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Interest Rate Hike Fails to Relieve Pressure on Russia's Ruble

By The Moscow Times

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The Russian Central Bank's recent interest rate hike significantly exceeded analysts' expectations, but the bold decision may not be enough to tackle the sliding ruble and climbing inflation as plunging global oil prices and Western sanctions hurt the economy.

The bank said Friday that it had not changed its ruble exchange rate intervention policy, confounding speculation that it might use that day's meeting to announce changes that would have enabled a stronger defense of the ruble.

The 1.5 percentage point increase, which takes the one-week minimum auction repo rate to 9.5 percent, compares with analysts' forecasts of a half-point rise in a Reuters poll earlier in the week.

The Central Bank's decision brings the cumulative increase this year to four percentage points, despite the economy's weakness.

"This represents a pretty bold move by [the Central Bank] to regain the initiative, having been faced with a collapse of their currency," said Neil Shearing, chief emerging markets economist at Capital Economics. "The question is will it work?"

"I expect the market will keep testing the Central Bank. A consequence of this will be continued ruble weakness," Shearing said.

In a separate statement, the bank told Reuters that it had not changed its exchange rate intervention policy, which involves keeping the currency within a nine-ruble-wide band against a dollar-euro basket. The bank plans to scrap the band at the end of this year when it floats the ruble.

There had been speculation that the bank might use Friday's meeting to scrap the band ahead of schedule, or bring in a more discretionary policy that would enable bigger interventions.

"My concern is that the pressure on the ruble that we saw before this was hardly the result of interest rates being too low," said VTB Capital economist Vladimir Kolychev. "I very much want to believe that this [rate rise] will help the ruble. If not, then the Central Bank will have to change its exchange rate policy."

The Central Bank has been under pressure to raise rates to defend the ruble, which has shed around 20 percent against the dollar since mid-year due to falling prices of oil, a major export earner, and the sanctions imposed over Russia's actions in Ukraine.

The move appeared to do little to buttress the Russian currency, even though higher rates should make it more attractive to hold deposits and other instruments in rubles. The ruble continued to weaken over the long holiday weekend, falling to 43.67 at 6:25 p.m. on Tuesday.

The ruble had already fallen past 43 to the dollar on Friday, following a surprise 3 percent rally on Thursday which traders had linked to rumors over an agreement between Russia and Ukraine over Crimea, which Moscow annexed in March.

While no such agreement has materialized, Ukraine, Russia and the European Union signed a deal on Thursday under which Moscow will resume gas supplies to its ex-Soviet neighbor.

Standard Bank analyst Timothy Ash said Friday's rise would probably not be enough. "Market reaction suggests that they will need to do more — which could well push the Russian economy formally into recession," he said in a note to clients.

"Long term it is unlikely to stop the rot, given the underlying drivers for ruble weakness which the rate hike does not help ... structural weaknesses in the economy, sanctions, strains in the relationship with the West, and lower oil prices."

High Inflation

In an earlier statement explaining its rate decision, the Central Bank said annual inflation in September and October had increased more rapidly than expected, reaching 8.4 percent as of Oct. 27. It expected inflation to remain above 8 percent until the end of the first quarter of 2015.

The bank also cited "significant changes in external conditions" since its last rates meeting on Sept. 12, referring to a "considerable fall in oil prices and stricter sanctions imposed by certain countries against several large Russian companies."

The bank said that higher inflation was the result of the weaker ruble, as well as Russian counter-sanctions which have banned the import of many Western food products. It expected inflation to decline as the economy gradually adjusts to these factors, but this would be slower than previously expected.

"If external conditions improve, and a persistent trend for lowering inflation and inflation expectations emerges, the Central Bank will be ready to start to ease its monetary policy," the bank said in its statement.

The bank also said it expected economic growth to be close to zero in the fourth quarter of this year and in the first quarter of next year. However, it said the weak economy was having only a limited downward impact on inflation as slow growth was the result of structural factors.

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