Bank of Russia

The Central Bank of the Russian Federation

No. 4

DECEMBER 2017

MONETARY POLICY REPORT

Moscow

DEAR READERS,

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

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

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

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

4. What is your professional field of interest?

Many thanks in advance for your assistance.

The report has been prepared based on statistics as of 8 December 2017.
Data cut-off date for forecast calculations is 1 December 2017 (if statistics and other information relevant for decision-making appear after the data cut-off date, they are included in the text of the Report and may be used for the adjustment of the mid-term forecast).

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

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

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Summary

From September through mid-December, the Russian economy continued to grow at almost potential rates, whereas inflationary pressure remained low.

In November, annual inflation totalled 2.5%, with average inflation for the past twelve months down to 3.9%. The extent of the slowdown in prices registered in the past months has somewhat overshot the Bank of Russia's expectation, which was predominantly conditioned on temporary factors. One of the key factors was expanded supply in the agricultural market on the back of the good harvest and shortage in capacity for the long-term storage of some agricultural items, as well as the base effect associated with a delay in the harvesting season. The impact of temporary factors generated by the food market on the annual inflation is expected to dissipate over a one-year horizon. The contribution of the ruble's appreciation to annual inflation continues to wane and will come close to zero in early 2018.

At the end of 2017, inflation will be below 3% and will gradually reach 4% by the end of 2018 as the impact of temporary factors will be exhausted. Apart from the temporary factors, low inflationary pressure in the economy was assisted by modest consumer and lending activity as well as a decline in inflation expectations shaped, among other things, by the consistently moderately tight monetary policy. In September-December, a slowdown in price growth was registered across all key product groups, both food and non-food. The exception to this were only certain products (e.g., oil products) whose price growth was a result of the increase in oil and services prices. However, price growth remained relatively low even for these groups of products, hovering at all-time lows. A broad range of price dynamics indicators, including across certain markets and regions, demonstrates that inflation deceleration to the level below 4% has become strong and wide-spread.

Robust recovery of domestic consumer demand remained the main driver for the economic growth, though evolving rather smoothly without hampering the slowdown of price growth. Incomes continued to be the main factor fuelling consumer activity. Growth in incomes was accompanied by a gradual improvement in the quality of credit portfolios which prompted a cautious easing of non-price lending conditions by banks. In combination with declining market interest rates as a result of the implemented and expected Bank of Russia key rate cuts, this led to a slight increase in the credit availability in the economy. The Bank of Russia estimates that these credit activity trends will remain in place over the forecast horizon, thereby contributing to the expanded range of sources to finance corporate investment and household consumption. The smoothness of this process is called to prevent any risks to the price and financial stability. This will be in part helped by a gradual and well-balanced switch from the moderately tight to neutral monetary policy.

Decline in inflation expectations was observed both among market professionals and households. At the same time, survey results point that household inflation expectations are still elevated relative to the 4% target and continue to be highly sensitive to temporary factors. To improve the sustainability of inflation expectations of economic agents, as well as their confidence in future and, consequently, readiness to expand the planning horizon for business decision-making, may take longer time and may also require additional communications from the Bank of Russia.

Developments in the global oil market became the main factor behind the revision of assumptions underlying the medium-term forecast and overall risk assessment. Due to the continued implementation of the agreement between some oil producing countries to curb production, the baseline scenario raised the assumed oil price trajectory for 2018. This also helped to update the forecast and assessment of external risk balance for the Russian economy and inflation over the near term.

According to the Bank of Russia's baseline scenario, in 2017-2018 annual GDP growth is to range between 1.5–2%, close to the estimates of the Russian economic potential in the medium term. In 2019, amid a deterioration in external conditions regarding oil prices (as suggested by the baseline scenario), growth will adjust for a short while (to 1.0–1.5%). The slowdown, however, will be brief, followed by the recovery in GDP growth to 1.5–2% in the medium term. The adjustment in GDP growth, caused by the permanent downturn of oil prices, will be relatively brief and insignificant due to the economy's enhanced resilience to external shocks, made possible by the fiscal consolidation policy, conducted by the Russian Government, and the application of the budget rule, finally embedded in the Budget Code. Elevation of potential economic growth to a higher level will become possible on the back of successful structural reforms and institutional changes in the Russian economy, which will take some time.

In view of lower uncertainty regarding oil price movements in 2018, the Bank of Russia estimates that the risks of upward inflation deviation from the 4% target have declined over a one-year horizon. However, medium-term pro-inflationary risks still dominate over the risks of persistent downward deviation from the target. Main risk sources of inflation overshooting the target include excessive consumer and lending activity in the economy, wages growing faster than labour productivity, as well as unstable inflation expectations. A number of factors shape both upward and downward deviations from the 4% inflation target: increased volatility of food prices, impacted by supply-side factors, and price fluctuations in global raw materials and commodity markets – a source of uncertainty in 2019-2020. The economy's sensitivity to volatility in raw materials markets will be somewhat eased by the budget rule. While assessing the balance of risks, the Bank of Russia will take into account future decisions on fiscal and tariff policy, together with possible changes in external conditions other than global oil prices.

Taking into account current inflation trends and the forecast of inflation and economic activity for the medium term, along with the risks of upward or downward deviation from the 4% inflation target, on the 15 December 2017, the Bank of Russia Board of Directors decided to cut the key rate by 50 bp to 7.75% per annum. Moving forward, the Bank of Russia's key rate decisions will be based on its assessment of the balance of risks of inflation's material and sustainable deviation in either direction from the target, as well as the dynamics of economic activity against the forecast. The Bank of Russia holds open the prospect of some key rate reduction in the first half of 2018.

1. MACROECONOMIC CONDITIONS

External conditions

In September-December 2017, the external economic situation evolved largely in line with existing trends and did not stand in the way of the continued recovery of the Russian economy as inflation benchmarks were achieved and the financial system remained stable. The impact of external factors was mostly consistent with previous forecasts, excluding the dynamics of global oil prices, with both current and expected price forecasts being surpassed.

The growth in the global economy continued to accelerate gradually (Chart 1.1). Taking into account positive statistics published in certain developed countries and emerging market economies (including European countries and China), the Bank of Russia revised the estimated aggregate GDP growth of Russia's trading partners upwards for 2017 compared with the September Monetary Policy Report (hereinafter, the MPR), from 2.3–2.4% to 2.7–2.8%.

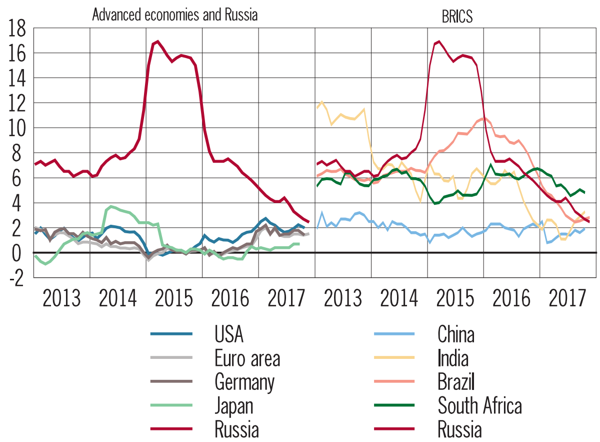
The recovery in global demand was relatively steady, which preserved the moderate inflation climate in most developed countries and emerging market economies (Chart 1.2). In this context, a relatively easy monetary policy prevailed in the largest global economies, which was in line with the forecasts. Together with other factors, this buoyed the muted optimism in the global financial markets (Charts 1.3 and 1.4).

Amid the recovery in global demand, upward trends dominated in price dynamics for most commodities, including oil (Chart 1.5). This, together with confident growth in demand, was also

Chart 1.2

Inflation in key advanced and emerging economies

(percent change on corresponding period of previous year)

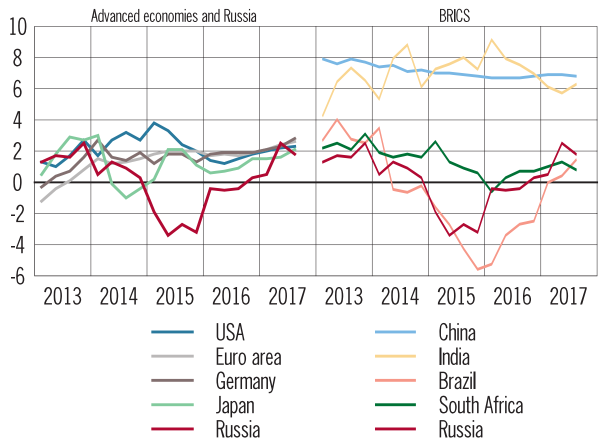


Sources: national statistics agencies, Bloomberg.

Chart 1.1

GDP growth in key advanced and emerging economies

(percent change on corresponding period of previous year)

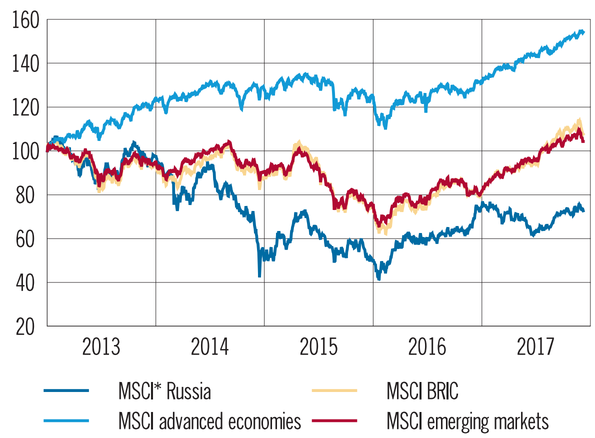


Sources: national statistics agencies, Bloomberg.

Chart 1.3

Global stock indices

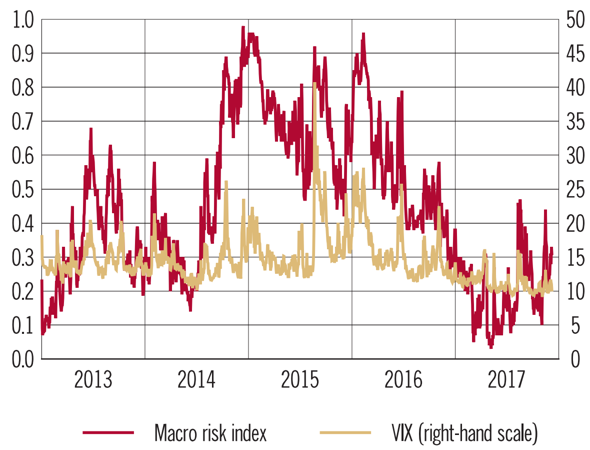
(January 2013 = 100%)



** See the Glossary.*
Source: Bloomberg.

Chart 1.4

Indices of volatility and global financial market risk perception by investors

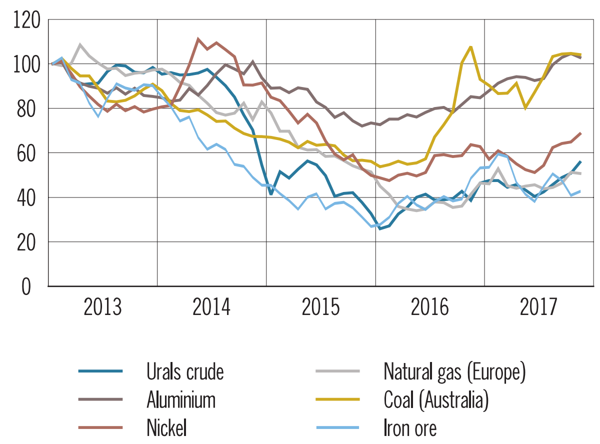


Source: Bloomberg.

Chart 1.5

World prices of Russian principal export commodities

(January 2013 = 100%)



Sources: World Bank, Reuters data (Urals crude price).

supported by a range of supply-side factors. The joint agreement on reducing production between OPEC and other oil-exporting states, reached through negotiations at the end of November, was extended to 2018. In addition, oil supplies to the global market were restricted by local trends such as falling exports from Iraq (amid internal political conflict in Iraq), decreasing production in Venezuela, the delayed revival in Libya and Nigeria, and growing political risks in Saudi Arabia. Given the combined impact of these factors, in its baseline scenario, the Bank of Russia assumes that Urals crude prices will be roughly $57 per barrel in 2018 Q1 ($59 per barrel in 2017 Q4).

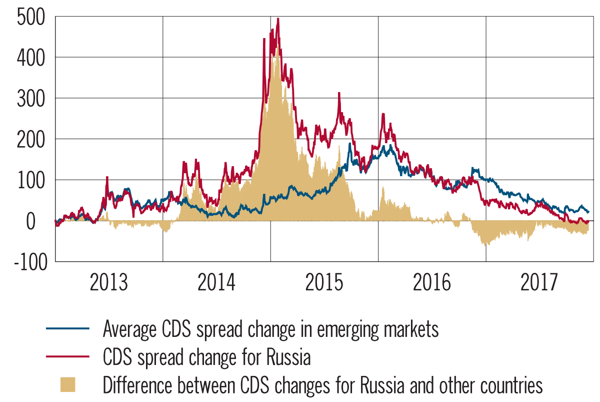
The situation in the global oil market had a mixed impact on the Russian economy. On the one hand, the international production restriction agreement restrained growth in Russian oil export volumes, and eventually passed through to production and investment activity in the mining sector. On the other hand, the price factor supported growth in the value of export revenues. Taken together, with growing exports of other goods buoyed up by external demand, this raised the trade balance and ensured the stability of Russia's current account balance overall (see Annex 'Dynamics of major items in the Russian balance of payments in 2017 Q3').

Across the EME group, economic indicators exhibited predominantly favourable dynamics (Chart 1.1). Against this backdrop, the risk premiums for these countries were significantly lower on average than summer levels, despite the short-lived

Chart 1.6

Change in risk premium in Russia and emerging markets*

(basis points)



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

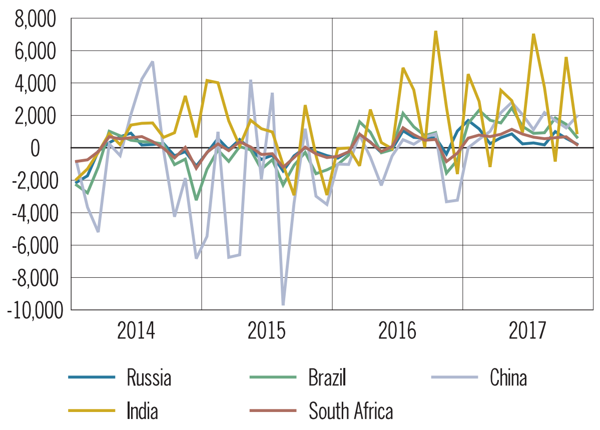
growth at the start of September and beginning of November (Chart 1.6). International investors continued to show interest in the financial assets of emerging market economies (Chart 1.7). However, the currencies of most EMEs depreciated slightly against the US dollar in September-November (Chart 1.8). This may be largely down to local improvements in investor expectations in relation to the US economic growth outlook amid discussions of possible fiscal policy stimulus measures.

The change in the risk premium for Russia, inflow of foreign investor funds into Russian markets, and the ruble exchange rate were all largely in line with the dynamics of these indicators for all emerging market economies in September-

Chart 1.7

Portfolio foreign investment flows to BRICS nations*

(millions of US dollars)



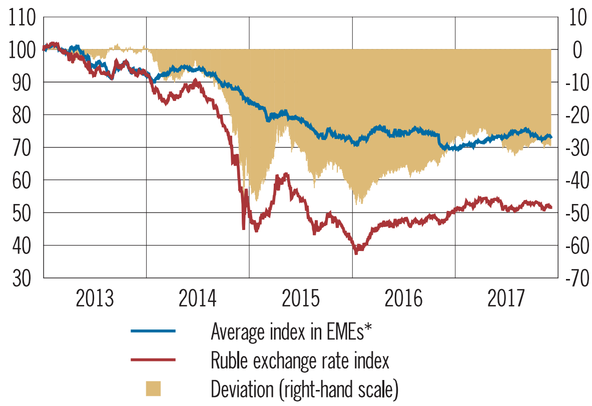
** For November 2017, estimate is based on weekly readings.*

Source: EPRF Global.

Chart 1.8

Change in the exchange rates of the ruble and EME currencies against US dollar

(1.01.2013 = 100%)



** Average index for EMEs includes the exchange rates against the US dollar of the Hungarian forint, Brazilian real, Korean won, Turkish lira, Mexican peso, Polish zloty, Romanian leu, Malaysian ringgit, Philippine peso, Indonesian and Indian rupee.*

Sources: Bloomberg, Bank of Russia calculations.

November. However, the ruble's depreciation was atypical, accelerating in November (Chart 1.8) amid the growth in global oil prices. This discrepancy, in addition to the aforementioned factor of the strengthening US dollar, can be explained by the fact that market participants perceived the observed oil price increase to roughly $60 per barrel as short-term. Furthermore, the ruble exchange rate's sensitivity to fluctuations in oil prices weakened the pass-through effect of the Russian Ministry of Finance's operations to purchase foreign currency in the domestic FX market as part of the budget rule implementation aimed at accumulating sovereign funds in the medium term and alleviating the impact of global commodity market movements on the Russian economy (see box 'Budget rule' in Section 2).

In the near term, Russia's appeal to external investors is expected to remain, supported in part by the recovery in economic activity and consistent economic policy. Foreign debt repayments and refinancing by the Russian corporate and banking sectors are within the expected limits and, according to Bank of Russia estimates, do not pose any additional risks to capital flows and the situation in the domestic financial market.

The depreciation of the ruble in October-November may have a constraining effect on imports growth, which accelerated in 2017, thereby buoying the trade balance and reducing the negative contribution of net exports to annual GDP growth in real terms. However, it will also make a contribution to inflation dynamics through import prices: the annualised disinflationary effect of exchange rate dynamics, witnessed for most of 2017, is expected to disappear in 2018 (see Sub-section 'Inflation'). At the same time, the change in external prices (in view of the inflation levels in Russia's trading partners and the dynamics of global commodities prices) has not exerted and is not expected to exert any additional pressure on inflation in Russia over the coming months.

Internal financial conditions

In September-November, internal financial conditions in the Russian economy continued to ease, but still remained moderately tight. They were shaped by two main factors. First, given the current and expected inflation dynamics, the Bank of Russia continued to cut its key rate. However, the change in the key rate was relatively smooth and, in general, the monetary policy stance remained moderately tight. Second, domestic financial market participants for the most part retained a conservative attitude towards risk, which contained the easing of both price and non-price lending conditions.

Overall, these domestic financial conditions helped to maintain the incentives to accumulate savings and contributed to muted demand for borrowing in the economy. As a result, they limited risks to price stability from aggregate demand, but did not hamper natural growth in economic activity.

The Bank of Russia's liquidity management operations helped to keep short-term money market rates close to the Bank of Russia key rate and to reduce them in line with changes in the key rate (Chart 1.9). The persistence of the slightly negative spread between interbank lending rates and the key rate (money market rates were in the lower bound of the interest rate corridor), given the structural liquidity surplus in the banking sector, was linked to the Russian money market's limited opportunities to redistribute funds among credit institutions.

Under the cumulative influence of the Bank of Russia key rate cutting and its further expected change (taking into account monetary policy signals), bond market yields and credit and deposit rates predominantly continued to fall (Chart 1.10). However, since the start of 2017, the adjustment in interest rates across different segments has been mixed. The reduction in rates for long-term credit and deposit operations was less pronounced than for short-term operations in most segments of the lending market and bond market. This reflected the end of the transition to a neutral monetary policy expected by market participants in the medium term. In future, this trend is expected to remain.

A reduction in bond market yields occurred both in the government and corporate debt sectors. In November, it reached the levels observed at end-2013 – early 2014. Against this backdrop, the activity of bond market participants remained relatively high both in terms of current trade turnover and new investment volumes. In January-November 2017, the amount of bonds placed had already exceeded the cumulative figure for the entirety of 2016. The continued high activity of bond market participants expanded its contribution to aggregate lending growth in the economy. The appeal of this segment, both for investors and for borrowers, was supported in part by current interest rate levels (higher than rates for bank deposits and lower than rates for bank loans for certain corporate borrowers). Investing in bonds grew increasingly popular among households. Over January through October 2017, household investments in OFZs rose by ₽87 billion and in corporate bonds by ₽78 billion, which is more than twice the 2016 level.

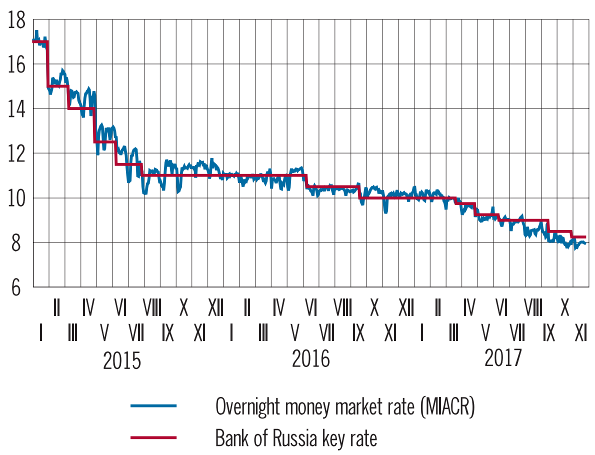
The rate of growth of household investments in bank deposits was generally in line with income dynamics in the economy. However, in September-October, like in previous months, short-term ruble-denominated deposits grew the fastest (Chart 1.11). This was due to the convergence of short-term and long-term interest rates amid expectations of a further reduction in the Bank of Russia key rate in the medium term. The dollarisation of deposits continued to shrink. The relatively high propensity to invest in ruble-denominated deposits was buoyed by the attractiveness of real interest rates and continued trust in the domestic financial system.

The on-going recovery in economic activity contributed to an improvement in borrowers' financial standing, raised banks' trust in their customers, and led to a gradual and cautious easing of non-price bank lending conditions. However, overall, banks

Chart 1.9

Bank of Russia key rate and MIACR

(% p.a.)

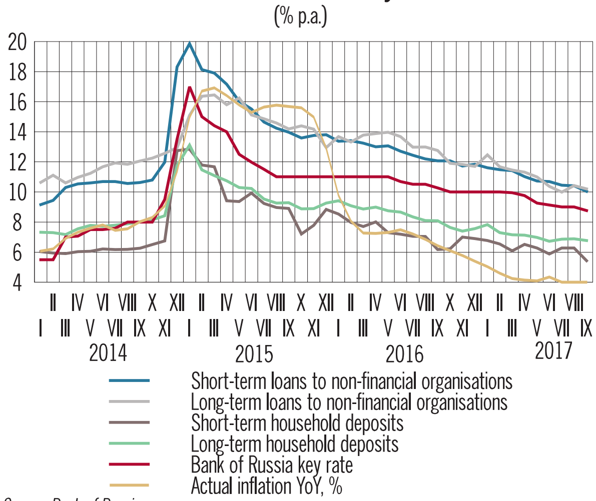


Source: Bank of Russia.

Chart 1.10

Interest rates on bank ruble operations and Bank of Russia key rate

(% p.a.)

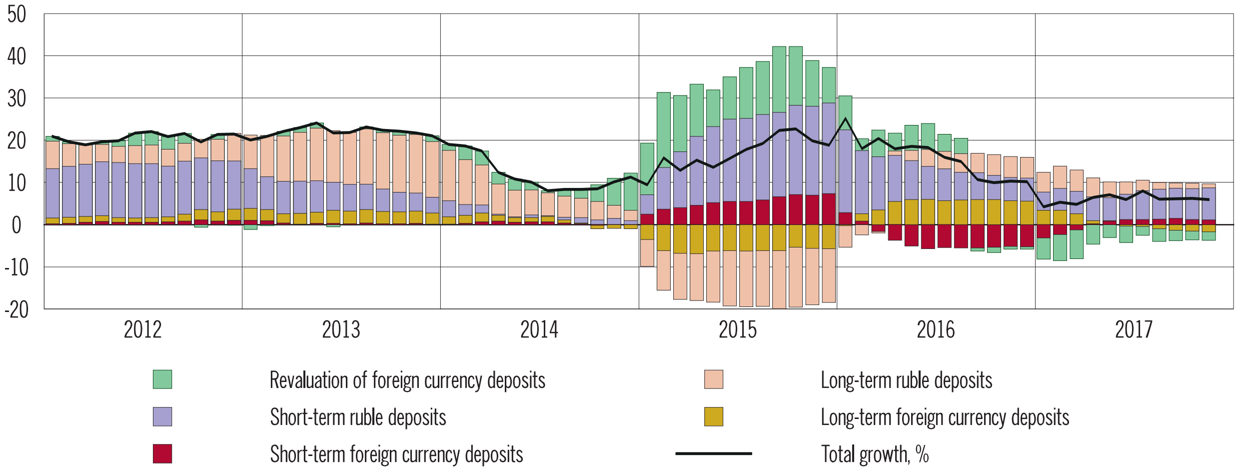


Source: Bank of Russia.

Chart 1.11

Contribution of various components to annual growth rate of household deposits

(percentage points)



Source: Bank of Russia.

continued to adopt a relatively conservative policy, preferring less risky investment areas.

According to a survey by the Bank of Russia, in 2017 Q3, bank lending conditions were eased (Chart 1.12) largely due to the fall in interest rates and the cautious easing of requirements for loan collateral. Apart from the Bank of Russia's policy, the largest contribution to the easing in price-based lending conditions continued to come from the intensifying competition between creditors. In the consumer lending segment, the reduction in rates was also aided by the on-going decrease in the maximum level of total cost of credit[1] and the Bank of Russia's macroprudential measures implemented in spring 2017[2].

However, the easing of non-price lending conditions continued to be slow and uneven across lending segments and borrower categories (Chart 1.13). The preservation of the banks' conservative approach to borrower selection in the corporate segment was determined by the assessment of credit risk and customers' financial standing. The proportion of overdue debt in banks' credit portfolios declined in 2017, but the trend was slow, and the value of overdue debt was still higher than at the start of 2014. According to banks' estimates, the growth in demand for loans from businesses slowed slightly in Q3 (Chart 1.12).

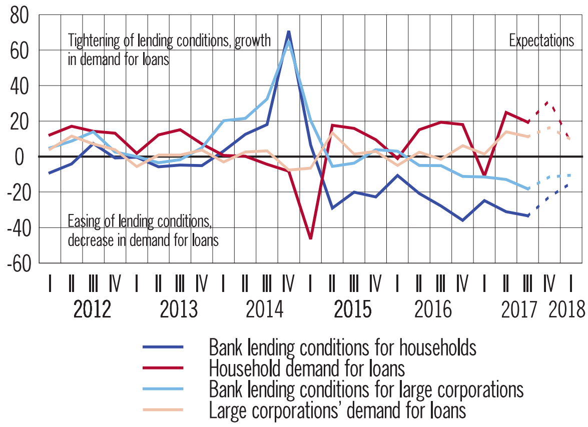
[1] Established by the Bank of Russia for certain categories of consumer loans and are to be applied in the next quarter based on actual average market rates in the corresponding categories of loans issued by banks in the previous quarter.

[2] The Bank of Russia revised its risk scale for consumer loans to calculate capital adequacy ratios.

Chart 1.12

Lending conditions and demand for loans indices

(percentage points)

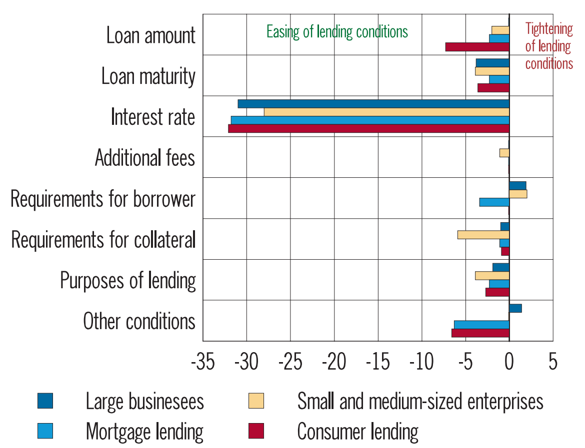


Source: Bank of Russia.

Chart 1.13

Indices of changes in certain lending conditions for borrowers in 2017 Q3

(percentage points)

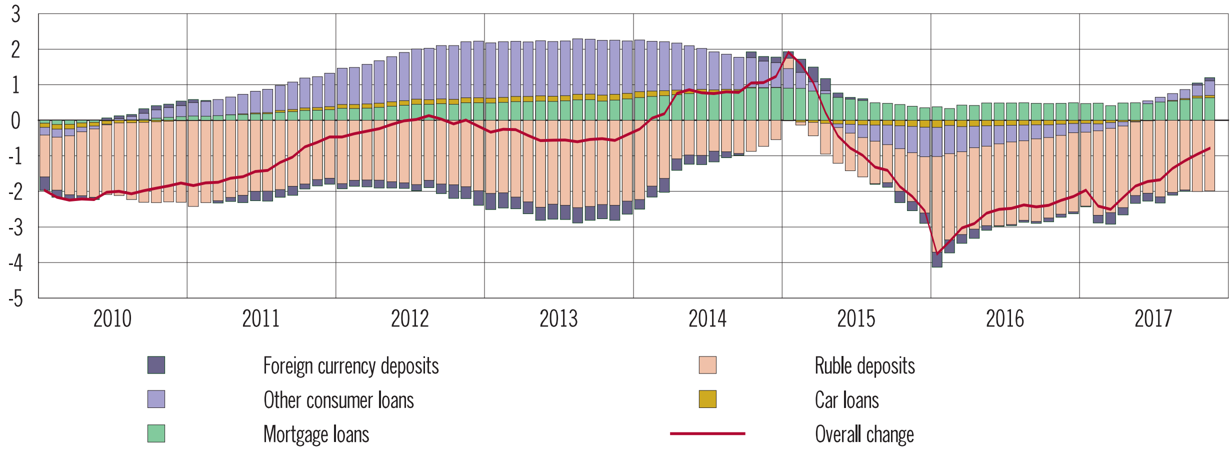


Source: Bank of Russia.

Chart 1.14

Annual change in retail bank operations*

(trillions of rubles)



** Positive values mean increase in net banking claims on households.*
Source: Bank of Russia.

This constraining effect was a result of non-price conditions rather than loan interest rates. Hence, according to business monitoring data from the Bank of Russia, more than half of companies view current ruble-denominated bank loan rates as acceptable.

In the household lending segment, the easing of BLC was more pronounced, which supported growth in demand for loans (Chart 1.14). As before, banks increased the amount of mortgage lending the most, which is the least risky type of lending due to the presence of collateral. However, a revival was also observed in unsecured consumer lending. Given the long slack in this segment, the Bank of Russia considers current household lending dynamics to be a natural recovery process consistent with households' gradual transition from the savings behaviour model to growth in consumer activity and the end of borrowers' protracted "deleveraging". Overall, amid stable deposit dynamics, the relatively gradual recovery in households' propensity to borrow is not associated with any elevated inflation risks.

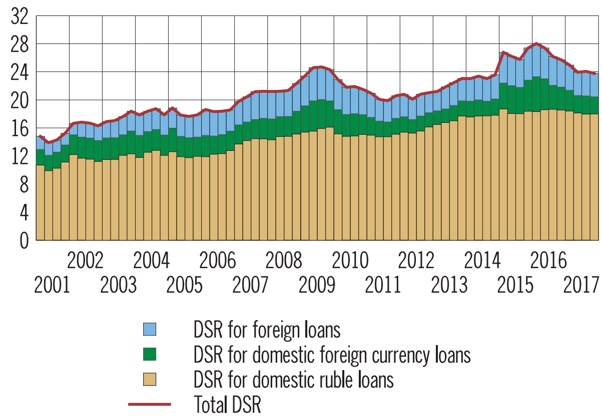
According to banks' estimates, in 2017 Q4 – 2018 Q1, the trend towards the easing of lending conditions will continue, mostly on account of a further cut in rates. Against this backdrop, banks anticipate moderate growth in demand for loans from all of the main borrower categories, especially from mortgagors (Chart 1.13).

Taking all of these current trends into account, the Bank of Russia has revised its growth forecast for banking sector lending to the economy[3] for 2017 upwards from 3–5% to 7–9%. The change in the short-term lending forecast is being viewed, first, as a consequence of the more pronounced and faster normalisation process in the financial standing and debt burdens of borrowers (Chart 1.15) and,

Chart 1.15

Debt service ratio

(%)



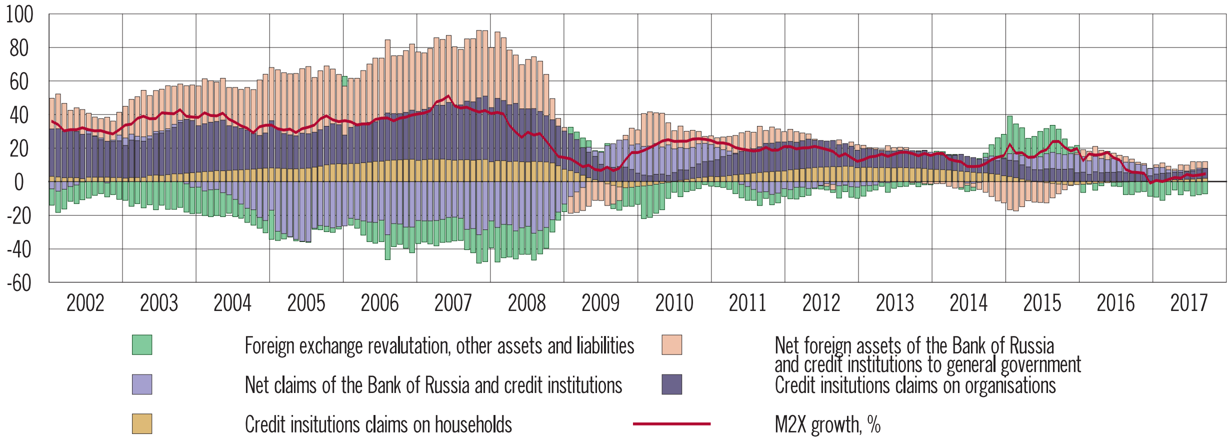
** The loan to GDP ratio is based on banking sector statistics related to the lending to non-financial organisations and individuals (in rubles and foreign currency), and also data on the amount of external debt of other sectors.*
Source: Bank of Russia.

[3] *Banking sector lending to the economy means all of the banking sector's claims on non-financial and financial institutions and households in the currency of the Russian Federation, a foreign currency and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investments in debt and equity securities and promissory notes, as well as other forms of equity holdings in non-financial and financial institutions, and other accounts receivable on settlement operations involving non-financial and financial institutions and households.*

Chart 1.16

Dynamics of broad money sources

(contribution to annual M2X growth, percentage points)



** Data before and after 1.01.2016 are temporary inconsistent.*
Source: Bank of Russia.

second, as a natural outcome of the replacement of reduced government funds (amid the gradual contraction in the actual budget deficit in 2017 compared with the forecast level) by private lending to the economy in the structure of money supply. According to Bank of Russia estimates, the lending activity recovery process was, on the whole, balanced in 2017. Moreover, the overall growth in money supply is proportionate to the increase in economic activity and does not pose any additional pro-inflationary risks (Chart 1.16). Taking this into account, the Bank of Russia is retaining (unchanged from the September MPR) its money supply dynamics forecast for 2017, and its medium-term money supply and lending forecasts including the scenario assumptions regarding oil price dynamics (Section 2).

Economic conditions

Taking into account the combination of external factors and domestic financial conditions mentioned above, the economic situation in Russia largely developed in line with forecast trends. Growth in the Russian economy continued. Moreover, growth rates came close to the level that the Bank of Russia estimates to correspond to the long-term potential of the economy in view of its current structure. These economic activity dynamics did not exert any upward or downward pressure on inflation levels.

In Q3, annual GDP growth was 1.8%, which corresponded to the Bank of Russia's expectations (the forecast in the September MPR was 1.7–2.2%[4]). Within the GDP structure by expenditure type, gross fixed capital formation's contribution is estimated to be slightly less than forecast. However, domestic consumer demand continued to be a stable driver of growth (Chart 1.17).

In Q3, fixed capital investment growth slowed as expected, but the scale of the slowdown overshot the forecast in the previous MPR and in the informational and analytical commentaries on the economy for October and November: annual growth was 3.1% compared with the earlier expected 4–5%. In October, investment activity dynamics (production and imports of investment goods, construction) also pointed to a slowdown in the year-on-year growth (Chart 1.18). Such investment demand dynamics may be related to the noticeable reduction in the contribution of temporary factors, including infrastructure facilities construction, which buoyed investment demand in the first half of the year. Annual growth in gross fixed capital formation may be 3.2–3.6% in 2017, which is lower than the forecast in the September MPR (4–5%). The forecast growth in gross capital formation for 2017 as a whole was adjusted negligibly to 6–6.5% (still within the limits of the previous forecast, 6–7%), taking into account a corresponding upward adjustment in the forecast for inventory dynamics.

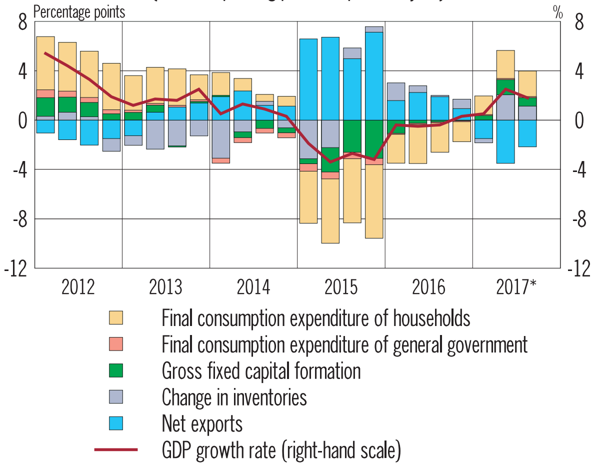
The sluggish growth in investment demand was in part passed through to production activity

[4] *In October's informational and analytical commentary on the economy, GDP growth was estimated at 1.8–2.2% in Q3.*

Chart 1.17

GDP growth structure by expenditure

(on corresponding period of previous year)

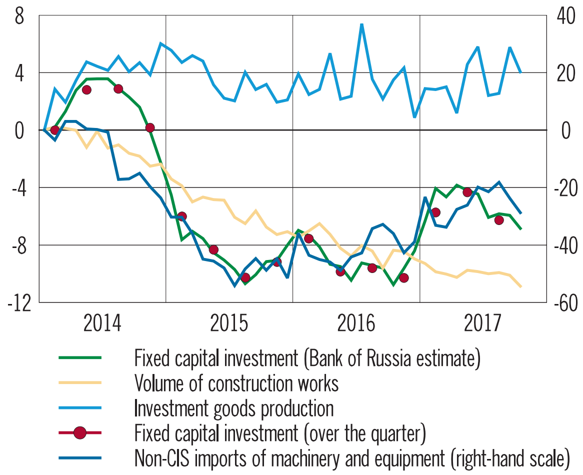


** 2017 Q3 – Bank of Russia estimate of expenditure.*
Sources: Rosstat, Bank of Russia calculations.

Chart 1.18

Investment activity indicators

(seasonally adjusted, percent change on January 2014)

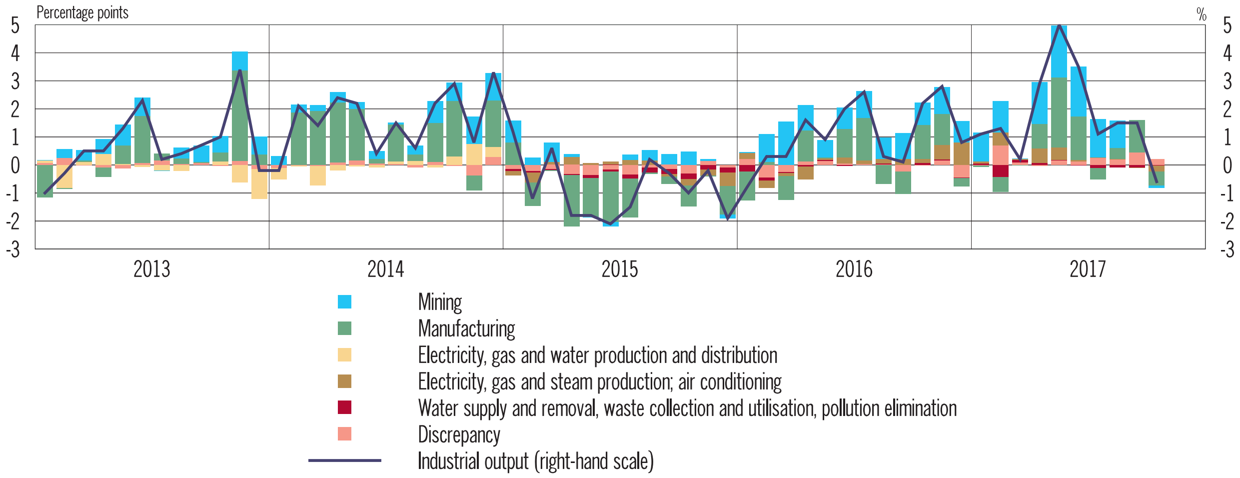


Sources: Rosstat, FCS of Russia, Bank of Russia calculations.

Chart 1.19

Contribution of industrial output components

(adjusted for calendar factor, on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

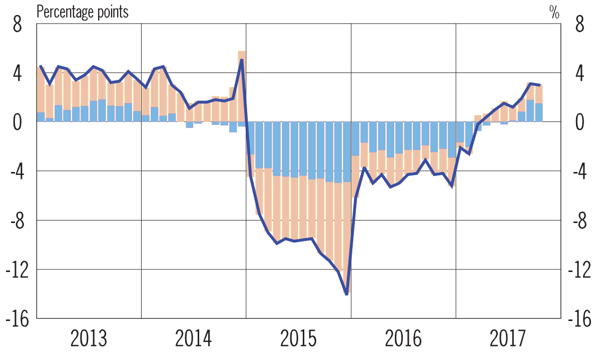
dynamics (Chart 1.19). The output of investment and intermediate goods contracted in September-October. The unstable domestic producer demand dynamics for most intermediate materials, such as output from the timber, pulp and paper industries, and also metallurgy industries, caused a reduction in commodity-based processing volumes (excluding agricultural raw materials). Another constraining factor on industries was the impact of the oil production restriction agreement, which affected production and investment activity in the commodity-based industry (Chart 1.20) and, in turn, oil exports dynamics. At the same time, annual growth in aggregate exports, in real terms, remained stable (4.4% in Q3), which was assisted by stable external demand for other Russian commodity and non-commodity exports.

In turn, real imports continued to exhibit sustainable year-on-year growth, for both consumer and investment goods. The conditions for this were created by the recovery in domestic demand and the strengthening of the ruble year-on-year. In Q3, net export dynamics continued to make a negative contribution to annual GDP growth (Chart 1.17). In Q4, this trend is expected to remain, but the negative contribution is anticipated to be considerably lower,

Chart 1.20

Growth in retail trade turnover

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

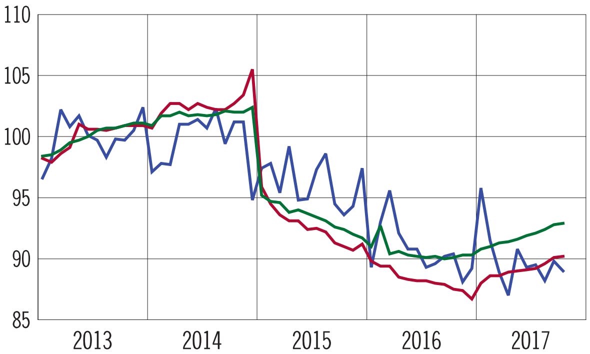


Sources: Rosstat, Bank of Russia calculations.

Chart 1.21

Real wages, disposable income and consumer spending of households

(seasonally adjusted, 2013 = 100%)

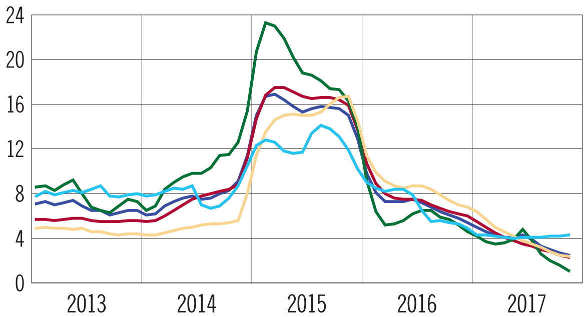


Sources: Rosstat, Bank of Russia calculations.

Chart 1.22

Prices of consumer goods and services

(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

largely as a result of a sluggish growth in imports amid the slowing year-on-year strengthening of the ruble.

At the same time, the confident recovery in domestic consumer activity continued to buoy output. Annual growth in retail trade turnover was roughly 3% in September-October (Chart 1.21). The increase in consumer confidence and in households' domestic demand was primarily due to the persistently stable situation in the labour market. Wage growth accelerated (Chart 1.22) in nominal and (taking into account the slowdown in inflation) real terms. Unemployment remained low, close to the level estimated by the Bank of Russia to be its natural level (where it does not exert any additional pressure on wages and prices). The gradual increase in credit availability and a slight reduction in the propensity to save amid the ongoing decrease in interest rates also created conditions for a revival in consumer activity.

Domestic consumer demand supported the production of durable goods (furniture, household appliances and passenger vehicles). Output of food products received a further boost due to the good harvest this year (including the processing of agricultural raw materials – sunflower oil, cereals and sugar).

In November-December 2017, consumer demand is expected to continue to recover, and by the end of 2017, the growth in household expenditure on final consumption will be 3.5–4.0%, according to estimates (the forecast in the September MPR was 3.0–3.5%). Amid the implementation of a consistent and conservative fiscal policy, general government expenditure on final consumption continues to exhibit weak growth in real terms, which is having slightly constraining effect on the dynamics of aggregate demand and inflation.

Taking into account the expected domestic demand dynamics, business sentiment among manufacturers remains relatively high, as shown in survey data. According to the results of a survey carried out by the E.T. Gaidar Institute for Economic Policy, in November output forecasts and optimism in demand forecasts reached their highest values in recent years. Research by Markit PMI also suggests that business expectations remain relatively positive.

Overall, in view of these trends, the Bank of Russia is keeping its GDP growth forecast for 2017 at 1.7–2.2%, like in the September MPR.

Inflation

In September-November, inflation continued to slow. In November, annual inflation fell to 2.5% (Chart 1.22) and core inflation – to 2.3%. The reduction in the average year-on-year inflation[5], which was 3.9% in November, also continued. The continued moderate consumer and lending activity in the economy and on-going reduction in inflation expectations, helped in part by a consistent moderately tight monetary policy, underpinned these trends of slowing price growth. The strengthening of the ruble year-on-year also continued to make a contribution to the reduction in annual inflation.

However, a more noticeable slowdown in inflation relative to the forecast in the September MPR (3.5–3.8%) and the forecasts presented in Bank of Russia monetary policy press releases can be largely explained by the impact of temporary factors. According to estimates, the contribution of temporary factors to the reduction in annual inflation will be roughly 1.0 percentage point at the end of 2017. In the autumn months, the largest contribution to the decrease in annual food inflation came from the expanded supply of crop products, base effects linked to the later harvesting period and specific one-off factors in the field vegetables market. This assumption is confirmed by the analysis of dynamics for a wide range of price change indicators (see box 'Underlying inflation indicators') and the review of the regional specifics of inflation processes (see Annex 'The economic situation in Russian regions'). The impact of these temporary food supply-side factors on annual inflation is expected to disappear over one-year horizon, which will cause a slight acceleration in annual inflation and bring it closer to 4% without any further change in monetary policy.

The fall in food inflation was more pronounced (Chart 1.22). The annual growth in prices for food products was 1.1% in November. In particular, prices for fruit and vegetables, granulated sugar, meat and poultry, cereals and pulses, etc. were lower than the previous year. Food prices depreciated or exhibited slowing growth amid an increase in supply shaped, on the one hand, by bumper harvests for a number of agricultural crops and a stable growth in the supply of livestock products and, on the other hand, pent-up demand, limitations in transport and storage logistics, coupled by producers and retailers seeking to sell certain types of vegetables more quickly due to the harvest's quality being unsuitable for long-term storage. The expanded supply caused a year-on-year decline in producers' prices in agriculture and the food industry, which contributed to a slowdown in food price growth in the consumer market. The market imbalance towards food supply is temporary. As it dissipates by spring 2018, year-on-year food price growth could accelerate slightly.

Annual growth in non-food goods prices also continued to slow down and amounted to 2.7% in November. The year-on-year strengthening of the ruble contributed to the slowing or negative price growth for a number of non-food goods with a high percentage of imports (in particular, household appliances and electronics, and medical goods). However, price growth rates for motor fuel picked up due to the accelerated growth in prices set by oil product producers amid higher prices in international commodity markets.

The growth in services prices increased slightly in November (to 4.3%, after 4.2% in October and September), largely due to the pick-up in annual growth rates for transport services prices (partly linked to higher fuel prices and partly caused by base effects) and foreign tourism prices. It should be noted that the increase in services prices relative to goods prices this year, being a reflection of the price dynamics of non-tradable goods relative to tradable goods prices, was consistent with the observed actual strengthening of the ruble.

Amid the consistent slowdown in inflation, inflation expectations continued to fall (Table 1.1). Data from the December inFOM survey commissioned by the Bank of Russia showed a significant drop in household inflation expectations. Indeed, direct estimates of observed inflation over the past year and household inflation expectations for the next 12 months decreased (to 10.0% and 8.7% respectively) to fresh historic lows, nonetheless still remaining well above the 4% level. However, according to the

[5] *It reflects the change in the average prices over the past 12 months compared with the average prices in the previous 12 months. This figure is less sensitive to one-off shocks due to its high inertia.*

Box 1. Underlying inflation indicators

The Bank of Russia pays considerable attention to analysing inflation. It is particularly important to identify the stable component of consumer price dynamics that is free from the influence of one-off effects, such as surges in supply in certain commodities markets, or temporary changes in relative prices due to one-off fluctuations in the exchange rate or consumer sentiments. Given the time lag of the monetary policy transmission mechanism, the Bank of Russia's response to such shocks may lead to an increase in medium-term inflation volatility and weigh heavily on output. Conversely, a unidirectional change in prices for a wide range of goods and services that is linked to wider economic factors can be a sign of an elevated risk that inflation will deviate from the target (both upwards and downwards) in the medium term, which may suggest the need for changes in the monetary policy.

Core inflation, as published by Rosstat, is free of the distortions caused by the dynamics of administered prices, as well as the high volatility of prices partly induced by seasonality. However, it includes several components that, at certain times, can be unstable. To identify the stable component of inflation, central banks employ a set of underlying inflation indicators calculated on the basis of the consumer price index (CPI) and CPI components. These include the following:

1. Various consumer price sub-indices excluding a fixed set of volatile and unstable components subject to temporary shocks.

2. Various 'trimmed' inflation indicators, i.e. price indices excluding a certain proportion of the most volatile components or components with the lowest and highest price growth rates (the set of these indicators varies).

3. Price sub-indices calculated using alternative weights not equal to the proportions of positions excluded from the consumer basket. For example, the weight may be inversely proportional to the standard deviation of the inflation component.

4. A diffusion index dependent on changes in the proportions of consumer basket components whose price growth has accelerated or slowed.

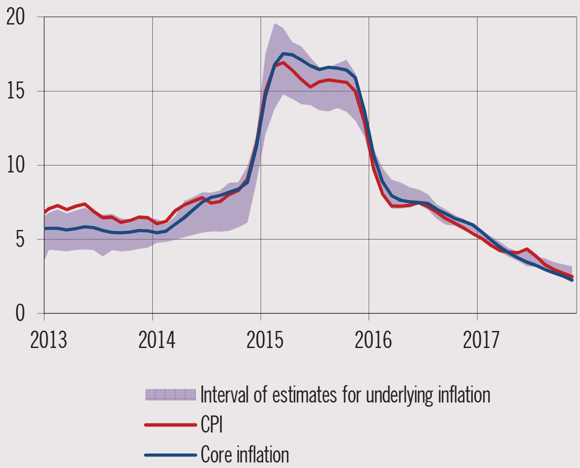
5. Indices obtained using factor models, which make it possible to identify general and random components in the dynamics of various CPI components. In this case, the general component is used as an estimate of underlying inflation.

The Bank of Russia uses most of the indicators mentioned above to analyse the stable inflation component (Chart 1.23). Sub-indices that exclude housing and utility services, administered prices and tariffs, or fruit and vegetable prices are used to remove from inflation dynamics the noise created by its certain components. Removing the upper and lower 'tails' of price growth distributions or excluding the most volatile components helps avoid outliers in the prices

Chart 1.23

Interval of underlying inflation estimates in Russia

(percent change on corresponding month of previous year)

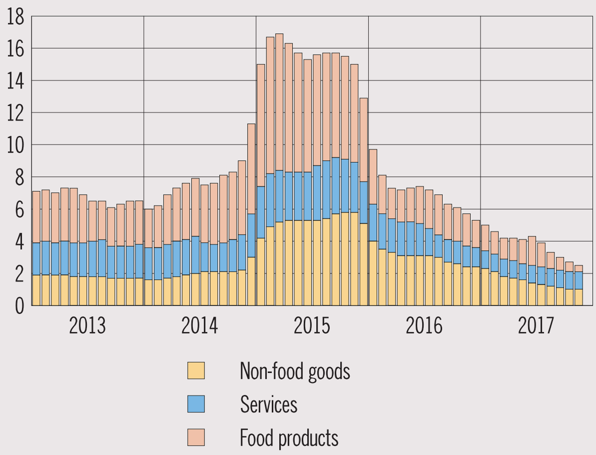


Sources: Rosstat, Bank of Russia.

Chart 1.24

Contribution to inflation

(percentage points on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

of goods and services in the consumer basket. The median price growth for certain elements of the consumer basket can also serve as an alternative to the classic CPI. The Bank of Russia uses estimated underlying inflation together with dynamic factor models as an alternative to the methods listed above.

All of these underlying inflation indicators point to a stable slowdown in consumer price growth over 2017. According to estimates for November, they range from 2.2% to 3.2%. Interestingly, like in 2016, inflation and core inflation are close to the lower bound of this range (by contrast, they had moved towards the upper bound in 2015). While in 2016 this primarily reflected the normalisation of consumer market situation following pro-inflationary shocks in 2015, this year, the relationship between underlying inflation indicators suggests that temporary factors are playing a greater role in the decline in observed inflation and core inflation, chiefly due to growth in food supply. The stable component of price dynamics is above current inflation indicators, close to 4%. This means that as the impact of temporary factors wears out, inflation will grow slightly in 2018, moving closer to the 4% level.

survey, households traditionally anticipate sharper price growth on the eve of New Year holidays. This suggests that, despite the decline, household inflation expectations remain highly sensitive to the effects of one-off factors, including the dynamics of prices for certain goods and services and calendar factors.

Medium-term forecasts by professional financial market participants stabilised around 4%. Downward trends dominated the dynamics of business inflation expectations, with the exception of certain markets affected by one-off factors (see box ‘Business price expectations’). The level and volatility of inflation expectations should decrease further as inflation stabilises around 4%.

Exchange rate dynamics continued to have a constraining effect on the year-on-year inflation dynamics in September-November. Despite the slight depreciation of the ruble over this period, it remained stronger than in the corresponding period of the previous year. According to estimates, the year-on-year contribution of the strengthening ruble to the reduction in consumer inflation in November was 0.5–1.0 percentage points. Taking into account current trends in exchange rate dynamics, the disinflationary effect of this factor is expected to disappear over the coming months.

According to Bank of Russia estimates, inflation will be 2.4–2.6% by the end of 2017. Going forward, as the effects of the temporary factors mentioned above dissipate over the course of the year, inflation is expected to pick up, moving closer to 4%.

However, several risks that inflation will deviate upwards and downwards from the forecast level still remain. In the short term, such factors include changes in food prices due to supply-side dynamics for agricultural produce, price dynamics in global commodities markets, and exchange rate fluctuations.

Taking current and forecast inflation and economic activity dynamics into account, as well as the balance of short-term and medium-term risks, in September-December, the Bank of Russia continued to reduce its key rate, gradually transitioning from the moderately tight to neutral monetary policy.

Table 1

Inflation expectations of economic agents

Survey	Expectation horizon	2014				2015				2016				2017											
		QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	January	February	March	April	May	June	July	August	September	October	November	December
Inflation expectations (absolute), %																									
Households																									
Public Opinion Foundation	next 12 months	11.8	11.7	12.5	15.5	15.7	15.0	16.0	16.4	14.7	14.2	14.2	12.4	11.5	12.9	11.2	11.0	10.3	10.3	10.7	9.5	9.6	9.9	8.7	8.7
Public Opinion Foundation (Bank of Russia calculations)	next 12 months	8.1	9.0	9.6	14.4	13.8	12.2	14.5	12.8	7.4	6.7	5.9	5.1	4.6	4.4	4.0	3.7	3.7	4.0	4.1	3.2	2.8	2.5	2.3	2.4
Professional analysts																									
Bloomberg	2017										4.7	5.2	4.5	4.4	4.3	4.2	4.1	4.1	4.0	4.2	4.0	3.7	3.3	3.0	
Interfax	2017									5.7	5.5	4.9	4.7	4.7	4.4	4.2	4.1	4.0	3.9	4.1	4.1	3.7	3.1	2.6	
Thomson Reuters	2017											5.1	4.6	4.1	4.3	4.1	4.1	4.1	4.0	4.1	4.0	3.5	3.0	2.6	
Financial markets																									
OFZ-IN	next 7 years							6.4	5.8	5.4	4.6	4.5	4.6	4.6	4.5	4.5	4.3	4.1	4.3	4.5	4.3	3.9	3.6	3.8	
OFZ-IN (without option adjustment)	next 7 years							8.1	7.3	6.9	6.0	5.3	5.4	5.0	4.9	4.9	4.7	4.6	4.7	4.9	4.7	4.3	4.1	4.3	
Bond market	next quarter	6.9	7.0	7.7	8.3	10.6	15.0	14.1	14.2	12.0	6.9	7.2	6.6	–	–	5.4	–	–	4.5	–	–	4.6			
Interbank market	next quarter	6.7	7.5	8.2	10.2	14.8	17.1	15.0	13.3	9.9	5.3	5.4	5.6	–	–	4.5	–	–	3.6	–	–	3.3			
Inflation expectations (balance of replies*)																									
Households																									
Public Opinion Foundation	next 12 months	84	85	84	83	76	72	80	83	84	78	82	80	80	83	79	80	78	80	82	79	82	74	74	78
Public Opinion Foundation	next month	79	82	76	77	68	60	71	78	72	68	70	76	72	72	68	71	66	68	73	67	73	65	66	73
Enterprises																									
Russian Economic Barometer	next 3 months	26	26	32	70	32	20	28	48	14	38	36	46	42	20	22	14	26	20	24	10				
Bank of Russia	next 3 months	14.3	12.4	13.9	30.3	14.8	12.7	12.1	17.3	12.4	12.1	10.4	12.4	9.8	7.7	6.8	6.9	7.7	9.6	7.2	6.7	6.6	7.0		
Retail prices (Rosstat)	next quarter	42	41	41	43	31	28	30	29	32	29	28	27	–	–	27	–	–	24	–	–	24			
Tariffs (Rosstat)	next quarter	6	5	2	5	7	6	2	2	5	5	0	0	–	–	4	–	–	3	–	–	0			

Change compared with previous 3 months:
– inflation expectations improved (more than 1 standard deviation)
– inflation expectations improved (less than 1 standard deviation)
– inflation expectations remain unchanged (± 0.2 standard deviations)
– inflation expectations deteriorated (less than 1 standard deviation)
– inflation expectations deteriorated (more than 1 standard deviation)

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

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

Box 2. Business price expectations[1]

Real-sector businesses base their economic decision-making on both past and expected price changes. The dynamics of business price expectations can not only largely predict inflation dynamics, but also influence them.

The extent of interconnectedness between the selling prices that businesses expect for their own products and observed consumer inflation varies by industry. It is most pronounced in the trade sector, focused on selling finished goods to households, and less pronounced in other industries. This is due to the fact that the price expectations of businesses outside of the trade sector are passed on to the consumer price index indirectly via changes in the prices for intermediate goods and the costs incurred by the consumers of these goods.

However, the impact of business price expectations on consumer inflation can intensify during certain periods. For example, the CPI acceleration in June was preceded by a surge in agricultural producers' price expectations, which was linked to poor harvest forecasts in 2017 and their expectations of increased expenditure on harvesting and subsequent storage. Trade sector price expectations also grew over this period on the back of agricultural producers' expectations, in part causing an acceleration in price growth for fruit and vegetables.

In the trade sector, respondents are highly sensitive to emerging economic trends, and changes in their expectations generally precede statistical observations. Elevated inflation expectations in this category of respondents start to wane two months after the actual slowdown in inflation. Hence, by monitoring the dynamics of trade enterprises' price expectations, the start and end of inflation spikes can be estimated with a high degree of precision (Chart 1.25).

According to business surveys, the most important factor influencing price expectations is production costs. Despite the downward trends in price expectations generally prevailing for most industries, they have peaked for livestock enterprises since August 2017. This is conditioned on the introduction of electronic veterinary certifications in production and processing starting 1 January 2018. It has already led to an increase in this sector's costs to acquire software, train employees, and expand veterinarian staff, and in future (by late 2017 – early 2018) it could raise the cost of livestock produce by 3–4% and, as a result, exert an upward pressure on food inflation.

Chart 1.25

Expectations dynamics by price growth and their materialisation

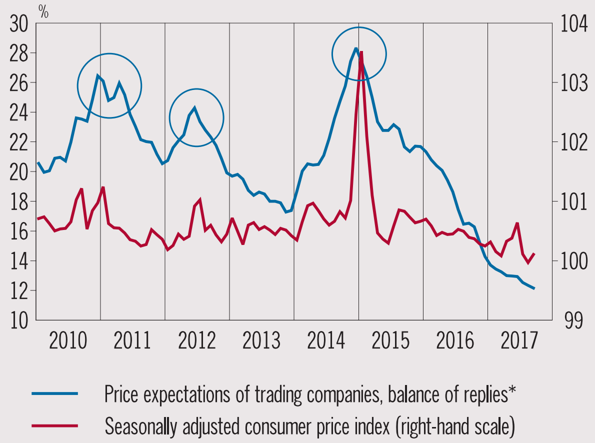
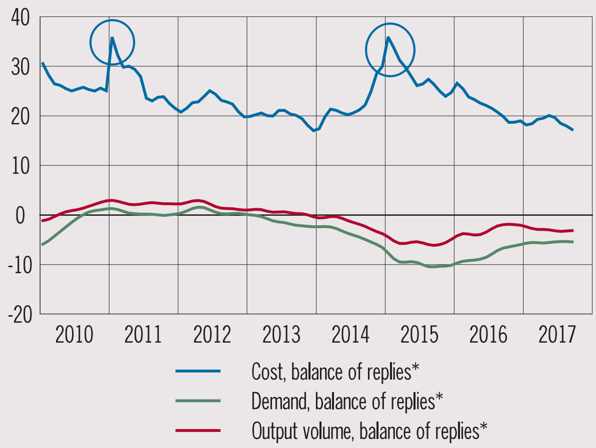


Chart 1.26

Trends in cost, demand and output movements

(%)



** Balance of replies is calculated as a difference between the proportions of replies 'more' (increase) and 'less' (decrease), as percentage, to the total of proportions of replies ('more', 'less', 'unchanged').*

Source: Bank of Russia.

[1] *The Bank of Russia conducts monthly surveys of non-financial organisations to find out how they perceive the current economic situation, their own investment activity and demand for banking services, and what changes they expect in future. More than 13,000 businesses from various industries take part in the surveys across all regions of Russia. In surveys on economic situation, respondents report on their price expectations and factors influencing their activities: past and expected changes in demand for manufactured goods, output volume, etc. Answers to the question of how prices for the businesses' finished goods will change over the next three months (increase, decrease, remain unchanged) are used to calculate the distribution of answers across key industries.*

Price expectations are also closely correlated with the current and expected dynamics of demand for goods. According to business survey data, the significant decrease in demand from late 2014 through May 2015 partially smoothed over the impact of the cost of final consumer goods prices, which have grown due to the depreciation of the ruble (Chart 1.26).

Hence, the level of risks to inflation arising in the short term can be estimated by monitoring expectation dynamics from business surveys with respect to growth in prices for their goods, costs, demand and other indicators.

Since the start of 2017, business price expectations in most industries have consistently declined and are currently at all-time lows.

2. ECONOMIC OUTLOOK AND KEY RATE DECISION

The Bank of Russia's medium-term forecast has been adjusted relative to the September MPR. The main reason underpinning the adjustment was the fact that exporters decided in November to extend the oil production restriction agreement until the end of next year. This set conditions for oil prices to remain at a higher level in 2018 compared with the level assumed in the baseline scenario of the September MPR[1]. The situation in the oil market and the generally favourable macro-economic climate will provide some support for economic activity in Russia next year. That said, the medium-term outlook both for domestic forecast factors and for estimated potential growth in the Russian economy remains unchanged. Recent actual data also had a slight impact on the forecasts for certain indicators (for example, lending to the economy).

Hence, in this MPR, the baseline scenario assumes that signatories will comply with the oil production restriction agreement in 2018 and terminate the agreement thereafter, which will cause oil prices to fall in 2019 and remain at a relatively low level in the medium term. Unlike the baseline scenario, the scenario with rising oil prices assumes that the oil production restriction agreement will remain in force after 2018 and that the global economy will exhibit more dynamic growth.

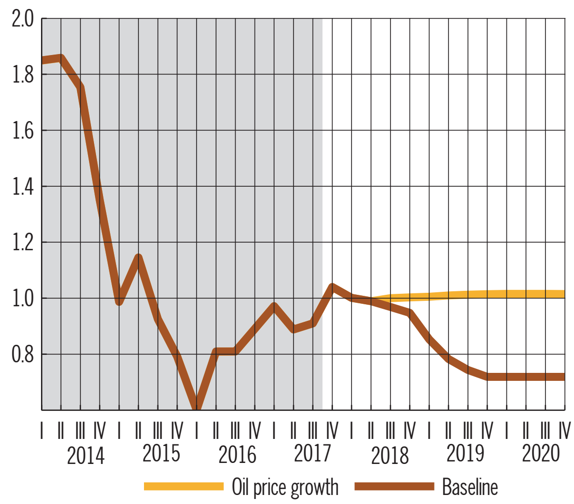
Baseline scenario

If signatories diligently fulfil their obligations under the oil production restriction agreement, prices in 2018 will be close to this year's average level (roughly $55 per barrel) (Chart 2.1). Thereafter, they are expected to gradually fall to roughly $40 per barrel[2] in 2019 and remain at this level (in real terms) in 2020. The Bank of Russia's outlook for the key factors shaping these energy price dynamics has remained broadly unchanged compared with the September MPR. In terms of supply-side factors, a steady expansion of oil production at shale deposits in the USA could exert a downward pressure on prices in the medium term[3]. Moreover, the potential for an increase in demand for oil will be limited by the relatively moderate growth rates in the global economy. In addition, the reduced growth in China's oil consumption amid the expected slowdown in its economic growth over the forecast period could exert a further downward pressure.

The medium-term outlook for global economic dynamics has also not undergone any significant changes compared with the previous forecast. According to Bank of Russia estimates, growth rates in Russia's trading partners will be 2.3–2.4% in the medium term. The moderate economic activity will not be accompanied by any significant inflationary pressure in Russia's trading partners and will not pose any additional inflation risks for Russia.

Chart 2.1

Terms of trade



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

[1] *The baseline scenario in the September MPR assumed that relatively high oil prices would remain until the end of 2018 Q1 and would gradually fall until the end of 2018 to roughly $40 per barrel.*

[2] *In real terms, i.e. at 2017 prices.*

[3] *The risks associated with further rapid growth in oil production in Libya and Nigeria have abated. These countries reported that, in 2018, their production will not exceed the maximum levels achieved in 2017.*

External price dynamics will in part be limited by the largest global central banks' policies aimed at anchoring inflation around respective target levels. The US Fed's rhetoric suggests that it will continue to gradually normalise US monetary policy. Favourable trends in euro area dynamics also point to the possibility of a gradual increase in rates over the forecast period. A narrowing in the rate differential between emerging market economies and developed countries could somewhat reduce global investors' risk appetite, weakening the appeal of assets from EMEs, including Russia.

In 2018, considering commodity prices dynamics and the prospect of changes in external financial conditions, according to Bank of Russia estimates, Russia's risk premium (CDS) will remain close to the current relatively low levels (roughly 150 bp), reflecting the continued appeal of Russian assets to foreign investors. At the same time, opportunities for residents to build up their foreign assets will also improve amid growth in economic agents' incomes. Moreover, the growth in investment in foreign assets and, consequently, in net private sector lending to the rest of the world is forecast to exceed the September MPR measures, given higher expected receipts from foreign economic activity amid persistently high oil prices. The estimate of the current account balance has also been revised upwards, primarily due to the upward revision of the export earnings forecast (see Table 2.1, Annex 'Balance of payments forecast for 2017-2020').

Further ahead, over the forecast period, as oil prices will fall, export earnings will gradually decrease. As a result, the current account balance will shrink from $43 billion in 2018 to roughly $12 billion in 2019, and roughly $3 billion in 2020. Russia's risk premium will be adjusted to roughly 170 bp. Net private sector lending to the rest of the world is expected to decrease slightly, to roughly $8-9 billion in 2019–2020 after $16 billion in 2018. Internal financial conditions in the Russian economy will continue to be shaped by the Bank of Russia's monetary policy, on the one hand, and the ongoing moderate risk appetite of economic agents, on the other.

In terms of monetary policy, decisions already adopted by the Bank of Russia in 2017 will have an impact on the economy, including decisions made at the Board of Directors meeting in December, as well as future measures to cut the key rate, the potential for which will remain in place over the forecast period. Factors such as the balanced recovery in demand relative to production capacity, the reduction in inflation expectations in response to the actual inflation, and the comparatively stable exchange rate dynamics in the absence of significant external shocks are all creating the necessary conditions for the easing of monetary policy over the forecast period. In the medium term, the Bank of Russia will gradually transition from a moderately tight to a neutral monetary policy. According to Bank of Russia estimates, the neutral monetary policy rate is 6–7% over the forecast period. The horizon to deliver the key rate to this level will depend on economic activity dynamics, the balance of risks that inflation will deviate upwards or downward from the forecast, inflation expectations dynamics, and their sensitivity to the effects of temporary pro-inflationary factors.

As monetary policy is gradually eased over the forecast horizon, interest rates in the economy will continue to fall in line with the Bank of Russia key rate and under the influence of expectations of further changes to the key rate. At the same time, the incomes of potential borrowers will gradually increase amid continued growth in the Russian economy, whose growth prospects have been revised upwards for 2018 compared with the September MPR (see below). This will help to increase banks' trust in new customers, expand the range of lending areas, and, as a result, improve lending activity in the economy. According to Bank of Russia estimates, under the baseline scenario, the growth in lending to the economy will continue to follow the trends of rising incomes and robust financial positions of economic agents over the forecast horizon, without exerting any additional inflationary pressure. In 2018, the growth in lending to the economy is expected to be in the range of 8–11% (Table 2.2). Market participants' greater incomes and improved sentiment will exert an upward pressure on the level of healthy risk appetite among economic agents, and will also create additional incentives for growth in consumer demand, including through increased lending.

These processes began in 2017 and are expected to continue in the medium term. They were the cause of the faster-than-expected recovery in growth in lending to the economy. In 2019, market participants' optimism may diminish slightly due to

Table 2.1

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

	2016 (actual)	2017	2018		2019		2020	
			baseline	oil price growth	baseline	oil price growth	baseline	oil price growth
Current account	**26**	**40**	**43**	**45**	**12**	**52**	**3**	**58**
Balance of trade in goods	90	112	121	124	92	134	83	143
Exports	*282*	*349*	*365*	*366*	*333*	*382*	*325*	*395*
Imports	*-192*	*-237*	*-243*	*-243*	*-241*	*-248*	*-242*	*-252*
Balance of services	-24	-27	-29	-30	-30	-31	-30	-31
Exports	*51*	*59*	*60*	*60*	*61*	*62*	*63*	*65*
Imports	*-74*	*-86*	*-89*	*-90*	*-91*	*-93*	*-94*	*-96*
Primary and secondary income balance	-41	-44	-49	-49	-50	-51	-51	-53
Capital account	-1	0	0	0	0	0	0	0
Current and capital accounts balance	**25**	**40**	**43**	**45**	**12**	**52**	**3**	**58**
Financial account (excluding reserve assets)	**-12**	**-9**	**-9**	**-10**	**-1**	**-13**	**-3**	**-14**
General government and the central bank	3	19	7	7	6	6	6	6
Private sector	-15	-29	-16	-17	-8	-19	-9	-20
Net errors and omissions	**-5**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Change in reserve assets ('+' – decrease, '-' – increase)	**-8**	**-31**	**-35**	**-35**	**-11**	**-38**	**0**	**-45**

** Signs according to BPM5.*

Note: owing to rounding the sums of the separate items may differ from the totals shown.

Table 2.2

Key parameters of the Bank of Russia's forecast scenarios

(growth as % of previous year)

	2016 (actual)	2017	2018		2019		2020	
			baseline	oil price growth	baseline	oil price growth	baseline	oil price growth
Urals price, average for the year, US dollars per barrel	42	53	55	56	45	58	42	60
Inflation, % in December year-on-year	5,4	2.4-2.6	3.5-4.0	3.5-4.0	4,0	4,0	4,0	4,0
Inflation, yearly average	6,5	3,5	3.5-4.0	3.5-4.0	4,0	4,0	4,0	4,0
Gross domestic product	-0,2	1.7-2.2	1.5-2.0	1.5-2.0	1.0-1.5	1.5-2.0	1.5-2.0	1.5-2.0
Final consumption expenditure	-3,5	2.8-3.2	2.5-3.0	2.5-3.0	1.0-1.5	2.5-3.0	1.5-2.0	2.0-2.5
– households	*-4,5*	*3.5-4.0*	*3.0-3.5*	*3.0-3.5*	*1.0-1.5*	*3.0-3.5*	*2.0-2.5*	*2.5-3.0*
Gross formation	1,5	6.0-6.5	2.0-3.0	2.0-3.0	1.0-2.0	2.5-3.5	2.0-3.0	1.5-2.5
– gross fixed capital formation	*-1,8*	*3.2-3.6*	*2.5-3.0*	*2.5-3.0*	*1.5-2.0*	*2.5-3.0*	*2.0-2.5*	*2.0-2.5*
Exports	3,1	4.0-4.5	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0
Imports	-3,8	15.0-15.5	4.0-4.5	4.0-4.5	2.0-2.5	5.5-6.0	4.0-4.5	4.0-4.5
Money supply in national definition	9.2	8-10	8-11	9-12	8-11	9-12	7-10	8-11
Lending to non-financial organisations and households in rubles and foreign currency	-0.6	7-9	8-11	8-11	8-11	9-12	7-10	8-11

sluggish economic growth in 2019 amid a decline in oil prices. However, it will be short-lived and will be essentially offset as soon as 2020. According to estimates, in 2019–2020, the growth in lending to the economy[4] will be 7–11%. Moreover, in 2017, a trend was formed towards the growing role of the bond market in lending to the economy; this trend is expected to remain in place.

The dynamics of household and corporate lending and overall lending to the economy will largely change in the same direction. According to Bank of Russia estimates, household lending will outstrip growth rates in lending to non-financial organisations over the entire forecast period. However, this growth in lending to non-financial organisations will represent catching up after a rather long period of weak lending dynamics with a low base, and will not generate any inflation risks. According to Bank of Russia estimates, the growth in lending to households will be roughly 9% in 2018 and roughly 10% in 2019–2020. Lending to organisations, including financial and non-financial organisations, is expected to increase by 9–9.5% in 2018 and by 8–9% in 2019–2020.

With the Government of the Russian Federation consistently implementing the fiscal consolidation policy, the growth in lending to the economy over the forecast horizon will make the main contribution to the dynamics of money supply in the national definition. As the budget deficit reduces, net lending from the banking system to the general government will gradually contribute less to the increase in money supply. As a result, the growth in money supply will move closer to the growth in lending to the economy and will be 8–11% in 2018 and 7–11% in 2019–2020. The increase in money supply will be consistent with the pace of GDP growth, taking into account the gradual build up in the level of monetisation in the economy.

Due to the revision of the oil price path, according to Bank of Russia estimates, GDP growth will remain close to its potential in 2018, and GDP dynamics will slow the following year. Growth estimates for GDP components have also been adjusted in view of the revision of the oil price path over the forecast period. Besides, the Bank of Russia's outlook for the structure of GDP growth has not undergone any significant changes compared with the September MPR.

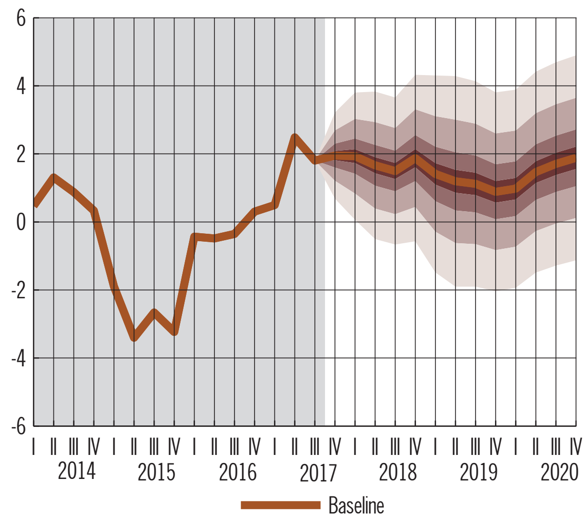
In 2018, annual GDP growth will be roughly 1.5–2.0%, which is close to the estimated medium-term potential for the Russian economy (Chart 2.2). With continued growth in incomes and the gradual recovery of lending activity, annual growth in household final consumption expenditure will be 3.0–3.5%, which is close to 2017 levels. As before, consumer demand will be satisfied both through domestically produced goods and through imports, which will continue to grow steadily in real terms at the annual rate of 4.0–4.5% in 2018. However, annual export growth in real terms will be far lower than import growth, causing net exports to make a negative contribution to GDP growth in 2018. According to estimates, gross fixed capital formation will also demonstrate robust growth at the annual rate of 2.5–3.0% amid improved businesses' incomes and confidence in the real sector of the economy.

In 2019, GDP growth will temporarily slow to 1.0–1.5% year-on-year before returning to its potential, estimated to be in the range of 1.5–2.0%, and will remain close to this level in the medium term. A relatively short-lived and negligible adjustment to GDP growth in response to a permanent

Chart 2.2

GDP growth rate

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

[4] *Banking sector lending to the economy means all of the banking sector's claims on non-financial and financial institutions and households in the currency of the Russian Federation, a foreign currency, and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investments in debt and equity securities and promissory notes, as well as other forms of equity holdings in non-financial and financial institutions, and other accounts receivable on settlement operations involving non-financial and financial institutions and households.*

decline in oil prices will be caused by the Russian economy's greater stability in the face of external shocks, which will be aided in part by the Russian Government's policy of fiscal consolidation and the implementation of the budget rule. Compared with the baseline scenario in the September MPR, the Bank of Russia's revised forecast accounts for the budget rule mechanism that has been finally incorporated into the Budget Code and has been slightly adjusted for 2018–2020 compared with its transitional form which was in effect in 2017. The rule is geared towards alleviating the economy's sensitivity to fluctuations in commodity markets and supporting resilience in government finances in the long term (see box 'Budget rule'). Opportunities for GDP growth that is higher over the forecast period compared with current estimates of the Russian economy's medium-term potential will largely depend on the scale, speed and effectiveness of structural reforms and institutional changes. According to Bank of Russia estimates, amid the gradual reduction in the budget deficit in 2017–2020 as part of the fiscal consolidation, the contribution of the fiscal policy to aggregate output dynamics in 2017 will be negative and will remain negative over the forecast period. If the plans set out in the budget projections and the adopted law on the budget for 2018 are complied with, the fiscal policy is not expected to pose any significant risks to inflation in the medium term.

The reduction in energy prices in 2019 will be passed on to the slowing growth of income in the economy and the slight worsening of sentiments in the real sector, which will lead to a temporary reduction in investment demand growth. According to Bank of Russia estimates, annual growth in gross fixed capital formation will be adjusted downwards to 1.5–2.0% in 2019. Then, as producer activity stabilises, it will recover to 2.0–2.5% and stabilise at this level in the medium term. In particular, the certain deterioration in companies' investment plans will lead to a downward adjustment in import growth in real terms amid the slowing growth in income and the depreciation of the ruble. Annual growth in import quantities in 2019 will be 2.0–2.5%, but will return to 2018 levels after one year amid recovered investment and consumer activity. Despite the temporary slowdown, import growth in real terms will outstrip the expansion in exports over the entire forecast period, meaning that net exports will make a small negative contribution to GDP. Annual export growth will be 1.5–2.0% over the mid-term forecast horizon. A more confident recovery in export growth is possible if domestic production in the non-oil sector of the economy grows further, which even now is bolstering growth in Russian exports.

Consumer demand, like investment demand, will react to the decrease in overall income caused by a downward adjustment in oil prices. According to Bank of Russia estimates, annual growth in household final consumption expenditure will slow to 1.0–1.5% in 2019. Further ahead, in the medium term, consumer demand will grow at a moderate pace of 2.0–2.5%, which is in line with the speed at which incomes will recover in the economy and, as a result, will not create any additional pro-inflationary risks over the forecast period.

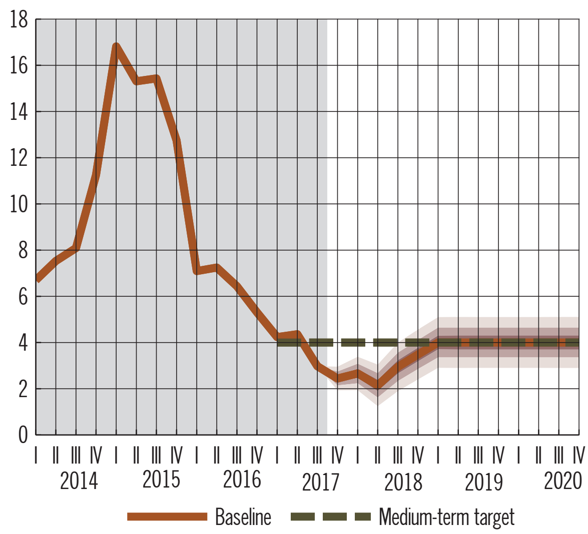
The Bank of Russia's policy over the forecast horizon will be aimed at setting the necessary conditions to keep economic growth rates close to potential levels and inflation at 4% (Chart 2.3). According to Bank of Russia estimates, over the forecast period, annual inflation and estimated average price growth year-on-year will gradually rise towards 4% in 2018, as the effect of the high supply of food products will wear out, and they will remain close to this level thereafter.

Wage growth over the forecast horizon will be moderate. According to Bank of Russia estimates, this growth will be in line with labour productivity growth and therefore will not exert any pro-

Chart 2.3

Inflation

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

Box 3. Budget rule

The budget rule is a fiscal discipline mechanism that regulates the correspondence between expenses and forecast income, together with certain parameters about accumulating and spending government assets (sovereign funds) and financing the budget deficit to achieve the long-term stability of government finances.

The Russian Ministry of Finance announced the introduction of the budget rule in its Fiscal Policy Guidelines for 2017 and the Period of 2018 and 2019. Beginning in February 2017, a temporary mechanism took effect with regard to foreign currency purchases/sales in the amount of surplus (missing) oil and gas revenues (hereinafter, the transitional budget rule), which is calculated using the formula:

$$Int = OGI\ (Urals_{forec.};\ FX_{forec.}) - OGI\ (Urals_{base.=\$40};\ FX_{\$/₽=67.5}),$$

where $OGI\ (Urals_{forec.};\ FX_{forec.})$ is the budget's forecast oil and gas revenues;

OGI $(Urals_{base.=\$40};\ FX_{\$/₽=67.5})$ is the budget's baseline oil and gas revenues specified in the budget law for 2017 and calculated on the basis of the baseline Urals price of $40 per barrel and the average US dollar exchange rate of ₽67.5);

$Urals_{forec.}$ is the forecast Urals crude price ($/barrel);

$FX_{forec.}$ is the forecast average US dollar to ruble exchange rate for the year.

Beginning in 2018, the regular budget rule will take effect. Its parameters are set forth in the Budget Code of the Russian Federation. This rule does not only regulate operations to replenish and spend the National Wealth Fund (NWF), but also the amount of federal budget expenses, together with certain parameters for funding the budget deficit.

The change in the formula to calculate the surplus (missing) oil and gas revenues assumes a change in the amount of interventions in relation to the transitional budget rule for 2017:

$$Int = OGI\ (Urals_{forec.};\ FX_{forec.}) - OGI\ (Urals_{base.};\ FX_{forec.}).$$

The main adjustments to operations to replenish and spend funds represent changes to the ruble exchange rate used to calculate the baseline oil and gas revenues. Beginning in 2018, on a monthly basis, the current ruble exchange rate will be used (in the transitional budget rule, the exchange rate was specified in the budget law).

In addition, the regular budget rule regulates the maximum federal budget expenses, which are tied to income in order to achieve a balanced budget:

$$E = OGI\ (Urals_{base.};\ FX_{forec.}) + NOGI\ (GDP_{forec.};\ FX_{forec.}) + \%E,$$

where E is the maximum amount of budget expenses;

$NOGI\ (GDP_{forec.};\ FX_{forec.})$ is the budget's forecast non-oil and gas revenues;

$\%E$ is the amount of interest expenses restricting the size of the actual budget deficit.

While in 2017 the increase in intra-year expenses was only envisaged to be in line with the increase in non-oil and gas revenues (since the baseline oil and gas revenues were fixed) as a result of the improved macro-economic forecast, in 2018 both components of the budget's income could change and influence the amount of expenses.

When analysing changes in the parameters of the budget rule, several aspects of both the mechanism of the Russian Ministry of Finance's operations in the FX market and expenses restrictions must be taken into account.

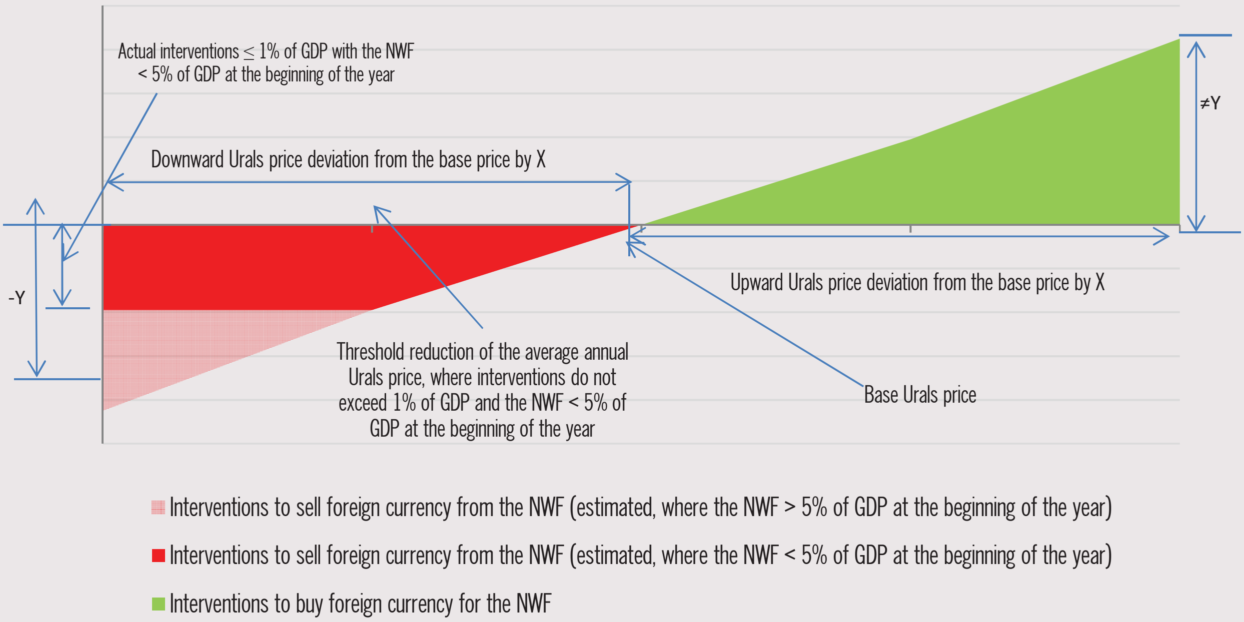
First, given the same deviation in the actual Urals price in either direction relative to the baseline price, beginning in 2018 the amount of interventions under the budget rule will be higher than under the parameters of the transitional rule in 2017.

Additionally, under the regular budget rule, given the same deviation in the Urals price from the baseline price in either direction, the amount of foreign currency purchases and sales may not coincide in absolute terms. The formulae used to calculate certain oil and gas taxes (for example, export duties) assume a non-linear change in revenues relative to the Urals price, especially if it falls below $25 per barrel[1].

[1] *For example, if the Urals price is below $15 per barrel, oil export duties will be zero. Moreover, the formula for oil export duties is different for different price ranges: $15–20, $20–25 and $25 per barrel or higher. In each of these ranges, oil export duties are calculated using a separate formula, which implies a non-linear character of interventions when prices fall below $25 per barrel.*

Chart 2.4

Budget rule's asymmetry relative to base Urals price



Second, when the amount of the NWF at the start of the year is less than 5% of GDP (under current conditions, roughly ₽4.5 trillion), the amount of interventions to sell foreign currency in the amount of income missing when average Urals prices fall below the baseline level cannot exceed 1% of GDP (under current conditions, roughly ₽0.9 trillion). However, when Urals prices exceed the baseline, the amount of interventions to purchase foreign currency in the amount of surplus oil and gas revenues is not restricted by specific ratios.

These two facts characterise the lack of symmetry in the budget rule relative to the baseline Urals price (Chart 2.4). Hence, in certain periods, this will contribute to the tightening of the fiscal policy, which is necessary to maintain the stability of government finances in the long term.

Third, intra-year changes in the budget deficit due to the actual ruble exchange rate's deviation from the forecast rate will only be offset by adjusting the borrowing plan, and not by introducing changes to the plan for use of NWF funds. As such, the depreciation of the ruble relative to the forecast will lead to growth in income and a contraction in the budget deficit, which will allow for a reduction in OFZ placements. According to Bank of Russia estimates, growth in the actual US dollar exchange rate by ₽1 relative to the forecast level will allow for a reduction in OFZ placements by ₽80–85 billion.

inflationary pressure. During the temporary slowdown in growth in 2019, amid the falling oil prices, demand will constrain inflation. Over the remainder of the forecast period, demand-side effect on inflation will be more neutral. The contribution of spending dynamics to inflation will continue to be moderate, in part due to the indexation of administered prices and tariffs for services provided by natural monopolies at a rate not exceeding 4%.

According to Bank of Russia estimates, exchange rate dynamics will not have a material impact on consumer price growth over the forecast horizon. The pass-through of energy price fluctuations onto exchange rate and inflation dynamics will be constrained by the implementation of the budget rule by the Russian Ministry of Finance (see box 'Budget rule').

Keeping inflation close to 4% will help reduce inflation expectations further and weaken their sensitivity to internal and external factors. This will also be aided by the Bank of Russia implementing a consistent and coherent information policy.

Scenario with rising oil prices

The scenario with rising oil prices assumes that OPEC and non-OPEC countries will retain oil production restrictions after 2018 and that the global economy will recover more robustly. These factors will buoy energy prices, which will in turn cause Urals crude prices to gradually rise from roughly $55 per barrel in 2018 to $60 per barrel in 2020. Given the similarity of the assumptions regarding external conditions for 2018, this scenario's main difference from the baseline scenario lies in the dynamics of economic indicators in 2019–2020. However, the main trends over this period are generally similar to the forecast for 2018.

According to Bank of Russia estimates, the upward trajectory of oil prices will be a factor buoying economic agents' confidence and foreign investors' interest in the assets of EMEs, including Russia. The more positive environment in the global commodity markets compared with the baseline scenario and the more confident economic growth in Russia's trading partners (at 2.5–2.6% annually, according to Bank of Russia estimates) will have a positive impact on economic activity in Russia.

Against this backdrop, Russia's risk premium will gradually reduce, supporting the inflow of foreign investment. In addition, opportunities for companies to borrow as their incomes grow will be greater than in the baseline scenario. As a result, Russian private sector's net lending to the rest of the world will be higher than in the baseline scenario.

In the absence of external shocks, investment and production activity will continue to grow in the economy and consumption will increase amid positive household income dynamics. As a result, annual growth in gross fixed capital formation and household consumption will not decline in 2019–2020, unlike in the baseline scenario, but will remain close to 2018 levels at 2.0–3.0% and 2.5–3.5% respectively.

The improvement in consumer and investment expenditure will support an expansion in imports, causing them to be higher than in the baseline scenario, both in real terms and value terms. According to Bank of Russia estimates, growth in import quantities will be 4.0–6.0% in the medium term.

The upward dynamics of oil prices and their consolidation at a relatively high level, coupled by accelerated growth in the global economy, will contribute to an increase in demand for Russian exports. However, as before, exports will grow slower than imports in real terms. According to Bank of Russia estimates, the annual growth in exports will be 1.5–2.0% in 2018–2020 in real terms, meaning that net exports will make a negative contribution to GDP. However, in value terms, exports are expected to surpass imports, resulting in a growing positive trade and current account balance over the entire forecast horizon.

Hence, in this scenario, the trends observed in 2018 will be preserved in 2019–2020. The Russian economy will continue to grow at an annual pace of 1.5–2.0% over the entire forecast period, which is close to its medium-term potential. In terms of the overall fiscal policy, the Russian Government will continue to implement its fiscal consolidation strategy. In the scenario with rising oil prices, the federal budget deficit may fall slightly faster than in the baseline scenario, due to significant tax revenues amid the higher growth of economy. However, the permanent application of the budget rule will limit expenditures by providing a more regulated spending framework and, as a result, the predictability of the government budget's 'profile'.

The Russian Ministry of Finance's operations to purchase foreign currency to replenish the National Wealth Fund will continue to have a slightly weakening effect on the ruble. Like in the baseline scenario, these operations will lead to growth in international reserves over the entire forecast period. According to Bank of Russia estimates, the weakening influence on the ruble will exert an upward pressure on consumer price growth in Russia, but will not prevent them from being held at a level close to 4% over the forecast horizon.

As the fiscal consolidation policy is implemented, the banking system's net lending to the general government will gradually contribute less to money supply dynamics. As in the baseline scenario, the main source of money supply will be lending to the economy. Its annual growth in 2019–2020 is estimated to be 8–12%, which is close to estimated money supply dynamics. Growth in lending activity, closely followed by money supply dynamics, will slightly outstrip the equivalent indicators under the baseline scenario. However, according to Bank of Russia estimates, these processes will be supported by the continued income growth in the economy and further stabilisation of household and corporate debt burdens and, as a result, will not exert any inflationary pressure.

In the absence of any temporary deterioration in the economic situation in this scenario caused by external factors, monetary policy and, more generally, internal financial conditions could be slightly softer than in the baseline scenario. The Bank of Russia will keep inflation close to 4% over the entire forecast horizon through monetary policy measures. However, if risks of an imbalance arise in certain market segments, the Bank of Russia will react to them using macroprudential policy measures that have a punctuated effect.

Medium-term forecast risks

The development of the internal and external economic situation in recent months has to some extent influenced the Bank of Russia's analysis of medium-term forecast risks. First, the uncertainty in the dynamics of external factors has reduced slightly with regard to the path of changes in oil prices. Taking current and expected inflation trends into account, the risks that inflation will deviate (upwards or downwards) from the target in 2018 have become more balanced. However, in the medium term, pro-inflationary risks prevail over the risks of an excessive slowdown in inflation.

The extension of oil exporting countries' international agreement to restrict oil production to 2018 increased certainty surrounding oil price factors. The likelihood of the materialisation of the risk scenario in 2018 has decreased. This scenario implies a sharp decline in oil prices, which could be followed by the significant depreciation of the ruble, a negative response in economic agents' sentiments and expectations and an increase in inflationary pressure. However, taking into account the large number of demand- and supply-side factors affecting global oil prices, over the 2019–2020 period, changes in these factors will remain a source of uncertainty and risk in forecasting. Nonetheless, the economy's sensitivity to fluctuations in the commodities markets over the forecast horizon will be smoothed over by the implementation of the budget rule.

Another significant risk to inflation forecasts in the medium term is the elevated volatility of food prices. Food price dynamics could create risks that inflation will deviate from the target both upwards and downwards. The market for food goods, especially agricultural products, may experience significant supply fluctuations, which can be difficult to predict (for example, caused by weather conditions) and are beyond the control of monetary policy, since they are conditioned on non-monetary factors (see Report 'Non-monetary factors affecting inflation and measures to reduce inflation volatility'). Given that these categories of goods account for a large proportion of the consumer basket, the risks of price fluctuations are still significant even after inflation and inflation expectations have generally stabilised. In the medium term, measures aimed at mitigating infrastructural limitations in certain markets (including related to transport logistics, improving the quality of storage of certain types of food products – especially fruit and vegetables, etc.) may help reduce the impact of this factor. If such measures are successfully implemented, inflation's reduced sensitivity to temporary shocks across certain markets would have a significant positive effect on price stability and – more broadly – on macroeconomic stability in Russia.

According to Bank of Russia estimates, in the medium term, a number of factors that are a source of predominantly pro-inflationary risks also remain. These primarily include inflation expectation dynamics due to two key aspects. First, the rather high level of inertia in inflation expectations dynamics hampers their quick 'fine-tuning' and adapting to relatively low levels of inflation. Second, risks associated with inflation expectations are related to their sensitivity to short-term changes in the economy as a whole, as well as in individual markets (primarily the food markets). Accordingly, the Bank of Russia's consistent and open information policy, which builds households' and businesses' trust in the policy and their confidence in macroeconomic indicators for Russia as a whole, gains special significance. Working with the expectations of a wide range of economic agents, including individuals without any economic education, is also important. To meet these objections, for example, the Bank of Russia conducts various events to increase households' financial literacy.

One factor that must be mentioned among the risks threatening the medium-term forecast is also a possible sharp increase in consumer activity in the economy amid a growing propensity to consume and a fast increase in demand for borrowed funds not supported by income dynamics. The former poses a threat to price stability, while the latter causes more concern in terms of risks to financial stability and also comes into view when making decisions about the key rate. Household sentiments, expectations and preferences remain highly sensitive to a wide range of both internal and external factors, so changes in these may be difficult to predict over the long-term horizon and require constant and close monitoring.

Another source of risk to inflation posed by consumer demand is a possible surge in wages to levels far exceeding labour productivity growth in the economy. Such an excess does not typically emerge without any reasons and can be caused by structural problems, such as an imbalance between labour demand and supply in certain economic sectors, inconsistent fiscal policy, insufficient labour mobility, and high income volatility in certain industries sensitive to external conditions (in particular, commodities). Some of these factors already came into play in Russia in the past. Currently, the Bank of Russia views the shortage of qualified workers due to unfavourable demographic trends and insufficient training and educational opportunities for existing personnel to be one of the main causes underlying this growing pressure on wage dynamics.

In addition, when estimating the balance of risks, the Bank of Russia will take into account future decisions on fiscal and tariff policy, as well as potential changes to other external conditions, excluding global oil prices.

According to Bank of Russia estimates, given the increased certainty surrounding oil prices in 2018, the risks that inflation will deviate upwards from 4% over the course of the year have reduced slightly. However, medium-term pro-inflationary risks are greater than the risks that inflation will deviate steadily downwards.

In view of this, the Bank of Russia admits the possibility of a slight reduction in the key rate in the first half of 2018. In its decision-making on the key rate, the Bank of Russia will assess the balance of risks of inflation's material and sustainable deviation in either direction from the target, as well as the dynamics of economic activity against the forecast. In the event that certain segments of the financial market show signs of imbalance, the Bank of Russia may also use macroprudential policy measures.

ANNEXES

Dynamics of major items in the Russian balance of payments in 2017 Q3

In 2017 Q3, recovery trends continued to be seen in current account dynamics.

The state of the trade balance improved, largely due to increase in global prices of commodities, which constitute the bulk of Russian exports. The high grain harvests and one-off factors also helped to boost exports[1]. However, growth[2] in the volume of goods exports slowed from 23% in Q2 to 19% in Q3 due to the fact that changes to prices for oil and oil products are passed on to export contract prices with a certain delay.

According to FCS data, total oil and oil products export quantities decreased slightly as Russia fulfilled its commitments under the production restriction arrangements. Russian supplies to its main market – the European oil market – fell slightly amid the increase in exports to the EU from a number of countries not bound by obligations to restrict production (Libya, Nigeria, Iran and the USA). According to estimates based on Eurostat data, their total share in the EU imports of oil and oil products grew from 12% in 2016 Q3 to 18% in 2017 Q3. Nonetheless, Russia remained the main supplier in the European oil market, accounting for more than 30% of imports to the EU. Overall, the said period saw a partial re-orientation of Russian oil supplies from the West to the East. The EU's share in the Russian exports of oil and oil products dropped from 61% to 56%, while the combined share of China and India rose from 12% to 16%. The growth in oil exports to these Asian countries partially offset the reduced exports to the EU. At the same time, Russian natural gas export quantities remained virtually unchanged in 2017 Q3.

Annual growth in the volume of goods imports dropped from 28% in Q2 to 21% in Q3 due to weaker support from the ruble exchange rate. However, imports continued to show solid growth amid the intensification of business and consumer activity in Russia. The expansion of imports was more due to investment goods than consumer goods. According to estimates based on FCS data and Rosstat classification, the volume of imported investment goods increased by 24% in Q3. The number of imported cargo motor vehicles rose by more than half, while the number of imported tractors tripled. Imports of computers and telephones for mobile or other wireless networks also went up. The 16% increase in imports of consumer goods was mostly due to medicines, food and shoes. The lifting of the ban on imports of a number of food products from Turkey influenced the increase in food imports. The twofold growth in the proportion of grapes and apricots imported to Russia in 2017 Q3 was entirely due to the resumption of supplies from Turkey. However, the increased imports of formerly banned goods from Turkey made only slight contribution to growth in the value of Russia's aggregate goods imports, amounting to only 1.7%[3].

The recovery in consumer demand amid the stable situation in the labour market and low inflation, together with improved relations with Turkey, contributed to an increase in imported services in Q3, most notably in imported tourism services, thereby leading to growth in the balance of services deficit (Chart 1). Apart from Turkey, Russian tourists showed greater interest in Georgia, Spain, China, Ukraine and Finland. Imports of business services, such as re-insurance services, technical, trade intermediary and other business services, also recovered in 2017.

Among the non-tradable current account components, the wage deficit grew due to the

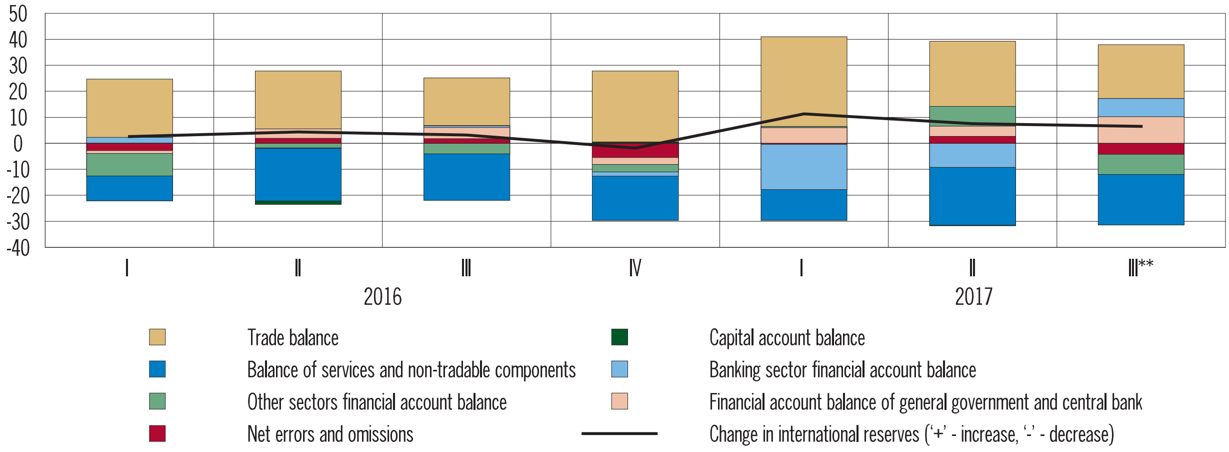
[1] *For example, large-scale deliveries of gold to Great Britain and Switzerland.*

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

[3] *According to FCS data, goods imports went up by $11 billion in 2017 Q3 compared with 2016 Q3, while imports of formerly banned goods from Turkey grew by $0.18 billion.*

Chart 1

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



** According to BPM5.*
*** Estimate.*
Source: Bank of Russia.

increase in the wages of temporary migrant workers in dollar terms amid the strengthening of the ruble. The investment income deficit reduced in 2017 Q3, according to preliminary estimates. The growth in investment income payable amid the acquisition of foreign assets by Russian companies, exceeded the increase in payments to non-residents.

At the same time, higher prices for key export goods along with the growth in the Russian economy presented wider domestic and foreign investment opportunities for Russian companies.

In 2017 Q3, Russian private sector's net lending to the rest of the world increased due to higher demand for foreign assets among Russian companies. The non-banking sector expanded its foreign assets, primarily in the form of direct investments, by $14 billion in 2017 Q3, compared with $2 billion in 2016 Q3.

Conversely, banks' foreign assets shrank on the back of substantial external debt repayments. However, given more favourable economic situation, their demand for foreign currency refinancing operations declined. The repayment of foreign currency liquidity previously granted by the Bank of Russia contributed to the contraction in banks' foreign assets.

Unlike banks, other sectors were able to build up their foreign liabilities, mostly by attracting direct investments from abroad, despite the limited access to Western capital markets as a result of the imposed sanctions.

Russia's reserve assets went up significantly as a result of both the acquisition of foreign currency for the Russian Ministry of Finance as a part of the budget rule implementation, and banks' shrinking outstanding amounts to the Bank of Russia under FX repos.

The economic situation in Russian regions

Regional analysis of trends in inflation components

In October-November 2017, inflation for Russia as a whole was below 4%. In the overwhelming majority of regions, inflation continued to display a slowdown, driven mainly by the dynamics of fruit and vegetable prices. The median of annual inflation distribution shifted to the left in October 2017, compared with the previous quarter, while the number of constituent territories reporting price growth below 4% increased from 59 in July to 79 in October (Chart 1).

Like in Q3, the largest contribution to inflation in Russia during this period came from two groups of regions: regions with inflation between 2.5% and 3% p.a. (the contribution to the national figure was roughly 0.7 pp) and the group of regions with inflation between 3.5% and 4% (the largest regions,

Chart 1

Distribution of Russian regions by annual inflation

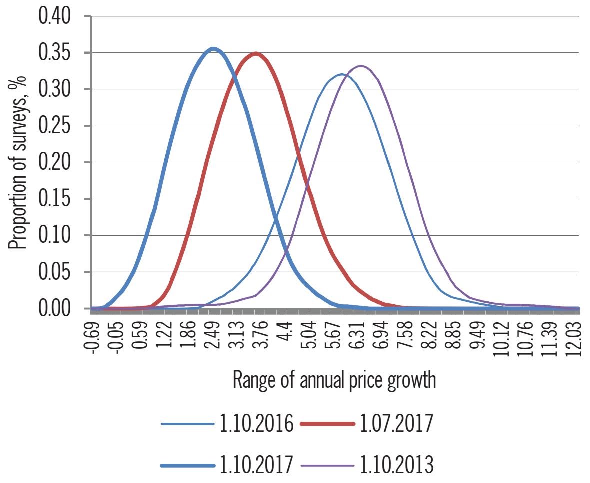
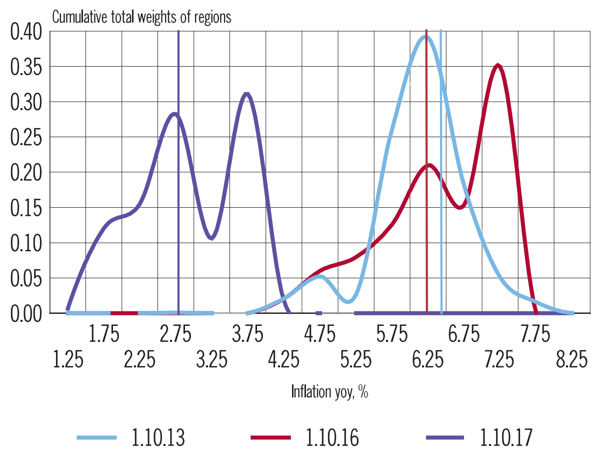


Chart 2

Correlation of regions' weights by inflation



Source: Bank of Russia.

including Moscow, Saint Petersburg and the Tyumen Region, with a contribution of 0.9 pp). Compared with Q3, the number of regions with inflation below 2.5% increased. The group of regions with inflation above the Russian average began to drift away from the general trend in inflation dynamics at the end of 2013 – early 2014. Since this group comprises regions with high levels of income (Moscow, Saint Petersburg and the Tyumen Region) and relatively high consumer demand, the reduction in inflation has been slower there. As a result, by October 2017, one can observe a clear division between regions with inflation of 2–3% (roughly at or below the Russian average) and inflation above the Russian average (3–4%). The weights of these groups in Russia's overall inflation figures are almost equal (Chart 2).

Broken down by region, 90% of constituent entities recorded a slowdown in inflation for food products and non-food goods. For services, the situation was mixed: some regions reported acceleration in price growth due to local indexation of certain types of services, while the remainder reported stabilisation of inflation.

Food products

The slowdown in price growth for food products, in particular for fruit and vegetables, was the main driver of inflation decline in the regions.

Annual inflation was below trimmed inflation figures in all federal districts[4]. This suggests that the trimmed product groups (including fruit and vegetables) exerted a considerable downward pressure on aggregate inflation in the districts over the period under consideration.

However, the uneven quality of the harvest for certain crops (primarily, potatoes and root vegetables) and underdeveloped storage infrastructure in certain regions could lead to price growth for fruit and vegetables in 2018 Q2.

Non-food goods

Inflation for non-food goods decreased in 72 regions. This was largely to due to the strengthening of the ruble year-on-year. Despite the fact that certain regions (primarily high-income regions) reported increased demand for durable goods, this did not exert any pro-inflationary pressure. The recovery in demand is still moderate.

In the near term, fuel price growth may accelerate due to higher wholesale fuel prices on exchanges and the Moscow oil refinery's closure for repairs. Growing fuel prices could affect goods prices in those regions that are most dependent on goods imports from abroad or other regions (due to the increase in the transport component of goods prices). This may make a contribution to overall inflation, but its scale is estimated to be relatively low and not likely to pose any risk to maintaining inflation close to the target.

[4] *Trimmed inflation figures are obtained after trimming the tails of the inflation distributions for product groups. The average of the remaining distribution is then calculated and used as the trimmed figure. The aim of trimming the distribution is to remove from the CPI those price changes that may be related to a change in relative prices.*

	Far Eastern FD	Volga FD	North-Western FD	North Caucasus FD	Siberian FD	Urals FD	Central FD	Southern FD
Annual inflation, %								
All goods and services	2.36	2.03	3.29	2.57	2.04	2.82	3.26	2.58
Trimmed inflation indicators								
CPI without 20%	2.88	2.96	3.67	3.92	2.89	3.27	3.65	3.23
CPI without 40%	2.65	2.58	3.25	3.48	2.64	2.92	3.28	2.79
CPI without 60%	2.71	2.4	3.38	3.52	2.63	2.93	3.31	2.53
CPI without 80%	2.58	2.25	3.25	3.47	2.76	3	3.37	2.56
CPI excluding various components								
Core consumer price index	2.52	1.96	2.79	2.95	1.94	2.74	2.81	2.33
Inflation excluding prices for vegetables and fruit, oil and fats, sugar, alcohol, petrol, passenger transport services and utility services	2.65	2.1	2.85	3.07	2.08	2.85	2.87	2.48
Inflation excluding prices for utility services	2.27	1.77	3.06	2.45	1.85	2.77	3.04	2.37

Exceeding untrimmed CPI (more than 0.3 standard deviations)
Roughly totalling untrimmed CPI (+/- 0.3 standard deviations)
Below untrimmed CPI (more than 0.3 standard deviations)

Services

In September-October 2017, 51 regions saw a slight acceleration in price growth in the services segment. In most regions, this was linked to the indexation of education, passenger transport services, housing and utilities, and communications services.

It is still likely that in other regions, where services price growth was not raised in October, indexation will take place over the remaining months until the end of the year.

Uniformity of economic activity recovery in the regions

In 2017 Q3, economic activity and demand indicators in the regions continued to grow, but slower than in the previous quarter.

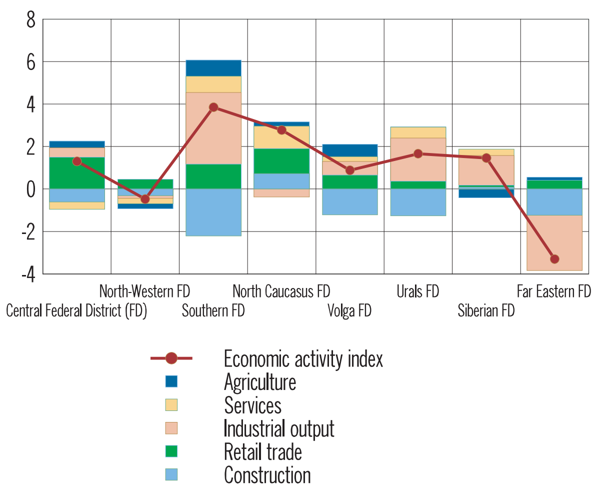
For Russia as a whole, GDP growth over the period under consideration was lower than in Q2 (1.8% compared with 2.5% in the previous period). Broken down by region, the slack in economic activity was recorded in 46 constituent entities (40 in the previous period) and was accompanied by a slowdown in industrial production growth (mining industry) and a continued slump in construction.

The Southern federal district was an exception to the overall trend. The significant growth in industry's contribution to economic activity in the district is temporary and is related to the one-off fulfilment of a high-value order by the company Rostvertol in the Rostov Region (the production index for other vehicles and equipment in the Rostov Region rose by a factor of 36 in September). A considerable increase in the industrial production index was also recorded in the Astrakhan Region due to the expansion of hydrocarbon production by LLC LUKOIL-Nizhevolzhskneft at the North Caspian deposit (whereas, for the country as a whole, mining remained virtually unchanged in September).

Chart 3

Contribution to economic activity by actity type

(percent change on corresponding period of previous year)

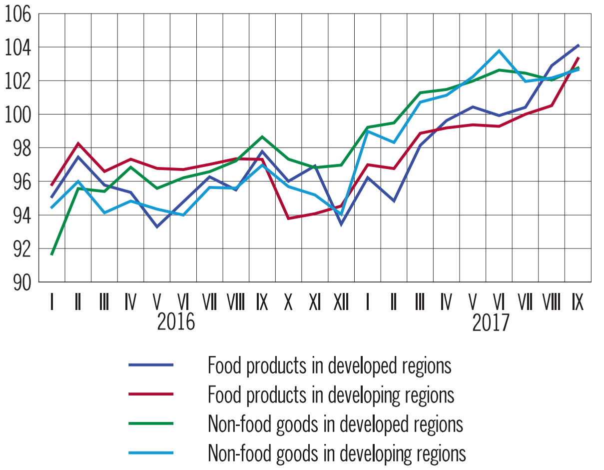


Sources: Rosstat, Bank of Russia calculations.

Chart 4

Retail trade turnover*

(percent change on corresponding period of previous year)



** The chart classifies regions as developed and developing based on the set of features of activity types. A region's manufacturing sector is characterised by the economy size (GRP per capita), industrial labour productivity (volume of finished products relative to the number of workers) and diversification (proportion of services in the gross value added). Living standards in a region are indirectly characterised through indicators capturing the levels of well-being, public health services, human capital quality and migration attractiveness.*

Sources: Rosstat, Bank of Russia calculations.

At the federal level, the substantial decline in the volume of construction work continued in Q4. The trend was uniform across the regions: in seven of the eight federal districts, the construction industry remained depressed, with residential construction still exhibiting the greatest slump.

The trend of increasing consumer activity remained in most regions, both in the food segment and the non-food segment. Positive growth in retail trade turnover in food goods was recorded in all federal districts and was due to the record harvest. However, lower income regions in the Siberian, Urals and Far Eastern federal districts recorded a slight decrease in the annual growth of non-food goods turnover.

Balance of payments forecast for 2017-2020

Compared with the previous MPR, oil price assumptions have been adjusted and the forecast parameters for a number of macro-economic indicators have been updated[5]. These changes, taken together with the balance of payments estimates for the last few months, had an effect on the projected dynamics of balance of payments items.

As noted in Section 2, due to the fact that OPEC and several non-OPEC countries have extended the production restriction agreement until the end of next year, oil price assumptions have been revised upwards to an average of $55 per barrel in 2018. For the remainder of the forecast horizon, the Bank of Russia's outlook for oil price dynamics is still conservative. If the arrangements are not extended beyond 2018 and production in the USA continues to grow, prices are expected to fall to $40 per barrel by the end of 2019. In future, prices are expected to remain at this level in real terms.

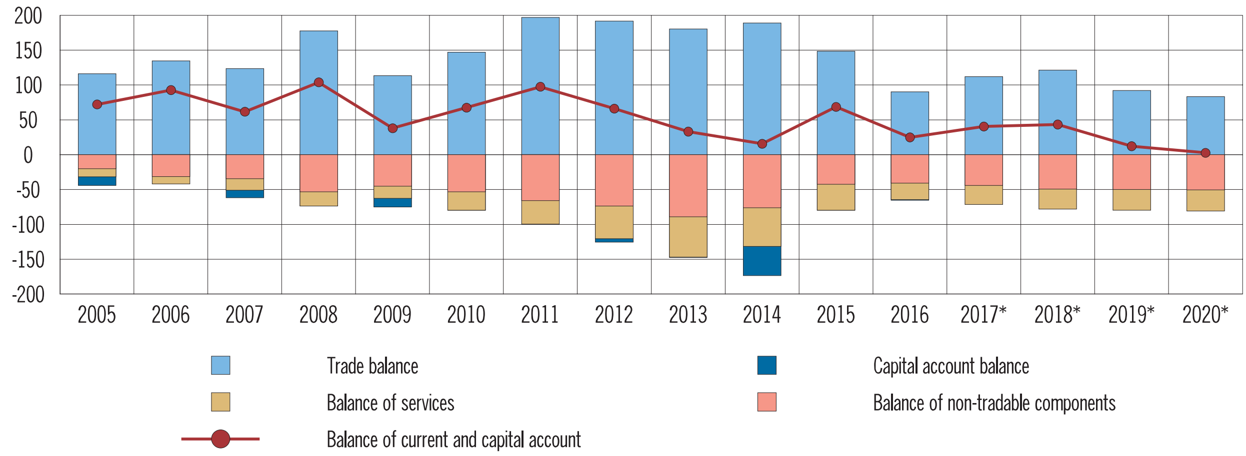
Compared with the baseline scenario in the previous MPR, the current account surplus has been revised upwards in the baseline scenario due to the increase in export volumes. Apart from the upward adjustment in the trajectory of oil prices, forecast exports, especially non-oil exports, were also favourably affected by the improvement in estimated external demand – that is, growth in Russia's trading partners amid good statistics issued for certain developed countries and EMEs. In 2017, the volume of exported goods and services is expected to rise by 23%, compared with the 16% increase forecast in the September MPR. In 2018, the growth in exports will continue, but will slow in line with oil prices. In 2019, export volumes will shrink significantly: the negative pass-through of prices will only be partially offset by the increase in energy supplies on the back of the lifting of oil production restrictions. In 2020, due to the slight reduction in average oil prices, the volume of exports will continue to fall, but at a slower pace due to stabilising energy prices.

The forecast volume of imported goods and services has also been raised, in part because the increase in import quantities in recent months has exceeded expectations and because of the lifting of the ban on the imports of a number of food items from Turkey. In 2017, it is expected to increase by 22% (17% in the previous MPR). In 2018, imports growth is expected to slow. In 2019, amid the depreciation of the ruble and declining Russian economic growth, goods and services imports will shrink slightly. In 2020, growth in imports will resume given higher domestic demand amid the acceleration of economic growth in Russia.

[5] *See section 2 'Economic outlook and key rate decision'.*

Chart 1

Major current account components*
(billions of US dollars)



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

The external trade surplus will increase markedly in 2017–2018 amid higher growth in exports, in dollar terms, compared with imports. In 2019, the external trade will deteriorate due to the greater squeeze on exports given falling oil prices. In 2020, the external trade surplus will continue to fall: goods and services imports will grow amid a slight reduction in exports.

The deficit in the non-tradable current account components will increase in 2017–2018 due to larger expenditure on servicing the increasing external debt and dividend payments to non-residents amid improved financial performance of Russian companies. However, in 2019–2020, it will remain low: because of lower oil prices, Russian companies' less favourable income situation will constrain growth in investment payments to foreign investors.

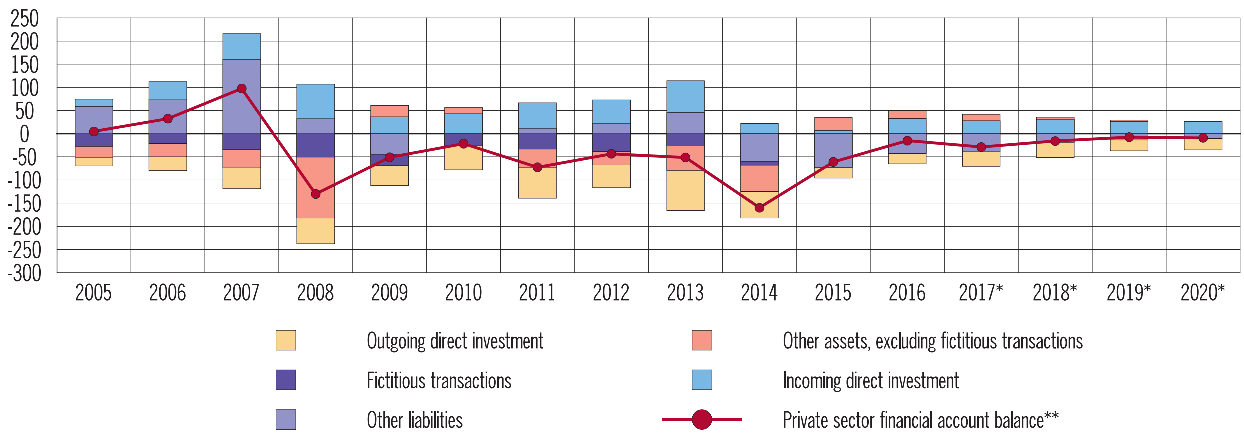
Overall, the current account surplus will reflect the dynamics of the external trade balance, growing to roughly 2.7% of GDP in 2018 before falling to 0.2% of GDP in 2020 (Chart 1).

The financial account (excluding reserve assets) is still expected to be dominated by private sector capital flows (Chart 2).

From 2017, the main contribution to private sector net lending to the rest of the world will once again come from growth in foreign assets.

Chart 2

Major private sector financial account components*
(billions of US dollars)



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

This growth will accelerate in 2018 amid Russian companies' increased foreign investment opportunities arising as a result of growth in oil prices. In 2019, amid the fall in receipts from foreign economic activity, demand for foreign assets will wane. In 2020, Russian companies' acquisition of foreign assets will intensify due to the increase in economic agents' incomes as Russian economy will grow. However, it will be modest by historical standards amid moderate growth of the economy and low prices for key Russian export goods.

The reduction in banks' foreign liabilities will decrease further over the coming years, as external debt repayments are scheduled to decline. In 2018, companies are expected to expand foreign investments in Russia due to the improvement of the country's investment appeal amid growing oil prices and persistently attractive interest rates. Companies' accumulation of foreign liabilities will also be aided by their re-orientation towards sources of external funding not affected by sanctions. Overall, there is expected to be a transition from a net reduction in private sector foreign liabilities in 2017 to a net inflow of capital in the form of an increase in foreign liabilities in 2018. In 2019, the inflow will slow down as oil prices will drop, thus making Russian assets less appealing to foreign investors, but will recover in subsequent years.

Aggregate net lending to the rest of the world by the Russian private sector will decline in 2018 due to the less intensive reduction in banks' foreign liabilities. In subsequent years, net lending dynamics will be shaped by changes in assets: net lending will decrease in 2019 due to the reduced accumulation of foreign assets, and in 2020 it will grow due to higher demand for foreign assets.

Amid continued government borrowing in 2017–2020, the government sector expects a net inflow of foreign capital.

Hence, the current and financial account dynamics projected in this scenario will create conditions for an increase in reserve assets in 2017 through Bank of Russia FX repos and the acquisition of foreign currency for the Russian Ministry of Finance. In 2018–2019, reserves are expected to grow solely through operations under the budget rule. In 2020, no changes to international reserves are expected to be made through operations reflected in the balance of payments.

The scenario with rising oil prices assumes that OPEC and non-OPEC countries will continue to be bound by production restrictions beyond 2018, that is, longer than in the baseline scenario. The difference in the balance of payments forecast in these scenarios is primarily linked to oil price assumptions for 2019–2020. According to the scenario with rising oil prices, the production restrictions in OPEC and non-OPEC countries and the greater global demand for oil will contribute to an increase in average oil prices from $53 per barrel in 2017 to $60 per barrel in 2020. Due to the higher oil prices and global economic growth, the volumes of exports will be higher in 2019–2020 than in the scenario where the agreement is extended until the end of 2018. In turn, imports will also be higher amid the faster growth in the Russian economy and internal demand. Since the growth in exports is expected to outstrip the growth in imports and the increase in the deficit of non-tradable components, the current account surplus will grow over the entire forecast period and, in 2019–2020, will be higher than in the baseline scenario.

The more favourable outlook for commodity prices and the Russian economy as a whole will contribute to an improvement in Russia's investment appeal. This will help attract foreign capital to Russia. However, it is expected to be more than offset by growth in the Russian private sector's demand for foreign assets facilitated by increased incomes. As a result, Russia's net private sector lending to the rest of the world will expand compared with the baseline scenario. The greater acquisition of foreign currency for the Russian Ministry of Finance amid higher oil prices will, in turn, stimulate considerable growth in reserve assets in 2019–2020.

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

Table 1

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

The Bank of Russia expanded the Lombard List	On 10 November 2017, the Bank of Russia Board of Directors expanded the Lombard List with seven securities issues: one regional bond issue and six corporate eurobond issues
The Bank of Russia revised its approaches to shaping the Lombard List: new minimum ratings	Starting from 1 January 2018, for bonds of Russian constituent territories, municipalities and resident legal entities other than credit institutions to be included in the Lombard List, their issues (issuers) should be rated no lower than A (RU) / ruA in the classification of credit rating agencies ACRA (JSC) / JSC Expert RA respectively
The Bank of Russia discontinued one-week and 28-day FX repo auctions	Starting from 11 September 2017, the Bank of Russia has abandoned regular one-week and 28-day FX repo auctions; the last 28-day FX repo auction was held on 2 October 2017
The Bank of Russia announced the strategy for a phased withdrawal of special-purpose refinancing mechanisms	The Bank of Russia Board of Directors approved a medium-term strategy for a phased withdrawal of special-purpose refinancing mechanisms. This strategy is aimed at a piecemeal reduction of concessional lending as it is replaced with market mechanisms. One of the strategy's key principles is to avoid worsening of conditions on previously issued loans. The strategy will be implemented piecemeal during several years. At the first stage (starting from 2 October 2017), the Bank of Russia has continued to issue loans but stopped increasing the limits on all special-purpose refinancing mechanisms
The Bank of Russia expanded the use of the electronic document workflow in secured loan issues	Starting from 25 September 2017, the Bank of Russia has given credit institutions with basic accounts at its Main Branch for the Central federal district (hereinafter - the Main Branch) and Main Branch divisions the opportunity to make use of electronic document flow when applying to the Bank of Russia for secured loans. Previously, this option was only open to credit institutions with basic accounts at Main Branch divisions located in Moscow and the Moscow Region
The Bank of Russia launched a direct electronic document exchange in its deposit operations	Starting from 13 November 2017, the Bank of Russia supplemented the effective means of document exchange with a direct electronic document exchange in deposit operations with credit institutions. This move is aimed at technological advancement in Bank of Russia deposit operations and user-friendliness of this instrument for credit institutions
The Bank of Russia established required reserve ratios for basic licence holder banks	In recognition of changes in the Russian law which provide for a possibility of setting differentiated mandatory reserve requirements for different types of credit institutions (universal licence holders, basic licence holders, and non-bank credit institutions), the Bank of Russia established separate mandatory reserve requirements for basic licence holder banks starting from 1 December 2017. For universal licence holder banks and non-bank credit institutions required reserve ratios for all liability categories and required reserve averaging ratios are established at the current level
The Bank of Russia changed the timeframe for settlements under deposit and credit operations	Starting from 4 December 2017, the Bank of Russia changed the maturity of Bank of Russia loans to credit institutions and Bank of Russia deposit operations. The Bank of Russia makes deposit operation repayments from 10:30 till 11:30 local time, and forwards collection orders for loan repayments from 16:00 till 17:00 local time. The timeframe for repayment of overnight loans and loans secured with assets pledged under other loans remained unchanged

Table 2

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

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.17	From 27.03.17	From 2.05.17	From 19.06.17	From 18.09.17	From 30.10.17	From 18.12.17
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[1]; repos	1 day	daily	11.00	10.75	10.25	10.00	9.50	9.25	8.75
		Loans secured by non-marketable assets[2]	from 2 to 549 days		11.75	11.50	11.00	10.75	10.25	10.00	9.50
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets[2]	3 months	monthly[3]	10.25	10.00	9.50	9.25	8.75	8.50	8.00
		Repo auctions	1 week	weekly[4]	10.00 (key rate)	9.75 (key rate)	9.25 (key rate)	9.00 (key rate)	8.50 (key rate)	8.25 (key rate)	7.75 (key rate)
			from 1 to 6 days	occasionally[5]							
		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[4]							
		OBR auctions[2]	3 months	occasionally	-	-	-				
	Standing facilities	Deposit operations	1 day, call	daily	9.00	8.75	8.25	8.00	7.50	7.25	6.75

[1] From 23 December 2016, interest rates on foreign currency leg equal LIBOR for 1-day USD/EUR loans (depending on the currency of the operation).
[2] Operations conducted at a floating interest rate linked to the Bank of Russia key rate.
[3] Operations have been discontinued since April 2016.
[4] 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.
[5] Fine-tuning operations.
Memo item: from 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date.

Source: Bank of Russia.

Table 3

Interest rates on specialised refinancing facilities[1]

(% p.a.)

<table>
<tr><th>Purpose of indirect bank lending</th><th>Maturity</th><th>Collateral</th><th>As of 1.01.17</th><th>From 27.03.17</th><th>From 2.05.17</th><th>From 19.06.17</th><th>From 18.09.17</th><th>From 30.10.17</th><th>From 18.12.17</th></tr>
<tr><td>Non-commodity exports</td><td>Up to 3 years</td><td>Claims under loan agreements secured by contracts of insurance of JSC EXIAR</td><td rowspan="3">9.00</td><td rowspan="3">8.75</td><td>6.50</td><td>6.50</td><td>6.50</td><td>6.50</td><td>6.50</td></tr>
<tr><td rowspan="2">Large-scale investment projects[2]</td><td rowspan="2">Up to 3 years</td><td>Claims under bank loans for investment projects secured by the government guarantees of the Russian Federation</td><td rowspan="2">8.25</td><td rowspan="2">8.00</td><td rowspan="2">7.50</td><td rowspan="2">7.25</td><td rowspan="2">6.75</td></tr>
<tr><td>Bonds placed to fund investment projects and included in the Bank of Russia Lombard List</td></tr>
<tr><td rowspan="2">Small and medium-sized enterprises</td><td>Up to 3 years</td><td>Claims under loan agreements of JSC SME Bank[3]</td><td rowspan="2">6.50</td><td rowspan="2">6.50</td><td rowspan="2">6.50</td><td rowspan="2">6.50</td><td rowspan="2">6.50</td><td rowspan="2">6.50</td><td rowspan="2">6.50</td></tr>
<tr><td>Up to 3 years</td><td>Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises</td></tr>
<tr><td>Leasing</td><td>Up to 3 years</td><td>Claims on loans to leasing companies</td><td>9.00</td><td>8.75</td><td>8.25</td><td>8.00</td><td>7.50</td><td>7.25</td><td>6.75</td></tr>
<tr><td>Military mortgage</td><td>Up to 3 years</td><td>Mortgages issued under the Military Mortgage programme</td><td>10.00</td><td>9.75</td><td>9.25</td><td>9.00</td><td>8.50</td><td>8.25</td><td>7.75</td></tr>
</table>

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

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

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

Source: Bank of Russia.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments and obligations on liquidity absorption instruments, billions of rubles			
					As of 1.10.16	As of 1.10.17	As of 1.11.17	As of 1.12.17
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	2.6	0.0	0.0	0.0
		Lombard loans			1.2	0.0	0.0	0.0
		FX swaps			49.8	0.0	6.4	0.0
		Repos			408.7	43.9	10.7	4.1
		Loans secured by non-marketable assets	from 1 to 549 days		331.7	57.8	40.4	37.8
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly[1]	216.2	0.0	0.0	0.0
			18 months	occasionally[2]				
		Repo auctions	1 week	weekly[3]	0.0	0.0	0.0	0.0
			from 1 to 6 days	occasionally[4]				
		FX swap auctions	from 1 to 2 days		0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days		180.0	886.1	1110.0	1386.3
			1 week	weekly[3]				
		OBR auctions	3 months	occasionally	-	151.3	328.3	306.2
	Standing facilities	Deposit operations	1 day, call	daily	374.7	223.1	247.7	159.8

[1] *Operations have been discontinued since April 2016.*
[2] *Operations have been suspended since 1 July 2016.*
[3] *Either a repo or a deposit auction is held depending on the situation with liquidity.*
[4] *Fine-tuning operations.*

Source: Bank of Russia.

Table 2

Required reserve ratios

(%)

<table>
<tr><th rowspan="2">Liability type</th><th colspan="5">Reporting periods</th></tr>
<tr><th>From 1.01.16</th><th>From 1.04.16</th><th>From 1.07.16</th><th>From 1.08.16</th><th>From 1.12.17</th></tr>
<tr><td colspan="6">Universal licence holder banks and non-bank credit institutions</td></tr>
<tr><td>To households in rubles</td><td rowspan="6">4.25</td><td rowspan="4">4.25</td><td rowspan="3">4.25</td><td rowspan="3">5.00</td><td rowspan="3">5.00</td></tr>
<tr><td>Other liabilities in rubles</td></tr>
<tr><td>To non-resident legal entities in rubles</td></tr>
<tr><td>To households in foreign currency</td><td>5.25</td><td>6.00</td><td>6.00</td></tr>
<tr><td>To non-resident legal entities in foreign currency</td><td rowspan="2">5.25</td><td rowspan="2">6.25</td><td rowspan="2">7.00</td><td rowspan="2">7.00</td></tr>
<tr><td>Other liabilities in foreign currency</td></tr>
<tr><td colspan="6">Basic licence holder bank</td></tr>
<tr><td>To households in rubles</td><td rowspan="6">4.25</td><td rowspan="4">4.25</td><td rowspan="3">4.25</td><td rowspan="3">5.00</td><td rowspan="2">1.00</td></tr>
<tr><td>Other liabilities in rubles</td></tr>
<tr><td>To non-resident legal entities in rubles</td><td>5.00</td></tr>
<tr><td>To households in foreign currency</td><td>5.25</td><td>6.00</td><td>6.00</td></tr>
<tr><td>To non-resident legal entities in foreign currency</td><td rowspan="2">5.25</td><td rowspan="2">6.25</td><td rowspan="2">7.00</td><td rowspan="2">7.00</td></tr>
<tr><td>Other liabilities in foreign currency</td></tr>
</table>

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

Types of credit institutions	From 1.01.16
Banks	0.8
Non-bank credit institutions	1.0

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

<table>
<tr><th rowspan="2">Instrument</th><th rowspan="2">Term</th><th rowspan="2">Frequency[1]</th><th>Minimum auction rate and interest rate for dollar leg of FX swaps[2] (as spread to LIBOR[3], pp)</th><th colspan="4">Bank of Russia claims, millions of US dollars[4]</th></tr>
<tr><th>From 23.12.16</th><th>As of 1.10.16</th><th>As of 1.10.17</th><th>As of 1.11.17</th><th>As of 1.12.17</th></tr>
<tr><td rowspan="3">Repo auctions</td><td>1 week</td><td rowspan="3">weekly</td><td rowspan="2">2.00</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>28 days</td><td>9,728.7</td><td>598.0</td><td>294.4</td><td>0.0</td></tr>
<tr><td>12 months</td><td>3.00</td><td>159.2</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td rowspan="2">Loan auctions</td><td>28 days</td><td rowspan="2">monthly</td><td>2.25</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>365 days</td><td>3.25</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>USD/RUB sell/buy FX swaps</td><td>1 day</td><td>daily</td><td>1.50</td><td>1,000.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
</table>

[1] In 2016 and in January-August 2017, no loan auctions were held; 12-month repo auctions have been suspended since 1 April 2016; one-week and 28-day FX repo auctions with maximum allotment amount of $100 million have been discontinued since 11 September 2017.
[2] The rate for the ruble leg is equal to the Bank of Russia key rate less 1 pp.
[3] In respective currencies and for respective terms.
[4] Claims on credit institutions under the second leg of repos.

Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities[1]

Purpose of indirect bank lending	Maturity	Collateral	Bank of Russia claims on credit institutions, billions of rubles				Limit as of 1.09.17, billions of rubles
			As of 1.10.16	As of 1.10.17	As of 1.11.17	As of 1.12.17	
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by contracts of insurance of JSC EXIAR	49.6	45.1	44.9	45.8	75.00
Large-scale investment projects[2]	Up to 3 years	Claims under bank loans for investment projects secured by the government guarantees of the Russian Federation	101.1	104.9	103.8	106.2	150.00
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List	0.8	0.0	0.0	0.0	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[3]	44.0	24.5	21.9	19.9	175.00
	Up to 3 years	Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises	25.0	81.1	83.6	84.2	
Leasing	Up to 3 years	Claims on loans to leasing companies	0.0	0.2	0.2	0.2	10.00
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	29.3	29.3	29.3	29.3	30.00

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

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

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

Source: Bank of Russia.

Table 6

Consumer prices by group of goods and services

(growth as % of previous period)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2015								
January	3.9	3.5	5.7	3.7	22.1	3.2	3.5	2.2
February	2.2	2.4	3.3	2.7	7.2	2.1	2.3	0.8
March	1.2	1.5	1.6	1.6	1.2	1.4	1.6	0.3
April	0.5	0.8	0.3	0.9	-3.7	0.9	0.9	0.0
May	0.4	0.6	0.1	0.2	-1.0	0.5	0.6	0.5
June	0.2	0.4	-0.4	0.2	-5.0	0.3	0.3	1.0
July	0.8	0.4	-0.3	0.3	-4.2	0.5	0.3	3.0
August	0.4	0.8	-0.7	0.5	-9.8	0.8	0.7	1.3
September	0.6	0.8	0.4	0.7	-2.3	1.1	1.1	0.0
October	0.7	0.7	1.0	0.8	2.9	1.0	1.1	-0.1
November	0.8	0.6	1.2	0.7	5.6	0.7	0.8	0.2
December	0.8	0.6	1.2	0.6	6.6	0.4	0.5	0.7
Total for the year (December on December)	12.9	13.7	14.0	13.6	17.4	13.7	14.5	10.2
2016								
January	1.0	0.8	1.2	0.6	6.2	0.7	0.8	1.0
February	0.6	0.7	0.7	0.5	2.3	0.8	0.9	0.3
March	0.5	0.6	0.4	0.6	-1.3	0.8	0.8	0.1
April	0.4	0.5	0.4	0.5	-0.1	0.6	0.6	0.3
May	0.4	0.5	0.4	0.3	0.6	0.4	0.4	0.5
June	0.4	0.4	0.1	0.3	-1.1	0.5	0.4	0.6
July	0.5	0.3	0.0	0.5	-4.2	0.4	0.3	1.7
August	0.0	0.4	-0.6	0.4	-8.9	0.4	0.4	0.3
September	0.2	0.5	-0.1	0.4	-5.4	0.6	0.6	0.1
October	0.4	0.4	0.8	0.6	2.5	0.5	0.6	-0.3
November	0.4	0.4	0.7	0.5	2.5	0.4	0.5	0.0
December	0.4	0.3	0.6	0.6	0.9	0.3	0.3	0.3
Total for the year (December on December)	5.4	6.0	4.6	6.0	-6.8	6.5	6.8	4.9
2017								
January	0.6	0.4	0.8	0.3	5.3	0.5	0.4	0.5
February	0.2	0.2	0.2	0.1	0.6	0.2	0.2	0.3
March	0.1	0.2	0.1	0.1	0.3	0.2	0.2	0.0
April	0.3	0.2	0.6	0.1	4.7	0.2	0.1	0.2
May	0.4	0.1	0.6	-0.1	5.8	0.2	0.1	0.3
June	0.6	0.1	1.0	0.0	8.3	0.1	0.0	0.7
July	0.1	0.1	-1.0	0.1	-8.3	0.1	0.1	1.6
August	-0.5	0.1	-1.8	0.0	-15.5	0.1	0.1	0.4
September	-0.2	0.3	-0.7	0.0	-6.9	0.3	0.2	0.1
October	0.2	0.1	0.4	0.1	2.7	0.3	0.3	-0.2
November	0.2	0.2	0.2	0.0	2.2	0.3	0.3	0.1

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

Sources: Rosstat, Bank of Russia calculations.

Table 7

Consumer prices by group of goods and services

(month-on-month, %, seasonally adjusted)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol	Services
2015								
January	3.5	3.4	4.7	3.6	14.1	3.2	3.6	2.2
February	2.1	2.3	2.8	2.7	3.4	2.1	2.3	1.0
March	1.2	1.4	1.4	1.6	-0.4	1.4	1.5	0.7
April	0.5	0.8	0.3	1.0	-4.3	0.9	0.9	0.2
May	0.3	0.7	0.0	0.4	-3.8	0.6	0.6	0.5
June	0.2	0.6	-0.3	0.4	-5.4	0.4	0.4	0.8
July	0.4	0.5	0.2	0.3	-0.1	0.6	0.4	0.6
August	0.9	0.8	0.7	0.5	2.4	0.8	0.7	1.5
September	0.9	0.7	1.1	0.7	4.4	1.0	1.0	0.6
October	0.8	0.6	0.9	0.7	2.1	0.9	0.9	0.5
November	0.7	0.5	0.8	0.6	2.7	0.6	0.7	0.5
December	0.5	0.5	0.6	0.4	2.2	0.5	0.6	0.6
2016								
January	0.6	0.7	0.3	0.5	-0.8	0.7	0.8	1.0
February	0.5	0.6	0.2	0.4	-1.3	0.8	0.9	0.4
March	0.4	0.6	0.2	0.6	-2.7	0.8	0.8	0.3
April	0.5	0.5	0.4	0.6	-0.9	0.6	0.6	0.4
May	0.3	0.6	0.2	0.5	-2.3	0.5	0.5	0.3
June	0.4	0.6	0.2	0.5	-1.4	0.6	0.5	0.3
July	0.4	0.5	0.5	0.5	0.1	0.5	0.4	0.3
August	0.6	0.4	0.8	0.5	3.4	0.4	0.4	0.5
September	0.5	0.4	0.6	0.4	1.0	0.4	0.5	0.5
October	0.4	0.3	0.6	0.5	1.6	0.4	0.4	0.2
November	0.3	0.3	0.3	0.4	-0.4	0.3	0.4	0.3
December	0.2	0.3	0.0	0.4	-3.2	0.3	0.3	0.1
2017								
January	0.3	0.2	0.0	0.2	-1.5	0.5	0.5	0.5
February	0.1	0.1	-0.2	0.1	-2.8	0.2	0.2	0.3
March	0.1	0.1	0.0	0.1	-1.2	0.2	0.1	0.3
April	0.4	0.2	0.6	0.2	3.7	0.2	0.1	0.3
May	0.3	0.3	0.4	0.1	2.6	0.2	0.1	0.3
June	0.6	0.3	1.2	0.2	8.0	0.2	0.1	0.5
July	-0.1	0.3	-0.5	0.1	-4.0	0.2	0.2	0.2
August	0.0	0.2	-0.6	0.0	-3.9	0.2	0.1	0.5
September	0.2	0.2	-0.1	0.0	-0.6	0.1	0.1	0.5
October	0.2	0.1	0.2	0.0	1.7	0.2	0.2	0.3
November	0.1	0.1	-0.2	-0.1	-0.7	0.2	0.2	0.3

[1] *Excluding vegetables and fruit.*

Sources: Rosstat, Bank of Russia calculations.

Table 8

Consumer prices by group of goods and services

(month on corresponding month of previous year, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2015								
January	15.0	14.7	20.7	18.4	40.7	11.2	11.4	12.3
February	16.7	16.8	23.3	20.8	43.5	13.0	13.5	12.8
March	16.9	17.5	23.0	21.1	38.0	13.9	14.6	12.6
April	16.4	17.5	21.9	20.8	30.0	14.2	15.0	11.8
May	15.8	17.1	20.2	19.5	25.7	14.3	15.1	11.6
June	15.3	16.7	18.8	18.4	22.8	14.2	15.0	11.7
July	15.6	16.5	18.6	17.5	27.9	14.3	15.0	13.4
August	15.8	16.6	18.1	17.0	29.1	14.6	15.3	14.1
September	15.7	16.6	17.4	16.4	27.7	15.2	16.0	13.8
October	15.6	16.4	17.3	16.2	27.9	15.6	16.6	13.1
November	15.0	15.9	16.3	15.5	24.3	15.7	16.7	11.9
December	12.9	13.7	14.0	13.6	17.4	13.7	14.5	10.2
2016								
January	9.8	10.7	9.2	10.2	2.0	10.9	11.4	9.0
February	8.1	8.9	6.4	7.8	-2.7	9.5	9.9	8.5
March	7.3	8.0	5.2	6.7	-5.1	8.8	9.1	8.2
April	7.3	7.6	5.3	6.3	-1.6	8.5	8.7	8.4
May	7.3	7.5	5.6	6.4	0.0	8.4	8.5	8.4
June	7.5	7.5	6.2	6.5	4.1	8.5	8.7	7.9
July	7.2	7.4	6.5	6.7	4.2	8.4	8.7	6.5
August	6.9	7.0	6.5	6.7	5.3	8.1	8.4	5.5
September	6.4	6.7	5.9	6.4	1.9	7.5	7.9	5.6
October	6.1	6.4	5.7	6.1	1.5	7.0	7.4	5.4
November	5.8	6.2	5.2	6.0	-1.5	6.7	7.0	5.3
December	5.4	6.0	4.6	6.0	-6.8	6.5	6.8	4.9
2017								
January	5.0	5.5	4.2	5.7	-7.6	6.3	6.4	4.3
February	4.6	5.0	3.7	5.4	-9.0	5.7	5.7	4.3
March	4.3	4.5	3.5	4.8	-7.6	5.1	5.0	4.2
April	4.1	4.1	3.6	4.5	-3.1	4.7	4.6	4.1
May	4.1	3.8	3.9	4.0	2.0	4.4	4.2	4.0
June	4.3	3.5	4.8	3.8	11.6	4.0	3.8	4.1
July	3.9	3.3	3.8	3.4	6.9	3.7	3.5	4.1
August	3.3	3.0	2.6	2.9	-0.8	3.4	3.2	4.1
September	3.0	2.8	2.0	2.5	-2.4	3.1	2.8	4.2
October	2.7	2.5	1.6	2.0	-2.2	2.8	2.5	4.2
November	2.5	2.3	1.1	1.4	-2.5	2.7	2.4	4.3

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

Sources: Rosstat, Bank of Russia calculations.

Table 9

Macroeconomic indicators

(seasonally adjusted, growth as % of previous period)

	Industrial output	Agriculture	Construction	Freight turnover	Retail trade turnover	Real consumer expenditure	Unemployment[1]	Output index of goods and services by key industries	GDP[2]
2015									
January	-0.9	0.1	-1.1	-0.3	-9.1	-7.0	5.3	-3.6	
February	-1.3	0.0	-0.5	0.6	-2.8	-0.5	5.4	-0.8	
March	1.2	0.3	-1.2	1.6	0.1	-0.1	5.5	0.5	-2.6
April	-1.4	-0.1	0.3	-2.0	-0.3	-0.9	5.5	-0.6	
May	0.2	0.1	-0.2	-0.4	0.3	0.2	5.6	0.1	
June	-0.5	0.4	0.0	0.3	-0.2	-0.3	5.5	0.3	-0.3
July	0.4	-1.4	-1.2	2.4	-0.2	-0.3	5.5	-0.1	
August	1.2	1.3	-0.5	-1.1	-0.1	-0.4	5.6	0.7	
September	0.1	0.5	0.9	1.1	-0.7	-0.5	5.6	0.3	-0.2
October	-0.4	-1.4	-1.2	2.7	0.0	-0.2	5.6	-0.3	
November	0.2	1.1	-0.6	-1.3	-0.5	-0.5	5.7	-0.3	
December	-0.3	0.3	0.2	-0.1	-0.3	-0.4	5.7	0.8	-0.3
2016									
January	0.2	0.1	-0.4	-2.6	-1.0	-0.7	5.6	-1.4	
February	0.0	0.3	0.5	0.7	0.0	1.8	5.5	1.2	
March	1.1	-0.1	0.5	0.4	-1.0	-2.5	5.7	-0.5	-0.2
April	-0.9	0.3	-0.8	-1.1	-0.1	0.2	5.7	0.0	
May	-0.7	0.2	-1.1	-0.5	-0.6	-0.4	5.6	-0.6	
June	0.6	0.0	-0.6	1.3	-0.2	-0.1	5.6	0.4	0.0
July	1.1	1.4	0.8	2.2	0.0	0.0	5.5	1.2	
August	-0.7	-1.3	-0.4	-0.2	-0.3	0.1	5.5	-0.5	
September	0.1	-0.5	-1.3	2.5	-0.1	-0.2	5.5	-0.2	0.3
October	1.3	1.9	1.4	-1.6	-0.3	0.1	5.4	1.2	
November	0.5	-0.4	-0.1	1.6	0.1	0.2	5.4	0.3	
December	-1.1	0.0	-0.6	0.6	-0.3	-0.1	5.3	-1.0	0.4
2017									
January	0.0	-0.2	-0.3	1.8	0.7	0.6	5.4	1.0	
February	-0.6	0.1	-0.6	-0.4	-0.2	0.3	5.3	-0.6	
March	0.6	0.3	-0.2	-1.8	0.5	0.2	5.2	0.7	0.6
April	1.2	0.1	-0.2	3.8	0.1	0.2	5.2	0.5	
May	0.8	0.2	0.6	-0.5	0.3	0.2	5.3	0.6	
June	-0.6	0.0	-0.1	0.8	0.3	0.3	5.2	-0.2	0.7
July	-0.9	-0.3	-0.2	-0.4	0.1	0.2	5.3	-0.6	
August	0.1	1.3	0.1	1.4	0.3	0.2	5.2	0.6	
September	0.0	0.9	-0.2	-1.9	0.4	0.4	5.2	0.2	0.5
October	-0.4	-1.7	-0.8	1.3	0.2	0.1	5.2	-0.7	

[1] *As % of labour force, seasonally adjusted.*
[2] *Quarterly data.*

Sources: Rosstat, Bank of Russia calculations.

Table 10

Macroeconomic indicators

(as % of corresponding period of previous year)

	2016	2017											Memo item: 2016
	Total	January	February	March	April	May	June	July	August	September	October	January-October	January-October
Output of goods and services by key industries	0.5	2.6	-2.3	1.6	2.4	5.2	3.8	1.0	2.5	2.5	0.5	2.0	0.5
Industrial output	1.3	2.3	-2.7	0.8	2.3	5.6	3.5	1.1	1.5	0.9	0.0	1.6	1.2
Agricultural output	4.8	0.6	0.2	1.1	0.8	0.3	1.3	2.7	5.1	8.5	-2.5	2.9	4.6
Construction	-2.2	-2.5	-5.0	-5.4	-5.4	-1.9	-1.0	-0.6	0.6	0.1	3.1	2.1	-2.8
Retail trade turnover	-4.6	-2.1	-2.6	-0.2	0.4	1.0	1.5	1.2	1.9	3.1	3.0	0.8	-4.5
Household real disposable money income	-5.9	8.8	-3.2	-3.8	-7.5	0.0	0.0	-1.6	-0.3	-0.3	-1.3	-1.3	-5.6
Real wage per employee	0.8	3.1	1.0	3.2	3.7	2.8	3.9	3.1	2.4	4.4	4.3	3.0	0.3
Number of unemployed	-0.5	-3.2	-4.6	-10.0	-10.4	-8.3	-7.9	-5.3	-6.1	-5.0	-5.9	-6.7	0.9
Unemployment (as % of economically active population)	5.5	5.6	5.6	5.4	5.3	5.2	5.1	5.1	4.9	5.0	5.1	5.2	5.6

Sources: Rosstat, Bank of Russia calculations.

Table 11

Change in Bank of Russia forecasts of GDP growth of Russia's trading partners[1]

(%)

		Forecast of GDP growth in 2017		Memo item: country's share in aggregate GDP of trading partners
		September 2017	December 2017	
Total		2.4	2.7	100.0
1	Germany	1.7	2.0	14.6
2	China	6.4	6.6	10.3
3	Italy	0.9	1.2	9.3
4	Turkey	3.0	3.8	6.9
5	Belarus	0.3	0.3	5.5
6	Japan	1.3	1.4	5.3
7	Korea, Republic of	2.5	2.9	4.7
8	Belgium	1.3	1.5	4.6
9	Poland	3.3	3.7	4.4
10	United Kingdom	1.6	1.4	4.4
11	Kazakhstan	2.7	3.1	4.2
12	The Netherlands	1.9	2.6	3.3
13	United States	2.1	2.2	3.1
14	France	1.3	1.6	3.1
15	Finland	1.6	2.2	3.1
16	Latvia	3.7	4.1	3.0
17	India	6.6	6.4	1.9
18	Switzerland	1.1	0.8	1.5
19	Czech Republic	2.6	3.4	1.4
20	Hungary	3.4	3.7	1.4
21	Slovakia	2.9	3.0	1.4
22	Lithuania	3.1	3.3	1.3
23	Spain	2.6	2.8	1.3
24	Ukraine	2.0	2.2	0.0

[1] *The aggregate GDP growth rate is calculated based on the shares of 24 Russia's trading partners in 2013-2015 (previous indicator was calculated for the 2010-2014 period). The share of each country was determined based on the exports to major trading partners. The aggregate GDP forecast excludes the economy of Ukraine and includes the re-exports of Russian energy commodities from the Netherlands.*

Source: Bank of Russia.

Table 12

Monetary policy rates in various countries

Country	Policy rate	Current level	Date of latest change	Previous level	Change	Number of rate changes over the past 12 months	Inflation: Current level, %	Inflation: 12-month change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	0	2.5	2.50
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	0	2.5	1.40
Czech Republic	repo rate (14 days)	0.50	02.11.2017	0.25	0.25	2	2.9	2.10
Romania	base rate	1.75	06.05.2015	2.00	-0.25	0	2.6	3.06
Bulgaria	base rate	0.00	01.02.2016	0.01	-0.01	0	2.5	3.10
Serbia	key policy rate	3.50	09.10.2017	3.75	-0.25	2	2.8	1.40
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	0	0.2	0.49
Brazil	target rate	7.00	06.12.2017	7.50	-0.50	8	2.8	-4.2
Chile	monetary policy rate	2.50	18.05.2017	2.75	-0.25	4	1.9	-1.0
China	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	0	1.9	-0.20
	deposit rate (12 months)	1.50	26.10.2015	1.75	-0.25	0		
	required reserve rate	17.00	01.03.2016	17.50	-0.50	0		
India	reverse repo rate	6.00	02.08.2017	6.25	-0.25	1	3.6	-0.62
	repo rate	5.75	02.08.2017	6.00	-0.25	2		
Indonesia	target rate	6.50	16.06.2016	6.75	-0.25	0	3.3	-0.28
Korea, Republic of	base rate	1.50	30.11.2017	1.25	0.25	1	1.3	-0.20
Malaysia	target overnight rate	3.00	13.07.2016	3.25	-0.25	0	3.7	2.30
Mexico	target rate	7.25	14.12.2017	7.00	0.25	6	6.6	3.32
Philippines	monetary policy rate	3.00	03.06.2016	4.00	-1.00	0	3.3	0.80
Russia	repo auction rate (7 days)	8.25	30.10.2017	8.50	-0.25	6	2.5	-3.30
South Africa	repo rate	6.75	20.07.2017	7.00	-0.25	1	4.8	-1.60
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0	1.0	0.39
Turkey	repo rate (7 days)	8.00	24.11.2016	7.50	0.50	0	13.0	5.98
United States	federal funds rate (upper bound)	1.50	13.12.2017	1.25	0.25	3	2.0	0.40
Euro area	refinancing rate	0.00	16.03.2016	0.05	-0.05	0	1.5	0.90
United Kingdom	base rate	0.50	02.11.2017	0.25	0.25	1	3.0	2.10
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0	0.2	0.10
Canada	target overnight rate	1.00	06.09.2017	0.75	0.25	2	1.4	-0.10
Australia	overnight rate	1.50	02.08.2016	1.75	-0.25	0	1.8	0.50
New Zealand	overnight rate	1.75	10.11.2016	2.00	-0.25	0	1.9	1.50
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0	1.4	1.30
	certificate of deposit rate	-0.65	08.01.2016	-0.75	0.10	0		
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	0	0.8	1.10
	3m LIBOR - max	-0.25	15.01.2015	0.25	-0.50	0		
Sweden	repo rate	-0.50	11.02.2016	-0.35	-0.15	0	1.7	0.55
Norway	key deposit rate	0.50	17.03.2016	0.75	-0.25	0	1.2	-2.50

Note: as of 14 December 2017, changes occurred from the compilation time of the previous Monetary Policy Report issue (12 September 2017) are put in colour.

Source: Bloomberg.

LIST OF BOXES

GLOSSARY

Adaptive expectations

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

Averaging of required reserves

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

Bank lending conditions index

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

Bank of Russia interest rate corridor (interest rate corridor)

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

Bank of Russia key rate

The minimum interest rate at the Bank of Russia 1-week repo auctions and the maximum interest rate at the Bank of Russia 1-week deposit auctions. It is set by the Bank of Russia Board of Directors.

Bank of Russia Lombard List

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

Banking sector liquidity

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

Broad money (monetary aggregate M2X)

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

Carry trade

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

CDS spread

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

Consumer price index (CPI)

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

Core inflation

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

Credit default swap (CDS)

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

Current liquidity deficit/surplus

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

Dollarisation of deposits

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

Factors of banking sector liquidity

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

Financial stability

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

Floating exchange rate regime

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

Floating interest rate on Bank of Russia operations

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

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

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

Generalised (composite) consumer confidence index

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

Gross credit of the Bank of Russia

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

Import substitution

Substitution of imported goods by domestic goods which leads to the increase in the proportion of domestic goods in the internal market.

Inflation expectations

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

Inflation risks

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

Inflation targeting regime

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

Interest rate corridor

See Bank of Russia interest rate corridor.

Macro Risk Index

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

Monetary aggregate M1

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

Monetary policy 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 on holding or changing the key rate and its future path from the financial market segments to the real sector and as a result to inflation. The key rate changes are translated into the economy through the following major channels: interest rate, credit, foreign currency and asset price channels.

Money supply

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

Money supply in the national definition (monetary aggregate M2)

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

MSCI indices

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

Net credit of the Bank of Russia to credit institutions

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

Net private capital inflow/outflow

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

Non-price bank lending conditions

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

Non-tradable sector of the economy

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

Outstanding amount on Bank of Russia refinancing operations

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

Open market operations

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

PMI indices

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

Relative price

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

Repo operation

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

Required reserves

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

Ruble nominal effective exchange rate index

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

Ruble real effective exchange rate index

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

Shadow banking sector

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

Standing facilities

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

Structural liquidity deficit/surplus

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

Structural non-oil and gas primary budget deficit

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

Structural transformations

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

Terms of foreign trade

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

Tradable sector of economy

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

Underlying inflation

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

VIX

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

ABBREVIATIONS

AHML – Agency for Housing Mortgage Lending

BLC – bank lending conditions

bp – basis points (0.01 pp)

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

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

Cbonds IFX–Cbonds – corporate bond total return index

Cbonds-Muni – municipal bond index calculated by Cbonds

CCPI – core consumer price index

CPI – consumer price index

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

ECB – European Central Bank

EME – emerging market economies

EU – European Union

FAO – Food and Agriculture Organization of the United Nations

FCS – Federal Customs Service

Fed – US Federal Reserve System

FGUP – federal state unitary enterprise

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

GRP – gross regional product

IBL – interbank loans

IEA – International Energy Agency

Industrial PPI – industrial producer price index

inFOM – Institute of the Public Opinion Foundation

MC – management company

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

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

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

MIC – military-industrial complex

MICEX SE – MICEX Stock Exchange

MPD – Monetary Policy Department of the Bank of Russia

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

NPF – non-governmental pension fund

OBR – Bank of Russia bonds

OECD – Organisation for Economic Cooperation and Development

OFZ – federal government bonds

OFZ-IN – inflation-indexed federal government bonds

OFZ-PD – permanent coupon-income federal government bonds

OFZ-PK – variable coupon-income federal government bonds

OJSC – open joint-stock company

OPEC – Organization of the Petroleum Exporting Countries

PJSC – public joint-stock company

PMI – Purchasing Managers' Index

pp – percentage point

PPI – producer price index

QPM – quarterly projection model of the Bank of Russia

REB – Russian Economic Barometer, monthly bulletin

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

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

SME – small and medium-sized enterprises

SNA – system of national accounts

TCC – total cost of credit

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

VAT – value added tax

VCIOM – Russian Public Opinion Research Centre

VEB – Vnesheconombank

VECM – Vector Error Correction Model