# INFLATION AND MONETARY POLICY IN JULY 2013

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*In July 2013, the Consumer Price Index (CPI) amounted to 0.8% (against 1.2% in July 2012), which is by 0.4 p.p. higher than its value recorded in June 2013. Over the period from 1 August through 26 August, the CPI rose by 0.1%. Thus, the inflation rate in per annum terms increased above 5.6%. In Q2 2013, according to the Bank of Russia's preliminary estimates, net capital outflow from Russia reached the level of $ 10bn; on the whole over the first half year of 2013, it amounted to $ 38.4bn, which is by $ 1.7bn below its index for the first half year of 2012.*

In July, the inflation rate in the Russian Federation accelerated: the Consumer Price Index (CPI), as seen by the month's results, amounted to 0.8% (against 0.4% in June 2013), thus declining below its index for 2012 (1.2%). Thus, the inflation rate in per annum terms climbed to 5.6% (*Fig. 1*). The core inflation rate[1] in July 2013 was 0.3%, which is below its index for the same period of last year by 0.2 p.p.

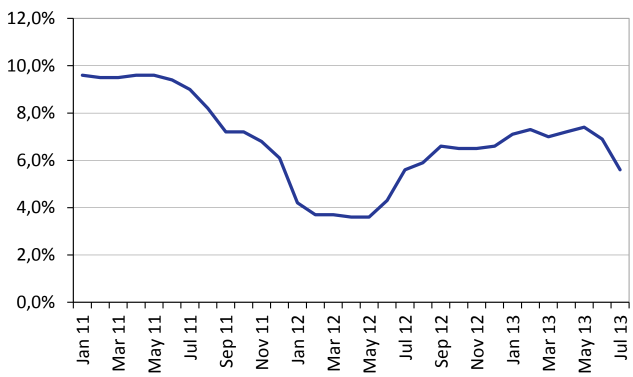
The prices of foodstuffs in July remained unchanged (against growth by 0.5% in June). This happened due to the decline, on June, of the prices of fruit and vegetable products (-3%) and a slowdown in the growth rate of prices for granulated sugar (from 1.0% in June to 0.1% in July), bread and bakery products (from 0.5% in June to 0.3% in July), and alcoholic beverages (from 0.8% in June to 0.5% in July). At the same time, the growth rate of butter prices increased (from 0.7% in June to 1.1% in July), as well as that of prices for milk and dairies (from 0.2% in June to 0.8% in July).

The growth rate of the prices and tariffs established for commercial services rendered to the population in July amounted to 3.1%, thus rising significantly above its June level (0.6%), which was largely due to the upward adjustment, at the month's beginning, of the housing and utilities tariffs – by 7%. The most significant increase was demonstrated by the tariffs for natural gas supply (12.6%) and electricity (11.2%). The prices of passenger transport services continued their upward movement, having increased by 2.2%, which was also true of prices of spa resort services and out-bound tourism – these rose by 4.1% and 3.1% respectively. The prices of personal consumer services (+0.4%), insurance services (+0.4%) and medical services (+0.6%) were also on the rise.

In July, the growth rates displayed by the prices of nonfood commodities declined on June 2013, amounting, by the month-end results, to 0.1% (against +0.2% in June). In this commodity group, the steepest upward movement was demonstrated by the prices of tobacco products (+1.2%) (against +1.6% in June 2013), pharmaceuticals (+0.5%) (against +0.6% in June 2013), motor gasoline (+0.1%) (against -0.2% in June 2013). Meanwhile, the prices of radio and television sets moved in the opposite direction in July (-0.1%).

The CPI, as determined by the results of the period of 1–26 August, increased by 0.1%. Thus, the cumulative inflation rate since the year's beginning rose to the level of 4.5% (against 4.7% over the same period of 2012). As of 26 August, the per annum inflation rate increased above 5.6%.

Later on, prices may experience upward pressure in response to the expected lower crop yields resulting from the unfavorable weather conditions in some regions (drought in the south of Russia and rains across the Middle Volga Region and Siberia); another contributing factor may become the weakening of the Russian ruble. The factors suppressing the inflation rate's growth will be the declining domestic demand (a phenomenon that has already been observed for a




*Source:* Rosstat.

*Fig. 1. The CPI Growth Rate in 2011–2013 (% Year-on-Year)*

1 The core consumer price index reflects the level of inflation on the consumer market after adjustment for the seasonal (prices of vegetable and fruit products) and administrative (regulated tariffs for certain types of services, etc.) factors. This index is also calculated by the RF Statistics Service (Rosstat).

year) and the continuing slowdown in the growth rate of money supply (the per annum growth rate of M2 dropped from 19.1% as of 1 July 2012 to 15.5% as of 1 July 2013).

In July 2013, the broad monetary base shrank by 2.2% to Rb 8,862bn (*Fig. 2*). Among the shrinking components of the broad monetary base one may point to the monies kept on commercial banks' correspondent accounts with the RF Central Bank (-18.5% to Rb 817.4bn), banks' deposits (by -12.4% to Rb 125.7bn), and cash in circulation, including the cash balances of credit institutions (by -0.1% to Rb 7,411.5bn). The size of required reserves increased by 2.0% to Rb 507.5bn.

The narrow monetary base (currency issued by the Bank of Russia plus required reserves) over July remained practically unchanged, amounting to Rb 7,919bn (*Fig. 3*).

In July 2013, the surplus reserves held by commercial banks[1] shrank by 17.7% to Rb 943.1bn, while the amount of banks' repo debt increased by 14.8% – to a level in excess of Rb 2.3 trillion. As of 30 August, banks' repo debt remained unchanged, at Rb 2.3 trillion. The interest rate in the interbank market[2] in July was on the average at the level of 6.08% (against 6.3% in June 2013). Over the period from 1 through 29 August, the average interest rate was 6.11%.

As of 1 August 2013, the Bank of Russia's international reserves volume amounted to $ 512.8bn, having shrunk since the year's beginning by 4.6% (*Fig. 3*). The downward movement of the volume of international reserves in July resulted from the Bank of Russia's sales of foreign currencies on the domestic market. At the same time, the reserves backed by monetary gold over the month of July increased by $ 4,082m due to an upward adjustment of asset value. Meanwhile, it should be noted that on the whole, the shrinkage of Russia's international reserves volume denominated in USD over the first half year of 2013 was caused in the main by the upward movement of the euro-to-USD exchange rate, and in part – by the Bank of Russia's currency interventions.

As seen by the month-end results, the scale of currency interventions by the Bank of Russia in July was $ 4,182.5m and € 376.5m, their purpose being to level down the volatility of the ruble's exchange rate during the periods of its rapid weakening (*Fig. 4*). The volume of currency sales in July hit its record high since October 2011. Over that month, the regulator three

1 The surplus reserves held by commercial banks at the RF CB are understood as the aggregate balance of their correspondent accounts, deposits with the RF CB and the bonds issued by the RF CB and held by commercial banks.

2 The interbank interest rate is the average monthly interest rate on overnight ruble-denominated interbank loans (Moscow Interbank Actual Credit Rate – MIACR).

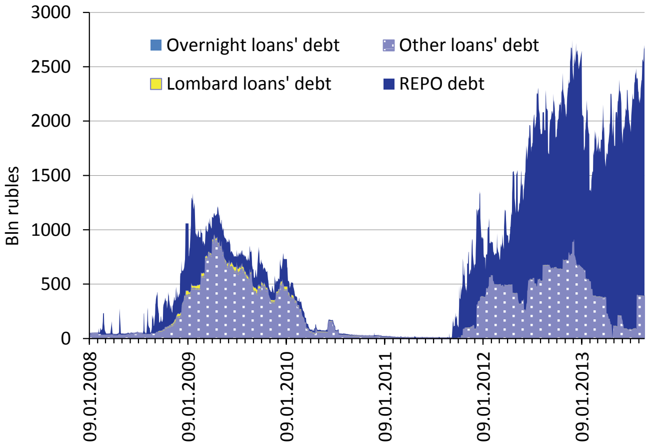



*Fig. 2. The Movement of Commercial Banks' debt to the Bank of Russia in 2008–2013*

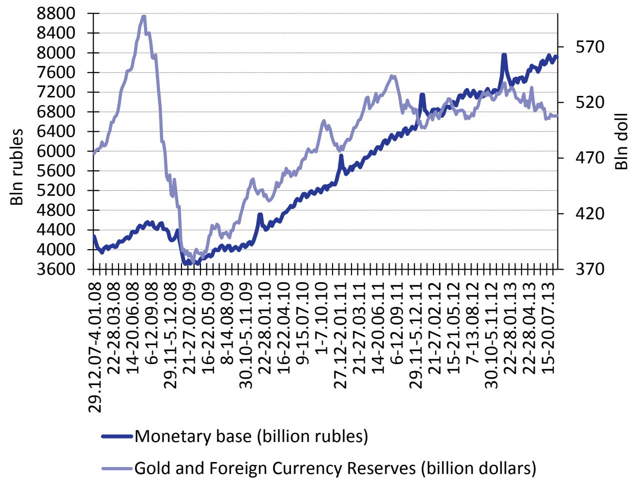
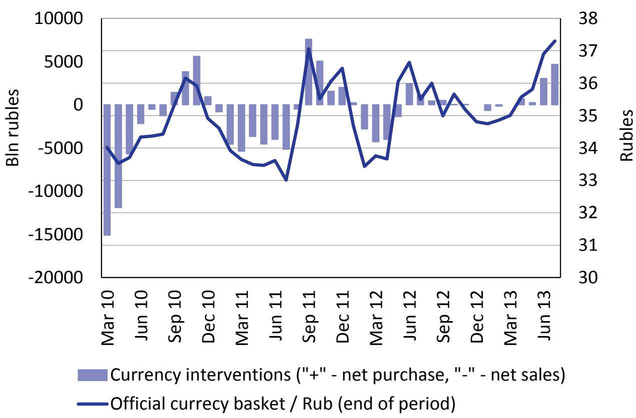



*Fig. 3. Behavior of Russia's Narrow Monetary Base and Gold and Foreign Currency (International) Reserves in 2007 – 2013*



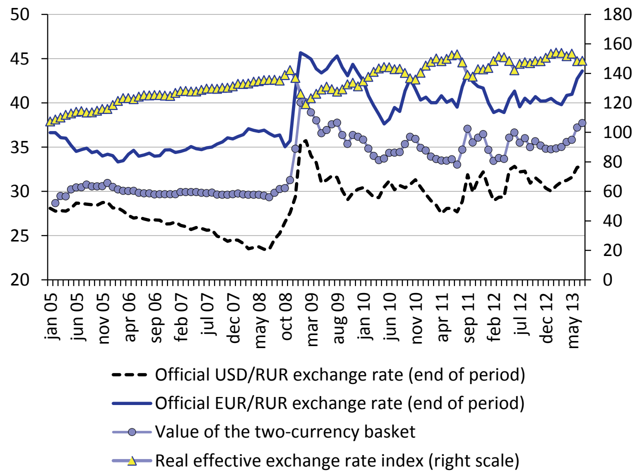

*Source*: RF CB; the author's calculations.

*Fig. 4. The Bank of Russia's Currency Interventions and the Ruble Exchange Rate against the Bi-currency Basket in March 2010 – July 2013*

times revised the boundaries of the bi-currency basket's floating corridor by 5 kopecks. As of 31 July, the boundaries of the bi-currency basket's floating corridor were set at Rb 31.85–38.85. The repeated further upward adjustment of the bi-currency basket's corridor by 5 kopecks in August pushed the corridor boundaries up, to Rb 32.15–39.15.

According to the Bank of Russia's preliminary estimates, net capital outflow from Russia in Q2 2013 increased to $ 10bn, and on the whole for the first half year this index amounted to $ 38.4bn, which is by $ 1.7bn less than the same index for the first half year of 2012. From January through June 2013, net capital outflow from the banking sector was $ 19.4bn, while that from the other sectors amounted to $ 18.9bn.

In July, the ruble's real effective exchange rate gained 0.1% (against -3.3% in June 2013) (*Fig. 5*). As seen by the quarter-end results of Q2 2013, the ruble's real effective exchange rate declined by 1.7%.




*Source*: RF CB; the author's calculations.

*Fig. 5. Behavior of the Ruble's Exchange Rate Indicators in January 2005 – July 2013*

The exchange rate of the US dollar against the ruble over July rose by 0.1%, to Rb 32.9, which happened as a result of capital outflow from the developing markets in response to the continuing uncertainty as to whether the US Federal Reserve System's third round of quantitative easing (QE3) was going to be halted towards the year's end. The growth of the euro's exchange rate over July amounted to 1.9% (Rb 43.6), which had to do with the expected release of optimistic statistics concerning the situation in the eurozone. In July, the average exchange rate of the euro against the US dollar amounted to 1.31. The value of the bi-currency basket over July increased by 1.02% to Rb 37.7. As seen by the month-end results, in August the USD/ruble exchange rate rose by 0.65%, to Rb 33.2, the euro/ruble exchange rate – by 0.5%, to Rb 44.0. As a result, the bi-currency basket's value increased by 0.6%, to Rb 38.1. Thus, the average euro/USD exchange rate for August was 1.33.

On 12 July, at a planned meeting of the Bank of Russia's Board of Directors, e Bank's main interest rates were left unchanged. At the same time, the Bank of Russia announced the launching of a new instrument for refinancing the banking system – credit auctions for issuing loans secured by non-marketable assets or sureties for a period of 12 months. According to the Bank of Russia's CEOs, the purpose of that new instrument was not to increase the actual refinancing volume, but to redistribute it in favor of instruments with longer term times. Thus, the limits for overnight direct repo operations may be brought down by a comparable value. The minimum interest rate for this new refinancing instrument will be set at 5.75% per annum, which means that it will be only by 0.25 p.p. higher than the minimum interest rate for direct overnight repo auctions. Besides, the Bank of Russia promised that the evaluation of collaterals will be done promptly. It should be added that, on 29 July, the first auction designed to refinance banks against the collateral of non-marketable assets took place, the ceiling being set at Rb 500bn. The volume of concluded transactions exceeded Rb 306.8bn.

It should be noted that, on the whole, the attractiveness of the new instrument for the bank will largely be determined by the collateral evaluation procedures and the discount on collaterals. It may indeed become possible, in general, to alter the refinancing structure in favor of instruments with longer term times; however, we believe that, given the current macroeconomic situation with high employment and inflation levels, the softening of monetary policy cannot bring about any positive changes. Moreover, to supply the economy with 'long money' is the task for the entire financial system, and not for the central bank. The most efficient methods of boosting economic activity are to bring down inflation risks, develop the institutional environment and deepen the financial sector's capacity.