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# Central Bank Keeps Rates on Hold, But Future Easing Looms

By The Moscow Times

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The Central Bank signaled policy easing ahead on Friday and introduced a new mechanism for long-term bank funding to try and boost lending, while keeping interest rates on hold for now.

Despite pressure from the Kremlin to cut rates to boost Russia's economy, which is growing at its slowest pace in four years, the bank left its main policy rate, the one-day minimum auction repo rate, at 5.5 percent for the 10th month in a row.

It was the first policy meeting since former Kremlin economic aide Elvira Nabiullina became the bank's chairwoman, a change many analysts predict may tilt the bank towards a less hawkish stance than under predecessor Sergei Ignatyev.

The economy grew just 1.6 percent in the first quarter from a year earlier and President Vladimir Putin has instructed government and central bank officials to come up with ways to ensure the flow of more affordable credit.

The government forecasts economic growth of 2.4 percent this year, well down on 3.4 percent last year.

However, with inflation running at 6.9 percent in June, above the Central Bank's 5 to 6 percent target range, the regulator is reluctant to cut rates just yet.

In an innovation that underscores her commitment to better communication, Nabiullina gave a press conference shortly after the decision to leave rates on hold.

While reiterating her predecessor's commitment to bring down inflation, she also said that the economy was growing below potential, implying that there was room to ease policy.

"The Bank of Russia estimates that this small negative output gap will continue during the course of the year, which signifies the absence of inflationary pressure from demand," she said.

A policy statement accompanying the bank's decision to hold rates also contained dovish rhetoric that many analysts believe presages interest rate cuts.

The bank said that "risks of economic slowdown remain given the weak investment activity and the sluggish recovery in external demand," while predicting that inflation would fall within the bank's target range by the end of the year.

"The comments on the decision were quite dovish, which have strengthened our confidence that the turnaround to monetary easing is coming very soon," BNP analyst Julia Tsepliaeva said in a note.

The ruble firmed briefly after the statement but then erased its gains to trade down 0.2 percent versus the dollar-euro basket at 1200 GMT.

## New Mechanism

In another sign that Nabiullina is keen to heed Putin's call for monetary measures to boost growth, the Central Bank introduced a new mechanism for long-term financing of banks.

It announced the launch of auctions for loans secured against non-market assets and guarantees, for 12 months with a floating rate initially set at 5.75 percent, determined as a spread of 0.25 percent over the minimum repo rate.

"What is more important than their outlook for rates and inflation is their decision to introduce this long-term funding," said Vladimir Osakovsky, Russia economist for Bank of America Merrill Lynch. "It effectively represents a 175 basis point cut for one-year operations."

The first auction will be held this month. Russian banks until now could borrow from the Central Bank for one-year against similar illiquid collateral at 7.5 percent.

However, Central Bank deputy chairman Sergei Shvetsov played down suggestions that the new instrument would greatly increase the volume of Central Bank financing for banks.

"The instrument is not aimed at an increase in refinancing, but is aimed at substituting for the weekly repo and freeing collateral which will be used on the interbank market," he told reporters.

In another move on Friday, the Central Bank postponed implementation of the Basel III framework of capital adequacy rules for banks by three months to Jan. 1, 2014.

Initially, the central bank wanted to enforce the new rules — designed to strengthen the ability of banks to withstand financial shocks — as of Oct. 1.

Under Basel III, banks would be required to maintain a minimum core Tier 1 capital adequacy ratio of 5 percent, Tier 1 capital at 5.5 percent and total capital adequacy at 10 percent of risk-weighted assets.