

Central Bank's Credibility at Stake

By [The Moscow Times](#)

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President Vladimir Putin's engagement in Ukraine threatens to divert Russia's Central Bank from its goals of reducing inflation and free-floating the ruble, undermining the credibility it has built up.

The Central Bank has been operating in emergency mode since Putin's declaration of his right to invade Ukraine and his implicit support for Crimea's plans to join Russia.

Worried investors have sold the ruble and moved money abroad, forcing the regulator to raise interest rates to stem capital flight and spend \$15 billion to defend the currency, a distraction from fighting inflation.

While the bank does not enjoy as much latitude as its Western counterparts, it has built up a reputation for steady economic management and is seen by analysts as the most autonomous institution in modern Russia.

With the West considering sanctions that could isolate Russia and tip the economy

into recession, the crisis in Ukraine could hurt the central bank and the reputation of its boss, Elvira Nabiullina, a Putin protege.

"Should events deteriorate, the Central Bank is unlikely to maintain its status quo," said Dmitry Polevoy, an economist at ING Bank in Moscow.

The Central Bank is aiming to shift to an inflation-targeting policy regime and a flexible exchange rate from 2015. The ruble currently trades in a managed band tied to a dollar-euro basket.

Before this can happen, the regulator must establish it is capable of fighting inflation but events in Ukraine have forced it to focus instead on another key goal — preserving financial stability.

The ruble has fallen 10 percent against the dollar so far this year, which may push up inflation and make the year-end target of 5 percent harder to reach.

Allowing more ruble flexibility when investors are trying to sell the currency would also be a risky strategy.

"The Ukrainian crisis has left the central bank with no choice but to postpone plans to increase the flexibility of the ruble," said Vladimir Kolychev, an analyst at VTB Capital in Moscow.

Limited Choices

When Putin picked Nabiullina to run the bank a year ago, critics expected her to pursue a more dovish course than her predecessor Sergei Ignatyev, who cut inflation to single digits during his 11 years as chairman.

But Nabiullina has surprised many, managing to establish herself as a credible inflation fighter, withstanding pressure to cut rates to aid the stagnating economy and insisting the Central Bank will let the ruble float freely as of next year.

Her efforts may soon come to nothing.

"The Central Bank has had to adopt a new strategy from the open, noninterventionist, mantra it had been sticking to ahead of the planned full deregulation at the end of the year," said Chris Weafer, an analyst at Macro-Advisory in Moscow.

The Central Bank says its plans have not changed and when markets return to normal it will refocus on its goals.

"After normalization of the situation on financial markets, the Central Bank intends to continue the implementation of measures to shift to a floating exchange rate and inflation targeting," the Central Bank said on March 3.

But a central bank's ability to choose policies is seen as crucial for ensuring a country's long-term economic wellbeing.

"After the model of the German Bundesbank, an independent central bank is widely seen as a guarantee of monetary stability and low inflation," said Anders Aslund, a senior fellow at the Peterson Institute for International Economics in Washington, who served in the past as an adviser to Russia.

Analysts are worried that should economic sanctions materialize or the regional conflict broaden, a major economic crisis could emerge, leaving the Central Bank with few options but to focus on financial stability at the expense of other goals.

"Then, it will be important to keep the banking system from collapsing and the population and firms from hurrying to withdraw their funds," ING's Polevoy said.

"In such a situation hardly anyone will think about inflation at the end of the year, or how to save face as a regulator, or the trustworthiness that the Central Bank has gradually earned."

Turning Point

Many analysts say tensions should ease following a May 25 presidential election in Ukraine after Crimea is expected to decide in a referendum on Sunday to join Russia.

But the crisis has further exposed the hazards of institution-building in a country where power has become increasingly centralized and unpredictable.

Former Central Banker and Finance Ministry official Sergei Aleksashenko, now an outspoken critic of the Kremlin, says the Central Bank, although far from having a fully free hand, is still the country's most independent institution.

"It is not because Putin understand its importance but because he recognizes that the Central Bank of Russia is extremely difficult to be managed and requires a lot of professionalism," Aleksashenko said.

Nevertheless he said Putin was damaging Russia's institutions.

"That creates a very unstable system without checks and balances that will collapse. It is only a question of time."

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