



Bank of Russia

RUSSIA'S ECONOMIC
OUTLOOK AND
MONETARY POLICY

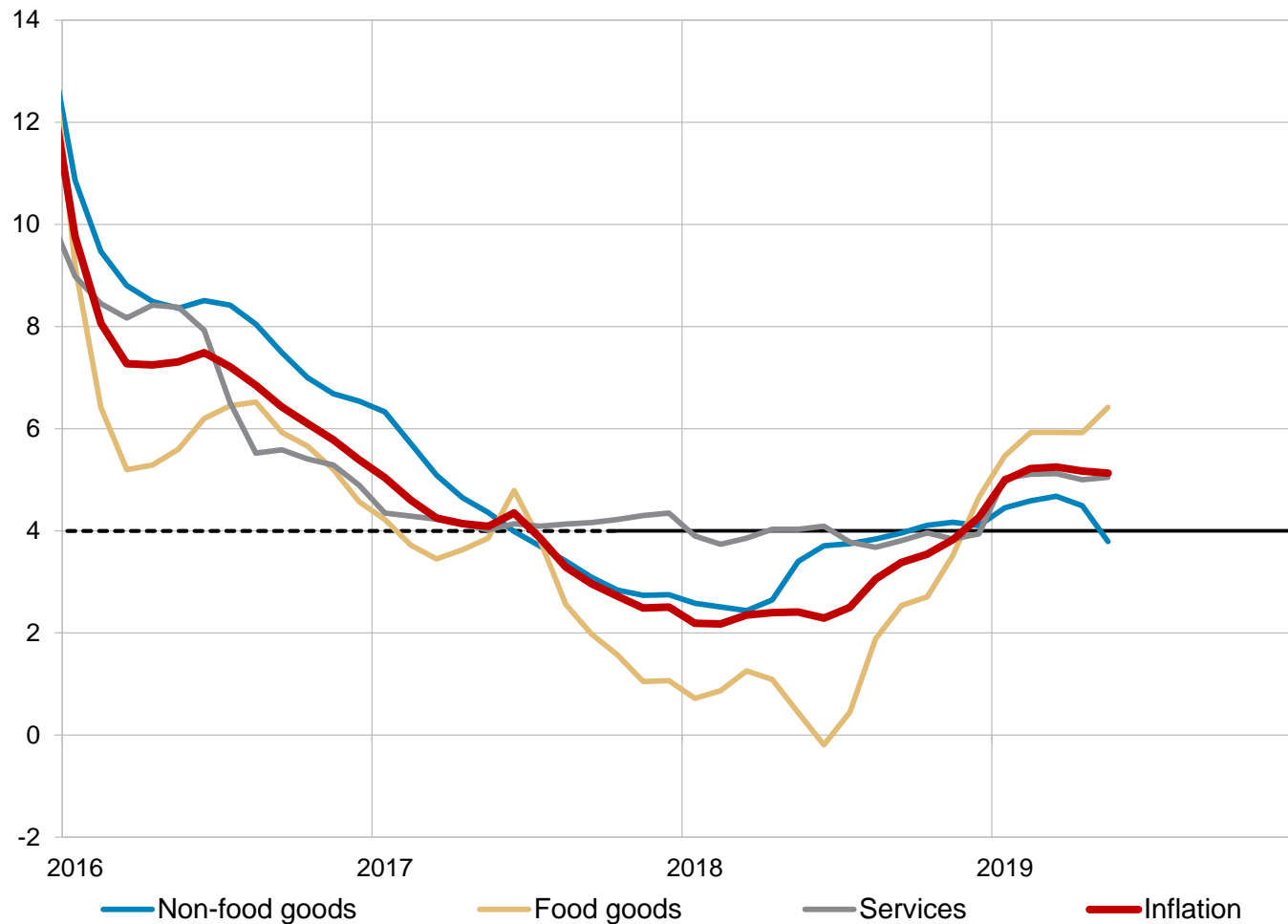
JUNE 2019



Consumer prices

Annual inflation slowdown is continuing. In May, CPI declined to 5.1% YoY.

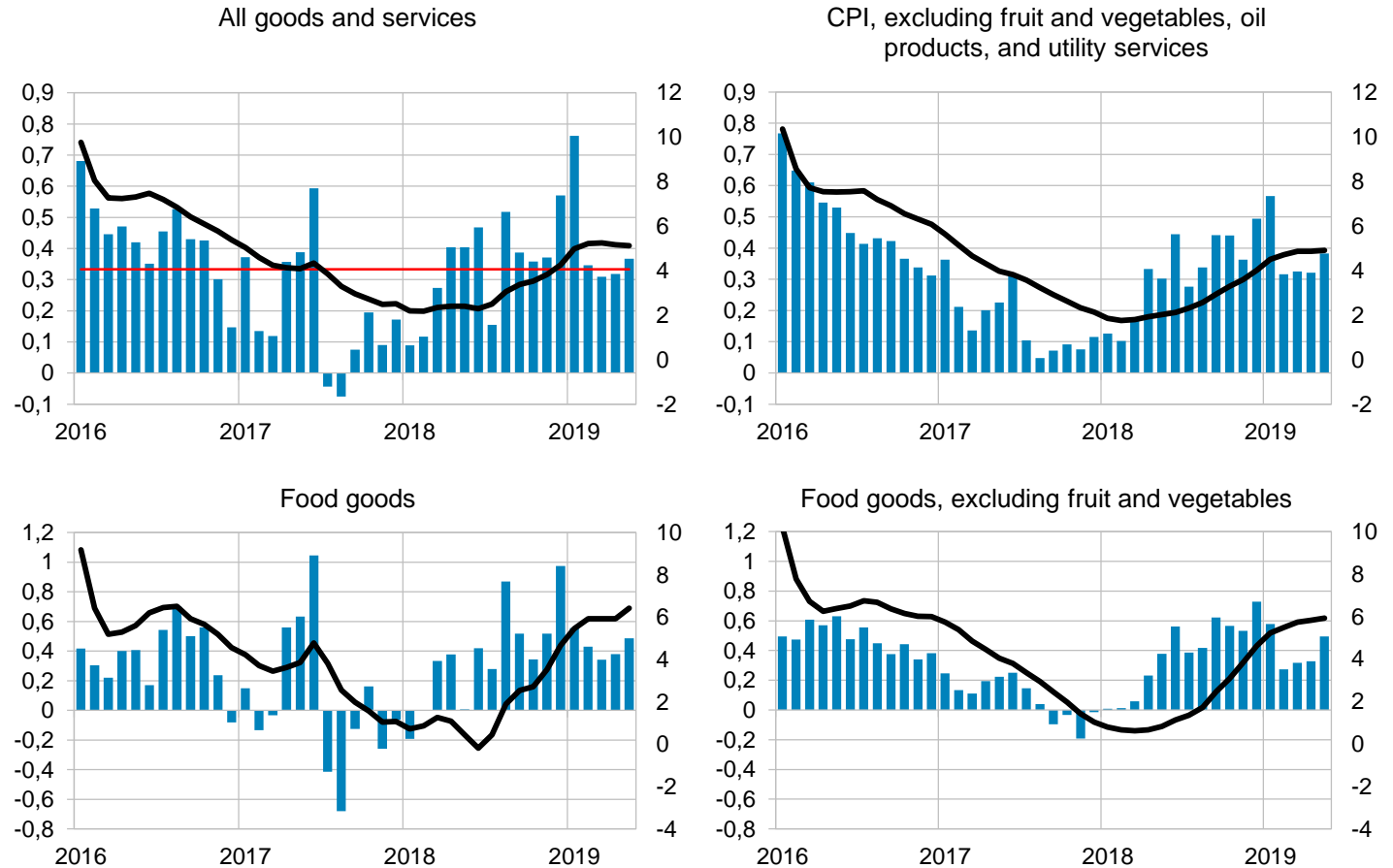
Consumer demand trends constrain inflation. Also, temporary disinflationary factors contributed to slowing consumer price growth, among those ruble appreciation since the beginning of the year and the high base effect in the price dynamics of principal types of motor fuel.



Inflation rates for main groups, seasonally adjusted (1)

In March-May MoM SA inflation stood at 0.3-0.4%, in accordance with the baseline forecast.

MoM SA food inflation and food inflation, excluding fruit and vegetables, accelerated: dairy products, eggs.

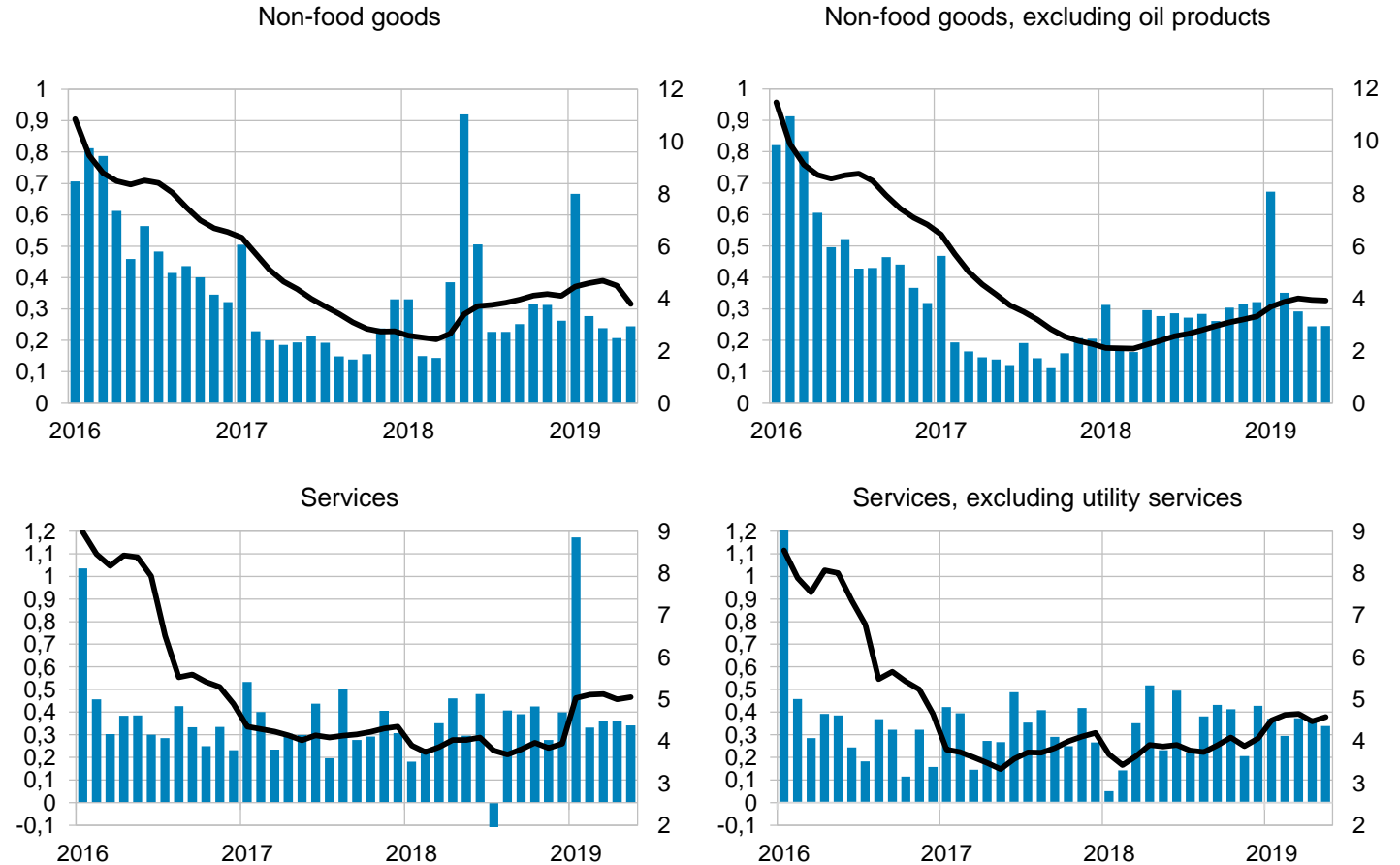


Columns – monthly price growth rate, seasonally adjusted, %
Line – annual inflation, % (rhs)

Inflation rates for main groups, seasonally adjusted (2)

In May compared to April non-food goods MoM SA inflation accelerated mainly because of oil products.

Services prices growth (as well as that excluding utility services) is mostly unchanged.



Columns – monthly price growth rate, seasonally adjusted, %
Line – annual inflation, % (rhs)

Inflation expectations – summary

Horizon		2017				2018												2019				
		I	II	III	IV	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Inflation expectations (absolute numbers), %																						
Households																						
FOM	Next 12 months	11.2	10.3	9.6	8.7	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	10.1	9.3	9.8	10.2	10.4	10.1	9.1	9.4	9.3
FOM (observed inflation)	Prev. 12 months	14.0	12.4	11.2	10.0	9.9	9.4	9.2	8.3	9.2	10.6	10.3	10.4	10.2	10.1	10.1	10.2	10.1	10.6	10.0	10.5	10.4
FOM (Bank of Russia calculations)	Next 12 months	4.0	4.0	2.8	2.5	2.1	2.1	2.2	2.2	2.2	2.6	2.8	3.5	3.8	3.8	4.4	5.4	6.2	5.9	5.7	5.5	5.4
Professional analysts																						
Bloomberg	2019									4.0	4.0	4.2	4.4	4.7	4.5	4.6	4.5	4.7	4.6	4.7	4.5	4.5
Interfax	2019					3.6	3.7	3.8	4.1	4.0	4.1	4.3	4.4	4.3	4.2	4.4	4.7	4.8	4.7	4.6	4.5	4.5
Reuters	2019								3.9	3.9	4.0	4.3	4.5	4.5	4.5	4.7	5.0	4.8	4.8	4.8	4.8	4.6
Financial markets																						
OFZ IN (option not subtracted)	2023	4.9	4.6	4.2	5.1	4.0	3.9	3.8	4.1	4.2	4.5	4.6	5.2	5.3	5.1	5.1	5.1	5.1	5.0	4.9	4.6	4.3
OFZ IN (option not subtracted)	2028									4.3	4.6	4.6	5.0	5.4	5.2	5.2	5.1	4.9	4.9	4.8	4.7	4.3
Inflation expectations (balanced index*)																						
Households																						
FOM	Next 12 months	0.0	-1.3	-5.5	-5.3	-5.6	-0.5	-0.4	1.0	3.7	10.3	8.2	10.2	6.3	8.9	11.6	14.8	14.5	11.9	9.2	13.0	13.3
FOM	Next month	-12.2	-12.3	-16.1	-16.1	-23.0	-18.0	-14.6	-16.5	-11.7	-3.4	-8.4	-4.9	-4.8	-5.5	-5.9	-3.3	1.6	-6.6	-7.9	-6.7	-8.9
Businesses																						
Bank of Russia monitoring	Next 3 months	7.9	8.6	7.5	7.3	6.8	6.3	7.0	8.8	10.1	10.3	11.0	11.2	12.5	13.0	13.7	16.1	18.1	12.7	11.0	9.9	9.5
PMI input prices	Next month	7.8	9.0	12.2	10.6	9.2	11.4	12.2	27.4	27.2	28.4	21.6	22.8	24.2	23.4	22.6	22.0	35.0	26.8	23.6	19.8	14.2
PMI output prices	Next month	1.0	3.4	6.8	3.0	2.8	2.8	4.0	13.6	6.4	6.6	8.2	6.6	5.8	7.6	7.6	5.6	20.4	14.4	10.0	8.8	5.6
Retail prices (Rosstat)	Next quarter	27	24	24	22	-	-	20	-	-	20	-	-	20	-	-	19	-	-	21	-	-
Tariffs (Rosstat)	Next quarter	4	3	0	0	-	-	5	-	-	5	-	-	0	-	-	1	-	-	...	-	-

Change:

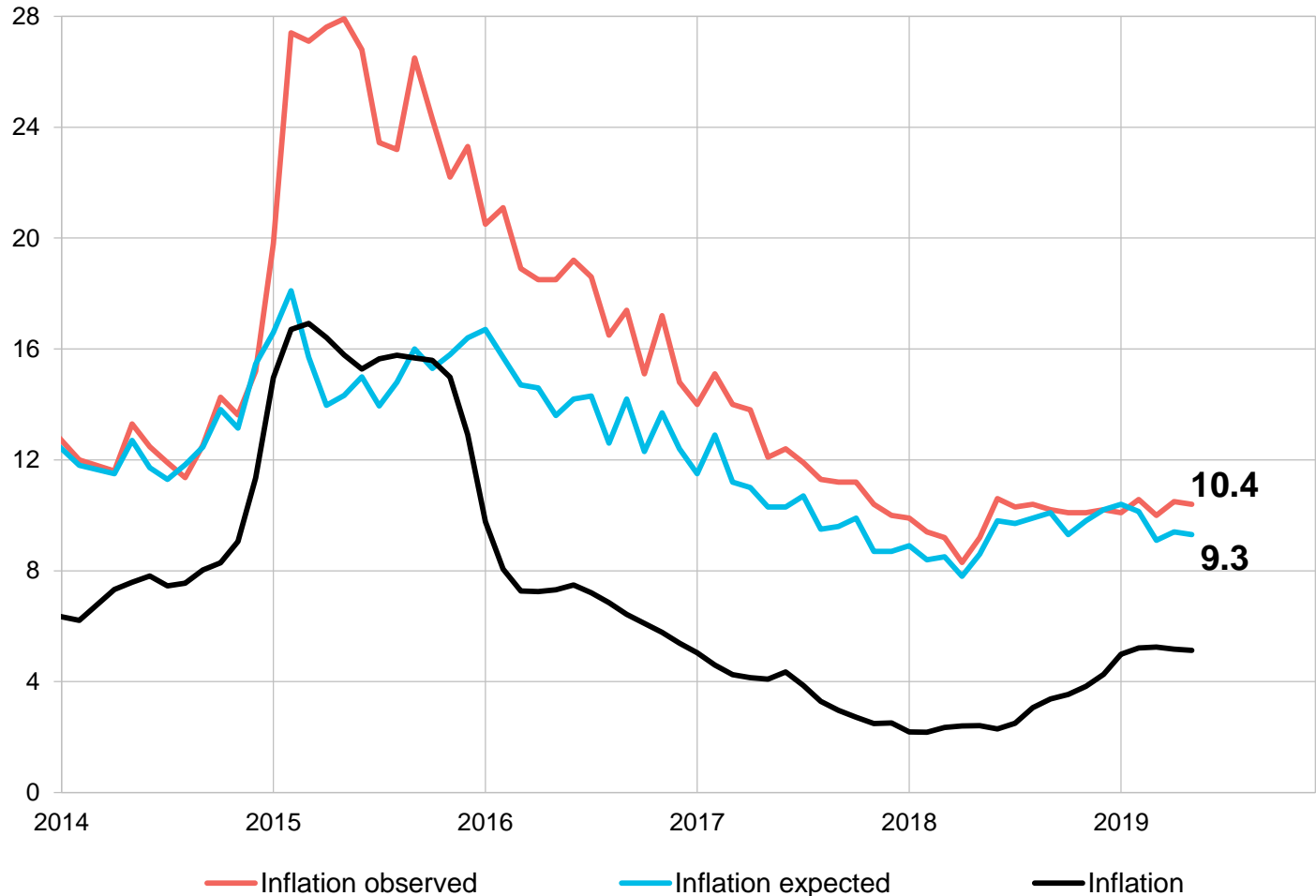
- Inflation expectations become better (more than 1 standard deviation)
- Inflation expectations become better (less than 1 standard deviation)
- Inflation expectations unchanged ($\pm 0,2$ standard deviations)
- Inflation expectations become worse (less than 1 standard deviation)
- Inflation expectations become worse (more than 1 standard deviation)

*Balanced index is the difference between the shares of those who expect prices to rise and to fall

Inflation expectations – households

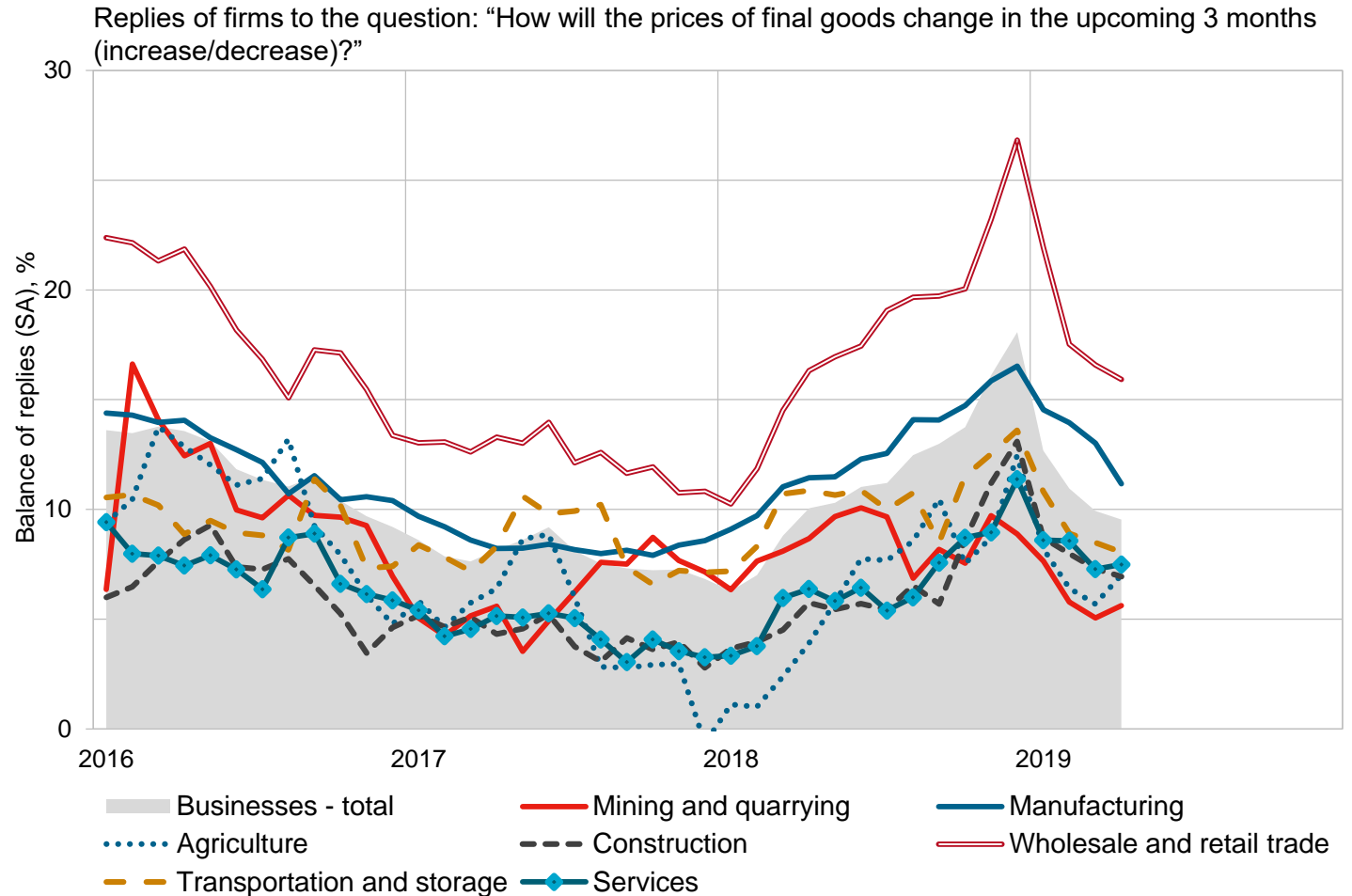
Did not materially change in May (9.3%) and remain elevated.

Observed inflation decreased to 10.4%.



Inflation expectations – businesses

The price expectations of businesses continued to decline, though at a slower pace.

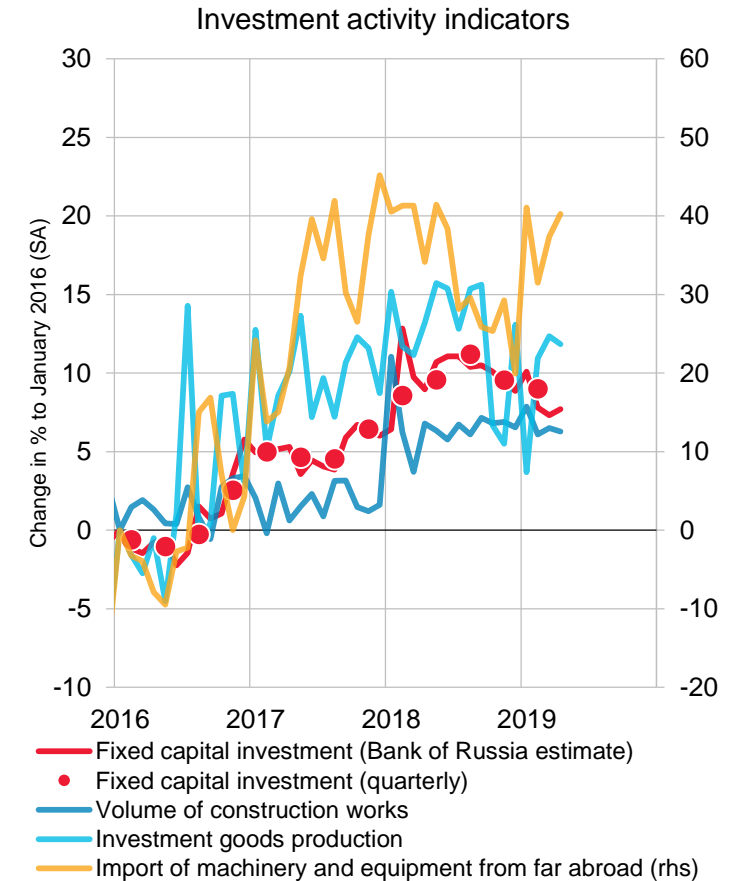
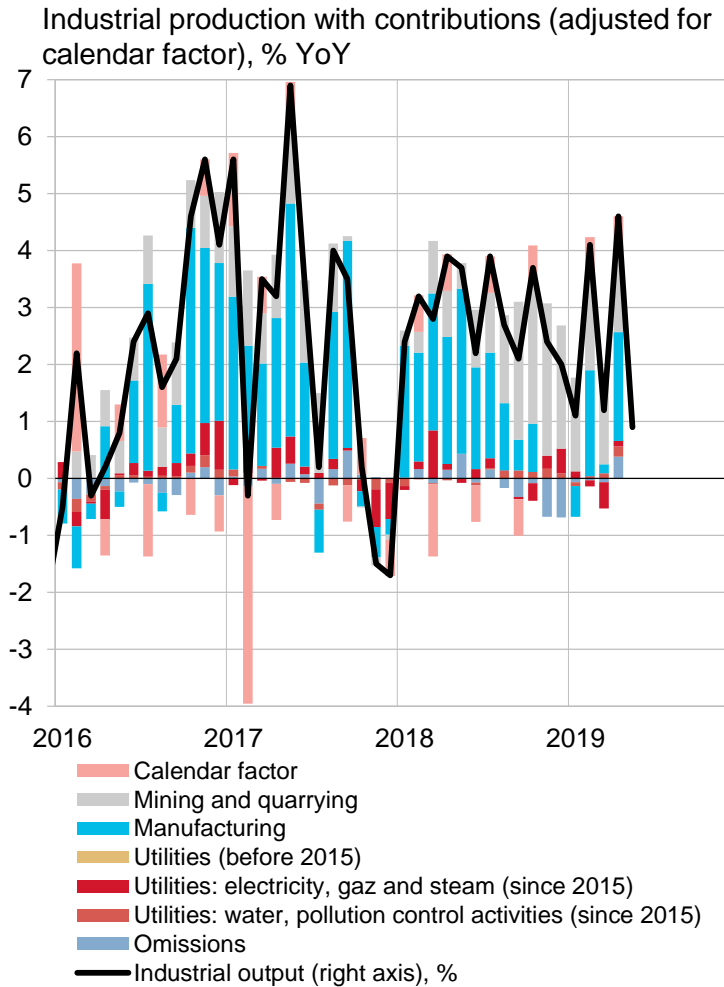


Industrial production and investment activity

Economic growth in 1H 2019 is lower than the Bank of Russia's expectations.

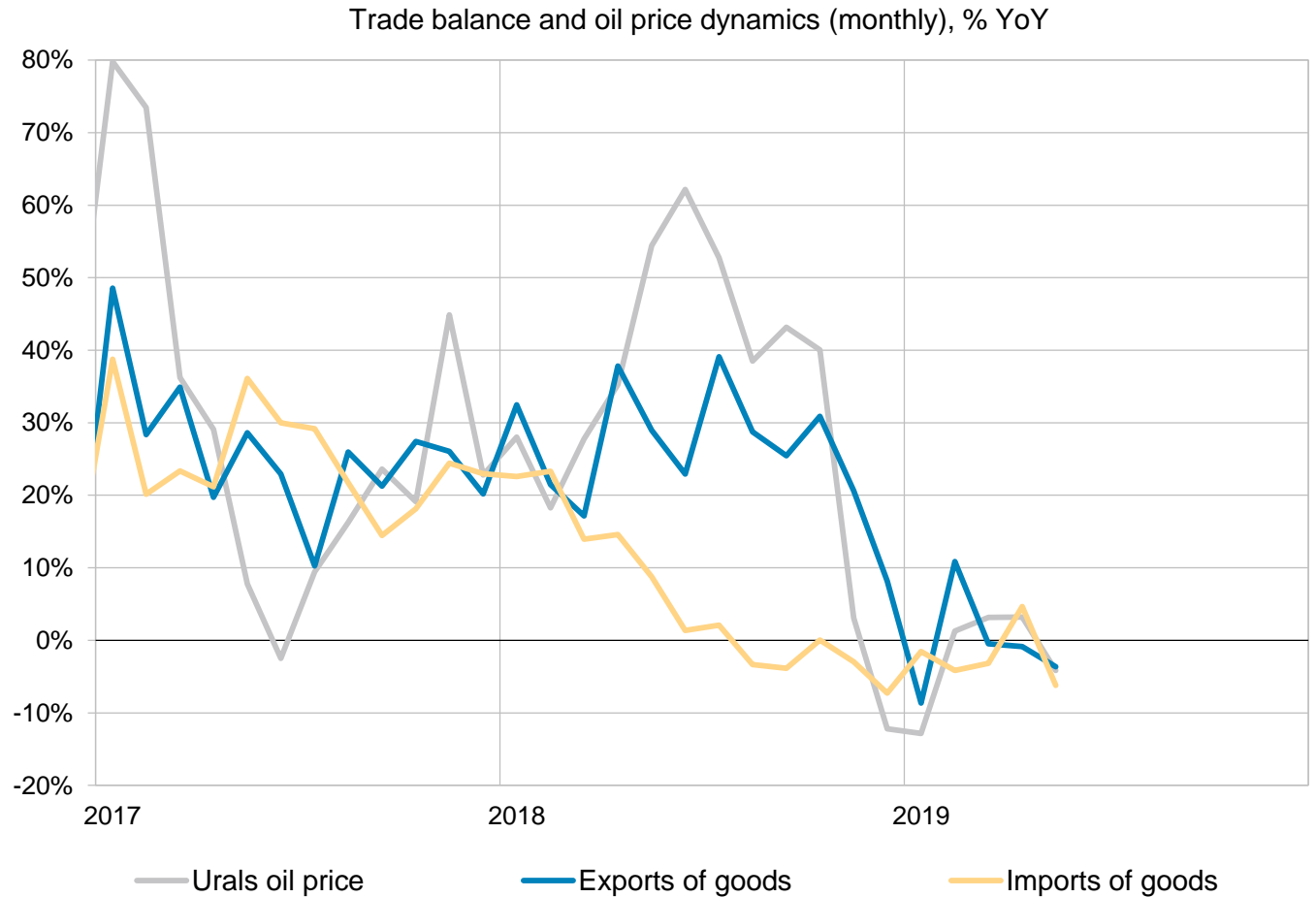
In January-April, the annual industrial production growth rate remained close to the readings of 2018 Q4.

Investment activity remains muted.



Trade performance

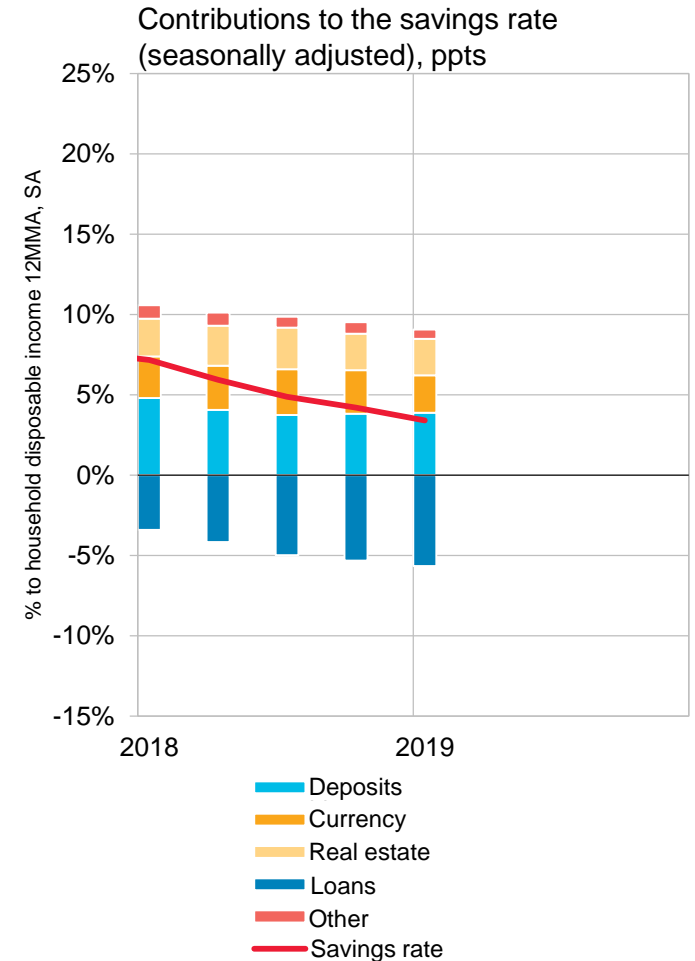
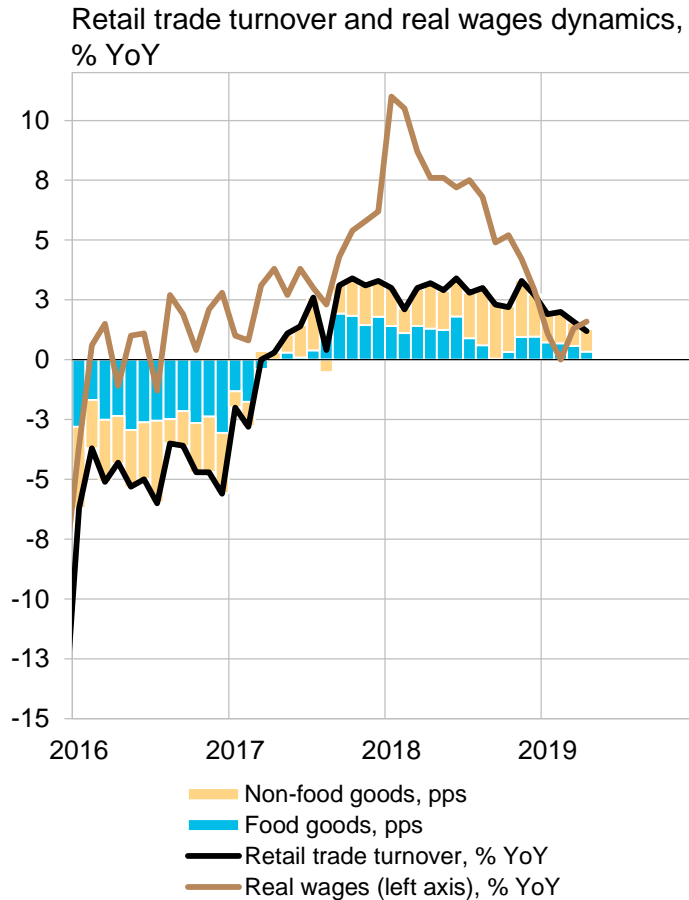
Export growth rates have declined in 1H 2019 amid weakening external demand.



Retail sales and savings rate

Annual retail sales growth rate has been slowing down since February on the back of moderate dynamics of household income.

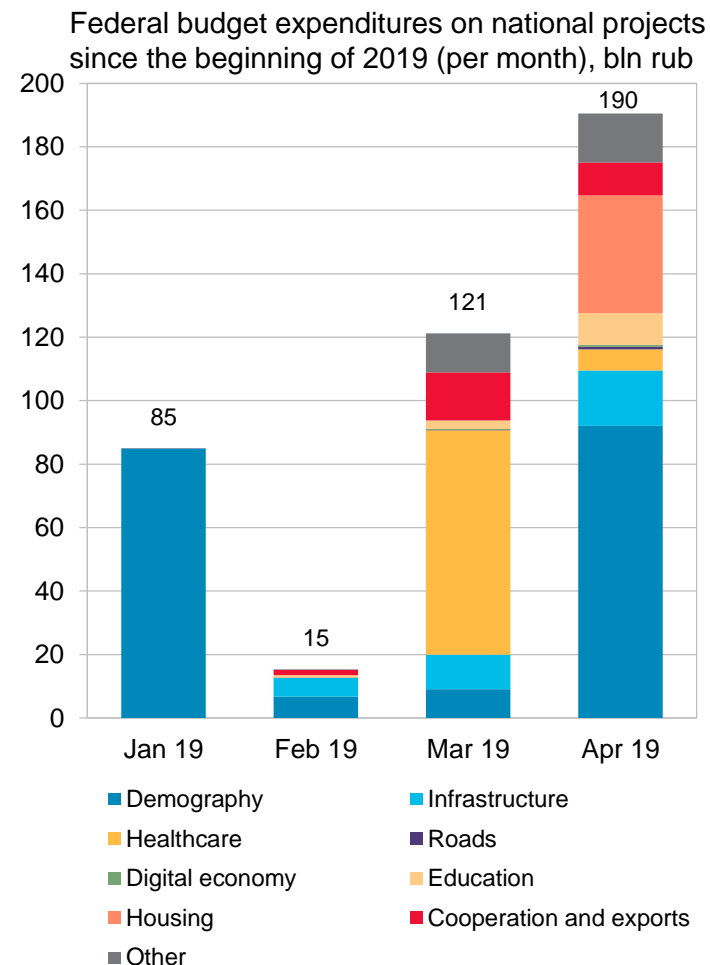
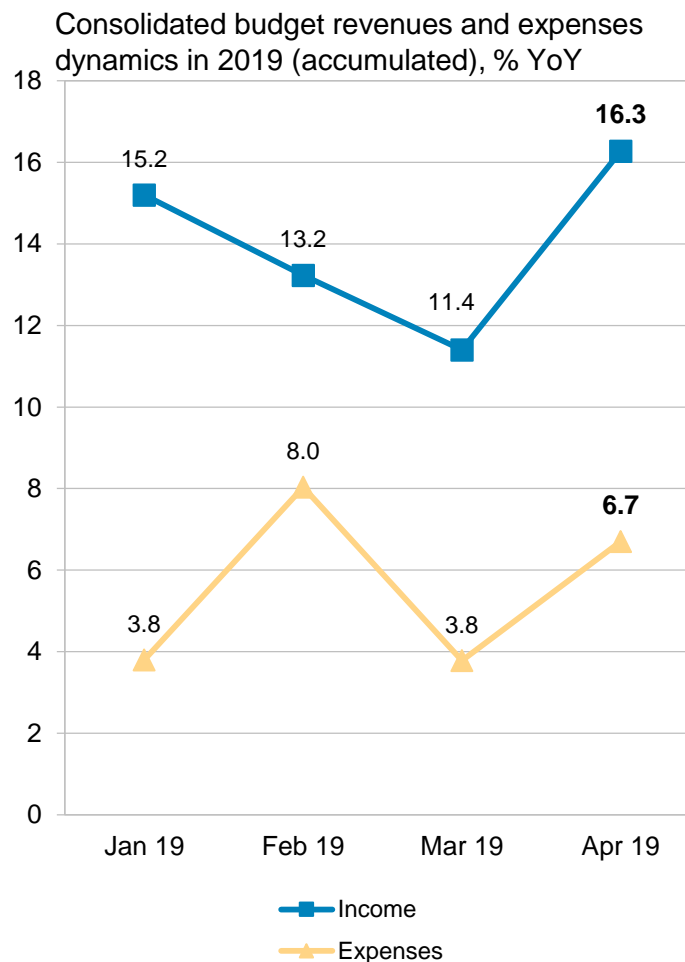
Savings rate in 1Q19 continued to decline amid growing consumer lending.



Fiscal policy

During the first four months of the current year, the growth in general government income outperformed the growth in expenses, which, in part, is due to the shift of the implementation of a number of national projects to 2H 2019 .

In the second half of 2019, the incremental budget revenues will be used to raise government spending, including investment.



Deposit and credit market – interest rates

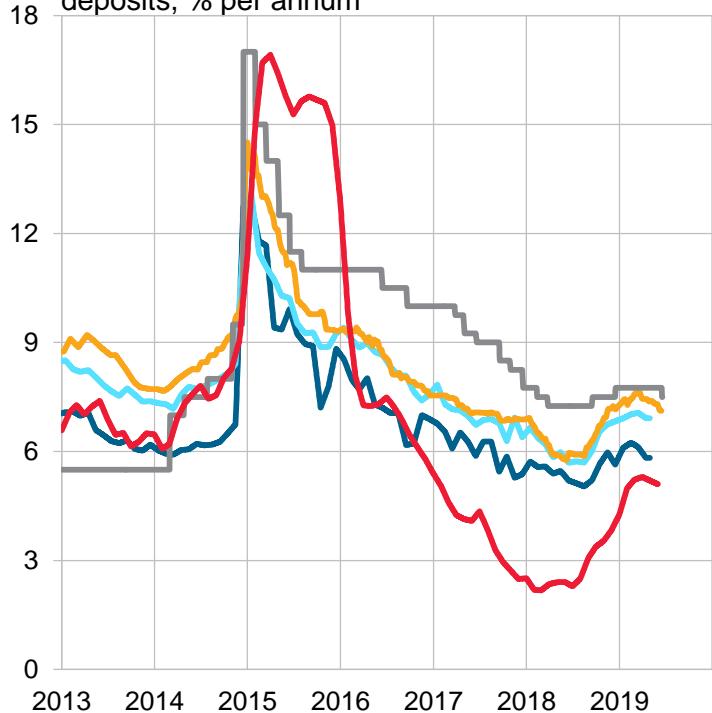
Monetary conditions have somewhat eased since the last Board meeting.

OFZ yields and deposit rates have declined.

The potential for lending rates growth has mostly exhausted.

That said, the Bank of Russia’s decision to cut the key rate and the year-to-date decline in OFZ yields create conditions for the decline of deposit and lending rates in the future.

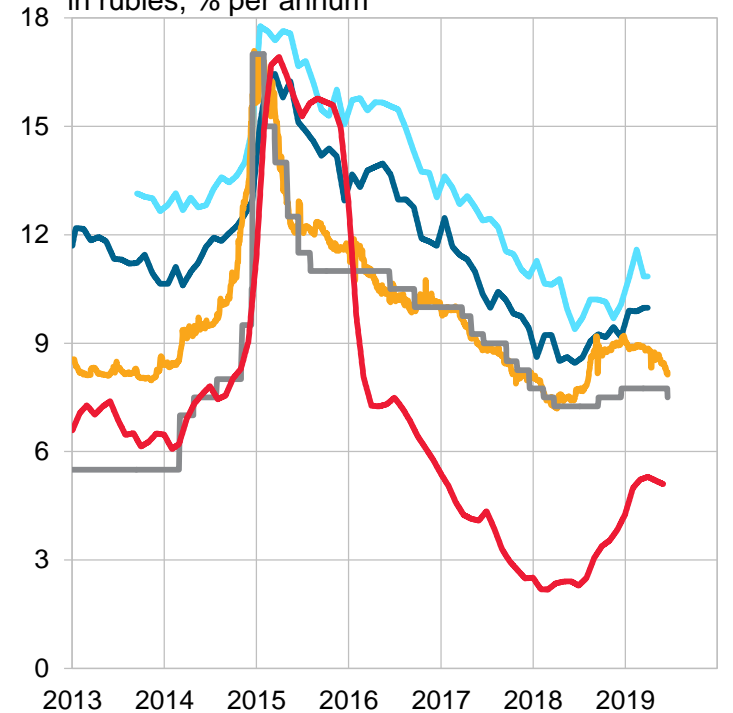
The dynamics of interest rates on household ruble deposits, % per annum



- Interest rate on short-term household deposits
- Interest rate on long-term household deposits
- Maximum interest rate on household deposits*
- Key rate
- CPI, % YoY

* Monetary policy department estimate

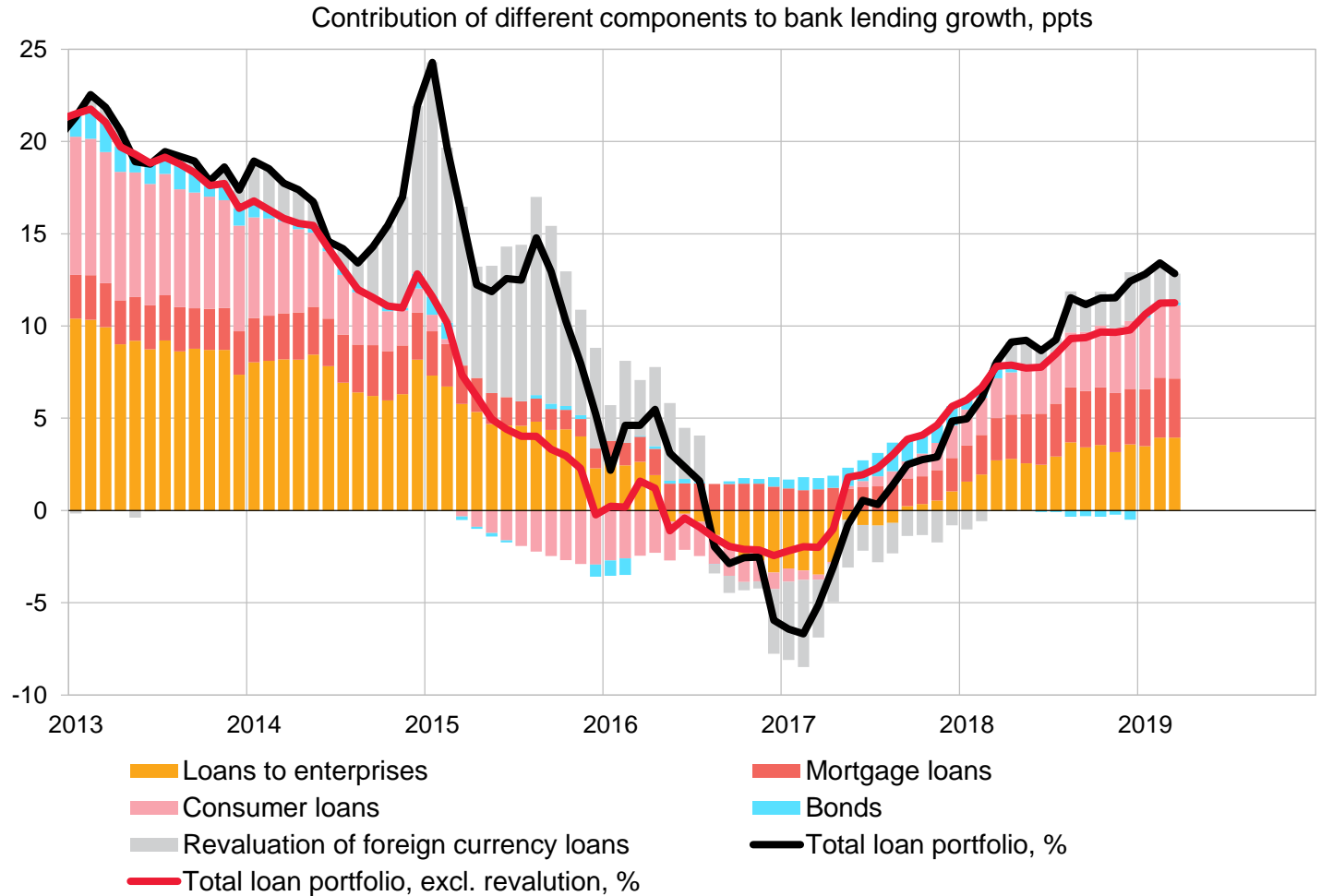
The dynamics of interest rates on corporate loans in rubles, % per annum



- Interest rate on long-term loans
- Interest rate on long-term loans for small businesses
- Corporate bond yield (IFX-Cbonds)
- Key rate
- CPI, % YoY

Deposit and credit market – lending

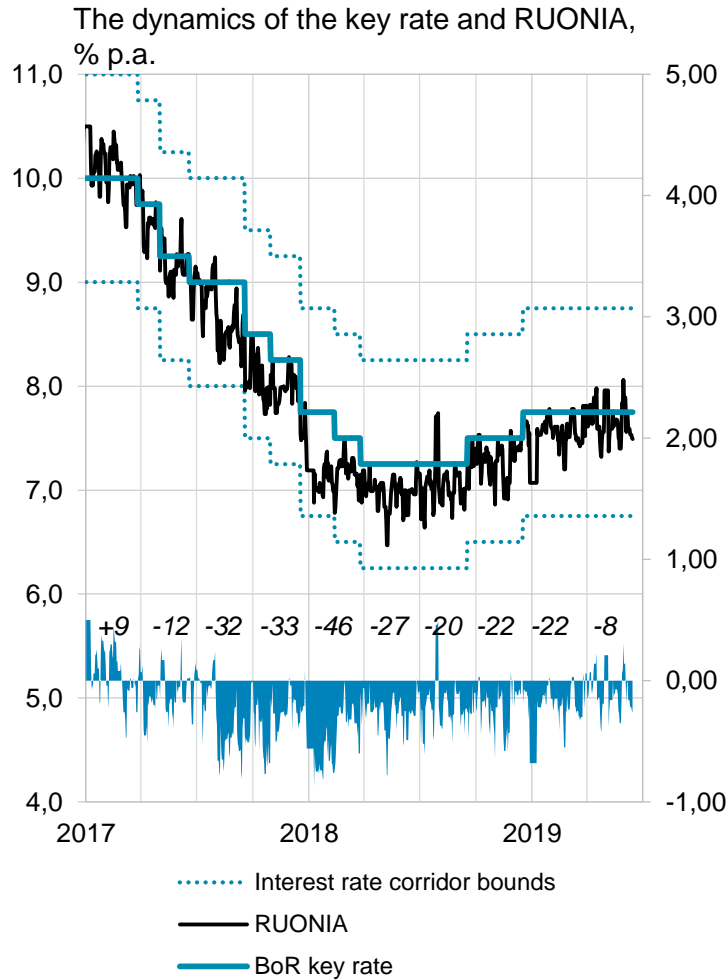
Lending to households remains the main contributor to the growth of loans.



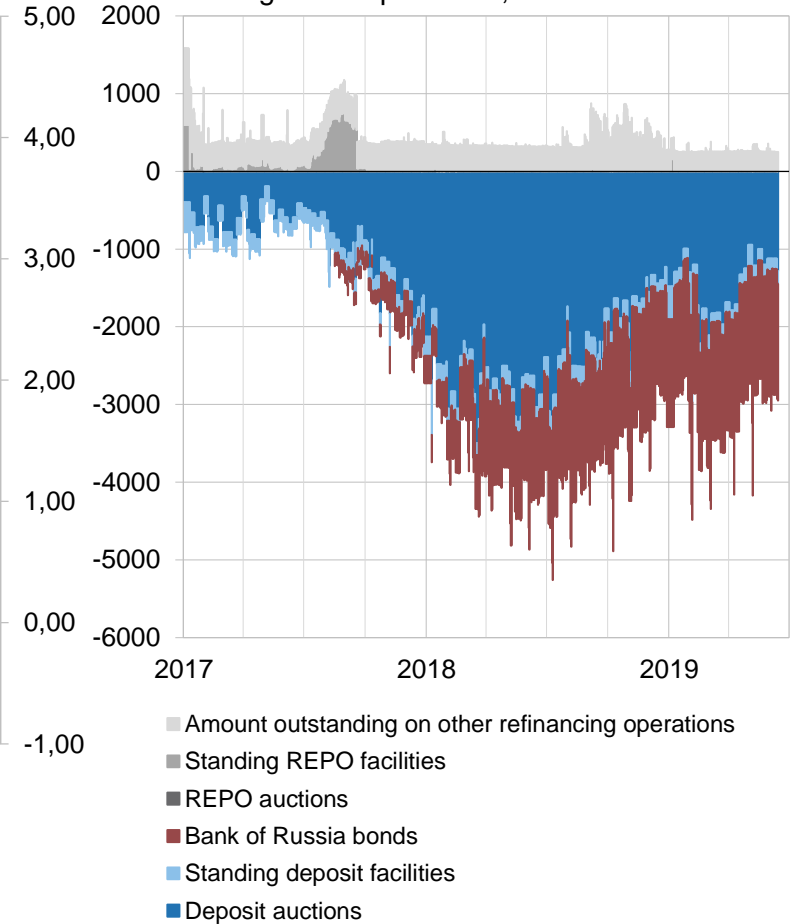
Money market conditions

Due to the structural liquidity surplus RUONIA remains moderately below the key rate.

In 1Q19 the spread averaged at -22 bps. As of 14th June, in 2Q19 the spread narrowed to -8 bps.



The structure of the Bank of Russia's liquidity management operations, bln rubles

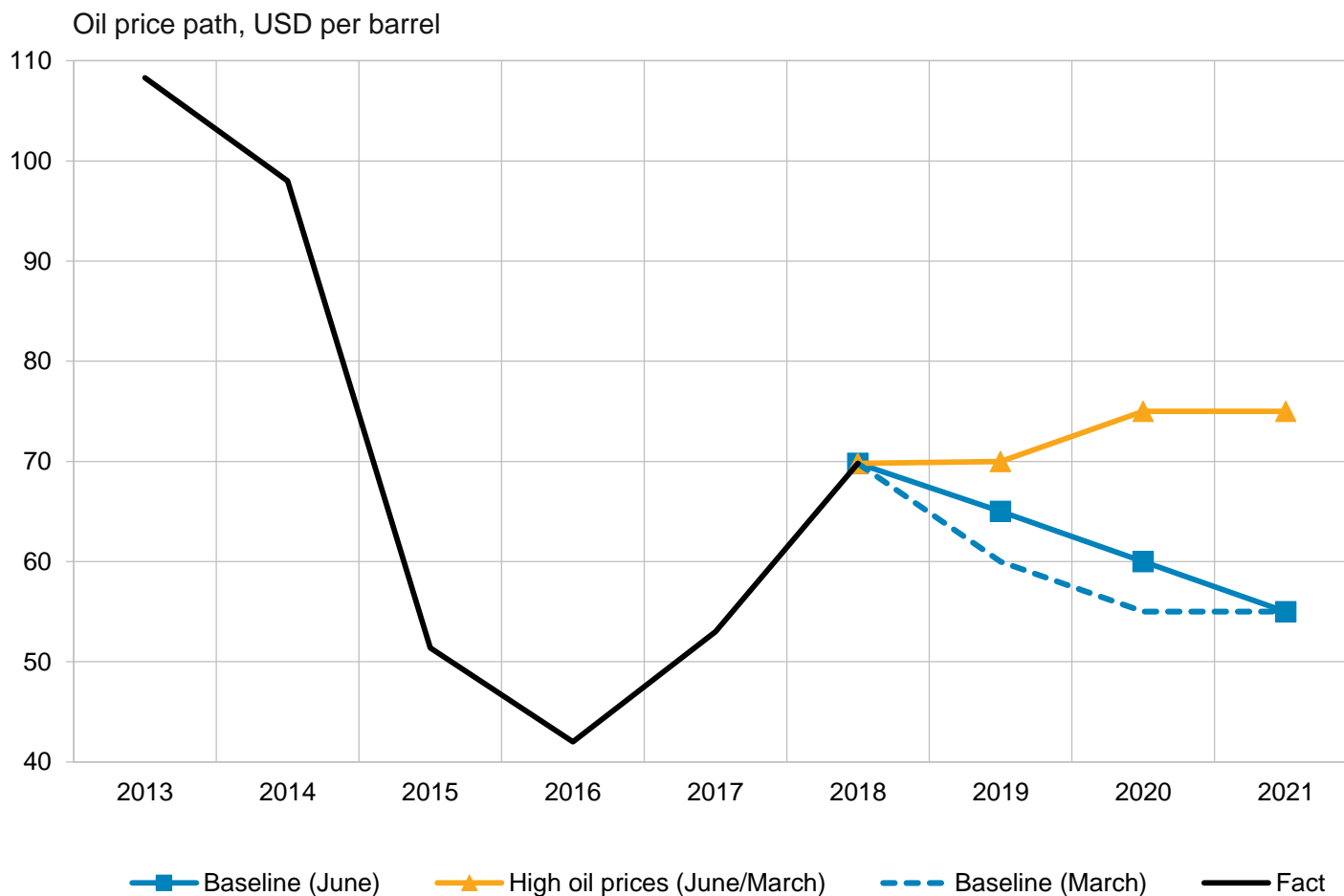


Assumptions – Oil price

Higher Urals price projections in the baseline scenario: \$65/bbl in 2019 and \$60/bbl in 2020.

2019-2020 projections are marked mostly to the fact of 1H2019 and persisting expectations of production cuts in Venezuela and Iran.

High oil prices scenario projections are unchanged compared to March.



Bank of Russia forecast, June 2019 (1)

Key parameters of the Bank of Russia's forecast scenarios (growth as % of previous year, if not indicated otherwise)	2018 (actual)	BASELINE			HIGH OIL PRICES		
		2019	2020	2021	2019	2020	2021
Urals price, average for the year, US dollars per barrel	69.8	65	60	55	70	75	75
Inflation, as % in December year-on-year	4.3	4.2-4.7	4.0	4.0	4.2-4.7	4.0	4.0
Inflation, average for the year, as % year-on-year	2.9	4.7-4.9	4.0	4.0	4.7-4.9	4.0	4.0
Gross domestic product	2.3	1.0-1.5	1.8-2.3	2.0-3.0	1.0-1.5	2.0-2.5	2.0-3.0
Final consumption expenditure	1.8	1.0-1.5	1.8-2.3	2.0-2.5	1.0-1.5	2.0-2.5	2.0-2.5
– households	2.3	1.0-1.5	1.8-2.3	2.5-3.0	1.0-1.5	2.3-2.8	2.5-3.0
Gross capital formation	0.8	0.5-1.5	3.5-4.5	3.5-4.5	0.5-1.5	3.5-4.5	3.5-4.5
– gross fixed capital formation	2.9	1.0-2.0	3.5-4.5	3.5-4.5	1.0-2.0	3.5-4.5	3.5-4.5
Exports	5.5	0.8-1.3	2.7-3.2	2.7-3.2	0.8-1.3	2.7-3.2	2.7-3.2
Imports	2.7	1.0-1.5	3.8-4.2	4.5-5.0	1.0-1.5	4.0-4.5	4.5-5.0
Money supply in national definition	11.0	8-12	7-12	7–12	9-13	8-13	8-13
Claims on organisations and households in rubles and foreign currency ¹	11.5	8-12	7-12	7–12	9-13	7-12	7-12
– claims on non-financial and financial organisations in rubles and foreign currency, growth as % over year	8.4	7-10	6-10	6–10	8-11	6-10	6-10
– claims on households in rubles and foreign currency, growth as % over year	22.0	15-20	11-16	10–15	16-21	12-17	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 the currency of the Russian Federation, a 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.

Bank of Russia forecast, June 2019 (2)

Russia's balance of payments indicators* (billions of US dollars)	2018 (actual)	BASELINE			HIGH OIL PRICES		
		2019	2020	2021	2019	2020	2021
Current account	114	98	72	50	106	112	103
Balance of trade	194	184	160	139	190	203	199
<i>Exports</i>	443	434	424	415	443	475	493
<i>Imports</i>	249	250	264	276	253	272	294
Balance of services	-30	-33	-37	-37	-31	-35	-40
<i>Exports</i>	65	62	63	66	66	70	73
<i>Imports</i>	95	95	100	103	97	105	113
Balance of primary and secondary income	-51	-53	-51	-52	-53	-56	-56
Current and capital account balance	113	98	72	50	106	112	103
Financial account (excluding reserve assets)	77	32	16	7	32	29	24
Government and the central bank	9	-18	-6	-6	-18	-6	-6
Private sector	68	50	22	13	50	35	30
Net errors and omissions	3	0	0	0	0	0	0
Change in reserve assets ('+' – increase, '-' – decrease)	38	66	56	43	74	83	79

* 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.

Monetary policy decision on 14 June 2019

Inflation and inflation expectations

- Annual inflation slowdown is continuing. CPI declined in May to 5.1% YoY and stood at 5.0% YoY as of 10 June.
- Starting in February, MoM SA consumer price growth has remained close to 4% (annualised).
- In May, households' inflation expectations and business price expectations did not materially change and remain elevated.
- The Bank of Russia has lowered its end-of-year annual inflation forecast for 2019 from 4.7-5.2% to 4.2-4.7%.
- The revised forecast takes into account the completion of the VAT increase pass-through to prices (including the influence of secondary effects) and the preservation of relatively favourable external conditions and moderate dynamics of domestic demand.
- Moving on, according to the Bank of Russia's forecast, annual inflation will stay close to 4%.

Monetary conditions

- Monetary conditions have somewhat eased since the last Board meeting.
- OFZ yields and deposit rates have declined. The potential for lending rates growth has mostly exhausted.
- the Bank of Russia's decision to cut the key rate and the year-to-date decline in OFZ yields create conditions for the decline of deposit and lending rates in the future.

Economic activity

- Economic growth in 1H 2019 is lower than the Bank of Russia's expectations.
- During the first four months of 2019, the growth in general government income outperformed the growth in expenses, which, in part, is due to the shift to 2H 2019 of the implementation of a number of national projects.
- Taking into account GDP growth statistics for 2018 — 2019 Q1 published by Rosstat, the Bank of Russia lowered its GDP growth forecast for 2019 from 1.2-1.7% to 1.0-1.5%.

Short-term proinflationary risks have abated compared to March

Internal risks

- The effects of the VAT hike have fully materialised (↓)
- Elevated and unanchored inflation expectations
- Medium-term fiscal policy parameters

Moderate risks – estimates are mostly unchanged:

- Wage movements
- Prices of individual food products
- Possible changes in consumer behavior

External risks

- Risks of persistent capital outflows from emerging markets (↓)
- Slowdown in global economic growth
- Geopolitical factors
- The volatility of global oil prices

Decision

The Bank of Russia
cuts the key rate by 25 bp
 to 7.50% p.a.

Signal

"...If the situation develops in line with the baseline forecast, the Bank of Russia admits the possibility of further key rate reduction at one of the upcoming Board of Directors' meetings and a transition to neutral monetary policy until mid-2020.

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..."