

Elvira Nabiullina: Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017.

Presentation by Ms Elvira Nabiullina, Governor of the Bank of Russia, at a meeting of the Committee on the Budget and Taxes of the State Duma of the Russian Federation, Moscow, 13 October 2014.

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Accompanying slides can be found on the Bank Russia's website: [Slides](#) (PDF).

Dear colleagues, good afternoon!

Today we present for discussion the draft Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017. This document was prepared in rather difficult conditions. The first factor is a slowdown in economic growth. The second is the volatility and tension in the foreign exchange and financial markets. And the third is a leap of inflation, which occurred recently. This all creates a rather complicated environment for developing the strategy of the guidelines for the monetary policy.

We have prepared three scenarios. I suggest starting with the baseline scenario in **slide 2**.

The baseline scenario is based on the assumptions of a steady recovery of the global economic growth, a slight decrease in oil prices, a gradual resolution of geopolitical problems and lifting during 2015 of most of the imposed mutual sanctions and restrictions.

Nevertheless, in the first half of 2015, in our view, factors limiting investment activity will remain, and investment activity is one of the key elements that can affect the trends in economic growth. However, with the normalisation of the external economic environment and opening up of access to the global capital markets for Russian companies, the investment demand will gradually recover. Implementation of large infrastructure financing projects, including energy export project in the framework of co-operation with China, will also contribute to the investment growth. According to our estimates, the decline in fixed capital investment will cease in 2015, and in 2016–2017 the investment growth rate will gradually pick up.

The restrictions on the imports of certain food products introduced in August 2014 will be conducive for import substitution. The import growth rates will remain low in 2015. Against the backdrop of low growth in the world economy and in the external demand combined with a decline in energy prices, no significant increase in export growth is expected.

The impact of these factors on export and import dynamics will result in a decrease of the current account surplus to \$15 billion in 2017, whereas the private capital outflow will be gradually reducing.

In the baseline scenario, we expect an acceleration of the GDP growth from 0.4% in 2014 (these are our assessments for this year) to 1.0% in 2015, 1.9% in 2016 and 2.3% in 2017.

At the same time, the inflation will gradually decrease to 4.5–5.0% in 2015 (I stress again, that these assessments are based on rather optimistic assumptions of the baseline scenario) and to 3.7–4.2% in 2016–2017.

The consumer price growth will slow down together with the exhaustion of the effect of the external factors that played a prominent role in the first half and in the middle of this year; exchange rate dynamics is also expected to normalise. With the stabilisation and subsequent reduction in inflation expectations during 2015, the baseline scenario predicts a gradual easing of the monetary policy. The more pronounced the downward trend in inflation and inflation expectations will be, the more accommodative the monetary policy may become. **(Slide 3)**

In addition to the baseline scenario, built on fairly optimistic assumptions, we have prepared two more alternative scenarios, number II and III. They are based on more negative assumptions.

Scenario II predicts that the mutual sanctions and trade restrictions will remain during the whole period under review. This will lead to a certain increase in the capital outflows coupled with corresponding exchange rate dynamics. It should be noted that the ruble volatility, on the one hand, partially offsets the negative impact of external environment by maintaining the competitiveness of Russian producers and accelerating import substitution, however, on the other hand, it leads to enhanced inflationary pressures. Scenario II also assumes a possible increase in the tax burden. Due to the decision taken by the government on this issue, we plan to finalise this scenario. This scenario forecasts lower GDP growth rates compared with the baseline scenario (you can see it on the slide), and a slower decline in inflation. The level of 4.0% will be reached by 2017.

In addition to scenario II, scenario III assumes a more significant decline in oil prices, i.e. down to \$87 per barrel in 2017. The GDP growth rate in this scenario slows down to less than 1%. The scenario forecasts the use of the Reserve Fund within the framework of existing budget rules in order to stabilise the situation in the economy. As a result, the fiscal policy, in our opinion, will make a more pronounced positive contribution to the aggregate demand dynamics.

In scenarios II and III the reduction of inflation to the medium-term target of 4.0% will require more time than in the baseline scenario; we believe it possible to reach this level in 2017. According to the forecast, the inflation will be 6–6.5% in 2015, 4.5–5.0% in 2016 and 4.0–4.5% in 2017.

In both alternative scenarios, the Bank of Russia will focus on ensuring financial stability, preventing the reduction of confidence in the domestic financial system and national currency. To do this, we will be ready to use additional tools, including non-standard ones that have not been applied earlier.

Currently, the Bank of Russia is also developing the so-called stress scenario – an emergency scenario, which implies a sharp and more significant drop in oil prices over the forecasted horizon. We consider the possibility of adding this scenario to the Guidelines at the next stage of the document finalisation. Even though we work on this scenario, we still believe that the probability of its realisation is not feasible. However, in our opinion, such scenario should also be analysed. **(Slide 4)**

As today we are discussing the draft federal budget for the next three years, I would like to address separately the issue of comparing the baseline scenario of the Bank of Russia with the baseline scenario of the Russian Ministry of Economic Development. Overall, they are similar in key assumptions and projected paths of changes in most key macroeconomic indicators. However, I would like to note that our baseline scenario is the most optimistic of the three scenarios, whereas the baseline scenario of the Ministry of Economic Development is the most pessimistic one.

Projections are rather difficult to make in the conditions of high uncertainty. We should take this into account and understand that we forecast and build different scenarios on the basis of different assumptions. In the baseline forecast of the Ministry of Economic Development the price of Urals crude will be \$100 per barrel during next three years. In the forecast of the Bank of Russia, we are assuming a steady decline in the average annual Urals crude price from \$105 to \$102 in 2017. Many may say that the level of \$105 is not a proper starting point for a realistic forecast, because now the prices are lower. But oil prices are quite volatile and we are always inclined to make projections based on their current dynamics. I would like to remind you that as far back as this summer the oil price exceeded \$110. Therefore the baseline scenario is built on the basis of the average annual oil price in 2015, which will be slightly below the average price in 2014. Further on, we project a gradual downward

adjustment of the average annual oil price. If necessary, we shall review the base assumptions of oil price before submitting the final draft of the document to the State Duma.

Another difference of the forecast prepared by the Ministry of Economic Development is in the fact that its projected 2015 inflation is 5.0–6.0%, which is higher than the forecast of the Bank of Russia. In our assumptions we expect the exhaustion of the factors that have caused the rise in inflation this year, and in the baseline scenario, we assume that the inflation will reach 4–4.5%.

According to our estimates, the difference between the key parameters of the federal budget, calculated on the basis of the forecast of the Ministry of Economic Development (this is the way the draft budget is calculated) and the one calculated on the basis of the Bank of Russia forecast, is also insignificant. The federal budget deficit in 2015–2017 will remain low. We welcome the policy aimed at ensuring the sustainability of public finance, especially bearing in mind long-term risks which may be caused, firstly, by the demographic situation, secondly, by the escalation of pension system problems, and thirdly, by a possible fall in oil and gas revenues. These long-term risks are already in place, and, therefore, in our opinion, it is very important to maintain a conservative approach to budgeting process over a longer-term horizon. Besides, it is necessary to continue improving the efficiency of budget spending, particularly in terms of investment projects, in order to increase the share of expenditures that have a multiplication effect on the economic growth within the budget structure. It will also indirectly affect the monetary policy and the possibility of its easing.

In our opinion, the Bank of Russia contributes to creating conditions for structural changes in the economy by decreasing inflation and keeping it at a consistently low level. Firstly, we need to bring the inflation to a low level, and secondly, we need to keep it there.

In 2014, the Bank of Russia is completing the longstanding transition to the inflation targeting regime, and from 2015 it plans to conduct monetary policy within the framework of this regime.

Why does the Bank of Russia pursue its previously set goals, in spite of the current difficult situation, high uncertainty of its future development and volatility of financial and foreign exchange markets? (**Slide 5**)

The first and perhaps the most fundamental reason explaining why we believe that the reduction of inflation is so important is the following. According to public opinion polls, for about 70% of Russians the inflation not only remains the number one problem, but it is even becoming more acute. On these slides you see that the value of all other parameters and of all other problems that worry the Russians is going down, while the significance of inflation goes up. This is, perhaps, one of the most disturbing factors.

High inflation erodes salaries and pensions, depreciates savings. In order to stop people being afraid of saving, to make them confident of their financial future and able of conducting organised savings (organised savings create conditions for long-term investments and, consequently, for economic growth), we believe that it is critically important to pursue a policy aimed at reducing the inflation.

Now there are many concerns, and I would say these are justified concerns, about the problem of expensive loans in the Russian economy. It is true that interest rates on loans, especially for investment purposes, are high. But we should understand that, as a rule, it is the inflation that sets the lower limit for interest rates on deposits and loans. Why? Because neither households nor businesses are inclined to bring their savings to banks, if the interest rate is not as high as the inflation. In turn, the banks, being financial intermediaries, do not provide loans at rates lower than the cost of funds raised from households and businesses. And our survey of banks showed that when banks are asked about the key rate, in particular, whether they are ready to reduce their corporate lending rates in case the Bank of Russia reduces the key rate, banks respond in the negative, because there is a problem of excessive outstanding borrowings of enterprises in some industries and another problem of

high risks. And, of course, interest rates on loans can only be reduced after the reduction of inflation. However, this is not enough, it is important to conduct changes in the real sector itself, it is necessary to reduce the risks of borrowing in order to bring down lending rates.

I need three minutes more, please...

There should be a selection of efficient projects, competition for efficient projects, and the rates reduction based on lowered inflation, which will allow the financing of investment projects. (**Slide 6**)

It is quite obvious that under the influence of unforeseen external factors the inflation will be higher this year than we projected. Unfortunately, it will reach 8%, but we have all the grounds and prerequisites for the inflation reduction in the medium run.

Besides, we believe it is important to fix our inflation target for the medium term at 4.0%. In our view, this level corresponds to the state of the Russian economy: on the one hand, it is conducive to the necessary changes; on the other hand, it stimulates investment processes.

On slide 6 you see our inflation forecasts for different scenarios. I will not dwell on them. (**Slide 7**)

And on slide 7, if there is a desire, we may have a look at the international experience of formulating inflation targets, and determining the actual target. In our opinion, the inflation targets, that we set, are quite consistent with the international experience.

The inflation targeting will allow us to steer the interest rates better. (**Slide 8**)

Slide 8 shows that interest rate management within the framework of the inflation targeting regime allows creating a more predictable economic environment for our businesses. The interest rate is now no longer extremely volatile in the money market and, therefore, allows the economy to operate in a more predictable environment.

It should be noted, that we do not intend to reduce the inflation very fast, we will proceed from the situation in the economy, and will not create excessive pressure on the economic growth. The current economic slowdown, in our view, is a result of structural limitations. On the last slides (**slides 9, 10, 11 and 12**), there is some evidence to this, i.e. the structural limitations constrain the economic growth and the top priority task is the liquidation of bottlenecks.

I would like to say that the draft Guidelines are available on the official website of the Bank of Russia. We are now discussing the document with experts and analysts. It was reviewed at a Russian Government meeting. Based on the discussion outcomes, including the today's discussion, we will be ready to finalise the document and submit it for consideration to the State Duma.

Thank you very much for your attention!