SUMMARY OF THE KEY RATE DISCUSSION

In the course of preparations for making the key rate decision on 22 March 2024, the participants in the discussion, including members of the Bank of Russia Board of Directors, heard the reports by the Monetary Policy Department and the Research and Forecasting Department. The departments presented their assessments of economic trends and how they are consistent with the baseline macroeconomic forecast for 2024–2026 and its variations that were considered during the last core meeting on the key rate. The Bank of Russia Main Branches presented their reports on the situation in the Russian regions. 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.

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ECONOMIC SITUATION AND INFLATION

MAIN FACTS

According to recent data and surveys, at the beginning of the year, domestic demand grew faster than forecast by the Bank of Russia. Growth in real wages sped up at the end of 2023. In January 2024, unemployment declined to new lows of 2.7%, seasonally adjusted (SA). The dynamics of various inflation indicators were diverse. In February, annual inflation accelerated to 7.7% and current inflation remained at the January level of 6.3% (seasonally adjusted annualised rate, SAAR). The current growth in prices for food products and non-food goods slowed down considerably while that for services prices, on the contrary, sped up significantly. Core inflation went up from 6.8% (SAAR) in January to 7.7% (SAAR) in February, which was due to the rise in prices for outbound tourism. Concurrently, according to the Bank of Russia, most measures of underlying inflation remained in the range of 6–7% (SAAR). Inflation expectations of households and price expectations of companies edged down but remained elevated.

DISCUSSION

Taking into consideration the diverse dynamics of inflation measures, the participants discussed whether there was further progress towards the easing of inflationary pressure. Most agreed that **inflationary pressure was easing in recent months, although less markedly than at the end of 2023**. In February, core inflation increased because outbound tourism services had become more expensive. It was probably due to the fact that more consumers were booking spring and summer tours in advance, which led to accelerated price growth in this segment. Without this component, core inflation continued to decline in February. The current growth in food and non-food prices slowed down considerably. The current price growth accelerated in services, but the price movements were very diverse even in this sector. Many truncated and model-based inflation indicators calculated by the Bank of Russia continue to decrease. The participants came to the conclusion that, in January–early March, inflation movements were generally in line with the February forecast of the Bank of Russia. Nevertheless, they noted that continued high domestic demand and elevated inflation expectations could lead to greater inertia in inflation dynamics and, accordingly, to its slower decrease in the future. Therefore, **it takes time to be certain that disinflationary trends are stable and quick enough**.

The discussion participants **indicated uneven dynamics of inflation expectations of different groups of economic agents**. Households' inflation expectations declined in February–March among both groups of respondents – with and without savings. However, they still remained elevated, that is, above the levels observed when inflation was close to 4%. Price expectations of companies decreased in most industries, except retail. Analysts' expectations for inflation in 2024 and implied inflation for OFZ-IN for the next four years increased slightly. This probably demonstrated market participants' concerns about continued elevated inflation driven by expanding domestic demand. Investors also require additional information on sources of financing for additional budget expenditures announced in the Presidential Address to the Federal Assembly of the Russian Federation (Presidential Address).

A comparison of the dynamics of economic activity in 2023 Q4 and 2024 Q1 became the subject of a separate discussion. Participants agreed that **while economic growth showed signs of a slowdown at the end of 2023, it sped up again in the first months of 2024**. In addition to real-time indicators, this was evident from surveys of companies. Thus, the Bank of Russia's Business Climate Index was up to its highest value over the recent 12 years. Current estimates of companies regarding demand for and supply of goods and services improved. Expectations regarding future output and demand had been record high since May 2013. Some discussion participants expressed the opinion that the acceleration in economic growth in 2024 Q1 might be temporary.

The participants agreed that **ongoing strong dynamics in consumer activity were among major surprises at the beginning of the year**. Rosstat data on the amount of retail sales for January indicated further growth in consumption. Real-time data showed increased spending by Russians in almost all categories, except public catering (which grew quickly in past periods). The Main Branches of the Bank of Russia reported that consumer activity remained close to the high level of previous months. According to survey data, the consumer sentiment index was at its highs, and the propensity to make large purchases was growing. The discussion participants explained the high consumption by significantly increased earnings of households in 2023 Q4 and accelerated growth in consumer lending. Some participants believed that the continued rapid growth in consumer activity might be temporary and was due to the fact that people were spending bonuses received at the end of the year.

After some stabilisation in recent months, **the labour market tightness increased again**. Unemployment dropped to a new historic low. The labour force shortage continued to grow again in many industries. In the course of discussions, the Main Branches reported that a severe labour shortage in a number of industries made companies to expand their recruitment geography. Real wages were growing. It was suggested that the measures outlined in the Presidential Address to increase wages in the public sector could further stimulate wage growth in other sectors of the economy due to competition for labour resources. Eventually, an increase in labour productivity may lag further behind wage growth amid continued tensions in the labour market.

The discussion participants emphasised a number of high-frequency and indirect indicators that could evidence **ongoing high investment activity at the beginning of the year**. First, domestic production of investment goods increased. Second, investment imports remained high. The participants noted that the investment-driven phase of economic growth would be continued, which would be accompanied by a higher share of investment in the GDP structure in the coming years.

The participants agreed that the current situation in the labour market and the domestic demand trends indicated **a persistently significant positive output gap**. However, estimates of its scale depend on estimates of the level of potential, the expansion of which may also contribute to some extent to the current strong growth of the Russian economy. Significant investment and the eventual creation of new capacities, productivity growth, and the use of new technologies could boost economic potential. **Estimates of the output gap remain a significant uncertainty factor**. These estimates may be clarified after the publication of updated quarterly GDP data for 2021–2023 and new high-frequency data on economic activity for the first months of 2024.

The discussion participants agreed that **the degree of influence of additional budget expenditures on inflation would depend primarily on the sources of their financing**, i. e. the ratio between tax revenues and borrowings. The impact of the announced measures may be assessed after publishing specific parameters of the changes. It was noted that fiscal policy would continue to have a significant impact on the conditions of monetary policy implementation.

MONETARY CONDITIONS

MAIN FACTS

Monetary conditions tightened. Since the February meeting, the OFZ (federal government bonds) curve has moved upwards. Real OFZ-IN (inflation-indexed federal government bonds) yields reached a new historical high. Interest rates were still rising in the credit and deposit markets. A significant inflow of household funds into banks continued. In January–February, there were signs of a slowdown in lending activity, although it was uneven. The dynamics of corporate lending were moderate. As compared to the end of the last year, the slowdown in the mortgage segment of the market was caused by a reduction in the issuance of loans both on market terms and within the framework of subsidised programmes. Nevertheless, the issuance of subsidised loans was at the level of the beginning of 2023. Unlike corporate and mortgage lending, the monthly growth rates of unsecured consumer loans and car loans remained high.

DISCUSSION

The participants discussed **the reasons for the continued monetary tightening** since the February key rate decision. In the OFZ market, the increase in yields was associated with two main factors: first, with expectations that the current key rate would be kept at the same level for a longer period after the February decision of the Bank of Russia Board of Directors; second, with changes in expectations regarding fiscal policy, as the market was waiting for more detailed information about the sources of financing for additional budget expenditures. Growing rates in the credit and deposit markets demonstrated the ongoing adjustment of interest rates to previously made decisions on the key rate.

The discussion participants agreed that **lending activity was slowing down in general, but so far unevenly**. In addition to monetary policy, one-time factors and existing subsidised programmes have a significant impact on lending dynamics. These factors limit the slowdown in lending to levels consistent with balanced economic growth.

- Some **cooling in lending activity in the corporate segment** at the beginning of the year was associated both with tighter monetary conditions and with companies receiving payments under existing public procurement contracts and advancing new ones. If, before 2022, the main budget expenditures were made at the end of the year, now significant advance payments from the budget are made at the beginning of the year. This allows companies to repay previously received loans and take out less new ones.

- **Companies remain resilient to high interest rates**. High profit (net financial result) gives companies a greater safety cushion and the ability to service debt even despite high interest rates. In addition, an analysis of companies that submitted updated IFRS financial statements shows decreased sensitivity to interest rate risks.

- **Mortgage lending is expanding more slowly than in the autumn months**. In the market-based mortgage segment, this is associated with rising interest rates, whereas in subsidised lending – with tighter conditions of government subsidised programmes. Nevertheless, the amount of subsidised mortgage loans issued remains high – at the level of the same period of 2023.

- **Unsecured consumer lending continued to grow at a high pace (above the Bank of Russia's forecast), which was a great surprise** for the discussion participants. They noted that the further growth in incomes and consumer sentiment allowed households to receive more loans despite rising interest rates. The strong growth in unsecured consumer lending is reflective of high consumer activity.

- In the car lending segment, high growth rates in February could be fuelled by the resumption of government subsidised lending programmes and incentives offered by car manufacturers and dealerships. In addition, **one-time factors could contribute to the increased demand for car loans**: the expectation of higher car prices after a change in the procedure for calculating the recycling fee from 1 April 2024, as well as sales of cars at lower prices at the beginning of the year, including due to high stocks accumulated earlier. According to the discussion participants, in the future when these factors gradually disappear, more moderate growth in car lending could be expected.

Saving activity remains high. Retail deposits usually are down at the beginning of the year. But in January 2024, they decreased less compared to January last year. In February, the reduction was followed by steady growth: both current accounts and time deposits (mainly up to one year, as usual) grew. During the discussion, it was noted that there was a rather atypical situation in which, **amid high income growth rates, households were simultaneously increasing both consumption and savings**. At the beginning of the year, additional incentives were available due to significant indexation of social payments and traditional end-year bonuses. The participants noted that increased savings would be a preferable option to achieve a more considerable slowdown in inflation. A decrease in inflation expectations from current elevated levels will further stimulate interest in savings.

The participants **discussed in detail estimates of the degree of monetary tightness**. On the one hand, when comparing with past periods of elevated inflation, the current levels of real rates may be estimated as high. On the other hand, the current economic situation is different. In past periods, disinflation was occurring in conditions of fairly rapid normalisation of fiscal policy. This enabled a quick reduction in the key rate after passing the peak of inflation. Now inflation is slowing down amid a significant fiscal impulse that is being reduced slowly. Subsidised programmes have a distorting effect on lending interest rates. Due to the persistent continuation of elevated inflation and inflation expectations, disinflation may require higher real interest rates. Hence, **a higher level of real interest rates than those that previously helped maintain low inflation is required in the current situation for a consistent return of inflation to the target**. The discussion participants also noted that if monetary conditions had been indeed excessively tight, this would be seen in the dynamics of some indicators: there would have been an immediate slowdown in lending and consumption. However, this has not happened yet.

The participants agreed that **taking into consideration transmission lags and the current monetary policy stance, monetary conditions would tighten in the coming months and the impact of such conditions on savings and lending activity would become more profound**. During the year, additional monetary tightening will be supported by factors independent of monetary policy, which were mentioned during the February key rate meeting: the expected transition of the banking system from a structural liquidity surplus to a liquidity deficit, the cancellation of most regulatory easing measures for banks (primarily as regards the compliance with the liquidity coverage ratio), macroprudential policy measures.

EXTERNAL ENVIRONMENT

MAIN FACTS

Global economic growth and inflation are higher than expected. The US economy is growing faster than expected. Growth in the euro area and China is roughly in line with expectations. Price growth sped up in early 2024 in many countries, including the United States and the euro area. In China, inflation moved from negative territory for the first time since September amid a revival in consumer demand. Prices for most Russian export goods and their quantities have increased since the February key rate meeting. After a decline at the beginning of the year, the total value of imported goods recovered in February to approximately the February 2023 level.

DISCUSSION

The discussion participants noted that if earlier the situation in the global economy had been improving only in services, now it shows an improvement in the industrial production. This has led to a rise in prices in commodity markets and supported Russian exports. However, despite high economic activity, there is no rapid and sustainable inflation decrease worldwide so far. This may slow down monetary policy easing by key central banks.

There is still high uncertainty regarding the future dynamics of exports and imports.

- On the one hand, recent data indicate some adaptation of the Russian economy to the additional complications with payments and logistics: exports are recovering, and foreign exchange earnings are increasing. The decline in exports of petroleum products due to accidents at refineries and the introduction of restrictions on petrol exports may be largely offset by an increase in crude oil exports. On the other hand, the effects of sanctions may still develop and make a restrictive impact on foreign trade.

- The discussion participants highlighted the resumption of import growth in February amid strong domestic demand. They emphasised that opportunities for financing imports were limited by a decline in Russian exports due to sanctions and a significant reduction in the ability to raise foreign capital for Russia. The discussion participants agreed that maintaining tight monetary conditions would support more balanced import dynamics.

The participants believe that changes in prices and export quantities remain a significant risk to movements in the ruble exchange rate. The fiscal rule mechanism helps compensate for the impact of crude oil price fluctuations on budget revenues and exchange rate movements. However, the impact of changes in other export prices may not be softened by the fiscal rule.

INFLATION RISKS

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

Among the main **proinflationary risks**, the discussion participants highlighted the following:

- *High and unanchored inflation expectations sensitive to short-term rises in prices for certain goods and services*. This may entail secondary effects in the inflation dynamics.

- *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 with high demand for imports may create risks for the ruble exchange rate and inflation dynamics.

- *Increasing labour market tightness.* A further increase in the labour shortage may lead to even a larger gap between labour productivity and growth in real wages. Eventually, amid the high utilisation of production capacities and labour shortages, the imbalance between the dynamics of supply and demand will increase. This will result in continued high inflationary pressure or its growth.

- *Longer period of fiscal policy normalisation.* Currently, the main uncertainty is associated with the sources of financing for additional budget expenditures.

- *Lending within government subsidised programmes, which will weaken the functioning* of the monetary policy transmission channel, if the amounts of such lending remain significant.

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 pressure in the economy might be weaker.

CONCLUSIONS FOR MONETARY POLICY AND THE KEY RATE DECISION

Taking into consideration the data obtained after the February key rate decision and the assessment of the development of the situation as regards the February forecast of the Bank of Russia, the discussion participants only **considered keeping the key rate at 16.00% per annum**. The key arguments in favour of this decision were the following:

- *There is no certainty about the speed of further disinfltion yet*. Current price growth remains high, whereas measures of underlying inflation are in the range of 6–7% (SAAR). The surprise of the past period was the trends in consumption and unsecured consumer lending. Significant growth in incomes helps households to simultaneously save and spend more. This may accelerate the inertia of inflation, especially in its underlying component.

- *Monetary conditions have not yet fully adjusted to the previous key rate increases.* Adjustments of lending amounts will continue in the coming months. Monetary conditions will also become tighter due in part to an increase in real interest rates, taking into consideration the decline in inflation expectations of households and businesses since the beginning of the year. Maintaining the key rate level will ensure the necessary tightness of monetary conditions to return inflation to the target in 2024.

- *The risks from a premature key rate cut may be significant*. Economic agents may adjust their expectations towards a too fast reduction in interest rates. This may result in a rapid decline in the propensity to save, an easing of monetary conditions and, as a consequence, a further increase in demand and inflation. The experience of other countries shows that a premature reduction in interest rates leads to a second wave of inflation, which is even more difficult to curb than the first one. Such an untimely reduction may require that the monetary authorities raise the key rate again and much higher at a later date.

The participants discussed in detail **the signal about the future key rate path**. There was a general consensus on the need to follow the guidance to maintain tight monetary conditions in the economy for a long period. Nevertheless, some participants also expressed opinions about the need **to give additional guidance on possible changes in the key rate at the coming meetings**.

The participants who proposed to give **a signal about the advisability of raising the key rate at the next meetings** provided the following key considerations:

- *There is no persuasive evidence that disinflation has gained sufficient momentum.* Proinflationary surprises in data on the labour market, consumer demand and consumer lending may suggest that the scale of the positive output gap is underestimated. The risks that underlying inflation will remain at the current elevated level or go up are significant. This may require a higher key rate to return inflation to 4%.

- *As inflation has mainly been above the target for more than three years, there may be risks to the credibility of monetary policy if the inflation target is reached later than forecast.* An undermined credibility may lead to sustainable growth in inflation expectations, a reduction in the planning horizon for households and businesses, and a deterioration in the prospects for long-term economic growth.

Those discussion participants who spoke in favour of **a signal about the advisability of lowering the key rate at the coming meetings** provided the following arguments:

- *The necessary tightness of monetary conditions has been achieved.* It depends not so much on the level of nominal rather than on the level of real interest rates. If actual inflation continues to slow down steadily and inflation expectations decline among a broad range of economic agents, monetary conditions may quickly tighten in real terms. Maintaining the same level of tightness of monetary conditions (in real terms) will be possible only with a gradual reduction in the key rate level.

- *Inflation, especially its underlying component, is below the levels that were observed when the key rate was raised to 16.00% per annum in December 2023.* If disinflationary trends continue and inflation expectations decline further on, this creates space for a key rate reduction at the next meetings, which needs to be mentioned in the signal.

As a result of the discussion, a consensus was reached that **at the March meeting there should be no additional guidance regarding changes in the key rate level at the coming meetings**. The majority of the discussion participants agreed that uncertainty regarding the further development of the situation in the economy remained high. At the current stage, a signal about a key rate decrease may result in a premature easing of monetary conditions. In addition, a softening of the signal in a situation with no confidence in the speed of a further decrease in inflation, while domestic demand continues to grow rapidly, may pose significant risks to credibility and lead to a rise in inflation expectations. In turn, a signal about a key rate increase may lead to an additional, excessive tightening of monetary conditions, while their adjustment to the previous key rate increases has not been completed yet. It takes time to assess the stability and speed of emerging disinflationary trends and their compliance with the February medium-term forecast.

The participants additionally discussed **what situation could lead to a key rate decrease or increase**. According to the discussion participants, to reduce the key rate, the following conditions are required: a further sustainable slowdown in current inflation, cooling of consumer lending and consumer activity, a reduction in labour market tightness, a lack of materialisation of proinflationary risks posed by budget expenditures or external conditions. An increase in the key rate in turn may be caused by inflation anchoring at the current level (especially in its underlying component) or its rise, the absence of signs of a decline or further increase in consumer activity, higher labour market tightness and a larger scale of the positive output gap in the economy, the materialisation of other proinflationary risks threatening the return of inflation to the target in 2024.

Following the discussion, **on 22 March 2024, the Bank of Russia Board of Directors made the decision to set the key rate at 16.00% per annum from 25 March 2024**. The Bank of Russia Board of Directors also deemed it appropriate to **keep the signal about the need to maintain tight monetary conditions in the economy for a long period** without giving additional guidance on possible further steps to change the key rate at the coming meetings.