SUMMARY OF THE KEY RATE DISCUSSION

In the course of preparations for making the key rate decision on 16 February 2024, the participants in the discussion heard the reports by the Monetary Policy Department and the Research and Forecasting Department. The departments presented their suggestions concerning the baseline macroeconomic forecast for 2024–2026 and its variations, taking into account recently received data and current trends. 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

In 2023, GDP increased by 3.6%, which is significantly higher than forecast, including because of the revision of the data for 2021 and 2022. The growth of GDP was mainly driven by domestic demand (investment, changes in inventories, and household consumption). Economic activity remained high in early 2024, although its increase slowed down somewhat, according to recent data. The unemployment rate is at its record low (2.8% in December (seasonally adjusted), and the level of tightness in the labour market stopped growing. Annual inflation equalled 7.4% in 2023. Current price growth decelerated in December 2023 and January 2024, compared to the peaks of autumn 2023. Companies' price expectations and households' inflation expectations went down, while remaining elevated.

DISCUSSION

As noted by the participants, in contrast to the December meeting when the extent and pace of the adjustment of the economy and inflation to the key rate increases were estimated as not entirely certain, it became obvious over the past two months that **the effect of the monetary policy transmission mechanism had sped up through all channels**. In particular, credit and deposit rates rose, imports and the ruble exchange rate adjusted, inflation expectations decreased among all economic agents, the expansion of the loan portfolios decelerated, and savings were growing quickly.

Inflationary pressure had been weakening gradually amid the tightening of monetary policy. Although all the participants supported this conclusion, their views regarding the intensity of disinflation processes varied considering persistently high inflation risks and the overall uncertainty. On the one hand, price growth slowed down notably, namely to 6.5% (seasonally adjusted annualised rate, SAAR) on average in December 2023–January 2024, compared to 11.3% (SAAR) on average over July–November 2023. Price growth decelerated across a wide range of goods and services. As a result, the estimates of underlying inflation, including core inflation, decreased considerably, in particular from 9.8% SAAR on average in July–November 2023 to 7.0% SAAR on average in December 2023–January 2024. On the other hand, there was an opinion that the deceleration of inflation was largely associated with transitory factors. Thus, price growth in certain food markets slowed down in December–January because the situation with supply improved. Furthermore, despite the fact that the weight of the consumer basket components that demonstrated rapid price growth in the total index started to go down during those months, the pace of the decline was lower than that of the increase in 2023 H2. This might be a sign of inertia in underlying inflation.

As noted by the participants in the discussion, **inflationary pressure in January generally remained at the same level as in December**, except for the service sector where price growth (excluding housing and utility services) surged from

5.4% SAAR in December 2023 to 11.5% SAAR. This acceleration was mostly due to higher prices for health resort services. Supposedly, this could be because of changed seasonality in the dynamics of prices for domestic tourism services as Russians had refocused from foreign travel to trips inside the country. The participants in the discussion supported the view that movements of service prices were generally an important indicator of changes in demand (including as a result of monetary policy). It is currently difficult to accurately assess whether this trend in service prices was driven by persistent or one-off factors.

The participants discussed **the risks that inflation might get entrenched at higher levels for a long period**. Beginning from the outbreak of the pandemic, inflation had been elevated for the most part due to both demand- and supply-side factors. Households' inflation expectations and businesses' price expectations stay high and unanchored, despite decreasing from their peak levels. Consequently, the return of inflation to 4% might be hampered by considerable inertia and require a long period of tight monetary conditions.

As noted in the course of the discussion, **Russia's GDP in 2023 significantly surpassed the October estimates**. Firstly, Rosstat revised upwards the statistics on economic activity in 2021–2022. Secondly, GDP growth in 2023 was largely driven by increased investment (gross fixed capital formation) and inventories. The participants agreed that the expansion of inventories over 2023 should not be unambiguously interpreted as excessive stocks of consumer and/or investment goods, the use of which during 2024 might be slowing down GDP growth. However, this component should be a special focus in the analysis of the GDP statistics through the course of 2024.

Relying on the findings of the monitoring of businesses and the economic trends actually observed in the Russian regions, the participants concurred that **the output of goods and services generally continued to expand at the end of 2023**. That said, trends varied across industries. In particular, the reduction in agriculture was associated with earlier harvesting in 2023, while the decline in railway transportation was caused by the contraction in the exports of coal and petroleum products. Contrastingly, road transportation was increasing fast. As reported by the Volga-Vyatka Main Branch, auto manufacturers were able to remove bottlenecks in auto component purchases that had previously hindered the increase in the output of cars. Moreover, manufacturers were ramping up the output of cars at previously idle facilities of automobile plants in Central Russia and the North-West. Overall, the output in manufacturing continued to expand. According to the February estimates, the Business Climate Index evidences a further increase in business activity.

The persistence of inflationary pressure depends on economic conditions and on how close the economy is to its potential. Therefore, the participants in the discussion scrutinised **the nature of the significant rise in GDP over 2023**. This surge could be driven by both a more notable increase in the economy's potential (e.g., resulting from higher labour productivity, the launch of new production facilities, and the use of new technologies) and a larger positive output gap (occurring when the economy is expanding faster than its potential and supply is insufficient to meet demand). In the course of the previous discussions, the participants rather agreed that the economic growth observed was predominantly driven exactly by the positive output gap. It occurred due to the expansion of domestic demand fuelled by, among other factors, the surge in lending and high government expenditures. The positive gap resulted in soaring inflation, high utilisation rates of production capacities, and overheating in the labour market. In the course of the discussion in February, it was conjectured that the increase in the economy's potential could have made a larger contribution than previously estimated by the Bank of Russia. This conclusion could be made because inflationary pressure had been weakening over the past few months and the labour market had not been tightening further. The updated quarterly statistics on GDP growth in 2021–2023 to be released in April will provide important additional data to assess the economic dynamics and carry out retrospective analysis.

Relying on recent data and the assessments of the monitoring of businesses, the participants in the discussion acknowledged that **investment activity remained high**. The indicator of businesses activity for 2023 Q4 hit a record high. The companies surveyed expect investment to remain high in 2024 Q1. The discussants noted a number of essential factors that would support companies' investment activity at a high level even despite the rise in interest rates. In the first place, the utilisation rate of production capacities is close to 100%. With the machinery available, some companies' output has already reached the maximum, which is encouraging them to ramp up their production capacities. The second factor is rising wages and intensifying labour shortages, which is pushing up the demand for projects aimed at automating production processes and enhancing their efficiency. Thirdly, as revenues in a number of industries are high, companies are able to finance investment projects even in the conditions of higher credit rates. Thus, enterprises' net financial performance over the rolling 12-month period both in general and across most industries either remains close to historical highs or reaches new record highs.

The labour market was still a key topic of the discussion. The participants analysed **whether the labour market had passed the peak of tension**. On the one hand, the trends generally remain the same, that is, the unemployment rate is at its record low, hiring expectations are at the maximum level on record, employment is growing, and the staffing level is extremely low according to companies. The Bank of Russia Main Branches noted that staff shortages in the regions persisted.

A number of industries (retail, construction, services, and the pharmaceutical sector) report that the deficit of personnel continued to intensify. On the other hand, the level of tightness in the labour market stopped growing in some industries, specifically manufacturing, mining and quarrying, metallurgy, machine building, and chemical production, as noted by the participants. They also specified several possible reasons for the end of growth in the labour market tightness. In the first place, this could be the result of the transfer of staff across both industries and the country's regions. As reported by the Main Branches, in the regions where staff shortages are more acute, companies temporarily employ people from other regions on a fly-in-fly-out basis. To be able to hire workers, companies expand social packages and subsidise rent and housing purchases, thus making the jobs more attractive. However, this practice augments enterprises' costs and might have a proinflationary effect. Concurrently, in the conditions of staff shortages, companies were investing funds in projects aimed at reducing the labour intensity of their production processes. The participants in the discussion agreed that it was premature to speak of how steady the current trends in the labour market would be.

A key parameter of the effectiveness of monetary policy is the growth rate of consumer demand. The participants **concurred that consumer demand remained high and had just started to respond to the tightening of monetary conditions**. The Main Branches reported a slower rise in consumer activity in individual regions and its decline from the peak levels in the South of Russia and the Far East. The views regarding how steady the deceleration of the increase in consumer demand might be varied. Some participants referred to the contraction of consumer imports as an indicator of the current and further decline in consumer demand, whereas others said that there were no signs of a stable slowdown in the growth of consumer demand at the moment and it might speed up again amid high inflation expectations. They also mentioned that, according to the monitoring of businesses, companies' expectations about future demand remained at record high levels.

The discussants noted that budget system spending in January was close to the historical norm. Most participants agreed that **budget spending planned for the medium term and tax policy were critical factors for aggregate demand**. Both of them are already influencing companies' output targets and households' expectations about incomes, as well as related credit activity. In contrast to the planned government expenditures and signed contracts, the schedule of actual payments from the budget over the course of the year is of secondary importance for changes in aggregate demand. The key factor for monetary policy is the parameters of the medium-term budget stipulated within the budgeting process. Besides, many participants noted that fiscal policy decisions remained an essential factor for assessing the appropriate level of the tightness of monetary policy.

MONETARY CONDITIONS

MAIN FACTS

From the day of the December meeting on the key rate, the yield curve of federal government bonds (OFZ) became more inverted, with short-term yields staying high and long-term yields dropping by 0.5 percentage points. Deposit and credit rates were up. The expansion of the loan portfolio in corporate and consumer lending started to decelerate in December 2023–January 2024. Mortgage lending continued to surge in December, primarily driven by government subsidised programmes, and began to cool down in January. The inflow of households' funds into deposits is still high. The saving ratio notably increased in 2023 Q4.

DISCUSSION

The participants in the discussion noted **the tightening of monetary conditions after the December meeting on the key rate**. The OFZ yield curve became much more inverted. Real yields on inflation-indexed federal government bonds (OFZ-IN) exceeded 5% per annum. Alongside other price and non-price indicators, this rise is evidence of tight monetary conditions. Interest rates on deposits were growing, primarily those with maturities from one to nine months. Credit rates were rising as well. The participants in the discussion concurred that **credit rates would continue to adjust to the monetary policy tightening**. Besides, credit rates will increase further due to the influence of factors not associated with monetary policy. The first one is that the banking sector's structural surplus of liquidity will reverse to its deficit, which means that banks will be raising more funds from the Bank of Russia rather than depositing them. As a result, the negative spread between short-term money market rates and the key rate will turn positive, which will imply a greater extent of the tightness of monetary policy with the key rate staying at the same level. Secondly, the cancellation of most regulatory easing measures for banks, primarily those related to compliance with the liquidity coverage ratio (LCR) causes a slight rise in the liquidity premium in credit rates. Additionally, macroprudential policy measures will also continue to influence the extent of the tightness of bank lending conditions.

Having scrutinised the credit market's response to the monetary policy tightening, the participants in the discussion noted that **the growth was slowing down in almost all lending segments** (except for car lending where demand was rebounding after a slump). The increase in retail lending was decelerating. Furthermore, unsecured consumer and mortgage lending were responding more quickly to interest rate changes, and accordingly, the expansion in these credit market segments was slowing down more notably. In addition to higher interest rates, the growth in unsecured consumer and mortgage lending was also moderated by the adopted macroprudential measures aiming to limit risks. The effect of these measures on lending was taken into account when making monetary policy decisions. In December, the segment of mortgage lending for existing housing recorded emerging signs of a decline in disbursements. The demand for new housing mortgages remained high as loans were mostly issued within subsidised programmes. In January, mortgage lending for both existing and new housing decreased overall, which was associated with seasonal factors, high market rates, and the tightening of subsidised mortgage lending parameters. The participants in the discussion pointed out that the expansion of the mortgage portfolio would continue to decelerate as a result of both rising interest rates and the toughening of the macroprudential measures. The effect of the latter will increase after the enactment of additional measures in March 2024.

The discussants emphasised that **corporate lending was less responsive to interest rate changes** as the increase in the corporate portfolio was slowing down less notably. Several reasons for that were specified. In the first place, a considerable proportion of corporate loans are issued at variable interest rates, and this share is growing. Companies might be more willing to raise such loans expecting interest rates to go down. Secondly, the response to rising interest rates might be slower when corporate loans are related to the already launched projects as the costs of their suspension are frequently higher than the effects associated with rising borrowing costs. Thirdly, as companies' financial performance is good, they are able to raise and service loans at higher interest rates. Fourthly, the companies surveyed remain positive about business prospects, expecting the demand for their products, including from the public sector, to stay high. Finally, in December, companies were apparently raising additional loans expecting planned investment of budget funds in early 2024.

In the course of the discussion, the participants indicated that **financial stability risks associated with high interest rates were minor**. Banks neither report an increase nor expect a rise in the short term in the number of loan restructuring applications due to deterioration of borrowers' financial standing. The assessment of real sector companies' financial position confirms that there is currently no risk of systemic growth in loan restructuring applications.

The discussants agreed that **the effect of tight monetary policy on credit activity would continue to intensify**. The expansion of lending will be decelerating during 2024. To bring inflation back to the target and close the positive output gap in the economy, it is necessary to ensure a significant slowdown in lending growth compared to 2023. However, extensive subsidised lending programmes are still distorting the effect on the credit market, which may be offset by a more considerable decline in credit activity in the market segment.

The participants noted that **households' propensity to save was growing**, driven by a number of factors. The higher key rate causes a tightening of monetary conditions, which increases the inflow of funds into bank deposits and slows down the expansion of retail lending. Simultaneously, households are able to save more as their incomes are quickly growing. The participants in the discussion concurred that a higher propensity to save was limiting the growth of consumer demand, although there was no considerable decline in consumption at the moment yet. **The propensity to save might increase further** in the future: when inflation expectations go down, interest rates are becoming increasingly attractive even if they stay at the same level.

EXTERNAL ENVIRONMENT

MAIN FACTS

In 2023 Q4, GDP growth in the USA surpassed the expectations, while the euro area managed to avoid a recession. China's GDP continued to increase fast, despite the challenges in the real estate sector. According to the new statistics for January, the world economy improved the dynamics compared to 2023 Q4. Considering stabilising inflation, advanced economies' central banks might start decreasing their policy rates by mid-2024.

Russia's exports in 2023 Q4 were considerably below the Bank of Russia's October forecast. Prices for the majority of Russian exports and the quantities of exports both decreased. The nominal exchange rate of the ruble against the currencies of Russia's main trading partners stayed nearly the same.

DISCUSSION

From the previous meeting, the discussants' opinion about global GDP dynamics in 2024 remained unchanged overall. Growth in the USA is expected to be slightly faster than predicted before. The revised data for the previous years suggest a higher path of potential GDP in the USA. Economic growth rates in the euro area will be lower due to the continuing decline in exports and higher energy prices. The economies of Russia's trading partners will continue to expand quickly, which will support the demand for Russian exports. China's economic growth rates will edge down somewhat, while remaining high.

The discussants agreed that **the fast deceleration of inflation might encourage advanced economies' central banks to ease their monetary policies more quickly than assumed before**. Nevertheless, they wish to receive more evidence of a steady return of inflation to the targets before they start cutting their policy rates. A faster easing of external monetary policy might strengthen disinflationary trends in Russia because of the expansion of the gap between internal and external interest rates, even though this transmission channel has become less efficient since 2022.

The participants in the discussion decided **not to change the forecast path of the Brent price compared to the baseline scenario presented in October**. As before, oil prices will be additionally supported by the OPEC+ agreement on oil production cuts. However, the discussants pointed out that the risks of a faster decline in oil prices persisted due to a further expansion of non-OPEC+ oil production. A decrease in oil prices might exacerbate proinflationary pressure in the Russian economy.

In the course of the deliberations, special attention was paid to **the reasons behind the reduction in the export of a wide range of Russian goods**.

The participants indicated that the observed growth of global GDP was largely accounted for by the service sector which is less resource-intensive. Consequently, prices for Russian exports are now driven by the global growth to a lesser extent. The discussants considered two main scenarios of future export dynamics. The first one assumes a temporary contraction resulting from the adjustment to the changing environment and more complicated settlements and logistics. Over time, exports will be bouncing back taking into account global growth and its structure. The second scenario assumes that exports will decline in response to the structural changes in the external environment and the recovery in the near future will be limited. According to the latter scenario, exports will be partly redirected to the domestic market, which might become a disinflationary factor. To a certain extent, these processes can already be observed, e.g., in the Urals that used to focus on exports largely. Companies' refocusing from the export of their products to domestic consumers is one of the patterns of the ongoing structural transformation of the country's economy. Furthermore, the discussants emphasised that the composition of Russian exports had been changing, with the share of agricultural products in exports increasing.

The situation in the foreign exchange market remained stable. Fiscal rule-based operations additionally limited the sensitivity of the ruble exchange rate to oil price fluctuations. The discussants pointed out that oil price dynamics continued to influence Russian companies' foreign currency earnings with a time lag. **Foreign currency sales in the market decreased over the past period, following the decline in the value of exports**. Nevertheless, the proportion of foreign currency earnings sold by exporters remained steadily high. In November–December 2023, the ruble exchange rate was additionally supported by transactions related to dividend payouts by Russian companies. Simultaneously, importers' demand for foreign goods contracted somewhat, which could be partially associated with an expected decline in consumer demand amid tight monetary conditions. Hence, tight monetary policy continues to cool down the demand for imports in ruble terms, which helps stabilise the ruble exchange rate fluctuations. High ruble interest rates also support the demand for ruble-denominated financial instruments as a store of value.

According to the participants' opinion, changes in export quantities and prices for non-oil and gas exports remain a major source of risks to the exchange rate as the negative effect of such changes cannot be mitigated through the mechanism of the fiscal rule. The discussants scrutinised implications of additional difficulties in external settlements. It was noted that, if such issues affected both exports and imports, it was not necessarily that they would have any significant impact on the exchange rate. The participants also reiterated their view that, if the executive order obliging the largest exporters to sell foreign currency earnings was not extended, its termination would not be a major factor affecting future dynamics of the exchange rate.

INFLATION RISKS

The participants in the discussion stated that the current **ratio of risks was still shifted towards proinflationary ones**. Among the **proinflationary risks**, the discussants emphasised the following:

- High and unanchored inflation expectations that are sensitive to short-term rises in prices for certain products and services, which might entail secondary effects on inflation.

- Worsening of the foreign trade environment due to the impact of the geopolitical situation and deteriorating conditions in commodity markets.

- The situation in the labour market where risks are associated with a slower rise in labour productivity compared to real wages.

- Lending within government subsidised programmes that might distort the functioning of the monetary policy transmission channel if the amounts remain significant.

- A longer period of fiscal policy normalisation, which is a major proinflationary risk even though it has not risen.

The discussants 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

The discussants considered the updated forecast estimates. In addition to the baseline scenario, the participants also discussed a number of its variations, including those covering inflation risks. In particular, those were variations on a short-term inflation path, the ruble exchange rate, and the estimates of the size and the pace of the decrease in the positive output gap (including with various levels of the potential).

Taking into account the data received after the key rate meeting held in December 2023 and the updated forecast estimates, **the participants in the discussion were choosing between two alternatives**:

- Keeping the key rate unchanged at 16.0% per annum.

- Raising the key rate by 100 basis points to 17.0% per annum.

The main arguments for **maintaining the key rate at 16.0% per annum** were as follows:

- The effects of the monetary policy tightening continue to intensify, which is slowing down the expansion of lending and encouraging households to save more. In the future, the effects of the earlier key rate increases will continue to have impact on the dynamics of economic indicators and contain inflationary pressure.

- The substantial deceleration of current price growth, including the underlying components of inflation, over December–January suggests that the extent of the Bank of Russia's monetary policy is already sufficiently high. Nevertheless, it would be premature to predict how steady the disinflationary trends will be. For disinflation processes to solidify, it is necessary to maintain tight monetary conditions for a long period.

- The positive output gap in the economy remains significant, but has presumably reached its peak in the middle of 2023 Q4. Considering the recent data on inflation and domestic demand movements, the gap has started to contract gradually. Furthermore, a higher growth rate of GDP in 2023, combined with the weakening of inflationary pressure, might suggest a stronger potential of the Russian economy. An increase in workers' intersectoral and interregional mobility and labour productivity might improve the flexibility of the labour market to a certain extent. However, these effects should be analysed in greater detail.

- In 2024, monetary conditions will be tightening further because of several factors not associated with monetary policy, specifically the cancellation of most regulatory easing measures for banks (including those related to compliance with the LCR), the effect of the macroprudential regulation measures, and the banking sector's switch from a structural surplus of liquidity to its structural deficit.

The main arguments for **raising the key rate to 17.0% per annum** were as follows:

- By early February, there had been no unambiguous evidence of a steady decline in inflation. At the current stage, the economy might need tighter monetary policy to decelerate inflation at a desired pace, that is, to bring inflation back to the target in 2024. A failure to decrease inflation to the target could adversely affect inflation expectations that might anchor at elevated levels, which would complicate the task of disinflation in the future.

- There is a risk that the output gap in the economy or the pace of its decrease might be underestimated. In particular, the slowdown in the growth of consumer activity might turn out not to be steady.

- The inertia in lending dynamics might persist due to the distorting effect of government subsidised programmes and borrowers' elevated inflation expectations.

- Over the period from the date of the December meeting, the conditions in foreign trade worsened considerably, specifically, commodity prices declined, the discount on Russian crude increased, payments became even more complicated, and exports contracted.

Having scrutinised the arguments for each of the alternatives, the discussants agreed that the decision to keep the key rate at 16.0% per annum would be more reasonable.

- In the first place, the Bank of Russia's medium-term baseline forecast suggests that maintaining the key rate unchanged at the February meeting is in line with the objective to return inflation to the target in 2024 and stabilise it close to 4% further on.

- Secondly, additional tightening of monetary policy might involve risks of a significant downward deviation of inflation from its target in 2025. The resulting increase in output fluctuations would not meet the objective of long-term stabilisation of inflation at the target.

- Thirdly, the arguments for the key rate increase to 17.0% per annum were predominantly associated with proinflationary risks to the baseline scenario, while they should be taken into account in the course of deliberations about a future key rate path.

The participants discussed in detail all the opinions about a possible **future key rate path**.

- They agreed to raise the forecast of the average key rate for 2024–2025. This is associated with the fact that the Russian economy started the year 2024 with a more considerable positive output gap, i.e. higher inflationary pressures, than expected in October. The upward shift of the forecast key rate path will promote the conditions for solidifying the disinflationary trends in the economy.

- The discussants emphasised that it was essential to again signal the need to maintain tight monetary conditions in the economy for a prolonged period in order to ensure the desired effect of monetary policy. However, the participants agreed that it was important to avoid the interpretation of the signal as the express statement that the key rate itself would remain unchanged for an extended period. If inflation and inflation expectations lower steadily, the same degree of the tightness of monetary conditions (that is, the same level of real interest rates) will be ensured by a gradually decreasing key rate. Most participants expected that, under the baseline scenario, the conditions for starting key rate cuts would form in 2024 H2. Some of them admitted that a key rate reduction might begin a little earlier.

- It was stressed also that, at the current stage, any decisions on a key rate path should be made especially carefully. The experience of past years shows that households might shift from savings towards higher consumption relatively sharply amid considerable changes in the key rate. Accordingly, the key rate should be cut gradually.

Following the discussion, the Bank of Russia Board of Directors made the decision on 16 February 2024 to set the key rate at 16.0% per annum from 19 February 2024.

Furthermore, the Bank of Russia signalled that it would need to maintain tight monetary conditions in the economy for a long period. The Bank of Russia Board of Directors concluded that, **considering the current level of the tightness of monetary conditions and the increased forecast of the average key rate, the baseline scenario would provide for the conditions that should be sufficient for bringing inflation back to the target in 2024 and stabilising it close to 4% further on. Given the monetary policy stance, the Russian economy will return to a balanced growth path by 2026**. More details on the medium-term forecast are available in the Bank of Russia's Commentary on the Medium-term Forecast.