

RUSSIA'S INFLATION AND MONETARY POLICY IN MAY 2015

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Further stabilization of inflation and the ruble exchange rate allowed the Bank of Russia Board of Directors to further cut the key interest rate to 11.50% p.a. on 15 June 2015. The cut was triggered by the fact that Russia's economy was still facing serious risks of a downturn amid weakening inflation risks. The Bank of Russia announced on 14 May that it will resume its interventions to buy foreign exchange, \$100m to \$200m on a daily basis, in order to increase the international reserves. In May 2015, consumer prices increased 0.4% (0.9% in May 2014), i.e. down 0.1 p.p. from April 2015. As a result, inflation in May 2015 stood at 15.8% compared to May 2014. The Consumer Price Index increased 0.2% in the first 22 days of June 2015, showing a substantial slowdown.

Inflation continued to slow down in May in Russia: the month-end growth of the Consumer Price Index (CPI) decreased to 0.4% (0.5% in April 2015), a decrease of 0.5 p.p. compared to 2014. As a result, inflation in May of 2015 was 15.8% compared to May 2014 (Fig. 1). The core inflation¹ in May of 2015 stood at 0.6%, a decrease of 0.3 p.p. compared to the previous year.

The growth in prices of food products slowed down in May to 0.1% (0.3% in April) (Fig. 2). Fruit and vegetable products continued to see their price fall (-3.7% in April, -1% in May) due to both the appreciation of the ruble and the onset of seasonal decline of the price of fruits and vegetables. The following food products saw their price fall most: eggs (to -12.1% in May from -1.3% in April), grains and beans (to -1.4% in May from -0.3% in April), granulated sugar (to -2.1% in May from -2.9% in April). Note that the decline of prices of food products was determined not only by the exchange rate and seasonal dynamics, but also a record fall since June 2010 of world prices of food products, stabilized situation in the domestic grain market due to a duty imposed on exports of wheat for a term of 1 February till 14 May, and also because the demand didn't push the prices up.

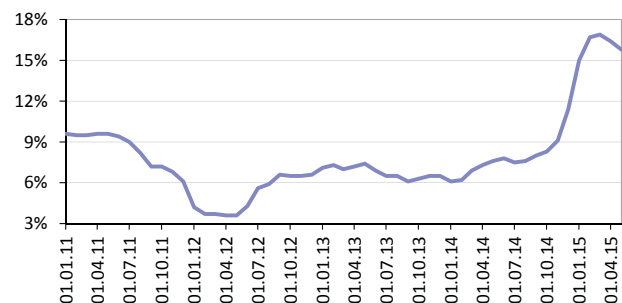
The prices and tariffs on paid services for individuals in May increased 0.5%, whereas in April 2015 they stood unchanged. Prices of outbound tourism services increased due to a holiday season (to 1% in May from -5.2% in April). Prices of insurance services kept increasing (to 1.5% in May from 3.5% in April). This group of services took the lead in the price raise: the prices increased 36.8% over the period of 12 months.

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).

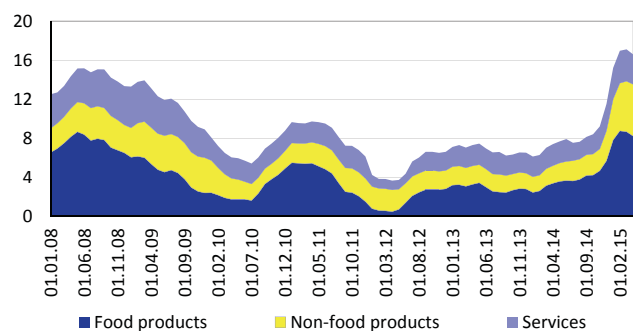
An increase of the prices of spare parts for motor vehicles and OSAGO (Compulsory Motor TPL Insurance) rates had a strong effect on insurance rates.

In May, prices of non-food products grew at a rate of 0.5%, down 0.4 p.p. compared to the values seen in April 2015. The appreciation of the ruble resulted in slower growth of the prices of medicaments (0.9% in April and 0.3% in May), washing and cleaning products (3.8% in April and 2.5% in May), textiles (1.9% in April and 1.2% in May).

Overall, as measured by a percentage change from corresponding month of previous year, food products,



Source: The Federal State Statistic Service of Russia (Rosstat).
Fig. 1. CPI growth rate in 2011 to 2015 (% YoY)



Source: Rosstat.
Fig. 2. The contribution of the key components to the CPI on a year-over-year basis in 2008 to 2015

non-food products, prices and tariffs of paid services for individuals in May contributed respectively 47.7%, 33.5%, and 18.8% to the inflation growth rate.

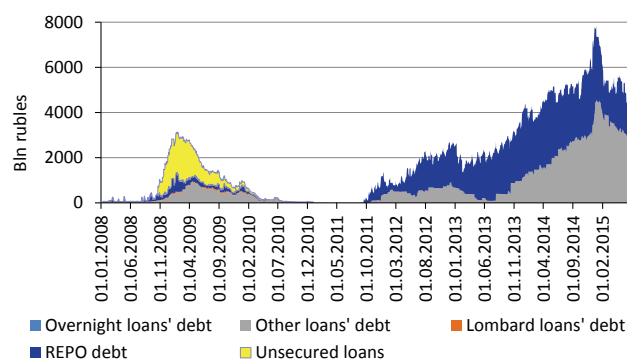
Inflation annual rates in June continued to decline. In the first 22 days of June, the CPI increased 0.2% compared to May (a total of 0.6% in June 2014). The appreciation of the ruble chiefly due to a growth in crude oil prices, and no demand push on prices remained the key factors constraining the inflation.

In May 2015, the monetary base (broad definition) shrank by 3.3% to Rb 9201.9bn as of the beginning of June (Fig. 3). The following shrank components of the broad monetary base are worth mentioning: banks' funds on correspondent accounts held with the Bank of Russia (a decrease by 6.5% to Rb 954.8bn), the required reserves (a decline by 5.4% to Rb 459.4bn), bank deposits shrank by 21.3% to Rb 247bn. The volume of cash in circulation including cash balances in credit institutions dropped by 2.1% to Rb 7540.7bn. The monetary base (narrow definition) (cash plus required reserves) declined in May by 2.3% to reach Rb 8000.1bn (Fig. 4).

In May 2015, the average daily volume of commercial banks' reserves was running at Rb 1465.6bn, a decrease of 5.4% from April, whereas the required reserves on special accounts held with the central bank amounted to Rb 459.4bn (a decrease of 5.4% from April), and in the period between 10 May 2015 and 10 June 2015 the averaged amount of reserves amounted to Rb 1006.2bn (a decline of 5.4% from April). In the period between 10 May 2015 and 10 June 2015, commercial banks' surplus reserves¹ averaged Rb 349bn (down 2.2% compared to the previous period), of which banks' deposits on the accounts held with the central bank averaged Rb 207.1bn (a growth of 4.5% compared to the previous period), and correspondent accounts, less the averaged amount of reserves, averaged Rb 141.9bn in the period under review (a decrease of 10.5% compared to the previous period).

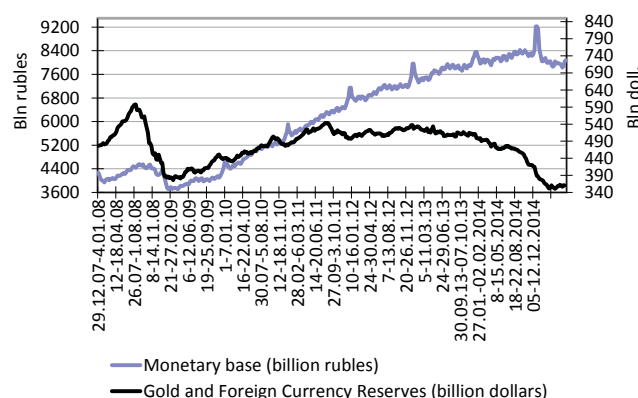
As of 1 June 2015, the amount of loans, deposits and other funds raised by credit institutions from the Bank of Russia reached Rb 6,84 trillion, a decrease of 9% since the beginning of May. Banks' debt on repo transactions diminished by 16.7% to Rb 1.8 trillion and the debts on loans secured by non-marketable assets reached Rb 3.0 trillion, down 7.9%. According to the data available as of 26 June, banks' debt on repo transactions dropped by 5% to Rb 1.7 trillion, whereas debts on other loans increased to Rb 3.1 trillion.

¹ Commercial banks' surplus reserves held with Russia's Central Bank is the amount of commercial banks' deposits held with the Bank of Russia and correspondent accounts less the averaged amount of required reserves.



Source: The Central Bank of Russia.

Fig. 3. The ruble-denominated debt of commercial banks (in key instruments) to the Bank of Russia in 2008 to 2015

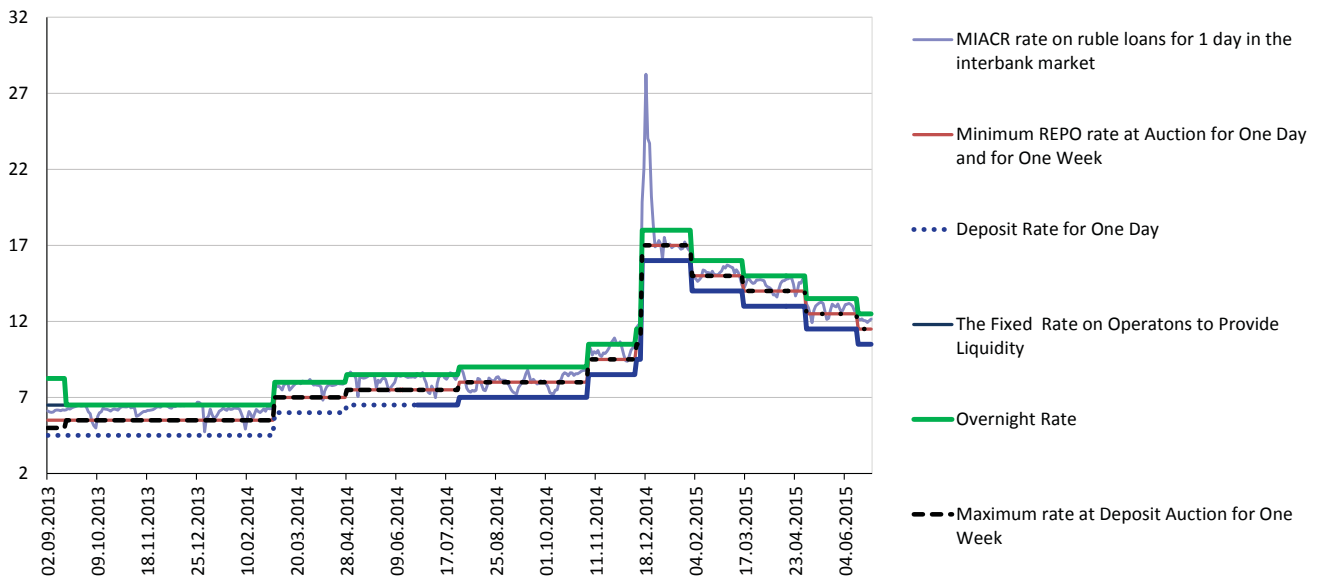


Source: The Central Bank of Russia.

Fig. 4. The dynamics of the monetary base (narrow definition) and the Russian Federation international reserves in 2007 to 2015

In May 2015, the interbank interest rate MIACR (Moscow InterBank Actual Credit Rate) on overnight interbank loans denominated in rubles didn't cross beyond the cap of the interest rate band and averaged at 12.8% (14.4% in April 2015). In the period between 1 June and 25 June, the average interbank interest rate was 12.5% (Fig. 5). As a reminder, the average MIACR decreased following the Bank of Russia decisions dated 30 April and 15 June to cut the interest rate respectively by 1.5 p.p. to 12.5% and 1 p.p. to 11.5% p.a.

No FX swap transactions for the provision of FX liquidity to the banking system were held in May. There was weak demand for this type of transactions among banks because of high interest rates (the interest rate on the ruble-denominated part of a transaction was set at 11.5% since 5 May, 10.5% since 16 June, 1.5% on the part denominated in foreign currencies). The volume of foreign currencies allotted during a repo auction held in May was \$0.1bn at a weighted average rate of 2.3% for a term of one week, \$5.0bn at a weighted average rate of 2.2% for a term of 28 days, \$0.8bn at a weighted average rate of 3.2% for a term



Source: The Central Bank of Russia.

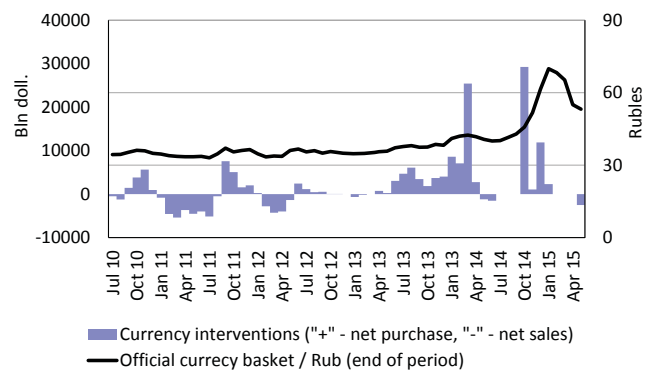
Fig. 5. The Bank of Russia interest rate band and the dynamics of the interbank lending market in 2012 to 2015 (in percent per annum)

of 12 months. According to the data as of 26 June, the volume of foreign currencies allotted during the repo auction equaled \$0.03bn at a weighted average rate of 2.2% for a term of one week, \$6.8bn at a weighted average rate of 2.2% for a term of 28 days. It is worthwhile noting that demand for loans denominated in foreign currencies was weakening due to the regulators' decisions dated 30 March, 10 April and 21 April to increase foreign currency funding.

The Bank of Russia held on 15 May a credit auction at which the Bank provided credit institutions with loans denominated in US dollars and secured by claims on the loans. The auction was cancelled because there was only one bidder. A similar auction was held on 11 June, at which the Bank allotted \$441.0m for a term of 28 days at a rate of 2.4390% p.a.

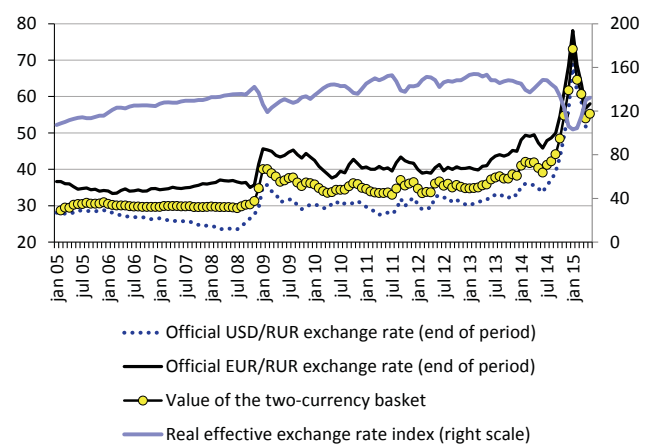
The Central Bank international reserves increased 0.2% to \$357bn as of 1 June 2015. The increase of banks' debts denominated in foreign exchange to the central bank was offset by a stronger Euro against the US dollar and the appreciation of gold. On 14 May 2015, the Bank of Russia began to buy foreign exchange through currency interventions in order to accumulate the international reserves. Currency interventions in May totaled \$2531m. Note that the regulator decision, although it was not intended to maintain a specific exchange rate, had a substantial effect as early as in May on the expectations of economic agents.

According to the Bank of Russia preliminary estimations, net capital outflows from the country in Q4 2014 reached \$32.6bn, down 31.7% compared to the similar period last year. In Q1 2015, net capital exports



Source: The Central Bank of Russia.

Fig. 6. Bank of Russia currency interventions and the ruble exchange rate against the currency basket in March 2010 to April 2015



Source: The Central Bank of Russia.

Fig. 7. Ruble exchange rate indicators in January 2005 to May 2015

from banks and other sectors amounted to \$14.6bn and \$18.0bn, respectively. As a reminder, capital outflows totaled Rb 151.5bn in 2014, 2.5 times the value seen in 2013.

The Russian ruble continued to strengthen in real terms in May. The ruble's real effective exchange rate strengthened by 1.5% against foreign currencies (13.1% in April 2015). Overall, the real effective exchange rate weakened by 17.7% in the period of January–May 2015 as compared to January–May 2014. As a reminder, the ruble's real effective exchange rate lost 28.5% in H2 2014 (*Fig. 7*).

The USD/RUB exchange rate in May increased 3.3% to 52.8 rubles per dollar and , the EUR/RUB exchange rate was down by 1% (57.7 rubles per euro). In May, the EUR/USD exchange rate averaged 1.1. The value of the dual-currency basket in May increased 2.2% to 55.0 rubles. In the first 26 days of June, the USD/RUB exchange rate increased 3.8% to 54.8 rubles per dollar, and the EUR/RUB exchange rate was up 6.4% to 61.4 rubles per euro, thus raising the value of the dual-currency basket by 5% to 57.8 rubles. The EUR/USD exchange rate in May was 1.12. As a reminder, the appreciation of the ruble in February–April was

determined by a current account surplus, optimistic dynamics of oil prices, high interest rates on Bank of Russia refinancing instruments, gradually declining capital outflows, a lower demand for foreign exchange by banks and the corporate sector amid external debt reduction, and a weaker demand for foreign exchange by individuals as a result of lower adverse expectations and panic sentiments. The depreciation of the ruble in May–June was determined by rising geopolitical tensions, the Bank of Russia currency interventions which were aimed at accumulating the international reserves and had a bearing on the expectations of economic agents, and a fall of oil prices.

Further stabilization of inflation and the ruble exchange rate allowed the Bank of Russia Board of Directors to further cut on 15 June 2015 the key interest rate to 11.50% p.a. The cut was caused by the fact that the economy was still facing serious risks of a downturn. Note that the regulator decision to ease the monetary policy seems to be reasonable because the ruble's real exchange rate is nearing its fundamentally substantiated values and inflation has hit its year highest of 16.9% in March 2015. ●