



Bank of Russia



TALKING TRENDS

Economy and markets

Research and Forecasting Department Bulletin

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The views and recommendations expressed in the bulletin do not necessarily reflect the official position of the Bank of Russia.

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Executive summary

MONTHLY SUMMARY

- Statistical data for October and leading indicators for November both pointed to sustained robust growth in economic activity. Credit continued to make a significant contribution to mounting consumer and aggregate demand in the economy. However, *retail* lending started to show a loss of momentum, with households taking a stronger interest in time deposits following the increase in deposit rates. This is set to hold back excessive growth in consumer demand fuelled by high inflation expectations. As of today, seasonally adjusted growth in consumer prices is invariably high. Persistently high inflation expectations of households and businesses delay a moment when inflationary pressure will finally begin to drop.
 - In November, the seasonally adjusted growth of consumer prices was slightly slower but remained overly high. With domestic and foreign manufacturers and transport companies unable to promptly meet the rapidly growing demand, inflationary pressure is doggedly high across multiple segments of the Russian economy. That said, the current monetary policy will work to constrain excessive growth in demand; as logistics problems ease and production gradually expands, the supply of goods and services will rise over the next year.
 - The domestic economy posted sustained growth paces between October and November, with accelerated expansion recorded in the investment sector. Corporate demand for credit resources remained strong in defiance of higher lending rates. Although unemployment (seasonally adjusted) hit an all-time low again, nominal wages did not grow at a substantially accelerated pace. Apparently, this comes as a sign of improvements in migration as well as advancements in the structural adjustment of the labour market to the needs of a post-pandemic economy, which drives the redistribution of labour resources between industries.
 - Tighter monetary conditions led to slower growth momentum in retail lending in October. Households are growing increasingly more interested in deposits in response to rising deposit rates. This is reflected in an increased saving ratio.
 - In November, Russian financial markets including the foreign currency market came under strong pressure from geopolitical and other external factors. As a result, the foreign exchange channel of monetary policy failed to make a constraining effect on consumer price growth.

IN FOCUS. Takeaways from the Great Inflation of the 1970s-1980s for central banks

- The US Fed and Bundesbank's experience of monetary policy in times of strong inflation growth in the 1970-1980s highlights the importance of an operational target for monetary policy. It is essential for building confidence of economic agents, which is key to anchoring inflation expectations. Thereafter, this opens up more opportunities to conduct countercyclical monetary policy notwithstanding temporary inflation shocks.
- Unanchored inflation expectations in the case of price shocks (even if caused by supply-side factors) may necessitate a stronger monetary policy response to bring inflation back to target. This, in turn, comes with higher economic costs than when a central bank policy anchors inflationary expectations faster.

1. Inflation

Monthly consumer price inflation adjusted for seasonal and one-off factors remains elevated. Extensively growing aggregate demand coupled with rising costs and continuing supply disruptions is pushing prices up.

At the same time, current monetary policy seeks to contain excessive demand, bringing households back to the savings-oriented behaviour and, together with macroprudential policy, putting brakes on retail lending expansion. These trends have already emerged but so far have not gained strength. Given the lagged effect of monetary policy, a meaningful disinflationary impact of this will make itself felt in the next few months.

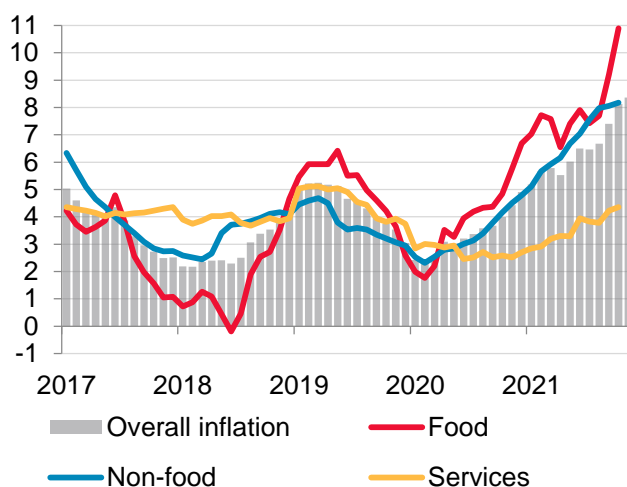
1.1. Inflationary pressure remains elevated

- Inflationary pressure remained far above 4% in October–November, pushing annual inflation higher. The elevated pace of price rises is still driven by a steady demand expansion, with supply lagging behind due to enduring and temporary factors which contain output growth and increase producer costs.
- Recent monetary policy decisions are starting to affect macroeconomic and financial indicators, but this is not yet sufficient for a sustainable disinflationary trend to emerge in price movements.
- As the effect of fiscal policy coming back to normal and monetary policy tightening strengthens, we expect it to ensure a substantial decline of inflationary pressure and inflation deceleration to 4.0–4.5% towards the end of 2022.

The estimate of annual inflation came in at 8.4%¹ (Figure 1) as of 29 November. Inflationary pressure viewed as the dynamics of stable CPI components adjusted for the impact of one-off and temporary factors remains elevated relative to the Bank of Russia target. That said, some of its individual components produce significant volatility of price movements from month to month. According to our estimate, seasonally adjusted month-on-month consumer price inflation calculated from weekly data slowed in November (Figure 2) from 13.66% MoM SAAR² (Figure 3). The effect of producer cost rises on prices is the strongest in the food segment. Most of the supply-side impact on the non-food sector comes from disruptions in the supply of some components. Despite some cooling of consumer demand in Q4, it keeps buoying overall price rises on a level above the Bank of Russia target. This, brings about, among other things, a depressed savings ratio since consumers are set on buying things for fear of a decline in money's purchasing power in the future.

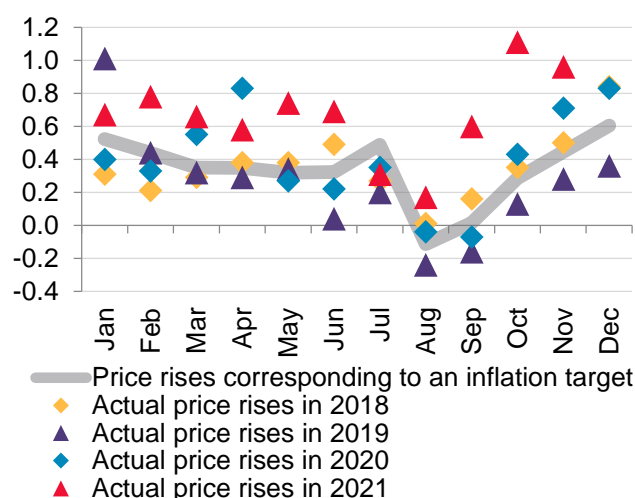
¹ Based on weekly Rosstat estimates.

² SAAR – seasonally adjusted annualised rate.

Figure 1. Inflation and its components, % YoY

Note: November 2021 figure is a preliminary estimate based on weekly data.

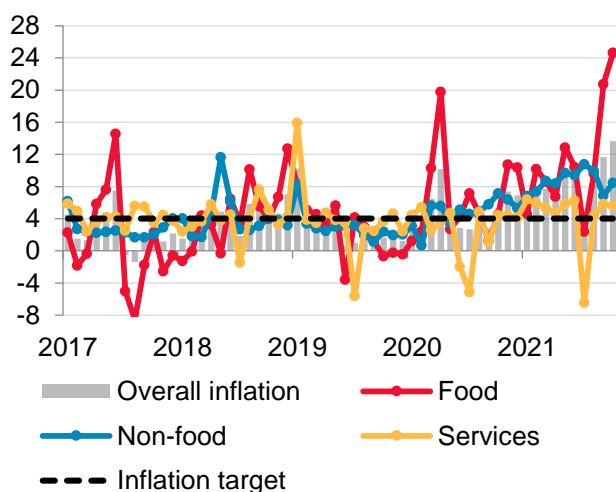
Source: Rosstat.

Figure 2. Price rises corresponding to an inflation rate of 4%, % MoM

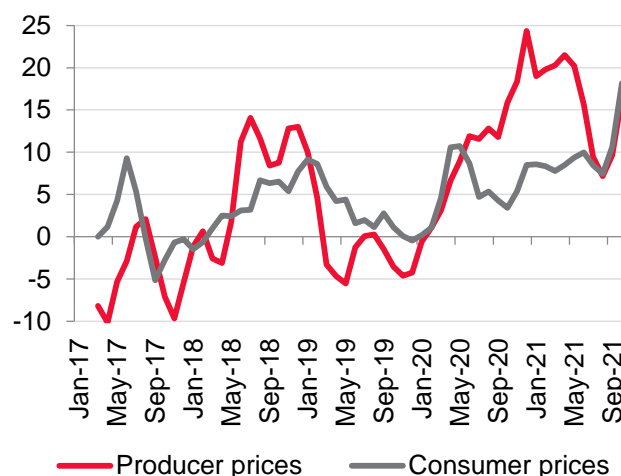
Note: November 2021 figure is a preliminary estimate based on weekly data.

Source: Rosstat, R&F Department estimates.

October's acceleration of seasonally adjusted food price rises (Figure 3), reflecting the continued impact of temporary (a shift in the harvesting period) and strengthening of enduring factors (the pass-through of rising producer costs to prices) was, according to our estimate, partially offset in November. The contribution of fruit and vegetables to annual inflation was marginal since the industry was able to catch up with the normal harvesting schedule.

Figure 3. Seasonally adjusted inflation, % MoM SAAR

Source: Rosstat, R&F Department estimates.

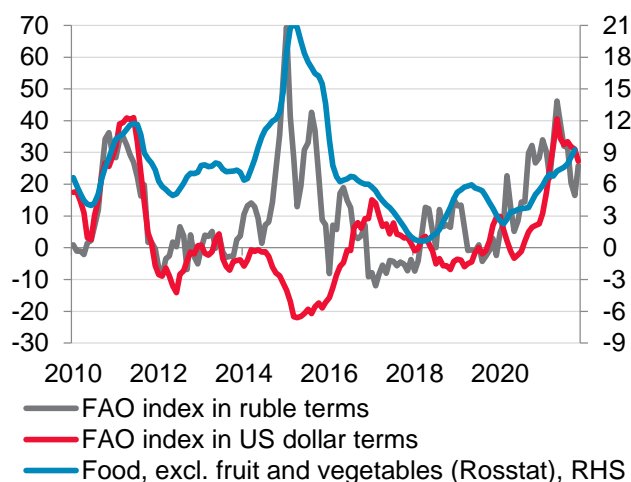
Figure 4. Price dynamics of food products, % three-month moving average growth in annual terms

Source: Rosstat, R&F Department estimates.

That said, the impact of *persisting* supply-side factors in the food sector remains pro-inflationary – the pace of price rises continues to accelerate across a wide range of food products, reflecting the pass-through of costs, which have risen significantly in 2021. Producer price movements suggest that this process may well continue in the months to come (Figure 4).

[According to FAO data](#), world food price growth continued in November slowing somewhat relative to October (in USD terms). This keeps up pressure on domestic prices from external markets (Figure 5).

Figure 5. World and domestic food prices % YoY



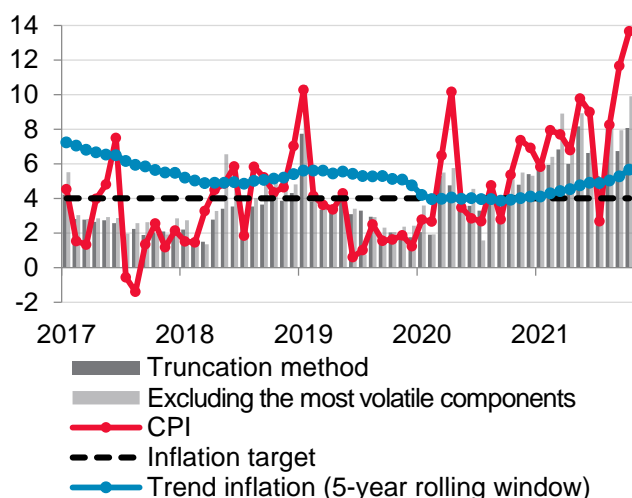
Sources: Rosstat, FAO, R&F Department estimates

Non-food price rise acceleration in October and, according to preliminary estimates, in November compared with the Q2 average is put down to refined petroleum product price increases after their decline in September (Figure 3). Net of excisable products, price rises in this category have, for several consecutive months, hovered around 8% MoM SAAR. Meanwhile, the “heavy” components’ price movements are non-uniform: in addition to petrol, price rises are the most pronounced in passenger cars, furniture, and tele-radio goods. The restraining effect continues to come from a decline in the prices of construction materials after their surge in the first half of the year.

The services sector’s price rises remain the lowest in large CPI components, continuing, however, to show elevated volatility on the back of epidemic restrictions (Figure 3). Rises in the prices for the services of passenger transport, hotels, and health resorts were spurred by temporary factors, such as the imposition of “days off” at the end of October – the start of November. After October’s drop in the prices of foreign tourism services, they rose again in November on ruble weakening and a surge in the prices of pre-New-Year tours to Turkey.

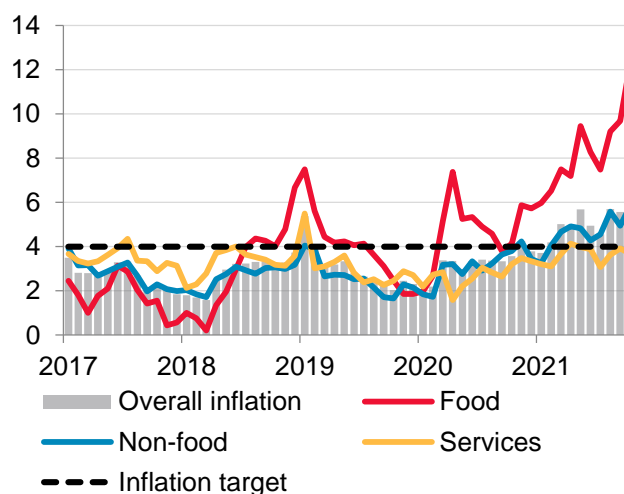
The analytical indicators of price movements point to an increasing contribution of the stable components to elevated inflationary pressure at the start of Q4. In October, trend inflation and median price rises continued to drift away from 4% in annualised terms, coming in at 5.66% and 5.94%, respectively (Figure 6, Figure 7). The average reading of modified core inflation indicators also climbed from the preceding month’s level.

Figure 6. Modified core inflation indicators and trend inflation estimates, % in annual terms



Source: Rosstat, R&F Department estimates.

Figure 7. Median distribution estimated on disaggregated components, % MoM SAAR



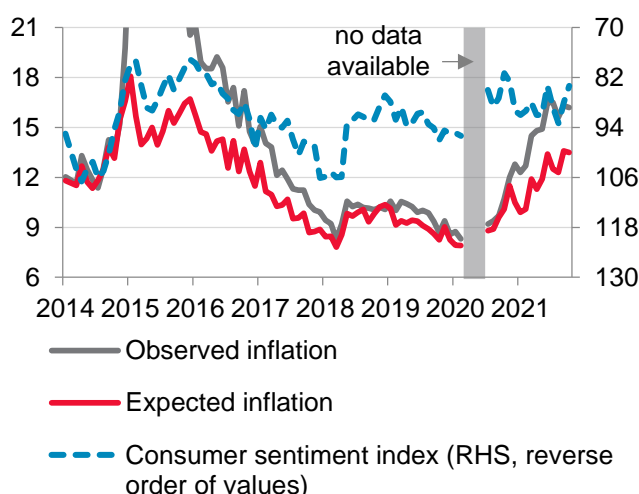
Source: Rosstat, R&F Department estimates.

Business and household inflation expectations remained elevated in November, although they declined somewhat relative to October. Respondents remain sensitive to price hikes in many food products of animal origin, which boosts the secondary effect of expectations on demand and prices.

That said, businesses are reporting demand weakening and a cost rise slowdown, providing an indirect signal of consumer price rise slowdown in the medium term.

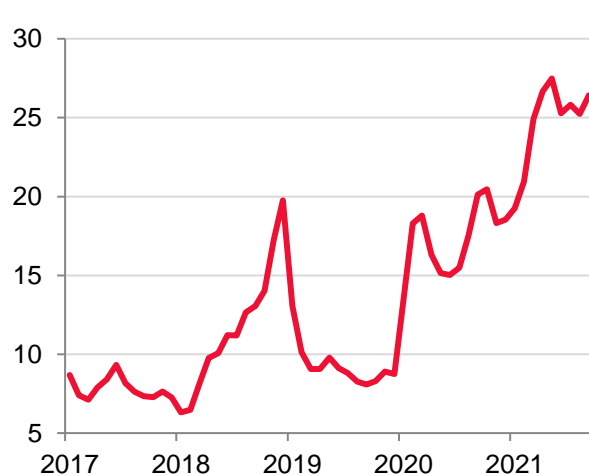
The earlier monetary policy decisions are starting to gradually affect deposit and loan dynamics (See Section 2.2). This is set to contain excessive demand, creating conditions for a gradual price growth slowdown. It is, however, too early to claim that sustainable disinflationary trends have set in.

Figure 8. Median estimates of observed and expected inflation by households, % YoY



Source: Bank of Russia.

Figure 9. Price expectations of enterprises for the next three months, balance of answers, %



Source: Bank of Russia.

As the expected increase in the disinflationary effect of the Bank of Russia's monetary policy tightening materialises, the year 2022 will see seasonally adjusted month-on-month price growth start slowing, with annual inflation declining to 4.0–4.5% to subsequently remain close to 4%.

2. Economic activity

The preliminary estimates of the Q3 results suggest that seasonally adjusted quarterly GDP growth continued at 1.0%. The lower crop output relative to last year and a “pause” in the investment sector of the economy did not cause a GDP growth slowdown. Activity expansion in the consumer and exporting sectors kept GDP growth at the Q2 level.

Q4 sees a largely opposite picture: as the consumer sector growth slows down, the investment sector is showing a new growth impetus, supporting further export expansion. Some cooling of consumer demand provides conditions for easing inflationary pressure exerted by demand. The recent turnaround towards a credit impulse decline in the retail sector will help this trend to continue.

At the same time, supply disruptions are still constraining growth, at the same time increasing logistics costs. Disruptions have even worsened in some logistics segments, such as maritime and rail transportation in the Far East.

2.1. Consumer demand growth slows marginally

- Economic activity expansion has continued in Q4. The nation-wide “day-off” period at the start of November had a limited effect on economic activity, as evidenced by data from payment systems (Figure 10, Figure 12). The volume of payments and the level of activity expectedly went down during the week from 1 to 7 November but subsequently recovered to the end of October's level.
- Production activity growth was posted in mining and quarrying, as well as in manufacturing in October but was slower than at the end of Q3 (Figure 13). Mining and quarrying output was buttressed by the expansion of external demand for key energy exports and an increase in crude oil extraction quotas as part of the OPEC+ deal.
- Manufacturing's output performance varies across the larger groups of industries (Figure 14). October's output growth in industries meeting *investment* and *intermediate* demand, was secured chiefly by the subgroups of industries traditionally showing elevated output volatility,³ whereas most of other subindustries posted either output stabilisation relative to September or its decline.

³ In industries meeting investment demand, it is the manufacture of other transport equipment. In industries oriented to intermediate demand – the manufacture of refined petroleum products in the wake of crude oil output expansion.

- Most subindustries meeting *consumer demand* saw output expansion in October in the wake of demand growth over recent quarters. The autumn months, however, posted output growth slowdown relative to the preceding period.
- Survey data point to the continuation of manufacturing output growth in November: an Institute for Economic Policy survey suggests its slight weakening, while a PMI poll shows its acceleration. Real-time indicators suggest a minor cooling of *consumer demand* in Q4. The most tangible consumption growth slowdown is posted in the non-food segment. October's food sales remained all but unchanged after gaining pace in August–September. Despite a spending rise during the season of bargain sales, offsetting an income drop in the “day-off” period, spending expansion slowed in November compared with October. Apart from budget policy's return to normal, this was helped by gradual monetary tightening. As the Bank of Russia's key interest rate decisions are transmitted to the economy, the pace of consumer demand growth will come back to more balanced levels, helping gradual easing of inflationary pressure.
- Demand growth slowdown is accompanied by some alleviation of tension in the labour market: the unemployment rate decline is slowing gradually.⁴ October saw the HeadHunter index⁵ add 0.2 points for the first time over half a year (Figure 16). The job vacancy number showed seasonally unadjusted zero growth for the first time over half a year, whereas a rise in the number of active CVs continued, reaching 4%.⁶ We also see the recovery of work migration: according to Ministry of the Interior real-time data, the number of migrant workers employed in Russia is already very close to the 2019 level.
- Against this background, wage growth is showing signs of slowdown, as suggested by October's performance of the SberIndex tracking changes in median wages (growth easing to 9.8% YoY⁷ from 10.8%YoY in September) and by personal tax revenue in September. This cooling is seen across a wide range of industries, including those posting the most severe deficits, such as construction, the hotel industry, and public food services. At the same time, the trade and IT industries continue to record an elevated pace of growth, with the agricultural sector even showing wage growth acceleration. We, therefore, see no signs that the range of industries developing an elevated rate of wage growth is widening even as profit expansion is continuing in the Russian economy. This suggests that pro-inflationary risks from the Labour market has somewhat subsided recently.
- We expect overall economic growth to continue at a rate close to potential after the completion of the recovery phase.

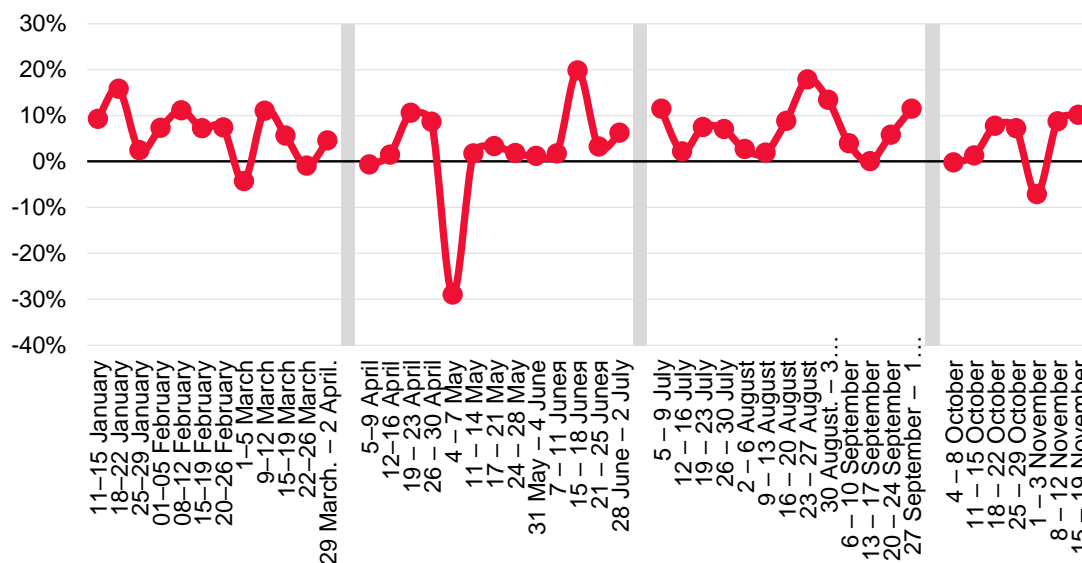
⁴ 4.3% SA in October.

⁵ The HeadHunter index reflects the ratio of the number of active CVs to that of job vacancies.

⁶ Annual vacancy growth has stabilised, while the number of vacancies did not decline for the first time over three months (Figure 3).

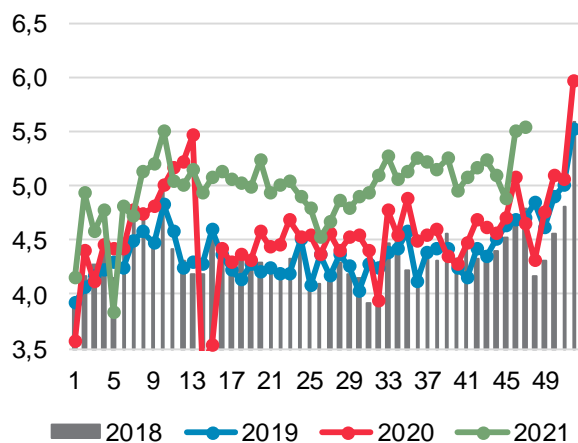
⁷ The slowdown was even steeper at over 3 pps relative to October 2019.

Figure 10. Growth in incoming payments relative to the previous quarter's average in 2021, weighted by the share of industries in gross value added, seasonally adjusted, %



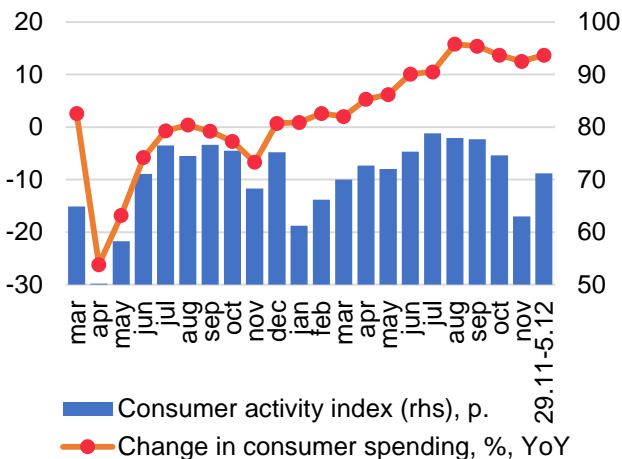
Sources: Bank of Russia, R&F Department estimates.

Figure 11. Nominal weekly household everyday expenditure, thousand rubles



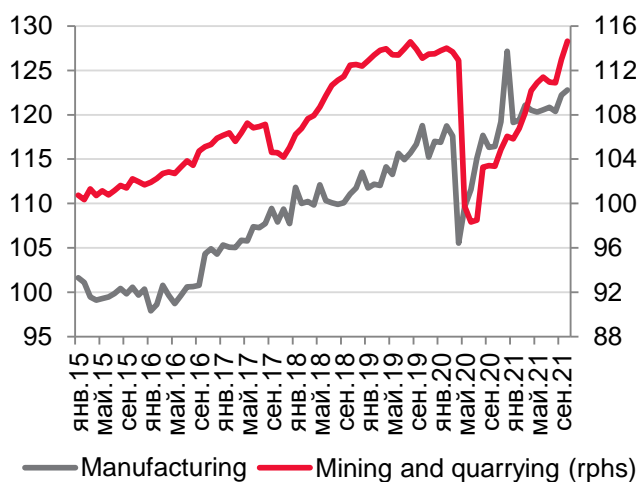
Sources: Romir.

Figure 12. Spending on goods and services and the consumer activity index



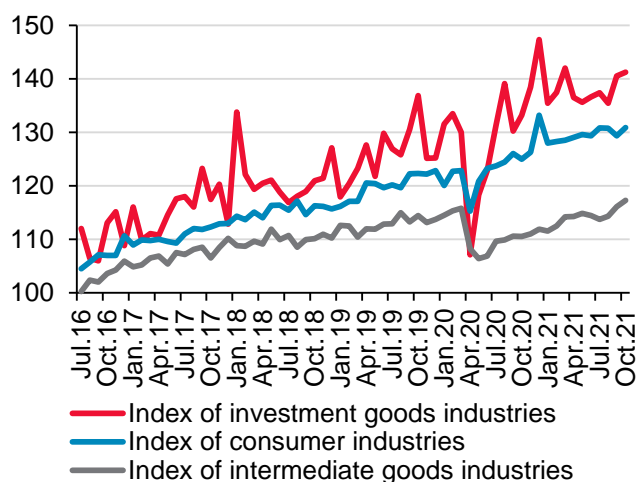
Source: SberIndex.

Figure 13. Mining and quarrying and manufacturing (2014 = 100)



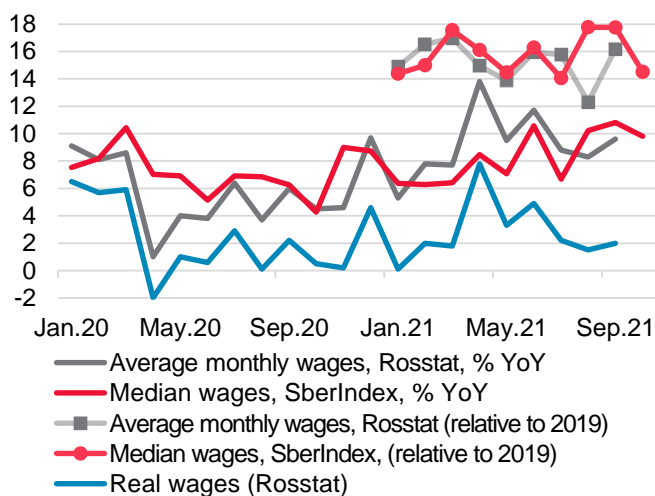
Sources: Rosstat, R&F Department estimates.

Figure 14. Output in groups of manufacturing industries, January 2016=100%, seasonally adjusted



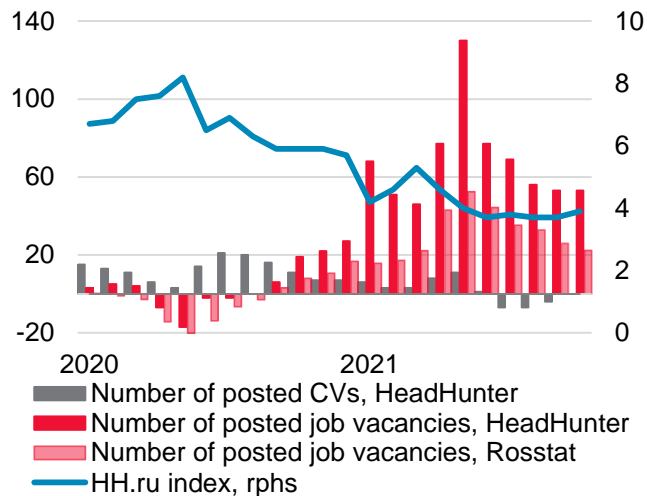
Sources: Rosstat, R&F Department estimates..

Figure 15. Growth in median (SberIndex) and average monthly (Rosstat) wages, %



Sources: Rosstat, SberIndex, R&F Department estimates.

Figure 16. CVs and job vacancies (% YoY), the HeadHunter index



Источники: Rosstat, HeadHunter.

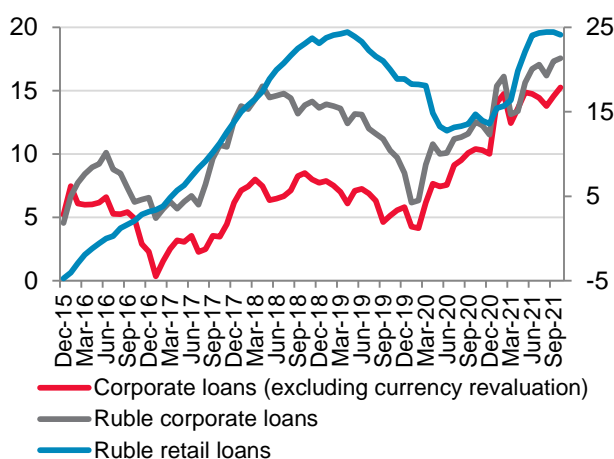
2.2. Credit impulse declines in retail lending

- The Bank of Russia's monetary policy tightening and macroprudential requirements toughening are gradually slowing lending expansion to more sustainable levels. But this effect has yet to gain more strength in the months to come.
- The rate of *retail* lending growth remained elevated in October but was lower than at its peaks in the spring – start of the summer.

- That said, the credit impulse in the retail segment started declining as household funds at banks continued to expand, shifting from funds in accounts to time deposits. This means that households' credit and deposit activity is reducing its contribution to consumption growth. This will likely bring down consumption growth from elevated levels, alleviating inflationary pressure associated with it.
- Lending expansion is slowing but also remains elevated in the *corporate segment*. The credit impulse seems to have passed its local peak in the first half of the year but is so far showing volatile performance.
- The banking sector's net profit remains much higher than in recent years, while non-performing loans are steadily declining. All other things being equal, these factors help boost lending, which further monetary policy should take into account.

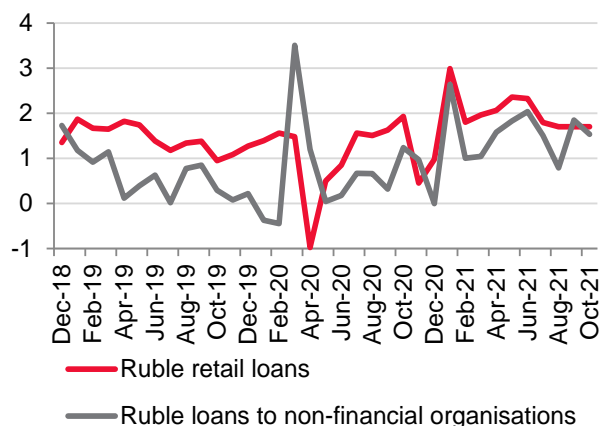
Month-on-month retail lending growth slowed at the end of the summer – start of the autumn relative to Q2 but remained elevated: the loan portfolio has expanded for three consecutive months at a rate of 1.7% MoM SA (Figure 18). The continuation of strong retail lending expansion is likely buoyed by persistently high inflation expectations along with expectations for further lending rates increases. Meanwhile, the Bank of Russia' recent monetary policy decisions and toughening of macroprudential requirements are gradually starting to affect lending performance and will ensure its growth slowdown to more sustainable levels going further.

Figure 17. Banks' credit growth % YoY



Sources: Bank of Russia, R&F Department estimates.

Figure 18. Banks' ruble credit growth, % MoM SA



Sources: Bank of Russia, R&F Department estimates.

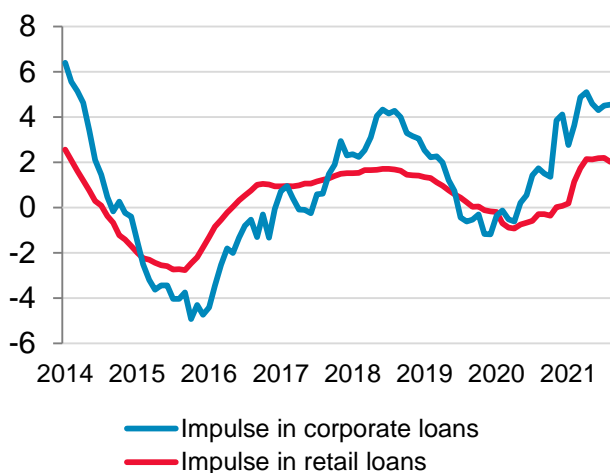
The performance of retail lending varies across its segments. As macroprudential policy measures were implemented, a rise in unsecured consumer lending slowed to 1.3% MoM SA in October from 1.6% MoM SA (Figure 21), auto lending growth softened to 1.3% SA from 1.6% MoM SA. The unsecured consumer lending segment saw [the contraction of cash and POS loan issuance](#). Still, increased lending demand continues in some segments. For example, according to United Credit Bureau data, a record [number of credit cards](#) were issued

in October (up 3% MoM and 59% YoY). According to [the National Bureau of Credit Histories](#), this is owed to the convenience of using cards for customers and banks' ability to efficiently manage credit risk through changing limits for cards.

Meanwhile, the mortgage lending segment recorded growth acceleration in October. Portfolio expansion, with mortgage-backed securities included, stood at 2.2% MoM SA, up from 1.7% MoM SA in September (Figure 21). The mortgage loan portfolio expansion largely stems from an average check increase, driven by a rise in housing prices. Expectations for further housing price increases following the key interest rate raises stimulate elevated loan demand in this segment. This trend is most likely temporary: mortgage lending growth may slow after the interest rate increases.

According to our estimate, the credit impulse started to soften for retail lending in Q3. The credit impulse defined as lending growth acceleration in absolute terms as a percentage of GDP, has started to decline, helping a gradual consumption expansion slowdown from elevated levels and the easing of inflationary pressure from excessive demand (Figure 19).

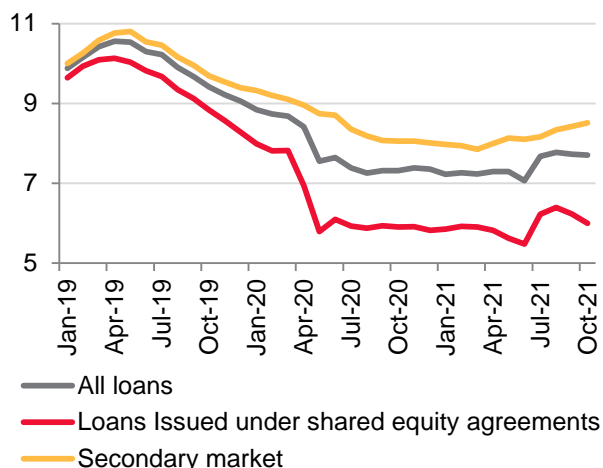
Figure 19. Credit impulse in the retail and corporate segments*



* Based on Form 101 data. Monthly data is used to calculate annual credit impulse – annual change in the flow of credit expressed as a percentage of GDP.

Sources: Bank of Russia, Rosstat, R&F Department estimates.

Figure 20. Interest rates in the mortgage loan market, pp



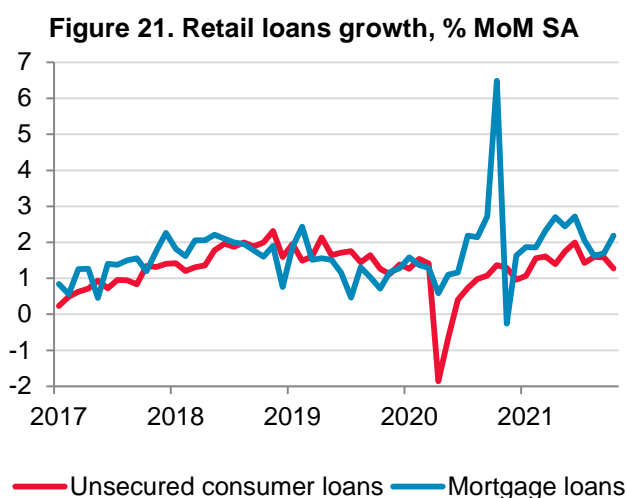
Sources: Bank of Russia, R&F Department estimates.

Growth in ruble loans to non-financial organisations excluding sole proprietorships slowed from 1.8% MoM SA to 1.5% MoM SA but remained close to the elevated average⁸ level of Q3. The credit impulse in corporate lending is so far showing mixed performance amid the overall downtrend (Figure 19).

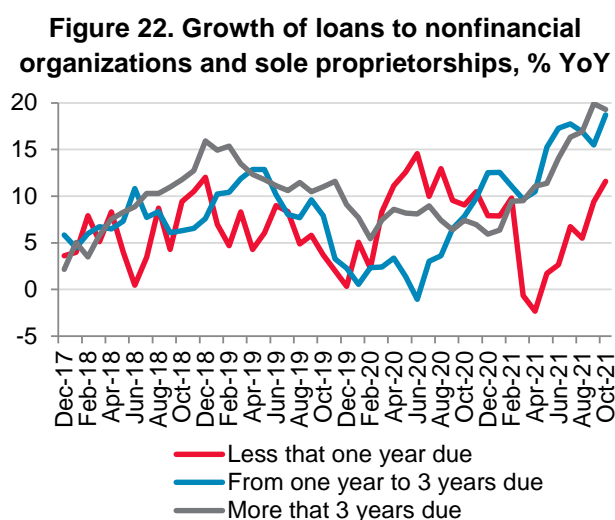
⁸ Growth in loans to financial organisations accelerated from 0.1% MoM SA to 0.5% MoM SA, a rise in loans to sole proprietorships inched up from 1.8% MoM SA to 1.9% MoM SA.

In year-on-year terms, short- and medium-term loans to non-financial organisations and sole proprietorships show the fastest growth acceleration (Figure 22). Long-term loan growth eased marginally after increased growth rates in preceding months.

The effect of the key interest rate hikes is gradually gaining strength via the deposit channel of monetary policy. An increase in funds on household accounts and deposits at banks slowed from 1.3% MoM SA to 1.0% MoM SA in October but was still faster than in July and August. The faster growth in September is likely to have reflected the saving of part of one-off social payments. That said, the structure of the holdings is continuing to gradually shift from funds on accounts towards short- and medium-term deposits as deposit rates are rising to the October 2019 level (Figure 23), thus helping relieve inflationary pressure.



Sources: Bank of Russia, R&F Department estimates.



Sources: Bank of Russia, R&F Department estimates.

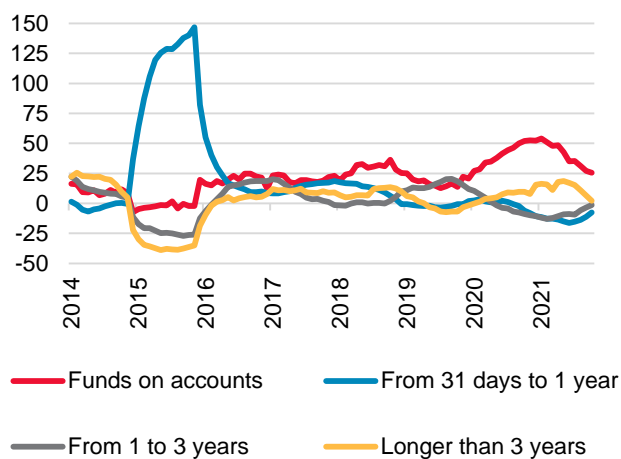
Growth in corporate customers' funds accelerated from 1.0% MoM SA to a five-month high of 2.0% MoM SA. Corporate deposit expansion may reflect the rise in deposit rates to a lesser extent, since the accumulation of funds on deposits is not a key objective of non-financial companies' business. Rather, it is, first of all, indirect evidence of an increase in their profits. This extra profit can potentially go towards wage indexation or employees' bonuses, dividends to shareholders, and fixed investment.

The share of overdue loans in loan claims continues to decline steadily as does the share of problem and bad loans (Figure 24). This may largely stem from fast loan portfolio growth. At the same time, right now banks manage to maintain both fairly strong lending activity and loan portfolio quality. [Banks' conservative loan issuance policies](#) can help prevent the build-up of new credit risks.

The banking sector's net profit came in at 231 billion rubles in October, up 37% and 31%, from the same month of 2020 and 2019, respectively. The banking sector's strong financial result is buttressed by a significant [net fee and commission and net interest income](#), driven by, above all, growth in customer loan portfolio and charges for bank card transactions, including acquiring. The banking sector's financial result is improving despite the realisation of interest

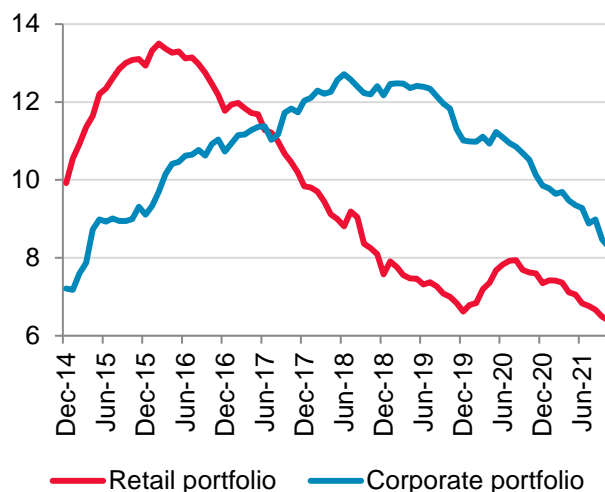
risk as interest rates rise. The realisation of interest risk is evidenced by a rise in the negative revaluation of debt securities priced at fair value.⁹

Figure 23. Household ruble funds at banks, % YoY



Sources: Bank of Russia, R&F Department estimates.

Figure 24. Share of problem and bad loans in loan claims



Sources: Bank of Russia, R&F Department estimates.

⁹ Through profit and loss and through other comprehensive income.

IN FOCUS. Lessons of the Great Inflation of the 1970–1980s for central banks

- The US Federal Reserve and Deutsche Bundesbank's experience of conducting monetary policy in the 1970–1980s, i.e., the period of rapid inflation acceleration, graphically illustrates the importance of setting an operational objective for monetary policy. This is important for securing economic agents' confidence, which is conducive to anchoring inflation expectations. Subsequently, this provides broader opportunities to pursue countercyclical monetary policy ignoring temporary pro-inflationary shocks.
- If inflation expectations fail to be anchored in the event of price shocks (even if they arise from supply-side factors) a stronger response of monetary policy may be required to bring inflation back to the target. This in turn involves heavier economic costs than those borne in conducting the kind of policy which anchors inflation expectations faster.

In 1973–1974 and 1979–1980, many countries encountered a sharp inflation acceleration stemming from steep rises in the oil price on the back of oil crises¹⁰ and food prices due to severe weather conditions and global crop failures (Figure 25). The major central banks' experience of combatting soaring inflation in those periods can be useful in developing monetary policy decisions to address the current situation, bearing in mind the largely similar nature of this surge in inflation.

The first oil shock of the early 1970s coincided in time with the collapse of the Bretton Woods system. This made the Deutsche Bundesbank, which had prior to this used a fixed rate of the Deutsche mark to the US dollar, move to the floating exchange rate (the Jamaican monetary system) and choose a new monetary policy paradigm. The Deutsche Bundesbank decided on an operational objective of money supply growth, setting a target of annual money supply expansion. This in turn required interest rates to be raised extensively. The floating exchange rate enabled the regulator to largely anchor economic agents' inflation expectations and sustainably bring down inflation in the second half of the 1970s.

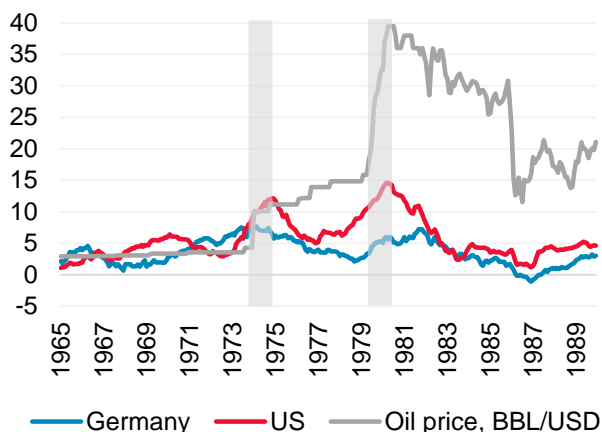
The US authorities' macroeconomic policy decisions in the 1970s were based on a consensus among the leading economists in that period who tended to view cost-push inflation as a structural problem beyond monetary policy's control.¹¹ The Fed's reaction to the first oil shock of the 1970s was to incoherently and belatedly raise interest rates (Figure 26). Moreover, this was accompanied by placing interest rate caps on savings accounts, massive budget spending on defence, large-scale social reforms, steadily significant wage growth amid strong

¹⁰ In October 1973, OPEC member countries imposed an embargo on oil exports to some countries (including the US), triggering a surge in oil prices. In 1979, the US president J. Carter cut the number of trade transactions with Iran and abolished government regulation of oil prices, sparking a stock exchange panic and a new oil price surge.

¹¹ This concept was later radically rethought, giving rise to a problem of finding a trade-off between inflation acceleration risks and economic growth slowdown in implementing macroeconomic policy measures, and those of monetary policy in particular.

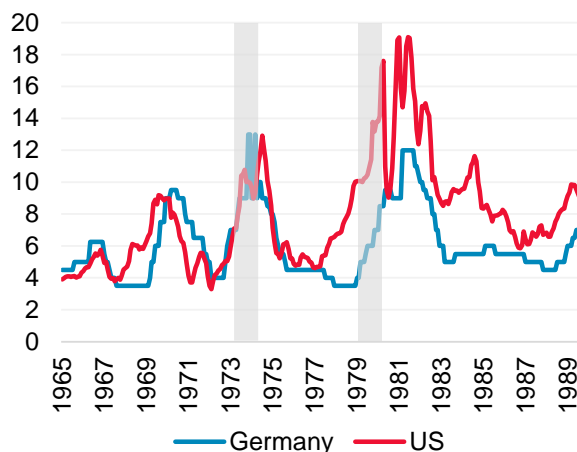
trade union activity and striving to raise the country's employment rate, as well as by price regulation which slowed the adjustment of supply to structural changes.

Figure 25. Annual inflation in US and Germany (%) and oil prices



Source: Federal Reserve Bank of St Louis.

Figure 26. Key interest rates in US and Germany, %



Sources: Deutsche Bundesbank, Federal Reserve Bank of St Louis.

One factor worsening the effectiveness of the Fed's policy in the 1970s was also the regulation of deposit interest rates effective at that time (regulation Q).¹² It used to set a cap on interest rates which credit institutions were allowed to pay on deposits. This hampered the operation of the deposit channel of monetary policy's transmission mechanism in the periods when the US Federal Reserve raised interest rates in order to curtail inflation. When inflation accelerated and interest rates were raised, nominal returns on deposits failed to rise, and economic agents received negative real returns on their funds (Figure 27). The abolishment of deposit rate regulation in the late 1970s improved the effectiveness of the transmission mechanism, which, among other things, helped address inflation problems in the 1980s as a result of change in approach to the Fed's policy after the arrival of Paul Walker.¹³

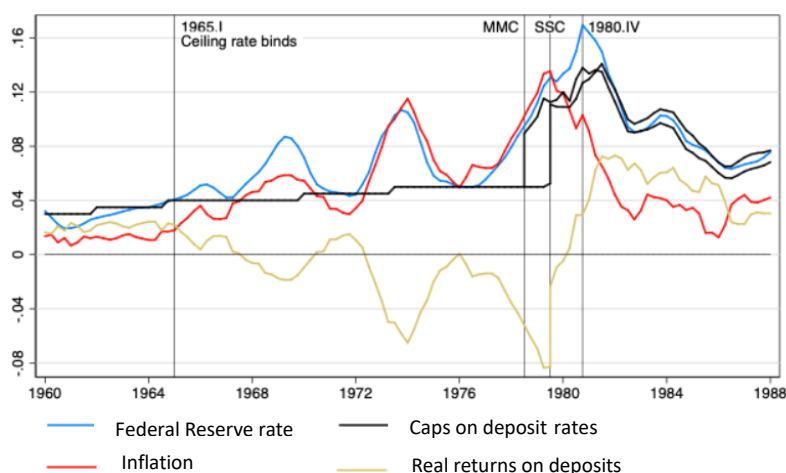
While the initial policy responses to the 1973–1974 oil price shocks were similar in the US and Germany, further interest rate and inflation dynamics were far different (Figure 25, Figure 26). After the second oil shock, both countries' central banks tightened their policies. But the consequences of the previous policy and the US Federal Reserve's low credibility gave rise to a more pronounced inflation acceleration in the US and required a much stronger reaction from the regulator: The interest rate was much higher at its peak than in Germany. But even this failed to promptly and sustainably bring down elevated inflation and devaluation expectations formed in the US, producing a greater adverse effect on GDP (including investment) and employment and a much weaker impact on inflation (Figure 28).

¹² These were the findings of Drechsler, Savov and Schnabl (2020) [The Financial Origins of the Rise and Fall of American Inflation, What really drives inflation.](#)

¹³ But since these features of US Federal Reserve monetary policy's transmission mechanism were well known, policy should have taken them into account.

A subsequent change in approach to monetary policy after the arrival of the Federal Reserve chairman Paul Walker brought down inflation, eased uncertainty and helped a fast recovery of the economy, including investment and consumer activity. However, at the initial stage, *this required an additional and even more radical interest rate increase, which, among other things played a role of a signal that the Federal Reserve was firmly committed to addressing the problem of high inflation at all costs.* All this was achieved at the cost of a significant temporary rise in unemployment above the natural rate during the first years of a tough inflation curbing policy.

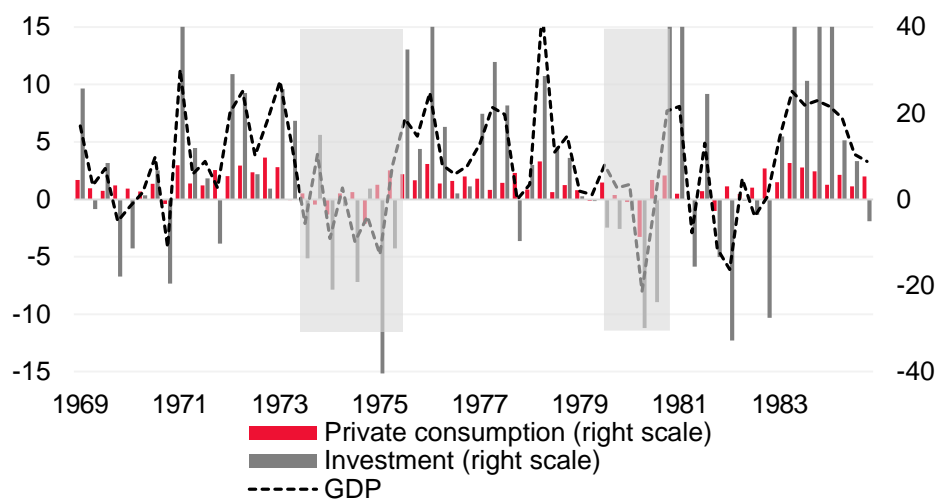
Figure 27. Federal funds rate, inflation, caps on deposit rates (regulation Q), and real returns on deposits, %



Source: Drechsler, Savov and Schnabl (2020). [What really drives inflation](#)

Thus, the experience of the 1970–1980s shows that monetary policy conducted with inflation expectations anchored reduces the need for additional actions signalling the central bank's commitment to stick to the inflation target in response to price shocks. This in turn helps bear smaller short-term economic costs in addressing the goal of maintaining price stability. In particular, this makes it possible to conduct countercyclical monetary policy ignoring transient pro-inflationary shocks. That said, the formation of anchored inflation expectations is a years-long process based on a central bank's consistent and successful efforts to achieve and maintain price stability.

Figure 28. Growth in GDP, private consumption, and investment in the US, % SAAR



Source: Federal Reserve Bank of St Louis.

Table 1. US and Germany's average indicators, %

Years	GDP growth		Growth in GDP per capita		Key interest rate		Yields of 10-year government securities	
	US	Germany	US	Germany	US	Germany	US	Germany
1960-1964	4.3	-	3.1	-	2.91	4.32	4.0	6.1
1965-1969	4.8	-	3.5	-	5.45	4.81	5.3	7.1
1970-1974	2.8	3.3	1.6	3.0	7.10	7.64	6.8	8.8
1975-1979	3.7	2.9	2.6	3.1	7.11	4.68	8.2	7.4
1980-1984	2.5	1.2	1.5	1.3	12.26	7.88	12.4	8.7
1985-1989	3.8	2.7	2.8	2.5	7.67	5.58	8.8	6.6

Sources: Deutsche Bundesbank, Federal Reserve Bank of St Louis.

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