COURTESY OF THE CENTRAL BANK OF RUSSIA

Pursuing Stability

***Elvira Nabiullina** explains how bold policy action helped Russia avert a deeper recession and reform the banking sector*

WITHIN A FEW SHORT MONTHS after taking up her post as governor of the Central Bank of Russia in 2013, Elvira Nabiullina faced a growing economic crisis brought on by plunging oil prices and geopolitical tensions with Ukraine. By December 2014, the exchange rate and the banking system were under severe pressure, and the economy was heading into recession. A decisive response was needed, and the central bank chose to float the currency, announce an immediate move to inflation targeting, and step up the pace of banking reform. These bold policies have yielded significant positive results.

The first female governor of the Central Bank of Russia, Nabiullina was named 2015 Central Bank Governor of the Year by *Euromoney* magazine and 2016's Best Central Bank Governor in Europe by *The Banker*. She has also appeared on Forbes' list of the world's most powerful women.

In this interview with Olga Stankova of the IMF's Communications Department, Nabiullina, who previously served as minister of economic development, discusses her experience leading Russia's central bank during this challenging period.

F&D: Inflation targeting—when a central bank announces a target for inflation and manages inflation expectations through its policy actions—is considered fairly complex and demanding for emerging market economies. What was the rationale for adopting this policy in Russia?

EN: Looking at the experience of other countries we saw that inflation targeting is a policy that makes it possible to reduce inflation and maintain it consistently at a fairly low level. Of course, this policy can be challenging for emerging markets, because their financial markets are relatively shallow and—what is probably more important—inflation targeting requires the management of inflation expectations. This is challenging in an emerging market where the public has lived through periods of high inflation, has grown accustomed to high inflation and does not believe that low inflation can be achieved over the longer term.

We in any event did not make an abrupt switch to inflation targeting. We had already begun to prepare for it after the 2008–09 crisis. First, we developed the tools needed to refinance banks, and those tools made it possible to use interest rate policy—through the transmission mechanism—to manage inflation. Second, we gradually moved to a more flexible exchange rate, from a fairly strictly managed rate to a floating rate. Third—and very importantly—inflation targeting depends greatly on the quality of models, projections, and analysis, so we also developed that capacity. I think that these three elements were crucial to ensuring that we were able to achieve the effects that we had promised the public.

F&D: The exchange rate was floated at the peak of the crisis in late 2014. Were there any other good choices in that situation? And was managing the exchange rate for a while longer an option?

EN: Indeed, we had to move to a floating exchange rate during a period of elevated risks to financial stability. I am convinced, however, that this was not a reason to put off the decision. We would have simply spent some part of our gold and forex reserves and then would have needed to float anyhow.

In my view, the floating exchange rate has worked well to absorb external shocks and has facilitated a rapid adjustment of the balance of payments. We saw that again during the following cycle, in 2016. You will recall that in early 2016, oil prices fell, and thanks to the floating exchange rate, the effects on the financial markets as a whole were unremarkable.

F&D: What has the central bank done to broaden public support for its policies? What was the role of communications?
EN: Communications were very important during the transition from one policy to another, both to explain to society what was happening and to demonstrate the benefits of the new policy.

Inflation targeting requires a qualitatively higher level of communications with the market than other policies, because it is based on the management of expectations and on forecasts.

We greatly expanded our communications toolkit, starting with announcing the dates of board meetings a year in advance. We also began to hold press conferences and to provide more analytical materials, reports, interviews, and surveys and arrange meetings with investors and analysts.

At first, the focus was on ensuring that analysts and market professionals understand what we do. In fact, we see that inflationary expectations of market participants are now better anchored. What is important now is to communicate with a broader business audience and the public, to build trust in our policy, and to give people greater confidence as they make their life and business plans.

F&D: You also reformed the banking sector. What were the economic and political considerations behind your course of action?
EN: Stable economic growth requires a stable, strong financial system. A weak financial system cannot support economic growth. Our banking system had accumulated a range of problems that we have been tackling in recent years.

First, the banking system lacked sufficient genuine capital. You will recall that the banking system emerged very quickly in the early 1990s, and without capital. Even afterwards, capital did not flow into the system in any significant amounts. Second, as a result of the crises of 2008 and then 2014–15, the quality of banks' assets deteriorated. Those assets remained on banks' balance sheets, and it was necessary to deal with them. Another reason is that banks were often used for unscrupulous practices. Their owners used them to finance their own business, with poor risk management, and there was money laundering.

It became obvious that the banking system had to be restructured, as it could not support growth and would continue to require large financial infusions to survive a crisis. We had to improve the health of the banking system also to avoid new infusions in the future.

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We recognize that the market would like to see a reduction in the share of state ownership, and we certainly intend—and are working on it—to put banks in which we are temporarily holding a share back on the market as soon as there is an opportunity.

F&D: What leadership qualities are essential for success as a central banker?
EN: First, find professionals you can rely on, and do not be afraid to surround yourself with strong people. Stimulate debate, so people are not afraid to express their opinions. And then, on this basis, take a decision, and do not deviate from it.

It is important for people who work at a central bank to understand that they are working for the public good, for long-range goals. We need to deliver on our promises to society. That is a key principle for me and for our staff.

In any policy, including monetary policy, it is not possible to avoid compromises. However, it is important to understand that there are limits to compromise. FD

This interview has been edited for length and clarity. A longer version of the interview is available at www.imf.org/fandd.