



Bank of Russia

RUSSIA'S ECONOMIC
OUTLOOK AND
MONETARY POLICY

JULY 2019



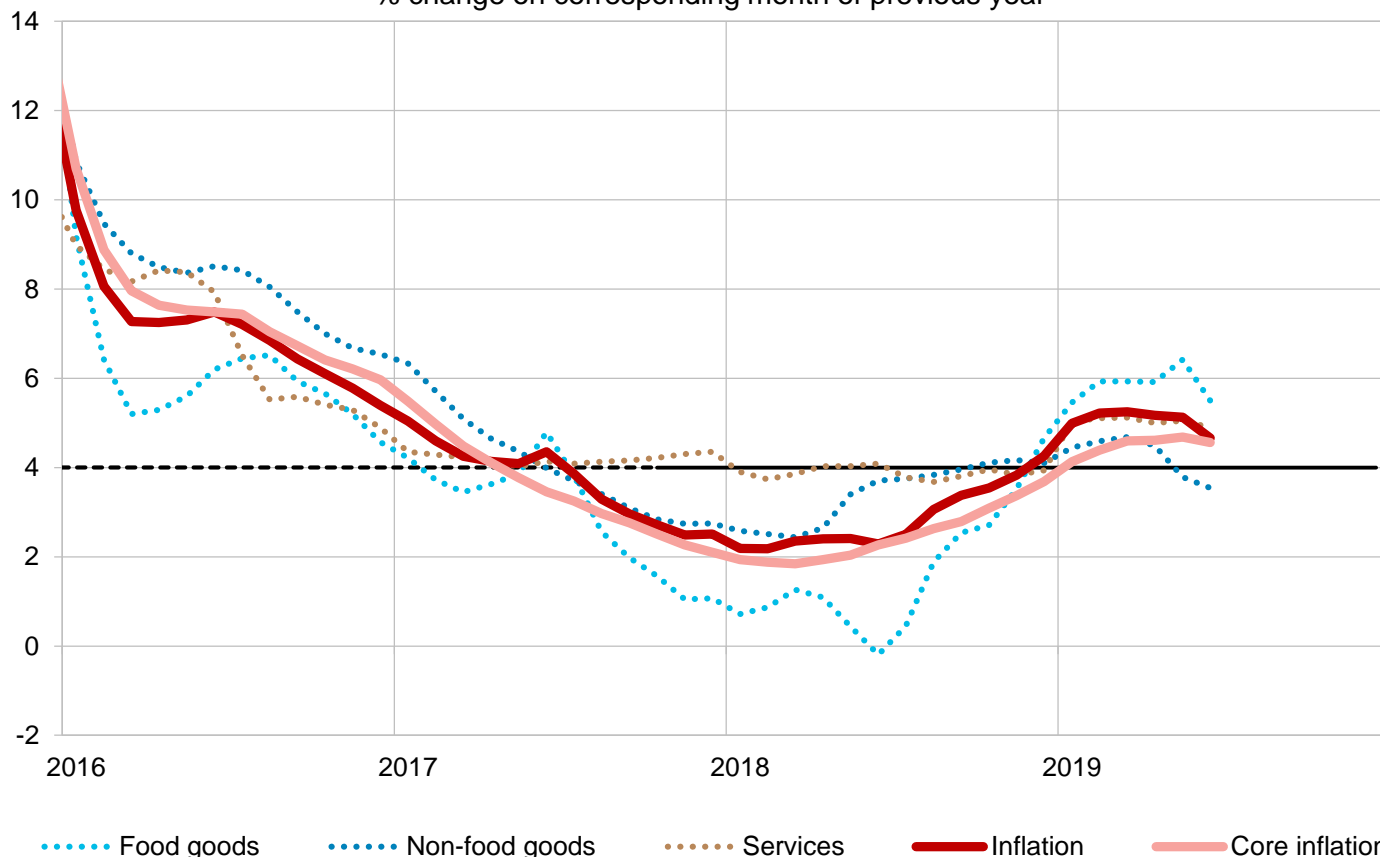
Consumer prices

Inflation slowdown is continuing. In June inflation declined to 4.7% YoY.

Core inflation declined in June for the first time since March 2018 and reached 4.6% YoY.

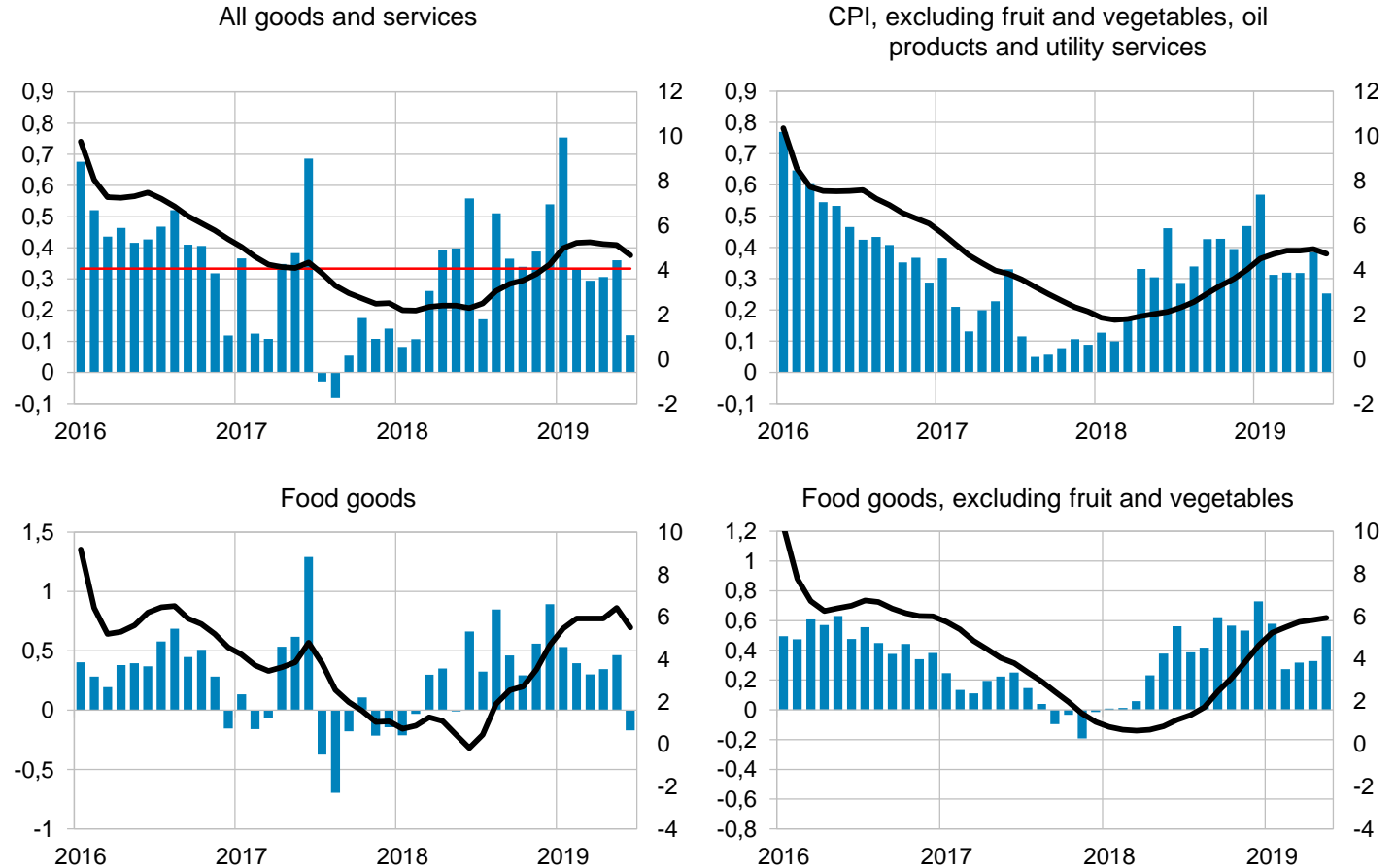
Consumer demand trends constrain inflation, as well as temporary disinflationary factors also (ruble appreciation since the beginning of the year and the decline in fruit and vegetable prices on the back of early new harvest arrival). Annual inflation dynamics were also influenced by base effects.

Inflation by main groups and core inflation, % change on corresponding month of previous year



Inflation rates for main groups, seasonally adjusted (1)

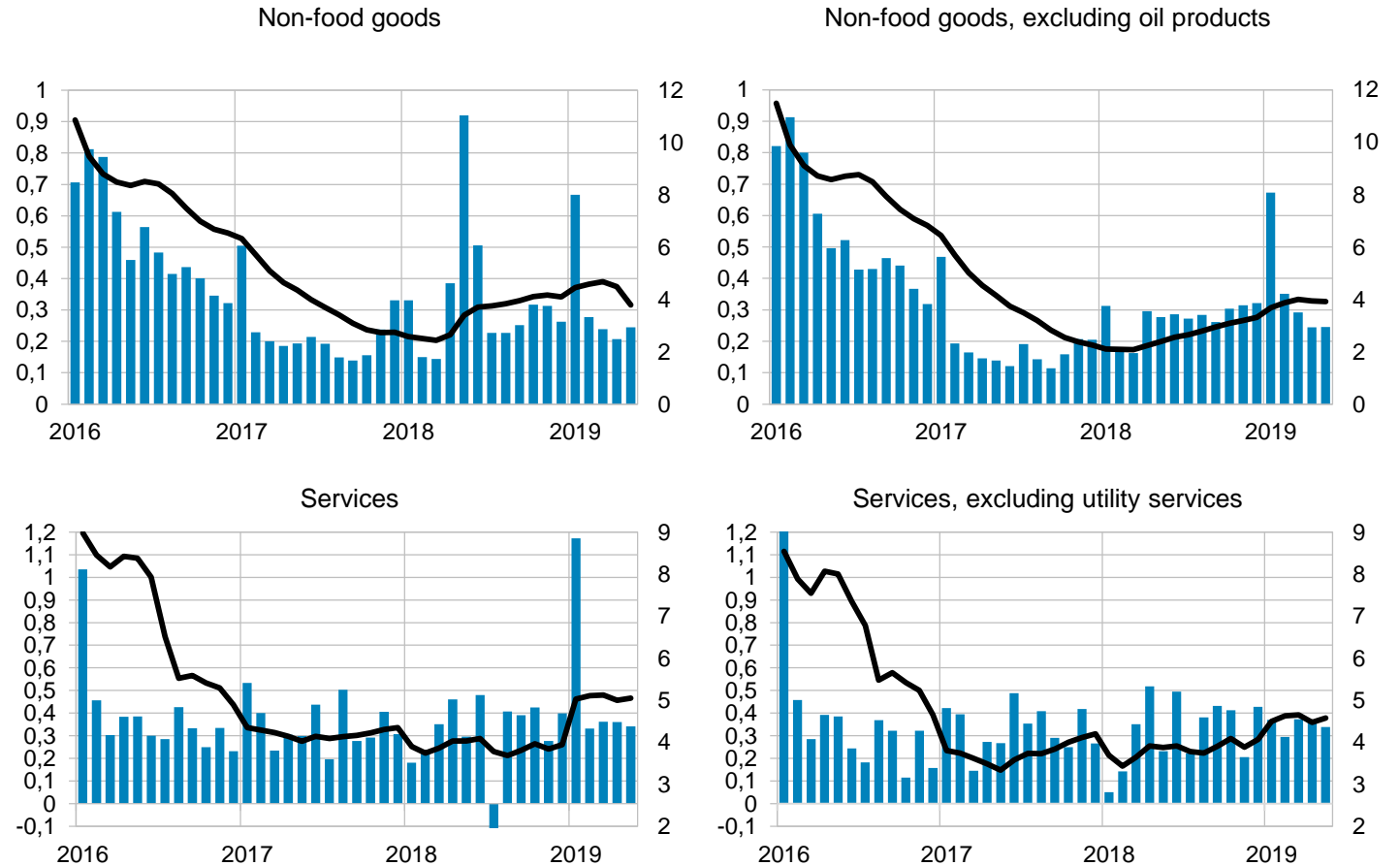
In June seasonally adjusted monthly consumer price growth rate slowed down to 0.1% vs 0.3-0.4% in February-May, which was primarily related to the decline in fruit and vegetable prices.



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

Inflation rates for main groups, seasonally adjusted (2)

The seasonally adjusted increase in prices of non-food goods and services remained within the range seen since February and was consistent with the path to 4% inflation.



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

Inflation expectations – summary

		2017				2018												2019						
		I	II	III	IV	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Inflation expectations (absolute numbers), %																								
Households																								
FOM	Next 12 months	11.2	10.3	9.6	8.7	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	10.1	9.3	9.8	10.2	10.4	10.1	9.1	9.4	9.3	9.4	9.4
FOM (observed inflation)	Prev. 12 months	14.0	12.4	11.2	10.0	9.9	9.4	9.2	8.3	9.2	10.6	10.3	10.4	10.2	10.1	10.1	10.2	10.1	10.6	10.0	10.5	10.4	10.2	9.9
FOM (Bank of Russia calculations)	Next 12 months	4.0	4.0	2.8	2.5	2.1	2.1	2.2	2.2	2.2	2.6	2.8	3.5	3.8	3.8	4.4	5.4	6.2	5.9	5.7	5.5	5.5	4.9	5.3
Professional analysts																								
Bloomberg	2019								4.0	4.0	4.2	4.4	4.7	4.5	4.6	4.5	4.7	4.6	4.7	4.5	4.5	4.5	4.5	4.3
Interfax	2019					3.6	3.7	3.8	4.1	4.0	4.1	4.3	4.4	4.3	4.2	4.4	4.7	4.8	4.7	4.6	4.5	4.5	4.3	-
Reuters	2019								3.9	3.9	4.0	4.3	4.5	4.5	4.5	4.7	5.0	4.8	4.8	4.8	4.8	4.6	4.3	-
Financial markets																								
OFZ IN (option not subtracted)	2023	4.9	4.6	4.2	3.9	4.0	3.9	3.8	4.1	4.2	4.5	4.6	5.2	5.3	5.1	5.1	5.1	5.1	5.0	4.9	4.6	4.2	3.9	3.7
OFZ IN (option not subtracted)	2028									4.3	4.6	4.6	5.0	5.4	5.2	5.2	5.1	4.9	4.9	4.8	4.7	4.3	3.9	3.8
Inflation expectations (balanced index*)																								
Households																								
FOM	Next 12 months	-4.4	-4.1	-3.6	0.5	-1.5	-0.9	-3.2	-4.8	-3.1	9.1	8.6	11.3	9.8	7.9	14.3	20.6	18.6	11.5	8.0	5.6	6.5	5.4	-
FOM	Next month	-12.2	-10.4	-16.5	-16.9	-24.5	-19.5	-15.9	-17.3	-12.6	0.0	-5.6	-3.7	-4.5	-5.9	-6.8	-3.5	1.9	-8.2	-9.8	-8.1	-10.7	-14.6	-
Businesses																								
Bank of Russia monitoring	Next 3 months	7.9	8.6	7.5	7.3	6.8	6.3	7.0	8.8	10.2	10.3	10.9	11.1	12.4	12.9	13.7	16.1	18.1	12.8	11.0	10.0	9.6	10.2	9.0
PMI input prices	Next month	7.8	9.0	12.2	10.6	9.2	11.4	12.2	27.4	27.2	28.4	21.6	22.8	24.2	23.4	22.6	22.0	35.0	26.8	23.6	19.8	14.2	11.8	-
PMI output prices	Next month	1.0	3.4	6.8	3.0	2.8	2.8	4.0	13.6	6.4	6.6	8.2	6.6	5.8	7.6	7.6	5.6	20.4	14.4	10.0	8.8	5.6	4.4	-
Retail prices (Rosstat)	Next quarter	27	24	24	22	-	-	20	-	-	20	-	-	20	-	-	19	-	-	21	-	-	-	-
Tariffs (Rosstat)	Next quarter	4	3	0	0	-	-	5	-	-	5	-	-	0	-	-	1	-	-	...	-	-	-	-

Change:

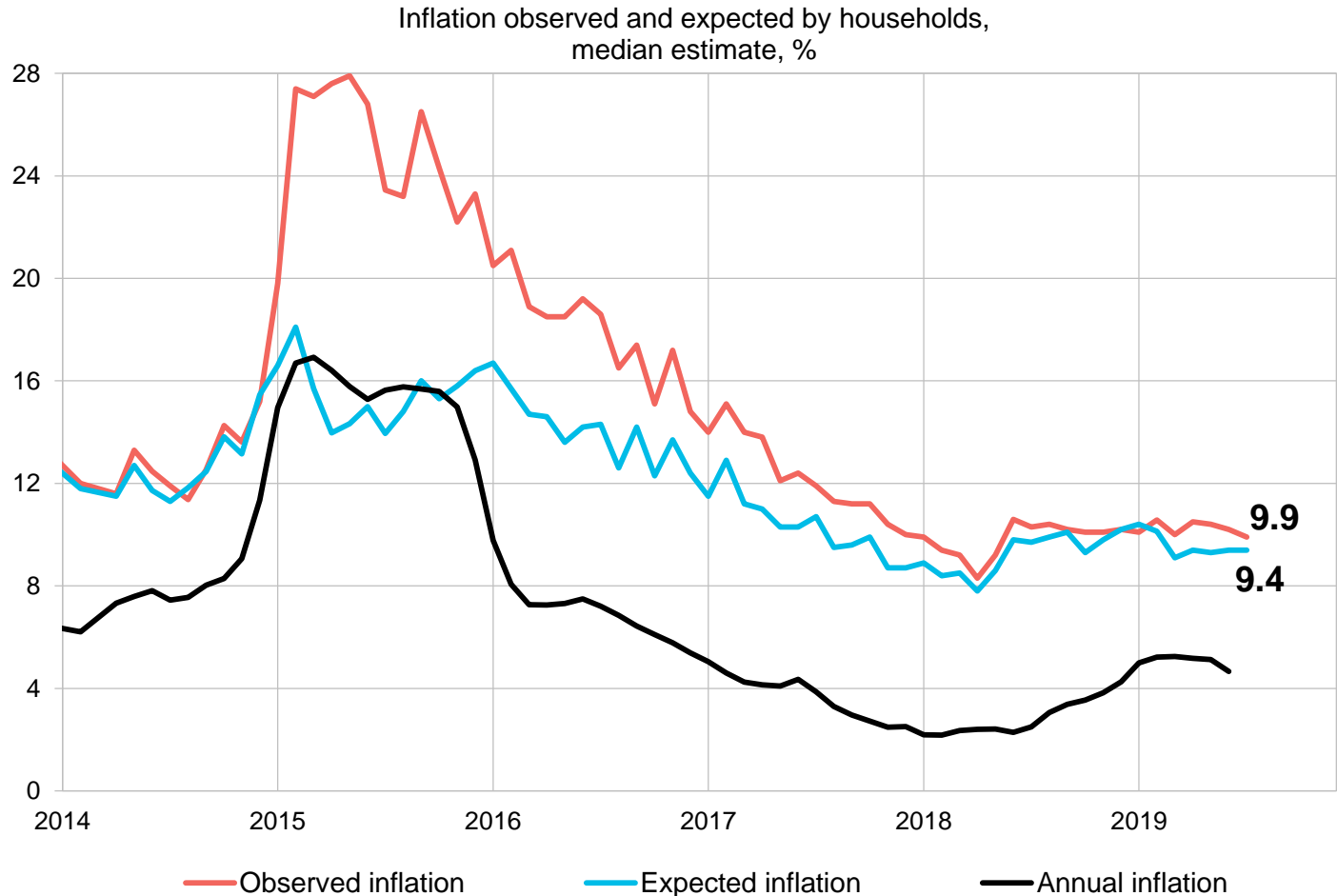
- Inflation expectations become better (more than 1 standard deviation)
- Inflation expectations become better (less than 1 standard deviation)
- Inflation expectations unchanged ($\pm 0,2$ standard deviations)
- Inflation expectations become worse (less than 1 standard deviation)
- Inflation expectations become worse (more than 1 standard deviation)

*Balanced index is the difference between the shares of those who expect prices to rise and to fall

Inflation expectations – households

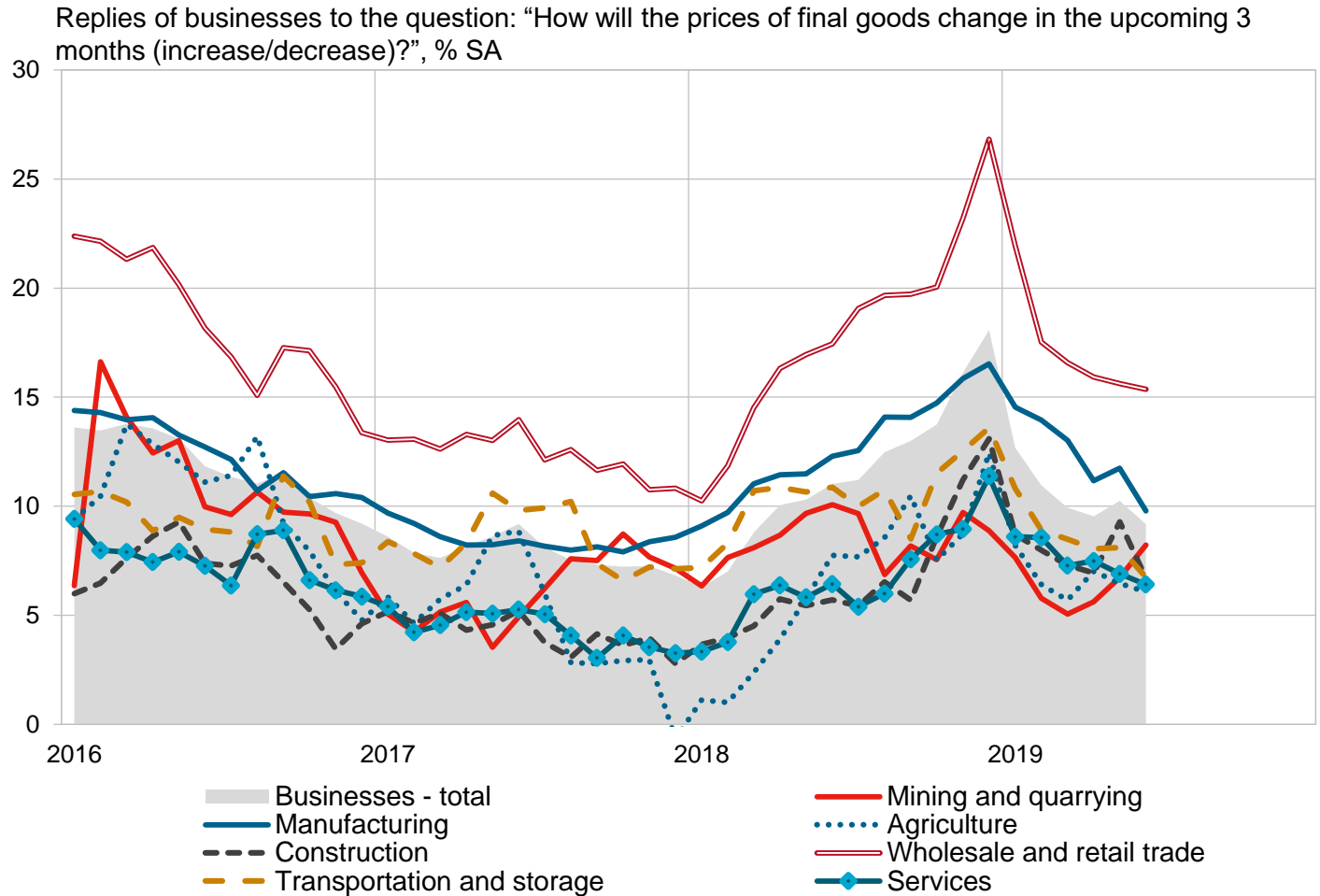
Since April households' inflation expectations have not materially changed and remain elevated.

In July observed inflation continued to slow down.



Inflation expectations – businesses

Short-term price expectations of businesses continued to decline, despite a temporary increase in June.



GDP growth and investment activity

Russian economy's growth rate since the beginning of the year has been lower than the Bank of Russia's expectations.

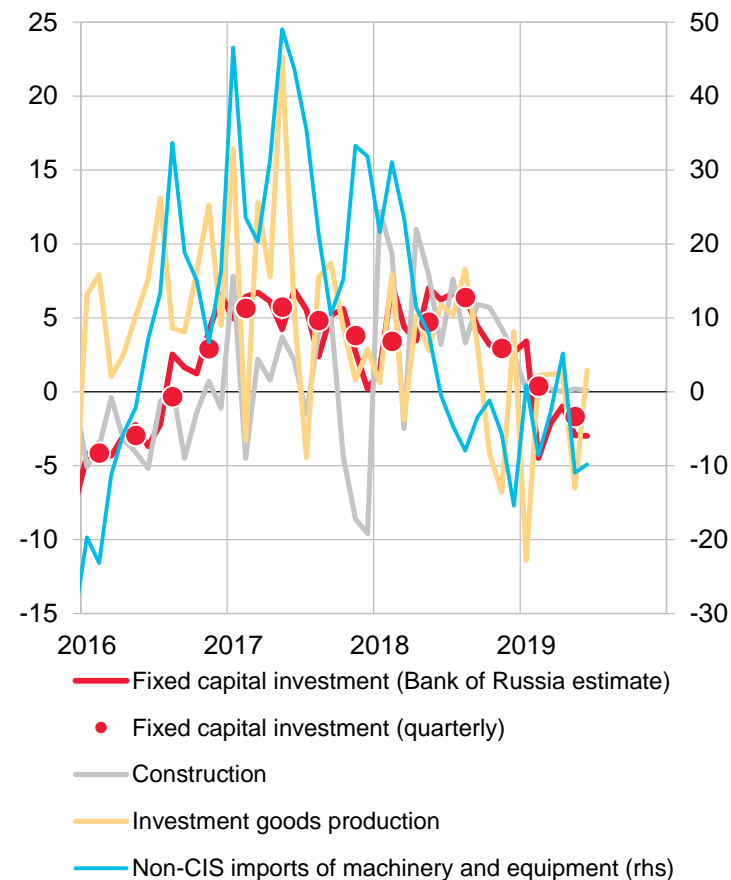
This was caused by weak investment activity dynamics and a significant drop in annual export growth rates, including on the back of weaker external demand.

Growth in the elements of GDP use,
% YoY

	2018				2019
	Q1	Q2	Q3	Q4	Q1
GDP	1.9	2.2	2.2	2.7	0.5
Final consumption					
households	2.1	1.5	1.6	2.0	1.2
government	2.7	1.9	2.0	2.6	1.6
Gross capital formation					
GFCF*	0.4	-2.2	1.1	3.0	-3.1
Exports	3.5	4.2	5.5	0.2	-2.6
Imports	7.2	7.8	4.8	2.6	-0.4
	10.0	2.8	0.1	-0.3	-1.6

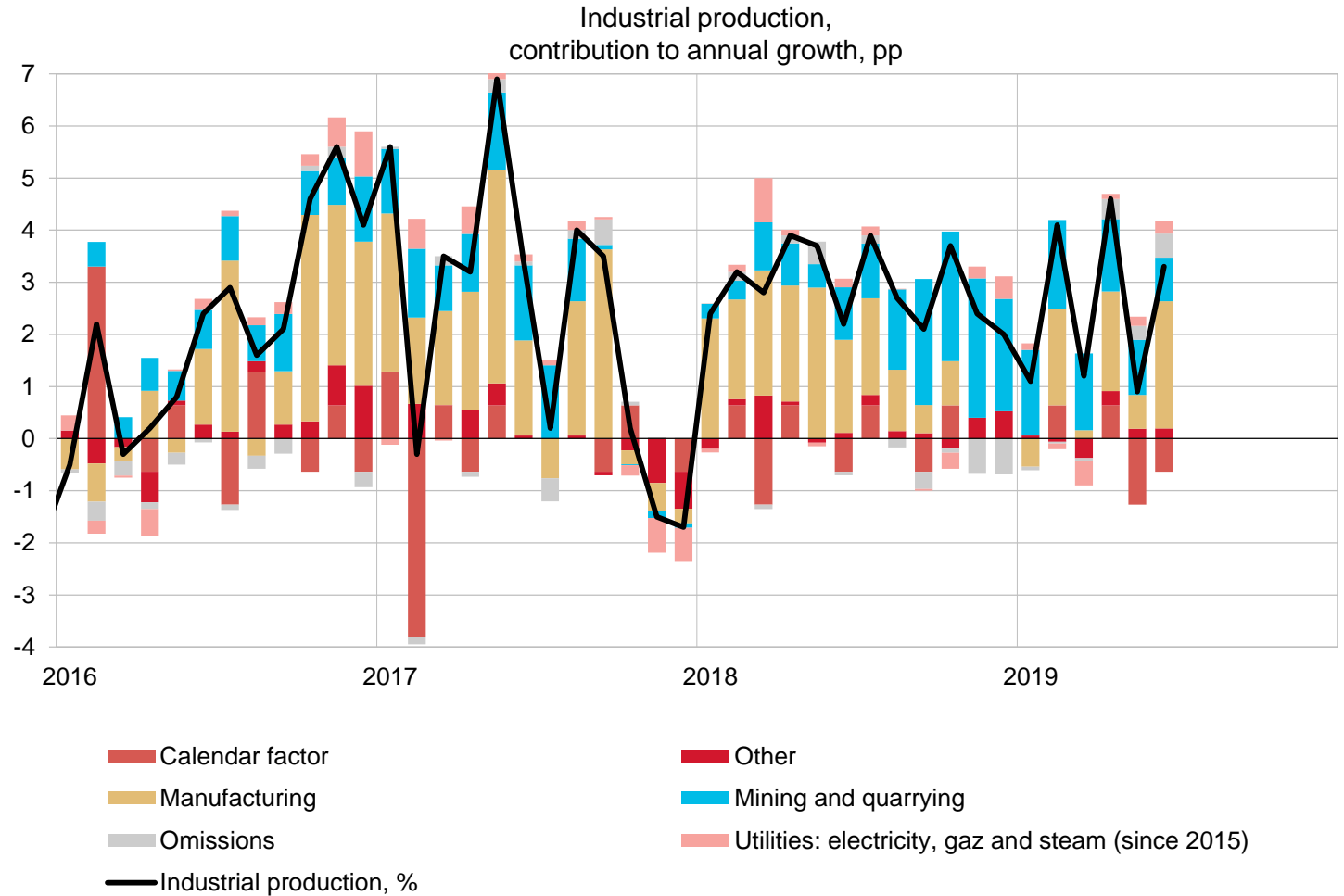
* Gross fixed capital formation

Investment activity indicators,
% YoY



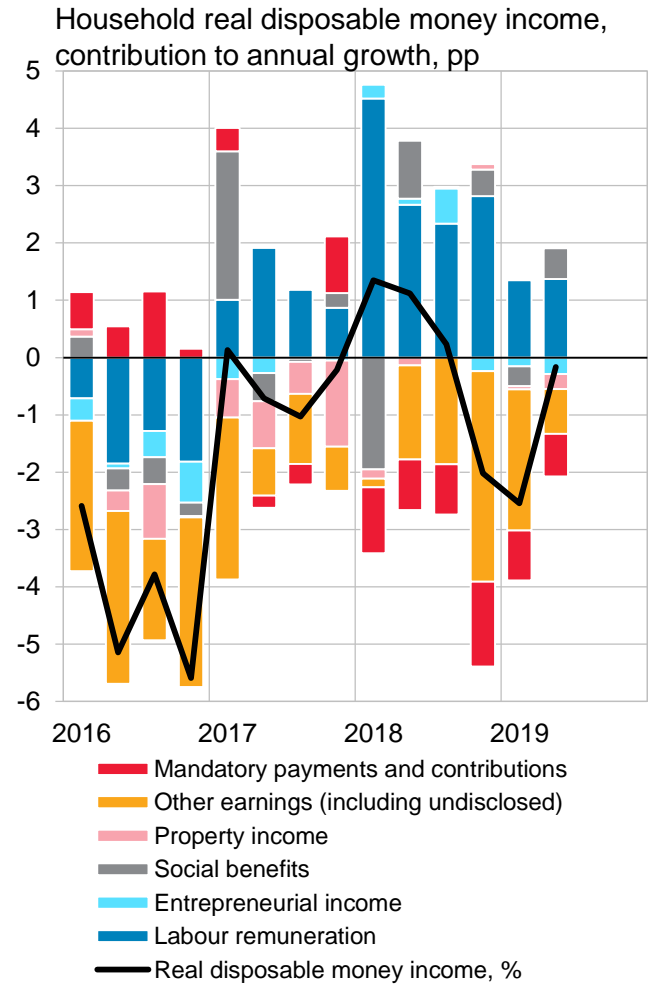
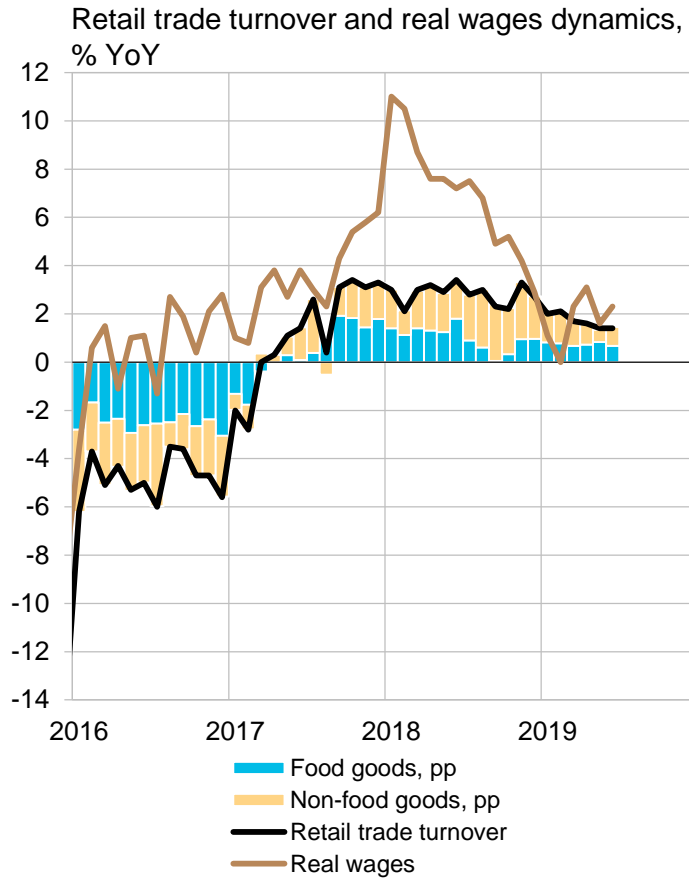
Industrial production

The second quarter saw an increase in annual industrial production growth, which may not be steady.



Retail sales and disposable money income

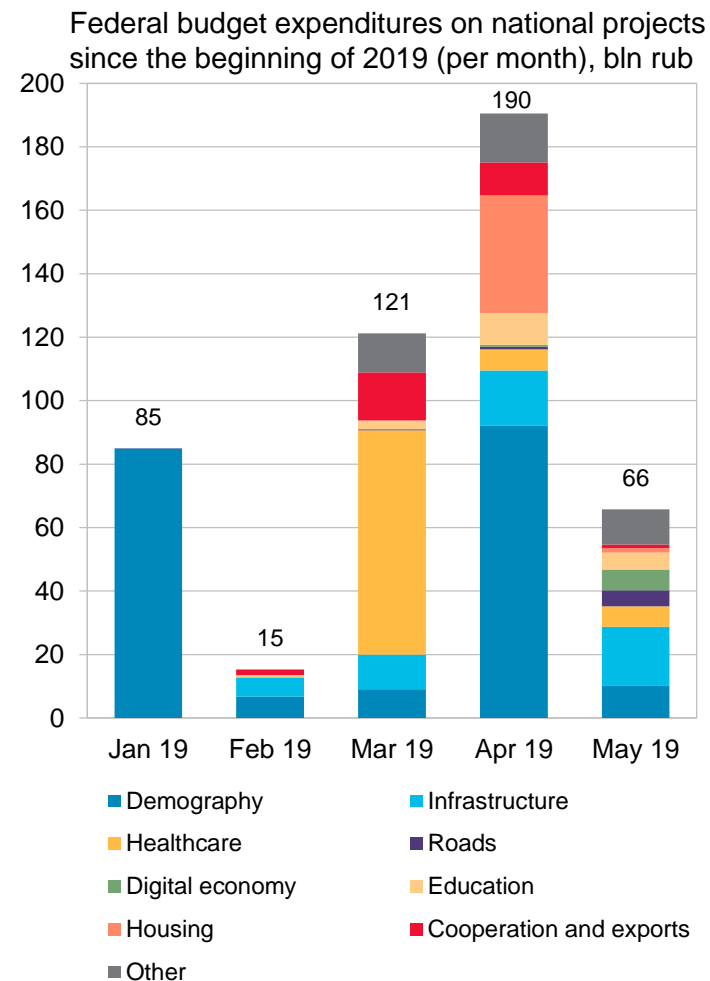
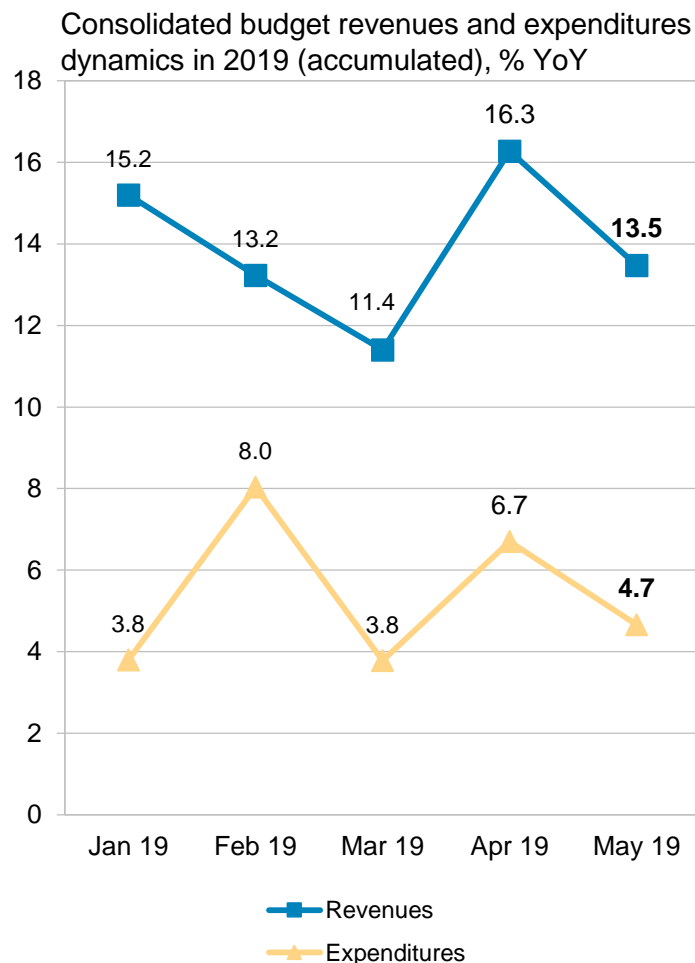
Retail trade turnover growth continued to decline YoY amid falling real disposable household incomes.



Fiscal policy

In the first half of the year, fiscal policy had additional constraining effect on the economic activity, which is in part related to the shift of implementation schedule of a number of national projects planned by the Government.

Since the second half of 2019, government spending, including investment expenditures, is expected to rise.



Deposit and credit market – interest rates

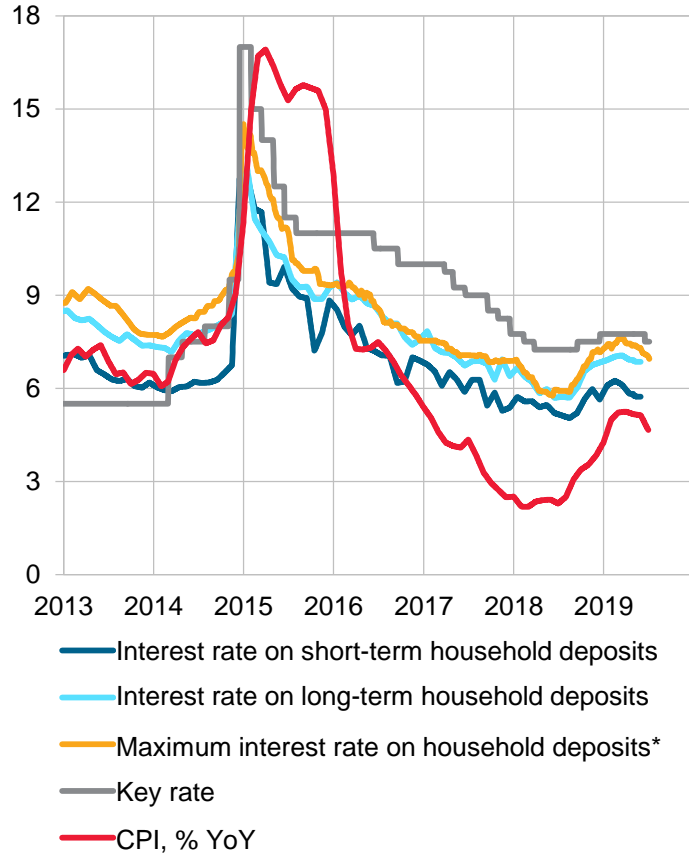
Monetary conditions continued to ease since the last Board meeting.

This was driven by the change in expectations of financial market participants with regard to the Bank of Russia's key rate path and the downward revision of expected interest rate paths in the US and the euro area.

OFZ yields and deposit interest rates continued to decline.

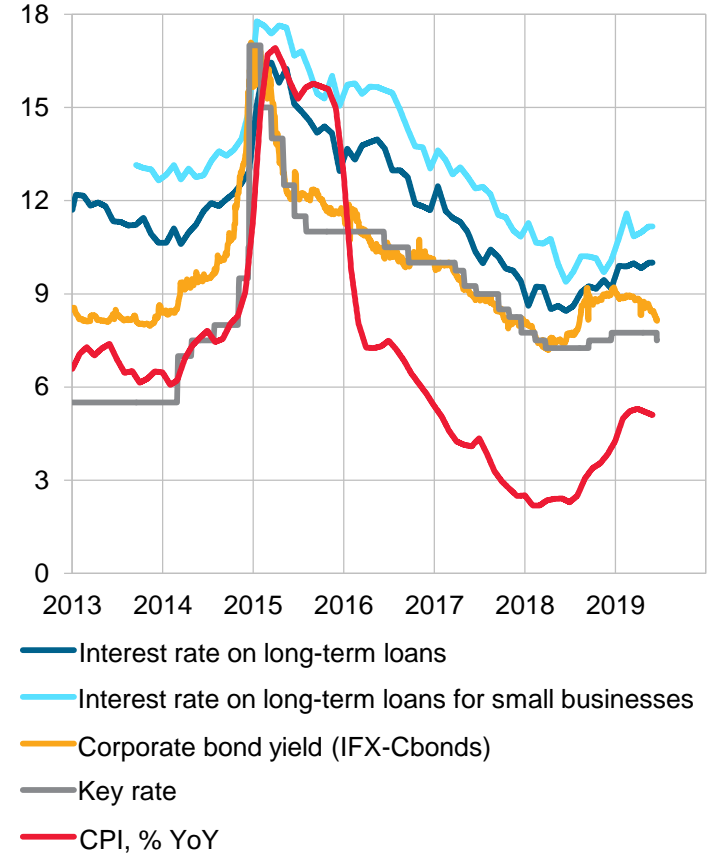
The Bank of Russia's decisions to cut the key rate and the decline in OFZ yields observed since the beginning of this year create conditions for the decrease in deposit and lending rates in the future.

The dynamics of interest rates on household ruble deposits, % per annum



* Bank of Russia's estimate

The dynamics of interest rates on corporate loans in rubles, % per annum

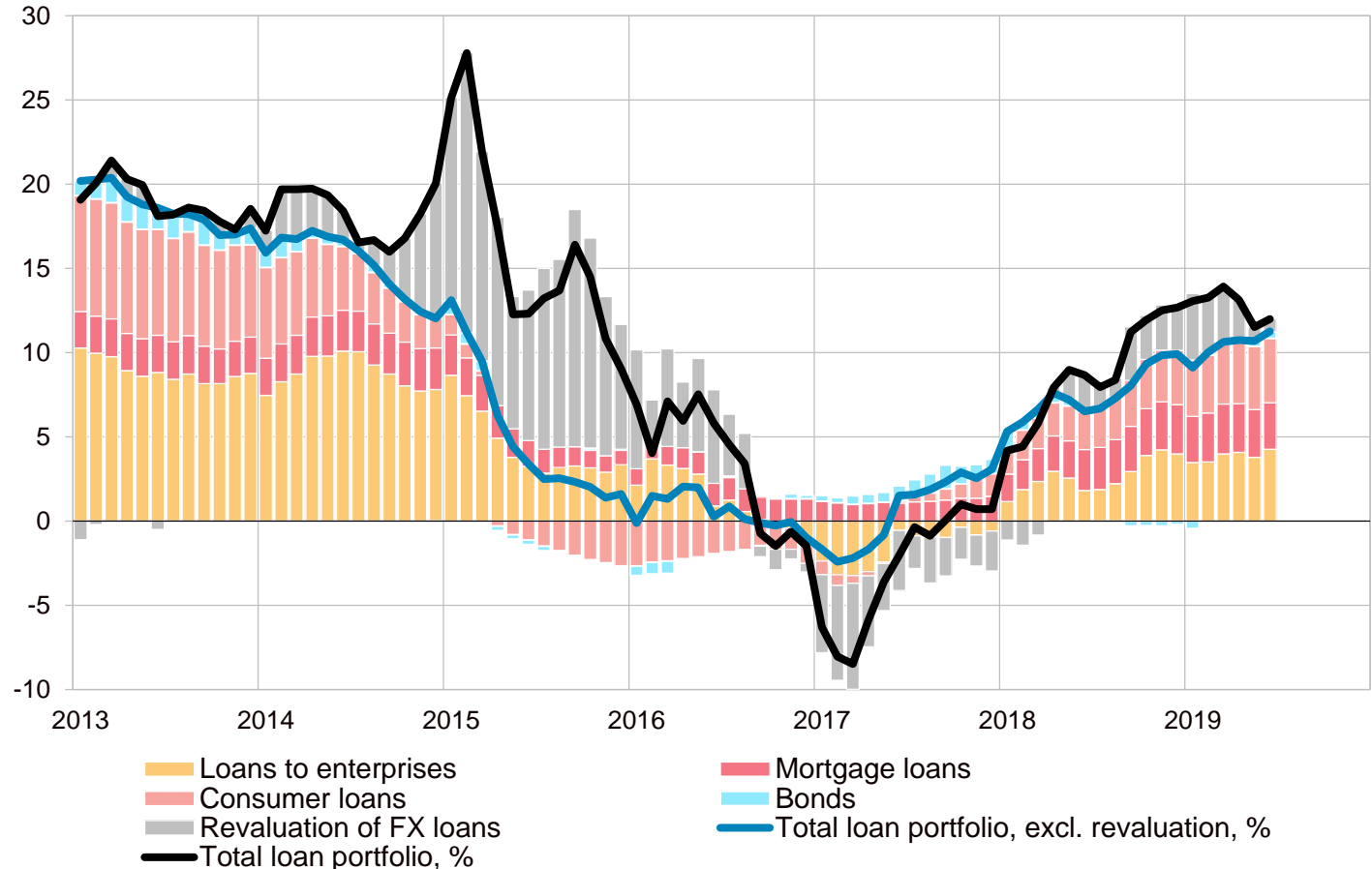


Deposit and credit market – lending

In June, real sector lending continued to grow on the back of eased monetary conditions.

Annual growth rate of loans to non-financial organisations reached the maximum level since 2015 while the growth rate of household loans stabilised after a tangible increase in the previous months.

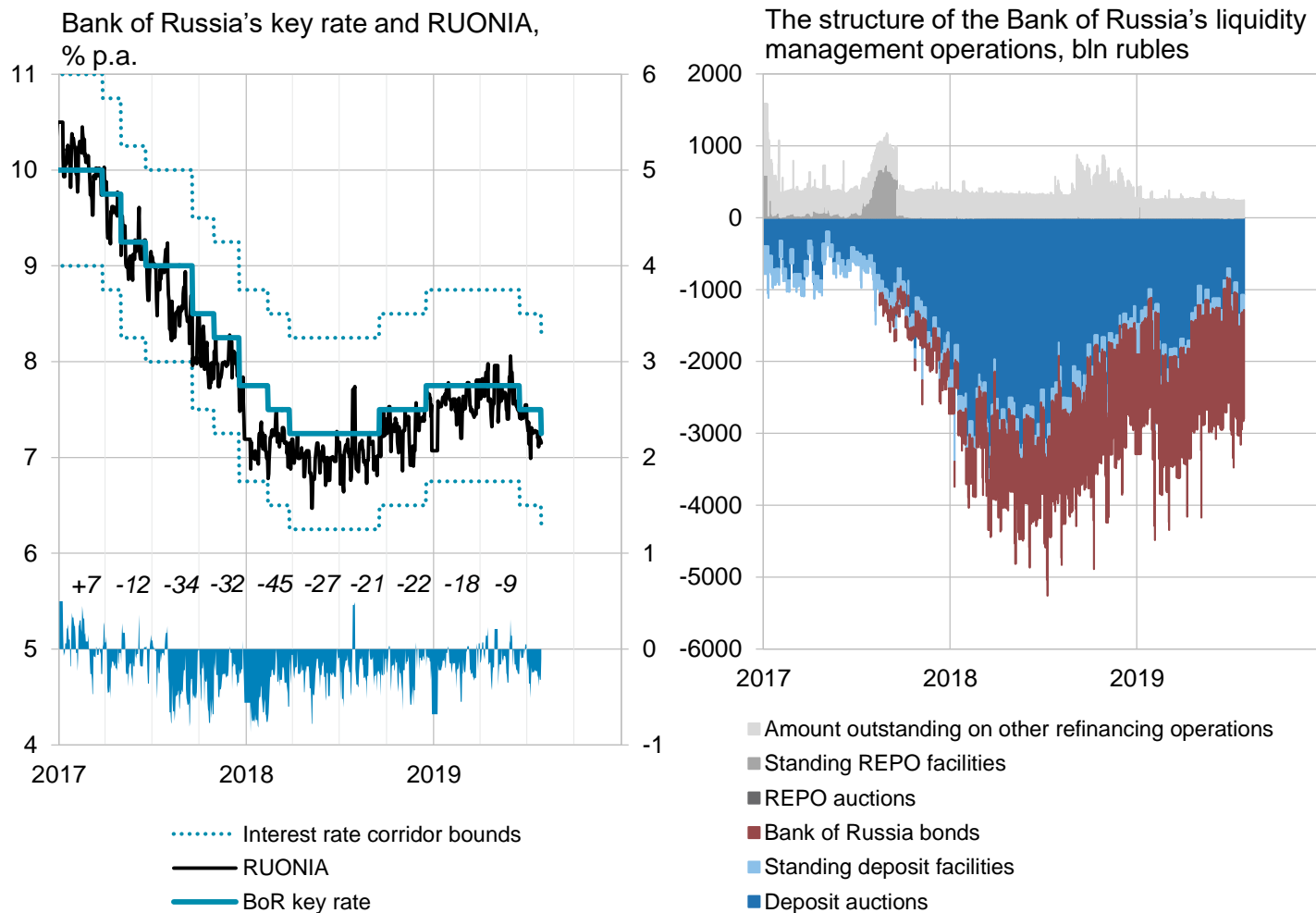
Contribution of various components to annual growth of bank claims on non-financial organisations, pp



Money market conditions

Due to the structural liquidity surplus RUONIA remains moderately below the key rate.

In 2Q19 the spread narrowed and averaged at -9 bps after -18 bps in 1Q19.

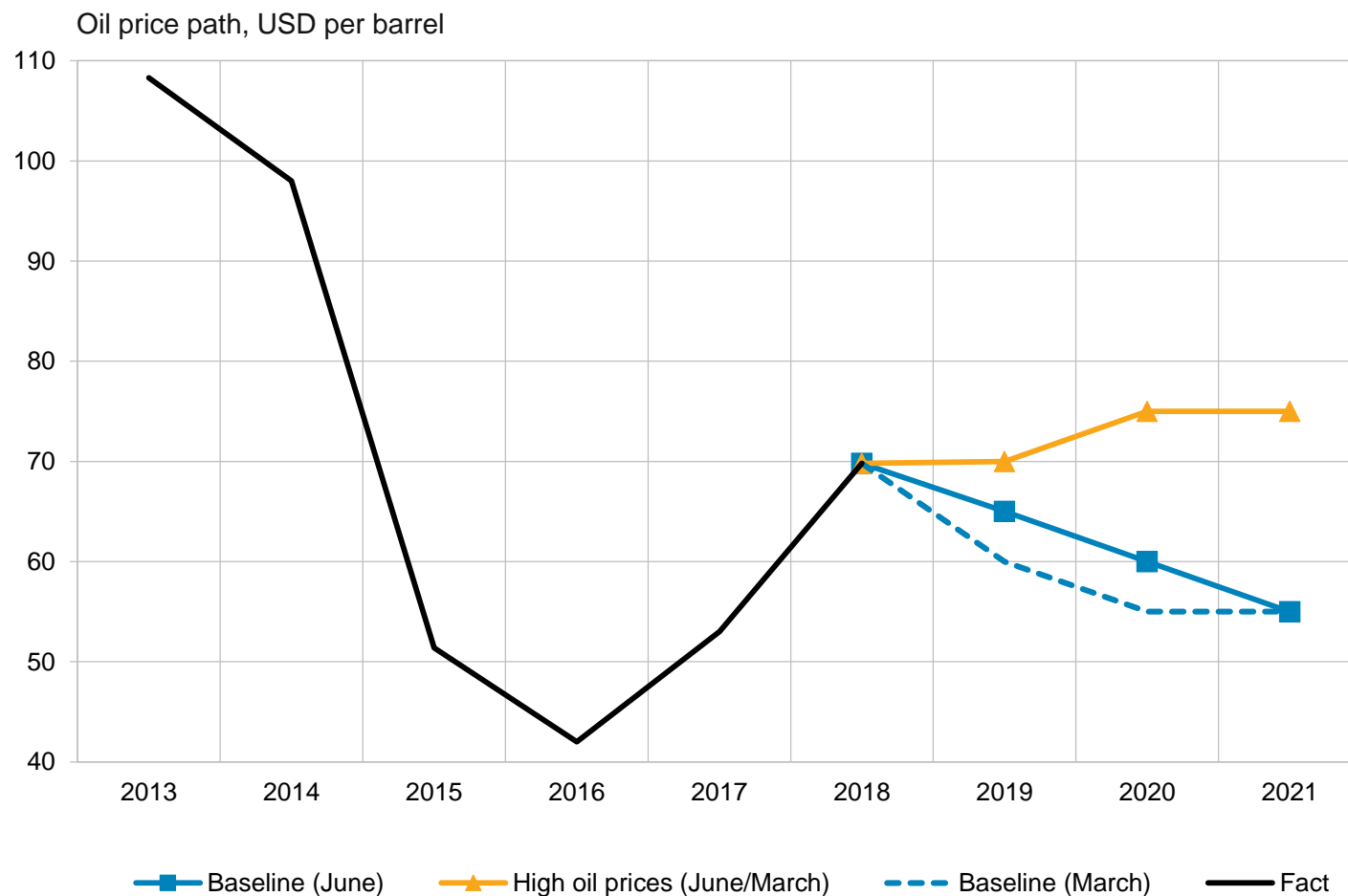


Assumptions – Oil price

Higher Urals price projections in the baseline scenario: \$65/bbl in 2019 and \$60/bbl in 2020.

2019-2020 projections are marked mostly to the fact of 1H2019 and persisting expectations of production cuts in Venezuela and Iran.

High oil prices scenario projections are unchanged compared to March.



Bank of Russia forecast, June 2019 (1)

Key parameters of the Bank of Russia's forecast scenarios (growth as % of previous year, if not indicated otherwise)	2018 (actual)	BASELINE			HIGH OIL PRICES		
		2019	2020	2021	2019	2020	2021
Urals price, average for the year, US dollars per barrel	69.8	65	60	55	70	75	75
Inflation, as % in December year-on-year	4.3	4.2-4.7	4.0	4.0	4.2-4.7	4.0	4.0
Inflation, average for the year, as % year-on-year	2.9	4.7-4.9	4.0	4.0	4.7-4.9	4.0	4.0
Gross domestic product	2.3	1.0-1.5	1.8-2.3	2.0-3.0	1.0-1.5	2.0-2.5	2.0-3.0
Final consumption expenditure	1.8	1.0-1.5	1.8-2.3	2.0-2.5	1.0-1.5	2.0-2.5	2.0-2.5
– households	2.3	1.0-1.5	1.8-2.3	2.5-3.0	1.0-1.5	2.3-2.8	2.5-3.0
Gross capital formation	0.8	0.5-1.5	3.5-4.5	3.5-4.5	0.5-1.5	3.5-4.5	3.5-4.5
– gross fixed capital formation	2.9	1.0-2.0	3.5-4.5	3.5-4.5	1.0-2.0	3.5-4.5	3.5-4.5
Exports	5.5	0.8-1.3	2.7-3.2	2.7-3.2	0.8-1.3	2.7-3.2	2.7-3.2
Imports	2.7	1.0-1.5	3.8-4.2	4.5-5.0	1.0-1.5	4.0-4.5	4.5-5.0
Money supply in national definition	11.0	8-12	7-12	7–12	9-13	8-13	8-13
Claims on organisations and households in rubles and foreign currency ¹	11.5	8-12	7-12	7–12	9-13	7-12	7-12
– claims on non-financial and financial organisations in rubles and foreign currency, growth as % over year	8.4	7-10	6-10	6–10	8-11	6-10	6-10
– claims on households in rubles and foreign currency, growth as % over year	22.0	15-20	11-16	10–15	16-21	12-17	10-15

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

Bank of Russia forecast, June 2019 (2)

Russia's balance of payments indicators* (billions of US dollars)	2018 (actual)	BASELINE			HIGH OIL PRICES		
		2019	2020	2021	2019	2020	2021
Current account	114	98	72	50	106	112	103
Balance of trade	194	184	160	139	190	203	199
<i>Exports</i>	443	434	424	415	443	475	493
<i>Imports</i>	249	250	264	276	253	272	294
Balance of services	-30	-33	-37	-37	-31	-35	-40
<i>Exports</i>	65	62	63	66	66	70	73
<i>Imports</i>	95	95	100	103	97	105	113
Balance of primary and secondary income	-51	-53	-51	-52	-53	-56	-56
Current and capital account balance	113	98	72	50	106	112	103
Financial account (excluding reserve assets)	77	32	16	7	32	29	24
Government and the central bank	9	-18	-6	-6	-18	-6	-6
Private sector	68	50	22	13	50	35	30
Net errors and omissions	3	0	0	0	0	0	0
Change in reserve assets ('+' – increase, '-' – decrease)	38	66	56	43	74	83	79

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

Monetary policy decision on 26 July 2019

Inflation and inflation expectations

- Inflation slowdown is continuing. CPI declined in June to 4.7% YoY and was close to 4.6% YoY as of 22 July.
- Core inflation declined in June for the first time since March 2018 and reached 4.6% YoY.
- In June MoM SA inflation slowed down to 0.1% vs 0.3-0.4% in February-May. Most MoM SA indicators reflecting the most sustainable price movements are close to 4% (annualised).
- Inflation expectations remain elevated. Inflation slowdown paves the way for a future decline in inflation expectations.
- According to the Bank of Russia's forecast, taking into account the pursued monetary policy, annual inflation will return to 4% in early 2020.

Monetary conditions

- Monetary conditions continued to ease since the last Board meeting.
- OFZ yields and deposit interest rates continued to decline.
- The Bank of Russia's decisions to cut the key rate and the decline in OFZ yields observed since the beginning of 2019 create conditions for the decrease in deposit and lending rates in the future.
- In June, real sector lending continued to grow on the back of eased monetary conditions.

Economic activity

- Economic growth since the beginning of 2019 has been lower than the Bank of Russia's expectations. This was caused by weak investment activity dynamics and a significant drop in annual export growth rates.
- Q2 saw an increase in annual industrial production growth, which may not be steady.
- Retail trade turnover growth continued to decline YoY amid falling real disposable household incomes.
- Unemployment remains at the historic lows, however, it does not create any additional inflationary pressure.
- In H1 2019, fiscal policy had additional constraining effect on the economic activity.

Disinflationary risks exceed pro-inflationary risks over the short-term horizon which is primarily related to weak dynamics of domestic and external demand

Internal risks

- Elevated and unanchored inflation expectations
- Short-term and medium-term fiscal policy parameters

Moderate risks – estimates are mostly unchanged:

- Wage movements
- Prices of individual food products
- Possible changes in consumer behavior

External risks

- Risks of persistent capital outflows from emerging markets (↓)
- Slowdown in global economic growth
- Geopolitical factors
- The volatility of global oil prices

Decision

The Bank of Russia
cuts the key rate by 25 bp
to 7.25% p.a.

Signal

"...If the situation develops in line with the baseline forecast, the Bank of Russia admits the possibility of further key rate reduction at one of the upcoming Board of Directors' meetings and a transition to neutral monetary policy in the first half of 2020.

In its key rate decision-making, the Bank of Russia will take into account actual and expected inflation dynamics relative to the target and economic developments over the forecast horizon, as well as risks posed by domestic and external conditions and the reaction of financial markets..."