

Alexey Zobotkin: Monetary Policy Guidelines for 2022–2024

Speech by Mr Alexey Zobotkin, Deputy Governor of the Bank of Russia, at the press conference on Monetary Policy Guidelines for 2022–2024, Moscow, 2 September 2021.

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Good afternoon,

At the beginning of September, we usually release the first draft of the Bank of Russia's strategic document on monetary policy — the Monetary Policy Guidelines for the next three years. Today's event is held to present this document.

Monetary policy goals and principles

The goal of monetary policy is to maintain price stability. The Bank of Russia implements its monetary policy within the inflation targeting regime, seeking to ensure the annual growth rate of the consumer price index of around 4%.

We influence the economy primarily through money market rates keeping them close to the key rate. The effect of monetary policy and key rate decisions on the economy and price movements has a significant time lag. Therefore, when making our decisions, we always rely on the comprehensive analysis of the current situation and the medium-term macroeconomic forecast. Moreover, it is crucial to take into account the balance of risks in the baseline forecast and other possible developments of the situation. According to economists, this is what is called a robust policy.

Another important instrument of our policy is communication. We adhere to the principle of communication transparency to implement our monetary policy efficiently. We believe it essential for financial market participants, businesses, and households to understand how our policy responds to changes in the economy and how we ensure price stability. To this end, beginning from April 2021, the Bank of Russia publishes the projected path of the key rate as one of the indicators of its medium-term forecast. We have also systematised and released the materials about the model-based approaches we apply to build our forecasts.

People's confidence in the monetary policy pursued is critical to anchor inflation expectations, reduce the inflation risk premium, and maintain interest rates at a moderate level. The Monetary Policy Guidelines we present annually promote this confidence.

Economic situation in 2020–2021

For the second consecutive year, the global economy has been developing in the conditions of the coronavirus pandemic. The main problem a year ago was plummeting aggregate demand, whereas the major challenge since the beginning of this year has been increasingly higher inflationary pressure. Russia is no exception. After the downturn of last year, our economy has swiftly recovered. The rebound was faster than many expected. Russia's GDP returned to its pre-crisis level as early as 2021 Q2, despite the remaining oil production cuts under the OPEC+ deal. This rise was driven by, among other things, fiscal support measures and accommodative monetary policy.

However, due to the pace of the recovery, disruptions and bottlenecks in production chains caused by anti-pandemic restrictions, shifts in the structure of final demand from services towards products, a number of industries faced a situation when the expansion of demand surpassed their potential to ramp up output. This involves not only a shortage of production capacities, but also of labour resources. Among other reasons, this was caused by restrictions on the inflow of labour migrants and a larger number of employees who are on the sick leave

or in self-isolation.

Although many of the factors fuelling inflation this year are due to supply issues, this is the expansion of demand which makes it possible for companies to simultaneously and fully pass their increased costs on to output prices and build up their output.

No less important is the fact that higher inflation expectations also boost demand, especially for durable goods. In the middle of this year, households' and businesses' inflation expectations in Russia rose to their five-year highs.

When the expectations regarding future inflation are elevated, households have a lower propensity to save and rather prefer to spend more for current consumption. Moreover, as interest rates are low, households opt to invest in higher-risk securities market instruments, rather than deposit their savings. Companies tend to revise their prices more often. Employees assume that the growth rate of wages will be higher.

Short-term inflation fluctuations around the central bank's target, for instance, those observed in Russia in 2017, 2018, and 2019, with inflation expectations being relatively stable and even lowering, do not contradict price stability. Conversely, high inflation expectations that might entail a longer-lasting deviation of inflation upwards from the target involve significant risks to it. These are the risks of a decline in the purchasing power of incomes and savings, which is especially sensitive for the most economically vulnerable groups of the population. Monetary policy should mitigate such risks.

Therefore, already in March 2021, as the economy bounced back to its pre-pandemic level, the Bank of Russia started to raise the key rate from its record-low of 4.25% to 6.5% p.a. following the July meeting of the Board of Directors. The Bank of Russia will make decisions on its further moves depending on the path of economic development and the trends of inflation and inflation expectations.

Baseline scenario

I would like to remind you that the Bank of Russia updates its medium-term baseline forecast four times a year in the course of the Board of Directors' core meetings on the key rate. The forecast presented in the draft Guidelines was released earlier following the meeting held on 23 July 2021, but this draft extends the forecast horizon to 2024. The key assumptions of the baseline scenario are as follows: (1) a gradual improvement of the pandemic situation worldwide owing to the progress of the vaccination, the development of the herd immunity, and the absence of new, more dangerous coronavirus strains; (2) the continuing recovery of the global economy; (3) debottlenecking the supply chain; (4) phasing-out of stimulus measures in major economies beginning from 2021 H2 and timely normalisation of their monetary policies to prevent persistently rising inflationary pressure.

After the accelerated recovery, the Russian economy will slow down to its potential growth rate in 2022. Taking into consideration the structural measures implemented by the Government to boost the potential growth pace, it will probably edge up to 2–3% a year over the forecast horizon. Annual inflation will go down gradually from 2021 H2 as a result of the weakening impact of temporary factors and the effect of the earlier monetary policy decisions made by the Bank of Russia. Given the actual price growth rate in 2021 H1, we expect that inflation will reach 5.7–6.2% as of the end of the year. Next year, inflation will slow down to 4.0–4.5% and will stay close to the Bank of Russia's 4% target further on. The key rate will average 6–7% p.a. next year and then return to its long-term neutral range estimated by the Bank of Russia at 5–6% p.a.

Alternative scenarios

Nevertheless, there is still significant uncertainty about how the situation might be unfolding

in the future. Seeking to pursue a robust monetary policy, the Bank of Russia considers three alternatives in its Guidelines in addition to the baseline scenario. I would like to emphasise that the alternative scenarios are less probable than the baseline one.

This year, the logic behind the alternative scenarios is based on the key possible factors in the external environment. First of all, this is the risk of the pandemic worsening in 2022. Secondly, we consider the risk of a more persistent rise in inflationary pressure in the world economy and, accordingly, a faster and more considerable tightening of monetary policies by foreign central banks in the next few years. Thirdly, this is the risk that a considerable increase in debt burden in a number of countries might provoke a financial crisis over the medium-term horizon.

The Worsening Pandemic scenario assumes that many countries will have to reintroduce tough anti-pandemic restrictions, which will drag down economic activity. Consequently, as in the previous year, Russia will face a decline in the demand and prices for its exports and will also be forced to impose anti-pandemic restrictions, which will reduce domestic demand, although not as drastically as in 2020. Nonetheless, contracting demand will cause a faster decline in inflationary pressure, as compared to the baseline scenario. Hence, it will become reasonable to cut the key rate as early as 2022 H1. The economy will start to recover in 2022 H2, and it will be appropriate to shift towards neutral monetary policy in order to maintain price growth rates in the future.

According to the Global Inflation scenario, the acceleration of global inflation will become steadier by 2022. Elevated inflationary pressure and a further rise in inflation expectations will force advanced economies' central banks to start monetary policy normalisation earlier. In particular, the US Fed might begin to raise its policy rate as early as 2022 Q2. Monetary policy normalisation in advanced economies will cause a decline in external demand and, consequently, a slightly lower growth pace of the Russian economy in 2023–2024, as compared to the baseline scenario. Furthermore, inflation will speed up in 2022, spurred by a rise in Russian companies' costs and higher inflation expectations. Nonetheless, in 2023–2024, inflation will edge down closer to 4% due to contracting external demand and a tighter monetary policy than assumed in the baseline scenario.

The third alternative considered in the Guidelines this year is the Financial Crisis scenario. Its difference from the Global Inflation scenario is in how financial markets might respond to monetary policy normalisation in the USA. The rebound in the world economy and low rates caused spikes in debt burden, primarily public debt. This process still continues, although at a more moderate pace. It remains to be seen yet whether particular countries are capable of handling this debt burden. If it turns out to be excessive, monetary policy normalisation in advanced economies might provoke a credit crisis which is assumed to outbreak in 2023 according to our scenario. In the case of a decline in external demand and prices for Russian exports, increased uncertainty and risks will entail a downturn in the Russian economy in 2023.

A deterioration of the external economic environment and risk premiums in global financial markets will weaken the ruble, which will become a considerable, although temporary proinflationary factor. In order to limit risks to price stability, the Bank of Russia will need to substantially tighten its monetary policy in early 2023. As proinflationary risks lower and inflation expectations normalise, the Bank of Russia will ease its monetary policy, which will support the recovery growth of the economy in 2024.

Long-term factors (ESG, demography)

The scenarios described give an idea of how the economic situation might develop in the mid run. However, there are some factors that have not yet manifested themselves significantly, but are critical in the long term. These are climate and demographic changes. They

might impact both the development of the economy in general, that is, the overall economic balance, and the monetary policy transmission mechanism. These issues are covered in specific boxes included in the draft Guidelines.

Review of monetary policy

Winding up, I would like to remind you that the Bank of Russia has announced its plans to review its monetary policy over the period since the switch to the inflation targeting regime. Within this review, the Bank of Russia will analyse the actual results achieved, the changes in the economic environment over this period, and long-term trends that might impact the implementation of monetary policy in the future. The results of this work and the findings relevant for the parameters and practice of the Bank of Russia's policy will be presented by the middle of next year and will be taken into consideration in the course of the elaboration of the Guidelines for 2023.

Conclusion

Recently, Russia's economy has demonstrated multiple times its ability to adjust to the changing environment. Regardless of how the situation unfolds, we will do our best to create necessary conditions to further develop the country's economy and enhance its resilience. Monetary policy aimed at ensuring price stability and enabling a countercyclical response to changes in the economy is an essential condition for sustainable and well-balanced economic growth.

Thank you for attention. I am ready to answer your questions.