

Nabiullina's Bank of Russia

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Summary

This week Elvira Nabiullina will formally become next governor of the Bank of Russia. Nabiullina is an interesting, and largely unexpected, candidate for the job. She is a low-key Putin loyalist who has also developed a reputation as a moderniser, a liberal and a private advocate of a Russian 'normalisation strategy' - piloting Russia into the WTO in 2012. She is likely to bring the same instincts to the Bank of Russia, on both monetary policy and in the new responsibilities of the Bank of Russia for financial regulation. But managing Russian politics, and a dramatically beefed up institutional remit will test her undoubted skills.

This week Elvira Nabiullina will formally become the next governor of the Bank of Russia. Nabiullina was an interesting, and largely unexpected, candidate for the job. She is a low-key Putin loyalist who has also developed a reputation as a moderniser and economic liberal as Russian Minister of Economic Development and the chief negotiator for the final phase of Russia's entry in to the WTO.

The role had been widely expected to go to former finance minister Alexei Kudrin, who had been closely cultivated, but who refused at the last minute. The other favourite was Alexey Ulyukaev, the current first deputy governor of the bank and the architect of current Russian monetary policy, but he was regarded as lacking the political charisma - and political connections - for the role.

A bigger Bank of Russia

Nabiullina inherits a bank that is itself in transition. From the first of August, the Bank of Russia is set to absorb the regulatory and supervisory functions of the Federal Service for Financial Markets financial markets regulator (with the Federal Insurance Supervisory Service insurance regulator). It will also take on supervision of non-state pension funds. The transformation of the CBR into a 'megaregulator' was conceived in 2011 in part to satisfy the leadership appetite of Alexei Kudrin. The practicalities of the merger are likely to dominate Nabiullina's tenure.

It is hoped that the concentration of all major regulatory and supervisory functions within one

powerful body will eliminate a lot of existing duplication and uncertainty and increase public and business confidence in the regulator. But integrating different structures and departments during the merger presents a range of problems. The professional standard of Bank of Russia specialists is widely regarded as being much higher than any of the agencies it is going to absorb. Pay in the Bank of Russia is substantially higher than the agencies. Levelling these disparities is likely to be a headache for the top management of the Bank of Russia and the Russian government. The new governor has certainly never overseen anything quite like it.

The merger is also strongly contested from a policy point of view. Domestic critics of the megaregulator concept, including Russian opposition Communist party, worry that charging the bank with both economic growth and financial stability is to invite policy tension at best and conflict of interest at worst. They point to the experience of the UK FSA before the banking crisis of 2008, which was charged with both regulating the City of London and promoting its international competitiveness. But there are also counter examples - the Indian RBI has managed a double remit for bank supervision and monetary policy comparatively well.

Nevertheless, Russian critics want a new statute to underpin the Bank of Russia's economic obligations and to clarify its strategic objectives. In many respects their concerns mirror the intense debate in Frankfurt over how to manage the merging of bank supervision into a European Central Bank responsible

for warming and cooling the Eurozone economy through monetary policy.

Nabiullina herself has been tight-lipped about the scope of her new role. But she almost certainly has her own private questions about an institution whose scale is as much a result of institutional empire building as it is markets regulation experience. She will have followed the intense debate in the UK since 2010 when prudential financial markets regulation was moved back into the Bank of England, concentrating huge supervisory and monetary power in the individual of the governor of the Bank of England in a way that has left many observers feeling queasy. As in London, the expectations on the Bank of Russia to sustain clear mechanisms of accountability and transparency will be high.

Rates and Regulations

Unsurprisingly however, initial questions of Nabiullina, especially from the markets, will focus on her approach to monetary policy. Russia has had the tightest monetary policy of any major jurisdiction for the last five years, bucking a trend for large scale monetary stimulus that has defined policy almost everywhere else. In a world of central bank activism the Bank of Russia's conservatism - the main Russian refinancing rate is 8.25% - has been its defining characteristic.

There are three basic reasons for this. First, the Russian economy has weathered the global downturn comparatively well, growing consistently since 2009, albeit almost solely off the back of hydrocarbon revenues. Second, a surge in capital flight since 2011 driven in part by a general global flight to safety but also by a tangible deterioration in the Russian investment climate has placed a premium on stabilising reserves. Finally, Russian public sensitivity to rising prices - inflation is currently 7.4% but expected to ease - is widely perceived to drive a policy preference from the President down that argues that ordinary Russians may not understand monetary policy, but they fear and will punish inflation. Putin has called Russia's monetary conservatism 'largely justified'.

Needless to say, this hawkish stance has plenty of domestic critics, both in and outside of government. Minister for economic development Andrei Belousov has called it a barrier to higher economic growth that is starving Russian corporates of capital. Nabiullina, who has done Belousov's job herself, is likely to bring a similar set of concerns to her new role.

The basic expectation must be a strong element of continuity. Inflation will remain a political and policy anathema, and with the Russian economy more likely to stagnate rather than contract in the next twelve months, a stimulatory policy seems very unlikely. We can speculate that in the first month of a Nabiullina governorship there will be a cut or two in the Russian base rate as Nabiullina reacts to easing inflation pressure and signals her understanding of growth concerns to Russian corporates and borrowers. Nabiullina is also likely to take a close interest in the transmission mechanism for rate cuts, putting pressure on the main Russian lenders to pass on rate cuts to borrowers.

This is likely to be the context in which Nabiullina makes the key decisions about the implementation of new international banking standards - in particular the new Basel III capital, leverage and liquidity requirements. The current Bank of Russia leadership have pressed for Basel III implementation in Russia in 2013, and changes in Russian rules on common and Tier 1 equity to bring them into line with Basel III are scheduled for October. Nabiullina's experience in guiding Russia into the WTO suggests an instinctive multilateralist and an operator who is sensitive to the reputational value for Russia of adherence to international standards. The EU will implement Basel III from this year, with a phase in period stretching until 2018. India has also adopted the new standards.

However, the Bank of Russia's judgements are likely to reflect a wider debate around Basel III. With the US yet to transpose the Basel III standards into domestic rules and some US regulators increasingly openly sceptical about the Basel III approach to risk-weighting and leverage there will be a clear incentive for Moscow to slow pedal at minimal reputational cost.

Prominent Russian bankers, including Sberbank Chairman and Nabiullina's ministerial predecessor German Gref, have openly called for the new Bank of Russia leadership to be more cautious about Basel III, arguing that higher prudential standards could have a further chilling effect on lending. It would not be surprising if Nabiullina's first strategic trade off with Russia's banks is a more incremental approach to Basel III in return for a faster and more visible translation of loosening monetary policy into cheaper and higher lending.

Nabiullina's normalisation strategy

Like Mark Carney in the UK, Nabiullina takes the helm at the Bank of Russia at a time when expectations of central banks and central bankers globally are evolving rapidly and in some respects radically. Unlike Carney, or his analogues in Japan, Frankfurt and Washington, Nabiullina will face comparatively limited demand for monetary policy innovation. Barring a Russian economic meltdown, in a world of monetary radicals, Nabiullina's Bank of Russia will not be under pressure to experiment with large scale monetary stimulus.

This is not to say that her tenure will be uneventful. Managing a massive institutional transformation is likely to test a skilled and intelligent technocrat with comparatively limited institutional management experience. On the policy front, a long period of tightening combined with some signs of falling inflation suggest her initial tenure will be defined by some basic calls on when to loosen policy without provoking politically-toxic price inflation or encouraging further capital flight. She will also have to make a big call on bringing Russia into line with a somewhat shaky global consensus on capital, liquidity and leverage.

From the perspective of 'Russia risk' what does her appointment suggest? This can be read a number of ways. Nabiullina is Putin loyalist, but of an intelligent and considered stripe. She has arguably been one of the clearer and more respected voices in the Russian system over the last decade for Russian multilateralism and reform. She consistently argued in private that Russian WTO entry needed to be part

of a wider economic 'normalisation' strategy for Moscow - one that has been consistently squandered through no fault of her own. She is likely to bring the same mind-set to the Bank of Russia - seeing monetary policy and financial prudential policy, including the vexed question of Russian implementation of Basel III - through the prism of how to project Russian economic and investment stability, predictability and conventionality. How this ambition survives the competing pressures of Russian politics will be her big test.

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