Bank of Russia

13.05.2024

SUMMARY OF THE KEY RATE DISCUSSION

DURING THE QUIET PERIOD AND IN THE COURSE OF THE MEETING OF THE BANK OF RUSSIA BOARD OF DIRECTORS

Discussants: members of the Bank of Russia Board of Directors, senior executives of the Monetary Policy Department, Research and Forecasting Department, Bank of Russia Main Branches, and other Bank of Russia departments.

The Monetary Policy Department together with the Research and Forecasting Department presented the results of the analysis of the current economic developments nationwide and worldwide, as well as their suggestions regarding the baseline macroeconomic forecast for 2024–2026 and its variations. The Bank of Russia Main Branches provided information on the situation in the Russian regions, including based on companies' surveys. Furthermore, the participants in the discussion considered the information from the Financial Stability Department and the International Settlements Department.

This Summary covers the **key points of the discussion** in the course of preparation of the decision on 26 April 2024.

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ECONOMIC SITUATION AND INFLATION

MAIN FACTS

In 2024 Q1, the economy showed more considerable growth compared to the Bank of Russia's forecast issued in February. Domestic demand remained the major growth factor, with the increase in households' consumption exceeding the Bank of Russia's expectations. Investment activity was also more intensive compared to the Bank of Russia's forecast. The Bank of Russia's Business Climate Index slightly decreased in April while remaining near its highs for the 12-year period. In February, the overall financial performance of large and medium-sized enterprises (except for credit institutions) for the last 12 months equalled ₽33.8 trillion, holding close to its historical peaks. The labour market became tenser. The unemployment rate was still at its lowest historical level of 2.7% (seasonally adjusted, SA). The companies' surveys showed increased personnel shortages in most industries. Wages continued to grow quickly both in the private and public sectors. Current price growth rates notably dropped from 6.3% in February (seasonally adjusted annualised rate, SAAR) to 4.5% SAAR in March. Most measures of underlying inflation also went down. In particular, core inflation declined to 6.1% SAAR compared to 6.8% SAAR in February.

DISCUSSION

The participants in the discussion noted that **consumer price dynamics in March signalled further weakening of inflationary pressures.** In March, a large number of analytical indicators of current price growth rates were below the range of their December–February values. At the same time, certain underlying inflation indicators ticked upwards slightly compared to February. The discussants generally agreed that the majority of underlying inflation indicators were close to 6% SAAR.

However, questions regarding the steadiness of disinflation and its future pace triggered debates. Many participants specified the factors that might slow down disinflation. Firstly, there was no decline in consumer activity or lending, contrary to what had been expected given the tightening of monetary conditions. The second factor was persistently high price growth rates in the market services segment where underlying inflation was most pronounced as it was influenced by demand. Thirdly, disinflation in March was predominantly driven by volatile rather than underlying factors, namely greenhouse vegetables, as the reduction in their prices was atypical for March and could be attributed to the warm weather.

April weekly data available on 26 April 2024 suggest that the actual price growth, including both the current rate and the rate excluding volatile components, remains higher than the target. The discussants considered the fact that weekly data might differ significantly from the monthly inflation

trend due to the limited range of goods and services subject to weekly monitoring.

Inflation expectations dynamics across groups of economic agents have been heterogeneous since February. Households' inflation expectations continued to decrease, while businesses' price expectations went up in April for the first time since the beginning of this year. Analysts' expectations for inflation in 2024 and 2025 remained unchanged. Implied inflation for inflation-indexed federal government bonds (OFZ-IN) increased. The meeting pointed out that continued elevated inflation expectations might decelerate the disinflation process.

As agreed by the participants, **consumer activity data confirmed that disinflation stayed at a high level since the beginning of this year.** The Bank of Russia's February forecast suggested a faster consumption response to tightening monetary conditions. However, households continued to increase both consumption and savings amid growing incomes. Most discussants shared the view that the effects of the rising key rate would become more prominent, slowing down the consumer demand growth in the following quarters. The representatives of the majority of the Bank of Russia Main Branches (MBs) noted that consumer activity remained high, although some Russian regions saw the signs of its decline.

In the first quarter, the labour market became tenser. The labour force shortage intensified, with the most notable deficit being that of blue-collar workers, as estimated by companies operating in the Russian regions. The MBs reported that businesses approached the personnel shortage problem in different ways, but mostly by raising wages to attract labour force from other enterprises, regions, and countries. At the beginning of the year, many companies increased wages for certain categories of employees, expressing their commitment to raise them further. Businesses are also taking other measures to solve this problem: for example, many industrial enterprises are opting for more intensive use of labour force, increasing the number of working shifts and business days. As a further tool, companies are employing pensioners and personnel with no working experience. In addition to that, businesses are more actively investing in automation of manual labour and upgrading their equipment. Nevertheless, there are still companies that are failing to solve the labour force shortage problem, thus lacking capacities to ramp up their output. The participants in the discussion noted that it was unclear whether those measures would ease the labour market tension, which in turn would aggravate proinflationary pressures if continued.

The discussants noted that **investment activity also remained high despite tight monetary conditions.** First of all, this could be attributed to the fact that overall investment activity is largely driven by projects associated with government demand, which is easier to predict. In addition, some of those projects are less sensitive to changing market rates as they are backed by

government support. The second reason is that corporate profits that are close to record highs in most sectors allow companies to use their own funds rather than rely on debt financing. Third, companies may expect a rather high return on investments in the long run, given persistently high demand and lower competition in a number of sectors due to decreased imports. This allows companies to expect that these projects will generate profits over a longer-term horizon despite the temporary increase in interest expenses during the period of tight monetary policy. According to the MBs' estimates, tight monetary conditions have a certain effect on businesses' investment plans despite the above factors, although companies generally continue working on the projects that have already been launched. At the same time, an increasing number of companies operating in the Russian regions primarily mentioned labour force shortages and challenges related to the import of equipment among the key factors hampering further expansion of their production capacities. The meeting agreed that a more moderate increase in investments compared to the previous quarters could be expected as the investment stage of the ongoing projects would be coming to an end.

The participants continued discussing changes in the potential of the economy amid its structural transformation. **Solid economic growth rates may partly be associated with the continued building-up of the economy's potential following its decline caused by the COVID-19 pandemic and 2022 geopolitical crisis.** Historically considerable investments could facilitate both the expansion of production capacities and higher labour productivity through automated processes. The increase in labour productivity could also be attributed to enhanced internal procedures. All of these factors contribute to the growing potential of the economy.

The participants concurred that **increasing tension in the labour market indicated that there was still a positive output gap.** Its estimates remain a significant factor of uncertainty. High economic activity in January–February suggests that the positive output gap may close later than expected in the February forecast, leading to a slower decrease in the inflation rate. On the contrary, companies' efforts aimed at building up potential and increasing labour productivity will facilitate more prominent and fast disinflation, provided that they deliver considerable and/or quick outcomes.

Regarding fiscal policy, the discussants once again highlighted its strong influence on aggregate demand and, consequently, the importance of its predictability for the medium-term forecast. When discussing the baseline forecast assumptions, the participants deemed, as before, that the path of fiscal policy normalisation would remain unchanged and additional expenditures would be fully financed through increasing tax revenues. The estimated contribution of fiscal policy to the aggregate demand dynamics may be updated after the parameters of expected tax changes are published.

MONETARY CONDITIONS

MAIN FACTS

The yields of federal government bonds (OFZ) increased since the discussion in March. The most notable growth was observed in the long-term securities segment, resulting in a less pronounced OFZ yield curve. Real OFZ-IN yields reached a new historical high. Deposit interest rates stabilised, accompanied by a significant steady increase in households' deposits. Although interest rates on loans continued to grow, lending activity remained high and diverse across sectors. While unsecured consumer and car lending accelerated, mortgage lending continued to slow down due to the trends in the market segment. The growth of corporate lending sped up in March, following more subdued January–February dynamics.

DISCUSSION

Changes in monetary conditions were one of the key topics of the discussion at the meeting. The participants emphasised the heterogeneity of the factors behind it. On the one hand, price conditions became tougher. OFZ yields (including real yields) continued to grow, explained by changing expectations about fiscal policy (uncertainty regarding specific sources of financing additional budget expenditures) and future key rate dynamics following the March decision. Interest rates on loans continued to increase. Deposits were steadily growing. On the other hand, lending activity also remained high. The yield curve became less inverted, evidencing softer monetary conditions. Given the above, the discussants concluded that the **overall tightness of monetary conditions stayed at the same level since the key rate meeting in March.**

The participants noted that the **expected slowdown in lending was not happening at the moment yet.** The rapid growth of households' and companies' incomes allows them to raise more loans. Furthermore, elevated lending activity in different loan market segments is driven by specific factors of various origin and duration. Longer-lasting factors may intensify the inertia in the lending trend, which should be taken into account in the course of the implementation of monetary policy.

Retail lending continued to grow at a strong pace, driven by unsecured consumer and auto loans.

- The growth of unsecured consumer loans accelerated in March and was above the Bank of Russia's forecast, which was most prominent in the credit card segment. It was suggested that in the context of high deposit rates, the availability of credit cards with a grace period might foster the motivation to use them to pay for current expenses instead of using other types of consumer loans or spending savings.

- Car lending is still growing at an accelerated pace following a significant decline. In this segment, growth is due not only to the realisation of pent-up demand, but also to the effect of government support programmes and promotions run by manufacturers and car showrooms. As these factors cease to have effect, more moderate dynamics of car lending can be expected.

- Mortgage lending slowed down, especially in the market segment where the impact of tightened monetary policy is already obvious. The termination of non-targeted subsidised mortgage lending programmes from July will have a noticeable additional restraining effect on the mortgage lending trend.

The growth of corporate lending accelerated in March, while in 2024 Q1 it was slower than in 2023 Q4 (SA). The corporate lending dynamics are still driven by elevated government demand. Companies remain positive about business prospects given their demand expectations. Profitable companies are able to continue to actively raise loans even at high interest rates. All these factors are relatively stable, supporting the growth of corporate lending and making it less sensitive to the changes in the key rate.

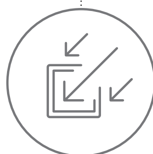
The participants discussed how consumer lending dynamics would be affected by the planned tightening of macroprudential measures aimed at reducing risky lending from 1 July 2024. According to the discussants, these measures will not have a significant impact on the overall consumer lending trend, but will lead to a redistribution of lending in favour of less risky categories of borrowers.

The discussants noted that the activity in the stock market remained high, which was due to a number of factors. Firstly, the role of the Russian stock market in diversifying the savings of domestic investors increased owing to their limited access to the external financial market. Secondly, businesses continued to substitute external financing with domestic borrowings given restricted access to external capital markets. Thirdly, companies’ strong financial performance allowed them to pay high dividends, which additionally stimulated interest in investing in shares.

Saving activity stays at a high level. The attractiveness of Russian ruble savings is supported by high deposit rates. Term deposits are growing steadily, mainly because of the segment of deposits with maturities of less than one year. Significant income growth still allows households to increase both savings and consumption. The discussants noted that, due to accelerated income growth, an even higher saving ratio might be required to ensure steady disinflation.

The assessment of the monetary tightness and its sufficiency remained a matter of the discussion. Real interest rates calculated using various measures of inflation expectations and inflationary pressures are close to their highs over the period of inflation targeting and have stayed at these levels for several months already. Nevertheless, the participants concurred that current monetary conditions generally could not be considered

excessively tight given the overall lending dynamics, as well as high consumer and investment activity. The participants pointed out that the assessment of the tightness depends largely on the judgement regarding the level of the neutral rate of interest. A number of discussants suggested that the neutral interest rate level might be higher than the Bank of Russia's estimate published in the Monetary Policy Guidelines (2–3% in real terms and 6–7% in nominal terms). In this case, higher real interest rates might be required to bring inflation down to the target. Estimates of the neutral rate of interest will be updated as usual when preparing the annual Monetary Policy Guidelines.



EXTERNAL ENVIRONMENT

MAIN FACTS

The world economy is rapidly growing both in the industrial and services sectors, with the exception being the euro area where the state of the industrial sector has been deteriorating since the beginning of the year. The US and Chinese economies are growing faster than expected in February. Inflation (SA) accelerated both in advanced and emerging market countries. Prices for most Russian export goods were up since the March key rate meeting. The value of exports increased considerably in March, while imports remained close to February levels.

DISCUSSION

The discussants pointed out that **global disinflation was slow and the world economy was showing greater resilience to the 2022–2023 policy rate increases than expected.** Rising wages and increasing labour costs in many countries are hindering the deceleration of inflation. Higher inflation means later interest rate cuts by the central banks of developed countries. This narrows the gap between domestic (Russian) and foreign interest rates compared to earlier forecasts and may act as a factor reducing the tightness of monetary conditions. However, this transmission channel is still weaker than it was before 2022.

The extension of additional OPEC+ restrictions and rising tensions in the Middle East caused an increase in oil prices. The participants shared the view that **Brent crude prices in 2024 and 2025 would probably exceed the ones assumed in the February forecast** due to higher expectations regarding global economic growth and the effect of the OPEC+ production cuts.

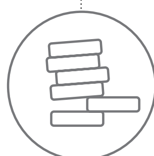
In 2024 Q1, the current account surplus increased both year-on-year and quarter-on-quarter due to a faster decline in imports of goods and services compared to exports.

The discussants noted that the **relatively weak dynamics of imports did not correlate with strong domestic demand.** Several assumptions were made in this regard. The imports trend may reflect problems with payments that were mentioned by representatives of all MBs. The participants in the discussion pointed out that companies used to be able to find ways to solve these

problems, showing high flexibility. However, challenges related to payments remain a factor of uncertainty. It was also suggested that, given significantly longer logistics chains, the current trend in imports was more a reflection of the demand for imports at the end of last year when importing companies probably expected lower domestic demand and planned for smaller imports. Accordingly, continued strong domestic demand may lead to an adjustment of their estimates and a reversal of imports trend in future.

The discussants concurred that a reduction in imports might have both proinflationary and disinflationary effects. On the other hand, smaller imports contribute to a stronger ruble, ensuring disinflation. On the other hand, lower imports reduce the supply of goods in the domestic market and may have a proinflationary effect in the current environment.

The participants discussed the factors that had led to higher Q1 exports dynamics than expected. Exports were supported by a number of factors: higher oil prices, stronger demand in the international market amid expanding business activity in the world, a good harvest of grains, and shifting supplies from the European to the Asian market. The participants reiterated their view that the inflow of foreign exchange earnings from exports was still happening with a lag. Therefore, the observed trend reflects the change in the value of exports over the previous one to two months rather than their current state. Accordingly, higher exports in March–April will contribute to the growth of foreign exchange earnings in the domestic market in the coming months.



INFLATION RISKS

The participants in the discussion agreed that the **balance of risks was still shifted towards proinflationary ones.**

The main **proinflationary risks** mentioned by the discussants were as follows:

- *Increasing labour market tightness.* Further expansion of the personnel deficit may lead to labour productivity lagging even more behind the growth of real wages. Eventually, high utilisation of production capacities and staff shortages may contribute to the increased imbalance between the dynamics of supply and demand, which in turn will be conducive to persisting high inflationary pressures or their growth.
- *Longer periods of fiscal policy normalisation.* Currently, the main uncertainty is associated with specific sources of financing of additional budget expenditures.
- *Lending within government subsidised programmes* that might weaken the functioning of the monetary policy transmission channel if the amounts remain significant.

- *Worsening of the foreign trade environment due to the impact of the geopolitical situation and deteriorating conditions in global commodity markets.* In particular, a decline in exports coupled with persistently high demand for imports may create risks to the ruble exchange rate and inflation dynamics.

- *High and unanchored inflation expectations that are sensitive to short-term rises in prices for certain goods and services,* which might entail secondary effects on inflation.

The participants agreed that **disinflationary risks** were minor and mostly associated with a faster deceleration of the increase in domestic demand under the influence of the earlier monetary policy tightening. Besides, if the growth of the economy was driven, to a greater extent, by the expansion of its potential rather than the cyclical component (gap), inflationary pressures in the economy might be weaker.

CONCLUSIONS FOR MONETARY POLICY AND THE KEY RATE DECISION

The participants considered how the main factors influencing the key rate decision, identified during the March discussion, had been developing. They noted that, on the one hand, the expected easing of inflationary pressures continued. Risks associated with the budget and external environment did not materialise, although they persist. On the other hand, consumer lending and consumer activity were growing further contrary to what had been expected. Furthermore, the labour market became tighter, which may indicate a continued significant positive output gap in the economy, with no signs of its decline. Therefore, it was not yet possible to come to an unambiguous conclusion as to whether the key rate should be cut or raised.

The participants considered the updated forecast estimates, focusing on the baseline scenario variations. Differences in the variations related to the short-term inflation path, as well as the estimated size and pace of the decrease in the positive output gap (including at different levels of potential). In all baseline scenario variations, the positive output gap was gradually narrowing, which is essential for further sustained deceleration of inflation. The range of the baseline scenario variations assumed that both key rate cuts in 2024 H2 and keeping the key rate unchanged until the end of the year are possible. In addition, the discussants considered an alternative scenario assuming a further rise in tension in the labour market, with sustained or accelerating growth of consumer, investment and credit activity. This scenario also implies that the positive output gap will not close in 2024 and disinflation will slow down considerably. This alternative scenario calls for an increase in the key rate to bring inflation back to the target. Although most participants agreed that at the moment there was no reason to believe this scenario to be the baseline one, some of them gave more weight to it.

Taking into account the data received after the March decision on the key rate and the updated forecast calculations, the **participants in the discussion were choosing between two alternatives**:

- Keeping the key rate unchanged at 16.00% per annum.
- Raising the key rate by 100 basis points to 17.00% per annum.

The main arguments for **maintaining the key rate at 16.00% per annum** were as follows:

- Inflationary pressures are weakening, with both price growth rates and most indicators of underlying inflation declining. In general, the weakening of inflation in 2024 Q1 was in line with the February forecast.
- The previous key rate increases have not fully translated into monetary conditions yet, with the peak effect still expected in 2024 Q2. More time may be required to fully assess the adjustment of monetary conditions.
- A number of factors may support the disinflation process in 2024 H2, namely the rollback of the non-targeted subsidised mortgage programme starting from July.
- The economy's potential may be higher than estimated due to increased labour market flexibility and/or productivity growth.

The main arguments for **raising the key rate to 17.00% per annum** were as follows:

- The realisation of the alternative scenario is highly probable. New data on economic activity, especially the labour market, could indicate a larger positive output gap and its slower closure in the coming quarters. Increasing labour shortages and budget spending are fuelling real wage growth and, consequently, consumer demand. As a result, with the current degree of monetary tightness, the disinflation process may stop in the coming months or even reverse to inflation acceleration. A higher key rate will ensure the efficiency of monetary policy in the case of the alternative scenario.
- Due to an increase in the share of autonomous demand, which is less responsive to rises in the key rate (especially demand from the government sector), the key rate elasticity of aggregate demand may have decreased overall. Accordingly, the same output gap should be tackled by a greater change in the key rate.
- The neutral rate of interest may be well above the Bank of Russia's estimate released last year.

Most discussants concurred that **new proinflationary surprises in economic activity require additional tightening of monetary conditions.** At the same time, the participants pointed out that **it was not so much the current decision on the key rate as its future path that was important for the disinflation process to take hold.** An upward revision of the forecast for the average annual key rate will facilitate the adjustment of economic agents' expectations, which in turn will bring about the required tightening of monetary conditions in real terms.

Following the discussion, **on 26 April 2024, the Bank of Russia Board of Directors decided to keep the key rate at 16.00% per annum from 27 April 2024.** The Bank of Russia Board of Directors also deemed it appropriate to give a tougher signal, indicating **a longer period of maintaining tight monetary conditions in the economy**, without signalling any definite changes in the key rate at the upcoming meetings. The Bank of Russia Board of Directors believes this decision to provide greater monetary tightness needed to bring inflation back to the target and stabilise it near 4% thereafter.

The Bank of Russia Board of Directors expects the positive output gap in the baseline scenario to gradually narrow from the 2024 Q2 under the influence of the monetary policy pursued, which would support the disinflation process. However, the convergence of inflation back to the target will take more time than expected. In 2024, inflation will fall to 4.3–4.8% and equal 4% in 2025 and 2026. Bringing inflation back to the target will require maintaining tight monetary conditions for a longer period than previously assumed. The forecast of the average annual key rate for 2024 and 2025 was revised upwards. It will be in the range of 15.0–16.0% per annum in 2024 and 10.0–12.0% in 2025. The key rate forecast assumes that if disinflation is stable and inflation expectations decrease, a key rate reduction is possible in 2024 H2; if disinflation is too slow, maintaining the current key rate until the end of the year is not excluded. The Russian economy's growth forecast for 2024 and 2026 was also revised upwards. The economy will grow by 2.5–3.5% in 2024, 1.0–2.0% in 2025, and 1.5–2.5% in 2026. More details on the forecast are available in the Bank of Russia's Commentary on the Medium-term Forecast.