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Inflation and Monetary Policy

In December the pre-Christmas growth in foodstuffs prices and in transport tariffs provoked acceleration of inflation, which made 0.5% within the month (against 0.4% in December 2011). As a result, by the end of 2012 the inflation rate made 6.6%, having matched the recent official forecast of the RF Central Bank. In January 2013 the increased excise duties and continued seasonal growth in prices for fruit and vegetables resulted in significantly accelerated growth rate of consumer prices: over the first three weeks of the month it amounted to 0.6%. In 2012 the monetary base in broad definition remained virtually unchanged, but by the end of the year it has significantly increased: only in the last month of the year it increased by 19%. Therefore, within the year its growth rate made 14% (against 5.5% in 2011). In the Q4 2012 capital outflow from the country has accelerated, having reached \$9.4bn. After the Bank of Russia has reviewed the balance of payments for the first three quarters of 2012, the tentative estimate of the net outflow of capital as of 2012 results amounted to \$56.8bn, as compared with \$80.5bn in 2011.

As per 2012 results, consumer price index made 6.6% (it should be noted, that within the entire contemporary history of Russia the minimum indicator of inflation was 6.1% in 2011).

In the last month of 2012 inflation has traditionally accelerated: as of the month results, the CPI has grown by 0.2 p.p. as compared with November and made 0.5% (+0.4% in December 2011). The main contribution to accelerated inflation in December 2012 was made by the pre-Christmas growth of prices for foodstuffs, as well as for commercial services.

Growth rate of food prices in December has nearly doubled as compared with November and made 0.9%. In December the utmost growth was noted in prices for eggs (+7.4%). They were followed by the highest growth rates in prices for fruit and vegetable products (+2.4%). Sugar price, which was declining within the preceding months, in December has also increased (+1%). There was no reduction in prices for any foodstuffs in December.

As of 2012 results, the only depreciating items in the group of foodstuffs under review were cereals and beans, which prices have decreased by 7%. At the same time, the highest growth over the year was observed in prices for alcoholic beverages (+12.1%), bread and bakery products (+12%), as well as fruit and vegetable products (+11%). The main reason for the increase in alcohol prices was the increase of excise taxes, while higher prices for bakery products, fruit and vegetables were due to the poor harvest of 2012.

In December, after the November pause, prices and tariffs for commercial services started to grow again, having increased within the month by 0.4% (against +0.3% in December 2011). The utmost growth was noted in prices for passenger transport (+3.3%). This was due to a substantial increase in the cost of long-distance trains. Herewith, prices were declining for healthcare and recreational services (-0.3%) and foreign tourism (-0.5%).

As of the year results, the leading position in the list of commercial services, which demonstrated the most significant price growth, were educational services (+10.6%), which have surpassed the traditional leader in price growth, i.e., housing and public utilities (+9.4%). They were followed by services of cultural organizations and healthcare services, the prices of which

rose accordingly by 8.8% and 8.6%. There was no reduction in prices for any type of commercial services throughout 2012.

In December growth of prices for non-food goods continued to slow down (- 0.4% in November 2012), amounting by the end of the month to 0.3%, similar to 2011. In the last month of the year the rate of growth continued to slow down in gasoline prices, which decreased by 0.1% (as compared with growth by 0.5% in November). Like a month earlier, audio-video goods became cheaper (- 0.2%). Herewith, prices for tobacco products continued to grow (+0.7%).

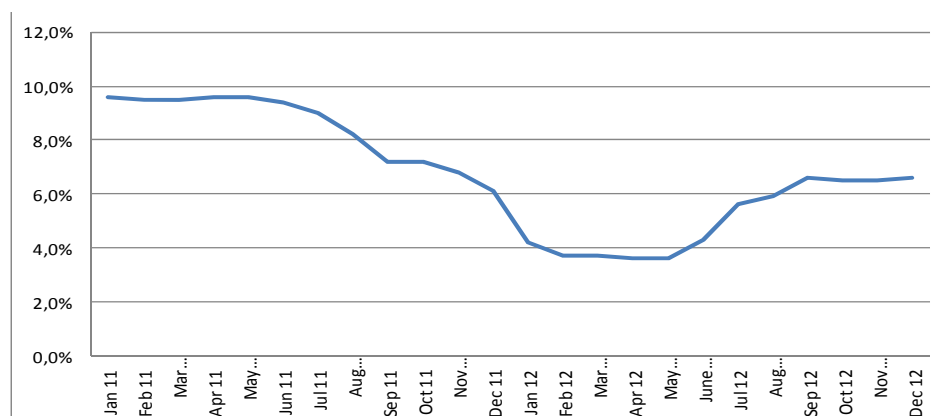
According to the results of 2012, similar to 2011, the leader in price growth among all groups of consumer goods was tobacco, which has grown by 22.6% due to increased excise taxes. Herewith, the growth rate of gasoline prices slowed down more than twice, from 14.9% to 6.8% due to the freezing of retail prices in Q1 of the current year, as well as due to the stabilized global oil prices. In 2012 there was a decline in prices for one group of non-food goods, namely for audio-video goods, which became cheaper by 1.1% within the year.

The core consumer price index¹ in December continued to decline and amounted to 0.4%, like in 2011. As of the year results, core inflation made 5.7%, which is lower in comparison with 2011 (+ 6.6%) (See *Fig. 1*). The slowdown in core inflation against the background of accelerating cumulative inflation demonstrates that prices growth in 2012 was largely of nonmonetary nature.

In January 2013 inflation has accelerated: as of the first three weeks of the month the CPI made 0.6% and exceeded the relevant indicator of January 2012 (+0.5%). The main impact on prices growth was provided by the increased excise taxes on alcohol products, the rising cost of transport services, as well as fruit and vegetable products: within the period under review, vodka has grown in price by 14.4%, tram and trolleybus tickets – by 6% and 5.6%, accordingly, fruit and vegetables – by 6-10%.

According to the official forecast of the Ministry of Economic Development of Russia, annual inflation in 2013, like in the last year, amounts to 5-6%. At the beginning of the year inflation will start to accelerate again due to increased rates of excisable goods and to seasonal growth in foodstuff prices. In Q2 one can expect some slowdown in consumer inflation as a result of decline in economic growth, slowdown in core inflation and moderate extension of monetary supply (the growth rate of monetary supply M_2 on December 1 made 14.4% vs. 20% in 2011). However, the decline of inflation rate term will be short, and in summer it will start to grow again along with the increased regulated tariffs of state monopolies. The factor of agricultural products harvest, hardly predictable, but having a significant impact on consumer prices, should be taken into regard as well. In the absence of external shocks, inflation in annual terms will largely depend on this factor.

¹ 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*).



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2009-2012 (% year to year)

As of 2012 results, the monetary base in broad definition increased by 14% to Rb 9,852.8bn. Herewith, the utmost extension of monetary base was noted in the last month of the year, when it increased at once by 19%, or by Rb 1,595.8bn. The main reason for the sharp increase in the monetary base in December was the traditional growth in budget expenditures at the end of the year. Within this month all components of the monetary base (except for the Bank of Russia bonds) were growing. Herewith, the utmost growth was demonstrated by deposits of banks, as well as correspondent accounts of credit institutions with the RF Central Bank, which have increased over the preceding month three-fold and 1.6-fold, accordingly. Due to a significant extension in December, the growth rate of monetary base in broad definition as per 2012 results increased by 2.5 times as compared with 2011 (+5.5%).

As per results of 2012, correspondent accounts of commercial banks with the Bank of Russia, which increased within the year by 38% to Rb 1,356.3bn, became the main item of growth of monetary base in broad definition. The amount of cash (aggregate M_0), as well as the amount of mandatory reserves were also significantly extended, by 11.2% to Rb 7,667.7bn and by 12.5% to Rb 425.6bn, accordingly. Growth of banks' deposits with the Bank of Russia within the year made 3.9%, and as a result, by the end of the year deposits reached Rb 403.3bn.

Note that the monetary base in narrow definition (cash plus mandatory reserves) in 2012 remained virtually unchanged as well. The utmost growth occurred in HQ 2012 and in the last month of the year, when it got increased at once by 11% to Rb 8,093.3bn (*see Fig. 3*). As a result, the monetary base in narrow definition (cash plus mandatory reserves)² in 2012 has grown by 11.3% (against 21.8% in 2011).

In December 2012, the excessive reserves of commercial banks³ continued to grow: within the month they have almost doubled to Rb 1,806.3bn. The volume of correspondent accounts with the RF Central Bank increased to Rb 1,403bn and the volume of deposits - up to

² We would like to remind, that the monetary base in broad definition is not a monetary instrument, it reflects the obligations of the Bank of Russia in national currency. The monetary base in narrow definition is a monetary instrument (one of indicators of the volume of monetary supply), which is under total control of the RF Central Bank.

³ 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.

Rb 403.3bn. The inflow of budget funds to the banking sector at the end of the year was a seasonal factor. Anyway, by the end of January, the excessive liquidity on correspondent accounts and deposits of banks with the RF Central Bank will start to decrease in view of the onset of tax payments period. As a result of liquidity growth available to commercial banks by the end of the year, the banks indebtedness under REPO transactions has decreased to Rb 2 trillion (see Fig. 2). Apparently, along with liquidity depletion, the volume of refinancing will continue to grow.

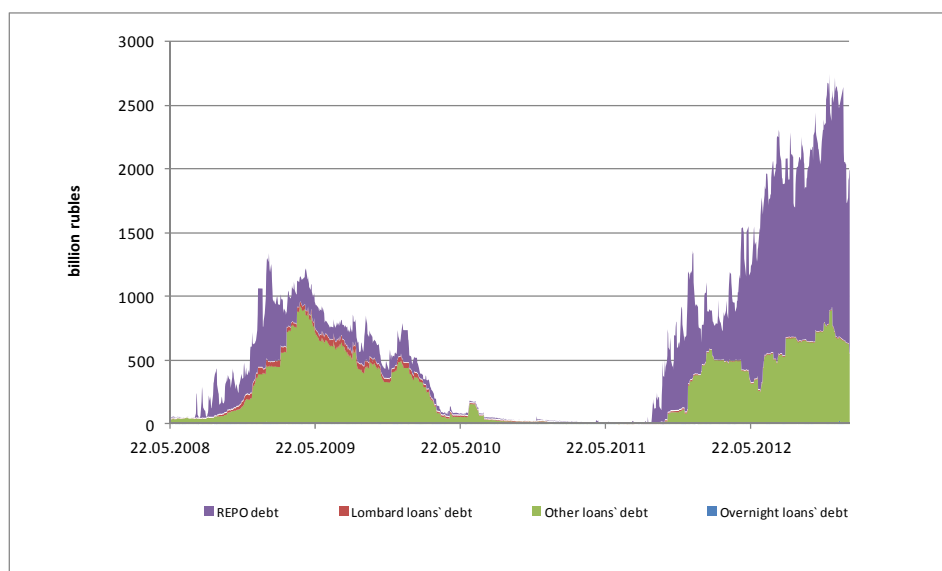


Fig. 2. Arrears of commercial banks with the Bank of Russia in 2008–2012

As of the end of 2012 the amount of net international reserves has increased by 6.4% from \$505.4bn to \$537.6bn. In the last month of the year, the reserves increased by 1.8%. The main reason for reserves growth was the change of US dollar against Euro.

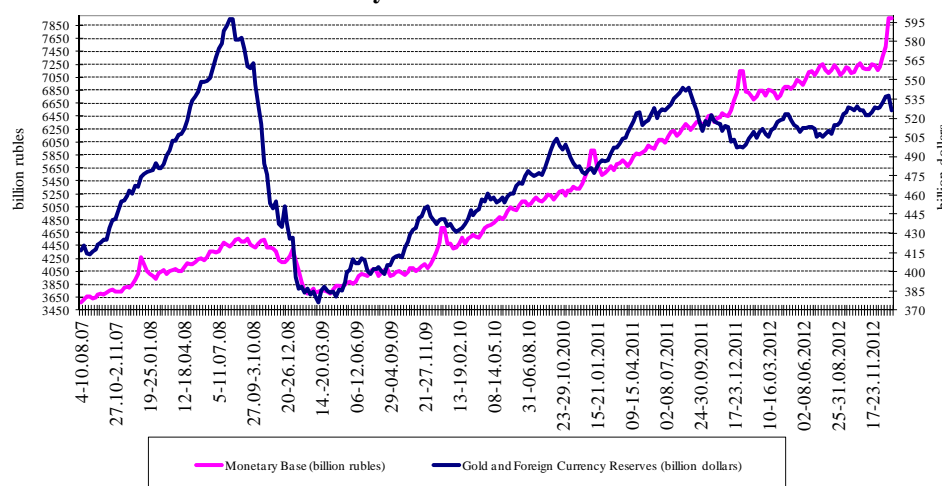
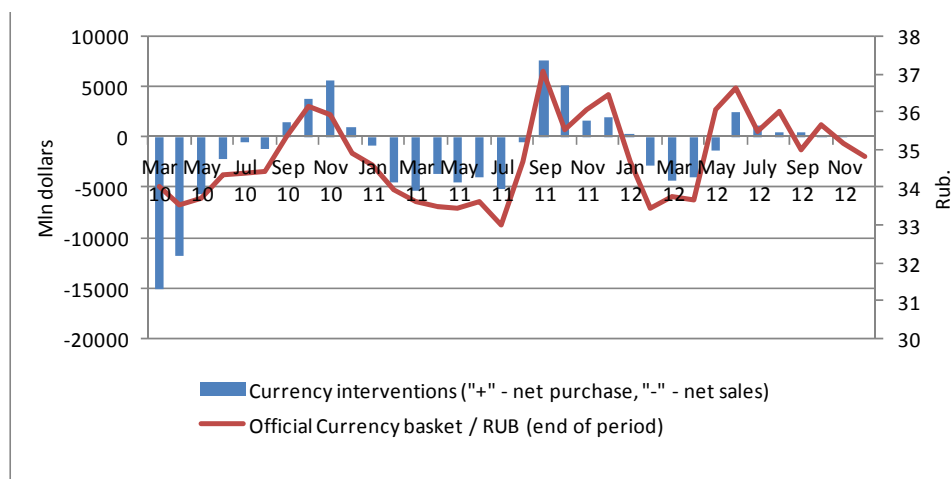


Fig. 3. Dynamics of the monetary base (in narrow definition) and foreign currency and gold (international) reserves in 2007–2012

Throughout 2012 the RF Central Bank was consistently reducing its presence in the foreign currency market. In December 2012, for the first time since 2008, the Bank of Russia did not carry out foreign currency interventions (see Fig. 4).



Source: RF Central Bank, author's estimates.

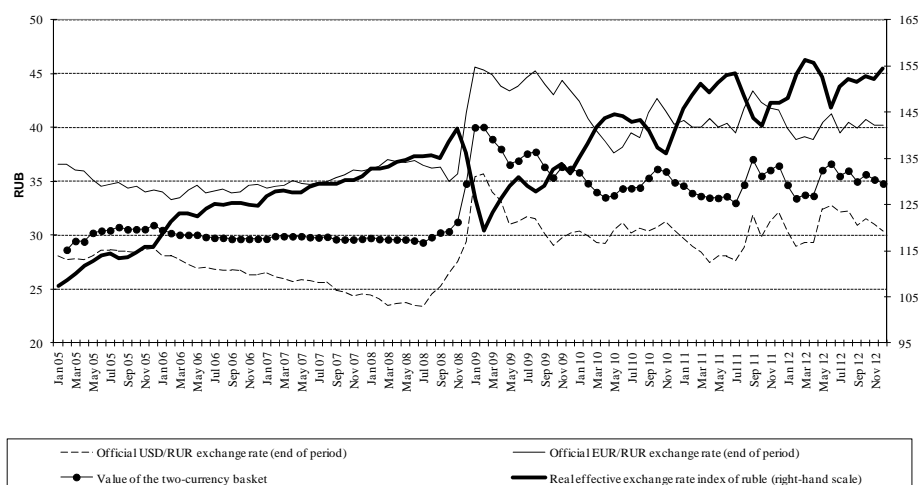
Fig. 4. The Bank of Russia FX interventions and ruble exchange rate against FX basket in March 2010-December 2012⁴

As of the end of 2012 the net outflow of capital from the country amounted to \$56.8bn, which was lower than the recent forecast of the RF Central Bank (\$ 67bn). This is also 1.5 times lower than the net capital outflow in 2011, when it amounted to \$80.5bn. Capital outflow has reached its maximum of \$33.3bn in Q1 2012. According to the tentative estimates of the RF Central Bank, in Q4 2012 capital outflow has increased again, having reached \$9.4bn. Herewith, in the last quarter of the year the capital outflow from the non-financial sector has virtually doubled (-\$23.6bn) along with the two-fold capital inflow to the banking sector (+\$14.2bn). Capital outflow growth from the non-financial sector in Q4 could be urged by the peak of payments of external debts of Russian companies, which happens at the end of the year.

In December the ruble real effective exchange rate resumed its growth again (+1.5%). As a result, index of the real effective exchange rate increased to 154.561⁵ (see Fig. 4). As of the end of 2012, the ruble strengthening in real terms against FX basket made 2.4%, slightly exceeding estimates of the Ministry of Economic Development of Russia for this indicator (- 2%). In 2011, the ruble strengthening amounted to 4.7%.

⁴ The level of January 2002 is accepted as 100%.

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Source: RF Central Bank, author's estimates.

Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – December 2012

From the second decade of December 2012 and in January 2013 the US currency rate against the ruble was declining. As a result of 26 days of January, dollar has been depreciated by 1% to Rb 30.05. There was a number of factors contributing to the ruble rate strengthening. Prevention measures against «fiscal downfall» in the USA have inspired the investor's interest in risky assets, including Russian currency. Ruble was also supported to some extent by high global oil prices and by the onset of the domestic tax period. The Euro exchange rate against the ruble within 26 days of January remained virtually unchanged, staying at the level of Rb 40.24. The value of the two-currency basket within the period under review has decreased by 0.5% to Rb 34.6.