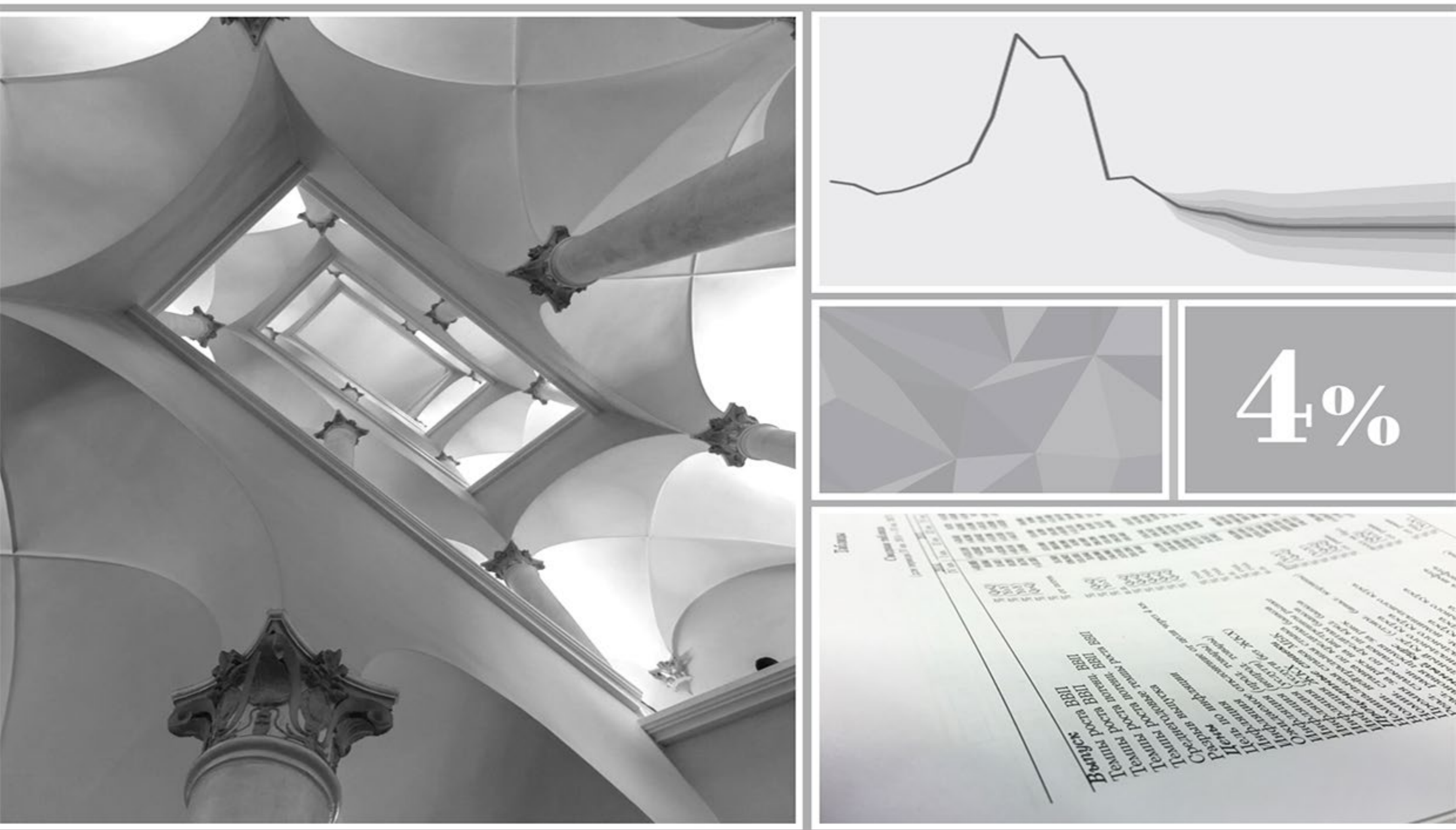
Bank of Russia

The Central Bank of the Russian Federation



No. 1

MARCH 2018

MONETARY POLICY REPORT

Moscow

DEAR READERS,

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

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

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

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

4. What is your professional field of interest?

Many thanks in advance for your assistance.

The report has been prepared based on statistics as of 19 March 2018.
Data cut-off date for forecast calculations is 9 March 2018 (if statistics and other information relevant for decision-making appear after the data cut-off date, they are included in the text of the Report and may be used for the adjustment of the mid-term forecast).

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

The situation in the Russian economy in the second half of December 2017 – March 2018 broadly evolved in line with the Bank of Russia's forecast presented in the December Monetary Policy Report (hereinafter, the Report). In view of the above, the Bank of Russia's overall perception of the medium-term situation in the Russian economy has remained unchanged. Key changes to the mid-term forecast were linked to the revision of assumptions underlying the external conditions shaped by the trajectory of energy prices. Based on the aggregate factors, oil price assumptions have been adjusted upwards in the baseline scenario for the whole range of scenarios discussed by the Bank of Russia Board of Directors in its key-rate decision-making.

The updated baseline scenario implies that oil prices will remain close to the level of $60 per barrel in 2018 and will gradually move towards $50 per barrel by the end of the forecast horizon. The previous baseline scenario used by the Bank of Russia to make a key-rate decision assumed, firstly, a generally lower oil price level, and, secondly, its faster decline, i.e. from $55 per barrel in 2018 to roughly $45 per barrel over the mid-term horizon. That scenario has been retained as a conservative scenario for the economic development in the forecast.

Inflationary pressure was modest from the second half of December through March. Price growth rates evolved at low levels and were rather consistent both by commodity and service groups and by region, thereby showing more stability. The annual inflation reached 2.2% in January-February 2018, an all-time low. Underlying inflation indicators showing consumer price dynamics cleared of most volatile elements remain broadly in the 2-3% range. The average year-on-year inflation dropped from 3.5% in January to 3.2% in February, in line with other price-shaping indicators, which demonstrated a systematic price growth reduction.

Low inflationary pressure in the economy was broadly assisted by a consistent moderately tight monetary policy which created assumptions for a further decline in inflation expectations, balanced easing of monetary conditions, lending activity recovery and a 'robust' expansion of the domestic demand in the economy fuelled by income dynamics.

***Inflation expectations.** Household inflation expectations decreased sustainably, though still notably above 4% due to their inherent high rigidity. Business expectations remained rather varied by economy sector, while generally being by far lower compared with previous years' readings. According to the findings of the Bank of Russia's survey, more than a half of surveyed companies build their 2018 business plans around inflation levels not exceeding 4%. The expectations of professional financial market participants have also consolidated near 4%. It will take some time for expectations to drop to the levels close to the actual inflation and to firm up there. The implementation of this process will be helped, among other things, by the consistent and clear informational policy pursued by the Bank of Russia.*

***Monetary conditions.** The process of monetary policy easing during 2016-2017 continued to feed through to the easing of domestic monetary conditions in the Russian economy. Decline in market interest rates continued in line with Bank of Russia key-rate cuts from mid-December through March. Alongside the above, longer-term market interest rates were shaped not only by the actual key-rate cut but also by its further expected cuts, including considering expectations around the level and time to deliver on the neutral rate of the monetary policy which were largely determined by Bank of Russia information policy signals. Non-price bank lending conditions have also generally eased, though at a considerably lower rate compared with price lending conditions. This demonstrated the prevalence of banks' conservative approach to credit risk assessment. Recovery in lending activity was proportionate to income growth and* *did not lead to the accumulation of excessive debt burden in the real sector of the economy. Further on, over the forecast horizon, expansion in lending to the economy will support consumer and investment activity. The Bank of Russia will continue to closely monitor developments both in the consumer and corporate lending in order to prevent any overheating in lending and to be able to promptly identify signs of unreasonable risk appetite among banks and borrowers.*

Food supply. *Slowdown in food price growth turned out to be more prolonged and more significant than expected earlier. The current downward food price dynamics reflect not only the favourable weather conditions, but also a structural expansion in supply through realised investments and technological development, including government support measures, among other things. In 2018 Q2, the annualised food inflation is expected to lower slightly due to the high base effect. From 2018 Q3 on, with the arrival of a new harvest food price growth rates will be getting closer to the growth rates of other commodity basket components. This will help to bring inflation back to 4%.*

The exchange rate. *Relatively favourable external conditions alongside moderately tight monetary policy and the effect of the budget rule supported the stability of the ruble exchange rate. With this in view, the pass-through effect of exchange rate dynamics on inflation in late 2017 and early 2018 was virtually neutral.*

Inflation. *In 2018 H1, the annual inflation will remain low mainly due to the food price dynamics. In 2018 H2, it will get back to 4% due to the on-going recovery in demand supported by a steady reduction in the moderating effect of the monetary policy. According to the baseline forecast, the annual inflation will be at 3-4% in late 2018 and will remain close to 4% in 2019.*

Economic activity. *Following a certain slowdown in 2017 Q4, the economic growth recovered to the levels expected by the Bank of Russia. In 2018-2020, the annual GDP growth will be close to its potential estimated at 1.5-2% by the Bank of Russia, provided the current economic structure remains the same. A more considerable growth is possible on the back of successful structural and institutional changes in the Russian economy, which will require more time and joint efforts by economic ministries and agencies.*

The sustainable growth of consumer and investment activity observed in the Russian economy in December-February will continue in the medium term. Additional support for this trend will come from moderate positive sentiments among economic agents, as well as the easing of monetary conditions over the forecast horizon.

Mid-term risks. *The Bank of Russia's view of key risks and their pass-through effect on the medium-term forecast parameters have generally remained unchanged compared to the December issue of the Report with the exceptions of labour market risks. If the faster-than-expected wage growth continues in the medium term, it may create assumptions for a noticeable increase in consumer activity and exert an upward pressure on inflation. To capture the impact of this factor on the forecast parameters, the Bank of Russia will continue to monitor wage dynamics and overall situation in the labour market, including in order to assess the extent to which the increase in wages observed earlier this year was created by one-off factors. Additionally, instances of enhanced volatility observed in other countries amid monetary policy normalisation, as well as increase in uncertainty in trade policy may influence capital flow dynamics in emerging market economies and feed through to the parameters of domestic financial markets. The mid-term risks for inflation forecasts continue to include consistent and elevated inflation expectations, accelerated lending growth supporting consumer activity, enhanced volatility of food inflation and oil price volatility.*

Considering the above factors, on 23 March 2018, the Bank of Russia Board of Directors decided to cut the key rate by 25 bp to 7.25% per annum. During 2018, the Bank of Russia will continue to reduce the key rate and will complete the transition to neutral monetary policy.

1. MACROECONOMIC CONDITIONS

External conditions

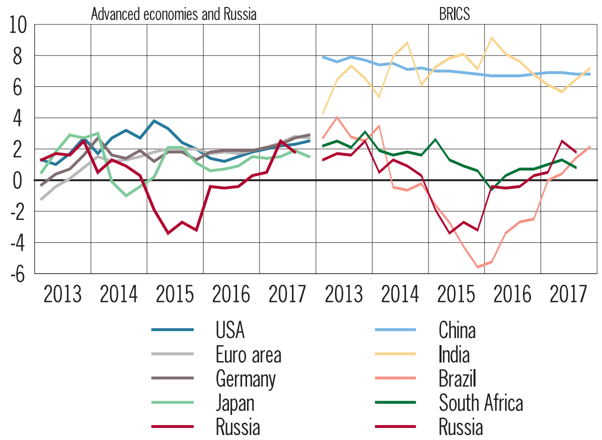
At the end of 2017 – start of 2018, external conditions developed largely in line with previous trends and were close to the macroeconomic forecast set out in the Bank of Russia's baseline scenario in December's MPR. Nevertheless, they were slightly more positive in terms of external demand and commodity price dynamics. However, external factors had a predominantly favourable impact on inflation in Russia.

By the end of 2017, global economic growth was relatively high, having accelerated considerably compared with the previous year to a level slightly higher than market participants' expectations over the year. In early 2018, business activity indicators pointed to stable global growth. This accelerated growth continued to predominantly represent a recovery, as shown in part by the absence of any significant inflationary pressure in major advanced and emerging market economies (Charts 1.1 and 1.2). At the same time, growth rates in many of these countries have been approaching long-term stable levels and the potential of a further acceleration in 2018 is diminishing. In view of this, the forecast 2018 output growth in Russia's trading partners is close to 2017 figures.

Chart 1.1

GDP growth in key advanced and emerging economies

(percent change on corresponding period of previous year)



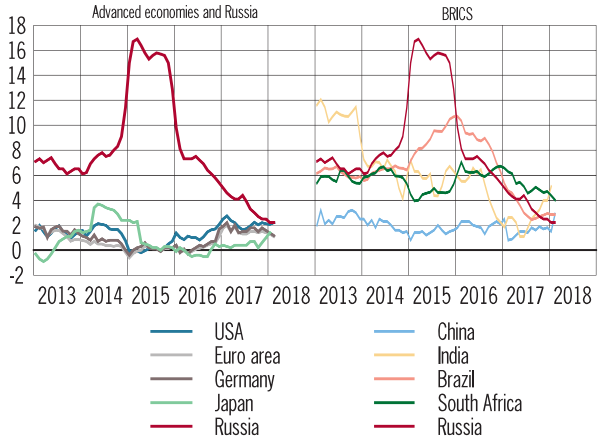
Sources: national statistics agencies, Bloomberg.

Certain emerging markets help ensure there is enough room for an inflation-free acceleration in growth. These are, particularly, several commodity-based economies recovering from the recession that followed the slump in the global commodity markets in 2014-2015. These countries still can ease their monetary policy further (see Box 'Brazil: inflation targeting in tough economic environment'), unlike the majority of advanced economies where conditions are in place for monetary normalisation (tightening).

Chart 1.2

Inflation in key advanced and emerging economies

(percent change on corresponding period of previous year)

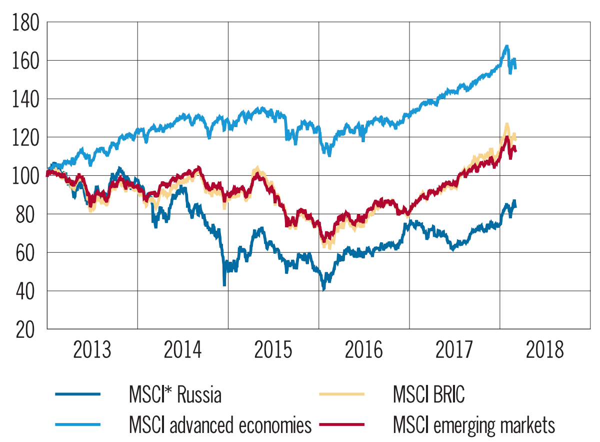


Sources: national statistics agencies, Bloomberg.

Chart 1.3

Global stock indices

(January 2013 = 100)

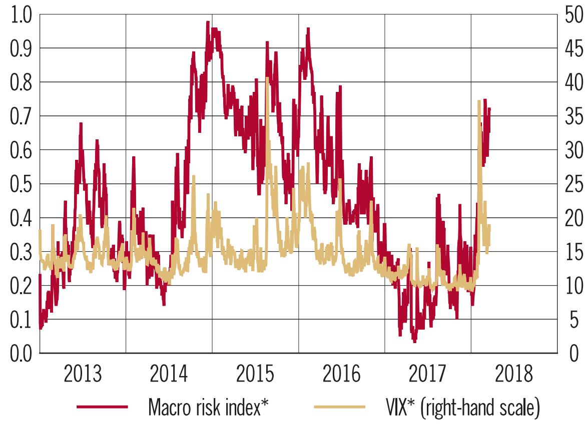


** See the Glossary.*
Source: Bloomberg.

Chart 1.4

Indices of volatility and global financial market risk perception by investors

(points)



** See the Glossary.*
Source: Bloomberg.

At the start of 2018, global financial market participants' sentiment was slightly less stable than previously. As investors revised their expectations of further global developments, primarily the implementation of macroeconomic policy measures in the US, and the uncertainty over the international trade policy increased, US government bond yields rose, stock markets saw a local correction, and volatility and risk-sensitivity indicators went up (Charts 1.3 and 1.4). That said, given the relatively stable positive global economic dynamics, investors preserved interest in risky assets, including investments in emerging markets such as Russia (Charts 1.5 and 1.6).

The stable growth in global demand supported the ongoing medium-term upward trend in global commodity market prices. In late 2017 – early 2018, prices in global energy and metal markets continued to rise (Chart 1.7). In the global oil market, price growth continued to receive additional support from supply-side factors: the production cut deal between the OPEC and other oil exporting countries extended to 2018 and the compliance with this agreement exceeding expectations at the end of 2017 – start of 2018, as well as the temporary reduction in supplies from certain regions due to local political and man-made factors. As a result, Urals crude prices were slightly above the level predicted in the previous MPR, at $61 and $65 per barrel in 2017 Q4 and 2018 Q1 respectively (vs forecast $59 and $57 per barrel). As temporary supply-side factors wane, Urals crude prices are expected to fall slightly in the near future to an average of $62 per barrel in 2018

Chart 1.5

Change in risk premium in Russia and emerging markets*

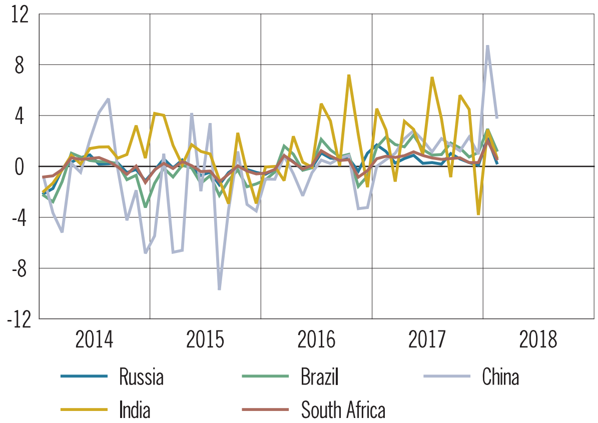
(basis points)

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

Chart 1.6

Foreign portfolio investment flows to BRICS nations*

(billions of US dollars)



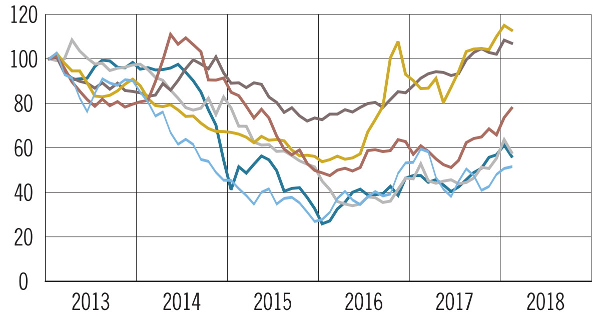
** For February 2018, estimate is based on weekly readings.*
Source: EPFR Global.

Q2. However, the higher than previously expected current and forecast global oil demand, together with developing supply and stock dynamics, made financial market participants revise their medium-term oil price forecasts upwards. The Bank of Russia also refined its own medium-term outlook for oil price movements, which serve as parameters of the medium-term macroeconomic forecast (see Section 2 'Economic outlook').

In the global food markets, however, the supply factor had a mostly constraining effect on price growth in the last months of 2017 – start of 2018 (Chart 1.8). The relatively good results for the agricultural year caused prices to stabilise or even reduce in the autumn and winter months in most of Russia's important segments of the global food

Chart 1.7

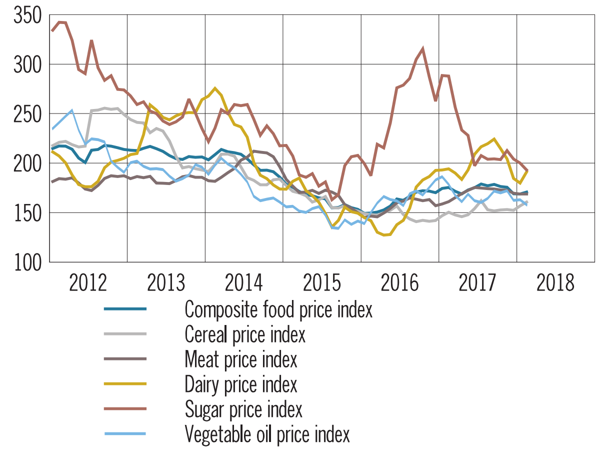
World prices of principal Russian export commodities
(January 2013 = 100)



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

Chart 1.8

World food prices
(2002–2004 = 100)



Source: UN Food and Agriculture Organization (FAO).

market, including the grain, vegetable oil (Russian export goods), dairy produce, meat (Russian imports), and sugar markets.

The current global climate had an impact on Russian economic environment and inflation via several channels.

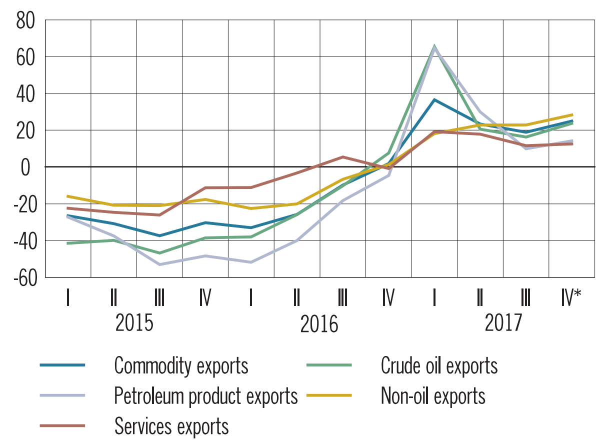
First, from the perspective of foreign trade operations and economic activity, the continued stable growth in the global economy has resulted in steady growth in demand for Russian exports (commodities and non-commodities) (Chart 1.9). By the end of 2017, it proved higher than previously expected, both in nominal and real terms. Together with the higher commodity prices, this helped buoy economic activity, both directly, through the output of export-oriented sectors, and indirectly, through the shaping of business confidence and expectations, and the investment appeal of Russian assets. However, the international production cut agreement between the OPEC and non-OPEC countries continued to constrain oil production and export supplies.

Second, in terms of financial flows, international investors' persistent interest in Russia has primarily been reflected in the continued inflow of non-residents' investments into government bonds, largely through the secondary market. This resulted in a net inflow of capital into the public sector by the end of 2017. At the start of 2018, non-residents' interest in Russian government debt persisted and was buoyed by the attractive yields, the upgrade of Russia's sovereign rating to investment grade from Standard & Poor's, the international ratings agency, and the US decision not to expand its sanctions on government bonds at this point. At the same time, the floating exchange rate restricted the impact of external lending conditions on the Russian economy. In addition, the effective international sanctions against certain Russian companies and banks continued to affect external financial flows.

Overall, with the moderately tight internal monetary conditions and the inflow of funds from foreign trade in place, Russia remained the world's net creditor. By the end of 2017, Russia's net private sector lending to the rest of the world retained largely the same structure as in 2016 (Chart 1.10). With direct investments factored out, banks and other sectors registered a simultaneous

Chart 1.9

Annual growth in Russian exports
(%)

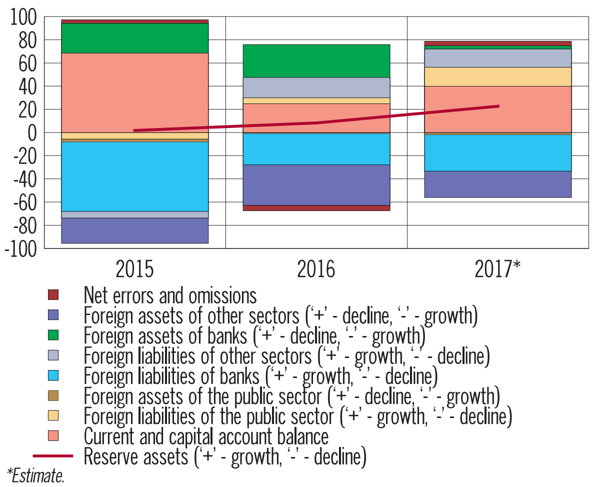


** Estimate.*
Source: Bank of Russia.

Chart 1.10

Russia's major balance of payments accounts

(billions of US dollars)



**Estimate.*

Source: Bank of Russia.

reduction in external financial assets and liabilities in 2017 (with the decrease in liabilities being more pronounced). This can be interpreted as a lower degree of Russian economic agents' participation in foreign financial markets, in part due to external financial sanctions, and the balance of external and internal yields and risks, which had an impact on the relative appeal of external savings and borrowing. Additionally, banks repaid FX borrowings to the Bank of Russia, which reflected a healthy ability to redeem external debt and manage FX liquidity. Net lending was also observed in other sectors' direct investments. However, unlike portfolio investments, as in previous periods, this item saw a simultaneous increase in private sector external assets and liabilities, with assets growing more intensely.

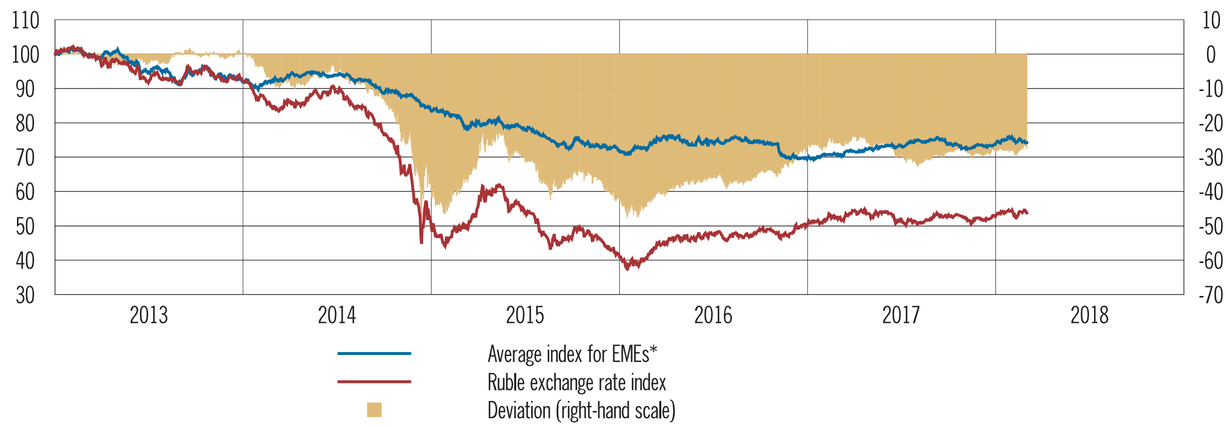
Third, with regard to the exchange rate, the foreign business activity, commodity situation and overall external financial conditions combined to buoy the ruble at the end of 2017 – start of 2018. The ruble's performance followed the general trends for peer emerging markets and commodity exporters (Chart 1.11). At the same time, the traditionally high exchange rate sensitivity to oil price growth was restricted by the budget rule (including the Russian Ministry of Finance's operations in the domestic foreign exchange market); the transition to the new format of the budget rule was completed in early 2018. This in turn reduced the effect of the external commodity situation on budget indicators and economic activity as a whole.

Fourth, in terms of external conditions affecting inflation, a set of factors was at play. On the one hand, the absence of signs that external demand was overheating, despite its stable growth, ensured low external inflationary pressure. The significantly higher global food prices also continued to be a favourable factor. At the end of 2017 – start of 2018, the impact of exchange rate dynamics was virtually neutral, according to estimates. However, the growth in global energy market prices caused higher pressure on expenses and Russian producer prices. Nevertheless, the impact of this factor on headline inflation is expected to be limited (see Sub-section 'Internal economic conditions and inflation').

Chart 1.11

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

(1.01.2013 = 100)



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

Sources: Bloomberg, Bank of Russia calculations.

Brazil: inflation targeting in tough economic environment

The Bank of Brazil switched to an inflation targeting regime in 1999. After a period of adaptation by economic agents and households, it managed to achieve a sustainable reduction in inflation expectations at the start of the 2000s, consistently keeping inflation readings within the acceptable range.

At the same time, in 2014-2015, Brazil, like many other commodity-based economies, was confronted with a major negative change in the external climate, causing a slump in commodity prices and increased volatility in financial markets. The deterioration in the external climate exerted considerable downward pressure on the exchange rate of the Brazilian real and significantly increased inflation risks in the economy. At the same time, Brazil was also faced internal challenges. One of the most serious was its budget crisis caused by decisions adopted in 2011-2014. Following the fiscal policy measures, which included the budget expanding to cover additional pension liabilities and offering tax holidays for a number of industries, and given the inability to fine-tune other budget items, the budget deficit rose from 2% of GDP in 2010 to 10% of GDP in 2015, while pension expenses reached 11% of GDP. As a result, Brazil witnessed a simultaneous slowdown in lending and economic activity, increased inflationary pressure and greater risks to financial stability.

In these difficult economic conditions, the Bank of Brazil decided that it was essential to tighten its monetary policy (Chart 1.12). This helped normalise the inflationary pressure and made it possible to maintain stability in the financial system. The adoption of a fiscal consolidation plan, aimed at reducing budget expenditure in certain areas and restoring certain taxes, also helped normalise the situation. However, fundamentally, the budget crisis has not yet been resolved, resulting in the downgrading of Brazil's sovereign rating by Standard & Poor's in January and by Fitch in February 2018. After a slump in 2015-2016, economic dynamics recovered. By the end of 2017, inflation readings were slightly below the target range, mostly due to a record harvest.

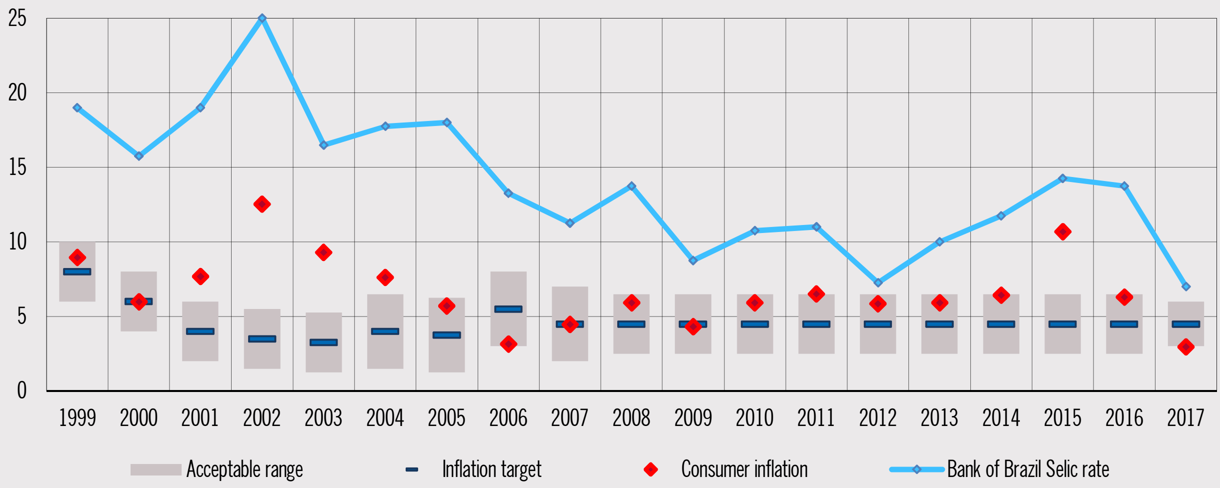
Brazil is a typical example of a small open economy with commodity industries accounting for a high proportion of its exports. Brazil, like many developing countries, has entered a recovery after a period of unstable dynamics with two recessions in the last decade. This recovery may still accelerate without any developments in concomitant inflation processes (Charts 1.1 and 1.2).

There are a number of distinctive features unique to Brazil – regulated prices for a number of goods and services (electricity, medical services, fuel, etc.); a high proportion of loans issued at low non-market rates not tied to the policy rate (roughly 50% of the overall loan portfolio), high market rates by international standards (the average market rate was 41.1% in January 2018 compared with 9.5% in the non-market segment[1]); and the specific orientation

Chart 1.12

Historical inflation, inflation target and monetary policy rate in Brazil

(% p.a.)



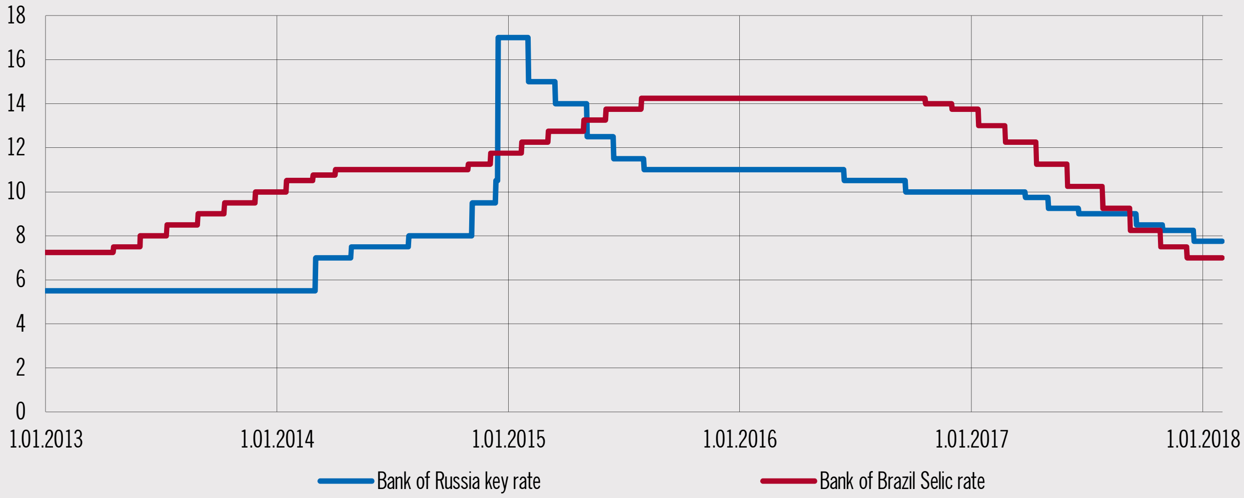
Source: Central Bank of Brazil.

[1] *Bank of Brazil's portal (https://www.bcb.gov.br/sgspub/localizarseries/localizarSeries.do?method=prepararTelaLocalizarSeries).*

Chart 1.13

Bank of Russia key rate and Bank of Brazil Selic rate

(%)



Sources: Bank of Russia, Central Bank of Brazil.

of commodity industries. The high proportion of non-market loans is reflected in the effect of the monetary policy transmission mechanism and has an impact on decisions on the policy rate and how it is changed. In 2017 Brazil followed international experts' advice to launch measures to reduce the influence of non-market lending on monetary conditions, which included both changes to the formula to calculate non-market rates and reduction of non-market lending. However, these specifics do not affect the big economic picture, and Brazil's experience is interesting to Russia as both countries have similar fundamental economic factors. Meanwhile Brazil has a far longer record of inflation targeting.

The similarity of their economic dynamics, shaped by global factors, means that the trajectory of Brazil's and Russia's monetary policy has been similar in recent years. 2017 was a period of renewed growth and the gradual departure from moderately tight monetary policy, which may be completed this year (Chart 1.13). It is important to note that the Bank of Brazil and the Bank of Russia have extremely similar estimates of the long-term neutral level of monetary policy rates. In September 2017, the Bank of Brazil estimated the neutral real rate at roughly 3%[2].

One important condition for the future stable growth of both countries' economies is structural reforms, which may help overcome structural limitations in order to accelerate growth and reduce sensitivity to the external climate. Like the Bank of Russia, the Bank of Brazil has mentioned this in its informational materials[3].

[2] *Bank of Brazil, Inflation Report, December 2017 (http://www.bcb.gov.br/htms/relinf/ing/2017/12/ri201712b1i.pdf).*

[3] *Bank of Brazil, Statement following the Meeting on 6 December 2017 (http://www.bcb.gov.br/en/#!/c/copomstatements/184).*

Internal financial conditions

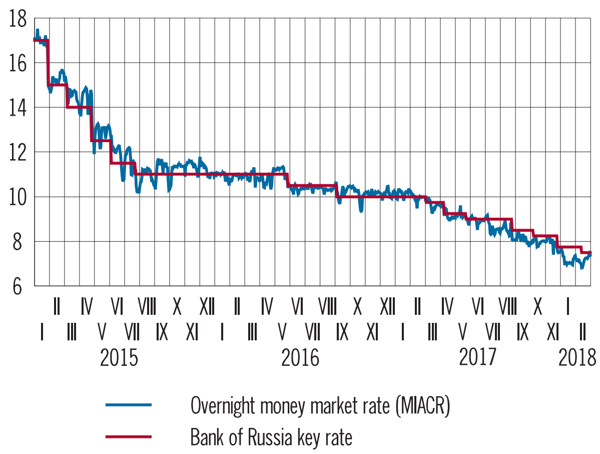
At the end of 2017 – start of 2018, the Russian financial system remained stable and the internal financial conditions were in line with the Bank of Russia's baseline forecast. However, several important points regarding monetary conditions can be identified.

First, internal monetary conditions were gradually eased further, primarily due to the transfer of less tight monetary policy to market interest rates. Short-term money market interest rates remained close to the key rate (Chart 1.14), however, as in previous months, they remained in the lower half of the Bank of Russia's interest rate corridor. The spread between the interbank rate and the Bank of Russia key rate increased in certain periods triggered by the significant inflow of budget funds to banks, liquidity supply operations by certain credit institutions as part of measures to increase their financial stability, increased turnover from banks' customer operations (see the Bank of Russia's analytical paper 'Banking Sector Liquidity and Financial Markets', January and February

Chart 1.14

Bank of Russia key rate and MIACR

(% p.a.)

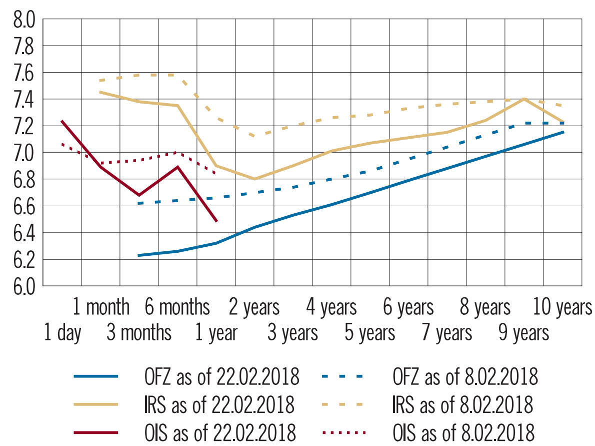


Source: Bank of Russia.

Chart 1.16

Bond and money market yield curves

(% p.a.)

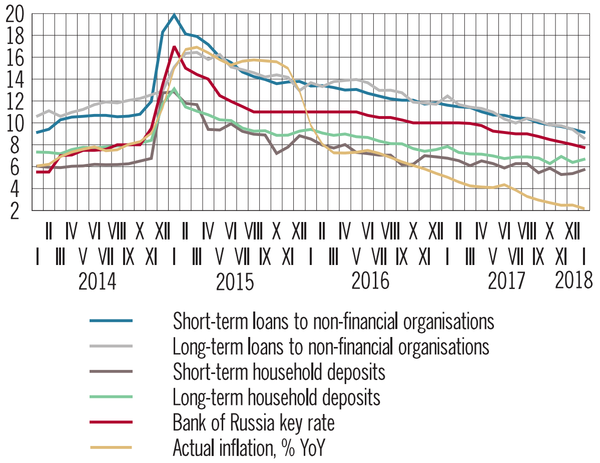


Source: Bloomberg.

Chart 1.15

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

(% p.a.)

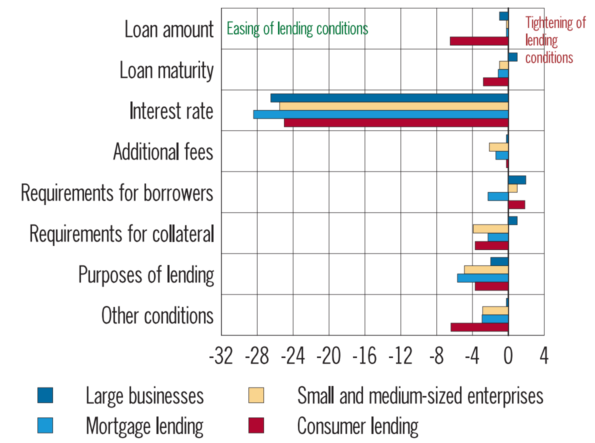


Source: Bank of Russia.

Chart 1.17

Indices of changes in certain lending conditions for borrowers in 2017 Q4

(percentage points)



Source: Bank of Russia.

2018). Incoming funds were redistributed among banks only gradually, which created uncertainty for market participants with regard to their own liquidity positions. In future, as the banking sector adapts to the growing liquidity surplus, the spread between market rates and the Bank of Russia key rate is expected to narrow. According to Bank of Russia forecasts, the spread could remain at 25-50 bp over the coming months. The Bank of Russia will take this into account in its decision-making on the key rate.

Second, both the actual and expected reduction in the key rate had an impact on longer-term market interest rates (Chart 1.15). That said, interest rates on instruments with varied maturities pointed to the fact that financial system participants took into account the Bank of Russia's message on the estimated long-term neutral level of monetary policy interest rates, which is estimated at 6–7%[1], and likely to be reached in 2018 (Chart 1.16). Although the monetary policy easing expected in 2018 has already had an effect on market participants' expectations, market lending rates may reduce further in the coming months due to the key rate pass-through.

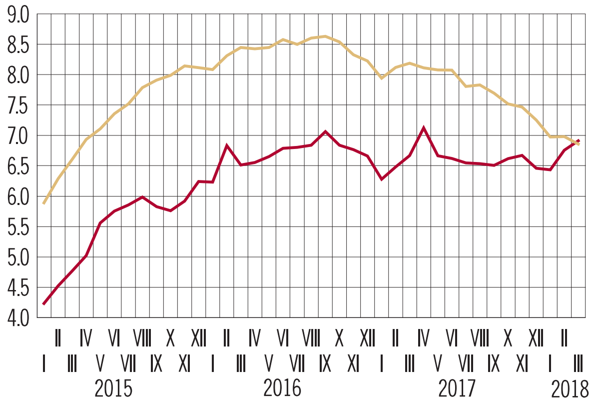
Third, non-price lending conditions (including lending terms, collateral requirements and other factors) have been eased, but to a lesser degree than price conditions (Chart 1.17). This is reflected in banks' justifiably conservative approach to credit

[1] *Monetary Policy Guidelines for 2018-2020.*

Chart 1.18

Overdue bank loans

(%)

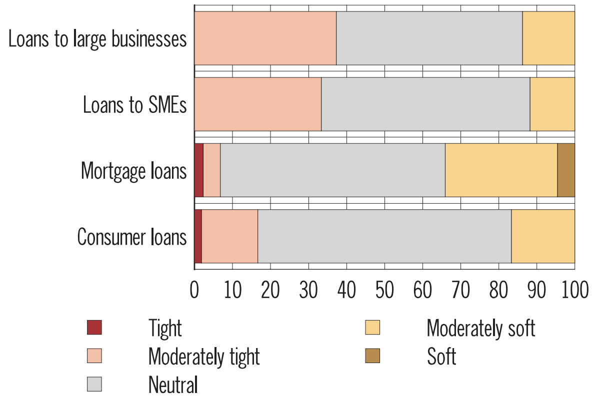


Source: Bank of Russia.

Chart 1.19

Banks' assessment of long-term lending tightness in 2017 Q4*

(%)



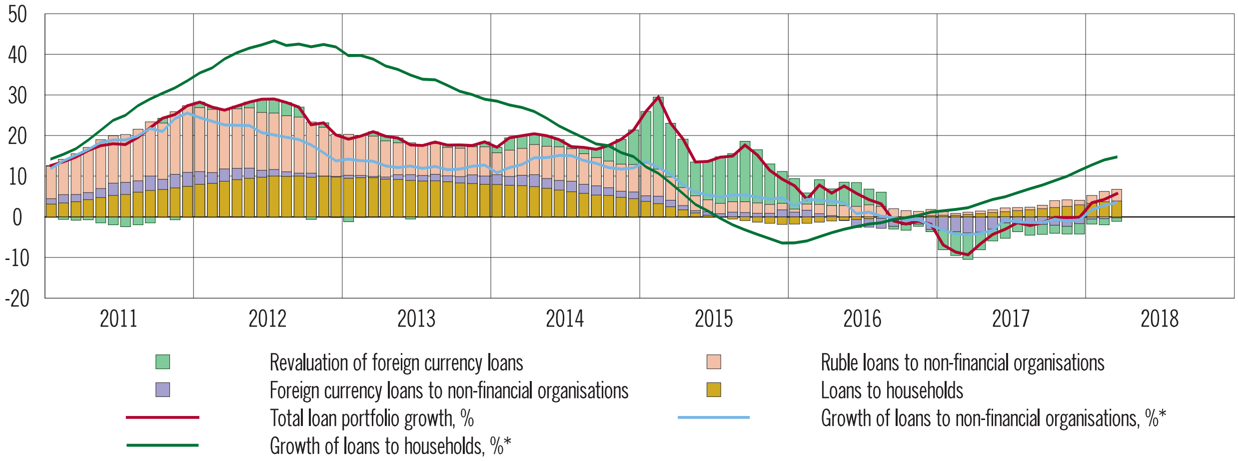
* Characterised by the share of banks which have chosen certain degree of lending tightness in the total credit institutions polled.

Source: Bank of Russia.

Chart 1.20

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

(percentage points)



* Excluding foreign currency revaluation.

Source: Bank of Russia.

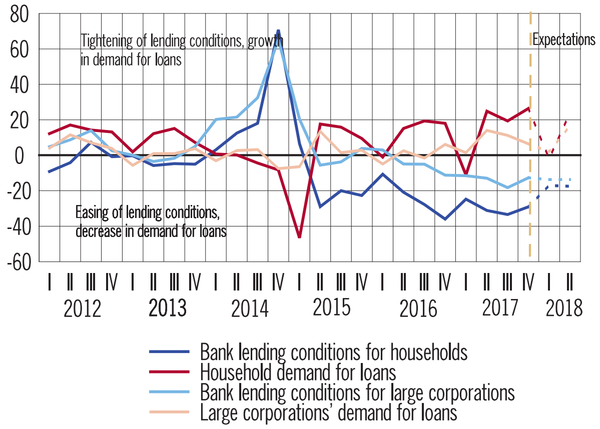
risk assessment. In 2017 – early 2018, credit risks gradually reduced as economic uncertainty abated, borrowers' financial positions improved and the debt burden normalised. For now, the debt burden is still slightly higher than before the increase in 2014–2015, which is confirmed in particular by overdue loan performance (Chart 1.18). However, according to bank surveys, most banks already consider the tightness of current long-term lending conditions to be neutral (Chart 1.19), that is the conditions do not restrict access to credit for most groups of potential borrowers and do not have a significant impact on the number of potential borrowers and their demand for loans. For corporate customers, lending conditions, including non-price conditions, continue to be largely restrictive. However, the risk premiums embedded in banks' long-term and short-term interest rates for corporate lending gradually fell in 2017, and, according to estimates, they moved closer to their long-term stable levels as of the start of 2018. Given the above, the change in risk premiums will contribute less to interest rates in future. However, non-price lending conditions are still expected to ease slightly this year. The easing will be as smooth as before, which will limit the risks to financial and price stability and support a stable monetary transmission.

Fourth, as lending conditions gradually eased and economic activity rose, the growth in lending activity continued to recover (Chart 1.20). By the end of 2017, the growth in corporate and household lending developed in line with the baseline forecast

Chart 1.21

Lending conditions and demand for loans indices

(percentage points)

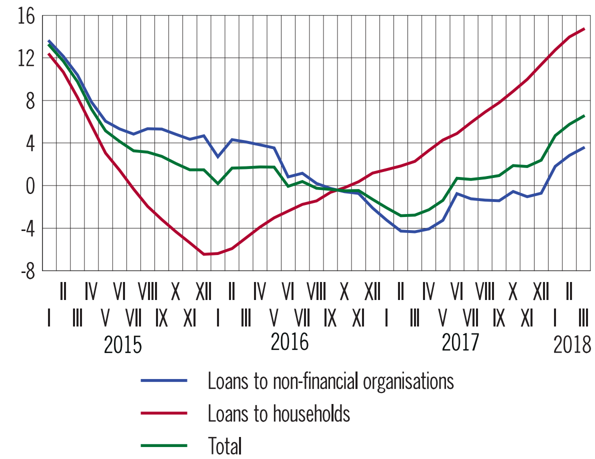


Source: Bank of Russia.

Chart 1.22

Annual growth in loans to real sector

(%, excluding foreign currency revaluation)



Source: Bank of Russia.

presented in the previous MPR. At the end of 2017 – start of 2018, the acceleration in lending was proportional to the increase in borrowers' incomes and their demand for credit, taking into account the easing (both previous and expected) in price and non-price lending conditions. That said, the demand to refinance previously borrowed medium- and long-term debt at lower rates intensified. This trend will cause current monetary policy to have a significant effect on lending and economic activity. This year, the balanced growth in credit to the economy is expected to accelerate further in most market segments, which will help realise the effects of the gradual transition to neutral monetary policy on demand and economic activity.

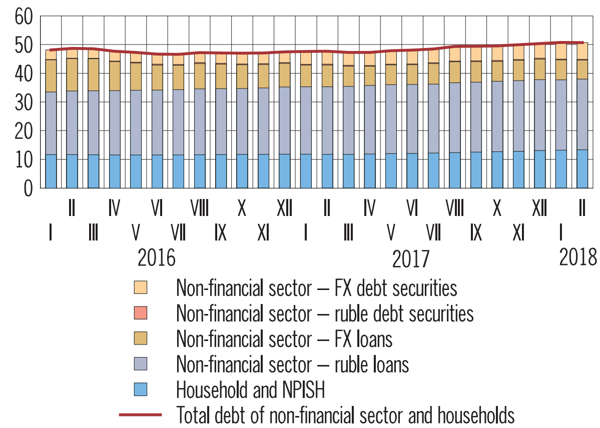
The structure of the annual growth in lending to certain segments reflected the relationship between the developing lending conditions, demand from solvent borrowers, and differences in previous dynamics (Charts 1.21 and 1.22). Growth in household borrowing, which continued to recover from the low base, still outstripped growth in lending to non-financial sector. However, growth in debt securities continued to make a significant contribution to corporate debt dynamics. Placing debt securities continued to be an attractive way to raise funds, taking into account their interest rates compared with bank lending conditions (Chart 1.23).

Mortgage lending, which banks see as one of the least risky areas of lending, witnessed dynamic growth. Unsecured consumer lending also expanded. The accelerated growth in this

Chart 1.23

Debt of non-financial sector and households on bank loans and debt securities

(trillions of rubles)



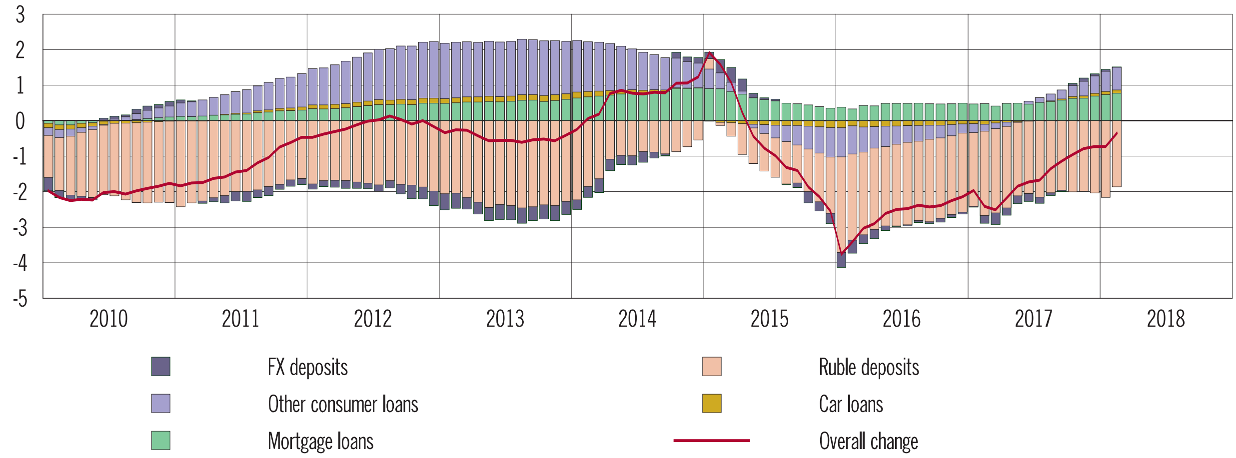
Source: Bank of Russia.

segment points to banks' willingness to increase their presence in relatively high-risk segments of the credit market, and to the expansion of their solvent borrower base as economic activity rises and interest rates fall. That said, the overall share of this type of operation in lending to the economy remained moderate, and the change in households' net deposit and credit operations with the banking sector still indicates a relatively conservative attitude toward borrowing (Chart 1.24). This is also confirmed by household surveys and household savings rates (see Sub-section 'Internal economic conditions and inflation'). Overall, the current growth in mortgage and unsecured consumer household lending does not pose any risk of inflation exceeding 4%.

Chart 1.24

Annual change in retail bank operations*

(trillions of rubles)

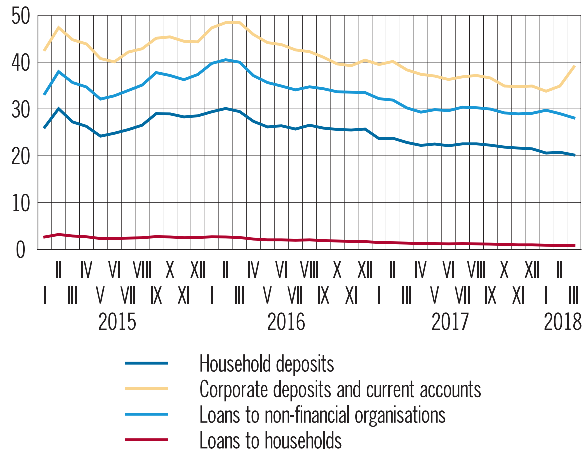


** Positive values mean increase in net banking claims on households.*
Source: Bank of Russia.

Chart 1.25

Dollarisation of bank loans and deposits

(%)



Source: Bank of Russia.

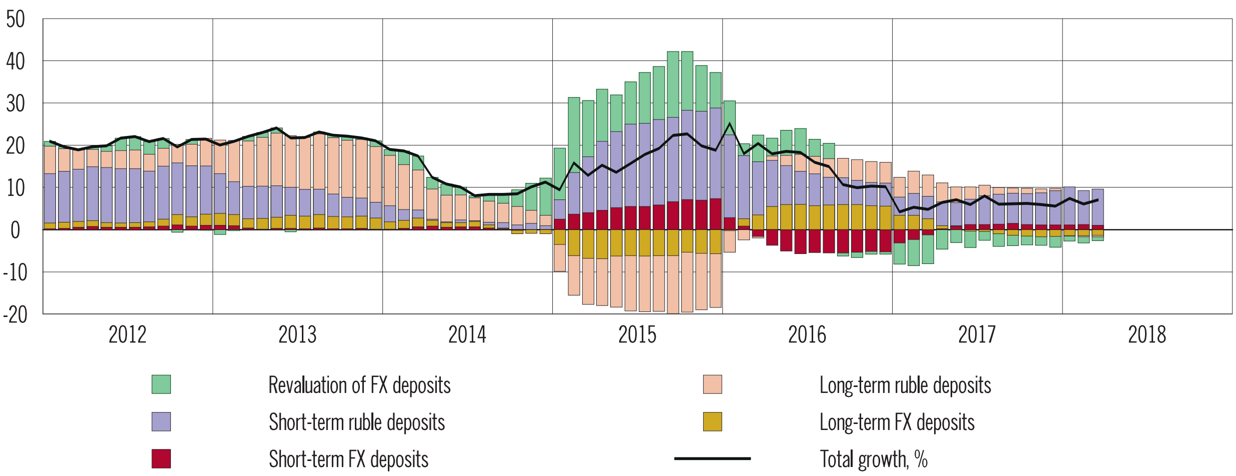
In its baseline scenario, the Bank of Russia expects mortgage lending growth to accelerate slightly over the coming quarters, proportionally to income growth and the easing of lending conditions. However, the Bank of Russia will continue to carefully monitor developments in this segment to prevent its overheating and detect signs of unwarranted changes in banks' and borrowers' risk appetite, which can threaten price and financial stability.

Finally, fifth, it is important to note that, overall, the structure of money supply looks balanced at this point and in the short run, which is consistent with a return to the long-term stability of a balanced banking sector, taking into account the ongoing recovery in business activity. Deposit dollarisation

Chart 1.26

Contribution of various components to annual growth of household deposits

(percentage points)

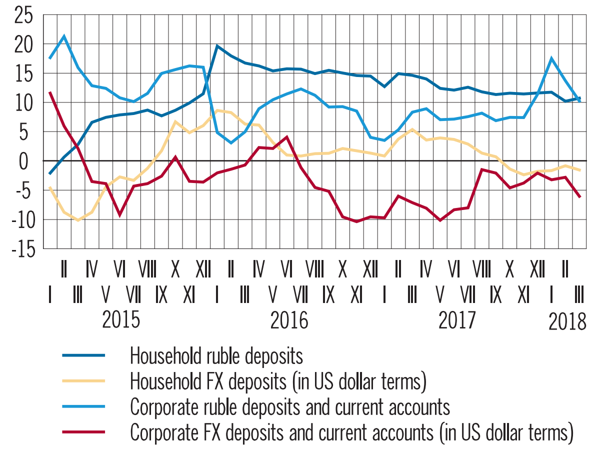


Source: Bank of Russia.

Chart 1.27

Annual bank deposit growth

(%)

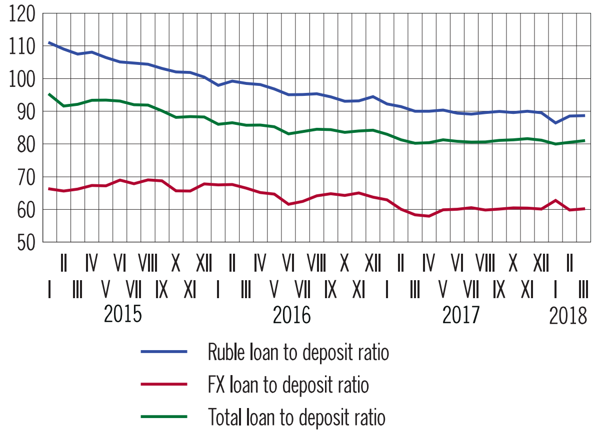


Source: Bank of Russia.

Chart 1.28

Ratio between bank loans to households and non-financial organisations and household and corporate deposits and current accounts

(%)

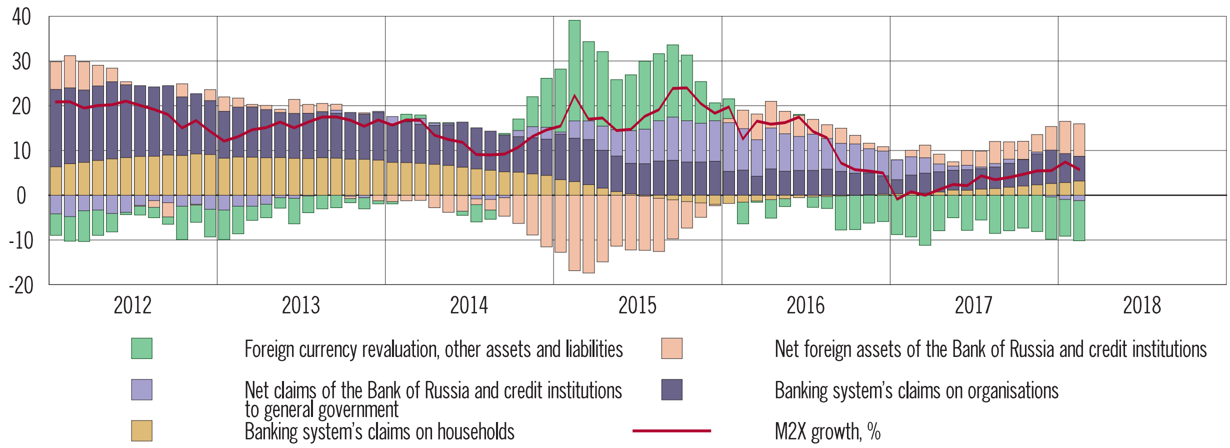


Source: Bank of Russia.

Chart 1.29

Broad money sources*

(contribution to M2X annual growth, percentage points)



** Data before and after 1 January 2016 are temporarily inconsistent.*
Source: Bank of Russia.

is falling, approaching pre-crisis levels (Chart 1.25). The dynamics of short-term ruble deposits drive growth in deposits (Chart 1.26). Moreover, the growth rates of corporate and household deposits are expected to continue to approach stable positive levels (Chart 1.27). The loan-to-deposit ratio for the banking sector as a whole and for certain segments are at the long-term, stable levels typically considered to be normal in global practice (Chart 1.28).

Money supply growth remains stable, in line with the estimated natural growth of monetisation of the economy (Chart 1.29). At the same time, the increased lending to the economy is making an increased contribution to the structure of money supply growth, which offsets the reduced contribution of the change in net lending to the general government amid the gradual implementation of budget consolidation (see Box 'Fiscal policy').

Fiscal policy

According to preliminary data from the Federal Treasury, the consolidated budget deficit for January-December 2017 was ₽1,349 billion (1.5% of GDP), which is significantly lower than the ₽2,093 billion (2.3% of GDP) deficit expected by the Russian Ministry of Finance, as published in the 'Fiscal, Tax and Customs Policy Guidelines for 2018-2020' (FTCPG). The federal budget deficit was ₽1,331 billion (1.4% of GDP), which is also lower than the ₽2,008 billion level expected in the budget forecasts (2.2% of GDP). The lower budget deficit was the result of reduced expenditure and increased revenues compared with forecast levels on the back of the improved external economic climate and recovery in economic activity in Russia.

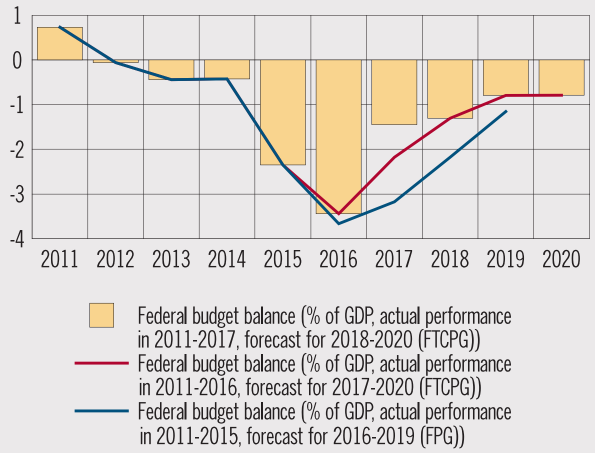
The significant reduction in the budget deficit (by 2.2 pp of GDP) and federal budget deficit (by 2.0 pp of GDP) in 2017 was due to the fiscal consolidation that occurred faster than the Russian Ministry of Finance's planned '3–2–1% of GDP' trajectory for 2017-2019, as set out in the 'Fiscal Policy Guidelines for 2017-2019' (FPG). The trajectory of fiscal consolidation has been corrected using the actual figures for 2017 and the adjusted budget parameters for 2018-2019 (Chart 1.30, 1.31), which reflects the gradual tightening of fiscal policy. These changes were aided by the improved external economic climate, in part due to the successful implementation and extension of the oil production restriction agreement between OPEC countries and Russia, resulting in growth in oil prices in 2017-2018, and growth in economic activity in Russia.

Changing the formula for interventions by the amount of additional oil and gas revenues will help increase the intervention amount for every $1 per barrel change in the Urals crude price. Keeping Urals crude prices above the baseline level will allow for growth in the National Wealth Fund in the medium term. In 2018, funds accumulated from interventions in 2017 (more than ₽829 billion) in the federal budget's foreign currency accounts are expected to be transferred, while funds from interventions in 2018 are expected to be transferred in 2019. These interventions have helped reduce the sensitivity of the ruble's exchange rate and the Russian economy to changes in external commodity prices.

In 2018, as a result of the ongoing improvement in external economic conditions and revival in economic activity in Russia, the budget system and federal budget are expected to report a surplus. At the same time, in 2018, expenditure plans for the 2018-2020 budgets may be expanded compared with the parameters set out in the FTCPG. The expenditure plans for the federal budget and budget system may be adjusted, among other things, to take into account the expected revision of the Russian Government's macroeconomic forecast. In addition, further proposals to adjust expenditure may be presented after the new Government is formed in 2018 Q2. At the same time, inflation risks from fiscal policy as a result of the revision of the Russian Ministry of Finance's forecasts amid the improved

Chart 1.30

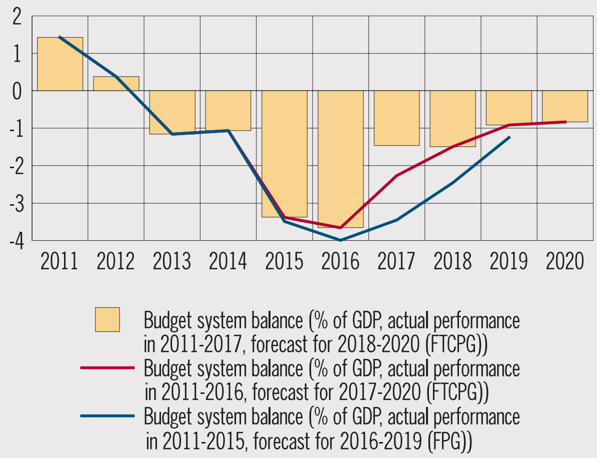
Fiscal consolidation path adjustment (by federal budget balance) in 2016-2020



Sources: Ministry of Finance, Federal Treasury, Rosstat, Bank of Russia calculations.

Chart 1.31

Fiscal consolidation path adjustment (by budget system balance) in 2016-2020



Sources: Ministry of Finance, Federal Treasury, Rosstat, Bank of Russia calculations.

macroeconomic forecast are limited, since the increase in expenditure at the federal level is limited by the increase in income, thanks to the implementation of the budget rule. Any significant increase in budgetary expenditure will be limited by opportunities provided by other elements of the budget system (regional budgets and extra-budgetary funds) to fund the deficit.

Internal economic conditions and inflation

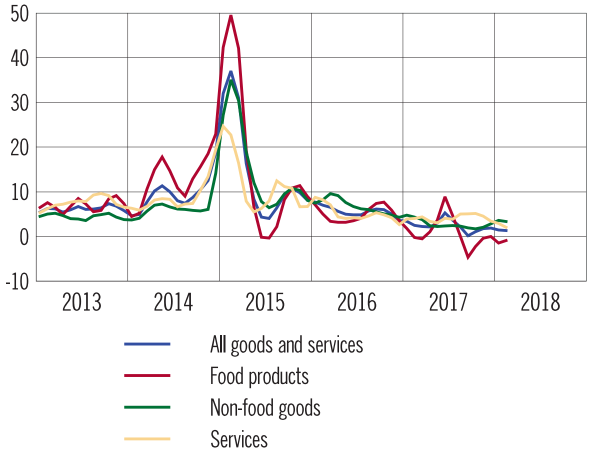
In terms of internal economic conditions, the persistently moderate inflation climate continued to be a key factor in monetary policy decision-making. However, the Bank of Russia considered it crucial to understand which factors are responsible for the current inflation slowdown and how sustainable it will be. An overall development of economic activity and the extent to which monetary policy influences economic activity and inflation were important factors.

The following points can be identified with respect to price dynamics. The shift of price growth rates to a lower level than in previous years has been systematic, broad, and can already be called stable. Prices for most consumer goods and services are growing at low rates. Consumer price growth (month on month, seasonally adjusted) slowed from mid-2017 onwards to an annualised level of less than 4% (Chart 1.32). In January-February 2018, annual inflation was at its lowest over the period under review – 2.2% (Chart 1.33). Annual growth in prices for most consumer goods and services ranges between 3-4% (Chart 1.34). Moreover, for roughly three quarters of the categories in the consumer basket, annual price growth is below 4%, while the difference between the highest price growth and the average in the basket is shrinking. Core inflation indicators, reflecting consumer price dynamics and excluding the most volatile components, hold below 4%, mostly in the 2-3% range (Chart 1.35). The dynamics of inflation indicators for certain product

Chart 1.32

Prices of consumer goods and services

(seasonally adjusted monthly price growth, three-month average in annual terms)

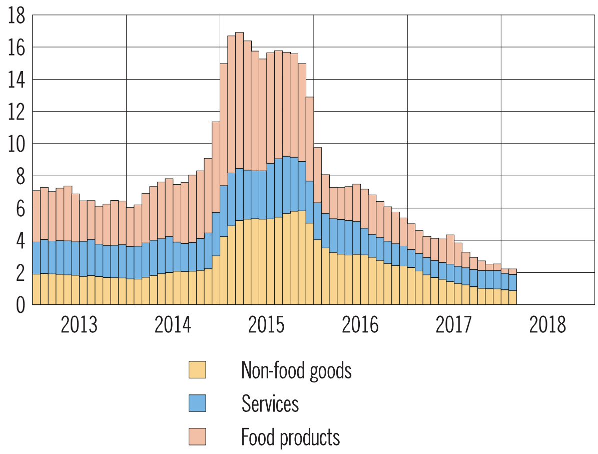


Sources: Rosstat, Bank of Russia calculations.

Chart 1.33

Contribution to inflation

(on corresponding period of previous year, percentage points)

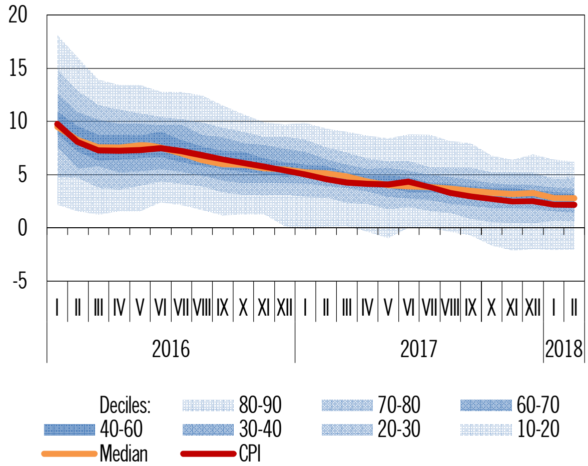


Sources: Rosstat, Bank of Russia calculations.

Chart 1.34

Annual price growth

(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Table 1.1

Inflation expectations of economic agents

Survey	Expectation horizon	2014				2015				2016				2017				2018	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	January	February
Inflation expectations (absolute), %																			
Households																			
Public Opinion Foundation	next 12 months	11.8	11.7	12.5	15.5	15.7	15.0	16.0	16.4	14.7	14.2	14.2	12.4	11.2	10.3	9.6	8.7	8.9	8.4
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	7.4	6.7	5.9	5.1	4.0	4.0	2.8	2.4	2.1	2.2
Professional analysts																			
Bloomberg	2018														4.0	4.0	4.0	4.0	4.0
Interfax	2018													4.2	4.1	4.1	3.9	3.8	3.8
Thomson Reuters	2018														4.1	4.0	4.1	3.8	3.8
Financial markets																			
OFZ-IN	next 7 years							6.4	5.8	5.4	4.6	4.5	4.6	4.5	4.3	3.9	3.7	3.7	
OFZ-IN (without option adjustment)	next 7 years							8.1	7.3	6.9	6.0	5.3	5.4	4.9	4.7	4.3	4.1	4.1	
Bond market	next quarter	6.9	7.0	7.7	8.3	10.6	15.0	14.1	14.2	12.0	6.9	7.2	6.6	5.3	4.4	4.5	3.3		
Interbank market	next quarter	6.7	7.5	8.2	10.2	14.8	17.1	15.0	13.3	9.9	5.3	5.4	5.6	4.6	3.7	3.4	2.5		
Inflation expectations (balance of replies*)																			
Households																			
Public Opinion Foundation	next 12 months	84	85	84	83	76	72	80	83	84	78	82	80	79	80	82	78	78	75
Public Opinion Foundation	next month	79	82	76	77	68	60	71	78	72	68	70	76	68	68	73	73	69	61
Enterprises																			
Russian Economic Barometer	next 3 months	26	26	32	70	32	20	28	48	14	38	36	46	22	20	14	52		
Bank of Russia		14.3	12.4	13.9	30.3	14.8	12.7	12.1	17.3	12.4	12.1	10.4	12.4	6.8	9.6	6.6	9.4	7.1	
Retail prices (Rosstat)	next quarter	42	41	41	43	31	28	30	29	32	29	28	27	27	24	24	22		
Tariffs (Rosstat)	next quarter	6	5	2	5	7	6	2	2	5	5	0	0	4	3	0	0		

Change compared with previous three months:

– inflation expectations improved (more than 1 standard deviation)

– inflation expectations improved (less than 1 standard deviation)

– inflation expectations remain unchanged (± 0.2 standard deviations)

– inflation expectations deteriorated (less than 1 standard deviation)

– inflation expectations deteriorated (more than 1 standard deviation)

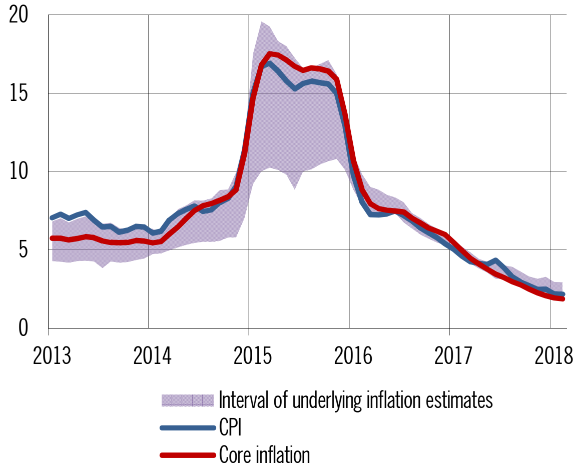
** Balance of replies is a difference in the share of replies of the respondents, who expect that prices will increase and that prices will decrease.*

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

Chart 1.35

Interval of underlying inflation estimates in Russia

(percent change on corresponding month of previous year)

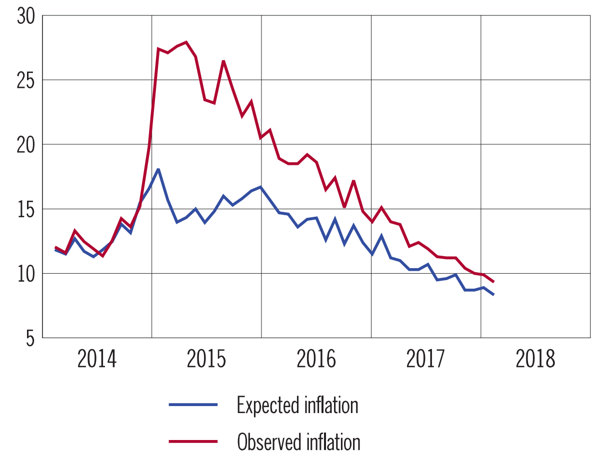


Sources: Rosstat, Bank of Russia calculations.

Chart 1.37

Median estimate of expected and observed inflation

(%)

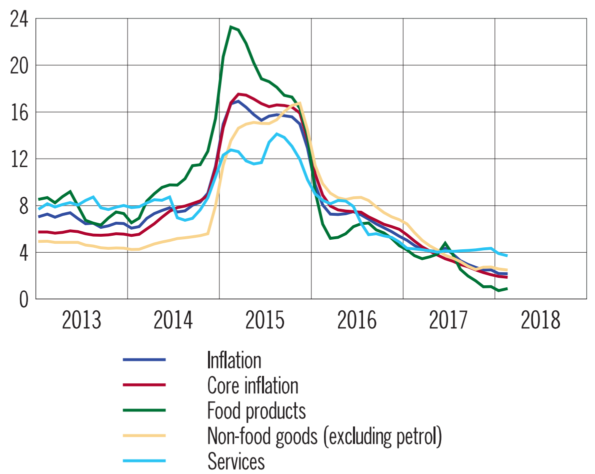


Source: InFOM.

Chart 1.36

Prices of consumer goods and services

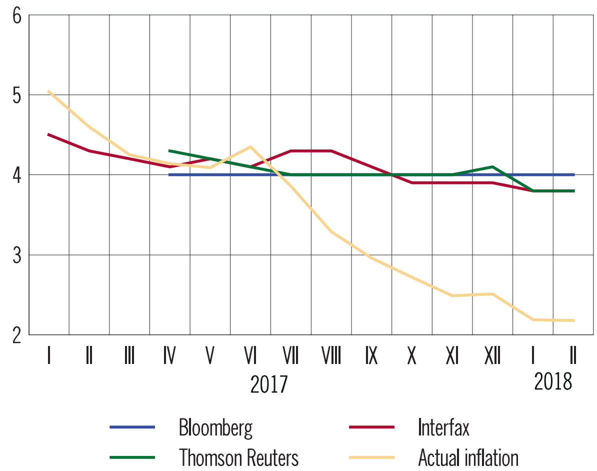
(percent change on corresponding month of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.38

Consensus forecasts by professional analysts: inflation in 2018



Sources: Rosstat, Interfax, Bloomberg, Thomson Reuters.

groups (Chart 1.36) and broken down by region (see Annex 'Inflation in Russian regions') also confirm the homogeneity of the reduction in price growth.

The inflation's steady shift to lower levels can be explained by permanent factors: lower inflation expectations and moderate demand dynamics. Monetary policy is supporting the slowdown in inflation by influencing these factors. At the end of 2017 – start of 2018, their impact was as follows.

Favourable trends continued to be observed in inflation expectations of various categories of economic agents (Table 1.1). Household inflation expectations continued to fall to fresh lows, though remaining elevated compared to the inflation target (Chart 1.37). Expectations of professional financial market participants, in their turn, stabilised at roughly 4% (Chart 1.38). This is confirmed both by surveys and indirect estimates based on pricing of inflation-indexed federal government bonds (OFZ-IN).

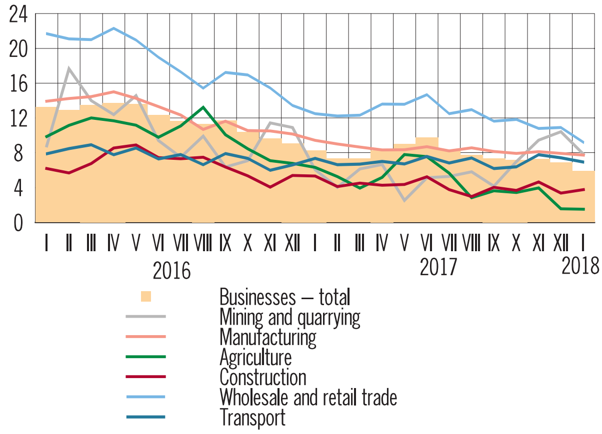
Producers' price expectations were more varied, especially in certain sectors (Chart 1.39), but remained lower than in previous years. According to the Bank of Russia's special random survey, roughly 60% of businesses[2] are assuming inflation will remain below 4% (predominantly from 3.1% to 4.0%) when making their financial plans for 2018. Businesses largely base their inflation estimates on the current and future expense dynamics, which are in turn connected to the use of fixed assets, wage

[2] *The sample consists of 1,680 businesses across the country. Manufacturers accounted for 43.1% of the sample, wholesalers and retailers – 12.4%, agricultural producers – 11.2%, and transportation and storage companies – 8.3%.*

Chart 1.39

Businesses' answers to the question: 'How will finished product prices change (increase/decrease) over the next three months?'

(balance of replies, seasonally adjusted, %)

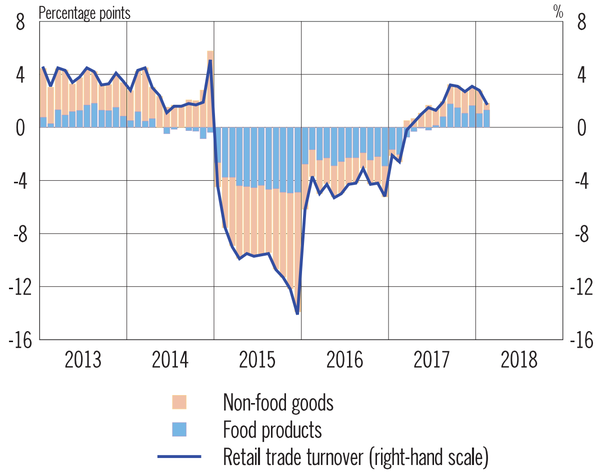


Sources: Bank of Russia, surveys of businesses.

Chart 1.40

Growth in retail trade turnover

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



Sources: Rosstat, Bank of Russia calculations.

indexation, and expected purchase price dynamics. They also factored in changes in government regulation of natural monopoly tariffs and household demand for their products. In a number of regions, businesses engaged in various types of economic activity[3] expected inflation below 1% (Republic of Khakassia, Vladimir Region, Republic of Buryatia, Chelyabinsk Region and Kamchatka Territory) or deflation (Kamchatka Territory and Penza Region). Having said that, a small group of manufacturers in such sectors as machinery and equipment, and woodworking and timberware, forecast inflation of 10%.

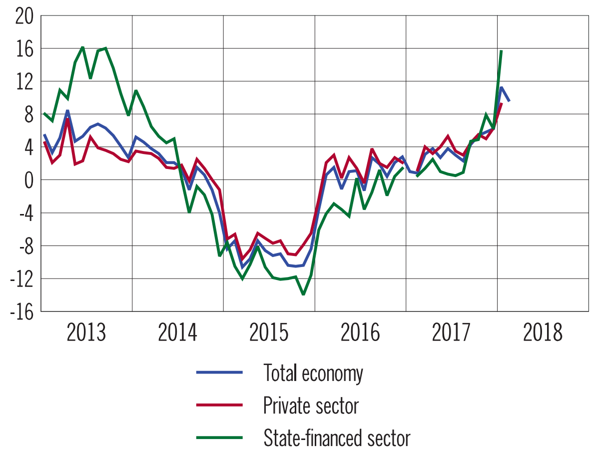
Expectations has been brought down by the growing confidence in the Bank of Russia's policy, which has already contributed to reduced inflation, has remained consistent and is becoming more transparent and understandable by the public due to a dynamic information policy. Inflation expectations form the basis for price changes through wage indexation, medium-term production planning, sales, and consumer spending. Their reduction and stabilisation at a lower level make a significant contribution to ensuring price stability (Chart 1.40).

As for internal demand, it grew sustainably at the end of 2017 and start of 2018. In the first quarters of 2018, consumer demand growth is expected to remain close to the levels observed at the start of

Chart 1.41

Real wages

(percent change on corresponding month of previous year)



Sources: Rosstat, Bank of Russia calculations.

the year. Among other factors, monetary policy had an impact on demand on several levels.

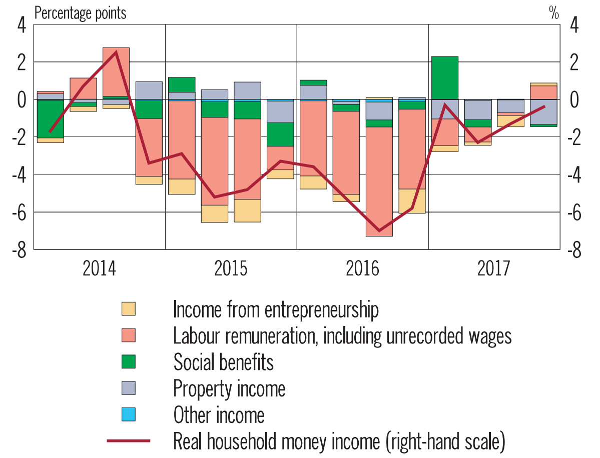
First, on a company level, the moderate easing in lending conditions created more favourable conditions to expand production, support stable demand for labour, and moderately increase investment demand while maintaining balanced growth in employee wages. At the end of 2017 – start of 2018, unemployment reduced slightly, but, taking into account the structure of the labour market, it remained close to a level that the Bank of Russia considers to be natural (not exerting any additional pressure to change wages and prices). On the other hand, increased competition between employers for skilled labour and higher public sector wages in the categories falling under

[3] *Businesses producing food, chemicals and chemical products, other vehicles and equipment; metalworking businesses, wholesalers and retailers, transportation and storage companies, and agricultural producers.*

Chart 1.42

Real household money income growth

(on corresponding quarter of previous year)

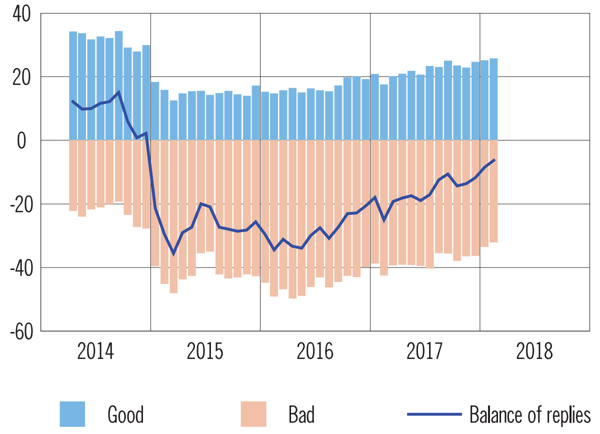


Sources: Rosstat, Bank of Russia calculations.

Chart 1.43

Estimate of favourableness of this time period for large purchases

(as % of all respondents)



Source: inFOM surveys.

the May Presidential decrees were important factors influencing the accelerated wage growth. As a result, in January-February 2018, real wage growth significantly accelerated year-on-year, far exceeding expectations (Chart 1.41). Growth in households' real disposable income, which in addition to wages includes social payments, income from business and financial transactions (Chart 1.42), also increased, but remained at lower levels, hampering growth in consumption (Chart 1.40).

Second, amid the monetary easing, household demand for loans gradually increased while investment activity in ruble-denominated financial assets remained stable. As a result, in 2017, savings rates exhibited downward trends, and, at the start of 2018, were close to long-term average levels (see Box 'Shaping household savings behaviour'). Surveys suggest that households are relatively conservative about their incomes and conditions for saving money and making large purchases (Chart 1.43). In future, with the sustained positive real interest rates in the economy, savings rates are expected to remain at a near-stable level amid balanced lending growth and sustained household interest in ruble-denominated savings.

Shaping household savings behaviour

An important factor in maintaining restrained and predictable price dynamics is preserving stable household savings behaviour. Since mid-2015, the Russian economy has witnessed a gradual decline in the savings rate, which attracted the economic community's attention in its discussion of a potential growth in inflationary pressure. At the same time, the Bank of Russia considers the change in the savings rate to be a natural process following the savings rate's precautionary surge during the 2014-2015 crisis. By the end of 2017, the savings rate returned to its stable pre-crisis levels of roughly 8%[1], and, according to Bank of Russia estimates, it will stabilise at approximately this level in the first half of 2018 (Chart 1.44).

When analysing household savings, it is important to remember that they are made up of various components and the dynamics of each of them are shaped by both general and specific factors. In addition, the impact of some factors on certain components can be varied. For example, growth in real wages, on the one hand, can have a

[1] *To calculate the savings rate, the Bank of Russia uses banking statistics (on households' and sole proprietors' outstanding loans and deposits in rubles and foreign currencies, to estimate real estate investments in the primary market), balance of payments data (on cross-border transfers, to estimate investments in foreign real estate), Moscow Exchange data (on net securities purchases), and Rosstat data (on household disposable income). Changes in outstanding loans are included in savings as a negative value. The savings rate is calculated as the ratio of savings to household disposable income over a specified period of time.*

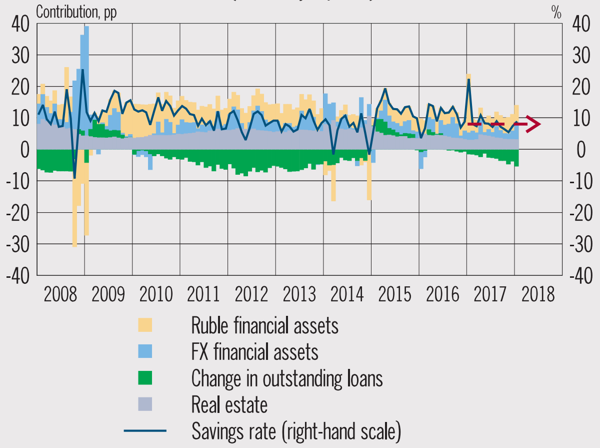
positive impact on savings by increasing the value of ruble-denominated and foreign exchange assets and real estate investments, but on the other hand, it can have a negative impact, since it stimulates growth in outstanding loans (included in savings as a negative value).

Hence, in order to estimate the savings rate's possible future trajectory, household savings were assigned to four categories: ruble-denominated assets (change in households' and sole proprietors' ruble-denominated account balances, net purchases of securities and change in cash held by households), foreign exchange assets (change in households' and sole proprietors' foreign currency account balances, net purchase of foreign currency), real estate investments (purchases of real estate in Russia on the primary market and abroad), and changes in households' and sole proprietors' outstanding loans.

Chart 1.44

Savings rate stabilises near pre-crisis level

(seasonally adjusted)



Source: Bank of Russia calculations.

An analysis of the breakdown of the savings rate in previous periods makes it possible to identify certain patterns in the behaviour of individual components. For example, the initial reaction to a change in economic conditions that is accompanied by a substantial depreciation of the ruble is often a reduction in the savings rate in terms of investments in ruble-denominated assets. This can be explained by households' effort to protect savings from depreciation by acquiring durable goods, foreign currency and property. However, the savings rate recovers relatively quickly and exceeds its previous levels. In this case, an elevated (relative to long-term stable figures) savings rate is not only supported by the accumulation of assets as a precaution, but also by changes in outstanding loans, which start to make a positive contribution to the savings rate (loan repayments exceed new loans).

In periods when the economic situation is relatively favourable, a change in outstanding loans can make a negative contribution to the savings rate (households actively seek new loans instead of paying off existing loans). This has been observed since the end of 2016. With growth in outstanding loans accelerating, the negative contribution of outstanding loans has gradually increased, causing a gradual reduction in the savings rate.

However, in the first half of 2018, according to the Bank of Russia's estimates, the growth in households' outstanding loans will not accelerate drastically. On the one hand, growth in real wages, reduction in loan rates, and increase in maturities (as a result of the longer planning horizon due to the increased economic stability) will contribute to growth in household lending. Nevertheless, this effect will be partially offset by increased repayments on existing loans (an effect of delaying repayment of debt). As a result, the changes to outstanding loans are expected to make approximately the same negative contribution to overall savings rates dynamics in the coming months.

According to estimates, the foreign exchange assets are stabilising close to the long-term average after a small short-term surge in January 2018, due in part to the strengthening of the ruble in December-January. The intensity of investments in ruble-denominated assets may slow somewhat in the first half of 2018 as interest rates fall. At the same time, real estate investments are expected to stabilise, aided by falling mortgage rates and the government's mortgage assistance programme for families with children.

Hence, in the first half of 2018, the change in outstanding loans and foreign exchange assets will make a small contribution to savings rate dynamics, while the slightly reduced growth in ruble-denominated assets will be offset by the slowing decline in real estate investment. As a result, after a short-term surge in January 2018 (caused by growth in foreign exchange assets), the savings rate is expected to stabilise close to its long-term stable level.

Considering the combination of the above factors, the baseline scenario assumes that consumer demand will continue to smoothly increase in the first half of 2018, gradually bringing inflation closer to the target.

With regard to the exchange rate factor, the moderately tight monetary policy, along with the budget rule, helped maintain a relatively stable ruble exchange rate at the end of 2017 – start of 2018. At the same time, the large number of both external and internal factors continued to have a mixed impact on the current exchange rate (see Section 'External conditions'). The ruble's exchange rate fluctuations had an overall negligible impact on annual inflation in late 2017 – early 2018.

Supply-side factors also continued to have an effect on inflation at the end of 2017 – start of 2018. These are mainly the internal agricultural market, and factors related to price regulation and changes in the external commodity markets.

Annual food inflation was 0.9% in February 2018 (0.7% in January) with annual price growth for non-food goods and services at 2.5% and 3.7% respectively (Chart 1.37). Having said that, it was even slightly lower than previously expected, which was the main driver of a slight reduction in the overall consumer inflation forecast for the coming months. It should be noted that it is quite difficult to unequivocally estimate the high harvest's impact on inflation taken separately. The current downward trend in food prices not only directly reflects the increase in yield (including when the favourable weather conditions are taken into consideration), but also the structural expansion of supply through investment and technological development (including those supported by government measures). In 2018 Q2, year-on-year food inflation is still expected to fall due to the base effect. From Q3 onwards, as the new harvest comes in, and amid the increase in demand, it will accelerate to levels comparable with other categories (non-food goods and services), approaching consumer inflation at 4%.

Price regulation factors had a disinflationary effect. In January–February 2018, the increase in rail fares, which was less than the previous year, contributed to the slowdown in annual inflation. Prices for medical products, which are regulated in case of essential drugs and the most important medicines, remained lower than the previous year. Another factor was the increase in excise taxes, which typically takes place at the start of the year. The contribution of this factor to annual inflation is estimated to be lower than in 2017 (see Box 'Impact of changes in excise rates on inflation in 2018').

Impact of changes in excise rates on inflation in 2018

In 2018, as in previous years, excise rates on certain goods in the consumer basket used to calculate the consumer price index are to be increased, in accordance with the Russian Tax Code (Table 1.2). Excise taxes have been partially increased since the start of 2018, with the remaining increase taking place after 1 July 2018. This factor's combined contribution to consumer inflation in 2018 is estimated to be 0.2 pp (Table 1.3) compared with 0.3 pp in 2017. Hence, the increase in excise taxes will not exert any significant additional inflationary pressure this year.

The 2018 increase in excise tax on fuel will take place in two stages: after 1 January and after 1 July. Overall, over the course of the year, excise taxes on motor petrol will increase by an average of 17%, causing petrol's price to increase by 2 rubles 7 kopeks per litre. Diesel excise taxes will increase by 11.4%, causing diesel's price to growth by

Table 1.2

Excise rate movements and their share in excisable goods prices

(%)

Excisable goods	Excise growth rate in 2018	Excise share in consumer price in 2017
Motor petrol	17	19.5
Diesel fuel	11.4	16.6
Light vehicles	4.2	2.8
Tobacco products	8.2	48.9

Sources: Rosstat, Tax Code of the Russian Federation, Bank of Russia calculations.

76 kopeks per litre. If the dual excise increases are fully translated into petrol and diesel retail prices, all things being equal, there will be a 5.3% and 1.9% growth in petrol and diesel prices, which will contribute roughly 0.14 pp to annual inflation.

Since 1 January 2018, excise taxes on light vehicles have increased by 4.2%, which, all things being equal, will cause retail vehicle prices to increase this year by an average of 853 rubles 79 kopeks, or 0.1%. The increase in excise rates on light vehicles will have an insignificant impact on inflation.

After 1 July 2018, excise taxes on cigarettes are expected to increase by 8.2%, which, all things being equal, will lead to average price growth of 3 rubles 61 kopeks per packet of cigarettes, or 4%. The contribution to annual inflation will be roughly 0.05 pp.

Table 1.3

Excisable goods price movements and their impact on inflation

Excisable goods	Consumer price growth rate in 2018	Contribution to annual inflation in 2018, pp
Motor petrol	5.3	0.13
Diesel fuel	1.9	0.01
Light vehicles	0.1	0.01
Tobacco products	4	0.05
Cumulative contribution to inflation	-	0.2

Sources: Rosstat, Tax Code of the Russian Federation, Bank of Russia calculations.

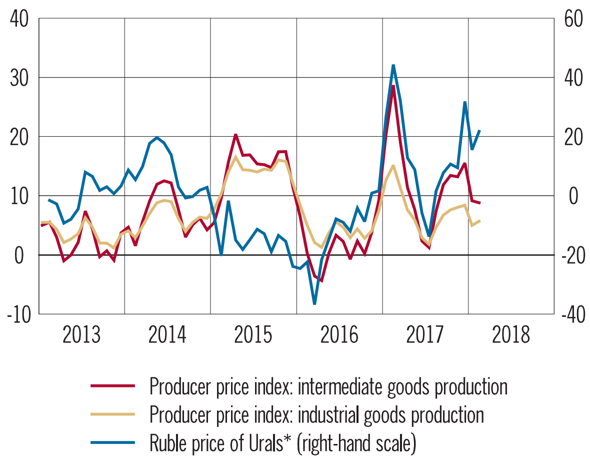
Overall, the favourable climate in the global food markets (see Section 'External conditions') did not pose any significant risks of acceleration in consumer price growth in Russia. However, growth in global energy prices, against the comparable levels in the previous year, is exerting some upward pressure on producers' expenses and prices (Chart 1.45).

In the first half of 2018, annual inflation will remain low, primarily due to food price dynamics. The conditions for its gradual return to 4% in the second half of the year will result, firstly, from the end of excess supply factors and, secondly, from the ongoing revival in demand, buoyed by income dynamics and a gradual reduction in the constraining influence of monetary policy.

Chart 1.45

Producer prices and oil price

(percent change on corresponding period of previous year)



** One month lag.*
Sources: Rosstat, Bank of Russia, Thomson Reuters, Bank of Russia calculations.

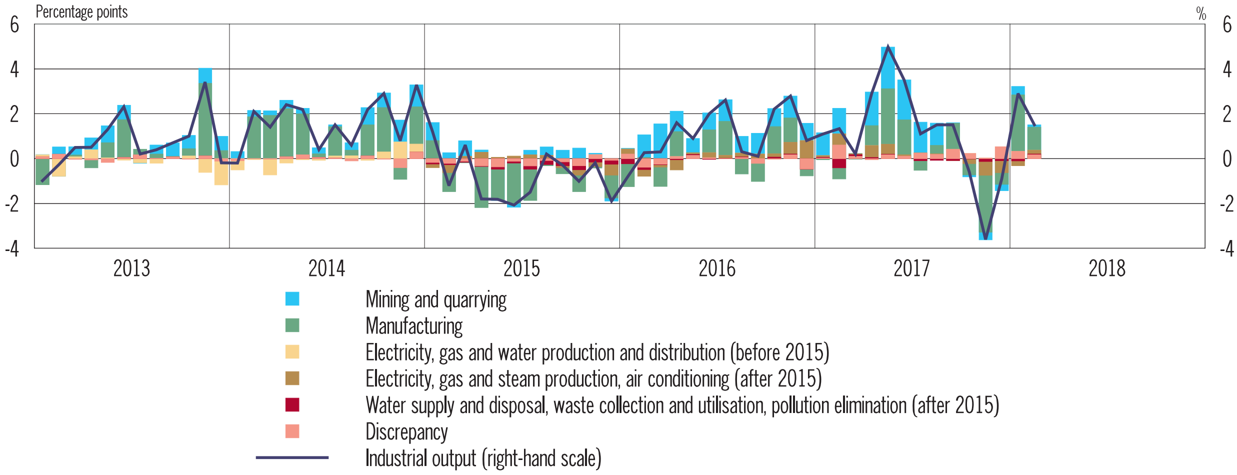
With regard to estimates of current dynamics and economic activity forecasts at the end of 2017, GDP growth was 1.5%, which is slightly below the lower bound of the previous MPR's forecast. The main reason for this deviation from the forecast was the slightly higher than expected slowdown in economic activity in 2017 Q4. This can be largely explained by the effects of temporary factors, which mostly came in October and November and resulted in low production activity indicators in these months (Chart 1.46). In particular, there was a reduction in energy, gas and water production and distribution as a result of warm weather and slowing annual growth in metallurgy (due to the high base effect of the previous year) and certain manufacturing industries, in part due to shrinking government orders.

At the same time, in January 2018, economic activity witnessed renewed growth, including the production of commodities and intermediate goods, investment goods, and consumer goods (mostly non-food goods). February's industrial production data pointed to more moderate growth in production

Chart 1.46

Contribution of industrial output components

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

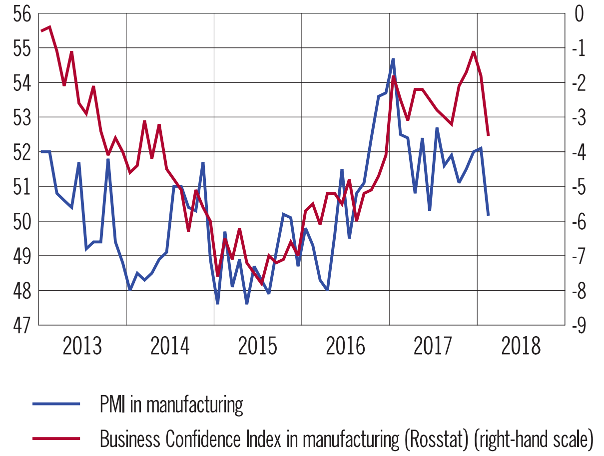


Sources: Rosstat, Bank of Russia calculations.

Chart 1.47

Business Confidence Index and PMI index

(seasonally adjusted)

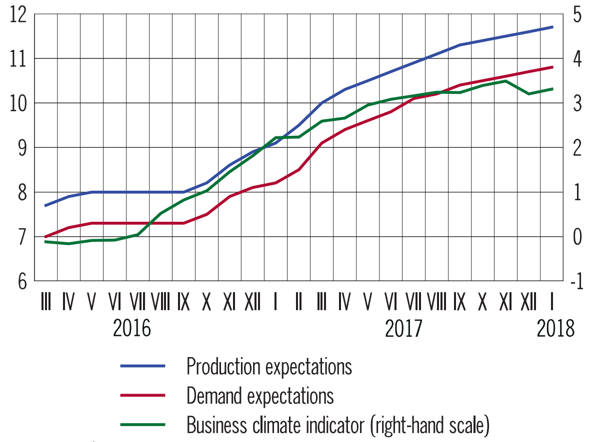


Sources: Rosstat, Markit PMI.

Chart 1.48

Business expectations for the next three months and business climate indicator*

(balance of replies, seasonally adjusted, %)



** All sectors of the economy.*
Source: Bank of Russia.

compared with the previous year. However, overall economic activity indicators, including when viewed alongside January's figures, are in line with the Bank of Russia's baseline scenario forecast.

Business sentiment remains overall positive (Chart 1.47). According to the Bank of Russia's surveys of non-financial companies, the majority of respondents have an optimistic outlook for the future, expecting growth in demand and increased production in February-April 2018. Overall, the business climate indicator[4] for the economy as a whole and key economic industries was positive, with its value in January 2018 improving compared with December 2017. The exception was construction, for which the business climate indicator has been negative for a long time (Chart 1.48).

Exports are still growing steadily, despite the current restrictions on oil production. In the second half of winter, exports were further buoyed by European demand for energy, due to cold weather. Indirect indicators pointed to a recovery in investment activity (Chart 1.49).

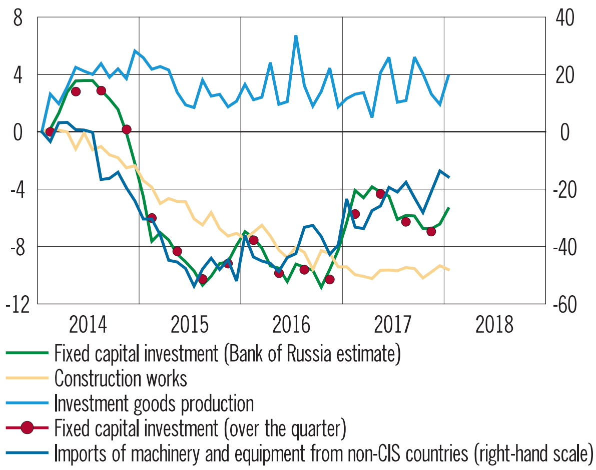
Overall, the structure of growth in domestic output remains stable. The expansion of domestic output is due to recovering demand (both internal and external) (Chart 1.50). At the same time, the increased consumer and investment demand has

[4] *The business climate indicator is a figure reflecting business confidence. It is calculated using estimates of actual and expected changes in supply and demand in the market from businesses surveyed by the Bank of Russia. It uses seasonally adjusted figures for the analysis.*

Chart 1.49

Investment activity indicators

(percent growth on January 2014, seasonally adjusted)

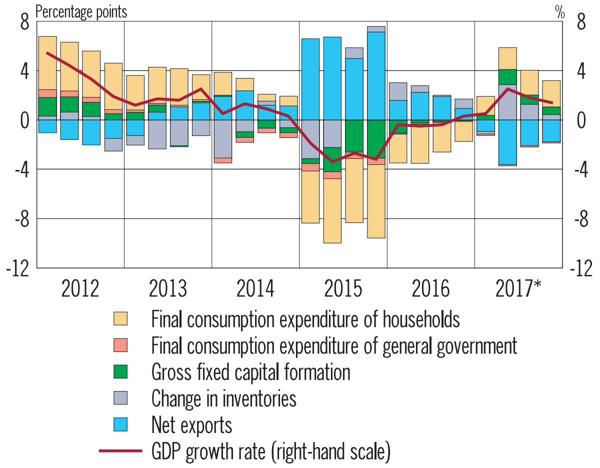


Sources: Rosstat, FCS of Russia, Bank of Russia calculations.

Chart 1.50

GDP growth structure by expenditure

(on corresponding period of previous year)



** 2017 Q4 - Bank of Russia estimate.*

Sources: Rosstat, Bank of Russia calculations.

been largely satisfied through the rapid increase in imports, considering the structure of the increase and given the stable exchange rate dynamics. Modest government expenditure, both on final consumption and on capital investment, amid the conservative fiscal policy geared towards the long-term stability of government finances, made a negative contribution to output growth.

In 2018 Q1–Q2, growth in output is expected to accelerate compared with 2017 Q4 and annual GDP growth will be 1.5-2.0%, which is largely in line with previous forecasts.

2. ECONOMIC OUTLOOK

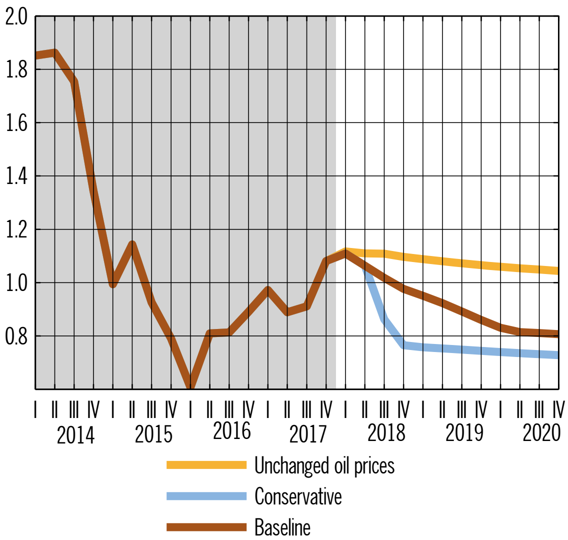
Developments in the Russian and global economy at the end of 2017 – first few months of 2018 did not significantly change the Bank of Russia's outlook on key trends in inflation and economic activity in Russia in the medium term relative to the picture presented in the previous MPR. In this MPR, the Bank of Russia has only refined its medium-term forecast to account for statistical data and recent events. The outlook on key internal economic development factors remained largely unchanged compared with December's MPR. The main update in the forecast is related to the assumptions regarding oil prices and growth in the global economy, which are reflected in Russia's income from foreign economic activity. However, taking into account the effects of the budget rule, which smoothes over energy price fluctuations' effect on internal economic conditions, the differences in the oil price scenarios are becoming less significant in terms of oil prices' impact on medium-term forecast parameters and monetary policy decision-making.

The oil price assumptions have been adjusted slightly upwards in all of the scenarios examined by the Bank of Russia's Board of Directors in its key rate decision-making (Chart 2.1). The revised baseline scenario assumes that oil prices will remain at roughly $60 per barrel in 2018 and gradually fall to $50 per barrel by the end of the forecast period. The baseline scenario in December's MPR assumed lower oil prices and a faster decrease from $55 per barrel in 2018 to roughly $45 per barrel in the medium term. In the updated forecast, this scenario has been retained as a second (conservative) scenario. The third scenario assumes that oil prices will remain close to average levels for January-March this year (roughly $65 per barrel) over the entire forecast period. Two of these scenarios cover the most likely course of events considered by the Bank of Russia's Board of Directors in its key rate decision-making around the baseline scenario.

The upward revision of oil price assumptions in all of the scenarios is related to the following factors. First, the upward trends in current energy price dynamics amid the faster than expected decline in global oil reserves and high degree of compliance with the oil production cut agreement by OPEC+ countries are creating the necessary pre-conditions for higher oil prices than those set out in the baseline scenario of December's MPR. Second, the consistently high level of compliance with the production cut agreement shows that the parties to the agreement still have incentives to keep oil prices at relatively high levels. As a result, it is more likely that the easing of the restrictions under the agreement will be gradual rather than drastic in the medium term. This will cause a gradual adjustment in oil prices after the agreement expires. Third, more dramatic growth in global demand for energy, as forecast by a number of international organisations[1] amid more favourable global economic outlook[2], could also help to buoy oil prices.

Chart 2.1

Terms of trade



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

[1] *In March, a number of international organisations revised their 2018 global oil demand forecast upwards relative to December's estimates: OPEC – from 1.5 million B/D to 1.6 million B/D; the International Energy Agency – from 1.3 million B/D to 1.5 million B/D; and the US Energy Information Administration (EIA) – from 1.6 million B/D to 1.7 million B/D.*

[2] *In January 2018, the IMF revised its global GDP growth forecast for 2018 and 2019 upwards by 0.2 pp to 3.9%.*

This revision of oil price assumptions has mainly had an effect on the adjustment of forecast parameters associated with foreign economic activity, including balance of payments indicators, and real export and import dynamics. At the same time, as noted above, this adjustment has not led to any significant change in the forecast for other economic indicators compared with December's MPR, due to the gradual increase in the Russian economy's resilience to changes in external conditions, including under the influence of the budget rule.

Baseline scenario

In terms of external conditions, together with adjusting the trajectory of oil prices, aggregate estimates of annual growth in Russia's trading partners have also been slightly improved, from 2.3-2.4% to 2.4-2.6% in the medium term. The slightly higher growth in external demand will help buoy Russian exports slightly, but will not have any significant impact on economic growth rates in Russia. Amid the higher than expected oil prices, the forecast for a current account surplus has been revised upwards compared with December's MPR, mainly due to the value of exports being revised. As we approach the end of the forecast period, amid the gradual reduction in oil prices, the current account balance will gradually reduce, from 3.5% of GDP in 2018 to roughly 1.3% of GDP in 2020 (see Annex 'Balance of payments forecast for 2018-2020'). With higher current account revenues, the ruble will be stronger than in December's baseline scenario. However, thanks to the budget rule, which smoothes over ruble exchange rate fluctuations, the exchange rate is not expected to make a significant contribution to inflation in the medium term.

The global economy growth, which has been steadier than previously anticipated, will support incentives for foreign central banks to gradually normalise monetary policy, exerting an upward pressure on interest rates in developed countries. In these conditions, according to Bank of Russia estimates, external inflationary pressure will remain modest and will not have any significant impact on price dynamics in Russia like the situation in the foreign commodity market[3]. In the medium term, foreign rates may exert some upward pressure on rates for foreign currency banking operations in Russia.

The reduced difference between the rates in advances and emerging market economies, which has already been partly observed and has an impact on global investors' risk attitudes, may somewhat weaken their interest in emerging markets in future. In the medium term, this could lead to a gradual flow of capital between developed countries and emerging market economies, which will, firstly, contribute to a weakening of emerging market countries' currencies and, secondly, exert upward pressure on their risk premiums. Taking this into account, in the medium term, a slight increase in risk premiums, including for Russia, is possible. However, in the absence of significant preconditions for a substantially accelerated convergence of financial conditions in relation to what has been observed in recent months, this process will remain gradual, and its impact will not be decisive in shaping these indicators in the near future. However, compared with December's estimates, the baseline forecast predicts a lower risk premium for Russia, taking into account the assumption that oil prices will be higher, together with the strong demand for Russian assets observed in the initial months of 2018, even amid periods of increased volatility in global financial markets. Overall, this confirms the willingness of foreign investors to invest in Russian assets, which will contribute to an inflow of capital.

With Russia's improved investment appeal and the relatively favourable economic activity dynamics under the baseline forecast, companies are expected to increase their foreign liabilities more intensively in the medium term than predicted in December's MPR. Opportunities for Russian companies and banks to increase their foreign assets will also expand due to the higher export revenues as a result of higher oil prices. In the baseline scenario, according to Bank of Russia estimates, net private sector lending to the rest of

[3] *The anticipated good harvest and high global grain stock in 2018 and the reduction in oil prices in 2019-2020 predicted in the Bank of Russia's baseline scenario will constrain global food prices.*

Table 2.1

Russia's balance of payments indicators*

(billions of US dollars)

	2017 (estimate)	2018		2019		2020	
		baseline	unchanged oil prices	baseline	unchanged oil prices	baseline	unchanged oil prices
Current account	**40**	**59**	**76**	**39**	**74**	**23**	**74**
Balance of trade in goods	116	140	164	121	165	107	170
Exports	*354*	*398*	*419*	*384*	*437*	*372*	*451*
Imports	*-238*	*-258*	*-254*	*-263*	*-272*	*-265*	*-281*
Balance of services	-30	-32	-33	-32	-36	-33	-39
Exports	*58*	*61*	*61*	*65*	*65*	*66*	*66*
Imports	*-88*	*-93*	*-94*	*-97*	*-100*	*-99*	*-106*
Primary and secondary income balance	-45	-50	-55	-51	-56	-52	-57
Capital account	0	0	0	0	0	0	0
Current and capital account balance	**40**	**59**	**76**	**39**	**74**	**23**	**74**
Financial account (excluding reserve assets)	**-21**	**-9**	**-20**	**-8**	**-21**	**1**	**-17**
General government and the central bank	14	9	9	8	8	8	8
Private sector	-35	-19	-28	-15	-28	-7	-25
Net errors and omissions	**4**	**0**	**0**	**0**	**0**	**0**	**0**
Change in reserve assets («+» – decrease, «-» – increase)	**-23**	**-50**	**-57**	**-31**	**-53**	**-24**	**-57**

** Signs according to BPM5.*

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

Table 2.2

Key parameters of the Bank of Russia's forecast scenarios

(growth as % of previous year, unless indicated otherwise)

	2017 (actual)	2018		2019		2020	
		baseline	unchanged oil prices	baseline	unchanged oil prices	baseline	unchanged oil prices
Urals price, average for the year, US dollars per barrel	53	61	65	55	65	50	65
Inflation, % in December year-on-year	2.5	3.0-4.0	3.0-4.0	4.0	4.0	4.0	4.0
Inflation, yearly average, as % year-on-year	3.5	2.5-3.5	2.5-3.5	4.0	4.0	4.0	4.0
Gross domestic product	1.5	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0
Final consumption expenditure	2.3	2.7-3.2	3.0-3.5	2.0-2.5	2.5-3.0	2.0-2.5	2.0-2.5
– households	*3.4*	*3.8-4.3*	*4.0-4.5*	*2.5-3.0*	*3.0-3.5*	*2.5-3.0*	*2.5-3.0*
Gross formation	7.6	2.5-3.5	2.5-3.5	3.0-4.0	3.5-4.5	2.0-3.0	2.0-3.0
– gross fixed capital formation	*3.6*	*3.5-4.0*	*3.5-4.0*	*3.2-3.7*	*3.5-4.0*	*2.5-3.0*	*2.5-3.0*
Exports	5.4	1.8-2.3	2.0-2.5	1.5-2.0	1.5-2.0	1.5-2.0	1.5-2.0
Imports	17.0	7.5-8.0	7.5-8.0	6.0-6.5	7.0-7.5	4.5-5.0	4.5-5.0
Money supply in national definition	10.5	8-10	9-12	9-12	9-12	8-12	8-12
Lending to non-financial and financial organisations and households in rubles and foreign currency	9	8-10	9-12	9-12	9-12	8-12	8-12
– lending to non-financial and financial organisations in rubles and foreign currency, growth as % over year	*8.1*	*7-9*	*8-11*	*8-11*	*8-11*	*7-10*	*7-10*
– lending to households in rubles and foreign currency, growth as % over year	*12*	*11-13*	*12-15*	*11-14*	*12-14*	*11-14*	*12-14*

the world has been revised upwards compared with December's MPR. At the same time, in 2019-2020, the Russian private sector's demand for foreign assets will remain low by historical standards (see Table 2.1; Annex 'Balance of payments forecast for 2018-2020').

Although external economic conditions continue to be a major factor in the development of the Russian economy, internal factors will have the greatest impact on both economic activity and inflation.

On 23 March 2018, the Bank of Russia decided to reduce the key rate by 25 bp to 7.25% p.a., and in 2018, will continue to reduce the key rate as it completes the transition to neutral monetary policy. Internal financial conditions in the Russian economy will continue to be shaped by the Bank of Russia's transition from moderately tight to neutral monetary policy, on the one hand, and economic entities' deliberate approach to risk-taking, on the other hand. In the medium term, the Bank of Russia's key rate may move both upwards and downwards depending on inflation, economic activity, and their medium-term forecasts. Under the baseline forecast, according to Bank of Russia estimates, the gradual monetary policy easing will stimulate effective demand for loans in the economy, contributing to balanced growth in consumer and investment activity, and creating conditions for inflation to return to roughly 4% without accumulating systemic risks and imbalances. The moderate growth in lending will also be buoyed by income dynamics in the economy, remaining healthy in terms of risks to financial stability and not creating excessive proinflationary pressure. In the event of signs of imbalance in certain market segments, the Bank of Russia will promptly mitigate them using macroprudential policy measures.

As monetary policy is eased over the forecast period, lending rates to ultimate borrowers will continue to fall. As in the past, it will be more gradual, following the Bank of Russia key rate. Taking into account the expected easing of monetary policy in 2018 and the delay in the transmission of key rate decisions to various segments of the financial market, in the baseline scenario, the main potential for an interest rate reduction will disappear by 2019. A further reduction in nominal interest rates on loans will be possible as inflation expectations decrease and the situation in the economy as a whole improves.

Interest rates for households are expected to decrease slightly faster than for companies. This is due to this segment's greater accumulated potential for reduced borrowing costs when compared with the corporate segment, and, among other factors, is due to banks' conservative approach to assessing risks for this group of borrowers. The faster reduction in interest rates for households will cause household lending to grow slightly faster than in the corporate sector.

In terms of easing of non-price lending conditions, banks will continue to adopt a measured approach, preferring the most reliable borrowers, and gradually and cautiously switching over to more risky segments of the credit market. The main factor behind the reduction in the tightness of non-price conditions will continue to be the dynamics of borrowers' financial positions. In the medium term, income growth will be the main factor behind the expansion in lending. Alongside higher incomes, extended maturities will make a positive contribution to the lending growth, reflecting the general increase in the planning horizon amid stabilising macroeconomic dynamics in the medium term.

In 2018, the annual growth in lending to the economy (here and elsewhere, in broad definition[4]) will range between 8-10% to accelerate slightly to 9-12%) in 2019 as economic activity growth rates continue to be higher than in the previous years and confidence improves. In the medium term, it will stay close to the current levels (Table 2.2, Chart 2.2).The aggregate debt burden[5] in the Russian economy consistent with growth will stabilise at 21-22% of GDP in the medium term, which corresponds to its value at the start of 2018 (Chart 2.3). The future trajectory of lending growth and debt burden dynamics is overall in line with

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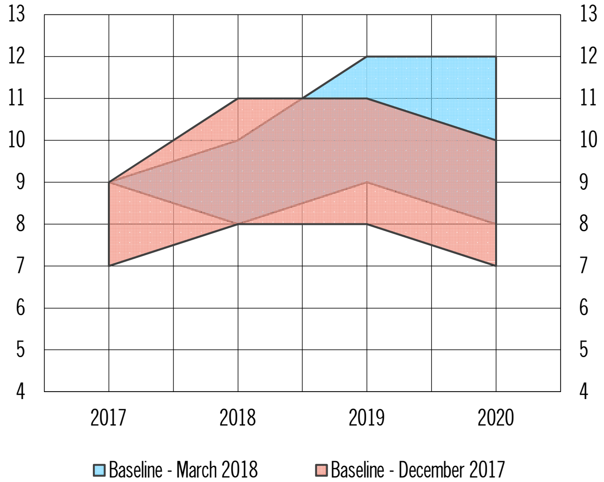
[4] Banking sector lending to the economy means all of the banking sector's claims on non-financial and financial institutions and households in the currency of the Russian Federation, foreign currency, and precious metals, including loans issued (including overdue loans), overdue interest on loans,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

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

Chart 2.2

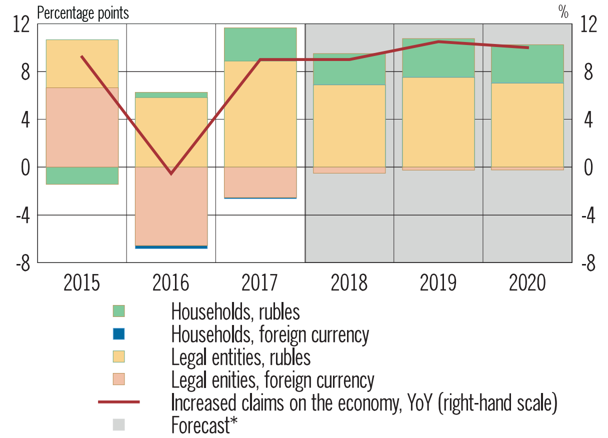
Lending to the economy
(percent change on previous year)



Source: Bank of Russia calculations.

Chart 2.4

Contribution to increased claims on the economy
(percent change on previous year)



** Forecast decomposition is provided for the increased claims on the economy corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations.

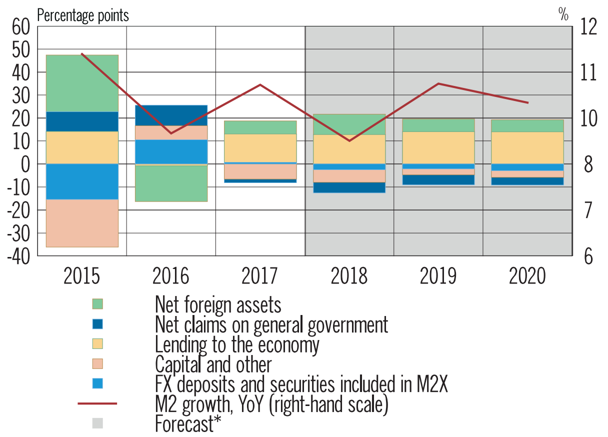
Chart 2.3

Debt burden*
(% of GDP)

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

Chart 2.5

Contribution of components to M2 growth
(percent change on previous year)



** Forecast decomposition is provided for M2 growth corresponding to the middle of the forecast range.*
Source: Bank of Russia calculations.

December's MPR assumptions. Slightly higher than previously assumed quantitative estimates (in December's MPR, growth in lending to the economy was estimated at 8-11% in 2018-2019 and 7-10% in 2020) are attributed to the Bank of Russia's more optimistic outlook on income dynamics in the Russian economy and relatively high oil prices hold for a longer period and decline more smoothly on the forecast horizon, among other things. The upward adjustment of growth in lending to the economy will largely come from income growth, and therefore will not cause excessive debt burden.

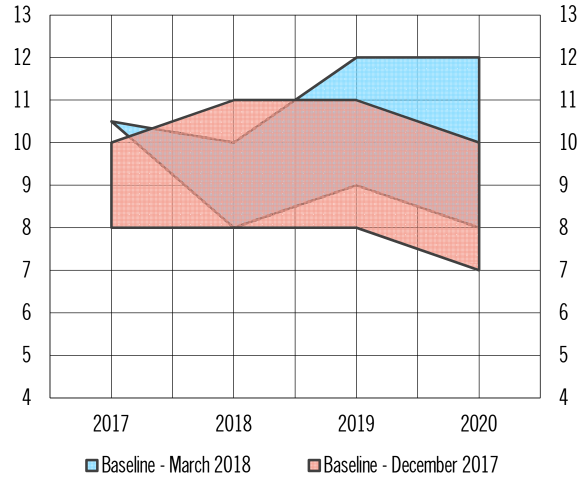
The corporate sector is expected to see further gradual debt shrinkage after the surge in accumulated debt in 2015. Annual growth in corporate lending is expected to be 7-9% in 2018 and 7-11% over the rest of the forecast period. Household lending will outpace lending to the corporate sector: its medium-term annual growth is estimated at 11-14%. Growth in household lending will be accompanied by a slight increase in the debt burden. However, given the smooth nature of these processes, and the gradual increase in households' engagement in financial transactions, this growth may be considered a return to the long-term trend. As inflation and exchange rate dynamics stabilise over the forecast period, foreign currency loans will lose their appeal to ruble loans; this will shrink their share in the structure of claims on the economy (Chart 2.4).

As before, we expect growth in lending to the economy to be the main contributor to money supply

Chart 2.6

Money supply

(percent change on previous year)

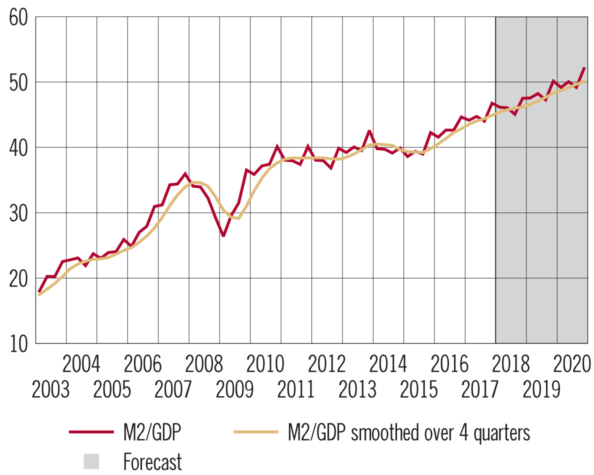


Source: Bank of Russia calculations.

Chart 2.7

Economy monetisation

(money supply in national definition relative to GDP, %)



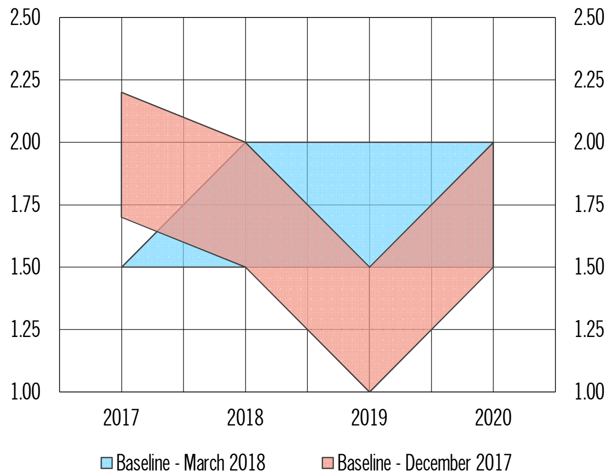
Source: Bank of Russia calculations.

in the national definition, balancing the dynamics of other money supply components to meet the economy's demand for money (Chart 2.5). Net banking sector lending to the general government will gradually reduce as the Russian Government progressively implements its fiscal consolidation policy and the mechanism to accumulate funds under the budget rule. Amid moderate fund expenditure, the monetary base dynamics will be in line with money supply dynamics over the forecast period and will largely be determined by changes in cash in the economy. Net foreign assets will increase, mostly through the accumulation of international reserves. However, the contribution

Chart 2.8

GDP

(percent change on previous year)



Source: Bank of Russia calculations.

of this component to money supply dynamics will gradually decline over the forecast period.

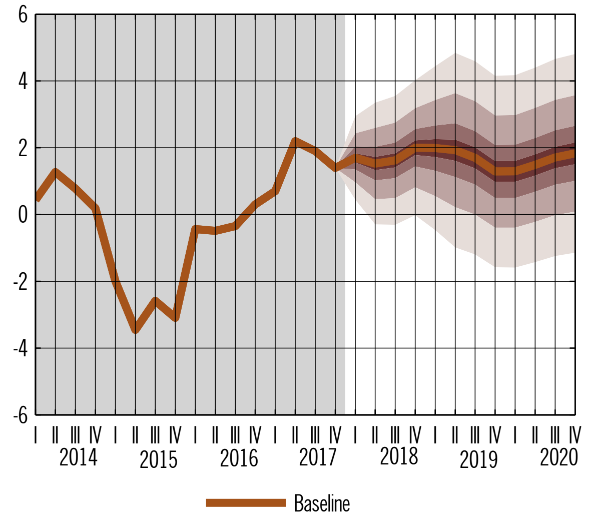
Given these factors, the annual growth in money supply will be close to the growth in lending to the economy in the medium term, and will be 8-10% in 2018, 9-12% in 2019, and 8-12% in 2020 (Chart 2.6). The increase in money supply will be consistent with GDP growth, taking into account the gradual increase in the level of monetisation of the economy, in line with previous trends (Chart 2.7). The outlook for money supply and lending to the economy remained generally unchanged compared with the previous MPR. The upward revision of the estimated increase in money in the economy is related to the period of high economic growth, which has been longer than in the baseline scenario in December's MPR, and therefore related to the larger number of transactions in the economy.

Over the forecast period, GDP growth will be close to its potential level, considering that the current economic structure remains unchanged, and will be 1.5-2.0% YoY in 2018-2020 (Chart 2.8). Unlike December's MPR, growth in GDP as a whole and its components broken down by use, is not expected to slow significantly (or even temporarily) over the forecast period (Chart 2.9). This will be aided, first, by a reduction in oil prices that is smaller and more gradual than previously forecast, and, second, economic activity indicators' increased resilience to external shocks, including as a result of the budget rule. In other respects, the outlook for the structure and main factors behind growth

Chart 2.9

GDP growth

(percent change on corresponding period of previous year)

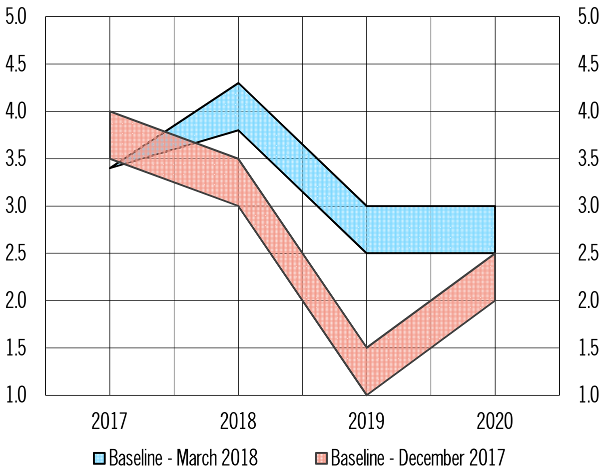


Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on historical estimates of GDP growth uncertainty.
Source: Bank of Russia calculations.

Chart 2.10

Household final consumption

(percent change on previous year)



Source: Bank of Russia calculations.

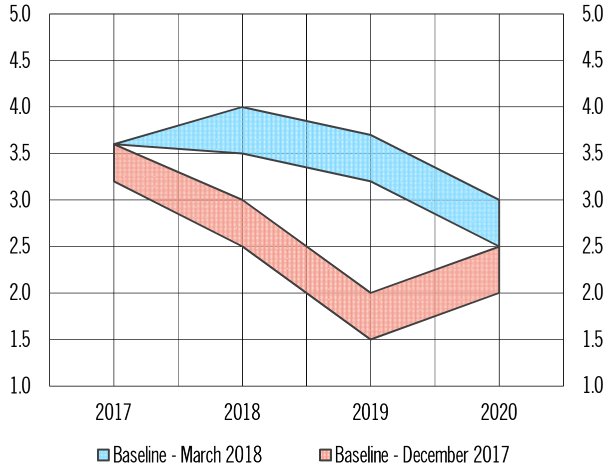
in the Russian economy, and inflation dynamics in general, has not undergone any significant change compared with December's MPR.

With producers' remaining moderately optimistic and in view of the balanced labour market, the baseline scenario anticipates real wage growth to continue. Over the forecast period, wage growth rates will be in line with labour productivity and will not exert any proinflationary pressure. The increase in earned incomes and growth in consumer lending amid the gradual easing of its conditions will buoy

Chart 2.11

Gross fixed capital formation

(percent change on previous year)



Source: Bank of Russia calculations.

consumer activity, helping return annual inflation to levels close to 4%. According to the baseline scenario estimates, annual growth in household expenditure on final consumption will be 3.8-4.3% in 2018, which is generally in line with the previous MPR (Chart 2.10). The slight adjustment in quantitative estimates is linked to weaker than expected actual consumption dynamics in 2017, according to Rosstat data. In future, growth in consumer demand will slow to 2.5-3.0% over the forecast period and will remain at this level in the medium term, amid a relatively stable economic activity overall.

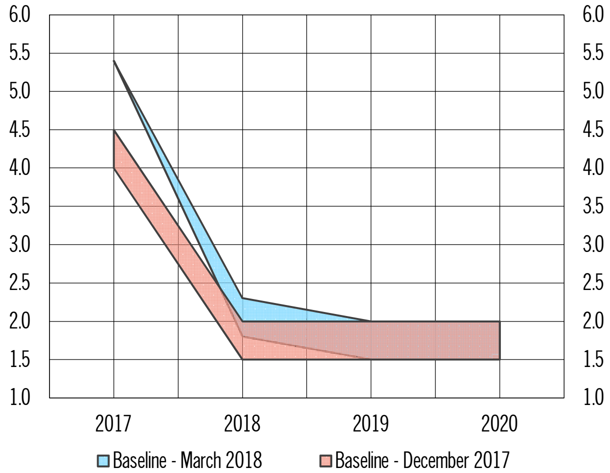
The producers' continued moderate optimism amid the increase in external and internal demand will support investment activity in the Russian economy. Growth in gross fixed capital formation in the baseline scenario is estimated at 3.5-4.0% in 2018, which is generally consistent with Rosstat data for 2017 (Chart 2.11). If there are no large-scale or sudden structural changes in the Russian economy that could potentially create new incentives to invest in internal production, growth in gross fixed capital formation will be close to 3.2-3.7% in 2019, before gradually slowing to 2.5-3.0% in the medium term. If structural and institutional changes are successfully implemented in the Russian economy, investment growth may be faster than in the baseline scenario.

The contribution of net exports to annual GDP growth will continue to be negative over the forecast period, gradually decreasing towards the end of the

Chart 2.12

Exports

(percent change on previous year)

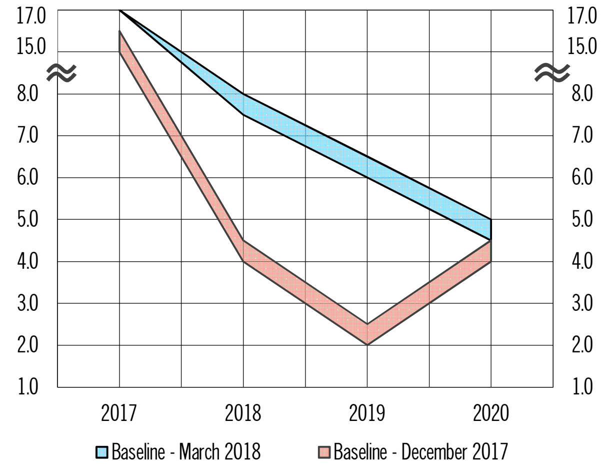


Source: Bank of Russia calculations.

Chart 2.13

Imports

(percent change on previous year)



Source: Bank of Russia calculations.

period. This will be due to imports growing faster than exports. The annual growth in physical export volumes in 2018 will be slightly higher than in the previous MPR, amid faster growth in Russia's trading partners, and considering Rosstat's higher growth estimates for physical export volumes in 2017. According to the Bank of Russia's baseline scenario estimates annual exports will grow by 1.8-2.3% in real terms in 2018 to stabilise around 1.5-2.0% in the rest of the forecast period as previously assumed (Chart 2.12).

As previously, internal demand (consumer and investment) will be satisfied through domestically produced goods and imported goods. In 2018, real import growth will range between 7.5-8.0%, higher than assumed in December's MPR. This will be aided by higher incomes and a stronger ruble than previously expected over the forecast period. According to Bank of Russia estimates, as consumer demand reaches a saturation point, growth in imports will gradually slow, causing its annual growth to fall to 4.56.5% in real terms in 2019-2020 (Chart 2.13).

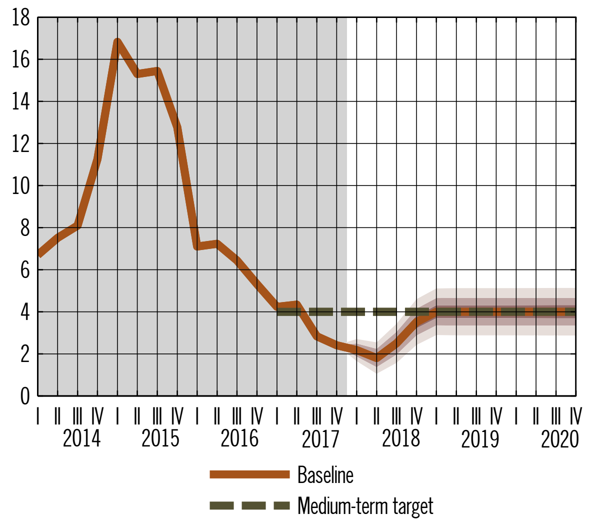
Hence, the main contribution to GDP will come from growth in consumer and investment demand. Public sector consumption amid the fiscal consolidation will not provide any significant support for GDP, and the contribution of net exports will remain negative.

According to Bank of Russia estimates, annual inflation will be close to 4% in the medium term (Chart 2.14). It will return to this level in 2019. In the second half of 2018, inflation will gradually return to its target level and, at the end of the year, according to Bank of Russia estimates, will stand at 3.0-4.0%. This forecast factors in, on the one hand, the gradual fading of temporary disinflationary factors from the food market, and on the other hand, the fact that any further revival in demand amid monetary easing and increase in incomes will contribute to raising inflation from the low levels of early 2018.

Chart 2.14

Inflation

(percent change on corresponding period of previous year)



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

Source: Bank of Russia calculations.

Overall, the outlook for key inflation factors over the forecast period has remained unchanged compared with the previous MPR.

First, producers' continued moderate optimism is expected to buoy production activity over the forecast period, contributing to a balanced labour market, and moderate wage growth that stimulates consumer activity without posing any proinflationary risks. The contribution of spending dynamics to inflation will remain moderate, in part due to the indexation of administered prices and tariffs for services provided by natural monopolies at a rate not exceeding 4%.

Second, the cumulative effect of the gradual monetary easing in 2016-2017 will result in a slight acceleration in lending growth, particularly consumer lending. Lending growth over the forecast period will contribute to increased consumer demand, helping to keep inflation close to 4%. Due to borrowers' measured approach to their debt burden, the expansion of lending will not pose any threat to financial stability.

Third, according to Bank of Russia estimates, exchange rate dynamics will not have a significant impact on consumer price growth over the forecast period. The pass-through of temporary energy price fluctuations onto the ruble's exchange rate and inflation will in part be constrained by the Russian economy's increased resilience to external shocks, and the further use of budget rule by the Russian Ministry of Finance. Moreover, external inflationary pressure in Russia's trading partners will continue to be moderate and will not pose any significant proinflationary risks.

As annual consumer price growth is anchored close to 4% in the medium term, inflation expectations will gradually become linked to the inflation target, and reduce their sensitivity to internal and external factors. This will be aided by the Bank of Russia's open and coherent information policy, and a range of measures to increase households' financial literacy.

Unchanged oil price scenario

Like in December's MPR, this scenario is based on the assumption that OPEC and non-OPEC countries continue to restrict oil production after 2018, and the global economy recovers more rapidly. These factors will support energy prices in the medium term, helping keep them at a higher level compared with the baseline scenario. Unlike the scenario in December's MPR, which assumed gradual price growth as the external conditions mentioned above improve, this MPR assumes relatively stable oil prices, close to average levels for January-March 2018 (roughly $65 per barrel) over the entire forecast period.

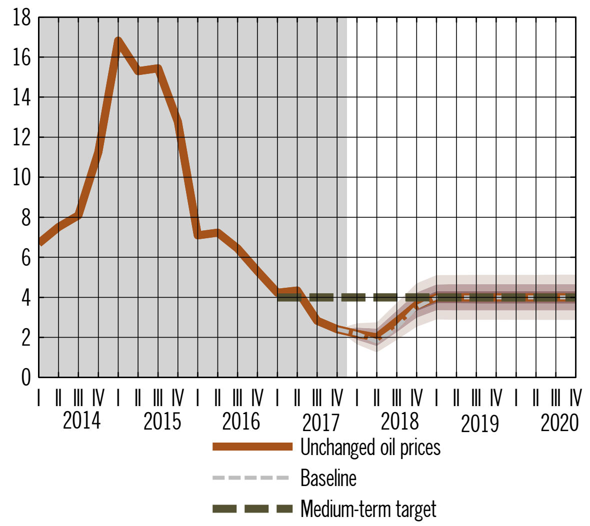
The revision of oil price conditions has not fundamentally changed the outlook for key macroeconomic indicators, compared with both the baseline scenario and December's scenario, which assumed that oil prices would rise. Key trends in the forecast dynamics for inflation, real sector indicators, and monetary policy remained broadly in line with the baseline scenario. This was also a consequence of the Russian economy's growing resilience to changes in external conditions, including energy price fluctuations, partly as a result of the application of the budget rule.

In the absence of downward oil price dynamics, compared with the baseline scenario, the ruble will be slightly stronger and its contribution to inflation dynamics will be lower. In these conditions, in 2019-2020, the key rate may be slightly lower than in the baseline scenario.

Chart 2.15

Inflation

(percent change on corresponding period of previous year)

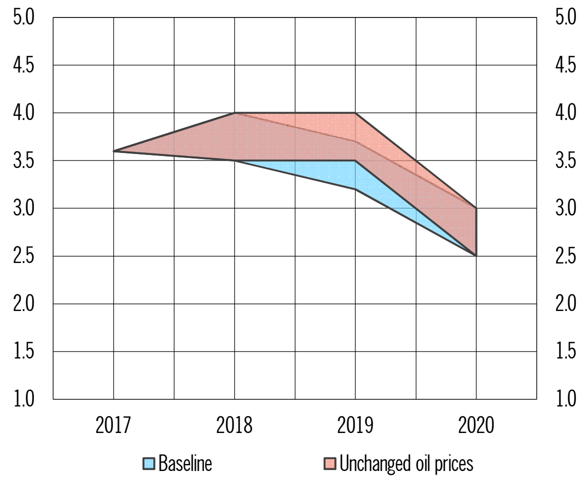


Note: shaded areas on the forecast horizon show the probability of different inflation values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on historical estimates of inflation uncertainty.
Source: Bank of Russia calculations.

Chart 2.16

Gross fixed capital formation

(percent change on previous year

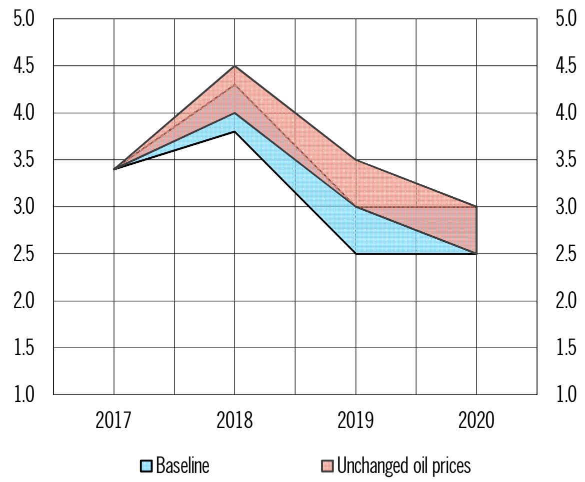


Source: Bank of Russia calculations.

Chart 2.17

Household final consumption

(percent change on previous year)



Source: Bank of Russia calculations.

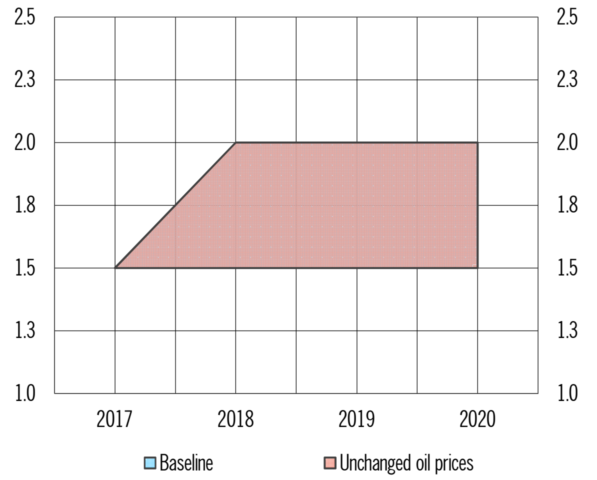
In the medium term, like in the baseline scenario, the Bank of Russia will use monetary policy to keep inflation close to 4% (Chart 2.15). If localised imbalances occur in certain segments of the financial market, the Bank of Russia will offset them using specific macroprudential policy measures. Keeping inflation at levels close to the Bank of Russia's target will be aided by balanced and moderate dynamics in economic activity indicators (despite support from external conditions), on the one hand, and monetary conditions and economic participants' risk appetite, on the other hand.

With oil prices higher and sentiment more optimistic than in the baseline scenario, in 2018, there will be slightly higher investment and consumption growth than in the baseline scenario.

Chart 2.18

GDP

(percent change on previous year)



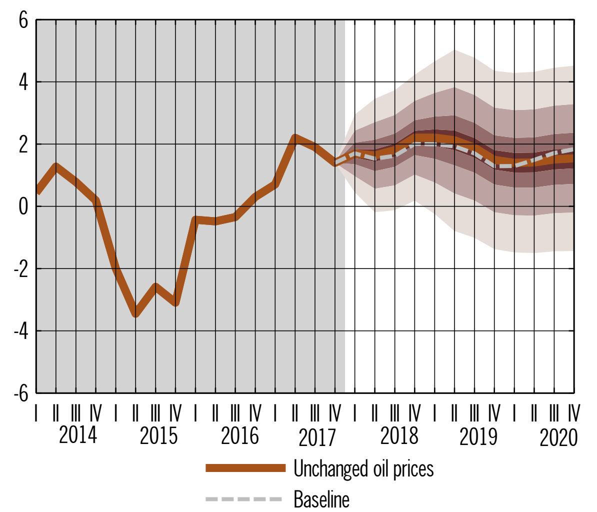
Source: Bank of Russia calculations.

In subsequent years, growth in gross capital formation and household expenditure on final consumption will reduce slightly, moving closer to relatively stable levels in the medium term – 2.5-4.0% for gross fixed capital formation and 2.5-3.5% for consumer spending (Charts 2.16 and 2.17). Overall, annual economic growth over the three-year period will be in the range of 1.5-2.0%, which is in line with the estimated potential GDP growth if the current economic structure remains unchanged (Charts 2.18 and 2.19). However, in the first half of the forecast period, it will be closer to the upper

Chart 2.19

GDP growth

(percent change on corresponding period of previous year)



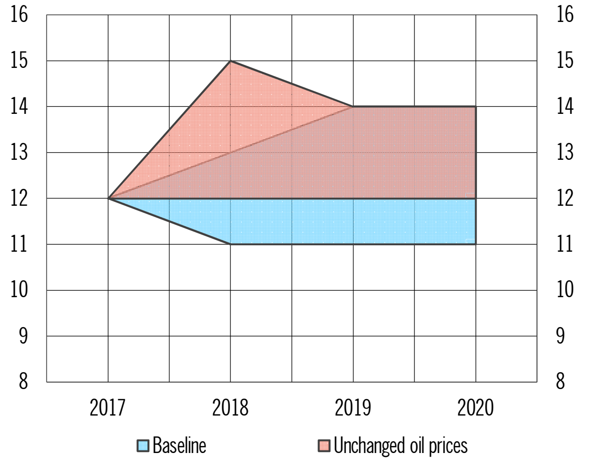
Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on historical estimates of GDP growth uncertainty.

Source: Bank of Russia calculations.

Chart 2.20

Loans to households

(percent change on previous year)

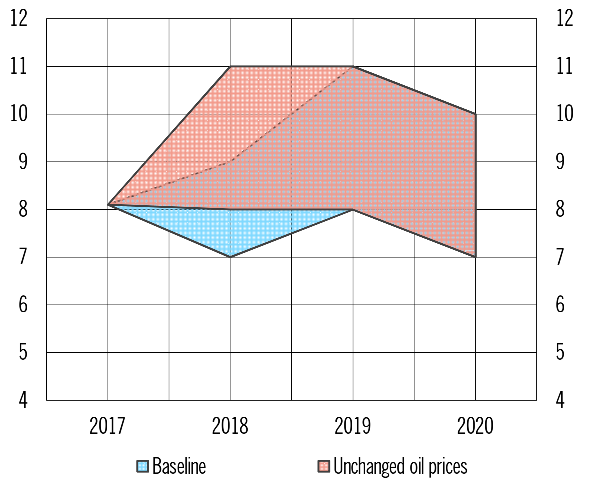


Source: Bank of Russia calculations.

Chart 2.21

Loans to businesses

(percent change on previous year)

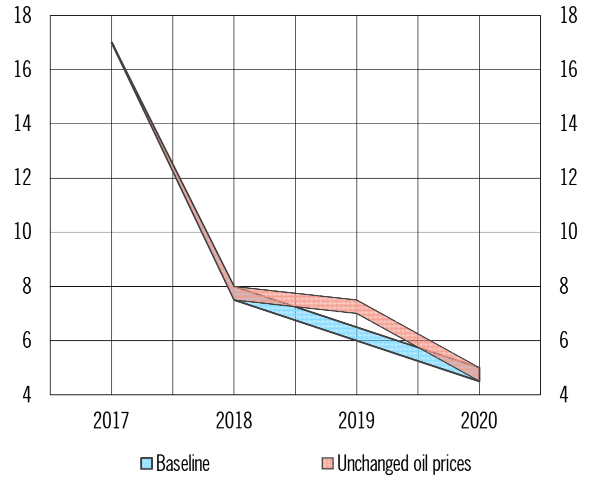


Source: Bank of Russia calculations.

Chart 2.22

Imports

(percent change on previous year)

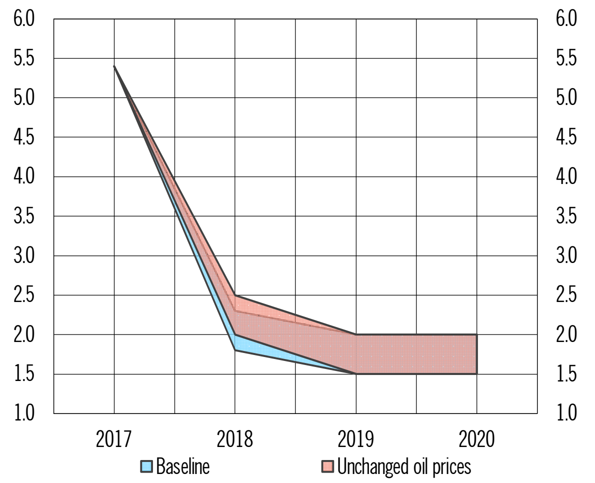


Source: Bank of Russia calculations.

Chart 2.23

Exports

(percent change on previous year)



Source: Bank of Russia calculations.

bound, and in the second half, closer to the lower bound.

Growth in lending activity, and in turn money supply dynamics, will slightly outstrip the equivalent indicators under the baseline scenario. However, according to Bank of Russia estimates, these processes will be buoyed by the improved solvency of economic participants as their incomes grow and by the continued moderate household and corporate debt burden, and so will not exert any excess inflationary pressure. The annual growth in lending to the economy will be 8-12% over the forecast period. Household lending will increase at an annual rate of 12-15% and corporate lending at 7-11% (Charts 2.20 and 2.21). According to Bank of Russia estimates, annual money supply growth will be in the same range as growth in lending to the economy as the fiscal consolidation continues.

Growth in internal demand and the stronger ruble will buoy imports, meaning that internal demand growth will slow less in 2019 than in the baseline scenario. In 2018, annual growth in imports will be 7.5-8.0%, slowing to 7.0-7.5% in 2019, and approaching the baseline scenario levels in 2020 amid the gradual 'saturation' of consumer demand and the high base of 2018 (Chart 2.22). Due to these factors and support from oil prices, the value of goods and services imports will be higher than in the baseline scenario over the entire forecast period.

Stronger growth in the global economy will contribute to rising demand for Russian exports. In 2018, annual real export growth will be 2.0-2.5%, higher than in the baseline scenario. However, by 2019, it will slow to a relatively stable level of 1.5-2.0% in the medium term, given the continuing structural limitations of more active export growth under the current economic structure (Chart 2.23). Hence, like in the baseline scenario, real exports will grow slower than imports, meaning that net exports will make a negative contribution to GDP. At the same time, in value terms, the increase in exports will outstrip the increase in imports, meaning that the trade balance will be positive, like in the baseline scenario, but will be higher and will increase in the medium term.

Stable Russian economic growth combined with continued relatively high commodity prices will lead to lower risk premiums for Russia than in the baseline scenario and an increase in Russian assets' investment appeal for foreign investors, which will facilitate Russian companies' access to external funding. Given that growth in economic actors' incomes will contribute to an increase in residents' investments in foreign assets, the private sector's financial balance will gradually decrease in this scenario, but will still remain higher than in the baseline scenario.

Conservative scenario

The conservative scenario assumes a more substantial decline in oil prices than in the baseline scenario, with the lifting of the production restrictions under the OPEC+ agreement beyond 2018. This scenario anticipates that oil prices will fall as early as the second half of 2018 and stabilise at roughly $45 per barrel in the medium term. The main trends in the Russian economy that account for such external conditions were reflected in the baseline scenario in December's MPR and have not substantially changed. A slightly higher key rate than in the other two scenarios is possible in this scenario. Annual inflation will approach 4% slightly more quickly and the Bank of Russia will keep it close to the target level thereafter.

Compared with the baseline, the conservative scenario reflects more restrained growth in the economy and monetary indicators in 2018-2019. Slower growth in key economic activity indicators than in the baseline scenario is expected, primarily in view of the downward revision of oil prices to the level where they will stabilise in the medium term. However, this adjustment will be, first of all, relatively gradual, and, secondly, temporary. The oil price correction will end in 2019 and its impact on economic indicators will be virtually cancelled out by 2020.

As a result, GDP growth will be 1.0-1.5% in 2018-2019, slightly below the baseline scenario, before accelerating to 1.5-2.0% in the medium term. Similar trends are also expected in the dynamics of key GDP components based on the expenditure approach. Given the reduced support from both income dynamics and lending, consumer and investment activity will continue to be modest over the entire forecast period. The slowdown in investment activity will be linked in part to companies' cautious outlook regarding demand for their products.

With production activity being weaker than in the baseline scenario, companies will increase their employee wages less intensively over the forecast period. Moreover, opportunities to reduce household and corporate debt burdens will shrink, which will reduce incentives for banks to issue new loans and for borrowers to increase their debt burden. This will contribute to a slight slowdown in growth in lending to the economy over the forecast period (both as a whole and broken down by sector) compared with 2017 and the estimates of the baseline scenario. As a result, annual growth in lending to the economy and money supply will be 7-10% overall in the medium term. The convergence of lending and money supply growth rates, like in the other scenarios, will be aided by the Russian Government's fiscal consolidation policy, with a gradual reduction in the budget deficit, which will cause net lending to the general government to make a negative contribution to money supply growth over the forecast period.

The support from external factors, which is weaker than in the other scenarios, will result in a weaker ruble which, in turn, will contribute to slowing import growth. At the same time, the fall in oil prices will generally only have a negligible effect on actual export dynamics, causing annual export growth to sit in the same ranges as in the baseline scenario, in real terms. The contribution of net exports to GDP growth over the entire forecast period will continue to be negative, and in absolute terms will be comparable with the baseline scenario.

The slightly more significant reduction in oil prices will have an effect on the value of exports and imports. With the temporary deterioration in external conditions, the positive trade balance will reduce over the forecast period following moderate growth in 2018. As a result, the current account surplus will stabilise in the medium term at significantly lower levels than in the baseline scenario.

The decrease in oil prices will also lead to a slight deterioration in external financing conditions for Russian companies. This will be reflected in external liabilities that are lower than in the baseline scenario over the entire forecast period. At the same time, residents' demand for foreign assets will also reduce due to the slower income growth and a ruble that is weaker than in the baseline scenario. As a result, the private sector's financial deficit will fall and will generally be lower than in the baseline scenario.

Forecasting risks

The Bank of Russia's outlook on key risk factors and their impact on medium-term forecast parameters in general has not undergone any significant change compared with December's MPR, excluding labour market risks. The Bank of Russia takes into account the risks that inflation may deviate both above and below the 4% target level, with the likelihood of encountering proinflationary risks considered to be greater in the medium term than in the short term. Risks mostly emanate from certain internal inflation factors.

First, faster than expected wage growth may pose the risk of inflation deviation above the 4% target in the medium term. On the one hand, this may result from the greater than forecast optimism among producers of goods and services. On the other hand, structural factors such as the imbalance between supply and demand in certain labour market segments (for example, in certain regions or activities), limited labour mobility, and skilled labour shortage, etc. may persist and slightly surpass expectations regarding the magnitude of their impact. To take this risk into account in the forecast parameters, the Bank of Russia will continue to monitor unemployment and wage dynamics regularly, estimating their impact on consumer behaviour and inflation.

Second, in the medium term, as economic actors' optimism increases with regard to growth prospects, growth in household consumer spending may be stronger than forecast, which, in turn, may be accompanied by an increase in unsecured consumer lending. A rise in consumer demand that exceeds the increased production activity in the economy may lead to excessive proinflationary pressure. Moreover, if it is buoyed by excess growth in the debt burden, the problem may affect not only price stability, but also financial stability. As previously, the Bank of Russia will continue to regularly assess and take both factors into account in its medium-term macroeconomic forecast. If the risk of excess growth in consumer lending materialises, the Bank of Russia does not rule out the possibility of using macroprudential policy measures in certain segments of the credit market, including increasing risk ratios for certain borrower categories or revising all risk ratios, depending on the extent of the potential impact on financial stability.

Third, there remains the risk of increased volatility in food inflation, caused by supply-side factors. This risk exerted significant downward pressure on price growth in Russia at the end of 2017 and, due to its inertia, will continue to contribute to annual inflation dynamics throughout 2018. The significant slowdown in food price growth was largely due to the record harvest, resulting in food supply that far exceeded demand. It cannot be ruled out that this situation may repeat in the medium term, or perceptible food shortage may arise (for example, due to a poor harvest caused by bad weather). The impact of food supply factors may be partially offset by increased storage capacity for agricultural produce, increased produce quality, optimised transportation times for perishable goods and other measures aimed at mitigating infrastructure limitations in certain markets. Such measures do not directly fall under monetary policy and require joint measures between the Government of the Russian Federation and the Bank of Russia.

Fourth, inflation expectation dynamics still pose a medium-term risk to inflation. Two key aspects are important when it comes to inflation expectations. First, the inertia that is inherent in expectations, especially household expectations. Second, the sensitivity of inflation expectation dynamics to the volatility of certain external and internal market indicators. High inflation throughout most of Russia's modern history has left its mark on high inflation expectations that far exceed actual inflation. Overall, over the last 18 months, inflation expectation dynamics have shown a downward trend, pointing to a gradual adjustment to the new reality regarding price growth. This adjustment process is often complicated by short-term inflation fluctuations, usually caused by food price hikes, which interrupt the downward trend in inflation expectations. In order to accelerate the adjustment process, and keep inflation expectations close to 4% in the medium term, the Bank of Russia will continue to pursue an open and consistent information policy and help increase financial literacy.

In addition to internal inflation factors, external conditions continue to cause some uncertainty in forecasts. Instances of elevated volatility in global markets amid the normalisation of monetary policy in other countries and increasing uncertainty in trade policy may have an impact on capital flows in emerging markets and may affect global investors' risk appetite. This could have an effect on internal financial market parameters. At the same time, it has become less likely that oil prices may have a significant impact on medium-term forecast parameters, as mentioned in December's MPR, as some certainty emerged with regard to the prospects of extending the oil production restriction agreement by OPEC+ countries. In future, when assessing medium-term inflation risks and economic activity forecasts, the Bank of Russia will continue to take into account changes in external conditions, including not only oil price movements, but also global financial market dynamics, and adopted and planned fiscal and customs and tariff policy decisions.

ANNEX

Dynamics of major items in the Russian balance of payments in 2017 Q4

In 2017 Q4, the current account surplus increased due to growth in exports that exceeded growth in imports. The external trade surplus added roughly 30%[1].

According to preliminary estimates, growth in the value of exports of goods and services accelerated from 18% in Q3 to 23% in 2017 Q4. As before, the increase was due to higher global prices for most key commodities. The strong support from oil price growth mitigated the negative effect on exports from the reduced oil production in Russia under the agreement.

The reduction in actual exports of oil and oil products in Q4 was due to the European market, amid increased competition from growing production in Iran, Libya, Nigeria and the US. The decrease in Russia's oil exports to EU countries was in part offset by increased supply to the rapidly growing Chinese market. Oil supplies to Belarus also continued to recover compared with 2016 after oil-and-gas disputes with Russia were settled in April 2017.

Actual exports of certain other goods increased, which also contributed to higher current account revenues. Record grain harvests expanded supply of Russian wheat to the global market. Growing external demand boosted exports of aluminium, coal, fertilisers, and turbojet engines and gas turbines.

Annual growth in imports of goods and services remained at Q3 levels in Q4 (21%). The increase in imports was driven by the intensified business activity and higher demand on the back of growing real Russian wages. Imports were also buoyed by the strengthening of the ruble and growth in online trading.

As before, the increase in imports in 2017 Q4 was mostly driven by capital goods than consumer goods. Actual imports of capital goods such as bulldozers, tractors, and freight vehicles increased. Imports of light vehicles and consumer goods such as footwear, medicines, grapes and other products continued to expand.

In 2017 Q1-Q3, compared with the corresponding quarters in 2016, the increase in the value of imports was mostly driven by higher physical import volumes rather than price growth. Russia's FCS has yet to release its estimates of external trade indices for 2017 Q4. This trend is expected to continue in Q4. At the same time, some imported goods increased in price, in dollar terms, in 2017 Q4 (for example, computers and computer components, telephones).

The current account balance of non-trade components remained virtually unchanged in 2017 Q4 (Chart 1).

However, higher commodity prices increased the inflow of foreign currency into exporters' bank accounts, which had an effect on Russia's balance of payments. As a result, in 2017 Q4, Russian banks increased their foreign assets on the back of higher prices for key exports. Growth in banks' foreign assets was also due to FX swap operations. At the end of 2017, the Bank of Russia provided FX liquidity through FX swaps amid a temporary yet relatively significant increase in the cost of FX borrowing in the FX swap market that resulted from market participants' arbitrage and the slight deterioration in the foreign currency liquidity situation amid the 'year-end' effect.

As a result, in 2017 Q4 Russian net private sector lending to the rest of the world increased compared with 2016 Q4, mostly due to bank operations.

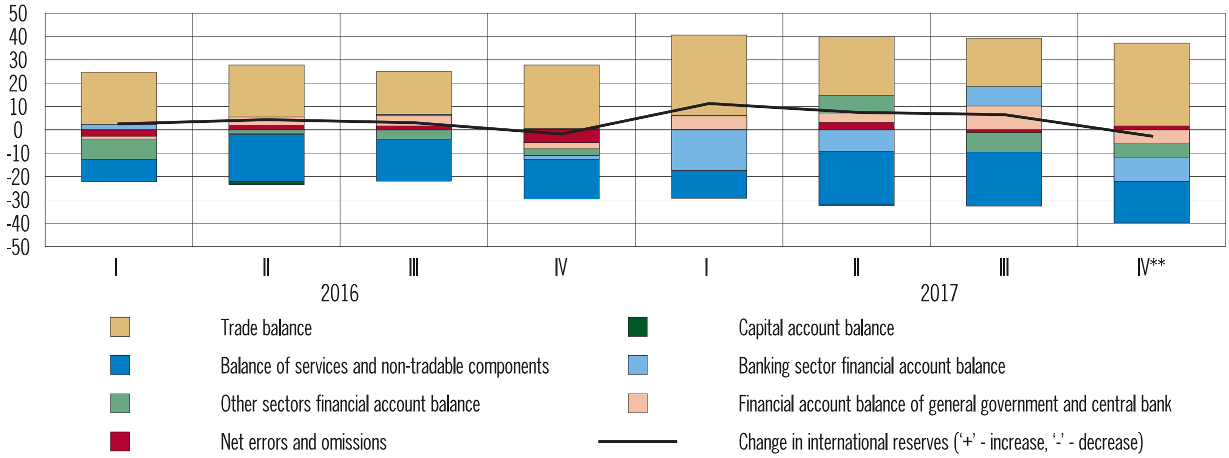
In 2017 Q4, reserve assets decreased overall, due to operations reflected in the balance of payments. Their dynamics where affected by a variety of counterbalancing factors, which partially offset one another. The reduction in reserve assets was due in part to the FX swap operations

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

Chart 1

Major balance of payments components*

(billions of US dollars)



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

mentioned above. At the same time, the Bank of Russia's acquisition of foreign currency for the Russian Ministry of Finance under the budget rule and the return of FX liquidity to the Bank of Russia under FX repos contributed to an increase in reserves.

Inflation in Russian regions

In January-February 2018, annual inflation in all federal districts was below the target; however, the uniform decrease observed in the previous quarter gave way to varied inflation dynamics. Annual consumer price growth reduced the most in the North-Western and Central Federal Districts, accounting for almost half of national inflation in Russia (43.5%). Inflation in these federal districts slowed, mostly due to the postponement of tariff indexation to the middle of the year (last year, it was in January), and the ongoing imbalance between supply and demand in the food market. In the North Caucasus, Volga, Ural and Siberian federal districts, which account for 46.4% of national inflation in Russia, annual inflation accelerated in February, largely due to food prices, which may result from the renewed price growth following the low growth rates and low base in these regions in February last year (Table 1). Overall, in all federal districts, temporary factors are having a significant impact on the current decline in inflation.

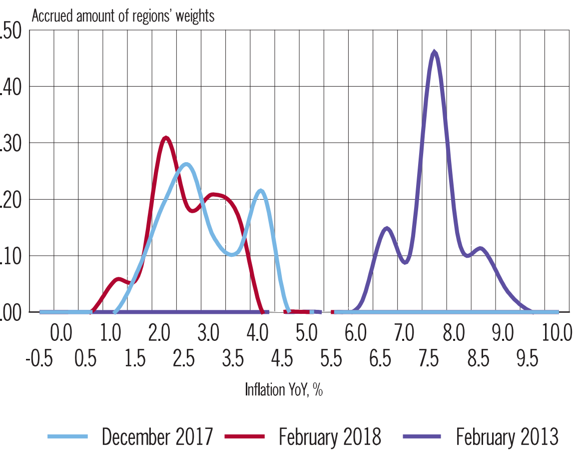
In January-February, inflation became more varying across the regions (the variance increased from 0.29 in December 2017 to 0.31 in February 2018). The highest inflation was observed in the Republic of Ingushetia (4.44%), the Republic of Sakha (3.3%) and Moscow (3.19%). The lowest annual inflation was seen in the Republic of Crimea (0.66%), Novosibirsk Region (0.77%), and the Republic of Mordovia (0.84%).

Like in 2017 Q4, two groups of regions contributed the most to average Russian annual inflation during this period: regions with inflation above the Russian average and regions with inflation below the Russian average (Chart 1). Given February's contributions, the distribution across regions has changed considerably: the relative weight of regions with inflation above the Russian average increased significantly, and regions with a more significant acceleration in inflation can be identified among regions with inflation below the Russian average.

The number of regions with annual inflation above the Russian average increased from 6 in December 2017 to 14 in February 2018. The total weight of this group of regions increased from 0.23 in December 2017 to 0.38 in February 2018. The slower decline in inflation in regions with incomes below the Russian average led to an increase in the number of regions in the group with inflation above the Russian average. These regions witnessed a slight acceleration in food price growth in February, due to renewed growth and the low base of February 2017. At the same time, in January-February 2018, regions exhibiting a more significant slowdown in

Chart 1

Ratio of regions' weights to inflation



1. December 2017 – right-hand hump, six regions (including Moscow, St. Petresburg, and the Kaluga Region), total weight in CPI equals 0.23.
2. February 2018 – right-hand hump, 14 regions (including Moscow, the Moscow Region, St. Petresburg, and the Republic of Sakha (Yakutia)), total weight in CPI equals 0.38.
3. February 2013 – large hump, 39 regions, total weight in CPI equals 0.5.

Sources: Rosstat, Bank of Russia calculations.

Table 1

Annual inflation in federal districts in January-February 2018

Annual inflation, %	Russian Federation	Central Federal District	North-Western Federal District	Southern Federal District	North Caucasian Federal District	Volga Federal District	Urals Federal District	Siberian Federal District	Far-Eastern Federal District
January 2018	2.19	2.84	2.41	1.91	1.75	1.75	2.1	1.67	1.77
February 2018	2.18	2.7	2.27	1.91	1.83	1.82	2.3	1.86	1.77
District's contribution to CPI, February 2018	2.18	0.91	0.22	0.19	0.1	0.31	0.19	0.18	0.08

Sources: Rosstat, Bank of Russia calculations.

annual inflation could be identified in the group with inflation below the Russian average, due to the continued imbalance in the food market in these regions.

In 2017 Q4, the highest annual inflation was observed in Moscow, the Republic of Sakha, and the Republic of Ingushetia. In December 2017 – February 2018, annual inflation in these regions varied: in the Republic of Sakha, it slowed from 4.44% in December 2017 to 3.3% in February 2018; in Moscow it slowed from 3.82% to 3.19%; and in the Republic of Ingushetia, it accelerated from 4.03% to 4.44%. The substantial slowdown in inflation in the Republic of Sakha was due to disinflationary processes in transportation services – all freight and passenger fares were reduced, especially for rail and air transport services. The significant acceleration in inflation in Ingushetia was due to rapid growth in real household incomes, increasing consumer activity, the low base of the previous year and monopolisation of the food market.

Balance of payments forecast for 2018-2020

Compared with December's MPR, the trajectory of oil prices has been revised slightly upward. Combined with the slight adjustment in the forecast parameters for a number of macroeconomic indicators[2], this has had an impact on the forecast dynamics of balance of payments items.

The upward adjustment of oil price trajectories over the forecast period was due to the increase in international organisations' forecast growth in global demand for oil amid the more favourable growth prospects for the global economy. In addition, the higher oil prices were facilitated by high expectations of record-breaking compliance with the production restriction agreement by OPEC countries and a number of non-OPEC states. In the 2018 baseline scenario, the average annual price is now expected to be close to $60 per barrel, which is higher than in the previous MPR ($55 per barrel). At the same time, as the restrictions under the agreement are relaxed, prices are expected to fall to $50 per barrel in 2020.

In this scenario, the forecast current account surplus has been increased relative to the baseline scenario presented in December's MPR, due to the value of exports being revised upwards amid expectations that oil prices will be higher. The higher external demand estimates (upward adjustment of economic growth forecasts in Russia's trading partners) have also had a favourable impact on exports.

In 2018, the value of exports is expected to continue to increase due to growth in oil prices. However, in future, exports of goods and services will shrink: the increase in actual foreign supplies, amid the relaxation of oil production restrictions, will only be partially offset by the negative effect of the reduction in energy prices.

The forecast value of imports of goods and services over the entire forecast period has also been increased due to higher internal demand compared with the baseline scenario in the previous MPR. Unlike exports, imports will continue to increase, not only in 2018, but also in 2019-2020 amid growth in the Russian economy. However, the expansion of imports will slow: the exchange rate will not support imports as oil prices decrease.

The current account surplus is forecast to increase to 3.5% of GDP because exports will increase more than imports in 2018. However, in 2019-2020, as the external trade surplus reduces amid falling energy prices, the current account balance is expected to shrink to 1.3% of GDP in 2020 (Chart 1).

The financial account (excluding reserve assets) will largely be shaped by the movement of private sector capital. Russia's forecast net private sector lending to the rest of the world has been revised upwards for 2018-2019 compared with the baseline scenario in the previous MPR. With higher oil prices, the private sector may invest more funds to increase its foreign assets. The increased demand for foreign assets will be facilitated by economic agents' higher incomes amid growth in Russia's economy. At the same time, in 2019-2020, the Russian private sector's demand for foreign assets will remain low by historical standards. Amid the reduced oil prices and low growth rates in the Russian economy, the financial position of economic agents will not improve to the extent that they can significantly increase the amount of their funds used to acquire foreign assets.

The reduction in banks' foreign liabilities is expected to slow over the coming years: according to the repayment schedule, the volume of external debt payments will decrease. Overall, from 2018 onwards, the private sector (banks and other sectors) is forecast to start increasing its foreign liabilities, given Russia's improved investment appeal amid the higher oil prices and economic growth in Russia. The private sector's accumulation of foreign liabilities will also be aided by companies turning to sources of external funding not affected by sanctions.

As a result, the private sector's financial account balance will also reduce from 1.1% of GDP in 2018 to 0.9% of GDP in 2019, due to banks reducing their foreign liabilities less intensively than before. In 2020, it is expected to fall to 0.4% of GDP due to weakening Russian private sector demand for foreign assets as oil prices fall (Chart 2).

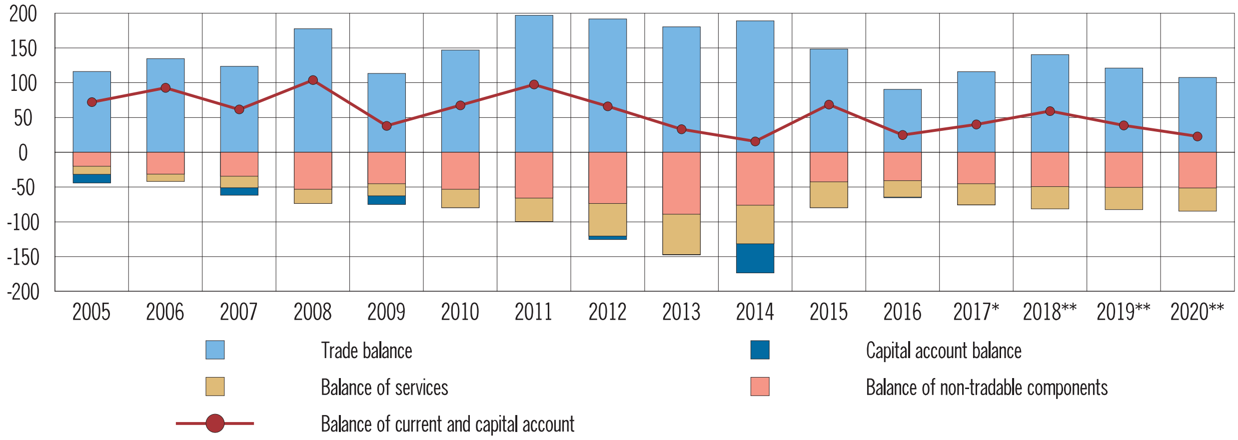
In 2018-2020, the public sector is still expected to see an inflow of capital due to continued government borrowing.

[2] *See Section 2 'Economic outlook'.*

Chart 1

Major current account components*

(billions of US dollars)



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

The forecast increase in reserve assets in the baseline scenario has been raised compared with the baseline scenario in the previous MPR. With the higher oil prices in 2018-2020, the Bank of Russia is expected to purchase more foreign currency for the Russian Ministry of Finance under the budget rule. The contribution of returned foreign currency liquidity supplied by the Bank of Russia through FX swap operations at the end of 2017 has also been taken into account in the growth in reserves in 2018.

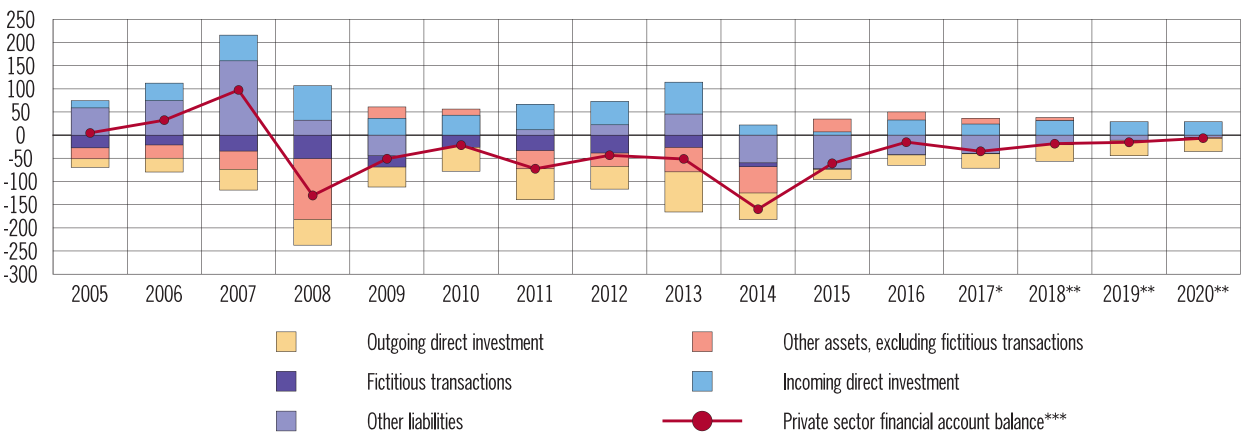
According to the scenario with unchanged oil prices at roughly $65 per barrel in 2018-2020, the higher growth rates in the global economy, combined with higher oil prices, will lead to higher export values compared with the baseline scenario. At the same time, the Russian economy's faster recovery and higher ruble exchange rate will lead to higher growth in import volumes. The trade surplus will be higher than in the baseline scenario and will increase over the forecast period amid the rapid growth in exports compared with imports. The deficit in the non-trade components will in turn increase amid growth in external debt repayments. As a result, the current account surplus will expand significantly in 2018 and subsequently stabilise at levels higher than in the baseline scenario.

The improvement in the internal economic situation, combined with higher commodity prices, will increase the investment appeal of Russian assets and facilitate Russian companies' access to

Chart 2

Major private sector financial account components*

(billions of US dollars)



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

external funding. At the same time, income growth will help increase residents' investments in foreign assets. The private sector's financial account balance in this scenario will gradually decrease due to rapid growth in foreign liabilities compared with foreign assets, but will generally remain higher than in the baseline scenario. The Russian Ministry of Finance's acquisition of more foreign currency amid higher oil prices will, in turn, stimulate higher growth in reserve assets in 2018-2020.

The conservative scenario assumes that average annual oil prices will fall from $55 per barrel in 2018 to $45 per barrel in 2019 and will remain close to this level in future. As a result of the drop in oil prices, the value of Russian exports will be lower than in the baseline scenario. However, the domestic economy's slower recovery and the lower ruble exchange rate will lead to comparatively fewer imports of goods and services. The expected growth in exports will outstrip the increase in imports in 2018, but, subsequently, the decline in exports in 2019, with a recovery in 2020 that is slower than imports, will lead to a reduction in the trade surplus following moderate growth in 2018. As a result, the current account surplus will grow slightly in 2018, before shifting downwards and remaining at levels significantly lower than in the baseline scenario over the entire forecast period.

The decline in oil prices will lead to deterioration in external financing conditions for Russian companies and will be reflected in fewer foreign liabilities compared with the baseline scenario over the entire forecast period. At the same time, slower growth in incomes and the weaker ruble will cause residents to purchase less foreign assets. As a result, in the conservative scenario, the private sector's financial deficit will fall and will generally be lower than in the baseline scenario. The growth in reserve assets will also be lower than in the baseline scenario as a result of reduced purchases of foreign currency by the Russian Ministry of Finance under the budget rule amid lower oil prices.

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

Table 1

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

The Bank of Russia amended the Bank of Russia Regulation 'On Credit Institutions' Required Reserves'	The Bank of Russia released the Ordinance on amending Bank of Russia Regulation No. 507-P, dated 1 December 2015, 'On Credit Institutions' Required Reserves'. The Ordinance specifies the procedure whereby required reserves shall be built up by credit institutions acting as central counterparties pursuant to the Federal Law 'On Clearing, Clearing Activity and Central Counterparty'. Additionally, changes have been made to the calculation of a penalty payable by a credit institution non-compliant with the required reserve averaging ratios. Amendments introduced by the Ordinance include those related to the identification of credit institutions' reservable liabilities. The Ordinance became effective from 1 February 2018 and applies to the amount of required reserves credit institutions calculate for February 2018.
The Bank of Russia expanded the use of the electronic document flow in secured loan issues	Starting from 19 February 2018, the Bank of Russia enabled all credit institutions to use the electronic document flow when obtaining secured loans under the standard refinancing facilities. Before that, only credit institutions with basic accounts at the Bank of Russia's Main Branch for the Central Federal District and Main Branch divisions were given such an opportunity.
The Bank of Russia centralised certain functions related to credit operations under standard refinancing instruments	Effective 19 February 2018, the Market Operations Department takes up the functions of Bank of Russia loan issuing and regulating the limit of intraday and overnight loans, while the Bank of Russia's Main Branches (excluding the Main Branch for the Central Federal District) are responsible for settling liabilities on Bank of Russia loans (including the records of settlements of loans) and opening non-receivable interest income accounts.
The Bank of Russia abolished the limit for ruble funding under FX swaps	The Bank of Russia decided to give up setting the upper limit of ruble funding under FX swaps from 1 January 2018. The decision is grounded on sustained stability in the domestic foreign exchange market against the background of a structural liquidity surplus when most credit institutions see no need for ruble funding from the Bank of Russia.
The Bank of Russia extended the Lombard List	In accordance with the Bank of Russia Board of Directors' decisions the Lombard List was extended to include another 42 bond issues on 18 December 2017, 27 December 2017 and 14 February 2018.
The Bank of Russia reduced the aggregate limit on foreign currency refinancing operations	The maximum amount of credit institutions' debt to the Bank of Russia under FX repos and FX loans is set at the equivalent of $15 billion for 2018. As the domestic foreign exchange market evolves towards normalisation in line with the forecast, the Bank of Russia reduces this amount in a consistent manner.

Table 2

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

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.17	From 27.03.17	From 02.05.17	From 19.06.17	From 18.09.17	From 30.10.17	From 18.12.17	From 12.02.18	From 26.03.18
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg)[1]; repos	1 day	Daily	11.00	10.75	10.25	10.00	9.50	9.25	8.75	8.50	8.25
		Loans secured by non-marketable assets[2]	From 2 to 549 days		11.75	11.50	11.00	10.75	10.25	10.00	9.50	9.25	9.00
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets[2]	3 months	Monthly[3]	10.25	10.00	9.50	9.25	8.75	8.50	8.00	7.75	7.50
		Repo auctions	1 week	Weekly[4]	10.00 (key rate)	9.75 (key rate)	9.25 (key rate)	9.00 (key rate)	8.50 (key rate)	8.25 (key rate)	7.75 (key rate)	7.50 (key rate)	7.25 (key rate)
			From 1 to 6 days	Occasionally[5]									
		FX swap auctions (ruble leg)[1]	From 1 to 2 days										
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	From 1 to 6 days										
			1 week	Weekly[4]									
		OBR auctions[2]	3 months	Occasionally									
	Standing facilities	Deposit operations	1 day, call	Daily	9.00	8.75	8.25	8.00	7.50	7.25	6.75	6.50	6.25

[1] *From 23 December 2016, interest rates on the foreign currency leg equal LIBOR on overnight loans in US dollars or euros (depending on the currency of the transaction).*

[2] *Operations conducted at a floating interest rate linked to the Bank of Russia key rate.*

[3] *Operations have been suspended since April 2016.*

[4] *Depending on the situation with liquidity, the Bank of Russia holds either a repo or a deposit auction. See press-release http://www.cbr.ru/press/PR.aspx?file=19 012 015_154 523if2015-01-19T15_41_11.htm.*

[5] *Fine-tuning operations.*

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

Source: Bank of Russia.

Table 3

Interest rates on specialised refinancing facilities[1]

(% p.a.)

Purpose of indirect bank lending	Maturity	Collateral	As of 1.01.17	From 27.03.17	From 02.05.17	From 19.06.17	From 18.09.17	From 30.10.17	From 18.12.17	From 12.02.18	From 26.03.18
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by the insurance contracts of JSC EXIAR[2]	9.00	8.75	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Large-scale investment projects[3]	Up to 3 years	Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation	9.00	8.75	8.25	8.00	7.50	7.25	6.75	6.50	6.25
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List	9.00	8.75	8.25	8.00	7.50	7.25	6.75	6.50	6.25
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[4]	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
	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	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Leasing	Up to 3 years	Claims on loans to leasing companies[2]	9.00	8.75	8.25	8.00	7.50	7.25	6.75	6.50	6.50
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	10.00	9.75	9.25	9.00	8.50	8.25	7.75	7.50	7.25

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

[2] Effective 26 March 2018, the rate equals the lower of the two values: 6.5% p.a. or the Bank of Russia key rate.

[3] Projects are selected in compliance with the rules established by Regulation of the Government of the Russian Federation No. 1016, dated 14 December 2010, 'On Approving the Rules to Select Investment Projects and Principals for the Provision of the Russian Federation State Guarantees on Loans or Bonded Loans Attracted to Carry out Investment Projects' or Regulation of the Government of the Russian Federation No. 1044, dated 11 October 2014, 'On Approving the Programme to Support Investment Projects Implemented in the Russian Federation Based on Project Financing'. The interest rate equals the lower of the two values: 9.00% p.a. or the Bank of Russia key rate less 1 pp.

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

Source: Bank of Russia.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments and obligations on liquidity absorption instruments, billions of rubles					
					As of 1.01.17	As of 1.07.17	As of 1.10.17	As of 1.01.18	As of 1.02.18	As of 1.03.18
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	4.2	0.0	0.0	0.0	0.0
		Lombard loans			0.6	0.0	0.0	0.0	0.0	0.0
		FX swaps			37.8	0.0	0.0	0.0	0.0	0.0
		Repos			593.9	103.2	43.9	3.6	4.0	2.5
		Loans secured by non-marketable assets	From 1 to 549 days		410.7	8.8	57.8	5.5	5.1	5.1
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly[1]	215.6	0.0	0.0	0.0	0.0	0.0
			18 months	occasionally[2]						
		Repo auctions	1 week	weekly[3]	0.0	0.0	0.0	0.0	0.0	0.0
			From 1 to 6 days	occasionally[4]						
		FX swap auctions	From 1 to 2 days		0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	From 1 to 6 days		396.9	469.7	886.1	2,124.9	2,444.2	2,279.1
			1 week	weekly[3]						
		OBR auctions	3 months	occasionally	-	-	151.3	357.4	498.1	707.0
	Standing facilities	Deposit operations	1 day, call	daily	388.3	188.7	223.1	246.8	208.4	166.8

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

Source: Bank of Russia.

Table 2

Required reserve ratios

(%)

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

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

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

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

<table>
<tr><th rowspan="2">Instrument</th><th rowspan="2">Term</th><th rowspan="2">Frequency[1]</th><th>Minimum auction rate and interest rate for dollar leg of FX swaps[2] (as spread to LIBOR[3], pp)</th><th colspan="6">Bank of Russia claims, millions of US dollars[4]</th></tr>
<tr><th>From 23.12.16</th><th>As of 1.01.17</th><th>As of 1.07.17</th><th>As of 1.10.17</th><th>As of 1.01.18</th><th>As of 1.02.18</th><th>As of 1.03.18</th></tr>
<tr><td rowspan="3">Repo auctions</td><td>1 week</td><td rowspan="3">Weekly</td><td rowspan="2">2.00</td><td>2,635.2</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>28 days</td><td>8,719.9</td><td>2,305.5</td><td>598.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>12 months</td><td>3.00</td><td>26.2</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td rowspan="2">Loan auctions</td><td>28 days</td><td rowspan="2">Monthly</td><td>2.25</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>365 days</td><td>3.25</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td><td>0.0</td></tr>
<tr><td>USD/RUB sell/buy FX swaps</td><td>1 day</td><td>Daily</td><td>1.50</td><td>1,000.0</td><td>0.0</td><td>0.0</td><td>2,490.7</td><td>307.5</td><td>0.0</td></tr>
</table>

[1] *No loan auctions for any terms or 12-month repo auctions were held in 2017 and January-March 2018; regular one-week and 28-day repo auctions have been suspended since 11 September 2017.*

[2] *The rate for the ruble leg is equal to the Bank of Russia key rate less 1 pp.*

[3] *In respective currencies and for respective terms.*

[4] *For repos – claims on credit institutions under the second leg of repos.*

Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities[1]

Purpose of indirect bank lending	Maturity	Collateral	Bank of Russia claims on credit institutions, billions of rubles						Limit as of 1.03.18, billions of rubles
			As of 1.01.17	As of 1.07.17	As of 1.10.17	As of 1.01.18	As of 1.02.18	As of 1.03.18	
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by the insurance contracts of JSC EXIAR	43.4	33.5	45.1	47.4	48.3	45.6	75.00
Large-scale investment projects[2]	Up to 3 years	Claims under bank loans for investment projects, whose performance is secured by the government guarantees of the Russian Federation	112.6	102.4	104.9	103.3	103.2	103.7	150.00
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List	0.6	0.0	0.0	0.0	0.0	0.0	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[3]	43.1	31.8	24.5	18.3	16.4	14.9	175.00
	Up to 3 years	Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises	48.2	73.6	81.1	81.5	82.2	81.5	
Leasing	Up to 3 years	Claims on loans to leasing companies	0.0	0.2	0.2	0.2	0.2	0.2	10.00
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	29.3	29.3	29.3	29.3	29.3	29.3	30.00

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

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

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

Source: Bank of Russia.

Table 6

Monetary policy rates in various countries

Country	Policy rate	Current level	Latest revision	Previous level	Change	Number of rate revisions over the past 12 months	Inflation	
							Current level, %	12-month change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	0	1.4	-0.80
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	0	1.9	-1.00
Czech Republic	repo rate (14 days)	0.75	01.02.2018	0.50	0.25	3	1.8	-0.70
Romania	base rate	2.25	07.02.2018	2.00	0.25	2	4.7	4.52
Bulgaria	base rate	0.00	01.02.2016	0.01	-0.01	0	2.0	0.30
Serbia	key policy rate	3.25	14.03.2018	3.50	-0.25	3	1.9	-0.60
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	0	0.2	-0.21
Brazil	target rate	6.75	07.02.2018	7.00	-0.25	7	2.8	-1.92
Chile	monetary policy rate	2.50	18.05.2017	2.75	-0.25	3	2.0	-0.70
China	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	0	2.9	2.10
	deposit rate (12 months)	1.50	26.10.2015	1.75	-0.25	0		
	required reserve rate	17.00	01.03.2016	17.50	-0.50	0		
India	reverse repo rate	6.00	02.08.2017	6.25	-0.25	1	4.4	0.79
	repo rate	5.75	02.08.2017	6.00	-0.25	2		
Indonesia	target rate	6.50	16.06.2016	6.75	-0.25	0	3.2	-0.65
Korea, Republic of	base rate	1.50	30.11.2017	1.25	0.25	1	1.4	-0.50
Malaysia	target overnight rate	3.25	25.01.2018	3.00	0.25	1	1.4	-3.10
Mexico	target rate	7.50	08.02.2018	7.25	0.25	5	5.3	0.48
Philippines	monetary policy rate	3.00	03.06.2016	4.00	-1.00	0	4.5	1.20
Russia	repo auction rate (7 days)	7.50	12.02.2018	7.75	-0.25	7	2.2	-2.40
South Africa	repo rate	6.75	20.07.2017	7.00	-0.25	1	4.0	-2.30
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0	0.4	-1.02
Turkey	repo rate (7 days)	8.00	24.11.2016	7.50	0.50	0	10.3	0.13
United States	federal funds rate (upper bound)	1.75	21.03.2018	1.50	0.25	3	2.2	-0.50
Euro area	refinancing rate	0.00	16.03.2016	0.05	-0.05	0	1.1	-0.90
United Kingdom	base rate	0.50	02.11.2017	0.25	0.25	1	2.7	0.40
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0	1.4	1.00
Canada	target overnight rate	1.25	17.01.2018	1.00	0.25	3	1.7	-0.40
Australia	overnight rate	1.50	02.08.2016	1.75	-0.25	0	1.9	0.40
New Zealand	overnight rate	1.75	10.11.2016	2.00	-0.25	0	1.6	0.30
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0	0.5	-0.40
	certificate of deposit rate	-0.65	08.01.2016	-0.75	0.10	0		
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	0	0.6	0.00
	3m LIBOR - max	-0.25	15.01.2015	0.25	-0.50	0		
Sweden	repo rate	-0.50	11.02.2016	-0.35	-0.15	0	1.6	-0.30
Norway	key deposit rate	0.50	17.03.2016	0.75	-0.25	0	2.2	-0.30

Note: as of 28 February 2018, changes occurred from the compilation time of the previous Monetary Policy Report issue (7 December 2017) are put in colour.

Source: Bloomberg.

LIST OF BOXES

GLOSSARY

Adaptive expectations

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

Averaging of required reserves

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

Bank lending conditions index

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

Bank of Russia interest rate corridor (interest rate corridor)

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

Bank of Russia key rate

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

Bank of Russia Lombard List

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

Banking sector liquidity

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

Broad money (monetary aggregate M2X)

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

Carry trade

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

CDS spread

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

Consumer price index (CPI)

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

Core inflation

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

Credit default swap (CDS)

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

Current liquidity deficit/surplus

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

Dollarisation of deposits

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

Factors of banking sector liquidity

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

Financial stability

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

Floating exchange rate regime

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

Floating interest rate on Bank of Russia operations

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

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

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

Generalised (composite) consumer confidence index

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

Gross credit of the Bank of Russia

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

Import substitution

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

Inflation expectations

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

Inflation risks

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

Inflation targeting regime

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

Interest rate corridor

See Bank of Russia interest rate corridor.

Macro Risk Index

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

Monetary aggregate M1

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

Monetary policy transmission mechanism

The process of transferring the impulse of monetary policy decisions to the economy as a whole and to price dynamics, in particular. The process of transmitting the central bank's signal on holding or changing the key rate and its future path from the financial market segments to the real sector and as a result to inflation. The key rate changes are translated into the economy through the following major channels: interest rate, credit, foreign currency and asset price channels.

Money supply

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

Money supply in the national definition (monetary aggregate M2)

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

MSCI indices

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

Net credit of the Bank of Russia to credit institutions

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

Net private capital inflow/outflow

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

Non-price bank lending conditions

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

Non-tradable sector of the economy

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

Open market operations

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

Outstanding amount on Bank of Russia refinancing operations

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

PMI indices

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

Relative price

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

Repo operation

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

Required reserves

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

Ruble nominal effective exchange rate index

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

Ruble real effective exchange rate index

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

Shadow banking sector

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

Standing facilities

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

Structural liquidity deficit/surplus

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

Structural non-oil and gas primary budget deficit

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

Structural transformations

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

Terms of foreign trade

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

Tradable sector of economy

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

Underlying inflation

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

VIX

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

ABBREVIATIONS

AHML – Agency for Housing Mortgage Lending

BLC – bank lending conditions

bp – basis point (0.01 pp)

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

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

Cbonds IFX-Cbonds – corporate bond total return index

Cbonds-Muni – municipal bond index calculated by Cbonds

CCPI – core consumer price index

CPI – consumer price index

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

ECB – European Central Bank

EME – emerging market economies

EU – European Union

FAO – Food and Agriculture Organization of the United Nations

FCS – Federal Customs Service

Fed – US Federal Reserve System

FGUP – federal state unitary enterprise

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

GRP – gross regional product

IBL – interbank loans

IEA – International Energy Agency

Industrial PPI – industrial producer price index

inFOM – Institute of the Public Opinion Foundation

MC – management company

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

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

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

MIC – military-industrial complex

MICEX SE – MICEX Stock Exchange

MPD – Monetary Policy Department of the Bank of Russia

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

NPF – non-governmental pension fund

NPISH – non-profit institutions serving households

OBR – Bank of Russia bonds

OECD – Organisation for Economic Cooperation and Development

OFZ – federal government bonds

OFZ-IN – inflation-indexed federal government bonds

OFZ-PD – permanent coupon-income federal government bonds

OFZ-PK – variable coupon-income federal government bonds

OJSC – open joint-stock company

OPEC – Organization of the Petroleum Exporting Countries

PJSC – public joint-stock company

PMI – Purchasing Managers' Index

pp – percentage point

PPI – producer price index

QPM – quarterly projection model of the Bank of Russia

REB – Russian Economic Barometer, monthly bulletin

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

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

SME – small and medium-sized enterprises

SNA – system of national accounts

TCC – total cost of credit

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

VAT – value added tax

VCIOM – Russian Public Opinion Research Centre

VEB – Vnesheconombank

VECM – Vector Error Correction Model