Bank of Russia
The Central Bank of the Russian Federation

No. 1
March 2015

Information and Analytical Review

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 on the basis of data as of 5 March 2015.
Data cut-off date for forecast calculations is 5 March 2015.

An electronic version of the information and analytical report 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

During the period following the publication of the previous Monetary Policy Report, the situation in the Russian economy has changed considerably leading to the revision of the Bank of Russia forecast of macroeconomic development and conditioning the decisions taken.

In mid-December 2014 external conditions continued to deteriorate. The fall in oil prices was accompanied by downward revision of their further dynamics by international organisations and market participants. Amid restricted access to international capital markets, companies showed increased demand for foreign currency in the domestic market to redeem foreign debts. As a result, continuing weakening of the ruble led to considerable growth in depreciation expectations, higher households' demand for foreign currency, and increased deposit dollarisation. Inflation expectations rose and a threat of considerable further acceleration of consumer price growth emerged. Under these conditions, the unscheduled meeting of the Bank of Russia Board of Directors decided to raise the key rate from 10.5% to 17.0% from 16 December 2014. In addition to this, on 17 December 2014, a set of measures aimed at sustaining stability of the financial sector was adopted. Besides, the Bank of Russia expanded the set of refinancing instruments in foreign currency, increased the frequency of these operations and their allotment amount.

The taken decisions prevented the outflow of funds from ruble denominated household deposits, improved the situation in the domestic foreign exchange market, and decreased volatility of the national currency exchange rate. As a result depreciation and inflation expectations stabilised to the extent the Bank of Russia had expected.

In early 2015, the balance of risks of accelerated consumer price growth and lower economic activity shifted towards more considerable economy cooling. Under these conditions, the Bank of Russia has cut the key rate twice, on 30 January 2015 and 13 March 2015 by the total of 3 percentage points to 14.0% p.a. As inflation risks weaken, the Bank of Russia will further reduce the key rate.

The risks of further considerable economy cooling increased due to the ongoing oil price decrease. According to the Bank of Russia forecast, years 2015-2016 will see an output contraction amid consistently low oil prices averaging $50-55 per barrel in 2015 and $60-65 per barrel in 2016. Amid high prices for imported investment goods, deteriorated financial results of companies, restricted access to international capital markets, and tighter lending conditions, fixed capital investments will continue to contract. The labour market will adjust to the new conditions primarily through wage reduction and part-time employment, alongside with slowdown in retail lending growth rates it will result in further decrease in consumer activity. Exchange rate dynamics will facilitate exports to some extent and together with weak domestic demand will lead to import contraction. As a result, net export contribution to GDP growth will be positive. According to the Bank of Russia forecast, output will contract by 3.5-4.0% in 2015 and by 1.0-1.6% in 2016. The economic activity is expected to recover in 2017 facilitated by oil price growth to the average of $70-75 per barrel, development of import substituting industries, gradual diversification of funding sources, and easing of domestic lending conditions. According to the Bank of Russia forecast, GDP growth rate in 2017 is expected to be 5.5-6.3%.

Considerable rise in annual inflation observed in December 2014 – February 2015 was expectable and reflected the impact of restrictions of certain food imports imposed in August 2014 on prices and the effect of accelerated price adjustment to ruble depreciation. This phenomenon is temporal. Under the impact of one-off factors and considering the low base effect, the annual inflation will continue to grow, peaking in 2015 Q2, however it will then gradually slow down. The decline in monthly consumer price growth that began in February 2015 will persist. Weak economic activity will facilitate lower inflation and inflation expectations. The slowdown in money supply growth will also exert counter-inflationary effect. The current

monetary policy will provide for a slowdown in consumer price growth to the level of about 9% in March 2016, and to the target level of 4% in 2017.

Meanwhile, the main source of uncertainty for the forecast is oil price dynamics. Its further decline will lead to more serious economic downturn in 2015. Besides, there are risks of accelerated consumer price growth connected with persistently high inflation expectations, revised plans of administered price and tariff increase, fiscal policy easing, and possible acceleration of nominal wage growth. In case these risks materialise, Bank of Russia decisions will depend on their impact on the economic activity and consumer price dynamics.

1. MACROECONOMIC CONDITIONS

1.1. External economic conditions and balance of payments

External economic conditions continue to be unfavourable for Russia and are still having a moderating impact on the Russian economy both on account of a decrease in export income and a reduction in opportunities to attract external financing. The growth in the aggregate GDP of Russia's trading partners is expected to accelerate in 2015 compared with 2014, however, growth rates will be lower than forecast in the previous quarter.

Nevertheless, a further decline in external economic conditions is not expected. Yields on Russian Eurobonds are already considerably exceeding the yields of securities issued by countries with similar credit ratings. They are unlikely to increase more. There are also signs pointing to a stabilisation of oil prices. The majority of market participants do not expect prices to drop further. The uneven economic growth around the world has led to the misalignment of monetary policy cycles in various countries: while the majority of central banks continue to relax their monetary policy, the US Federal Reserve System (Fed) and the Bank of England are preparing to tighten their policies. Expectations that the key rate in the US would rise contributed to the strengthening of the US dollar against the majority of currencies since 2014 Q3, which, together with the increase in surplus supply and weak demand, was a factor underlying the fall in commodity prices in the global market. The decline in global energy and food prices in turn led to the weakening of inflationary pressure among a significant number of Russia's trading partners. However, the potential positive impact on the Russian economy driven by an increase in economic growth rates and a fall in inflation in Russia's trading partners will be limited by factors specific to Russia, such as the food embargo and the financial sanctions against Russian companies and banks.

Economic activity and inflation abroad

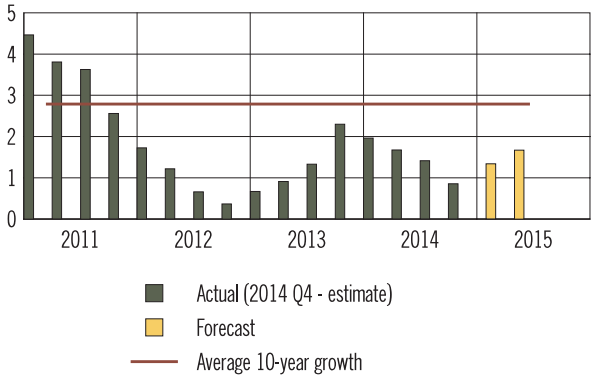
Leading business activity indicators point to continuing low growth in the global economy in 2015 Q1. Indeed, the manufacturing PMI fell both in advanced and emerging market economies, with the most significant decreases seen in Canada, South Africa, and Russia.

The International Monetary Fund's (IMF) forecast for the global economy's growth rates in 2015–2016 was revised downward in January to 3.5% and 3.7% respectively (in October, the forecasts were 3.8% and 4.0%).

Growth in the global economy continues to be uneven. According to IMF forecasts, the GDP growth of developed countries will increase from 1.8% in 2014 to 2.4% in 2015–2016. The economies of the US and the United Kingdom continue to grow steadily amid a further recovery in consumer spending and the improving situation in the labour market, while in the euro area deflationary processes are intensifying and Japan barely managed to avoid a recession at the end of 2014.

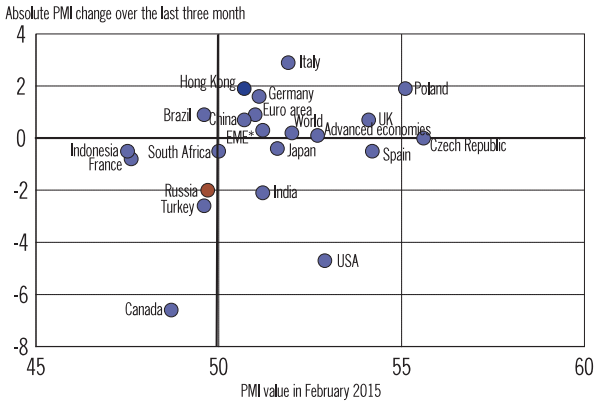
Emerging market economies saw economic growth slowdown in line with IMF forecasts from 4.4% in 2014 to 4.3% in 2015 due to increased

Aggregate GDP of Russia's trading partners (as % of corresponding quarter of previous year)



Note: Bank of Russia projections are prepared with consideration of outlooks published by the IMF, World Bank, OECD, European Commission, Asian Development Bank, national central banks, and consensus forecasts produced by Consensus Economics, Bloomberg, and Thomson Reuters.
Sources: national statistics agencies, Eurostat, Bank of Russia calculations and projections.

Changes in business indicators



** EME - emerging market economies.*
Note: PMI indices in manufacturing industries, and PMI of HSBC in China. Data for the world as a whole are calculated by J.P.Morgan based on the data for the USA, Japan, Germany, Spain, Italy, France, BRICS nations, Australia, Mexico, etc.
Sources: Bloomberg, Bank of Russia calculations.

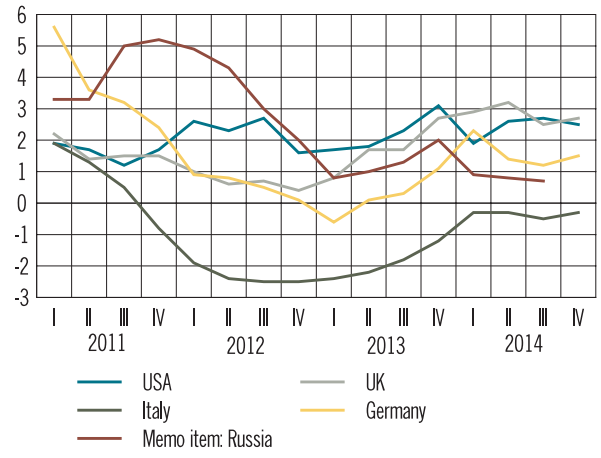
volatility in the global financial markets and the restraining influence of low economic activity in trading partner countries. However, growth will accelerate to 4.7% in 2016. One of the main factors underpinning growth in the economies of oil-importing nations will be low energy prices, which encourage consumer spending and contribute to a reduction in production costs. At the same time, growth in oil-exporting nations will, in contrast, be held back if exported commodity prices remain low.

The CIS countries' economic outlook is also deteriorating. In addition to factors affecting all emerging market economies, the CIS countries are being negatively impacted by low economic growth rates in Russia, deepening recession in Ukraine, and low global oil prices.

In the coming quarters, the Bank of Russia expects economic growth to increase globally on the whole and in Russia's trading partners in particular. This will be buoyed, among other things, by the accommodative measures introduced by the central banks of the world's largest economies (euro area, Japan, and China). At the same time, GDP growth in Russia's trading partners will remain low, while the risks that the situation will deteriorate due to the unfavourable external environment and the impact of structural restrictions continue to be high. More detailed information on the Bank of Russia's GDP growth expectations for Russia's trading partners is provided in the annex.

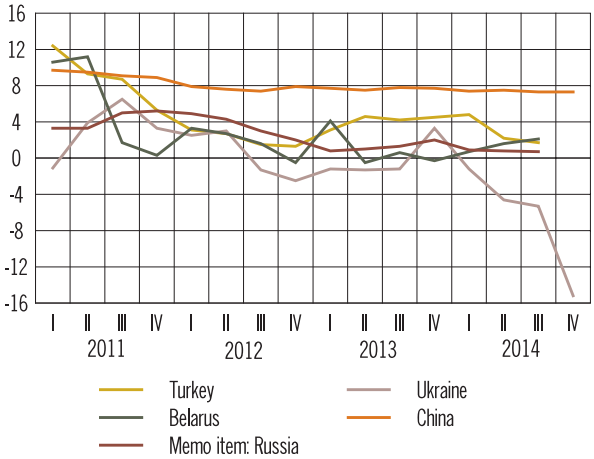
Overall, in December 2014–January 2015, inflation slowed among Russia's trading partners, excluding the CIS countries where, in contrast, inflation accelerated. In January 2015, the majority of European countries witnessed deflation. In Asian countries (China, South Korea, and Japan) and the US, annual inflation growth over this period also fell. These changes were primarily due to decreased global food and energy prices and poor economic growth in a number of regions around the world. However, in some countries inflation has begun to accelerate in recent months. For instance, in Brazil annual price growth was markedly higher than the target level. Belarus and Ukraine also saw a significant acceleration in inflation, caused primarily by the depreciation of their national currencies. A further factor affecting the increase in inflation rates in Ukraine was the indexation of administered tariffs.

GDP growth rates of Russia's trading partners: developed economies (as % of corresponding quarter of previous year)



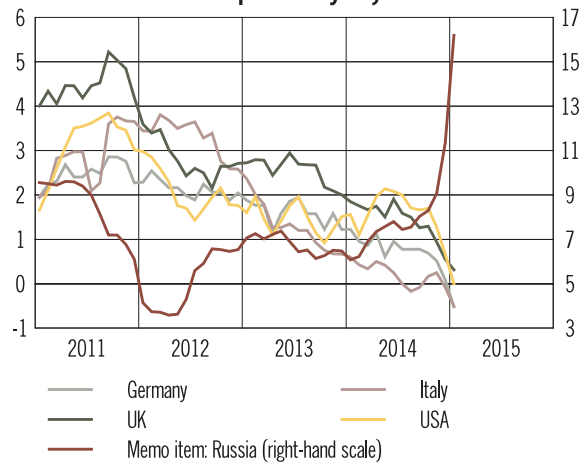
Sources: national statistics agencies, Eurostat.

GDP growth rates of Russia's trading partners: emerging economies (as % of corresponding quarter of previous year)



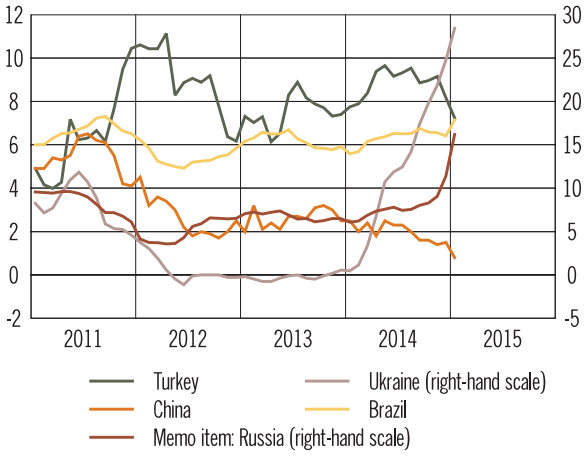
Sources: national statistics agencies.

Inflation in Russia's trading partners: developed economies (as % of corresponding period of previous year)



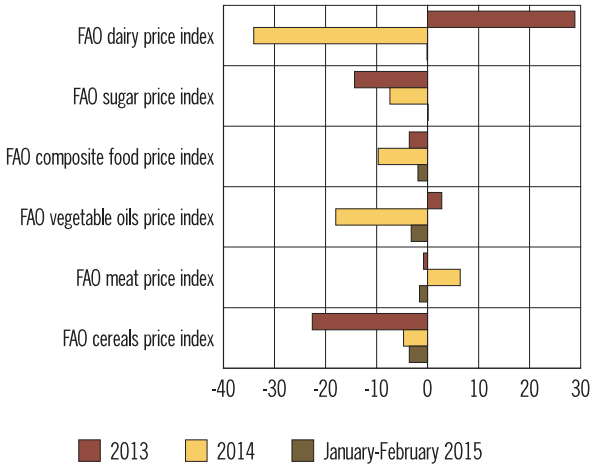
Sources: national statistics agencies, Eurostat.

Inflation in Russia's trading partners: emerging market economies (as % of corresponding period of previous year)



Sources: national statistics agencies.

Global food prices (%)*



** Last month value to last December value.*
Source: FAO.

Changes in global food prices also point to a fall in external inflationary pressure. Global food prices were lower on average in December 2014–January 2015 than in September–November 2014. Increased food production amid poor growth in demand and the global economy's uncertain recovery exerted pressure on prices. The United Nations' Food and Agriculture Organisation's (FAO) food price index decreased over this period by 4.1%. During the coming quarters, amid the growth in global supply and expectations held by the majority of market participants that harvests of cereals will be favourable, the prices are likely to continue sliding down in the world food market.

However, for Russia, the overall fall in external inflationary pressure is offset by the embargo on the imports of a number of food products from several countries. In addition, the drastic drop in the ruble exchange rate is negatively affecting price levels in the country. This factor's influence on domestic prices is expected to linger in the short run, but will diminish as Russian production output grows and supplies increase from those countries not affected by the restrictions.

External financial conditions

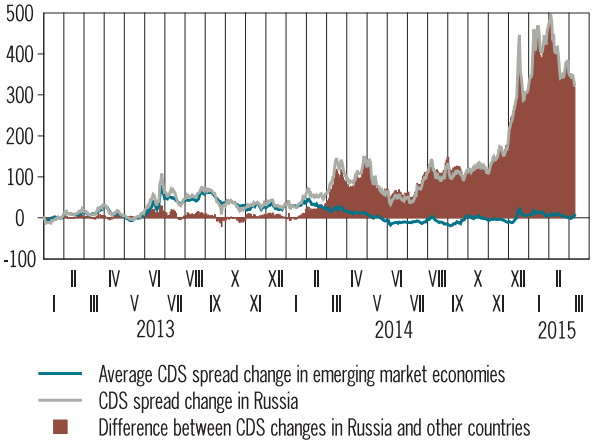
The slowdown in inflation and low economic growth rates observed in a number of regions around the world are forcing key central banks to maintain a loose monetary policy. The European Central Bank's (ECB) announcement of the launch of a quantitative easing programme was a key monetary policy event in the period under consideration. In March, the European regulator will start buying up the sovereign bonds of euro area countries and several European organisations. The total value of the programme (including the previously made purchases of covered bonds and asset-backed securities) will be 60 billion euros per month, and assets will continue to be acquired until at least September 2016. The ECB's measures are aimed at keeping inflation rates close to the target level of 2%. These efforts are expected to contribute to a reduction in the euro exchange rate relative to the US dollar and acceleration in economic growth in the euro area.

In December 2014–January 2015, the majority of central banks continued to implement

Weighted average monetary policy rate of emerging market economies (%)

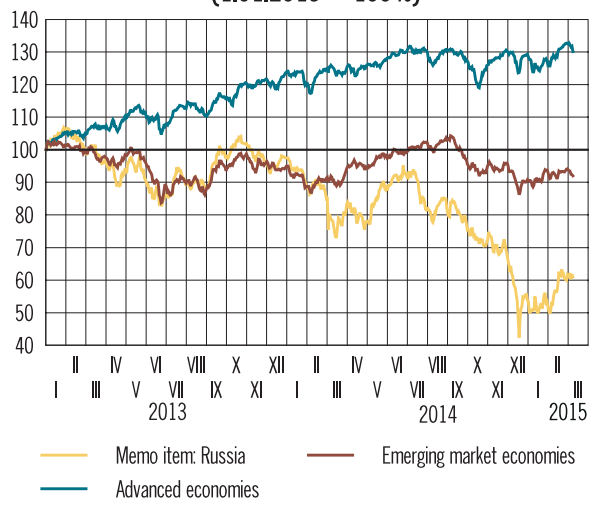
Note: values of central bank assets were used as weights to calculate the average rate; March data as of 6 March 2015.
Sources: Bloomberg, IMF, central banks, Bank of Russia calculations.

Change of risk premium in Russia and emerging market economies from 1 January 2013 (basis points)



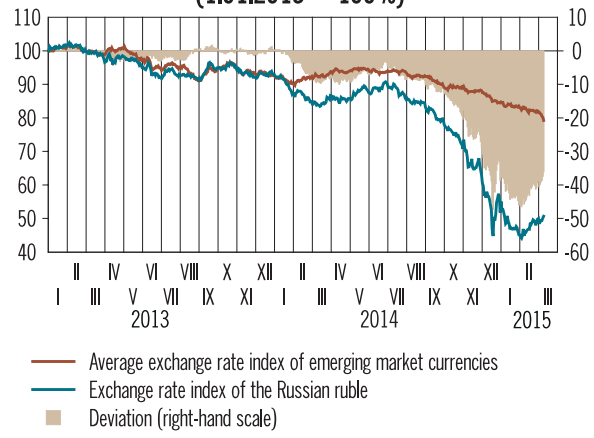
Note: average CDS spread for emerging market economies is based on the data for Brazil, China, Turkey, Mexico, Malaysia, Poland, Hungary, etc.
Sources: Bloomberg, Bank of Russia calculations.

Global stock indices MSCI (1.01.2013 = 100%)



Source: Bloomberg.

Exchange rate indices against the US dollar (1.01.2013 = 100%)



Note: average exchange rate index of emerging market currencies is a geometric average of the exchange rates against the US dollar of Hungarian forint, Brazilian real, Turkish lira, Mexican peso, Polish zloty, Romanian leu, Malaysian ringgit, Philippine peso, Indonesian rupiah and Indian rupee.
Sources: Bloomberg, Bank of Russia calculations.

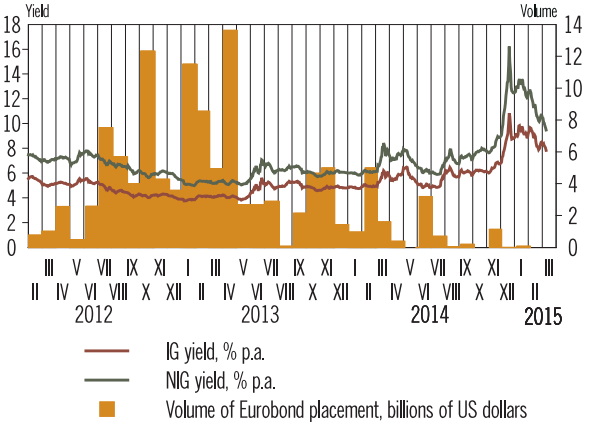
accommodative monetary policy measures. The main reasons for these actions are the fall in inflation in developed countries, caused specifically by low energy prices, and the slowdown in economic growth in emerging market economies. Since early December, a large number of central banks have decided to cut their rates. In particular, this measure was implemented in Australia, India, Indonesia, Canada, China, Turkey, and Sweden. For the first time since mid-2012, the People's Bank of China reduced its required reserves, alongside the second decrease in rates in the last four months.

Market participants' expectations regarding the policies of the Fed have also changed. Amid weakening global economic growth and contradictory US statistics, the regulator may make the cycle of increasing rates more gradual or put off the decision to raise rates until 2015 Q3.

The extremely loose policies of key central banks kept interest rates low in the global financial market. Despite this, widening spreads between the sovereign bond yields of emerging market economies and the yields of risk-free assets point to the steady tightening of financial conditions for these countries; amid high levels of uncertainty, investors are showing a preference for more reliable assets.

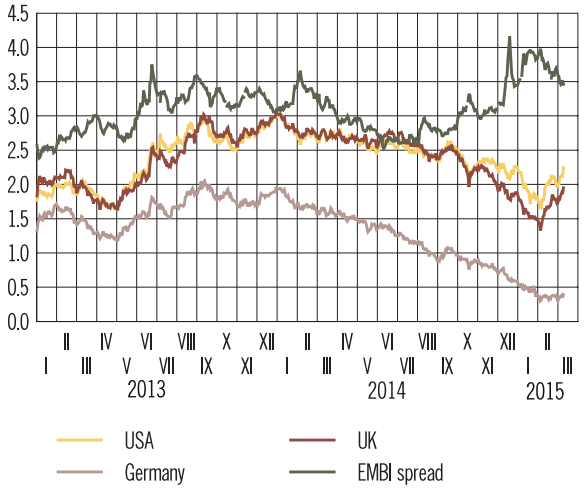
Global stock indices mainly fell in December 2014 and the first half of January 2015 against the backdrop of weak statistics for the euro area and certain Asian countries, but the ECB's decision to start the quantitative easing programme stimulated

Effective yield and volume of placement of Russian corporate Eurobonds



Note: yield and duration for IG and NIG are calculated on the basis of indexed portfolio of Eurobonds with investment-grade and upper non-investment grade ratings respectively.
Source: information agency Cbonds.ru.

10-year developed economies' government bond yields, emerging markets bond index (EMBI) spread (%)



Source: Bloomberg.

market growth. As a result, over the period under consideration, the MSCI world index increased by 0.5%. Moreover, the MSCI index for advanced economies rose by 0.7%, but it dropped by 1.4% for emerging market economies. Indicators of global investors' risk perception over the same period changed negligibly and global market volatility stayed high.

Financial conditions for Russia deteriorated significantly, with external capital markets remaining virtually inaccessible to Russian borrowers. The main factors underlying the fall in investor demand for Russian assets over the period under review were low oil prices, expectations that Russia's sovereign credit rating would be downgraded by international ratings agencies, excess volatility in the foreign exchange market, and the complex external political situation. However, the actual downgrading of Russia's sovereign credit rating did not have a significant impact on the situation, because by the time of its revision it had already been factored in into the prices of Russian assets by market participants.

As a result, in December 2014–February 2015, 5-year CDS spreads on Russian government bonds increased from 345 to 480 bp, the ruble-US dollar exchange rate fell by 20%, and Russian issuers' Eurobond yields rose amid small placement volumes.

Moreover, the market climate improved somewhat in February: the CDS spread and Eurobond yields fell, while the Russian ruble was the currency that appreciated the most (by 12%) relative to the US dollar. Increased oil prices and relaxed tensions in Eastern Ukraine after the signing of the Minsk Protocol played a key role in stabilising the situation.

Nevertheless, in view of low oil prices, sanctions, and foreign economic uncertainty, external financial conditions will continue to be unfavourable for Russia for the next few quarters at least.

Terms of trade

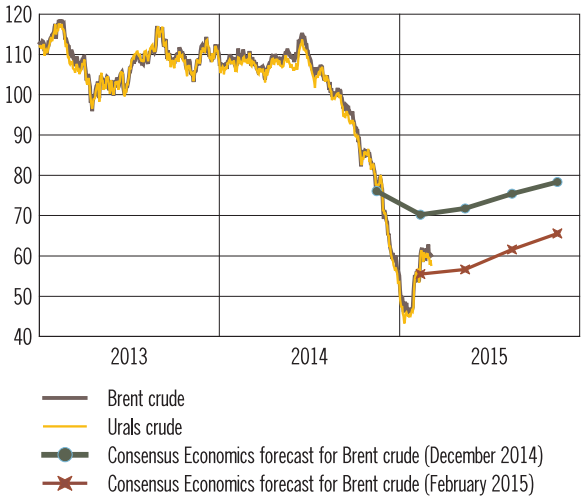
December 2014–February 2015 saw a fall in global prices for Russia's main exports, which deteriorated the terms of trade.

The price of Urals crude fell from $87.3 per barrel on average for September–November 2014 to $55.1 per barrel for December 2014–February 2015. However, after a seven-month downslide, in February 2015 oil prices rose to $57.9 per barrel.

The downward pressure on oil prices came from factors such as the high level of oil inventories in developed countries, excess supply due to rapid expansion of oil production in non-OPEC (Organisation of the Petroleum Exporting Countries) members, including from unconventional sources, weak growth in global demand, and OPEC's aversion to reduce production quotas. Additional factors behind the drop in oil prices were discounts offered by certain OPEC member states to buyers and the appreciation of the US dollar against most currencies.

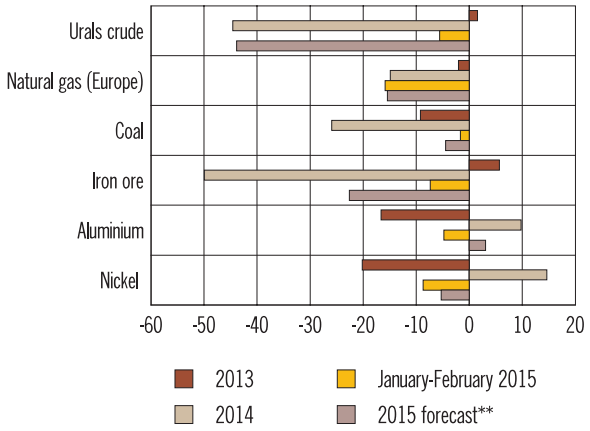
The price growth in February was linked to expectations that balance in the global oil market

Global oil prices (US dollars per barrel)



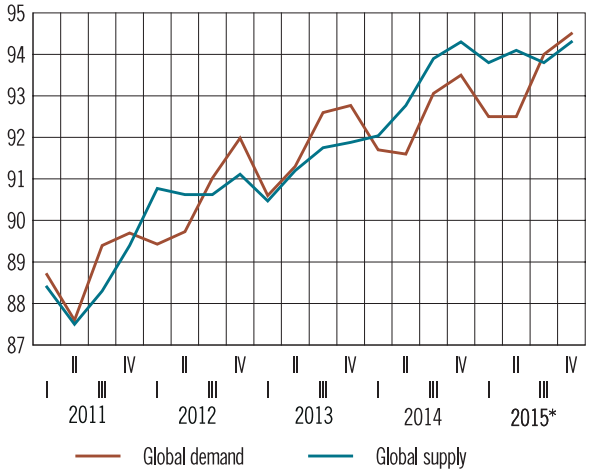
Sources: Reuters, Consensus Economics.

World prices of Russian principal export commodities (%)*



** Last month average for the period to last December average.*
*** 2015 forecast to 2014 average.*
Sources: World Bank, for oil - Reuters data and Bank of Russia forecast.

Global oil supply and demand (millions of barrels per day)



** Forecast.*
Source: International Energy Agency.

would be restored due to falling supplies, as the number of drilling rigs declines in the US, oil companies' investment in oilfield development falls, and oil production in Libya contracts following the closure of key oil ports because of the armed conflict.

According to International Energy Agency forecasts, in the first half of 2015 the global oil market will continue to be saturated by excess supply. The closure of unprofitable production facilities and the decline in investment will reduce supply no sooner than in the second half of 2015. Falling demand caused by repairs and strikes at US oil refineries could also contribute to continued surplus of oil supplies in the global market.

The majority of market participants expect oil prices to increase in the future as the situation in the market normalises following a reduction in supply levels after unprofitable projects are frozen or closed, and demand recovers driven by acceleration in global economic growth. However, the risks of increasing oil surplus will persist if the ban on crude oil exports from the US is fully lifted and restrictions on oil import from Iran are relaxed.

The price of natural gas in the European market dropped amid falling demand from European countries and high inventories. International organisations expect gas to become cheaper in 2015 as a result of adjustments in contract prices linked to oil prices and weak demand in the European market.

Global coal and metal prices also fell given slowing growth in demand from China, high inventory levels, and the US dollar appreciation. In 2015, coal and metals will continue to fall in price if these factors stay on.

Balance of payments and exchange rate

The increase in the current account surplus in 2014 Q4 and over 2014 as a whole came about largely due to a decline in the investment income deficit linked to decreased spending on servicing the small external debt. However, there was a significant reduction in goods imports and exports.

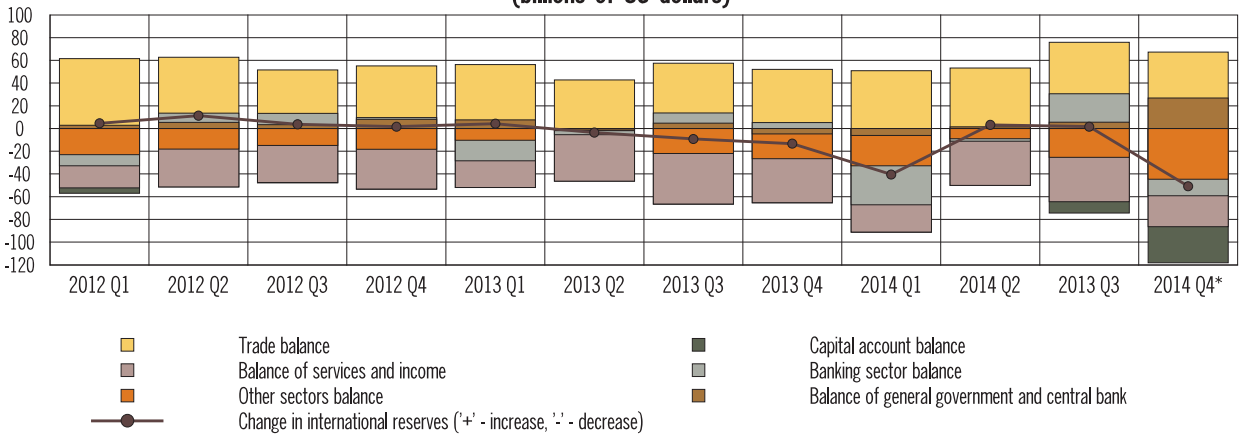
The fall in exports was driven both by the drop in global oil and gas prices and the reduction in their physical quantities sold in external markets. Despite the increase in oil production, the actual quantities of crude oil exports from Russia have dropped for the fourth year in a row (in 2014, exports fell by 5.6% to 223.4 million tonnes), while the quantities of crude oil processed in Russia are growing. At the same time, supplies of oil products to the global market are increasing (in 2014, exports rose by 8.8% to 164.8 million tonnes). The 12.1% drop in actual natural gas export quantities in 2014 occurred due to suspended gas supplies to Ukraine from 16 June 2014 until 31 October 2014, when Russia, Ukraine, and the European Union (EU) signed an agreement on the resumption of Russian gas supplies to Ukraine and Ukraine's repayment of its debt for gas.

The decline in imports in 2014 compared with 2013 was brought about by the cooling of the Russian economy, the depreciation of the ruble, and the bans on importing certain types of products into Russia, which were introduced over the course of the year. Total imports in December 2014 fell by $7.1 billion year on year. The biggest contributor to the decrease in exports was the reduction in the supplies of machinery, equipment, and transport vehicles (imports for these goods categories fell by $3.6 billion, accounting for 51.4% of the overall drop in imports). The food embargo introduced by Russia in August 2014 was not a major driver of the sharp reduction in total imports: in December 2014, imports of food affected by the embargo fell by $0.9 billion year on year, which accounted for 12.1% of the overall reduction in imports. However, the restrictions on importing certain types of products from a number of countries had a significant impact on food imports. Imports of food products and agricultural raw materials dropped by 28.4% in December 2014 compared with December 2013, and over 2014 as a whole they dropped by 7.8%, entirely as a result of products affected by the embargo.

The net private capital outflow increased to record levels in 2014 Q4, reaching an all-time high by the end of 2014. The main factor behind the intensifying capital outflow in 2014 Q4 was the repayment of companies and banks' external debt given the reduced opportunities for refinancing debt because of EU and US financial sanctions. In 2014 Q4, private sector external debt fell by $66.9 billion, and over 2014 as a whole by $103.6 billion to $547.6 billion.

The increasing capital outflow was caused both by a reduction in foreign liabilities and growth in foreign assets, chiefly in other sectors. A significant proportion of the growth in other sectors' foreign assets came about as a result of two main factors: direct investment abroad and an increase in household cash balances in foreign currency. Meanwhile, the volume of fictitious transactions decreased threefold in 2014. The increase in banks' foreign assets in view of the significant reduction in external resources partly occurred due to the Bank of Russia providing these organisations with foreign currency liquidity.

Major balance of payments components (billions of US dollars)

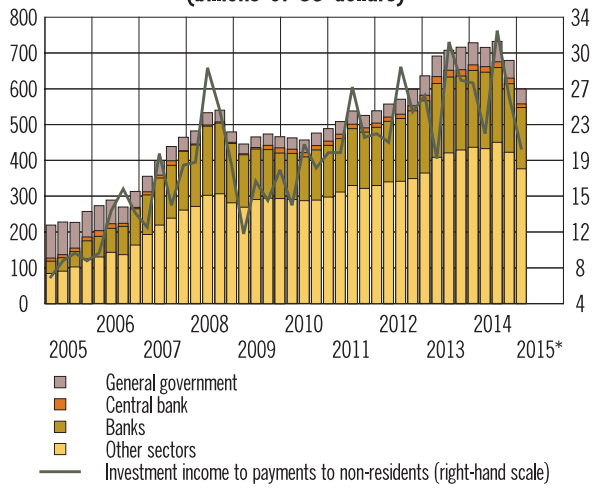


** Estimate.*

Note: items 'Banking sector balance' and 'Change in international reserves' are adjusted by the amount of FX swaps of the Bank of Russia with resident banks, operations on resident banks' correspondent accounts with the Bank of Russia and funds provided by the Bank of Russia to resident banks in foreign currency on a reverse basis; item 'Other sectors balance' includes item 'Net errors and omissions'.

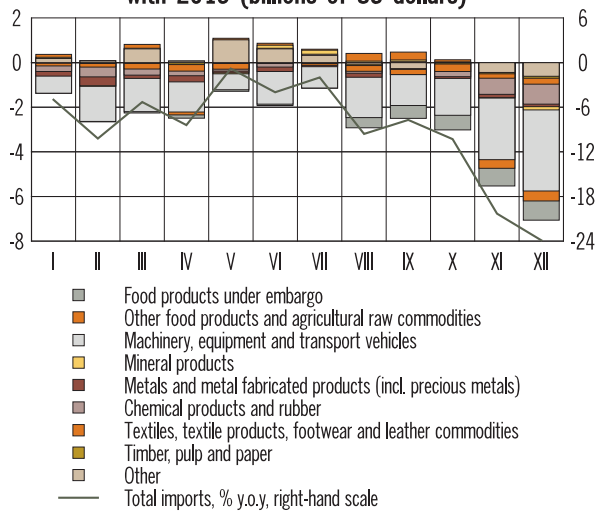
Source: Bank of Russia.

External debt of the Russian Federation (billions of US dollars)



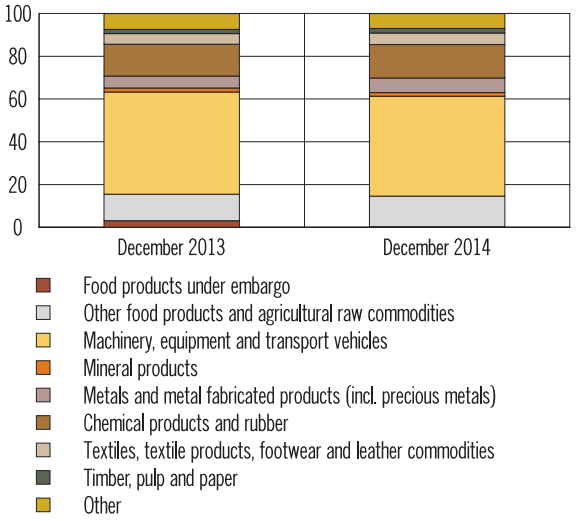
** As of 1.01.2015 - estimate.*
Source: Bank of Russia.

Growth in imports by product type in 2014 compared with 2013 (billions of US dollars)



Source: Federal Customs Service.

Russian imports by product type (%)



Source: Federal Customs Service.

The significant fall in prices for key export goods combined with the need to repay private sector external liabilities and transition to a floating exchange rate regime, has led to a sizeable drop in the ruble rate. Another source of pressure on the ruble was growing expectations of economic agents, including households, that the ruble would depreciate further. This led to a surge in speculative activity in the domestic FX market and triggered precautionary FX cash purchases at the end of 2014.

To smooth out sharp fluctuations in the ruble exchange rate and maintain financial stability, in 2014 the Bank of Russia carried out foreign exchange interventions totalling $87.8 billion. As a result, by the end of 2014 the Russian Federation's international reserves fell to $385.5 billion.

1.2. Financial conditions

The situation in the financial market in December 2014-February 2015 was extremely varied, with the overall trend of tightening financial conditions continuing over this period. The Bank of Russia's substantial increase in its key rate in mid-December led to growth in the cost of borrowing in all market segments, including loans. In February, following a decrease in the key rate and the resulting change in short-term money market rates, prices in the domestic bond money market recovered, and there were signs of bank deposit rates falling and loan rates stabilising. Meanwhile, the tightening of price and non-price lending conditions that has already taken place in the period under consideration, combined with a projected drop in economic activity, will lead to a further fall in annual loan portfolio growth and suppress growth of monetary aggregates. As a result, financial conditions will continue to be strict, contributing to lower inflation in the medium term.

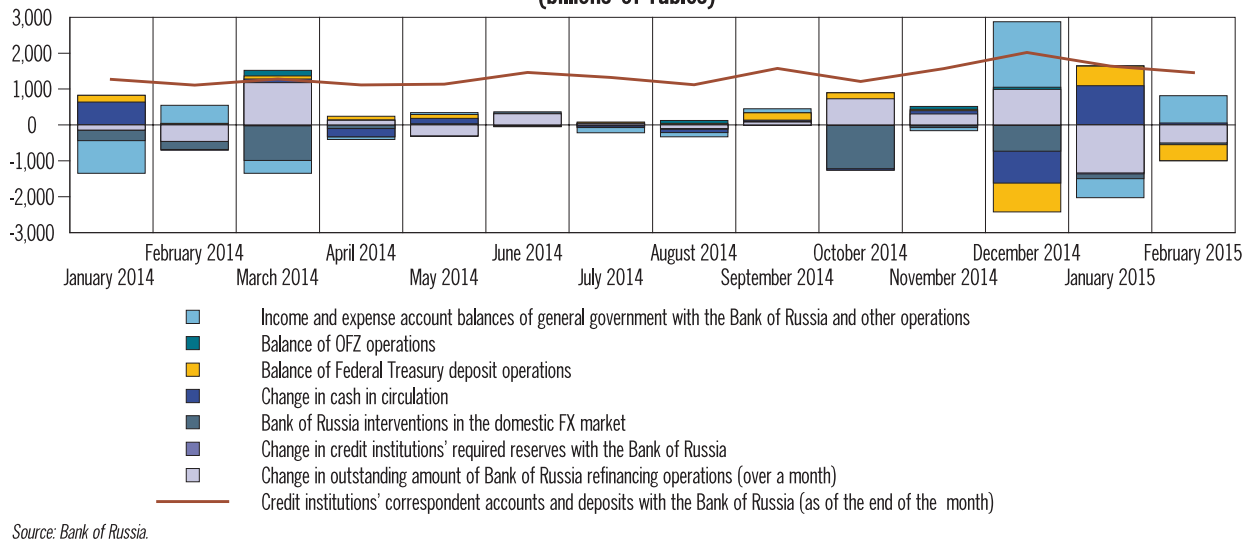
Money market and Bank of Russia banking sector liquidity management

The period from December 2014 to February 2015 was characterised by traditional growth in credit institutions' demand for refinancing at the end of 2014 and a subsequent fall in demand at the start of 2015. These trends, together with the Bank of Russia's decisions to change the key rate, and increased uncertainty in the foreign exchange market in many ways shaped the movement of short-term money market rates.

Higher demand for cash in December 2014, caused both by seasonal factors and a temporary change in consumer behaviour, as well as Bank of Russia interventions in the domestic foreign exchange market in the first half of the month, led to a larger-than-expected outflow of liquidity from the banking sector.

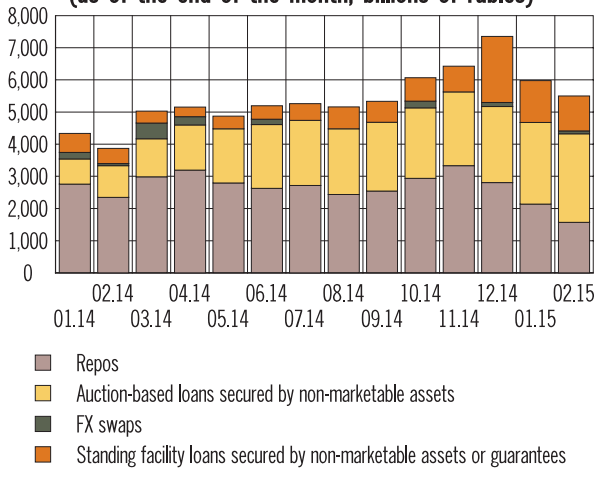
In this environment, the maximum outstanding amounts on Bank of Russia repos reached 3.8 trillion rubles, which was accompanied by higher marketable collateral scarcity of banks and led to significant growth in their demand for standing facility loans secured by non-marketable assets or guarantees. To reduce the impact of these operations on money market rates and to offset local demand for liquidity at the end of December 2014, the Bank of Russia held an auction to provide 3-week loans secured by non-marketable assets, which helped credit institutions receive 0.3 trillion rubles. In December 2014, the Bank of Russia continued to use the conservative approach to determining the volumes of liquidity to be provided to the banking sector through auction-based operations and maximum allotment amounts through FX swap operations to buy US dollars and euros with rubles. Moreover, during the period of increased demand for liquidity, FX swap amounts were adjusted promptly. Thus, at the end of December, the maximum allotment amount

Banking sector liquidity and liquidity factors (billions of rubles)



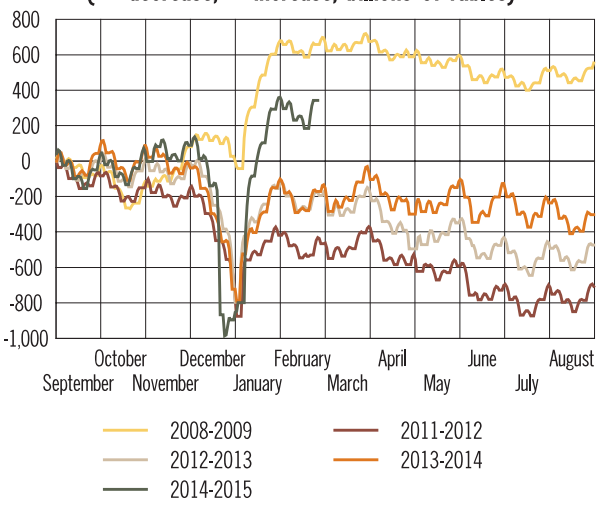
Source: Bank of Russia.

Credit institutions' outstanding amount on Bank of Russia refinancing operations in 2014 - early 2015 (as of the end of the month, billions of rubles)



Source: Bank of Russia.

Cumulative change in cash in circulation ('+' decrease, '-' increase, billions of rubles)



Source: Bank of Russia.

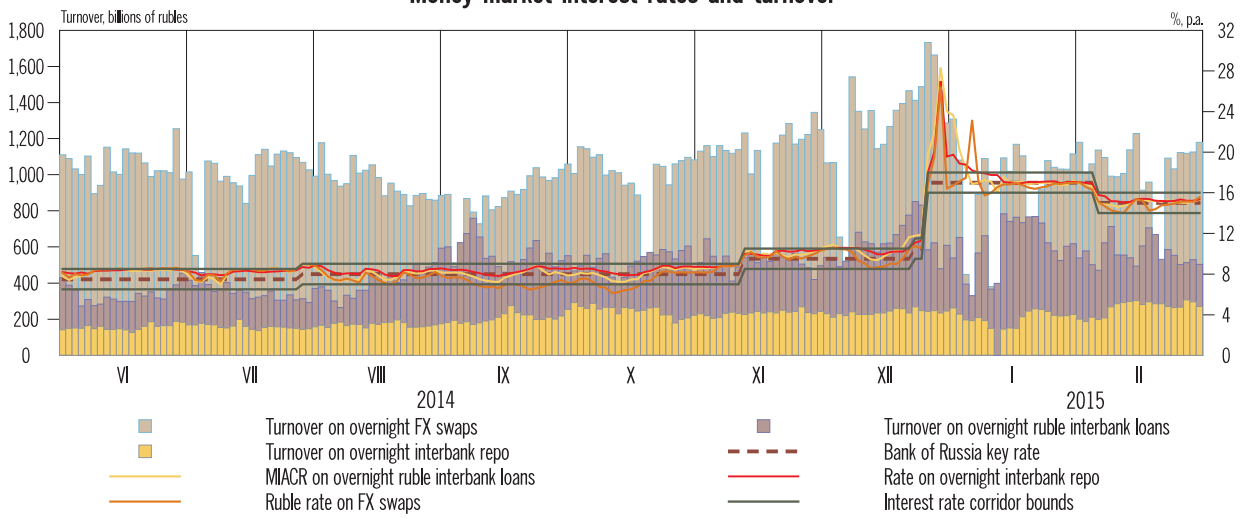
was changed from the equivalent of $2 billion to $10 billion.

Credit institutions' higher demand for refinancing and the exhaustion of accessible marketable collateral at certain banks, together with heightened volatility in the foreign exchange market, led to increased grounds for caution in the money market, reflected in part by growth in credit risks placed by market participants in interbank loan rates. Therefore, the Bank of Russia's hike of its key rate to 17% p.a. in mid-December 2014 was accompanied by a substantially larger short-term rise in interbank overnight rates, peaking at 28% p.a., and an increase in their volatility.

Despite growth in the level and the increased volatility of interbank interest rates in the second and third ten-day period of December 2014, turnovers in the ruble-denominated overnight segment of the money market continued to be high during this period. This can largely be explained by raised borrowing in the money market by credit institutions that lacked available marketable collateral in order to receive funds through Bank of Russia repos.

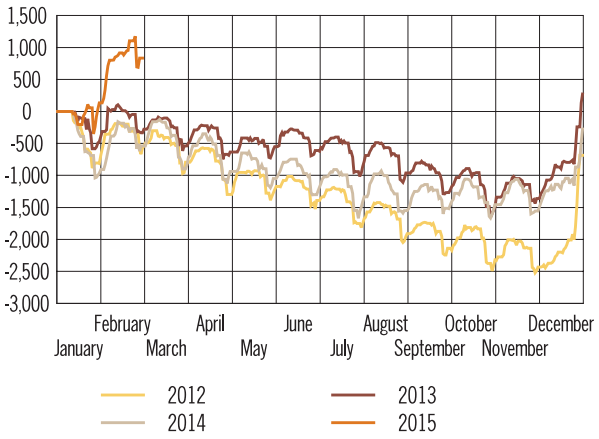
By the end of 2014, the situation in the money market started to stabilise. This was helped by falling volatility in the foreign exchange market and a slight improvement in ruble liquidity amid traditional growth in budget spending during this period. An inflow of liquidity due to changes in general government accounts with the Bank of Russia and other operations created credit institutions's demand for refinancing totalling 7.3 trillion rubles at

Money market interest rates and turnover



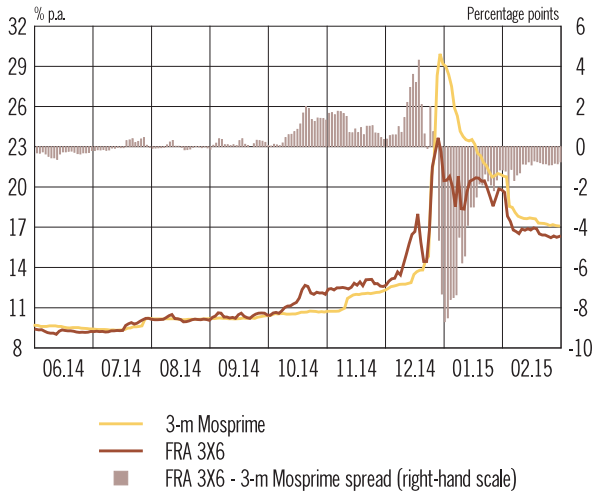
Source: Bank of Russia.

Cumulative change in general government accounts with the Bank of Russia* ('+' decrease, '-' increase, billions of rubles)



** Excluding Federal Treasury deposits at credit institutions and OFZ operations.*
Source: Bank of Russia.

FRA 3X6 - 3-month Mosprime spread



Source: Bank of Russia.

The forecast of banking sector liquidity factors (trillions of rubles)

		2013	2014	2015 [1] (forecast)
Total for liquidity factors	1 = 2 + 3 + 4 + 5	-1.7	-2.5	[-1.2; 0]
of which:				
– change in general government accounts with the Bank of Russia (incl. other operations[2])	2	-0.4	1.3	[1.1; 1.3]
– change in cash in circulation	3	-0.5	-0.3	[-0.2; 0]
– Bank of Russia interventions in the domestic FX market	4	-0.9	-3.5	[-2.2; -1.1][5]
– change in credit institutions' required reserves with the Bank of Russia»	5	0	0	[-0.1; 0.0]
Change in free bank reserves [3]	6	0	0.2	[0; 0.1]
Change in outstanding amount of Bank of Russia refinancing operations	7 = 6 - 1	1.7	2.8	[0; 1.3]
Memo item: outstanding amount of Bank of Russia refinancing operations (as of the end of the year)[4]	8	4.5	7.3	[7.3; 8.6]

[1] January-February 2015 – actual, March-December 2015 – forecast.

[2] Including purchases of monetary gold and interest payments on Bank of Russia operations.

[3] During the forecast period, the demand for free bank reserves is determined on the basis of credit institutions' correspondent account balances with the Bank of Russia (taking into account the averaged amount of required reserves held at correspondent accounts, banks' need to perform settlements and precautionary motives) and the volume of credit institutions' deposits with the Bank of Russia.

[4] Excluding the subordinated loan of Sberbank of Russia and bonds of certain credit institutions in the Bank of Russia portfolio.

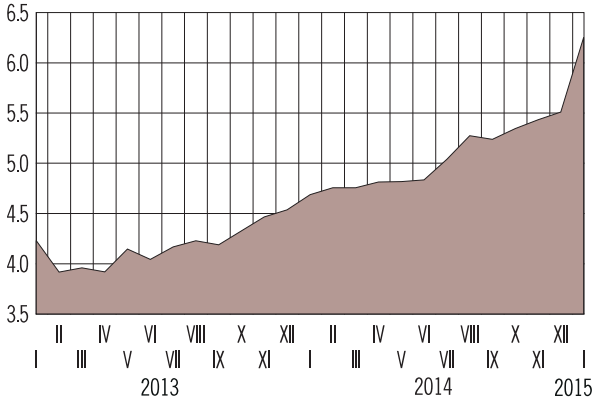
[5] Estimates of volume of Bank of Russia foreign currency sell/buy operations in the domestic FX market due to the operations related to accumulation (expenditure) of sovereign funds in foreign currencies by the Federal Treasury.

the end of 2014, which was in line with the range of values presented in the previous Monetary Policy Report.

In January-February 2015, a seasonal fall in the balances of credit institutions' correspondent accounts with the Bank of Russia and an inflow of liquidity due to a change in factors shaping liquidity contributed to a fall in demand for refinancing among credit institutions. This was largely the result of a drop in cash in circulation caused by the flow of funds from customers to the banking sector, a decrease in cash in bank vaults, and a significant increase in budget spending at the start of the year.

By the end of February 2015, credit institutions' demand for Bank of Russia refinancing dropped to 5.5 trillion rubles, which was also reflected in the decreased value of funds provided through repos. Moreover, the inflow of liquidity to the banking sector allowed credit institutions to partially repay their standing facility loans secured by non-marketable assets or guarantees, which had been provided in December 2014.

Securities held by credit institutions included in the Bank of Russia Lombard list (as of the end of period, trillions of rubles)*



** Including securities pledged as collateral under repos.*
Source: Bank of Russia.

Amid lower demand for liquidity at the start of 2015, the situation in the money market finally normalised. Money market rates responded in kind to the Bank of Russia decision to cut the key rate at the end of January. As a result, overnight interbank rates and repo rates in January-February 2015 were predominantly close to the Bank of Russia key rate.

The high volatility of overnight interest rates was also reflected in the changed term structure of money market interest rates. In December 2014, the spread between the short and long ends of the yield curve (both Mosprime and OIS) widened significantly and subsequently narrowed at the start of 2015. In February 2015, the OIS curve became inverted: the 6-month ROISfix rate was almost 50 bp lower than the Bank of Russia key rate. This indicates that market participants expect a further fall in short-term money market rates and thus in the Bank of Russia key rate. This is also evident from a significant negative spread between FRA 3x6 and effective Mosprime rate.

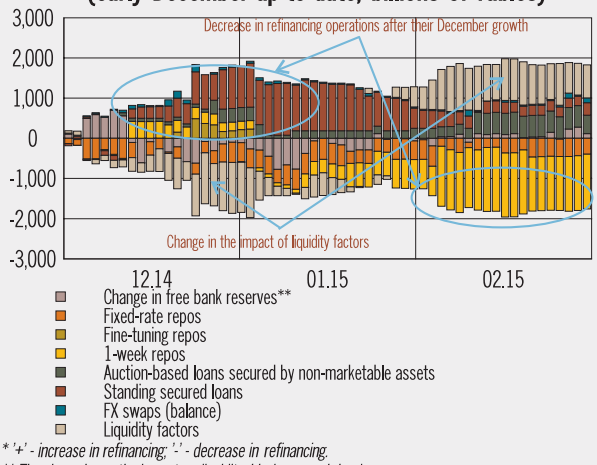
Beginning in March 2015, credit institutions' demand for refinancing is expected to resume its growth. Increased budget spending at the start of the year will allow budget flows to have a more uniform impact on banking sector liquidity over the course of the year. Bank of Russia repos will, as before, play a key role in managing banking sector liquidity, while medium-term demand for liquidity will be regulated by loans to be provided against non-marketable assets on an auction basis. In this regard, the Bank of Russia monetary policy will be geared towards ensuring the conditions are in place to establish money market rates at a level close to the Bank of Russia key rate.

Reasons for lower credit institutions' debt on Bank of Russia repos in January-February 2015

Under the inflation targeting regime, the Bank of Russia's operational goal is to keep short-term money market rates close to the key rate. To achieve this goal, the Bank of Russia manages banking sector liquidity by carrying out operations with credit institutions to supply or absorb liquidity through auctions. The Bank of Russia changes the value of these operations to satisfy banks' objective needs for liquidity and to offset its inflows or outflows caused by factors unrelated to the system of instruments that the Bank of Russia uses to manage liquidity. However, due to a change in the amounts of the Bank of Russia auction-based operations, the monetary policy stance is not changing, because these changes are directly aimed at creating conditions to keep money market rates close to the key rate.

In January-February 2015, the Bank of Russia drastically cut the value of funds provided through repo auctions. While at the end of December 2014 credit institutions' debt to the Bank of Russia under repos was 2.8 trillion rubles, by the end of February 2015 it stood at 1.5 trillion rubles. This was a consequence of increasing liquidity supply through reduced cash in circulation and decreased general government balances with the Bank of Russia in connection with higher budget spending at the start of the year. The total inflow of liquidity as a result of these factors amounted to 1.5 trillion rubles in January-February 2015. Ultimately, a significant increase in liquidity supply was offset by the Bank of Russia by reducing the value of funds supplied through repos. However, the amount of Bank of Russia repos was still sufficient to satisfy credit institutions' demand for liquidity. The behaviour of short-term money market rates, which were close to the Bank of Russia key rate in January-February 2015, and credit institutions' lower demand for standing facilities can be seen as confirmation of this.

Banking sector refinancing structure at end-2014 – early 2015 (early December-up-to-date, billions of rubles)*



** '+' - increase in refinancing; '-' - decrease in refinancing.*
*** The signs shows the impact on liquidity: '-' - increase, '+' - decrease.*
Source: Bank of Russia.

The fall in repo volumes in January-February 2015 was caused not only by growth in liquidity supply through other channels, but also a seasonal[1] decline in credit institutions' demand for liquidity (correspondent account balances with the Bank of Russia). Credit institutions' demand for liquidity stems from their need for funding to make reserves averaging and to effect interbank and customer payments and settlements. Thus, the amount of bank funds in correspondent accounts can change over the averaging period, including the current level of money market rates taken into account. However, in the medium term, credit institutions' demand for liquidity and Bank of Russia refinancing operations does not depend on rates on these operations, as the need to make averaging and settlements does not let banks reduce the amount of funds in correspondent accounts with the Bank of Russia significantly or for an extended period. At the same time, given the structural liquidity deficit, credit institutions do not have any incentive to keep excess funds in correspondent accounts with the Bank of Russia, because banks have an alternative to reduce their debts on Bank of Russia refinancing operations or invest funds in the money market.

[1] *At the end of the calendar year, credit institutions' correspondent account balances with the Bank of Russia increased due to an inflow of liquidity as a result of budget spending and banks forming a "stock" of liquidity to make settlements in the long holiday period.*

Foreign exchange market and Bank of Russia foreign currency liquidity provision

Trends in the ruble segment of the money market were shaped by the lingering dollar liquidity deficit that emerged in the second half of 2014 as a result of external financial sanctions introduced against a number of major Russian banks and companies. As the amount of foreign currency provided by the Bank of Russia through FX repos increased, the foreign currency liquidity situation improved: the overnight basis[1] in the money market in January-February 2015 shrank to –23 bp on average (in August-December 2014, it was roughly –50 bp). In the segment for longer-term operations, there were also signs of a reduction in the foreign currency deficit: by the end of February 2015, the USD/RUB Basis Swap 1Y1 value stood at around –150 bp, which was in line with the level at the start of the period when the foreign currency liquidity deficit was formed (August 2014).

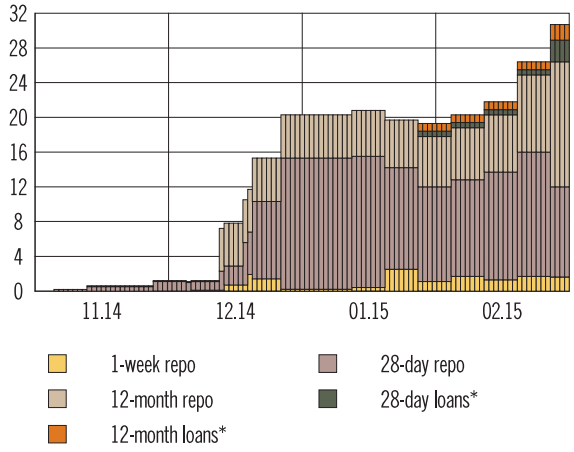
The Bank of Russia will continue to provide credit institutions with foreign currency liquidity on a reverse basis. The value of these operations will be estimated taking account of banking and non-financial sector demand for foreign currency based on projected major components of the balance of payments and the aim of ensuring financial stability.

In December 2014-February 2015, the exchange rate was shaped by its growing dependency on changes in oil prices and on-going geopolitical factors.

For example, increased volatility in the exchange rate of the ruble and its significant depreciation in December 2014 could largely be explained by a sharp fall in oil prices at the end of November and in the first half of December and growing demand for foreign currency among

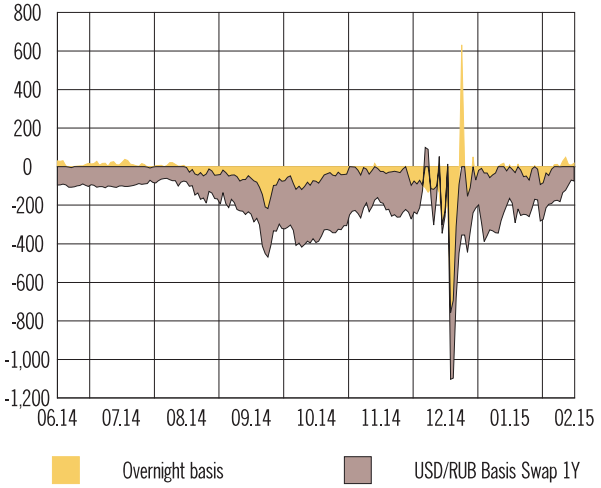
[1] *Overnight basis is the spread between the implied ruble rate on overnight FX swap operations and the rate on overnight ruble-denominated interbank loans. Negative overnight basis values reflect a positive premium compared with the London Interbank Offered Rate (LIBOR), which Russian banks pay for overnight foreign currency liquidity. The USD/RUB Basis Swap 1Y reflects a similar premium for one-year loans.*

Credit institutions' debt to the Bank of Russia under refinancing FX instruments (billions of US dollars)



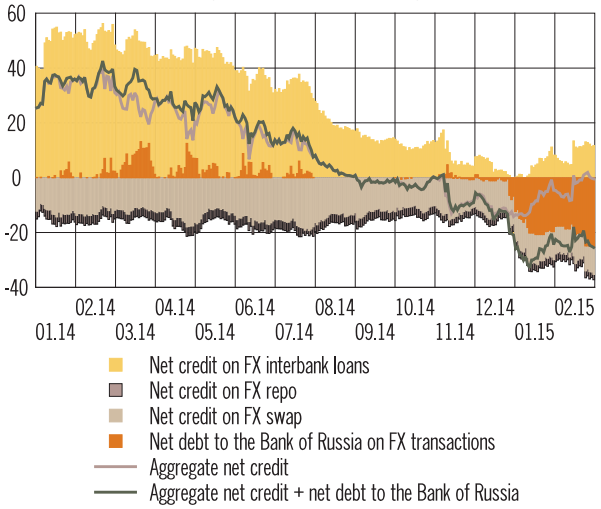
** Bank of Russia US dollar loans secured by the pledge of claim on US dollar loans.*
Source: Bank of Russia.

USD/RUB Basis Swap 1Y and overnight basis (basis points)



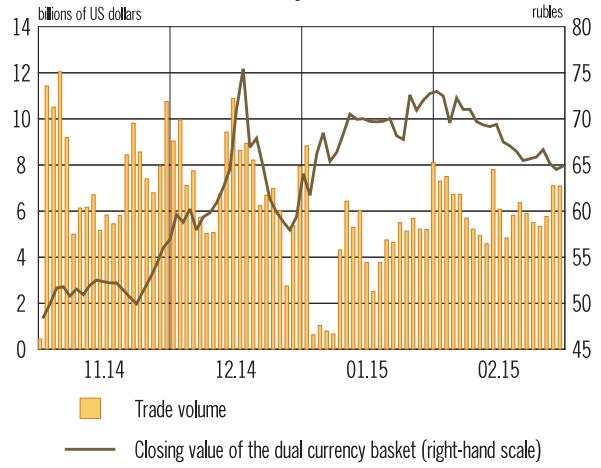
Sources: Bank of Russia, Bloomberg.

Net FX credit from resident banks to non-resident banks (billions of US dollars)



Source: Bank of Russia.

Volume of US dollar and euro trade at the Moscow Exchange cash segment and the value of the dual currency basket

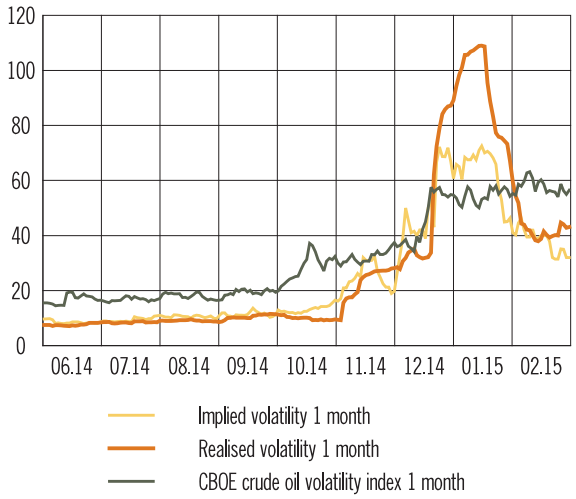


Sources: Moscow Exchange, Bank of Russia calculations.

households and companies, amid expectations of a further fall in the exchange rate and the need to accumulate funds to repay external debts. Under the floating exchange rate mechanism in place since November 2014, the Bank of Russia carried out foreign exchange interventions in the first half of December to maintain financial stability and limit expectations of a further depreciation of the national currency. At the same time, the continuing decline in oil prices and the revision of forecasts by international organisations and market participants towards their more significant and prolonged fall than previously anticipated, pointed to growing fundamental prerequisites for the depreciation of the ruble and the limited effectiveness of foreign exchange interventions. In these conditions, since mid-December 2014 the Bank of Russia has not carried out any foreign exchange interventions.

By the end of December 2014, tension in the foreign exchange market started to wane, helped by the Bank of Russia's raising its key rate to 17% p.a., increasing the volume of foreign currency provided on a reverse basis, and introducing measures to maintain financial sector stability, in addition to the stabilisation of oil prices in the third ten-day period of December (at roughly $60 per barrel) and higher sales of foreign exchange proceeds by major Russian export companies. In addition, some support for the ruble exchange rate came from the Bank of Russia operations in the domestic foreign exchange market linked to foreign exchange sales by the Federal Treasury

US dollar/ruble exchange rate volatility (percentage points)



Source: Thomson Reuters.

from its foreign currency accounts with the Bank of Russia. As a result of these factors, at the end of 2014 the ruble value of the dual currency basket was 61.69 rubles, a decrease of more than 9 rubles as compared with the Moscow Exchange's closing value on 15 December 2014.

Exchange rate behaviour at the beginning of 2015 continued to be shaped largely by changes in oil prices. After January's fall in the ruble exchange rate, in February the ruble rallied, helped in part by expectations that the situation in Eastern Ukraine would be resolved. Another factor underlying the fall in the ruble-denominated value of the dual currency basket in February 2015 was a significant depreciation of the euro against the US dollar, due to the ECB's decision to launch a quantitative easing programme in the euro area.

A moderate reduction in turnovers combined with lower exchange rate volatility since mid-January 2015 can point to normalisation of the situation in the foreign exchange market. Estimated household demand for foreign currency also imply an improvement in the situation: according to preliminary data, FX purchases by households in January-February 2015 fell sharply as compared with December 2014.

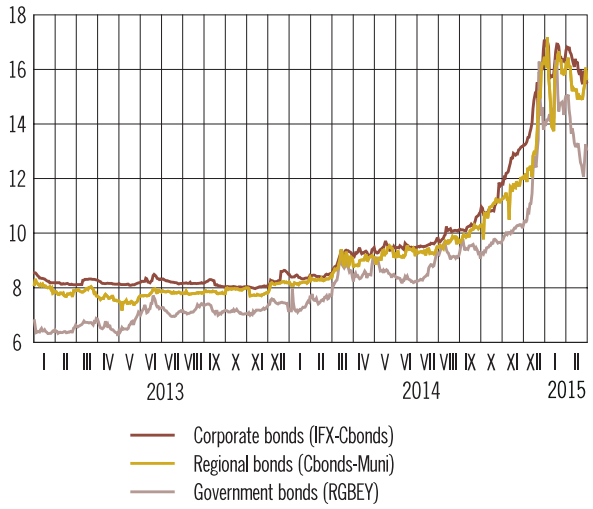
Given the projected stabilisation of oil prices and the absence of any new foreign political tension, exchange rate volatility could continue to drop over the coming months.

Asset prices and bond market

The situation in the foreign exchange market, Bank of Russia's monetary policy decisions, and expectations concerning international credit rating agencies' actions in relation to Russia's sovereign credit rating and their subsequent implementation were key factors shaping the dynamics of Russian financial asset prices between the end of 2014 and the beginning of 2015.

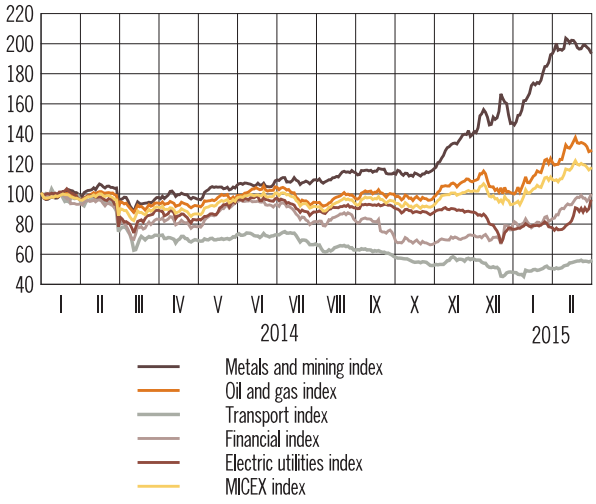
In the first half of December 2014, due to the accelerating decline in global oil prices and the depreciation of the ruble, the situation in key segments of the Russian stock mark deteriorated considerably. Against the backdrop of the Bank of

Bond yields (%, p.a.)



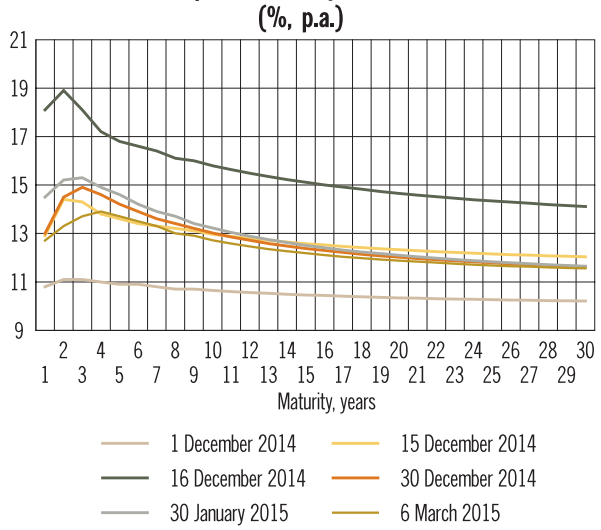
Sources: MICEX SE, Cbonds.ru.

Moscow Exchange equity indices growth rates (%)*



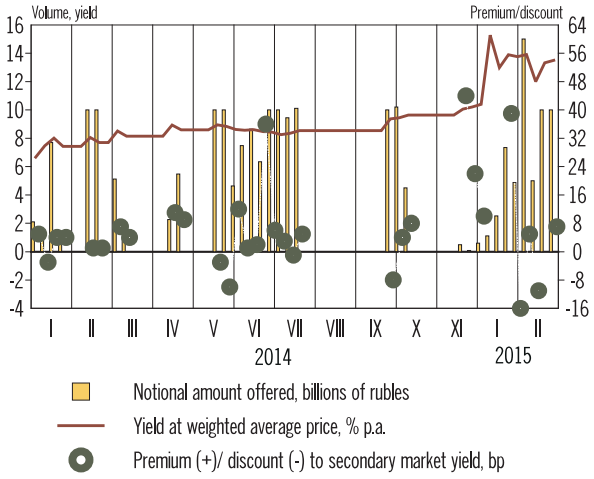
** 100% = values of indices as of 1 January 2014.*
Sources: MICEX SE, Bank of Russia calculations.

Coupon-free OFZ yield curve (%, p.a.)



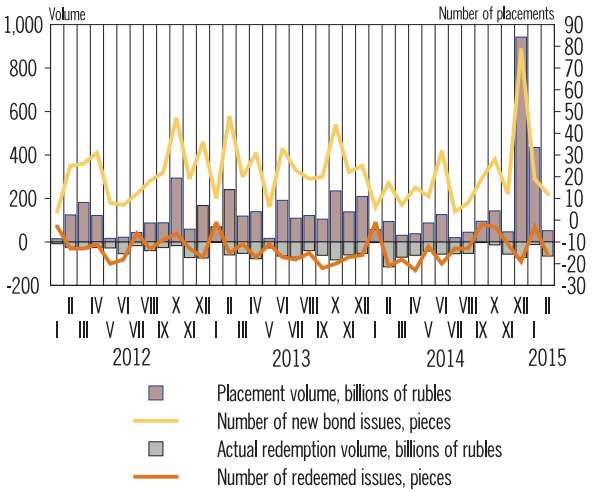
Source: MICEX SE, calculated using the method elaborated together with the Bank of Russia.

Ministry of Finance auctions for OFZ placement/additional placement



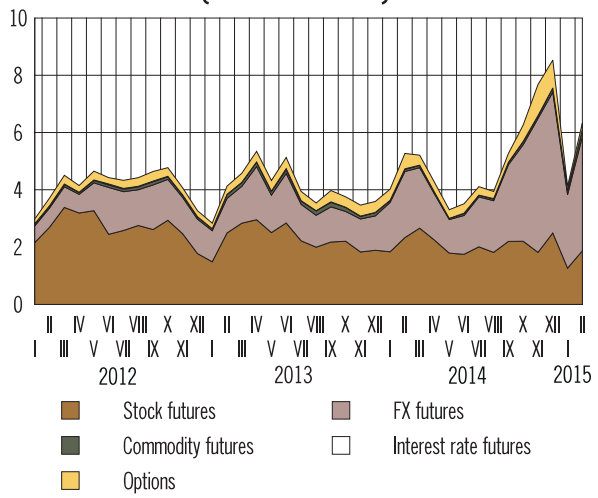
Sources: MICEX SE, Bank of Russia calculations.

Primary placement at the Moscow Exchange and redemption of corporate bonds (defaults on bond issues)



Sources: MICEX SE, Cbonds.ru, Bank of Russia calculations.

Exchange-traded derivatives turnover by underlying assets (trillions of rubles)



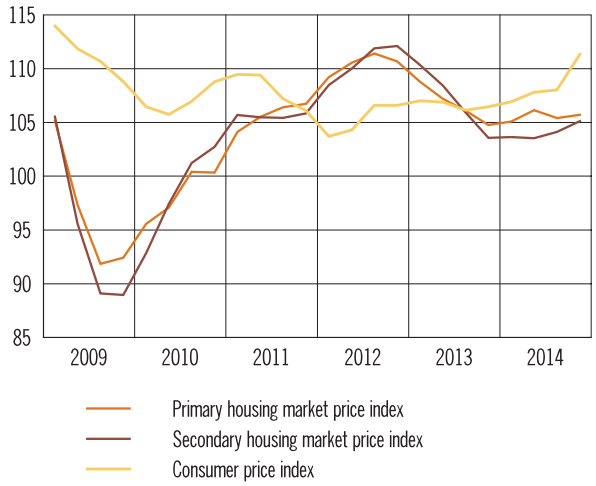
Sources: Moscow Exchange, Bank of Russia calculations.

Russia's actively raising its key rate, as had been expected by market participants, corporate and government bond yields rose by 1 percentage point and 3 percentage points respectively, and, after a hike of the key rate in mid-December, increased by an additional 3 percentage points on average and reached their highest values seen in the most acute phase of the 2008–2009 crisis.

Subsequently, as tension in the foreign exchange market decreased, and due to the measures taken by the Bank of Russia to stabilise the situation in the domestic financial market, the stock market situation improved. In the government securities segment, the second half of January 2015 saw a decrease in federal government bond (OFZ) yields, which accelerated after the Bank of Russia decided to cut its key rate at the end of January. The ruble-denominated MICEX index reached its highest level in many years in mid-February. Meanwhile, the dollar-denominated RTS index, though it increased, remained at a relatively low level. Only at the end of February did equity and bond prices undergo a small downward correction in relation to Moody's downward revision of Russia's sovereign credit rating to below investment grade. However, the persistent inversion of the OFZ yield curve's long part still indicates market participants' expectations of falling interest rates in the medium term.

Further growth in Russian asset prices in 2015 Q2-Q3 will be suppressed by the continuation of

Housing and consumer goods price indices (quarter as % of corresponding quarter of previous year)



Sources: Rosstat, Bank of Russia calculations.

geopolitical and economic risks, as well as the recent downgrading of Russia's sovereign credit rating.

Despite the increased volatility of bond yields in the secondary market, activity by Russian issuers in the primary market in December 2014-January 2015 was relatively high. Taking into account the current market climate, the Russian Ministry of Finance showed flexibility in adjusting its domestic borrowing policy (issue volumes and terms). Beginning in the second half of January, the issuer introduced a new instrument, OFZs with a coupon rate tied to the money market rate, which may make it possible to avoid any further burden on the budget in the future. The increased volume of OFZ issues, together with growth in investment in the domestic corporate bond market, including as a result of the limited access of Russian companies and banks to external funding, contributed to a significant rise in the aggregate value of bonds circulating in the domestic market by the end of February 2015. The placement of large OJSC Rosneft bond issues at the end of December 2014 and in January 2015 contributed the most to this growth. Activity in the primary market could significantly decline over the coming months amid the economic slowdown, a relatively high cost of borrowing, and the worsening financial position of certain issuers.

As a result of the stabilisation of the situation in underlying asset markets in January-February 2015, derivatives trading volume decreased slightly after its sharp growth in November-December 2014. Economic entities' improved awareness of the need to manage foreign exchange risks under the floating exchange rate and a higher role of the interest rate channel of the monetary policy transmission mechanism should contribute to growth in operations to hedge foreign exchange risks and interest rate risks in the future.

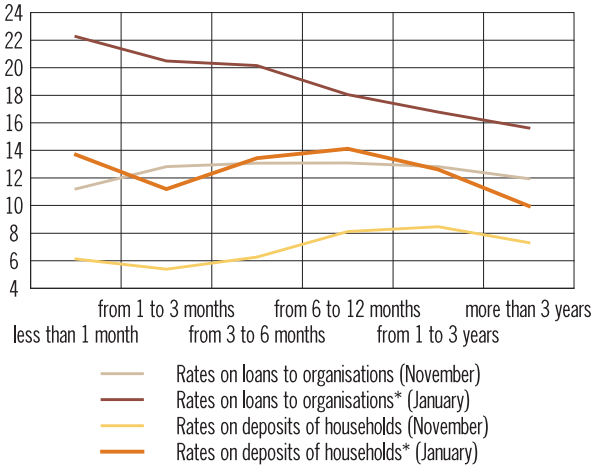
With the intensification of economic uncertainty in 2014 Q4, household interest in residential property investment increased markedly, while growth in primary and secondary housing market price indices lagged behind growth in the consumer price index. Given the projected cooling of the economy, accompanied by a slowdown in lending growth and a downturn in household income, growth rates in housing prices will be significantly below inflation rates over the coming quarters.

Bank lending and deposit operations

At the end of 2014 and start of 2015, the banking sector saw a continuing trend of decreased risk appetite among major groups of market participants, shown in part through the increased activity with large and trustworthy counterparties, whose share in the total value of operations rose. In this context, the influence of the changed Bank of Russia key rate on the parameters and volumes of credit institutions' operations widened over the period under consideration. In December 2014, following the Bank of Russia key rate's hike, banks raised household and corporate deposit rates, with growth in deposit rates far exceeding that in loan rates. This was due to growing competition for depositors between banks amid higher costs of and reduced access to other sources of funding, including foreign loans.

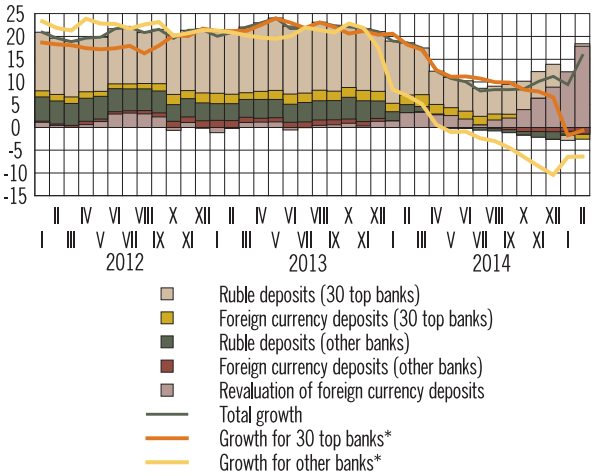
Growth in deposit rates in December 2014 was not uniform. Firstly, a rise in long-term rates lagged far behind that of short-term rates (an increase by 3.3 percentage points and 6.0 percentage points respectively), reflecting an expected fall in rates in the medium term. The uneven growth in rates was reflected in the structure of household deposit operations: over the period from December 2014 to January 2015, ruble-denominated deposits with terms of up to one year rose more than 1.6-fold, while long-term deposits shrank by 22% over the same period.

Term structure of rates on ruble bank transactions in November 2014 and January 2015 (% p.a.)



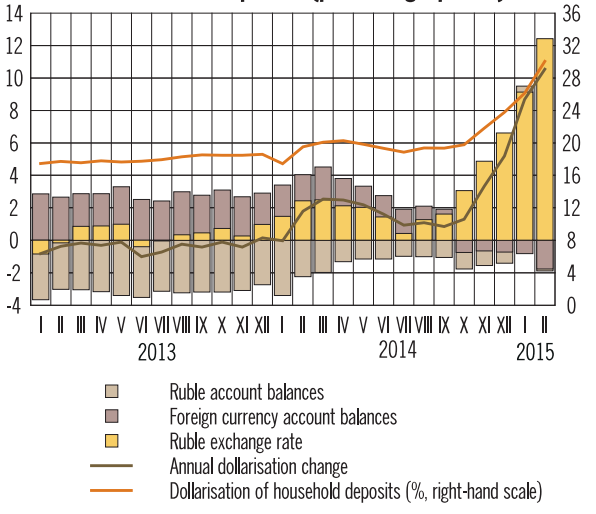
** Data for January are based on preliminary estimates.*
Source: Bank of Russia.

Contributions of various components to the annual growth rates of bank deposits of households (%)



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

Dollarisation and contribution of various components to its development (percentage points)



Source: Bank of Russia.

Secondly, with the decreased household risk appetite, accompanied by a flow of deposits into large banks, and higher household demand for cash at the end of 2014, small and medium-sized banks were forced to rapidly raise their deposit rates in order to hold on to depositors (amid the tougher competition for depositors, certain large banks also significantly increased their deposit rates). As a result, the spread of deposit rates within the banking sector grew considerably, which led to an active flow of depositors' funds between banks. In December, deposit market turnover increased almost four-fold as compared with November while the overall amount of deposits at the end of the month shrank slightly. These changes point to mass early withdrawals of deposits with the aim of transferring them to a new, higher rate or moving them to another bank. The total value of new deposit agreements concluded in December-January stood at roughly 50% of bank total household ruble deposit liabilities as of 1 February 2015.

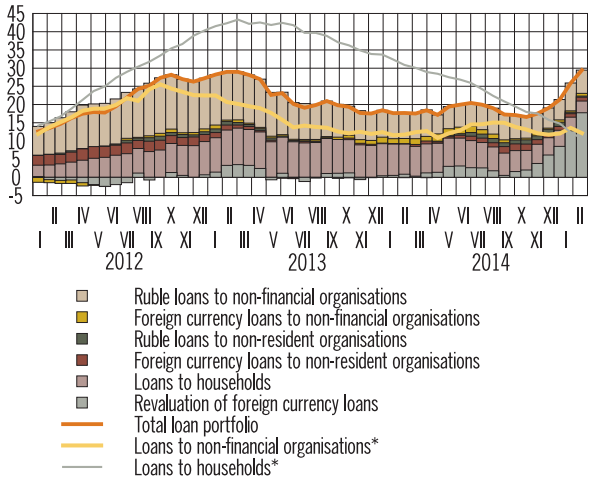
In January, by assessing the increased value of retail funding, a number of large banks started to adjust rates on their deposits downwards, especially on long-term deposits. Following the Bank of Russia's decision to cut its key rate at the end of January 2015, a moderate decline in deposit rates was observed across a larger group of banks.

Moreover, the overall increased level of deposit rates helped stabilise the household deposit market. Annual growth rates for household ruble deposits with banks[2] which moved into negative territory on 1 January 2015, showed a slight positive value at the start of February: 0.6%. According to preliminary data, the flow of funds into household ruble deposits also continued in February.

Despite the depreciation of the ruble at the end of 2014, households continued to reduce their funds in foreign currency deposits, instead preferring FX cash. Annual growth rates for foreign currency deposits have been negative since October 2014. In this regard, growth in household deposit dollarisation witnessed over this period was

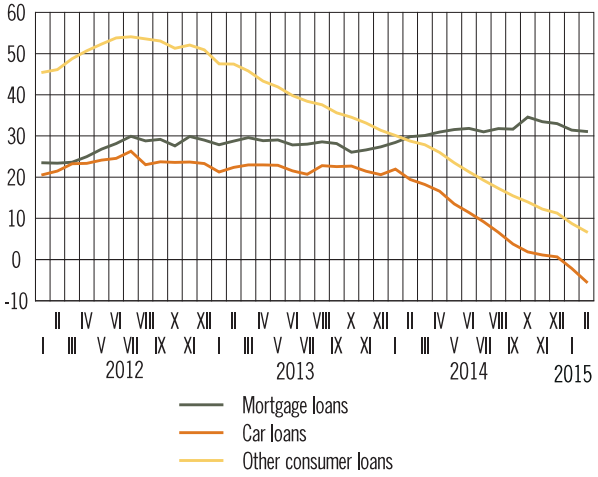
[2] *Here and below in this subsection, banking sector indicators are given from the financial statements of the operating credit institutions entered in the State Register of Credit Institutions as of the reporting date. Data in charts (excluding interest rates and bank lending indices) are given at the start of the period.*

Contributions of various components to the annual growth rates of bank loan portfolio (%)



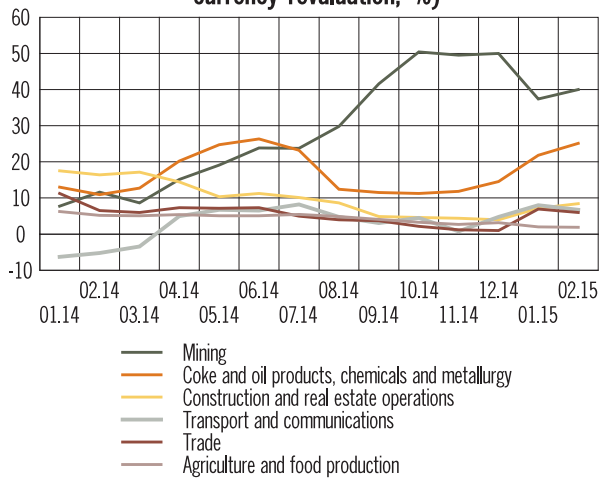
* *Excluding foreign currency revaluation.*
Source: Bank of Russia.

Annual growth rates of outstanding loans to households (%)*



* *According to section 1 and 3 of reporting form 0409115.*
Source: Bank of Russia.

Annual growth rates of loans to certain groups of industries (excluding foreign currency revaluation, %)



Source: Bank of Russia.

Annual growth rates of outstanding loans to organisations and individual entrepreneurs (%)*

* *According to reporting form 0409302, excluding foreign currency revaluation.*
Source: Bank of Russia.

caused exclusively by an increase in the ruble value of foreign currency deposits.

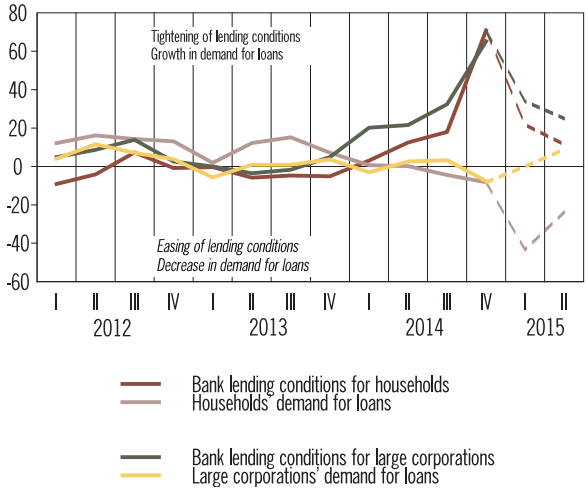
The flow of depositors' funds to large banks, which are traditionally seen as adopting a more conservative policy, as witnessed for a large part of 2014, combined with decreased risk appetite contributed to a further shift from more risky to less risky lending: in the retail segment of the loan market, consumer lending gave way to mortgage lending, and in the corporate segment, large company lending expanded amid a fall in lending to small businesses. Moreover, on the whole, less risky corporate lending rose faster than retail lending.

In the corporate loan portfolio, the share of industries such as mining, metallurgy, transport and communications rose steadily, while the share of industries with traditionally higher rates of borrowing shrank (primarily, trade and agriculture).

It is worth noting that the shift from retail to corporate lending, as well as the change in the corporate loan portfolio structure can be explained not only by banks moving over to a more prudent policy, but also growing demand for loans from large Russian companies experiencing difficulties in borrowing in external markets.

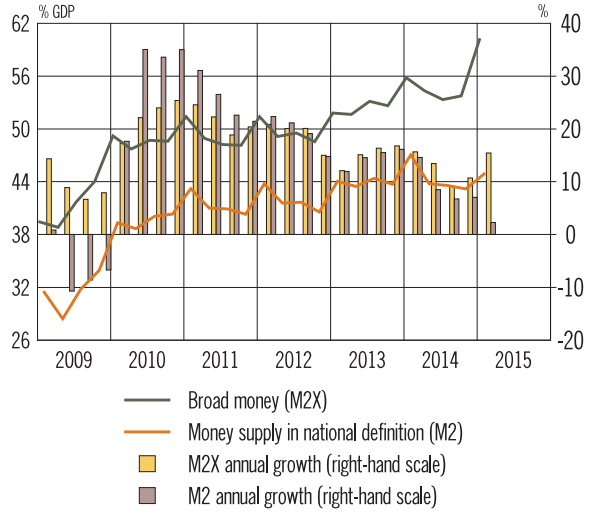
As a result of banks' stricter approach to borrower selection, despite a marked increased cost of financing, growth in market average loan rates was moderate in December, falling far behind growth in rates on deposits, bonds and certain loan products of some banks. An additional factor underpinning

Lending conditions index (points)



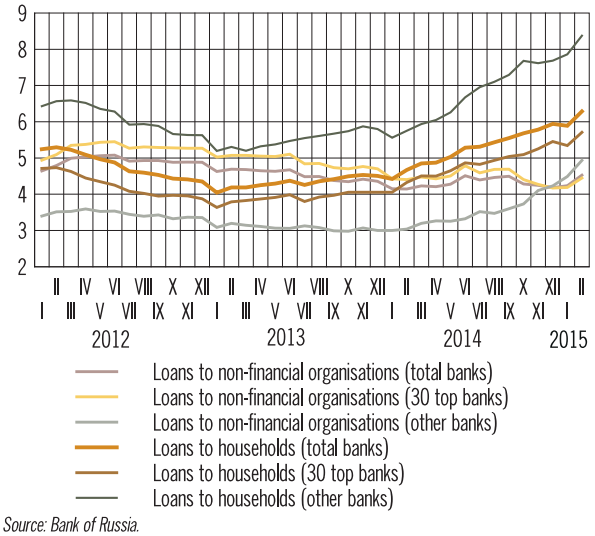
Source: Bank of Russia.

Monetary aggregates (as % of GDP)



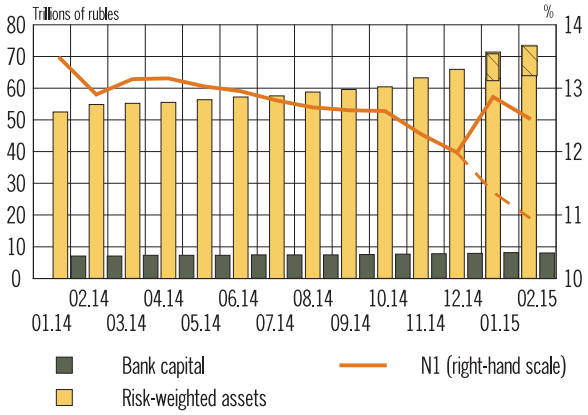
Source: Bank of Russia.

Overdue bank loans (%)



Source: Bank of Russia.

Impact of revaluation on N1 ratio



Hatched are assets not included in N1 calculation, a dashed line shows the N1 dynamics if special prudential measures were not imposed
Source: Bank of Russia.

negligible growth in loan rates in December was the lengthy procedure to approve loan agreement conditions. A number of loans issued in December had been submitted for approval months ago. Rates for these loans reflected the loan market situation in the previous period and reduced the market average loan rate. According to preliminary estimates, in January 2015 growth in loan rates accelerated markedly, exhausting a large part of their growth potential.

Despite lower deposit rates in February, the high rates on deposits taken in December-January will push loan rates upwards. In the first half of 2015, the potential for these rates to fall will be limited, especially in market segments associated with higher risk (consumer lending, and lending to small businesses).

A rise in loan rates over this period was accompanied by a tightening of non-price lending conditions. They became stricter in 2014 Q4 primarily due to higher requirements for borrowers and loan collateral[3], according to a quarterly survey of bank lending conditions. The banks that took part in the survey planned to continue the stricter price- and non-price lending conditions in the first half of 2015.

Higher interest rates, combined with the stricter non-price bank lending conditions, could be one of the reasons for decreased demand for loans that

[3] *The survey was carried out in January 2015.*

has been seen in most market segments. Based on the results of the survey, banks expect demand for loans to fall up until June 2015.

Lower demand for loans will lead to a further decrease in annual loan portfolio growth rates. Moreover, given an increase in overdue loans, primarily retail ones, we can expect banks' risk appetite to remain low or to continue to fall. Accordingly, the changes to the loan market structure, which are due to the stricter borrower selection criteria, will continue in the short term. In combination with the expected downturn in economic activity, this will contribute to a further decline in annual lending growth rates, which in turn will suppress growth of monetary aggregates and lead to slowing monetisation of the economy.

Decelerated lending growth, increased overdue loans and faster growth in rates on bank liabilities lead to a deterioration in the financial position of the Russian banking sector. As of the end of January 2015, Russian banks had losses totalling 24 billion rubles (in January 2014, they recorded 93 billion rubles of profit). The main source of these losses was a drastic increase in loss provisions. At the same time, due to temporary changes to the procedure used to assess and classify credit institutions' assets and liabilities, which were introduced by the Bank of Russia in December 2014, the losses recorded by banks did not lead to any downturn in compliance with prudential ratios. The introduction of these regulatory measures and the launch of a state programme to increase bank capitalisation through an OFZ mechanism will smooth over any potential constraining influence of these ratios on bank lending activity over the coming quarters.

1.3. Internal economic conditions

The economic slowdown witnessed in 2014 was caused largely by structural factors, while the expected fall in aggregate output in the first half of 2015, which, according to estimates, could be roughly 2% relative to the corresponding period in the previous year, will essentially be cyclical in nature.

The structure of aggregate demand changed in 2014. Net exports' positive contribution to GDP growth increased considerably. In the first half of 2015, net exports will be the only demand component making a positive contribution to economic growth amid cooling investment and consumer activity.

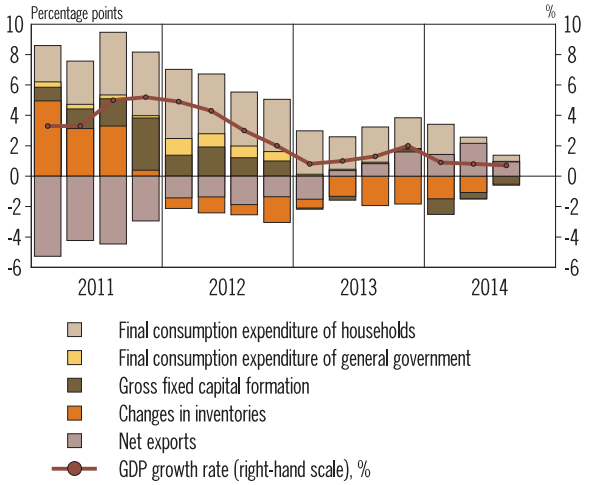
Growth in consumer prices from 2014 Q4 to the start of 2015 accelerated rapidly, largely due to the depreciation of the ruble. In view of the impact of ruble exchange rate dynamics on prices distributed over time, inflation is forecast to be higher over the coming months. Annual growth in consumer prices will peak in 2015 Q2, subsequently slowing as the exchange rate returns to a level based on fundamental factors and as inflation expectations normalise. The negative output gap will hold back price growth.

Demand

In 2014, the growing geopolitical risks, economic sanctions against Russia and a sharp drop in oil prices caused economic activity to cool. Moreover, structural factors have had a moderating impact on economic growth. GDP growth in 2014 dropped to 0.6%, as expected, after 1.3% in 2013.

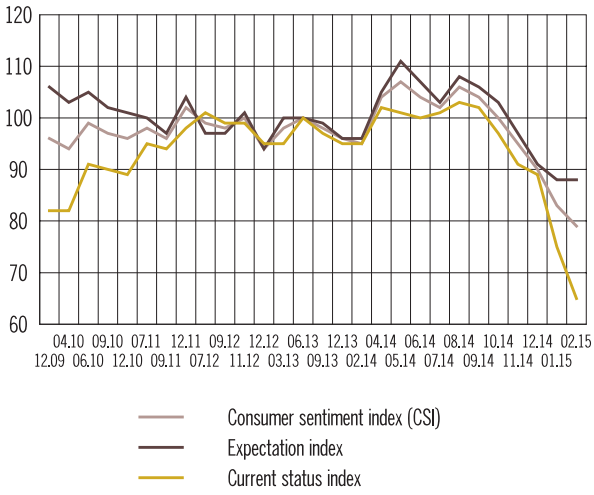
In 2014, the aggregate demand structure changed. The contribution of consumer demand to economic growth dropped considerably. Annual growth in household final consumption expenditure fell to 1.9% in 2014 from 5.9% in 2013, despite a transitory surge in panic buying caused by the increase in household inflation and depreciation expectations at the end of 2014. Amid the slowdown in real wage growth (from 4.8% in 2013 to 1.3% in 2014), consumption was buoyed by a slack in households' propensity to save. For example, the share of household savings in disposable money income dropped to 7.8% from 11.1% in 2013.

GDP growth structure by expenditure (percentage points, of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Consumer sentiment (points)

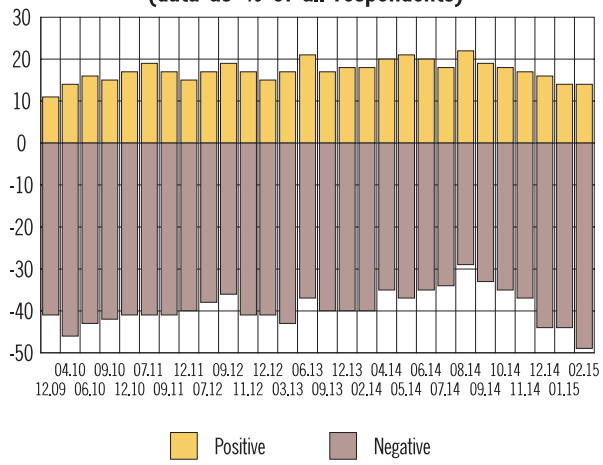


Source: Public Opinion Foundation survey results.

In 2015, there is expected to be a further reduction in final consumption expenditure of households. Consumer demand will contract amid decreasing real wages (both in the private and public sector, taking into account the limited indexing of wages paid to workers in public sectors). Moreover, final consumption expenditure will be restrained by a recovery in households' propensity to save if interest rates on bank deposits remain high, and by worsening consumer sentiment.

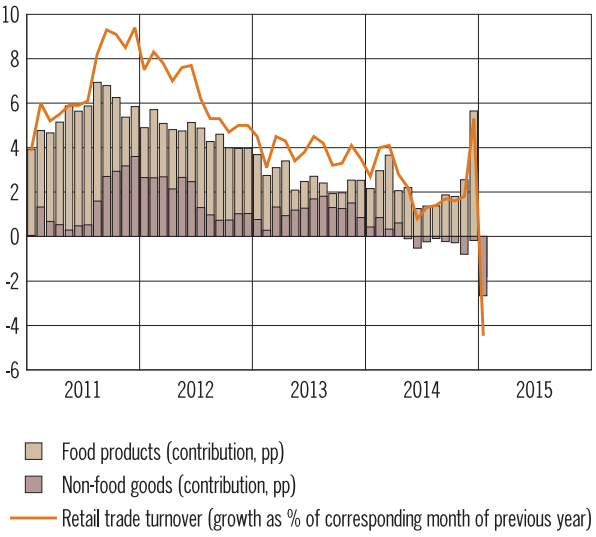
Reported data for January 2015 confirm these trends. Retail sales decreased compared with the corresponding period in the previous year (by 4.4%). A fall in sales occurred both in the food products and in the non-food goods segments. According

Do you consider current situation to be generally positive or negative to save up? (data as % of all respondents)



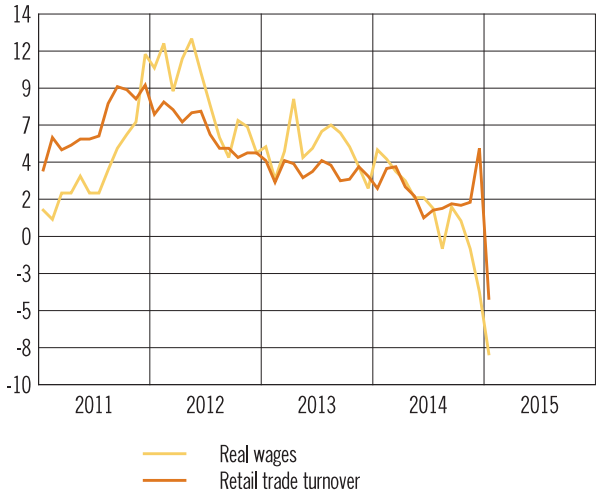
Source: Public Opinion Foundation survey results.

Retail trade turnover



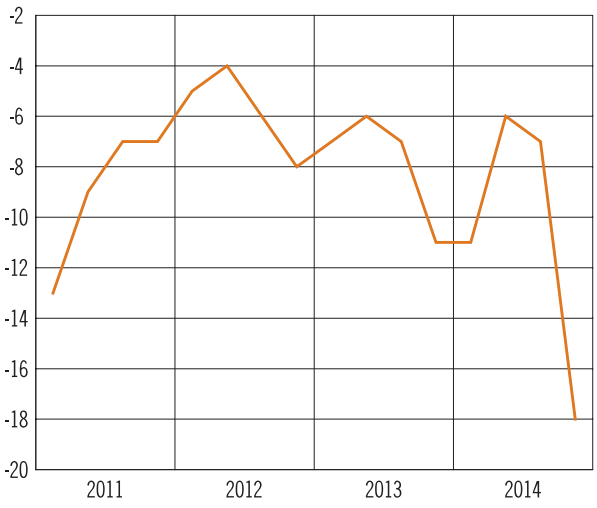
Sources: Rosstat, Bank of Russia calculations.

Real wages and retail trade turnover (growth as % of corresponding month of previous year)



Source: Rosstat.

Consumer confidence index



Source: Rosstat.

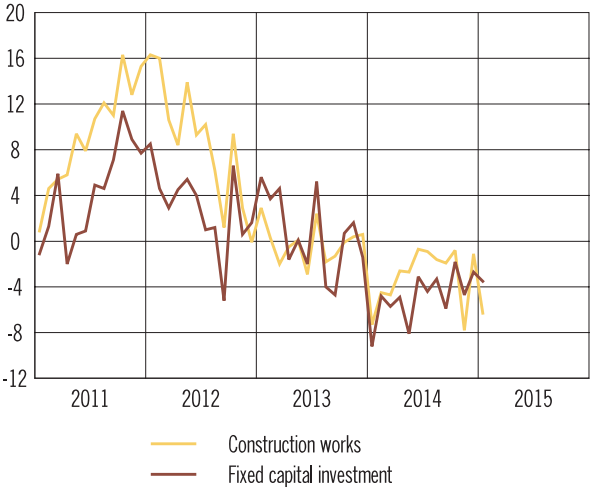
to the survey by the Russian Public Opinion Research Centre carried out at the end of January 2015, one in five Russians has opted to purchase cheaper food products or to refrain from buying certain goods entirely (23% of those surveyed). The drop in consumer confidence (Rosstat) and consumer sentiment indices (the Public Opinion Foundation) indicates that consumer expectations are deteriorating.

In Q1 and Q2 2015, the decrease in final consumption expenditure is forecast to be 2–2.5% relative to the corresponding period in the previous year (expenditure on service consumption will traditionally be more stable than on goods purchases).

In 2014, the contribution of gross capital formation to GDP growth was negative due to a fall both in fixed capital investment and inventories. Geopolitical tensions, piling up economic risks, escalating prices of imported investment goods, deteriorating net financial results of enterprises, worsening non-price lending conditions and the growing cost of credit resources caused in part by Russian companies' restricted access to international financial markets led to a decrease (by 2.7%) in fixed capital investment in 2014 compared with the previous year.

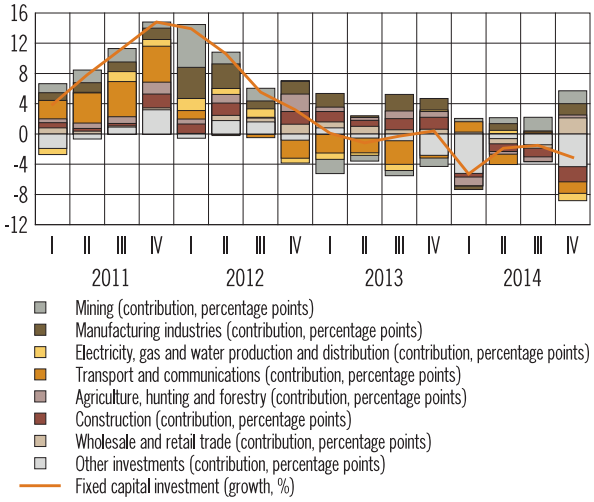
In 2014, investment in the public and infrastructure sectors showed a slight decline, while private investment contracted much more

Fixed capital investment and construction works (growth as % of corresponding period of previous year)



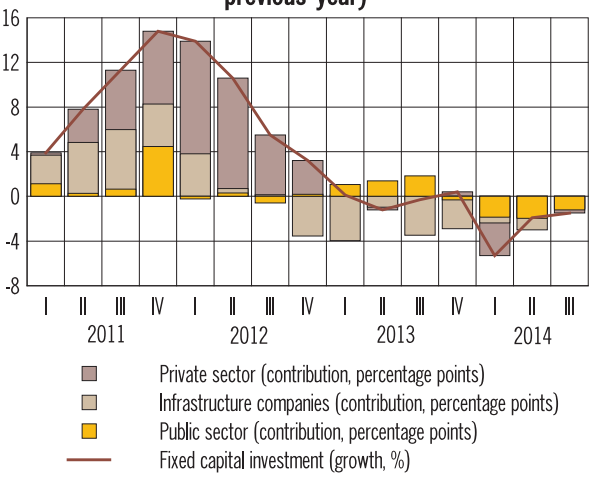
Source: Rosstat.

Fixed capital investment by activity type (of corresponding quarter of previous year)



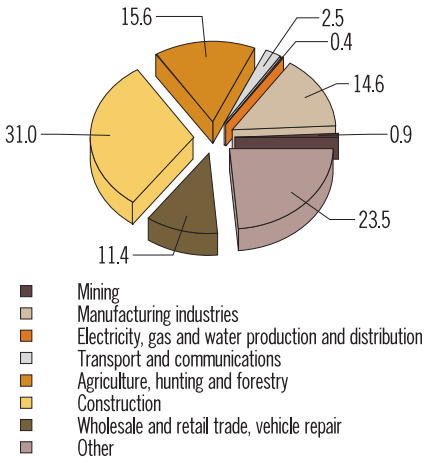
Sources: Rosstat, Bank of Russia calculations.

Fixed capital investment by public, private sector and infrastructure companies (of corresponding quarter of previous year)



Sources: Rosstat, Bank of Russia calculations.

Fixed capital investment structure of small enterprises by activity type in 2014 Q3 (as % of total fixed capital investments of small enterprises)



Source: Rosstat.

significantly (by 3.5% compared with the previous year).

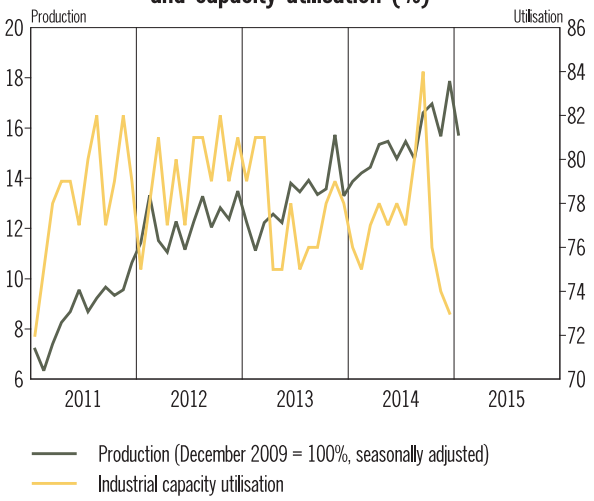
High economic uncertainty, a further deterioration in the financial position of businesses and expensive credit resources will perpetuate the reduction of private capital investment in the first half of 2015. The biggest contribution to the negative capital investment dynamics could be made by construction and real estate transactions. Agriculture could provide some support for investment activity on account of import substitution and growth in lending to the agricultural sector coupled by state support measures.

Reduced investment programmes in the electric power generation industry and postponed oil and gas projects will be reasons for a substantial fall in investment demand in the infrastructure sector.

A lack of budget funds, in turn, will lead to a decline in investment activity in the public sector. However, the implementation of projects planned for 2015 to modernise the Baikal-Amur Railway, the Trans-Siberian Railway, and Yamal LNG, and to construct a central ring road in the Moscow Region will likely make the drop in the public capital investment less significant compared with the fall in infrastructure and private investment.

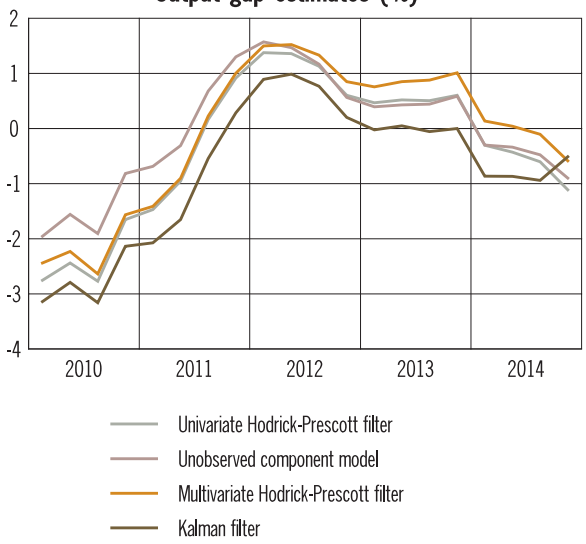
Overall, the decline in investment demand is expected to intensify in the first half of 2015. According to estimates, the reduction in gross fixed capital formation could be 6–7% in the first half

Industrial production growth and capacity utilisation (%)



Sources: Rosstat, Bank of Russia calculations, Russian Economic Barometer.

Output gap estimates (%)



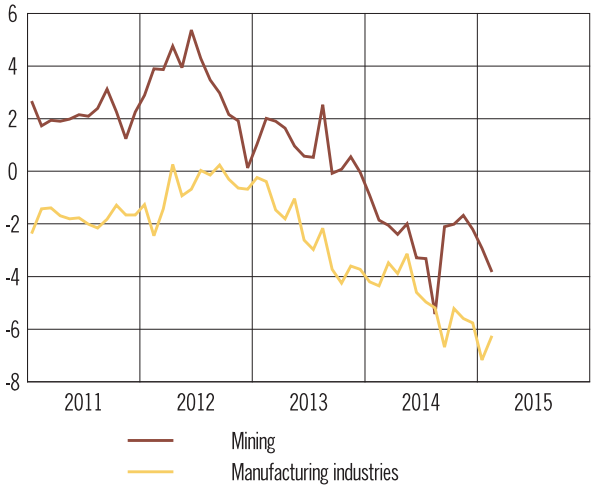
Source: Bank of Russia calculations.

of 2015 (in January 2015 fixed capital investment reduced by 6.3% compared with the corresponding period of the previous year).

The contraction of internal demand alongside the ruble depreciation caused an increase in net exports' contribution to economic growth in 2014. It is expected that net exports will be the only component of the aggregate demand making a positive contribution to GDP growth in the first half of 2015.

Consequently, according to estimates, GDP could contract by roughly 2% in the first half of 2015. The slowdown will mainly be cyclical in nature, which will broaden the negative output gap in the first half of 2015 to 3–4%.

Business confidence indices by activity type (seasonally adjusted)



Sources: Rosstat, Bank of Russia calculations.

Supply

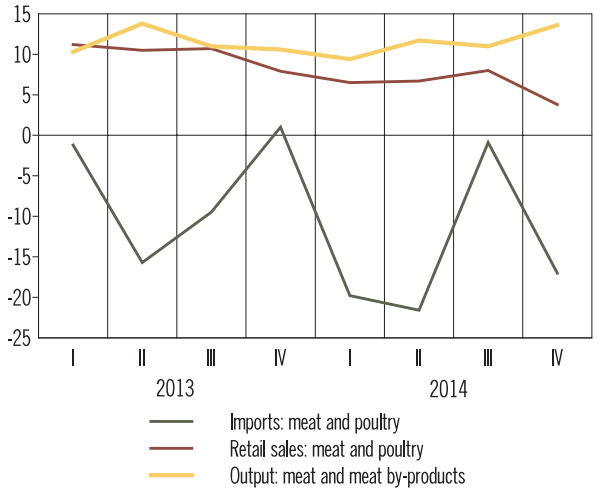
Data on GDP in 2014 points to weakening activity affecting virtually all sectors. As in previous years, the annual growth in gross value added (GVA) came largely from an increase in the intermediary services sector (real estate transactions and financial services). This sector's contribution fell to 0.6 pp compared with 0.9 pp in 2013. The reduced contribution of financial services could in part be caused by a decrease in banks' interest margin amid growing costs of internal funding and imposed restrictions on access to global capital markets. The contribution of mining, electricity/gas/water production and distribution, construction and transport to GVA was small or negative. The 2014 good harvest shaped a positive contribution from agricultural output.

GVA growth by 0.4 pp came from manufacturing output. Moreover, growth in this sector of the economy was largely due to export-oriented output (coke and oil products, metallurgy), while internal investment demand-oriented industries (machinery, equipment and electrical equipment) stagnated.

Among producers focusing on domestic consumer demand, the food industry alone demonstrated positive growth rates. In 2014 Q4, significant growth in output was only seen for certain product groups affected by the import restrictions (meat and meat products, cheese).

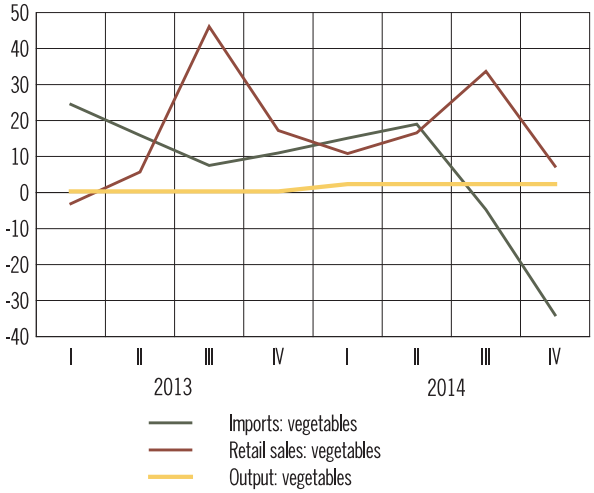
Econometric assessments point to relatively limited potential for import substitution in the

Meat and poultry imports, output and retail sales (growth as % of corresponding period of previous year)



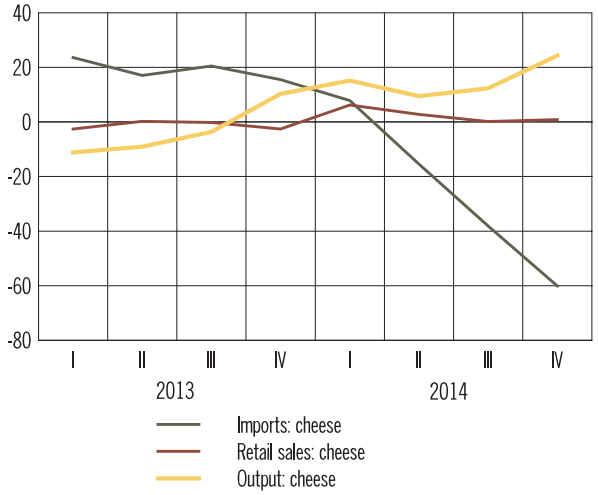
Sources: Rosstat, Federal Customs Service, Bank of Russia calculations.

Vegetable imports, output and retail sales (growth as % of corresponding period of previous year)



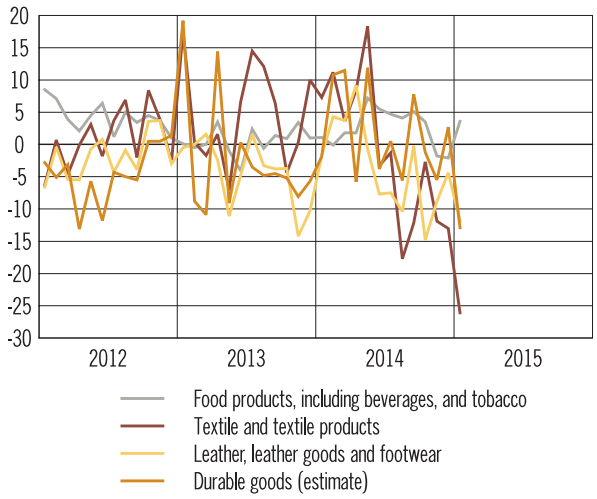
Sources: Rosstat, Federal Customs Service, Bank of Russia calculations.

Cheese imports, output and retail sales (growth as % of corresponding period of previous year)



Sources: Rosstat, Federal Customs Service, Bank of Russia calculations.

Production growth by consumer-oriented industries (as % of corresponding period of previous year)



Source: Rosstat.

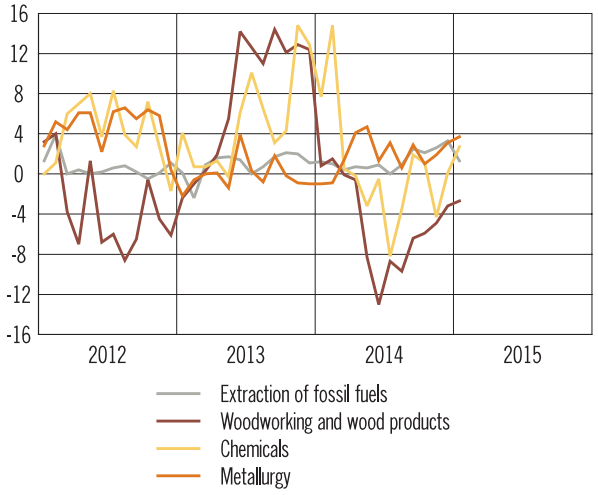
economy as a whole. According to estimates, imports of food products are sensitive to exchange rate movements: the elasticity of food product imports relative to the exchange rate is nearly 1 (i.e. when the ruble real effective exchange rate falls by 1%, the imports of these products will also fall by 1%). However, an analysis of the exchange rate fluctuations pass-through effect on output showed that its influence on production in this sector is negligible, and the same is true of domestic consumer demand-oriented industries in general. This suggests that we can only expect import substitution intensification in the output of certain products, as was seen at the end of 2014.

The elasticity of imports relative to the exchange rate is higher than 1 for product categories such as petrol, clothing, machinery and equipment, medicine, and foreign transport services. However, no perceptible positive effect from the exchange rate on output was observed in these industries.

Conversely, the ruble depreciation had a positive impact on output in export-oriented industries, in particular in the oil industry and the chemical and metallurgy industries.

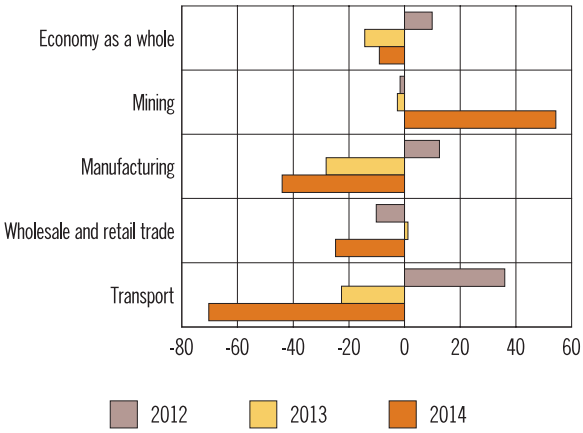
Thus, if demand-side restrictions persist, we can expect export-oriented industries to generally support economic growth. Output in the food industry will likely grow due to rising production of certain categories of goods affected by the trade restrictions. The largest drop is foreseen in the production of high-tech goods, and in construction (the only economic activity type where the

Production growth by export-oriented industries (as % of corresponding period of previous year)



Source: Rosstat.

Net financial result* of large and medium Russian enterprises in 2012-2014 (growth as %, year on year)



** Profit (loss) before taxes.*
Source: Rosstat.

Breakeven exchange rate estimates[1]

Activity	Breakeven exchange rate, RUB/USD	Memo item: share in gross value added (2013), %
Mining	—[2]	10.8
Metallurgy	—[2]	1.6
Chemicals	—[2]	1.1
Woodworking and wood products	—[2]	0.3
Pulp and paper industry; publishing and printing	—[2]	0.5
Rubber and plastic products	—[2]	0.3
Transport	—[2]	6.6
Communications	387	1.9
Wholesale and retail trade; repair of vehicles, motorcycles, household appliances and personal gadgets	137	18.2
Finished metallic goods	68	0.4
Electric, electronic and optical equipment	59	0.5
Textile and textile products	54	0.2
Construction	54	7.2
Machinery and equipment (excluding arms and ammunition)	52	0.8
Food products, including beverages, and tobacco	48	2.4
Other non-metallic mineral products	47	0.7
Means of transport and equipment	36	1.3
Leather, leather goods and footwear	29	0.0

[1] With consideration of direct and indirect impact of exchange rate dynamics on expenditures and export financial performance.
[2] Breakeven increases infinitely as exchange rate rises.

Source: Bank of Russia calculations.

depreciation of the ruble had a negative impact on output).

Low demand had a negative influence on organisations' financial indicators in 2014 by reducing their revenues. In a number of activity types, this was amplified by an increase in costs due to strict price and non-price lending conditions in internal and external markets, and by limited opportunities to increase prices for finished products because of tight tariff restrictions. At the end of 2014, the positive profit and loss balance for the economy as a whole[1] was 9.1% less than in 2013.

The impact of the ruble depreciation on organisations' financial performance in 2014 was mixed. The overall effect was determined by the relationship between increased spending on imports and receipts from export operations.

Analysing the pass-through effect of the ruble depreciation for the profitability of key types of

[1] Excluding small businesses, banks, insurance companies and budget-financed organisations.

economic activity[2], it is clear that export-oriented activities (mining, basic timber processing and pulp industry, chemical fertiliser industry, raw materials for plastics, and rolled ferrous and non-ferrous metals) gained from the depreciation. In these industries, the growing export receipts made a positive contribution to the financial result and exceeded the negative impact of exchange rate dynamics on their expenses. At the end of 2014, the positive profit and loss balance in mining was 54.4% more than in 2013; it made up almost half of the net financial result for the economy as a whole. In the metallurgical industry, the net profit rose by 65.0% (an additional factor was the improved situation in the global commodities markets).

According to estimates, transport, communications and trade have a relatively large 'safety margin' against the depreciation of the ruble. However, the impact of the fall in demand turned out to be greater, and as a result the net financial result in these types of economic activity fell compared with the previous year.

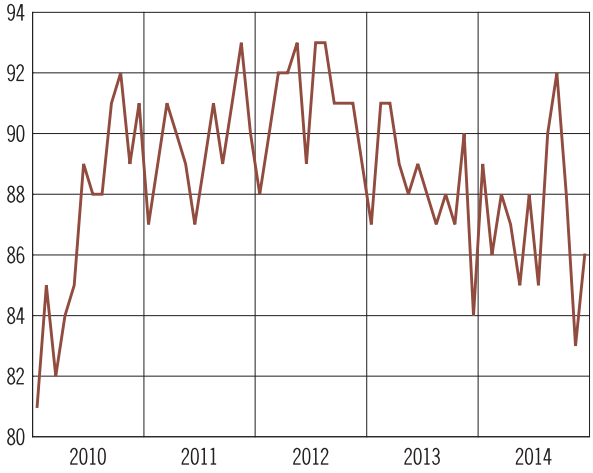
In the majority of other activities, the ruble depreciation made the financial result worse (it was particularly evident in transport and equipment production, leather and leather goods industry, and footwear industry). Overall, in the manufacturing sector the net financial result was 43.9% less in 2014 than in 2013.

Labour market

In 2014 and in early 2015, amid worsening financial indicators, organisations optimised their employment and labour remuneration strategies. The trends of decreasing labour utilisation, which had been observed since the second half of 2012, persisted. Companies, unable to fully pass growing costs on to the price of their output, opted to limit wage increases while keeping their headcount unchanged, possibly in anticipation of future recovery. Overall growth rates in nominal accrued wages slowed in the economy, according to preliminary data, to 9.2% in 2014 compared with

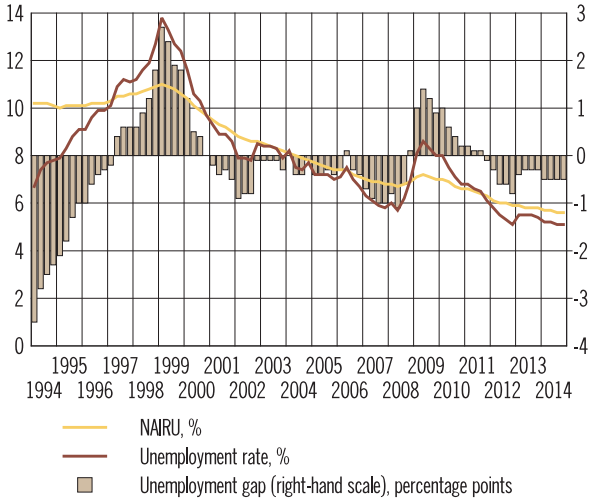
[2] *The approach used is that of the Higher School of Economics National Research University, 'Development Centre' Economic Research Fund (Bulletin 'Commentary on the state and business'. 2014. No. 63). The exchange rate's impact on spending and income was taken into account when assessing 'zero profitability'.*

Utilisation of available labour force in industrial production (normal level = 100%)



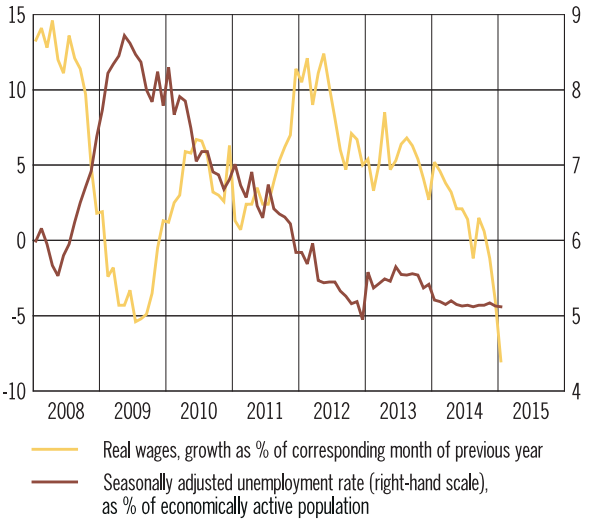
Source: Russian Economic Barometer.

Non-accelerating inflation rate of unemployment (NAIRU) and unemployment gap



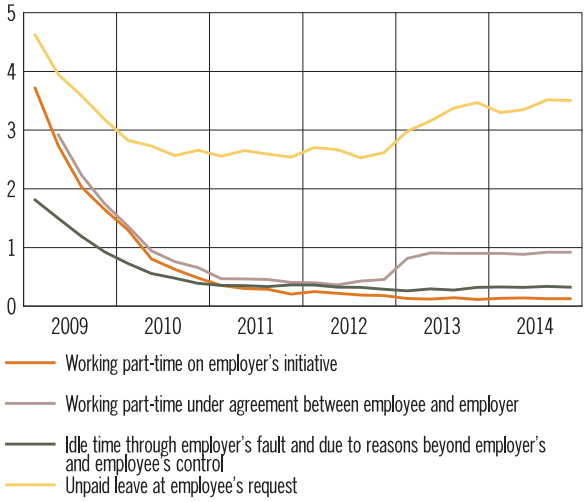
Sources: Rosstat, Bank of Russia calculations.

Unemployment and real wage rate



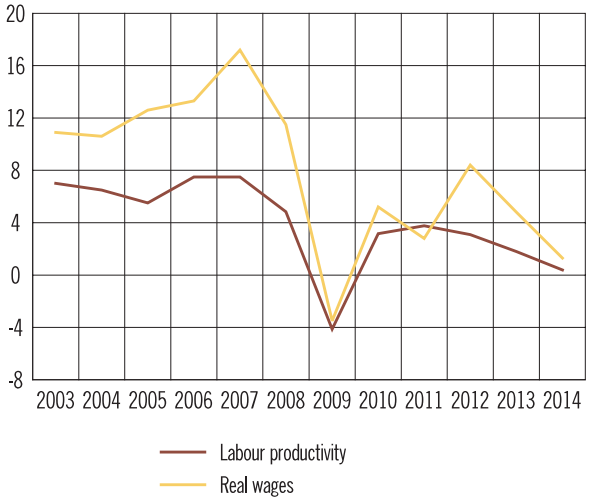
Sources: Rosstat, Bank of Russia calculations.

Part-time employment (as % of total number of employed, seasonally adjusted)



Sources: Rosstat, Bank of Russia calculations.

Labour productivity and real wages (growth as % of previous year)



Source: Rosstat.

11.5–13.9% in the last four years; in January 2015 it was 5.8% compared with January 2013.

Real wage growth rates dropped over 2014 as a whole. In Q4, against the backdrop of galloping inflation, real wage growth was negative (the decrease was 1.7% year on year, including in December when it was 4.0%). Overall, in 2014 growth in real wages slowed to 1.3% according to preliminary data from Rosstat, registering the lowest value in the last five years. As a result, the gap between this figure and labour productivity growth narrowed.

At the start of 2015, the fall in real wages accelerated, reaching 8.0% in January, according to Rosstat estimates. Under current conditions, it is expected that real wage growth will remain negative in the first half of 2015. Despite the cooling of economic activity, the unemployment remained low (5.0–5.2% seasonally adjusted, in 2014–early 2015). On the one hand, it was limited by long-term demographic factors that shaped a reduction trend in labour supply which was not offset by the inflow of labour migrants. On the other hand, this trend in the unemployment level reflects the unique nature of the Russian labour market: adjustment to changing conditions comes primarily through changes in wages, not though changes in employment levels. In view of this, despite the forecast downturn in output, unemployment rate is not expected to rise significantly in the first half of 2015.

The impact of exchange rate dynamics on economic activity

The fall in the ruble exchange rate in 2014 Q4 was larger in scale than in the 2008–2009 crisis. For this reason, estimating the exchange rate dynamics' impact on key macroeconomic indicators is important. While exchange rate shocks' pass-through effect on the level of inflation in Russia is relatively well researched and authors' estimates only differ quantitatively (Kataranova, 2011[1]), macroeconomic theory and empirical studies do not give an unequivocal response to the question of how exchange rate fluctuations influence economic activity (Kartaev, 2009[2]).

Here we will provide an econometric assessment of the impact of real effective exchange rate dynamics on economic activity in various sectors of the national economy. However, the main interest is not the short-term effect of a fall in the exchange rate, but rather the cumulative impact of shocks on long-term indicators. Above, we provided an assessment of the effect of exchange rate shocks on annual output growth, taking into account the multiplier effect.

For the analysis, we used a second-order vector autoregressive model with exogenous variables. As endogenous variables in the model, we included the real effective exchange rate index, real interest rate, output index, inflation,

[1] *Kataranova M. The connection between the exchange rate and inflation in Russia // Voprosy Economiki. 2010. No. 1. P. 22–62.*

[2] *Kartaev F. Econometric modelling of the interaction between the ruble exchange rate and GDP dynamics // MSU Vestnik. Series 6. Economics. 2009. No. 2.*

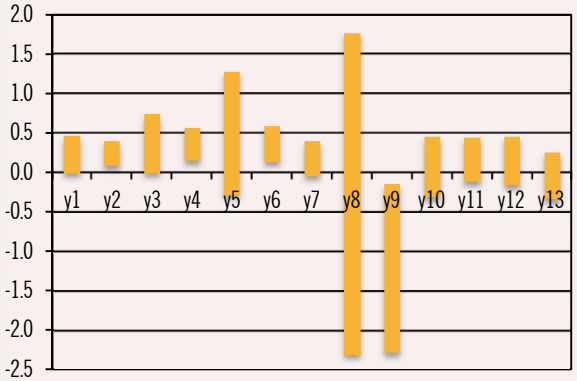
Economic activity indicators

No.	Indicator (industry)
y1	Basic industry index
y2 +	Domestic consumption and export oriented industries
y3	Domestic consumption oriented industries
y4 +	Oil, metal and chemical exports
y5	Industries with high import expenditures
y6 +	Industries with low import expenditures
y7	Industrial production index
y8	Agriculture
y9 —	Construction
y10	Freight turnover
y11	Retail trade
y12	Wholesale trade
y13	Food products, including beverages, and tobacco output

Note: '+' means positive impact of ruble depreciation on economic activity, '-' means negative impact, no mark indicates lack of considerable impact.

Source: Bank of Russia calculations.

Confidence intervals (95%) of accumulated effect of real effective exchange rate shock on annual output growth (percentage points, positive values indicate accelerated output growth as the exchange rate decreases)



Source: Bank of Russia calculations.

Estimates by detailed industries

Impact of ruble depreciation	Industry
Positive	Mining (including fuel-energy complex) Woodworking and wood products Pulp and paper industry; publishing and printing Coke and oil products Chemicals Rubber and plastic products Other non-metallic mineral products Metallurgy, finished metallic goods Electricity, gas and water production and distribution
None	Textile and textile products Leather, leather goods and footwear Machinery and equipment Electric, electronic and optical equipment Means of transport and equipment Agriculture Freight turnover Food industry Retail trade
Negative	Construction

Source: Bank of Russia calculations.

and growth of the M2 monetary aggregate[3]. For the assessment, we used monthly data for the period from March 2005 to September 2014 inclusive.

As exogenous variables, we used growth in Urals crude prices and the Chicago Stock Exchange VIX volatility index in order to take into account the external situation. This model can be described as follows:

$\gamma_t = X_t \beta + Z_t \alpha + A^{-1} \Sigma \varepsilon_t$,

where γ_t *is the vector of endogenous variables;*

Z_t *is the vector of exogenous variables;*

$X_t = II_k \otimes (\gamma_{(t-1)}, \gamma_{(t-2)})$;

β and α are coefficient matrices before regressors;

A is a matrix of parameters accounting for the decomposition of shocks;

Σ is a diagonal matrix of the standard deviations of endogenous variable shocks;

ε_t are orthonormalised shocks.

The results suggest that there is no significant impact driven by a change in the ruble exchange rate on aggregate indicators (primary industries index and manufacturing index). At the same time, it is worth noting the positive effect of a change in the ruble exchange rate on export-oriented industries, especially on exporters of natural resources and chemicals. A single negative shock in the exchange rate (i.e. the depreciation of the ruble) leads on average to an additional 0.36 pp of output growth in export-oriented industries. Moreover, from the indicators under consideration, only a fall in the ruble exchange rate has a negative impact on the construction industry (a fall in output growth by 1.21 pp on average for each exchange rate shock). The impact on all other indicators, according to estimates, is either negligible or positive. More detailed data for each industry are provided in the table. To verify the stability of results, the model was assessed using nominal rates instead of the real one. The stability of reactions over time was also verified with the help of a model with changing coefficients (Nakajima, 2011[4]).

[3] *For more information, see Badasen P., Kartaev F., Khazanov A. An Econometric assessment of the impact of the ruble exchange rate on output dynamics // Preprints of the MSU Faculty of Economics. Series ER1.*

[4] *Nakajima J., 2011. Time-Varying Parameter VAR Model with Stochastic Volatility: An Overview of Methodology and Empirical Applications // IMES Discussion Paper Series 11 E-09, Institute for Monetary and Economic Studies, Bank of Japan.*

These results are in line with economic theory: depreciation of the national currency increases the competitiveness of domestic goods in foreign markets. However, if the proportion of spending in a foreign currency is high (if imported equipment or materials are used as capital goods), a fall in the exchange rate leads to increased costs, which has a negative impact on economic activity.

Fiscal policy

According to data from the Russian Treasury, in 2014 the Russian Federation's budget expenditure amounted to 38.3% of GDP and non-interest expenditure was 37.6% of GDP, which is higher than the same indicators for 2013 by 0.1 pp. The reason for the increased expenditure is fund allocation in December 2014 for the additional capitalisation of systemically important credit institutions. This capitalisation also led to a slight worsening of the uniformity of budget spending during the year.

With budget income rising relative to GDP due to the increase in oil and gas revenue amid the fall in the ruble exchange rate, the federal budget deficit in the budget system decreased relative to 2013 by 0.1 pp, to 1.2% of GDP. Moreover, the non-oil and gas primary deficit increased by 0.4 pp to 10.9% of GDP.

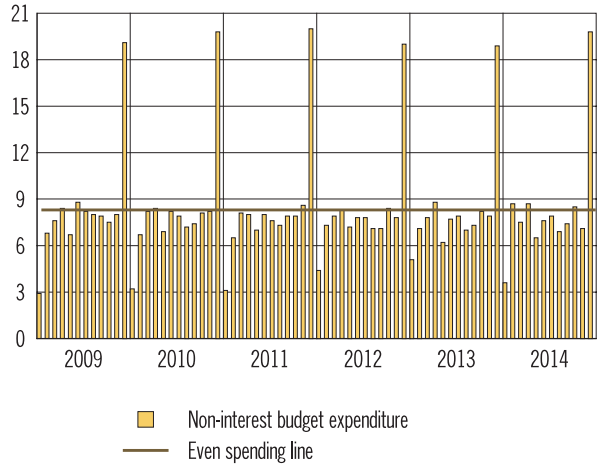
According to Bank of Russia estimates, which are based on the baseline forecast, in 2015 the income-to-GDP ratio will fall compared with 2014 by 1.2 pp of GDP, because of a drastic decrease in oil and gas revenues as a result of falling oil prices. Unadjusted spending on a regional level could rise by 2.4 pp of GDP (based on spending from the Budget Policy Guidelines for 2015–2017 with a proposed adjustment of 0.3 trillion rubles on the federal budget level). In this case, the deficit will grow by 3.6 pp to 4.8% of GDP, with the structural non-oil and gas primary deficit increasing by only 0.7 pp to 11.5% of GDP, which can partly be explained by a significant growth in the negative output gap.

According to Bank of Russia estimates, in 2015 the general government sector is expected to have a positive effect on aggregate demand growth, which, excluding budget spending adjustments on the regional level, could reach 1.0 pp. This effect will likely stay positive, considering the possible adjustments and owing to expected additional effect from investing a portion of the the National Wealth Fund.

According to Bank of Russia estimates, in 2015 the use of the Reserve Fund could reach 2.2 trillion rubles. This amount includes financing the additional federal budget deficit created by unearned (albeit planned) income, regional budgets' increased need for lending, and substituting missing sources of deficit funding, i.e. all foreign loans and income from privatisation, and half of internal loans.

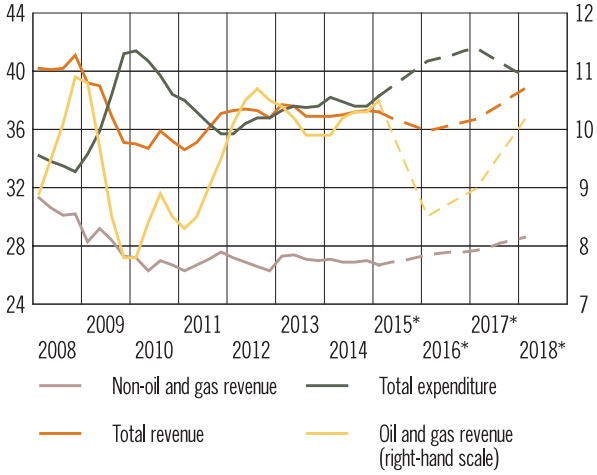
In the short run, Russia's public finances will remain highly stable. However, maintaining the

Russian federal budget expenditure by month (as a share of total non-interest expenditure)



Sources: Federal Treasury, Budget Policy Guidelines for 2015 and the Period of 2016 and 2017, Bank of Russia calculations.

Russian Federation budget revenue and expenditure (moving over last four quarters, as % of GDP)



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

stability of public finances in the medium term will depend on an adequate response, including within a long-term plan, to existing risks associated with the current unfavourable demographic trends.

Inflation

From the end of 2014 to early 2015, inflation peaked sharply. In December 2014, it reached 11.4% year on year, and in February 2015 it was 16.7%. The main reason for this accelerated growth in consumer prices was the direct and indirect influence of the ruble depreciation, the pace of which markedly increased towards the end of 2014.

As a result of the impact of the ruble exchange rate dynamics, playing the role of a general pro-inflationary factor, from the end of 2014 to the start of 2015 price growth for all main subgroups of goods and services in the consumer basket accelerated. In 2014, the greatest price increase was seen in food products (by 15.4%), with the accelerated growth in prices resulting from the depreciation of the ruble, the impact of import restrictions, and the fall in the produced quantities of a number of agricultural crops. Excluding the food industry, core inflation pace also picked up significantly (from 6.2% in November to 9.5% in December). At the start of 2015, inflation for the main components of the consumer basket continued to increase.

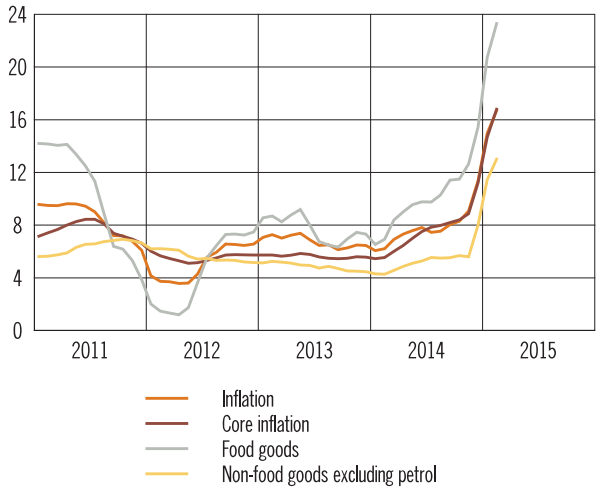
The depreciation of the national currency is directly reflected in domestic markets' price dynamics through an increase in the price of imported intermediate and finished products. A secondary effect of the depreciation is the worsening of inflation expectations, leading in the short term to growth in economic agents' propensity to consume and an increase in demand-side pressure on prices. Another channel of the exchange rate dynamics' indirect influence on inflation is through the increase in returns on export operations, encouraging an expansion in the exports volume, including by reducing supply in the domestic market.

Overall, in 2014 the exchange rate's direct impact on inflation is estimated to be 2.5 pp. Adjusted by indirect effects, it is estimated to be over 4 pp.

Between the end of 2014 and early 2015, inflation increased noticeably in categories of consumer goods and services where imports account for a considerable market share or where imported raw materials and components are used in production. These include, among others, certain types of fruit and vegetables, meat, dairy produce, sugar, tea, coffee, detergents and cleaning products, household appliances and electronics, transport vehicles, medical products, foreign tourism services, and car insurance.

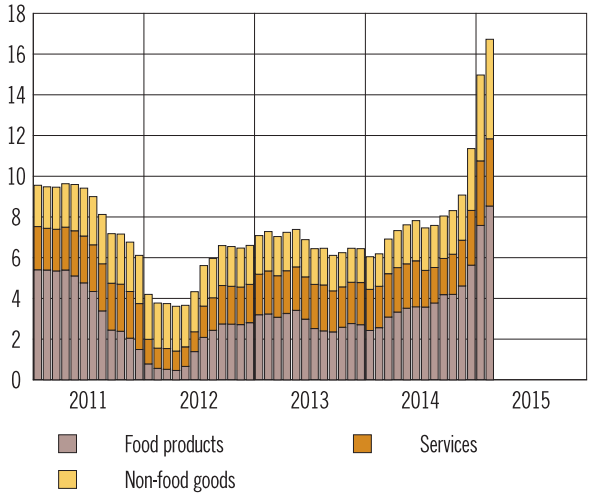
Aside from the depreciation of the ruble, other specific factors, mainly the import restrictions, played an important role in the food markets. The resulting replacement of foreign suppliers and growth in the supply of domestic products were accompanied by an increase in costs and prices, which added, according to estimates, roughly 1.5 pp to inflation in 2014. In January-February

Prices of consumer goods and services (month on corresponding month of previous year, %)



Sources: Rosstat, Bank of Russia calculations.

Contribution to inflation (percentage points, of corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

2015, the import restrictions' contribution to annual inflation remained at approximately the same level.

Another pro-inflationary factor was the fall in the produced quantities of a number of crops in 2014: sugar-beet (by 16.8% compared with 2013), sunflowers (by 17.0%), and buckwheat (by 20.6%). The fall in supply volumes deteriorated the price situation in the markets of granulated sugar, buckwheat, sunflower, and other groats and oils, as well as their substitutes.

As a result of increased returns on export transactions, the ruble depreciation indirectly pushed up domestic producer prices for cereals and oil crops. For example, during nine months in 2014, agricultural producer prices for cereals and sunflower seeds were lower than during the same months in 2013, but in December they were up by 4.4% and 17.7% respectively. In these conditions, at the end of 2014 and in early 2015, inflation picked up for flour, bread and bakery, and sunflower oil in the consumer market.

Another indirect effect of the ruble depreciation was the increase in inflation expectations in December 2014, which triggered panic buying and caused a surge in prices for household appliances and electronics (to 10.0–17.9% on the corresponding month in the previous year from 1.2–5.6% in November). In February 2015, price growth for this product group slowed, but still remained high.

Specific factors underlying the acceleration in inflation also manifested in the services market. Price growth was high for housing services (19.0% for the last year), largely linked to the implementation of the new mechanism for funding capital repairs in apartment buildings. The overall growth in prices for housing and utility services was 9.4% in 2014 and was only 0.4 pp lower than in 2013, despite strict housing tariff indexing parameters.

The favourable situation in the global food market (where key food indices have dropped since spring 2014) and the fall in domestic producer prices in the mining sector, which followed the drop in global oil prices, were both factors that suppressed inflation.

Over the coming months, inflation will still be shaped by the depreciation of the ruble. According to estimates, the contribution of the ruble depreciation, which was observed in January and February 2015, to monthly inflation will peak in March to roughly 0.45 pp. In June, the exchange rate dynamics overall contribution to year-on-year inflation could be roughly 5 pp, and taking into account secondary effects, it could be up to 9 pp.

Moreover, producer expenses are expected to grow, in part due to the increase in domestic prices for oil and petroleum products as a result of the 'tax manoeuvre' and transport services indexing. Petrol price dynamics contribution to the growth of consumer prices (see the box), as well as the role of other tax changes (increasing excise rates

Assessment of the impact of changes in tax legislation on petrol prices in 2015

Beginning 1 January 2015, changes to tax legislation, known as the 'tax manoeuvre' in the oil industry, took effect. Designed to lessen the budget's dependence on global oil prices, these changes provide for a cut in export customs duty rate on oil and oil products, and a simultaneous increase in the basic oil extraction tax. In 2015, the cap on export customs duties on crude oil falls to 42% (down by 29%) and the basic mineral resources extraction tax rises to 766 rubles per tonne of oil extracted (up by 55%). Since both measures have a buoyant effect on domestic oil prices (through increased exports profitability, on the one hand, and growth in the production cost of oil extraction, on the other hand), to protect domestic consumers, from 1 January 2015, petrol excise rates are reduced on average by 25%, according to estimates.

According to our calculations, with the average price of Urals crude at $50 per barrel in 2015, the 'tax manoeuvre' could raise the average annual price of 1 litre of petrol by roughly 13%, which will in part (by 5 pp) be offset by the fall in excise rates.

It is important to note that the 'tax manoeuvre' also provides for the cut in export duties on petrol which, by increasing the attractiveness of its export and reducing internal supply, could exert an upward pressure on petrol prices in Russia. However, the influence of this factor is estimated to be small.

Overall, in 2015 the rising petrol prices' contribution to inflation, effected by the change in tax legislation, is estimated at roughly 0.3 pp.

on tobacco and passenger motor-vehicles), is estimated to be roughly 0.4 pp.

At the same time, the return of the national currency's exchange rate to a level determined by fundamental factors will be accompanied by a fall in consumer price growth in the second half of 2015. The ongoing adaptation of Russian food markets to the new geography of imported products and import substitution growth in certain industries will dampen the pro-inflationary effect of the food embargo. The export duties introduced on 1 February 2015 will have a positive effect on the state of the domestic cereals market. The overall balanced situation in global agricultural markets is also a stabilising factor. Demand-side restrictions will have a generally restraining influence on price dynamics.

In these conditions, year-on-year inflation is expected to increase in the first half of the year. During next six months, the inflation path will be downward as the exchange rate returns to a level shaped by fundamental factors and as inflation expectations normalise. The weakening demand will keep price growth in check.

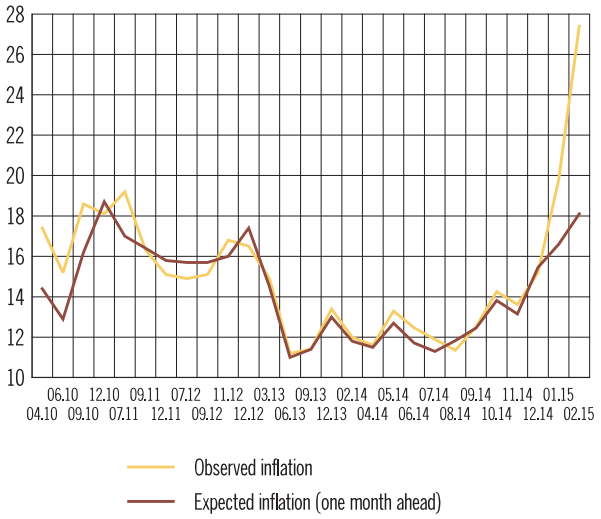
Inflation expectations

Households

According to estimates made using various statistical methods, household inflation expectations stabilised in early 2015. Although direct assessments of observed annual inflation and inflation expectations for the year continued to rise in February, the proportion of respondents believing that price growth would slow or halt entirely over the next 12 months increased considerably. On the one-month horizon, qualitative assessments of inflation remained at an all-time high (since the end of 2009). Moreover, price growth expectations for the month ahead continued to slide down in February. Households tended to identify the ruble depreciation, economic uncertainty and the inertia of inflation processes as the factors exerting the greatest impact on price growth.

According to Bank of Russia estimates[3], in the first months of 2015, inflation expectations stabilised after the sharp growth in 2014 Q4[4]. As follows from the survey conducted in February, future inflation perceptions[5] are estimated at 15.7% using a normal distribution, while a uniform distribution yields 15.2% (compared with 16.1% and 16.7% in January). Estimates using a non-central Student's distribution fell from 29.2% in January to 26.0% in February. It is worth noting that the interval estimate was up from 20.0% in January to 22.5% in February this year. Overall, this means that households expect inflation to stabilise in the double-digits close to the current level.

Direct inflation estimates: median values (%)



Source: Public Opinion Foundation survey results.

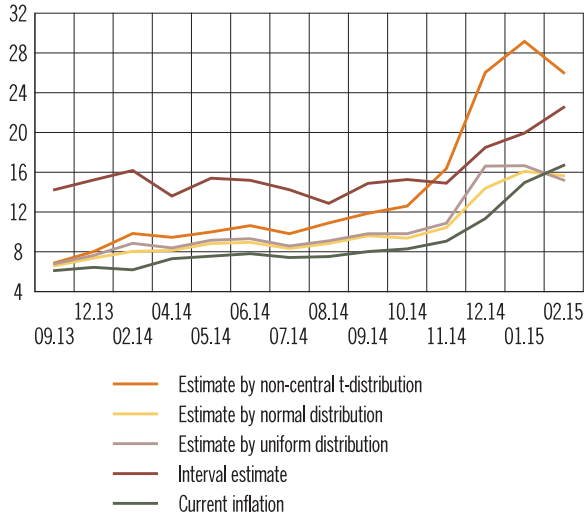
According to the household survey conducted by inFOM, in February 2015 the median expected inflation among households for the forthcoming year increased again (by 1.5 pp, to 18.1%). Estimates of observable annual inflation were up 7.6 pp to 27.4% (its maximum since 2009) due to acceleration in actual inflation at the beginning of 2015.

[3] *Based on FOM survey data.*

[4] *For reference: inflation expectations are quantified, based on respondents' perception regarding future inflation, relative to inflation for the last 12 months. Since there were no official inflation statistics for the previous month at the time the FOM data was received, expectations were initially built using Bank of Russia inflation estimates based on weekly values. At the beginning of February, January inflation estimates significantly differed from the official figure obtained later, and therefore there is a difference in the quantification. Nonetheless, qualitative conclusions regarding the stabilisation of expectations remain unchanged.*

[5] *Inflation for the next 12 months (February 2016 relative to February 2015).*

Quantified inflation expectations (%)



Sources: Public Opinion Foundation survey results, Bank of Russia calculations.

The results of qualitative estimates point to a deterioration in households' perception of the last 12-month inflation. The share of respondents who believed that prices started to rise faster than before has been growing for the fifth month in a row (in February this year by 8 pp, to 71%). Furthermore, the breakdown of responses to the question on price dynamics over the coming 12 months showed a positive shift. In February, the share of those believing that inflation might increase over the coming year fell (by 8 pp, to 15%), while the share of respondents expecting a slowdown or halt in inflation grew (by 6 pp, to 20%).

With respect to the one-month horizon, the share of respondents expecting prices to rise shrank by 3 pp (to 72%), primarily due to those surveyed who believed that prices would rise 'significantly'. The share of respondents who saw price growth over the month stayed at its highest (97%) for the third month in a row in February 2015, with the majority of respondents indicating that 'prices rose significantly'.

Opinions about the ruble depreciation, economic uncertainty and inflation inertia, as before, dominated in the responses to an open question about possible causes of the inflation. The impact of the ruble depreciation on the economic conditions of their lives was viewed as being negative by 68% of respondents, which is 15 pp higher than in January this year, and 20 pp higher than in December 2014.

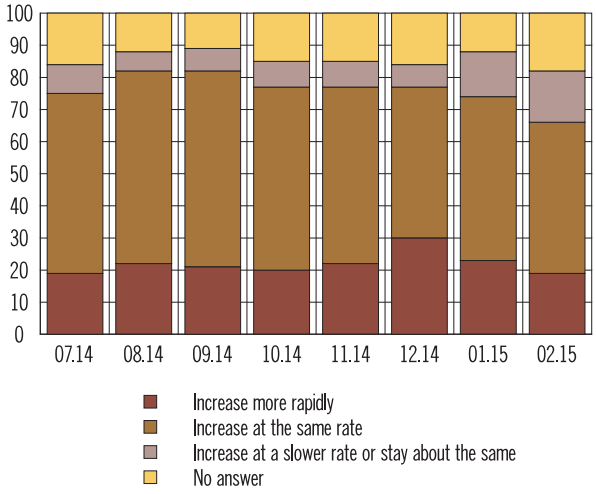
In February 2015, household concern about rising prices for the majority of food products hiked noticeably. The situation in categories such as meat and poultry, and fruit and vegetables was marked as especially worsening.

Businesses

Surveys of business leaders in various economic segments have generally suggested prevailing expectations of price rises for produced and purchased goods. Business leaders in some industries were concerned about unit costs increase as a result of faster price rises for purchased goods compared with output price rises.

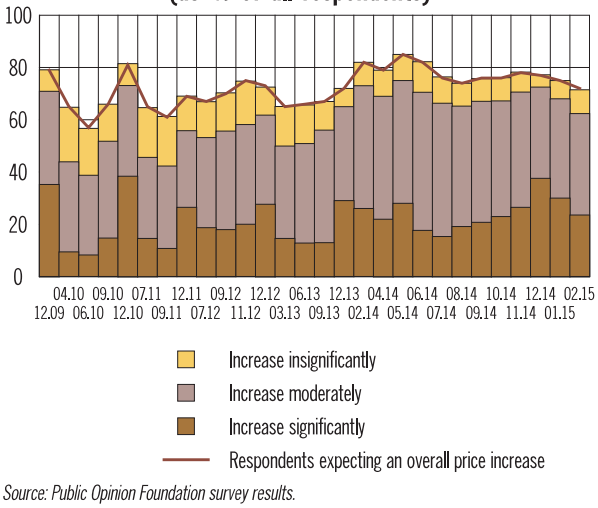
According to a survey by the Russian Economic Barometer, in December 2014 the majority of business leaders expected prices to grow over the coming three months both for purchased

In your opinion, how will the prices develop in the next 12 months (a year)? (as % of all respondents)



Source: Public Opinion Foundation survey results.

In your opinion, how will the prices for food products, non-food goods and services develop in the next month? (as % of all respondents)



Source: Public Opinion Foundation survey results.

and produced goods at the beginning of 2015. According to those surveyed, price increases for purchased goods outpaced those for produced goods. Between the end of 2014 and the start of 2015, the gap between these figures shrank as a result of rising prices for finished industrial goods due to a short-term increase in consumer demand.

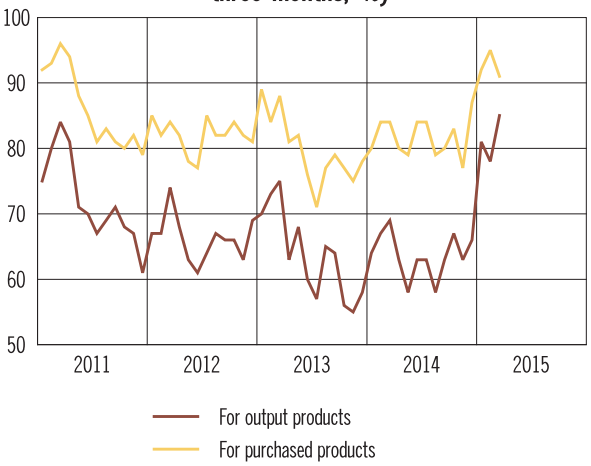
Roughly 50% of respondents mentioned an unfavourable shift in relative prices for their businesses. More often than not, this shift was indicated by the representatives from the chemical and light industries. According to surveys by the Bank of Russia, in December 2014 respondents' concerns continued to be dominated by inflation expectations. At the same time, the intensity of negative expectations decreased, with more businesses starting to expect a fall in prices for finished goods. The largest growth in this group was seen among wholesale and retail businesses, manufacturers of transport vehicles and equipment, electrical, electronic and optical equipment, and in steam / hot water production, delivery and distribution.

Professional analysts

Professional analysts' inflation forecasts for the end of 2015 continued to rise. In the long term, experts expect inflation to fall to 5–6%.

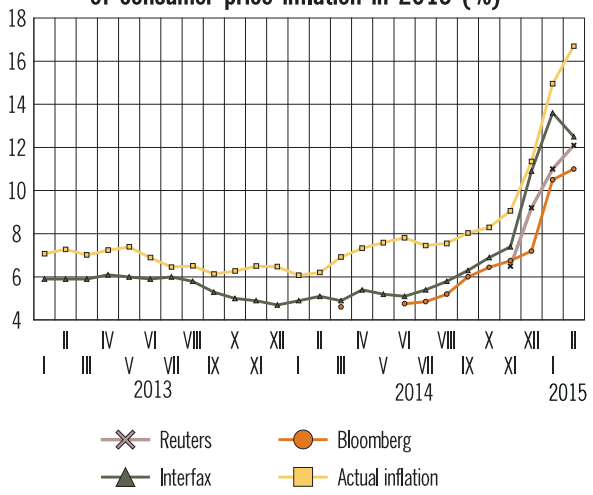
At the beginning of 2015, professional analysts continued to revise their inflation forecasts for 2015

Diffusion price index for industrial production, expected changes (share of enterprises showing higher rates over three months, %)



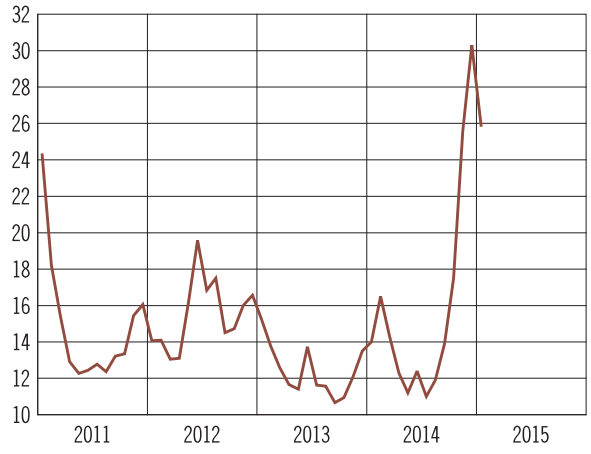
Source: Russian Economic Barometer survey results.

Professional analysts' consensus-forecasts of consumer price inflation in 2015 (%)



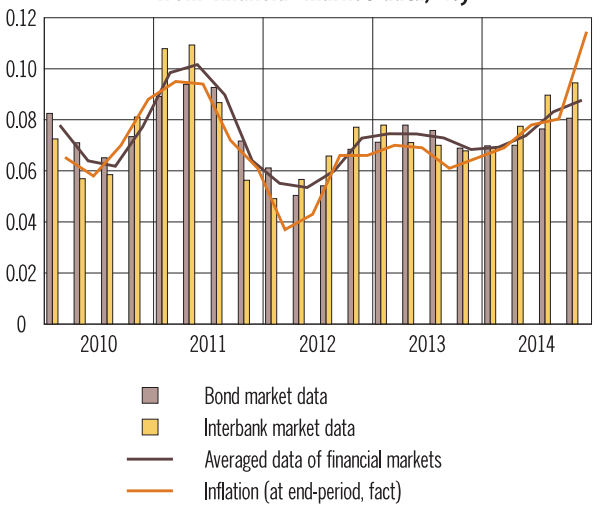
Sources: Rosstat, Interfax, Bloomberg, Reuters.

Expected changes in prices (tariffs, sale prices) for finished goods (services) of enterprises in the next three months (Russia as a whole)



Source: Bank of Russia.

Inflation expectations (estimate derived from financial market data, %)



Source: Bank of Russia calculations.

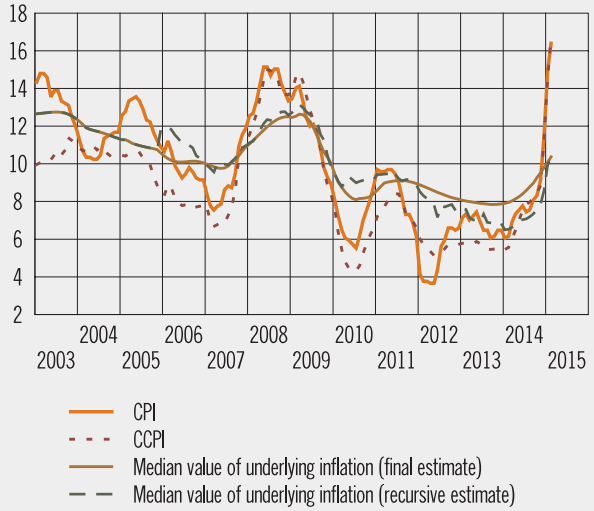
upward. The ruble's continuing depreciation and the persistent economic uncertainty affected the revision of estimates. The consensus forecast by Bloomberg in February of this year increased to 11% compared with 10.5% in January. End-2015 median expected inflation, calculated based on the accuracy of Bloomberg survey participants' forecasts, was 11%.

Short-term inflationary expectations, which were calculated using financial market data in 2014 Q4, also point toward accelerating inflationary expectations for the next quarter.

Assessment of underlying inflation characteristics for Russia

Due to the lag in monetary policy, i.e. the time interval between application of a policy tool by a central bank and reaction thereto in the form of price growth rate, any changes in the economic situation can be considered in the context of their impact on future inflation levels. If an observed temporary acceleration in inflation is caused by factors that are one-off and short-lived by nature, the central bank does not need to react by increasing rates or applying other monetary policy measures, because by the time the measures take effect, these factors will have already leveled out and the need for further intervention by monetary authorities will have passed.

Underlying inflation derived from dynamic factor models (annual growth rate, %)



To split overall inflation, measured by the consumer price index, into its long-term and temporary components, the Bank of Russia calculates a number of indicators of underlying inflation, whose best characteristics are shown by indicators which are calculated using estimates of an unobserved trend based on dynamic factor models[1].

By the end of 2014, the median indicator for underlying inflation, calculated on the basis of three alternative models, was roughly 8.5%. In January-February 2015, it grew to over 10%. The sharp divergence of overall and underlying inflation which has evolved since September 2014 reflects temporary factors' influence on inflation, including those linked to adjusted price levels for imported goods and food products. The scale of the revision[2] of historic underlying inflation dynamics reflects uncertainty with regard to current estimates. Now this uncertainty has grown.

[1] *The results of this study are being prepared for release in series 'Economic research reports by the Bank of Russia'.*

[2] *Reflected in the deviation of final estimates from recursive (i.e. obtained in real time).*

2. ECONOMIC OUTLOOK, RISK ASESSMENT AND MONETARY POLICY DECISIONS

In this Monetary Policy Report, the Bank of Russia considered two macroeconomic development scenarios. The key differences in these scenarios are the assumptions made about oil price dynamics. Taking into account expected global economic trends, the Bank of Russia sees the most likely scenario as Urals crude oil prices remaining around $55 per barrel in 2015, gradually recovering to roughly $70 per barrel by 2017. As a risk scenario, the Bank of Russia considered the possibility of oil prices falling to $40 per barrel and staying at that level through 2015–2017. In both scenarios, the projected fall in GDP will be less than in 2009, despite the comparable reduction in average oil prices over the year. This can be explained, on the one hand, by the larger adjustment of the real ruble exchange rate than at the end of 2008–2009 and, on the other hand, the more stable situation in the global economy.

The Bank of Russia thinks the current acceleration in inflation to be temporary. As the factors causing this acceleration are exhausted, inflation is expected to fall beginning in the second half of 2015. In the baseline and risk scenarios, inflation is forecast to drop to the medium-term target of 4% in 2017.

2.1. Economic outlook

In the previous Monetary Policy Report (December 2014), the Bank of Russia looked at two macroeconomic development scenarios (baseline and risk). The key difference between these scenarios was the assumption made regarding the oil price trajectory in 2015–2017. Observed trends in global commodity and financial markets suggest that the situation in the Russian economy will, at least in 2015, develop in line with a scenario that is closer to the risk scenario, which assumes that in 2015 oil prices will on average be $60 per barrel.

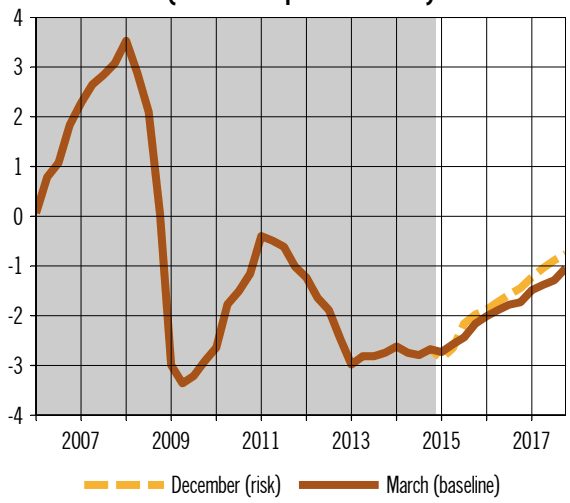
In December 2014-February 2015, the price of Urals crude oil fluctuated between $43-61 per barrel. Given these oil prices, a significant proportion of new oil extraction projects will be unprofitable, and existing capacity has already begun to collapse, with emerging signs of reduced investment in oil extraction in the USA and other developed countries. In the long term, these processes, together with the recovery of the global economy (and, consequently, demand for oil) will lead to equalisation of supply and demand. However, this trend could take a long time, considering the continued growth in extraction and oil reserves in the USA, the use of new technologies to guarantee constant growth in productivity in the development of new deposits, and the readiness of OPEC nations to offer discounts to consumers in order to maintain their share of the market.

In view of these factors, the forecast for oil prices and trading conditions for 2015 was adjusted downwards, even compared with the risk scenario considered in the previous Monetary Policy Report. The updated baseline scenario assumes that the annual average price for Urals crude oil in 2015 will be in the range of $50–55 per barrel. It is then expected to rise smoothly to $60–65 per barrel in 2016 and $70–75 per barrel in 2017, the levels that are justifiable in terms of estimated costs across the whole production cycle.

Lower oil prices relative to previous years will lead to a deterioration of trading conditions and a drop in export revenues. However, despite a fall in average oil prices comparable in size to the drop in the 2008–2009 crisis, the external economic climate's negative impact on the Russian economy is expected to be not so significant. This is due to the fact that a fall in energy prices in 2008–2009 was accompanied by a drastic reduction in global economic growth rates. Currently, the global economy is forecast to enter a gradual revival (and exhibit growing demand for Russian exports)[1]. However, in terms of the overall impact on the

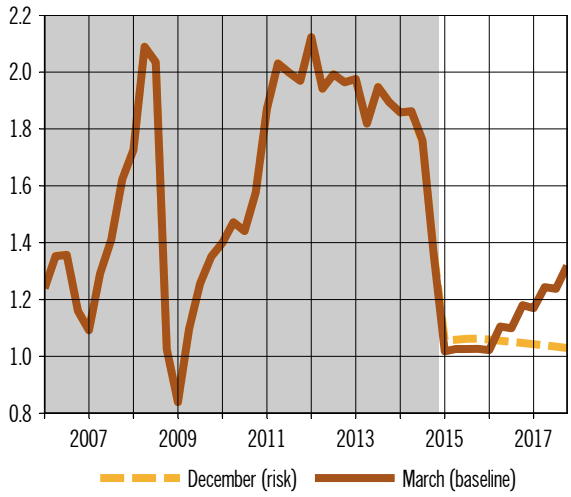
[1] *Compared with the scenarios presented in the previous Monetary Policy Report, the external demand forecast was revised downwards, chiefly due to lower growth forecasts for CIS countries.*

External sector output gap (as % of equilibrium level)



Source: Bank of Russia calculations.

Terms of trade



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

Russian economy, this will not be enough to offset the deterioration in trading conditions.

Another factor behind the differences in the Russian economy's reaction to the current fall in oil prices is a larger adjustment of the ruble real exchange rate (at the end of 2014) as compared with the 2008–2009 crisis, which maintains the level of ruble-denominated revenues received by exporters from foreign trade operations. A similar effect will be likely for federal budget revenues. The net impact of lower oil prices on the budget's oil and gas receipts in 2015 (as compared with 2014) is estimated to be -4.6 percentage points of GDP. However, it will be offset in part by the ruble depreciation (+2.8 percentage points of GDP). As a result, this year budget income from oil and gas is forecast to shrink from 10.5% in 2014 to 7.5% of GDP.

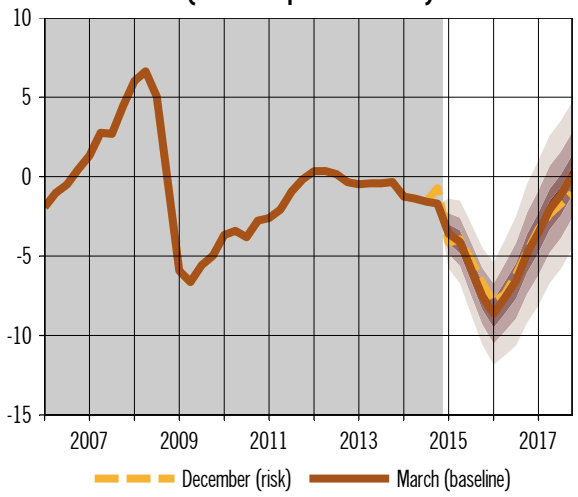
External financial conditions are expected to continue to have a dampening effect over the entire period under consideration. As a result of financial sanctions imposed on Russia, companies' and banks' access to global capital markets will be significantly restricted. In addition, the normalisation of monetary policy in the coming years by a large number of central banks in developed countries will contribute to higher interest rates in external markets and the increased cost of borrowing for emerging market economies. External financial conditions will be most constraining in 2015. The situation is then expected to improve gradually as sources of raising funds in international markets start to diversify.

It should be noted that the effect of global capital markets' restrictions on Russia's economic growth will be longer-lasting as compared with the 2008–2009 crisis, when lower risk aversion shown by international investors caused a renewed inflow of portfolio investments to the Russian financial market and opportunities to build up total external debt as soon as the second half of 2009.

The indirect impact of deteriorating trading conditions, together with increased foreign economic uncertainty and the largely closed-off global capital markets, will be reflected in economic agents' long-standing negative outlooks, which will restrict investment and consumer activity. The need to repay foreign debt and tighten internal price and non-price lending conditions will also suppress economic growth (annual growth in lending to the economy in 2015–2016 will be 2–9%).

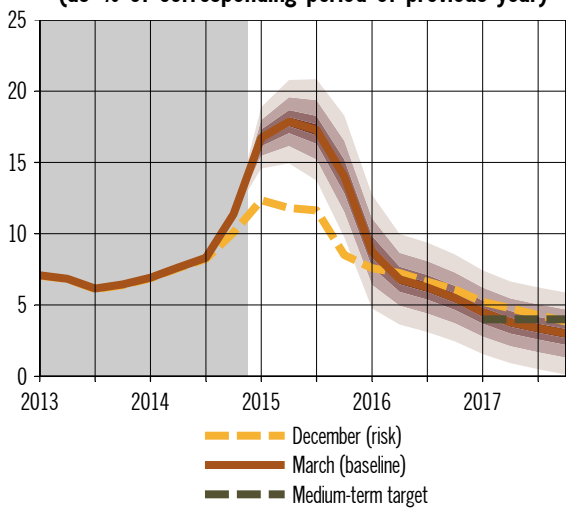
These factors will have a negative impact on economic growth rates for a long time, resulting in GDP decreasing by 3.5–4.0% in 2015 and by 1.0–1.6% in 2016. It is expected that the dampening effect caused by these factors will start to wane in the second half of 2016. At the same time, growth in oil prices to levels justified by the fundamental relationship between supply and demand in global commodity markets, the development of import substitution processes, an increase in export volumes (including exports other than oil and gas), the access to Asian capital markets and gradual domestic borrowing easing (annual growth in credit aggregates and money supply is forecast to increase to 20–25%) will ensure that the economy

Output gap
(as % of potential level)



Source: Bank of Russia calculations.

Inflation
(as % of corresponding period of previous year)



Source: Bank of Russia calculations.

starts to recover in 2017. GDP growth is estimated to reach 5.5–6.3% in 2017.

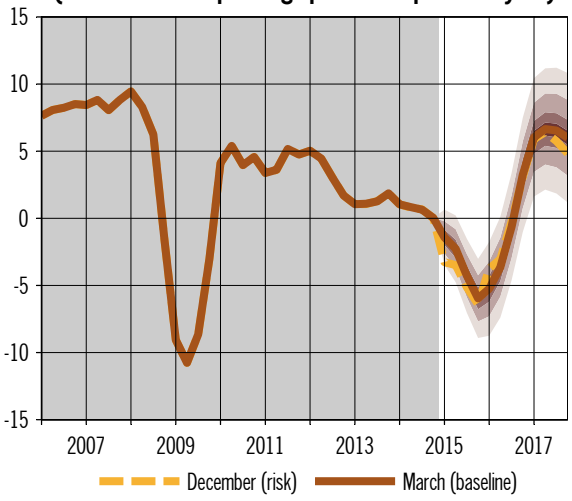
Thus, the period of negative growth is expected to be longer than in the 2008–2009 crisis, but a recovery is likely to be faster and primarily due to internal factors.

According to Bank of Russia's estimates, fiscal policy will promote economic growth. In 2015–2016, the general government sector is expected to have a positive effect on aggregate demand, taking into account the possible adjustment of budget spending at a regional level in 2015, in part due to the estimated additional effect of investing a portion of funds from the National Wealth Fund.

In 2015, the main negative contribution to GDP growth will come from gross capital formation (due to a fall in both fixed capital investment and inventories). The scale of the decrease in gross capital formation will be comparable with the previous crisis period. Alongside the aforementioned factors restricting economic activity, increased investment will be curbed by the halting of a number of investment projects dependent on foreign technologies. Fixed capital investment growth will break into positive territory in 2017.

Household final consumption expenditure is forecast to contract in 2015 by 5.5–5.7%, which is comparable with the fall in 2009, despite the lower expected decrease in total output. This can be explained primarily by the greater fall in real wages in the public sector than in 2009, in line with planned indexing parameters (by 5.5% in nominal terms). In 2009, growth in real wages in the public sector

GDP growth rates
(as % of corresponding quarter of previous year)



Source: Bank of Russia calculations.

was positive, which buoyed up consumer demand. Growth in final consumption is only expected in 2017, when economic activity is forecast to recover and inflation rates are expected to be lower.

Net exports will be the only component making a positive contribution to GDP growth in 2015–2016. Amid weak internal demand and the adjustment of the real ruble exchange rate, imports are expected to shrink by 34–36% in 2015 and by nearly 1% in 2016. In 2017, imports are forecast to grow by 9–11% amid a recovery in both consumer and investment demand.

In the forecast period, export fluctuations are expected to be less severe than during the 2008–2009 crisis. A fall in external demand caused a reduction in the volume of Russian exports in

2008 Q4-2009 Q3 by an average of roughly 9%. However, in 2009 Q4, export growth reached 8.3% as compared with the corresponding period of the previous year amid the recovery in the global economy. Export dynamics in the forecast period (a decrease by 2.2–2.5% in 2015 and a moderate recovery in 2016–2017) will be mostly caused not by changes in global demand, but internal processes, a partial redistribution of raw resource supplies between European and Asian markets, and gradual growth in exports other than oil and gas.

Despite projected negative GDP growth, unemployment is not expected to grow significantly in 2015–2016. According to estimates, the unemployment rate will not exceed 6.0–6.2%. Unfavourable demographic trends and the unique nature of the Russian labour market, where adaptation to changes in economic activity occurs primarily in the form of a change in wages, will serve to suppress mounting unemployment. However, the utilisation of production capacity for the economy as a whole is forecast to fall (the exception is the food industry, where it is likely that import substitution will become more prevalent).

The expectation that oil prices will remain low for a long period of time as compared with the levels observed in previous years and an ongoing pause in investment create conditions for a gradual downturn in the potential growth of the Russian economy from a level of about 2% to figures close to zero in 2015 and the beginning of 2016. They are subsequently forecast to recover to roughly 1%. A comparable slowdown in potential growth was seen in the 2008–2009 crisis period: a fall from 4.5–5% in the pre-crisis period to roughly 2% by the start of 2010.

At the same time, in 2015–2016 the negative output gap is forecast to grow. According to estimates, it will increase to 8.5–9% by 2016 Q1 and then gradually close, while in 2008–2009 the highest negative output gap did not exceed 6.5% (2009 Q2). These differences are due to the fact that before the 2008–2009 crisis the Russian economy was overheated (a drop in growth occurred from higher levels).

The suppressing influence of the negative output gap will start to take full effect on inflation dynamics in the second half of 2015 and, accordingly, will be significantly larger as compared with that observed in 2009. As the effect of one-time factors is exhausted, including the depreciation of the ruble at the end of 2014 and the import restrictions introduced in August 2014 on certain food products, quarterly price growth is expected to fall significantly from 2015 Q3. As a result, by the end of 2015, inflation will be 12–14%, and by the end of 2016 Q1 it could drop to 8.5–9% as compared with the corresponding period of the previous year. This slowdown in price growth will continue in the future. It is expected that inflation will slow to the medium-term target of 4% in 2017.

Balance of payments

A significant drop in oil prices in 2015 as compared with 2014 will lead to exports falling by more than 26% in dollar terms. Ruble exchange rate dynamics will not give substantial support for exports. Moreover, import volumes, especially those of the import of services, will contract in dollar terms at a faster rate due to the slowdown in economic growth and the depreciation of the ruble, as well as the effects of international financial and trade sanctions. As a result, the aggregate trade surplus in goods and services will decrease, however the current account will increase from $57 billion to $64 billion due to an improvement in the balance of non-tradable components, primarily lower investment income due. In 2016–2017, as global oil prices recover, exports are expected to grow rapidly, as well as the current account (to more than $100 billion in 2017), despite a revival in imports as internal demand regains.

The effect of the financial sanctions against Russia will continue for the larger part of the period under consideration and will still have a strong impact on the foreign assets and liabilities of banks and other sectors. Hampered access to external lending sources means that, unlike in previous years, companies will not be able to refinance a significant proportion of their external debts due for repayment in 2015–2017.

Total private sector payments on external debt in 2015, including interest, are estimated to be roughly $120 billion, with the banking sector accounting for 35% of this figure and the remainder non-financial sector payments. Considering that a portion of the debt will likely be successfully refinanced in external markets, and a certain percentage is residents' debts to non-residents belonging to a single group of

companies (intra-group loans), in 2015 the amount due for repayment could be roughly $65 billion. In 2016–2017, the amount of repayments will gradually decrease as the overall debt falls and alternative sources of financing are found, though it will remain high. The forced reduction in external debt (traditionally residents are inclined to increase the net volume of external liabilities) will become the main component of capital outflow in 2015–2017. Residents may make payments from a buffer of accumulated liquid foreign exchange assets, current revenues from foreign trade, and Bank of Russia's FX liquidity provision operations on a reverse basis.

In addition, amid the continuing sanctions and a projected fall in economic growth rates, non-residents' demand for direct and portfolio investment in the Russian economy will be low and the forecast inflow of funds through these items in 2015 will be less than one third of 2014 levels.

However, the deterioration of Russian companies' financial standing will lead to a reduction in a capital outflow in the form of investments in foreign assets, primarily in the form of direct investment abroad, which will in part offset the decreased investment in Russian assets by non-residents. As a result, the net capital outflow is forecast to be roughly $110 billion in 2015 and $80–90 billion in 2016–2017.

2.2. Risk assessment

The process of finding equilibrium and liquidating excess supply in the oil market could take a long time. According to estimates by the International Energy Agency, the excess in oil extraction over consumption will remain at least until the second half of 2015. This forecast is based primarily on expectations that global demand for oil will increase. If global economic growth rates (especially in emerging market economies, which have the potential to increase oil consumption) are lower than expected or oil supply increases (for example, due to the lifting of restrictions on supplies from Iran or sustainable oil extraction from unconventional sources despite low prices), the market imbalance will persist for a long time and will be more acute. As a result, the decline in oil prices could restart, and they could remain low for a long time. Therefore, the Bank of Russia has considered a risk scenario for Russian economic growth, in which Urals crude prices fall to $40 per barrel by 2015 Q2 and remain at that level until the end of 2017.

A more serious deterioration in the terms of trade, combined with the other factors limiting economic growth, as indicated in the baseline scenario (economic agents' worsening sentiment, inaccessible external financial markets, and strict domestic lending conditions), will lead to a further fall in GDP in 2015 (by 5.3–5.8%). A corresponding adjustment of the ruble exchange rate and fiscal policy will help mitigate the excessive cooling of economic activity. Accumulated sovereign funds will be used to support the economy in the event of a sharp fall in the national revenue and limited opportunities to finance the budget deficit.

According to estimates, a revival in economic growth will begin in 2016 due to a faster structural reorganisation of the economy. In particular, ruble exchange rate adjustments will enhance the competitiveness of Russian exports, including its non-oil and gas component. Intensified inflationary pressure in 2015 will boost import substitution. Moreover, positive GDP growth in 2016 will come from the low base of the previous year.

In the risk scenario, similarly to the baseline one, inflation is forecast to lessen as the effects of short-term factors are exhausted (the depreciation of the ruble and the effect of restrictions on the import of a number of food products). Weak demand will contribute to a slowdown in growth. According to estimates, the negative output gap will reach 8.5% by mid-2015 and will then begin to narrow. As a result, inflation will drop to the medium-term target of 4% by the end of 2017, which will be possible given a significant loosening of monetary policy.

In addition, the preservation of high inflation expectations, which may promote a possible hike in natural monopolies' tariffs, fiscal policy relaxation, and accelerated growth in nominal wages pose risks for our inflation forecast.

Balance of payments

As a result of oil prices falling by more than 50%, goods export quantities in 2015 contracted to their minimum since 2009, to roughly $310 billion (compared with more than $360 billion in the baseline scenario). Nonetheless, the balance of payments remains stable, as the drop in economic growth (larger than in the baseline scenario) and the depreciation of the ruble will lead to a comparable drop in imports. As a result, the current account balance in the risk scenario will not differ significantly from the baseline scenario: roughly $60 billion in 2015, $89 billion in 2016, and about $97 billion in 2017.

As in the baseline scenario, it is expected that Russian companies and banks will have to reduce their debt to non-residents by $60–70 billion. There are risks of even more significant capital outflow under this item, since opportunities to refinance in external markets under acceptable conditions will be more limited amid a sharper downturn in the Russian economy and the ruble depreciation. Periods of tension are also likely to arise in the foreign exchange market, which may bring about an ongoing increased demand from households for FX cash, albeit at a lower level than in 2014. However, the decrease in the economy's aggregate income will lead to a weaker demand for foreign assets. As a result of these factors, under the risk scenario the net private sector capital outflow in 2015 could exceed $130 billion. In the future, as the situation in the economy normalises the outflow is expected to shrink to roughly $90 billion in 2016 and less than $80 billion in 2017.

As in the baseline scenario, international reserves will need to be reduced to maintain the

balance payments with the ruble exchange rate at a level that does not pose any risks to financial stability. The Bank of Russia will provide FX liquidity to banks on a reverse basis in the required amounts and will carry out operations in the FX market to convert Reserve Fund resources. Under the risk scenario, in 2015 reserves are expected to contract by more than $75 billion.

2.3. Changes in the system of instruments and other monetary policy measures

In the period from December 2014 to February 2015, the Bank of Russia took steps to expand credit institutions' opportunities to refinance with the Bank of Russia, to maintain financial stability, which is a key requirement of the effective performance of the monetary policy transmission mechanism, and to stimulate certain segments of the credit market where development has been stunted by structural factors.

Given a limited amount of available marketable collateral, the Bank of Russia sought to create additional opportunities for credit institutions to manage liquidity and increase their potential for refinancing. Credit institutions in the 3rd classification group[1] were allowed to use required reserves averaging mechanism and to obtain certain types of secured loans from the Bank of Russia. Credit institutions were also allowed to use non-financial organisations' bonds and mortgage bonds from issuers without a credit agency rating, Russian Federation government guarantees, and guarantees of the Agency for Housing Mortgage Lending as collateral for refinancing operations. New securities issues were added to the Bank of Russia Lombard List. Discounts were reduced, correction ratios used to adjust the value of securities were raised, and correction ratios used to adjust the value of non-marketable assets taken as collateral for Bank of Russia loans were also increased. In addition, in order for credit institutions to more effectively manage their marketable collateral portfolios, settlement dates for FX repos with various maturities were synchronised with the settlement dates for one-week ruble repos.

In order to improve its monetary policy signal, the Bank of Russia changed its approach to setting interest rates on standing facilities with terms longer than one day. Since 16 December 2014, loans for terms from two to 549 days are provided at a floating interest rate linked to the Bank of Russia key rate (previously such loans for terms from two to 90 days were provided at a fixed rate). Thus, a change in the key rate translates into a change in the cost of funds previously issued by the Bank of Russia, which allows it to more effectively regulate money market rates.

To maintain stability in the financial sector, the Bank of Russia implemented a range of measures.[2] In particular, to smooth over the effects of the ruble exchange rate's volatility, credit institutions were temporarily allowed to use the exchange rate as of 1 October 2014 when calculating their prudential ratios for foreign currency operations. In connection with the sharp downturn in asset prices, a temporary moratorium was introduced on recognising a negative revaluation on credit institutions and non-bank financial organisations' securities portfolios. Moreover, to avoid a situation where large numbers of the Bank of Russia's counterparties fail to fulfil their obligations on repo transactions, the decision was made to temporarily stop collecting margin calls (margins are now again being applied to repo transactions).

As part of measures aimed at stimulating certain segments of the loan market where development was hampered by structural factors, in December 2014 the Bank of Russia introduced a new specialised refinancing mechanism for credit institutions against the pledge mortgages issued under the military residential savings and mortgage system (the 'Military Mortgage' programme). Up to the present, the Bank of Russia does not plan to recognise other forms of mortgage collateral, but from the risk management perspective, the Bank of Russia is prepared to accept securities issued through the securitisation of mortgage portfolios as collateral for refinancing operations. The Bank of Russia intends to further promote the development of securitisation mechanisms, which should take place with credit institutions' active involvement.

Bank of Russia special measures implemented during the period under consideration were called forth by the need to solve specific problems related, among other things, to the evolving challenging conditions under which the economy and the financial and banking sectors are operating. In

[1] *In accordance with Bank of Russia Ordinance No. 2005-U, dated 30 April 2008, 'On Assessing Bank's Economic Situation'.*

[2] *See the Bank of Russia's press release, dated 17 December 2014, 'On Bank of Russia measures to maintain stability of Russian financial sector' (http://cbr.ru/press/PR.aspx?file=17122014_171432dkp2014-12-17T17_02_49.htm).*

this respect, the Bank of Russia's approach to monetary policy has not changed. Regular one-week repo auctions, three-month loan auctions, and overnight standing facilities still form the backbone of its system of instruments. Being equal or linked to the key rate, the minimum auction rates have a direct effect on the minimum cost of borrowing in the economy. Interest rates on standing facilities form the bounds of the Bank of Russia's interest rate corridor. Using these operations, the Bank of Russia strives to maintain balance in the overnight money market segment and keep this segment's rates close to the key rate, which is the operational goal of the monetary policy.

Bank of Russia operations with foreign currency

In the period under consideration, after switching to the floating exchange rate, the Bank of Russia carried out FX liquidity provision operations on a reverse basis to the Russian banking sector in order to maintain relative stability in the domestic FX market.

To expand credit institutions' opportunities to manage foreign currency liquidity and to refinance external loans taken out by Russian exporters in foreign currency, which are due to be repaid in the near future, on 23 December 2014, the Bank of Russia added a mechanism to provide foreign currency to the banking sector with foreign currency loans secured by the pledge of receivables on foreign currency loans. The list of the Bank of Russia's counterparties includes credit institutions with equity capital exceeding 100 billion rubles, and Vnesheconombank.

Bank of Russia foreign currency loans are provided at auctions for the terms of 28 to 365 calendar days, and the minimum interest rate is set at LIBOR in the corresponding currencies for comparable terms plus 0.75 pp. The Bank of Russia accepts receivables on foreign currency loans provided to large Russian exporters as collateral on these operations. Besides, the currency of Bank of Russia loans must be the same as the collateral currency.

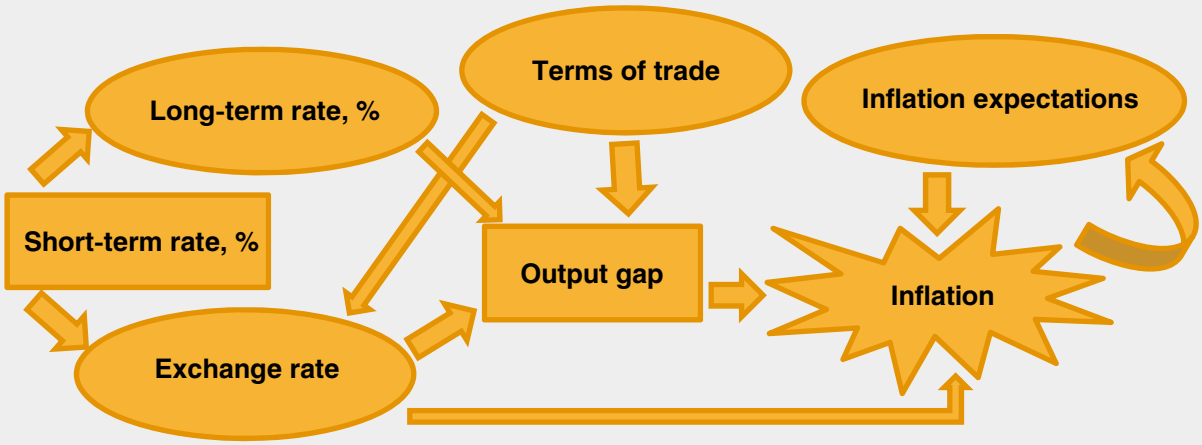
The previously established ceiling on credit institutions' outstanding amount to the Bank of Russia under FX repos, in the amount totalling $50 billion, was expanded to include foreign currency loans and remained at the same level. If necessary, the Bank of Russia may raise this ceiling.

Monetary policy in the Bank of Russia's forecast

Decision-making on monetary policy is based on an analysis of the current situation in the economy and an assessment of prospects for future growth. Therefore, the macroeconomic medium-term forecast is one of the foundations and key sources of information for decision-making on monetary policy. The forecast is generated by a large group of Bank of Russia specialists in collaboration with Board of Directors members and offers a coordinated opinion on the most likely development of the economy, accounting for the policy aimed at achieving inflation targets.

In accordance with the best global practices, central banks use a wide range of formal analysis methods, from simple extrapolation algorithms to multidimensional econometric models and structural general equilibrium models based on economic theory. Many central banks use a model or set of models specially developed to support monetary policy decision-making as the basis for their forecast.

The Bank of Russia's forecast is created through a process of reconciling assertions and calculations based on a set of models in a system for forecasting and analysis. The core of the system is the quarterly forecasting model (QFM)[1]. This is a structural model developed on the basis of the standard version of the New Keynesian monetary model in gaps. It takes into consideration the specifics of Russia's economy and monetary policy transmission mechanism. An outline of the model is provided below.



The model is a means of scenario forecasting and a tool to organise the forecasting process. Calculations using this model are verified and adjusted, factoring in the results of calculations based on other models of varying complexity. Model calculations are also supplemented by expert judgements. The forecast is developed for three years, but the most important forecast for monetary policy decision-making is the macroeconomic forecast for the period corresponding to the lag of the monetary policy transmission mechanism, which is roughly equal to two years.

Sources of the forecast include initial conditions (i.e. an estimate of the Russian economy's position in the economic cycle), expected external economic dynamics (to assess the future development of the external environment, Bank of Russia specialists rely on consensus forecasts and their own assessments), and the assessment of long-term equilibrium trajectories (or trends). Together with the assessment of initial conditions, the assessment of the development of processes over the next one-two quarters (i.e. a short-term forecast) makes an important contribution to the medium-term forecast. This is prepared using both simple single-equation econometric models and more complex models, as well as expert assessments. The short-term forecast is included in the medium-term forecasting model.

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[1] *Work to create the model was performed by the Research and Information Department at the Bank of Russia since 2007. The model is being continually improved and expanded and its parameters are refined at the Bank of Russia. The initial variant of the model is described in the work: Borodin A.D., Gorbova E.A., Plotnikov S.V., Plushchevskaya Yu.L. Assessment of the potential output and other unobserved variables in the monetary policy transmission mechanism model (using Russia as an example) // The problems of selecting an effective monetary policy in a transitional economy: Collection of reports // International Scientific Practical Conference, Minsk, 19–20 May 2008 – Minsk: National Bank of the Republic of Belarus, 2008. P. 119–143.*
http://www.nbrb.by/Publications/Research/MonetaryPolicyOptionsInTransitionEconomy.pdf

The model's equations describe key interactions in the Russian economy and between the Russian economy and the rest of the world. It includes behavioural equations describing demand (the Investment-Saving (IS) curve), price formation (the Phillips curve), exchange rate dynamics (uncovered interest rate parity), and a simplified interest rate time structure. An important property of the model is the fact that it contains a function describing the central bank's reaction to macroeconomic dynamics. The model reflects the active countercyclical effect of monetary policy measures on monetary conditions in the open economy and through them – on aggregate demand and supply dynamics in order to bring inflation to the target level. As such, the model formalises policy objectives and their relative priority.

The ultimate goal of the Bank of Russia's monetary policy is a sustainable and low inflation. Achieving the operational monetary policy objective, which is to keep short-term money market rates close to the key rate, is a mandatory requirement. To do this, the Bank of Russia regulates banking sector liquidity using instruments to supply and absorb liquidity. The operation of the transmission mechanism's interest rate channel assumes that the cost of borrowing for banks, which is established by the central bank, influences bank lending rates, i.e. the cost of borrowed funds for economic agents, which in turn influences the level of business activity and, consequently, inflation.

The central bank's work to set short-term interest rates in the money market is formalised in the forecast as a simple function of the central bank's reaction, which is coordinated with the determination of the Bank of Russia's goals[2]. The equation is based on the modified Taylor rule and simulates the central bank's reaction (changes in short-term interest rates) on future and current economic dynamics. In other words, the reaction function defines the level of short-term interest rates as a function of the expected inflation's deviation from the target inflation level over the monetary policy horizon (four quarters in the model) and current output gap values. The estimate of inflation and output gap reflects the dynamics of all of the macroeconomic variables included in the model.

The central bank's reaction is aimed at returning the economy to a state of equilibrium in the medium term (in terms of gaps) and gradually bringing inflation to its target level (4% in 2017). The target trajectory for inflation is an element of the forecast model.

The central bank's reaction function is expressed as follows:

$$i_t = \gamma_1 i_{t-1} + (1-\gamma_1)\left(i_t^{neutral} + \gamma_2(E_t\pi 4_{t+4} - \pi_{t+4}^{TAR}) + \gamma_3 y_t^{gap}\right) + \varepsilon_t^{MP},$$

where i_t is the nominal short-term money market rate (a monetary policy operational indicator);
γ_1 is the interest rate dynamics smoothing parameter;
i_{t-1} is the value of the rate in the previous period (the autoregressive component);
$i_t^{neutral}$ is the monetary policy's inflation-neutral nominal interest rate, which is the sum of the equilibrium (or neutral) real interest rate for the money market and inflation expectations calculated in the model;
γ_2 is the weight of inflation's deviation from the target (the deviation of actual output rates from the potential ones);
$\pi 4_{t+4} - \pi^{tar}_{t+4}$ is inflation's expected deviation from the target in four quarters in annual terms;
γ_3 is the weight of the output gap;
y^{gap}_t is the output gap calculated in the model using the Kalman filter;
ε^{MP}_t is a monetary policy shock.

Thus, the equation describes the main principles underlying the determination of the target level for the Bank of Russia's monetary policy operational indicator. The interest rate's target level deviates from the neutral level to such an extent as to offset inflation's expected deviation from the target path. The current output gap is accounted for by the specified weight. Moreover, the equation includes an autoregressive component that reflects smoothing due to interest rate dynamics and implies a gradual change in the operational indicator's level. A gradual change in the rate also makes it possible to estimate the effect of a change in it and to factor in new incoming data.

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[2] *'The primary objective of the single state monetary policy is to ensure price stability, which implies the achievement of sustainable and low inflation. (…)The monetary policy goal is to lower inflation to 4% in 2017 and keep it close to this level. (…)As long as it does not hamper achieving the inflation target, the Bank of Russia's monetary policy seeks to smooth out cyclical fluctuations of economic activity and financial indicators relative to their fundamental levels.' Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017. P. 6.*

The rule parameters (γ_1, γ_2, γ_3) reflect the central bank's preferences in decision-making and are calibrated in such a way as to guarantee that monetary policy has a stabilising effect: it brings inflation to the target value, taking into account the need to minimise output fluctuations. Bearing in mind the long-term and forward-looking nature of the reaction function, this functional form cannot be estimated by econometric means using a single equation, based on historical data. Moreover, an econometric assessment of the rule is complicated by the relatively short-lived monetary policy regime and operational procedure based on interest rate regulation.

The existence of an econometrically assessed rule based on historical data does not mean that the central bank always makes decisions in accordance with the rule or will do so in future, by basing them on the rule's coefficients that characterise policy preferences. The inflation targeting regime flexibility is generally formalised in the equation by assigning a non-zero value to the coefficient of the output gap variable. Other variables that may be considered in policy decision-making process and that characterise, for example, financial stability or exchange rate dynamics, are factored into the reaction function indirectly (in the dynamics of all variables in the model), to the extent that they have an effect on target macroeconomic processes, i.e. inflation and economic growth.

Thus, a certain interest rate trajectory, created using a forecast's specific assumptions, is aligned with each Bank of Russia forecast. Moreover, the target rate supports:

1) achieving inflation targets (4% in the medium term);

2) a reasonable balance between achieving the inflation target and the full utalisation of production capacity (full consumption of resources) in the economy.

However, this trajectory cannot be viewed as an obligatory trajectory for future interest rates. In practice, central banks use policy rules as one of the analytical support tools for their decision-making: for modelling economic situation and analysing the potential consequences of various decisions in monetary policy. The arrival of new information, changes to forecast assumptions and other factors can cause the forecast trajectory to be revised and actual interest rates to deviate from modelled trajectories.

It is important to understand that the existence of rules does not suggest that they are applied mechanically in decision-making to set key rate levels. Expert assessments are always used in decision-making. Publishing policy rules could create a false impression of decision-making, because the formula over-simplifies reality. The main purpose of rules is to formalise the consistent policy and to define systems and hierarchies of aims and tools: the ultimate and main goal of monetary policy is to gradually reduce inflation to the target level, while the operational target is the money market rate.

Glossary

Asset-backed securities (ABS)

Bonds or other securities backed by pooled assets which usually generate predicable cash flows and which are formed by banks or other credit institutions.

Average rate on interbank loans

An average rate on Russian banks' operations to provide loans to other banks. Rates are calculated on all interbank loans (MIACR), loans extended to Russian banks with investment grade ratings (MIACR-IG), and loans extended to Russian banks with speculative grade ratings (MIACR-B). The spread between MIACR-B and MIACR-IG is one of the indicators of credit risk assessment by interbank lending market participants.

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.

Banking sector liquidity

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

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, as a percentage) + 0.5 x (share of banks reporting a moderate tightening of lending conditions, as a percentage) – 0.5 x (share of banks reporting a moderate easing of lending conditions, as a percentage) – (share of banks reporting a significant easing of lending conditions, as a percentage). 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

Interest rate on main operations of the Bank of Russia to manage banking sector liquidity. A key monetary policy indicator.

Basis point

One hundredth of a percentage point.

Broad money (monetary aggregate M2X)

Total amount of cash in circulation and funds of the Russian Federation residents (nonfinancial and financial (excluding credit) organisations 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.

CBOE crude oil volatility index

The Chicago Board Options Exchange (CBOE) index calculated by applying the VIX methodology and reflecting the market's expectations of 30-day volatility of crude oil prices.

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, telecommunication services, and the majority of housing and public utility services).

Countercyclical currency

A currency which normally faces appreciation in periods of instability in global markets and/ or recession in the global economy. Specifically, this type of currencies includes the US dollar, Japanese yen, and Swiss franc.

Covered bonds

Bonds secured by payments on mortgage loans or government debt obligations. The difference between covered bonds and asset backed securities lies in the fact that covered bonds remain on the issuer's balance sheet after the issue, therefore making the issuer liable for the credit risk on the assets which back the bonds.

Credit default swap (CDS)

A contract under which the seller of the contract commits to pay a pre-set sum to the buyer if a certain credit event occurs.

Cross-currency basis swap

Currency interest rate swap under which floating interest rate payments in different currencies are swapped. The price of this swap reflects the premium to one of the floating rates.

Current liquidity deficit

An excess of banking sector demand for liquidity over the liquidity supply on a given day covered by daily Bank of Russia operations in the money market. A reverse situation, called 'current liquidity surplus', is an excess of the liquidity supply over demand on a given day.

Dollarisation of deposits

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

Dual currency basket

Operational indicator of the exchange rate policy of the Bank of Russia expressed in the national currency (in rubles) and made up of US dollars and euros (effective since February 2005). The ruble value of the dual currency basket is calculated as the sum of 0.55 US dollars and 0.45 euros in rubles (effective since 8 February 2007).

Factors of banking sector liquidity

Changes in the central bank balance sheet 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 general government account balances 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.

Fiscal stress indicator

An approach developed by the IMF experts using an integral early crisis warning indicator, calculated on the basis of signals from three complementary groups of variables: basic fiscal variables; long-term fiscal trends; and, asset and liability management (12 variables in total). For each variable a threshold is calculated, which, if exceeded, signals the threat of a crisis in the following year. A signal strength showing the weight of each variable in the fiscal stress indicator is also estimated. For more details see the methodology in: Baldacci E., McHugh J., Petrova I., 'Measuring Fiscal Vulnerability and Fiscal Stress: A Proposed Set of Indicators'. IMF Working Paper, No. 94, 2011, and Baldacci E., Petrova I., Belhocine N., Dobrescu G., Mazraani S., 'Assessing Fiscal Stress'. IMF Working Paper, No. 100, 2011.

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 influence the domestic FX market occasionally in order to smooth out the ruble's exchange rate volatility and prevent its excessive deviations.

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 of the key rate with effect from the corresponding date.

Foreign exchange swap

A deal which consists of two legs: one party of the deal initially exchanges a certain amount in domestic or foreign currency for an equivalent amount in another currency provided by the second party of the deal. Then, once the deal term has expired, the parties make a reverse transaction (in the corresponding volumes) at a predetermined rate. Foreign exchange swaps are used by the Bank of Russia to provide credit institutions with refinancing in rubles and foreign currency (US dollars).

Forward rate agreement (FRA)

A forward interest rate contract under which one party of the contract pays a fixed interest on a specified notional amount in future. Parties of the contract commit to make compensation payments on the effective date in case the interest rate on such date differs from the fixed rate.

Free bank reserves

Include ruble correspondent and deposit accounts of credit institutions with the Bank of Russia, as well as credit institutions' investments in Bank of Russia bonds.

Funds in general government's accounts

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.

Implied volatility

A measure of exchange rate volatility that reflects current market prices of FX options under Black-Scholes model (as a rule, at-the-money).

Inflation targeting regime

A monetary policy framework which considers price stability as the final target of the central bank. 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.

Managed floating exchange rate regime

Under the managed floating exchange rate regime the central bank does not interfere in the trends of ruble dynamics which are shaped by fundamental macroeconomic factors. No fixed limits or targets are set for the ruble rate, with the central bank seeking to smooth out exchange rate fluctuations in order to support economic agents' gradual adaptation to changes in external economic environment.

MICEX index

MICEX index is the composite index of the Russian stock market calculated by CJSC MICEX Stock Exchange (hereinafter, the Exchange) based on the ruble prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

MSCI indices

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

Monetary aggregate M1

Total amount of cash in circulation and funds of the Russian Federation residents (nonfinancial and financial (excluding credit) organisations 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 stance

The characteristics of a monetary policy's impact on the economy. Tight stance suggests the restraining effect of the monetary policy on economic activity in order to reduce inflationary pressures, whereas a loose monetary policy stance implies economic stimulation with possible upward pressure on inflation.

Monetary policy transmission mechanism

The process of transferring the impulse of monetary policy decisions (i.e. decisions made by a central bank in relation to changes to interest rates on its operations) to the economy as a whole and to price dynamics, in particular. The most important channel of monetary policy transmission is the interest rate channel. The impact of the latter is based on the influence of a central bank policy on changes to the interest rates at which economic agents may deposit and raise funds, and, as a result, on decisions regarding consumption, saving and investment and, thereby, on the aggregate demand, economic activity and inflation.

Money supply

Total amount of funds held by residents of the Russian Federation (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 and Broad money).

Money supply in the national definition (monetary aggregate M2)

Total amount of cash in circulation and funds of the Russian Federation residents (nonfinancial and financial (excluding credit) organisations 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.

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, and investments by credit institutions in Bank of Russia bonds (at prices fixed as of the start of the current year).

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.

Nominal effective ruble exchange rate index

The nominal effective ruble 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 to the currencies of Russia's main trading partners. 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.

Non-marketable assets eligible as collateral for Bank of Russia loans

Promissory notes and credit claims eligible as collateral for Bank of Russia loans in accordance with Bank of Russia Regulation No. 312-P, dated 12 November 2007, 'On the Procedure for Extending Bank of Russia Loans Secured with Assets or Guarantees to Credit Institutions'.

Non-price bank lending conditions

Bank lending conditions aside from the cost of a loan to the borrower, such as maximum loan amount and lending term, requirements to collateral and the financial standing of the borrower.

Open market operations

Operations carried out on the initiative of a central bank. This type of operations includes auction-based refinancing and liquidity-absorbing operations (repo auctions, deposit auctions, etc.), as well as purchases and sales of financial assets (government securities, currency, and gold).

Output gap

Deviation of GDP from potential output, expressed as a percentage. Characterises the balance between demand and supply and may be regarded as an aggregate indicator of the effect which the demand factors have on inflation. If the actual output is larger than the potential output (positive output gap), all else equal, inflation is expected to accelerate. A negative output gap is an indicator of an expected slowdown in price growth. Output fluctuations around the potential level are called cyclical fluctuations.

Outstanding amount on Bank of Russia refinancing operations

Outstanding amount on loans extended by the Bank of Russia against the collateral of securities, non-marketable assets, guarantees, and gold, as well as repo auctions and FX swaps.

Overnight index swap (OIS)

An interest rate swap where fixed-rate payments are swapped for floating-rate payments set on the basis of overnight money market rates over a respective period of time.

Potential output

The aggregate level of output in the economy achieved under normal utilisation of production factors with existing resource and institutional constraints. Reflects the volume of products that may be produced and sold without creating prerequisites to a change in price growth rates. The level of potential output is not linked to a certain level of inflation; it merely indicates the presence or absence of conditions for the inflation acceleration or deceleration.

Procyclical currency

A currency which normally appreciates in periods of global economic growth. Specifically, this category of currencies includes the euro, the Canadian dollar, and the Australian dollar.

Real effective ruble exchange rate index

Calculated as the weighted average change in real exchange rates 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 real effective ruble exchange rate index reflects changes in the competitiveness of Russian goods in comparison to those of Russia's main trading partners.

Realised volatility

Exchange rate volatility measure calculated on the basis of historical data taken for a given period of time. As a rule, the sum of squared daily logarithmic returns of the exchange rate is assumed to be its realised volatility.

Repo operation

A deal which consists of two legs: one party to the deal initially 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 ruble liquidity in exchange for collateral in the form of securities.

RGBEY index

RGBEY (Russian Government Bond Effective Yield to Redemption) index reflects an effective yield to redemption of Russian government bonds calculated as an average gross yield to redemption without accounting for bond issue duration.

Risk premium on market securities portfolio

Calculated in accordance with the capital asset pricing model as the difference between the yield

of a market securities portfolio and the yield of a risk-free asset. The yield of a risk-free asset is, as a rule, taken to be the yield of government securities (for example, OFZ – federal government bonds). Measured in percentage points (pp).

RTS index

RTS Index is the composite index of the Russian stock market calculated by the Exchange based on the US dollar prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

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 at the initiative of credit institutions.

Structural liquidity deficit

The state of the banking sector characterised by a stable demand by credit institutions for Bank of Russia liquidity provision operations. The reverse situation, characterised by a stable demand by credit institutions to deposit funds with the Bank of Russia, is a structural liquidity surplus. A calculated level of structural liquidity deficit/surplus is a difference between amounts outstanding on Bank of Russia refinancing and liquidity-absorbing operations.

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.

STATISTICAL ANNEX

Table 1

Operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Interest rate since 16.03.15, % p.a.	Bank of Russia claims on liquidity provision instruments, Bank of Russia obligations on liquidity absorption operations (at the beginning of the first businessworking day, billions of rubles)					
						01.2014	04.2014	07.2014	10.2014	01.2015	03.2015
Liquidity provision	Standing facilities (fixed interest rates)	Overnight loans	1 day	daily	15.00	0.0	0.0	0.0	5. 1	0.0	0.0
		FX swaps (ruble leg)				278.7	488.2	166.0	0.0	121.6	90.0
		Lombard loans				6.6	2.0	1.0	0.4	3.7	3.8
		Repo				14.1	27.5	57.8	138.3	201.6	139.6
		Loans secured by gold[1]	1 day		15.00	0.4	0.6	0.4	0.6	1.2	0.6
			from 2 to 549 days[2]		15.50						
		Loans secured by non-marketable assets or guarantees[1]	1 day		15.00	600.5	370.9	420.5	651.6	2,055.9	1,088.5
			from 2 to 549 days[2]		15.75						
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets	from 1 to 3 months	occasionally	14.25	691.8	1,184.5	1,982.5	2,139.3	2,370.9	2,751.2
			3 months[3]	monthly							
			12 and 18 months[3,4]	occasionally							
		Lombard loan auctions[3]	36 months	occasionally		-	-	-	-	-	-
		Repo auctions	from 1 to 6 days[5]	occasionally	14.00 (ключевая ставка)	2,883.4	2,956.1	2,570.7	2,402.3	2,707.8	1,432.3
			1 week[6]	weekly							
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days[5]	occasionally		0.0	0.0	0.0	0.0	0.0	0.0
			1 week[6]	weekly							
	Standing facilities (fixed interest rates)	Deposit operations	1 day, call	daily	13.00	517.6	118.7	89.0	216.1	804.6	309.6

[1] From 16 December 2014, loans for 2 to 549 days are provided at a floating interest rate linked to the Bank of Russia key rate. From 30 June to 15 December 2014, loans for up to 90 days were provided at a fixed interest rate, loans for 91 to 549 days - at a floating interest rate linked to the Bank of Russia key rate.

[2] Until 30 June 2014, loans were provided for 2 to 365 days, from 30 June 2014, loans are provided for 2 to 549 days.

[3] Loans provided at a floating interest rate linked to the Bank of Russia key rate.

[4] Until 16 October 2014, loans were provided for 12 months, from 16 October 2014, loans are provided for 18 months.

[5] Fine-tuning operations.

[6] Faced by structural liquidity deficit, the Bank of Russia holds repo auctions, in other conditions it holds deposit auctions.

Source: Bank of Russia.

Table 2

Required reserve ratios

Liability type	Ratio, %
To non-resident legal entities	4.25
To households	
Other liabilities	

Source: Bank of Russia.

Table 3

Average required reserve ratio

Types of credit institutions	Ratio
Credit institutions, excluding settlement non-bank credit institutions and non-bank credit institutions, which are entitled to transfer funds without opening bank accounts, and to conduct other related bank operations	0.7
Non-bank credit institutions entitled to transfer funds without opening bank accounts and to conduct other related bank operations	1

Source: Bank of Russia.

Table 4

Operations to provide foreign currency

Type of instrument	Instrument	Term	Frequency	Interest rate, % p.a.	Bank of Russia claims on credit institutions, millions of US dollars (at the beginning of the first business day of the month)		
					10.2014	01.2015	03.2015
Open market operations (minimum interest rates)	FX repo auctions	1 week	weekly	LIBOR[1]+0.50	-	209.7	1,616.5
		28 days			-	15,075.1	10,393.4
		12 months[3]			-	4,960.0	14,446.4
	FX loans secured by foreign currency denominated credit claims	28 days	monthly	LIBOR[1]+0.75	-	-	2,500.6
		365 days	monthly		-	-	1,817.1
Standing facilities (fixed interest rates)	USD/RUB sell/buy FX swaps	1 day	daily	13.0[2] (ruble leg), 1.50 (dollar leg)	581.4	1,600.0	0.0

[1] In respective currencies and for respective terms.
[2] Bank of Russia key rate less 1.00 pp since 16 March 2015.
[3] Until 16 December 2014 auctions were held monthly.
Source: Bank of Russia.

Table 5

Consumer prices by group of goods and services (month on previous month, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2013								
January	1.0	0.5	1.8	1.2	7.4	0.4	0.4	0.6
February	0.6	0.4	0.8	0.6	2.8	0.4	0.4	0.4
March	0.3	0.4	0.4	0.5	0.1	0.4	0.4	0.2
April	0.5	0.4	0.7	0.4	3.6	0.4	0.4	0.5
May	0.7	0.3	1.0	0.3	6.5	0.3	0.3	0.8
June	0.4	0.3	0.5	0.2	3.0	0.2	0.2	0.6
July	0.8	0.3	0.0	0.4	-3.0	0.1	0.1	3.1
August	0.1	0.5	-0.7	0.6	-11.3	0.5	0.3	0.9
September	0.2	0.7	0.0	0.8	-7.6	0.5	0.4	0.1
October	0.6	0.6	1.1	0.9	3.6	0.5	0.5	-0.1
November	0.6	0.6	0.9	0.7	3.0	0.4	0.5	0.2
December	0.5	0.4	0.8	0.5	2.8	0.2	0.3	0.6
Total for the year (December to December)	6.5	5.6	7.3	7.1	9.3	4.5	4.4	8.0
2014								
January	0.6	0.4	1.0	0.5	5.8	0.3	0.3	0.5
February	0.7	0.5	1.2	0.7	5.1	0.4	0.4	0.4
March	1.0	0.8	1.8	1.3	5.3	0.7	0.6	0.5
April	0.9	0.9	1.3	1.2	2.3	0.6	0.6	0.7
May	0.9	0.9	1.5	1.3	2.4	0.5	0.5	0.8
June	0.6	0.8	0.7	1.1	-2.8	0.4	0.4	0.9
July	0.5	0.6	-0.1	1.0	-8.1	0.4	0.3	1.4
August	0.2	0.6	-0.3	0.9	-10.7	0.5	0.4	0.7
September	0.7	0.9	1.0	1.2	-1.2	0.6	0.5	0.3
October	0.8	0.8	1.2	1.0	2.8	0.6	0.6	0.6
November	1.3	1.0	2.0	1.3	8.7	0.6	0.6	1.2
December	2.6	2.6	3.3	2.2	12.9	2.3	2.5	2.2
Total for the year (December to December)	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	3.9	3.5	5.7	3.7	22.1	3.2	3.5	2.2
February	2.2	2.4	3.3	2.7	7.2	2.1	2.3	0.8

[1] *Excluding vegetables and fruit.*
[2] *Bank of Russia estimate.*

Sources: Rosstat, Bank of Russia calculations.

Table 6

Consumer prices by group of goods and services (month on corresponding month of previous year, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2013								
January	7.1	5.7	8.6	7.8	16.1	5.1	4.9	7.8
February	7.3	5.7	8.7	7.8	16.8	5.3	5.0	8.2
March	7.0	5.6	8.3	7.7	13.8	5.2	4.9	7.9
April	7.2	5.7	8.8	7.7	18.3	5.1	4.9	8.1
May	7.4	5.9	9.2	8.0	19.1	5.0	4.8	8.3
June	6.9	5.8	8.0	7.9	8.2	4.9	4.9	8.1
July	6.5	5.6	6.8	7.4	1.3	4.8	4.6	8.4
August	6.5	5.5	6.5	7.2	0.8	4.9	4.6	8.7
September	6.1	5.5	6.3	7.2	-1.4	4.7	4.4	7.8
October	6.3	5.5	6.9	7.2	4.4	4.5	4.3	7.7
November	6.5	5.6	7.5	7.3	8.9	4.5	4.4	7.9
December	6.5	5.6	7.3	7.1	9.3	4.5	4.4	8.0
2014								
January	6.1	5.5	6.5	6.4	7.7	4.3	4.3	7.8
February	6.2	5.6	6.9	6.5	10.1	4.3	4.3	7.9
March	6.9	6.0	8.4	7.5	15.9	4.6	4.5	8.2
April	7.3	6.5	9.0	8.3	14.4	4.9	4.7	8.5
May	7.6	7.0	9.5	9.5	10.1	5.1	4.9	8.4
June	7.8	7.5	9.8	10.5	3.9	5.3	5.0	8.7
July	7.5	7.8	9.8	11.2	-1.5	5.6	5.2	7.0
August	7.6	8.0	10.3	11.5	-0.8	5.5	5.3	6.7
September	8.0	8.2	11.4	12.0	6.1	5.5	5.3	6.9
October	8.3	8.4	11.5	12.1	5.3	5.7	5.4	7.6
November	9.1	8.9	12.6	12.8	11.1	5.9	5.6	8.7
December	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	15.0	14.7	20.7	18.4	40.7	11.2	11.4	12.3
February	16.7	16.8	23.3	20.8	43.5	13.0	13.5	12.8

[1] *Excluding vegetables and fruit.*
[2] *Bank of Russia estimate.*

Sources: Rosstat, Bank of Russia calculations.

Table 7

Macroeconomic indicators (seasonally adjusted, growth as % of previous period)

	Industrial production[1]	Agriculture	Construc-tion	Freight turnover	Retail trade turnover	Fixed capital investment	Household consumer expenditure	Output of goods and services by key industries[2]	GDP[3]
2013									
January	-1.1	1.4	3.1	-1.1	0.4	1.4	0.6	-0.2	
February	-1.0	-0.1	-1.5	0.0	-0.2	-0.8	0.1	-0.3	
March	1.0	0.0	1.0	-0.2	0.6	-1.0	0.4	0.5	0.3
April	0.3	0.5	-1.9	0.8	0.4	0.0	0.7	-0.2	
May	-0.3	0.3	2.6	-0.8	0.1	0.8	0.2	-0.2	
June	1.4	-0.2	-2.9	-0.8	0.6	-1.3	0.3	0.5	0.5
July	-0.3	0.7	2.3	1.0	0.3	1.3	0.5	0.0	
August	0.4	-0.2	-2.0	1.3	0.2	-0.9	0.2	-0.1	
September	-0.5	1.2	1.3	1.5	0.0	0.3	-0.1	-0.5	0.5
October	0.2	1.1	-2.7	1.4	0.3	-0.3	0.3	1.0	
November	1.9	-0.4	2.3	-3.1	0.5	0.7	0.3	0.5	
December	-2.1	-1.6	-2.0	2.1	-0.4	-0.5	-0.1	-1.3	0.5
2014									
January	0.5	1.2	-1.9	0.0	0.0	-0.6	-0.3	0.3	
February	0.3	0.0	1.0	-2.0	0.5	0.2	0.5	0.6	
March	0.2	0.1	-0.6	-0.9	0.3	0.6	0.2	-0.2	-0.5
April	0.8	0.3	-0.1	-0.2	0.1	-0.3	-0.1	0.1	
May	0.1	-0.2	-1.0	1.2	0.3	-0.6	0.0	0.2	
June	-0.6	0.2	0.6	0.4	0.1	0.6	0.1	-0.6	0.2
July	0.6	0.8	-0.6	-1.5	0.5	-0.8	0.2	0.4	
August	-0.6	-0.5	0.1	-0.2	0.4	0.2	0.3	-0.2	
September	1.6	22.3	-1.3	1.0	0.5	-1.0	0.4	0.7	0.4
October	0.3	-19.9	0.9	0.0	0.4	0.3	0.1	-0.6	
November	-1.1	2.0	-0.9	-0.2	0.4	-0.7	0.2	-0.1	
December	1.9	0.5	-0.1	-0.7	1.1	-0.2	0.6	0.5	
2015									
January	-1.8	-0.8	-0.1	-0.9	-9.5	-1.0	-8.7	-1.0	

[1] *Rosstat estimate.*
[2] *Output index of goods and services by key industries.*
[3] *Quarterly data.*

Sources: Rosstat, Bank of Russia calculations.

Table 8

Macroeconomic indicators (as % of corresponding period of previous year)

	2014	2015	Memo item: 2014
	January	January	
Output of goods and services by key industries	-0.5	1.1	0.9
Industrial output	-0.2	2.1	0.2
Agricultural output	0.8	1.0	5.5
Fixed capital investment	-7.0	-3.5	-0.5
Construction	-5.4	-2.4	-1.4
Retail trade turnover	2.7	4.0	3.9
Household real disposable money income	-0.5	0.5	3.8
Real wage	5.2	4.6	5.7
Number of unemployed	-6.6	-2.5	-1.1
Unemployment (as % of economically active population)	5.6	5.6	5.5[1]

[1] *As of the end of period.*

Sources: Rosstat, Bank of Russia calculations.

Table 9

Change in Bank of Russia forecasts of GDP growth of Russia's main trading partners in 2015

		Forecast of GDP growth in 2015, %		Memo item: country's share in aggregate GDP of trading partners, %
		March 2015	December 2014	
Total		1.8	2.3	**100**
1	Netherlands	1.3	1.4	15.7
2	Italy	0.5	0.6	8.7
3	Germany	1.2	1.3	8.0
4	China	7.1	7.1	7.0
5	Ukraine	-3.9	0.2	6.5
6	Turkey	3.4	3.7	6.4
7	Belarus	0.2	2.1	5.9
8	Poland	3.4	3.2	4.9
9	United Kingdom	2.6	2.6	3.5
10	USA	3.3	3.0	3.5
11	Finland	0.8	0.8	3.4
12	Kazakhstan	2.3	4.9	3.4
13	Japan	1.4	1.0	3.3
14	France	0.9	0.8	3.2
15	Republic of Korea	3.4	3.8	2.8
16	Switzerland	1.2	1.8	2.6
17	Latvia	2.8	3.3	1.9
18	Hungary	2.5	2.3	1.8
19	India	6.1	6.2	1.7
20	Belgium	1.1	1.4	1.5
21	Czech Republic	2.5	2.6	1.5
22	Slovakia	2.6	2.9	1.5
23	Spain	2.0	1.8	1.3

Source: Bank of Russia.

Table 10

Monetary policy rates in various countries

Country	Policy rate name	Current level	Date of last change	Previous level	Change	No. of rate changes during last 12 month	Inflation	Current level (%)	12-months change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	2		-1.3	-1.80
Hungary	base rate	2.10	22.07.2014	2.30	-0.20	5		-1.0	-1.10
Czech Republic	repo rate (14 days)	0.05	01.11.2012	0.25	-0.20	0		0.1	-0.10
Romania	base rate	2.25	04.02.2015	2.50	-0.25	5		0.4	-0.65
Bulgaria	base rate	0.01	01.01.2015	0.02	-0.01	6		-1.0	1.20
Serbia	key policy rate	8.00	13.11.2014	8.50	-0.50	3		0.1	-3.00
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	3		-0.5	-1.91
Brazil	target rate	12.75	04.03.2015	12.25	0.50	5		7.7	2.02
Chile	monetary policy rate	3.00	16.10.2014	3.25	-0.25	5		4.4	1.01
China	lending rate (1 year)	5.35	02.03.2015	5.60	-0.25	2			
	deposit rate (1 year)	2.50	02.03.2015	2.75	-0.25	2		1.4	-0.60
	reserve requirements rate	19.50	05.02.2015	20.00	-0.50	1			
India	reverse repo rate	7.50	03.03.2015	7.75	-0.25	2		5.1	--
	repo rate	6.50	04.03.2015	6.75	-0.25	2			
Indonesia	target rate	7.50	17.02.2015	7.75	-0.25	2		6.3	-1.46
Republic of Korea	base rate	2.00	15.10.2014	2.25	-0.25	2		0.5	-0.50
Malaysia	target overnight rate	3.25	10.07.2014	3.00	0.25	1		1.0	-2.40
Mexico	target rate	3.00	06.06.2014	3.50	-0.50	1		3.0	-1.23
Philippines	monetary policy rate	4.00	12.09.2014	3.75	0.25	2		2.5	-1.60
Russia	repo auction rate (1-6 days)	15.00	02.02.2015	17.00	-2.00	6		16.7	10.50
South Africa	repo rate	5.75	17.07.2014	5.50	0.25	1		4.4	-1.40
Thailand	repo rate	2.00	12.03.2014	2.25	-0.25	1		-0.5	-2.48
Turkey	repo rate (7 days)	7.50	24.02.2015	7.75	-0.25	5		7.6	-0.34
USA	fed funds rate's interval (upper bound)	0.25	16.12.2008	1.00	-0.75	0		-0.1	-1.70
Euro area	refinancing rate	0.05	04.09.2014	0.15	-0.10	2		-0.3	-1.00
UK	base rate	0.50	05.03.2009	1.00	-0.50	0		0.3	-1.60
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0		2.4	1.00
Canada	target overnight rate	0.75	21.01.2015	1.00	-0.25	1		1.0	-0.50
Australia	overnight rate	2.25	03.02.2015	2.50	-0.25	1		1.7	-1.00
New Zealand	overnight rate	3.50	24.07.2014	3.25	0.25	4		0.8	-0.80
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	1		0.0	-0.30
	certificate of deposit rate	-0.75	06.02.2015	-0.50	-0.25	6			
Switzerland	3m LIBOR - min	-1.25	15.01.2015	-0.75	-0.50	2		-0.8	-0.70
	3m LIBOR - max	-0.25	15.01.2015	0.25	-0.50	1			
Sweden	repo rate	-0.10	12.02.2015	0.00	-0.10	3		0.4	0.19
Norway	key deposit rate	1.25	11.12.2014	1.50	-0.25	1		1.9	-0.20

Note: Colour is used to highlight changes occurred from the time of the previous release of the Monetary Policy Report.
Source: Bloomberg.

Table 11

Balance of payments of the Russian Federation (billions of US dollars)

	2013					2014				
	I	II	III	IV	Total	I	II	III	IV[1]	Total[1]
Current account	25.0	1.8	-0.7	8.0	34.1	26.8	12.9	6.4	10.5	56.7
Current account, YoY, %	*-36.4*	*-88.8*	*-87.3*	*-23.0*	*-52.2*	*7.2*	*616.7*	*814.3*	*31.3*	*66.3*
Trade balance	48.6	42.8	43.7	46.8	181.9	50.9	51.9	45.4	37.5	185.6
Trade balance, YoY, %	*-17.3*	*-13.1*	*14.5*	*3.1*	*-5.1*	*4.7*	*21.3*	*3.9*	*-19.9*	*2.0*
Exports of goods	125.2	127.3	131.0	139.8	523.3	123.1	132.4	125.8	112.4	493.6
Exports of goods, YoY, %	*-4.5*	*-3.0*	*4.6*	*-0.2*	*-0.8*	*-1.7*	*4.0*	*-4.0*	*-19.6*	*-5.7*
crude oil	43.2	40.7	44.0	45.7	173.7	38.8	42.3	40.3	31.1	152.5
crude oil, YoY, %	*-6.4*	*-10.5*	*3.1*	*-2.0*	*-4.0*	*-10.2*	*3.9*	*-8.4*	*-31.9*	*-12.2*
oil products	25.5	29.3	27.1	27.4	109.3	27.5	30.5	31.8	25.0	114.9
oil products, YoY, %	*-0.5*	*10.9*	*7.5*	*3.9*	*5.5*	*7.8*	*4.1*	*17.3*	*-8.8*	*5.1*
natural gas	18.1	13.9	16.4	18.8	67.2	17.8	16.4	9.9	10.7	54.8
natural gas, YoY, %	*-1.8*	*3.4*	*22.9*	*10.3*	*7.9*	*-1.7*	*18.0*	*-39.6*	*-43.1*	*-18.5*
other	38.3	43.3	43.6	47.9	173.0	39.0	43.2	43.8	45.6	171.5
other, YoY, %	*-6.2*	*-5.6*	*-0.8*	*-4.1*	*-4.2*	*1.8*	*-0.2*	*0.5*	*-4.8*	*-0.9*
Imports of goods	-76.6	-84.5	-87.3	-93.0	-341.3	-72.2	-80.5	-80.4	-74.9	-308.0
Imports of goods, YoY, %	*6.0*	*3.2*	*0.3*	*-1.7*	*1.6*	*-5.7*	*-4.7*	*-7.9*	*-19.5*	*-9.8*
Balance of services	-10.5	-13.7	-19.8	-14.4	-58.3	-11.0	-14.4	-18.9	-10.4	-54.6
Balance of services, YoY, %	*26.4*	*34.5*	*28.8*	*13.2*	*25.1*	*4.8*	*5.1*	*-4.5*	*-27.8*	*-6.3*
Exports of services	15.2	17.9	18.4	18.6	70.1	15.1	17.3	17.8	16.5	66.6
Exports of services, YoY, %	*15.8*	*13.8*	*12.6*	*8.6*	*12.4*	*-0.7*	*-3.4*	*-3.3*	*-11.3*	*-5.0*
Imports of services	-25.7	-31.5	-38.2	-33.0	-128.4	-26.1	-31.7	-36.7	-26.8	-121.2
Imports of services, YoY, %	*19.9*	*21.5*	*20.4*	*10.5*	*17.9*	*1.6*	*0.6*	*-3.9*	*-18.8*	*-5.6*
Compensation of employees	-2.9	-2.9	-3.6	-3.9	-13.2	-2.4	-2.2	-2.6	-1.8	-9.0
Investment income	-8.7	-23.2	-17.8	-17.5	-67.2	-8.8	-21.5	-13.9	-12.7	-56.9
Receivable	10.5	8.2	9.5	9.6	37.9	13.0	11.1	11.8	7.7	43.5
Payable	-19.2	-31.4	-27.4	-27.1	-105.1	-21.8	-32.6	-25.6	-20.3	-100.3
Rent	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.0	-2.0
Secondary income	-1.5	-1.3	-3.3	-3.1	-9.3	-2.0	-0.8	-3.7	-2.1	0.9
Nontradable components	**-13.1**	**-27.4**	**-24.7**	**-24.5**	**-89.6**	**-13.2**	**-24.5**	**-20.1**	**-16.6**	**-67.0**
Nontradable components, YoY, %	***17.0***	***19.1***	***42.9***	***9.9***	***21.4***	***0.8***	***-10.6***	***-18.6***	***-32.2***	***-16.9***
Capital account	**0.0**	**0.0**	**-0.2**	**-0.1**	**-0.4**	**-0.2**	**0.0**	**-10.0**	**-31.8**	**-42.0**
Balance of current and capital accounts	**25.0**	**1.8**	**-0.9**	**7.9**	**33.7**	**26.6**	**12.9**	**-3.6**	**-21.3**	**14.7**
Financial account (except reserve assets)	**-13.3**	**-7.8**	**-4.5**	**-19.3**	**-45.0**	**-50.7**	**-30.0**	**-5.1**	**-39.8**	**-125.6**
Net incurrence of liabilities ('+' – increase, '-' – decrease)	**86.2**	**19.1**	**8.0**	**12.5**	**125.8**	**2.2**	**7.7**	**-24.2**	**-34.5**	**-48.7**
Federal government, local governments, and central bank	8.0	-0.2	4.1	-2.2	9.7	-6.7	1.9	-3.3	-4.5	-12.5
Banks and other sectors	78.2	19.4	3.8	14.8	116.0	8.8	5.7	-20.8	-29.9	-36.2
Net acquisition of financial assets, excluding reserve assets ('+' – decrease, '-' – increase)	**-99.5**	**-27.0**	**-12.5**	**-31.8**	**-170.8**	**-52.9**	**-37.7**	**19.0**	**-5.3**	**-76.9**
General government and central bank	-0.3	-1.2	0.6	-2.6	-3.6	0.5	-0.5	8.8	31.4	40.2
Banks and other sectors	-99.2	-25.8	-13.0	-29.3	-167.3	-53.4	-37.2	10.3	-36.7	-117.1
Net errors and omissions	**-6.8**	**1.6**	**-1.9**	**-3.8**	**-10.8**	**-3.3**	**6.8**	**3.0**	**-3.1**	**3.4**
Change in FX reserves ('+' – decrease, '-' – increase)	**-4.9**	**4.4**	**7.4**	**15.2**	**22.1**	**27.4**	**10.3**	**5.7**	**64.2**	**107.5**
Net capital import/export by banks and enterprises	**-28.2**	**-5.5**	**-10.4**	**-16.9**	**-61.0**	**-48.5**	**-22.4**	**-7.7**	**-72.9**	**-151.5**
Certain indicators adjusted by the amount of FX swaps between the Bank of Russia and resident banks, the amount of FX funds provided by the Bank of Russia to resident banks on a reverse basis, as well as funds in resident banks' correspondent accounts with the Bank of Russia										
Change in FX reserves ('+' – decrease, '-' – increase)	**-4.3**	**3.6**	**9.2**	**13.3**	**21.8**	**40.5**	**-3.2**	**-1.6**	**50.8**	**86.5**
Net capital import/export by banks and enterprises	**-28.9**	**-4.6**	**-12.2**	**-15.0**	**-60.7**	**-61.7**	**-8.9**	**-0.4**	**-59.5**	**-130.5**

[1] *Estimate.*

Source: Bank of Russia.

Table 12

Main indicators of Bank of Russia forecast (%, unless indicated otherwise)

	2013 (actual)	2014 (actual)	2015		2016		2017	
			baseline	stress	baseline	stress	baseline	stress
Urals crude price (annual average), US dollars per barrel	108.3	98.0	50-55	40-45	60-65	40-45	70-75	40-45
Inflation, December on December of previous year	6.5	11.4	12.0-14.0	17.0-19.0	5.5-7.5	7.2-9.2	3.0-5.0	3.2-5.2
Gross domestic product, YoY, %	1.3	0.6	-(3.5-4.0)	-(5.3-5.8)	-(1.0-1.6)	0-0.5	5.5-6.3	2.0-2.5
Final consumption expenditure	3.5	1.5	-(4.6-4.8)	-(6.1-6.4)	-(1.0-1.4)	-(0.7-1.0)	4.8-5.3	1.7-2.0
by households	4.7	1.9	-(5.5-5.7)	-(8.0-8.6)	-(1.5-2.0)	-(1.2-1.7)	6.5-7.0	2.0-2.5
Gross capital formation	-6.1	-5.7	-(35.0-38.0)	-(43.0-45.0)	-(3.0-4.0)	-0.2-0.1	16.0-19.0	4.0-5.5
gross fixed capital formation	-0.1	-2.5	-(10.0-12.0)	-(15.0-16.0)	-(0.5-1.5)	-(0.5-1.0)	3.6-4.1	3.5-4.1
Net export	5.7	14	104.0-109.0	131.0-133.0	4.0-5.5	11.0-15.0	-(20.0-24.0)	-(0.5-1.0)
exports	4.2	-2	-(2.2-2.5)	-(2.7-3.0)	0.5-0.9	-0.5-0.1	2.4-2.9	1.7-2.2
imports	3.7	-6.8	-(34.0-36.0)	-(43.0-45.0)	-1.0-0	-(4.0-5.0)	9.0-11.0	2.6-3.0
Money supply in national definition, annual growth	14.6	2.2	2-7	less than 0	2-7	5-10	20-25	10-15
Monetary base in narrow definition, annual growth	8.0	2.7	0-5	less than 0	1-5	2-7	16-20	7-12
Lending to non-financial organisations and households in rubles and foreign currency, annual growth	17.1	25.9	4-9	less than 5	2-7	5-10	20-25	10-15

Source: Bank of Russia.

Table 13

Russian balance of payments forecast (billions of US dollars)

	2013 (actual)	2014 (actual)	2015		2016		2017	
			baseline	stress	baseline	stress	baseline	stress
Urals crude price (annual average), US dollars per barrel	108,3	98,0	50-55	40-45	60-65	40-45	70-75	40-45
Current account	**34**	**57**	**64**	**60**	**90**	**89**	**119**	**97**
Balance of trade	182	186	141	124	159	129	186	128
Exports	*523*	*494*	*362*	*311*	*380*	*303*	*443*	*308*
Imports	*-341*	*-308*	*-221*	*-187*	*-221*	*-174*	*-257*	*-180*
Balance of services	-58	-55	-18	-9	-18	7	-16	14
Exports	*70*	*67*	*57*	*54*	*58*	*58*	*65*	*60*
Imports	*-128*	*-121*	*-75*	*-63*	*-76*	*-52*	*-82*	*-46*
Balance of primary and secondary income	-90	-74	-60	-55	-51	-46	-50	-45
Capital account	**0**	**-42**	**0**	**0**	**0**	**0**	**0**	**0**
Balance of current and capital accounts	**34**	**15**	**64**	**60**	**90**	**89**	**119**	**97**
Financial account (except reserve assets)	**-56**	**-126**	**-114**	**-134**	**-90**	**-92**	**-83**	**-81**
General government and central bank	*6*	*29*	*-3*	*-3*	*-3*	*-3*	*-3*	*-3*
Private sector (including net errors and omissions)	*-62*	*-151*	*-111*	*-131*	*-87*	*-89*	*-80*	*-78*
Change in FX reserves ('+' - decrease, '-' - increase)	**22**	**108**	**50**	**74**	**0**	**3**	**-36**	**-16**

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

Source: Bank of Russia.

LIST OF BOXES