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## Inflation and Monetary Policy

*Significant slowdown in the growth rate in prices for non-food goods and maintained prices for commercial services at the level of the preceding month resulted in the fact, that the baseline inflation slowed down from 0.5 % per month in October to 0.3% in November (against 0.4% in November 2011). In December, due to the growth of consumer activity at the background of the New Year Eve, growth rate of consumer prices increased: consumer price index as of 17 days of the month made 0.3%, having matched the indicator of the same period of preceding year. As a result, the cumulative inflation since the beginning of the year amounted to 6.3% as of December 17 (compared to 6% in 2011). Herewith, from December 11, 2012 the Bank of Russia has again increased the interest rate on the RF CB ruble deposits on fixed terms by 0.25 p.p. up to 4.5% and decreased the rate of the RF Central Bank ruble transactions “currency swap” by the same amount to 6.25%.*

In November, there was a slowdown in prices growth: as of the month results, the consumer price index amounted to 0.3%, which is lower than in November last year (+0.4%). This resulted in a significant reduction in the rate of price growth for non-food products, as well as for commercial services.

The growth rate for industrial goods has decreased almost by half - from 0.7% in October to 0.4%, mainly due to a significant reduction in gasoline price growth (+0.5% versus +2.4% in the previous month). Moreover, the growth rate of prices has declined for a variety of non-food goods – by 1.5 times for tobacco (+0.8%), twice - for fabrics and medicines (+0.3%) and construction materials (+0.1%). Like in previous months, audio visual goods became cheaper (-0.2%).

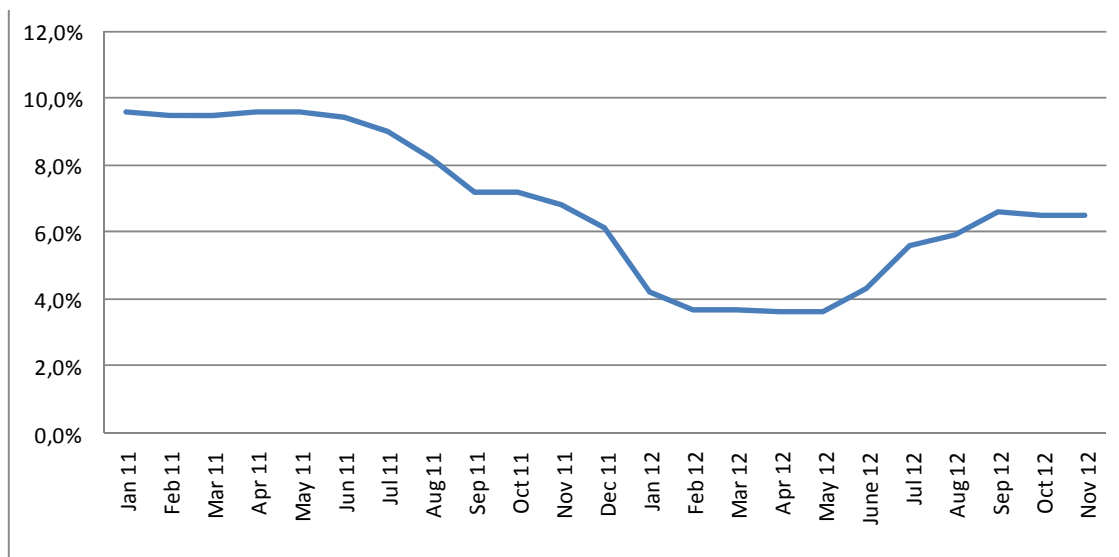
In November, prices and tariffs for commercial services did not grow (as compared with growth by 0.1% in October). It was due to the significant decline in prices for passenger transport (-1.7%), as well as to slowing growth rate for housing utilities by half (0.2%). As in the previous month, there was continued a decline in healthcare and recreational services (-0.7%) and foreign tourism (-0.5%). Growth rate of education services also decreased (+0.1% versus +0.6% in October). The most significant growth in prices was noted in November in the services of cultural organizations (+1.3%).

Like in October, prices for foodstuffs in November rose by 0.5%. Dynamics of prices for most of food products in November was similar to October indicators. There was continued a decrease in prices for sugar (-1.6%) and fruit and vegetable products (-1.3%). The utmost growth in prices, like in October, was observed for sunflower oil (+2.5%) and eggs (+3.7%).

In November, the inflation in annual terms (November 2012 against November 2011) remained unchanged as compared with October and amounted to 6.5% (see *Fig. 1*). For comparison, as of the same date of 2012 the inflation made 6.8%. In November, the core

consumer price index<sup>1</sup> continued to decline (+0.5% against +0.6% in October). Annual core inflation in November against November also remains at the same level within the second consecutive month and makes 5.8% against 6.9% in 2011.

In December, inflation was coherently accelerated: as of 17 days it amounted to 0.3%. As a result, cumulative inflation since the beginning of the year reached 6.3%, which is by 0.3 p.p. more than in the last year. Thus, it can be already noted, that the annual rate of price growth will exceed the 2011 inflation.



Source: RF Statistical Service.

**Fig. 1. The Growth Rate of the CPI in 2011-2012 (% year to year)**

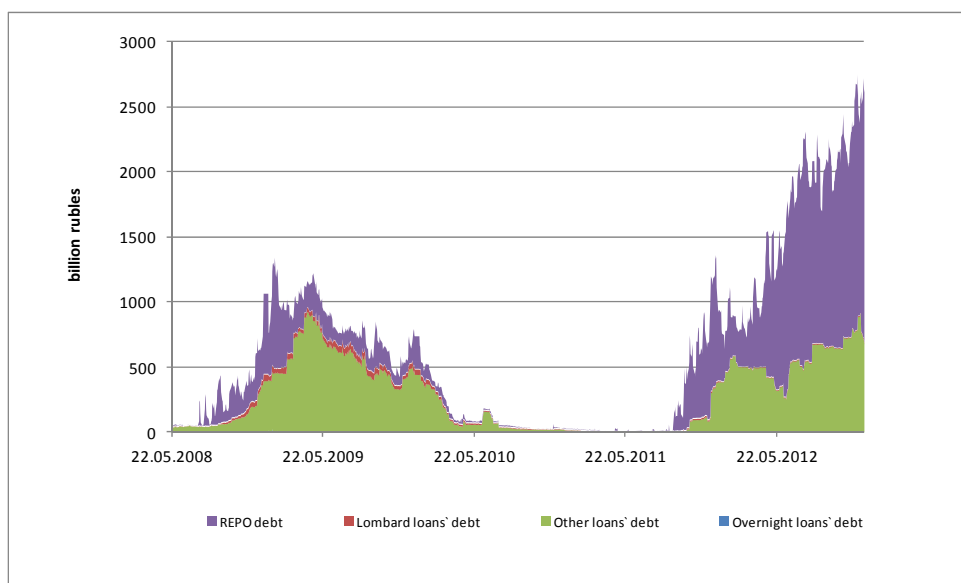
After three months of reducing, the monetary base in broad definition in November rose to Rb 8,257bn (+2.6%). All components of the monetary base were growing. The utmost growth was demonstrated by banks' correspondent accounts with the RF Central Bank and banks' deposits with the Central Bank, which rose, accordingly, by 14.8% to Rb 827.4bn and by 36.5% to Rb 138.3bn. In annual terms, the monetary base in broad definition rose by 10.6%.

In November liquidity situation in the banking sector has improved. The October decline of the excessive reserves of commercial banks<sup>2</sup> in November was replaced with their growth. As of the month results, they increased by 17.5% to Rb 965.7bn. The Bank of Russia in November continued to fund the banking sector. High demand for REPO auctions was sustained. The scope of provided liquidity increased significantly: the limit of the one day REPO has grown by December 20-s to Rb 600-760 bn. Amounts of overdue loans of credit institutions rose to almost Rb 2 trillion (see Fig. 2). Indicative rate on ruble loans for 1 day in the interbank market in December also continued to grow up to 6.5%. The situation with bank liquidity should improve

<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*).

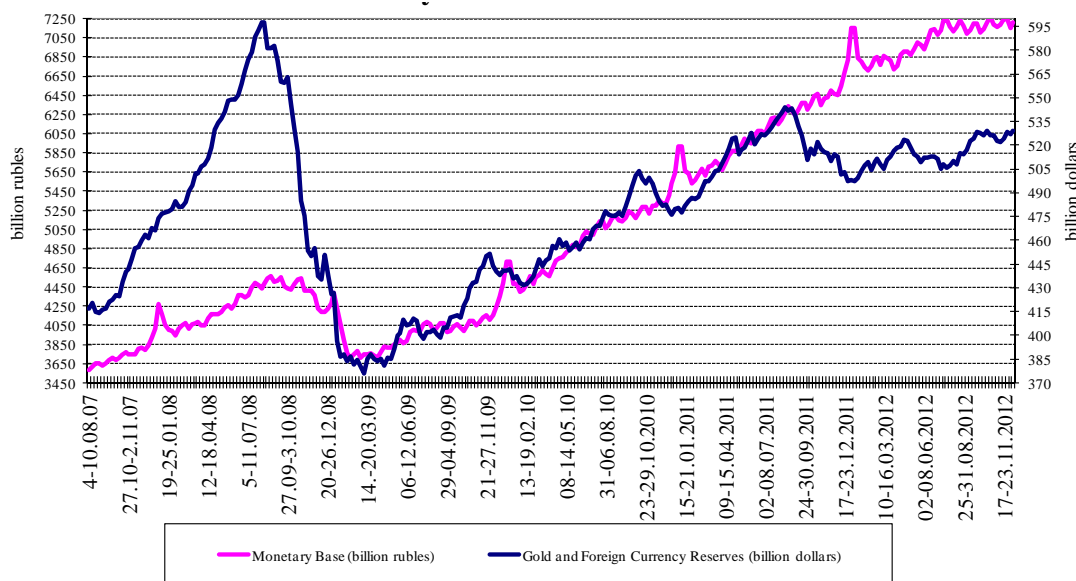
<sup>2</sup> Under the excessive reserves of commercial banks with the RF Central Bank is understood the sum of correspondent accounts of commercial banks, their deposits with the RF CB and the RF CB bonds of commercial banks.

by the end of December, when the traditional increase in budget spending is expected. However, most likely in early 2013 the increase in the refinancing of the banking system will continue.



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

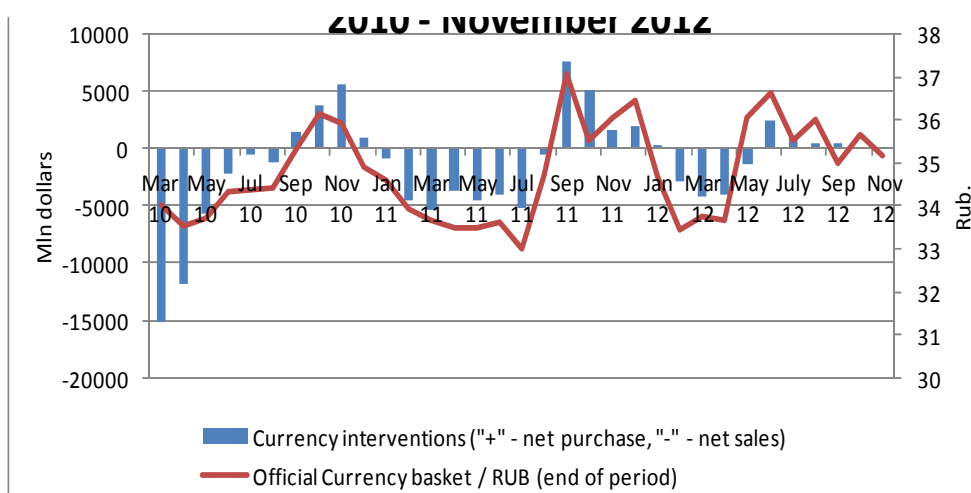
In November, monetary base in narrow definition (cash plus mandatory reserves) has increased: over the month it rose by 0.9% to Rb 7.2913 trillion (see Fig. 3).



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

In November the net sales of foreign currency of the RF CB was low and amounted to \$55m (see Fig. 4). Within the first three weeks of December the Bank of Russia was not involved in currency trading.

In November the volume of international reserves remained virtually unchanged, amounting to \$528.2bn by December 1 (+0.3% vs. November 1). Since the beginning of the year to mid-December the international reserves increased by 6%, or by \$30.2m.

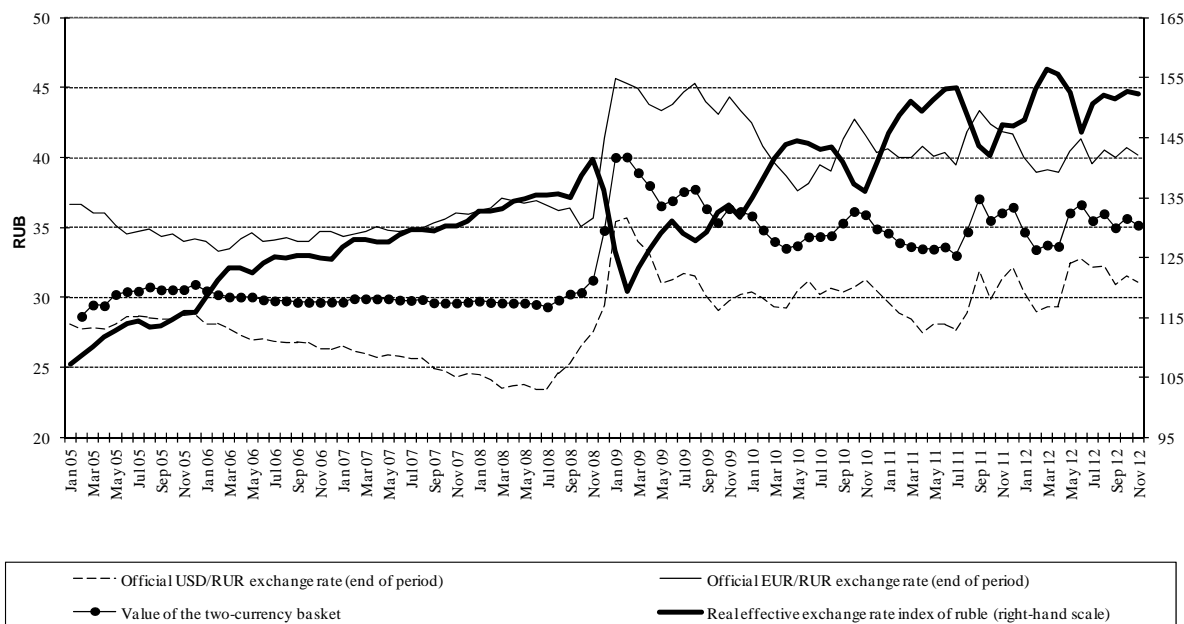


Source: RF Central Bank, author's estimates.

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

According to tentative estimates of the RF Central Bank, the net outflow of private capital from Russia in January-November of this year reached \$59bn. In December due to the upcoming payments on external debt by banks and companies, the outflow is likely to increase.

After October strengthening, the real effective exchange rate of ruble declined again in November (-0.3%) (See Fig. 5). Since the beginning of the year, the real effective ruble exchange rate rose by 3.8%. In nominal terms, the ruble exchange rate against major currencies in November remained virtually unchanged



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**

On December 10 the Bank of Russia announced, that it upheld the refinancing rate and interest rates on most of the basic operations of the Bank of Russia. At the same time, since December 11, the operating standards for "currency swap" have been changed: the interest rate

of the ruble amount was reduced from 6.75% per annum to 6.5%. In addition, from December 11 the RF Central Bank has increased interest rate on deposits of the Bank of Russia on fixed terms by 0.25 p.p., now it will make 4.5% per annum.

In our view, changes in the interest rates made by Central Bank are aimed primarily at improving the efficiency of its interest rate policy by narrowing the interest rate corridor, through which the Bank of Russia influences the financial markets. Recall that in the periods of excessive liquidity an important role in determining the interest rates in the interbank market were playing the rates on deposit operations of the RF Central Bank, and in the periods of liquidity shortage – the rates of the RF Central Bank on liquidity provided to the banks (including "currency swap" operations). Gradual reduction of the spread between interest rates on liquidity provision and absorption allows the Bank of Russia to manage market interest rates more effectively.