GAIDAR INSTITUTE FOR ECONOMIC POLICY

RUSSIAN ECONOMY IN 2023

TRENDS AND OUTLOOKS

(*Issue 45*)

Gaidar Institute Publishers
Moscow / 2024

UDC 338.1(470+571)“2023”
BBC 65.9(2Рос)”

R95 **Russian economy in 2023. Trends and outlooks. (Issue 45)** / [V. Mau et al; scientific editing by Kudrin A.L., Doctor of sciences (economics), Radygin A.D., Doctor of sciences (economics), Sinelnikov-Murylev S.G., Doctor of sciences (economics)]; Gaidar Institute. – Moscow: Gaidar Institute Publishers, 2024. – 422 pp.: illust.

ISBN 978-5-93255-672-6

The review “Russian economy. Trends and outlooks” has been published by the Gaidar Institute since 1991. This is the 45th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 5 big sections that highlight different aspects of Russia’s economic development, which allow to monitor all angles of ongoing events over a prolonged period: the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

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ISBN 978-5-93255-672-6

1.1. Russia's monetary policy in 2023 [1]

1. Key trends of monetary policy

In 2023, monetary policy of the Bank of Russia continued to be implemented amid significant restrictions on capital movements, freezing of international reserve assets and trade restrictions, thereby creating additional risks for macroeconomic and financial stability.

During 2023, inflation accelerated, driven by rapid growth of aggregate demand in Russia amid mild fiscal policy, as well as by transfer to prices of the ruble depreciation. This marked the beginning of tightening the monetary policy cycle in H2 2023. In H1, the regulator kept the key rate unchanged at 7.5% per annum, only tightening the key rate movement signal at each subsequent meeting.

Since July 2023, the CBR has raised the key rate five times: on July 21 by 1 p.p. up to 8.5% per annum, on August 14 by 3.5 p.p. up to 12.0% per annum, September 15 by 1 p.p. up to 13% per annum, on October 27 by 2.0 p.p. up to 15% per annum and on December 15 up to 16% per annum (*Fig. 1*).

Moreover, the August meeting of the Bank of Russia turned out to be unscheduled and was caused by the weakening of the ruble exchange rate. Considering that after several rounds of rate increases lending growth rates remained high, and signs of a slowdown in certain segments appeared only in October 2023, the CBR still plans to maintain tight monetary conditions in the economy for a long time.

In 2023, a significant decline in the current account balance (4.7 times in 2023 vs 2022) impacted the domestic foreign exchange market, reducing the supply

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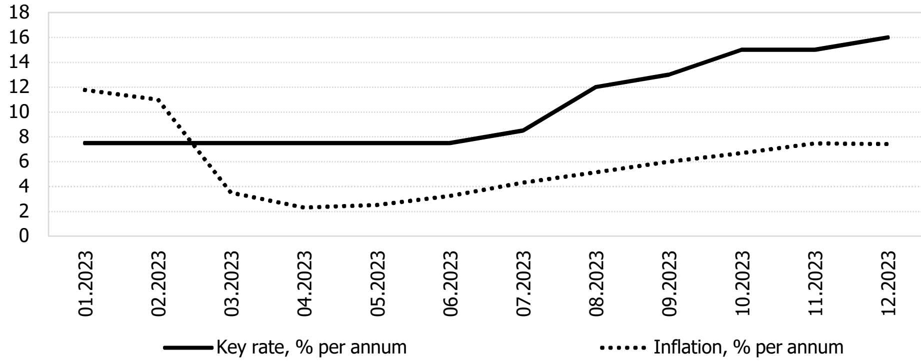

Fig. 1. Dynamics of the Bank of Russia key rate (% per annum) and inflation (% for previous 12 months) in 2023

Source: Bank of Russia.

of foreign currency in Russia against growing demand from importers, while aggregate demand expanded rapidly.

Apart from that, the currency imbalance in international settlements resulting from the expansion of payments in rubles, challenges in conducting transactions in the currencies of countries that imposed sanctions against Russia, as well as in the currencies of a number of friendly countries due to their limited convertibility, played a certain role in the depreciation of the ruble.

A striking example is the currency imbalance between Russia and India, which arose as a result of a trade imbalance: Russian exports to India significantly exceed imports of Indian goods to Russia. This caused the accumulation of Indian rupees in the accounts of Russian exporters in Indian banks due to limited opportunities for their conversion into rubles, a reduction in the inflow of export revenues to Russia and weakening of the ruble.

Weakening of the ruble started as early as Q4 2022 and continued for four consecutive quarters; thus, as a result, the ruble/dollar exchange rate has decreased 1.7 times to Rb97.41 /dollar at the end of Q3 2023. Having said that, the exchange rate dynamics became one of the factors of inflation acceleration.

In H2, the ruble was supported by a gradual tightening of monetary policy by the Bank of Russia, as well as by suspension of currency purchases in the domestic market under the fiscal rule. Moreover, mandatory sale of export proceeds by some major Russian exporters was reintroduced on October 16, 2023 aimed to stabilize the foreign exchange market.

In compliance with the rules, at least 80% of export foreign currency proceeds must be credited by the exporter to accounts with Russian banks within 60 days of receipt. However, mandatory sale of export proceeds should be at least 90% of the credited funds and not less than 50% of each contract.

As a result, the size of net sales of export proceeds increased from $23.1 bn in Q3 2023 to $41.2 bn in Q4 2023. This measure supported ruble, resulting in growth in the supply of currency already in November 2023. It has to be recalled that a similar measure was temporarily introduced in 2022, which also contributed to financial stability in 2022.

During 2023, the CBR repeatedly revised the inflation forecast and the expected pathway of the key interest rate, taking into account changing external economic conditions, as well as the dynamics of domestic economic activity. In February 2023, the inflation rate forecasted by the regulator at the end of the year amounted to 5–7% with the average annual interest rate of 7–9%. In April, the Bank of Russia lowered its inflation forecast to 4.5–6.5% with the key rate of 7.3–8.2% per annum. However, due to the continuing growth of domestic demand exceeding the capacity to increase supply, shortage of employees in the labor market, and the increase in government spending, the regulator's forecast has been revised upward three times since April 2023.

In this way, in October 2023, the inflation forecast for the end of 2023 was raised by the Bank of Russia to 7.0–7.5% with the average annual rate of 9.9% (*Table 1*). The inflation forecast for the end of 2024 was raised to 4.0–4.5%, and the forecast for average inflation in 2024 increased by 0.8–0.9 p.p. to 5.8–6.5%. Furthermore, the Bank of Russia raised its estimate of the neutral key rate from 5.0–6.0% at the beginning of the year to 6.0–7.0%. This means that with all other things being equal, the Central Bank of Russia will maintain increased interest rates to ensure price stability (12.5–14.5% per annum on average in 2024, 7–9% p.a. in 2025).

Table 1

Mid-term forecast by the Bank of Russia

Month of the forecast publication	February 2023	April 2023	July 2023	September 2023	October 2023
Inflation, December 2023 against December 2022, %	5–7	4.5–6.5	5.0–6.5	6.0–7.0	7.0–7.5
Average inflation for 2023, % against previous year	4.0–5.3	3.9–4.9	5.1–5.7	5.5–5.9	5.8–5.9
Mid-year key rate in 2023, % per annum	7–9	7.3–8.2	7.9–8.3	9.6–9.7	9.9

Source: own estimates based on mid-term forecasts of the Bank of Russia

Trends observed for Russia's inflation in 2023 driven by structural reorganization of the economy under sanctions differ from the global trends. In 2023, inflation was slowing down in most countries of the world. This is due to the tightening of monetary policy and stabilization of world prices for food and energy commodities. Thus, inflation in the USA dropped from 6.5% in December 2022 to 3.4% in December 2023, from 9.2% in December 2022 to 2.9% in December 2023 in the Eurozone, from 10.5% in December 2022 to 4.0% in December 2023 in Great Britain (*Table 2*).

Table 2

Inflation and key rate in a number of developed and developing countries

	Actual inflation, December 2023 against December 2022, %	Key rate at the end of December 2023, % p.a.
Developing countries		
Poland	6.20	5.75

	Actual inflation, December 2023 against December 2022, %	Key rate at the end of December 2023, % p.a.
Indonesia	2.1	6
India	5.69	6.5
Peru	4.4	6.5
Chile	4.15	7.25
South Africa	5.10	8.25
Hungary	5.50	10.00
Brazil	4.62	11.25
Mexico	5.09	11.25
Columbia	9.28	12.75
Kazakhstan	9.80	15.25
Russia	**7.40**	**16.00**
Turkey	64.77	45.00
Developed countries		
Australia	4.1	4.35
Norway	4.8	4.5
EC	2.9	4.5
Canada	3.4	5
Great Britain	4	5.25
USA	3.4	5.5
New Zealand	4.7	5.5
Czech Republic	6.9	6.75
Iceland	7.7	9.25

Source: websites of central banks

By Q4 2023, the cycle of monetary policy rate hikes in the developed G20 countries has been completed. In the US, the federal funds rate reached in September a twenty-year high of 5.25–5.5%, while in the eurozone it has hit an all-time high of 4.5%. In developing countries, the rates remained elevated, reached by the end of 2022. In addition to Russia, the cycle of key rate increases was resumed by the central bank of Turkey from mid-2023.

As a result of tight monetary policy by central banks of both developed and developing countries, real rates measured based on actual inflation evidenced

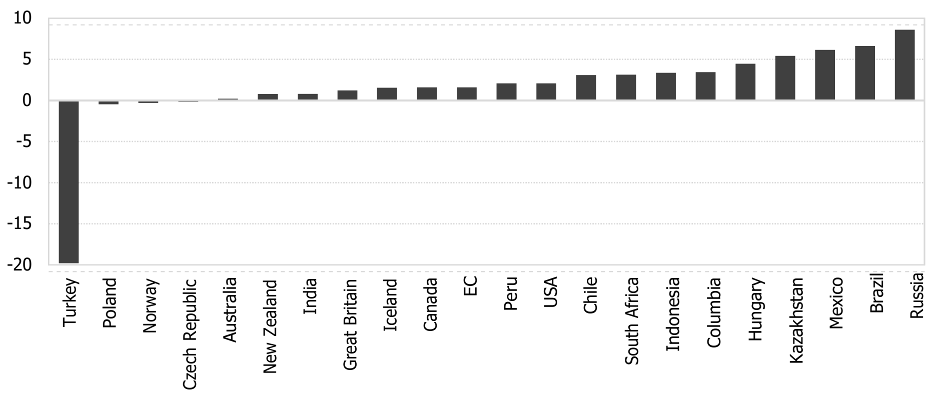

Fig. 2. Real key interest rate at the end of December 2023, % p.a. (measured based on inflation for the previous 12 months)

Sources: websites of central banks; own calculations positive in most countries in 2023 (8.6% p.a. in Russia, 6.63% p.a. in Brazil, 5.45% p.a. in Kazakhstan, 2.1% p.a. in Peru, 2.1% p.a. in the US, 1.6% in the EU) (*Fig. 2*).

Among the reviewed countries, Russia is the leader in terms of the real key interest rate at the end of December 2023. Negative real key interest rate in December 2023 was established in a number of developed countries, including the Czech Republic (-0.15% p.a.), Norway (-0.3% p.a.), as well as in Turkey in the context of significant acceleration of inflation (-19.8% p.a.).

On the whole, inflation, both overall and core, continues to be well above target in most of the countries under consideration, indicating persistent elevated price pressures and suggesting a prolonged period of tight monetary policy.

2. Monetary market

The Bank of Russia's policy in 2022 made it possible to stabilize the situation in the monetary market and satisfy banks' demand for ruble liquidity. In H1 2023, monetary market evidenced a liquidity surplus[1] in the amount of Rb1.8 trillion on average. High values of liquidity surplus at the beginning of the year (Rb3.4 trillion on average in January 2023) due to the inflow of funds to banks resulted from budget operations gradually declined (to Rb0.5 trillion in July 2023) due to the April increase in mandatory reserve requirements, as well as to the growing demand for cash mainly because of the increase in cash settlements in new regions of Russia.

In July 2023, the size of liquidity surplus has significantly reduced, and since mid-September, monetary market turned to liquidity deficit of the banking sector. This transition is primarily associated with the suspension of mirroring[2] operations under fiscal rule (cessation of foreign currency purchases by the Central Bank of the Russian Federation until the end of 2023) from August 10, 2023 due to the need to stabilize the domestic foreign exchange market. Fiscal operations also contributed to the outflow of bank liquidity in H2 2023 (*Fig. 3*).

1 According to the definition of the Bank of Russia, the level of structural liquidity deficit/surplus means the difference between the debt on refinancing operations and absorption operations of the Bank of Russia. Structural liquidity deficit of the banking sector is a state of the banking sector marked by a stable need of credit institutions to attract liquidity through operations with the Bank of Russia. The reverse situation, i.e. a stable need of credit institutions to place funds with the Bank of Russia, is a structural liquidity surplus. Since November 2023, the Bank of Russia has clarified the methodology for calculating the liquidity deficit/surplus of the banking sector. Now the balance between the balances on banks' correspondent accounts and the averaged amount of required reserves (RRR) is taken into account when assessing the indicator. Taking into account in the calculation the balance between banks' correspondent accounts and the RRR allows excluding the impact on the indicator of operations that reflect banks' strategies for maintaining the RR.

2 Operations carried out by the Bank of Russia in the foreign exchange market aimed to ensure neutrality of the impact of operations under the fiscal rule on the monetary market. In addition, the investment of the NWF funds requires their withdrawal from the liquid part of the NWF denominated in foreign currency, the sale of foreign currency on the foreign exchange market and purchase of ruble assets. The sale of foreign currency from the NWF is mirrored by the CBR in the foreign exchange market.

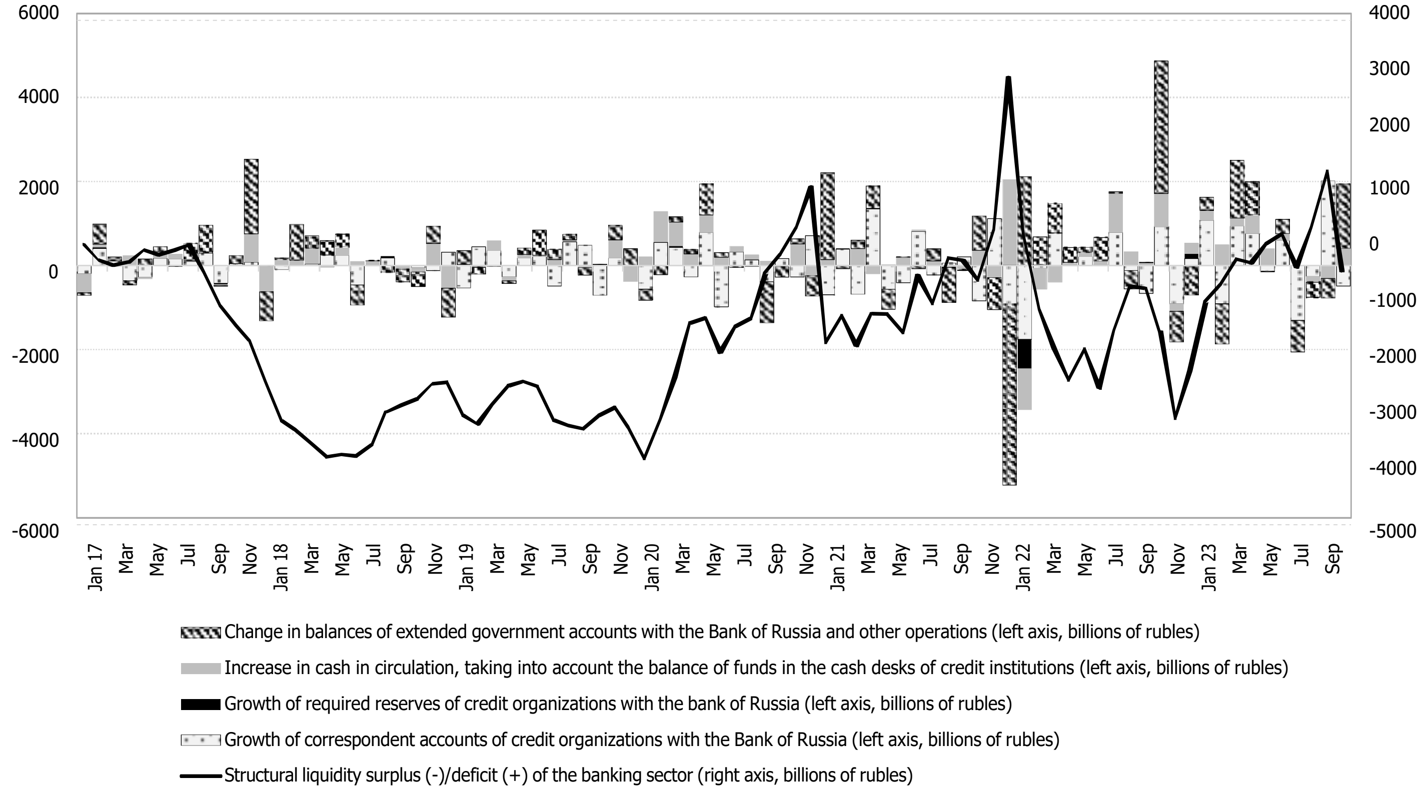

Fig. 3. Structural liquidity surplus of the banking sector and its components, 2017–2023

Source: Bank of Russia

In the period from January to July 2023, the Russian Ministry of Finance sold foreign currency in the amount of Rb550 bn under fiscal rule due to the situation that actual oil and gas revenues did not exceed the base level. In August-December 2023, due to growth of actual oil and gas revenues, the Russian Ministry of Finance should have bought foreign currency, but, as noted above, taking into consideration the continued weakening of the ruble, currency purchase operations (in the amount of about Rb1.7-1.8 trillion) were postponed until 2024.

Besides, starting from August 1, 2023, the CBR started mirroring the operations on investment of the NWF funds to permitted financial assets (i.e. sterilization of rubles spent from the NWF by selling foreign currency from international reserves), implemented by the Russian Ministry of Finance in H1 2023 in the amount of Rb288.4 bn.

The Bank of Russia planned to conduct mirroring operations evenly during August 2023 – January 2024 with a daily volume of operations of Rb2.3 bn. However, in the period from September 14 to September 22, 2023, the Bank of Russia accelerated these operations by increasing the daily volume to Rb21.4 bn instead of Rb2.3 bn. As a result, the total volume of foreign currency sales by the Bank of Russia under operations of mirroring NWF investments in the period from August to December 2023 amounted to Rb280.1 bn.

It has to be noted that starting from 2024, the Bank of Russia resumed operations on the foreign exchange market using the NWF funds: during the first six months, the CBR plans to buy or sell foreign currency, adjusting the volume of operations announced by the Russian Ministry of Finance under the fiscal rule by the amount of currency sales in the amount of Rb 2.1 trillion (Rb1.4 trillion is the difference between the volume of currency purchases deferred from August 10 to December 31, 2023 under the fiscal rule and the volume of NWF expenditures aimed to finance budget deficit in 2023 apart from fiscal rule, Rb 0.7 trillion, is the sale of foreign currency in the volume of net investment of the NWF).[1] The planned currency sales in H1 2024 will support the ruble.

Operations under fiscal rule, as well as the revaluation of assets influenced the dynamics of international reserves[2] in 2023. In 2023, the total amount of international reserves of the CBR increased by 2.9% to $598.6 bn (*Fig. 4*). However, the share of foreign exchange reserves in the total volume of international reserves as of January 1, 2024 evidenced 74.0% (76.6% as of January 1, 2023),while the share of monetary gold was 26.0% (23.4% as of January 1, 2023). The revaluation of reserve assets against dollar as well as positive revaluation of monetary gold had an upward effect on the size of international reserves,[3] whereas RMB sale transactions implemented under new fiscal rule until August 2023, as well as operations of mirroring transactions for the investment of NWF funds implemented in H2 2023, contributed to their reduction in the amount of Rb832.8 bn. It should be noted that currently the central bank's assets, which

1 URL: https://www.cbr.ru/press/event/?id=18330
2 Data on the structure of international reserves are not available due to reduction of statistical information published by the Bank of Russia.
3 Data on the size of revaluation of international reserves are not published as such.

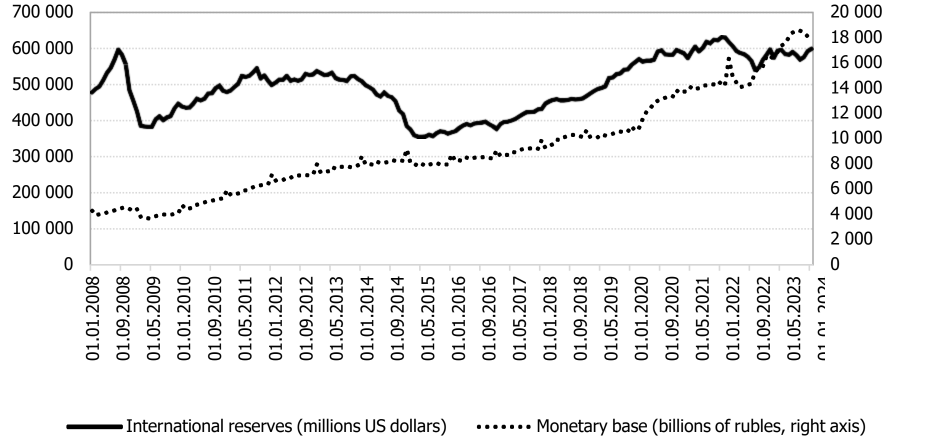

Fig. 4. Dynamic of monetary base (in proper definition) and gold and foreign exchange (international) reserves of the Russian Federation, 2008–2023

Source: Bank of Russia

are not frozen due to sanctions, consist mainly of yuan and gold. In the context of external financial sanctions, this structure of international reserves makes it possible to implement the mechanism of the fiscal rule, as well as to set up reserves in case of risks to financial stability.

Among the banking sector liquidity deficit formed in H2 2023 at the 2023 year-end, the value of loans attracted by credit institutions from the Bank of Russia increased by 17.4% to Rb5.2 trillion (Rb4.5 trillion as of January 1, 2023) (*Fig. 5*). Banks' indebtedness through repo auctions averaged Rb 1.4 trillion, which is 60% higher than in 2022, when this indicator averaged Rb0.9 trillion. The increase in banks' indebtedness through this channel appears to be due to the placement of OFZ by the Russian Ministry of Finance during the year. Banks' indebtedness on loans secured by non-marketable assets in 2023 averaged Rb0.9 trillion, which is the same as the average level of the previous year. On average, in 2023, the demand for lombard loans was significantly lower than in 2022, and the average debt of banks on this type of lending amounted to Rb 15.9bn, down by 76% year-on-year. In 2022, significant growth of lombard loans was secured by the increased demand of commercial banks for ruble liquidity amidst uncertainty and turbulence in the monetary market.

In 2023, banking sector continued to demand deposit auctions of the Bank of Russia. This was due to heterogeneous liquidity situation among banks: some banks attracted funds, while others, on the contrary, placed them on deposits. The amount of funds placed as part of weekly deposit auctions averaged Rb2.2 trillion at a weighted average rate of 9.96% per annum (Rb1.7 trillion in 2022 at a weighted average rate of 8.4% per annum). In order to maintain short-term money market rates close to the key interest rate in 2023, the Bank of Russia repeatedly conducted one day "fine-tuning" deposit auctions. The average amount of funds raised under these operations amounted to Rb1.1 trillion at a weighted average rate of 10.2% p.a. (Rb1.0 trillion in 2022 at a weighted average rate of 16.0% p.a.) (*Fig. 6*).

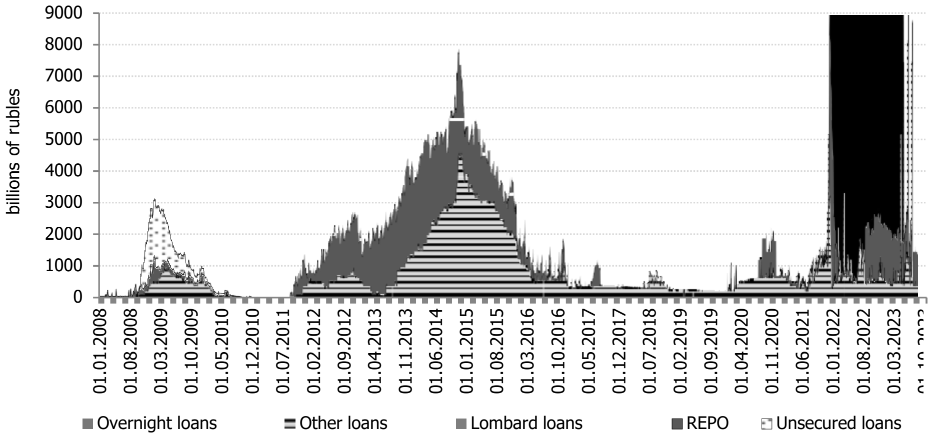

Fig. 5. Commercial banks' ruble debt to the Bank of Russia, 2008–2023

Source: Bank of Russia

It has to be noted that in 2023, "fine-tuned" repo auctions for provision of liquidity were not conducted in the context of a relatively stable situation in the money market. These operations were actively conducted by the regulator in February-April 2022 with the aim to maintain stability of credit institutions.

Amidst structural liquidity surplus in H1 2023, the MIACR rate was predominantly in the lower part of the interest rate corridor and its spread to the key rate was -0.3 p.p. on average.

In H2, as a result of transition from the banking sector liquidity surplus to deficit, the average value of the spread declined 1.8 times to -0.17 p.p. In July, October – November 2023, predominantly positive values of the spread were observed.

In the context of monetary policy tightening, the MIACR rate reached 9.79% per annum on average in 2023 (10.4% per annum on average in 2022). It has to be noted that volatility (standard deviation) of the spread of the interbank lending rate against the key rate in 2023 declined 1.3 times compared to 2022 (from 0.35 to 0.26 p.p.).

For 2023, the monetary base in the broad definition grew by 8.5% to Rb26,507 bn (for 2022 it grew by 20.1% to Rb24,429 bn). Among the fastest growing components of the broad monetary base at the end of 2023 are mandatory reserves (+86.2% to Rb271.7 bn), correspondent accounts of credit organizations (+51.8% to Rb4,530.5 bn), cash in circulation (+12.1% to Rb18,321 bn).

At the same time, banks' deposits with the Bank of Russia decreased by 31.7% to Rb3,384 bn. It should be noted that growth in the size of mandatory reserves is due to the increase in the norms for rubles liabilities from 4 to 4.5% and in foreign currency from 5.5 to 6% from June 1, 2023. On the whole, amidst transition to liquidity deficit of the banking sector, the size of excess reserves[1] for 2023 declined insignificantly by 0.3% and amounted to Rb7,914 bn (*Table 3*).

1 Excess reserves of the banking system include deposits of credit organizations with the Bank of Russia, correspondent accounts of credit organizations with the Bank of Russia, as well as bonds

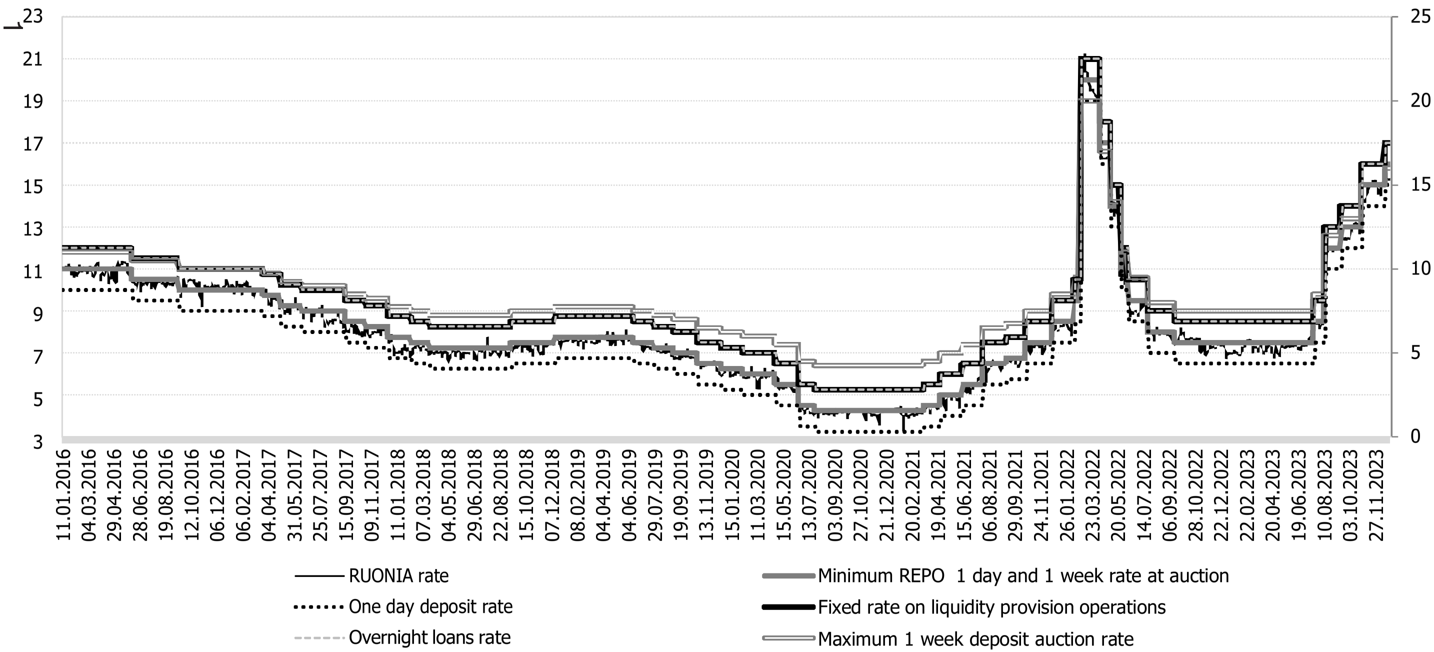

Fig. 6. Bank of Russia interest rate corridor and dynamics of interbank market rates, 2016–2023

Source: Bank of Russia

Table 3

Dynamics of monetary base in broad definition in 2021–2023, Rb bn

	01.01.2022	01.01.2023	01.01.2024
Monetary base (in broad definition)	20 338.9	24 428.6	26 506.8
Cash in circulation assuming cash balances of credit organizations	14 068.1	16 347.7	18 320.7
Correspondent accounts of credit organizations with the Bank of Russia	2 650.6	2 983.6	4 530.5
Required reserves	815.3	145.9	271.7
Deposits of credit organizations with the Bank of Russia	2 805	4 951.4	3 383.9
Bonds of the Bank of Russia with credit organizations	0.0	0.0	0.0
Reference: excess reserves	5 456	7 935	7 914

Source: Bank of Russia

Stimulating aggregate demand and credit activity, in 2023, growth of budget expenditures resulting from spending of the NWF funds continued to make a positive contribution to the dynamics of money supply. Thus, the average monthly growth rate of money supply M2 (relative to the same period of the previous year) in 2023 reached 23.2%, while in 2022 it was 19.3%. Assuming that the average growth rate of the monetary base in 2023 was 21.4%[1] (4.3% in 2022), the money multiplier (the ratio of the M2 aggregate to the monetary base) was 3.6 (3.5 in 2022). Growth of M2 money supply is explained by the expansion of both retail and corporate lending. In October 2023, signs of a slowdown in unsecured consumer credit growth after several rounds of key interest rate hikes were evident, however, corporate lending continued to grow at a fast pace, as businesses did not perceive credit conditions as tight due to high inflation expectations.

It should be noted that dynamics of mortgage lending made a significant contribution to growth of money supply. Thus, in September 2023 credit institutions provided a record volume of mortgages in the primary market (with subsidized rates). Expectations of economic agents regarding tightening of credit conditions increased the demand for mortgages. As a result, the Bank of Russia tightened macroprudential requirements for mortgage loans, which had a deterrent effect on the dynamics of mortgage lending.

3. Inflation processes

In 2023, inflation accelerated as a result of a soft fiscal policy, rapid growth of aggregate demand and credit activity, as well as a significant weakening of the ruble (*Fig. 7*). In Q2 2023, annual inflation (over the last 12 months) reached a minimum (2.3% in April 2023 against April 2022), and then it began to gradually increase due to depletion of high base effect (high values of inflation in March – May 2022) and an increase in inflationary pressure.

of the Bank of Russia with credit organizations.

1 Average growth rate (month over corresponding month of the previous year) calculated on the basis of the geometric mean.

Table 3

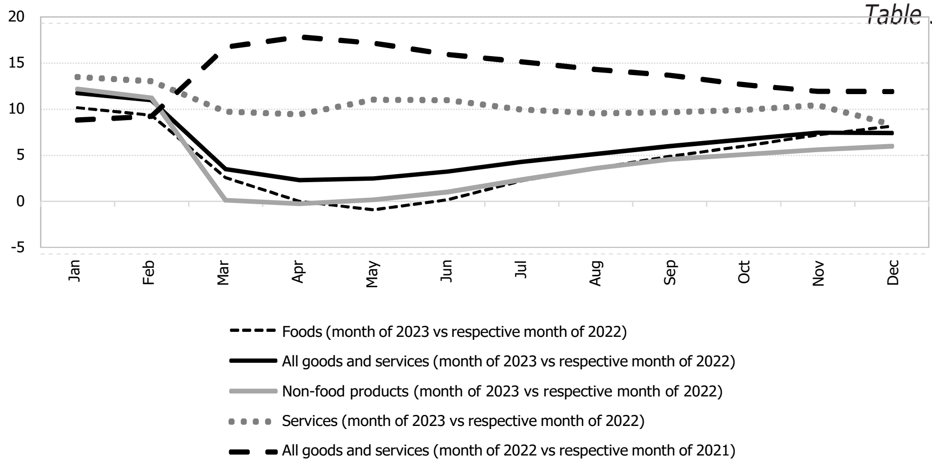

Fig. 7. PPI growth rate in 2022-2023, % over the previous 12 months

Sources: Rosstat, own calculations

Hence, by December, annual inflation reached 7.4%, corresponding to September 2021. This means that inflation at the end of 2023 (December 2023 vs December 2022) was near the upper limit of the Bank of Russia's forecast (7.0–7.5%).

Along with growing inflation since May 2023, there was an increase in core inflation from 1.99% in April 2023 vs April 2022 to 6.83% in December 2023 vs December 2022. In this case, unlike 2022, marked by excess of core inflation over the headline inflation (spread from 2 to 4 p.p. during certain months in May-December 2022), since April 2023, core inflation has been below the headline inflation (spread from 0.4 to 1.3 p.p. during certain months in April-December 2023).

This means that in addition to acceleration of a stable component of inflation (cleared from the influence of administrative and seasonal factors), contributing a lot to headline inflation in 2023, growing prices for regulated and volatile components (accounting for market factors) also contribute to higher consumer prices.

Acceleration of inflation in 2023 was typical for certain groups of food and non-food goods, while the services sector experienced consistently high rates of price growth throughout the year (*Fig. 7*).

Food inflation at the end of December 2023 amounted to 8.2% against December 2022 (+10.3% in December 2022 against December 2021). Eggs were leaders in price growth (+61.4% in December 2023 vs December 2022), as well as fruit and vegetables (+24.2% vs December 2022) and meat and poultry (+16.2% vs December 2022) (*Table 4*). Growth in prices for non-food products in December reached 5.96% vs December 2023 (+12.7% in December 2022 vs December 2021). Medicines were the most expensive (7.90% in December 2023 vs December 2022 vs 10.78% in December 2022 vs December 2021), as well as motor gasoline (7.23%

Table 4

Annual growth rate of prices for certain types of consumer goods and services in 2021–2023, %, December vs December of the previous year

	2021	2022	2023	2021–2023
PPI	**8.4**	**11.9**	**7.4**	**30.3**
Foods	**10.6**	**10.3**	**8.2**	**30.8**
Shugar	30.6	13.5	8.2	60.3
Eggs	16.0	-6.5	61.4	75.0
Meat and poultry	17.5	4.0	16.2	42.1
Fruit and vegetables	14.0	-2.0	24.2	38.8
Fish and seafood	10.7	14.0	5.8	33.5
Bread and bakery	10.3	13.0	5.2	31.1
Milk and dairy products	9.8	15.2	0.5	27.2
Pasta products	15.0	14.6	-3.8	26.8
Cereal and legumes	16.1	9.0	-2.4	23.5
Alcoholic beverages	2.6	8.1	2.5	13.7
Sunflower oil	8.7	5.2	-1.4	12.7
Non-food products	**8.6**	**12.7**	**6.0**	**29.7**
Detergents and cleaners	7.4	29.8	2.2	42.5
Tobacco goods	16.4	10.2	7.0	37.3
Construction materials	23.8	3.6	5.5	35.2
Medicines	4.6	10.8	7.9	25.1
Knitwear	4.2	9.7	3.6	18.4
Motor gasoline	8.8	0.9	7.2	17.8
Clothing and underwear	3.4	7.9	3.2	15.1
Mass media products	12.7	-4.3	-6.2	1.2
Services	**5.0**	**13.2**	**8.3**	**28.7**
Foreign tourism	2.6	70.7	24.8	118.6
Passenger transportation	9.6	10.7	15.7	40.3
Insurance	6.7	28.2	-1.1	35.4
Household services	6.9	11.0	8.5	28.7
Health resort services	5.9	10.8	9.3	28.3
Medical services	5.8	11.7	7.8	27.5
Housing and utility services	4.1	11.6	2.3	18.9
Education	5.5	6.1	8.2	21.1

Source: Rosstat

in December 2023 vs December 2022 vs 0.91% in December 2022 vs December 2021), tobacco (7.03% in December 2023 to December 2022 vs 10.24% in November 2022 to November 2021), and construction materials (5.46% in December 2023 to December 2022 vs 3.58% in December 2022 to December 2021).

Note that in October 2023, a decrease in motor fuel prices was recorded for the first time since February. The reasons were the return to the original version of the damping mechanism, as well as the ban on the export of oil products from September 21.

Paid services to households in December 2023 rose in price by 8.33% vs December 2022 (13.19% in December 2022 vs December 2021). However, prices for foreign tourism (+24.77%), passenger transportation (+15.69%), health resort and recreation (+9.31%), hotels and other accommodation (+9.11%), education (+8.17%) grew quite rapidly.

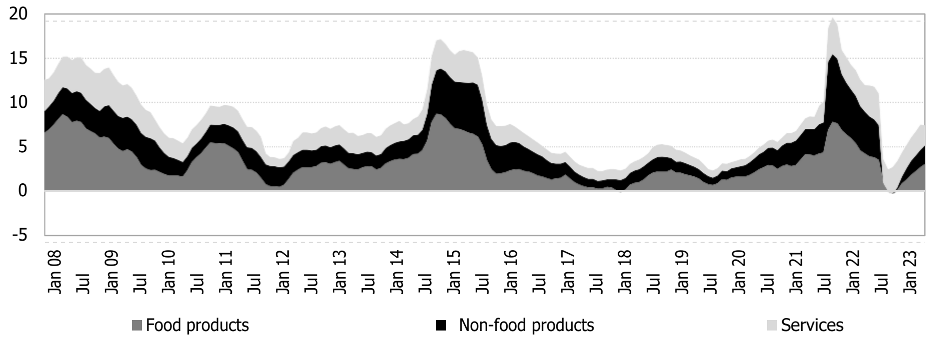

Fig. 8. Structure of inflation in 2008–2023, %, month vs respective month of the previous year

Sources: Rosstat, own calculations

On the whole, decomposition of inflation by components shows that the largest contribution to inflation amounting to 7.4% in December 2023, was made by growing food prices (3.1 p.p.), while the contribution of services and non-food group amounted to 2.3 and 2.1 p.p., respectively (*Fig. 8*).

Weakening of the ruble in Q1–Q3 2023 (by 11.4% on average on a quarterly basis) and gradual impact of this weakening on prices were important factors in accelerating inflation. However, stabilization of the ruble exchange ratein October-December 2023 resulting from several rounds of monetary policy tightening by the Bank of Russia, as well as the recovery of mandatory sale of foreign currency earnings by major exporters will contribute to slow down inflation in 2024.

As noted above, in 2023, soft fiscal policy was one of the important pro-inflationary factors. Thus, federal budget expenditures in 2022 grew by 25.7% to Rb31.1 trillion compared to 2021 and remained high in 2023 (Rb32.4 trillion).

Federal budget expenditures planned for 2024 will grow to Rb 37.0 trillion. Relatively high values of the federal budget deficit in 2022 (Rb3.3 trillion) and in 2023 (Rb3.2 trillion) also indicate high pro-inflationary demand risks. In this regard, in the medium term, soft fiscal policy will remain an important pro-inflationary factor.

Rising demand exerted upward pressure on inflation. From April to December, retail trade turnover increased on average monthly by 10.6% against the corresponding month of the previous year (-9.6% on average in April – December 2022). Monthly growth in the volume of paid services provided to households in April-December 2023 averaged 5.0% (3.4% on average in April-December 2022). Real households' monetary incomes grew by 4.6% in 2023 (-0.6% in 2022).

According to the survey of LLC "InFOM", during 2023 inflation expectations of households were persistently high (10.4–12.2%) and reached a local maximum of 14.2% in December 2023.

Price expectations of enterprises also remained high during 2023: share of enterprises planning price growth, declined in H1 to 15.7% in June and rose to 23.3% in December 2023. High inflation expectations will contribute to the persistence of enhanced inflation in 2024.

According to CBR forecasts, taking into account existing monetary policy, inflation will return to the target of 4.0-4.5% by the end of 2024, and afterwards will consolidate near 4%. According to our forecast, annual inflation will continue to accelerate until the end of Q2 2024, peaking at 8.0%.

A steady slowdown in annual inflation will start from mid-2024, and by the end of 2024 it will decline to 5.5–6.0%.[1,2] It should be noted that quarterly seasonally smoothed inflation began to decline already from Q4 2023. The main reasons for slowdown in inflation will include cooling of consumer and investment demand due to tight monetary policy, as well as gradual depletion of the impact of allocation of exchange rate in prices.

4. Balance of payments and ruble exchange rate

According to preliminary balance of payments estimate for 2023 published by the Bank of Russia, the current account balance amounted to $50.6 bn, which is 4.7 times less than the current account balance for 2022. ($238.0 bn). Due to difference in the breakdown in the balance of payments published by the CBR, the current account could only be described in terms of two basic balances: trade in goods and services and balance of primary and secondary incomes.

The balance of trade in goods in 2023 amounted to $120.1 bn, which is 2.6 times lower (in absolute value of $195.5 bn) than the level of 2022 ($315.6 bn). A significant drop in the value of goods exports from $592 bn in 2022 to $424 bn in 2023 (by 28%) was pivotal, while imports of goods increased from $276.5 bn in 2022 to $303.8 bn in 2023 (by 9.9%).

Such dynamics of exports was due to the decline in prices for basic goods of Russian exports (primarily oil, gas and oil products), which was observed along with the reduction in the physical volume of exports. Imports recovered due to high domestic demand and reorientation towards alternative suppliers.

Growth of imports in goods was accompanied by weakening of national currency: according to the Bank of Russia, the fall in the index of real ruble-dollar exchange rate for 2023 was 19%, which proves a significant weakening, meaning a relative price hike of import supplies.[3]

Balance of trade in services in 2023 amounted to -$34.7 bn, an absolute value 56% higher than its negative value for 2022 (-$22.2 bn). As with trade in goods, there was a decline in services exports (mainly transportation) from $48.6 bn

1 *Yuriy N. Perevyshin*, *Pavel V, Trunin* Monitoring of economic situation in Russia. The Bank of Russia announced a prolonged period of tight monetary policy. February 2024.

2 For more details about the model see: Yuriy N. Perevyshin. Short-term forecasting of inflation in the Russian economy // Economic Policy. 2022. V. 17. No.5. P. 1-18.

3 On the impact of exchange rate dynamics on trade see *Alexander Yu. Knobel*. Assessment of import demand function in Russia // Applied econometrics. 2011. No. 4 (24). p. 3–26; *Alexander Knobel, Alexander Firanchuk.* Russia in global export in 2017 // Russian Economic Development. 2018. No. 9. p. 17–21.

in 2022 to $40.7 bn in 2023 (down 16%) and growth in services imports (mainly travel) from $70.9 bn in 2022 to $75.4 bn in 2023 (up 6%).

Balance of primary and secondary incomes in 2023 has significantly declined compared to 2022. In 2023, it amounted to -$34.9bn, which is 36.9% less in absolute terms than the same indicator in 2022 (-$55.3 bn). However, in 2023, both income receivable (reduction in capital income receipts from abroad from $51.5 bn in 2022 to $44.7 bn in 2023) and income payable (reduction in the withdrawal of income and repatriation of profit abroad, including due to restrictions on the cross-border movement of capital from $106.8 bn in 2022 to $79.6 bn in 2023) have significantly dropped.

In the near future it can be expected that due to stabilization of restrictions on capital movement, difficulties related to repatriation of profits from Russia by foreign investors, restriction by the EU and the US, primary and secondary income payable will remain at approximately the current level, and in 2024 their balance will amount to -$30 bn to -$40 bn (in 2023 the balance of primary and secondary income was -$35 bn).

As for trade balance, as well as current account balance, one can expect a moderate reduction in 2024 (compared to 2023) due to decline in prices for basic goods of Russian exports and continued recovery of imports.

As we have already noted, since starting from Q1 2022 the balance of payments estimates is published by the Bank of Russia in aggregate form, the financial account is represented by data on net external assets and liabilities of all sectors of the economy.

In 2023, the balance of payments financial account, excluding reserve assets, showed $56.3 bn, down 4.2 times from 2022 ($234.8 bn).

The balance of the financial account, excluding reserve assets, in 2023 was drawn under the impact of growth of foreign assets of all sectors and decrease in the volume of foreign liabilities. Growth of foreign assets (excluding reserve assets) in 2023 amounted to $50.2 bn, which is 2.2 times lower than in 2022 ($108.7 bn).

In 2023, foreign assets were increasing as a result of accumulation of residents' funds on foreign accounts and deposits, growth in other investments through receivables, including those related to outstanding foreign trade settlements, as well as foreign direct investments.[1]

Liabilities of all sectors of the Russian economy to non-residents in 2023 reduced by $6.2 bn, which is significantly lower than in 2022 (-$126.1 bn), due to a lower intensity of foreign capital outflow from Russia than a year earlier. As of January 1, 2024, the external debt of the Russian Federation amounted to $326.6bn, having decreased by 15% compared to January 1, 2023.

The external debt of public administration authorities declined most of all (by 29% in the Q1–Q4 2023 to $32.7 bn). The share of non-residents in the OFZ market continued to decline from 11.1% as of January 1, 2023 to 7.4% as of January 1, 2024, corresponding to July-August 2012.

1 Balance of payments of the Russian Federation. No.4 (17). Q4 2023. Information and analytical commentary of the Bank of Russia.

Other sectors of economy reduced their external liabilities by 18% to $199.4bn, which was mainly due to a decline in their liabilities on attracted loans. The external debt of banks and the CBR remained virtually unchanged ($94.4bn as of January 1, 2024).

Russia's reserve assets in 2023 declined by $10bn (-$7.3 bn in 2022). As noted above, the reduction in reserve assets was facilitated by the sale of yuan, implemented under new fiscal rule until August 2023, as well as operations on mirroring transactions on investment of the FNB funds, implemented in H2 2023.

Ruble depreciation, which lasted for four consecutive quarters (since Q4 2022), stopped in Q4 2023, and it appreciated against the dollar by 7.9% to Rb89.7/dollar.

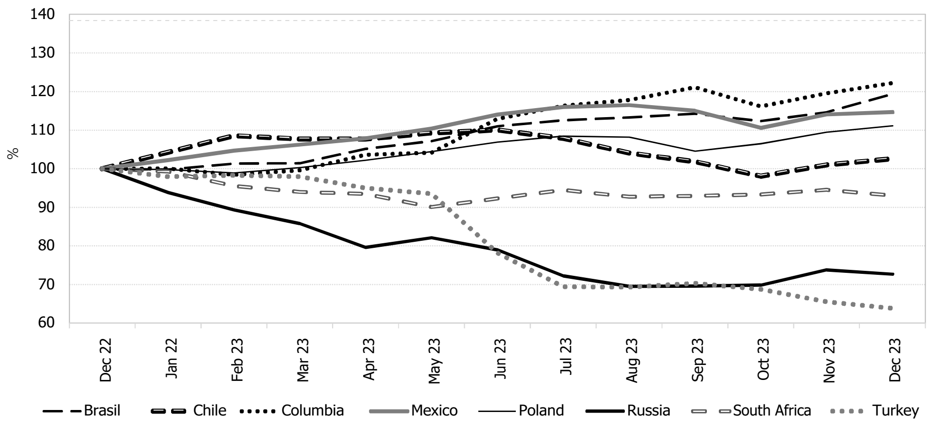

Fig. 9. Dynamics of nominal effective exchange rate of currencies of developing countries targeting inflation (December 2022 = 100%)

Source: Bank of Russia

The ruble appreciation at the end of 2023 was due to an increase in net sales of foreign currency by major exporters from $23.1 bn in Q3 2023 to $41.2 bn in Q4 2023, including due to adoption of measures on mandatory sale of export proceeds by some major Russian exporters, which increased the supply of currency and reduced pressure on the ruble.[1] The ruble appreciation was also supported by the sale of foreign currency by the Bank of Russia in Q4 2023 and its tightening of monetary policy (after five rounds of growth, the key rate reached 16% p.a. in December 2023), resulting in growing attractiveness of national assets, as well as in reduction in demand for imports. It should be noted that on the whole, the nominal effective exchange rate of the ruble declined by 27.3% in 2023. The Turkish lira (36.2%) and the South African rand (7%) have also declined, while the effective exchange rates of currencies of many other inflation-targeting

1 Since October 16, at least 80% of export foreign currency proceeds must be credited by exporters to accounts in Russian banks within 60 days of receipt. Mandatory sale of export proceeds must be at least 90% of the credited funds and at least 50% of each contract.

developing countries, on the contrary, strengthened (19.3% – in Brazil, 22.2% – in Colombia, 14.6% – in Mexico, 2.6% – in Chile) (*Fig. 9*).

This is mainly due to relatively high real interest rates in a number of developing countries resulted from implementation of tight monetary policy, which determined the attractiveness of buying such assets by foreign investors.

According to our estimates, if oil prices remain at $65-70/bbl and assuming the monetary policy pursued by the Bank of Russia, measures to stabilize the foreign exchange market and the Bank of Russia’s operations with the NWF funds on the domestic foreign exchange market described in the subsection “Monetary Market”, the ruble exchange rate in 2024 will average Rb 90-100/dollar.