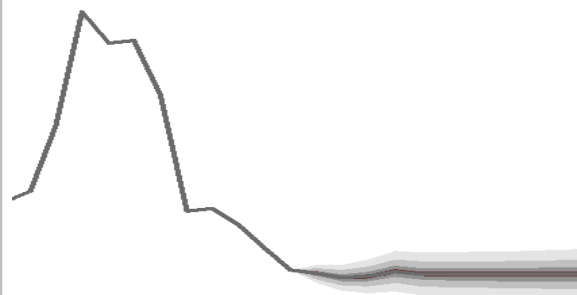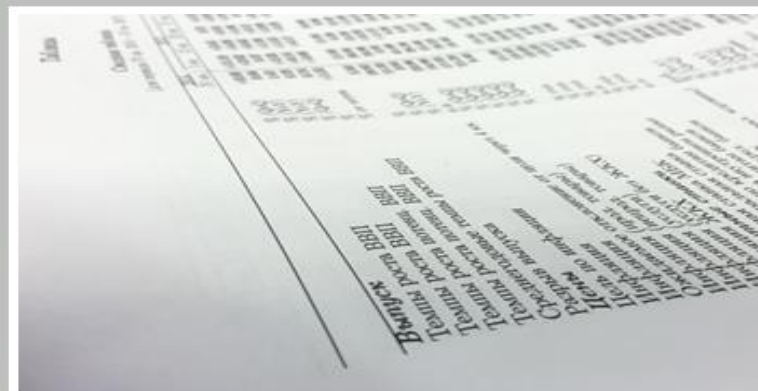# Bank of Russia
The Central Bank of the Russian Federation

4%

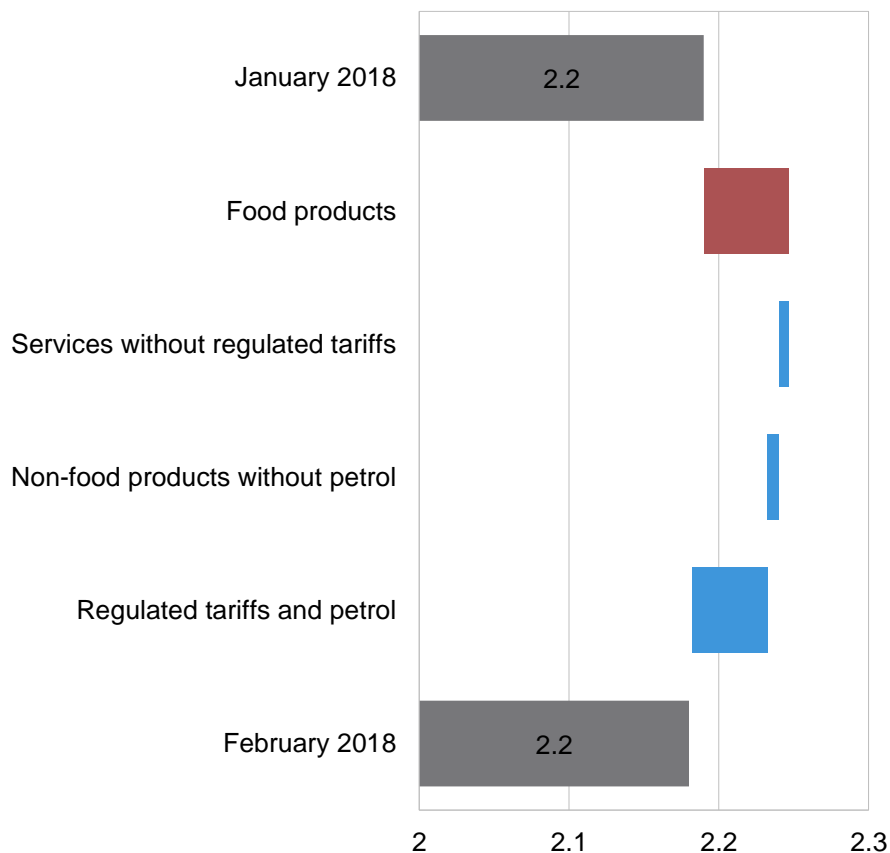## RUSSIAN ECONOMIC OUTLOOK AND MONETARY POLICY CHALLENGES

March 2018

Annual inflation remains sustainably low: 2.2% in February 2018
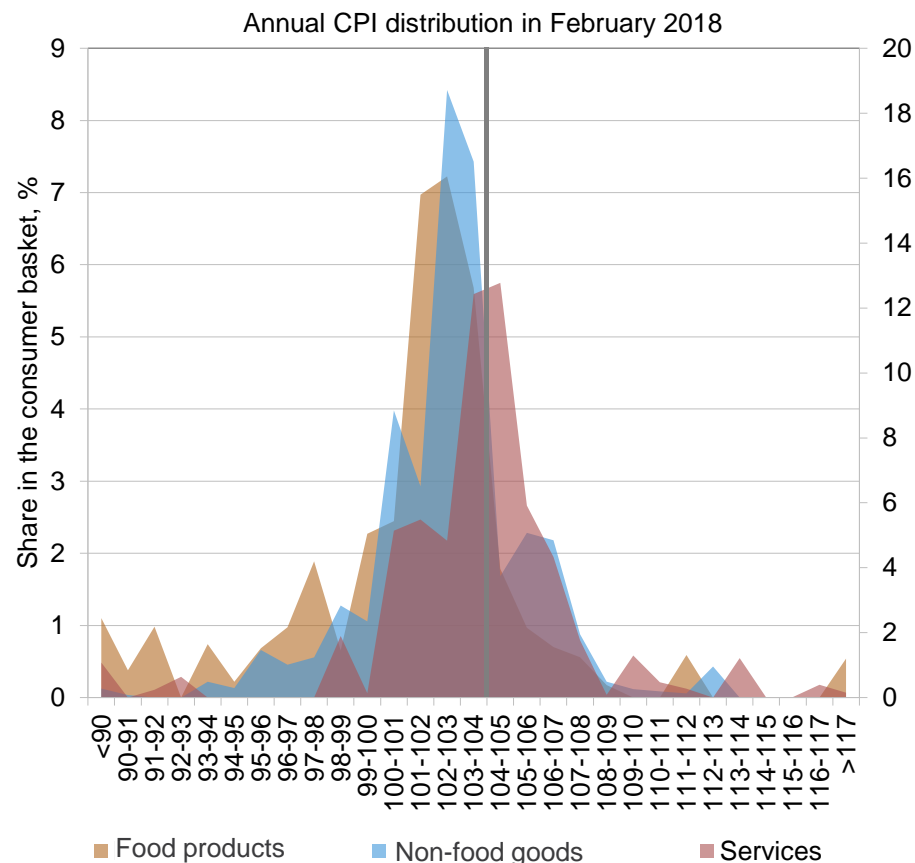
In February 2018 regulated tariffs and petrol put the biggest disinflationary pressure on annual inflation

Contributions to the change of annual inflation in February 2018, p.p.

Prices of food and non-food goods are predominantly growing with rates lower than 4%

Annual CPI distribution in February 2018

Sources: Rosstat, Bank of Russia

Sources: Rosstat, Bank of Russia

Underlying inflation indicators stabilised at 2-3%

	Sen.16	Oct.16	Nov.16	Dec.16	Jan17	Feb.17	Mar.17	Apr.17	May.17	Jun.17	Jul.17	Aug.17	Sen.17	Oct.17	Nov.17	Dec.17	Jan.18	Feb.18
Annual inflation, %																		
All goods and services	6.4	6.1	5.8	5.4	5.0	4.6	4.3	4.1	4.1	4.4	3.9	3.3	3.0	2.7	2.5	2.5	2.2	2.2
Trimmed inflation indicators																		
CPI without 40%	6.4	6.1	5.9	5.7	5.5	5.3	4.8	4.4	4.2	4.0	3.8	3.6	3.4	3.1	3.0	3.0	2.8	2.7
Median (CPI without 100%)	6.0	5.9	5.6	5.5	5.2	5.1	4.8	4.4	4.0	3.9	3.9	3.7	3.5	3.3	3.2	3.3	2.9	2.8
CPI without volatile components (for 3 months)																		
CPI without 20%	6.9	6.3	5.9	5.4	5.2	4.7	4.2	4.0	4.0	4.0	3.6	3.3	3.0	2.7	2.3	2.2	2.2	2.3
CPI without volatile components (for 24 months)																		
CPI without 20%	6.7	6.2	5.8	5.3	5.0	4.6	4.1	4.0	3.8	4.0	3.6	3.1	2.7	2.4	2.1	2.3	2.3	2.4
CPI with different weights (more volatility – less weight)																		
All goods and services	6.0	5.7	5.5	5.3	5.1	4.8	4.6	4.4	4.2	4.5	4.0	3.9	3.6	3.3	3.1	3.2	2.8	2.7
CPI without various components																		
Core inflation	6.7	6.4	6.2	6.0	5.5	5.0	4.5	4.1	3.8	3.5	3.3	3.0	2.8	2.5	2.3	2.1	1.9	1.9
Core inflation without food products	7.0	6.6	6.4	5.9	5.3	4.6	4.2	3.8	3.5	3.2	3.2	3.0	3.1	3.0	3.0	3.1	3.0	3.0
CPI without housing and unitilities	6.5	6.2	5.8	5.4	5.0	4.5	4.1	4.0	4.0	4.3	3.8	3.1	2.8	2.5	2.3	2.3	2.0	2.0
CPI without fruits and vegetables	6.6	6.3	6.1	5.9	5.6	5.2	4.8	4.4	4.1	4.0	3.7	3.5	3.2	2.9	2.7	2.6	2.3	2.2
CPI without "volatile" regions, %																		
Without 10%	6.5	6.1	5.8	5.4	5.0	4.6	4.3	4.2	4.2	4.4	3.9	3.4	3.0	2.8	2.6	2.6	2.3	2.2
Without 20%	6.5	6.2	5.8	5.4	5.1	4.7	4.3	4.2	4.2	4.5	4.0	3.4	3.1	2.9	2.7	2.7	2.4	2.3
Median (regions)	6.6	6.3	5.8	5.5	5.2	4.7	4.3	4.2	4.1	4.4	3.9	3.2	2.9	2.7	2.5	2.3	2.2	2.2
Alternative inflation indicators																		
Inflation without exchange rate impact (DRF)	6.3	6.6	6.8	6.3	6.2	6.6	7.2	7.4	7.0	6.7	5.8	4.7	4.0	3.5	3.3	3.1	2.7	2.3
Inflation indicators with inertia, %																		
Trendline inflation	8.1	7.9	7.6	7.4	7.2	7.0	6.8	6.6	6.5	6.4	6.2	6.0	5.8	5.6	5.5	5.4	5.3	5.2
12MMA	9.2	8.4	7.7	7.1	6.7	6.4	6.1	5.9	5.6	5.3	5.1	4.8	4.5	4.2	3.9	3.7	3.5	3.2
24MMA	11.7	11.6	11.5	11.2	10.8	10.3	9.8	9.3	8.8	8.3	7.9	7.3	6.8	6.3	5.8	5.4	5.1	4.8

Quarter average inflation

- lower than 4% (more than 0.3 st. dev.)
- close to 4% (±0.3 st. dev.)
- higher than 4% (more than 0.3 st, dev.)

Sources: Rosstat, Bank of Russia

Inflation expectations at historic lows

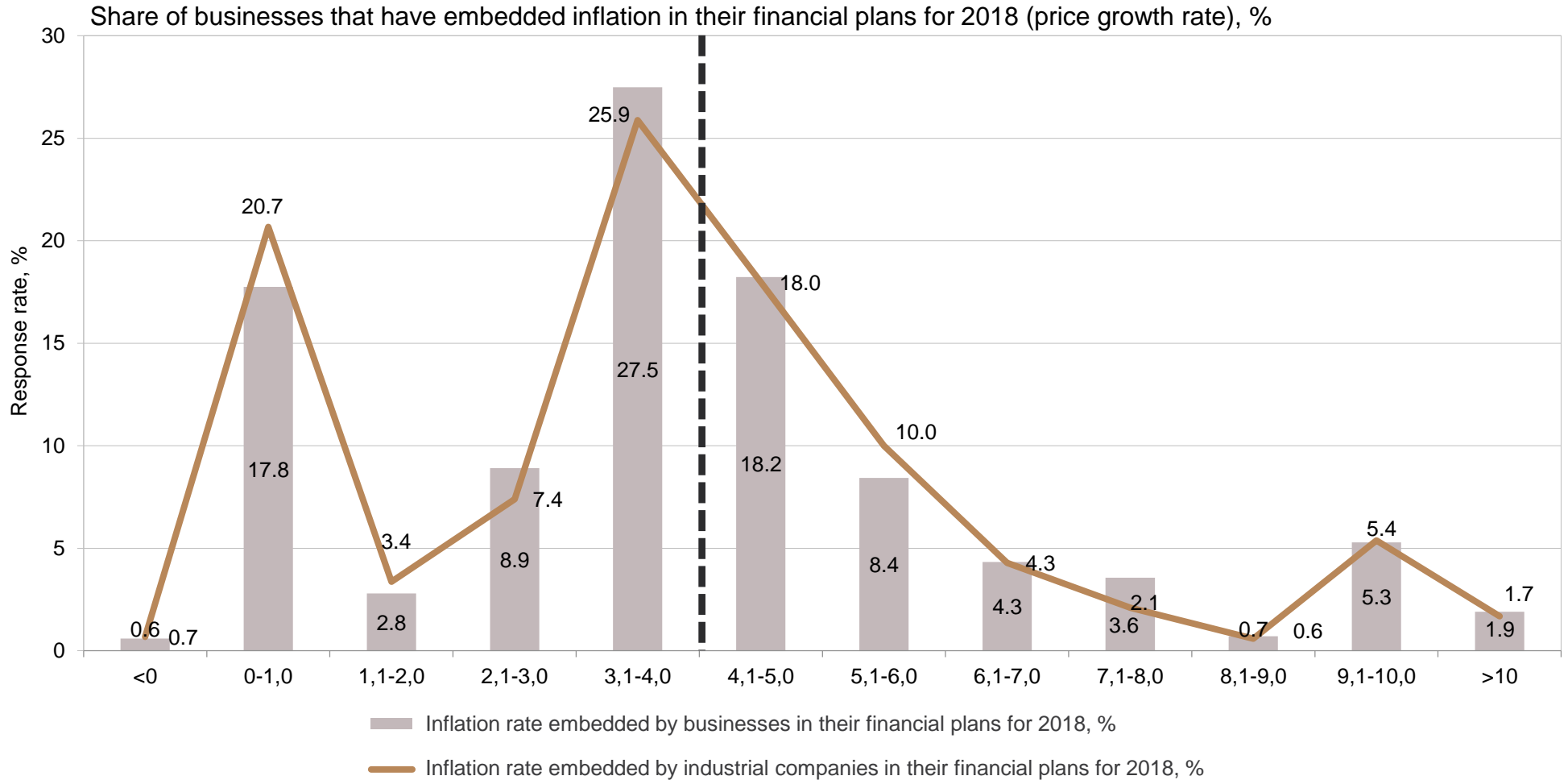|	Expectations horizon	I.2016	II.2016	III.2016	IV.2016	I.2017	II.2017	III.2017	IV.2017	Jan-18	Feb-18	Mar-18
Inflation expectations (absolute value), %												
Households												
FOM	Next 12 months	14.7	14.2	14.2	12.4	11.2	10.3	9.6	8.7	8.9	8.4	8.5
FOM (Bank of Russia estimates)	Next 12 months	7.4	6.7	5.9	5.1	4.0	4.0	2.8	2.4	2.1	2.2	2.1
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	
Reuters	2018						4.1	4.0	4.1	3.8	3.8	
Financial markets												
OFZ IN	Next 6 years	5.4	4.6	4.5	4.6	4.5	4.3	3.9	3.7	3.7		
OFZ IN (option not substracted)	Next 6 years	6.9	6.0	5.3	5.4	4.9	4.7	4.3	4.1	4.1		
Bond market	Next quarter	12.0	6.9	7.2	6.6	5.3	4.4	4.5	3.3			
Interbank market	Next quarter	9.9	5.3	5.4	5.6	4.6	3.7	3.4	2.5			
Inflation expectations (balanced index*)												
Households												
FOM	Next 12 months	84	78	82	80	79	80	82	78	78	75	
FOM	Next month	72	68	70	76	68	68	73	73	69	61	
Businesses												
REB	Next 3 months	14	38	36	46	22	20	14	52			
Bank of Russia	Next 3 months	12.4	12.1	10.4	12.4	6.8	9.6	6.6	9.4	7.1		
Retail prices (Rosstat)	Next 3 months	32	29	28	27	27	24	24	22			
Tariffs (Rosstat)	Next quarter	5	5	0	0	4	3	0	0			

Change against 3MMA:

- Inflation expectations become better (more than 1 standard deviation)
- Inflation expectations become better (less than 1 standard deviation)
- Inflation expectations unchanged (±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 those expecting them to fall
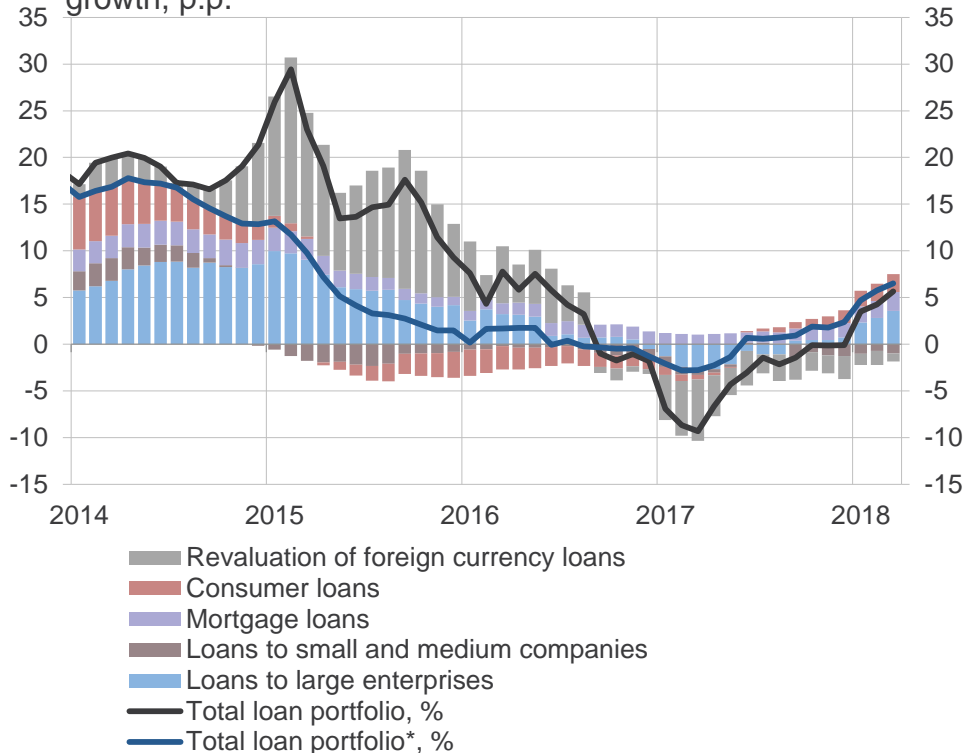
Sources: FOM, Bank of Russia etc.

58% of businesses assume 4% or lower inflation rate in their financial plans

Share of businesses that have embedded inflation in their financial plans for 2018 (price growth rate), %

Inflation rate embedded by businesses in their financial plans for 2018, %

Inflation rate embedded by industrial companies in their financial plans for 2018, %

Source: Bank of Russia survey

Lending growth is supported by the key rate decrease. Non-price lending conditions are gradually becoming looser for the most reliable borrowers but are still restrictive

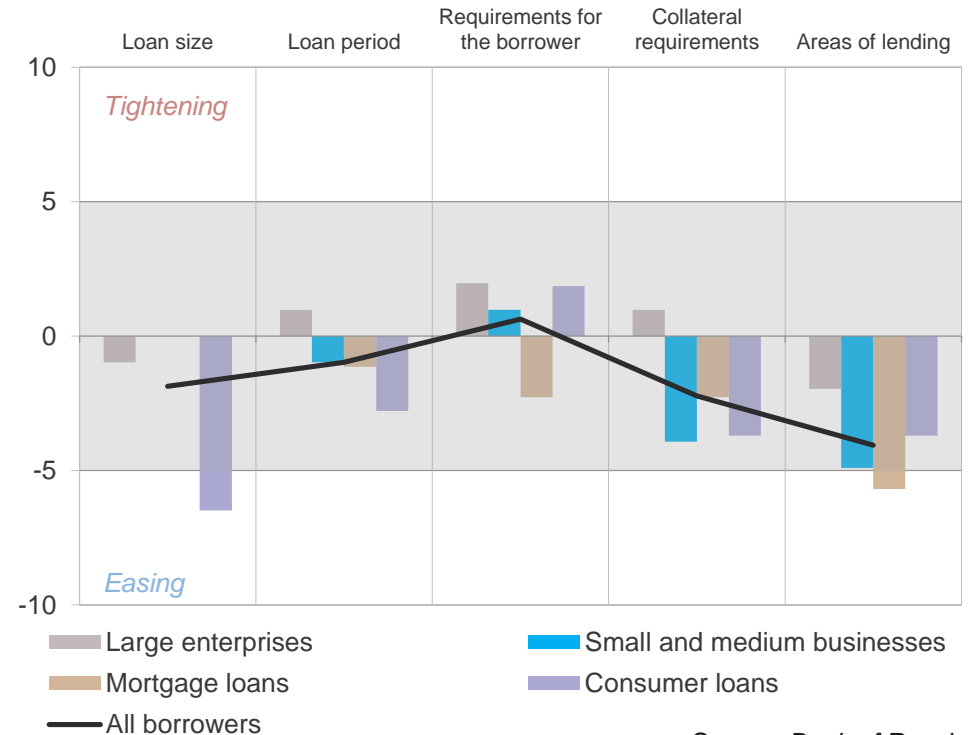Contribution of different components to the bank lending growth, p.p.

- Revaluation of foreign currency loans
- Consumer loans
- Mortgage loans
- Loans to small and medium companies
- Loans to large enterprises
- Total loan portfolio, %
- Total loan portfolio*, %

Excluding foreign currency revaluation.   *Source: Bank of Russia*

Indexes of changes in certain lending conditions in Q4 2017 (preliminary data), p.p.

- Large enterprises
- Mortgage loans
- Small and medium businesses
- Consumer loans
- All borrowers

Source: Bank of Russia

Dollarisation of Loan Portfolio (%)					
	1.11.17	1.12.17	1.01.18	1.02.17	1.03.18
Loans to non-financial organizations	28.9	29.1	29.7	29.0	28.1
Loans to households	1.0	1.0	0.9	0.8	0.8
Total	21.0	21.1	21.4	20.9	20.1

Dollarisation of Deposits (%)					
	1.11.17	1.12.17	1.01.18	1.02.17	1.03.18
Household deposits	21.6	21.5	20.6	20.7	20.2
Corporate deposits and current accounts	34.8	34.9	33.8	34.9	33.7
Total	28.4	28.5	27.3	28.1	27.1

Recovery in consumer demand is supported by rising real wages and expanding retail lending

% Retail trade turnover and real wages dynamics (YoY) p.p.

Non-food products

Food products

Retail trade turnover (left axis, %)

Real Wages (left axis, %)

Sources: Rosstat, Bank of Russia

Components of savings rate (share of income, SA)

Equity

Borrowing

Currency assets (currency, currency deposits)

Ruble financial assets (deposits, stock and cash)
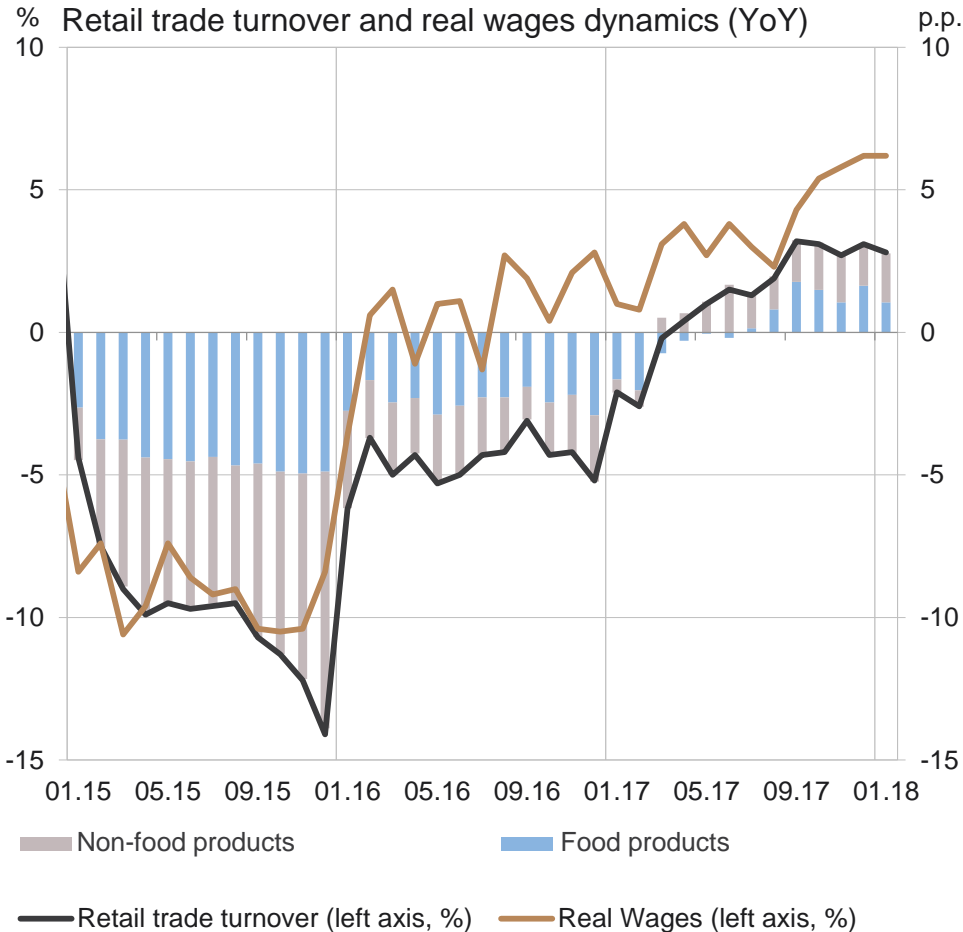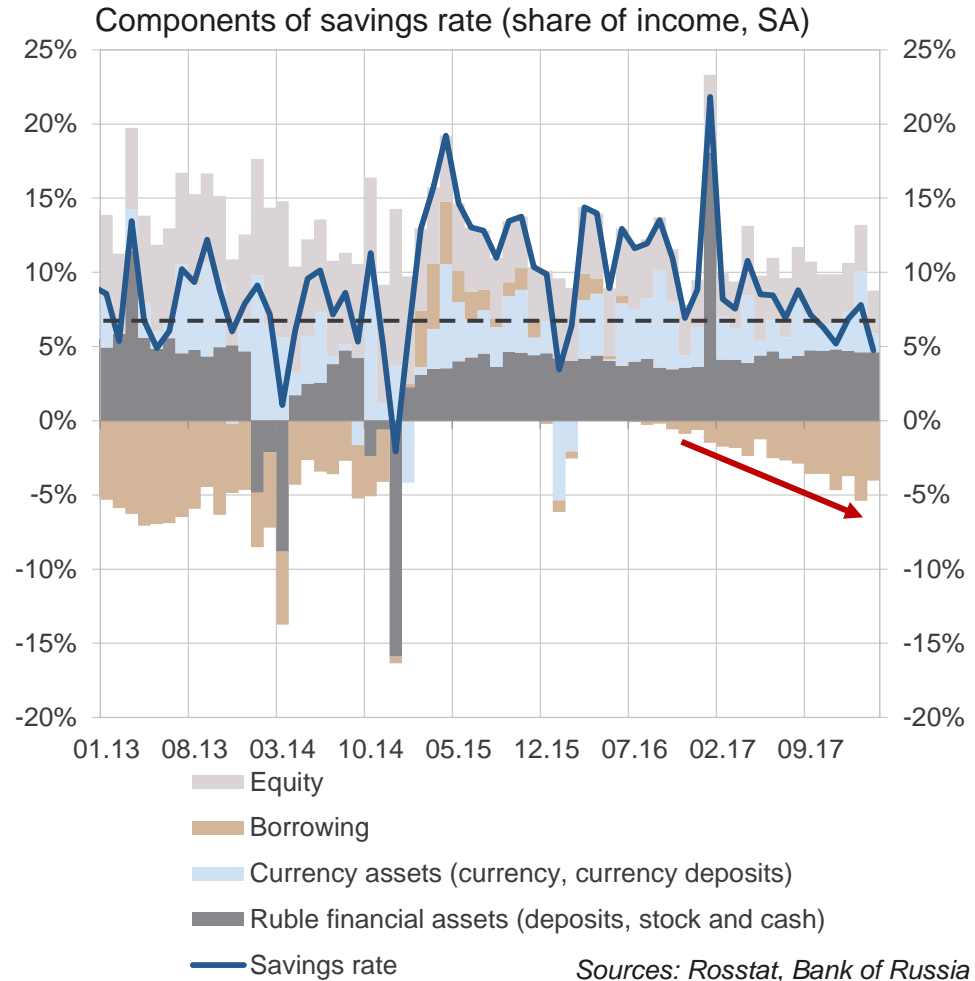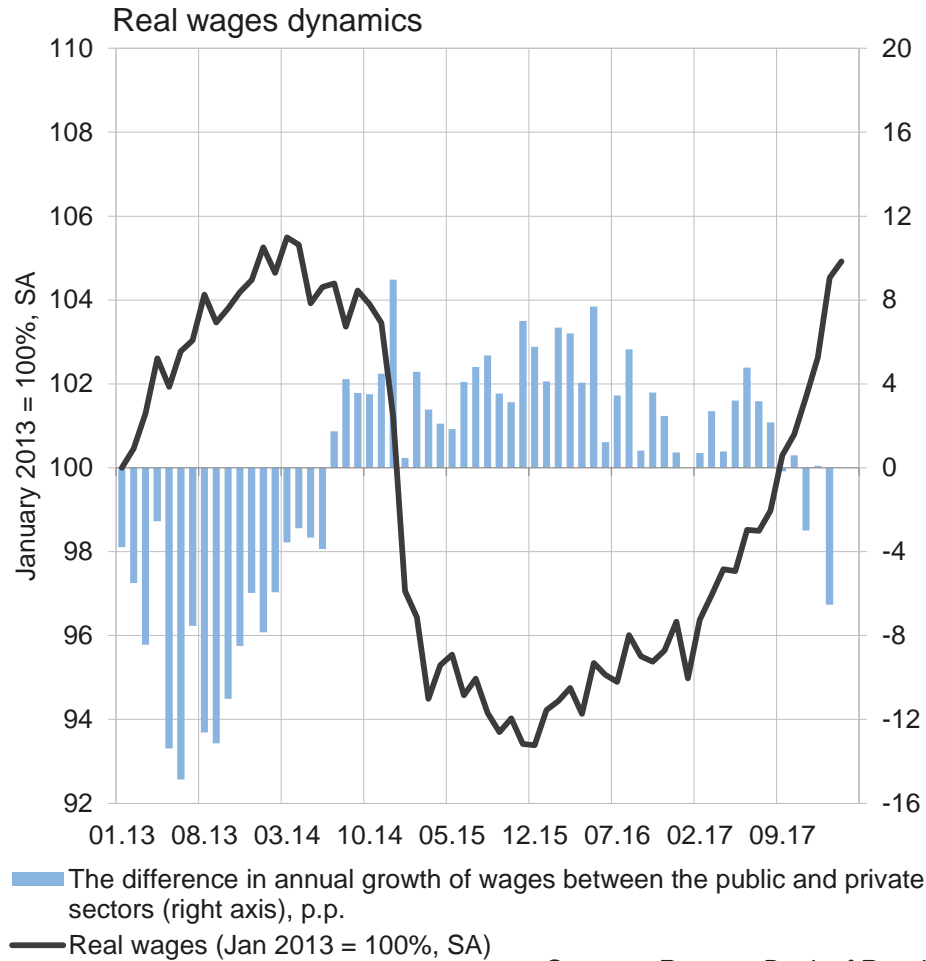
Savings rate
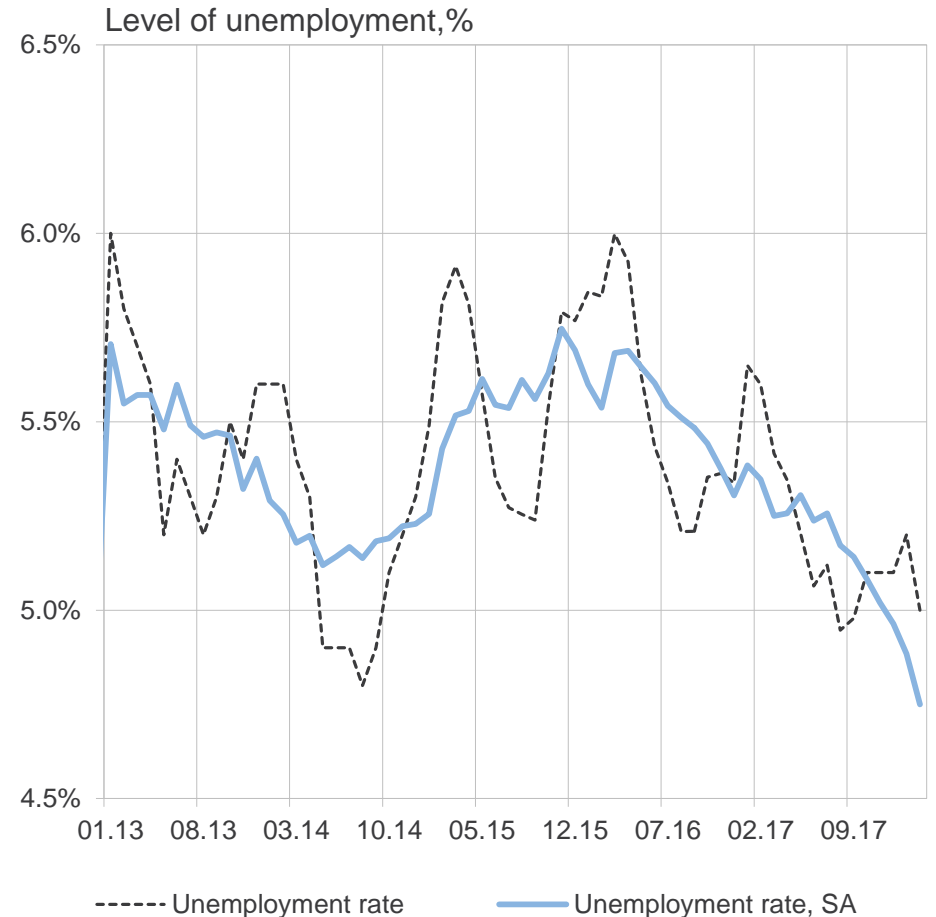
Sources: Rosstat, Bank of Russia

* Average savings rate in 2013-2014 – 0,0665 (horizontal line)

Dynamics of wages and unemployment creates ground for potentially higher inflationary pressure and requires further analysis
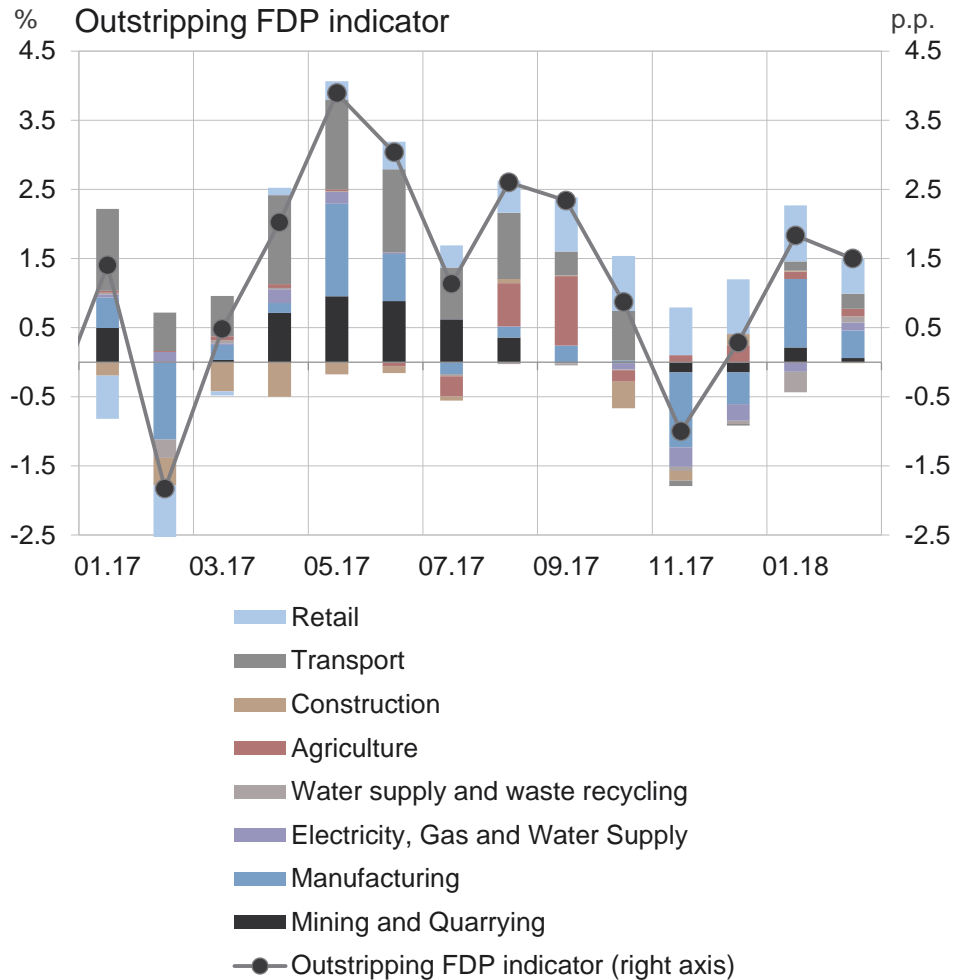

Real wages dynamics

The difference in annual growth of wages between the public and private sectors (right axis), p.p.

Real wages (Jan 2013 = 100%, SA)

Sources: Rosstat, Bank of Russia

Level of unemployment,%
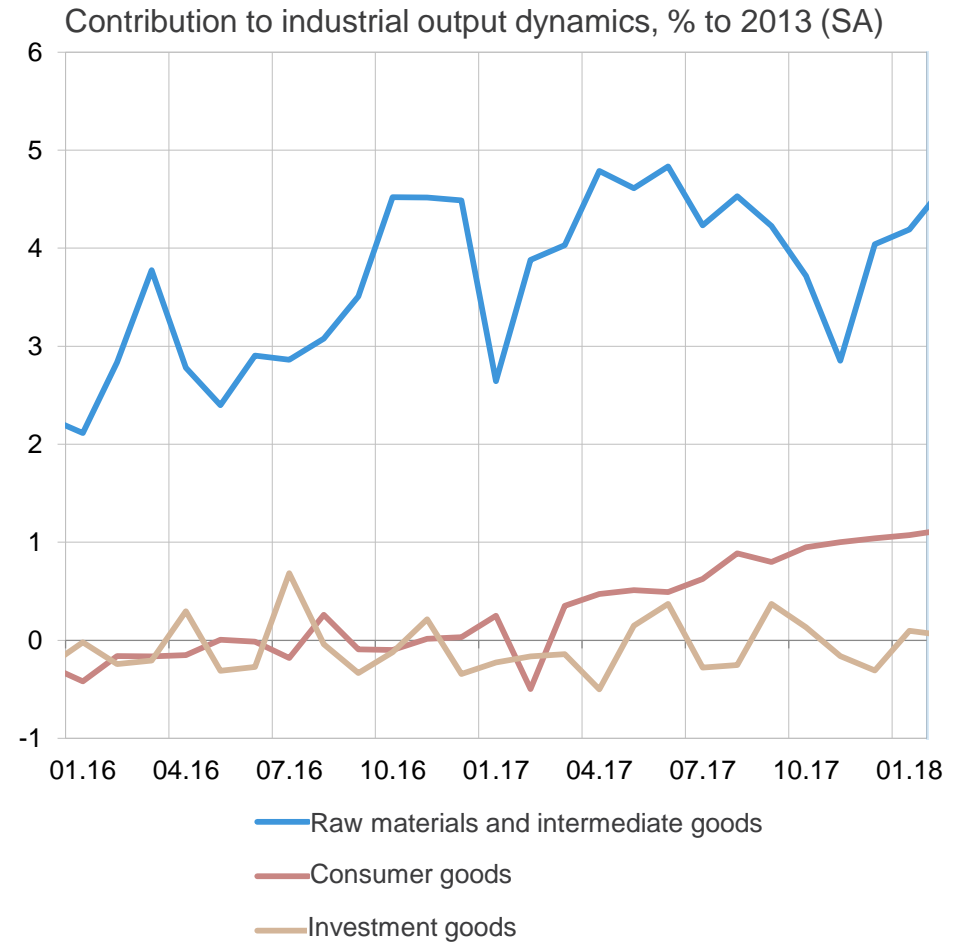
----- Unemployment rate

Unemployment rate, SA

Sources: Rosstat, Bank of Russia

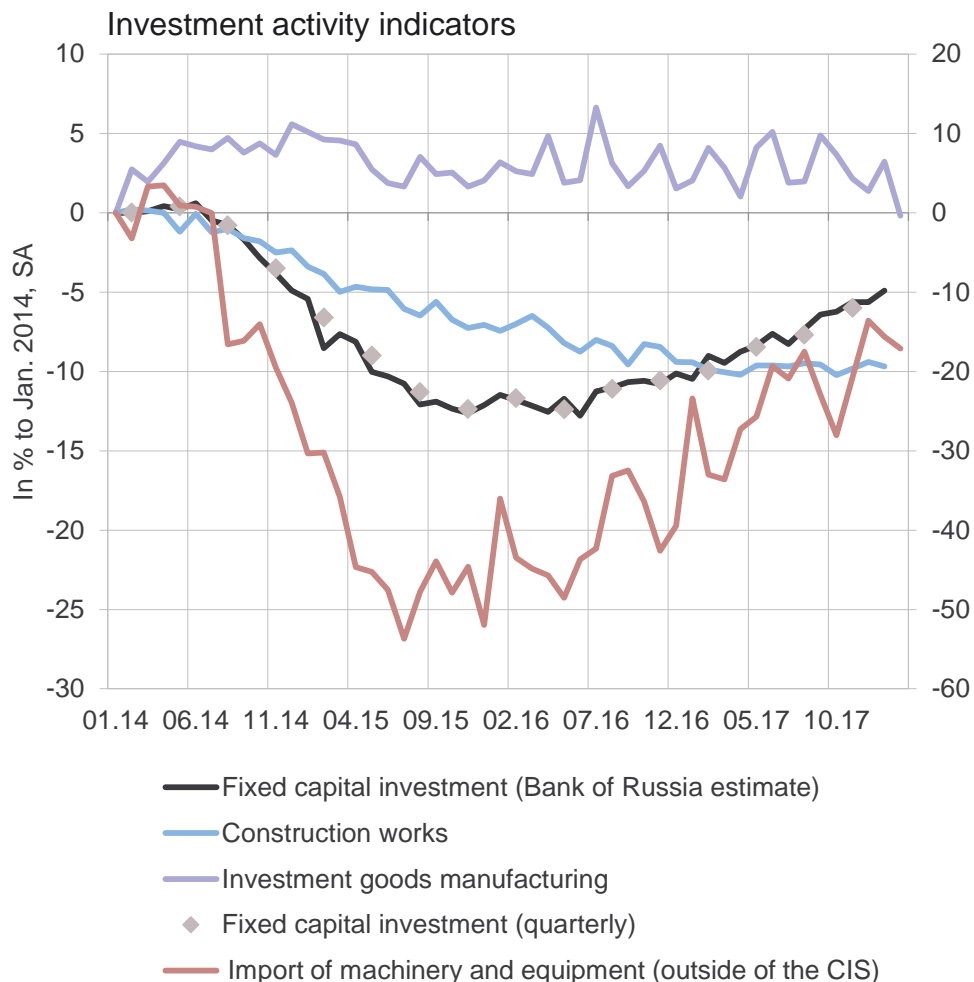## Economic growth resumed in early 2018 following the decline triggered by temporary headwinds in late 2017

Outstripping FDP indicator

Legend:
- Retail
- Transport
- Construction
- Agriculture
- Water supply and waste recycling
- Electricity, Gas and Water Supply
- Manufacturing
- Mining and Quarrying
- Outstripping FDP indicator (right axis)

Sources: Rosstat, Bank of Russia

Contribution to industrial output dynamics, % to 2013 (SA)

Legend:
- Raw materials and intermediate goods
- Consumer goods
- Investment goods

Sources: Rosstat, Bank of Russia

Investment activity shows positive dynamics

Investment activity indicators

- Fixed capital investment (Bank of Russia estimate)
- Construction works
- Investment goods manufacturing
- ◆ Fixed capital investment (quarterly)
- Import of machinery and equipment (outside of the CIS)

Sources: Rosstat, Bank of Russia

Fixed capital investment, bln RUB in 2010 prices (SA)

- Public sector
- Infrastructure sector
- Private sector (right axis)
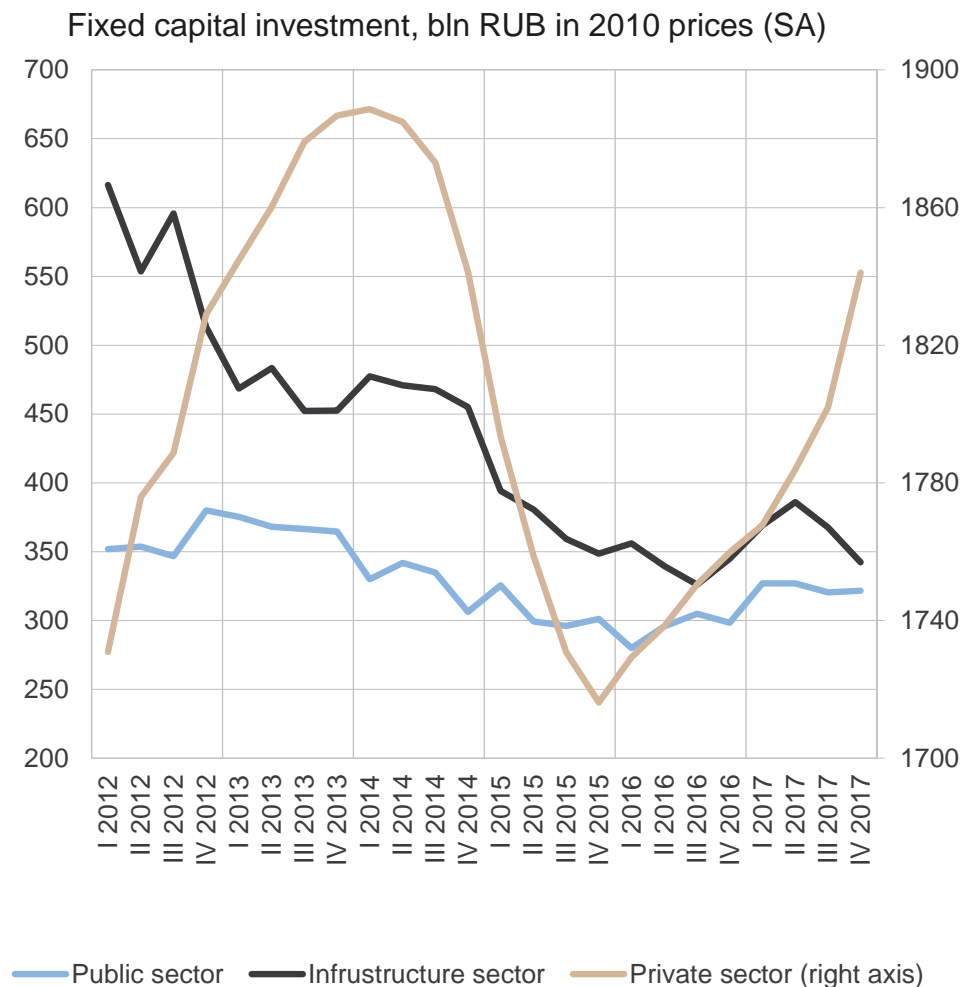
Source: Rosstat

Fiscal policy will presumably reach its consolidation target in 2018

Conservative Fiscal Policy in 2018-2020:
More than ₽0.5 trln of expenditures were not executed in 2017. The budget will shift from a 1.4% deficit in 2017 to a surplus below 1% of GDP in 2018-2020.

New Budget Rule in 2018-2020:
According to the fiscal rule, starting from 2018 the amount of public expenditures will be linked to the amount of federal budget revenues. The Ministry of finance will continue the FX operations. The Ministry of finance sterilises extra oil and gas revenues while the Urals price is above $40 and transfers these revenues into the National Wealth Fund (NWF) through the intervention (foreign currency purchases) mechanism. In 2018 the volume of foreign currency purchases will amount to $45 bln.

Borrowing as a Source of Financing Public Expenditures Instead of the Reserve Fund:
In 2018 the net placement of OFZ will amount to ₽0.8 trln, compared to ₽1.1 trln in 2017. In march 2018 the Ministry of finance implemented a eurobonds exchange of $4 bln, in the first half of 2018 the Ministry of finance will place new $3 bln eurobonds under the condition of credit rating upgrade by Standard&Poor's in February 2018.

In 2018 the government raised wages and salaries in the budget sector of the economy:
Within the framework of "May Decrees" implementation in Q1 2018 wages of social sphere workers (education / medical care / social care / science) were increased by 20-30%. In early 2018 wages of other budget sector workers (non-social sphere) were indexed by 4%. In May 2018 the minimum wage in Russia will be raised to the level of the living wage. This measure will also increase the wages of a small part of budget and private sector workers.

Main Indicators of the Federal Budget

| Federal Budget	February 2017 (moving average over the latest 12 months)	2018 (Bank of Russia estimates in the baseline scenario – Urals 61 $/barrel)
Revenues, % of GDP	16.5	17.3
Expenditures, % of GDP	17.6	16.4
Deficit, % of GDP	-1.1	0.9
Transfers from sovereign funds (NWF) in 2018, ₽ trln	0	1.1

Higher volatility in the world financial markets in February 2018 has not yet had significant influence on investors' interest towards EM assets

Change in risk premiums for Russia and other EM*

bp

- Difference between the change in CDS for Russia and other countries
- Average change in the CDS spread for EM
- Change in CDS for Russia

Average CDS spread for EM includes Brazil, China, Turkey, Mexico, Malaysia

Sources: Bloomberg, Bank of Russia

Cumulative capital inflows (EPFR), USD bln

- EM
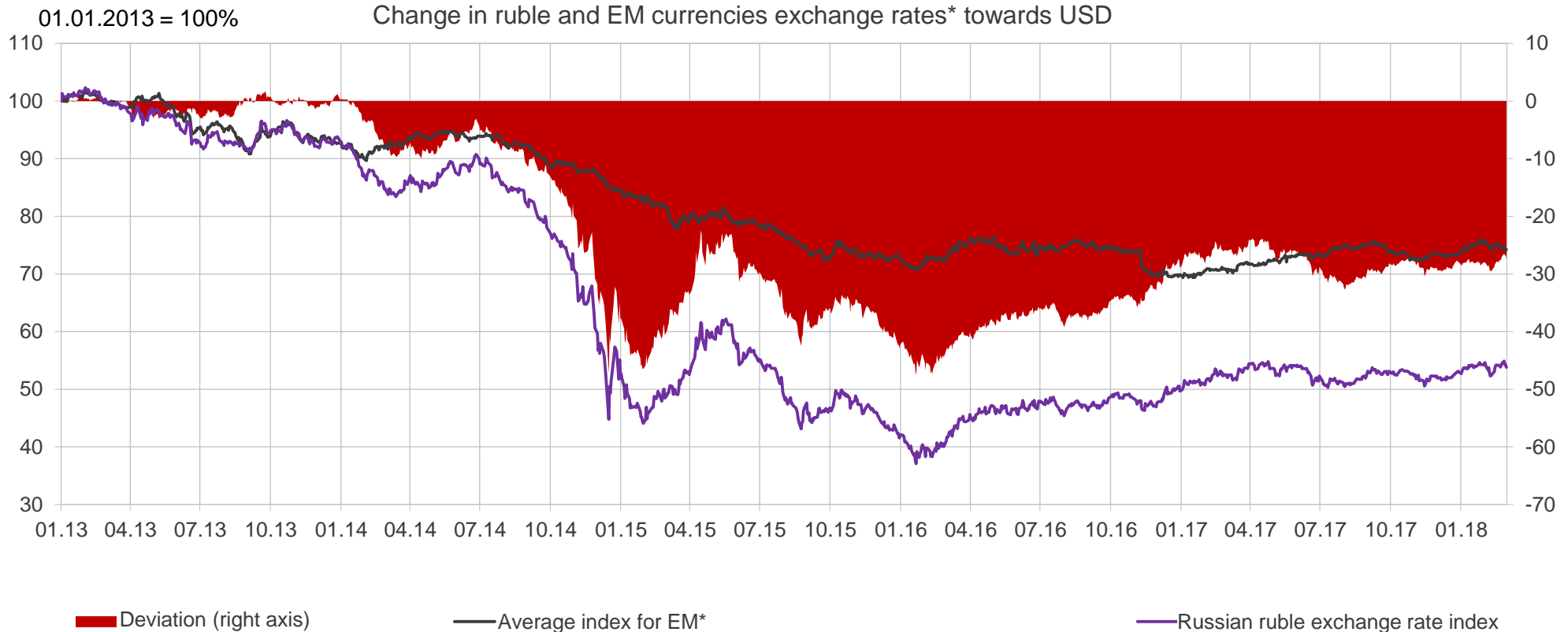- Russia (right axis)
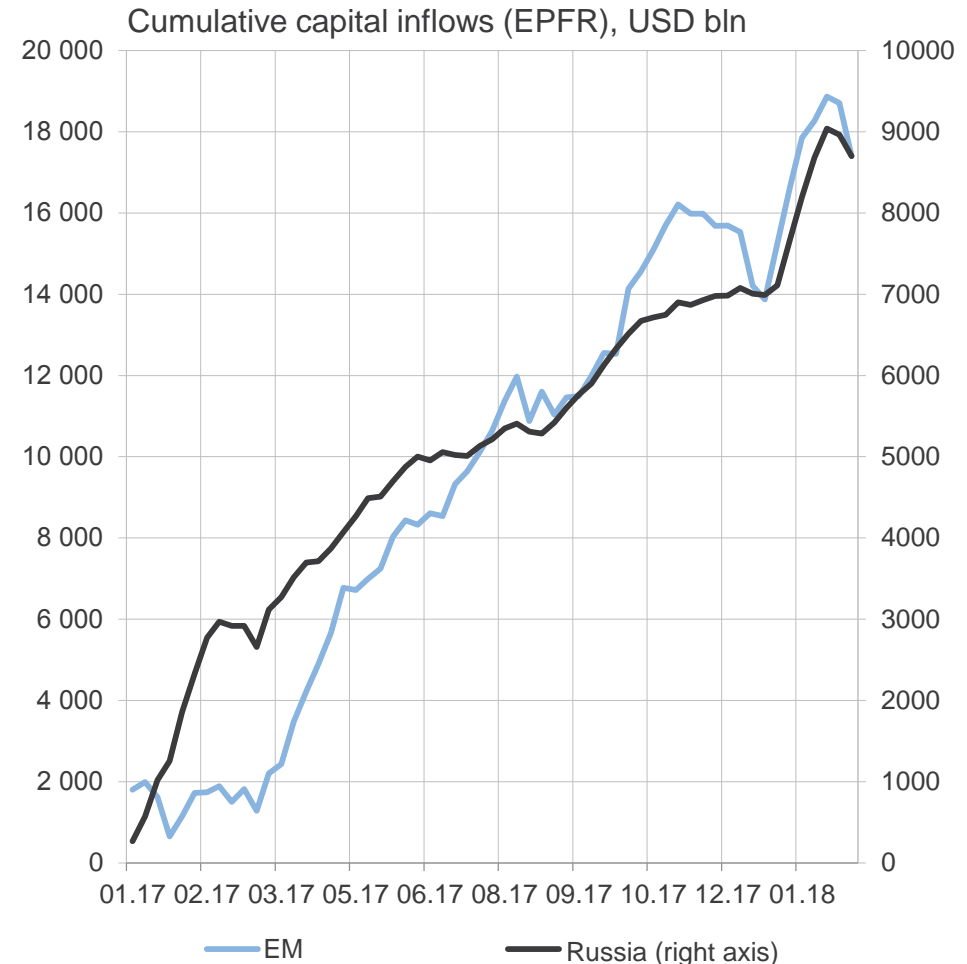
Sources: Bloomberg, Bank of Russia

Dynamics of other EM currencies had a key influence on the ruble. Oil prices have weaker influence due to the implementation of the budget rule

01.01.2013 = 100%

Change in ruble and EM currencies exchange rates* towards USD

Legend:
- Deviation (right axis)
- Average index for EM*
- Russian ruble exchange rate index

Average index for EM includes the exchange rate with respect to USD of the Hungarian forint, Brazilian real, Korean won, Turkish lira, Mexican peso, Polish zloty, Romanian leu, Malaysian ringgit, Philippine peso, Indonesian and Indian rupee

Sources: Bloomberg, Bank of Russia

High OPEC+ agreement compliance and continuing reduction of world oil inventories have created ground for implementing higher oil prices in the baseline scenario

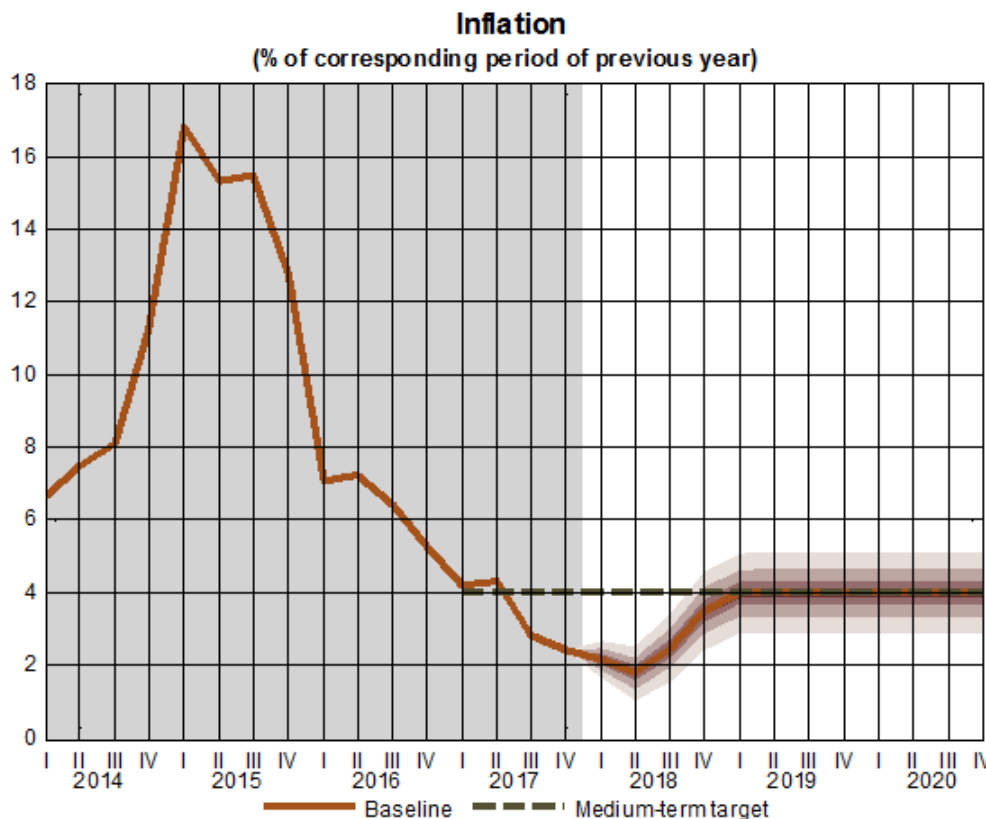Oil price (Urals) forecast*, USD per barrel

— Baseline scenario (March)   — Unchanged oil prices scenario (March)   — Fact   -■- Baseline scenario (December)
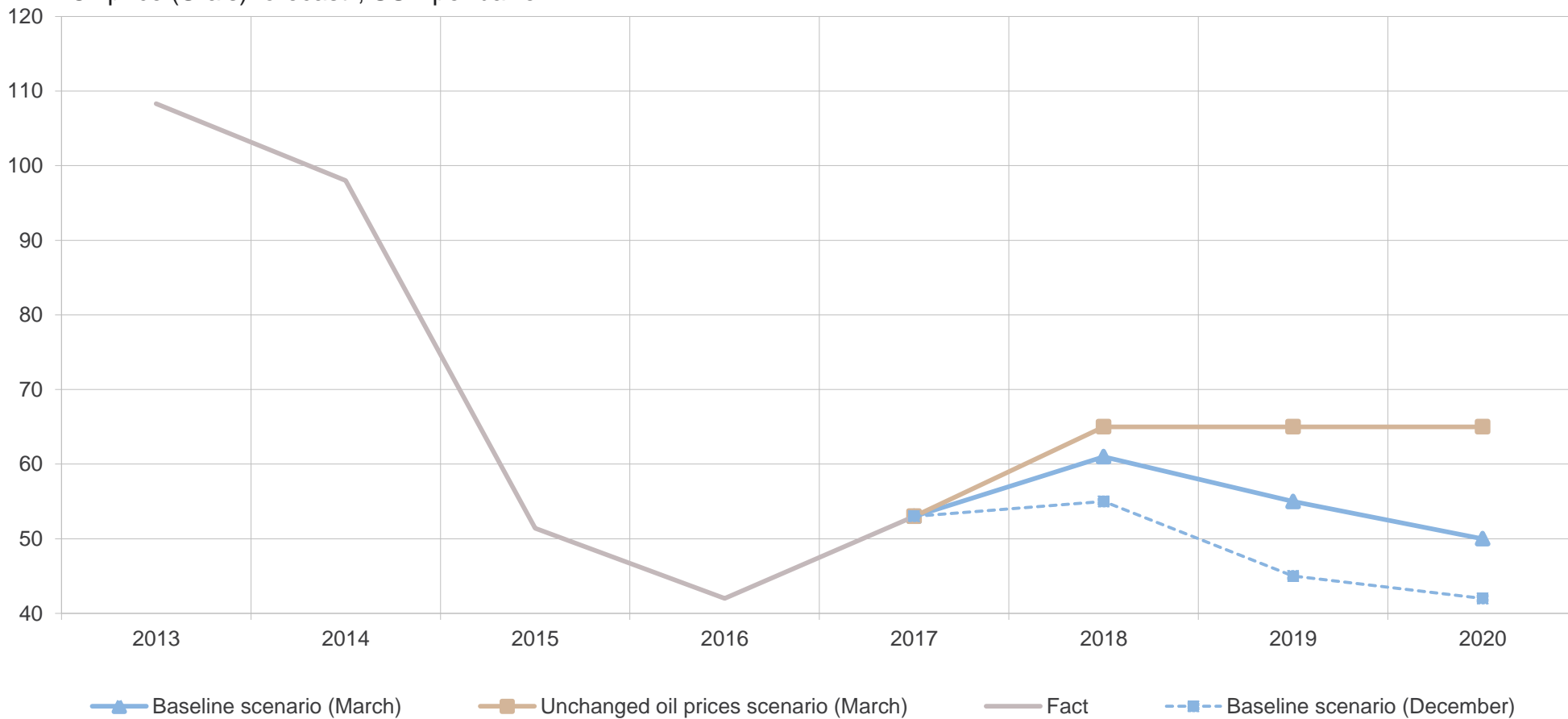
As presented in Monetary Policy Report №1 (March 2018)

Sources: Bank of Russia

Baseline scenario*: GDP growth rate close to potential, inflation – 3-4% in late 2018 and close to 4% in 2019

Inflation
(% of corresponding period of previous year)

GDP growth rates
(% of corresponding period of previous year)

Note: shaded areas on the forecast horizon show the probability of different inflation values.
Colour gradation reflects probability
Source: Bank of Russia calculations.
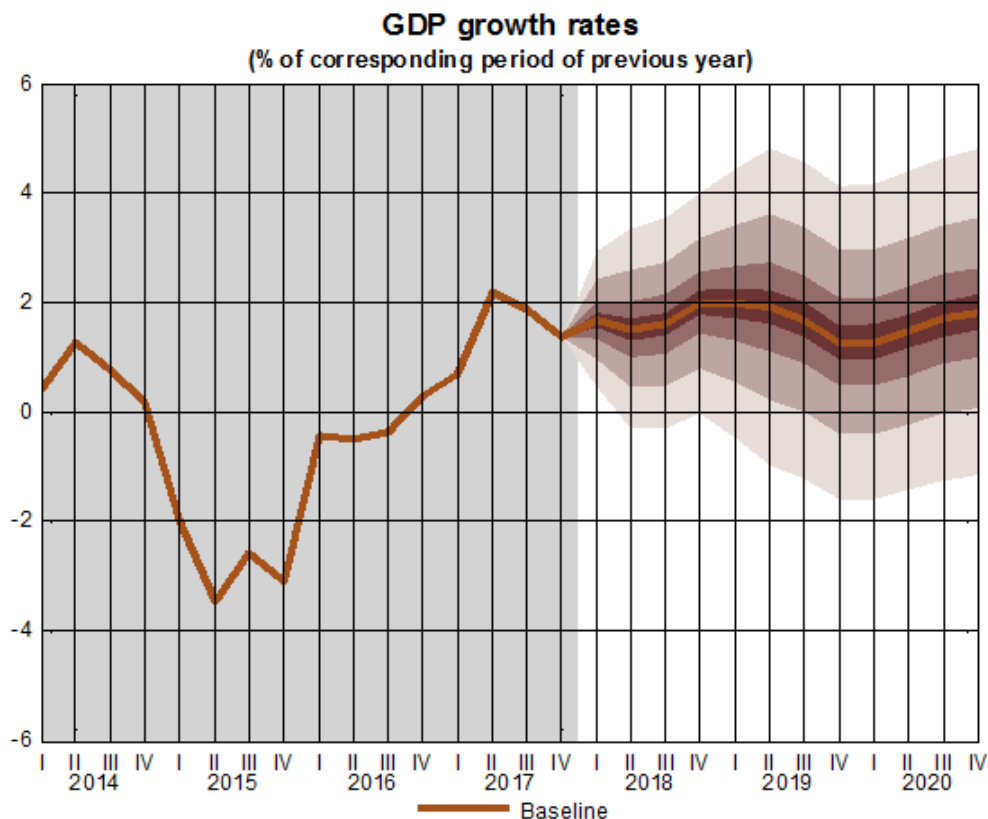
Note: shaded areas on the forecast horizon show the probability of different inflation values.
Colour gradation reflects probability
Source: Bank of Russia calculations.

As presented in Monetary Policy Report №1 (March 2018)

Baseline scenario: key parameters of the forecast

as % of previous year (unless indicated otherwise)	2017 (actual)	2018	2019	2020
		Baseline*		
Urals price (annual average), US dollars per barrel	53	61	55	50
Inflation, % in December year-on-year	2.5	3.0-4.0	4.0	4.0
Inflation, yearly average	3.5	2.5-3.5	4.0	4.0
Gross domestic product	1.5	1.5-2.0	1.5-2.0	1.5-2.0
Final Consumption Expenditure	2.3	2.7-3.2	2.0-2.5	2.0-2.5
- households	3.4	3.8-4.3	2.5-3.0	2.5-3.0
Gross formation	7.6	2.5-3.5	3.0-4.0	2.0-3.0
- gross fixed capital formation	3.6	3.5-4.0	3.2-3.7	2.5-3.0
Exports	5.4	1.8-2.3	1.5-2.0	1.5-2.0
Imports	17.0	7.5-8.0	6.0-6.5	4.5-5.0
Money supply in national definition	10.5	8-10	9-12	8-12
Lending to non-financial organisations and households in rubles and foreign currency**	9.0	8-10	9-12	8-12
- lending to non-financial and financial organisations in rubles and foreign currency	8.1	7-9	8-11	7-10
- lending to households in rubles and foreign currency	12	11-13	11-14	11-14

*As presented in Monetary Policy Report №1 (March 2017)
** Banking sector lending to the economy means all of the banking sector's claims on non-financial and financial institutions and households in the currency of the Russian Federation, a foreign currency and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investments in debt and equity securities and promissory notes, as well as other forms of equity holdings in non-financial and financial institutions, and other accounts receivable on settlement operations involving non-financial and financial institutions and households.

Source: Bank of Russia

Baseline scenario: balance of payments

(Billions USD)	2017 (actual)	Baseline*		
		2018	2019	2020
Current account	**40**	**59**	**39**	**23**
Balance of trade	116	140	121	107
Exports	*354*	*398*	*384*	*372*
Imports	*-238*	*-258*	*-263*	*-265*
Balance of services	-30	-32	-32	-33
Exports	*58*	*61*	*65*	*66*
Imports	*-88*	*-93*	*-97*	*-99*
Primary and secondary income balance	-45	-50	-51	-52
Capital account	0	0	0	0
Balance of current and capital accounts	**40**	**59**	**39**	**23**
Financial account (except reserve assets)	**-21**	**-9**	**-8**	**1**
General government and central bank	*14*	*9*	*8*	*8*
Private sector	*-35*	*-19*	*-15*	*-7*
Net errors and omissions	**4**	**0**	**0**	**0**
Change in reserve assets ('+' - decrease, '-' - increase)	**-23**	**-50**	**-31**	**-24**

*As presented in Monetary Policy Report №1 (March 2018). Signs according to BPM5

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

Source: Bank of Russia

Monetary policy of the Bank of Russia in March 2018

Inflation and inflation expectations

- Annual inflation remains sustainably low
- Factors, previously seen as mostly temporary, are becoming more persistent (agriculture, exchange rate dynamics)
- Inflation expectations are gradually decreasing

Economic activity

- Economic growth resumed in early 2018, following the decline due to temporary headwinds in late 2017

Pro-inflationary (↑) and disinflationary (↓) risks

• Fluctuations of food and oil prices	↑↓
• High sensitivity of inflation expectations	↑
• Possible changes in consumer behaviour	↑
• **Labour market imbalances**	↑
• **Volatility in the global markets**	↑
• Budget and tariff decisions	

Decision

The Bank of Russia cuts the key rate

by 25 bp to 7.25% p.a.

Signal

The Bank of Russia will continue to reduce the key rate and will complete the transition to neutral monetary policy in 2018

Appendix

Underlying inflation indicators stabilised at 2-3% (2)

	Sen.16	Oct.16	Nov.16	Dec.16	Jan17	Feb.17	Mar.17	Apr.17	May.17	Jun.17	Jul.17	Aug.17	Sen.17	Oct.17	Nov.17	Dec.17	Jan.18	Feb.18
Monthly inflation (seasonally adjusted, annualised), %																		
All goods and services	6.2	5.1	4.0	1.8	4.5	1.3	1.1	4.1	3.8	8.0	-0.6	-0.6	1.8	2.2	1.3	2.2	0.9	1.0
Trimmed inflation indicators																		
CPI without 40%	5.5	5.1	4.1	4.1	4.7	3.1	3.1	3.1	3.1	3.4	2.1	2.7	2.0	2.3	2.4	2.3	2.2	1.2
Median (CPI without 100%)	5.0	5.6	4.3	4.4	4.2	3.4	3.0	3.1	3.2	3.8	2.3	2.5	1.9	2.3	2.4	2.3	2.3	1.5
CPI without volatile components (for 3 months)																		
CPI without 20%	6.3	5.8	4.1	1.6	3.9	0.9	0.5	4.2	4.2	7.9	-0.9	0.1	1.9	2.4	1.1	2.1	-0.1	0.5
CPI without volatile components (for 24 months)																		
CPI without 20%	6.1	5.5	4.0	1.7	3.9	1.1	0.5	4.0	4.0	8.6	-1.2	-0.6	1.6	2.0	0.6	2.2	0.1	0.3
CPI with different weights (more volatility – less weight)																		
All goods and services	5.5	5.0	4.5	4.2	5.1	3.1	2.9	3.1	3.0	3.7	2.2	2.9	3.8	2.1	2.1	2.5	2.1	1.6
CPI without various components																		
Core inflation	4.8	4.5	4.1	3.4	2.5	1.5	1.4	2.3	3.1	3.0	2.8	2.4	2.3	1.6	1.3	1.2	0.6	0.6
CPI without housing and utilities	6.4	5.0	3.9	1.6	4.0	0.9	0.7	4.1	3.7	8.4	-0.6	-1.5	1.8	1.9	1.0	2.0	0.4	0.3
CPI without fruits and vegetables	5.6	4.6	4.5	3.7	5.2	2.6	1.8	2.3	2.4	3.7	2.4	2.4	2.2	1.5	1.8	2.3	2.0	1.2
Alternative inflation indicators																		
Core inflation (trimming method)	5.6	5.1	4.1	4.2	4.3	2.7	2.4	2.7	2.6	2.8	1.5	2.2	1.7	1.9	1.7	2.0	1.8	1.1
Core inflation (without volatile components)	5.0	5.6	4.3	4.4	4.2	3.0	2.7	3.0	2.9	3.2	1.8	2.5	1.8	1.7	2.1	2.3	1.9	1.6
Balance indicators of inflation, % (difference of shares of components with accelerating and decelerating inflation)																		
Annual inflation	-51.9	-43.5	-24.4	-22.0	-34.2	-37.2	-44.5	-41.9	-35.1	-37.6	-43.2	-42.2	-50.2	-38.8	-33.4	-30.2	-40.2	19.8
Monthly inflation (annualised)	3.7	-1.8	-7.1	-5.8	-6.3	-49.7	-10.2	-5.6	-0.1	21.9	-12.7	-16.7	-24.9	6.1	-6.6	14.9	6.1	-31.2

Quarter average inflation

- lower than 4% (more than 0.3 st. dev.)
- close to 4% (±0.3 st. dev.)
- higher than 4% (more than 0.3 st, dev.)

Sources: Rosstat, Bank of Russia

Consumer demand is growing

	Growth of the indicator in February 2018 (change in February 2018 with respect to January 2018)	Growth of the indicator in 2017 (growth in 2017 with respect to 2016)	Comparison with pre-crisis levels (change in February 2018 with respect to the beginning 2014)
Retail trade turnover	0.0% SA	1.2%	−9.8% SA
Volume of paid services	−0.2% SA	0.2%	2.0% SA
Real wages	0.4% SA	3.5%	−0.3% SA
Real disposable incomes of households (including the January 2017 single payment)	0.3% SA	−1.7%	−6.1% SA
Sales of durable goods	3.0% SA (January 2018)	5.4%	7.7%
Sales of passenger vehicles	−1.0% SA	11.9%	−33.6%
Index of consumer confidence (Rosstat)	...	+10.9 p.p.	+0.5 p.p.
Index of consumer sentiment (FOM)	−1.0 p.p. (March 2018)	+11 p.p.	+9 p.p. (March 2018)
Index of favourable conditions for significant purchases (Rosstat)	...	+9.3 p.p.	−6.4 p.p.
Evaluation of favourable conditions for significant purchases (FOM)	−3 p.p. (March 2018)	+12 p.p.	−11 p.p. (March 2018)
Savings rate	+2.6 p.p. (January 2018)	−1.3 p.p.	+0.2 p.p. (January 2018)

Performance under structural excess liquidity since January 2017. The Bank of Russia mostly conducts deposit auctions and started issuing bonds in August 2017

Bank of Russia operations and the dynamics of MIACR

Legend:
- Deposit auctions
- Standing deposit facilities
- Bank of Russia bonds
- REPO auctions
- Standing REPO facilities
- Amount outstanding on other refinancing operations
- BoR key rate (right-hand scale)
- Interbank market O/N rate (MIACR)

Source: Bank of Russia