

BANK OF RUSSIA'S MONETARY POLICY REVIEW: PLANNED ANALYTICAL WORK AND EVENTS

AS OF 31.01.2023

In 2021, the Bank of Russia started a comprehensive analysis of its monetary policy over the period of inflation targeting (IT) – the Monetary Policy Review (MPR) project. The objective of the MPR is to assess how effective the selected regime is and how well the current monetary policy parameters conform to the changing environment. In 2022, the dramatic changes in the external environment had a significant impact on the conditions of monetary policy implementation. In view of this, the Bank of Russia rescheduled the completion of the MPR for 2023 in order to factor in the experience of 2022 and carry out a more profound analysis of the influence of the new economic conditions on its monetary policy.

Since 2015, the Bank of Russia has been implementing its monetary policy under the IT regime. The transition to this regime took place stage by stage during several years. Switching to IT, the Bank of Russia defined the objective of its monetary policy framework to reduce annual inflation to 4% in 2017 and maintain it close to this level [further on](#).

The years of 2015–2016 were a period of disinflation when the Russian economy was overcoming the consequences of the external shocks of 2014 and adjusting gradually to the new monetary policy framework. Owing to the monetary policy pursued, the inflation rate approached the Bank of Russia's target as early as the beginning of 2017. In 2017–2020, annual inflation hovered around 4% on average.

The outbreak of the coronavirus pandemic in 2020 and accommodative policy measures implemented to address its economic consequences caused demand and supply imbalances both in Russia and globally. In these conditions, annual inflation deviated upwards from the target in 2021. Large-scale external trade and financial restrictions enacted against Russia by a number of countries in 2022 entailed an additional surge in prices. It has become clear that the Russian economy needs a structural transformation. Currently, the Bank of Russia pursues its monetary policy in such a way as to return inflation to the target, without hindering the structural transformation of the Russian economy.

In 2021, the Bank of Russia started the work within the MPR project – a comprehensive analysis of the conditions of monetary policy implementation, the results achieved over the period of IT, and the extent to which these results conform to the main goal of monetary policy stipulated by law, which is to protect the ruble and ensure its strength through maintaining price stability.¹ The Bank of Russia stays totally committed to the price stability

¹ Articles 3 and 34.1 of Federal Law No. 86-FZ, dated 10 July 2002, 'On the Central Bank of the Russian Federation (Bank of Russia)'.

mandate established by law and the inflation targeting strategy. Considering the drastic changes in the external environment for the Russian economy in 2022, the Bank of Russia rescheduled the completion of the MPR for 2023. In the future, the Bank of Russia plans to conduct monetary policy reviews regularly, every five years.



ANALYTICAL WORK

Within the MPR project, the Bank of Russia's research units carry out analysis in six blocks of topics (work streams):

Work stream 1. Inflation target format.

Work stream 2. The operational procedure of monetary policy.

Work stream 3. Retrospective assessment of the effectiveness of monetary policy.

Work stream 4. Communication as a monetary policy instrument.

Work stream 5. Monetary policy and financial stability.

Work stream 6. New challenges to monetary policy.

The findings of the research will be published on the Bank of Russia website as authored analytical notes and economic research papers. The Bank of Russia will also release a consultation paper presenting the findings and proposals based on the work completed.



PUBLIC CONSULTATIONS

Communication transparency is crucial to promote society's confidence in monetary policy and, accordingly, to implement it effectively. Therefore, the Bank of Russia believes it essential to carry out a public discussion of the issues studied in the course of the work within the MPR project.

The Bank of Russia will hold a series of public consultations, including at its regional branches. An open dialogue will provide a more thorough understanding of the perception of inflation and the Bank of Russia's monetary policy by society. The consultations are scheduled for the first half of 2023.

The Bank of Russia will hold a series of meetings with analysts and experts in Moscow until the end of April to discuss the preliminary findings of the research. In late May–June, after the release of its consultation paper, the Bank of Russia will carry out a series of meetings in Russian regions with representatives of all types of businesses, public organisations, regional authorities, and the expert community. At the same time, the Bank of Russia will present the main findings of its analysis to the State Duma of the Federal Assembly of the Russian Federation, the Federation Council of the Federal Assembly of the Russian Federation, the Government of the Russian Federation, and the Accounts Chamber of the Russian Federation.



THE MPR COMPLETION

Considering the planned cycle of the analytical works and events, the Bank of Russia plans to complete the MPR by the middle of 2023. By that moment, the Bank of Russia, relying on the findings of its research, will make decisions on maintaining or adjusting the parameters of its monetary policy. These decisions will be taken into account when preparing the Monetary Policy Guidelines for 2024–2026.

ANALYTICAL WORK STREAMS

WORK STREAM 1 INFLATION TARGET FORMAT

The international experience of the last thirty years demonstrates that the IT regime is highly efficient in ensuring price stability. However, the economic theory and the practice of macroeconomic policy worldwide do not give an unambiguous answer about the appropriate inflation target. Central banks set the level and format of their inflation targets depending on the specifics of their economies, the extent of fluctuations of absolute and relative prices, the magnitude of risks of deflation, etc. Switching to the IT regime in 2015, the Bank of Russia set the objective of maintaining annual inflation close to 4%.

Within work stream 1, the Bank of Russia sets the following objectives:

- analyse whether the inflation target of 'close to 4%' conforms to the current conditions of monetary policy implementation in Russia, including in the context of other countries' experience;
- assess whether the Russian economy has formed the conditions for reducing the inflation target, considering the changes in the structure of the Russian economy in the new conditions, among other things;
- assess the pros and cons of various methods for setting the inflation target (e.g. a point, or a target range, or a point with a range);
- identify the most relevant indicator for IT: the headline consumer price index (CPI), the core CPI, etc.; and
- assess the pros and cons of alternative monetary policy frameworks aimed at maintaining price stability (e.g. average IT and price level targeting), including model-based assessments for the Russian economy.

WORK STREAM 2 THE OPERATIONAL PROCEDURE OF MONETARY POLICY.

The Bank of Russia built its current system of monetary policy instruments back in 2013. Specifically, the Bank of Russia introduced a symmetrical interest rate corridor with the key rate as its centre and one-week auctions as the main operations. In the subsequent years, the Bank of Russia enhanced the existing monetary policy instruments and added new ones. However, their key parameters and approaches to their use remained unchanged. The conditions for managing money market rates in Russia have been changing as well, with a structural deficit in the banking sector reversing to a structural surplus and new segments developing in the money market. During certain periods in 2020–2022, external shocks provoked very sharp fluctuations in the banking sector's liquidity, including a rapid switch from a structural surplus to a structural deficit of liquidity and back. In addition, foreign central banks significantly altered their operational procedures over the past decade, including the formats of their operational goals, the range of counterparties in operations, and the approaches to organising operational procedures.

Taking into account these changes and relying on its own experience and the experience of foreign central banks, within work stream 2, the Bank of Russia plans to:

- assess the effectiveness of the current operational procedure of the Bank of Russia's monetary policy, including in the conditions of 2022, and outline possible areas for its future development;
- assess whether the existing operational goal of monetary policy is coherent with the current conditions of monetary policy implementation in Russia;
- consider different types of monetary policy operational procedures and estimate the optimal width of the interest rate corridor; and
- analyse the objectives and parameters of required reserves and the principles of counterparty policy.

WORK STREAM 3**RETROSPECTIVE ASSESSMENT OF THE EFFECTIVENESS OF MONETARY POLICY**

Under the IT regime, the Bank of Russia makes its monetary policy decisions relying on a complex of model-based calculations and expert opinions of the Board of Directors regarding economic developments and price dynamics over the forecast horizon, potential risks created by internal and external conditions, and financial markets' response to these risks.

To make an in-depth assessment of IT results, within work stream 3, the Bank of Russia carries out a model-based retrospective analysis of the monetary policy pursued since 2015. In particular, within this analysis, the Bank of Russia plans to:

- explore the timeliness of the monetary policy response to internal and external shocks that materialised and posed a threat to price stability;
- compare the monetary policy pursued and alternative strategies for making monetary policy decisions that are based on theoretical methods for modelling an optimal policy;
- assess how limited access to data and the publication of statistics with a time lag affected the efficiency of the decisions made and the accuracy of macroeconomic forecasts;
- identify the effect of the fiscal rule on fluctuations in the main macroeconomic indicators of the Russian economy.

WORK STREAM 4 COMMUNICATION AS A MONETARY POLICY INSTRUMENT

Communication is an essential instrument of monetary policy within the IT framework. Enhancing the transparency of monetary policy, the central bank seeks to reduce inflation expectations and anchor them at a low level, strengthen confidence in the monetary policy pursued, and increase the predictability of interest rate levels in the economy. Beginning from 2015, the Bank of Russia has been consistently expanding and improving its communication policy, seeking to provide information in a timely and comprehensive manner.

Within work stream 4, the Bank of Russia analyses the efficiency of these efforts, in particular it plans to:

- assess the predictability of the Bank of Russia's decisions on monetary policy and its criteria, including as compared with the experience of foreign central banks;
- determine a set of key factors influencing the predictability of monetary policy decisions;
- assess whether the Bank of Russia's current communication is clear to the main target audiences, including during crisis periods; and
- identify the optimal parameters for the Bank of Russia's communication, including the range of target audiences, channels for communicating information to them, and its content and form.

WORK STREAM 5 MONETARY POLICY AND FINANCIAL STABILITY

By influencing the financial sector, monetary policy may impact systemic risks in the economy, including in finance. Mitigation of such risks is the objective of financial stability policy. The monetary policy pursued can both intensify and weaken systemic risks that may generate, through the financial sector, potentially adverse consequences for the stable functioning of the real sector. Besides, the conditions of monetary policy implementation can be influenced by measures taken to maintain the stability of the financial sector, due to which they should be factored in when making monetary policy decisions. As monetary policy and financial stability are interconnected, it is critical to consider approaches to their interaction.

Within work stream 5, the Bank of Russia plans to:

- make an integrated assessment of the world experience of interaction between monetary policy and financial stability policy, including in the context of achieving goals in the conditions of capital controls;
- analyse the Russian experience of monetary policy implementation under the IT regime during the periods of emerging and materialising systemic risks, as well as during the further recovery of the economy and the adaptation of the financial system; and
- assess, considering the structural transformation of the Russian economy, possible areas for enhancing the Bank of Russia's approaches to interaction between monetary policy and financial stability policy that are described in the Bank of Russia's official documents.

WORK STREAM 6 NEW CHALLENGES TO MONETARY POLICY

In recent years, the world economy has been developing in challenging conditions. Trade frictions and protectionist measures, the pandemic and restrictions on usual activities, escalating geopolitical tensions and market fragmentation – all these factors have had a significant impact on economic trends and inflation globally.

Nevertheless, long-term trends associated with the progressive evolution of society continue to develop. Advancing digitalisation, an increasing diversity in the financial sector, global warming and growing environmental awareness, demographic changes – all these processes are simultaneous in many countries, although their development varies due to the economic, institutional and socio-cultural context. Some of these trends have become more pronounced, being impacted by the events that have happened. For example, digitalisation processes have accelerated due to the pandemic, and the trend towards decarbonisation has intensified amid growing geopolitical tensions. Secular trends are changing the conditions of monetary policy implementation in the medium and long term by transforming society's priorities and preferences and consumption, saving and investment practices.

In 2022, the Russian economy faced additional shocks induced by alterations in the external environment. The adaptation to the new conditions not only sets new priorities in the earlier formed trends, but is also a separate challenge to monetary policy in the medium term.

Within work stream 6, the Bank of Russia plans to analyse the nature of the influence of the following critical medium- and long-term challenges on the conditions of monetary policy implementation in Russia:

- 1. Structural transformation of the Russian economy.** The Russian economy is to go through extensive transformation processes. Some companies will considerably refocus their production and shift towards other types of products, whereas others will be forced to exit the market and replaced by new enterprises in new niches. The balance of industries in the economy will change. The ratio of production factors may also change in the course of the structural transformation. All this together means that, before a new equilibrium is reached, the economy might experience notable fluctuations in relative prices and the growth rate of potential output, which should be taken into account in monetary policy decisions. In addition, the forced capital controls that were enacted have an adverse impact on the flexibility of capital markets, thus exerting an additional effect on the monetary policy transmission.
- 2. Evolution of the financial architecture.** The financial industry is evolving together with society. First, the advancing digitalisation of payment and settlement infrastructure (including the emergence of cryptocurrencies and the system of decentralised finance) has created the demand for a new, digital, form of money. Many central banks have started the development of sovereign digital currencies, and the Bank of Russia is in the forefront. In 2022, the Bank of Russia completed the pilot testing of the digital ruble. Second, households are increasing the demand for financial services, while changing their preferences for savings instruments chosen from

among available alternatives (deposits, brokerage services, algorithm-based products, and others). Consequently, there is a growing number of non-bank financial intermediaries whose role in the financial system is becoming increasingly important. Improving financial literacy and the expanding share of non-bank intermediaries have a direct impact on the effectiveness of the monetary policy transmission mechanism. Third, there has been a long-standing discussion in the world of the need for a better-balanced multipolar financial system to ensure global financial stability. The escalation of geopolitical tensions in 2022 has sped up the development of alternative settlement mechanisms, including those based on digital currencies. The changes in the mechanisms and composition of settlements are altering the interaction of the Russian economy and financial sector with international capital markets and may influence the conditions of monetary policy implementation in the future.

- 3. Decarbonisation and global warming.** Global warming is a slow process, although it might have significant implications for the economy. Climate policy might limit the growth of temperature, but the coordination of a single international approach involves challenges because financial and commodity resources differ across countries. This might cause a long and turbulent adjustment of the world economy to a new equilibrium in commodity markets, while industrial production will have to adapt to a new balance of energy sources. In the next few decades, both the transition process and global warming will be considerably affecting economic trends and risks and, accordingly, the conditions of monetary policy implementation.
- 4. Demographic changes.** The size of the population in Russia, just as in many other large countries, is decreasing, while life expectancy is increasing. This in turn might significantly alter consumption and saving practices and influence companies' investment capabilities, which might change the responsiveness of aggregate demand to interest rate changes and thus impact the monetary policy transmission mechanism.
- 5. The problem of inequality.** Most countries are facing the problem of inequality. Financial inequality among various groups of households does not only affect their preferences, but also causes differences in the response of consumer behaviour to economic shocks. In view of this, the level of inequality in society might change the transmission mechanism of monetary policy.