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, 10 September 2021.

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Good afternoon,

We have made the decision to raise the key rate by 25 basis points to 6.75% per annum and we hold open the prospect of further rises at the upcoming meetings.

Our today's decision is based on the following.

First, the economy is returning to a balanced growth path. Although the pandemic persists, economic activity bounced back to its pre-pandemic levels already in the second quarter of 2021. Moreover, excluding the oil sector where production is still limited due to the OPEC+ agreement, output in the economy has not only recovered, but returned to the trend, to the growth path observed before the outbreak of the pandemic. Employment has restored almost completely. According to July data, the unemployment rate is close to its record lows. In other words, a further development of the economy and output growth will predominantly depend on the growth rate of labour productivity. According to the Bank of Russia's estimate, taking into account the structural measures implemented by the Government, the pace of such balanced, or potential GDP growth, which is the same, will equal from 2% to 3% annually.

Of course, the development of the economy is uneven. The pandemic caused significant changes in the work and everyday life of both households and businesses. As the economy continues to adjust to these changes, the situation is still uneven across different sectors. In addition to the above-mentioned oil industry, passenger transportation and international travel still remain below pre-pandemic levels as well. When restrictions were toughened, public catering and entertainment companies faced a decline in the demand for their services. Nonetheless, a lot of industries are demonstrating steadily higher output and sales than before the outbreak of the pandemic. Specifically, there has been a surge in the demand for durable goods (computers, telecommunication devices, and household appliances) and online trade and delivery services. The lockdown period boosted the demand for countryside housing and better housing conditions in general. These uneven trends across both industries and regions are also described in the Regional Economy report released by our regional branches before the quiet period.

The situation in the labour market also evidences that the economy has not only recovered, but is generally returning to its pre-pandemic growth path. The number of vacant jobs is at its peaks. High demand for labour resources is demonstrated by companies in construction and transport, a whole range of manufacturing enterprises, and in trade. These are the industries that started to bounce back earlier and were recovering faster and where demand exceeds pre-pandemic levels. A further expansion of output is possible through a restoration of the inflow of labour migrants, but — first of all — through an increase in labour productivity. This all means that after the rebound of the economy completes, it will develop more smoothly, at a more gradual pace, as compared to the recovery growth of output observed over the last 12 months.

In a situation when companies experience a shortage of workers or components, monetary policy measures promoting demand will not increase output or consumption. For instance, if the demand for cars rises even more, this will not boost their output, when there are no parts, but will only increase the queues for them and speed up price growth.

As regards inflation, it is above the forecast rate, and inflation expectations remain high. In August, annual inflation was 6.7%. According to the steady indicators of inflation measuring the inflation rate without volatile components, inflationary pressure continued to considerably exceed our target in both August and early September.

Indeed, inflation is impacted by multiple factors that do not depend on our monetary policy. The most important of them are world commodity prices, the country's fruit and vegetable harvest, and bottlenecks in global supply chains (container shipments, microcircuit manufacture, etc.). It has been stated recently that these factors should be completely ignored if monetary policy cannot influence them.

This opinion leaves out one essential circumstance, namely, the fact that all these factors impact inflation expectations which, in turn, influence consumers' sentiment and behaviour. Hence, they drive inflation across a wide range of products. Higher inflation expectations boost demand and increase the extent of the pass-through of higher costs to consumers. As a result, companies have the opportunity to almost completely pass costs to prices and thereby maintain or even increase their profits, which in turn discourages them to take efforts in order to reduce costs and improve labour productivity.

Monetary policy should prevent the inflationary spiral from getting out of control. Therefore, it should respond to transitory factors to the extent they transform into steady factors through higher inflation expectations. This is especially relevant when households' inflation expectations and companies' price expectations are at their peaks recorded over several years, as they are now.

Third, monetary conditions are adjusting to key rate increases faster.

Over the period after our July meeting, the yield curve of federal government bonds with maturities of up to three years has risen. Furthermore, yields on long-term government bonds remain almost unchanged since last March, when we started to raise the key rate. I would like to remind you once again that the stability of long-term interest rates is crucial for the stability of bank rates on investment loans and mortgages.

Interest rates in the deposit market were growing in July—August. The demand for bank deposits started to edge up. As of the end of July, the outflow of funds from retail time deposits ended for the first time since the beginning of last year. Moreover, it even reversed to a slight inflow in August, according to recent data. Our today's decision on the key rate will support this trend, increasing the attractiveness of deposits and the propensity to save.

Lending still continues to expand at a fast pace. In July, the annual growth rate in corporate lending remained close to its six-year high. Growth in mortgage lending has slowed down somewhat after the conditions of the subsidised programme were changed, but is still close to its peaks as well. Unsecured consumer lending remains a matter of our great concern as annual growth rates in this segment continue to rise still, including due to the base effects. If the current trends persist, we admit the possibility of additional macroprudential measures to cool down this segment of the credit market, besides those provided for beginning from 1 October.

Monetary conditions continue to adjust to our decisions. At our next meetings, we will consider changes in interest rates and in credit and deposit activity and assess whether these changes are sufficient in order to create such monetary conditions that would help bring inflation back to 4% and stabilise it at this level.

As regards the risks to the forecast, their balance is still significantly shifted towards proinflationary ones.

The key demand-side risk is persistently elevated inflation expectations, fuelled by, among other factors, the still high inflationary pressure in the global economy. Another important risk is that deposit and credit rates are adjusting to the changes in the key rate more slowly than we expect, that is, the transmission of our decisions to monetary conditions takes more time.

As to supply-side risks, logistics problems and bottlenecks in production chains remain a significant risk as these issues may persist longer than we estimate today. The above-mentioned problem of a limited availability of labour resources is another risk, which is becoming increasingly important. Moreover, this problem may become even more serious. This is equally relevant for both the Russian labour market and the constraints experienced by other economies.

A decline in global demand due to a slowdown in the world economy may become a disinflationary risk. This may happen, for instance, in the case of a large-scale new wave of the pandemic, accompanied by extensive lockdowns in the majority of countries. Another scenario where inflationary pressure might also weaken faster in the Russian economy is a quick easing of the restrictions on foreign travel for both outbound tourism and the inflow of labour migrants.

There is a number of factors, the potential impact of which is uncertain today. In the first place, these are the volumes and quality of the grain and vegetable harvest this year both in Russia and worldwide. Moreover, it is still uncertain how steady global inflation is and how fast and extensively other central banks will respond to it.

Winding up, I would like to comment on our future actions.

We hold open the prospect of further key rate rises at the upcoming meetings. We will assess whether it is reasonable to increase the key rate, as well as how long the key rate should be maintained at the level achieved taking into account economic developments, inflation trends, and largely the balance of risks to future inflation, including those associated with persistently elevated inflation expectations.

In addition to the baseline scenario, we also consider various other scenarios of potential developments in the Russian and global economies. The three scenarios describing the key possible circumstances in the external environment were released last week in the Monetary Policy Guidelines for the next three years. Monetary policy will be able to bring inflation back to the target regardless of whether the baseline or an alternative scenario materialises.

Thank you all for your attention.