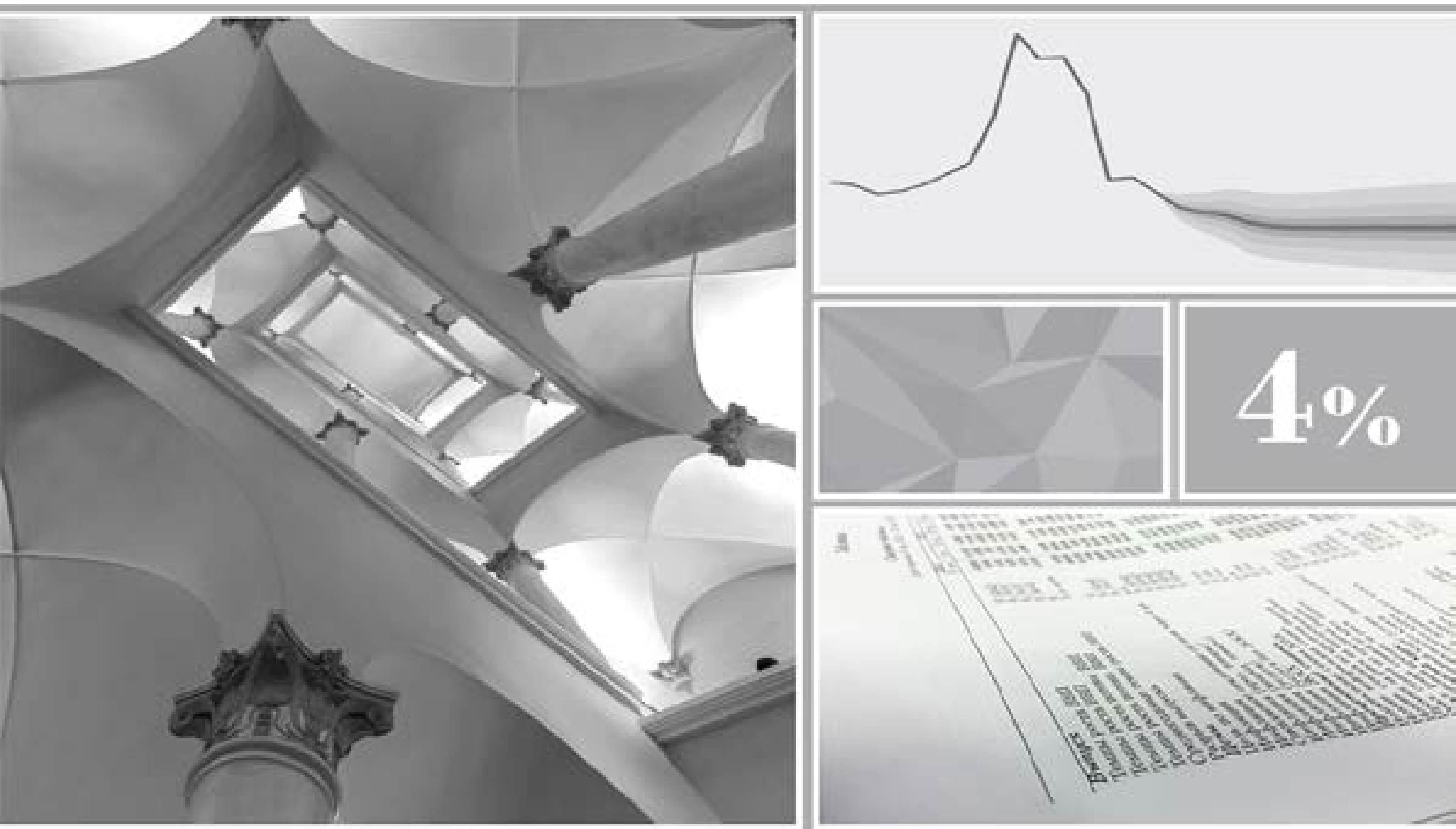
Bank of Russia
The Central Bank of the Russian Federation



No. 4
DECEMBER 2016

MONETARY POLICY REPORT

Moscow

DEAR READERS,

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

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Many thanks in advance for your assistance.

The report has been prepared based on statistics as of 13 December 2016.
Data cut-off date for forecast calculations is 13 December 2016.

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

In September-November, the situation in the Russian economy broadly evolved in line with Bank of Russia forecasts published in the previous release of the Monetary Policy Report. Inflation continued its downward movement, while the economy was gradually entering the phase of recovery growth. However, the dynamics of production activity are still mixed. The rate of inflation slowdown corresponded to Bank of Russia expectations, and inflation risks subsided. Seasonally adjusted monthly price growth fell in September-November compared with July-August. Disinflation trends became more homogeneous by various groups of goods and services. Inflation slowdown was partly supported by a range of transitory factors, such as ruble appreciation and favourable situation in the Russian agricultural market. Demand-side disinflationary drag remained in force, while signaling some weakening against the backdrop of positive growth in real wages. The slowdown of consumer price growth was also supported by the dynamics of producer prices, given persistent and relatively low prices in commodity markets and moderate indexation rates for the tariffs of infrastructure companies' goods and services. However, despite the ongoing slowdown of actual inflation, the decline in inflation expectations was unstable, with their level being elevated. In this setting, the Bank of Russia decided to keep the key rate at 10.00% p.a. in October and December.

The deal on oil output cuts agreed upon by oil-producing countries influenced the situation in global commodity markets, raising the probability of the scenario with higher global oil prices than under the baseline scenario, especially over the short-term horizon and, at the same time, lowering the chances for the risk scenario's materialisation. At the same time, any assertions regarding fundamental changes in the market should be very cautious so far. Factors underpinning the emergence of excess supply in the oil market are still in effect. These include the enhanced flexibility of oil supply (including from non-conventional sources), high oil inventories, and the slow growth of the global economy. Considering the above, the Bank of Russia follows a conservative approach when formulating assumptions for the baseline scenario of the macroeconomic forecast, which still assumes that oil prices will remain at $40.00 per barrel throughout the whole forecast period. The Bank of Russia's view of the key domestic factors and trends underlying the Russian economic development remains broadly unchanged over the forecast horizon.

Annual GDP growth will move into the black as early as 2017 Q1. Economic activity will recover gradually and rather evenly. Consumer demand will grow moderately on the back of the persistently high savings rate and positive real interest rates supporting the attractiveness of savings. Investment activity will recover following improved expectations regarding Russia's economic outlook, the gradual easing of lending conditions and abatement in debt burden. Import substitution and the build-up of non-commodity exports will continue, though remaining moderate as in 2016.

GDP growth in 2017 is expected to be low at 0.5-1.0%, if the baseline scenario materialises. The years of 2018 and 2019 will see a quicker economic rebound, by 1.5-2.0% annually. An increase in oil prices, growth in foreign trade revenues and the revised expectations of economic agents and foreign investors with regard to Russia's economic outlook will lead to a more confident recovery of the economic activity than the one envisaged in the baseline scenario. GDP growth in 2017 may stand at over 1% and accelerate to 2.0-2.5% in 2018-2019. However, internal structural factors, including those related to the demographic situation, infrastructural and institutional characteristics of the economy, will hamper further output growth, irrespective of the external developments. Under this scenario, economic growth will slow down to 1.0-1.5%, which corresponds to the estimates of the Russian economic potential in the medium term. In case of structural reforms implementation GDP growth rates may be higher.

The restraining effect of domestic demand, moderate growth in producer prices and relatively stable exchange rate dynamics will be conducive to inflation slowing down to the 4% target in late 2017. The *anticipated gradual decline in inflation expectations will also become an important factor of inflation stabilisation at the 4% level in the medium term. However, staying elevated due to high inertia inflation expectations pose a major risk, which may influence the pace of inflation slowdown. Fiscal policy uncertainty subsided. The implementation of approved fiscal consolidation plans and moderate indexation of administered tariffs and social benefits will contribute to inflation reduction. More substantial than planned government spending growth may lead to inflation risks build-up. Additional risks still stem from possible premature changes in household savings behaviour, as well as from volatile external factors influencing internal prices through the ruble's exchange rate and expectations dynamics. Under the Bank of Russia's risk scenario of external developments assuming a reduction in oil prices and their further staying at a lower level, inflation will decline slower than in the baseline scenario to reach the target only in the first half of 2019. Should the risk scenario or any of the indicated inflation risks materialise, the Bank of Russia will have to pursue a tighter monetary policy than the one envisaged in the baseline scenario.*

As the trend towards a sustainable decline in consumer price growth takes root, the Bank of Russia will consider an opportunity of cutting the key rate in the first half of 2017. Monetary conditions will continue to be moderately tight for a rather long period, thus creating prerequisites for the balanced approach of economic agents to borrowing and consumption and facilitating a further reduction in inflation and inflation expectations. In its decision-making the Bank of Russia will assess inflation risks and the alignment of key economic indicators, including inflation, with the updated forecast.

1. MACROECONOMIC CONDITIONS

In September-November 2016, the external economic conditions in Russia were broadly in line with the forecast published in the previous Monetary Policy Report[1] (hereinafter, Report).

The increased volatility in the global commodity and financial markets did not have a significant impact on internal conditions in the Russian economy. The slowdown in the annual GDP reduction continued, accompanied by signs of a recovery in economic activity, in particular across certain sectors and regions. Inflation slowed according to the Bank of Russia's expectations and inflation risks decreased slightly. However, temporary factors, such as the strengthening of the ruble and good harvest, continued to make a significant contribution, and the decrease in inflation expectations remained unstable. In these conditions, the moderately tight monetary policy implemented by the Bank of Russia was aimed at maintaining savings incentives for economic agents, all the while contributing to a further slowdown in inflation, ensuring the delivery of inflation on the 4% target in 2017 and supporting financial stability.

External conditions

The series of negotiations on cutting oil production by oil-exporting countries and the election of Republican Donald Trump as the future US President, one of whose basic economic policies is to significantly soften the US fiscal policy, were key events affecting external economic conditions for Russia in September-November. The oil production deal influenced the situation in the commodity market and hydrocarbon price dynamics over the entire period. Trump's election was unexpected by market participants and primarily influenced the dynamics of global stock market indices in November and expectations of a normalisation in US monetary policy, thus creating some uncertainty for the future.

Despite the unstable trends in the global commodity and financial markets and the persistently high uncertainty in strategic planning for economic growth and monetary policy in the USA, in the autumn months of 2016, the global economy generally developed in line with previous trends (Chart 1.1). The continued recovery of the US economy and the slight stabilisation in Chinese economic growth rates helped to buoy global demand. However, the diversity in the situations of developed and emerging market economies remained: business activity dynamics were relatively stable in developed countries and far greater volatility was witnessed in EMEs[2]. In view of these factors, the Bank of Russia retained its conservative economic growth forecast for Russia's trading partners, at roughly 2% p.a.

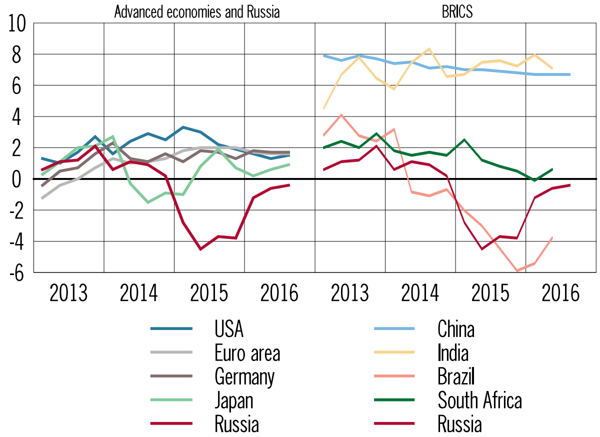
Given the moderate recovery in global demand and relatively high supply and inventories, global commodity prices for the most part remained low (Chart 1.2).

However, high volatility was still observed in the energy markets. A significant factor behind this volatility was the uncertainty surrounding the

Chart 1.1

GDP growth in key advanced and emerging economies

(percent change on corresponding period of previous year)



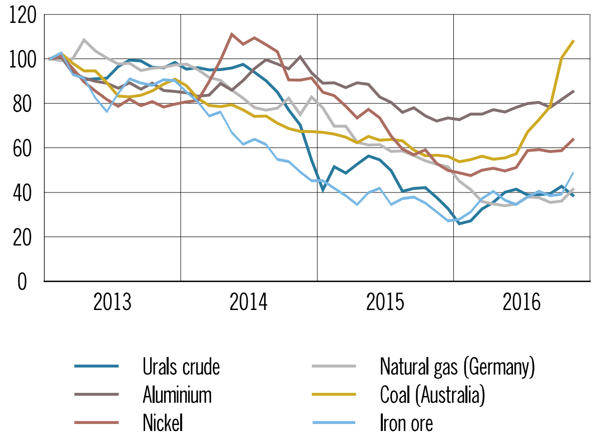
Sources: national statistics agencies, Bloomberg.

[1] *Monetary Policy Report No. 3 (15), September 2016.*

[2] *See the Abbreviations.*

Chart 1.2

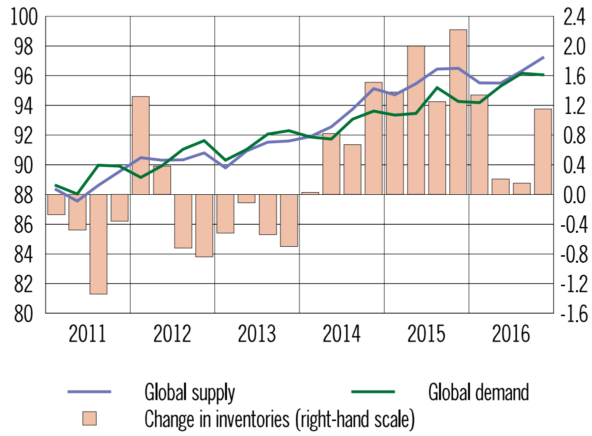
World prices of Russian principal export commodities
(1.01.2013 = 100%)



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

Chart 1.3

Balance of global supply and demand for oil and other liquid fuel
(million barrels/day)



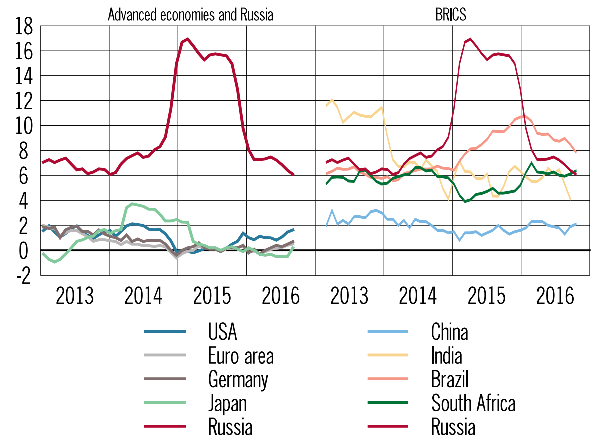
Source: US Department of Energy.

decision to cut production by oil-exporting countries in and outside OPEC. On the one hand, prices in August-October were under a marked upward pressure coming from the yet unknown outcome of the negotiations between these groups of countries on the matter of reducing oil production and the reaching of a corresponding preliminary deal between OPEC member states at the 28 September meeting. On the other hand, the lack of a full consensus between OPEC member states and the delay in the drafting of a roadmap to restrict production volumes together with the significant growth in oil production in OPEC member states coupled by record production levels in October were factors underlying the price adjustment in November. The final deal on determining the individual quotas of OPEC member states to reduce total production was concluded on 30 November[3], which led to a new increase in quotations in the oil market. Given that the OPEC agreement to reduce production will likely not lead to a sustainable price growth (since it may be offset by an earlier than assumed recovery in production in the USA), the Bank of Russia retained conservative assumptions in its baseline forecast regarding Urals crude prices at $40 per barrel up to the end of 2016 (Chart 1.3).

In September-October, the ruble strengthened in the context of increasing oil prices. In November, the ruble started to weaken amid unstable expectations regarding further developments in the global markets. Despite the increased exchange rate volatility and U-turn in the exchange rate trajectory in November, the ruble strengthened overall over the autumn months, which will help to slow inflation in the near term.

Chart 1.4

Inflation in key advanced and emerging economies
(percent change on corresponding period of previous year)



Sources: national statistics agencies, Bloomberg.

The positive energy price dynamics in September-October and the expectations that supply will contract in certain commodity markets (sugar, milk) contributed to continued recovery in global food price growth; however, the increase in the ruble exchange rate over the autumn months restricted its impact on internal prices in Russia.

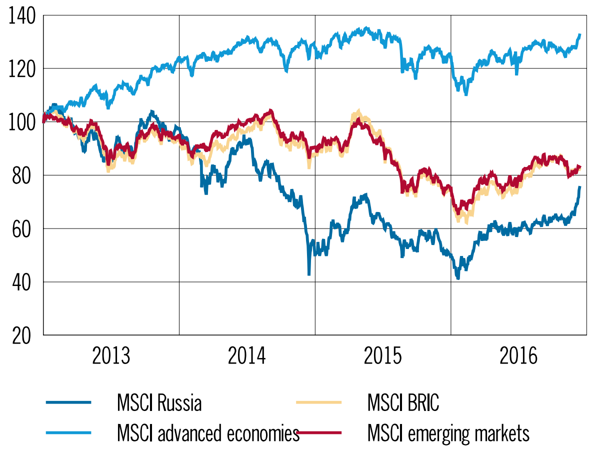
Inflation in Russia's trading partners remained broadly rather low in autumn (Chart 1.4). This was helped, on the one hand, by the moderate dynamics

[3] On 10 December, it was supplemented by an agreement to restrict oil production between OPEC member states and 11 countries that are not part of the cartel (including Russia).

Chart 1.5

Global stock indices

(January 2013 = 100%)

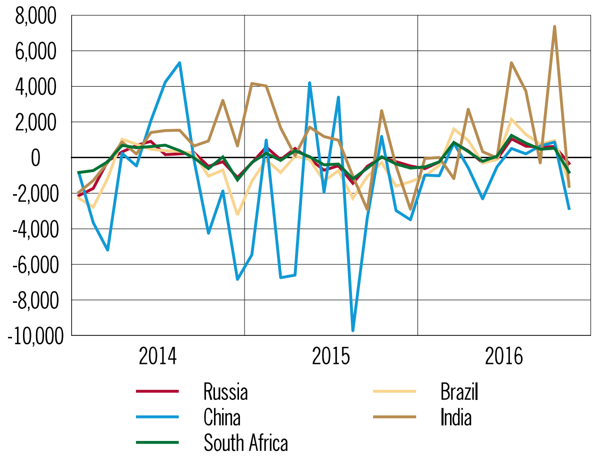


Source: Bloomberg.

Chart 1.7

Capital inflow into BRICS countries

(billions of US dollars)

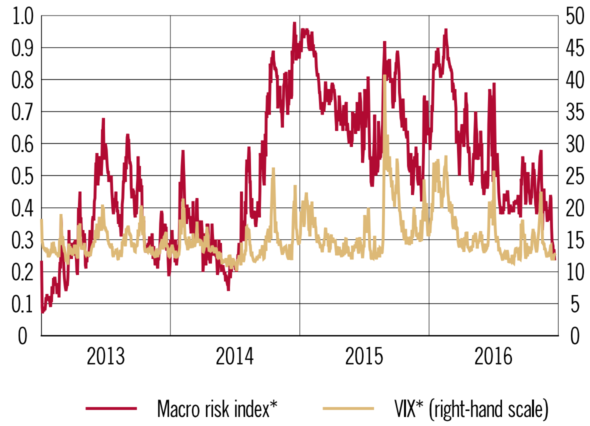


Source: EPFR Global.

Chart 1.6

Indices of volatility and global financial market risk perception by investors

(points)

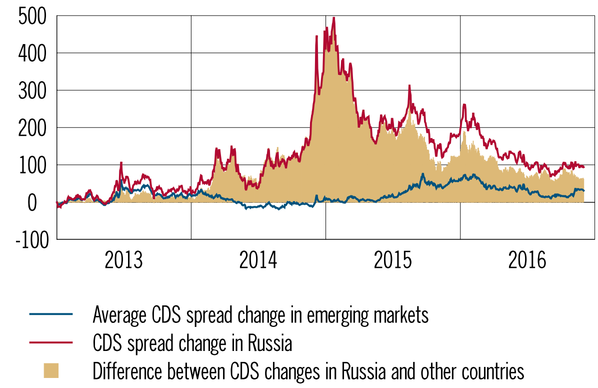


* See the Glossary.
Source: Bloomberg.

Chart 1.8

Change of 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, Malaysia, Poland, Hungary, etc.
Sources: Bloomberg, Bank of Russia calculations.

of business activity in the global economy and, on the other hand, the persistence of relatively low energy prices overall.

However, in top economies such as the USA and the euro area, the autumn months in 2016 saw a slight acceleration in inflation, even amid the relatively easy monetary policy pursued by central banks (see box 'US election results', Annex, table 'Monetary policy rates in various countries'). In the USA, this was also accompanied by an increase in inflation expectations due to the increased likelihood of an easing in fiscal policy in the short term. Under these conditions, market participants' forecasts have shifted significantly in favour of a higher likelihood of a rapid normalisation of the US Fed's monetary policy. A decision to increase the Fed's rates by 25 bp to 0.5–0.75% was taken at a meeting on 14 December. Two or three rate increases are also forecast for 2017.

These events contributed to an increase in the yields of developed countries' financial assets and influenced global financial market dynamics overall (Charts 1.5, 1.6).

The adjustment of stock indices in November and increased market volatility were accompanied by a weakening in investor risk appetite. As a result, the demand for risky assets shown by global investors in September-October started to shrink, which led to a renewed capital outflow from EMEs in November, including from Russia, and a slight increase in the country risk premium (Charts 1.7, 1.8). Russia's risk premium was also raised in September-October, somewhat outstripping the risk premium dynamics of other EMEs, amid the situation evolving in Syria and expectations of a potential expansion of EU sanctions against Russia. However, since mid-October, the growth in Russia's risk premium has slowed and moved closer to the equivalent figure for other emerging economies.

US election results

Donald Trump, a republican, won the US presidential elections on 8 November 2016; the Republican Party gained a majority in both the Senate and House of Representatives. These election results came as a surprise for most market participants and caused a perceptible surge in volatility in the global financial markets.

The key points of Mr Trump's campaign programme included fiscal policy easing and protectionist trade policy.

Mr Trump's announced programme of increased spending and tax cuts, if implemented, will boost inflation in the US and, consequently, trigger an earlier and faster rate hike by the US Fed. This shifted market participants' expectations towards higher probability of an accelerated normalisation of US monetary policy, and also caused ten-year US treasury bond yields to rise significantly, followed by an increase in the bond yields of a number of other developed and developing countries.

According to OECD estimates, the most likely scenario provides for a gradual increase in federal funds rate in the US to 2% in December 2018 from their current rate of 0.5%. Various forecasts suggest that the 3-month LIBOR rate in US dollars for non-residents could reach 1.5% in 2017.

The cost of borrowing in US dollars increased significantly for emerging market economies immediately after the elections (by 47 bp to 5.2%) and has remained relatively high. A downturn in external financing conditions has also manifested itself through the outflow of portfolio investments from emerging market countries (including Russia). It restarted as investors' risk appetite went down amid the uncertainty surrounding the economic policy of the Trump administration.

However, the impact of the election results on the US economy and global economy will in many respects depend on the degree to which Mr Trump's campaign initiatives are implemented.

On the one hand, OECD estimates suggest that fiscal policy easing will boost further US GDP growth by roughly 0.4 pp in 2017 and by 0.8 pp in 2018. Faster economic growth in the US will also have a positive impact on the global economy thanks to an increase in US demand for imported goods and services. The OECD expects the accommodative US fiscal policy to result in additional growth in global GDP by 0.1 pp in 2017 and 0.3 pp in 2018.

On the other hand, the negative impact of a tighter foreign trade policy may offset the positive effect of the fiscal incentives. The new administration's protectionist measures aimed at China and Mexico could evoke responses from their trading partners. Experts believe that it could slow down economic growth in the US in the event of a full-scale trade war. Higher foreign trade barriers will also hamper the development of international trade and the global economy and could ultimately affect external demand for Russian goods and services.

Uncertainty still lingers around the effect of the new US economic policy on the commodity market. On the one hand, if Mr Trump delivers on his campaign promise to remove restrictions on energy production, domestic production in the US could be expanded and imports would contract accordingly. Combined with the strengthening of the US dollar, it will intensify the downward pressure on oil prices and therefore the ruble exchange rate. On the other hand, Mr Trump's declaration that he would withdraw the US from the Paris Agreement[1] on emissions could buoy demand and prices in the oil market.

[1] The Paris Agreement was adopted by members of the UN Framework Convention on Climate Change and signed on 22 April 2016 by the representatives of 175 countries, including the US. The agreement is a roadmap of measures to reduce emissions and increase stability in the face of climate change. The parties to the agreement undertake to take measures to limit the increase in the global temperature to 1.5 degrees Celsius.

Internal financial conditions

Back in November, volatility in the global financial markets had only an occasional impact on the Russian foreign exchange and stock markets and generally did not produce any appreciable influence on internal financial conditions for Russia in September-November. One of the key factors shaping financial conditions in autumn was still the moderately tight monetary policy aimed at reducing inflation and maintaining the stability of the financial system. The September meeting of the Bank of Russia Board of Directors decided to reduce the key rate from 10.5% to 10% p.a. This decision was accompanied by a signal of a possible future key rate cut no earlier than 2017 Q1-Q2.

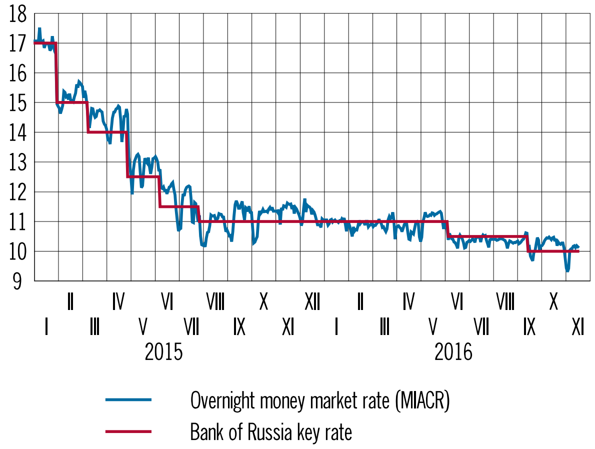
Short-term interbank loan (IBL) rates for the most part remained close to the Bank of Russia key rate (Chart 1.9). In 2017 Q1, with the banking sector's transition to a structural liquidity surplus, the use of instruments to absorb liquidity will enable the Bank of Russia to continue its effective management of IBL rates.

Interest rates on bank operations decreased in nominal terms in August-October (Chart 1.10), reflecting the total reduction in the key rate in June and September 2016 by 1 pp. However, the observed reduction was generally rather slow as a result of the impact on the market produced by the Bank of Russia's signal about the prospect of a further reduction in the key rate.

Chart 1.9

Bank of Russia key rate and MIACR

(% p.a.)

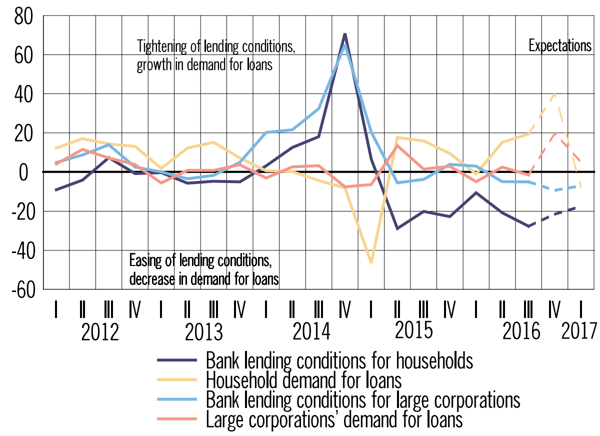


Sources: MICEX SE, Bank of Russia.

Chart 1.11

Lending conditions and demand for loans indices

(percentage points)

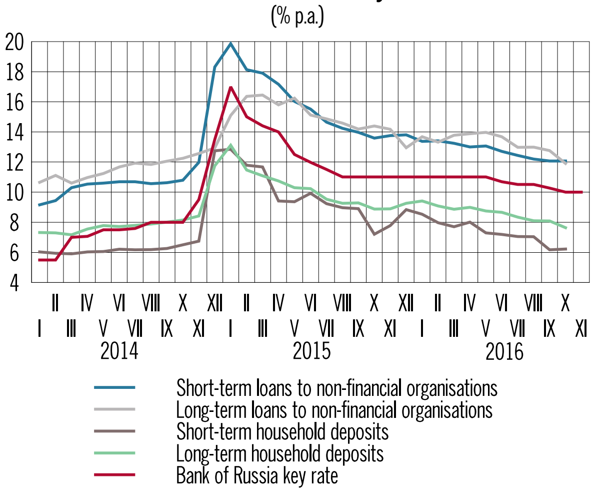


Source: Bank of Russia.

Chart 1.10

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

(% p.a.)

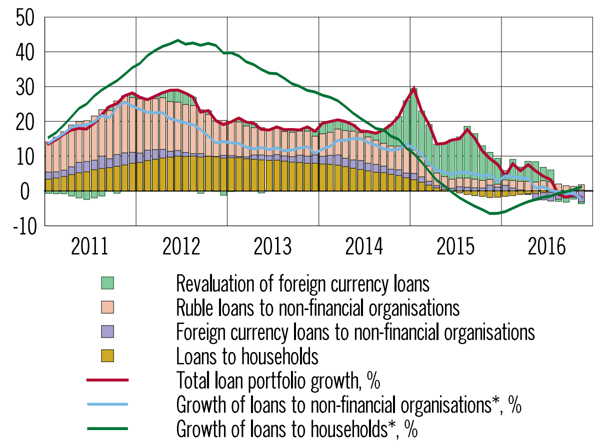


Source: Bank of Russia.

Chart 1.12

Contribution of various components to annual growth rate of banks' loan portfolio

(percentage points)



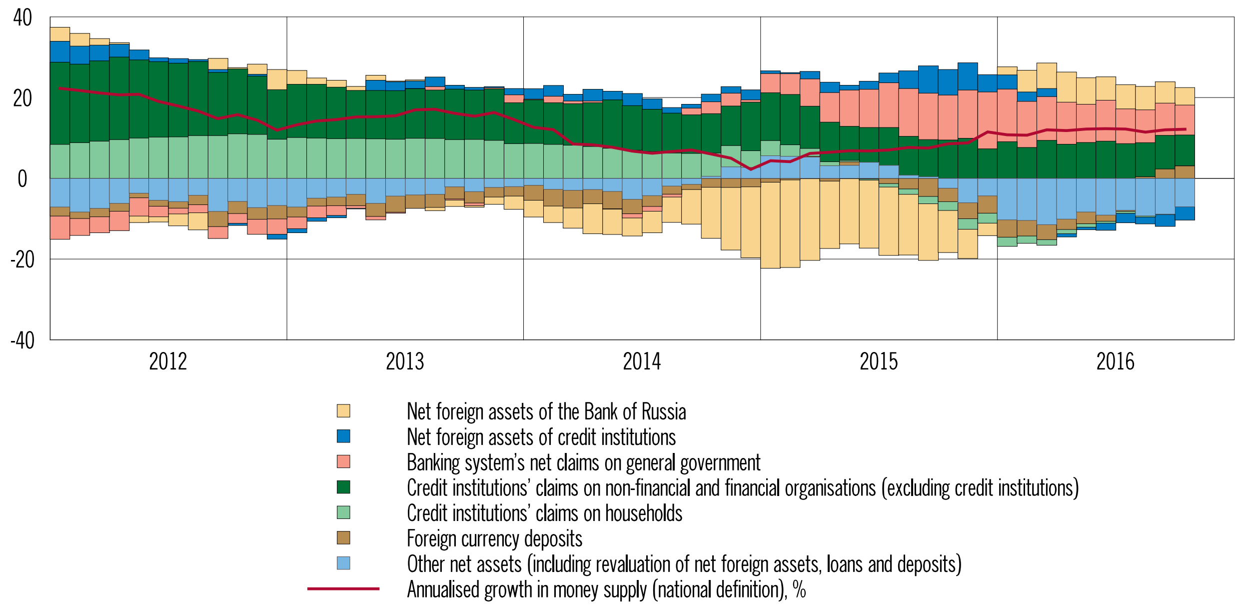
** Adjusted for foreign currency revaluation.*

Source: Bank of Russia.

Chart 1.13

Sources of money supply (national definition)*

(contribution to annual growth of monetary aggregate M2, percentage points)



Source: Bank of Russia.

The Bank of Russia's tough rhetoric led to an upward adjustment in market participants' expectations regarding future key rate dynamics. Inflation expectations reduced in line with nominal interest rates. Interest rates remained high in real terms, contributing to the continuation of economic agents' balanced approach to consumption and lending, and also to supporting financial stability.

With the gradual reduction in rates, banks moderately eased their non-price bank lending conditions[4] in 2016 Q3 (Chart 1.11), primarily the loan amount and maturity, and an expanded range of lending types. The conditions for this were shaped by the gradual stabilisation of banks' credit and bond portfolios amid signs of improvement across certain sectors.

At the same time, banks' policies remained broadly conservative: requirements for collateral and borrowers' financial standing continued to be high. The slight growth in consumer lending in 2016 Q3 is still unstable, coming from only a small number of major banks, and may be largely down to the refinancing of previous loans. According to estimates, taking into account the generally weak consumer lending dynamics in recent years, the revival in the consumer lending market to current levels does not pose significant risks to inflation or financial stability.

The persistently low risk appetite of financial market participants given the unstable economic dynamics and the higher total debt burden in a number of industries in the real sector held back growth in lending activity in the economy: in August-November the annual growth in banks' loan portfolios slowed to near zero (Chart 1.12). Taking into account the lending dynamics observed in recent months, which have been weaker than previously expected, the growth in banking sector lending to the economy[5] is estimated to be 0–3% at the end of 2016, which is lower than the forecast given in the previous Report (4–6%).

Against the backdrop of the weak demand for lending given the on-going positive contribution made to money supply growth by the increase in net lending to the general government from the banking system, the Bank of Russia's forecast of annual money supply growth (according to

[4] *Non-price bank lending conditions include the loan maturity, loan amount, requirements for the borrower's financial standing, collateral requirements, and the range of lending types.*

[5] *The estimates of the growth in lending to the economy provided here and in Section 2 of 'Economic outlook and key rate decision' are an estimate of the growth in banking sector claims on non-financial organisations and households, which is slightly broader than banks' loan portfolios as they also include bonds, promissory notes, shares, receivables linked to bank settlements, etc.*

the national definition) as of the end of 2016 was revised downward, to 8–11% compared with 9–12% in the previous Report (Chart 1.13, see box 'Fiscal policy').

Economic Conditions

The Russian economic recession continued to slow amid the muted growth of the global economy and persistently relative stability of internal financial conditions. According to Rosstat data, in 2016 Q3, the slowdown in the annual GDP was 0.4% (after 0.6% the previous quarter), which is in line with the forecast published in the previous Report (Chart 1.14). Quarterly seasonally adjusted GDP growth moved into the positive territory, according to Bank of Russia estimates, which points to the necessary conditions being in place for a recovery in economic activity in the near term. These conditions were supported in part by the moderate optimism of producers, especially in the services sector, as indicated by PMI survey data. However, this was mostly exhibited in the segment of corporate services, while the dynamics of household services remained weak.

The gradual adaptation of the economy to the new conditions is evident across regions. In most Russian regions, key macroeconomic dynamics improved slightly over the autumn months (Annex 'Statistical analysis of differences in economic development of Russian regions').

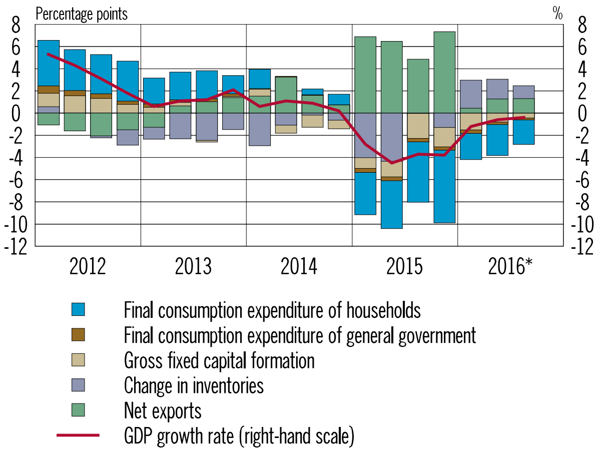
The recovery in production activity was still mixed (Chart 1.15). The average annual growth in industrial production in August-October was near zero, although some months saw positive growth in production.

The contribution of the mining industry to the growth in industrial production roughly remained at the same level as previous months (0.5–0.7 pp). In August-October, the manufacturing industry still witnessed a revival in the production of certain types of investment goods (metal goods, finished wood work) and consumer goods (household appliances, shoes, pharmaceuticals, soap, office equipment, and furniture). However, the positive contribution of these goods to industrial production dynamics was still generally small. Support for the output of non-food consumer goods came from the partial realisation of deferred household demand

Chart 1.14

GDP growth structure by expenditure

(on corresponding period of previous year)

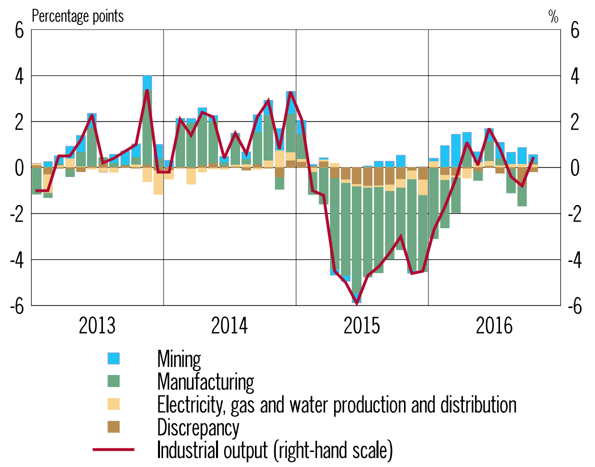


* 2016 Q3 - Bank of Russia estimate.
Sources: Rosstat, Bank of Russia calculations.

Chart 1.15

Contributions of industrial output components (adjusted for calendar factor)

(on corresponding period of previous year)

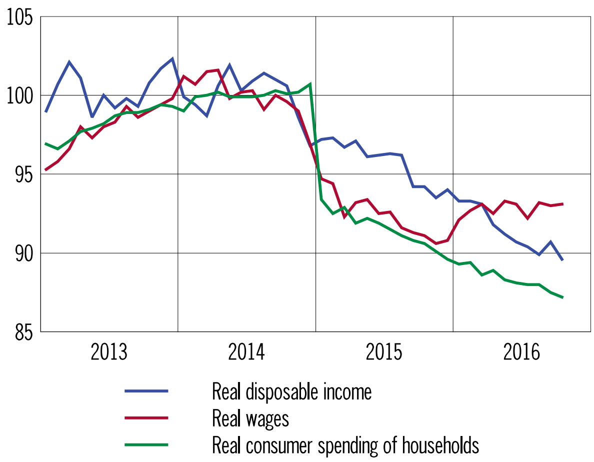


Sources: Rosstat, Bank of Russia calculations.

Chart 1.16

Real wages, disposable income and consumer spending of households

(seasonally adjusted, 2014 = 100%)



Sources: Rosstat, Bank of Russia calculations.

Fiscal policy

According to data from Russia's Federal Treasury, the Russian Federation's budget deficit stood at ₽1.0 trillion, or 1.5% of GDP[1] in January-October 2016, an increase of ₽0.4 trillion compared with the same period in 2015. The federal budget deficit was ₽1.5 trillion (2.2% of GDP), an increase of ₽0.9 trillion.

In the period between January and October 2016, budget income reduced by 0.2% compared with the same period in 2015 to ₽21.9 trillion (32.2% of GDP) and federal budget income fell by 7.9% year-on-year to ₽10.4 trillion (15.4% of GDP). The main factor behind this drop in income was the 24.2% year-on-year reduction in oil and gas revenues amid the fall in oil prices compared with 2015. However, non-oil and gas revenues remained stable, primarily due to a 12.6% year-on-year growth in social insurance receipts and an 11.8% year-on-year growth in revenues from taxation of goods (VAT and excises) amid a slight growth in nominal wages and household expenditure. The Russian Government plans to perpetuate the dividend checkoff rate for state-owned companies and federal state unitary enterprises at 50% of the net profit from 2017. The checkoff rate was introduced in April 2016. This measure will help support non-oil and gas income.

Budget expenditure grew by 1.7% year-on-year to ₽22.9 trillion (33.7% of GDP) and federal budget expenditure went down by 0.2% year-on-year to ₽12.0 trillion (17.6% of GDP). As national defence and security expenditure shrank, social policy and health care expenditure was revised upwards. As much as 72.9% of the planned federal budget expenditure was used in January-October. The remainder is expected to be used before the end of the year: the federal budget will allocate up to ₽4.4 trillion in November-December.

Budget deficit was not financed from the Reserve Fund in September-October 2016. Total expenditure from the Fund amounts to ₽1.2 trillion since the start of the year. According to the draft Fiscal Policy Guidelines for 2017 and 2018-2019 (hereinafter, FPG), the Russian Ministry of Finance plans to use more than ₽2.1 trillion from the fund in 2016.

As regards deficit financing from alternative sources, the Government sold a 50.1% portfolio of shares in the public joint-stock oil company Bashneft for ₽329.7 billion in October 2016 and a 19.5% portfolio of shares in the public joint-stock oil company Rosneft for ₽710.8 billion in December 2016. The privatisation programme may be extended in 2017 – portfolios of shares in the public joint-stock companies VTB and Sovcomflot are expected to be sold for roughly ₽130-140 billion.

According to the draft FPG, the Reserve Fund will be exhausted in 2017. In this case, funds from the National Wealth Fund may be used to finance budget deficit. Total use of sovereign fund resources could reach ₽1.8 trillion in 2017, ₽1.2 trillion in 2018, and roughly ₽0.1-0.2 trillion in 2019.

The total government debt as of 1 November 2016 stood at ₽13.2 trillion, ₽0.4 trillion less than at the beginning of the year, primarily due to the external debt repayment and foreign exchange revaluation.

In 2016, the Russian Ministry of Finance successfully carried out its ₽1 trillion-worth OFZ placement programme and also placed Eurobonds worth $3 billion. From mid-November, the Russian Ministry of Finance has been carrying out further OFZ placements. Their value is to reach ₽200 billion by the end of the year. The Russian Ministry of Finance also intends to issue ₽0.9 trillion guarantees to the defence industry. The year 2017 will see another Eurobond placement worth $7 billion. The draft FPG suggests that the Russian Ministry of Finance plans annual ₽1.05 trillion-worth net OFZ placements in 2017-2019.

At the end of 2016, the federal budget deficit may exceed ₽3 trillion (3.7% of GDP[2]). In 2017-2019, the Government plans to implement fiscal consolidation and reduce the budget deficit by 1 pp annually from 3.2% of GDP in 2017 to 1.2% of GDP in 2019. Even if the foreign economic climate improves, this strategy will significantly mitigate inflation

[1] Here and throughout this box we use preliminary estimates for GDP by the Russian Ministry of Finance based on the SNA 1993 methodology.

[2] Bank of Russia estimates, GDP calculated using the SNA 2008 methodology.

risks from fiscal policy, including the risks associated with wage indexation[3] and supplementary pension[4] benefit. The Bank of Russia estimates that in this case the contribution of fiscal policy to economic activity is likely to be near zero in 2016 and to become slightly negative in 2017-2019 as the budget deficit reduces. Growth in public expenditure and a related increase in the budget deficit against the approved budget parameters will create additional inflation risks.

[3] *Wages for certain job categories are to be indexed under Decree of the Russian Federation President No. 597, dated 7 May 2012, 'On Measures to Implement State Social Policy'.*

[4] *In August 2016, the Government of the Russian Federation decided to pay a one-time ₽5,000 pension benefit in January 2017. This decision will partly offset the 2016 pension shrinkage in real terms, but carries less inflation risks than an additional indexation of pensions in the medium term.*

for durable goods, the consumption of which shrank materially over the previous year amid downward income dynamics.

The halt in the decline of real wages and their stabilisation at 2016 Q2 levels contributed to a revival in consumer demand for certain groups of non-food goods. Together with the stable and low unemployment (5.5%, seasonally adjusted) this points to signs of a slight recovery in economic activity (Chart 1.16, Table 1.1).

The real disposable household income continued to shrink at the expense of other income components (excluding wages). In these conditions, weak lending dynamics and on-going growth in household deposits with banks point to the dominance of household saving behaviour model, being one of the key factors constraining consumer demand, which remained broadly weak over the autumn months. In October, the fall in retail trade turnover accelerated after a slight slowdown in September, from 3.6% to 4.4% relative to the corresponding month of the previous year (Chart 1.17). According to Bank of Russia estimates, demand's negative contribution to inflation will remain until the end of this year, but the impact of demand-side restrictions will continue to dissipate gradually. A robust recovery in consumer demand is not likely to start earlier than the first half of 2017.

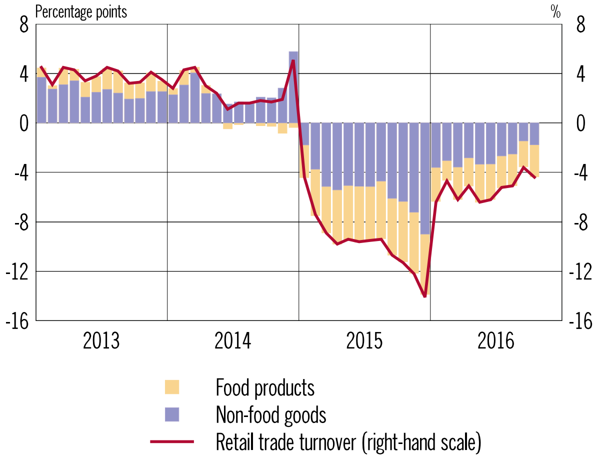
Investment demand, like consumer demand, remained weak (Chart 1.18). The dynamics of indirect investment activity indicators (construction works, imports and production of investment goods) were unstable and mixed in August-October. The best dynamics were observed in machinery and equipment imports. As a result, in 2016 Q3 fixed capital investment increased by 0.3% year on year, largely due to the low base effect. Fixed capital investment growth was slightly negative compared with 2016 Q2, seasonally adjusted.

The conservative corporate investment policies, relatively high debt burden across a number of sectors, moderately tight lending conditions, and uncertainty around future demand dynamics (whose contribution, however, had gradually worn out by the end of 2016) were all factors restricting

Chart 1.17

Growth in retail trade turnover

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

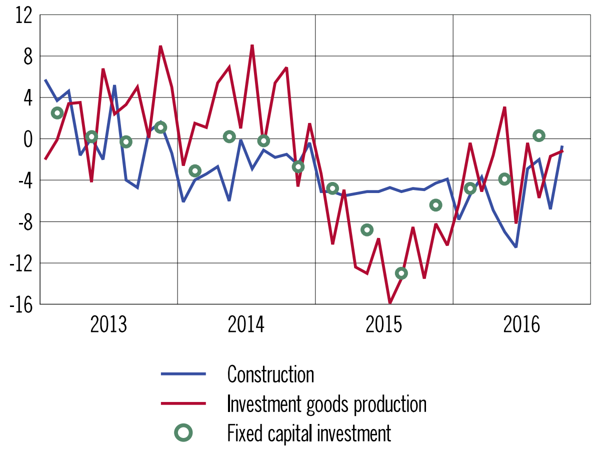


Sources: Rosstat, Bank of Russia calculations.

Chart 1.18

Investment, construction and investment goods production

(growth, percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Table 1.1

Labour market

Indicators	2014				2015				2016		
	I	II	III	IV	I	II	III	IV	I	II	III
Employment and unemployment (seasonally adjusted)											
Unemployment rate, %	5	5.2	5.2	5.2	5.2	5.7	5.6	5.7	5.4	5.8	5.7
Employed to unemployed ratio	18.6	18.3	18.3	18.3	17.9	16.5	16.9	16.6	17.4	16.2	16.9
PMI Composite Employment Index, points	48.2	47.4	48.2	46.6	44.8	46	47.4	45.9	46.5	48.6	49.3
Wages (as % year-on-year)											
Nominal wages	11.1	10.2	8.3	7.7	5.7	5.9	4.7	3.3	7.7	7.9	8.1
Real wages	4.4	2.4	0.6	-1.7	-9	-8.5	-9.5	-9.8	-0.6	0.5	1.2
Wage arrears	6.2	5.7	-11.9	-10.2	7.9	22.6	38.6	55.9	45.4	24.5	6.2
Part-time employment											
Number of part-time employees, as % of previous period (seasonally adjusted)											
Total	-1.2	-0.1	2.2	0.1	1.1	2.6	0.2	1.2	0.6	0.1	0.4
Part-time employment	7.8	-4.2	-3.4	4.6	11.9	2.7	-3.5	3.8	9.8	1.1	-11.5
Part-time employment on employer's initiative	13.7	-2.2	-5.7	10.6	17.1	22.1	-1	-8	-1.5	14.8	-17.1
Part-time employment upon mutual agreement	5.5	-2.9	-1.7	2	9.5	1.4	-2	3.8	10.2	0.7	-9
Idle employees	-0.1	-1.4	13.1	-11.3	10.2	-3.1	-3.1	1.5	-8	0.2	-3.9
Unpaid leave	1.5	-0.1	0.8	0.3	0.2	1.4	0.1	0.3	0.8	0.4	1
Part-time employees, as % of headcount											
Total	9.0	9.5	10.4	10.3	9.4	10.4	11.0	11.0	10.0	10.7	11.4
Part-time employment	2.2	2.1	2.0	2.2	2.4	2.5	2.4	2.5	2.8	2.8	2.5
Part-time employment on employer's initiative	0.3	0.3	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Part-time employment upon mutual agreement	1.9	1.8	1.8	1.9	2.0	2.1	2.0	2.1	2.4	2.4	2.2
Idle employees	0.7	0.6	0.6	0.8	0.8	0.7	0.5	0.9	0.7	0.6	0.5
Unpaid leave	6.1	6.8	7.8	7.3	6.2	7.2	8.1	7.6	6.5	7.3	8.4
Alternative indicators of part-time employment											
Average working hours per employee (year-on-year)	0.3	0.4	0.2	-0.1	-0.3	-0.4	-0.5	-0.1	-0.3	0.1	-0.3
Labour force utilisation in industrial production (normal level = 100)	87.7	86.7	89	85.7	81.7	86.7	87.7	88	83.7	88.3	88

Change compared with previous 12 months:
- – situation improved (more than 1 standard deviation)
- – situation improved (less than 1 standard deviation)
- – situation remains unchanged (± 0.15 standard deviations)
- – situation deteriorated (less than 1 standard deviation)
- – situation deteriorated (more than 1 standard deviation)

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

growth in fixed capital investment (see box 'Factors of private fixed capital investment').

Support for investment demand continued to come from the improved financial position of manufacturing companies (see box 'Financial position of real sector organisations in January-September 2016'). In the second half of the year, growth in non-financial organisations' profits and the further strengthening of the ruble, observed since March 2016, are expected to be factors behind the improvement in investment dynamics.

Amid the persistently weak consumer and investment demand, the accumulation of inventories[6] continued to make a significant contribution to GDP. However, according to Bank of Russia estimates, no material positive signs of a change in the inventories structure have been observed. This points to the unstable improvement in inventory dynamics and suggests that companies are still viewing the prospects of a recovery in demand in a relatively pessimistic light. In recent quarters, this has not been down to the expectations of a recovery in demand, but rather to the low base effect, an expected and actually good harvest and, generally, weaker demand dynamics compared to production. As a result, according to Bank of Russia estimates, the positive impact of the change in inventories on GDP dynamics will remain until the end of 2016, but will weaken slightly further.

[6] *According to the index of structural changes in inventories in constant prices, seasonally adjusted. For more detail on the calculation methodology, see Monetary Policy Report No. 2 (14), June 2016.*

Growth in net exports also continued to make a positive contribution to GDP. In the context of relatively stable external demand, the annual growth in exports was roughly 2.5% in 2016 Q3 in real terms, according to estimates. In 2016 Q4, due to the high base effect of the previous year, export growth is expected to be slightly negative in real terms.

At the same time, given the strengthening of the ruble in September-October and the emerging signs of a recovery in economic activity, the reduction in imports slowed in real terms (to 3% year on year, according to estimates). This reduction in imports was largely shaped by the imports of capital goods, in particular machinery and equipment.

As a result, the contribution of net exports to annual GDP growth in 2016 Q4 will be roughly 0.2 pp, according to Bank of Russia estimates.

These factors, together with the generally unfavourable situation concerning Russian export goods prices, made a marked contribution to the further annual reduction in Russia's current account balance in 2016 Q3. With the on-going international financial sanctions, the private sector cut its foreign liabilities, as reflected in the further capital outflow. Banks continued to repay debts on Bank of Russia FX liquidity provision operations on a reverse basis (Annex 'Dynamics of major items in the Russian balance of payments in 2016 Q3').

Taking these consumption, investment and net exports trends into account, in 2016 GDP will decrease by 0.5–0.7%, according to Bank of Russia estimates. However, annual GDP growth is expected to move to the positive territory in 2017 Q1.

Factors of private fixed capital investment

Fixed capital investment includes a wide range of capital investments. Here belong investment directly related to production processes (machinery, equipment, manufacturing facilities and buildings, etc.) and other investment (private housing projects, etc.). As a result, the analysis of the factors affecting investment demand in the economy should be based on corporate investment data and exclude public[1] investment, as its dynamics are shaped by administrative decisions, social obligations, and the availability of budget or extra-budgetary funds, among other things. Private fixed capital investment covers most investment in the economy. Estimates show that such investment accounts for more than two thirds of total fixed capital investment.

We built a multiple linear regression to assess the impact of various factors on private capital investment dynamics. We used seasonally adjusted quarterly growth in fixed capital investment to large, medium and small businesses, less investment funded by the budget and extra-budgetary funds, as dependent variable.

Consumer activity, the availability of corporate financial resources, terms of borrowing, the availability of imported investment goods and the level of economic uncertainty served as exogenous factors. We used seasonally adjusted quarterly growth in real household spending on final consumption as the indicator of consumer activity[2].

Profits adjusted for the investment goods price index were an indicator of companies' financial capabilities[3]. We used the nominal interest rate on loans to non-financial organisations with maturity of more than one year to reflect the terms of borrowing. The nominal effective ruble exchange rate reflected the availability of imported investment goods in the model. It is important to note that the exchange rate impacts on investment activity not only through the prices of imported investment goods, but also through changes in foreign currency debt, which can lead to changes in the debt-to-asset ratio and influence firms' investment expenditure[4]. We used Rosstat industrial survey data to calculate the indicator of economic certainty[5]. These three variables were not fixed and were used in the model as growth against the previous quarter.

[1] Fixed capital investment funded by the budget and extra-budgetary funds.

[2] Given that the SNA 1993 methodology was replaced with SNA 2008 over the research period (2006-2016), in order to ensure the data comparability some final consumption expenditure figures were based on indices of the actual value of this indicator against the corresponding period of the previous year.

[3] The real profit indicator was the only fixed time series and was incorporated into the model as absolute deviations from the average.

[4] For the purposes of this study, we estimated the cumulative effect of the exchange rate on investment activity (not broken down by channels).

[5] The index was calculated from estimates of economic uncertainty in mining, manufacturing, production of energy, gas and water, weighted by the share of the corresponding sector in total industrial investment.

Some factors may have a varying impact on investment activity depending on the phase of the economic cycle. To verify this hypothesis, the model included fictitious variables in the regression coefficients[6].

The results show that consumer activity is an important factor behind investment activity dynamics irrespective of the phase of the economic cycle. A 1 pp growth in this indicator translates into a 0.42 pp increase in private capital investment growth.

Investment also reacts to exchange rate dynamics irrespective of the stage of the economic cycle. This reaction is delayed by one quarter, which may be attributed to a temporal lag between the agreement date and the actual delivery of such high-tech goods as machinery and equipment. This result is in line with expert assessments by other organisations[7].

The profit figure has a significant positive effect on private fixed capital investment. However, its strength eases in the time of crisis. A weak reaction or a lack thereof to factors linked to the investment's source of financing can be explained by the fact that during a crisis firms often have no incentive to renew their fixed assets and increase their production.

We did not reveal any significant impact of the interest rate on investment activity during crisis periods. However it is a significant factor and affects capital investment dynamics with a half-year lag in the periods of economic stability. Such a long lag can be explained by the need to calculate the return on investment, taking into account the new effective interest rate, as well as institutional restrictions directly linked to the borrowing process.

The growth in economic uncertainty, which is characteristic of crises, has a negative impact on capital investment dynamics with a half-year lag. At the same time, lower uncertainty during periods of economic stability is not a significant factor stimulating investment activity.

Seasonally adjusted quarterly growth in private investment moved into positive territory in 2016 Q3. The appreciation of the ruble in the previous quarter made a positive contribution to investment activity and became its key driver (Chart 1.19). However, the estimates show that the contribution of the profit factor decreased in the third quarter.

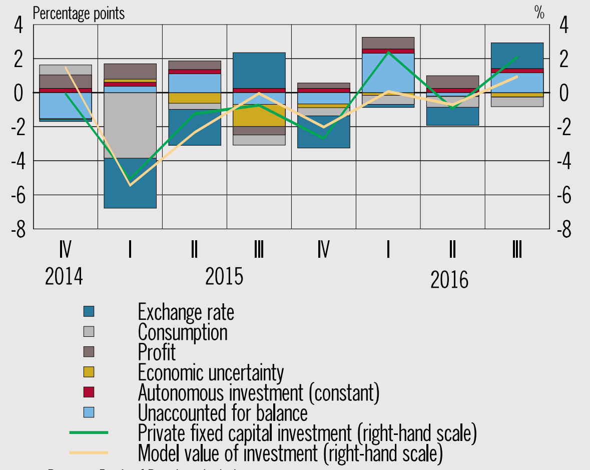
Weak demand remained one of the main factors negatively impacting private investment dynamics. The impact of economic uncertainty had significantly shrunk by 2016. It may suggest that companies have adapted slightly to operating amid elevated economic risks.

The estimates suggest that the exchange rate dynamics will continue to have a positive effect on investment demand in late 2016 – early 2017. The improvement in the financial position of companies will also buoy investment activity. In addition, the negative contribution of consumer activity is expected to go down slightly. As a result, the positive dynamics of seasonally adjusted quarterly growth in private fixed capital investment may hold over the next two quarters.

Chart 1.19

Factors' contribution to investment activity

(on previous quarter, seasonally adjusted)



Sources: Rosstat, Bank of Russia calculations.

[6] *For crisis periods (2008 Q3 – 2010 Q1 and 2014 Q4 – 2016 Q3) the dummy variable equaled 1 and for all other periods it equaled 0.*

[7] *Analysis by the Centre for Macroeconomic Analysis and Short-term Forecasting 'Investment Activity in the Economy' for 2016 Q1.*

Financial position of real sector organisations in January-September 2016

The financial position of Russian companies improved in the period between January and September 2016. The positive profit and loss balance was 20.6% higher than in the same period of the previous year, according to preliminary data from Rosstat. Profits grew by 10.1%, while losses shrank by 21.4%.

The largest net profits were seen in the manufacturing industry; the industry's share in the overall profits in the economy has grown since 2014 (Chart 1.20). The financial position of manufacturing businesses has improved amid negligible demand and weak production activity. It points to the effectiveness of measures to reduce non-operational losses and to cut costs (including labour costs). A moderate increase in commodity prices, and relatively low indexation of prices for goods and services of infrastructure companies also curbed the increase in costs. As a result, the 17.2% increase in profits of successful manufacturing companies came amid a marked reduction in losses in unprofitable industries (by 34.4%).

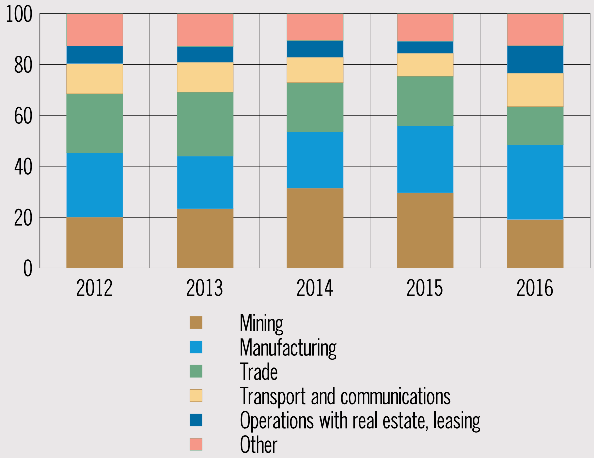
In contrast, net profits fell in the mining sector (by 21.7%) against the comparable period in 2015, despite a drop in losses. This reflected the downturn in the global commodity markets. Trade showed similar profit and loss dynamics, even the significant reduction in losses failed to offset a decline in profits amid the demand-side restrictions.

Better financial results in the manufacturing industry – a potential driver of economic growth – precondition positive structural changes in the economy.

Chart 1.20

Profit and loss balance by activity in January-September

(%)



Sources: Rosstat, Bank of Russia calculations.

Inflation

These financial and economic conditions created the preconditions for a further slowdown in inflation in line with the Bank of Russia's forecast. Monthly seasonally adjusted price growth decreased in September-November compared with July-August. In November, annual inflation was 5.8% (Charts 1.21, 1.22). Disinflationary trends also continued to persist in the regions.

A reduction in annual price growth was witnessed for all major groups of goods and services. However, the increase in the cost of services was less than the growth in goods prices (non-food goods and food products, excluding fruit and vegetables, which are characterised by high price volatility). This is a manifestation of the inertia in relative price changes in the economy, which has been in effect since the end of 2014, as a result of the global oil price shock, depreciation of the ruble and slump in economic activity. In future, amid the recovery in business activity and improvement in economic efficiency, this effect will be gradually offset (see box 'Relative price dynamics').

Despite some signs of demand-side restrictions weakening (the relative stability of real seasonally adjusted wages and the partial realisation of deferred household demand for durable goods), consumer demand continued to make a significant contribution to the slowdown in inflation. According to Bank of Russia estimates, the continuing demand-side restrictions will have a constraining effect on inflation until the end of this year.

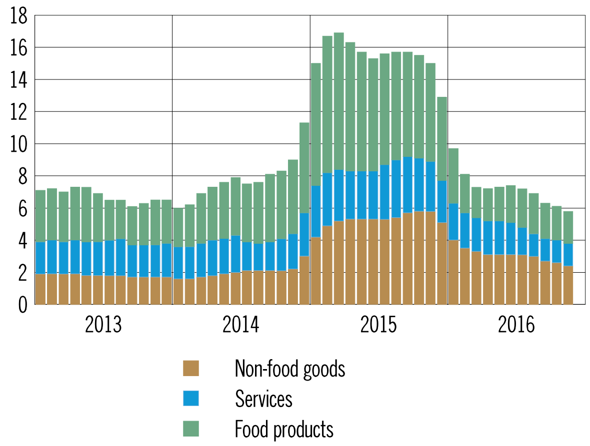
Another factor contributing to the slowdown in price growth is producer price dynamics. Given the restrained price growth in global commodity markets and the low indexation of tariffs for infrastructure company goods and services, producer price growth in the commodity and infrastructure segments slowed.

Additionally, the reduction in the growth of food prices was aided by temporary factors, such as

Chart 1.21

Contribution to inflation

(on corresponding period of previous year, percentage points)

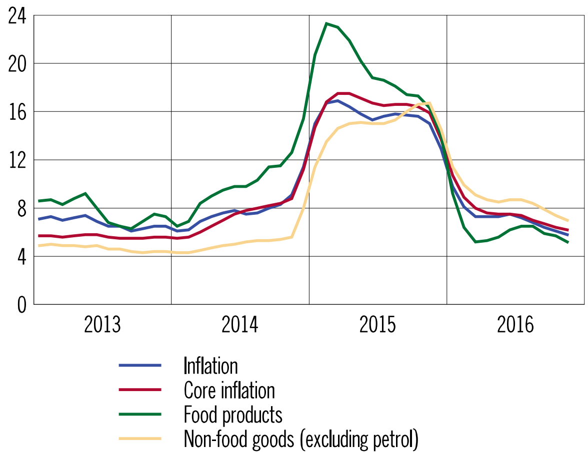


Sources: Rosstat, Bank of Russia calculations.

Chart 1.22

Prices of consumer goods and services

(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

the favourable situation in the agricultural market in Russia (see box 'Impact of global grain price dynamics on consumer prices').

Another temporary factor that restricted consumer price growth, as in previous months, was the appreciation of the ruble in September-October amid the expectations of an agreement to be reached on a reduction in oil production. According to estimates, the contribution of the ruble's exchange rate to annual inflation in November remains typical for the period of moderate exchange rate volatility. The previous strengthening of the ruble will continue to contribute to the slowdown in inflation in the coming months.

Relative price dynamics

Annual inflation has slowed throughout 2016 as household consumption moderated, ruble appreciated, and cost-side pressure from businesses weakened. Annual growth in prices for key components of the consumer basket went down, but varies considerably. Prices for non-food goods show the highest annual growth rates. In November 2016, they grew by 6.7%, while food prices went up by 5.2% and service prices increased by 5.3%. The growth in non-food prices was the highest in December 2015, while during this period differences in growth rates were less pronounced.

The lower food price increase compared with the rising cost of non-food goods was down to the impact of specific supply-side factors combined with the general anti-inflationary conditions. These factors included heavy crop of grains, potatoes and vegetables in 2015, optimistic harvest forecasts for the new agricultural year in 2016 H1, record figures from the harvest campaign, and generally favourable situation in the global agricultural markets.

However, in the services market, specific factors only affected the regulated segment (moderate growth in utility rates). Nevertheless, the increase in the cost of services (other than housing and utility services) due to general factors was less pronounced than the hike in non-food prices.

Faster growth in non-food prices compared with the rising prices of services in 2015-2016 generally reflects changes in pricing proportions in the economy. In addition, the price dynamics for this group of goods are the best indicator of these changes, as food inflation includes 'noise' from the impact of one-off supply-side shocks. Non-food goods are tradable and their price formation is closely linked to price dynamics in Russia's trading partners[1]. At the same time, household services largely fall under the definition of non-tradable goods: they play little role in foreign

[1] *According to estimates, imports accounted for roughly half of non-food retail turnover in 2016.*

trade turnover and their prices are determined by internal factors. The change in non-food prices relative to service prices[2] can be taken as an indicator of price dynamics for tradable goods compared with non-tradable ones.

In turn, changes in the relative prices of tradable and non-tradable goods in Russia are a component of the dynamics of the ruble's real effective exchange rate, which reflects changes in the cost of domestic goods compared with foreign goods. The fall in the ruble's purchasing power in foreign trade operations, i.e. its depreciation, is consistent with the relative increase in the price of tradable goods. The fall in labour productivity in the Russian economy relative to its trading partners underlies this process.

Since 2015, non-food prices have been growing on average faster than service prices, and tradable goods have been gaining in prices relative to non-tradable ones (Chart 1.23). The price increase is in line with the ruble's real depreciation witnessed since 2014 H2 and results from a negative external shock, a downturn in business activity in Russia and the fall in economic efficiency[3]. But these are trends: fluctuations in the exchange rate, which are influenced by multiple one-off factors, are only volatility-driven, unlike inertial changes in relative prices, which reflect the effects of fundamental factors.

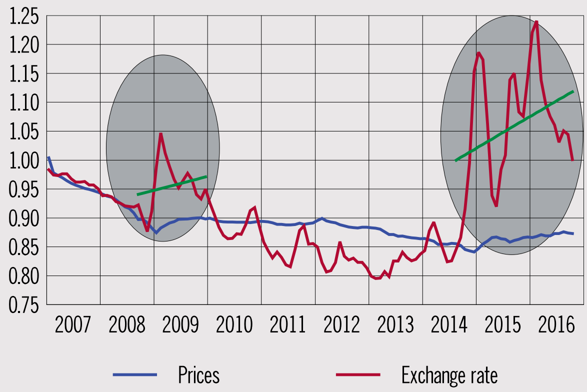
A similar situation was seen in late 2008 – early 2009: the oil price shock resulted in a drop in GDP and labour productivity, depreciation of the ruble, and a shift in relative prices. As economic growth is recovering and the exchange rate is returning to its 'pre-crisis' levels, the relative prices of tradable goods have ceased to grow and resumed a downward trend seen until the end of 2014.

Hence, an increase in non-food prices relative to service prices is in many ways shaped by fundamental factors. Future non-food price dynamics and real exchange rate trends will ultimately depend on the prospects of recovery in business activity and an increase in economic efficiency.

Chart 1.23

Prices of non-food goods vs. service prices (excluding utilities) and real effective exchange rate

(December 2006 = 1)



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

[2] *Here and throughout this box, excluding housing and utility services.*

[3] *From July 2014 to October 2016, the ruble's real effective exchange rate fell by 15.1%. The growth in labour productivity slowed (to 0.9%, according to Rosstat) in 2014, and it decreased (by 3.2%) in 2015. The decrease continued in 2016, according to estimates.*

However, instability in inflation expectations dynamics and their persistently high level are still causing concerns with regard to their pass-through effect on inflation (Table 1.2). On average, inflation expectations over September-November decreased slightly compared with the June-August levels. In absolute terms, the decrease was negligible, and the inflation expectations dynamics were extremely uneven when broken down by month[7]. The presence of significant fluctuations in inflation expectations indicator points to a lack of stable downward trends and therefore poses certain risks regarding the resumption of an accelerated price growth.

Overall, as previously, main inflation risks are associated with the elevated level of inflation expectations, depressed savings incentives and the impact of variable external factors.

The Bank of Russia's moderately tight monetary policy will help to consistently reduce inflation further and to limit inflation risks in 2016. According to the baseline forecast, inflation will be 5.4–5.8% by the end of 2016.

[7] *According to estimates based on the trajectory of median forecast inflation for the year calculated by inFOM and the probabilistic methods used by the Bank of Russia.*

Impact of global grain price dynamics on consumer prices

The Russian grain market is closely linked to the global market: Russia became the largest grain exporter in the previous agricultural year[1] and it could further increase its exports this year. Roughly one third of the harvest is exported abroad free of export duties. In these conditions, fluctuations in global prices affect the situation in the domestic markets for grain and grain-based products (cereals, flour, bread, pasta and confectionaries) and livestock (Charts 1.24 and 1.25). Secondary effects may arise in markets for other goods.

We developed vector autoregression models to conduct a quantitative analysis of the impact of changes in global grain prices on domestic prices for certain consumer goods. We analysed three groups of consumer goods whose price dynamics may depend on changes in global grain prices. The first group includes flour-based products: pasta and bread. The second group comprises livestock products (meat and milk), as feed grain is essential in making fodder. The third group covers goods whose prices are subject to a secondary effect of changes in grain prices (non-food goods).

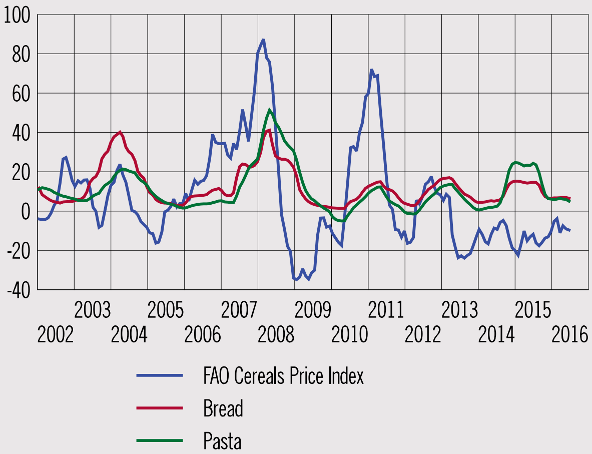
The results indicate that a shock in global grain prices has a significant impact on consumer prices for bread and pasta, and this impact persists for three quarters. The global price elasticity of consumer prices accumulated over this period is 0.18 and 0.33 respectively. The impact of global price changes on livestock prices (the second group) turned out to be negligible. The results are more than likely linked to the different shares of the cost of grain in the price of the finished goods. In 2015, it was 20-25% for bread and pasta[2], while for meat and milk it was less than 10%[3]. A low share of grain in the cost reduces the dependence of consumer prices on grain price fluctuations.

The secondary effect of price changes (the third group) was also negligible. The main reason for secondary inflation effects is the distribution of economic agents' price expectations for groups of goods and services which are not directly linked to the source of the shock. The secondary effects' lack of significance indicates that Russian households perceive pricing processes in certain markets to be local and to have no relationship with the prices of other goods. In addition, surveys show that most Russian households do not monitor the situation in the global markets and, as a result, do not even relate food price dynamics to the market climate.

Chart 1.24

World cereal prices and consumer prices of bread and pasta

(percent change on corresponding period of previous year)

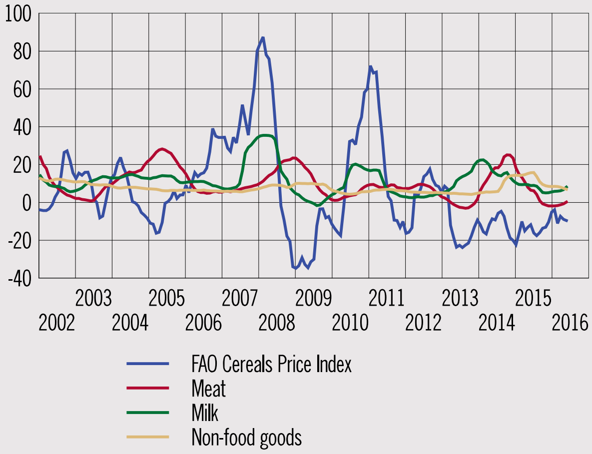


Sources: Rosstat, FAOstat.

Chart 1.25

World cereal prices and consumer prices of meat, milk and non-food goods

(percent change on corresponding period of previous year)



Sources: Rosstat, FAOstat.

[1] *From July 2015 to June 2016.*

[2] *Rosstat data.*

[3] *Rosstat data, Bank of Russia estimates.*

Table 1.2

Inflation expectations of economic agents

Survey	Expectation horizon	2014				2015				2016											
		I	II	III	IV	I	II	III	IV	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	16.7	15.7	14.7	14.6	13.6	14.2	14.3	12.6	14.2	12.3	13.7	12.4
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	10.8	7.8	7.4	7.2	6.5	6.7	6.9	6.4	5.9	5.8	5.6	5.2
Professional analysts																					
Bloomberg	2016						6.7	7.0	7.2	8.0	8.3	7.9	7.4	7.2	6.5	6.4	6.3	6.1	5.9	5.8	
Interfax	2016					7.0	6.7	7.4	7.6	8.5	8.3	7.6	7.4	7.3	6.7	6.6	6.2	6.0	5.8	5.7	
Thomson Reuters	2016								7.5	8.1	7.9	7.4	7.1	7.0	6.5	6.3	6.0	6.0	6.1	5.8	
Financial markets																					
OFZ-IN	next 7 years							6.4	5.8	6.2	6.1	5.4	5.2	5.0	4.6	4.6	4.4	4.5	4.5	4.8	
OFZ-IN (without option adjustment)	next 7 years							8.1	7.3	7.7	7.6	6.9	6.7	6.5	6.0	5.8	5.5	5.3	5.5	5.8	
Bond market	next quarter	7.1	7.2	7.9	8.4	10.7	15.1	14.2	14.2	—	—	12.4	—	—	7.3	—	—	7.6	—	—	6.9
Interbank market	next quarter	7.2	8.1	8.9	9.7	15.0	17.4	15.5	14.0	—	—	10.4	—	—	6.5	—	—	6.6	—	—	6.2
Inflation expectations (balance of replies*)																					
Households																					
Public Opinion Foundation	next 12 months	84	85	84	83	76	72	80	83	85	82	84	83	81	78	82	77	82	78	79	80
Public Opinion Foundation	next month	79	82	76	77	68	60	71	78	80	76	72	74	70	68	72	69	70	70	74	76
Enterprises																					
Russian Economic Barometer	next 3 months	26	26	32	70	32	20	28	48	46	22	14	16	30	38	28	26	36			
Bank of Russia (Banking Supervision Department)	next 3 months	14.3	12.4	13.9	30.3	14.8	12.7	12.1	17.3	15.6	13.6	12.4	11.5	11.5	12.1	10.1	9.9	10.4	10.1		
Retail prices (Rosstat)	next quarter	42	41	41	43	31	28	30	29	—	—	32	—	—	29	—	—	28	—	—	27
Tariffs (Rosstat)	next quarter	6	5	2	5	7	6	2	2	—	—	5	—	—	5	—	—	0	—	—	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, Russian Economic Barometer.

2. ECONOMIC OUTLOOK AND KEY RATE DECISION

Baseline scenario

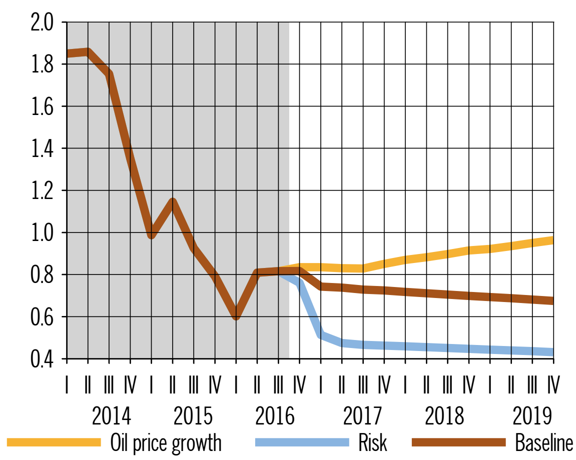
The baseline economic development scenario for Russia considered in the previous Report assumed that Urals crude price would fall to $40 per barrel in 2016 Q4 and remain close to that level on average over the three-year forecast horizon. The actual oil price was slightly higher than this level, at $45.3 per barrel in September-November 2016, amid expectations of a deal between OPEC member states to reduce oil production.

Although the deal was reached at the end of November, the path of oil prices will be shaped in the medium term by a wide range of varying factors. Uncertainty remains with respect to the actual implementation of the arrangement to restrict oil production. In addition, the reduction in supplies from OPEC may be offset by increased production at US shale deposits. An additional factor affecting growth in the supply to the oil market may be the resumption in supplies from Libya and Nigeria. Besides, a slight slowdown is forecast in the economic growth in China, which is the largest importer and a driver of growth in the global demand for oil.

Time is needed to reduce the uncertainty surrounding the overall impact of these factors.

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.

In these conditions, the Bank of Russia continues to maintain a conservative approach to the development of its baseline scenario assumptions. According to Bank of Russia estimates, a fall in oil prices from current levels to $40 per barrel in 2017–2019 is still likely. At the same time, the central bank admits that the situation in the oil market may turn out to be more favourable in 2017.

In October-November 2016, international organisations kept their global economic growth forecasts virtually unchanged[1]. Taking into account the structure of Russian foreign trade relations, the Bank of Russia's forecast of the average GDP growth in its trading partners also remained unchanged for 2017–2019 at roughly 2%, which is a conservative assessment. Amid the slow forecast growth in the global economy, inflation in Russia's trading partners will remain low, and the forecast for global food prices does not anticipate any perceptible increase compared with the average level for 2016[2]. As a result, the Bank of Russia does not expect foreign inflation to have any appreciable impact on domestic consumer price growth.

The US election results exacerbated uncertainty surrounding the macroeconomic and especially fiscal policy of the new US administration, which makes the Fed's monetary policy less predictable. At present, a significant spread is observed in the assessments of the future policy of the US monetary authorities, but the majority of market participants anticipate no more than three increases in the key rate in 2017. The Bank of Russia expects that the Fed will normalise its monetary policy gradually, taking into account the economic conditions, and anticipates that the Fed and other central banks in developed countries will maintain a broadly easy monetary policy. This will keep global financial market rates at a low level or will result in a relatively moderate growth.

[1] *The IMF forecasts global economic growth at 3.4% in 2017; the OECD improved its global economic growth forecast for 2017 from 3.2% to 3.3% and expects growth to be 3.6% in 2018.*

[2] *The Bank of Russia's forecast based on IMF and World Bank estimates.*

In its baseline scenario, the Bank of Russia assumes that the current heightened country risk premium for Russia and other EMEs will decline as the uncertainty surrounding the policies of the new US administration abates. This will lead to the country risk premium for Russia stabilising at a relatively low level, close to the average value for the second half of 2016, by the second half of 2017, given there are no significant fluctuations in oil prices.

The Bank of Russia assumes that the international financial sanctions will remain in force over the entire forecast horizon. However, like in 2015–2016, Russian companies and banks are expected to be able to continue to refinance most of their external debts. As the planned external debt repayments gradually reduce and economic activity recovers, the largest contribution to private capital outflow will come from the net increase in foreign assets. However, purchases of foreign assets while the sanctions are in force will be significantly lower compared with the levels observed in the 2010–2014 period. The net private capital outflow in 2017–2019 is expected to remain low. This will be aided in part by interest rate levels supporting the attractiveness of investment in ruble-denominated financial assets.

Monetary conditions will continue to be moderately tight for a relatively long time under the influence of monetary policy. This will mean, among other things, that positive real interest rates will remain in the economy. However, as inflation slows in line with the forecast, the Bank of Russia will resume key rate cutting, potentially as early as in the first half of 2017. Further, after inflation has fallen to 4% at the end of 2017 and inflation expectations have stabilised around this level, the Bank of Russia will reduce the tightness of its monetary policy. In these conditions, nominal rates will gradually decline in the economy. The Bank of Russia expects that banks will also gradually ease their non-price lending conditions and expand the range of lending types, all the while maintaining a conservative approach to borrower assessment. As a result, in 2017 the growth in banking sector lending to the economy will be moderate (4–7%) (Table 2.1). In 2018–2019, it is expected to accelerate to 8–11%.

Growth in money supply (according to the national definition) is estimated to continue to outstrip the increase in lending to the economy in 2017, at 8–11%. This will be primarily due to the contribution of net banking sector lending to the government, taking into account the continued spending of sovereign funds. Further, in the context of the fiscal consolidation, the contribution of net lending to the government to money supply will shrink. As a result, the growth in money supply in 2018–2019 will be close to the lending growth rates.

The growth in lending and money supply will accelerate amid the economic recovery and will not create any significant inflation risks.

The fiscal consolidation measures approved in December 2016 anticipate a further consistent reduction in the budget deficit towards a balanced path by 2020[3], which will have a slight constraining effect on business activity and make a further contribution to the reduction in inflation. The implementation of the long-term fiscal consolidation strategy will set up the conditions necessary to support the stability of government finances and the financial system, which is important to maintaining macroeconomic stability in the medium and long-term horizon. According to Bank of Russia estimates, if the approved fiscal consolidation plans for 2017 are implemented, the increase in the wages of certain employee categories pursuant to the Decree[4] of the Russian Federation President (hereinafter, the Decree), dated 7 May 2012, will not create any significant inflation risks in 2017, given that the wage fund for employees falling under this Decree, as a percentage of the total wage fund, is relatively low, and the indexation stipulated in the Decree will not result in any further increase in the budget deficit.

In stable foreign economic conditions and with relatively tight internal financial conditions and a conservative fiscal policy, economic activity will gradually recover relatively evenly in 2017–2019. Positive real deposit rates will help to maintain savings incentives, which will cause moderate growth in consumer spending (by 0.6–1.0%) in 2017. In 2018–2019, as income grows, sentiment improves and consumer lending revives, household

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[3] *In accordance with the fiscal consolidation measures approved by the Federal Law 'On the Federal Budget for 2017 and the Plan Period of 2018 and 2019', the federal budget deficit is expected to reduce to 3%, 2% and 1% in 2017, 2018 and 2019 respectively.*

[4] *Decree of the Russian Federation President No. 597 dated 7 May 2012 'On Measures to Implement State Social Policy'.*

Table 2.1

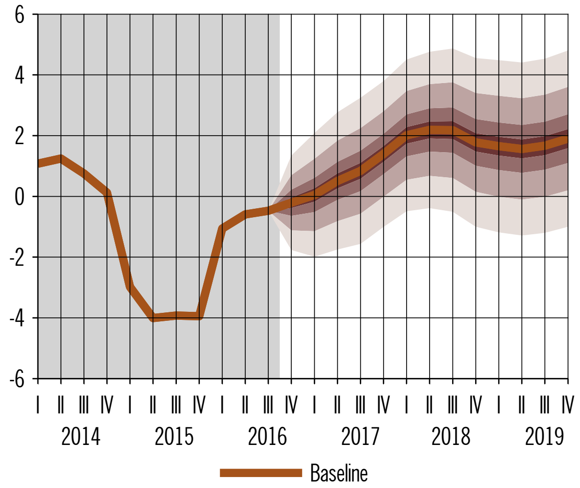
Key parameters of the Bank of Russia's forecast
(as % of previous year. unless indicated otherwise)

	2016	2017			2018			2019		
	Baseline scenario	Baseline scenario	Higher oil price scenario	Risk scenario	Baseline scenario	Higher oil price scenario	Risk scenario	Baseline scenario	Higher oil price scenario	Risk scenario
Urals price. average for the year. US dollars per barrel	41	40	46	25	40	50	25	40	55	25
Inflation. % in December year-on-year	5.4-5.8	4.0	4.0	5.0-6.0	4.0	4.0	4.0-4.5	4.0	4.0	4.0
Gross domestic product	-(0.7-0.5)	0.5-1.0	1.2-1.7	-(1.5-1.0)	1.5-2.0	2.0-2.5	-(0.5-0.1)	1.5-2.0	2.0-2.5	1.3-1.7
Final consumption expenditure	-(3.8-3.6)	0.3-0.7	1.8-2.2	-(2.7-2.3)	2.5-3.0	2.9-3.3	-(1.0-0.5)	2.0-2.5	2.9-3.3	1.3-1.8
– households	*-(4.6-4.2)*	*0.6-1.0*	*2.5-2.9*	*-(3.5-3.0)*	*3.5-4.0*	*4.0-4.4*	*-(1.5-1.0)*	*3.0-3.5*	*4.0-4.4*	*2.0-2.5*
Gross formation	5.0-5.5	2.2-3.0	3.1-3.9	-(6.0-5.0)	2.0-2.5	3.1-3.9	-(1.0-0.0)	2.0-2.5	3.1-3.9	0.5-1.5
– gross fixed capital formation	*-(4.5-4.0)*	*1.2-1.7*	*1.5-2.0*	*-(6.5-5.5)*	*2.0-2.5*	*3.7-4.2*	*-(1.2-0.8)*	*1.8-2.3*	*3.7-4.2*	*0.5-1.0*
Net exports	8.5-11.2	-(6.5-2.4)	-(17.7-13.6)	34.2-38.7	-(11.9-7.8)	-(21.1-17.0)	10.0-13.3	-(10.6-5.6)	-(21.1-17.0)	2.5-7.0
– exports	*-(1.2-0.8)*	*1.3-1.7*	*0.6-1.2*	*1.7-2.2*	*0.7-1.2*	*0.5-1.0*	*0.7-1.1*	*0.7-1.2*	*0.5-1.0*	*1.3-1.8*
– imports	*-(5.5-5.0)*	*2.6-3.0*	*4.2-4.6*	*-(5.8-5.4)*	*3.7-4.2*	*6.0-6.5*	*-(2.3-1.9)*	*3.0-3.5*	*6.0-6.5*	*0.5-1.0*
Money supply in national definition	8-11	8-11	13-15	8-10	8-11	13-15	7-9	7-10	7-10	8-10
Monetary base in narrow definition	3-7	4-8	4-8	0-3	5-7	4-8	3-5	4-6	4-8	4-6
Loans to non-financial organisations and households in rubles and foreign currency	0-3	4-7	8-12	0-3	8-10	9-13	2-4	9-11	9-13	8-10

Chart 2.2

GDP growth rate

(percent change on corresponding period of previous year)

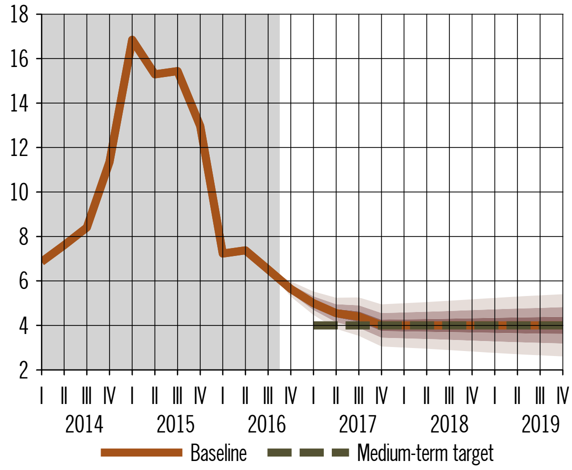


Source: Bank of Russia calculations.

Chart 2.3

Inflation

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

final consumption expenditure will increase by 3–4%.

Investment activity will recover amid improved business expectations regarding Russian economic outlook, a gradual easing in lending conditions, and a reduction in the debt burden. Annual gross fixed capital formation growth will gradually pick up from 1.2–1.7% in 2017 to 1.8–2.5% in 2018–2019. The change in inventories will buoy growth in gross formation in 2017–2018 against the backdrop of improved consumer demand dynamics.

The Bank of Russia expects that import substitution processes and the development of non-commodity exports will continue, but will be moderate, as in 2016. However, as household income grows, internal demand will recover not only for domestic, but also for imported goods. The forecast increase in imports volume was adjusted upwards, taking into account current dynamics, to 2.6–3.0% in 2017 and to roughly 3–4% in 2018–2019. External demand for Russian goods amid the restrained global growth and relative excess capacity in the global economy will remain weak, causing the growth in non-oil and gas exports to remain at a moderate level. The expected reduction in Russia's oil production as a result of its assumed obligations under the November agreement between OPEC member states will slightly reduce the growth in oil and gas exports, according to Bank of Russia estimates, but will not drag heavily on economic growth rates over the forecast horizon. As a result, annual growth in actual exports volumes will be 1.3–1.7% in 2017 and no more than 1.2% in 2018–2019. Taking into account the rapid growth in imports, net exports' contribution to GDP will be negative in 2017–2019, which is normal during the recovery phase of the economic cycle.

Under the influence of the internal and external factors mentioned above, in 2017, economic activity is expected to show signs of a gradual recovery and GDP growth will move into the positive territory. The economic growth forecast has remained unchanged: in 2017 GDP will increase by 0.5–1.0%, followed by an accelerated recovery growth in the economy by 1.5–2.0% in 2018–2019. Economic growth will further slow to 1.0–1.5%, which is in line with the estimates of the Russian economy's medium-term potential, taking into account the current structural constraints.

Annual inflation will continue to slow from 5.4–5.8% in 2016 to 4% at the end of 2017. The main factor behind the fall in inflation will be the restrained demand caused the high savings rates. Further down the line, inflation is expected to stabilise around its target level.

Amid the stable foreign economic situation and moderately tight monetary policy, foreign exchange dynamics will not have a significant impact on price growth. Another factor hampering inflation will be the slowdown in producer price growth coupled by the moderate indexation of administered prices of, and tariffs on, services provided by natural monopolies and the persistently low energy prices. Additionally, as inflation will slow, inflation expectations will fall. The Bank of Russia admits that a decrease in inflation expectations over a certain time could lag behind the slowdown in actual inflation. In future, the consistent monetary policy and keeping inflation close to 4% will help to stabilise inflation expectations around the target range.

It cannot be ruled out that the pass-through factors maintaining moderate oil prices under the baseline scenario will grow gradually. This will cause a smoother reduction in oil prices in 2017 and push average prices for the year well above $40 per barrel. In this situation, GDP growth in 2017 will be slightly higher than assumed in the baseline scenario, but the improvement in GDP dynamics will be short-lived and will be offset by lower economic growth rates in 2018. The slowdown in inflation in the first half of 2017 may evolve faster amid the more favourable exchange rate dynamics, which will help to bring down inflation expectations.

With the on-going uncertainty surrounding developments in the global economic situation and in the global financial and commodity markets, alongside the baseline scenario, the Bank of Russia is also considering a scenario assuming an increase in oil prices and a risk scenario.

Scenario with rising oil prices

This scenario assumes that Urals crude prices will gradually rise in 2017–2019 to $55 per barrel and remain at this level further. Conditions for trade could evolve along this trajectory in the event of a more dynamic growth in the global economy, increased investor optimism in global markets and lower risks to growth in major EMEs, especially in China. The scenario anticipates that global central banks will gradually raise interest rates and that the pace of this increase will be slightly higher than in the baseline scenario. A cut in oil production by OPEC member states to the extent stipulated in the November oil deal will drastically increase the likelihood of the situation developing in line with the scenario in which oil prices rise compared with the previous Report.

Faster growth in receipts from foreign economic activity and the revision of economic agents' and foreign investors' expectations regarding the Russian economic outlook will lead to a more confident recovery in economic activity than in the baseline scenario. This will feed through to a more rapid increase in both consumption and investment. GDP growth will exceed 1% in 2017 and accelerate to 2.0–2.5% in 2018–2019. However, the increase in economic growth will be short-lived, being fueled by rising oil prices and recovery in economic processes. Further economic growth will be constrained by structural factors and will stabilise at around 1.5%, as in the baseline scenario.

The drag of improved terms of trade on inflation will be mixed. The moderating impact on inflation produced by the ruble appreciation is expected to be stronger than the pro-inflationary effect induced by increasing incomes and improving sentiment of economic agents. Inflation may be delivered to the target range sooner in this case than in the baseline scenario. In future, growth in demand will be supported by the recovery in investment and production and will not generate any additional inflationary pressure. In these conditions, the Bank of Russia will be able to ease the monetary policy stance faster to the extent that this does not create a risk causing inflation to deviate from its target.

Amid more favourable external climate and growth in receipts from foreign trade operations, the budget deficit is likely to contract faster, meaning there is potential for funds to be allocated to the Reserve Fund. According to Bank of Russia estimates, these funds may start to arrive as early as 2019, although the amount will be small over the course of the year.

In this scenario, the Bank of Russia does not rule out purchasing foreign currency with a view to increasing its international reserves, including in the framework of budget rule provisions designed for the transition period. The scale of these operations will be determined in such a way as to not have a marked impact on the ruble's exchange rate dynamics.

The current account balance and net capital outflow will increase over 2017–2019, exceeding baseline scenario parameters. Growth in oil prices in this period will be the main driver of growth in current account earnings, while the higher capital outflow will be down to the private sector's demand for foreign assets amid higher incomes and stronger ruble than in the baseline scenario. Credit institutions are expected to repay their debts on Bank of Russia foreign currency refinancing operations in 2017, which will eventually lead to the increase in international reserves.

Table 2.2

Russia's balance of payment indicators*
(USD, bn)

	2016	2017			2018			2019		
	Baseline scenario	Baseline scenario	Higher oil price scenario	Risk scenario	Baseline scenario	Higher oil price scenario	Risk scenario	Baseline scenario	Higher oil price scenario	Risk scenario
Current account	**22**	**15**	**25**	**12**	**19**	**28**	**12**	**18**	**37**	**11**
Balance of trade	85	83	98	74	87	112	73	89	129	75
Exports	*274*	*283*	*313*	*220*	*294*	*358*	*212*	*308*	*390*	*222*
Imports	*-190*	*-201*	*-215*	*-146*	*-207*	*-245*	*-139*	*-219*	*-261*	*-147*
Balance of services	-22	-26	-29	-25	-25	-37	-22	-27	-41	-24
Exports	*51*	*53*	*54*	*46*	*56*	*59*	*46*	*58*	*59*	*48*
Imports	*-74*	*-80*	*-83*	*-71*	*-81*	*-96*	*-68*	*-85*	*-100*	*-72*
Primary and secondary income balance	-40	-42	-44	-37	-43	-47	-39	-43	-51	-40
Capital account	-1	0	0	0	0	0	0	0	0	0
Current and capital account balance	**21**	**15**	**25**	**12**	**19**	**28**	**12**	**18**	**37**	**11**
Financial account (excluding reserve assets)	**-7**	**-7**	**-17**	**-20**	**-19**	**-28**	**-12**	**-18**	**-37**	**-11**
General government and the central bank	11	6	6	4	3	3	3	3	3	3
Net private capital outflow (including net errors and omissions)	-18	-13	-23	-24	-22	-31	-15	-21	-40	-14
Change in FX reserves («+» – decrease, «-» – increase)	**-14**	**-8**	**-8**	**8**	**0**	**0**	**0**	**0**	**0**	**0**

* *According to BPM5.*

Risk scenario

The risk scenario, which the Bank of Russia also considers to be one of the possible ways that events could unfold, assumes a significant deterioration in the terms of trade. The likelihood of this scenario occurring has reduced slightly as a result of the agreement reached between oil exporting countries, however, it would be premature to rule it out entirely at the present time. The fall in oil prices assumed in this scenario could occur if the global economy slows and the growth in global oil demand wanes. Amid a significant reduction in oil prices, the agreement between exporting nations to restrict production could prove unstable. A more rapid normalisation of the Fed's monetary policy could also exert further downward pressure on the market climate. In the context of these factors, a decrease in oil prices from current levels to $25 per barrel at the start of 2017 is likely. Prices are then expected to remain close to this level until the end of 2019.

A significant and steady downturn in the terms of trade will lead to a continued economic recession in 2017–2018 against the backdrop of worsening expectations regarding Russian economic outlook and a further reduction in Russia's investment appeal to domestic and foreign investors. This will be reflected in a more intensive capital outflow and the ruble depreciation, which could lead to a reduction in the solvency of borrowers with debt in foreign currency. In the event of risks to Russian companies' and credit institutions' ability to service their external debts, the Bank of Russia will be ready to increase the amount of foreign currency refinancing operations.

A marked reduction in tax receipts from the oil and gas sector amid the limited opportunities for budget debt refinancing may require a reduction in budget expenditure. In these conditions, a slight increase in the budget deficit cannot be ruled out in 2017, however the Bank of Russia expects to maintain its conservative approach to public finance further and to continue the implementation of the fiscal consolidation strategy.

An unfavourable turn of events will cause a decrease in GDP in 2017–2018, but it will be negligible, not exceeding 1.5% p.a., given the increased resilience of the Russian economy to fluctuations in the foreign economic situation.

Instability in the global trade and financial markets may lead to elevated exchange rate volatility in EMEs, including ruble volatility, which will intensify inflation risks and cause economic agents to revise their inflation and exchange rate expectations. As a result, inflation will decrease slower than in the baseline scenario and by the end of 2018 it can reach 4.0–4.5%, hitting its target level in the first half of 2019.

To mitigate inflation risks, the Bank of Russia will implement a tighter monetary policy than in the baseline scenario. The central bank will monitor any possible threats to financial stability and will be ready to use various instruments, including foreign exchange interventions, to maintain stability.

Medium-term forecast risks

Under any of the considered scenarios, the Bank of Russia does not rule out the possibility of additional risks which can have an impact on consumer price dynamics. These risks are primarily linked to the possible persistence of high inflation expectations over the long-term horizon and premature changes in household savings behaviour.

Based on existing data, it is still too early to speak of any stable downward trends in inflation expectations. Elevated expectations amid the slowing inflation in the second half of 2016 point to the high degree of inertia in these indicators. In future, this could hamper the fall in inflation, which the Bank of Russia considers to be the most significant inflation risk.

Another source of risk is the possibility that household spending on final consumption will grow faster than income recovers, which could cause further inflationary pressure.

The likelihood of these risks materialisation via the fiscal policy channel has significantly reduced given the approval of fiscal consolidation plans. However, more significant growth in budgetary expenditure could lead to an increase in inflation risks.

Should these inflation risks intensify or materialise, the Bank of Russia will assess the need to adjust the degree of tightness of its monetary policy.

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Considering that the situation in the Russian economy and inflation dynamics were broadly in line with the forecast and inflation risks reduced somewhat, the Bank of Russia decided to maintain its key rate at 10.00% in December 2016, with the option of reducing it in the first half of 2017. In its future decision-making, the Bank of Russia will assess inflation risks and the extent to which economic and inflation dynamics correspond to the baseline forecast.

ANNEX

Dynamics of major items in the Russian balance of payments in 2016 Q3

The more than fourfold decrease[1] in the current account surplus in 2016 Q3 should not be viewed as an extremely negative trend as it was caused by the difference in global commodity prices in the current and previous year, while actual export volumes remained high. In addition, it was driven by expanded imports, primarily investment goods, amid signs of the situation improving in the Russian economy. The squeeze of the trade balance was offset in part by the reduction in the deficit of the balance of services, primarily through the fall of imports in the 'Travel' item following the suspension of flights to Egypt (one of the most popular destinations for Russian tourists abroad). However, compared with the same period in the previous year, in 2016 Q3, the investment income deficit increased for the first time in several years. In 2015, given a reduction in external debt and, accordingly, in external debt payments, the $26 billion drop in investment income balance made the main contribution to the $11.5 billion growth in the current account surplus. In 2016, the contraction in external debt slowed and, as a result, external debt interest payments did not decrease in 2016 Q3 as much as before. Following the reduction in the Russian private sector's (mostly banks) foreign assets in 2015–2016, the associated investment income also fell.

The decline in the trade surplus slowed from 49% in Q2 to 35% in Q3. The annual fall in exports decreased from roughly 26% to 10% amid record oil production volumes in Russia. Actual exports of crude oil and petroleum products rose overall by 3% in 2016 Q3, while for natural gas they rose by 4% according to FCS data. At the same time, with the 4% increase in actual exports of crude oil, supplies of petroleum products shrank slightly due to the partial re-orientation towards crude oil in connection with the implementation of a tax manoeuvre. Global commodity prices, constituting the bulk of Russian exports, exhibited varied trends, but generally shifted upwards in recent months. However, they remained low compared with 2015 Q3 (Urals crude price fell by 12% and the price of natural gas in the European market lost 36%).

In 2016 Q3, the negative impact of the fall in exports on the current account was no longer offset by shrinking imports. The imports of goods, after a 4% fall in 2016 Q2 year on year, picked up by 5% in Q3 amid the strengthening of the ruble and the slight recovery in business activity. The greatest contribution to the increase in imports came from machinery, equipment and vehicles, which accounted for half of goods imports. The potential for a further increase in total imports is limited by low economic growth expectations. An expansion in imports will be also constrained by foreign trade restrictions. However, the foreign exchange base effect can cause fluctuations in imports growth rates during some periods.

In 2016 Q3, net private capital outflow[2] increased from $0.1 billion to $6.0 billion. This was due to the fact that, unlike in 2015 Q3, foreign liabilities were reduced by both banks and other sectors. In 2016 Q3, the amount by which banks reduced their foreign liabilities roughly halved, to approximately $7 billion, which was in line with the amounts on the external debt repayment schedule. Due external debt repayments were sufficiently funded by the sales of foreign assets amid the reduction in the amount of FX liquidity provided by the Bank of Russia to credit institutions on a reverse basis. In 2016 Q3, other sectors also reduced their foreign liabilities (by $3 billion), but by significantly smaller

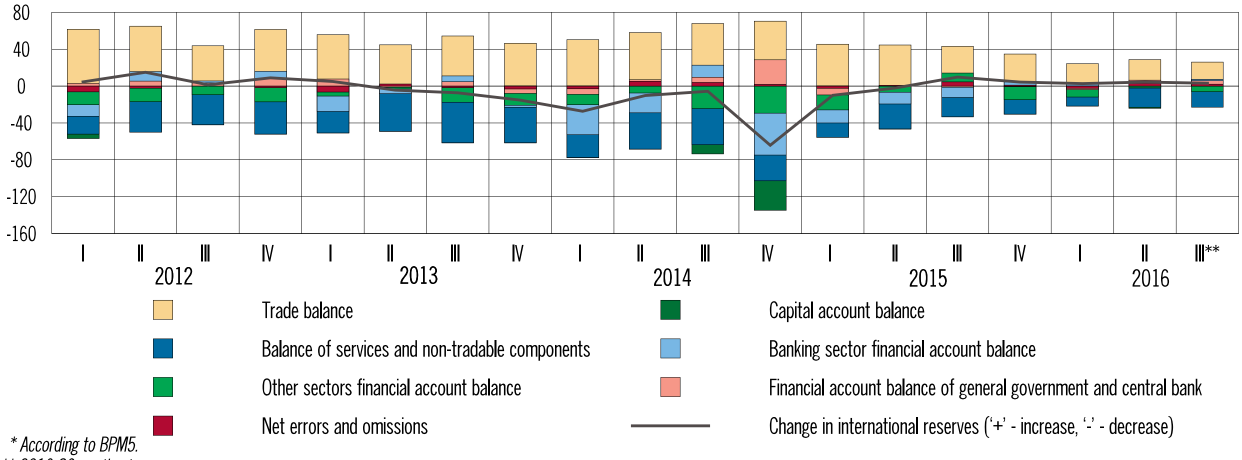
[1] Hereinafter, changes are relative to the corresponding period of the previous year, unless otherwise indicated.

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

Chart 1

Major balance of payments components*

(billions of US dollars)



* According to BPM5.
** 2016 Q3 - estimate.
Source: Bank of Russia.

amounts than those stipulated in the external debt repayment schedule ($19 billion). They managed to refinance a substantial proportion of their foreign debt, despite the sanctions. Since the start of the year, funds attracted by other sectors have exceeded the amounts they have spent on external debt repayment. The inflow of funds in the form of direct investment offset the repayment of debt on borrowings and loans.

The reduction in banks' and companies' foreign liabilities in 2016 Q3 still made the main contribution to the net private capital outflow. Additionally, as economic agents' revenues improved, bigger contribution to capital outflow has been consistently made by the buildup of foreign assets, primarily by other sectors.

Balance of payments forecast for 2016-2019

The balance of payments forecast has been adjusted slightly compared with the forecast presented in the previous Report taking into account the release of actual balance of payments data and an updated forecast for a number of macroeconomic indicators[1].

The baseline scenario still assumes that oil prices will fall to $40 per barrel in 2017 Q1 and will stabilise close to this level until 2019. The arrangements on restricting oil production by exporting countries will very likely provide only a short-term support for oil prices. The reduction in production by OPEC coupled by an increase in prices could be offset by a more rapid recovery in production in the USA in view of the growing drilling activity and higher productivity at shale deposits. A further fall in prices from the current higher level will also come from increased supplies from Libya and Nigeria, which are not affected by the restrictions in the OPEC deal, the strengthening of the US dollar due to the increase in the Fed's rates, and substantial oil reserves. However, weak growth in global demand will not provide a significant support for energy prices.

Given the fall in global oil and gas prices[2] and actual supply volumes remaining high[3], the value of goods exports will reduce in 2016 by almost 20% year on year. Nevertheless, compared with the previous period, goods exports will increase in 2016 Q3 for the second quarter in a row. This trend is expected to remain in 2016 Q4. In 2017–2019, amid stable oil prices and a recovery in global prices for other commodities, the value of exports is expected to gradually increase in the context of the moderate growth in external demand. However, the exports forecast has been adjusted downwards compared with the previous Report, in part due to the statement by Russia's energy minister following the OPEC deal that oil production in Russia will decrease by 300,000 barrels per day in the first six months of 2017.

In turn, the forecast for goods imports has been slightly raised compared with the previous Report, taking into account the faster than expected recovery in imports in Q3. The marked strengthening of the ruble, which has been on-going since the start of 2016, will contribute to the further growth in imports. Overall, the value of imports will fall by less than 2% in 2016. In 2017–2019, imports will increase together with renewed consumption as the Russian economy grows.

The balance of services deficit, which provided significant support for the current account when the deficit reduced in 2015–2016, will in contrast grow in 2017–2019 due to increased imports of tourism services. The resumption of charter flights between Russia and Turkey, which came about after the ban introduced on 1 December 2015 was lifted at the end of August 2016, will contribute to growth in imports of tourism services. Furthermore, the expected resumption of flights to Egypt could also have a favourable impact on the imports of tourism services.

The negative balance of non-tradable components will continue to be low. At the same time, with the shift in the private sector's focus toward a net foreign liability position, interest payments on external debt will increase and the investment income deficit will consequently grow.

As a result of the gradual recovery in goods exports, the more rapid growth in goods imports and the increase in the balance of services and non-tradable components deficit, the current account surplus will significantly decrease in 2017 in the baseline scenario, however in 2018–2019 it will stabilise at a level slightly below $20 billion. Taking into account the revised estimates for imports and exports, the current account surplus forecast has been reduced compared with the previous Report.

The forecast of the net private capital outflow in 2017–2019 has also been adjusted downwards, because with lower current account revenues, the Russian private sector will have less funds to purchase foreign assets.

Like in 2015, the main component of the private capital outflow in 2016 will be the forced (amid ongoing international sanctions) settlement

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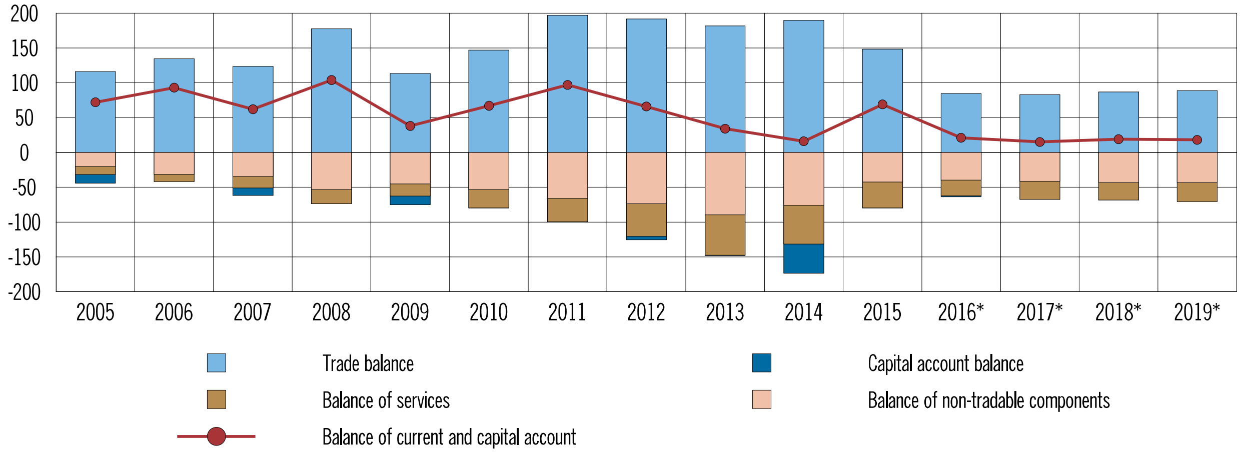
[1] See section 2 'Economic outlook and key rate decision'.

[2] The average price of Urals crude in 2016 will fall by 20% to $41 per barrel in the baseline scenario. According to World Bank data, natural gas prices (11% of exports in January-September 2016) fell by 39% in the European market (Russia's main market) in January-November 2016 compared with the same period in 2015.

[3] Actual exports of crude oil and natural gas increased by 6% and 5% respectively in January-October 2016, according to FCS data, although the exports of oil products fell by 10%.

Chart 1

Major current account components
(billions of US dollars)



Baseline scenario forecast.
Source: Bank of Russia.

of external liabilities by Russian companies and banks. However, the impact of the sanctions is gradually weakening, the amount of external debt repayments is reducing, and companies are successfully refinancing their external debt[4]. With the expected continued growth in liabilities in the form of direct investment and the partial refinancing of debts, the actual total net reduction in private sector liabilities is estimated to be significantly lower overall in 2016 than set out in the external debt repayment schedule. Compared with the previous Report, the estimate of the reduction in liabilities has been raised slightly, taking into account certain deterioration in external borrowing conditions for EMEs amid the decrease in investor risk appetite, which is linked to growing uncertainty surrounding US economic policy following the presidential elections[5], including the speed at which the Fed will raise rates. This situation will likely to remain in the first few months of 2017. As the economic situation improves and, consequently, Russia's appeal increases in the eyes of foreign investors, companies' opportunities to use sources not affected by the sanctions will expand. The amount of capital outflow associated with the net reduction in liabilities will continue to decline in 2017, and for 2018–2019 the forecast suggests a net increase in liabilities to non-residents.

The private capital outflow linked to the demand among Russian banks and companies for foreign assets will resume amid economic agents' growing income and, from 2017, will again become the main component of the overall net private capital outflow. However, against the backdrop of the forecast low economic growth, the financial position of the Russian private sector will improve gradually. Some liquid foreign assets will be used to fund payments on liabilities, including the repayment of banks' debt on Bank of Russia foreign currency refinancing operations.

As a result, after a fall in 2016–2017 due to reduced external debt repayments, the net private capital outflow will grow in 2018–2019 to roughly $20 billion due to an increase in foreign assets, but will remain low by historical standards.

However, a net capital inflow is expected in the government sector. The forecast growth in the foreign liabilities of government sector has been upgraded as a result of foreign investors' higher than previously expected interest in Russian government securities.

According to the scenario assuming that oil prices will gradually increase over three-year horizon to $55 per barrel on average by 2019 and global economic growth rates will be generally higher[6], the value of exports in 2017–2019 will be higher than in the baseline scenario. Robust economic growth in Russia combined with a stronger ruble will also lead to an accelerated growth in imports. This growth in

[4] *In 2016 Q1–Q3, other sectors managed to increase their foreign liabilities by $2 billion, while the schedule envisaged the repayment of $53 billion in foreign debt.*

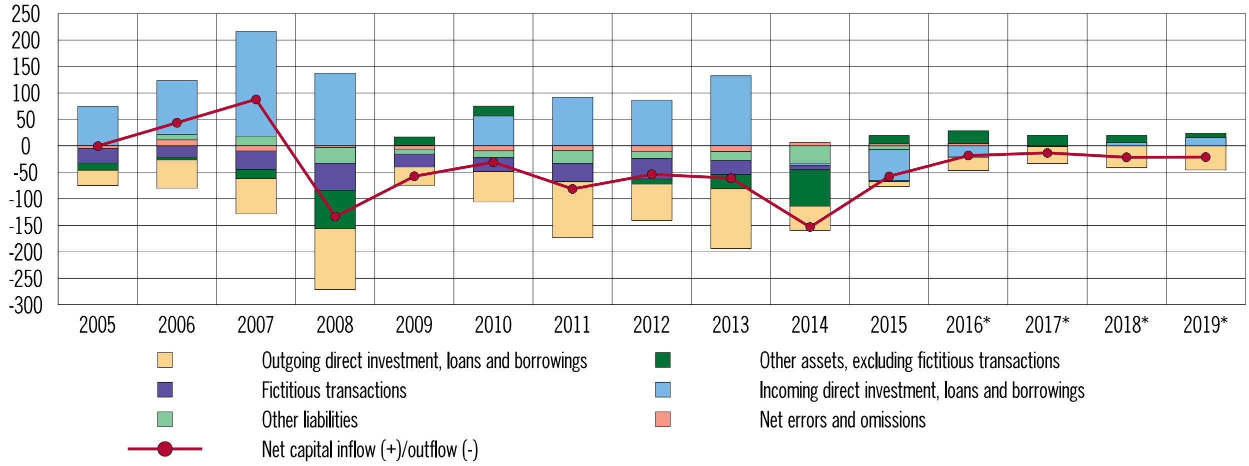
[5] *See box 'US election results'.*

[6] *See Section 2 'Economic outlook and key rate decision''.*

Chart 2

Private capital inflow/outflow*

(billions of US dollars)



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

exports will outstrip the recovery in imports and, as a result, the current account balance in 2017–2019 will gradually grow and will end up generally higher compared with the baseline scenario. At the same time, amid the growth in oil prices, the improved perception of Russian economic outlook by foreign investors and increase in Russia's investment appeal will set up more favourable external borrowing conditions for resident companies. However, the simultaneous increase in investment in foreign assets by economic agents as their revenues gradually grow will materially increase their liabilities, meaning that the capital outflow in this scenario will increase considerably compared with the baseline scenario. As in the baseline scenario, credit institutions will be able to fully repay their debts on foreign exchange repos with the Bank of Russia by the end of 2017, which will lead to growth in international reserves.

If the Bank of Russia's scenario in which oil prices reduce to $25 per barrel in 2017 and remain close to this range until the end of 2019 materialises[7], this will result in a significant contraction in exports compared with the baseline scenario. At the same time, a persistent recession in the economy in 2017–2018 will lead to a fall in demand for imported goods compared with the baseline scenario. The fall in the value of exports is expected to be greater than the fall in imports, and the current account surplus is expected to decrease markedly in 2017–2018. The net reduction in liabilities will grow significantly as external financing conditions tighten and the Fed's monetary policy quickly normalises, therefore investment in Russia will become less appealing to foreign investors and it will become more difficult (compared with the baseline scenario) to refinance existing loans and obtain new ones. All this means that the capital outflow in 2017 will be considerably higher in the risk scenario than in the baseline scenario. In future, with incomes falling, demand for foreign assets among residents will be far weaker and, consequently, the private capital outflow will be slightly lower in 2018–2019 than in the baseline scenario. Given the above, the Bank of Russia does not rule out the possibility of increasing the amount of its foreign currency provision operations on a reverse basis in 2017–2019 to avoid risks to financial stability, should companies and banks experience difficulties in funding their external debt payments.

[7] *See Section 2 'Economic outlook and key rate decision'.*

Statistical analysis of differences in economic development of Russian regions

Figures reflecting growth in the regions[1] improved in January-October 2016 and became more uniform.

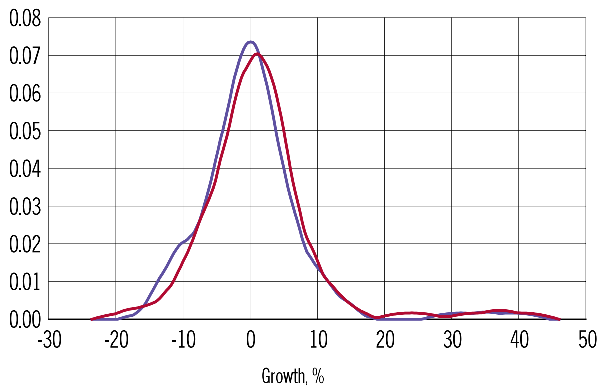
In the period between January and October, production activity recovered in most Russian regions, but was still insufficient to ensure sustainable production growth in the country. However, the recovery was unstable and varied across regions (Chart 1). In 12 constituent entities of the Russian Federation, industrial production contracted by more than 4%, while in 21 regions it grew by more than 5%. Production fell considerably mostly in the Far Eastern and North Caucasian federal districts. An increase in production was seen both in industrially developed regions (due to the existing growth points) and in less economically developed regions (due to the low base).

Nominal wages in most regions grew faster in the period between January and September 2016 compared with the same period in the previous year. Furthermore, the differences between regions with high and low nominal wage growth became less pronounced (Chart 2). Most constituent entities enjoyed moderate wage growth (from 5% to 6.5%), but in a large number of regions wage growth still remained sluggish: in 12 regions wages increased by merely 4%.

As incomes other than wages were down, households retained their propensity to save in January-October 2016. This is reflected in the on-going trend of reduced spending to purchase goods. In most Russian regions, the year-on-year reduction in retail trade turnover continued in January-October 2016. However, it slowed significantly compared with the same period in the previous year, and the gap between regions with high and moderate reductions in this figure shrank considerably (Chart 3). While in January-October 2015, a more than 5% decline in retail trade turnover was witnessed

Chart 1

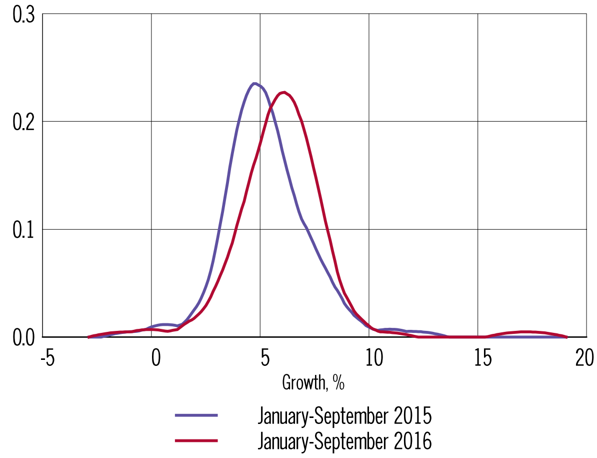
Distribution of regions by actual manufacturing output growth rate
(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 2

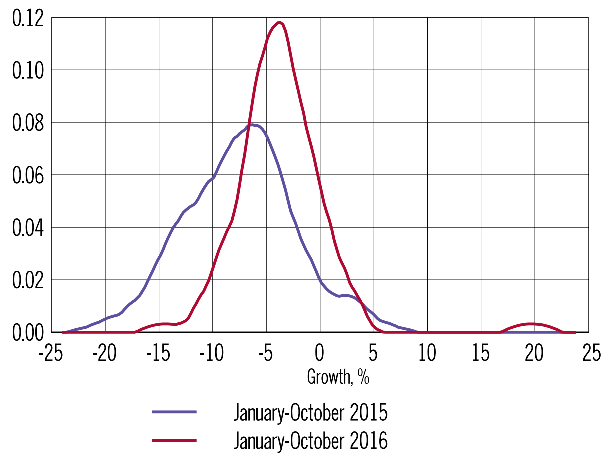
Distribution of regions by nominal wage growth rate
(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 3

Distribution of regions by retail trade turnover growth rate
(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

[1] *82 regions were examined, including Crimea and Sevastopol.*

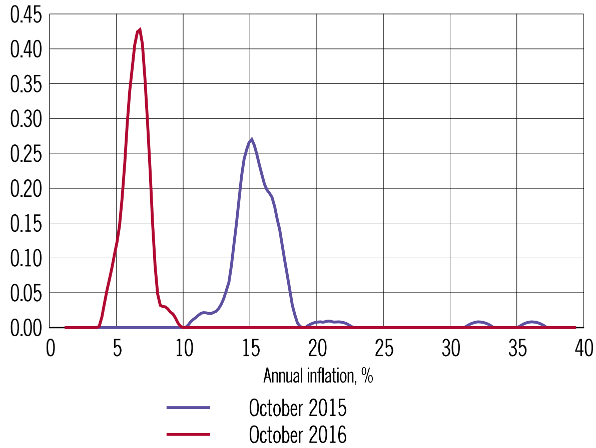
in 75% of regions; in January-October 2016, this share reduced to 40%. The greatest slowdown in the decline of this figure was observed in regions where retail trade turnover reduced the most over the past year, i.e. as a result of the low base effect.

In October 2016, consumer price growth continued to slow. The number of regions with high price growth shrank significantly (Chart 4). Weak household demand for goods and services, the ruble's exchange rate dynamics, and the high supply of agricultural produce amid the record harvest largely pushed inflation downwards. In five constituent entities (Republic of Mordovia, Udmurt Republic, and the Saratov, Orenburg and Magadan Regions), annual inflation was roughly 4% at the end of October, largely down to the specifics of these regions' development.

Chart 4

Distribution of regions by annual inflation

(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

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

Updating the composition of credit institutions' reservable liabilities to be included in required reserve calculations.	On 25 November 2016, the Bank of Russia decided to update the reservable liabilities of credit institutions to be included in their required reserve calculations. This decision stipulated that the reservable liabilities would not include liabilities on subordinate instruments and issued bonds with maturity of more than three years not subject to early redemption. This update of the composition of reservable liabilities reverses the ineffective measure to exempt corporate deposits and bonds with maturity of more than three years not subject to early redemption from reserve provisions. Due to the change in the procedure for compiling credit institutions' daily balances, the method used to calculate required reserve amounts was also updated. In addition, the decision was made to relax measures imposed on credit institutions for violation of required reserve regulations. Prospective easing of measures imposed on credit institutions for insufficient contributions to required reserves or failure to average required reserves will encourage banks to notify the Bank of Russia of any violations of required reserve regulations of their own accord. The corresponding Bank of Russia Ordinance No. 507-P, dated 1 December 2015, 'On Credit Institutions' Required Reserves' was approved by the Bank of Russia Board of Directors. With effect from 1 January 2017, required reserve ratios for long-term liabilities have been set at the level of existing ratios for the corresponding categories of liabilities (this will come into effect beginning with the payment of required reserves for January 2017); the required reserve averaging ratio used by banks and non-bank credit institutions has been left unchanged.
Expansion of the Bank of Russia Lombard List.	According to the decisions of the Bank of Russia Board of Directors of 30 September, and 2 and 30 November 2016, 45 securities issues were added to the Bank of Russia Lombard List.

Table 2

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

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.15	From 2.02.15	From 16.03.15	From 5.05.15	From 16.06.15	From 3.08.15	From 14.06.16	From 19.09.16
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by gold, non-marketable assets or guarantees; FX swaps (ruble leg); repos	1 day	daily	18.00	16.00	15.00	13.50	12.50	12.00	11.50	11.00
		Loans secured by gold	from 2 to 549 days[1]		18.50	16.50	15.50	14.00	13.00	12.50	12.00	11.50
		Loans secured by non-marketable assets or guarantees			18.75	16.75	15.75	14.25	13.25	12.75	12.25	11.75
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets	3 months[1]	monthly	17.25	15.25	14.25	12.75	11.75	11.25	10.75	10.25
			from 1 to 3 weeks[2]	occasionally								
			18 months[1,2]									
		Lombard loan auctions	36 months[1,2]									
		Repo auctions	1 week	weekly	17.00 (key rate)	15.00 (key rate)	14.00 (key rate)	12.50 (key rate)	11.50 (key rate)	11.00 (key rate)	10.50 (key rate)	10.00 (key rate)
			from 1 to 6 days[3]	occasionally								
		FX swap auctions	from 1 to 2 days[3]									
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days[3]									
			1 week[4]	weekly								
	Standing facilities	Deposit operations	1 day, call	daily	16.00	14.00	13.00	11.50	10.50	10.00	9.50	9.00

[1] Loans provided at a floating interest rate linked to the Bank of Russia key rate.
[2] Operations have been suspended since 1 July 2016.
[3] Fine-tuning operations.
[4] The Bank of Russia holds repo auctions amid structural liquidity deficit. See press-release http://www.cbr.ru/eng/press/PR.aspx?file=19012015_173846eng2015-01-19T17_35_59.htm.
Memo item: In 2015, the Bank of Russia refinancing rate was 8.25% p.a. From 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date. From 1 January 2016, no individual values are set for the refinancing rate.

Source: Bank of Russia.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments and obligations on liquidity absorption instruments, billions of rubles							
					As of 1.01.15	As of 1.07.15	As of 1.01.16	As of 1.07.16	As of 1.09.16	As of 1.10.16	As of 1.11.16	As of 1.12.16
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	4.0	0.0	1.5	3.7	2.6	0.0	0.0
		Lombard loans			3.7	4.0	2.9	1.2	1.3	1.2	1.3	1.0
		FX swap			121.6	49.9	14.9	0.0	0.0	49.8	0.0	0.0
		Repos			96.2	275.9	264.9	273.7	362.5	408.7	291.3	437.9
		Loans secured by gold	from 1 to 549 days		1.2	0.5	0.5	0.0	0.0	0.0	0.0	0.0
		Loans secured by non-marketable assets or guarantees	from 1 to 549 days		2,055.9	335.1	234.8	242.1	339.1	331.7	303.3	519.6
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly	2,370.9	2,685.0	1,553.8	219.6	216.2	216.2	215.7	215.6
			from 1 to 3 weeks[1], 18months[1]	occasionally								
		Repo auctions	1 week	weekly[2]	2,727.6	1,572.3	1,448.5	370.7	0.0	0.0	0.0	0.0
			from 1 to 6 days	occasionally[3]								
		FX swap auctions	from 1 to 2 days	occasionally[3]	—	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days	occasionally[3]	0.0	0.0	0.0	0.0	220.8	180.0	201.8	302.6
			1 week	weekly[2]								
	Standing facilities	Deposit operations	1 day, call	weekly	804.5	293.1	557.8	436.8	366.4	374.6	297.8	225.3

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

Source: Bank of Russia.

Table 2

Required reserve ratios in 2015-2016

(%)

<table>
<tr><th rowspan="2">Liability type</th><th colspan="4">Periods</th></tr>
<tr><th>From 1.01.15 to 31.03.16</th><th>From 1.04.16</th><th>From 1.07.16</th><th>From 1.08.16</th></tr>
<tr><td>To non-resident legal entities in rubles</td><td rowspan="6">4.25</td><td rowspan="4">4.25</td><td>4.25</td><td>5.00</td></tr>
<tr><td>To households in rubles</td><td>4.25</td><td>5.00</td></tr>
<tr><td>To households in foreign currency</td><td>5.25</td><td>6.00</td></tr>
<tr><td>Other liabilities in rubles</td><td>4.25</td><td>5.00</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></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	As of 1.01.15	From 10.09.15
Banks	0.7	0.8
Settlement non-bank credit institutions, settlement centre of the organised securities market, and non-bank credit institutions entitled to transfer funds without opening bank accounts and to conduct other related bank operations	1.0	1.0
Non-bank credit institutions performing deposit and lending operations	0.7	1.0

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

Instrument	Term	Frequency	Minimum auction rate as spread to LIBOR[1], pp; fixed interest rate for FX swaps[2], % p.a.					Bank of Russia claims, millions of US dollars[3]									
			As of 1.01.15	From 30.03.15	From 13.04.15	From 21.04.15	From 14.12.15	As of 1.01.15	As of 1.07.15	As of 1.01.16	As of 1.04.16	As of 1.07.16	As of 1.08.16	As of 1.09.16	As of 1.10.16	As of 1.11.16	As of 1.12.16
Repo auctions	1 week	weekly	0.50	1.00	1.50	2.00	2.00	209.8	18.3	100.1	100.0	0.0	0.0	0.0	0.0	0.0	0.0
	28 days							14,900.8	6,623.6	5,016.7	12,109.5	12,955.2	12,189.2	10,919.0	9,913.4	9,032.1	7,284.1
	12 months[4]		0.50	1.00	1.75	2.50	3.00	4,737.3	23,479.2	15,550.0	4,346.6	168.5	164.0	159.6	159.6	154.0	148.0
Loan auctions	28 days	monthly	0.75	1.25	1.75	2.25	2.25	—	440.0	—	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	365 days		0.75	1.25	2.00	2.75	3.25	—	2,526.8	1,494.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
USD/RUB sell/buy FX swaps	1 day	daily	1.50	1.50	1.50	1.50	1.50	1,600.0	0.0	0.0	0.0	420.5	0.0	0.0	0.0	0.0	1,000.0

[1] *In respective currencies and for respective terms.*
[2] *For dollar leg; the rate for ruble leg is equal to the Bank of Russia key rate less 1 pp.*
[3] *Claims on credit institutions under the second leg of repos.*
[4] *From 1 June through 14 December 2015 and from 1 April 2016, 12-month FX repo auctions were suspended.*

Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities[1]

Purpose of indirect bank lending	Maturity	Collateral	Interest rate from 19.09.16, % p.a.[2]	Bank of Russia claims on credit institutions, billions of rubles								Limit as of 1.12.16, billions of rubles
				As of 1.01.15	As of 1.07.15	As of 1.01.16	As of 1.07.16	As of 1.09.16	As of 1.10.16	As of 1.11.16	As of 1.12.16	
Non-commodity exports	Up to 3 years[3]	Claims under loan agreements secured by contracts of insurance of JSC EXIAR	9.00	—	10.41	39.66	50.98	51.46	49.62	44.66	42.02	75.00
Large-scale investment projects[4]	Up to 3 years	Claims under bank loans for investment projects secured by the government guarantees of the Russian Federation	9.00	—	3.68	53.44	91.02	99.96	101.12	104.14	105.72	150.00
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List	9.00	2.85	2.85	2.85	0.86	0.83	0.83	0.83	0.59	
Small and medium-sized enterprises	Up to 3 years[3]	Claims under loan agreements of JSC SME Bank[5]	6.50	23.26	23.93	40.10	43.20	43.07	44.01	36.15	35.83	125.00
	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[6]		—	—	0.08	8.50	20.65	24.95	32.27	41.06	
Leasing	Up to 3 years	Claims on loans to leasing companies[7]	9.00	—	—	0.00	0.00	0.00	0.00	0.00	0.00	10.00
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	10.00	—	10.00	21.01	29.31	29.31	29.31	29.31	29.31	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 hamper the achievement of its key objective of ensuring price stability.*

[2] *For more information on the interest rates on the Bank of Russia's specialised instruments see the section Monetary Policy on the Bank of Russia website.*

[3] *Until 1 June 2015, the maturity of Bank of Russia loans was from one to 365 days. From 1 June 2015, the maturity of Bank of Russia loans was extended to three years.*

[4] *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'.*

[5] *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.*

[6] *The instrument was introduced in June 2015.*

[7] *The instrument was introduced in December 2015.*

Source: Bank of Russia.

Table 6

Consumer prices by group of goods and services
(month on previous month, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2014								
January	0.6	0.4	1.0	0.5	5.8	0.3	0.3	0.5
February	0.7	0.5	1.2	0.7	5.1	0.4	0.4	0.4
March	1.0	0.8	1.8	1.3	5.3	0.7	0.6	0.5
April	0.9	0.9	1.3	1.2	2.3	0.6	0.6	0.7
May	0.9	0.9	1.5	1.3	2.4	0.5	0.5	0.8
June	0.6	0.8	0.7	1.1	-2.8	0.4	0.4	0.9
July	0.5	0.6	-0.1	1.0	-8.1	0.4	0.3	1.4
August	0.2	0.6	-0.3	0.9	-10.7	0.5	0.4	0.7
September	0.7	0.9	1.0	1.2	-1.2	0.6	0.5	0.3
October	0.8	0.8	1.2	1.0	2.8	0.6	0.6	0.6
November	1.3	1.0	2.0	1.3	8.7	0.6	0.6	1.2
December	2.6	2.6	3.3	2.2	12.9	2.3	2.5	2.2
Total for the year (December on December)	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	3.9	3.5	5.7	3.7	22.1	3.2	3.5	2.2
February	2.2	2.4	3.3	2.7	7.2	2.1	2.3	0.8
March	1.2	1.5	1.6	1.6	1.2	1.4	1.6	0.3
April	0.5	0.8	0.3	0.9	-3.7	0.9	0.9	0.0
May	0.4	0.6	0.1	0.2	-1.0	0.5	0.6	0.5
June	0.2	0.4	-0.4	0.2	-5.0	0.3	0.3	1.0
July	0.8	0.4	-0.3	0.3	-4.2	0.5	0.3	3.0
August	0.4	0.8	-0.7	0.5	-9.8	0.8	0.7	1.3
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

[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 corresponding month of previous year, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2014								
January	6.1	5.5	6.5	6.4	7.7	4.3	4.3	7.8
February	6.2	5.6	6.9	6.5	10.1	4.3	4.3	7.9
March	6.9	6.0	8.4	7.5	15.9	4.6	4.5	8.2
April	7.3	6.5	9.0	8.3	14.4	4.9	4.7	8.5
May	7.6	7.0	9.5	9.5	10.1	5.1	4.9	8.4
June	7.8	7.5	9.8	10.5	3.9	5.3	5.0	8.7
July	7.5	7.8	9.8	11.2	-1.5	5.6	5.2	7.0
August	7.6	8.0	10.3	11.5	-0.8	5.5	5.3	6.7
September	8.0	8.2	11.4	12.0	6.1	5.5	5.3	6.9
October	8.3	8.4	11.5	12.1	5.3	5.7	5.4	7.6
November	9.1	8.9	12.6	12.8	11.1	5.9	5.6	8.7
December	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	15.0	14.7	20.7	18.4	40.7	11.2	11.4	12.3
February	16.7	16.8	23.3	20.8	43.5	13.0	13.5	12.8
March	16.9	17.5	23.0	21.1	38.0	13.9	14.6	12.6
April	16.4	17.5	21.9	20.8	30.0	14.2	15.0	11.8
May	15.8	17.1	20.2	19.5	25.7	14.3	15.1	11.6
June	15.3	16.7	18.8	18.4	22.8	14.2	15.0	11.7
July	15.6	16.5	18.6	17.5	27.9	14.3	15.0	13.4
August	15.8	16.6	18.1	17.0	29.1	14.6	15.3	14.1
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

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

Sources: Rosstat, Bank of Russia calculations.

Table 8

Macroeconomic indicators

(seasonally adjusted, growth as % of previous period)

	Industrial production[1]	Agriculture	Construction	Freight turnover	Retail trade turnover	Consumer expenditure	Output index of goods and services by key industries	GDP[2]
2014								
January	0.4	1.0	0.8	0.5	0.0	-0.3	0.8	
February	1.1	0.2	-1.2	-1.7	1.1	0.9	1.4	
March	-0.2	0.1	0.9	-0.9	0.7	0.0	-0.6	-0.1
April	1.5	0.6	0.1	0.3	-0.1	0.2	1.1	
May	0.2	0.2	-0.8	1.7	-0.1	-0.3	0.0	
June	-0.8	0.0	0.1	0.0	-0.1	0.1	-0.3	0.5
July	0.3	2.1	-0.2	-2.6	0.2	0.0	-0.1	
August	-0.7	-1.6	-0.3	0.2	0.1	0.1	-0.4	
September	0.8	0.8	-2.2	0.2	0.2	0.4	-0.3	-0.1
October	0.0	-9.1	-0.4	-0.3	0.1	-0.3	-0.3	
November	-1.1	9.5	-1.3	0.3	0.2	0.2	-0.3	
December	1.7	0.5	-1.6	-0.7	1.2	0.4	-0.2	-0.1
2015								
January	-3.7	0.1	-1.7	0.1	-8.8	-7.2	-0.8	
February	-1.5	0.1	0.2	0.5	-1.3	-1.0	-1.0	
March	0.8	0.5	-2.5	1.0	0.0	0.5	0.2	-3.2
April	-1.5	0.0	-0.8	-1.2	-0.8	-1.1	-1.2	
May	-0.4	0.1	-0.7	-0.6	0.3	0.4	0.2	
June	-0.2	0.3	0.1	0.2	-0.4	-0.3	-0.5	-0.6
July	0.8	-1.0	-3.7	2.0	-0.5	-0.4	0.0	
August	-0.4	0.9	-0.1	-0.9	-0.2	-0.5	-0.1	
September	1.3	1.3	1.4	0.3	-1.1	-0.3	0.5	-0.1
October	0.0	-1.1	-2.2	2.8	-0.2	-0.2	-0.5	
November	-0.6	1.0	0.3	-0.7	-0.6	-0.6	-4.1	
December	0.2	0.4	0.6	-0.3	-0.8	-0.6	0.8	-0.2
2016								
January	-0.8	0.0	-1.5	-2.0	-0.5	-0.3	0.6	
February	1.5	0.4	0.0	0.4	0.1	0.1	0.5	
March	-0.5	0.1	0.0	-0.2	-1.0	-0.9	0.4	-0.3
April	-0.2	0.2	-0.8	-0.1	0.0	0.3	0.1	
May	-0.1	0.2	-0.9	-0.6	-0.8	-0.6	-0.3	
June	0.5	0.0	-0.7	1.3	-0.3	-0.3	0.0	-0.1
July	-0.9	0.7	1.6	1.4	0.0	-0.1	0.0	
August	0.5	0.5	-0.7	0.2	-0.4	-0.1	-0.2	
September	-0.3	-0.6	-1.3	1.4	0.1	-0.5	-0.2	0.1
October	0.3	0.5	1.3	-1.5	-0.7	-0.3	-0.1	

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

Sources: Rosstat, Bank of Russia calculations.

Table 9

Macroeconomic indicators

(as % of corresponding period of previous year)

	2015	2016											Memo item: 2015
	Total	January	February	March	April	May	June	July	August	September	October	January-October	January-October
Output of goods and services by key industries	-4.1	-3.5	0.6	-0.5	-0.4	-0.3	-0.4	-1.0	0.6	-0.9	-0.9	-0.7	-4.1
Industrial output	-3.4	-2.7	1.0	-0.5	0.5	0.7	1.7	-0.3	0.7	-0.8	-0.2	0.3	-3.3
Agricultural output	2.6	2.5	3.1	2.7	2.7	2.6	2.1	4.7	5.9	1.7	2.4	2.9	2.7
Construction	-4.8	-7.8	-5.4	-3.7	-6.9	-9.0	-10.5	-2.9	-2.0	-6.8	-0.8	-5.0	-5.1
Retail trade turnover	-10.0	-6.4	-4.7	-6.2	-5.1	-6.4	-6.2	-5.2	-5.1	-3.6	-4.4	-5.3	-9.2
Household real disposable money income	-4.3	-5.7	-4.3	-1.3	-7.0	-6.0	-4.5	-7.0	-8.2	-1.5	-5.9	-5.3	-4.5
Real wage	-9.0	-3.6	0.6	1.5	-1.1	1.0	1.1	-1.3	2.7	1.9	2.0	0.5	-9.2
Number of unemployed	7.4	6.2	0.4	1.4	2.3	0.3	2.1	1.4	-0.7	-0.4	-3.6	0.9	6.9
Unemployment (as % of economically active population)	5.6	5.8	5.8	6.0	5.9	5.6	5.4	5.3	5.2	5.2	5.4	5.6	5.5

Sources: Rosstat, Bank of Russia calculations.

Table 10

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

(%)

		Forecast of GDP growth in 2016		Memo item: country's share in aggregate GDP of trading partners
		August 2016	November 2016	
Total		1.91	2.09	100.0
1	Germany	1.35	1.76	14.6
2	China	6.41	6.64	10.3
3	Italy	0.81	0.73	9.3
4	Turkey	3.40	3.14	6.9
5	Belarus	-2.80	-2.18	5.5
6	Japan	0.49	0.65	5.3
7	Korea, Republic of	2.51	2.74	4.7
8	Belgium	1.05	1.21	4.6
9	Poland	3.40	2.98	4.4
10	United Kingdom	1.81	1.90	4.4
11	Kazakhstan	0.32	0.38	4.2
12	The Netherlands	1.37	1.60	3.3
13	United States	1.81	1.54	3.1
14	France	1.19	1.23	3.1
15	Finland	0.53	0.73	3.1
16	Latvia	2.07	1.86	3.0
17	India	7.49	7.53	1.9
18	Switzerland	0.79	1.45	1.5
19	Czech Republic	2.13	2.27	1.4
20	Hungary	1.76	1.97	1.4
21	Slovakia	3.03	3.41	1.4
22	Lithuania	2.39	1.94	1.3
23	Spain	2.53	3.08	1.3
24	Ukraine	1.27	1.37	0.0

[1] The aggregate GDP growth rate is calculated based on 24 Russia's trading partners which account for more than 1% of Russian exports on average for 5 years (from 2010 to 2014). Previously, the calculation for 2008-2012 was based on 23 countries. The share of each country was determined based on the exports to major trading partners. In this report, 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 11

Monetary policy rates in various countries

Country	Policy rate	Current level	Date of latest change	Previous level	Change	Number of rate changes over the past 12 months	Inflation	
							Current level, %	12-month change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	0	0.0	0.60
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	3	1.0	0.90
Czech Republic	repo rate (14 days)	0.05	01.11.2012	0.25	-0.20	0	0.8	0.60
Romania	base rate	1.75	06.05.2015	2.00	-0.25	0	-0.4	1.21
Bulgaria	base rate	0.00	01.02.2016	0.01	-0.01	1	-0.6	0.00
Serbia	key policy rate	4.00	07.07.2016	4.25	-0.25	2	1.5	0.10
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	0	-0.3	0.39
Brazil	target rate	13.75	30.11.2016	14.00	-0.25	2	7.9	-2.06
Chile	monetary policy rate	3.50	17.12.2015	3.25	0.25	1	2.8	-1.20
China	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	0	2.1	0.80
	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	1		
India	reverse repo rate	6.25	04.10.2016	6.50	-0.25	2	4.2	-0.80
	repo rate	5.75	04.10.2016	6.00	-0.25	2		
Indonesia	target rate	6.50	16.06.2016	6.75	-0.25	4	3.6	-1.31
Korea, Republic of	base rate	1.25	09.06.2016	1.50	-0.25	1	1.3	0.30
Malaysia	target overnight rate	3.00	13.07.2016	3.25	-0.25	1	1.4	-1.10
Mexico	target rate	5.25	17.11.2016	4.75	0.50	5	3.1	0.58
Philippines	monetary policy rate	3.00	03.06.2016	4.00	-1.00	1	2.5	1.40
Russia	repo auction rate (7 days)	10.00	19.09.2016	10.50	-0.50	2	5.8	-9.20
South Africa	repo rate	7.00	17.03.2016	6.75	0.25	2	6.4	1.70
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0	0.6	1.57
Turkey	repo rate (7 days)	8.00	24.11.2016	7.50	0.50	1	7.0	-1.10
United States	federal funds rate (upper bound)	0.50	16.12.2015	0.25	0.25	1	1.6	1.40
Euro area	refinancing rate	0.00	10.03.2016	0.05	-0.05	1	0.6	0.50
United Kingdom	base rate	0.25	04.08.2016	0.50	-0.25	1	0.9	1.00
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0	0.1	-0.20
Canada	target overnight rate	0.50	15.07.2015	0.75	-0.25	0	1.5	0.50
Australia	overnight rate	1.50	02.08.2016	1.75	-0.25	2	1.3	-0.20
New Zealand	overnight rate	1.75	10.11.2016	2.00	-0.25	4	0.4	0.00
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0	0.1	0.00
	certificate of deposit rate	-0.65	08.01.2016	-0.75	0.10	1		
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	0	-0.3	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	1	1.1	0.17
Norway	key deposit rate	0.50	17.03.2016	0.75	-0.25	1	3.7	1.20

Note: As of 6 December 2016, changes occurred from the compilation time of the previous Monetary Policy Report issue (1 September 2016) are put in colour.

Source: Bloomberg.

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GLOSSARY

Asset-backed securities (ABS)

Bonds or other securities backed by pooled assets which usually generate predicable cash flows and which are formed by banks or other credit institutions.

Averaging of required reserves

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

Banking sector liquidity

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

Bank lending conditions index

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

Bank of Russia interest rate corridor (interest rate corridor)

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

Bank of Russia key rate

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.

Basis point

One hundredth of a percentage point.

Broad money (monetary aggregate M2X)

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

Butterfly

An option position including options with the same maturity, whose quotation is calculated according to the formula: BF=(CALL+PUT-2*ATM)/2, where CALL and PUT are implied volatility values for call and put options with the respective deltas, and ATM is an implied volatility value for at-the-money option. This quotation means that the implied distribution of expectations of future exchange rate fluctuations has fatter tails relative to the risk neutral measure.

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.

CBOE crude oil volatility index

The Chicago Board Options Exchange (CBOE) index calculated by applying the VIX methodology and reflecting the market's expectations of 30-day volatility of crude oil prices.

CDS spread

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

Consumer price index (CPI)

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

Core inflation

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

Countercyclical currency

A currency which normally faces appreciation in periods of instability in global markets and/or recession in the global economy. Specifically, this type of currencies includes the US dollar, the Japanese yen, and the Swiss franc.

Covered bonds

Bonds secured by payments on mortgage loans or government debt obligations. The difference between covered bonds and asset-backed securities lies in the fact that covered bonds remain on the issuer's balance sheet after the issue, therefore making the issuer liable for the credit risk on the assets which back the bonds.

Credit default swap (CDS)

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

Cross-currency basis swap

Currency interest rate swap which implies an exchange of nominal values and interest payments in different currencies. The price of this swap reflects the premium to one of the floating rates.

Current liquidity deficit/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.

Fiscal stress index

Conceptual approach developed by IMF experts proposes an aggregate index which provides early warning signals of risks. The index is calculated on the basis of the study of the signals produced by three complementary sets of variables: basic fiscal variables, long-term fiscal trends, and asset and liability management (the total of 12 variables). Thresholds are calculated for all variables. By exceeding its threshold, the variable signals an upcoming crisis in the following year. Besides, each variable is assigned signaling power which shows its weight in the fiscal stress index. For more information on the approach see Baldacci E., McHugh J., Petrova I. Measuring Fiscal Vulnerability and Fiscal Stress: A Proposed Set of Indicators. IMF Working Paper, No. 94, 2011 and Baldacci E., Petrova I., Belhocine N., Dobrescu G., Mazraani S. Assessing Fiscal Stress. IMF Working Paper, No. 100, 2011.

Floating exchange rate regime

According to the IMF classification, under the floating exchange rate regime the central bank does not set targets, including operational ones, for the level of, or changes to, the exchange rate, allowing it to be shaped under the impact of market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to influence the domestic FX market occasionally to smooth out the ruble's exchange rate volatility and prevent its excessive deviations.

Floating interest rate on Bank of Russia operations

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

Foreign exchange swap

A deal which consists of two legs: one party of the deal initially exchanges a certain amount in domestic or foreign currency for an equivalent amount in another currency provided by the second party of the deal. Then, once the deal term has expired, the parties make a reverse transaction (in the corresponding volumes) at a predetermined rate. Foreign exchange swaps are used by the Bank of Russia to provide credit institutions with refinancing in rubles and foreign currency (US dollars).

Forward rate agreement (FRA)

A forward interest rate agreement on a certain future obligation, according to which the parties are bound, as of the effective date, to compensate for the differences in the amount of interest payments calculated on the basis of the agreed and actual rates and the agreed nominal value.

Funds in general government's accounts

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

Generalised (composite) consumer confidence index

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

Gross credit of the Bank of Russia

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

Implied volatility

A measure of exchange rate volatility that reflects current market prices of FX options under Black-Scholes model (as a rule, at-the-money).

Inflation-neutral output

Total output in economy which may be produced and allocated without setting grounds for changing the price growth rate. Besides, the volume of inflation-neutral output is not linked to any specific level of inflation, it only signals the existence/absence of conditions for its acceleration/deceleration.

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.

Managed floating exchange rate regime

Under the managed floating exchange rate regime the central bank does not interfere in the trends of ruble dynamics which are shaped by fundamental macroeconomic factors. No fixed limits or targets are set for the ruble rate, with the central bank seeking to smooth out exchange rate fluctuations in order to support economic agents' gradual adaptation to changes in external economic environment.

MICEX index

Composite index of the Russian stock market calculated by CJSC MICEX Stock Exchange (hereinafter, the Exchange) based on the ruble prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

MSCI indices

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

Monetary aggregate M1

Total amount of cash in circulation and funds of the Russian Federation residents (non-financial and financial organisations (excluding credit ones) 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 (i.e. decisions made by a central bank in relation to changes to interest rates on its operations) to the economy as a whole and to price dynamics, in particular. The most important channel of monetary policy transmission is the interest rate channel. The impact of the latter is based on the influence of a central bank policy on changes to the interest rates at which economic agents may deposit and raise funds, and, as a result, on decisions regarding consumption, saving and investment and, thereby, on the aggregate demand, economic activity and inflation.

Money supply

Total amount of funds 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).

Money supply in the national definition (monetary aggregate M2)

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

Net credit of the Bank of Russia to credit institutions

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

Net private capital inflow/outflow

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

Non-marketable assets eligible as collateral for Bank of Russia loans

Promissory notes and credit claims eligible as collateral for Bank of Russia loans in accordance with Bank of Russia Regulation No. 312-P, dated 12 November 2007, 'On the Procedure for Extending Bank of Russia Loans Secured by Assets or Guarantees to Credit Institutions'.

Non-price bank lending conditions

Bank lending conditions aside from the cost of a loan to the borrower, such as maximum loan amount and lending term, requirements for collateral and the financial standing of the borrower.

Non-tradable sector of the economy

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

Open market operations

Operations carried out on the initiative of a central bank. They include auction-based refinancing and liquidity-absorbing operations (repo auctions, deposit auctions, etc.), as well as purchases and sales of financial assets (government securities, foreign currency, and gold).

Output gap

Deviation of GDP from inflation-neutral output, expressed as a percentage. Characterises the balance between demand and supply and may be regarded as an aggregate indicator of the effect which the demand factors have on inflation. If the actual output is larger than the inflation-neutral output (positive output gap), all else equal, inflation is expected to accelerate. A negative output gap is an indicator of an expected slowdown in price growth.

Outstanding amount on Bank of Russia refinancing operations

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

Overnight index swap (OIS)

An interest rate swap where fixed-rate payments are swapped for floating-rate payments set on the basis of overnight money market rates over a respective period of time.

PMI 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.

Procyclical currency

A currency which normally appreciates in periods of global economic growth. Specifically, this category of currencies includes the euro, the Canadian dollar, and the Australian dollar.

Realised volatility

Exchange rate volatility measure calculated on the basis of historical data taken for a given period of time. As a rule, a mean-square deviation of daily logarithmic returns of the exchange rate is assumed to be its realised volatility.

Relative prices

A ratio between CPI subindex and CPI.

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 fulfill reserve requirements. The latter comprises required reserve ratios and a required reserve averaging ratio.

RGBEY index

RGBEY (Russian Government Bond Effective Yield to Redemption) index reflects an effective yield to redemption of Russian government bonds calculated as an average gross yield to redemption without accounting for bond issue duration.

Risk-neutral measure

A theoretical measure of probability derived from the assumption that the current value of an option is equal to the mathematical expectation of its future payoff discounted at the risk-free rate.

Risk premium on market securities portfolio

Calculated in accordance with the capital asset pricing model as the difference between the yield of a market securities portfolio and the yield of a risk-free asset. The yield of a risk-free asset is, as a rule, taken to be the yield of government securities (for example, OFZ – federal government bonds). Measured in percentage points (pp).

Risk reversal

An option position, whose quotation is calculated as a difference between implied volatility values for call and put options with the respective deltas and same maturities (an option delta is roughly equal to the market participants' estimate of at-the-money option probability). This quotation reflects an asymmetric distribution of expectations of future exchange rate fluctuations relative to the risk-neutral measure.

RTS index

Composite index of the Russian stock market calculated by the Exchange based on the US dollar prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

Ruble 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 to the currencies of Russia's main trading partners. The weights are determined according to the foreign trade turnover share of Russia with each of these countries in the total foreign trade turnover of Russia with its main trading partners.

Ruble real effective exchange rate index

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

Shadow banking sector

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

Standing facilities

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

Structural liquidity deficit/surplus

The state of the banking sector characterised by a stable demand by credit institutions for Bank of Russia liquidity provision operations. The reverse situation, characterised by a stable demand by credit institutions to deposit funds with the Bank of Russia, is a structural liquidity surplus. A calculated level of structural liquidity deficit/surplus is a difference between amounts outstanding on Bank of Russia refinancing and liquidity-absorbing operations.

Structural non-oil and gas primary budget deficit

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

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.

US dollar index (DXY)

The DXY is a weighted geometric mean of the US dollar's value relative to a basket of six foreign currencies (EUR, JPY, GBP, CAD, SEK, CHF).

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

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

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

IBL – interbank loans

IEA – International Energy Agency

IFX – Cbonds – corporate bond yield index

Industrial PPI–Industrial Producer Price Index

inFOM – Institute of the Public Opinion Foundation

MC – management company

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

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

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

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

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 – Organisation 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

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

VCIOM – Russian Public Opinion Research Centre

VAT – value added tax

VEB – Vnesheconombank

VECM – Vector Error Correction Model

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