Bank of Russia

FEBRUARY 2020

MONETARY POLICY REPORT

17 February 2020

The report has been prepared based on statistics as of 6 February 2020.
The data cut-off date for forecast calculations is 31 January 2020 (if statistics or other information relevant for decision-making come in after the data cut-off date, they are included in the text of the Report and may be used to adjust the mid-term forecast).

A soft copy of the information and analytical review is published on the Bank of Russia website in the section Publications/Monetary Policy Report at www.cbr.ru/publ/?PrtId=ddcp.
Please send your suggestions and comments to monetarypolicyreport@mail.cbr.ru.

This publication has been prepared by the Monetary Policy Department.

Cover photo: Shutterstock/FOTODOM
Address: 12 Neglinnaya Street, Moscow, 107016
Phone: +7(495) 771-46-74, +7(495) 771-59-08
Bank of Russia website: www.cbr.ru

CONTENTS

STATEMENT BY BANK OF RUSSIA GOVERNOR
ELVIRA NABIULLINA 2

BANK OF RUSSIA'S MEDIUM-TERM FORECAST 7

1. ECONOMIC OUTLOOK 8

1.1. Baseline scenario 10

1.2. Forecast uncertainty factors 17

2. INFLATION AND INFLATION EXPECTATIONS 20

3. MACROECONOMIC CONDITIONS 29

3.1. External conditions and balance of payments 30

3.2. Monetary conditions 40

3.3. Economic activity 44

3.4. Public finances 54

4. THE BANK OF RUSSIA'S MONETARY POLICY 59

4.1. Key rate decisions 59

4.2. System of monetary policy instruments
and other monetary policy measures 60

BOXES 64

On economic effects of the measures specified in the Presidential Address
to the Federal Assembly in 2020–2024 64

Using different price dynamics indicators 67

Impact of changes in excise rates on inflation in 2020 69

ANNEXES 70

Economic situation in Russian Regions 70

Statistical tables 78

GLOSSARY 84

ABBREVIATIONS 87

STATEMENT BY BANK OF RUSSIA GOVERNOR ELVIRA NABIULLINA

IN FOLLOW-UP TO BOARD OF DIRECTORS MEETING 7 FEBRUARY 2020

Today, the Board of Directors has decided to cut the key rate by 25 bp to 6.00% per annum.

We hold open the prospect of key rate reduction at the upcoming meetings, if the situation develops in accordance with our baseline forecast.

When taking our decision today, we took into account a wide range of factors.

First. Inflation dynamics.

In January, annual inflation declined to 2.4%. Let me remind you that it was 3% by the end of 2019. The inflation slowdown itself vs the December reading was expected and was mainly related to the factoring out of the VAT rate hike from the calculation last year. However, inflation showed a more considerable decline than we had expected.

The seasonally adjusted monthly inflation rate also indicates a low inflationary pressure. Core inflation and other stable price dynamics indicators are close to 3% or lower in annual terms.

We expect that, in the first quarter, annual inflation will reach about 2%. In the middle of the year, it will begin to rise, gradually returning to the target. We maintain our inflation forecast for 2020 at 3.5–4%.

Now, let me speak about the drivers behind current inflation dynamics and why we think that it will return to the target.

<u>Economy's demand.</u> Although we recorded an increase in domestic demand in the second half of the last year, external demand remained quite subdued. Among other things, this resulted in a decline in Russian exports. That said, the dynamics of domestic demand in 2019 were very irregular. Weak demand in the first half of the year led to a fast inflation slowdown to the current low level. The revival in domestic demand in the second half of 2019 and its further expansion this year will become the main driver behind the return of inflation to the target.

Both consumer and public demand has improved. Private consumption growth was driven by increasing real wages and disposable income, including due to falling inflation. The end of the last year also saw a rise in public expenditures and a more extensive usage of funds to implement national projects. In our opinion, these trends will continue this year.

I think it's important to particularly note the following. From 2015 to 2019, the macroeconomic policy – both monetary and fiscal – was largely determined by the necessity to adapt our economy to the dramatic changes in external conditions that took place in 2014. By the need to increase macroeconomic stability, price stability and fiscal sustainability, to lower the dependency of the economy on the situation in commodity markets and geopolitical risks.

As of today, this goal has been largerly accomplished. The period of adaptation has ended. Budget consolidation has completed, and there is even some space for the accommodative fiscal policy.

Annual inflation has reached the target and since 2017 has averaged 3.7%. It was already last autumn that we completed the transition from a moderately tight to neutral monetary policy.

We cannot afford treating last five years' achievements recklessly. These achievements have established a foundation to implement an effective countercyclical economic policy.

It is important to note that the effect of the fiscal and monetary policies will largely depend on the behaviour and sentiment of private business and households. It will depend on their response to the decline in interest rates, their use of additional income (whether they will save or spend it) and on whether private investment will grow in response to the budgetary impulse. And this, in turn, depends heavily on the sentiment of producers and consumers, their confidence in the future, their investment horizon, personal plans and the business climate in general. If the sentiment remains cautious, moderate, both fiscal and monetary policy measures will only have a limited effect on the expansion of aggregate demand and sustainable economic growth.

Back to the current situation. <u>Exchange rate dynamics</u> are yet another driver behind the deviation of inflation from the target and subsequent return to it. Last year, the ruble significantly appreciated, and today we still see the accumulated effect of this appreciation. Even with the January fluctuations factored in, the ruble remains stronger than in the previous year. In the first half of the year, the effect of the last year's appreciation and its disinflationary influence will be exhausted.

<u>Food markets.</u> We are observing price dynamics that are not typical for this time of the year. Seasonally adjusted food prices have basically remained at the same level for several months without growth. The supply factor and the successful developments of our agricultural sector play an important role here. It is difficult to estimate the proportion of temporary and persistent factors in the food market reliably. There remains a potential for further production growth and capacity expansion. At the same time, this sector's export capabilities are also expanding. Production growth leads to increased competition. We base our view on the fact that this will gradually result in the aligning of food price dynamics with those of other goods and services.

<u>Inflation expectations.</u> No significant changes have been observed here in the recent months. Over the one-year horizon, analysts' expectations are forming close to 4%. Short-

term price expectations of businesses have stabilised at an all-time low levels. Households' inflation expectations are currently holding close to the two-year minimum. However, we continue to estimate this level as increased. The main thing is that we are yet to estimate the anchoring of inflation expectations of both households and businesses when the slowdown of inflation ends and it returns to the target.

Economic growth dynamics are the second most important factor behind our decision besides inflation.

In 2019, GDP grew by 1.3%, which is the upper bound of our forecast range. Internal consumption growth slightly overshoot our expectations whereas external demand was weaker. As I have already noted, the growth of demand and other economic activity indicators occurred in the second half of the last year, including owing to the accelerated budget execution.

The Board of Directors retained almost the same view for 2020 and medium-term forecast at this meeting. This year, economic growth will exceed the last year's reading and reach 1.5–2%. This will also drive inflation back to the target. We expect that the growth rate of households' consumption will remain at the current level while investment growth will notably accelerate. The effect of fiscal measures on the forecast may be clarified after the introduction of amendments to the budget by the Government. Regarding external demand, the forecast implies that exports will recover after the last year's decline. However their dynamics will be contained by moderate global economic growth rates. In our view, the global economy can be affected by the next phase of trade negotiations as well as the further development of the coronavirus situation. At the moment, we estimate its influence as temporary.

Third. Monetary conditions. They have been generally easing.

This fully refers to price lending conditions. Yields of federal government bonds stay at their lows for the last few years. Interest rates in the deposit and credit market continue to go down. The average interest rate on housing mortgage loans hit its new low in December, dropping to exactly 9% per annum. There is room for further decrease in interest rates owing to the earlier key rate decisions.

However, non-price conditions have been changing in diverse manner. In consumer lending, they have been tightening, which is associated with the macroprudential measures implemented by the Bank of Russia. I would like to remind that these are targeted measures we are taking to maintain financial stability in individual segments of the financial market. In this situation, the growth of consumer lending is slowing down, and this trend will continue.

At the same time, there is a potential for easing of non-price conditions in the corporate segment. This is already happening at the moment. Areas of lending to corporate borrowers are expanding; long-term loans are becoming more affordable, including owing to the development of the bond market. This is also driven by the gradual improvement of the loan servicing quality.

Fourth. There have been some changes in external conditions. But our opinion regarding their overall impact has generally remained the same. *China and the USA have signed a trade agreement. This means that the significant risks we saw in foreign trade have not materialised. This positive news supported market sentiment.*

Yet, new challenges have emerged and they involve new risks to global economic growth. The coronavirus problem is already affecting the economic situation in both individual countries and the world in general. Speaking of Russia, its influence on our economy is currently estimated as minor.

The reaction of the ruble exchange rate to a substantial decline in oil prices in January and early February and increased volatility in foreign financial markets was moderate. The country risk premium for Russian assets is currently close to its record lows, after its persistent and significant decrease last year. This trend is supported by macroeconomic stability, primarily the accumulated safety cushion in the form of the National Wealth Fund.

Finally, regarding inflation risks.

First, I would like to remind you what we call 'risks for inflation', or 'inflation risks'. The Bank of Russia's baseline forecast implies a certain path for inflation to return to the target. When we are talking of risks, we mean the reasons that may cause inflation to deviate from the forecast path upwards or downwards. These are proinflationary and disinflationary risks respectively.

Currently, disinflationary risks significantly prevail over the short-term horizon.

First and foremost, this is how demand is changing in the domestic market, both among consumers and investors. An increase in consumption and investments may be lower than we expect, even in the situation of the continuing easing of monetary conditions and accommodative monetary policy. This scenario is possible if there are no marked positive changes in business and consumer sentiment.

Another short-term disinflationary risk is a more considerable and longer-term impact of the ruble appreciation last year, than it was assumed in our baseline forecast.

In addition, there is a range of factors related to both disinflationary and proinflationary risks. One of them is food prices which are very volatile. External conditions are another factor. If the coronavirus situation deteriorates or any complications arise at next stages of the trade negotiations between the USA and China, this can lead to a rise in volatility in financial and commodity markets, a capital outflow and pressures on emerging market currencies, which are proinflationary factors. At the same time, worsening of the situation in the global economy against this background, a decline in external demand for Russia, a slower inflation growth in Russia's trade partners may ultimately become a considerable disinflationary factor.

The nature of influence of fiscal policy on inflation will depend on the pace and efficiency of the implementation of the planned measures over the forecast horizon.

As before, we can say that unanchored inflation expectations may also be considered a proinflationary risk.

Besides, previous decisions to cut the key rate may have a stronger upward effect on inflation than we estimate in the baseline forecast.

Given the above, we currently estimate mid-term risks for our inflation forecast as balanced.

And to conclude, a few words about the outlook for monetary policy.

Given the today's key rate decision, we have reached the lower bound of the 6–7% range which we consider neutral for the inflation target around 4%. I would like to emphasise once *again that, as such, the neutral rate of interest is not observed directly, it may be determined only approximately. Besides, it may change in time under the influence of various factors. We have yet to estimate and, possibly, adjust this range. Objectively, today we still lack sufficient data for this. It will require a longer period of time, maybe even more than a year.*

But what is important to stress today when the key rate is at the lower bound of the range that we have estimated. These bounds, both the upper and the lower ones, do not in any way set any thresholds for possible movements of the key rate, whether upwards or downwards. If our estimate of inflation and the economic situation require, the key rate may be set beneath the lower bound of the neutral range. This will mean loose monetary policy. Similarly, when inflation significantly deviated upwards from 4%, we maintained the key rate above the upper bound of this neutral range for a long period of time.

We hold open the prospect of key rate reduction at the upcoming meetings, if we consider it necessary to bring inflation back to the target, that is close to 4%.

Bank of Russia Governor ***Elvira Nabiullina***

BANK OF RUSSIA'S MEDIUM-TERM FORECAST[1]

IN THE FOLLOW-UP TO THE BOARD OF DIRECTORS KEY RATE MEETING ON 7 FEBRUARY 2020

KEY PARAMETERS OF THE BANK OF RUSSIA'S FORECAST UNDER THE BASELINE SCENARIO *Table 1*
(growth as % of previous year, unless indicated otherwise)

	2019 (actual)	Baseline		
		2020	2021	2022
Urals price, average for the year, US dollars per barrel	64	55	50	50
Inflation, as % in December year-on-year	3.0	3.5-4.0	4.0	4.0
Inflation, average for the year, as % year-on-year	4.5	3.0-3.4	4.0	4.0
Gross domestic product	1.3	1.5-2.0	1.5-2.5	2.0-3.0
Final consumption expenditure	2.4	1.5-2.0	1.5-2.0	1.8-2.3
– households	*2.3*	*2.0-2.5*	*2.0-2.5*	*2.0-2.5*
Gross capital formation	2.7	3.5-4.5	3.5-4.5	2.5-3.5
– gross fixed capital formation	*1.4*	*3.5-4.5*	*3.5-4.5*	*2.5-3.5*
Exports	-2.1	2.0-2.5	2.0-2.5	2.5-3.0
Imports	2.2	3.0-3.5	3.5-4.0	2.5-3.0
Money supply in national definition	9.7	7-12	7-12	7-12
Banking system claims on the economy in rubles and foreign currency*	10.1	7-12	7-12	7-12
– corporates	*7.1*	*6-10*	*6-10*	*6-10*
– households	*19.0*	*10-15*	*10-15*	*10-15*

** Banking sector claims on organisations and households means all of the banking sector's claims on non-financial and financial institutions and households in rubles, foreign currency and precious metals, including loans issued (including overdue loans), overdue interest on loans, credit institutions' investment in debt and equity securities and promissory notes, as well as other forms of equity interest in non-financial and financial institutions, and other accounts receivable from settlement operations involving non-financial and financial institutions and households.*
Claims' growth rates are given with the exclusion of foreign currency revaluation. In order to exclude the effect of foreign currency revaluation, the growth of claims in foreign currency and precious metals is converted to rubles using the period average USDRUB exchange rate.
Source: Bank of Russia.

RUSSIA'S BALANCE OF PAYMENTS INDICATORS UNDER THE BASELINE SCENARIO* *Table 2*
(billions of US dollars)

	2019 (estimate)	Baseline		
		2020	2021	2022
Current account	**71**	**47**	**30**	**18**
Balance of trade	163	136	122	115
Exports	*418*	*395*	*388*	*392*
Imports	*255*	*259*	*266*	*277*
Balance of services	-35	-36	-38	-42
Exports	*64*	*64*	*65*	*65*
Imports	*98*	*100*	*103*	*107*
Primary and secondary income account	-58	-53	-54	-55
Current and capital account balance	**70**	**47**	**30**	**18**
Financial account (net of reserve assets)	**-2**	**9**	**4**	**4**
General government and the central bank	-24	-6	-6	-6
Private sector	22	15	10	10
Net errors and omissions	**-5**	**0**	**0**	**0**
Change in FX reserves ('+' is increase, '-' is decrease)	**66**	**38**	**25**	**14**

** Using the methodology of the 6th edition of 'Balance of Payments and International Investment Position Manual' (BPM6). In the Financial account, '+' stands for net lending,'-' – for net borrowing. Due to rounding total results may differ from the sum of respective values.*
Source: Bank of Russia.

[1] The Bank of Russia's forecast under the supplementary scenarios (high oil prices and risk) were published in the Monetary Policy Guidelines for 2020-2022 on 25.10.2019, www.cbr.ru/Content/Document/File/79959/on_2020_eng.pdf.

1. ECONOMIC OUTLOOK

The Bank of Russia has retained its mid-term view on the rate of economic growth in key economies of the world. In the baseline scenario, the Bank of Russia assumes that global economic growth will slow down in 2020. Although, according to the Bank of Russia's estimates, risks associated with trade disputes have somewhat abated, uncertainty persists over the progress of the trade agreement signed in January between the US and China and the prospects of resolving the remaining trade issues between the two countries (in the second round of the negotiations). This will weigh on business, investment and consumer sentiment the world over in 2020 and beyond. An additional factor of uncertainty for growth of the global economy in the coming quarters of 2020 is further spread of the coronavirus.

In its baseline scenario, the Bank of Russia still assumes that global oil prices will gradually decrease over the forecast horizon. As in the December issue of its Monetary Policy Report (MPR 4/19), the Bank of Russia projects that the average price for Urals crude oil will total $55 per barrel in 2020 and $50 per barrel in 2021–2022. It is expected to reach the level of $50 per barrel by early 2021. As regards other external forecast assumptions, the Bank of Russia has reduced the equilibrium country risk premium for Russia in its baseline scenario, compared with MPR 4/19, in the light of its considerable decrease in 2019, which reflects a decline in global credit spreads and a structural reduction in Russia's sovereign risk due to the accumulation of the fiscal buffer in the form of the liquid portion of the NWF.

Taking into account the developments in the Russian economy, including the dynamics of domestic consumer prices, and the pursued monetary policy, the Bank of Russia still predicts that annual inflation will come in at 3.5–4.0% as of the end of 2020 and hold close to 4% further on. In addition to monetary policy, during the year, the exhaustion of the effect of a number of one-off disinflationary factors in the food market, the easing of fiscal policy and the revival of consumer demand will also facilitate a gradual rise of annual inflation from the low levels of early 2020 to 4%.

The Bank of Russia's view on the Russian economy's growth in 2020–2022 have remained overall unchanged. The GDP growth rate will gradually increase from 1.5–2.0% in 2020 to 2–3% in 2022. This will be possible as the Government takes measures for overcoming structural constraints in the Russian economy, which include the implementation of national projects.

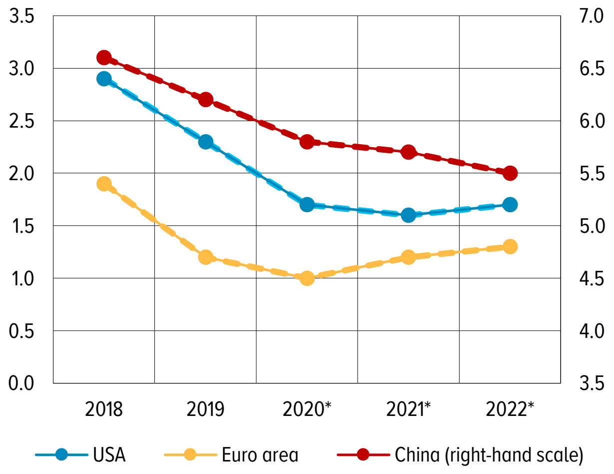
The main uncertainties in the baseline scenario over the forecast horizon involve both external and internal factors. According to the Bank of Russia's estimates, disinflationary risks still prevail over proinflationary ones in the short run. This is primarily related to the state of domestic and external demand. Disinflationary risks associated with movements in prices for certain food products persist, including on the back of increasing supply. The 2019 appreciation of the ruble may continue to influence price growth. The response of both consumer and investment demand in the private sector to the easing of monetary conditions and accommodative fiscal measures may be limited by the moderate sentiment of consumers and businesses.

At the same time, a number of proinflationary factors remain significant over the forecast horizon. In particular, the risks that food market trends may reverse cannot be ruled out, given that the ratio of temporary and permanent factors in this market is hard to estimate. Moreover, the monetary policy easing that has already been undertaken may have a stronger upward effect on inflation than the Bank of Russia estimates. The risk of a further slowdown in global economic growth persists, including under the influence of geopolitical factors and intensified volatility in global commodity *and financial markets, which may affect the exchange rate and inflation expectations. The schedule of budget expenditure will also influence inflation movements in 2020.*

A number of internal conditions continue to pose proinflationary risks over a longer-term horizon. Significant risks are posed by elevated and unanchored inflation expectations. Mid-term inflation dynamics may also be affected by fiscal policy parameters, including decisions on the investment of the liquid part of the National Wealth Fund in excess of the threshold level set at 7% of GDP.

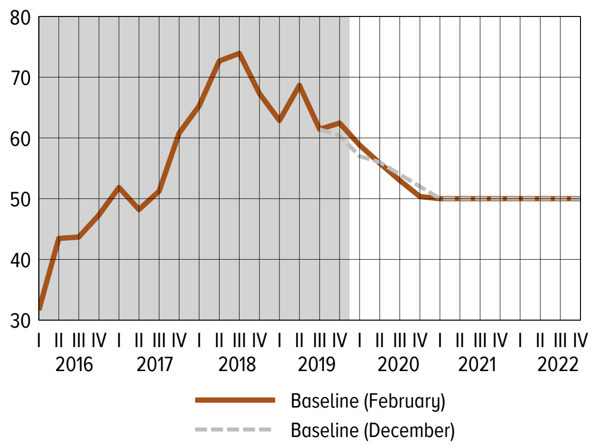
The Bank of Russia leaves mostly unchanged its estimates of risks associated with wage movements and possible changes in consumer behaviour. These risks remain moderate.

GDP GROWTH IN MAJOR ECONOMIES IN THE BASELINE SCENARIO *Chart 1.1.1*
(% change YoY)



** Forecast. Dotted line shows the previous forecast (December 2019).*
Source: Bank of Russia calculations.

OIL PRICE TRAJECTORY* IN THE BASELINE SCENARIO *Chart 1.1.2*
(US dollars per barrel)



** Nominal Urals crude prices (the arithmetic mean of Urals crude price delivered to the Mediterranean and north-western Europe).*
Source: Bank of Russia calculations.

1.1. BASELINE SCENARIO

FORECAST ASSUMPTIONS

Global economic growth. The Bank of Russia has retained its mid-term view on the rate of economic growth in key economies of the world (Chart 1.1.1). Thus, in the baseline scenario, the Bank of Russia assumes that global economic growth will slow down in 2020.

Over the 2020 horizon, business activity will be supported to some extent by the trade agreement signed between the US and China in January (in the first round of the talks). However, the persisting uncertainty over the progress of this agreement and the prospects of resolving the remaining trade issues between the US and China (in the second round of the negotiations) will weigh on business, investment and consumer sentiment the world over both in 2020 and further on over the forecast horizon.

Further spread of the coronavirus may become an additional constraint for global economic growth in 2020.

In 2021–2022, given the developments in international trade assumed in the baseline scenario, the Bank of Russia expects a transition to a later stage of the economic cycle in the US, somewhat subdued economic activity in the euro area, and a smooth slowdown in China's economic growth which is partially structural in nature.

Oil price. As before, the Bank of Russia assumes that the Urals crude price will gradually decline to $50 per barrel by the beginning of 2021 and remain close to this level further on (Chart 1.1.2). Taking this into account, the Bank of Russia forecasts in its baseline scenario that the average annual oil price will be $55 per barrel in 2020 and $50 per barrel in 2021–2022. In addition, the oil price path over the 2020 horizon has been revised to factor in the actual movements of global oil prices since the beginning of this year.

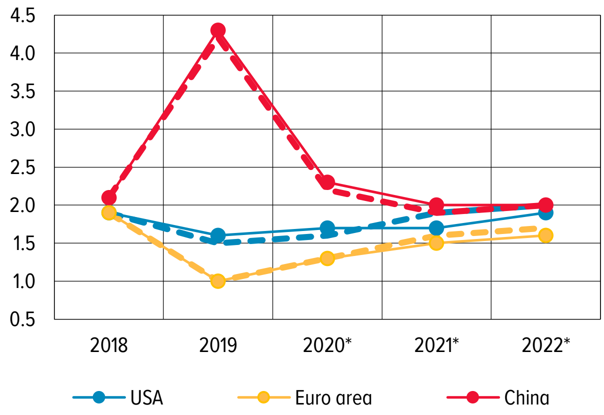
The oil price path is still based on the assumption that the rate of global economic growth will decrease and supply in the oil market will somewhat exceed demand amid a significant rise in production in non-OPEC+ countries.

However, the Bank of Russia believes that in 2020 a number of factors will have both upward and downward pressure on global oil prices. Thus, oil prices will be supported by supply-side factors: the OPEC+ agreement to reduce oil production until March 2020, including voluntary overperformance versus output cut quotas by individual parties to the agreement; the ongoing expectations that Iran, Libya and Venezuela will decrease their oil production and exports amid political tensions; and a certain easing of the trade tensions between the US and China owing to the trade agreement signed by the countries in January. At the same time, global oil prices will be dragged down by the uncertainty related to the coronavirus outbreak, which contains growth of global demand for oil.

Inflation abroad. The Bank of Russia has retained its mid-term view on the dynamics of consumer prices in key economies of the world. As in December, the Bank of Russia's baseline scenario assumes a gradual increase in inflation in advanced economies in 2020–2022 (Chart 1.1.3). Monetary policy of the US Fed and the ECB amid a slower growth of the global economy and declining oil prices will gradually bring inflation in the US and the euro area closer to their targets. However, inflation in the euro area will generally remain below the target over the entire forecast horizon amid subdued economic activity in the region, as assumed in the baseline scenario. In turn, the slowdown in China's economic growth (expected in the baseline scenario) and the faded effect of a number of one-off proinflationary supply-side factors in the food market that manifested in late 2019–early 2020 (refer to Subsection 3.1) will lead to a gradual decline and stabilisation of inflation in China at a low level by the end of the forecast horizon (Chart 1.1.3).

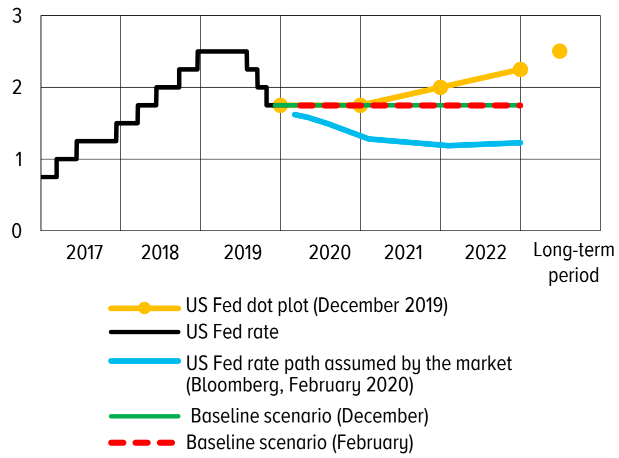
Monetary policies of foreign central banks. The Bank of Russia continues to assume that the US and the euro area will maintain accommodative monetary policy in 2020–2022. In contrast to MPR 4/19, the baseline scenario assumes that the US Fed's base rate and the ECB's deposit rate will be held at their current levels (Charts 1.1.4 and 1.1.5) throughout the entire forecast horizon (in MPR 4/19: a slight

INFLATION INDICATORS IN MAJOR ECONOMIES IN THE BASELINE SCENARIO *Chart 1.1.3*
(% change YoY, average for Q4 in each period)



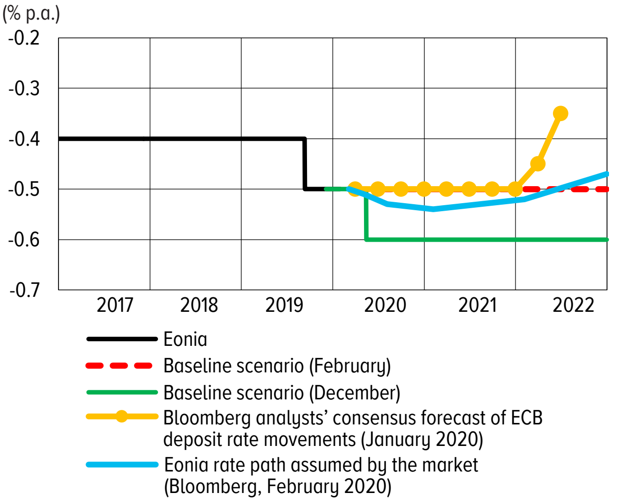
** Forecast. Dotted line shows the previous forecast (December 2019).*
Note : PCE Price Index is forecast for the USA, HICP – for the euro area, and CPI – for China.
Sources: Bank of Russia calculations, Bloomberg.

EXPECTED MOVEMENTS OF US FEDERAL FUNDS RATE *Chart 1.1.4*
(% p.a.)



Sources: Bank of Russia calculations, US Fed, Bloomberg.

EXPECTED PATHS OF INTEREST RATES IN THE EURO AREA *Chart 1.1.5*
(% p.a.)



Note: baseline scenario – Eonia rate path.
Sources: Bank of Russia calculations, Bloomberg.

reduction of the ECB's deposit rate in the first half of 2020 (by 10 bp) and maintenance of the US Fed's base rate).

Such interest rate path in the US and the euro area factors in the latest US Fed's and ECB's rhetoric on monetary policy prospects amid subdued global economic activity, and in addition, it is overall consistent with market participants' expectations.

As before, the Bank of Russia's baseline scenario also takes into account asset purchases by the ECB as part of the quantitative easing programme started from 1 November 2019, which will intensify the accommodative nature of monetary policy in the euro area.

Global financial markets. In its baseline scenario, the Bank of Russia continues to assume that the US dollar will gradually weaken against the euro over the forecast horizon. Such path is forecast based on the opinion that the USD/EUR exchange rate will gradually return to its equilibrium as determined by the purchasing power parity.[1] In turn, the maintenance of soft monetary conditions in advanced economies expected in the baseline scenario will limit the risks of steady capital outflows from emerging market economies (EMEs).

In the baseline scenario, the Bank of Russia has retained the equilibrium country risk premium for EMEs at the same level as in MPR 4/19. However, the Bank of Russia has reduced the equilibrium country risk premium for Russia compared with MPR 4/19 in the light of its considerable decrease in 2019 reflecting a decline in global credit spreads and a structural reduction in Russia's sovereign risk due to the accumulation of the fiscal buffer in the form of the liquid portion of the NWF.

Equilibrium country risk premiums for EMEs in general and for Russia in particular factor in the actual dynamics of risk premiums over the past few years, and also reflect the totality of

[1] *Parity means that prices for various goods and services in two countries should be equal (if compared in the same currency). This means that the dollar-denominated price of goods and services in the USA should equal the price of the same goods and services in the euro area converted into US dollars at the current exchange rate. If prices in one country are relatively higher than in another, there is no parity, and in the long run the exchange rate may be expected to adjust, which will offset price differences.*

assumptions regarding the external environment. As in MPR 4/19, the Bank of Russia believes that risk premiums will converge to their equilibrium by 2021 Q3.

Geopolitical factors. As before, in its baseline scenario, the Bank of Russia expects that the international sanctions imposed on Russia in 2014–2019 will remain in place over the entire forecast horizon. This involves instituting an equilibrium country risk premium for Russia at a slightly higher level than if there were no sanction restrictions. Relying on the conservative risk premium assumptions, the Bank of Russia's baseline scenario takes into account potential volatility in financial markets in case of short-term increases in geopolitical tensions.

Economic policy of the Russian Government. As in MPR 4/19, among the key internal assumptions, the Bank of Russia takes into account the effect of the fiscal rule over the entire forecast horizon that smooths out the impact of oil price dynamics on the domestic economic environment. At the same time, the baseline scenario assumes that the funds flowing into the NWF under the fiscal rule will continue to be invested in liquid low-risk FX instruments. In addition to the fiscal rule, the following measures of the Government of the Russian Federation[2] will also influence monetary policy conditions in 2020–2022: planned changes in the tax system and a set of measures aimed at overcoming the structural constraints in the Russian economy, which include the implementation of national projects.

Among the key tax policy measures, the Bank of Russia assumes changes in excise duties on certain products in the consumer basket[3] and the oil and gas tax manoeuvre to take place in 2019–2024. According to the Bank of Russia's estimates, the latter will have a nearly zero contribution to annual inflation in 2020–2022.

The Bank of Russia also maintains its estimates[4] of the impact on the Russian economy of the Russian Government's measures[5] aimed at alleviating the existing structural constraints in the Russian economy and accelerating its potential growth rates. Such measures include a phased increase in the pension age, as well as additional investment expenditures and spending on human capital development in 2019–2024.

MEDIUM-TERM FORECAST

Inflation. As forecast in MPR 4/19, annual inflation will equal 3.5–4.0% in 2020 and will stay close to 4% further on. However, the Bank of Russia expects that annual inflation will come in at approximately 2% in 2020 Q1 (in MPR 4/19: below 3%) given its actual dynamics since the beginning of the year.

Inflation will hold steadily close to 4% over the mid-term forecast horizon primarily due to the Bank of Russia's monetary policy. In addition, inflation will progressively move up to 4% over the course of 2020 from the low levels of the beginning of the year owing to the exhaustion of the effect of one-off disinflationary factors in the food market (see Section 2), a gradual easing of fiscal policy, and a pick-up in consumer demand.

Over the mid-term forecast horizon, inflation will be dragged down by subdued external demand amid balanced domestic demand, as assumed in the baseline scenario. In turn, the baseline forecast takes into account the indexation of administered prices and tariffs by the inflation rate close to 4%, which implies that this factor will not exert excessive upward pressure on prices. In accordance with the assumptions of the baseline scenario, the implementation of economic and structural policy measures by the Government will not have any considerable proinflationary effect over the mid-term horizon.

Given the year-to-date actual dynamics of inflation, the Bank of Russia slightly revised the forecast path of annual inflation over the 2020 horizon (Chart 1.1.6). However, the regulator still expects that average annual inflation will be in

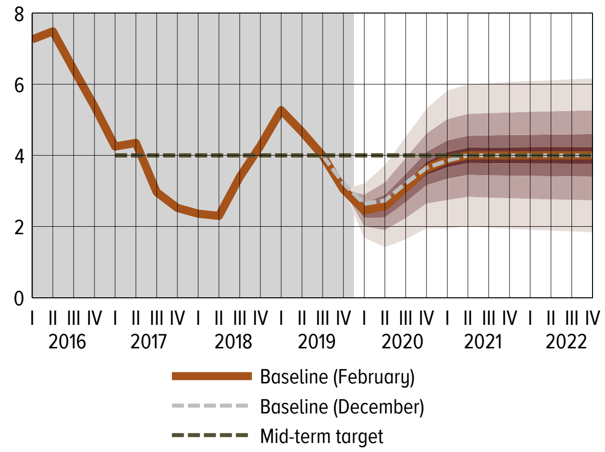
[2] *Pursuant to the Fiscal and Customs Policy Guidelines for 2020 and the Plan Period of 2021 and 2022, and the Tax Code of the Russian Federation.*

[3] *Alcohol and alcohol-containing products, main types of motor fuel, tobacco, and other types of products.*

[4] *Estimates published in the baseline scenario in October 2019 in the MPG 2020–2022.*

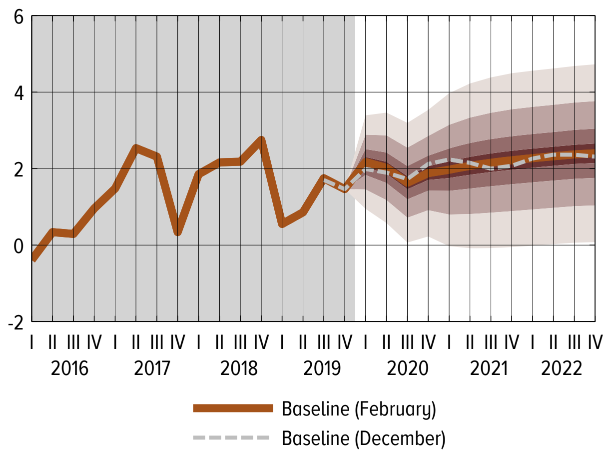
[5] *Social and economic measures under Decree of the President of the Russian Federation No. 204, dated 7 May 2018, scheduled for implementation in 2019–2024.*

INFLATION TRAJECTORY IN THE BASELINE SCENARIO *Chart 1.1.6*
(% change on the same period of the previous year)



Note: shaded areas on the forecast horizon show the probability of different inflation values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on historical estimates of inflation uncertainty.
Source: Bank of Russia calculations.

GDP GROWTH TRAJECTORY IN THE BASELINE SCENARIO *Chart 1.1.7*
(% change on the same period of the previous year)



Note: shaded areas on the forecast horizon show the probability of different GDP growth values. Colour gradation reflects probability intervals. Confidence intervals are symmetrical and based on historical estimates of GDP growth uncertainty.
Source: Bank of Russia calculations.

the range of 3.0–3.4% in 2020, and will stabilise close to 4% in 2021–2022.

Economy. The Bank of Russia has maintained overall unchanged its view on the growth of the Russian economy in 2020–2022. In its baseline scenario, the Bank of Russia still predicts that GDP growth will total 1.5–2.0% in 2020.

As regards the GDP growth structure in 2020, as was forecast in MPR 4/19, an increase in public investment spending explained by the transition to the active stage of the implementation of national projects will be the major contributor to higher economic growth rates. In this context, annual growth of gross fixed capital formation will total 3.5–4.5% in 2020. This will also impact the dynamics of import quantities: their annual growth rate will come in at 3.0–3.5%. The growth of the economy in 2020 will be also supported by a certain revival of consumer demand amid improving household income dynamics, including through the growth of real wages (both in the private and public sectors). It will manifest through a 2.0–2.5% increase in final consumption expenditure of households in 2020. At the same time, slack external demand expected in the baseline scenario and the OPEC+ agreement on oil production cuts (until March 2020) will constrain export growth in 2020. The Government's measures to stimulate non-commodity exports within the International Cooperation and Exports national project will help mitigate this impact. In these circumstances, annual export growth will not exceed 2.0–2.5% in 2020.

In 2021–2022, Russia's economic growth will accelerate to 1.5–2.5% and 2.0–3.0% respectively (Chart 1.1.7). This will be primarily driven by a gradual accumulation of the positive effect of the planned fiscal policy measures and national projects, provided they are implemented successfully. At the same time, growth of the Russian economy in 2021–2022 will continue to be limited by slack external demand expected over the forecast horizon amid which the increase in export quantities will remain low: 2.0–2.5% in 2021 and 2.5–3.0% in 2022. Taking into account the implementation of the Government's plans to gradually reduce the share of federal budget expenditure in GDP and non-oil and gas deficit[6] which is expected over the mid-term forecast horizon, the growth rate of gross fixed capital formation will slow down to 2.5–3.5% in 2022 (vs 3.5–4.5% in 2020–2021). This will result in, among other things, a lower growth rate of import quantities: it is expected to fall to 2.5–3.0% in 2022 (vs 3.0–3.5% in 2020 and 3.5–4.0% in 2021).

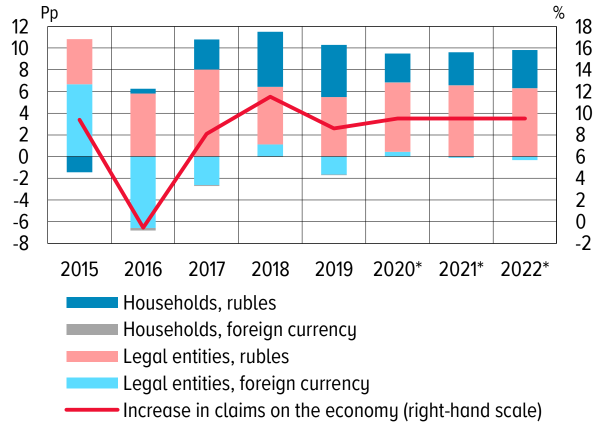
Monetary indicators. As was forecast in MPR 4/19, according to the Bank of Russia's baseline scenario, monetary conditions in the Russian economy will continue to gradually ease and will be generally neutral over the forecast horizon. This is mainly associated with the completion of the adjustment of credit and deposit rates in the economy to the key rate reduction since June 2019 and the easing of non-price bank lending conditions.

According to the baseline scenario, the banking system's claims on the economy will sustainably increase in 2020–2022 as a result of a gradual economic growth acceleration and better household income dynamics, as well as under the influence of monetary conditions forming over the forecast horizon. That said, the baseline forecast of monetary indicators of the banking system's claims on households factors in a smooth deceleration of consumer lending growth, including owing to the measures aimed at limiting the increase in debt burden of households in general and of particular categories of borrowers, as well as due to the saturation of the consumer lending market. In turn, the gradual easing of price lending conditions will support stable growth in corporate and mortgage lending. Non-price lending conditions will slowly moderate, reflecting banks' conservative approach to borrower assessment and risk acceptance.

Given the impact of all the above factors, lending activity will generally continue to grow in 2020–2022 at a pace corresponding to the effective demand increase and posing no risks to price stability (Chart 1.1.8). The debt burden of the economy will rise smoothly, forming at levels that do not threaten financial stability in the economy (Charts 1.1.9 and 1.1.10). Lending

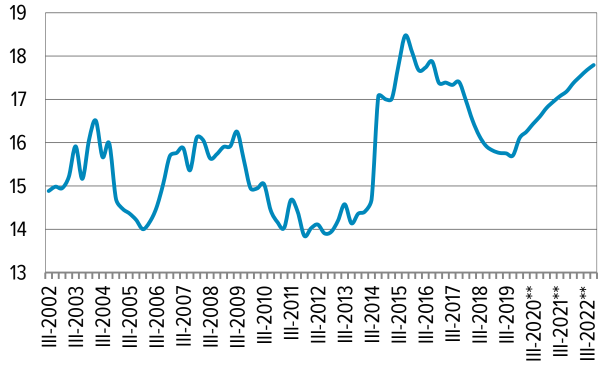
[6] In accordance with Federal Law No. 380-FZ, dated 2 December 2019, 'On the Federal Budget for 2020 and the 2021–2022 Planning Period'.

DECOMPOSITION OF THE INCREASE IN CLAIMS ON THE ECONOMY IN THE BASELINE SCENARIO *Chart 1.1.8*
(contribution to annual growth)



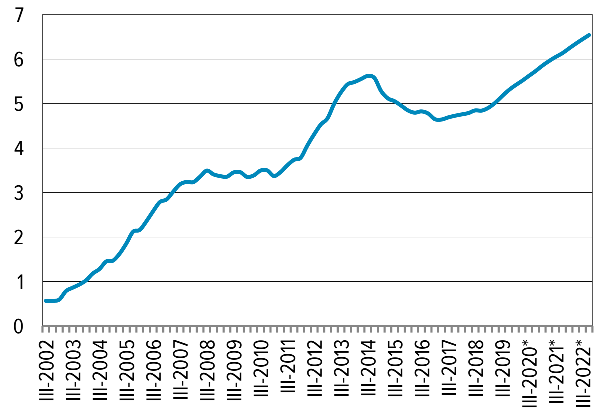
** Forecast. Decomposition is shown for the increase in claims on the economy corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

CORPORATE DEBT BURDEN *Chart 1.1.9*
(debt service ratio*, % of GDP)



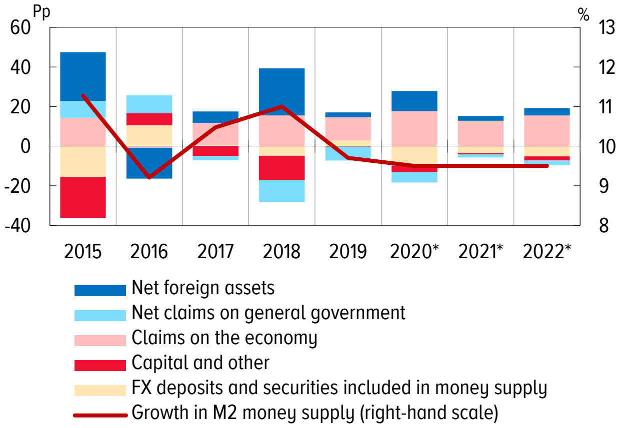
** The debt service ratio was calculated on the basis of the methodology described by S.A. Donets, A.A. Ponomarenko. Debt burden indicators. Money and Credit No. 4, 2017 2019 Q3 value – Bank of Russia estimate.*
*** Forecast. Debt burden is calculated for the level of claims corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

HOUSEHOLD DEBT BURDEN *Chart 1.1.10*
(debt service ratio, % of GDP)



** Forecast. Debt burden was calculated for the level of claims corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

DECOMPOSITION OF MONEY SUPPLY GROWTH IN THE NATIONAL DEFINITION IN THE BASELINE SCENARIO BY SOURCE *Chart 1.1.11*
(contribution to annual growth)



** Forecast. Decomposition is shown for the money supply growth in the national definition corresponding to the middle of the forecast range in the baseline scenario.*
Source: Bank of Russia calculations.

will remain the key driver of money supply movements, and in these conditions, money supply increase will be close to the growth rates of claims on the economy (Chart 1.1.11).

Balance of payments. The Bank of Russia has updated its 2020–2022 forecast for the balance of payments indicators in its baseline scenario, compared to MPR 4/19. This was associated with both the release of actual data on Russia's balance of payments for 2019 and a slight revision of the Bank of Russia's view on changes in the primary and secondary income account over the forecast horizon.

Thus, the forecast current account balance has been decreased from \$52 billion to \$47 billion for 2020, from \$34 billion to \$30 billion for 2021, and from \$23 billion to \$18 billion for 2022. According to the updated forecast, the primary and secondary income account balance will be somewhat lower in 2020–2022 than it was assumed in MPR 4/19. The reasons behind this include higher dividend payments by Russian corporates expected over the forecast horizon and a rise in interest payments on external debt, primarily on the back of a considerable increase in the proportion of non-residents in the OFZ market in 2019.

Overall, despite a gradual decline, the current account balance will remain consistently positive over the mid-term forecast horizon: approximately 3% of GDP in 2020 and 1–2% of GDP in 2021–2022 (vs 4.2% of GDP in 2019). This is explained by a gradual drop in oil prices and a slight increase in export quantities against the backdrop of subdued growth of the global economy. The Government's measures aimed at stimulating non-commodity exports will support growth in export quantities, which will smooth out the effects of the expected oil price decline and global economic slowdown (Chart 1.1.12).

As regards the financial account, in its baseline scenario the Bank of Russia has decreased the financial account balance for the private sector from \$20 billion to \$15 billion in 2020 and from \$15 billion to \$10 billion in 2021–2022, compared to MPR 4/19. This downward revision of the forecast reflects, among other things, the update of the forecast for the current account balance as related to the primary and secondary income account.

Overall, according to the baseline forecast, the private sector financial account balance will shrink from 1.3% of GDP in 2019 to roughly 0.5–1% of GDP in 2020–2022. This will be caused by both a reduction in Russian residents' payments on external principal debt and a slight decrease in Russian companies' possibilities to accumulate foreign assets amid lower prices for core Russian exports (Chart 1.1.13).

As in MPR 4/19, the financial account balance of the public sector will remain negative over the entire forecast horizon, totalling $6 billion (signs according to BPM6, i.e. net capital inflow). Given a range of external assumptions in the baseline scenario, the Bank of Russia expects a smaller annual inflow of funds from foreign investors to the OFZ market, after a significant net capital outflow in 2019.

In 2020–2022, the Bank of Russia will continue to replenish international reserves under the fiscal rule. The forecast also factors in foreign currency purchases in the domestic market suspended in 2018 that should be completed in early 2022.

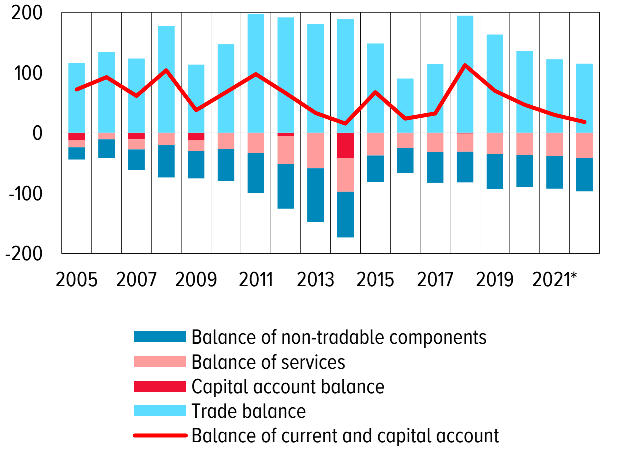
1.2. FORECAST UNCERTAINTY FACTORS

External conditions. Since December 2019, proinflationary risks associated with specific external factors have remained low. The risks of a considerable capital outflow from EMEs stay low as financial market participants expect that the US and the euro area will maintain accommodative monetary policy in the medium term amid the generally soft rhetoric of the US Fed and the ECB and the stabilisation of leading economic indicators in these regions.

However, other external risks remain significant. In particular, there are ongoing risks that the slowdown of economic growth observed in most key economies worldwide may last longer and turn out to be steadier than assumed in the baseline scenario. Growth of the global economy may be adversely affected by unfavourable developments associated with a range of geopolitical factors. In particular, these are how the EU and Great Britain build their political and economic relations after the UK

MAIN CURRENT ACCOUNT COMPONENTS IN THE BASELINE SCENARIO
(billions of US dollars)

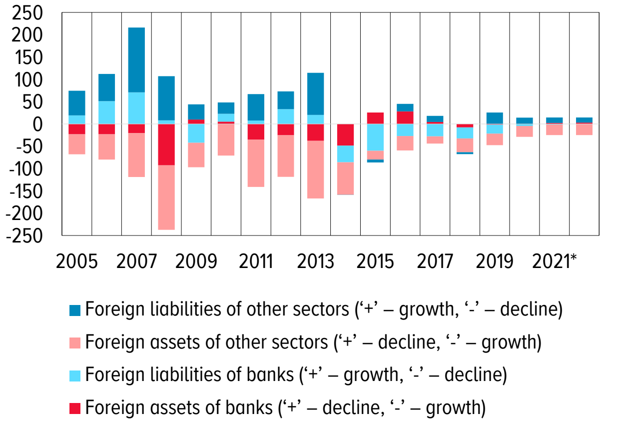
Chart 1.1.12



** Forecast.*
Source: Bank of Russia calculations.

MAIN COMPONENTS OF THE PRIVATE SECTOR'S FINANCIAL ACCOUNT IN THE BASELINE SCENARIO
(billions of US dollars)

Chart 1.1.13



** Forecast.*
Source: Bank of Russia calculations.

formally exits the EU and the transition period ends in late 2020, as well as how the US and their key trade partners (first of all, China) deal with mutual foreign trade restrictions. Thus, the imposition of new external trade restrictions, primarily between China and the US (if these countries fail to deliver on the trade agreement signed by them in January 2020), may negatively impact both advanced and emerging market economies, including Russia. This effect may manifest through both a worsening economic growth outlook on the back of lower external demand and a decline in demand for high-risk assets coupled with a rise in risk premiums amid increasing volatility in financial markets. In the short run, the deteriorating environment in EMEs' financial markets may create proinflationary risks through the dynamics of national currencies and exchange rate expectations. However, in the medium term, a slowdown in the global economy due to potential deepening of trade tensions may generally have a disinflationary effect for most economies, including EMEs.

Future movements of oil prices remain a source of uncertainty. Their volatility may increase due to both supply- and demand-side factors in the oil market. In this context, oil prices over the forecast horizon may be either lower or higher than in the baseline scenario. In particular, further spread of the coronavirus will be a significant factor of uncertainty in 2020 as regards oil price trends and global economic growth in general.

In these circumstances, the Bank of Russia maintains a conservative approach when formulating its baseline scenario assumptions related to external factors.

Inflation expectations. Inflation expectations are highly sensitive to increases in prices for certain goods and services and are not anchored, which continues to pose significant risks of an upward deviation of inflation from the baseline forecast.

Non-monetary inflation factors. Inflation dynamics over the forecast horizon may also be affected by non-monetary factors, including those influencing food and motor fuel prices. The impact of non-monetary factors can lead to both upward and downward deviations of inflation from the forecast path of the baseline scenario. While having a significant influence on inflation movements, non-monetary factors are beyond the scope of monetary policy. Given the above, in its monetary policy, the Bank of Russia will continue to take into account the specifics of pricing in the markets of certain goods and services.

Economic policy measures of the Russian Government. The scope and influence of the complex of fiscal and structural policy measures planned by the Government are factors of uncertainty for the economic growth outlook over the forecast horizon. They will depend on the pace and efficiency of the implementation of the planned changes.

Fiscal policy (in case of deviations from assumptions of the baseline scenario) may have a substantial impact on both short- and mid-term inflation dynamics. In particular, more extensive spending of funds (compared to the levels assumed in the baseline scenario) planned by the Government for the implementation of national projects may positively influence consumer demand owing to household income dynamics. This will create conditions under which the expansion of demand in the economy will outpace the expansion of production capacity and increase inflationary pressure in the economy. If the rise in the economic growth pace in 2020–2022, driven by the increase in public expenditure, continues to significantly outpace production capacity, the upward pressure on inflation may hold over the entire medium-term forecast horizon. However, if investment project funding is further delayed, domestic demand will grow at a slower pace than assumed in the baseline scenario, thus increasing disinflationary pressure in the economy.

In turn, a gradual elimination of the structural constraints in the Russian economy may simultaneously reduce the sensitivity of domestic prices to particular external and internal factors and have a downward effect on inflation in case of faster-than-expected growth of the Russian economy. This may occur as a result of reduced dependence of the Russian economy on exports of energy resources, increased competition, and the development of transport and logistics infrastructure.

Additional factors of uncertainty over the forecast horizon are the structure and specific time frame of investment of the liquid portion of NWF resources above the threshold amount set at 7% of GDP in the Budget Code. According to the Bank of Russia's baseline scenario, this threshold will be reached in 2020.

The Bank of Russia will continue to focus on assessing short- and long-term effects of the planned fiscal measures by clarifying their scope and impact on the economy and inflation as they are elaborated in greater detail and implemented, including the influence of demographic and social measures stated in January in the Presidential Address to the Federal Assembly.

Demographic trends. The expected demographic trends may influence the medium-term inflation dynamics and economic growth. Due to the current age structure of the population, the economically active population will continue to decrease in the near future. This will remain a factor limiting potential economic growth in 2020–2022, even with account of the positive contribution of the retirement age increase. Supply shortage in the labour market can affect the dynamics of wages and household consumption and put an upward pressure on inflation. Yet, the impact of the demographic factor on potential output and inflation can be mitigated if the decrease in Russia's economically active population is substantially offset owing to a higher labour market flexibility, reduction of non-productive jobs, and migration from other countries. Migration flows will depend not only on the Government's migration policy, but also on the overall attractiveness of the Russian economy for foreign labour force as compared with other states.

Other factors. According to the Bank of Russia's estimate, risks associated with wage dynamics in the absence of a pronounced effect of the demographic factor, as well as with possible changes in consumer behaviour remain moderate over the forecast horizon.

2. INFLATION AND INFLATION EXPECTATIONS[1]

As of 2019 year-end, inflation stood at 3.0%. In January 2020, it declined to 2.4%. Monthly increases in prices for goods and services (seasonally adjusted) during those months stayed close to the lower bound of the range typical for August–November 2019. The expansion of the food supply, the strengthening of the ruble and moderate demand dynamics exerted downward pressure on prices. The decline of annual inflation at the beginning of 2020 was mostly due to the factoring out the effect of the VAT rate hike from calculation in the previous year. A slowdown in the annual increase in prices for individual goods due to the indirect influence of that effect was already observed at the end of 2019.

Household inflation expectations declined in January 2020 after a short-term rise in December 2019. Price expectations of companies were generally stable. Professional analysts' mid-term inflation expectations remained anchored to the Bank of Russia's target (near 4%).

According to the Bank of Russia's forecast, given the monetary policy being pursued, annual inflation will stand at 3.5–4.0% as of the end of 2020 and will stay close to 4% further on.

[1] *The section takes into account the statistics on the dynamics of prices for goods and services for January published on 10 February 2020 (after the February meeting of the Bank of Russia Board of Directors).*

In December 2019, annual inflation accounted for 3.0%, having declined by 0.5 pp compared to November. This corresponds to the middle of the forecast range published by the Bank of Russia in the Monetary Policy Report 4/19. In January 2020, it continued to decline to 2.4% (Chart 2.1).

In late 2019–early 2020, inflation experienced downward pressure from such factors as high saturation of a large number of food product markets, strengthening of the ruble and moderate demand dynamics. At the beginning of 2020, annual inflation declined mostly due to the statistical effect of comparison with the high base of the beginning of 2019, when inflation acceleration was caused by a one-time permanent factor—that is, the VAT rate increase. This effect started to influence the dynamics of non-food goods prices as early as the end of 2019. It was due to their acceleration in late 2018 under the influence of a temporary stepping-up of demand shortly before the tax changes.

The indicators reflecting stable trends in price dynamics were down (Chart 2.2). In December 2019, annual core inflation slowed down compared to November by 0.4 pp to 3.1%, and in January 2020, to 2.7%. The median value of the distribution of annual increases in prices declined by 0.2 pp to 3.3% in December 2019 and then continued to decline to 2.5% in January 2020. Trend inflation[1] also declined to 4.2% in January. In December 2019, the growth of the moving average annual inflation observed since October 2018 started to slow down. In January 2020, it stood at 4.3% (0.3 pp less than in November 2019).

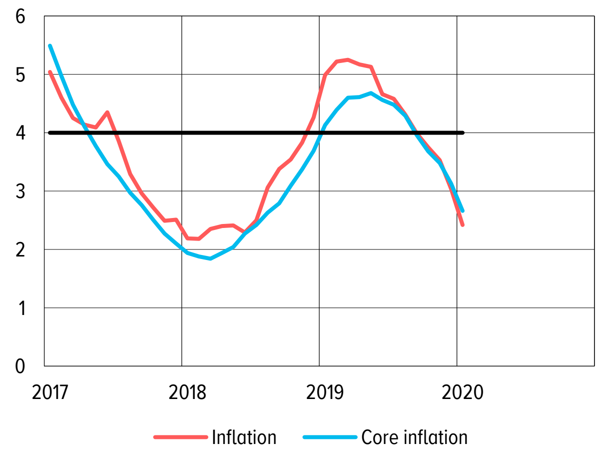
In general, annual growth rates of prices for almost all main groups of goods and services went down (Chart 2.3).

The monthly growth rate of consumer prices in December 2019–January 2020 (seasonally adjusted, 'SA') stayed within the August–November range of 0.1-0.2% (Chart 2.4).

The average monthly growth rates of prices (SA) for the main groups of goods and services in December 2019–January 2020 were generally

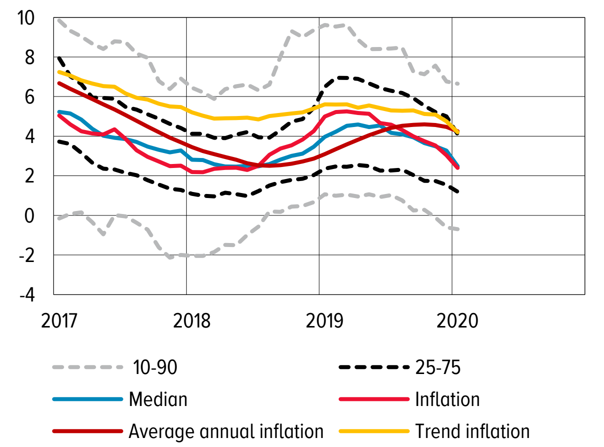
[1] *For more information on trend inflation, see Macroeconomic Bulletins in the Research section of the Bank of Russia website.*

INFLATION AND CORE INFLATION *Chart 2.1*
(% change on the same month of the previous year)



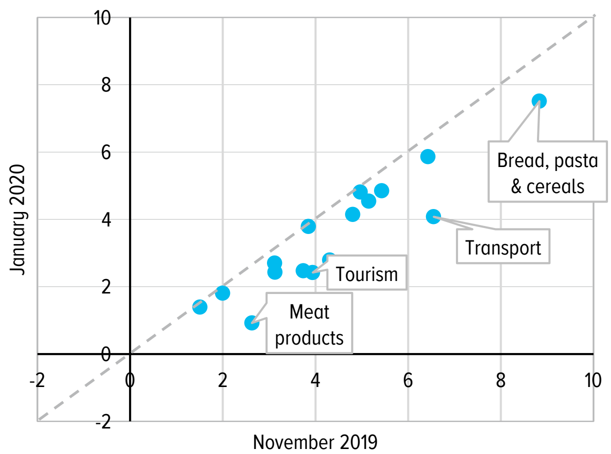
Source: Rosstat.

INFLATION AND PRICE CHANGE DISTRIBUTION *Chart 2.2*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

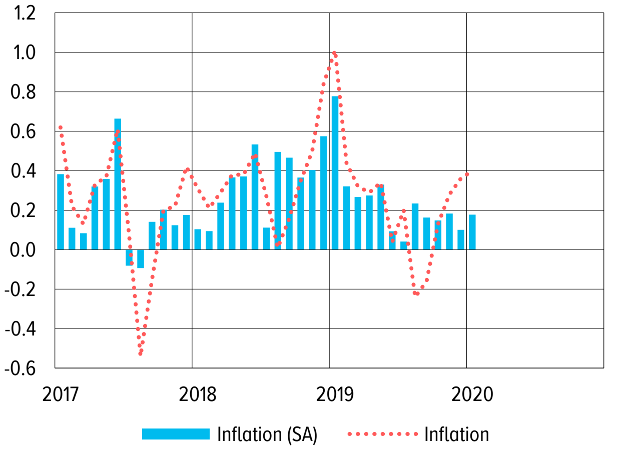
GROWTH IN PRICES OF INDIVIDUAL GOODS AND SERVICES *Chart 2.3*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

INFLATION
(per cent change on previous month)

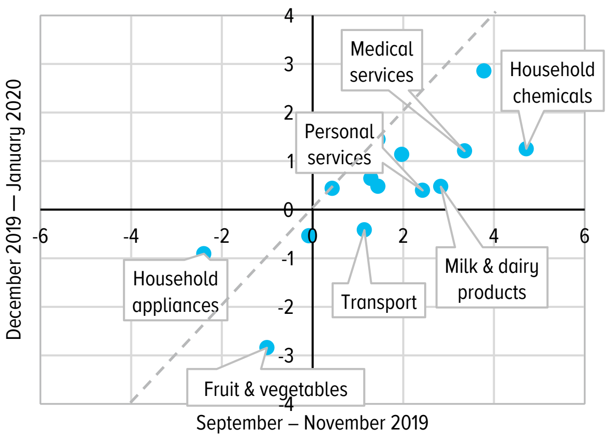
Chart 2.4



Sources: Rosstat, Bank of Russia calculations.

GROWTH IN PRICES OF INDIVIDUAL GOODS AND SERVICES
(annualised growth, %, SA, average for the period)

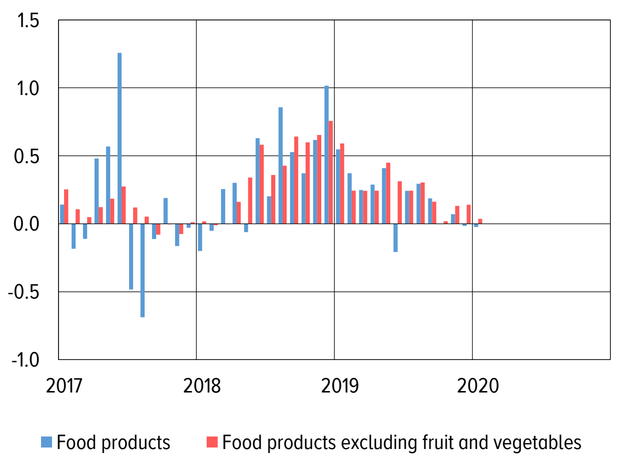
Chart 2.5



Sources: Rosstat, Bank of Russia calculations.

FOOD PRICES
(% change month-on-month, SA)

Chart 2.6



Sources: Rosstat, Bank of Russia calculations.

lower than the average rates in September–November (Chart 2.5).

FOOD PRODUCTS

The decline of food inflation in December 2019 and throughout the past year made the biggest contribution to the inflation slowdown. In January 2020, it continued.

A restraining influence on food inflation was primarily exerted by favourable conditions in the main domestic food markets as a result of a good harvest of the main agricultural crops and a stable expansion of supply of animal products. The growth of prices for imported products, both finished and intermediary, was restrained by the strengthening of the ruble.

In December 2019–January 2020, the average level of prices for food products remained unchanged (SA) (Chart 2.6). Over the previous two months, these prices went up by approximately 0.1% (SA).

Annual food inflation in December went down to 2.6% (1.1 pp less than in November, Chart 2.7). In January 2020, it stood at 2.0%. The dynamics of fruit and vegetable and animal product prices played the main role in the slowdown of food price growth.

In late 2019–early 2020, almost all food market segments demonstrated an overall slowdown of annual price growth rates. Favourable conditions in domestic markets of agricultural products and processed goods are expected to limit the growth of consumer prices for food products over the next few months. There are potential risks associated with trends in global prices for individual food products, e.g., vegetable oils.

Animal products. In December 2019–January 2020, the annual growth rate of prices for meat products[2] continued to decline as it had since last June amid a stable expansion of supply. These prices went up by 1.7% overall over the year. In January 2020, meat products were 0.9% more expensive than a year before, while meat and poultry were 0.9% cheaper (Chart 2.8).

[2] *Share in the CPI is 9.54% (here and onwards, in 2019).*

Eggs prices also fell,[3] which made a tangible contribution to the slowdown in the rise of prices for food products. In January, eggs were 8.6% cheaper than a year before. That was partially associated with the high base effect of the previous year; in December 2018, there was a one-time price surge, which was most probably caused by the materialisation of continuously increasing cost pressure.

In December 2019–January 2020, the annual growth of prices for milk and dairy products[4] that started in October continued to slow down (Chart 2.9). It was supported by the growth of dairy feedstock production.

Processed cereal and oil crop products.[5] Amid ample supply of the main cereal and oil crops, the growth rates of prices for the products of their processing mostly declined in late 2019–early 2020. Thus, the growth in prices for bread, bakery products and pasta continued to slow down (Chart 2.10). The growth rates of prices for all sorts of cereals and legumes went down, except for buckwheat, which rose in price due to a poor harvest.

Fruit and vegetable products.[6] The dynamics of fruit and vegetable prices made the biggest contribution to the slowdown of food inflation in December 2019. These products became 2.0% cheaper than a year before compared with November when they were 2.8% more expensive (Chart 2.11). A high supply of domestic fruit and vegetables, both ground and greenhouse, contributed to that decrease in price. The growth of prices for greenhouse vegetables was restrained by lower costs of heat and electric power amid unusually warm weather in many regions of the country. The slowdown in annual price growth rates for imported products (primarily, fruit) was influenced by a reversal of the ruble exchange rate dynamics: in 2019, the ruble mostly strengthened, while in 2018, it weakened. In January 2020, the downturn of fruit and vegetable prices accelerated. They

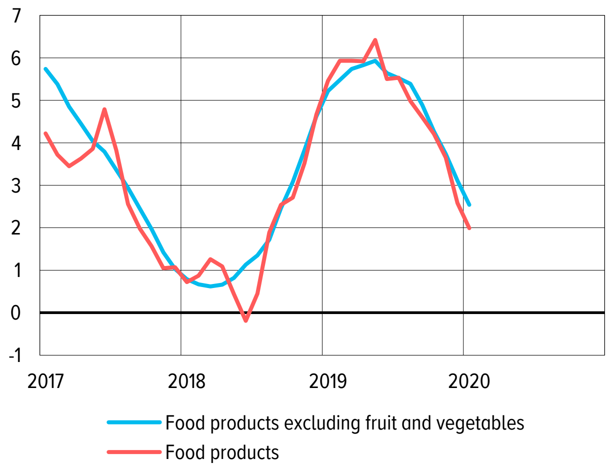
[3] Share in the CPI is 0.51%.

[4] Share in the CPI is 5.03%.

[5] The total share of bread, bakery products, confectionery, pasta, cereals and vegetable fats in the CPI is 5.45%.

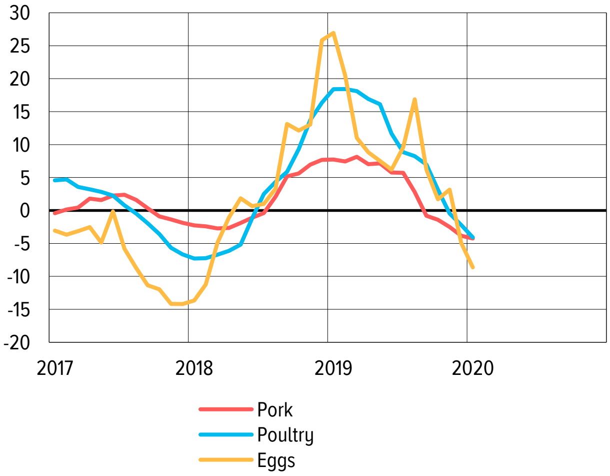
[6] Share in the CPI is 4.0%.

FOOD PRICES *Chart 2.7*
(% change on the same month of the previous year)



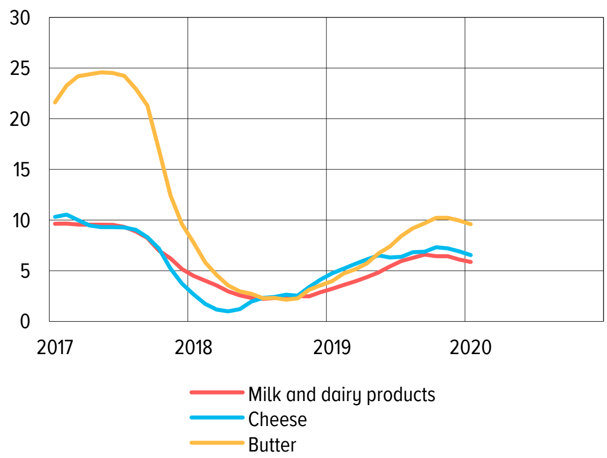
Source: Rosstat.

MEAT AND EGG PRICES *Chart 2.8*
(% change on the same month of the previous year)



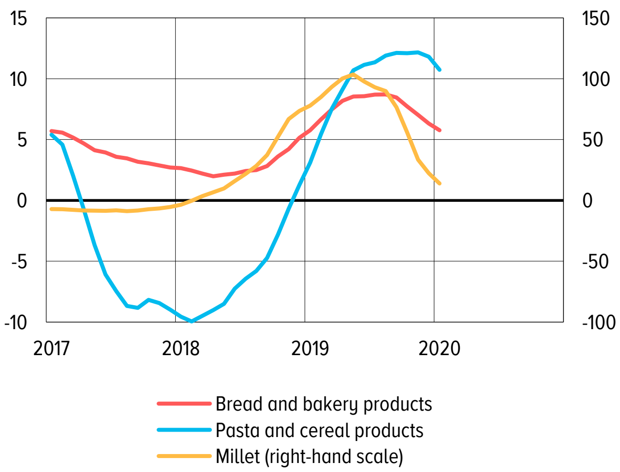
Source: Rosstat.

DAIRY PRODUCT PRICES *Chart 2.9*
(% change on the same month of the previous year)



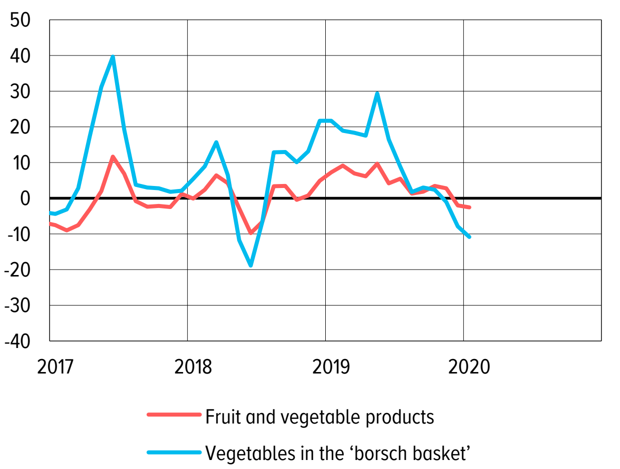
Source: Rosstat.

GRAIN PRODUCT PRICES *Chart 2.10*
(% change on the same month of the previous year)



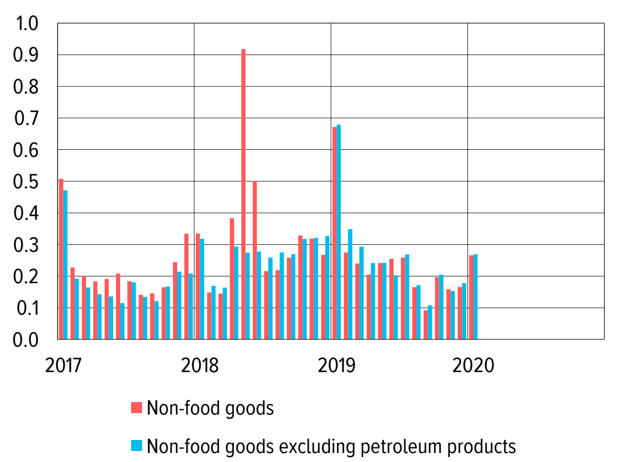
Source: Rosstat.

FRUIT AND VEGETABLE PRICES *Chart 2.11*
(% change on the same month of the previous year)



Sources: Rosstat, Bank of Russia calculations.

NON-FOOD GOODS PRICES *Chart 2.12*
(% change month-on-month, SA)



Sources: Rosstat, Bank of Russia calculations.

became 2.6% cheaper on average vs January 2019.

Nevertheless, fruit and vegetable price volatility remains high, and the influence of their price dynamics on food inflation remains unstable.

NON-FOOD PRODUCTS

In December 2019, a monthly rise in the price of non-food products (SA) was estimated at 0.2%, which is close to the average value established in February–November (Chart 2.12). In January 2020, it accelerated to 0.3%. This was associated with a slower decline or stabilisation of prices for communication facilities, household appliances, TV and radio goods, and PCs, as well as with faster growth of prices for cars and petrochemicals, including due to the increase in excise taxes and disposal fees from 1 January 2020. The price dynamics in this consumer market segment are generally formed under the influence of disinflationary factors, such as restrained demand and strengthening of the ruble. In the oil product market, they are augmented by the effect of the reverse excise duty (with a damping component).

At the beginning of 2020, the annual growth rates of non-food goods prices went down. This was mainly caused by the 2019 base effect, when the growth in price for those goods accelerated considerably on the back of the VAT hike. This effect started to influence annual indicators as early as in late 2019: during the last months of 2018, prices somewhat accelerated on the back of expanding demand from households who wanted to purchase durable goods before tax changes.

Against this backdrop, in December 2019–January 2020, the annual increase in non-food goods prices slowed down notably to 2.5% (0.6 pp less than in November, Chart 2.13). The annual growth rates of prices declined for almost all major positions in the commodity group under review.

In general, YoY changes in prices for the major groups of non-food goods in late 2019–early 2020 fell into a small range with a downward trend (Chart 2.14).

Durable goods.[7] In December 2019–January 2020, the annual rise in price of durable goods slowed down significantly. The main influence was exerted by the base effect: in late 2018–early 2019, the prices for the goods of this group were influenced by direct and indirect effects of the VAT rate hike.

In late 2019–early 2020, the price dynamics for passenger cars made the biggest contribution to the slowdown of the annual rise in prices for non-food products. Due to the base effect and the prolonged sales slowdown, their growth rate declined to 2.5%, 1.2 pp less than in November.

Petroleum products.[8] In late 2019–early 2020, petroleum product prices continued to grow at a low rate amid the decline of export parity prices and the effect of the reverse excise duty mechanism (with a damping component) (Charts 2.15, 2.16). In December 2019, they were 1.8% higher than a year before, and in January 2020, 1.4% higher.

SERVICES

In December 2019, the growth rate of service prices is estimated at 0.2% (SA), which is 0.2 pp less than in November, when their temporary increase was recorded due to one-off events (Chart 2.17). In January 2020, it returned to 0.4% (SA), largely due to the rise in capital repair charges.

The annual growth rate of service prices dropped by 0.1 pp in December and returned to the October level (3.8%). In January 2020, the slowdown accelerated to 2.8% mostly due to the high base effect in the regulated segment (Chart 2.18).

In general, the annual growth rates of prices for different services were mostly slowing down (Chart 2.19).

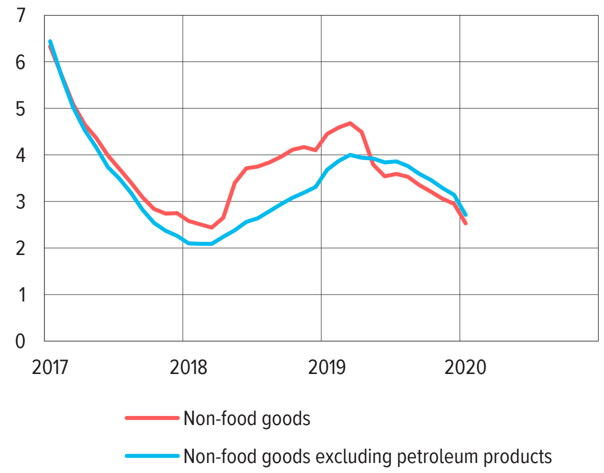
Housing and utility services.[9] In December 2019, tariffs for housing and utility services remained virtually unchanged, which is in line with the usual seasonality. Overall, they grew by 4.3% over the year, with the solid waste management charges surging 39.7% amid the

[7] *The total share of furniture, household appliances and electronics and building materials in the CPI is 11.66%.*

[8] *Share in the CPI is 4.36%.*

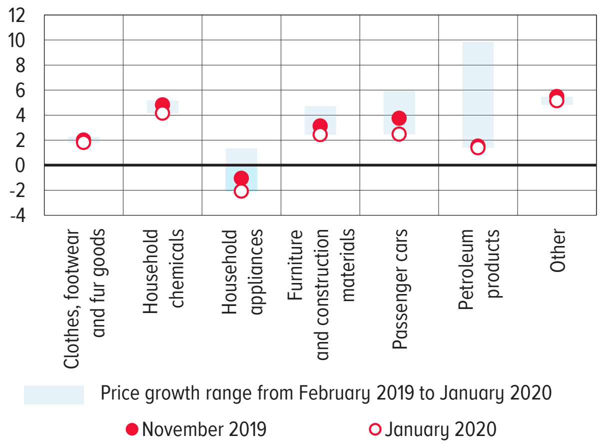
[9] *Share in the CPI is 9.99%.*

NON-FOOD GOODS PRICES *Chart 2.13*
(% change on the same month of the previous year)



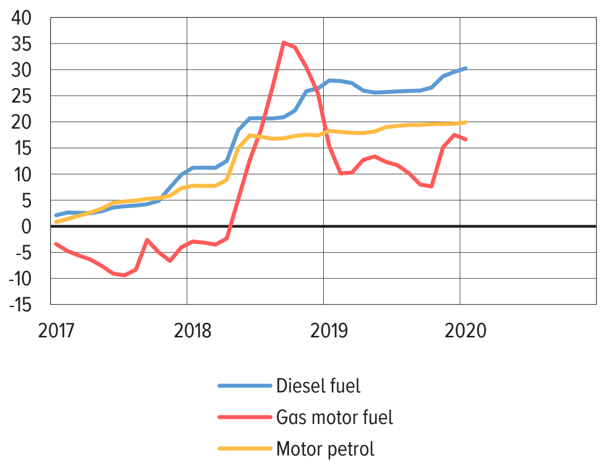
Sources: Rosstat, Bank of Russia calculations.

PRICES FOR KEY NON-FOOD GOODS GROUPS *Chart 2.14*
(% change on the same month of the previous year)



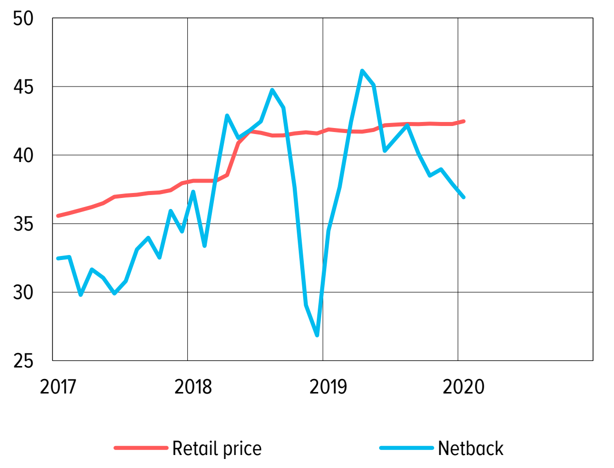
Sources: Rosstat, Bank of Russia calculations.

PETROLEUM PRODUCT PRICES *Chart 2.15*
(% change on December 2016)



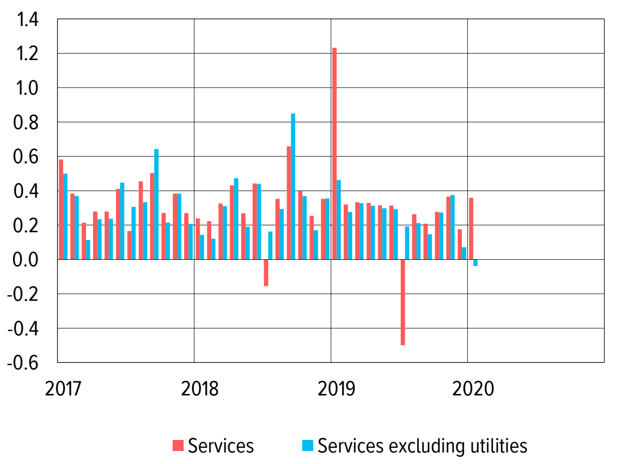
Sources: Rosstat, Bank of Russia calculations.

AI-92 PETROL PRICES
(rubles per litre)
Chart 2.16



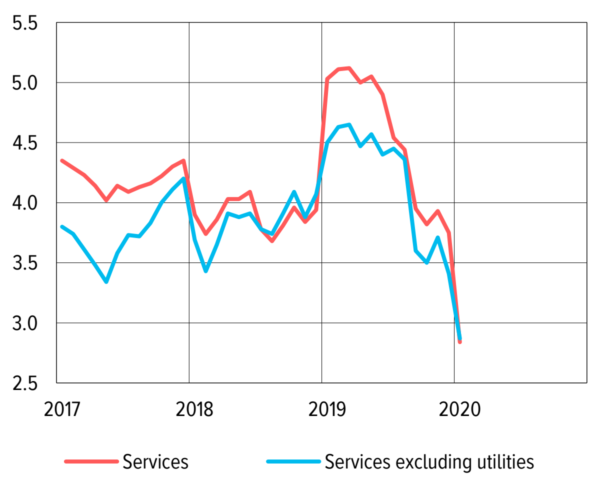
Sources: Rosstat, SPIMEX, Bank of Russia calculations.

SERVICES PRICES
(% change month-on-month, SA)
Chart 2.17



Sources: Rosstat, Bank of Russia calculations.

SERVICES PRICES
(% change on the same month of the previous year)
Chart 2.18



Sources: Rosstat, Bank of Russia calculations.

beginning of reforms in the sector. Net of the above position, tariffs for utility services grew by 4.2% in 2019.

In January 2020, housing and utility services became 1.0% more expensive (SA), according to estimates, mainly due to higher capital repair charges. The annual growth rate of tariffs for housing and utility services slowed down to 2.8% due to the base effect. This effect will contribute to maintaining a low annual growth rate of tariffs for housing and utility services until July of the current year.

Transport services.[10] In December 2019 – January 2020, the annual growth rate of air travel prices slowed down significantly (from 15.5% in November to 7.1%), making a hefty contribution to the overall slowdown of the growth rate of service prices. However, the annual increase in air ticket prices remained one of the highest in the retail service segment. In 2019, the air travel market was affected by an increase in aviation fuel prices and the overall outrunning growth of expenses, which resulted in the accumulation of losses in the industry. It received financial support from the state. It is expected that the decisions to increase subsidy volumes this year will help constrain air travel prices.

Railway transport fares, which are subject to regulation, grew by 4.0% in 2019. In January 2020, their annual growth slowed down to 2.1%, inter alia, due to a change in the annual indexation pattern.

Services with predominantly market pricing.[11] The growth of prices for market services was limited by moderate demand and the strengthening of the ruble. In December 2019–January 2020, the annual service price growth net of housing and utility services and railway transportation slowed down to 2.9% (from 3.7% in November 2019).

The price dynamics of individual market segments was affected by specific factors. For example, in December 2019–January 2020, prices in the overseas tourism industry adjusted after an upsurge in November. Theatre ticket

[10] *Share in the CPI is 2.39%.*

[11] *The total share of personal, medical and financial services and services of cultural organisations, air transport and tourism in the CPI is 9.71%.*

prices saw a continuing annual growth, which has been observed since October due to increased costs of cultural organisations following the entry into force of new ticket sale rules.[12]

INFLATION EXPECTATIONS

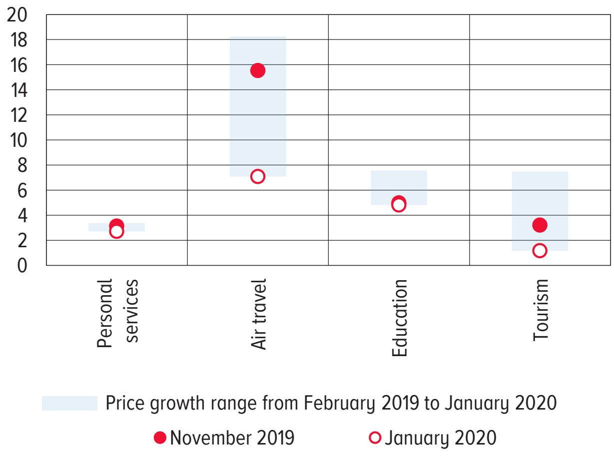
Inflation expectations of economic agents in December 2019–January 2020 remained unchanged on average. In January, inflation expectations of households returned to their November level after a one-off rise in December. Short-term price expectations of companies had similar dynamics. In January, they stayed close to the average value of 2019 H2 after a small rise in December. A consensus forecast of professional inflation analysts for 2020 went down from 3.8% to 3.6%, and it remains near 4% for the mid-term perspective.

Inflation expectations of households. According to the inFOM surveys commissioned by the Bank of Russia, in January 2020, the median estimate of inflation observed by households over the past 12 months was 8.6%. Therefore, it declined to the level of November 2019 after a one-off rise in December (Chart 2.20). The median estimate of inflation expected in the next 12 months also returned to its November reading (8.3%).

Households are generally more attentive to the rise in prices of the most frequently bought goods and services. In January, goods with the biggest price growth rates, in the respondents' opinion, included eggs, bread, alcohol, tea and coffee, cheese and sausages, fruit and vegetables, as well as passenger transport fares. The acceleration of price growth for most of the above items at the beginning of the year is of a seasonal nature.

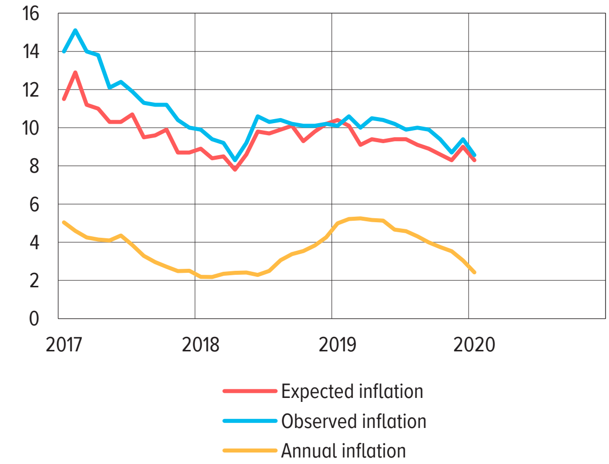
Business price expectations. According to the Bank of Russia's surveys,[13] in December 2019–January 2020, short-term price expectations of companies were close to the value observed in 2019 H2 (Chart 2.21). Nevertheless, they

PRICES FOR KEY SERVICES GROUPS *Chart 2.19*
(% change on the same month of the previous year)



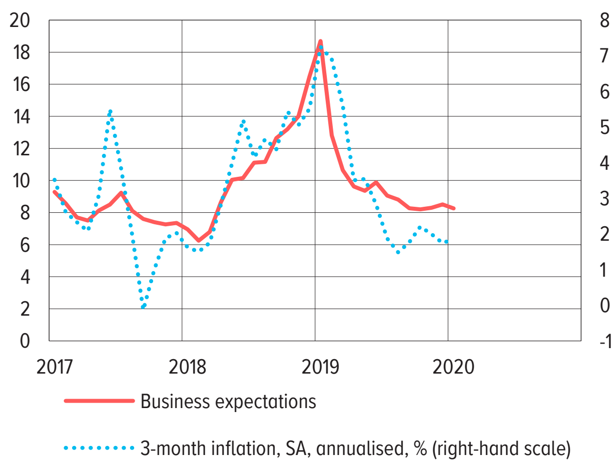
Sources: Rosstat, Bank of Russia calculations.

ANNUAL INFLATION, AND INFLATION OBSERVED AND EXPECTED BY HOUSEHOLDS *Chart 2.20*
(median estimate, %)



Sources: Rosstat, inFOM.

BUSINESS PRICE EXPECTATIONS *Chart 2.21*
(balance of responses, pp)

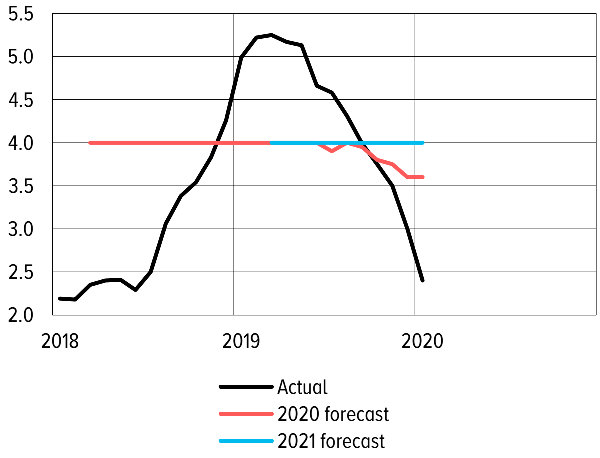


Sources: Bank of Russia, Rosstat.

[12] *In particular, the rules stipulated by Federal Law No. 193-FZ, dated 18 July 2019, that became effective on 1 September oblige cultural organisations to reimburse the cost of unused tickets (provided that certain conditions are observed).*

[13] *For more details on the methodology of surveys, see the methodological review 'Analysis of Price Expectations of Businesses', December 2018, www.cbr.ru/Content/Document/File/62829/analysis_18–12.pdf.*

ANALYST INFLATION FORECASTS *Chart 2.22*
(balance of responses, pp)



Sources: Bloomberg, Rosstat.

are lower than in the first half of the previous year. Among the main factors that affected expectations, respondents named weak demand and moderate dynamics of costs. Companies' expectations in various sectors showed mixed dynamics shaped by specific factors.

Inflation expectations of professional analysts. Annual inflation forecasts made by professional analysts[14] declined to 3.5–3.6% (Chart 2.22). Analysts' mid-term inflation expectations remain anchored to the Bank of Russia's target near 4%.

[14] *Surveys by Interfax, Bloomberg and Thomson Reuters.*

3. MACROECONOMIC CONDITIONS

In 2019 Q4, a slowdown in global economic growth paused amid expectations and the subsequent conclusion of the first phase of a trade deal between the US and China. In the US, GDP growth accelerated on a year-on-year basis, while in the euro area it slowed down. The US Fed forecasts keeping the same rate in 2020, while the ECB allows for its possible decline in its comments. Most G20 central banks have paused easing their monetary policy. In Q4, the demand for risky assets grew, and the US dollar weakened against most currencies of developed and emerging markets; however, in the second half of January the trend changed: credit risks in emerging markets started to grow, while the US dollar partially recovered and strengthened against the emerging market currencies as of the end of January. In December, global oil prices held above the November level due to the OPEC+ decision to increase production cuts. However, in January, oil prices dropped amid the falling Chinese demand on the back of the coronavirus epidemic.

In Q4, the current account surplus continued to decline. As of 2019 year-end, this decline amounted to $43 billion. It was primarily caused by a drop in the global price of hydrocarbons. In Q4, non-oil exports were also falling. The total value of imports increased following the strengthening of the ruble. In Q4, net lending by the Russian private sector to the rest of the world decreased to $6 billion. The inflow of foreign capital in the public sector grew to $4 billion, while reserve assets grew by $15 billion.

Short-term IBL rates were still formed in the lower half of the interest rate corridor. Long-term money market rates declined owing to the revision of the expected key rate path by the market. The OFZ yield curve continued to descend. In December, the Russian stock market continued to grow, but in January this trend reversed and the indices went down. In Q4, deposit and loan rates continued to decline. In 2019, household deposits significantly grew, with the share of foreign currency deposits reaching a five-year minimum. The end of Q4 saw an acceleration of corporate lending growth. Mortgage rates reached a historical low. The growth of retail lending slowed down.

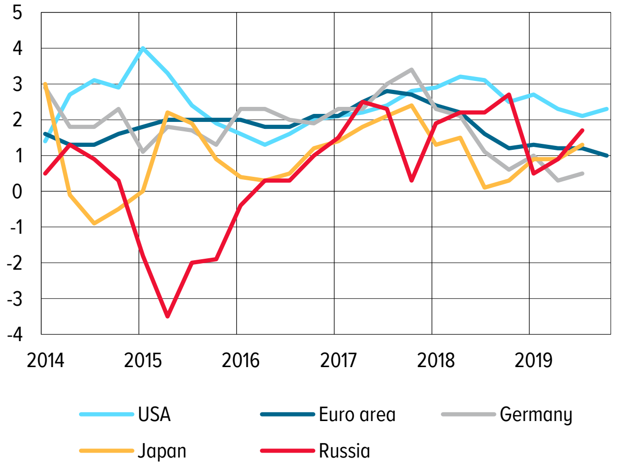
Gross fixed capital formation and consumption by households and public administration bodies were the principal contributors to GDP growth in 2019. Industrial production growth slowed down in Q4 and turned out lower than a year before in 2019. In Q4, the output of investment goods slowed down (unlike the output of consumer goods, which continued to grow), and the freight turnover declined. The agricultural output still grows at a high pace. In October–November, the growth rates of the financial result of large and medium companies slowed down, primarily, in the mining sector on the back of falling oil prices.

The growth of household final consumption expenditure in Q4 slowed down due to a high base effect. It was supported by the revival of retail trade and the improvement in consumer sentiment, as well as by growing real disposable money income of households. In Q4, fixed capital investment grew due to the acceleration of capital budget expenditures.

The fiscal policy in Q4 continued to stimulate domestic demand. As of year-end, the underutilisation of federal budget expenditures under national projects amounted to ₽150 billion. The largest percentage of the utilisation is observed under national social projects, and the lowest, under infrastructure projects. The non-oil and gas deficit of the federal budget as of year-end declined to 5.4% of GDP.

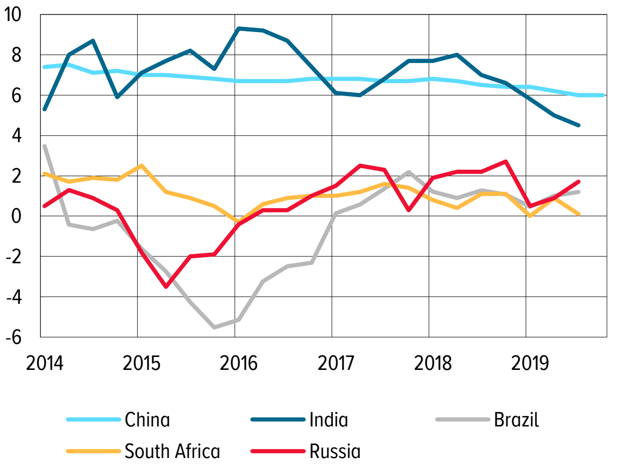
In 2020 Q1, the GDP growth is expected to accelerate on the back of an increase in gross capital formation and exports as well as the low base of 2019 H1.

GDP GROWTH RATES: ADVANCED ECONOMIES AND RUSSIA *Chart 3.1.1*
(% change on the same period of the previous year)



Source: Bloomberg.

GDP GROWTH RATES: EMES AND RUSSIA *Chart 3.1.2*
(% change on the same period of the previous year)



Source: Bloomberg.

3.1. EXTERNAL CONDITIONS AND BALANCE OF PAYMENTS

GLOBAL ECONOMY

Economic growth worldwide. In 2019 Q4, the downward trend in the economic activity paused as a result of changes in the sentiment of economic agents pending conclusion of a trade deal between the US and China and following the concurrent easing of the monetary policy by a number of countries in the second half of the last year.

In Q4, the annual growth rate in China remained at the Q3 level (6.0%), but the economy accelerated in quarterly terms from 1.4 to 1.5% (Chart 3.1.2), in line with expectations. The Caixin composite and industrial PMI indices accelerated in November (53.2 and 51.8, respectively) to values close to those of early 2018, and then slowed down somewhat in December (52.6 and 51.5, respectively). The composite and industrial PMI indices, calculated by the National Bureau of Statistics, indicate some deterioration in economic conditions in January (53 and 50 vs 53.5 and 50.2 in December), but these indicators might not yet reflect the influence of the coronavirus on the economy in Q1.

The US GDP accelerated from 2.1 to 2.3% YoY (Chart 3.1.1), which is somewhat above the forecast of 2.2%. Composite PMIs grew in December and January: Markit grew from 52 in November to 52.7 and 53.1, respectively, and ISM increased from 53.3 in November to 54.1 in December (Chart 3.1.1). The ISM PMI index for industry left the recession zone in January (50.9). The number of new jobs in December decreased to 145,000; however, the average rate of new job creation for three months (184,000) remains high.

The growth rate in the euro area (Chart 3.1.1) in Q4 amounted to 1.0% YoY (after 1.2% in Q3). Mitigation of risks of a no-deal Brexit, which negatively affected growth rates throughout 2019, is becoming an important positive factor for the economies of the euro area. The composite PMI in the euro area grew from 50.6 in October–November to 50.9 in December–

January, and the industrial PMI grew from 46.3 in December to 47.8 in January.

The risks of a more substantial slowdown of the global economy associated with trade disagreements decreased. The US and China have formalised the first phase of a trade deal that rests upon additional purchases of US goods by China for the amount of $200 billion within two years to mitigate trade imbalance. In this context, the exchange rate of the yuan (one of the indicators of the level of trade disagreements between the countries) strengthened since early December to mid-January from 7.04 to 6.9 yuans per one US dollar (followed by a decline of the yuan to 7.02 as of the beginning of February on the back of the pandemic).

The progress of implementation of phase 1 of the deal between the US and China, trade disagreements between the US and the EU, and the coronavirus spreading in China and South-East Asia may pose risks for further trends in business activity. Just like the SARS virus in 2002, it may affect the economy of China and other countries of the region.

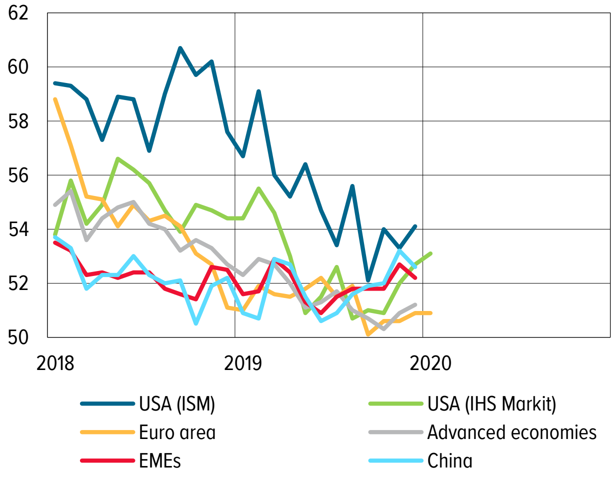
Inflation worldwide. After a period of low price pressure during the first three quarters of 2019, in Q4, a number of economies experienced accelerated inflation (Chart 3.1.4, 3.1.5). However, the causes were different for different economies, and for now, it does not look like a global inflation acceleration trend.

In the US, annual inflation rose to 2.3% in December (compared to 2.1% in November), while month-on-month inflation slowed down to 0.2% (in November, 0.3%). Core inflation remains at the level of 2.3%. At the same time, the Core PCE index used by the US Fed amounted to 1.6%. In December, wage growth slowed down from 3.1% YoY and 0.3% MoM (SA) in October and November to 2.9% and 0.1%, respectively. This indicator fell below 3% on a year-on-year basis for the first time since July 2018. The latest data on inflation and wage trends are an argument in favour of the retention of rates at their current level for the US Fed.

Inflation in the euro area in December and January sped up to the maximum level since June 2019 (1.3 and 1.4% YoY, respectively, after 0.7% in October and 1% in November), primarily

DYNAMICS OF PMI COMPOSITE
(points)

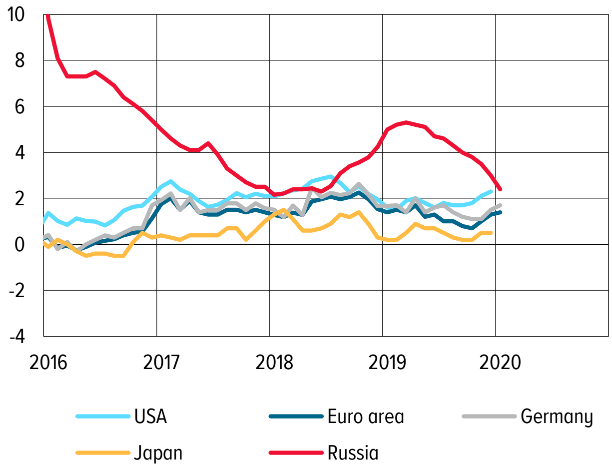
Chart 3.1.3



Source: Bloomberg.

INFLATION: ADVANCED ECONOMIES AND RUSSIA
(% change on the same period of the previous year)

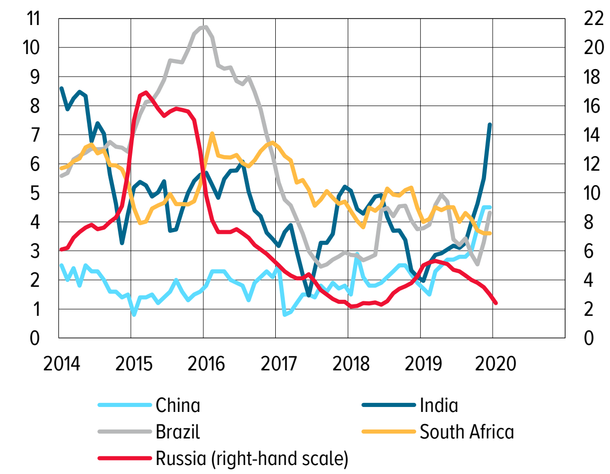
Chart 3.1.4



Source: Bloomberg.

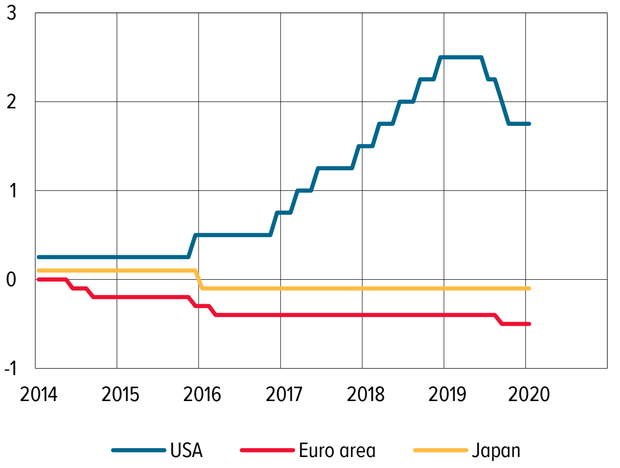
INFLATION: EMES AND RUSSIA
(% change on the same period of the previous year)

Chart 3.1.5



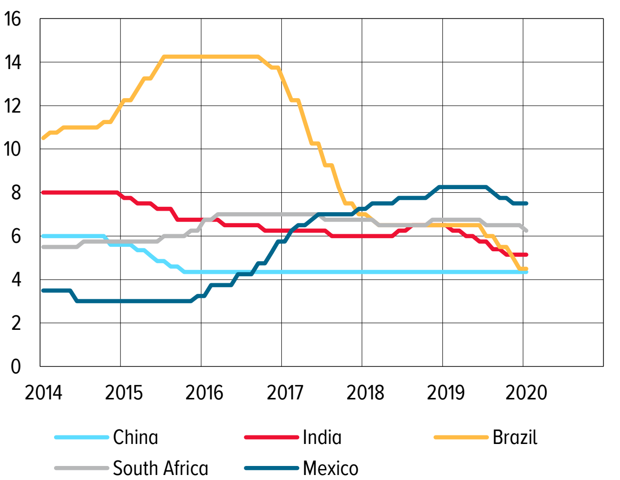
Source: Bloomberg.

POLICY RATES, ADVANCED ECONOMIES *Chart 3.1.6*
(%)



Source: Bloomberg.

POLICY RATES, EMES *Chart 3.1.7*
(%)



Source: Bloomberg.

because of the increase in prices for energy products, while core inflation in December remained at the same level as in November (1.3%), and slowed down to 1.1% in January.

The most notable acceleration of inflation by the end of the year among large economies was observed in China, India, and Brazil. In China, inflation in November–December sped up to 4.5% due to food inflation dynamics on the back of the swine flu epidemic, while core inflation remains low (1.4%).

In India, in November and December, the price growth rate was 5.5% and 7.4%, respectively, also due to a pickup in food inflation as a result of rains. In Brazil, annual inflation in December accelerated from 3.3 to 4.3% as a result of the exchange rate shock in November, which, in turn, could be caused by a combination of such factors as aggressive easing of the monetary policy amid increased social tension and doubts about the attainability of budget consolidation.

MONETARY POLICIES OF FOREIGN CENTRAL BANKS

Monetary policies in the US and the euro area (Chart 3.1.6). Following three policy rate cuts in July–October 2019, the US Fed declared a pause in its monetary policy easing at its meeting in December and confirmed it in January. The US Fed's macro forecast assumes that the rate will remain unchanged throughout 2020. From 15 October 2019 to the beginning of 2020 Q2, the US Fed will continue to purchase short-term treasury bills in the amount of $60 billion per month.

Low price pressure in the euro area continues to shape the conditions for the accommodative policy of the ECB. After the meeting on 12 September 2019, the ECB cut the deposit rate by 10 bp to -0.5% and kept the rate unchanged after the meetings on 12 December and 23 January. They also continued the asset purchase programme for an amount of €20 billion per month.

Monetary policies in other countries (Chart 3.1.7). In the light of the pause taken by the US Fed, most G20 central banks also paused their monetary policy easing cycles, which reached their peaks in July–October 2019. At the end of

December, the rate was cut in Mexico (by 25 bp, to 7.25%), although the country retains one of the highest levels of real rates among EMEs. January saw a rate cut in Turkey (by 75 bp to 11.25%), South Africa (by 25 bp to 6.25%) and Malaysia (by 25 bp to 2.75%).

In December, the Bank of Sweden (the Riksbank) increased the rate (by 25 bp to 0%). This decision was caused by the Bank of Sweden's expectations that inflation would come close to the 2% target despite the economic slowdown. The Riksbank was the first of the world central banks to move the rate into the negative territory in 2009, and now it is the first to finish a nearly five-year period of negative rate policy.

GLOBAL FINANCIAL MARKETS

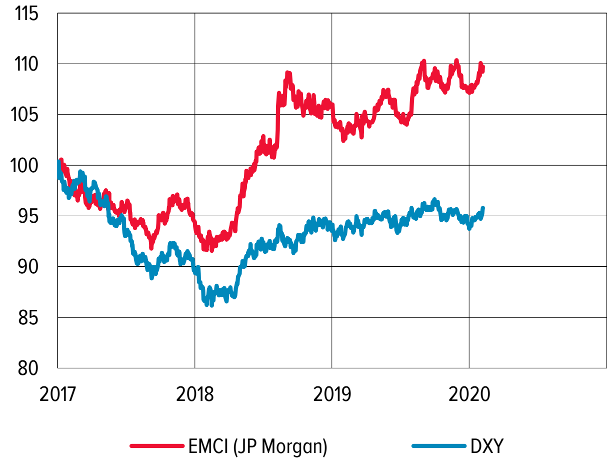
Currencies. In 2019 Q4–January 2020, the sentiment of international investors improved significantly, and the demand for risky assets grew. The US dollar was losing ground against the currencies of most developed economies (the USD index fell by 2.1%) and EMEs (by 2.0% on average) (Chart 3.1.8). Among the latter, only the Chilean and Argentinian pesos along with the Turkish lira demonstrated a significant negative trend.

This financial market dynamics took shape owing to the softening of financial conditions in many countries and the stabilisation of outrunning economic indicators in November–December, as well as due to the mitigation of foreign trade risks in the US–China negotiations and Brexit.

However, in the second half of January, the coronavirus outburst caused a significant decline in demand for risky assets because of high uncertainty about the extent of the adverse impact of the new virus on the global economy. As a result, the USD index fully recovered from its decline in 2019 Q4, and EME currencies returned to their values of the beginning of December.

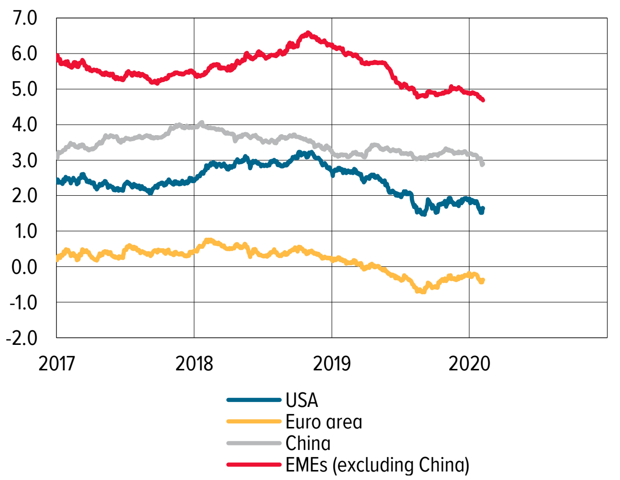
Interest rates. In Q4, increased demand for risky assets led to moderate growth of the yield on the long-term public debt of advanced economies. However, in January its level partially adjusted because of investors' flight

US DOLLAR EXCHANGE RATE AGAINST ADVANCED ECONOMIES' AND EMES' CURRENCIES *Chart 3.1.8*
(100 = 02.01.2017)



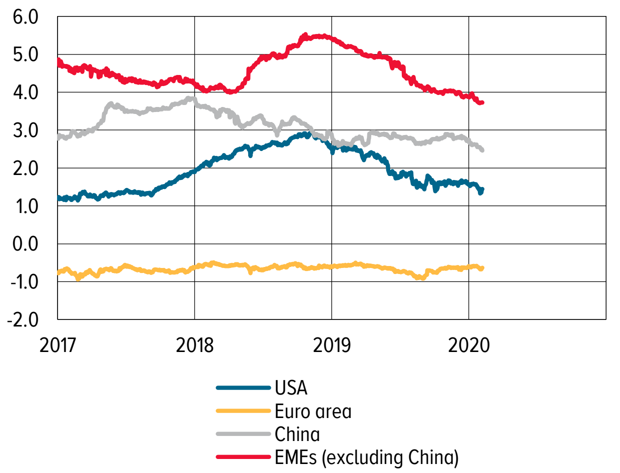
Sources: Reuters, Bank of Russia calculations.

YIELDS ON 10-YEAR GOVERNMENT BONDS *Chart 3.1.9*
(change on 02.01.2017, pp)



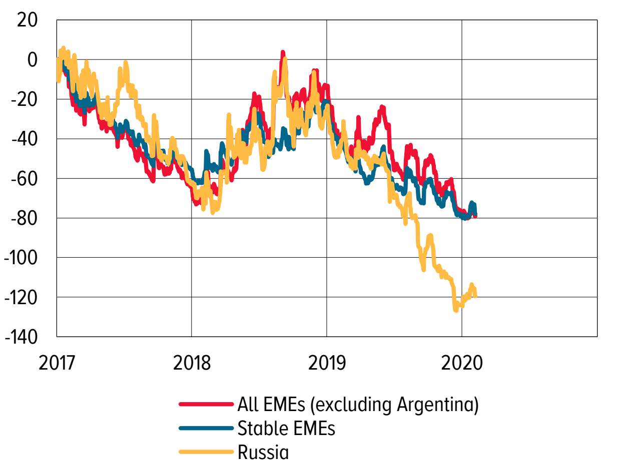
Sources: Reuters, Bank of Russia calculations.

YIELDS ON 2-YEAR GOVERNMENT BONDS *Chart 3.1.10*
(change on 02.01.2017, pp)



Sources: Reuters, Bank of Russia calculations.

CDS OF EMES *Chart 3.1.11*
(change on 02.01.2017, bp)



Source: Reuters.

to quality. In October 2019–February 2020, the growth of yield on 10-year debt of advanced economies amounted to 1–10 bp (except the US, where it dropped by 3 bp). Greater growth was observed in the euro area and Japan (20 bp) as expectations regarding the rates somewhat recovered (Chart 3.1.19). At the short end of the curve, some growth of yield on 2Y debt was observed in Japan (within 20 bp) on the back of improved economic growth forecasts due to fiscal incentives.

Changes in yields at the EME public debt market were mostly associated with the actions of national central banks. Following policy rate cuts in most countries, yield on government bonds also declined (Chart 3.1.10), with the exception of Latin American countries, where the debt market remains volatile.

Country risk premiums. Risk premiums in most EMEs declined on the back of softer financial conditions and reduced concerns regarding a sharp slowdown of the global economy. Risk premiums on 5-year debt have declined by 25 bp on average since the beginning of October (Chart 3.1.11). The cost of insurance against the default of advanced economies did not change significantly.

Stocks. Stock indices of most countries have been growing confidently since October reaching new historical highs in many countries (the US, Germany, Russia, Canada, Brazil, India and others) (Chart 3.1.12). Rate cuts led to a positive revaluation of companies and stabilised expectations regarding economic growth. However, the January sell-off significantly affected EME stock markets, and most indices returned to the levels observed in early December. Stock indices of advanced economies were more stable and won back almost all their losses in early February.

GLOBAL COMMODITY MARKETS

Oil – price. The average price of Urals oil in December 2019 was $66 per barrel, having grown by 4% since November on the back of the improvement of trade relations between the US and China and the OPEC+ decision to increase production cuts. The signing of Phase 1 of the trade deal between the US and China at the beginning of 2020 continued to support the price of oil. At the same time, amidst the expected acceleration of supply growth outside OPEC in 2020 and concerns about demand in China, the price of oil declined to $62 per barrel on average in January (Chart 3.1.13).

Oil – global demand. The growth of global oil consumption might be weaker than expected. Air transportation declined due to the coronavirus, which will reduce demand for fuel. A deterioration in global economic growth outlook on the back of a worsening situation in tourism and growing uncertainty may also have an adverse effect on global oil consumption.

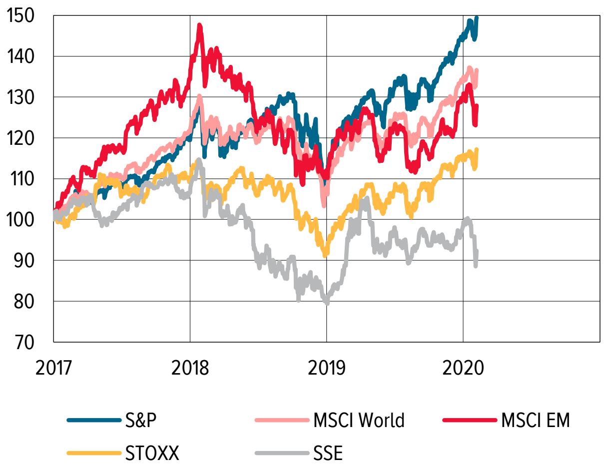
Oil – OPEC+. The overfulfilment of OPEC+ agreements continued to support oil prices (Chart 3.1.14). In December, OPEC production declined while the degree of compliance with the agreement by OPEC members exceeded 150%. The discipline of Iraq, Nigeria and UAE regarding the discharge of obligations to cut production notably improved. Based on data from OPEC secondary sources, Saudi Arabia, which is the leader in overfulfilling the agreements, cut its production further by over 100,000 barrels per day in December. Since October 2018, its production has decreased by 0.9 million barrels per day. Angola, Kuwait and other countries also overfulfilled their obligations in December. Non-OPEC countries, including Russia, have also cut production by about 0.2 million barrels per day since October 2018.

Oil – supply from Iran, Venezuela and Libya. In December 2019, due to the US sanctions, oil production in Iran remained at its 30-year low (about 2 million barrels per day) while in Venezuela, it was close to its minimum for over 15 years (0.7 million barrels per day). Based on the data of the US Department of Energy, Iran has cut its production by 1.8 million barrels per day over the last three years, and Venezuela – by 1.4 million barrels per day. In contrast, Libya, which is also not covered by the restrictions under the OPEC+ agreement, has increased its production over the same period by 0.5 million barrels per day to 1.2 million barrels per day. At the same time, in January 2020, Libya faced the risk of supply disruption after force majeure was announced at two large fields.

Oil – non-OPEC+ production. The growth of production by non-OPEC countries partially

STOCK INDICES
(100 = 02.01.2017)

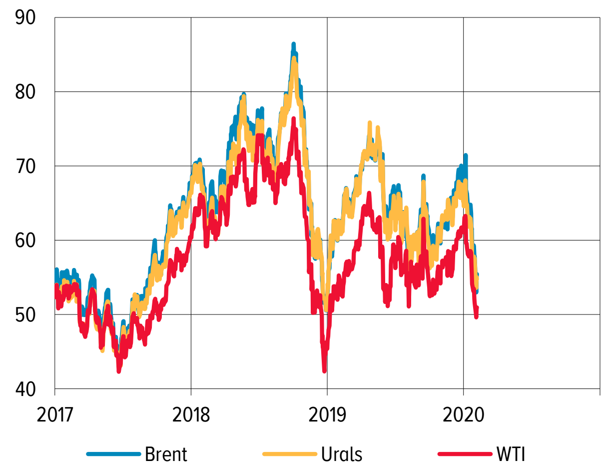
Chart 3.1.12



Sources: Reuters, Bank of Russia calculations.

OIL PRICES
(US dollars per barrel)

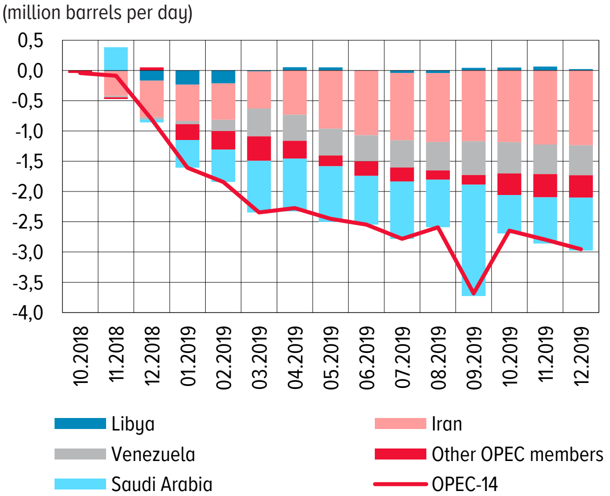
Chart 3.1.13



Sources: Thomson Reuters, Bloomberg.

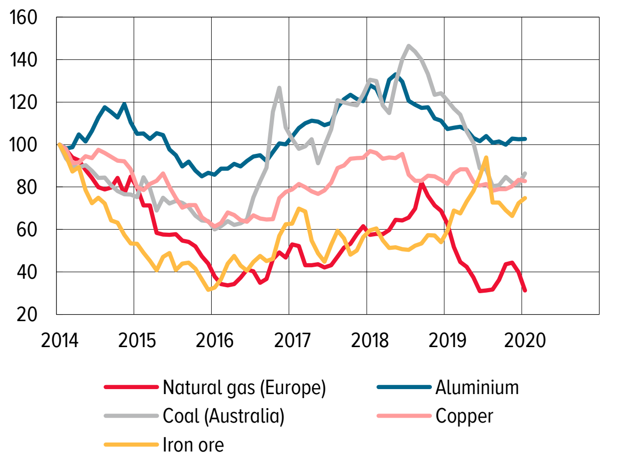
CHANGE IN OPEC CRUDE OIL PRODUCTION SINCE OCTOBER 2018*
(million barrels per day)

Chart 3.1.14



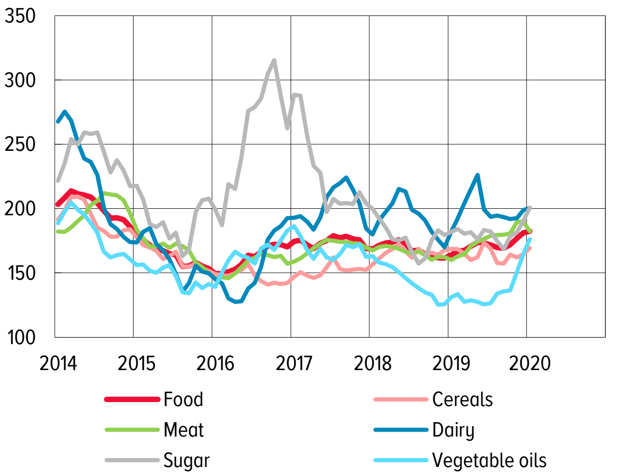
** For Kuwait – since September 2018.*
Source: calculations based on OPEC secondary source data.

GLOBAL PRICES FOR KEY RUSSIAN EXPORT COMMODITIES *Chart 3.1.15*
(January 2014 = 100%)



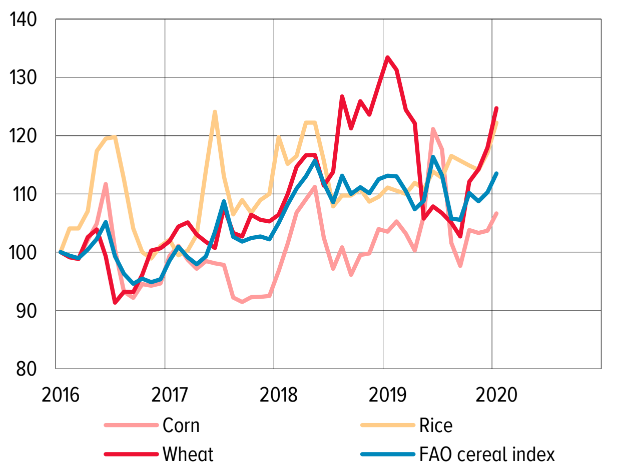
Source: World Bank.

GLOBAL FOOD PRICES *Chart 3.1.16*
(2002–2004 = 100%)



Source: UN Food and Agriculture Organization (FAO).

GLOBAL PRICES FOR CEREALS *Chart 3.1.17*
(January 2016 = 100%)



Sources: World Bank, Bloomberg, UN Food and Agriculture Organization (FAO).

levels out production cut by OPEC+, Iran and Venezuela. Based on the data of the US Department of Energy, in December 2019, crude oil production in the US grew by 1.3 million barrels per day as compared with October 2018, and the supply of oil and other liquid fuel grew by more than 2 million barrels per day. Though weakening of drilling activity suppresses production in the US, its growth will remain the main contributor to supply growth outside OPEC. Furthermore, substantial growth of production is expected in Brazil, Canada and other countries.

Situation in other commodity markets. In December 2019–early 2020, global prices for the key commodities showed mixed dynamics. Gas prices in the European market (the main market for Russia) hit long-time lows due to a warm winter, a high level of reserves and a significant volume of LNG supply due to implementation of new projects (Chart 3.1.15). The reduction of imports by China due to governmental restrictions brought downward pressure on global coal prices. At the same time, global prices for many metals in December increased somewhat on the back of improved trade relations between the US and China. However, concerns about the Chinese demand amid the deteriorating epidemiological situation in January 2020 suppressed global prices for metals.

Food products. The growth of global prices for food accelerated at the end of 2019, mostly due to vegetable oils, dairy products and meat amid a significant demand and a limited supply (Chart 3.1.16). Wheat prices grew at the end of 2019 on the back of the increased import demand from China and logistic problems in France due to the continuing protests against the pension reform (Chart 3.1.17). In early 2020, FAO Composite Food Price Index grew to its five-year high and remained more than 10% above the level of last January. However, in 2019, it only grew by 2% on average as compared with 2018, while global prices for cereals in 2019 declined by 1% due to a record-breaking harvest. Furthermore, external inflationary pressure was suppressed by the strengthening of the ruble.

BALANCE OF PAYMENTS[1]

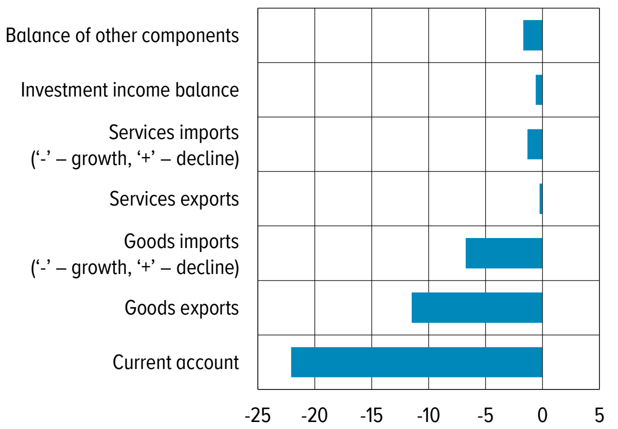
Current account. The current account surplus in 2019 Q4 decreased by $22 billion to $16 billion (here and below, changes are relative to the corresponding period of the previous year, unless otherwise indicated) (Chart 3.1.18). In 2019, it declined overall by $43 billion to $71 billion. That was mainly caused by the contraction of the trade balance surplus. Another reason was the expanded deficit of the investment income balance as a result of larger dividend payouts by Russian companies to investors, particularly to foreign investors.

Exports. The value of goods and service exports continued to decline in Q4, dropping by 8% (2019 Q3: -6%) (Chart 3.1.19). The reason for that was that global prices for energy commodities and some metals remained below the previous year's level amid the subdued growth of the global economy.

Oil exports. The value of oil and petroleum product exports declined by 14% in Q4, with the price of Urals crude falling by over 7%. The negative price effect increased due to the 1–2-month time lag of changes in the global oil price affecting the export prices of oil and petroleum products. Thus, the value of exports in Q4 was also affected by a larger annual drop in the global oil price in August–September. Exports were also restrained by the decrease in oil production in Russia, as required by the OPEC+ agreements. However, the physical volume of oil and petroleum product exports, based on the real-time data of the FCS of Russia, grew by 3% in October–November 2019, mainly due to the increase in supplies to Turkey, which became possible due to the improvement of the economic situation in that country and the refocusing of its oil imports from sanctioned Iran to other countries. In addition, competition between Russia and the US for the EU market tightened. However, Russia retained its leadership in this market (in January–November 2019, 29% of oil and petroleum product imports to the EU, according to Eurostat). Russia's positions in the Chinese market remained

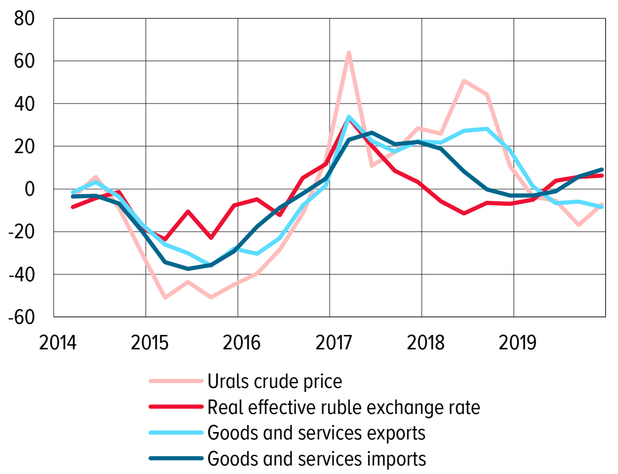
[1] *The balance of payments section includes a preliminary estimate of its indicators in 2019 Q4 and actual data on international reserves.*

GROWTH STRUCTURE OF THE CURRENT ACCOUNT BALANCE IN 2019 Q4* *Chart 3.1.18*
(billions of US dollars on the same quarter of the previous year)



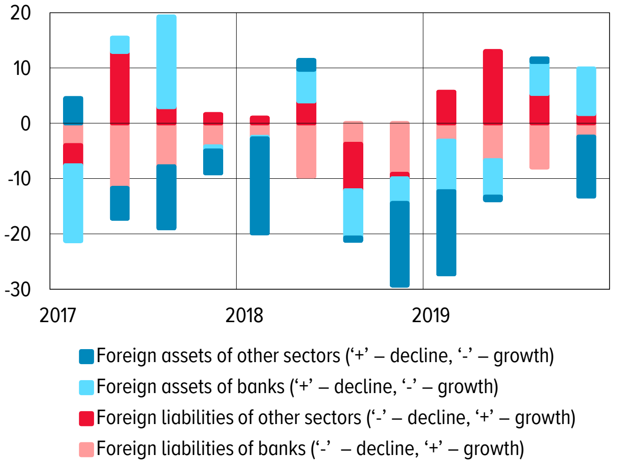
** Assessment for 2019 Q4.*
Source: Bank of Russia.

FOREIGN TRADE *Chart 3.1.19*
(% change on the same quarter of the previous year)



** Assessment of exports and imports for 2019 Q4.*
Sources: Bank of Russia, Thomson Reuters.

MAJOR PRIVATE SECTOR FINANCIAL ACCOUNT COMPONENTS *Chart 3.1.20*
(billions of US dollars)



* *Assessment for 2019 Q4.*
Source: Bank of Russia.

at a good level close to the previous year (in January–November 2019, 15% of oil imports by China, according to the customs service's data). The growth of exports from Russia and Saudi Arabia offset the shrinkage of supplies to China from Iran and Venezuela.

Gas exports. The decline in the value of exports of natural gas in the gaseous state slowed down to 25% in Q4 compared to 32% in Q3. First, this was the result of the recovery of the price of gas in Europe (which is a key market for Russia). According to the World Bank, it was up by 29% against 2019 Q3, yet it remained 41% below its level recorded in 2018 Q4. Second, the export quantities of Russian gas increased by 9% in October–November 2019, according to the Federal Customs Service. This growth was primarily driven by larger supplies to the EU amid the contraction of gas production in the EU. Another contributor to the expansion of Russian exports was the upsurge in LNG exports (by 2.5 times in October–November 2019). It was associated with the fact that the Yamal LNG plant reached its design capacity in late 2018 and the Cryogas-Vysotsk plant started shipping LNG, in particular to the external market, in 2019.

Non-oil and gas exports. The value of non-oil and gas exports of goods decreased by 3% in 2019 Q4 (in 2019 Q3, +7%). According to the Federal Customs Service of Russia, October–November 2019 saw a marked reduction in both the value and quantities of ferrous metal, aluminium, copper and coal exports amid moderate external demand. The IHS MPI index (new export orders in manufacturing) also indicated weak external demand over that period. Russian exports were also suppressed by trade restrictions, in particular by the EU, on Russian ferrous products.

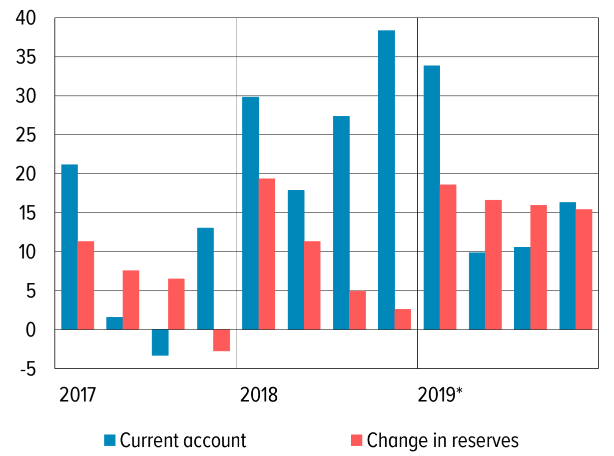
Imports. The expansion of the value of goods and services imports in 2019 Q4 accelerated to 9% (in 2019 Q3, 6%) following the strengthening of the ruble. The annual growth rate of the nominal effective exchange rate of the ruble in Q4 increased to 6% (in Q3, 4%). The quicker growth of the Russian economy in 2019 H2 also supported imports. According to the Federal Customs Service, October–November 2019 recorded an increase in imports of some investment goods (machinery, industrial and laboratory equipment, pipeline and boiler fittings, and railway locomotive parts). Imports of a number of consumer goods (medicines, telephones, some apparels) also increased. The revival of consumption also supported an increase in the imports of services, primarily tourism services, resulting in a larger deficit in the balance of services.

Financial account – private sector. In 2019 Q4, net lending by the Russian private sector to the rest of the world decreased by $6 billion (in 2018 Q4: $33 billion), mostly owing to banking operations. In 2019 Q4, banks' foreign assets decreased in comparison with 2018 Q4 when they grew amid the suspension of fiscal rule-based foreign currency purchases. The contraction of the balance of the private sector's financial transactions in 2019 Q4 was also associated with a lesser decline in banks' external liabilities. Foreign liabilities of other sectors went up in 2019 Q4 owing to foreign direct investment. However, the growth of foreign assets in other sectors was lower than the previous year against the backdrop of smaller direct investments than the year before (Chart 3.1.20).

Financial account – public sector. In 2019, net borrowing grew to over $5 billion (in 2018 Q4: net lending amounted to $1 billion, and in 2019 Q3: net borrowings amounted to $3.5 billion) as non-residents increased their purchases of Russian securities amid slower inflation and the expected easing of monetary policy by the Bank of Russia. The balance of foreign investors' transactions to buy and sell Russian sovereign debt securities in the secondary market denominated in both Russian rubles and foreign currency expanded to $4 billion (in 2018 Q4: - $1.5 billion, and in 2019 Q3: + $1 billion), primarily driven by purchases of ruble-denominated securities.

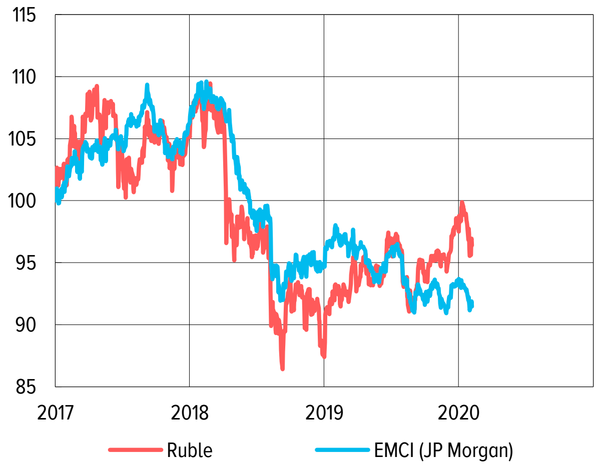
Foreign currency reserves. As a result of transactions recognised in the balance of payments, the reserve assets increased by $15 billion in 2019 Q4 (in 2018 Q4: +$3 billion) (Chart 3.1.21). This was primarily driven by fiscal rule-based foreign currency purchases. Overall, supported by transactions, revaluations and other adjustments, the international reserves

RESERVE ASSETS AND CURRENT ACCOUNT *Chart 3.1.21*
(billions of US dollars)



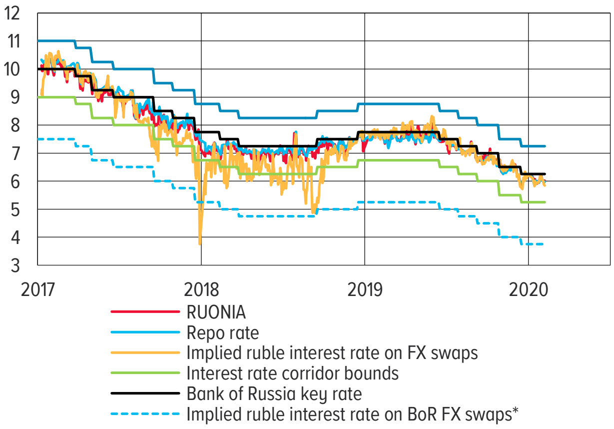
** Assessment of the current account for 2019 Q4.*
Source: Bank of Russia.

RUBLE/US DOLLAR EXCHANGE RATE AND EMCI *Chart 3.1.22*
(100 = 02.01.2017)



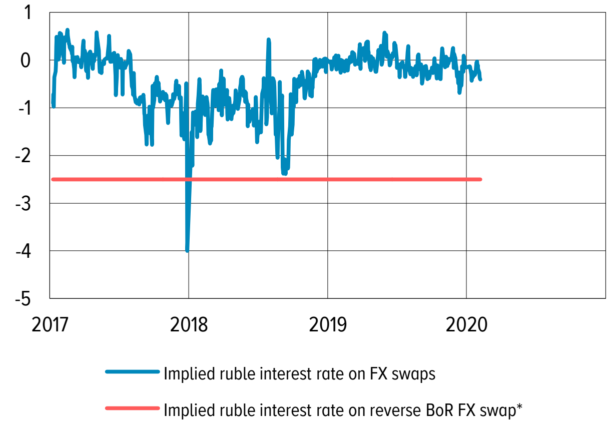
Source: Thomson Reuters.

MONEY MARKET RATES
(% p.a.)
Chart 3.2.1



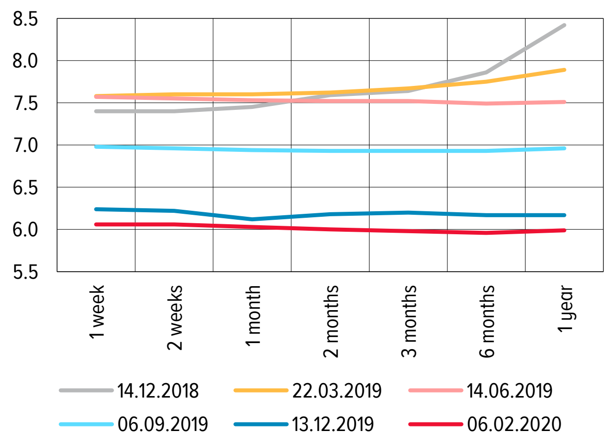
*Implied rate on BoR reverse FX swap = ruble lending rate – FX borrowing rate + LIBOR (since 19.12.2016: key rate – 1 pp - (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).
Source: Bank of Russia calculations.

SPREAD OF INTEREST RATE IN FX SWAP SEGMENT TO KEY RATE
(pp)
Chart 3.2.2



*Implied rate = ruble lending rate – FX borrowing rate + LIBOR (from 19.12.2016: key rate – 1 pp – (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).
Source: Bank of Russia calculations.

ROISFIX CURVE
(% p.a.)
Chart 3.2.3



Note. ROISFIX (RUONIA Overnight Interest Rate Swap) is an indicative rate (fixing) for RUONIA IR swaps. It reflects the expected average RUONIA rate over a horizon from 1 week to 1 year.
Source: SRO NFA.

grew by $23 billion in 2019 Q4 to $554 billion. As forecast by the Bank of Russia, the fiscal rule will lead to the further building up of Russia's international reserves in 2020.

FOREIGN EXCHANGE MARKET

Ruble exchange rate. After the meeting of the Bank of Russia Board of Directors in December, the ruble continued to strengthen. This was largely driven by the general strengthening of EME currencies amid the growing risk appetite. On the first days of January, the strengthening of the ruble was also supported by rather large purchases of OFZs by foreign investors (₽20 billion), which were probably associated with the re-opening of previously closed positions (due to the long New Year holidays). Furthermore, those days saw increased sales of foreign currency by exporters, which could also be explained by deferred demand for Russian rubles. However, in the second half of January–the beginning of February, the coronavirus outbreak in China, followed by the sell-off in the global markets, weakened the ruble and pushed it back to the values observed in beginning of December 2019.

3.2. MONETARY CONDITIONS

MONEY MARKET

Short-term rates. Short-term interbank lending rates in the money market stayed in the lower half of the interest rate corridor close to the Bank of Russia key rate (Chart 3.2.1). The average spread stood at -21 bp in December–January (in Q4, -14 bp) and fluctuated in the range of -40 to -2 bp (in Q4, in the range of -52 to 26 bp). The formation of IBL rates and the liquidity situation are discussed in more detail in Section 4.2 'The system of monetary policy instruments and other monetary policy measures.'

Foreign currency liquidity. Interest rate spreads in the FX swap and IBL segments did not change, amounting to -4 bp in December–January (in Q4, 0 bp) (Chart 3.2.2). The low cost of foreign currency borrowings in the Russian market is supported by the availability of reserves of foreign currency liquidity accumulated in banks in 2018 H2–2019 H1.

Long-term rates. Money market rates for the period exceeding one day declined along the curve (ROISFIX – by 9–22 bp, Mosprime – by 12–16 bp) (Chart 3.3.3, 3.3.4). The rates declined a little after the decision to reduce the key rate by 25 bp taken by the Bank of Russia Board of Directors in December.

STOCK MARKET

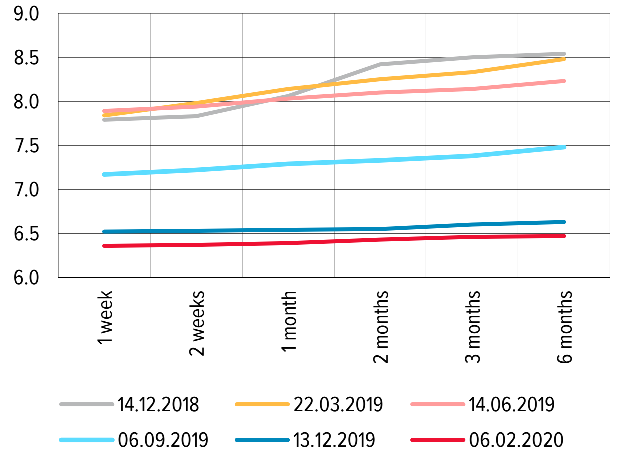
In December 2019–February 2020, the situation in the Russian stock market was mostly determined by external factors. The growth of prices observed until the middle of January on the back of the general growth of risk appetite in the global markets gave way to a decline due to the coronavirus outbreak in China. Its potential influence on the Russian market is still unclear and will depend on the effectiveness of fight against this new infection.

Government bond market. No significant changes were observed in the government bond market during the period under review. The Ministry of Finance of Russia completed its 2019 borrowing plan early and cancelled the last OFZ placement auction scheduled for December. In Q1, the agency plans to borrow ₽600 billion. The first auctions in 2020 were rather successful: the Russian Ministry of Finance raised ₽319.2 billion, 47% of which were bought by foreign investors. The OFZ yield curve continued to descend gradually and went down by 13–30 bp over the period under review, depending on maturity. The sell-off on the back of the concerns about the spread of the coronavirus had almost zero effect on the OFZ market, which is evidenced by the absence of large sales by foreign investors in the secondary market.

Corporate bond market. Issuing activity in the corporate bond market continued to recover amid the decline of yields and OFZ placement rates. The decline of yields was explained by a mostly similar trend in the OFZ market and the growing demand of investors for higher-yield securities. The latter is particularly evidenced by the shrinking of the spread between the yields of corporate and government securities to its lowest value since the end of 2018.

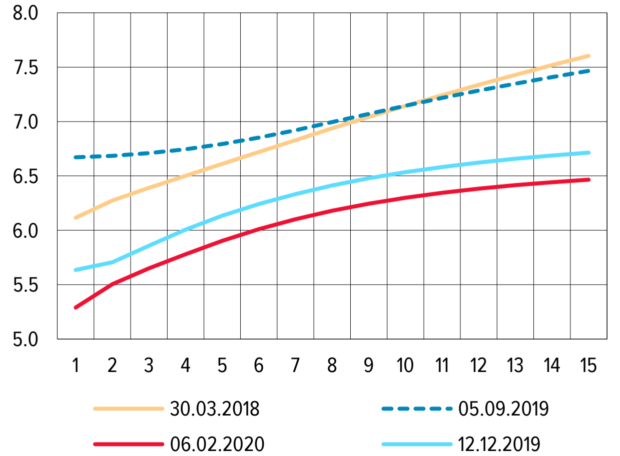
Equity market. After the December meeting of the Bank of Russia Board of Directors, the equity indices continued to grow following

MOSPRIME CURVE
(% p.a.)
Chart 3.2.4



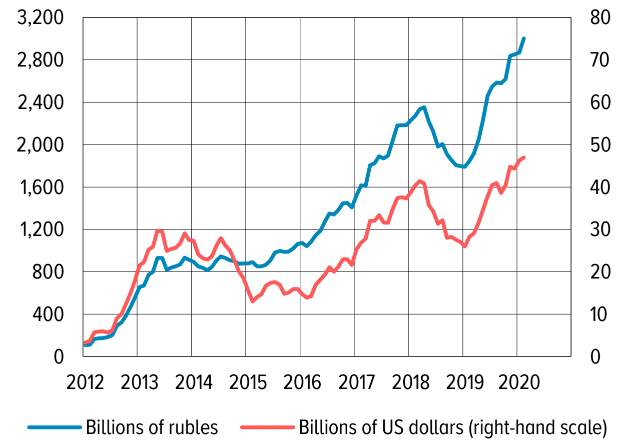
Source: SRO NFA.

OFZ ZERO COUPON YIELD CURVE
(% p.a.)
Chart 3.2.5



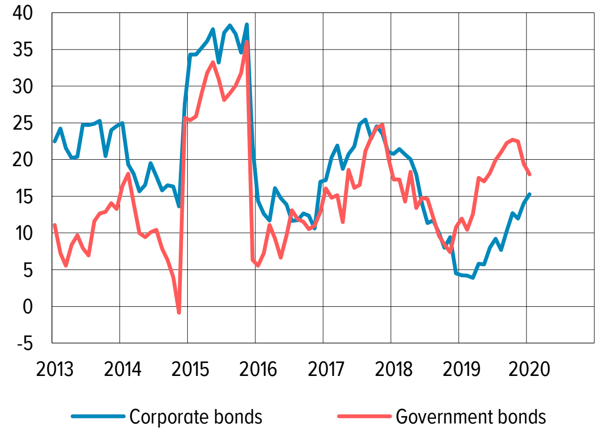
Source: Moscow Exchange.

NOMINAL VALUE OF OFZ HELD BY NON-RESIDENTS
Chart 3.2.6



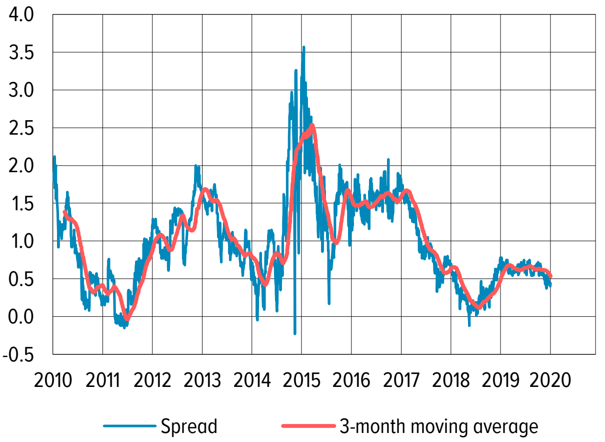
Source: National Settlement Depository.

CORPORATE AND GOVERNMENT SECURITIES PORTFOLIO
(% growth on the same period of the previous year)
Chart 3.2.7



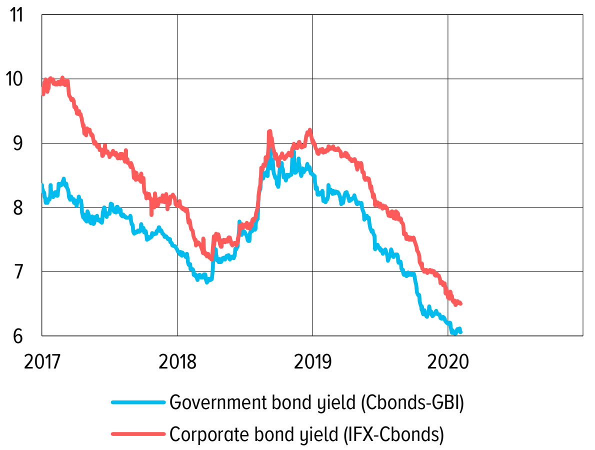
Source: Cbonds.ru.

SPREAD BETWEEN CORPORATE AND GOVERNMENT BOND YIELDS
(pp)
Chart 3.2.8



Source: Cbonds.ru.

YIELD INDICES OF CORPORATE AND GOVERNMENT BONDS
(% p.a.)
Chart 3.2.9



Source: Cbonds.ru.

the global markets; however, the coronavirus outbreak caused a significant decline of the demand for risky assets, which affected the EME equity markets to a large extent. For example, the MSCI EM index declined by 3.9% against its maximum in January, and MSCI Russia fell by 8.0%. The MOEX index calculated in rubles dropped somewhat less, by 3.8%. As a result, following the period under review (December 2019–February 2019), EME equity indices showed near-zero growth, and their further trend will depend on the influence of the coronavirus on the global economy.

DEPOSIT AND LOAN MARKET

Deposit rates. In 2019 Q4, the deposit rates continued to decline comparable with inflation and bond yields (Chart 3.2.11). In November, the rate for short-term deposits in rubles was 4.6% p.a., 0.5 pp less than in September. The rate for long-term deposits decreased by 0.4 pp to 5.8% p.a over the same period. In December 2019 and January 2020, the largest banks in the deposit market mainly reduced their deposit rates, which suggests a further decline in the average market rate in early 2020.

Deposit operations. Positive real deposit rates supported the attractiveness of deposits and contributed to further inflow of household funds. In 2019, household deposits grew by 9.8%[2] (the maximum annual increase since the middle of 2017).

Ruble transactions remained the main driver of the increase in household deposits over the last months of the year (Chart 3.2.12). The annual increase in short-term deposits in November–December (mostly due to on-demand deposits, which can be explained by the further growth of the popularity of debit cards), but remained lower than the similar indicator for long-term deposits.

[2] *Hereinafter, increases in banks' balance sheet indicators are calculated based on reporting data of operating credit institutions recorded in the State Register as of the relevant reporting date. Increases in foreign currency claims and liabilities are calculated in US dollar terms. To analyse flows of funds between banks and their customers, the growth of the foreign currency component is converted into rubles using the period average exchange rate where increases in balance sheet indicators comprising foreign currency and ruble components are calculated herein.*

In November–December 2019, the balance of household foreign currency deposits grew slowly, and their annual growth rates as of the end of the year were somewhat lower than the similar indicator of the ruble market segment. Combined with the strengthening of the ruble, this drove the share of household FX deposits to a five-year low.

Lending rates. In 2019 Q4, the cheapening of bank funding contributed to the further decline of credit rates. The pace of the decline of the rates in the major credit market segments was comparable with that of deposit rates (Chart 3.2.11).

In November, the average market rate on long-term loans to non-financial organisations was 8.7% p.a., 0.5 pp lower than in September. The rate on short-term loans during the same period fell from 8.3% to 7.8% p.a. The mortgage rate in December reached a new historical low (9.0% p.a.), having declined by 0.7 pp as compared with September. In December 2019 and January 2020, banks continued to reduce rates on standard credit products, which suggests a further reduction in average market loan rates.

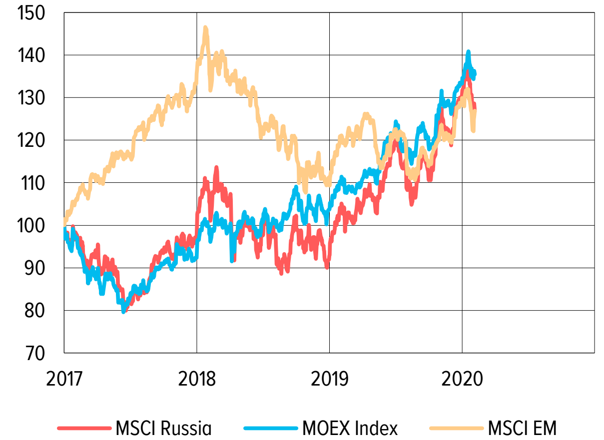
Corporate lending. In 2019 Q4, the quality of the corporate loan portfolio of banks saw a trend towards the improvement. As of year-end, the share of overdue debt in the corporate loan portfolio amounted to 7.75%, having declined by 27 bp as compared with the beginning of October. On the back of the improved quality of the loan portfolio, a further revival was observed in the segment of lending to higher-risk industries (construction, trade).

As of the end of Q4, the activity of the participants of the credit market corporate segment somewhat increased: the annual growth rate of corporate lending at the end of December amounted to 4.3% against 3.4% at the beginning of October (Chart 3.2.13).

Retail lending. The retail segment of the credit market also saw a stable improvement of the quality of the loan portfolio (the share of overdue debt decreased to 4.3% by the end of the year, having reached a six-year low), which preserved banks' interest in this area of lending. Nevertheless, the annual increase in retail lending continued to slow down to reach 18.5%

STOCK INDICES
(100 = 03.01.2017)

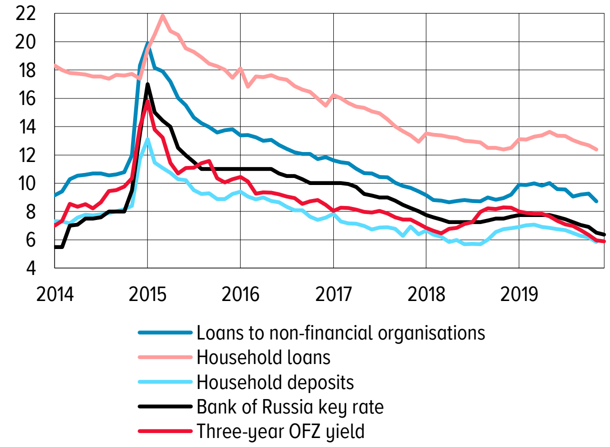
Chart 3.2.10



Source: Bloomberg.

INTEREST RATES ON LONG-TERM RUBLE OPERATIONS IN THE RUSSIAN MARKET
(% p.a.)

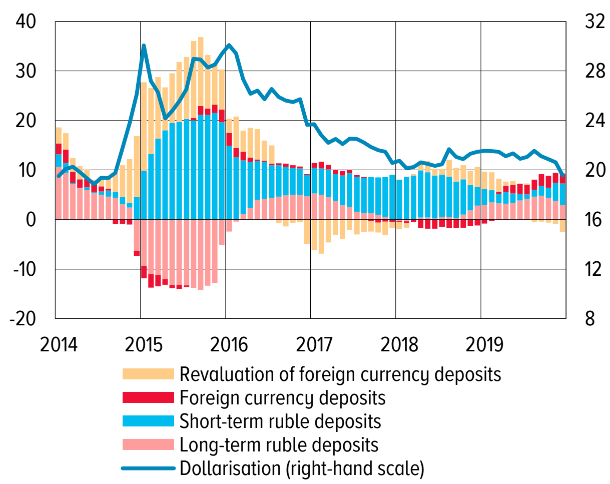
Chart 3.2.11



Source: Bank of Russia.

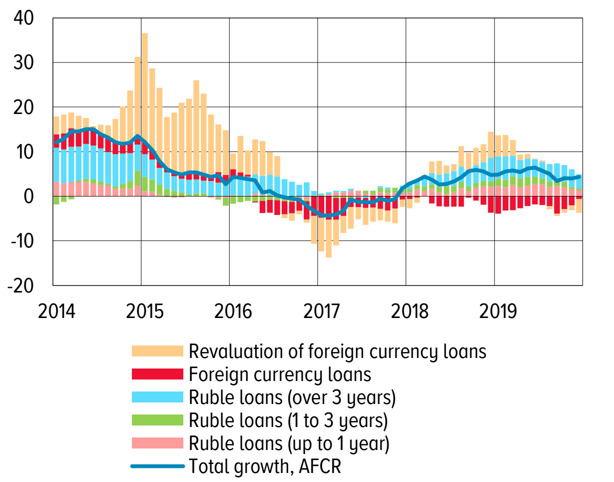
ANNUAL GROWTH OF HOUSEHOLD DEPOSITS
(contribution of individual components, pp)

Chart 3.2.12



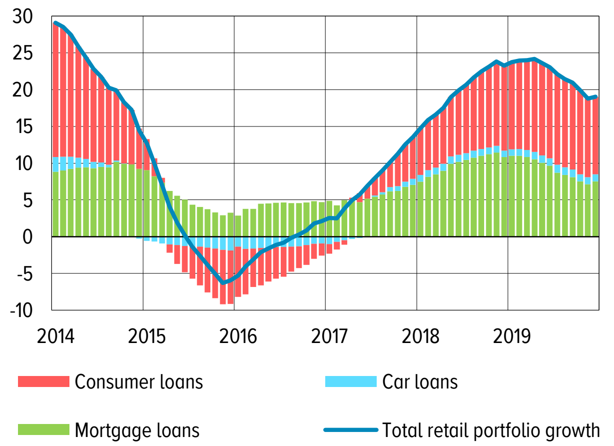
Source: Bank of Russia.

ANNUAL GROWTH OF CORPORATE LOAN PORTFOLIO (contribution of individual components, pp) *Chart 3.2.13*



Source: Bank of Russia.

ANNUAL GROWTH OF RETAIL LOAN PORTFOLIO (contribution of individual components, pp) *Chart 3.2.14*



Source: Bank of Russia.

as of year-end against 20.7% three months before. In Q4, after the add-ons to risk weights on unsecured consumer loans to borrowers with a high debt burden came into force, the consumer lending segment became the major contributor to the slowdown of retail lending (Chart 3.2.14). In early 2020, the potential for a further slowdown of the growth of household lending remained mainly due to the decline of activity in the consumer lending segment.

3.3. ECONOMIC ACTIVITY

GROSS DOMESTIC PRODUCT

In accordance with Rosstat's primary estimate, annual GDP growth totalled 1.3% in 2019 (Chart 3.3.1), which corresponds to the upper bound of the Bank of Russia's forecast range of 0.8–1.3%.[3]

Concurrent with the 2019 data, Rosstat released revised dynamics for GDP and its expenditure components for 2018. Overall economic growth estimates rose from 2.3% to 2.5%. Significantly revised were households' final consumption expenditure (from 2.3% to 3.3%) and public administration expenditure (from 0.3% to 1.3%). Higher growth in the final consumption expenditure of households compared with Rosstat's previous estimates was suggested by the dynamics of retail sales and paid services to households in 2018. The upward revision of general government consumption might be attributed to the accelerated growth of budget expenditure in 2018 for civil servant wages, purchases of goods, works and services, etc. Considerable downward adjustments were made to the dynamics of gross fixed capital formation (GFCF) (from 2.9% to 0.1%). This might be associated with a downward revision of the growth rate of gross value added in construction from 4.7% to 2.6%.

The slowdown of GDP growth in 2019 by 1.2 pp (Chart 3.3.2) was associated with two key factors. First, oil production caps under the OPEC+ agreement, along with the weakening of external demand amid a slowdown in global economic growth, caused a significant

[3] See *Monetary Policy Report 4/19*.

contraction in exports of Russian goods (-2.1% against 2018). Second, the expansion of households' consumption activity slowed down somewhat as average annual inflation rose, largely on the back of the VAT increase at the beginning of the year. At the same time, the dynamics of GFCF and accumulation of inventories, due to the implementation of national projects and to good harvests, had a positive effect on output growth.

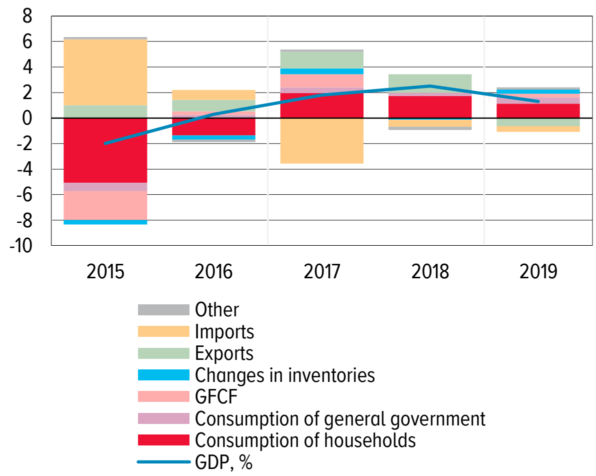
The dynamics of final consumption expenditure remained the key driver of GDP growth in 2019. Moreover, apart from household consumption, whose growth contributed the most to the GDP growth in 2019, the final consumption expenditure of general government grew significantly as well (in 2019: 2.8%, in 2018: 1.3%), which reflects confident growth of budget system expenditures during that period. An increase in gross fixed capital formation and accumulation of inventories also produced a positive and commensurate impact on GDP growth. The decline in real exports of mostly interim goods was the key factor suppressing the growth of the total output in the Russian economy.

According to the Bank of Russia forecast,[4] the annual GDP growth rate will amount to 2.0–2.5% in 2020 Q1. This will be supported by an increase in domestic demand. It is estimated that household final consumption expenditure will increase by 3.0–3.5% year-on-year amid the accelerated growth of real wages (see 'Labour market and earnings'). Under the influence of more active budget spending than in 2019 Q1, inter alia, during the implementation of national projects, the growth rates of gross fixed capital formation will amount to 2.0–2.5%. An increase in domestic demand will be supported both by domestic and foreign goods and services, which, according to estimates, will lead to a 6.0–6.5% increase in imports. At the same time, the demand for Russian export goods remains moderate on the back of the global economic slowdown and the effect of oil production

[4] *The Bank of Russia forecast is calculated on the basis of Rosstat quarterly data on the trends of GDP and its usage components, which have not been revised and do not match the annual results published 3 February 2020. They will be updated in April 2020.*

GDP
(contribution to annual growth, pp)

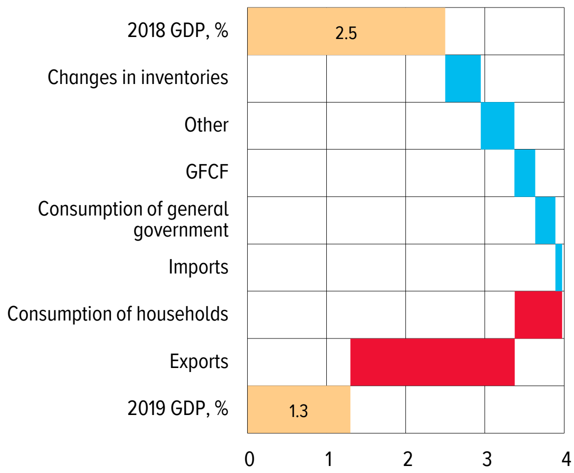
Chart 3.3.1



Sources: Rosstat, Bank of Russia calculations.

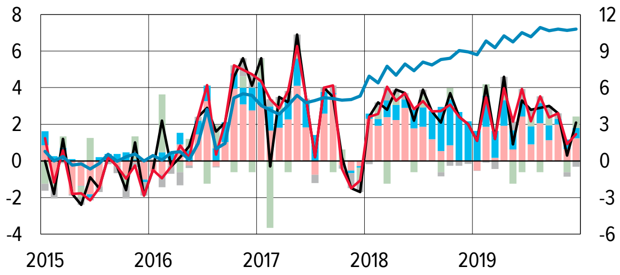
DECOMPOSITION OF CHANGES IN ANNUAL GDP GROWTH
(pp)

Chart 3.3.2



Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL OUTPUT *Chart 3.3.3*
(contribution to annual growth, pp)



Sources: Rosstat, Bank of Russia calculations.

restrictions under the OPEC+ agreement. Export growth year-on-year will amount to 1.5–2.0%, which will mostly result from the low base effect of 2019 with the retention of insignificant quarterly growth rates in 2020.

PRODUCTION ACTIVITY

In 2019 Q4, the industrial production growth slowed down both in annual and in quarterly terms (SA) (Chart 3.3.3). This was primarily driven by the slowdown of raw material output growth and the decline in investment goods production. Annual industrial production growth rates declined to 1.7% in Q2 against 2.9% a quarter before.

Raw material production. The growth of mineral extraction volumes (SA)[5] in Q4 slowed down significantly (Chart 3.3.4). Production of Russian natural gas continued to decline (SA) as a result of lower external demand. The decline of gas supplies to Turkey following the growing competition between the Russian pipeline gas and the Azerbaijani gas (commissioning of TANAP Phase 1) and LNG made a notable negative contribution to export dynamics. The output of liquefied gas (SA), which had supported mineral production significantly since the beginning of the year, contracted in Q4.

Oil and associated gas production did not change a lot as compared with 2019 Q3 (0.2% SA). On the one hand, production volumes in Q4 declined after the outrunning trend in August–September due to the underperformance of the OPEC+ agreement by Russia. On the other hand, crude oil output was somewhat supported by the expected decision to exclude gas condensate from the deal. An increase in production of non-ferrous metal ores in response to the increase in global demand for certain kinds thereof made a significant positive contribution in raw materials output. Production of other minerals, including, rock, sand and clay, also saw significant growth. This may indicate growing volume of construction works under national projects. Coal production revived in Q4 after its decline in 2019 Q2–Q3 due to low prices in Europe.

[5] *Adjusted for seasonal and calendar effects.*

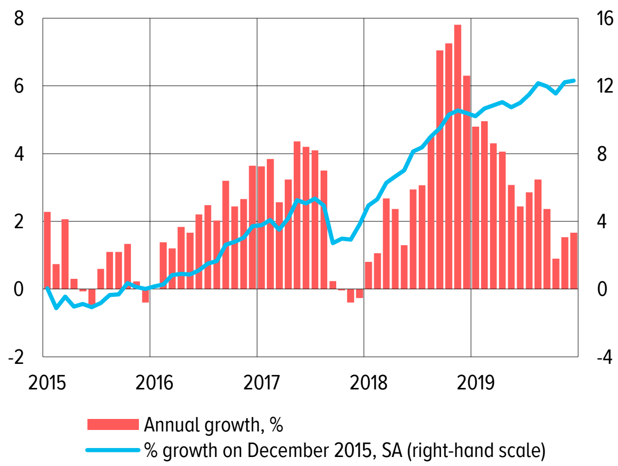
Those trends caused a decline in the annual growth of mineral production volumes from 2.9% in Q3 to 1.3% in Q4 (Chart 3.3.4).

Intermediate goods production. The intermediate goods output (SA) in 2019 Q4 grew against Q3 (on average: +1%; in Q3: 0.4%; Chart 3.3.5). The most substantial growth was observed in oil products output (+3.0 SA), especially in the production of straight-run petrol used as raw feedstock for the petrochemical industry, and in pulp-and-paper production (2.7% SA). Despite the near-zero growth rates of chemical industry output in general, a number of its sectors grew solidly in 2019 Q4 (SA). For example, production of ethylene and plastics made thereof increased significantly due to the commissioning of the largest petrochemical complex in Russia, ZapSibNeftekhim, owned by SIBUR. A notable decline in Q4 (SA) was observed in the ferrous metallurgy due to the full or partial completion of construction of the TurkStream, Nord Stream-2 and Power of Siberia gas pipelines and enhanced restrictions on the imports of Russian steel by European consumers.

Production of investment goods. The output of investment goods in 2019 Q4 decreased (SA) and returned to the Q2 level due to a decline in the output of machine-building products, mostly vehicles, except cars (-1.4 pp) and machine tools (-0.3 pp). The reduction of the vehicle output was probably associated to a large extent with weak dynamics of aircraft production, including civil aircraft. This is particularly evidenced by a notable under-execution of the government programme 'Development of the Aviation Industry for 2013–2025' in 2019 (according to the estimates of the Russian Ministry of Finance, about 40% of the programme budget as of 1 December 2019). The output of investment goods in 2019 Q4 was supported by the production of mechanical equipment and electrical equipment.

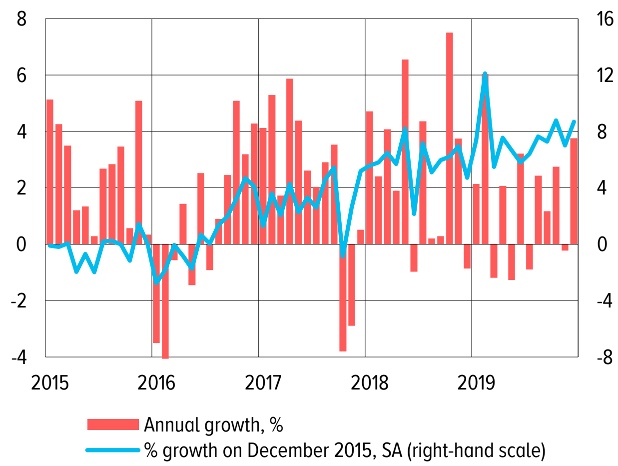
Production of construction materials remained at the level of 2019 Q3. The growth of the output of finished metal items slowed down. However, the output of mineral products continued to decline. According to the Bank of Russia's estimates, production of ceramic tiles (-0.3 pp) and clayware (-0.2 pp) made a

RAW MATERIALS *Chart 3.3.4*



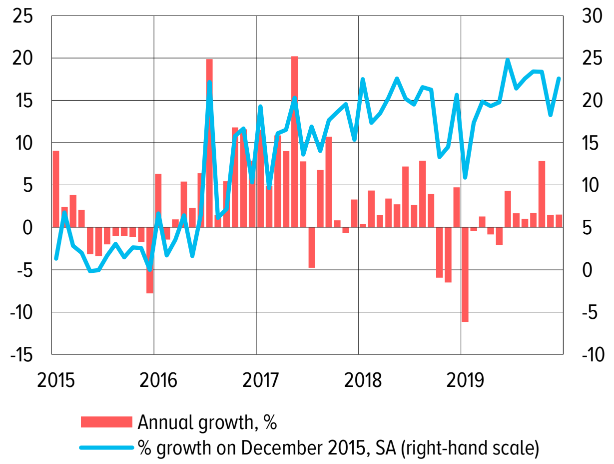
Sources: Rosstat, Bank of Russia calculations.

INTERMEDIATE GOODS *Chart 3.3.5*



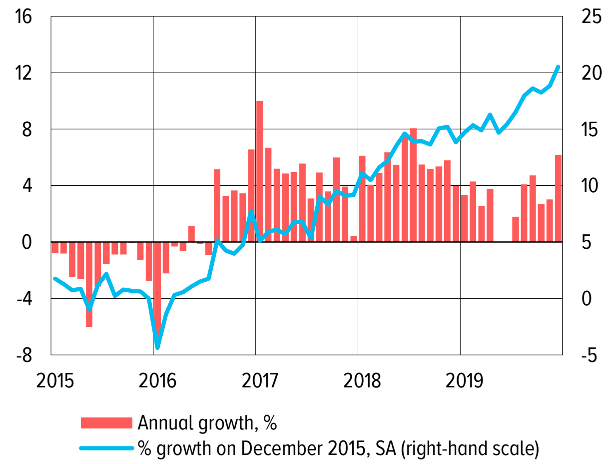
Sources: Rosstat, Bank of Russia calculations.

INVESTMENT GOODS *Chart 3.3.6*



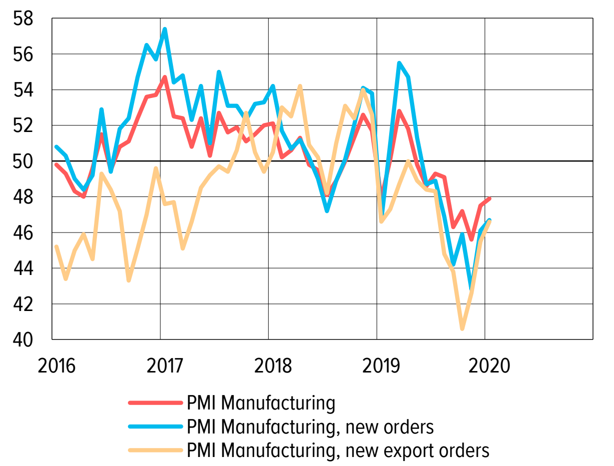
Sources: Rosstat, Bank of Russia calculations.

CONSUMER GOODS *Chart 3.3.7*



Sources: Rosstat, Bank of Russia calculations.

PMI: COMPANIES' ESTIMATES OF DEMAND FOR THEIR PRODUCTS *Chart 3.3.8*
(SA)



Source: IHS Markit.

notable negative contribution to the trend of construction materials output. This could have been caused by weak dynamics in construction, which was particularly evidenced by the slowdown of the growth of construction cargo transportation by railway in October and its decline in November (Chart 3.3.6).

Production of consumer goods. The consumer goods output in 2019 Q4 grew by 1.3% (SA) (in Q3: 1.9%) (Chart 3.3.7). Production of food products observed continuously (SA) since June 2019 was the major contributor to its increase. The average increase in the output in Q4 amounted to 2.6% against the average level of the previous quarter. The output of dairy and meat products (butter, cheese, pork) and processing of plant products (processing of potatoes and vegetables, sugar production) made the biggest contribution to the increase in production of food products.

The output of non-food products decreased over the said period (-1.4% SA), thus offsetting the previous quarter's increase. However, its dynamics were mixed in different types of production. Amid the increase in real disposable income and expanding demand, consumer goods production was growing. Besides, increased export supplies (medicine) also supported certain sectors. At the same time, despite the revival of demand, the output of individual durable goods declined (e.g., household appliances, cars), mostly because of the sale of the reserves of finished goods accumulated earlier.

Business surveys. Russia's PMI Manufacturing index in January amounted to 47.9 points and stayed close to the previous month's level (December: 47.5). Despite little growth, the index has remained below 50 points for the ninth month running, which evidences further deterioration of business sentiment in manufacturing (Chart 3.3.8). Furthermore, the volume of new orders both in the external and domestic markets continued to decline in January, though the decline rate slowed down. At the same time, other outrunning indicators in January demonstrated mixed trends. Amid the decline in oil and gas production, the Rosstat business confidence index in mining and quarrying significantly declined but grew in the manufacturing (Chart 3.3.9). The mixed signals as regards the state of the economy from the Rosstat and IHS Markit indices may be attributed to different samples of respondent companies.[6]

Transport. The transport turnover in 2019 Q4 declined by 0.9% year-on-year (in Q3, -0.2%) (Chart 3.3.10). Freight turnover broken down by transport showed mixed dynamics. The retail trade revival in Q4 contributed to the accelerated growth of motor transportation. Pipeline transportation demonstrated near-zero dynamics. It was supported by the opening of the Power of Siberia pipeline in December 2019. At the same time, railway freight turnover, which had been declining for three months running, made a notable negative contribution to the general dynamics of this indicator. The contraction of railway transportation resulted from the decline in the exports of coal and ferrous metals on the back of sluggish external demand.

Agriculture. A bumper harvest of certain crops, including cereals, sunflower, sugar beet and greenhouse vegetables, as well as high growth of livestock production contributed to the increase in agricultural output in 2019 Q4, according to the estimates, by 4–5%.[7] In December 2019, agricultural production continued to grow due to the increase in pork and milk output.

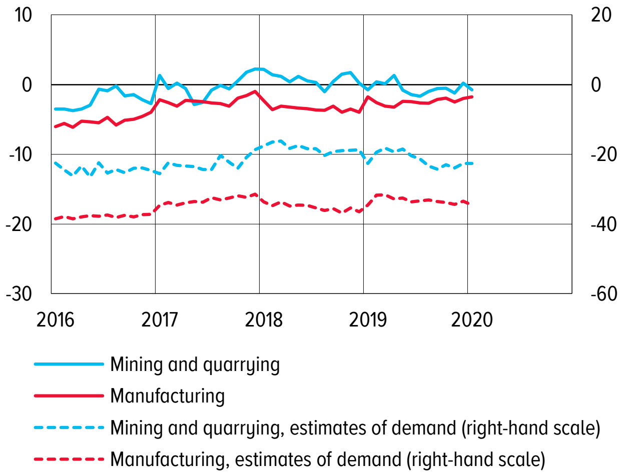
INVESTMENT ACTIVITY

The Bank of Russia estimates that the annual growth of fixed capital investment stood at 0.8% in 2019 Q4, same as in the previous quarter (Chart 3.3.11). That growth was supported by the strengthening of the ruble in 2019 H2 and softening of monetary conditions. The growth of investment activity was explained by an increase in government and infrastructural investments, inter alia, related to the implementation of national projects. At

[6] *Deviations in the survey results by Rosstat and IHS Markit are explained by different sampling of surveyed enterprises and by different calculation methodologies.*

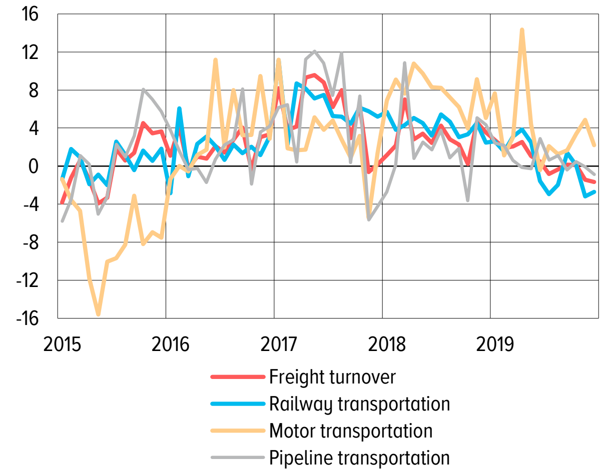
[7] *According to the Rosstat data published on 7 February 2020 (after the meeting of the Bank of Russia Board of Directors), the growth rate of agricultural output in 2019 Q4 amounted to 5.3%, which is close to the Bank of Russia's estimates.*

ROSSTAT BUSINESS CONFIDENCE INDICES *Chart 3.3.9*
(%, SA)



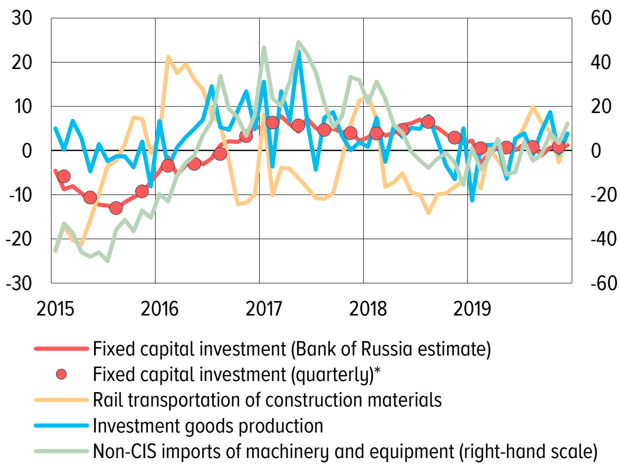
Source: Rosstat.

FREIGHT TURNOVER *Chart 3.3.10*
(% growth on the same month of the previous year)



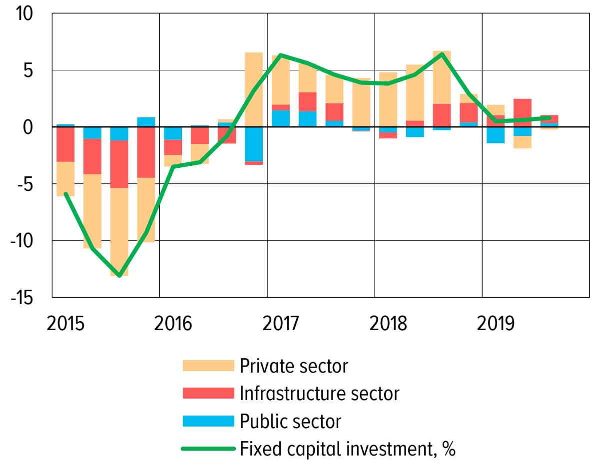
Source: Rosstat.

INVESTMENT ACTIVITY INDICATORS *Chart 3.3.11*
(% growth on the same period of previous year)



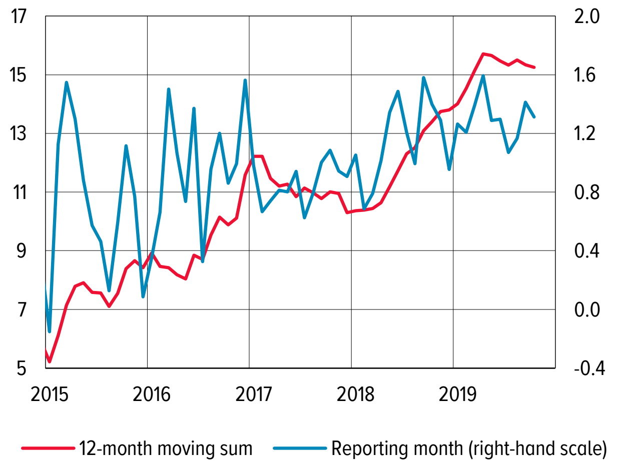
** 2019 Q4 - Bank of Russia estimate.*
Sources: Rosstat, FCS, JSC RZhD, Bank of Russia calculations.

FIXED CAPITAL INVESTMENT
(contribution to annual growth, pp)
Chart 3.3.12



Sources: Rosstat, Bank of Russia calculations.

CORPORATE PROFITS BEFORE TAX, NET OF LOSSES
(trillions of rubles)
Chart 3.3.13



Sources: Rosstat, Bank of Russia calculations.

the same time, the estimated contribution of private fixed capital investments to the annual growth rate of investments in 2019 Q4, like in Q2–Q3, was negative (Chart 3.3.12). In 2020, deferred investment demand and further easing of monetary conditions will support private investments, after which their growth could resume.

The dynamics of indirect investment activity indicators in December 2019 evidenced the preservation of the ascending trend of fixed capital investments. At the beginning of the current year, investment demand is likely to continue to grow, which is evidenced by the increase in engineering imports and growing railway transportation of construction materials. According to estimates, in 2020 Q1, investment activity will continue to be supported by the execution of national projects.

Weak growth of fixed capital investments in 2019 Q4 and near-zero growth of other components were reflected in the gross fixed capital formation dynamics. Its growth in 2019 Q4 is estimated at 0–0.5% year-on-year.

FINANCIAL STANDING OF ENTERPRISES

Financial result. The growth rate of the balanced financial result continues to slow down, but its dynamics already demonstrate signs of stabilisation. The growth rate of the accumulated financial result for the rolling year in November amounted to 11% (here and onwards, changes are against the same period of the previous year, unless indicated otherwise) against 14% in October (Chart 3.3.13).

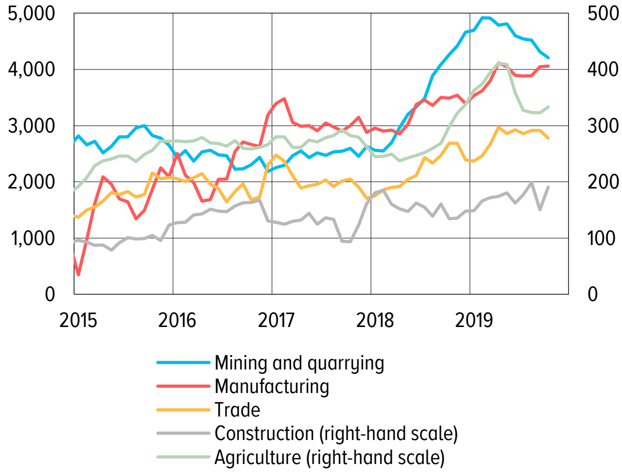
According to the data accumulated since the beginning of 2019, in November, the growth rate of the net financial result somewhat accelerated. In particular, the increase in the financial result over January–November 2019 in all segments amounted to 9.1% (in January–October: 8.5%; peak value in January–April: 51.4%). The structure of the financial result by sectors generally remained unchanged, but the trends of individual sectors changed against the period of January–September (Chart 3.3.14). In November, the financial result in mining and quarrying and in agriculture declined even more (18.6% against 15.3% in January–September, and 14.5% against 12.1%, respectively). In the mining and quarrying sector the biggest decline was observed in coal mining (-60.9%), and in agriculture, in forestry and timber harvesting (-64.3%) In construction, the sharp growth at the beginning of October (84.7%) changed to a 9.3% decline in November. The biggest contraction of the financial result (-62.1%) was observed in the companies performing specialised works in construction (preparing construction sites, cleaning territories, exploration drilling, installing windows, doors, etc.). The growth in manufacturing and trade in January–November slowed down somewhat (16.4% against 18.7%, and 24.0% against 35.2%, respectively). The financial result of a number of manufacturing sectors declined in January–November, in particular, in production of tobacco goods (-15.4%), clothes (-14.2%), leather and leather goods (-46.6%), paper and paper products (-11%), electrical equipment (-12.5%) and finished metal items, except machines and equipment (-13.1%). The contraction of the financial result in trade was observed only in the segment of wholesale and retail trade of motor vehicles and motorcycles and their repair (-12.2%).

The share of profit-making companies in all segments appeared to be somewhat higher than a year before (71.9% against 71.0%), which, along with slower growth of the financial result, may rather indicate contraction of the profit margin than the contraction of product sale opportunities.

The total loss of enterprises in January–November 2019 amounted to almost ₽1.7 trillion, having decreased by 20.8%. Agriculture (2.5 times greater), water supply and disposal (1.3 times), transportation and storage (1.2 times) and construction (1.3 times) remained the leaders by the growth rate of losses in January–November.

Debt. The volume of claims of the banking system against legal entities,[8] including financial institutions, in rubles and foreign currency, grew in 2019 Q4 by 1.5% (in Q3, 1.6%). The positive growth rates were retained due to the trend of ruble-denominated claims, which grew in

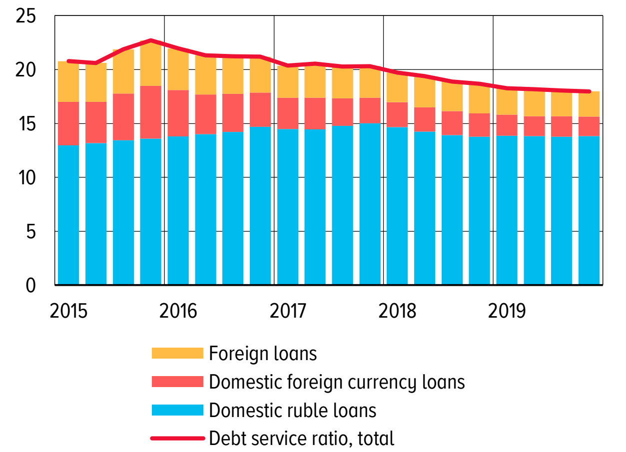
CORPORATE PROFITS BEFORE TAX BY INDUSTRY, NET OF LOSSES
(12-month moving sum, billions of rubles)
Chart 3.3.14



Sources: Rosstat, Bank of Russia calculations.

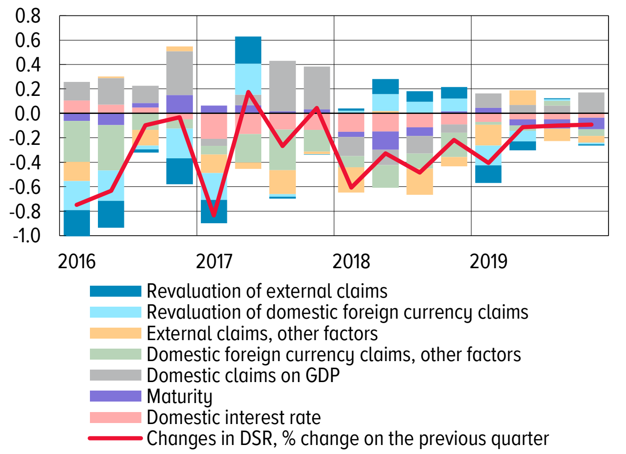
[8] *Includes loans and borrowings, debt securities and other claims.*

NON-FINANCIAL CORPORATIONS TOTAL DEBT BURDEN *Chart 3.3.15*
(debt service ratio and its components, % of GDP)



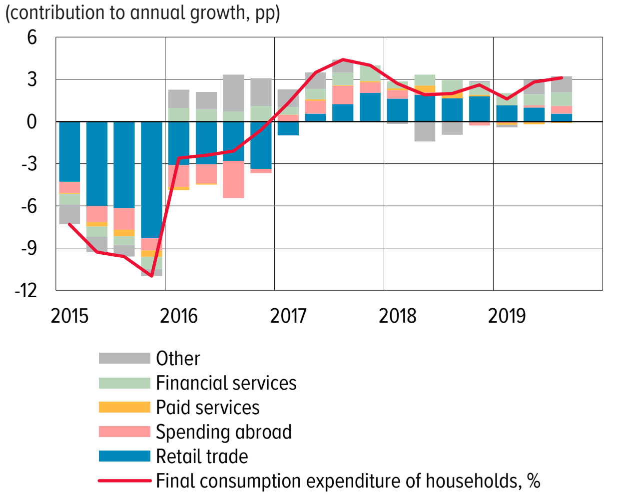
Source: Bank of Russia calculations.

DECOMPOSITION OF CORPORATE DEBT BURDEN DYNAMICS *Chart 3.3.16*
(DSR and contribution of its components, % of GDP)



Source: Bank of Russia calculations.

FINAL CONSUMPTION EXPENDITURE OF HOUSEHOLDS *Chart 3.3.17*
(contribution to annual growth, pp)



Sources: Rosstat, Bank of Russia calculations.

October–December 2019 by 2.5% (In Q3, 1.3%). Foreign currency claims fell by 3.6% in ruble terms over the same period (in Q3, they grew by 3.4%), which is explained by the strengthening of the ruble exchange rate. The growth of the banking system's claims against legal entities in 2019 Q4 amounted to 5.1% year-on-year (in 2018 Q4, 8.4%). However, the debt burden remained almost unchanged as compared with Q3 (Charts 3.3.15, 3.3.16): the quicker growth of ruble-denominated domestic claims against the GDP growth rates compensated the downward pressure of the combination of other factors.

CONSUMPTION AND SAVINGS

Household final consumption expenditure In 2019 Q3, the growth of household final consumption expenditure accelerated to 3.1% year-on-year (in Q2, 2.8%) (Chart 3.3.17), which exceeded the Bank of Russia's estimates.[9] The expansion of consumer activity was mostly due to the increase in retail expenditures abroad and in foreign online stores, while the growth of retail trade turnover slowed down. Furthermore, an increase in demand for financial services was observed. According to the Bank of Russia's estimates, in 2019 Q4 the growth of household final consumption expenditure slowed down to 2.5–3.0% because of the high base effect of the previous year. It was supported by the accelerated growth of retail sales during the said period. Household final consumption expenditure grew by 2.3% as of end of 2019.

Retail trade turnover. 2019 Q4 saw a revival of retail trade. The annual growth rate of its turnover accelerated to 2.0% (in Q3, 0.9%) (Chart 3.3.18). This resulted from both the slowdown of inflation and improved consumer sentiment amid increasing household income (see 'Labour market and incomes'). The most notable acceleration of retail trade turnover growth year-on-year was observed in November among non-food goods (in November: 3.0%; in October and December: 2.1%). Sales of durable goods grew the most, namely, furniture, washing machines and refrigerators. This could be associated with a more successful 'Black

[9] *In MPR 4/19, the expected annual growth rate of household final consumption expenditures was 2.0–2.5%.*

Friday' sale[10] than the year before. According to a GfK report, sales of household appliances and electronics during the 'Black Friday' week in 2019 grew by 35.3% against the previous week, which is 5 pp higher than in 2018.

The Bank of Russia's estimates that the retail trade turnover will grow by 2.8–3.2% year-on-year on the back of further growth of revenues and the slowdown of inflation in 2020 Q1.

Consumer sentiment. The expansion of consumer activity was accompanied by an improvement in consumer sentiment. The Rosstat consumer confidence index in 2019 Q4 was the highest during the year. The results of the inFOM survey also confirm the improvement of sentiment: in October 2019–January 2020 the consumer sentiment index exceeded the values of the previous months.[11] The attitude of respondents towards large purchases was the most positive since May 2018, and the maximum value of the index was observed in November. Besides, the assessment of the current and future changes in the personal financial standing of respondents also grew significantly.

Savings ratio. In 2019 Q4, the savings ratio remained near the level of the previous quarter (Chart 3.3.19). Compared with the beginning of the year, it was elevated due to the slowdown of consumer lending growth and the inflow of funds in retail deposits, mostly with the maturity of over one year (see Section 3.2).[12]

LABOUR MARKET AND INCOMES

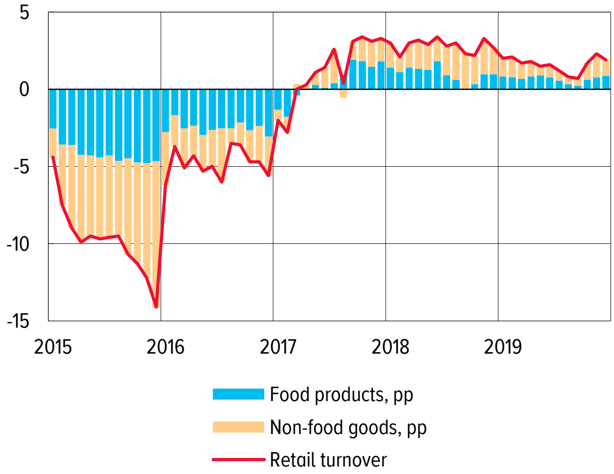
Unemployment. In October–December 2019, unemployment stayed close to the average levels of the past months (4.5–4.6% SA, Chart 3.3.20). According to an IHS Markit PMI survey, the number of employees decreased in manufacturing. That is indicated by the PMI Manufacturing employment index, which was negative throughout October–December (47.7–48.0 SA, Chart 3.3.21). The PMI in services remained positive (51.4–52.1 SA). The overall situation in the labour market did not change

[10] *'Black Friday' was on 29 November 2019.*

[11] *See the information and analytical comment 'Inflation Expectations and Consumer Sentiment' (No. 1 (37), January 2020).*

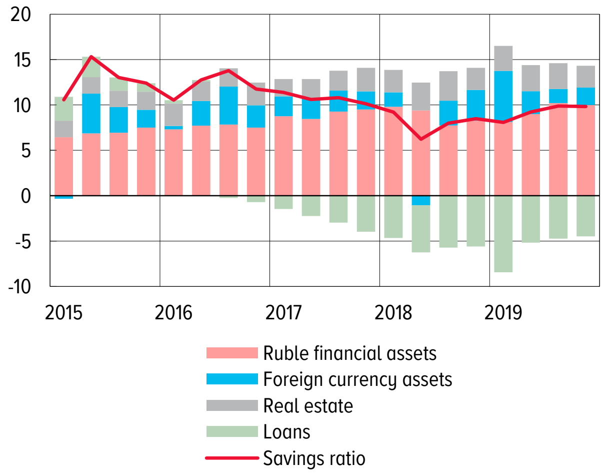
[12] *See the information and analytical material 'Banking Sector Development in 2019'.*

RETAIL TURNOVER *Chart 3.3.18*
(% growth on the same month of the previous year)



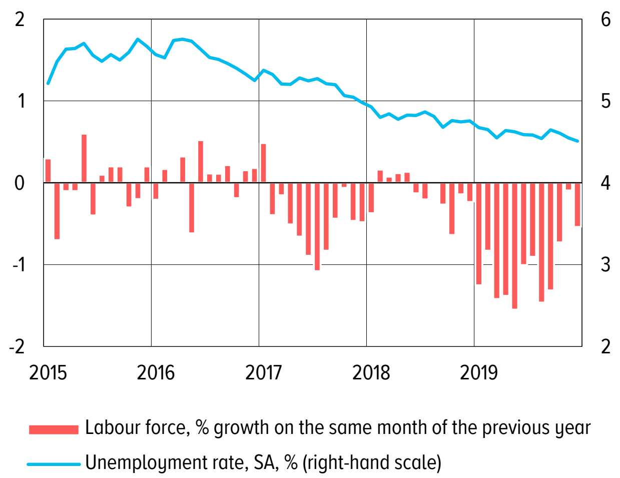
Sources: Rosstat, Bank of Russia calculations.

SAVINGS RATIO *Chart 3.3.19*
(% of household disposable income, SA)



Sources: Rosstat, Bank of Russia calculations.

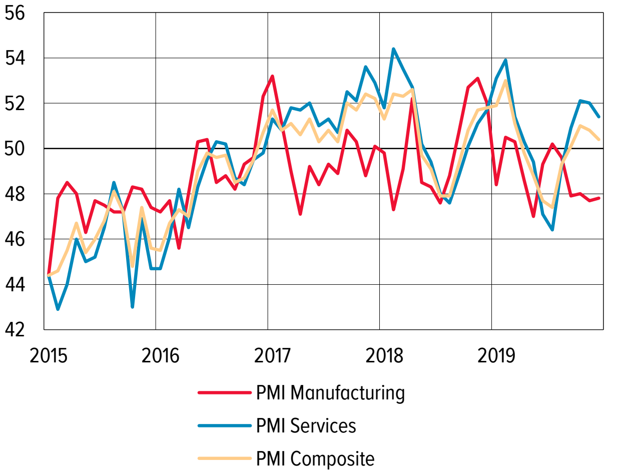
UNEMPLOYMENT RATE AND LABOUR FORCE *Chart 3.3.20*



Note. For comparability purposes, the statistics on annual labour force growth in 2015 are given excluding the Republic of Crimea and Sevastopol.
Source: Bank of Russia calculations.

PMI FOR EMPLOYMENT
(SA)

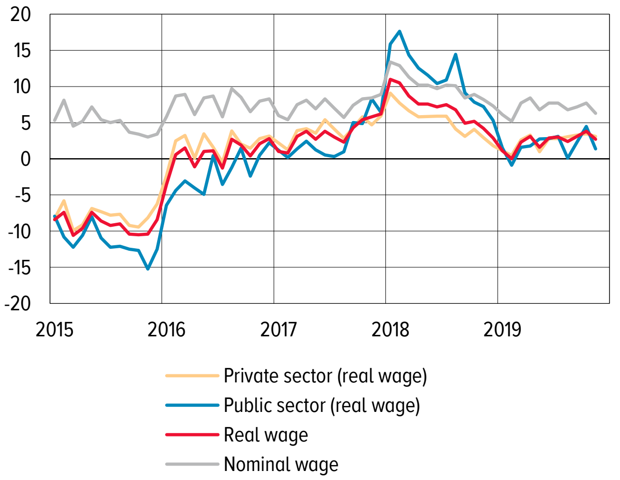
Chart 3.3.21



Source: IHS Markit.

WAGE
(% growth on the same month of the previous year)

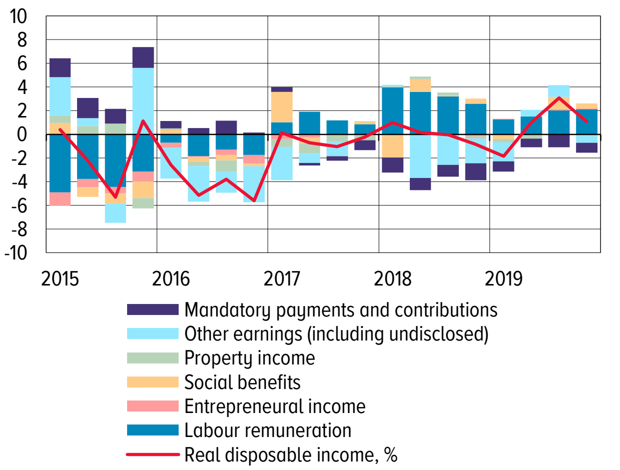
Chart 3.3.22



Sources: Rosstat, Bank of Russia calculations.

REAL HOUSEHOLD DISPOSABLE MONEY INCOME
(contribution to annual growth, pp)

Chart 3.3.23



Sources: Rosstat, Bank of Russia calculations.

significantly: survey indicators remained within their volatility spread with no significant structural changes.

Wages. Real wages in October–November 2019 grew by 2.7–3.8% year-on-year (Chart 3.3.22). Real wages in the budget sector grew at an outrunning pace in October, mostly due to the indexation of the wages of government employees and servicemen by 4.3% starting 1 October 2019, and also due to a shift in the seasonality of certain payments (from November to October). The annual growth in the private sector remained at the level of September. According to the Bank of Russia's estimates, real wages grew by 2.5–3.0% on average in 2019. In 2020 Q1, growth is expected to accelerate to 3.5–4.0% due to a further slowdown in price growth and the dynamics of labour income in the budget sector, where the main driver will include 5.4% wage indexation in the social and cultural sectors.[13]

Household incomes. In 2019 Q4, growth in real disposable household income slowed down to 1.1% year-on-year (Chart 3.3.23). This resulted from the contraction of other income (including undisclosed earnings) and a slowdown in the growth of social benefits. That said, remuneration of employees continued to be the main contributor to income growth.

3.4. PUBLIC FINANCES

From September to the end of 2019, the fiscal policy stimulated internal demand. However, as of 2019 year-end, the budget sector made a negative contribution to the economic dynamics because of the tough policy in the first half of the year. In 2019, the federal budget was executed with a surplus of 1.8% of GDP. The non-oil and gas deficit of the federal budget declined by 0.6 pp of GDP as compared with 2018, to 5.4% of GDP. Furthermore, at the beginning of 2019, it was planned that as of 2019 year-end the non-oil and gas deficit of the federal budget would amount to 6.0% of GDP.[14]

[13] *See the Guidelines for the Fiscal, Tax, and Customs and Tariff Policy for 2020 and the 2021–2022 Planning Period.*

[14] *In accordance with Federal Law No. 459FZ, dated 29 November 2018, 'On the Federal Budget for 2019 and the 2020-2021 Planning Period'.*

The under-execution of the federal budget expenditure in 2019 amounted to ₽281 billion, including ₽150 billion under national projects. The balance of budgetary funds in accounts with the banking system in 2019 was, on average, higher than in 2018. Fiscal rule-based foreign currency purchases in 2019 amounted to $46 billion. The Ministry of Finance of Russia fully performed the borrowing programme for 2019. As of year-end, the federal government debt amounted to 12.4% of GDP, including external debt of 3.1% of GDP.

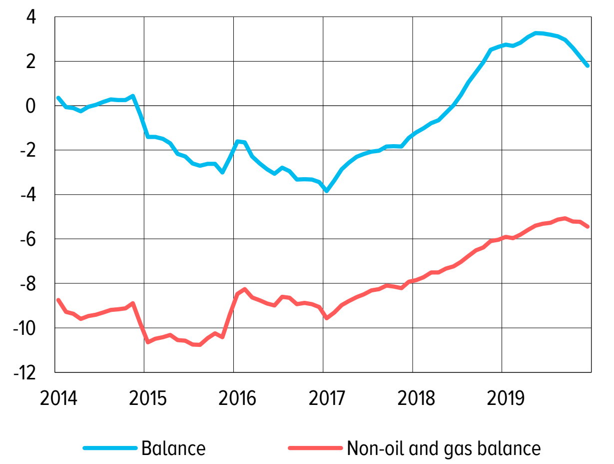
Macroeconomic effects of fiscal policy. In September–December, the fiscal policy produced a positive effect on economic activity. Growing capital public expenditure in 2019 H2 supported the investment activity in 2019 Q3–Q4. The wage indexation in the budgetary sector performed in September–October made a positive contribution to household revenues and, consequently, to the household final consumption expenditure in 2019 Q4. Household demand in 2020 will be supported by the January indexation of insurance pensions (by 6.6%) and wages in the social sector (by 5.4% on average). The Bank of Russia estimates that, in 2020, the fiscal momentum will be positive.

The package of social and demographic measures announced in the Presidential Address to the Federal Assembly of the Russian Federation on 15 January 2020 will mainly facilitate the growth of household consumption in 2020.

Federal budget. The preliminary assessment of the execution of the federal budget in December 2019[15] suggests that the nature of the fiscal policy has remained accommodative since September. However, as of 2019 year-end, the contribution to the aggregate demand and inflation was restraining. This is indicated by the non-oil and gas deficit, which declined by 0.6 pp of GDP to 5.4% of GDP (Chart 3.4.1). The under-execution of the federal budget expenditure in 2019 amounted to ₽281 billion, including ₽150 billion under national projects. Non-oil and gas revenue exceeded the target by ₽120 million.

[15] *Progress report on the fulfilment of the federal budget as of 1 January 2020 (Federal Treasury).*

FEDERAL BUDGET BALANCE *Chart 3.4.1*
(12-month moving sum, % of GDP)



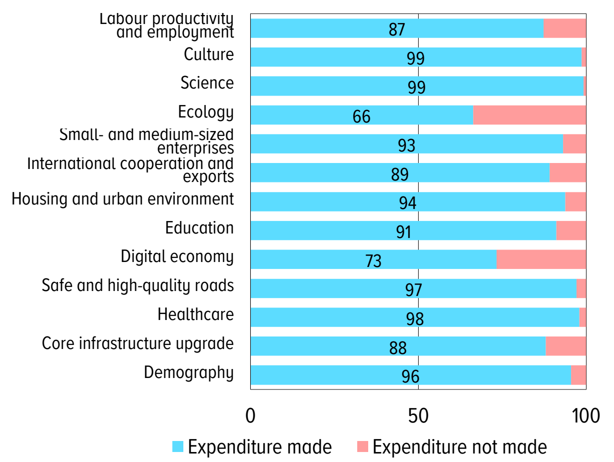
Sources: Federal Treasury, Bank of Russia calculations.

BUDGET SYSTEM PARAMETERS *Table 3.4.1*
(12-month moving sum, % of GDP)

	2017	2018	Nov 2019	Dec 2019
General government				
Revenue	33.8	35.8	35.9	
Spending	35.3	32.9	33.5	
Balance	-1.5	2.9	2.4	
Central government				
Revenue	16.4	18.6	18.4	18.4
Oil and gas revenue	6.5	8.6	7.4	7.2
Extra oil and gas revenue (excess revenue)	0.9	4.1	2.8	2.7
Non-oil and gas revenue	9.9	10.0	10.9	11.2
Spending	17.9	16.0	16.2	16.6
Balance	-1.4	2.6	2.2	1.8

Sources: Federal Treasury, Bank of Russia calculations.

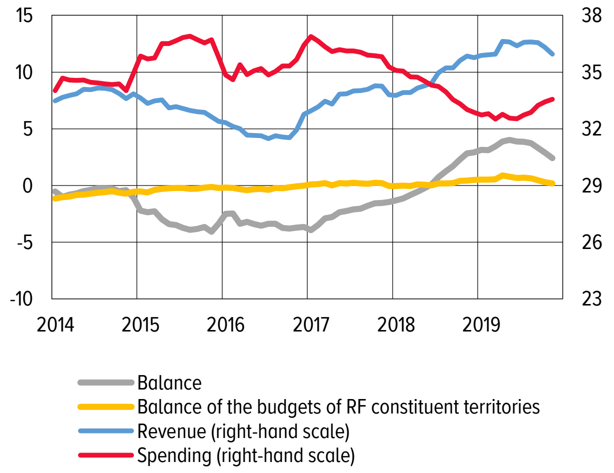
FEDERAL BUDGET SPENDING ON NATIONAL PROJECTS IN 2019 *Chart 3.4.2*
(%)



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

GENERAL GOVERNMENT BALANCE
(12-month rolling total, % of GDP)

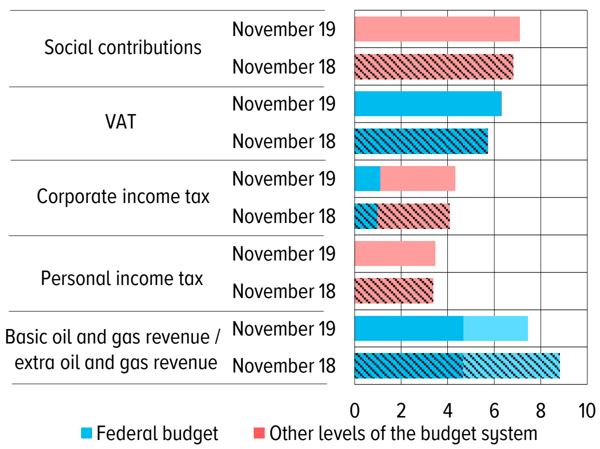
Chart 3.4.3



Sources: Federal Treasury, Bank of Russia calculations.

BUDGET REVENUE COMPOSITION, MAJOR TAXES
(January-November, % of GDP)

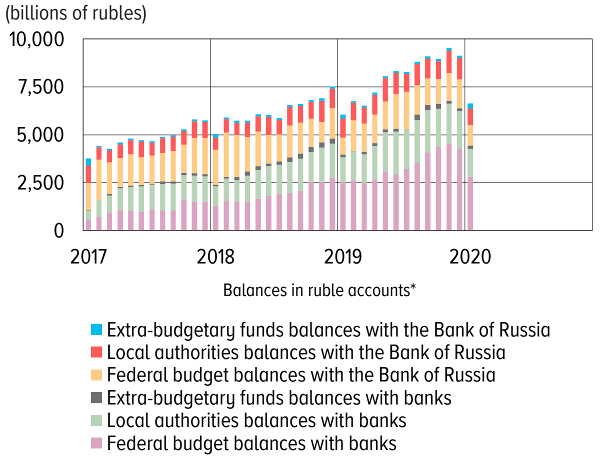
Chart 3.4.4



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

BALANCES OF BUDGET SYSTEM FUNDS IN RUBLE ACCOUNTS WITH BANKS AND THE BANK OF RUSSIA
(billions of rubles)

Chart 3.4.5



** According to banking reporting form 0409301 'Performance indicators of a credit institution' of the Bank of Russia's balance sheet.*
Source: Bank of Russia.

The federal budget surplus in Q4 continued to decline and reached 1.8% of GDP by the end of 2019 (Table 3.4.1). The reduction in the surplus was due to slower revenue growth and faster execution of expenditures. In 2019, the annual growth of expenditure (+8.9%) was higher than the growth of revenue (+3.7%). The slowdown of the annual revenue growth (after +7.5% in the end of 2019 Q3) was caused by a quicker decline in oil and gas revenue (to -12.1% YoY) as a result of a lower oil price vs the previous year. Instead, the annual growth rate of expenses in 2019 Q4 accelerated and was particularly high as of year-end under such items as 'Education and healthcare' (+22.2%), and 'National economy' (+17.6%). The execution of expenditure under national projects as of 2019 year-end amounted to 91.4% of the annual target.[16] In 2019 Q4, the expenditure of the federal budget for the implementation of national projects amounted to 42% of the annual volume, including 21% of the final amount in December. As of year-end, the following national projects showed a high percentage of execution (over 95%): 'Culture', 'Science', 'Healthcare', 'Demography', 'Safe and high-quality roads' (Chart 3.4.2). However, the execution of capital-intensive projects was poor ('International cooperation and export': 89%; ' Comprehensive plan for upgrading and expanding core infrastructure ': 88%; 'Digital economy': 73%; 'Environment': 66%) (Chart 3.4.2).

General government budget. In November 2019, the budget system surplus for the rolling year declined to 2.4% of GDP[17] (at the end of Q3, 3.3% of GDP) (Table 3.4.1). It was driven, among other factors, by the reduction of the regional budget surplus (Chart 3.4.3). In November, this figure continued to decline to 0.2% of GDP vs the April maximum level of 0.9% of GDP. As of the end of November 2019, the growth rate of general government budget expenditures accelerated to 8.0% in annual terms (in the

[16] Preliminary data on the execution of federal budget expenditures for the implementation of national projects (Ministry of Finance of Russia, as of 17 January 2020).

[17] The monthly report of the Federal Treasury 'On the execution of the consolidated budget of the Russian Federation and budgets of state extra-budgetary funds' as of 1 December 2019.

end of Q3, 7.4%), including the growth rate of investment expenditures[18] amounting to 15.6%. The growth of earnings slowed down to 5.6% (in the end of Q3, 8.6%). A decline in the growth of income tax receipts (to 11.3%) and personal income tax receipts (to 8.0%) led to a slowdown in the growth of non-oil and gas revenue (to 11.1%) in the first 11 months of 2019. However, the share of receipts to the GDP from the main non-oil and gas taxes in the first 11 months of 2019 appeared to be higher than for the same period of 2018 (Chart 3.4.4).

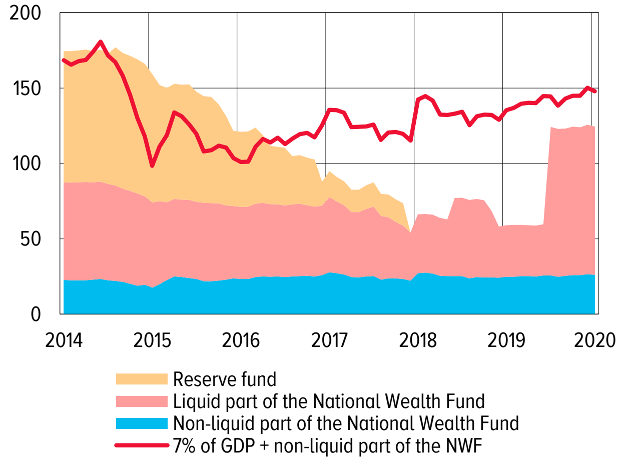
Balances of funds in budget accounts with the banking system. In December, the budget system agencies reduced their balances of funds in the banking system to finance budget expenditure (Chart 3.4.5). In particular, the amount of funds placed by the Federal Treasury with credit institutions decreased almost twofold (see Section 4.2). Nevertheless, as of 2019 year-end, the ruble balance of funds of the general government increased due to the incomplete execution of budget expenditures.

National Wealth Fund. The volume of the National Wealth Fund as of 1 January 2020 totalled $125.6 billion (7.1% of GDP in 2019), including the liquid part of $99.1 billion (5.6% of GDP, Chart 3.4.6). As of 1 January 2020, the special foreign currency account of the federal budget accumulated $46.2 billion (2.6% of GDP) received from fiscal rule-based purchases of foreign currency in the amount of extra oil and gas revenue of 2019 (Chart 3.4.7). After this amount is transferred to the NWF (in the middle of 2020), the liquid part of the Fund will exceed the threshold of 7% of GDP, thus making it possible to invest NWF funds in other eligible financial assets.

Public debt. According to the Ministry of Finance of Russia, the cumulative federal public debt of the Russian Federation in 2019 increased by 7.8% as compared with the previous year to 12.4% of GDP, which was 0.3 pp of GDP higher than a year ago (Chart 3.4.8). The cumulative federal debt grew owing to the internal debt (+10.8% as compared with 2018).

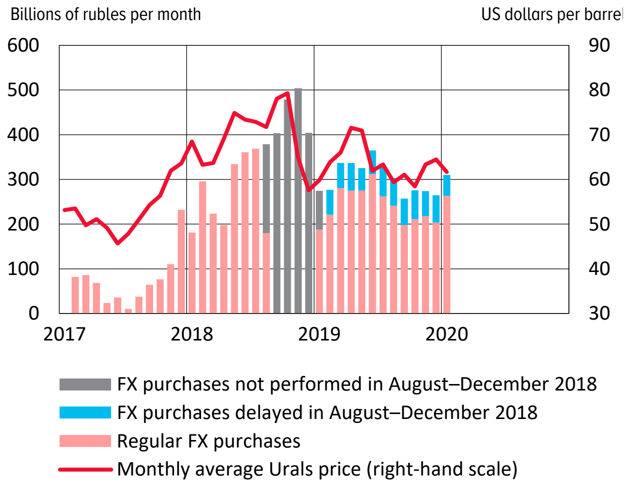
[18] *Capital investment in government property.*

SOVEREIGN FUNDS OF THE RUSSIAN FEDERATION *Chart 3.4.6*
(billions of US dollars)



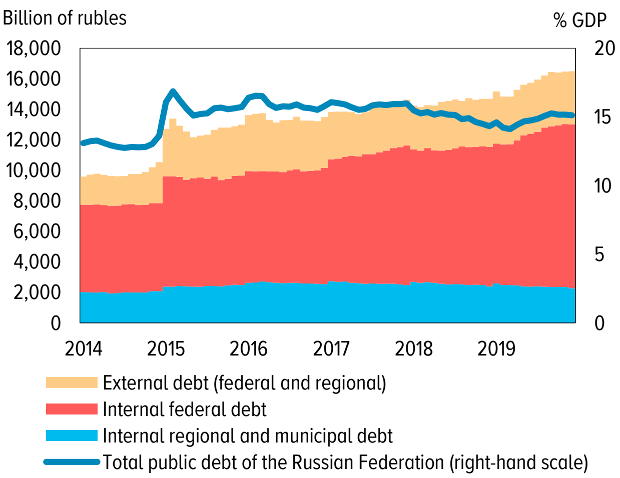
Sources: Ministry of Finance, Bank of Russia calculations.

OPEN MARKET OPERATIONS TO REPLENISH THE NATIONAL WEALTH FUND *Chart 3.4.7*



Sources: Ministry of Finance, Bank of Russia.

PUBLIC DEBT OF THE RUSSIAN FEDERATION *Chart 3.4.8*
(billions of rubles)



Source: Ministry of Finance.

External federal debt, despite the growth of its US dollar equivalent (+11.6%), remained almost unchanged when converted into the national currency due to the strengthening of the ruble, and amounted to 3.1% of GDP.

In 2019, the Ministry of Finance of Russia reached the annual target on borrowings and placed OFZs worth ₽2.08 trillion.[19] In 2020 Q1, the Ministry of Finance plans a placement worth ₽600 billion.

[19] Federal Law No. 459FZ, dated 29 November 2018, 'On the Federal Budget for 2019 and the Plan Period of 2020 and 2021' (as amended on 2 December 2019).

4. THE BANK OF RUSSIA'S MONETARY POLICY

4.1. KEY RATE DECISIONS

Key rate decisions. On 7 February, the Bank of Russia Board of Directors decided to cut the key rate by 25 bp to 6.00% per annum.

Over the period since the meeting of the Board of Directors on 13 December, annual inflation has continued to go down more quickly than expected. According to the Bank of Russia's estimates, inflation indicators reflecting the most sustainable price movements over the said period were close to or below 3%. On the back of the slowdown of annual inflation, households' inflation expectations and businesses' price expectations remained generally stable. However, according to the Bank of Russia's estimates, disinflationary risks still exceeded proinflationary ones over the short-term horizon during the said period, primarily due to the state of domestic and external demand. In this context and given the monetary stance, the Bank of Russia retained in February its 2020 forecast of annual inflation within the range of 3.5–4.0%, while admitting that annual inflation might approximate 2% in Q1, which is below the forecast given in Monetary Policy Report 4/19.

In addition, beginning in December, the Bank of Russia, when making its key rate decisions, continued to take into account possible proinflationary risks associated with trends in the food market, as well as the impact on inflation of the easing of monetary policy being implemented since June 2019.

Following its February decision, the Bank of Russia also noted that the situation with the coronavirus spread and the schedule of budget expenditure remain important factors of uncertainty over the 2020 horizon.

In late 2019–early 2020, monetary conditions continued to ease. Among other things, this was driven by the decision to reduce the key rate made by the Board of Directors in December, as well as by the signal regarding the future stance of monetary policy which was given following the December meeting. Yields on federal government bonds, as well as deposit and loan interest rates decreased.

In 2019 Q4, economic activity indicators mostly continued to improve. In late 2019, investment activity was supported by an accelerated increase in capital budget expenditure, including owing to the implementation of national projects. Annual retail turnover and industrial output continued to expand. However, the decline in external demand for Russian exports amid the global economic slowdown still restrained economic activity. In this context, in February, the Bank of Russia kept its GDP growth forecast for 2020–2022 overall unchanged. Furthermore, the Bank of Russia also noted that the implementation of the additional social measures announced in January will not have a considerable pro-inflationary impact over the forecast horizon.

Mid-term monetary policy. Considering the Board of Directors' February decision, the key rate has reached the lower bound of the Bank of Russia's neutral rate range: 2–3% p.a. in real terms and 6–7% p.a. in nominal terms (given the inflation target – close to 4%). If the situation develops in line with the baseline forecast, the Bank of Russia holds open the prospect of further key rate reduction at its upcoming meetings. In its key rate decision-making, the Bank of Russia will take into account actual and expected inflation dynamics relative to the target and economic developments over the forecast horizon, as well as risks posed by domestic and external conditions and the reaction of financial markets.

Throughout the forecast horizon, the Bank of Russia will pursue monetary policy in such a way as to ensure inflation stabilisation close to 4%.

Effect of the decisions made on key rate expectations. Since the release of Monetary Policy Report 4/19, market expectations regarding the key rate have generally remained almost unchanged. At its December meeting, the Bank of Russia Board of Directors decided to cut the key rate to 6.25% (by 25 bp). Following that meeting, the Bank of Russia also emphasized that disinflationary risks continued to prevail over proinflationary ones over the short-term horizon. In addition, in its signal the regulator noted that it will consider the necessity of a further key rate reduction in 2020 H1. In this context, most analysts and financial market participants still expected that the key rate would be cut further to 6.00% p.a. in 2020 Q1 and remain at this level until the end of 2020.

In view of the developments in the global economy and in Russia's economy, as well as the new data on inflation movements released, the proportion of financial market participants expecting a key rate cut as early as in February was progressively increasing in January–early February. Accordingly, shortly before the February decision on the key rate, most analysts and financial market participants expected a 25 bp key rate reduction to 6.00% p.a. at the upcoming meeting.

The expectations of financial market participants regarding the path of the Bank of Russia key rate were reflected in the dynamics of money and stock market rates, including federal government bonds and corporate bonds (see Subsection 3.2 for more details).

4.2. SYSTEM OF MONETARY POLICY INSTRUMENTS AND OTHER MONETARY POLICY MEASURES

Banking sector liquidity. The surplus of structural liquidity increased from ₽3.0 trillion to ₽3.6 trillion in December 2019–January 2020 (Chart 4.2.1, Table 4.2.1). As of the end of 2019, it amounted to ₽2.8 trillion, which was below the Bank of Russia's forecast of ₽3.6–3.9 trillion. A smaller-than-expected liquidity inflow via the budget channel in December was the main reason behind this deviation. In its forecast, the Bank of Russia assumed that if the budget expenditures planned for 2019 were partially carried over to 2020 and onwards, the Federal Treasury would be able to increase the amount of funds offered for depositing with banks. However, credit institutions' debt under these transactions reduced twofold over December.

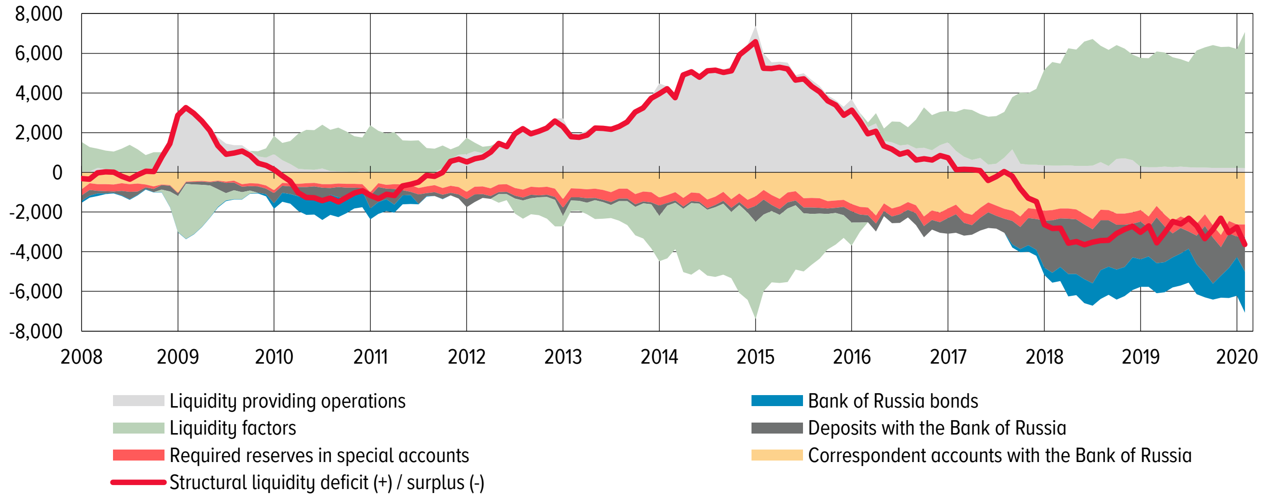
Banks somewhat delayed their required reserves averaging, which became another factor causing the downward deviation of the actual surplus from the forecast. At the beginning of the averaging period, banks' strategies were influenced by expectations of a key rate cut at the Bank of Russia Board of Directors' meeting on 13 December. After the key rate decision, banks gradually increased their correspondent account balances. Taking into account the seasonal shift of budgetary expenditures to the last week of the year and the fact that after the holidays there was still one week remaining before the end of the required reserves averaging period, the balance in banks' correspondent accounts at year-end was ₽2.6 trillion, which was ₽0.3 trillion more compared to the Bank of Russia's forecast.

Budget account operations. In December, the liquidity inflow was driven by a seasonally large amount of budget account operations. However, the increased expenditures did not fully offset their lagging over the year. At the same time, the Federal Treasury and local governments significantly reduced the amount of deposits with banks and claims on other operations for the management of temporarily available balances of budgetary funds. Thus, credit institutions' debt on Federal Treasury operations decreased from ₽3.2 trillion to ₽1.6 trillion in December.

At the beginning of 2020, the Federal Treasury recommenced to gradually build up the amount of funds placed with banks. As a result, by the end of January, the liquidity inflow totalled ₽0.5 trillion. In addition, about ₽0.1 trillion was

BANK OF RUSSIA BALANCE SHEET
(start of business, billions of rubles)

Chart 4.2.1



Source: Bank of Russia calculations.

STRUCTURAL LIQUIDITY SURPLUS AND LIQUIDITY FACTORS
(trillions of rubles)

Table 4.2.1

	December 2019	January 2020
1. Liquidity factors	-0.1	0.9
– change in the balances of general government accounts with the Bank of Russia, and other operations*	0.3	0.5
– change in cash in circulation	-0.4	0.4
– Bank of Russia interventions in the domestic FX market and monetary gold purchases	0.0	0.0
– regulation of banks' required reserves with the Bank of Russia	0.0	0.0
2. Change in free bank reserves (correspondent accounts)	0.2	0.0
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	-0.3	0.9
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	0.0	0.0
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	-2.8	-3.6

** Including fiscal rule-based operations to buy (sell) foreign currency in the domestic FX market, settlements on Bank of Russia USD/RUB FX swaps, and other operations.*
Source: Bank of Russia calculations.

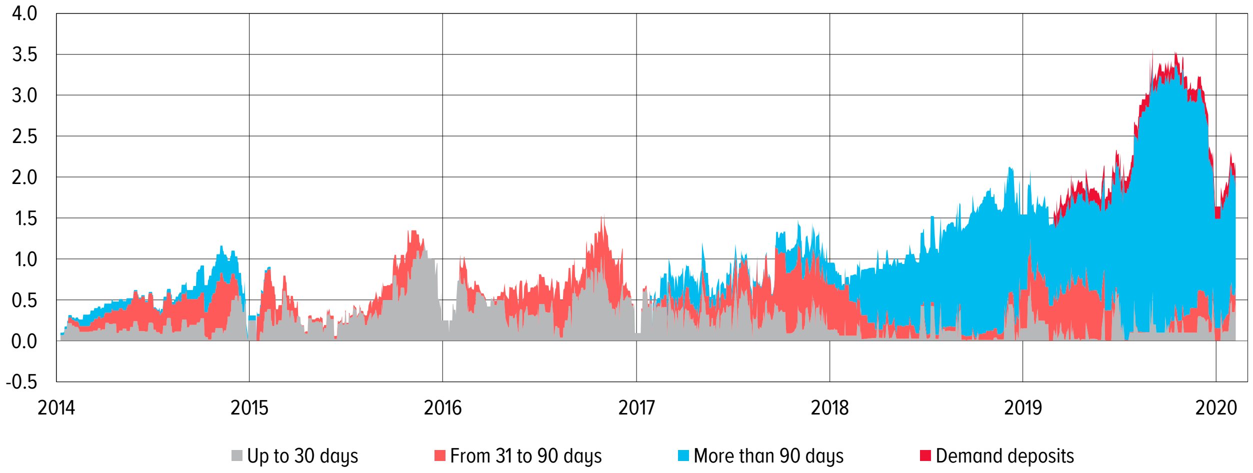
repaid to banks through the OFZ operations of Russia's Ministry of Finance. Given the coupon yield payments, these redemptions exceeded the amount of placements of government securities over the said period. Budget expenses and banks' proceeds from VAT refunds increased in January 2020 compared to previous years. Overall, the above operations exceeded the outflow of funds caused by bank clients' large tax payments.

Cash in circulation. In December, the outflow of liquidity from banks was driven by an increase in the amount of cash in circulation. For most of the month, this indicator stayed close to the previous year's readings. However, the last day of December saw a liquidity inflow to banks. Nevertheless, the receipts in January 2020 were less by the same amount. A possible reason was that retail enterprises had completed the recording of their cash receipts a little earlier than usual. Thus, as a result of the change in the amount of cash in circulation, the liquidity outflow in December and the inflow of funds in January were somewhat below the forecast.

Monetary policy instruments. The Bank of Russia continued to gradually increase the volume of coupon bond (coupon OBR) placements in order to absorb the stable

BANKS' OUTSTANDING AMOUNTS ON FEDERAL TREASURY DEPOSITS, REPOS AND SWAPS
(trillions of rubles)

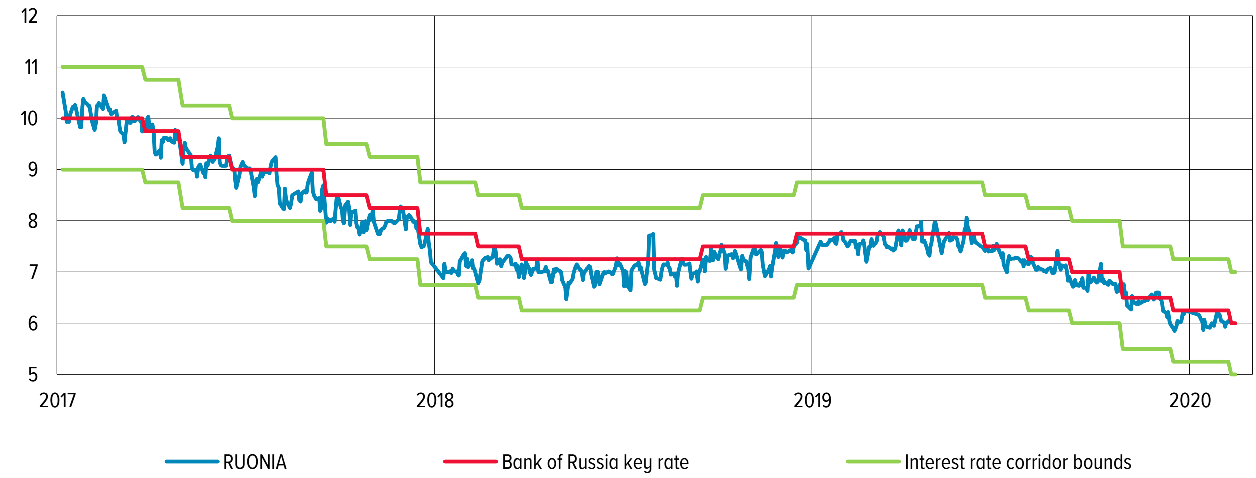
Chart 4.2.2



Sources: Federal Treasury, Bank of Russia calculations.

RUONIA AND BANK OF RUSSIA INTEREST RATE CORRIDOR
(% p.a.)

Chart 4.2.3



Source: Bank of Russia.

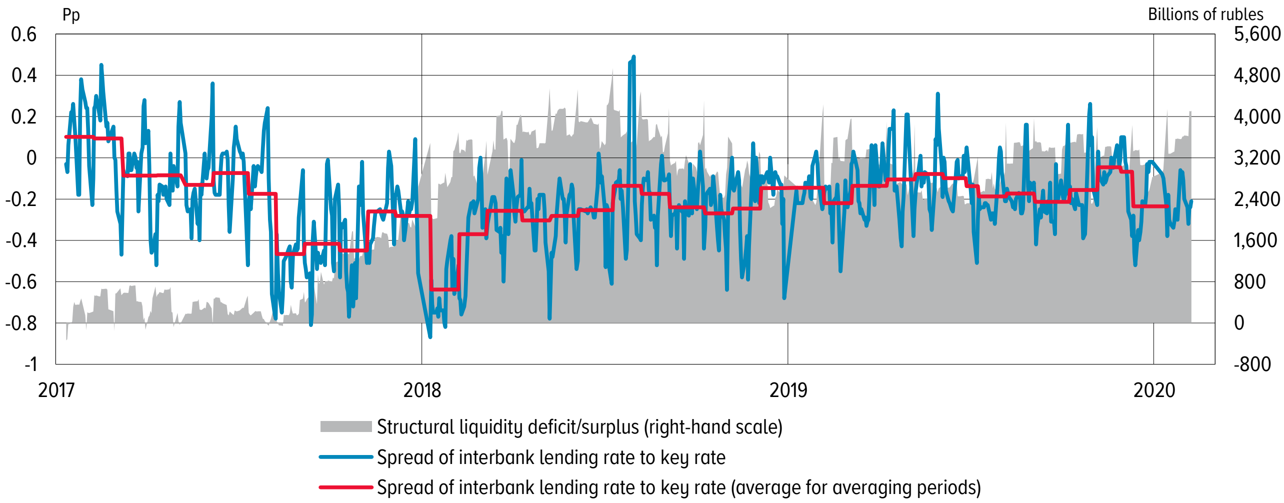
component of the banking sector's structural liquidity surplus. Thus, banks' investments in this instrument rose by ₽0.6 trillion in December 2019–January 2020. Considering the actual situation in the money market and the level of credit institutions' demand for coupon OBRs, in January 2020, the Bank of Russia changed its approach to setting the minimum price for its coupon OBRs at auctions for their placement (additional placement). The minimum price for new coupon OBR issues will be set at the level of 100% of their par value, which implies that there will be no premium to the Bank of Russia key rate.

The forecast structural liquidity surplus for the end of 2020 is ₽3.4–3.9 trillion. As before, the Bank of Russia expects that the surplus will somewhat expand in subsequent years, driven by the resumption of fiscal rule-based foreign currency purchases in the domestic market suspended in 2018.

Achieving the operational objective of monetary policy. Short-term interbank lending rates in the money market stayed in the lower half of the interest rate corridor, close to the Bank of Russia key rate (Chart 4.2.3). The average spread equalled -21 bp in December–

STRUCTURAL LIQUIDITY SURPLUS AND MONEY MARKET RATES

Chart 4.2.4



Source: Bank of Russia calculations.

January (vs -14 bp in Q4), fluctuating from -40 to -2 bp (vs from -52 to 26 bp in Q4).

The spread widened in some periods, which was associated with banks' delays in required reserves averaging, explained by, among other factors, the expectations for a key rate cut at the Bank of Russia Board of Directors' meeting. At the end of December, the spread narrowed after large tax payments. However, it slightly expanded again in early January, due to a seasonal inflow of budgetary funds and changes in the amount of cash in circulation.

BOXES

ON ECONOMIC EFFECTS OF THE MEASURES SPECIFIED IN THE PRESIDENTIAL ADDRESS TO THE FEDERAL ASSEMBLY IN 2020–2024

In his Address to the Federal Assembly of the Russian Federation on 15 January 2020 (hereinafter, 'the Address'), the President proposed a range of social and demographic measures aimed at improving the birth rate, the quality of life and welfare of low-income households, as well as at enhancing education and healthcare. The measures that are the most important ones from the perspective of fiscal policy and social and demographic policy, as well as in terms of budget allocations required for the implementation of these measures, are specified in Table 1 and Chart 1.

Depending on the way of financing the expenses for the implementation of the measures mentioned in the Address, their ultimate effect on GDP will differ.[1] Below are the estimates of the impact of the said measures in the conditions where their financing does not entail a rise in tax burden.

Additional payments to class teachers (₽5 thousand per month), hot meal provision at schools, and an increase in the number of state-funded places at schools and medical universities will impact GDP due to the specifics of the income-based calculation of this indicator. Therefore, the direct impact of this measure on 2020 GDP will total +₽110 billion, or approximately 0.09–0.1% of GDP. Moreover, positive secondary effects are possible.

Payments for children aged 3 to 7 are a social transfer, which may influence GDP through consumer demand growth that will partially drive imports and consumer prices. The use of the total government expenditure multiplier suggests that this measure may increase GDP by ₽70–80 billion, or nearly 0.06–0.07% of GDP.

The package of social and demographic measures may have a more comprehensive effect on GDP, both in 2020 and onwards. Some people who will receive the maternity capital in 2020 will use this money in subsequent years. Moreover, they will not spend the maximum possible limit (Chart 2, Table 2). Thus, over the period of 2011–2018, the actual use of the maternity capital by the recipients averaged 85–86% (Table 2) of the maximum possible amount. In 2010–2019, the actual budget expenditure for the maternity capital programme totalled 94–95% of the target. A notable decline in the level of these expenses has been observed in recent years because of the optimistic assumptions regarding the birth rate factored in the budget (Chart 2).

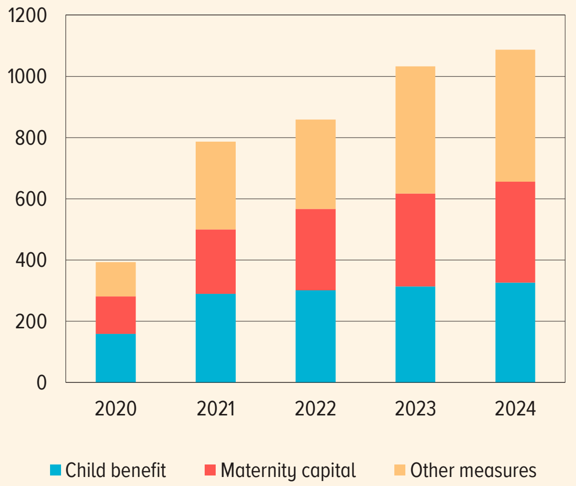
ADDITIONAL BUDGET EXPENDITURES FOR THE IMPLEMENTATION OF THE SOCIAL AND DEMOGRAPHIC MEASURES IN 2020–2024, ACCORDING TO THE DRAFT AMENDMENTS TO FEDERAL LAW NO. 380-FZ, DATED 2 DECEMBER 2019, 'ON THE FEDERAL BUDGET FOR 2020 AND THE 2021–2022 PLANNING PERIOD' *Table 1*
(February 2020)*

No	Social and demographic measures	Estimates of additional budget expenditures in 2020–2024	
		2020	2020–2024
1	Maternity capital for the birth of the first child, in the amount of ₽466.6 thousand.	₽122 billion	₽1.2 trillion
2	Maternity capital increase by ₽150,000 after the birth of the second child – from ₽466,6 thousand to ₽616,6 thousand		
3	Social allowance for children aged 3–7 in the amount of ½ of the subsistence minimum of a child in a given region (≈ ₽5.5 thousand) and the full amount of the subsistence minimum (≈ ₽11 thousand) starting from 2021	₽159 billion	₽1.4 trillion
4	Measures in education (additional payments to class teachers in the amount of ₽5,000, provision of free hot meals to primary school pupils, increase in the number of state-funded places at schools and medical universities, etc.), tax investment deduction, etc.	₽112 billion	₽1.5 trillion
Total additional budget expenditures		**₽393 billion**	**₽4.1–4.2 trillion**

** According to the estimates of Russia's Ministry of Finance*
Sources: Administration of the President of the Russian Federation (kremlin.ru), Ministry of Finance of the Russian Federation.

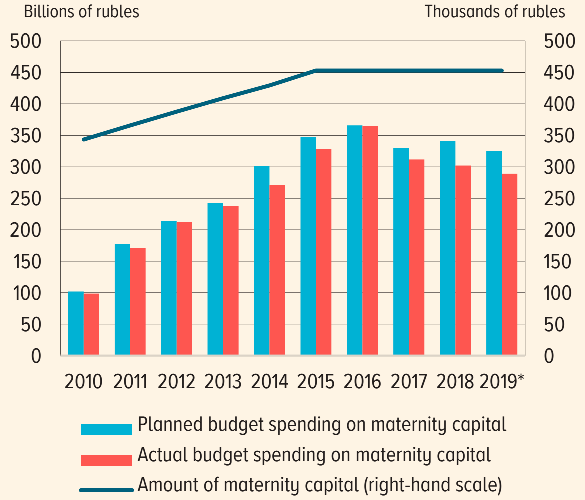
[1] *Additional expenses may be financed both through improving the collection of the main taxes and non-tax revenues, as well as by raising funds or using the carry-over balances of funds of the budget system.*

VOLUME AND STRUCTURE OF ADDITIONAL BUDGET SPENDING AIMED AT IMPLEMENTING SOCIAL AND DEMOGRAPHIC MEASURES *Chart 1*



Source: Ministry of Finance.

BUDGET SPENDING ON MATERNITY CAPITAL IN 2010-2019 *Chart 2*



** Estimate.*
Sources: Pension Fund, Federal Treasury, Rosstat, Bank of Russia calculations.

MATERNITY CAPITAL PAYMENTS IN 2011–2018 *Table 2*

	2011	2012	2013	2014	2015	2016	2017	2018
Number of second-born children in families, thousands of persons	647	694	701	728	737	727	652	622
Maternity capital certificates issued, thousands of units	700	724	787	823	1 041	925	727	698
Number of people who used the maternity capital, thousands of persons	521	643	700	767	798	848	855	855
Ratio of the actual budget expenditure for the maternity capital to the maximum possible expenditure, %	89,9	85,2	83,0	82,2	90,9	95,1	80,5	78,0

Sources: Pension Fund of Russia, Federal Treasury, Rosstat, Bank of Russia calculations.

Given these facts, changes in the maternity capital payment parameters will cost the budget system approximately ₽120–130 billion in 2020 (Table 1, lines 1 and 2). Households' welfare (wealth) will increase by the same amount in 2020. However, these funds are not likely to be used in consumption or invested in full amount over 2020.

Their impact on GDP will depend on the consumer behaviour model. If the wealth increase is used in a uniform manner, the effect on GDP in 2020 will amount to ₽7–10 billion (this estimate is based on the average mortgage loan term).[2] Conversely, if the entire wealth increase is used in consumption or invested in housing construction over the current year, this can result in higher GDP growth in 2020 by ₽60–70 billion, or 0.06% of GDP. However, this is unlikely to happen. These measures will have the greatest effect if an increase in wealth becomes the determinative for households' housing purchase decisions. In this case, residential property purchases using loans will boost demand for real estate, which will be 3–4 times higher than the increase in households' wealth. However, then households will have to service this debt, which will reduce their disposable income.

These measures are not expected to have a significant impact on investments in 2020. In subsequent years, housing construction investments may grow because of a rise in relative prices for residential property and higher attractiveness of housing construction for investors.

[2] *When the maternity capital is used to improve housing conditions by repaying mortgage loans, this reduces monthly interest payments for borrowers, and households thus get additional available funds that can be used in consumption or saved.*

According to the Bank of Russia's estimates, if additional expenses are financed using the carry-over balances of budget funds or borrowings, the overall positive effect of fiscal policy over the calendar year will approximate ₽190–200 billion, which will add 0.17–0.18 pp to GDP growth.

This effect may be enhanced by measures promoting investment through encouraging local authorities to implement the investment tax deduction (by compensating for 2/3 of the shortfall in income from federal budget funds). However, the impact of this measure on investment is rather hard to estimate since there is no information on the target amounts and structure of budget expenditures in this area.

Taking into account probable time lags associated with the regulatory and legislative approval of the measures proposed, their effect on the output will manifest only beginning in 2020 H2.

As estimated by Russia's Ministry of Finance, these liabilities may be financed in 2020 by using additional non-oil and gas revenues, reallocating expenses between different items in favour of social areas, using the carry-over balances of budget expenditures not used in 2019, as well as the excess amount of the actual 2019 non-oil and gas revenue above the level factored in the budget law. As long as such adjustments are not expected to cause any major changes in the budget system balance (as % of GDP), the effect of the implementation of these measures on inflation in 2020–2022 is estimated as limited. The Bank of Russia will consider potential influence of the additional fiscal measures on the medium term forecast after the approval of the package of amendments to Federal Law No. 380-FZ, dated 2 December 2019, 'On the Federal Budget for 2020 and the 2021–2022 Planning Period'.

USING DIFFERENT PRICE DYNAMICS INDICATORS

The inflation target close to 4% was determined on the basis of Rosstat's consumer price index (CPI) calculated against the same month of the previous year[1] (annual inflation).

In its analysis of price movements, the Bank of Russia also relies on the indicators of price changes compared to the previous month (hereinafter, monthly price growth values are annualised) and the 12-month moving average inflation (average annual inflation) (Chart 1). The use of different price indicators, each of which has its own specifics, provides a comprehensive picture of inflation. We will consider the correlation between the said indicators using the example of changes in prices for all goods and services.

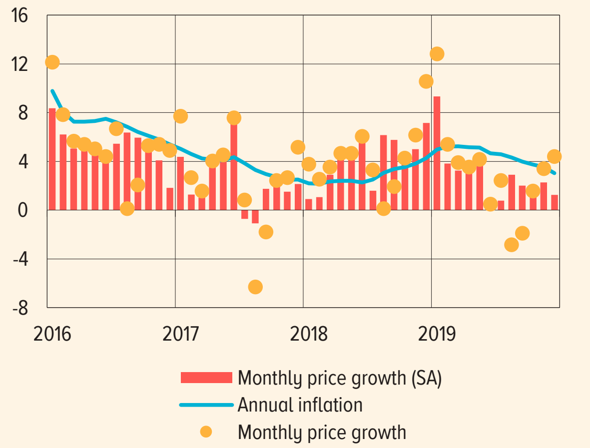
Seasonally adjusted monthly inflation. Monthly inflation indicators reflect current price dynamics. They are not exposed to the base effect. However, they are characterised by regular fluctuations during a year (seasonality) which do not affect annual inflation. To exclude these fluctuations from movements of goods and service prices, we apply a seasonality adjustment algorithm.[2] Seasonally adjusted (SA) indicators enable the comparative analysis of current price dynamics in individual months.

Annual inflation. This indicator corresponds to target inflation and is understandable to general public. This is the ratio of the price level in the current month to the price level in the same month of the previous year. Thus, this indicator shows the average price growth over a year. By its structure, annual inflation is the total of 12 monthly price increases.

Moving average inflation. The analysis of longer-term price trends is based on the average annual indicator measuring the average price level over the last 12 months compared to the average price level over the previous 12 months. It is less exposed to the influence of one-off factors which exhaust their effect within a short period (up to a year) due to the averaging of positive and negative significant price increases over a year. Average annual inflation dynamics enable measuring average inflationary pressure over the last year.

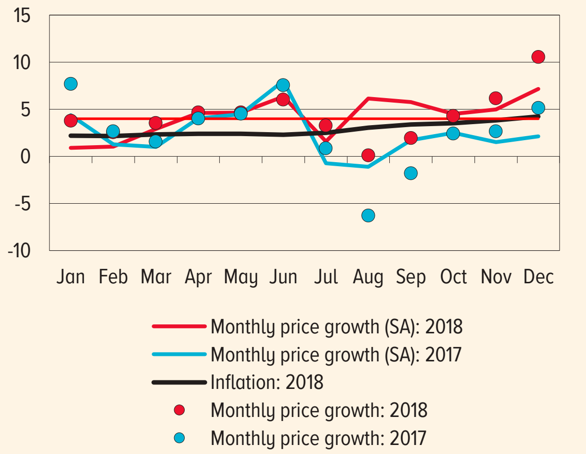
There are some specifics in measuring price growth over a long period. Such indicators depend on price dynamics for several previous periods. For instance, average annual inflation depends on annual inflation readings for the last 12 months. In turn, annual inflation is assessed based on monthly price increases over the last year. However, current price dynamics may differ. Thus, in April–December 2018, the monthly price increase (SA) stayed above 4% (except July 2018) (Chart 2). In addition, annual inflation remained stable

DYNAMICS OF INFLATION INDICATORS *Chart 1*



Sources: Rosstat, Bank of Russia calculations.

RELATION BETWEEN MONTHLY AND ANNUAL PRICE GROWTH IN 2017–2018 *Chart 2*

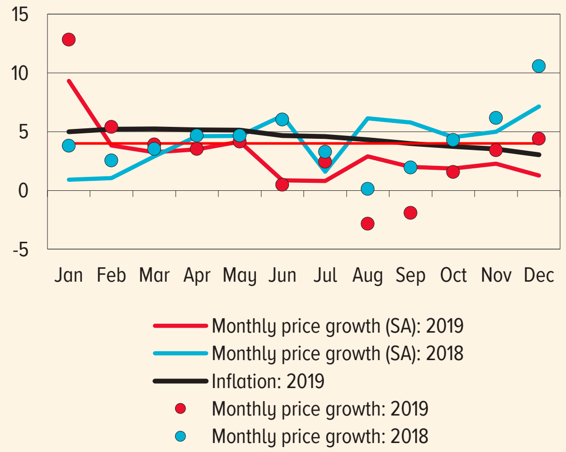


Sources: Rosstat, Bank of Russia calculations.

[1] *For more details about choosing the target indicator of price dynamics, refer to the subsection 'BoR Monetary Policy' in the section 'Monetary Policy' on the Bank of Russia website, www.cbr.ru/DKP/about_monetary_policy/inflation.*

[2] *See the Review of Methodological Specifics of Consumer Price Index Seasonal Adjustment in the Bank of Russia. Working Paper Series. No. 33. June 2018, www.cbr.ru/Content/Document/File/44277/wp33.pdf.*

RELATION BETWEEN MONTHLY AND ANNUAL PRICE GROWTH IN 2018–2019 *Chart 3*



Sources: Rosstat, Bank of Russia calculations.

enough, not exceeding 2.5% until July 2018, while average annual inflation was declining. Beginning in August 2018, inflation started to grow, while reaching 4% only in December. Low annual inflation was due to the monthly price increases in 2017 H2: they were negative (SA) in July–August, and approached 2% starting in September. Therefore, the acceleration of annual inflation in 2018 H2 (from 2.5% to 4.3%) was primarily associated with the following: the low monthly price increases in 2017 were excluded from the calculation, while the monthly price growth (SA) in 2018 was relatively stable.

The same effect was observed in the 2019 price dynamics, and it will maintain in 2020. Thus, inflation remained relatively stable in March–May 2019 because the difference between the assessments of the monthly price increases in the corresponding months of 2018 and 2019 was insignificant (Chart 3). Starting in June, annual inflation was slowing down as the high monthly price increases recorded in 2018 were excluded from the calculation. This effect had the maximum impact on inflation in December 2019–January 2020, when the influence of the VAT rate hike on 1 January 2019 was excluded from the calculation base. According to the Bank of Russia's estimates, inflation will remain low in the first half of the current year, as long as its rate will factor in the low readings of the monthly price increases in June–July 2019. As the low monthly price increases in 2019 H2 are excluded from the calculation, inflation will speed up and reach 3.5–4.0% by the end of the year, while average annual inflation will continue to go down for much of 2020. In this context, the assessment of monthly price increases (SA) will be a more up-to-date and informative indicator of the acceleration of inflationary pressure and the return of inflation to 4%.

IMPACT OF CHANGES IN EXCISE RATES ON INFLATION IN 2020

The Tax Code of the Russian Federation provides for annual indexation of excise rates for certain goods in the consumer basket used to calculate the consumer price index. The excise rates for petrol, diesel fuel, cigarettes and cars were raised beginning on 1 January 2020. Furthermore, the WTO requires equal conditions for domestic and foreign manufacturers. For this reason, the preferential excise rates for wine and champagne with a protected geographical indication and designation of origin were cancelled from the beginning of 2020 (Table 1).

The excise rates for alcoholic beverages are expected to rise the most. A full pass-through of the excise tax increase to retail alcohol prices, all else being equal, will increase average prices for beer by 0.8%, for wine – by 3.5%, and for strong alcoholic drinks – by 1.2%. As a result, the contribution to annual inflation will approximate 0.08 pp.

From the beginning of this year, the excise rates for cigarettes grew by 2.8%. All else being equal, this will cause a rise in cigarette prices by 1.4%. However, tobacco products account for a small share in the consumer basket when the consumer price index is calculated. Therefore, the contribution of the tobacco excise rate increase to inflation will be insignificant (below 0.02 pp).

The motor fuel excise rates will rise in 2020 by 3.5% on average. As a result, prices for petrol and diesel fuel will go up by 0.7% and 0.5%, respectively. That said, an increase in motor fuel prices not exceeding the inflation rate will not trigger any undesirable secondary effects caused by higher producer costs. The contribution to annual inflation will approximate 0.03 pp.

Starting from 1 January 2020, the excise rates for cars will grow by 4.0%. All else being equal, this will cause an average increase in retail car prices by 0.2%. Thus, the rise in the excise rates for cars will have a minor impact on inflation.

The overall contribution of the excise rate growth to annual inflation may approximate 0.15 pp (Table 2).

EXCISE RATE MOVEMENTS AND THEIR SHARE IN EXCISABLE GOODS PRICES *Table 1*
(%)

Excisable goods	Excise growth in 2020	Excise share in consumer prices in 2019
Alcoholic beverages, beer	4.8	17.6
Alcoholic beverages, wine	158.8*	4.2*
Alcoholic beverages, strong alcoholic drinks	4.0	31.1
Tobacco products	2.8	49.5
Motor petrol	3.5	21.1
Diesel fuel	3.4	15.6
Cars	4.0	4.0

** Taking into account the cancellation of the preferential excise rates for wine and champagne with a protected geographical indication and designation of origin.*
Sources: Rosstat, Federal Tax Service, Tax Code of the Russian Federation, Bank of Russia calculations.

MOVEMENTS OF EXCISABLE GOODS PRICES AND THEIR EFFECT ON INFLATION *Table 2*

Excisable goods	Consumer price growth in 2020, %	Contribution to annual inflation in 2020, pp
Alcoholic beverages, beer	0.8	0.01
Alcoholic beverages, wine	3.5*	0.05*
Alcoholic beverages, strong alcoholic drinks	1.2	0.02
Tobacco products	1.4	0.02
Motor petrol	0.7	0.03
Diesel fuel	0.5	0.00
Cars	0.2	0.01
Overall contribution to inflation		0.15*

** Taking into account the cancellation of the preferential excise rates for wine and champagne with a protected geographical indication and designation of origin.*
Sources: Rosstat, Federal Tax Service, Tax Code of the Russian Federation, Bank of Russia calculations.

ANNEXES

ECONOMIC SITUATION IN RUSSIAN REGIONS

In December 2019, inflation in most Russian regions continued to slow down and became more homogeneous across regions. The improvement of real wage dynamics that emerged in September in most regions boosted growth of consumer activity that was the most pronounced in the Central Federal District. Growth of consumer demand in the Central FD also determined the overall positive dynamics of economic activity in November. In other districts it largely depended on the effect of short-term factors in individual sectors (primarily, construction) and remained mixed. That said, the improvement in the dynamics of real wages and consumer activity in all federal districts came amid a uniform slowdown in consumer lending and failed to have a considerable proinflationary effect.

PRINCIPAL ECONOMIC AND INFLATION INDICATORS BY FEDERAL DISTRICT *Table 1*
(%)

	Central FD	North-Western FD	Southern FD	North Caucasian FD	Volga FD	Urals FD	Siberian FD	Far Eastern FD
Inflation (December)	3.0	3.0	2.7	3.2	2.7	3.1	3.6	3.9
Economic activity indicator (YoY, November)	3.1	-1.1	-1.4	4.1	-0.3	-1.5	-1.3	-3.1
Industrial output (YoY, November)	5.2	2.5	0.3	2.5	0.2	2.1	-0.1	-0.9
Retail trade turnover (YoY, November)	3.8	0.5	2.9	2.6	1.6	0.9	2.3	2.2
Volume of paid services (YoY, November)	2.2	-2.3	-0.4	0	-0.4	-2.9	-2.9	-4.5
Volume of construction works (YoY, November)	-7.8	-17.7	-39.7	33.0	-13.1	-18.6	-11.3	-11.5
Growth in outstanding amounts on household loans (YoY, December)	20.3	19.8	20.1	18.5	16.7	15.3	16.0	17.6
Growth in outstanding amounts on corporate loans (YoY, November)	3.3	5.6	5.7	8.9	-1.2	6.6	3.6	30.0
Real wage (YoY, November)	2.9	1.2	3.4	2.8	3.5	1.6	1.7	2.7
Unemployment rate (Q4)	2.9	3.6	5.3	11.1	4.1	4.1	5.8	6.3

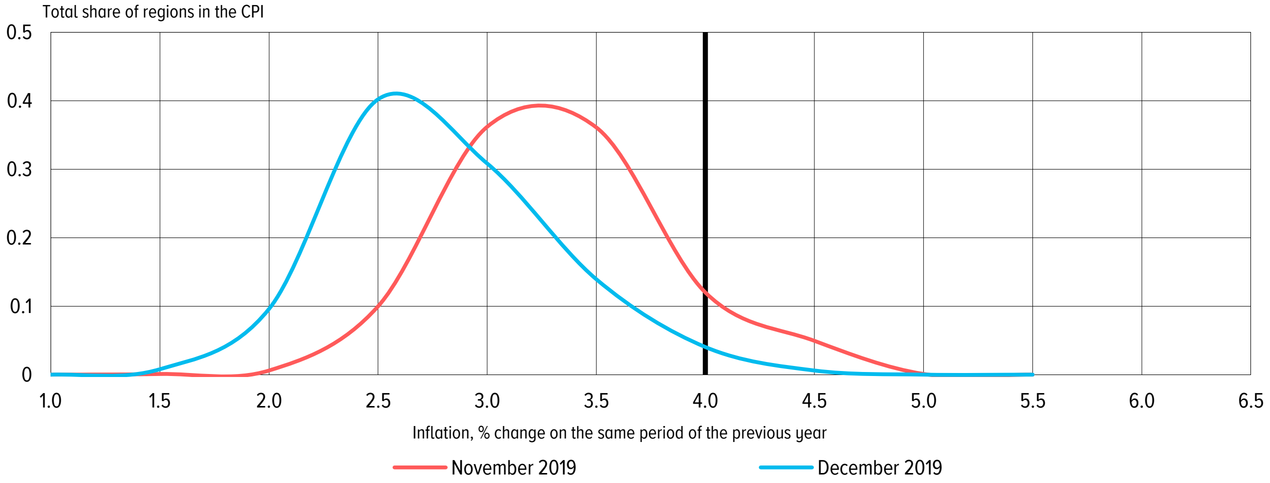
Sources: Rosstat, Bank of Russia.

INFLATION AND PRICE EXPECTATIONS

DISTRIBUTION OF REGIONS BY INFLATION LEVEL

In December, inflation continued to slow down in the majority of regions (80 out of 85). The deceleration was the most pronounced in the North Caucasian (by 0.7 pp) and Southern (by 0.6 pp) federal districts. Food inflation was the main contributor to the slowdown in the rate of price growth in these regions and countrywide. Inflation accelerated in three regions where its readings were significantly lower than Russia's average indicators (Khanty-Mansi Autonomous Area, Yamalo-Nenets Autonomous Area and Altai Republic), and in two Far Eastern constituent territories (Sakhalin Region and Primorye Territory). As in the previous months, the trend towards a decline in price growth seen throughout Russia came amid less heterogeneous dynamics across regions (Chart 1). In December, the values of annual inflation in Russian regions were in the range from 1.6% (Yamalo-Nenets Autonomous District) to 4.8% (Amur Region), with the national average of 3.0%. Inflation in the Far Eastern regions considerably exceeds the Russian average value (Chart 3). The slowdown in the dynamics of food prices (the component that contributes the most to inflation deceleration in

DISTRIBUTION OF REGIONS BY ANNUAL INFLATION* *Chart 1*



** Data for the Tyumen and Arkhangelsk Regions incorporate data for autonomous areas.*
Sources: Rosstat, Bank of Russia calculations.

Russia) started in these regions later than in other districts and remains less pronounced because of their remoteness from the country's core agricultural regions. Inflation in many Siberian regions also remains above the Russian average. There holds the effect of short-term factors which manifested themselves in the first half of the year in the markets of food (contracting supply of livestock products) and services (deferred increase in air ticket fares following the 2018 rise in fuel prices).

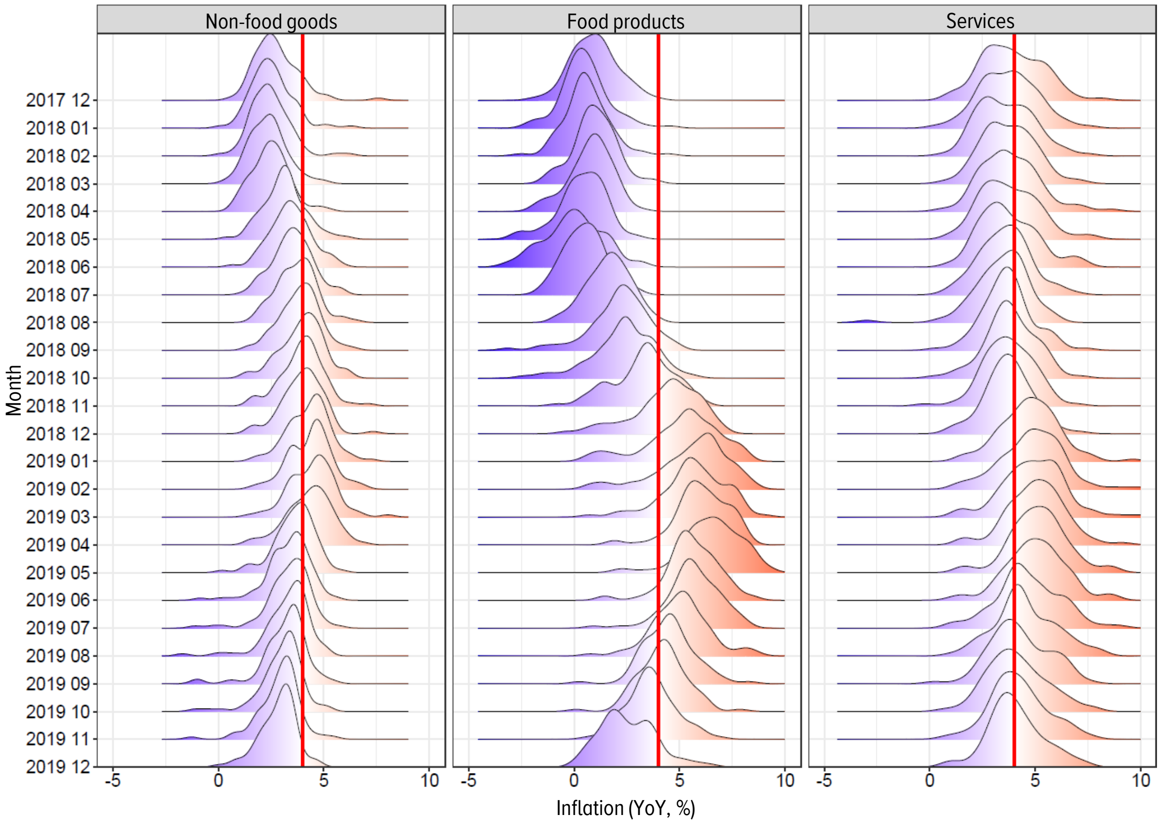
FOOD INFLATION

Regional heterogeneity of food inflation rose in December, while two peaks emerged in regions' distribution by annual price growth (Chart 2). The rise in uncertainty and the shaping of the right peak in the distribution resulted mainly from less considerable than in other regions food inflation slowdown in the Far Eastern and East Siberian regions. In the European part of the country, the regions of which mainly fall into the left part of the distribution, the greatest contribution to the deceleration of food price growth came from the movements in fruit and vegetable prices which entered negative territory in most regions amid abundant supply and low production costs of greenhouse vegetables due to warm weather. In the Far East and most Siberian regions, the expansion of supply was considerably smaller; as a result, the growth of fruit and vegetable prices decreased somewhat though remaining in positive territory. This discrepancy in dynamics is caused by the geographical remoteness of the country's Asian territories from its core fruit and vegetable producing regions and the low agricultural self-sufficiency of the above territories. Given the high transportation component in the ultimate price and the high share of imports, the disinflationary effect of expansion in supply that manifested itself the most in European Russia was weaker in the Far East.

NON-FOOD INFLATION

In December, the regional heterogeneity of non-food inflation continued to contract (Chart 2) on the back of both a decelerating price growth in the regions with the highest inflation (Yaroslavl Region, Jewish Autonomous Region) and an acceleration in the constituent territories where it held low in recent months (Altai Republic, Yamalo-Nenets Autonomous Area). Overall, regional discrepancies in the rate of non-food inflation have been low since April due to a unidirectional effect of countrywide factors (persistently subdued demand, ruble appreciation) in most regions.

DISTRIBUTION OF REGIONS BY ANNUAL INFLATION OF GOODS AND SERVICES *Chart 2*



Note: the horizontal axis shows inflation (YoY, %); the vertical axis shows the total of the regions.
Sources: Rosstat, Bank of Russia calculations.

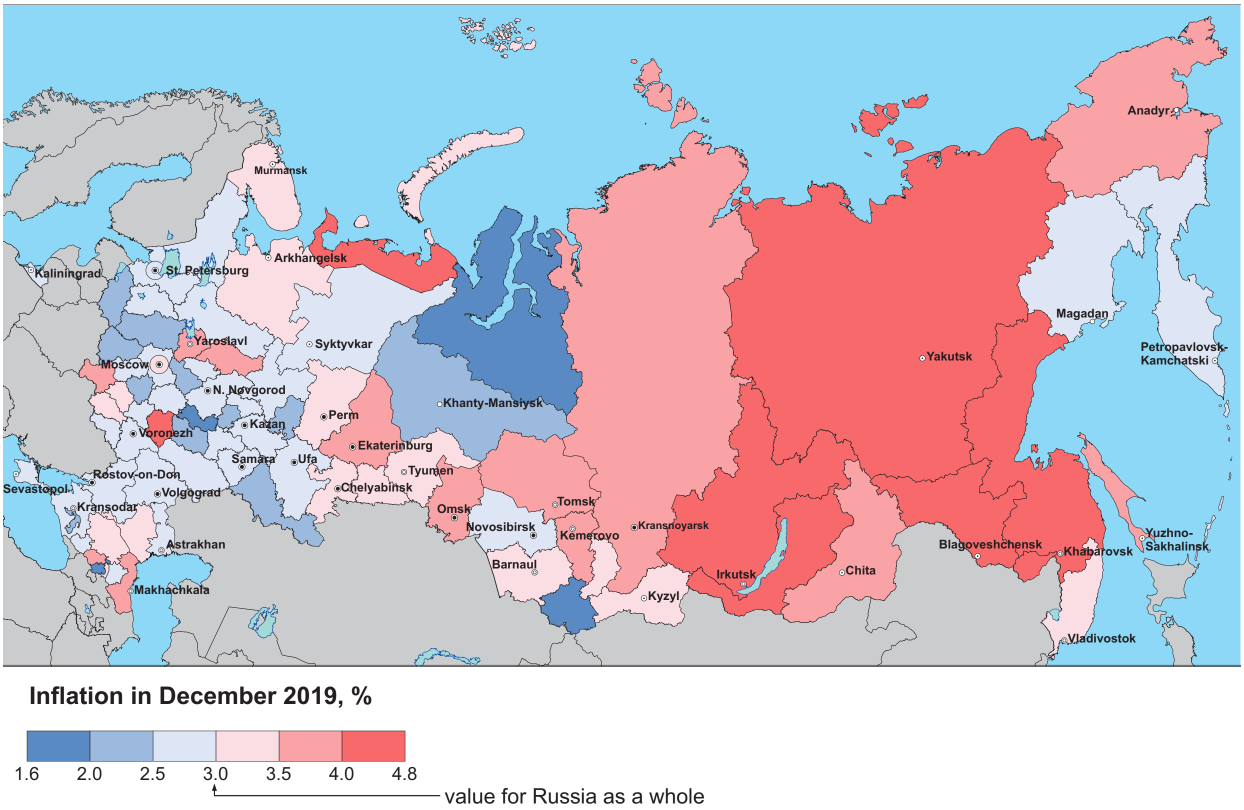
INFLATION IN THE SERVICES SECTOR

The December slowdown in services inflation entailed further reduction of its regional heterogeneity (Chart 2). Unlike in most regions where price trends were close to those observed throughout Russia, services inflation in the North-Western and Far Eastern districts slightly accelerated (by 0.02 and 0.03 pp respectively). In the Far East, this acceleration was caused by the movements in passenger transportation fares (fast increase in railway and urban transportation fares) and tourism services. In the North-Western Federal District, the growth rate of air and railway transportation fares increased. The acceleration of growth of railway ticket prices may be caused by the rise in demand and the effect of dynamic pricing programmes in RZD trains (though transportation fares remained unchanged in December). The same factor is likely to result in the increase in the rate of growth of certain air fares.

PRICE EXPECTATIONS

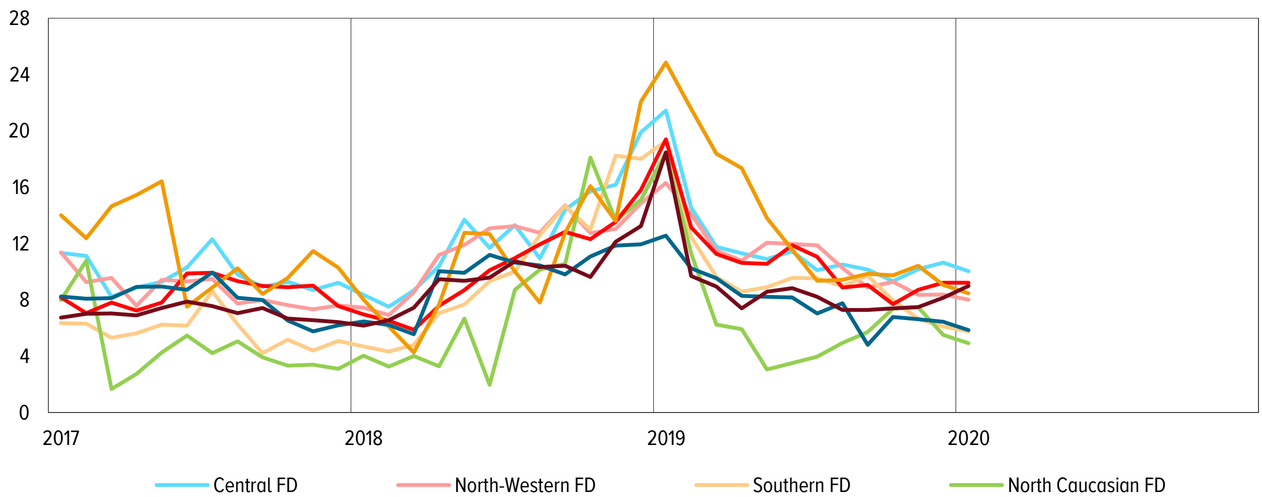
Businesses' price expectations for the three months ahead decreased somewhat in most regions in December 2019–January 2020 (Chart 4). A considerable hike in expectations was only registered in the Far East where it was mainly associated with rising expectations of agricultural, construction and trading companies. The lowest price expectations were registered in the North Caucasian and Southern federal districts due to, among other things, the lowering in the expectations of the agricultural sector. This reduction was caused by a good condition of winter crops and the forecasts of bumper harvests in 2020, as well as the fading effect of non-monetary factors in the market of

INFLATION IN THE REGIONS IN DECEMBER 2019 *Chart 3*



Sources: Rosstat, Bank of Russia.

BUSINESS PRICE EXPECTATIONS *Chart 4*
(balance of responses, %)



Source: Bank of Russia.

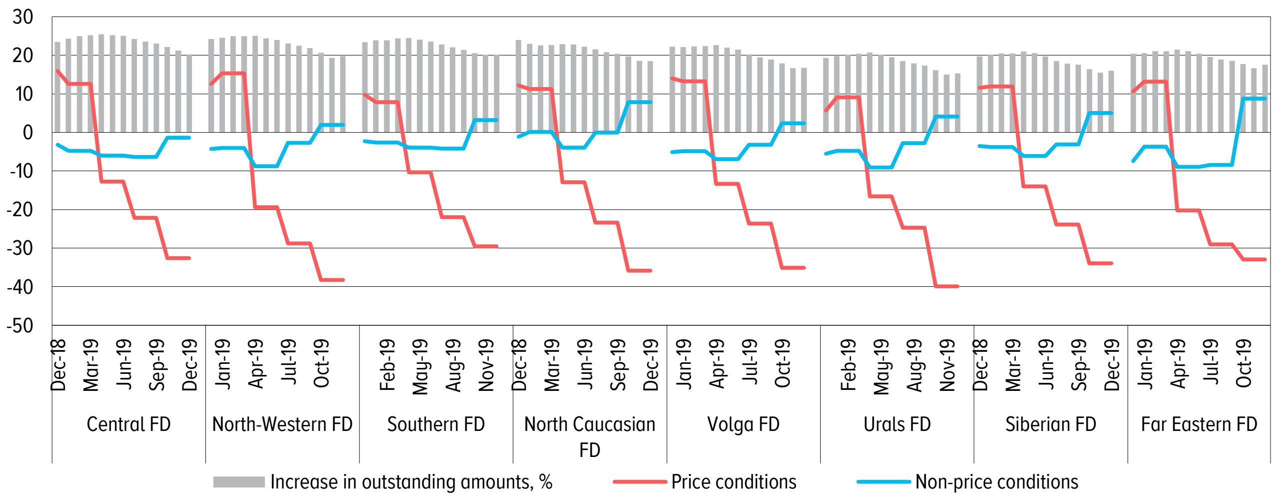
dairy and meat products, which affected inflation and price expectations in the North Caucasus in September–November. In Siberia, price expectations also held low, mainly due to mining and quarrying companies, which continue to face low global prices for certain commodities (coal, metallic ore and gas). Price expectation in the Central FD that observes a considerable revival of consumer activity continue to post the highest readings despite a slight decrease.

MONETARY CONDITIONS

HOUSEHOLD LENDING

In 2019 Q4, price conditions of bank lending (BLC)[1] to households continued to ease in all federal districts (Chart 5) as inflation slowed down, the Bank of Russia reduced the key rate and inflation expectations lowered. However, in Q4, the easing of non-price lending conditions for individuals gave way to tightening in most regions. Overall, the assessments of household lending conditions in the majority of regions remained unchanged (in 46 out of 68, where the survey was conducted). Compared to Q3, the number of constituent territories where bank lending conditions were assessed as loose decreased (from 29 to 12), and the number of constituent territories where banks described conditions as tight increased (from 4 to 10). The growth rates of consumer lending in November–December continued to go down in all regions due to countrywide factors (the introduction of new macroprudential measures for unsecured consumer loans to highly indebted borrowers and the completion of economic revival of 2017–early 2019). A slight acceleration of retail lending as a whole seen in December in certain districts was largely attributed to the dynamics of outstanding mortgage loans, the growth rate of which increased in most federal districts, bar the Central FD and the North Caucasian FD.

CHANGES IN BANK LENDING CONDITIONS (NEGATIVE ZONE – EASING, POSITIVE ZONE – TIGHTENING) AND INCREASE IN OUTSTANDING AMOUNTS ON HOUSEHOLD LOANS (YOY) *Chart 5*



Source: Bank of Russia.

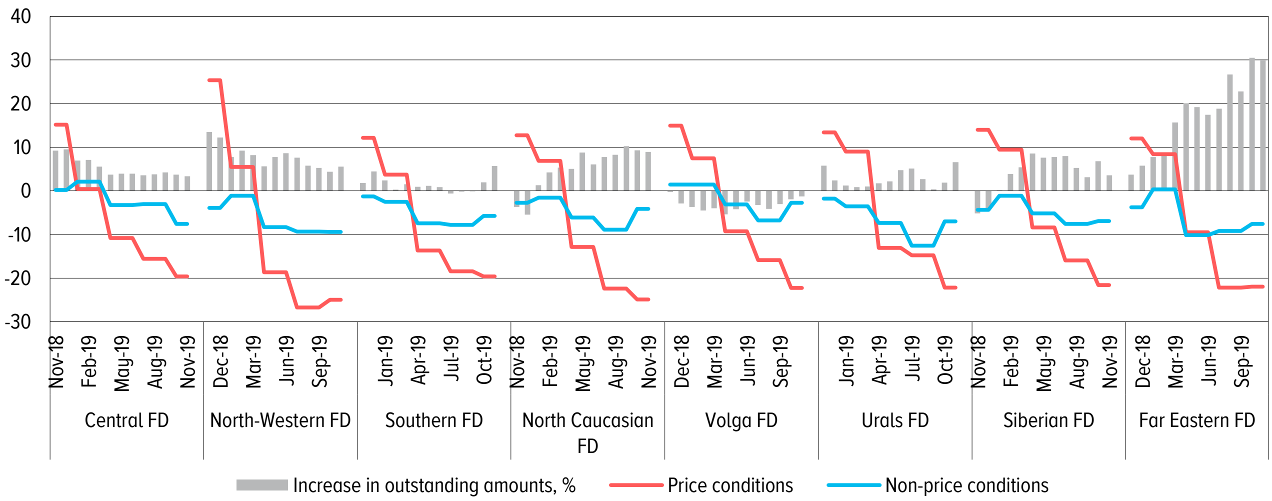
CORPORATE LENDING

Price conditions of bank lending to corporate borrowers in 2019 Q4 continued to soften in all federal districts with the most tangible easing in the North-Western FD and the North Caucasian FD (Chart 6). The easing of non-price conditions was less pronounced, but was also observed in all districts. Nevertheless, the assessments of BLC for legal entities remain tough in the majority of regions (37 out of 68, where the survey was conducted) and federal districts (except the Urals FD, Siberian FD and the North-Western FD, where they were neutral). Upward trends prevailed in the dynamics of corporate lending (in annual terms) in October–November in the majority of federal districts. The loan portfolio contracted only in the Volga Federal District, where this

[1] *Pursuant to the data of a quarterly survey of major banks conducted by the Bank of Russia. BLCs are assessed on the basis of the diffusion index, which reflects the balance of responses of credit institutions assessing the change in conditions as tightening or easing.*

CHANGES IN BANK LENDING CONDITIONS (NEGATIVE ZONE – EASING, POSITIVE ZONE – TIGHTENING) AND INCREASE IN OUTSTANDING AMOUNTS ON CORPORATE LOANS (YOY)

Chart 6



Source: Bank of Russia.

process has been ongoing since November 2018. The highest rate of lending growth (in October–November, 30% YoY) remained in the Far East where loan portfolios of economic entities engaged in basic economic activities increased. Broken down by sector, in all federal districts high growth of corporate lending was observed in construction (where project financing of housing constriction was introduced in July) and agriculture (where governmental programmes support the sector, including through subsidising interest rates on loans). The decrease in the share of overdue corporate loans in October–November continued in most regions (61 out of 85).

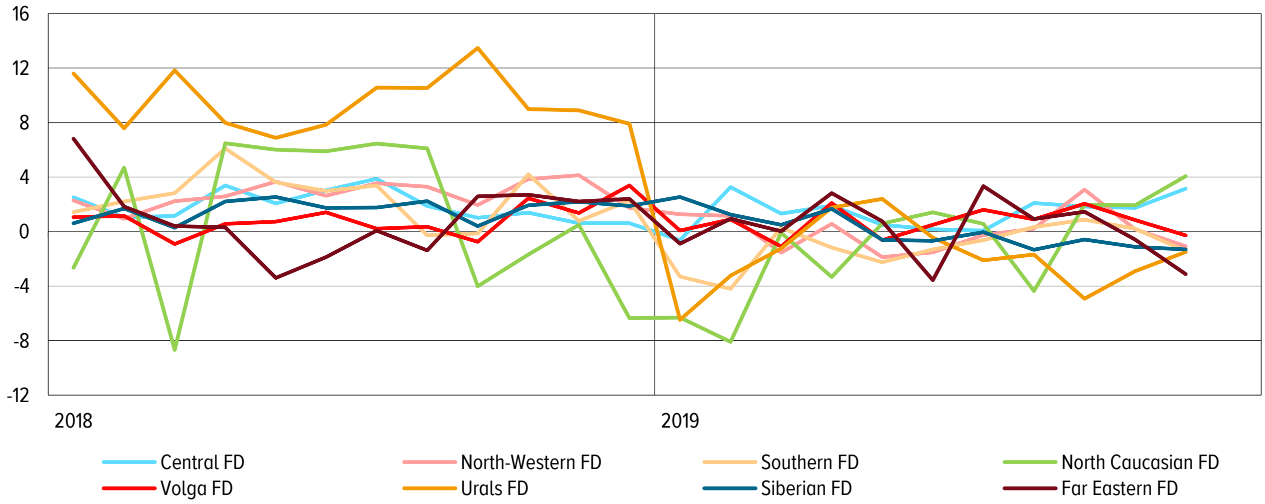
PRODUCTION AND INVESTMENT ACTIVITY

ECONOMIC ACTIVITY INDICATOR

Regional heterogeneity of economic activity rose considerably in November. According to the economic activity indicator (EAI),[2] the growth rate accelerated significantly in the Central Federal District and in the North Caucasus, whereas in other districts the dynamics were negative (Chart 7). The acceleration of growth in the Central FD and the North Caucasian FD was attributed to different factors. In the Central Federal District, economic activity has improved in recent months amid a steady increase in consumption and real wages; broken down by industry, the main contribution to the EAI dynamics comes from retail trade and services connected with consumer demand, growth in industrial production is also ongoing (due to manufacturing). In the North Caucasus, temporary factors are at play – since September the main contributor to the EAI dynamics has been construction, where growth may be associated with the implementation of several large projects, given the district's small size. In the majority of other districts, the main contribution to the decrease of the EAI came from the negative dynamics in construction (broken down by region, online indicators of this sector are highly volatile and, as a rule, considerably revised by Rosstat as of year-end), and in case of Siberia and the Far East, the dynamics of commercial services.

[2] The economic activity indicator (EAI) is calculated as the weighted average annual growth rate of the main economic activities: mining and quarrying, manufacturing, electricity, gas and steam supply, water supply, sewerage, waste collection and disposal, agriculture, construction, paid services provided to households, and trade. The weights of the respective economic activities in the structure of the gross regional product (GRP) are used as weights for calculating the average figure. The EAI is the regional equivalent of the key industry index published by Rosstat.

ECONOMIC ACTIVITY INDICATOR (JANUARY 2018–NOVEMBER 2019) *Chart 7*
(YoY, %)

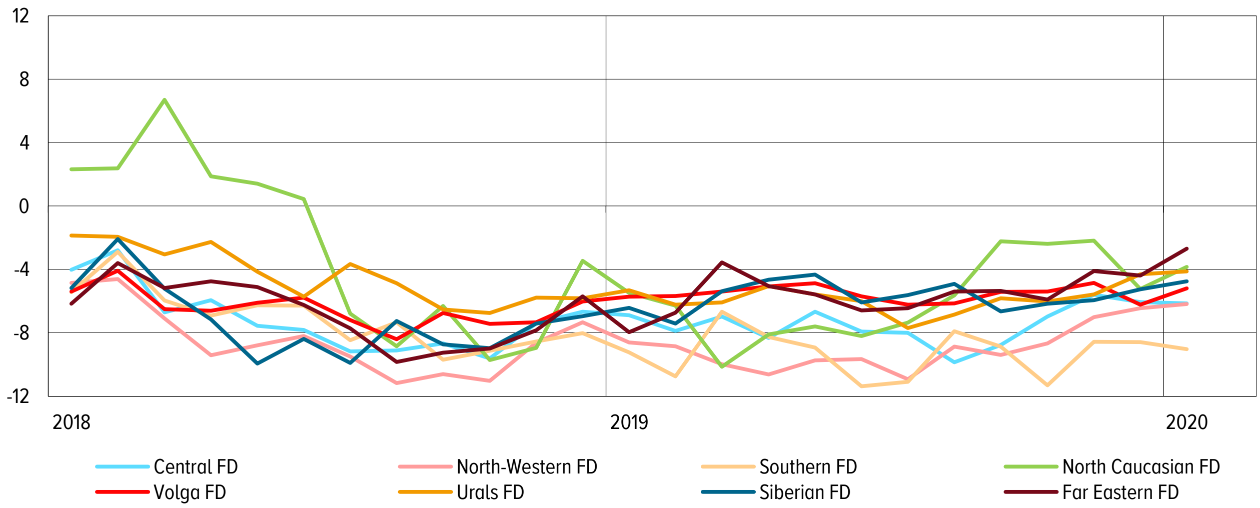


Sources: Rosstat, Bank of Russia calculations.

BUSINESS SENTIMENT

The assessments of economic conditions by businesses participating in the Bank of Russia's survey in December 2019–January 2020 broken down by federal district were mixed. The assessments improved in the Urals, Far East, Siberia and in the North West, and deteriorated in the Central and North Caucasian FDs. In the Southern and Volga federal districts the assessments changed only slightly (Chart 8). Broken down by industry, improvements in the economic conditions were mentioned by companies of the agricultural and manufacturing sectors, where an upturn was seen amid falling business risk estimates and a rise in estimated demand. Assessments by companies of the transportation and storage sector and service companies deteriorated somewhat (largely due to the falling demand mentioned by these companies).

ASSESSMENT OF CHANGES IN ECONOMIC SITUATION BY BUSINESSES *Chart 8*
(balance of responses,%)



Source: Bank of Russia.

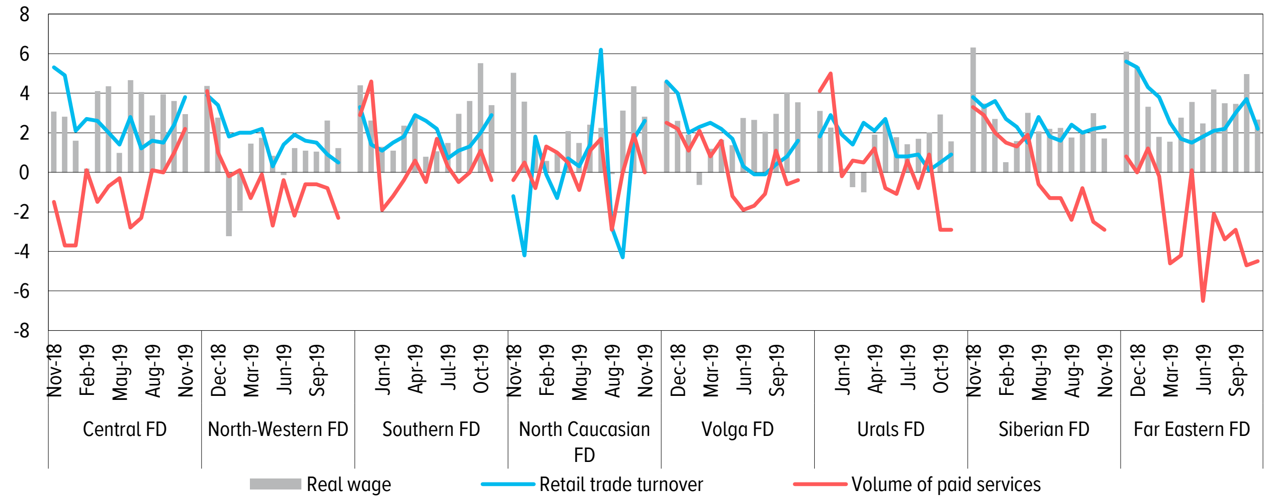
CONSUMER DEMAND AND SAVINGS

REGIONAL CONSUMPTION PECULIARITIES

In November, consumer activity in the regions improved somewhat amid positive real wage movements. The acceleration of wage growth seen in September–October in nearly all constituent territories gave way to a slowdown in November; meanwhile, the rates of growth remained positive in most regions – in 75 out of 85 in November, and in 83 in October (Chart 9). The most tangible rise in consumer demand was observed in the regions of the Central FD (in Moscow and the Moscow Region). However, a slowdown in consumer lending had a constraining effect on households' consumption, as in the previous months (Chart 10). As the dynamics of real wages improved, growth of retail sales continued to accelerate in the majority of regions. In November, an increase was registered in 68 constituent territories (59 in October) and in all federal districts. At the same time, annual growth rates of paid services since May remain negative in most regions (in November, in 55 out of 85) and federal districts (in November, in all federal districts except the Central and North Caucasian FDs).

REAL WAGE, RETAIL TRADE TURNOVER AND VOLUME OF PAID SERVICES
(YoY, %)

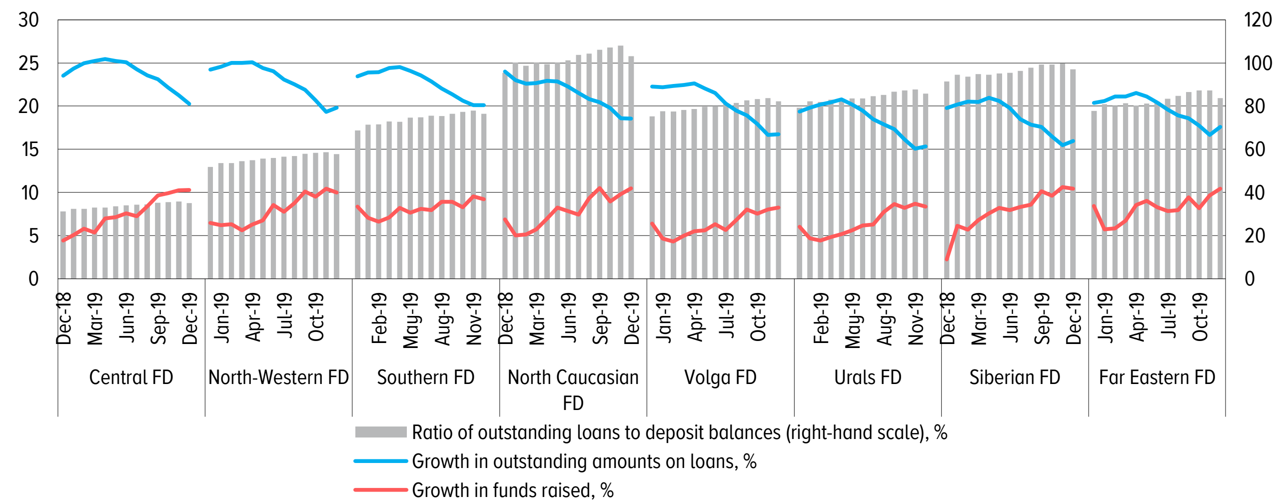
Chart 9



Source: Bank of Russia.

HOUSEHOLD LOANS AND DEPOSITS IN FEDERAL DISTRICTS*

Chart 10



** The outlier in the deposit growth dynamics for the Siberian Federal District in early 2019 is related to changes in the statistical accounting by branches in a bank of the Novosibirsk Region.*
Source: Rosstat.

STATISTICAL TABLES

INTEREST RATES ON BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY

(% p.a.)

Table 1

Purpose	Type of instrument	Instrument	Term	Frequency	As of 01.01.2019	From 17.06.2019	From 29.07.2019	From 09.09.2019	From 28.10.2019	From 16.12.2019	From 10.02.2020	General approach to rate-setting[1]
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by non-marketable assets; FX swaps (ruble leg);[2] repos	1 day	Daily	8.75	8.50	8.25	8.00	7.50	7.25	7.00	Key rate + 1.00
		Loans secured by non-marketable assets[3]	From 2 to 549 days		9.50	9.25	9.00	8.75	8.25	8.00	7.75	Key rate + 1.75
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets[3]	3 months	Monthly[4]	8.00	7.75	7.50	7.25	6.75	6.50	6.25	Key rate + 0.25
		Repo auctions	1 week	Weekly[5]	7.75 (key rate)	7.50 (key rate)	7.25 (key rate)	7.00 (key rate)	6.50 (key rate)	6.25 (key rate)	6.00 (key rate)	Key rate
			From 1 to 6 days	Occasionally[6]								
		FX swap auctions (ruble leg)[2]	From 1 to 2 days									
Liquidity absorption	Open market operations (minimum interest rates)	Deposit auctions	From 1 to 6 days									
			1 week	Weekly[5]								
	Standing facilities	Deposit operations	1 day[7]	Daily	6.75	6.50	6.25	6.00	5.50	5.25	5.00	Key rate - 1.00

[1] From 4 June 2018, interest rates on Bank of Russia operations with credit institutions are set as key rate spreads. See press release www.cbr.ru/press/pr/?file=01062018_180510dkp2018-06-01T18_04_36.htm.

[2] From 23 December 2016, interest rates on the foreign currency leg equal LIBOR on overnight loans in US dollars or euros (depending on the currency of the transaction).

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

[4] Operations have been discontinued since April 2016.

[5] Either a repo or a deposit auction is held depending on the situation with liquidity.

[6] Fine-tuning operations.

[7] Before 16 May 2018, also demand deposits. From 17 May 2018, the Bank of Russia only conducts overnight deposit operations with credit institutions.

Memo item: from 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date.

Source: Bank of Russia.

BANK OF RUSSIA OPERATIONS TO PROVIDE AND ABSORB RUBLE LIQUIDITY *Table 2*
(billions of rubles)

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims under liquidity provision instruments and liabilities under liquidity absorption instruments					
					As of 01.01.19	As of 01.04.19	As of 01.07.19	As of 01.10.19	As of 01.01.20	As of 01.02.20
Liquidity provision	Standing facilities	Overnight loans	1 day	Daily	8.1	0.0	1.1	0.0	0.0	0.0
		Lombard loans			0.0	0.0	0.0	0.0	0.0	0.0
		FX swaps			4.1	32.8	3.6	0.0	12.6	0.0
		Repos			3.6	2.6	1.4	0.0	0.0	0.0
		Loans secured by non-marketable assets	From 1 to 549 days		5.1	8.1	5.1	5.1	5.1	5.1
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	Monthly[1]	0.0	0.0	0.0	0.0	0.0	0.0
		Repo auctions	1 week	Weekly[2]	0.0	0.0	0.0	0.0	0.0	0.0
			From 1 to 6 days	Occasionally[3]						
		FX swap auctions	From 1 to 2 days		0.0	0.0	0.0	0.0	0.0	0.0
Liquidity absorption	Open market operations	Deposit auctions	From 1 to 6 days		1,478.2	1,680.0	704.4	2 180.0	696.6	1,619.4
			1 week	Weekly[2]						
		Auctions for the placement and additional placement of coupon OBRs[4]	Up to 3 months	Occasionally	1,391.3	1,515.3	1,716.6	808.2	1,956.3	2,072.2
	Standing facilities	Deposit operations	1 day[5]	Daily	423.8	136.4	152.8	135.1	329.7	146.7

[1] Operations have been discontinued since April 2016.
[2] Either a repo or a deposit auction is held depending on the situation with liquidity.
[3] Fine-tuning operations.
[4] If the reporting date falls on a weekend or holiday, the indicated amount of outstanding Bank of Russia coupon OBRs includes the accrued coupon interest as of the first working day following the reporting date.
[5] Before 16 May 2018, also demand deposits. From 17 May 2018, the Bank of Russia only conducts overnight deposit operations with credit institutions.
Source: Bank of Russia.

REQUIRED RESERVE RATIOS *Table 3*
(%)

Liability type	Validity dates			
	01.12.17–31.07.18	01.08.18–31.03.19	01.04.19–30.06.19	From 01.07.19[1]
Banks with a universal licence and non-bank credit institutions				
To households in the currency of the Russian Federation Other liabilities in the currency of the Russian Federation To non-resident legal entities in the currency of the Russian Federation	5.00	5.00	4.75	4.75
To households in foreign currency	6.00	7.00	7.00	8.00
To non-resident legal entities in foreign currency Other liabilities in foreign currency	7.00	8.00	8.00	8.00
Banks with a basic licence				
To households in the currency of the Russian Federation Other liabilities in the currency of the Russian Federation	1.00	1.00	1.00	1.00
To non-resident legal entities in the currency of the Russian Federation	5.00	5.00	4.75	4.75
To households in foreign currency	6.00	7.00	7.00	8.00
To non-resident legal entities in foreign currency Other liabilities in foreign currency	7.00	8.00	8.00	8.00

[1] Bank of Russia Ordinance No. 5158-U, dated 31 May 2019. See the press release published on the Bank of Russia website on 31 May 2019.
Source: Bank of Russia.

REQUIRED RESERVE AVERAGING RATIO *Table 4*

Types of credit institutions	
Banks with a universal licence, with a basic licence	0.8
Non-bank credit institutions	1.0

Source: Bank of Russia.

REQUIRED RESERVES AVERAGING SCHEDULE FOR 2020 AND INFORMATION ON CREDIT INSTITUTIONS' COMPLIANCE WITH RESERVE REQUIREMENTS

Table 5

Averaging period to calculate a required reserves amount for a respective reporting period	Averaging period duration (days)	Memo item:		Actual average daily balances in correspondent accounts	Required reserves to be averaged in correspondent accounts	Required reserves recorded to their respective accounts
		Reporting period	Required reserves regulation period			
11.12.2019 – 14.01.2020	35	Nov-19	13.12.2019 – 17.12.2019	2,526	2,428	617
15.01.2020 – 11.02.2020	28	Dec-19	22.01.2020 – 24.01.2020	2,479	2,418	618
12.02.2020 – 10.03.2020	28	Jan-20	14.02.2020 – 18.02.2020			
11.03.2020 – 07.04.2020	28	Feb-20	16.03.2020 – 18.03.2020			
08.04.2020 – 12.05.2020	35	Mar-20	14.04.2020 – 16.04.2020			
13.05.2020 – 09.06.2020	28	Apr-20	20.05.2020 – 22.05.2020			
10.06.2020 – 07.07.2020	28	May-20	15.06.2020 – 17.06.2020			
08.07.2020 – 04.08.2020	28	Jun-20	14.07.2020 – 16.07.2020			
05.08.2020 – 08.09.2020	35	Jul-20	14.08.2020 – 18.08.2020			
09.09.2020 – 06.10.2020	28	Aug-20	14.09.2020 – 16.09.2020			
07.10.2020 – 10.11.2020	35	Sep-20	14.10.2020 – 16.10.2020			
11.11.2020 – 08.12.2020	28	Oct-20	16.11.2020 – 18.11.2020			
09.12.2020 – 12.01.2021	35	Nov-20	14.12.2020 – 16.12.2020			

KEY ECONOMIC AND FINANCIAL INDICATORS *Table 6*

		01.19	02.19	03.19	04.19	05.19	06.19	07.19	08.19	09.19	10.19	11.19	12.19	01.20
Real sector														
Inflation	% YoY	5.0	5.2	5.3	5.2	5.1	4.7	4.6	4.3	4.0	3.8	3.5	3.0	2.4
GDP[1]	% YoY			0.5			0.9			1.7				
GDP in current prices[1]	trillions of rubles			24.5			26.2			28.0				
Output by key activity types	% YoY	0.3	2.3	0.2	3.1	0.0	2.1	2.6	2.3	3.1	3.1	1.5		
Industrial production	% YoY	1.1	4.1	1.2	4.6	0.9	3.3	2.8	2.9	3.0	2.6	0.3	2.1	
Agricultural output	% YoY	0.7	1.0	1.5	1.4	1.0	1.1	6.2	3.4	5.6	5.2	5.8		
Construction	% YoY	0.0	0.1	0.3	0.0	0.3	0.1	0.2	0.2	1.0	1.1	0.3	0.4	
Fixed capital investment[1]	% YoY			0.5			0.6			0.8				
Freight turnover	% YoY	2.4	1.8	2.5	2.6	1.0	0.5	-0.9	-0.3	0.5	0.2	-1.2	-1.7	
PMI Composite Index	% SA	53.6	54.1	54.6	53.0	51.5	49.2	50.2	51.5	51.4	53.3	52.9	51.8	52.6
Retail turnover	% YoY	2.0	2.1	1.7	1.8	1.5	1.6	1.2	0.8	0.7	1.7	2.3	1.9	
Real disposable money income[1]	% YoY			-1.8			0.9			3.1			1.1	
Real wage	% YoY	1.1	0.0	2.3	3.1	1.6	2.9	3.0	2.4	3.1	3.8	2.7		
Nominal wage	% YoY	6.1	5.2	7.7	8.4	6.8	7.7	7.7	6.8	7.2	7.7	6.3		
Unemployment rate	% SA	4.7	4.7	4.6	4.6	4.6	4.6	4.6	4.5	4.6	4.6	4.6	4.5	
Banking sector														
Broad money supply	% YoY, AFCR	6.5	7.9	7.0	6.6	6.7	6.4	7.0	7.3	8.0	7.9	8.3	7.7	
Money supply (M2)	% YoY	9.9	9.9	8.9	7.7	8.0	7.3	7.8	7.2	9.1	8.7	9.6	9.7	
Household deposits	% YoY, AFCR	5.4	5.7	5.6	6.8	7.0	7.3	7.1	8.2	9.4	9.2	9.8	9.8	
in rubles	% YoY	7.8	7.5	6.6	7.0	6.7	6.6	6.5	7.8	8.9	8.6	10.0	9.9	
in foreign currency	% YoY	-3.6	-1.2	1.6	5.8	8.1	9.9	9.5	9.6	11.3	11.7	9.6	9.8	
dollarisation	%	21.5	21.5	21.5	21.1	21.3	20.9	21.1	21.5	21.1	20.9	20.6	19.6	
Loans to non-financial organisations	% YoY, AFCR	4.8	5.6	5.7	5.4	6.2	6.4	5.7	5.0	3.4	4.1	4.0	4.3	
short-term (less than 1 year)	% YoY, AFCR	-0.6	-2.0	2.7	-1.0	1.3	4.7	4.9	2.1	1.2	1.3	0.6	0.4	
long-term (more than 1 year)	% YoY, AFCR	4.9	6.1	5.2	5.8	5.9	5.4	4.3	4.0	2.1	3.0	3.1	3.2	
overdue loans	%	7.8	7.9	7.9	7.8	7.9	7.9	8.1	8.0	8.0	8.0	7.9	7.8	
Loans to households	% YoY, AFCR	23.0	23.4	23.5	23.8	23.3	22.8	21.9	21.2	20.7	19.7	18.6	18.5	
housing mortgage loans	% YoY, AFCR	24.7	24.8	24.2	23.5	22.7	21.6	19.8	19.0	18.3	17.3	16.4	16.9	
unsecured consumer loans	% YoY	23.4	23.7	24.2	25.2	24.9	24.6	24.4	23.7	23.4	22.6	21.1	20.8	
overdue loans	%	5.4	5.3	5.1	5.1	5.0	4.9	4.9	4.8	4.7	4.6	4.5	4.3	

Legend:
YoY – on corresponding period of previous year;
SA – seasonally adjusted.
AFCR – adjusted for foreign currency revaluation.

[1] Quarterly data.
Sources: Rosstat, IHS Markit, Bank of Russia calculations.

KEY ECONOMIC AND FINANCIAL INDICATORS: BALANCE OF PAYMENTS

Table 7

		2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4[1]
Balance of payments[2]									
Urals crude price	% YoY	25.9	50.8	44.3	10.7	-3.7	-5.5	-16.9	-7.2
USD/RUB exchange rate ('+' – ruble's strengthening, '-' – ruble's weakening)	% YoY	3.4	-7.5	-9.9	-12.1	-14.0	-4.3	1.4	4.3
Goods and services exports	% YoY	21.7	27.3	28.2	18.2	1.2	-6.6	-6.0	-8.4
Goods and services imports	% YoY	18.8	8.2	-0.2	-3.0	-3.0	-1.1	5.8	9.1
Current account	**billions of US dollars**	29.8	17.9	27.4	38.4	33.8	9.9	10.6	16.3
Balance of trade	billions of US dollars	44.1	45.4	47.8	57.2	47.0	39.5	37.6	39.1
Exports	billions of US dollars	101.5	108.8	110.4	122.4	102.6	101.5	102.9	110.9
Imports	billions of US dollars	57.4	63.4	62.7	65.2	55.7	62.0	65.3	71.9
Balance of services	billions of US dollars	-6.6	-7.7	-8.8	-6.9	-5.7	-9.1	-11.3	-8.5
Exports	billions of US dollars	13.9	16.7	17.4	16.7	14.2	15.7	17.3	16.4
Imports	billions of US dollars	20.5	24.3	26.1	23.6	20.0	24.8	28.6	24.9
Balance of primary and secondary income	billions of US dollars	-7.7	-19.8	-11.6	-11.9	-7.4	-20.5	-15.7	-14.2
Current and capital account balance	billions of US dollars	29.6	17.7	27.4	37.7	33.9	9.6	10.5	16.1
Financial account excluding reserve assets (net lending (+) / net borrowing (-)	**billions of US dollars**	12.4	9.3	24.1	30.8	12.6	-5.1	-7.2	-2.1
Public sector	billions of US dollars	-6.5	11.1	2.9	1.5	-9.0	-5.9	-3.5	-5.3
Private sector	billions of US dollars	18.9	-1.8	21.2	29.3	21.6	0.8	-3.8	3.2
Net errors and omissions	billions of US dollars	2.1	2.9	1.7	-4.3	-2.6	1.9	-1.8	-2.8
Change in reserve assets ('+' – increase, '-' – decrease)	**billions of US dollars**	19.3	11.3	5.0	2.6	18.6	16.6	15.9	15.4

[1] Estimate.
[2] Signs according to BPM6.

GLOSSARY

BALANCE OF PAYMENTS OF THE RUSSIAN FEDERATION

A statistical system reflecting all economic transactions between residents and non-residents of the Russian Federation, which occurred during the reporting period.

BANKING SECTOR LIQUIDITY

Credit institutions' funds held in correspondent accounts with the Bank of Russia in the currency of the Russian Federation, mainly to carry out payments through the Bank of Russia payment system and to comply with obligatory reserve requirements.

BANK OF RUSSIA KEY RATE

A main instrument of the Bank of Russia's monetary policy. The Bank of Russia Board of Directors sets the rate eight times a year. Key rate changes influence lending and economic activities and make it possible to achieve the primary objective of the monetary policy. It corresponds to the minimum interest rate at Bank of Russia one-week repo rate auctions and the maximum interest rate at Bank of Russia one-week deposit auctions.

CONSUMER PRICE INDEX (CPI)

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 the previous (reference) period's prices. This index is calculated by the Federal State Statistics Service. The CPI shows changes over time in the overall price level of goods and services purchased by households for private consumption. The CPI is calculated on the basis of data on the actual structure of consumer spending, being therefore one of the key indicators of living costs. Additionally, the CPI possesses a number of properties facilitating its wide-spread application: simple and clear construction methods, calculation on a monthly basis and publication in a timely manner.

CORE INFLATION

An inflation indicator characterising its most stable part. Core inflation is measured using the core consumer price index (CCPI). The difference between the CCPI and the consumer price index (CPI) lies in the CCPI calculation method, which excludes the change in prices for individual goods and services subject to the influence of administrative and seasonal factors (certain types of fruit and vegetables, passenger transportation services, telecommunication services, housing and public utility services, motor fuel, etc.).

CREDIT DEFAULT SWAP (CDS)

A financial instrument which allows a CDS buyer to insure against a certain credit event (e.g., default) under financial obligations of a third party in exchange for regular payment of a premium (CDS spread) to the CDS seller. The higher the paid premium, the more risky the obligations which served as the subject matter of the credit default swap.

DOLLARISATION OF BANK DEPOSITS (LOANS)

The share of deposits (loans) denominated in foreign currency in total banking sector deposits (loans).

FINANCIAL STABILITY

A financial system characterised by the absence of systemic risks which, once they have evolved, may impact negatively on the process of transforming savings into investment and the real economy. In the event of financial stability, the economy demonstrates better resilience to external shocks.

FLOATING EXCHANGE RATE REGIME

An exchange rate regime, under which the central bank does not set targets, including operational ones, for the level of or changes to the exchange rate, allowing it to be influenced by market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to sell it should threats to financial stability arise.

INFLATION

A sustained increase in the overall price level of goods and services in the economy. Inflation is generally associated with changes over time in the cost of a consumer basket, i.e. a set of food products, non-food goods, and services consumed by an average household (see also 'Consumer price index').

INFLATION EXPECTATIONS

Economic agents' expectations about future price growth. Inflation expectations can be given by businesses, households, financial markets, and professional analysts. Driven by expectations, economic agents make their economic decisions and future plans, which include consumption, savings, borrowings, investment and loan/deposit rates. Capable of producing a certain effect on inflation, inflation expectations constitute an important indicator for the monetary policy decision-making process.

INFLATION TARGETING

A monetary policy strategy governed by the following principles: the main objective of monetary policy is price stability; the inflation target is specified and declared; monetary policy influences the economy largely through interest rates under a floating exchange rate regime; monetary policy decisions are taken based on the analysis of a wide range of macroeconomic indicators and their forecast. The Bank of Russia seeks to set clear benchmarks for households and businesses, including through enhanced information transparency.

MONETARY BASE

Total amount of certain cash components and credit institutions' funds in Bank of Russia accounts and bonds denominated in the currency of the Russian Federation. The monetary base in a narrow definition includes cash in circulation (outside of the Bank of Russia) and credit institutions' funds in accounts recording required reserves on funds attracted by credit institutions in the currency of the Russian Federation. The broad monetary base includes cash in circulation (outside of the Bank of Russia) and the total funds of credit institutions in Bank of Russia accounts and bonds.

MONEY SUPPLY

Total Russian Federation residents' funds (excluding general government's and credit institutions' funds). For the purposes of economic analysis, various monetary aggregates are calculated (M0, M1, M2, M2X).

MONEY SUPPLY IN THE NATIONAL DEFINITION (M2 MONETARY AGGREGATE)

Total amount of cash in circulation outside the banking system and funds of Russian Federation residents (non-financial and financial organisations (excluding banks), and households) in settlement, current and other sight accounts (including bank card accounts), time deposits and other types of deposits in the banking system, denominated in the currency of the Russian Federation, and interest accrued on them.

MSCI INDICES

A group of indices calculated by Morgan Stanley Capital International. Calculations are made for indices for individual countries (including Russia), global indices (for various regions, for advanced/emerging economies), and the 'world' index.

NEUTRAL RATE

The level of the key rate when monetary policy neither slows down nor spurs inflation.

OPERATIONS TO ABSORB LIQUIDITY

Bank of Russia reverse operations to absorb liquidity from credit institutions. These are operations either to attract deposits or place Bank of Russia bonds.

REFINANCING OPERATIONS

Bank of Russia reverse operations to provide credit institutions with liquidity. They may be in the form of loans, repos or FX swaps.

REQUIRED RESERVE RATIOS

Ratios ranging from 0% to 20% are applied to reservable liabilities of credit institutions to calculate the standard value of required reserves. They are set by the Bank of Russia Board of Directors.

RUONIA (RUBLE OVERNIGHT INDEX AVERAGE)

Reference weighted rate of overnight ruble deposits in the Russian interbank market. It reflects the cost of unsecured loans of banks with minimum credit risk. To calculate RUONIA, the Bank of Russia applies the method elaborated by the National Finance Association in cooperation with the Bank of Russia based on the information on deposit transactions made between member-banks. The list of RUONIA member banks is compiled by the National Finance Association and concurred with the Bank of Russia.

STRUCTURAL LIQUIDITY DEFICIT/SURPLUS

A structural deficit is the state of the banking sector characterised by stable demand of credit institutions for Bank of Russia liquidity. A structural surplus is characterised by a stable surplus in credit institutions' liquidity and the need for the Bank of Russia to conduct liquidity-absorbing operations. The level of a structural liquidity deficit/surplus is a difference between the outstanding amount on refinancing operations and Bank of Russia liabilities on operations to absorb excess liquidity.

TRANSMISSION MECHANISM

The process of transferring the impulse of monetary policy decisions to the economy as a whole and to price dynamics, in particular. The process of transmitting the central bank's signal about a/no change in the key rate and its future path, from financial market segments to the real sector and as a result to inflation. Changes in the key rate are translated into the economy through different channels (interest rate, credit, foreign exchange, balance sheet, inflation expectations, and other channels).

ABBREVIATIONS

- AE – Advanced economies
- AFCR – adjusted for foreign currency revaluation
- AHML – Agency for Housing Mortgage Lending
- BLC – bank lending conditions
- bp – basis point (0.01 percentage points)
- BPM6 – the 6th edition of the IMF's Balance of Payments and International Investment Position Manual
- BRICS – a group of five countries: Brazil, Russia, India, China and South Africa
- Cbonds-Muni – municipal bond index calculated by Cbonds
- CCPI – core consumer price index
- CPI – consumer price index
- DSR – debt service ratio (the ratio of the cash flow available to pay current debt obligations, including principal and interest, to current income value)
- ECB – European Central Bank
- EME – emerging market economies
- EU – European Union
- FAO – Food and Agriculture Organization of the United Nations
- FCS – Federal Customs Service
- Fed – US Federal Reserve System
- FGUP – federal state unitary enterprise
- FPG – fiscal policy guidelines
- GDP – gross domestic product
- GFCF – gross fixed capital formation
- GRP – gross regional product
- IBL – interbank loans
- IEA – International Energy Agency
- IFX-Cbonds – corporate bond return index
- Industrial PPI – industrial producer price index
- inFOM – Institute of the Public Opinion Foundation
- MC – management company
- MIACR – Moscow Interbank Actual Credit Rate (weighted average rate on interbank loans provided)
- MIACR-B – Moscow Interbank Actual Credit Rate-B-Grade (weighted average rate on interbank loans provided to banks with speculative credit rating)
- MIACR-IG – Moscow Interbank Actual Credit Rate-Investment Grade (weighted average rate on interbank loans provided to banks with investment-grade rating)
- MIC – military-industrial complex
- MICEX SE – MICEX Stock Exchange

- MPD – Monetary Policy Department of the Bank of Russia
- MPG 2020-2022 – Monetary Policy Guidelines for 2020-2020 (approved by the Bank of Russia Board of Directors on 25 October 2019)
- MPR – Monetary Policy Report (mentioned in the text as 2/19 – No. 2 2019; 3/19 – No. 3 2019; 4/19 – No. 4 2019)
- MTVECM, TVECM – Momentum Threshold Vector Error Correction Model, Threshold Vector Error Correction Model
- NPF – non-governmental pension fund
- NPISH – non-profit institutions serving households
- NWF – National Wealth Fund
- OBR – Bank of Russia bonds
- OECD – Organisation for Economic Cooperation and Development
- OFZ – federal government bonds
- OFZ-IN – inflation-indexed federal government bonds
- OFZ-PD – permanent coupon-income federal government bonds
- OFZ-PK – variable coupon-income federal government bonds
- OJSC – open joint-stock company
- OPEC – Organization of the Petroleum Exporting Countries
- PJSC – public joint-stock company
- PMI – Purchasing Managers' Index
- pp – percentage point
- PPI – producer price index
- QPM – quarterly projection model of the Bank of Russia
- REB – Russian Economic Barometer, monthly bulletin
- RGBEY – Russian Government Bonds Effective Yield until Redemption (calculated by the Moscow Exchange)
- RUONIA – Ruble OverNight Index Average (reference weighted rate of overnight ruble deposits in the Russian interbank market)
- SME – small and medium-sized enterprise
- SNA – system of national accounts
- TCC – total cost of credit
- SA – seasonally adjusted
- TVP FAVAR – Time-Varying Parameter Factor-Augmented Vector Auto-Regression
- VAT – value added tax
- VCIOM – Russian Public Opinion Research Centre
- VEB – Vnesheconombank
- VECM – Vector Error Correction Model