



**THE CENTRAL BANK
OF THE RUSSIAN FEDERATION
(BANK OF RUSSIA)**

Inflation Review

Third Quarter ♦ 2004

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Research and Information Department

Major Inflation Indicators

According to the Federal Statistics Service, consumer prices rose by 8.0% in September 2004 as compared with December 2003 as against 8.6% in the same period last year.

In 2004 Q3, consumer prices increased by 1.8% as against 2.5% in Q2 and 3.5% in Q1. Month-on-month consumer price growth in July stood at 0.9% and in August and September 0.4%. Consumer price inflation stood at 11.4% in September 2004 as compared with September 2003 (in September 2003 it stood at 13.3%), which is a high figure with regard to the official inflation target.

Core inflation stood at 6.8% in September 2004 as compared with December of last year (it was 7.3% in the same period of 2003). Prices of the goods included in the core inflation calculation grew by 2.4% in 2004 Q1, 1.8% in Q2 and 2.4% in Q3.

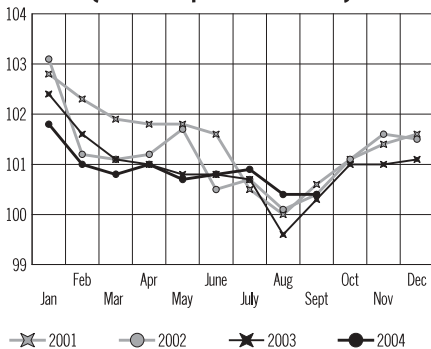
Calculated in the 12-month moving period, core inflation last September

slowed to an estimated 10.7% as against 10.8% in September 2003. This means that core inflation was slower than consumer price inflation by 0.7 percentage points and that, taking into consideration the dynamics of prices of goods and services not included in the core inflation calculation, the full-year inflation rate may slightly surpass the official inflation target.

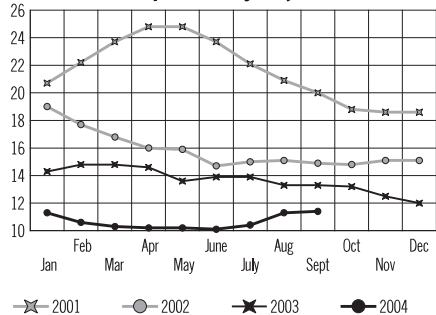
Estimates show that growth in the prices of goods and services included in the calculation of core inflation in January-September 2004 accounted for 5.5 percentage points, or 68.4%, of overall consumer price growth as against 6.0 percentage points, or 69.1%, in the same period last year. Thus, core inflation's contribution to overall consumer price growth was smaller than last year.

The high level of core inflation registered in the past two years has been caused mostly by volatile, short-term rather than long-term factors. In January-September 2004, a major factor of the

Consumer prices
(as % of previous month)

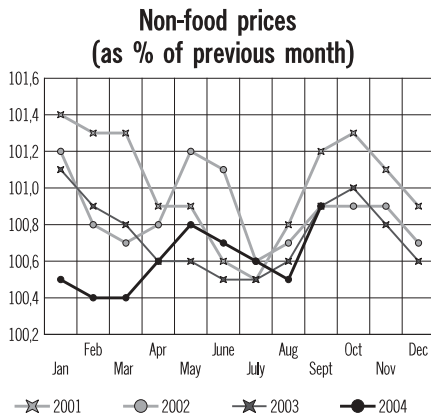


Inflation in the 12-month moving period
(as % of corresponding month of previous year)



slowing growth in the prices of goods and services included in the calculation of core inflation was the reduction of the growth rate for non-food prices. At the same time, a poor grain harvest in Russia and Europe in 2003 and tension on the world's meat market contributed to higher food prices, especially for bread, bakery products, meat and poultry.

Non-food prices rose by 5.5% in September 2004 as compared with December 2003 (in the same period of 2003 they increased by 6.6%). This is the lowest level registered in the period under review in the last ten years. At the same time, in 2004 Q2 and Q3 non-food prices grew faster (by 2.1% and 2.0% respectively) than in Q1 (1.4%). After a slight rise in 2004 Q1 (by 0.6%), the growth in petrol prices accelerated to 13.6% in Q2 and 11.4% in Q3. Overall, the price of petrol increased by 27.3% in September as compared with December 2003. Such significant increment was due to high energy prices on the world market and, consequently, considerable price growth in the oil-extracting and oil-refining indus-



tries. In January-September 2003, the price of petrol increased by 14.1%. According to estimates, consumer price growth, measured without petrol prices, in September 2004 as compared with December 2003 was slower than inflation by 0.3 percentage points (in the same period of 2003, it was slower by 0.1 percentage points).

Growth in the price of major non-food products was slower than in January-September 2003. Television and radio set

Table 1

Inflation rates on the consumer goods market as a whole (%)

	Growth (September 2004 on December 2003)	Growth (September 2003 on December 2002)	Result
Prices of goods and services included in core inflation calculation	6.8	7.3	Retardation by 1.1 times
of which:			
food prices excluding vegetable and fruit prices	8.0	7.1	Acceleration by 1.1 times
non-food prices	5.5	6.6	Retardation by 1.2 times
Service prices	14.3	19.7	Retardation by 1.4 times
of which:			
prices of goods and services regulated at federal and regional levels	16.1	21.0	Retardation by 1.3 times
Vegetable and fruit prices	-1.4	-3.4	

prices were down 1.4%. Estimates show that in January-September 2004 non-food price growth accounted for 1.5 percentage points, or 19.1%, of overall consumer price growth as against 1.8 percentage points, or 21.2%, in January-September 2003.

In the first nine months of 2004, food prices, excluding vegetable and fruit prices, grew faster than non-food prices.

In September 2004, **food prices as a whole** rose by 7.2% as compared with December 2003 as against 6.1% in the same period last year. Food price growth in 2004 Q1 stood at 3.8%, Q2 2.1% and Q3 1.1%.

Food price growth calculated without taking account of vegetable and fruit prices accelerated to 8.0% in September as compared with December 2003 as against 7.1% in the same period last

year. Growth in 2004 Q1 stood at 3.2%, Q2 1.9% and Q3 2.7%.

In January-September, growth in the prices of this group of products accounted for 4.1 percentage points, or 50.8%, of overall price increment on the consumer goods market as against 3.6 percentage points, or 41.6%, in the same period of 2003.

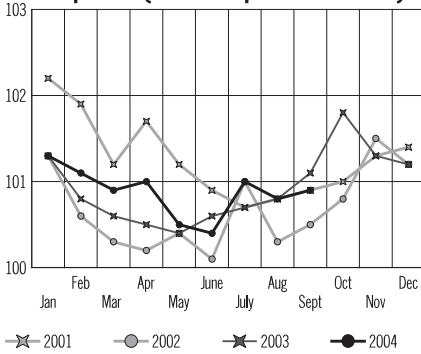
The most significant growth in September 2004 as compared with December 2003 was registered in the prices of **bread and bakery products** (14.8%), pasta (12.8%) and granulated sugar (13.0%). However, bread and bakery product prices this year grew less than last year (in January-September 2003, they increased 19.2%). While in January-June 2004 bread and bakery product prices increased by 20% faster than in the same period last year (13.6% as against 11.8%),

Table 2

Food price inflation (%)

	Growth (September 2004 on December 2003)	Growth (September 2003 on December 2002)	Outcome
Bread and bakery products	14.8	19.2	Retardation by 1.3 times
Cereals and legumes	10.5	17.4	Retardation by 1.7 times
Pasta	12.8	7.7	Acceleration by 1.7 times
Meat and poultry	11.7	5.0	Acceleration by 2.3 times
Fish and seafood	5.3	9.6	Retardation by 1.8 times
Milk and dairy products	3.6	2.6	Acceleration by 1.4 times
Butter	1.0	4.4	Retardation by 4.4 times
Sunflower oil	-0.4	7.6	
Granulated sugar	13.0	-0.9	
Alcoholic beverages	6.8	7.3	Retardation by 1.1 times

Food prices, excluding vegetable and fruit prices (as % of previous month)



in 2004 Q3 their growth was six times slower than in the same period last year (1.1% as against 6.6%).

After significant month-on-month growth in July (9.1%), the price of granulated sugar rose by 1.2% in August and in

September it fell by 1.9%. These dynamics reflect a high level of price volatility for this product, which is due to changes in customs policy and instability of world market demand.

Meat and poultry prices rose by 11.7% in September as compared with December 2003, whereas in the same period last year they grew by 5.0%. Growth in meat and poultry prices constantly accelerated in the second half of 2004. In June, they rose by 1.2% month on month, whereas the figure for September was 1.7%. At the same time, the dynamics of meat and poultry prices differed significantly. Beef and pork prices rose by 16.0% and 19.2% respectively in September as compared with December 2003 (beef prices were up 0.7% in the same period last year and pork gained 0.3%), while poultry prices inched up 0.5% as

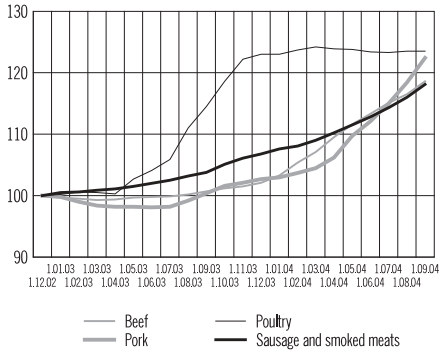
Table 3

Major meat and poultry market indicators (% growth)

	Meat and poultry		Beef		Pork		Poultry	
	2004	2003	2004	2003	2004	2003	2004	2003
Food production (January-September as % of January-September of previous year)	2.3	14.5						
Livestock* and poultry production (January-September as % of January-September of previous year)								
-- by farms of all kinds	0.2	6.9						
-- by agricultural enterprises	2.1	8.6	-7.7	3.2	-4.5	18.5	18.8	10.1
Imports (January-August as % of January-August of previous year)								
-- volume	-13.8	-8.6					-16.6	-9.6
-- value	-2.5	-5.8					-14.3	-9.9
Prices								
-- livestock and poultry selling prices (September as % of December previous)	15.2	3.3						
-- consumer prices (September as % of December previous)	11.7	5.0	16.0	0.7	19.2	0.3	0.5	14.4
-- import prices (August as % of December previous)	6.8	-0.1					-1.7	-5.3
Livestock population* as of beginning of month (October as % of October previous)			-6.2	-4.8	-12.2	-0.5		

*Cattle and pigs.

Meat and meat product prices (December 2002=100%)



against 14.4% in January-September 2003. The gap between the rates of growth in meat and poultry prices, created by the accelerated increase in poultry prices from May to November 2003, became smaller from the start of this year.

Growth in the prices of some foodstuffs in September as against last December slowed down as compared with the same period of 2003 (growth in fish and seafood prices slowed by 1.8 times, cereals and legumes by 1.7 times and butter from 4.4% to 1.0%). The price of sunflower oil dropped 0.4% in that period.

The accelerated growth of agricultural producer prices had a negative effect on food price dynamics. In the first nine months of the year, the selling prices of farm produce increased by 7.5% as against 6.8% in January-September 2003.

Vegetable and fruit prices fell by 1.4% in September as compared with December 2003 (they were down 3.4% in the same period last year).

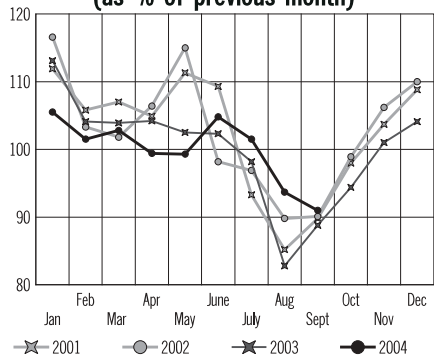
Vegetable and fruit price dynamics in January-September 2004 were less volatile than they have been in the last few

years. In the first half of the year, vegetable and fruit prices hardly grew and in April and May they even declined month on month. In June, vegetable and fruit prices rose by 13.9% as compared with December 2003 (in the same period last year they increased by 33.7%). It was the smallest growth registered in this period in ten years. Therefore, the low level of vegetable and fruit prices in the first half of the year precluded any significant decline in these prices typical of July-October. In 2004 Q3, vegetable and fruit prices decreased by a lowly 13.4% as against 27.8% in the same period of 2003 and 21.6% in the same period of 2002.

According to estimates, in January-September 2004, the decrease in vegetable and fruit prices accounted for a reduction in the general rate of inflation by 0.1 percentage points, or 0.9%. In January-September 2003, the negative contribution of the decline in vegetable and fruit prices to consumer price growth stood at 0.2 percentage points, or 2.1%.

If we exclude from the consumer price index such products as bread and bakery products, pasta, flour, meat (beef and

Vegetable and fruit prices (as % of previous month)



pork) and petrol, this aggregate's growth in September 2004 as compared with December 2003 will be slower than inflation by an estimated 1.2 percentage points (in 2003, it stood at 0.6 percentage points, whereas in 2002 it exceeded inflation by one percentage point).

Prices of the **paid services provided to the public** rose 14.3% in the first nine months of the year against 19.7% in the same period last year. In 2004 Q1 they increased by 6.4%, Q2 by 4.4% and Q3 by 3.0%. The slowing of growth in service prices was due to **the slowing of government-regulated service prices**, which in September 2004 increased by an estimated 16.1% as compared with December 2003 against 21.0% a year earlier.

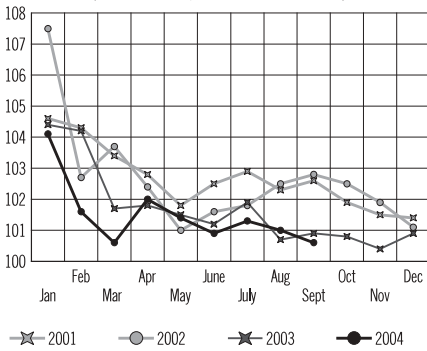
As for the government-regulated prices, mention should be made first of all of the slowing of growth in rent and amenities charges. Nevertheless, growth in rent and amenities prices was most significant in January-September 2004 at 21.8% against 26.3% in the same period last year. There was a sharp rise in pre-school tuition fees (19.7%), while communica-

tions service charges fell 0.7%, the first decrease in this period over the past ten years. Meanwhile, the supply of communications services offered to the public expanded 20.4% in January-September as compared with the same period in 2003.

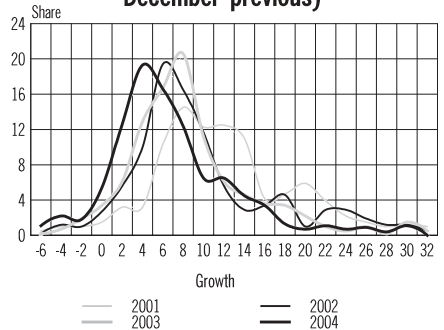
Growth in service prices in January-September was faster than growth in the prices of goods, which stood at 6.5%. Estimates indicate that growth in service prices accounted for 2.5 percentage points, or 30.9%, of overall consumer price growth against 3.4 percentage points, or 39.3%, in January-September 2003.

The analysis of the distribution of increases in the prices of goods and services in January-September 2001-2004, based on a selection of more than 400 kinds of consumer goods and services and made without taking account of their weights in consumer expenses, revealed a continuous decline in the average rate of price growth¹. However, each year's decline had its specifics.

**Service prices
(as % of previous month)**



**Consumer goods and services price
growth distribution (September on
December previous)**



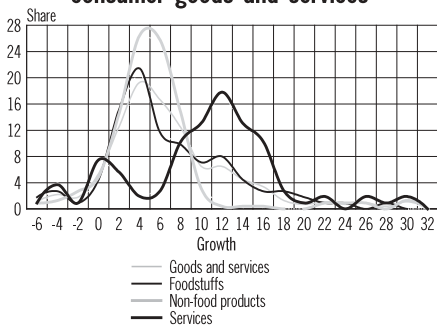
¹ Price growth distributions shown in the charts are based on a smoothed histogram. Twenty growth ranges with a span of 2% each have been used.

In September 2003, unlike the situation in September 2002, inflation slowed as compared with December of the previous year due to a contraction of the share of goods and services with a fairly high rate of price growth. This phenomenon characterises the process of price dynamics between different groups of goods and services evening out and reflects the macroeconomic situation. At the same time, the range of growth in the prices of the bulk of consumer goods and services remained virtually unchanged in 2003 as the slight change of the distribution median (7.6% as against 8.0% in 2002) indicates.

Inflation slowed in January-September 2004 due to slowing growth in the prices of goods and services in the principal growth range. This process confirms the measures taken to reduce inflation are effective, because the price slowdown affected a broad range of goods and services.

Another positive development with regard to inflation was closing the gap between the rates of growth in food and non-food prices and services. However, this process has not yet become a sustained trend.

Price growth distribution (September 2004 on December 2003) by kind of consumer goods and services

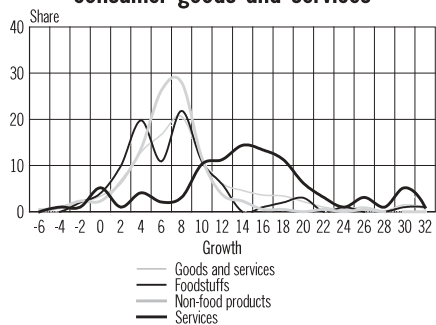


In the first nine months of the year, the biggest growth (a sample average) was registered in service prices, and the smallest in non-food prices. However, there was little difference between the price growth medians calculated for the bulk of foodstuffs and non-food products.

A statistical analysis of food price increases indicates a fall in the sample average in January-September 2004. At the same time, on the one hand, the price growth range of the bulk of foodstuffs grew narrower, reflecting smaller differences in food price dynamics. On the other hand, the share of goods in the 14-20% price growth range was quite large due to a significant growth in the prices of bread and bakery products and pasta, caused by last year's poor grain harvest. Meat prices also remained within this price growth range (except poultry), although their dynamics in January-September 2003 were moderate.

The distribution of non-food price increases was characterised by a pronounced maximum and small dispersion. Therefore, the increases in the prices of most goods in this group remained within a narrow range. In the first nine months of

Price growth distribution (September 2003 on December 2002) by kind of consumer goods and services



2004, goods in the 1-9% price growth range accounted for 81.4% of all non-food products. In the same period last year, the principal price growth range was 3-11% and goods in this range accounted for 79.4%.

Slowing growth in the prices of goods in this group in January-September 2004 was due on average to slowing growth in the prices of non-food products in the main growth range. At the same time, as a result of rapid growth in petrol prices, the share of non-food products whose prices rose significantly expanded compared to the previous year.

The distribution of service price increases in the first nine months of 2004 is characterised by three local highs. The first falls within the 10-14% range and reflects the price dynamics of most consumer services. The second local high reflects relatively slow growth in the prices of tourist services. Unlike the situation in the past few years, the third local high in 2004 corresponded to the deflationary growth range, which included several communications services.

Factors of inflation

Several factors shaped consumer prices in January-September 2004.

External economic conditions

External economic conditions affect not only output and producer price dynamics, but also the flow of foreign currency earnings to the domestic foreign exchange market.

According to Bank of Russia estimates, the average level of world market prices of major Russian exports, adjusted to their structure, rose by 16.8% in January-September 2004 as compared with

the same period last year. The price of Urals crude was up 23.1%, petrol 33.3%, diesel fuel 26.6%, fuel oil 2.8% and natural gas in Europe 4.0%. Non-ferrous metal prices increased by 34% as the price of aluminium gained 20%, copper 65% and nickel 58%.

As energy prices and prices of other raw materials continue to rise on world markets and a gap remains between domestic and world prices, Russian producers are likely to continue raising prices on the domestic market.

The favourable price situation on world commodity markets for Russian exporters and the increased demand for goods and services exported by Russia led to a growth in exports and an increase of the country's trade surplus.

In January-September 2004, exports expanded by 32.1% year on year to \$129.1 billion and imports grew by 24.8% to \$66.6 billion. The **trade surplus** amounted to \$62.6 billion, an increase of 40.8% on January-September 2003 when it stood at \$44.4 billion.

Oil, ferrous metals, petroleum products and non-ferrous metals accounted for most of the growth in the value of exports in January-September 2004. Exports of machinery, equipment and transport vehicles, natural gas, timber, chemical raw materials and mineral fertiliser also increased. According to the latest statistics, the share of energy products in the total value of exports slightly contracted, while the share of ferrous and non-ferrous metals expanded.

Imports grew mostly due to greater imports of investment goods, which increased by more than 40%. Consumer goods imports rose by more than 25%

chiefly as a result of growth in the import of non-food consumer goods and some foodstuffs.

The terms of Russia's trade with foreign countries in January-September 2004 improved by an estimated 20-22% as compared with the same period last year due to the accelerated growth in export prices.

The current account surplus increased by an estimated \$12.9 billion in January-September 2004 as compared with the same period last year and stood at \$40.0 billion, or 9.6% of GDP as against 8.7% of GDP in the first nine months of 2003. The significant increase in exports was the main reason for growth.

The capital and financial account deficit (net of the changes in reserves) rose from \$7.6 billion in January-September 2003 to an estimated \$14.6 billion in the first nine months of the year. The private sector's net capital outflow increased to \$15.1 billion from \$3.9 billion in January-September 2003.

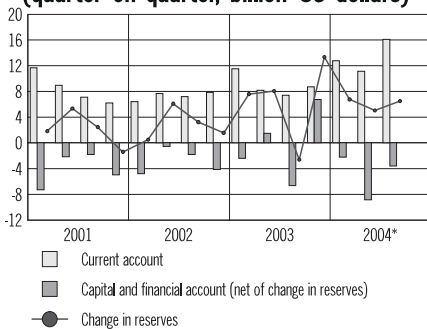
According to preliminary balance of payments data, the net inflow of foreign investment to the private sector of the

Russian economy fell to \$19.7 billion in January-September 2004 from \$23.3 billion in the same period last year, as the banking sector's foreign debt obligations this year grew less than in the first nine months of 2003. However, net foreign capital inflow to the non-financial enterprise sector increased to \$18.5 billion as against \$18 billion in January-September 2003. Foreign direct investment in the non-financial enterprise sector declined slightly and stood at an estimated \$8.1 billion as against \$8.3 billion in January-September 2003, while foreign capital inflow in the form of credits and loans contracted to \$9.3 billion from \$10.9 billion. At the same time, capital inflow in the form of portfolio investments amounted to \$1.2 billion, whereas in January-September 2003 there was a portfolio investment outflow of \$1.3 billion.

Private capital outflow increased as investing abroad became more attractive. Private sector investments in foreign economies increased to an estimated \$28.9 billion in January-September 2004 as compared with the same period last year (in January-September 2003, they were valued at \$23.4 billion). At the same time, capital outflow from the non-financial enterprise sector increased to \$21.2 billion from \$17.1 billion in the first nine months of 2003. The de-dollarisation of the Russian economy slowed down.

Russia's international reserves rose by \$18.1 billion in January-September 2004 (in the same period last year they expanded by \$14.3 billion) and as of October 1, 2004, they aggregated \$95.1 billion as against \$62.1 billion as of October 1, 2003. By the end of last September, Russia had sufficient gold and currency reserves to finance imports for 9.3

Major balance of payments components (quarter on quarter, billion US dollars)



* 2004 Q3: estimate.

months as compared with 7.7 months a year earlier.

International financial markets

In the middle of the year, the US Federal Reserve raised the federal funds rate for the first time since the middle of 2000. In June, the US overnight interbank rate was raised from 1% p.a. to 1.25% p.a., while in August it was raised to 1.5% p.a. and in September to 1.75% p.a. The Federal Reserve switched to a tighter interest rate policy during a cyclic surge of the US economy, which started in November 2001, to curb inflation. The monetary policy of the Economic and Monetary Union was neutral to the changes in economic conditions in January-September 2004. The European Central Bank has not changed its key refinancing rate since June 2003.

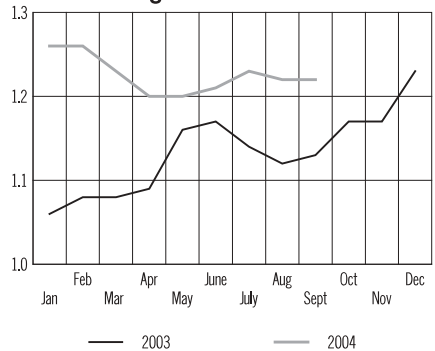
LIBOR rates on US dollar-denominated deposits with terms from one month to one year rose by 0.1-0.6 percentage points in January-September 2004 as compared with the same period last year, whereas LIBOR rates on euro-denominated deposits with similar terms fell by 0.1-0.4 percentage points year on year. The yield on US treasury bonds with maturity from two to ten years rose by 0.4-0.7 percentage points on average as compared with January-September 2003 and the yield on similar financial assets in the eurozone by 0.1-0.2 percentage points.

There was a moderate rise in US interest rates in January-September 2004. During the first three quarters of the year, US business activity indices fluctuated significantly and slow job growth rates had a negative effect on economic agents' sentiments amid the growing balance of payments deficit. The accelerated growth of

world oil prices undermined confidence in the dollar owing to the consumption of extremely large amounts of oil by the US economy. As a result, the exchange rate of the dollar against other major world currencies in January-September 2004 was lower than in the same period last year despite the dollar's significant gains in the period from mid-February to mid-May 2004.

In the first nine months of the year, the dollar lost 10.1% on average against the euro as compared with the same period last year. The dollar also depreciated against the Japanese yen, British pound and many other currencies, including the currencies of Russia's leading trading partners, such as the Swiss franc, Danish krone, Swedish krona, Hungarian forint, Polish zloty, Czech koruna, Slovak koruna, Lithuanian litas, Latvian lat, Estonian kroon, Turkish lira, Kazakh tenge, South Korea's won and Indian rupee. The only currencies of Russia's leading trading partners that fell against the dollar were the Belarussian ruble and Romanian leu. The dollar rate against the Ukrainian hryvnia in January-September 2004 was

US dollar average monthly rate against the euro



virtually the same as in the corresponding period last year.

Domestic supply and demand

In the first nine months of 2004, consumer price inflation was accompanied by a **high level of production and investment activity**.

The key branch output index in that period was the same as in the corresponding period of 2003 at 6.9%. At the same time, the first-half rate of its growth in 2004 was faster than last year (7.9% as against 7.1%). Production growth rates in 2004 Q3 slowed slightly in industry, construction and transport. At the same time, agricultural output, which declined in 2003 Q3, increased in 2004 Q3 owing to a bumper grain harvest. Retail trade turnover increased by 70% year on year. As a result, the key branch output index gained 5.4% in July-September 2004, a decrease of 1.1 percentage points as compared with the same period last year.

Industrial production growth stood at 6.5% in January-September 2004 (7.4% in January-June) as against 6.8% in the same period last year (in January-June 2003, it was also 6.8%). The seasonal slowing of industrial output growth in 2004 Q3 was largely due to the year-on-year slowdown of production growth in the electric-power industry (by 3.1 times), fuel sector (by 1.4 times), ferrous metallurgy sector (by 2.0 times) and food industry (by 2.1 times). These sectors account for nearly 50% of overall industrial output. Despite a minor production slowdown in the machine-building industry in 2004 Q3 as compared with the same period last year, output continued to expand rapidly in this sector (by 8.6%) and nine-month growth this year was bigger than in 2003 (12.7% against 8.1%).

Transport's freight turnover in January-September 2004 increased by 6.8% as compared with the same period last year (January-September 2003 growth stood at 7.5%). Railways increased their freight turnover by 8.7%, automobile transport 4.4% and pipeline transport 7.0%.

Business activity remained high in the construction branch in January-September 2004. The volume of construction work done by contract in that period surpassed last year's level by 11.1% (14.4% in the same period of 2003).

Agricultural output increased by 0.1% in January-September 2004 year on year, whereas in the same period of 2003 it contracted by 0.2%. However, in the first half of the year agricultural production declined by 1.2% as against 0.3% in January-June 2003.

Investor and consumer demand remained high in January-September 2004. Fixed capital investment grew by 11.6% year on year (in January-September 2003, it increased 11.9%). In 2004 Q1, fixed capital investment rose by 13.1%, in Q2 12.3% and in Q3 10.3%.

This year, as in the past few years, the sectors that were the major recipients of investments were the fuel sector, transport and the housing and amenities sector. In the first half of the year, these sectors received about 50% of all investments made by large and medium-sized enterprises and organisations (in January-June 2003, these sectors accounted for more than 56%). As for the structure of the sources of fixed capital investment, 48.6% were investors' own funds and 51.4% were borrowed funds (in the first half of 2003, the respective percentages were 46.5% and 53.5%). The share of budget funds

Economic growth and inflation

When a target for inflation is set, potential economic growth (the output of goods and services) is evaluated, because output growth at rates exceeding potential output growth may testify to oversupply and increased inflationary pressure on the economy. Potential output makes for economic equilibrium, which does not cause inflation to accelerate, and characterises the economy's supply possibilities. A gap between actual and potential output is a sign of imbalance. The output gap is the percentage difference between actual and potential output.

Potential output is difficult to determine in Russia because too little time has passed since the beginning of reforms and because there are no reliable data for calculating the production function and mechanical smoothing procedure. The expert method of determining potential output and the output gap and its impact on price

dynamics is more appropriate for the Russian economy, taking into consideration its statistical problems and specifics of the evaluation of production factors.

According to the calculated trend, the annual growth of potential output may stand at 6.5%, a rate close to the five-year annual average. Growth in potential output may be affected by gradual loading of production capacity and the productivity factor, which reflects the effect of scientific and technological progress. Taking all the above factors into account, one can estimate potential output at 6-8%.

When analysing the changes in the correlation between actual and potential output growth, the Bank of Russia monitors the state of the balance of payments in order to be able, if necessary, to make adjustments to its monetary and foreign exchange policies to achieve the inflation targets.

contracted significantly, from 18.4% in the first half of 2003 to 16.2% in 2004 1H. At the same time, the share of bank loans expanded considerably (from 4.8% to 7.3%). This is the highest first-half level since 1997.

Gross capital formation relative to GDP, calculated using the income consumption method, increased to 18.5% in 2004 1H from 17% in 2003 1H, mainly due to the increased share of turnover stocks. At the same time, gross capital formation growth slowed slightly year on year. In 2004 Q1, gross capital formation increased by 13.5% on the same period last year and in 2004 Q2 it increased by 15.6% as against 15.4% and 19.5% in the same periods last year respectively.

Real disposable money income in January-September 2004 rose by 9.8% as compared with the same period last year (in January-September 2003, it increased 14.1%). At the same time, in 2004 Q3 real disposable money income grew by 10.2% year on year as against 11.4% a year earlier.

The continued increase in household income led to growth in consumer spending, which rose by an estimated 11.3% in January-September 2004 year on year as against 9.0% in January-September 2003. At the same time, the share of expenses on goods and services in the structure of household income use expanded in the period under review as compared with January-September 2003. Consumer expenses grew faster than incomes, pushing consumer prices up.

The situation on the labour market improved in January-September 2004 compared to the same period last year. There was a fall in the number of jobs in January-September 2003, whereas in the same period this year job numbers increased. The number of jobless, which increased in the first nine months of 2003, declined this year. Of the total economically active population, 91.9% were gainfully employed in January-September 2004 and 8.1% were classified as unemployed according to ILO methodology

(91.2% and 8.8% respectively in the first nine months of 2003). Job numbers increased by an estimated 2% as compared with January-September 2003, while unemployment was down 5.3%.

Job growth created conditions for consumer price increases, but growth in labour productivity contained this process.

Exchange rate

The exchange rate policy pursued by the Bank of Russia continued to play a positive role in curbing core inflation. In September 2004, the nominal rate of the ruble against the US dollar was 0.7% higher than in December 2003.

The ruble's nominal rally against the dollar contained growth in the prices of imported consumer goods and their domestically manufactured analogues. The exchange rate dynamics affected non-food price dynamics more than food price dynamics. As Russian foodstuffs were highly competitive on the domestic market due to both quality and price, the exchange rate largely affected them through producer prices in the food industry, the industry that uses imported raw materials more than any other industry. As for the non-food price dynamics, the exchange rate affected them directly owing to the low competitive power of the domestically manufactured non-food consumer goods.

Imports accounted for 44% of retail trade commodity resources in 2004 Q2 and Q1, whereas in 2003 Q1 imports accounted for 46% of retail trade commodity resources and in 2003 Q2 for 43%. As for foodstuffs, imports accounted for 34% in 2004 Q1 and Q2 as against 37% in 2003 Q1 and 32% in 2003 Q2.

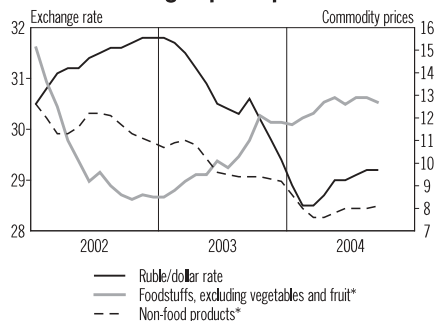
Estimates indicate that the ruble's nominal rise in January-September 2004

reduced core inflation growth by about 0.2 percentage points.

Inflation dynamics on the consumer goods market were affected by price dynamics in industries whose output goes directly to the consumer goods market. According to estimates, producer price growth in these industries accounted for 4.8 percentage points of growth in the prices of goods and services included in the core inflation calculation in January-September 2004. Price dynamics in these industries were accompanied by growth in **production costs**. Production cost dynamics were the result of growth in **industrial producer prices**, which rose by 23.3% in September 2004 as compared with December 2003 (they increased 10.5% in the same period last year). Rapid growth in industrial producer prices was caused by growth in the world prices of energy products and other raw materials.

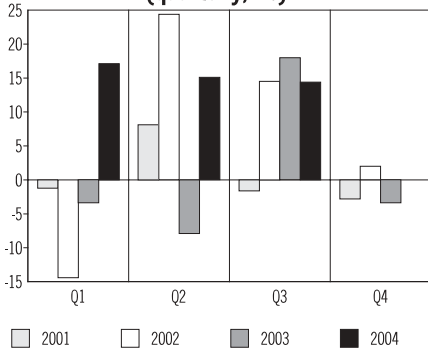
The most significant growth in producer prices in January-September was registered in the ferrous metallurgy sector (55.3% as against 25.0% in the same period last year) and fuel sector (54.2% as against 5.0%). At the same time, pro-

US dollar/ruble exchange rate and prices of some groups of products



* Monthly year-on-year % change.

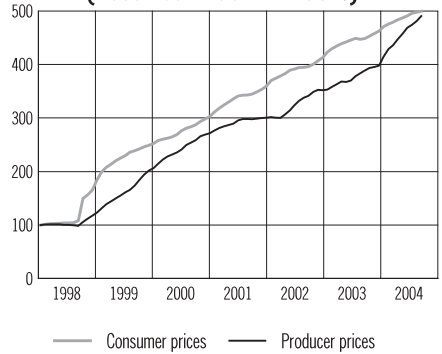
Fuel sector producer price growth (quarterly, %)



ducer prices in the electric-power industry grew less than last year (11.7% as against 13.7%).

Overall, analysis shows that in the long term industrial producer price growth and consumer price growth slow at almost the same pace, despite their different short-term dynamics. In September 2004, industrial producer prices increased by 4.9 times as compared with December 1997 and consumer prices rose also as much over that period (five times).

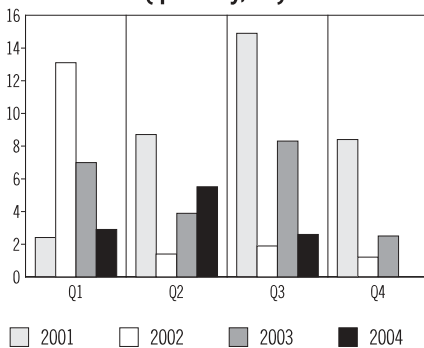
Consumer and industrial producer prices (December 1997 = 100%)



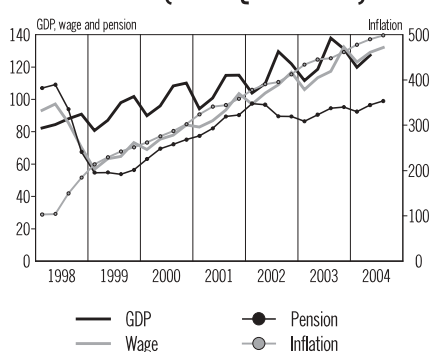
Growth in **freight transportation charges** in September 2004 stood at 11.4% as compared with December 2003 as against 20.5% in the same period last year. At the same time, railway fares increased by 12.6% as against 26.5% in the same period of 2003.

Wages and salaries increased at fairly rapid rates in January-September 2004, faster than labour productivity. Moreover, the gap between the rates of growth in real wage and labour productiv-

Growth in freight transportation charges (quarterly, %)



GDP, real wage, real pension and inflation (1997 Q4 = 100%)



ity widened compared to the same period last year, creating conditions for further price growth.

The trend of real wage growth rates exceeding GDP growth rates as compared with 1997 Q4, which emerged in 2003 Q4, continued in 2004. At the same time, the dynamics of real pensions continued to lag behind GDP growth and have not yet recovered to the 1997 Q4 level. The excess of real wage growth over production growth amid the widening gap between labour productivity and wage dynamics is a factor of additional inflationary pressure on the economy.

The average monthly nominal imputed **wage** in January-September 2004 stood at 6,590 rubles as against 5,214 rubles in the same period last year, an increase of 25.3%. In real terms, this wage increased by 13.3% as against 9.1% in the same period last year.

As in the past few years, significant wage differences between various sectors of the economy remained. As before, wages were the highest in the fuel and non-ferrous metallurgy sectors and in the sphere of finance, credit and insurance, and the lowest were in the social sphere (education, culture and the arts and healthcare), agriculture and light industry.

At the same time, the most significant year-on-year growth in the average monthly wage this year was registered in healthcare, physical culture and social security and culture and the arts. Wage growth rates in the electric-power industry and the fuel sector were a little slower than in the social sphere, but they were roughly the same as in industry as a whole.

Despite increased costs, there was no acceleration of price growth in the light and food industries, whose output goes

directly to the consumer goods market. One reason for this was the efforts made by enterprises in these industries to retain control over their markets. In January-September 2004, producer price growth in the food industry slowed by 0.1 percentage points year on year (to 8.5% as against 8.6%) and in light industry to 6.3% as against 9.2%. At the same time, the rate of profitability of large and medium-sized enterprises in the light and food industries in 2004 1H stood at 7.3% and 2.6% respectively against 7.8% and 0.5% in January-June 2003.

Other factors

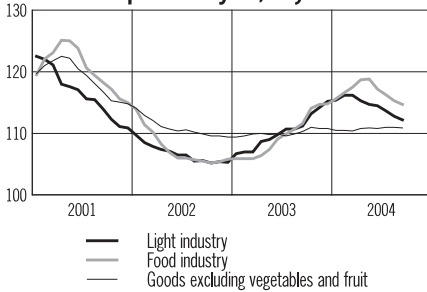
In the first nine months of the year, Russia continued to maintain a **budget surplus**, which restrained borrowings on the domestic market and inflation growth.

According to Finance Ministry data, federal budget revenue stood at 20.1% of GDP in January-September 2004, expenditure 15.2% and the federal budget surplus 4.9% as against 2.5% in the same period last year.

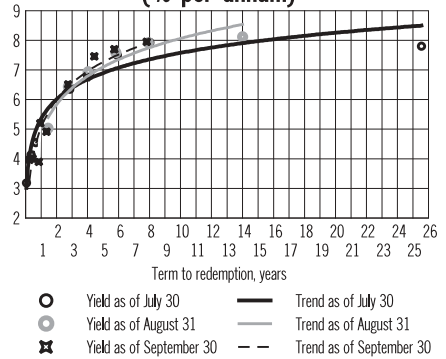
Relatively low **inflationary expectations** were a major factor responsible for slowing price growth. According to surveys conducted by the Russian Government's Centre for Economic Studies, the inflationary expectations of managers at key industrial enterprises in January-September 2004 were lower than in the same period last year. Price growth in the near future was predicted during that period by 29-34% of respondents as against 31-35% in January-September 2003.

The structure of interest rates on the financial instruments with different maturity periods remained balanced in Q3, despite fluctuations in the demand for money and its supply and interest rate volatility on

Producer prices in light and food industries and prices of goods except vegetables and fruit (month on month of previous year, %)



GKO-OFZ yield curve in 2004 Q3 (% per annum)



the money market. The yield curves of major financial instruments tended to rise, reflecting the stable nature of Russian financial market players' inflationary expectations.

The rate of production capacity utilisation affects, to a certain extent, inflation dynamics in the economy. According to surveys of managers at key industrial enterprises, the average rate of production capacity utilisation in September was 59% and posed no serious threat of

the acceleration of inflation. The highest rates of production capacity utilisation were registered in the fuel sector (83%), ferrous metallurgy sector (78%) and wood-paper industry (73%), and the lowest in machine-building and metalworking (50%), light industry (51%) and the food industry (54%).

At present, there is a backlog of unused production capacity, which can be utilised if demand for traditional goods rises or new products are manufactured.

On the state of production capacity in the light and food industries

The rate of capital consumption² in light industry has been high in recent years, preventing the industry from turning out high-quality products. As of the beginning of 2003, it stood at 48.8%, lower than in industry as a whole (53%). Of all industries, light industry has the lowest rate of fixed capital renovation³ (0.4). It is 4.5 times lower than in industry as a whole. According to surveys conducted by the Russian Government's Centre for Economic Studies (CES), light industry has one of the lowest rates of production capacity utilisation in industry (51%).

Domestically produced goods cannot always compete with their imported counterparts in terms of quality. As a result, output has declined in the past few years (2002-2004) despite growth in household income. However, surveys conducted by the CES indicate that evaluations of the competitiveness of light industry products in 2004 has improved a little as compared with the previous year, but it remains low nonetheless. In 2003 Q1, just 6% of light industry factory managers evaluated their competitiveness on the domestic market as high and in 2004 Q1 their

share increased by 4 percentage points to 10%. In 2004 Q1, as in 2003 Q1, the managers of only 2% of the enterprises surveyed evaluated their competitiveness on the CIS market as high.

The rate of capital consumption in the food industry stood at 35.7% as of the beginning of 2003 and was lower than in industry as a whole (53%). The rate of fixed capital renovation in the food industry was 2.9, or 1.6 times higher than in industry as a whole. The rate of production capacity utilisation in the food industry is low - 54%, according to CES data (as against 59% in industry as a whole).

However, continuing demand allowed food industry enterprises to boost output at a fairly rapid rate. According to the CES's surveys, in 2004 Q1 the competitiveness of the food industry's output decreased as compared with the same period last year. In 2003 Q1, the managers of 29% of food industry enterprises evaluated their competitiveness on the domestic market as high, whereas in 2004 Q1 their share contracted by 12 percentage points to 17%. The number of managers who evaluated the competitiveness of their enterprises as high on the CIS market also declined, from 11% in 2003 Q1 to 2% in 2004 Q1.

² Capital consumption is the ratio of depreciation deductions for renovation (recovery) to the original cost of fixed assets.

³ The rate of fixed capital renovation is calculated as the ratio of the cost of putting basic production assets into operation to their availability as of the end of the year.

Monetary Indicators

The dynamics of monetary indicators in 2004 Q3 were affected by demand for foreign currency-denominated assets, slowing economic growth and the increased influence of the budget due to the expansion of the Stabilisation Fund.

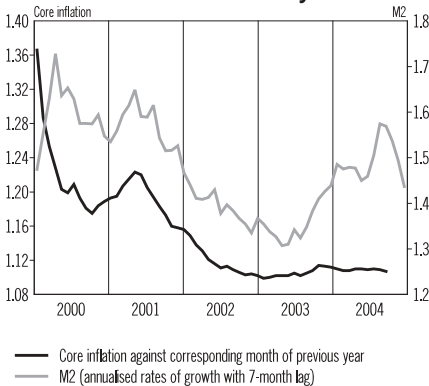
A trend towards slowing growth in monetary indicators which emerged in March 2004 continued in the third quarter of the year. In September, M2 growth rates slowed to an annualised 35.4% from 47.7% a year earlier. In 2004 Q3 as a whole, money supply grew less than in the previous quarter owing to seasonal factors and its growth rate stood at 1.1% as against 4.8% in 2003 Q3. July saw an uncharacteristic contraction of the ruble supply and in August the ruble supply's rate of growth was considerably slower than the monthly average of the past few years.

M2 growth rates in the last month of the quarter were close to those of the past two years, a process that may indicate an

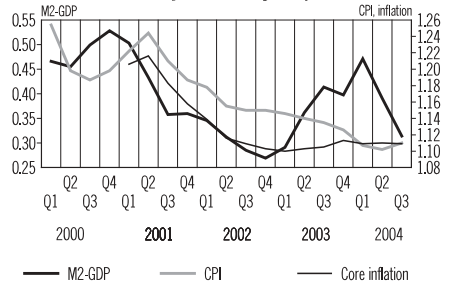
end to the trend towards the slowing of M2 growth.

The accelerated and prolonged (since 2003) growth of the ruble supply (annualised M2 growth rates) created a cumulative effect that pushed prices up. Since there is a lag between money supply growth and core inflation, this pressure reached a peak in the third quarter of the year (July-October). However, inflation's reduced susceptibility to changes in the dynamics of monetary indicators, on the one hand, and the contraction of core inflation's contribution to consumer price growth, on the other, affected actual consumer price inflation, which slightly exceeded the projected rate. Although consumer price growth accelerated year on year, core inflation in the 12-month moving period only slowed in September, as money supply growth continued to bring pressure to bear on the general rate of inflation.

Core inflation and M2 dynamics



Gap between money supply and GDP growth rates, core inflation and consumer prices (quarter on quarter of previous year)



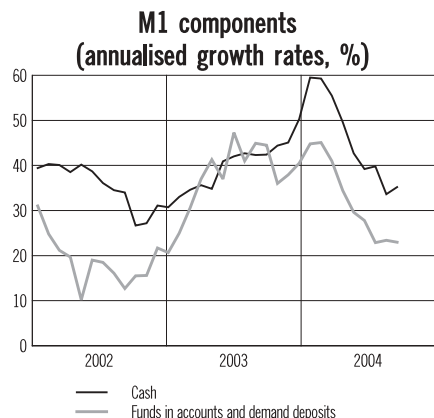
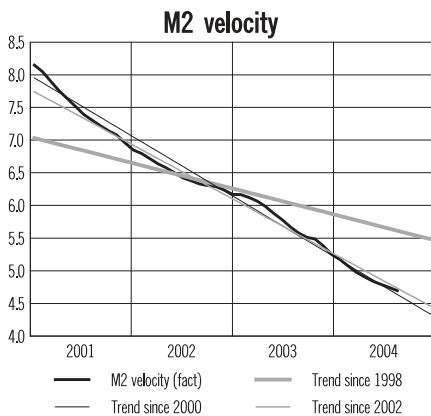
Slowing growth in the ruble supply, registered from March to August, will reduce its pressure on core inflation in the first half of the next year. At the same time, the significant and rapid reduction of M2 growth after a long period of acceleration may serve as an indication that core inflation growth due to the increased money supply is hardly possible in the medium term.

The gap between M2 and GDP growth rates, which characterises the part of monetary growth that exceeded the level necessary to finance the increased amount of transactions, grew considerably narrower in Q3 and reached the 2003 Q1 level. Since this gap can influence inflation, it is important that in interpreting it, one should evaluate correctly the dynamics of the velocity of the economically sound path.

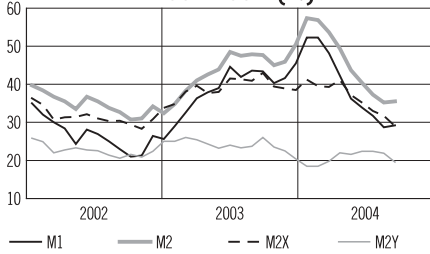
The greater-than-expected fall in M2 velocity in the first half of the year contained price growth, balancing out the correlation between the expansion of the money supply and economic growth. Instability in the demand for the domestic currency affected the dynamics of money velocity: its reduction slowed down significantly in the third quarter (to 1.9%), whereas in the previous

four quarters it declined at an average quarterly rate of 4.6%.

The slowing of annualised rates of growth in the third quarter was characteristic, above all, of the ruble monetary aggregates (M0, M1 and M2). One factor behind this process was economic agents' increased demand for foreign exchange, caused by the ruble's nominal depreciation against the dollar and the after-effects of instability in the banking sector. This affected the dynamics of aggregates, including non-financial agents' foreign currency-denominated assets. The rate of growth of M2X, the aggregate comprising non-cash foreign exchange, slowed from an annualised 35.2% as of July 1, 2004, to 29% as of October 1, 2004. It was less significant than the slowing of M2 growth. M2X growth rates were slightly faster than M2 growth rates (by one percentage point) from the beginning of the year due to considerable growth in the value of foreign currency deposits, which grew faster than ruble deposits (by 6.1% as against 0.9%) in July-September 2004. Foreign cash expanded even more significantly, a process evidenced by the dynamics of broader contingent ag-



Monetary aggregates' annual growth rates in 2002-2004 (%)



*Definitions of aggregates:
 M1 = M0 + current accounts and demand deposits;
 M2 = M1 + time deposits in rubles;
 M2X is the money supply in the monetary survey definition = (M2 + foreign currency deposits);
 M2Y is the broader contingent monetary aggregate = M2X + an estimated amount of foreign exchange in the non-banking sector.*

gregate M2Y, which comprises an estimated amount of foreign exchange in the non-financial enterprise and household sector. According to preliminary balance of payments data, the value of foreign exchange in the non-financial enterprise and household sector increased by \$1.2 billion in 2004 Q2 and Q3, whereas in the same period of 2003 it contracted by \$4.2 billion.

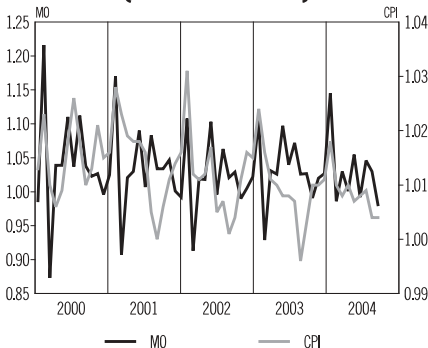
Although the annualised M2Y aggregate did not go down from January to August, it was below last year's level. In September, the M2Y growth rates slowed to an

annualised 26% (as against 19.6% a year earlier) amid the ruble's nominal rise against the dollar and decline in the demand for foreign exchange.

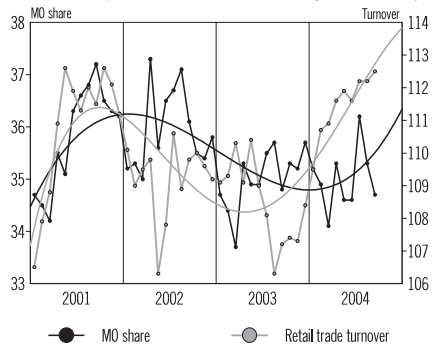
The most significant influence on consumer prices is exerted by transaction money, which has a high level of liquidity and shorter lags of influence unlike less liquid components of the money supply. The rate of growth of the M1 aggregate (the most liquid components of the money supply), which reflects the economic conditions at home and abroad and economic agents' preferences, slowed in 2004 Q3 from 33.9% to 29.2%.

The rates of growth in funds in accounts and demand deposits slowed to 23% in September from 27.8% in June and were considerably slower than in September 2003 (44.5%). Moreover, in 2004 Q3 these funds contracted in absolute terms. The fall was partly due to the seasonal slowing of growth in corporate current accounts in the first month of the quarter, which was stimulated by the crisis of confidence in the banking sector, and the decrease of funds in personal demand deposits throughout the quarter.

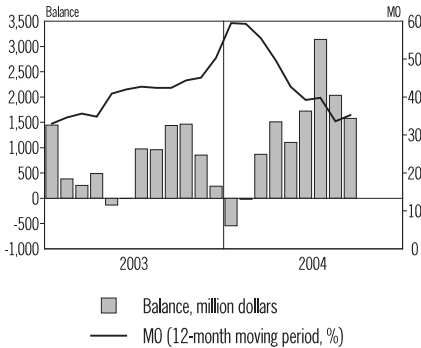
M0 (with 1-month lag) and CPI (month on month)



Cash in M2 structure (%) and retail trade turnover (annualised rates of growth, %)



MO and balance of household sector operations with foreign exchange



The outflow of ruble funds from bank accounts was stimulated by growth in household sector demand for foreign exchange and changed preferences. As the nominal rate of the ruble against the dollar declined in 2004 Q2 and Q3, net purchases of foreign exchange by the household sector began to increase in April and rose sharply in July as banks were hit by the crisis of confidence. In July-September they amounted to more than \$5.7 billion as against \$1.8 billion in the same period last

year and this determined the cash ruble dynamics.

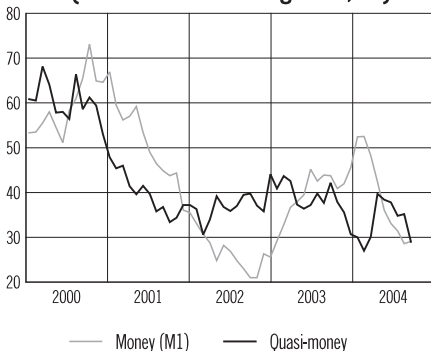
By the beginning of October, cash growth rates were slower than in Q3 (35.2% as against 42.4% on an annualised basis). In July-September, cash expanded by 1.4% in volume, a rate considerably slower than the Q3 average of the previous years. The fall in M0 growth also came as a result of slightly slower growth in household income, which grew less than in the same period last year.

M0's moderate growth in Q3 had no stimulating effect on consumer prices in the short term.

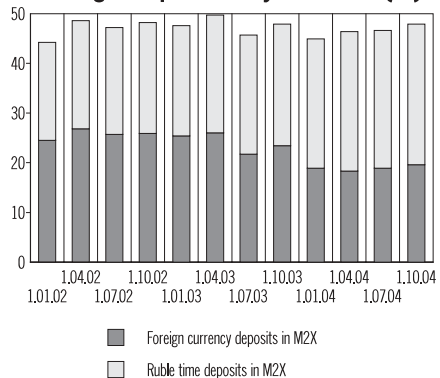
The slowing of M0 growth this year was not accompanied by any significant contraction of its share in the M2 structure (as of October 1, 2004, it accounted for 34.7%, i.e., was virtually unchanged from a year earlier). This may indicate, to some extent, that the expanding retail trade turnover is mostly serviced by cash and that the consumer still prefers to use cash as a means of payment.

Against the backdrop of the downward trends in the dynamics of cash and funds in

Money and quasi-money (annualised rates of growth, %)



Change in quasi-money structure (%)



transaction accounts, the rates of growth in the money aggregate in the monetary survey definition (similar to M1) slowed to 29.1% by the end of 2004 Q3 from 43.8% a year earlier. As for the dynamics of the quasi-money aggregate, the savings component of the money supply in the monetary survey definition (M2X), the downward trend that emerged at the beginning of 2003 resumed at the end of Q2 and gained ground: by October 1, 2004, the annualised rate of growth in quasi-money slowed to 29% from 42.2% a year earlier.

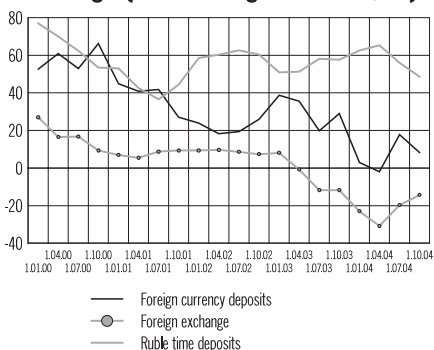
The quasi-money aggregate comprises funds used by economic agents as savings, i.e., less liquid components of the money supply, which represent the absorption element with smaller potential and a longer lag of influence on prices. The rate of growth in these funds slowed owing to the similar dynamics of the ruble and foreign currency components. In 2004 Q3, the rates of growth in time ruble deposits (4%) and foreign currency deposits (6.1%) were slower than in 2004 Q2 and 2003 Q3.

The significant slowing of growth in time deposits in the national currency was connected with the outflow of household

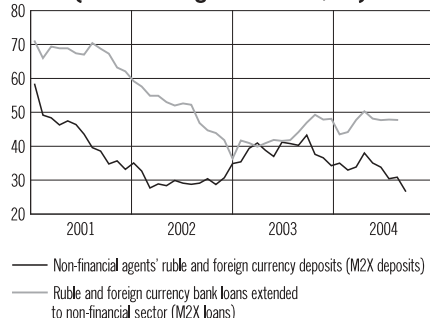
sector funds from the banking system, caused by the erosion of public confidence in this system and the changed preferences for the currency of savings. As a result, a long-term trend towards accelerated growth in time deposits in rubles (mostly household deposits) came to a halt but started to gain ground again in August and September. In the meantime, the non-financial enterprise sector's time deposits continued to grow as enterprises' incomes increased and their financial standing improved.

As a result, although foreign currency deposits increased faster than time deposits in rubles, as in Q2, the structure of quasi-money changed little in July-September. The share of the foreign currency component in the money supply structure in the monetary survey definition (M2X) as of October 1, 2004, expanded by half a percentage point to 19.6%. The ruble component of quasi-money continued to predominate in M2X (28.3% as of October 1, 2004, as against 27.7% as of July 1, 2004). In the medium term (compared to 2003 Q3), a trend towards national currency having a greater share in quasi-money was more evident: the

Quasi-money components and foreign exchange (annualised growth rates, %)



M2X non-cash money and loans to non-financial sector (annualised growth rates, %)



share of the household and corporate sectors' time deposits in rubles expanded by nearly four percentage points, while that of foreign currency deposits contracted almost as much.

The dynamics of the foreign currency component of broader contingent aggregate M2Y, which comprises both cash and non-cash foreign currency funds, mainly reflect the flow of economic agents' funds from ruble to foreign currency assets. As the annualised rates of growth in time deposits in rubles and foreign currency deposits slowed, the rates of growth in foreign cash started to accelerate steadily in the second quarter of the year.

The third quarter saw a significant rise in economic agents' demand for foreign exchange, caused by the changed exchange rate dynamics, banking sector problems and devaluation expectations. In July and August, the household sector purchased record amounts of foreign exchange and in July-September the amount of foreign exchange in the non-financial enterprise and household sector expanded by \$900 million, according to a balance of payments estimate (in 2004 Q2 it grew by \$300 million and in 2004 Q1 it decreased by \$3.2 billion).

As a result, the share of foreign exchange in broader aggregate M2Y expanded slightly in 2004 Q3 (by 1 percentage point to about 48%), but it was considerably smaller (by almost 10 percentage points) than in 2003 Q3.

The corporate and household sector's ruble and foreign currency funds drawn by banks for various terms (on the one hand, these funds absorb some of the money supply and on the other hand, they serve as the basis for the expansion of lending volumes) increased by 76.4 billion rubles in July-September 2004. Slower growth in the funds

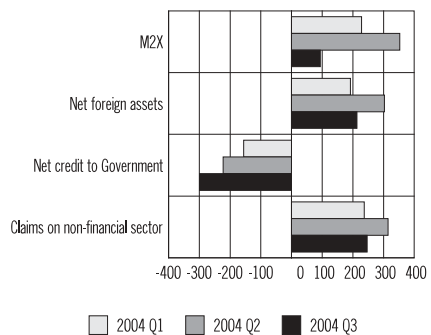
drawn by banks in 2004 Q3 (2.3% as against 8% a year earlier) was not accompanied by corresponding reduction in the real sector's obligations to the banking sector, which stimulate the expansion of aggregate money supply.

The increase of the banking sector's claims on the non-financial sector of the economy in 2004 Q3 was a major source of growth in the money supply: in July-September 2004 it amounted to 246.7 billion rubles, while M2X expanded by 94 billion rubles.

At the same time, the dynamics of monetary indicators were affected by the continued growth of banking sector net foreign assets, mainly caused by the Bank of Russia increasing its foreign exchange reserves. Meanwhile, the accumulation of funds in the general government's accounts, caused by the expansion of the Stabilisation Fund, had a serious restraining effect on money supply growth.

The accumulation of budget funds in Bank of Russia accounts has a two-pronged effect on the dynamics of monetary indicators. On the one hand, the expansion of the Stabilisation Fund to its base level of 500

Sources of money supply growth (change over period, billion rubles)



billion rubles, which is taking place this year, has a medium-term sterilisation effect, containing growth in the money supply created by a massive inflow of export earnings to the country. On the other hand, the increase in the budget fund balances, unaccounted for in the Stabilisation Fund, may only be regarded as a short-term factor of absorption, as it carries the risk of recurrent sharp growth in expenditures at the end of the year, which may cause the inflation rate to accelerate at the beginning of the next year.

In the final analysis, although the current path of monetary indicators shows that money supply growth will not cause core inflation to accelerate in the coming period, it creates uncertainty about the future stability of the dynamics of monetary indica-

tors. In addition to the marked restraining effect of the Stabilisation Fund and Bank of Russia sterilisation measures on money supply dynamics, a major role in slowing growth in the ruble supply was played by the increased outflow of capital, mainly in the form of the changed preferences for the currency of assets. Therefore, as confidence in the national currency and banking sector is gradually restored and strengthened and, consequently, the process of de-dollarisation intensifies, it will be important in the coming period to preserve the structure of the money supply that formed in 2003 and the first quarter of 2004 by expanding the share of its low-liquidity ruble components.

Financial Market Indicators

The term structure of interest rates on ruble-denominated financial instruments with different maturity periods was determined in the third quarter of the year by fluctuating money supply and demand for money. The principal factors that affected the level of financial market interest rates in the period under review were a relatively high level of banking sector liquidity, increased borrowings on the GKO-OFZ market and stability of the nominal dollar/ruble exchange rate.

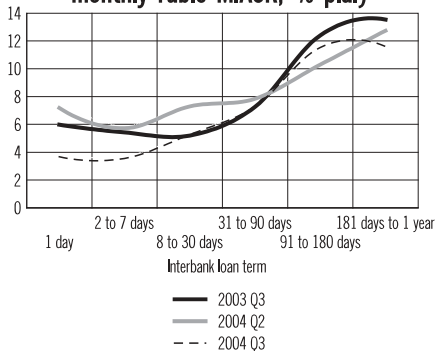
In the third quarter of the year when the average quarterly level of commercial banks' liquidity increased, interest rates declined on ruble interbank loans with almost all terms. As interest rates on loans with terms up to a month decreased significantly, the interbank yield curve became more abrupt while retaining its rising slope. Interest rates on the longest-term loans changed less. **The term structure of interbank interest rates in July–September continued to reflect the**

relatively low and stable level of market players' inflationary expectations.

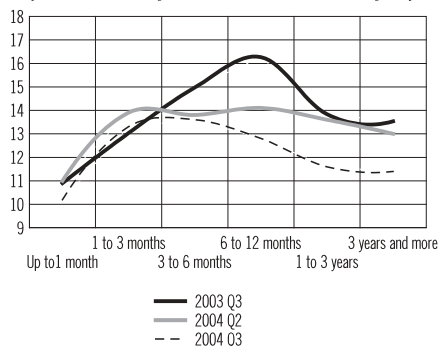
The yield curve of banks' lending operations in the third quarter of the year became more salient while retaining a positive slope in the sector of up to six months, whereas the negative slope of the yield curve in the longer-term sector increased. The fall in interest rates on operations with terms longer than six months in July–September caused this sector of yield curve to move downwards. **The shape of the yield curve of banks' lending operations can be regarded as evidence of the persistent expectations of a further moderate decline in interest rates in this segment of the Russian market in the medium-term only and following a possible slowing of inflation.**

As turnovers on the secondary government securities market increased slightly, the average quarterly yield on domestic government debt instruments rose by 0.2 per-

Interbank loan yield curve (average monthly ruble MIACR, % p.a.)



Bank lending yield curve (loans to corporate borrowers, % p.a.)



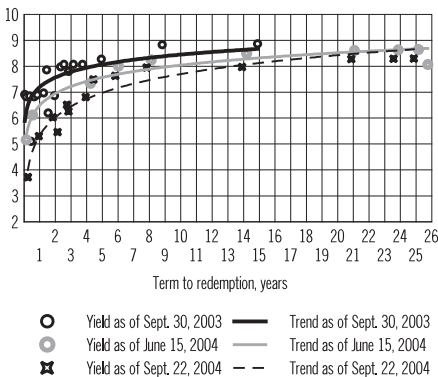
centage points quarter on quarter. The GKO-OFZ yield curve retained its rising slope in 2004 Q3. At the end of September, the yield on government bonds with all maturity periods was lower than in June and the yield curve's slope increased due to a quicker fall in the yields on papers with maturity periods up to four years. **No inflation risk premium was included in the price of short-term government bonds** while the ensuing yield level was determined by the structure of demand on the money market. The medium- and long-term inflationary expectations of market players were unchanged from the previous quarter. **Investments in medium-term government bonds are susceptible to moderate inflation risk. The risks involved in papers with terms to redemption longer than five years were determined by market players by evaluating risks involved in medium-term issues.**

GKO-OFZ secondary market turnovers increased to \$940 million a day in Q3 as against \$900 million a day in Q2. While banking sector liquidity levels remained high, the structure of turnover changed sig-

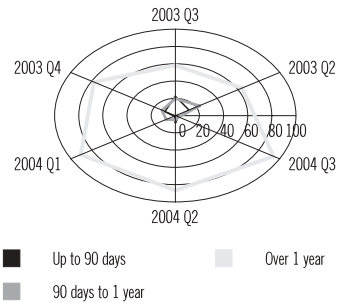
nificantly, especially as a result of the Finance Ministry's massive placements and additional placements of medium- and long-term OFZ issues. The share of government bonds with terms to redemption up to three months contracted from 8.7% in Q2 to 2.9% in Q3, the share of government bonds with terms from three months to a year decreased from 4.8% to 3.2%, while the share of medium- and long-dated papers in the secondary government bond market turnover expanded from 86.5% to 94%. **The GKO-OFZ turnover structure in July-September reflected the change of priorities of government securities market players amid persistent relatively low inflationary expectations.**

An analysis of the term structure of interest rates in the surveyed segments of the financial market shows that the price indicator volatility of major ruble-denominated financial instruments was moderate in the third quarter of the year. In that situation, the yield curves of the main ruble instruments on the Russian market retained their

GKO-OFZ effective yield curve (% p.a.)



GKO-OFZ secondary trade turnover structure by term to redemption in 2003-2004 (%)



informative importance, especially as an indicator of the inflationary expectations of market players.

There were no serious imbalances in the interest rate structure by instrument with different maturity periods. **The yield curves of key financial instruments mostly had a rising slope, reflecting the stable nature of the short- and medium-term inflationary expectations of Russian financial market players.**

Long-term inflationary expectations cannot be evaluated accurately owing to the small scale of operations with long-term financial instruments. **That the yield curves of the various longest-term instruments remained almost flat in the third quarter of the year may testify to a certain degree of inertia in market players' expectations.**

Statistical Addendum

Consumer price dynamics by group of goods and services (month on month, %)

	Monthly inflation	Food price growth	Growth in food prices, excluding vegetable prices	Vegetable and fruit price growth	Non-food price growth	Core inflation	Service price growth
2003							
January	2.4	2.5	1.3	13.1	1.1	1.2	4.4
February	1.6	1.2	0.8	4.1	0.9	0.9	4.2
March	1.1	1.0	0.6	3.9	0.8	0.7	1.7
April	1.0	1.0	0.5	4.2	0.6	0.6	1.8
May	0.8	0.7	0.4	2.5	0.6	0.6	1.5
June	0.8	0.8	0.6	2.3	0.5	0.6	1.2
July	0.7	0.4	0.7	-1.8	0.5	0.7	1.9
August	-0.4	-1.4	0.8	-17.2	0.6	0.7	0.7
September	0.3	-0.2	1.1	-11.2	0.9	1.1	0.9
October	1.0	1.1	1.8	-5.6	1.0	1.4	0.8
November	1.0	1.2	1.3	1.0	0.8	1.1	0.4
December	1.1	1.5	1.2	4.1	0.6	1.0	0.9
Full year (December on December)	12.0	10.2	11.8	-4.2	9.2	11.2	22.3
2004							
January	1.8	1.6	1.3	5.5	0.5	0.9	4.1
February	1.0	1.1	1.1	1.5	0.4	0.8	1.6
March	0.8	1.1	0.9	2.8	0.4	0.7	0.6
April	1.0	0.8	1.0	-0.6	0.6	0.8	2.0
May	0.7	0.4	0.5	-0.7	0.8	0.6	1.4
June	0.8	0.8	0.4	4.8	0.7	0.5	0.9
July	0.9	1.0	1.0	1.5	0.6	0.8	1.3
August	0.4	0.1	0.8	-6.3	0.5	0.7	1.0
September	0.4	0.0	0.9	-9.0	0.9	0.9	0.6

**Consumer price dynamics by group of goods and services
(on accrual basis since start of year, %)**

	Inflation over period	Food price growth	Growth in food prices, excluding vegetable prices	Vegetable and fruit price growth	Non-food price growth	Core inflation	Service price growth
2003							
January	2.4	2.5	1.3	13.1	1.1	1.2	4.4
February	4.1	3.7	2.2	17.8	2.0	2.1	8.8
March	5.2	4.8	2.8	22.4	2.8	2.8	10.6
April	6.2	5.8	3.3	27.6	3.5	3.4	12.6
May	7.1	6.5	3.8	30.8	4.1	4.0	14.2
June	7.9	7.4	4.4	33.7	4.6	4.7	15.6
July	8.7	7.8	5.1	31.4	5.1	5.4	17.8
August	8.3	6.3	6.0	8.7	5.7	6.2	18.7
September	8.6	6.1	7.1	-3.4	6.6	7.3	19.7
October	9.7	7.3	9.1	-8.9	7.7	8.9	20.7
November	10.8	8.6	10.4	-7.9	8.6	10.1	21.2
December	12.0	10.2	11.8	-4.2	9.2	11.2	22.3
2004							
January	1.8	1.6	1.3	5.5	0.5	0.9	4.1
February	2.8	2.8	2.3	7.1	0.9	1.7	5.8
March	3.5	3.8	3.2	10.1	1.4	2.4	6.4
April	4.6	4.7	4.2	9.5	2.0	3.2	8.5
May	5.3	5.2	4.8	8.7	2.8	3.8	10.0
June	6.1	6.0	5.2	13.9	3.4	4.3	11.0
July	7.1	7.1	6.2	15.6	4.0	5.1	12.5
August	7.6	7.2	7.1	8.3	4.6	5.8	13.6
September	8.0	7.2	8.0	-1.4	5.5	6.8	14.3

Inflation Growth Structure

**Inflation growth over period since start of year due to changes
in prices by group of goods and services**

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit	Inflation over period, %
2003						
January	0.7	0.3	1.0	0.8	0.7	2.4
February	1.1	0.5	1.7	1.5	0.9	4.1
March	1.4	0.8	2.3	1.8	1.2	5.2
April	1.7	1.0	2.8	2.2	1.4	6.2
May	1.9	1.1	3.3	2.4	1.6	7.1
June	2.2	1.3	3.8	2.7	1.8	7.9
July	2.6	1.4	4.4	3.1	1.6	8.7
August	3.0	1.6	5.0	3.2	0.5	8.3
September	3.6	1.8	6.0	3.4	-0.2	8.6
October	4.5	2.1	7.2	3.5	-0.5	9.7
November	5.2	2.4	8.2	3.6	-0.4	10.8
December	5.9	2.5	9.1	3.8	-0.2	12.0
2004						
January	0.6	0.1	0.8	0.7	0.3	1.8
February	1.2	0.2	1.4	1.0	0.4	2.8
March	1.6	0.4	2.0	1.1	0.5	3.5
April	2.1	0.5	2.6	1.4	0.5	4.6
May	2.4	0.8	3.1	1.7	0.4	5.3
June	2.6	0.9	3.5	1.9	0.7	6.1
July	3.1	1.1	4.2	2.1	0.8	7.1
August	3.5	1.3	4.7	2.3	0.4	7.6
September	4.1	1.5	5.5	2.5	-0.1	8.0

* Excluding vegetables and fruit.

**Monthly inflation growth rate due to changes
in prices by group of goods and services**

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit	Inflation over month, %
2003						
January	0.7	0.3	1.0	0.8	0.7	2.4
February	0.4	0.2	0.7	0.7	0.2	1.6
March	0.3	0.2	0.6	0.3	0.2	1.1
April	0.3	0.2	0.5	0.3	0.3	1.0
May	0.2	0.2	0.4	0.3	0.2	0.8
June	0.3	0.1	0.5	0.2	0.1	0.8
July	0.3	0.1	0.5	0.4	-0.1	0.7
August	0.4	0.1	0.6	0.1	-1.1	-0.4
September	0.5	0.2	0.9	0.2	-0.6	0.3
October	0.9	0.3	1.2	0.1	-0.3	1.0
November	0.6	0.2	0.9	0.1	0.0	1.0
December	0.6	0.2	0.8	0.2	0.2	1.1
2004						
January	0.6	0.1	0.8	0.7	0.3	1.8
February	0.5	0.1	0.6	0.3	0.1	1.0
March	0.4	0.1	0.6	0.1	0.1	0.8
April	0.5	0.2	0.6	0.4	0.0	1.0
May	0.3	0.2	0.5	0.3	0.0	0.7
June	0.2	0.2	0.4	0.2	0.3	0.8
July	0.5	0.1	0.6	0.2	0.1	0.9
August	0.4	0.2	0.5	0.2	-0.4	0.4
September	0.5	0.3	0.7	0.1	-0.5	0.4

* Excluding vegetables and fruit.

Contribution to Inflation Growth
Contribution to inflation growth over period since start of year
by group of goods and services

	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit
2003					
January	27.5	12.4	40.6	31.6	28.5
February	26.7	13.4	41.8	37.1	22.8
March	27.3	14.9	44.2	35.3	22.5
April	27.0	15.3	44.9	34.7	23.1
May	26.9	15.9	46.1	34.5	22.7
June	28.1	16.0	47.9	33.7	22.2
July	29.7	16.2	50.2	35.2	18.8
August	36.5	19.1	60.7	38.9	5.5
September	41.6	21.2	69.1	39.3	-2.1
October	46.7	21.6	74.3	36.4	-4.7
November	48.5	21.7	76.3	33.6	-3.8
December	49.1	21.0	75.9	31.7	-1.8
2004					
January	35.8	7.6	43.2	40.3	16.3
February	42.3	9.0	50.0	35.4	13.3
March	45.0	10.3	55.3	30.2	14.5
April	46.1	11.7	57.5	31.5	10.7
May	45.2	14.2	58.5	32.2	8.5
June	42.2	15.3	57.2	30.7	11.8
July	43.4	15.4	58.8	29.9	11.3
August	46.9	16.6	62.6	30.8	5.7
September	50.8	19.1	68.4	30.9	-0.9

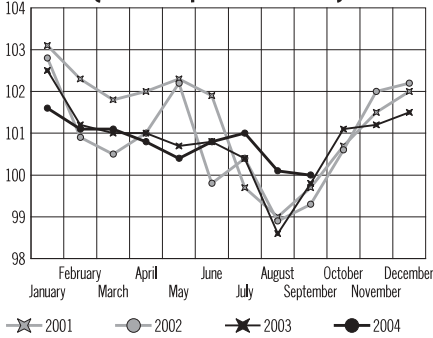
* Excluding vegetables and fruit.

**Contribution to inflation growth over month
by group of goods and services (%)**

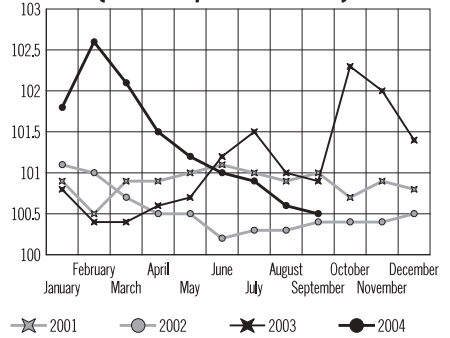
	Foodstuffs*	Non-food products	Core inflation	Paid services	Vegetables and fruit
2003					
January	27.5	12.4	40.6	31.6	28.5
February	25.5	15.0	43.7	45.0	14.6
March	29.7	20.3	53.0	28.3	21.7
April	25.5	17.2	48.7	31.6	25.7
May	25.9	21.2	55.3	33.1	19.8
June	38.4	16.6	62.7	26.9	18.1
July	46.8	18.9	74.7	50.7	-16.4
August	<i>Estimate impossible for negative value</i>				
September	164.8	72.9	270.6	50.5	-188.3
October	86.6	25.6	114.6	14.2	-26.4
November	63.8	23.3	94.1	8.4	4.5
December	53.8	14.2	71.7	15.1	16.9
2004					
January	35.8	7.6	43.2	40.3	16.3
February	53.5	11.5	61.8	26.8	8.1
March	54.6	14.8	74.3	11.5	19.2
April	49.6	17.1	65.1	36.3	-2.9
May	39.1	30.1	64.9	36.2	-5.4
June	22.8	22.7	48.2	21.0	33.6
July	50.6	15.8	68.1	24.8	8.8
August	101.4	35.8	122.3	46.0	-83.2
September	116.9	63.8	164.9	34.1	-114.8

* Excluding vegetables and fruit.

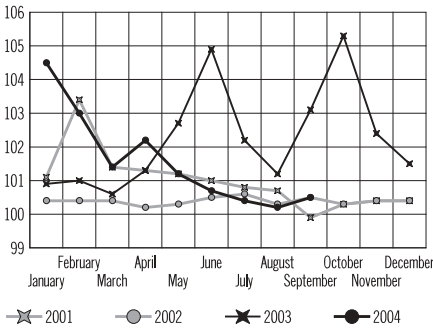
Food prices, total
(as % of previous month)



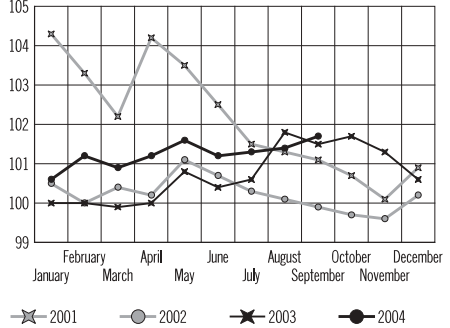
Pasta prices
(as % of previous month)



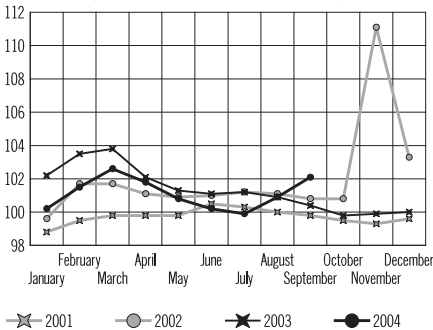
Bread and bakery product prices
(as % of previous month)



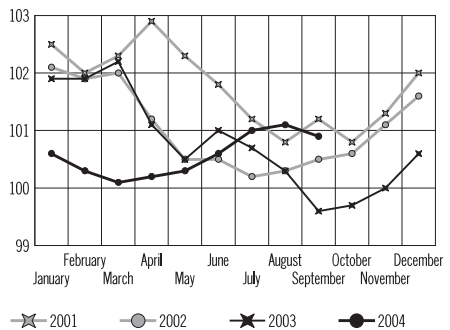
Meat and poultry prices
(as % of previous month)



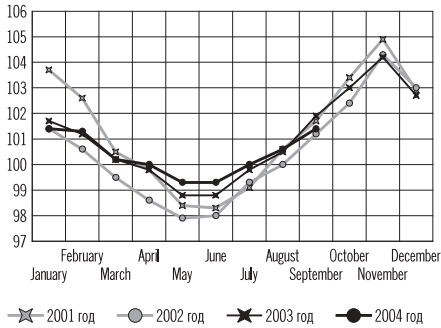
Cereal and legume prices
(as % of previous month)



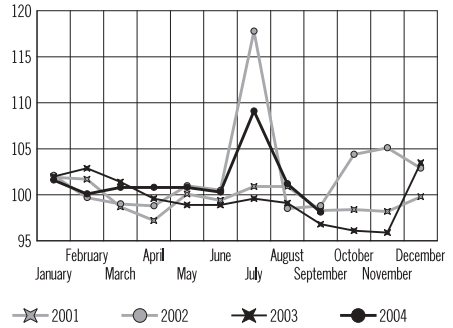
Fish and seafood prices
(as % of previous month)



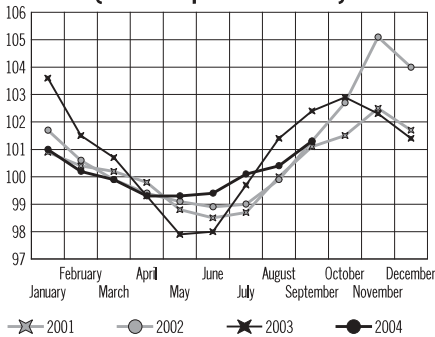
Milk and dairy product prices (as % of previous month)



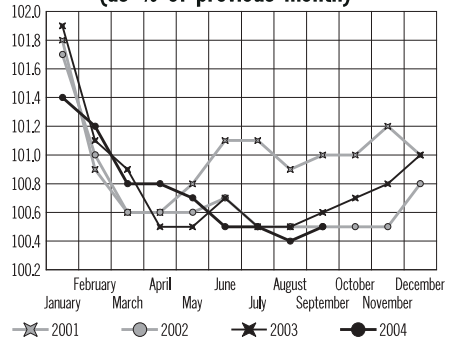
Granulated sugar prices (as % of previous month)



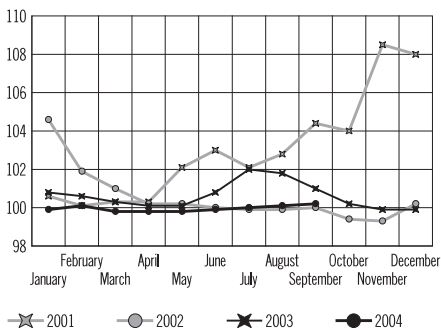
Butter prices (as % of previous month)



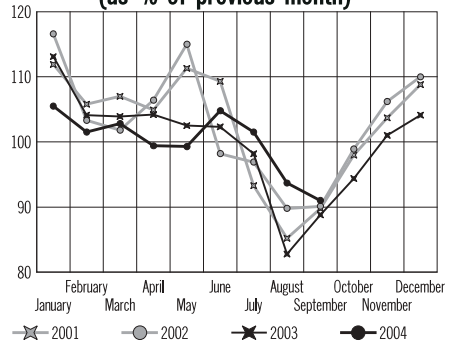
Alcoholic beverage prices (as % of previous month)



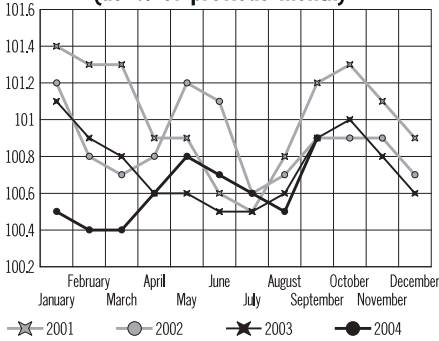
Sunflower oil prices (as % of previous month)



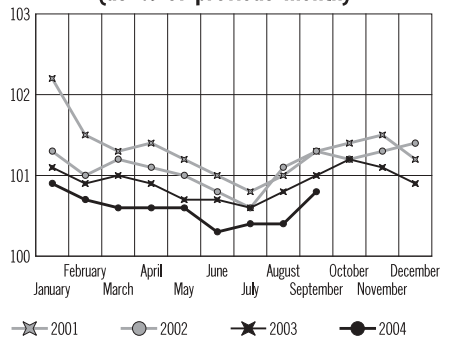
Vegetable and fruit prices (as % of previous month)



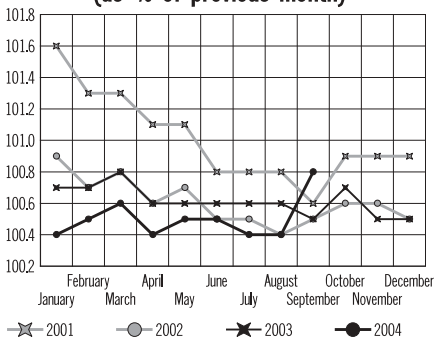
Non-food prices, total
(as % of previous month)



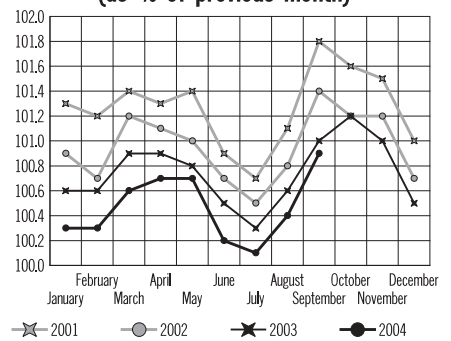
Knitwear prices
(as % of previous month)



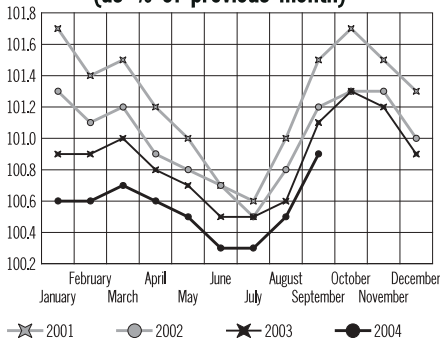
Fabrics prices
(as % of previous month)



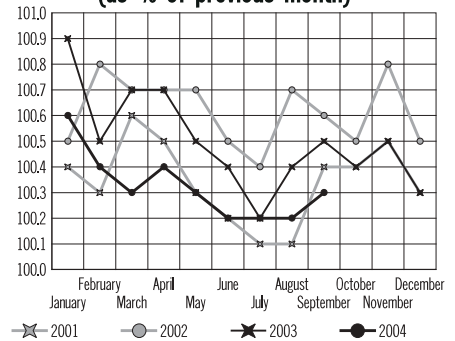
Footwear prices
(as % of previous month)



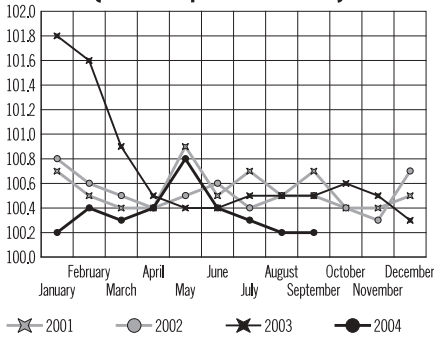
Clothes and underwear prices
(as % of previous month)



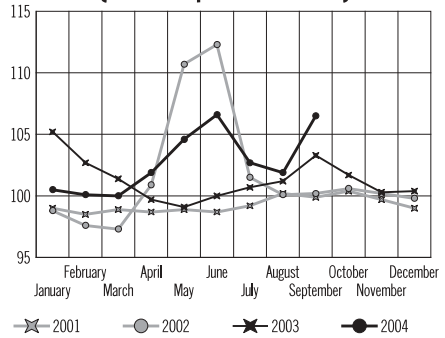
Detergent and cleaning product prices
(as % of previous month)



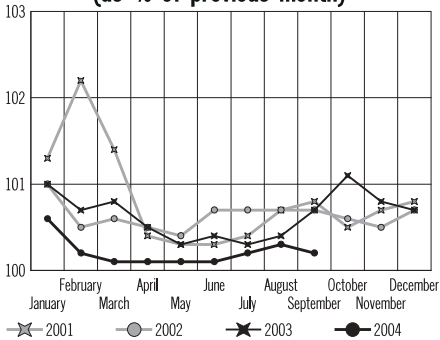
Tobacco prices
(as % of previous month)



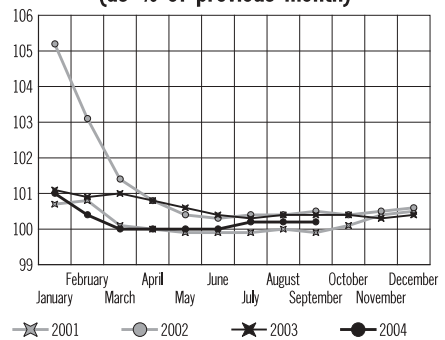
Petrol prices
(as % of previous month)



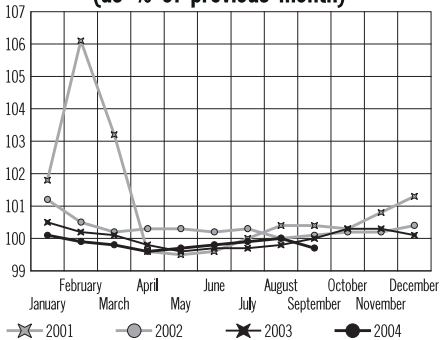
Household electric appliances prices
(as % of previous month)



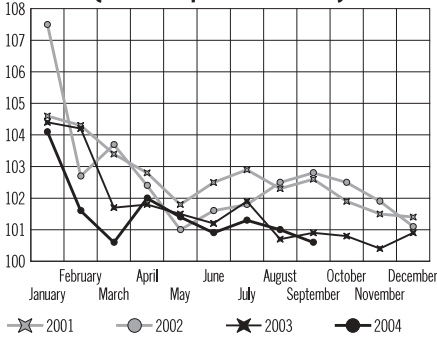
Medicine prices
(as % of previous month)



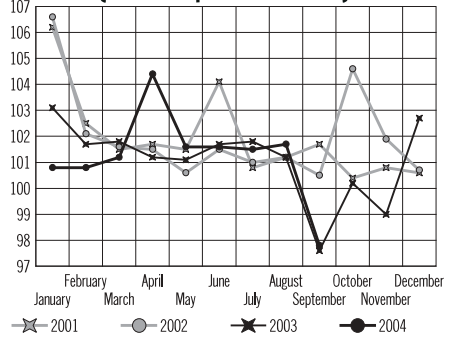
TV and radio prices
(as % of previous month)



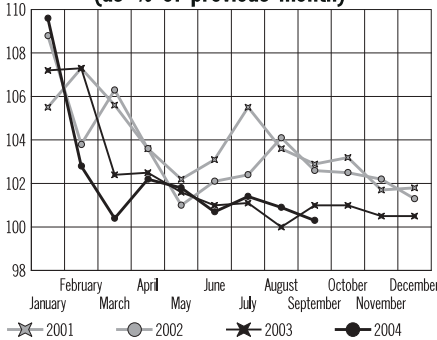
Service prices
(as % of previous month)



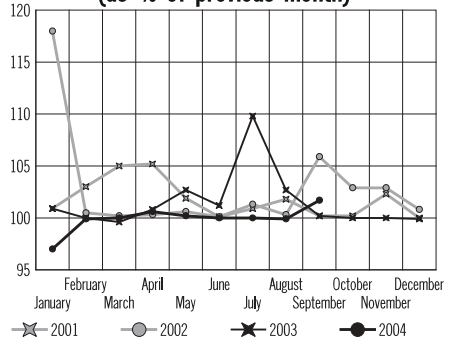
Passenger transport fares
(as % of previous month)



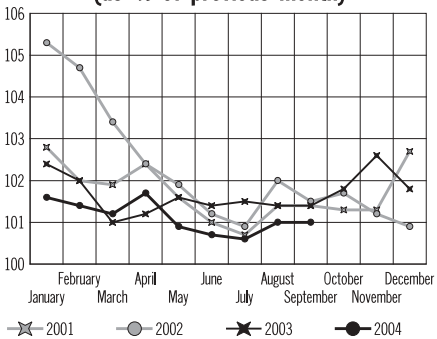
Rent and communal service prices
(as % of previous month)



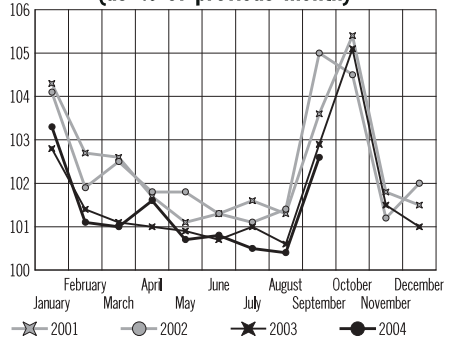
Communication fees
(as % of previous month)



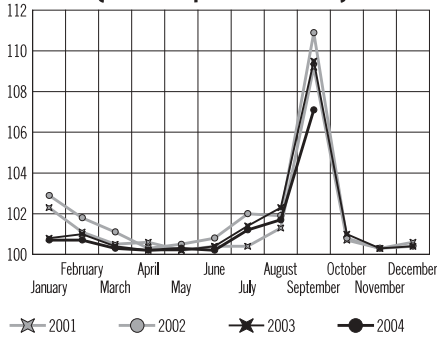
Healthcare prices
(as % of previous month)



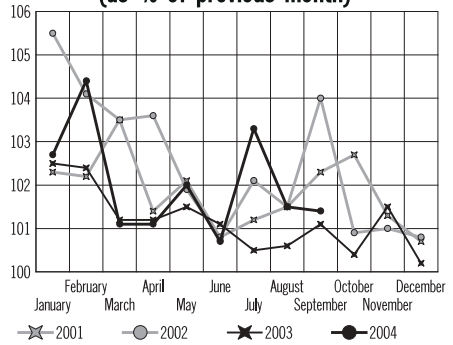
Entertainment and leisure prices
(as % of previous month)



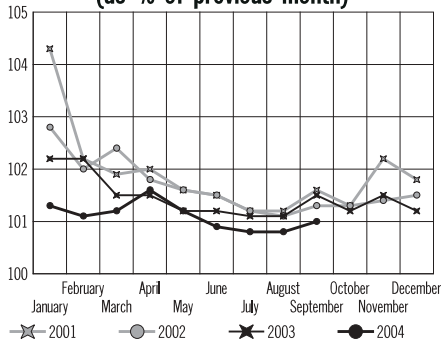
**Education fees
(as % of previous month)**



**Pre-school tuition fees
(as % of previous month)**



**Everyday service prices
(as % of previous month)**



**Sanatorium and health resort
accommodation prices
(as % of previous month)**

