INFLATION AND MONETARY POLICY IN DECEMBER 2013

A.Bozhechkova

The consumer price index stood at 0.5% in December 2013 (0.5% in December 2012), having declined 0.1 p.p. below the value observed in November 2013. As a result, inflation reached 6.5% at the end of the 12-month period. The consumer price index stood at 0.4% within the first 20 days in January 2014. Net capital outflow from the country reached $16,6bn in Q4 2013 and totaled $64,7bn within 12 months, based on the Bank of Russia's preliminary estimates.

Inflation remained at a high level in the Russian Federation in December 2013: the consumer price index stood at 0.5% at the month end (as compared to 0.6% in November 2013) and was found to be equal to the level recorded in 2012. As a result, inflation reached 6.5% on an annualized basis (*Fig. 1*) against 6.6% in 2012 and 6.1% in 2011. Core inflation[1] stood at 0.4% in December 2013, being equal to the corresponding value observed in the previous year.

Prices of food products increased 0.8% in December 2013 against November 2013 (*Fig. 2*). Growth rate in prices of butter (from 2.8% in November 2013 to 2.3% in December 2013), fruit and vegetable products (from 3.0% to 2.8%), alcoholic beverages (from 0.5% to 0.4%) slowed down. Prices of the following food products kept growing : milk and dairy products (1.6% in December 2013, the same in November 2013), fish and seafood products (from 0.7% in November 2013 to 1.5% in December 2013). Prices of eggs stopped growing (prices of this product dropped 0.6% in December 2013, after having gained 11.6% in November 2013). Prices of the following food products kept falling: cereal and bean products (-0.1% as compared to -0.3% in November 2013), granulated sugar (-1.4% as compared to -2.7% in November 2013), sunflower oil (-1.1% as compared to -1.2% in November 2013), macaroni products (-0.1% as compared to -0.6% in November 2013), meat and poultry (-0.1% in November 2013 and in December 2013).

Prices and tariffs of retail paid services increased 0.6% in December 2013, whereas they grew up 0.2% in November 2013. Tariffs of housing and public utility services grew at a rate of 0.1% in December 2013, being equal to the value observed in November 2013. Prices of the following services increased: passenger transport services (from -0.5% in November 2013 to 3.4% in December 2013), international travel services (from -0.6% in November 2013 to 0.1% in December 2013). Prices of the following services slowed down: medical services (from 1.1% in November 2013 to 0.6% in December 2013), culture organizations' services (from 1.7% in November 2013 to 1.5% in December 2013), domestic services (from 1.0% in November 2013 to 0.5% in December 2013), insurance services (from 0.5% in November 2013 to 0.3% in December 2013), education services (from 0.3% in November 2013 to 0.0% in December 2013).

In December 2013 prices of non-food products slowed down 0.2 p.p. against November 2013 and stood at 0.2%. Prices of the following products slowed down most in this group of products: clothes and underclothes – 0.4% (+0.7% in November 2013), knit goods – 0.5% (+0.9% in November 2013), footwear – 0.2% (+0.7% in November 2013), tobacco products – 0.8% (1.2% in October 2013).

In January 2014, inflation kept growing basically through growth in the price of fruits and vegetables and dairy products. Note that weakening of the ruble made a certain contribution to the growth in the consumer price index, factoring in a big share of imported goods in the consumption of economic agents in the Russian Federation. The consumer price index stood

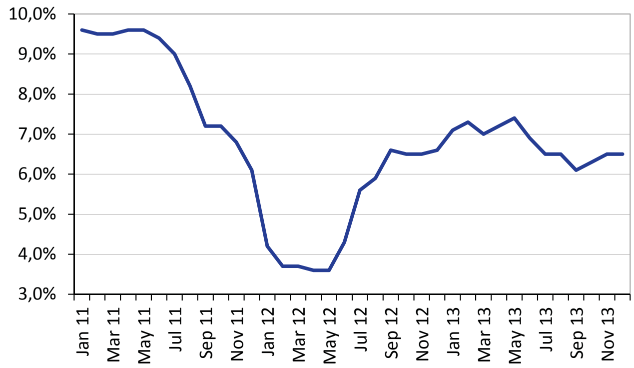

Fig. 1. CPI growth rate in 2011–2013 (% year over year)

1 The reference consumer price index is an indicator which describes the level of inflation in the consumer market, net of seasonal factors (prices of fruit and vegetable products) and administrative factors (tariffs of regulated types of service, etc.). The index is also calculated by the Federal State Statistic Service of Russia (Rosstat).

at 0.4% at the end of 20 days in January 2014 (0.6% in the corresponding period of 2013). No marked pressure upon prices on the demand side, as well as good grain and pulse crops in 2013 and improved situation in the global agricultural market is the key factor constraining inflation.

In December 2013, the monetary base (broad definition) increased 15% to Rb 10504bn (*Fig. 3*). Banks' correspondent accounts (an increase of 26.4% to Rb 1270bn), banks' deposits (an increase of 416% to Rb 517,6bn), The volume of cash in circulation, including cash on hand at credit institutions which rose 10.4% to Rb 8308bn can be distinguished among the broad money's components in growth. The volume of obligatory reserves decreased 19.9% to reach Rb 408,8bn.

The monetary base (narrow definition) (cash plus obligatory reserves) in increased 8.5% to Rb 8716,3bn in December 2013 (*Fig. 4*).

In December 2013, the volume of excessive reserves at commercial banks[1] increased 61.8% to Rb 1788bn. The increase in excessive liquidity on banks' corresponding accounts and deposits with the Central Bank of Russia is of seasonal nature and associated with a year-end inflow of federal budget funds to the banking sector. However, by the end of January 2014 the amount of excessive reserves will begin to shrink with the beginning of a tax payment period. Banks' debt under repo transactions increased 11.6% to Rb 2,9 trillion. Banks' debt under repo transactions declined to Rb 2,7 trillion on the basis of the data available as of January 27, 2014. Given the persisting liquidity structural deficit in the banking sector, the interest rate in the interbank lending market[2] averaged 6.4% in December 2013 (6.2% in November 2013 2013), having eclipsed 19% the correspondent value recorded in January 2014 (5.4% in January 2013). The interest rate averaged 5.95% in the period of January 1, 2014 thru January 23, 2014 (*Fig. 5*). Note that the growth in the interest rates which was recorded in November–December 2013 was associated with the tension triggered in the interbank lending market by the revocation of the banking license of certain Russian banks.

On January 13, 2014, the Central Bank provided Russian banks with Rb 480bn out of a limit of Rb 500bn as part of a 3-month repo auction secured by non-market assets. The hurdle rate was 5.76% with a lowest rate of 5.75%. It is to be recalled that the regulator extended Rb 500bn at 5.76% p.a. as part of the first such action which was held in October 15, 2013. It is only large banks, whose collateral base is distinctly bigger, that can afford such actions despite fairly easy terms of lending at a floating interest rate.

1 Commercial banks' excess reserves with the Central Bank are referred to the amount of commercial banks' correspondent accounts, their deposits with the Central Bank, as well as Central Bank bonds held by commercial banks.

2 Interbank interest rate is the monthly average MIACR, an interest rate on ruble overnight interbank loans.

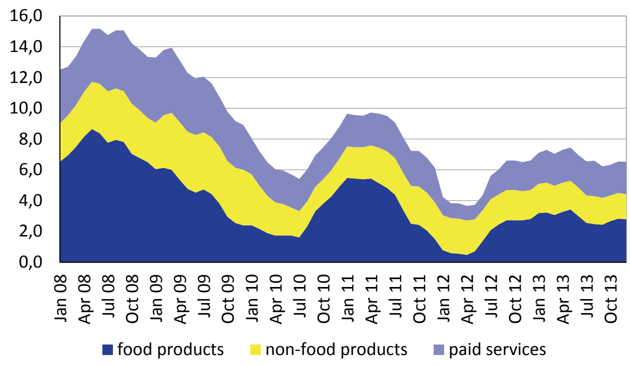

Fig. 2. Inflation factors in 2008–2013 (%, month to the corresponding month of the previous year)

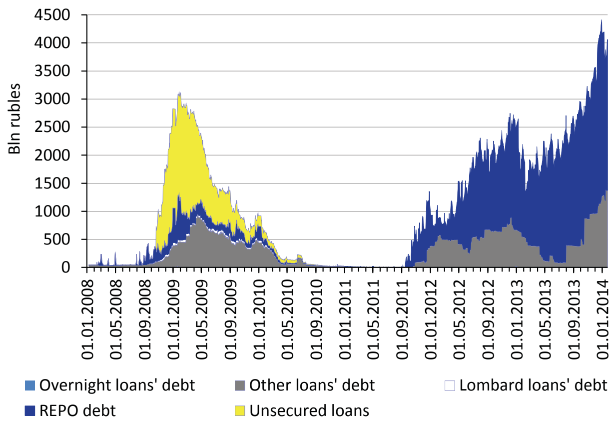

Fig. 3. Commercial banks' debt owed to the Bank of Russia in 2008–2013

The Central Bank's international reserves totaled $509,6bn as of January 1, 2014, having declined 5.2% year to date (*Fig. 4*). At the same time, the monetary gold reserves shrank $1,5bn in December 2013 because of a negative revision of the assets. In general, the contraction of the international reserves in 2013 was caused by the regulator's foreign currency interventions aimed at flattening volatility of the ruble exchange rate in the periods of its rapid weakening, as well as a negative revaluation of gold.

Bank of Russia's foreign currency interventions amounted to $3570m and 326m euro at the end of December 2013 and were aimed at flattening volatility of the ruble exchange rate (*Fig. 6*). In December 2013 the regulator conducted no operations to purchase foreign currencies in connection with the Federal Treasury replenishing or spending foreign currency resources of sovereign funds. The Eight-time 5-kopek extension of the borders of the dual-currency corridor in December 2013 pushed them to a level of Rb 33,05–40,05. In the period of January 1, 2014 thru January 23, 2014, the regulator repeatedly extended by 5 kopeks the borders of the dual-currency corridor. As of January 23, 2014, the borders of the dual-currency corridor were set within a range of Rb 33,45–40,45. In the period of January 1, 2014 thru January 23, 2014, Bank of Russia's foreign currency sales volumes amounted to $2600m, and the regulator made no foreign currency interventions in connection with the Federal Treasury replenishing or spending foreign currency resources of sovereign funds.

According to the Bank of Russia's preliminary estimates, net capital outflow from the country reached $16,6bn in Q4 2013 and $64,7bn during the 12 months of the preceding year, having exceeded by $10,1bn the level observed in the corresponding period in 2012. Banks' and other sectors' net capital export reached $5,2bn and $ 59,7bn respectively in the period of January 2013 thru December 2013.

In December 2013 the real effective ruble exchange rate vs. foreign currencies weakened by 0.9% (-0.3% in November 2013). In the period of January 2013 thru December 2013 the real effective ruble exchange rate stood at +1.2% on an annualized basis (*Fig. 7*).

The USD/RUB exchange rate dropped from 1.3% to Rb 32,7 in December 2013. The Euro weakened 0.3% vs. the Ruble (Rb 44,97) in December 2013. The EUR/USD exchange rate averaged 1.37 in December 2013. The value of the dual currency basket dropped 0.7% to Rb 38,2 in December 2013. At the end of the 25th day of January 2014 the US dollar gained 4.9% vs. the Ruble and reached Rb 34,26, while the Euro gained 4.1% vs.

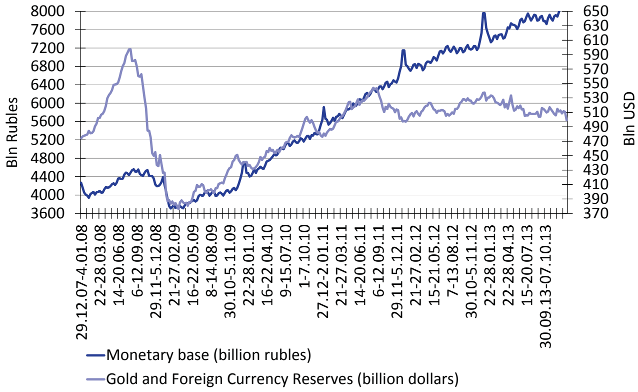

Fig. 4. Dynamics of the monetary base (narrow definition) and gold and foreign currency (international) reserves of the Russian Federation in 2007–2013

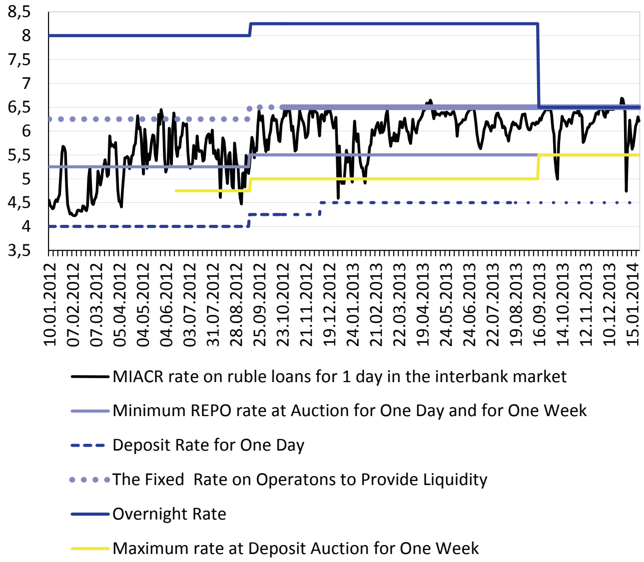

Fig. 5. Bank of Russia's interest rates corridor and dynamics of the interbank lending market in 2012–2013 (% p.a.)

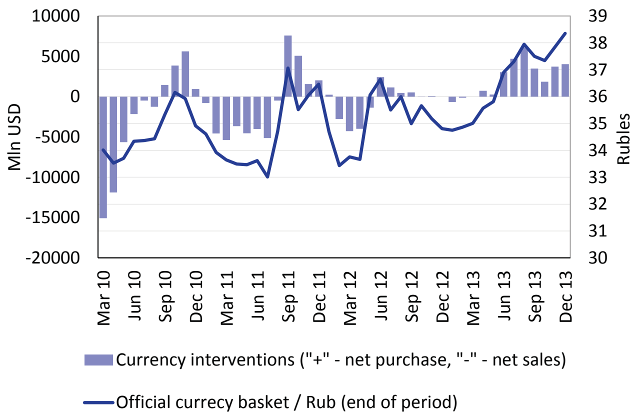

Fig. 6. Bank of Russia's currency interventions and ruble exchange rate vs. the currency basket in March 2010 – December 2013

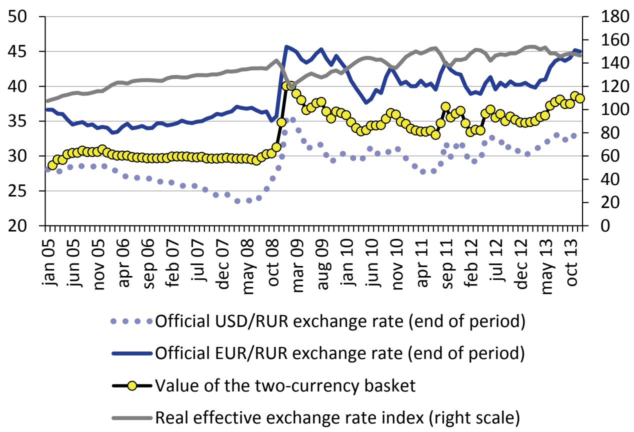

Fig. 7. Ruble exchange rate indicators in January 2005 – December 2013

the Ruble and reached Rb 46,9. As a result, the value of the dual currency basket increased 4.5% to Rb 39,9. The EUR/USD exchange rate averaged 1.36 in January 2014. The ruble lost vs. the US dollar basically because of a trend towards decline in the current account balance and capital outflow from the country. Note that the Euro strengthened in response to the Euro-zone recovering from recession. The ruble strengthened a bit vs. foreign currencies in December 2013 basically because of escalation of the tension in the interbank lending market triggered by the revocation of the banking license of certain Russian banks, high interest rates in the money market, as well as the effect of tax payments.

The Bank of Russia Board of Directors made a decision on January 13, 2014 to cut the volume of targeted interventions from $60m to 0 daily. This measure of the Central Bank of Russia is aimed at further enhancing flexibility of the exchange rate formation mechanism, creating conditions so that economic agents can gradually adapt to fluctuations of the exchange rate and master currency risk management instruments.