

INFLATION AND MONETARY POLICY IN JULY 2015

A.Bozhechkova

The Bank of Russia Board of Directors decided on 31 July 2015 to further cut the base rate to 11.0% p.a., or by 0.5 p.p., because risk balances had shifted towards economic downturn. Consumer prices in July 2015 increased 0.8% (0.5% in July 2014), showing a growth of 0.6 p.p. compared to the value seen in June 2015. As a result, inflation in July 2015 reached 15.6% compared to that in July 2014. The Consumer Price Index gained 0.1% in the first 24 days of August 2015.

Inflation rate in July 2015 saw an increase: the month-end Consumer Price Index (CPI) gained 0.8% (0.5% in July 2014), a growth of 0.6 p.p. compared to the value seen in June 2015. As a result, inflation in July 2015 stood at 15.6% compared to July 2014 (Fig. 1). Core inflation¹ in July 2015 was 0.4%, a decrease of 0.2 p.p. compared to the value seen in the previous year.

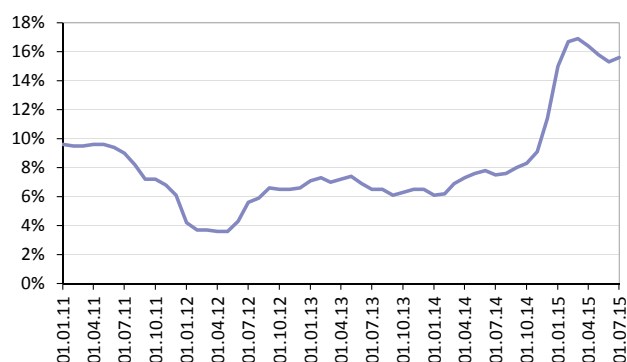
The food product sector in July experienced a deflation: prices of food products declined by an average of 0.3% (prices of food products in June decreased by 0.4%). Prices of vegetables and fruits (-5% in June, -4.2% in July) and eggs (-5.4% in June, -3.7% in July) saw a deeper decline than those of other food products.

Prices of non-food products in July increased 0.5% (0.3% in June). Prices of motor gasoline increased 2.5% in July (0.9% in June) due to a higher demand in summer time and the increase in May of crude oil exports to other countries. Prices of tobacco products increased 2.9% in July (2.1% in June).

Prices and tariffs of paid services for individuals in July increased 3% (1% in June). The increase in prices of natural monopoly services resulted in a 7.1% growth of prices of utility services. Prices of outbound tourism and sanatorium & health services were pushed up by a seasonal factor by respectively +4.6% and +2.7%.

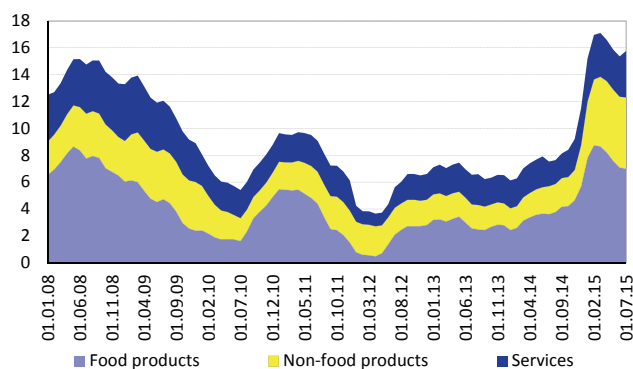
All in all, food products, non-food products, prices and tariffs of paid services for individuals, being measured by a percentage change from corresponding month of previous year, contributed in July respectively 44.4%, 33.7%, and 21.9% to the inflation growth rate.

It should be noted that inflation expectations reflecting the next 12 months have become slightly higher, according to the surveys conducted in July 2015 by



Source: The Federal State Statistic Service of Russia (Rosstat).

Fig. 1. CPI growth rate in 2011 to 2015
(YOY percentage change)



Source: Rosstat.

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

OOO INFORM (a limited liability company). The data of the survey in July show that inflation is expected to estimate 12.2–12.8% compared to 12–12.5% in June.

The Consumer Price Index (CPI) in the first 24 days of August stood at 0.1% (overall 0.2% in August 2014). It should be noted that inflation will further be pushed down by a weak domestic demand. A key factor which can lead to a new upsurge in inflation is the last summer ruble denomination pass-through to prices.

The monetary base (broad definition) in July 2015 increased 1.02% to Rb 9805.7bn as of the beginning

¹ The baseline consumer price index is an indicator which reflects the level of inflation in the consumer market, excluding 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).

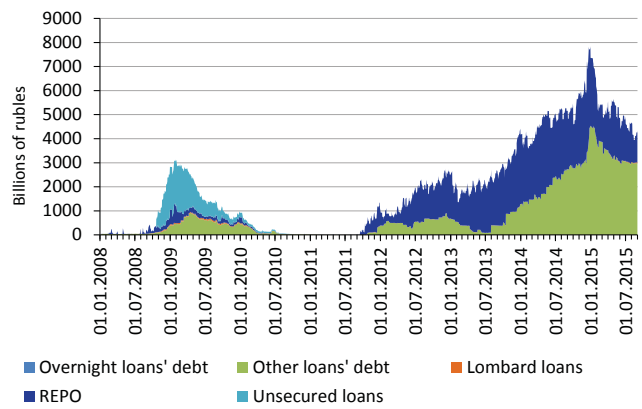
of August. The following components of the broad monetary base increased in July: the required reserves (a growth of 2.4% to Rb 477.3bn), bank deposits increased 9.7% to Rb321.7bn, the volume of cash in circulation including cash balances in credit institutions increased 1.03% to Rb 7718.1bn. banks' balances on correspondent accounts held with the Bank of Russia decreased by 1.5% to Rb 1288.6bn). The analysis of the dynamics of liquidity accumulation factors in July 2015 shows that the broad monetary base increased largely due to Bank of Russia's interventions in the foreign exchange market (Rb 224.9bn) and changes in the general government's balances on the accounts held with the Bank of Russia (Rb 223.8bn). The narrow monetary base (cash plus required reserves) in July increased 1.02% to Rb 8013.7bn (Fig. 4).

The average daily volume of commercial banks' reserves in July increased 2.6% compared to that in June to Rb 1525.7bn, and the averaged amount of reserves in the period between 10 July 2015 and 10 August 2015 amounted to Rb 1048.4bn (an increase of 2.7% compared to the period). In the period between 10 July 2015 and 10 August 2015, commercial banks' surplus reserves¹ averaged Rb 450.6bn (a decline of 0.4% compared to the period), of which banks' deposits on the accounts held with the Russian central bank averaged Rb 296.3bn, remaining unchanged compared to the previous period, and correspondent accounts, less the averaged amount of reserves, averaged Rb 154bn in the period under review (a decline of 1.1% compared to the previous period).

As of 1 August 2015, the amount of loans, deposits and other funds raised by credit institutions from the Bank of Russia reached Rb 6.69 trillion, down by 3.4% since the beginning of July. Banks' debt on repo transactions decreased by 10.6% to Rb 1.7 trillion, and debts on loans secured by non-marketable assets reached Rb 3.0 trillion, a decline of 2% (Fig. 3). This trend continued in August, banks' debt on repo transactions dropped by 23.3% to Rb 1.3 trillion and debts on other loans decreased to Rb 2.98 trillion.

In July 2015, the MIACR (Moscow Interbank Actual Credit Rate) on overnight interbank loans denominated in rubles didn't hit the interest rate band cap and stood within an average range of 11.5% (12.5% in June 2015). The interbank average lending rate was 10.9% in August (Fig. 5). As a reminder, the average MIACR decreased following the Bank of Russia decision of 31 July to cut the base rate by 0.5 p.p. to 11% p.a.

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.



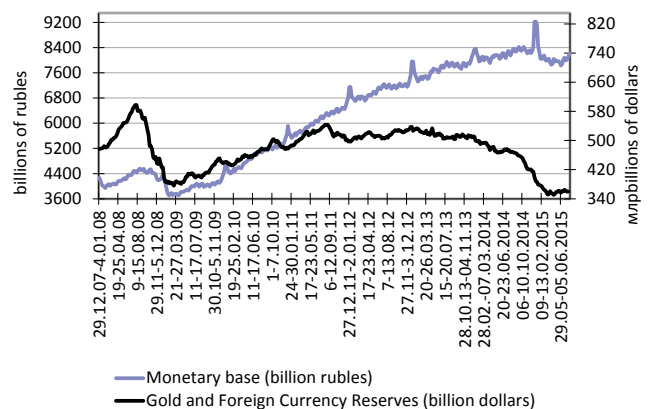
Source: The Central Bank of Russia.

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

In July, the foreign-currency swap transaction for the provision of FX liquidity to the banking system amounted to \$309.1m. Sluggish demand for this type of transactions by banks is determined by high interest rates (the interest rate on the ruble-denominated portion of transaction was set at 10.5% since 16 June, 1.5% on the portion denominated in foreign currencies). The value in August reached \$501.8m.

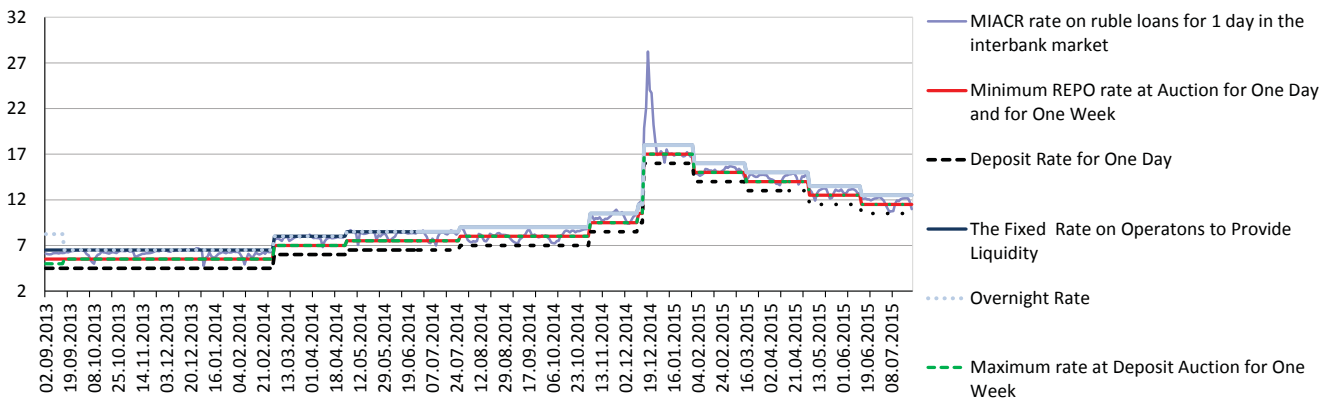
The volume of foreign currencies allotted during a repo auction held in July amounted to \$179.9mn at a weighted average rate of 2.2% for a term of one week, \$6.7bn at a weighted average rate of 2.2% for a term of 28 days. The volume of foreign currencies allotted during a repo auction held in August was equal to \$0.3bn at a weighted average rate of 2.2% for a term of one week, \$9.6bn at a weighted average rate of 2.2% for a term of 28 days.

The Bank of Russia held on 10 July a credit auction to provide its US dollar-denominated loans secured by pledge of receivables. The amount of funds lent for a term of 28 days at an interest rate of 2.4367% p.a.



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



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)

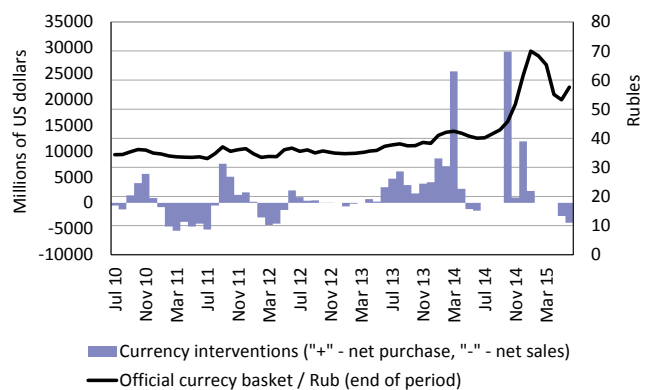
was equal to \$442.0m. A similar auction was held on 7 August 2015, \$443.0m were lent for a term of 28 days at an interest rate of 2.4415% p.a..

Bank of Russia’s foreign currency interventions in July 2015 amounted to \$3.76bn, an insignificant decline from June 2015. The Russian central bank’s international reserves shrank from \$361.6bn to \$357.6bn (as of 1 August 2015) as a result of exchange rate revaluation. It seems reasonable that the Bank of Russia aims to increase the international reserves amid low predictability for oil prices and restricted access for Russian companies to international capital markets. At the same time, consideration must be given to inflation risks which may result from such policy. It should be noted that foreign currency interventions do not contradict the inflation targeting regime as long as inflation remains the principal target for the central bank. International practices show that central banks in most countries, which follow the inflation targeting regime, in one way or another participate in the foreign exchange market.

According to the central bank’s preliminary estimate, net capital outflow from the country in Q2 2015 reached \$20bn, 8.3% less than in the same period of 2014. Net capital export in Q2 2015 through banks and other sectors was running at \$14.1bn and \$18.4bn, respectively. As a reminder, capital outflow in H2 2015 totaled Rb 52.5bn, 24.4% less than in the same period of 2014.

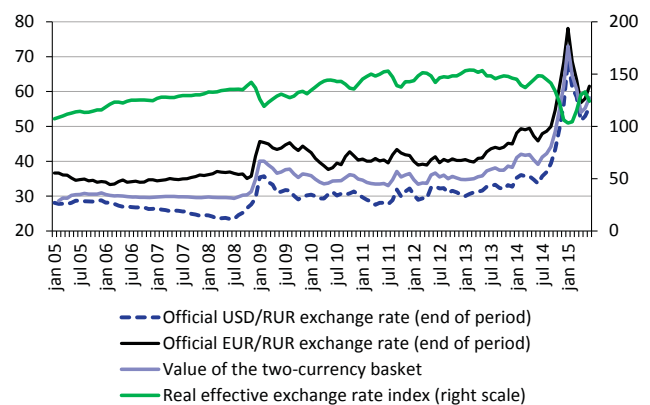
The ruble depreciated in real terms in July. The ruble’s real effective exchange rate decreased by 2.6% (-6.5% in June 2015). Overall, the ruble’s real effective exchange rate in H1 2015 decreased by 17.4% compared to H1 2014. As a reminder, the ruble’s real effective exchange rate decreased by 28.5% in H2 2014 (Fig. 7).

The dollar-ruble exchange rate in July increased 8.1% to 60.3 rubles per one dollar, the euro-ruble exchange



Source: The Central Bank of Russia.

Fig. 6. Bank of Russia foreign currency interventions and the ruble exchange rate against the currency basket in March 2010 – August 2015



Source: The Central Bank of Russia.

Fig. 7. Ruble exchange rate indicators in January 2005 – June 2015

rate was up 5.8% (66.0 rubles per one euro). The euro-dollar exchange rate in the same month averaged 1.1. The value of the dual-currency basket in July increased 7% to 62.9 rubles. As of the end of August, the dollar-ruble exchange rate gained 10.6% to 66.7 rubles per one dollar and the euro-ruble exchange rate increased

13.4% to 74.8 rubles per one euro. As a result, the value of the dual-currency basket increased 11.9% to 70.4 rubles. Additionally, it should be noted that after a substantial appreciation in the last spring the ruble began to depreciate mostly due to adjustment of oil prices and central bank measures aimed at appreciation of foreign currency liquidity and step-wise cut of the base rate.

The Bank of Russia Board of Directors decided on 31 July 2015 to further cut the base rate to 11.0% p.a., or

by 0.5 p.p., because risk balances had shifted towards economic slowdown. As a reminder, This is the fifth stage of monetary easing following a drastic increase in the CBR base rate to 17% in December 2014. For instance, in the first quarter the Goods and Services Output Index by Key Types of Economic Activity decreased by 2.3% compared to Q1 2014, whereas in Q2 it fell 6.2% compared to the same period last year. In this respect, the monetary easing appears to be reasonable. ●