



**THE CENTRAL BANK  
OF THE RUSSIAN FEDERATION  
(BANK OF RUSSIA)**

# **Inflation Review**

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***First Quarter ♦ 2004***

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**Research and Information Department**



## Major Inflation Indicators in 2004 Q1

According to Russia's Federal State Statistics Service, consumer price inflation in 2004 Q1 rose 3.5%, a decrease from the growth of 5.2% in January-March 2003 and the smallest first quarter increase since the 3.0% rise in 1998.

In January 2004, consumer prices went up 1.8% month on month, in February 1.0% and in March 0.8% (March 2003 growth stood at 1.1%). Consumer price inflation in March 2004 ran at 10.3% year on year against 10.6% in February 2004.

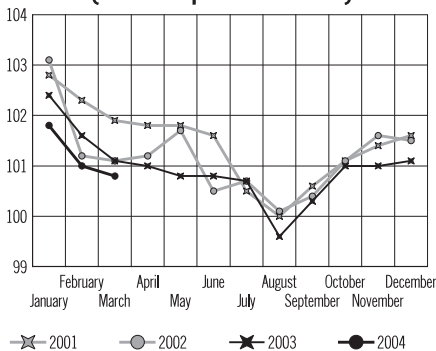
**Core inflation** stood at 2.4% in 2004 Q1 against 2.8% in January-March 2003. In January-March, growth in prices of goods and services included in the basic consumer price index calculation slowed down: in January it was 0.9%, in February 0.8% and in March 0.7%. According to estimates, growth in the prices of goods and services included in the calculation of the basic consumer price index accounted for 2.0 percentage points of 2004 Q1 price growth, or

55.3% of total increment in consumer prices (in January-March 2003, the respective ratios stood at 2.3 percentage points and 44.2%). A reduction in the rate of growth in non-food prices was a major factor of the slowing of growth in the prices of goods and services included in the BCPI calculation

**Food prices** rose 3.8% in 2004 Q1 against 4.8% in the same period last year and in March 2004 they were up 1.1% against 1.0% in March 2003.

**Vegetable and fruit prices** grew 10.1% in 2004 Q1 against 22.4% in the same period of 2003. In March 2004, vegetable and fruit prices went up 2.8% against 3.9% in March 2003. In the previous three years, January-March growth in vegetable and fruit prices had exceeded 22%. Estimates show that growth in vegetable and fruit prices caused the general rate of inflation to accelerate by half a percentage point in 2004 Q1. In January-March 2003, growth in vegetable and fruit prices caused consumer

**Consumer Price Dynamics  
(as % of previous month)**



**Inflation in 12-Month Moving Period (as % of corresponding month of previous year)**

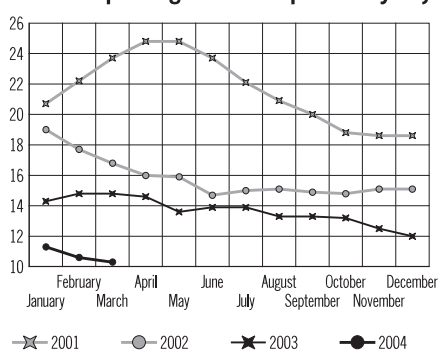


Table 1

**Inflation Rates in the Consumer Market as a Whole (%)**

	2004 Q1 growth	2003 Q1 growth	Result
Prices of goods and services included in core inflation calculation	2.4	2.8	slowing by 1.17 times
of which:			
- food prices excluding vegetable and fruit prices	3.2	2.8	accelerating by 1.14 times
- non-food prices	1.4	2.8	slowing by 2.0 times
Service prices	6.4	10.6	slowing by 1.66 times
of which:			
- prices of goods and services regulated at federal and regional levels	7.8	13.3	slowing by 1.71 times
Vegetable and fruit prices	10.1	22.4	slowing by 2.22 times

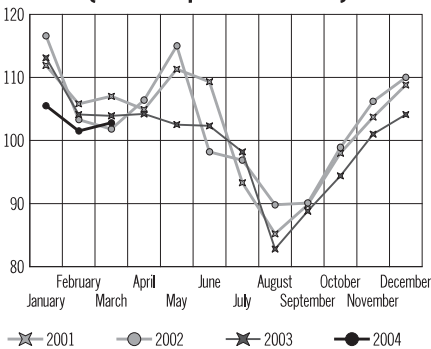
prices to rise by 1.2 percentage points, or 22.5%.

**Growth in food prices, excluding vegetable and fruit prices, stood at 3.2% in 2004 Q1 against 2.8% in the same period last year.** In March 2004, food prices, vegetable and fruit prices excluded, edged up 0.9% against 0.6% in March 2003. Growth in the prices of this group of products accounted for an increase of 1.6 percentage

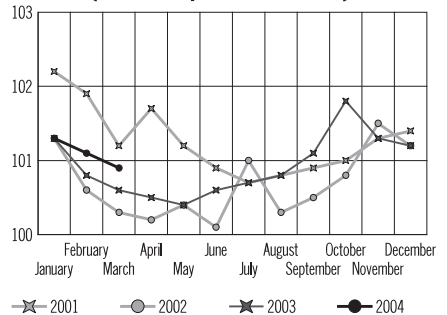
points, or 45.0% of overall consumer price growth in 2004 Q1 against 1.4 percentage points and 27.3% in January-March 2003.

Although growth in bread and bakery product prices slowed down each month, it was high in 2004 Q1 due to a rise in the selling price of grain (14.8%) (2.4% in January-March 2003) amid a reduction in supply. Grain sales by agricultural enterprises in 2004 Q1 stood at 57.7% of the January-

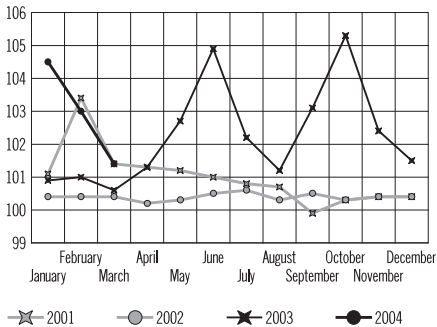
**Vegetable and Fruit Price Dynamics (as % of previous month)**



**Dynamics of Food Prices, Excluding Vegetable and Fruit Prices (as % of previous month)**



## Bread and Bakery Products Price Dynamics (as % of previous month)



March 2003 volume. At the same time, the output of bread and bakery products contracted 1.2%.

The most significant growth in 2004 Q1 was registered in the price of bread and bakery products (9.1%) and pasta (6.6%). Compared to the same period last year, growth in the prices of these products accelerated 3.6 times and 3.9 times respectively.

Growth in prices of some foodstuffs slowed down in 2004 Q1 year on year (fish and seafood by 6.1 times, butter 5.4 times, granulated sugar 2.6 times and cereals and legumes 2.2 times). By the end of the period, the price of sunflower oil had fallen 0.2%. Meat and poultry prices rose 2.7% in 2004 Q1, whereas in 2003 Q1 they fell 0.2%. The increase was due to 4.9% growth in the selling price of livestock and poultry in January-March 2004 (in the same period of 2003, the selling price of livestock and poultry was down 0.7%).

Food price dynamics in 2004 Q1 were largely impacted by producer price growth in food industry, where prices grew 4.4% against 2.0% in 2003 Q1 and in agriculture. Q1 growth in agricultural producer prices in 2004 stood at 8.2% against 2.5% in 2003 Q1.

In 2004 Q1 as a whole, growth in food prices, excluding vegetable and fruit prices, was faster than growth in non-food prices.

**Non-food prices** went up 1.4% in 2004 Q1 against 2.8% in the same period

In 2004, the EU, Russia and Ukraine expect a better wheat harvest than in 2003. According to a forecast by the British weekly *The Public Ledger*, the EU may produce 126 million tonnes of wheat, an increase of 18% on 2003. According to Russia's Acting Minister of Agriculture Alexei Gordeyev, gross output of grain in Russia in 2004 will be around 73-76 million tonnes, an increase of 9-13% on last year's 67.2 million tonnes.

Meanwhile, the situation with grain stocks remains difficult. As of April 1, 2004, agricultural, procurement and processing organisations had a total of 18.9 million tonnes of grain. This represents a decrease of 24.3% as compared with April 1, 2003, and 84.9% of the average stocks in the previous four years. According to data reported by procurement and processing organisations, the most significant reduction was registered in commercial rye stocks (52.4%).

At present, the state regulates the grain market by conducting purchase and commodity interventions and imposing customs duties. A grain export duty of 25 euros per tonne has been in effect since the middle of

last January. Purchase and commodity interventions allow regional food funds to contain growth in bread and bakery product prices by selling the grain they buy to flour mills at lower prices.

The principles of the state regulation of the grain market are set out in the Federal Grain Law (No. 4973-1 of May 14, 1993) and aimed at meeting the interests of grain producers and the state to the fullest extent. However, grain producers today do not receive the compensation of at least one-third of their costs per tonne of grain they produce and sell to the federal or regional grain reserves, as is required by this law.

State support for agricultural producers chiefly aims to maintain budget-financed agribusiness organisations and restructure producers' debts and only a small part of it goes to subsidise interest rates on commercial loans and harvest insurance.

In the European Union, on the contrary, agricultural producers receive substantial support, which helps cushion grain market fluctuations and prevent abrupt price changes.

Table 2

**Food Price Inflation (%)**

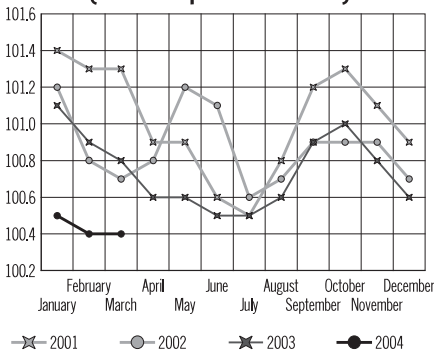
	2004 Q1 growth	2003 Q1 growth	Result
Bread and bakery products	9.1	2.5	accelerating by 3.64 times
Groats and legumes	4.3	9.6	slowing by 2.23 times
Pasta products	6.6	1.7	accelerating by 3.88 times
Meat and poultry	2.7	-0.2	
Fish and seafood	1.0	6.1	slowing by 6.10 times
Milk and dairy products	3.0	3.2	slowing by 1.07 times
Butter	1.1	5.9	slowing by 5.36 times
Sunflower oil	-0.2	1.7	
Granulated sugar	2.5	6.5	slowing by 2.60 times
Alcoholic beverages	3.5	4.0	slowing by 1.14 times

last year. In March 2004, non-food prices rose 0.4%, as in February, against 0.8% in March 2003. The last time non-food prices grew so little in March was in 1998 (0.2%). In 2004 Q1 as a whole, the most significant growth in non-food prices was registered in knitwear prices (2.2%) and clothing and

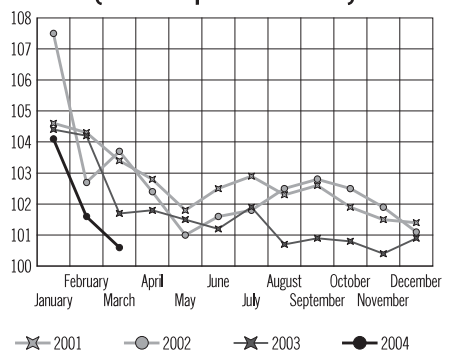
underwear prices (1.9%). Growth in prices of major non-food products in 2004 Q1 was smaller than in January-March 2003. There was a 0.2% fall in television and radio prices, while petrol prices inched up 0.6% against 9.6% in 2003 Q1.

Growth in non-food prices accounted

**Non-food Price Dynamics  
(as % of previous month)**



**Service Price Dynamics  
(as % of previous month)**



for 0.4 percentage points, or 10.3%, of total increment in consumer prices in 2004 Q1 against 0.8 percentage points, or 14.9%, in January-March 2003.

**Prices and tariffs of paid services provided to households** rose 6.4% in 2004 Q1 against 10.6% in the same period of 2003. In March 2004, they went up 0.6% against 1.7% in March 2003. Rent and utilities prices posted the most significant increase in 2004 Q1 - 13.1% against 17.7% in January-March 2003. There was also a major rise in pre-school tuition fees (8.4%) and entertainment and recreation prices (5.4%). Communication service charges were down 3.1%, the first decrease in 10 years.

Service prices in 2004 Q1 rose considerably faster than prices of goods in general (by 2.8%), accounting for 1.1 percentage points, or 30.2%, of overall consumer price growth against 1.8 percentage points, or 35.3%, in January-March 2003.

### Factors of Inflation

Several factors were behind consumer price dynamics in 2004 Q1.

#### **External Economic Factors**

External economic factors are important not only for price and production dynamics, but also the inflow of foreign currency to the country.

According to a Bank of Russia estimate, the price of natural gas in Europe rose 5.4% in 2004 Q1 compared to 2003 Q1, petrol 1.3% and non-ferrous metals 30% (the price of aluminium was up 18.2%, copper 64.2% and nickel 77.0%). The price of Urals crude was down 0.9%, fuel oil 14.1% and diesel fuel 6.5%.

The average level of world market prices of major Russian exports, adjusted for their structure, rose 3.1% in 2004 Q1 compared

to 2003 Q4 and 3.7% compared to 2003 Q1, according to Bank of Russia estimates.

**The favourable price situation enjoyed by Russian exporters on world commodity markets** and the expansion of demand for goods and services exported by Russia led to growth in exports and increased the country's trade surplus.

In 2004 Q1, exports rose 20.0% year on year to \$37.3 billion and imports grew 21.3% to \$19.2 billion. Russia's trade surplus expanded 18.7% to \$18.1 billion against \$15.2 billion in January-March 2003.

Export growth was also due to the expansion of export volumes of some products. Exports of oil, ferrous and non-ferrous metals and machinery, equipment and transport vehicles made the biggest contribution to growth in the value of exports in the first three months of the year. There was also a rise in the exports of natural gas, chemical raw materials, mineral fertiliser and timber products. According to the latest statistics, the share of energy products in the total value of exports contracted, while that of ferrous and non-ferrous metals expanded.

The expansion of imports was largely due to the increased purchases of investment goods, whose imports rose by an estimated 40%. According to updated figures, consumer goods imports increased 15% as a result of growth in the imports of non-food consumer goods and a contraction in the imports of food and edible raw materials, particularly meat and raw sugar.

Estimates show that the terms of Russia's trade with foreign countries in 2004 Q1 were better than in 2003 Q1, as export prices rose faster than import prices.

According to a balance of payments estimate, in 2004 Q1, the current account

surplus contracted by \$600 million as compared with 2003 Q1 to \$11 billion, or 9.0% of GDP (in 2003 Q1, it stood at 12.7% of GDP). The main reason for the decline was an almost threefold increase in the non-financial enterprise sector's payments abroad, which aggregated \$3.4 billion against \$1.2 billion in 2003 Q1.

According to estimates, the capital and financial account deficit (net of the changes in reserves) expanded from \$2.4 billion in 2003 Q1 to \$3 billion in 2004 Q1. At the same time, net outflow of capital by the private sector declined by an estimated \$200 million from \$400 million in 2003 Q1.

According to balance of payments estimates, net inflow of foreign investments in the private sector of the Russian economy increased 40% to \$6.5 billion in 2004 Q1; of this, net inflow of foreign investments in the banking sector expanded 70% to \$1 billion and the non-financial enterprise sector 38% to \$5.5 billion. The inflow of foreign direct investments in the non-financial enterprise sector rose 2.3 times to \$2.8 billion, while the inflow of foreign capital to this sector in the form of loans decreased 16% to an estimated \$2.7 billion.

The outflow of capital by the private sector of the Russian economy increased as investments abroad became more attractive. Estimates show that Russian private sector investments in foreign economies increased 1.6 times over as compared with 2003 Q1 to \$5.5 billion.

The use of the US dollar in the Russian economy continued to decline in 2004 Q1. Foreign exchange savings of the non-financial enterprise and household sectors decreased by an estimated \$3.5 billion (in 2003 Q1, they contracted by \$800 million).

According to balance of payments data, foreign exchange reserves rose by \$6.8

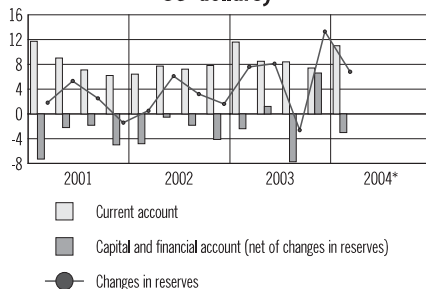
billion in 2004 Q1, whereas in 2003 Q1 they grew by \$7.6 billion. As of April 1, 2004, Russia's international reserves stood at \$83.4 billion against \$55.5 billion as of April 1, 2003. At the end of 2004 Q1, Russia had enough international reserves to finance the import of goods and services for 10 months against eight months at the end of 2003 Q1.

### International Financial Markets

In 2004 Q1, US and EMU short-term interest rates were lower on average than in 2003 Q1. UK interest rates rose as the Bank of England adopted a tighter monetary policy, while in Japan interest rates remained close to nought. At the same time, economic growth along with the exacerbation of the budget deficit problem caused yields on medium-term dollar-, pound- and yen-denominated financial assets to rise. The yield on medium-term government securities in the eurozone, where economic activity remained low in 2003, was virtually unchanged in 2004 Q1 as compared with 2003 Q1.

In 2004 Q1, the US dollar lost 16.4% against the euro year on year, 14.7% against the pound sterling, 10.9% against the yen and 8.8% against the Swiss franc. The de-

**Dynamics of Major Balance of Payments Components (quarterly, in billion US dollars)**



\* 2004 Q1: estimate.



preciation of the dollar throughout 2003 was attributable to the US current account deficit and the efforts of the US economic authorities to use the weakened dollar as an instrument to boost the competitiveness of US goods and stimulate economic activity and employment. However, signs of a stabilisation of the exchange rates of major world currencies appeared in 2004 Q1 as the US current account deficit started to contract and European governments became increasingly concerned over the strengthening of the euro.

The level of share prices rose significantly on the stock markets of North America, Europe, Asia and Latin America in 2004 Q1 as compared with 2003 Q1. The rise was the result of low interest rates in the industrialised nations, the world economic recovery and the improved corporate profit forecasts. In the second half of 2004 Q1, however, share price growth in the United States and some other countries slowed down noticeably as the exchange rates of major world currencies stabilised and the expectations of the Federal Reserve's switch to a tighter monetary policy increased.

### **Domestic Supply and Demand**

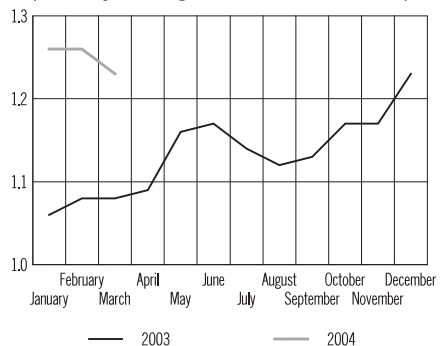
In 2004 Q1, consumer price inflation was accompanied by **a high level of production and investment activity**. Output in the key branches of the economy rose 7.9% compared to 2003 Q1, the biggest growth in three years (in 2001 Q1, it stood at 5.1%, in 2002 Q1, 3.3% and in 2003 Q1, 6.7%). There was a rise in output in industry, the construction sector and transport. Retail and wholesale trade turnovers expanded significantly. At the same time, there was a fall in agricultural production.

Industrial output grew 7.6% in 2004 Q1 as compared with 2003 Q1 (2003 Q1 growth stood at 6%). Investment industries posted

the biggest growth in production: 17.5% in the machine-building industry, 11.8% in the building materials industry, 8.6% in the fuel sector and 10.7% in the chemical and petrochemical industry. In 2003 Q1, production expanded at rapid rates (9.9% and 11.1%) in the fuel sector and ferrous metallurgy sector. At the same time, production growth in investment industries was smaller than in industry as a whole—3.9% in machine-building and 3.5% in the building materials industry.

As industrial output grew, producer price growth accelerated in industry. In 2004 Q1, **industrial producer price growth** exceeded consumer price growth 2.7 times (it was 1.7 times slower in the same period last year). Industrial producer prices rose 9.5% in 2004 Q1 against 3.1% in 2003 Q1. These consumer price dynamics were the result of the acceleration of price growth in the light and food industries and significant price increases in the cost-creating industries. In 2004 Q1, producer prices rose 5.9% in the machine-building industry and 4.5% in the building materials industry (in 2003 Q1, 2.5% and 4.0% respectively). The acceleration of price growth in these industries cre-

**US Dollar Versus Euro  
(monthly average, dollars to the euro)**



ated conditions for more rapid producer price growth in the construction sector.

Transport companies' freight turnover expanded 7.7% in 2004 Q1 compared to 2003 Q1, despite **the slowing of growth in cargo transportation charges** (2003 Q1, growth stood at 7.2%). The freight turnover of railway transport grew 8.1%, automobile transport 4.9% and pipeline transport 8.8%.

Agricultural output declined 1.4% in 2004 Q1 as compared with the same period last year (in 2003 Q1, it grew 1.1%). The production of milk fell 3.2% and eggs 2.0%, while meat production increased 1.3%. Against this background, **there was a rise in producer prices in agriculture.**

There was a rise in business activity in the construction sector at the beginning of 2004. The volume of construction work done by contract in 2004 Q1 rose 13.8% as compared with the same period last year (2003 Q1 growth stood at 13.6% and 2002 Q1 growth posted 2.5%). **Producer price**

**growth accelerated in the construction sector:** from 1.9% in 2003 Q1 to 2.3% in 2004 Q1.

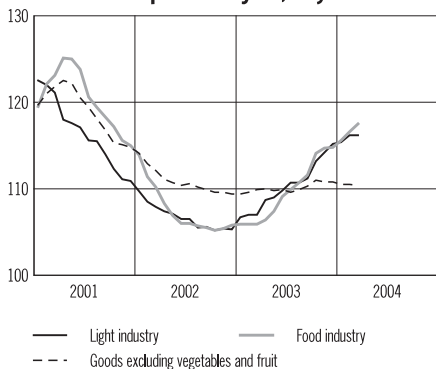
**Investment and consumer demand continued to rise at rapid rates** in 2004 Q1. Fixed capital investment grew 13.1% as compared with 2003 Q1 (2003 Q1 growth stood at 10.1%).

The continued rise in household money income led to growth in consumer spending, which increased by an estimated 11.0% in 2004 Q1 against 7.9% in 2003 Q1, and, consequently, to consumer price growth. However, the share of expenses on goods and services in the structure of household income use contracted as compared with 2003 Q1, which is a positive trend from the viewpoint of the influence of these expenses on inflation.

**The situation in the labour market** in 2004 Q1 changed compared to the same period in 2003. In 2003 Q1, the number of people employed in the economy decreased, whereas in 2004 Q1 it increased; in 2004 Q1, the number of unemployed declined, whereas in 2003 Q1 it grew. In 2004 Q1, 92.0% of Russia's economically active population had work and 8.0% were classified as unemployed according to the ILO methodology (against 90.9% and 9.1% in 2003 Q1). Compared to 2003 Q1, the number of people employed in the economy increased 3.1% in 2004 Q1, while the number of jobless fell 10.2%. The last time such a high level of Q1 employment was registered in this country in 1995. In 2003 Q1, the number of jobholders declined 1.0%, while the number of unemployed rose 8.3%.

Growth in employment created conditions for a consumer price increase, but the rise in labour productivity contained that process.

**Producer Price Dynamics in Light and Food Industries and Price Dynamics of Goods, Vegetables and Fruit Excluded (month on corresponding month of previous year, %)**

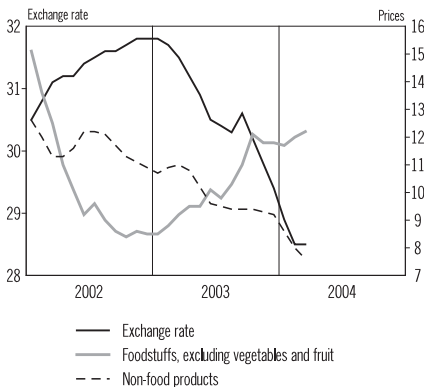


**Exchange Rate**

The exchange rate policy pursued by the Bank of Russia continued to play a positive role in curbing core inflation. The ruble continued to rally on the domestic foreign exchange market in January-February 2004. In January 2004, it gained 1.8% against the dollar in nominal terms month on month and in February 1.4%, but in March the ruble lost 0.1% month on month. Compared to December 2003, in March 2004, the ruble gained 3.2% against the dollar in nominal terms.

The ruble's nominal rise against the dollar checked growth in the prices of imported consumer goods and, consequently, the prices of their domestically produced analogues. The influence of exchange rate dynamics on non-food price dynamics was stronger than on food price dynamics. As domestically produced foodstuffs were highly competitive on the Russian market (thanks to both quality and prices), the effect of the exchange rate dynamics was

**Ruble Rate Dynamics and Price Dynamics of Individual Groups of Products (month on corresponding month of previous year, %)**

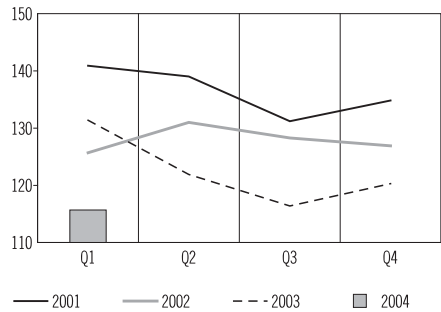


mostly evident in the producer prices in food industry, where imported raw materials are used more than in any other industry. As for the non-food price dynamics, they are more susceptible to the direct influence of the exchange rate owing to the low level of competitiveness of domestically manufactured non-food products.

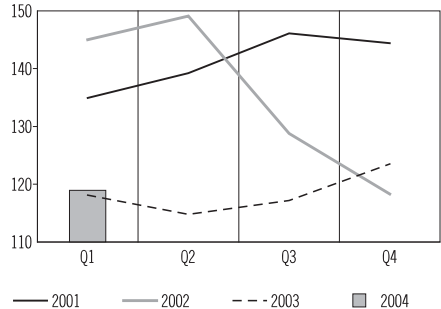
**Costs**

Consumer price inflation was also influenced by price dynamics in the cost-creating industries, which directly affect enterprises' costs. Producer prices rose signifi-

**Producer Price Dynamics in Electric-Power Industry (quarter on corresponding quarter of previous year, %)**



**Freight Transportation Price Dynamics (quarter on corresponding quarter of previous year, %)**



cantly in the fuel sector and electric-power industry in 2004 Q1 (by 17.1% and 10.9% respectively), whereas in 2003 Q1, producer prices fell 3.4% in the fuel sector and rose 12.0% in the electric-power industry. This and the appreciable rise in nominal wage (by 28.2% against 25.8% in 2003 Q1) stimulated growth in costs and, consequently, price increases in various sectors of the economy and consumer price growth.

Consumer price dynamics were also influenced by the change in freight transportation fares, which grew 2.9% in 2004 Q1, owing to January growth, against 7.0% in 2003 Q1. At the same time, freight railway transport fares grew faster than in 2003 Q1.

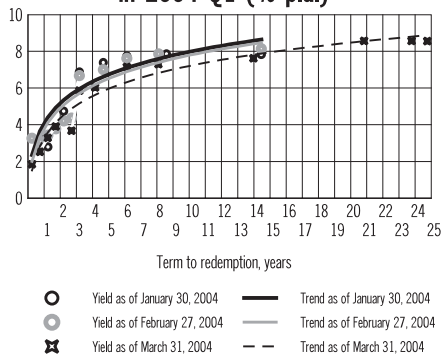
Producer price growth also accelerated in light and food industries (to 4.1% and 4.4% respectively against 3.2% and 2.0% in 2003 Q1), whose output goes directly to the consumer goods market and this had a negative effect on consumer price dynamics.

#### Other Factors

According to preliminary data, in 2004 Q1, Russia retained a **budget surplus**, which restrained borrowings on the domestic market and inflation growth.

Relatively low **inflation expectations** were a major factor of the slowing of price growth. According to the Russian government's Centre for Economic Studies, polls show that the inflationary expectations of managers of major industrial enterprises in 2004 Q1 were lower than in 2003 Q1. In March, selling price growth in the near future was predicted by 31% of respondents

GKO-OFZ Yield Curve  
in 2004 Q1 (% p.a.)



against 29% in February and 32% in January 2004 (in 2003 Q1, the respective index was 33-35%).

The structure of interest rates on instruments with different terms remained balanced in Q1 amid moderate growth in financial market price volatility. The yield curves of major financial instruments had a tendency to rise, reflecting the stability of the inflationary expectations of financial market participants.

The **production capacity utilisation level** influences inflation in the economy to some extent. According to polls of managers of basic industrial enterprises, the average utilisation ratio of production capacity in 2004 Q1 stood at 57%, the highest percentage since May 1995, and posed no significant threat of the acceleration of inflation. At present, there is a reserve of unused production capacity that can be put into operation if demand for core products increases or if new products are launched.

## Monetary Indicators

The tendency towards the accelerated growth of the money supply (M2 aggregate), noted in 2003, continued and even intensified a little in 2004 Q1. The deviation of this indicator from its seasonal path was particularly obvious in January when, unlike the situation in the previous years, the money supply virtually did not contract in absolute terms. In February and March, M2 growth rates were somewhat slower than in the corresponding months last year, but in 2004 Q1 as a whole they stood at 6.8% against 4.3% in 2003 Q1. On an annualised basis, M2 growth rate was 54.1% as of April 1, 2004, against 41% as of April 1, 2003.

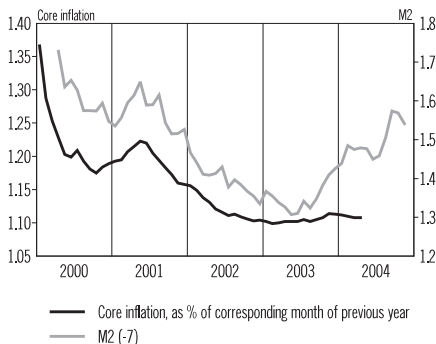
The expansion of the M2 aggregate was accompanied by economic growth and a moderate rise in prices. There was no acceleration of inflation in the period under review. However, although consumer price growth slowed down as compared with the corresponding period last year, core inflation in the moving 12-month period had not

begun to decline by the beginning of April 2004. Taking into consideration a lag of seven to nine months between growth in the money supply and core inflation, the rapid rates of growth in the money supply may push prices up in the period until October or November 2004.

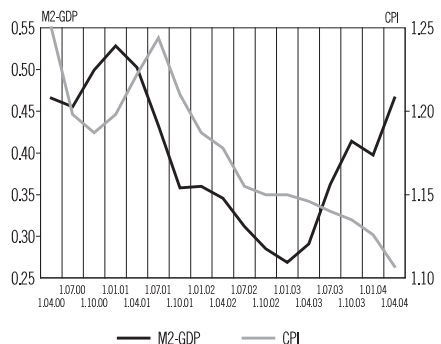
Taking into consideration that the qualitative interpretation of the time lag between the money supply and core inflation is difficult, only the part of money that exceeds the amount necessary for the financing of the Russian economy can stimulate inflation. This part of monetary growth is characterised by the monetary gap indicator or the gap between monetary growth (M2) and GDP growth. Taking into consideration that the high velocity of money supply growth is largely preconditioned by objective growth in the demand for money, the increase of this gap may be very important amid the stability of the velocity of money.

At the same time, M2 velocity, whose

**Core Inflation and M2 Dynamics with 7-month Lag**



**Gap between Money Supply and GDP Dynamics and Consumer Prices**



decline was more significant than the trend suggested, contributed to the curb on inflation.

Compared to other monetary aggregates, M2 increased at the most rapid rates in 2003 and 2004 Q1. The rates of growth in the M2X aggregate, which comprises non-cash foreign currency funds, were considerably slower beginning from 2003 Q2. At the same time, the M1 aggregate, which contains transactional components of the money supply such as cash and household and non-financial enterprise sector current and settlement deposits and demand deposits, also grew at rapid rates, reflecting the non-financial enterprise sector's rising demand for money it needs to conduct transactions and service the increased payment turnover.

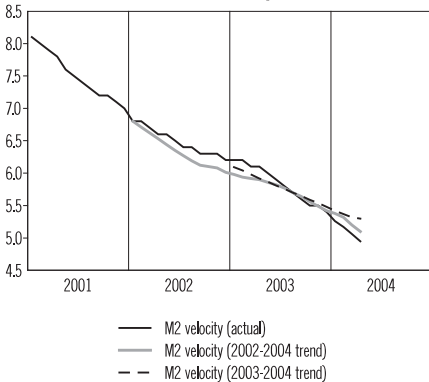
The M1 aggregate's rapid rates of growth were the result of the expansion of all its components. Cash grew at rapid rates throughout 2003 and in 2004 Q1 owing to a rise in household income, the expansion of consumer spending and a fall in the demand for foreign exchange. By the beginning of April, cash growth rates stood at an annualised 155.5% and they were consid-

erably faster than in the 1<sup>st</sup> quarter of last year (135.6%), at the same time, the share of cash in M1 slightly expanded (as of April 1, 2004, it stood at 51.9% against 49.6% as of the same date a year earlier). The rates of growth in funds in accounts and demand deposits, which reflect growth in corporate profits and the improvement of their financial standing, were also high at an annualised 141.8% as of April 1, 2004, against 137% a year earlier. However, there was a slowing of growth in both components in March.

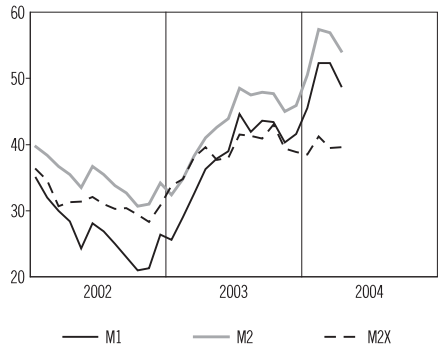
The components of the money supply with different liquidity levels influence consumer prices with different strength and lags. The short-term effect of the monetary aggregate dynamics on inflation is strictly seasonal. The analysis of the growth dynamics of money supply and consumer price index in recent years shows that the recurrent significant increase in the M0 aggregate in December is followed by the recurrent consumer price surge at the beginning of the year (in January).

This year, however, despite the seasonal rise of the consumer price index in January month on month, the influence of the De-

**M2 Velocity**



**Monetary Aggregate Annual Growth Rates in 2002-2004 (%)**



ember expansion of the money supply on inflation at the beginning of the year was less significant than in the previous years. The rates of consumer price growth last January were slower than in January 2003 and inflation dynamics in the 1<sup>st</sup> quarter of the year on the whole fit in with the projected downward trend.

M0 dynamics in 2004 Q1 were affected by the 2003 tendencies towards growth in household money income and decline in individuals' demand for foreign exchange. The growth in household money income, which was accompanied by an increase in consumer spending and rapid rates of growth in retail trade turnover, caused the household sector's demand for cash to rise in 2004 Q1.

Owing to the ruble/dollar exchange rate dynamics in the 1<sup>st</sup> quarter of the year, the household sector's foreign exchange sales increased and this led to growth in cash rubles in circulation, which in January-March grew 1.6%, whereas in 2003 Q1 the M0 aggregate contracted 1.8% in absolute terms.

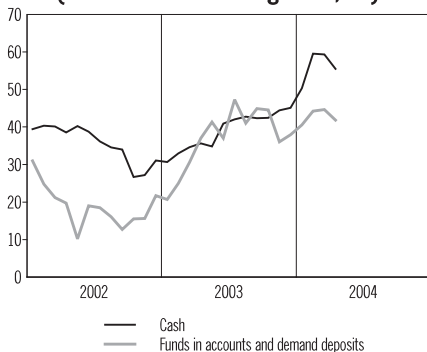
Nevertheless, cash growth rates slowed down 0.1% last March (in March 2003, they

slowed down 2.5%). The significant slowing of M0 growth that month along the virtually unchanged nominal ruble/dollar rate (28.53 in March and 28.52 in February) was largely attributable to the household sector's resumed demand for foreign exchange.

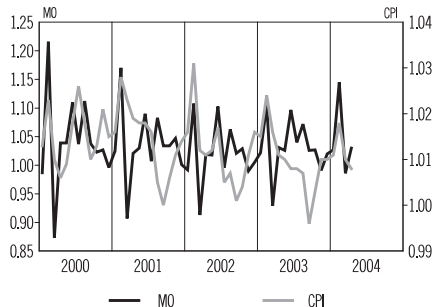
As cash and funds in transaction accounts tended to increase, the rate of money aggregate growth in the monetary survey definition (similar to the M1 aggregate) by the end of 2004 Q1 was almost twice the rate of growth in quasi-money, the savings component of M2X broad money (the opposite trend was registered a year ago). In the moving 12-month period as of April 1, 2004, the money aggregate increased 48.9% against 36.7% as of April 1, 2003, whereas the quasi-money aggregate grew 30.1% against 42.6% a year earlier.

The slowing of growth in the quasi-money aggregate, which includes funds used by economic agents as savings and investments, was due to the different dynamics of the ruble and foreign currency components, which changed the structure of quasi-money. The significant slowing of the non-cash foreign currency dynamics caused

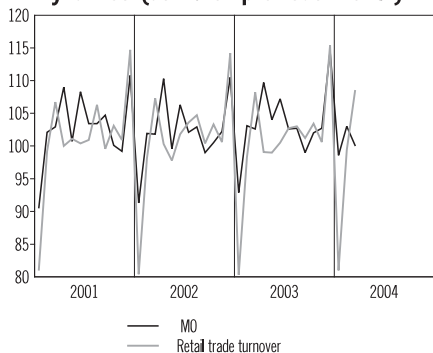
**M1 Components  
(annualised rates of growth, %)**



**M0 Dynamics (with 1-month Lag)  
and Consumer Price Dynamics  
(as % of previous month)**



### MO Aggregate and Retail Trade Turnover Dynamics (as % of previous month)

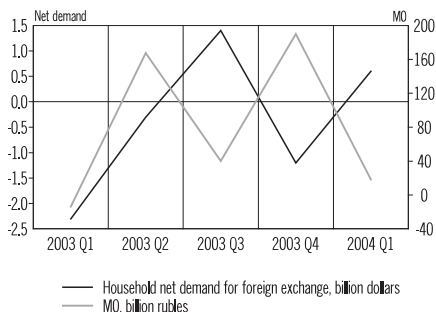


the contraction of their share in broad money and the ruble component of quasi-money has prevailed since the middle of 2003.

Household and enterprise sector ruble time deposits accounted for 28% of the M2X aggregate as of April 1, 2004 against 23.7% as of April 1, 2003, while the share of foreign currency deposits contracted by almost 8 percentage points year on year to 18.3%.

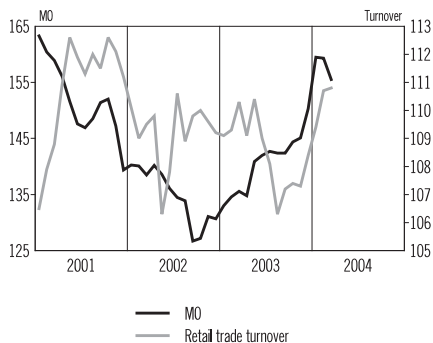
The rate of growth in foreign currency deposits slowed down almost three times in

### Quarter-on-Quarter Dynamics of Household Net Demand for Foreign Exchange and MO Monetary Aggregate

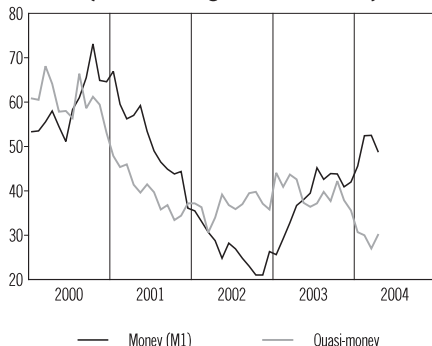


2004 Q1 year on year and stood at about 3%. At the same time, there was a significant contraction in foreign exchange in the non-banking sector of the economy (by \$3.5 billion against \$800 million in 2003 Q1, according to preliminary balance of payments data). The ruble's nominal rise in 2004 Q1, as in 2003 as a whole, contributed to the tendency towards decline in the demand for foreign exchange, which emerged in 2003. In addition, such dynamics of the exchange rate of the ruble contained growth in consumer prices.

### MO Cash and Retail Trade Turnover (annualised growth rates, %)

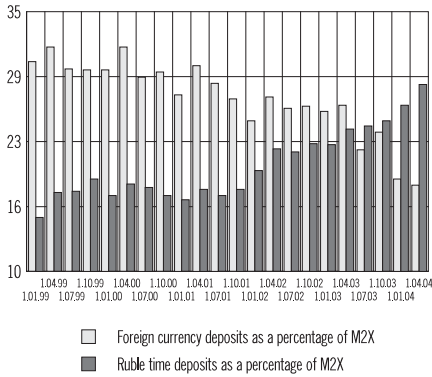


### Money and Quasi-Money Dynamics (annualised growth rates, %)





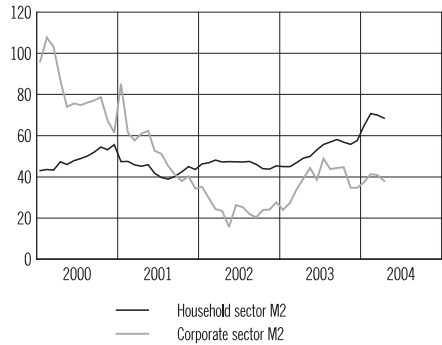
### Change in Quasi-Money Structure (%)



The accelerated growth in ruble time deposits in the first half of 2003 and especially in the 1<sup>st</sup> quarter of the year was principally due to the expansion of household funds, particularly deposits with terms from one year to three years.

Growth in the ruble time component (by about 14% in 2004 Q1 against 12.1% in 2003 Q1) accounted for more than two-thirds of growth in the M2 aggregate in the 1<sup>st</sup> quarter of the year. However, non-cash ruble dynamics were different in the household sector and corporate (non-financial

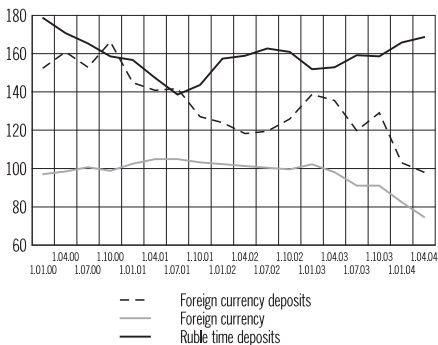
### Non-Cash Money Growth by Sector (annualised percentages)



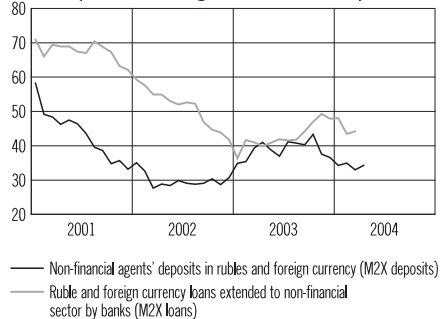
enterprise) sector. Although growth in household sector ruble funds slowed a little on an annualised basis in 2004 Q1, it was nonetheless faster than last year. At the same time, the tendency towards the slowing of growth in corporate sector bank accounts, which emerged in the second half of 2003, continued, reflecting the increased role of the household sector as a source of resources for banks.

Funds attracted by banks for various terms from enterprises and households in rubles and foreign currency, which are less

### Quasi-Money Components and Foreign Currency (annualised rates of growth, %)



### Non-Cash M2X Money and Loans to Non-financial Sector (annualised growth rates, %)



liquid elements of the money supply and, at the same time, provide the basis for the expansion of lending volumes, increased by 162 billion rubles in 2004 Q1 (10.6% against 9% a year earlier). In the 1<sup>st</sup> quarter of the year, growth in the banking sector's lending activity, which facilitates the expansion of the money supply, was a major source of money stock growth (claims on private sector enterprises rose by 235 billion rubles in January-March 2004). At the same time, the dynamics of monetary indicators were also affected by the continued increase of banking sector net foreign assets.

Overall, the tendency towards growth in the demand for money continued at faster-than-expected rates at the beginning of the year due to rapid economic growth and de-dollarisation of the economy.

Analysis has shown that owing to the weakening of interrelations between monetary and macroeconomic indicators, instability of currency exchange rates on world markets and the increased uncertainty about the stability of internal macroeconomic trends, the influence of the monetary factor on inflation cannot be definitely described. Taking into consideration that the velocity of money may slow down as a result of structural changes in the monetary sphere (notably, the adoption of the deposit insurance law), the accelerated growth in the money supply may not have a negative influence on consumer price growth in the short term. At the same time, the downward trend of monetary indicators should facilitate the achievement of the medium- and long-term macroeconomic objectives.

## Financial Market Indicators

### The term structure of interest rates on ruble-denominated financial instruments with different maturities in January–April reflected the balance between the demand for money and its supply.

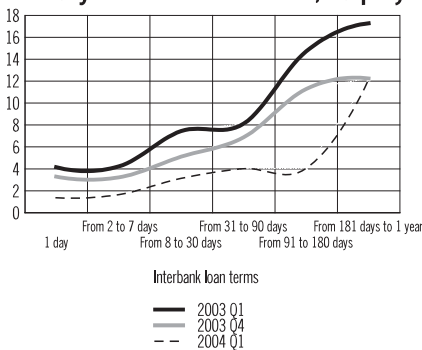
The main factors of importance for the level of financial market interest rates in the period under review were, as before, the level of banking liquidity, the issuer’s policy on the GKO-OFZ market and the dynamics of the nominal dollar/ruble rate.

Interest rates on interbank ruble loans continued to decline in January–March as the average quarterly level of commercial banks’ liquidity increased. In the 90-day segment of the loan market, interest rates decreased relatively evenly. The differences in the nature of changes in interest rates in longer-term credit operations were connected with small volumes of operations and could not be regarded as an indisputable sign of change in market participants’ inflationary expectations. The interbank yield

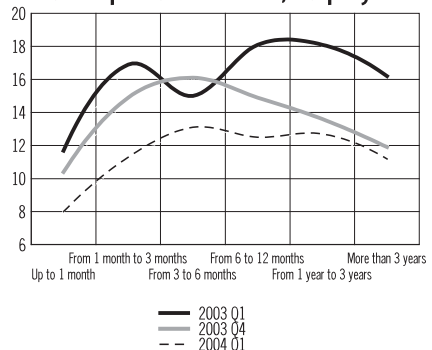
curve continued to rise gently in the 1<sup>st</sup> quarter, but in the second half of April the demand for short-term ruble resources soared due to the following mutually augmenting factors: the acceleration of the nominal rate of the dollar against the ruble, which made currency and interest rate arbitrage operations increasingly attractive; the need to effect month-end compulsory payments; growth in supply on the corporate and municipal bond market; the immobilisation of a part of bank funds before the May Day holidays. As a result, the average weighted Moscow Interbank Actual Credit Rate (MIACR) on overnight ruble loans rose to 5.2% p.a. in April against 1.8% p.a. in March. At the same time, **the term structure of interest rates on interbank loans in January–April continued to reflect a relatively low and stable level of market participants’ inflation expectations.**

The yield curve of bank credit operations remained concave in the 1<sup>st</sup> quarter of

**Interbank Loan Yield Curve (average monthly MIACR on ruble loans, % p.a.)**



**Bank Credit Operations Yield Curve (loans to corporate borrowers, % p.a.)**



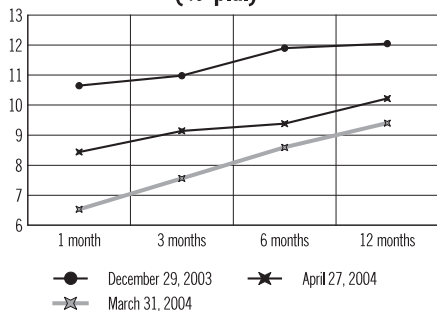
the year, but more rapid decline in interest rates on operations with terms shorter than one year smoothed it. In the segment of operations with terms from three months to three years the yield curve was almost flat. **The term structure of interest rates on bank credit operations in the period under review may indicate the emergence of expectations of further moderate decline in interest rates in this segment of the Russian market in the medium term in the wake of a possible reduction of inflation.**

The term structure of interest rates on promissory notes was virtually unchanged in the 1<sup>st</sup> quarter of the year. The yield curve of the most liquid notes continued to rise. The ruble's fall against the dollar in nominal terms and growth in yields in the adjacent segments of the stock market in April caused the yield of the ruble-denominated notes to increase. Over the month, the yield of the market portfolio of the most liquid notes with different terms to redemption rose by 0.8-1.9 percentage points. The most significant growth in yields was demonstrated by 1- to 3-month notes. **The term structure of note rates in January-April reflected**

**the current situation in this segment of the market and testified to the lack of short-term expectations of higher inflation.**

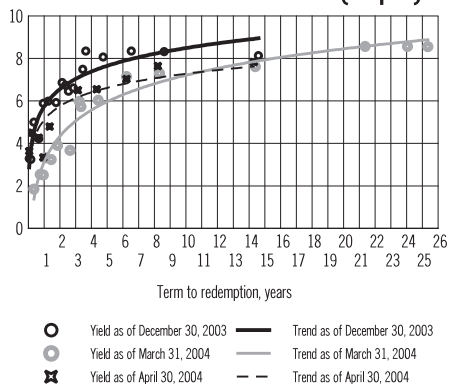
The GKO-OFZ yield curve kept on rising in January-April. As the government securities market portfolio and turnovers expanded quarter on quarter, the yield of the instruments with maturity from 1 year to 9 years declined significantly, while the yield of longer-term papers remained almost unchanged. Yields fell to their lows at the end of March and subsequently the yield of most of the GKO-OFZ market instruments began to rise. **The inflation risk premium was not included in the price of short-term government bonds**, while yield fluctuations were caused by changes in the structure of demand on the money market. The yield volatility of medium- and long-term instruments did not change significantly quarter on quarter. Government securities with terms to redemption longer than one year remained a liquid market instrument. The medium-term inflation expectations of market participants slightly abated, while the long-term expectations that appeared in the 4<sup>th</sup> quarter of last year

**Promissory Note Yield Curve**  
(% p.a.)\*

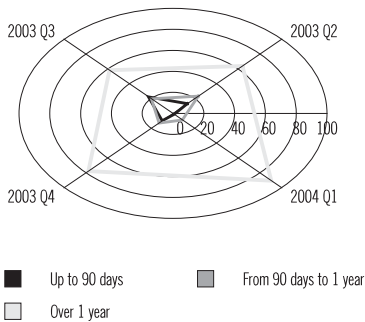


\* RUX-Region yield indices.

**GKO-OFZ Effective Yield Curve (% p.a.)**



### GKO-OFZ Turnover Structure by Maturity (%)



persisted. **Investments in medium-term government securities are subject to moderate inflation risk. The risk of investing in securities with terms longer than five years is determined by assessing the risk involved in medium-term issues.**

The GKO-OFZ secondary market turnovers expanded 2.4 times in 2004 Q1 as compared with 2003 Q4. In this situation, the share of government bonds with terms shorter than one year contracted by more than a half in the overall GKO-OFZ secondary market turnover. The share of medium- and long-term papers expanded to more than 90% of the government securities secondary market turnover in 2004 Q1, the highest level in the past few years. The GKO-OFZ secondary market turnover contracted significantly in April and stood at a little over 40% of the March value, while the share of government bonds with maturity up to 1 year expanded from 0.2% to 5.3% of aggregate turnover. **The GKO-OFZ turnover**

**structure in January–April, determined by the portfolio structure of outstanding papers and different liquidity levels of instruments with different terms, reflected government securities market participants' preferences amid relatively low inflationary expectations.**

\*\*\*

The analysis of the term structure of interest rates in the financial market segments under review shows that the price volatility of most of the ruble-denominated instruments of the financial market was moderate in January–April and started to show a tendency towards growth at the end of the period under review. In this situation, the yield curves of major ruble-denominated instruments of the Russian market retained their informative significance, especially as an indicator for the inflationary expectations of market participants.

The interest rate structure by maturity remained balanced in the period under review. Improvements in most sectors of the Russian economy eased inflationary expectations. **The yield curves of major financial instruments continued to rise, reflecting the stability of Russian financial market participants' short- and medium-term inflation expectations.**

The small scale of operations with long-term financial instruments does not allow one to accurately evaluate long-term inflationary expectations. **The fact that the yield curves of the longest-term instruments remained almost flat in January–April may reflect the inertia of market participants' expectations.**

## Addendum

### Consumer price dynamics of individual groups of goods and services (month on month, %)

	Monthly inflation	Food price growth	Growth in food prices, excluding vegetable prices	Growth in vegetable and fruit prices	Non-food price growth	Core inflation	Growth in service prices
<b>2003</b>							
January	2.4	2.5	1.3	13.1	1.1	1.2	4.4
February	1.6	1.2	0.8	4.1	0.9	0.9	4.2
March	1.1	1.0	0.6	3.9	0.8	0.7	1.7
April	1.0	1.0	0.5	4.2	0.6	0.6	1.8
May	0.8	0.7	0.4	2.5	0.6	0.6	1.5
June	0.8	0.8	0.6	2.3	0.5	0.6	1.2
July	0.7	0.4	0.7	-1.8	0.5	0.7	1.9
August	-0.4	-1.4	0.8	-17.2	0.6	0.7	0.7
September	0.3	-0.2	1.1	-11.2	0.9	1.1	0.9
October	1.0	1.1	1.8	-5.6	1.0	1.4	0.8
November	1.0	1.2	1.3	1.0	0.8	1.1	0.4
December	1.1	1.5	1.2	4.1	0.6	1.0	0.9
Full year (December on December)	12.0	10.2	11.8	-4.2	9.2	11.2	22.3
<b>2004</b>							
January	1.8	1.6	1.3	5.5	0.5	0.9	4.1
February	1.0	1.1	1.1	1.5	0.4	0.8	1.6
March	0.8	1.1	0.9	2.8	0.4	0.7	0.6

### Consumer price dynamics of individual groups of goods and services (on accrual basis since start of year, %)

	Inflation over period	Food price growth	Growth in food prices, excluding vegetable prices	Growth in vegetable and fruit prices	Non-food price growth	Core inflation	Growth in service prices
<b>2003</b>							
January	2.4	2.5	1.3	13.1	1.1	1.2	4.4
February	4.1	3.7	2.2	17.8	2.0	2.1	8.8
March	5.2	4.8	2.8	22.4	2.8	2.8	10.6
April	6.2	5.8	3.3	27.6	3.5	3.4	12.6
May	7.1	6.5	3.8	30.8	4.1	4.0	14.2
June	7.9	7.4	4.4	33.7	4.6	4.7	15.6
July	8.7	7.8	5.1	31.4	5.1	5.4	17.8
August	8.3	6.3	6.0	8.7	5.7	6.2	18.7
September	8.6	6.1	7.1	-3.4	6.6	7.3	19.7
October	9.7	7.3	9.1	-8.9	7.7	8.9	20.7
November	10.8	8.6	10.4	-7.9	8.6	10.1	21.2
December	12.0	10.2	11.8	-4.2	9.2	11.2	22.3
<b>2004</b>							
January	1.8	1.6	1.3	5.5	0.5	0.9	4.1
February	2.8	2.8	2.3	7.1	0.9	1.7	5.8
March	3.5	3.8	3.2	10.1	1.4	2.4	6.4

## Inflation Growth Structure

**Inflation growth over period since start of year due to changes in prices  
of individual groups of goods and services**

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit	Inflation over period, %
<b>2003</b>						
January	0.7	0.3	1.0	0.8	0.7	2.4
February	1.1	0.5	1.7	1.5	0.9	4.1
March	1.4	0.8	2.3	1.8	1.2	5.2
April	1.7	1.0	2.8	2.2	1.4	6.2
May	1.9	1.1	3.3	2.4	1.6	7.1
June	2.2	1.3	3.8	2.7	1.8	7.9
July	2.6	1.4	4.4	3.1	1.6	8.7
August	3.0	1.6	5.0	3.2	0.5	8.3
September	3.6	1.8	6.0	3.4	-0.2	8.6
October	4.5	2.1	7.2	3.5	-0.5	9.7
November	5.2	2.4	8.2	3.6	-0.4	10.8
December	5.9	2.5	9.1	3.8	-0.2	12.0
<b>2004</b>						
January	0.6	0.1	0.8	0.7	0.3	1.8
February	1.2	0.2	1.4	1.0	0.4	2.8
March	1.6	0.4	2.0	1.1	0.5	3.5

\* Excluding vegetables and fruit.

## Monthly inflation growth due to changes in prices of individual goods and services

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit	Inflation over month, %
<b>2003</b>						
January	0.7	0.3	1.0	0.8	0.7	2.4
February	0.4	0.2	0.7	0.7	0.2	1.6
March	0.3	0.2	0.6	0.3	0.2	1.1
April	0.3	0.2	0.5	0.3	0.3	1.0
May	0.2	0.2	0.4	0.3	0.2	0.8
June	0.3	0.1	0.5	0.2	0.1	0.8
July	0.3	0.1	0.5	0.4	-0.1	0.7
August	0.4	0.1	0.6	0.1	-1.1	-0.4
September	0.5	0.2	0.9	0.2	-0.6	0.3
October	0.9	0.3	1.2	0.1	-0.3	1.0
November	0.6	0.2	0.9	0.1	0.0	1.0
December	0.6	0.2	0.8	0.2	0.2	1.1
<b>2004</b>						
January	0.6	0.1	0.8	0.7	0.3	1.8
February	0.5	0.1	0.6	0.3	0.1	1.0
March	0.4	0.1	0.6	0.1	0.1	0.8

\* Excluding vegetables and fruit.

## Contribution to Inflation Growth

### Contribution to inflation growth over period since start of year by groups of goods and services

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit
<b>2003</b>					
January	27.5	12.4	40.6	31.6	28.5
February	26.7	13.4	41.9	37.1	22.8
March	27.3	14.9	44.2	35.3	22.5
April	27.0	15.3	44.9	34.7	23.1
May	26.9	15.9	46.1	34.5	22.7
June	28.1	16.0	47.9	33.7	22.2
July	29.7	16.2	50.3	35.2	18.8
August	36.5	19.1	60.7	38.9	5.5
September	41.6	21.2	69.1	39.3	-2.1
October	46.7	21.6	74.3	36.4	-4.7
November	48.5	21.7	76.3	33.6	-3.8
December	49.1	21.0	75.9	31.7	-1.8
<b>2004</b>					
January	35.8	7.6	43.2	40.3	16.3
February	42.3	9.0	50.0	35.4	13.3
March	45.0	10.3	55.3	30.2	14.5

\* Excluding vegetables and fruit.

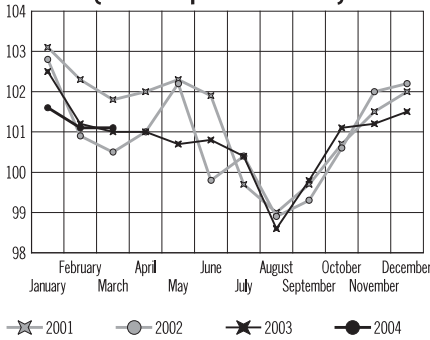
### Contribution to inflation growth over month by individual groups of goods and services

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit
<b>2003</b>					
January	27.5	12.4	40.6	31.6	28.5
February	25.5	15.0	43.8	45.0	14.6
March	29.7	20.3	53.0	28.3	21.7
April	25.5	17.2	48.7	31.6	25.7
May	25.9	21.2	55.3	33.1	19.8
June	38.4	16.6	62.7	26.9	18.1
July	46.8	18.9	74.7	50.7	-16.4
August	<i>estimate is impossible for negative values</i>				
September	164.8	72.9	270.6	50.5	-188.3
October	86.6	25.6	114.4	14.2	-26.4
November	63.8	23.3	93.9	8.4	4.5
December	53.8	14.2	71.8	15.3	16.7
<b>2004</b>					
January	35.8	7.6	43.2	40.3	16.3
February	53.5	11.5	61.8	26.8	8.1
March	54.6	14.8	74.3	11.5	19.2

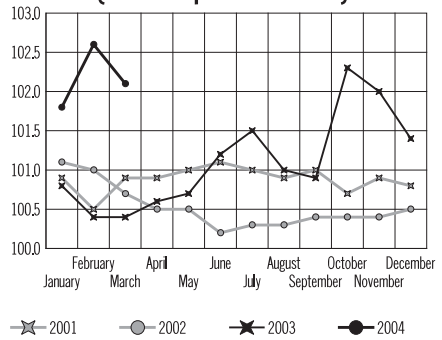
\* Excluding vegetables and fruit.



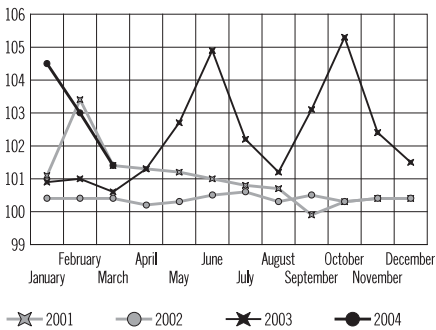
**Food price dynamics, total**  
(as % of previous month)



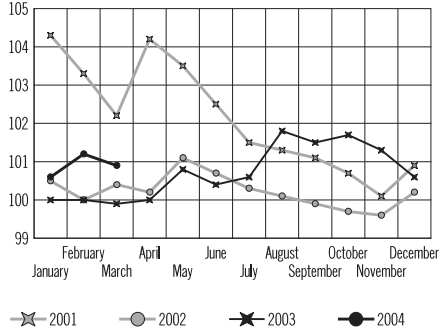
**Pasta price dynamics**  
(as % of previous month)



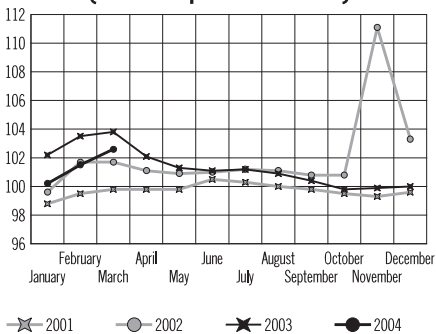
**Bread and Bakery Products Price Dynamics**  
(as % of previous month)



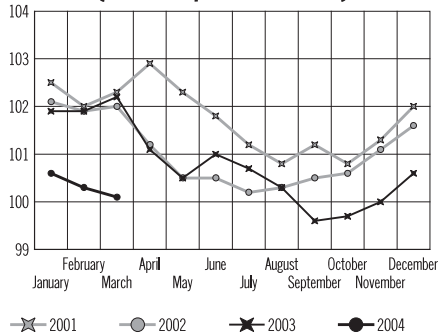
**Meat and poultry price dynamics**  
(as % of previous month)



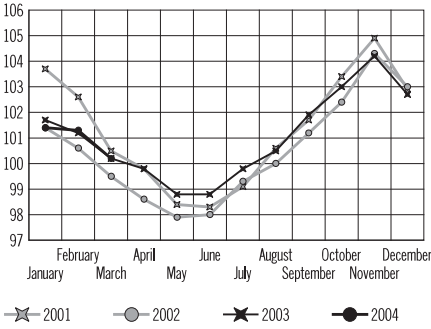
**Groats and legume price dynamics**  
(as % of previous month)



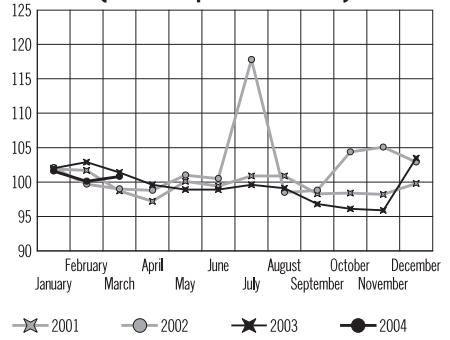
**Fish and seafood price dynamics**  
(as % of previous month)



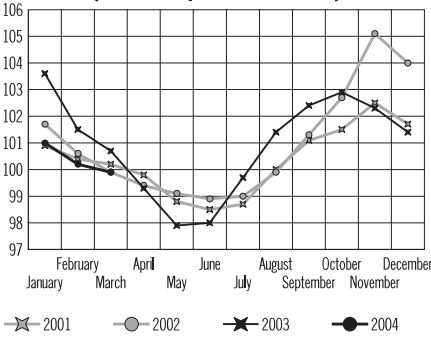
**Milk and dairy products price dynamics  
(as % of previous month)**



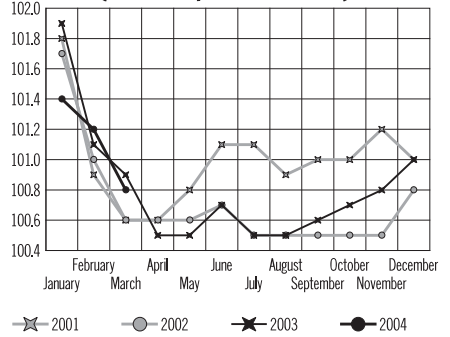
**Granulated sugar price dynamics  
(as % of previous month)**



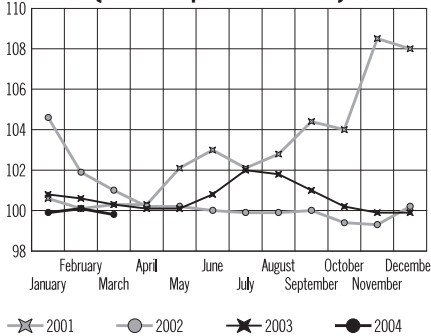
**Butter price dynamics  
(as % of previous month)**



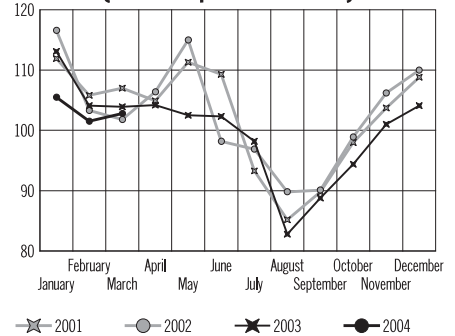
**Alcohol price dynamics  
(as % of previous month)**



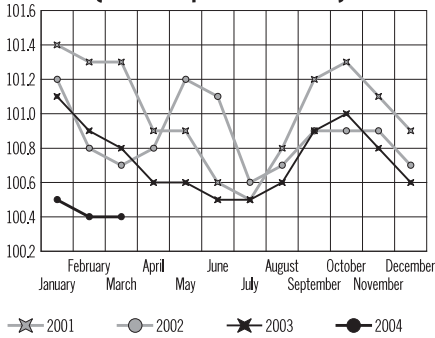
**Sunflower oil price dynamics  
(as % of previous month)**



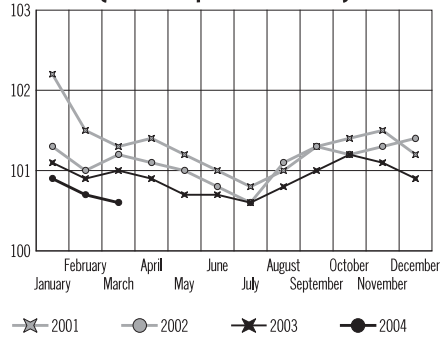
**Vegetable and fruit price dynamics  
(as % of previous month)**



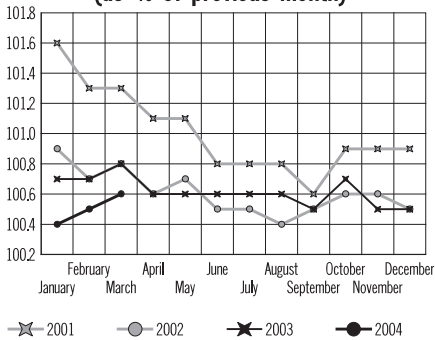
### Non-food price dynamics (as % of previous month)



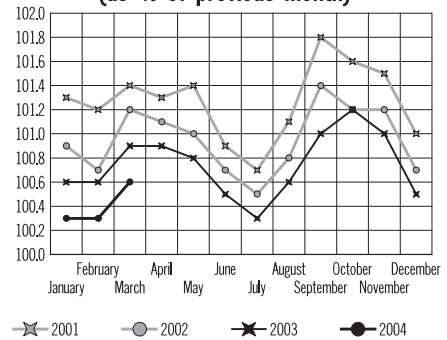
### Knitwear price dynamics (as % of previous month)



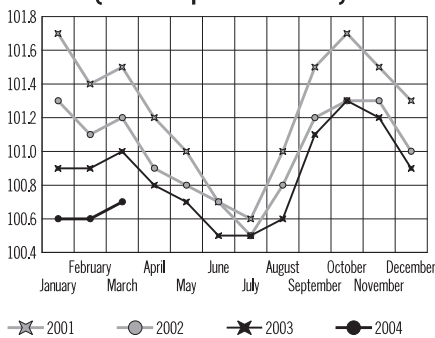
### Fabrics price dynamics (as % of previous month)



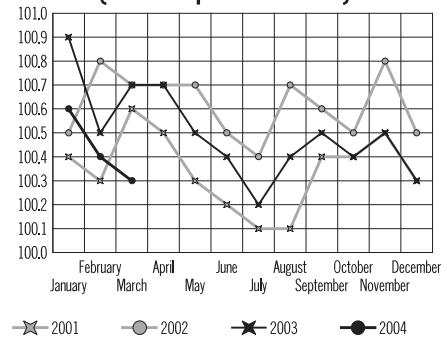
### Footwear price dynamics (as % of previous month)



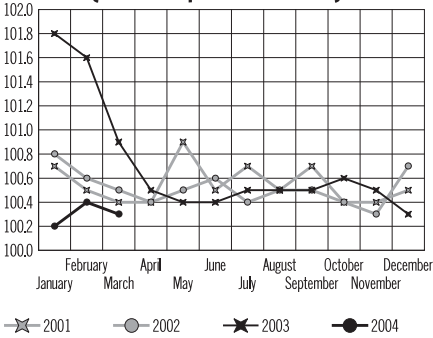
### Clothing and underwear price dynamics (as % of previous month)



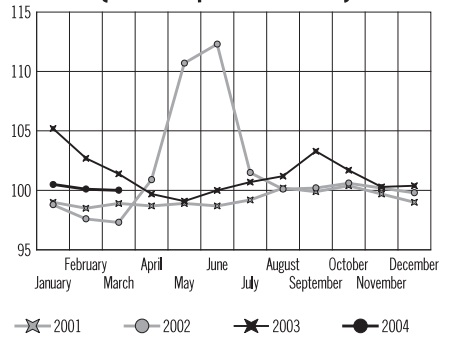
### Detergent price dynamics (as % of previous month)



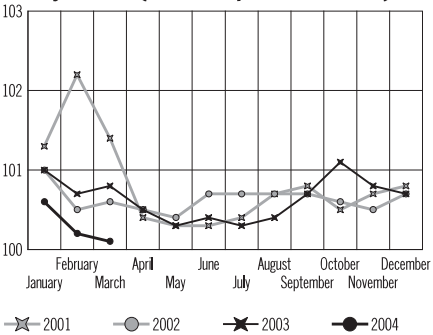
### Tobacco price dynamics (as % of previous month)



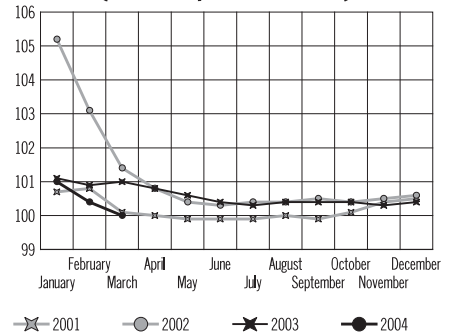
### Petrol price dynamics (as % of previous month)



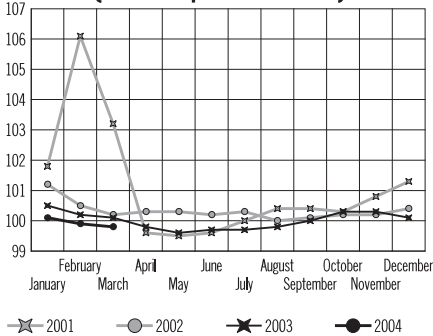
### Household electric appliances price dynamics (as % of previous month)



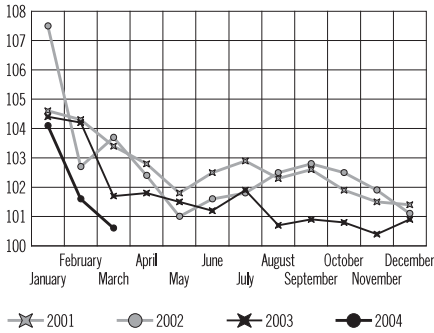
### Medicine price dynamics (as % of previous month)



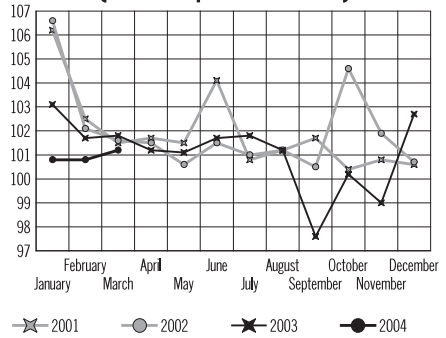
### TV and radio price dynamics (as % of previous month)



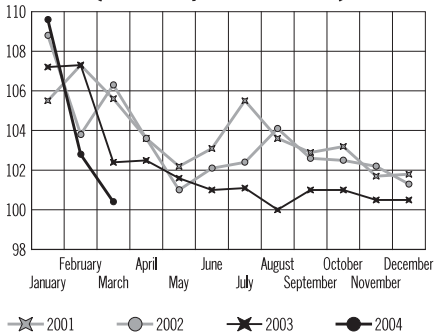
**Paid service price dynamics  
(as % of previous month)**



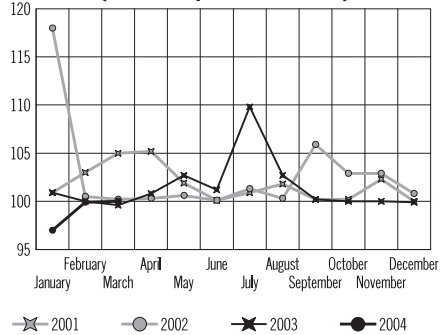
**Passenger transport fare dynamics  
(as % of previous month)**



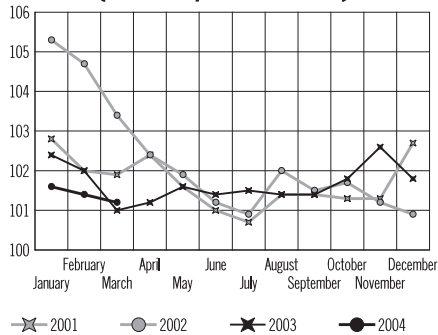
**Rent and utilities price dynamics  
(as % of previous month)**



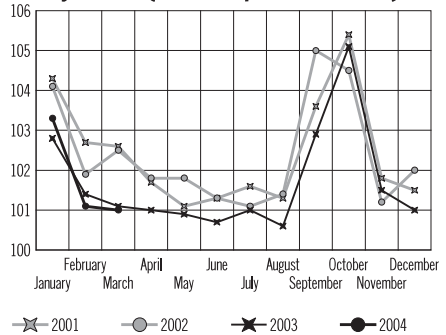
**Communications service price dynamics  
(as % of previous month)**



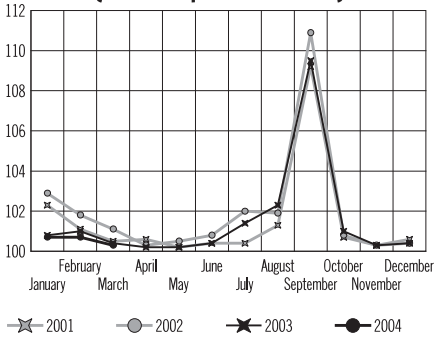
**Healthcare price dynamics  
(as % of previous month)**



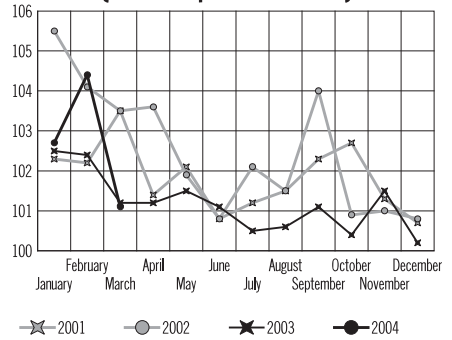
**Entertainment and recreation price dynamics  
(as % of previous month)**



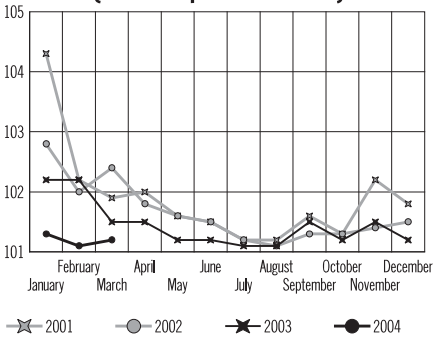
**Education price dynamics  
(as % of previous month)**



**Pre-school tuition fee dynamics  
(as % of previous month)**



**Personal services price dynamics  
(as % of previous month)**



**Dynamics of prices charged by sanatoria  
and health-building centres  
(as % of previous month)**

