Monetary Policy Challenges in Russia

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For many years Russian central bank had a "de facto" fixed exchange rate regime

- In 1999 – 2008 Russian economy experienced substantial inflow of foreign currency due to growing oil prices
- In 2006 – 2007 the financial account also became positive due to huge inflow of foreign capital
- Russian central bank accumulated FX reserves to prevent nominal appreciation of the ruble
- FX interventions was only partly sterilized in the national welfare funds
- As a result money supply was growing fast and inflation remained high

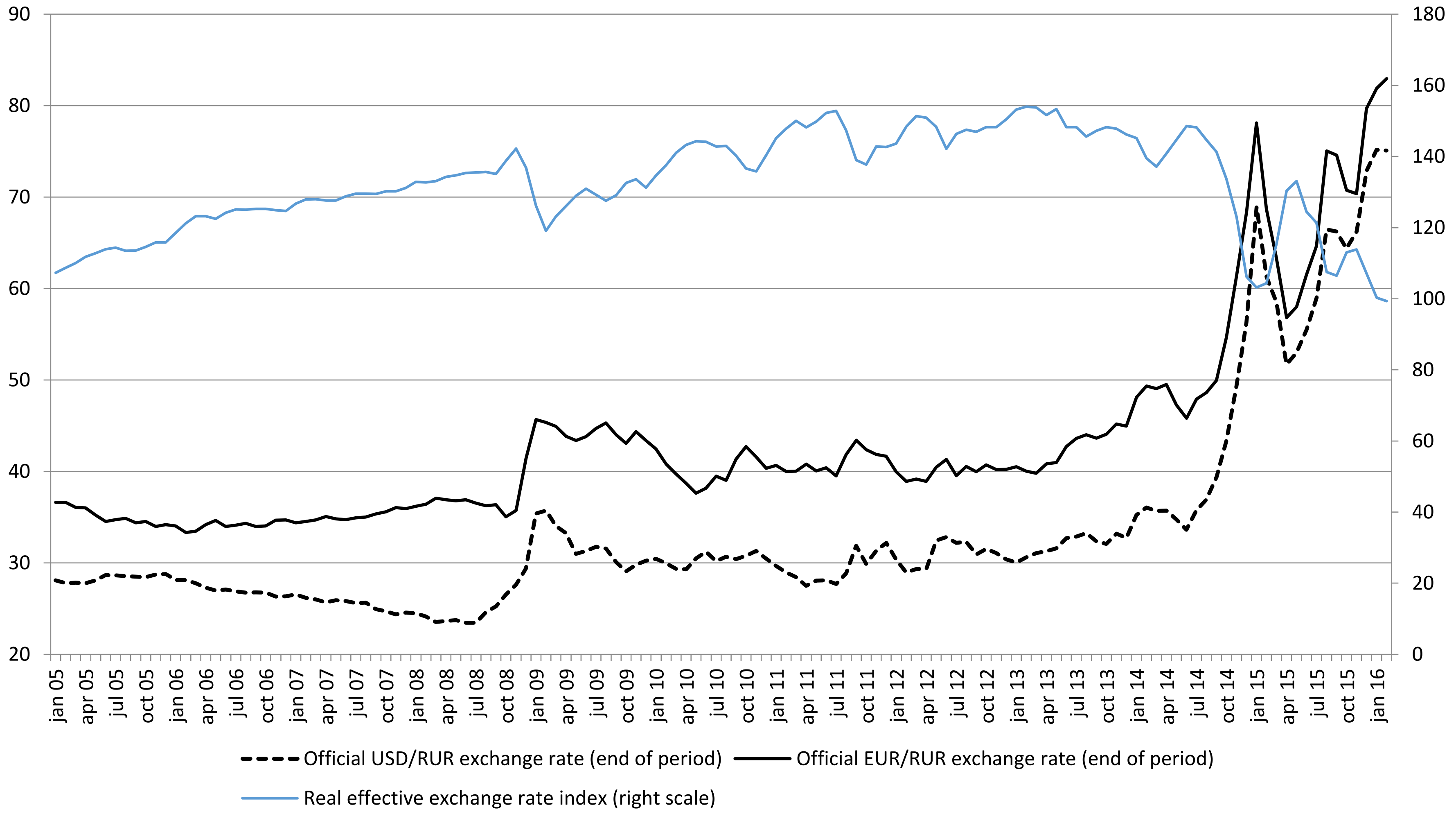
The crisis of 2008-2009 changed Russian monetary policy

- Massive capital outflow and sharp fall of oil price caused major ruble pressure
- CBR used its reserves to support the nominal exchange rate
- CBR policy turned out to be successful thanks to the oil price rebound in 2009
- In order to sterilize FX interventions CBR started giving loans to commercial banks
- The growth of such debt finally made CBR interest rates a powerful monetary policy instrument
- That was a start of the transition to inflation targeting

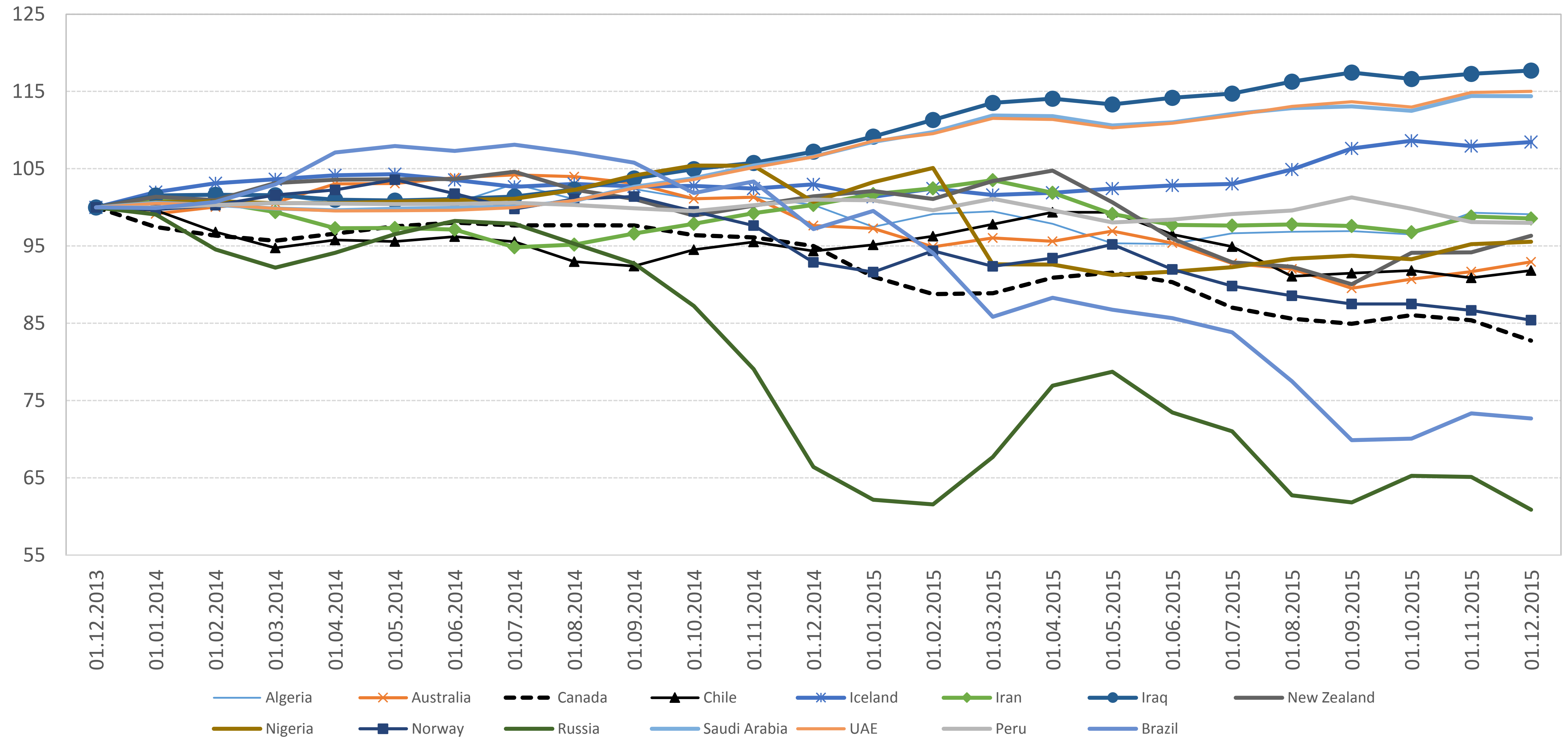
Transition to inflation targeting faced a major challenge in 2014

- Political conflict in Ukraine caused sanctions against Russia and closed international capital markets for Russian economic agents
- External debt of Russian private sector exceeded 650 bln USD on 01/01/2014 and in 2014 it contracted more than 100 bln USD; moreover, Russian private sector conducted more than 50 bln USD of interest payments abroad
- The price of oil fell from 110+ to 45 USD per barrel, while the share of oil and oil products in Russian exports exceeds 50%

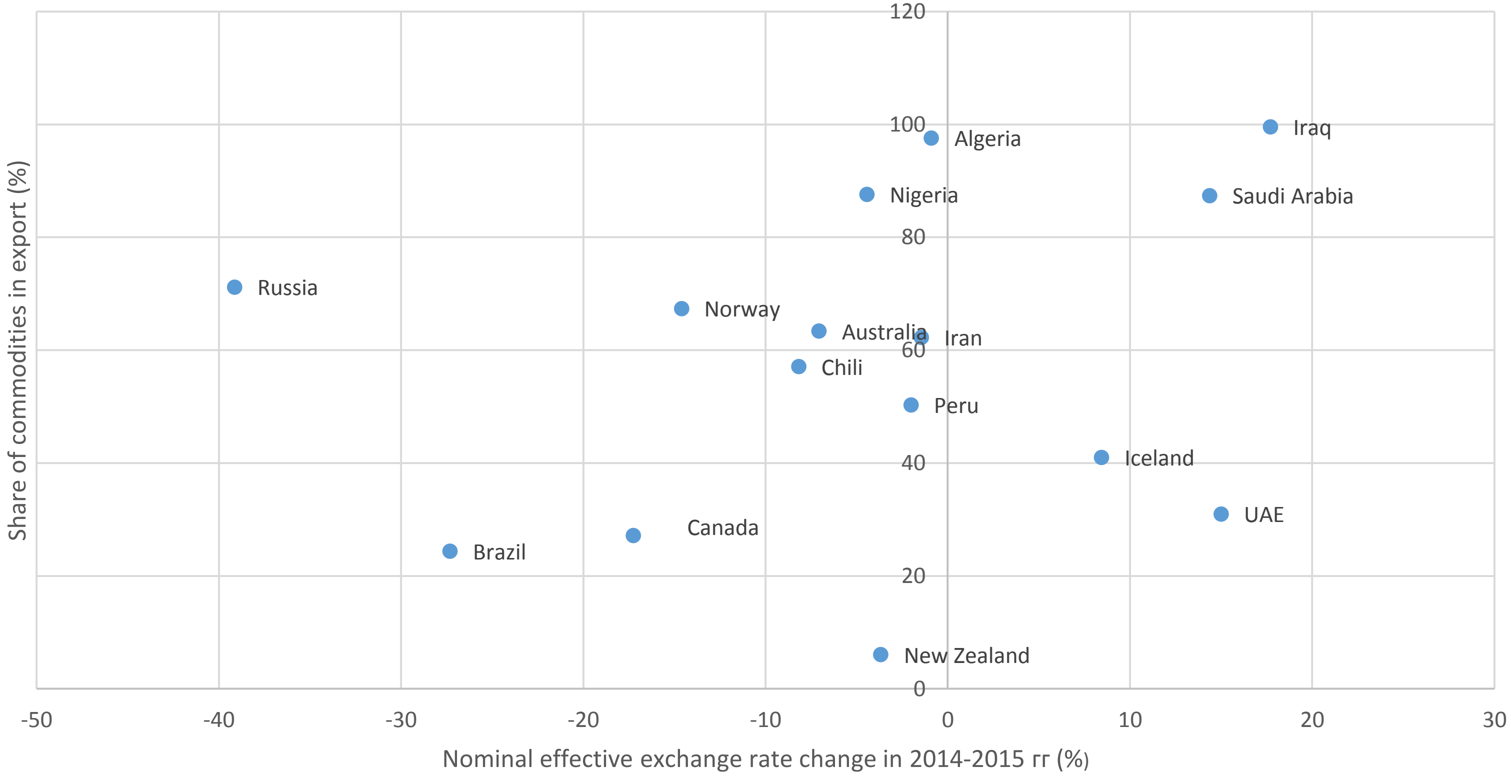
All these problems created immense pressure for the ruble



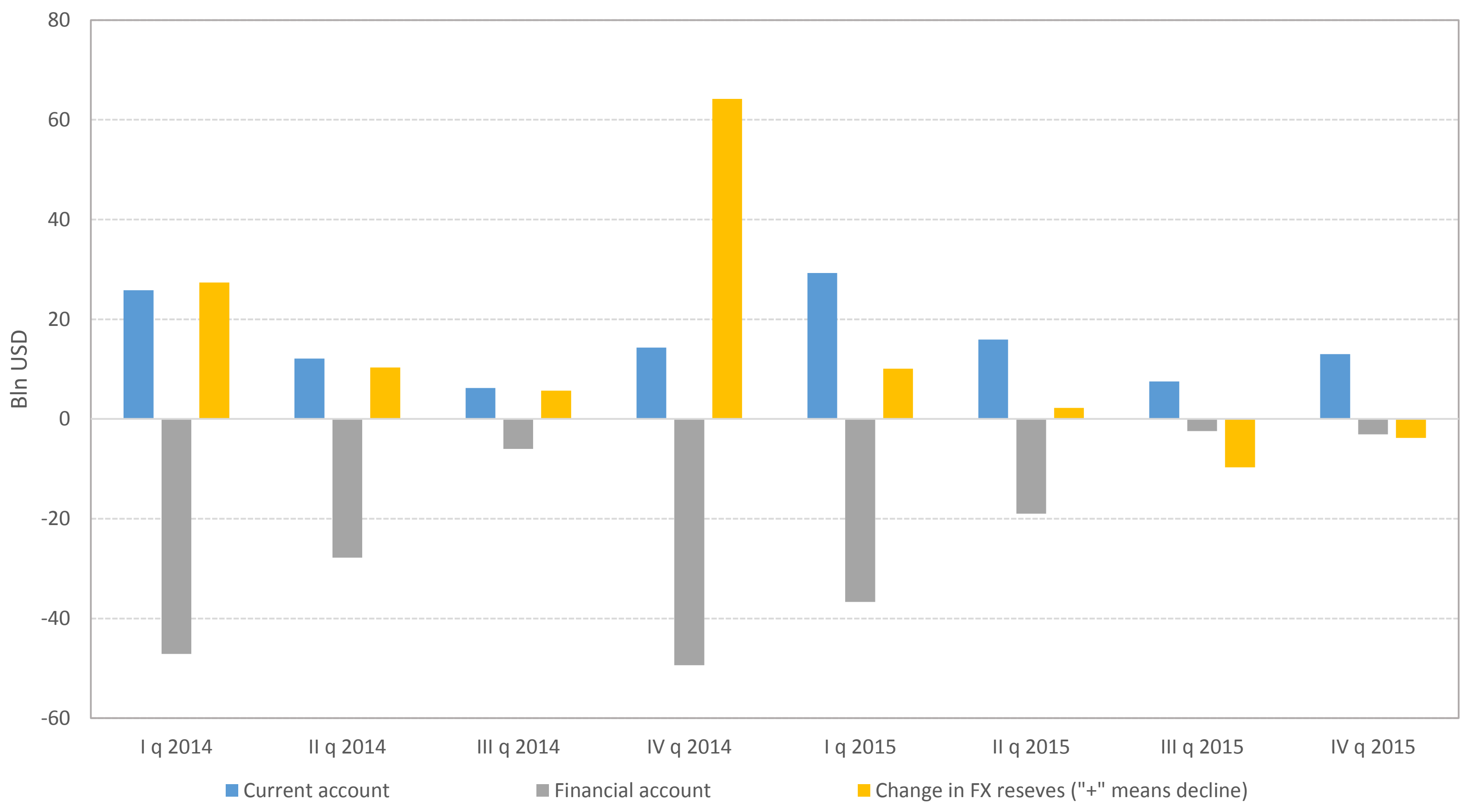
Nominal effective exchange rate of the ruble fell much more than other "commodity" currencies



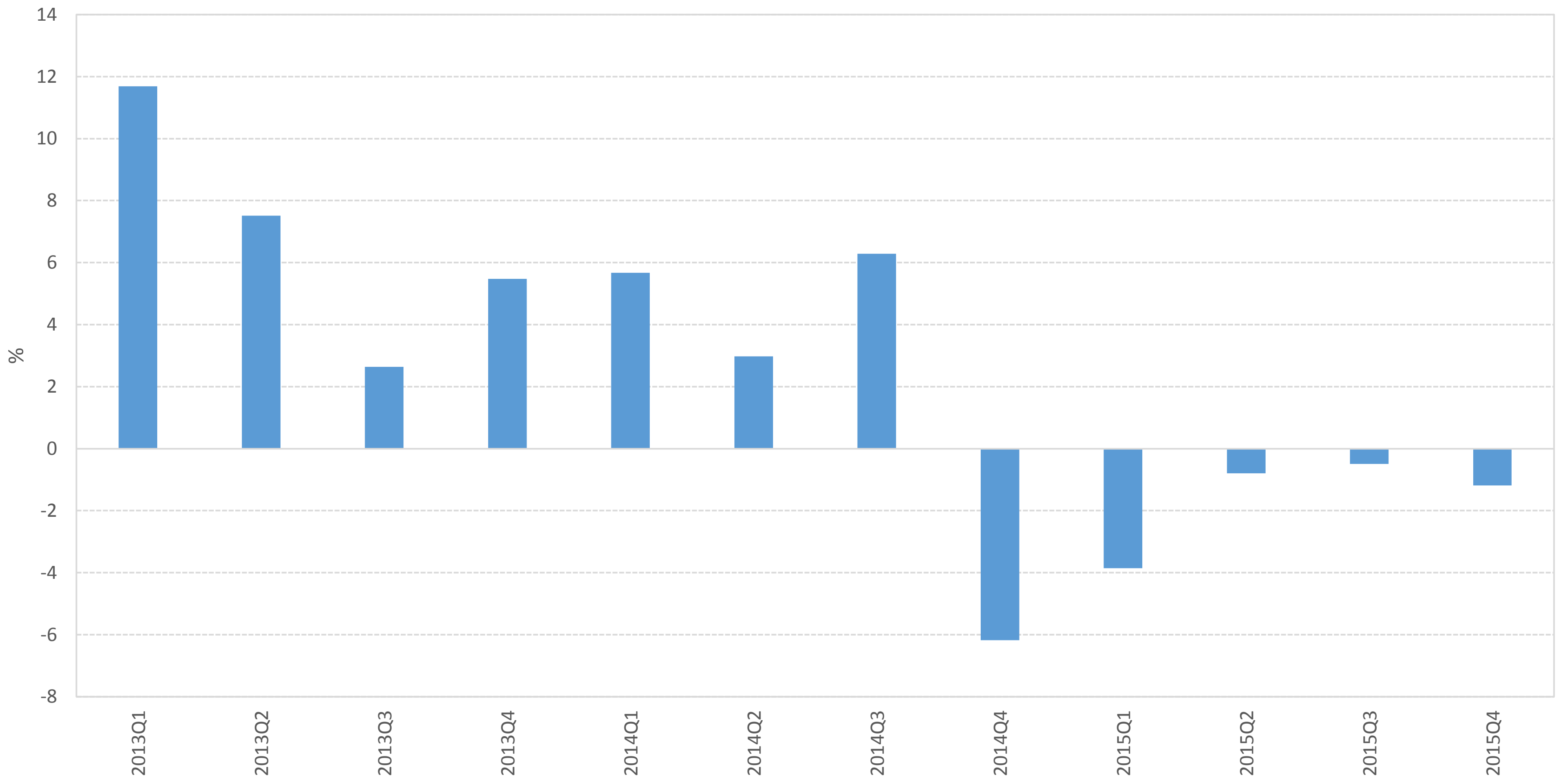
Ruble depreciation can`t be explained only by the fall in oil price



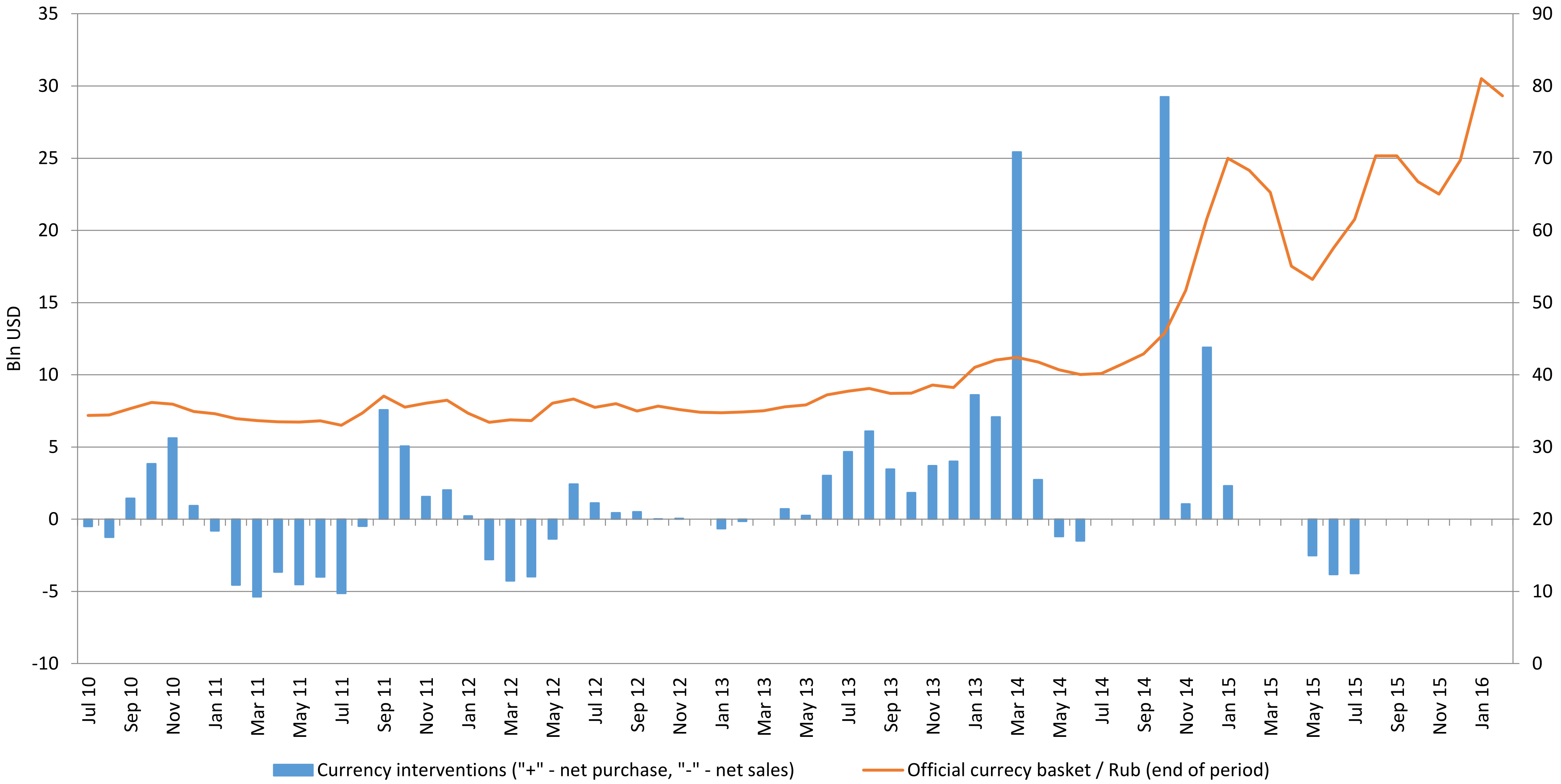
Sanctions were one of the reasons for excess ruble devaluation



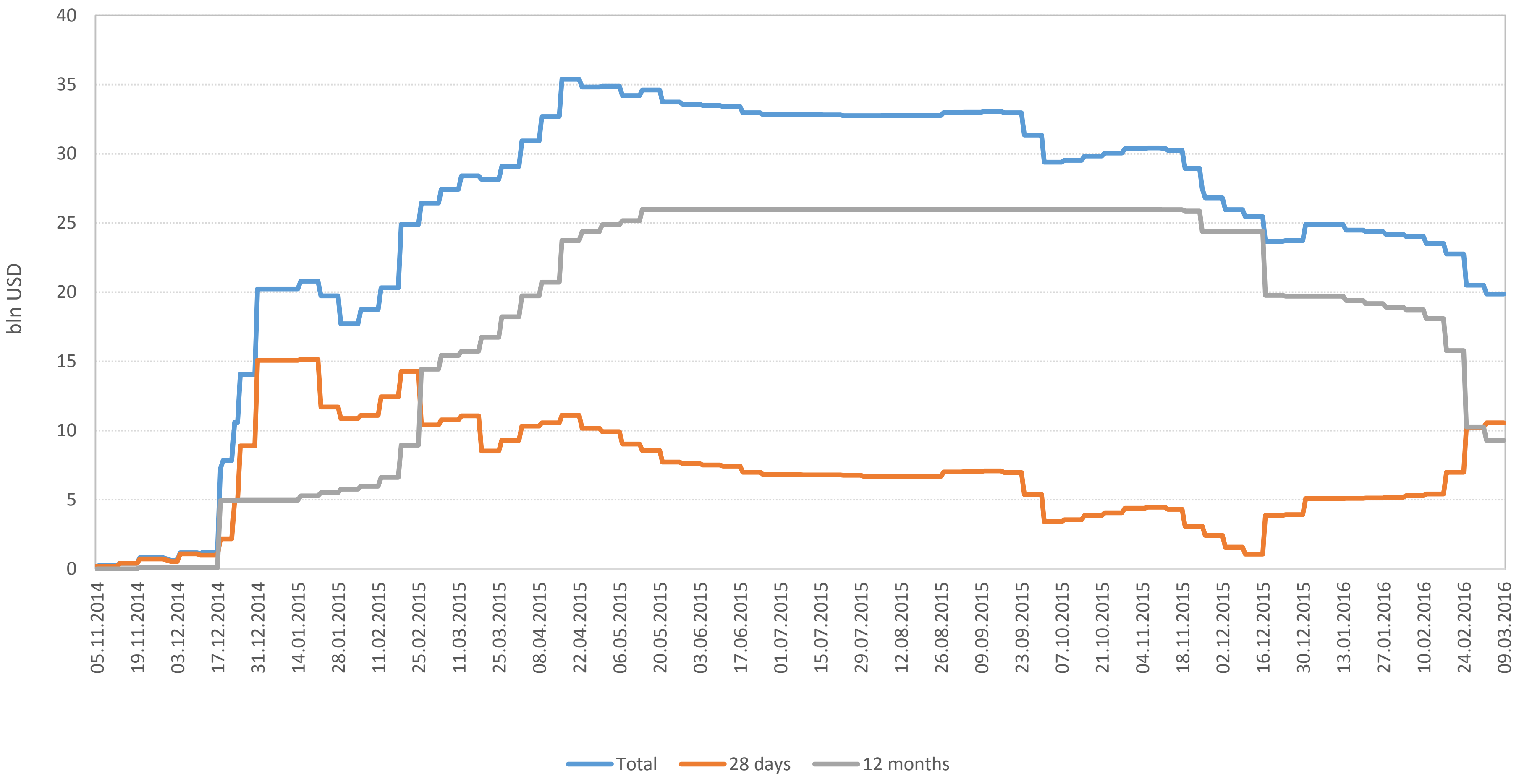
Another reason was excess real ruble appreciation in the past



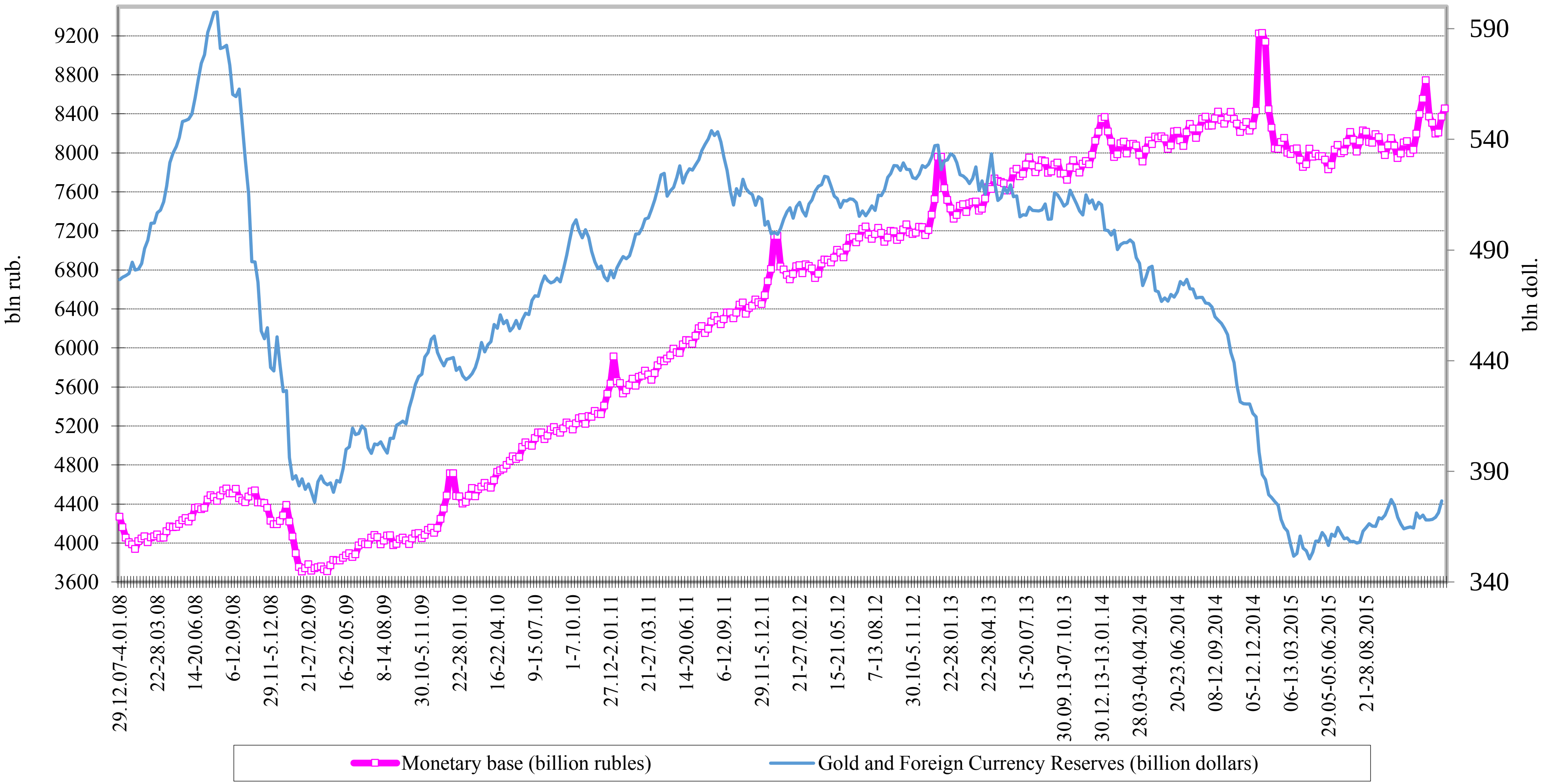
Ruble devalued despite FX interventions



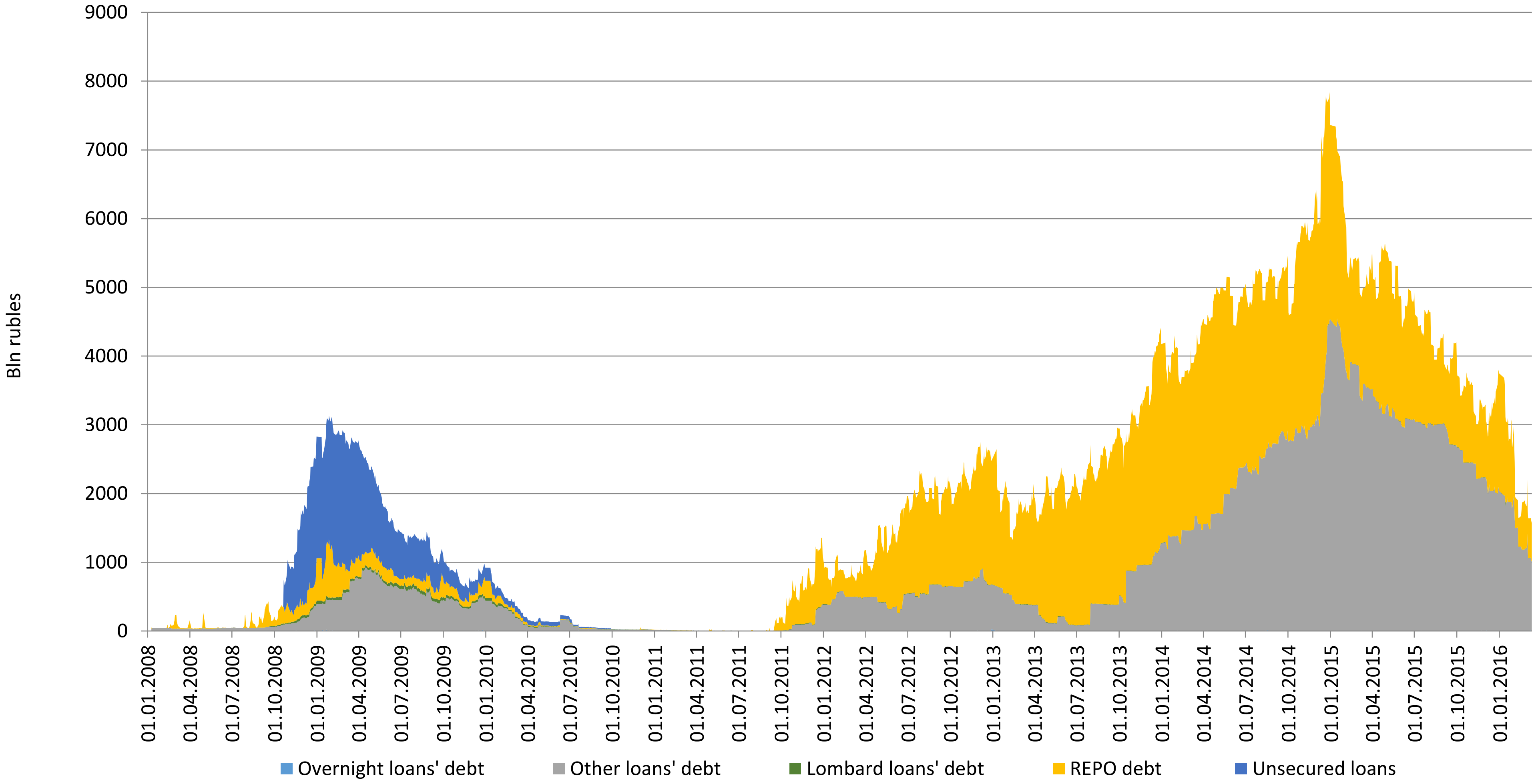
But CBR started to use FX loans to commercial banks to stabilize the market



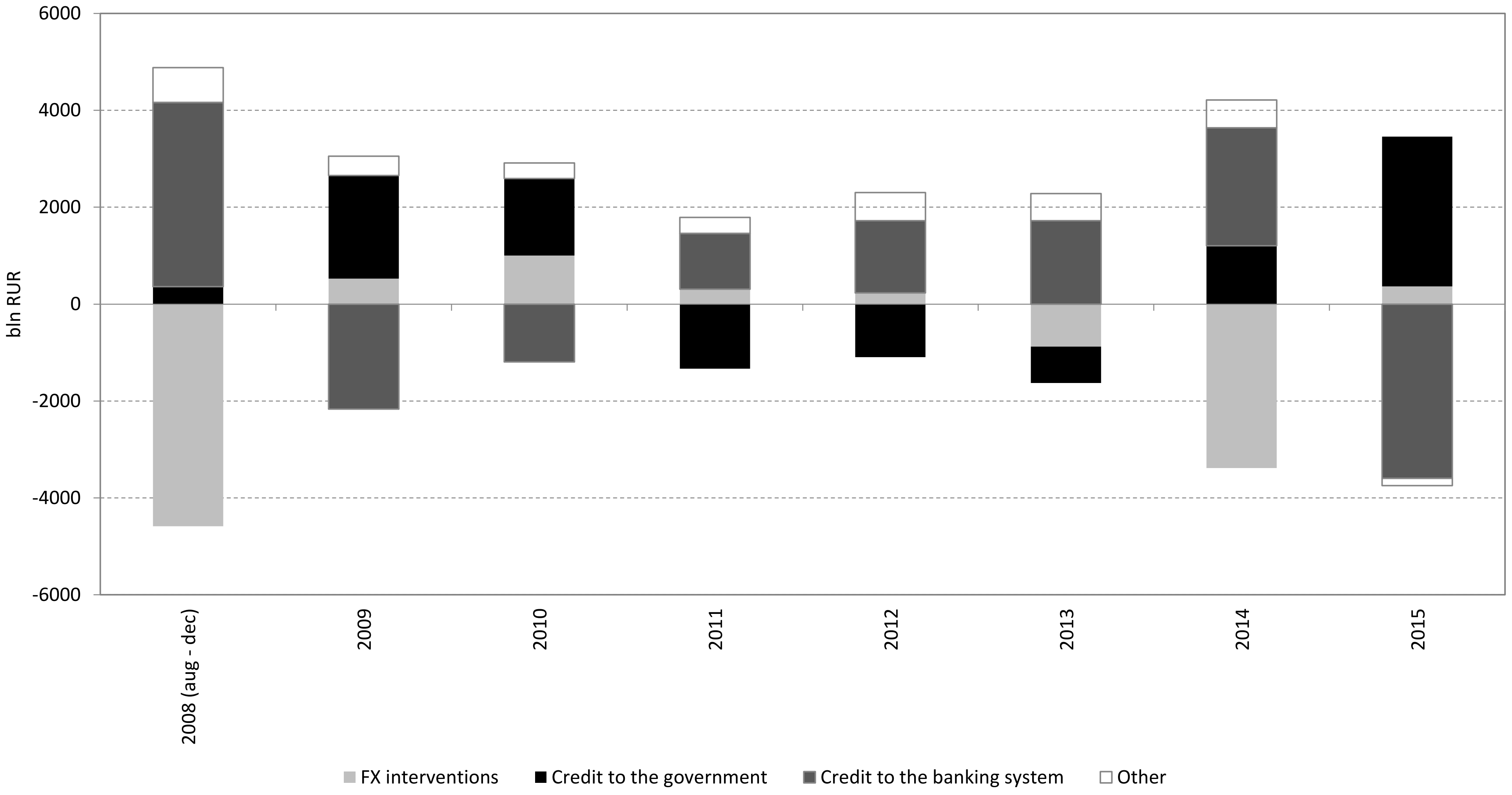
Massive interventions decreased international reserves but the MB kept growing



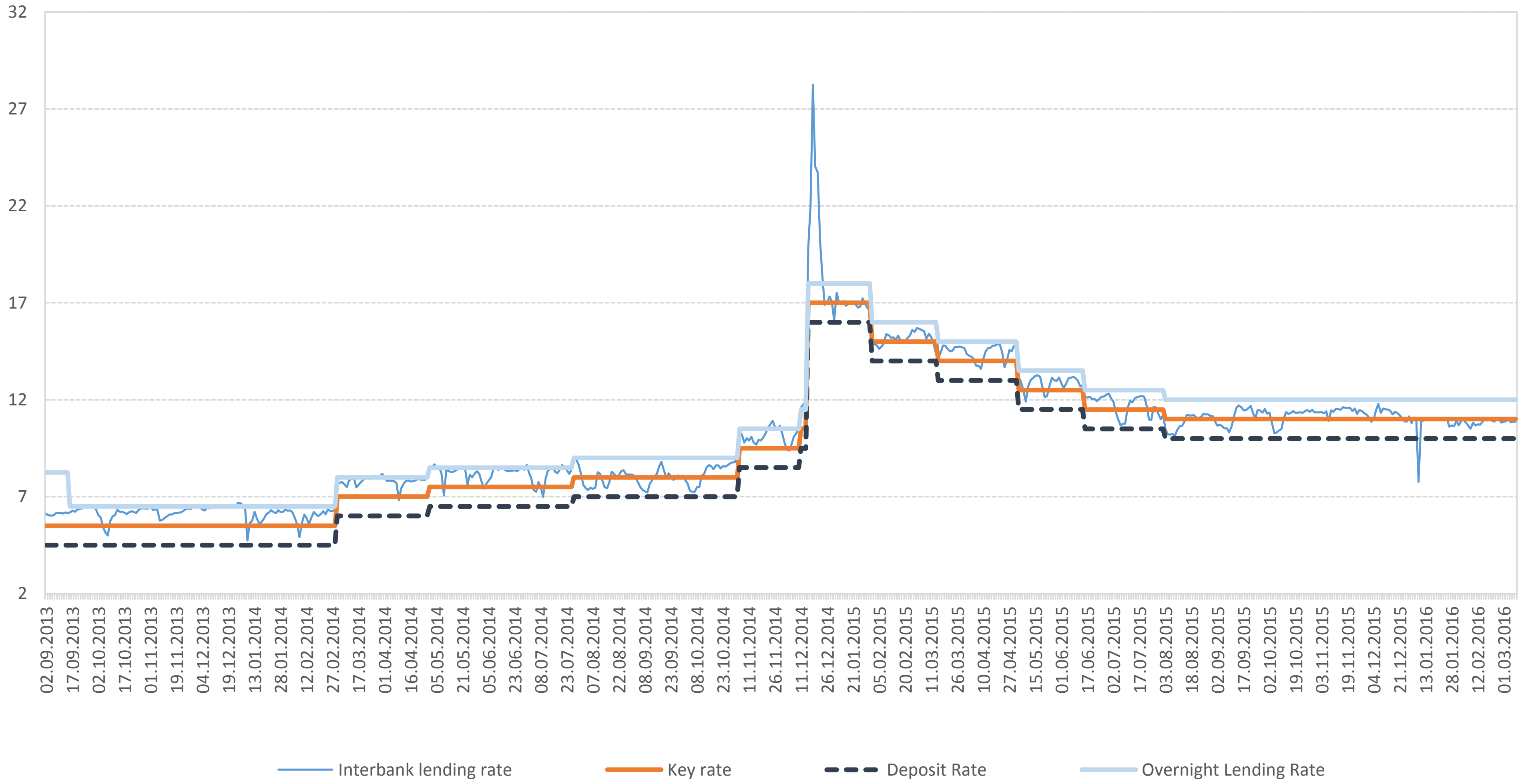
To maintain money growth CBR had to give loans to commercial banks



Shift in the structure of money supply growth



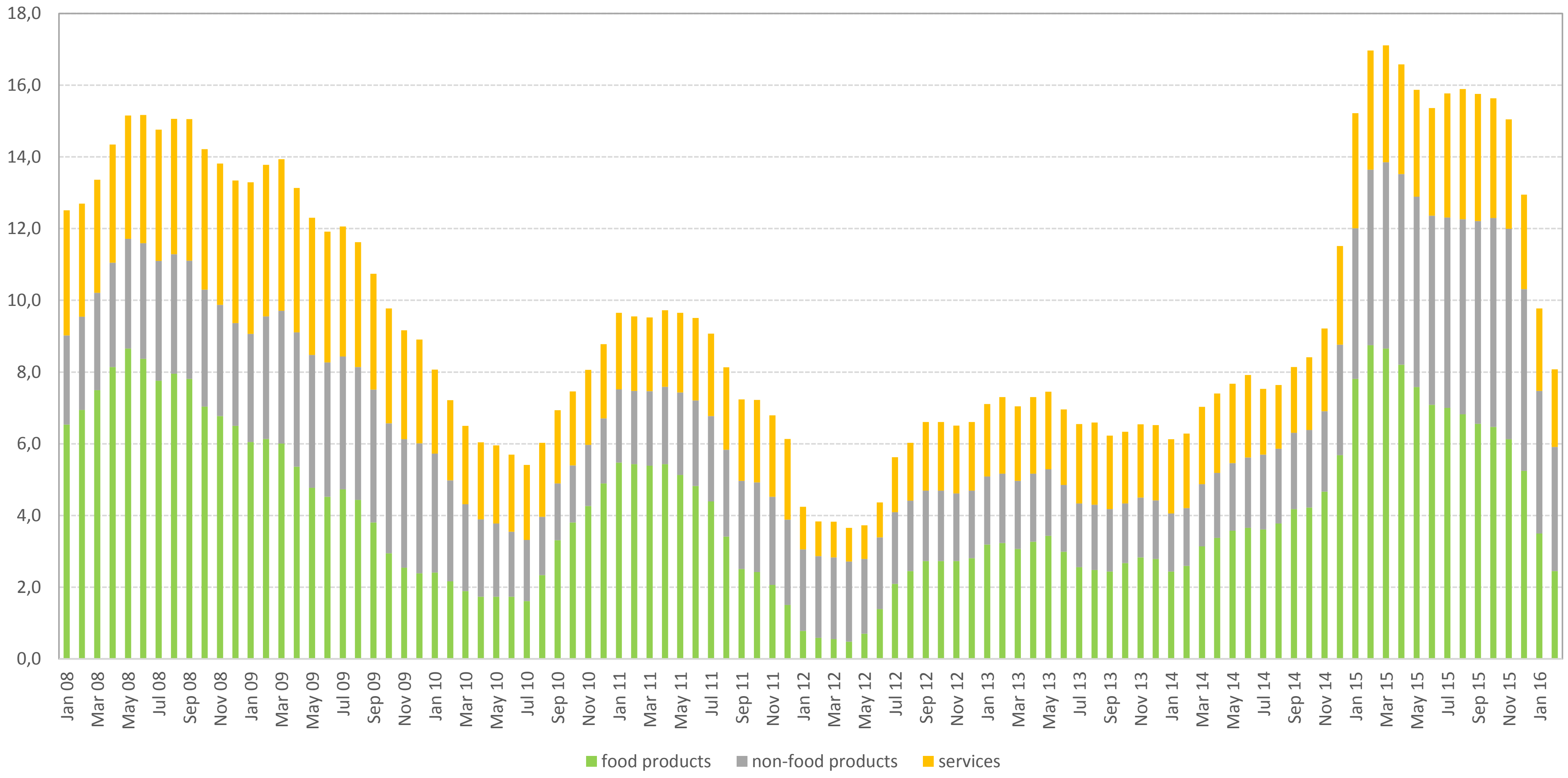
At the same time CBR increased its key rate to contain ruble depreciation and inflation expectations



In mid-December the situation in the FX market deteriorated rapidly

- On December,16 USD/RUR exchange rate fell almost 12%
- Late night December,16 CBR increased its key rate from 10,5% to 17%
- Russian authorities made state-owned companies provide currency supply for the market
- In late December the law was passed to provide Russian banks with 1 trillion rubles of additional capital (besides Sberbank)
- The amount of retail deposit insured by the state in each bank was increased from 0,7 mln RUR to 1,4 mln RUR
- In early 2015 USD/RUR exchange rate fluctuated around 65 RUR per USD

Exchange rate devaluation increased inflation



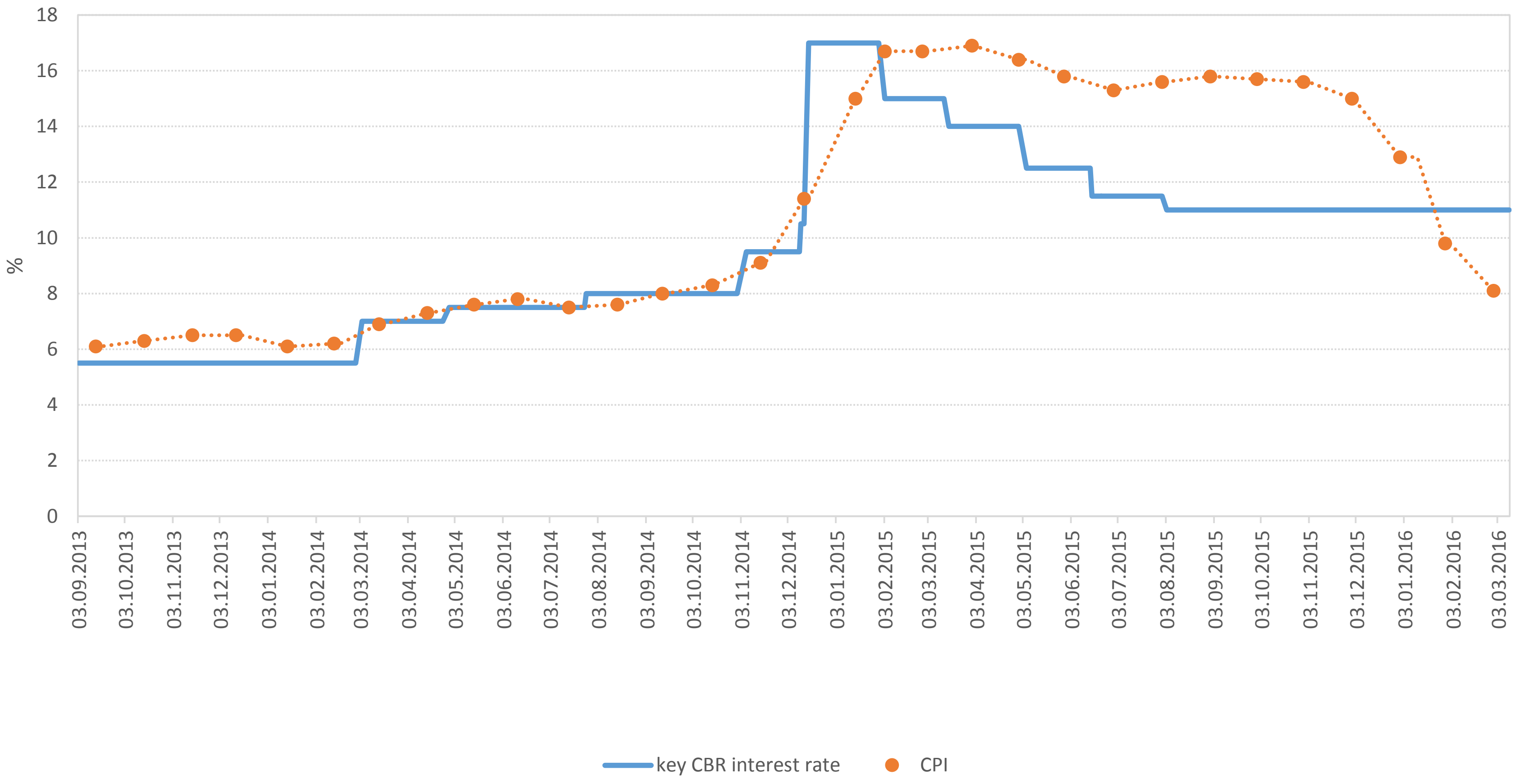
Inflation outlook

- Estimates of exchange rate pass-through in Russia vary from 10% to 20%
- RUR/USD exchange rate fell almost 50% in 2014
- Additional “pass-through” inflation reached 10 p.p.
- The pass-through can take up to 8 months
- Without RUR devaluation Russian CPI in 2015 could have reached 4-5%
- In 2016 CPI will slow down to 8,5-9%

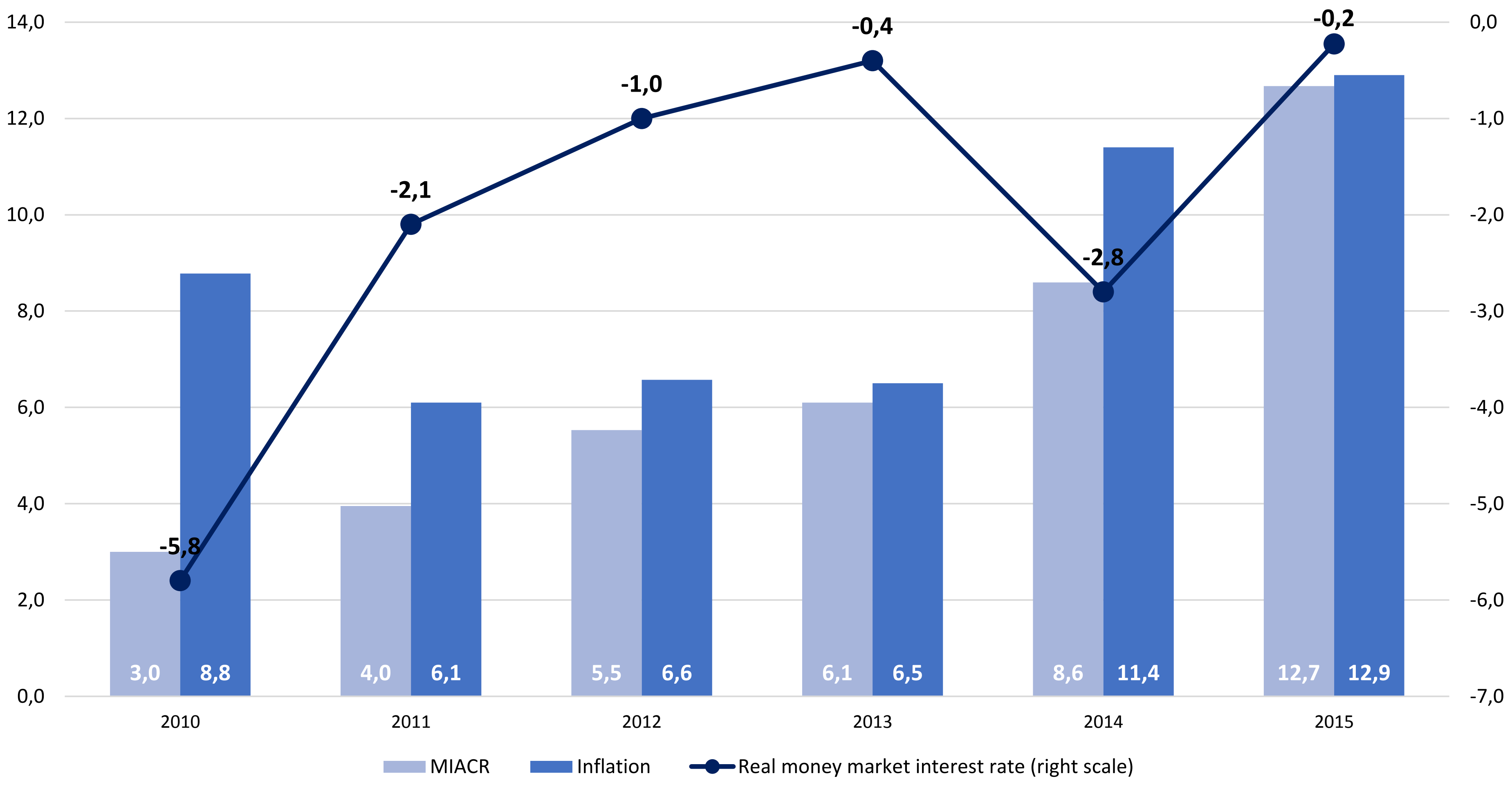
Monetary policy perspective

- Household inflation expectations exceed 15% YoY
- Weak fiscal policy boosts money supply and stimulates inflation
- Inflation momentum is high in Russia
- High inflation can cause further ruble devaluation
- Decrease in the key rate prevents savings in national currency and suppresses demand for rubles
- Macroeconomic stability demands moderately tight monetary policy

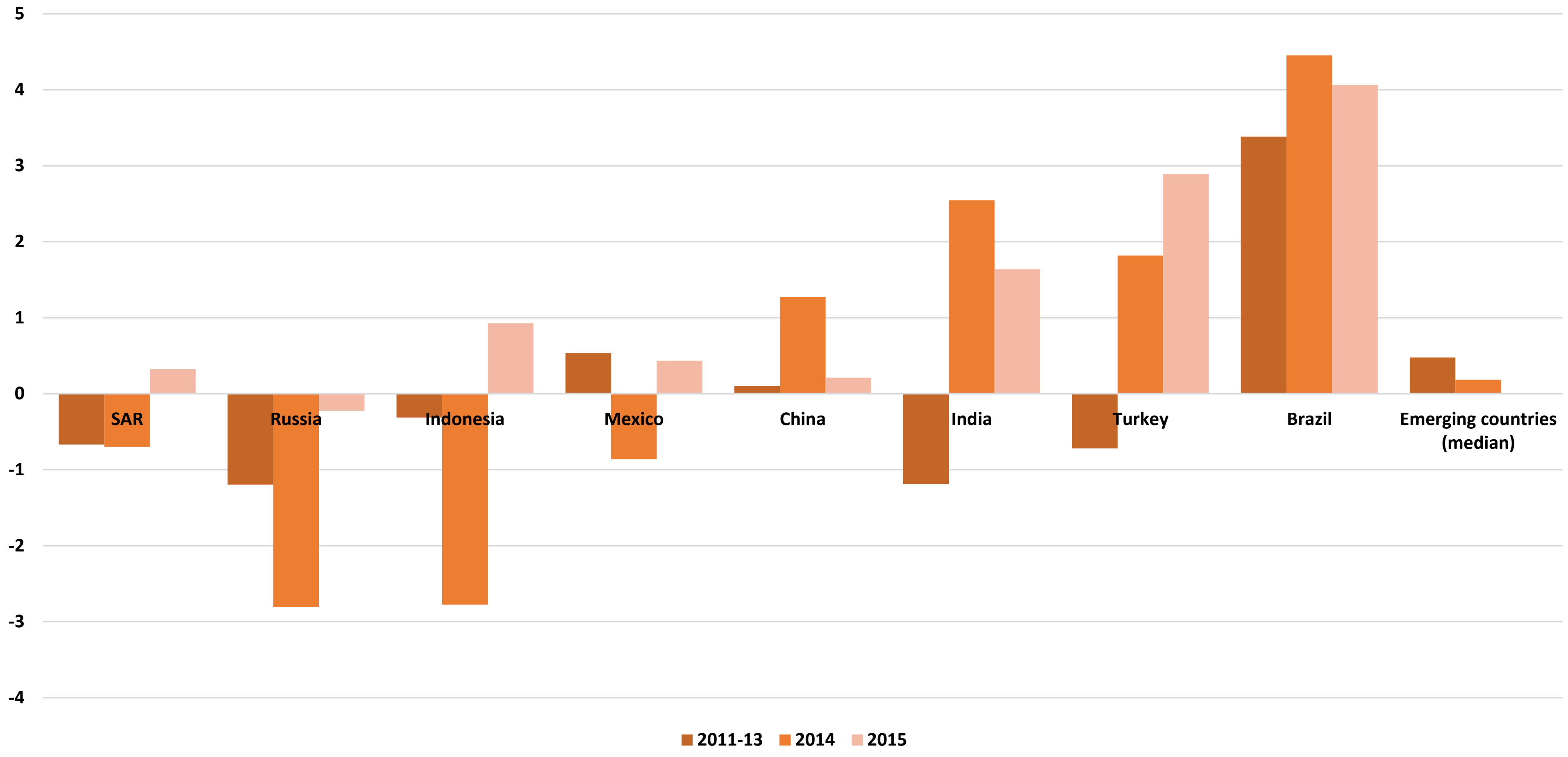
It`s important to look at the real interest rates



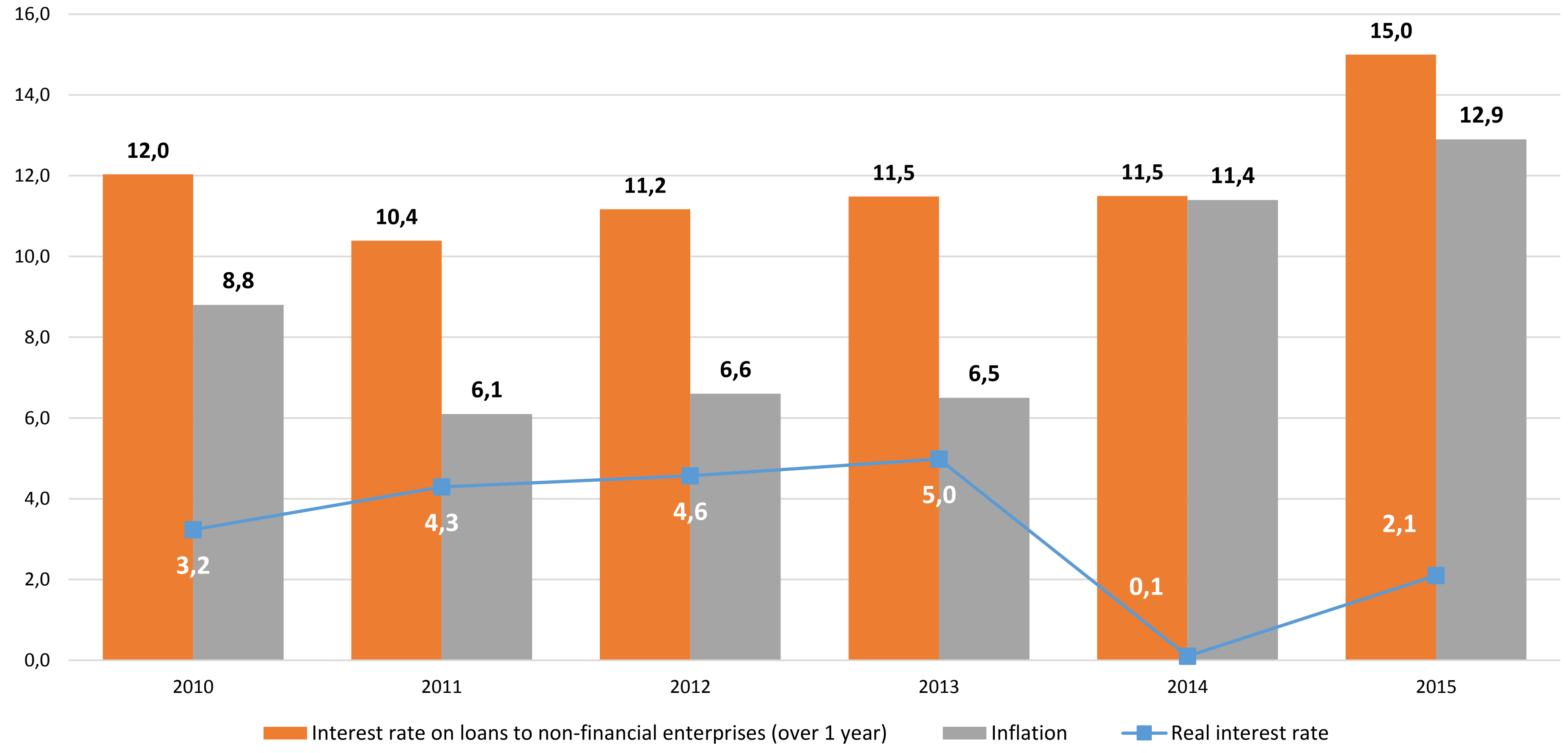
Is CBR monetary policy too tight?



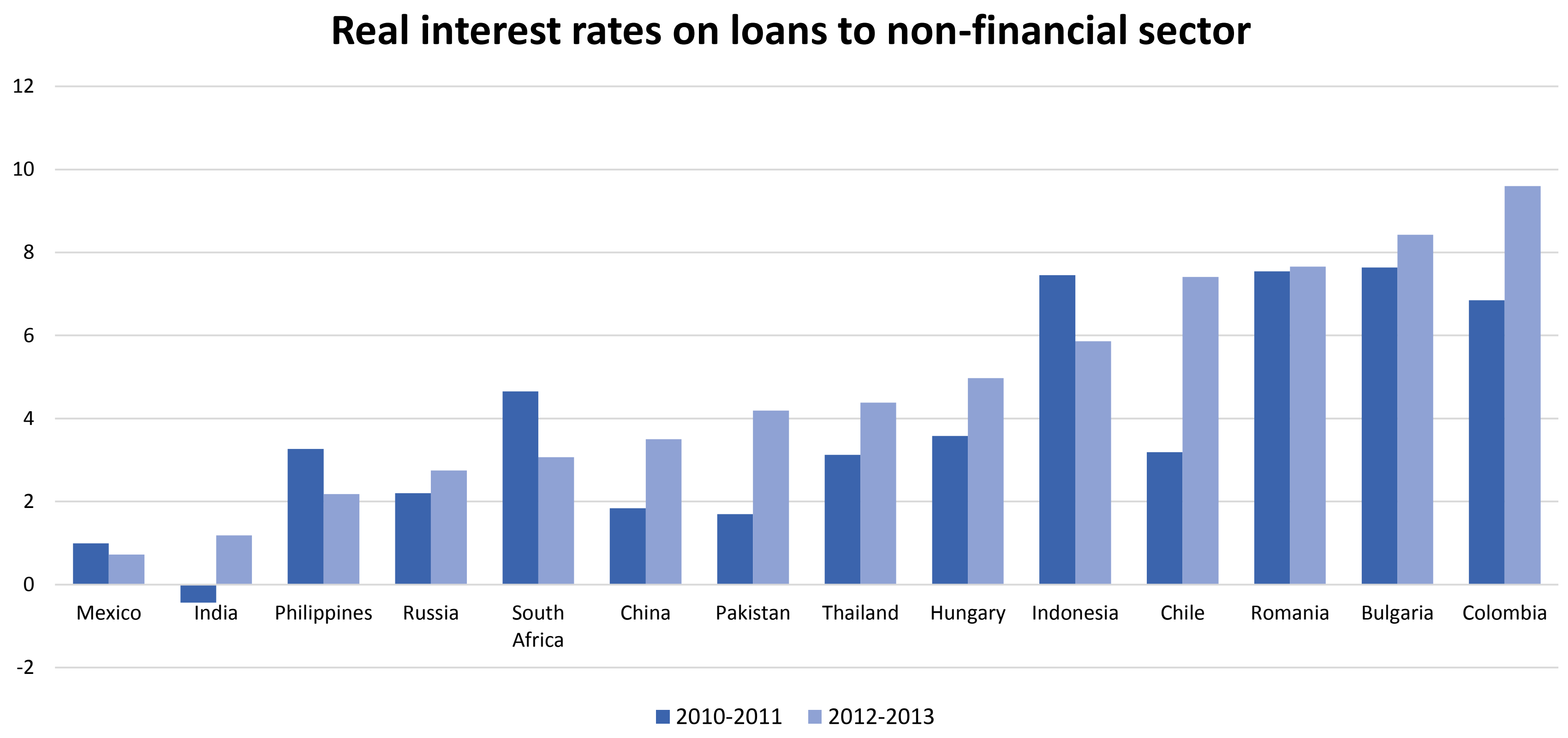
Real money market rate in Russia is moderate compared to other G20 developing countries



Real interest rates for the Russian non-financial sector are moderate too, …



… even compared to other countries



It means that inflation should be the main priority of CBR monetary policy!

Thank you for your attention!