SUMMARY OF THE KEY RATE DISCUSSION

DURING THE QUIET PERIOD AND IN THE COURSE OF THE MEETING OF THE BANK OF RUSSIA BOARD OF DIRECTORS ON 7 JUNE 2024

Discussants: members of the Bank of Russia Board of Directors, senior executives of the Monetary Policy Department, the Research and Forecasting Department, and a number of other Bank of Russia Departments and Main Branches.

The Monetary Policy Department together with the Research and Forecasting Department presented the results of the analysis of the current economic developments nationwide and worldwide as well as the comparisons of the unfolding economic trends against the baseline macroeconomic forecast for 2024–2026 and its variations. The Bank of Russia Main Branches provided information on the situation in the Russian regions, including based on companies' surveys. Furthermore, the participants in the discussion considered the information from the International Settlements Department.

This Summary covers the **key points of the discussion.**

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ECONOMIC SITUATION AND INFLATION

MAIN FACTS

Over 2024 Q1, the domestic economy expanded by 5.4% year-on-year (YoY), exceeding the Bank of Russia's forecast. The economic growth slowed down slightly in April but remained fast, according to recent data. As assessed, household consumption increased more significantly in 2024 Q1 than expected by the Bank of Russia. High-frequency data show that consumer activity stays high in 2024 Q2, although there are some signs of deceleration. Investment demand remains high, which is evident from business surveys and the dynamics of fixed capital investment. The Bank of Russia's Business Climate Index rose in May and was close to its 12-year highs. In March, the overall financial performance of large and medium-sized enterprises (except for credit institutions) for the past 12 months totalled ₽33.9 trillion, holding close to its historical peaks. The level of tightness in the labour market continued to increase. Unemployment dropped to a new record low of 2.6% in April. The rise in nominal wages notably sped up in March, reaching 21.6% YoY. Current price growth rates edged up from 5.7% on average in 2024 Q1 (seasonally adjusted annualised rate, SAAR) to 5.8% SAAR in April. Most measures of underlying inflation went up in April. In particular, core inflation accelerated to 8.3% SAAR compared to the average of 7.1% SAAR in 2024 Q1.

DISCUSSION

The participants in the discussion inferred that **the easing of inflationary pressures observed since December 2023 paused in April 2024**. According to weekly statistics, current price growth rates remain elevated. However, the weekly price monitoring covers a limited range of goods and services, which is why it is impossible so far to draw an unambiguous conclusion regarding the inflation dynamics in May. Besides, the elevated price growth rates in April–May were partially associated with one-off factors, including the indexation of communication service tariffs and higher prices for domestic cars.

The most debated topic was further inflation trends. Some discussants pointed out that, even though the inflation data were incomplete, many measures excluding volatile components suggested persistently high price growth rates in May. Moreover, as the expansion of lending and consumption was not slowing down, inflation might get entrenched at the current elevated level or even start accelerating. Other discussants considered that the price dynamics over the past few months had been impacted by multiple one-off factors, due to which the monthly price growth rates had been very volatile. This makes it impossible to draw an unambiguous conclusion about how inflation will be changing in the future: whether it will accelerate, slow down, or stay at the current level. A number of the discussants reckoned that inflation might still decelerate as the effects of the monetary policy pursued translated into the dynamics of lending and consumer activity.

The participants discussed **additional factors that might influence future inflation trends**. **Food prices are not expected to surge because of the harvest. According to the discussants, the ruble appreciation in May will have a moderate effect on price dynamics.** Harvest forecasts are still close to their five-year averages despite the unfavourable weather conditions in spring. Their negative effect on the harvest of grains may be partially offset by replanting. The decrease in the supply of fruit and berries may be replaced by expanding imports. As regards the effect of a stronger ruble, it may be offset by the impact of the sanctions on prices for imported goods and services.

The Departments presented their **assessments of the influence of the fiscal novelties announced by the Russian Government on the price dynamics**. **The discussants concluded that the overall effect of the tax reform on inflation would rather be neutral** as extra non-oil and gas revenues earned as a result of the tax modifications would fully cover the expected additional budget expenditures. However, **there might be secondary effects related to the structure of these expenditures and revenues**. In particular, the tax reform might influence households' and businesses' behaviour and demand. Depending on the effect that will prevail, inflation might speed up or slow down.

Inflation expectations remain elevated, increasing the inertia of underlying inflation. Most measures of inflation expectations were up in May, including households' inflation expectations, analysts' inflation expectations for 2024 and 2025, and breakeven inflation for inflation-indexed federal government bonds (OFZ-IN). Companies' price expectations did not change, staying elevated.

The discussants concurred that **rising consumer demand was still exceeding the capacities to ramp up supply, which was the main factor fuelling price growth**. In 2024 Q1, consumer activity was increasing steadily. Contrastingly, in 2024 Q2, high-frequency indicators have been changing diversely. Therefore, it is impossible to draw a firm conclusion whether the expansion of consumer demand has started to decelerate or not. On the one hand, the increase in commercial services to households, including public catering, continued at the beginning of 2024 Q2, which is evidence of persistently high consumer demand. On the other hand, Rosstat's data on retail turnover for April suggest a decline in consumer demand because of lower demand for non-food goods. Representatives of a number of the Main Branches reported a certain decrease in shopping mall traffic and buyers' activity on marketplaces, which might also be a sign of a decline in consumer activity. The participants in the discussion noted that the statistics on consumption for the past few months might be distorted by one-off factors. In particular, it was conjectured that the surge in consumer demand in 2024 Q1 and its possible adjustment at the beginning of 2024 Q2 might be partially attributed to the dynamics of car sales. As the rules for importing motor vehicles through the EAEU were tightened from 1 April, sales could be redistributed from Q2 to Q1. If this factor is taken into account, consumer demand was rather steadily high without any signs of a decline. Additional statistics on consumer activity for May will enable a better assessment of the effects of one-off and steadier demand-side factors.

The discussants agreed that staff shortages remained the major constraint on the expansion of supply. The level of tightness in the labour market has been increasing. Competing for employees, companies have been raising wages as they are able to do so owing to high financial performance. Accordingly, wages continue to grow faster than labour productivity. Furthermore, wages are changing very unevenly across industries and regions. In February–March, an additional rise in wages could be attributed to the payment of higher annual bonuses for the previous financial year that was very successful for many companies. It will be possible to evaluate the influence of this factor after the data for April are released. Representatives of the Main Branches pointed out that the rise in wages was moderated to a certain extent as a result of hiring migrants and because of interregional and intersectoral migration.

Investment activity remains high. As before, investment is driven by businesses' high financial performance, government demand, subsidised lending programmes, and lower competition from a number of imported products amid elevated domestic demand. The discussants still expect more moderate investment dynamics, including as the investment stage of the projects that are currently underway is completed.

The participants in the discussion concurred that **the available data were insufficient to conclude that the economy's growth rate in 2024 Q1 had significantly deviated from the baseline scenario**. **The statistics on GDP in 2024 Q1 were distorted due to the leap-year effect. The estimated contribution of this factor to the GDP increase was a matter of dispute.** The range of the estimates of the leap-year effect suggests that the economy's sequential growth rate could both be close to the baseline scenario, that is, was going down compared to 2023 Q4, or exceed it. The increase in business activity slowed down slightly in April, according to high-frequency data. Representatives of the Main Branches noted some signs of this decline, including decreases in the Business Climate Index and companies' expectations about future demand. Therefore, the rise in economic activity might be expected to decelerate somewhat in the future.

The discussants agreed that **the labour market tightness and elevated price growth rates were evidence of a considerable positive output gap**. Nevertheless, it is **impossible so far to draw an unambiguous conclusion about the gap dynamics**. Some discussants pointed out that the overheating in the economy could increase in 2024 Q1. They mentioned growing labour shortages accompanied by a surge in wages, as well as signs of a reversal of the inflation trend in April–May. The leap-year effect on the economic growth was limited in Q1, in their opinion. To the contrary, other participants said that the available data were insufficient to conclude that the overheating had increased. They stressed that the contribution of the leap-year effect could be substantial. Moreover, the economy's high growth rates could be partially associated with the continuing expansion of its potential, which was the result of both increasing production capacities and higher labour productivity. These drivers, in particular, were referred to by many companies surveyed by the Bank of Russia. According to the respondents, the commissioning of new equipment and business processes optimisation were the main reasons for higher labour productivity. Besides, a number of companies explained that labour productivity had risen owing to staff trainings and the use of new software and new materials.

MONETARY CONDITIONS

MAIN FACTS

Money market rates and yields on federal government bonds (OFZ) soared over the period from the April meeting. The OFZ yield curve became less inverted. Real yields on OFZ-IN surged, while the rise in breakeven inflation was relatively less significant. Deposit and loan rates were up as well. Household deposits continued to increase fast. Credit activity remained high, but its monthly growth rates were below the peaks of autumn 2023. After a slight slowdown at the beginning of the year, in April, the surge in corporate and unsecured consumer lending resumed month-on-month (MoM), seasonally adjusted (SA). The growth rate of mortgage lending remained unchanged in April, staying considerably below the levels of 2023 (MoM SA).

DISCUSSION

The discussants concurred that **monetary conditions had tightened since the April meeting primarily in terms of price conditions**.

- Money market rates and OFZ yields soared. Market participants were adjusting their expectations about the future path of the key rate. Among other things, their expectations were influenced by the Bank of Russia's communication regarding a longer period of tight monetary conditions, as well as the released statistics on GDP growth and inflation. Long-term OFZ yields were rising, driven by a higher term premium. It was conjectured that higher borrowing costs for all economic agents, including the government, were associated with rising competition for savings. This is because the structural transformation of the economy has been pushing up the demand for investment financed from savings.

- The discussants noted that banks' deposit rates had surged in May, according to recent data. This could be associated with both the upward adjustment of expectations about the key rate following the Bank of Russia's communication and the increase in competition after the cancellation of the fee for depositors' money transfers between their accounts within the monthly limit of ₽30 million. Loan rates were also growing, continuing to adjust to the earlier monetary policy decisions. The participants in the discussion inferred that, given the actual rise in OFZ yields, loan and deposit rates would increase further.

The meeting concluded that, **in contrast to the expectations, the increase in lending was not slowing so far**. As a result of higher incomes, households and businesses are able to raise more loans, while banks have sufficient capital cushions to expand lending further despite the toughened macroprudential measures.

- Retail lending continues to soar. The rise in unsecured consumer lending sped up in April, primarily in the credit card segment. The fast growth of car lending is still supported by the government programmes. The surge in mortgage lending has been driven by the government subsidised programmes, whereas the unsubsidised segment is demonstrating rather moderate dynamics.

- Corporate lending has been soaring, but the growth rate is below the peaks of autumn 2023 (MoM SA). The expansion of market-based lending has been expectedly decelerating in response to the rise in interest rates. However, multiple measures to support the economy, alongside companies' high financial performance, have made corporate lending less responsive to tight monetary conditions.

- The discussants stressed that the higher would be the proportion of credit not responsive to market rates, the higher would be interest rates for the industries not having access to subsidised loans.

In the course of the discussion, the participants noted that the activity in the stock market remained high. Furthermore, amid higher interest rates, prices in the money and debt markets adjusted, and investors transferred funds from the stock market to the money market.

The discussants noted that, **due to accelerated income growth, a higher saving ratio might be required to ensure steady disinflation**. On the one hand, in 2024 Q1, households' saving activity reached a seasonal peak of the past 10 years. In April, time deposits continued to soar. On the other hand, the increase in incomes and lending was driving a surge in consumption. Some discussants conjectured that the saving ratio would continue rising given the current level of monetary tightness. This would happen as a result of higher deposit rates and a gradual slowdown of the increase in retail lending following the toughening of the requirements under the subsidised programmes and the macroprudential measures. Others believed that further monetary policy measures would be needed to ensure higher saving ratio.

The assessment of the monetary tightness was one of the key topics of the deliberations. According to some participants, the lack of a notable deceleration in the lending expansion might be evidence of insufficiently tight monetary conditions, which would require additional monetary policy measures. Others said that more time was needed for the tightened price conditions to fully translate into the lending dynamics. Expecting a key rate decrease in the near future, many economic agents could raise loans either at floating interest rates or planning to refinance them on more beneficial terms. Following the Bank of Russia's communication, these expectations should be adjusted, which will influence the lending growth rate. Furthermore, the growth of credit is considerably affected by the subsidised programmes. After the termination of the non-targeted subsidised mortgage programme from July, the effect of the monetary policy pursued on credit activity should become more significant. Additional data are needed to draw a conclusion whether the current monetary conditions are sufficiently tight or not.

EXTERNAL ENVIRONMENT

MAIN FACTS

The world economy continued to expand steadily. In 2024 Q1, the euro area and China demonstrated higher economic growth rates than expected in April, whereas the US economy was slightly below the forecast. From the beginning of the year, inflation in key advanced economies stabilised at elevated levels. Contrastingly, because of subdued consumer demand, inflation in China remained low. Market expectations about the US Fed and ECB policy rates suggest that monetary policy normalisation in the USA and the euro area will be slower than predicted before. Prices for most Russian exports were down since the April key rate meeting, but stayed above the levels of early 2024. From the beginning of 2024, the current account surplus was larger than last year. The value of exports was generally close to last year's readings, while the value of imports edged down.

DISCUSSION

The participants in the discussion concurred that, **over the period from the April meeting, the external environment was generally in line with the Bank of Russia's baseline forecast**.

The world economy stays resilient to higher interest rates and has been growing fast. Its steady expansion is supporting prices for Russian crude and other exports. However, with the current crude prices, non-OPEC+ oil production has been soaring, which is containing the rise in prices. Nevertheless, oil prices remain high and stable overall, being consistent with the assumptions of the baseline scenario. The extension of the OPEC+ agreement[1] will additionally prop up crude prices.

The situation in the global grain market does not involve any significant inflationary risks so far, including because of flexible export duties.

The disinflation process is slow worldwide. Hence, key advanced economies are likely to considerably ease their monetary policies later than expected in April. Therefore, the gap between internal and external interest rates will also be narrower than predicted earlier and **may act as a factor**

[1] OPEC+ decided to extend the voluntary oil production cuts by 2.2 million barrels per day through September 2024, with a further gradual increase in production by the end of 2025, as well as to extend the main production cuts through 2025.

reducing the tightness of monetary conditions in Russia. However, this transmission channel is still weaker than it used to be before 2022.

The current account surplus remained larger YoY. This was associated with both stable export dynamics and a more moderate increase in imports. There was no seasonal rise in imports in March–April. Imports could be affected by problems with payments. Furthermore, imports are influenced by tight monetary policy dampening the demand for imports and making ruble assets more attractive.

The moderate dynamics of imports associated with the sanctions, coupled with stable exports, are paving the way for ruble strengthening, which has a disinflationary effect. Concurrently, such a trend reduces the supply of goods and services and increases importers' transaction costs, which might have a proinflationary effect if domestic demand stays high. Some discussants said that the proinflationary effect would prevail, while the majority noted that **the ultimate effect on inflation was still a factor of uncertainty**.

INFLATION RISKS

The participants in the discussion inferred that the **ratio of risks had shifted towards proinflationary ones even more**.

The main **proinflationary risks** mentioned by the discussants were as follows:

- *Increased labour market tightness*. Further expansion of labour shortages may lead to labour productivity lagging even more behind the growth of real wages. Eventually, high utilisation of production capacities and staff shortages may contribute to the increased imbalance between the dynamics of supply and demand, which in turn will be conducive to persisting high inflationary pressures or their growth.

- *Persistently large lending amounts under the government subsidised programmes,* in particular if lending expands within other programmes after the termination of the non-targeted subsidised mortgage programme from July. When subsidised lending that is not responsive to key rate changes remains significant, this is weakening the effect of the key rate on the overall lending dynamics and involves the risk that inflation might get entrenched at the current elevated level, as well as is augmenting the burden on the budget. Consequently, a more significant monetary policy response might be needed to bring inflation back to the target.

- *Worsening of the terms of foreign trade due to the impact of the geopolitical situation and deteriorating conditions in global commodity markets*. In particular, a decline in exports coupled with persistently high demand for imports might create risks to the ruble exchange rate and inflation dynamics.

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

- *Expansion of the budget deficit and the emergence of secondary effects associated with the structure of extra revenues and expenditures of the budget system*. The rise in the mineral extraction tax and the profit tax (for a number of export-oriented industries) increases the procyclicality of fiscal policy. If the situation in global commodity markets worsens, this might entail expansion of the budget deficit, which would have a proinflationary effect. Inflation risks are also associated with the pass-through of companies' costs related to the increased profit tax to prices. The discussants noted that the new structure of expenditures might have a stronger proinflationary effect despite the balance between budget expenditures and revenues. In particular, a further extensive use of instruments subsidising interest rates from the budget is creating leverage, making it possible to significantly expand domestic demand compared to more conventional areas of government expenditures. Furthermore, the proportion of the recipients of budget funds who are less sensitive to interest rate changes and demonstrate a higher propensity to consume is increasing in the new structure of budget expenditures. In addition to the structure of expenditures, the expectations of their steadily high amounts support demand, which might also provoke proinflationary risks.

Disinflationary risks are 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 pressures in the economy might be weaker. A number of the discussants also noted that the increased profit tax might have an additional downward impact on investment demand, which might in turn cause a short-term disinflationary effect. Another potential disinflationary factor is further strengthening of the ruble due to moderate imports growth if the latter largely results from the influence of tight monetary policy.

CONCLUSIONS FOR MONETARY POLICY AND THE KEY RATE DECISION

Taking into account the data received after the April decision on the key rate and the assessment of the developments relative to the Bank of Russia's April forecast, the **participants in the discussion were choosing between two alternatives**:

- Raising the key rate by 100–200 basis points to 17.00–18.00% per annum.

- Keeping the key rate unchanged at 16.00% per annum.

Those supporting **a key rate increase to 17.00–18.00% per annum** stated the following:

- *The economy had most probably deviated from the baseline scenario presented in April towards a more proinflationary one,* which was confirmed by the available data on GDP, inflation, the labour market, and lending. Current monetary conditions were not sufficiently tight to increase households' and businesses' propensity to save to the required level, slow down the lending expansion and cool down demand, while those were prerequisites for bringing inflation down to the target next year. Accordingly, a higher key rate would promote the conditions for a resumption of disinflation in the economy.

- *Higher inflation expectations had strengthened the inertia of the inflation dynamics and caused risks to the achievement of the inflation target in 2025.* A key rate increase would help make economic agents more confident in the Bank of Russia's determination to achieve the inflation target and prevent a further rise in inflation expectations and secondary effects.

The discussants arguing for **keeping the key rate at 16.00% per annum** stressed the following:

- *The monetary policy tightening, given its time-lagged effects, and the impact of factors independent of it had not yet fully translated into the demand and inflation dynamics.* Over the period from the April decision on the key rate and following the Bank of Russia's communication, monetary conditions tightened further, which would continue to influence lending and consumer activity. Furthermore, a number of factors not associated with monetary policy might additionally tighten monetary conditions, specifically the rollback of the non-targeted subsidised mortgage programme, the macroprudential measures, and the cancellation of the regulatory easing.

- *Disinflationary effects of the expansion of the economy's potential* (as a result of increased labour market flexibility and/or productivity growth) might be underestimated.

- *More data were needed to accurately assess the economic situation and the pace and persistence of the inflation trend.* The statistics received after the April meeting on the key rate were largely distorted by one-off factors, including the rise in car and communication prices, the leap-year effect on the GDP dynamics, and payments of increased annual bonuses. As of the moment of the decision, there were no data on many important indicators for April–May.

All the discussants agreed that **the alternative scenario had become more likely**. However, considering that the data on many macroeconomic indicators for 2024 Q1–early Q2 were distorted, additional information on the dynamics of lending, economic activity, the labour market and inflation was needed to draw a conclusion about the scenario of the economic developments. As of the moment of the June decision on the key rate,

there were no decisive arguments to reject the baseline scenario in favour of the alternative one and raise the key rate. However, if the statistics provide convincing evidence of the alternative scenario realising in the economy, in July, the Board of Directors might decide to significantly increase the key rate.

Following the discussion, **on 7 June 2024, the Bank of Russia Board of Directors decided to keep the key rate at 16.00% per annum from 10 June 2024**. The Board of Directors toughened the signal, stating that **it might raise the key rate at the next meeting and that monetary conditions in the economy should remain tight for a much longer period** than assumed in April. The monetary policy pursued will solidify the effects of the tightening of monetary conditions that happened in April and help bring inflation down to the target in 2025 and stabilise it close to 4% further on.