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Central Bank Defends Hawkish Stance

By The Moscow Times

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The Central Bank stepped up its defense of its reluctance to ease policy, offering more insight Wednesday into the methods it uses to set interest rates and describing its current stance as neutral.

Under political pressure to cut rates in response to slowing growth and tightening credit, the Central Bank said financial conditions are "neutral" and Russia's growth rate is in line with potential.

"The monetary gap, it is neutral," first deputy chairman Alexei Ulyukayev told reporters Wednesday. "We don't see a significant gap between potential growth and actual growth. In this sense, we consider monetary policy neutral considering the risks."

He also said inflation could fall within the Central Bank's target range of 5 to 6 percent in the second quarter of this year, despite a spike in January to 7.1 percent.

Ulyukayev, a leading contender to replace outgoing chairman Sergei Ignatyev in June, emphasized the Central Bank's independent thinking at a presentation of its first quarterly monetary policy report.

The Central Bank is making greater efforts to communicate its rationale for keeping key interest rates on hold since September. Government leaders have called for monetary easing to revive flagging growth.

The bank is seeking to complete a shift toward Western-style inflation targeting and away from a focus on the exchange rate, instead steering inflation expectations and fine-tuning interest rates.

As it tries to make monetary policy more predictable and systematic, the bank has for the first time published two of the key indicators — often referenced by Western central banks — it uses to make its rate call each month.

"In this text we show the recipe for how we make decisions," Ulyukayev said, highlighting sections of the report that measure the monetary and output gaps.

The Central Bank uses an index of financial conditions that is designed to show how far conditions in the financial sector are impeding or encouraging economic growth.

This measure — a composite indicator combining factors such as interest rates, money supply trends, the level of the exchange rate and the stock market — was just below zero as of last November but has trended positive since mid-2012.

The bank interprets this as contradicting recent comments by officials, bankers and businessmen that the Central Bank's interest rate policies are contributing to a marked economic slowdown.

The bank also looks at the output gap, the difference between current economic output and the potential level. It says this gap had shrunk from more than 6 percent of GDP in 2009 to zero at the end of last year, implying that easing monetary conditions right now would stoke inflation, and not growth.

Hinting at a possible compromise, Ulyukayev said the Central Bank would discuss bringing its 8.25 percent refinancing rate, which is largely symbolic, closer in line with its main policy rates.

"Such a prospect exists, not only for macroeconomic reasons. The refinancing rate, as you know, isn't a key policy rate but is more of a historical one," he said.

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