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## Inflation and Monetary Policy

*The effect of September indexation of housing and public utilities prices began to subside, leading to a slowdown of inflation in October: as per the month results, the CPI equaled the same period of the last year and amounted to 0.5%. In November, the growth rate of consumer prices remained unchanged and on November 19 amounted to 0.3%. As a result, the cumulative inflation since the beginning of the year on that date amounted to 6% (against the relevant indicator of 5.6% last year). Thus, as per the year results, inflation is likely to be within the projected value, the upper level of which is 7%. According to tentative estimates of the RF Central Bank, the net capital outflow from the country within ten months of the current year reached \$61bn (vs. \$60bn the relevant period of 2011).*

Reduced growth rate of prices for paid services in October has led to a slowdown in consumer inflation to 0.5% (the same indicator was recorded in October last year). After the September one-percent increase, in October prices for commercial services increased only by 0.1%. Growth price rate has slowed down in educational services from 5.1 to 0.6%, in housing and public utilities from 2.4 to 0.4%, and fitness services from 2.3 to 0.6%. There is still a decline in healthcare and recreation services (3%), passenger transportation (-1.3%), international tourism (1.4%) and insurance services (-0.1%). At the same time, the demand for the services of cultural organizations has grown, which prices got up by 0.8%.

In October the growth rate in food prices has matched the previous year level, amounting to 0.5%, having significantly increased as compared with September (+0.1%). Prices for fruit and vegetables continued to decrease (-2.2%), as well as for sugar (-2.9%), although the rate of decline has slowed more than twice. The greatest increase in prices, which, however, was lower as compared with September, was observed in sunflower oil (+ 4.3%) and eggs (+3.5%). Also a rapid growth was noted in prices of bread and bakery products (+1.9%), as well as pasta (1.6%).

In October, the growth rate of non-food prices remained unchanged and amounted to 0.7%. Like in previous month, the utmost growth was observed in gasoline (+2.4%) and tobacco (1.3%). With the onset of cold weather prices for seasonal footwear has increased (+1%). The only cheapening items in October among non-food goods were still video and audio appliances (-0.2%).

In September, the annual inflation (October 2012 against October 2011) made 6.5% (see Fig. 1). The relevant indicator of the last year was 7.2%.

In October the core consumer price index<sup>1</sup> has again declined to the level of August (+0.6%).

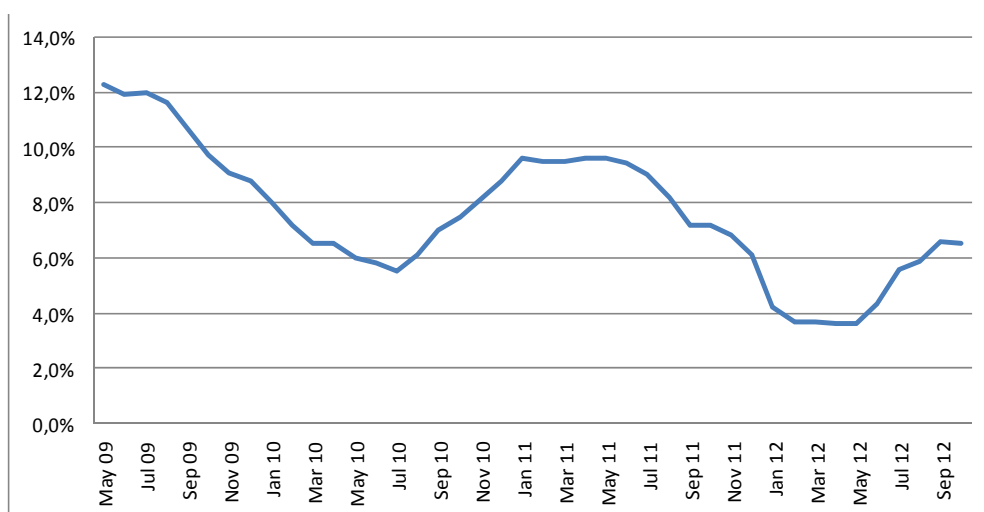
In November, weekly growth rates of consumer prices did not exceed 0.1%: as a result, the CPI indicator as of 19 days of the month made 0.3% (against 0.4% in 2011). Cumulative

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<sup>1</sup> The core consumer price index reflects the level of inflation in 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, which is also calculated by the RF Statistical Service (Rosstat).

inflation since the beginning of the year to November 19 reached 6%, which is 0.4 p.p. higher than the indicator of the same period last year.

By the end of the year the rate of inflation traditionally accelerates. As usual, significant budget expenditures and pre-holiday upsurge in consumer demand become the main factors of price growth. Nevertheless, most likely, inflation will be stay within the updated official forecast. In the revised version of the "Guidelines for the Consistent Monetary and Credit Policy for 2013-2015", submitted by the RF Central Bank to the State Duma at the beginning of November 2012 the forecasted for 2012 inflation rate is increased from 6 to 7%, which matches the estimates of the Ministry of Economic Development of Russia and Gaidar Institute. Significant constraint factor of inflation will be the continued decrease of monetary supply: M2 growth rate in annual terms has slowed down from 21.4% as of October 1, 2011 to 14.9% on October 1, 2012.



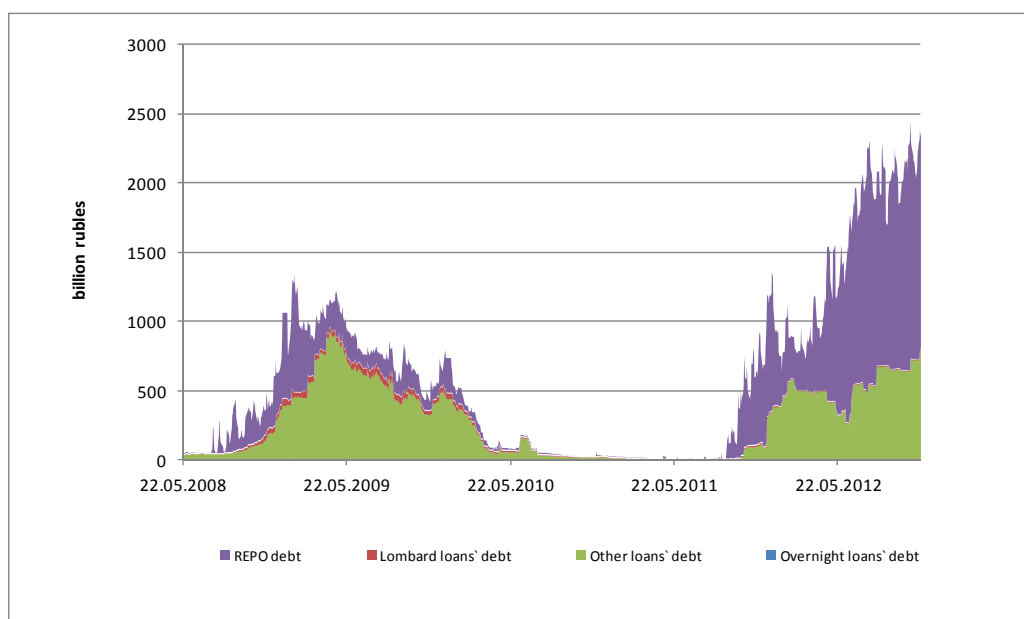
Source: RF Statistical Service.

**Fig. 1. The Growth Rate of the CPI in 2009-2012 (% year to year)**

Like in previous two months, in October the monetary base in broad definition has continued to decline: over the month it decreased by 0.5% to Rb 8,045.6bn. The basic reason for the monetary base decrease was the reduction of commercial banks' deposits with the banks. Over the month, they have been reduced by 5.6% to Rb 720.9 bn. Other components of monetary base in broad definition were growing: commercial banks' deposits with the RF Central Bank - by 11.6% to Rb 101.3bn, mandatory reserves – by 0.6% to Rb 413.9bn.

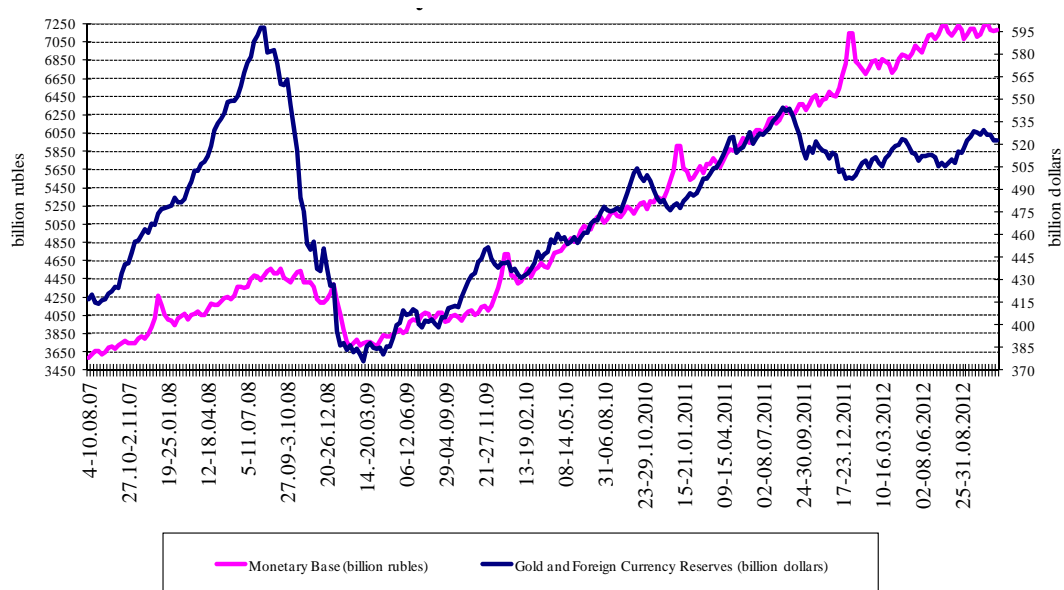
In October, the excessive reserves<sup>2</sup> of commercial banks were still decreasing: Over the month they decreased by 5.4% to Rb 822.2bn. The liquidity deficiency is sustained, as evidenced by the growth dynamics of borrowing from the RF Central Bank (see Fig. 2). The main sources of its completion, as in the past year, remain the Bank of Russia auctions against guarantee of securities.

<sup>2</sup> Under the excessive reserves of commercial banks with the RF Central Bank is understood the sum of correspondent accounts of commercial banks, their deposits with the RF CB and the RF CB bonds of commercial banks.



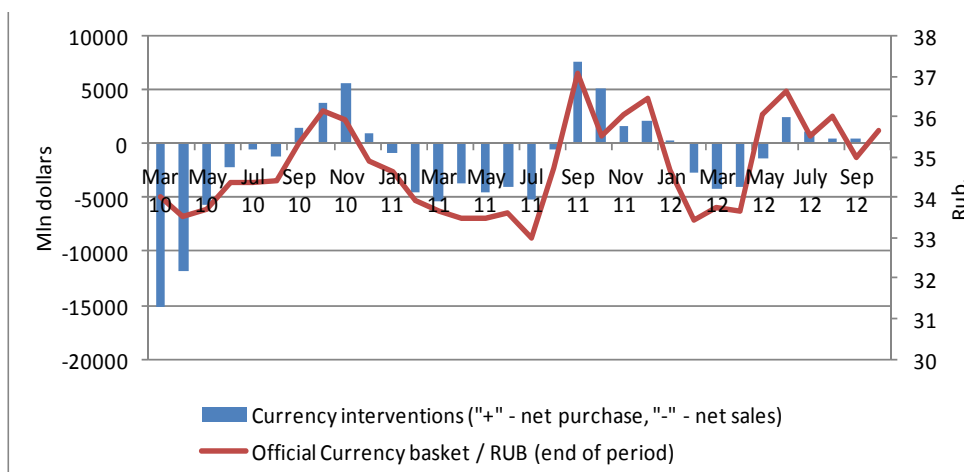
**Fig.2. Arrears of commercial banks with the Bank of Russia in 2008–2012**

In October the monetary base in narrow definition (cash plus mandatory reserves) remained virtually unchanged, having made Rb 7223.3bn (-0.2%) (See Fig. 3).



**Fig. 3. Changes in the Monetary Base in the Gold Foreign Currency Reserves in 2007-2012**

In October the Bank of Russia practically did not participate in the foreign exchange trading. The RF CB entered the market with currency net sales, but their volume has significantly decreased - by 22-fold as compared with September. Net foreign exchange interventions in October amounted to only \$23.64m (see Fig. 4).



Source: RF Central Bank, author's estimates.

**Fig. 4. Central Bank currency Interventions and Dynamics of Ruble Exchange Rate in March 2010 – October 2012**

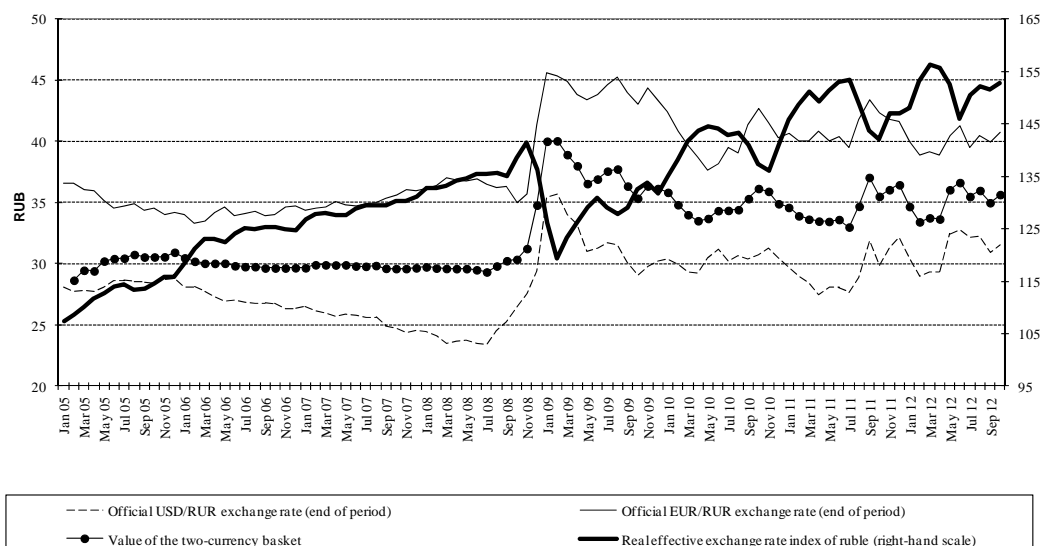
According to tentative estimates of the Bank of Russia, within ten months of the current year, net capital outflow reached \$61bn, exceeding the outflows of the same period last year by \$1bn. Thus, in October, the outflow of capital from Russia has not stopped and reached from \$3bn (RF CB assessment) to \$5bn (estimates of the Ministry of Economic Development).

An essential reason for the outflow of capital from Russia in recent years has been the Regulator effort to minimize the intervention in the currency market. In this situation, the surplus of the current account balance of payments is leveled by the deficit of the capital operations account and financial instruments. With the stable foreign reserves, capital outflow is correlated with the inflow of currency into the country as a result of export-import operations. Herewith, sustained ruble nominal exchange rate reflects the balance of supply and demand in the foreign exchange market. Thus, if current trends are kept up, the surplus of the current account balance of payments in 2012 will be approximately equal to the value of 2011, which means also comparable to the last year outflow level. In other words, the outflow of capital from Russia in 2012 is likely to be \$75-85bn.

Over the month from mid-October the amount of international reserves by November 16 decreased by 1.4% to \$522.2bn. Foreign exchange and gold reserves decline was due to currency revaluation, as well as lower prices of gold. Over ten months of the current year international reserves increased slightly - by 5.6% or \$28bn. Over the same period last year, the reserves have increased by 9.6% or \$46bn.

In October, ruble real effective exchange rate after the September decline rose by 0.8%. As a result, the ruble real effective exchange rate index has grown to 152.74<sup>3</sup> (see Fig. 5).

<sup>3</sup> The level of January 2002 is accepted as 100%.



*Note. The level of January 2002 is accepted as 100%.*

*Source: RF Central Bank, author's estimates.*

**Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – September 2012**

Since early November, the dollar exchange rate against ruble has downgraded by 1.3% to 30.13 Rb/\$ (as of November 24). The dynamics of the Euro against ruble rate in the first half of the month reflected the dynamics of the European currency against dollar. Due to the publication of poor statistical data on the Eurozone economy and uncertain position of the European Commission on the issue of providing financial assistance to Greece, Euro was gradually declining, having reached on November 13 the two-month minimum in the world market. As a result, over 24 days of November the European currency has decreased by 1.4% to Rb40.14/Euro. During the same period, the two-currency basket was downgraded by 1.3% to Rb35.18.

On November 7 the Bank of Russia has made minor amendments to the draft Guidelines for the Consistent State Monetary Policy for 2013 and the period of 2014 and 2015. The estimated net capital outflow was adjusted from \$65 to \$67bn, and the amount of international reserves by the year end – from \$505 to \$508bn.