



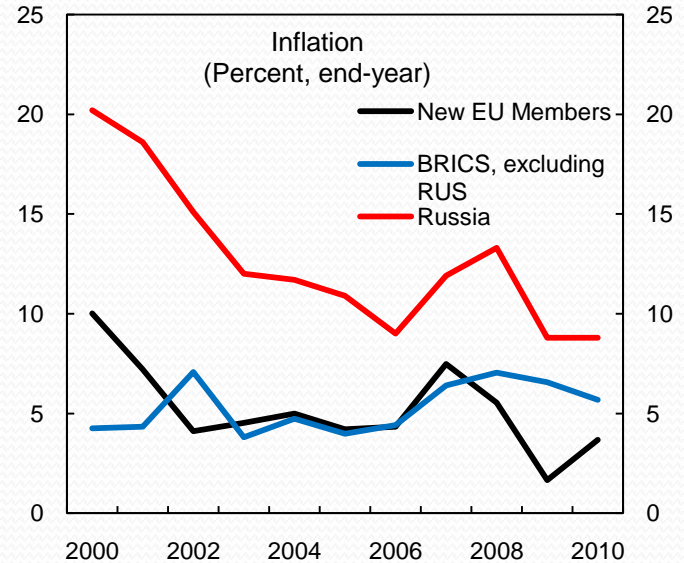
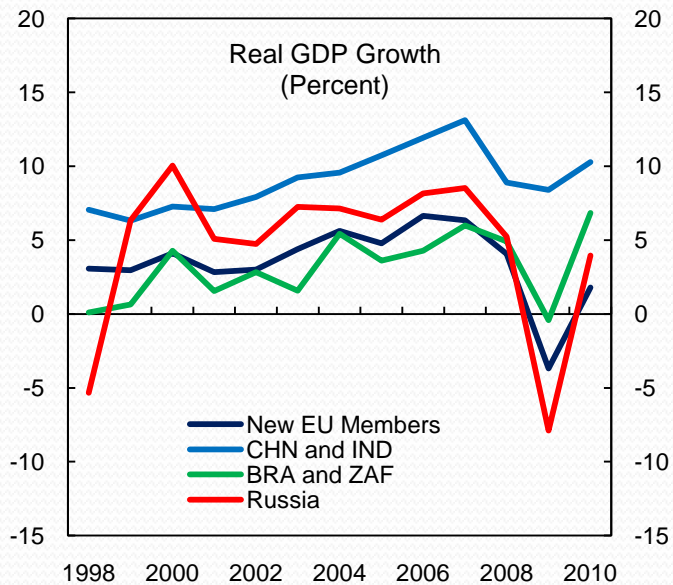
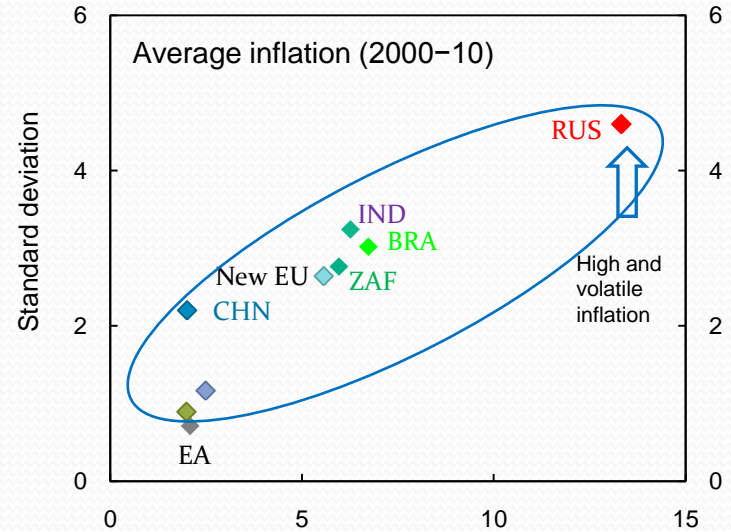
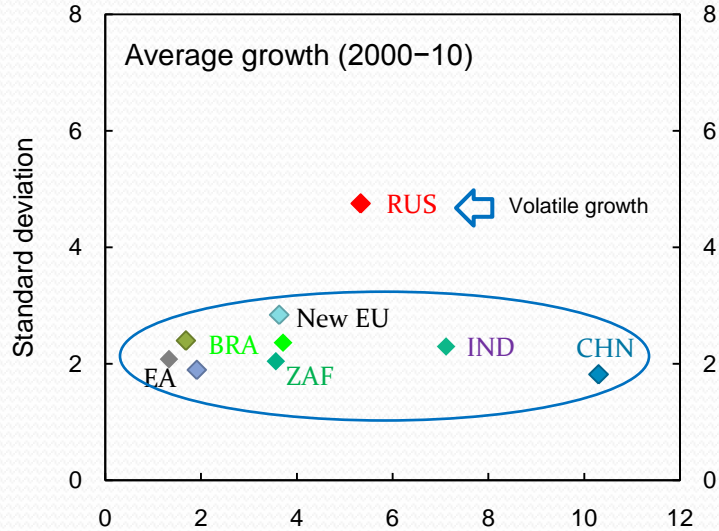
Russia's Move Towards Inflation Targeting

Odd Per Brekk
Senior Resident Representative
September 14, 2011

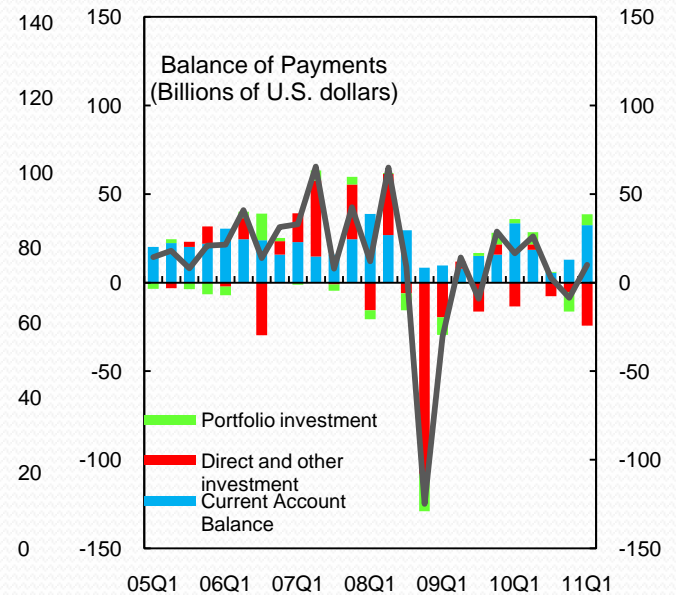
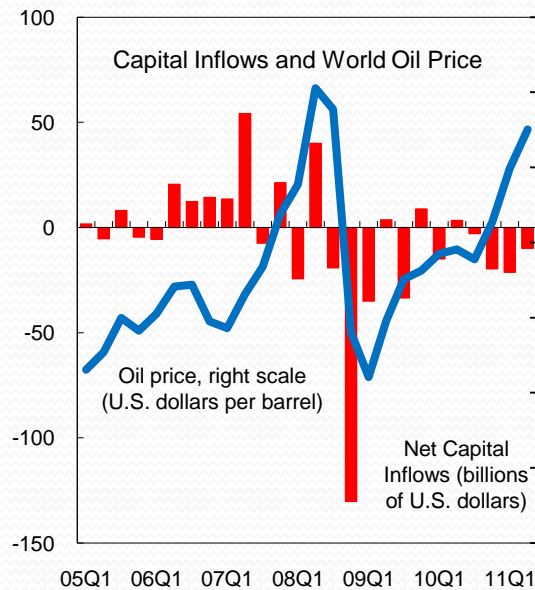
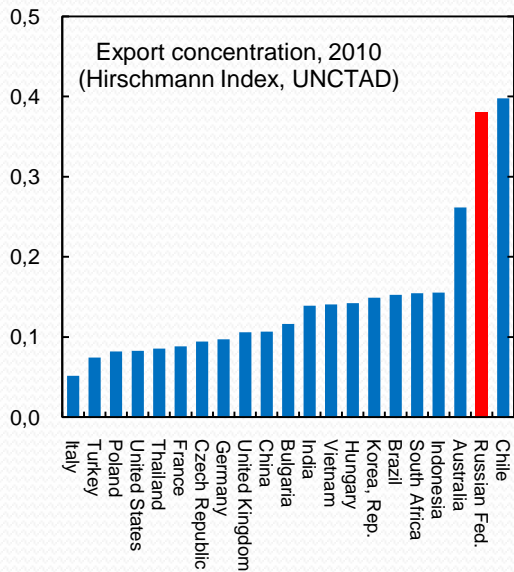
Overview

- A volatile macroeconomic backdrop
- The role of economic policy frameworks as anchors
- Looking ahead: steps towards formal inflation targeting

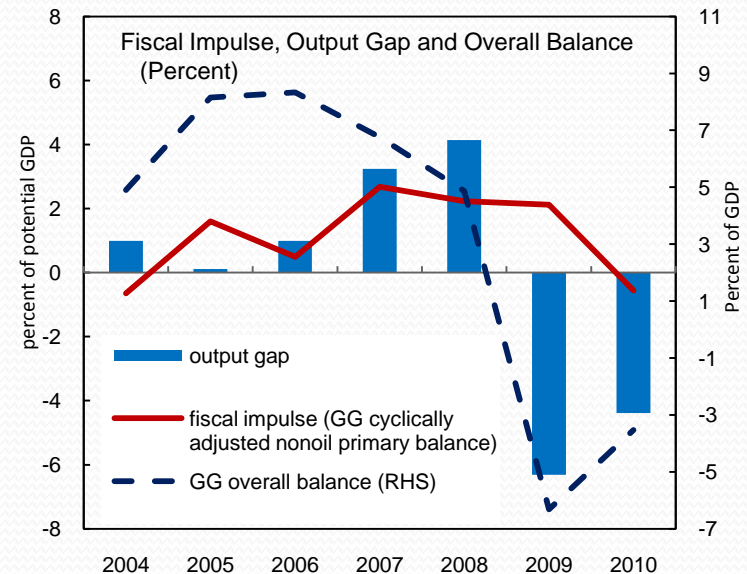
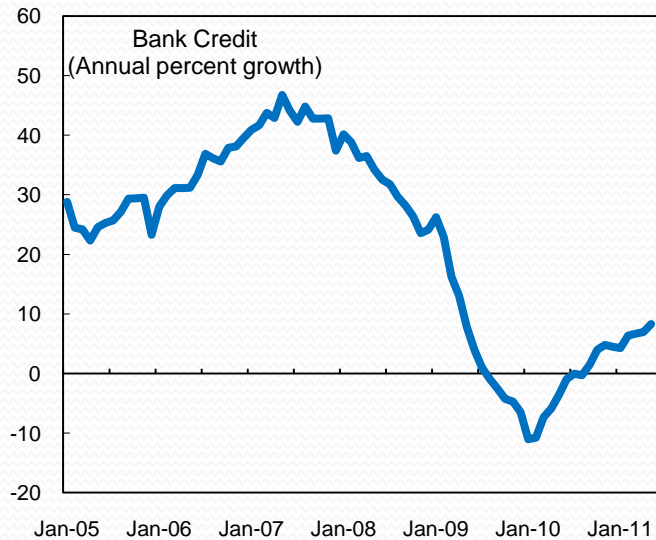
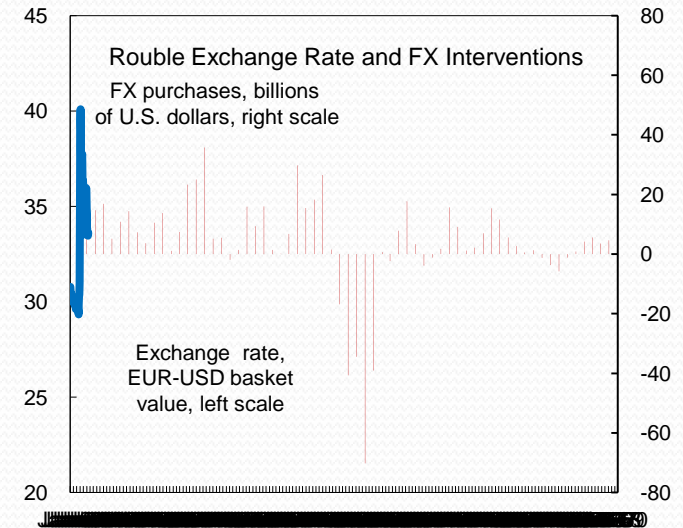
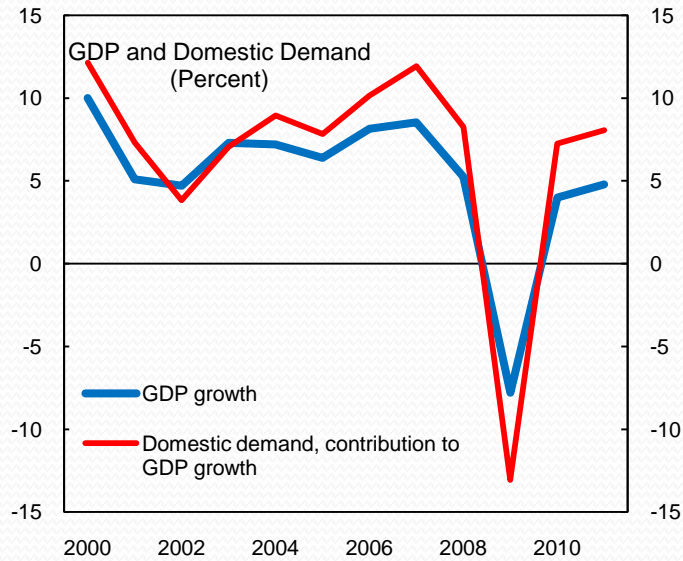
Greater instability in Russia than in peers...



...caused by an economic structure vulnerable to external shocks...



...but Russia's procyclical macro policies have also contributed to the instability



Macroeconomic Policy Frameworks

Monetary policy framework

Formal inflation targeting: inflation anchor

Supporting policies (including flexible exchange rate)

Budget framework

Fiscal anchor/rules

Fiscal institutions

Financial supervision framework

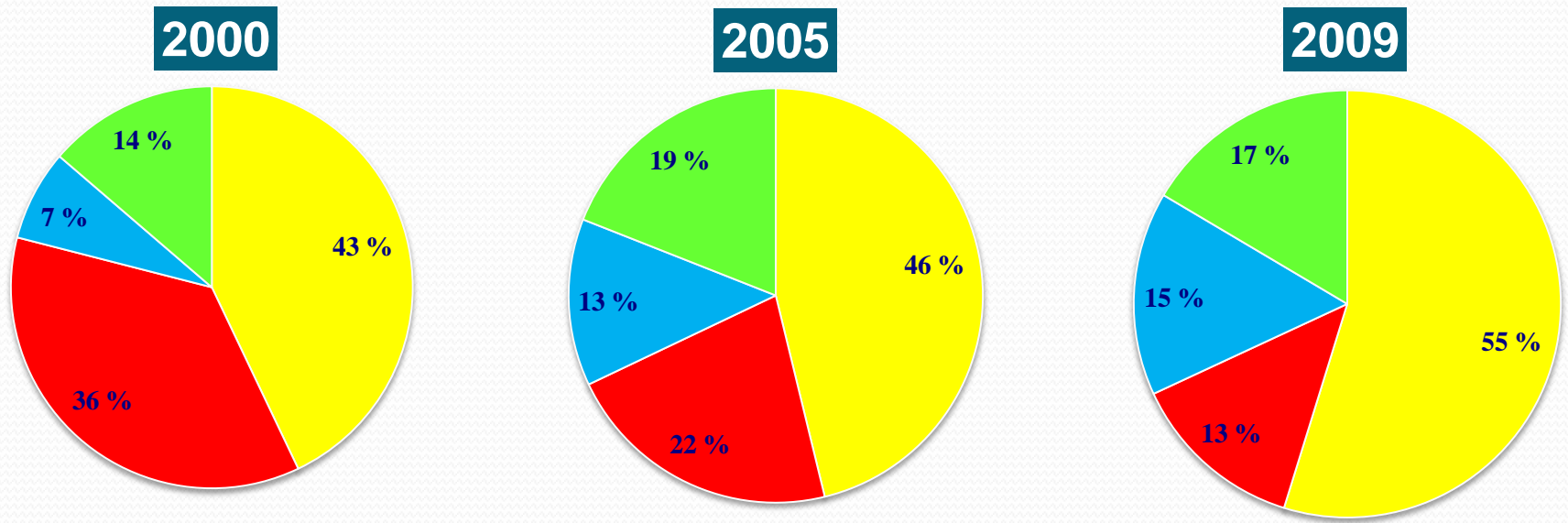
Priorities for stability and credit recovery

Longer-term priorities

“Investment environment”

Monetary Policy Regimes

(Percent of IMF member countries)



■ Exchange rate anchor

■ Monetary aggregate target

■ Inflation-targeting framework

■ Other

Why Formal Inflation Targeting ?

Failure of Alternative Nominal Anchors

- *1950s and 1960s* – Bretton Woods fixed exchange rates
- *1970s* – Monetary targeting
- *1990s* – Exchange rate crises

Seminal academic contributions

- *Vertical Long-Run Phillips Curve* (In the 1960s, many believed in a permanent trade-off between inflation and unemployment; Friedman and Phelps (1968) theorized that no long-run trade-off exists.)
- *Time Inconsistency Problem* (Kydland and Prescott (1977); Barro and Gordon (1983))

Experience with formal inflation targeting

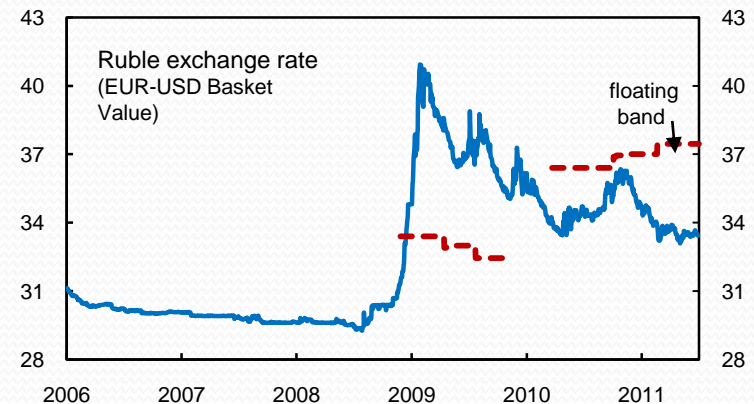
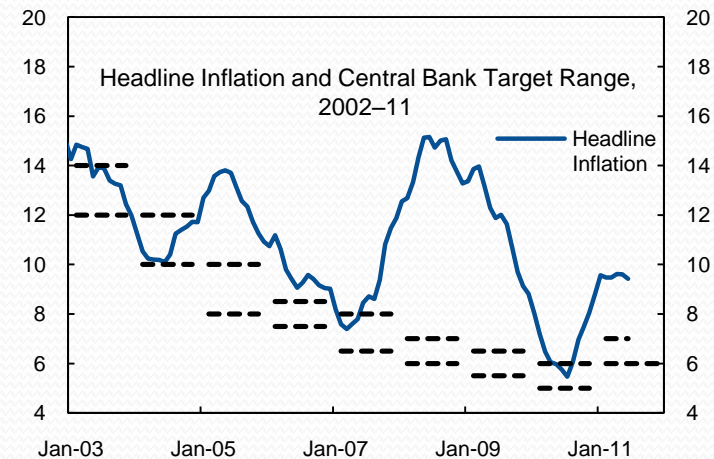
- *Benefits of formal inflation targeting: experience pre-crisis* (Kuttner and Posen (2001), Levin et al (2004), Truman (2004), Batini, Kuttner and Laxton (2005, 2007))
- *Experience during recent crisis*
 - Some positive tentative evidence (Scott, IMF, 2009)
 - But also fundamental rethinking of basic tenets

Formal Inflation Targeting – Underpinnings

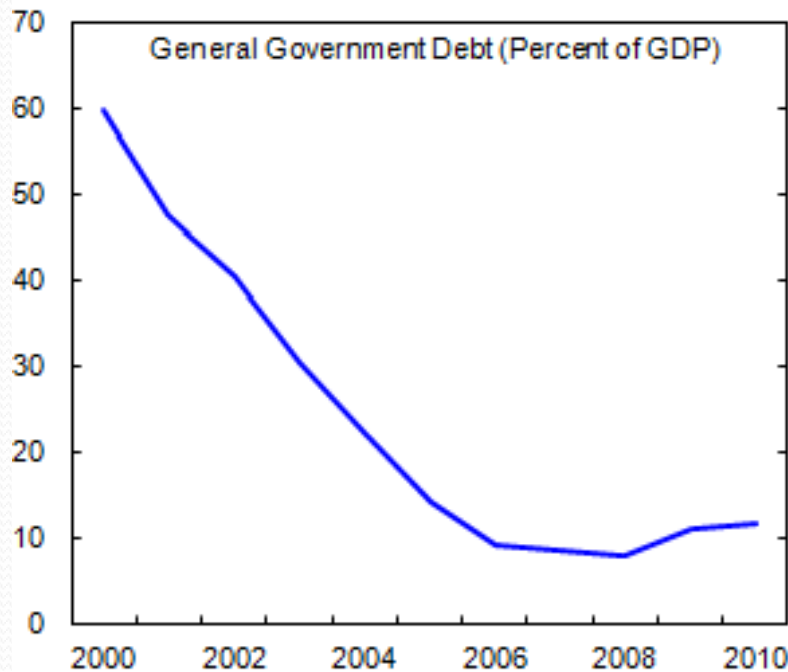
- Priority of inflation over other goals
 - Flexible exchange rate
 - Absence of fiscal dominance
 - Sound financial institutions
- Central bank operational independence and communication
- Control over policy instrument and transmission
- Forecasting ability

Russia — Inflation and Exchange Rate Policy

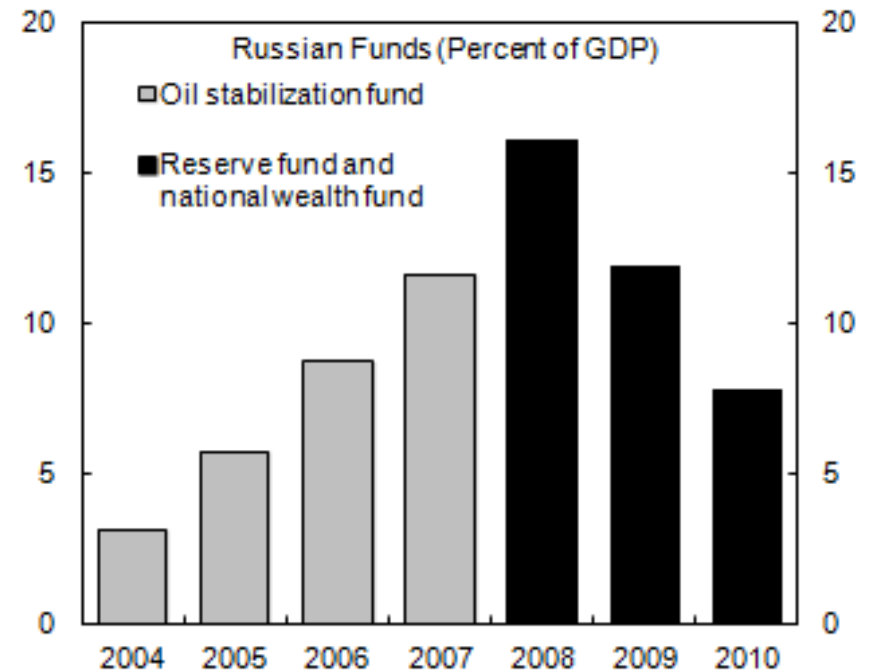
- *Early transition period (1992-94):* the ruble floating
- *Corridor period (mid-1995 to end-1997):* the ruble kept within a periodically adjusted band
- *Pegged rate period (January-August 1998):* the ruble pegged at 6.20 Rub/US\$ (with bands of +/- 15 percent)
- *Post 1998-crisis period (August 1998 -):* smoothing of the ruble, combined with objectives for inflation



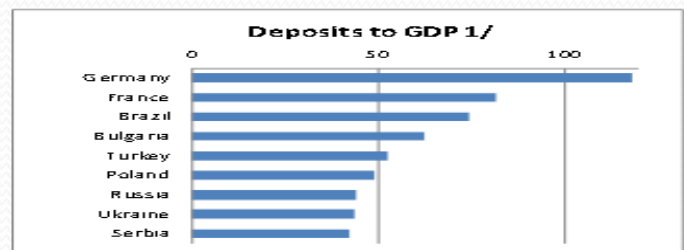
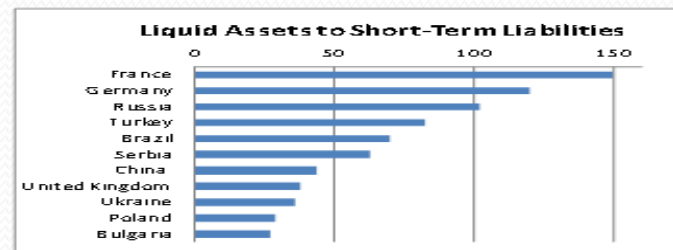
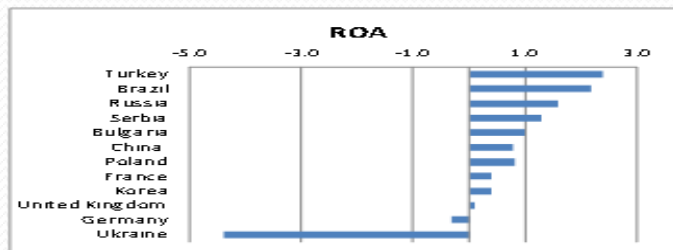
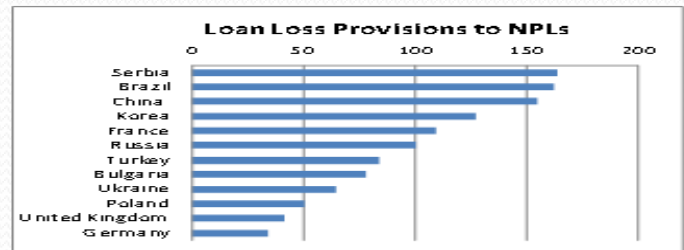
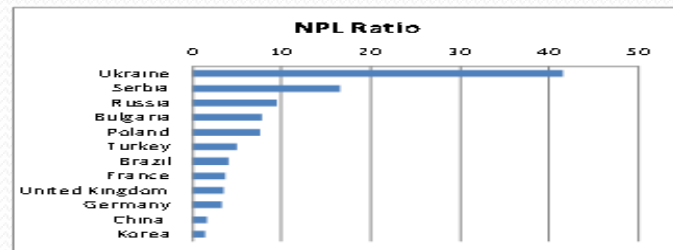
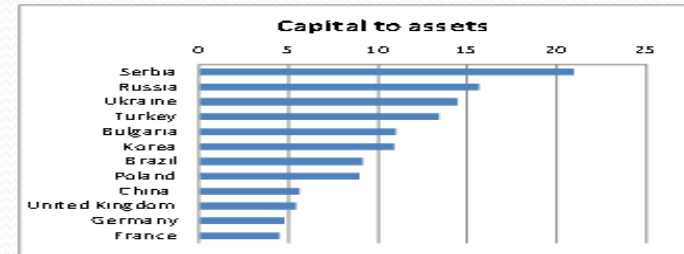
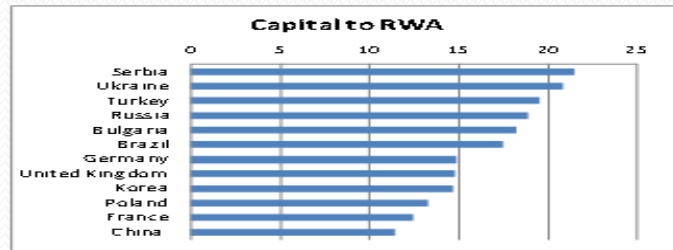
Russia: “Dominance” — Government Budget



Sources: Russian authorities; and IMF staff estimates.



Russia: “Dominance” — Banking Sector



Central Bank Operational Independence and Communication

Mandate and legal basis

- Article 75 of the Constitution lays down the principle of the Bank of Russia being independent from other state bodies when performing its basic function to protect the ruble and ensure its stability
- The Bank of Russia Law stipulates that the Bank of Russia performs the functions and exercises the powers established by the Constitution and the Bank of Russia Law independently from other federal bodies of state power, regional authorities and local governments
- The Bank of Russia is accountable to the State Duma, which appoints and dismisses the Bank of Russia Chairman (on the proposal of the President) and members of the Bank of Russia Board of Directors (on the proposal of the Bank of Russia Chairman)

Communication

- Statements by senior officials
- Monthly “Monetary Policy Statement” (since 2009)
- Inflation Report (but without forward looking analysis)
- Challenge: complex set of instruments

Control over Policy Instruments and Forecasting Ability

- **Complex set of monetary policy instruments**
 - Policy interest rates
 - Differentiated reserve requirements
 - Market and FX operations
 - Fragmented money market
- **Forecasting ability**
 - Challenge: Understanding inflation process and transmission mechanism
 - Ongoing Bank of Russia research to build inflation models
 - TA from the IMF

All told ...

- Focus monetary policy firmly on inflation
(allow increased flexibility in the exchange rate)
- Strengthen other elements of the monetary policy framework
- Better anchor and bolster economic policy frameworks



Thank you !