**Speech by Ms Elvira Nabiullina, Governor of the Bank of Russia, at the 43rd Meeting of the Central Bank Governors' Club of Central Asia, Black Sea Region and Balkan Countries**

1. A double shock hit the Russian economy in the first quarter of 2020: Covid-19 and the oil price collapse. The latter, however, was mostly the manifestation of the quarantine-induced collapse of global transportation and demand for fuel. Thus, developments in energy markets was just another consequence of Covid-19 pandemic.

**Covid-19 pandemic**

2. Russia's total number of diagnosed Covid-19 cases exceeded 400,000 this weekend. This is the third highest count after the US and Brazil. One of the factors is a widespread testing of the population. New cases topped at over 11,000 on 11 May, and since then moderated to around 9,000. The count of recoveries has been exceeding the amount of new cases for some time.
3. The achievement of the turning point in the fight with the Covid-19 came at significant economic costs from the restrictions on economic activity and mobility of people, imposed to slow-down the infection spreading.
4. The slowing of the spread of infection allowed for a gradual and phased opening up in the second half of May. The pace of the opening up will be decided by the regional authorities, depending on the pandemic situation and the capacity of healthcare system in each region.

**Impact on the Russian economy**

5. At first, we confronted financial market shock from the dislocations in the global financial markets, which emerged in the second half of February, and shock in external demand related to lockdowns in China. A domestic shock started later, prompted by the introduction of broad and tight lockdown measures in the end of March.
6. After growing by 1.6 per cent in 1Q 2020 y-o-y, the Russian economy contracted by 12 per cent in April y-o-y, according to the government's estimate based on core economic data. As in other countries the services sector and non-food retail were affected the most amid the lockdown.
7. A road to full economic recovery may be long and slow no matter how quickly COVID-19 related restrictions are lifted.
8. The Bank of Russia forecast published in late April saw GDP to contraction of 8% in 2Q y-o-y and 4-6% in 2020. Inflation shall be 3.8-4.8% this year, and then remain at our target of around 4% thereafter. But the risks to these projections – both growth and inflation – are already skewed to the downside. The lasting impact from Covid-19 pandemic on the potential output for Russia as such and the world economy at large, is the major source of uncertainty for the forecast.

**Financial markets**

9. Russian financial markets experienced a significant stress in March, with the ruble losing more than 20 per cent of its value against the US dollar, bond yields rising and stock markets falling. Yet, this time the financial market volatility and duration of stress were much milder than in both 2008-9 and 2014-15.
10. Markets have been recovering in April and May. The ruble has pared about half of its February-March drop, a strong recovery was seen in equities. And local government bonds yields have dropped to new historic lows. The 10-year bond reached to 5.6%, before modest correction in the second half of last week.
11. Local banks and institutional players, as well as retail investors, provided support to Russian financial markets and the ruble, partly offsetting the capital outflows by foreign investors.

**Policy response to shocks**

12. Russia faced this downturn much better prepared than on previous occasions – in 2014-15 and during GFC. Inflation and inflation expectations are much lower and better anchored, banking sector is in much better shape, has additional accumulated macroprudential buffers. Cross-border corporate loans have declined markedly (by over one third) since 2014.
13. Government debt is just 13% of GDP. We have a budget rule, which substantially buffers Russian budget from oil price fluctuations, and provides the government with automatic funding source in the period of stress. Thus, it reduces the required increase in government debt issuance to provide fiscal accommodation.
14. Nonetheless, when financial market stress hit Russia in March, we decided that we need to behave conservatively, and ensure that financial stability risks and short-term inflation spike are in check, while moving to more policy easing later. Therefore, at our March monetary policy meeting we kept policy rate unchanged and embarked on policy easing only in April.
15. We also started modest FX sales, largely to preempt the sales under the budget rule (as it lags the oil price movements by about one month), and somewhat enhanced them at very low oil price by additional sales from the proceeds from the Sberbank's deal. Overall, we spent on the outright FX operations just over 9 bn US dollars since 10 March (all of them within the framework of the budget rule, but exercising some discretion on timing). This was sufficient to ensure smooth functioning of the FX market and arrest build-up of depreciation expectations.
16. We have not intervened on the government bond market and have no intention to do so. The banking system has seen the structural liquidity surplus since 2017, and remains in that position. Nevertheless, we several times provided markets with extra Rouble liquidity through our regular short-term fine tuning REPO facilities to calm the stress from spikes in margin payments and increase in demand for cash in circulation amidst the lockdown. Even though the banking system remains in structural liquidity surplus, but distribution of this liquidity is

uneven and shifts in assets and liabilities of banks' balance shits amidst lockdown and loan reprofiling complicate their liquidity management in the interim. Thus, we introduced 1 month and 1 year REPO (with a narrower pool of collateral than our regular operations) to assist banks through this period, and reduce the need for the use of our fine tuning operations. Yet, the first 1 month REPO saw no bids from banks, confirming that liquidity conditions in the banking sector currently are quite normal. We also increased the limit of our standing FX swaps facility, which similarly has not been tapped by the market.

17. We deployed a broader range of measures on regulatory front. We allowed banks to tap their capital buffers and introduced a number of temporary regulatory forbearance measures to support debt restructuring and prevent procyclical behavior of the financial system, creating space to carry out required adjustments. We judge that macroprudential buffers in the system are sufficient to accommodate losses.
18. So far we believe that this policy mix produced the desired results. Markets have stabilized to a large extent. Inflation, after the short-lived spike in March and April, has reverted to levels consistent with our 4% target, and as in other countries may undershoot it in the coming quarters as constrained demand acts as a powerful disinflationary factor. Government bonds yield curve moved some 50-75bp below early February marks across all maturities, as the market anticipates further monetary policy easing and maintains confidence in the integrity of the fiscal policy. This provides government with space to increase borrowing at reasonable cost.

**Risks**

19. The major risks stem from a significant uncertainty about the length of the pandemic and its effect on the global economy. Russia entered the crisis with prudent macroeconomic policy framework and significant buffers, but these should be deployed equally prudently to maintain policy space in the event the pandemic proves to be of more extended nature. Therefore, we believe that we should not use all of the ammunition at once and be prepared to potential future shocks.
20. We see mostly downside risks to our growth forecast as supply-side disruptions may prove to be more pronounced. Oil output constraints of the April OPEC+ deal is an additional factor to take into account.
21. A sizable permanent loss of potential GDP is inevitable, but it is hard to judge with confidence how large that could be in the long-run. Moreover, sizable structural shifts in the composition of economic activities, and hence employment, are also almost predetermined.