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RUSSIA MOVES TOWARDS FREE FLOATING RUBLE

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The idea of letting the ruble float freely is not a new one – the Bank of Russia and experts have been cherishing it over a couple of past years. This move is aimed at securing market conditions for the national currency exchange rate as well as inflation targeting. This Central Bank's intention[1] aroused a new wave of discussions of advantages and disadvantages of a free float. Nevertheless, the Central Bank is not yet ready to leave the currency market.

The Bank of Russia chooses from two 'free float' strategies. The first one is a sharp move towards the floating rate that will put an end to market interventions. This will result in higher volatility of the currency market, reduction of foreign capital inflows, inflation growth, and higher investment risks among other negative consequences. A bright illustration to it was the market's response to the Central Bank deputy chairman A. Ulyukaev's statement that the ruble might soon reach the upper limit of a basket of dollars and euros[2], when the national currency fell by 35 kopecks versus the dollar in one trade session. Consequences of the first strategy might raise market worry, and it is the Central Bank who will manage new market threats. Yet, there is something positive about the first option: transition to a free float will be quick, and market players will soon get used for new market conditions, though not without pain.

The other option is letting the ruble float freely through gradual reduction of the Central Bank's presence in the currency market. The current 'controlled floating rate' practice that allows big moves of the ruble versus the basket of currencies enables the Central Bank to lead a flexible policy of smoothing the rate fluctuations. According to Ulyukaev, the Bank of Russia has chosen the second option focusing on volatility minimization along with keeping the ruble rate within the basket corridor limits[3].

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[1] The first deputy chairman of Russia's Central Bank stated in an interview to RIA Novosti at the St. Petersburg Economic Forum that the move towards free floating of the currency and inflation targeting would be one year ahead of schedule – in 2010.

[2] As of January 23, 2009 the Central Bank of Russia set the limits of the basket of currencies between 26 and 41 rubles. From February, the bank moved towards free floating currency with limits automatically corrected depending on the scope of the Central Bank interventions. Currently, the ruble is held at a basket level around 35 to 38 (Rossiyskaya Gazeta).

[3] The Central Bank will use both active (within the floating corridor) and passive (at the corridor limits) interventions. 'But the latter will fall while active interventions will rise' (RIA Novosti).

The Central Bank has a good setting for fulfilling its plans. According to the Federal State Statistics Service, in 2009 consumer prices grew 8.8% – a much more modest rise than officially forecasted[4]; while the average yearly ruble rate moved as the Ministry of Economic Development predicted (between 30.8 and 31.8 rubles per dollar). For the first time in their history, Russia's monetary authorities managed to fulfill their base parameter promises before the target. Pity, the Bank of Russia is unlikely to repeat this positive experience this year. The main obstacle to reaching the intended parameters is the oil prices that influence the Russian economy. This parameter is out of the Central Bank's control.

[4] In the original 2009 federal budget he inflation rate was set at 8.5%; in mid-December 2008 the Ministry of Economic Development stated that inflation will increase 11% in 2009. In January 2009 the forecast was updated to 13% (Lenta.ru).