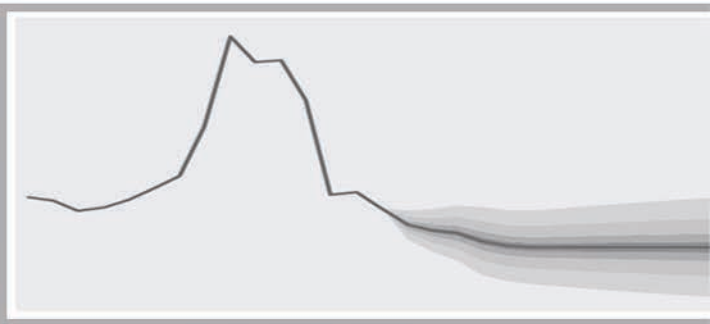
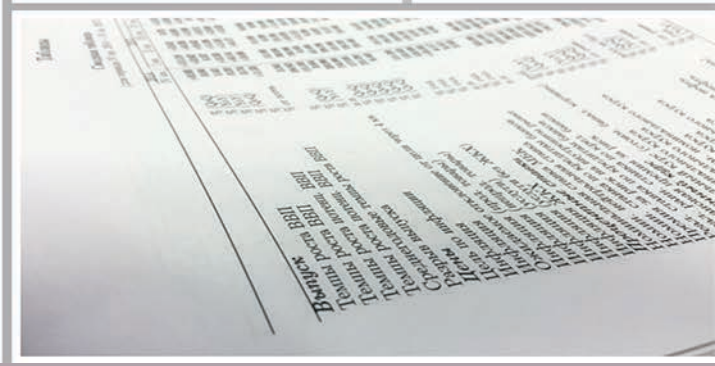
Bank of Russia

The Central Bank of the Russian Federation



4%



No. 2
JUNE 2017

MONETARY POLICY REPORT

Moscow

DEAR READERS,

In order to improve the effectiveness of the Bank of Russia's information policy with regard to its monetary policy and to assess the relevance of and demand for the materials published, we would be grateful if you could answer the following questions.

1. Do you consider there to be an optimal level of detail in the material presented?

2. Which subjects, in your opinion, should be illustrated in this report?

3. Do you have any other comments or suggestions regarding the report?

4. What is your professional field of interest?

Many thanks in advance for your assistance.

The report has been prepared based on statistics as of 9 June 2017.
Data cut-off date for forecast calculations is 2 June 2017 (if statistics and other information relevant for decision-making appear after the data cut-off date, they are included in the text of the Report and may be used for the adjustment of the mid-term forecast).

An electronic version of the information and analytical review can be found on the Bank of Russia website at http://www.cbr.ru/publ/.

Please send your suggestions and comments to monetarypolicyreport@mail.cbr.ru.

CONTENTS

SUMMARY

In March-June, the situation in the Russian economy has evolved broadly in line with the forecast presented in the March release of the Monetary Policy Report (hereinafter, the Report).

Inflation has approached the 4% target. In January-May, the average monthly consumer price growth (seasonally adjusted) was 0.3%. The current price dynamics corresponds to the baseline scenario path. Growth in prices for non-food goods and services continued to decline. A slight increase in food price inflation was a result of the depletion of the previous year's vegetable and fruit stocks, while remaining within the range expected by the Bank of Russia. The influence of the unfavourable weather conditions of the 2017 spring on the new harvest may produce another temporary surge in food price growth rates during several months ahead.

Short-term inflation risks linked to changes in the external economic situation skewed a little to the downside. This was helped by subdued uncertainty in the commodity markets' dynamics in 2017 – early 2018, given the extension of the oil production restriction agreement. However, the uncertainty will remain over the mid-term horizon, thereby forcing the Bank of Russia to maintain a conservative approach to the selection of oil price assumptions and to keep considering alternative scenarios depending on external conditions. Legislative adoption and implementation of the budget rule will alleviate the economy's dependence on changes in the external economic situation.

In spring, the decline in price growth was supported by the consumer demand dynamics which demonstrated gradual recovery, though remaining rather moderate. Inflation expectations also declined; their dynamics contributed to inflation slowdown. Exchange rate dynamics also produced a downward pressure on price growth rates, though the scale of this influence was much less pronounced than at the start of the year.

Recovery in the Russian economy continued and became robust. As previously, revival was observed in industrial sectors, it was most noticeable in the production of raw materials and consumer goods. Investment activity continued to expand. This was helped by the steadily improving financial position of enterprises and the positive influence of the ruble appreciation on capital-intensive and high-tech sectors. Sustainable recovery processes are also observed in the consumer activity dynamics. According to Rosstat, retail trade turnover stopped declining in April. The rebound in demand seen in 2017 Q1 was supported by positive dynamics of real wages, taking place since the end of 2016. This comes largely as a result of generally increased demand for labour together with consistently low unemployment rate, close to its natural level. At the same time, real household income generally continued to reduce. This, in combination with the persistent and moderately tight monetary stance, shaped a gradual recovery in consumption.

Given the inflation closing on the target, inflation expectations staying on the downward track and economic activity recovering, the Bank of Russia decided to reduce the key rate to 9.00% p.a.

The prolongation of the oil production restriction agreement up to March 2018 did not change the Bank of Russia's medium-term view, however, it formed the basis for minor changes to the forecasts in all scenarios, mainly regarding short-term prospects. According to the Bank of Russia's baseline scenario, in 2017 GDP growth rates will be close to the potential level at 1.3-1.8%. In 2018, despite a temporary deterioration in external conditions, there are no grounds to expect a considerable slowdown in economic growth or a deterioration in domestic economic conditions in Russia in general. Relatively short-term growth adjustment amid aggravated external conditions is a result of a gradual increase in the economy's resilience against external shocks and lower sensitivity to the fluctuations in the commodity markets. This trend will

be further supported by setting the budget rule, whose transitional version has been implemented by Russia's Finance Ministry since February 2017. Additionally, the safety margin achieved due to the continued recovery processes will support the economy's resilience to various shocks. In 2019-2020, GDP growth rates will be around 1.5-2.0%, which is close to the current assessment of its potential level. The possibilities of higher growth will be mainly shaped by the speed and scale of structural reforms and institutional changes.

Economic activity recovery will improve the quality of bank's credit portfolios and will create conditions for the easing of requirements for borrowers and other non-price lending conditions. However, the on-going conservative approach maintained by banks will help avoid risks and select most reliable borrowers. Consistent moderately tight monetary stance will support incentives for saving in the Russian economy. In these settings, the recovery in demand will be the result of growth in incomes, and the transition from the saving behaviour model to the consumption behaviour model among households will be gradual and will not cause inflation deviate from the target. However, a sharper fall in households' propensity to save might lead to increased inflationary pressure. Accelerated growth in wages that exceeds the rise in labour productivity might also become a pro-inflationary factor given increased structural labour shortages. Moreover, the final anchoring of inflation expectations close to the inflation target may take a long time. This is due to the high sensitivity of inflation expectations to the price and exchange rate fluctuations, even short-term and transitory by nature. An additional source of uncertainty may come from the non-oil and gas tax manoeuvre which may cause a short-term inflation hike.

Thus, despite a decline in the short-term, inflation risks remain over the mid-term horizon. The moderately tight monetary policy is a must to maintain inflation close to the 4% target.

The Bank of Russia sees room for cutting the key rate in the second half of 2017. While making its decision hereinafter, the Bank of Russia will assess inflation risks, the inflation dynamics and economic developments against the forecast.

1. MACROECONOMIC CONDITIONS

External conditions

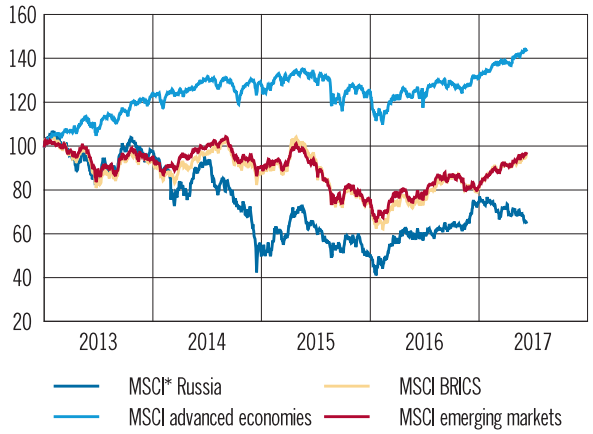
In March-June, external economic conditions for Russia were shaped by the high degree of discipline in adhering to the oil production restriction agreement and increased optimism among global investors due to relatively favourable dynamics in the Chinese economy, together with improved certainty about the future with respect to the political and economic developments across a number of major countries. Global stock indices in the main groups of countries showed solid growth in March-June, and indicators of volatility and investors' perceptions of risk remained low on the whole (Charts 1.1, 1.2). An occasional increase in volatility was linked primarily to uncertainty over the outcome of the French presidential election in April-May.

The dynamics of global commodity markets were influenced by oil-exporting countries honouring the oil production restriction agreement, which contributed to energy prices being higher in spring compared with the same period in 2016. This helped to support Russian exports and economic activity as a whole (see box 'Influence of the oil production restriction agreement on participatory countries' and Annex 'Dynamics of major items in the Russian balance of payments in 2017 Q1').

Supply and demand in the oil market returned to equilibrium relatively quickly in the first half of 2017 (Chart 1.3). The average Urals crude price in March-May was roughly $50 per barrel, which was slightly lower than at the start of the year. One of the reasons for the slight price adjustment was the production increase in the US, which exceeded

Chart 1.1

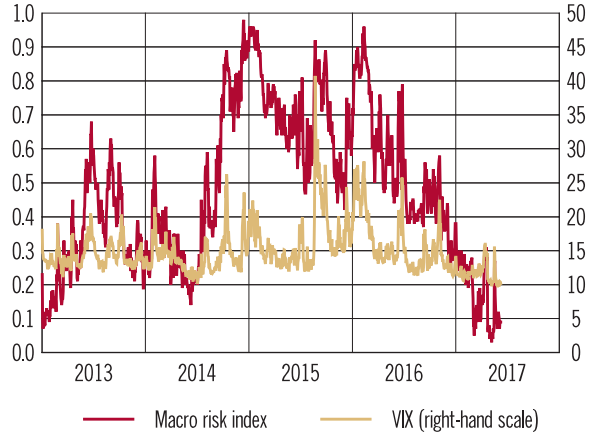
Global stock indices
(January 2013 = 100%)



** See the Glossary.*
Source: Bloomberg.

Chart 1.2

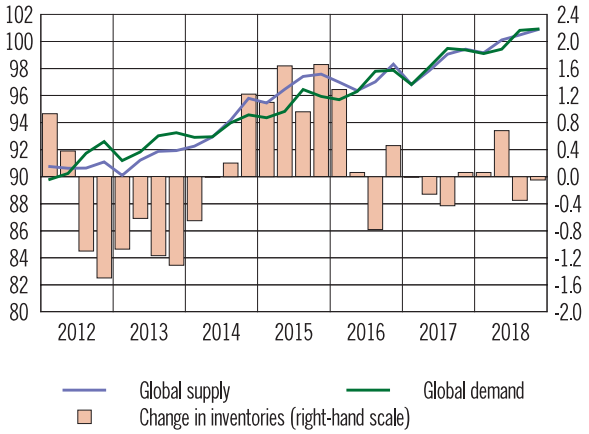
Indices of volatility and global financial market risk perception by investors
(points)



Source: Bloomberg.

Chart 1.3

Balance of global supply and demand for oil and other liquid fuel
(million barrels/day)



Source: US Department of Energy.

Influence of the oil production restriction agreement on participatory countries

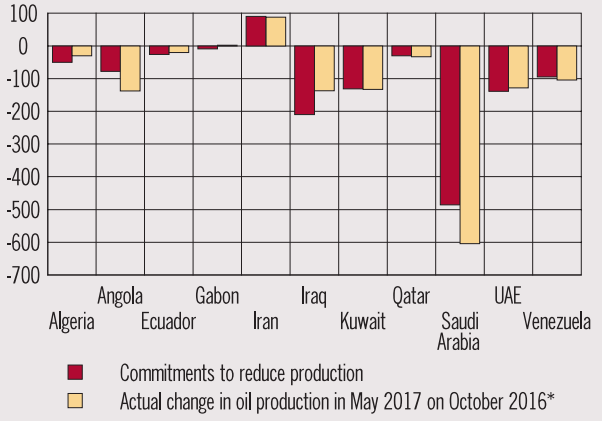
In the first half of 2017, the OPEC member countries[1] and 11 non-OPEC countries dutifully fulfilled their obligations under the agreement to reduce oil production by a total of 1.8 million barrels per day compared with October 2016. The Joint Ministerial Monitoring Committee[2] noted that the extent of compliance with the arrangements grew in April by 4 percentage points, to 102%. This unprecedented compliance accelerated the rebalancing of the market (Chart 1.4). Global production reduced and some OPEC countries contracted their oil export quantities. According to IEA estimates, the surplus global supply went down from 0.6 million barrels per day in 2016 Q4 to almost zero in 2017 Q1, and in Q2 a deficit of 0.5 million barrels per day is expected. Oil reserves shrank rapidly compared with seasonal norms.

According to IEA estimates, in 2017 Q1, as a result of 9% growth in oil prices compared with 2016 Q4, OPEC's daily income from oil production increased by roughly 5%, despite the 4% reduction in production quantities. Iran benefited the most in dollar terms ($15 million per day).

Non-OPEC countries, particularly Russia, also experienced positive effects on prices from the agreement. According to estimates from the advisory company IHS Markit, thanks to the arrangements reached, the $7 per barrel growth in oil price[3] outweighed the effect of the reduced production and resulted in a 20% increase in tax receipts in Russia ($9 billion) in the first half of 2017, while Russian oil companies' profits from oil production increased by $0.9 per barrel (23% in dollar terms and 17% in ruble terms). According to data from the FCS of Russia, the value of Russia's crude oil exports in 2017 Q1 increased by 8% quarter on quarter due to a 12% growth in the average actual export price, despite the 4% reduction in actual quantities.

Chart 1.4

Full compliance with agreements by OPEC members
(thousand barrels/day)



** Adjustment for Angola: on September 2016.*
Source: OPEC.

[1] *Excluding Libya and Nigeria.*

[2] *The Joint Ministerial Monitoring Committee, which oversees the implementation of the oil production restriction agreement, was established in accordance with OPEC's 171st Ministerial Conference Decision of 30 November 2016, and the Declaration of Cooperation approved at the joint OPEC-non-OPEC ministerial meeting held on 10 December 2016.*

[3] *Growth in oil prices, as the three-month average after the agreement, compared with the three-month average before the agreement.*

expectations. Should this trend continue further it could to a certain extent weaken the upward effect on prices from the restrictions imposed on oil production. Renewed production in Libya and Nigeria could also exert additional downward pressure on prices. Taking these factors into account, the Bank of Russia assumed in its baseline scenario that the balance of demand for, and supply of, energy resources will stay at a level close to that observed in the first half of 2017 and that Urals crude prices will remain close to current levels up to the end of the year. If oil prices are maintained relatively high over 2017, this will continue to buoy economic activity in Russia.

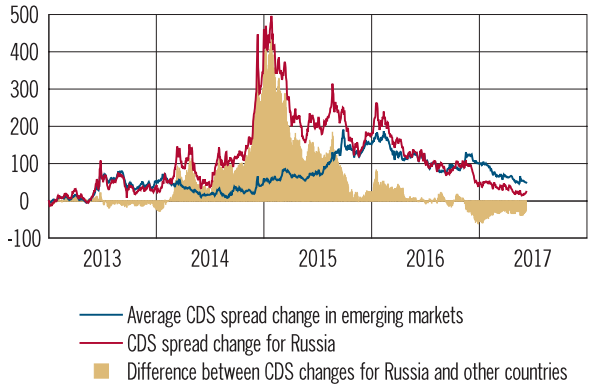
The dynamics of commodity market prices together with increased optimism among global investors and their interest in high-risk assets contributed to a further inflow of capital into emerging markets, including Russia (Charts 1.5, 1.6). Against this backdrop, Russia's risk premium decreased and was, on the whole, comparable with the average for EMEs (see Abbreviations). In these conditions, Russian companies have built up their foreign liabilities, although the external debt repayment schedule still assumed significant debt repayments.

The favourable capital flow dynamics and persistently high sales of FX export earnings continued to provide support for the ruble exchange rate. The

Chart 1.5

Change in risk premium in Russia and emerging markets*

(basis points)

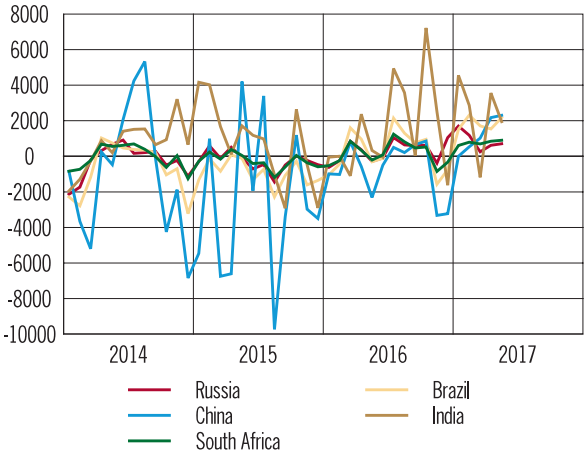


** Average CDS spread for emerging markets is based on the data for Brazil, China, Turkey, Mexico, and Malaysia.*
Sources: Bloomberg, Bank of Russia calculations.

Chart 1.6

Portfolio investment inflow into BRICS countries

(millions of US dollars)

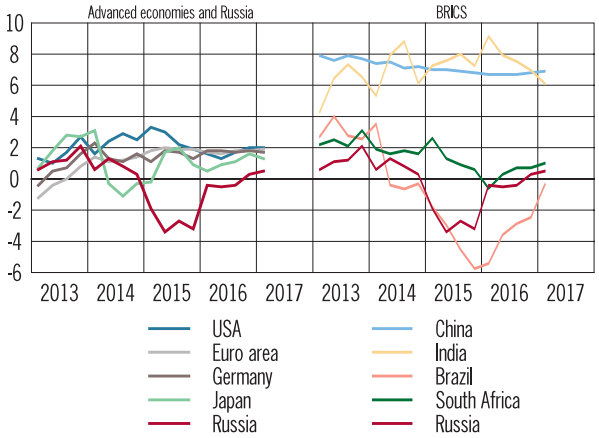


Source: EPFR Global.

Chart 1.7

GDP growth in key advanced and emerging economies

(percent change on corresponding period of previous year)

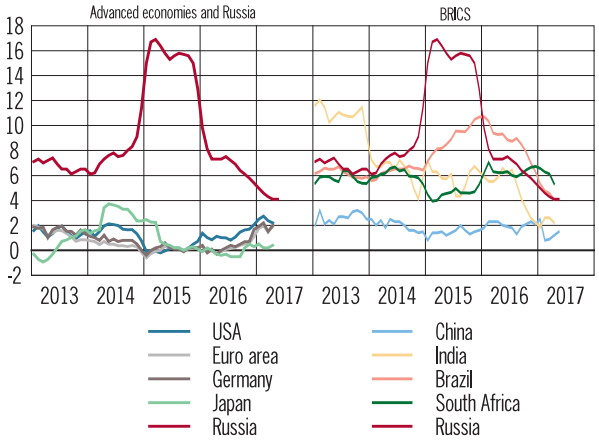


Sources: national statistics agencies, Bloomberg.

Chart 1.8

Inflation in key advanced and emerging economies

(percent change on corresponding period of previous year)



Sources: national statistics agencies, Bloomberg.

episodic increase in volatility in the market linked to political events was accompanied by a short-term depreciation of the ruble on several days in April-May. This was in part also due to the drop in oil prices amid expanded drilling activity in the US and the increase in oil production in Libya at the start of May. However, given the moderate demand for foreign currency and the ruble exchange rate's generally subdued sensitivity to fluctuations in oil prices, no significant exchange rate volatility was observed. Overall, in spring the ruble exchange rate dynamics exhibited growth trends, albeit significantly less pronounced than in previous months. The strengthening of the ruble, including in the first few months of the year, continued to contribute to the slowdown in inflation.

Amid the marked improvement in sentiment across global financial markets, demand in the global economy remained relatively stable on the whole, which was also a factor supporting economic dynamics in Russia. In 2017 Q1, advanced economies still grew for the most part at a moderate pace of 1.6–2%, while growth in emerging economies, as previously, was more varied, both in terms of scale and dynamics (Chart 1.7). In view of these trends, the Bank of Russia retained its estimate of aggregate growth for Russia's trading partners, at roughly 2%.

External inflationary pressure in March-April also remained moderate on the whole and did not create any significant risks of a surge in price growth in Russia. For Russia's trading partners, inflation demonstrated mixed dynamics, including inflation in some of the largest economies (Chart 1.8). In the US, amid growing doubts surrounding the successful implementation of Donald Trump's economic programme, including fiscal policy measures, inflation expectations abated in April-May. Price growth for a wide range of goods also slowed. However, the low level of unemployment and the massive creation of new jobs in the economy still allowed the US Fed to continue with the further normalisation of its monetary policy in 2017, according to statements by Fed representatives. The slight increase in inflation in euro-area countries in April also created the pre-conditions for the ECB to normalise its monetary policy in the medium term.

Despite the relatively stable global demand and energy market, prices for key Russian export goods (primarily metals) recovered at a somewhat slower pace in March-April (Chart 1.9). Operational indicators suggest that this may in part be aided by the slight slowdown in growth in Chinese business activity, which has exerted downward pressure on demand in the global metal market. Global food prices also reduced overall in spring, due to the good harvests and favourable prospects for still better harvests in future. This helped to keep food inflation relatively low in Russia.

Internal financial conditions

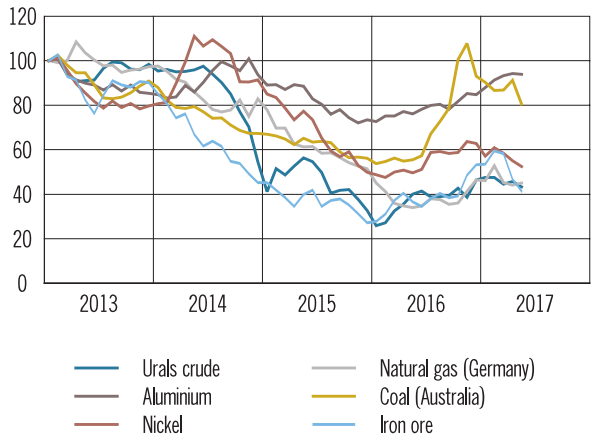
In April-June 2017, the situation in the financial sector of the Russian economy was shaped by the Bank of Russia's monetary policy, which was aimed at achieving the 4% inflation target by the end of 2017 and maintaining price stability in future. The Bank of Russia's decisions to cut the key rate in March and April determined the path of short-term money market rates and government bond yields and, eventually, price indicators across other segments of the financial market. At the same time, the Bank of Russia's signals regarding the possible scale and speed of changes to the key rate over the short term influenced market participants' expectations, causing them to remain moderately optimistic and to apply a well-balanced approach to determining the parameters of their operations in various market segments. Due to market participants' conservative approach to risk and the Bank of Russia's gradually reducing the key rate, monetary conditions were moderately tight in March-June 2017. This contributed to a further decline in inflation and inflation expectations and helped to maintain positive real interest rates in the Russian economy.

The Bank of Russia's operations to absorb liquidity kept short-term money market rates close to the Bank of Russia's key rate (Chart 1.10). In spring, the banking sector predominantly operated in the situation of a structural liquidity surplus; the transition to it had been completed in early 2017.

Chart 1.9

World prices of Russian principal export commodities

(1.01.2013 = 100%)

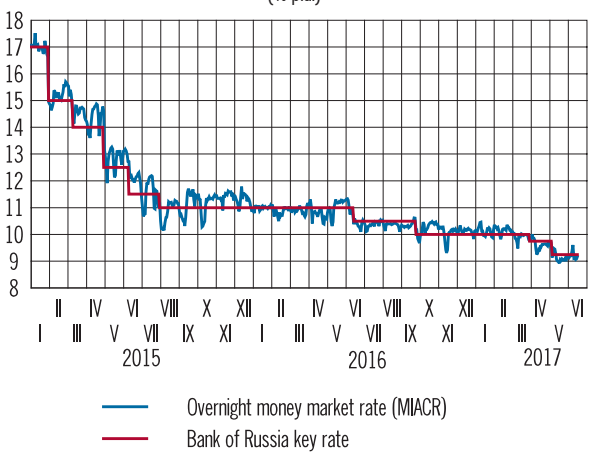


Sources: World Bank, Reuters data (Urals crude price).

Chart 1.10

Bank of Russia key rate and MIACR

(% p.a.)



Source: Bank of Russia.

Fiscal policy

Amid the more positive foreign economic climate and faster than expected economic recovery, budget income was higher than planned. As a result, the Russian Ministry of Finance continued with its strategy of fiscal consolidation, despite increased budget allocations on social spending[1].

In January-May 2017, the federal budget was executed with the deficit of ₽564 billion (1.7% of GDP[2]), which was funded primarily through internal borrowing as part of the successful OFZ placement. However, sovereign funds were not used to fund the budget deficit in January-May 2017. In February-June, the amount of additional oil and gas revenues was ₽307 billion, which the Russian Ministry of Finance used to acquire foreign currency to replenish the Reserve Fund.

The year-on-year federal budget deficit reduced from 3.4% of GDP at the end of 2016 to 2.5% of GDP at the end of May 2017. As such, the budget deficit fell below the deficit of 3.2% of GDP initially set out in Federal Law No. 415-FZ 'On the Federal Budget for 2017 and the Plan Period of 2018 and 2019' (hereinafter, the budget law).

Against this backdrop, in May 2017, the Russian Government approved the Russian Ministry of Finance's proposed amendments and additions, and submitted to the State Duma the draft of a new budget law based on the socio-economic growth forecast published by the Russian Ministry of Economic Development in April 2017.

According to the updated draft federal budget for 2017, the expenditure plan was increased by ₽362 billion to ₽16,603 billion (18.0% of GDP), on account of certain fund allocations for economic (including contributions to the authorised capitals of Rosselkhozbank (Russian Agricultural Bank), Roskosmos and Russian Railways) and social purposes. At the same time, the forecast for budget income was adjusted upwards by ₽1,191 billion to ₽14,679 billion (16.9% of GDP), on account of growth in both oil and gas revenues and non-oil and gas revenues.

The increase in the forecast for oil and gas revenues was linked to the growth in oil prices at the start of 2017 and oil prices remaining above $40 per barrel. The increase in the forecast for non-oil and gas revenues was linked to the material annual growth in receipts from taxes on goods (VAT and excises) and profit tax (17.7% growth in January-April compared with the same period in 2016), and to the repayment of a portion of the asset contribution to the capital of the DIA.

As a result, the federal budget deficit reduced by ₽829 billion to ₽1,924 billion (2.1% of GDP). The use of sovereign funds to finance the deficit fell insignificantly to ₽1,725 billion in view of the less active use of alternative sources, including a lower estimate of net borrowings under external loans and the abandonment of plans to privatise a 10.9% block of shares in VTB (₽96 billion).

[1] The one-time ₽5,000 payment to pensioners in January 2017 and two indexations of pensions and social benefits in February in April (see box 'Fiscal policy' in the previous Report).

[2] GDP is based on the Russian Ministry of Finance's preliminary estimates.

Growth in the surplus was constrained by significant tax payments by banks' customers amid subdued budgetary expenditure (see box 'Fiscal policy') and seasonal growth in cash in circulation in the run up to the May holidays. Maintaining the structural liquidity surplus in future will still not exert a significant influence on the Bank of Russia's ability to manage money market rates. In April through mid-June, the FX liquidity situation in the Russian market was also favourable; this was in part due to the inflow of foreign currency into the current account amid relatively high oil prices. This contributed to a further reduction in banks' outstanding amounts on Bank of Russia foreign currency refinancing operations.

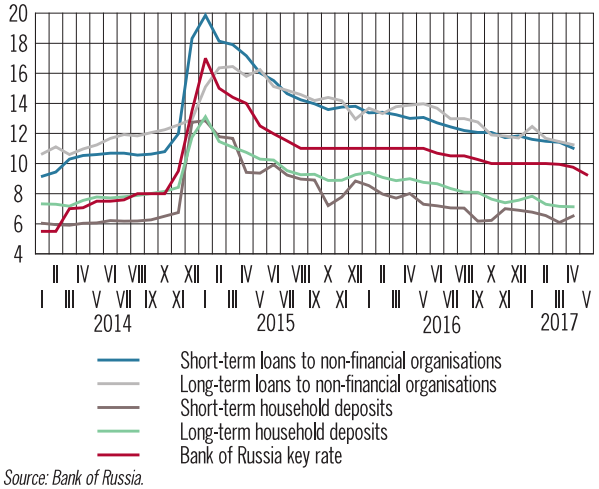
Both the March and April decisions by the Bank of Russia Board of Directors to cut the key rate (by 25 and 50 bp respectively) had a downward effect on loan and deposit rates, and on expectations regarding their future dynamics (Chart 1.11). The reduction of the key rate in March after a rather long series of decisions to leave it unchanged amid the relatively propitious situation in the Russian economy was generally expected by market participants. The decision to cut the key rate by 25 bp[1] was per-

[1] In 2016, the key rate was cut in 50 basis-point steps.

Chart 1.11

Interest rates on bank ruble operations and Bank of Russia key rate

(% p.a.)

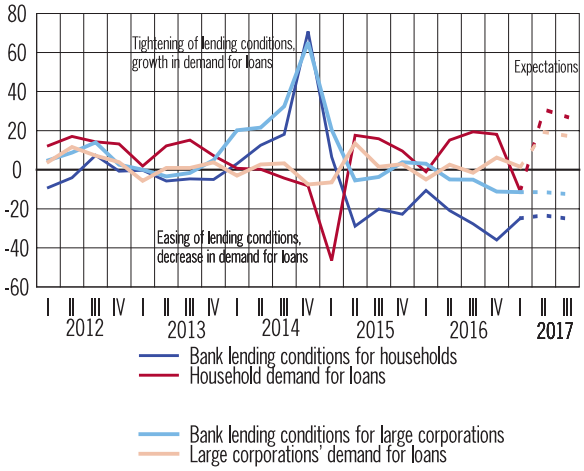


Source: Bank of Russia.

Chart 1.12

Lending conditions and demand for loans indices

(percentage points)



Source: Bank of Russia.

ceived as additional confirmation of a conservative approach to easing monetary policy in future. The April decision also did not lead to any considerable adjustments in expectations. As previously, market participants anticipated a significant reduction in rates over the long-term horizon, whereas there was far less certainty about short-term dynamics. This was manifested in the rapid drop in long-term rates across certain market segments.

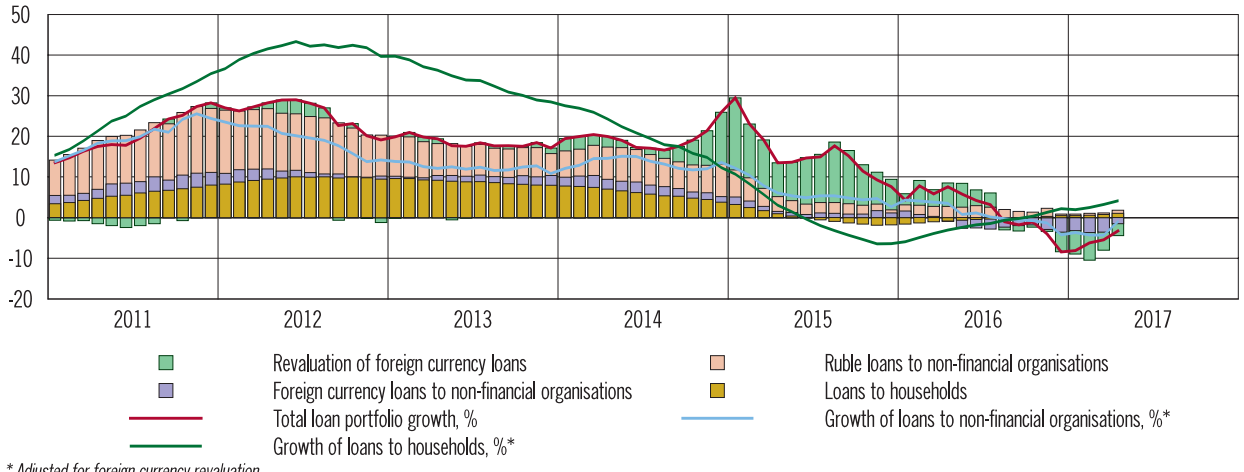
The continuation of moderately tight price lending conditions was facilitated by the gradual easing of the Bank of Russia's monetary policy. Banks' overall policies also remained conservative, as manifested by persistently rather strict requirements for borrowers (Chart 1.12). Banks continued to avoid risky lending, competing for the most reliable borrowers and expanding their bond portfolios. This selective approach to choosing customers, amid the gradual economic recovery, which has contributed to an improvement in borrowers' financial positions, caused, among other things, an increase in the quality of banks' loan and bond portfolios.

In these conditions, lending dynamics remained constrained in spring 2017. The contraction in the size of banks' loan portfolio slowed slightly, and their annual growth was near zero (Chart 1.13). Lending to non-financial organisations continued to

Chart 1.13

Contribution of various components to annual growth rate of banks' loan portfolio

(percentage points)



** Adjusted for foreign currency revaluation.*
Source: Bank of Russia.

decrease, mostly due to certain major budget-funded organisations repaying their liabilities. Household lending also made a positive contribution to loan portfolio dynamics. Furthermore, mortgage lending continued to demonstrate solid growth, while consumer lending dynamics remained modest and did not pose any significant inflation risks. In January-April 2017, consumer lending grew by an estimated 0.65%, with annual growth remaining negative. Over the same period, mortgage lending increased by 2.9%, with annual growth still exceeding 10%.

Monetary aggregates' dynamics were also moderate and stayed generally in line with the Bank of Russia's expectations. A significant factor contributing to money supply continued to be net lending to the general government from the banking system. Over 2017, as economic activity further recovers and borrower quality improves, banks are expected to continue to ease lending conditions, which will support lending activity in the economy. If banks and borrowers stick to conservative behaviour patterns, economy will see a rise in lending not threatening with any additional inflation risks.

Economic conditions

The Russian economy continued to recover in 2017 Q1. According to Rosstat data, annual GDP growth accelerated to 0.5%, after 0.3% the previous quarter (Chart 1.14). This is consistent with the Bank of Russia's estimate published in the previous Report[2].

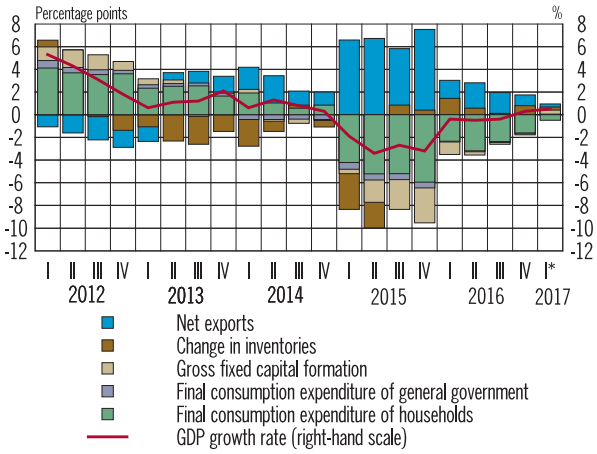
The trend of renewed production activity continued, both for Russia as a whole and in the majority of regions. Annual growth in industrial production, adjusted for the calendar factor, was in positive territory (Chart 1.15). In April, it reached 2.9% – its highest value since January 2015. However, electricity and heat production made a significant contribution, given the unusually cold weather in April.

As before, industrial production dynamics varied by type of good. In March-April, the growth in production was mainly due to the output of raw materials and intermediate goods (metallurgical and oil products, gas production). A slight revival was also seen in consumer goods production.

Chart 1.14

GDP growth structure by expenditure

(on corresponding period of previous year)



** 2017 Q1 GDP growth structure - Bank of Russia estimate.*
Sources: Rosstat, Bank of Russia calculations.

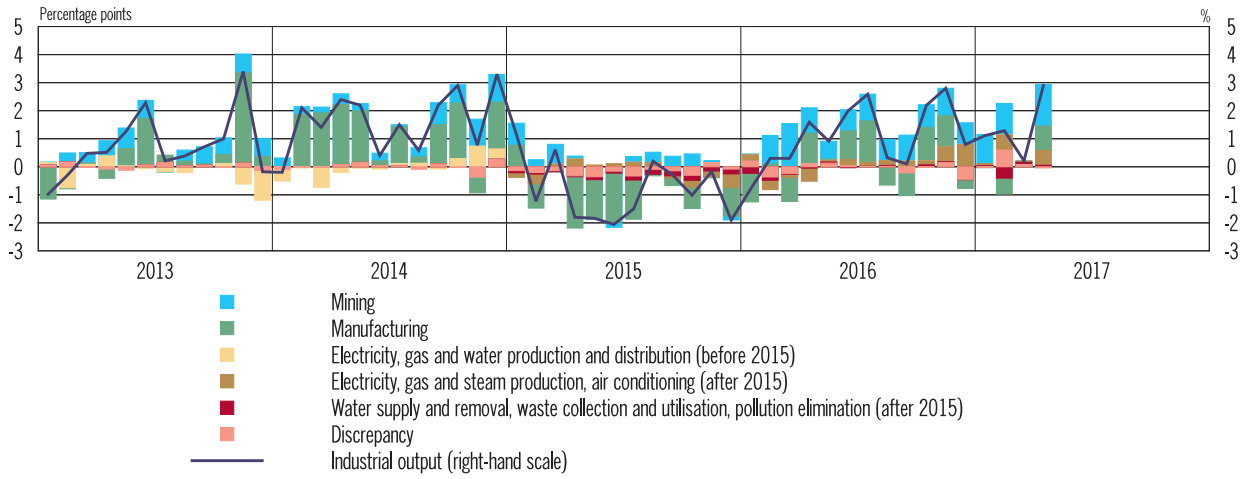
However, investment goods production dynamics were still muted, in particular in April 2017 when recovery processes slowed slightly in mechanical engineering. In contrast, imports of investment goods expanded given the ruble appreciation. Investment in equipment, including imported equipment, is creating the necessary conditions for the modernisation of production and output growth in future. The dynamics of investment goods output also reflected the on-going year-on-year contraction in the production of construction materials, which is linked to the further decrease in the volume of construction works, including housing construction. Decline in commissioned housing was in part a delayed reaction to the decrease in household real disposable income and the tightening of price and non-price mortgage lending conditions in 2014–2015. According to Bank of Russia estimates, annual growth in housing construction is not expected to move into positive territory before the second half of 2017 (see box 'Housing construction continues to fall').

However, investment activity continued to increase in the Russian economy. The annual growth in fixed capital investment was 2.3% in 2017 Q1, which is in line with the Bank of Russia's estimate

[2] *In April's information and analytical commentary on the current economic situation, the estimate calculated in March was adjusted slightly downwards to 0.2–0.4% year-on-year due to Rosstat's release of more accurate data for 2016. However, the actual current rate of GDP growth was close to the Bank of Russia's March estimate.*

Chart 1.15

Contribution of industrial output components (adjusted for calendar factor)
(on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Housing construction continues to fall

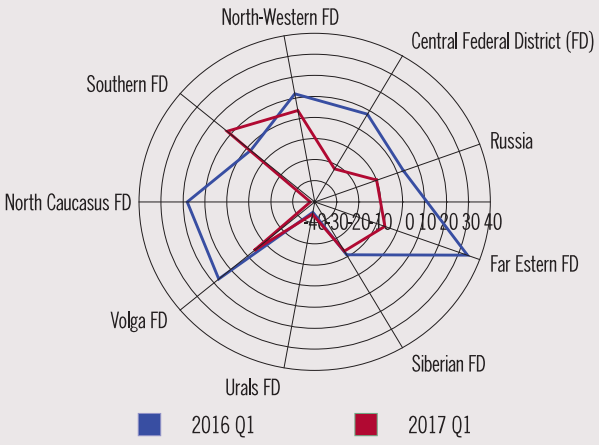
Despite the recovery in economic activity and considerable growth in mortgage lending, in 2016 housing construction shrank by 6.5% in Russia as a whole, but at the start of this year, this downward trend intensified further[1]. This trend was most pronounced in the Urals, Siberian, North-Western and Central Federal Districts.

The fall in demand for housing in 2015[2] led to a fall in the number of new construction projects. During the construction of blocks of flats, approximately 1.5–2 years pass between the start of construction and the time when the property is commissioned. As a result, by 2017, old projects had been completed, but new projects were not being released to the market as actively as before.

Chart 1.16

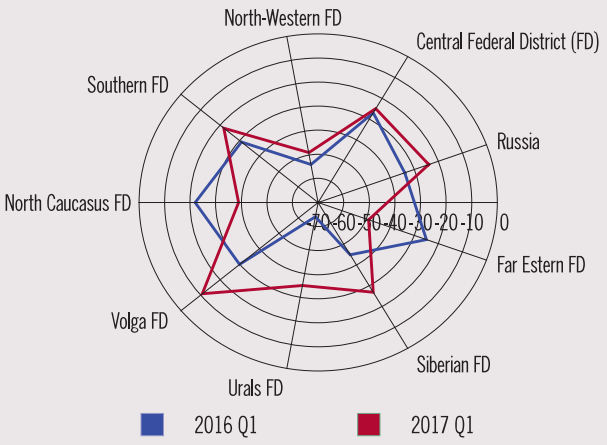
Housing commissioning by federal district
(percent change on corresponding period of previous year)

Blocks of flats



Sources: Rosstat, Bank of Russia calculations.

Individual housing construction



Sources: Rosstat, Bank of Russia calculations.

[1] *In January 2017, housing construction reduced by 21.6% year on year. Subsequently, the annual rate of decrease slowed slightly, which could be linked to the low base effect of the previous year.*

[2] *In 2015, the amount of mortgage lending reduced by 34%, which dealt a serious blow to demand (in 2014, one third of apartments was purchased using a mortgage).*

The main reason for these negative dynamics in new housing commissioning may be the continued squeeze in household real disposable income amid the persistently high supply of housing in many regions leading by housing construction, as well as the downturn in the financial position among, and withdrawal from the market of, small and some medium-sized construction companies.

Construction of blocks of flats is characterised by high inertia, while individual housing construction is generally faster at reacting to changes in the economic situation. Therefore, the former shrank rapidly in 2016–2017 (Chart 1.16).

The situation in the mortgage market also had a significant impact on housing construction dynamics. While in 2016 mortgage lending grew actively, which largely restrained the slump in the housing market, in 2017 this growth slowed considerably due to the termination of the mortgage interest rate subsidy programme. This impact eventually dissipated (Chart 1.17). For example, in the Central Federal District[3], where roughly two thirds of residential real estate[4] were purchased using mortgages in 2016, the amount of mortgages granted in 2017 Q1 increased by only 1.9% relative to the corresponding period of the previous year (31.9% in 2016), whereas the fall in housing construction accelerated by almost threefold[5].

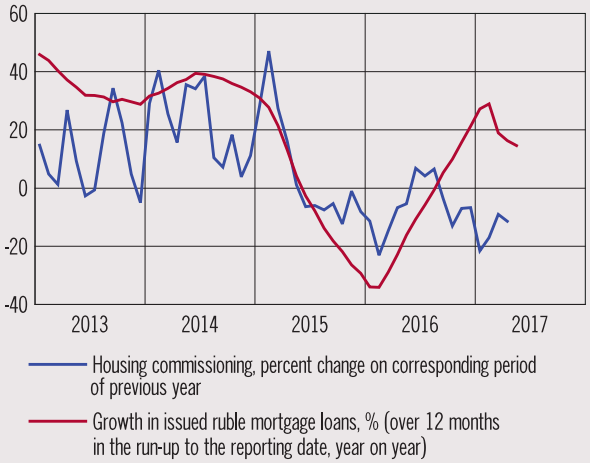
Taking this into account, the main slump in housing construction may occur in 2017. At the same time, it will not likely be very profound, as evidenced by businesses' expectations regarding the stabilisation of prices in the industry in April-June 2017.

Housing construction should not be expected to negatively impact investment activity dynamics – its influence has already been largely realised. Fixed capital investment includes actual expenditure on housing construction during each reporting period, while the 'commissioned housing' indicator reflects housing construction. Since expenditure on housing construction is on-going until the new housing is commissioned, the current slump in housing construction has already been reflected in investment.

According to Bank of Russia estimates, housing construction growth cannot be expected to move into positive territory before the second half of 2017. Over the next few years, certain support for housing construction will come from currently implemented government programmes[6]. These will be supplemented by incentive programmes offered by banks and real estate developers, and also expectations of a further easing of bank funding conditions. In particular, the said government programmes include the 'Renovation' programme designed to demolish five-storey buildings in Moscow. This programme may comprise as many as 7,900 residential buildings covering a total area of 25.1 million sq.m, which is more than 30% of the residential floor area commissioned in 2016 across Russia as a whole.

Chart 1.17

Decline in mortgage lending support for housing contruction



Sources: Bank of Russia, Rosstat, Bank of Russia calculations.

[3] *According to Bank of Russia data from surveys conducted among Central Federal District construction organisations, in April 2017, the factors affecting their activities were ranked as follows by their relevance: 56.9% of respondents pointed to the impact of demand; 44.2% – the availability of working capital; 33.0% – the existence of business risks; and 16.8% – lending conditions. In the opinion of directors of construction organisations, the high level of taxation and payments to extra-budgetary funds, the high cost of construction materials and designs, the long lending process, insufficient work orders, and client insolvency also dragged heavily on their activities (according to random sampling of the business activities of construction organisations performed by statistics agencies in 2017 Q1).*

[4] *According to data from the Federal Service for State Registration, Cadastre and Cartography (Rosreestr) on transactions in the primary and secondary residential real estate markets.*

[5] *Average rate of growth in the commissioned volumes for blocks of flats and individual housing.*

[6] *The following government programmes are currently in effect: to re-house people living in substandard housing – in the Republic of Karelia, Murmansk Region, Republic of Crimea and a number of other regions; to renovate housing stock and demolish old housing stock – in Moscow and the Sakha Republic (Yakutia); and to provide housing and improve household living conditions – in the Leningrad, Yaroslavl and Tyumen Regions.*

Financial position of real sector organisations in 2017 Q1

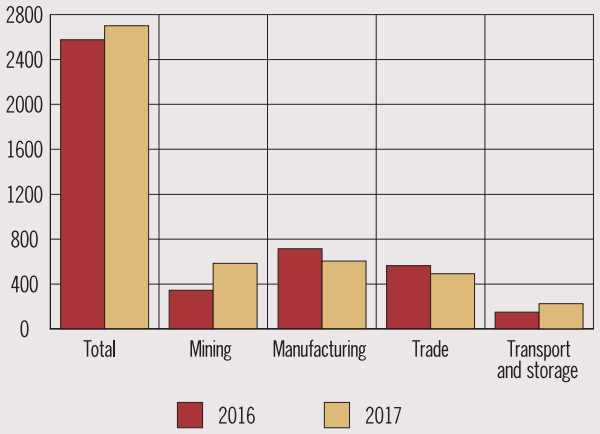
In 2017 Q1, the balance of profits and losses at Russian organisations[1] was 4.9% higher than in the previous year, according to preliminary data from Rosstat (Chart 1.18). The proportion of loss-making organisations reduced by 0.7 pp to 34.2%.

The highest balance of profits and losses in the economy was seen in manufacturing industries, as in 2016. However, it was 15.4% less than the previous year, which may be due to increasing competition from imports amid the ruble appreciation and on-going demand-side restrictions. Among the main types of economic activity, net profits also fell in trade and pipeline transportation. Construction performed with losses.

Conversely, amid the increase in global and domestic energy prices, the financial position in the mining industry improved noticeably: the balance of profits and losses rose by 69.2% and was almost equal to the financial result of the manufacturing industry.

Overall, the on-going trends towards improving financial positions among businesses are forming prerequisites for further growth in investment and production activity.

Chart 1.18
Net financial result in January-March 2016-2017
(billions of rubles)



Source: Rosstat.

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

Impact of the ruble appreciation on the industries of the Russian economy

At the start of 2017, the ruble continued to rally, following the trend of the previous year when the national currency increased in value against the US dollar by 16.8% (end-December 2016 on end-December 2015). The change in the exchange rate had various effects on the output, structure of spending, and financial position of various industries in the Russian economy.

After the sharp depreciation of the ruble at end-2014 – early 2015, Russian businesses re-oriented their spending towards domestic components, which led to reduced dependence on imports and exchange rate fluctuations. According to estimates, the resultant decrease in sensitivity to exchange rate fluctuations meant that output dynamics[1] were also less responsive to exchange rate movements. This reaction is asymmetric: depreciation of the ruble stimulates increased output in a number of industries (for example, in agriculture, food production, the chemical industry, metallurgy, and mining), while output does not contract when the ruble rallies. This is likely related to firms' unwillingness to wind down output and employment, preferring instead to adjust prices and wages. Thus, the change in the parameters of companies' production activity caused by a strengthening ruble could impact their financial positions differently.

To estimate the strengthening ruble's impact on real-sector companies' finances, a 'threshold' value was calculated for the ruble-US dollar exchange rate at which the cut in spending on imported components, raw materials and goods due to an increase in the value of the ruble is offset by the reduction in revenue from exports, and product profitability

[1] *The output elasticity at the real effective exchange rate was estimated for various industries to determine the impact on production activity.*

Table 1.1

Breakeven exchange rate estimates

Activity	Exports to imported materials costs	Breakeven exchange rate, RUB/USD	Rank
Textile and textile products	0.41	*	Positive effect from ruble appreciation
Non-metallic mineral products	0.57	*	
Means of transport and equipment	0.39	*	
Electric, electronic and optical equipment	1.91	**	
Machinery and equipment (excluding weapons)	1.37	2.5	
Chemicals	4.2	**	Ruble appreciation supports financial sustainability
Food products	1.76	**	
Pulp and paper industry	2.7	**	
Transport	95.82	5.35	
Construction	4.59	19.19	
Metallurgy	10.86	19.33	
Mining	313.79	54.18	
Oil products	609.56	65.39	
Rubber and plastic products	1.98	40.57	Ruble appreciation may cause low profitability
Leather, leather goods and footwear	4.97	55.28	
Woodworking and wood products	31.07	57.78	

** Ruble appreciation pushes profitability upwards.*

*** Ruble appreciation pushes profitability downwards, with profitability remaining positive.*

Sources: Rosstat, Bank of Russia calculations.

reaches the breakeven point[2]. The activity types were then ranked according to the level and nature of the exchange rate dynamics' pass-through effect on their financial stability (Table 1.1). This methodology was used solely to examine the exchange rate's impact on operating activities. Expenditure on capital investment (the cost of purchasing and servicing equipment) was not taken into account. In addition, one of the assumptions of these calculations is that global prices remain unchanged[3]. As a result of these methodological limitations, the estimate of the 'breakeven exchange rate' was biased for certain types of activity. In these cases, their rank was adjusted.

According to the results, the strengthening ruble has a positive impact on profitability in capital-intensive activities focused primarily on internal demand: production of means of transport and equipment, textile and textile products, and production of construction materials (in the first two types, due to the high share of imports in expenses, and in the last one, due to the low proportion of exports).

Despite the obtained 'breakeven exchange rate' value (close to current values for the USD/RUB exchange rate), mining and oil products were classified as highly-stable types of activity, because the reduction in ruble-denominated export receipts caused by the ruble appreciation is offset by an increase in receipts due to growth in global energy prices (which is typically a reason underlying growth in a national currency's exchange rate). A similar rank adjustment affects high-tech industries, which predominantly use imported equipment: electronic, optical and electrical equipment, and machinery and equipment.

Profitability in the food industry, construction, transportation, chemical industry, and metallurgy decreases when the ruble appreciates, but still remains in positive territory. The high financial stability in the face of a strengthening ruble in certain industries is linked to the comparability of export earnings and expenditure on imported raw materials, while in other industries it is due to initially high levels of profitability.

---

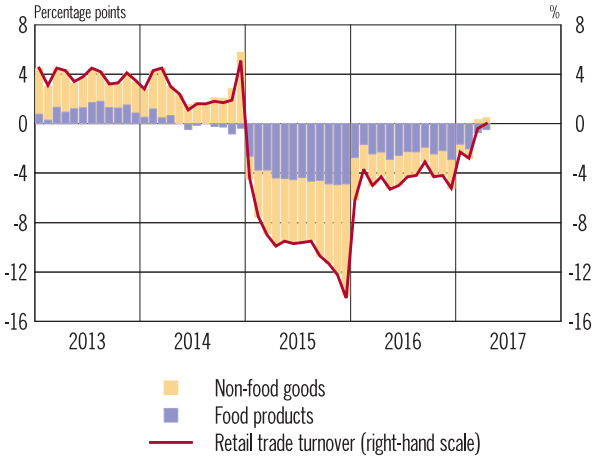
[2] The 'breakeven exchange rate' is defined as the minimum exchange rate (e) that satisfies the breakeven condition: $П0+(X0-M0)*(e-e0)\geq 0$, where П0 is the financial result in rubles; M0 is imports of raw materials and goods in US dollars; X0 is exports of finished goods in US dollars; and e0 is an indirect quotation of the nominal exchange rate of the ruble against the US dollar. All variables were taken for the first three quarters of 2016. The results of an estimate using a similar methodology, but for a situation where the ruble depreciates, were published in Monetary Policy Report, No. 1(9) (March 2015).

[3] This methodology does not take into account a number of factors which exist when exchange rates change. Specifically, when the ruble appreciates the following processes occur: demand shifts from domestic products to imported ones and domestic prices fall, the proportion of imports expands within the structure of spending, export prices increase, and domestic demand increases overall as a result of the strengthening ruble. For most activity types, the shift in demand and falling prices are assumed to be offset by other factors that cut expenses and increase revenue (see A. V. Klimovets (2015). Analysing the Impact of Ruble Depreciation on Certain Types of Activity in the Russian Economy // Money and Credit, No. 8).

The strengthening of the ruble can depress profitability of certain types of activity focused on intermediate (including external) demand, i.e. wood products, rubber and plastic products. This is linked to the massive dominance of exports over expenditure on imported raw materials. At the same time, as noted above, changes in spending structure and production technologies, and a transition to manufacturing patterns with higher added value can all reduce these industries' dependence on exchange rate fluctuations over time.

Chart 1.19

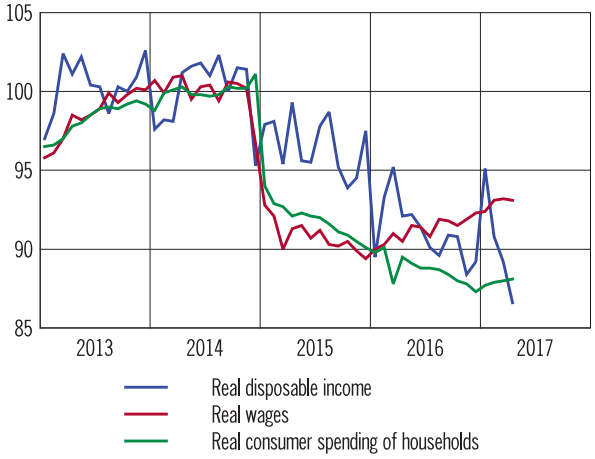
Growth in retail trade turnover
(contribution to growth rate, on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Chart 1.20

Real wages, disposable income and consumer spending of households
(seasonally adjusted, 2014 = 100%)



Sources: Rosstat, Bank of Russia calculations.

published in the previous Report[3]. In April, the revival in both investment and production activity accelerated slightly. This was aided by the favourable trend in businesses' financial positions and the positive effect of the ruble appreciation on capital-intensive and high-tech activities (see boxes 'Financial position of real sector organisations in 2017 Q1' and 'Impact of the ruble appreciation on the sectors of the Russian economy'). Their growth may be also constrained by unstable producer sentiment about the speed at which the demand for their products[4] will recover. Taking this into account, the Bank of Russia estimates the annual growth of gross fixed capital formation at 1.5–3.0% in 2017 Q2.

Recovery processes have gradually grown increasingly stable not only in the production sector, but also in consumer demand dynamics. In March, the fall in retail trade turnover slowed from 2.8% to 0.4% year-on-year, and in April it stopped falling (Chart 1.19). However, consumer goods output grew mainly due to durable goods (household appliances, motor vehicles), which may be a sign of renewed manifestation of deferred household demand and is being observed both for Russia as a whole and across the regions.

The favourable real wage dynamics witnessed from mid-2016 onwards, primarily due to overall growth in demand for labour amid persistently low unemployment (5.2%, seasonally adjusted), was one of the factors behind the revival in demand in 2017 Q1. In addition, the growth in wages may be linked to structural changes seen in recent years in the labour market, such as employers' demand shifting towards a highly-qualified workforce and the narrowing gap between payment for labour in the public and private sectors, among other things (see box 'Labour market: reduction in sectoral wage differentiation'). However, the growth in real wages did not offset the downward dynamics of other forms of income. Real disposable income contin-

[3] *The range of growth in fixed capital investment expected in 2017 Q1, as provided in April's information and analytical commentary on the current economic situation, was adjusted slightly downwards compared with the March report due to the release of data on indirect investment activity indicators for March. However, the actual current value was closer to the Bank of Russia's March estimate.*

[4] *According to research data from Markit PMI and survey results from the market survey laboratory at the Gaidar Institute for Economic Policy.*

Labour market: reduction in sectoral wage differentiation

In the last decade, the Russian labour market has seen decreased differentiation in wages across sectors. From 2010 to 2016, the coefficient of variation reduced by 2 pp to 41%.

To analyse this process, different types of economic activity were divided into four groups by wage level. The first group includes activities partially funded by the budget (government administration, health care, and education) and agriculture, which receives a significant amount of state support. The second group encompasses non-tradable activities, including production and distribution of electricity, gas, and water; construction; trade and repairs; hotels and restaurants; transportation; and communications. The third group covers processing activities. The fourth group includes activities with the highest wages: mining, financial services, real estate transactions and services, fishery, and fish farming.

In 2010–2016, wages in the groups with the highest and lowest wages moved significantly closer to the average wage in Russia (Chart 1.21). The most active drop in sectoral wage differentiation was observed in 2012–2014 (Chart 1.22). During this period, the lagging behind the average wage in the economy reduced significantly in the public sector and agriculture.

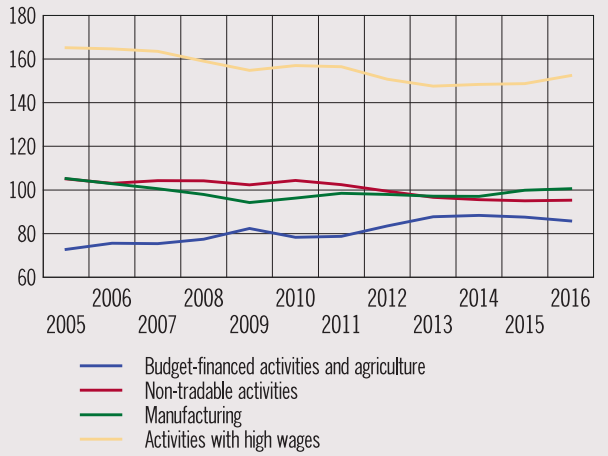
This was primarily aided by the implementation of the so-called 'May decrees' of the President of the Russian Federation. On average, from 2012 to the first half of 2014, the annual growth in labour remuneration in the public sector was more than 18%, and it by far exceeded the equivalent figure in the private sector. The active implementation of government agricultural development programmes[1], Russia's introduction of food counter-sanctions, and the phased-out increase in the minimum wage[2], – they all contributed to the increase in the average wage in the agricultural industry.

On the other hand, the fall in the wage spread was linked to employers' demand shifting towards a highly-qualified workforce, which was especially evident in manufacturing and in the production and distribution of electricity, gas, and water. While in 2010 most workers in these sectors had a primary or secondary professional education (25.8% and 25.6% respectively), in 2014 staff with a higher professional education accounted for the largest share of workers (26.7%). In non-tradable types of activity, the share of employees with a higher education also rose over this period. In turn, the re-orientation of employers towards a more qualified workforce led to a change in the distribution of

Chart 1.21

Relative wage dynamics

(percent change on average wage in the economy)

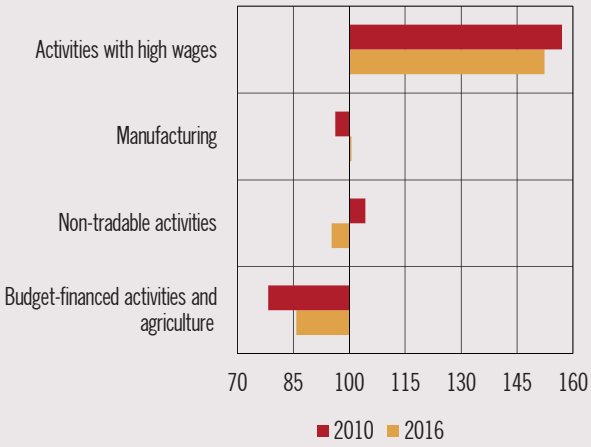


Sources: Rosstat, Bank of Russia calculations.

Chart 1.22

Relative wages

(percent change on average wage in the economy)



Sources: Rosstat, Bank of Russia calculations.

[1] *Government programmes for agricultural development and regulation of agricultural produce, raw materials and food markets in 2008–2012 and 2013–2020.*

[2] *The agricultural industry actively employs low-paid and low-qualified labour, so the increase in the minimum wage has an impact on employers setting the lower boundary of their wage range.*

workers by wage. Amid the contraction in low-paid staff, the share of workers receiving 30,000–50,000 rubles per month rose (in 2011, this percentage fluctuated between 12–22%, and in 2015, between 21–29%). It is highly probable that this process contributed to faster wage growth in these types of activity compared with activities with traditionally high wages (and high levels of personnel training). Given that these types of activity account for more than half of all employed, this led to an increase in the average wage for the economy as a whole. Another consequence was the reduction in the pay gap from the average wage in high-income activities.

In 2015–2016, a period of weaker economic activity, the reduction in sectoral wage differentiation slowed slightly for two reasons. First, budget-financed wage indexation slowed for workers in education and health care. Second, during this period, most types of economic activity saw a fall in output, accompanied by a slowdown in wage growth. The exception was activities with high wages, which did not experience a slowdown in wage growth. This therefore led to the widening of a wage gap between highly-paid workers and those with average wages.

Any further reduction in the wage differentiation across types of economic activity will depend on the development of processes meant to modernise and restructure the economy, and the indexation of wages as part of the 'May decrees'.

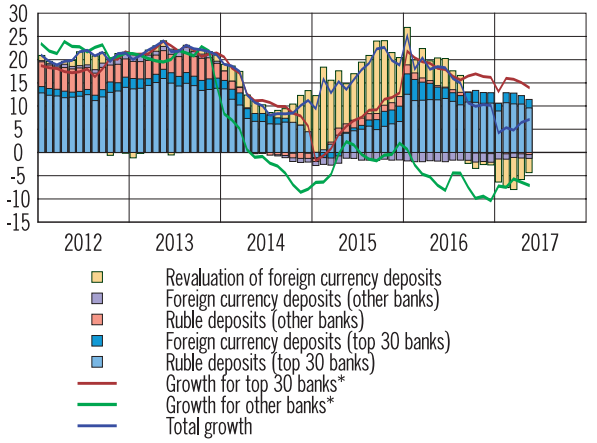
ued to fall year-on-year, while in terms of a quarterly comparison, this indicator (seasonally adjusted) remained at the level registered at the end of the previous year (Chart 1.20), as reflected by the moderate recovery in demand.

The gradual recovery in demand in March-April against the backdrop of weak real disposable income dynamics did not prevent the slowdown in inflation. Firstly, this was down to supply-side factors, since demand recovered amid the perceptible revival in production activity. Secondly, the on-going incentives to save and households' balanced approach to risk, as reflected in the dynamics and structure of the deposit portfolio, were a constraining factor. Average deposit rates in the market remained above inflation, but they fell faster than loan rates. As a result, demand for deposits continued to increase, with its growth slowing slightly (Chart 1.23). Signs of households maintaining a balanced approach to savings and lending were also visible in the structure of consumer lending sources. As shown in estimates based on household survey data[5], in 2016 households built up consumption primarily on account of increased income, thereby not creating any significant inflation risks. In addition, they sought not to increase their debt burden and, in fact, looked to repay existing debts using accumulated savings and income (see box 'Household consumption dynamics: a microlevel view'). According to Bank of Russia estimates, these factors will continue to influence consumption dynamics in the near future. Given households' generally conservative approach to savings and consumption, the Bank of Russia expects the observed transition from the saving behaviour model to the consumption behaviour model to continue to be gradual and, in view of the persistently moderately tight monetary policy, this will not bring about any inflation risks. As a result, the annual growth in household final consumption expenditures will be 0.6–1.1% in 2017 Q2.

Chart 1.23

Contribution of individual groups of banks to annual growth in household deposit portfolio

(percentage points)



** Adjusted for foreign currency revaluation.*
Source: Bank of Russia.

Amid the previous recovery in consumer demand, the need to accumulate inventories gradually

[5] *Russian monitoring of households' economic position and health by the National Research University Higher School of Economics. Data from the last survey for 2016 were used.*

Household consumption dynamics: a microlevel view

The steady slowdown in inflation in 2016 evolved amid moderately tight monetary conditions which allowed households to maintain a balanced approach to consumption and borrowing. First, this was manifested in household consumption dynamics – with growing incomes, they predominantly sought to accumulate savings, leaving consumption levels virtually unchanged compared with the previous period. Second, the analysis of incomes, savings, and loans also corroborates the hypothesis of households' conservative approach to increasing debt burden and their generally low inclination to expand consumption using borrowed funds. To illustrate these hypotheses, work was done to analyse the results of household surveys, conducted as part of Russian monitoring of households' economic position and health by the National Research University Higher School of Economics[1] for 2006–2016.

The analysis used the findings of the survey of a representative sample which was divided into groups based on average income per capita (Table 1.2 shows the criteria and descriptions of three income groups in 2016). This step was necessary to identify potential differences in the preferred means to fund consumption by households with different income levels.

The results of the analysis generally corroborate the hypothesis that in 2015–2016 all household income groups adopted a cautious behaviour pattern (Chart 1.24). In all three groups, most people facing a reduction in their income endeavoured to not increase their consumption using loans. Instead, they sought only to keep consumption at current levels, despite their reduced income.

The next step of the analysis was to reconcile households' balance of income and expenditure based on their responses. It was however taken into account that the responses of certain households often suffered from inaccuracy (for example, for an individual household, income and expenditure may differ manifold in certain years). To mitigate the impact of these shortcomings in the primary data on the results of the analysis, net household income was calculated on the basis of the formula (1) which uses the original survey data on consumption, savings, and borrowing separately for each income group:

$$Income = Consumption + \Delta Savings - \Delta Loans \quad (1)$$

After this, based on balance (1), the percentage increase in consumption was broken down by factors (2):

$$\frac{\Delta Consumption_t}{Consumption_{t-1}} = \frac{\Delta Income_t}{Consumption_{t-1}} + \frac{\Delta^2 Loans_t}{Consumption_{t-1}} - \frac{\Delta^2 Savings_t}{Consumption_{t-1}}, \quad (2)$$

where $\Delta^2 X_t = \Delta X_t - \Delta X_{t-1}$.

In this construct, the increase in income and change in debt on outstanding loans make a positive contribution to consumption (Chart 1.25). However, the increase in the flow of savings, conversely, contributes to a decline in consumption.

Table 1.2

Description of income groups

	Income group I	Income group II	Income group III
Criterion of group formation by income distribution per person	< 3rd decile group	from 3rd to 7th decile group	> 7th decile group
Income per person	less than ₽12 thousand	from ₽12 to ₽21 thousand	over ₽21 thousand
Number of persons	4.109	4.283	3.068
Household average income	₽27 thousand	₽40 thousand	₽73 thousand
Number of households	1.285	1.719	1.287

[1] *Russian monitoring of households' economic position and health by the National Research University Higher School of Economics (RLMS-HSE), conducted by the National Research University Higher School of Economics and Demoscope LLC, together with the Carolina Population Centre at North Carolina University at Chapel Hill and the Institute of Sociology of the Russian Academy of Sciences. (RLMS-HSE survey sites: http://www.cpc.unc.edu/projects/rlms and http://www.hse.ru/rlms.)*

In 2015–2016, income growth made a stable and positive contribution to consumption dynamics in income groups II and III. For income group I, income's contribution to consumption in 2015 was roughly zero, and in 2016 it became negative.

Adopting a conservative approach to debt accumulation, all three income groups showed a preference for repaying outstanding loans, and therefore lending made a negative contribution to consumption.

To smooth over consumption levels, income groups I and II were forced to partially fund their consumption by reducing savings, so savings made a small positive contribution to consumption. This is consistent with the hypothesis regarding the savings behaviour model. Income group III, conversely, increased its savings, making a slightly negative contribution to consumption.

Chart 1.24

Household behaviour in view of decline in income

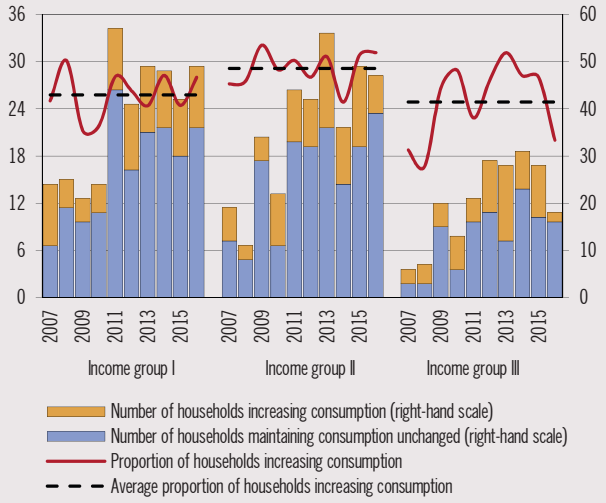
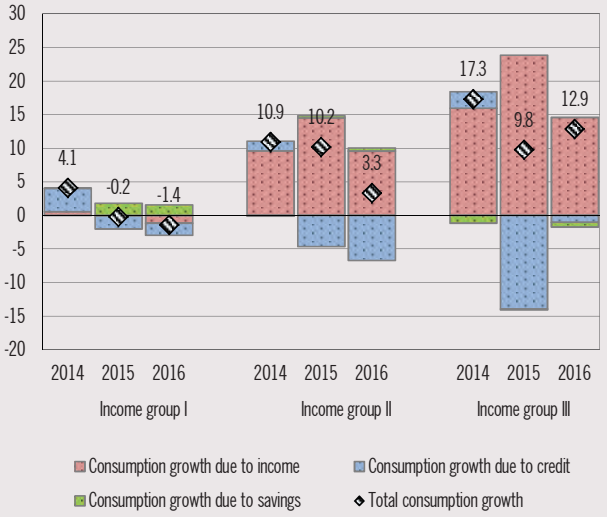


Chart 1.25

Contribution of various sources of income to consumption dynamics



dissipated. According to Bank of Russia estimates, this trend will persist throughout 2017. Moreover, the contribution of the change in inventories to GDP dynamics will continue to be positive, though to a lesser extent than in 2016.

As before, according to Bank of Russia estimates, the contribution of net exports to annual GDP growth significantly shrank in 2017 Q1 compared with 2016 Q4. This was primarily due to the marked growth in import quantities amid the recovery in economic activity and the ruble appreciation. However, as previously noted, investment imports grew rapidly (as in the previous quarter). Upward trends were also observed in export dynamics during this period. Gas and oil product exports grew noticeably in view of the pick-up in demand from Turkish and European consumers. Exports of certain types of machinery and equipment also demonstrated growth. However, overall, export growth lagged behind the increase in imports. In 2017 Q2, according to Bank of Russia estimates, net exports' contribution to annual GDP growth will move into negative territory against the background of the rapid recovery in imports, given the lack of grounds for a meaningful and relatively fast expansion in the exports of both commodities, amid the current extraction restrictions, and non-commodities.

Taking these trends into account, the Bank of Russia estimates that GDP will continue to recover at the annual growth rate of roughly 0.9–1.3% in 2017 Q2. Favourable investment activity dynamics, alongside the gradual recovery in consumer demand, will contribute to economic growth. The policy of fiscal consolidation will help maintain stability in government finance and will not hamper a further recovery in economic activity in Russia.

Inflation

Inflation continued to fall in spring. In April, annual price growth was 4.1% year-on-year and remained at this level in May (Charts 1.26, 1.27). Seasonally adjusted monthly growth in consumer prices reduced to 0.3%, which is in line with the path of the Bank of Russia's baseline forecast. The annual core inflation, which reflects the price dynamics of key goods and services, excluding items with volatile price dynamics and administered prices, continued to slow to 3.8% in May. This points to weakening short-term inflation risks.

The consistency of disinflationary processes in the regional breakdown remains and in fact becomes more pronounced (for more detail see Annex 'Regional analysis of trends in inflation components'). The interruption in the decline in inflation in May was linked to a pick-up in prices for vegetables and fruit compared with the same month of the previous year (after falling over previous six months). The slight increase in food inflation was in line with expectations. It was linked to the depletion of vegetable stocks from the previous harvest, and, potentially, to a later and longer planting season compared with the previous year, amid unfavourable weather conditions (see box 'Vegetable and fruit price dynamics'). However, price growth for non-food goods and services continued to slow down.

Year-on-year average price growth also continued to slide down to 5.6% in January-May, after 7.1% in December 2016. The year-on-year inflation estimate by far overshoots the standard annual estimate, since it takes into account relatively high previous values. However, it does make it possible to estimate the average level of inflationary pressure over the entire previous year. As inflation stabilises near the 4% target, the year-on-year average annual inflation estimate will move closer to the annual inflation estimate.

Muted consumer demand dynamics supported a drop in price growth in spring. Amid the continued and growing stability in the recovery of consumer activity, demand-side restrictions' contribution to the slowdown in inflation gradually diminished. Over the course of 2017, demand dynamics will continue to keep inflation in check. This will be aided by the gradual transition from the savings behaviour model to the consumption behaviour model, the retention of household savings incentives and a balanced approach to risk, and also wage growth in line with growth in labour productivity.

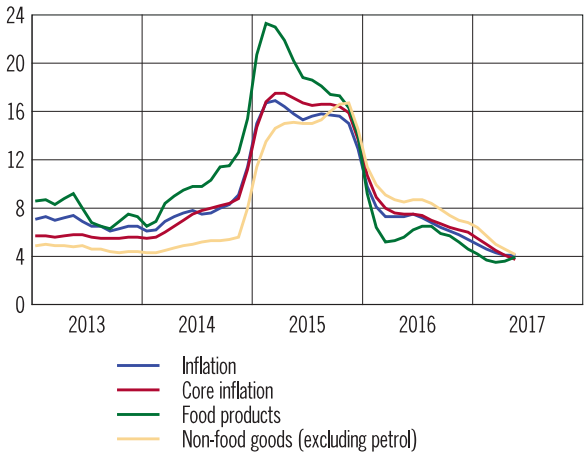
The increasingly stable decline in inflation expectations also contributed to the slowdown in inflation (Table 1.3). However, their level still considerably surpassed actual inflation. A longer period of time may be needed to finally anchor not only inflation, but also inflation expectations near the target level. Also, even a short-term surge in inflation expectations, due to their inertia, can have a negative impact on future inflation dynamics.

The ruble's exchange rate dynamics continued to be an important factor behind the decrease in

Chart 1.26

Prices of consumer goods and services

(percent change on corresponding period of previous year)

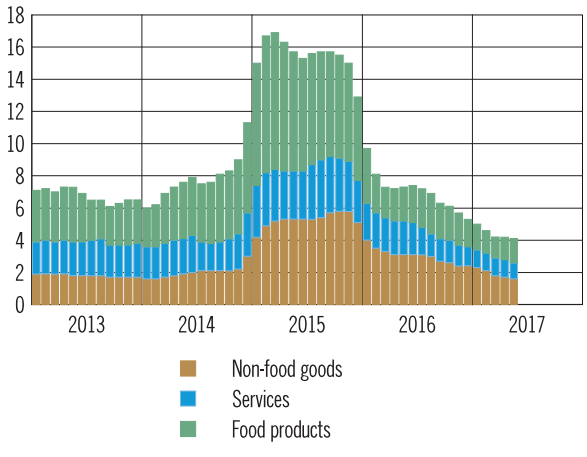


Sources: Rosstat, Bank of Russia calculations.

Chart 1.27

Contribution to inflation

(on corresponding period of previous year, percentage points)



Sources: Rosstat, Bank of Russia calculations.

inflation. The drop in price growth in the first few months of 2017 overshot the Bank of Russia's forecast, largely due to the ruble appreciation from the end of the previous year, amid the revival in the global commodity markets. Despite the slight reduction in the extent to which the ruble rallied in March-May, its contribution to the decrease in inflation will remain over the coming months due to the delayed pass-through effect of exchange rate dynamics on prices.

As previously, the Bank of Russia considers a number of risks for future inflation dynamics over the medium term. Increased volatility in global commodity and financial markets, including due to the unstable external political climate in the Middle East, could exacerbate further inflationary pressure and increase its pass-through effect on the price growth in Russia. In addition, due to the relatively high prices in global commodity markets, risks associated with producer price dynamics still persist in the oil segment.

There are also short-term risks of an increase in food inflation, which could weigh heavily on inflation expectations. According to forecasts prepared by the Russian Ministry of Agriculture and a number of analytical centres and organisations, Russia's grain harvest in 2017 will be lower than last year's record. Unfavourable weather conditions during the planting season, as well as expectations of a later harvest campaign, worsened harvest prospects. Nonetheless, the forecast total grain yield for 2017 will not be below the average levels for 2011–2015. The level of supply, including accumulated stocks, will make it possible to satisfy both internal demand and ensure export deliveries.

After cold spells in spring, expectations regarding vegetable and fruit harvests have worsened. However, according to estimates by the Russian Ministry of Agriculture, possible losses of field vegetable harvest will be offset by future increases in the production of greenhouse crops, based on the construction of new greenhouses and the modernisation of existing ones. Nonetheless, over the coming months, vegetables, fruit and potatoes arriving from the new harvest later than last year could cause fluctuations in annual food inflation.

In terms of internal economic conditions, risks may emerge in the labour market due to the intensification of the structural labour deficit. This may trigger excessive wage growth outstripping any increase in labour productivity, which will exert additional pro-inflationary pressure. Another risk is households' accelerated transition from the savings behaviour model to the consumption behaviour model and, as a result, a sharp decline in their propensity to save.

Taking these factors into account and bearing in mind inflation remaining close to the target level, the on-going drop in inflation expectations and the economic recovery, on 16 June 2017, the Bank of Russia Board of Directors decided to reduce the key rate to 9.00% p.a. The Bank of Russia sees room for cutting the key rate in the second half of 2017. When making its decision hereinafter, the Bank of Russia will assess inflation risks, inflation dynamics and economic developments against the forecast.

Vegetable and fruit price dynamics

In 2017 Q1, inflation fell faster than forecast. This was largely due to vegetable and fruit price dynamics, which picked up by only 6.3% over the quarter. This value is low for the start of the year: in 2011–2014 (a period with relatively moderate growth in consumer prices), the average rate of price growth for vegetables and fruit was 12.8% in January-March. According to seasonally-adjusted estimates, in the first three months of this year, vegetables and fruit dropped in price (by 4.9%), while other food products increased in price (by 0.6%).

The ruble's rally at end-2016 – early 2017 made a noticeable contribution to vegetable and fruit price dynamics. In addition to this factor, vegetable prices seemed to reflect the impact of the expanded supply of greenhouse products at agricultural companies, family-owned farms, and farms of individual entrepreneurs in 2016 (by 14.0% relative to 2015). In addition, the lower than usual quality of field vegetable harvests (due to the bad weather in autumn) may have been an incentive to sell off vegetable stocks faster.

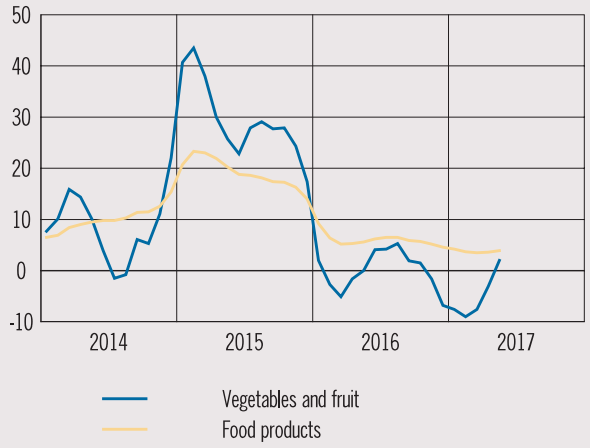
The depletion of stocks led to resumed growth in vegetable prices in April-May (seasonally adjusted). Prices for potatoes started to grow as early as March. This caused an increase in annual food inflation (Chart 1.28). Nonetheless, inflation levels are still low and do not hamper the achievement of the inflation target.

The unfavourable weather conditions in a number of Russian regions during the planting season could worsen the harvest outlook and push back the harvest schedule compared with the previous year, which will lead to fluctuations in annual price growth for vegetables and fruit, and for food products in general[1]. On the other hand, price growth will be further constrained by the active development of greenhouses[2] and the lifting of the embargo on fruit and vegetable supplies to Russia from Turkey (excluding tomatoes)[3]. On average, annual food inflation is expected to be close to April levels over the coming months.

Chart 1.28

Food products and vegetable and fruit price growth rates

(percent change on corresponding period of previous year)



Source: Rosstat.

[1] It should be noted that the situation in the vegetable and fruit market is sensitive to shocks, due to the dominance of field products, whose supply depends on weather conditions, in the structure of domestic production, as well as short storage periods, underdeveloped storage facilities, and the high proportion of imports in the winter-spring period. The result is high price volatility for vegetables and fruit. According to seasonally-adjusted estimates, the average price growth for vegetables and fruit over the last five years is 0.6%, while the standard deviation is 3.8 pp. This also explains a wide confidence interval in price dynamics forecasts.

[2] According to the Russian Ministry of Agriculture, as of 5 June 2017, the gross yield of greenhouse vegetable crops exceeded the previous year's level by 42.2% for the country as a whole.

[3] Resolution of the Government of the Russian Federation No. 672 dated 2 June 2017.

Table 1.3

Inflation expectations of economic agents

Survey	Expectation horizon	2015				2016												2017				
		I	II	III	IV	January	February	March	April	May	June	July	August	September	October	November	December	January	February	March	April	May
Inflation expectations (absolute), %																						
Households																						
Public Opinion Foundation	next 12 months	15.7	15.0	16.0	16.4	16.7	15.7	14.7	14.6	13.6	14.2	14.3	12.6	14.2	12.3	13.7	12.4	11.5	12.9	11.2	11.0	10.3
Public Opinion Foundation (Bank of Russia calculations)	next 12 months	13.8	12.2	14.5	12.8	10.8	7.8	7.4	7.2	6.5	6.7	6.9	6.4	5.9	5.8	5.6	5.1	4.6	4.4	4.0	3.7	3.8
Professional analysts																						
Bloomberg	2017									6.0	4.7	5.4	5.4	5.2	5.0	4.5	4.5	4.4	4.3	4.2	4.1	4.1
Interfax	2017					6	5.6	5.7	5.7	5.7	5.5	5.5	5.1	4.9	4.8	4.8	4.7	4.7	4.4	4.2	4.1	4.0
Thomson Reuters	2017											4.8	5.1	5.1	4.8	4.5	4.6	4.1	4.3	4.1	4.1	4.1
Financial markets																						
OFZ-IN	next 7 years			6.4	5.8	6.2	6.1	5.4	5.2	5.0	4.6	4.6	4.4	4.5	4.5	4.8	4.6	4.6	4.5	4.5	4.3	4.1
OFZ-IN (without option adjustment)	next 7 years			8.1	7.3	7.7	7.6	6.9	6.7	6.5	6.0	5.8	5.5	5.3	5.5	5.8	5.4	5.0	4.9	4.9	4.7	4.5
Bond market	next quarter	10.6	15.0	14.1	14.2	—	—	12.0	—	—	6.9	—	—	7.2	—	—	6.6	—	—	5.5	—	—
Interbank market	next quarter	14.8	17.1	15.0	13.6	—	—	9.9	—	—	5.3	—	—	5.4	—	—	5.6	—	—	4.4	—	—
Inflation expectations (balance of replies*)																						
Households																						
Public Opinion Foundation	next 12 months	76	72	80	83	85	82	84	83	81	78	82	77	82	78	79	80	80	83	79	80	78
Public Opinion Foundation	next month	68	60	71	78	80	76	72	74	70	68	72	69	70	70	74	76	72	72	68	71	66
Enterprises																						
Russian Economic Barometer	next 3 months	32	20	28	48	46	22	14	16	30	38	28	26	36	34	32	46	42	20	22		
Bank of Russia	next 3 months	14.8	12.7	12.1	17.3	15.6	13.6	12.4	11.5	11.5	12.1	10.1	9.9	10.4	10.1	11.5						
Retail prices (Rosstat)	next quarter	31	28	30	29	—	—	32	—	—	29	—	—	28	—	—	27	—	—	27		
Tariffs (Rosstat)	next quarter	7	6	2	2	—	—	5	—	—	5	—	—	0	—	—	0	—	—	4		

Change compared with previous 3 months:

– inflation expectations improved (more than 1 standard deviation)

– inflation expectations improved (less than 1 standard deviation)

– inflation expectations remain unchanged (± 0.2 standard deviations)

– inflation expectations deteriorated (less than 1 standard deviation)

– inflation expectations deteriorated (more than 1 standard deviation)

* *Balance of replies is a difference in the share of replies of the respondents, who expect that prices will increase and that prices will decrease.*

Sources: Public Opinion Foundation/inFOM survey results, Rosstat, Interfax, Bloomberg, Thomson Reuters, Bank of Russia calculations, Russian Economic Barometer.

2. ECONOMIC OUTLOOK AND KEY RATE DECISION

May's extension of the oil production restriction agreement (hereinafter, the agreement) to March 2018 did not lead to any change in the Bank of Russia's medium-term outlook for external conditions' impact on macro-economic parameters, but it served as the basis for a slight adjustment in the forecast compared with the March Report.

There was slightly less uncertainty in the assessment of the situation in global commodity markets for the near future, but the likelihood of oil price settling around current levels until end-Q1 next year has increased. This will have an impact on GDP dynamics in the Russian economy, including certain components of GDP, over the medium term. The Bank of Russia examines three potential scenarios for the development of the Russian economy, taking into account both internal and external factors. However, unlike previous reports, in this macro-economic forecast the Bank of Russia will include the path of Urals crude prices in real terms, i.e. at 2017 prices[1].

The baseline scenario retains a conservative outlook with respect to the evolution of external conditions for the majority of the forecast horizon. In this scenario, external factors neither contribute to the further acceleration of recovery processes in the Russian economy, nor do they exert any significant constraining effect on them. In its decision-making on the key rate, the Bank of Russia is primarily guided by the parameters of the baseline scenario. However, the two other scenarios take into account possible changes in the foreign economic situation and their impact on the recovery of the Russian economy and corresponding inflation paths. In the scenario assuming growth in oil prices, internal and external factors combine in such a way that they contribute to a relatively faster recovery in economic growth than in the baseline scenario, with the growth nearing potential levels, and a faster drop in inflation. The risk scenario assumes a strong downturn in oil prices and, generally, a marked deterioration in external conditions, which negatively impact both the speed of the recovery of the Russian economy and inflation dynamics.

Baseline scenario

The adjustment of the oil price assumptions in the Bank of Russia's baseline scenario due to the aforementioned extension of the agreement primarily affected intra-year oil price dynamics in 2017–2018, while the average levels remained virtually unchanged in 2017. Given the uncertainty at the time of the publication of the March report, the Bank of Russia assumed a gradual reduction in Urals crude prices in the second half of 2017, from roughly $50 per barrel to $40 per barrel by the end of the year. However, the high degree of discipline observed among participatory countries in fulfilling the agreement, and the decision taken in May 2017 to extend the agreement, increased the likelihood of relatively high oil prices remaining throughout 2017 and the first few months of next year.

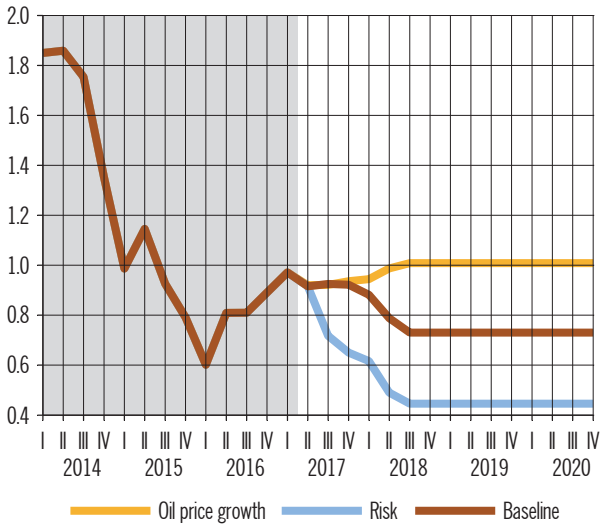
Estimates of future energy price dynamics are linked to a number of factors of demand- and supply-side uncertainty. On the demand side, one important risk is a perceptible slowdown in the consumption of oil products in China and India, caused by the implementation of environmental standards in these countries and the possible start of a transition to alternative types of fuel. This could exert a significant downward pressure on global demand and prices. On the supply side, there remain risks of accelerated growth in production at US shale deposits and the resumption of production in Libya and Nigeria.

Combined, these factors could produce a significant downward pressure on global energy prices. Moreover, supply and demand dynamics overall will create uncertainty surrounding the prospects of extending the agreement beyond 2018 Q1. In addition, the actual and expected contraction in

[1] *However, the oil price value is adjusted for external inflation, which is calculated as a weighted combination of the US and euro-area consumer price indices with weights proportionate to their shares in the dual-currency basket.*

Chart 2.1

Terms of trade



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

global oil stocks could reduce incentives to further extend the agreement in the medium term. Considering these factors, the Bank of Russia assumes that Urals crude prices will remain close to current levels (roughly $50 per barrel) until March 2018 before falling to roughly $40 per barrel over the following quarter and staying at this level over 2019–2020 (for more detail see Chart 2.1, box 'Factors affecting oil price assumptions').

Despite the significant adjustment in intra-year dynamics, estimates of the average oil price for 2017 have remained virtually unchanged compared with the baseline scenario presented in the March Report. This was due to the slight downward adjustment of oil prices in April-May amid increased US production, which exceeded expectations. As a result, the actual oil price in the first half of 2017 was slightly below the level set out in the Bank of Russia's March forecast. This largely offset the upward price adjustment in the forecast for the second half of 2017 due to the extension of the agreement.

A moderate drop in prices over the forecast period will help maintain a relatively stable situation in raw materials and commodity markets, and financial markets. In these conditions, global demand will continue to gradually recover. Aggregate economic growth in Russia's trading partners will be roughly 2% per year or slightly higher, which is generally consistent with the Bank of Russia's previous estimates and forecasts by international organisations[2]. However, as before, there is not expected to be any significant external inflationary pressure and its pass-through onto internal prices and inflation expectations in Russia. This will in part be aided by some of the largest global central banks' policies of keeping inflation close to target levels using monetary policy measures.

If the slight acceleration in inflation in the euro area witnessed in April resumes and becomes a trend in future, it could create the conditions for a gradual normalisation of the ECB's monetary policy. However, for the time being the ECB is not providing any forward guidance regarding any specific actions in this direction.

According to statements by representatives of the Fed, the US will continue to normalise its monetary policy. The likelihood of a faster normalisation decreased slightly the lessening of inflation expectations amid the emergence of doubts surrounding the successful implementation of Donald Trump's pre-election programme, and the slowdown of price growth observed for a wide range of goods in the spring. Taking this into account, as in the past, the Bank of Russia is working on the assumption that there will be three Fed rate hikes in 2017 (including the increases effected in March and June), which is generally consistent with market expectations.

The Fed's policy will continue to influence global financial markets and capital flows in the medium term. However, together with a change in interest rate policy, which has been for the most part already embedded in market participants' expectations, we may see the Fed start to shrink its balance sheet in the medium term. According to statements by the Fed's representatives, there are plans to gradually limit the amount of revenue from redeemable securities that is reinvested in new treasury bonds. This could exert an upward pressure on the yields of these securities, strengthen the US dollar against major world currencies, and reduce the inflow of capital into emerging market economies. These factors could lead to an increase in the risk premium for EMEs, including Russia. However, according to Bank of Russia estimates, such

[2] *The IMF raised its global economic growth forecast by 0.1 percentage points to 3.5% in 2017 and retained its previous growth forecast for 2018 at 3.6%. The OECD expects growth of 3.5% (+0.2 pp) in 2017 and 3.6% in 2018. The World Bank forecasts global economic growth of 3.4% in 2017 and 3.6% in 2018.*

Factors affecting oil price assumptions

According to estimates based on US Department of Energy data, oil production under the existing arrangements shrank in May 2017 compared with October 2016, by at least 1.6 million barrels per day[1]. Over the same period, the US production of oil and other liquid fuel increased by 660,000 barrels per day. As a result, the reduction in production due to the agreement still outweighs the growth in production in the US. Due to the arrangements, the market has almost achieved equilibrium (see box 'Influence of the oil production restriction agreement on participatory countries'), with the average Urals crude price rising from $43.5 per barrel in November 2016 to more than $51 per barrel in January-May 2017.

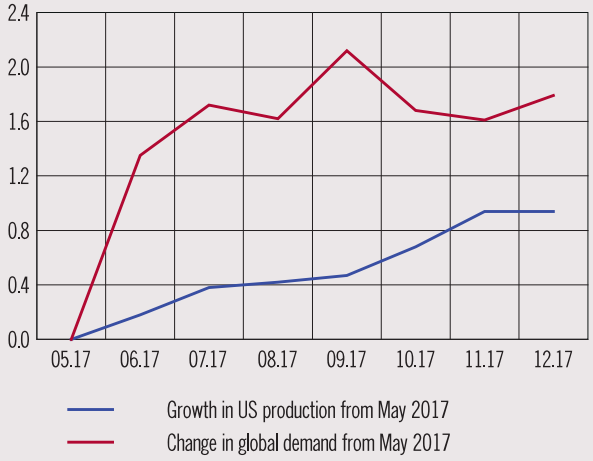
To further stabilise the market, i.e. to reduce global oil stocks to average levels over the last five years, on 25 May 2017 OPEC and non-OPEC states extended the oil production restriction agreement by 9 months, beginning 1 July 2017. This is longer than anticipated when it was originally signed (by 6 months). The agreement helps support oil prices and is the reason for the upward adjustment in oil prices in the baseline and risk scenarios. The baseline scenario anticipates Urals crude price will remain at roughly $50 per barrel in 2017, i.e. close to January-May levels.

The oil price adjustment in the baseline scenario took into account the fact that the recovery in production at US shale deposits would be faster than expected, amid growing drilling activity and investment. Against this backdrop, analytical organisations revised production forecasts upwards for the US. The Energy Information Administration of the US Department of Energy now expects US production of oil and other liquid fuel to go up by 1.2 million barrels per day more than the previous year, with a comparable oil price forecast for 2017[2]. OPEC and the IEA also raised their forecasts of the growth in US production in May. Considering this factor, the average annual price for 2017–2018 was reduced by 7% in the scenario assuming positive price dynamics in the oil market.

However, according to US Department of Energy forecasts, global demand growth by 1.8 million barrel per day in December 2017, compared with May, will surpass the increase in US production by 0.9 million barrels per day and global supply by 1.4 million (Chart 2.2). The IEA and OPEC also expect far greater growth in global oil consumption

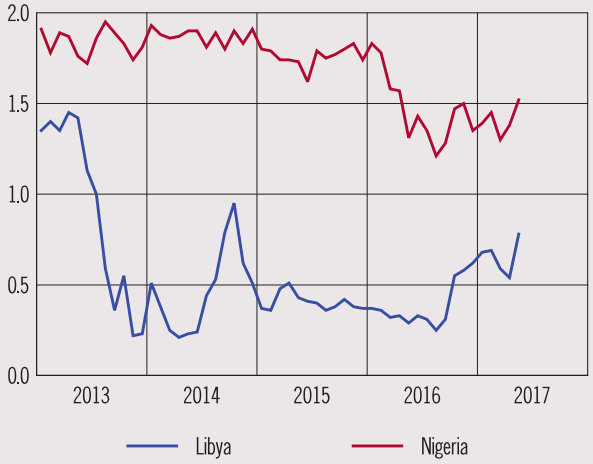
Chart 2.2

Growth in the global demand for oil and other liquid fuel will surpass US oil production expansion
(million barrels/day)



Source: Energy Information Administration of the US Department of Energy.

Recovery of oil production by OPEC members not covered by restrictions
(million barrels/day)



Source: Energy Information Administration of the US Department of Energy.

[1] *The change in crude production among OPEC members, excluding Libya and Nigeria, and the production of oil and other liquid fuel in Russia, Mexico, Azerbaijan, Equatorial Guinea, Kazakhstan, Malaysia, Oman and South Sudan is taken into account. For Angola, the change is compared with September 2016. The production of countries participating in the arrangements, such as Brunei, Bahrain and Sudan, is not taken into account.*

[2] *In June 2017, with an average Brent crude price of $52.7 per barrel for the year, the US Department of Energy forecast an increase in US production by 1.6 million barrels per day by December 2017, relative to December 2016, while in June 2016, with prices at $51.8 per barrel, it forecast an expansion in US production by 0.4 million barrels per day over the same period.*

compared with the increase in non-OPEC production in 2017. Therefore, taking all of these factors into account, there is not expected to be any downward pressure on oil price dynamics.

At the same time, the resumption of production in Libya and Nigeria, which are not affected by production restrictions under the agreement, is a factor posing a risk to these oil price assumptions (Chart 2.2).

In May 2017, according to US Department of Energy forecasts, crude oil production in Libya grew to its highest level since 2014 – almost 800,000 barrels per day, i.e. by 245,000 more than in April 2017. This growth is down to the lifting of the blockade on one of the country's largest oil fields – El Sharara, with a production capacity of 330,000 barrels per day – at the end of April and the resumption of production at the El Feel deposit, with a production capacity of up to 90,000 barrels per day. The US Department of Energy estimated the shortfall in supply from Libya at 520,000 barrels per day in May. At the same time, the IEA has pointed out that an increase in Libya's production to 1.1 million barrels per day by August would be difficult to achieve. The political instability, damaged oil infrastructure as a result of armed conflicts and the lack of investment are constraining recovery in production. In early June, oil production in the country fell by almost a quarter, to roughly 600,000 barrels per day, after the closure of the El Sharara oilfield due to worker strikes.

According to US Department of Energy data, crude oil production in Nigeria continued to grow in May, increasing over the month by 140,000 to 1.52 million barrels per day, due to the completion of maintenance work at the Bonga offshore oilfield. The resumption of work at the Forcados export terminal is aiding production. The IEA reported that the loading facilities, which have a through-put of 200,000 barrels per day, were closed in 2016 due to military hostilities. The situation improved after the stepping-up of negotiations between the government and regional leaders in the Niger river delta, who claimed a larger share of the income from oil. According to US Department of Energy estimates, the shortfall in supply from Nigeria was 360,000 barrels per day in May.

The likelihood of the risk of a rapid resumption in production being realised is limited. However, if conflicts are resolved, the countries may significantly increase their production: the US Department of Energy estimates the total shortfall in oil supply from Libya and Nigeria to have been 880,000 barrels per day in May. This risk is taken into account in the risk scenario.

an increase would be small due to the gradual nature and modest size of the planned change to the Fed's balance sheet. In view of this, and the moderate pace at which the Fed's interest rate policy is being normalised, the appeal of investment in EME assets, including Russia, will still remain in the medium term. According to Bank of Russia estimates, up to the end of 2017, the risk premium for Russia will remain close to current levels (roughly 150 bp), amid the relatively stable climate in global markets. Under the impact of a reduction in oil prices in 2018, the CDS level could rise to 200 bp. However, as the situation stabilises in raw materials markets, the CDS level will start to decrease again and, in the medium term, will return to 2017 levels.

The net capital outflow in 2017 will be close to 2016 levels, after which it will reduce slightly due to less pronounced increases in foreign assets amid a reduction in oil prices in 2018 (see Table 2.2, Annex 'Balance of payments forecast for 2017–2020'). In the medium term, the net private capital outflow will stabilise at roughly $14 billion. Moreover, the inflow of foreign investment into Russia will partially offset the increase in Russian companies' demand for foreign assets. The Russian Ministry of Finance's operations to purchase foreign currency with a view to replenishing sovereign funds will bolster reserve asset dynamics in 2017–2018. They are not expected to change significantly over the forecast period.

As in the past, internal financial conditions will be shaped by the Bank of Russia's moderately tight monetary policy. As inflation anchors close to the 4% target and inflation expectations subside, the Bank of Russia will gradually ease the tightness of its monetary policy. However, as before, the Bank of Russia's decisions regarding the speed at which it cuts the key rate will be focused on maintaining price stability and improving the investment climate in Russia without creating obstacles to balanced economic growth. As monetary conditions become less tight, nominal rates will also reduce. Amid falling deposit rates, savings rates will continue to re-

duce gradually, supporting a smooth transition from the savings behaviour model to the consumption behaviour model. However, the persistence of households' overall conservative outlook for the future and moderately tight monetary conditions, as before, will have a constraining effect on the speed at which consumption recovers. According to the Bank of Russia's baseline scenario, final consumption expenditure will only start to grow faster than real wages in 2019–2020, when deposit rates will fall and the economy will transition to a sustainable growth.

The gradual recovery in economic activity will contribute to an improvement in the quality of banks' loan portfolios, thus creating the necessary conditions to ease requirements for borrowers and other non-price lending conditions. By maintaining a conservative policy banks will be able to make well-balanced decisions, select most reliable borrowers and avoid risk. This will support banking sector sustainability and help maintain financial stability in the economy as a whole. If risks accumulate in certain market segments, the Bank of Russia will use macroprudential measures, among others, to mitigate them.

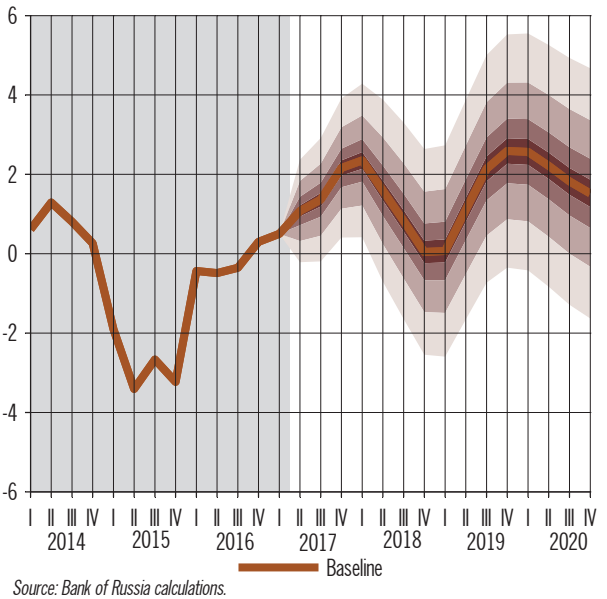
In these conditions, lending activity will recover gradually, without creating additional inflation risks. According to Bank of Russia estimates, growth in banking sector lending[3] to the economy in 2017 is estimated at 5–7%, which is generally consistent with the forecast published in the previous Report (Table 2.1). In the medium term, the growth in lending to the economy will reach a stable level of 7–10%, which corresponds to the Bank of Russia's March forecast. The expansion of lending activity will be supported by a recovery in real incomes and will not pose any risks to price and financial stability in the Russian economy.

The increase in lending to the economy will be one of the key components shaping monetary aggregate dynamics. A positive contribution to the growth in money supply (according to the national definition) will also continue to come from the dynamics of net general government borrowing from the banking system for funding the budget deficit

Chart 2.3

GDP growth rate

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

over a large part of the forecast period. According to Bank of Russia estimates, in 2017 money supply will increase by 9–12% year on year. By the end of the forecast period, money supply growth will be close to the growth in lending to the economy, due to the gradual reduction in the budget deficit[4].

The expansion in lending activity, together with the gradual improvement in sentiment and growing incomes, will support recovery processes in the Russian economy, with growth in monetary aggregates ensuring the required number of transactions without creating any additional inflationary pressure. In these conditions, economic activity will continue to recover. In 2017, GDP growth will be close to the estimate of the Russian economy's medium-term potential, at 1.3–1.8% year-on-year, which is slightly above the March forecast. The upward adjustment was due to the increasingly confident and protracted recovery in economic activity amid relatively high oil prices over the entirety of 2017. Further ahead, given the slight deterioration in external conditions, economic growth will temporarily slow to 1.0–1.5%. However, by 2019, it will recover to 1.5–2.0% (Chart 2.3). The short-term and negligible adjustment in growth amid the deterioration in external conditions is linked to the gradual increase in economic stability in the face of external shocks

[3] *The estimates of the growth in lending to the economy provided here and below are an estimate of the growth in banking sector claims on organisations and households, which is slightly broader than banks' loan portfolios, as it also includes bonds, promissory notes, shares, receivables linked to bank settlements, etc.*

[4] *Fiscal policy will be directed at fiscal consolidation with a gradual reduction in the federal budget deficit to 3%, 2% and 1% in 2017, 2018 and 2019 respectively.*

and reduced sensitivity to fluctuations in the situation in raw materials markets. This will in many ways be aided when the budget rule is finally enshrined in law. A transitional mechanism for this has been employed by the Russian Ministry of Finance since February 2017. In addition, the cumulative positive effect of the previous recovery in 2016–2017 will provide support for the economy dynamics in the medium term. Structural factors will, as before, determine the opportunities for a faster-than-expected increase in economic growth.

The outlook for the structure of economic growth over the forecast period also has not changed overall compared with the previous Report. The adjustment of the growth forecast for certain components of aggregate output is largely linked to the update of Rosstat data on the GDP breakdown by component for 2016.

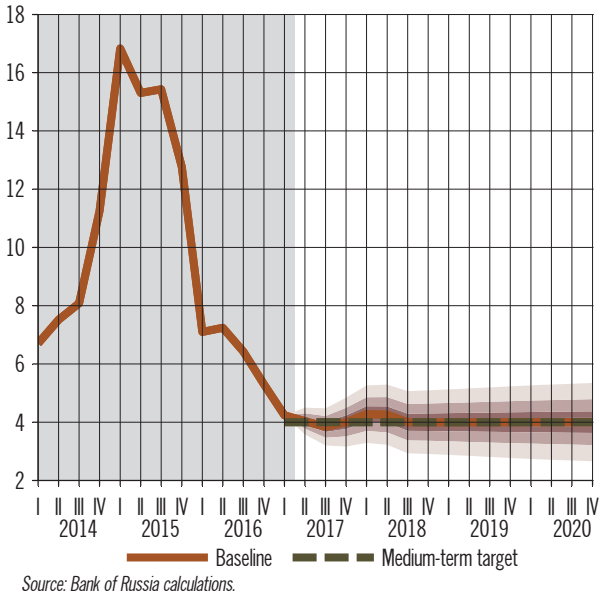
The recovery processes in the economy, together with the gradual easing of bank lending conditions and increased opportunities to use loans as a source of funding for investments, will provide support for investment demand. According to Bank of Russia estimates, the annual growth in gross fixed capital formation will be between 2.3–2.8% in 2017, which is consistent with the Bank of Russia's March forecast. The recovery in inventories will continue in 2017, but will be less active than previously anticipated. A reduction in oil prices in 2018 could have a certain temporary impact on companies' sentiment and their assessment of the prospects of future demand for their products. As a result, growth in gross fixed capital formation will slow to 1.0–1.5% in 2018–2019. In future, in the absence of strong external shocks, companies will gradually adapt to the existing conditions, and growth in investment activity will resume at the annual rate of 2.3–2.8%. The contribution of the growth in inventories to gross capital formation dynamics will gradually diminish in 2019–2020.

The recovery in production activity and improvement in business sentiment will buoy demand for labour. However, inflation anchoring close to the target level will help to continue the growth in real wages by 1.5–2.3%, and contribute to a gradual recovery in household real disposable income in the medium term. Together with an improvement in consumer sentiment, this will be conducive to a further recovery in demand.

Chart 2.4

Inflation

(percent change on corresponding period of previous year)



Source: Bank of Russia calculations.

According to the Bank of Russia's forecast, household final consumption expenditures in 2017–2018 will grow at a moderate pace of 1.5–2.2%. The forecast for 2017 was adjusted slightly downwards compared with the March Report (2.0–2.5%) given the update of Rosstat data on consumer activity dynamics in 2016[5]. In future, growth in household final consumption expenditures will accelerate slightly over the forecast period, to 2.0–3.5%, which is generally in line with the March forecast. However, the pick-up in consumer activity will be somewhat more stable than investment dynamics. Favourable conditions for robust growth in consumption will be largely assisted by the Bank of Russia's policy of anchoring inflation close to the 4% target. The Russian Ministry of Finance's policy of fiscal consolidation will continue to help maintain the stability of government finances, without preventing a further recovery in economic activity in Russia.

At the same time, moderately tight monetary conditions and positive real interest rates in the economy are expected to be conducive to households' propensity to save. Households maintaining the savings behaviour model will have a slightly constraining effect on the speed of consumption recovery. In addition, banks' gradual easing of lending conditions, coupled by their conservative attitude

[5] *This was caused by the base effect due to the upward revision of the Rosstat's estimate of growth in household final consumption expenditures in 2016.*

toward borrower selection, will support households' balanced approach to borrowing.

The gradual recovery in consumer activity will buoy household demand, including for imported goods. The forecast increase in annual import quantities for 2017, similar to the forecast household final consumption expenditures, was adjusted slightly downwards compared with the previous Report, to 7.0–7.5% (8.2–8.7% in the March report). This was in part due to the more restrained recovery in consumption and the high base effect of 2016 compared with the initial estimates by Rosstat.

Annual growth in export quantities over the forecast horizon will also be moderate. In 2017, it will be 2.5–3.0%, which is slightly higher than the Bank of Russia's March forecast, amid the favourable actual dynamics at the start of 2017[6]. Going forward, according to Bank of Russia estimates, the annual growth in export quantities will slow slightly due to structural restrictions from available capacity in the Russian economy, dropping to 0.5–1.0% in 2018–2020. Net exports' contribution to annual GDP growth is expected to move into negative territory as early as 2017 Q2 and remain there over the medium term.

With oil prices remaining relatively high in 2017, the increase in the value of exports will outstrip the increase in the value of imports, thereby causing growth in the trade surplus and current account surplus. Under the influence of falling oil prices in 2018–2019, the foreign trade surplus and current account surplus will shrink noticeably. And in 2020, with oil prices remaining unchanged in real terms, the current account surplus will stabilise at a little below $10 billion.

In the context of the gradual recovery in economic activity and the economy's increasing resilience to external shocks, inflation will reach the 4% target in 2017. Going forward, the Bank of Russia will use monetary policy measures to keep price growth rates close to 4% (Chart 2.4). However, it cannot be ruled out that in certain periods of the year price growth rates may be either slightly lower or slightly higher than 4% due to temporary factors. This is typical for economic indicators in general. Year-on-year average inflation will also be roughly 4%.

The gradual recovery in consumer activity amid the smooth transition from the savings behaviour model to the consumption behaviour model among households will contribute to a slowdown in inflation throughout the forecast period. The contribution of demand-side restrictions to inflation will remain negative for some time and will gradually move closer to zero over the forecast period.

Growth in spending in the economy will be moderate and will not exert any additional pro-inflationary pressure. This will also be aided by the moderate indexation of administered prices and tariffs for services provided by natural monopolies.

Keeping inflation at roughly 4% will contribute to a further reduction in inflation expectations and will anchor them at a stable and low level, close to actual inflation. Reducing inflation expectations is one of the most important tasks under the Bank of Russia's remit of maintaining price stability and ensuring general predictability in internal economic conditions.

Taking these factors into account, in order to keep inflation close to the 4% target, the Bank of Russia will continue to implement a moderately tight monetary policy.

Scenario with rising oil prices

The scenario with rising oil prices assumes that incentives will remain to extend the oil production restriction agreement among oil exporting countries over the entire forecast horizon. In combination with global demand recovering faster, than in the baseline scenario, this will buoy energy prices and will contribute to increased optimism in global commodity and financial markets. However, amid the more rapid than expected expansion in US oil production, oil price assumptions for 2018 were revised slightly downwards compared with the March Report. As a result, Urals crude prices are expected to be roughly $55 per barrel in 2018 and will gradually grow to $60 per barrel over the remainder of the forecast period.

Given a further recovery in global economic demand, inflation processes may accelerate slightly in large countries and major global central banks are more likely to normalise their monetary policies faster. However, persistent relatively low interest rates in advanced economies, limited potential interest rate increases, and a general improvement in

[6] *According to estimates based on data from the Federal Customs Service of Russia.*

investor sentiment in the global economy will maintain interest in risky assets and contribute to an increase in capital inflow into EMEs, including Russia.

These factors are expected to improve external borrowing conditions for Russian companies and to support a stronger ruble exchange rate than in the baseline scenario. This will create prerequisites for the faster easing of monetary conditions and will be conducive to increasingly dynamic improvements in business sentiment and a recovery in production and investment activity in the economy. The increased optimism in the real sector of the economy will help support real wage and income dynamics, contributing to a faster and more stable recovery in consumer activity than in the baseline scenario.

However, as previously, the pace of recovery in consumer demand is not expected to outstrip the pace of revival in the production sector. This will be supported by continued incentives to save amid a gradual reduction in inflation expectations, which will help maintain positive real interest rates in the economy.

Like in the baseline scenario, the increase in import quantities will outstrip the growth in exports over the forecast horizon. However, the contribution of net exports to economic dynamics will remain negative. Against the backdrop of growing oil prices, the trade balance and current account balance will go up. Growth in incomes in the economy will expand opportunities to acquire foreign assets which, combined with growth in FX receipts from export earnings, will contribute to a capital outflow. The net private capital outflow will be higher than in the baseline scenario and will gradually decline over the forecast horizon. Moreover, the purchase of foreign currency by the Russian Ministry of Finance, larger than in the baseline scenario, will lead to growth in international reserves over the whole forecast period. As in the baseline scenario, the fiscal policy will include fiscal consolidation measures. The federal budget deficit may reduce slightly faster than planned by the Ministry of Finance, due to significant tax receipts amid the relatively faster economic revival than in the baseline scenario.

In 2017, economic dynamics and inflation will be generally consistent with the estimates in the baseline scenario. In future, due to the more active revival in investment and consumer demand compared with the baseline scenario, economic growth may be higher and move closer to the potential level of 1.5–2.0% as early as 2018. However, like in the baseline scenario, higher than expected growth may be possible if structural reforms in the economy are successful.

In these settings, monetary policy measures will be used to keep inflation close to the target over the whole forecast horizon. In the scenario with rising oil prices, the Bank of Russia does not rule out a slightly faster decline in the key rate than in the baseline scenario. Like in the baseline scenario, the tightness of monetary policy will be maintained to the extent it will be necessary to anchor inflation close to the target and bring inflation expectations down.

Risk scenario

The risk scenario assumes a significant deterioration in external conditions, not only in terms of raw materials market dynamics, but also in terms of the prospects of a recovery in global demand. Under the impact of rapid and notable growth in oil exports from Libya and Nigeria, on the one hand, and with economic growth slowing in China and a much weaker demand in the energy market, on the other hand, oil prices will gradually fall from the middle of this year onwards, reaching roughly $25 per barrel by the middle of next year. In these conditions, incentives to extend the agreement beyond 2018 Q1 may be reduced, which will lead to oil prices stabilising at roughly $25 per barrel in the medium term.

The deterioration in external conditions in this scenario will lead to reduced appeal for borrowing in external markets and growth in the cost of servicing debts for companies. The risk premium will also increase, which will lead, among other things, to a growth in the capital outflow from Russia and the ruble depreciation.

In these conditions, the cost of imported equipment and consumer goods will significantly rise, which, together with the downturn in sentiment, could have a considerable negative impact on investment and consumer demand. As a result, economic growth will be much lower than in the baseline scenario. The slowdown could in fact start as early as mid-2017. Consumer activity will also decrease. However, the overall slump in consumption may not be as significant as previously, largely due to more predictable price and financial condi-

Table 2.1

Key parameters of the Bank of Russia's baseline forecast
(growth as % of previous year, unless indicated otherwise)

	2016 (actual)	2017	2018	2019	2020
Urals price, average for the year, US dollars per barrel	42	50	42	42	42
Inflation, % in December year-on-year	5.4	4.0	4.0	4.0	4.0
Inflation, yearly average	6.5	4.0	4.0	4.0	4.0
Gross domestic product	-0.2	1.3-1.8	1.0-1.5	1.5-2.0	1.5-2.0
Final consumption expenditure	-3.5	1.3-1.8	1.0-1.5	1.5-2.0	2.5-3.0
– households	*-4.5*	*1.7-2.2*	*1.5-2.0*	*2.0-2.5*	*3.0-3.5*
Gross formation	1.5	4.0-5.0	1.0-2.0	2.0-3.0	1.5-2.5
– gross fixed capital formation	*-1.8*	*2.3-2.8*	*1.0-1.5*	*1.0-1.5*	*2.3-2.8*
Net exports	20.7	-(17.4-12.9)	-(3.0-2.0)	-(7.5-3.0)	-(7.5-3.0)
– exports	*3.1*	*2.5-3.0*	*0.5-1.0*	*0.5-1.0*	*0.5-1.0*
– imports	*-3.8*	*7.0-7.5*	*1.0-1.5*	*2.0-2.5*	*2.0-2.5*
Money supply in national definition	9.2	9-12	9-12	10-13	8-11
Monetary base in narrow definition	3.8	3-7	3-7	4-8	4-8
Loans to non-financial organisations and households in rubles and foreign currency	-0.6	5-7	5-7	7-10	7-10

tions, the stability of government finances, and the economy's generally reduced sensitivity to external shocks. The gradual recovery in economic growth will start in the second half of 2018, and in the medium term, GDP growth will be close to potential levels and will be shaped by structural factors in future.

Due to heightened inflation expectations, the decrease in inflation at end-2017 – early 2018 may pause slightly, and the prospect of inflation temporarily overshooting 4% as early as 2017 cannot be ruled out. However, amid the recovery processes over the course of the year, annual price growth will return to target levels. In the event of a significant downturn in external conditions, a tighter monetary policy cannot be ruled out. The Bank of Russia will determine the necessary level of tightness, taking into account all internal and external economic conditions, as well as risks to price and financial stability and economic recovery prospects.

Medium-term forecast risks

Among the key risks to maintaining future price stability and recovery processes in the Russian economy, the Bank of Russia, as before, examines future inflation expectation dynamics and household attitudes toward consumption and savings.

First, more time may be needed to definitively anchor inflation expectations close to the target inflation level, despite the gradual reduction in inflation expectations. This can in part be explained by inflation expectations' enhanced sensitivity to pro-inflationary factors, even temporary ones.

Second, the reduced incentives to save in the event of a faster than expected recovery in banks' and borrowers' risk appetite may lead to rapid growth in lending relative to incomes and the imbalances accumulating in certain market segments.

Third, as already noted in the section 'Macroeconomic conditions', there is a chance of risks emerging in response to the growing structural imbalances in the labour market. A further increase in the labour deficit in several industries may trigger excessive wage growth that outstrips any increase in labour productivity, which will exert additional pro-inflationary pressure. Besides, a lack of workers with required qualifications could also be a factor limiting the potential for a recovery in production.

If the scenario with rising oil prices occurs, the budget deficit may fall slightly faster than assumed by the Russian Ministry of Finance's current principle of fiscal consolidation, which may create incentives to further increase budgetary expenditure and, as a result, pro-inflationary pressure in the

Table 2.2

Russia's balance of payment indicators – baseline scenario*

(USD, bn)

	2016 (actual)	2017	2018	2019	2020
Current account	**25**	**37**	**14**	**8**	**8**
Balance of trade in goods	90	105	82	80	85
Exports	*282*	*323*	*309*	*308*	*318*
Imports	*-192*	*-219*	*-226*	*-228*	*-233*
Balance of services	-24	-26	-27	-29	-30
Exports	*51*	*55*	*58*	*58*	*60*
Imports	*-74*	*-82*	*-85*	*-86*	*-90*
Primary and secondary income balance	-41	-42	-42	-44	-47
Capital account	-1	0	0	0	0
Current and capital accounts balance	**24**	**37**	**14**	**8**	**8**
Financial account (excluding reserve assets)	**-16**	**-10**	**-5**	**-8**	**-8**
General government and the central bank	3	9	6	6	6
Private sector (including net errors and omissions)	-19	-19	-11	-14	-14
Change in reserve assets («+» – decrease, «-» – increase)	**-8**	**-27**	**-9**	**0**	**0**

** Signs according to BPM5.*

Note: owing to rounding the sums of the separate items may differ from the totals shown.

economy. The non-oil and gas tax manoeuvre currently being discussed at the Ministry of Finance is still an uncertainty factor surrounding the drafting of the forecast and could therefore contribute to increased inflation over the forecast horizon. As certainty emerges regarding the parameters of the manoeuvre and its timing, the Bank of Russia will take this factor into account when preparing its forecast.

If any of these risks evolves, a tighter monetary policy than that assumed in the Bank of Russia's scenario may be required. In addition, in the event that certain segments of the financial market show signs of imbalance, the Bank of Russia will be prepared to use macroprudential policy measures to offset risks to price and financial stability in the economy.

ANNEX

Dynamics of major items in the Russian balance of payments in 2017 Q1

In 2017 Q1, the current account surplus increased relative to the corresponding quarter of the previous year for the first time since 2015 due to the improvements in the trade balance.

Compared with 2016 Q1[1], the value of goods exports increased by 36%, which far surpassed the growth in imports, largely due to the increase in global oil prices as exporter countries scrupulously complied with their agreements. Other commodities, which make up the bulk of Russian exports, also increased in price over the year. Prices of natural gas rose in Europe amid low stocks and problems with nuclear energy in France in 2017 Q1. Global prices for coal and key export metals held significantly above the previous year low[2].

Physical volumes of energy exports still exceeded the levels seen in 2016 Q1 as production had been expanded last autumn, before the agreement to cut oil production became effective. According to the FCS of Russia data, exports of oil and oil product rose by 3% due to growing supply to the key markets, European and Chinese ones[3]. The significant reduction in oil exports to Belarus in 2017 Q1 was temporary. In April, the countries settled disputes over oil and gas and signed documents to expand exports of Russian oil to Belarus to 24 million tonnes in 2017, up from 18 million tonnes in 2016, and Belarus paid off its debt for Russian gas supplies. Physical volumes of natural gas exports from Russia rose by 10% in 2017 Q1, entirely due to exports to Europe. The EU[4] has increased gas purchases from abroad in recent years as gas prices fell and internal production reduced. As a result, the combined share of oil, oil products, and natural gas in total commodity exports increased from 54% in 2016 Q1 to 60% in 2017 Q1.

Annual growth in the value of goods imports to Russia increased from 9% in 2016 Q4 to 25% in 2017 Q1 on the back of accelerated growth in the Russian economy and more sizeable annual appreciation of the ruble than in the previous quarter. The ruble's real effective exchange rate against foreign currencies rose by one third. According to estimates based on FCS of Russia data, the almost 80% increase in imports was mainly down to capital and intermediate goods[5] amid growing business activity in industry. Imports of investment goods rose by 25% and intermediate goods by 37% in the first quarter. Although imports grew in almost all of the main product groups, roughly half of the growth came from the 29% increase in imports of machinery, equipment, and vehicles, data from the FCS of Russia suggest. Imports were also buoyed by the improved consumption: the annual decline in retail sales slowed in the first quarter to come to a halt in April. Imports of consumer goods increased by 13% in 2017 Q1.

The slight improvement of consumer confidence combined with the strengthening ruble also triggered growing deficit in the balance of services, primarily due to an increase in imports of tourism services. The value of imports under the 'Trips' item increased by 18% in 2017 Q1. The number of outbound tourism trips by Russians increased by almost a quarter, according to Rosstat data. Growth was observed for most destinations: not only Turkey (after the ban on charter flights was lifted in August 2016), but also Finland, China, Thailand, and

[1] *Hereinafter, changes are relative to the corresponding period of the previous year, unless indicated otherwise.*

[2] *In 2017 Q1, Urals crude oil prices rose by 62% compared with 2016 Q1. According to World Bank data, natural gas prices in Europe increased by 18%, global iron ore prices by 78%, Australian coal by 60%, copper by 25%, aluminium by 22%, and nickel by 21%.*

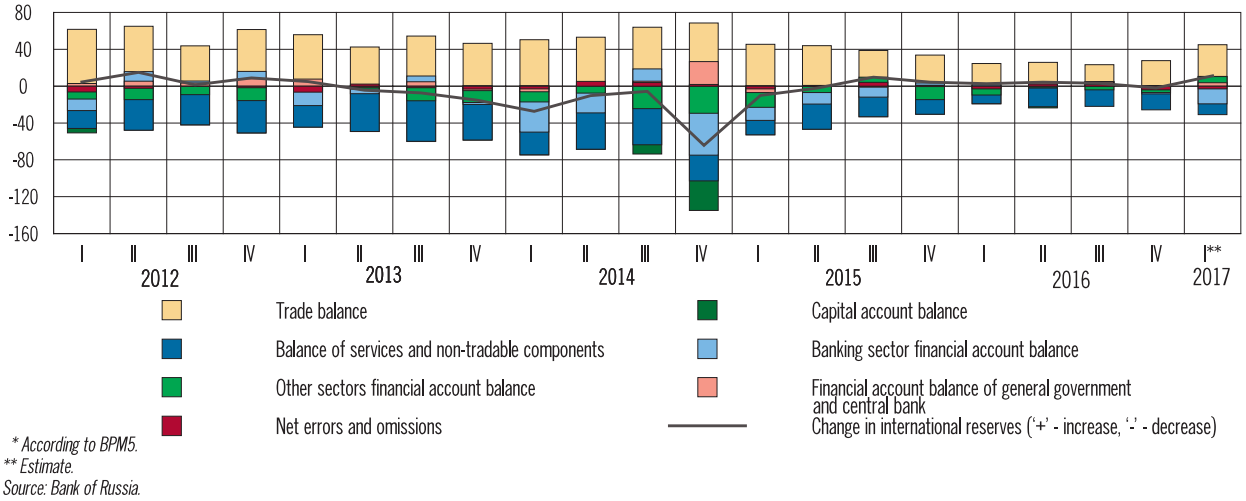
[3] *In 2016, the EU accounted for 62%, China for 19%, and Belarus for 7% of actual oil exports from Russia.*

[4] *The EU's share of actual natural gas exports from Russia was roughly 70% in 2016.*

[5] *Investment goods are goods used to replace, update, or improve the quality of fixed assets, and intermediate goods are goods used for production of goods and services rather than final consumption.*

Chart 1

Major balance of payments components*
(billions of US dollars)



* According to BPM5.
** Estimate.
Source: Bank of Russia.

other countries. Imports of services in other categories also increased. For example, imports of transport services grew by 4%. Imports of other services, predominately business services, rose by 6%.

The non-tradable component deficit also expanded. However, growth in the trade surplus by half far exceeded the increase in the negative contribution of other current account components (Chart 1).

As the current account surplus increased, the net outflow of private capital also intensified due to banks' accumulation of foreign assets. According to preliminary estimates, it grew by half, to $22 billion[6] in 2017 Q1. The growth in banks' foreign assets was down to foreign currency revenue from a major privatisation deal[7].

At the same time, the reduction in banks' foreign liabilities slowed. Preliminary estimates suggest that other sectors increased their foreign liabilities both in the form of direct investments and through loans and borrowing in 2017 Q1, as companies switched to borrowing from sources not affected by sanctions. In 2016, incoming direct foreign investment from Singapore increased significantly due to a major privatisation deal. Foreign liabilities of the Russian private sector in the form of direct investment from the Bahamas and Bermuda have been growing intensively for more than three straight years. They accounted for one quarter of incoming direct foreign investment in 2016.

[6] *Adjusted for the volume of foreign exchange liquidity provided by the Bank of Russia to credit institutions on a repayable basis, the operations in resident banks' correspondent accounts at the Bank of Russia, and the amount of foreign currency received by the Bank of Russia under FX swaps.*

[7] *The deal itself was reached in December 2016; the foreign currency arrived in the buyer's account in January 2017.*

Regional analysis of trends in inflation components

Inflation has become consistently more uniform across regions over the year. The trend towards slower annual inflation (4.1% for Russia as a whole in April 2017) remained, as reflected in the leftward shift in the mode of inflation distribution in April 2017, compared with November 2016 (Chart 1). During the past six months, the number of regions where inflation stood below 4% increased from 28 to 43.

According to Bank of Russia estimates, inflation dynamics in the regions inhabited by the majority of the population (70%) were comparable with that for the Russian Federation as a whole:

– food products saw slower price growth with a slight acceleration in April;

– non-food goods recorded a stable slowdown in price growth;

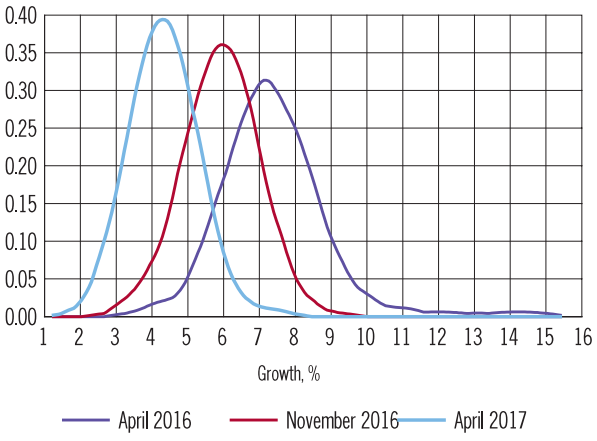
– prices for services were virtually unchanged by the end of the period under review.

Some regions saw inflation deviating from the average Russian level by one of the components mostly due to temporary factors (Chart 2).

Chart 1

Distribution of Russian regions by annual inflation

(percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

Food products

The deviation from federal trends for food in certain regions was down to temporary local changes in potato and meat price dynamics.

Chart 2

Inflation trends across Russian regions

On the map, the regions are distributed by the dynamics of the gap between seasonally adjusted inflation in individual regions and in Russia in November 2017 through April 2017.

Inflation is below the level in Russia. Inflation dynamics are in line with Russian measures.	Inflation is above the level in Russia. Inflation slows down relative to Russian measures.	Inflation is below the level in Russia. Inflation accelerates relative to Russian measures.	Inflation is above the level in Russia. Inflation accelerates relative to Russian measures.
49 constituent entities 58% of the population	5 constituent entities 5% of the population	21 constituent entities 30% of the population	7 constituent entities 7% of the population

The spike in inflation for potatoes in March-April was localised in the European Russia, as well as the North Caucasian and Southern Federal Districts, through which most potatoes are imported. Regional businesses evidence that the spike resulted from importing a more expensive new batch compared with local stock prices to certain regions, while in other regions it was caused by protests against the Platon system (Republic of Dagestan) and system failures (Republic of Kalmykia).

An increase in inflation for meat products was recorded in certain regions in the North Caucasian and Southern Federal Districts with low internal meat production and cattle numbers continuing to fall. Price increases were also registered in the Siberian Federal District: in the Irkutsk Region, livestock numbers fell due to a flare-up of African swine fever in March 2017, and the Tyva Republic saw cattle losses and forced slaughter due to abundant snowfall and insufficient fodder. However, the loss from these events was not significant and only led to a short-term surge in inflation.

Services

The heterogeneity in disinflation trends observed in the services sector was linked to a non-uniform change in administered tariffs for public utilities and passenger transport, and the economy's adaptation to the fall in household purchasing power.

The rising tariffs for communications services (mobile and cable Internet), observed on a federal level, were relatively widespread across the regions. This growth may be due to service providers' measures to restore their margins, which dropped faster than for Russia as whole in 2015–2016. Thereby, price growth for key components of electronic communications services is a likely trend for the short term.

Non-food goods

The deviation in inflation for non-food goods in certain regions from overall Russian trends was also largely down to temporary factors. Heterogeneity in petrol price dynamics resulted from tightening/easing anti-monopoly regulations in certain regions, and local spikes in inflation for medical products were attributed to high logistical costs associated with stock replenishment.

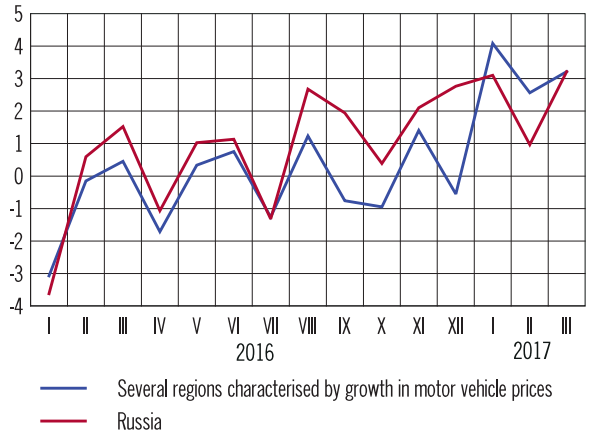
Accelerated growth in car prices amid increased vehicle sales was reported in high-income regions displaying a recovering consumer demand (higher growth in real wages and/or retail trade turnover compared with average figures for Russia as a whole) (Charts 3 and 4). Nonetheless, growth in retail sales of all non-food goods, both in Russia as a whole and high-income regions, remained moderate and, according to Bank of Russia estimates, will not exert any significant upward pressure on inflation.

Special focus should be made on inflation in the Central Federal District which makes the largest contribution to aggregate inflation figures for Russia.

Chart 3

Real wages

(percent change on corresponding period of previous year)

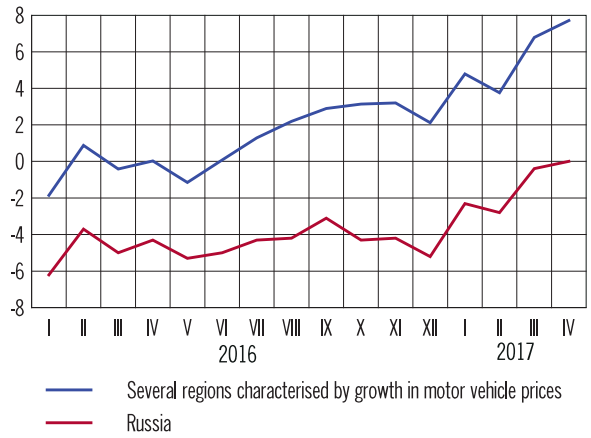


Sources: Rosstat, Bank of Russia calculations.

Chart 4

Retail trade turnover

(percent change on corresponding period of previous year)

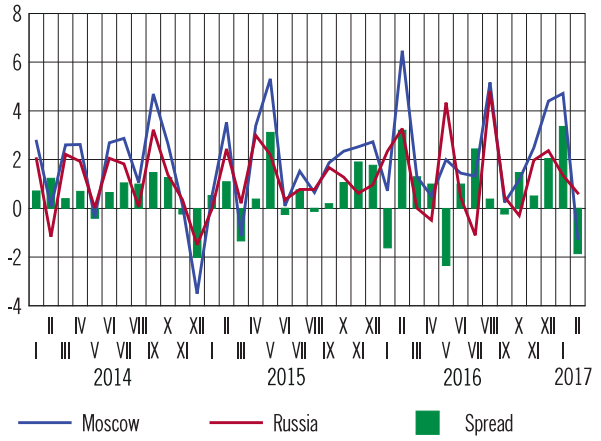


Sources: Rosstat, Bank of Russia calculations.

Chart 5

Real wage growth rates in Moscow and in Russia

(seasonally adjusted, percent change on previous month)

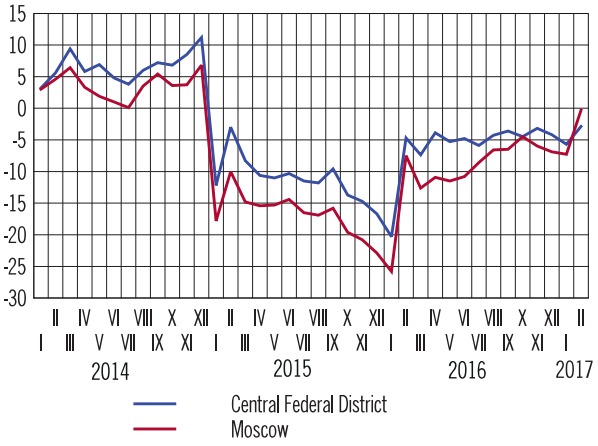


Sources: Rosstat, Bank of Russia calculations.

Chart 6

Retail trade turnover

(percent change on corresponding period of previous year)



Source: Rosstat.

Year-on-year inflation in the Central Federal District has consistently exceeded the readings for Russia as a whole (analysis period, since 2011). The positive inflation gap between the Central Federal District and Russia has been shaped over the past few years by higher growth in prices compared with overall Russian figures in all three CPI components – food products, non-food goods, and services.

Moscow is the main driver of elevated inflation in the Central Federal District. Prices of some product groups increase persistently faster in Moscow compared with overall price growth in Russia:

- Food products: fruit, meat, fish, milk, tea;
- Non-food goods: medical products, furniture and household appliances, homecare products, vehicles, audiovisual devices;
- Services: education, public utilities.

Estimates suggest that the reason behind the existence of these product categories, which show persistently faster price increase in Moscow, is a more stable (compared to the Russian average) demand for goods and services and qualitative differences in consumption of Muscovites and residents of other regions. Firstly, the influx of population to Moscow – several times higher than that in other regions of the Central Federal District – pushes demand constantly upwards. Secondly, the Central Federal District reports the highest growth in real wages (Chart 5). Against this backdrop, the low growth in retail trade turnover can be explained by the special structure of retail trade turnover in Moscow: the overall retail sales can decline due to slower growth in the premium segment (Chart 6). However, growth in demand in the mass-market segment exceeds overall Russian readings. Bank of Russia-conducted surveys of businesses indirectly confirm the large share of imported goods in the consumer basket of residents of the Central Federal District.

Balance of payments forecast for 2017-2020

Compared with the March Report, oil price assumptions have been revised. As OPEC and non-OPEC countries extended their agreement on oil production caps for another nine months, oil price projections were revised upwards in the baseline and risk scenarios. At the same time, the scenario assuming a more favourable external economic climate now provides for lower growth in oil prices than the previous Report, as production in the US is expanding more rapidly. The change in oil price assumptions and adjustment of forecasts for other macroeconomic indicators[1] had a marked impact on the parameters of the balance of payments forecast.

The baseline scenario assumes that oil prices will hold at roughly $50 per barrel until the end of 2017 following the extension of the agreement. However, the Bank of Russia remains conservative in its oil price assumptions. Prices are still expected to drop to $40 per barrel by the middle of next year rather than by this year-end, as was predicted in the previous Report, amid the increased production in the US and expiration of the agreement in spring 2018. Oil prices are expected to remain close to $40 per barrel in real terms and increase slightly in nominal terms in 2019–2020.

Export forecasts revised up on the back of oil price adjustment and the increase in supply due to oil and gas dispute settlement with Belarus. At the same time, the constraining effect of the extended restrictions under the agreement on Russia's production was factored in. In 2017–2019, the value of exports is expected to mirror average annual oil price dynamics: growing in 2017 and falling in 2018–2019. In 2020, exports will increase thanks to both stronger external demand and nominal growth in oil prices.

In 2017, imports will increase faster than anticipated in the previous Report, in part due to the rallying of the ruble since the start of the year. Imports will continue to expand in 2018–2019 as Russian GDP grows, albeit at a slower rate. In 2020, annual growth in imports will also increase on the back of accelerated economic growth in Russia.

As export growth is outstripping that of imports in 2017, the foreign trade surplus will increase considerably. It will drop significantly in 2018–2019 due to a reduction in exports as commodity prices fall and imports continue to increase, but will increase in 2020 amid nominal growth in oil prices.

Non-tradable component deficit will expand due to interest payments on growing external debt, but will remain low.

As the trade surplus was revised upwards thanks to higher oil prices, the forecast for the current balance of payments surplus was raised to $37 billion in 2017. Nonetheless, after having grown significantly this year, the current account surplus will shrink considerably in 2018–2019 on the back of deteriorating foreign trade balance. In 2020, it will stabilise slightly below $10 billion: the improvement in the trade balance will be offset by an increase in the negative contribution made by the non-tradable component balance (Chart 1).

Starting from 2017, the accumulation of foreign assets will become the main component of the net outflow of private capital. The forecast has been revised upwards for the current year. Higher oil prices and, accordingly, higher export revenues will offer the private sector wider opportunities to acquire foreign assets. In 2018, as oil prices and revenue from foreign economic activity drop, the private capital outflow will slow. In 2019–2020, demand for foreign assets will grow as economic agents' income increases amid the rebound in the Russian economy. At the same time, it will remain low by historical standards: foreign investment opportunities will be restricted by low oil prices and low forecast economic growth.

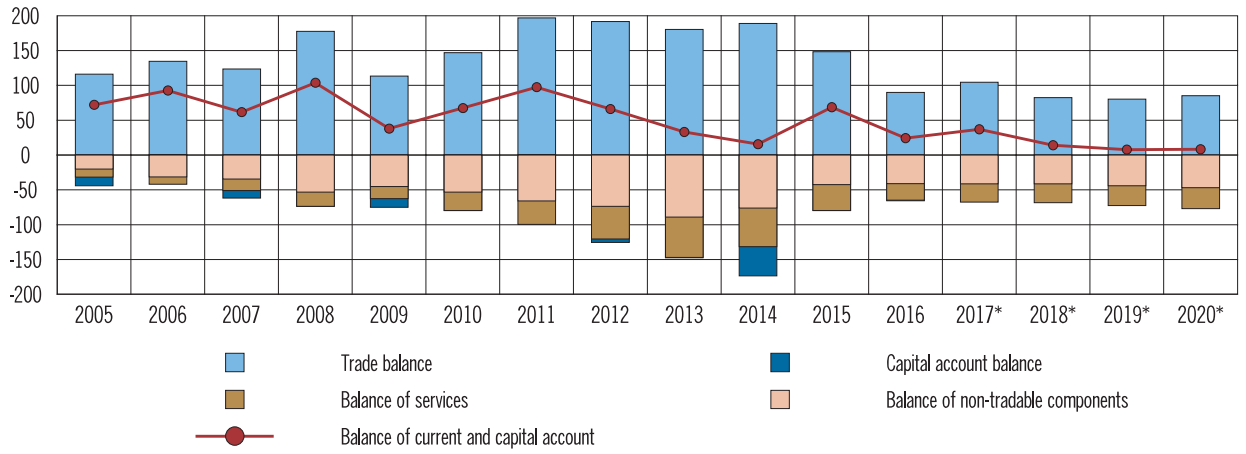
However, the private sector's foreign liabilities will shrink less considerably in 2017–2018 than in previous years, because foreign debt repayments will reduce in compliance with the repayment schedule and companies will start to find sources of external funding not affected by the sanctions. In addition, the growing Russian economy will make investment to Russia more appealing, and from 2019 onwards the private sector is expected to see a net inflow of foreign liabilities. Relatively attractive interest rates will also help buoy non-residents' demand for Russian assets.

As a result, the aggregate net outflow of private capital is expected to fall from roughly $20 billion in 2017 to $11 billion in 2018, due to lower accumu-

[1] *See Section 2 'Economic outlook and key rate decision'.*

Chart 1

Major current account components*
(billions of US dollars)



* Baseline scenario forecast.
Source: Bank of Russia.

lation of foreign assets as oil prices drop. In 2019–2020, it will stabilise at roughly $14 billion: the inflow of foreign investment into Russia will in part be offset by increased demand for foreign assets from Russian companies (Chart 2).

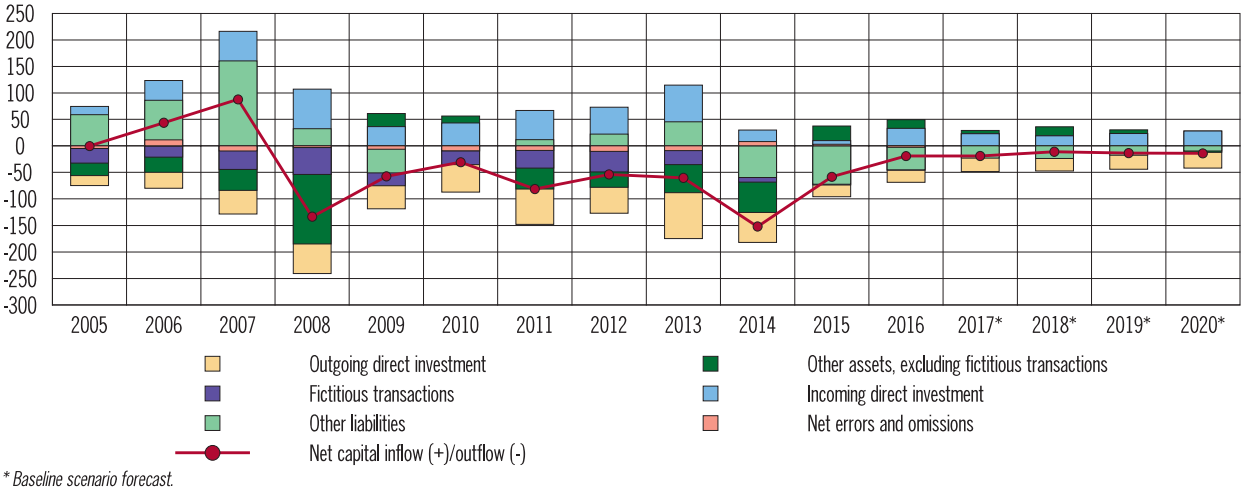
In turn, the general government expects a net inflow of foreign capital over the entire forecast period amid continued government borrowing.

In 2017, reserve assets will increase significantly as banks fully repay their debt on FX refinancing operations to the Bank of Russia and foreign currency will be purchased for the Russian Ministry of Finance under the transitional fiscal rule. In 2018, due to the higher average oil price ($44 per barrel compared with $40 in the previous Report), growth in reserves is expected to be boosted exclusively by operations for the Russian Ministry of Finance. In 2019–2020, no significant change in reserve assets is expected.

According to the scenario assuming a gradual increase in average oil prices to roughly $60 per barrel in 2020 and higher global economic growth, Russian exports will be significantly higher in 2017–2020 compared with the baseline scenario. Imports will also increase considerably compared with the baseline scenario amid the accelerated recovery of the Russian economy and the higher ruble exchange rate. Exports are expected to grow faster than imports, meaning that the positive trade balance and current account will gradually increase in 2017–2019, stabilising at higher levels than the baseline scenario assumes in 2020.

Chart 2

Capital outflow*
(billions of US dollars)



* Baseline scenario forecast.
Source: Bank of Russia.

The rise in commodity prices and higher economic growth in Russia will make Russian assets more attractive for foreign investors, which will boost external borrowing by Russian companies and the public sector. At the same time, growing incomes are also expected to foster investment in foreign assets by the Russian private sector. Overall, the net capital outflow under this scenario will gradually decrease, though staying higher than projected in the baseline scenario. However, credit institutions will fully redeem their debts on foreign currency repos with the Bank of Russia by the end of 2017. Larger foreign currency purchases by the Russian Ministry of Finance than assumed in the baseline scenario will lead to growth in international reserves over the forecast period.

The risk scenario anticipates that oil prices will gradually decrease to $25 per barrel by mid-2018 and remain close to this level until the end of 2020. Lower commodity prices and global economic growth will result in a significant reduction in Russian export volumes compared with the baseline scenario. At the same time, demand for imported goods will decrease with the weaker ruble and lower Russian economic growth. A slump in exports that outpaces the decline in imports will be reflected in a decreased positive trade balance and a fall in the current account surplus in 2017–2019. Afterwards, they are expected to stabilise at lower levels compared with the baseline scenario.

The reduction in Russian assets' appeal to foreign investors will lead to a rise in the risk premium and a downturn in external funding conditions. As a result, the net reduction in liabilities will be higher in 2017–2018 than in the baseline scenario and the transition to a net liability position will shift from 2019 to 2020. At the same time, the capital outflow in connection with the growth in foreign assets will be at levels close to the baseline scenario in 2017–2020. As a result, the net outflow of private capital under the risk scenario will significantly accelerate in 2017–2020 compared with the baseline scenario, and reserve assets will shrink due to the Russian Ministry of Finance's reverse operations.

Changes in the system of monetary policy instruments and other Bank of Russia measures

Table 1

Changes in the system of monetary policy instruments and other Bank of Russia measures

The Bank of Russia has suspended loans secured by gold	Starting from 3 April 2017, the Bank of Russia has suspended loans secured by gold, given the lack of demand for this instrument from credit institutions.
The Bank of Russia has extended the hours for loan applications from credit institutions	Starting from 10 May 2017, the hours have been extended for credit institutions to apply for Bank of Russia loans secured by assets and issued under standard standing facilities. The application can now be submitted electronically until 19:00 Moscow time. Paper applications may be submitted to the Bank of Russia's Operations Department until 17:00, and in all other cases until 19:00 local time.
The Bank of Russia has expanded the Lombard List	In accordance with decisions of the Bank of Russia Board of Directors of 14 April and 29 May 2017, further 32 securities issues were included in the Bank of Russia Lombard List.
The Bank of Russia has decided to gradually reduce adjustment ratios / increase discounts for low credit quality bonds with signs of restructuring.	Starting from 1 April 2017, if changes are adopted with regard to the issue conditions of securities included in the Bank of Russia Lombard List and rated B-/B3 or B/B2 under classifications by the rating agencies S&P Global Ratings, Fitch Ratings, and Moody's Investors Service, in connection with increasing volumes or extending maturities, the adjustment ratio should be reduced to 0.4/the discount should be raised to 60% on the fourth business day after the disclosure of the indicated information for these securities, and three months later the adjustment ratio should be set at zero/repos should be suspended.

Table 2

Interest rates on Bank of Russia operations to provide and absorb ruble liquidity

(% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.17	From 27.03.17	From 2.05.17	From 19.06.17
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by gold[1], non-marketable assets or guarantees; FX swaps (ruble leg)[2]; repos	1 day	daily	11.00	10.75	10.25	10.00
		Loans secured by gold[1]	from 2 to 549 days[3]		11.50	11.25	10.75	10.50
		Loans secured by non-marketable assets or guarantees			11.75	11.50	11.00	10.75
	Open market operations (minimum interest rates)	Auctions to provide loans secured by non-marketable assets	3 months[3]	monthly[4]	10.25	10.00	9.50	9.25
		Repo auctions	1 week	weekly[5]	10.00 (key rate)	9.75 (key rate)	9.25 (key rate)	9.00 (key rate)
			from 1 to 6 days[6]	occasionally				
		FX swap auctions (ruble leg)[2]	from 1 to 2 days[6]					
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	from 1 to 6 days[6]					
			1 week	weekly[5]				
	Standing facilities	Deposit operations	1 day, call	daily	9.00	8.75	8.25	8.00

[1] Operations have been suspended since 1 April 2017.
[2] From 23 December 2016, interest rates on foreign currency leg equal LIBOR for 1-day USD/EUR loans (depending on the currency of the operation).
[3] Loans provided 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. See press-release http://www.cbr.ru/press/PR.aspx?file=19012015_154523if2015-01-19T15_41_11.htm.
[6] Fine-tuning operations.

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.

Statistical tables

Table 1

Bank of Russia operations to provide and absorb ruble liquidity

Purpose	Type of instrument	Instrument	Term	Frequency	Bank of Russia claims on liquidity provision instruments and obligations on liquidity absorption instruments, billions of rubles					
					As of 1.01.16	As of 1.04.16	As of 1.01.17	As of 1.04.17	As of 1.05.17	As of 1.06.17
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	0.0	0.0	0.0	1.9	0.0
		Lombard loans			2.9	3.2	0.6	0.0	0.0	0.0
		FX swaps			14.9	0.0	37.8	0.0	0.0	12.8
		Repos			264.9	192.6	593.9	59.1	155.8	47.3
		Loans secured by gold[1]	from 1 to 549 days		0.5	0.6	0.0	0.0	-	-
		Loans secured by non-marketable assets or guarantees	from 1 to 549 days		234.8	637.3	410.7	259.8	259.6	9.6
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly[2]	1,553.8	744.9	215.6	0.0	0.0	0.0
			18 months[3]	occasionally						
		Repo auctions	1 week	weekly[4]	1,448.5	650.3	0.0	0.0	0.0	0.0
			from 1 to 6 days	occasionally[5]						
		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		0.0	0.0	397.0	320.0	360.0	590.0
			1 week	weekly[4]						
	Standing facilities	Deposit operations	1 day, call	daily	557.8	400.9	388.2	174.0	286.0	197.1

[1] Operations have been suspended since 1 April 2017.
[2] Operations have been discontinued since April 2016.
[3] Operations have been suspended since 1 July 2016.
[4] Either a repo or a deposit auction is held depending on the situation with liquidity.
[5] Fine-tuning operations.

Source: Bank of Russia.

Table 2

Required reserve ratios

(%)

Liability type	Periods			
	From 1.01.16 to 31.03.16	From 1.04.16	From 1.07.16	From 1.08.16
To households in rubles	4.25	4.25	4.25	5.00
To non-resident legal entities in rubles				
Other liabilities in rubles				
To households in foreign currency			5.25	6.00
To non-resident legal entities in foreign currency		5.25	6.25	7.00
Other liabilities in foreign currency				

Source: Bank of Russia.

Table 3

Required reserve averaging ratio

Types of credit institutions	From 1.01.16
Banks	0.8
Non-bank credit institutions	1.0

Source: Bank of Russia.

Table 4

Bank of Russia operations to provide foreign currency

Instrument	Term	Frequency[1]	Minimum auction rate and interest rate for dollar leg of FX swaps[2] (as apread to LIBOR[3], pp)	Bank of Russia claims, millions of US dollars[4]					
			From 23.12.16	As of 1.01.16	As of 1.04.16	As of 1.01.17	As of 1.04.17	As of 1.05.17	As of 1.06.17
Repo auctions	1 week	weekly	2.00	100.1	100.0	2,635.2	0.0	0.0	0.0
	28 days			5,016.7	12,109.5	8,719.9	4,810.8	4,115.0	3,006.9
	12 months		3.00	15,550.0	4,346.6	26.2	0.0	0.0	0.0
Loan auctions	28 days	monthly	2.25	0.0	0.0	0.0	0.0	0.0	0.0
	365 days		3.25	1,494.7	0.0	0.0	0.0	0.0	0.0
USD/RUB sell/buy FX swaps	1 day	daily	1.50	0.0	0.0	1,000.0	54.9	0.0	0.0

[1] In 2016 and in January-May 2017, no credit auctions were held; 12-month repo auctions have been suspended since 1 April 2016.
[2] The rate for ruble leg is equal to the Bank of Russia key rate less 1 pp.
[3] In respective currencies and for respective terms.
[4] Claims on credit institutions under the second leg of repos.

Source: Bank of Russia.

Table 5

Bank of Russia specialised refinancing facilities[1]

Purpose of indirect bank lending	Maturity	Collateral	Interest rate, % p.a.[2]				Bank of Russia claims on credit institutions, billions of rubles						Limit as of 1.06.17, billions of rubles
			As of 1.01.17	From 27.03.17	From 2.05.17	From 19.06.17	As of 1.01.16	As of 1.04.16	As of 1.01.17	As of 1.04.17	As of 1.05.17	As of 1.06.17	
Non-commodity exports	Up to 3 years	Claims under loan agreements secured by contracts of insurance of JSC EXIAR	9.00	8.75	6.50	6.50	39.66	51.01	43.38	30.77	31.46	32.68	75.00
Large-scale investment projects[3]	Up to 3 years	Claims under bank loans for investment projects secured by the government guarantees of the Russian Federation	9.00	8.75	8.25	8.00	53.44	74.16	112.62	100.70	102.56	100.87	150.00
		Bonds placed to fund investment projects and included in the Bank of Russia Lombard List	9.00	8.75	8.25	8.00	2.85	2.85	0.59	0.00	0.00	0.00	
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank[4]	6.50	6.50	6.50	6.50	40.10	41.24	43.12	38.68	36.60	34.64	125.00
	Up to 3 years	Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises					0.08	1.10	48.17	64.51	65.80	67.97	
Leasing	Up to 3 years	Claims on loans to leasing companies	9.00	8.75	8.25	8.00	0.00	0.00	0.00	0.18	0.20	0.20	10.00
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	10.00	9.75	9.25	9.00	21.01	21.01	29.31	29.31	29.31	29.31	30.00

[1] Specialised refinancing facilities are Bank of Russia instruments aimed at encouraging bank lending to certain segments of the economy whose development is hampered by structural factors. Under these facilities, the Bank of Russia provides funds to credit institutions at lower rates and for longer maturities compared with standard Bank of Russia operations. Specialised refinancing facilities are temporary Bank of Russia instruments, which will be valid until conditions for their replacement with market instruments are created in the financial market. The provision of funds under the specialised facilities is restricted, because their application should not distort the stance of the monetary policy and prevent the achievement of its key objective of ensuring price stability.

[2] For more information on the interest rates on the Bank of Russia's specialised instruments see the section Monetary Policy on the Bank of Russia website.

[3] Projects are selected in compliance with the rules established by Regulation of the Government of the Russian Federation No. 1016, dated 14 December 2010, 'On Approving the Rules to Select Investment Projects and Principals for the Provision of the Russian Federation State Guarantees on Loans or Bonded Loans Attracted to Carry out Investment Projects' or Regulation of the Government of the Russian Federation No. 1044, dated 11 October 2014, 'On Approving the Programme to Support Investment Projects Implemented in the Russian Federation Based on Project Financing'.

[4] Claims under loans issued to banks and microfinance organisations partnering with JSC SME Bank under the Programme for Financial Support of Small and Medium-sized Enterprises Development for lending to SMEs and claims under loans issued to leasing companies partnering with JSC SME Bank for leasing property to SMEs.

Source: Bank of Russia.

Table 6

Consumer prices by group of goods and services

(month on previous month, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2015								
January	3.9	3.5	5.7	3.7	22.1	3.2	3.5	2.2
February	2.2	2.4	3.3	2.7	7.2	2.1	2.3	0.8
March	1.2	1.5	1.6	1.6	1.2	1.4	1.6	0.3
April	0.5	0.8	0.3	0.9	-3.7	0.9	0.9	0.0
May	0.4	0.6	0.1	0.2	-1.0	0.5	0.6	0.5
June	0.2	0.4	-0.4	0.2	-5.0	0.3	0.3	1.0
July	0.8	0.4	-0.3	0.3	-4.2	0.5	0.3	3.0
August	0.4	0.8	-0.7	0.5	-9.8	0.8	0.7	1.3
September	0.6	0.8	0.4	0.7	-2.3	1.1	1.1	0.0
October	0.7	0.7	1.0	0.8	2.9	1.0	1.1	-0.1
November	0.8	0.6	1.2	0.7	5.6	0.7	0.8	0.2
December	0.8	0.6	1.2	0.6	6.6	0.4	0.5	0.7
Total for the year (December on December)	12.9	13.7	14.0	13.6	17.4	13.7	14.5	10.2
2016								
January	1.0	0.8	1.2	0.6	6.2	0.7	0.8	1.0
February	0.6	0.7	0.7	0.5	2.3	0.8	0.9	0.3
March	0.5	0.6	0.4	0.6	-1.3	0.8	0.8	0.1
April	0.4	0.5	0.4	0.5	-0.1	0.6	0.6	0.3
May	0.4	0.5	0.4	0.3	0.6	0.4	0.4	0.5
June	0.4	0.4	0.1	0.3	-1.1	0.5	0.4	0.6
July	0.5	0.3	0.0	0.5	-4.2	0.4	0.3	1.7
August	0.0	0.4	-0.6	0.4	-8.9	0.4	0.4	0.3
September	0.2	0.5	-0.1	0.4	-5.4	0.6	0.6	0.1
October	0.4	0.4	0.8	0.6	2.5	0.5	0.6	-0.3
November	0.4	0.4	0.7	0.5	2.5	0.4	0.5	0.0
December	0.4	0.3	0.6	0.6	0.9	0.3	0.3	0.3
Total for the year (December on December)	5.4	6.0	4.6	6.0	-6.8	6.5	6.8	4.9
2017								
January	0.6	0.4	0.9	0.3	5.3	0.5	0.4	0.5
February	0.2	0.2	0.2	0.1	0.6	0.2	0.2	0.3
March	0.1	0.2	0.1	0.1	0.3	0.2	0.2	0.0
April	0.3	0.2	0.6	0.1	4.7	0.2	0.1	0.2
May	0.4	0.1	0.6	-0.1	5.8	0.2	0.1	0.4

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

Sources: Rosstat, Bank of Russia calculations.

Table 7

Consumer prices by group of goods and services

(month on corresponding month of previous year, %)

	Inflation	Core inflation	Food	Food[1]	Vegetables and fruit	Non-food goods	Non-food goods excluding petrol[2]	Services
2015								
January	15.0	14.7	20.7	18.4	40.7	11.2	11.4	12.3
February	16.7	16.8	23.3	20.8	43.5	13.0	13.5	12.8
March	16.9	17.5	23.0	21.1	38.0	13.9	14.6	12.6
April	16.4	17.5	21.9	20.8	30.0	14.2	15.0	11.8
May	15.8	17.1	20.2	19.5	25.7	14.3	15.1	11.6
June	15.3	16.7	18.8	18.4	22.8	14.2	15.0	11.7
July	15.6	16.5	18.6	17.5	27.9	14.3	15.0	13.4
August	15.8	16.6	18.1	17.0	29.1	14.6	15.3	14.1
September	15.7	16.6	17.4	16.4	27.7	15.2	16.0	13.8
October	15.6	16.4	17.3	16.2	27.9	15.6	16.6	13.1
November	15.0	15.9	16.3	15.5	24.3	15.7	16.7	11.9
December	12.9	13.7	14.0	13.6	17.4	13.7	14.5	10.2
2016								
January	9.8	10.7	9.2	10.2	2.0	10.9	11.4	9.0
February	8.1	8.9	6.4	7.8	-2.7	9.5	9.9	8.5
March	7.3	8.0	5.2	6.7	-5.1	8.8	9.1	8.2
April	7.3	7.6	5.3	6.3	-1.6	8.5	8.7	8.4
May	7.3	7.5	5.6	6.4	0.0	8.4	8.5	8.4
June	7.5	7.5	6.2	6.5	4.1	8.5	8.7	7.9
July	7.2	7.4	6.5	6.7	4.2	8.4	8.7	6.5
August	6.9	7.0	6.5	6.7	5.3	8.1	8.4	5.5
September	6.4	6.7	5.9	6.4	1.9	7.5	7.9	5.6
October	6.1	6.4	5.7	6.1	1.5	7.0	7.4	5.4
November	5.8	6.2	5.2	6.0	-1.5	6.7	7.0	5.3
December	5.4	6.0	4.6	6.0	-6.8	6.5	6.8	4.9
2017								
January	5.0	5.5	4.2	5.7	-7.6	6.3	6.4	4.4
February	4.6	5.0	3.7	5.4	-9.0	5.7	5.7	4.3
March	4.3	4.5	3.5	4.9	-7.6	5.1	5.0	4.2
April	4.1	4.1	3.6	4.5	-3.1	4.7	4.6	4.1
May	4.1	3.8	3.9	4.0	2.0	4.4	4.2	4.0

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

Sources: Rosstat, Bank of Russia calculations.

Table 8

Macroeconomic indicators

(seasonally adjusted, growth as % of previous period)

	Industrial production[1]	Agriculture	Construction	Freight turnover	Retail trade turnover	Consumer expenditure	Output index of goods and services by key industries	GDP[2]
2015								
January	-2.9	-0.1	-1.9	-0.3	-9.1	-7.0	-3.6	
February	-1.7	0.0	-0.2	-0.1	-1.5	-0.5	-0.7	
March	1.9	0.3	-2.2	2.3	-0.9	-0.1	-0.1	-2.5
April	-0.8	-0.1	-0.5	-1.9	-0.6	-0.9	-1.3	
May	-0.6	0.1	-1.4	-0.5	0.0	0.2	0.5	
June	0.8	0.4	-0.1	0.6	-0.7	-0.3	-0.6	-0.4
July	0.0	-1.1	-2.6	2.2	0.1	-0.3	0.3	
August	0.6	1.2	-0.3	-1.0	-0.3	-0.4	0.0	
September	0.6	0.1	0.4	0.6	-0.9	-0.5	1.0	-0.2
October	-0.7	-0.2	-1.2	2.9	-0.4	-0.2	-0.1	
November	0.1	0.3	-0.4	-1.3	-0.4	-0.4	-1.1	
December	0.5	0.2	1.1	-0.1	0.5	-0.4	0.7	-0.3
2016								
January	-1.1	0.2	-1.3	-2.7	-1.5	-0.7	-0.5	
February	3.0	0.3	0.2	2.8	-0.6	1.8	0.6	
March	-1.8	0.0	-0.2	-1.4	0.0	-2.4	0.0	-0.2
April	-0.4	0.3	-1.4	-1.2	-0.9	0.2	0.0	
May	0.4	0.1	-0.2	-0.3	-0.3	-0.4	-0.2	
June	0.7	0.0	-0.7	1.6	-0.1	-0.1	0.0	0.1
July	-0.3	0.7	0.9	1.7	0.0	0.0	0.5	
August	0.4	-0.2	-0.5	0.4	0.0	0.1	-0.1	
September	-0.5	0.1	-0.6	1.6	0.0	0.0	0.2	0.1
October	0.6	0.4	0.6	-1.5	-0.7	0.0	0.3	
November	1.1	0.2	-0.1	1.8	-0.3	0.1	0.4	
December	-1.5	0.1	-0.9	0.4	-0.9	-0.1	-0.3	0.3
2017								
January	0.7	0.1	0.2	1.8	1.1	0.5	0.0	
February	-1.5	0.2	-0.4	-1.2	0.6	0.2	-0.7	
March	1.3	0.3	-0.2	-0.9	0.0	0.1	1.2	0.3
April	0.8	0.1	0.6	3.4	0.3	0.1	0.9	

[1] Rosstat estimate.
[2] Quarterly data.

Sources: Rosstat, Bank of Russia calculations.

Table 9

Macroeconomic indicators

(as % of corresponding period of previous year)

	2016	2017					Memo item: 2016
	Total	January	February	March	April	January-April	January-April
Output of goods and services by key industries	0.4	2.1	-2.8	1.3	3.1	1.0	-0.2
Industrial output	1.1	2.3	-2.7	0.8	2.3	0.7	1.1
Agricultural output	4.8	0.6	0.2	1.1	0.8	0.7	3.6
Construction	-4.3	-2.4	-4.5	-5.0	-0.4	-3.1	-5.1
Retail trade turnover	-4.6	-2.3	-2.8	-0.4	0.0	-1.4	-4.8
Household real disposable money income	-5.9	8.0	-3.8	-2.3	-7.6	-2.2	-4.6
Real wage	0.7	3.1	1.0	3.2	2.5	2.4	-0.7
Number of unemployed	-0.5	-3.2	-4.6	-10.0	-10.4	-7.1	6.2
Unemployment (as % of economically active population)	5.3[1]	5.6	5.6	5.4	5.3	5.3[1]	5.9[1]

[1] Data as of the end of period.

Sources: Rosstat, Bank of Russia calculations.

Table 10

Change in Bank of Russia forecasts of GDP[1] growth of Russia's trading partners

(%)

		Forecast of GDP growth in 2017		Memo item: country's share in aggregate GDP of trading partners
		March 2016	June 2017	
Total		2.03	2.14	100.0
1	Germany	1.28	1.50	14.6
2	China	6.10	6.23	10.3
3	Italy	0.52	0.60	9.3
4	Turkey	2.47	2.40	6.9
5	Belarus	0.80	0.24	5.5
6	Japan	0.56	0.80	5.3
7	Korea, Republic of	2.23	2.21	4.7
8	Belgium	0.99	1.13	4.6
9	Poland	2.80	2.82	4.4
10	United Kingdom	1.21	1.56	4.4
11	Kazakhstan	1.65	2.25	4.2
12	The Netherlands	1.32	1.65	3.3
13	United States	2.15	2.16	3.1
14	France	0.95	1.02	3.1
15	Finland	0.59	0.80	3.1
16	Latvia	2.61	2.45	3.0
17	India	6.75	6.75	1.9
18	Switzerland	1.18	1.13	1.5
19	Czech Republic	2.22	2.19	1.4
20	Hungary	2.37	2.92	1.4
21	Slovakia	2.89	2.72	1.4
22	Lithuania	2.24	3.02	1.3
23	Spain	2.03	2.15	1.3
24	Ukraine	2.24	2.24	0.0

[1] The aggregate GDP growth rate is calculated based on the shares of 24 Russia's trading partners in Russian exports for the period from 2013 to 2015. Previously, the rate was calculated for the period 2010-2014. The share of each country was determined based on the exports to major trading partners. The aggregate GDP forecast excludes the economy of Ukraine and includes the re-exports of Russian energy commodities from the Netherlands.

Source: Bank of Russia.

Table 11

Monetary policy rates in various countries

Country	Policy rate	Current level	Date of latest change	Previous level	Change	Number of rate changes over the past 12 months	Inflation	Current level, %	12-month change, pp
Poland	target rate	1.50	04.03.2015	2.00	-0.50	0		1.9	2.80
Hungary	base rate	0.90	24.05.2016	1.05	-0.15	0		2.1	2.30
Czech Republic	repo rate (14 days)	0.05	01.11.2012	0.25	-0.20	0		2.4	2.30
Romania	base rate	1.75	06.05.2015	2.00	-0.25	0		0.6	3.86
Bulgaria	base rate	0.00	01.02.2016	0.01	-0.01	0		2.6	4.80
Serbia	key policy rate	4.00	07.07.2016	4.25	-0.25	1		4.0	3.60
Israel	target overnight rate	0.10	23.02.2015	0.25	-0.15	0		0.7	1.62
Brazil	target rate	10.25	31.05.2017	11.25	-1.00	6		4.1	-5.20
Chile	monetary policy rate	2.50	18.05.2017	2.75	-0.25	4		2.6	-1.60
China	lending rate (12 months)	4.35	26.10.2015	4.60	-0.25	0		1.5	-0.50
	deposit rate (12 months)	1.50	26.10.2015	1.75	-0.25	0			
	required reserve rate	17.00	01.03.2016	17.50	-0.50	0			
India	reverse repo rate	6.25	04.10.2016	6.50	-0.25	1		3.0	-2.48
	repo rate	6.00	06.04.2017	5.75	0.25	2			
Indonesia	target rate	6.50	16.06.2016	6.75	-0.25	1		4.3	1.00
Korea, Republic of	base rate	1.25	09.06.2016	1.50	-0.25	1		2.0	1.20
Malaysia	target overnight rate	3.00	13.07.2016	3.25	-0.25	1		4.4	2.30
Mexico	target rate	6.75	18.05.2017	6.50	0.25	7		6.2	3.56
Philippines	monetary policy rate	3.00	03.06.2016	4.00	-1.00	1		3.1	1.50
Russia	repo auction rate (7 days)	9.25	02.05.2017	9.75	-0.50	4		4.1	-3.20
South Africa	repo rate	7.00	17.03.2016	6.75	0.25	0		5.3	-0.90
Thailand	repo rate	1.50	29.04.2015	1.75	-0.25	0		0.0	-0.50
Turkey	repo rate (7 days)	8.00	24.11.2016	7.50	0.50	1		11.7	5.14
United States	federal funds rate (upper bound)	1.00	15.03.2017	0.75	0.25	2		2.2	1.10
Euro area	refinancing rate	0.00	16.03.2016	0.05	-0.05	0		1.4	1.50
United Kingdom	base rate	0.25	04.08.2016	0.50	-0.25	1		2.7	2.40
Japan	overnight rate	0.10	19.12.2008	0.30	-0.20	0		0.4	0.70
Canada	target overnight rate	0.50	15.07.2015	0.75	-0.25	0		1.6	-0.10
Australia	overnight rate	1.50	02.08.2016	1.75	-0.25	1		2.1	0.80
New Zealand	overnight rate	1.75	10.11.2016	2.00	-0.25	2		2.2	1.80
Denmark	lending rate	0.05	20.01.2015	0.20	-0.15	0		1.0	1.30
	certificate of deposit rate	-0.65	08.01.2016	-0.75	0.10	0			
Switzerland	3m LIBOR – min	-1.25	15.01.2015	-0.75	-0.50	0		0.5	0.90
	3m LIBOR – max	-0.25	15.01.2015	0.25	-0.50	0			
Sweden	repo rate	-0.50	11.02.2016	-0.35	-0.15	0		2.0	0.92
Norway	key deposit rate	0.50	17.03.2016	0.75	-0.25	0		2.1	-1.30

Note: as of 8 June 2017, changes occurred from the compilation time of the previous Monetary Policy Report issue (16 March 2017) are put in colour.

Source: Bloomberg.

LIST OF BOXES

GLOSSARY

Averaging of required reserves

The right of a credit institution to meet reserve requirements set by the Bank of Russia by maintaining a share of required reserves not exceeding the averaging ratio in a correspondent account with the Bank of Russia during a specified period.

Banking sector liquidity

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

Bank lending conditions index

A generalised indicator of changes to bank lending conditions, as calculated by the Bank of Russia based on the results of a quarterly survey among leading Russian banks operating in the lending market as follows: (share of banks reporting a significant tightening of lending conditions, as a percentage) + 0.5 x (share of banks reporting a moderate tightening of lending conditions, as a percentage) – 0.5 x (share of banks reporting a moderate easing of lending conditions, as a percentage) – (share of banks reporting a significant easing of lending conditions, as a percentage). Measured in percentage points (pp).

Bank of Russia interest rate corridor (interest rate corridor)

The basis of Bank of Russia interest rate system. The centre of the corridor is set by the Bank of Russia key rate; the upper and lower bounds are rates on overnight standing facilities (deposit facilities and refinancing facilities) symmetric to the key rate.

Bank of Russia key rate

The minimum interest rate at the Bank of Russia 1-week repo auctions and the maximum interest rate at the Bank of Russia 1-week deposit auctions. It is set by the Bank of Russia Board of Directors.

Bank of Russia Lombard List

A list of securities eligible as collateral for Bank of Russia refinancing operations.

Broad money (monetary aggregate M2X)

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

Carry trade

A strategy in which money is borrowed at a low interest rate in order to invest in higher-yielding assets. This strategy is employed by FX and stock market players to benefit from the positive differentials between active and passive interest rates in different currencies or for different maturities.

CDS spread

Premium paid by the CDS buyer to the seller, usually expressed in basis points of the nominal value of the debt and paid with a certain periodicity.

Consumer price index (CPI)

The CPI measures changes over time in the overall price level of goods and services purchased by households for private consumption. This index is calculated by the Federal State Statistics Service as the ratio of the value of a fixed set of goods and services in current prices to the value of the same set of goods and services in prices of a previous (reference) period. The CPI is calculated on the basis of data on the actual structure of consumer spending being therefore one of the key indicators of household living costs.

Core inflation

Inflation being measured as a core consumer price index (CCPI). The difference between the CCPI and the consumer price index (CPI) lies in the CCPI calculation method, which excludes a change in prices for individual goods and services subject to the influence of administrative and seasonal factors (fruit and vegetables, fuel, passenger transportation services, telecommunications services, and the majority of housing and public utility services).

Credit default swap (CDS)

An insurance contract protecting from default on reference obligations (sovereign or corporate securities with fixed yields). It is a credit derivative allowing the buyer of the contract to get insured against a certain credit event of the reference obligation issuer by paying an annuity premium (CDS spread) to the insurance seller.

Current liquidity deficit/surplus

An excess of banking sector demand for liquidity over the liquidity supply on a given day. A reverse situation, an excess of the liquidity supply over demand on a given day, is current liquidity surplus.

Dollarisation of deposits

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

Factors of banking sector liquidity

Changes in the central bank balance-sheet items affecting banking sector liquidity, but which do not result from central bank liquidity management operations. These factors include changes in cash in circulation, changes in balances of general government accounts with the Bank of Russia, Bank of Russia operations in the domestic foreign exchange market (excluding operations regulating banking sector liquidity), as well as changes in required reserves deposited by credit institutions in required reserve accounts with the Bank of Russia.

Floating exchange rate regime

According to the IMF classification, under the floating exchange rate regime the central bank does not set targets, including operational ones, for the level of, or changes to, the exchange rate, allowing it to be shaped under the impact of market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to influence the domestic FX market occasionally to smooth out the ruble's exchange rate volatility and prevent its excessive deviations.

Floating interest rate on Bank of Russia operations

An interest rate tied to the Bank of Russia key rate. If the Bank of Russia Board of Directors decides to change the key rate, the interest rate applied to the loans previously provided at a floating interest rate will be adjusted by the change in the key rate with effect from the corresponding date.

Funds in general government's accounts

Funds in accounts with the Bank of Russia representing funds of the federal budget, the budgets of constituent territories of the Russian Federation, local budgets, government extra-budgetary funds and extra-budgetary funds of constituent territories of the Russian Federation and local authorities.

Generalised (composite) consumer confidence index

Calculated by the Federal State Statistics Service on the basis of quarterly surveys, as an arithmetical mean value of five indices: occurred and expected changes in personal wealth; occurred and expected changes in the economic situation in Russia; and the favourability of conditions for high-value purchases. Partial indices are calculated by drawing up the balance of respondents' estimates (as a percentage). The balance of estimates is the difference between the sum of shares (as a percentage) of decisively positive and 1/2 of the rather positive answers and the sum of shares (as a percentage) of negative and 1/2 of the rather negative answers. Neutral answers are not taken into account.

Gross credit of the Bank of Russia

Includes loans extended by the Bank of Russia to credit institutions (including banks with revoked licences), overdue loans and overdue interest on loans, funds provided by the Bank of Russia to credit institutions through repos and FX swaps (USD/RUB and EUR/RUB swaps).

Inflation targeting regime

A monetary policy framework setting that the final target of the central bank is to ensure price stability, i.e. achieving and maintaining sustainably low inflation. Under this regime a quantitative inflation target is set and announced. The central bank is responsible for achieving this target. Typically, under an inflation targeting regime, the monetary policy affects the economy through interest rates. Decisions are made primarily on the basis of economic forecasts and inflation dynamics. An important feature of this regime is regular explanations to the public of decisions adopted by the central bank, which guarantees its accountability and transparency.

Interest rate corridor

See Bank of Russia interest rate corridor.

Macro Risk Index

An index calculated by Citibank and demonstrating the perception of risk level in the global financial markets by investors. The index is bound between 0 (low risk level) to 1 (high risk level). The index is based on the historical dynamics of emerging market sovereign Eurobond yield spreads to the yield spreads of US treasuries, credit spreads on US corporate bonds, US swap spreads, and implied exchange rate, stock index and interest rate volatility.

MSCI indices

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

Monetary aggregate M1

Total amount of cash in circulation and funds of the Russian Federation residents (non-financial and financial organisations (excluding credit ones) and households) in settlement, current and other on-demand accounts (including accounts for bank card settlements) opened in the banking system in the currency of the Russian Federation and interest accrued on them.

Monetary policy transmission mechanism

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

Money supply

Total amount of funds of the Russian Federation residents (excluding general government and credit institutions). For the purposes of economic analysis various monetary aggregates are calculated (see Monetary aggregate M1, Money supply in the national definition (monetary aggregate M2), and Broad money).

Money supply in the national definition (monetary aggregate M2)

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

Net credit of the Bank of Russia to credit institutions

Gross credit of the Bank of Russia to credit institutions net of correspondent account balances in the currency of the Russian Federation (including the averaged amount of required reserves) and deposit account balances of credit institutions with the Bank of Russia, investments by credit institutions in Bank of Russia bonds (at prices fixed as of the start of the current year), and credit institutions' claims on the Bank of Russia under the ruble leg of FX swaps (USD/RUB swaps).

Net private capital inflow/outflow

The total balance of private sector operations involving foreign assets and liabilities recorded on the financial account of the balance of payments.

Non-price bank lending conditions

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

Non-tradable sector of the economy

Sector of the economy engaged in electricity, gas and water supply, construction, wholesale and retail trade, motor vehicle and motorcycle maintenance, household goods and personal appliance repairs, hotels and restaurants, transport and communications, financial activity, real estate, leasing and services, including other communal, social and personal services.

Open market operations

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

Outstanding amount on Bank of Russia refinancing operations

Outstanding amount on loans extended by the Bank of Russia to credit institutions against the collateral of securities, non-marketable assets, guarantees, gold, repo operations, and FX swaps (USD/RUB and EUR/RUB swaps).

PMI indices

Indicators of business activity based on company surveys in manufacturing and/or services industries. The PMI index series describe dynamics for the following aspects of business climate: output (or business activity for the services industry), new orders, new export orders, backlogs of work, stocks of finished goods, stocks of purchases, quantity of purchases, suppliers' delivery times, employment, output prices (prices charged for the services industry), input prices, and expectations for activity one year ahead (for the services industry). PMI readings over 50 indicate an expansion of business activity, while readings below 50 suggest a decline.

Repo operation

A deal which consists of two legs: one party to the deal sells securities to the other party in return for cash, and then, once the deal term has expired, buys them back at a predetermined price. Repos are used by the Bank of Russia to provide credit institutions with liquidity in rubles and foreign currency in exchange for collateral in the form of securities.

Required reserves

Funds maintained by credit institutions in correspondent accounts with the Bank of Russia and accounts to record required reserves in order to fulfill reserve requirements. The latter comprise required reserve ratios and a required reserve averaging ratio.

Ruble nominal effective exchange rate index

The ruble nominal effective exchange rate index reflects changes in the exchange rate of the ruble against the currencies of Russia's main trading partners. It is calculated as the weighted average change in the nominal exchange rates of the ruble to the currencies of Russia's main trading partners. The weights are determined according to the foreign trade turnover share of Russia with each of these countries in the total foreign trade turnover of Russia with its main trading partners.

Ruble real effective exchange rate index

Calculated as the weighted average change in real exchange rates of the ruble to the currencies of Russia's main trading partners. The real exchange rate of the ruble to a foreign currency is calculated using the nominal exchange rate of the ruble to the same currency and the ratio of price levels in Russia to those in the corresponding country. When calculating the real effective exchange rate, weights are determined according to the foreign trade turnover share of Russia with each of these countries in the total foreign trade turnover of Russia with its main trading partners. The ruble real effective exchange rate index reflects changes in the competitiveness of Russian goods in comparison to those of Russia's main trading partners.

Shadow banking sector

Financial intermediaries providing credit intermediary services whose activity is not regulated by the banking legislation.

Standing facilities

Operations to provide and absorb liquidity carried out by the Bank of Russia on the initiative of credit institutions.

Structural liquidity deficit/surplus

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

Structural non-oil and gas primary budget deficit

Budget items that are not dependent on the phase of the business cycle and are determined by general government decisions. It is the overall budget deficit, excluding oil and gas revenues, net interest payments, one-off budget revenues, and other items directly dependent on changes in economic activity.

Terms of foreign trade

Ratio between a country's export price index and import price index.

Tradable sector of economy

Economy sector made up of agriculture, hunting, forestry, fishery, fish farming, mining and quarrying, and manufacturing industries.

Underlying inflation

Inflation indicator cleared of all shocks which are irrelevant for the monetary policy. The underlying inflation indicator used by the Bank of Russia is calculated on the basis of dynamic factor models.

VIX

Calculated by Chicago Board Options Exchange index of expected volatility of S&P 500 stock index over the next 30-day period. VIX is constructed as a weighted average of premiums of a wide range of prices of put and call options on the S&P 500 index.

ABBREVIATIONS

AHML – Agency for Housing Mortgage Lending

BLC – bank lending conditions

bp – basis points (0.01 pp)

BRICS – a group of five countries: Brazil, Russia, India, China and South Africa

BPM6 – the 6th edition of the IMF's Balance of Payments and International Investment Position Manual

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

FPG – fiscal policy guidelines

GDP – gross domestic product

GFCF – gross fixed capital formation

IBL – interbank loans

IEA – International Energy Agency

IFX–Cbonds – corporate bond yield 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)

MICEX SE – MICEX Stock Exchange

MPD–Monetary Policy Department of the Bank of Russia

MTVECM, TVECM–Momentum Threshold Vector Error Correction Model, Threshold Vector Error Correction Model

NPF – non-governmental pension fund

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 – Organisation 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 bond market, calculated by Cbonds)

SME – small and medium-sized enterprises

SNA – System of National Accounts

TCC – total cost of credit (see the definition in the Glossary)

TVP FAVAR – Time-Varying Parameter Factor-Augmented Vector Auto-Regression

VCIOM – Russian Public Opinion Research Centre

VAT – value added tax

VEB – Vnesheconombank

VECM–Vector Error Correction Model