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Executive summary

Monthly summary

- Recent statistics suggest that the Russian economy continues to grow – despite the slight slowdown seen at the end of 2023. Business expectations for 2024 remain optimistic. Expanding consumer demand was constrained by a slowdown in retail lending, coming on the back of rising rates and tightened macroprudential limits. This was also helped by households' bank deposits growing at an accelerated pace, in particular time deposits for up to one year, thanks to their attractive rates. As a result, price growth between December and January moderated. Having said that, it is still high. This can be clearly seen in the more persistent components of inflation, which in December-January suggested there were early signs of abating inflationary pressures. Both household and corporate inflation expectations are still elevated. In coming months, the recently made monetary policy decisions are set to enable a gradual slowdown in inflation processes and ensure the economy is back on a balanced growth and low inflation path.

  - Effective demand in the domestic economy is still outpacing the supply of goods and services. However, consumer demand growth, fuelled by rising wages and incomes, on the one hand, and strong retail lending, on the other hand, appears to be slowing as savings incentives strengthen. Current labour shortages and production facilities running close to full capacity are likely to drive growth in wages more than in output, which is a factor working to sustain increased inflationary pressures.

  - In December–January, seasonally adjusted consumer price growth showed a marked slowdown. However, that was in large part driven by temporary disinflationary factors in the markets for individual goods and services as well as a stronger ruble – rather than a decline in overall inflationary pressures. For example, the indicators that characterise the more persistent components of price growth diverged in December.

  - The slowdown in price growth in January had benign effects on the OFZ market where long-term government securities put in notably lower yields. This was further helped by a conservative stance of the Russian Finance Ministry in relation to the placement of new issues. As a result, the inverse trend of OFZ yield curves (yields on long-term securities are lower than medium-term (2+ years) ones) was the most pronounced in the current cycle of monetary tightening.

In focus. Economic performance beat expectations in 2023

- As in 2022, the Russian economy in 2023 showed resilience to shocks, starting to grow and surpassing the level of early 2022. Thus, it beat the expectations of analysts, forecasting at the start of 2023 its contraction for the year.

- Domestic demand expansion consistently accelerated throughout 2023, buttressed by the fiscal and credit impulse, which offset the external demand contraction. But as business activity and the economy's structural transformation gained pace, the utilisation of domestic production factors, mainly labour, expanded. Amid limited labour supply, this helped wages to grow and unemployment to hit all-time lows.

- Inflation was notably above analysts and professional market participants' expectations for the year. At the root of it were a fast recovery of domestic, including consumer, demand, household sentiment improvement, buoyant consumer lending, as well as ruble weakening on the back of a larger-than-expected balance of trade shrinkage.

1. Inflation

December 2023 – January 2024 saw a disinflationary trend emerging in the consumer segment. It is so far more apparent in overall price movements than in the performance of various analytical indicators portraying persistent inflationary pressure. Ruble stabilisation and strengthening driven largely by monetary policy tightening helped ease pressure in consumer prices heavily dependent on the exchange rate at a faster pace.

Therefore, the transmission of the key rate rises into price moves is becoming increasingly notable. As a result, price growth, which so far remains above 4% in annualised terms, will decelerate at an even faster rate.

How can the disinflation process combine with the continuing acute shortage of labour in the economy, making employers raise wages at a faster pace than that of productivity growth? Firstly, the retail lending growth slowdown, which is already in evidence, will curtail additional debt-funded household demand for, above all, durable goods. Secondly, double-digit interest rates on bank deposits have made the latter attractive to households. As a result, a fast buildup of funds in time deposits is continuing. Therefore, a larger proportion of wage and household income growth is being saved in bank deposits and the instruments of money and financial markets.

As a result, savings and the savings ratio are rising, with consumption growth slowing and inflationary pressure easing. It is obvious that in order to maintain a high savings ratio essential to disinflation amid a labour shortage in the economy and to financing investment expansion, the attractiveness of interest rates on savings instruments needs to be maintained. Which requires a tight monetary stance to be kept up.

1.1. Gradual easing of persistent inflationary pressure

- The pace of consumer price rises notably slowed in December–January. They are, however, still far above 4% in annualised terms.

- It is too early to claim that we are witnessing a sustainable trend towards a price growth slowdown. The pro-inflationary impact of temporary factors, which, among other things, significantly contributed to price growth acceleration in the second half of 2023, has given place to their disinflationary effect. In addition, downward pressure on prices was exerted in December by factors of technical nature, such as the seasonality of new components in domestic tourism services and pass-through of price indexation to passenger transport services.

- Household and business inflation expectations remain elevated. The recent monetary policy tightening is yet to have a full effect on demand and prices.

Consumer price growth significantly slowed in December and the first half of January relative to previous months, coming in at 6.5% MoM SAAR after 10.2% MoM SAAR in November and an average of 11.3% MoM SAAR over the autumn months. A slowdown was registered in all enlarged categories but was the most notable in services. Annual inflation

edged down to 7.4% from 7.5% in November (Table 1, Figure 2). Month-on-month price rises slowed in January, while annual inflation stood at 7.3%[1] as of 29 January.

Table 1. Inflation and its components

	Dec.	Dec.	Oct.	Nov.	Dec.
	2021	2022	2023		
% YoY					
All goods and services	**8.4**	**11.9**	**6.7**	**7.5**	**7.4**
Core inflation	**8.9**	**14.3**	**5.5**	**6.4**	**6.8**
Food	10.6	10.3	6.0	7.2	8.2
Non-food goods	8.6	12.7	5.1	5.6	6.0
Services	5.0	13.2	9.9	10.4	8.3
% MoM SAAR					
All goods and services	**8.8**	**5.6**	**9.4**	**10.2**	**6.5**
Core inflation	**8.3**	**0.3**	**10.9**	**12.0**	**5.5**
Food	8.1	-0.5	12.5	12.7	8.8
– net of fruit and vegetables	**11.7**	**-1.5**	**13.8**	**10.9**	**8.2**
Non-food goods	8.2	0.8	5.7	6.0	5.3
– net of refined petroleum products	**8.0**	**0.8**	**9.9**	**8.4**	**6.3**
Services	10.6	22.4	10.0	12.2	5.1
– net of housing and communal services	**15.2**	**12.0**	**10.3**	**13.6**	**5.5**

Sources: Rosstat, R&F Department estimates.

**Figure 1. Price rises corresponding to an inflation rate of 4%, % MoM**
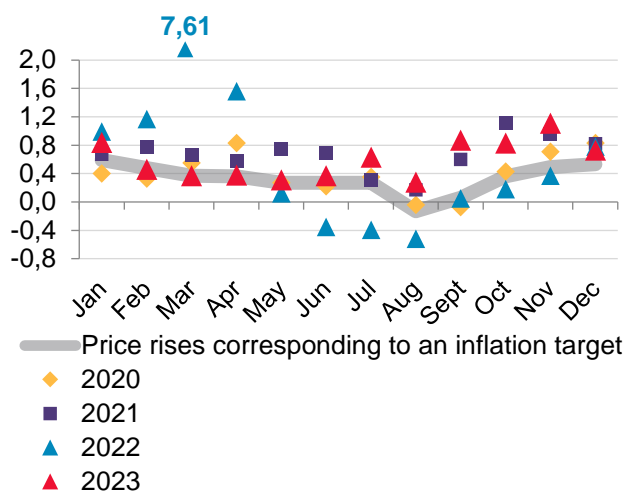
Sources: Rosstat, R&F Department estimates.

The pace of food price rises eased to 8.8% MoM SAAR in December from 12.7% MoM SAAR in November. A slowdown was registered in seasonally adjusted fruit and vegetable price growth. Net of this category, food price rises also decelerated, but less significantly, to 8.2%% MoM SAAR from 10.9% MoM SAAR, driven chiefly by a reversal of meat product price moves (chicken meat prices went down 1.9%). Egg price hikes gained pace substantially, driven by elevated seasonal demand and limited supply. By mid-January, however, a seasonal drop in demand and supply expansion thanks to, among other things, imports, led prices to inch down. That said, market participants do not expect prices to drop considerably from their current levels, since foreign suppliers' purchase prices are little different from those in Russia.

The non-food segment saw price growth slow to 5.3% MoM SAAR from 6.0% MoM SAAR in November. The picture was mostly the same across components. That said, the prices of refined petroleum products stopped declining. Based on weekly data, retail fuel prices resumed growth in late December. Exchange (wholesale) prices began to climb again at the start of the year, which may have stemmed from petroleum refining output contraction after an equipment breakdown at a major refinery. Market participants do not, however, expect notable price growth in the short term, given a seasonal drop in demand, strong output, and inventories accumulated after export restrictions were imposed in the autumn. The resumption of full payments under the damper mechanism also limits the potential of price rises in refined petroleum products. After November's sale campaigns were over, the pace of price growth in most electrical goods and household appliances remained moderate. Amid ruble strengthening and exchange rate stabilisation in November, the median of price rises in goods highly sensitive to exchange rate movements also stabilised late in the year at notably lower levels than in August–October (Figure 4).
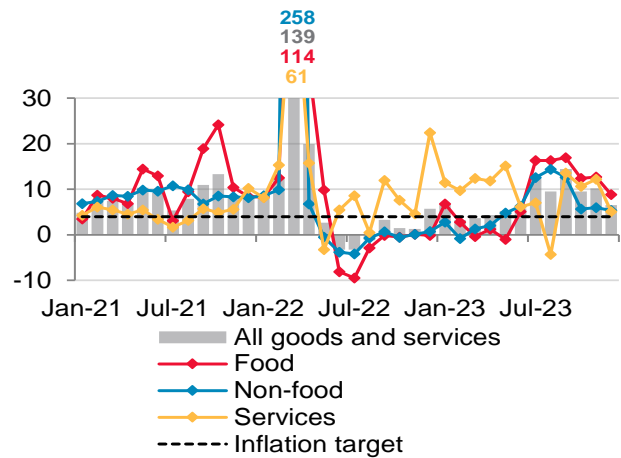
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[1] All estimates for 2024 use the weights and composition of the 2023 consumer basket.

**Figure 2. Inflation and its components, % YoY**
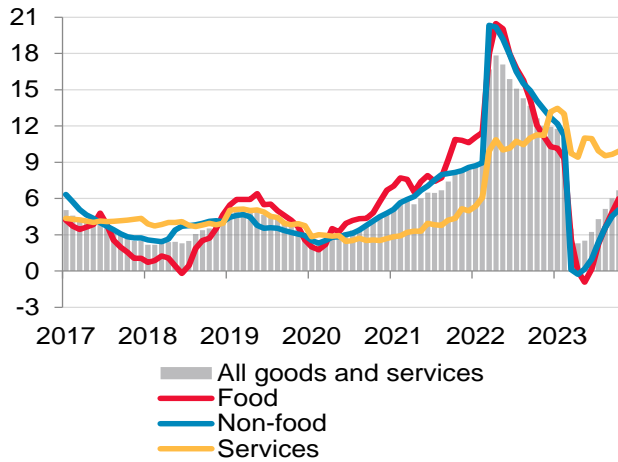
Sources: Rosstat.

Figure 3. Seasonally adjusted price growth, % MoM SAAR

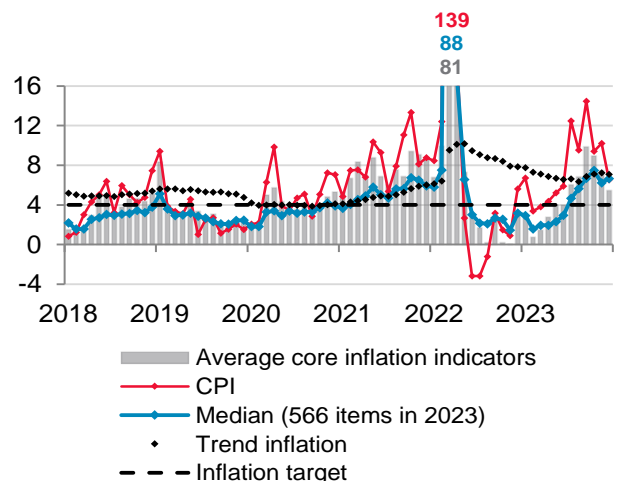*Sources: Rosstat, R&F Department estimates.*

Services price rises sharply slowed to 5.1% MoM SAAR in December from 12.2% in November. The resumption of price growth in foreign tourism services was offset by a drop in the prices of domestic vacation services. The largest contribution to a fall in domestic tourism prices came from a reduction in the prices of travel to the Black Sea coast, which was included in the calculation of the consumer basket price starting only as late as 2023. This price decline seems to be seasonal in nature, while a reliable estimation of the seasonal factor is problematic because of a small number of retrospective observations. The slowdown of services price growth is also owed to passenger transport: air and rail travel became less expensive (after an earlier than usual price indexation in the preceding month[2]). Net of tourism, air and rail transport, services price rises also slowed 6.5% versus 11.1% a month earlier. This came on the back of slower price hikes in housing leasing and a number of household services.

Figure 4. Median CPI (% MoM SAAR) and US dollar to ruble exchange rate (%)
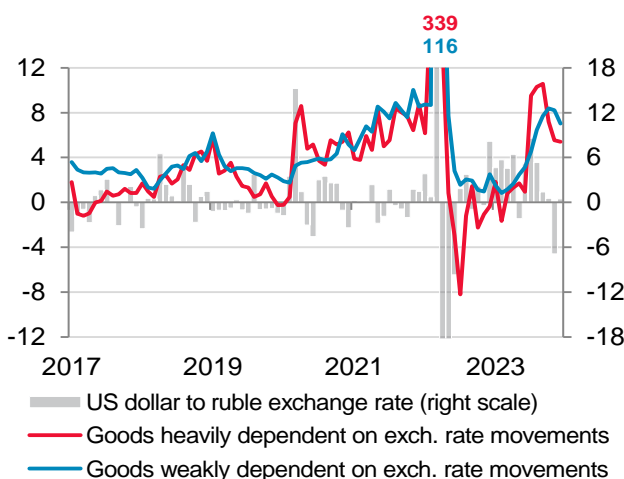
Sources: Bank of Russia, Rosstat, R&F Department estimates.

Figure 5. Modified core inflation indicators* (% in annualised terms) and trend inflation estimate (%YoY)


* Indicators are computed using the method of excluding the most volatile components and the truncation method.
Sources: Rosstat, R&F Department estimates.

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[2] November observations included travel with departure dates at the end of December, i.e., the planned time of Russian Railways' price indexation.

Figure 6. Aggregate weight of goods and services* distributed based on seasonally adjusted price growth

■ Price decline
■ Moderate price growth (0-4% in annualised terms)
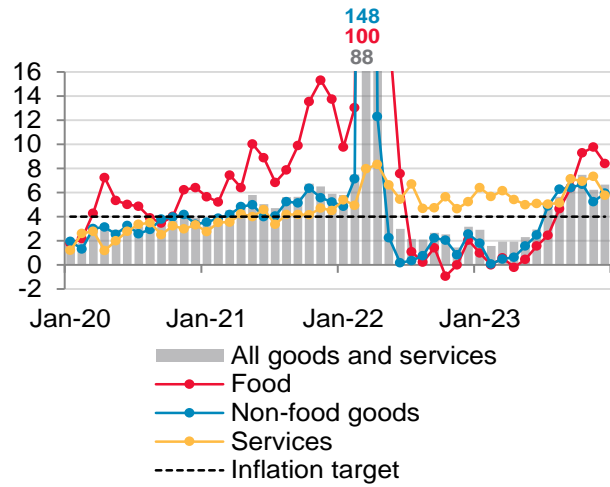■ Accelerated price growth (above 4% in annualised terms)
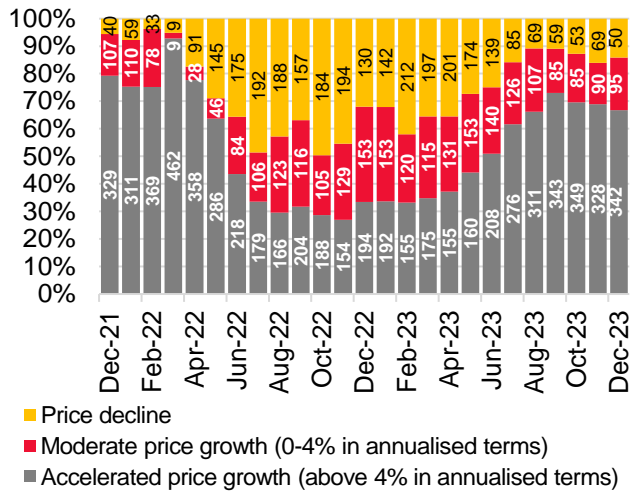
*Net of fruit and vegetables and regulated services.

Note. The figures represent the number of items.

Sources: Rosstat, R&F Department estimates.

Figure 7. Distribution medians calculated on disaggregated components*, % MoM SAAR

▭ All goods and services
— Food
— Non-food goods
— Services
------- Inflation target

* 566 items in the 2023 basket

Sources: Rosstat, R&F Department estimates.

The analytical indicators of price movements suggest some easing of inflationary pressure, but much lesser in scale than a slowdown in the rise of the headline CPI. The estimate of trend inflation in a five-year interval decreased to 7.08% from 7.24% in November, remaining elevated. That said, the decline is mainly technical in nature, owed to the departure from calculation of accelerated price rises in December 2018. By contrast, the estimate in a three-year interval somewhat rose to 8.12% from 8.09% in November. Modified core inflation indicators continued to decline (Figure 5). The weight of items whose prices are rising at an accelerated pace continues to slowly dwindle (Figure 6). The median distribution of price rises, however, went up at the same time. These estimates generally bear out that the price growth slowdown is gradual in nature and unsustainable.
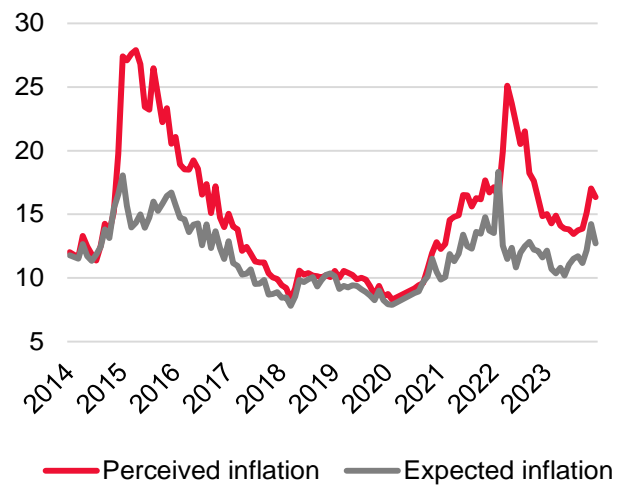
Figure 8. CPI and PPI, three-month rolling average, annualised, %

▭ Consumer prices
— Manufacturing*
— Manufacture of food products and beverages
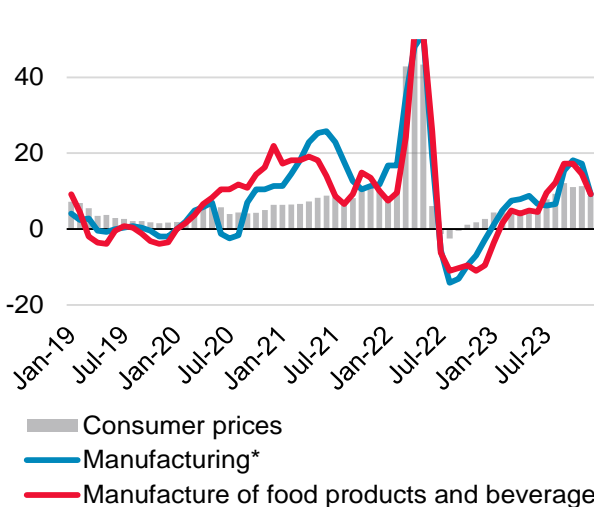
*Net of manufacture of base metals and refined petroleum products.

Sources: Rosstat, R&F Department estimates.

Figure 9. Direct estimates of annual inflation, median values, % YoY

— Perceived inflation   — Expected inflation

Source: inFOM.

Producer price rises in manufacturing (net of manufacture of base metals and refined petroleum products) came to a halt in December (Figure 8). Based on December's S&P Global poll data, pressure from costs abated but risks remain. Companies were reporting strong domestic demand and continued to expand employment. The Bank of Russia's Monitoring of Businesses shows similar results: companies' price expectations rose marginally amid strong demand, with business activity continuing to climb. The assessment of expected demand growth slightly declined, which was in part reflected in an adjustment of production and hiring plans. Given the above, price expectations will be going down throughout 2024 as the effect of monetary stance tightening gradually makes itself felt.

At the start of January, price growth slowed relative to December, prices climbed 0.62% over the 1–29 January period, with December trends mostly continuing across individual components. The food segment net of fruit and vegetables saw price growth slowdown continue. Price rises remain moderate in non-food goods, fuel price growth posted since late December is still in evidence. Despite a substantial deceleration of price growth in the monitored basket (net of fruit and vegetables and regulated prices), the median distribution and the weight of items with an accelerated price growth remained elevated (Figure 10), suggesting a substantial input of some components.

A price growth slowdown in December–January was largely driven by a reversal of temporary factors' effects from pro-inflationary to disinflationary and by one-off factors. We are, however, witnessing a rise in households' pro-savings sentiment and some cooling of consumer lending. Real-time indicators of consumer activity (SberIndex, Romir) remain at a high level amid confident wage growth and high inflation expectations (Figure 9).

Therefore, the effects of monetary policy tightening are translating into the economy, but more slowly than could be assumed based solely on the performance of the headline CPI.
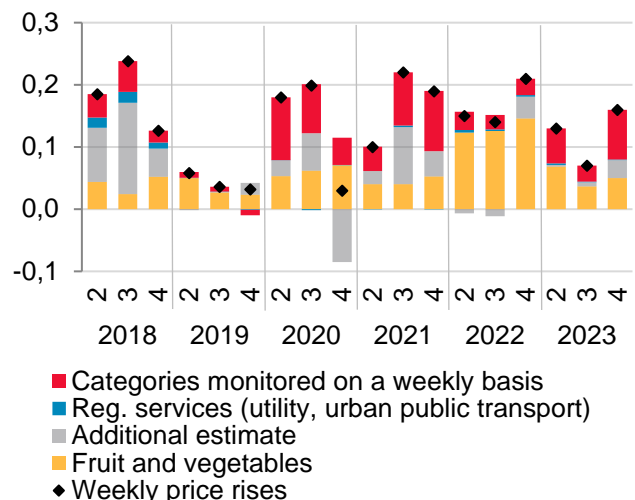
Figure 10. Price growth and median distribution of weekly price increases, %

Rise in monitored basket*
Median of monitored basket
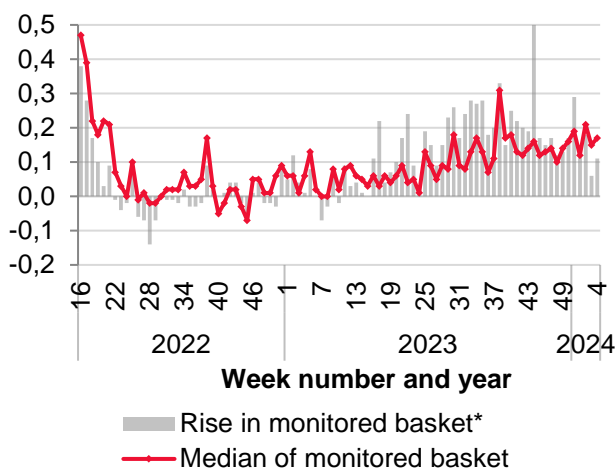
Note: The calculation is based on an enlarged list of goods and services net of fruit and vegetables and regulated services.

Sources: Rosstat, R&F Department estimates.

Figure 11. Decomposition of weekly price rises, pp

Categories monitored on a weekly basis
Reg. services (utility, urban public transport)
Additional estimate
Fruit and vegetables
Weekly price rises

Sources: Rosstat, R&F Department estimates.

2. Economic performance

Based on real-time indicators, economic growth continues, despite some slowdown late in the year. Overall, business expectations for 2024 have remained upbeat.

All in all, it can be said that the economy is adjusting to the tight monetary stance. This process may be accompanied by temporary rises in the volatility of economic performance indicators.

One can expect a household consumption growth slowdown for 2024, with real wage and income expanding at a faster pace. Some slowdown in gross capital formation growth is also likely. But public procurement, subsidised investment lending programmes for priority sectors and projects, and niches left vacant in the goods and services market after foreign producers and suppliers' departure will help expand investment. It appears that imports stabilised after a drop, following ruble appreciation. Given the global economy's weakness in 2024, Russian oil and gas exports will, in terms of value rather than in physical terms, primarily depend on price movements in global markets and the level of discount for Russian goods.

2.1. First signs of slowdown in economic activity growth

- Rosstat's estimate of GDP by end use released at the end of last year borne out preliminary estimates of growth acceleration in Q3 2024.[3] Household consumption came as the key driver, while the input of expenditure for public administration and investment was more moderate. Given a substantial upward revision of 2021–2022 GDP (see the section In Focus), this means that the economy's aggregate output did not only exceed the pre-crisis levels but also deviated from the balanced growth trajectory even further upwards than earlier estimated.

- Real-time data suggest growth continuation in Q4 2023, but a number of indicators point to its slowdown relative to Q3. Indeed, a more moderate business activity expansion is evidenced by incoming flows of the Bank of Russia's payment system (Figure 12), PMI indices (Figure 14), and an optimism drop in industry shown by Institute for Economic Policy surveys.[4]

- The Core Industries Output Index also started to slide in October (Figure 13). But, according to our estimates, this arose solely from the shift of the harvesting season to the third quarter due to favourable weather conditions, which led to agricultural output contraction in the fourth quarter. Exclusive of this factor, core industries' output continued to rise in the autumn months. Growth even marginally accelerated in November, driven by a turnaround of industry and construction's output, but was slower than Q3.

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[3] To 1.8% QoQ SA from a rise of 1.2% in Q2, according to an R&F Department estimate.

[4] This indicator shed 8 points over the past two months on the back of downward revisions to all of companies' plans and forecasts. That said, a rise in all of industry's indicators will continue based on companies' estimates.

- In industry, mining and quarrying output was stable for many months in a row, while manufacturing output shows month-to-month volatility. That said, Q4 2023 saw overall stabilisation after growth for most of 2023 (Figure 15). This output pattern is seen across all enlarged groups of industries in the manufacturing sector.

- November's rise in key metrics of consumer demand was also close to 2023 lows (Figure 17). Some cooling of consumer activity was mostly owed to a savings ratio increase: the pace of household deposit growth accelerated to 2023 highs,[5] while divergence between the pace of labour income increase and that of consumption widened (Figure 18). Monetary and macroprudential policy tightening also caused retail lending expansion to slow.

- That said, real wage growth accelerated to levels deemed high on a historical scale, up 1.3% MoM SA. This reflected the strengthening of employers' competition for personnel amid the limited labour supply (Figure 20). Unemployment hit an all-time low again (Figure 19).

- Aggravation of the skilled industrial labour shortage in January and accelerated job creation in late 2023[6] give reason to expect wages to continue climbing in the short term, with potential for expanding the supply of goods and services at a rate needed to meet demand lacking. This may require maintaining tight monetary conditions for a long time in order to keep up a high savings ratio and to cool pro-inflationary pressure from domestic demand.

Figure 12. Incoming payments growth[7] relative to the previous quarter average weighted by industries' shares in gross value added, seasonally adjusted, %
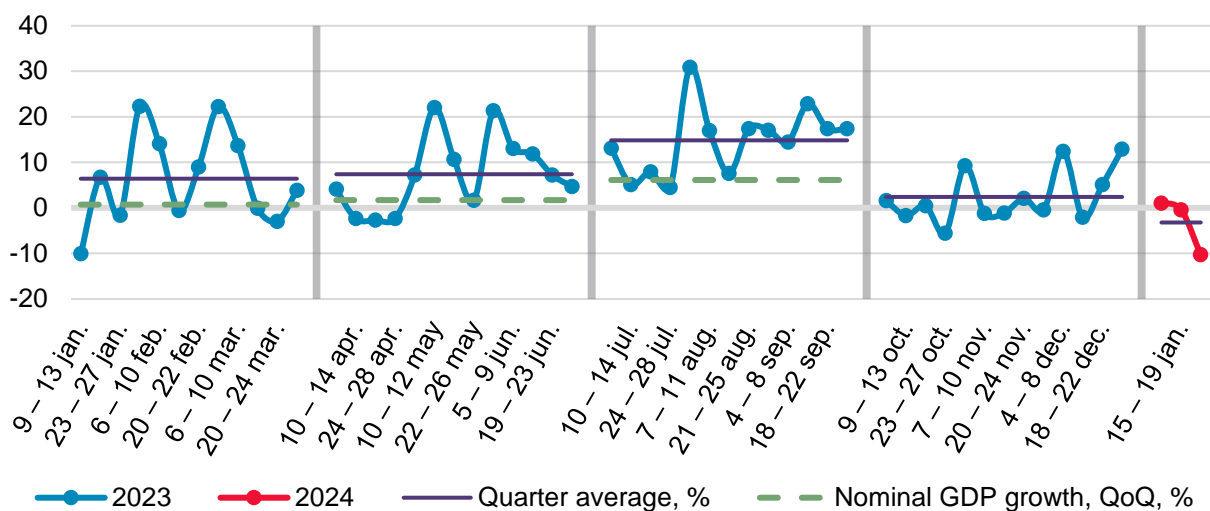

Sources: Bank of Russia, Monitoring of individual industries' financial flows.

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[5] To 3.3% MoM SA in December from 2.6% in November.

[6] Based on December's PMI poll, companies of the manufacturing and services sectors posted a rise in employment, with the pace of job creation accelerating to the highest level since June.
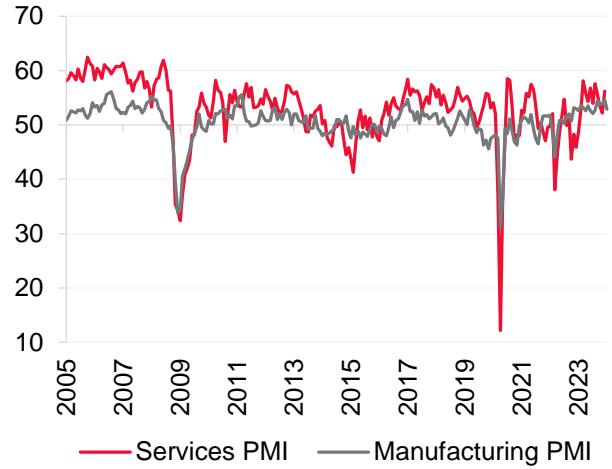
[7] Growth means a percentage change in the value: $g = \frac{(x_1 - x_0)}{x_0} * 100$.

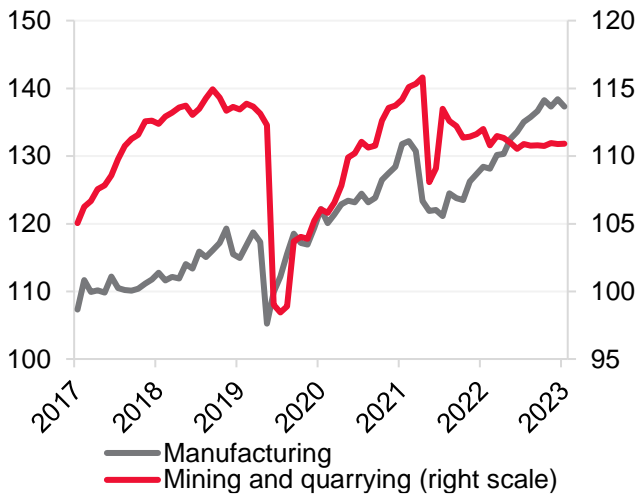**Figure 13. Core economic activities output and GDP, Q4 2020 = 100[8]**

Index of Core Economic Activities Output
GDP
CEAI net of agriculture
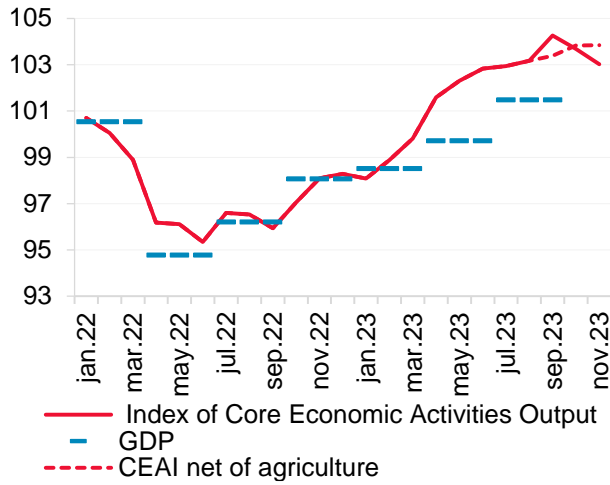
Sources: Rosstat, R&F Department estimates.

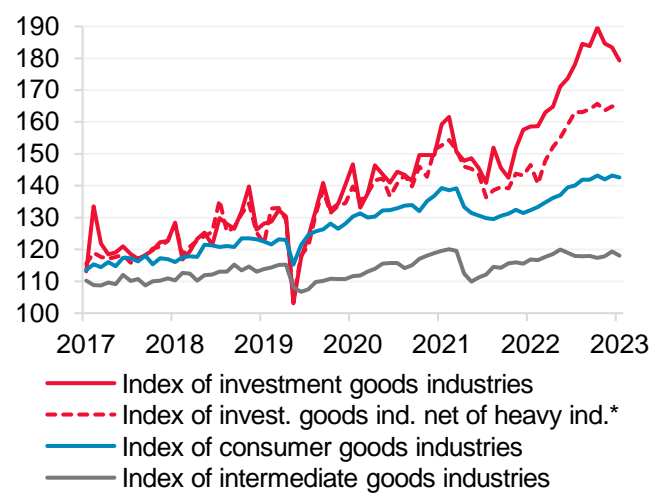**Figure 14. Russia's Manufacturing and Services PMI, points**

Services PMI — Manufacturing PMI

Source: S&P Global.

Figure 15. Mining and quarrying and manufacturing indices (2014 = 100)

Manufacturing
Mining and quarrying (right scale)

Sources: Rosstat, R&F Department estimates.

Figure 16. Output in groups of manufacturing industries, SA, 01.2016=100%

Index of investment goods industries
Index of invest. goods ind. net of heavy ind.*
Index of consumer goods industries
Index of intermediate goods industries

Sources: Rosstat, R&F Department estimates.

*The production of "finished metal products other than machinery and equipment" and "other vehicles and equipment" are excluded.

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[8] An estimate of the Core Economic Activities Index (CEAI) exclusive of agriculture's contribution in September–November calculated based on an aggregated indicator, whose composition and performance are the same as CEAI and includes seasonally adjusted core industries' output growth relative to the preceding month.

Figure 17. Retail, catering and services sector sales, 1.2019=100%, SA
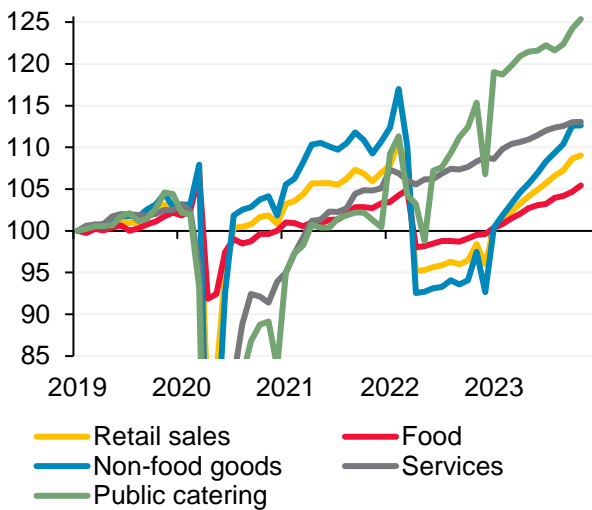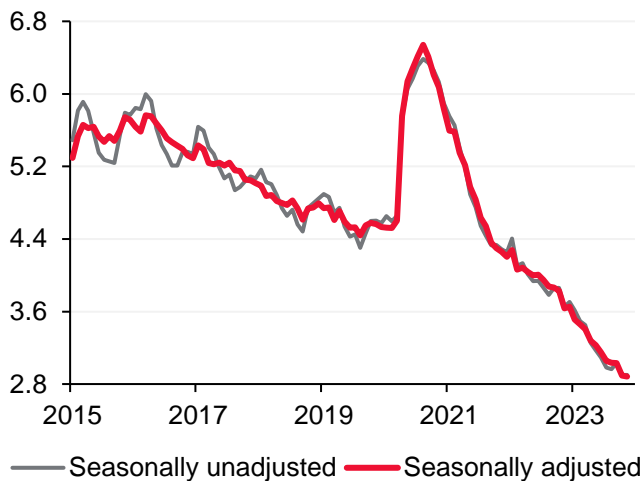

Sources: Bank of Russia, Rosstat, R&F Department estimates.

Figure 18. Proxy indicator of consumption (sum of retail, services and public food service' sales) and real wages, 01.2019 = 100, SA, %
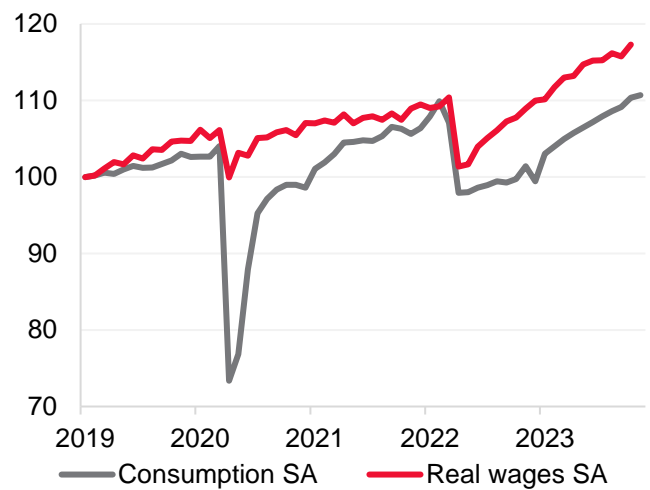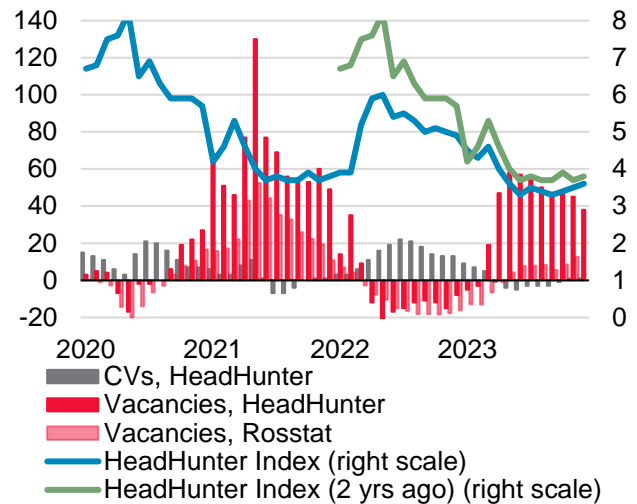

Sources: Rosstat, R&F Department estimates.

Figure 19. Unemployment rate, %

Sources: Rosstat, R&F Department estimates.

Figure 20. CVs, vacancies (% YoY) and HeadHunter index* (points)

*Ratio of active CVs to vacancies.

Sources: Rosstat, HeadHunter.

2.2. Monetary and macroprudential policy tightening puts a brake on retail lending expansion

- After its previous extra fast pace, retail lending growth significantly slowed towards year-end, coming close to a balanced rate of 0.6% MoM SA in December, down from 1.3% MoM SA in November (it hovered around 2% MoM SA throughout most of 2023, Figure 21). On top of the loan rate hikes, a significant contribution to the retail lending slowdown

came from the tightening of macroprudential measures restricting unsecured consumer lending to borrowers with a high debt-to-income ratio.

- Against this background, the number of loans extended under the subsidised lending programmes hit record highs (Figure 22). This stemmed from feverish demand on the back of December's decision by the RF government to tighten requirements under some of subsidised lending programmes.[9] A sustainable trend towards a decrease in the number of approved loan applications suggests a likely further activity cooling in the mortgage lending segment (Figure 23). An increase in add-ons to risk weights for mortgage loans to high debt-to-income ratio borrowers by the Bank of Russia as of 1 March 2024 will come as a further restraining effect.

- The impact of the interest rate raises on corporate lending is so far not so significant. December saw growth in ruble loans to non-financial organisations accelerate to 2.4% MoM SA from 1.4% MoM SA[10] (an average slowdown over Q4 was minor – to 1.8% MoM SA from 1.9% MoM SA in Q3), despite the high cost of borrowing (Figure 26). Corporate lending's restrained reaction to monetary policy tightening arises from a number of factors. One of them is a strong financial result for the year and continuing upbeat business expectations regarding demand. Strong loan demand is also buoyed by the need to finance investment projects, including the construction of infrastructure. At the end of the year, companies may have additionally increase loan demand ahead of the expected receipt of budget funds. Recent months have seen an increase in the share of floating rate loans. This suggests that companies expect interest rate cuts in the foreseeable future and do not want to fix high rates for the entire loan term. An increase in the number of floating rate loans also allows banks to lower interest rate risk.

- High deposit rates ramp up the attractiveness of deposits. A rise in ruble funds on accounts accelerated to 3.3% MoM SA from 2.6% MoM SA (Figure 27). Customers seem to be trying to fix high rates, because deposits with maturities of 31 days to 1 year are showing the most dynamic growth for the fourth consecutive month (Figure 28).

- The pace of foreign currency deposit contraction accelerated to 2.7% MoM SA in December from 2.1% MoM SA a month earlier. At the same time, interest in yuan deposits may become a driver of foreign currency deposit growth in 2024. Based on end-December data, 59 banks offered Chinese currency deposits,[11] up significantly from the 2022 level.
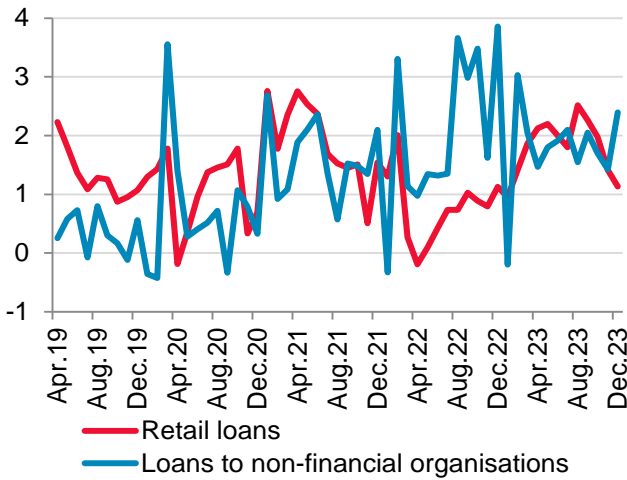
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[9] An increase in the minimum initial installment and a cut to the maximum loan sum in metropolitan regions.

[10] Growth in the portfolio of loans to sole proprietors slowed to 1.5% MoM SA from 2.2% MoM SA.

[11] The number of banks offering deposits denominated in yuans – 59 (39 in 2022), in US dollars – 51 (48), in euros – 40 (32), in dirhams – 7 (0).

**Figure 21. Ruble loans portfolio growth[12], % MoM SA**

Sources: Bank of Russia, R&F Department estimates

**Figure 22. Loan issuance under subsidies mortgage loan programmes, billion rubles**

■ Far East mortgage lending programme
■ IT-mortgage lending programme
■ Family mortgage lending
■ Subsidies mortgage loan programme
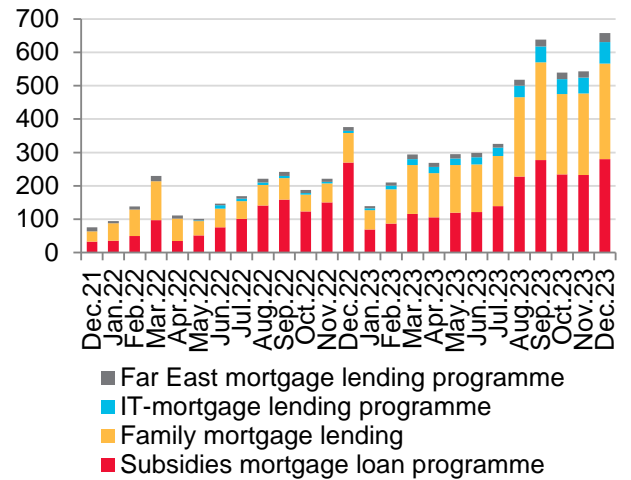
Sources: DOM RF, R&F Department estimates.

Figure 23. Approved mortgage loan applications, thousand
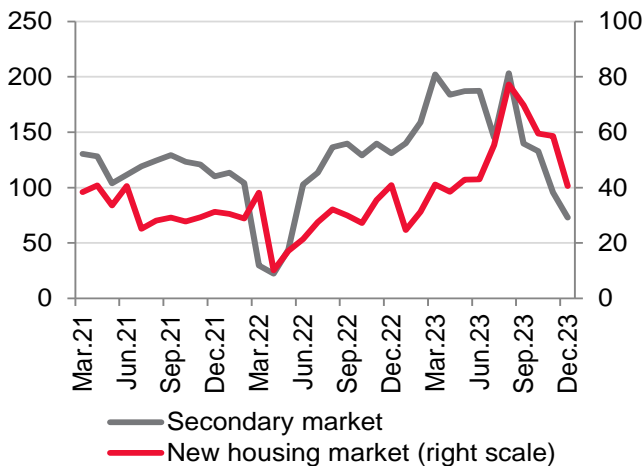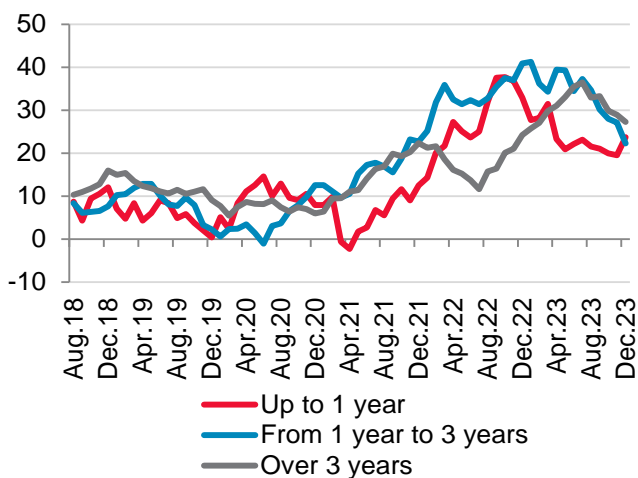

Sources: Domclick, R&F Department estimates.

Figure 24. The range of average offered rates on consumer loans, %
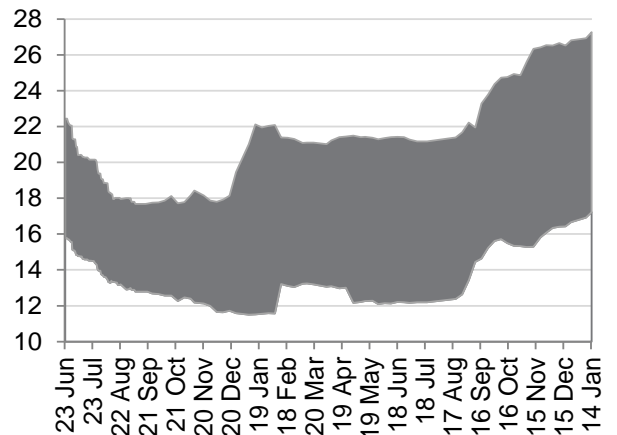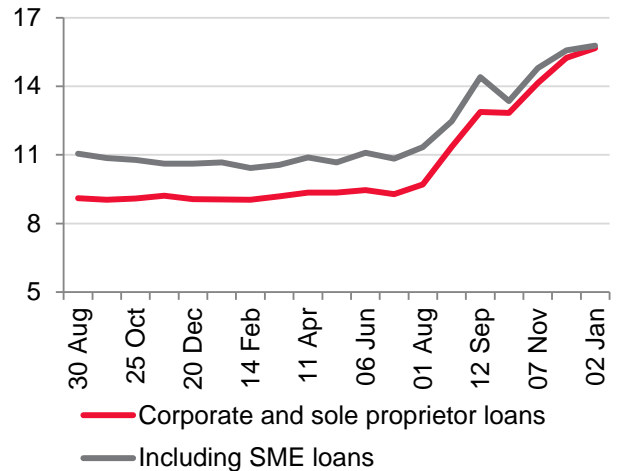

Sources: banki.ru, R&F Department estimates.

Figure 25. Ruble loans to non-financial organisations, % YoY

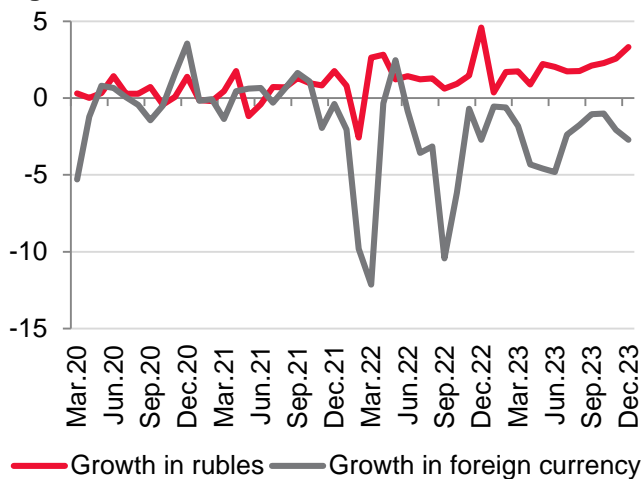Sources: Bank of Russia, R&F Department estimates

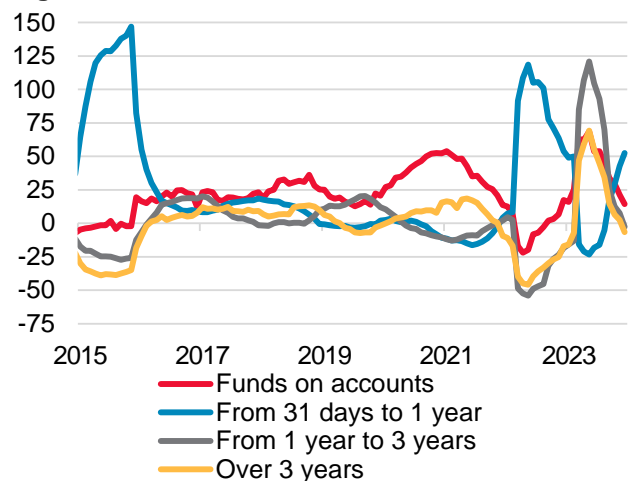**Figure 26. Corporate loan rate movements, pp**

Sources: Bank surveys, R&F Department estimates.

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[12] December data adjusted for a securitisation transaction (250 billion rubles).

Figure 27. Household funds with banks, % MoM SA

Sources: Bank of Russia, R&F Department estimates

Figure 28. Household ruble funds with banks, % YoY

Sources: Bank of Russia, R&F Department estimates

# In Focus. Economic performance beat expectations in 2023

- As in 2022, the Russian economy in 2023 showed resilience to shocks, starting to grow and surpassing the level of early 2022. Thus, it beat the expectations of analysts, forecasting at the start of 2023 its contraction for the year.

- Domestic demand expansion consistently accelerated throughout 2023, buttressed by the fiscal and credit impulse, which offset the external demand contraction. But as business activity and the economy's structural transformation gained pace, the utilisation of domestic production factors, mainly labour, expanded. Amid limited labour supply, this helped wages to grow and unemployment to hit all-time lows.

- Inflation was notably above analysts and professional market participants' expectations for the year. At the root of it were a fast recovery of domestic, including consumer, demand, household sentiment improvement, buoyant consumer lending, as well as ruble weakening on the back of a larger-than-expected balance of trade shrinkage.

After the Russian economy's contraction in 2022, most analysts and professional participants of the financial market assumed at the start of 2023 that it will continue, albeit at a slower pace. The most optimistic forecast expected just minor GDP expansion for the year. But economic performance offered surprises throughout 2023 (Figure 29): GDP growth came in at 3% YoY in January–September and will surpass this level for the full year. Together with an upward revision to 2021–2022 estimates,[13] this means that the economy will exceed the long-term trend by end-2023 (Figure 31).

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[13] 2021 GDP growth was revised to 5.9% from 5.6%, GDP contraction – to -1.2% from -2.1%.

Thanks to a rapid adaptation to external and domestic conditions which changed in 2022, the economy performed better than expected, enjoying strong support from the government sector.[14] That said, the *private* sector's capital expenditure was far above expectations, growing at a pace comparable with government investment.[15] The private sector's fixed investment growth was driven by a significant improvement in business sentiment (Figure 32)[16] and the need for investment to ensure the economy's structural transformation: to set up import substitution, restore frozen production facilities,[17] renovate and expand transport and logistics infrastructure, and restructure business processes.

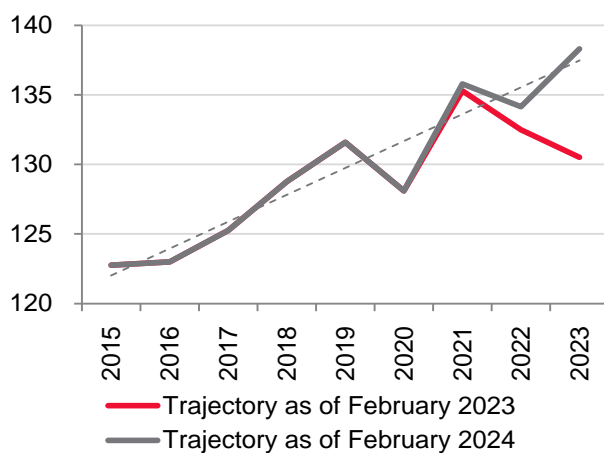**Figure 29. Change during 2023 in analyst expectations for 2023 GDP growth, %**
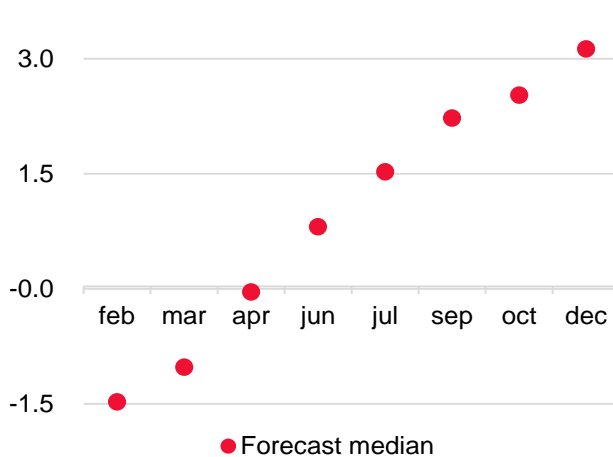
Source: Bank of Russia macroeconomic poll.

Figure 30.Change in analyst expectations in 2023 for end-year inflation, % r/r
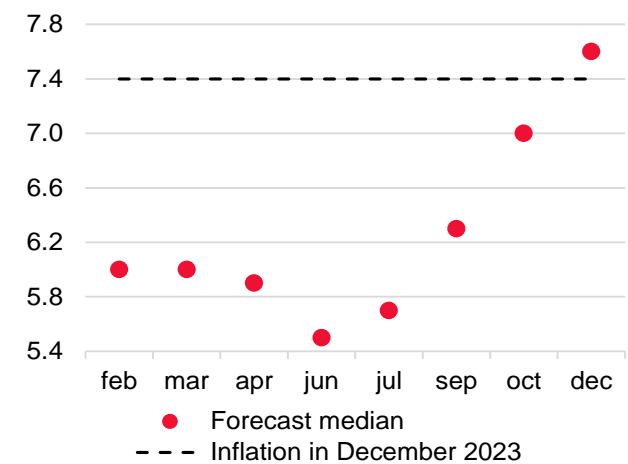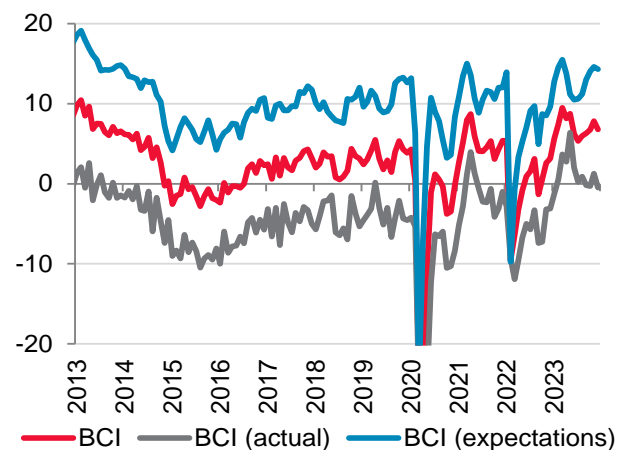

Sources: Bank of Russia macroeconomic poll, Rosstat.

Figure 31. GDP at 2021 prices, trillion rubles

Sources: Rosstat, R&F Department estimates.

Figure 32. Bank of Russia's Business Climate Index, p., SA

Source: Bank of Russia.

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[14] The key public finance indicators for the year were most likely in line with expectations at the start of the year – despite the accelerated spending of budget revenue in the first months of the year, the RF Finance Ministry strictly complied with the fiscal rule in 2023.

[15] In January–September 2023, growth in capital expenditure financed with budget revenue, own funds, and debt stood at 22%, 20%, and 7% YoY, respectively.

[16] The expectations component of the Bank of Russia's Business Climate Index in 2023 hit the highest level for 10 years.

[17] As foreign companies departed from the Russian market due to sanction risks, capital constraints and so on. The inability for a part of Russian businesses whose owners were subject to individual sanctions to invest abroad partly played a role.

Domestic demand growth and the need to expand supply ramped up demand for labour. As a result, unemployment came in far below a median forecast of 4.3% in 2023, standing at 2.9% at year end. Insufficient geographical and inter-industry labour mobility and a migrant inflow contraction further intensified competition for labour, accelerating wage growth. Strong labour income growth gave rise to households' upbeat financial sentiment and consumer demand expansion at a much higher rate than was assumed at the start of the year. Therefore, supply expansion lagged growth in demand, pushing up inflationary pressure in the economy.

Accordingly, inflation at end-2023 came in far above 6% expected by analysts and professional market participants at the start of the year (Figure 30). The key factors underlying the analyst forecast of inflationary pressure aggravation since end-2022 materialised in 2023,[18] but at a much larger scale. Our estimate of the input of demand and supply shocks to the 2023 price index adjusted for the trend component[19] (Figure 33, D and S, respectively) shows that price growth was at the start of the year restrained by supply and demand factors alike. In the second half of the year, however, the balance of supply factors became close to neutral (the sum of negative shocks was approximately equal in modulus to that of positive shocks), while demand factors began to make an important contribution to price rise acceleration. The disinflationary effect of the strong harvest and ruble strengthening in 2022 all but came to an end roughly in mid-2023. Stocks of imported goods built up in the period of the strong ruble dwindled and ceased to restrain consumer price growth. That said, the upbeat consumer sentiment supported by labour income expansion and high inflation expectations helped buoyant lending growth (Figure 34). The pent-up demand of 2022 was also rapidly realised in the non-food segment as supply recovered, with auto loan demand also rising. All this enabled producers to pass rising costs through to prices.

Figure 33. Contribution of shocks (pp) to the detrended price index since January 2023, MoM SA
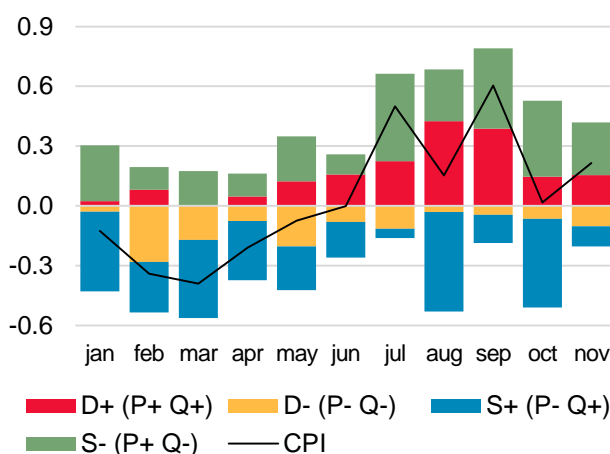
Sources: Rosstat, R&F Department estimates.

Figure 34. Retail ruble lending and real wages, SA
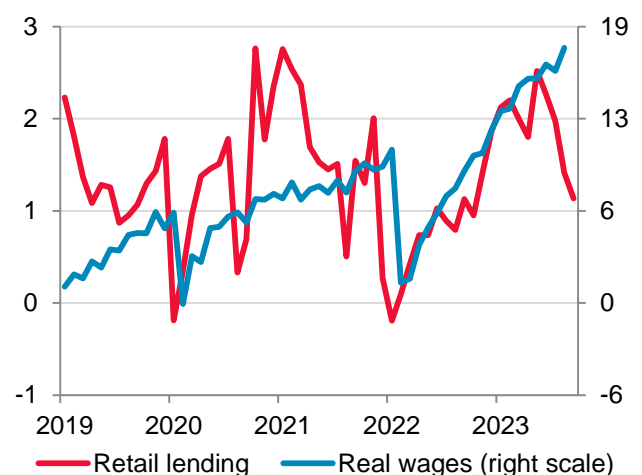
* December data adjusted for the securitisation transaction (250 billion rubles).

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

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[18] Continuation of demand expansion driven by rising budget expenditure and lending, mounting of pressure from the labour market, as well as contraction in inventories on the back of restrictions related to sanctions.

[19] For details of the decomposition methodology see analytical note "Estimation of the contribution of demand and supply factors to consumer price movements in 2022–2023" (2023).

Dynamic expansion in domestic demand led to a rise in demand for imports, with exports concurrently shrinking. The 2023 trade surplus came in over USD 50 billion below the analyst forecast at the start of the year. The balance of trade contraction was one of the key factors behind ruble depreciation in Q3, whose scale was far above producers' expectations. The ruble weakening translated into prices both directly, via rising producer costs, and through a rise in inflation expectations, prompting price growth, including in goods with a low import component.

The monetary policy tightening cycle started late in July 2023, but the process of price growth slowdown, especially among the sustainable consumer basket components, required time. At year end, consumer price growth was still above the trend level, but the magnitude of the positive demand shock (D+) significantly declined relative to Q3. The Bank of Russia's monetary policy decisions were gradually translating into the economy. In particular, hikes in deposit rates triggered a substantial inflow of household deposits to the economy. However, a key interest rate raise in 2023 amid strong optimism and elevated household inflation expectations had a relatively lesser restraining effect on lending than in previous episodes of substantial monetary policy tightening. The return of inflation to the target requires maintaining tight monetary stance for a long period.

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