

Bank of Russia increases key rate by 200 bp to 15.00% p.a.

27 October 2023

Press release

On 27 October 2023, the Bank of Russia Board of Directors decided to increase [the key rate](#) by 200 basis points to 15.00% per annum. Current inflationary pressures have significantly increased to a level above the Bank of Russia's expectations. Steadily rising domestic demand is increasingly exceeding the capabilities to expand the production of goods and the provision of services. Inflation expectations remain elevated. Lending growth paces are invariably high. The updated medium-term parameters of fiscal policy assume a slower than expected decline in fiscal stimulus in the years ahead. Therefore, it is required to additionally tighten monetary policy to limit the upward deviation of inflation from target and return it to 4% in 2024. The return of inflation to target and its further stabilisation close to 4% also means that tight monetary conditions will be maintained in the economy for a long period.

In its further key rate decision-making, the Bank of Russia will take into account actual and expected inflation dynamics relative to the target and economic developments over the forecast horizon, as well as the risks posed by domestic and external conditions and the reaction of financial markets. According to the updated forecast of the Bank of Russia, annual inflation will range from 7.0 to 7.5% in 2023. Given the current monetary policy stance, annual inflation will decline to 4.0-4.5% in 2024 and stay close to 4% further on.

Inflation movements. Current inflationary pressures have significantly increased to a level above the Bank of Russia's expectations. In the third quarter, seasonally adjusted price growth averaged 12.1% in annualised terms (compared to 5.1% in the second quarter). Similarly, core inflation went up to 9.6% (compared to 5.7% in the second quarter). As of October 23, annual inflation rose to 6.6% from 6.0% in September.

Higher inflationary pressures are seen across an increasingly broader range of goods and services. This means that a steady rise in domestic demand is progressively exceeding the capabilities to expand the production of goods and the provision of services. These conditions boost businesses' appetite to pass higher costs on to consumers, which is driven among others by the weakening of the ruble and labour shortages.

Households' inflation expectations remain elevated. Businesses' price expectations have continued to rise, reaching multi-year highs. Analysts' inflation expectations for 2023 and 2024 have increased as well, but they are anchored close to 4% for the medium term.

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Monetary conditions have tightened further following the rise in the key rate in July–September. Since the September Board meeting, interest rates in the credit and deposit market have increased, as have OFZ yields. The OFZ curve remains flat, which indicates moderate tightness of current monetary conditions. Medium- and long-term OFZ yields are up following the reassessment of proinflationary risks by market players, among other things, as a result of a softening in medium-term parameters of fiscal policy.

Following the increase in deposit rates, credit institutions are seeing a higher inflow of household funds, including due to cash being returned to bank accounts. Concurrently, some funds have been transferred from current accounts to time deposits.

At the same time, the growth of nominal interest rates has so far affected lending to varying degrees. Growth in unsecured consumer lending has slowed. This comes as a result of shorter lags in the transmission of monetary policy decisions in this market segment and the effects of the recent macroprudential measures. Mortgage lending continues to expand apace, including due to the large volume of loans issued under government subsidised lending programmes. Taking into account high inflation expectations and the unchanged levels of nominal interest rates, such programmes are increasingly attractive to borrowers. Credit activity has remained high in the corporate segment, including due to the expectations of future payments for public contracts.

The Bank of Russia's key rate decision will speed up the formation of monetary conditions needed to ensure balanced growth in lending and steady disinflationary trends. This, among other things, suggests that in 2024 the proinflationary effect of broader fiscal stimulus on domestic demand will be offset by a decrease in the credit impulse. In the baseline scenario, the Bank of Russia predicts that the growth of banking credit to the economy will slow down to 5–10% in 2024 from 17–20% in 2023.

Economic activity. Recent data for the third quarter suggest that the economy is expanding faster than the Bank of Russia expected in September. High domestic demand is inducing the upward deviation of the Russian economy from the balanced growth path. This strengthens persistent inflationary pressures.

The steady growth of domestic demand is caused by expanding private demand, while public sector demand remains high and fiscal stimulus is expected to increase again. The growth in consumer activity is boosted by rising real wages and high credit growth. Significantly increased profits of companies and positive business sentiment, including due to the fiscal stimulus, support high investment demand.

The expansion of domestic demand is reflected, among other things, in increased demand for imports, which has substantially contributed to the weakening of the ruble since the beginning of 2023. Recent data on foreign trade show that imports have stabilised. In the coming quarters, demand for imports in ruble terms will continue to adjust to the recent key rate decisions.

In addition to external sanctions on imports, the key supply-side constraint on the Russian economy is related to labour market conditions. According to companies' surveys, the labour shortage continues to widen. Unemployment is at a historical low. Poor geographic and cross-sectoral labour force mobility is an additional structural constraint.

The Bank of Russia's monetary policy will create conditions to return the economy to the balanced growth path. In its baseline scenario, the Bank of Russia forecasts that GDP will grow at 2.2–2.7% in 2023, 0.5–1.5% in 2024, 1.0–2.0% in 2025, 1.5%–2.5% in 2026.

Inflation risks. Proinflationary risks remain substantial over the medium-term horizon.

The Bank of Russia's updated baseline scenario rests on the Government's decisions which have been already made regarding the medium-term expenditure path of the federal budget and the fiscal system as a whole. If the budget deficit increases further, proinflationary risks will rise again and tighter

monetary policy may be required to return inflation to target in 2024 and keep it close to 4% further on.

Persistently elevated inflation expectations and their further increase pose a significant risk. This will propel lending to continue its rapid expansion, while households' propensity to save will continue to decrease. As a result, growth in domestic demand will continue to outpace the supply expansion capacity, intensifying underlying inflationary pressures in the economy. Due to limited labour resources, labour productivity growth may lag further behind an increase in real wages.

Geopolitical tensions affecting terms of foreign trade also create proinflationary risks. Increasing foreign trade and financial restrictions can further weaken demand for Russian exports, contributing to inflation through exchange rate movements. In addition, the increasing complexity of production and supply chains and payments due to external restrictions may push up import prices. Significant short-term proinflationary effects may also be caused by a deterioration in the global economic outlook and a further rise in volatility in global financial markets.

Disinflationary risks are primarily related to the situation when domestic demand starts to slow down faster than expected in the baseline scenario. In addition, growth in prices for key Russian exports or an increase in their physical volumes may result in a stronger ruble.

The return of inflation to target in 2024 and its subsequent stabilisation close to 4% imply that tight monetary conditions will be maintained in the economy for long. In its further key rate decision-making, the Bank of Russia will take into account actual and expected inflation dynamics relative to the target and economic developments over the forecast horizon, as well as risks posed by domestic and external conditions and the reaction of financial markets.

Following the meeting of the Board of Directors regarding the key rate on 27 October 2023, the Bank of Russia has released its [medium-term forecast](#).

The Bank of Russia Board of Directors will hold its next key rate review meeting on [15 December 2023](#). The press release on the Bank of Russia Board decision is to be published at 13:30 Moscow time.

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