DOLLARS)



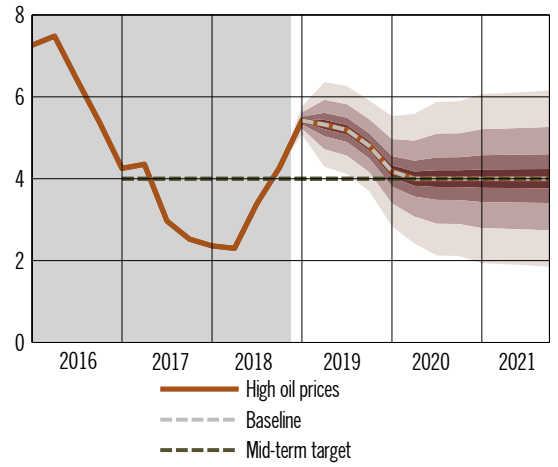
** Forecast.*
Source: Bank of Russia.

OIL PRICE *Chart 1.2.1*
(US DOLLARS PER BARREL)



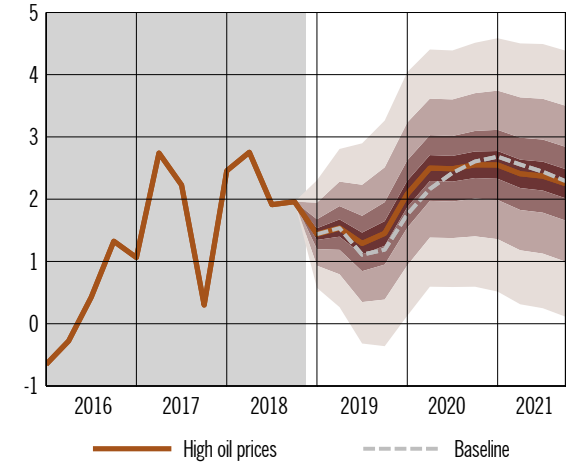
Note: Urals crude nominal prices.
Source: Bank of Russia calculations.

INFLATION *Chart 1.2.2*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



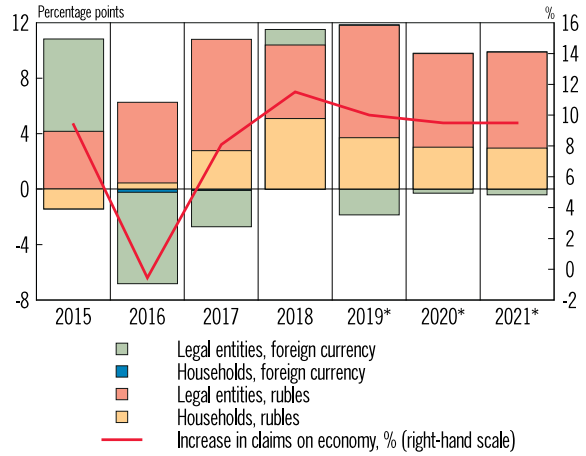
Note: shaded areas on the forecast horizon show the probability of different inflation values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on the historical estimates of inflation uncertainty.
Source: Bank of Russia calculations.

GDP GROWTH RATE *Chart 1.2.3*
(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 the historical estimates of GDP growth rate uncertainty.
Source: Bank of Russia calculations.

DECOMPOSITION OF INCREASE IN CLAIMS ON ECONOMY IN HIGH-OIL-PRICE SCENARIO *Chart 1.2.4*
(CONTRIBUTION TO ANNUAL GROWTH, PP)



** 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.

In the current high oil price scenario, the Bank of Russia provides for the same number of increases in the Fed's base rate and the key rate of the ECB in 2019–2021 as in the baseline scenario. However, these increases will take place a quarter earlier than in the baseline scenario.

In the high oil price scenario, the contribution of the oil and gas tax manoeuvre to annual inflation dynamics in 2019–2021 will also be positive in contrast to the baseline scenario.

MEDIUM-TERM FORECAST

Inflation. Inflation forecast under the high oil price scenario remained close to the baseline forecast; therefore, it was similarly revised downwards for 2019 compared to the December 2018 forecast. A somewhat faster expansion of domestic demand, than in the baseline scenario, along with the oil and gas tax manoeuvre will have a slight upward pressure on inflation in 2019. However, the downward pressure of the exchange rate pass-through will in part offset the effect of these factors on inflation because the ruble will prove somewhat stronger than in the baseline scenario, according to Bank of Russia estimates. In these conditions, in 2019, annual inflation will remain within the same range as in the baseline scenario (4.7–5.2%), while in 2020–2021 it will be close to 4% (Chart 1.2.2).

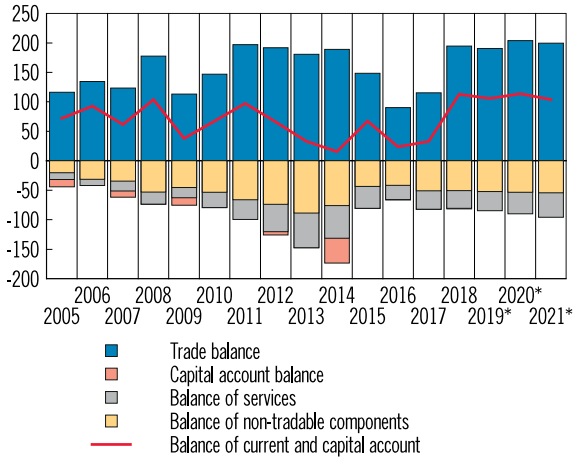
Economy. The estimated economic growth in the high oil price scenario was also close to the baseline scenario due to the effect of the fiscal rule, which smoothed over the influence of oil price fluctuations on the domestic economic environment. At the same time, the dynamics of individual domestic demand components and GDP growth will be slightly higher in 2020 compared to the baseline scenario against the backdrop of increased oil prices, which will provide additional support to business sentiment and consumer and investment activities (Chart 1.2.3). As oil prices in both scenarios will remain stable, their further dynamics will not have any significant additional effect on GDP growth rates.

Monetary indicators. The dynamics of credit and monetary aggregates will stay generally close to baseline scenario levels and will not pose any risks for price and financial stability (Chart 1.2.4). Credit growth rates will vary slightly in 2019–2020.

They will be a bit higher than in the baseline scenario following income dynamics that will grow somewhat faster in the context of higher oil prices. Growth in retail lending will demonstrate a smoother slowdown in 2019–2020. Additionally, on the back of a faster expansion of the banking system's net foreign assets under the high oil price scenario, the growth in money supply over the forecast horizon may slightly exceed the growth in credit to the economy, therefore being higher than in the baseline scenario; however, this will not create any additional inflation risks.

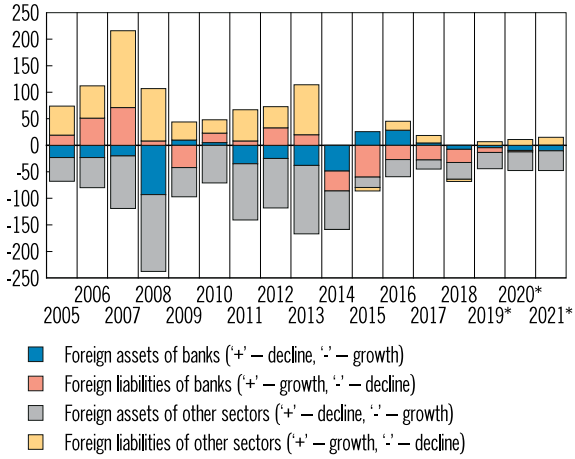
Balance of payments. As in December, the difference between the balance of payment indicators of the high oil price scenario and the ones of the baseline scenario is due to the marked positive effect of higher global oil prices on export volumes in 2019–2021. The current account balance (Chart 1.2.5) over the entire forecast horizon will exceed the baseline scenario and amount to approximately 5–6% of GDP in 2019–2021. The private sector negative financial account balance (Chart 1.2.6) will also be higher than in the baseline scenario and will amount to 2% of GDP in 2019–2021. This will be facilitated by a slightly greater expansion of foreign assets held by Russian companies and banks amid a more significant increase in export revenues. The high oil price scenario assumes that international reserves will show a more sizeable increase compared to baseline scenario projections due to more significant fiscal rule-based foreign currency purchases in the context of higher oil prices.

MAJOR CURRENT ACCOUNT COMPONENTS IN HIGH-OIL-PRICE SCENARIO *Chart 1.2.5*
(BILLIONS OF US DOLLARS)



** Forecast in signs according to BPM6.*
Source: Bank of Russia.

MAJOR PRIVATE SECTOR FINANCIAL ACCOUNT COMPONENTS IN HIGH-OIL-PRICE SCENARIO *Chart 1.2.6*
(BILLIONS OF US DOLLARS)



** Forecast.*
Source: Bank of Russia.

1.3. RISK SCENARIO

FORECAST ASSUMPTIONS

External conditions. In March, risk scenario assumptions remained unchanged compared to the risk scenario released in December. They still suggest a significant deterioration in external conditions over the entire forecast horizon. However, the timing of this deterioration has shifted from the first quarter to the third quarter of 2019.

The risk scenario implies a significant global economic slowdown, which is both long and cyclical by nature. This may be accompanied by increased volatility in global financial markets, a

considerable decline in global risk appetite and a drop in global oil prices to $35 per barrel due to a weaker global demand for energy. The further consolidation of global oil prices at $35 per barrel will be also conditioned on supply-side factors and related to the deteriorating coordination of oil production within OPEC+ and a significant non-OPEC production growth. Such serious changes in external conditions will drag negatively on EMEs, including on Russia. Should the risk scenario materialise, the Russian economy, as other EMEs, will face worse economic growth prospects, a significant increase in its country risk premium and higher capital outflows. An additional factor increasing the scale of capital outflow is the further escalation of geopolitical tension implied by the risk scenario. At the same time, the fiscal rule will smooth the impact of deteriorating trade terms on public finance, the economy and the exchange rate.

MEDIUM-TERM FORECAST

Inflation. The inflation forecast will remain generally unchanged compared to the December 2018 risk scenario. Worsening external conditions will result in a faster capital outflow in 2019 and exert a downward pressure on the current account. This may cause a short-term weakening of the ruble and a surge in exchange rate and inflation expectations. Therefore, in 2019, should the risk scenario materialise, prices may grow at a considerably higher rate than in the baseline scenario. However, a timely response of the monetary policy will help return annual inflation to Bank of Russia's target around 4% by the end of 2020 – beginning of 2021.

Economy. The deterioration of external conditions in 2019 (as implied by the risk scenario), along with proinflationary effects, will cause a short-term contraction in domestic demand. For this reason, the risk scenario forecasts the beginning of an economic slump at the end of 2019. However, the GDP response to the realisation of external risks will be longer than the inflation response, and the recession in the economy will settle until the end of 2020. In 2021, as the economy adjusts to the new external conditions, total output growth will again turn positive and gradually approach baseline scenario levels.

2. INFLATION AND INFLATION EXPECTATIONS

From the end of 2018 through the first two months of 2019, annual inflation grew under the influence of specific factors created by the supply of certain types of food, the weakening of the ruble in the second half of 2018, and the increased VAT starting 1 January 2019. The pass-through of the VAT hike to price dynamics is estimated as moderate, and the indexation of regulated prices and tariffs was in line with planned parameters.

As implied by expectations, food inflation demonstrated the highest growth in this period. As in previous months, this was caused by exchange rate dynamics and the adjustment of individual food products' supply to demand. The low base effect, including price dynamics for fruit and vegetables, made a certain contribution to the increase in annual growth rates. The direct effect of VAT is estimated as minor, as most food products are taxed at a discounted rate.

The annual growth of non-food prices was moderate in late 2018 – early 2019. In February, monthly price growth (seasonally adjusted) returned to the level of September – December 2018 after the January surge mainly due to the VAT increase. The growth of motor fuel prices in January–February was in line with agreements between the Government and major oil companies.

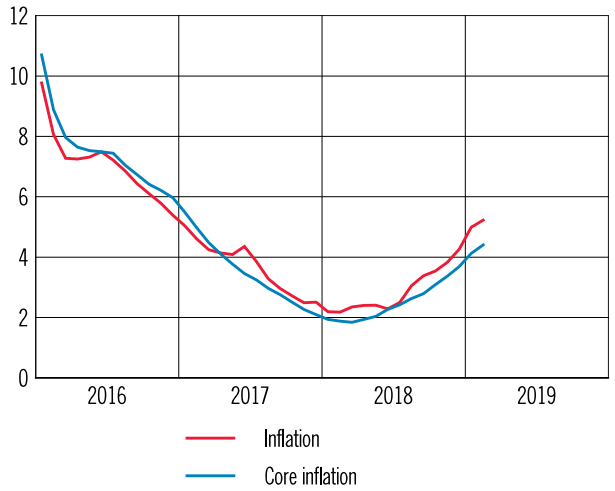
In January 2019, services prices accelerated markedly mainly due to the indexation of utilities following tax changes. In February, monthly rates of appreciation in services (seasonally adjusted) fell noticeably.

A slowdown in price dynamics may indicate that the VAT hike pass-through to prices have been generally completed. However, monthly core inflation, as well as other indicators of price dynamics, cleared of volatility components and seasonally adjusted exceeded 4% y.o.y. in February. Moreover, the possibility that the deferred effects of the VAT hike may manifest themselves in the months to come cannot be ruled out.

Household and business inflation expectations grew from December 2018 through January 2019. In February and March, they decreased, which may suggest that economic agents viewed the accelerated inflation at the beginning of the year as temporary and caused by the one-time effect of the VAT increase. However, their inflation expectations remain elevated and unanchored. Analysts maintain their inflation expectations tied to the Bank of Russia's inflation target near 4%. According to their forecasts, annual inflation will start declining as early as in the second quarter this year and will approach its target range in the first quarter next year.

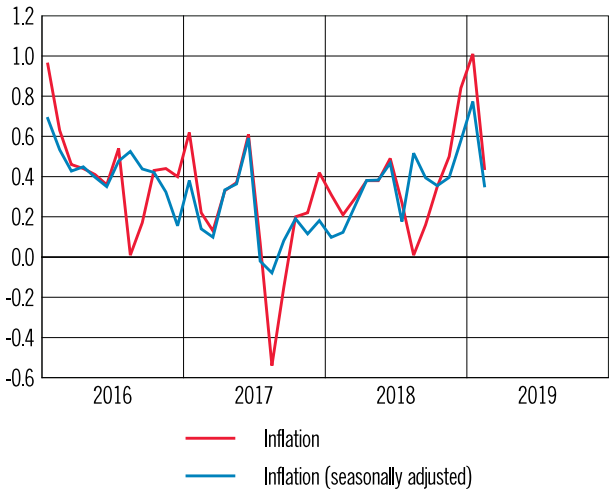
According to Bank of Russia forecasts, annual inflation will pass its peak in March–April on the back of the base effect, reaching approximately 5.5%. Further out, annual inflation will drop down to the Bank of Russia's target near 4%.

INFLATION AND CORE INFLATION
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)
Chart 2.1



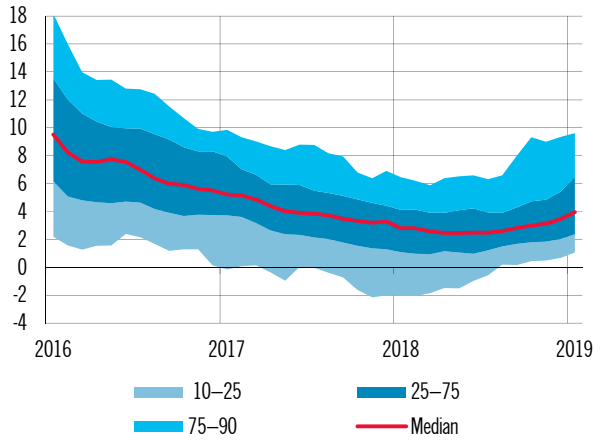
Source: Rosstat.

INFLATION
(PER CENT CHANGE ON PREVIOUS MONTH)
Chart 2.2



Sources: Rosstat, Bank of Russia calculations.

DISTRIBUTION OF GOODS AND SERVICES PRICE GROWTH
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)
Chart 2.3



Sources: Rosstat, Bank of Russia calculations.

In December 2018, the increase in annual inflation observed since June continued. At the end of the year, it came in at 4.3%. The trend towards accelerated growth in consumer prices since the second half of 2018 was primarily shaped by specific supply-side factors in several food products and the weakening of the ruble in the same period. In early 2019, as expected, the VAT hike produced an additional effect.

The base effect also contributed to the growth in annual price dynamics from December 2018 to February 2019, because a year earlier, the growth rates of consumer prices were unusually low predominantly on the back of food product supply-side factors. Consumer behaviour remained conservative and did not create any meaningful proinflationary risks. In February 2019, annual inflation came in at 5.2% (1.4 pp higher than in November 2018, Chart 2.1). Seasonally adjusted monthly inflation slowed down markedly after its acceleration in December and January (Chart 2.2).

The dynamics of volatility components, primarily fruit and vegetables, made a significant contribution to inflation growth from December 2018 to February 2019. In this context, annual core inflation demonstrated weaker growth (at up to 4.4%) than inflation in general (1.0 pp higher compared to November). Underlying inflation indicators demonstrated moderate growth; these reflect price dynamics cleared of the effect of one-time factors. In particular, the median values of annual consumer price growth distributions of consumer prices grew by 1.1 pp and came in at 4.2% in February (Chart 2.3). VAT increase is estimated to have contributed to annual inflation about 0.6-0.7 pp, which corresponds to the lower bound of the Bank of Russia's expectations range (see Box 'Pass-through of VAT hike to inflation').

However, in February, monthly core inflation and other price dynamics indicators, cleared of volatility components (for example, growth in prices for non-food products excluding oil products, core inflation excluding food goods) and adjusted for seasonality were still higher than 4% y.o.y.

According to Rosstat estimates based on current information, on 25 March annual inflation is estimated at 5.2–5.3%, which is in line with the Bank of Russia's baseline forecast trajectory.

Monthly growth in seasonally adjusted consumer prices is estimated as close to the February level, which is lower than in December 2018 – January 2019. The slowdown in price dynamics from February to March suggests that the pass-through of the VAT hike to prices may be considered for the most part complete. However, the deferred effects of the VAT increase may manifest themselves over the coming months.

According to the Bank of Russia's forecast, annual inflation will pass its peak in March–April in part on the back of the base effect, reaching approximately 5.5%. Further ahead, as the effect of temporary factors is exhausted, inflation will drift down to the Bank of Russia's near 4% target.

FOOD PRODUCTS

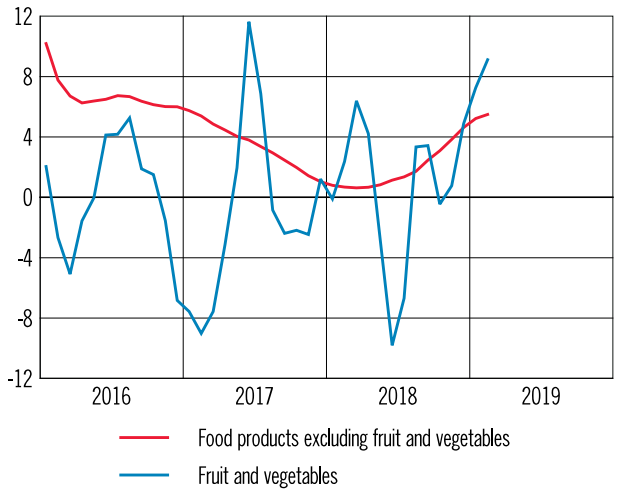
From December 2018 to February 2019, an upswing in inflation was largely attributable to food price dynamics. In February, they were 5.9% higher than a year earlier (3.5% in November 2018). As in previous months, the accelerated growth in food prices was based on such factors as the supply-demand adjustment for certain food products and exchange rate dynamics. The low base effect contributed to some extent to the acceleration of the annual indicator. For example, from January to February 2018, annual food inflation came in at 0.7-0.9% amid highly saturated markets. Thus, from February 2017 to February 2019, accumulated food inflation reached 6.8%, growing by 3.4% annually.

Fruit and vegetables. The increase in food prices from late 2018 to early 2019 was to a greater extent brought about by the acceleration of growth in fruit and vegetable prices, which had an annual rate of 9.1% in February 2019 (Chart 2.4). This was largely attributable to tomato and cucumber price movements characterised by high volatility (Chart 2.5). However, the price for these vegetables (seasonally adjusted) returned to the 2017 H1 levels (Chart 2.6). The extensive promotion of the greenhouse farming helps maintain moderate prices for its products[1].

The pass-through of the VAT hike effected in January–February 2019 to fruit and citrus

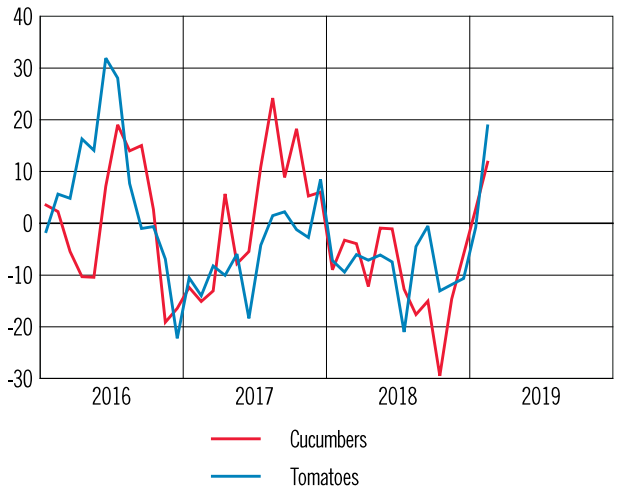
[1] *Over past five years, greenhouse vegetable production by Russian agricultural companies grew by a factor of 1.6. In 2018, their gross output for the first time exceeded 1 million tonnes.*

GROWTH OF FOOD PRICES *Chart 2.4*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



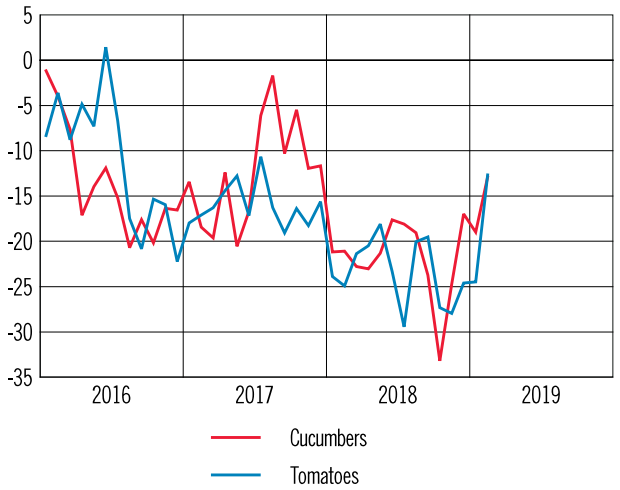
Source: Rosstat.

GROWTH OF TOMATO AND CUCUMBER PRICES *Chart 2.5*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



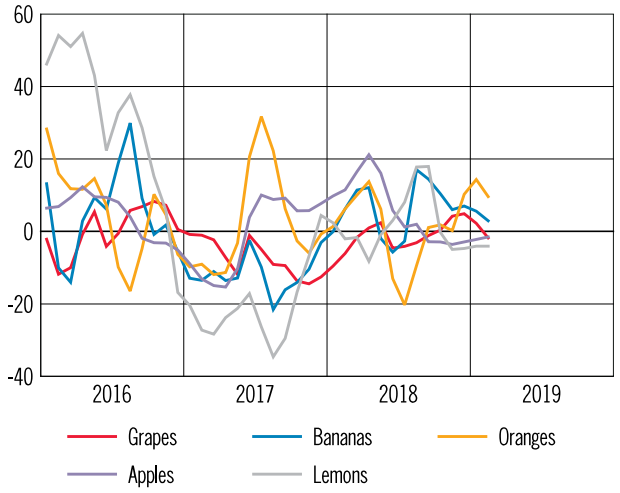
Source: Rosstat.

GROWTH OF TOMATO AND CUCUMBER PRICES *Chart 2.6*
(PER CENT CHANGE ON DECEMBER 2015)



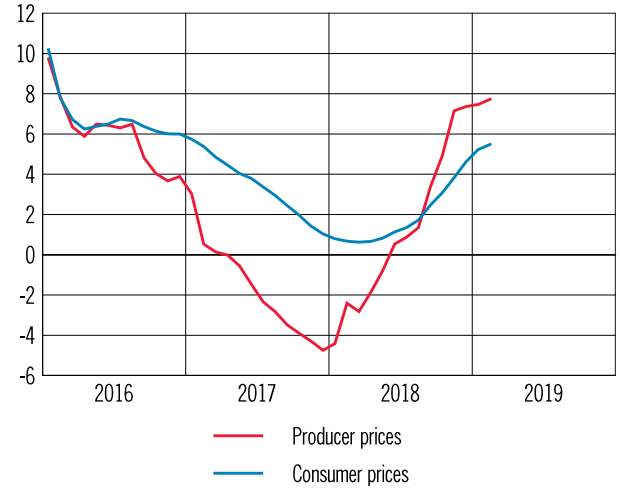
Sources: Rosstat, Bank of Russia calculations.

GROWTH OF FRUIT AND CITRUS FRUIT PRICES *Chart 2.7*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



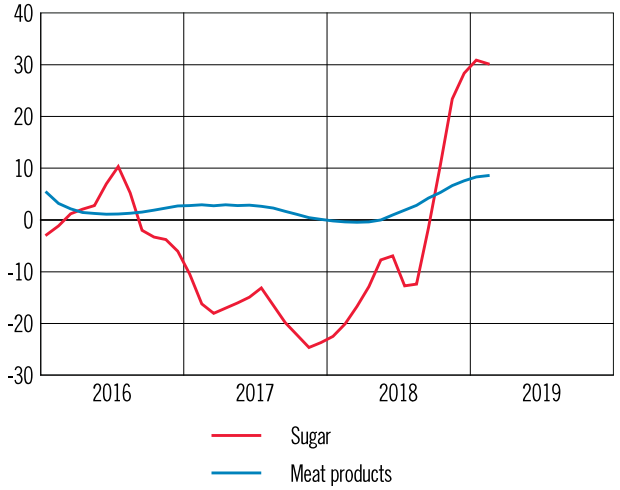
Source: Rosstat.

GROWTH OF PRODUCER PRICES AND CONSUMER PRICES FOR FOOD PRODUCTS* *Chart 2.8*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



** Excluding fruit and vegetables.*
Source: Rosstat.

GROWTH OF SUGAR AND MEAT PRODUCT PRICES *Chart 2.9*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



Source: Rosstat.

fruit prices was apparently compensated by the effect of other factors, including those specific for individual markets. This is evidenced by mixed price dynamics. For example, annual price indices for grapes, bananas and oranges fell, while those for apples and lemons grew (Chart 2.7).

Food products (except fruit and vegetables). From December 2018 to February 2019, the annual growth in consumer prices for the food products group, net of fruit and vegetables, continued exhibiting the same upward trend as producer prices (Chart 2.8).

Such accelerated annual growth in food prices was largely spawned by the further rise of meat prices that started in 2018 H2 (Chart 2.9). In February 2019, they were 8.6% higher than in the previous year (a 6.6% growth in November 2018). Starting mid-2018, meat price movements were largely determined by production adjustments to consumption; in 2015–2017, production expanded at a faster rate than demand. Producers focused on reducing the overhang of market saturation and maintaining profitability. Additional pressure on expenditures on, and prices of, livestock processed products came from the appreciation of fodder prices, including feed grain. Moreover, growth in expenditures was attributable to the weakening of the ruble. These factors (expenditure growth, profitability recovery measures and exchange rate dynamics) also spurred the fast annual growth of egg prices.

Contracted supply also shaped an upward trend in sugar prices. This development came as a result of shrinking crop areas and reduced sugarbeet harvest in the aftermath of the 2017 decline in prices. In February 2019, sugar consumer prices were 30.2% higher than in the previous year. However, it should be noted that despite certain growth, they remain lower than in late 2015 (Chart 2.10).

The growth in grain prices in 2018 H2 resulted in the moderate appreciation of grain-based products. In particular, in 2019, bread and bakery cost by 6.7% more than in the previous year, while the price for pasta and cereals was higher by 5.5%.

At the same time, February's movement of consumer prices for meat products, eggs and sugar suggests a certain weakening in the pressure from supply-side factors. Preliminary cereal crop

forecasts report a good condition of winter crops[2], which suggests a low probability of additional proinflationary risks.

NON-FOOD PRODUCTS

In late 2018 – early 2019, the acceleration of growth in prices for non-food products continued (Chart 2.11). In February 2019, the annual growth in consumer prices reached 4.6% (by 0.4 pp higher than in November 2018).

In January, price growth was faster both y.o.y and m.o.m (seasonally adjusted), which was in part prompted by the effect of the VAT increase. In February, the monthly price growth of non-food goods (seasonally adjusted) returned to the level observed in September–December 2018 (0.3%). This may, in particular, mean that producers and trading companies are restricted in their capacity to pass the increased VAT to prices. The moderate growth in non-food prices generally points to a limited effect of increased VAT on price dynamics.

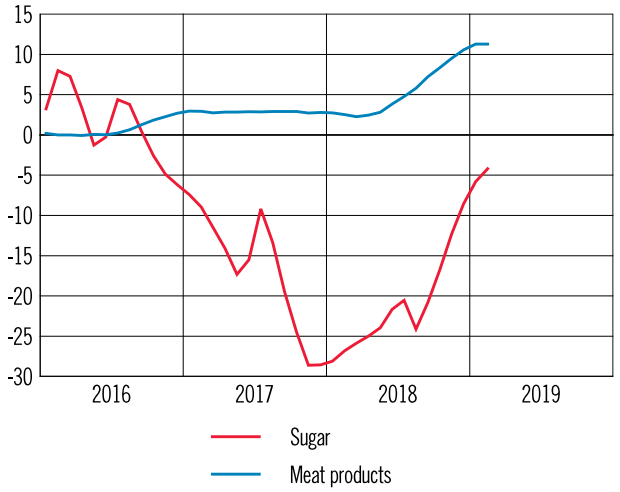
Motor fuel. The growth in prices for the main types of motor fuel (petrol and diesel fuel) in the second half of 2018 – early 2019 slowed down (Chart 2.12) given the fulfilment of agreements with the Russian Government by major oil companies. In December 2018, fuel prices dropped; they grew again by 0.6% in January–February, which is in line with the arrangements achieved for the first quarter. Annual petrol price growth fell by 1.5 pp to 9.8% as compared to November. Gas fuel price was declining starting in October 2018 after its rather fast appreciation in May–September. Overall, these price movements generally correspond to the upward trend in petrol and diesel prices, but exhibit a higher volatility (Chart 2.13).

Other non-food products. In December 2018 – February 2019, the annual appreciation of non-food products (excluding petrol and diesel fuel) grew to 3.9% (0.6 pp higher than in November 2018).

However, price dynamics for individual commodity groups varied substantially (Chart 2.14). Thus, the annual growth in prices for passenger cars, tools and household chemicals demonstrated further acceleration. In contrast,

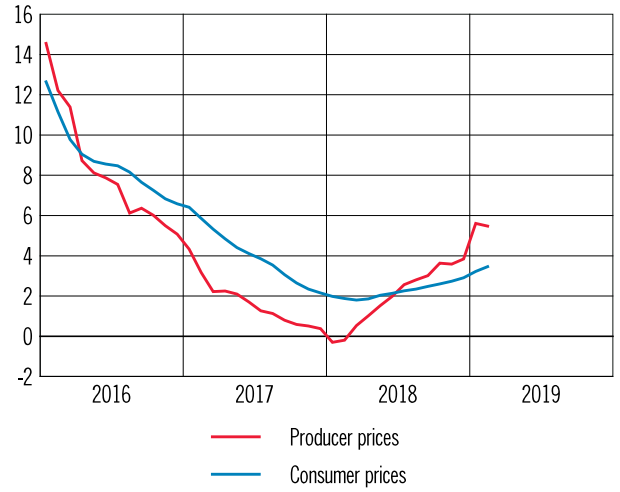
[2] *The current cereal crop forecast of the Ministry of Agriculture is 118 million tonnes, which exceeds the 2018 figure by 5%. Market experts and analysts also expect increased crop volumes.*

GROWTH OF SUGAR AND MEAT PRODUCT PRICES *Chart 2.10*
(PER CENT CHANGE ON DECEMBER 2015)



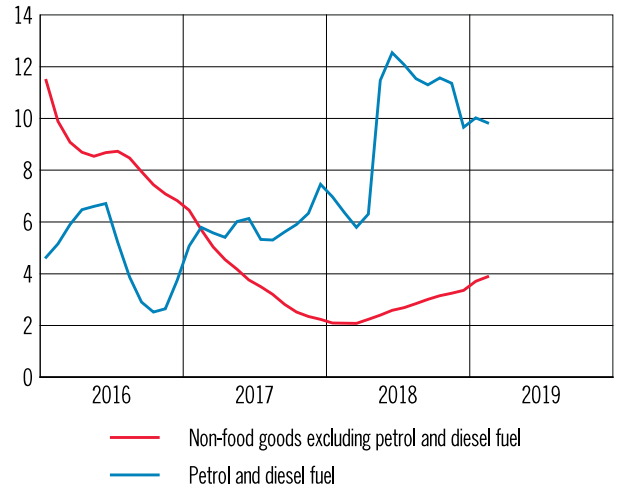
Sources: Rosstat, Bank of Russia calculations.

GROWTH OF PRODUCER PRICES AND CONSUMER PRICES FOR NON-FOOD GOODS *Chart 2.11*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



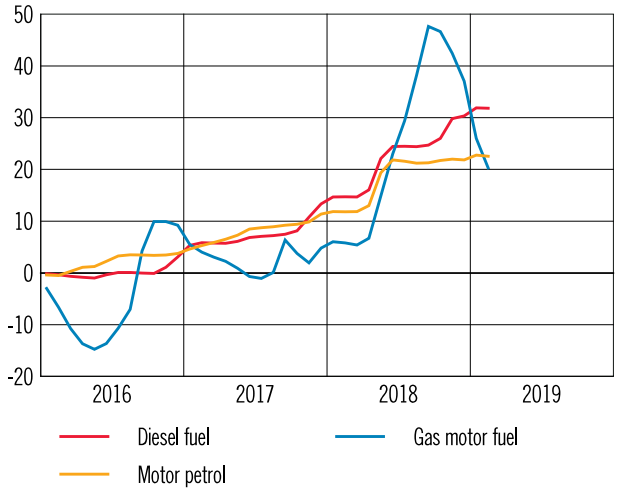
Sources: Rosstat, Bank of Russia calculations.

GROWTH OF NON-FOOD PRICES *Chart 2.12*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



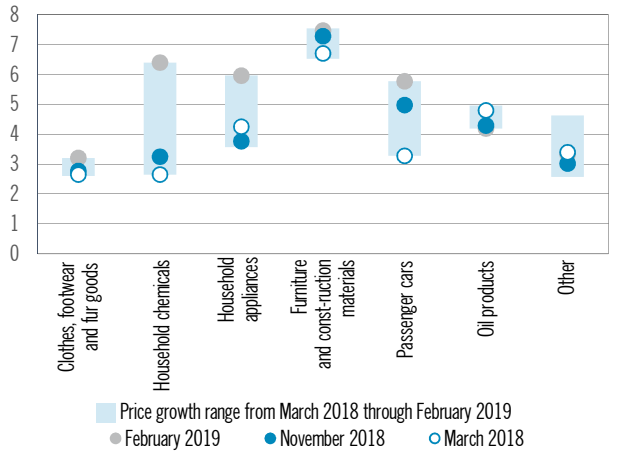
Source: Rosstat.

GROWTH OF OIL PRODUCT PRICES *Chart 2.13*
(PER CENT CHANGE ON DECEMBER 2015)



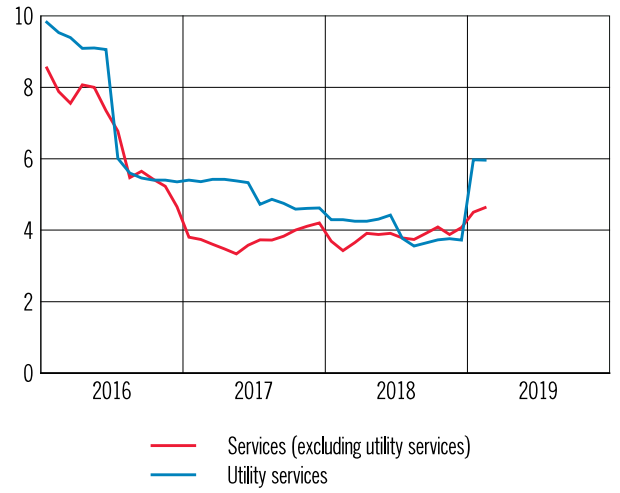
Sources: Rosstat, Bank of Russia calculations.

PRICE GROWTH FOR KEY NON-FOOD PRODUCT GROUPS *Chart 2.14*
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



Sources: Rosstat, Bank of Russia calculations.

GROWTH OF SERVICES PRICES *Chart 2.15*
(PERCENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



Source: Rosstat.

the annual appreciation of footwear, cell phones and TV and radio goods slowed down. This suggests that there are other factors, apart from tax decisions, that had a significant effect on the price developments in non-food products, which include, among other things, households' conservative consumer behaviour.

Monthly growth in prices for non-food products (net of oil products) accelerated in January and was estimated at 0.7% (seasonally adjusted) after the growth by 0.3% in April–December 2018. In February, the pace of appreciation dropped to 0.4%. This slowdown in price dynamics may suggest that the VAT pass-through to prices has largely completed.

However, one shall not rule out that there are still stocks built up before the change in VAT. As contracts are renewed, goods taxable at the new rate will come into the market. Moreover, the muted demand and competition for market share prevent producers and trading companies from quickly passing the tax change on to prices. Given these factors, the deferred effects of tax decisions may become apparent over the upcoming months.

SERVICES

In January 2019, the services prices demonstrated faster annual growth (by 1.1 pp up to 5.0%) after generally stable dynamics in 2018, when they fluctuated within the range of 3.7–4%. This was largely due to the movements in regulated prices and tariffs, primarily for utility services (Chart 2.15). In February, growth in services prices slowed down and its annual rate came in at 5.1%. After the January surge, monthly growth rates (seasonally adjusted) dropped markedly in February (by an estimated 0.9 pp) to 0.3%. This is 0.1 pp below the average level registered in the period from September till December 2018.

Utilities. The accelerated appreciation of services in January 2019 was mainly attributed to the movements in utility tariffs, which were raised by 1.5–1.9%. Their indexation, untypical of this month, was caused by the VAT change. However, the January increase will be offset by the lower indexation of households total utility payments, due in July (2.4%). Hence, the total 2019 rise is poised to hold close to the target rate of inflation.

Moreover, in January many regions experienced a significant increase in tariffs for the disposal of solid household waste (SHW) as part of applicable reforms, and in some regions tariffs were raised two- or even three-fold (Chart 2.16). The Bank of Russia estimated the contribution of increased tariffs for SHW disposal to inflation from 0.001% (the Omsk Region) to 0.4% (the Bryansk Region), with Russia's average indicator being 0.075%.

In February, the annual price growth in this market segment stabilised. In March, individual regions discussed a possible downward revision of tariffs in the coming months, which may in part reduce the contribution of this factor to annual inflation throughout 2019.

Services (excluding utilities). Passenger fares also recorded a noticeable rise in annual growth paces, which has been ongoing since December 2018. The upward trend here was led by urban surface and air transport fares, which must have been to a great degree linked to the delayed impact of the past year's fuel price hikes.

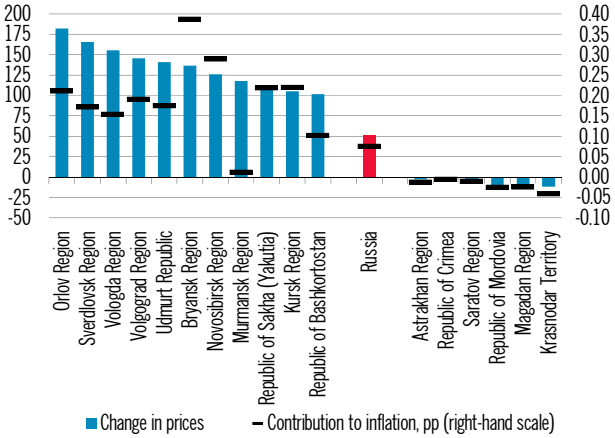
The changes in prices and tariffs for other groups of services were not uniform (Chart 2.17). From November 2018 to February 2019, the highest growth was recorded in prices for communication services, personal services and tourism services (by 0.4–0.9 pp), which reflected the effect of both the exchange rate dynamics and the VAT hike. In contrast, the annual growth in prices for medical services declined (by 0.1 pp).

In February, the overall annual growth in prices for services, excluding utilities, was 4.6%, or 0.8 pp higher than in November 2018.

INFLATION EXPECTATIONS

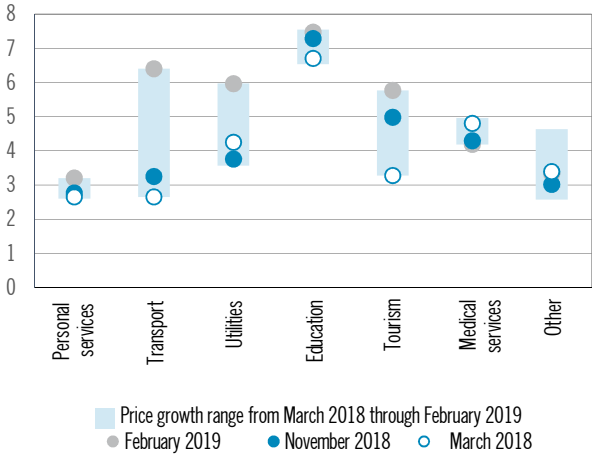
In November 2018 – January 2019, the inflation expectations of economic agents grew in the context of observed price dynamics and their expected acceleration due to the VAT increase in early 2019. From February to March, expectations generally declined. This suggests that the inflation surge attributable to the VAT hike pass-through to prices is mostly complete, and economic agents further expect only a slight adjustment of prices to the new VAT rate. However, household and business inflation expectations remain elevated and unanchored. Professional analysts, in turn,

CHANGE IN SOLID HOUSEHOLD WASTE DISPOSAL PRICES, FEBRUARY *Chart 2.16*
(PERCENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



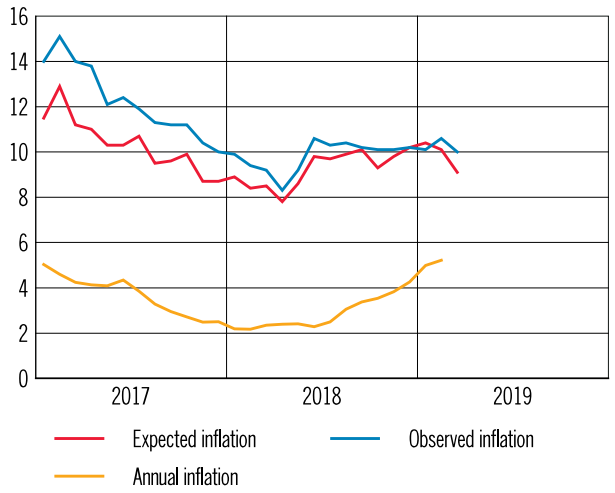
Source: Rosstat.

PRICE GROWTH FOR KEY SERVICES GROUPS *Chart 2.17*
(PERCENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)



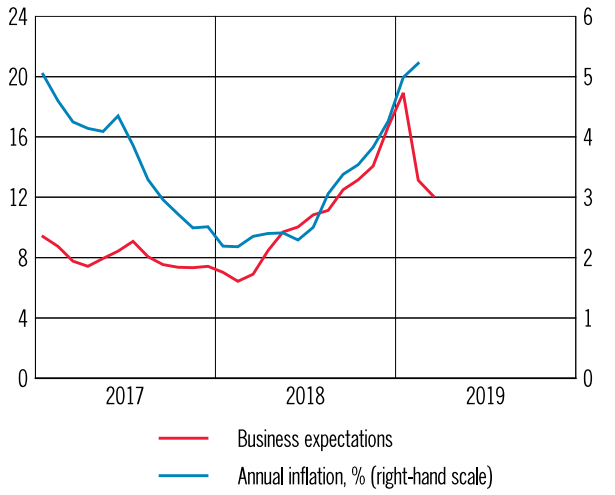
Sources: Rosstat, Bank of Russia calculations.

INFLATION OBSERVED AND EXPECTED BY HOUSEHOLDS *Chart 2.18*
(MEDIAN ESTIMATE, %)



Sources: Rosstat, inFOM.

BUSINESS PRICE EXPECTATIONS *Chart 2.19*
(BALANCE OF RESPONSES, PP)



Sources: Rosstat, Bank of Russia.

forecast inflation to start declining as early as 2019 Q2 to drift down to the 4% level in 2020 Q1.

Household inflation expectations. According to the inFOM surveys commissioned by the Bank of Russia, in November 2018 – January 2019, the median estimate of inflation observed by households remained at the level registered in September 2018 (10.1–10.2%, Chart 2.18). In February 2019, this assessment grew by 0.5 pp to 10.6%. The growth in prices for many goods and services consumed by the population was mentioned more frequently. Nonetheless, in March, the assessment of observed inflation fell to 10%, returning to the level typical of the second half of 2018. The perception of inflation by households generally corresponded to price dynamics formed in the consumer market.

Household inflation expectations for 12 months ahead grew from November to January to reach 10.4%, or the maximum value since August 2017. It follows from respondent answers that expectations were formed under the influence of observed inflation, especially growth in the prices of the most frequently purchased goods (food products and petrol). Concerns were in part related to the possible pass-through effect of the VAT hike to prices. In January 2019 (for the first time since January 2015), expected inflation exceeded observed inflation. This pointed to the elevated concerns of households about future price dynamics.

In February, the median estimate of expected inflation dropped, again falling below observed inflation. In March, the decline continued. This may indicate an improvement in household estimates

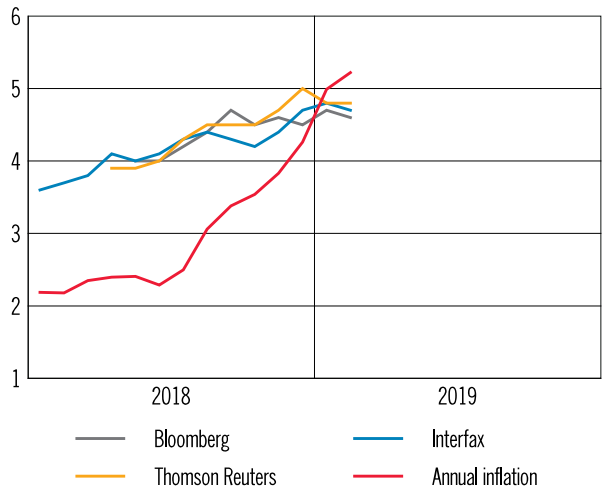
of price dynamics outlook. However, their inflation expectations remain elevated and unanchored.

Business price expectations. According to business surveys carried out by the Bank of Russia[3], in November 2018 – January 2019, businesses demonstrated increased price expectations for three months ahead, as it was the case in the previous months of 2018. This followed the growth in producer prices caused by the weakening of the ruble, increased cost-side pressures (brought about, inter alia, by the fast growth of oil and oil products prices, as well as cereal prices) and the VAT hike in early 2019.

However, in February 2019, business price expectations fell substantially, which was also the case in March (Chart 2.19). The most marked decline in expectations was registered in trade, construction and agriculture. This may indicate that businesses viewed the process of the VAT hike's pass-through to prices as mostly complete. However, their price expectations, as well as household inflation expectations, remain unanchored.

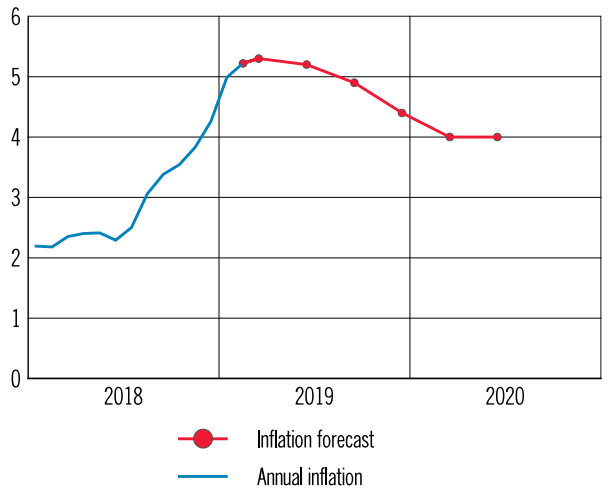
Analysts' inflation expectations. From late 2018 to early 2019, experts raised their forecasts regarding inflation for the end of 2019 (Chart 2.20). In February, the forecast range narrowed slightly to 4.7–5.1%. That said, both analysts and the Bank of Russia believe that inflation acceleration in 2019 is temporary by nature. Their long-term forecasts remain linked to the inflation target. According to their forecasts, annual inflation is set to start declining in 2019 Q2 to return to around 4% in 2020 Q1 (Chart 2.21).

CHANGE IN 2019 INFLATION FORECASTS *Chart 2.20*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



Sources: Bloomberg, Thomson Reuters, Interfax, Rosstat.

ANALYSTS' FORECAST THROUGH MID-2020 *Chart 2.21*
(MEDIAN ESTIMATE, %)



Sources: Bloomberg, Rosstat.

[3] *For more information about the survey, see the Analysis of Price Expectations of Companies (December 2018), http://www.cbr.ru/Content/Document/File/62829/analysis_18-12.pdf. The aggregate index is a balance of replies, i.e. the difference in the share of respondents who expect that prices will increase, and those expecting prices to decrease.*

3. MACROECONOMIC CONDITIONS

The external conditions for the development of the Russian economy in late 2018 and early 2019 were quite favourable. In January–February 2019, Urals crude price exceeded the level set in the baseline scenario of Monetary Policy Report 4/18. Overall external inflationary pressure also remained low. There was a decrease in expectations regarding the tightness of financial conditions in advanced economies. Country risk premiums for EMEs, including Russia, normalised.

The ruble exchange rate in late 2018 and the first months of 2019 remained relatively stable and was somewhat stronger than the rate the Bank of Russia had expected when preparing the December forecast.

Since the beginning of 2019, monetary conditions in Russia have not seen any significant changes. The growth of deposit rates continued, which supported the attractiveness of deposits for depositors. The lending market also saw an increase in interest rates, albeit unstable and heterogeneous. Following the positive dynamics of sentiment in foreign and domestic financial markets, participant expectations regarding the level of long-term rates also decreased in January and February.

At the end of 2018, GDP growth rate was higher than forecast by the Bank of Russia. This can be attributed both to a number of temporary factors affecting the Russian economy during this period, and to a significant refining of Rosstat data regarding the volume of construction work in the Russian economy.

In late 2018 and during the first months of 2019, the moderate increase in production activity continued. The expansion of investment activity remained unstable, while also demonstrating mixed dynamics of its various indicators. Consumer activity was moderate in the context of unstable dynamics of household real income, as well as the VAT hike introduced in January and a temporary pick-up in inflation. Demand was supported by a persistent growth in retail lending. In late 2018 – early 2019, the labour market was close to equilibrium, with the dynamics of its main indicators meeting Bank of Russia expectations.

According to the Bank of Russia's forecast, in 2019 Q1–Q2, GDP will continue to grow at a moderate pace in the context of muted growth rates in domestic (investment and consumer) and external demand.

Situation in the corporate sector of the economy has remained generally stable. The financial standing of legal entities predominantly improved in 2018. Corporate debt burden continued to decline, including in the context of moderate growth in corporate lending.

At the end of 2018, the budget of the general government was reconciled with a surplus for the first time since 2012. The Bank of Russia assesses the financial position of the general government in 2018 as constraining. In 2019 and over the medium-term horizon, according to Bank of Russia estimates, the share of investment expenses of the general government will gradually expand, including as part of the implementation of national objectives and priority projects (see Section 'Economic outlook').

3.1. EXTERNAL CONDITIONS AND BALANCE OF PAYMENTS

GLOBAL ECONOMY

Economic growth worldwide. Between December and February, economic slowdown continued both in advanced economies (AEs) and emerging market economies (EMEs). Thus, in 2018 Q4, annual GDP growth rates slowed down for such Russia's trading partners as the euro area and China. In the euro area, they went down from 1.6 to 1.2% y.o.y and growth for 2018 as a whole was the lowest over the past four years, totalling 1.8% (2.4% in 2017). In China, the main slowdown was in 2018 Q3 (from 6.7 to 6.5%), in Q4, the 'soft landing' of the economy continued (6.4%), and growth for the entire year totalled 6.6% (6.7% in 2017), which is the lowest value for the past 28 years.

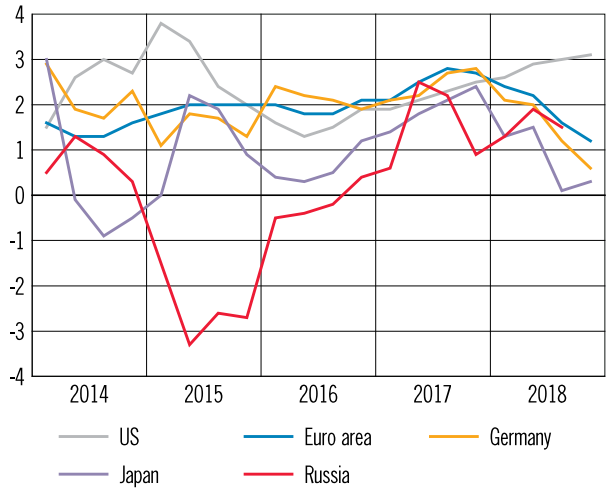
As noted in Monetary Policy Report 4/18, changes in trade agreements, risks associated with the introduction of new tariffs, and the deterioration of economic expectations primarily affect export-focused economies, such as China or Germany, the leading economy of the euro area, where quarterly GDP growth in Q4 was 0% after a 0.2% decline in Q3. The German economy is in effect balancing between stagnation and recession. Its growth rate has weathered an additional negative impact from the temporary contraction in the automotive industry output due to the transition to new environmental standards.

In the US, annual GDP growth rates remain at a high level (3.1% y.o.y in Q4), but quarterly data suggest that the effect of the fiscal stimulus on the economy is fading.

Among other major economies, high growth rates persist in India, where GDP growth rates were 6.6% (7% in Q3). A slowdown in Q4 was recorded in Canada, Mexico, and Brazil.

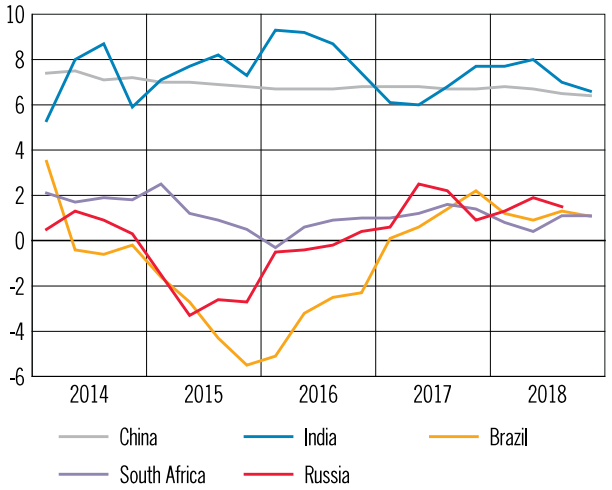
PMI indicators show a further slowdown in economic activity at the beginning of this year in most AEs and EMEs, including in the euro area and China. In February, the slowdown in the euro area was suspended due to the services sector (PMI rose from 51.2 to 52.3); however, this downward trend continued in industry (PMI dropped from 50.5 to 49.2). In the US, economic activity fell from high to normal levels.

GDP GROWTH RATE: ADVANCED ECONOMIES AND RUSSIA *Chart 3.1.1*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



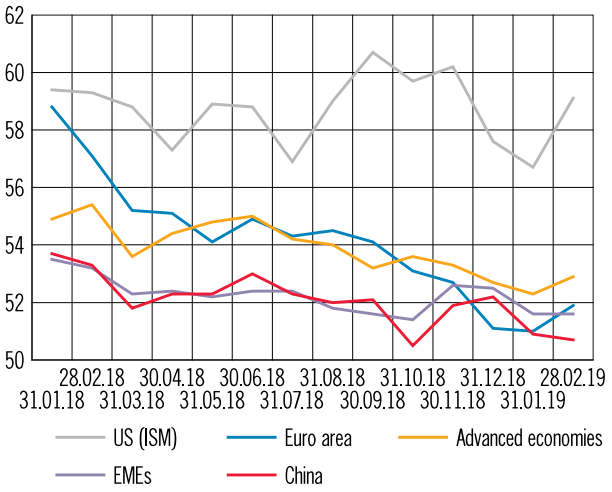
Source: Bloomberg.

GDP GROWTH RATE: EMEs AND RUSSIA *Chart 3.1.2*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



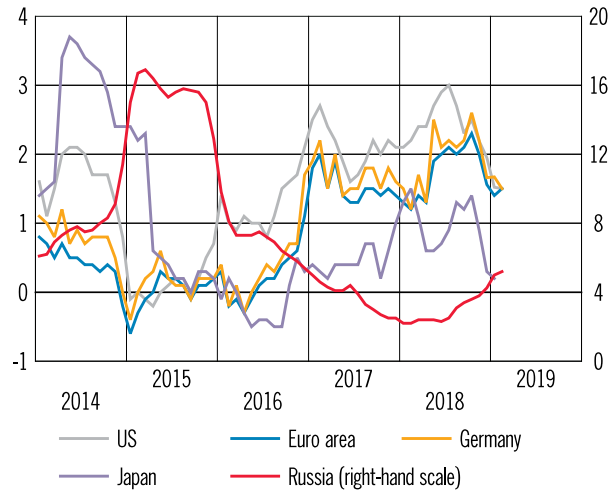
Source: Bloomberg.

DYNAMICS OF PMI COMPOSITE *Chart 3.1.3*
(POINTS)



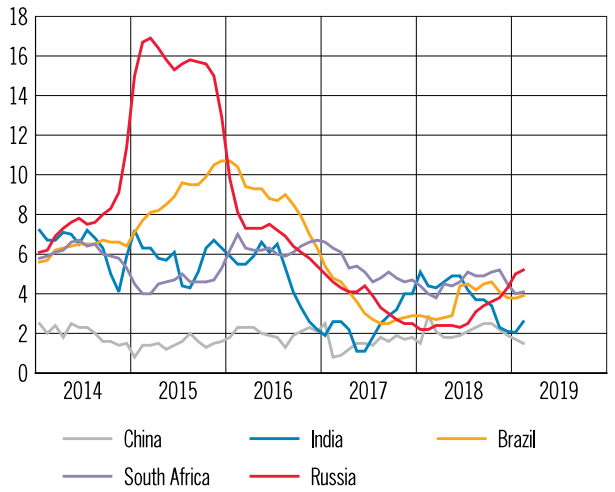
Source: Bloomberg.

INFLATION: ADVANCED ECONOMIES AND RUSSIA *Chart 3.1.4*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



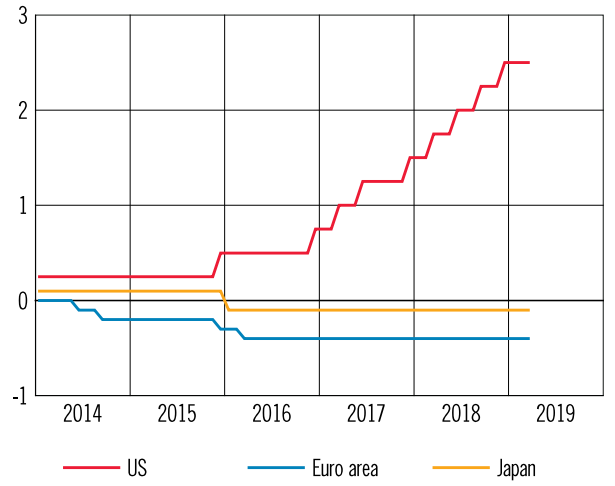
Source: Bloomberg.

INFLATION: EMEs AND RUSSIA *Chart 3.1.5*
(PER CENT CHANGE ON CORRESPONDING PERIOD OF PREVIOUS YEAR)



Source: Bloomberg.

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



Source: Bloomberg.

Inflation worldwide. External inflationary pressure from December through February remained as a whole relatively low in AEs and most EMEs (Charts 3.1.4 and 3.1.5). In the US, annualised inflation slowed down in February to 1.5% (1.9% in December) and slightly accelerated in the euro area to 1.5% (1.4% in December). Among other AEs, price growth rates declined in Canada and Australia, and in Japan inflation once again approached zero. Among large EMEs, in China inflation dropped to 1.7% in February (1.9% in December), and in India price growth rates accelerated from 2% in January (the lower bound of the inflation target range) to 2.6% in February. As lower energy commodity prices translate into consumer prices (compared to last year's maximums), economic growth slows down across major global economies, and inflationary pressure is set to remain muted.

MONETARY POLICIES OF FOREIGN CENTRAL BANKS

At the beginning of the year in response to a slowdown in growth rates and downward adjustment of growth forecasts for 2019-2020 in most countries, monetary authorities suspended the tightening of their monetary policies. A certain role was also played by the volatility of global financial markets in late 2018, which manifested itself primarily in a significant decrease in US stock indices.

The monetary policy of the US and the euro area. In December, for the fourth time in 2018, the Fed raised the rate by 25 bp. However, the signs of slowdown in the global economy and decline in the US stock market led to a significant softening of the regulator's rhetoric regarding both further normalisation and balance-sheet reduction parameters in January to March. The chart (dot plot) of the expectations of the members of the Federal Open Market Committee published following the 19-20 March meeting shows that the median of expectations corresponds to the unchanged target rate for federal funds in 2019 (two increases were expected in December) and forecasts only one increase – by 25 bp in 2020 (as it was the case in December). The long-term target rate level remained at 2.75%. The process of the Fed's balance sheet reduction will slow

down after May and stop at the end of September this year.

At the end of 2018, the ECB completed its quantitative easing programme; however, in March, amid a downturn in economic activity in the euro area, it announced additional incentives in the form of a new round of the targeted long-term refinancing operations (TLTRO III). At the same time, it was confirmed that this year there will be no rate increase in the euro area.

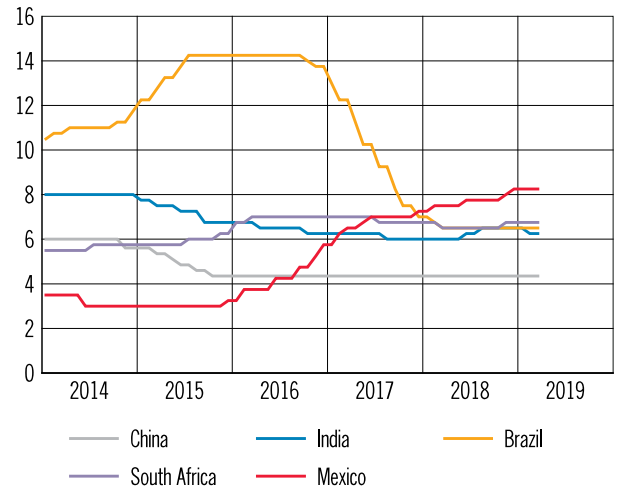
Monetary policy in other countries. Speaking about other countries, policy rates were raised in Mexico (following the lead of the US), Chile, and Thailand. In India, as inflation approached the lower bound of the target range, the key rate was reduced by 0.25 pp to 6.25%.

GLOBAL FINANCIAL MARKETS

Currencies. The index of EMEs' currencies to the US dollar strengthened noticeably in January, returning to mid-2018 levels, and then stabilised in a narrow range in February and March. The volatility of most currencies has decreased significantly compared to Q4. The currencies of the countries experiencing the greatest pressure in Q3 (Turkey and Argentina) remained stable against the US dollar in December and January due to the implementation of tight monetary policies and governments' efforts. The weakening of the Argentine peso resumed in February due to the acceleration of inflation and the deterioration of economic data, but did not lead to significant changes in the exchange rates of other Latin American currencies. The dynamics of the currencies of the AEs were mixed. The change in the expected level of interest rates in the US contributed to the weakening of the American currency against such currencies as the Japanese yen and the British pound. At the same time, the weakness of economic data from the euro area did not allow the European currency to strengthen.

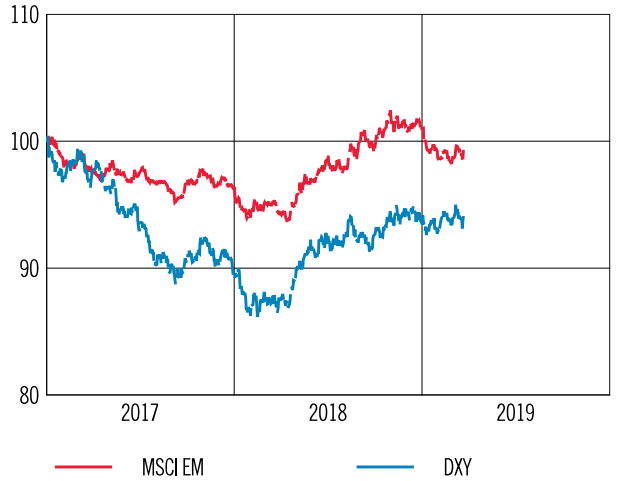
Interest rates. The slowdown of global economic growth and the decline in global energy prices alleviated inflationary pressure on most advanced and emerging economies. This lowered expectations for the pace of monetary policies' tightening in the US and other countries, softened the rhetoric of the largest central banks, and reduced debt market interest rates. As a result,

POLICY RATES, EMEs *Chart 3.1.7*
(%)



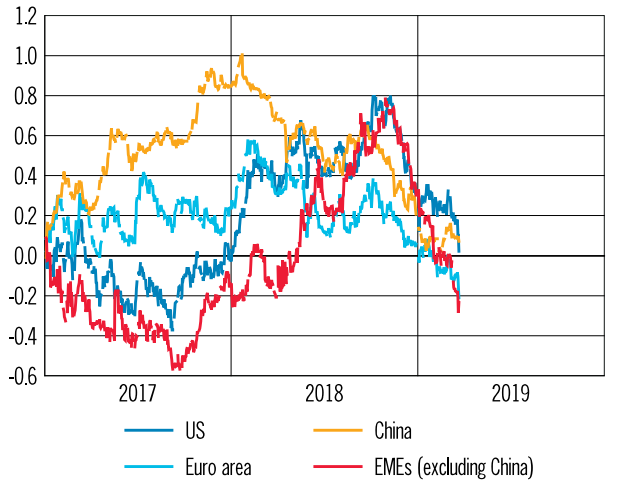
Source: Bloomberg.

US DOLLAR EXCHANGE RATE AGAINST ADVANCED ECONOMIES' AND EMEs' CURRENCIES *Chart 3.1.8*
(100 = 1.03.2017)



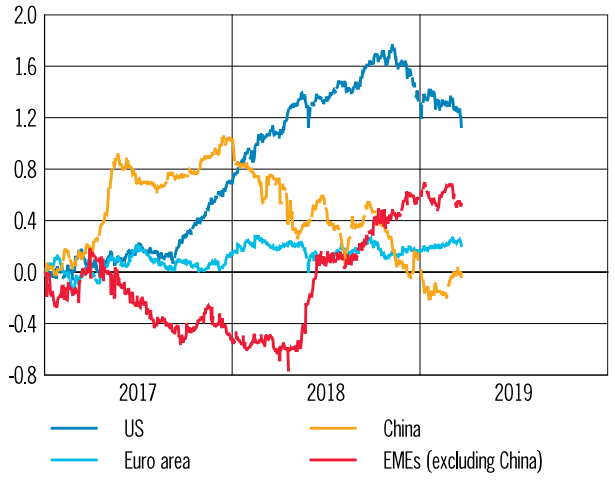
Sources: Thomson Reuters, Bank of Russia calculations.

YIELDS ON 10-YEAR GOVERNMENT BONDS *Chart 3.1.9*
(CHANGE ON 03.01.2017, PP)



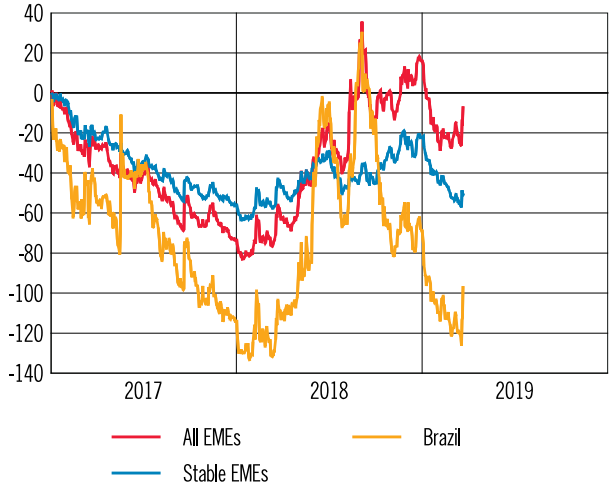
Sources: Thomson Reuters, Bank of Russia calculations.

YIELDS ON 2-YEAR GOVERNMENT BONDS *Chart 3.1.10*
(CHANGE ON 03.01.2017, PP)



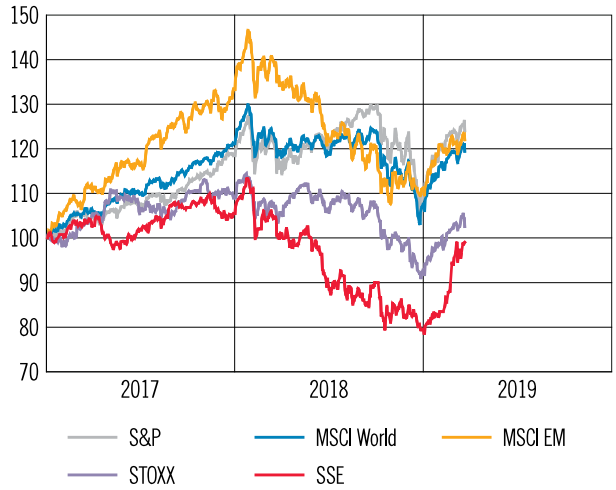
Sources: Thomson Reuters, Bank of Russia calculations.

CDS OF EMEs *Chart 3.1.11*
(CHANGE ON 03.01.2017, BP)



Sources: Thomson Reuters, Bank of Russia calculations.

STOCK INDICES *Chart 3.1.12*
(100 = 3.01.2017)



Source: Thomson Reuters.

the yield on 10-year US government bonds fell below 2.50% after the Fed's meeting on 19-20 March, which means the inversion of the yield curve of US government bonds on 3-month / 10-year intervals. Yields declined across all major euro area countries, as well as in the UK and Japan. The yield of government bonds with a shorter maturity remained more stable, having decreased significantly only in the US (in the range 2.5–2.6% for two-year debt) following the revision of the number of increases already in 2019-2020, and in Italy (it consolidated below 0.7%) due to decrease in political risks and the achievement of budget agreements with the European Commission. In EMEs (including Turkey and Brazil), the yields in the debt market have also predominantly declined since the end of December.

Country risk premiums. In the largest AEs, the market for credit default swaps has remained stable since mid-December, the cost of 5-year contracts has changed insignificantly. In Italy, the cost of insurance against the sovereign default remained volatile because of persistent political risks; and the average level of risk premium remained substantially below the level of Q4 after Italy reached compromise with the European Union over its budget. In EMEs, the cost of 5-year credit default swaps has significantly dropped since the end of December. For 'stable' EMEs, they returned to levels observed in the first six months of 2018. Normalisation of risk premiums in EMEs occurred along with the reduction of expectations for tight financial conditions in AEs, as well as due to the progress achieved in the US-China trade negotiations and the mitigation of risks to international trade.

Stocks. Most global stock exchanges dipped to local minimum levels in 2018 in the last weeks of December; thereafter stock markets of both the AEs and EMEs rebounded. In January–March, most of the EME indices were able to return to the beginning of Q4, and in some countries, particularly in China, they significantly exceeded them. Stocks of AEs recovered slightly slower due to a more pronounced decline in the economic growth expectations for 2019-2020.

GLOBAL COMMODITY MARKETS

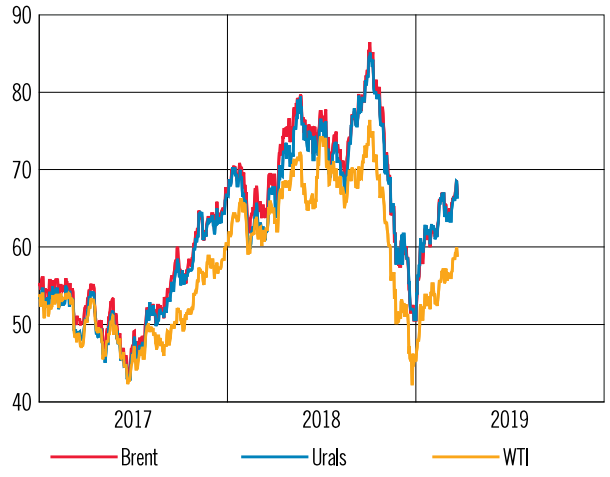
Oil. After a decline in late 2018, world prices of oil, Russia's key export commodity, grew during the first months of 2019. On March 20, the Urals crude price hit its maximum of $69 per barrel since the beginning of the year, with the average price coming in at $63 per barrel in January–March. This significantly exceeds $55 per barrel for 2019, which the Bank of Russia included in the baseline scenario in Monetary Policy Report 4/18. Due to these dynamics, the oil price assumptions for 2019 were revised. The main reason for these dynamics was a significant reduction in the production by OPEC, both within the framework of the OPEC+ agreement reached in December and as a result of Venezuela and Iran sanctions. At the same time, oil consumption forecasts for 2019 are being revised downwards.

Oil – global demand. Support for oil prices from global demand has weakened. According to the IEA, the expansion of demand has slowed from 1.5 million barrels per day in 2017 to 1.3 million barrels per day in 2018 in the context of sluggish economic growth in China and the euro area. At the same time, growth in US oil consumption accelerated amid the economic upswing fueled by the accommodative fiscal policy.

Oil – OPEC+. The decrease in OPEC oil production in January and February by more than 1.5 million barrels per day compared to October was primarily ensured by a very good level of compliance with the agreements reached in December. At the same time, Saudi Arabia and some other OPEC members overperformed their obligations. Saudi Arabia allowed production to drop in March to 9.8 million barrels per day, which meant an additional reduction in excess of the agreed volume by 0.5 million barrels per day. The decline in production by non-OPEC countries also supported oil prices. For example, according to the Ministry of Energy of the Russian Federation, Russia has already cut oil production by about 100,000 barrels per day since October.

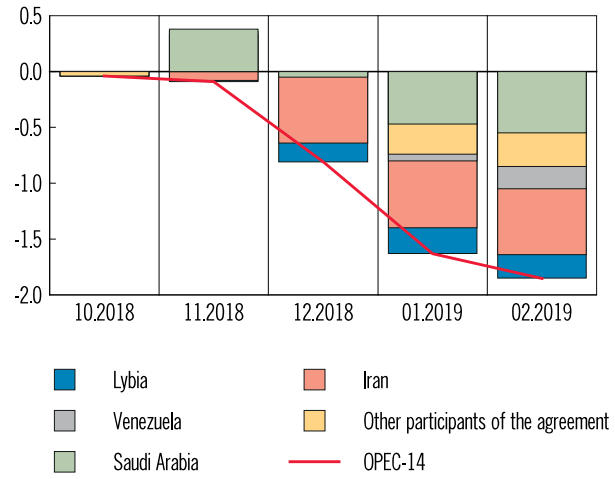
There was also a noticeable decline in oil production in Venezuela due to the introduction of new sanctions by the US. Venezuela is forced to stop crude oil supplies to the US as a result of restrictions causing all payments due to the Venezuelan state-owned company to be credited

OIL PRICES
(US DOLLARS PER BARREL)
Chart 3.1.13



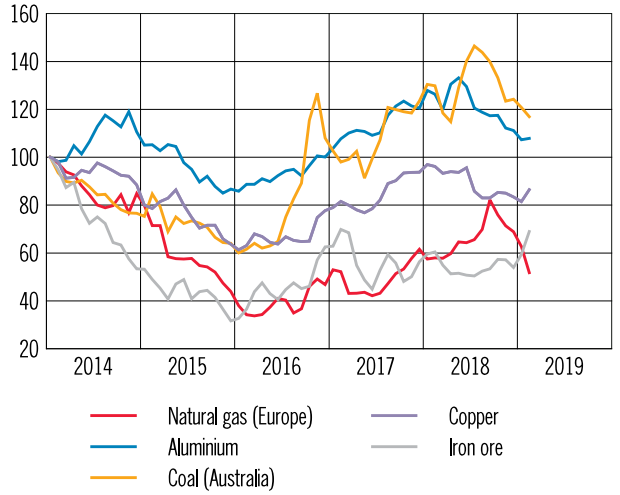
Sources: Thomson Reuters, Bloomberg.

CHANGE IN OPEC CRUDE OIL PRODUCTION SINCE OCTOBER 2018*
(MILLION BARRELS PER DAY)
Chart 3.1.14



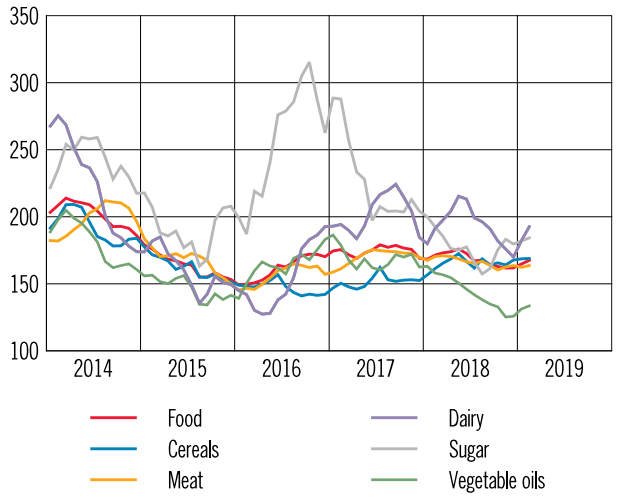
** For Kuwait – since September 2018.*
Source: calculations based on OPEC secondary source data.

WORLD PRICES OF RUSSIAN PRINCIPAL EXPORT COMMODITIES
(JANUARY 2014 = 100%)
Chart 3.1.15



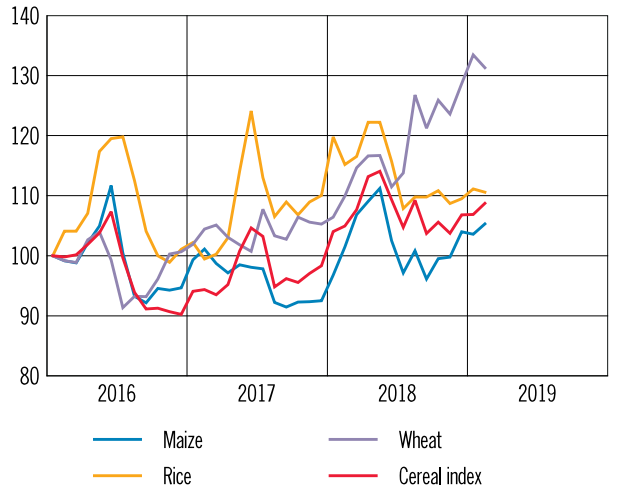
Source: World Bank.

WORLD FOOD PRICES
(2002–2004 гг. =100%)
Chart 3.1.16



Source: UN Food and Agriculture Organization (FAO).

WORLD CEREALS PRICES
(JANUARY 2016 г. = 100%)
Chart 3.1.17



Sources: World Bank, Bloomberg.

only to blocked accounts. The ban on light crude imports from the US, which is required to dilute Venezuelan extra heavy oil, further restricts oil blend exports from Venezuela. US sanctions also adversely affected Iran's production, which has dropped by more than 0.5 million barrels per day since October. At the same time, it stabilised in January and February against the background of easing US requirements for the importers of Iranian oil.

Oil – production outside of OPEC+. At the same time, the prices experienced a marked downward pressure from the increase in oil supply in non-OPEC countries that do not participate in the agreement (Brazil, US and others). US production and exports rose to record highs amid the construction of pipelines from oil fields to ports. Further out, it is expected that the increase in US oil supplies will continue but at a slower pace on the back of companies' capital cost-cutting plans. Their expansion will be also constrained by a decline in drilling activities, which began in late 2018.

Situation in other commodity markets. The dynamics of world prices for other key Russian export commodities were mixed (Chart 3.1.15). In February, the price of natural gas in Europe fell to its lowest level since the fall of 2017 due to the warm winter. In January and February, world prices for iron ore increased due to accident-related interruptions in supplies from Australia and Brazil. At the same time, aluminum prices dropped amid concerns about China's economic slowdown and the lifting of US sanctions imposed against RUSAL. World coal prices continued to decline because of China's restrictions on its imports.

Food products. The dynamics of world food prices still do not drag heavily on inflation in Russia, especially against the background of the low share of imports in the consumption of a number of food products[1]. In January and February 2019, the FAO global food price index remained below last year readings. Its growth by 3% by December was due to an increase in prices for dairy products against the background of limited exports from Europe and expectations for the seasonal decrease in exports from Oceania. World cereal prices also rose in the

[1] *According to Rosstat, in 2018 Q1–Q3, the share of imports in Russia's commodity resources of meat and poultry was 8%, cheese – 28%, and vegetable oils – 18%.*

context of declining wheat exports in the Black Sea region and concerns about the disruption of corn supplies. El Nino natural phenomenon may affect some regions, but FAO does not expect its overall effect to be significant.

BALANCE OF PAYMENTS OF THE RUSSIAN FEDERATION

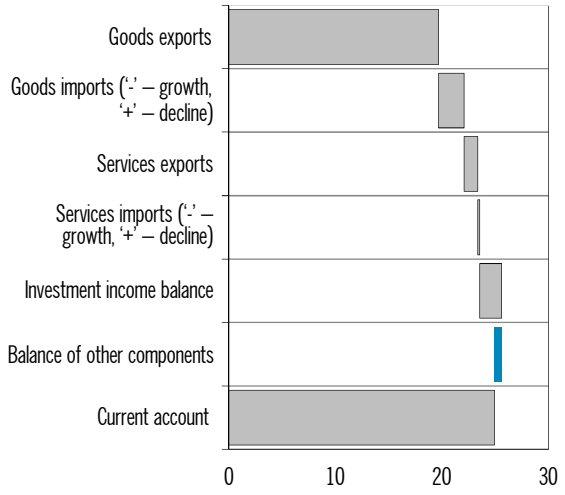
Current account. In 2018 4Q, the current account surplus grew by $25 billion[2] to $38 billion ($114 billion or 7% of GDP for 2018 as a whole). The main factor underlying the expansion of surplus was the increase in exports amid high energy prices. Another significant factor was a reduction in the imports of goods and improvement in the balance of investment income. According to operational data, in January–February 2019, the current account surplus was $22 billion ($116 billion for the past 12 months).

Exports. Amid the decline in global prices for many commodities by the end of 2018, growth in goods and services exports slowed down from 28% in Q3 to 18% in Q4. The increase in oil export quantities was shaped by the build-up of Russia's oil production which occurred prior to the time when the new arrangements were reached by OPEC+ in December 2018. In the European market, Russia remained the largest supplier with a share in EU imports of about 30%, according to Eurostat data. At the same time, US competition has exacerbated. The weight of the US in EU oil and oil products imports rose to 6% (4% a year earlier). Following growth in previous periods, the export quantities of Russian gas declined in 2018 4Q due to high base effect and against the background of the weakening economic growth of key importers – Germany and Turkey. The growth in the value of non-oil and gas exports of goods slowed to 5% from 9% in Q3 amid a drop in the grain harvest from the 2017 record highs and a less favourable situation with metals. In January–February 2019, the value of goods and services exports declined slightly in the context of lower oil prices compared to January–February 2018.

Imports. The volume of goods and services imports in 2018 4Q contracted by 3% given a 7% decline in the ruble real effective exchange

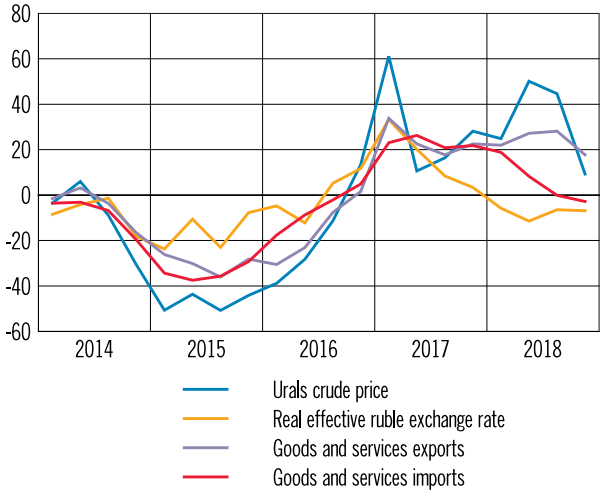
[2] *Here and below, changes are relative to the corresponding period of the previous year, unless otherwise indicated.*

GROWTH STRUCTURE OF CURRENT ACCOUNT BALANCE IN 2018 Q4 *Chart 3.1.18*
(BILLIONS OF US DOLLARS ON CORRESPONDENT QUARTER OF PREVIOUS YEAR)



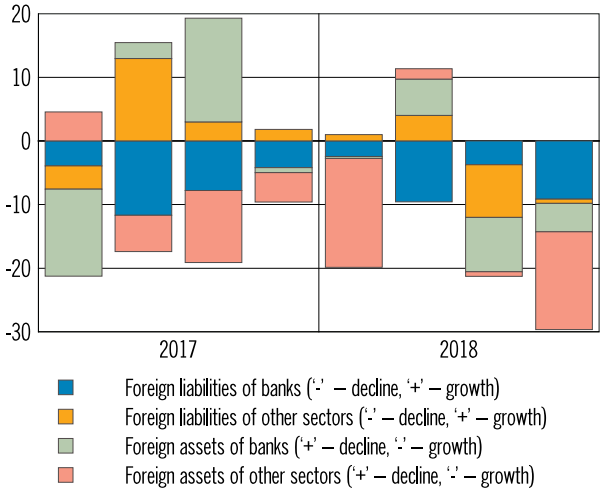
Source: Bank of Russia.

FOREIGN TRADE *Chart 3.1.19*
(PER CENT CHANGE ON CORRESPONDING QUARTER OF PREVIOUS YEAR)



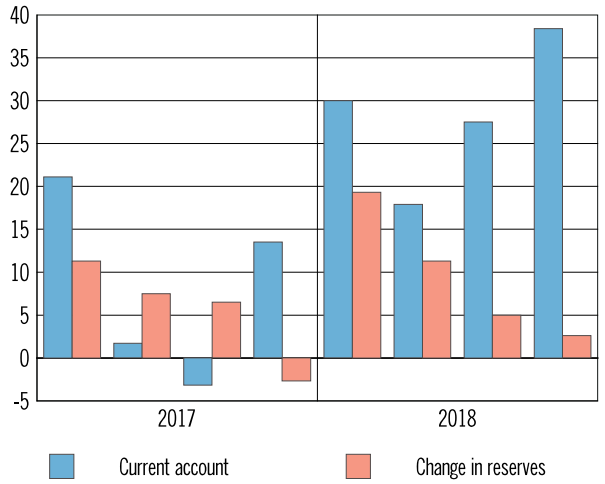
Sources: Bank of Russia, Thomson Reuters.

MAJOR PRIVATE SECTOR FINANCIAL ACCOUNT COMPONENTS *Chart 3.1.20*
(BILLIONS OF US DOLLARS)



Source: Bank of Russia.

RESERVE ASSETS AND CURRENT ACCOUNT *Chart 3.1.21*
(BILLIONS OF US DOLLARS)



Source: Bank of Russia.

rate. At the same time, imports contracted both in terms of quantity and price. Machines for air and gas liquefaction, ships and certain types of equipment accounted for the largest share of the reduction in import volumes. In January and February 2019, import volumes continued to decline amid the weakening ruble.

Financial account – private sector. In 2018 4Q, the private sector financial account balance grew by $22 billion to $30 billion ($68 billion or 4% of GDP for 2018 as a whole), mainly due to the growth of foreign assets. Bank accounts accumulated a larger amount of foreign currency against the background of higher oil prices and the suspension of fiscal rule-based foreign currency purchases. Russian companies not only increased their assets in the form of foreign direct investment but also provided trade loans and made advance payments to non-residents. In addition, as in Q3, a perceptible contribution to the increase in the private sector financial account balance in 2018 Q4 was due to the reduction in foreign liabilities of both banks and businesses amid limited access to foreign capital markets. Operational data for January and February point to the similar dynamics of capital flows in the private sector at the beginning of the year.

Financial account – public sector. In 2018 Q4, the public sector financial account balance was around zero against the background of a decrease in non-residents' sales of Russian government bonds in the secondary market compared to 2018 Q3.

Foreign currency reserves. The increase in reserves in 2018 Q4 due to operations was negligible amid the suspension of fiscal rule-based foreign currency purchases. In January–February, there was an increase in foreign currency reserves due to the resumption of fiscal rule-based foreign currency purchases – both regular purchases (they started on 15 January) and purchases postponed in 2018 (they started on 1 February in the amount of RUB2.8 billion per day).

FOREIGN CURRENCY MARKET

Ruble exchange rate. In late 2018 – early March 2019, the ruble exchange rate remained relatively stable. The weakening of the ruble, which was observed in the second half of December, was

caused by the operations of some large market participants and was offset by the increase in oil prices and the positive dynamics in global financial markets in January 2019. In the second half of March, the ruble strengthened significantly again; as at the beginning of the year, this was linked to an increase in demand for risky assets as the Fed softened its rhetoric. In addition, during Q1, the ruble was supported by the progress in China / US trade negotiations (through increased demand for risky assets) and rising global oil prices. In the run up to the key rate meeting of the Board of Directors on 22 March, the USD/RUB exchange rate fell below 64 rubles per dollar, the lowest level since August 2018. Overall, the ruble average exchange rate in 2019 Q1 turned out to be stronger than the Bank of Russia anticipated when preparing the forecast of Monetary Policy Report 4/18.

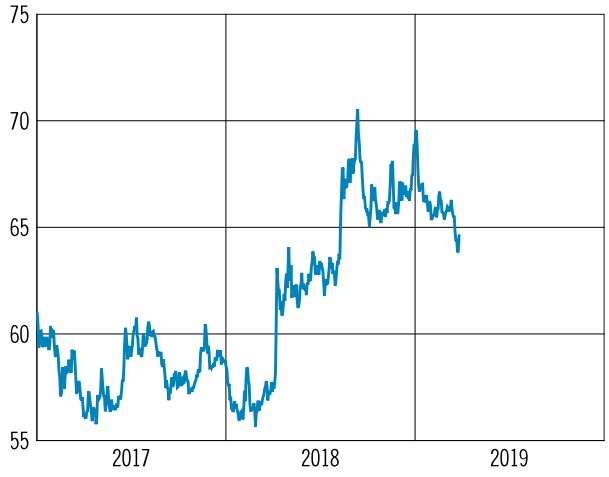
3.2. MONETARY CONDITIONS

MONEY MARKET

Short-term interest rates. Short-term interest rates in the interbank segment of the money market were formed in the lower half of the interest rate corridor, close to the Bank of Russia key rate. From the beginning of the year until 22 March, the average spread was -19 bp (-22 bp in Q4); it fluctuated in the range from -55 to 3 bp (from -68 to 7 bp in Q4). For more details regarding the formation of interbank interest rates and the liquidity situation, see the Section 'The system of monetary policy instruments and other Bank of Russia measures'.

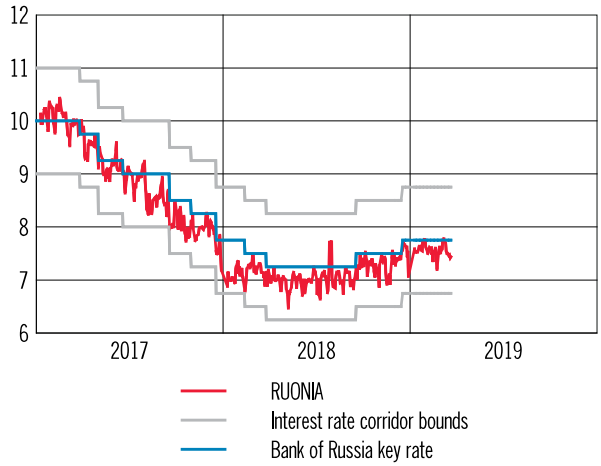
FX liquidity. The short-term interest rate spread in the interbank lending and FX swap segments narrowed on the back of FX liquidity improvements in the banking sector. In November–December, the average spread of short-term rates in these segments was 14 bp or 54 bp higher than in September–December (-40 bp). The situation with foreign currency liquidity was supported by a seasonally high inflow of foreign currency in the current account of the balance of payments, given low foreign currency purchases within the framework of the fiscal rule. The start of regular and postponed foreign currency purchases in 2018 under the fiscal rule did not exert a significant

RUB/USD EXCHANGE RATE *Chart 3.1.22*
(RUB/USD)



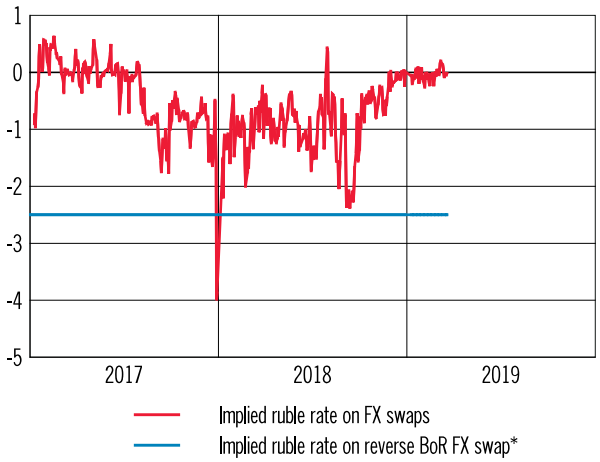
Source: Thomson Reuters.

RUONIA AND BANK OF RUSSIA INTEREST RATE CORRIDOR *Chart 3.2.1*
(% P.A.)



Source: Bank of Russia.

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

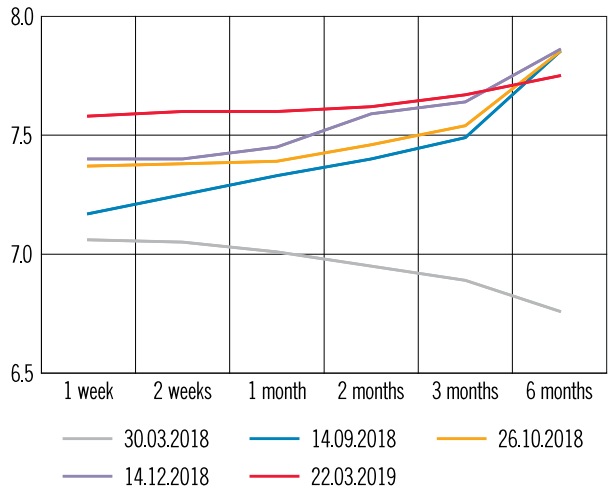


** Implied rate = ruble lending rate – FX borrowing rate + LIBOR (from 19.12.2016: key rate – 1 pp – (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).*
Source: Bank of Russia calculations.

negative impact on the situation with foreign currency liquidity; as it was the case with the increase by non-residents of long ruble positions and the corresponding increase in ruble lending in the FX swap segment. In the short term, it is expected that the spread of interest rates in the interbank lending and FX swap segments will remain near zero.

Long-term interest rates. Money market interest rates for the period of more than one day were formed in accordance with the dynamics of short-term interest rates. The decision of the Bank of Russia to raise the key rate by 25 bp on 14 December 2018 led to an increase in interest rates for periods up to one year as a result of market participants reviewing the expected key rate path. In January–March, long-term expectations dropped slightly, reflecting positive sentiment in foreign and domestic financial markets, as well as lower inflation expectations. In March, the drop in expected interest rates was also associated with the actual inflation dynamics. In the coming months, the dynamics of long-term interest rates, same as before, will depend on the monetary policy of the Bank of Russia – the level of short-term interest rate and its further expected path.

ROISFIX CURVE
(% P.A.)
Chart 3.2.3



Source: SRO NFA.

OFZ YIELDS
(% P.A.)
Chart 3.2.4

Sources: Moscow Exchange, Bank of Russia.

STOCK MARKET

In January to March 2019, the situation in the Russian stock market was more favourable than the Bank of Russia forecast in the run up to the Board of Directors in December 2018, largely due to a more favourable situation in global financial markets, rising oil prices, changes in expectations regarding the Bank of Russia's monetary policy stance, as well as the absence of negative changes in Russia sanctions rhetoric.

Government bond market. A significant part of foreign capital inflows was channeled to the government bond market. In January, February and March, foreign investors purchased securities worth RUB64, 88 and 97 billion respectively. News about the possible tightening of Russia sanctions, which appeared in mid-February, temporarily reduced the interest of non-residents in Russian assets but did not cause a significant outflow of their funds, as it happened in similar cases in the past. In addition to the global demand for risky assets, the decision of the Ministry of

Finance of Russia to cancel limits on OFZ auctions contributed to the growth of non-residents' investment in OFZs.

Among domestic investors, the largest buyers of securities were systemically important banks, which since the beginning of the year have acquired securities worth RUB191 billion. Collective investors, who actively built up their portfolios in recent years, did not make large-value purchases in 2019.

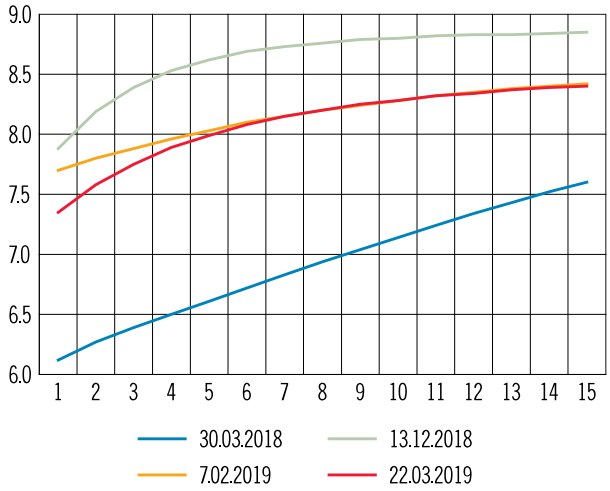
As expected, the rebounding non-residents' demand contributed to the decline in OFZ yields as compared to mid-December 2018. At the same time, the spread between the yields of long and short issues, which narrowed at the beginning of February to the annual minimum, returned to the average level for 2018, mainly due to the decrease in the yield of short-term OFZs that are most sensitive to expectations for the path of the Bank of Russia key rate.

Corporate bond market. There were no significant changes in the corporate bond market. After the growth of late 2018, yields in January returned to the average level for September-December following the decline in the yields of government bonds. The growth rate of the corporate bond portfolio continued to decline, which was largely conditioned on the negative trends in the bond market observed in the second half of 2018.

At the same time, the spread between corporate and government bond yields continued to expand, which, should external risks abate, will support investors' demand for this type of securities.

Equity market. Russian stock indices, as well as global stock indices, demonstrated a robust growth in January and February (Chart 3.2.9), playing out a change in the US Fed's rhetoric and progress in the US / China trade negotiations. In the second half of February and March, these factors faded into the background and most EME markets were at the reached level. These dynamics are consistent with the operations of foreign investors, who in January acquired shares of Russian companies worth RUB38 billion, which is at least a 5-year high (earlier statistics are not available), and did not make any significant purchases in February-March.

OFZ ZERO COUPON YIELD CURVE *Chart 3.2.5*
(% P.A.)

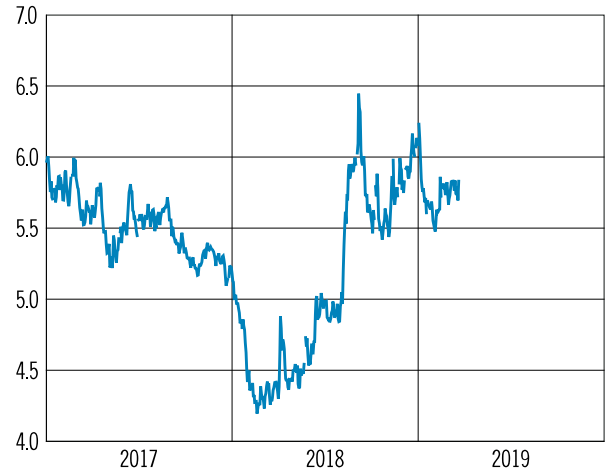


Source: Moscow Exchange.

SPREAD OF 10-YEAR OFZ YIELDS TO 2-YEAR OFZ YIELDS *Chart 3.2.6*
(PP)

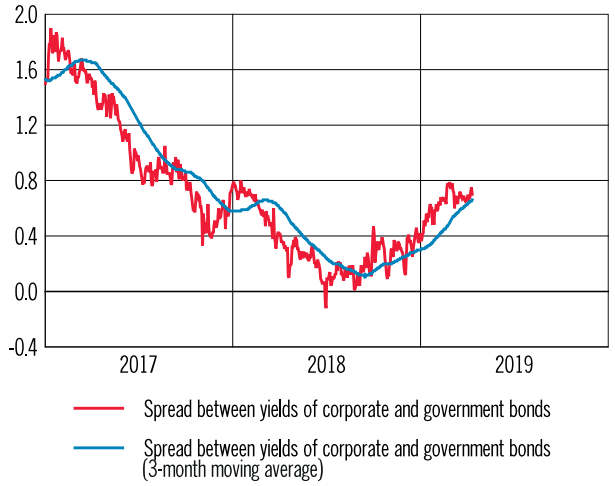
Source: Moscow Exchange.

SPREAD BETWEEN 10-YEAR YIELDS OF RUSSIAN AND US GOVERNMENT BONDS *Chart 3.2.7*
(PP)



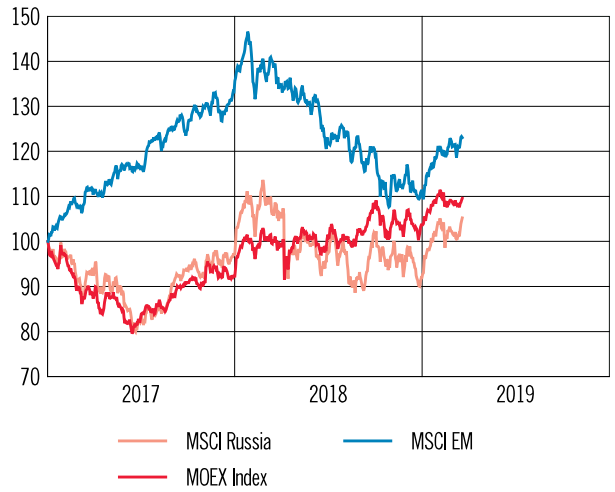
Sources: Moscow Exchange, Bank of Russia.

SPREAD BETWEEN YIELDS OF CORPORATE AND GOVERNMENT BONDS *Chart 3.2.8*
(PP)



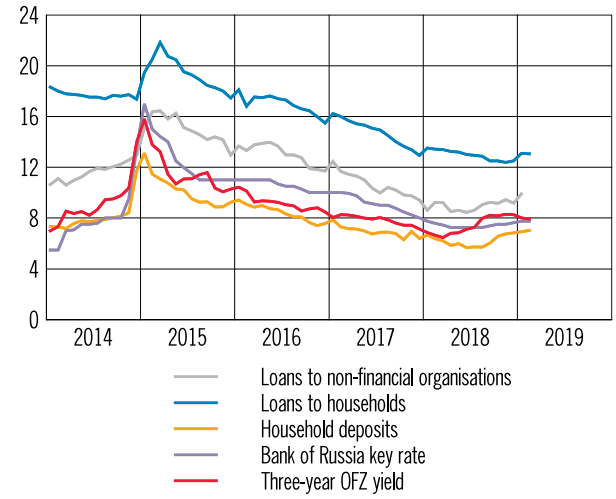
Source: Cbonds.ru.

STOCK INDICES *Chart 3.2.9*
(100 = 3.01.2017)



Source: Bloomberg.

INTEREST RATES ON LONG-TERM RUBLE OPERATIONS IN RUSSIAN MARKET *Chart 3.2.10*
(% P.A.)



Source: Bank of Russia.

DEPOSIT AND LOAN MARKET

Deposit rates. At the end of 2018 and in early 2019, the growth of deposit interest rates continued (Chart 3.2.10). According to preliminary estimates, in February 2019, the interest rates on both short-term and long-term deposits exceeded the November 2018 level by 0.3 pp. In March, banks continued to raise interest rates on deposits and offer seasonal deposits at higher interest rates. Based on the cessation of the upward trend in the long-term interest rates of the money and stock markets, a gradual stabilisation of deposit rates may be expected in the near term.

Deposit operations. Thanks to the increase in nominal rates, bank deposits remained attractive to depositors. In early March, the annual growth rates of household ruble deposits amounted to 7.5%, while depositors continued to recover interest in long-term deposits (Chart 3.2.11). The growth of depositors' interest in foreign currency deposits, which emerged in late 2018, led to a slowdown in the annual rates of funds outflow from household foreign currency deposits. As of the beginning of March 2019, balances of household foreign currency deposits were 1.2% less than on the same date the previous year (the annual reduction in foreign currency deposits was 5.6% in early December 2018)[3]. In the first six months of this year, we can expect the current rate of inflow of household funds to deposits to stay steady, with ruble deposits dominating growth in the deposit portfolio of banks.

Credit rates. From December through February, the lending market also saw an increase in interest rates (Chart 3.2.10), albeit unstable and heterogeneous. The largest increase in interest rates was observed in the mortgage market, where a number of large banks raised their mortgage interest rates in January–February; and mortgage risk ratios with a low down payment were also increased. Mixed changes in interest rates associated with fluctuations in the market structure were observed in the consumer lending and corporate lending markets. Decline in the yield of long-term instruments of the stock

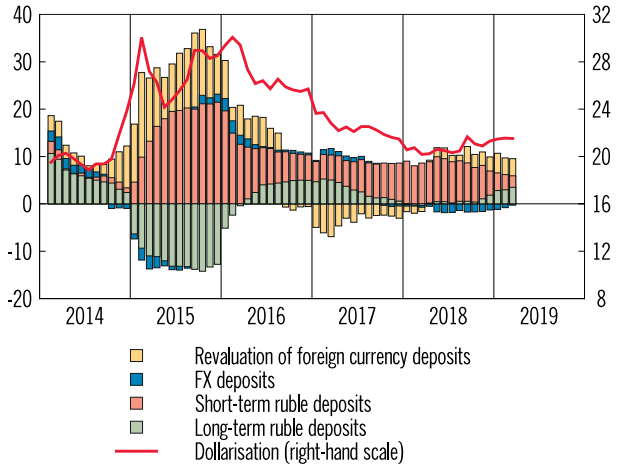
[3] *Here and below, the growth of bank foreign currency balance sheet indicators are shown in the dollar equivalent; balance sheet indicators that include foreign currency and ruble components are shown net of foreign currency revaluation.*

market will constrain lending interest rate growth potential over the coming months and form the preconditions for their decrease over a longer-term horizon.

Corporate lending. From late 2018 to early 2019, corporate lending continued to grow slowly. In early March, the annual growth rate of loans to non-financial organisations approached the local peaks of October and November, coming in at 5.6%. The replacement of FX loans with ruble-denominated ones continued, with the annual growth of ruble loans to non-financial organisations amounting to 12.1%, and the annual reduction of FX loans standing at 10.3%. Over the first six months of this year, we can expect a certain recovery in the corporate segment of the lending market, given the continued dedollarisation of this market segment.

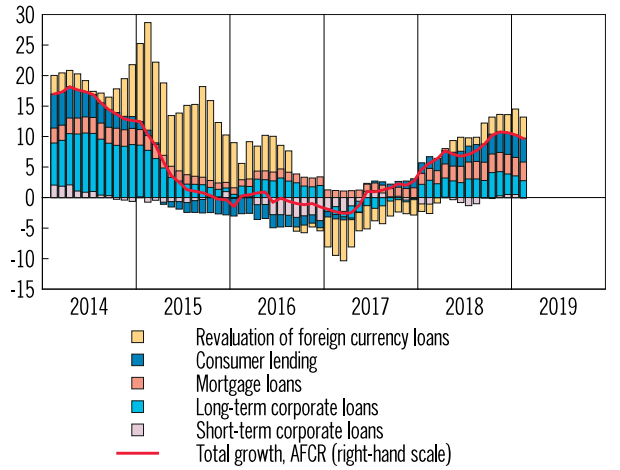
Retail lending. The retail lending market witnessed a steady and persistent growth in lending (Chart 3.2.12). In early March 2019, the annual growth rate of household loans was 23.4% as compared to 22.6% three months earlier. Mortgage and consumer lending made a comparable contribution to the dynamics of retail lending (including large-scale mortgage loan securitisation transactions carried out in late 2018). As was expected in Monetary Policy Report 4/18, the potential for the acceleration of consumer lending growth was limited. The growth in the consumer loan portfolio in December to February was slightly less than in the three previous months. However, in the short term, we can expect the current growth rate of the retail loan portfolio to remain unchanged, with moderate potential to slow down by the end of the year.

CONTRIBUTION OF VARIOUS COMPONENTS TO ANNUAL GROWTH OF HOUSEHOLD DEPOSITS *Chart 3.2.11*
(PP)



Source: Bank of Russia.

CONTRIBUTION OF VARIOUS COMPONENTS TO ANNUAL GROWTH OF BANKS' LOAN PORTFOLIO *Chart 3.2.12*
(PP)



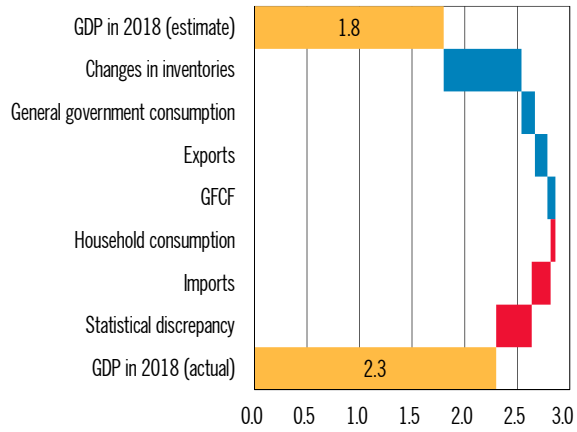
Source: Bank of Russia.

3.3. ECONOMIC ACTIVITY

GROSS DOMESTIC PRODUCT

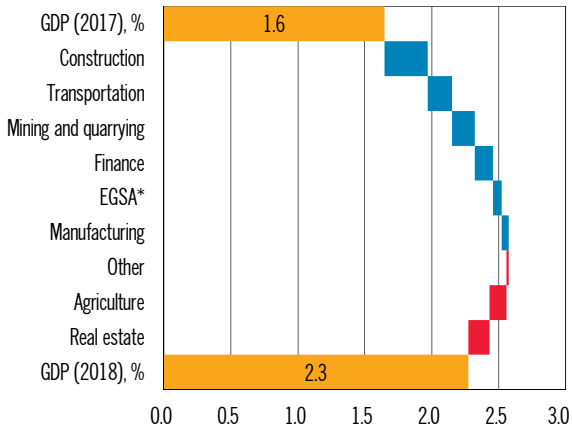
GDP dynamics in 2018. In 2018, GDP growth rate was 2.3%. This exceeded the Bank of Russia's forecast (1.5–2.0%) published in Monetary Policy Report 4/18 mainly due to the effect of temporary factors. These primarily include growth in the volume of construction works, the pace of which accelerated significantly according to updated data from Rosstat, exceeding the expectations of the Bank of Russia. Among GDP components

DECOMPOSITION OF DIFFERENCE BETWEEN ACTUAL GDP GROWTH AND BANK OF RUSSIA ESTIMATE *Chart 3.3.1*
(PP)



Sources: Rosstat, Bank of Russia calculations.

DECOMPOSITION OF CHANGE IN GDP GROWTH RATES IN 2018 BY ECONOMIC ACTIVITY *Chart 3.3.2*
(PP)



** EGSA – electricity, gas and steam supply; air conditioning.*
Sources: Rosstat, Bank of Russia calculations.

GDP AND GVA BY KEY ECONOMIC ACTIVITY *Table 3.3.1*
(PER CENT CHANGE ON PREVIOUS YEAR)

	2017	2018
GDP	1.6	2.3
Agriculture	2.4	2.5
Mining and quarrying	2.4	3.8
Manufacturing	1.1	1.5
Construction	-1.2	4.7
Trade	2.5	2.2
Transportation	0.1	2.9
Finance	2.8	6.3
Real estate	2.2	0.5
Public administration	3.4	3.5
Net taxes	9.9	9.7

Source: Rosstat.

by expenditure, the growth of inventories turned out to be stronger than expectations (Chart 3.3.1).

GDP based on production measure. Construction output made a sizeable contribution to economic growth in 2018. A number of major projects, including with state participation, such as the construction of the Nord Stream–2 and Power of Siberia gas pipelines, a plant for liquefying natural gas in the Tyumen Region, the railway section of the Crimea Bridge and the reconstruction of the Baikal-Amur Mainline, contributed to the increase in construction works. The contribution of the increase in gross value added (GVA) in construction to GDP growth was 0.3 pp.

The expansion of external demand for Russian raw materials and products of their processing (including coal, gas, oil and oil products, as well as metals) supported mining and quarrying, manufacturing output, wholesale trade, as well as transportation and storage. The contribution of GVA growth across these types of activities to GDP growth was 1 pp. The expansion of lending conditioned an increase in the net interest income of credit institutions and led to an increase in GVA in financial and insurance activities, which contributed 0.2 pp to GDP growth.

Agriculture made a negative contribution to GDP dynamics last year as a result of a lower grain harvest after the record high level of 2017, as well as a slowdown in the growth of livestock production (primarily poultry meat and eggs), mainly due to the saturation of the domestic market. Because of these factors the contribution of GVA in agriculture to GDP growth was negative (-0.1 pp), whereas in 2017, it made a positive contribution of 0.1 pp. (Table 3.3.1, Chart 3.3.2).

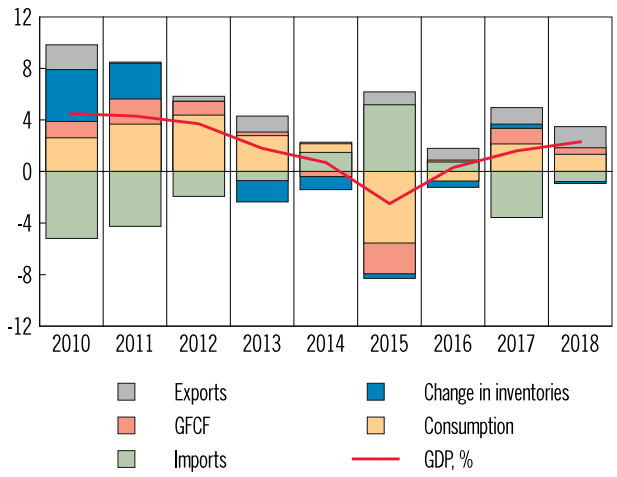
GDP components by expenditure. GDP growth in 2018 was largely due to growth in goods and services exports (Chart 3.3.3). The increase in their physical volume was 6.3%, or slightly above the upper bound of the Bank of Russia's forecast (5.5–6.0%).

Growth in domestic demand remained moderate. Household final consumption expenditure rose by 2.2%, or slightly less than expected in Monetary Policy Report 4/18. The increase in investment activity, supported by the implementation of large projects, affected the increase in gross fixed capital formation, which

totalled 2.3% and slightly exceeded the Bank of Russia's estimate (1.5–2.0%). The contribution of the dynamics of inventories to GDP growth was negative in 2018, as companies were increasing their volumes slowly after a massive build-up in 2017. Nevertheless, the deceleration rates were lower than anticipated by the Bank of Russia. Overall, the growth rate of gross accumulation was 1.5% (it was expected to be down by 0.5–1.5%).

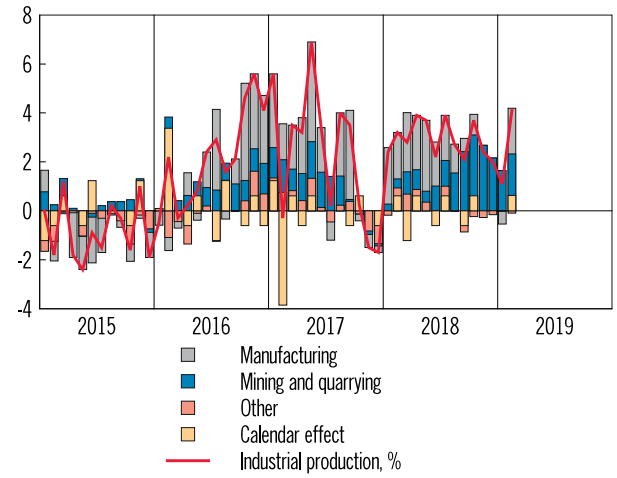
According to the forecast, in 2019 Q1–Q2, GDP will grow at a modest pace based on moderate growth in both domestic (consumer and investment) and external demand. In the subsequent quarters, growth will accelerate as a result of an increase in public investment and the gradual accumulation of effects from the implementation of national projects.

GDP BY EXPENDITURE
(CONTRIBUTION TO ANNUAL GROWTH, PP)
Chart 3.3.3



Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL PRODUCTION
(CONTRIBUTION TO ANNUAL GROWTH, PP)
Chart 3.3.4



Sources: Rosstat, Bank of Russia calculations.

PRODUCTION ACTIVITY

In November 2018 – January 2019, industrial output (adjusted for seasonal and calendar factors) remained close to the level of August–October 2018, or the highest level since December 2015. However, the growth rates of industrial output remained low on average. This was due to the impact of external factors and the VAT increase. In February 2019, growth in industrial output accelerated both m.o.m (adjusted for seasonal and calendar factors) and y.o.y (Chart 3.3.4).

Raw material production. In November 2018 – February 2019, mining and quarrying outputs (adjusted for seasonal and calendar factors) reached their historical record highs. Annual growth rates also remained elevated. However, the monthly growth rates (adjusted for seasonal and calendar factors) were on average small over the specified period due to the influence of external factors. Oil production was constrained by the implementation of updated OPEC+ agreements. In November 2018 – January 2019, gas production fell amid a slack demand in Europe and Turkey because of warm weather and growing competition with other gas suppliers, including Iran, Turkmenistan and the US. In February, the growth of external demand picked up, which passed on to gas production volumes. An additional factor making a positive contribution to the increase in gas production in November 2018 – February 2019

was the commissioning of natural gas liquefaction lines as part of the Yamal LNG project.

The growth of coal production was encouraged by the expansion of both domestic and external demand, primarily from countries of the Asia-Pacific region.

Intermediate goods production. In November 2018 – February 2019, the output of raw materials processing was also on average close to historic highs. During these months, both monthly (adjusted for seasonal and calendar factors) and annual growth rates showed noticeable fluctuations mainly as a result of production dynamics in ferrous metallurgy, subject to the influence of specific factors.

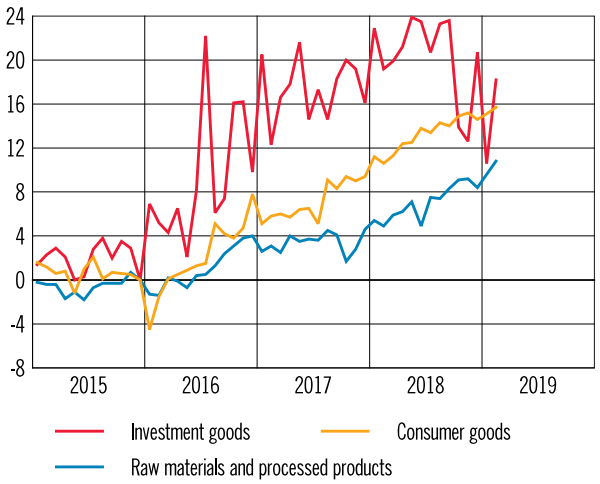
The production dynamics of other intermediate goods were more stable. After the contraction in the output of oil products in October – December 2018 (on the previous month, seasonally adjusted), their production picked up in January–February 2019. A number of industries, such as chemical production and fertilizer production, were supported by expanding exports.

Over the coming months, steady growth in the production within this product group may be hampered both by demand-side factors, primarily external demand (slowing global economy, trade wars), and supply-side factors (lack of production capacity in a number of industries, and transportation and logistics infrastructure constraints).

Consumer goods production. In November 2018 – February 2019, the annual growth of output of non-food consumer goods slowed down after a temporary surge in October, most likely linked to a faster growth in consumer demand, which peaked in November 2018 (see Section 'Consumption and savings'). Growth in the output of food products, both y.o.y and m.o.m (adjusted for seasonal and calendar factors), also slowed down from November 2018 to January 2019 and stabilised in February.

Investment goods production. In November 2018 – February 2019, the dynamics of investment goods production remained volatile, while maintaining the downward trend. In February 2019, the output of investment goods was virtually unchanged, remaining at the level of the same month a year earlier (Chart 3.3.5). The highest volatility was registered for the production of

INDUSTRIAL PRODUCTION BY PRODUCT GROUP *Chart 3.3.5*
(PER CENT CHANGE ON DECEMBER 2015, SA)



Sources: Rosstat, Bank of Russia calculations.

engineering goods. The dynamics of production of construction materials were more stable. Increase in the volume of construction works contributed to growth in demand for these products (see Subsection 'Investment activity').

Overall, the dynamics of industrial production from late 2018 to early 2019 suggested a slowdown in GDP growth under the influence of conservative consumer behaviour, as well as the temporary factor of the VAT hike.

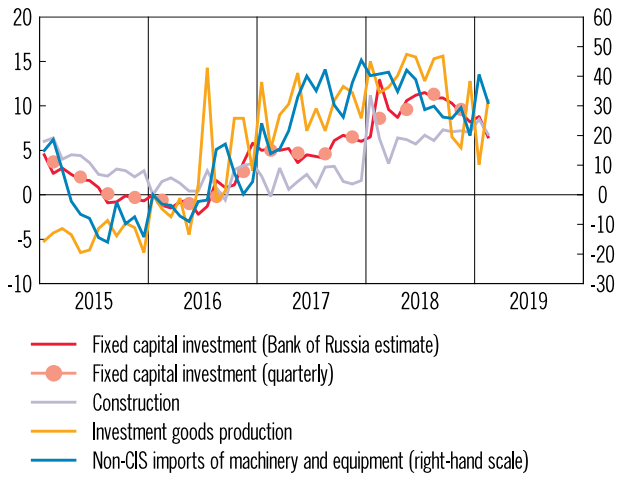
INVESTMENT ACTIVITY

The annual growth rate of fixed capital investment slowed in 2018 Q4 because of the ruble's weakening, a contraction in state orders (Charts 3.3.7 and 3.3.8) and enhanced overall macroeconomic uncertainty. In January–February 2019, indirect indicators suggested that fixed capital investment was slightly below the level of the corresponding period of the previous year. According to estimates, the annual growth rate of gross fixed capital formation and overall gross formation in 2019 Q1 will be 1–1.5%. In Q2, it will slow down further due to the high base effect.

Fixed capital investment in 2018 Q4. In 2018 Q4, annual growth in fixed capital investment slowed to 2.9% (6.4% in Q3).

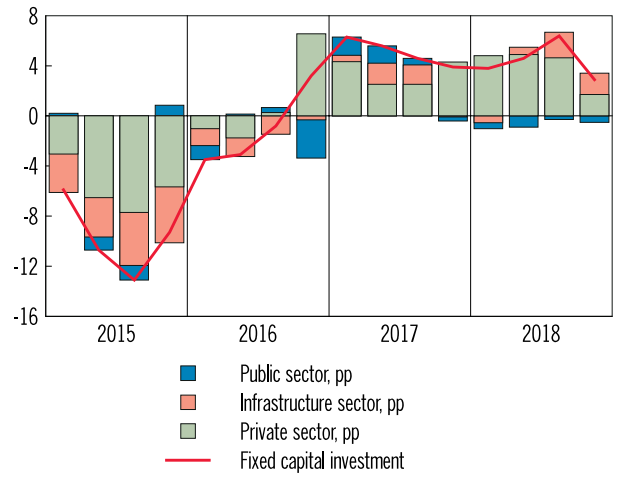
The dynamics of indicators that allow for a more detailed analysis of investment activity were mixed. On the one hand, under the influence of the ruble's weakening in Q3, investment imports declined (Chart 3.3.6). The output of domestic investment goods also decreased (see Subsection 'Production activity'). On the other hand, investment activity in Q4 was supported by the construction and reconstruction of transport infrastructure facilities (see Subsection 'Gross domestic product'). In 2018 Q4, the overall contribution of infrastructure and public investment in fixed capital to the annual growth of investment was estimated at 1.2 pp. (Charts 3.3.7 and 3.3.8). The largest positive contribution to the general dynamics of capital investment in Q4 in annual terms was made by the investments of large and medium-sized enterprises. The investments of small enterprises featured weak positive dynamics, and their contribution to the overall change in investment was negligible (Chart 3.3.9).

INVESTMENT ACTIVITY INDICATORS *Chart 3.3.6*
(PER CENT CHANGE ON JANUARY 2016, SA)



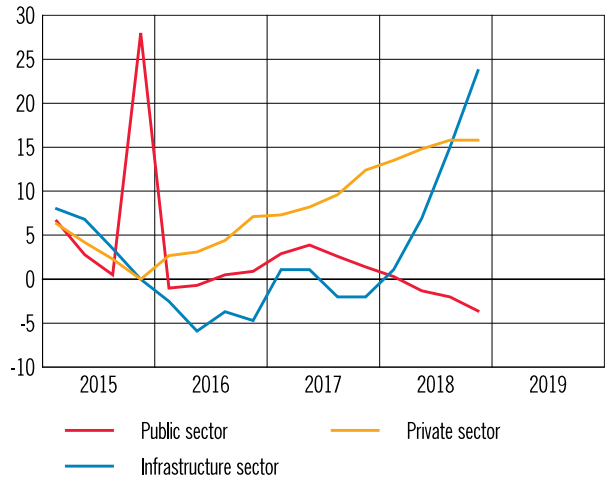
Sources: Rosstat, FCS, Bank of Russia calculations.

FIXED CAPITAL INVESTMENT *Chart 3.3.7*
(PER CENT CHANGE ON CORRESPONDING QUARTER OF PREVIOUS YEAR)



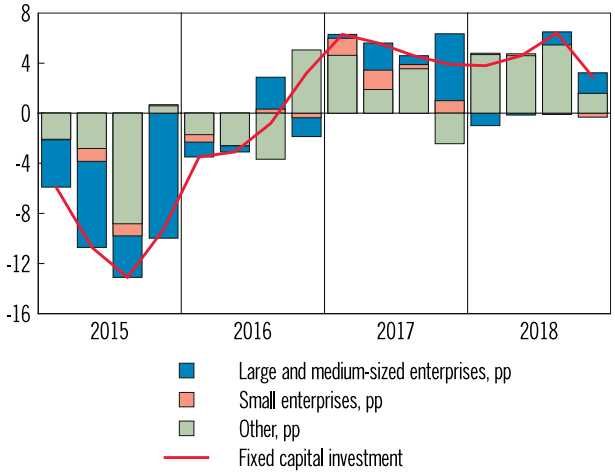
Sources: Rosstat, Bank of Russia calculations.

FIXED CAPITAL INVESTMENT
(PER CENT CHANGE ON 2015 Q4, SA)
Chart 3.3.8



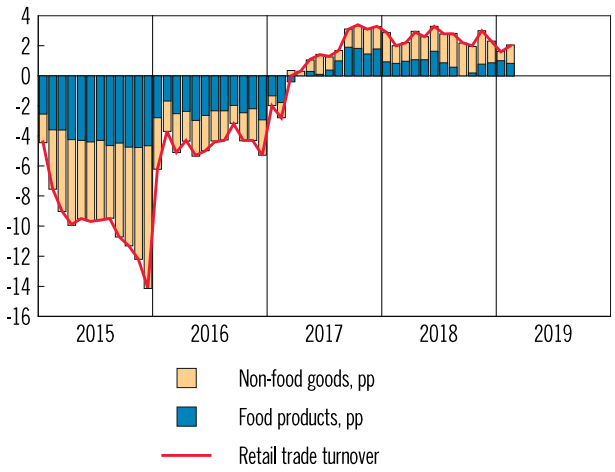
Sources: Rosstat, Bank of Russia calculations.

FIXED CAPITAL INVESTMENT
(PER CENT CHANGE ON CORRESPONDING QUARTER OF PREVIOUS YEAR)
Chart 3.3.9



Sources: Rosstat, Bank of Russia calculations.

RETAIL TRADE TURNOVER
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)
Chart 3.3.10



Sources: Rosstat, Bank of Russia calculations.

Investment activity in January–February 2019. The dynamics of indicators of investment activity, including the output of investment goods and engineering imports, were heterogeneous and unstable (Chart 3.3.5) in early 2019 (see Subsection 'Production activity'). In contrast, the volume of construction works (adjusted for seasonal and calendar factors) continued to be at the level of December 2018. The slowdown in the annual growth of this indicator was conditioned on the base effect. According to the revised data from Rosstat, in January 2018, the volume of construction works grew significantly. Based on this trend, the Bank of Russia estimates that fixed capital investment in January and February 2019 remained slightly below the level of the respective months of the previous year.

CONSUMPTION AND SAVINGS

In November 2018, the growth of retail trade turnover temporarily accelerated based on expectations for price growth in early 2019 due to the VAT increase. In December 2018 – February 2019, they slowed to minimum levels of one and a half years. Demand was supported to a certain extent by a fall in the savings rate. In 2019 H1, the current trends in the dynamics of household income and consumer activity are expected to remain in place. Growth in households final consumption expenditure is forecast at 1–1.5% in 2019 Q1. In 2019 Q2, as the population adapts to the increase in VAT and inflation slows down, the growth in final consumption expenditure may accelerate slightly.

Retail trade turnover. In November 2018, retail trade turnover grew by 3.0% y.o.y (Chart 3.3.10). This was mainly due to the realisation of household demand (partly deferred) based on the expectations for a rise in prices in early 2019 due to the VAT increase. The impact of this effect was mainly reflected in the sales of non-food goods, the growth of which accelerated to 4.3% (3.4% in October 2018). The dynamics of food sales remained moderate. In December 2018 – February 2019, the annual growth of retail turnover slowed down as expected.

The dynamics of real household disposable money income (Chart 3.3.11; see Subsection

'Labour market and incomes') continues to be the main factor keeping in check consumer demand.

According to Bank of Russia estimates, in 2019 H1, retail trade turnover will evolve in the context of a weak growth in real household incomes limited in part by a temporary pick-up in inflation. Its growth rates are estimated at 1.5–2.0% y.o.y.

Consumer sentiment. Household surveys also point to the weakening of consumer activity after the November surge. According to a survey conducted by inFOM[4], from December 2018 to February 2019, the consumer sentiment index dropped to its lowest level in the past two years. In January–February 2019, the assessment of how favourable this time period is for large purchases was lower than a year earlier. However, the March survey data indicate a recovery in consumer sentiment to the level of October–November 2018.

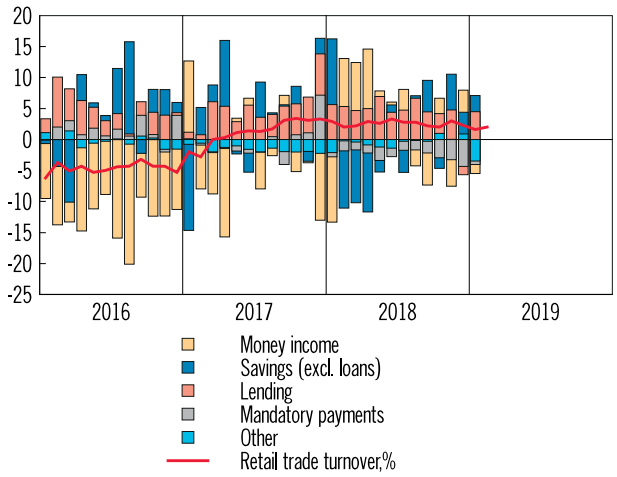
Savings rate. The expansion of consumer demand in 2018 Q4 was accompanied by a decrease in the savings rate. In November–December 2018, its level remained significantly below the average readings of 2015–2017 (Chart 3.3.12). The decrease in the savings rate was mainly conditioned on a considerable expansion in household lending; additional effect also came from a slowdown in deposit growth (see Section 'Monetary conditions'). A further decrease in the savings rate seems unlikely.

LABOUR MARKET AND INCOMES

According to Bank of Russia estimates, the labour market was close to equilibrium in late 2018 – early 2019. The dynamics of its main indicators corresponded to Bank of Russia expectations.

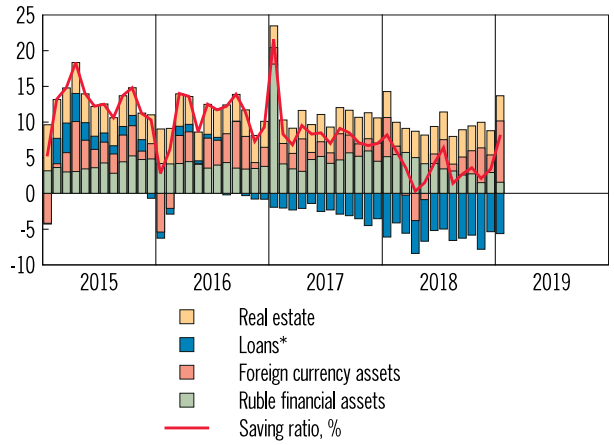
Unemployment rate. In November 2018 – February 2019, unemployment (seasonally adjusted) remained at the historically minimum level of 4.7–4.8% (Chart 3.3.13). The gradual decline observed since the end of 2017 was mainly caused by demographic factors and was not cyclical; it is estimated that the unemployment rate corresponds to its current inflation-neutral value. According to Bank of Russia estimates, in

RETAIL TRADE TURNOVER AND HOUSEHOLD SPENDING *Chart 3.3.11*
(CONTRIBUTION OF HOUSEHOLD INCOME AND SPENDING COMPONENTS TO ANNUAL GROWTH OF RETAIL TRADE TURNOVER IN CONSTANT PRICES, PP)



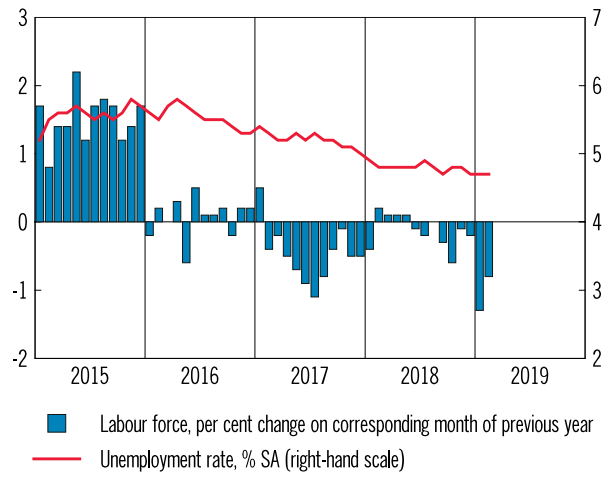
Sources: Rosstat, Bank of Russia calculations.

SAVINGS RATIO *Chart 3.3.12*
(CONTRIBUTION, PP, SA)



** Given changes in the methodology of banking reporting, in January 2019, the contribution of lending was calculated on the basis of the assumption that growth in overdue interest payments was in line with previous year levels.*
Sources: Rosstat, Bank of Russia calculations.

UNEMPLOYMENT AND LABOUR FORCE *Chart 3.3.13*



Sources: Rosstat, Bank of Russia calculations.

[4] *See the summary of the Inflation Expectations and Consumer Sentiment review, No. 2 (26), March 2019.*

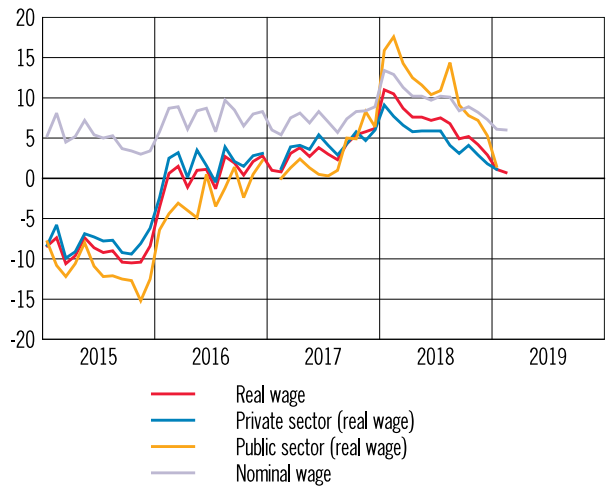
2019 H1, the unemployment rate will remain close to its current level.

Wages. In November 2018 – February 2019, the annual growth rate of nominal wages continued to decline. In January–February, it stabilised at 6% (after 8.2% in November and 7.3% in December, Chart 3.3.14). The most noticeable slowdown of growth in wages was in the public sector; according to estimates, it was associated with the gradual implementation of the President's May Decrees (labour remuneration of social sector and cultural workers neared the target values[5]). Together with inflation pick-up, this affected real wages, the annual increase of which slowed down from November 2018 to February 2019. In February 2019, it was 0.7%, which is the lowest reading since mid-2016 (Chart 3.3.14).

The dynamics of wages are generally in line with Bank of Russia expectations. According to the results of 2018, their growth in real terms was 6.8%, which is close to the Bank of Russia's forecast published in Monetary Policy Report 4/18 (7–8%). Net of the implementation effect of the Russian President's May Decrees, wages are estimated to post 4.6% growth. In 2019 Q1–Q2, amid a temporary surge in inflation, it is expected that the annual growth of real wages will be moderate, not exceeding 2%.

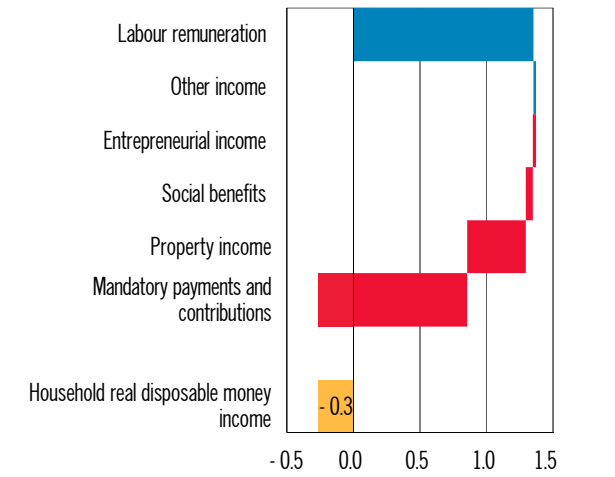
Household incomes. In November 2018 – January 2019[6], real disposable household money income showed varied dynamics: the November decline (-3.1%) changed to a weak growth y.o.y (+0.1%) in December, and then in January, annual growth rates once again became negative (-1.3%). This appears to be shaped by

WAGES
(PER CENT CHANGE ON CORRESPONDING MONTH OF PREVIOUS YEAR)
Chart 3.3.14



Sources: Rosstat, Bank of Russia calculations.

DECOMPOSITION OF GROWTH IN REAL HOUSEHOLD DISPOSABLE MONEY INCOME IN 2018
(CONTRIBUTION TO ANNUAL GROWTH, PP)
Chart 3.3.15



Sources: Rosstat, Bank of Russia calculations.

[5] *The target level means the wage level of social sector and cultural workers, which should increase in accordance with the President's May Decrees. A specific level is established for each category of workers. It typically equals the average wage in the region.*

[6] *In February 2019, Rosstat switched to a new methodology for calculating household income levels and therefore suspended the publication of monthly data. Based on its new methodology, estimates of household incomes from wages and entrepreneurial activities will be refined. Additionally, income from the sale of financial assets (mainly foreign currency) will be taken into account for the calculation of savings and not for the calculation of income, as previously. Moreover, when evaluating savings, the purchase of real estate in the secondary market from legal entities will be taken into account too. Estimates of household spending on the purchase of goods and services, including their expenditures abroad, will be refined.*

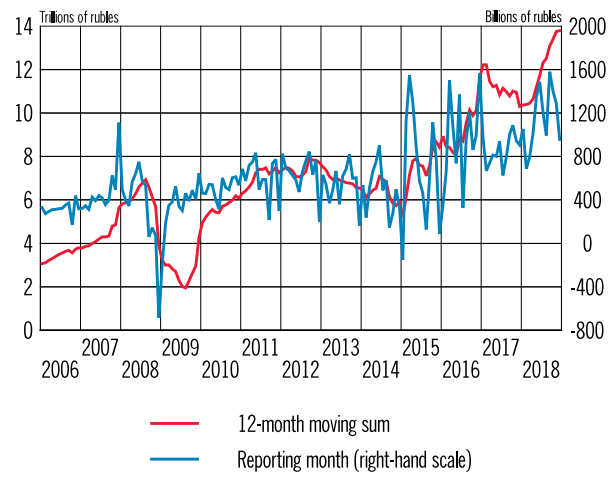
the dynamics of other incomes (including hidden ones) characterised by enhanced volatility. It is also estimated that the contribution of property and mandatory payments income to the change in household disposable income remained negative in early 2019, as in 2018 (Chart 3.3.15). First, property income continued to shrink in real terms (in 2018, it dropped by 8.1%). Second, there was an increase in mandatory payments and contributions as a result of an increase in interest payments in the context of expanding consumer lending, as well as an increase in tax payments based on an improved collection rate and an increased tax base (+10.2%).

FINANCIAL STANDING OF ENTERPRISES

Financial result. According to Rosstat operational data, in 2018, the balanced financial result of large and medium-sized enterprises amounted to RUB13.8 trillion, which is higher than in the previous year by a factor of 1.5. A significant increase in the balance of profits and losses was observed in mining and quarrying amid relatively high oil prices in 2018. On the back of favourable demand dynamics, the financial result in trade has virtually recovered to its 2016 level. The growth of industrial production, in turn, supported the dynamics of the balance of profits and losses in manufacturing activities. The balance of profits and losses in construction remained broadly at the level of 2017 as a result of the implementation of large infrastructure projects in early 2018. Speaking about major industrial sectors, the balance of profits and losses declined in transportation, which may be associated with increased costs amid rising energy prices. For economy as a whole, business sales profit grew by almost a third compared to 2017. According to Bank of Russia estimates, the key factor underlying this growth was an increase in the sales profit margin, which suggests the improving efficiency of businesses. According to the operational data of Rosstat, the total losses of businesses dropped by 11.5%. The segment of unprofitable companies was 27.4%, which is close to the level of the previous year.

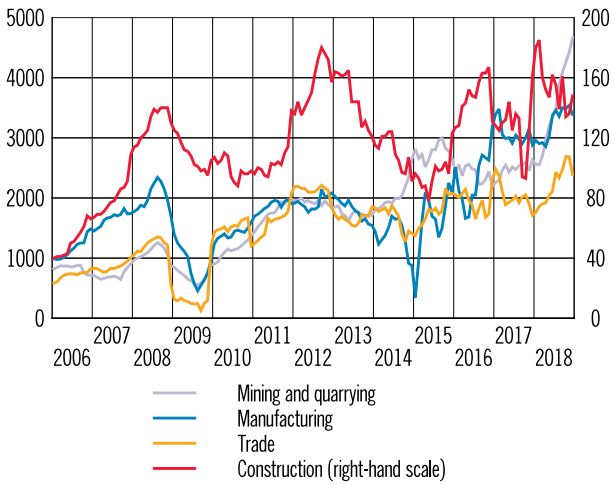
Debt. According to Bank of Russia estimates, in 2018 Q4, corporate debt to banks in rubles and foreign currency increased by 10.3% y.o.y from

BALANCED FINANCIAL RESULT *Chart 3.3.16*



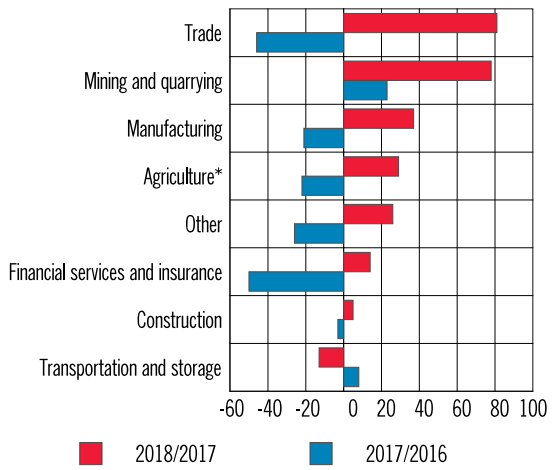
Sources: Rosstat, Bank of Russia calculations.

BALANCED FINANCIAL RESULT BY ACTIVITY TYPE *Chart 3.3.17*
(12-MONTH MOVING SUM, BILLIONS OF RUBLES)



Sources: Rosstat, Bank of Russia calculations.

CHANGE IN BALANCED FINANCIAL RESULT BY ACTIVITY TYPE *Chart 3.3.18*
(PER CENT CHANGE ON PREVIOUS YEAR)



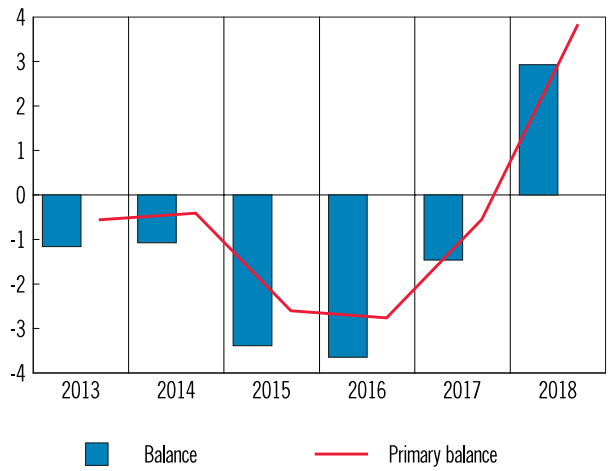
** Agriculture, forestry, hunting, fishery, fish farming.*
Sources: Rosstat, Bank of Russia calculations.

BUDGET SYSTEM PARAMETERS
(12-MONTH MOVING SUM, % GDP)
Table 3.4.1

	2017	2018	January 2019	February 2019
Consolidated budget				
Revenue	33.7	35.6	35.8	-
Spending	35.2	32.7	32.6	-
Balance	-1.5	2.9	3.2	-
Federal budget				
Revenue	16.4	18.8	18.9	18.9
Oil and gas revenue	6.5	8.7	8.7	8.7
Additional oil and gas revenue (excess revenue)	0.9	4.1	4	4
Non-oil and gas revenue	9.9	10.1	10.2	10.2
Spending	17.8	16.1	16.1	16.2
Balance	-1.4	2.6	2.8	2.7

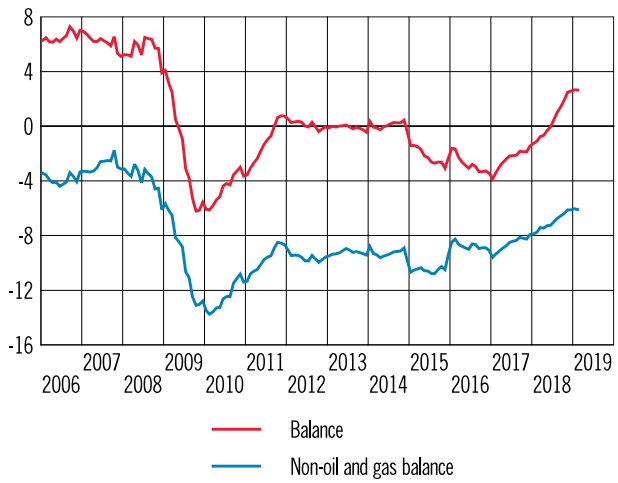
Sources: Federal Treasury, Bank of Russia calculations.

BUDGET SYSTEM BALANCE
(% GDP)
Chart 3.4.1



Sources: Federal Treasury, Bank of Russia calculations.

FEDERAL BUDGET BALANCE
(12-MONTH MOVING SUM, % GDP)
Chart 3.4.2



Sources: Federal Treasury, Bank of Russia calculations.

9.5% in the previous quarter. The expansion of lending was accompanied by a gradual decrease in overdue loans after the surge in 2018 Q1. The leaders in debt accumulation in annualised terms were transportation, communications, mining and quarrying, agriculture, and trade.

3.4. PUBLIC FINANCES

In late 2018, the general government budget of the Russian Federation[7] was fulfilled with a surplus for the first time since 2012 (Chart 3.4.1). This was conditioned on the faster growth of revenues amid relatively high oil prices and favourable economic activity dynamics. Operational data on the structure of funds credited to budget accounts in January and February 2019 indicate the formation of high non-oil and gas revenue consisting of considerable receipts from the personal income tax, VAT and corporate income tax. The contribution of fiscal policy to the dynamics of the aggregate demand in 2018 is estimated by the Bank of Russia as constraining.

Federal budget. According to the Federal Treasury[8], the federal budget surplus was 2.6% of GDP (in 2017, there was a deficit of 1.4% of GDP) (Chart 3.4.2). The revenues of the federal budget in nominal terms exceeded the level of 2017 by almost a third. Oil and gas budget revenues posted the most significant increase (by a factor of 1.5). This was facilitated by the oil price increase accompanied by the increase in the USD/RUB exchange rate (compared to 2017). In 2018, the non-oil and gas revenues of the federal budget increased mainly due to the growth of receipts from VAT and corporate income tax. The volume of expenditure was determined in accordance with the fiscal rule, which was finalised in the Budget Code version of 30 July 2017. At the end of 2018, expenditure in nominal terms remained virtually unchanged compared with 2017 and decreased in relation to GDP (Table 3.4.1, Box 'Fiscal rules framework at work in Russia').

[7] *Here and below, the concept of general government includes the consolidated budget of the federal centre, the constituent entities of the Russian Federation, and state extra-budgetary funds.*

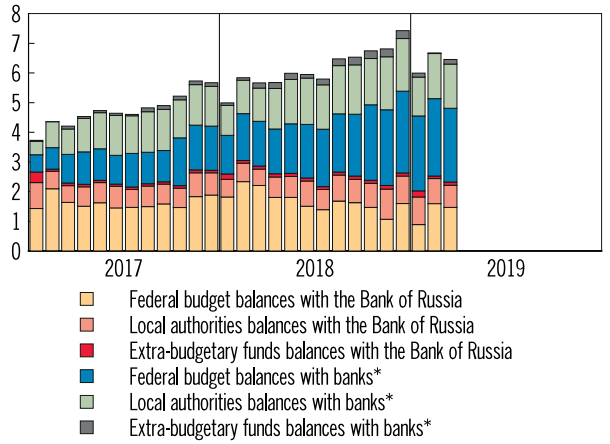
[8] *Data source: the Federal Treasury report on the 'Consolidated budget of the Russian Federation and the budgets of state extra-budgetary funds of the Russian Federation', dated 28 February 2019.*

General government budget. According to the Federal Treasury, the budget system also posted surplus in 2018 (Table 3.4.1). In 2018, the revenues of the budget system of the Russian Federation to GDP exceeded the level of 2017 by 1.9 pp. As regards non-oil and gas revenues, the most significant increase in receipts was observed for personal income tax, VAT and corporate income tax. In 2018, budget expenditure grew in nominal terms. The most significant growth was noted in healthcare and education, including in connection with the implementation of the President's May Decrees, dated 7 May 2012. In relation to GDP, the expenditure was 2.5 pp less than a year earlier.

Balances of funds in budget accounts with the banking system. Execution of the revenue side in excess of the plan and the transfer of expenditure items to beneficiaries in a smaller-than-planned volume lead to an increase in the balance of funds in budget accounts with the Bank of Russia and credit institutions. The Federal Treasury and financial bodies of the constituent entities of the Russian Federation also seek to earn additional income by placing temporarily free budgetary funds with banks. By the beginning of 2019, the volume of banking sector liabilities to the budgetary system reached RUB4.6 trillion, or 5% of the total assets of the banking sector (Chart 3.4.3).

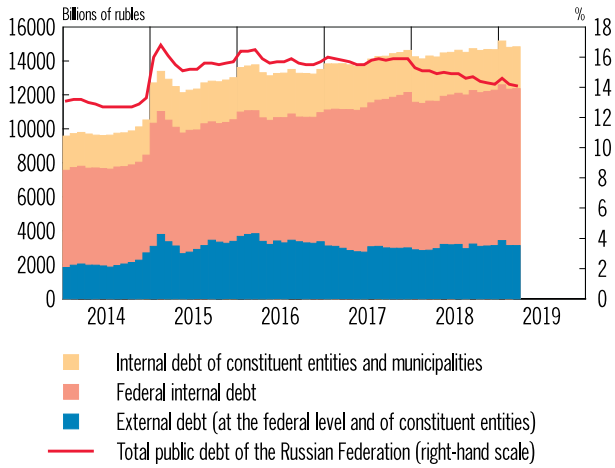
National Wealth Fund. The volume of the National Wealth Fund (NWF) totalled $59.1 billion (3.7% of GDP) as of 1 March 2019. In 2018, it was replenished with additional oil and gas revenues for 2017 ($14.2 billion) credited to its accounts. Funds of the NWF totalling $16.5 billion were used to finance the budget deficit of the Pension Fund of the Russian Federation. The volume of oil and gas excess revenues received in 2018 and awaiting transfer to the NWF in the current year amounted to roughly $66.5 billion. However, the volume of fiscal rule-based foreign currency purchases in the open market was approximately half as much due to the Bank of Russia suspending FX purchases from the last third of August until the end of 2018. In February 2019, the Bank of Russia resumed purchases postponed in 2018, with their full volume to be completed within 36 months. As a result, the daily volume of FX purchases will increase by RUB2.8 billion. Taking into account the crediting of additional oil and gas revenues

BUDGET SYSTEM BALANCES OF FUNDS ON RUBLE ACCOUNTS WITH BANKS AND BANK OF RUSSIA *Chart 3.4.3*
(TRILLIONS OF RUBLES)



** According to data from banking reporting template 0409301 'Indicators characterising the performance of a credit institution'.*
Source: Bank of Russia.

PUBLIC DEBT OF THE RUSSIAN FEDERATION *Chart 3.4.4*



Source: Russian Ministry of Finance.

received in the previous year, the Bank of Russia estimates that in the baseline scenario the NWF volume will be about $124.6 billion at the end of 2019, and $174.4 billion at the end of 2020[9].

Public debt. According to the Ministry of Finance of Russia, the volume of the aggregate public and municipal debt of the Russian Federation totalled 14.3% of GDP as of 1 March 2019, which is higher in nominal terms than the last year level (Chart 3.4.4). Over the past 12 months, the domestic federal debt has increased slightly. Starting in February 2019, the Ministry of Finance of Russia changed the procedure for holding OFZ auctions; they are now held without a previously announced placement volume. In 2019 Q1, this allowed for the OFZ placement worth RUB492.4 billion, which is 9.4% more than the planned amount[10]. The future attraction of funds in the domestic capital market can be slightly reduced as a result of the largest one-time placement of Russian Eurobonds since 2014 amid favourable market conditions.

[9] *Calculated on the basis of estimates of additional oil and gas revenues for 2019 and the USD/RUB exchange rate as of 28 March 2019.*

[10] *In accordance with Federal Law No. 459-FZ, dated 29 November 2018, 'On the Federal Budget for 2019 and the Plan Period of 2020 and 2021', the planned volume of OFZ placement for 2019 is RUB2,425 billion. In accordance with the official information of the Ministry of Finance of Russia about the schedule of auctions for OFZ placement, the planned volume of placement for 2019 Q1 is RUB450 billion, and RUB600 billion for 2019 Q2 at par value.*

4. THE BANK OF RUSSIA'S MONETARY POLICY

4.1. KEY RATE DECISIONS

Key rate decisions. On 8 February and 22 March, the Bank of Russia Board of Directors decided to keep the key rate unchanged at 7.75% p.a. The Bank of Russia made these decisions taking into account inflation and economic developments against the forecast, as well as the risks of external conditions and the response of financial markets.

In this period, the Bank of Russia had to determine whether its 14 September and 14 December 2018 decisions to increase the key rate from 7.25 to 7.75% p.a. would be sufficient to prevent sustainable inflation anchoring at a level significantly exceeding the Bank of Russia's target, making sure inflation would return to 4% in the first half of 2020. These decisions were proactive: they were made with regard to the growing proinflationary risks and expected inflation acceleration. These were caused by deteriorating external conditions in the second half of 2018 and the planned increase in the standard VAT rate from early 2019. Key uncertainty factors included the extent of price and inflation expectations response to the increased VAT, as well as further changes in external conditions and their effect on the prices of financial assets and on market participants' expectations.

As actual data became available in the first months of the year, the Bank of Russia made a phased revision of its assessments of the pass-through of these factors to the inflation forecast. At the end of January, inflation dropped to the lower bound of expectations, with the VAT hike making a moderate contribution to inflation acceleration. These factors along with reduced risks of capital outflow from EMEs allowed the Board of Directors' meeting in February to keep the key rate unchanged and somewhat soften the signal over the future monetary policy stance. Over subsequent months, the situation evolved under a better scenario than the Bank of Russia expected in terms of the VAT hike effect, changes in external conditions and inflation expectations. In March, all this gave grounds for the Bank of Russia to lower its end-of-year annual inflation forecast in 2019, maintain the key rate unchanged and soften the signal over future monetary policy.

However, the Bank of Russia continues to view the balance of inflation risks as skewed towards proinflationary risks, which is primarily due to a number of persisting external risks, as well as elevated and unanchored inflation expectations (see Section 1.1). Moreover, though the pass-through of the VAT hike to inflation has largely faded away, the extent of its effect remains to be determined. Amid modest demand and competition for a market share, the VAT change pass-through to prices could be protracted. An accurate assessment of its effect can be made in the second quarter.

Monetary policy over a medium-term horizon. Providing that the situation evolves in line with the revised baseline forecast, the Bank of Russia holds open the prospect of the switch to a key rate reduction cycle in 2019. Given the downward revision of the inflation forecast and reduced short-term inflation risks in the baseline scenario, the expected key rate path was shifted downwards as compared to the path implied in Monetary Policy Report 4/18, which did not rule out monetary policy easing in late 2019 – early 2020.

In the high oil price scenario, monetary policy will be close to that of the baseline one, as additional proinflationary and disinflation factors in the high oil price scenario will balance each other and cause inflation dynamics to be close to the baseline scenario over the entire forecast horizon (see Section 1.2). In the risk scenario and in case additional proinflationary risks materialise (see Subsection 'Forecast uncertainty factors' of Section 1.1), the key rate path will be higher than assumed in the baseline scenario mostly over a short-term horizon. If this is the case, a prompt response from the monetary policy will make it possible to limit the duration and scale of inflation deviation from the target.

The effect of key rate decisions on expectations. After the Board of Directors meeting in December, as the balance of inflation risks for 2019 was updated and appropriate adjustments were made to the Bank of Russia's signal, market participants gradually adjusted their expectations regarding the future key rate path. At the end of 2018, after the Bank of Russia's proactive increase in the key rate in December, market participants were taking into account persistent uncertainty regarding further external developments and the response of inflation and inflation expectations to the upcoming VAT hike; they believed it possible for the key rate both to remain unchanged or to grow further in 2019 H1. However, as new data on inflation dynamics, inflation expectations and the situation in global financial markets came in at the beginning of the year and after the Bank of Russia's February decision and signal, the number of market participants expecting a further increase in the key rate in 2019 reduced substantially.

In March, analysts shifted their consensus forecast towards an unchanged key rate throughout 2019, while financial markets started to factor in a possible decrease in the key rate in the second half of the year by 25–50 bp. After the 22 March meeting, when the Bank of Russia announced the possibility of cutting the key rate in 2019, analysts shifted their consensus forecast towards one possible reduction by 25 bp in H2. Opinions about the timing of such reduction vary considerably.

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

Banking sector liquidity. From December 2018 to January–February 2019, the structural liquidity surplus grew from RUB2.7 trillion to RUB3.6 trillion, which can be attributed to the seasonal dynamics of operations across budget accounts and resumed FX purchases in the domestic foreign currency market in early 2019 on the instruction of the Russian Ministry of Finance. In late 2018, typically high seasonal budget expenditure was financed from the balances of accounts held with the Bank of Russia, including the resources of the National Wealth Fund. The Federal Treasury and Russian local governments did not practically reduce the volume of funds placed with credit institutions[1]. In December, the volume of cash in circulation increased as banks had to channel the sufficient amount of cash to cash offices and ATMs before the long holidays. In early 2019, cash money returned to bank accounts with the Bank of Russia, mostly in the form of the cash receipts of companies. At the end of this period, the overall effect of this factor was close to neutral.

Federal Treasury operations. The Russian Ministry of Finance and the Federal Treasury seek to expand the line of instruments to deposit temporarily available budgetary funds with banks. In December 2018 – February 2019, the Federal Treasury started using FX swaps, a stock-exchange instrument, which expanded the range of possible participants in operations with budgetary funds, and held a deposit auction for the placement of funds in bank accounts (on demand). The majority of funds provided in Federal Treasury operations are taken by banks for long terms. The effective and predictable placement of temporarily available budgetary funds with banks helps reduce the effect of fiscal flows on banking sector liquidity.

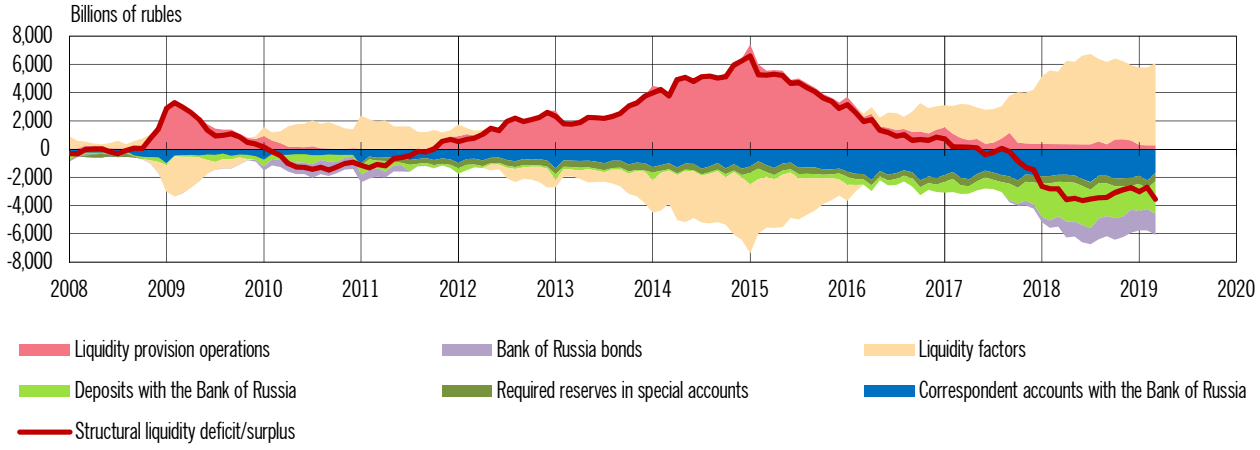
Achieving the operational goal of the monetary policy. Short-term rates in the interbank lending segment of the money market stayed in the lower half of the interest rate corridor near the Bank of Russia key rate[2]. The average spread from the beginning of the year until 22 March was -19 bp (-22 bp in Q4); it fluctuated from -55 to 3 bp (from -68 to 7 bp in Q4). The growth in liquidity surplus did not have any significant effect on market rates. Over the same period last year, it grew by RUB0.4 trillion to RUB3.4 trillion (in Q4, it dropped by RUB0.1 trillion to RUB3.0 trillion). In January–February 2019, all coupon bonds issued by the Bank of Russia were placed. Banks' claims on the Bank of Russia under these operations grew by RUB0.1 trillion. At the same time, the demand for Bank of Russia deposits was often below the established limits. The volume of

[1] *See Section 3.4.*

[2] *See Subsection 'Money market' of Section 'Monetary conditions'.*

BANK OF RUSSIA BALANCE SHEET
(START OF BUSINESS)

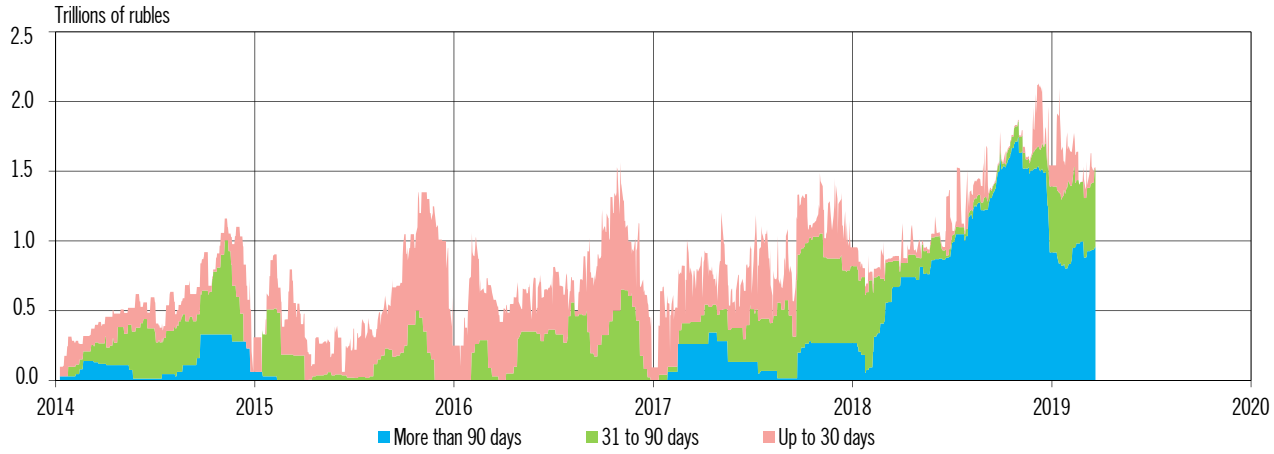
Chart 4.2.1



Source: Bank of Russia calculations.

BANKS' OUTSTANDING AMOUNTS ON FEDERAL TREASURY DEPOSITS, REPOS AND SWAPS

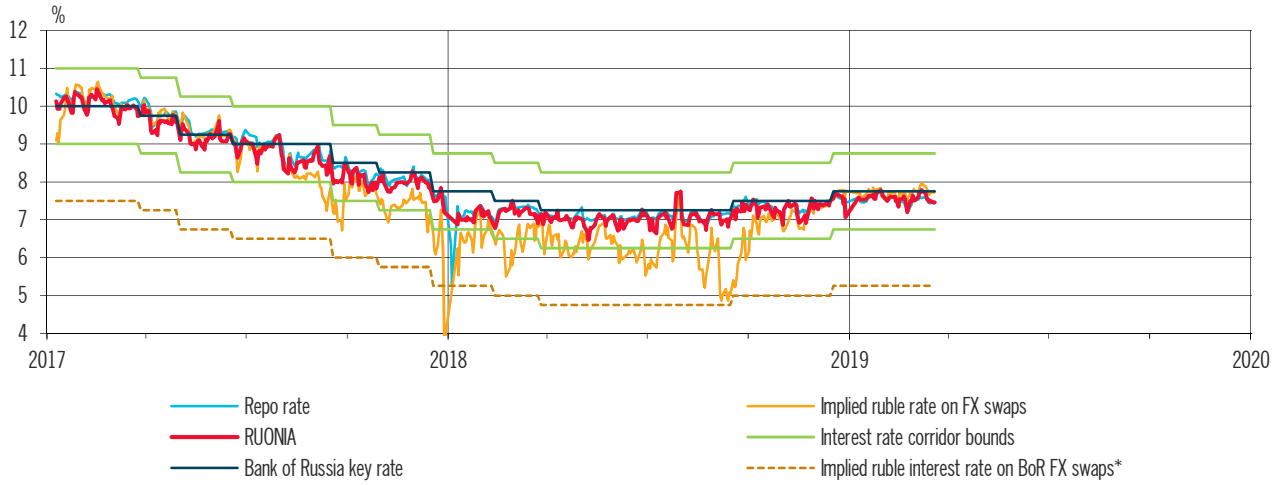
Chart 4.2.2



Sources: Federal Treasury, Bank of Russia calculations.

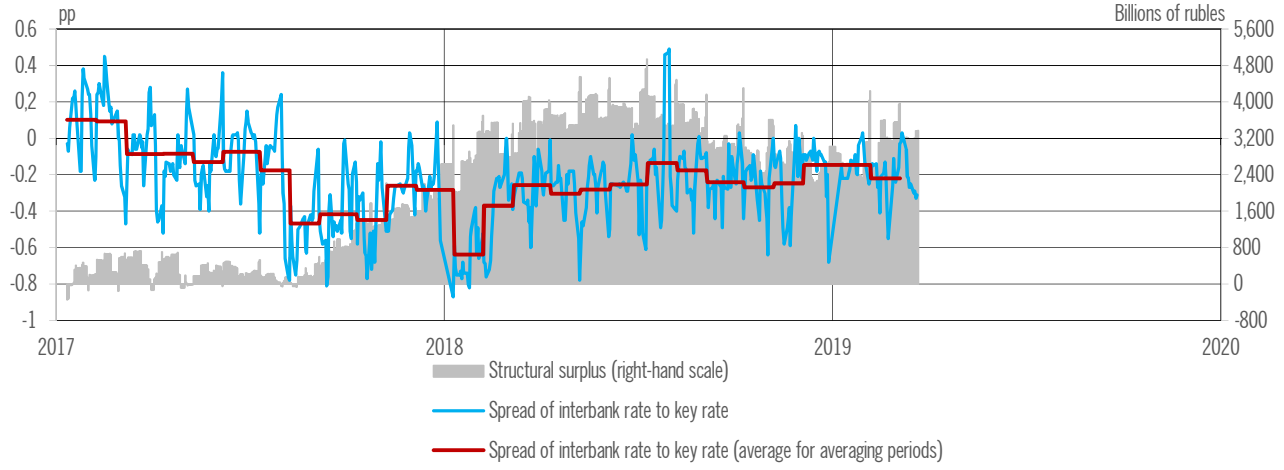
MONEY MARKET RATES

Chart 4.2.3



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

STRUCTURAL LIQUIDITY SURPLUS AND MONEY MARKET RATES *Chart 4.2.4*



Source: Bank of Russia calculations.

STRUCTURAL LIQUIDITY SURPLUS AND LIQUIDITY FACTORS *Table 4.2.1*
(TRILLIONS OF RUBLES)

	Dec 2018	Jan 2019	Feb 2019
1. Liquidity factors	**0.2**	**0.0**	**0.3**
– changes in the balances of general government accounts with the Bank of Russia, and other operations*	0.7	-0.5	0.3
– change in cash in circulation	-0.5	0.5	0
– Bank of Russia interventions in the domestic FX market and monetary gold purchases	0.0	0.0	0.1
– regulation of banks' required reserves with the Bank of Russia	0.0	0.0	0.0
2. Change in free bank reserves (correspondent accounts)	**-0.1**	**0.3**	**-0.5**
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	**0**	**-0.3**	**0.9**
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	**-0.3**	**0.0**	**0.0**
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	**-3.0**	**-2.7**	**-3.6**

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

funds attracted to deposits from the beginning of the year varied from RUB1.0 trillion to RUB2.0 trillion. This was in particular related to banks' liquidity management strategies. At the start of required reserve averaging periods, banks typically maintained high balances in their correspondent accounts with the Bank of Russia and averaged their reserves in advance. By the end of the averaging period, banks' need for maintaining high balances in their correspondent accounts with the Bank of Russia fell, whereas their demand for fine-tuning auctions for better liquidity management grew. In 2019, the funds raised by the Bank of Russia under these operations totalled from RUB0.3 trillion to RUB1.3 trillion.

From December 2018 to January–February 2019, banks' outstanding amounts on Bank of Russia refinancing operations totalled RUB0.3 trillion on average. In the first half of December, outstanding amounts on Bank of Russia standing lending facilities were maintained at a high level by certain banks, however by the end of the year these operations were replaced with market borrowings.

Mandatory reserve requirements. In February, to increase transparency and unify the procedure for calculating required reserves, the Bank of Russia decided to clarify the composition of the reservable liabilities of credit institutions from 1 April 2019, by including all their long-term liabilities and liabilities to international financial institutions and State Development Corporation VEB.RF. To compensate for the increase in required reserves, the Bank of Russia simultaneously reduced required reserve ratios for individual types of liabilities by 0.25 pp to 4.75%.

BOXES

FISCAL RULES FRAMEWORK AT WORK IN RUSSIA

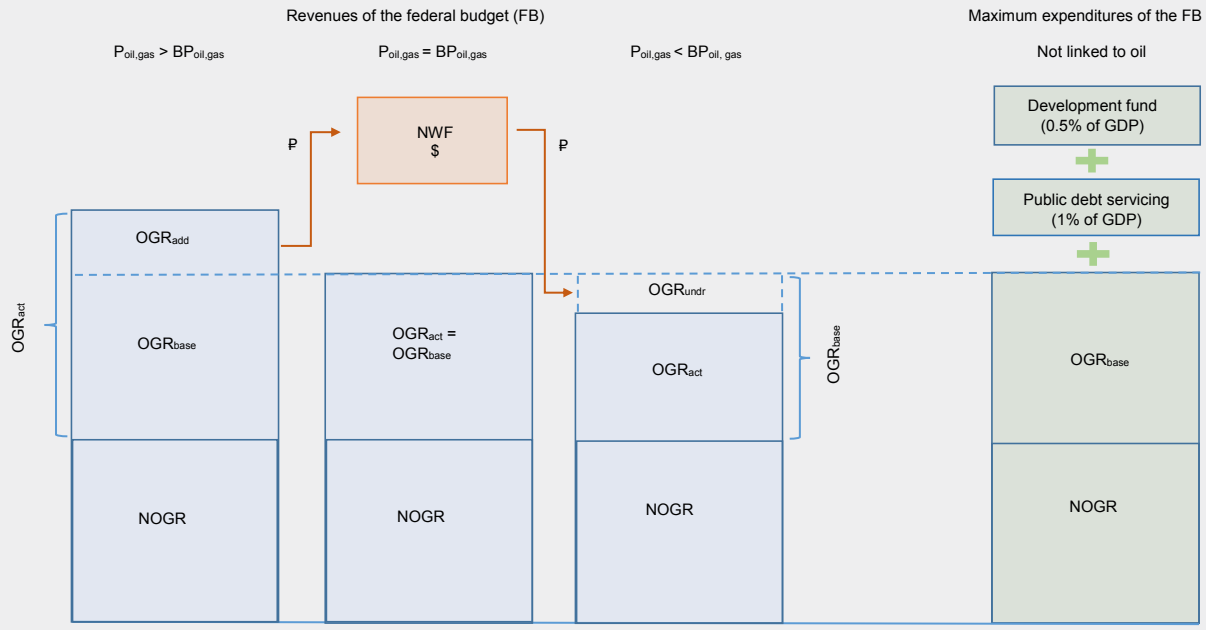
One of the key elements of Russia's fiscal policy is fiscal rules framework. It was first introduced in 2004 and has undergone substantial changes since then. The current structure of fiscal rules was first used in 2017 in terms of its transitional provisions, and was finally included in the Budget Code in 2018.

The current structure of fiscal rules is based on the framework for forming budget expenditures irrespective of commodity cycle phases. Economic revenues received amid relatively high foreign economic conditions or, on the contrary, under-received because of low commodity prices, are regulated by flows between the budget and the National Wealth Fund[1] (Chart 1).

Base oil price (BPoil) is an administratively established price of $40 per barrel in the 2017 prices. It is indexed annually by 2% starting from 2018. In 2018, the base oil price was $40.8 per barrel, $41.6 in 2019, $42.4 in 2020, $43.3 in 2021, $44.2 in 2022, and so on.

Base export gas price (BPgas) is a forecast value of the annual average export price for gas multiplied by the ratio of the base oil price to the projected oil price.

CURRENT STRUCTURE OF RUSSIAN FISCAL RULES *Chart 1*



Note: P_{oil}, P_{gas} – are forecast prices for oil and gas respectively.

[1] *The National Wealth Fund (NWF) is a portion of federal budgetary funds subject to separate accounting and management to ensure the co-financing of voluntary pension savings of Russian citizens and a balance (deficiency payments) between the federal budget and the budget of the Russian Pension Fund.*

$$BP_{gas} = P_{gas} * \frac{BP_{oil}}{P_{oil.}}$$

Additional oil and gas revenue (OGRadd) is the difference between oil and gas revenues[2] calculated using the forecast oil price and export gas price (OGRforec), and oil and gas revenue calculated using the base oil price and base export gas price (OGRbase). Additional oil and gas revenue is determined in the ruble equivalent based on the forecast USD/RUB exchange rate. Additional oil and gas revenue is formed when the forecast oil and gas price[3] is higher than the base price. It is converted into the foreign currency that accrues in the treasury account of the Ministry of Finance of Russia throughout the year and is credited to the NWF not later than 1 October of the following year.

$$OGR_{add} = OGR_{forec}(P_{oil}, P_{gas}, \text{Exchange rate}) - OGR_{base}(BPoil, BP_{gas}, \text{Exchange rate})$$

The exchange rate is the forecast USD/RUB exchange rate.

Under-received oil and gas revenue (OGRundr) is calculated similarly to additional oil and gas revenue. It is formed when the forecast oil and gas prices are lower than the base prices. In this event, funds may be released from the NWF (by selling foreign currency) to cover the deficit of the federal budget and the budget of the Russian Pension Fund in the amount not exceeding the amount of under-received oil and gas revenue (if the NWF was >5% of GDP at the end of the previous year) or not exceeding 1% of GDP per year (if the NWF was <5% of GDP at the end of the previous year). When the liquid part of the NWF reaches 7% of GDP, the resources of the fund may be invested in projects to develop the national economy.

$$OGR_{undr} = OGR_{base}(BPoil, BP_{gas}, \text{Exchange rate}) - OGR\ forec(P_{oil}, P_{gas}, \text{Exchange rate})$$

The maximum limit of federal budget expenditures is the maximum volume of federal budget expenditures equal to the total of base oil and gas revenue, non-oil and gas revenue[4] and forecast expenditures for public debt management (Clause 3 of Article 99 of the Budget Code of the Russian Federation). In 2018, an increment of 1% of GDP was introduced to the expenditure formula, and in 2019–2024 the increment will total 0.5% (expenditures in the Development Fund).

$$\text{Maximum expenditures of the FB} = OGR_{base} + NOGR_{forec} + \text{Public debt servicing} + \text{DF increment}$$

The structure of fiscal rules introduced in 2018 in Russia is designed to improve federal budget sustainability and guarantee the execution of all government obligations regardless of oil price volatility, and also create predictable macroeconomic and financial conditions[5] required to ensure sustainable economic growth, as well as price and financial stability.

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[2] *Oil and gas revenue includes income from taxes on the production of oil, natural gas and gas condensate, as well as export customs duties on crude oil, natural gas and oil products. They are transferred to the federal budget.*

[3] *If in the reporting month there is a deviation in actual prices for energy commodities and the ruble exchange rate from their forecast values used in the calculation of additional /under-received oil and gas revenue, the next month currency purchase/sale amount will be adjusted for the amount of such deviation.*

[4] *All budget revenues excluding oil and gas revenues.*

[5] *After the Ministry of Finance of Russia launched its operations in the domestic foreign exchange market in early 2017, the ruble exchange rate and overall Russian economy have become substantially less dependent on, and sensitive to, global oil price dynamics.*

PASS-THROUGH OF VAT HIKE TO INFLATION

In January 2019, the VAT rate was increased from 18 to 20%. As expected, this had an effect on inflation: in January, both annual and monthly growth in consumer prices accelerated[1].

However, increased price dynamics were only partly attributable to tax changes. Prices started to demonstrate a upward trend in 2018 H2, when the supply of certain food products was adjusting to demand, cost-side pressures were intensifying (appreciation of oil, oil products and agricultural raw materials), and the ruble was weakening. The January acceleration of annual inflation was in part attributable to the low base effect. Compared to December, it grew by 0.7 pp, whereas monthly price growth (seasonally adjusted) was up only by 0.2 pp.

In 2018 H2, the Bank of Russia assessed the potential scale of the pass-through of the increased VAT to inflation[2]. This depended on a range of factors, including consumer demand, the production and price strategies of companies and market competition. In addition to the direct effect from the tax rate change on the categories of goods and services taxed at the standard rate, there may also be secondary effects (growing costs and inflation expectations) that also affect goods and services subject to discounted taxation. The scale of such effects also depends on a number of conditions, and its assessment is fraught with high uncertainty. Given the above, the possible pass-through of tax increase to prices was assessed within a rather broad interval (0.6–1.5 pp).

Price dynamics across various segments of the consumer market point to a rather moderate scale of the realised pass-through of the VAT increase to prices. According to calculations made using various models, in February, its contribution to annual inflation totalled 0.6–0.7 pp, including the effects of a proactive price increase in late 2018 at the level of 0.1–0.2 pp. (Table 1).

For example, according to the 'difference in differences' method[3] taking into account sectoral, time, macroeconomic and specific effects, the contribution of the increased VAT to annual inflation in February 2019 was roughly 0.6 pp.

The analysis of factor decomposition of price growth in the basic groups of goods and services also suggests the moderate effect of the VAT increase.

ASSESSMENT OF THE POTENTIAL DIRECT PASS-THROUGH OF THE VAT HIKE TO ANNUAL INFLATION *Table 1*
(PP)

	Point estimate*, September 2018		Assessment of the contribution to annual inflation in February 2019		Difference	
	Price growth	Contribution to inflation	Price growth	Contribution to inflation	Price growth	Contribution to inflation
Total inflation	1.1		0.6–0.7		-(0.4–0.5)	
including:						
– food products	0.6	0.2	0.4–0.5	0.15–0.2	-(0.1–0.2)	-(0–0.05)
– non-food goods	1.5	0.5	0.4–0.6	0.15–0.2	-(0.9–1.1)	-(0.3–0.35)
– services	1.4	0.4	0.9–1.1	0.25–0.3	-(0.3–0.5)	-(0.1–0.15)
including utility services	1.7	0.1	1.7	0.1	0.0	0.0

**Direct pass-through, including the effect of discounted taxation.*
Sources: Rosstat, Bank of Russia calculations.

[1] *Here and below, monthly price growth rates are provided with an adjustment for seasonality.*

[2] *See the Report on the Estimated Pass-through of Increase in the Standard VAT Rate to Inflation (August 2018), http://www.cbr.ru/Content/Document/File/47495/2018_01_nds.pdf.*

[3] *The 'difference in differences' method is a statistical procedure used to study the effect of a certain event on the variable in question. This approach involves comparing the values of variables from the reference and test groups before and after the influence on the variables from the test group. The method can be used to assess the direct effect of increased VAT on inflation. The sample of consumer products and services is divided into the reference group (goods and services taxed at discounted VAT rate) and test group (goods and services taxed at the base VAT rate). VAT change is an event that affects price dynamics in the test group.*

Non-food goods prices

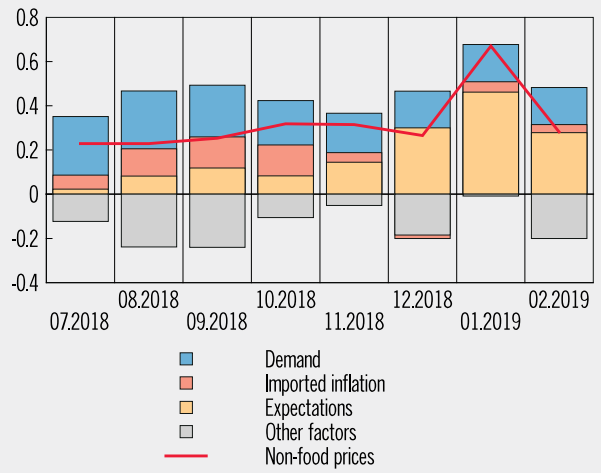
Non-food goods included in the consumer basket are taxed mainly at the base rate. A relatively small number of them are subject to discounted taxation (child and medical goods, book products, and periodicals). In January 2019, the monthly appreciation of non-food goods grew to an estimated 0.7%, which is 0.4 pp higher than it was in the period from September to December 2018.

In February, the monthly appreciation of non-food goods almost returned to its December level. One-time price growth acceleration in this segment of the consumer market suggests that it is largely attributable to the VAT hike.

According to Bank of Russia estimates, in December 2018 – February 2019, the contribution of economic agents' inflation expectations to the growth in prices for non-food goods picked up significantly (with a maximum in January), whereas in the previous five months[4], the contribution was rather stable (Chart 1). The indicator of expectations used in assessments is estimated and includes the aggregate data from surveys of companies[5] and households[6]. This variable is intended to reflect market conditions as a certain balance between the price strategies of producers and the consumer behaviour of households. Tax decisions have a significant effect on the behaviour of economic agents, and consequently on their inflation expectations.

In autumn 2018, respondents viewed the expected VAT increase as a significant event affecting their price expectations and strategies, as well as consumer behaviour. The inflation expectations of economic agents grew in December 2018. The noticeable peak of their contribution to the dynamics of non-food prices was in January 2019, with a subsequent decline. Its temporary nature implies that it was to a large extent attributable to a one-time event, namely the VAT increase. For the period December 2018 – February 2019 in aggregate, the contribution of expectations exceeded the level of two previous months by about 0.7 pp. Given the potential effect of other factors, this can be viewed as the upper bound of the assessed actual pass-through of the VAT hike to non-food prices. Considering their share in the consumer basket, the overall contribution of this pass-through to annual inflation in February 2019 may be estimated at roughly 0.2 pp.

DECOMPOSITION OF MONTHLY INCREASE IN NON-FOOD PRICES, SA *Chart 1*
(PP)



Source: Bank of Russia calculations.

It should be noted that producers and trading companies may have stocks formed before the VAT increase. As contracts are renewed, goods taxable at the new rate will come into the market. Taking into account these factors, the VAT change pass-through to prices could be protracted.

Services prices

In January 2019, tariffs for utility services were indexed due to the VAT increase. Their contribution to accelerating inflation was 0.1 pp.

In January–February 2019, monthly growth in services prices, excluding utilities, was estimated to have fallen. However, in January, there was a one-time acceleration in the contribution of inflation expectations to the dynamics of prices for this group of services (Chart 2), which may be associated with the effect of tax decisions. This gave an additional impetus to the pick-up in services price growth.

[4] *Period after the stabilisation of the oil products market.*

[5] *Based on the surveys of the Bank of Russia and Primakov National Research Institute of Word Economy and International Relations (Russian Economic Barometer).*

[6] *Surveys conducted by inFOM and commissioned by the Bank of Russia.*

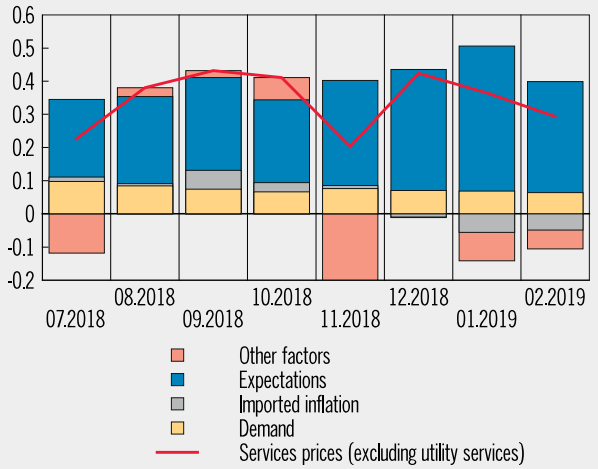
Food products prices

The VAT increase has a direct effect on a relatively smaller number of food products included in the consumer basket for CPI calculation (fruit and citrus fruit, confectionery products, alcohol products, catering and certain other items with a low weight in the consumer basket; the total share of listed items accounts for slightly over one third of all food products). However, it may have a direct effect on all types of food (its channels may include increased costs, changes in consumer behaviour and policies of trading companies for the allocation of increased costs among product items).

As the model decomposition shows, the peak of monthly growth in food prices was in December; it was related to the effect of one-time factors, mainly some food products' supply-side factors (Chart 3). However, in December 2018 – February 2019, economic agents' inflation expectations reflecting changes in market conditions as a result of the tax decisions were noticeably higher than in the previous months. Considering this, in February, the maximum amount of VAT pass-through, linked to the indirect effect on food prices, to annual inflation totalled roughly 0.2 pp.

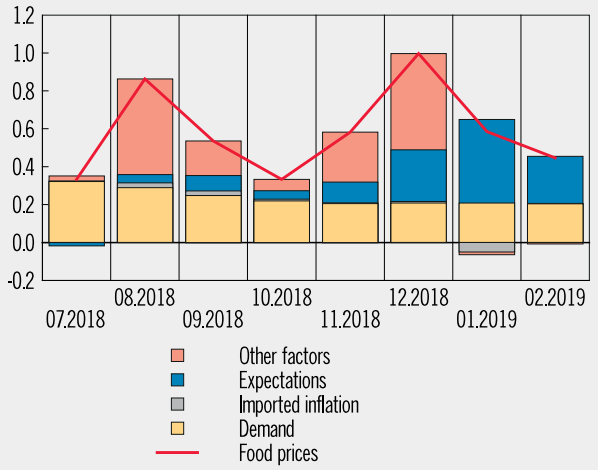
In February, the total realised pass-through of the VAT hike to annual inflation was moderate, staying around the lower bound of Bank of Russia preliminary estimates made in 2018. Its scale could have been influenced by the strategies of producers and sellers designed to maintain sales volumes or market share considering the conservative consumer behaviour of households. The growth in costs might have been temporarily absorbed by reduced business marginality or financial performance of companies.

DECOMPOSITION OF MONTHLY INCREASE IN SERVICES PRICES (EXCLUDING UTILITY SERVICES), SA *Chart 2*
(PP)



Source: Bank of Russia calculations.

DECOMPOSITION OF MONTHLY INCREASE IN FOOD PRICES, SA *Chart 3*
(PP)



Source: Bank of Russia calculations.

As consumer demand expands, producers and sellers will have an opportunity to regain their profits at the expense of consumers. Additional pressure may come from the secondary effects of the VAT increase. Overall, its total contribution to inflation may grow by the end of 2019.

The estimates of VAT pass-through to prices will be revised as additional data become available (for example, on producer prices and the financial performance of companies in the first months of 2019).

ANNEXES

ECONOMIC SITUATION IN RUSSIAN REGIONS

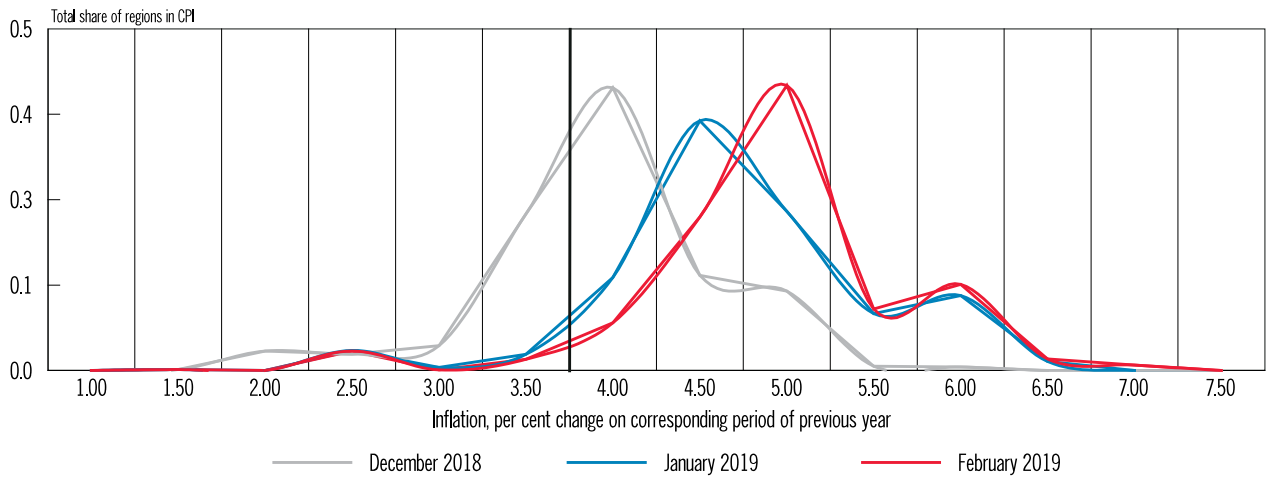
From late 2018 to early 2019, annual inflation accelerated in all Russian regions, but at different paces, which caused a greater variance of this indicator by region. The factors that contributed to diverse inflation indicators across regions included, inter alia, differences in the pass-through of the ruble's weakening and the VAT increase to prices, taking into account the geographic specifics of consumption and import flows. The differences in the dynamics of traditionally more volatile food prices (to a greater extent depending on the distribution of production facilities and logistics flows across the country) and the indexation of tariffs of natural monopolies at the beginning of the year were also of great significance. Production, income and consumer demand dynamics were not uniform, which is typical considering among other reasons the economic specialisation of the regions. At the same time, in all regions demand remained at levels that do not exert any additional inflationary pressure.

INFLATION AND PRICE EXPECTATIONS

Distribution of regions by inflation level

In December 2018 – February 2019, price growth accelerated in all regions. The spread of regional inflation levels grew to 5.1 pp (it averaged 3.8 pp in 2018) (Chart 1). November readings of annual inflation registered in Russian regions varied from 2 to 7.1%, whereas the Russian average figure stood at 5.2% (Chart 3). In early 2019, the unidirectional changes in price dynamics across regions were attributable to the country-wide factors: the persistent effect of the weakening ruble, the increased base VAT rate, and the low base effect of food inflation at the beginning of the previous year. Regional differences in inflation acceleration were largely due to the various speed and scale of these factors' pass-through, as well as the effect of local non-monetary factors. In February, the lowest inflation (less than 3%, four regions) was recorded in Khanty-Mansi (2.9%), Yamalo-Nenets (2.1%) and Nenets (2.7%) Autonomous Districts and the Republic of Ingushetia (2.0%), where price movements were

DISTRIBUTION OF REGIONS BY ANNUAL INFLATION *Chart 1*



Sources: Rosstat, Bank of Russia calculations.

largely shaped by local factors (such as the commissioning of large greenhouse production facilities in Ingushetia, and restrained growth of administered prices and tariffs in the autonomous districts of the Tyumen Region). In December–January, the group of regions with the highest inflation (over 6%, 17 regions), as in the previous months, included many regions in the Central Russia, the Crimea and Sevastopol, as well as certain Siberian, northern and remote regions. The rise in food prices was a key contributor to the acceleration of inflation in the majority of these regions.

Food inflation

In early 2019, among the key components of inflation, non-uniform growth in food prices, which are typically more volatile and more sensitive to one-off supply-side factors, was the most significant factor. The inflation upswing for individual food products (including fruit and vegetables, eggs, bread and bakery), that started in 2018 H2 after a long period of reduction, differed by pace and intensity from region to region. This effect was stronger in regions with developed agro-industrial complex (including the Kursk and Bryansk Regions and the Republic of Crimea), which experienced a greater inflation drop from 2017 H2 to early 2018 in the context of increased supply. The rise in food prices had a higher overall effect on inflation in the Crimea and Sevastopol and in several northern and remote regions with a higher share of food products in consumer expenditures.

Non-food inflation

In most regions, non-food inflation grew slower than food inflation. This, in particular, points to a moderate VAT increase pass-through to prices. Changes in the distribution of non-food price growth by region reflected the differences in price adjustments to tax measures and exchange rate dynamics. The variations in price response to these factors can be attributed to the specifics of the consumer basket and the geography of trading partner countries, as well as consumer demand dynamics. Sensitivity of inflation to exchange rate changes was higher in regions with high incomes and an elevated share of imports in consumption. Movements in motor fuel prices, whose regional differences were largely determined by the structure of local markets, were also a significant factor contributing to the spread of non-food inflation. Individual regions have a high share of networks independent from VIOCs[1] (for example, in Tyva and Dagestan), which are not bound by agreements with the Government. In such regions, fuel prices are generally more volatile and respond faster to changes in wholesale market prices. In early 2019, changes in fuel prices took different directions in regions with prevailing local networks of petrol filling stations and those with major VIOCs. Due to increased VAT, all VIOCs raised prices for motor fuel within the limits established by agreements with the Government, while small regional petrol filling stations decreased their prices following a reduction in wholesale prices.

Inflation in the services sector

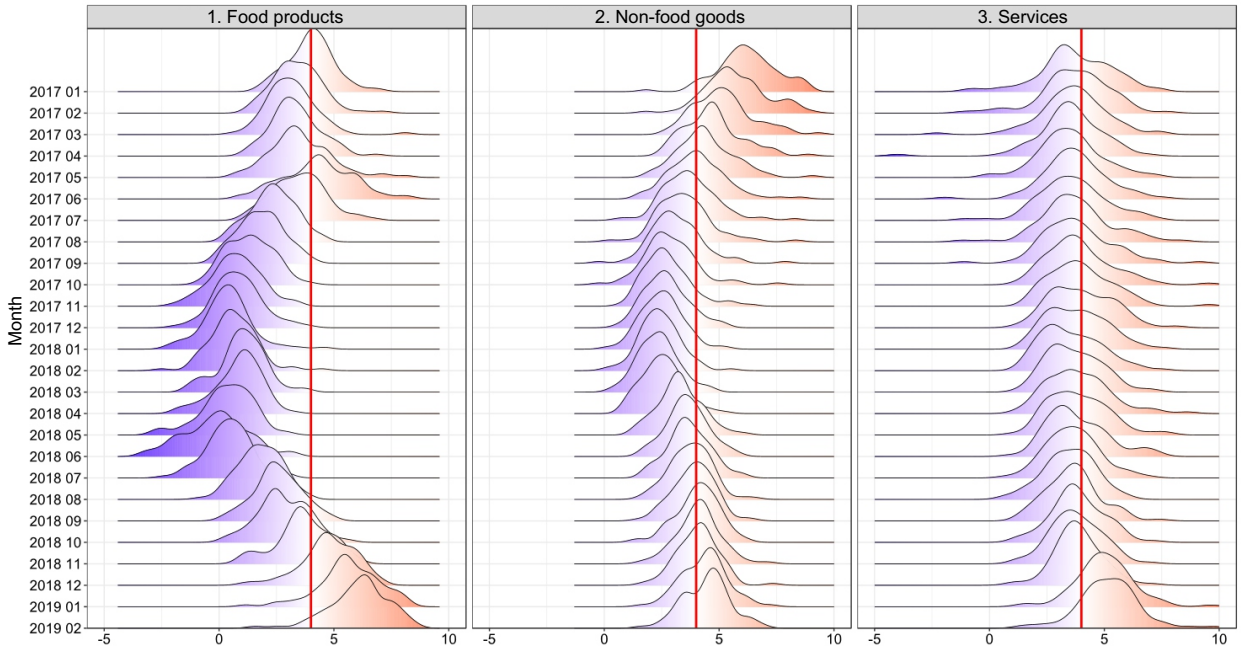
Different dynamics of services prices in regions were to a great extent attributable to differences in the indexation of utility tariffs early this year. A significant additional factor was the increase in tariffs for the disposal of solid household waste (SHW), following the reorganisation of the waste management system . With Russia's average growth in SHW disposal tariffs by 51% in January 2019, tariffs in individual regions more than doubled y.o.y (especially in the Orel, Sverdlovsk and Vologda Regions, by 150–180%). In March, however, local governments in many regions announced a possible reduction in tariff rates. In some remote regions of the Far East, Siberia and Urals, a more noticeable rise in inflation was largely due to increased fares for air transportation (including against the backdrop of growing prices for aviation fuel), which is also used to deliver goods.

Price expectations

According to the February–March 2019 surveys, after a considerable growth registered in late 2018, business price expectations for three months ahead dropped for all types of economic activities

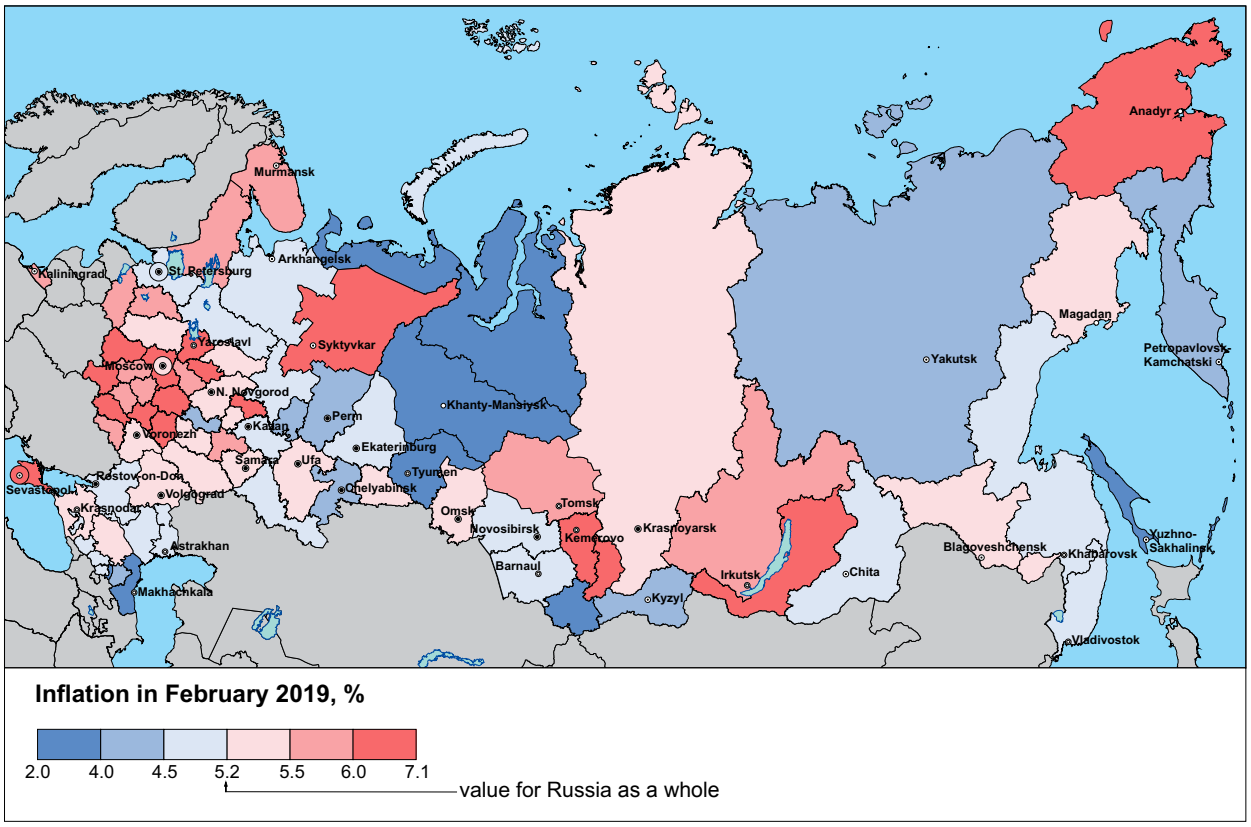
[1] *Vertically integrated oil companies.*

DISTRIBUTION OF REGIONS BY CONTRIBUTION TO ANNUAL INFLATION OF GOODS (FOOD AND NON-FOOD) AND SERVICES *Chart 2*



Note: the horizontal axis shows inflation (annualised, %); the vertical axis shows the total weight of regions.
Sources: Rosstat, Bank of Russia calculations.

INFLATION ACROSS REGIONS IN FEBRUARY 2019 *Chart 3*



Sources: Rosstat, Bank of Russia calculations.

INFLATION BY INDIVIDUAL SUBCOMPONENT ACROSS FEDERAL DISTRICTS

Table 1

	Weight in CPI								Inflation (%, February)							
	Central FD	North-Western FD	Southern FD	North Caucasian FD	Volga FD	Urals FD	Siberian FD	Far Eastern FD	Central FD	North-Western FD	Southern FD	North Caucasian FD	Volga FD	Urals FD	Siberian FD	Far Eastern FD
All goods and services	100	100	100	100	100	100	100	100	5.7	5.1	5.3	4.6	5.1	4.1	5.5	4.9
Food products	**36.2**	**37.2**	**40.4**	**45.2**	**37.4**	**36.5**	**37.8**	**37.4**	**6.8**	**5.7**	**6.3**	**4.7**	**5.6**	**4.5**	**5.8**	**5.7**
– excluding fruit and vegetables	**32.5**	**32.9**	**35.6**	**38.8**	**33.8**	**32.8**	**34.0**	**33.1**	**6.1**	**5.1**	**5.9**	**4.5**	**5.4**	**4.4**	**5.8**	**5.5**
Meat products	10.1	8.5	10.0	12.8	8.9	8.5	9.3	8.5	8.9	8.5	9.2	6.7	8.7	6.3	8.5	9.6
Milk and dairy products	4.2	4.8	4.4	4.9	4.2	4.4	4.4	4.1	4.2	4.0	3.9	2.9	2.0	3.4	3.5	4.5
Fruit and vegetables	3.6	4.3	4.7	6.5	3.5	3.8	3.8	4.3	12.4	10.0	9.5	6.3	7.4	6.1	6.3	7.1
Bread, pasta and cereals	2.2	2.4	2.9	3.4	2.7	2.4	2.6	2.3	6.9	4.0	8.0	3.0	5.9	6.0	7.2	7.1
Fish products	2.8	1.7	2.1	2.1	1.8	1.7	1.9	1.8	4.6	4.5	2.7	2.6	3.2	3.7	2.3	0.0
Oils and fats	1.0	1.1	1.4	2.2	1.2	1.0	1.2	1.0	3.4	2.8	4.1	5.2	3.0	2.0	5.5	4.1
Eggs	0.5	0.5	0.6	0.6	0.5	0.5	0.5	0.6	22.4	21.7	26.5	24.4	23.7	15.6	12.1	9.9
Sugar	0.3	0.3	0.5	1.3	0.5	0.4	0.6	0.4	31.8	30.2	31.3	18.9	34.7	27.6	30.4	20.9
Other	11.6	13.6	13.7	11.5	14.0	13.9	13.5	14.5	3.3	2.5	2.4	2.0	2.5	2.3	3.7	3.5
Non-food goods	**35.3**	**34.9**	**35.8**	**33.7**	**36.5**	**36.0**	**37.6**	**35.1**	**5.2**	**4.4**	**4.0**	**3.8**	**4.6**	**3.8**	**5.0**	**3.5**
– excluding petrol	**31.5**	**31.0**	**32.9**	**30.7**	**33.1**	**31.9**	**33.8**	**31.8**	**4.5**	**3.5**	**3.3**	**3.1**	**4.0**	**2.8**	**4.2**	**3.1**
Clothes, footwear and fur goods	9.2	8.4	9.2	10.6	9.2	7.8	8.5	9.1	2.7	2.1	1.2	1.3	2.4	0.7	2.1	1.8
Passenger cars	5.5	6.5	6.5	6.6	6.2	5.4	6.3	6.3	7.2	4.8	5.6	5.8	5.8	3.8	5.1	3.2
Oil products	3.6	3.2	4.4	3.5	3.7	3.3	3.5	3.5	10.3	10.0	10.1	8.9	10.1	10.6	10.7	6.3
Household appliances	3.1	2.8	3.6	3.5	3.6	2.7	3.2	3.2	1.8	-0.5	1.1	2.3	1.5	0.9	1.1	0.0
Furniture and construction materials	3.3	2.9	2.8	1.3	3.3	4.0	3.2	2.3	5.0	4.5	3.8	4.6	5.3	3.5	5.4	3.2
Household chemicals	2.3	2.4	2.0	2.3	2.3	2.5	2.5	2.3	4.8	4.8	2.6	2.9	4.2	3.1	2.8	6.7
Other	7.7	8.9	8.3	8.0	8.2	8.7	10.3	9.2	5.7	5.4	4.5	3.9	4.8	4.3	6.1	4.9
Services	**28.1**	**27.4**	**23.6**	**20.9**	**25.7**	**27.0**	**24.3**	**27.1**	**5.2**	**5.1**	**5.3**	**5.5**	**5.1**	**3.9**	**5.6**	**5.7**
Services excluding utilities	**18.8**	**18.1**	**13.8**	**12.0**	**16.2**	**17.2**	**15.3**	**16.2**	**4.8**	**4.2**	**4.7**	**5.2**	**4.7**	**3.4**	**4.8**	**5.9**
Utilities	10.2	11.0	9.4	8.0	9.0	8.9	7.9	9.2	6.0	6.7	6.0	5.9	5.8	4.7	6.9	5.3
Personal services	3.3	3.8	2.4	2.5	2.8	2.9	3.0	4.1	2.8	3.2	3.9	2.1	3.8	2.3	4.0	3.7
Passenger transport	2.4	2.5	2.6	2.3	2.5	2.6	2.4	2.9	6.1	4.0	9.4	9.7	5.6	5.2	7.2	9.7
Tourism services	2.5	1.8	2.3	1.4	2.3	1.9	1.8	2.3	8.4	6.3	4.1	3.9	4.6	2.9	5.9	8.2
Education services	3.2	2.1	0.8	0.4	1.7	3.0	1.0	1.1	7.4	6.1	6.0	7.2	6.9	6.8	8.2	13.6
Medical services	1.8	1.6	1.5	1.3	1.7	1.5	1.3	1.5	3.3	4.1	3.5	3.9	5.1	3.9	7.1	4.7
Other	5.2	5.9	4.4	4.4	5.5	5.3	6.1	5.3	2.1	2.8	3.4	5.0	3.4	2.1	2.5	2.1

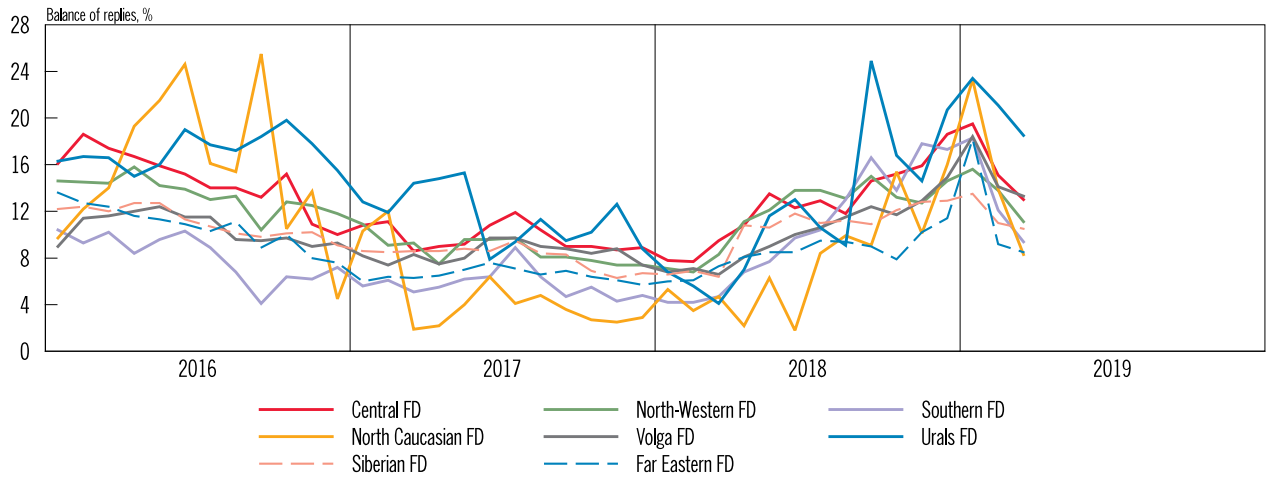
– *maximum values (weight and inflation) for all federal districts.*

– *minimum values for each subcomponent.*

Sources: Rosstat, Bank of Russia.

BUSINESS PRICE EXPECTATIONS

Chart 4



Source: Bank of Russia.

across all federal districts, returning to August–September readings (Chart 4). These dynamics can be linked to the pass-through of the VAT increase, effected in early 2019, which was the main reason for the growth of expectations in the final months of 2018. The drop was synchronous in all federal districts, with the only exception of the Urals, where high price expectations persisted against the backdrop of low inflation levels. This may suggest that inflation growth in the Urals Federal District (FD) will catch up in the coming months due to a later manifestation of the VAT increase pass-through. According to the survey, besides the VAT hike pass-through effect, price expectations remained elevated largely due to companies' concerns about growth in expenditures on electricity and fuel.

MONETARY CONDITIONS

Household lending

According to the quarterly survey of top banks, the change in bank lending conditions (BLC) for households in Russian regions was generally unidirectional at the end of 2018: in all federal districts price conditions were tightened and interest rates rose (Chart 5). The highest interest rates on household loans were established by the start of 2019 in the Central FD and in the North Caucasus (13.2 and 13.4%, respectively) and the lowest ones were in the Urals and North-Western regions (11.4 and 11.7%). The level of interest rates is partly explained by the share of mortgage loans with lower rates in the loan portfolio. This share is the highest in the Urals and North-Western FDs (47 and 45%, respectively) and the lowest in the North Caucasian FD (35%). Non-price conditions in all regions continued to soften, though less significantly than during the first six months of 2018. Overall, lending conditions for households remained in the area of soft values in the North-Western, Urals and Volga FDs, and in the area of neutral values in the Central, Southern, North Caucasian, Siberian and Far Eastern FDs[2]. This distribution correlates with the assessment of the credit risk level in the regions. Thus, the lowest values of the share of overdue outstanding amounts on household loans in late 2018 were observed in the North-Western, Volga and Urals FDs (4.2–4.6%) and the highest ones – in the Southern and North Caucasian FDs (6.2 and 7%, respectively). In December and January, the dynamics of household lending (y.o.y) slowed down in most regions amid rising interest rates, with the exception of the Central FD. Growth in lending in the central regions could not be held back even by tighter bank lending conditions compared to other federal districts. The level of households' debt burden here remains one of the lowest, largely due to higher incomes of the population.

Corporate lending

In late 2018, the price lending conditions for businesses tightened in all federal districts, with the strongest tightening registered in the North-Western FD (Chart 6). Non-price conditions slightly tightened in the central regions of the European part of Russia and the Volga region, while in other regions they mainly continued to soften. According to business surveys, the average level of acceptable interest rates for manufacturing and trading companies[3] in 2018 Q4 was close to actual average rates (for loans over one year, it was roughly 9–10%). The acceptable level of interest rates for agricultural companies is estimated lower, as the majority of them are not ready to pay more than 7% in interest for loans of over one year (which is explained by the existing concessional lending programmes). Overall, the assessments of BLC for businesses were in the territory of tight values across all federal districts, with the tightest conditions observed in the Central and Southern FDs. By the beginning of 2019, the highest level of corporate debt burden was established in the same districts[4] (51% in the Central FD, 27% in the Southern FD, with the average figure for the remaining

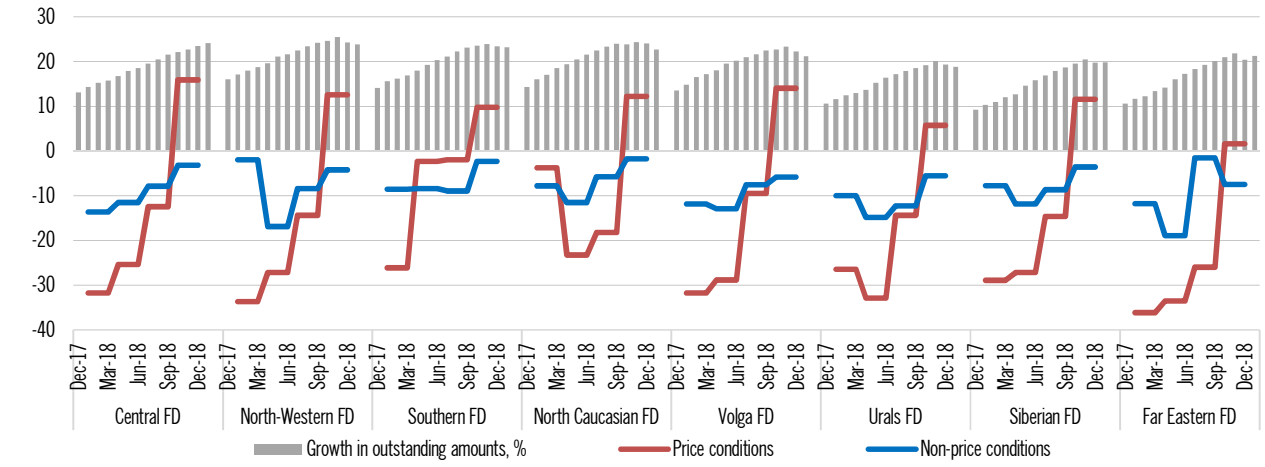
[2] *The level of tightness of BLCs was assessed on the basis of the results of a quarterly survey of top banks. BLCs were assessed as soft if the diffusion index was below -5, as neutral if it was in the range from -5 to +5, and as tight if it was above +5.*

[3] *According to the Bank of Russia's quarterly investment monitoring surveys.*

[4] *The debt burden of corporate borrowers by region (federal district) was calculated as the ratio of outstanding corporate loans to the volume of finished products and performed works/services (12-month moving sum).*

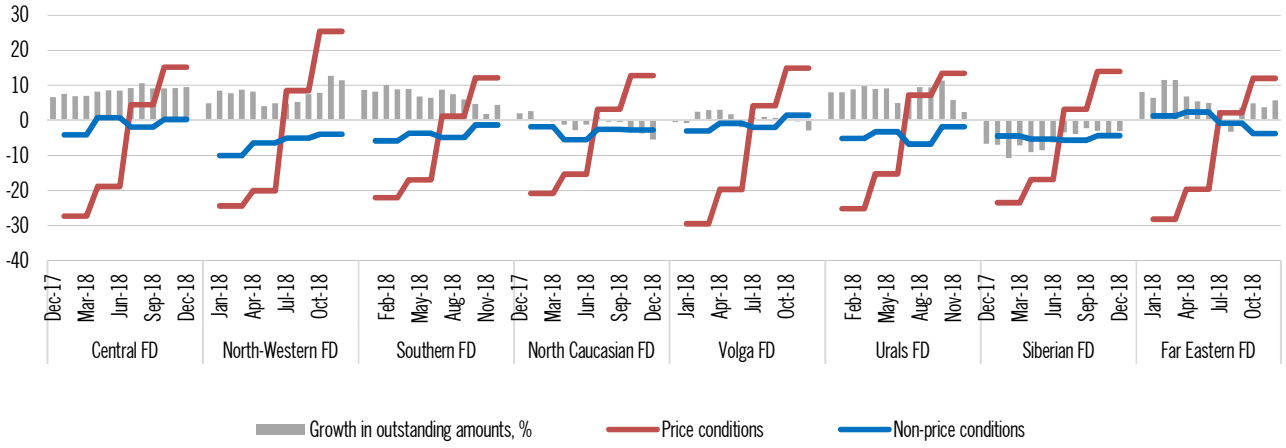
federal districts being 20%). In most regions, the debt burden level continued to be stable in late 2018. Some of its growth was registered only in the Far East and the North Caucasus, where the credit burden noticeably undershot the average Russian level (19% in the North Caucasian FD, 20% in the Far Eastern FD, 30% in Russia as a whole). At the end of 2018, the share of overdue outstanding amounts of corporate borrowers was relatively low and declining in most regions. The exceptions, in terms of dynamics, were individual regions of Siberia, where from mid-2018 there has been observed a slight increase in this indicator (due to the dynamics in certain industries, including construction). With regard to the level, the North Caucasus regions clearly stood out; here the share of overdue outstanding amounts, despite a decline at the end of the year, remains high (over 60% in Daghestan, Kabardino-Balkaria, Ingushetia). This region also posted the largest decrease in the value of outstanding amounts on corporate loans. Corporate lending also declined in the Volga and Siberian FDs, mainly due to manufacturing and construction companies.

CHANGE IN BANK LENDING CONDITIONS (NEGATIVE ZONE – EASING, POSITIVE ZONE – TIGHTENING) AND GROWTH IN OUTSTANDING AMOUNTS ON HOUSEHOLD LOANS (Y.O.Y) *Chart 5*



Source: Bank of Russia.

CHANGE IN BANK LENDING CONDITIONS (NEGATIVE ZONE – EASING, POSITIVE ZONE – TIGHTENING) AND GROWTH IN OUTSTANDING AMOUNTS ON CORPORATE LOANS (Y.O.Y) *Chart 6*



Source: Bank of Russia.

PRODUCTION AND INVESTMENT ACTIVITY

Economic activity indicator

In late 2018, the regional heterogeneity of the values of the economic activity indicator (EAI)[5] at the level of individual regions decreased in line with an increase in the number of entities with positive dynamics (y.o.y). However, in January 2019, the heterogeneity climbed up again against a slowdown in the indicator dynamics registered in most regions (Chart 7). The construction industry was the largest contributor to preserving the heterogeneity of the EAI in November and December. In the Urals and North Caucasus regions, where the EAI dynamics differed significantly from the overall group, the situation was mostly determined by construction. In late 2018, a significant decline in the volume of construction works in some regions of the North Caucasus was conditioned on the high base effect of December 2017 and a more even distribution of works performed during 2018. At the same time, according to 12-month results, total construction output continued to grow in the North Caucasian FD. Additionally, this district is traditionally characterised by a high volatility in construction dynamics and the overall economic activity, which is in part due to the small size of the economy. In the Urals FD, the positive dynamics of the construction industry in 2018 were mostly associated with the commissioning of a large gas liquefaction enterprise in the Yamal-Nenets Autonomous District, as well as with the construction of a number of other production facilities. In January 2019, similar to other federal districts, construction in the Urals experienced the base effect, which caused a deterioration in industry dynamics y.o.y. Other activities included in the EAI continued to grow.

Industry and business sentiment

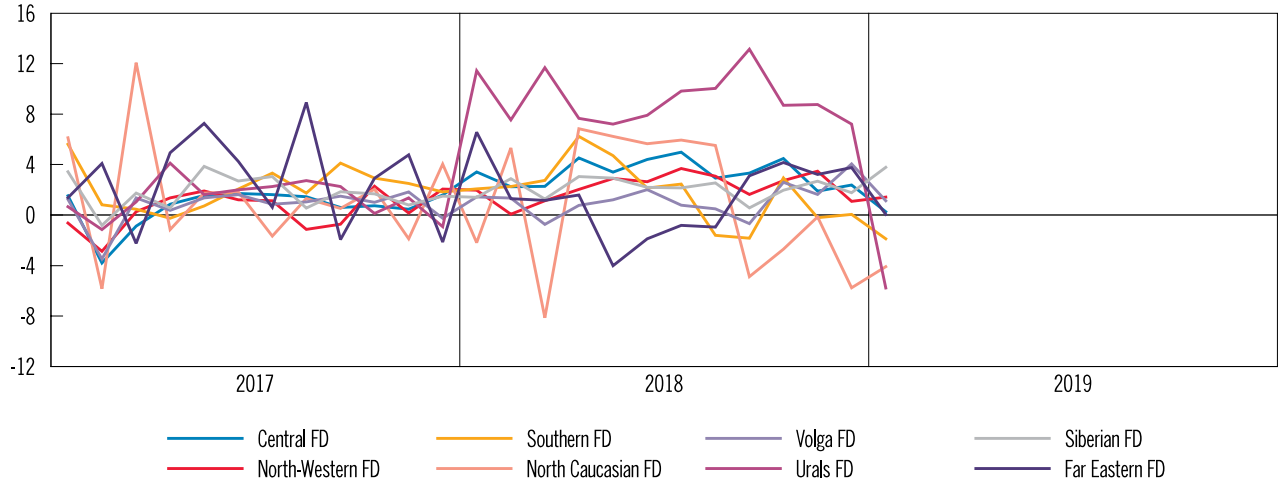
Industrial dynamics were the most homogeneous among regional types of economic activity at the end of 2018. In December, the highest industrial growth rates were observed in the Urals. There was an increase in both the mining and quarrying (gas production in the Yamal-Nenets Autonomous District) and the manufacturing (oil refining in the Tyumen Region, mechanical engineering in the Sverdlovsk Region). In January 2019, amid a slowdown in the overall country-wide dynamics of the industry, growth rates turned negative in some regions. This specifically occurred in the North Caucasus and Far East (both in mining and quarrying, including the Sakhalin Region and Yakutia, and in manufacturing) and in the south of European Russia (primarily in the Rostov Region due to the drop in output in the food industry and mechanical engineering). In late 2018, the assessments of economic situation by businesses participating in the Bank of Russia's monitoring stabilised after declining in Q2 and Q3 and improved slightly in early 2019. In most regions, they approached the early-2018 level and the long-term average level (Chart 8). The relative stability of lending conditions, as well as the weakening of the perceived negative drag from exchange rate movements and cost-side pressures have improved assessments of economic situation in recent months.

Investment

Over the first nine months of 2018, investment activity dynamics remained positive in most federal districts, with the exception of the North-Western and Southern FDs. At the level of individual regions, in 2018 H1, the completion of construction projects for the FIFA World Cup continued to influence investment dynamics. In January–September 2018, a drop in investment was observed in 9 of the 11 regions that hosted tournament matches. Only Moscow and the Nizhny Novgorod Region saw no decline, as major projects are being implemented there in residential construction and manufacturing, respectively. Estimates of investment activity by businesses participating in the Bank of Russia's monitoring in 2018 Q3 and Q4 continued to grow. The list of leaders includes the Urals, Far Eastern and Volga FDs, where the indicator values exceeded the highs of 2012–2013.

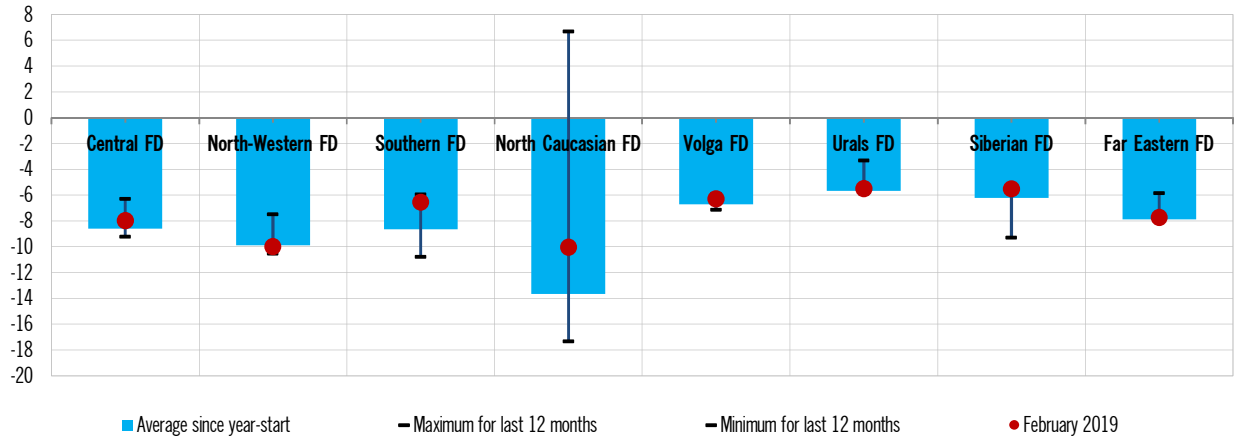
[5] *The economic activity indicator is calculated as the weighted average rate of the main economic activities: mining and quarrying, manufacturing, electricity, gas and steam supply, water supply, sewerage, waste collection and disposal, agriculture, construction, paid services provided to households, and trade. The weights of the respective economic activities in the structure of the gross regional product (GRP) are used as weights for calculating the average figure.*

ECONOMIC ACTIVITY INDICATOR (JANUARY 2017 - JANUARY 2019)
(Y.O.Y, %)
Chart 7



Sources: Rosstat, Bank of Russia calculations.

ASSESSMENT OF CHANGES IN ECONOMIC SITUATION BY BUSINESSES
(BALANCE OF RESPONSES, PP)
Chart 8



Source: Bank of Russia.

The change in investment activity is estimated less positively by businesses in the Southern, North Caucasian and North-Western FDs; nonetheless the balance of answers in these districts was in general positive at the end of the year. Capacity utilisation is estimated at a level close to the long-term average.

CONSUMER DEMAND AND SAVINGS

Regional consumption peculiarities

In late 2018 – early 2019, consumer demand dynamics remained positive almost in all federal districts. In most regions, there was a moderate increase in the retail trade turnover and paid services, though several regions saw their steady decline. In July–December, the decline in trade in the Republic of Daghestan continued due to a more significant drop in household income compared to the country as a whole. It determined the negative dynamics of trade for the entire North Caucasian FD. In the Southern FD, the months-long contraction in the value of paid services continues in the Crimea and Sevastopol alongside the growth of real household incomes. Overall, the positive dynamics of demand in most regions is supported by the persistent growth in consumer lending, which, despite the

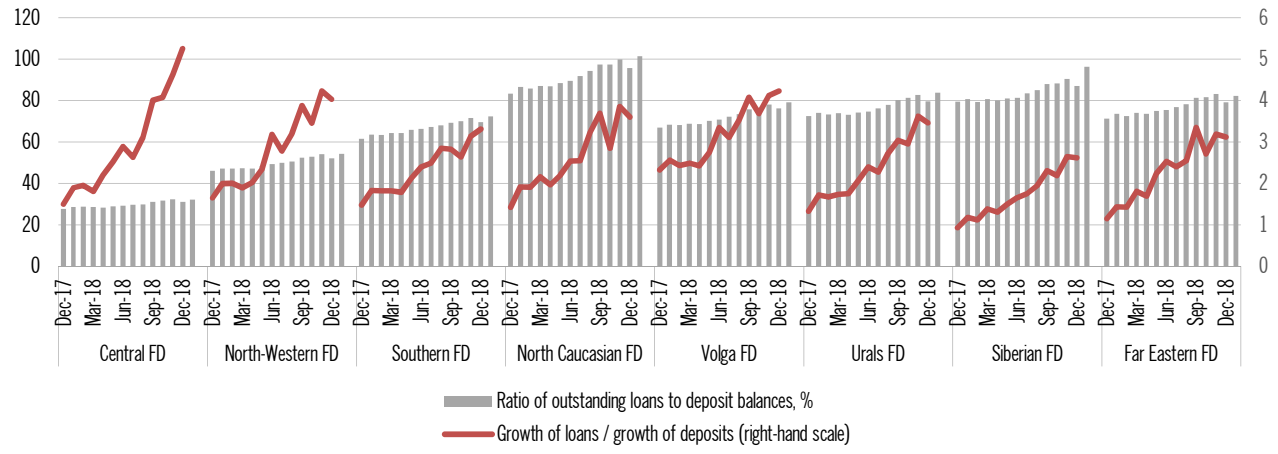
slowdown in December and January, remains significantly higher than the growth rates of household deposits in all regions (Chart 9). Regional differences in the changes of demand dynamics amid a relatively uniform growth in lending are determined by the different directions of household income dynamics. In late 2018, the heterogeneity of the dynamics of household deposits at the federal district level remained low: the growth rates of deposits slowed across all regions.

LABOUR MARKET AND INCOMES

Regional labour markets

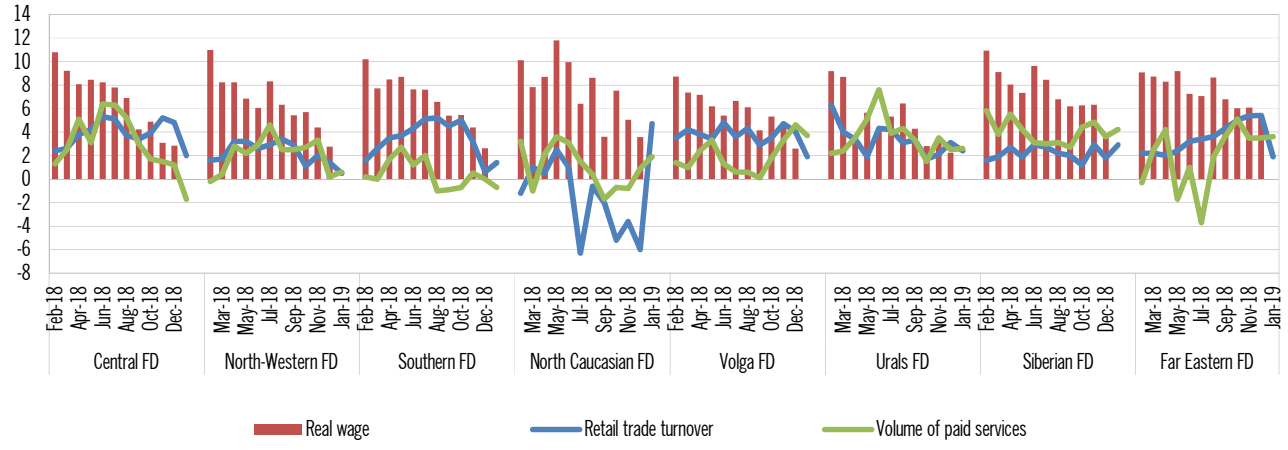
In 2018 H2, the employment rate of the population in most regions remained close to the average levels for the last 4–5 years. At the end of the year, in all federal districts, with the exception of the North Caucasus, its values ranged from 62 to 70%, with the average Russian value holding at 65.6%. The highest level of employment (over 70%) is maintained in Moscow, the Moscow Region, St. Petersburg, the Tyumen Region's autonomous districts, the Magadan Region, and Chukotka. The employment rate remains the lowest in the republics of the North Caucasian FD (the average value in the district is 59.2%). Real wages grew throughout 2018 in all federal districts, but in recent months

HOUSEHOLD LOANS AND DEPOSITS IN FEDERAL DISTRICTS *Chart 9*



Source: Bank of Russia.

REAL HOUSEHOLD INCOME, RETAIL TRADE TURNOVER AND VOLUME OF PAID SERVICES *Chart 10*
(Y.O.Y, %)



Sources: Rosstat, Bank of Russia calculations.

growth has slowed everywhere (Chart 10). In November–December, the highest (on average above 5%) real wage growth continued in the regions of the Far East and the lowest (2.3%) growth was in the Urals. In 2018 Q4, the unemployment rate (seasonally adjusted) continued to decline in most federal districts, excluding the Far Eastern FD. At the same time, the group of regions of the South of Siberia (the Republic of Altai, the Republic of Tyva and the Trans-Baikal Territory) and the North Caucasus republics still stand out. The average annual unemployment rate there significantly exceeds the indicators of other regions and its values are consistently above 10%. The regional spread of unemployment rates has remained relatively stable over the past two years.

STATISTICAL TABLES

INTEREST RATES ON BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY *Table 1*
(% P.A.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.2018	From 12.02.2018	From 26.03.2018	From 17.09.2018	From 17.12.2018	General approach to rate-setting[1]
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[2]; repos	1 day	Daily	8.75	8.50	8.25	8.50	8.75	Key rate + 1.00
		Loans secured by non-marketable assets[3]	2 to 549 days		9.50	9.25	9.00	9.25	9.50	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	7.75	8.00	Key rate + 0.25
		Repo auctions	1 week	Weekly[5]	7.75 (key rate)	7.50 (key rate)	7.25 (key rate)	7.50 (key rate)	7.75 (key rate)	Key rate
			from 1 to 6 days	Occasionally[6]						
		FX swap auctions (ruble leg)[2]	From 1 to 2 days							
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days							
			1 week	Weekly[5]						
	Standing facilities	Deposit operations	1 day[7]	Daily	6.75	6.50	6.25	6.50	6.75	Key rate - 1.00

[1] From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set as key rate spreads. See press release http://www.cbr.ru/press/pr/?file=01062018_180510dkp2018-06-01T18_04_36.htm.
[2] From 23 December 2016, interest rates on the foreign currency leg equal LIBOR on overnight loans in US dollars or euros (depending on the currency of 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 only conducts overnight deposit operations with credit institutions.
For reference: 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.

INTEREST RATES ON BANK OF RUSSIA SPECIALISED REFINANCING INSTRUMENTS[1]
(% P.A.)

Table 2

Purpose of indirect bank lending	Maturity	Collateral	As of 1.01.18	From 12.02.18	From 26.03.18	From 26.03.18	From 17.12.18	General approach to rate-setting[2]
Large-scale investment projects[3]	Up to 3 years	Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation	6.75	6.50	6.25	6.50	6.75	The lower of the two values: 9.00% p.a. or the Bank of Russia key rate less 1.00 pp.
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List						
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by the insurance contracts of JSC EXIAR	6.50	6.50	6.50	6.50	6.50	The lower of the two values: 6.50% p.a. or the Bank of Russia key rate
Small- and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[4]	6.50	6.50	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						
Leasing	Up to 3 years	Claims on loans to leasing companies	6.75	6.50	6.50	6.50	6.50	
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage Programme	7.75	7.50	7.25	7.50	7.75	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, the interest rates on Bank of Russia operations with credit institutions are set as spreads to the key rate. See press release http://www.cbr.ru/press/pr/?file=01062018_180510dkp2018-06-01T18_04_36.htm.

[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.

CLAIMS AND LIABILITIES ON BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY *Table 3*
(BILLIONS OF RUBLES)

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims and liabilities					
					As of 1.01.18	As of 1.04.18	As of 1.07.18	As of 1.10.18	As of 1.01.19	As of 1.03.19
Liquidity provision	Standing facilities	Overnight loans	1 day	Daily	0.0	0.8	14.6	0.4	8.1	0.0
		Lombard loans			0.0	0.0	0.0	0.0	0.0	0.0
		FX swaps			0.0	0.0	0.0	0.0	4.1	0.0
		Repos			3.6	6.5	2.4	10.0	3.6	2.7
		Loans secured by non-marketable assets	from 1 to 549 days		5.5	30.1	5.4	377.8	5.1	6.5
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly[1]	0.0	0.0	0.0	0.0	0.0	0.0
		Repo auctions	1 week	weekly[2]	0.0	0.0	0.0	0.0	0.0	0.0
			from 1 to 6 days	occasionally[3]						
		FX swap auctions	from 1 to 2 days		0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days		2,124.9	2,520.6	2,389.1	1,761.8	1,478.2	2,128.9
			1 week	weekly[2]						
		Auctions for the placement and additional placement of coupon OBRs[4]	up to 3 months	occasionally	357.4	1,139.1	1,123.0	1,502.1	1,391.3	1,515.1
	Standing facilities	Deposit operations	1 day[5]	daily	246.8	264.6	329.1	499.0	423.8	168.2

[1] Operations have been discontinued since April 2016.
[2] Either a repo or a deposit auction is held depending on the situation with liquidity.
[3] Fine-tuning operations.
[4] If the reporting date falls on a weekend or holiday, the indicated amount of outstanding Bank of Russia coupon OBRs includes the accrued coupon interest as of the first working day following the reporting date.
[5] Before 16 May 2018, also call operations. From 17 May 2018, the Bank of Russia only conducts overnight deposit operations with credit institutions.
Source: Bank of Russia.

REQUIRED RESERVE RATIOS
(%)

Table 4

Liability type	Validity dates		
	1.12.17–31.07.18	1.08.18–31.03.19	From 1.04.19
For banks with a universal licence and non-bank credit institutions			
To households in the currency of the Russian Federation	5.00	5.00	4.75
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation			
To households in foreign currency	6.00	7.00	7.00
To non-resident legal entities in foreign currency	7.00	8.00	8.00
Other liabilities in foreign currency			
For banks with a basic licence			
To households in the currency of the Russian Federation	1.00	1.00	1.00
Other liabilities in the currency of the Russian Federation			
To non-resident legal entities in the currency of the Russian Federation	5.00	5.00	4.75
To households in foreign currency	6.00	7.00	7.00
To non-resident legal entities in foreign currency	7.00	8.00	8.00
Other liabilities in foreign currency			

Source: Bank of Russia.

REQUIRED RESERVE AVERAGING RATIO

Table 5

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.

OUTSTANDING AMOUNTS ON BANK OF RUSSIA SPECIALISED REFINANCING FACILITIES[1] *Table 6*
(BILLIONS OF RUBLES)

Purpose of indirect bank lending	Maturity	Collateral	Bank of Russia claims on credit institutions						Limit
			As of 1.01.18	As of 1.04.18	As of 1.07.18	As of 1.10.18	As of 1.01.19	As of 1.03.19	As of 1.03.19
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by the insurance contracts of JSC EXIAR	47.4	46.4	48.8	50.0	39.1	42.8	75.0
Large-scale investment projects[2]	Up to 3 years	Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation	103.3	104.7	105.7	105.1	94.6	93.7	150.0
		Bonds placed to finance investment projects and included in the Bank of Russia Lombard List	0.0	0.0	0.0	0.0	0.0	0.0	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[3]	18.3	14.7	12.2	9.1	7.9	6.7	175.0
		Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises	81.5	81.4	78.7	78.1	85.0	77.6	
Leasing	Up to 3 years	Claims on loans to leasing companies	0.2	0.2	0.2	0.2	0.2	0.2	10.0
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage Programme	29.3	21.9	21.7	9.7	8.3	8.3	30.0

[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.

REQUIRED RESERVES AVERAGING SCHEDULE FOR 2019 AND INFORMATION ON CREDIT INSTITUTIONS' COMPLIANCE WITH RESERVE REQUIREMENTS

Table 7

Averaging period to calculate a required reserves amount for a respective reporting period	Averaging period duration (days)	Memo item:		Actual average daily balances in correspondent accounts	Required reserves to be averaged in correspondent accounts	Required reserves recorded to their respective accounts
		Reporting period	Required reserves regulation period			
9.01.2019 – 5.02.2019	28	December 2018	22.01.2019 – 24.01.2019	2,329	2,258	586
6.02.2019 – 5.03.2019	28	January 2019	14.02.2019 – 18.02.2019	2,368	2,273	588
6.03.2019 – 9.04.2019	35	February 2019	15.03.2019 – 19.03.2019	-	-	-
10.04.2019 – 7.05.2019	28	March 2019	12.04.2019 – 16.04.2019	-	-	-
8.05.2019 – 4.06.2019	28	April 2019	21.05.2019 – 23.05.2019	-	-	-
5.06.2019 – 9.07.2019	35	May 2019	17.06.2019 – 19.06.2019	-	-	-
10.07.2019 – 6.08.2019	28	June 2019	12.07.2019 – 16.07.2019	-	-	-
7.08.2019 – 3.09.2019	28	July 2019	14.08.2019 – 16.08.2019	-	-	-
4.09.2019 – 8.10.2019	35	August 2019	13.09.2019 – 17.09.2019	-	-	-
9.10.2019 – 5.11.2019	28	September 2019	14.10.2019 – 16.10.2019	-	-	-
6.11.2019 – 3.12.2019	28	October 2019	15.11.2019 – 19.11.2019	-	-	-
4.12.2019 – 7.01.2020	35	November 2019	13.12.2019 – 17.12.2019	-	-	-

KEY ECONOMIC AND FINANCIAL INDICATORS *Table 8*

		02.18	03.18	04.18	05.18	06.18	07.18	08.18	09.18	10.18	11.18	12.18	01.19	02.19
Real sector														
Inflation	% y.o.y	2.2	2.3	2.4	2.4	2.3	2.5	3.1	3.4	3.5	3.8	4.3	5.0	5.2
GDP[1]	% y.o.y		1.3			1.9			1.5					
GDP (the Bank of Russia's estimate)[1]	% y.o.y		2.5			2.8			1.9			2.0		
GDP in current prices[1]	trillions of rubles		22.2			24.8			27.0			29.5		
Output by key activity types	% y.o.y	3.5	2.4	4.7	4.2	2.3	4.0	1.7	1.5	4.0	1.8	1.9	0.2	
Industrial production	% y.o.y	3.2	2.8	3.9	3.7	2.2	3.9	2.7	2.1	3.7	2.4	2.0	1.1	4.1
Agricultural output	% y.o.y	2.3	2.4	2.3	2.2	0.8	1.7	-10.6	-4.7	12.1	-6.1	-0.1	0.7	1.0
Construction	% y.o.y	9.4	-2.5	11.0	7.9	3.2	7.6	3.3	5.9	5.7	4.3	2.6	0.1	0.3
Fixed capital investment[1]	% y.o.y		3.8			4.6			6.4			2.9		
Freight turnover	% y.o.y	2.2	4.3	5.1	2.8	2.4	4.2	2.6	2.0	1.5	2.2	3.2	2.4	1.7
PMI Composite Index	% SA	55.2	53.2	54.9	53.4	52.0	51.7	52.1	53.5	55.8	55.0	53.9	53.6	54.1
Retail trade turnover	% y.o.y	2.0	2.2	2.9	2.6	3.3	2.8	2.8	2.2	2.0	3.0	2.3	1.6	2.0
Real disposable money income	% y.o.y	3.5	3.8	4.8	-0.6	-0.2	1.5	-2.3	-4.1	0.0	-4.3	0.1	-1.3	
Real wage	% y.o.y	10.5	8.7	7.6	7.6	7.2	7.5	6.8	4.9	5.2	4.2	2.9	1.1	0.7
Nominal wage	% y.o.y	12.9	11.3	10.2	10.2	9.7	10.2	10.1	8.4	8.9	8.2	7.3	6.1	6.0
Unemployment rate	% SA	4.8	4.8	4.8	4.8	4.8	4.9	4.8	4.7	4.8	4.8	4.7	4.7	4.7
Banking sector														
Money supply (M2X)	% y.o.y, AFCR	6.6	7.6	8.5	7.7	8.3	8.1	8.2	8.2	7.9	7.9	7.9	6.5	
Money supply (M2)	% y.o.y	9.3	9.9	11.5	10.3	11.4	11.8	12.6	11.8	11.5	11.9	11.0	9.9	
Household deposits	% y.o.y, AFCR	7.9	8.4	8.3	7.7	7.1	7.7	7.0	6.0	6.5	5.7	5.4	5.4	5.7
in rubles	% y.o.y	10.7	11.4	12.9	12.3	11.5	11.8	11.2	9.9	10.4	8.9	8.3	7.8	7.5
in foreign currency	% y.o.y	-1.6	-2.4	-7.2	-7.9	-7.9	-6.2	-7.2	-7.3	-7.0	-5.6	-5.2	-3.6	-1.2
dollarisation	%	20.2	20.2	20.6	20.5	20.3	20.5	21.7	21.1	20.9	21.3	21.5	21.5	21.5
Loans to non-financial organisations	% y.o.y, AFCR	3.5	4.4	3.7	2.6	2.8	3.3	4.3	5.7	6.0	5.6	4.7	4.8	5.6
short-term (less than 1 year)	% y.o.y, AFCR	-0.1	0.3	-2.3	-5.6	-9.3	-7.1	-0.5	-1.3	2.2	3.7	3.8	-0.6	-2.0
long-term (more than 1 year)	% y.o.y, AFCR	3.9	5.5	4.8	4.3	5.4	5.3	4.9	7.2	6.9	6.0	5.4	4.9	6.1
overdue loans	%	6.9	6.9	6.9	6.8	6.7	6.8	6.7	6.6	6.7	6.6	6.3	7.8	7.9
Loans to households	% y.o.y, AFCR	14.7	15.6	16.5	18.0	18.8	19.6	20.5	21.4	22.0	22.6	22.2	23.0	23.4
housing mortgage loans	% y.o.y, AFCR	18.2	19.2	20.2	22.3	23.2	23.9	24.5	24.8	25.3	25.5	23.4	23.7	24.8
unsecured consumer loans	% y.o.y	13.2	13.9	14.7	15.6	17.0	18.1	19.3	20.5	21.4	22.5	22.7	23.2	23.6
overdue loans	%	6.9	6.7	6.4	6.3	6.1	6.0	5.9	5.8	5.6	5.5	5.1	5.4	5.3

Legend:
y.o.y – on corresponding period of previous year.
SA – seasonally adjusted.
AFCR – adjusted for foreign currency revaluation.
[1] Quarterly data.
Sources: Rosstat, IHS Markit, Bank of Russia calculations.

KEY ECONOMIC AND FINANCIAL INDICATORS: BALANCE OF PAYMENTS *Table 9*

		2017 Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4
Balance of payments[1]						
Urals crude price	% y.o.y	28.1	24.8	50.1	44.6	9.3
USD/RUB exchange rate ('+' – ruble's strenthening, '-' – ruble's weakening)	% y.o.y	8.0	3.4	-7.5	-9.9	-12.1
Goods and services exports	% y.o.y	22.5	22.0	27.2	28.1	17.7
Goods and services imports	% y.o.y	21.8	18.8	8.3	-0.1	-2.9
Current account	**billions of US dollars**	**13.5**	**30.0**	**17.9**	**27.5**	**38.4**
Balance of trade	billions of US dollars	35.0	44.2	45.4	47.8	57.1
Exports	billions of US dollars	102.6	101.7	108.7	110.5	122.2
Imports	billions of US dollars	67.5	57.4	63.4	62.7	65.1
Balance of services	billions of US dollars	-8.4	-6.5	-7.6	-8.8	-7.0
Exports	billions of US dollars	15.4	14.0	16.7	17.4	16.6
Imports	billions of US dollars	23.8	20.5	24.4	26.2	23.6
Balance of primary and secondary income	billions of US dollars	-13.1	-7.7	-19.8	-11.5	-11.7
Current and capital account balance	billions of US dollars	13.5	29.8	17.7	27.5	37.7
Financial account excluding reserve assets (net lending (+) / net borrowing (-)	**billions of US dollars**	**14.5**	**12.4**	**9.3**	**24.2**	**31.1**
Public sector	billions of US dollars	6.7	-6.5	11.1	2.9	1.5
Private sector	billions of US dollars	7.8	18.9	-1.8	21.3	29.7
Net errors and omissions	billions of US dollars США	-1.7	1.9	2.9	1.7	-4.0
Change in reserve assets ('+' – increase, '-' is decrease)	**billions of US dollars**	**-2.7**	**19.3**	**11.3**	**5.0**	**2.6**

[1] *Signs according to BPM6.*

GLOSSARY

BALANCE OF PAYMENTS OF THE RUSSIAN FEDERATION

A statistical system reflecting all economic transactions between residents and non-residents of the Russian Federation, which occurred during the reporting period.

BANKING SECTOR LIQUIDITY

Credit institutions' funds held in correspondent accounts with the Bank of Russia in the currency of the Russian Federation, mainly to carry out payments through the Bank of Russia payment system and to comply with obligatory reserve requirements.

BANK OF RUSSIA KEY RATE

A main instrument of the Bank of Russia's monetary policy. The Bank of Russia Board of Directors sets the rate eight times a year. Key rate changes influence lending and economic activities and make it possible to achieve the primary objective of the monetary policy. It corresponds to the minimum interest rate at Bank of Russia one-week repo rate auctions and the maximum interest rate at Bank of Russia one-week deposit auctions.

CONSUMER PRICE INDEX (CPI)

Ratio of the value of a fixed set of goods and services in current prices to the value of the same set of goods and services in the previous (reference) period's prices. This index is calculated by the Federal State Statistics Service. The CPI shows changes over time in the overall price level of goods and services purchased by households for private consumption. The CPI is calculated using data on the actual structure of consumer spending, and is therefore one of the key indicators of living costs. Additionally, the CPI possesses a number of properties facilitating its widespread application: simple and clear construction methods, calculation on a monthly basis and publication in a timely manner.

CORE INFLATION

An inflation indicator characterising its most stable part. Core inflation is measured using the core consumer price index (CCPI). The difference between the CCPI and the consumer price index (CPI) lies in the CCPI calculation method, which excludes the change in prices for individual goods and services subject to the influence of administrative and seasonal factors (certain types of fruit and vegetables, passenger transportation services, telecommunication services, housing and public utility services, motor fuel, etc.).

CREDIT DEFAULT SWAP (CDS)

A financial instrument which allows a CDS buyer to insure against a certain credit event (e.g., default) under financial obligations of a third party in exchange for regular payment of a premium (CDS spread) to the CDS seller. The higher the paid premium, the more risky the obligations which served as the subject matter of the credit default swap.

DOLLARISATION OF BANK DEPOSITS (LOANS)

The share of deposits (loans) denominated in foreign currency in total banking sector deposits (loans).

FINANCIAL STABILITY

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

FLOATING EXCHANGE RATE REGIME

An exchange rate regime, under which the central bank does not set targets, including operational ones, for the level of or changes to the exchange rate, allowing it to be influenced by market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to sell it should threats to financial stability arise.

INFLATION

A sustained increase in the overall price level of goods and services in the economy. Inflation is generally associated with changes over time in the cost of a consumer basket, i.e. a set of food products, non-food goods and services consumed by an average household (see also 'Consumer price index').

INFLATION EXPECTATIONS

Economic agents' expectations about future price growth. Businesses, households, financial markets and professional analysts can give inflation expectations. Driven by expectations, economic agents make their economic decisions and plans, which include consumption, savings, borrowings, investment and loan/deposit rates. Capable of producing a certain effect on inflation, inflation expectations constitute an important indicator for the monetary policy decision-making process.

INFLATION TARGETING

A monetary policy strategy governed by the following principles: the main objective of monetary policy is price stability; the inflation target is specified and declared; monetary policy influences the economy largely through interest rates under a floating exchange rate regime; monetary policy decisions are taken based on the analysis of a wide range of macroeconomic indicators and their forecast. The Bank of Russia seeks to set clear benchmarks for households and businesses, including through enhanced information transparency.

MONETARY BASE

The total amount of certain cash components and credit institutions' funds in Bank of Russia accounts and bonds denominated in the currency of the Russian Federation. The monetary base in a narrow definition includes cash in circulation (outside of the Bank of Russia) and credit institutions' funds in accounts recording required reserves on funds attracted by credit institutions in the currency of the Russian Federation. The broad monetary base includes cash in circulation (outside of the Bank of Russia) and the total funds of credit institutions in Bank of Russia accounts and bonds.

MONEY SUPPLY

The 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 (M0, M1, M2, M2X).

MONEY SUPPLY IN THE NATIONAL DEFINITION (M2 MONETARY AGGREGATE)

The total amount of cash in circulation outside the banking system and 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

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

NEUTRAL RATE

The level of the key rate when monetary policy neither slows down nor spurs inflation.

OPERATIONS TO ABSORB LIQUIDITY

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

REFINANCING OPERATIONS

Bank of Russia reverse operations to provide credit institutions with liquidity. They may be in the form of loans, repos or FX swaps.

REQUIRED RESERVE RATIOS

Ratios ranging from 0% to 20% are applied to reservable liabilities of credit institutions to calculate the standard value of required reserves. They are set by the Bank of Russia Board of Directors.

RUONIA (RUBLE OVERNIGHT INDEX AVERAGE)

Reference weighted rate of overnight ruble deposits in the Russian interbank market. It reflects the cost of unsecured loans of banks with minimum credit risk. To calculate RUONIA, the Bank of Russia applies the method elaborated by the National Finance Association in cooperation with the Bank of Russia based on the information on deposit transactions made between member-banks. The list of RUONIA member banks is compiled by the National Finance Association and concurred with the Bank of Russia.

STRUCTURAL LIQUIDITY DEFICIT/SURPLUS OF THE BANKING SECTOR

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 the difference between the outstanding amount on refinancing operations and Bank of Russia liabilities on operations to absorb excess liquidity.

TRANSMISSION MECHANISM

The process of transferring the impulse of monetary policy decisions to the economy as a whole and to price dynamics, in particular. The process of transmitting the central bank's signal about a/no change in the key rate and its future path, from financial market segments to the real sector and, as a result, to inflation. Changes in the key rate are translated into the economy through different channels (interest rate, credit, foreign exchange, balance sheet, inflation expectations and other channels).

ABBREVIATIONS

AFCR – adjusted for foreign currency revaluation
AHML – Agency for Housing Mortgage Lending
BLC – bank lending conditions
bp – basis point (0.01 percentage points)
BPM6 – the 6th edition of the IMF's Balance of Payments and International Investment Position Manual
BRICS – a group of five countries: Brazil, Russia, India, China and South Africa
Cbonds-Muni – municipal bond index calculated by Cbonds
CCPI – core consumer price index
CPI – consumer price index
DSR – debt service ratio (the ratio of the cash flow available to pay current debt obligations, including principal and interest, to current income value)
ECB – European Central Bank
EME – emerging market economies
Eonia – Euro Overnight Index Average (actual rate on overnight unsecured lending transactions in euro, undertaken in the European Union and European Free Trade Association countries)
EU – European Union
FAO – Food and Agriculture Organization of the United Nations
FCS – Federal Customs Service
Fed – US Federal Reserve System
FGUP – federal state unitary enterprise
FPG – fiscal policy guidelines
GDP – gross domestic product
GFCF – gross fixed capital formation
GRP – gross regional product
IBL – interbank loans
IEA – International Energy Agency
IFX-Cbonds – corporate bond return index
Industrial PPI – industrial producer price index
inFOM – Institute of the Public Opinion Foundation
MC – management company
MIACR – Moscow Interbank Actual Credit Rate (weighted average rate on interbank loans provided)
MIACR-B – Moscow Interbank Actual Credit Rate-B-Grade (weighted average rate on interbank loans provided to banks with speculative credit rating)
MIACR-IG – Moscow Interbank Actual Credit Rate-Investment Grade (weighted average rate on interbank loans provided to banks with investment-grade rating)
MIC – military-industrial complex
MICEX SE – MICEX Stock Exchange
MPD – Monetary Policy Department of the Bank of Russia
MPR 4/18 – Monetary Policy Report published on 14 December 2018
MSCI – Morgan Stanley Capital International indices (see the Glossary)
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
OPEC+ – oil production restriction agreements concluded by OPEC and several non-OPEC nations
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)
SA – seasonally adjusted
SNA – system of national accounts
SME – small and medium-sized enterprises
TCC – total cost of credit
VAT – value added tax
VCIOM – Russian Public Opinion Research Centre
VEB – Vnesheconombank
TVP FAVAR – Time-Varying Parameter Factor-Augmented Vector Auto-Regression
VECM – Vector Error Correction Model