

## INFLATION AND MONETARY POLICY IN OCTOBER 2015

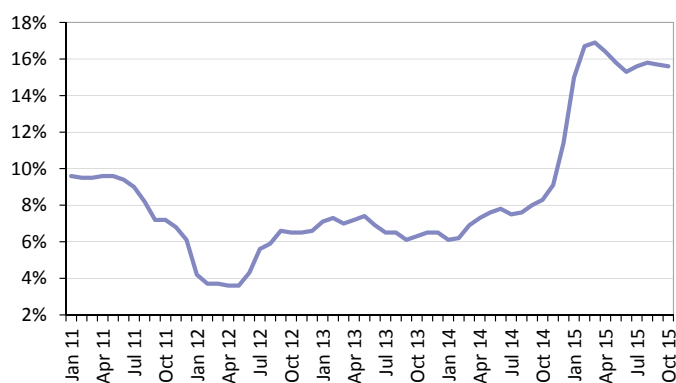
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The Consumer Prices Index (CPI) in October 2015 continued to grow, up 0.6% (0.7% in October 2014), reaching 0.7% (0.8% in Oct. 2014). The Russian rouble's exchange rate in October strengthened a bit in response to both uptrend in the crude oil market as well as some geopolitical improvements. Russia's Central Bank decided at a meeting on 30 October that the base rate of interest as well as the rates on Russian Central Bank operations on providing and absorbing liquidity will remain unchanged. It would be unreasonable to lower the base rate amid high risks of inflation and further depreciation of the rouble.

The Core Consumer Prices Index in October 2015 grew up 0.7% (0.6% in September 2015), staying at 15.6% year-over-year, down 0.1 p.p. from September 2015 (Fig. 1). Core inflation<sup>1</sup> in October stood at 100.7%, being equal to the CPI.

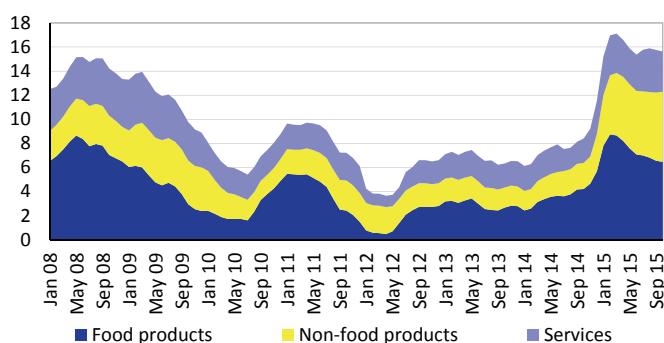
Prices of foods in October were growing at a faster pace to reach 100.8% (100.4% in September). Prices of the following foods saw the highest growth among other foods: eggs (up 10.9% in October, +4.9% in September) and sunflower oil (up 5.2% in September and October). Sunflower oil appreciated due to favourable conditions in the global oleaginous foods market as well as lower sunflower yields caused by drought conditions in some of the Russian regions. The decline in prices of fruit and vegetable foods in summer continued in September and then gave way to a price raise of 2.9% in October. Prices of granulated sugar fell 2.4% in October (up 0.8% in September).

Prices of non-foods in October increased 1% (1.1% in September), whereas prices of electrical products and other types of home appli-



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 year-over-year contribution of the key components to the CPI in 2008 to 2015

<sup>1</sup> The baseline consumer price index is an indicator reflecting the level of inflation in the consumer market, excluding seasonal factors (prices of fruit and vegetable foods) and administrative factors (tariffs of regulated types of service, etc.). The index is also calculated by the Federal State Statistic Service of Russia (Rosstat).

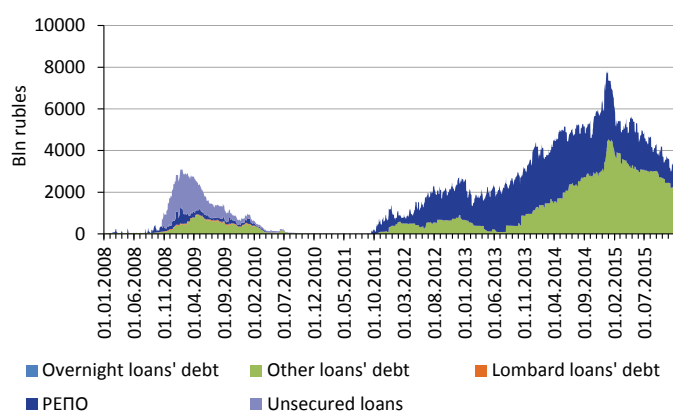
ances were growing slower than in the previous month (from 1.9% in September to 1.4% in October), audio visual goods (from 2.5% in September to 1.6% in October), thereby evidencing that the peak of the pass-through effect of exchange rate to prices of this family of goods had been reached. Prices of the following products increased in the same month: medicaments (from 0.7% in September to 0.9% in October), footwear (from 1.9% in September to 2.1% in October) and tobacco products (from 1.9% in September to 2.4% in October).

Prices and tariffs of paid services to individuals in October decreased by 0.01%, whereas in September they remained unchanged. There was a seasonal decline of prices of sanatorium and health-improving services (down 1.4%), outbound travel (tourism) services (down 2.1%). Additionally, prices of passenger transport services saw a decline of 1.3% (Fig. 2).

The median value of the anticipated twelve-month inflation increased from 16% in September to 15.3% in October, according to a survey, which is conducted by OOO INFORM (a limited liability company) and published monthly by the Bank of Russia. In our view, at the backdrop of the recent sweeping depreciation of the national currency, the 2015 yearend inflation is most probably anticipated to reach a value higher than 13%.

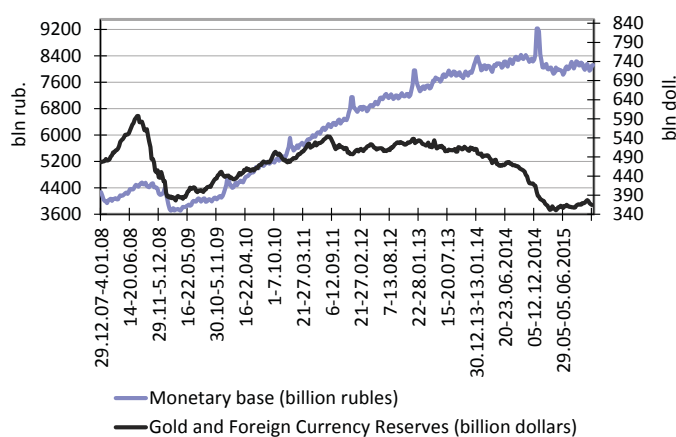
The Consumer Price Index (CPI) in the first 23 days of November gained 0.5% (a total of 1.3% in November 2014). Monetary factors exercised a restraining influence on inflation. Slow growth in bank lending volumes remained the key contribution to relatively slow growth rates in the monetary base.

The monetary base (broad definition) in October 2015 remained the same, running at Rb 9774.9bn as of the beginning of November. The following components of the broad monetary base saw a decline in October: banks' balances on correspondent accounts held with the Bank of Russia (a decrease by 2.26% to Rb 1420.9bn), banks' deposits (down by 9.9% to Rb 252.8bn). The required reserves deposited on special accounts increased 1.43% to Rb 369.3bn. The volume of cash in circulation, including cash balances in credit institutions, remained almost the same and amounted to Rb 7732bn. The key factor responsible for restraining the broad monetary base's growth was a decline in volumes of the Bank of Russia's liquidity provided to commercial banks, which was determined by stabilized conditions in the money



Source: The Central Bank of Russia.

Fig. 3. Commercial banks' rouble-denominated debt (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

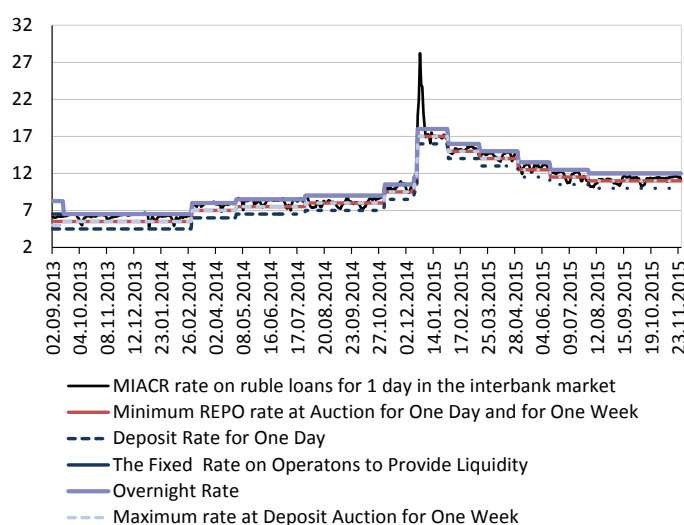
market and weaker demand by commercial banks for the central bank's resources denominated in roubles. The narrow monetary base (cash plus required reserves) in October increased 0.2% to Rb 7947.9bn (Fig. 4).

The average daily volume of reserves in commercial banks in October increased 4.2% from August to Rb 1689.9bn, and the averaged amount of reserves in the period between 10 October and 10 November 2015 was Rb 1320.6bn (an increase of 5% from the previous period). In the period between 10 September 2015 and 10 November 2015, commercial banks' surplus reserves<sup>1</sup> averaged Rb 323.4bn (a decrease by 16% from the previous period), of which banks' deposits on the accounts held with the Russian central bank averaged Rb 205.8bn, a decline of 20% from the previous period, and correspondent accounts, less the averaged amount of reserves, in the period under review were running at an average of Rb 117.6bn (down 7.9% from the previous period).

As of 1 November 2015, the amount of loans, deposits and other funds raised by credit institutions from the Bank of Russia reached Rb 5.5 trillion, a decrease by 5.2% from earlier in September. Banks' debt on repos increased decreased by 6% to Rb 1.1 trillion as debts on loans secured by non-marketable assets dropped 8.3% to Rb 2.4 trillion (Fig. 3). Banks' debt on repos in November fell 12.6% to Rb 1 trillion and debts on other loans decreased by 8.8% to Rb 2.2 trillion.

In October 2015, the MIACR (Moscow InterBank Actual Credit Rate) on overnight interbank loans denominated in roubles didn't hit the interest rate band cap and stood within an average range of 11.3% (11.2% in September 2015). In November, the interbank average lending rate was 11.4% (Fig. 5).

Banks' foreign currency repo debts to the Russian Central Bank in October dropped 6% to \$30.4bn including \$26.0bn on repos for a term of one year and \$4.4bn for a term of 28 days. Note that Russia's central bank announced on 27 November that it would resume from 14 December foreign currency repo auctions for a term of 12 months. Furthermore, the Libor spread was up 0.5 p.p. to 3%. This measure was most probably caused by the fact that commercial banks will have to honour their commitment to pay on foreign currency repo auctions for a term of one year, and Russian companies will have to honour their commitment to repay their foreign loans, and demand for foreign currency is likely to increase if the U.S. Federal Reserve raises rates in December 2015. In our view, however, this instrument is not supposed to



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)

<sup>1</sup> Commercial banks' surplus reserves held with Russia's Central Bank refer to the amount of commercial banks' deposits held with the Bank of Russia and correspondent accounts less the averaged amount of required reserves.

be used as long as financial sustainability is at risk, and in general the rouble exchange rate should remain floating thereby enabling the economy to adapt more efficiently to changing terms of trade.

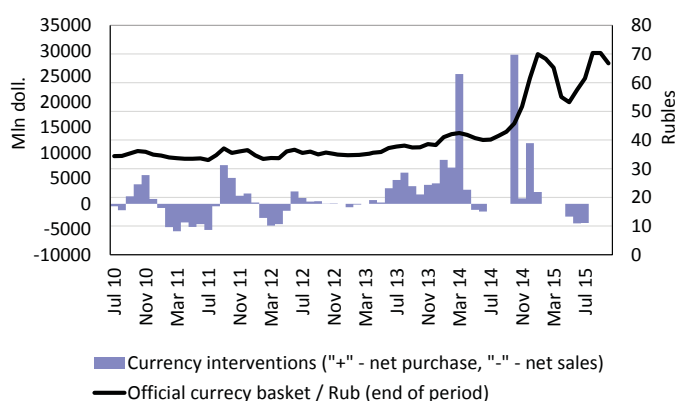
The Bank of Russia held on 2 October a credit auction to provide commercial banks with dollar-denominated loans secured by pledge of receivables. The Bank lent a total of \$445.0m for a term of 28 days at an interest rate of 2.444% p.a. The Bank of Russia announced a similar auction on 30 October, which was cancelled due to the lack of bids.

As a reminder, the Russian central bank announced on 29 July 2015 that it would not buy foreign currency to increase its international reserves. The decision was made with a view to reducing the demand for foreign currency in the market, which increased due to another fall in oil prices. As a result, the Bank of Russia performed no currency interventions in August–September 2015. In addition, the Russian central bank increased in October its international reserves from \$366.3bn to \$369.6bn as of 1 November 2015.

The Russian rouble appreciated in real terms in October. The rouble's real effective exchange rate gained 6.1% against foreign currencies (down 1% in September 2015). Overall, the rouble's real effective exchange rate in Q3 215 decreased by 13.7%. (Fig. 7).

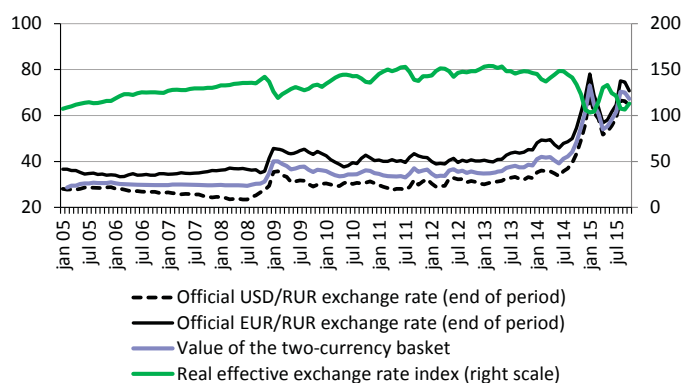
In October, the rouble gained 2.9% against the US dollar, from 63.8 roubles per US dollar, and 4.6% against euro, to 70.4 roubles per euro, and the value of the dual-currency basket decreased by 3.7% to 66.8 roubles. The rouble in October strengthened a bit in response to both an uptrend in the crude oil market and some geopolitical improvements. According to the data on 27 November, the rouble in November lost 3% against the US dollar, to 65.7 roubles per US dollar, due to a fall in crude oil prices and on economic agents' expectations the U.S. Federal Reserve will raise rates.

The Central Bank of Russia decided at a meeting on 30 October to leave the base rate of interest as well as the rates on Russian Central Bank operations on providing and absorbing liquidity unchanged. In our view, the decision was quite reasonable. Inflation rates decreased very slowly (15.7% in September, 15.6% in October) after the CPI increased to 115.8% in August due to the rouble's drastic depreciation. It would be unreasonable to lower the base rate amid high risks of inflation and further depreciation of the rouble.



Source: The Central Bank of Russia.

Fig. 6. Bank of Russia's foreign currency interventions and the rouble exchange rate against the currency basket in March 2010 – October 2015



Source: The Central Bank of Russia. T

Fig. 7. Rouble exchange rate indicators in January 2005 – October 2015