Bank of Russia

The Central Bank of the Russian Federation

GUIDELINES

for the Single State Monetary Policy in 2016 and for 2017 and 2018

Moscow

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INTRODUCTION

The main function of the Bank of Russia, as determined by the Russian Federation Constitution, is to protect the ruble and ensure its stability. The national currency's sustainability is achieved through maintaining price stability, which is the primary objective of the monetary policy as set forth in the Federal Law 'On the Central Bank of the Russian Federation (Bank of Russia)'. Price stability implies sustainably low inflation which, along with a clear and efficient state economic policy, is one of the key conditions of accumulating long-term ruble savings and higher fixed capital investment. The Bank of Russia is set to reduce inflation to 4% in 2017 and keep it close to this level in the years to come. Consumer price growth will decline progressively depending on the state of the Russian economy and inflation factors. Monetary policy decisions will be based on the trade-off between inflation risks and risks for the economic growth. Meanwhile, ensuring financial stability will remain one of the Bank of Russia's priorities.

The Bank of Russia adhered to this stance in 2015 after the adoption of the Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017. It was a challenging period, in many ways a watershed for both the Russian and global economy. Developments of December 2014 proved to be more negative than had been assumed in the Bank of Russia's stress scenario in the previous Guidelines for the Single State Monetary Policy. The almost twofold oil price slump below $50 per barrel given the insufficient diversification of Russian exports, the necessity to pay off considerable external debt amounts amid financial sanctions resulted in ruble depreciation, its elevated volatility and increased inflation and depreciation expectations. The situation called for actions to prevent the inflation, which had reached two-digit levels, from surging. The Bank of Russia raised the key rate to 17.00% p.a. in December 2014 and took measures to maintain financial stability. This, and growth in the sales of FX earnings by the largest Russian exporters, allowed it to stabilise expectations, reduce inflation risks and turn the situation in the banking sector and the financial market back to normal.

In 2015, the risk trade-off has shifted towards more considerable economy cooling. Unfavourable foreign economic situation, higher uncertainty, and deteriorated household and business sentiment along with tougher monetary conditions resulted in a considerable drop in both consumption and investment. At the same time, reduced domestic demand triggered the forecast inflation slowdown in spring as prices adjusted to the ruble depreciation and food embargo. Therefore, in 2015, the Bank of Russia Board of Directors has cut the key rate, which stood at 11.00% p.a. at the beginning of November.

In order to maintain financial stability in 2015 the Bank of Russia continued to apply FX refinancing instruments flexibly adjusting their parameters in response to FX market developments. This was the channel through which roughly $36 billion were provided in late 2014 – early 2015 to the banking sector and, consequently, to the real sector.

In May 2015, as the foreign economic situation improved and exchange rate stabilised, the Bank of Russia decided to launch operations to buy foreign currency to replenish the international reserves. Sizeable international reserves are required in the medium term to ensure financial stability in case of long-lasting negative external shocks. The Bank of Russia intends to gradual-

ly increase the international reserves to $500 billion, provided that the FX market conditions are favourable.

Currently, the high uncertainty over further developments in the Russian economy and financial markets in the next three years persists. This is caused by external factors, primarily changes in the oil market structure and an uncertain outlook for economic growth in China and the monetary policy of reserve currency issuers. The economic developments in Russia will also depend on the national economy's ability to adapt to possible external shocks.

The Bank of Russia has worked out three scenarios for 2016-2018 based on oil prices. The baseline scenario assumes that the oil price will remain at $50 per barrel in the next three years. The more optimistic scenario suggests that the oil price will gradually recover to $70-80 per barrel in 2018. Under the stress scenario also considered by the Bank of Russia, the oil price does not exceed $40 per barrel during the next three years.

The above scenarios differ considerably by GDP, inflation and other economic indicators. Under the baseline scenario, output recovery will begin only in 2017 due to a considerable decline in export earnings as compared with previous years. The annual inflation will fall noticeably in 2016 and will be close to the medium-term 4% target in 2017-2018. As inflation slows down in line with the forecast, the Bank of Russia will gradually reduce its key rate.

According to the optimistic scenario, as more favourable foreign economic conditions materialise, the GDP growth will turn positive already in 2016. Inflation will lower to the target faster than in the baseline scenario under a more relaxed monetary policy stance.

Finally, a slump in the oil price provided for in the stress scenario will become a new shock for the Russian economy and will result in a deeper and longer output drop. Inflation will fall slower calling for the need to pursue tougher monetary policy than assumed in the baseline scenario.

All the scenarios envisage the Bank of Russia to continue operations to provide foreign currency to credit institutions on a repayable basis in the amount required to ensure the smooth repayment of external debt. The FX liquidity volumes can be either increased or curtailed depending on the scenario. The Bank of Russia will come up with FX interventions to stem external shocks threatening financial stability.

Against the backdrop of high uncertainty the Bank of Russia is prepared for any possible developments. Having all the required instruments, the central bank will make flexible and efficient decisions with a view to reduce inflation avoiding excessive economy cooling and maintaining financial stability. However, the Bank of Russia's actions are not enough for the Russian economy to promptly adapt to the new external conditions. Close coordination with the Government of the Russian Federation is required to implement economic policy measures, including those related to indexation of tariffs, wages and pensions, and to harmonise possible anti-recession measures. To ensure that the current structural challenges are addressed promptly, active steps are required to improve investment climate, increase labour market flexibility, improve the quality of public institutions, diversify economy and develop import substitution. Higher economic growth and, ultimately, a better wellbeing of Russian citizens may be achieved by joint efforts only.

1. MONETARY POLICY GOALS AND PRINCIPLES

1.1. Main goals and principles of the monetary policy

Protecting and ensuring the stability of the ruble is the Bank of Russia's main function in accordance with Article 75 of the Constitution of the Russian Federation and the main goal of its monetary policy in accordance with Article 34.1 of Federal Law No. 86 FZ, dated 10 July 2002, 'On the Central Bank of the Russian Federation (Bank of Russia)' (the Bank of Russia Law). However, this goal has a wider scope in the Bank of Russia Law that states in particular that protecting and ensuring the stability of the ruble shall be achieved by maintaining price stability, in part to establish conditions for balanced and sustainable economic growth. Thus, ensuring the stability of the national currency does not mean fixing its exchange rate against other currencies at a specific level, but rather achieving stability by maintaining the purchasing power of the ruble, i.e. by ensuring price stability.

Ensuring price stability means achieving and maintaining sustainably low inflation. By forming a more predictable environment for long-term planning and economic decision-making and by assuring stable household incomes, price stability helps increase confidence in the national currency and creates conditions for investment growth and structural changes in the economy. Accordingly, sustainably low inflation helps raise the well-being of Russian citizens, and therefore helps achieve the ultimate goal of the government's economic policy.

The inflation target is defined for the consumer price index, measured for each month to the corresponding month of the previous year. As current monetary policy measures impact future price growth over up to two-year horizon, the specific inflation target level is determined for the medium term, i.e. for the next two or three years. This level is set by the Bank of Russia in conjunction with the Government of the Russian Federation. On the one hand, price stability requires the inflation target level to be low. On the other hand, the inflation target level should not be too low to avoid deflation, which leads to a downturn in economic growth, prompting households to postpone spending and businesses to cut back on production. In Russia, a significant part of the consumer basket is made up of food, prices for which are traditionally highly volatile, and goods and services, prices for which largely depend on administrative decisions and fluctuations in the ruble exchange rate. Taking this into account, and bearing in mind the experience of other emerging markets, the inflation target is set at 4%. The Bank of Russia plans to reduce consumer price growth to 4% in 2017 and to keep it close to this level thereafter.

In order to achieve the inflation target, the Bank of Russia primarily impacts the price of money in the economy – interest rates. It exerts this influence through the key rate, which is set by the Bank of Russia Board of Directors on a regular basis. The Bank of Russia takes decisions on the monetary policy independently of other government authorities, as set out in the Bank of Russia Law.

The floating exchange rate is an important prerequisite of the efficient monetary policy pass-through effect on the economy through interest rates. Serving as an embedded stabiliser, the floating exchange rate helps economy adapt to changes in external conditions. The Bank of Russia pursues the floating exchange rate regime through FX interventions aimed at maintaining the exchange rate, by not

preventing the emergence of ruble exchange rate movements driven by macroeconomic fundamentals. The ruble exchange rate is shaped by the balance between the demand for foreign currency and its supply in the domestic FX market.

The mechanism whereby the key rate influences inflation (or the monetary policy transmission mechanism) is a process of gradual dissemination of the Bank of Russia signal on keeping or changing the key rate and its future path from segments of the financial market to the real sector of the economy and ultimately to inflation. A change in the key rate is transferred into the economy through various channels: interest, credit, foreign exchange and asset price channels.

In the first stage of the monetary policy transmission mechanism functioning, the signal from the key rate is transferred to the rates in the overnight segment of the money market where 1 day credit and deposit transactions are made. An operational target of monetary policy is to keep rates in this segment close to the key rate. To achieve this, the Bank of Russia applies an operational framework (see Sub-section 1.2).

A change in rates in the short-term segment of the money market is followed by a change in rates in the bond market: this takes place relatively quickly in the medium-term segment, but slower in the long-term segment. With a slight lag (depending on the situation in the financial sector), this impulse is passed on to the rates of bank loans and deposits for households and non-financial organisations. As a rule, in periods when money market rates are falling, banks start to reduce their deposit interest rates faster than loan interest rates, and in contrast, in periods where rates are increasing, loan interest rates increase first. For economic agents this means a change in conditions for making decisions on consumption, savings, investment and production, which in turn impacts the price dynamics. All things being equal, a downturn in interest rates stimulates lending, helps increase consumption, and leads to investment growth, but inflationary pressure can also increase. By contrast, high interest rates contribute to growth in savings and constrain lending and investment activity, but reduce inflationary pressure.

Changes in the key rate also affect other financial indicators – exchange rates, financial asset prices (equity prices), and real estate prices. Higher key rate therefore makes investment in the national currency more attractive and strengthens the ruble. However, it also leads to an increase in the cost of borrowing and contains activity in the financial and housing markets.

Interest rates on long-term contracts always imply inflation expectations. The Bank of Russia proceeds from the fact that as the inflation and inflation expectations decline, long term rates on loans will go down boosting the economic growth. Amid low inflation expectations long-term rates will persistently develop at the low level. It is an important advantage of the inflation targeting, under which the Bank of Russia implements the monetary policy.

A change in the key rate impacts the economy not immediately but over time (over an up to two-year horizon) taking into account the described chain of interrelations. The effects of monetary policy measures mostly emerge in 12 to 18 months. Therefore, decisions on the key rate are based on medium-term macroeconomic forecasts (see Sub-section 3.1), which take into account such indicators as consumption, investments, exports, imports, output, inflation and others. The forecasts are developed on the basis of model calculations and expert estimates. In addition, the Bank of Russia discusses the economic situation and forecasts with other government authorities involved in economic policy, ensuring agreement on the macroeconomic forecasts.

In its decision-making on the level of the key rate, the Bank of Russia examines possible scenarios for economic developments and chooses the optimal path for inflation to reduce

to the target level that will evolve with certain changes in the key rate. In this regard, the Bank of Russia takes into account the capabilities of the Russian economy and the impact of the decision adopted on financial stability. The Bank of Russia does not react to the current acceleration or slowdown in inflation if the impact of the triggering factors is exhausted in the medium term and inflation reaches its target level without the need for additional measures. A forecast sustainable and prolonged deviation of consumer price growth from the target in the medium term serves as grounds for a change in the key rate. This approach in decision-making allows to avoid any undesirable volatility in economic indicators.

The Bank of Russia improves the quality of its economic analysis and forecasting, continues to refine its modelling tools and internal decision-making procedures, and uses the best practices of other central banks and international organisations. The Bank of Russia discusses the applied forecasting approaches and methods with the expert community and regularly publishes its forecasts and assessments, thereby improving understanding of decisions adopted.

The Bank of Russia sees the information channel as another important channel of the monetary policy transmission mechanism. In their decision-making, economic agents tend to rely on their expectations regarding a further change in prices and the dynamics of short-term interest rates and other economic indicators. Thus, the expectations of economic agents have a significant impact on the economy as a whole and inflation in particular. Therefore, when implementing its monetary policy the Bank of Russia strives to establish a predictable economic environment not only by setting clear guidelines and maintaining price stability, but also by following the principle of information transparency. Regular disclosure of information on the goals, substance and results of measures adopted and explanations of the nature of inflation processes in Russia and opportunities to influence them to the public increase the transparency of policies and help increase the efficiency of monetary policy implementation.

In implementing its monetary policy, the Bank of Russia follows an inflation targeting strategy characterised by the following principles: the primary goal of the monetary policy is price stability, the target inflation level is clearly specified and announced, under the floating exchange rate the monetary policy influences the economy primarily through interest rates, monetary policy decisions are based on an analysis of a wide range of macroeconomic indicators and their forecasts, and besides the Bank of Russia strives to set clear guidelines for households and businesses, including by increasing information transparency.

1.2. Monetary policy operational framework

The operational target of monetary policy is to keep overnight money market rates close to the key rate. To transfer the signal through the key rate to the economy it is not enough for the Bank of Russia to simply announce the key rate; it needs to ensure that actual rates on low-risk loans are set at the level close to the key rate. Banks grant these virtually risk-free loans to one another in large volumes on a daily basis in the overnight segment of the interbank money market. In its turn, the Bank of Russia can influence rates in this market segment by carrying out operations with credit institutions.

The operational target of monetary policy is achieved through the use of the system of instruments. The Bank of Russia employs the following instruments: reserve requirements, open market operations and standing facilities. Each instrument solves its own specific problem, but they are all incorporated in the system and united by their focus on a single goal.

Credit institutions' demand for liquidity, i.e. for cash in correspondent accounts opened by

credit institutions with the Bank of Russia, is determined by their own payments and settlements and those of their customers, as well as the need to meet reserve requirements. The central bank establishes required reserve ratios based on banking sector liquidity management goals. The Bank of Russia fully satisfies credit institutions' demand for liquidity, taking into account the forecast change in cash balances in correspondent accounts caused by factors not resulting from central bank liquidity management operations, influencing in particular cash circulation or budgetary fund movements. The required reserve averaging mechanism, according to which credit institutions are required to keep certain cash balance in their accounts not every day, but only on average over a particular period, makes the liquidity management process more flexible. The Bank of Russia does not have to hold auctions daily, and credit institutions do not have to borrow in the market every time the actual balance in a correspondent account falls below the required level.

To manage banking sector liquidity, the Bank of Russia uses open market operations with preannounced allotment amounts determined on the basis of liquidity forecast. Amid structural liquidity deficit, the central bank provides liquidity to credit institutions through reverse transactions (repo and loan auctions). The use of these operations compared with outright purchase of securities means that credit institutions regularly turn to the central bank for funds and provides the possibility to influence rates in the overnight segment of the money market. The Bank of Russia uses regular one-week auctions to provide liquidity as its main operations. This term is considered to be optimal as the Bank of Russia is still able to influence the rate in the overnight segment of the money market and timely respond to changes in liquidity level caused by liquidity factors. This means that credit institutions have an incentive to manage their own liquidity and redistribute funds in the interbank market. The Bank of Russia can also employ fine-tuning auctions with maturities from 1 to 6 days in cases of a significant shift in the level of banking sector liquidity on certain days. In the event of significant structural deficit, the Bank of Russia reduces the burden on its main refinancing operations through liquidity provision against non-marketable assets.

The minimum rates at auctions to provide liquidity and the maximum rates at auctions to absorb liquidity for standard maturities and shorter maturities are set equal to the key rate. If funds are obtained through auctions with longer maturities, a floating interest rate linked to the Bank of Russia key rate is used, i.e. interest on Bank of Russia loans is accrued depending on the current level of the key rate during the period when the credit institution uses the funds obtained. This means that, for credit institutions, the cost of borrowing from the Bank of Russia is close to the key rate level, which should help set the rates in the overnight segment of the money market at this level, i.e. achieve the operational target of the monetary policy.

Finally, another important role in the Bank of Russia's system of monetary policy instruments is played by standing facilities. Rates on one-day liquidity provision standing facilities form the upper bound of the market interest rate corridor, while rates on one-day deposit operations form the lower bound. The interest rate corridor is symmetrical relative to the Bank of Russia key rate, has a width of 2 percentage points and seems to be optimal at maintaining participants' activity levels in the overnight segment of the interbank money market and achieving the operational target. The bounds of the interest rate corridor both limit the volatility of market rates and help narrow the gap between them and the key rate.

1.3. Interaction of monetary policy with other Bank of Russia functions and other government social and economic policies

In order to implement monetary policy successfully, it is important for the Bank of Russia to efficiently perform its other functions. Along with maintaining price stability, the Bank of Russia is responsible for developing the payment system, developing and strengthening the banking system and the financial market, and ensuring their stability and financial stability in general. These goals are equally important for the Bank of Russia as they create favourable conditions for achieving other goals of social and economic policy. They are all closely linked to one another. In particular, for efficient functioning of the monetary policy transmission mechanism and ultimately for the price stability, it is important that the payment system operate continuously, there needs to be public confidence in banks and mutual trust between banks and financial market participants, there also needs to be the option of carrying out operations in the financial market at low transaction costs, and the financial market needs to be extensive and liquid. Problems in the financial system result in a loss of trust between participants and the narrowing of the money market, and also deteriorate the quality of real assets, and therefore the financial stability is an indispensable condition for achieving monetary policy goals.

When making decisions in each area of its activity, the Bank of Russia gives special attention not simply to their overlaps with other areas of responsibility, but also the need to promote performance of all of its functions and achievement of any goals set in the context of these duties. For example, on the one hand, in its monetary policy decision-making, the Bank of Russia takes into account the possible impact of banking regulation or financial market development measures on the behaviour of economic agents and the transmission mechanism. On the other hand, the Bank of Russia assesses the consequences of its monetary policy measures for banks and other financial institutions, keeping in mind its obligation to further strengthen the banking system and ensure financial stability. This mutual recognition of goals and measures is achieved due to the interaction between structural divisions, collaboration within committees and working groups, and the adoption of key decisions regarding the mentioned duties by a single body – the Bank of Russia Board of Directors – which brings together those in charge of the respective areas.

Instruments used to perform these equivalent functions are clearly demarcated in most cases. However, in some cases the Bank of Russia can employ instruments which were initially earmarked for one particular duty to achieve objectives and goals falling under other functions. For example, the Bank of Russia takes the decisions on the key rate to ensure price stability. At the same time, if a shock occurs, posing a significant threat to financial stability, and if there is a need to urgently impact the economy to neutralise such a threat, the Bank of Russia can decide to change the key rate if it considers that macroprudential measures cannot influence the situation adequately and timely. In order to prevent financial destabilisation, the Bank of Russia can also carry out operations in the foreign exchange market, including reverse transactions.

Sustainably low inflation definitely creates favourable conditions for achieving the government's social and economic goals. At the same time, the successful implementation of the monetary policy requires coordinated measures of the central bank and the Government of the Russian Federation.

Effective interaction between the Bank of Russia and federal ministries is achieved by openly exchanging information, discussing goals and measures of a policy being implemented, working out prerequisites and devel-

oping macroeconomic forecasts. In its monetary policy decision-making, the Bank of Russia takes account of measures which are being implemented or planned by the Government of the Russian Federation or federal ministries.

Fiscal, tariff, structural, industrial, anti-monopoly, and foreign economic policies have the greatest impact on economic phenomena and processes linked to the monetary policy transmission mechanism. In view of this, the Bank of Russia attaches particular importance to consultations on raising certain taxes and administered tariffs as they directly contribute to growth of consumer prices for goods and services. The central bank also pays attention to economic policy measures aimed at overall cutting costs and increasing investment performance (including in the public sector), which, by contrast, contribute the most to inflation reduction.

Consultations and coordination between the Bank of Russia and the Government of the Russian Federation are especially important in the context of exogenous shocks leading simultaneously to slower GDP growth and inflation acceleration, as in this case there is a need to ensure an optimal balance between the goal of supporting aggregate output and the goal of ensuring price stability.

The need for coordinated action also arises at the operational level in view of the impact that fiscal flows and Federal Treasury transactions to place budgetary funds in deposits with credit institutions and to conduct repo transactions and OFZ placement have on the aggregate banking sector liquidity.

The monetary policy contributes to higher well-being of Russian citizens primarily through ensuring price stability. However, when faced with difficult circumstances, the Bank of Russia assists in other areas of social and economic policy, not only by ensuring price stability, but also through other methods. First, the Bank of Russia can ease requirements for the quality of collateral eligible for refinancing operations. Second, the Bank of Russia may employ as a temporary measure the so-called specialised refinancing mechanisms, when providing liquidity to credit institutions for longer terms at lower rates. In doing so, the central bank stimulates certain segments of the economy where development is held back by structural factors. At the same time, the amount of funds supplied through specialised instruments is limited as the use of such instruments should not distort the monetary policy stance and prevent the Bank of Russia from achieving its primary goal of ensuring price stability.

2. RUSSIA'S ECONOMIC DEVELOPMENT AND MONETARY POLICY IN 2015

2.1. Monetary policy implementation: conditions and key measures

Last year, in the Guidelines for the Single State Monetary Policy in 2015 and for 2016-2017, the Bank of Russia considered five economic growth scenarios with different assumptions regarding changes in oil prices and the duration of financial and economic sanctions imposed on Russia. In these economic growth scenarios, the Urals crude price ranged from $84 to $105 per barrel on average in 2015 (the baseline scenario assumed an oil price of $95 per barrel). The Bank of Russia viewed the scenario in which oil prices dropped to $60 per barrel in 2015 as a stress one.

The slump of oil prices in November-December 2014 to levels close to those in the stress scenario led the situation to deviate notably from the baseline forecast. As expected, unfavourable external factors impacted Russia's economy through several channels. The significant deterioration in trade conditions caused drastic depreciation of the ruble. What's more, the speed and scale of changes in external conditions exerted a negative influence on economic agents' sentiment and expectations, causing growing uncertainty and enhanced volatility in the financial markets. These rendered investment in Russian assets less attractive, intensified capital outflow, and crushed investment activity. The ruble's noticeable weakening coupled by the growth in depreciation expectations spurred up inflation acceleration, which exceeded the forecast level of the Bank of Russia's stress scenario.

Thus, the Russian economy found itself facing ailing output, on the one hand, and galloping inflation, on the other hand. In this situation, the Bank of Russia conducted its monetary policy, attempting to balance between the imperative to reduce inflation and to prevent the excessive cooling of economic activity, and to maintain financial stability. Measures aimed at restricting the growth of inflation and depreciation expectations, and normalising the situation in the financial market included the following: the decision adopted on 16 December 2014 to bring the key rate up to 17.00% p.a., growing volume of Bank of Russia reverse operations to provide foreign currency liquidity to Russian credit institutions, and measures to support financial sector sustainability.

These measures helped stabilise the situation in the financial market, recover economic agents' trust in the Russian financial system as a whole, and had a constraining effect on depreciation and inflation expectations to the extent expected by the Bank of Russia. This made it possible to begin the key rate cutting already in January 2015. Meanwhile, the key rate path in 2015 was determined with due account of the balance between inflation risks and risks of a considerable drop in economic activity. In its monetary policy decision-making, the Bank of Russia relied on a medium-term macroeconomic forecast that was regularly revised in order to reflect changes in external conditions, among other things. The forecast was published in the quarterly Monetary Policy Report[1].

External economic conditions were persistently unfavourable in 2015. The average Urals crude price was $54.5 per barrel in January-September 2015 and, according to estimates, it will stay in the $45-55 per barrel range until the end of 2015, with the average for the year being at roughly $53 per bar-

[1] *The Monetary Policy Report is published in the Monetary Policy section of the Bank of Russia website (http://www.cbr.ru/publ/?Prtid=ddcp).*

rel. Moreover, throughout 2015 oil prices have been characterised by elevated volatility compared with previous years, which made a further negative impact on economic agents' sentiment and the level of economic activity in Russia.

In 2015, low oil prices lingered amid the ongoing considerable surplus supply in the global oil market, first signs of which appeared already in 2014, and as a result of the US dollar appreciation, the US economy's relatively faster recovery, and expected beginning of the US Federal Reserve's monetary policy normalisation.

On the one side, growth in energy demand slowed due to lower-than-forecast growth in the global economy (largely because of the economic slowdown in emerging markets, which have accounted for the bigger share of the growth in the global demand for oil in recent years). According to IMF estimates, in 2015, global economic growth will slow to 3.1% compared with 3.4% the year before and growth in developing economies will slow from 4.6% to 4.0%.

On the other side, OPEC's decision to not decrease production levels in response to the 2014 fall in oil prices helped maintain a high level of supply in the oil market. In the USA, the drop in shale oil production was less considerable than expected by many market participants owing to advances in technologies used to extract oil from unconventional sources, the cost of extraction at existing US shale oil deposits fell markedly.

Finally, oil prices experienced additional downward pressure from the expectations of a further increase in oil supply from Iran following the lifting of sanctions, and from other OPEC member states (such as Libya and Iraq).

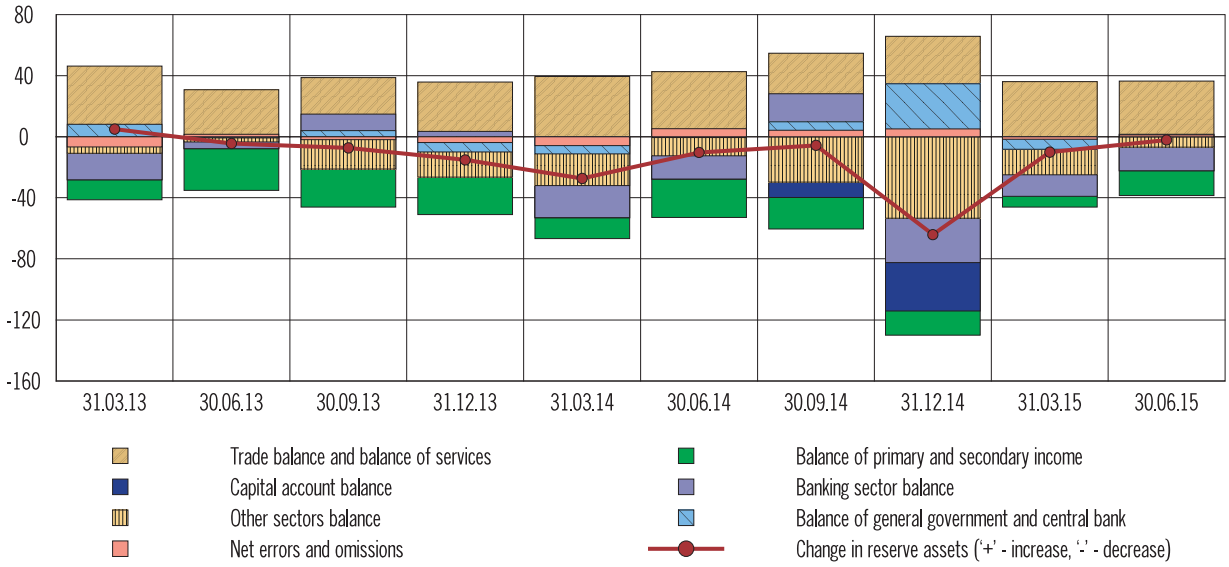
Despite the fact that each of these surplus supply factors partly shaped the sentiment of global commodity market participants, it was their simultaneous materialisation that triggered such a noticeable downturn in oil prices. As a result, the situation in the global energy market became even more unfavourable than assumed in the Bank of Russia's stress scenario.

According to estimates, in 2015, economic growth rates in Russia's trading partners will generally be lower than forecast last year. This is primarily due to the downturn in China's economic growth amid the exhaustion of its extensive growth model and the bursting of both the real estate market and stock market bubbles, and also reduction in goods and services output in the CIS countries (primarily, in Ukraine). At the same time, as expected, in 2015 economic growth in developed countries is gradually picking up: the US, euro area, and Japan are all seeing acceleration in growth and the UK economy is also growing steadily. The key factors underpinning this gradual acceleration of economic activity in developed countries are accommodative financial conditions and asset purchase programmes conducted by several central banks (by the ECB and the Bank of Japan), low global oil prices, and a neutral fiscal policy.

Amid the fall in prices for most commodities (in January-September 2015, prices for gas, coal, iron ore, other ferrous and non-ferrous metals fell) and decreased prices in global food markets, inflation remained low in most major economies. For example, in September 2015, annual growth in the CPI was 0.0% in the USA, and 1.6% in China. In the euro area, the CPI was down 0.1% year on year. However, despite moderate growth in external prices, the ruble depreciation and the effect of the import restrictions for certain categories of food goods introduced in August 2014 exerted significant upward pressure on the behaviour of domestic prices for imported goods in the Russian economy.

Faced with relatively low inflation and slow economic growth, the central banks of developed countries continued to implement loose monetary policy in January-September 2015. Furthermore, monetary conditions in developed economies have been relaxed for lon-

Major balance of payments components (billions of US dollars)



Source: Bank of Russia.

ger than expected the year before. In particular, the US Fed postponed raising rates, which kept interest rates subdued in global financial markets. However, this factor did not have a decisive impact on external lending conditions for Russian borrowers, because the persistent financial and economy sanctions imposed on Russia considerably hampered borrowings in the international capital markets for Russian companies and banks at the end of 2014 and in early 2015.

The forced settlement of external liabilities by Russian companies and banks resulted in a significant capital outflow. According to estimates, the payments on external debt peaked in 2014 Q4 – 2015 Q1 (roughly $80 billion). Despite the limited opportunities to refinance debt in the external capital markets, payments were made on time and in the required amounts, facilitated largely by Bank of Russia foreign currency refinancing operations. The amount of payments on external debt made by the private sector in 2015, adjusted for intragroup loans and borrowings, and the portion of debt that can be refinanced in external markets, is estimated to be about $70 billion. This accounts for roughly 60% of the amount on the official external debt repayment schedule. In view of the near-zero net demand for foreign assets, the net private capital outflow will be largely determined by the settlement of external liabilities and will equal an estimated $70 billion in 2015.

In February-May 2015, foreign exchange market saw a gradual decrease in the ruble exchange rate volatility and its return to fundamental values. During this period, the ruble appreciation and decreased volatility were assisted by the normalisation of the situation with foreign currency liquidity amid credit institutions' increased outstanding amounts on Bank of Russia foreign currency refinancing operations, the end of maximum payments on external debt by Russian organisations, and a slight increase in oil prices. However, the subsequent downward trend in oil prices, combined with expectations of a forthcoming tightening of the US Fed policy, caused the ruble to depreciate in June-September 2015.

Despite the occurred ruble depreciation, there was no perceptible hike in tension (markedly elevated exchange rate volatility or household demand for foreign currency) in the domestic foreign exchange market during this period, which suggests that market participants were gradually adapting to unfavourable exter-

nal conditions. According to estimates, net revenue in the current account balance and foreign exchange assets accumulated by Russian banks and companies will enable them to make uninterrupted payments on external debt up to the end of 2015 without putting any additional pressure on the ruble exchange rate. Stability in the foreign exchange market will also be supported by the opportunity for credit institutions to borrow foreign currency liquidity through existing Bank of Russia refinancing instruments on a reverse basis.

Overall, in 2015 external conditions continued to exert a constraining influence on Russian economic growth. But the impact of these conditions on the inflation that occurred largely at the end of 2014 – early 2015 gradually subsided over the year. However, ongoing high levels of external volatility created further uncertainty and risks in price dynamics.

In 2015, internal financial conditions underlying economic development remained relatively tight in view of the 17.00% increase in the Bank of Russia key rate at the end of 2014. However, these conditions have consistently relaxed over the course of the year. In December 2014 – January 2015, the hike of the key rate was replicated by increases in rates on banking lending and deposit operations. The growth in deposit rates outpaced the growth in lending rates, as a result of fierce competition for depositors among banks in the context of rising costs and restricted access to other sources of funding, including external borrowings.

Given the start of key rate cutting in January 2015, a trend of steadily falling market interest rates has been observed throughout 2015. At the same time, both price and non-price lending conditions in the economy continued to be tighter than in 2014.

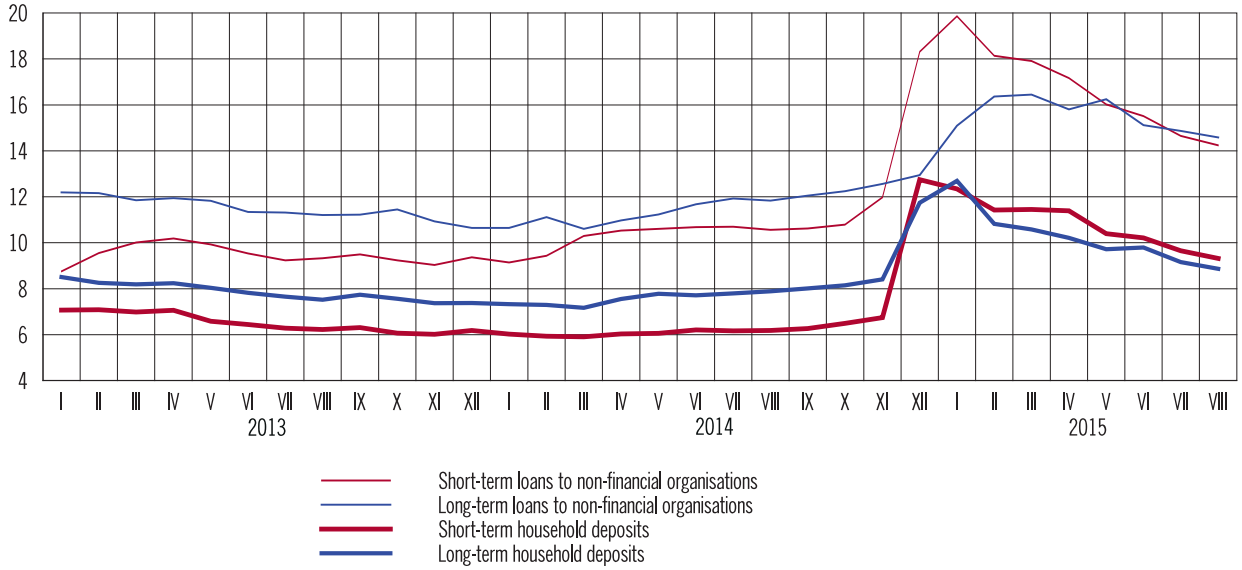
As in previous years, changes to rates in the economy were not uniform in 2015. In the short-term lending and deposit operations segment, the reduction in interest rates started earlier and was more pronounced than in the segment of similar long-term operations. This was in part down to the perception that the Bank of Russia's rate increase at the end of the year was a temporary measure. Expectations of a reduction in the Bank of Russia key rate as inflation slows down and the economy cools, which are reflected in interest rates on long-term operations, led to the inverted structure of interest rates at the start of the year in the lending and deposit segments of the market. Under these conditions, short-term deposits and long-term loans increased as a percentage of total banking operations.

Increased credit risks constituted one of the factors curbing the reduction in loan rates. Amid the contraction in real incomes and rising debt burden, driven in part by the increased cost of borrowing and foreign exchange revaluation, Russian corporate and private borrowers' debt servicing pattern deteriorated slightly, causing the growth of overdue debt on loans. Russian banks' capital experienced pressure from the writing-off of bad loans and the building-up of loan loss provisions, as a result of the impaired quality of banks' loan portfolios. However, a number of state measures adopted in 2015 (cf. Section 2.3) to support the banking sector held this pressure in check.

In this situation, bank lending activity continued to be low. Banks significantly tightened their requirements to borrowers compared with the previous year and showed a preference for less risky investments, further reducing their unsecured consumer lending and small and medium business lending activity. An additional factor stimulating banks to build up their lending for large corporations was the latters' increased demand for loans in an attempt to substitute the shrinking external debt.

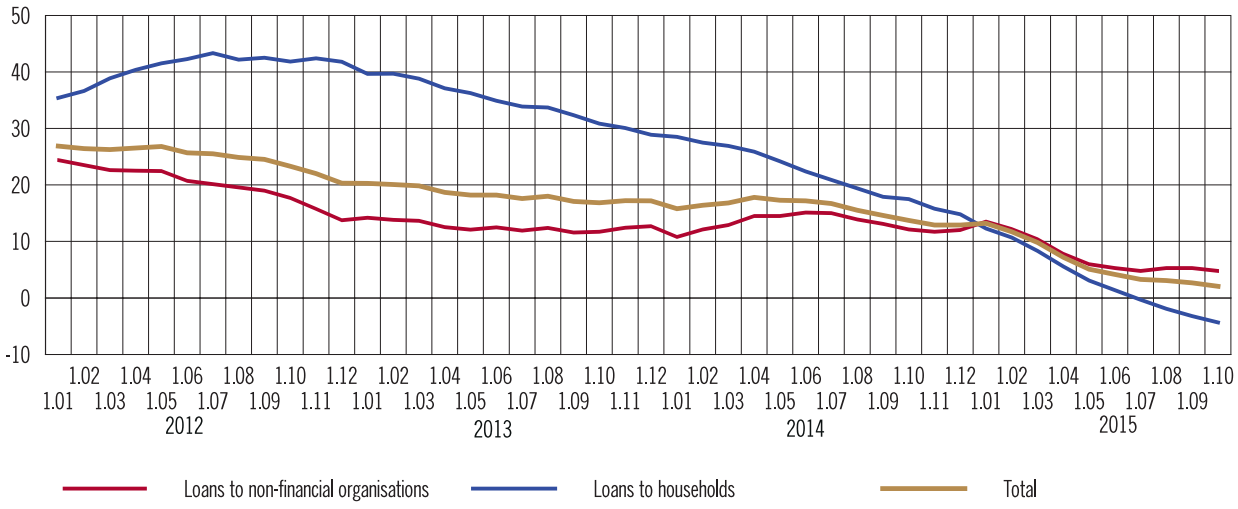
The drop in lending in 2015 was to a certain degree offset by another source of money supply growth: a surge in the banking system's net claims to general government, linked to financing the budget deficit using Reserve Fund assets and investing National Wealth Fund assets. As a result, the slack in money supply

Banking operations rates (% p.a.)



Source: Bank of Russia.

Loans to real sector* (annual percentage changes)



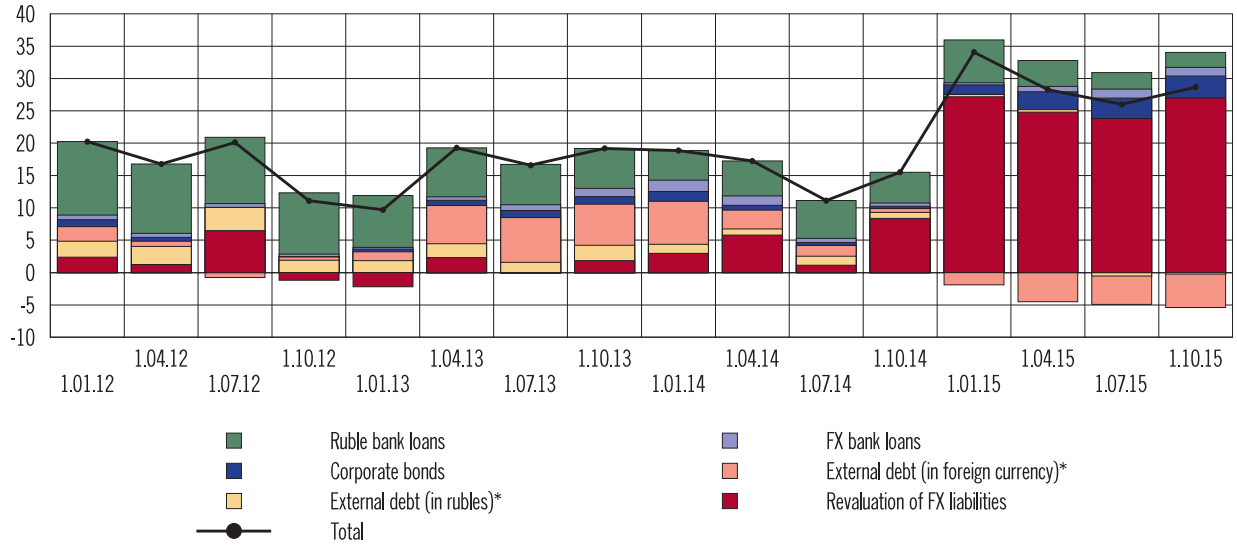
** Based on the data from reporting form 0409101, excluding foreign currency revaluation.*
Source: Bank of Russia.

growth observed in 2014 reverted to its stabilisation at a low level in 2015.

In 2015, the structure of money supply experienced certain changes. One of the sources of the renewed influx of household funds into bank deposits in 2015 was a reduction in cash (both in rubles and foreign currency) in circulation. The rates at which household and corporate funds flowed into ruble deposits slightly exceeded those for foreign currency deposits (in dollar terms), demonstrating that economic agents remained moderately sensitive to changes in the exchange rate as they adapted to its increased volatility.

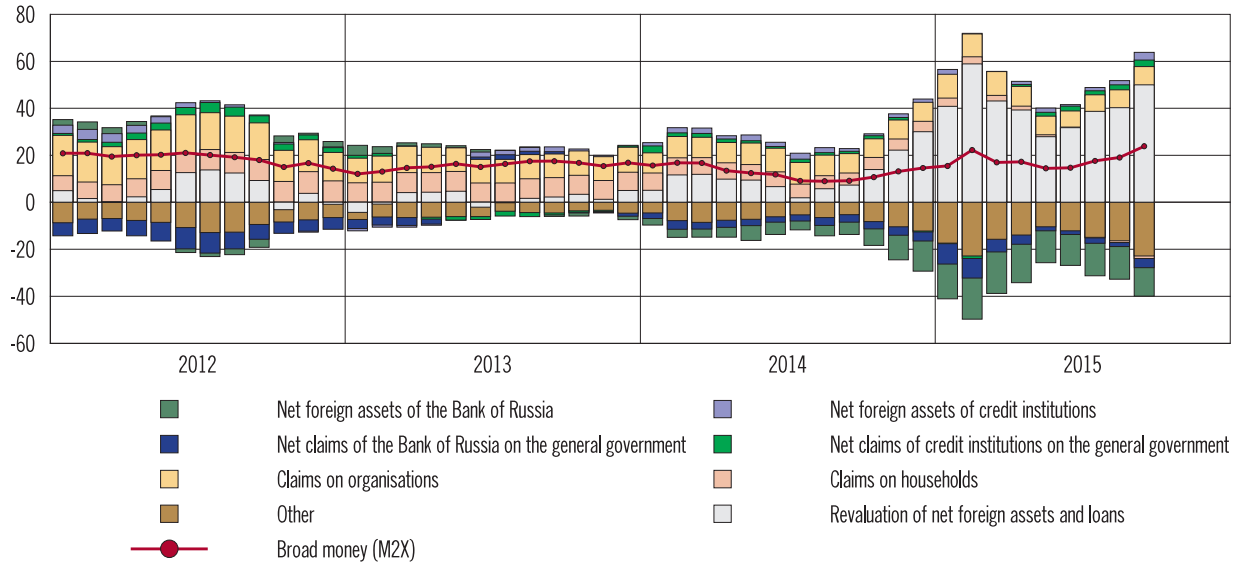
As expected, at the end of 2015, the growth in money supply (according to the national definition) and broad money supply (excluding foreign currency revaluation) will be slightly positive. At the end of the year, the growth in ruble- and foreign currency-denominated loans

Contribution of various components to the annual growth rates of Russian companies' outstanding amounts (pp)



** This amount includes liabilities of both non-financial organisations and non-bank financial institutions. Data as of 01.07.15 and 01.10.15 are based on preliminary estimates.*
Sources: Bank of Russia, Cbonds.ru, Bank of Russia calculation.

Broad money and counterparts (annual growth, %)



Source: Bank of Russia.

to non-financial organisations and households will be below 7%. In 2015, the dynamics of monetary and credit aggregates have been more moderate relative to the baseline forecast presented in the Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017 due to a more profound drop in economic activity and the persistently tighter monetary policy than assumed in the baseline scenario.

The impact of these internal and external factors shaping economic activity will cause GDP to reduce by an estimated 3.9-4.4% in 2015. A drop of this magnitude corresponds to the lower bound of the forecast stress scenario range. A year ago, the Bank of Russia baseline scenario forecast a zero GDP growth for 2015.

Structural factors such as the unfavourable demographic situation, high levels of fixed assets wear-out and low rates of their renewal,

and also institutional restrictions bringing down the growth potential of labour productivity in the short-term are continuing to have a constraining effect on economic growth in 2015. However, sluggish economic activity was conditioned, among other things, by the reduction in income in the economy, tighter external and internal financial conditions, and also a tougher monetary policy, and decline in economic agents' sentiment. Accordingly, internal demand (both consumer and investment) was significantly weaker than expected.

The labour market adjusted to the cooling economy by reducing demand for labour in 2015, increasing unemployment rate, and reducing wages in real terms.

The unemployment grew from 5.2% in January to 5.5% in September (seasonally-adjusted). The number of vacancies reported by employers to state employment services decreased. Furthermore, the scale of the currently observed decrease in the number of open job vacancies exceeds the similar scale of the 2008 – 2009 crisis. Unemployment is forecast to increase by the end of 2015. In the context of a significant economic recession, the growth in unemployment is being held back by the long-term trend of a labour supply crunch due to demographic factors.

Businesses' need to cut payroll expenses and the decision to cancel wage indexation in the sectors financed by the federal budget amid high inflation caused real wages to fall in 2015. In September, real wages were 9.7% lower than in the corresponding period of the previous year. Overall, in 2015 they are expected to fall by 8-9% year-on-year.

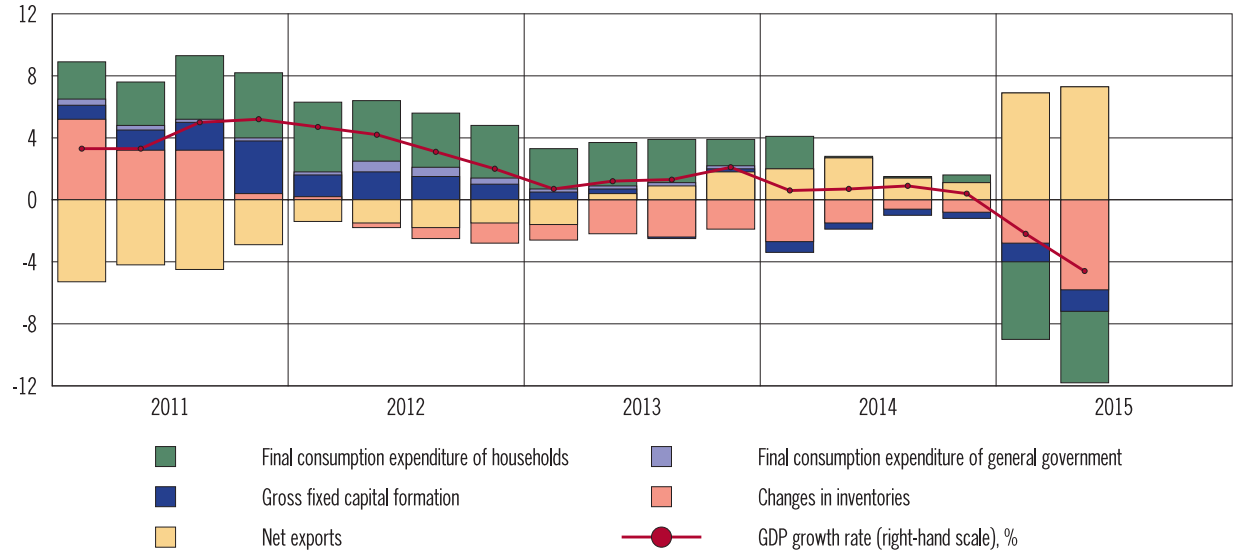
Reduction in household real income and slowdown in consumer lending growth given high accumulated debt of households caused a downturn in consumer demand. In September, retail trade turnover was down 10.4% compared with the corresponding period of the previous year. As a result of the aforementioned factors, in 2015, final consumption expenditure could fall by an estimated 6.2-6.9%.

Investment activity fell further due to the low level of business confidence, decreased income from export operations, Russian companies' restricted access to international financial markets, and tighter domestic borrowing conditions. In September 2015, fixed capital investment fell by 5.6% year-on-year. Gross fixed capital formation could contract by an estimated 7-8% at the end of 2015. However, in contrast to the 2008-2009 crisis, a smaller reduction in inventories is expected in 2015. This is explained by the fact that organisations already optimised their inventories in 2013-2014.

Despite a more moderate growth in external demand than expected in the previous year, growth in actual end-year export quantities could be around 1.5-2.5% (the baseline scenario assumes zero annual growth). This trend can in part be explained by the fact that the considerable ruble depreciation in real terms at the end of 2014 – start of 2015 provided some support for the export-oriented sectors of the Russian economy (especially the oil sector and metallurgy) by partially compensating businesses for losses linked to the fall in prices in global commodity markets. Given the fall in internal demand, in 2015 imports are estimated to shrink more significantly than expected the year before, possibly by about 30%. The ruble depreciation at the end of 2014 – start of 2015 also exerted a downward pressure on imports and encouraged import substitution in the production of certain goods. As a result, net exports will make a meaningful positive contribution to the GDP growth rate in 2015.

The aforementioned trends in the Russian and global economy are reflected in the structure of items in Russia's current account. A significant fall in the oil price in 2015 relative to 2014 exerted strong downward pressure on the total exports volume. Notwithstanding growth in real terms, the total volume of goods and services exports shrank by 32% in January-September 2015. By the end of 2015, the exports will fall by an estimated 30%. However, the imports volume is contracting even fast-

GDP growth structure by expenditure (percentage points, year-on-year)



Sources: Bank of Russia.

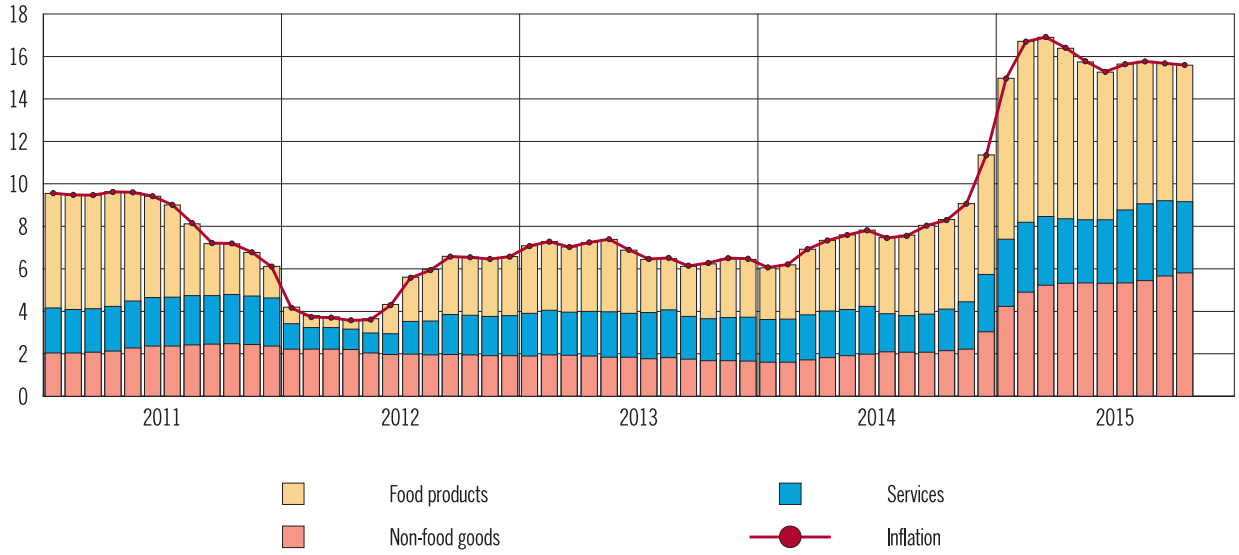
er under the influence of sluggish economic growth, the ruble depreciation in real terms, and international financial and trade sanctions.

In 2015, the trade surplus will go below the last year's level, but the current account balance is projected to rise to $65 billion from the previous year's $58 billion due to an improved balance of services and balance of non-tradable components, primarily the reduction in investment income payable.

In 2015, the inflation pattern evolved under the influence of a variety of opposing factors. Inflation was largely shaped by the lagging impact of the considerable ruble depreciation at the end of 2014, which boosted prices for imported unfinished and finished goods and had a number of secondary effects. The depreciation of the national currency caused inflation expectations to increase significantly at the end of 2014 – start of 2015, which was one of the reasons behind the growth in economic agents' propensity to consume and increased demand-driven pressure on prices over this period. The result was a significant acceleration in price growth for durable non-food goods. Moreover, as a result of increased exports income, the ruble depreciation indirectly increased domestic producer prices for certain categories of goods.

The foreign exchange market stabilisation facilitated by Bank of Russia measures, determined the steady decrease in the pass-through effect of exchange rate dynamics on price growth. According to estimates, by Q2 this year, the impact of the import restrictions for certain goods (which had been in effect since mid-2014) on expenses and prices had been exhausted. Another important factor behind the slowing inflation was shrinking domestic demand. Moreover, as price growth slowed down, inflation expectations improved. As a result, annual inflation, which peaked in March 2015 (16.9% year-on-year), fell to 15.3% in June. Inflation resumed its downward path after the 15.8% hike in July-August caused by the indexation of utility tariffs and increase in exchange rate volatility. In October, consumer price growth rate was 15.6%. The contribution of exchange rate volatility to the CPI behaviour is estimated at about 6.5 percentage points. This high value has been formed by one-off effects evolved at end-2014 – early 2015, such as, among other things, increase in the scale of exchange-rate fluctuation pass-through effect on prices. In future, as the ruble exchange-rate volatility will subside, its effect on the CPI growth will weaken. At the end

Contribution to inflation
(as % of correponding month of previous year)



Sources: Rosstat, Bank of Russia calculations.

of 2015, the inflation is forecast to slow to 12-13%.

In 2015, the Bank of Russia conducted a gradual relaxation of the monetary policy. In the first six months of the year, as inflation risks subdued, and risks of considerable economy cooling persisted, the key rate was reduced by a total of 5.5 percentage points to 11.50% p.a. In July – early September, the ruble depreciation spurred up inflation risks. In view of the above, in July, the Bank of Russia brought the scale of key rate reduction down to 50 basis points, lowering it to 11.00% p.a. In September-October, the key rate was kept unchanged.

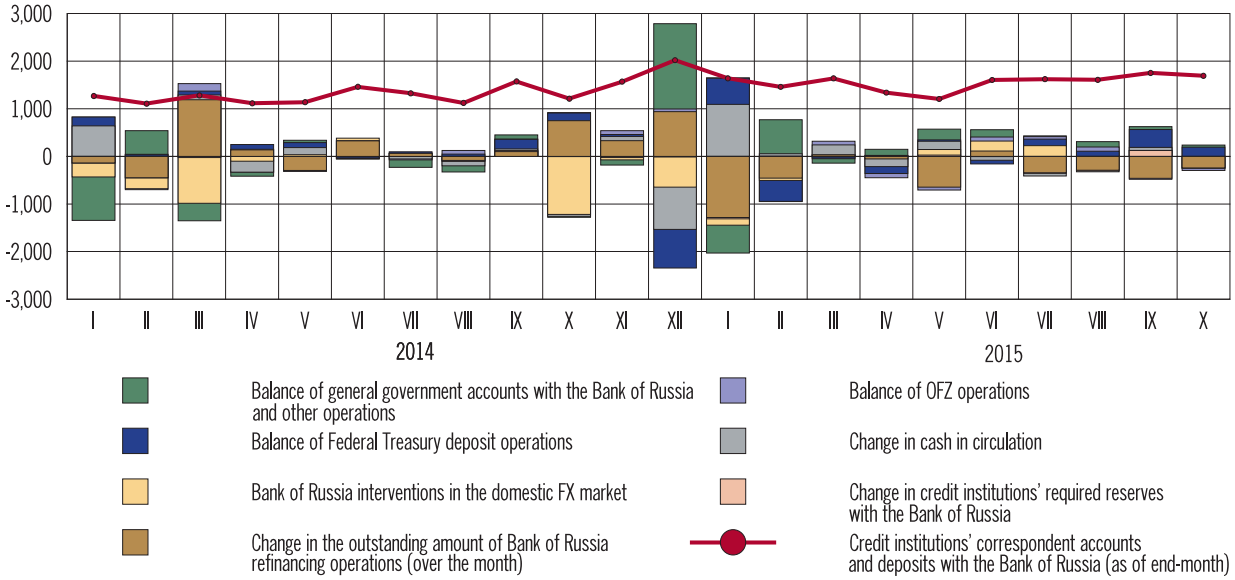
2.2. Use of monetary policy instruments

The Bank of Russia is steering money market interest rates in the presence of the structural liquidity deficit, i.e. the banking sector's persistent need to borrow from the central bank. Accordingly, the central bank is primarily carrying out liquidity provision operations. The Bank of Russia determines the amount of funds supplied at auctions on the basis of a banking sector liquidity forecast. Required amount of liquidity is channeled to credit institutions through auction-based operations. The minimum cost of liquidity provision through these operations is tied to the Bank of Russia key rate. This makes it possible to establish necessary conditions for credit institutions to redistribute funds in the interbank money market at rates close to the Bank of Russia key rate (for more details see Sub-section 1.2).

By the end of 2015, a decrease in the structural liquidity deficit and credit institutions' outstanding amounts on Bank of Russia refinancing operations may be expected. The Guidelines for Single State Monetary Policy in 2015 and for 2016-2017 assumed that credit institutions' demand for Bank of Russia refinancing operations would increase by the end of 2015. The actual structural liquidity deficit deviates from the forecast due to the impact of liquidity factors.

It was assumed that the main source of the increase in credit institutions' demand for refinancing would be growth in cash in circulation. However, in the first half of 2015, the amount of cash in circulation fell markedly compared with the same period across several years. This was caused by the overall downturn in economic activity and increase in households' propensity to save, in part due to the growing appeal of ruble-denominated deposits at banks

Banking sector liquidity and its factors (billions of rubles)



Source: Bank of Russia.

given the change in deposit rates (for more details see Sub-section 2.1). Despite the fact that the behaviour of cash in circulation pattern has returned to seasonal trends since May 2015, the cumulative effect of this factor at the end of the year will lead to an inflow of 0-0.3 trillion rubles of liquidity into the banking sector.

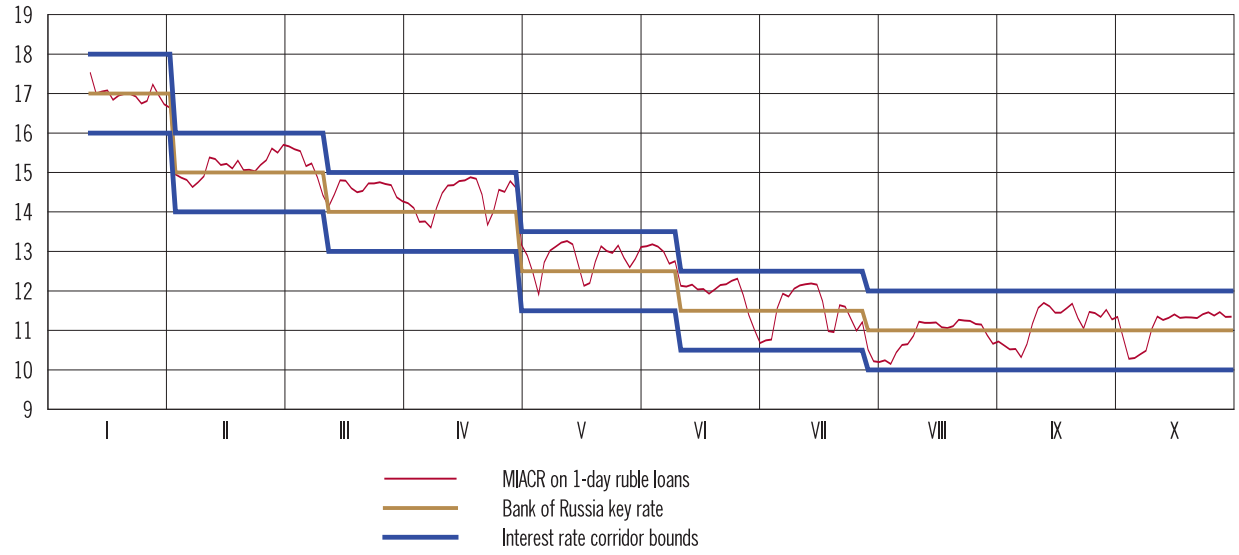
In 2015, the impact of the fiscal channel's flows on banking sector liquidity changed considerably. Traditionally, general government income exceeds its expenditure over the year, which generates additional demand for funds among credit institutions. However, at the start of 2015, budget spending rates were elevated, which, combined with certain high-value operations affecting general government accounts with the Bank of Russia, such as the transfer of pension savings to non-governmental pension funds[2] and investment of the National Wealth Fund assets, generated an inflow of liquidity into the banking sector. Over the year, the decline in federal budget income necessitated the use of the Reserve Fund assets for financing budget expenditure.

The Federal Treasury continued to hold auctions to place temporarily unallocated federal budget funds in deposits with credit institutions in 2015. These operations made it possible to smooth out the impact of changes in intrayear fiscal flows on banking sector liquidity. In the first half of 2015, amid the downturn in the banking sector demand for liquidity and decreased utilisation of the marketable collateral by credit institutions in repo transactions with the Bank of Russia, credit institutions' demand for Federal Treasury funds was limited. In the second half of 2015, the Federal Treasury raised the volume of placements with credit institutions, which became another reason behind the drop in their demand for Bank of Russia refinancing operations.

In 2015, to expand its ability to manage temporarily unallocated budget funds in accounts with the Bank of Russia, the Federal Treasury set about placing funds with credit institutions under repo contracts. These operations have a supplementary role compared with bank deposits. They do not produce a significant impact on the level of banking sector liquidity due to the small amounts involved and are to

[2] *Management companies (MC) and non-governmental pension funds (NPF) received funds comprised of insurance contributions to the funded pension component for the second half of 2013, pensions savings of those individuals who decided to migrate from state MCs to NPFs, individuals' contributions under the funded pension component co-financing plan, maternity capital, etc.*

Bank of Russia interest rate corridor and MIACR on one-day ruble loans in 2015 (%)



Source: Bank of Russia.

smooth out intraweek changes in federal budget account balances with the Bank of Russia.

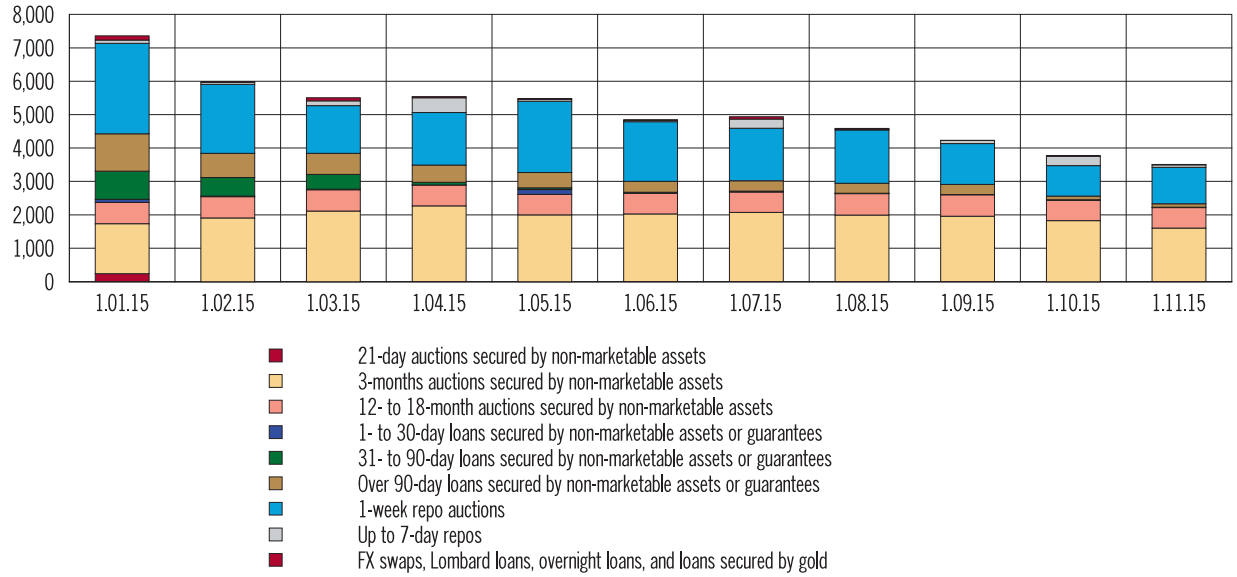
By the end of 2015, the excess of general government spending over its income will generate a 2.0-3.0 trillion ruble inflow into the banking sector. The scale of change in demand for refinancing driven by this factor will depend on the amount of Reserve Fund spending and National Wealth Fund investment.

The impact of Bank of Russia operations in the domestic foreign exchange market on banking sector liquidity was mixed in 2015. The central bank's sale of foreign currency in January 2015, associated with FX operations of the Federal Treasury, led to the outflow of liquidity from the banking sector. In May, the Bank of Russia decided to start operations to buy foreign currency in the domestic foreign exchange market to replenish its international reserves, which brought about an increase in the level of banking sector liquidity. These operations were suspended in July. If the Bank of Russia refrains from conducting them till the end of 2015, the net results of its operations in the domestic FX market could lead to the inflow of liquidity of 0.4 trillion rubles by the end of the year. The assessment of the growth in credit institutions' demand for refinancing presented in the Guidelines for Single State Monetary Policy in 2015 and for 2016-2017 was based on the assumption that the Bank of Russia would not conduct any operations in the domestic FX market to replenish its international reserves.

The aggregate effect of these factors brought down the banking sector's demand for liquidity. Depending on the scale of sovereign fund spending, credit institutions' outstanding amounts on Bank of Russia refinancing operations are estimated at 4.4-5.2 trillion rubles by the end of 2015.

The dynamics of short-term money market rates within the Bank of Russia's interest rate corridor were also affected by the situation with banking sector liquidity. Moreover, impressive structural liquidity deficit, despite its gradual reduction, and the peculiarities of the Russian money market's operation continued to exert an upward pressure on interbank market rates for a large part of the year. An exception was January-February 2015, when the inflow of liquidity into the banking sector due to high budget spending led to a slight reduction in money market rates. At the end of the year, the mean spread of the one-day ruble-denominated MIACR to the Bank of Russia key rate

Outstanding amounts on Bank of Russia operations, by maturity (billions of rubles)



Source: Bank of Russia.

will be roughly 20 bp, while money market rate volatility will be 40 bp[3] over this period.

The Bank of Russia fully satisfied banking sector demand for liquidity through its auction-based operations. The amount of funds supplied via Bank of Russia refinancing operations was determined by credit institutions' demand for liquidity and the dynamics of liquidity factors. When deciding on the amount of liquidity to supply, the Bank of Russia proceeded on the assumption that the funds would be redistributed among credit institutions in the interbank market. This opportunity to redistribute funds came in part as a result of credit institutions being granted the right to average their required reserves, i.e. to observe their required reserve ratios by maintaining a certain portion of their required reserves in correspondent accounts with the Bank of Russia on average during the established period of time.

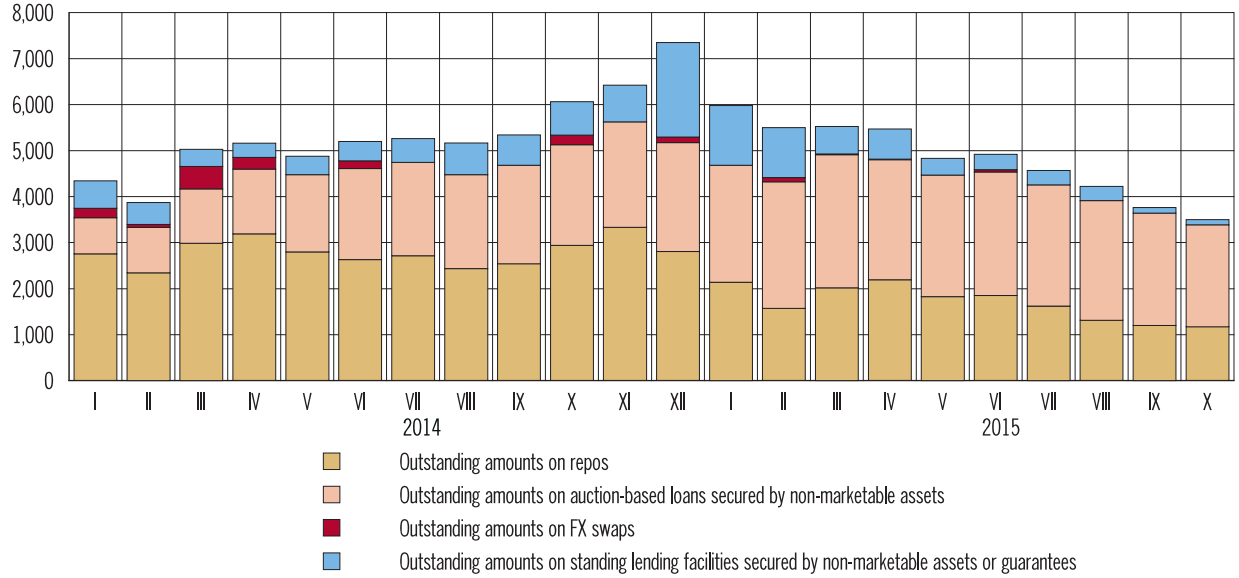
The Bank of Russia continued its efforts announced in the Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017 to improve the required reserve mechanism. For example, the decision was made to raise the required reserve averaging ratio used by banks to calculate the averaged amount of required reserves from 0.7 to 0.8[4] beginning 10 September 2015. This measure expanded credit institutions' ability to redistribute funds in the interbank market and enhanced their resilience to changes in banking sector liquidity. Moreover, the change in the required reserve averaging ratio led to the redistribution of funds between credit institutions' required reserve accounts and correspondent accounts at the Bank of Russia and did not have any significant impact on banking sector demand for Bank of Russia refinancing operations.

The fall in demand for refinancing over the year caused a change in the structure of credit institutions' outstanding amounts on Bank of Russia operations. Main refinancing operations used to steer money market rates were still Bank of Russia one-week repo auctions. The amount of funds supplied through these operations significantly dropped in the aftermath of the structural liquidity reduction. In 2015, the average outstanding amounts on these operations could total 1.6 trillion rubles, compared with 2.7 trillion rubles the year be-

[3] *The mean square deviation of the one-day ruble MIACR spread to the Bank of Russia key rate.*

[4] *For non-bank credit institutions carrying out deposit and loan operations, the required reserve averaging ratio was raised from 0.7 to 1.0.*

Bank of Russia refinancing operations in 2014 – 2015
(as of end-month, billions of rubles)



Source: Bank of Russia.

fore. However, the actual outstanding amounts on these operations could range between 0.8 and 3.0 trillion rubles (1.8 to 3.8 trillion in 2014).

Loans secured by non-marketable assets or guarantees continued to be an additional instrument for the refinancing of the banking sector. According to Bank of Russia assessments, decline in the structural liquidity deficit could reduce outstanding amounts on these operations from 4.4 trillion rubles at the start of the year to 2.1 trillion rubles at the end of the year. The structure of credit institutions' outstanding amounts on these operations also changed. In the first half of 2015, amid the expected continuation of the structural liquidity deficit, the Bank of Russia increased the amount of funds provided at loan auctions secured by non-marketable assets, which replaced credit institutions' outstanding amounts on equivalent standing lending facilities extended in December 2014. As a result, credit institutions' outstanding amounts on standing lending facilities secured by non-marketable assets or guarantees lowered from 2.1 to 0.1 trillion rubles. In the second half of the year, as banking sector demand for refinancing changed, the Bank of Russia gradually reduced the amount of funds provided through auction-based loans secured by non-marketable assets. Consequently, outstanding amounts on these operations could fall from 2.4 trillion rubles to 2.0 trillion rubles by the end of the year.

Amid the reduced burden on marketable collateral, credit institutions have shown limited demand for ruble liquidity provided through FX swaps. In 2015, the volume of deposit operations was also negligible.

Under its current operating procedure, the Bank of Russia continued to assess credit institutions' demand for liquidity on a daily basis. Whenever there were short-term deviations in demand for liquidity from its supply, which could not be offset by credit institutions through required reserves averaging or via the interbank lending market, the Bank of Russia held fine-tuning liquidity provision/absorption auctions. If in January-February, amid the inflow of liquidity due to various liquidity factors, the Bank of Russia held deposit auctions, starting from March, when there were no significant changes to the structural liquidity deficit, intraweek banking sector liquidity spurred demand for fine-tuning operations in the form of repo auctions. As credit institutions adapted to the operating procedure, under which no dai-

ly repo auctions[5] have been conducted since February 2014, demand for fine-tuning operations shrank. From February to December 2014, the Bank of Russia carried out 36 such operations, whereas from January to October 2015, their number fell to 19.

In 2015, the Bank of Russia made a number of changes to the system of monetary policy instruments, as announced in the Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017. For example, to expand credit institutions' access to refinancing, in June 2015, the Bank of Russia supplemented its system of monetary policy instruments with 1- to 2-day fine-tuning FX swap auctions. These operations will be used at the Bank of Russia's discretion alongside fine-tuning repo auctions if the high burden on marketable collateral used for main operations could have a negative impact on the Bank of Russia's ability to manage money market interest rates. In 2015, no such operations have been carried out.

As planned, in 2015, the Bank of Russia continued its efforts to increase the amount of collateral that credit institutions can use on Bank of Russia refinancing operations. The Bank of Russia Lombard List and the Bank of Russia List of Guarantor Entities were both significantly expanded. From 2015, the Bank of Russia Lombard List may include the bonds of Russian residents – non-financial organisations and mortgage-backed bonds from issuers (issues) without credit agency ratings or where performance of the issuer's obligations has not been secured by Russian government guarantees or a joint guarantee of the joint-stock company Agency for Housing Mortgage Lending (AHML). In 2015, decisions were also made to raise adjustment ratios and lower discounts applied to readjust the value of assets eligible as collateral for Bank of Russia refinancing operations.

[5] *Bank of Russia press release 'On the system of Bank of Russia monetary policy interest rate instruments', dated 13 September 2013.*

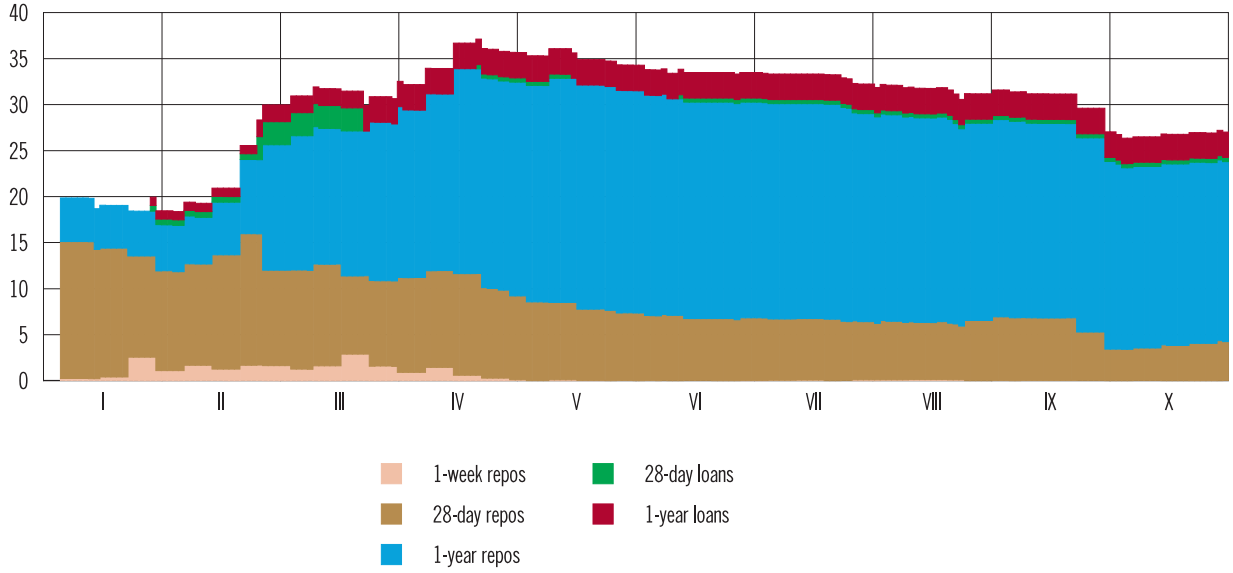
2.3. Monetary policy in conjunction with other Bank of Russia functions

The changing economic situation posed a serious challenge not only to monetary policy but also to the government's economic policy as a whole. In 2015, in the early stages of adapting to the significant downturn in foreign economic conditions which occurred in the second half of 2014, issues such as maintaining trust in the national currency and financial system, ensuring the stable functioning of financial markets and the banking sector, and supporting certain segments of the economy were of paramount importance. To resolve these issues, alongside its monetary policy toolkit, the Bank of Russia used foreign currency operations, specialised refinancing mechanisms, and changes to prudential regulation standards.

While developing and implementing these measures, the Bank of Russia paid particular attention to assessing their impact on monetary policy conditions and the prospect of inflation reaching the target level, among other things. The parameters of these operations were set and changed in such a way as to minimise their impact on the effectiveness of interest rate management, avoid distorting the monetary policy transmission mechanism and normal operation of the markets, and avoid creating or increasing imbalances in the economy.

In the second half of 2014, the stricter conditions under which Russian companies and banks could access Western financial markets after the introduction of external financial sanctions and the deterioration of the geopolitical climate combined with the sharp drop in global oil prices escalated tensions in the domestic foreign exchange market and therefore risks to financial and price stability. The most acute phase of this tension was over in December 2014. This was largely facilitated by Bank of Russia actions, including increases in the key

Credit institutions' outstanding amount on Bank of Russia foreign currency repos and loans (billions of US dollars)*



** Credit institutions' outstanding amounts are calculated for the second leg of repos and may be reduced by the amount of margin calls and securities-related payments. If the value of securities declines below the admissible threshold set by the Bank of Russia, a credit institution shall pay margin call in cash, thus reducing its obligations to the Bank of Russia under the second leg of repos. Whenever the Bank of Russia receives payment (coupon income, partial redemption of nominal value) related to securities received from credit institutions under the first leg of repos, credit institutions' obligations to the Bank of Russia under the second part of repos shall be adjusted by the same amount (i.e. these payments shall be counted towards the repayment of credit institution's outstanding amounts).*

Source: Bank of Russia.

rate and measures to maintain financial sector stability, in part through operations in the FX market. However, in early 2015, the high exchange rate volatility persisted and the elevated demand for foreign currency driven by the need to repay significant amounts of external debt continued to exert pressure on the ruble. To stabilise the situation in the foreign exchange market in these conditions, the Bank of Russia used reverse operations to provide foreign currency liquidity, as was proposed in the Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017. Moreover, in January 2015, to further increase the ability of credit institutions to manage their foreign currency liquidity and to refinance the external foreign currency loans of Russian exporters, as an addition to foreign currency repos, the Bank of Russia started to extend auction-based[6] foreign currency loans secured by the pledge of receivables on foreign currency loans.

Faced by the increase in Russian companies and banks' need for foreign currency to service their external obligations, at the beginning of the year, the Bank of Russia built up the volume of FX refinancing operations. Over the period from the start of January to mid-April 2015, the total outstanding amount of credit institutions on these operations increased by $16.8 billion to reach $36.7 billion. After Russian organisations successfully passed the peak of external debt payments in February-March, there appeared signs of a noticeable improvement in the situation with banking sector foreign currency liquidity: balance sheet indicators reflecting the amount of foreign currency liquidity at banks and the cost of borrowing in the money market returned to levels observed in the period prior to the introduction of the international financial sanctions. Together with other factors, such as the recovery of oil prices compared with their lows registered at the start of the year, the depreciation of the US dollar against the basket of key global currencies in March-April, and the fall in the corporate and households' demand for foreign currency, this constituted a major contribution to reduced volatility in the FX market and a quicker return of the ruble exchange rate to fundamental values in February-April.

[6] *This instrument was introduced by the decision of the Bank of Russia Board of Directors on 23 December 2014.*

Interest rates on Bank of Russia reverse operations to provide foreign currency (% p.a.)

Type of instrument	Instrument	Leg of operation	Term	Rate from			
				23.12.2014	30.03.2015	13.04.2015	21.04.2015
Standing facilities[1]	USD/RUB sell FX swaps	Ruble-denominated leg[2]	1 day	Key rate – 1.00			
		Foreign currency-denominated leg		1.5			
Auction-based operations[3]	Repos in US dollars and euros[4]		1 week	LIBOR + 0.50	LIBOR + 1.00	LIBOR + 1.50	LIBOR + 2.00
			28 days	LIBOR + 0.50	LIBOR + 1.00	LIBOR + 1.50	LIBOR + 2.00
			12 months	LIBOR + 0.50	LIBOR + 1.00	LIBOR + 1.75	LIBOR + 2.50
	Loans in US dollars and euros[4]		28 days	LIBOR + 0.75	LIBOR + 1.25	LIBOR + 1.75	LIBOR + 2.25
			365 days	LIBOR + 0.75	LIBOR + 1.25	LIBOR + 2.00	LIBOR + 2.75

[1] Operations are conducted at fixed interest rates.
[2] The rate for the ruble-denominated leg is set at the key rate less 1 percentage point.
[3] Minimum interest rates are given.
[4] The LIBORs are used in respective currencies and for respective terms.

The ruble appreciation had a positive impact on internal price dynamics and was one of the factors behind the slowdown in inflation from April 2015. Thus, foreign currency refinancing operations not only facilitated the stable functioning of the financial sector but also had a positive effect on monetary policy conditions by reducing the inflationary pressure caused by the ruble exchange rate movements. This effect, alongside other factors, was taken into account during decision-making on the key rate and, in part, made it possible to actively reduce the key rate in the first half of 2015.

However, providing foreign currency through reverse operations did not have a substantial impact on steering money market interest rates, as it did not lead to an outflow of ruble-denominated liquidity from the banking sector. The expansion of FX repos in the first half of 2015 provided an additional pressure on marketable collateral which was also used for main ruble-denominated refinancing operations. However, with the decline of the structural liquidity deficit and expansion in eligible collateral amid the active placements of corporate bonds and OFZs, the overall pressure on marketable collateral was lessened and, given the liquidity forecast, no problems with marketable collateral sufficiency are expected to evolve till the end of 2015.

Bank of Russia foreign currency liquidity provision operations significantly facilitated the economy's getting through the most acute stage of adaptation to the limited access to international capital markets. Afterwards, amid the stabilisation of the situation in the financial markets, the Bank of Russia took steps to encourage banks to more actively seek out alternative sources of foreign currency liquidity so that the central bank's instruments would not substitute market mechanisms. At the end of March-April 2015, the minimum interest rates on foreign currency liquidity-providing instruments were raised to bring them closer to market interest rates. In addition, in view of the falling demand for foreign currency refinancing operations demonstrated by the banking sector, the Bank of Russia suspended 364-day foreign currency repo auctions from June 2015. In the period up to the end of 2015, the Bank of Russia is prepared to promptly make decisions to change the limits on foreign currency repo auctions and loan auctions in the event of a change in banking sector demand for foreign currency liquidity, and in case there is a need to expand liquidity provision. However, it is expected that the amount of revenue in the current account balance of payments and the amount of foreign currency liquidity already accumulated by Russian companies and banks,

supplemented by Bank of Russia foreign currency refinancing operations, will largely ensure uninterrupted external debt payments during this period.

With the situation in the FX market stabilising, in May 2015, the Bank of Russia decided that there was a need to replenish its international reserves, taking into account their importance for supporting the stable functioning of the financial sector during the period of negative external shocks which could last for a long time.

The volume of daily operations to replenish reserves was determined based on the foreign exchange market climate, changes in foreign economic conditions, the state of the Russian economy and the balance of payments. Foreign currency was purchased in the domestic FX market in small amounts ($100-200 million) distributed evenly during the course of the day. The volume of these daily operations was set in such a way as to ensure that they would produce minimal impact on ruble exchange rate dynamics and volatility, and therefore on the level of risk to price and financial stability. Whenever necessary, foreign currency purchases were suspended for a day or for longer periods. In May-July, the total purchases of foreign currency amounted to $10.1 billion. From 28 July, no further operations were carried out in view of the growing exchange rate volatility caused by external economic factors.

Decisions regarding the possibility of resuming operations to replenish international reserves will be taken based on how the situation evolves in the domestic foreign exchange market, as well as in the global markets and in the Russian economy as a whole (see Subsection 3.3 for more details).

At the start of 2015, the Bank of Russia also carried out operations in the domestic foreign exchange market. These were linked to the sales of foreign currency by the Federal Treasury from its foreign currency accounts at the Bank of Russia. These operations totalled $2.3 billion. As for operations related to replenishing or spending sovereign funds by the Russian Ministry of Finance and Federal Treasury in 2015, they were carried out by converting foreign currency funds kept in accounts with the Bank of Russia into rubles, which meant that they did not have any impact on the exchange rate.

The Bank of Russia's anti-crisis measures implemented in the sphere of banking regulation also led to achieving its goal of ensuring stability for the Russian financial sector in 2015. In the first half of the year, the temporary changes introduced in December 2014 to the procedure used to assess and classify credit institutions' assets and liabilities continued to be in effect, including the moratorium on recognising negative revaluations of securities portfolios, the right to use fixed foreign currency exchange rates when calculating prudential requirements, and the relaxed procedure employed to assess the quality of outstanding loans[7].

Such easing of regulatory standards made it possible to reduce the unfavourable impact of the massive deterioration of external and internal economic conditions at the end of 2014 on banks' compliance with prudential requirements and on their credit activity, and supported the stable functioning of the banking system. This in turn maintained normal conditions for the implementation of monetary policy, because it influences the economy through interest rates which are set by the financial sector and are also affected by the dynamics of banks' balance sheet indicators.

Over 2015, a number of temporary measures easing regulatory standards were extended till 1 January 2016[8], including changes to the procedures of loan quality assessment and assets and liabilities recording at a fixed exchange rate (with the option to up-date

[7] *Bank of Russia press releases 'On Bank of Russia measures to maintain stability of the Russian financial sector', dated 17 December 2014 and 21 September 2015.*

[8] *Bank of Russia press releases 'On anti-crisis measures in banking regulation', dated 15 May 2015 and 21 September 2015.*

the values of rates to be used from 1 October 2015), while other easing measures were discontinued. These changes were installed following the analysis of a broad range of banking sector indicators and consultation with market participants. However, as banks adapt to the after-effects of the shocks, the said temporary easing measures are to be entirely stopped, so as to not distort the role of normal market mechanisms and incentives in banking sector operation, including with regard to risk assessment.

With the gradual winding-down of anti-crisis measures in banking regulation, stability in the banking sector will be assisted by the government's bank recapitalisation programme (with the involvement of the Bank of Russia) through the use of OFZs. This programme will also support the dynamics of priority lending segments, including mortgage lending, lending to small and medium businesses, constituent territories of the Russian Federation, agriculture, manufacturing industries, construction, transport, communications and housing services and utilities, as growth in these areas is one of the conditions for the participants in the recapitalisation programme.

In 2015, the Bank of Russia continued to use previously introduced special refinancing mechanisms, as proposed in the Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017. These include programmes to support funding for investment projects, lending to small and medium businesses and export-oriented economic sectors, and mortgage lending through the Military Mortgage programme. A number of these instruments were developed and implemented as part of state development programmes for certain sectors of the economy or are carried out jointly with the Government of the Russian Federation.

Supporting certain important lending segments through concessional funding and creating additional incentives was necessary at a time when the development of these segments was crucial for establishing favourable trends in the structure of economic growth, but due to a number of negative factors such support was not possible through market mechanisms alone. Moreover, overall strictness of monetary conditions continued to be sufficient to ensure that inflation dropped to the target level in the medium term.

In 2015, work continued to improve programmes supporting lending to small and medium businesses. The Bank of Russia raised maturity ceiling for loans provided to JSC SME Bank, the loans being secured by receivables under interbank loan agreements concluded by this bank with partner banks in the framework of the Financial Assistance Programme for small and medium businesses. JSC SME Bank was enabled to use Bank of Russia refinancing facilities for loans granted to microfinance organisations for the purpose of lending to small and medium businesses. In addition, a mechanism was set up to issue loans secured by the guarantees of JSC SME Corporation. The Bank of Russia increased from 50 to 100 billion rubles maximum allotment amount of funds provided through programmes to stimulate funding for investment projects, which were selected in accordance with the rules approved by the Government of the Russian Federation. These funds were also used to secure bonds placed to fund investment projects and included in the Bank of Russia Lombard List.

The interest rates on special refinancing instruments remained unchanged since the start of 2015, staying below the key rate. Offering funds at lower interest rates and for longer terms than under regular instruments was aimed at creating additional incentives for the banking sector to lend to certain segments of the economy and to improve the accessibility of financial resources for the development of these segments. As of 30 October 2015, the outstanding amounts on special refinancing instruments totalled 106.7 billion rubles, marking an increase of 80.6 billion rubles

compared with the start of the year (see Table 5 of the Annex). However, the amount of funds provided through these operations remained by far below the volume of main liquidity management operations of the banking sector and their implementation did not have any meaningful impact on the level of interest rates in the economy as a whole, and consequently on monetary policy pass-through effect on economic processes.

In addition, in 2015, the Bank of Russia continued its efforts to rehabilitate the banking sector, which imply its stable functioning, maintaining trust in the banking sector among the public and organisations, and preventing misconduct in the financial markets. All this is in many ways essential for creating normal environment for monetary policy implementation. In particular, improved bankruptcy and financial resolution mechanisms for banks (including the use of obligation settlement procedures) should increase the effectiveness of bank customer interests' protection and minimise the impact of these procedures on the functioning and sustainability of the financial sector as a whole and, therefore, on the operation of the monetary policy transmission mechanism.

3. MACROECONOMIC SCENARIOS AND MONETARY POLICY IN 2016-2018

3.1. Macroeconomic scenarios in 2016-2018

Monetary policy decisions are taken on the basis of the assessment of the current economic situation and medium-term macroeconomic forecast. Therefore, the Bank of Russia not only looks at the most likely economic development scenarios, but also analyses the external and internal risks that could potentially influence the financial system and economy as a whole and thus monetary policy decision-making.

The Bank of Russia bases its macroeconomic scenarios on the forecast of developments in external conditions, as well as the assumed impact of a number of domestic factors evolving outside the scope of monetary policy, particularly government policy and structural features of the economy. Besides, the economic development forecast is built upon an energetic monetary policy aimed at maintaining domestic price stability, i.e. reducing inflation and stabilising it at a low level over the three-year period under consideration. The main instrument for transmitting monetary policy signal to the economy is the Bank of Russia key rate, which is governed by the need to meet the inflation target, to maintain conditions for sustainable economic development and to ensure financial stability over the medium term.

The conditions for implementing monetary policy in the forecast period of 2016-2018 are expected to remain quite complicated, shaped largely by the international economic situation. Among the external factors that have a significant impact on the Russian economy, global oil prices are the most volatile. The Bank of Russia considered three economic development scenarios with different assumptions about the path of oil prices in the global markets. The baseline scenario assumes that the average annual Urals crude prices will remain at around $50 per barrel for the entire three-year period. The optimistic scenario assumes a gradual rise in the average annual oil prices to $70-80 per barrel in 2018, while the risk scenario assumes that the average annual oil prices will remain below $40 per barrel in 2016-2018.

On the supply side, the decisive factors behind oil market pricing will be technological advances and the intensity with which oil production from unconventional sources (shale oil) will be expanded. Some risks are associated with geopolitical situation's potential influence on supply dynamics.

The level of demand in the global energy market will be determined by the prospects for growth in the global economy, the pace of which is expected to remain low in all of the considered scenarios. In major developed nations, economic activity is expected to recover gradually from the relatively low levels of recent years. At the same time, the economic growth rates of developing markets remain more uncertain. In particular, one significant risk is the possibility of a downturn in the Chinese economy on the back of the exhaustion of its extensive growth model and the subsequent adjustment of financial markets in view of accumulated imbalances. Given the large scale of the Chinese economy, this could have a weighty impact on the global financial and commodity markets, including the oil market, and adversely affect the growth prospects of other emerging markets. The risk scenario considered by the Bank of Russia corresponds to the most unfavourable evolution of events, while the optimistic scenario is consistent with the most stable external growth patterns.

In addition to oil prices and the dynamics of external demand, the Bank of Russia also takes into account other external factors that will affect the development of the Russian economy, including external inflationary trends and financial conditions. Taking into account the forecast of low GDP growth rates of Russia's trading partners considered under all of the scenarios, inflation in Russia's main trading partner countries will accelerate somewhat from its current subdued levels, but will in general remain not high. Apart from energy market prices, the price situation in most global commodity markets is not expected to change significantly. The modest pace of external inflation will affect domestic price situation via import prices, as well as foreign exchange rates dynamics determined by the terms of trade.

In all of the considered scenarios, external sanctions imposed on the Russian economy are expected to continue for the duration of the three-year period without any significant change in scale or nature. The sanctions will exert a restraining influence on the Russian economy through elevated economic uncertainty, the ongoing restricted access to external financing for Russian companies and banks and the use of imported high-tech products for investment purposes.

The financial sanctions will play a decisive role in shaping strict external financing conditions for Russian borrowers. Another factor will be the rise in interest rates in global financial markets amid the expected transition of many central banks, primarily among developed economies, toward a gradual tightening of monetary policy as the economic recovery gains traction and deflationary risks subside. Borrowing costs in external markets for Russian borrowers will also be influenced by the trajectory of oil prices assumed in the scenarios, which will affect international investors' assessments of Russia's economic outlook and, consequently, risk premiums.

For the duration of the forecast period, current restrictions on the imports of certain foreign goods, which were introduced in response to the imposition of external sanctions on Russia, are expected to remain in place, but not to be expanded. Consequently, this factor will not produce any additional material pressure on the overall inflation. However, the remaining trade restrictions may affect the intensity of seasonal fluctuations of food prices.

As far as domestic conditions are concerned, one of the most important factors is the influence of government policy. Over the forecast horizon, the Bank of Russia expects fiscal policy to have a slight effect on economic growth. The potential increase of budget expenditure is limited by drop in oil and gas revenue in comparison with previous years, which will be most dramatic under the risk scenario and least dramatic under the optimistic one. Maintaining a conservative approach to government spending will make it possible to limit the budget deficit and ensure the long-term sustainability of public finances, taking into account objective changes in external conditions and the pension system-induced growing pressure on the budget. Preserving a moderate pace of wage indexing in the public sector and tariff indexing for natural monopolies' services will prevent an undesirable surge in inflation risks and will also create conditions for streamlining' producer costs.

The Bank of Russia's forecast assumes that structural limitations for the growth of the national economy, including those associated with adverse demographic trends and the low mobility of labour resources, will remain in place over the medium term under all of the presented scenarios. The effects of these limitations will decelerate the further adjustment of the economy to the overall deterioration in foreign economic conditions (compared with previous years) and will restrain the recovery of economic growth.

An important condition for increasing the long-term potential for economic growth lies in structural changes associated with channeling production resources from less com-

petitive industries into more competitive ones. Government measures designed to improve the business climate and boost the quality of labour resources and productivity growth will also be of key importance. If the implementation of these measures enables the economy to overcome its resource limitations faster over the medium term, the Bank of Russia does not rule out the possibility that the pace of economic growth will reach a higher level than in the considered scenarios without any additional rise in inflationary pressure for the economy.

Over the forecast period under the baseline and optimistic scenarios, conditions will evolve for a reduction in inflation expectations in the economy and a steady deceleration of inflation. These scenarios provide for a fast slowdown of inflation to 5.5-6.5% by the end of 2016. The most dynamic deceleration of inflation (to about 8%) will be observed in 2016 Q1, which will be largely determined by the exclusion from the calculation base of a sharp rise in prices as a result of the massive ruble depreciation pass-through effect registered at end-2014 – early 2015.

Subsequent slowdown in price growth over 2016 will be buoyed by the expected stability of the exchange rate and inflation expectations, as well as restricted consumer activity. Growth in household expenditure will be constrained by the moderate increase of wages and the persistence of a rather high propensity to save demonstrated by households, given their scarce borrowings amid relatively strict financial conditions. Over the forecast period, no cost-push external or internal inflationary shocks are expected to materialise (specifically, considering information on this-year harvest and scheduled indexing of tariffs in the infrastructure sector).

The key condition for ensuring a consistent inflation deceleration to the target level in 2017-2018 will be maintaining the relatively limited growth of income and consumer demand throughout most of this period in the context of a conservative fiscal policy and moderately rigid monetary policy.

With declines in inflation expectations and inflation, the Bank of Russia will lower its key rate. However, any change in interest rate policy will be gradual, and monetary policy will remain reasonably tight until inflation has stabilised at a low level. This is vital not only with respect to ensuring price stability but also with respect to supporting financial stability. The main internal source of risk to the latter may be excessive acceleration in the growth of the credit burden as compared to income dynamics in the economy, which is possible in the event of exceptional easing of financial conditions.

Any change in the key rate will be consistently transmitted onto deposit and lending rate dynamics and market yield curves with a lag of up to six months. During the forecast period, lending terms will be eased not only through reduced market interest rates on the back of the Bank of Russia key rate's path, but also through the adjustment of non-price lending conditions. Their easing will be assisted by the improved assessment of borrowers' financial standing, partly as the accumulated debt burden will shrink due to persistently slow growth in lending to the economy and reasonably tight monetary policy at the initial stage.

The easing of internal financial conditions will form prerequisites for the consistent recovery of lending in 2017-2018. This gives ground for expecting a gradual increase in the share of domestic credit in the total borrowings and a decrease in the dollarisation of both the assets and liabilities of economic agents. Growing trust in the national currency and propensity to save and lend via the Russian financial system shall be supported by a consistent and predictable monetary policy aimed at achieving internal price stability, maintaining floating exchange rate regime and preserving financial stability. This will shape conditions for the sustainable and well-balanced growth of the banking sector activity and consistent development

Bank of Russia key projections
(annual percentage changes, unless otherwise indicated)

	2014 (actual)	2015	2016		2017		2018	
		estimate	baseline	optimistic	baseline	optimistic	baseline	optimistic
Price of Urals crude, annual average, US$/barrel	98	53	50	60	50	70	50	75
Gross domestic product, year on year	0.6	-(3.9-4.4)	-(0.5-1.0)	0.0-0.5	0.0-1.0	1.0-2.0	2.0-3.0	2.5-3.5
Inflation, December on December of previous year	11.4	12.0-13.0	5.5-6.5	5.5-6.5	4.0	4.0	4.0	4.0
Money supply in the national definition, annual growth	2.2	5-8	4-7	8-10	8-11	13-16	13-16	13-16
Monetary base (narrow definition), annual growth	2.7	(-1)-1	1-4	5-8	2-5	5-8	5-8	5-8
Loans to non-financial organisations and households in rubles and foreign currency, annual growth	25.9	4-7	4-7	7-9	8-11	13-16	13-16	13-16

Source: Bank of Russia.

of financial markets, thereby supporting growth in economic activity in the medium run.

One of the important factors underlying the pace of economic growth recovery in the considered scenarios will be a change in business sentiment and expectations, which, along with trends in external and domestic financial conditions, will influence the propensity to invest in the Russian economy. The growth rates of fixed capital investment are expected to become positive in 2016 under the optimistic scenario, and possibly in 2017 – under the baseline scenario. This process will be supported by the easing of domestic financial conditions, including the reduction of the Bank of Russia key rate over the forecast horizon. Another favourable factor will be the release of additional funds for fixed capital investment as a result of a moderate increase in the cost of labour and the services of infrastructure companies. Measures to finance infrastructure projects using assets from the National Wealth Fund will also boost investment.

In the short term, consumer demand will be held back by the deteriorating situation in the labour market, which is characterised by a contracting demand for workers among companies and weak nominal wage growth both in the private and public sectors. The growth of consumer spending will be also restrained by limited increase in unsecured consumer lending, coupled by households' persistent propensity to save. In future, demand will speed up as household incomes rise amid increased production activity driven by expanded investments and positive trends in labour productivity. Another favourable factor will be improved access to borrowing partly as a result of a drop in interest rates. Consumption growth is expected to return to the positive zone in 2016, according to the optimistic scenario, or in 2018, according to the baseline scenario.

In light of these trends, Russia's economic growth rates will remain negative in 2016, according to the baseline scenario, after which they will gradually recover.

Under this scenario, given weak external demand and an unfavourable price situation in global commodities markets, Russian exports volume will increase very slowly, however the growth rates of the demand for imports will also be relatively low. These two factors in aggregate will ensure the stability of the trade balance and the current account balance of Russia's balance of payments. Apart from the trade components dynamics, the latter will be also conditioned by a decrease in the outflow of funds from the balance of primary and secondary income, which is largely due to a fall in interest and dividend payments on external liabilities amid a steady decline in external debt.

The continuation of payments on external liabilities will make a decisive contribution in the formation of a negative balance on Russia's

GDP and expenditure components
(in constant prices, year on year growth rates)

	2014	2015	2016		2017		2018	
	(actual)	estimate	baseline	optimistic	baseline	optimistic	baseline	optimistic
GDP	0.6	-(3.9-4.4)	-(0.5-1.0)	0.0-0.5	0.0-1.0	1.0-2.0	2.0-3.0	2.5-3.5
Final consumption expenditures	0.9	-(6.2-6.9)	-(1.0-1.4)	0.0-0.3	(-0.7)-0.3	0.8-1.5	1.5-2.5	2.0-3.0
– households	1.3	-(9.0-9.4)	-(1.0-2.0)	0.0-0.6	-(0.0-0.9)	1.1-1.7	1.8-2.9	2.5-3.5
Gross capital formation	-7.3	-(27.0-32.0)	-(3.2-6.6)	1.1-3.2	(-0.5)-2.5	4.7-7.7	5.5-7.2	11.5-14.0
– gross fixed capital formation	-2.0	-(7.0-8.0)	-(2.8-3.8)	0.6-1.6	(-0.5)-0.5	3.0-4.0	4.0-5.0	5.0-6.0
Net exports	29.8	89.5-106.5	8.5-10.5	-(1.5-3.5)	8.5-10.5	-(1.5-3.5)	-(5.0-7.0)	-(14.5-16.5)
– exports	-0.1	1.5-2.5	0.0-1.0	0.4-1.4	1.0-2.0	1.6-2.6	1.9-2.8	1.9-2.8
– imports	-7.9	-(26.0-30.0)	-(1.5-2.5)	0.5-2.6	(-1.0)-0.5	3.1-4.0	4.5-6.0	7.0-9.0

Sources: Rosstat, Bank of Russia.

balance of payments financial account. At the same time, residents' investment in foreign financial assets are forecast to be rather low amid expectations that exchange rate trends will remain stable, the income growth in the economy will slow down, and ruble interest rates will remain attractive, on account of the dynamics of the Bank of Russia' key rate, among other things. Therefore, net private capital outflow will go down in comparison with previous years, ending up in the range of $50-60 billion a year. This scenario does not foresee any prerequisites for the Bank of Russia to conduct operations in the domestic FX market and assumes that Russia's balance of payments will be robust in case of near-zero movements in the foreign currency reserves.

A continuation of modest growth in domestic consumer demand, relatively stable exchange rate dynamics and inflation expectations in the absence of any unforeseen pro-inflationary shocks, will ensure that inflation steadily falls and reaches the target level of 4% in 2017-2018. Under this scenario, the aforementioned combination of economic conditions will create grounds for gradually cutting the Bank of Russia key rate during the forecast period.

In the optimistic scenario, the restraining influence of external factors will be less pronounced and the Russian economy is expected to return to positive growth as early as in 2016.

The demand for Russian exports (both commodity and non-commodity) will turn out to be more elevated than under the baseline scenario. The growth of import quantities, meanwhile, will be driven by the increase in investment demand and, after that, by the recovery of consumer activity. Despite the somewhat faster growth of imports in real terms relative to exports, the US dollar equivalent of the balance of payments' current account balance will remain higher than assumed by the baseline scenario. Net private capital outflow, in the event of a more dynamic recovery of income growth in the economy and a larger influx of funds in the current account, will reach $55-65 billion a year exceeding the baseline scenario. The overall status of Russia's balance of payments under this scenario will enable the central bank to gradually build up its foreign currency reserves throughout the forecast period (see Sub-section 3.3 for more details). An improvement in foreign trade conditions coupled with a rise in oil prices will result in an elevated real ruble exchange rate.

Favourable exchange rate dynamics combined with the anticipated reduction in inflation expectations and moderate growth of consumer demand will ensure that inflation will slow to

Balance of payments of the Russian Federation (billions of US dollars)

	2014 (actual)	2015	2016		2017		2018	
		estimate	baseline	optimistic	baseline	optimistic	baseline	optimistic
Current account	59	65	61	81	61	77	55	72
Balance of trade	190	150	143	166	141	162	136	163
Exports	498	346	336	379	335	433	348	489
Imports	-308	-197	-194	-213	-194	-271	-212	-326
Balance of services	-55	-39	-37	-39	-38	-45	-44	-53
Exports	66	51	52	54	52	59	54	63
Imports	-121	-91	-89	-93	-90	-104	-98	-117
Balance of primary and secondary income	-75	-45	-44	-46	-42	-40	-38	-37
Capital account	-42	0	0	0	0	0	0	0
Current account and capital account balance	17	65	61	81	61	77	55	72
Financial account (excluding reserve assets)	-134	-73	-61	-66	-61	-62	-55	-57
General government and the central bank	29	-3	-3	-3	-3	-3	-3	-3
Private sector (including net omissions and errors)	-154	-70	-58	-63	-58	-59	-52	-54
Change in FX reserves ('+' – decrease, '-' – increase)[1]	108	8	0	-15	0	-15	0	-15

[1] Changes in FX reserves due to Bank of Russia operations, including FX repos, FX swaps, and Bank of Russia conversion operations in the domestic FX market due to the use of the Reserve Fund the National Wealth Fund. Given the transition to the floating exchange rate regime, all the presented scenarios do not envisage any direct Bank of Russia operations to buy and sell foreign currency in the domestic FX market in the framework of the exchange rate policy in 2016–2018.

Source: Bank of Russia.

the 4% target in 2017-2018 on condition of a faster reduction of the Bank of Russia key rate than assumed by the baseline scenario.

Under the risk scenario, the more unfavourable development of the external situation in comparison with the baseline and optimistic scenarios will bring about a stronger and more protracted economic decline. The adverse impact of the foreign economic situation on the economy will take the form of a drop in exports income, a deterioration in the solvency of borrowers who have outstanding debt in foreign currency, a reduction in the attractiveness of investment in the Russian economy for Russian and external investors, and limited ability to finance public spending. The combined effect of these factors will necessitate more profound structural changes in the Russian economy to offset insufficient economic growth. Under these conditions, GDP could fall by as much as 5% or more in 2016.

Given increasing uncertainty over the development of the external and domestic situation, this scenario assumes an increase in the financial markets volatility. Under these conditions, exchange rate and inflation expectations may deteriorate sharply, which will significantly aggravate inflation risks and risks to financial stability. In this situation, in order to avoid risk escalation the Bank of Russia can use either interest rate policy measures or other instruments, including operations in the domestic FX market (see Sub-section 3.3 for more details).

Under the risk scenario, the economic cooldown largely driven by structural factors, would have a limited deflationary effect. As a result, given the persistence of risks instigated by exchange rate and inflation expectations, in 2016, inflation will remain elevated in the range of 7-9%. For quite a long period, the Bank of Russia key rate will stay at a higher level than under the baseline and optimistic scenarios.

In any of the considered scenarios, additional risks could materialise, thus influencing inflation trends. At the current stage, the Bank of Russia estimates that risks are distributed asymmetrically across price dynamics and are largely shifted towards the pro-inflationary side, which calls for a relatively conservative approach to monetary policymaking. One risk for the inflation forecast is the fluctuation of traditionally highly volatile food prices depending on the harvest of particular crops. Changes in fiscal and tariff policies assumed by these scenarios could also have an inflationary effect. There also remain external risks driven by geopolitical factors that may affect price dynamics by changing foreign exchange rates.

The acceleration of annual rates of inflation under the influence of the above factors is usually short-lived (up to 12-18 months). In this case, inflation will return to the path leading to the medium-term goals without any additional change in monetary policy. If, however, such factors begin to influence the price dynamics for a wide range of goods and services, or if inflation expectations begin to rise, the Bank of Russia will pursue a tighter monetary policy.

As it receives new data, the Bank of Russia will regularly assess and adjust the parameters of its macroeconomic development forecast, which may affect its decisions regarding the implementation of monetary policy for the purpose of achieving the set target. The relevant information will be provided on an ongoing basis in the Bank of Russia's Monetary Policy Report, which is published on a quarterly basis.

3.2. Development of the system of monetary policy instruments

The Bank of Russia expects the structural liquidity deficit of the banking sector to stay in 2016-2018. Moreover, during the considered period it is expected that credit institutions' need for ruble-denominated refinancing from the Bank of Russia will decline primarily due to an influx of liquidity into the banking sector through the use of sovereign funds to finance federal budget spending. Furthermore, growth in cash in circulation, as the Russian economy begins to pick up speed, will lead to a slight liquidity outflow from the banking sector. The Bank of Russia forecasts that credit institutions' outstanding amounts on refinancing operations will be largely determined by the need either to use or to accumulate the Reserve Fund assets during the three coming years. According to the baseline scenario, credit institutions' outstanding amounts may be 1.0 trillion rules, whereas the optimistic scenario assumes their growth to 5.3 trillion rubles.

The Bank of Russia will continue to manage banking sector liquidity using the system of monetary policy instruments. This system has been generally finalised, and no significant changes are expected in the future. However, during the next three years, the Bank of Russia will continue to work on improving certain elements of the system.

From the beginning of 2016, the schedule of required reserves averaging periods will be synchronised with settlements on the Bank of Russia's main refinancing operations, which will reduce the likelihood of significant deviations in the demand for and supply of liquidity. The length of the averaging periods will be set at 4-5 weeks. In addition, over the course of the next three years, the Bank of Russia plans to continue raising the required reserve averaging ratio. This will expand credit institutions' ability to manage their own liquidity amid transitory changes to that liquidity due to the use of the required reserve averaging mechanism. In particular, on days when there evolves a short-term demand for liquidity (e.g. caused by unforeseen payments to the budget), credit institutions will be able to decrease their correspondent accounts at the Bank of Russia by necessary amounts without having to borrow funds in the money market or from the Bank of Russia. On the other hand, if the banks find themselves with a short-term surplus, they will

not rush to place these funds in the money market.

As banking sector gradually adapts to previously implemented and above mentioned changes to the system of instruments and improve management of their ruble liquidity, credit institutions' use of standing facilities and the need for Bank of Russia fine-tuning auctions are expected to become less frequent. This will ultimately help reduce the volatility of short-term money market interest rates and improve the efficiency of the monetary policy transmission mechanism.

In 2016-2018, another focus of the Bank of Russia's efforts will be on the improvement of the technological aspects of operations. In particular, steps will be taken to arrange access to tri-party collateral management services for repo transactions with a basket of collateral through exchange and over-the-counter channels for providing liquidity. The Bank of Russia also plans to develop electronic workflow system with credit institutions for operations involving the extension of loans secured by non-marketable assets.

In addition, the Bank of Russia will improve the contractual framework governing repo operations in the Russian financial market by migrating to a single master agreement of the Bank of Russia for all types of repos based on uniform close-out netting.

The Bank of Russia also plans to focus on improving the Russian financial market's settlement and clearing infrastructure with an emphasis on developing and diversifying the collateral management system for repo operations. This measure will assume integrating the Russian stock and money markets with international depositary and collateral management systems.

The Bank of Russia will continue its efforts aimed at harmonising the operating hours of the payment system and financial markets with the timing of its operations. This will optimise liquidity redistribution across the banking sector, cut credit institutions' operating costs, and set up conditions for improving the efficiency of monetary policy mechanisms by reducing the frequency with which credit institutions resort to the Bank of Russia's standing facilities to provide ruble liquidity.

The Bank of Russia will continue its joint work with the Federal Treasury on issues of managing the balance of budgetary funds in accounts at the Bank of Russia and the influence of fiscal flows on the implementation of monetary policy. Operations conducted by the Federal Treasury to place temporarily unallocated budgetary funds in bank deposits, as well as repo operations, will help smooth out the influence of fiscal flows on banking sector liquidity.

3.3. Monetary policy in conjunction with other functions of the Bank of Russia: development prospects

Over the next three years, certain problems persisting in the Russian economy will force the Bank of Russia to continue implementing additional unconventional measures. These problems will be both external and domestic in nature. External factors include the continuation of sanctions imposed on Russian companies by a number of countries. The domestic problems are related to the current structure of the Russian economy and its resource limitations, including those caused by unfavourable demographic trends. In taking additional measures, the Bank of Russia will assess their impact on the Russian economy in order to avoid any distortion of market mechanisms, and the formation and growth of imbalances.

In order to ensure the stable functioning of the banking sector and financial market in the situation of persistent restrictions on the access to international capital markets for Russian businesses, the Bank of Russia will continue to conduct foreign currency refinancing operations. These will be carried out primarily in the form of repo auctions. Decisions

on foreign currency allotment amounts for these auctions will continue to be made by the Bank of Russia based on its forecast of the balance of payments, taking into account, among other things, the expected amount of external debt repayments by financial and non-financial organisations. If the economic situation develops according to the baseline or optimistic scenarios, under which credit institutions and companies are supposed to gradually adapt to the imposed restrictions and shift toward other sources of financing, including Asian capital markets, the Bank of Russia will consider the possibility of reducing the volume of foreign currency refinancing for credit institutions. If, however, the situation unfolds according to the risk scenario, the central bank will probably have to increase the volume of foreign currency liquidity provision to credit institutions on a repayable basis.

The Bank of Russia will continue to pursue a floating exchange rate regime, but in case there appear any threats to financial stability, it will be prepared to intervene in the domestic FX market. In order to identify the emergence of threats to financial stability, the Bank of Russia will monitor a wide range of indicators, including FX market volatility indicators, as well as indicators of exchange rate deviations from fundamental levels.

In the event of protracted adverse shocks, substantial amounts of international reserves are needed to ensure the uninterrupted servicing of foreign liabilities for several years, the stable functioning of the Russian financial system as a whole and the currency market in particular. The Bank of Russia has estimated the necessary amount of international reserves at around $500 billion and plans to continue purchasing foreign currency in order to build up international reserves to this level.

As earlier, the Bank of Russia will not set a specific ruble exchange rate as a trigger for resuming or suspending such operations. When making decisions on foreign currency purchases and amounts thereof, the central bank will take into account the trends of exchange rate dynamics that have emerged under the influence of fundamental and transitory factors, as well as the state of the Russian economy and the balance of payments. Such operations will be generally conducted in small amounts during operational hours in order to minimise the impact on intraday ruble exchange rate dynamics. The medium term indirect influence on the national currency's exchange rate, made by interventions conducted to replenish reserves, will be taken into account for preparing macroeconomic forecasts and, consequently, for making decisions on the key rate levels. In addition, these operations will be taken into account by the Bank of Russia to determine ruble liquidity amounts to be provided to the banking sector and will not influence the effectiveness of interest rate management.

The process of increasing international reserves to the level of $500 billion will take a long time and will depend on the particular scenario according to which the situation will evolve.

Foreign currency purchases for the replenishment of international reserves and foreign currency refinancing facilities are both aimed at ensuring the stable functioning of the financial sector, but over different time horizons. Foreign currency provision operations are needed during the most acute phase of the economy's adaptation to the restricted access to international capital markets, whereas accumulating sufficient amounts of international reserves will increase the economy's resilience to future external shocks. However, since foreign currency is provided on a repayable basis, international reserves experience only short-term contractions and their adequacy remain unchanged over the mid-term perspective.

In 2016-2018, in order to stimulate certain segments of the lending market whose development is being held back by structural factors, the Bank of Russia will also continue using special refinancing tools, where funds are provided to credit institutions at preferential in-

terest rates and for longer terms. These mechanisms are aimed at supporting the funding of investment projects, including small and medium-sized businesses, export-oriented companies, and mortgage lending. The Bank of Russia will monitor and analyse the effectiveness of specialised mechanisms and will streamline their conditions. At the same time, the central bank will continue to limit the provision of funds under these programmes, since they are not among the main instruments of monetary policy and their use must not reduce the effectiveness of the monetary policy or hamper the achievement of the inflation target. The Bank of Russia plans to employ special refinancing instruments until the financial market is ready to replace stimulus programmes for priority segments of the economy with market mechanisms.

Over the next three years, work will progress on improving the coordination of Bank of Russia measures prescribed by its mandate.

The Bank of Russia will continue to study channels of mutual influence of measures under monetary policy, macro-prudential policy, and financial stability policy, as a whole, in order to ensure the effectiveness of measures being taken. It will strive to integrate quantitative assessments of data on mutual influences into the existing forecast models to make the better use of them in the decision-making process.

The Bank of Russia plans to carry out a comprehensive assessment of the impact produced by changes in prudential standards on bank lending activity, Bank of Russia operations and conditions for implementing monetary policy in general. The information obtained will enable the Bank of Russia, if need be, to make sure that the parameters of monetary policy instruments can be adapted to new conditions.

In order to enhance the transparency of the monetary policy, and to share opinions regarding the situation in the banking sector, economy as a whole, and its development prospects, the Bank of Russia will attempt to expand cooperation with credit institutions, banking associations, analysts, and academic community members. It will continue holding regular meetings with banking sector experts and conduct surveys of credit institutions and banking associations on most topical issues of monetary policy and financial stability.

APPENDIX

Table 1

GDP, inflation and interest rates in BRICS, USA and euro area[1]

	Key (target) interest rate of the central bank, percent p.a.	Interest rate on bank loans to non-financial sector for a term of up to 1 year/1 year, percent p.a.	Inflation rate, month on corresponding month of previous year, percent	GDP growth rates, quarter on corresponding quarter of previous year, percent
Russia	11.0	14.2	15.67	-4.6
Brazil	14.25	42.6	9.49	-2.6
India	6.75	10.1	5.14	7.0
China	4.35	4.9	1.6	6.9
South Africa	6.0	9.3	4.59	1.2
USA	0-0.25	3.3	-0.03	2.0
Euro area	0.05	2.9	-0.08	1.5

[1] Data on key (target) interest rates are given as of 4 November 2015, on interest rates on bank loans – for 2015 Q2 (for Russia - for August 2015), on inflation rate – for September 2015, and on GDP growth rates – for 2015 Q2 (for China and the USA - for 2015 Q3).

Sources: IMF, Bloomberg..

Table 2

Consumer prices by group of goods and services (month-on-month percentage changes)

	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
2013								
January	1.0	0.5	1.8	1.2	7.4	0.4	0.4	0.6
February	0.6	0.4	0.8	0.6	2.8	0.4	0.4	0.4
March	0.3	0.4	0.4	0.5	0.1	0.4	0.4	0.2
April	0.5	0.4	0.7	0.4	3.6	0.4	0.4	0.5
May	0.7	0.3	1.0	0.3	6.5	0.3	0.3	0.8
June	0.4	0.3	0.5	0.2	3.0	0.2	0.2	0.6
July	0.8	0.3	0.0	0.4	-3.0	0.1	0.1	3.1
August	0.1	0.5	-0.7	0.6	-11.3	0.5	0.3	0.9
September	0.2	0.7	0.0	0.8	-7.6	0.5	0.4	0.1
October	0.6	0.6	1.1	0.9	3.6	0.5	0.5	-0.1
November	0.6	0.6	0.9	0.7	3.0	0.4	0.5	0.2
December	0.5	0.4	0.8	0.5	2.8	0.2	0.3	0.6
Full year (December on December)	6.5	5.6	7.3	7.1	9.3	4.5	4.4	8.0
2014								
January	0.6	0.4	1.0	0.5	5.8	0.3	0.3	0.5
February	0.7	0.5	1.2	0.7	5.1	0.4	0.4	0.4
March	1.0	0.8	1.8	1.3	5.3	0.7	0.6	0.5
April	0.9	0.9	1.3	1.2	2.3	0.6	0.6	0.7
May	0.9	0.9	1.5	1.3	2.4	0.5	0.5	0.8
June	0.6	0.8	0.7	1.1	-2.8	0.4	0.4	0.9
July	0.5	0.6	-0.1	1.0	-8.1	0.4	0.3	1.4
August	0.2	0.6	-0.3	0.9	-10.7	0.5	0.4	0.7
September	0.7	0.9	1.0	1.2	-1.2	0.6	0.5	0.3
October	0.8	0.8	1.2	1.0	2.8	0.6	0.6	0.6
November	1.3	1.0	2.0	1.3	8.7	0.6	0.6	1.2
December	2.6	2.6	3.3	2.2	12.9	2.3	2.5	2.2
Full year (December on December)	11.4	11.2	15.4	14.7	22.0	8.1	8.0	10.5
2015								
January	3.9	3.5	5.7	3.7	22.1	3.2	3.5	2.2
February	2.2	2.4	3.3	2.7	7.2	2.1	2.3	0.8
March	1.2	1.5	1.6	1.6	1.2	1.4	1.6	0.3
April	0.5	0.8	0.3	0.9	-3.7	0.9	0.9	0.0
May	0.4	0.6	0.1	0.2	-1.0	0.5	0.6	0.5
June	0.2	0.4	-0.4	0.2	-5.0	0.3	0.3	1.0
July	0.8	0.4	-0.3	0.3	-4.2	0.5	0.3	3.0
August	0.4	0.8	-0.7	0.5	-9.8	0.8	0.7	1.3

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

Sources: Rosstat, Bank of Russia.

Table 3

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

	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
2013								
January	7.1	5.7	8.6	7.8	16.1	5.1	4.9	7.8
February	7.3	5.7	8.7	7.8	16.8	5.3	5.0	8.2
March	7.0	5.6	8.3	7.7	13.8	5.2	4.9	7.9
April	7.2	5.7	8.8	7.7	18.3	5.1	4.9	8.1
May	7.4	5.9	9.2	8.0	19.1	5.0	4.8	8.3
June	6.9	5.8	8.0	7.9	8.2	4.9	4.9	8.1
July	6.5	5.6	6.8	7.4	1.3	4.8	4.6	8.4
August	6.5	5.5	6.5	7.2	0.8	4.9	4.6	8.7
September	6.1	5.5	6.3	7.2	-1.4	4.7	4.4	7.8
October	6.3	5.5	6.9	7.2	4.4	4.5	4.3	7.7
November	6.5	5.6	7.5	7.3	8.9	4.5	4.4	7.9
December	6.5	5.6	7.3	7.1	9.3	4.5	4.4	8.0
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
June	15.8	17.1	20.2	19.5	25.7	14.3	15.1	11.6
July	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

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

Sources: Rosstat, Bank of Russia.

Table 4

Macroeconomic indicators (annual percentage changes, unless otherwise indicated)

	GDP[1]	IKI[2]	Industria production	Agriculture	Construction	Transport freight turnover	Retail trade turnover	Wholesale trade turnover	Fixed capital investment	Household real disposable money income	Real wages	Unemployment rate (as a percentage of economically active population)
2013												
January		1.3	-0.4	1.6	5.6	-1.6	4.5	2.2	4.0	0.4	5.4	6.0
February		-1.1	-3.1	1.5	3.7	-2.5	3.1	-1.5	1.1	6.6	3.3	5.8
March	0.7	1.3	-0.1	1.2	4.6	-1.3	4.5	1.0	2.8	9.6	5.1	5.7
April		1.7	1.1	0.8	-1.6	0.3	4.3	4.5	1.7	9.0	8.5	5.6
May		0.4	-0.5	0.6	0.1	0.4	3.4	-0.5	-0.6	0.2	4.7	5.2
June	1.2	1.2	1.7	1.2	-2.0	-0.5	3.8	-0.9	-0.1	2.1	5.3	5.4
July		1.9	0.8	5.5	5.2	-0.3	4.5	-1.8	2.0	4.5	6.4	5.3
August		0.2	-0.2	3.3	-4.0	0.6	4.2	-2.5	-1.2	4.2	6.8	5.2
September	1.3	1.2	1.3	1.8	-4.7	1.9	3.2	1.2	-1.5	0.8	6.3	5.3
October		2.8	1.0	21.9	0.7	6.2	3.3	0.5	-0.2	5.5	5.4	5.5
November		2.8	2.8	10.3	1.6	0.7	4.1	2.8	4.7	2.2	4.1	5.4
December	2.1	0.9	0.4	1.4	-1.4	2.5	3.5	3.3	-0.2	3.4	2.7	5.6
2014												
January		-0.7	-0.2	2.3	-9.2	3.3	2.8	-3.0	-7.3	-1.0	5.2	5.6
February		1.2	2.1	2.5	-4.8	1.1	4.3	-0.6	-4.5	-0.9	4.6	5.6
March	0.6	0.1	1.4	2.7	-5.7	0.4	4.5	-4.5	-4.7	-7.1	3.8	5.4
April		0.6	2.4	3.5	-4.9	-0.6	3.0	-4.6	-2.6	0.5	3.2	5.3
May		0.8	2.8	3.5	-8.1	1.4	2.4	-3.7	-2.7	6.2	2.1	4.9
June	0.7	-0.1	0.4	3.0	-3.1	2.9	1.1	-4.8	-0.7	-3.4	2.1	4.9
July		0.8	1.5	8.6	-4.4	0.1	1.6	-3.8	-0.9	2.6	1.4	4.9
August		-0.2	0.0	4.8	-3.3	-1.4	1.6	-4.0	-1.6	4.0	-1.2	4.8
September	0.9	2.2	2.8	16.5	-5.9	-1.6	1.8	-4.3	-1.9	0.2	1.5	4.9
October		-0.1	2.9	-11.7	-1.8	-3.1	1.7	-2.4	-0.8	2.1	0.6	5.1
November		-0.5	-0.4	0.7	-4.7	-0.4	1.9	-4.8	-7.8	-3.8	-1.2	5.2
December	0.4	1.9	3.9	4.2	-2.7	-3.0	5.1	-2.9	-1.1	-6.2	-4.0	5.3
2015												
January		-1.1	0.9	2.8	-3.5	-3.9	-3.6	-4.5	-3.9	-0.7	-8.4	5.5
February		-3.1	-1.6	3.2	-3.1	-1.4	-7.0	-8.8	-4.3	-1.6	-7.4	5.8
March	-2.2	-2.8	-0.6	4.2	-6.7	0.6	-8.5	-9.5	-2.7	-1.6	-10.6	5.9
April		-5.8	-4.5	3.3	-5.2	-1.2	-9.6	-14.2	-4.8	-3.9	-9.6	5.8
June		-6.8	-5.5	2.7	-10.3	-3.9	-9.2	-13.6	-7.6	-6.5	-7.4	5.6
July	-4.6	-6.1	-4.8	1.6	-10.0	-3.2	-9.4	-9.5	-7.1	-3.1	-8.6	5.4
July		-5.9	-4.7	-1.9	-10.3	1.8	-9.2	-13.8	-8.5	-2.0	-9.2	5.3

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

Source: Rosstat.

Table 5

Specialised refinancing instruments of the Bank of Russia

Objectives of the indirect support for bank lending	Loan maturity	Collateral	Interest rate valid in January-October 2015, % p.a.	Bank of Russia claims on credit institutions as of 01.01.2015, bln rubles	Bank of Russia claims on credit institutions as of 30.10.2015, bln rubles	Limit as of 30.10.2015, bln rubles
Export	Up to 3 years	Credit claims under loan agreements secured by the insurance contracts of JSC EXIAR	9.00	–	16.36	50.0
Large-value 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	–	37.93	100.0
		Bonds placed to finance investment projects and included in the Bank of Russia Lombard List	9.00	2.85	2.85	
Small and medium businesses	Up to 3 years	Credit claims under loan agreements of JSC SME Bank[2]	6.50	23.26	29.90	50.0
		Guarantees of JSC RSMB Corporation issued in the framework of the Programe to stimulate lending for small and medium businesses		–	–	
Military mortgage	Up to 3 years	Mortgage deeds issued in the framework of the Military Mortgage programme	10.75	–	19.65	30.0

[1] The projects shall be selected in line with the rules set out by Russian Federation 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 for Loans or Bonded Loans Attracted to Carry out Investment Projects' or Russian Federation 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] 1) Credit claims under the interbank loan agreements of JSC SME Bank signed with partner credit institutions in the framework of the Programme for the financial support of small and medium business development;
2) Credit claims under the loans of JSC SME Bank issued to microfinance organisations.

Table 6

Forecast of monetary programme indicators (trillion rubles, unless otherwise indicated)[1]

	1.01.2015 (actual)	1.01.2016 (estimate)	1.01.2017		1.01.2018		1.01.2019	
			baseline	optimistic	baseline	optimistic	baseline	optimistic
Monetary base (narrow definition)	9.1	9.1	9.2	9.4	9.4	9.8	10.0	10.5
– cash in circulation (outside the Bank of Russia)	8.8	8.7	9.0	9.2	9.4	9.8	10.0	10.5
– required reserves[2]	0.3	0.4	0.2	0.2	0.0	0.0	0.0	0.0
Net international reserves	20.7	20.6	20.9	21.8	21.3	23.0	21.6	24.1
– in billions of US dollars[3]	368	366	372	387	378	408	384	429
Net domestic assets	-11.6	-11.5	-11.7	-12.4	-11.9	-13.2	-11.6	-13.7
Net credit to the general government	-10.3	-8.2	-6.3	-7.2	-5.4	-7.6	-5.5	-9.7
Net credit to banks	6.5	3.0	0.5	1.7	-0.9	2.0	-0.7	3.7
– gross credit to banks	8.6	5.1	2.7	3.9	1.4	4.3	1.7	6.1
of which claims on refinancing opertaions[4]	7.4	4.4	2.0	3.2	0.7	3.6	1.0	5.3
– correspondent and deposit accounts of credit institutions with the Bank of Russia	-2.1	-2.0	-2.1	-2.1	-2.2	-2.2	-2.3	-2.3
Other non-classified assets, net	-7.7	-6.4	-5.9	-7.0	-5.6	-7.6	-5.5	-7.7

[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 2015 (56.2376 rubles for 1 USD).

[2] Credit institutions' required reserves deposited with the Bank of Russia for the ruble-denominated accounts (do not include funds on 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 the net international reserves is based on 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.

GLOSSARY

Averaging of required reserves

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

Banking sector liquidity

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

Bank lending conditions index

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

Bank of Russia interest rate corridor (interest rate corridor)

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

Bank of Russia key rate

Interest rate on main operations of the Bank of Russia to manage banking sector liquidity. A key indicator for the monetary policy stance. It is set by the Bank of Russia Board of Directors.

Bank of Russia Lombard List

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

Basis point

One hundredth of a percentage point.

Broad money (monetary aggregate M2X)

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

CDS spread

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

Consumer price index (CPI)

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

Core inflation

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

Countercyclical currency

A currency which normally faces appreciation in periods of instability in global markets and/or recession in the global economy. Specifically, this type of currencies includes the US dollar, Japanese yen, and Swiss franc.

Current liquidity deficit

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

Dollarisation of deposits

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

Dual-currency basket

Ruble exchange rate index calculated as the sum of 0.55 US dollars and 0.45 euros in rubles.

Factors of banking sector liquidity

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

Floating exchange rate regime

According to the IMF classification, under the floating exchange rate regime the central bank does not set targets, including operational ones, for the level of, or changes to, the exchange

rate, allowing it to be shaped under the impact of market factors. However, the central bank reserves the right to purchase foreign currency to replenish international reserves or to influence the domestic FX market occasionally to smooth out the ruble's exchange rate volatility and prevent its excessive deviations.

Floating interest rate on Bank of Russia operations

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

Foreign exchange swap

A deal which consists of two legs: one party of the deal initially exchanges a certain amount in domestic or foreign currency for an equivalent amount in another currency provided by the second party of the deal. Then, once the deal term has expired, the parties make a reverse transaction (in the corresponding volumes) at a predetermined rate. Foreign exchange swaps are used by the Bank of Russia to provide credit institutions with refinancing in rubles and foreign currency (US dollars).

Funds in general government's accounts

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

Generalised (composite) consumer confidence index

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

Gross credit of the Bank of Russia

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

Inflation targeting regime

A monetary policy framework which considers price stability as the final target of the central bank. Under this regime a quantitative inflation target is set and announced. The central bank is responsible for achieving this target. Typically, under an inflation targeting regime, the monetary policy affects the economy through interest rates. Decisions are made primarily on the basis of economic forecasts and inflation dynamics. An important feature of this regime is regular

explanations to the public of decisions adopted by the central bank, which guarantees its accountability and transparency.

Interest rate corridor

See Bank of Russia interest rate corridor.

Managed floating exchange rate regime

Under the managed floating exchange rate regime the central bank does not interfere in the trends of ruble dynamics which are shaped by fundamental macroeconomic factors. No fixed limits or targets are set for the ruble rate, with the central bank seeking to smooth out exchange rate fluctuations in order to support economic agents' gradual adaptation to changes in external economic environment.

MICEX index

MICEX index is the composite index of the Russian stock market calculated by CJSC MICEX Stock Exchange (hereinafter, the Exchange) based on the ruble prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

MSCI indices

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

Monetary aggregate M1

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

Monetary policy stance

The characteristics of a monetary policy's impact on the economy. Tight stance suggests the restraining effect of the monetary policy on economic activity in order to reduce inflationary pressures, whereas a loose monetary policy stance implies economic stimulation with possible upward pressure on inflation.

Monetary policy transmission mechanism

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

Money supply

Total amount of funds held by residents of the Russian Federation (excluding general government and credit institutions). For the purposes of economic analysis various monetary aggregates

are calculated (see monetary aggregate M1, money supply in the national definition and broad money definitions).

Money supply in the national definition (monetary aggregate M2)

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

Net credit of the Bank of Russia to credit institutions

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

Net private capital inflow/outflow

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

Nominal effective ruble exchange rate index

The nominal effective ruble 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.

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

Promissory notes and credit claims 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 with Assets or Guarantees to Credit Institutions'.

Non-price bank lending conditions

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

Open market operations

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

Output gap

Deviation of GDP from potential output, expressed as a percentage. Characterises the balance between demand and supply and may be regarded as an aggregate indicator of the effect which the demand factors have on inflation. If the actual output is larger than the potential output (positive output gap), all else equal, inflation is expected to accelerate. A negative output gap is an indicator of an expected slowdown in price growth. Output fluctuations around the potential level are called cyclical fluctuations.

Outstanding amount on Bank of Russia refinancing operations

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

PMI index

An indicator of business activity based on company surveys. A PMI of more than 50 represents an expansion of business activity, a reading under 50 represents a contraction.

Potential output

The aggregate level of output in the economy achieved under normal utilisation of production factors with existing resource and institutional constraints. Reflects the volume of products that may be produced and sold without creating prerequisites to a change in price growth rates. The level of potential output is not linked to a certain level of inflation; it merely indicates the presence or absence of conditions for the inflation acceleration or deceleration.

Procyclical currency

A currency which normally appreciates in periods of global economic growth. Specifically, this category of currencies includes the euro, the Canadian dollar, and the Australian dollar.

Repo operation

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

Required reserves

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

Risk premium on market securities portfolio

Calculated in accordance with the capital asset pricing model as the difference between the yield of a market securities portfolio and the yield of a risk-free asset. The yield of a risk-free asset is, as a rule, taken to be the yield of government securities (for example, OFZ – federal government bonds). Measured in percentage points (pp).

RTS index

RTS index is the composite index of the Russian stock market calculated by the Exchange based on the US dollar prices of trades executed in most highly capitalised liquid securities admitted to trading on the Exchange.

Ruble real effective exchange rate index

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

Shadow banking sector

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

Standing facilities

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

Structural liquidity deficit

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

Structural non-oil and gas primary budget deficit

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

ABBREVIATIONS

Cbonds-Muni —municipal bond index calculated by Cbonds

CCPI — core consumer price index

CI — credit institutions

CPI — consumer price index

GDP — gross domestic product

IFX-Cbonds — corporate bond index

MIACR — Moscow Interbank Actual Credit Rate (weighted average rate on interbank loans provided)

MIACR-B — Moscow Interbank Actual Credit Rate-B-Grade (weighted average rate on interbank loans provided to banks with speculative credit rating)

MIACR-IG — Moscow Interbank Actual Credit Rate — Investment Grade (weighted average rate on interbank loans provided to banks with investment-grade rating)

MICEX SE — MICEX Stock Exchange

NFA — net foreign assets

OFZ — federal government bonds

PMI — Purchasing Managers' Index

RGBEY— Russian Government Bonds Effective Yield until Redemption (calculated by the Moscow Exchange)

RUONIA — Ruble OverNight Index Average (average actual rate on interbank loans calculated by the Bank of Russia using the methodology elaborated jointly with the National Securities Market Association)