

## **Economists Warn Central Bank on Over-Reaction**

By **Howard Amos** 

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The Central Bank building on Neglinnaya Ulitsa in the city center. Maxim Stulov

The Central Bank must avoid overreacting to food price volatility as drought conditions spread in grain growing regions, fueling inflation fears, a top investment bank warned Tuesday.

Prices have already risen in the country's southern regions as scorching weather blights the harvest, prompting economists to highlight the risk of food price inflation feeding into the headline inflation rate and rendering the Central Bank's inflation target of 5 to 6 percent this year a fantasy.

"It is not central banks' job to fight a bad harvest [with interest rate hikes]," warned Ivan Tchakarov, chief economist at Renaissance Capital in Moscow in a note to investors Tuesday. "A mature inflation-targeting central bank should be able to see through temporary supplydriven food price increases."

The Russian Central Bank has left interest rates untouched since December, but speculation is rising that it could implement rate hikes at its next meeting to burnish its credentials as a serious inflation-fighting body.

"The monetary authorities are in a hawkish mood these days," said Alexander Morozov, chief Russian economist at HSBC in a report released last week. "We expect 75 base points of cumulative rate hikes in August, October, and December 2012."

Central Bank officials remain confident that the 5 to 6 percent inflation target will be met. "We have enough of a foundation to suppose that we will keep within this target band," Deputy Central Bank Chairman Sergei Shvetsov said on July 3. "We are sure that we will end the year in the target band."

Inflation last year was kept to 6.1 percent, a post-Soviet record, but utility price rises and a weaker ruble have been stoking consumer price growth in recent months. Inflation on July 9 was 5 percent higher than the same time the year before, the Central Bank said.

That figure is set to rise to between 6.6 percent and 6.8 percent by the end of 2012 and to 7 percent by the first quarter of 2013, according to a Friday note to investors by ING economist Dmitry Polevoy.

The exact size of the harvest, which will determine the impact of food prices on inflation, is not yet clear. But official forecasts were downgraded to below 80 million tons last week.

Harvest yields are almost 30 percent lower than in 2010, Prime Minister Dmitry Medvedev said Tuesday, RIA-Novosti reported.

One eventuality that might help take rate rises off the table is an economic slowdown, but without any dramatic external shocks this is unlikely to happen quickly enough to influence the Central Bank's imminent decision.

"We disagree with the Central Bank's objective of targeting year-end headline inflation," HSBC's Morozov wrote. "This means, in effect, that food prices [will] be determining policy rates in Russia, rather than the Central Bank."

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