Bank of Russia

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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 ON 25 OCTOBER 2024

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

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 2024–2027 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**.

CONTENTS

ECONOMIC SITUATION AND INFLATION

MAIN FACTS

Current price growth accelerated from 7.5% (seasonally adjusted annualised rate, SAAR) in August to 9.8% SAAR in September. Most of the underlying measures of current price growth also continued to rise in September. Core inflation went up from 7.7% SAAR in August to 9.1% SAAR in September. According to estimates, the economy continued to grow in 2024 Q3, although its growth rate was lower than in 2024 H1. Investment activity continued going up in 2024 Q3, albeit at a slower pace. According to high-frequency data and surveys, consumer activity increased again in September, following its slowdown in July–August. The Bank of Russia's Business Climate Index was up in October vs September. Companies improved their current output and demand estimates. In August, the unemployment rate stayed at its all-time low of 2.5% (seasonally adjusted, SA). The growth of nominal and real wages accelerated in July–August. In July, the net financial performance of large and medium-sized enterprises (except for credit institutions) for the last 12 months remained high, equalling ₽32.1 trillion.

DISCUSSION

Inflationary pressures intensified again in September 2024. Most of the underlying inflation indicators came close to their highs since early 2024. Overall, inflation is running considerably above the Bank of Russia's July forecast. The participants in the discussion agreed that **persistently high inflation in terms of its underlying components remained a reflection of high demand in the economy notably outstripping its current production capacities**.

The meeting pointed out that **a number of proinflationary risks** highlighted during the previous key rate discussions **had materialised since September**. These risks included further growth of inflation expectations as well as a ₽1.5 trillion increase in budget expenditures in 2024, resulting in a higher structural primary budget deficit. In addition, the following **new proinflationary factors emerged**: a considerable increase in the recycling fee in October 2024 and January 2025; announcement of the plans to raise utility tariffs and rail transportation rates at a significantly faster pace than assumed earlier; depreciation of the ruble in August–October 2024.

The discussants suggested that **part of additional budget expenditures for 2024 had already influenced the demand dynamics in the previous months, which was one of the reasons behind inflationary pressures being higher than forecast by the Bank of Russia**. Additional budget expenditures could affect aggregate demand both directly and indirectly, i.e. by influencing credit activity of companies. Expecting payments under government contracts, businesses could take out loans, which was also one of the factors contributing to the persistently elevated corporate lending growth rates. The remaining **additional budget expenditures are probably yet to be made by the end of the year. This will translate into price dynamics in the next few months.**

There was prominent growth in inflation expectations in October. Households' inflation expectations and businesses' price expectations reached their maximum levels since the beginning of the year. Breakeven inflation for inflation-indexed federal government bonds (OFZ-IN) picked up after several months of decline. Analysts considerably raised their inflation forecast for 2025 (to 5.3%). The meeting pointed out that higher inflation expectations reduced the tightness of monetary conditions in real terms, discouraging savings and boosting current households' and businesses' expenses. Besides, given high and rising inflation expectations, even one-off changes in prices for certain visible goods frequently purchased by households (especially in food markets) might generate secondary effects in inflation. This can cause the impact of one-off factors to become more permanent. The participants concurred that **the observed increase in inflation expectations was contributing to higher inflation and strengthening its inertia. In this context, additional monetary policy response was required to ease inflationary pressures.**

The meeting concluded that **a combination of new proinflationary factors would lead to inflation being notably higher in 2024 than the July forecast, while its return to the target and stabilisation at the level of close to 4% required tighter monetary conditions for a longer period than expected earlier**.

The economy continued to grow in 2024 Q3, although at a slower pace. The economic growth path was generally in line with the Bank of Russia's July forecast. The discussants agreed that there were more signs indicating that **slower economic growth was largely due to more severe supply-side constraints rather than the cooling of domestic demand**. Persistently high inflationary pressures were the main evidence of the foregoing. The meeting highlighted acute labour shortages, high capacity utilisation, logistics bottlenecks, more complicated supply chains, OPEC+ production cuts and lower harvest volume in 2024 among the key supply-side constraints.

Labour shortages remain the most significant factor limiting the capabilities to expand the supply of goods and services. Surveys indicate further growth in the share of companies experiencing labour shortages. The change in migration policy also influences the situation in the labour market. The growth of wages sped up again in July–August, following its slowdown in June. Competing for employees, companies continue to raise wages at a rate significantly outpacing the labour productivity growth. The participants also discussed the dynamics of other labour market indicators. Particularly, they pointed to the fact that recruitment agencies' data showed a decline in the number of job adverts amid an increase in the number of CVs. The discussants concurred that it would be premature to interpret these data as the signs of cooling. Firstly, recruitment agencies' data should be treated with caution, taking into account a possible shift in the sample by industry and profession. Secondly, a reduction in the number of job adverts could be associated with the fact that companies simply cannot find employees in the labour market or that the labour cost is too high, causing them to halt their search. This assumption is supported by the information provided by the Bank of Russia

Main Branches: during surveys, certain companies noted that they had to abandon their plans to expand output as they failed to hire new employees. An increase in the number of CVs in turn could indicate that because of growing wages, employees are actively monitoring offers in the labour market, even though they are already employed. The meeting concurred that **the overall situation in the labour market remained severe**.

Due to adverse weather conditions, **the harvest in 2024 is expected to be below the record highs of past years, as noted by the participants**. According to business surveys, labour shortages and a lack of production capacities have also been affecting output in agriculture and food industry. Nevertheless, the supply of agricultural products will be sufficient to meet domestic demand, considering stocks.

High-frequency data and surveys show that the deceleration of the consumer and investment demand growth in July–August did not continue in September. High domestic demand is supported by a considerable rise in households' and companies' incomes over recent years, as well as by significant fiscal incentives. These factors also allow households and businesses to keep increasing their borrowings despite high interest rates. Moreover, persistently high demand is attributable to high inflation expectations and a number of one-off factors. Specifically, in September, consumer demand was influenced by a surge in car purchases in anticipation of a hike in the recycling fee from 1 October 2024. The participants concluded that **the growth of domestic demand was still outstripping the capabilities to expand the supply of goods and services, and a considerable positive output gap persisted, with no signs of narrowing**.

According to the discussants, fiscal policy makes a substantial contribution to the increase in aggregate demand and, consequently, inflation dynamics. This fact should be taken into account when making monetary policy decisions. Predictable fiscal policy based on the fiscal rule is important for maintaining long-term stability of public finance and overall macroeconomic stability. The discussion separately considered approaches to incorporating updated budget projections into the calculation of the medium-term baseline forecast. The participants concurred that the baseline scenario for 2025 should include the assumption that budget expenditures would correspond to the figures announced in the draft law on the federal budget. In 2026–2027, expenditure dynamics in the baseline scenario will be determined according to the fiscal rule mechanism and the emerging development trajectory of the Russian economy.

MONETARY CONDITIONS

MAIN FACTS

From the meeting in September, money market rates and yields on federal government bonds (OFZ) for all maturities increased. The OFZ yield curve became more inverted. Real yields on OFZ-IN went up, with breakeven inflation rising. Deposit and loan interest rates were up as well. The inflow of household funds into banks accelerated. Deposits for up to one year and longer terms were *growing. Credit activity remained high on account of high growth rates in the corporate lending segment. The retail segment, on the contrary, saw a slowdown in the growth of mortgage and unsecured consumer lending.*

DISCUSSION

The participants in the discussion agreed that **monetary conditions had tightened significantly in nominal terms since the September meeting. However, the degree of tightening was lower in real terms due to rising inflation expectations.**

- Nominal interest rates notably increased in various financial market segments. In particular, the OFZ yield curve went up not only for short- and medium-term maturities but also for long-term ones. The growth of short-term OFZ yields is associated with the upward adjustment of market expectations regarding the future key rate path, following the September decision on monetary policy and the Bank of Russia's communication. The discussants opined that rising medium- and long-term OFZ yields could reflect higher inflation expectations of financial market participants due to increasing concerns that demand would grow faster and inflation would not return to the target over the medium-term horizon.

- Deposit and loan interest rates also continued to adjust to the monetary policy decisions taken earlier. The deposit rate curve became flatter, which indicates that banks expect monetary policy to remain tight for a longer period. The meeting noted that the cancellation of the easing related to the compliance of banks with the liquidity coverage ratio (LCR) was one of the reasons behind the deposit rate growth. To expand lending and comply with the LCR, banks have been actively attracting deposits for relatively long terms whenever possible. This strengthened the competition between banks for depositors' money (especially that of corporate depositors), causing them to raise deposit interest rates. The rise in the liquidity premium in banks' transfer rates, associated with the compliance with the LCR, is likely to be greater than expected earlier. This will have an impact on monetary conditions. As highlighted by the participants in the discussion, although the indirect effects of the LCR compliance on deposit rates create somewhat stronger incentives encouraging savings, this does not mean that this alone will guarantee the necessary monetary tightness for balanced lending growth. The latter can be ensured only through monetary policy instruments. The LCR compliance easing was cancelled for only one purpose – to make banks strengthen their balance sheets and restore their safety cushions in the form of highly liquid assets so as to be prepared for stressed cash outflows.

The overall growth rates of lending remain high, showing no signs of going down due to the corporate lending segment. As the corporate segment still has a large portion of loans issued at the interest rate less sensitive to any change in the key rate, the growth of claims on the economy in 2024 will be stronger than expected earlier. According to the discussants, **lending dynamics confirm that current monetary conditions are insufficiently tight to ensure a steady deceleration of inflation**.

- The growth of retail lending slowed down significantly. Higher interest rates on loans, combined with tightened macroprudential regulation, contained the expansion of unsecured consumer lending. Mortgage lending also notably declined in recent months, following the termination of the non-targeted subsidised mortgage programme and the modification of the terms of other subsidised programmes. Contrastingly, car lending growth rates remain high.

- Corporate lending continues to expand fast. Lesser sensitivity of the corporate credit to rising interest rates is still linked to steadily high financial performance and large profits accumulated by companies over several years, increased price expectations of businesses, and, to a great extent, the influence of factors independent of monetary policy on this segment. The latter include government subsidised programmes, project financing, lending to state-funded entities, and the need to complete investment projects started earlier. In contrast, the number of loan applications submitted by companies has been gradually declining in the segment that is more sensitive to the level of interest rates. The participants in the discussion emphasised once again that the greater the share of the loans insensitive to the key rate rises was, the higher the rates on all other loans should be to influence overall credit activity.

The meeting noted that according to the data available at the time of discussion, **the quality of the loan portfolio remained high so far**. However, there is a slight increase in the demand for loan restructuring in the segment of small enterprises, as well as moderate growth of the loans overdue for over 90 days in the retail segment, primarily unsecured loans. The discussants agreed that **careful monitoring of the situation and analysis of trends in the credit market were needed, taking into account, among other things, a substantial volume of loans issued at floating interest rates in the corporate segment**.

According to the participants, income growth still allows households both to save and consume more. Recent months saw an accelerating inflow of funds into ruble accounts and deposits. Considering a slowdown in the retail lending growth, this means that **the saving ratio could have grown slightly**.

The meeting concluded that **monetary policy should provide an additional impetus** to saving activity, slowdown of lending growth, and development of a steady disinflationary trend.

EXTERNAL ENVIRONMENT

MAIN FACTS

The growth of the world economy continues to gradually slow down. Inflation in the key advanced economies is decelerating faster than expected. Market expectations about the US Fed funds rate and the ECB policy rate suggest an earlier and faster monetary policy normalisation in the US and the euro area than *expected before. Since the key rate meeting in September, the index of prices for Russian exports has gone up, with the growth observed for almost all goods. The volatility of oil prices remains elevated. In 2024 Q3, the current account surplus fell both year-on-year and quarter-on-quarter. The value of exports remained generally stable, being close to last year's level. The value of imports recovered, reaching last year's level and thus rising quarter-on-quarter.*

DISCUSSION

The global economy was generally developing in line with the Bank of Russia's July forecast. However, trends were diverse across different countries. The growth in the US was overall stable and stronger than expected, whereas the economic growth in the euro area and China slowed down, with the deceleration rate exceeding expectations.

The discussants concurred that **considering a quicker slowdown of inflation in the US and the euro area, the central banks of these regions could ensure faster monetary policy normalisation** than expected by the Bank of Russia in July. However, they noted that proinflationary risks related to a high budget deficit persisted in the US, which might limit the speed and scale of the US Fed funds rate cuts in the next few years.

The meeting pointed to **the growing volatility of oil prices**. Two countervailing factors were influencing the oil price dynamics. On the one hand, the deterioration of the geopolitical situation in the Middle East pushed oil prices up. On the other hand, persistently high market concerns regarding global demand and production expansion pace, both within and outside OPEC+, restrained the growth of oil prices. According to the participants, as supply gradually increases, oil prices will go down to $70 per barrel in 2027. Nevertheless, **risks of slower global economic growth and, as a result, lower oil prices persist over the forecast horizon**. However, there are no reasonable grounds for revising the July oil price forecast downwards.

The smaller current account surplus in 2024 Q3 as compared with the previous year was mainly attributed to the imports dynamics. While in 2024 H1 imports were lagging behind last year's figures, recent months saw the value of imports exceeding last year's levels as well as normal seasonal dynamics. According to the discussants, this is largely indicative of high domestic demand. In addition, imports in September were influenced by the expansion of car stocks in anticipation of a higher recycling fee.

The meeting noted that the growing demand for imports amid stable exports dynamics had caused the ruble depreciation over recent months. Besides, the ruble exchange rate could have been influenced by the balancing of currency positions by companies and banks in this period. Overall, **the ruble depreciation is one of the proinflationary factors**. However, the ruble exchange rate was running close to the October 2023 and March–April 2024 levels. This means that companies could have taken into account these exchange rate levels in their business plans for the current year, so the ruble depreciation might produce no considerable proinflationary effect.

INFLATION RISKS

Some of the proinflationary risks highlighted during the September key rate discussion materialised. The participants inferred that **the balance of risks remained substantially shifted towards proinflationary ones**.

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

- *The persistent significant positive output gap (overheating) in the economy*, which could be the result of both persistently high domestic demand and more severe supply-side constraints. High domestic demand might be supported by, among other things, steadily high credit activity or its growth, as well as a higher share of autonomous demand, which is not affected by monetary policy, in its structure. A further increase in labour shortages might lead to labour productivity lagging even more behind the growth of real wages. Intensifying sanction pressures might eventually have a dampening effect on the growth rate of the economy's potential. Irrespective of the reasons, a persistent large positive output gap in the economy leads to persistently high inflationary pressures. An additional monetary policy response could be required to reduce such pressures.

- *Worsening of the terms of external trade due to the impact of the deteriorating conditions in global commodity markets and the geopolitical situation*. In particular, a greater slowdown in the growth of the world's largest economies as well as a faster transition to more energy-efficient technologies might entail a reduction in the demand for commodities. This in turn might lead to a contraction of Russian exports, which, if coupled with persistently high demand for imports in ruble terms, might create risks to the ruble exchange rate and inflation dynamics.

- *Further growth of inflation expectations*, which might both directly influence demand and price trends and strengthen the secondary effects of one-off factors in inflation dynamics.

- *Expansion of the budget deficit and the emergence of secondary effects associated with the structure of revenues and expenditures of the budget system*. In case fiscal policy is eased or subsidised lending programmes are expanded, monetary policy might need to be tightened to contain proinflationary effects.

- *The 2025 harvest*. The pace of autumn sowing lags behind that of last year, which might become another proinflationary factor.

Disinflationary risks are minor and mostly associated with a potentially faster deceleration in domestic demand under the influence of the monetary policy tightening. Besides, if the growth of the economy is 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 meeting considered the updated forecast estimates – the baseline scenario and its variations. The differences in the variations related to the estimated size and pace of the decrease in the positive output gap (including at different levels of potential), degree of fiscal policy easing and adaptivity of inflation expectations.

The discussants agreed that **further tightening of monetary conditions was needed to bring inflation back to the target**, taking into account the statistics released since the key rate meeting in September, proinflationary risks that had materialised, new proinflationary factors and updated forecast estimates. This required both raising the key rate and a significant upward revision of its medium-term forecast path in the baseline scenario. **The main arguments in favour of the need to tighten monetary policy** were as follows:

- Inflation, including underlying inflation, is substantially higher than the July forecast. There are no signs of its slowdown. There is a persistent considerable overheating in the economy, and the deceleration of its growth is predominantly associated with more severe supply-side constraints rather than the cooling of domestic demand. Additional monetary policy impetus is needed to return the economy to the balanced growth path and ensure the resumption of a steady disinflationary trend.

- Price dynamics in 2024 and 2025 will be additionally affected by the proinflationary risks that have already materialised and new proinflationary factors (including a notable increase in the recycling fee and a number of regulated tariffs). Additional tightening of monetary policy is needed to limit their impact on inflation.

- High inflation has considerably pushed up inflation expectations, which has led to monetary conditions being less tight in real terms than assumed by the Bank of Russia. In this context, an additional monetary policy response is needed to reduce inflation expectations and minimise their influence on inflation.

- Credit activity is still boosted by a large number of loans, the demand for which is less sensitive to the key rate changes. As a result, credit activity remains high. More prominent cooling of the market segment is needed to ensure decelerating growth of banks' aggregate loan portfolio.

Discussing the extent of the key rate increase at the upcoming meeting, **most of the participants were in favour of raising it to 21.00% per annum**. However, **some discussants suggested a more moderate increase, i.e. to 20.00% per annum, or a sharper increase – to 22.00% per annum**.

Those in favour of **a 300 bp rise** said that it would help reduce inflation faster and serve as a 'safety net' in case new proinflationary risks materialised, the chances of which remained high. This would also help lower inflation expectations with greater certainty. However, most participants in the discussion concurred that a drastic change in the key rate might lead to higher volatility in financial markets. More caution should therefore be exercised when choosing the size of the step.

The discussants who suggested **a 100 bp increase** pointed to the fact that the effects of the current tightening of monetary conditions would continue to accumulate if market participants formed adequate expectations regarding future policy. Nevertheless, the majority of the participants agreed that this decision was not commensurate with the proinflationary factors and risks that had materialised since the key rate meeting in September.

Having considered all pros and cons, **the meeting concluded that raising the key rate by 200 bp to 21.00% per annum was an optimal decision**. Combined with a strong upward shift of the forecast key rate path in the baseline scenario, a +200 bp step will provide the needed impetus to the greater tightening of monetary conditions required for a resumption of disinflation and reduction of inflation expectations.

The meeting concurred that the key rate decision should be accompanied by a guiding signal of its possible further increase. **The participants were choosing between the two following signals**: a tough (implying an open prospect of an increase) or a moderately tough (implying assessment of the necessity of an increase) signal, depending on the assessment of the probability of this step. Those in favour of a moderately tough signal opined that effects of the earlier key rate decisions on the economy required additional evaluation. Accordingly, a moderately tough signal implies a somewhat lower probability of a key rate increase than a tough signal. However, most discussants concurred that keeping the key rate unchanged at the next meeting would only be possible in case of a considerable deceleration of underlying inflation and the emergence of the factors that could lead to a faster return of inflation back to the target. So far, there are few prerequisites for this. The balance of risks is shifted towards proinflationary ones. In addition, a moderately tough signal could generate market participants' premature expectations of the end of the monetary policy tightening cycle. Although the key rate increase at the upcoming meeting is not predetermined, its probability is very high. Therefore, **the Bank of Russia should repeat the tough signal it gave in September**.

Following the discussion, **on 25 October 2024, the Bank of Russia Board of Directors made the decision to raise the key rate to 21.00% per annum from 28 October 2024 and give a guiding signal of a possible key rate increase at its upcoming meeting**.

The key rate path for 2024–2026 has been raised. In 2024, the annual average key rate will equal 17.5% per annum. Further on, the key rate is expected to average 17.0–20.0% per annum in 2025, 12.0–13.0% per annum in 2026, and reach a neutral range of 7.5–8.5% per annum in 2027.

The Bank of Russia Board of Directors expects the positive output gap in the baseline scenario to gradually narrow in 2025 under the influence of the monetary policy pursued. However, inflation will return to the target later. The inflation forecast for 2024–2025 has been revised upwards. In 2024, inflation will be 8.0–8.5%. It will drop to 4.5–5.0% in 2025, decrease to 4% in 2026 H1 and stay at the target further on. The Russian economy's growth forecast remains unchanged. The economy will grow by 3.5–4.0% in 2024, by 0.5–1.5% in 2025, by 1.0–2.0% in 2026, and by 1.5–2.5% in 2027. More details on the forecast are available in the Commentary on the Bank of Russia's Medium-term Forecast.