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Specter of '98 Default Haunts Russians as Ruble Weakens

By Howard Amos

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Russians have so far remained calm as Western sanctions, an economic slowdown and falling oil prices have slashed the value of the ruble

As the Russian ruble plunges to repeated record lows and the Central Bank ramps up market interventions to defend it, few want to mention Aug. 17, 1998.

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On that day, amid budgetary chaos and dwindling foreign currency reserves, Russia abandoned its support of the ruble and announced a default, prompting panic on the streets and sending the currency on its way to a 75 percent devaluation by the year's end.

Experts point to substantial differences between 1998 and today — including large foreign currency reserves, a relatively high oil price and a healthy budget — but the memory of those traumatic months still haunts both policymakers and ordinary Russians, who have watched the value of ruble plummet over 20 percent against the U.S. dollar since January.

Government and Central Bank officials are likely to be watching closely for any sign of spiking demand for foreign currency on the streets, said Sergei Aleksashenko, a prominent economist who was a deputy chairman at the Central Bank in 1998.

“Household panics can emerge in any country and at any moment: You cannot predict them or prevent them,” Aleksashenko said.

$40 Billion Panic

Any mass move by Russians to convert rubles into dollars would exacerbate pressure on the currency, analysts told The Moscow Times.

“If people start panicking, it will be very difficult for the Central Bank to stop,” said Dmitry Polevoy, chief economist for ING Bank in Moscow. “This is the key risk that could further complicate the situation with the exchange rate.”

About 1.6 trillion rubles ($40 billion) held by the Russian population could be converted into foreign currency if a run on the ruble begins, according to Sergei Pukhov, an economist at the Higher School of Economics — almost as much as the Central Bank has thrown into its long rearguard action against the ruble's slide since the start of the year.

Record-Breaking Ruble

The Russian currency fell to new historic lows Friday — the latest in a series of such records as the oil price has tumbled to four-year lows and Western sanctions on Moscow over its actions in Ukraine continue to bite.

The ruble passed the rate of 41 per U.S. dollar for the third time this week during Friday morning trading and touched a record low of 52.59 against the euro.

The battered Russian currency has lost 17.6 percent of its value against the greenback in the last three months alone.

Almost a third of 30 currency exchanges contacted had no dollars, business daily Vedomosti reported on Oct. 9. But such supply problems have not become systemic.

“It's just a matter of logistics, and if they want dollars they can fly them in,” said one Western banker in Moscow, who requested anonymity because he was not authorized to talk to the media.

‘No-One Is Buying Anything’

At four exchange points in downtown Moscow over the weekend workers said that there was no unusually high demand for dollars or euros.

There is actually even less demand than usual, said Elena, who was working at an exchange point on Ulitsa Krasnaya Presnya.

“Everything’s very expensive, no-one is buying anything,” she said.

At another exchange point by Mayakovskaya metro station, Natalya, who had worked in the industry for 20 years, said that everything was quiet. “People are tired now,” she said. “But back then [in the1990s] there was public excitement and when something was announced on TV people would run to buy currency.”

Past Crises

It is almost impossible to identify the triggers for a popular loss of confidence in a currency, making such an event very hard to foresee, analysts said.

Those present in Russia during the 1998 default recalled the speed with which events unfolded.

“It was really sudden, and it did feel as though it came out of nowhere,” said Chloe Arnold, then a reporter for The Moscow Times. “I remember long lines of people at banks and post offices.”

Extended ruble weakness, however, is not necessarily a trigger for panic: During the financial crisis in 2008 the ruble plummeted 44 percent against the dollar, and the Central Bank burned through about $200 billion of its foreign currency reserves — but there were never queues at exchange points.

The Corridor

Just as in 1998, Russia's Central Bank currently has a policy of intervening on the market by selling foreign currency to curb the ruble's fall. The regulator sets a trading corridor for the ruble and when the exchange rate butts up against the upper edge it sells foreign currency, shifting the range by 5 kopeks every time $350 million is sold.

While Russia has spent over $50 billion propping up the ruble this year, and over $10 billion this month alone, the Central Bank is in a significantly stronger position than 16 years ago, when the country simply ran out of reserves.

Russia had $451.7 billion worth of foreign currency on Oct. 10, according to the latest data on the Central Bank's website.

“There are enough reserves to adjust the level of the national currency,” President Vladimir Putin told reporters Friday.

Manipulating currency markets still carries risks, however. Former Finance Minister Alexei Kudrin, who was working as a deputy minister in the Finance Ministry in 1998, warned on Friday of the dangers associated with pegging the ruble.

An artificially high exchange rate, he wrote in Kommersant newspaper, was an important factor in both 1998 in Russia and Belarus in 2011.

Belarus suffered a painful default three years ago after burning through billions of dollars of foreign reserves in a fruitless attempt to shore up its currency.

Crisis Options

Russia moved this week to increase the circulation of foreign currency through the domestic financial system when the Finance Ministry said it would offer banks the chance to take part in foreign exchange deposit auctions later this month. Many experts also expect the Central Bank to raise interest rates.

But such conventional methods would be of little use in the case of a mass flight from the ruble, and the Central Bank could be forced to use extreme measures such as capital controls.

“If households panic, they will not be thinking about the interest rate,” said ING's Polevoy.

The Central Bank would either have to rapidly spend its reserves or pull back, allowing the currency to sharply devalue, said former central banker Aleksashenko.

“If the Central Bank leaves the market, the ruble would fall 10 to 30 percent,” he said.

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