Elvira Nabiullina: Review of recent inflation developments in Russia and economic outlook

Statement by Ms Elvira Nabiullina, Governor of the Bank of Russia, in the follow-up to the Board of Directors meeting, Moscow, 6 September 2019.

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Today, the Board of Directors has decided to reduce the key rate to 7% p.a.

If economic conditions are in line with our forecast, we will look into further key rate reduction at one of the upcoming meetings.

Let me dwell on the main factors behind the decision.

First. Annual inflation has already approached 4%. Our estimates suggest that as of the year-end it will fall within the range of 4.0-4.5%. Meanwhile, inflation is forecast to stand at 3.5-4.0% in the opening months of next year. This is largely associated with the fact that the VAT rate increase will be factored out from the calculation of annual inflation. This may be considered as a purely technical factor. Sustainable trends point to inflation of about 4%.

Second. Inflation expectations of households and businesses remain elevated. Therefore, we stay focused on their dynamics.

Right now, I will not highlight the figures we released last week. However, I would like to note that previously we abstained from posting the results of surveys on household inflation expectations during ‘the week of silence’. We have discussed this issue and from now on we will publish these data as soon as they are released. It is essential that the market promptly receives the information which the Board of Directors consults when making its decision. The Bank of Russia will continue to publish its analytical commentary that summarises and estimates expectations of households, businesses and analysts, after ‘the week of silence’.

Third. Monetary conditions are continuing to loosen. We expect that both previous and today’s key rate decisions will underpin this trend.

Market expectations for interest rates shifted downwards on the back of the signals in the follow-up to the Board meetings in June and July. This was also driven by the shifting expectations for monetary policies of the US Fed and the ECB as the economic growth outlook for the US and euro area deteriorated.

The decline in interest rates comes with an easing of non-price lending conditions in terms of maturities and volumes. The easing of both price and non-price monetary conditions contributes to expansion in lending. According to our estimates, corporate lending will rise by 7-10% while retail lending will increase by 15–20% this year.

Fourth. Economic activity undershot the Bank of Russia’s expectations in the second and early third quarter. This results from internal and external factors. This made us revise our 2019 GDP growth forecast from 1.0-1.5% to 0.8-1.3%.

An important external factor is a slowdown in growth of the global economy, which has proven more tangible than expected due to, among other things, the growing contradictions in international trade. A weakening in domestic demand already reduced export quantities in the first half of the year, and we forecast that they will contract for a wide range of goods as of the year-end.

The deterioration in the global growth outlook also affects investment plans. Though, certainly, business sentiment depends not only on external factors but also on the business environment as a whole. In the first half of the year, growth in fixed capital investment slowed considerably, which is associated with, among other things, a rather sizeable drop in public investment. According to our estimates, even with a revival in national project expenditures in the second half of the year factored in, total growth of gross fixed capital formation will come in at no higher than 1% as of the year-end.

Consumer demand continues to make a positive contribution to GDP growth. This year, the expansion of lending continues to offer strong support to consumption growth. Loans, however, cannot be the main driver of growth in demand. Consumption growth will remain slack as household incomes stagnate. This year, we expect it to come in at 1-1.5% range.

We have also updated our medium-term baseline forecast. Now, we expect the dynamics of domestic and external demand to be more moderate in 2020–2021. The most notable revision has been made for export growth rates. This reflects the deteriorated world economic outlook amid rising trade tensions.

As a result, we may only expect GDP growth to accelerate to 2-3% by the end of 2022, rather than in 2021. A higher economic growth rate should primarily be driven by the shift to a more extensive implementation of national projects and other governmental measures aimed at removing structural constraints. This will promote an increase in investment demand and a quicker rise in labour productivity, household income and, accordingly, consumption.

Lending will sustainably expand over the entire forecast horizon supporting economic growth. Corporate lending will annually increase at a pace of 6-10%, and household lending will grow by 10–15% each year. Mortgage loans will account for the bulk of household lending growth. Meanwhile, macroprudential measures will gradually reduce the growth pace of consumer lending.

We have updated the balance of payments to factor in the world economy dynamics, prices for oil and other Russian exports. We assume a gradual decline in oil prices to 50 US dollars per barrel in 2021 (as compared to 55 US dollars considered earlier). If external demand weakens, prices for other Russian exports will drop, too. In such conditions, the current account balance will shrink from 83 billion US dollars (5% of GDP) this year to 28 billion US dollars (which is about 2% of GDP) in 2022.

Given the actual dynamics observed since the beginning of the year, we have also slightly lowered the 2019 forecast for the private sector’s financial account balance from 50 to 40 billion US dollars. Later on, it is expected to gradually reduce to 20 billion US dollars by the end of 2022. I would like to emphasise once again that the fiscal rule mechanism smooths out the impact of a decrease in the current account balance on the domestic economic environment. However, it only pertains to oil price fluctuations.

I would like to stress that we have slightly changed our approach to publishing forecast scenarios. The key rate decision relies on our baseline macroeconomic forecast and the analysis of uncertainties and risks for the baseline forecast. This is the reason why we will continue to publish the baseline scenario four times a year in our press releases and Monetary Policy Report following core meetings.

We will release our supplementary scenarios – the high oil price scenario and the risk scenario that assumes that prices will plunge – in the same manner as the baseline scenario but once a year, in the Monetary Policy Guidelines. It is determined by the essence of these scenarios that remains almost unchanged across the meetings. The 2020–2022 Guidelines will be published on Monday.

Winding up, I would like to comment on monetary policy prospects.

After the five years of the evolution from tight to moderately tight and then to neutral monetary policy, we have finally entered the key rate range we consider as a probable neutral interval. Given today's decision, the key rate is at the top of this range equalling from 6% to 7% in nominal terms, or from 2% to 3% in real terms, which is the same, with inflation expected to reach 4%.

In this regard, it is of note that the neutral key rate estimate is not 'a point', but a range of values. It depends on various domestic and global drivers, as well as the monetary policy transmission mechanism, and may alter, being affected by them. It will therefore take time to 'feel' the thresholds of this 'neutral range' and make sure that they are in line with our current estimates. If necessary, we will adjust these estimates.

A sustainable inflation rate close to the 4% target will be the key criterion suggesting that we are right in our estimates of this range.