Bank of Russia

RUSSIA'S ECONOMIC OUTLOOK AND MONETARY POLICY

DECEMBER 2019
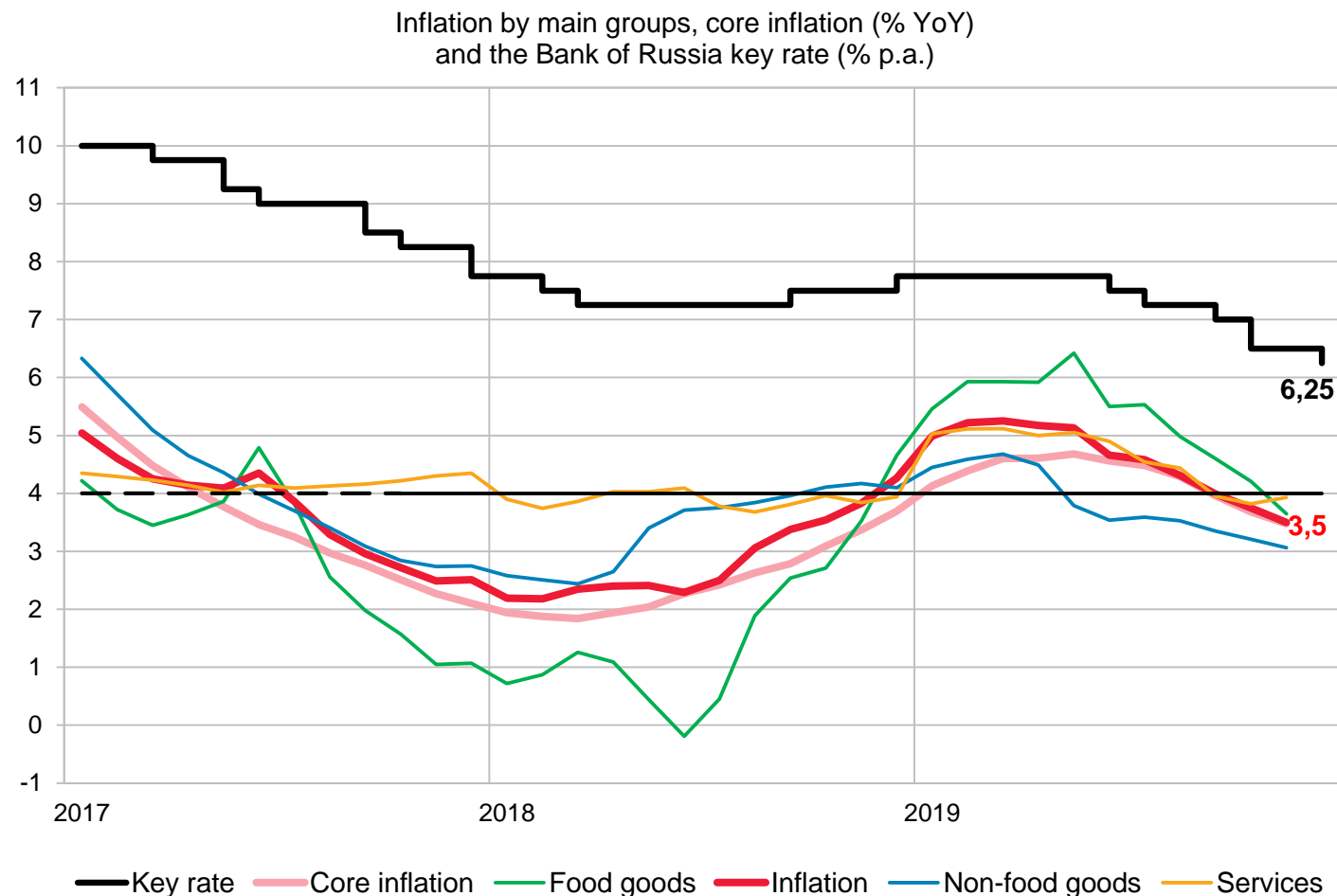
Consumer prices

Nov 2019	% YoY	Δ, pp
CPI	3.5	-0.2
Core	3.5	-0.2
Median	3.6	-0.1

Inflation slowdown is overshooting the forecast.

According to the Bank of Russia's estimates, inflation indicators reflecting the most sustainable price movements are close to or below 4%.

In November, disinflationary factors continued to exert considerable influence on inflation. Annual growth in prices of food products and non-food goods continued to decline.
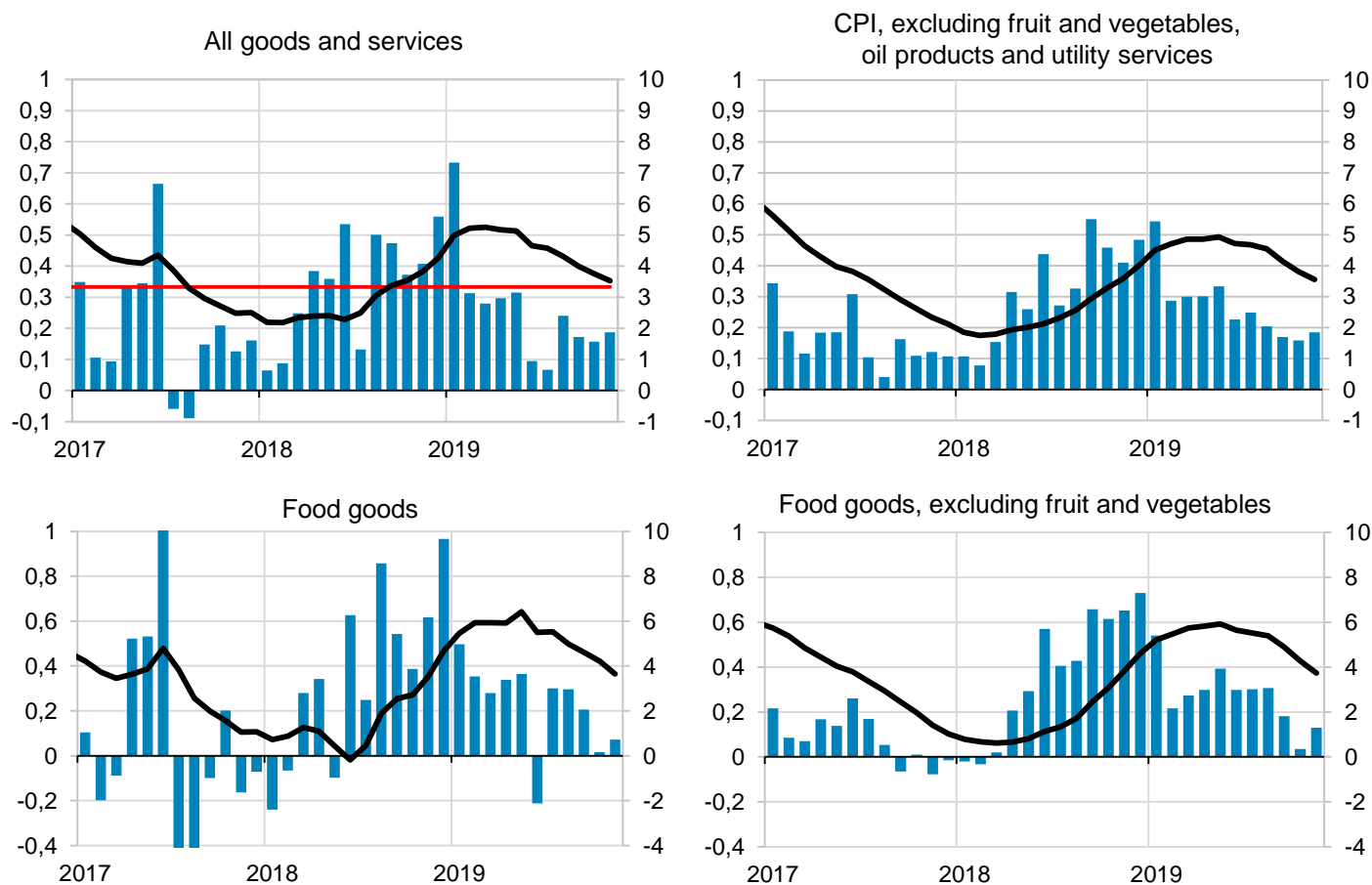

Inflation by main groups, core inflation (% YoY) and the Bank of Russia key rate (% p.a.)

Legend: Key rate — Core inflation — Food goods — Inflation — Non-food goods — Services

Inflation rates for main groups, seasonally adjusted (1)

Nov 2019, %	YoY	MoM SA
All	3.5	+0.18
- ex. F&V, oil prod. and util.	3.5	+0.18
Food	3.7	+0.07
- ex. F&V	3.7	+0.13

Such one-off factors as a good harvest and expanded supply in individual food market segments help maintain low growth rates of food prices, seasonally adjusted.

Disinflationary risks associated with movements in prices of certain food products persist, including on the back of a rise in supply of farm produce.

At the same time risks that food market trends may reverse cannot be ruled out, given that the ratio of temporary and permanent factors for this market is hard to estimate.
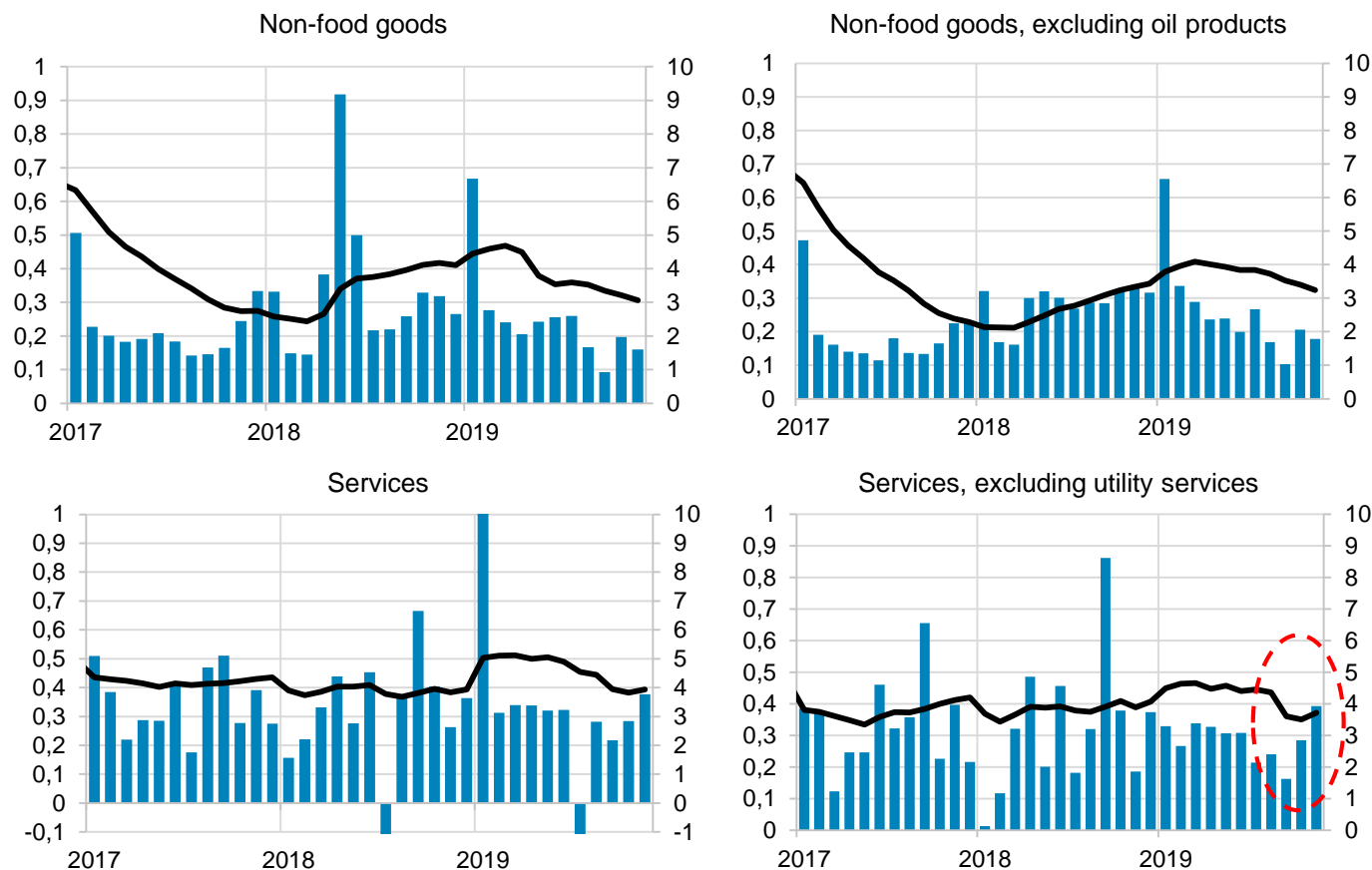

All goods and services

CPI, excluding fruit and vegetables, oil products and utility services

Food goods

Food goods, excluding fruit and vegetables

Columns – monthly price growth rate, seasonally adjusted, %
Line – annual inflation, % (rhs)
Red line – 4% saar

Sources: Rosstat, Bank of Russia's estimates

Inflation rates for main groups, seasonally adjusted (2)

Nov 2019, %	YoY	MoM SA
Non-food	**3.1**	**+0.16**
- ex. petrol	**3.2**	**+0.18**
Services	**3.9**	**+0.38**
- ex. utilities	**3.7**	**+0.39**

The ruble appreciation since the beginning of the year alongside with inflation slowdown in Russia's trading partners limits growth of import prices.

Subdued demand continues to influence inflation, including external demand. However, inflation acceleration registered in November in the services sector where prices are determined by the market may point to a revival in consumer demand.
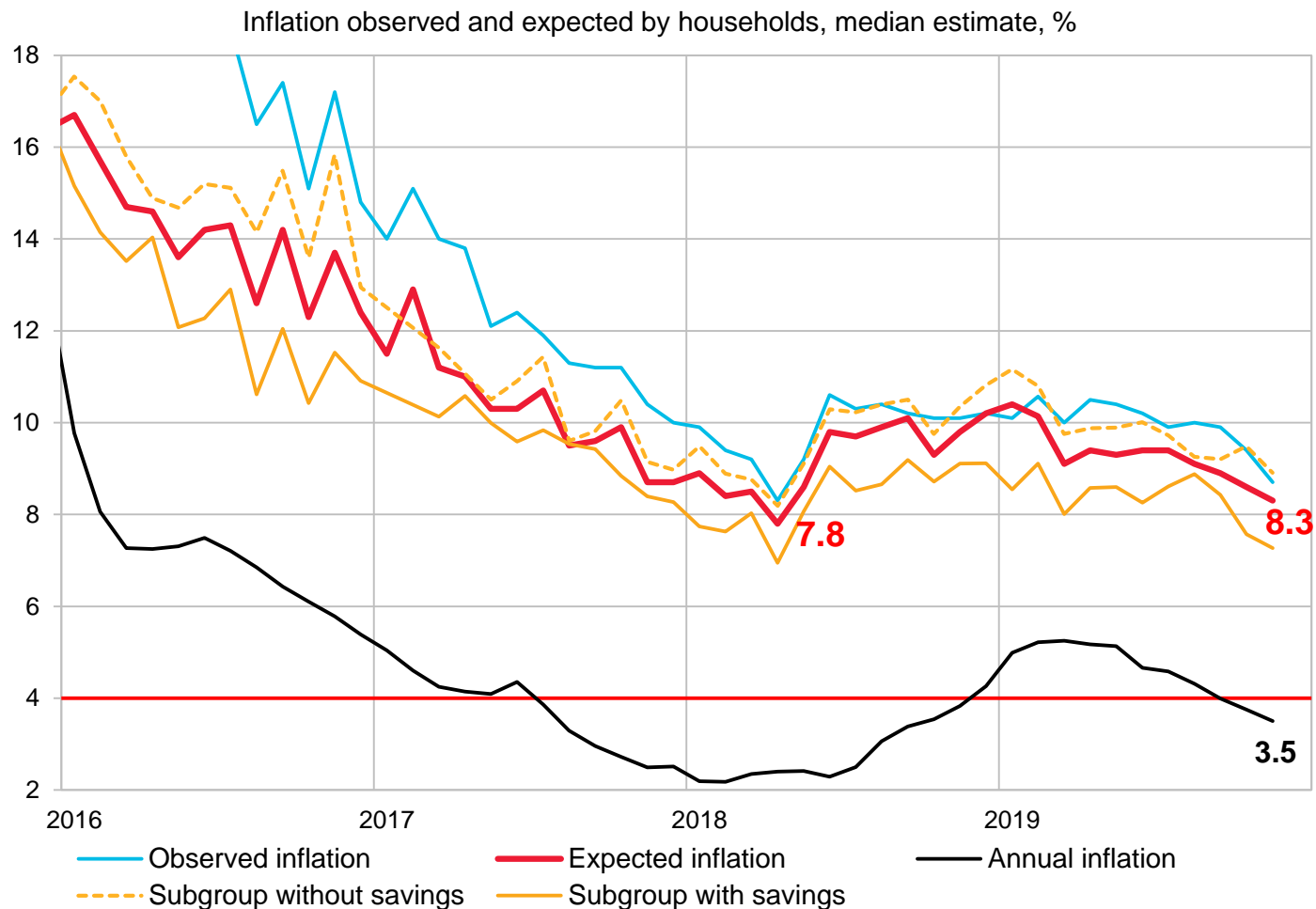
Non-food goods

Non-food goods, excluding oil products

Services

Services, excluding utility services

Columns – monthly price growth rate, seasonally adjusted, %
Line – annual inflation, % (rhs)

Inflation expectations – households

Nov 2019	%	MoM, pp
Observed	8.7	-0.7
Expected	8.3	-0.3
- with savings	7.3	-0.3
- w/out savings	8.9	-0.6

In November, households' inflation expectations continued to decrease, while remaining elevated.

Inflation observed and expected by households, median estimate, %

Legend: Observed inflation — Expected inflation — Annual inflation — Subgroup without savings — Subgroup with savings

Values noted on chart: 7.8, 8.3, 3.5

Price expectations – businesses

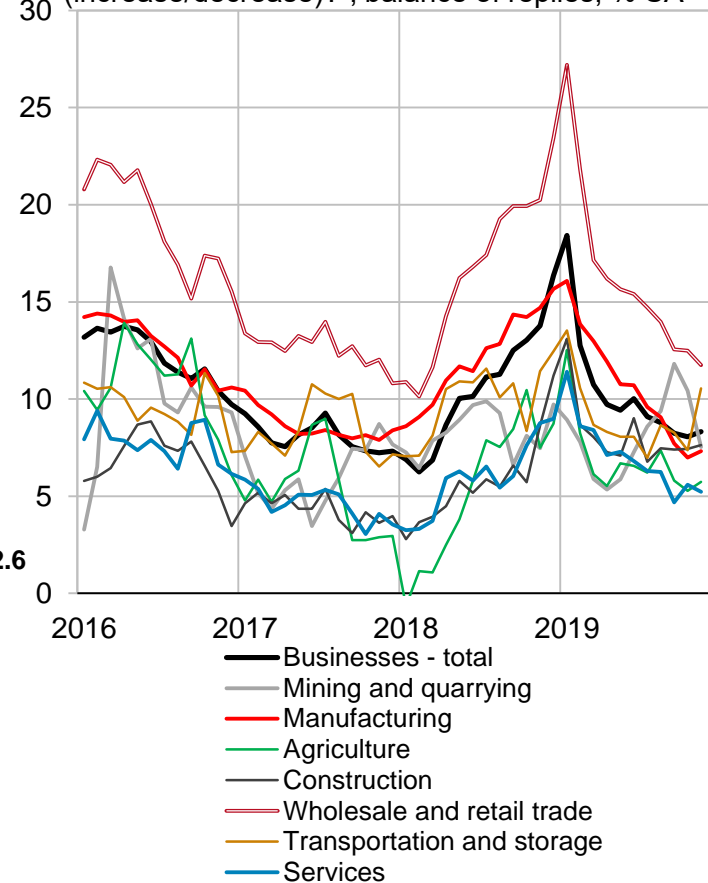|	Nov	Oct	Δ,pp
PMI M Input Prices	53.2	55.1	-1.9
PMI M Output Prices	50.7	51.3	-0.6
PMI S Input Prices	54.1	54.7	-0.6
PMI S Output Prices	52.5	52.7	-0.2

Business price expectations remain overall unchanged.

According to the PMI surveys, inflationary pressure in November was low due to a decrease in demand for manufacturing products and a drop in the purchase prices of intermediate goods producers.

PMI survey data on producer input and output prices, diffusion index, pp

PMI Mng — Input Prices — Output Prices
PMI Services
Среднее
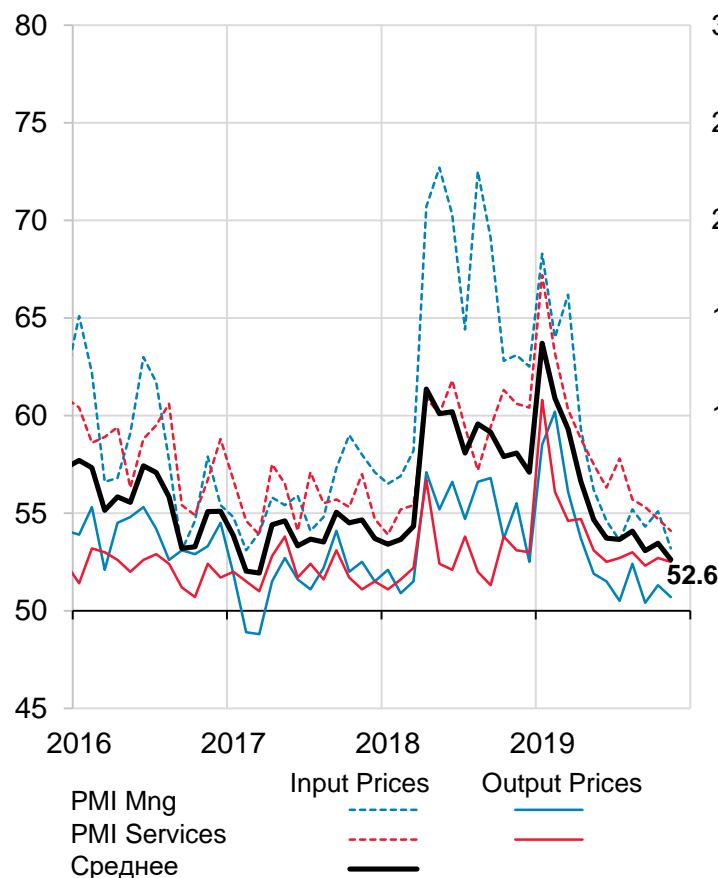
Replies of businesses to the question: "How will the prices of final goods change in the upcoming 3 months (increase/decrease)?", balance of replies, % SA

Businesses - total
Mining and quarrying
Manufacturing
Agriculture
Construction
Wholesale and retail trade
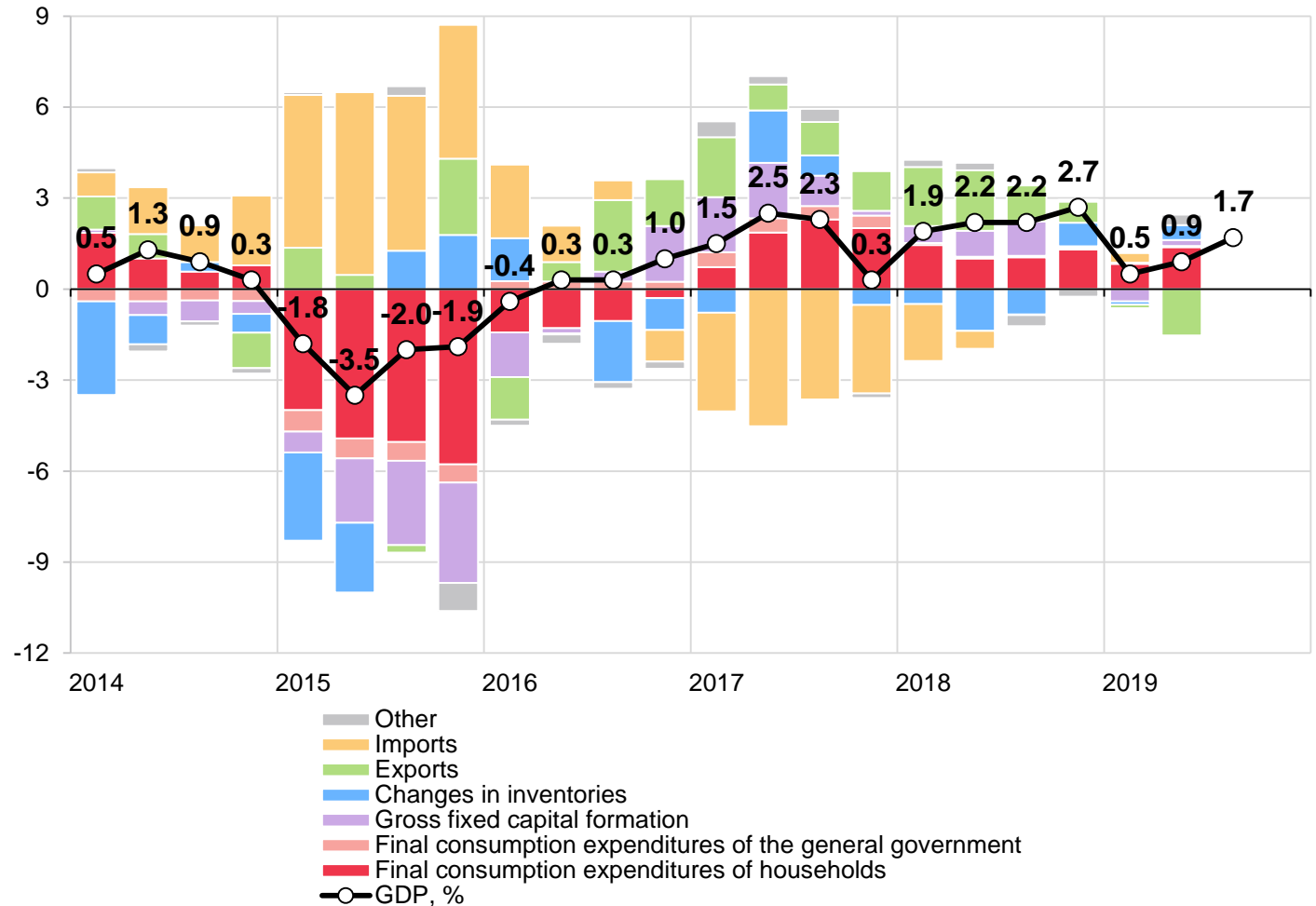Transportation and storage
Services

GDP growth

In 2019, the GDP growth rate may be close to the upper bound of the Bank of Russia forecast of 0.8–1.3%.

This is primarily associated with a higher-than-expected GDP growth rate in Q3. However, the stability of such economic growth rates has yet to be assessed.

Economic activity continues to be constrained by weakening external demand for Russian exports on the back of a global economic slowdown.

Decomposition of annual GDP growth rate, pp

Legend:
- Other
- Imports
- Exports
- Changes in inventories
- Gross fixed capital formation
- Final consumption expenditures of the general government
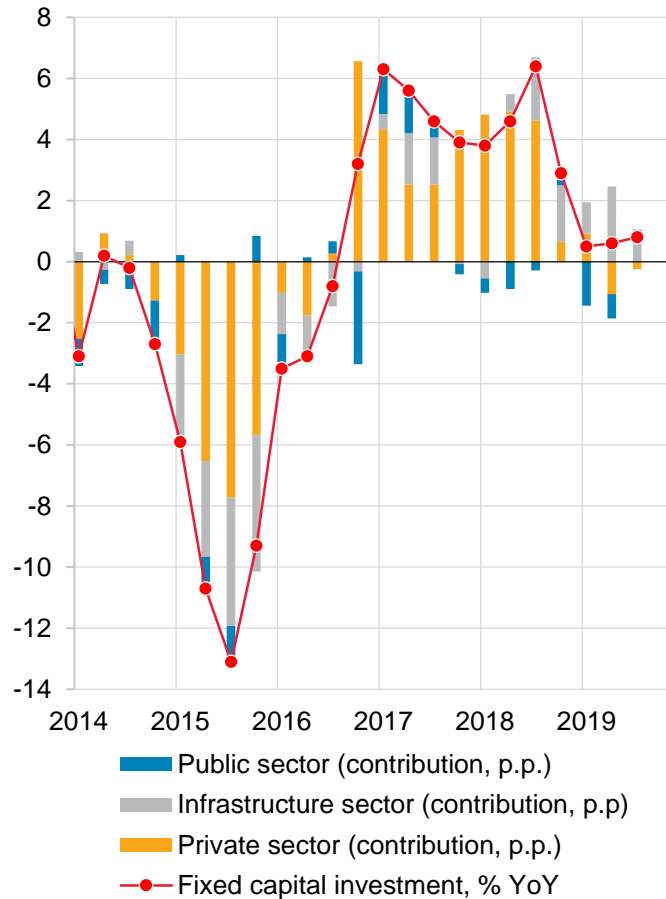- Final consumption expenditures of households
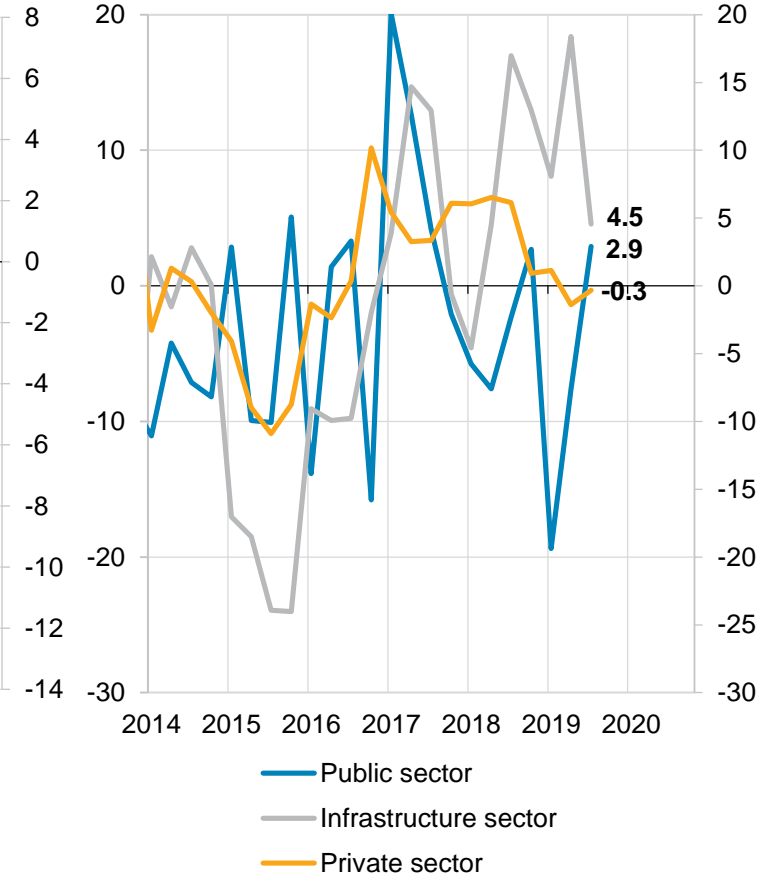- GDP, %

Investment activity

Domestic demand dynamics improved somewhat in Q3—Q4.

A slight increase was registered in investment activity, among other things, on the back of a rise in budget capital expenditure.
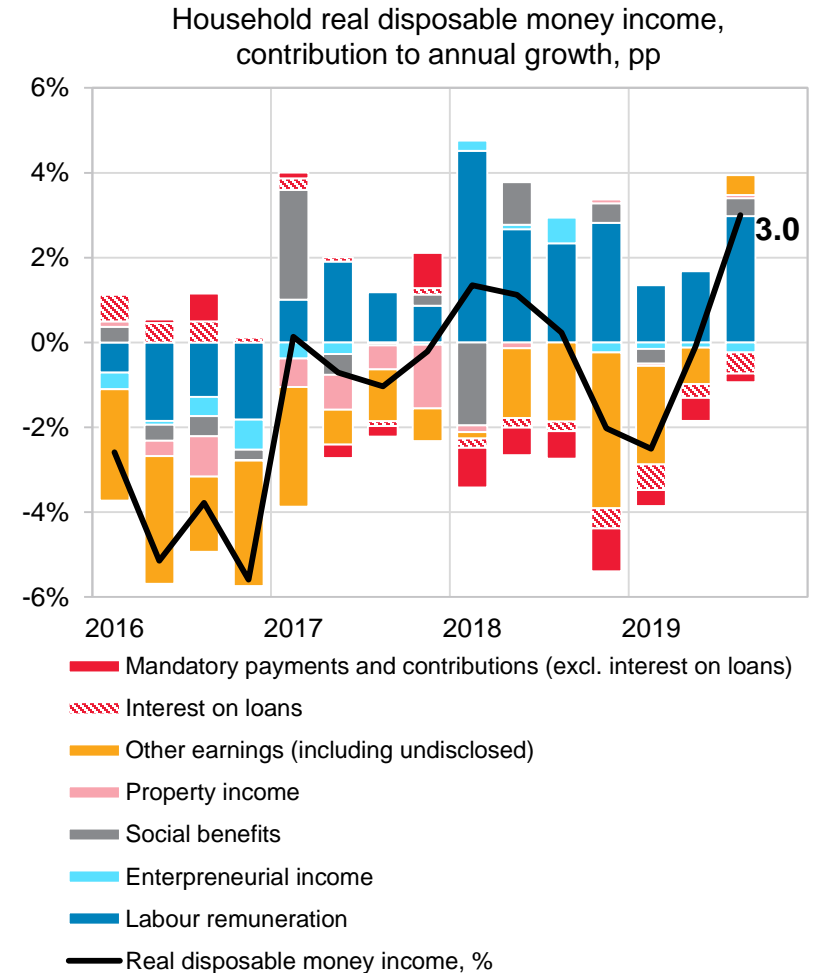

Investment activity dynamics*

Legend:
- Public sector (contribution, p.p.)
- Infrastructure sector (contribution, p.p)
- Private sector (contribution, p.p.)
- Fixed capital investment, % YoY

* Data for the corresponding quarter of the previous year

Annual growth rate, %

4.5
2.9
-0.3

Legend:
- Public sector
- Infrastructure sector
- Private sector

Retail sales and real disposable incomes

In October, the annual growth rate of retail trade turnover increased amid growth in real household income in Q3 2019.

Retail trade turnover and real wages, % YoY

Legend:
- Food products, pp
- Non-food goods, pp
- Retail sales
- Real wages

Household real disposable money income, contribution to annual growth, pp

3.0

Legend:
- Mandatory payments and contributions (excl. interest on loans)
- Interest on loans
- Other earnings (including undisclosed)
- Property income
- Social benefits
- Enterpreneurial income
- Labour remuneration
- Real disposable money income, %

Sources: Rosstat, Bank of Russia

Industrial production

Industrial production continued to grow in annual terms.

However, leading indicators point to a still weak business sentiment in industrial sector, which is mostly specific of export orders.
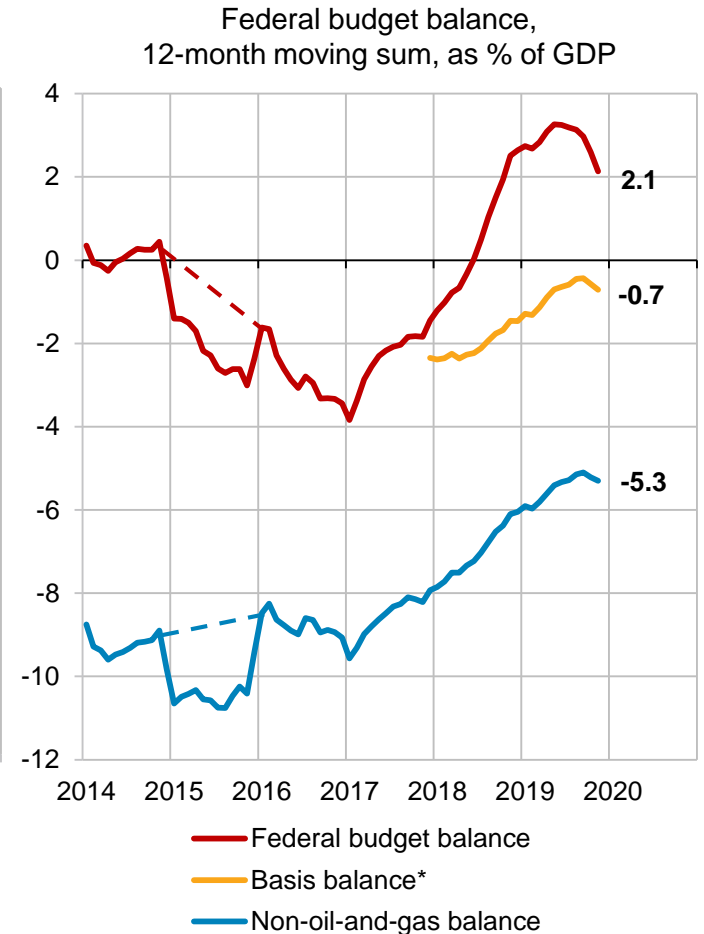
Industrial output,
contribution to annual growth, pp
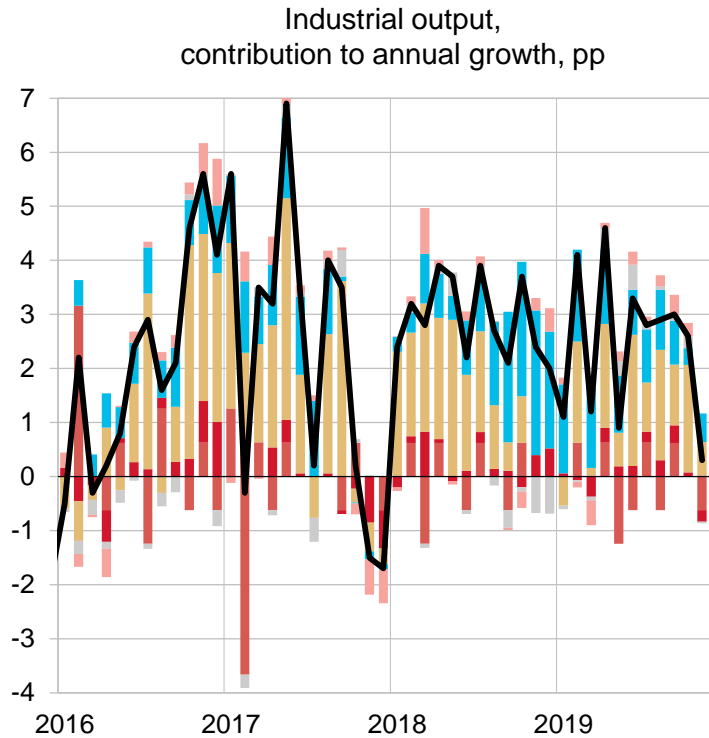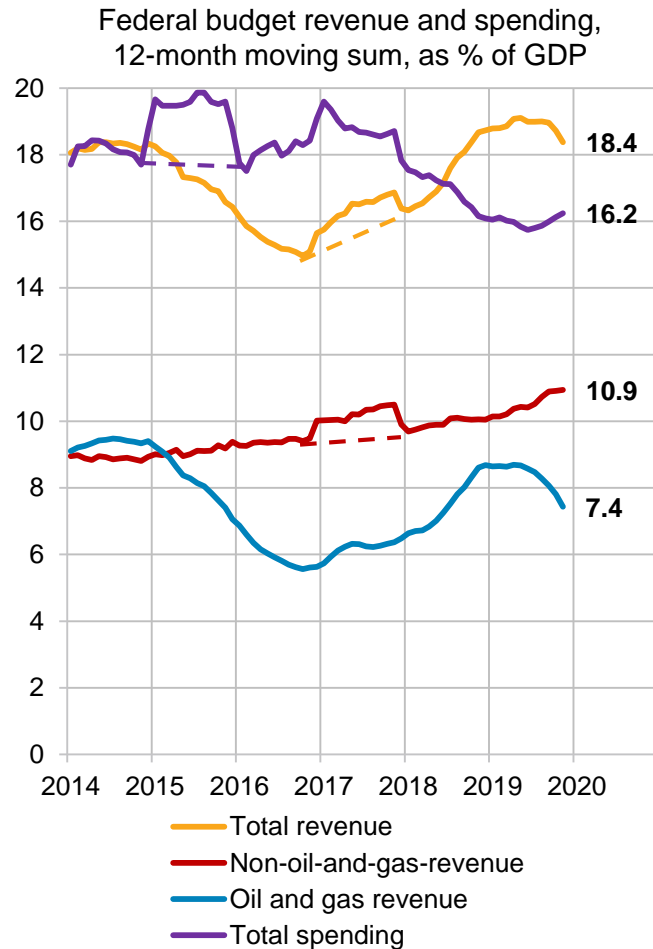

Utilities: electricity, gaz and steam (since 2015)
Omissions
Mining and quarrying
Manufacturing
Other
Calendar factor
Industrial production, %
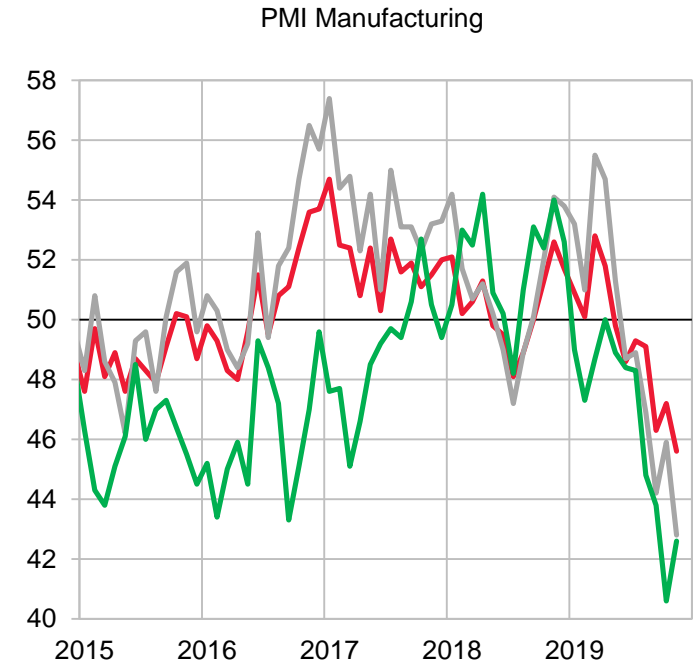
PMI Manufacturing

PMI Manufacturing
PMI Manufacturing New Orders
PMI Manufacturing New Export Orders

Fiscal policy (1)

In the second half of 2019, fiscal policy started to encourage economic growth on the back of, among other things, the implementation of national projects planned by the Government.
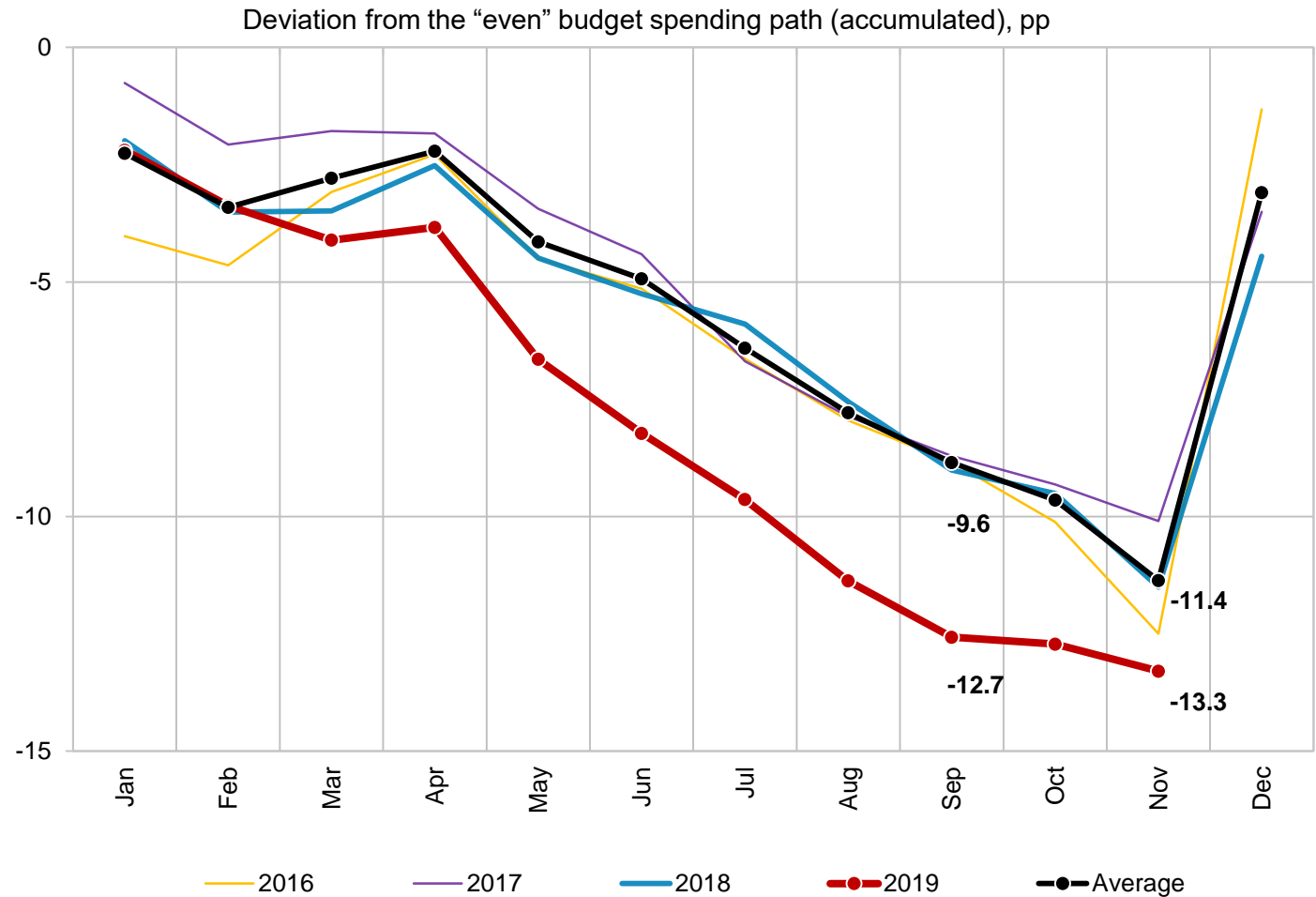
Federal budget revenue and spending, 12-month moving sum, as % of GDP

- 18.4
- 16.2
- 10.9
- 7.4

Total revenue
Non-oil-and-gas-revenue
Oil and gas revenue
Total spending

Federal budget balance, 12-month moving sum, as % of GDP

- 2.1
- -0.7
- -5.3

Federal budget balance
Basis balance*
Non-oil-and-gas balance

*Basis balance is an indicator of the budget policy calculated by the Ministry of Finance: basis balance = basis oil and gas revenue + non-oil-and-gas revenue – total spending.

Fiscal policy (2)

In November, the gap between the cumulative 11M19 and the average federal budget spending path lag in 2016-2018 narrowed to 1.9%, according to the Federal Treasury figures.

Pro-inflationary risks posed by budget expenditure growth in 2020 hold low because the rise in expenditures is likely to be distributed over time.

Deviation from the "even" budget spending path (accumulated), pp

-9.6

-11.4

-12.7

-13.3

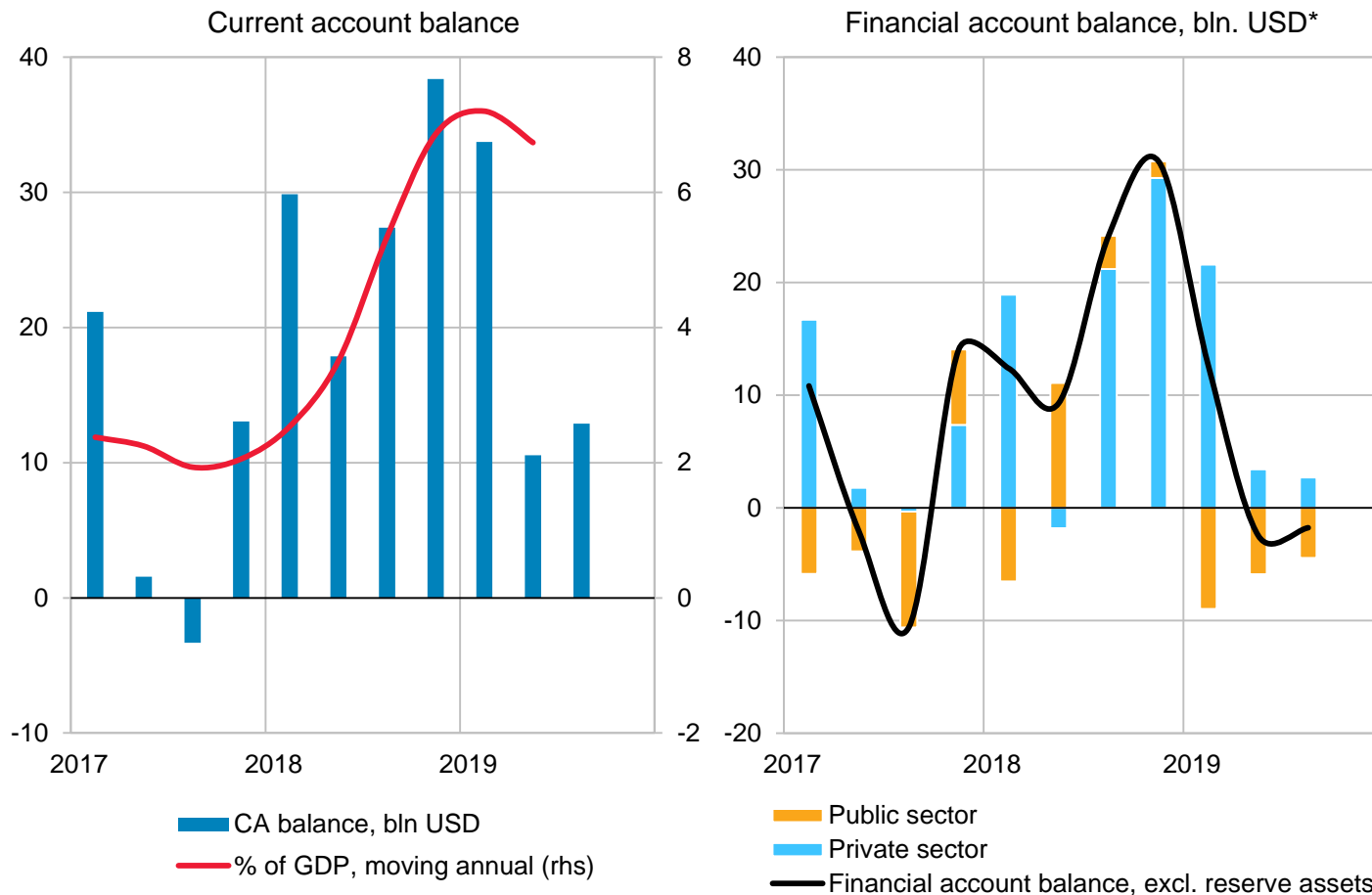Legend: 2016, 2017, 2018, 2019, Average

Balance of payments

In Q3 2019, the current account surplus decreased YoY mainly due to a decline in global energy prices.

Meanwhile, Q3 2019 saw fewer net foreign capital inflows to the public sector than in Q2 2019 on the back of a decrease in OFZ purchases by non-residents in the secondary market.

In the private sector, net lending to the rest of the world slowed down (compared to Q3 2018) as foreign assets of banks declined and foreign liabilities of other sectors increased.

Current account balance

- CA balance, bln USD
- % of GDP, moving annual (rhs)

Financial account balance, bln. USD*

- Public sector
- Private sector
- Financial account balance, excl. reserve assets

*"+" – net lending, "-" – net borrowing*

Deposit and credit market – interest rates

Monetary conditions have continued to ease since the last Board meeting. OFZ yields and deposit and lending rates have been down.

The Bank of Russia will assess the effect of the adopted key rate decisions on monetary conditions and inflation movements.

The monetary policy easing that has already been undertaken may have a stronger upward effect on inflation than the Bank of Russia estimates.
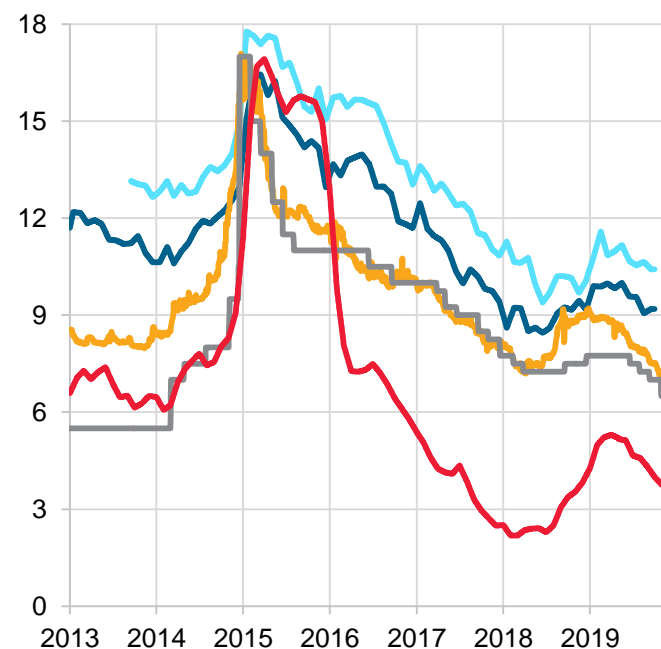
The dynamics of interest rates on household ruble deposits, % per annum

The dynamics of interest rates on corporate loans in rubles, % per annum
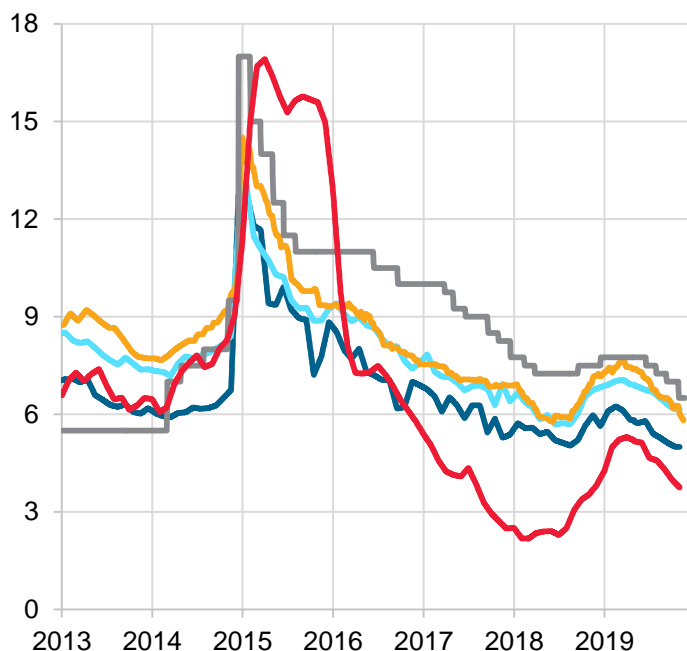
Interest rate on short-term household deposits
Interest rate on long-term household deposits
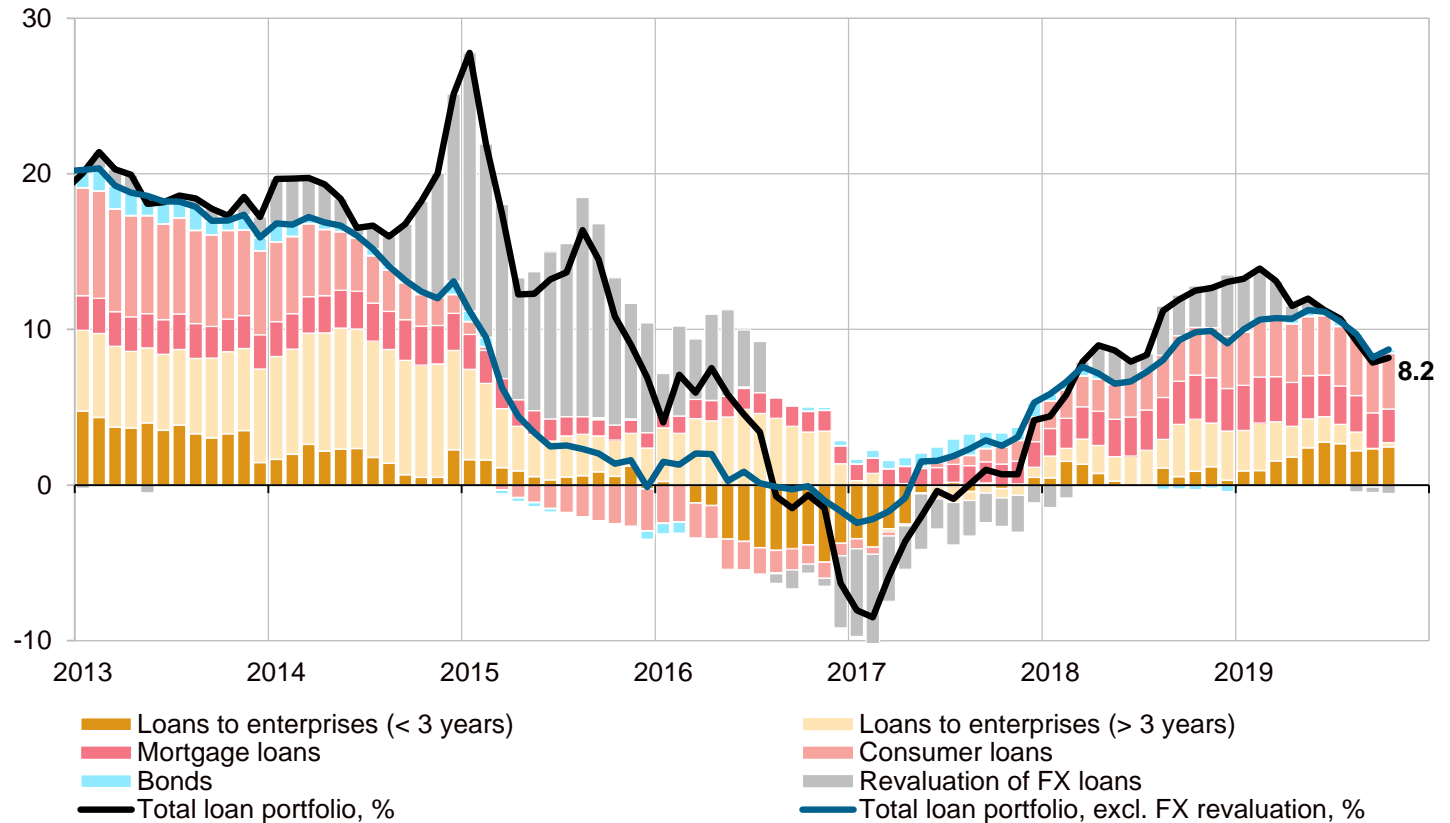Maximum interest rate on household deposits*
Key rate
CPI, % YoY

Interest rate on long-term loans
Interest rate on long-term loans for small businesses
Corporate bond yield (IFX-Cbonds)
Key rate
CPI, % YoY

Average of maximum declared one-year deposit interest rates (for deposits in top 10 banks amounting to 100 000 RUB, Monetary policy department estimate)

Deposit and credit market – lending

The Bank of Russia's decisions to cut the key rate and the decline in OFZ yields create conditions for a further reduction in deposit and lending rates.

This will support the expansion of corporate and mortgage lending.

Contribution of various components to annual growth of bank claims on non-financial organizations, pp

Legend:
- Loans to enterprises (< 3 years)
- Loans to enterprises (> 3 years)
- Mortgage loans
- Consumer loans
- Bonds
- Revaluation of FX loans
- Total loan portfolio, %
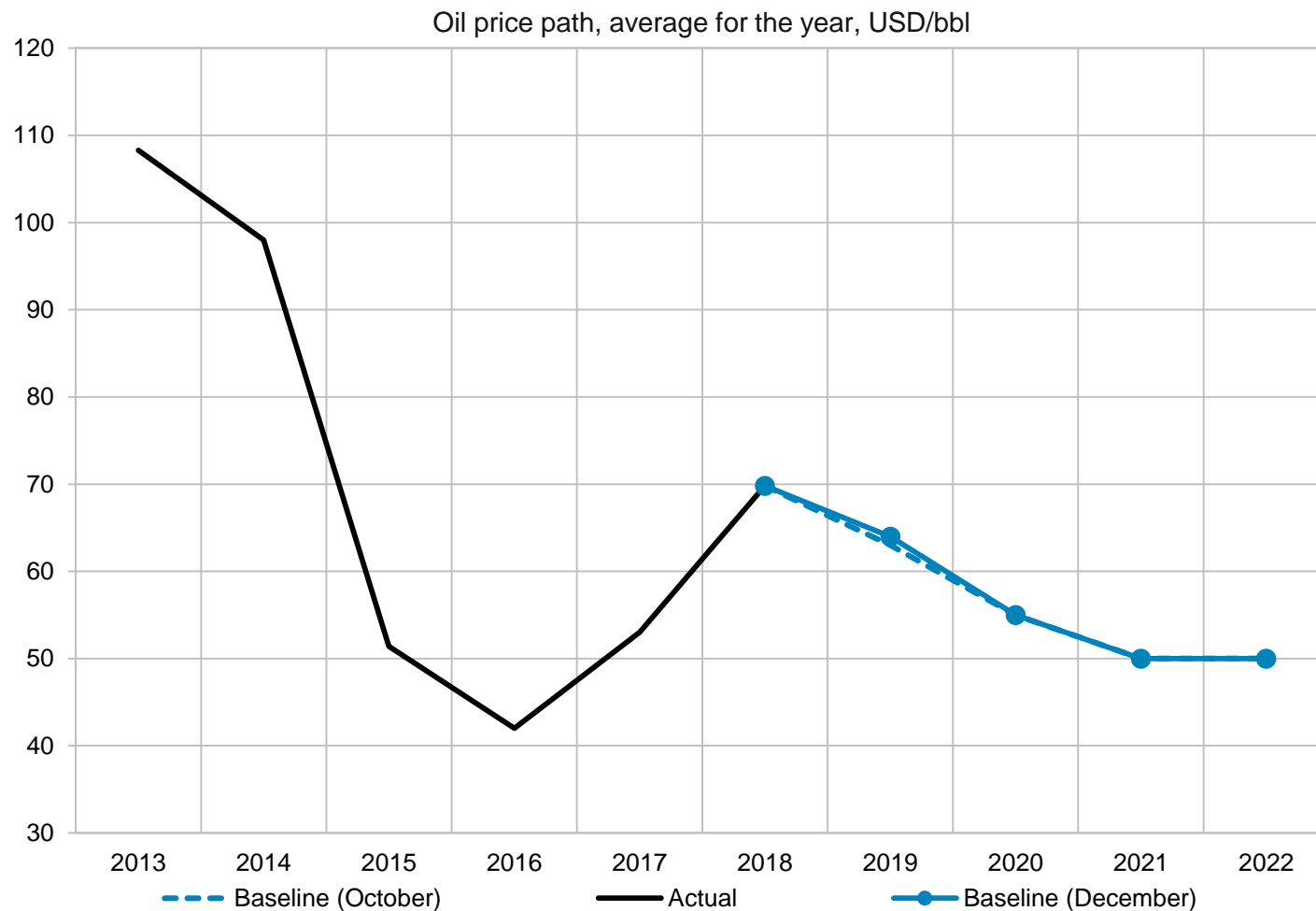- Total loan portfolio, excl. FX revaluation, %

8.2

Forecast assumptions – Oil price

The Bank of Russia has kept its longer-term outlook on Urals price dynamics in the baseline unchanged compared to October.

The average oil price estimate for 2019 has been slightly increased in view of the actual oil price movements since the beginning of the year.

Baseline oil price path: $64/bbl in 2019, $55/bbl in 2020 with $50/bbl in the longer-run.

Oil price path, average for the year, USD/bbl

Legend: Baseline (October) — — —   Actual ———   Baseline (December) ———●———

Bank of Russia forecast, December 2019 (1)

| Key parameters of the Bank of Russia's baseline scenario (growth as % of previous year, if not indicated otherwise)	2018 (actual)	BASELINE			
		2019	2020	2021	2022
Urals price, average for the year, US dollars per barrel	69.8	64	55	50	50
Inflation, as % in December year-on-year	4.3	2.9-3.2	3.5-4.0	4.0	4.0
Inflation, average for the year, as % year-on-year	2.9	4.5	3.0-3.4	4.0	4.0
Gross domestic product	2.3	0.8-1.3	1.5-2.0	1.5-2.5	2.0-3.0
Final consumption expenditure	1.8	1.3-1.8	1.5-2.0	1.5-2.0	1.8-2.3
– households	2.3	1.5-2.0	2.0-2.5	2.0-2.5	2.0-2.5
Gross capital formation	0.8	0.5-1.5	3.5-4.5	3.5-4.5	2.5-3.5
– gross fixed capital formation	2.9	0.0-1.0	3.5-4.5	3.5-4.5	2.5-3.5
Exports	5.5	-(1.3-1.8)	2.0-2.5	2.0-2.5	2.5-3.0
Imports	2.7	0.0-0.5	3.0-3.5	3.5-4.0	2.5-3.0
Money supply in national definition	11.0	8-11	7-12	7-12	7-12
Claims on organisations and households in rubles and foreign currency*	11.5	8-11	7-12	7-12	7-12
– on organisations, growth as % over year	8.4	5-8	6-10	6-10	6-10
– on households, growth as % over year	22.0	17-20	10-15	10-15	10-15

* Banking sector claims on organisations and households 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: Monetary Policy Report №4 (December 2019)

Bank of Russia forecast, December 2019 (2)

Russia's balance of payments indicators in the baseline scenario* (billions of US dollars)	2018 (actual)	BASELINE			
		2019	2020	2021	2022
Current account	**113**	**79**	**52**	**34**	**23**
Balance of trade	194	164	138	122	116
Exports	*443*	*414*	*392*	*385*	*392*
Imports	*249*	*250*	*254*	*263*	*277*
Balance of services	-30	-33	-35	-37	-40
Exports	*65*	*64*	*63*	*65*	*67*
Imports	*95*	*97*	*98*	*101*	*107*
Balance of primary and secondary income	-51	-52	-51	-52	-53
Current and capital account balance	**112**	**78**	**52**	**34**	**23**
Financial account (excluding reserve assets)	**77**	**17**	**14**	**9**	**9**
Government and the central bank	9	-24	-6	-6	-6
Private sector	68	40	20	15	15
Net errors and omissions	**2**	**3**	**0**	**0**	**0**
Change in reserve assets ('+' – increase, '-' – decrease)	**38**	**64**	**38**	**25**	**14**

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

Source: Monetary Policy Report №4 (December 2019)

Monetary policy decision on 13 December 2019

Key rate, % per annum — Inflation, % YoY
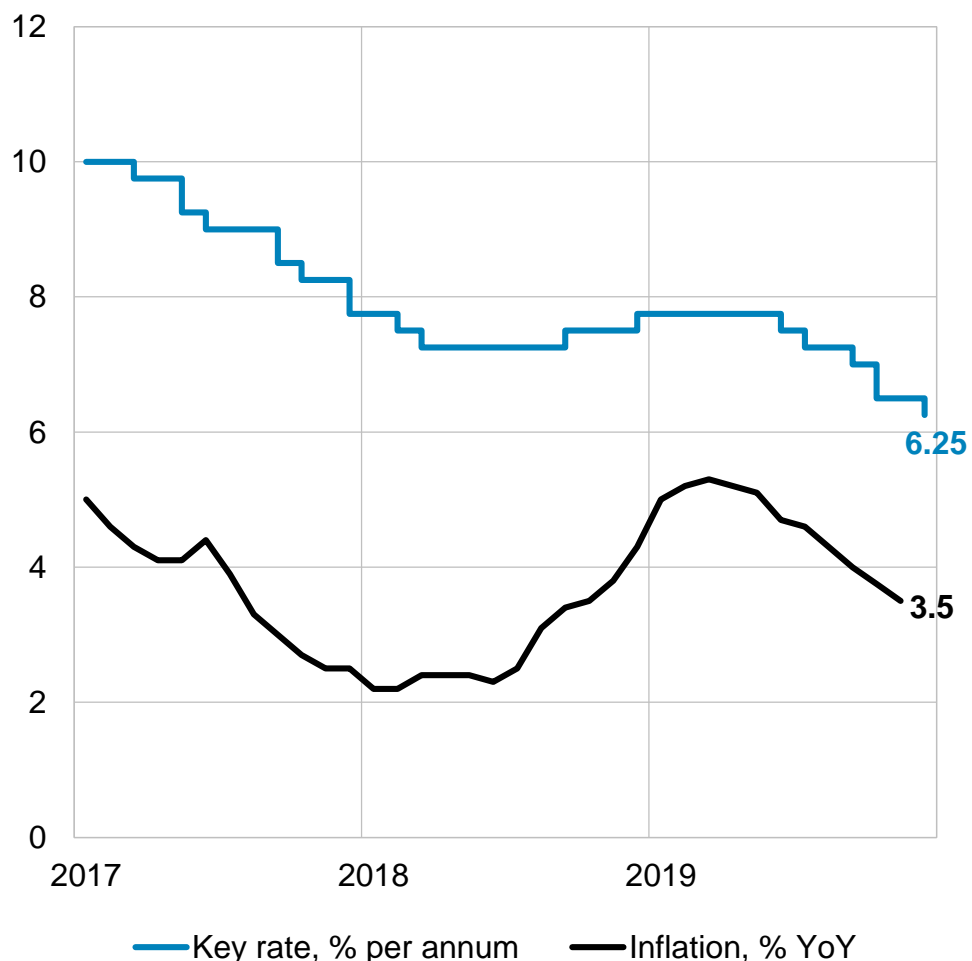
On 13 December 2019, the Bank of Russia Board of Directors decided to **cut the key rate by 25 bp to 6.25% per annum.** Inflation slowdown is overshooting the forecast. Households' inflation expectations continue to decrease. Price expectations of businesses remain overall unchanged. The growth rate of the Russian economy increased in Q3; however, its stability has yet to be assessed. Risks of a substantial global economic slowdown persist. **Disinflationary risks still exceed pro-inflationary risks over the short-term horizon.** Given the monetary policy stance, **annual inflation will come in at 3.5–4.0% in 2020 and will remain close to 4% further on.**

If the situation develops in line with the baseline forecast, **the Bank of Russia will consider the necessity of further key rate reduction in the first half of 2020.** In its key rate decision-making, the Bank of Russia will take into account actual and expected inflation dynamics relative to the target and economic developments over the forecast horizon, as well as risks posed by domestic and external conditions and the reaction of financial markets.

Source: Press release following the Bank of Russia's Board of Directors meeting as of 13.12.2019