INFLATION AND MONETARY POLICY IN JANUARY 2013

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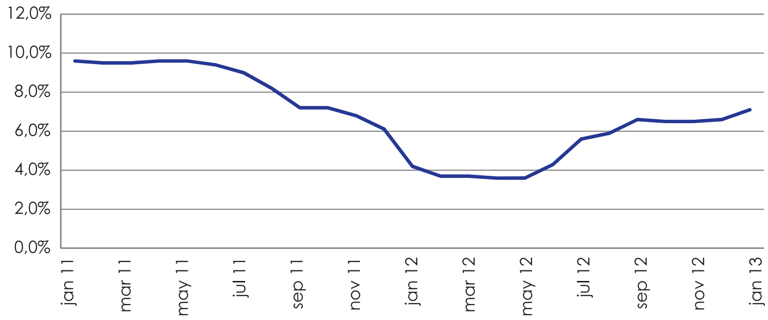
In January 2013 the seasonal growth in prices for fruit and vegetables, as well as the planned increase in excise duties have contributed to inflation by two-fold, as compared with December 2012: CPI for the month made 1%. As a result, the inflation rate in annual terms has reached 7.1%. In February, the growth rate of consumer prices has slowed down: in 18 days of the month it made 0.3%. According to tentative estimates of the Ministry of Economic Development of Russia, the net outflow of capital from the country at the beginning of 2013 has accelerated, having reached in January \$8-10bn. On February 12 the Bank of Russia has decided to establish a uniform rate for mandatory reserves for all categories of liabilities to credit institutions in the amount of 4.25%.

In January 2013 inflation has markedly accelerated, making twice as high as in the last month of 2012. As the result of the month, CPI reached 1% as compared with 0.5% in January 2012. Therefore, the inflation rate in annual terms has accelerated to 7.1% (*Fig. 1*). The utmost contribution to the increase in consumer prices made food products, which prices over the last month have grown by 1.8%. A significant contribution to the general growth in food prices has been made fruit and vegetable products (+7.4%). Increase in excise duties provoked a significant increase in alcohol price, which has grown in January by 4.9%. The only foodstuffs that have become cheaper in January were meat and poultry (-0.3%).



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2011–2013 (% year to year)

The rate of growth in prices and tariffs for public commercial services in January continued to increase – from 0.4 to 0.6%. However, the rate of growth for commercial services service prices was much lower than, for example, two years ago, which is explained by the transfer of indexing the administratively regulated tariffs from January to July. Higher tariffs for passenger railway tickets and for public transport caused general rise in the cost of services of passenger transport (+2.4%). At the same time, in the first month of the year prices for foreign tourism and telecom services have insignificantly decreased (by 0.1%).

Growth rate of non-food products prices has slightly increased in January from 0.3% to 0.4%. Due to the increase of excise duties, the utmost growth in January prices was noted in tobacco products, which increased by 1%. Medicines were also growing in price nearly at the same rate (+0.8%), as well as detergents and cleaning agents (+0.7%). Gasoline in January gasoline has also significantly gained in price (+0.6%). Apparently, the reason was the administrative restriction of cost in the past year. In the coming months one can expect only the acceleration rate of growth in gasoline price, which will be due to both, the increase in excise duties, and to the beginning of the high season. There was no price reduction in any non-food products in January.

Like in the last year, the CCPI[1] in January made 0.5%.

In February inflation has markedly slowed down: within 18 days of the month prices rose by 0.3%, having repeated the dynamics of the same period of the last year. As a result, the cumulative inflation since the beginning of the year made 1.3% (versus 0.8% for the relevant period in 2012).

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).

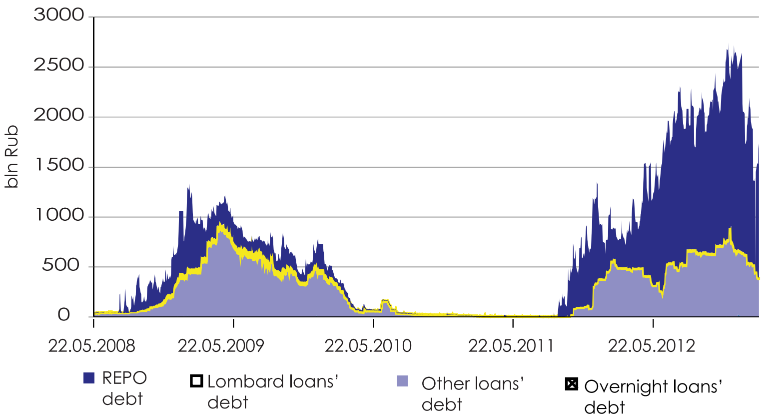


Fig. 2. Arrears of commercial banks with the Bank of Russia in 2008–2013

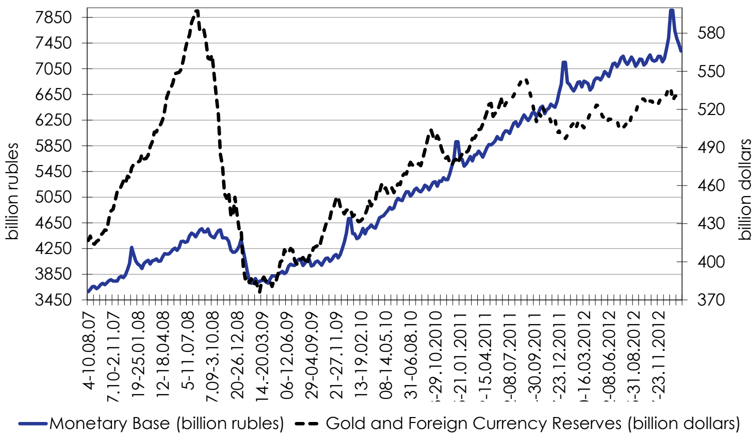
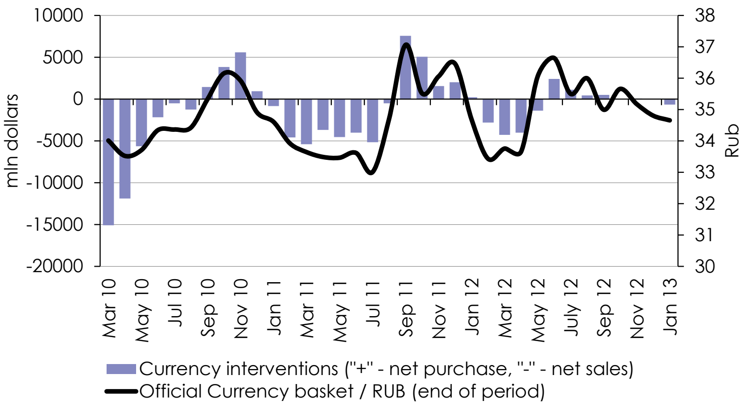


Fig. 3. Dynamics in the monetary base (in narrow definition) and in the RF gold and foreign currency (international) reserves in 2007–2013



Source: RF Central Bank, author's estimates.

Fig. 4. Central Bank of Russia currency interventions and ruble exchange rate vs. two-currency basket in March 2012 – January 2013

According to the estimates of the Ministry of Economic Development of Russia, the CPI in February amounts to 0.5-0.6%, higher than in 2012 (0.4%). The Bank of Russia expects in February the inflation in the range of 0.4–1%. Excess of inflation in early 2013 over the corresponding indicators of 2012 can be attributed to the low monetary base effect: in the first months of the last year the growth rate of consumer prices was much lower. In addition, at the beginning of the year prices for excisable goods, as well as for foodstuffs were rapidly growing.

In January 2013 there was a seasonal shrinkage of monetary base in broad definition after its expansion at the end of the year. As of the month result, it has decreased by 14.5% to Rb 8.4248bn (*Fig. 2*). Reduction of the monetary base in broad definition was associated with a simultaneous decrease in the volume of currency in circulation with regard to cash balances of credit institutions (-8.5%), correspondent accounts (1.7 times) and bank deposits with the Central Bank of Russia (2.6-fold). In January only mandatory reserves have increased by 3.6%.

Reduction of cash in circulation and the simultaneous growth of mandatory reserves in January led to a reduction in the monetary base in narrow definition (cash plus mandatory reserves) by 8.6% to Rb 7,454.5bn (*Fig. 3*).

After a two-fold increase in December 2012, the excessive reserves of commercial banks[1] in January 2013 declined, having returned to the level of the last November. Their volume at the end of the month reached Rb 970.3bn.

The volume of the Central Bank repo transactions with commercial banks in January–February was much lower than in December 2012. In early February the debt of banks under repo transactions has decreased below Rb 1 trillion (*Fig. 2*). However, this trend is temporary, as the banks' liquidity, obtained as a result of significant budget expenditures at the end of the year, will be gradually expired.

1 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.

After the December growth, in the first 1.5 months of 2013 the volume of net international reserves has decreased. As of February 15, they have declined by 1.5% to $529.5 bn. It was promoted by a negative revaluation of assets included in the portfolio of the RF Central Bank: the depreciation of the Euro and the British pound, as well as a drop in gold prices. Gold price at the end of February fell down to the minimum level since July 2012. After the December pause, in January 2013 the Bank of Russia has resumed foreign currency interventions, which were still insignificant. In the first month of this year the RF Central Bank has purchased $596m and Euro 48m (*Fig. 4*).

In January of this year, according to the tentative estimates of the Ministry of Economic Development of Russia, the net outflow of capital amounted to $ 8-10bn; this is lower than in January of the last year ($15.3bn), but higher than in the entire Q4 2012. Thus, in the current year, capital outflow has rapidly accelerated, having reached the 2nd version of the annual forecast (at the oil price of $97 doll/bbl.), estimated by the RF Central Bank in the Guidelines for monetary policy for the next three years.

In January of this year, the ruble real effective exchange rate continued its strengthening (+1.7%). As a result, the index of the real effective exchange rate has grown to 157.19[1] (*Fig. 4*).

In early February, the U.S. dollar continued to decrease against Russian ruble. The ruble was strengthening as a result of sustained high oil prices. The seasonal factor has also played its role: in Q1 exports traditionally exceeded imports, which also contributes to the growth rate of the national currency. By the third week of February there was a correction in the dollar-ruble pair: the U.S. currency has grown to $/Rb 29.93 on February 5 by 1% to $/Rb 30.23 on February 22.

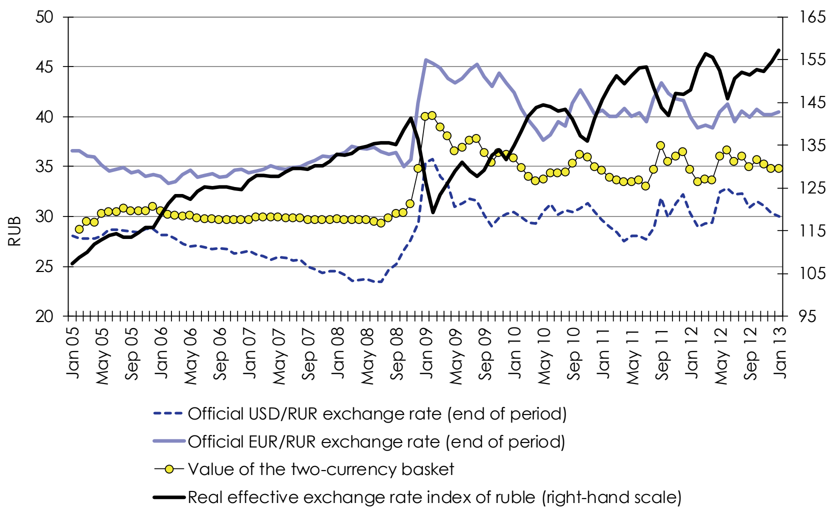
After the January strengthening, the European currency began to decrease in February. Over three weeks of February the Euro rate has declined by 1.6% to Rb 40.07 as of February 22. This trend reflects the dynamics of the Euro-dollar pair in the FOREX market, where the Euro over this period has decreased from 1.37 to 1.32. The internal problems of Europe continue to affect the rate of its currency: statistics on Eurozone GDP in the last quarter was worse than expected.

As a result of volatile dynamics of dollar and Euro rates, the two-currency basket in February changed slightly, amounting to Rb 34.66 on February 22 (-0.3%).

On February 12 the Bank of Russia announced that it remained unchanged the refinancing rate and interest rates on the main operations of the Bank of Russia. Note, that in early 2013 there was an active discussion, whether the Central Bank should mitigate its policy by reducing interest rates. In our view, the position of the Bank of Russia, announced in first published in the January 2013 "Report on Monetary Policy" is well-founded. Recall, that this paper shows, that at the present time any significant deviation from neither potential level of output level, nor the demand for money from the monetary supply is not typical for the Russian Federation. In this situation, mitigation of interest rate policy would affect primarily prices, rather than output.

At the same time, despite the acceleration of inflation, tightening of monetary policy is also unjustified, as the increase in the rate of prices growth is mainly based on non-monetary factors.

We believe that a key way to accelerate the economic dynamics in the Russian Federation should be institutional reforms, enhance-



*The level of January 2002 is accepted as 100%.
Source: RF Central Bank, author's estimates.

*Fig. 5. Indicators of Ruble Exchange Rate in January 2005 – January 2013**

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

ment of efficiency of still significant budgetary expenditures and government management. These measures can provide a significant incentive to economic development, while measures promoting aggregate demand provide only a short-term positive effect, which is further transforming in the acceleration of inflation.

Note, that in addition to keeping interest rates at the same level, the RF Central Bank has established from March 1 the unified mandatory reserve rate at 4.25% regardless of the types of liabilities. Recall, that up to November 2009 over a long period the rates of mandatory reserves were the same under all types of liabilities. However, later the regulations for the liabilities to legal entities-non-residents were increased more than under other liabilities. This differentiation was explained by the desire of the monetary regulation authorities to discourage involvement of foreign credits by banks. However, recently, due to the increased flexibility of the exchange rate policy of the RF Central Bank, the relevance of this issue has decreased. Moreover, we believe that the use of the instrument of monetary policy should be minimized on the one hand, due to its scale (it affects all banks), and on the other hand, due to the inflexibility (the same change in regulations provides different effects depending on the banks' size and structure of their liabilities).