

**Central Bank of Russia and the Financial
Crisis of 1998**

presented by

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Outline

- Facts about Russia
- Main functions of the Central Bank of Russia
- Comparison to the US Federal Reserve Bank
- Factors that led to the Financial Crisis of 1998
- The Role of the Central Bank during the Crisis
- After the Crisis



Some Facts

Geographical Area (km²)

1	Russia	17,075,200
2	Canada	9,976,140
3	United States	9,629,091
4	China (mainland)	9,596,960
5	Brazil	8,511,965

	Russia	United States
Population	143,782,338	293,027,571
GDP per capita (\$)	\$8,900	\$ 37,800

Source: CIA World Factbook

Bank of Russia (Central Bank)

Year established: 1990

Main Goal: Ensure stability of ruble's purchasing power

Functions:

1. Supervising and regulating banks
2. Acting as a bank for banks
3. Issuing paper currency
4. Managing international reserves
5. Conducting monetary policy

1998: Bank of Russia v. US Federal Reserve Bank

	US Fed	Bank of Russia
Experience	Mature institution (since 1913) managing a mature free market economy	Relatively young institution (since 1990) managing a rather unstable transitional economy
Exchange Rate Policy	Float	Crawling peg
Favorite Monetary Tool	Open Market Operations	Required Reserves Ratio Discount Rate
Maturity of monetary tools	High Degree of Maturity	Almost None

Situation in the beginning of 1998

It became clear that the macroeconomic achievements of 1997:

- stable currency
- stable exchange rate
- low inflation

had been bought at the price of:

- massive government borrowing
- large scale sales of international foreign currency reserves
- large revenues from oil and gas export.

Major problems:

- Large budget deficit (due to debt servicing expenses)
- Inability to service the debt (Debt/GDP=50%, and projected to increase by 23% in 1 year)
- Weak banking sector highly disposed to devaluation

Implications: Lenders required higher interest rates and insisted on short-term lending.

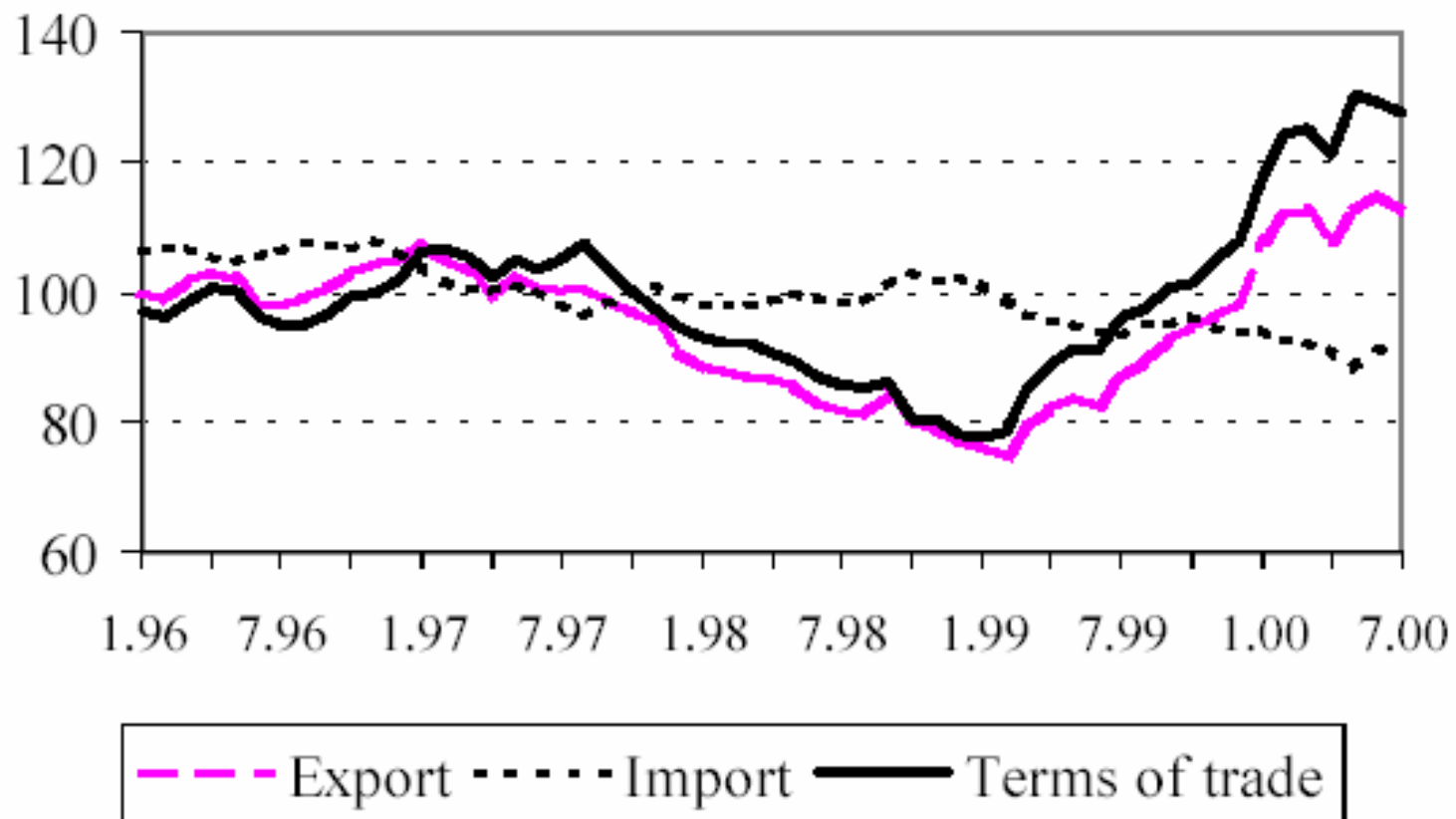
Beginning of August 1998

The situation in the Russian financial markets worsened.

The main triggers were:

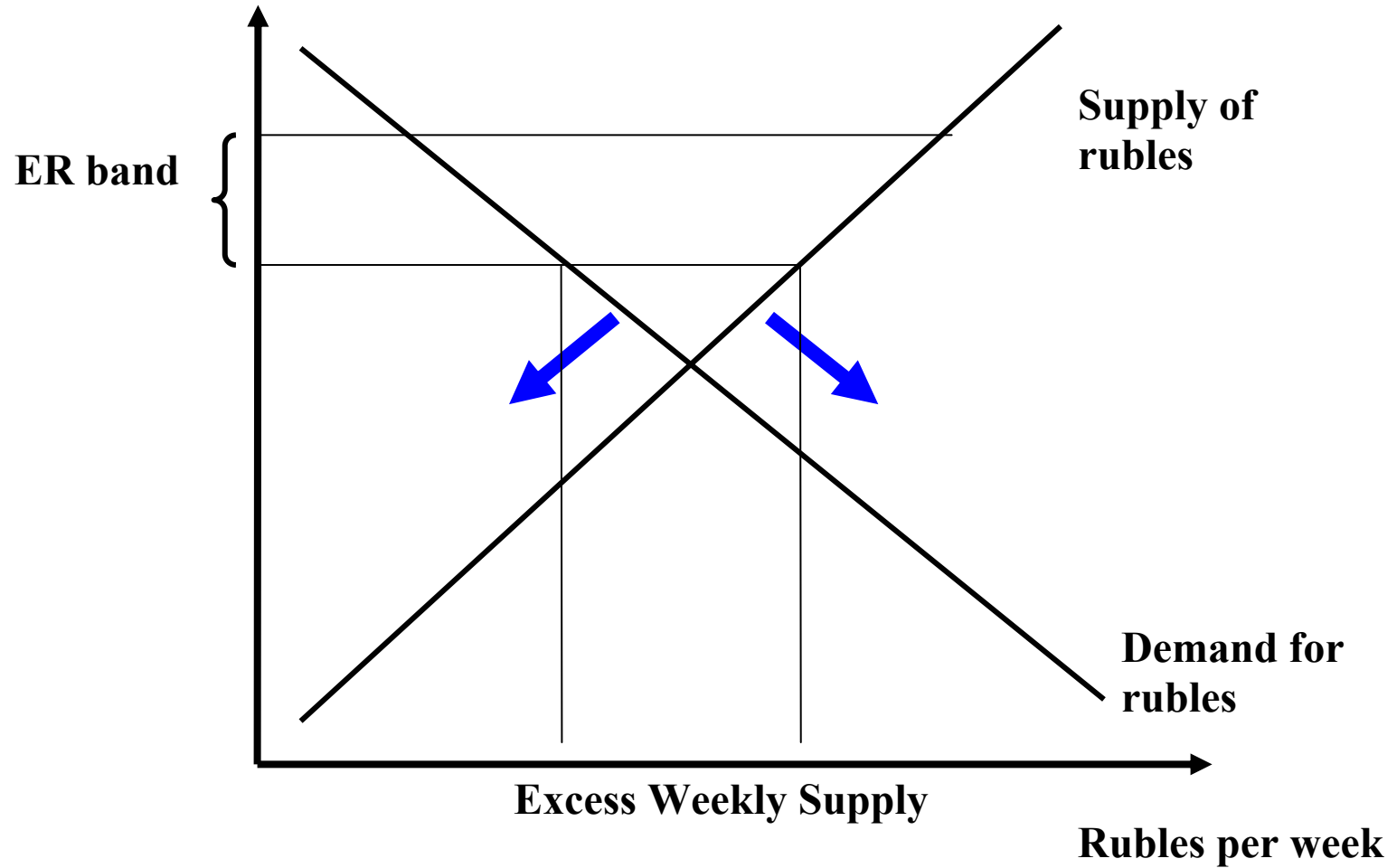
1. the global financial crisis which began in a number of countries in southeast Asia
2. the decline in world prices for Russia's main exports items, primarily oil, which has resulted in the worsening of the country's foreign trade balance.

Prices for Russian Exports (1997=100)

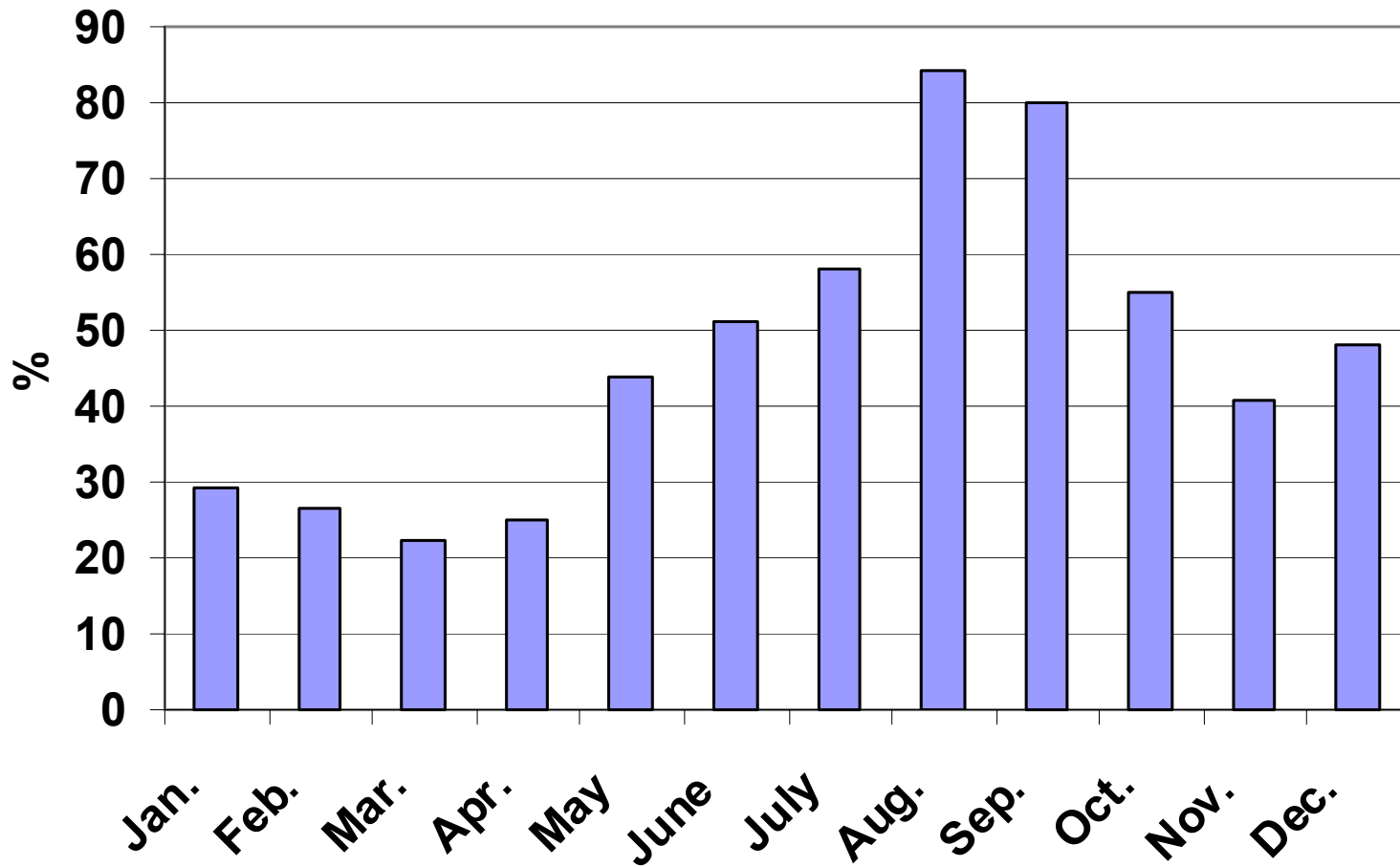


capital outflow + terms of trade deterioration => supply of rubles \uparrow , demand for rubles \downarrow

\$ / ruble



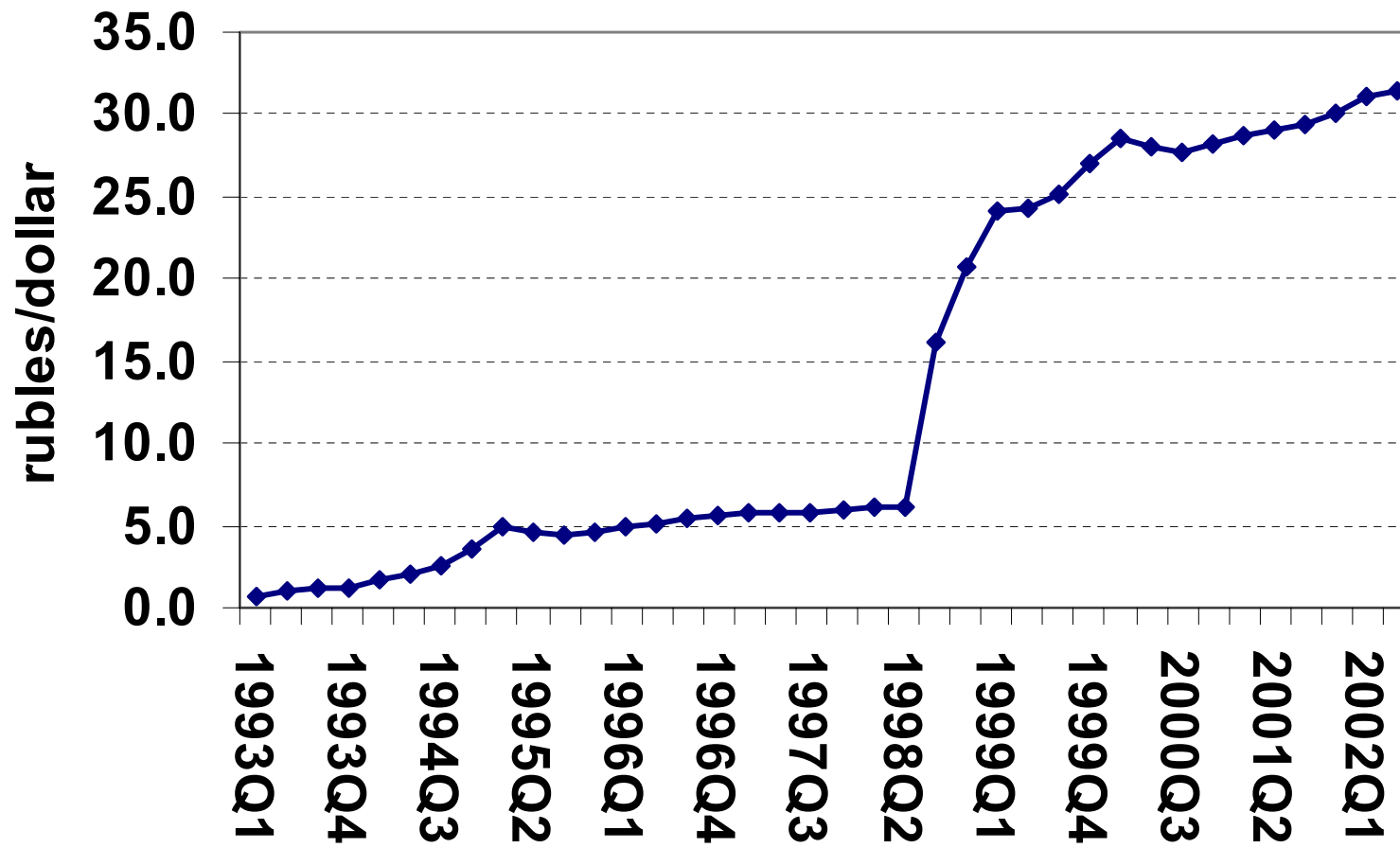
Short Term Interest Rate, 1998



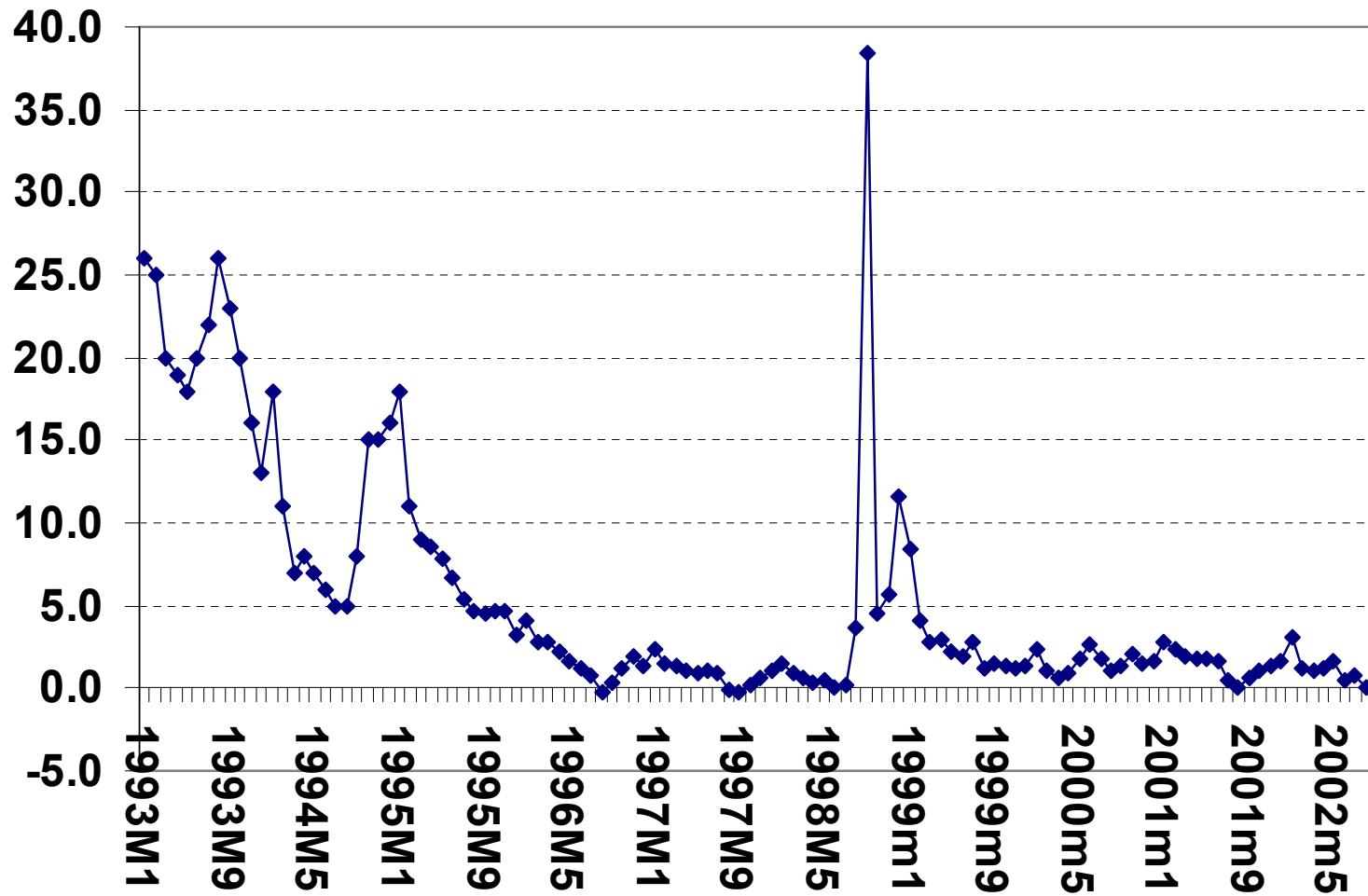
Outcome

- CBR floats ruble
- Government defaults on its bonds
- CBR is forced to finance government deficit
- Banking system collapses
- Inflation skyrockets

Exchange Rate



Percent change in CPI



After Crisis

CBR's policy in the months following the crisis was determined by the need to

- 1. provide liquidity support to the troubled commercial banks,**
- 2. finance the government deficit.**