FINANCIAL TIMES

November 7, 2014 4:14 pm

Russia: another rouble crisis, but this time it is different

Neil Buckley – East Europe Editor

Geopolitical problems, such as the troubles in the Ukraine, have an impact

Russians know a thing or two about rouble crises: the current one is the third they have lived through in the post-Soviet era, after 1998 and 2008.

They also remember that however painful and disastrous those crises seemed at the time, they eventually ended and were followed by economic recovery – especially after 1998. Helped by the boost to domestic manufacturing from the dramatic fall in the rouble, and later by rising oil and gas prices, the economy rebounded in 1999 in what would be the first of 10 years of growth averaging almost 7 per cent a year.

That helps explain why, until recent days, Russians had not been rushing to swap their rouble deposits into dollars.

As in the two previous crises, a falling oil price is again at the core of today's rouble pressure. But the currency decline – it has fallen 8.5 per cent this week and more than 40 per cent this year – comes against a different backdrop, of the conflict in Ukraine and western sanctions. That makes it potentially more unsettling both for Russian consumers and for investors.

"It is, in our view, hard to argue that current rouble moves are reflecting market fundamentals," Ivan Tchakarov, economist at Citi in Moscow, warned in a note on Friday.

Back in 1998, the external shocks of the Asian crisis and sharp fall in oil prices to little over $10 per barrel pushed Russia almost into bankruptcy. Foreign exchange reserves dropped to $11bn, while sovereign debt was almost 100 per cent of gross domestic product. Its central bank, still staffed partly by Soviet-era holdovers, was far less competent and experienced than today.

By the time the global financial crisis struck in 2008, the decade of growth and expert stewardship by finance minister Alexei Kudrin had transformed Russia's finances. General government debt was down to barely 8 per cent of GDP, while foreign exchange reserves, at about $650bn, were the world's third-highest.

As the oil price plunged and a heavily indebted corporate sector struggled to refinance its foreign debt, the central bank burnt through almost $200bn of those reserves slowing the rouble's descent. The cost was huge, but it prevented a panic run on the rouble that could have been disastrous for the banking sector.

This time around, as the oil price has dropped almost $25 to little over $80 a barrel, the central bank has spent almost $30bn supporting the rouble in October alone. But with a move to a free float and inflation targeting planned for early next year anyway, it signalled on Wednesday it was abandoning its policy of unlimited foreign exchange interventions – in essence moving to a free float.

In depth

Crisis in Ukraine

Pro-Moscow separatists in eastern Ukraine have escalated the political turmoil that

But what makes this crisis different from the previous ones, says Chris Weafer of Macro-Advisory, a Moscow consultancy, is that the rouble has devalued by far more than the fall in the oil price would merit.

Gold and foreign exchange reserves are still at just under $430bn, with general government debt at only 13 per cent of GDP. This year's budget is in surplus, and growth is still very modestly positive. Instead, uncertainty and even fear have become factors undermining the exchange rate.

"People are starting to worry about what is really going on, what surprises may be out there. Because if you look at the economics, the currency is far too weak," says Mr Weafer.

Investor sentiment and Russia's business climate have been badly damaged by the conflict in east Ukraine and resulting EU and US sanctions, which have cut off large parts of the economy from long-term western threatens to tear the country apart

Further reading

financing, and fuelled capital flight.

Pressure on the rouble has increased as the ceasefire agreement that ended large-scale fighting in eastern Ukraine in September has appeared to be unravelling in recent days, with reports of new Russian arms rolling into the Donetsk region. EU and US officials have signalled that – far from being rolled back, as the market had hoped – sanctions could be extended if the situation in Ukraine continued to worsen.

That means there are limits to what the central bank, headed by Elvira Nabiullina, a highly-regarded former economy minister and presidential adviser, can do.

"It probably needs broader actions from government towards sanctions, towards geopolitics, to improve sentiment." says Mr Weafer. "Right now, sentiment towards Russia and confidence in Russia is as bad as I have seen it since 1999."

RELATED TOPICS Russia Business & Finance, Central Banks, Russia, Russian politics