

RUSSIAN ECONOMIC OUTLOOK AND CHALLENGES TO MONETARY POLICY

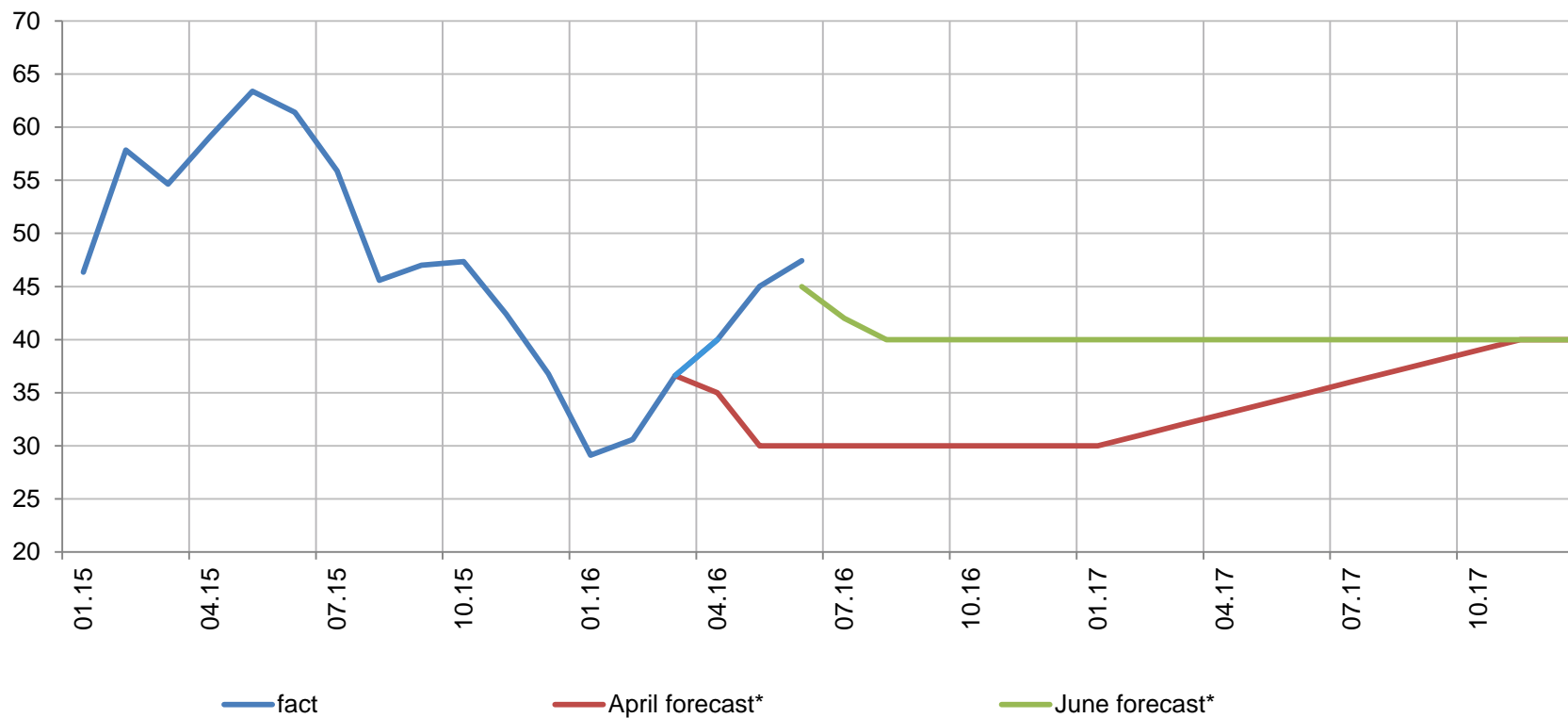
June 2016



Global markets were performing better than expected, providing a positive impact on economic activity and inflation

oil price, fact VS forecast

USD/bbl



*Bank of Russia baseline forecast



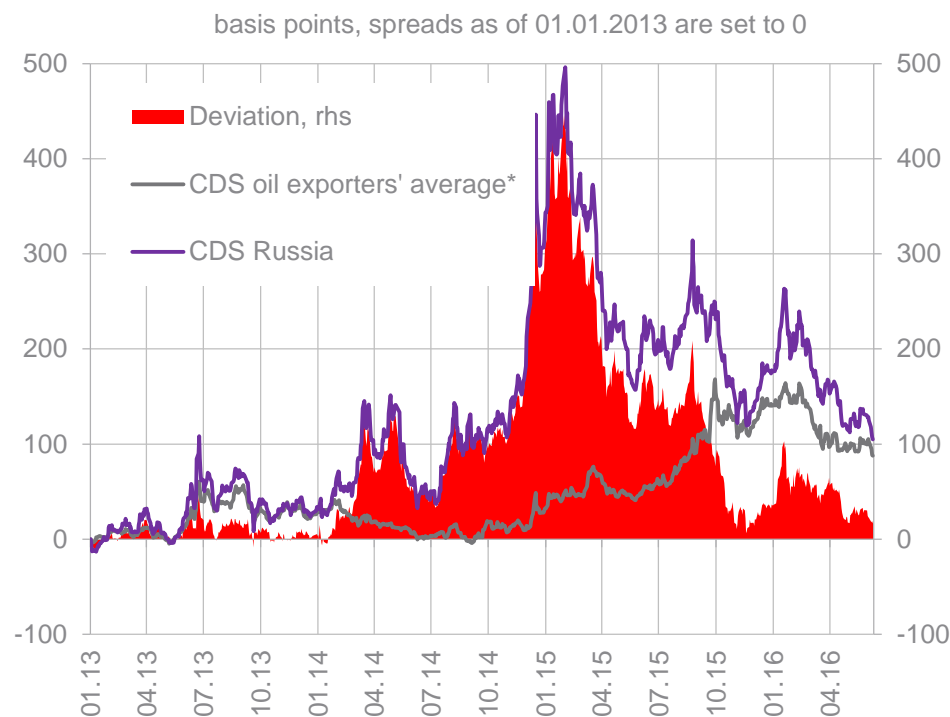
Global markets: overoptimistic, correction is plausible

MSCI global markets (1.01.2013=100%)



Source: Bloomberg.

Risk-premium in Russia and other oil-exporting countries (CDS spreads)



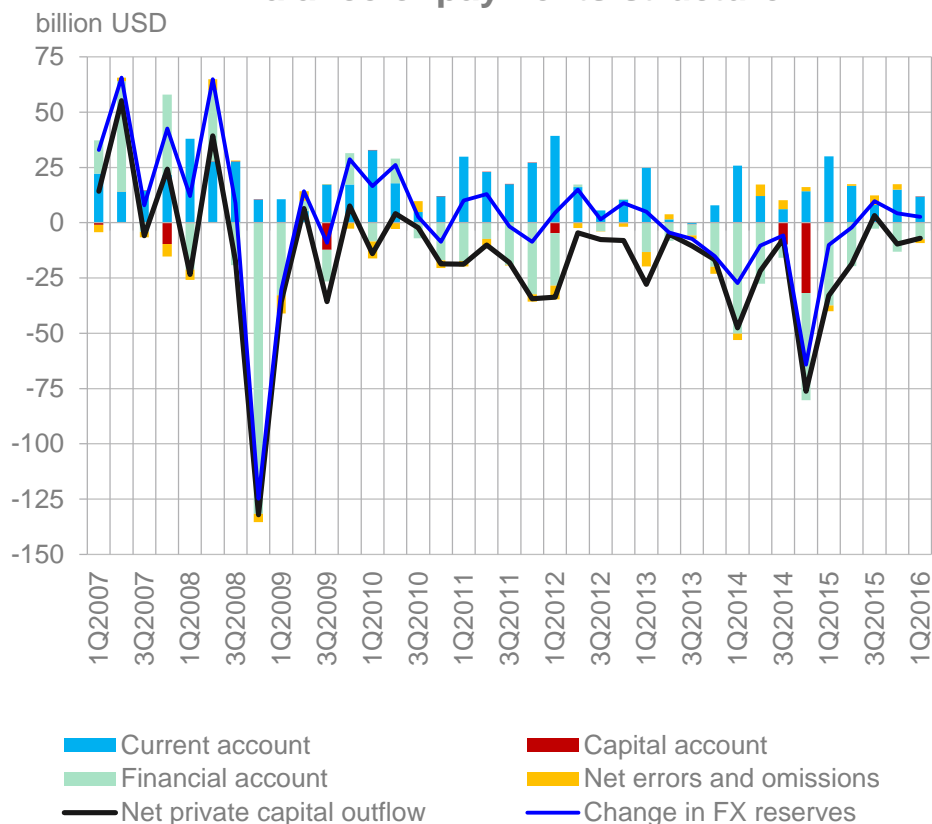
* simple mean of Brazil, Mexico, Malaysia and Norway CDS spreads

Source: Bloomberg.



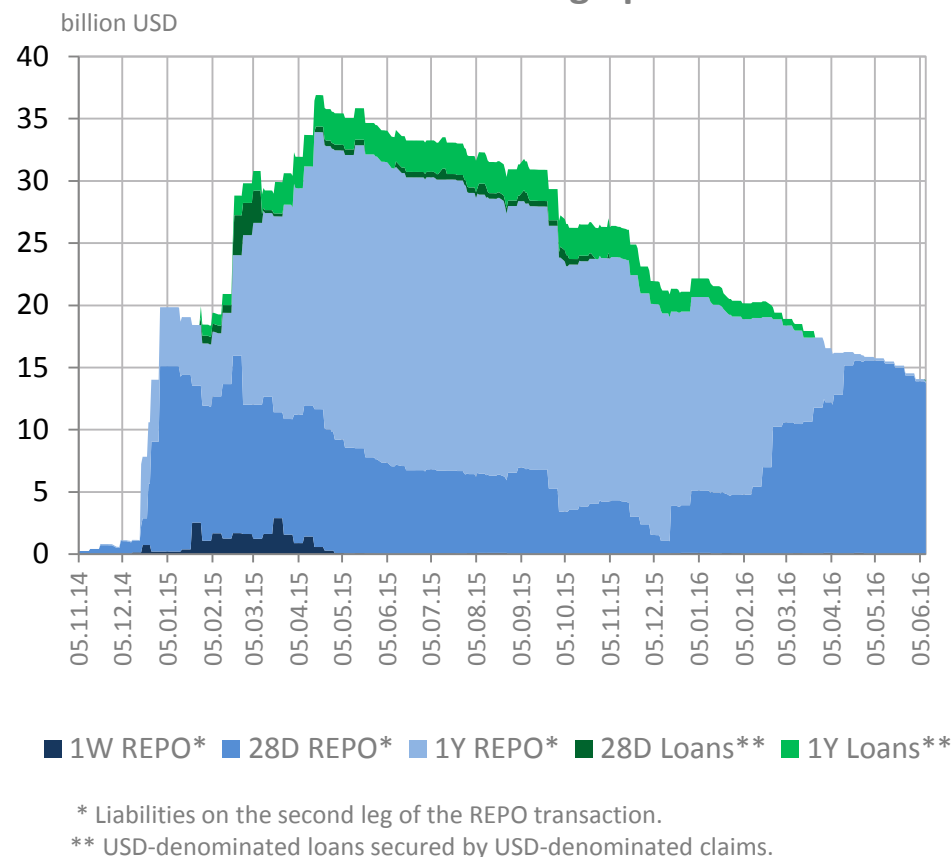
Current account surplus is sufficient to cover external debt payments. Demand for BoR refinancing operations subsides

Balance of payments structure



Source: Bank of Russia

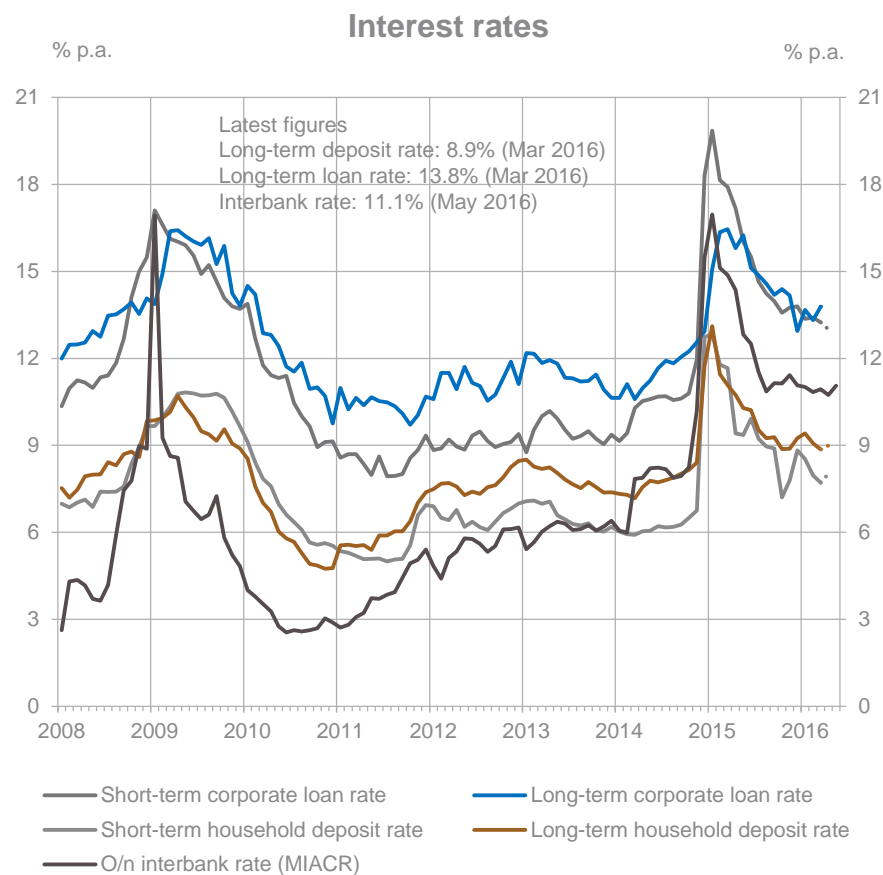
BoR FX refinancing operations



Source: Bank of Russia

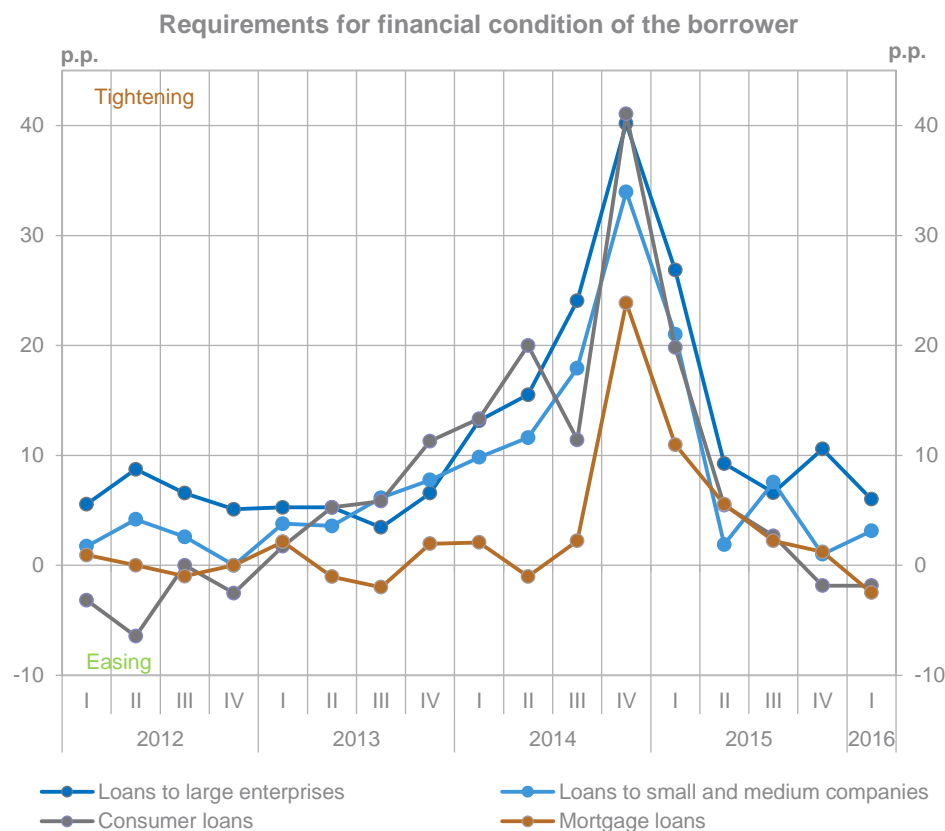


Monetary conditions remain tight. Interest rates: stabilization in nominal terms, moderate growth in real terms.



* Dotted lines represent BoR estimates.

Source: Bank of Russia.

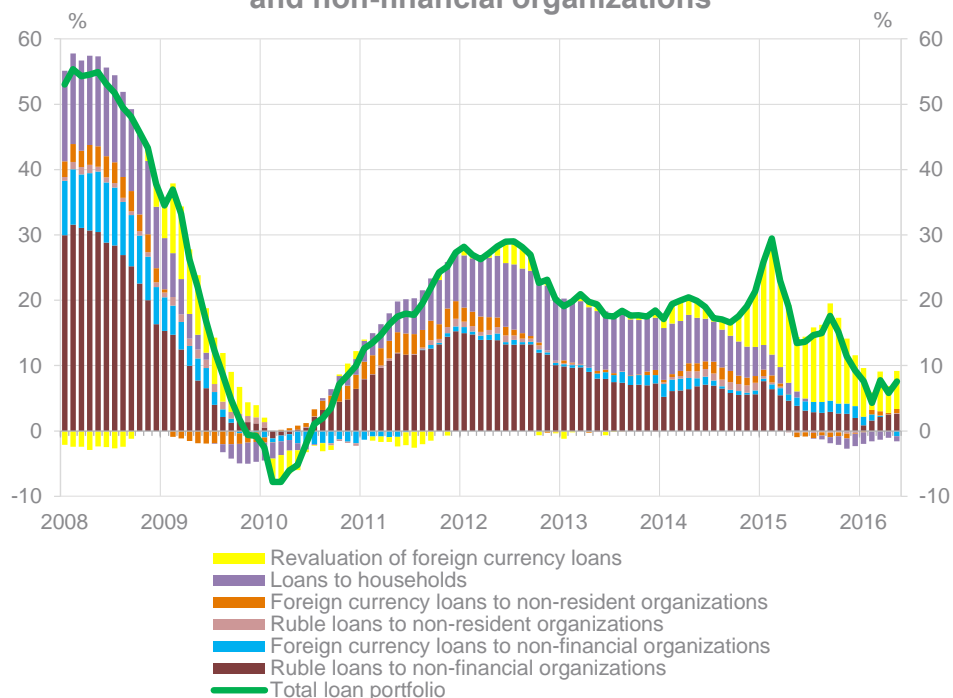


Source: Bank of Russia.



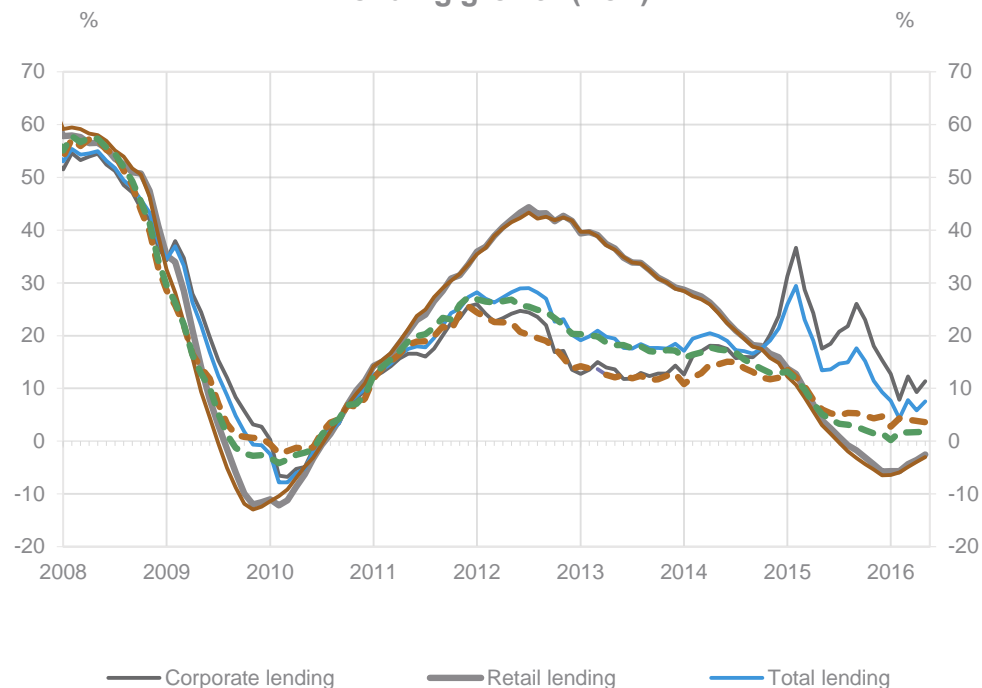
Credit activity remains slow due to weak economic activity and high debt burden

Contributions of various components to the annual growth rates of bank loans to households and non-financial organizations



Source: Bank of Russia.

Lending growth (YoY)*



* Dotted lines represent growth rate excluding currency revaluation. Source: Bank of Russia.

Dollarisation of loan portfolio (%)

	1.01.14	1.01.15	1.01.16	1.05.16
Loans to non-financial organizations	24.0	33.3	39.8	35.6
Loans to households	2.4	2.7	2.7	2.0

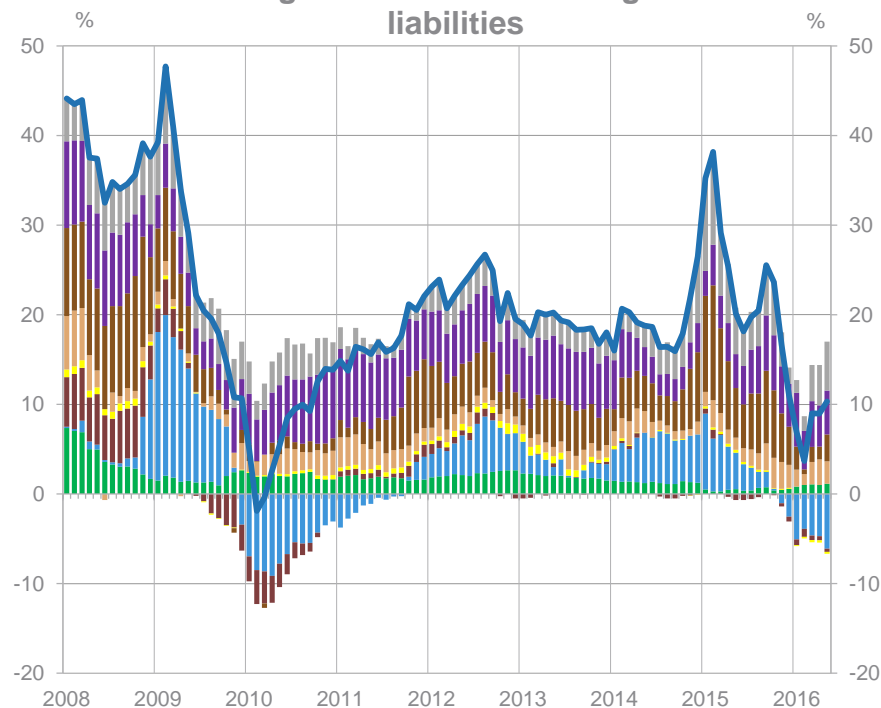
Overdue loans (as % of loan portfolio)

	1.01.14	1.01.15	1.01.16	1.05.16
Loans to non-financial organizations	4.2	4.2	6.2	6.7
Loans to households	4.4	5.9	8.1	8.4



Recovery of household deposit growth indicates stable saving activity

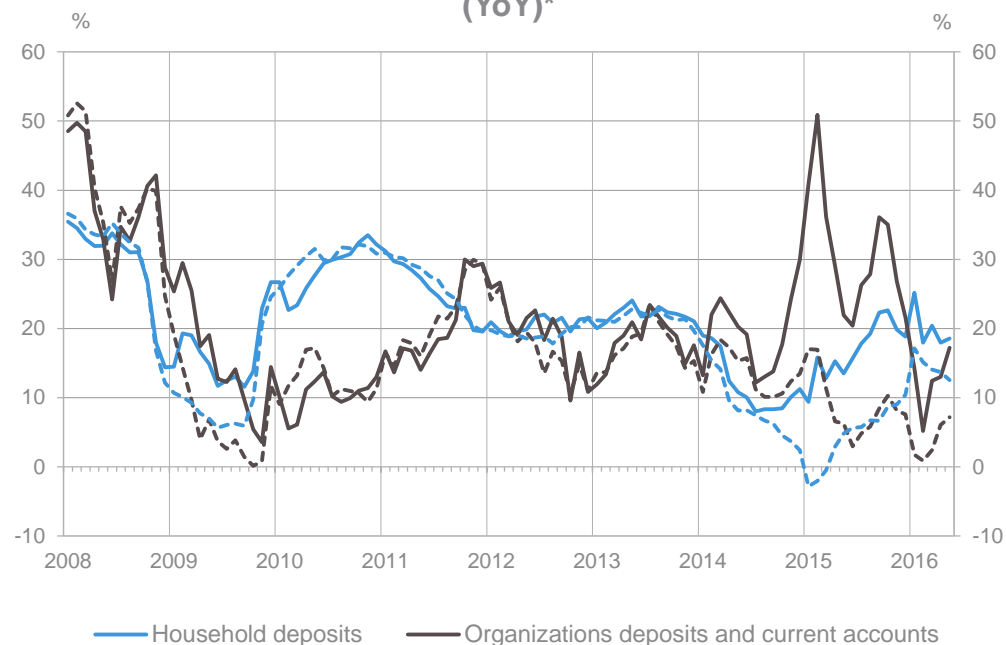
Contributions of various components to the annual growth rates of banking sector liabilities



- Other liabilities
- Deposits of organisations
- Bonds
- Borrowed funds from the BoR
- Total growth
- Household deposits
- Current accounts of organisations
- Loans of foreign banks
- Capital

Source: Bank of

Growth rate of corporate and households deposits (YoY)*



* Dotted lines represent growth rate excluding currency revaluation. Source: Bank of Russia.

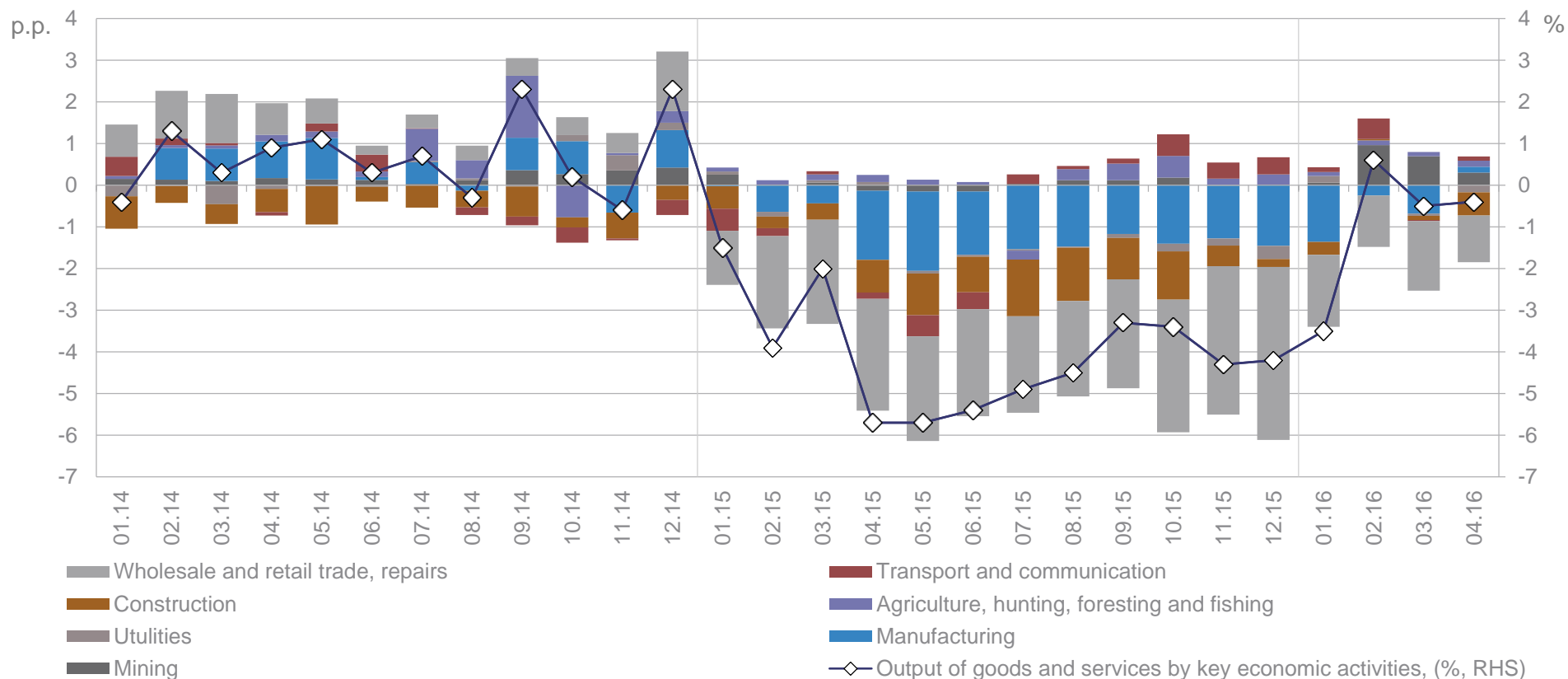
Dollarisation of deposits (%)

	1.01.14	1.01.15	1.01.16	1.05.16
Household deposits	17.4	26.1	29.4	26.2
Corporate deposits and current accounts	31.3	42.6	47.3	44.2
Total	24.5	35.5	39.2	36.0



Economic activity indicators improve without creating upward pressure on consumer prices

Decomposition of output of goods and services by key economic activities, YoY

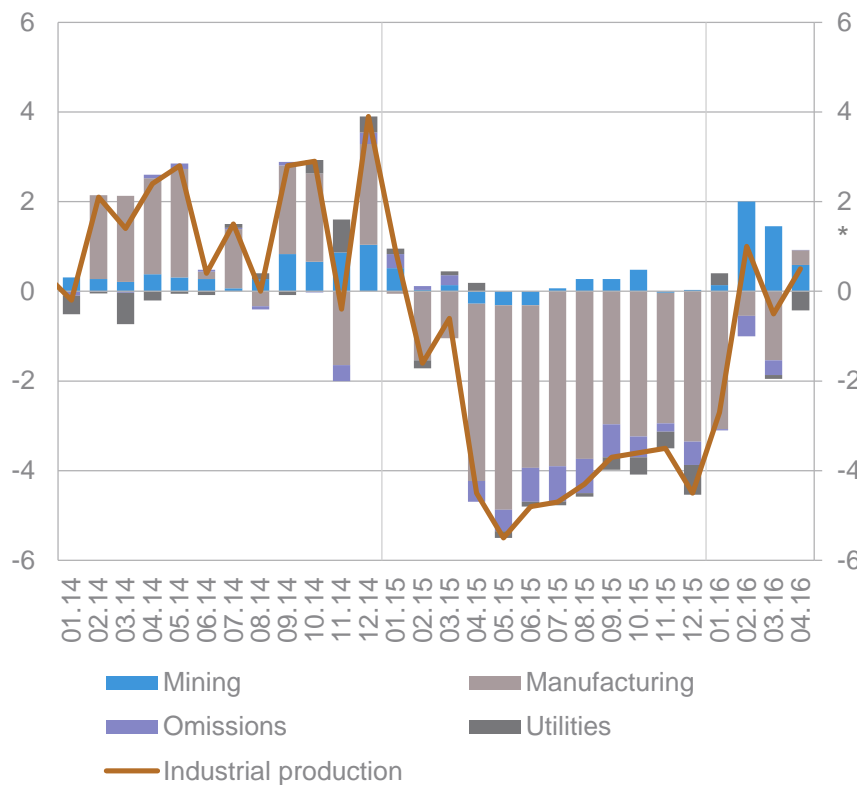


The decline in fall rates is mainly in tradable sector



A slight improvement in industrial production dynamics is observed, exports and import-substitution support individual industries

Industrial production dynamics and its decomposition, p.p., YoY



Output in manufacturing, %YoY

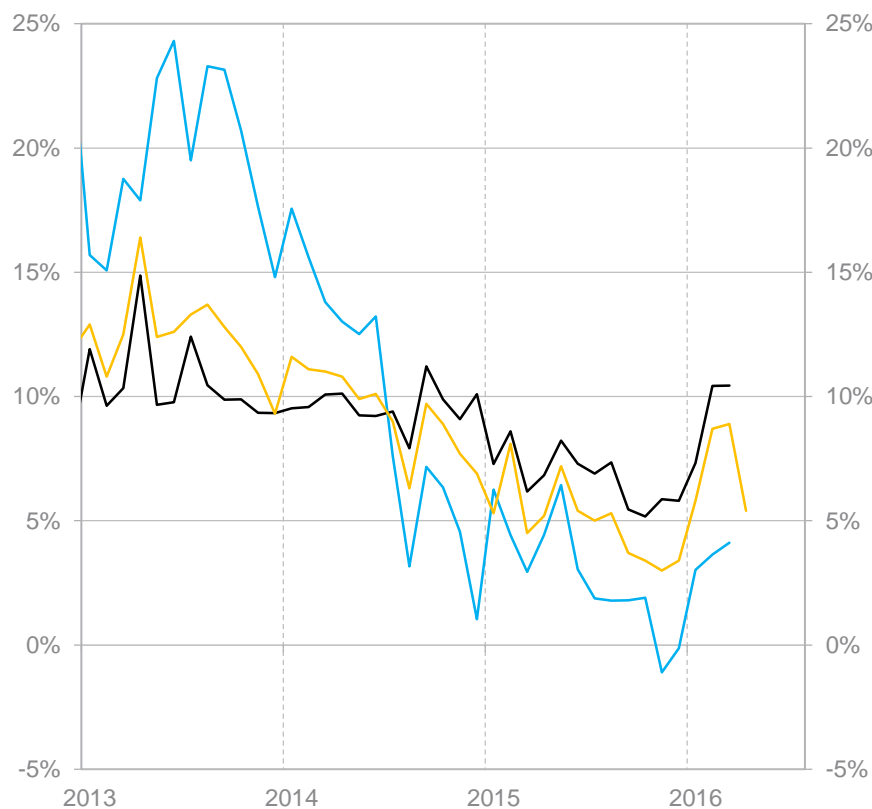


* Industrial production growth year-on-year is mainly due to base effect. February growth is based on calendar factor.

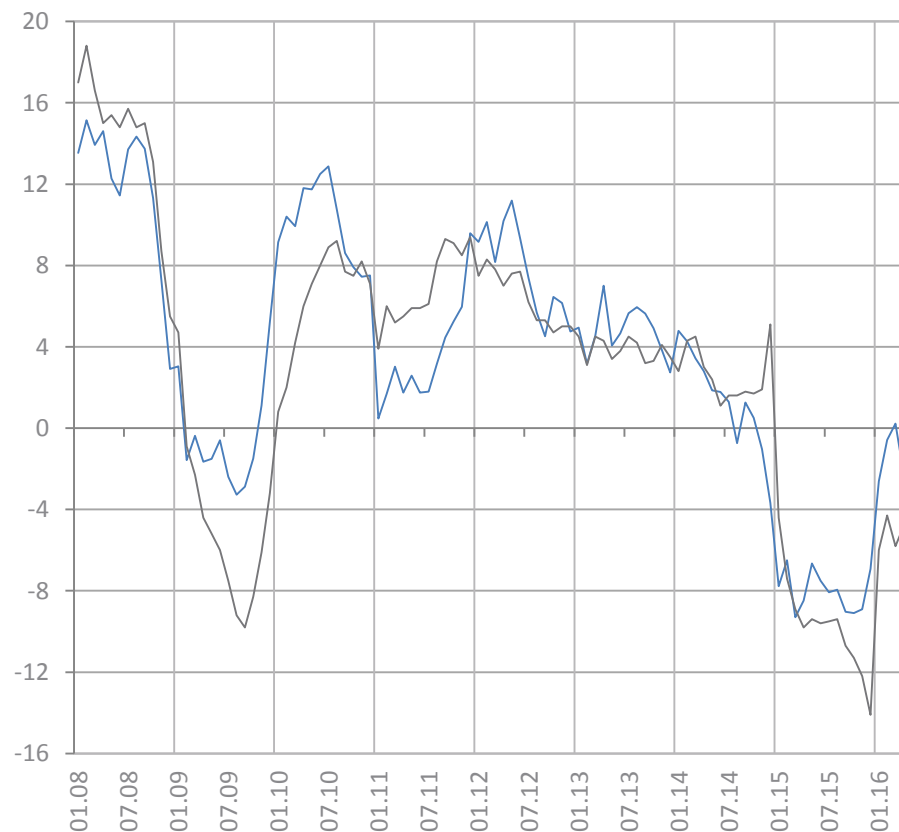


Private sector companies are able to increase salaries for their employees. Despite some improvement in real income dynamics consumer demand remains weak

Nominal wages growth rate, %



— Private sector — Public sector — Nominal wages, YoY



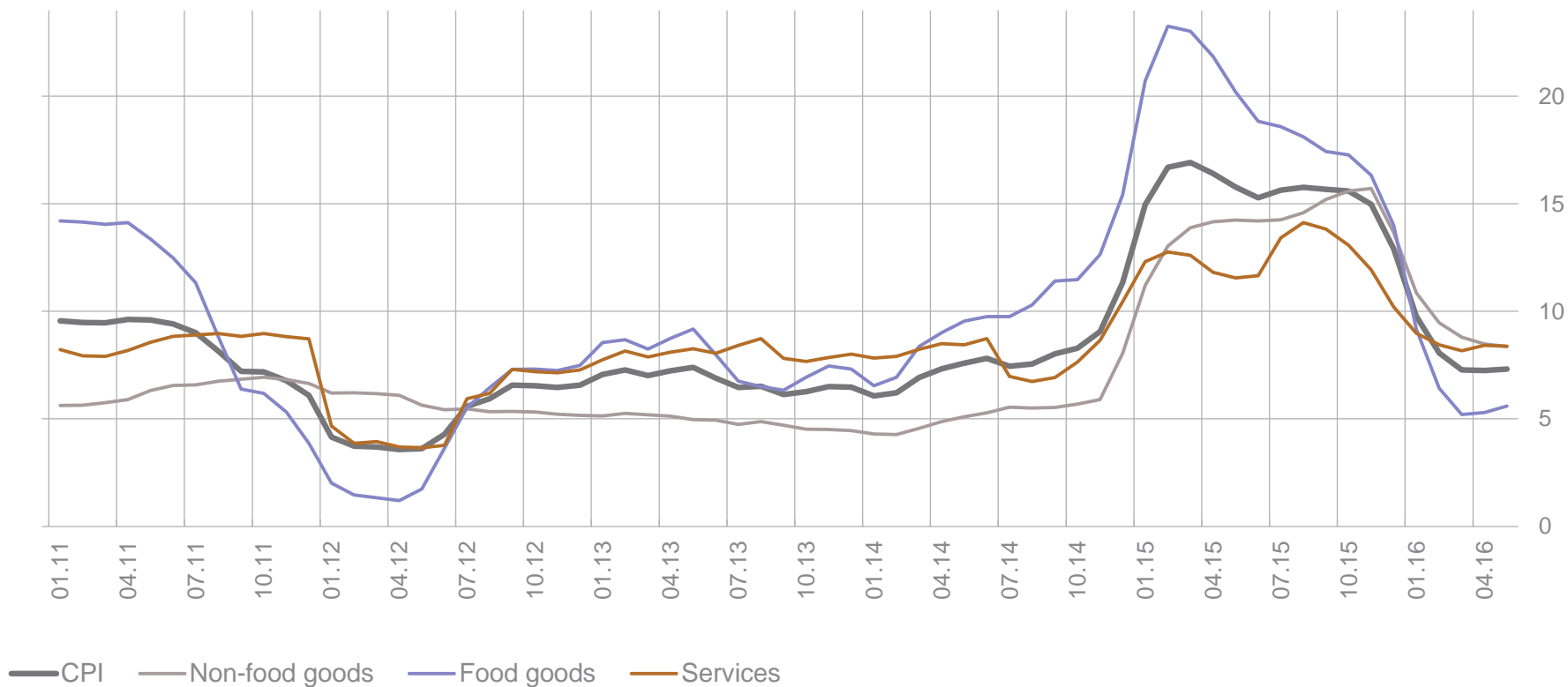
— Real income (pensions and wages) — Retail trade

(year-on-year growth rate, %)



Inflation rate stabilises in May, instead of expected acceleration

Inflation, YoY, %





Inflation expectations decline but still a matter of concern

Survey	Expectations horizon	I.2014	II.2014	III.2014	IV.2014	I.2015	II.2015	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Graph
Inflation expectations (absolute value), %																			
Households																			
FOM	next 12 months	11,8	11,7	12,5	15,5	15,7	15,0	13,9	14,8	16,0	15,3	15,8	16,4	16,7	15,7	14,7	14,6	13,6	
FOM (Bank of Russia calculations)	next 12 months	8,1	9,0	9,6	14,4	13,8	12,2	12,6	13,8	14,5	13,7	15,1	12,8	10,8	7,8	7,4	7,2	6,6	
Professional analysts																			
Bloomberg	2016						6,7	6,8	6,9	7,0	7,3	7,5	7,2	8,0	8,3	7,9	7,4	7,2	
Interfax	2016					7,0	6,7	6,1	6,4	7,4	7,2	7,2	7,6	8,5	8,3	7,6	7,4	7,3	
Reuters	2016										7,7	7,0	7,5	8,1	7,9	7,4	7,1	7,0	
Financial markets																			
OFZ IN	next 8 years							5,8	6,5	6,4	5,8	5,6	5,8	6,2	6,1	5,4	5,2	5,0	
OFZ IN (option not substracted)	next 8 years							7,4	8,0	8,1	7,3	7,1	7,3	7,7	7,6	6,9	6,7	6,5	
Bond market	next quarter	7,1	7,2	7,9	8,4	10,7	15,1	-	-	14,2	-	-	14,1	-	-	12,4			
Interbank market	next quarter	7,2	8,1	8,9	9,7	13,0	18,4	-	-	15,2	-	-	12,4	-	-	10,2			
Inflation expectations (balanced index*)																			
Households																			
FOM	next 12 months	84	85	84	83	76	72	74	73	80	80	82	83	85	82	84	83	81	
FOM	next month	79	82	76	77	68	60	63	67	71	73	79	78	80	76	72	74	70	
Businesses																			
REB	next 3 months	26	26	32	70	32	20	14	30	28	46	38	48	46	22	14			
Bank of Russia	next 3 months	14,3	12,4	13,9	30,3	14,8	12,7	13,3	13	12,1	13,2	15,4	17,3	15,6	13,6	12,4	11,5		
Retail prices (Rosstat)	next quarter	42	41	41	43	31	28	-	-	30	-	-	29	-	-	32			
Tariffs (Rosstat)	next quarter	6	5	2	5	7	6	-	-	2	-	-	2	-	-	5			

Change against 3MMA:

- - 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 deviation)
- - 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



Fiscal policy: conservative approach

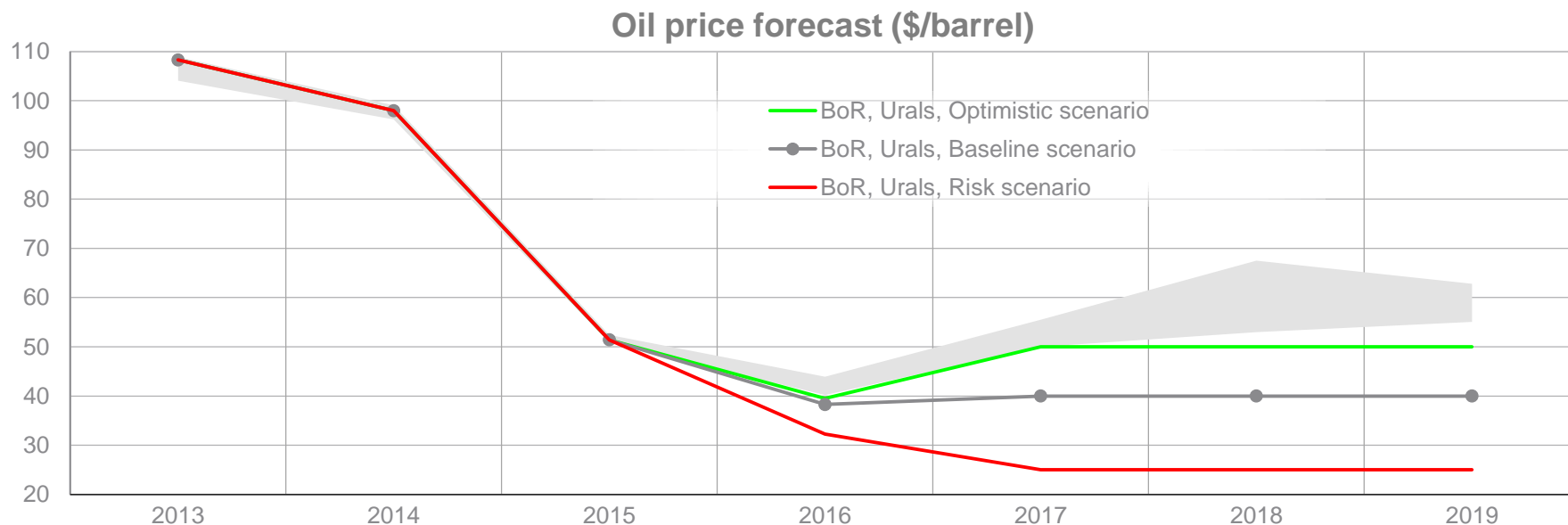
- The Ministry of Finance carries out a conservative fiscal policy in 2016:
 - Low indexation of social benefits and wages of fiscal sector employees
 - Low indexation of tariffs of natural monopolies
 - Low capital expenditures
 - To finance federal budget deficit the Ministry of Finance intends to use revenues from privatization besides the Reserve Fund and domestic and external borrowings

Main indicators of federal budget

	2015 (fact)	2016 (estimate of Bank of Russia in baseline scenario – Urals 40\$)
Revenues, % of GDP	16,9	15,5
Expenditures, % of GDP	19,3	19,2
Deficit, % of GDP	2,4	3,7
Financing from the Reserve Fund, trln roubles	2,6	2,8



Oil price forecasts have been raised. However uncertainty about future oil price dynamics persists. Bank of Russia considers 3 scenarios.



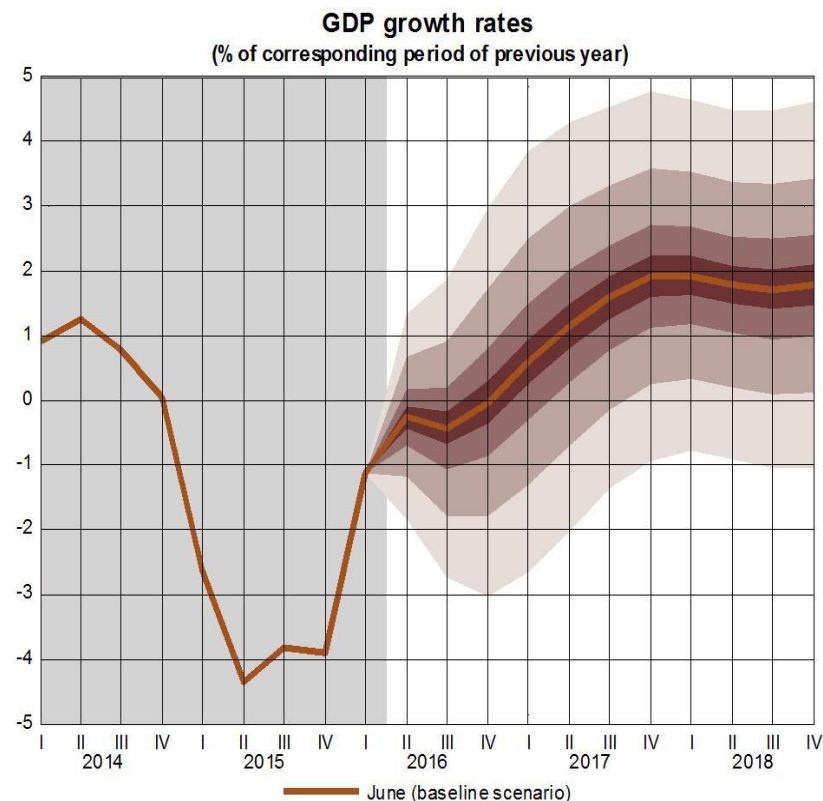
Note: grey area reflects the range of oil price forecasts made by international organizations and independent analysts and oil prices actually observed in previous years. The forecasts are made for oil grades: Brent, Dubai, WTI.

Sources: Bank of Russia, US Energy Information Administration, World Bank, IMF, The Economist, Consensus Economics.

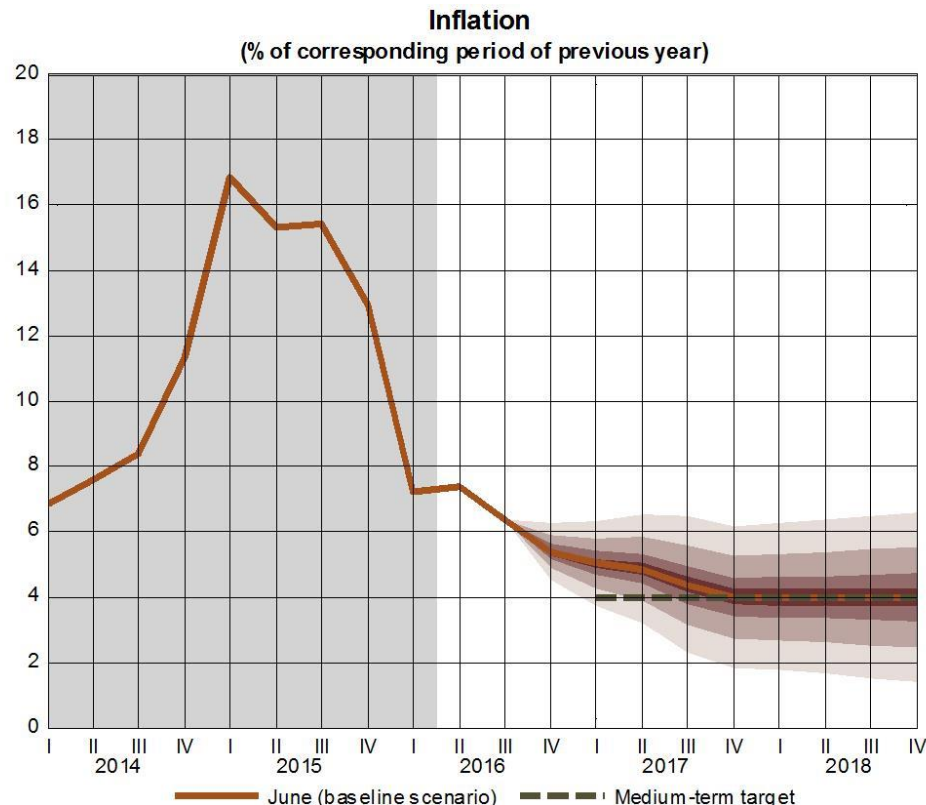
* As presented in Monetary Policy Report (June 2016)



Forecast: baseline scenario



Source: Bank of Russia calculations.



Source: Bank of Russia calculations.



Baseline scenario: key indicators

	2015 (actual)	2016	2017	2018
		Baseline*		
Urals crude price (annual average), US dollars per barrel	52	38	40	40
Inflation, % December on December of previous year	12.9	5.0-6.0	4.0	4.0
Gross domestic product, YoY, %	-3.7	-(0.7-0.3)	1.1-1.4	1.6-2.0
Balance of current and capital accounts, bln USD	69	40	32	29
Private sector capital outflow, bln USD	-63	-25	-25	-29
Change in FX reserves, bln USD ('+' - decrease, '-' - increase)	-2	-15	-7	0
Domestic credit growth, % December on December of previous year	7.1	5-8	6-8	7-9

* As presented in Monetary Policy Report (June 2016)

Source: Bank of Russia.



Baseline scenario: balance of payments forecast

(\$ bln)

	2015 (actual)	2016	2017	2018
		Baseline*		
Current account	70	40	32	29
Trade balance	149	114	106	105
Exports	341	291	304	317
Imports	-193	-177	-197	-212
Services balance	-37	-33	-32	-33
Exports	52	44	46	49
Imports	-88	-77	-79	-82
Balance of primary and secondary income	-42	-41	-42	-43
Capital account	0	0	0	0
Balance of current and capital accounts	69	40	32	29
Financial account (except reserve assets)	-73	-25	-25	-29
General government and central bank	-9	0	0	0
Private sector	-63	-25	-25	-29
Net errors and omissions	5	0	0	0
Change in FX reserves ('+' - decrease, '-' - increase)	-2	-15	-7	0

* As presented in Monetary Policy Report (June 2016)

Note: Total values may differ from totals for individual items due to rounding.

Source: Bank of Russia.



Monetary Policy in 2H 2015 – June 2016

End 2015 – early 2016

Growing inflation risks while the risks of economic cooling remain

Oil price decline and ruble depreciation

High inflation expectations

Highly volatile global financial markets

Keeping the key rate unchanged at 11.00%

Mar-June 2016

More confidence in steadily positive trends in the inflation dynamics

Positive trends in the economy are not accompanied by a higher inflationary pressure

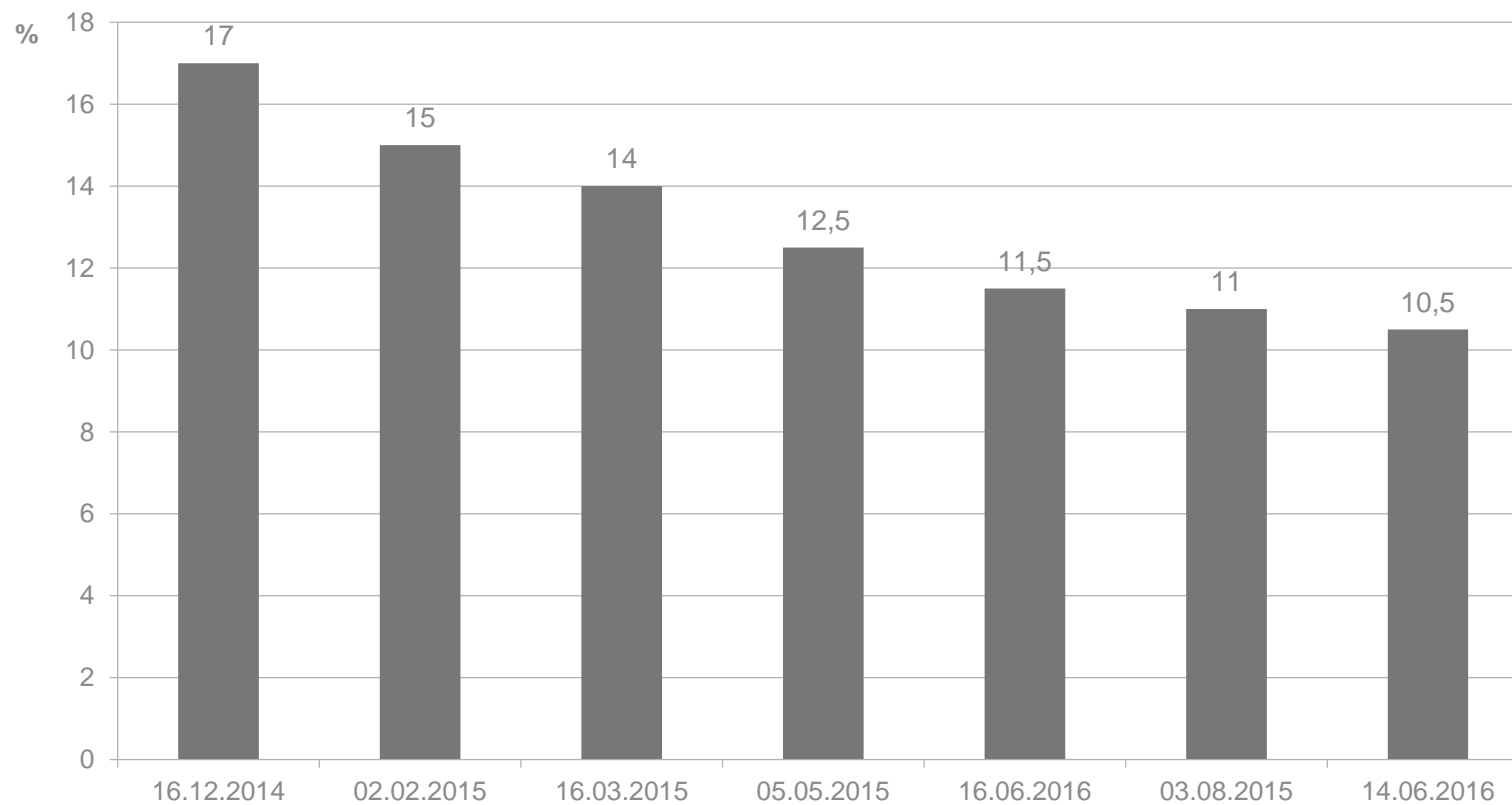
Inflation expectations continue to decrease

The situation in the global markets more favourable than expected

Reducing the key rate in June from 11.00 to 10.50% p.a.



Bank of Russia key rate





Monetary policy signal and risks

“The Bank of Russia will consider the possibility of a further rate cut based on estimates for inflation risks and alignment of inflation decline with the forecast trajectory.”

Inflation risks:

- Inflation expectation inertness
- Lack of mid-term budget consolidation strategy
- Uncertainty in the parameters of future indexation of wages and pensions
- Volatility in the global commodity and financial markets