



Банк России

Центральный банк Российской Федерации



Monetary Policy of the Bank of Russia

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Inflation Targeting in Russia: Motivation & Challenges

Motivation:

- Unanchored inflation Expectations
- Heavy Dependence on Resource Prices
- High level of Dollarization

Challenges:

- Fear of Floating
- FX Liquidity Deficit
- Oil Price Decline and Sanctions
- Underdeveloped Derivative Markets
 - limited potential to hedge interest rate risk and foreign exchange exposure

Bank of Russia Monetary Policy Framework

“Guidelines for the Single State Monetary Policy in 2015 and for 2016 and 2017”

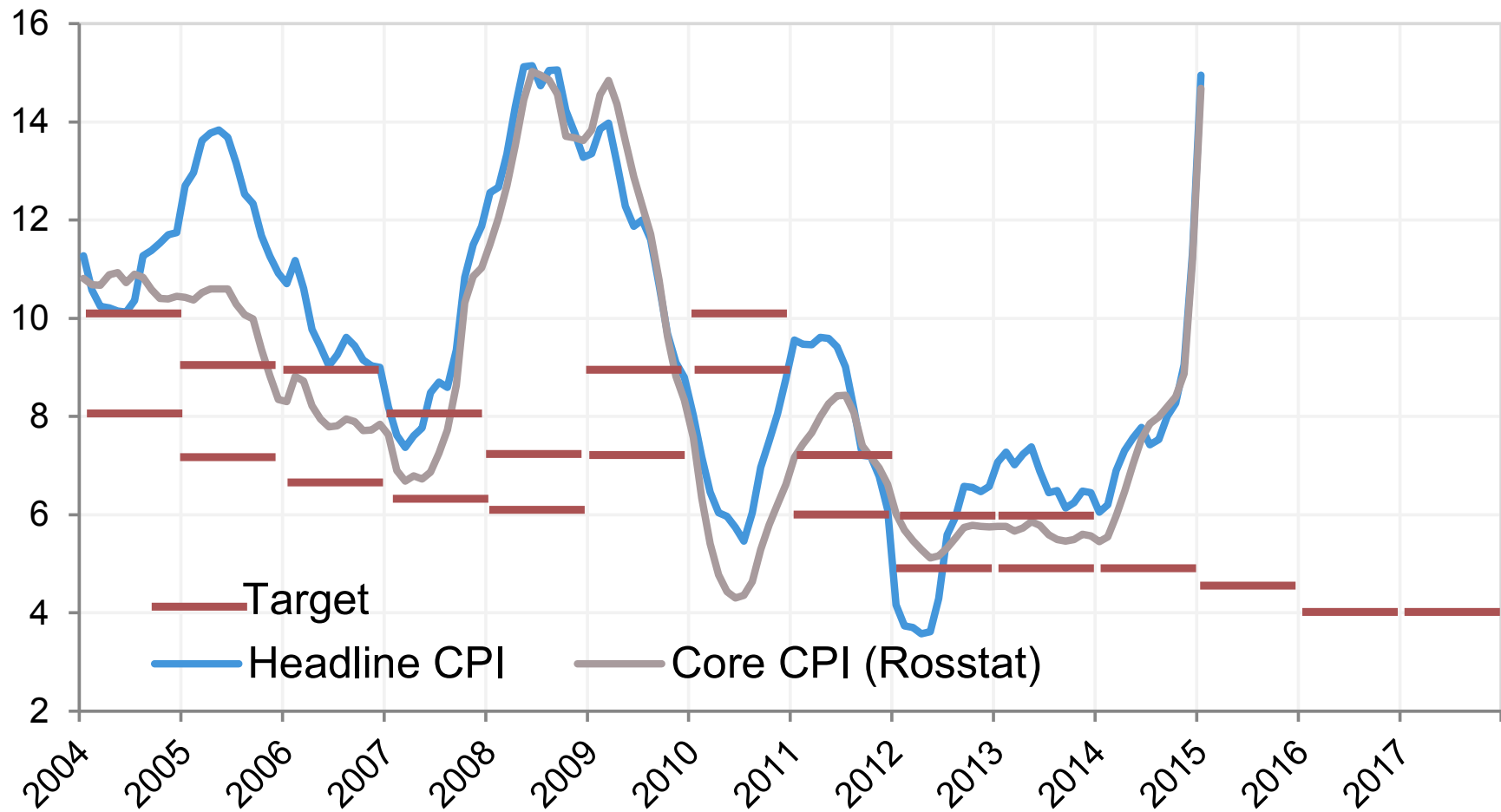
(Flexible) Inflation Targeting starts in 2015

- The monetary policy goal is to lower inflation to 4% in 2017 and keep it close to this level.
- The inflation target is set for the consumer price index (CPI), which is measured for a month on the corresponding month of the previous year
- As long as it does not hamper achieving the inflation target, the Bank of Russia’s monetary policy seeks to smooth out cyclical fluctuations of economic activity and financial indicators relative to their fundamental levels.
- By the end of 2014, the Bank of Russia will complete the transition to a floating exchange rate regime. Under the new regime, the regulator will abandon its domestic foreign exchange market operations designed to influence the exchange rate, except for the cases when it is necessary to maintain financial stability.

Financial Stability

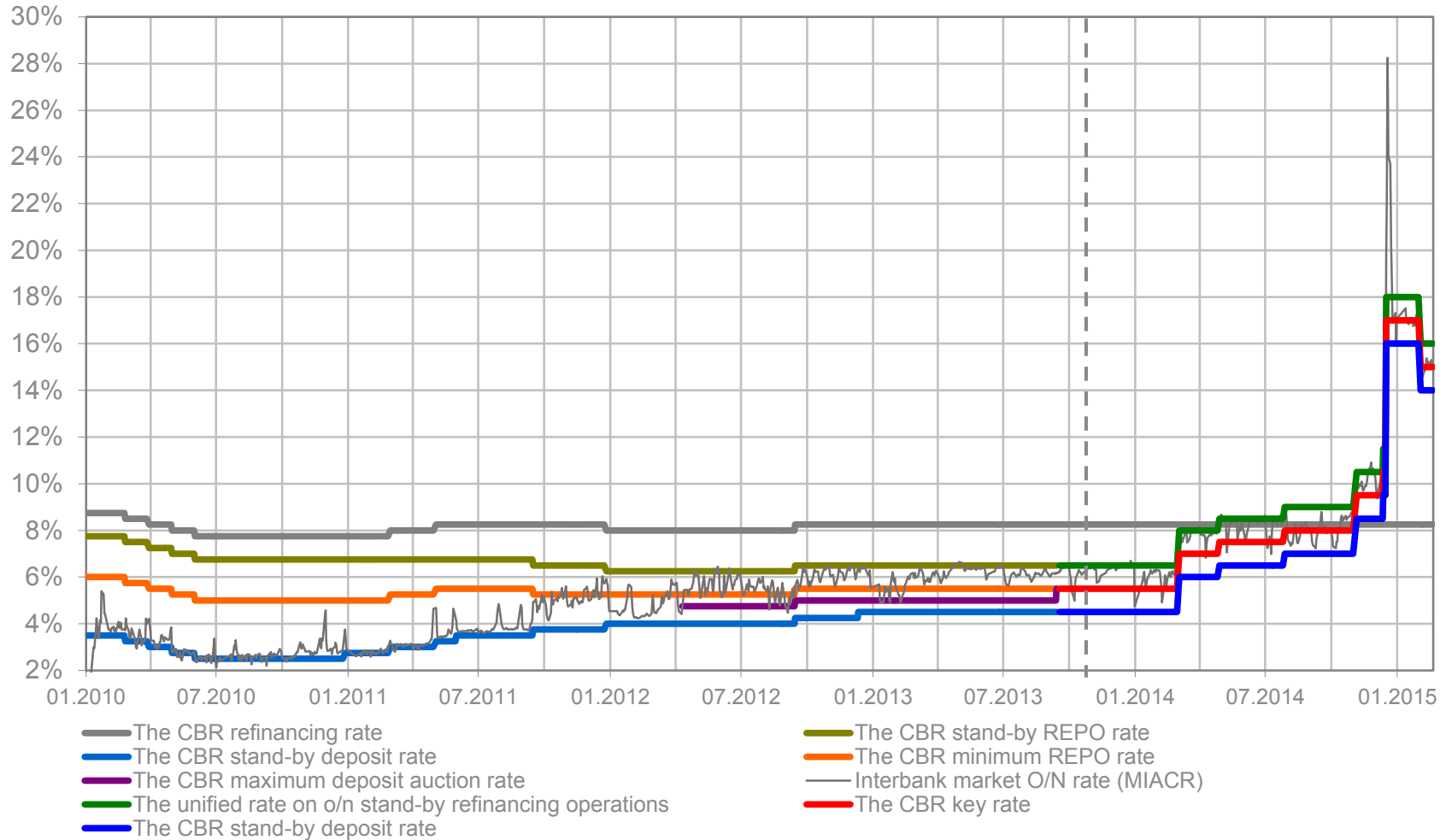
- In addition to price stability, the Bank of Russia also promotes sustainable functioning and development of the banking sector, financial market and payment system.

Inflation in Russia



Source: Rosstat, CBR

Transition to Key Interest Rate as Policy Instrument



Intermediate Regime

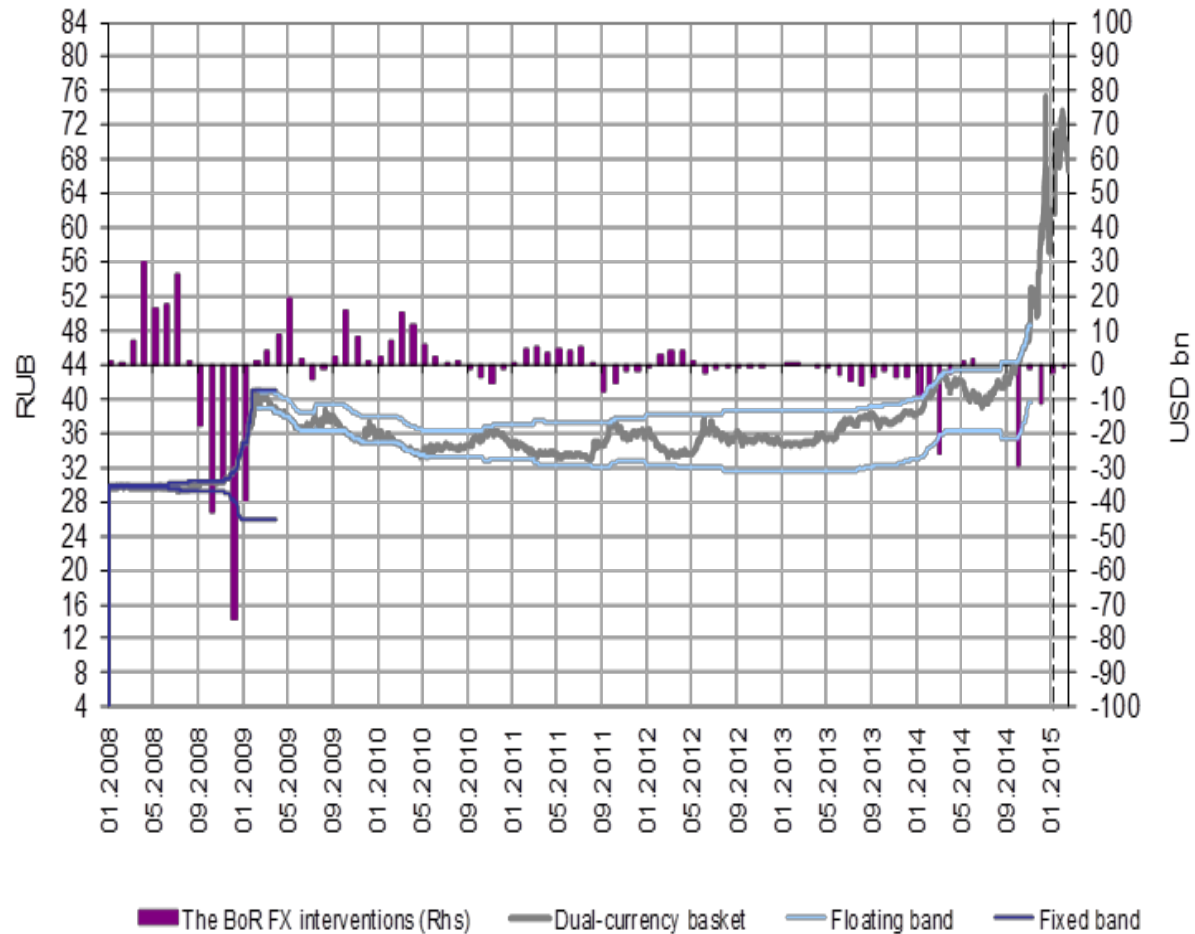
- Interest Rate Targeting
- Floating Exchange Rate Band

Bank of Russia Instruments

Purpose	Type of instrument	Instrument	Term	Rate, % p.a.
Liquidity provision	Standing facilities (fixed rates)	Overnight loans; REPO; FX swaps (ruble rate); Lombard loans; loans secured by gold; loans secured by non- marketable assets and guarantees	1 day	16
		Loans secured by gold	2-549 days	16.50
		Loans secured by non-marketable assets and guarantees	2-549 days	16.75
	Open market operations (minimum interest rates)	Loans secured by non-marketable assets, auctions	1-3 weeks, 3 months, 18 months**	15.25*
		REPO auctions	1 week, 1-6 days	15.00 (key rate)
Liquidity absorption	Open market operations (maximum interest rates)	Deposit auctions	1 week, 1-6 days	
	Standing facilities (fixed rates)	Deposit operations	1 day, call	14.00
FX liquidity provision		FX USD/RUB sell/buy swap	1 day	USD: 1.5 RUB: 7.0
		FX REPO	1 week, 28 days, 12 months	LIBOR + 0.5
		FX Credit	28 days, 365 days	LIBOR + 0.75

* Floating interest rate, linked to the BoR key rate. ** Held on an irregular basis.

Exchange Rate Moving Band as an Intermediate Regime



Source: CBR

The Moving band: an Evolution

- \$350*		- \$350		- \$350		- \$1500		- \$1500		- \$1000		- \$350	Upper boundary		\$350 million per day***	Bank of Russia's exchange rate policy mechanism abolished ****		
0.95 RUB	-\$400**	0.95 RUB	-\$400	0.95 RUB	-\$400	0.95 RUB	-\$400	0.95 RUB	-\$300	0.95 RUB	-\$200	0.95 RUB	\$0					
1 RUB	-\$200	1 RUB	-\$200	1 RUB	-\$200	1 RUB	-\$200	1 RUB	-\$100	1 RUB	\$0	1 RUB	\$0 "technical range"					
1 RUB	-\$70	1 RUB	-\$70	0.1 RUB	\$0	0.1 RUB	\$0	0.1 RUB	\$0	0.1 RUB	\$0	0.1 RUB	\$0					
1 RUB	\$0	0.1 RUB	\$0	3 RUB	\$0	3 RUB	\$0	3 RUB	\$0	3 RUB	\$0	5 RUB	\$0 "neutral range"					
1 RUB	\$70	1 RUB	\$70															
1 RUB	\$200	1 RUB	\$200	1 RUB	\$200	1 RUB	\$200	1 RUB	\$100	1 RUB	\$0	1 RUB	\$0					
0.95 RUB	\$400	0.95 RUB	\$400	0.95 RUB	\$400	0.95 RUB	\$400	0.95 RUB	\$300	0.95 RUB	\$200	1 RUB	\$0					
\$350		\$350		\$350		\$1500		\$1500				0.95 RUB	\$0					
												\$350	Lower boundary					
Up to 1 Oct 2013		1 Oct 2013		7 Oct 2013		3 March 2014		22 May 2014		17 June 2014		18 Aug 2014					5-7 Nov 2014	10 Nov 2014

Notes:

* - Cumulative volumes in USD mln leading to 0.05 RUB-shift of the band

** - Volumes of interventions within the ranges in USD mln

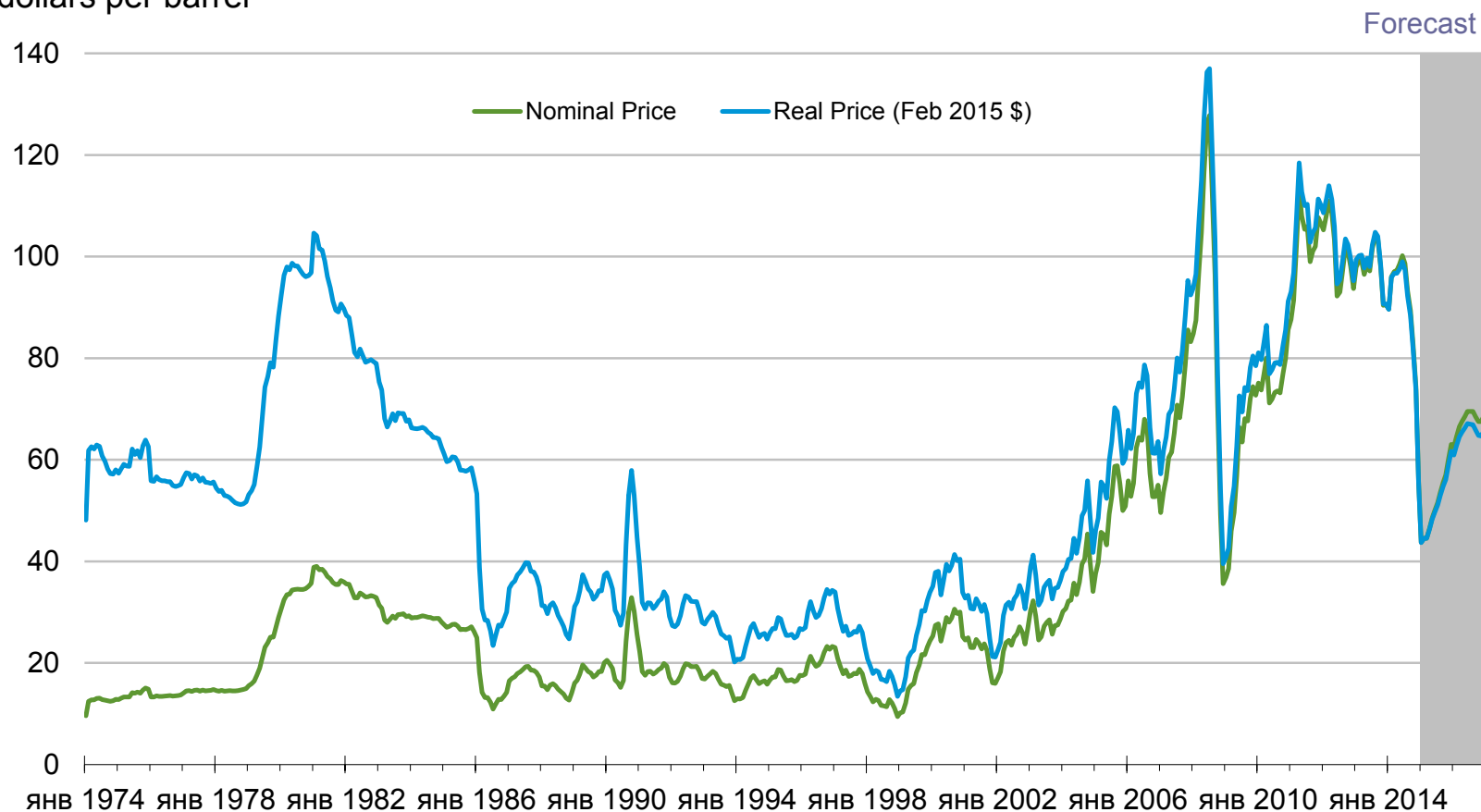
*** - From 5 to 7 November 2014 the Bank of Russia carried out foreign currency sell/buy operations with the intensity equal to \$350 million per day

**** - cancelling the permissible range of the dual-currency basket ruble values (operational band) and regular interventions on and outside the borders of this band

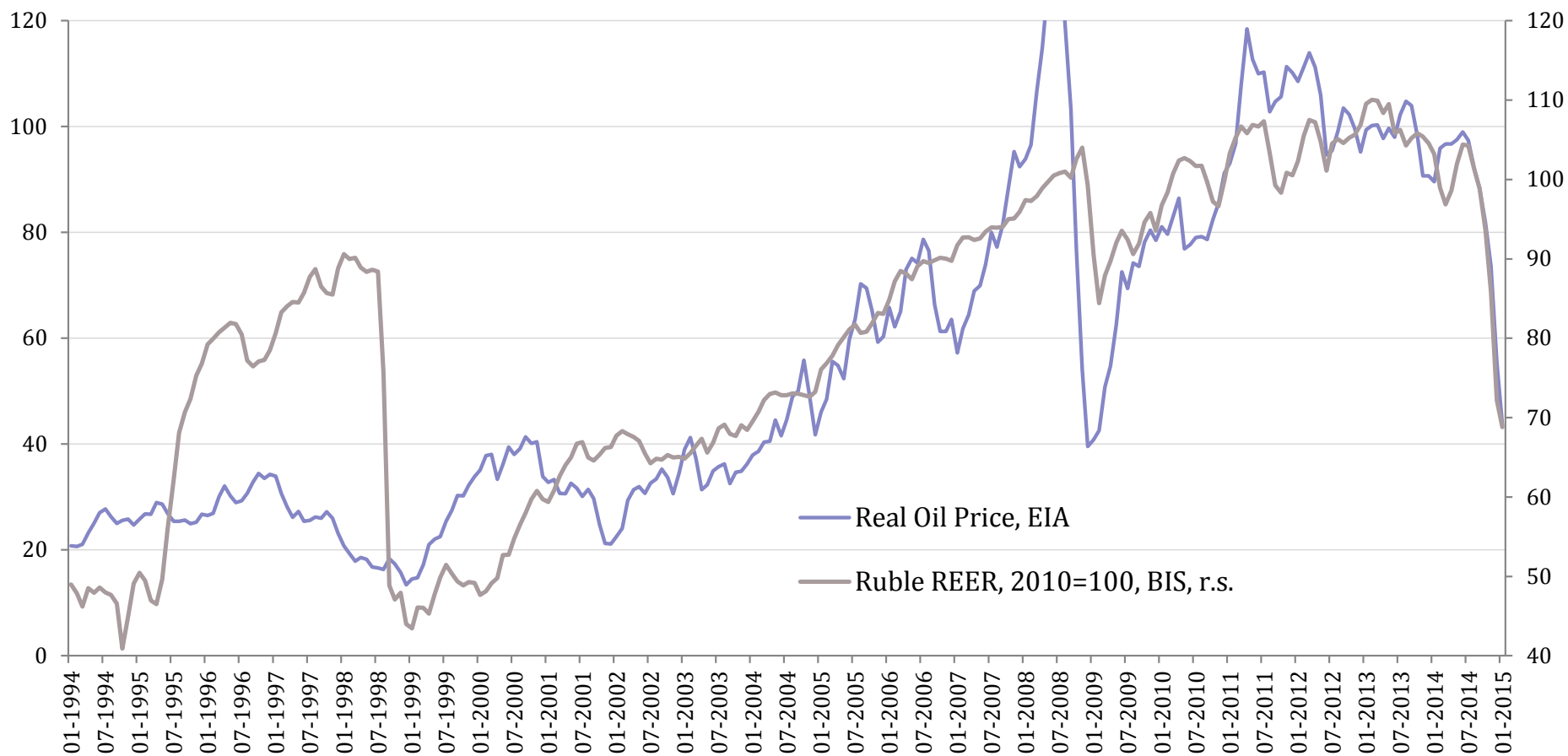
Challenges of 2014: Oil Prices

Monthly Imported Crude Oil Price

dollars per barrel

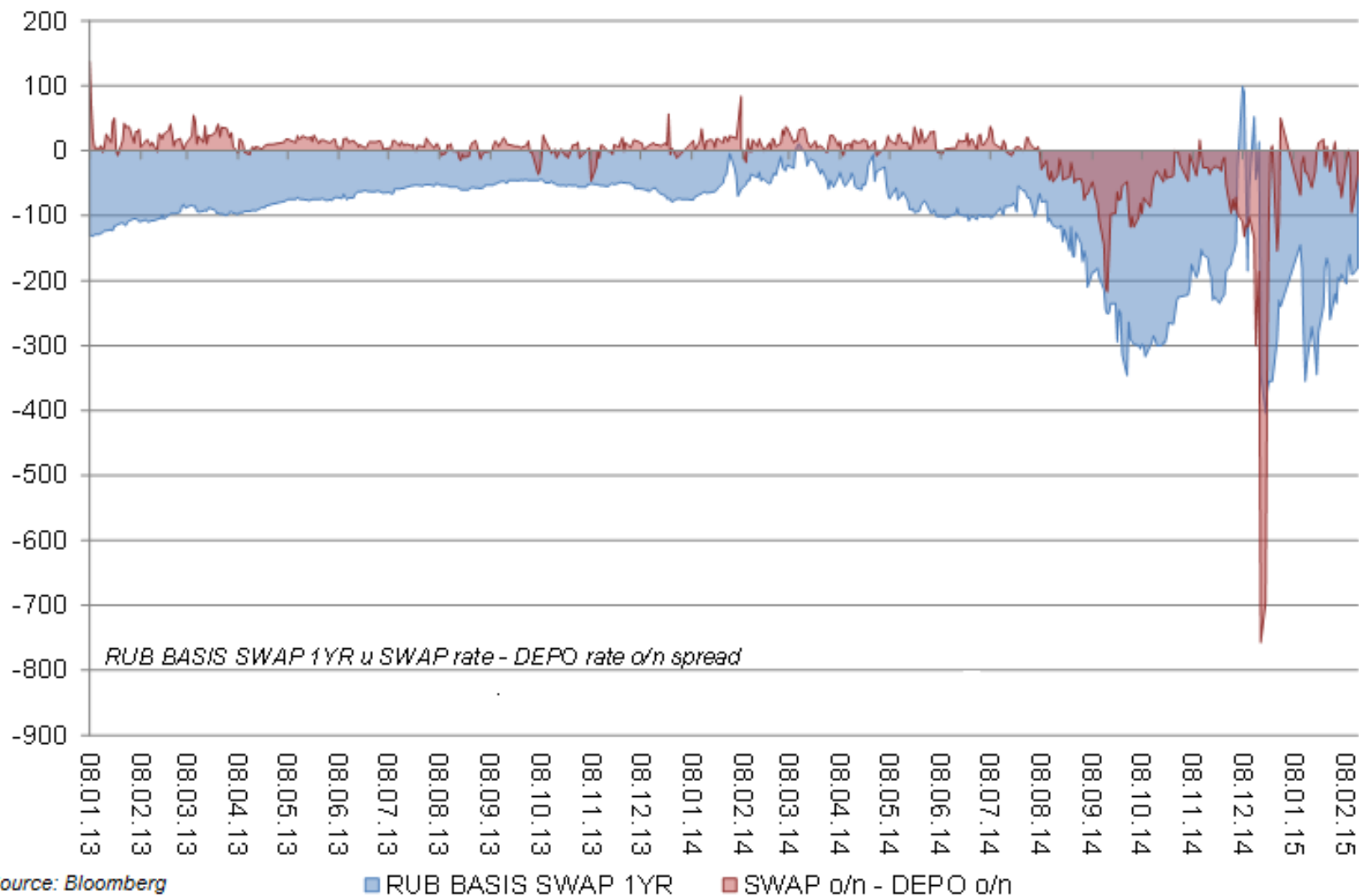


Challenges of 2014: Oil Prices and Exchange Rates



Source: BIS, EIA

Challenges of 2014: FX liquidity deficit



New Instruments aimed to address FX market disruption

Additional tools aimed at smoothing spikes in volatility of the ruble exchange rate due to short-term increase in demand for foreign currency

September 2014

one-day USD/RUB FX swaps at fixed interest rates

October 2014

1-week and 28-day FX REPO auctions (USD, EUR):

- at (LIBOR + 2.00) and (LIBOR + 2.25), respectively
- maximum total amount outstanding is limited at 50 bn. USD until the end of 2016

November 2014

12-months FX REPO auctions (USD, EUR)

1-week , 28-day, 12-months interest rates at LIBOR+1.5

December 2014

1-week , 28-day, 12-months interest rates set at LIBOR+0.5

28-day and 365-day FX credits with fx credits to exporters as collateral

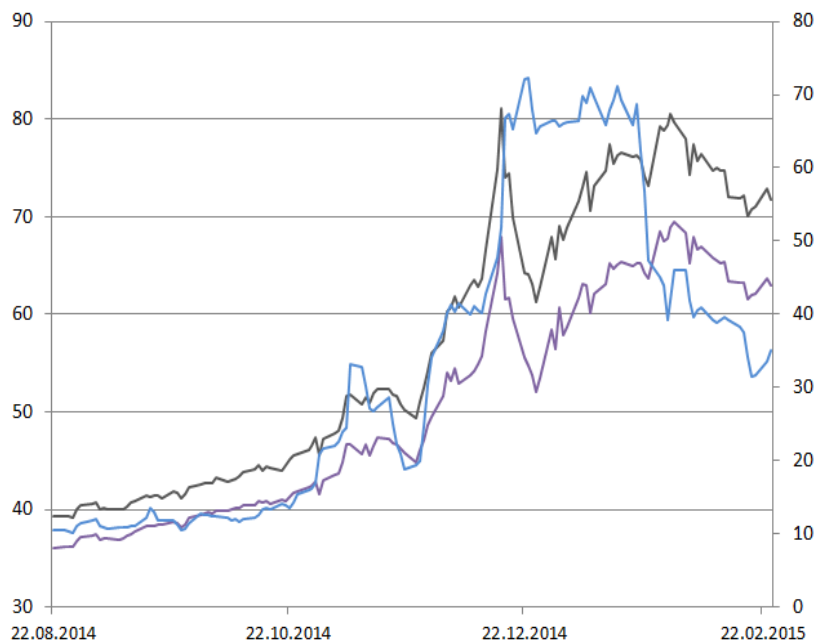
- the Interest rate at LIBOR+0.75

Policy implemented to balance between different policy goals

Bank of Russia measures to maintain stability of Russian financial sector in December'2014

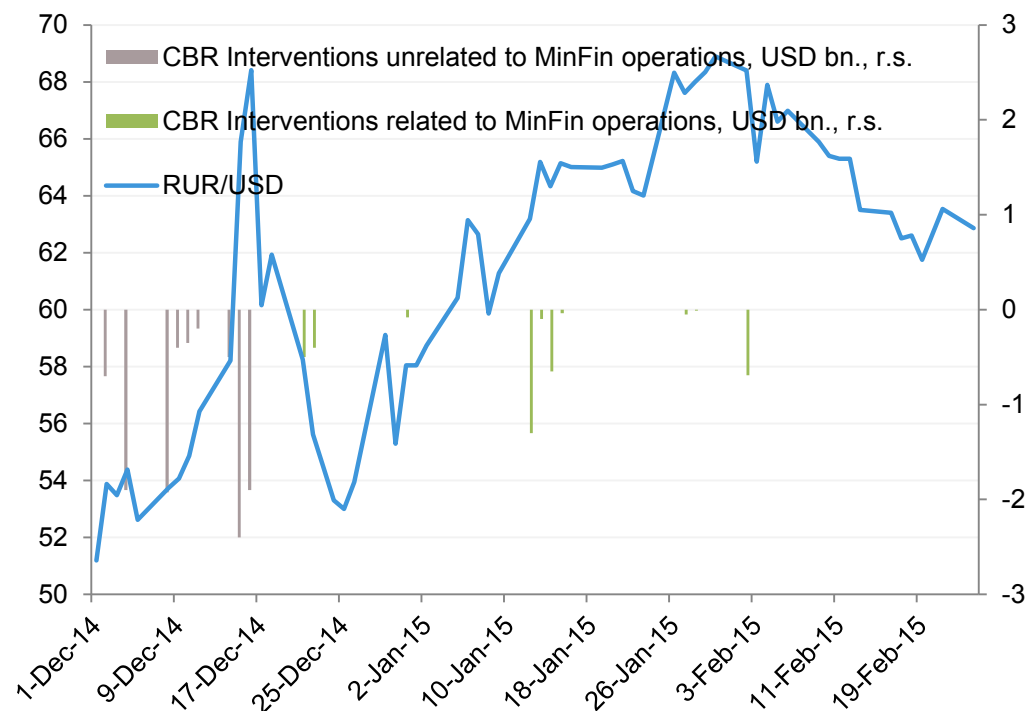
- FX loans secured by non-marketable assets to credit institution; lower interest rates on FX REPOs
- Support to the central counterparty at the Moscow Exchange for market participants to be convinced of the reliability of the centralized clearing and its uninterrupted functioning
- Measures to enhance interest rate risk management: restrictions on the values of effective interest rates of consumer loans; expansion of the range of standard market deviation of interest rates on household deposits.
- Measures to enhance credit risk management: ratings of the borrower's financial standing, provisions on loans, etc.
- The Bank of Russia and the Government of the Russian Federation develop measures for additional capitalisation of credit institutions in 2015

Current Situation: Exchange Rate Stabilized



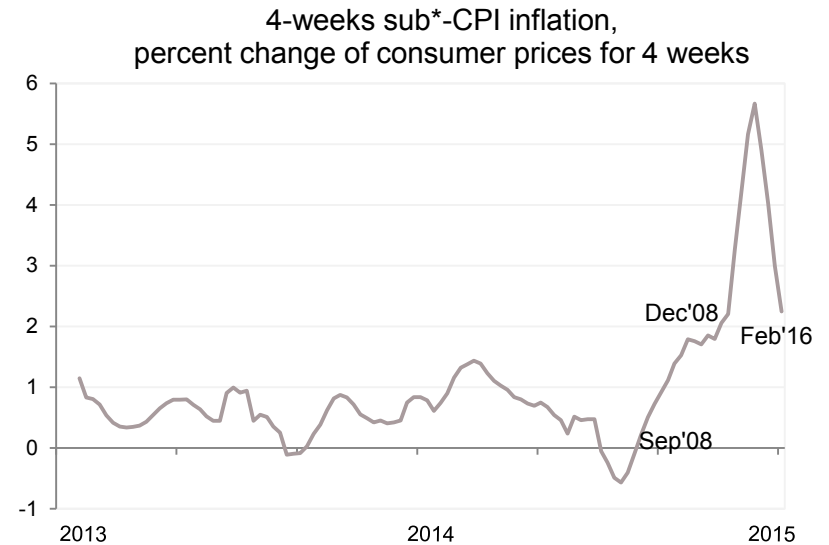
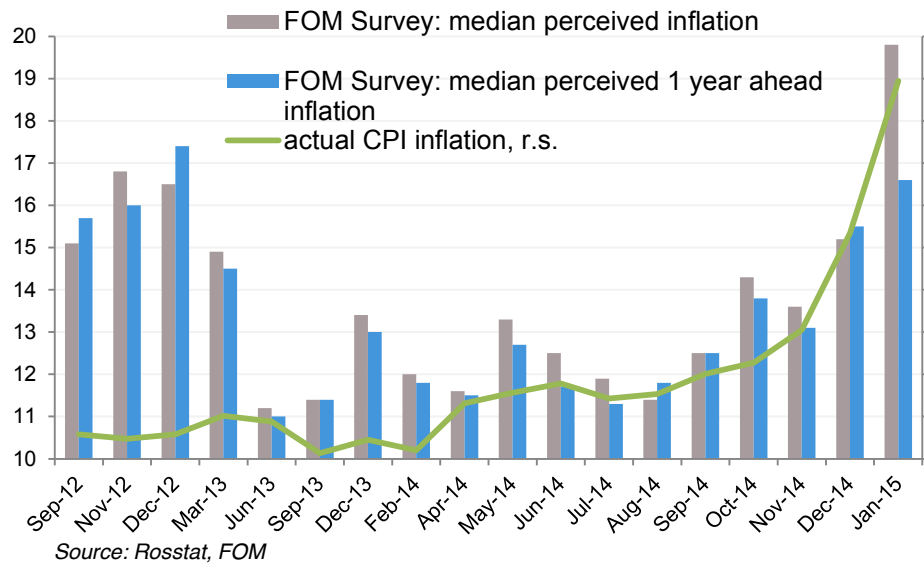
— USD/RUB exchange rate (rubles)
 — USD/RUB 1 year forward outright (rubles)
 — USD/RUB implied "at-the-money"
 1 month option volatility (%) (RHS)

Source: Bloomberg



Source: Bloomberg, CBR

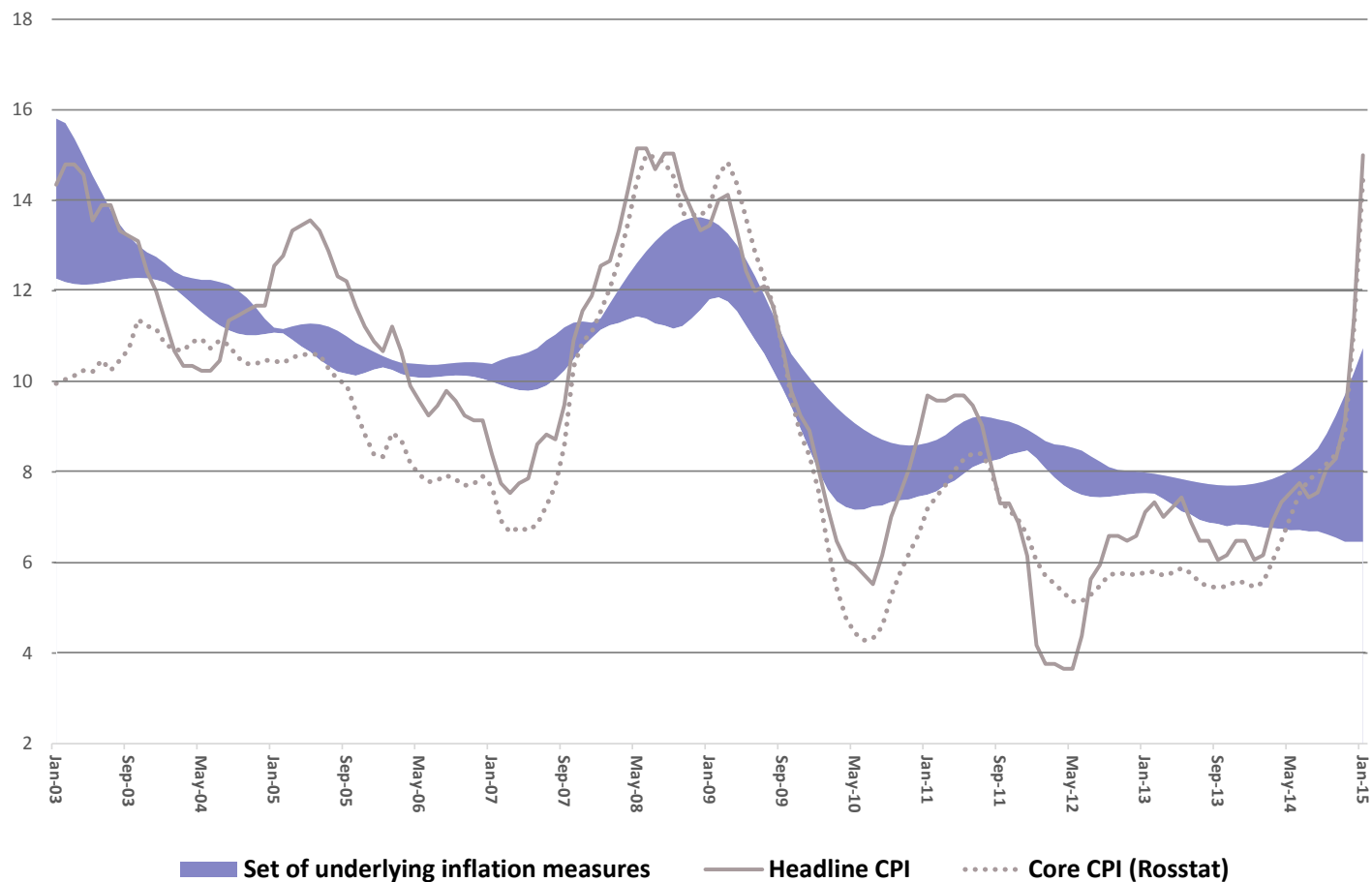
Current Situation: Inflation is major challenge



* - Weekly inflation represents around 30% of the CPI

Source: Rosstat, Bank of Russia calculations

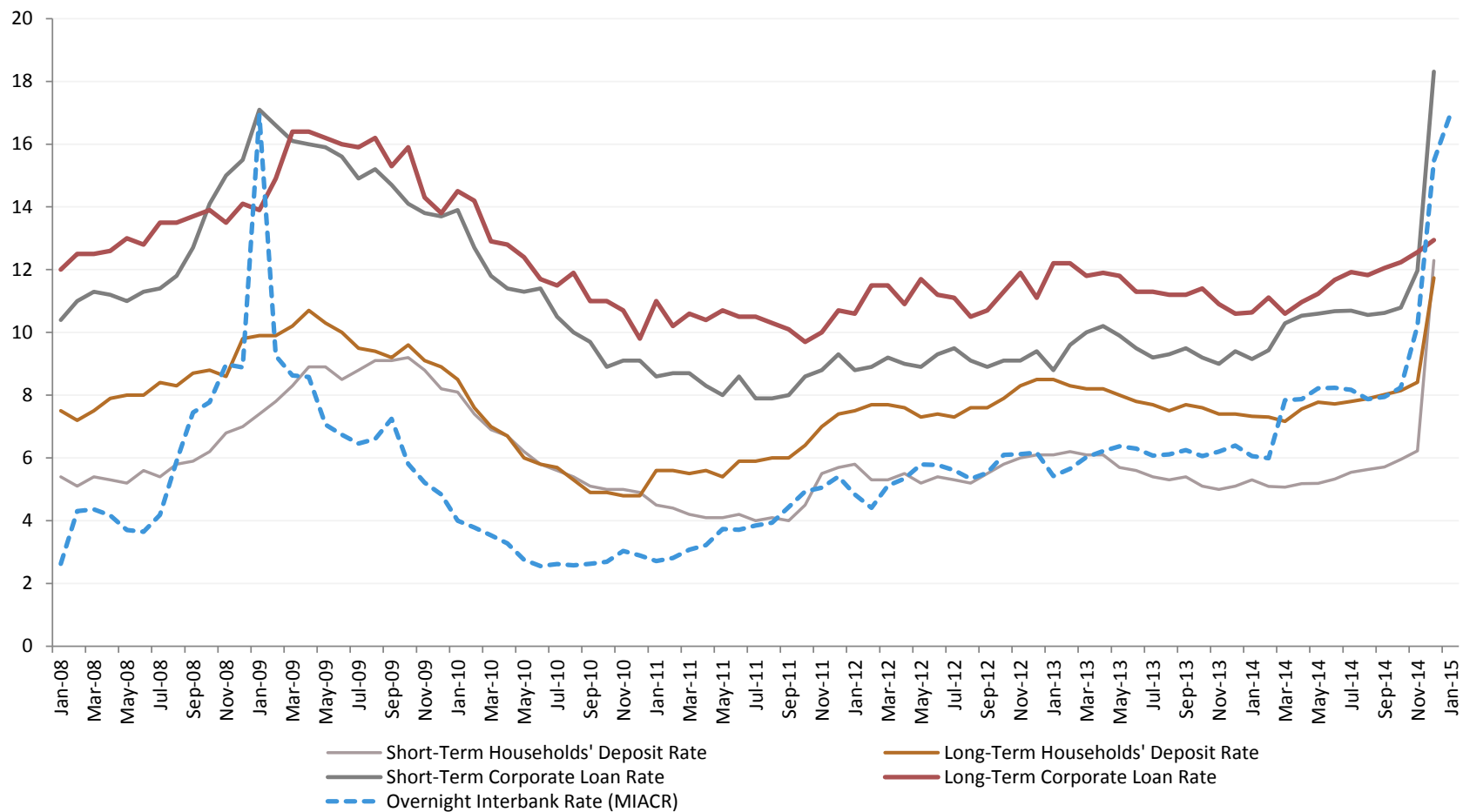
Current Situation: Inflation is major challenge



* - see Deryugina, et al. "Evaluating Core Inflation Measures for Russia", 2015, Bank of Russia Working Paper, to be published

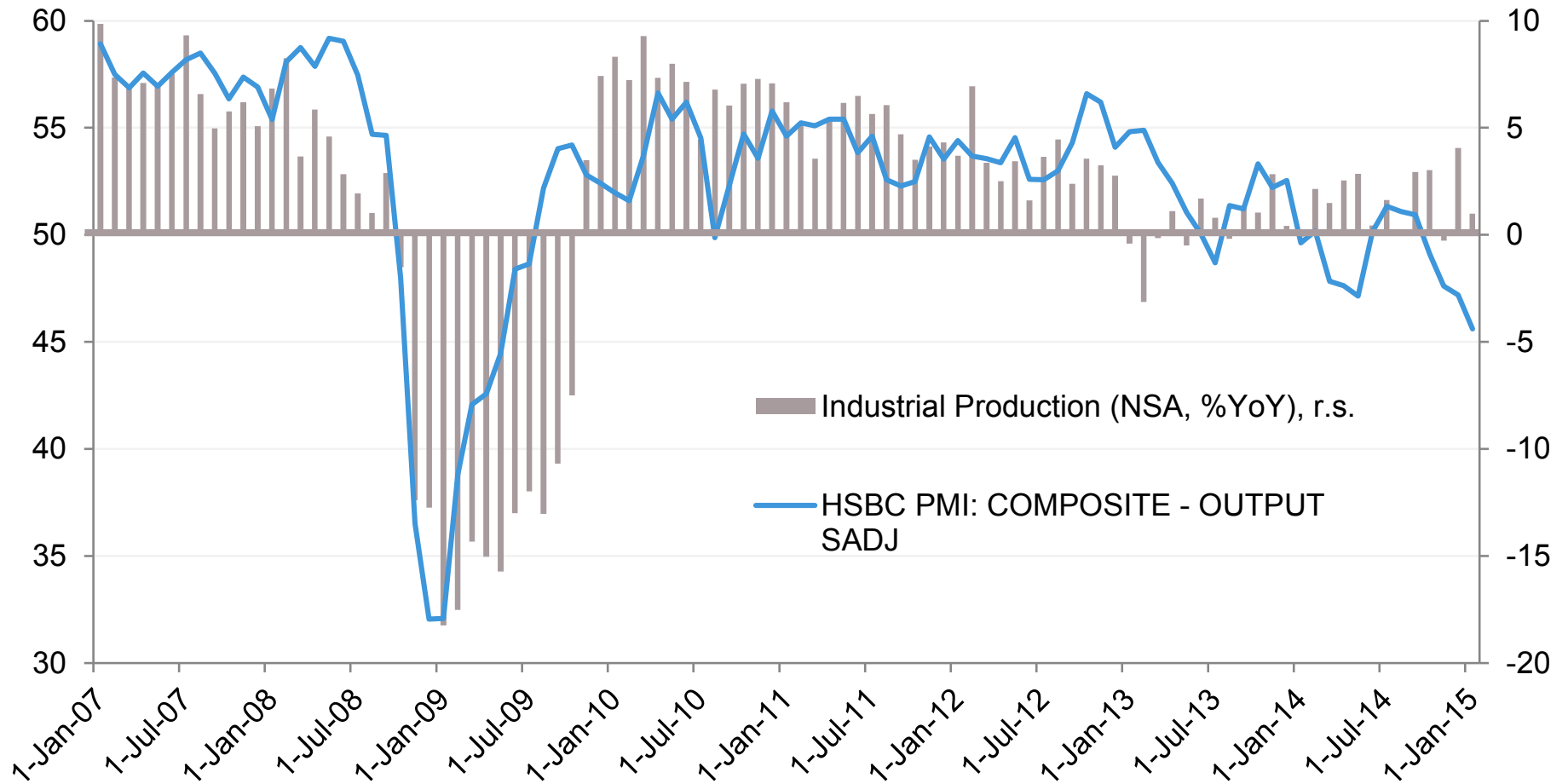
Current Situation: Market is still learning the new rules of the game

Interest Rates (% p.a.)



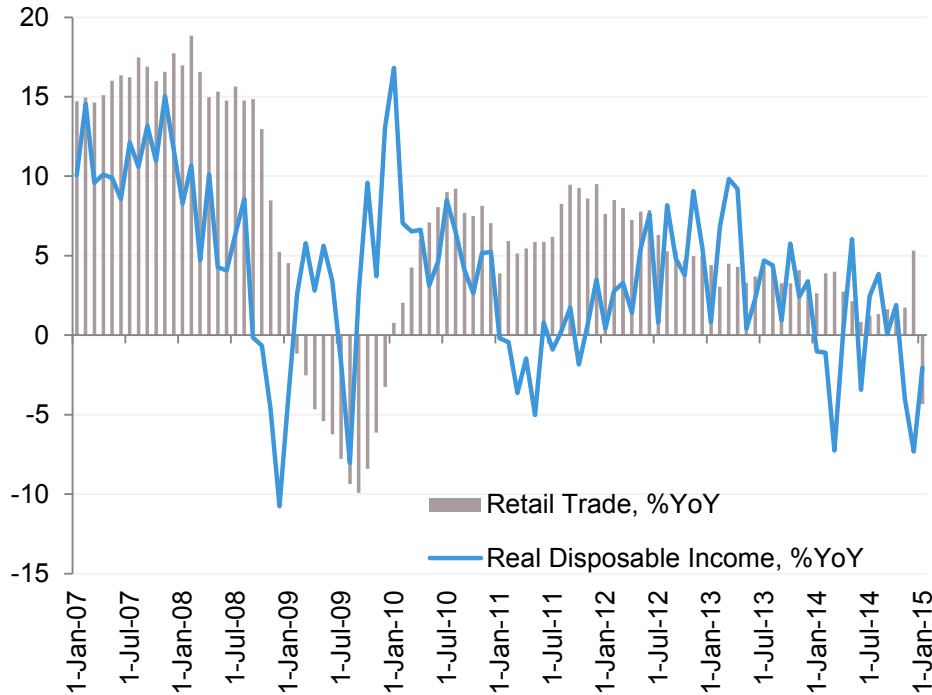
Source: Bank of Russia

Current Situation: Industrial Production is Resilient

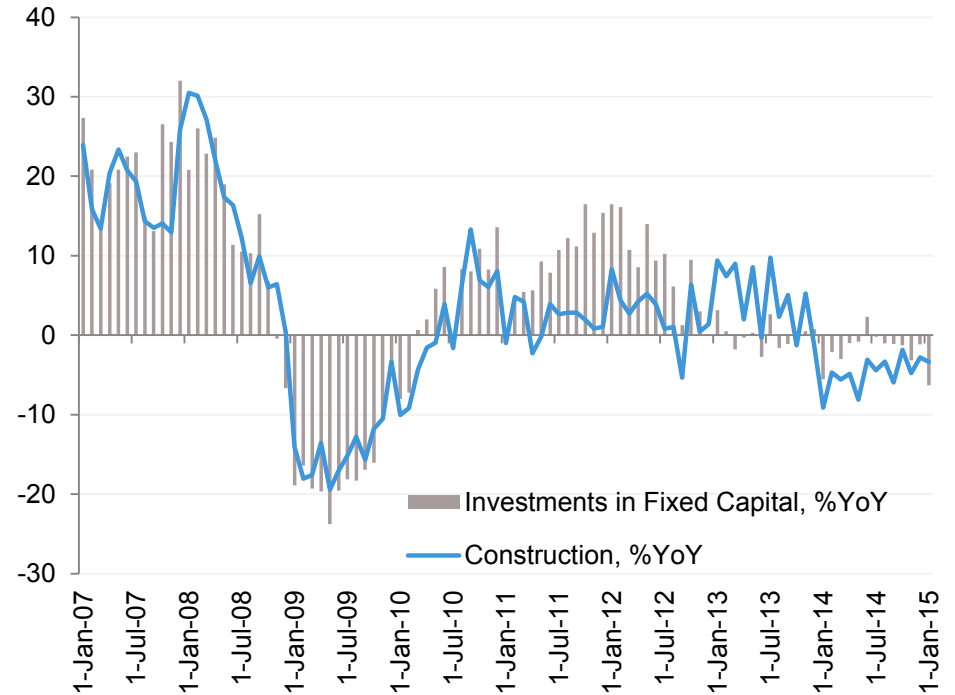


Source: HSBC, Rosstat

Current Situation: Consumer and Investment Demand Decline



Source: Rosstat

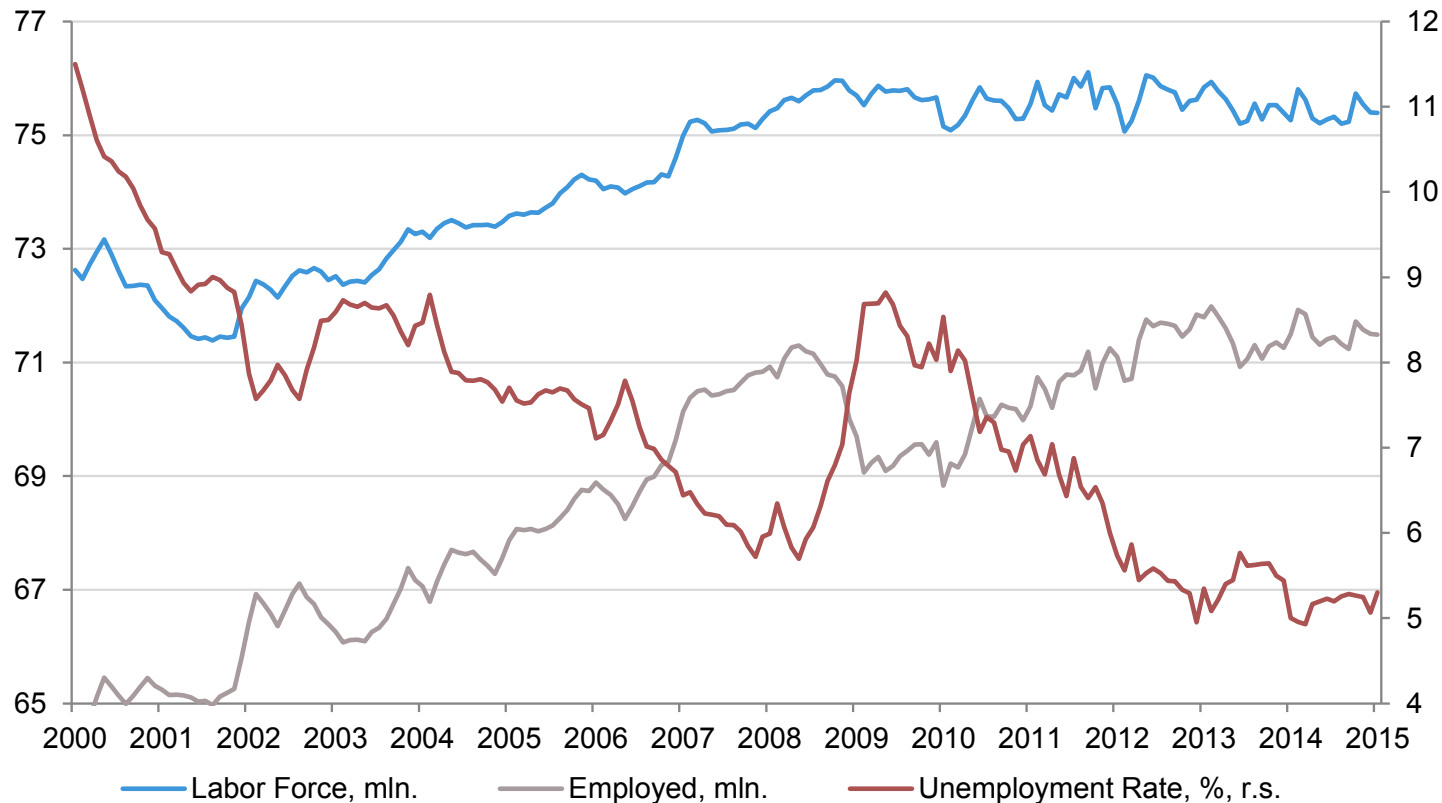


Source: Rosstat

Current Situation: Labor Market

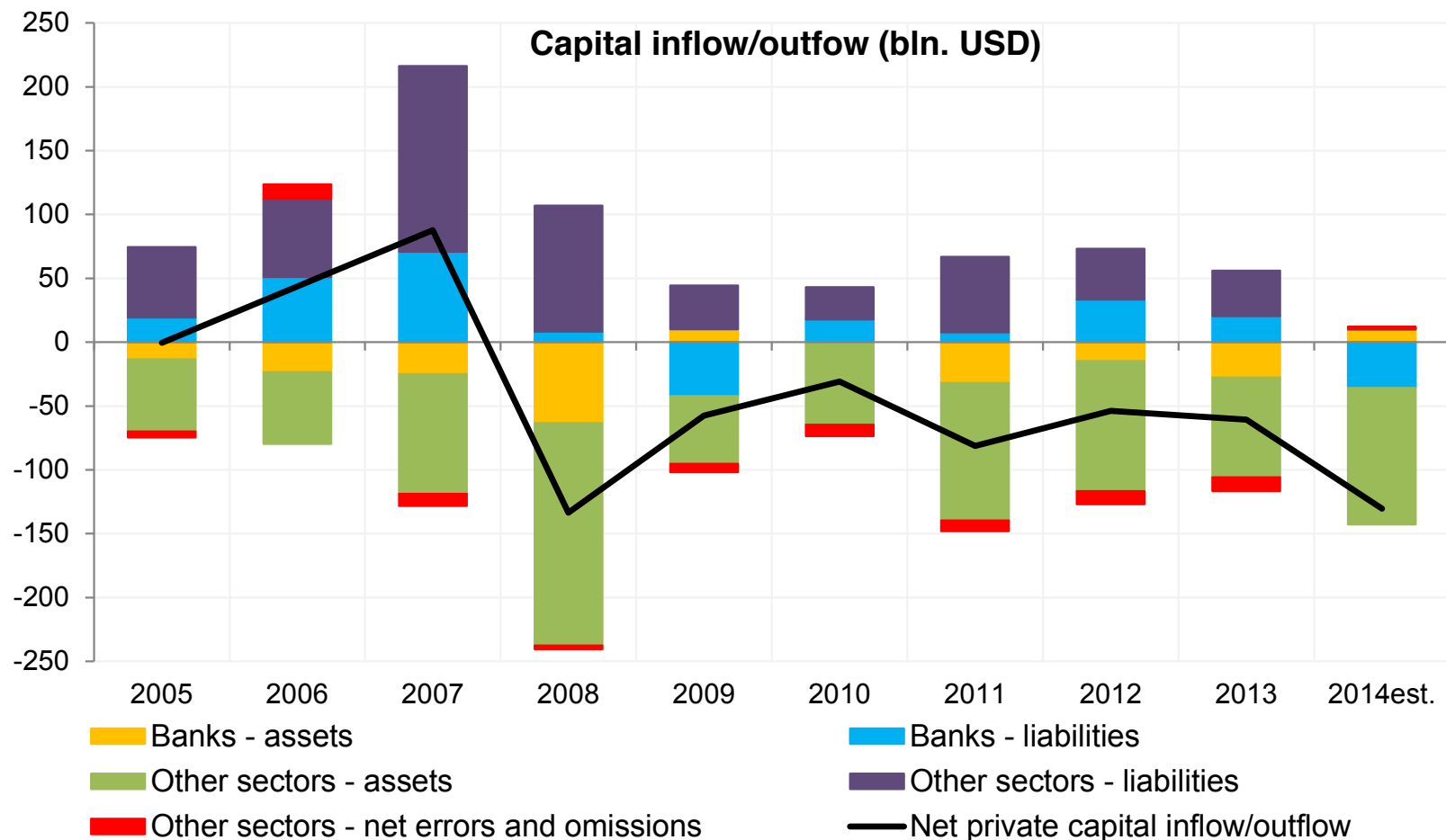
- Estimated 95% confidence interval for NAIRU is [5,6%; 7,7%]. Actual NSA Unemployment Rate in January'2015 is 5.5%

- LFP rate was 67.1% in 2007 vs. 69.4% in 2014



Source: Rosstat, Tramo-Seats SA by Bank of Russia

Current Situation: Capital Outflow and Reserves



Note: figures are adjusted to account for FX swaps and other FX liquidity-providing operations of the Bank of Russia and balances in credit institutions' accounts with the Bank of Russia

Source: CBR

The Central Bank of The Russian Federation

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