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Russia's Central Bank Says Inflation Will Fall Despite Ukraine Shocks

By The Moscow Times

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Russia's Central Bank can achieve low inflation despite economic shocks from the Ukraine crisis, the bank's Deputy Governor Ksenia Yudayeva said Wednesday.

She was cautious about economic growth, though, arguing that low growth was a serious structural problem facing the country that monetary policy was largely powerless to solve. The best the bank could do to help, she said, was to boost the confidence of long-term savers by bringing inflation under control.

Yudayeva, the bank's head of monetary policy, said the bank could reduce inflation to 4 percent by 2016-17, despite a spike this year that has pushed it well above target.

"The inflationary shocks that we have this year have a temporary character," she told the Reuters Russia Investment Summit.

Inflation is running just below 8 percent, well above the bank's 5 percent target for this year, partly as a result of an embargo on many food imports in retaliation for Western sanctions over Russia's policies in Ukraine.

Prices have also picked up as a result of a weaker ruble, but Yudayeva believed the market was underestimating the currency's worth. "Now the exchange rate is obviously undervalued," she said.

Although rising prices largely reflect factors outside the bank's control, Yudayeva said the failure to hit the target for a second year running reflected badly on policymakers.

"A significant challenge for us now is definitely the lack of a reputation of a Central Bank that is able to meet targets," she said. "This is a problem of Russia. Society is continually afraid that inflation will get out of control."

Yudayeva said it was uncertain whether the bank would hit next year's inflation target of 4.5 percent, with much depending on how long Western sanctions on Russia remain in place.

But the outlook was clearer for subsequent years, when the bank aims to reduce inflation to 4 percent.

"If we look at inflation in 2016-17 considering the factors we're talking about now, the situation is a lot clearer," she said. "Now, according to our forecasts, we can undoubtedly meet our medium-term goals."

Dovish Shift?

Faced with bouts of currency market turmoil as a result of the Ukraine crisis, the bank has raised interest rates three times this year, leading to criticism that it is being too aggressive in its determination to reduce inflation.

But the Central Bank left rates on hold this month even though inflation remained above target, leading some analysts to detect a "dovish" shift in its policy.

Yudayeva, however, said the bank's basic philosophy and objectives had not changed.

"The central challenge now is not to lose control of inflation, to prove that it is under control," she said.

By reassuring long-term investors, low inflation would help boost long-term savings, creating domestic sources of capital that would reduce Russia's excessive reliance on external financial markets, she said.

She rejected criticisms — including from within the Russian government — that the bank should be supporting economic growth by softening its monetary policy.

"Our view is that the falling economic growth that we now see has a structural character," she said, citing factors such as demographic trends, a weak investment climate, and a rising debt burden on households and companies.

"If [structural problems] aren't solved, softening monetary policy will lead not to faster economic growth, but inflation."

Still, the economic growth crunch was the biggest problem for Russia and a major concern for the Central Bank, she said.

"The fact that the Central Bank can't deal with it through monetary policy doesn't mean that we aren't worried about this problem, and it deserves serious attention," she said.

Financial Shocks

Despite setbacks in its fight against inflation, the Central Bank has gained kudos from markets and analysts for its ability to weather financial shocks caused by the Ukraine crisis.

The World Bank commended the Central Bank on Wednesday for shifting its policy to inflation targeting from next year.

Yudayeva said that steps to allow the ruble to float were back on track, after serious currency market jitters earlier in the year, which led many analysts to expect a delay.

Last month, markets reacted calmly when the Central Bank abolished currency market interventions until the ruble is at the edge of its corridor against a dollar-euro basket. The corridor will be scrapped altogether by the start of next year.

"We think we have acquired definite experience," Yudayeva said. "We will act in a way that there won't be a substantial influence on the market, as with the changes to the [intervention] parameters that took place this summer."

The relative market calm contrasts with the situation in March, when the Central Bank introduced temporary emergency measures enabling it to intervene heavily to defend the ruble, preventing more serious financial fallout.

More recently, too, the bank has responded flexibly to market conditions, with an innovative forex swap facility to meet a shortage of dollars.

Despite its new hands-off role in the currency markets, the bank stands ready to adopt similar tailor-made measures in future, Yudayeva said.

"If we see definite tendencies, definite indicators, showing that problems are forming on markets that could potentially destabilize them, then the Central Bank will discuss precisely what measures are necessary for securing financial stability," she said.

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