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The Russian central bank has dropped its key interest rate to 15% from 17% as the outlook for the country's economy weakens.

The Bank of Russia hiked interest rates by 6.5% last month in a shock decision that came at 1 a.m. local time. The measure was intended to head off a collapse in the value of the ruble, which fell to an all-time low of 80 rubles to the dollar and 100 rubles to the euro in December.

However, the sharp rate hike also put pressure on the country's already struggling economy, which was being buffeted by a combination of collapsing oil prices and Western economic sanctions over Russia's role in the ongoing crisis in Ukraine. Despite consumer price inflation remaining well above the bank's target, the worsening outlook for the economy has prompted the central bank to lower its key rate.

Here's the statement (emphasis added):

The Board of Directors of the Bank of Russia January 30, 2015 decided to cut the key interest rate of 17,00% to 15,00% per annum, **given the change in the balance of risks accelerating the growth of consumer prices and the cooling economy**. The Bank of Russia's sharp increase in the key rate adopted on December 15, 2014 has led to the stabilization of inflation and devaluation expectations to the extent expected by the Bank of Russia. We observed a surge in inflation caused by rapid adjustment of prices after the weakening of the ruble but what has happened is time-limited in character. **In the future, inflationary pressures will be restrained by a decrease in economic activity**. According to the forecast of the Bank of Russia, the growth rate of consumer prices will fall below 10% by January 2016.

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[Bloomberg](#) The dollar versus the ruble.

As the sign that the rate cut may not have been anticipated by markets, the ruble dropped sharply following the announcement, crossing 71 rubles to the dollar at the time of writing.

With inflation still in double digits, way above the central bank's 5% target for the year and still rising, the decision may appear to be a surprising one. [Economic Development Minister](#)

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[Alexei Ulyukayev has said](#) he expects inflation to hit 13% or even higher this month before it begins to subside in the second quarter.

So why did the central bank cut rates?

First and foremost the prospects for the Russian economy have deteriorated significantly over the past few months. In its World Economic Outlook update released earlier this week, [the International Monetary Fund joined a host of other major forecasters in downgrading the country's growth](#) forecasts. It now expects the Russian economy to contract by 3.5% this year and 1% next year, revised down from previously expected growth of 0.5% and 1.5% respectively.

Pushing interest rates up to 17% was designed to halt the collapsing value of the ruble, but in increasing the cost of borrowing money and servicing debt it also posed a risk to domestic spending. Though it was of limited success in achieving the former (as the crude oil price continued its slide pulling the ruble with it), the negative consequences of the rate hike have become all too easy to see.

One of its most obvious casualties was Russia's banking system, with [the government forced to inject \\$2.4 billion into financial institutions](#), including the state-owned lenders VTB and Gazprombank.

Interfax is now reporting that the ongoing troubles of the banks could well be behind the CBR's reported decision to lower rates. In [an article](#) last week the Russian news service quoted a letter from Anatoly Aksakov, the president of the Association of Regional Banks of Russia, to Russian central bank governor Elvira Nabiullina. It says (emphasis added):

"The situation in the Russian banking market is a serious concern. Despite some stabilization in the foreign exchange market and the expected inflow of tax and budgetary resources, banks are experiencing acute shortage of liquidity. According to bankers, skyrocketing interest rates caused an increase in the key rate, already launched the process of losing the solvency of companies. **Bankers believe that the preservation of the current situation will cause a wave of bankruptcies not only credit institutions but also a number of enterprises and companies.**"

Further trouble with the banks would provide yet another headwind to growth in the country and threaten to drain even more of the country's foreign currency reserves. That bill for

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efforts like the relief of VTB and Gazprombank is expected to rise, with [analysts suggesting that bailouts could cost the government a further \\$40 billion this year](#).

The banking sector's woes were deepened even further with [the downgrade of Russia's sovereign debt to "junk" status by S&P earlier this week](#). As BNP Paribas analysts point out in a recent note, " the downgrading of more BBB energy-related sovereigns (Kazakhstan, Russia etc.), will drag down corporate and bank ratings that are currently at the sovereign ceiling."

In short, the CBR has belatedly realized that its emergency rate hike may have been a costly mistake.