

18.03.2025

Betting On Geopolitics: “Let’s Wait And See”

Over the latest three years the stock markets in Russia have been tensely expecting not just good, but breaking geopolitical news. The Central Bank is waiting from these too, though in its key rate operations it has been traditionally guided by fundamental drivers and not by emotional moments. However, it is probable that in 2025 this external news background, largely changed versus rather recent realities, will grow into something more meaningful for the regulator.

Is the Ukrainian crisis situation considered in any of CBR scenarios, what overall effect could it have on the economic processes, on the inflation, on the key rate? This looming question (it was asked at a February press-conference of Elvira Nabiullina) was answered by the Head of the Bank of Russia in a very brief and categorical statement: “The base scenario does not feature this factor, it is too early to consider it... It will all depend on the unfolding events; geopolitical uncertainties remain high... Let’s wait and see”.

Meanwhile, shortly before this, the markets, eager for global positive news, had gotten carried away with an incredible euphoria: the MOEX index soared by 7,3%, and the dollar exchange rate at the Forex international trading slid lower than ₽90, which had not happened since September 2024. This emotional outburst had very concrete reasons for it, primarily, it had been the first phone conversation of the Russian and US Presidents since 2020. The optimism of domestic investors then grew even stronger at the background of the first round of American-Russian talks in Riyadh, rumors of an upcoming peace

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agreement, partial lifting of sanctions, return of Western brands and capital to the country.

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Persistent One-Off Shocks

But for now these rumors have been just rumors, ho hopes have come true or have been brought to fruition. According to Denis Manturov, First Vice-Prime Minister, no companies “have asked for anything by now”. Correspondingly, the current market sentiment has its own finite sources and rigid timing. The current situation (primarily with the rouble) should be treated as an ad hoc deviation from fundamental levels.

And these very macroeconomic conditions, these figures have not improved since last year, excluding, as stated by the CBR in its key rate summary, all types of lending (both consumer and corporate), which are being cooled down. At the same time, inflation expectations remain, creating secondary price dynamic effects. This is to say that “the population and corporates are prone to perceive temporary price changes as permanent and change their behavior: they increase the demand for goods, raw materials and services. This leads to a self-supporting inflation cycle and makes one-off shocks more persistent”.

According to the regulator, the annual inflation in 2025 will amount to 7-8%, which will be higher than the bank’s October outlook, “considering greater scale of economic overheating and higher (over 10%, with weekly rates of about 0,2%) inflation at the end of 2024, than previous estimates”. The shortage of labor remains the key factor, limiting supply expansion. At the same time, as reported by Head Hunter (referred to by the Central Bank in its “Trends Revealed” survey), employers publish fewer job openings at recruiting websites, which shows growing issues with required employee search.

The Central Bank has raised its key rate outlook for 2025 up to 19-22% from 17-20%, based on a number of objective preconditions, which are pointed out not only by the Bank. For example, according to the Economic Development Ministry, by February 17 food prices had climbed up to 11,5%, and for some products prices had shot up by scores of percent. And this, according to Alexei Vedev, Director of the Center of Structural Research, RANEPA, confirms the key argument that lending and inflation (where food prices are one of the drivers) are not related as closely, as assumed by the regulator.

“You do not get a loan to buy groceries. Groceries get more expensive due to a mismatch between demand and supply: for example, a person cannot eat a whole chicken in one go, correspondingly, there is no need to go to a store every day to buy it”, - explains Vedev.

“We cannot keep raising these expenditures infinitely”

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The fundamental driver of accelerated inflation is the fiscal stimulus, defense spending, says Igor Nikolayev, senior staff scientist at the RAS Economy Institute. Seasonal factors also play a role, particularly, more expensive fruit and vegetables in fall and winter, buying fever, vacation season.

Meanwhile, both independent experts and government officials are concerned that the fiscal stimulus could drive the federal purse out of balance and drain the primary government “coffers” – the National Wealth Fund, where the liquid part over the three latest years has gone from ₽8,4 trillion down to ₽3,7 trillion. “We spend 6,3% of our GDP on improving and strengthening our defense capabilities. To keep all the components in the country, all the building blocks in the life of the state — the economy, the social sphere in the broadest sense of the word, science, education, healthcare — developing, we cannot keep infinitely increasing these expenditures”, - noted President Vladimir Putin at a collegium of the Ministry of Defense.

We should also mention the December statement by Andrei Gangan, CBR Director of Monetary Policy Department. According to him, starting from the end of February 2022 the money supply (the amount of currency units in circulation) in Russia grew by ₽43 trillion, i.e. by 65%. The national economy has not seen such injections over the last 25 years and is not capable of digesting these. This results in supply lagging behind growing demand, leading to higher inflation and forcing the regulator to maintain (if not ramp up) a tougher monetary policy.

Considering the whole set of the fundamental drivers, could we actually suggest that decisions by the Bank of Russia are influenced by geopolitics and development of events at the negotiation track? We probably could, indeed, but not right now, sometime in the foreseeable future, for the simple reason that a favorable scenario (cessation of hostilities) means reduced government debt, defense spending and military personnel payroll expenses, an inflow of free labor force to the labor market, cheaper foreign trade transactions and logistics. Ultimately, supply will get a chance to catch up with demand.

Georgy Stepanov.

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