Russian Federation

4% Inflation: Russia and International Experience

IMF OFFICE IN THE RUSSIAN FEDERATION

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Inflation Targeting

**Constitutive Elements** (Svensson, 2010)

- **A Numerical Target** (though IT is never 'strict' always 'flexible' – CBs care also about output gap)

- **A major role for inflation forecasts** ('forecast targeting')

- **A high degree of Central Bank transparency**

- **Independent-Accountable Central Bank**

Inflation in Resource-Rich Emerging Economies (e.g. Brazil, Chile, Mexico, Russia)

- **Economic Cycle:** Textbook explanation. Inflation follows the cycle. Recent SIP-AIV found that Phillips Curve is "alive" in Russia.

- **Changes in Relative Prices:** Important factor in resource rich-countries. Inflation as mechanism to produce changes in relative prices.

- **Changes in Risk Perceptions:** Important in emerging economies. Changes in perceptions affect attractiveness of domestic financial assets. Fast changing. Creates challenges.

A word on covered real interest rate parity

- **RER, international real rates, risk perceptions** all affect what will be considered the 'natural' objective real rate in open economies.

- **Given a numerical inflation target** this will guide what investors will expect as the 'natural' nominal rate.

$$r_t = r_t^* + (E_t q_{t+1} - q_t) + \rho_t$$

$$\pi_t = i_t - [r_t^* + (E_t q_{t+1} - q_t) + \rho_t]$$

However, policy framework and economic structure matter

- **Policy Framework.** Anchoring expectations is policy dependent. Adequate monetary policy alone may be insufficient in the long-term.

- **Economic Structure.** E.g., in resource-rich countries, fiscal dependence on commodity revenues

- **RER expectations and Risk perceptions** are endogenous.

$$\rho_t = \rho(oil, policy)$$

$$E_t q_{t+1} = q(oil, policy)$$

Russia: Before and After IT

IT in Russia since end-2014: Summary

- **Adequate policy decision making** in a difficult context has contributed to lower both headline and inflation expectations.

- **Target chosen prudently and achieved relatively fast** vis-à-vis experience in EMs.

- With inflation around the CBR target, **there should be room to continue normalizing rates during 2017.**

- **Containing fiscal risks is essential** to support monetary policy going forward.

- **Risk perceptions:** Will continue to be volatile but adequate policy framework should reduce risk levels.

Terms of Trade (TOT) and RER

Terms of Trade have led RER and ULC dynamics, in part due to fiscal policy
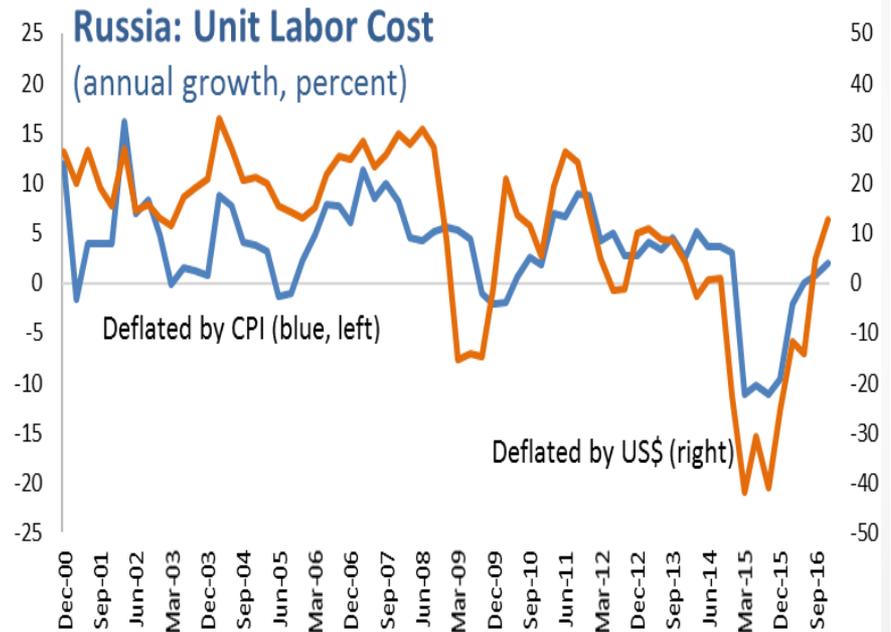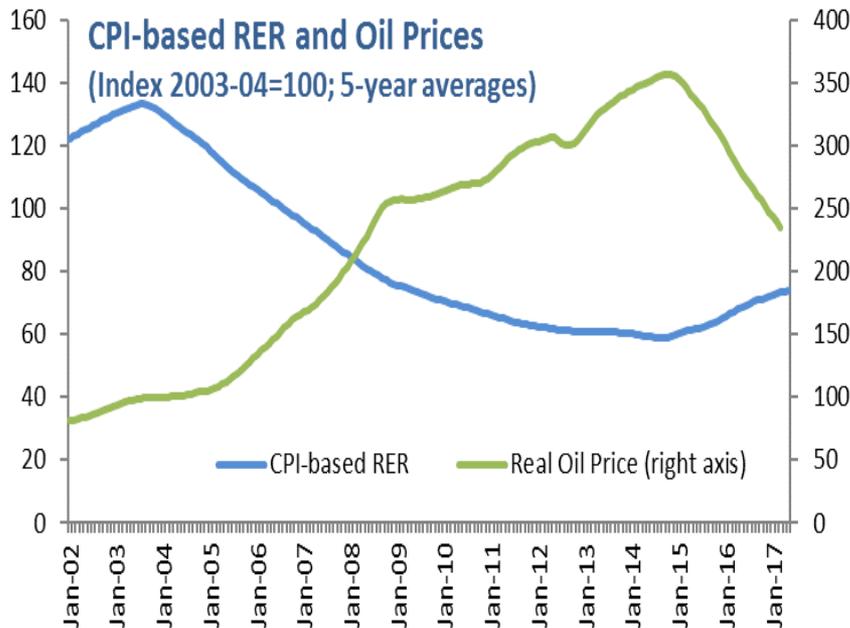
Inflation: Adjustment to TOT Shocks

Adoption of IT and the floating Ruble allowed the economy to adjust fast to lower oil prices
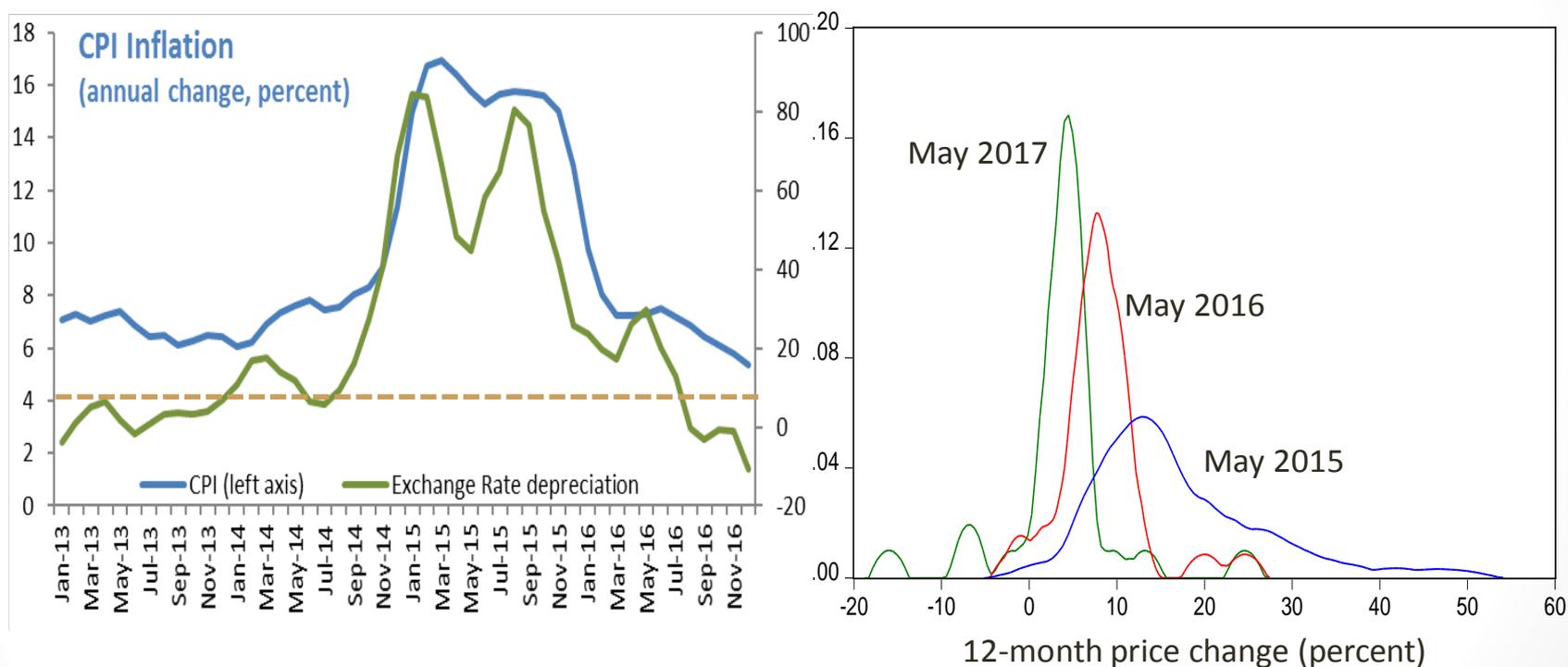
Inflation: Change in Relative Prices

Inflation during 2015-16 reflected the underlying change in relative prices, with tradable goods pushing inflation upwards. That adjustment is already concluded

September 2015

September 2016
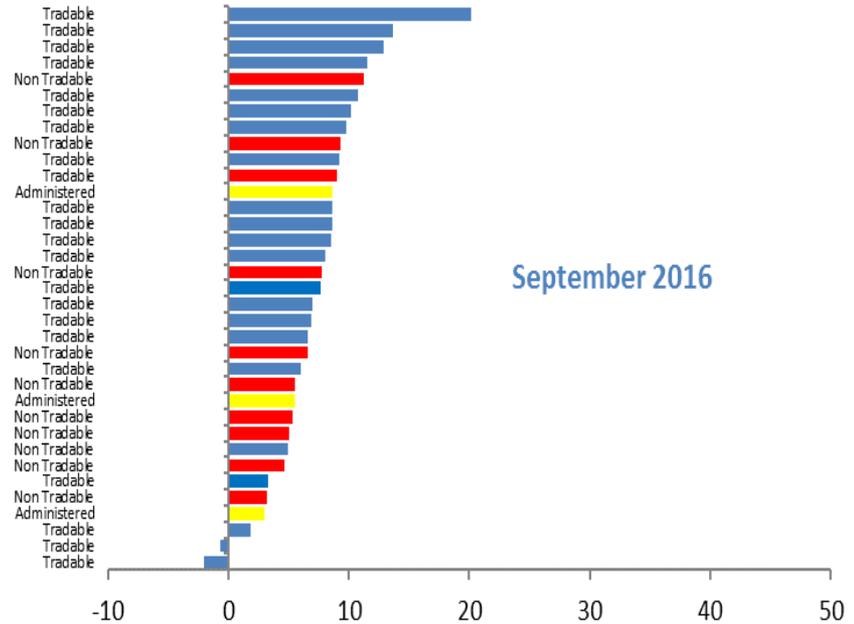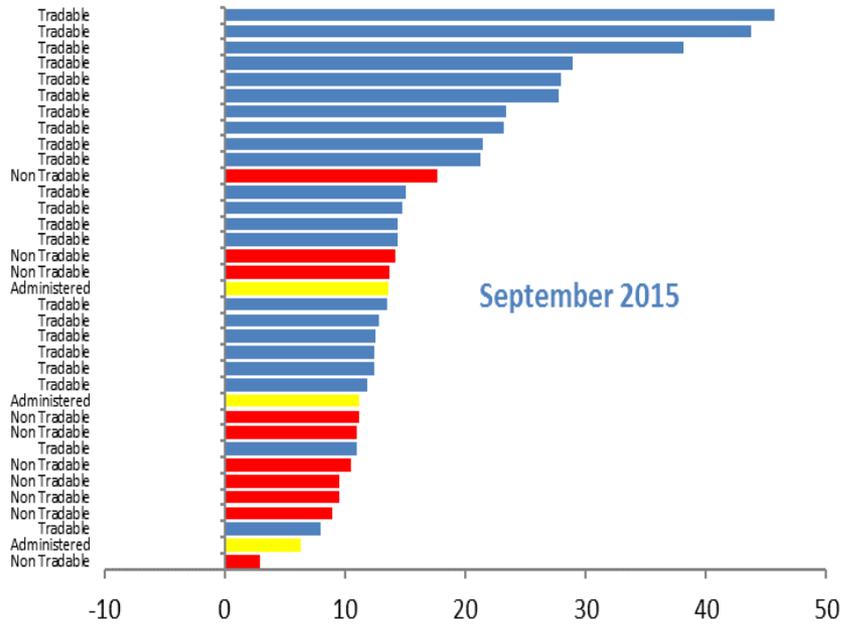
Fiscal Rule: Essential to Anchor Inflation and Expectations

Federal expenditure stabilized in US$-terms…

…but non-oil revenues still cover only about 50 percent of federal expenditures…

Russia. Federal Budget (12-month moving sum, US$ bn.)

Federal Revenues
Federal Expenditures
Non Oil Balance
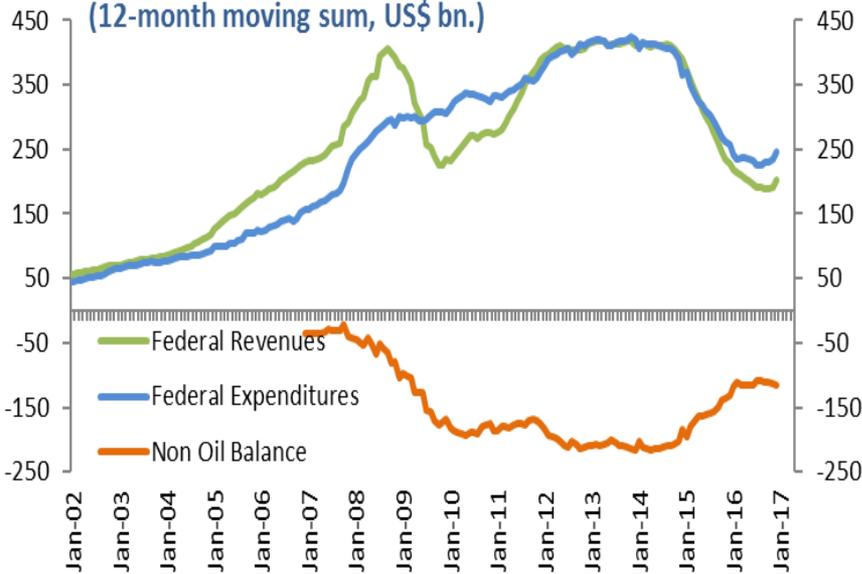
Russia. Non-Oil Revenues (Share of Federal Expenditures)
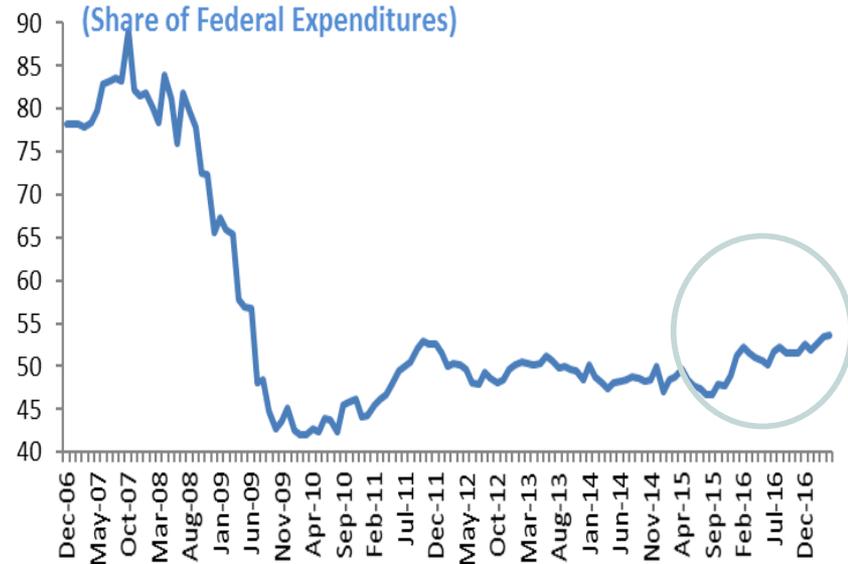
Fiscal Rule: Looking better

1. **MINFIN proposal an improvement vis-a-vis previous rules:** Oil Price benchmark (US$40/b) similar to 50-year average, prudent, more credible than 5/10 backward-looking MAs.

2. **Challenges – Issues for further thought**

- *Need mechanism to adjust benchmark downwards:* Changes in oil Prices are persistent; 80s/90s prices were persistently lower than 50-year average. Need mechanism to adjust benchmark (and non-oil deficit) downwards.

- *Target:* Primary balance may be an appropriate operational target for 2018-19, but low for inter-generational equity, and given demographics, pension liabilities and other inflexible spending.

Financial Flows and Risk Perceptions: Endogenous and Oil Dependent?

As the effect of sanctions petered out, financial outflows subsided. Risk perceptions reflect sentiment, oil prices, and in long term, should respond to policy

Foreign ownership of OFZs
(percent)
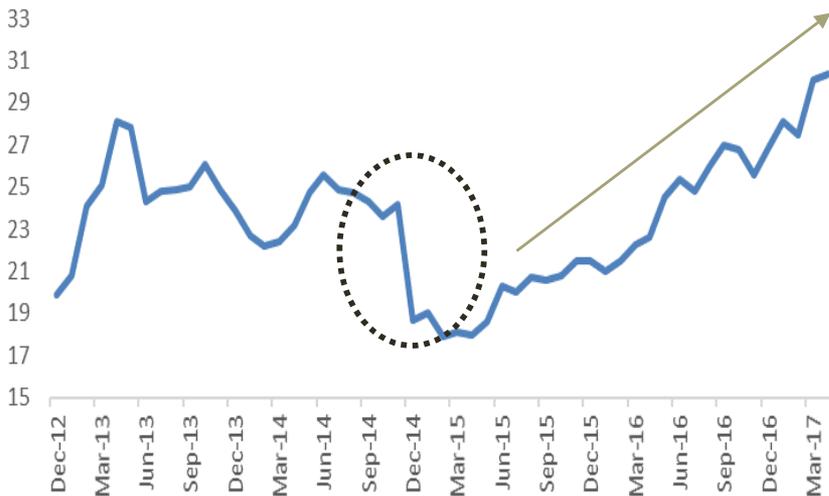
Russia. Exports, Imports and Financial Flows
(12-month changes, US$ billion)

Financial Flows

Imports G&S

Exports G&S

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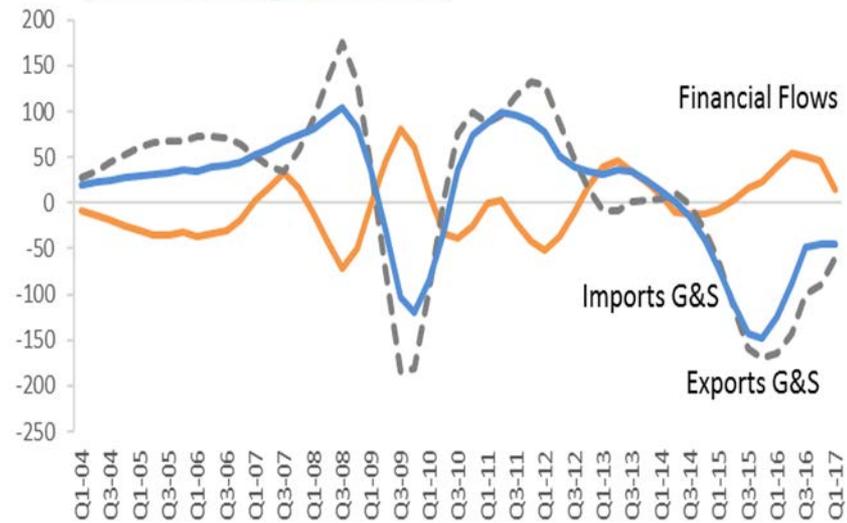
IT in Russia. Options for the Future?

- **All options** have their pros and cons (Apel and Claussen – Riksbank, 2016; Svensson, 2010)

- **Target.** Point target (as Russia now); Point target plus tolerance bands; target range.

- **Horizon.** Loose (e.g. 'the medium term'); Not loose (2-3 years, 6-8 quarters, etc.)

- **Inflation measure.** Main measure and control measures (e.g., headline CPI plus Core, etc.)

- **Publication of Interest Rate Path.** Some do, some don't.

IT in Russia: Options for the Future? Target: International Experience

- **Point Target (alone).** Norway, South Korea, Sweden, United Kingdom, Russia (so far), among other.

- **Point Target (plus tolerance band).** Brazil, Canada, Chile, Czech Republic, Mexico, Poland, Turkey, among other (it is the most popular option among ITs).

- **Target Range.** Australia, the Euro Area, Israel, South Africa, among other.

Большое Спасибо

Philips curve is alive and the slope is expected to increase with the recovery

- Our estimated PC shows that most of the **core** inflation dynamic is indeed explained by cyclical slack, exchange rate fluctuations and imported inflation and.

$$\pi_t = \theta_{1t}(u_{t-1} - u^*_{t-1}) + \theta_{2t}\pi^e_t + (1 - \theta_{2t})\pi_{t-1} + \theta_{3t}\pi_{m,t-1} + \theta_{4t}xr_{t-1} + \varepsilon_t$$

Inflation and Fitted Value
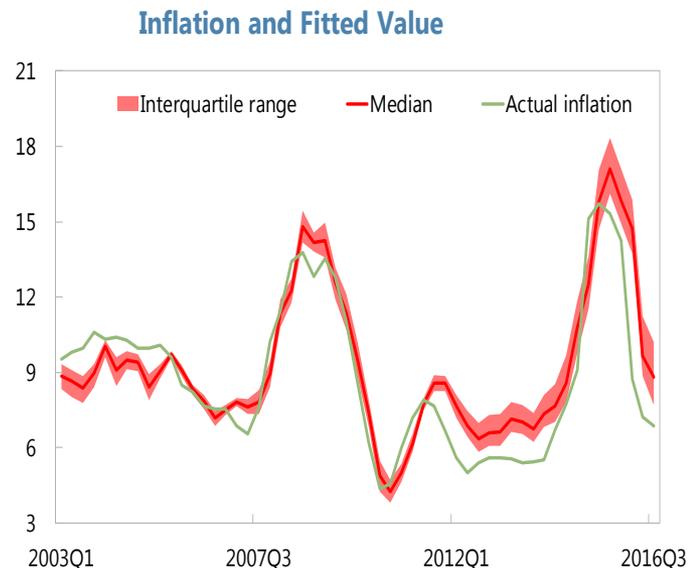
Sources: Haver Analytics; and IMF staff calculations.

Hybrid New Kenysian Philips curve for Russia's core inflation, in which the coefficients vary over time.

Four take away of Philips curve study

The impact of cyclical unemployment on core inflation (the slope of PC) tends to increase during normal business cycle times and to decrease in the aftermath of a crisis
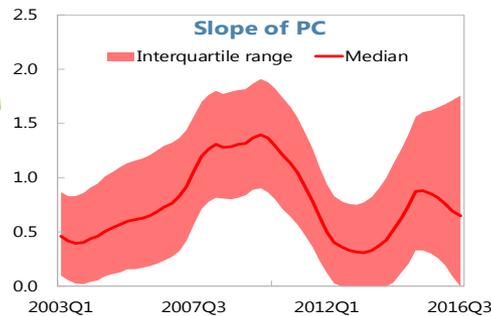
The inflation expectations is anchoring core inflation thanks to the credibility of IT regime
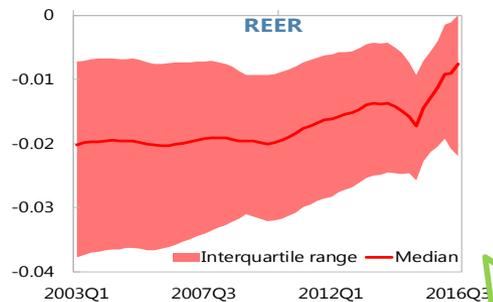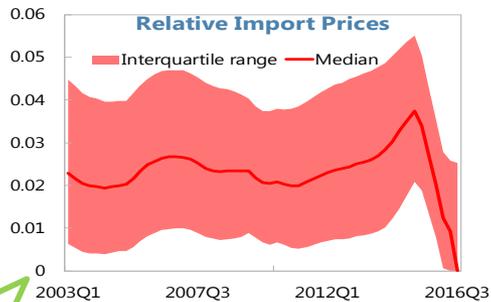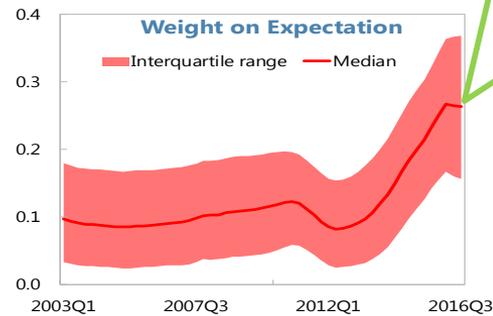
The importance of import price inflation has declined since the onset of sanctions

Impact of REER have been small and stable overtime

Sources: Haver Analytics; and IMF staff calculations.