

## INFLATION AND MONETARY POLICY IN MAY 2014

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*In May 2014, the consumer price index stood at 0.9% (0.7% in May 2013), being equal to the value observed in the previous month. Therefore, inflation stood at 7.6% at the end of the 12-month period. The consumer price index reached 0.4% within 23 days in June 2014. as of June 1, 2014 banks' debt owed to the regulator amounted to Rb 5.02 trillion. In May 2014, the value of the dual-currency basket contracted by 3% to Rb 40.4 and further declined by 3.2% to Rb 39.3 at the end of 27 days in June 2014.*

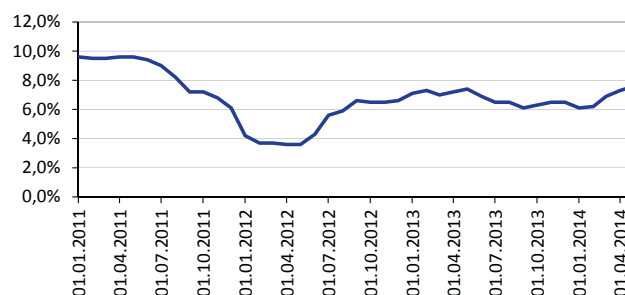
Inflation in the Russian Federation remained at a high level in May 2014: the consumer price index stood at 0.9% at the month's end (compared to that in April 2014 – 0.9%), showing an increase of 0.2 p.p. over the value observed in 2013. Therefore, inflation reached 7.6% on an annualized basis (Fig. 1). Core inflation<sup>1</sup> in May 2014 stood at 0.9%, also higher, up 0.6 p.p., than the value observed in the previous year.

In May 2014, prices of food products increased 1.5% compared to April 2014 (Fig. 2). Prices of the following food products saw higher growth rates: (from 2.3% in April to 2.4% in May 2014), pasta products (from 0.3% in April to 0.8% in May 2014), meat and poultry (from 1.5% in April to 4.4% in May 2014). Prices of the following food products saw slower growth rates: grains and beans (from 1.4% in April to 1.0% in May 2014), butter (from 1.4% in April to 1.0% in May 2014), milk and dairy products (from 1.8% in April to 0.9% in May 2014), granulated sugar (from 3.0% in April to 1.5% in May 2014), prices of eggs kept declining (-2.3% in April, -11.7% in May 2014).

In May, prices and tariffs of retail paid services increased 0.8%, while in April 2014 they increased 0.7%. Overall, tariffs of public utilities in May increased 0.8%, while in April 2014 they remained unchanged. Prices of the following services increased in May: insurance services (from 2.2% in April to 3.2% in May 2014), services rendered in the physical culture and sports sector (from 0.2% in April to 0.3% in May 2014). Prices of the following services fell in May: international travel services (from 2.3% in April to 1.6% in May 2014), passenger transport services (from 2.4% in April to 1.2% in May 2014), medical services (from 1.4% in April to 0.6% in May 2014), early childhood education services (from 0.8% in April to 0.4% in May 2014).

In May, growth rate of prices of non-food products slowed down by 0.1 p.p. relative to April 2014 and stood at 0.5%. Prices of the following non-food products saw faster growth rate: washing and cleaning products (from 0.5% in April to 1.1% in May 2014). Growth rate of prices of the following non-food products slowed down: tobacco products (from 4.6% in April to 3.3% in May 2014), motor gasoline (from 0.8% in April to 0.5% in May 2014), electrical products and household appliances (from 0.5% in April to 0.3% in May 2014), footwear (from 0.6% in April to 0.4% in May 2014).

In June 2014, inflation kept growing due to growth in prices of certain categories of fruit and vegetable products, red meat and poultry, millet. It's worth noting that a depreciation of the ruble exchange rate made a major contribution to the acceleration of inflation having regard to a great share of imported goods in the consumption of economic agents in the Russian Federation. There were more nonmonetary factors that pushed up inflation in January-June 2014: the restrictions imposed by the Rosselkhoznadzor (Federal Service for Veterinary and Phytosanitary Surveillance) on import of meat from the EU countries and the United States early in the year, livestock reduction due to a fodder shortage, adverse weather conditions in certain countries, as well as decline in shipments of certain categories of agricultural products from Ukraine.



Source: The Federal State Statistic Service of Russia (Rosstat).  
Fig. 1. CPI growth rate in 2011 to 2014 (% year over year)

1 The baseline 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).

The consumer price index stood at 0.4% within 23 days in June 2014 (0.4% in the same period of 2013). The lack of pronounced demand-driven pressure on prices, as well as the Bank of Russia's policies aimed at tightening the monetary policy remain the key factors constraining inflation.

In May 2014 the monetary base (broad definition) contracted by 1.1% to Rb 9326.1bn (Fig. 3). The volume of cash in circulation including cash balances in credit institutions declined 1.6% to Rb 7752.9bn, banks' deposits shrank 10.6% to Rb 88.1bn. The following components of the broad monetary base saw an increase: banks' correspondent accounts (growth of 3.3% to Rb 1050.3bn), obligatory reserves (a growth of 0.7% to Rb 434.8bn).

In May 2014, the monetary base (narrow definition) (cash plus obligatory reserves) shrank 1.5% to Rb 8187.7bn (Fig. 4).

In May, the volume of excessive reserves at commercial banks amounted to Rb 1329.4bn, with mandatory reserves on special accounts with the Central Bank amounting to Rb 434.8bn, while the average value of reserves in the period of 10.05.2014 to 10.06.2014 amounted to Rb 894.6bn. As of June 1, 2014, banks owed Rb 5.02 trillion to the regulator, seeing a timid decline of 0.7% since the beginning of May 2014. Bank's debt on REPO transactions declined 12.3% to Rb 2.8 trillion, the debt on loans secured by non-market assets amounted to Rb 2.1 trillion, an increase of 21.3%. According to the data available as June 26, 2014, banks' debt on REPO transactions saw a decline to Rb 2.6 trillion, while the debt on other loans increased to Rb 2.4 trillion. It should be noted that the Bank of Russia used REPO operations at a flat rate, in particular, an average of Rb 12,1bn were provided daily in May and June 2014 respectively. Furthermore, on May 20 and 21, 2014 the interest rate approximated very close to the interest rate cap. On the foregoing dates the volume of REPO operations at the flat rate amounted to Rb 15.9bn and Rb 11.8bn respectively. The interbank interest rate<sup>1</sup> in May stood at 8.2% on average (7.9% in April 2014). In the period of June 1 thru June 25 the average interbank interest rate stood at 8.2% (Fig. 5). The average interbank interest rate increased in May 2014 in response to the Bank of Russia's April 25, 2014 decision to lift the key interest rate, as well as interest rates on liquidity provision and absorption instruments, from 7.0% to 7.5% p.a., in order to mitigate risks of accelerating inflation and ensure financial stability.

The Bank of Russia provided banks with Rb 485.8bn at a cut-off rate of 7.77% p.a. as part of a 3-month

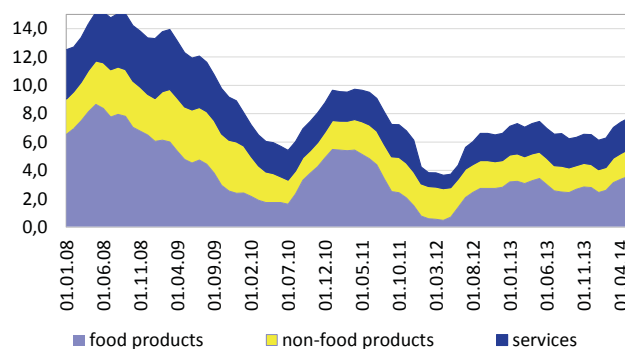


Fig. 2. Inflation factors in 2008 to 2014 (% , relative to the same month of the previous year)

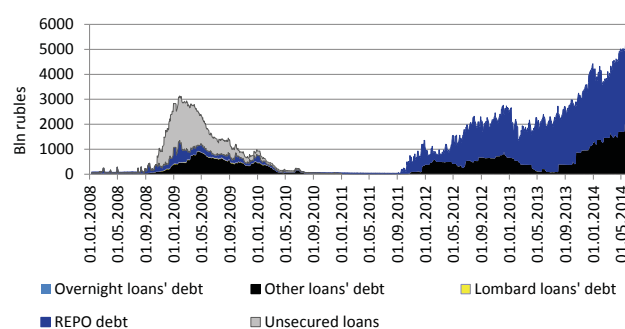


Fig. 3. Commercial banks' debt owed to the Bank of Russia in 2008 to 2014

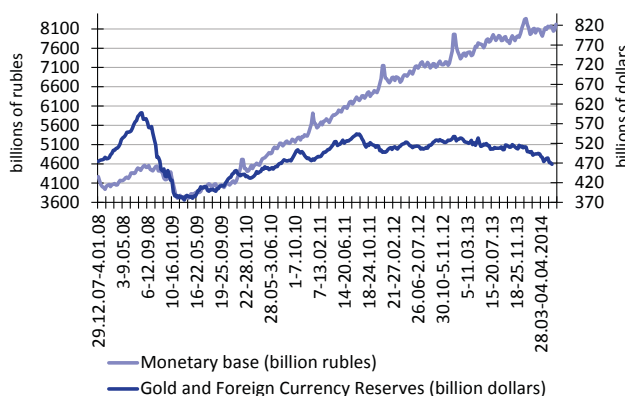


Fig. 4. Dynamics of the monetary base (narrow definition) and gold and foreign currency (international) reserves of the Russian Federation in 2007 to 2014

repo auction secured by non-market assets held on May 12, 2014. During a similar auction held on May 12, the Bank of Russia provided at total of Rb 485.8bn at a rate of 7.77% p.a. However, only large banks which have the required collateral base can afford such actions despite very beneficial terms of lending at a floating interest rate.

As of June 1, 2014, the Central Bank's international reserves totaled \$467.2bn, shrinking by 8.3% year to date (Fig. 4). At the same time, the monetary gold reserves shrank \$1.2bn in May 2014 due to a negative

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

revaluation of assets. The contraction of the international reserves in the period of January 2014 to April 2014 was basically caused by the regulator's foreign currency interventions aimed not only at flattening volatility of the ruble exchange rate, but also its retaining against in the face of the observed depreciation of developing countries' national currency exchange rate and unstable geopolitical situation in Ukraine.

Bank of Russia's foreign currency interventions through net purchases of foreign exchange amounted to \$1072.0m and 95.0m euro by the end of May 2014 (Fig. 6). In May, the regulator's operations on the purchase of foreign currency with regard to the Federal Treasury replenishing or spending foreign currency resources of sovereign funds amounted to \$1268m. In the same month the borders of the dual-currency trading band were extended and maintained within a range of Rb 36.40–43.40. In the period of June 1 thru June 26, 2014, the dual-currency trading band remained unchanged as well. At the same period, Bank of Russia's foreign currency interventions with regard to the Federal Treasury replenishing or spending foreign currency resources of sovereign funds totaled \$1510m.

According to the Bank of Russia's preliminary estimates, net capital outflow from the country reached \$50.6bn in Q1 2014, 1.8 times more than in the same period of 2013. Capital outflow from Russia amounted to \$59.7bn within 12 months in 2013. In Q1 2014, net capital exports by the banking sector and other sectors reached \$18.9bn and \$31.7bn respectively. A substantial capital outflow from Russia in Q1 2014 was determined by economic slowdown in the country as well as geopolitical turmoil.

In May 2014, the real effective exchange rate of the ruble gained 2.6% (2.7% in April 2014). Overall, in the period of January to May 2014 the real effective exchange rate fell 7.7% as compared to the corresponding period in 2013 (Fig. 7).

In May, the dollar-ruble exchange rate lost 2.3% to Rb 34.74, while the euro-ruble exchange rate lost 3.6% (Rb 47.3). In May, the euro-dollar exchange rate averaged 1.37. The value of the dual currency basket declined 3% to Rb 40.4 during the same month. At the end of 27 days in June 2014, the dollar-ruble exchange rate fell 3.3% to Rb 33.75, while euro-dollar exchange rate declined 3.2% to Rb 46.02, resulting in a decline of 3.2% (to Rb 39.3) in the value of the dual currency basket. The euro-dollar exchange rate in June 2014 was equal to 1.36. It should be noted that the ruble weakened against the dollar in January–April 2014 basically in response to a more intensive capital outflow from the country due to unstable geopolitical situation in Ukraine, optimistic projections about economic

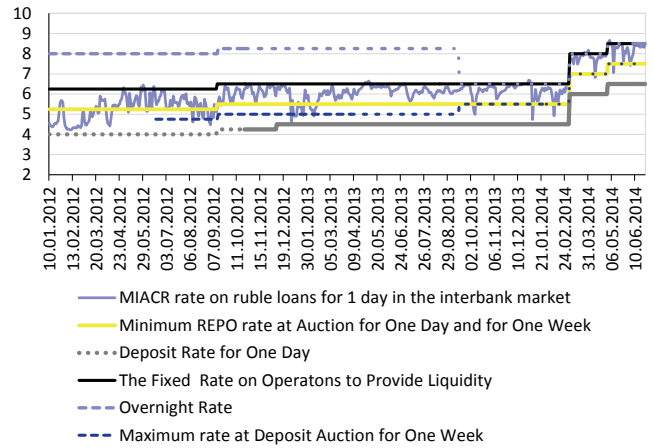


Fig. 5. Bank of Russia's interest rates band and dynamics of the interbank lending market in 2012 to 2014 (% p.a.)

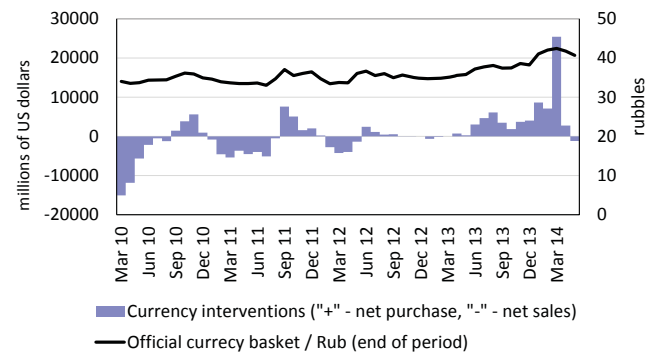


Fig. 6. Bank of Russia's currency interventions and ruble exchange rate vs. the currency basket in March 2010 to May 2014

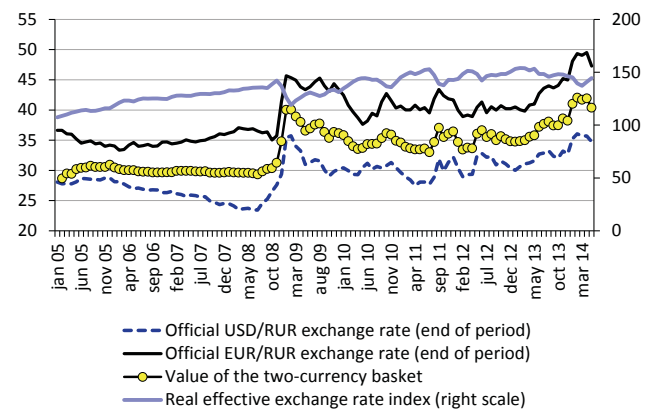


Fig. 7. Ruble exchange rate indicators in January 2005 to May 2014

growth in the United States and European Union, economic slowdown in the Russian Federation. The ruble appreciated in the period of May to June 2014 in response to the Bank of Russia's policy aimed at lifting the key interest rate, mitigating panic investor sentiments about the likelihood of Russia's intervention into the political situation in Ukraine, as well as

the lack of severe economic sanctions against Russia over the Crimea's accession to the Russian Federation, as well as growth in prices of crude oil in response to unfavorable development of the geopolitical situation in the Middle East countries. The dollar slightly appre-

ciated against the euro after the ECB lowered the key interest rate by 0.1 p.p. from 0.25% to 0.15% p.a., as well as the overnight deposit rate from 0 to -0.1% p.a. and the lending rate from 0.75 to 0.4% p.a. aimed at stimulating investment activity in the Eurozone. ●