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Ruble Up, But Demand Suffers From Uncertainty

By The Moscow Times

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The ruble, which capped its best year against the Central Bank's target dollar-euro basket since before the credit crisis, underperformed major commodity-linked currencies as lower interest rates and the ouster of Moscow's mayor eroded demand for Russia's currency.

The ruble gained 2.3 percent in 2010 versus the basket used to manage swings that disadvantaged exporters last year, the most since 2006 when it added 3.3 percent. The advance was driven by gains against the euro, with the ruble snapping four years of declines against the common currency to strengthen 6.7 percent, the biggest annual advance since at least 2004, according to data compiled by Bloomberg. The ruble weakened 0.9 percent against the dollar in 2010, the third straight yearly drop.

The currency lagged behind major commodity currencies even amid a 14 percent rise in crude oil, which along with natural gas makes up about a quarter of the country's economic output. Australia's dollar surged 13 percent versus the greenback, the South African rand added 11 percent and Brazil's real strengthened 4.8 percent.

The ruble "underperformed" this year because of Russia's comparatively lower interest rates and amid local political concerns, said Bartosz Pawlowski, head of currency and interest rates strategy for Central and Eastern Europe, the Middle East and Africa at BNP Paribas. The dismissal of Mayor Yury Luzhkov spurred Russians to convert their holdings, he said.

In the last day of official trading on MICEX last year, the currency weakened 0.3 percent to 30.57 per dollar by the 5 p.m. close. It slid versus the euro, tumbling 1.6 percent to 40.70. Those movements left it 0.9 percent weaker at 35.13 against the basket, which is calculated by multiplying the dollar-ruble rate by 0.55, the euro-ruble rate by 0.45, then adding them together.

BNP expects the ruble to appreciate 3.3 percent this year as rising benchmark interest rates make Russian yields more attractive to carry traders, and oil prices above $90 a barrel bolster the nation's current account. It will strengthen to 34 versus the basket by the end of 2011, Pawlowski said.

Traders are pricing in a 0.87 percentage point increase in Russian interest rates in the next three months, according to forward rate agreements, after the Central Bank raised the deposit rate by 0.25 percentage point to 2.75 percent at its Dec. 24 review. Inflation, which was at an 11-month high of 8.1 percent in November, will spur the Central Bank to raise all of its key rates in the first quarter, German Gref, chief executive officer of Sberbank, said at the end of last month.

The Central Bank and the government agree on the regulator's management regime for the ruble and both think a free-floating currency is "desirable," Prime Minister Vladimir Putin said at the end of December.

Estonia on Jan. 1 became the 17th country and the first former Soviet republic to join the euro zone, putting at least a temporary cap on the currency bloc's expansion as the sovereign debt crisis ripples through Europe.

Debt estimated by the European Union at 8 percent of gross domestic product in 2010 will make Estonia the most fiscally sound country in a currency bloc plagued by budget woes that forced Greece and Ireland to fall back on European and International Monetary Fund aid.

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