



Bank of Russia

The Central Bank of the Russian Federation



**Monetary Policy
Guidelines**
for 2017-2019

Moscow

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INTRODUCTION

Situation evolving during several recent years points to the need to change the economic development model in Russia. In order to ensure a sustainable economic growth and consistent increase in public well-being it is crucial to reduce the economy's vulnerability to changes in external conditions, as well as to resolve inherent internal structural problems. Those were revealed not only by the economic recession in the aftermath of the fall in the prices for Russian export commodities in 2014, but also by the fading economic dynamics registered previously (notwithstanding the favourable situation in the global commodities markets). The vector of Russia's development will be shaped by the readiness both of the general government and the whole society to switch to the investment- and innovation-oriented economic growth model as well as to make efforts to create the internal potential for growth and favourable business environment. This primarily calls for governance efficiency, renewing fixed assets, developing infrastructure, installing new technology, as well as establishing high-quality institutions, which will help increase labour productivity. In effect, this is a challenge for the general government, regulators and economic agents across all levels, including the Bank of Russia.

The Bank of Russia's policy is aimed at ensuring price and financial stability as the prerequisites of sustainable economic growth and social well-being. Complexity and diversity of the tasks to be resolved, and a broad range of pass-through effect produced on the economic system by Bank of Russia decisions, require the central bank to employ a well-balanced approach, especially in the context of piling structural constraints in the economy and persistent negative drag from external factors. The cornerstone of this approach is the alignment of decisions taken in all areas of Bank of Russia activities, and its operation in close contact with legislative and executive bodies.

The monetary policy under inflation targeting, alongside with other state policy measures amid extremely tense external conditions, has cushioned the impact of external shocks on the economy's functionality and people's lives. Bank of Russia measures will continue to support the stability of the national economy thereafter, first of all aiming at slowing down inflation and keeping it close to 4%, and also stimulating households' savings and protecting them against the inflationary depreciation, and setting conditions for savings to transform into investment which is crucial for the new model of economic growth to emerge. To address these tasks, the monetary policy shall remain moderately tight and be able to support positive real interest rates.

The central bank's policy ensures a number of important conditions for a well-balanced economic development. However, given the specific character of the central bank's tasks, its policy cannot become the main driver of the economic growth due to objective reasons. The success of Bank of Russia measures will broadly depend on the overall strategic direction of the macroeconomic policy and the outlook for overcoming structural limitations in the economy. In addition to providing stimulus for intensive development, the structural policy should be put on the top of the public, political and economic agenda to ensure a sustainable growth in well-being and raise the living standards.

1. MONETARY POLICY GOALS AND PRINCIPLES OVER THE MEDIUM TERM

Now that the overall situation in the Russian economy has been stabilised after the second round of oil shocks of mid-2015 – early 2016 and the signs of the economy’s adaptation to external changes are visible, setting conditions and incentives for Russia’s consistent and sustainable economic development becomes the first priority for the national macroeconomic policy. Preserving the economic growth model based on commodities exports and incentives for consumption will yield short-term effects, because its potential has been broadly exhausted in previous years. The current context warrants a strategy that aims at addressing structural issues in the Russian economy, enhances the functional properties of social and economic establishments, and ensures macroeconomic stability (including financial and price stability). Additionally, it is important that society members, in particular economic agents, understand that sources of extensive growth have been largely fully used. For the economic recovery to be followed by the stable economic growth and social well-being, it is essential to create internal sources for development, incentives for raising productivity and economic efficiency, improve the quality of governance across all levels, both in public and private sectors. The efforts of all government authorities, control and regulatory bodies, and overall public administration system shall be devoted to the creation of such long-term strategy and incentives for all economic agents to pursue intensive development.

In performing its statutory functions and objectives, the Bank of Russia assumes that the goals of its policy and methods for their attainment shall foster a stable economic development. Under its remit, the Bank of Russia creates the background necessary to achieve

these goals: it ensures price and financial stability, prevents the accumulation of financial imbalances and mitigates the negative impact on the economy coming from external shocks and processes. In addition, the Bank of Russia develops the national payment system, and also a competitive, stable and credible financial market, which employs advanced technologies, provides for individuals and businesses a wide range of financial services and meets the growing needs of the economy to the fullest extent. The Bank of Russia faces complex and multifactor objectives that require precise and coordinated actions in all areas of its activities, along with close cooperation with legislative and executive authorities. It was due to the decisive role of the coordination of Government of the Russian Federation and the Bank of Russia that the economy was able to navigate over the stormy phase of the crisis in late 2014 – early 2015 and reach further stabilisation.

However, successful performance by the Bank of Russia of its functions creates only part of conditions for economic prosperity and cannot become the key driver of economic growth by itself. The future of the economy will largely depend on the ability to overcome structural limitations. The government’s structural and fiscal policy shall determine the extent, form and conditions of its pass-through on the turnover of material and financial resources in the economy, encourage the emergence of new industries and sectoral diversification, promote optimal location of production factors, technological upgrade, development of all types of economic and social infrastructure, as well as the strengthening of the international competitiveness of Russian goods. The efficiency of Bank of Russia measures and their implications for the well-being of Russian citizens will

largely depend on the choice of the vector for overall macroeconomic policy.

The Bank of Russia's monetary policy plays a leading role in creating essential conditions for economic development and social stability, i.e. low inflation, predictable interest rates that protect savings against inflationary depreciation and are necessary for investment planning. These conditions are mainly ensured by restraining inflation processes. Monetary policy aims at the gradual decrease of annual inflation to 4% and keeping it close to this target further. Under persistently low inflation, companies and households will be more confident while developing business and family plans and making decisions on expenditure, savings and investment. By contrast, high inflation rate is usually subject to intensive volatility, it also raises uncertainty and economic risks, complicates the process of making projections for future, shrinks the planning horizon disincentivising savings and investment, and widens social gaps. As a rule, high and volatile inflation is included in interest rates, thus becoming an additional burden for households and companies. All else equal, high inflation builds up social inequality, differentiation by income, and exerts the utmost negative influence on middle and lower classes, which have relatively stable nominal income. No wonder that surveys show that Russians name high inflation as one of their most pressing personal issues (see Appendix 2). Price stability is an inalienable component of the favourable environment for living and business activities, as well as for stable economic growth.

Relatively high inflation may be conducive for the economic growth. However, such inflation is usually volatile and is likely to trigger further acceleration and transition to rapid price growth even if influenced by temporary factors. These circumstances create risks of accumulated imbalances in the financial sector and real economy, along with the aggravation of social unrest, making sustainable economic development impossible.

The 4% inflation target was chosen taking into account specifics of the Russian economy's pricing and structure. The figure is slightly higher than in developed economies with long experience in preserving price stability, strong confidence in monetary authorities and low inflation expectations. These countries usually set the inflation target between 1% and 3%. In Russia, to keep inflation persistently close to this level through monetary policy measures is a highly complicated task due to structural and economic problems: elevated monopolisation and relatively underdeveloped market mechanisms, low efficiency and poor sectoral diversification of the economy. Moreover, sustainable stabilisation of inflation on a historically low level, being quite uncharacteristic for Russia, at the initial stage will be hampered by the inertia of inflation expectations, i.e. the deep-rooted habit of households and businesses to operate under a high inflation.

Along with the factors mentioned above, our decision to set the 4% target was driven by the necessity to minimise the risks of deflationary trends in certain commodities markets. Current structure of the Russian economy causes uneven changes in prices for different goods, and consumer basket has a large share of goods and services with highly volatile prices. Therefore, given the total level of inflation considerably lower than 4%, we face the risk of a prolonged drop in prices – deflation – in the markets of certain goods. Price deflation in the wide range of markets has negative implications, same as a high inflation. To avoid deflation while smoothing out relative prices, the target growth rate of the total CPI for this country shall be set with a certain buffer. At the same time, this buffer shall not be excessive, because higher inflation (for example, around 10%), as a rule, is more volatile, and it becomes more difficult to maintain its stability and predict its behaviour, in case of various shocks, than under the 4% inflation. This is specifically the case when a considerable portion of the consumer basket consists of goods with highly

volatile prices. In Russia, these goods are food products, accounting for more than one third of the consumer goods basket. Food price dynamics are largely shaped by the harvesting conditions and the situation in global markets. When unfavourable factors are in effect, the low inflation target pulls down on the potential for price growth for this socially critical group of goods. The stability and predictability of consumer price growth are as significant for the economic development and the well-being of the population as their absolute low level.

The Bank of Russia implements monetary policy within the inflation targeting regime, focused on domestic demand management. The phased-out transition to this regime began after the 2008-2009 crisis and was completed in late 2014. Operating in this framework, the central bank predominantly uses the interest rate channel to impact on monetary conditions in the economy and, eventually, inflation. By changing the key rate the Bank of Russia influences short-term money market rates and, in doing so, all interest rates in the financial sector along the whole yield curve from interest rates on marketable bonds to interest rates on banks' deposits and loans. All else equal, increase in interest rates encourages savings, restrains lending activity and therefore contracts demand for goods and services and keeps in check inflationary pressure. By contrast, interest rate cuts stimulate domestic demand, create incentives for savings reduction and improve the availability of credit. It means that by using the interest rate channel to influence demand for goods and services, the central bank impacts on price growth in the economy. Interest rate movements in both directions also pass through to the national currency exchange rate dynamics which may be also changed by other factors, thereby dragging primarily on imported goods prices and, via them, on the overall inflation. The indirect pass-through of the exchange rate dynamics is linked to changes in the price attractiveness of domestic goods (compared to imports), which

in turn leads to changes in demand for and prices of these goods. Inflation's sensitivity to changes in the exchange rate depends not only on the share of imported goods in the consumer basket, but also on the nature of inflation expectations, as well as on public confidence in the monetary policy. If the central bank is able to persistently maintain price stability, households and businesses feel more confident that low inflation will remain. Economic agents become less sensitive to the impact of pro-inflationary factors and exchange rate dynamics. The public gets confident that the central bank will prevent any material volatility of consumer prices or their persistent and steady growth. In this context, inflation expectations remain stable and low and are responsive not only to actions but to announcements made by the central bank as well. Under these conditions, the following aspects become important: the central bank's information transparency, steps taken to inform the public about the objectives and expected outcomes of the monetary policy, publication of current situation assessments and forecasts. This improves the transparency and predictability of the pursued policy, thereby alleviating the level of economic uncertainty and strengthening the confidence in the central bank.

Inflation targeting strategy broadly fits Russia's needs at the current stage, especially against the backdrop of unfavourable and highly volatile global markets and restricted access to external funding for the Russian economy. Employing this approach, the central bank seeks to ensure domestic economic stability, primarily, price stability and predictability of interest rate movements. This model of the monetary policy is largely consistent with the task of creating favourable internal conditions conducive for economic development. In addition to helping preserve the foreign exchange reserves, the floating exchange rate regime, launched at end-2014, makes it possible to stimulate a proper reaction by all economic agents to changes in external con-

ditions, thereby ensuring an optimal adjustment of the national economy to them. Thus, the floating exchange rate protects the economy against piling imbalances, including the excessive growth in external debt, improving the economy's long-term resilience to external fluctuations. By contrast, as evidenced by the experience of Russia and other countries, any attempts to manage the exchange rate amid external shocks usually led to financial and economic crises. Marked volatility of the exchange rate shaped by the dynamics of global commodities markets is linked to the economy's considerable dependence on commodities and, undoubtedly, weighs heavily both on the real sector and inflation. However, these exchange rate fluctuations are produced by a sharp deterioration in external conditions coupled by persistent structural problems of the Russian economy rather than being caused by the inflation targeting. Economic growth rates and household living standards in a commodity-based and underdiversified economy, apart from exchange rate and prices; suffer from sharp price fluctuations in global commodity markets. Long-term stabilisation of the exchange rate, decrease in its response to changes in external conditions, producing only slight fluctuations in the exchange rate, and reduction in its pass-through on inflation, sentiment and expectations among households and companies, and overall situation in the economy will only become really possible after the economy stops to be dependent on energy products.

The central bank's drag on the demand and inflation via interest rates will inevitably feed through to economic activity. The efficiency of the monetary policy pass-through on inflation and the extent to which measures aimed at suppressing inflation are passed onto business activity will all depend on the economic system's sensitivity to movements in the central bank's key rate or, putting in differently, on the performance of the monetary policy transmission mechanism. It is determined by a vari-

ety of financial and real sector factors, as well as the specifics of the overall macroeconomic policy.

The clear pass-through of signal from the key rate to the financial sphere and its further drag on the companies' and households' activities broadly depends on the financial sector's role in money circulation in the economy, in generating savings and credit. Another important condition is households and companies' trust in financial intermediaries. Other things that matter are technological progress, and also payment and settlement procedures. Russia preserves high capacity to introduce qualitative changes and to reinforce the role of financial institutions in meeting the economy's needs. Consistent policy pursued by the Bank of Russia in the sphere of supervision, regulation and development across all segments of the financial system, aiming at strengthening financial institutions, will create conditions for the well-balanced development of the financial system. This will also improve the environment for the monetary policy implementation via raising the efficiency of the transmission mechanism. The enhanced quality of financial intermediation will have a positive impact on the availability of services for economic agents which can act both as reliable borrowers and issuers of securities for investment purposes. Expanding the range of facilities with varying risk/reward ratios will raise the investment attractiveness of the Russian financial market and its establishments.

As mentioned, the efficiency of the central bank's pass-through on consumer price dynamics is broadly determined by the nature of inflation expectations, whose level is still rather high in Russia (given their marked downward trend). Over more than twenty years when Russia survived several economic crises, households and companies have got used to noticeable and unpredictable price surges and have learned to plan their future accordingly. Russia is not unique to face this situation: many countries where inflation was high and un-

stable experienced similar problems and managed to gradually resolve them. After a certain period of time, consistent policy of the central bank aimed at inflation deceleration is able to bring down inflation expectations, thereby making it easier to keep inflation close to the target further.

The efficiency of Bank of Russia monetary policy measures is also determined by the structural peculiarities of the national economy. Price dynamics depend not only on movements in the effective demand (mainly regulated by the monetary policy) but also on supply-side factors. One can single out a number of structural reasons hampering the expansion of supply and lowering its flexibility, and suppressing the sensitivity of production and consumption to changes in the price level. This materially complicates the use of monetary policy channel in managing the inflation, and also suppresses the economic growth. These factors include a high level of monopolisation across many industries. Amid low competition, natural monopolies, other large enterprises and trade intermediaries are not sufficiently motivated to raise operational efficiency and cut production costs, thereby mainly passing them over to consumers. In these circumstances, partly under the influence of monetary policy measures, producers do not demonstrate a flexible response to demand changes. Moreover, companies' ability to build up output in response to increase in the effective demand will be limited by accumulated imbalances which hamper the growth potential of economy. Among other things, these imbalances are linked to the marked wear and tear of machinery and equipment, low implementation of advanced technologies, and poor development of transport and logistics infrastructure.

Another factor that can restrict the central bank's ability to impact prices via the effective demand is a high social inequality reflected in the uneven distribution of income and wealth in the society. Striking differences in income and savings may cause a weak price elastic-

ty of demand. On the one hand, in response to price growth, households with low income who mainly buy essential goods will not be able to contract their consumption (of the majority of goods) below minimum living standards. As a rule, such households do not have any savings; therefore their chances to obtain credit are rather low. The amount of such households' expenditure on consumption is almost insensitive to interest rate changes in the economy. On the other hand, well-off households spend only a small portion of their high income on key goods from the consumer basket. Mid-income households turn out to be most sensitive to any movements in interest rates and consumer prices, which in turn encourage producers to adjust to their changing demand. All else equal, the unevenness of savings distribution prevents their overflow into investment and drags negatively on the economic growth. The majority of Russian citizens have rather insignificant savings, whereas, given current developments, many well-to-do households tend to accumulate funds mostly in the form of deposits at foreign banks, investment in expensive real estate abroad and imported luxury goods, which does not support the development of the national economy. Economic policy fostering a more even distribution of income among the population will create conditions not only for the balanced development and social stability, but also for strengthening monetary policy signals which, depending on specific circumstances, increase households' propensity to consume or to save.

Structural problems and specifics of the Russian economy do not render inflation slow-down totally impossible for Russia, they rather suppress the efficiency of monetary policy measures, exacerbating the risks of inflation's non-delivery to the target or its meeting the target at the unacceptable cost of economy's 'over-cooling' and lowering its growth potential. The process of inflation slow-down becomes more painful and complicated, and to meet the inflation target, other things equal,

the central bank has to conduct a more tight monetary policy than it would otherwise have to do in the absence of structural constraints. Considering the above factors, the Bank of Russia pursues the strategy of the gradual inflation slowdown to 4% during several years, selecting its rate depending on economic conditions. Specifically, after a drastic downturn in the economic environment in 2014 which had a negative effect on the Russian economy, the horizon of the delivering inflation of the target was brought forward from 2016 to late 2017.

Given that key rate decisions weigh on the overall economic system, the Bank of Russia, in line with inflation risks, assesses and carefully examines potential implications of decisions made for the real and financial sectors of the economy so that its decisions do not threaten financial stability or trigger the downside changes in the economy. When taking measures and analysing their expected implications, the Bank of Russia employs a well-balanced approach seeking to reach an optimal trade-off in its decisions. This is achieved, among other things, through a three-year macroeconomic forecast which contains an overall analysis of factors and economic outlook based on recent trends, announced macroeconomic policy measures and potential risk sources. In its decision-making, the Bank of Russia primarily relies on long-term sustainable economic trends, paying less attention to short-term factors which may produce only a temporary effect on inflation and economic dynamics. This helps avoid unnecessary and frequent changes in the key rate, ensuring the stability of interest rates in the economy, and achieve more balanced mid-term results using the said policy.

At the same time, coordination in the activities of all general government bodies is crucial for the efficiency of overall macroeconomic policy, and also of monetary policy. The Bank of Russia takes into account the specifics of maintaining monetary policy amid existing structural problems and aligns its activities with the Government's efforts to overcome structur-

al limitations in the economy. Additionally, the alignment of the monetary policy and the fiscal policy is important for the operation of sovereign funds which mitigate the drag of changes in global commodity markets on the economy, including on the real exchange rate and the competitiveness of Russian goods and services. The build-up and spending of sovereign funds in line with the budget rule, which might be implemented starting as early as 2017¹, will ensure the stability of government finance and the overall predictability of macroeconomic policy.

Given the diversity of tasks faced by the Bank of Russia, the central attention shall be given to the mutual alignment and approval of steps taken across various areas of its mandate, and also their drag on the conditions around the implementation of monetary policy and overall macroeconomic policy. In so doing, the central bank shall employ the whole range of available instruments. Specifically, being an instrument with a broad-range impact, the key rate should not be used for single-spot actions. The Bank of Russia possesses macroprudential regulation instruments to counter financial imbalances, overheating in some segments of the financial market which may threaten price stability and have a negative impact on the economic situation.

At the current juncture, given accumulated structural imbalances and negative pass-through from external factors, the monetary policy essentially acts as a stabiliser for the economy. As it does not seem possible, due to the nature of tasks to be resolved, for the Bank of Russia to become the key driver of the economic growth, in addition to slowing inflation, it focuses on maintaining internal financial stability, encouraging the creation of savings

¹ *The methodology of budget rule implementation is described in the draft Monetary Policy Guidelines for 2017-2019. The start of budget rule operation is scheduled for 2020. As anticipated, budget rule provisions designed for the transition period will be implemented in 2017-2019.*

and the reduction of debt burden, mindful that the leverage is rather high in several sectors of the economy (in terms of the debt service ratio). To address these tasks and to suppress inflation, the central bank shall pursue moderately tight monetary policy in order to set nominal interest rates at the level ensuring positive real interest rates. Over the mid-term horizon, this approach will be preserved to achieve a gradual decline in inflation and nominal interest rates, and to keep real interest rates positive. This makes bank deposits and other ruble savings attractive for households, protecting them against inflationary depreciation and supporting households' propensity to save. In this context, the levels of lending rates will also be above inflation, thereby stimulating producers and trade intermediaries to improve operating efficiency and countering the accumulation of excessive debt burden, which will improve the resilience of balance sheets in the real and financial sectors. Interest rate stability protecting savings against inflation, and a predictable and gradual decrease in interest rates caused by a slowdown in consumer price growth, is perceived as an important contribution to the stabilisation of economy and one of conditions underlying the economy's transition to the phase of a sustainable growth.

Alternative approaches to the monetary policy, chiefly implying its sharp easing driven by the accelerated interest rate cuts and expansion in bank lending, can pose systemic risks for the economic stability and social well-being in the current conditions. At the present moment, the important vector of the state economic policy shall undoubtedly include creating conditions and stimuli for investment, for industrial technological upgrade and for channeling available resources to high-priority sectors and projects, which may become a catalyst for economic growth. However, any attempts to resolve this task via a large-scale expansion of money issuance will result in considerable inflation acceleration alongside interest rates falling and turning negative. This will

lead to the inflationary depreciation of savings and incomes for the majority of households. In essence, the proposed method stimulates industry through the inflation tax which downgrades the well-being of most households, especially disadvantaged social groups. This approach implies obvious threats to social and economic stability, failing though to resolve the task set due to at least two reasons. First, the strengthening of the government's role in selecting prospective areas for lending might require considerable preparatory adjustment in the operation of government institutions both nation-wide and at the level of individual sectors. The arbitrary positive responses to applications for cheap credit outside the system of efficient state governance will not support a robust economic growth. Second, bank lending is not the key source of investment for the majority of Russian companies. Over previous years, many of them have become highly leveraged, but the current circumstances, by contrast, warrant a reduction in debt burden, as in several industries it is close to the highest values among emerging economies. The further accumulation of debt even on low-interest products will lead to the build-up of systemic risks, thereby contradicting the task of raising the resilience of economy.

The promotion of the state's role for stimulating economic development calls for other solutions which will help avoid inflation acceleration and excessive imbalances, and which will not threaten social stability. Funding for priority projects and programmes in terms of economic development may be primarily sourced by the capital attracted via public-private partnerships, as well as via other market, tax, fiscal and regulatory mechanisms and stimuli. These will be used to redistribute accumulated funds among companies, industries and economy segments without any massive increase in bank lending or debt burden for the economy. Bank lending dynamics and ensuing growth in money supply are determined by the economy's needs which in turn depend on available

material, human and management resources needed for increasing the output of goods and services. Any concessional methods reducing interest rates on bank loans below the market level (except for budget subsidies) used to provide lending for certain projects and programmes at more relaxed terms shall be limited. All else equal, they increase the overall cost of credit for economy on account of the worsened lending conditions across industries not receiving concessional lending from the state. This is the main reason explaining why the Bank of Russia restricts the amount of lending in the form of its specialised refinancing facilities².

Global experience is aware of different patterns of role distribution between government institutions offering incentives for economic development. The most successful among the approaches used was the one under which a central bank and a ministry of finance are re-

sponsible at the macro level for price and financial stability, whereas other government agencies set up conditions and incentives for the redistribution of financial flows among the industries, sectors and segments of economy (on condition of observing overall resource constraints) within the framework of the approved system of the state strategic and operative governance. The main targets and principles of the monetary policy, being an integral part of the overall state economic policy, are quite universal for any model of economy. Under any forms of interaction between the state and business, price and financial stability foster economic and social well-being. Consistent monetary policy aimed at maintaining internal economic stability alleviates uncertainty, and creates clear indicators and understandable rules for all economic agents, which is important for their existing activities and for further plans.

² Information on Bank of Russia specialised refinancing facilities is given in Sections 2, 4 and in Table 9, Appendix 5.

2. MONETARY POLICY IMPLEMENTATION AND KEY MEASURES IN 2016

In 2015-2016, the Bank of Russia's monetary policy implemented under the inflation targeting regime was aimed at ensuring price stability along with maintaining financial stability amid highly volatile external environment. The Bank of Russia's operations to implement monetary policy and ensure sustainability of the banking sector and development of other sectors of the financial system made part of a coordinated macroeconomic policy aimed at keeping the Russian economy sustainable and shaping conditions to revive its growth. The moderately tight monetary policy facilitated gradual inflation slowdown (from 12.9% in December 2015 to 6.4% in October 2016) while underpinning stability of the financial system overall.

External economic factors largely determined the persistently challenging climate where the Russian economy developed and the Bank of Russia shaped its monetary policy. In late 2015 – early 2016, international markets saw a drop in oil prices comparable in its scale to the first 'oil shock' of late 2014 – early 2015. In the first months of 2016, Urals crude price fell to \$25-30 per barrel, having more than halved against the mid-2015 level. Global prices for energy and many other commodities accounting for the majority of Russian exports also showed negative dynamics and by early 2016 fell to their 5-7-year low. Overall, given considerable fluctuations in energy prices during the year, the average Urals crude price stood at roughly \$40 per barrel in January-October. That was closer to the risk scenario of the Guidelines for the Single State Monetary Policy in 2016 and for 2017 and 2018 (hereinafter, the Guidelines)¹.

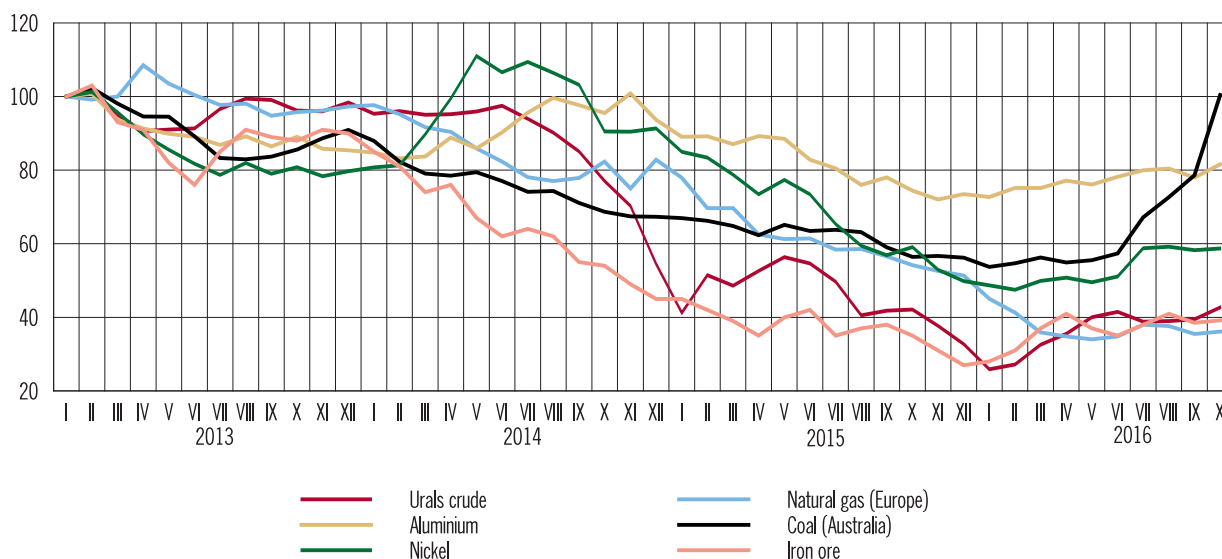
¹ The baseline scenario assumed the average Urals crude price at \$50 per barrel, and the risk scenario assumed it below \$40 per barrel.

Similar to commodity markets, global financial markets showed mixed dynamics, market participants' sentiment and expectations varied. Global investors were concerned about unsteady recovery of business activity in advanced economies, uncertainty over China's economic slowdown and its impact on other emerging markets. Macroeconomic policy decisions of major advanced and emerging economies' regulators remained in focus of economic agents. In particular, changing expectations regarding the pace of the US Fed's rate hike had a tangible impact on the global financial market environment. Global investors' sentiment was also affected by the June referendum on Britain's exit from the European Union. However, according to investors' estimates, views expressed by the representatives of some advanced economies' central banks and actual monetary policy easing by the Bank of England mitigated the associated potential risks. International financial sanctions, along with persistently unstable global financial markets, tightened external lending conditions for Russian borrowers.

The overall external climate remained unfavourable and constrained the development of Russian economy. In this environment the Bank of Russia sought to ensure price stability along with maintaining financial stability and ease negative impact of external factors on the Russian economy. Moderately tight monetary policy under the inflation targeting regime and floating exchange rate of the national currency helped meet these challenges.

When taking monetary policy decisions in a challenging economic environment, the Bank of Russia applied a balanced approach. First, the decisions were based on the medium-term forecast for economic development and inflation performance based on conser-

World prices of Russian principal export commodities (1.01.2013 = 100%)



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

vative assumptions regarding both internal structural factors (economic structure, demographic-, infrastructure- and institution-side restrictions) and external climate. The Bank of Russia's baseline scenario did not assume an increase in global oil prices against the respective market levels in the short and medium term. In 2015 H2-2016, according to the baseline scenario published in the Monetary Policy Report², the expected Urals crude price was in the range between \$30 and \$50 per barrel. In January-September 2016, Urals crude price averaged \$40 per barrel. The average price in 2016 is expected to stand at \$41 per barrel.

Second, along with the baseline scenario the Bank of Russia looked into risky developments in external environment and took account of possible materialisation of additional risks related to price dynamics. These risks included fluctuations of domestic and external food prices (with basic crops factored in); uncertainty of fiscal policy measures, indexation of pensions and wages in public and private sectors; decisions to raise administered prices and tariffs, persistently high inflation expect-

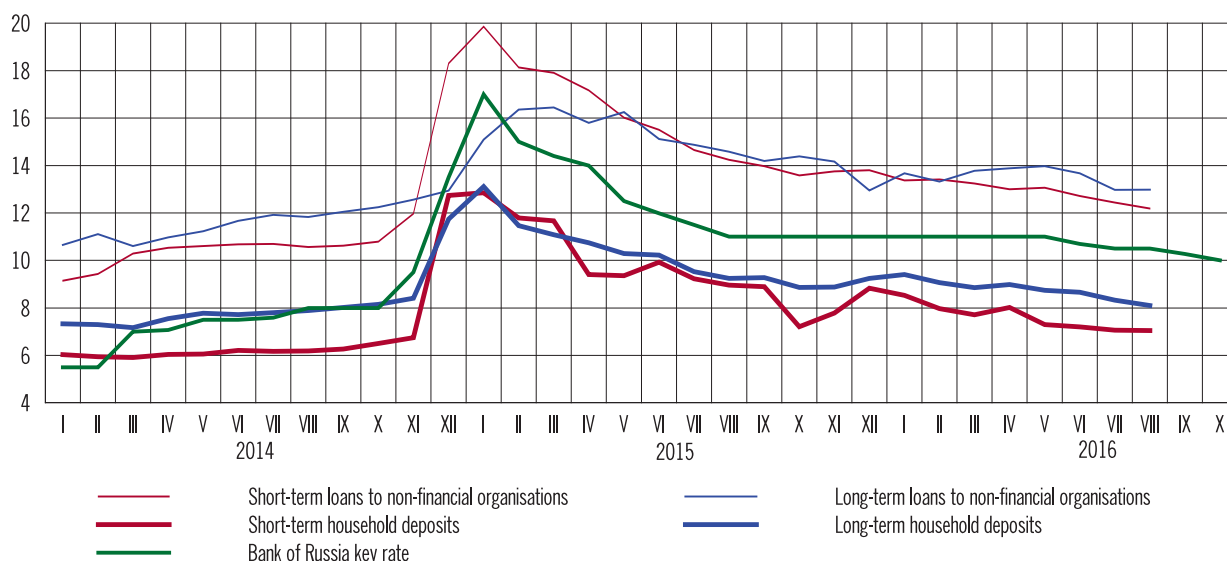
tations, and the possible weakening of households' stimuli for saving. In 2016, some inflation risks abated (related to crops, indexation of administered prices and tariffs), while the probability of others generally held (inflation expectations, nominal wage performance, and fiscal policy).

Third, when choosing the key rate path, the Bank of Russia proceeded from the balance of risks for price and financial stability and economic activity risks. The key rate was determined with a view to gradually reduce inflation while avoiding excessive economy cooling. When a new external shock materialised in late 2015 – early 2016, relatively high interest rates which encouraged savings in the economy, met several objectives. In addition to mitigating price stability risks by preventing excessive consumer demand growth, they also limited financial stability risks connected with depositors' flow into a foreign currency, increased capital flight and financial market turmoil, and subsequently alleviated negative impact on the economic growth.

The Bank of Russia also kept the balance between ensuring price stability and hampering economy cooling in making decisions on the use of additional specialised instruments. In 2016, the Bank of Russia joined other public

² The baseline scenario was released in 2015 as part of the Guidelines, and was further updated in 2016 on a quarterly basis in the March, June and September releases of the Monetary Policy Report.

Interest rates on bank ruble operations and Bank of Russia key rate (% p.a.)



Source: Bank of Russia.

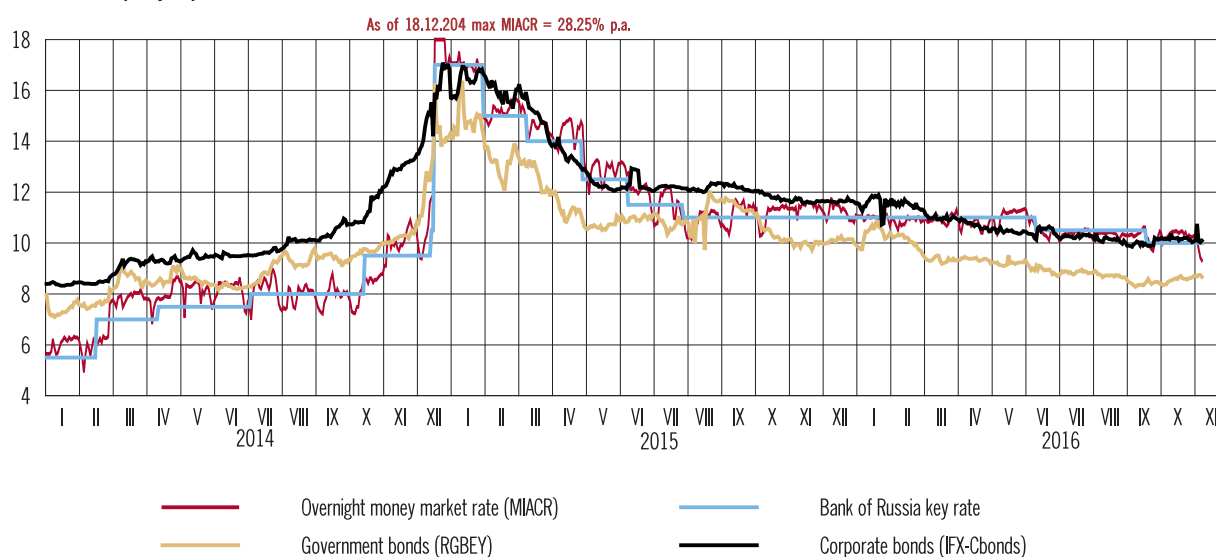
authorities in targeted efforts to support critical sectors of lending challenged by the market environment. In particular, the Bank of Russia continued to use specialised refinancing instruments for long-term lending to credit institutions at the rates below the key rate. Thereby, the Bank of Russia enabled credit institutions to provide companies with low-rate lending to finance specific projects and programmes (see Table 9, Appendix 5).

Most specialised refinancing instruments were in demand among credit institutions in 2016. As the previously set limits on individual instruments were almost fully used, the Bank of Russia decided to raise them in 2016. At the same time the amount of fund provision under specialised instruments remained low (in 2016, the debt on these instruments did not exceed 0.5% of total liabilities of the banking sector). Such a limitation stems from the fact that the provision of sizeable funds at low rates by the Bank of Russia may lead to easing in monetary conditions even if the key rate remains unchanged that is unreasonable in the context of efforts to reduce inflation. In turn, it may hinder inflation from hitting the target and prevent the Bank of Russia from cutting the key rate and reducing the cost of borrowing for all economic agents.

Finally, fourth, when deciding on the key rate the Bank of Russia recognised that sharp fluctuations of internal monetary conditions were undesirable and their changes should be predictable and consistent. Specifically, the Bank of Russia sought to avoid key rate hikes when external environment worsened and inflation risks grew in 2015-2016. A conservative balanced approach to steering the key rate allowed doing so. Under this approach, the Bank of Russia's interest rate policy is based on sustainable long-term trends in the economy and hardly responds to short-term improvements or worsening in external economic environment. The Bank of Russia stuck to the open communication to raise economic agents' awareness of its monetary policy.

The Bank of Russia had long kept the key rate unchanged at 11% p.a. (since August 2015), and then cut it twice by 0.5 pp in June and September 2016 to 10% p.a. The key rate level determined market interest rates along with market participants' expectations of further key rate and inflation path. In turn, their performance impacted on lending and deposit activity, investors' conduct in financial markets, and the dynamics of cross-border financial flows.

Bond market yields, Bank of Russia key rate and MIACR (% p.a.)



Sources: MICEX SE, Bank of Russia.

The Bank of Russia's instruments ensured that short-term money market rates held close to the key rate amid declining structural liquidity deficit caused by the inflow of money into the banking sector as the Reserve Fund was spent to finance the increasing budget deficit (see Section 3). Following the key rate and money market rate movements, interest rates on banks' loan and deposit operations and sovereign and corporate bond yields declined progressively in 2015 H2 - 2016.

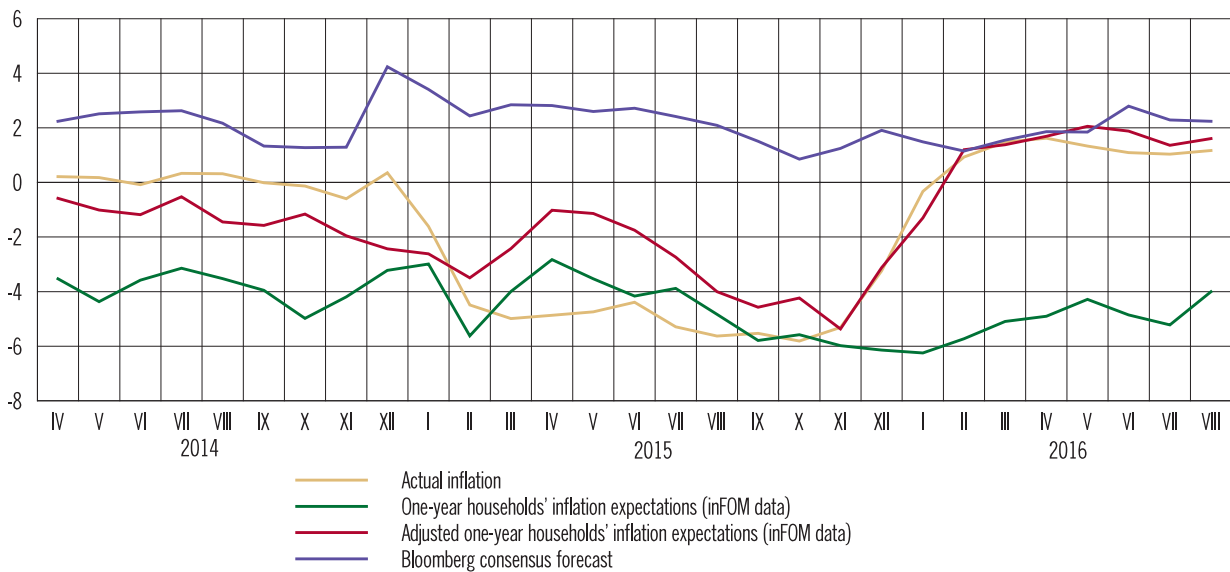
Having said that, the maturity structure of market interest rates, which had taken shape by autumn 2016, and surveys showed that market participants expected the reduction of the key rate to be more dramatic than forecast by the Bank of Russia. Thereby, their inflation forecast, though revised downwards, persistently exceeded the Bank of Russia's 4% target for late 2017. In this environment, the Bank of Russia's September and October press releases communicated the signal on the key rate staying unchanged at 10% p.a. at least until early 2017. This signal was aimed at further reducing inflation expectations and maintaining positive real interest rates that emerged in 2016. To achieve it, the decline in nominal market interest rates should not outstrip the slowdown in inflation and inflation ex-

pectations, underpinning propensity to save and simultaneously holding back the propensity to borrow in the economy by limiting the unfavourable increase in debt burden (expenses for debt servicing against borrowers' income) of individual sectors and companies. That was the role of positive real interest rates in 2016. The Bank of Russia's signal adjusted the yield curves in the money and capital markets, thereby creating monetary conditions conducive for a sustainable decline in inflation.

Maintenance of positive real interest rates shaped a set of trends in the dynamics of quantitative indicators of the financial sector.

On the one hand, growth in households' ruble deposits revived gradually after having dropped in late 2014 – early 2015. Since April 2016, their annual growth rate has stabilised at about 16% in nominal terms, being though below the pre-crisis level (in 2012-2013, above 20% on average), but indicative of a relatively high propensity to save given the current income and inflation dynamics. In the context of a floating exchange rate and positive real interest rates of the ruble, the attractiveness of foreign currency deposits deteriorated markedly and their growth lagged significantly behind the dynamics of ruble deposits (see Table 4, Appendix 5). This brought down the dollari-

Real interest rates on long-term household deposits calculated using different inflation expectations indicators (% p.a.)



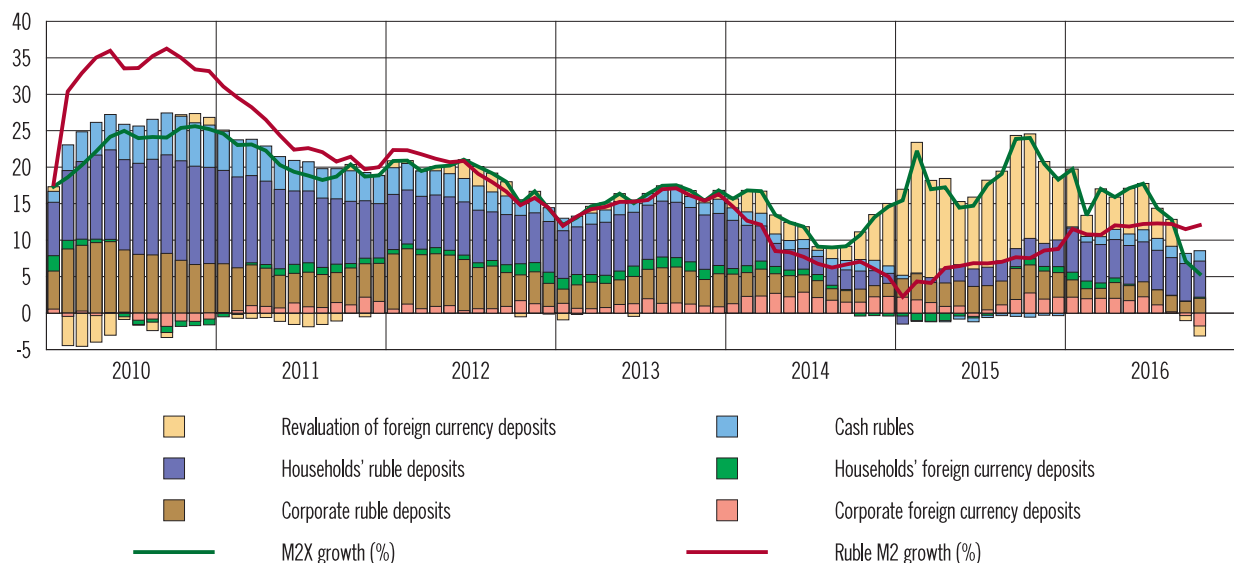
Sources: Rosstat, inFOM, Bloomberg, Bank of Russia calculations.

sation of the Russian economy. Money supply in national definition shows a 11-12% growth reached in late 2015.

On the other hand, lending dynamics were moderate. Growth in the banking sector's loan to the economy slowed somewhat in 2016 as compared to 2015 readings. Annual growth in banks' loans to non-financial organisations and households was 7.6% in 2015, while in 2016 it is expected to range between 2% and 5%. Such growth is in line with gradual nor-

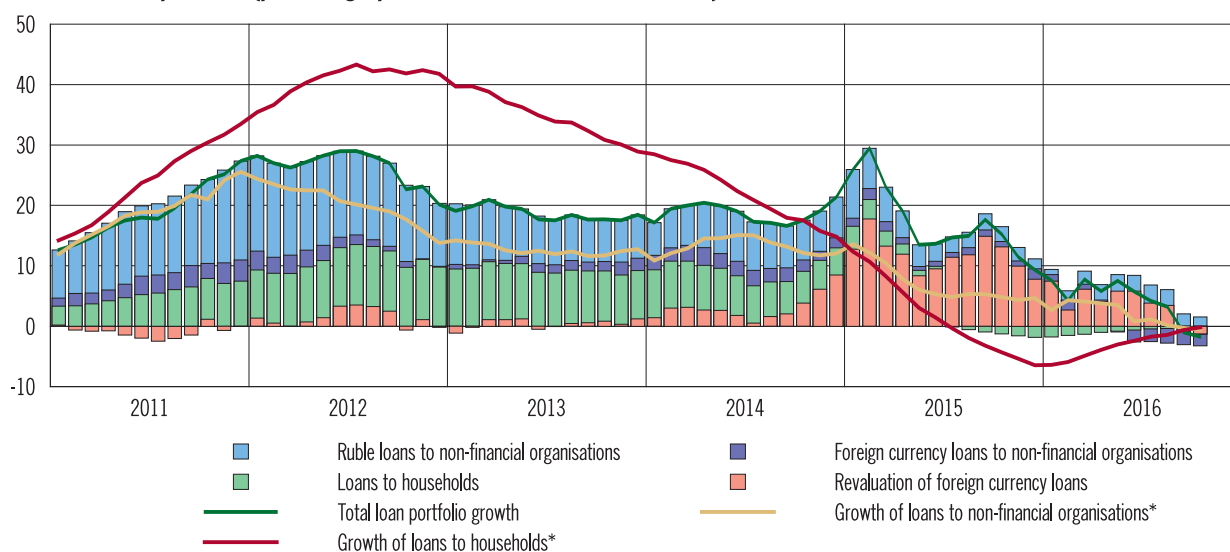
malisation of debt burden in individual sectors where it is elevated given the income dynamics in the economy. At the same time, debt movements vary in different types of lending. The most sluggish dynamics are seen in segments with high credit risks: unsecured consumer loans, loans to small and medium-sized enterprises, and foreign currency loans. Corporate lending is not unanimous either as the financial standing of borrowers varies across industries.

Contribution of various components to M2X annual growth (percentage points, unless indicated otherwise)



Source: Bank of Russia.

Contribution of various components to annual growth of banks' loan portfolio (percentage points, unless indicated otherwise)



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

The overall lending policy of banks remained conservative. Risk to financial stability went down progressively. Debt burden indicators which show borrowers' capability to service debts from operating profit were at their high in early 2016. In late 2015 – early 2016, they deteriorated following the next round of foreign currency debt revaluation amid ruble depreciation and ongoing economic slump. Overdue debt on bank loans showed much slower growth in 2016. The quality of new loan portfolio improved considerably compared to previous periods. Financial performance of Russian banks will outstrip that of 2015 on the back of net interest income growth. Growing profits are translated into profitability of the banking sector that shows visible growth. In this environment, most non-price bank lending conditions saw easing after an abrupt tightening in early 2015.

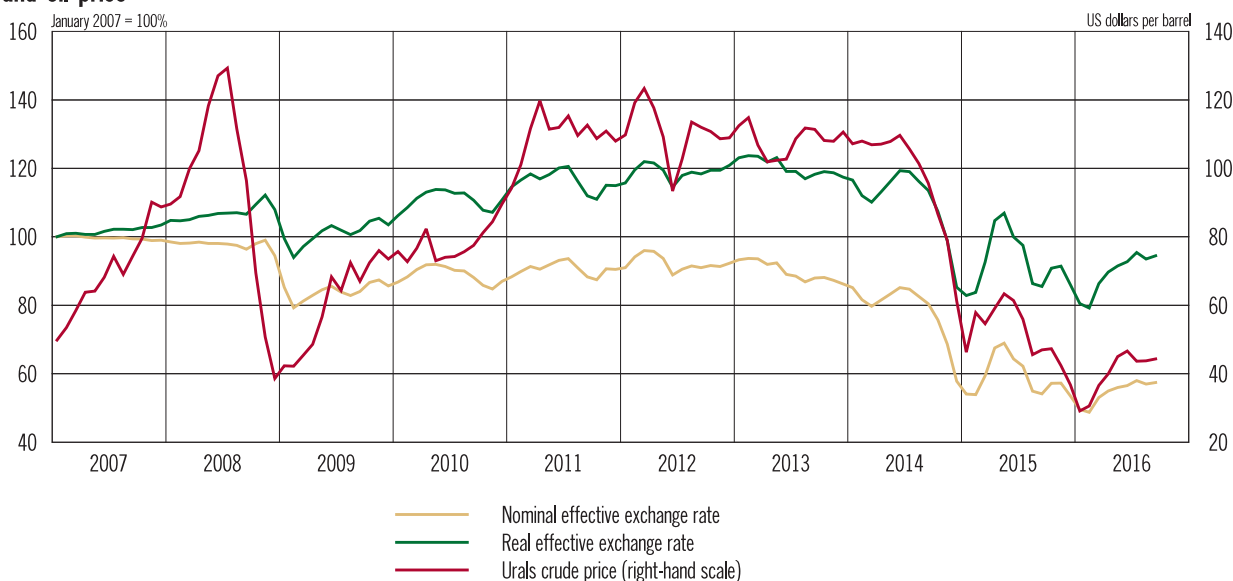
At the current stage, consistency in lending moderation is important not only in terms of the impact on inflation (as described below), but also for stability of the financial system and financial soundness of real sector borrowers. The Bank of Russia's macroprudential policy measures and introduction of international standards of banking regulation (including those established in the documents of the

Basel Committee on Banking Supervision) underpin credit institutions' balanced approach to risk-taking along with moderately tight monetary policy.

In 2016, the Bank of Russia continued the consolidation and rehabilitation of the banking sector to prevent crisis and systemic risks. The Central Bank provided long-term loans to the Deposit Insurance Agency (the DIA) to ensure the payment of compensation to the depositors of banks with revoked licences and to prevent bankruptcy among credit institutions. These measures preserved the confidence of depositors in the banking system, stability in the banking sector, and helped avoid the unjustified tightening of monetary conditions. Bank of Russia funds provided to the DIA were included in the estimate of credit institutions need for liquidity.

Interest rates on ruble instruments were relatively high as compared with external rates, thus underpinning relative attractiveness of ruble assets with account taken of the exchange rate expectations. Most global central banks continued to pursue loose monetary policy amid moderate recovery in demand and persistently low inflation pressure in the global economy. Money market rates and government bond yields remained low in most ad-

Ruble effective exchange rate and oil price



Sources: Bank of Russia, Bloomberg, Reuters.

vanced economies. It made Russian assets attractive for foreign investors for most of 2016 despite the volatile global energy markets, sanctions and ongoing recession. It resulted in a drop in country risk premium and net inflow of foreign investment in Russian equities and bonds. Better estimates of Russia's creditworthiness and expected economic recovery after the adjustment to the new level of oil prices also boosted foreign investors' interest in the Russian financial market.

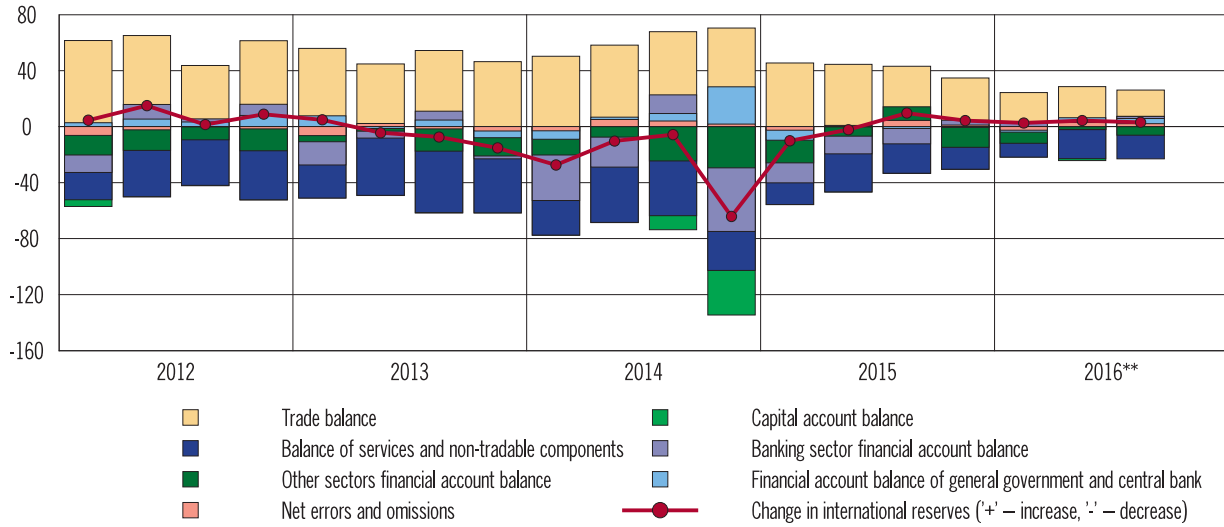
The Bank of Russia's regulatory measures aimed at 'deforestation' of bank balance sheets (reduction in foreign currencies' shares in credit institutions' operations) promoted the ruble as an operational currency of the financial sector (as compared to the foreign currency) along with high interest rates in the domestic market. In 2016, the Bank of Russia introduced increased risk ratios on bank assets in foreign currency for calculation of credit institutions' capital adequacy and raised required reserve ratios on credit institutions' liabilities in foreign currency (see Table 6, Appendix 5).

The trend towards higher ruble's attractiveness as a store of value manifested itself through the fact that the ruble depreciation, caused by a fall in global oil prices in late 2015

and in early 2016, failed to boost households' and companies' demand for foreign currency. It ensured relatively low capital outflow in the financial account of Russia's balance of payments, backed up the banking sector's stability and reduced foreign exchange rate fluctuations. This situation differed for the better from the period of growing financial tension in financial markets in late 2014 and early 2015, and encouraged the Bank of Russia to gradually cut FX refinancing operations (FX repos and FX loans). It resulted in a corresponding increase in the Bank of Russia's foreign currency reserves.

Instruments to provide FX liquidity introduced in late 2014 as an antirecessionary measure allowed to largely alleviate the most difficult stage of the economy's adjustment to a restricted access to international capital markets. The nature of FX refinancing operations, initially seen as temporary, provided for a development and implementation of a 'strategy to exit' from these operations (gradual shrinkage of credit institutions' foreign currency debt to the Bank of Russia depending on the decline in external debt, adequacy of current account proceeds and accessibility of alternative FX refinancing sources). Such a strategy allows the

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



* According to BPM5.
** 2016 Q3 – Bank of Russia estimate.
Source: Bank of Russia.

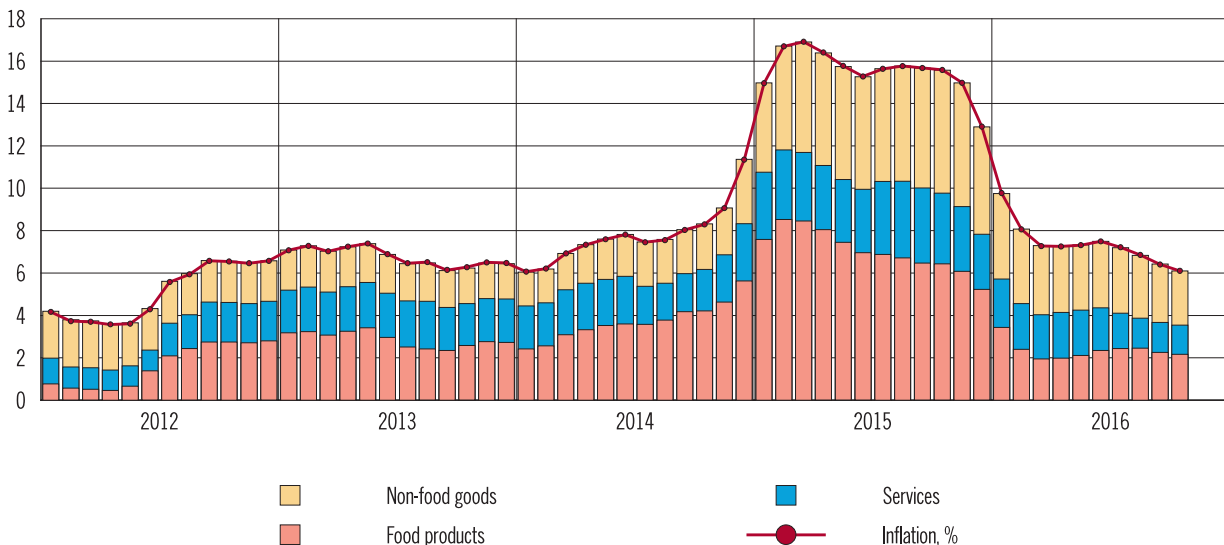
Bank of Russia to give up these operations without creating risks of FX liquidity shortage and destabilisation of financial markets.

As early as in 2015, as the situation with FX liquidity improved, the Bank of Russia started to encourage gradual decline in demand for operations in foreign currency by increasing their interest rates. In 2016, the Bank of Russia progressively cut refinancing in foreign currency (see Table 10, Appendix 5). As a result, credit institutions' debt on FX operations to the

Bank of Russia is expected to shrink in 2016 from \$22 billion to \$7 billion.

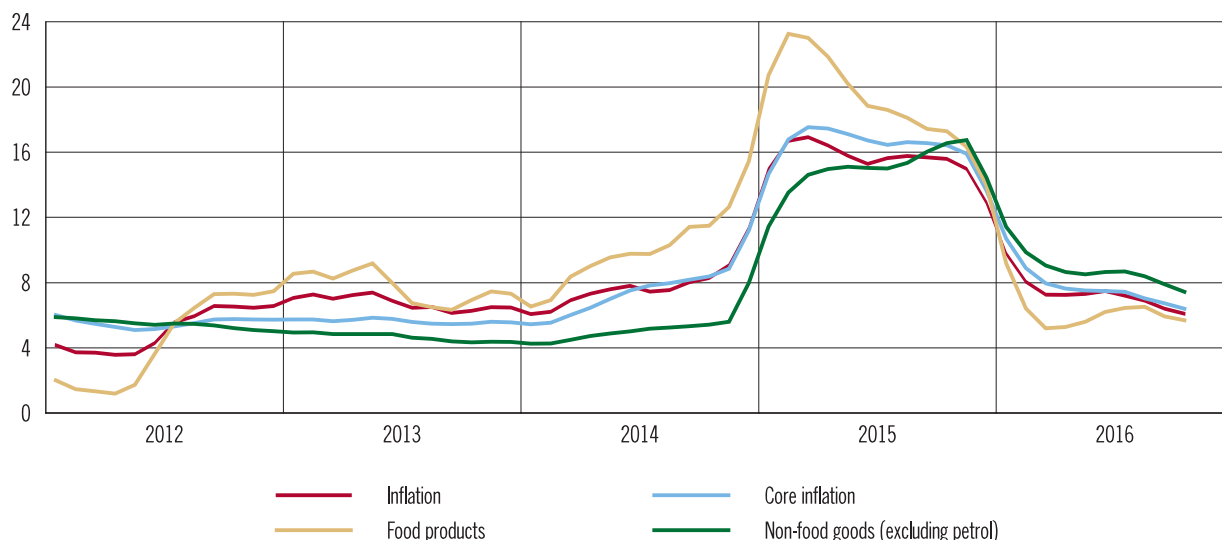
The above trends in development of financial conditions shaped by the monetary policy affected consumer behaviour, economic activity and prices. The persistently high real interest rates underpinned conservative behaviour of both households and companies with regard to savings and borrowings. Households' savings rate (determined with households' investments in financial assets and changes in

Inflation and its components
(on corresponding period of previous year, percentage points)



Sources: Rosstat, Bank of Russia calculations.

Prices of consumer goods and services (percent change on corresponding period of previous year)



Sources: Rosstat, Bank of Russia calculations.

their credit position factored in) held relatively high. It checked consumer demand and slowed inflation. By autumn 2016, signs of a weaker disinflationary impact of demand manifested themselves, which is likely to result from the persistently unsustainable dynamics of production activity amid structural challenges. They manifested themselves, among other things, in a slow decline in non-food price growth and core inflation. At the same time, demand-side restrictions remained a main factor behind a slowdown in current inflation driving price competitiveness of producers and suppliers. According to the forecast, households will continue to cut their spending for final consumption in 2016 though at a slower pace as compared to the previous year, to 4.0-4.6% (from 9.6% in 2015). Just like a year earlier, consumption reduced due to the shrinkage in imports pointing to the economy's somewhat lower dependence. The year 2016 is expected to see imports shrink by 6.5-7.0% in real terms.

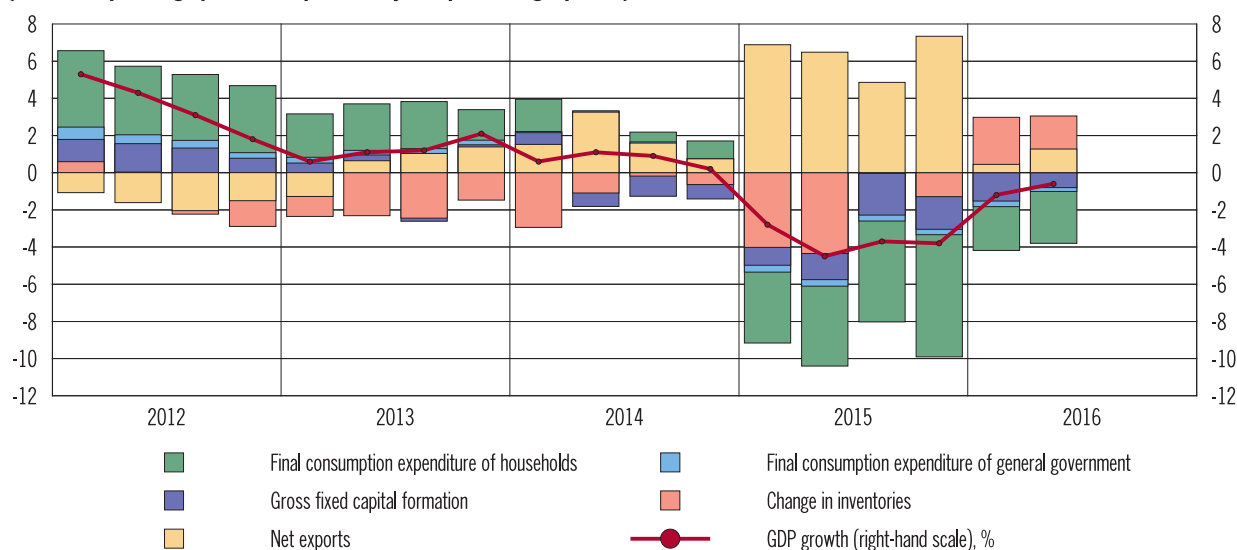
The persistent economic uncertainty and moderate demand along with lower financial performance in some industries constrained companies' capabilities to increase nominal wages, which could have translated into price growth. However, annual nominal wage growth has gone up to 6-10% in 2016 as compared to

2015 H2. This increase is likely to have resulted from companies' willingness to retain qualified personnel amid labour deficit and offset the earlier inflation acceleration not covered with income indexation last year. Annual real wage growth wobbled around zero following its continuous decline since February 2016 and exceeded 2.5% according to preliminary estimates in August and September. A balanced nominal wage growth will be an important condition for ensuring price stability through both supporting moderate consumer activity and producer cost channel.

Changes in inflation expectations make another important inflation factor. Higher exchange rate volatility amid worsened external climate in commodity markets resulted in an increase in households' inflation expectations in 2015 H2, while in 2016, on the contrary, a trend towards their decline prevailed. Such dynamics may be attributed to the effect of the observed inflation slowdown and persistence of moderately tight monetary conditions. However, inflation expectations remain elevated and require higher interest rates to hold to support a stable propensity to save in households, other things being equal.

Therefore, monetary conditions in 2016, on the one hand, ensure price stability – inflation

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



Sources: Rosstat, Bank of Russia calculations.

continues to go down (to 6.1% in October), its annual growth is expected to stand at 5.5-6.0% in 2016 and reach the 4% target in 2017, which is in line with the forecast of the Guidelines for the Single State Monetary Policy in 2016 and for 2017 and 2018. In this case the impact of exchange rate dynamics on annual inflation will be close to neutral. On the other hand, a balanced monetary policy remains a key element of financial stability and economic sustainability amid a highly changeable external environment. Another element important for alleviating the impact of negative external factors on the economy is a floating ruble exchange rate.

In 2016, the Russian economy continued to adjust to unfavourable external developments due to the stabilisation of sentiment and expectations of economic agents and the decline in their sensitivity to external economic factors. Employment showed a stable trend, production activity indicators improved (industrial production demonstrated growth during individual months), import substitution continued, some growth areas developed in industrial production, including manufacturing (in particular, food, chemicals, some segments of light industry, and production of certain equipment).

However, economic agents were mostly prudent in their decision-making. Sustainable

supply-side factors (including those related to structural challenges of the economy) and uncertain economic outlook checked the economic activity. Sectors and regions continued to demonstrate a mixed performance; some industries stagnated or showed lower output growth. Recovery in production activity lacked stability. Investment remained on the downward track.

The overall 2016 GDP growth rate is expected to remain negative ranging between 0.5% and 0.7% falling considerably below the 2015 readings (3.7%) and meeting the 2016 baseline forecast published in the Guidelines a year earlier.

The Bank of Russia will continue to pursue its moderately tight monetary policy aimed at inflation reduction while maintaining the stability of the financial system and the economy as a whole (see Section 4). At the same time, the possibility of nominal interest rate cut will be limited, and moderately tight monetary conditions will hold for quite a long time. When making decisions on the key rate, the Bank of Russia will assess inflation risks and the compliance of economic and price growth with the baseline forecast that implies inflation reduction to 4% by late 2017.

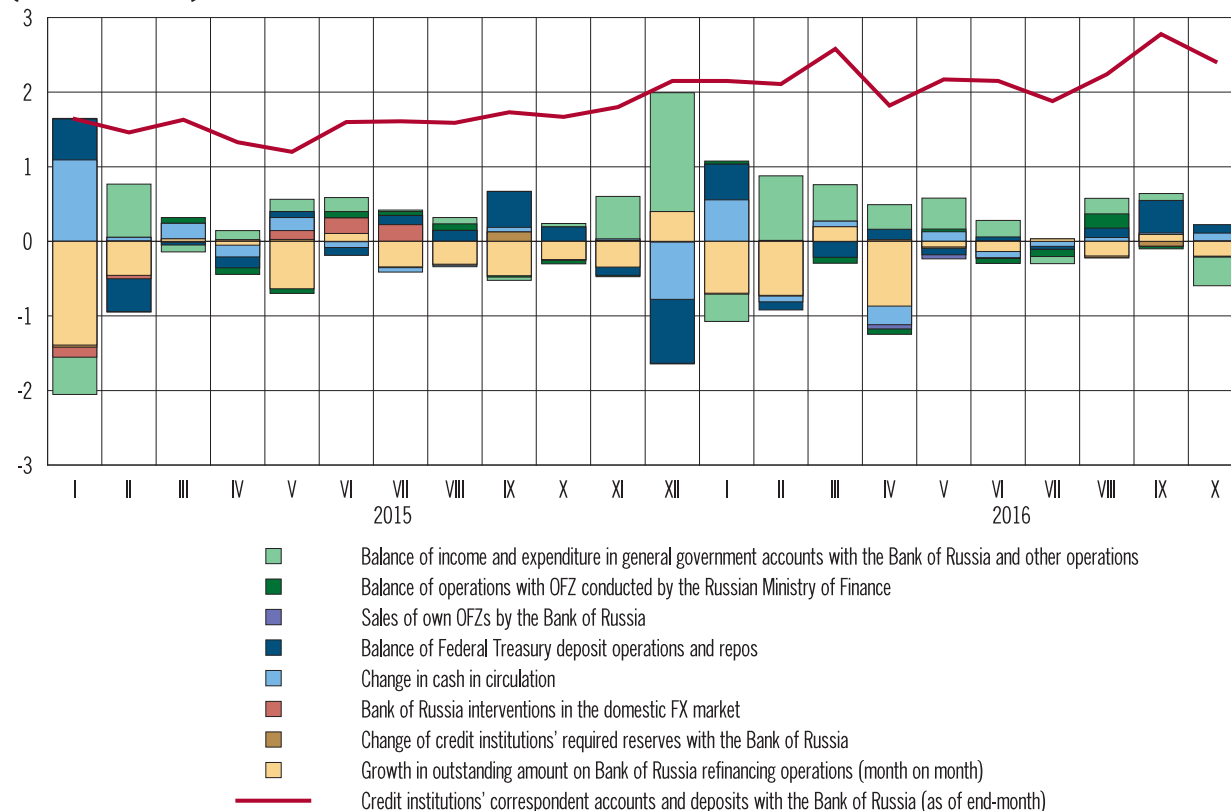
3. USE OF MONETARY POLICY INSTRUMENTS IN 2016 AND IN 2017-2019

The Bank of Russia exerts its influence on monetary conditions, economy and inflation primarily through interest rate channel. The reference point for creating the whole framework for financial sector interest rates are short-term money market rates, therefore it is important to keep them at the level that ensures the achievement of the inflation target. For that to happen, the Bank of Russia first develops the most likely macroeconomic scenario and chooses the direction of the key rate changes, which ensures the optimal path to inflation target in the medium term. Then the Bank of Russia keeps money market overnight rates close to the key rate level which constitutes the operational goal of monetary policy.

The Bank of Russia provides for the achievement of its operational goal through banking sector liquidity management by means of monetary policy instruments. The overall framework of monetary policy instruments has already been developed in the late 2013 and has not changed much since then. No significant changes in future are planned as well. Alongside this, the Bank of Russia will continue to improve feasibility and convenience of the monetary policy instruments used by banks.

Credit institutions' needs for liquidity, i.e. for funds in correspondent accounts with the Bank of Russia depend on their own payments and settlements and those of their customers, as well as on the necessary compliance with

**Banking sector liquidity and its factors
(trillions of rubles)**



Source: Bank of Russia.

**Banking sector liquidity and its factors
(trillions of rubles)**

	2016 Q1	2016 Q2	2016 Q3	Oct 2016	Jan-Oct 2016
1. Autonomous liquidity factors (supply)	1.7	0.7	0.7	-0.2	2.8
– change in general government accounts with the Bank of Russia and other operations	1.0	0.8	0.7	-0.4	2.0
– change in cash in circulation	0.6	-0.2	0.0	0.1	0.5
– Bank of Russia interventions in the domestic FX market and purchases of monetary gold	0.1	0.1	0.1	0.1	0.5
– change in credit institutions' required reserves with the Bank of Russia	0.0	0.0	-0.1	0.0	-0.1
2. Change in correspondent account balances with the Bank of Russia (demand)	0.6	-0.5	0.5	-0.3	0.3
3. Change in credit institutions' deposits with the Bank of Russia	-0.2	0.0	0.1	-0.1	-0.1
4. Change in credit institutions' outstanding amount on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	-1.2	-1.1	-0.1	-0.2	-2.6
Outstanding amount on Bank of Russia refinancing operations (as of end-period)	2.5	1.4	1.3	1.1	

Source: Bank of Russia.

reserve requirements¹. Mandatory reserve requirements include required reserve ratios and required reserve averaging ratio. The Bank of Russia sets required reserve ratios according to the banking sector liquidity management goals. At the same time, ratios for credit institutions' liabilities in rubles have more pronounced influence on the liquidity. Procedure for required reserves averaging, according to which credit institutions are required to maintain account balances not on a daily basis, but on average for a certain period, allows for flexible liquidity management for banks. Furthermore, banking sector liquidity volume is constantly changing under the influence of a number of factors², including fiscal flows and households' demand for cash. In order to meet credit institutions' needs for liquidity the Bank of Russia conducts liquidity provision operations, along with liquidity absorption if the liquidity is in excess. The volume of operations is based on the banking sector liquidity forecast.

The Bank of Russia seeks to provide or absorb liquidity from credit institutions mainly through key rate auctions. All of this creates

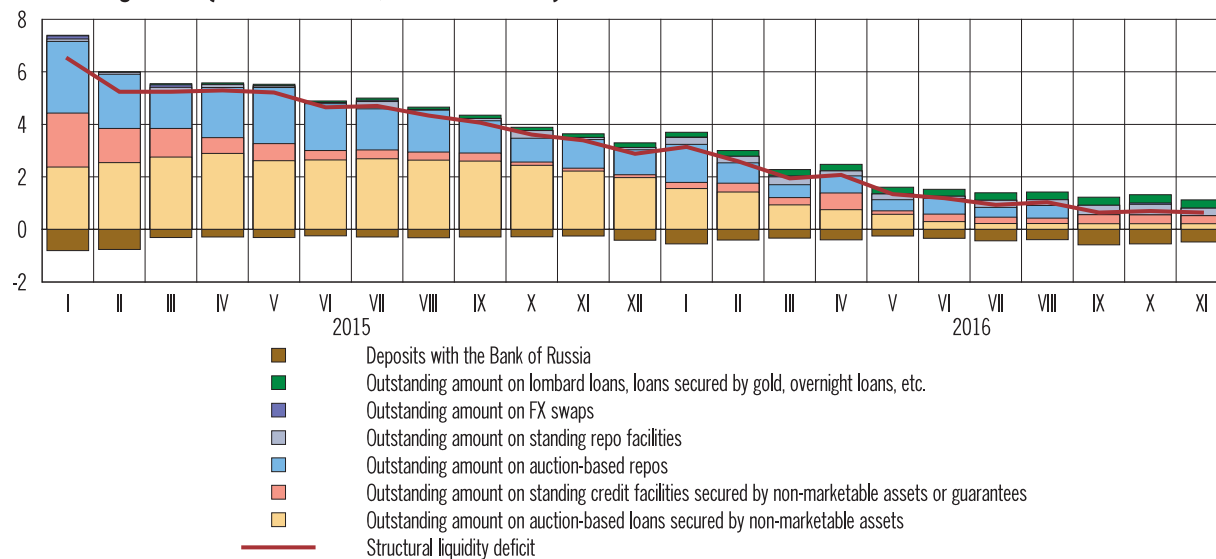
¹ Credit institutions' needs for liquidity are sometimes influenced by their obligation to comply with prudential requirements.

² Statistics on the liquidity factors are available on the Bank of Russia website in the subsection 'Monetary Policy Instruments of the Bank of Russia and Banking sector liquidity indicators' of the 'Statistics' section

the background for liquidity redistribution in the interbank money market at the rate close to the key rate. Achievement of the operational goal is also supported by the fact that credit institutions at any moment can request overnight loan or overnight deposit from the Bank of Russia at the rate of 1 pp above or below the key rate respectively. These rates shape the borders of the interest rate corridor.

In 2016 the Bank of Russia ensured achievement of the monetary policy operational goal under decreasing banking sector liquidity structural deficit, i.e. reduced need for banks to borrow from the Bank of Russia. Such circumstances were caused by liquidity inflows resulting from the Reserve Fund spending to finance the federal budget deficit. Another source of banking sector liquidity increase was the payment of insurance compensations to depositors by the DIA, together with bank resolution financing. Influenced by the said factors, the inflow of liquidity into the banking sector will be only partially counterbalanced by the outflow of funds, because of the end-year traditional growth in cash in circulation. The Bank of Russia has also been selling federal government bonds from its portfolio. According to Bank of Russia estimates, as a result, banking debt on refinancing operations will decrease from 3.7 trillion rubles at end-2015 to 0.9-1.5 trillion rubles at end-2016.

Credit institutions' outstanding amount on Bank of Russia refinancing operations, demand for Bank of Russia liquidity-absorbing operations, and structural liquidity deficit of the banking sector (as of month-start, trillions of rubles)



Source: Bank of Russia.

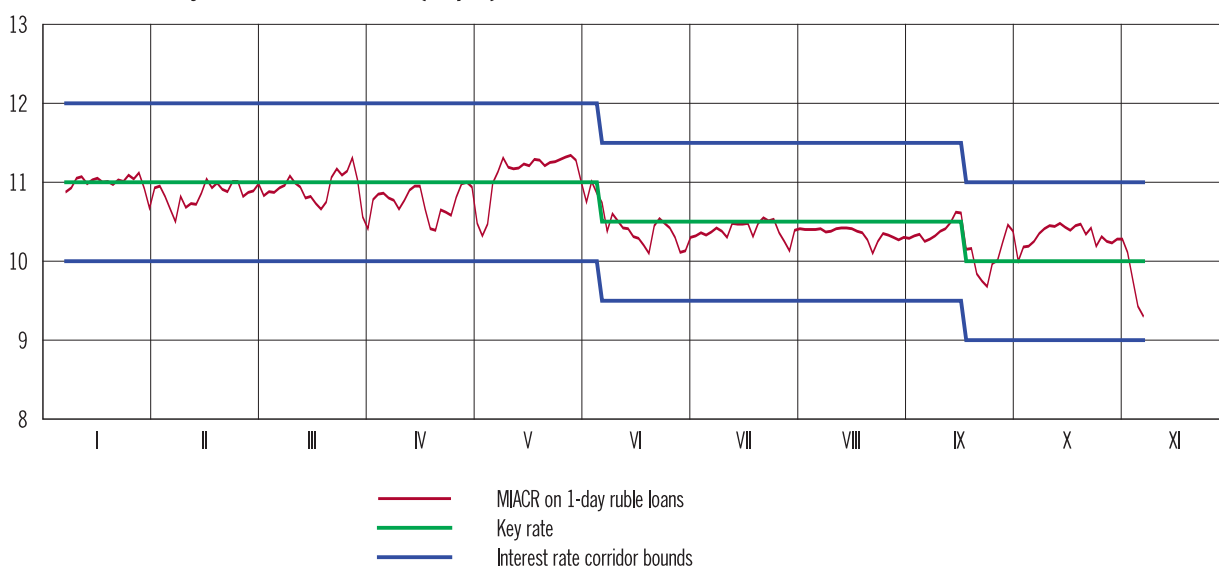
To ensure the steering of short-term money market rates, the Bank of Russia was fully serving Russian banking sector's needs for liquidity. In doing so, the Bank of Russia sought to create a structure for outstanding amount on its operations that allows to effectively influence the rates through its main operations – one-week repo auctions. Thus, while structural liquidity deficit continued to decline, the Bank of Russia was lowering the amount of long-term loans secured by non-marketable assets. Since April 2016, the Bank of Russia has cut to zero the auction-based loan provision secured by non-marketable assets. Given lessening needs for banks to borrow from the Bank of Russia, the outstanding amount on repos has been gradually decreasing. Since August 2016, the Bank of Russia has mainly held one-week deposit auctions instead of one-week repo auctions. This situation evolved amid the uneven liquidity distribution in the banking sector and outstanding amounts on long-term Bank of Russia facilities observed for some banks.

At the same time, the Bank of Russia took measures to limit the decrease in structural liquidity deficit. Since August 2016, required reserve ratios for all credit institutions' liabilities have been raised. To meet new requirements

banks had to keep higher correspondent account balances and transfer part of their funds to the required reserve accounts with the Bank of Russia. As a result, the demand for refinancing increased. The increase in required reserve ratios on banks' FX liabilities in April and July first and foremost aims for reducing incentives for credit institutions to create FX liabilities, but it also caused banks' higher demand for liquidity (see Table 6, Appendix 5).

In 2016, against the backdrop of a reduction in credit institutions' outstanding amounts on Bank of Russia refinancing operations and thus lowered marketable and non-marketable assets utilisation ratio the Bank of Russia began to gradually toughen the requirements to the collateral for its operations (after significant softening in 2014-2015). Equities and Russian depository receipts for equities were excluded from the Bank of Russia Lombard List. For the new securities included in the Lombard List, minimum levels for a long-term international credit rating of the issue were raised from B-/B3 to B+/B1 by the classification of international rating agencies. In 2016, the Bank of Russia suspended the provision of loans secured by the guarantees of credit institutions. At the same time, the Bank of Russia decreased ad-

Bank of Russia interest rate corridor and MIACR on 1-day ruble loans in 2016 (% p.a.)



Source: Bank of Russia.

justment ratios used to readjust the value of non-marketable assets that serve as a collateral for Bank of Russia loans.

Overall, in the context of significant changes in the scope of banking sector structural liquidity deficit the Bank of Russia effectively achieved the monetary policy operational goal: short-term money market rates mostly remained close to the key rate. To a certain extent, the decrease in their volatility was generated by synchronised schedules for required reserves averaging and Bank of Russia weekly operations. Periods, when short-term money market rates were slightly lower than the key rate were caused by increased unevenness in the distribution of liquidity among banks as it entered the banking sector and by certain fragmentation of the money market that undermined optimal liquidity redistribution. Banks placing large amounts of funds in FX swaps in order to attract FX liquidity also exerted a downward pressure on short-term money market rates. The said factors did not hinder the achievement of the monetary policy operational goal: according to the estimates, in 2016 average spread between short-term money market rates and the key rate will be relatively low, amounting to –10 bp.

Given the Reserve Fund spending to finance the budget deficit in 2016, the transition from structural deficit to liquidity surplus is expected in early 2017. It means that the amount of funds in banks' correspondent accounts with the Bank of Russia will be higher than they need for their day-to-day activities³. Therefore, the Bank of Russia will regularly carry out operations to absorb excess liquidity. Structural liquidity surplus growth is expected in 2017-2019; both according to the baseline and alternative scenarios (see Section 4). However, its pace will depend on the expenditure rate of sovereign wealth funds. In case of a noticeable deterioration in external economic conditions against the baseline scenario, the financing of budget expenditures will require the increased spending of sovereign funds, thus making structural liquidity surplus more sizable than under the baseline scenario. By contrast, improvements in world commodity markets will make structural liquidity surplus less sizable than the level implied by the baseline scenario.

Given the surplus, credit institutions will seek to place excess funds. As a result, in the following period one-week deposit auctions will

³ In order to carry out own and customer settlements and payments, and observe required reserve ratios.

become main monetary policy instruments. As significant structural liquidity surplus develops, the central bank also intends to use Bank of Russia coupon bonds (OBRs). OBRs will be issued for 3, 6 and 12 months with floating interest rate, linked to the Bank of Russia key rate. The Bank of Russia will issue OBRs with due regard to the situation in the financial market and its participants' behaviour, seeking not to impact the conditions of OFZ issue by the Russian Ministry of Finance. These liquidity-absorbing instruments will help short-term money market rates to remain close to the key rate. In turn, stability of money market rates is a requirement for the creation of sustainable level of interest rates and reduced uncertainty in the economy.

Despite the fact that in the following three years there will be excess liquidity in the banking sector, certain credit institutions might find it difficult to raise funds. In this case, they will

still be able to benefit from Bank of Russia standing liquidity provision facilities.

As with structural liquidity deficit, structural liquidity surplus has no direct influence on banks' lending activity. Lending dynamics are primarily determined by the supply-demand ratio. Loan supply depends on the economic backdrop, in particular on the lending market conditions, investment risks and regulatory requirements. Household and corporate demand for loans is based on their confidence in future, economic prospects perception, expected income, interest rate level and other factors. At the same time, lending in the real economy mostly does not cause changes in the total banking sector liquidity. When a loan is granted, the lender transfers funds to the borrower's account with another bank, meaning that funds are redistributed between banks and total liquidity remains the same.

4. MACROECONOMIC SCENARIOS AND MONETARY POLICY IN 2017-2019

The Bank of Russia takes monetary policy decisions based on the assessment of the current economic situation and medium-term macroeconomic forecast. The forecast covers a three-year period, which makes it possible to take account of the lags in monetary policy impact on the economy and provides benchmarks for economic agents to take decisions at the medium-term horizon. The Bank of Russia considers the most likely (baseline) scenario of economic development and analyses the alternative options for changes in the situation, external and internal risks, which may affect the financial system and the economy as a whole and, therefore, the monetary policy environment. On considering the whole range of options the Bank of Russia takes balanced decisions and pursues monetary policy to maintain price and financial stability under risk scenarios.

The backdrop for Russian economic development during the three-year forecast period is expected to be far from simple on the whole. Therefore, the pursuance of consistent and coherent macroeconomic policy will be critical to ensure economic stability and create conditions for a sustainable growth. The Bank of Russia policy on its part will contribute to the process through achieving price stability (implying inflation reduction to the 4% target) and financial stability, and also ensuring banking sector sustainability and financial system integral development.

The Bank of Russia builds its macroeconomic forecasts with due account of the number of factors, which are outside the scope of monetary policy and which influence the situation in the Russian economy. These include external conditions (global economic growth and the situation in the global financial and commodity markets) and internal conditions (gov-

ernment policy and structural features of the economy). The Bank of Russia predicts these factors on a scenario basis and takes them into account as prerequisites while building its forecast.

Domestic factors evolving outside the scope of monetary policy and having a material influence on the economic situation are supposed to be rather homogeneous in Bank of Russia scenarios. The regulator formulates prerequisites for such internal conditions based on the decisions taken so far and the announced plans for government policy. In order to keep up the forecast's reasonable conservatism the Bank of Russia does not make extra proposals on measures not yet registered in any official document, whose implications are hard to estimate given the lack of clearly cut parameters.

First, fiscal policy is crucial for building internal economic environment. The Bank of Russia assumes that a conservative approach to budget planning¹ formed by the Government of the Russian Federation and the Russian Ministry of Finance will be retained over the forecast horizon. On the one hand, the excess of budget expenditures over revenues over the three-year horizon brings about the need to spend a large part of funds from the Reserve Fund and highly likely from the National Wealth Fund. On the other hand, the planned constraints on budget expenditure growth will be conducive to gradual reduction in budget deficit to achieve its equilibrium in 2020, i.e., the scheduled start of the modified budget rule². The years 2017-2019 will see the implementation of budget rule provisions designed for the transition pe-

¹ In its forecasting, the Bank of Russia takes into account budget projections presented in the draft Monetary Policy Guidelines for 2017-2019.

² The methodology of budget rule application is set out in the draft Monetary Policy Guidelines for 2017-2019.

riod. This approach will allow for a secure level of government debt from the standpoint of financial stability and ongoing sustainability of government finance in the medium- and long-term perspective. Once implemented, the budget rule will also decrease the Russian economy's vulnerability to external changes by limiting fluctuations in the real exchange rate and, therefore, its impact on the competitiveness of Russian producers.

In the period under review, the stimulative impact of fiscal policy on the economy will be limited against the backdrop of moderate budget expenditures required to reduce the deficit. The contribution of the consumption expenditure of general government to GDP will be close to zero or slightly negative. Measures to optimise the structure of budget expenditures, as well as additional government measures aimed at increasing the long-term potential of steady and balanced economic growth, will be crucial.

Over the three-year horizon, the banking sector liquidity will be influenced by cash flows related to budget financing from the sovereign funds. According to Bank of Russia estimates, their final impact on lending conditions in the economy will be rather limited largely due to the effective use of Bank of Russia instruments to achieve the monetary policy's operational target, i.e., maintaining short-term money market rates close to the key rate (see Section 3).

Second, an important prerequisite for a medium-term inflation forecast is also the assumption that the increase in administered prices and tariffs in compliance with the Russian Government plans will be moderate. Adherence to the approach of tariff indexation implying that their growth rates will be lower than those of inflation will not exert an extra inflationary pressure on the part of this factor over the forecast period.

Third, the Bank of Russia proceeds from the assumption that the forecast period will see the ongoing structural limitations for economic growth linked to the demographic situation and

also infrastructural and institutional features of the economy. These limitations appear as a persistent imbalanced structure of the Russian economy, its inadequate diversification and dominant commodity-orientation. Russian exports remain shifted towards oil and gas products and other mining and quarrying products, while the share of exported domestic manufacturing products remains negligible. This makes the economy more sensitive to changes in external conditions, in particular to changed oil prices, and also influences income and prices. Insufficient development of certain segments of investment and consumer goods production is responsible for the low level of competition both domestically and with imported counterparts. This in turn may increase price volatility, hamper inflation reduction on the whole, and, all else equal, require monetary policy tightening to mitigate inflation risks.

Another feature of the economic system, which may also complicate inflation slowdown through monetary policy measures, is income inequality. The share of low-income households is still high, with their consumption shifted towards essential goods. Demand for such goods may be less sensitive to price changes than demand for other goods, which may reduce stimuli to price competition among producers and suppliers of certain goods in this category. Moreover, amid the relatively low level of income the share of food products within the consumer basket remains elevated, whose prices are highly volatile and sensitive to one-off factors on the supply side (for example, dependence on the agricultural crop).

As experience of Russia and other countries shows, a rather prolonged period exceeding the three-year forecast horizon is required, as a rule, to overcome the said limitations. The Bank of Russia will specify its medium-term forecasts and scenarios as the situation develops and the opportunities of raising the Russian economic growth potential, including through government policy measures, become clearer. After the elaboration and official approval

of specific government measures designed to overcome structural problems and to introduce a new economic growth model, the Bank of Russia will be able to prepare a respective scenario and calculate its parameters. The Bank of Russia believes that if the structural limitations ease, the Russian economy may accelerate its growth determined by supply-side factors and not accompanied by the demand-side increase in inflationary pressure, as well as risk growth in the financial sphere. In this case, an increased growth of domestic demand (in relation to forecasts in the respective scenarios) will not require an additional change in the key rate, since this growth will be accompanied by higher labour productivity and improved output effectiveness.

As far as internal financial environment is concerned, all the scenarios suppose that it will be moderately tight for a rather long period of time and the potential reduction in nominal interest rates in the economy will be limited given the monetary policy pursued by the Bank of Russia. Then, as inflation comes close to 4%, monetary conditions will ease gradually supporting the recovery in economic activity. The ongoing moderately tight monetary conditions in the first part of the forecast period will be determined by two major factors. On the one hand, the Bank of Russia's monetary policy will support positive real interest rates. Their equilibrium level for the economy is estimated at 2.5–3% at the medium-term horizon, though in the transition period they should be somewhat higher to reduce inflation and inflation expectations. This will be conducive to maintaining the appeal of ruble savings and moderate propensity to borrow inside the economy, which in turn will tell on the price dynamics both through restrained dynamics of domestic consumer demand and cross-border capital flows, and, therefore, the exchange rate.

On the other hand, the increased debt burden in the economy was one of the results of external risk materialisation and economic growth slowdown in previous periods. The ser-

vice of outstanding loans issued in the period of rapid economic growth is currently a source of risks for financial stability of many borrowers, primarily those of the corporate sector. This circumstance is expected to be an additional factor restricting opportunities for easing monetary conditions in the first half of the three-year forecast period, thus determining a more conservative behaviour of both lending banks (with regard to price and non-price lending conditions) and their borrowers. The moderately tight monetary policy will provide for, *inter alia*, the adjustment of the debt burden by certain categories of borrowers to bring it into compliance with the objectively changed income conditions. This process is a prerequisite for maintaining financial sector stability and launching sustainable economic growth in future.

Bank of Russia measures aimed at developing and increasing the effectiveness of the banking sector and financial markets, optimising approaches to their regulation, expanding financial inclusion, improving financial literacy of households and businesses will contribute to a balanced development of the financial system as a whole and an improvement of monetary policy conditions by enhancing the efficiency of transmission mechanism³.

The Bank of Russia will continue to use specialised refinancing instruments to support certain lending segments whose development is important for changes in economic structure but is complicated under market conditions. As before, in order to avoid an unfounded ease in monetary conditions, the volume of funds provided through these mechanisms will be limited and the range of loans accepted as collateral will be strictly determined. Taking into account the forecast excess of banking sector liquidity on the whole in the forthcoming period and an expected reduction in market interest rates as inflation slows down, credit insti-

³ For more details about the pass-through effect of financial market development on the monetary policy transmission mechanism see Section 1, page 7.

tutions' demand for specialised refinancing instruments may shrink.

Forecasts consider the following prerequisites with regard to external conditions. The slow growth of the global economy is expected to persist at the three-year forecast horizon with the ongoing heterogeneity of trends across the developed countries and emerging market economies. Russia's foreign trade structure is expected to be rather stable in the period under review. GDP annual growth rates in Russia's trading partners will remain at the level of 2015–2016, i.e., at about 2%, during the forecast period. Under these conditions, demand in the global commodity markets will remain moderate. Persisting relatively high supply and commodity stocks (with due account of technological changes and certain geopolitical factors) will limit commodity price growth. An elevated volatility in energy prices may persist under the impact of the supply-side short-term factors in particular.

Amid the restrained global demand and the expected commodity price dynamics and world food prices, the external inflationary pressure remains limited on the whole. Against this backdrop the monetary policy pursued by the majority of world central banks will soon be predominantly accommodative followed by its gradual normalisation. This will be conducive to a rather prolonged maintenance of relatively low interest rates in global financial markets. The medium-term horizon will see a gradual interest rate rise by central banks of developed countries (primarily the US Fed), which will be held taking account of the economic recovery rates.

Despite the persistent relatively favourable external financial conditions, opportunities for Russian borrowers to raise funds in global markets will still be limited by international financial sanctions imposed against Russia, whose retention over the whole forecast period is considered by the scenarios. Nevertheless, the limitations' impact will become less pronounced, largely due to diversified sources of fund rais-

ing from international markets, including sources not affected by sanctions. Given the stabilised oil prices and relatively unchanged trends of global economic development, the country risk premium for Russia is expected to stay at the level close to 2016 figures. Over the forecast horizon, external financial and trade conditions for Russia, in aggregate, will remain a factor hampering economic development.

It should be noted that the free floating exchange rate regime is still a major factor for the Russian economy to adapt to external environment. A flexible response of the ruble exchange rate to the changing external situation will ensure the adjustment of the Russian balance of payments and increase the production and employment stability. Thus, in case of an unfavourable change in external environment the ruble depreciation will encourage imports reduction, thereby promoting the domestic production competitiveness. Economic agents' adaptation to elevated volatility of the exchange rate significantly curbs risks to financial and price stability on the part of the exchange rate dynamics.

Taking into account that oil price changes at the forecast horizon will remain a major factor affecting the Russian economy (with regard to Russia's balance of payments, ruble exchange rate, and the Russian economy's appeal for foreign investors) and their dynamics, as is noted above, may continue to be volatile and hard-to-predict, the Bank of Russia considers several scenarios of their changes. **Scenario I (baseline scenario)**, which is considered as the most likely one, is based on the assumptions of the absence of any marked changes in global commodity markets and of the Urals crude price staying over the entire forecast horizon close to the average values formed during 2016, i.e., at roughly \$40 per barrel given the ongoing high supply in the energy market, improved oil production technologies and the low growth of global economy. The September 2016 OPEC agreement to reduce oil production will only provide a temporary support for

prices, given a potential response from the expanded production of shelf oil. The key parameters of the Bank of Russia's baseline scenario are similar to the baseline scenario prepared by Russian Ministry of Economic Development. In addition to the baseline scenario, the Bank of Russia considers **Scenario II** and **Scenario III**. These assume relatively slow and fast recovery of the global economic growth respectively, which will bring about either a low or high path for oil prices.

The **baseline scenario (Scenario I)** assumes that despite the aforementioned restraining external and internal factors, the financial sector stability, transparent and consistent monetary and fiscal policies, and economic agents' adaptation to the changed external conditions, including due to the free floating exchange rate regime, will be conducive to gradual improvement of sentiment, consumer and investment demand revival, and economic growth recovery. Therefore, the potential growth rates of the Russian economy will be small with due account of structural restrictions mentioned above. Under the baseline scenario, the economic growth rate is expected to be near 0.5–1.0% in 2017 and then rise to 1.5–2.0% in 2018–2019.

The expected inflation slowdown to 4% in 2017 and its stabilisation near the target will form in the second half of the three-year forecast period conditions conducive to the gradual easing of monetary policy. Against this backdrop, the short- and long-term market interest rates will decrease both in nominal and real terms. The real interest rates will remain positive, which is important for maintaining balanced saving and lending activities amid the current features of economic development. An additional factor for easing price and non-price lending conditions will be the expected normalisation of the debt burden and the respective consistent reduction in credit risks, which will be ensured by a conservative approach to changes in the borrowers' debt to income ratio. Under the baseline scenario, the annual growth

rate of the banking sector loan to the economy is forecast to stand at 4–6% in 2017 and then to accelerate to 7–11% in 2018–2019. Easy lending conditions along with the improved economic sentiment and expectations will contribute to the gradual recovery of consumer and investment demand growth.

As the aggregate demand structure shows, the economic recovery is forecast to be gradual and rather even, which will help keep the GDP structure relatively stable. The annual growth rates in final consumption expenditure are expected to amount to 0.2–0.6% in 2017 and 1.7–2.5% in 2018–2019. As producer confidence in the demand recovery strengthens, investment activity will be reinvigorated amid gradual easing of financial conditions. The annual growth rates in gross capital formation will stand at 1.2–1.7% in 2017 and go up to 2.7–3.2% and 3.2–3.7% in 2018–2019 respectively. Following the investment demand recovery offsetting its deep fall in previous periods, investment growth rates contained by economic peculiarities may slow down again. Amid the expected gradual consumer demand recovery the inventory dynamics will contribute to an increase in gross capital formation in 2017–2018.

A gradual revival of consumer and investment demand amid the expected stability of the exchange rate dynamics will be accompanied by imports recovery. Considering the supposed growth indicators of Russia's trading partners, as well as objective limitations for building up commodity exports, whose share in the Russian export structure is fairly large, the annual growth rates in exports in real terms will remain stable albeit low at 1-2%.

Given the quantities of exports and imports of goods and services and taking account of energy price stabilisation, the current account surplus will reduce gradually during the forecast period. Net private capital outflow is expected to remain low over the three-year horizon – at about 2% of GDP. Firstly, this will be ensured by the expected reduction in ex-

ternal debt payments amid the expanded opportunities to refinance it in international markets. Secondly, the excess of the domestic interest rates over the external ones and also the growing optimism about the economic recovery in Russia and the implementation of the balanced macroeconomic policy will facilitate the appeal of ruble investment for both Russian and global investors. Under the baseline scenario, the current account earnings in the years to come will be enough for Russian credit institutions and non-financial organisations to service their external debt. Against this backdrop, the Bank of Russia will continue to curtail its FX refinancing operations and expects credit institutions to be able to repay their outstanding amounts on these operations in full by the end of 2017. Given the combination of the above trends, the forecast horizon is expected to see relatively stable dynamics of the ruble exchange rate without exerting any additional inflationary pressure.

Apart from the restraining effect of moderate demand and exchange rate dynamics, the limited growth in producer costs will have an additional downward impact on consumer prices over the forecast period. The contributing factors are as follows: relatively low global energy prices, the lack of wide fluctuations in the exchange rate, and the aforementioned moderate rates of indexation of administered tariffs for services provided by natural monopolies.

Considering relatively weak consumer demand, stable exchange rate dynamics, and the lack of additional inflationary pressure from the costs factors, annual inflation will continue to go down gradually from 5.5–6.0% in December 2016 to the 4% target at the end of 2017 to stabilise close to this level further.

The Bank of Russia's alternative scenarios suggest a fall in oil prices to \$25 per barrel at the start of 2017 and their staying close to this level till the end of 2019 (**Scenario II**), and then their gradual growth to \$55 per barrel in 2019 (**Scenario III**).

Under **Scenario II**, oil price dynamics may be influenced by a combination of slowing growth in the global economy and oil demand in general, on the one hand, and additional factors increasing supply in a certain segment of the energy market, on the other hand. The recovery of oil deliveries from Nigeria and Libya may accelerate and oil supply from other oil exporting countries (mainly Iran and Iraq) may expand significantly.

These negative changes in external environment will affect the Russian economy through the reduced export revenues, including budget ones (thereby increasing the additional burden on the sovereign funds), decreased solvency of borrowers having debts in foreign currency, deterioration of expectations with regard to Russian economic growth outlook, and lower appeal for Russian and foreign investors. Therefore, greater economic resilience to such external shocks supported by corresponding response from monetary and fiscal policies, as well as flexible exchange rate changes, should be taken into account. This should contain the fall in total output. GDP may decrease by 1.0–1.5% in 2017 and by 0.1–0.5% in 2018, followed by the recovery.

The slowing economic activity will become a factor holding inflation in check. However, ruble depreciation amid the deteriorated external environment will exert an upward pressure on prices. Given the situation, the 4% inflation target will be more likely achieved in 2018, rather than at the end of 2017. This will require maintaining relatively tight monetary conditions for a longer period of time compared with Scenario I. This is needed to maintain the appeal of ruble savings, prevent destabilisation of inflation and exchange rate expectations, and ensure price and financial stability. Moreover, under the negative scenario the Bank of Russia will consider holding FX interventions to support financial stability and also increasing amounts of foreign currency provided to credit institutions of a reverse basis, should companies and

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

	2015 (actual)	2016	2017			2018			2019		
			Scenario I (baseline)	Scenario II	Scenario III	Scenario I (baseline)	Scenario II	Scenario III	Scenario I (baseline)	Scenario II	Scenario III
Urals price, average for the year, US dollars per barrel	52	41	40	25	46	40	25	50	40	25	55
Inflation, % in December year-on-year	12.9	5.5-6.0	4.0	5.0-6.0	4.0	4.0	4.0-4.5	4.0	4.0	4.0	4.0
Gross domestic product	-3.7	-(0.7-0.5)	0.5-1.0	-(1.5-1.0)	1.2-1.7	1.5-2.0	-(0.5-0.1)	2.0-2.5	1.5-2.0	1.3-1.7	2.0-2.5
Final consumption expenditure	-7.5	-(3.7-3.3)	0.2-0.6	-(2.7-2.3)	1.2-1.6	1.7-2.2	-(1.0-0.5)	3.2-3.6	2.0-2.5	1.3-1.8	3.4-3.8
– households	-9.6	-(4.6-4.0)	0.3-0.7	-(3.5-3.0)	1.6-2.0	2.4-2.8	-(1.5-1.0)	4.5-4.9	3.0-3.5	2.0-2.5	4.7-5.1
Gross capital formation	-18.7	4.0-5.0	1.8-2.5	-(6.0-5.0)	3.6-4.0	3.0-3.7	-(1.0-0.0)	1.6-2.0	0.8-1.3	0.5-1.5	2.5-2.9
– gross fixed capital formation	-7.6	-(4.5-4.0)	1.2-1.7	-(6.5-5.5)	2.0-2.5	2.7-3.2	-(1.2-0.8)	3.3-3.7	3.2-3.7	0.5-1.0	3.5-3.9
Net exports	96.0	10.0-13.0	-1.9-2.2	34.2-38.7	-(10.6-6.5)	-3.6-0.5	10.0-13.3	-(16.9-13.6)	-3.6-1.0	2.5-7.0	-(22.9-19.2)
– exports	3.6	-(1.5-1.0)	1.2-1.6	1.7-2.2	1.3-1.7	1.1-1.6	0.7-1.1	1.1-1.5	1.3-1.8	1.3-1.8	1.1-1.5
– imports	-25.7	-(6.5-6.0)	1.6-2.0	-(5.8-5.4)	3.5-3.9	1.9-2.4	-(2.3-1.9)	5.7-6.1	2.0-2.5	0.5-1.0	6.6-7.0
Money supply in national definition, % annual growth	11.4	9-11	7-9	8-10	9-11	8-10	7-9	10-12	9-11	8-10	8-10
Monetary base in narrow definition, % annual growth	-4.3	3-5	3-5	0-3	5-7	4-6	3-5	6-8	4-6	4-6	7-9
Lending to non-financial organisations and households in rubles and foreign currency, % annual growth	7.1	2-5	4-6	0-3	9-11	7-9	2-4	12-15	9-11	8-10	12-15

Sources: Rosstat, Bank of Russia.

Russia's balance of payment indicators*
(billions of US dollars)

	2015 (actual)	2016	2017			2018		2019		
			Scenario I (baseline)	Scenario II	Scenario III	Scenario I (baseline)	Scenario II	Scenario I (baseline)	Scenario II	Scenario II
Current account	69	27	27	20	33	25	35	25	18	43
Balance of trade	149	91	94	84	107	96	119	101	84	136
Exports	341	278	289	221	317	301	357	315	220	390
Imports	-193	-187	-194	-137	-210	-204	-238	-214	-136	-254
Balance of services	-37	-23	-24	-29	-29	-26	-36	-28	-27	-41
Exports	52	50	53	46	54	55	59	57	49	59
Imports	-89	-73	-77	-75	-83	-81	-95	-85	-77	-100
Balance of primary and secondary income	-43	-41	-44	-35	-46	-46	-48	-48	-38	-51
Capital account	0	0	0	0	0	0	0	0	0	0
Current and capital account balance	69	27	27	20	33	25	35	25	18	43
Financial account (except for reserve assets)	-71	-11	-18	-35	-23	-25	-35	-25	-25	-43
General government and the central bank	-9	3	0	0	0	0	0	0	0	0
Net private capital outflow	-62	-14	-18	-35	-23	-25	-35	-25	-25	-43
Net errors and omissions	4	-3	0	0	0	0	0	0	0	0
Change in FX reserves (←+→ – decrease, ↔ – increase)	-2	-13	-9	16	-9	0	12	0	7	0

* According to BPM5.
Source: Bank of Russia.

banks have problems with servicing their external debts.

Scenario III assumes a somewhat more dynamic and balanced growth in the global economy, increased investor optimism in the world markets, and reduced economic and financial risks faced by major emerging markets, first of all China. In this context, global central banks (primarily the US Fed) may raise their interest rates slightly quicker than in the baseline scenario.

Considering the aforementioned prerequisites, the main difference of Scenario III, as distinct from the others, is the higher rate of economic growth recovery supported by elevated external and internal optimism. It may reach 1.2–1.7% in 2017 and go up to 2.0-2.5% in 2018–2019.

It should be noted that a relative improvement of the external situation per se cannot have a material influence on the medium-term potential of the Russian economic growth, the increase of which requires the existing structural restrictions to be overcome. Following the recovery period of 2018–2019, Russian economic growth rates will stabilise around the potential GDP's growth rates at 1–1.5% and will not exceed baseline scenario indicators given similar dynamics of inflation and monetary conditions. If the situation evolves according to this scenario, it will be crucial to avoid excessive optimism in the economy when making monetary-policy or government-policy decisions, because excessive optimism may discourage restructuring, lead to the build-up of economic imbalances and to the appearance of financial bubbles. The timely response from monetary and macroprudential policies to the signs of overheating in the commodity and lending markets is critical to counter the risks of inflation acceleration, excessive debt burden growth, and financial market destabilisation.

Under Scenario III, the impact of the improved terms of trade on inflation will be mixed in the short term. On the one hand, the ruble appreciation amid the supposed growth in oil

prices will contain inflation. On the other hand, the increased income of economic agents and reinvigorated demand will be conducive to consumer expenditure growth, which will trigger a pro-inflationary effect. Nevertheless, the restraining influence of the exchange rate dynamics on inflation under this scenario proceeds faster, according to estimates, which will deliver inflation to the 4% target in the second half of 2017 and will enable a faster decline for the key rate amid the moderately tight monetary policy.

The approach to fiscal policy will also influence the developments under this scenario. The parameters of budget expenditure, the pace of deficit reduction and the structure of deficit financing will have an impact on economic dynamics and monetary policy conditions. Specifically, once this scenario materialises, the replenishment of the sovereign funds will be resumed following the implementation of the budget rule's transition provisions. Based on the above, the central bank expects that the fiscal consolidation will continue given the upward oil price dynamics. The Bank of Russia will consider fiscal policy measures while making decisions on the key rate and operational issues, including the parameters of its operations in rubles and foreign currency.

Taking into account that the external and internal conditions under this scenario will be slightly better than under the baseline scenario, the Bank of Russia will examine the possibility of resuming foreign currency purchases to replenish international reserves up to \$500 billion. These operations may be also conducted as part of the budget rule implementation. The \$500-billion level exceeds the reserve adequacy parameters calculated according to the standard criteria, proceeding inter alia from the cost of imports of goods during three-four months and the repayment of short-term external debt. However, precisely this (higher) level of international reserves seems to be appropriate for the stable functioning of the Russian economy amid unfavourable foreign econom-

ic environment and international trade and financial sanctions. The Bank of Russia does not set any specific timeframe for the international reserves to reach the \$500-billion mark, since their current level is already comfortable enough and the Bank of Russia replenishes these reserves regularly by buying gold in the domestic market. The resumption of foreign currency purchases to replenish international reserves will be considered only if these operations do not run counter to the goal of ensuring price and financial stability.

Under any of the considered scenarios the Bank of Russia does not rule out a possibility of additional risk materialisation, which may affect inflation dynamics. The unforeseen by these scenarios surges in internal and external food prices (influenced by supply-side factors), changes in fiscal policy, including possible acceleration of expenditure indexation or tax in-

creases, as well as an accelerated growth in administered prices and tariffs may be considered as material risks for inflation forecast over the three-year horizon. The required monetary policy response to the said risk materialisation will be determined with due account of the assessment of the scope and duration of their influence on inflationary processes. Specifically, if the fiscal consolidation process deviates from the announced plans and if the budget deficit increases, the Bank of Russia will have to tighten its monetary policy.

As new data arrive, the Bank of Russia on a regular basis makes an assessment of and specifies the parameters of macroeconomic development forecast, which may influence the monetary policy decision-making. The respective information will be promptly published in the Bank of Russia's quarterly Monetary Policy Report.

APPENDICES

APPENDIX 1

Schedule of Bank of Russia Board of Directors meetings on monetary policy issues in 2017

In 2017, the Bank of Russia is to hold its Board of Directors meetings on monetary policy issues on the following dates:

- 3 February;
- 24 March;
- 28 April;
- 16 June;
- 28 July;
- 15 September;
- 27 October;
- 15 December.

The Bank of Russia Board of Directors meetings on 24 March, 16 June, 15 September and 15 December will be followed by publications of Monetary Policy Reports and press conferences.

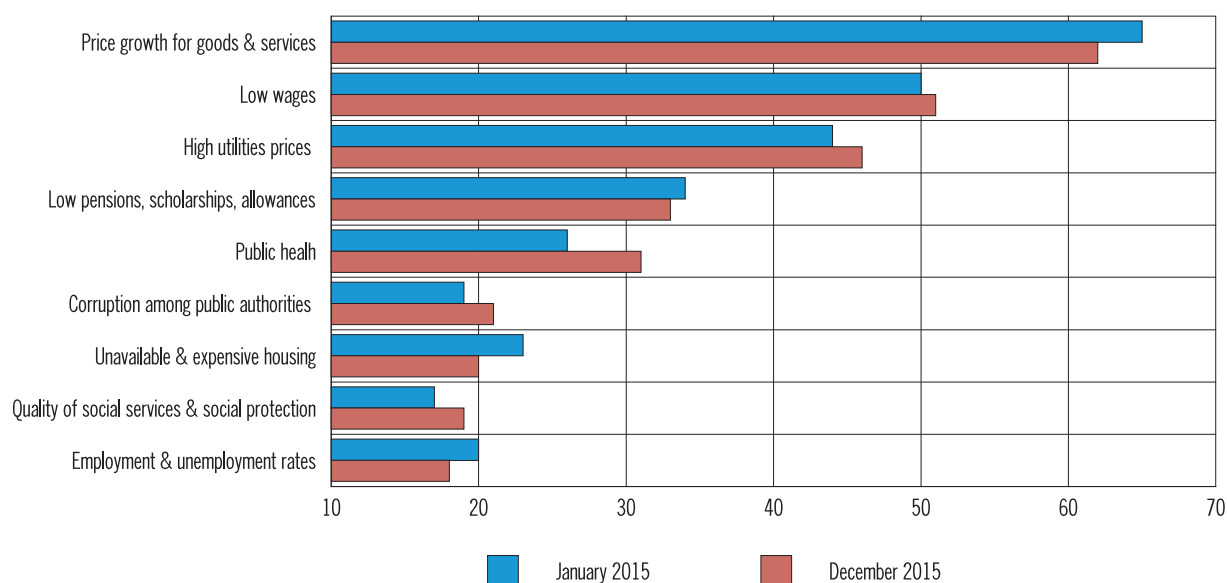
Press releases relating to Board of Directors decisions on monetary policy issues are to be published at 13:30 Moscow time.

APPENDIX 2

Public and business opinion surveys

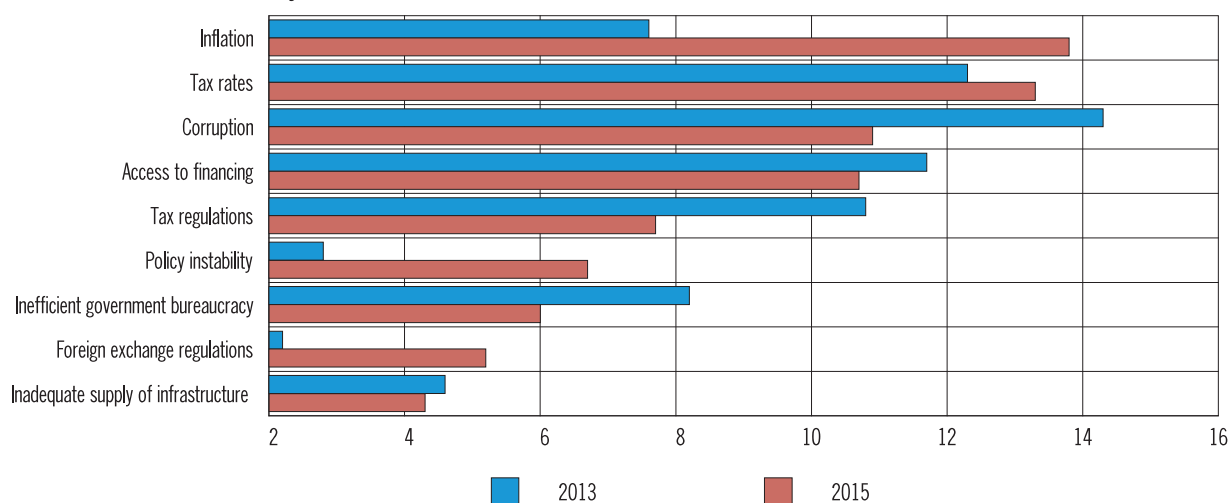
The results of Russian public opinion polls name the high inflation as one of the key concerns in this country. Business opinion surveys also place inflation as the main factor suppressing Russia's competitiveness.

Issues of concern for Russians, inFOM surveys



Source: inFOM.

Factors reducing Russia's competitiveness (in the opinion of foreign business community), World Economic Forum surveys



Source: World Economic Forum.

APPENDIX 3

Approaches to the assessment of real interest rates and inflation expectations

In every country with positive price growth rate economic agents choose between present day consumption and savings and investments (i.e. future consumption), taking into account the level of real rather than nominal interest rates. At the same time, real interest rates are estimated with due regard for inflation expectations, which may vary significantly among economic agents. Thus, choosing inflation expectations indicator is one of the key aspects of assessing real interest rates in the economy.

The easiest method of calculation for real interest rates is to use current inflation. This approach is based on the assumption that in future prices will change at the same pace as at the present time. However, this is not always the case. More reasonable way is to adjust nominal interest rates for household inflation expectations that may be obtained through a survey. In Russia such surveys are regularly conducted by inFOM¹. A survey includes questions both on the quantitative assessment of inflation by respondents (in percentage points), and on the qualitative evaluation of its changes (acceleration or slowdown)².

The estimates of household inflation expectations published by inFOM are based on both quantitative and qualitative answers. Quantitative answers are presented as figures and are adjusted to qualitative answers. However, respondents might find it difficult to identify precisely price growth rate. For this reason, the Bank of Russia only uses responses to qualitative questions to derive quantitative estimates of inflation expectations in line with the following approach:

- current level of inflation ‘perceived’ by respondents amounts to actual annual inflation;
- respondents who gave contradictory quantitative and qualitative responses are excluded from the sample;
- the assumption that responses are distributed according to ‘conventional’ laws of distribution (e.g. normal or uniform distribution) is introduced;
- distribution parameters are evaluated by means of standard procedures for optimisation, taking into account distribution of responses among possible variants³;
- median value of the distribution is used as a final quantitative indicator for inflation expectations.

In order to assess real interest rates it is also possible to use inflation expectations based on survey of professional market participants and yields on financial instruments, as well as inflation forecasts developed with the use of various models. Data of consensus forecasts made by independent experts in macroeconomic forecasting is often used as market participants’ inflation expectations indicator. Such indicator is calculated by agencies like Bloomberg and Thomson

¹ Details of the research method for inflation expectations is available on the Bank of Russia website in the subsection ‘Inflation and inflation expectations’ of the ‘Monetary Policy’ section.

² Qualitative question on expected price growth rate has the following possible answers: ‘prices will grow faster’, ‘price growth rate will remain the same’, ‘prices will grow more slowly’, ‘prices will remain at current level/will not change’, and ‘prices will decline’.

³ Details of the Bank of Russia’s research method for household inflation expectations are available on the Bank of Russia website in the subsection ‘Inflation and inflation expectations’ of the ‘Monetary Policy’ section.

Reuters⁴. Their consensus forecast has the form of median value of forecasts of inflation dynamics for the current and following years, presented regularly (once a month) by responding analysts.

Real interest rates on long-term household deposits and long-term loans to non-financial organisations (% p.a.)

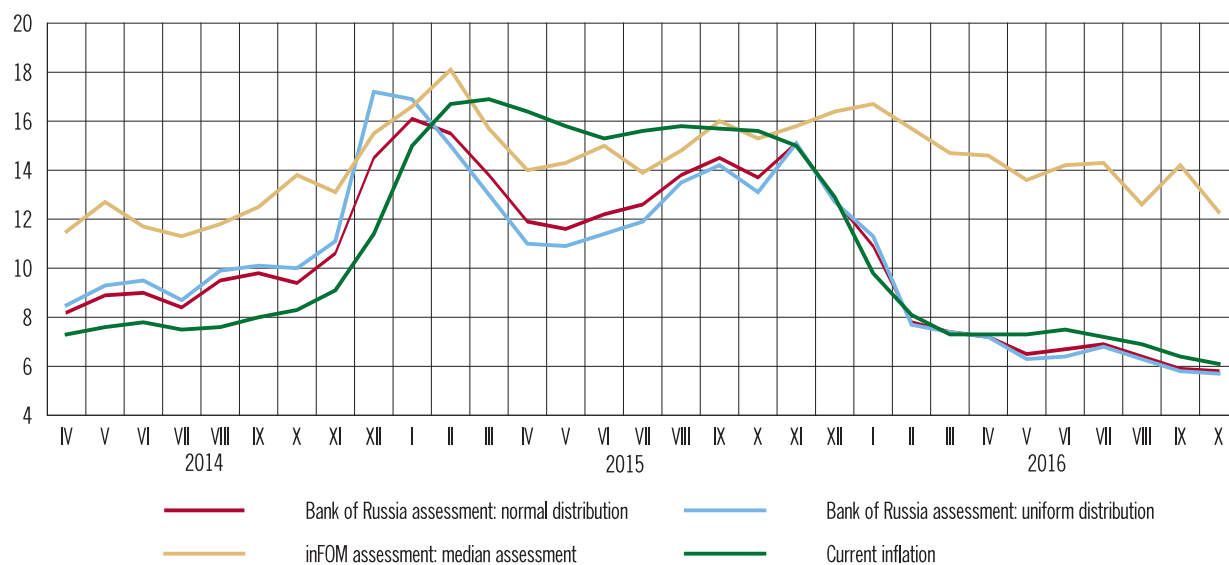
Reporting month*	Real interest rate on long-term household deposits adjusted for				Real interest rate on long-term loans to non-financial organisations adjusted for			
	actual inflation	household inflation expectations for the forthcoming year according to inFOM survey data	household inflation expectations for the forthcoming year according to Bank of Russia estimates**	Bloomberg consensus forecast	actual inflation	household inflation expectations for the forthcoming year according to inFOM survey data	household inflation expectations for the following year according to Bank of Russia estimates **	Bloomberg consensus forecast
2014								
April	0.2	-3.5	-0.6	2.2	3.4	-0.5	2.6	5.5
May	0.2	-4.4	-1	2.5	3.4	-1.3	2.2	5.8
June	-0.1	-3.6	-1.2	2.6	3.6	0.0	2.4	6.4
July	0.3	-3.1	-0.5	2.6	4.2	0.6	3.3	6.6
August	0.3	-3.5	-1.4	2.2	4.0	0.0	2.1	5.9
September	0.0	-3.9	-1.6	1.3	3.7	-0.4	2.1	5.1
October	-0.1	-5.0	-1.2	1.3	3.6	-1.4	2.6	5.1
November	-0.6	-4.2	-2.0	1.3	3.2	-0.5	1.8	5.2
December	0.4	-3.2	-2.4	4.2	1.4	-2.2	-1.4	5.4
2015								
January	-1.6	-3.0	-2.6	3.4	0.1	-1.3	-0.9	5.2
February	-4.5	-5.6	-3.5	2.4	-0.3	-1.5	0.8	6.9
March	-5	-4.0	-2.4	2.9	-0.4	0.6	2.3	7.8
April	-4.9	-2.8	-1.0	2.8	-0.5	1.6	3.5	7.5
May	-4.7	-3.5	-1.1	2.6	0.4	1.7	4.2	8.1
June	-4.4	-4.2	-1.8	2.7	-0.1	0.1	2.6	7.3
July	-5.3	-3.9	-2.7	2.4	-0.7	0.8	2.0	7.4
August	-5.6	-4.8	-4.0	2.1	-1.0	-0.2	0.7	7.1
September	-5.5	-5.8	-4.6	1.5	-1.3	-1.6	-0.3	6.1
October	-5.8	-5.6	-4.2	0.9	-1	-0.8	0.6	6
November	-5.3	-6.0	-5.4	1.3	-0.7	-1.4	-0.8	6.2
December	-3.2	-6.1	-3.1	1.9	0.0	-3.0	0.2	5.4
2016								
January	-0.3	-6.2	-1.3	1.5	3.6	-2.6	2.5	5.4
February	0.9	-5.7	1.2	1.1	4.9	-2.1	5.1	5.1
March	1.5	-5.1	1.4	1.5	6.1	-0.8	6.0	6.1
April	1.6	-4.9	1.7	1.9	6.2	-0.6	6.3	6.4
May	1.3	-4.3	2.1	1.8	6.2	0.3	7.0	6.7
June	1.1	-4.9	1.9	2.8	5.7	-0.5	6.6	7.5
July	1.0	-5.2	1.4	2.3	5.4	-1.2	5.7	6.7
August	1.2	-4.0	1.6	2.2	5.7	0.3	6.2	6.9

* InFOM calculates inflation expectations on a monthly basis since April 2014.

** Estimate was calculated on the basis of assumption about the normal distribution of responses in the inFOM survey.

⁴ As forecasts by Bloomberg and Thomson Reuters are similar, only Bloomberg data are included in the Table and the Chart.

Assessments of inflation expectations for the forthcoming year (%)



Sources: Public Opinion Foundation, inFOM, Bank of Russia calculations.

APPENDIX 4

*Forecast of key indicators in monetary authorities' accounts
(monetary programme indicators)¹
(trillion rubles, unless otherwise indicated)*

	1.01.2016 (actual)	1.01.2017 (estimate)	1.01.2018			1.01.2019			1.01.2020		
			Scenario I	Scenario II	Scenario III	Scenario I	Scenario II	Scenario III	Scenario I	Scenario II	Scenario III
Monetary base (narrow definition)	8.7	9.2	9.7	9.5	9.7	10.2	9.9	10.2	10.7	10.4	10.7
– cash in circulation (outside the Bank of Russia)	8.5	8.9	9.4	9.2	9.4	9.9	9.6	9.9	10.4	10.1	10.4
– required reserves ²	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net international reserves	26.3	27.6	28.7	26.9	28.7	29.1	26.4	29.1	29.5	26.3	29.5
– in billions of US dollars ³	360	379	394	369	394	399	362	399	405	361	405
Net domestic assets	-17.5	-18.5	-19.0	-17.4	-19.0	-18.9	-16.5	-18.9	-18.8	-15.9	-18.8
Net credit to the general government	-9.2	-6.6	-4.5	-3.0	-4.7	-3.4	-1.5	-3.7	-3.5	-1.3	-4.2
Net credit to banks	2.3	-0.9	-2.8	-4.9	-2.6	-3.9	-6.9	-3.5	-3.8	-7.5	-3.0
– gross credit to banks	4.4	1.9	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
of which claims on refinancing operations ⁴	3.7	1.2	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
– correspondent and deposit accounts of credit institutions with the Bank of Russia	-1.6	-2.3	-2.4	-2.4	-2.4	-2.5	-2.5	-2.5	-2.6	-2.6	-2.6
– deposit accounts of credit institutions with the Bank of Russia	-0.6	-0.6	-1.7	-3.8	-1.5	-2.6	-5.6	-2.2	-2.5	-6.1	-1.7
Other non-classified assets, net	-10.6	-11.0	-11.7	-9.5	-11.7	-11.6	-8.2	-11.7	-11.5	-7.2	-11.6

¹ Monetary programme indicators, calculated at a fixed exchange rate, are based on the official exchange rate of the ruble as of the beginning of 2016.

² Credit institutions' required reserves deposited with the Bank of Russia in the ruble-denominated accounts (do not include funds in the correspondent accounts of credit institutions with the Bank of Russia when a credit institution uses the required reserve averaging procedure).

³ Forecast of change in net international reserves takes into account Bank of Russia operations in the domestic FX market, including FX liquidity provision to Russian credit institutions, and also Bank of Russia operations with monetary gold.

⁴ Include claims on refinancing operations in rubles, including secured loans, repos, and FX swaps.

Source: Bank of Russia.

APPENDIX 5

Statistical tables

Table 1

GDP, inflation and interest rates in BRICS, USA and euro area¹

	Key (target) interest rate of the central bank, % p.a.	Interest rate on bank loans to non-financial sector for a term of up to 1 year/1 year, % p.a.	Inflation rate, month on corresponding month of previous year, %	GDP growth rates, quarter on corresponding quarter of previous year, %
Russia	10.0	12.2	6.1	-0.6
Brazil	14.0	52.7	8.5	-3.8
India	6.25	9.7	4.3	7.1
China	4.35	4.4	1.9	6.7
South Africa	7.0	10.5	6.1	0.6
USA	0.25-0.5	3.5	1.5	2.9
Euro area	0	3.1	0.5	1.6

¹ Data on key (target) interest rates are given as of 8 November 2016, on interest rates on bank loans: USA - for September 2016, Russia and euro area - for August 2016, Brazil, India and China - for July 2016, South Africa - for June 2016; on inflation rate: Russia and euro area - for October 2016, other countries - for September 2016; and on GDP growth rates: China, USA and euro area - for 2016 Q3, other countries - for 2016 Q2.

Sources: IMF, ECB, Bloomberg.

Table 2

**Consumer prices by group of goods and services
(annual percentage change)**

	Inflation	Core inflation	Food price growth	Food price growth ¹	Vegetable and fruit price growth	Non-food price growth	Growth in non-food prices, excluding petrol prices ²	Service price growth
2014								
January	6.1	5.5	6.5	6.4	7.7	4.3	4.3	7.8
February	6.2	5.6	6.9	6.5	10.1	4.3	4.3	7.9
March	6.9	6.0	8.4	7.5	15.9	4.6	4.5	8.2
April	7.3	6.5	9.0	8.3	14.4	4.9	4.7	8.5
May	7.6	7.0	9.5	9.5	10.1	5.1	4.9	8.4
June	7.8	7.5	9.8	10.5	3.9	5.3	5.0	8.7
July	7.5	7.8	9.8	11.2	-1.5	5.6	5.2	7.0
August	7.6	8.0	10.3	11.5	-0.8	5.5	5.3	6.7
September	8.0	8.2	11.4	12.0	6.1	5.5	5.3	6.9
October	8.3	8.4	11.5	12.1	5.3	5.7	5.4	7.6
November	9.1	8.9	12.6	12.8	11.1	5.9	5.6	8.7
December	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	15.0	14.7	20.7	18.4	40.7	11.2	11.4	12.3
February	16.7	16.8	23.3	20.8	43.5	13.0	13.5	12.8
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

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

Sources: Rosstat, Bank of Russia.

Table 3

Macroeconomic indicators
(annual percentage changes, unless otherwise indicated)

	GDP ¹	KII ²	Industrial production	Agriculture	Construction	Transport freight turnover	Retail trade turnover	Wholesale trade turnover	Household real disposable money income	Real wages	Unemployment rate (as a percentage of economically active population)
2013											
January		1.0	-0.4	1.6	5.6	-1.6	4.5	2.2	0.4	5.4	6.0
February		-1.4	-3.1	1.5	3.7	-2.5	3.1	-1.5	6.6	3.3	5.8
March	0.6	1.0	-0.1	1.2	4.6	-1.3	4.5	1.0	9.6	5.1	5.7
April		1.8	1.1	0.8	-1.6	0.3	4.3	4.5	9.0	8.5	5.6
May		0.5	-0.5	0.6	0.1	0.4	3.4	-0.5	0.2	4.7	5.2
June	1.1	1.3	1.7	1.2	-2.0	-0.5	3.8	-0.9	2.1	5.3	5.4
July		1.6	0.8	5.5	5.2	-0.3	4.5	-1.8	4.5	6.4	5.3
August		-0.2	-0.2	3.3	-4.0	0.6	4.2	-2.5	4.2	6.8	5.2
September	1.2	0.8	1.3	1.8	-4.7	1.9	3.2	1.2	0.8	6.3	5.3
October		2.7	1.0	21.9	0.7	6.2	3.3	0.5	5.5	5.4	5.5
November		2.8	2.8	10.3	1.6	0.7	4.1	2.8	2.2	4.1	5.4
December	2.1	0.9	0.4	1.4	-1.4	2.5	3.5	3.3	3.4	2.7	5.6
2014											
January		-0.4	-0.2	2.1	-6.1	3.3	2.8	-2.7	-0.5	5.2	5.6
February		1.3	2.1	2.3	-4.0	1.1	4.3	-0.3	-0.6	4.6	5.6
March	0.6	0.3	1.4	2.5	-3.4	0.4	4.5	-4.2	-6.7	3.8	5.4
April		0.9	2.4	3.3	-2.7	-0.6	3.0	-4.4	0.4	3.2	5.3
May		1.1	2.8	3.3	-6.0	1.4	2.4	-3.4	6.4	2.1	4.9
June	1.1	0.3	0.4	2.8	-0.1	2.9	1.1	-4.5	-3.5	2.1	4.9
July		0.7	1.5	8.3	-2.9	0.1	1.6	-3.5	2.9	1.4	4.9
August		-0.3	0.0	4.6	-1.1	-1.4	1.6	-4.0	4.4	-1.2	4.8
September	0.9	2.2	2.8	16.3	-1.8	-1.6	1.8	-4.3	0.4	1.5	4.9
October		-0.1	2.9	-11.9	-1.5	-3.1	1.7	-2.4	2.1	0.6	5.1
November		-0.6	-0.4	0.5	-2.5	-0.4	1.9	-4.6	-3.5	-1.2	5.2
December	0.2	2.3	3.9	4.0	-0.4	-3.0	5.1	-2.7	-7.6	-4.0	5.3
2015											
January		-1.5	0.9	2.8	-6.7	-3.9	-4.4	-6.9	-2.0	-8.4	5.5
February		-3.9	-1.6	3.2	-3.5	-1.4	-7.4	-11.1	-2.6	-7.4	5.8
March	-2.8	-2.0	-0.6	4.2	-4.9	0.6	-8.9	-11.4	-2.4	-10.6	5.9
April		-5.7	-4.5	3.3	-7.4	-1.2	-9.8	-13.6	-2.6	-9.6	5.8
May		-5.7	-5.5	2.7	-9.4	-3.9	-9.4	-14.9	-7.7	-7.4	5.6
June	-4.5	-5.4	-4.8	1.6	-8.1	-3.1	-9.6	-11.3	-4.2	-8.6	5.4
July		-4.9	-4.7	-2.0	-11.8	1.9	-9.5	-10.4	-4.1	-9.2	5.3
August		-4.5	-4.3	2.5	-11.1	0.6	-9.4	-8.4	-5.3	-9.0	5.3
September	-3.7	-3.3	-3.7	3.7	-8.6	1.0	-10.7	-7.7	-6.1	-10.4	5.2
October		-3.4	-3.6	7.6	-9.2	4.5	-11.3	-8.5	-6.8	-10.5	5.5
November		-4.3	-3.5	2.3	-3.9	3.4	-12.2	-10.8	-6.3	-10.4	5.8
December	-3.8	-4.2	-4.5	3.6	-1.5	3.7	-14.1	-6.4	-0.9	-8.4	5.8
2016											
January		-3.5	-2.7	2.5	-4.2	0.9	-6.4	-6.4	-5.7	-3.6	5.8
February		0.6	1.0	3.1	0.4	3.9	-4.7	5.2	-4.3	0.6	5.8
March	-1.2	-0.5	-0.5	2.7	-1.4	-0.2	-6.2	6.0	-1.3	1.5	6.0
April		-0.4	0.5	2.7	-5.9	0.7	-5.1	4.2	-7.0	-1.1	5.9
May		-0.3	0.7	2.6	-9.0	0.7	-6.4	4.9	-6.0	1.0	5.6
June	-0.6	-0.4	1.7	2.1	-9.7	1.9	-6.2	1.7	-4.5	1.1	5.4
July		-1.0	-0.3	4.7	-3.5	1.5	-5.2	-1.7	-7.0	-1.3	5.3
August		0.6	0.7	5.9	-2.0	3.0	-5.1	4.0	-8.2	2.7	5.2
September		-0.9	-0.8	1.7	-4.2	4.1	-3.6	-2.8	-2.8	2.8	5.2

¹ Quarterly data.² Output index of goods and services by key industries.

Source: Rosstat.

Table 4

Monetary indicators¹
(annual percentage changes)

	M2	M2X ²	Non-financial sector deposits in national currency		Non-financial sector deposits in foreign currency ³		Banking system net foreign assets ³	Credit to the economy ²	Household loans ²	Corporate loans ²
			Households	Organisations	Households	Organisations				
2013										
1.01.2013	11.9	13.0	19.0	6.4	21.3	18.0	5.5	20.2	39.2	14.6
1.02.2013	13.3	13.3	18.9	10.8	19.5	8.1	3.4	20.8	39.3	15.3
1.03.2013	14.2	13.7	19.6	12.4	14.3	7.2	0.9	20.9	38.4	15.6
1.04.2013	14.6	14.1	20.7	11.5	14.2	8.9	1.6	19.9	36.8	14.7
1.05.2013	15.2	15.3	21.6	11.8	16.0	14.5	1.2	18.9	35.9	13.6
1.06.2013	15.3	15.5	20.8	13.2	18.3	15.8	5.1	18.5	34.5	13.4
1.07.2013	15.5	16.4	20.7	14.5	17.3	24.8	3.2	18.4	33.5	13.5
1.08.2013	17.0	17.1	21.4	17.6	18.5	16.4	3.0	18.5	33.3	13.6
1.09.2013	17.1	17.0	21.0	18.1	15.8	16.5	2.1	17.8	31.9	13.1
1.10.2013	16.1	16.0	20.6	16.6	15.6	14.4	-0.8	17.9	30.4	13.5
1.11.2013	15.4	15.1	20.8	13.5	16.6	10.7	0.4	17.4	29.7	13.1
1.12.2013	16.3	15.6	19.6	16.6	13.7	9.9	-2.1	17.6	28.7	13.7
2014										
1.01.2014	14.6	14.4	18.2	14.2	9.6	16.3	-2.6	16.2	28.1	11.9
1.02.2014	12.7	13.9	15.2	11.5	10.9	26.4	-2.1	16.3	27.3	12.3
1.03.2014	12.1	13.7	13.2	12.7	13.5	27.1	-2.0	15.8	26.6	11.8
1.04.2014	8.5	10.8	8.6	9.5	11.6	31.5	-4.7	15.5	25.6	11.8
1.05.2014	8.3	9.9	7.5	10.7	8.7	25.2	-6.5	15.6	24.2	12.4
1.06.2014	7.7	10.1	7.6	8.6	9.1	33.5	-6.0	16.1	22.5	13.7
1.07.2014	6.7	8.6	6.6	8.4	10.4	24.7	-2.3	14.9	20.9	12.6
1.08.2014	6.2	7.5	6.7	5.7	5.8	20.5	-4.0	14.0	19.5	11.9
1.09.2014	6.6	7.2	7.1	5.8	2.1	16.8	-7.2	13.0	18.0	11.1
1.10.2014	7.0	6.9	6.6	6.6	-4.6	15.4	-10.7	12.5	17.4	10.5
1.11.2014	6.0	6.8	5.4	5.8	-3.8	21.7	-14.2	12.0	15.7	10.6
1.12.2014	5.0	6.0	3.7	6.4	-4.2	21.7	-17.5	11.8	14.6	10.7
2015										
1.01.2015	2.2	3.7	-3.0	8.9	-3.8	19.6	-19.2	13.7	12.0	14.3
1.02.2015	4.4	4.3	-0.3	12.9	-8.3	12.3	-21.2	12.4	10.4	13.3
1.03.2015	4.1	3.6	1.8	10.0	-9.5	10.3	-23.8	12.3	8.1	14.0
1.04.2015	6.2	4.8	5.4	11.8	-8.9	6.4	-21.3	9.6	5.2	11.4
1.05.2015	6.4	5.8	6.2	12.7	-3.9	7.6	-17.8	8.3	2.6	10.6
1.06.2015	6.8	4.8	6.7	13.5	-2.4	-3.2	-18.9	6.7	1.0	9.0
1.07.2015	6.8	5.7	6.9	12.3	-2.9	3.4	-18.1	6.4	-0.8	9.3
1.08.2015	7.0	6.8	7.6	12.1	-0.7	8.5	-17.2	6.4	-2.2	10.0
1.09.2015	7.6	8.3	6.8	16.0	2.2	13.3	-12.2	6.2	-3.4	10.1
1.10.2015	7.5	9.7	7.7	14.6	7.3	18.8	-8.4	5.5	-4.5	9.5
1.11.2015	8.6	9.2	9.0	15.3	5.4	12.3	-4.8	5.2	-5.5	9.4
1.12.2015	8.8	9.7	10.8	13.4	6.6	13.8	-0.5	5.1	-6.5	9.6
2016										
1.01.2016	11.5	11.8	19.4	8.9	8.2	13.2	1.3	3.4	-6.5	7.0
1.02.2016	10.8	10.5	18.2	5.4	7.9	10.5	5.4	4.5	-5.8	8.1
1.03.2016	10.7	10.5	17.0	5.2	5.7	11.1	8.4	4.0	-4.8	7.0
1.04.2016	12.0	11.5	16.5	8.2	5.4	11.9	9.7	5.5	-3.8	8.8
1.05.2016	11.9	10.8	15.8	7.8	1.9	10.6	8.2	5.3	-2.9	8.2
1.06.2016	12.2	11.4	16.4	7.7	-0.2	14.5	7.3	5.7	-2.4	8.6
1.07.2016	12.3	10.2	16.3	8.1	0.0	7.1	4.8	6.2	-1.4	8.8
1.08.2016	12.2	9.2	15.6	8.9	0.4	1.0	4.2	5.7	-1.3	8.1
1.09.2016	11.5	7.8	16.3	6.5	0.5	-2.2	4.5	5.6	-0.8	7.6
1.10.2016	12.0	6.8	15.8	8.5	1.2	-10.2	2.5	5.6	-0.3	7.5

¹ Calculated using data from the Banking System Survey (see Table 1.16 of the Bank of Russia Statistical Bulletin and 'Statistics' section on the Bank of Russia website).

² Excluding foreign currency revaluation.

³ Calculations based on data in billions of US dollars.

Source: Bank of Russia.

Table 5

Monetary indicators¹
(billions of rubles, unless otherwise indicated)

	M2	M2X	Non-financial sector deposits in national currency		Non-financial sector deposits in foreign currency, USD billion		Banking system net foreign assets, billions of US dollars	Credit to the economy	Household loans	Corporate loans
			Households	Organisations	Households	Organisations				
2013										
1.01.2013	27,405	32,226	11,725	9,250	79.4	79.4	570.1	31,781	8,413	23,368
1.02.2013	26,749	31,657	11,520	9,150	80.5	83.0	576.0	31,917	8,471	23,447
1.03.2013	27,174	32,195	11,790	9,243	80.1	83.8	574.6	32,285	8,603	23,682
1.04.2013	27,466	32,627	12,025	9,259	81.9	84.1	575.7	32,807	8,807	24,000
1.05.2013	27,841	33,167	12,412	9,076	83.4	87.0	585.3	33,403	9,076	24,327
1.06.2013	28,083	33,414	12,415	9,320	83.0	85.7	584.1	33,835	9,312	24,523
1.07.2013	28,506	34,133	12,711	9,325	83.1	88.9	571.6	34,477	9,549	24,927
1.08.2013	28,734	34,376	12,780	9,475	85.0	86.5	567.6	35,120	9,803	25,317
1.09.2013	28,779	34,561	12,862	9,407	86.0	87.9	559.3	35,736	10,047	25,689
1.10.2013	28,629	34,467	12,869	9,346	88.2	92.3	568.6	36,169	10,188	25,981
1.11.2013	28,546	34,398	12,951	9,176	89.6	92.9	570.6	36,666	10,417	26,249
1.12.2013	29,167	35,098	13,093	9,510	88.2	90.5	561.0	37,317	10,592	26,725
2014										
1.01.2014	31,405	37,272	13,855	10,565	87.0	92.3	555.5	37,241	10,795	26,446
1.02.2014	30,136	36,979	13,273	10,200	89.3	104.9	563.6	37,818	10,821	26,997
1.03.2014	30,459	37,579	13,341	10,419	91.0	106.5	563.1	38,108	10,937	27,171
1.04.2014	29,800	37,010	13,056	10,136	91.4	110.6	548.5	38,524	11,097	27,427
1.05.2014	30,160	37,285	13,339	10,044	90.7	108.9	547.5	39,250	11,304	27,946
1.06.2014	30,246	37,366	13,359	10,123	90.6	114.4	549.4	39,740	11,426	28,314
1.07.2014	30,426	37,240	13,552	10,111	91.8	110.8	558.6	39,747	11,550	28,197
1.08.2014	30,525	37,463	13,640	10,013	89.9	104.3	544.6	40,445	11,733	28,711
1.09.2014	30,689	37,723	13,774	9,950	87.8	102.7	519.2	40,909	11,878	29,031
1.10.2014	30,645	38,154	13,723	9,962	84.1	106.5	507.8	41,692	12,011	29,681
1.11.2014	30,268	38,912	13,653	9,708	86.2	113.0	489.5	42,714	12,126	30,588
1.12.2014	30,626	40,223	13,583	10,123	84.5	110.0	463.1	44,007	12,246	31,761
2015										
1.01.2015	32,111	43,032	13,435	11,504	83.7	110.4	448.8	45,740	12,245	33,495
1.02.2015	31,449	45,212	13,230	11,519	81.9	117.8	444.0	47,373	12,162	35,211
1.03.2015	31,716	43,959	13,585	11,459	82.3	117.5	429.1	46,513	11,977	34,536
1.04.2015	31,637	43,389	13,760	11,336	83.3	117.7	431.5	45,651	11,818	33,832
1.05.2015	32,103	42,668	14,160	11,324	87.2	117.2	450.1	44,953	11,691	33,262
1.06.2015	32,310	42,859	14,248	11,485	88.4	110.7	445.4	45,219	11,644	33,575
1.07.2015	32,493	43,802	14,484	11,350	89.1	114.5	457.4	45,599	11,589	34,010
1.08.2015	32,666	44,607	14,677	11,229	89.3	113.1	450.9	46,567	11,603	34,965
1.09.2015	33,031	46,729	14,707	11,538	89.7	116.4	455.8	47,944	11,641	36,304
1.10.2015	32,951	47,310	14,786	11,420	90.2	126.6	465.2	48,032	11,615	36,417
1.11.2015	32,860	46,874	14,880	11,193	90.8	126.9	466.2	48,080	11,567	36,512
1.12.2015	33,315	47,582	15,048	11,481	90.1	125.2	460.6	48,788	11,536	37,252
2016										
1.01.2016	35,809	51,523	16,046	12,524	90.6	125.0	454.8	49,813	11,536	38,277
1.02.2016	34,840	51,263	15,642	12,142	88.4	130.1	468.0	50,460	11,484	38,976
1.03.2016	35,105	51,444	15,899	12,057	87.0	130.6	465.0	50,467	11,461	39,006
1.04.2016	35,440	50,286	16,037	12,260	87.8	131.7	473.4	49,587	11,410	38,177
1.05.2016	35,909	49,964	16,402	12,205	88.9	129.6	487.2	49,288	11,406	37,882
1.06.2016	36,252	50,457	16,586	12,370	88.3	126.7	477.8	49,855	11,422	38,433
1.07.2016	36,487	50,097	16,850	12,265	89.2	122.7	479.4	49,782	11,463	38,319
1.08.2016	36,654	50,329	16,963	12,229	89.7	114.3	469.8	50,475	11,489	38,986
1.09.2016	36,821	50,059	17,097	12,286	90.1	113.8	476.4	50,383	11,540	38,842
1.10.2016	36,918	49,858	17,120	12,386	91.3	113.6	477.0	50,264	11,570	38,694

¹ Calculated using data from the Banking System Survey (see Table 1.16 of the Bank of Russia Statistical Bulletin and 'Statistics' section on the Bank of Russia website).

Source: Bank of Russia.

Table 6

Required reserve ratios (%)

Liability type	Periods			
	From 1.01.15 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			4.25	5.00
Other liabilities in rubles			4.25	5.00
To households in foreign currency		5.25	5.25	6.00
To non-resident legal entities in foreign currency			6.25	7.00
Other liabilities in foreign currency				

Source: Bank of Russia.

Table 7

Interest rates on Bank of Russia operations to provide and absorb ruble liquidity (% p.a.)

Purpose	Type of instrument	Instrument	Term	Frequency	As of 1.01.15	From 2.02.15	From 16.03.15	From 5.05.15	From 16.06.15	From 3.08.15	From 14.06.16	From 19.09.16	
Liquidity provision	Standing facilities	Overnight loans; lombard loans; loans secured by gold, non-marketable assets or guarantees; FX swaps (ruble leg); repos	1 day	daily	18.00	16.00	15.00	13.50	12.50	12.00	11.50	11.00	
		Loans secured by gold	from 2 to 549 days ¹	daily	18.50	16.50	15.50	14.00	13.00	12.50	12.00	11.50	
	Open market operations (minimum interest rates)	Loans secured by non-marketable assets or guarantees	3 months ¹	monthly	18.75	16.75	15.75	14.25	13.25	12.75	12.25	11.75	
		Auctions to provide loans secured by non-marketable assets	from 1 to 3 weeks ² 18 months ^{1,2} 36 months ^{1,2}	occasionally	17.25	15.25	14.25	12.75	11.75	11.25	10.75	10.25	
Liquidity absorption	Open market operations (maximum interest rates)	Lombard loan auctions	1 week	weekly ³	17.00 (key rate)	15.00 (key rate)	14.00 (key rate)	12.50 (key rate)	11.50 (key rate)	11.00 (key rate)	10.50 (key rate)	10.00 (key rate)	
		Repo auctions	from 1 to 6 days ⁴	occasionally	17.00 (key rate)	15.00 (key rate)	14.00 (key rate)	12.50 (key rate)	11.50 (key rate)	11.00 (key rate)	10.50 (key rate)	10.00 (key rate)	
	Standing facilities	FX swap auctions	from 1 to 2 days ⁴	occasionally	17.00 (key rate)	15.00 (key rate)	14.00 (key rate)	12.50 (key rate)	11.50 (key rate)	11.00 (key rate)	10.50 (key rate)	10.00 (key rate)	
		Deposit auctions	from 1 to 6 days ⁴	weekly ³	16.00	14.00	13.00	11.50	10.50	10.00	9.50	9.00	
		Deposit operations	1 day, call	daily	16.00	14.00	13.00	11.50	10.50	10.00	9.50	9.00	

¹ Loans provided at a floating interest rate linked to the Bank of Russia key rate.

² Operations have been suspended since 1 July 2016.

³ Depending on the situation with liquidity, the Bank of Russia holds either a repo or a deposit auction.

⁴ Fine-tuning operations.

Memo item: in 2015, the Bank of Russia refinancing rate was 8.25% p.a. From 1 January 2016, the value of the Bank of Russia refinancing rate equals its key rate as of the respective date. From 1 January 2016, no individual values are set for the refinancing rate.

Source: Bank of Russia.

Table 8

**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 1.01.15	As of 1.01.16	As of 1.07.16	As of 1.10.16	As of 1.11.16	
Liquidity provision	Standing facilities	Overnight loans	1 day	daily	0.0	0.0	1.5	0.0	0.0	
		Lombard loans			3.7	2.9	1.2	0.8	1.3	
		FX swaps			121.6	14.9	0.0	49.8	0.0	
		Repos			96.2	264.9	273.7	408.7	291.3	
		Loans secured by gold	1.2		0.5	0.0	0.0	0.0		
			Loans secured by non-marketable assets or guarantees	from 1 to 549 days		2,055.9	234.8	242.1	331.7	303.3
	Open market operations	Auctions to provide loans secured by non-marketable assets	3 months	monthly	occasionally	2,370.9	1,553.8	219.6	216.2	215.7
			from 1 to 3 weeks ¹ , 18 months ¹							
			1 week	weekly ²	occasionally ³	2,727.6	1,448.5	370.7	0.0	0.0
			from 1 to 6 days							
FX swap auctions	from 1 to 2 days		-	0.0	0.0	0.0	0.0			
Liquidity absorption	Open market operations	Deposit auctions	from 1 to 6 days 1 week	weekly ²	0.0	0.0	0.0	180.0	201.8	
	Standing facilities	Deposit operations	1 day, call	daily	804.5	557.8	436.8	374.7	280.6	

¹ Operations have been suspended since 1 July 2016.

² Either a repo or a deposit auction is held depending on the situation with liquidity.

³ Fine-tuning operations.

Source: Bank of Russia.

Table 9

Bank of Russia specialised refinancing facilities

Purpose of indirect bank lending	Maturity	Collateral	Interest rate, % p.a.			Bank of Russia claims on credit institutions, billions of rubles						Limit, billions of rubles					
			As of 1.01.15	As of 1.01.16	From 14.06.16	From 19.09.16	As of 1.01.15	As of 1.01.16	As of 1.07.16	As of 1.10.16	As of 1.11.16	As of 1.01.15	As of 1.01.16	As of 1.07.16	As of 1.10.16	As of 1.11.16	
Non-commodity exports	Up to 3 years	Credit claims under loan agreements secured by the insurance contracts of JSC EXIAR	9.00	9.00	9.00	9.00	9.00	39.7	51.0	49.6	44.7	50	50	75	75	75	
Large-scale investment projects ¹	Up to 3 years	Credit claims under bank loans issued for the implementation of investment projects, whose performance is secured by the Russian Federation state guarantees	9.00	9.00	9.00	9.00	9.00	53.4	91.0	101.1	104.1	100	100	150	150	150	
		Bonds placed to finance investment projects and included in the Bank of Russia Lombard List	9.00	9.00	9.00	9.00	2.9	0.9	0.8	0.8							
Small and medium-sized enterprises	Up to 3 years	Claims under loan agreements of JSC SME Bank ²						23.3	40.1	44.0	36.2	50					
		Guarantees of JSC Russian Small and Medium Business Corporation issued under the Programme for Encouraging Lending to Small and Medium-sized Enterprises	6.50	6.50	6.50	6.50	-	0.1	8.5	25.0	32.3	-	50	75	125	125	
Leasing	Up to 3 years	Claims on loans to leasing companies	-	9.00	9.00	9.00	-	0.0	0.0	0.0	0.0	-	10	10	10	10	
Military mortgage	Up to 3 years	Mortgages issued under the Military Mortgage programme	10.75	10.75	10.50	10.00	0.0	21.0	29.3	29.3	29.3	30	30	30	30	30	
Total							26.1	157.1	223.9	249.8	247.4	230.0	240	340	390	390	

¹ The projects shall be selected in line with the rules set out by RF Government Resolution 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 RF Government Resolution No. 1044, dated 11 October 2014, 'On Approving the Programme to Support Investment Projects Implemented in the Russian Federation on the Basis of Project Financing'.

² 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 10

Bank of Russia operations to provide foreign currency

Instrument	Term	Frequency	Minimum auction rate as spread to LIBOR ¹ , pp; fixed interest rate for FX swaps ² , % p.a.					Bank of Russia claims, millions of US dollars				
			As of 1.01.15	From 30.03.15	From 13.04.15	From 21.04.15	From 14.12.15	As of 1.01.15	As of 1.01.16	As of 1.07.16	As of 1.10.16	As of 1.11.16
Repo auctions ³	1 week	weekly	0.50	1.00	1.50	2.00	2.00	209.8	100.1	0.0	0.0	0.0
	28 days		14,900.8	5,016.7	12,955.2	9,728.7	9,032.1					
	12 months ⁴		0.50	1.00	1.75	2.50	3.00	4,737.3	15,550.0	168.5	159.2	154.0
Loan auctions	28 days	monthly	0.75	1.25	1.75	2.25	2.25	-	-	0.0	0.0	0.0
	365 days		0.75	1.25	2.00	2.75	3.25	-	1,494.7	0.0	0.0	0.0
USD/RUB sell/buy FX swaps	1 day	daily	1.50	1.50	1.50	1.50	1.50	1,600.0	0.0	420.5	1,000.0	0.0

¹ In respective currencies and for respective terms.

² For dollar leg; the rate for ruble leg is equal to the Bank of Russia key rate less 1 pp.

³ Claims on credit institutions under the second leg of repos.

⁴ From 1 June through 14 December 2015 and from 1 April 2016, 12-month FX repo auctions were suspended.

Source: Bank of Russia.

GLOSSARY

Autonomous factors of banking sector liquidity

Banking sector liquidity factors not connected with Bank of Russia operations to manage liquidity and steer overnight money market rate. These include changes in the amount of cash in circulation, changes in balances of general government accounts with the Bank of Russia, required reserves regulation, and Bank of Russia operations in the domestic FX market.

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 correspondent accounts with the Bank of Russia during a specified period.

Balance of payments of the Russian Federation

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

Banking sector liquidity

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

Bank of Russia key rate

The main monetary policy rate set by the Bank of Russia Board of Directors. The key rate changes influence lending and economic activities and allow for finally achieving the primary objective the monetary policy. It corresponds to 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.

Bank of Russia Lombard List

A list of securities eligible as collateral for Bank of Russia loans and repo operations.

Broad money (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.

Budget rule

A formal mechanism determining the procedure for medium-term budget planning, primarily with regard to expenditures, taking account of certain external and/or internal conditions for economic development assumed in the planning horizon.

Cash in circulation

Includes banknotes and coins being in circulation and usually used to make settlements and payments. Monetary base comprises all cash outside of the Bank of Russia. Money supply comprises all cash outside of the Bank of Russia, except for cash held in credit institutions' tills.

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).

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 sell it should threats to financial stability arise.

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.

Inflation

A sustained increase in the general price level of goods and services in an economy. Price movements in the economy are communicated by various price indicators, e.g. producer price indices, gross domestic product deflator, and consumer price index. Inflation is generally associated with the consumer price index (CPI), used to measure prices for a set of food products, nonfood goods and services (i.e. the cost of a consumer basket) consumed by an average household over time. The reason why the CPI has been selected as a key inflation indicator is explained by its important ability to serve as the indicator of households' cost-of-living dynamics. Additionally, the CPI possesses a number of properties facilitating its wide-spread application (simple and clear construction methods, calculation on a monthly basis, and publication in a timely manner).

Inflation targeting strategy

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

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 (refinancing facilities and deposit facilities) symmetric to the key rate.

International reserves of the Russian Federation

Highly liquid foreign assets held by the Bank of Russia and the Government of the Russian Federation.

Mandatory reserve requirements

A key instrument of the Bank of Russia's monetary policy. These are Bank of Russia requirements for credit institutions to maintain a certain amount of funds in accounts with the Bank of Russia. Mandatory reserve requirements comprise required reserve ratios and the required reserve averaging ratio.

Market asset utilisation ratio

The share of market assets used as collateral in operations with the Bank of Russia in total market assets, which may serve as collateral for Bank of Russia operations.

Monetary base

Total amount of certain cash components and credit institutions' funds in Bank of Russia accounts and bonds denominated in the currency of the Russian Federation. Monetary base in the narrow definition includes cash in circulation (outside of the Bank of Russia) and credit institutions' funds in accounts to record required reserves on funds raised by credit institutions in the currency of the Russian Federation. Broad monetary base includes cash in circulation (outside of the Bank of Russia) and the total funds of credit institutions in Bank of Russia accounts and bonds.

Monetary policy operational target

The target the Bank of Russia seeks to achieve in cooperation with credit institutions while pursuing its monetary policy. The Bank of Russia's monetary policy operational target is defined as an approximation of overnight money market rates to the Bank of Russia key rate.

Monetary policy transmission mechanism

The process of transferring the impulse of monetary policy decisions to the economy as a whole and to price dynamics, in particular. The process of transmitting the central bank's signal on holding or changing the key rate and its future path from the financial market segments to the real sector and as a result to inflation. The key rate changes are translated into the economy through the following major channels: interest rate, credit, foreign currency, and asset price channels.

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, for example, cash in circulation, money supply in the national definition, and broad money.

Money supply in the national definition (M2)

Includes 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 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-marketable asset utilisation ratio

The share of non-marketable assets of credit institutions used as collateral for Bank of Russia loans in total non-marketable assets eligible as collateral for Bank of Russia loans.

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

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

Non-price bank lending conditions

Bank lending conditions, which include loan maturity and amount, requirements for collateral and the financial standing of the borrower, additional fees, and the range of lending purposes. They are assessed on the basis of surveys of credit institutions by the Bank of Russia.

Open market operations

Bank of Russia operations to regulate banking sector liquidity. They include operations on a reverse basis other than standing facilities, which are carried out with the Bank of Russia making a specific offer (usually auction-based), as well as all operations to purchase/sell securities, foreign currency, and gold.

Operations to absorb excess liquidity

Bank of Russia operations to mop up (absorb) excess liquidity on a reverse basis. These are operations either to raise deposits or place Bank of Russia bonds.

Price elasticity of demand/supply

The degree of change in demand for or supply of a product, for example, depending on the change in its price.

Refinancing operations

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

Required reserve averaging period

The period set by the Bank of Russia, in the course of which credit institutions exercising the right to averaging should maintain the required amount of funds in correspondent accounts with the Bank of Russia. The calendar for the required reserve averaging periods is established by the Bank of Russia Board of Directors.

Required reserve averaging ratio

The ratio ranging from 0 to 1 is applied to the standard value of required reserves to calculate the average value of required reserves.

Required reserve ratios

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

Required reserve regulation

Changes in the amount of required reserves deposited by credit institutions in accounts to record required reserves with the Bank of Russia.

Required reserves

Funds maintained by credit institutions in accounts with the Bank of Russia to comply with mandatory reserve requirements. Credit institutions should maintain funds in accounts to record required reserves and/or correspondent accounts with the Bank of Russia.

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 the real exchange rate 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.

Standing facilities

Bank of Russia operations carried out daily to satisfy credit institutions' bids in full. The rates on overnight standing facilities shape the bounds of the interest rate corridor.

Structural liquidity deficit

The state of the banking sector characterised by a stable demand by credit institutions for Bank of Russia liquidity provision operations. The level of structural liquidity deficit is a positive difference between Bank of Russia claims to credit institutions on refinancing operations and Bank of Russia liabilities to them on operations to absorb excess liquidity.

Structural liquidity surplus

The state of the banking sector, under which the Bank of Russia has to regularly conduct excess liquidity-absorbing operations to achieve its operational target. The level of structural liquidity surplus is a positive difference between Bank of Russia liabilities to credit institutions on operations to absorb excess liquidity and Bank of Russia claims to them on refinancing operations.

ABBREVIATIONS

BPM – the IMF’s Balance of Payments and International Investment Position Manual

EAP – economically active population

Fed – US Federal Reserve System

GDP — gross domestic product

KII – key industry index

LIBOR – London Interbank Offered Rate

MIACR – Moscow Interbank Actual Credit Rate

OBR – Bank of Russia bonds

OFZ – federal government bonds

RGBEY – Russian Government Bonds Effective Yield until Redemption

SME — small and medium-sized enterprises