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Central Bank Raises Deposit Rate to 3.5%

By The Moscow Times

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The Central Bank surprised markets by raising its deposit rate on Monday, with Chairman Sergei Ignatyev citing a weekend decision to lift a grain export ban as a risk factor for inflation.

The hike in the deposit rate, the Central Bank's main tool for influencing money-market rates and liquidity, also reflects concern over capital outflows that have exceeded $50 billion in the past seven months despite oil prices over $100 per barrel.

The bank raised its overnight deposit rate by 25 basis points to 3.5 percent. However, it held its refinancing rate at 8.25 percent and repo rate at 5.5 percent, and indicated that current rates will "be acceptable" in coming months.

"The decision was made taking into account still-high inflation expectations and risks to steady economic growth," the Central Bank said in a statement.

"The achieved level of interest rates is seen by the Central Bank as securing an acceptable balance between risks that inflationary pressure will persist and that economic growth will slow in the coming months," the bank said.

April's mixed economic data, which showed higher unemployment, slower industrial output growth and "extremely low" capital investment, indicate that "substantial risks to steady economic growth remain," the Central Bank said.

The ruble inched up, firming to 33.4 versus the euro-dollar basket targeted by the Central Bank from 33.47, but staying in a tight range as players were wary of making new bets while markets in London and New York were closed for holidays.

Most analysts polled by Reuters had expected the bank to keep all interest rates unchanged due to the slowing pace of recovery. Ignatyev said last week that the Central Bank was "in no hurry to raise rates and reserve requirements." He struck a different note on Monday, however, describing the lifting of the grain export ban as "a significant risk factor."

Annual inflation, at 9.7 percent as of May 23, is a major issue ahead of parliamentary elections in December and a presidential election in March 2012, and analysts still expect the Central Bank to raise interest rates later this year.

Prices on the domestic grain market, depressed by the export ban, had already started rising in anticipation of its lifting and are seen by sector experts going up further.

Analysts also said the hike in deposit rates reflected an attempt by the Central Bank to staunch capital outflows that largely result from loose monetary policy, although Russia's negative image among some investors also plays a role.

"Low deposit rates facilitate capital outflows, which policymakers are not happy about," said Aurelija Augulyte, an analyst at Nordea Bank.

Russian rates remain too low to attract inflows from carry trades, where investors borrow in low-interest currencies and seek a yield advantage by investing in currencies offering a higher return, economists say.

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