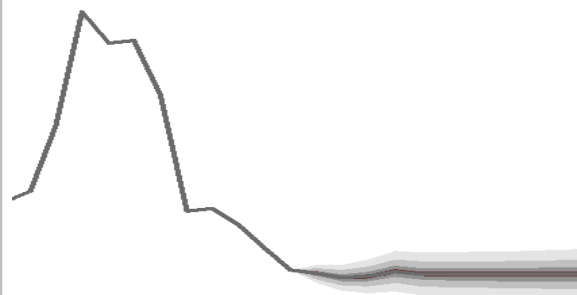# Bank of Russia
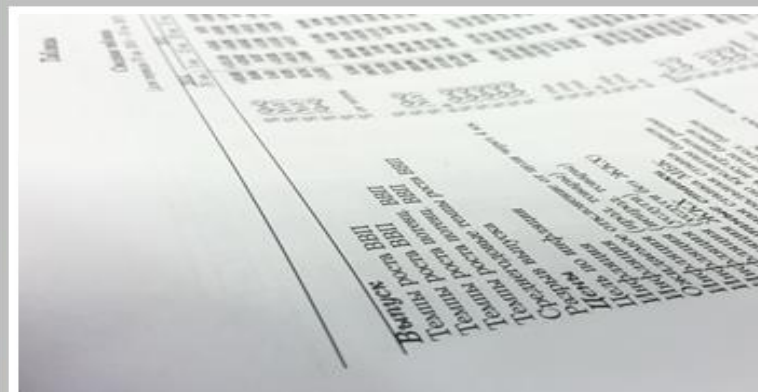The Central Bank of the Russian Federation

4%

RUSSIAN ECONOMIC OUTLOOK AND MONETARY POLICY CHALLENGES
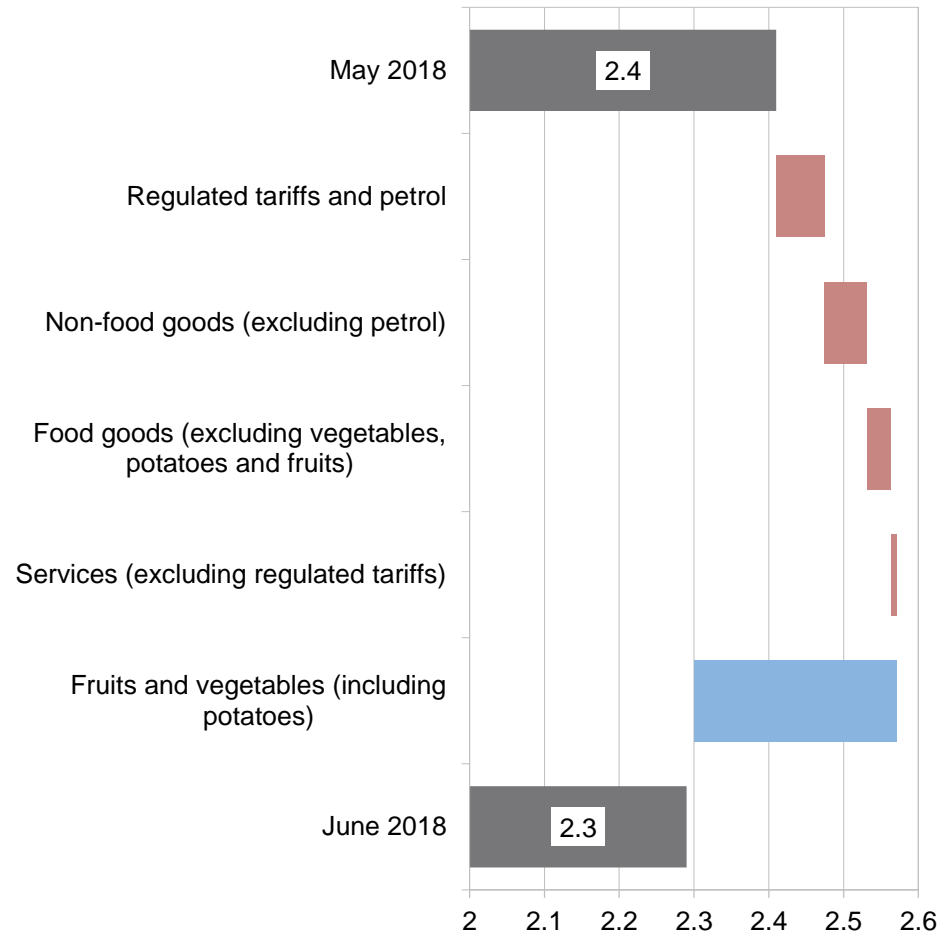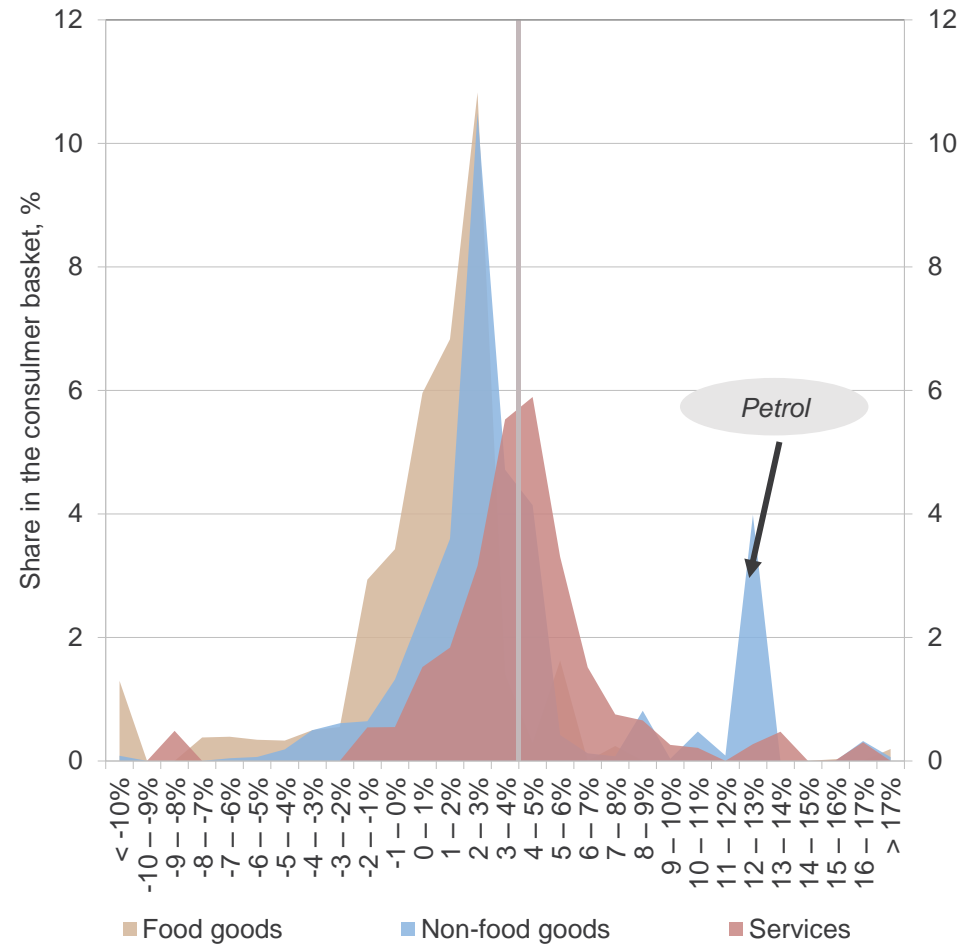
Bank of Russia

July 2018

Annual Inflation Remains Low and in General Corresponds with the Bank of Russia's Expectations. Inflation for Main Consumer Basket Product Groups Shows Mixed Dynamics

Contributions to the change in annual inflation in June 2018, ppts

Annual CPI distribution in June 2018

Sources: Rosstat, Bank of Russia

Sources: Rosstat, Bank of Russia

A Majority of Annual Inflation Indicators Reflecting the Most Sustainable Price Movements Suggests that Inflation Is Gradually Returning to the Target

	Jan.17	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	Mar.18	Apr.18	May.18	Jun.18
Annual inflation, %																		
All goods and services	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	2.4	2.4	2.4	2.3
Trimmed inflation indicators: median	5.2	5.1	4.8	4.4	4.0	3.9	3.9	3.7	3.5	3.3	3.2	3.3	2.8	2.8	2.6	2.5	2.5	2.5
CPI without volatile (for 3 months) components	5.2	4.7	4.2	4.0	4.0	4.0	3.6	3.3	3.0	2.7	2.3	2.2	2.6	2.4	2.1	2.5	2.3	2.6
CPI without volatile (for 24 months) components	5.0	4.6	4.1	4.0	3.8	4.0	3.6	3.1	2.7	2.4	2.1	2.3	3.1	2.9	2.7	2.7	3.0	3.1
CPI with different weights: only volatility	5.1	4.8	4.6	4.4	4.3	4.5	4.0	3.9	3.6	3.3	3.1	3.2	2.8	2.6	2.7	2.7	2.7	3.0
CPI with different weights: volatility and persistency	4.9	5.1	4.6	4.5	4.3	4.1	3.9	3.8	3.5	3.2	2.3	2.1	1.9	1.7	1.7	1.6	1.7	1.7
CPI without «volatile» regions	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	2.5	2.6	2.6	2.5
Inflation without exchange rate influence (DRF)	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	2.9	3.1	1.5	3.3
CPI without various components																		
Core inflation	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	1.8	1.9	2.0	2.3
Core inflation without food goods	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	2.9	3.1	3.1	3.3
CPI without housing and communal services	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	2.2	2.2	2.2	2.1
CPI without fruits and vegetables	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	2.2	2.3	2.7	2.9
Monthly inflation (seasonally adjusted, annualised), %																		
All goods and services	4.5	1.4	1.1	4.0	4.3	7.7	-1.0	-0.4	1.7	2.3	1.5	2.0	0.9	1.2	3.0	4.6	4.5	6.0
Trimmed inflation indicators: median	4.2	3.4	3.0	3.1	3.2	3.8	2.3	2.5	1.9	2.3	2.4	2.3	2.4	1.6	1.4	2.9	3.1	3.6
CPI without volatile (for 3 months) components	3.9	0.9	0.5	4.2	4.2	7.9	-0.9	0.1	1.9	2.4	1.1	2.1	2.0	1.6	1.1	2.2	3.0	3.7
CPI without volatile (for 24 months) components	3.9	1.1	0.5	4.0	4.0	8.6	-1.2	-0.6	1.6	2.0	0.6	2.2	2.6	1.9	1.8	3.3	3.5	3.7
CPI with different weights: only volatility	5.1	3.2	3.0	3.0	3.1	3.6	2.1	2.9	3.9	2.1	2.1	2.5	2.1	1.7	1.3	2.7	3.6	3.7
CPI with different weights: volatility and persistency	4.9	3.5	3.2	3.1	3.2	3.2	2.5	3.2	1.5	1.9	1.7	2.0	2.1	1.5	0.7	1.9	2.7	4.1
«Core inflation» (trimming method)	4.3	2.7	2.3	2.7	2.7	2.6	1.4	2.2	1.7	1.9	1.9	2.1	1.9	1.3	1.6	2.8	3.6	3.8
«Core inflation» (without volatile components)	4.2	3.2	2.9	2.8	2.9	2.9	1.2	2.5	1.8	1.7	2.1	2.2	1.9	1.7	1.5	2.5	3.7	3.7
CPI without various components																		
Core inflation	3..5	2.5	1.9	1.6	1.9	1.6	1.9	2.1	2.4	1.9	1.9	2.3	2.0	1.9	1.8	2.6	2.9	3.7
CPI without housing and communal services	4.0	1.0	0.7	3.9	4.3	8.1	-1.0	-1.3	1.6	2.1	1.2	1.8	0.5	0.8	2.8	4.5	4.4	6.1
CPI without fruits and vegetables	5.2	2.7	1.9	2.3	2.6	3.4	2.1	2.7	2.0	1.6	2.0	2.1	2.0	1.4	1.9	3.9	6.7	6.2
Inertia measures of inflation, %																		
Trend inflation (DRF)	7.2	7.0	6.8	6.6	6.5	6.4	6.2	6.0	5.9	5.6	5.5	5.4	5.3	5.2	5.1	5.2	5.2	5.3
12MMA	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	3.1	2.9	2.8	2.6
24MMA	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	4.6	4.4	4.2	4.0
Balance indicators of inflation (difference of shares of components with accelerating and decelerating inflation), %																		
Annual inflation	-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	-30.0	-1.7	14.9	24.9
Monthly (annualised)	-10.1	-49.7	-4.2	-13.0	0.8	17.5	-14.3	-16.7	-25.9	6.1	-6.6	13.9	3.8	-25.6	-3.9	29.5	33.0	30.9

Average inflation for 3 months
- 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

Petrol Price Movements Affected Inflation Expectations which Continued to Rise in June. Household Inflation Expectations Stabilised in July Due to Petrol Prices Ceasing to Increase

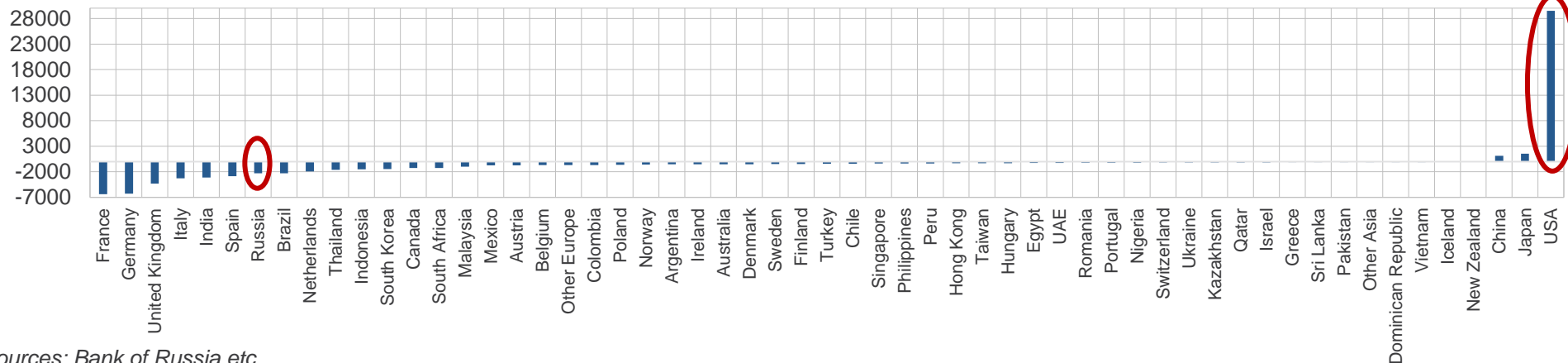|	Expectations horizon	I. 2016	II.2016	III.2016	IV.2016	I.2017	II.2017	III.2017	IV.2017	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18
Inflation expectations (absolute value), %																
Households																
FOM	Next 12 months	14.7	14.2	14.2	12,4	11.2	10.3	9.6	8.7	8.9	8.4	8.5	7.8	8.6	9.8	9.7
FOM (Bank of Russia calculations)	Next 12 months	7.4	6.7	5.9	5.1	4.0	4.0	2.8	2.4	2.1	2.1	2.2	2.2	2.2	2.4	
Professional analysts																
Bloomberg	2018						4.0	4.0	4,0	4.0	3.8	3.6	3.6	3.7	3.8	
Interfax	2018					4.2	4.1	4.1	3.9	3.8	3.8	3.7	4.0	3.8	3.8	
Reuters	2018						4.1	4.0	4.1	3.8	3.8	3.6	3.8	3.7	3.5	
Financial markets																
OFZ IN (option not subtracted)	Next 5 years	6.9	6.0	5.3	5.4	4.9	4.7	4.3	4.1	4.1	4.0	3.9	4.2	43	4.5	
Bond market	Next quarter	12.0	6.9	7.2	6.6	5.2	4.4	4.5	3.1	-	-	2.7				
Interbank market	Next quarter	9.9	5.3	5.4	5.6	4.6	3.7	3.4	2.3	-	-	1.9				
Inflation expectations (balanced index*)																
Households																
FOM	Next 12 months	84	78	82	80	79	80	82	78	78	75	74	76	76	79	
FOM	Next month	72	68	70	76	68	68	73	73	69	61	62	63	63	71	
Предприятия																
REB	Next 3 months	14	38	36	46	22	20	14	52	22	24	32	0			
Bank of Russia	Next 3 months	13.6	12.2	11.3	9.4	7.4	9.5	7.2	7.2	6.4	6.8	8.5	10.0	10.4	11.4	
Retail prices (Rosstat)	Next quarter	32	29	28	27	27	24	24	22	-	-	20	-	-	20	
Tariffs (Rosstat)	Next quarter	5	5	0	0	4	3	0	0	-	-	5	-	-	5	

Change against 3 previous months:

- 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 to fall
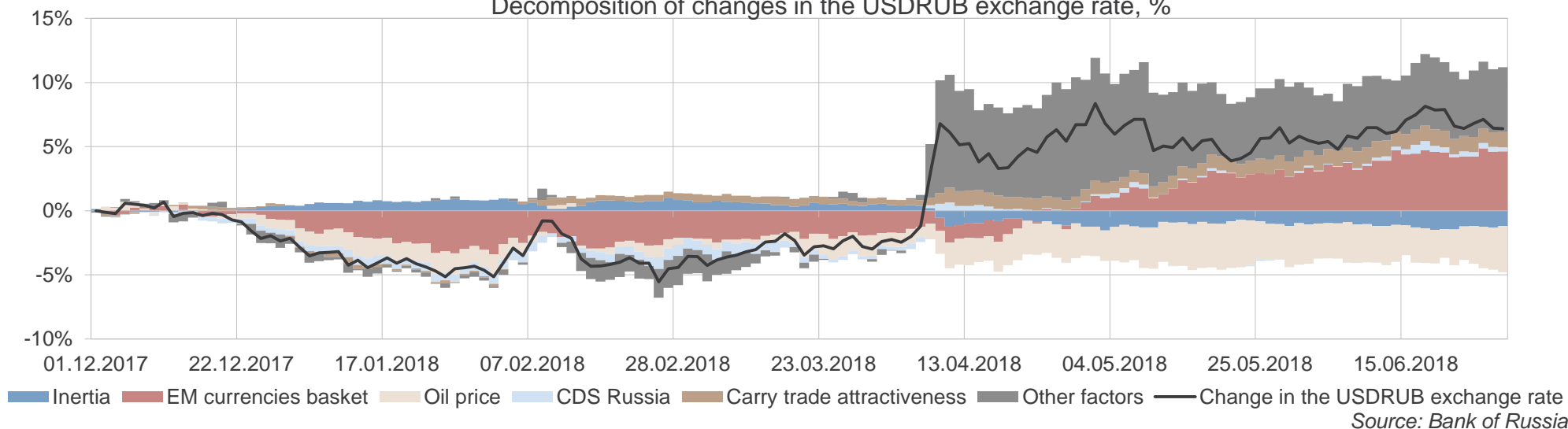
A Stronger US Dollar and the Expectations of a Faster Monetary Policy Stabilisation in the US Have an Impact on Capital Flows to EM and on EM Currencies, Including the Ruble

Capital flows to emerging and developed markets since 25.04.2018, USD bln

Sources: Bank of Russia etc.

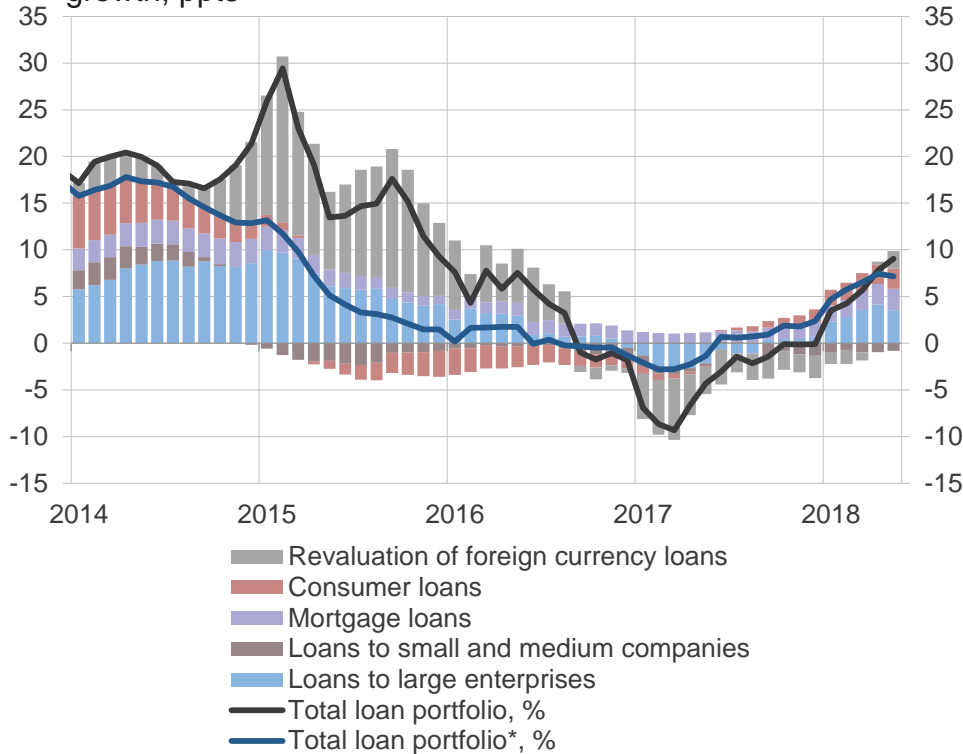Decomposition of changes in the USDRUB exchange rate, %

Inertia — EM currencies basket — Oil price — CDS Russia — Carry trade attractiveness — Other factors — Change in the USDRUB exchange rate

Source: Bank of Russia

Monetary Conditions Are Close to Neutral and Evolve, Among Other Things, Under the Influence of Earlier Decisions to Cut the Key Rate
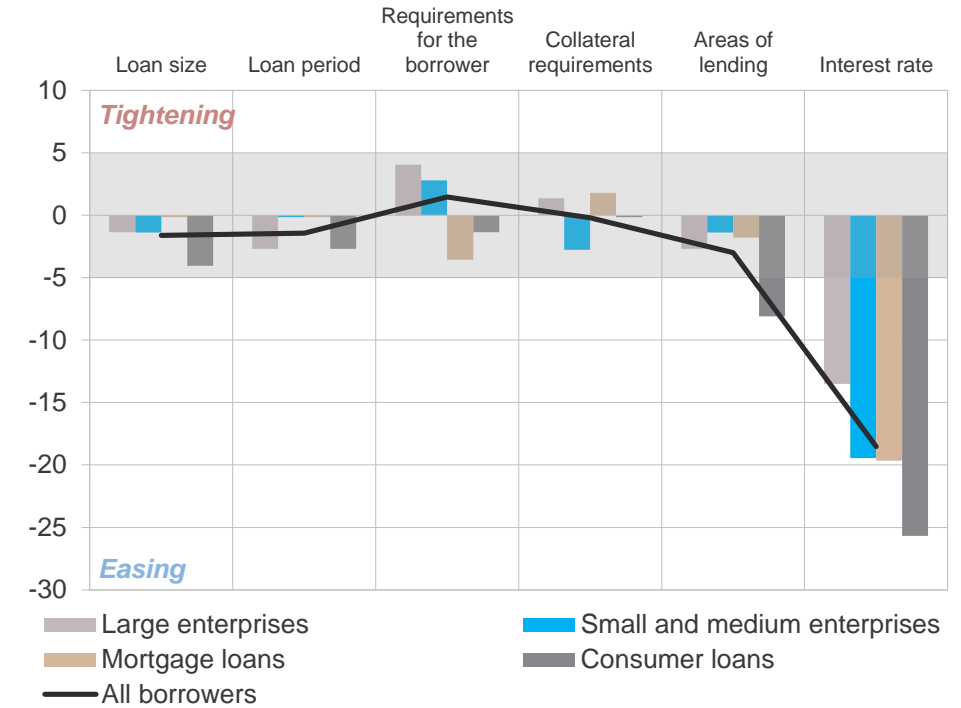
Contribution of different components to the bank lending growth, ppts

- 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 condition in Q2 2018**, ppts

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

*** Grey is the zone of insignificant changes of lending conditions*

Source: Bank of Russia

Dollarisation of loan portfolio (%)

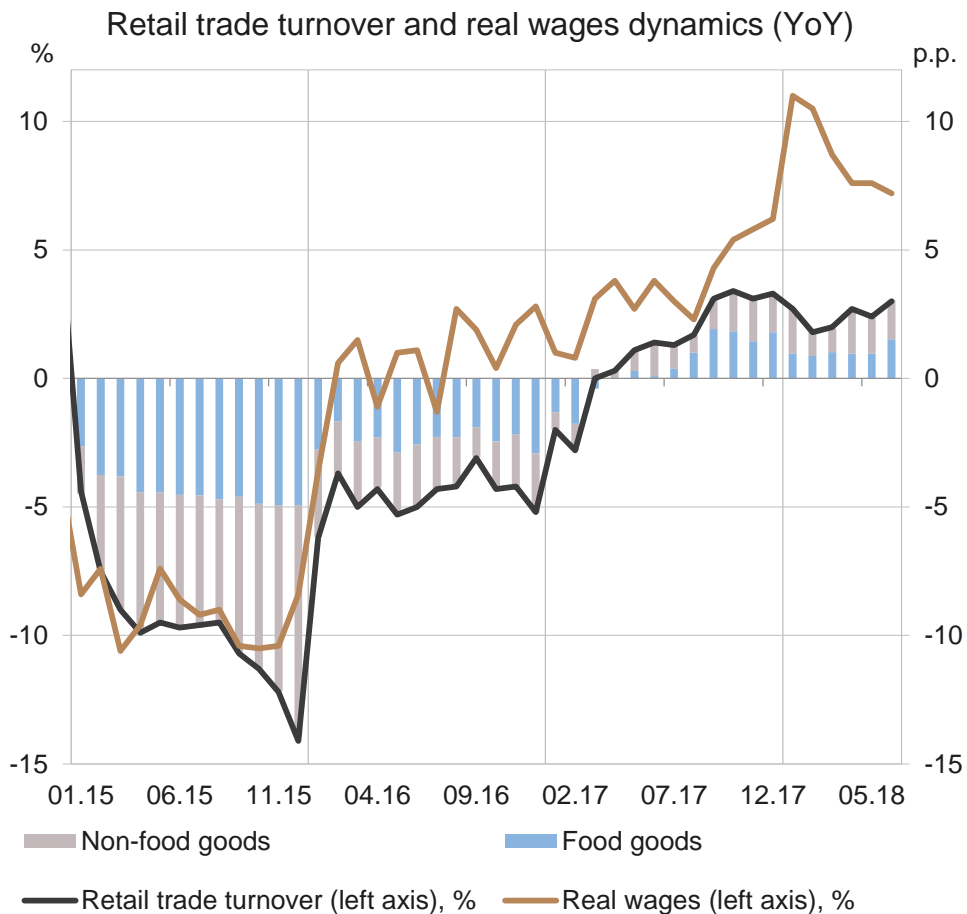|	1.03.18	1.04.18	1.05.18	1.06.18	1.07.18
Loans to non-financial organisations	28.1	28.3	29.0	28.8	28.5
Loans to households	0.8	0.8	0.8	0.8	0.7
Total	20.1	20.3	20.9	20.5	20.3

Dollarisation of Deposits (%)

	1.03.18	1.04.18	1.05.18	1.06.18	1.07.18
Household deposits	20.2	20.2	20.6	20.5	20.3
Corporate deposits and current accounts	33.7	34.5	35.1	35.2	33.9
Total	27.1	27.6	28.0	28.0	27.3

The Increase in Real Wages and the Expansion of Retail Lending Support the Growth of Consumer Demand

Retail trade turnover and real wages dynamics (YoY)

The decline in the savings rate due to foreign currency assets in March-April is temporary (share of income, SA)

Non-food goods
Food goods
Retail trade turnover (left axis), %
Real wages (left axis), %

Sources: Rosstat, Bank of Russia

Equity
Borrowing
Foreign currency assets (FX, FX deposits)
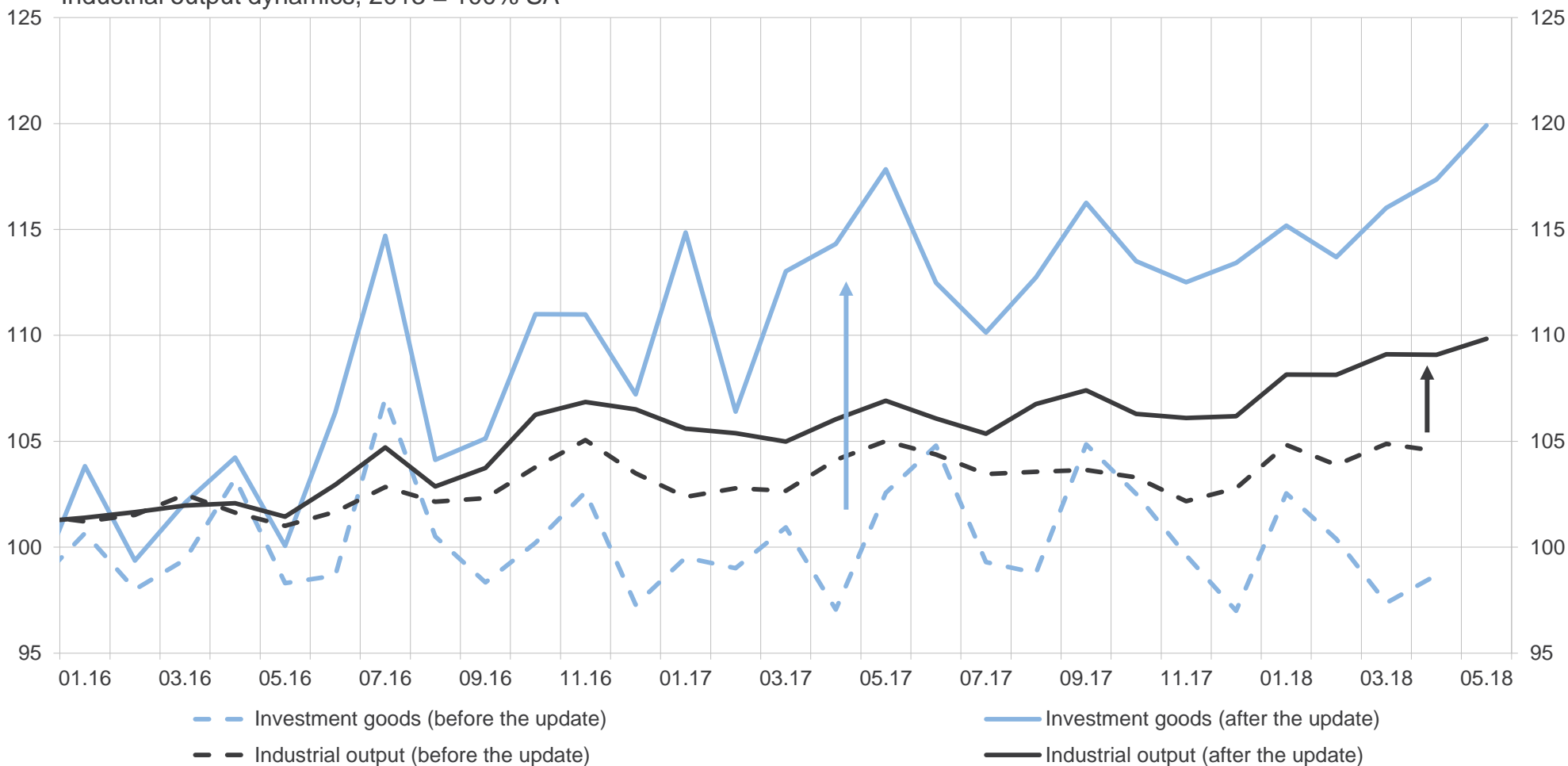Ruble financial assets (deposits, stock and cash)
Savings rate
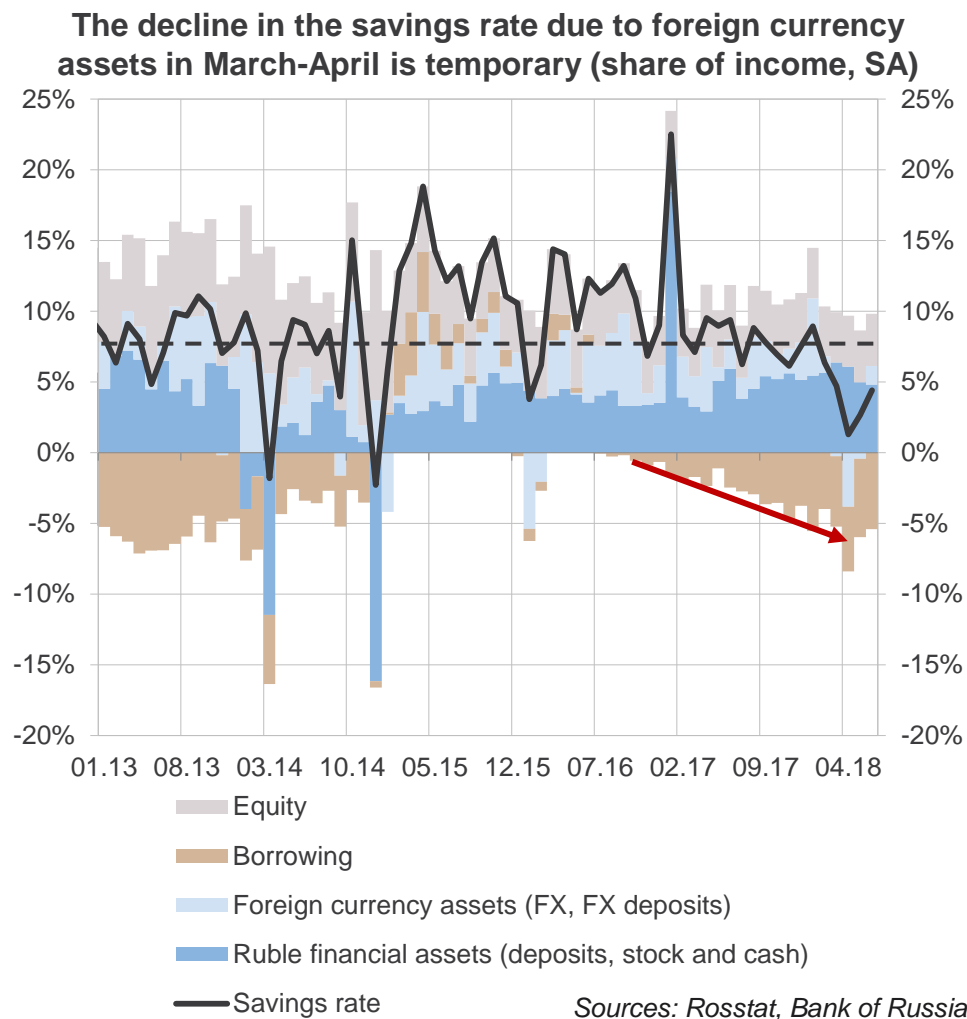
Sources: Rosstat, Bank of Russia

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

The Updated Rosstat Data Reflects Steadier Economic Growth in 2017 — Early 2018 Than Previous Estimates

Industrial output dynamics, 2013 = 100% SA

- - Investment goods (before the update)
- - Industrial output (before the update)
—— Investment goods (after the update)
—— Industrial output (after the update)

Sources: Rosstat, Bank of Russia

Fiscal Policy: Inflation Can Temporarily Overshoot 4% in 2019 Due to the Planned Increase of the VAT

Implementation of the package of measures within the framework of inaugural decrees:
In 2019-2024 the government will incur additional expenses of 8 trillion rubles, also from the intrabudgetary fund of infrastructure investments (3-3.5 trillion rubles during 6 years = 0.5-0.6 trillion roubles per year), and allocations for the development of human capital: education, medicare, infrastructure, environment and technological development.

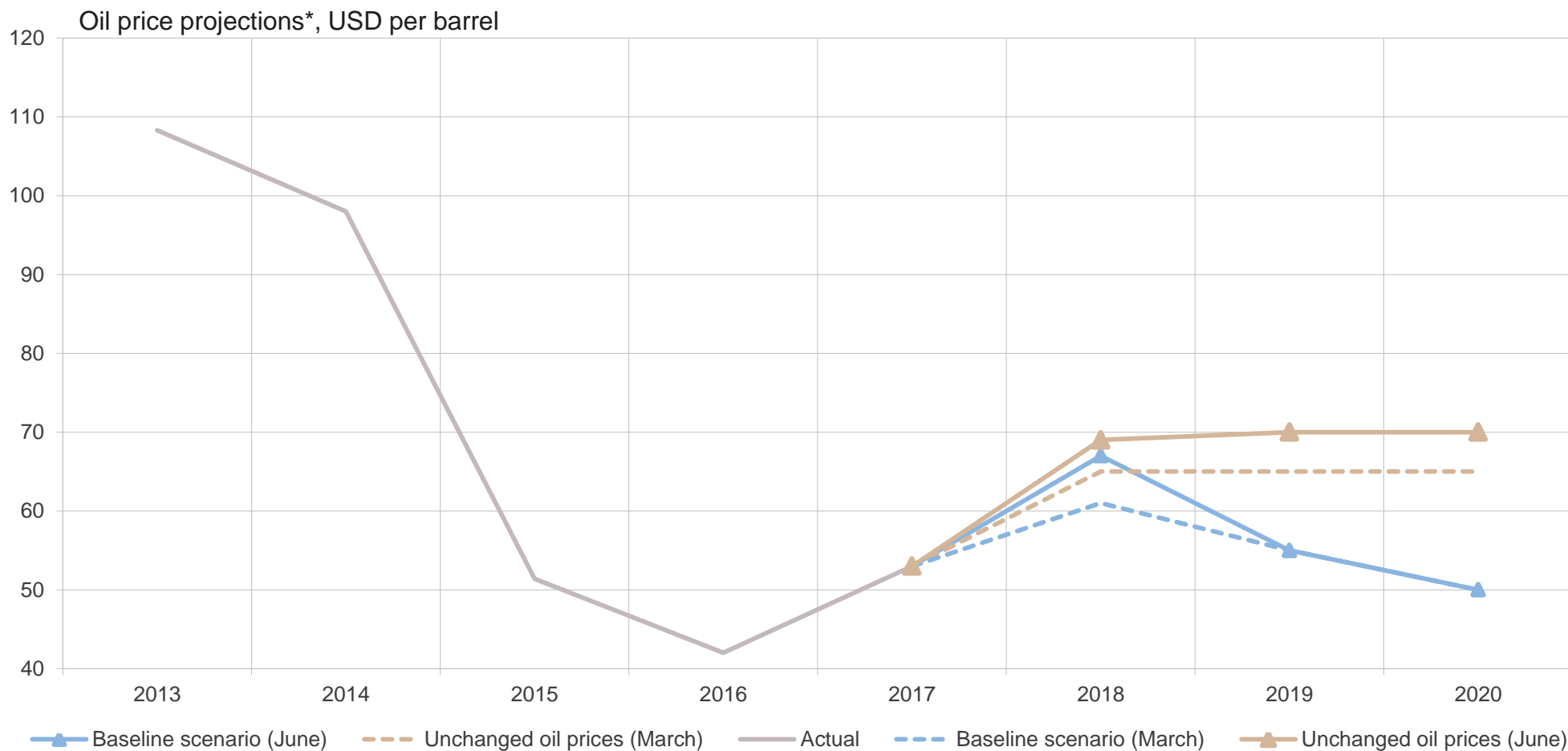**Sources of financing new expenditures :**
- To implement new expenditures, the Ministry of Finance of Russia proposes **the adjustment of the budget rule** – an increase in the marginal cost volume of a surcharge of 0.5-0.6% of GDP for the implementation of infrastructure fund allocations. This measures **will be mainly financed by new OFZ borrowings** (0.5-0.6 trillion roubles). Thus, gross allocations may exceed 2.2-2.3 trillion rubles in 2019-2024
- The government proposes **to raise the main VAT rate from 18% to 20%**. That could lead to a increase in revenues of about 600-650 billion rubles (0.5-0.6% of GDP) annually, or by 3.5-4.0 trillion rubles in 6 years. The Increase of the basic VAT rate could lead to inflation temporarily overshooting 4% in 2019 (the share of goods and services at the basic rate of VAT in the consumer basket is 70%).
- The government proposes **to increase the retirement age** from 2019 - annually by 0.5 years - for men to 65 years (by 2028) and for women to 63 years (until 2034). This measure can increase the potential output and accelerate economic growth in the range of +0.2 percentage points, as well as give additional income of about 45-85 billion rubles annually from social insurance contributions. The increase of the retirement age with planned growth of pensions' indexations from 4% to 7% annually in 2019-2024 years will lead to a small expansion of the budget system deficit within 100 billions of rubles. This effect presumes that the retirement age reform will have an impact on the collection of social security taxes and on the budget system's expenditures on pensions and wages of public employees.

Main Indicators of the Federal Budget

Federal Budget	01.07.2018 – 12 months indicators (MoF preliminary estimates)	2018 (Bank of Russia estimates in the baseline scenario – Urals $67/barrel)
Revenues, % of GDP	17.2	18.1
Expenditures, % of GDP	17.3	16.8
Deficit, % of GDP	-0.1	1.3
Transfer from sovereign funds (National Wealth Fund) in 2018, ₽ trln	0	1.1

Under the Current Oil Market Environment the Oil Price Projection for 2018 Has Been Updated in the Bank of Russia's Baseline Scenario. The Medium-Term Outlook Remains Unchanged

Oil price projections*, USD per barrel

Baseline scenario (June) — Unchanged oil prices (March) — Actual — Baseline scenario (March) — Unchanged oil prices (June)

* Based on Monetary Policy Report No.2 (June 2018)
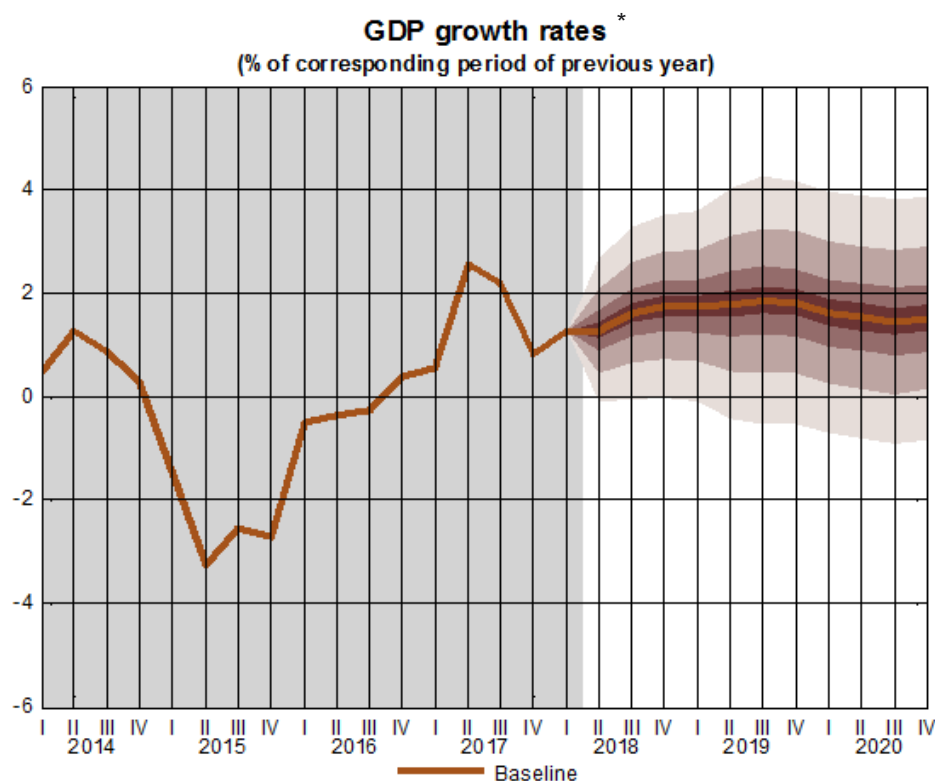
Source: Bank of Russia

Baseline Scenario: GDP Growth Rate Close to Potential, Inflation – 3.5–4% in Late 2018 With It Temporary Overshooting 4% in 2019 and Returning to 4% in Early 2020
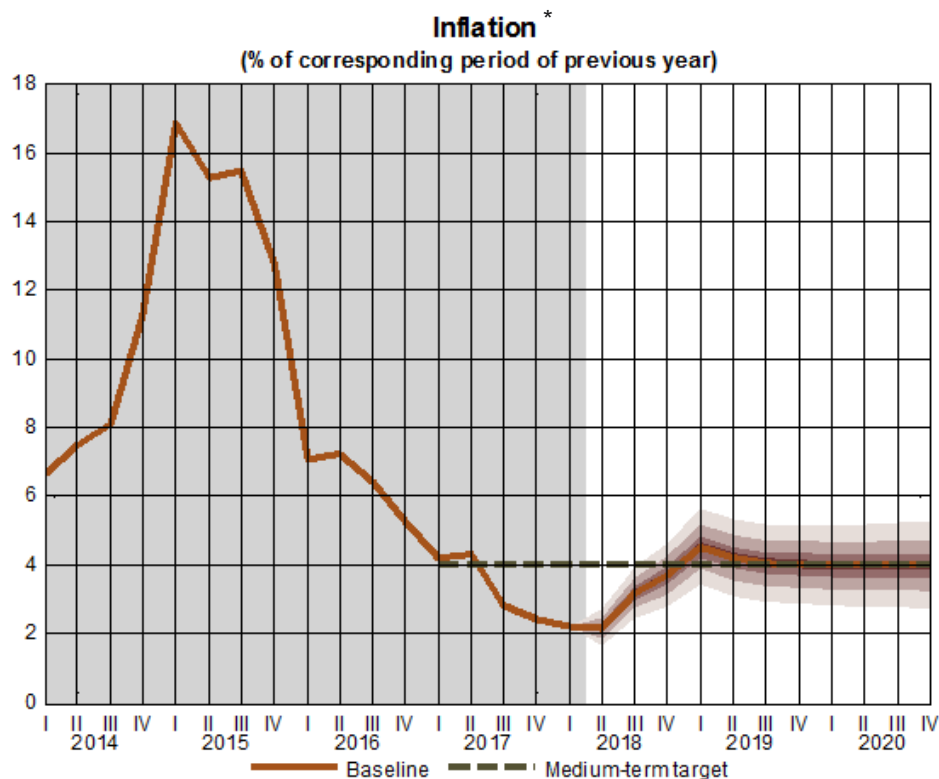
Inflation *
(% of corresponding period of previous year)

Baseline — Medium-term target

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

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

Baseline

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 №2 (June 2018)

Baseline Scenario: Key Projection Parameters

Increase compared to the previous period in % (unless noted otherwise)	2017 (actual)	2018	2019	2020
		Baseline*		
Urals price (average for year), USD per barrel	53	67	55	50
Inflation in December compared to previous December, %	2.5	3.5-4.0	4.0-4.5	4.0
Inflation (average for year) compared to the previous year, %	3.5	2.5-3.5	4.0-4.5	4.0
GDP	1.5	1.5-2.0	1.5-2.0	1.5-2.0
Final consumption expenditures	2.6	2.5-3.0	2.3-2.8	2.0-2.5
- of households	3.4	3.3-3.8	2.8-3.3	2.5-3.0
Gross formation	7.4	0.5-1.5	2.2-3.2	1.7-2.7
- gross fixed capital formation	4.3	2.7-3.2	2.2-2.7	2.2-2.7
Exports	5.1	3.3-3.7	1.7-2.2	1.7-2.2
Imports	17.4	7.4-7.9	4.7-5.2	5.3-5.8
Money supply (using the national definition)	10.5	10-13	8-11	8-11
Lending to non-financial organisations and households, in roubles and foreign currencies**	8.2	10-13	7-11	7-12
- Lending to non-financial and financial organisations, in rubles and foreign currencies	7.1	9-11	6-9	6-10
- Lending to households, in rubles and foreign currencies	12	13-18	10-13	10-13

* Published in Monetary Policy Report No.2 (June 2018)
** Banking sector's lending to the economy is defined as all the claims of the banking sector to financial and non-financial organisations as well as households in Russian or foreign currency and precious metals, including loans provided (with overdue debt counting as well), overdue interest on loans, credit institutions' investment in equity and debt securities and promissory notes, any forms of participating in the equity of financial and non-financial organisations, and any other receivables for settlements with financial and non-financial organisations and households

Source: Bank of Russia

Baseline Scenario: Projections for the Balance of Payments

USD billions	2017 (estimate)	Baseline*		
		2018	2019	2020
Current account:	**35**	**85**	**47**	**32**
Trade balance	115	166	129	115
Exports	*353*	*425*	*390*	*384*
Imports	*-238*	*-259*	*-261*	*-269*
Balance of services	-31	-31	-31	-31
Exports	*58*	*65*	*66*	*69*
Imports	*-89*	*-96*	*-97*	*-100*
Balance of primary and secondary income	-49	-50	-51	-52
Capital account	0	0	0	0
Current account and capital account surplus	**35**	**85**	**47**	**32**
Financial transactions account (reserve assets excluded)	**-16**	**-26**	**-12**	**-8**
Public administration and central banks	*13*	*4*	*3*	*4*
Private sector (net errors and omissions included)	*-29*	*-30*	*-16*	*-12*
Net errors and omissions	**4**	**0**	**0**	**0**
Change in FX reserves (+ is for decrease, - is for growth)	**-23**	**-60**	**-35**	**-24**

Using BPM 5 methodology. Due to rounding total results may differ from the sum of respective values

Source: Bank of Russia, Monetary Policy Report No. 2 (June 2018)

Monetary Policy of the Bank of Russia in July 2018

Inflation and inflation expectations

- Annual inflation remains low and in general corresponds to the Bank of Russia's expectations, but shows mixed dynamics for main consumer basket products (petrol ↑, food goods ↓)
- A majority of annual inflation indicators reflecting the most sustainable price movements suggests that inflation is gradually returning to the target
- Petrol price movements affected inflation expectations which continued to rise in June
- Annual inflation will temporarily overshoot 4% in 2019 due to the planned increase of the value added tax

Monetary conditions are close to neutral

Economic activity

- The updated Rosstat data reflects steadier economic growth in 2017 — early 2018 than previous estimates
- Medium-term outlook on economic growth is at large the same, but might be further updated to reflect a detailed estimate of influence of the set of the proposed fiscal measures

Inflation risks

- The main risks: (1) **the scale of secondary effects of the adopted tax decisions**, (2) external factors

- Moderate risks – estimates are mostly unchanged: (3) consumer and oil price volatility, (4) wage movements, (5) possible changes in consumer behaviour

Decision

The Bank of Russia keeps the key rate at 7.25% p.a.

Signal

"…In making its key rate decisions the Bank of Russia will assess inflation risks, inflation dynamics and economic developments against the forecast. The Bank of Russia considers that monetary policy is highly likely to shift to a neutral stance in 2019…"
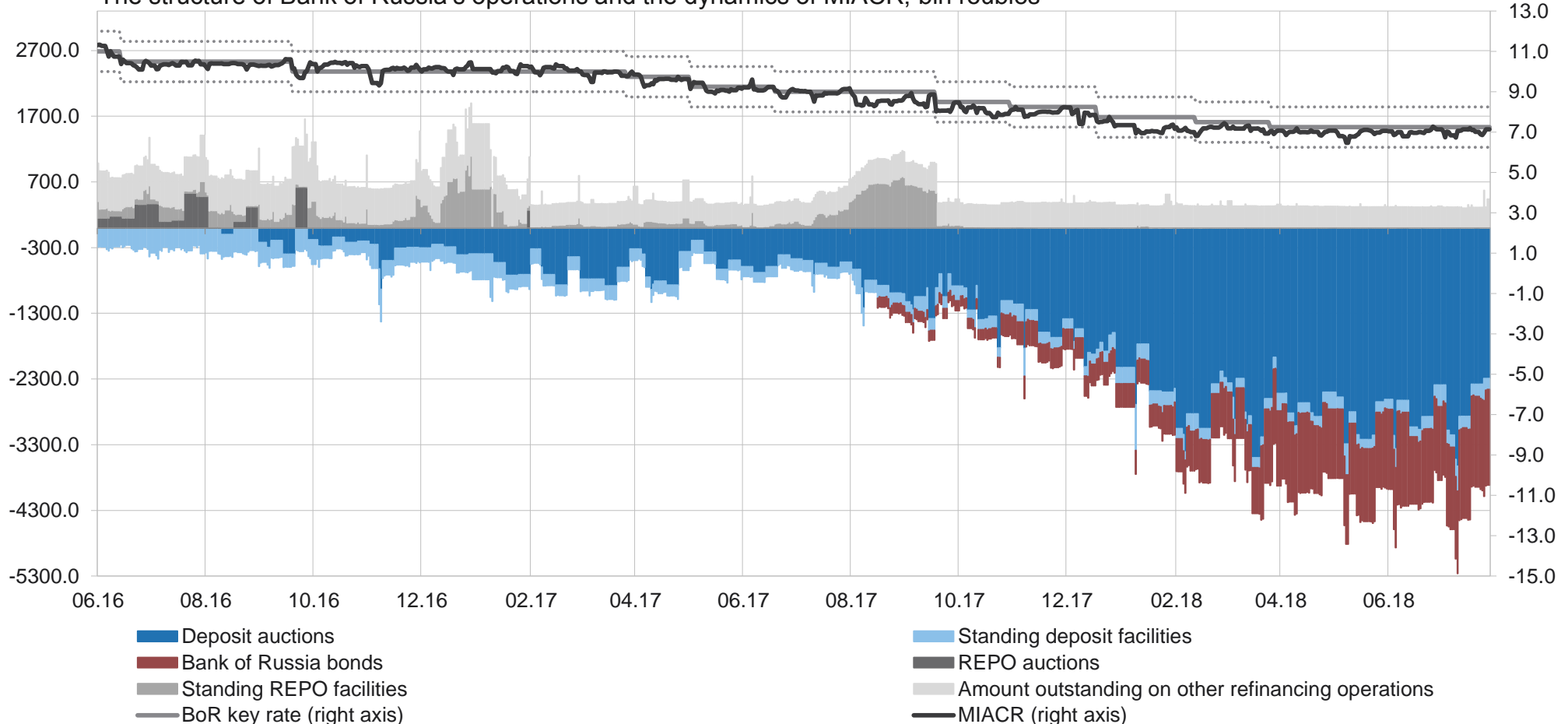
APPENDIX

Amid Structural Liquidity Surplus the Bank of Russia Mostly Conducts Deposit Auctions, With Bank of Russia Bonds (OBR) Being Issued Since August 2017

The structure of Bank of Russia's operations and the dynamics of MIACR, bln roubles

Deposit auctions
Bank of Russia bonds
Standing REPO facilities
BoR key rate (right axis)

Standing deposit facilities
REPO auctions
Amount outstanding on other refinancing operations
MIACR (right axis)

Source: Bank of Russia