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Central Bank Cuts Refinancing Rate

By The Moscow Times

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The Central Bank cut its refinancing rate and raised the deposit rate, but left its key one-day repo rate unchanged in a decision it said was "neutral" for the conduct of monetary policy.

The decision made at the end of last week to narrow its interest rate "corridor" brings the regulator a step closer to full-blown inflation targeting, a policy regime in which interest-rate policy assumes priority over its previous focus on exchange rates.

It also seeks to calm volatility on money markets, where lending rates have been forced up as investors, unsettled by political uncertainty after this month's parliamentary elections and the euro-zone crisis, have moved money out of the country.

In the surprise move, the Central Bank eased its largely symbolic refinancing rate by a quarter point to 8 percent and raised its deposit rate, also by 25 basis points, to 4 percent.

But it left its one-day repo rate — currently its key policy rate — unchanged at 5.25 percent.

Yaroslav Lissovolik , chief economist at Deutsche Bank, called the decision bullish for the ruble as it would help mop up an expected rise in liquidity resulting from the government's traditional year-end spending splurge.

"The hike in the deposit rate ... could help to sterilize liquidity when its amount increases after year-end money inflows from the budget," he said, adding that the refinancing-rate cut signaled confidence over the inflation outlook.

In a statement, the Central Bank described its decision to narrow its broad interest-rate corridor as "neutral with regard to the direction of monetary policy."

"It should facilitate a reduction of volatility in money-market rates and strengthen the effectiveness of the interest-rate channel of monetary policy in terms of its final goal of inflation targeting," the statement added.

Most economists surveyed by Reuters had expected the Central Bank to keep interest rates on hold this month, amid accelerating capital outflows linked to popular protests against alleged fraud in the Dec. 4 elections.

The regulator has been keeping its liquidity provision tight so as not to fuel capital flight, and analysts said the deposit-rate hike marked an attempt to make the policy rate more relevant.

"The decision to raise deposit rates will give the Central Bank better control over liquidity in the banking system in the first quarter of 2012," said Alexander Ovchinnikov , an analyst at Troika Dialog in Moscow .

Analysts surveyed by Reuters before the rate decision had said a benign inflation outlook may enable the Central Bank to ease its most market-relevant repo rate by 25 to 50 basis points in early 2012.

"A cut in the refinancing rate signals that inflation is under control, and now the focus will be turning toward economic growth," said Stanislav Yarushevichus , chief dealer at ING in Moscow .

In its policy assessment, the Central Bank noted that the annual rate of inflation had fallen to 6.4 percent as of Dec. 19, down from 6.8 percent at the end of November.

Delays to annual hikes of household utility bills would result in a "significant" drop in inflation in early 2012, although this would be temporary in nature, the regulator said.

The country's economy was being supported by strong consumer demand, while growth in the productive sector was moderate, the Central Bank said, with growth in industrial production low and capital investment slowing.

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