

New Russian Central Bank Head Nabiullina on Bank's Future Direction, Fiscal Policy

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Interview with Elvira Nabiullina, newly appointed head of Russian Central Bank, conducted by Dmitriy Butrin: "We Should Not Try To Artificially Influence Exchange Rate. Elvira Nabiullina on Short-Term Goals and Long-Term Tasks"

Today, Elvira Nabiullina assumes management of the Bank of Russia. In an interview with Kommersant, the head of the CB (Central Bank) tells about what is changing in the CB, what is certainly not changing, and what is the subject of discussion for the nearest future.

(Correspondent) You are leaving the post of presidential aide on economic questions. Are you certain that the new presidential aide will preserve the continuity of the course on basic economic questions?

(Nabiullina) The course is determined by the president, and not by his aides. Nevertheless, I hope that continuity in the work of the aide on economic questions will be retained. It is important for anyone who leaves a position to know that the main endeavors that he began have been continued. But I am a realist and understand that corrections are always introduced. Every person comes in with new ideas. It will be the same also in the CB: Both a continuity of policy, and certain changes.

(Correspondent) From your standpoint, are you as an economist associated with a specific course in economic policy, toward which others will orient themselves, knowing that you head up the Bank of Russia?

(Nabiullina) What is very important for me in economic policy is the adoption of institutional decisions, the change of institutions that lead to long-term changes, not short-term ones. A This work does not always yield quick results. But it is specifically the improvement in quality of institutions and quality regulation that can seriously change the situation in the economy as nothing else can.

(Correspondent) The key institution in the financial sphere, which was formed in the economy in the period when Sergey Ignatyev managed the CB, was strong banks with state participation. Today, considerable efforts are needed in order to return to some kind of divergence in this sphere. Is this a current task?

(Nabiullina) In the banking sphere, if we speak of institutions, competition is more important than the structure of ownership. We have become accustomed to believing that competition is characteristic for private banks, but in practice it also exists between private and state banks, as well as between state banks. It is possible, and it exists. The regulator must have an equal attitude toward credit organizations, regardless of their forms of ownership. Thus, access to the mechanism of refinancing must be based on an absolutely equal approach, regardless of ownership.

In the largest banks, and specifically in Sberbank, we must retain the controlling packet of shares for the foreseeable future. There are historical reasons for this: A considerable part of public deposits are kept in Sberbank, and the people trust Sberbank because it is backed by the state. This is already an institutional phenomenon, and it must be reckoned with. Nevertheless, equal conditions of competition are a principle that should also be applied to Sberbank.

(Correspondent) Your arrival to the CB has coincided with the project of mega-regulator -- expansion of the CB's regulatory functions to the financial sector. From your standpoint, was this decision evoked by already existing problems of regulation, or is this a preventive expansion? Will financial-banking-insurance groups that require united oversight make a full-fledged appearance in the future?

(Nabiullina) Such groups already exist, and have been around for quite a long time now. We may recall that the concept of the financial-industrial group appeared in Russia back in the 90's. In part, this intertwining has been inherited by today's economy, and in part the logic of development of business has led to the emergence of new financial groups -- mainly banks, which work with their insurance companies and non-state pension funds. Since the phenomenon exists, the problem of regulatory arbitration arises. Part of the operations and structural business elements in these groups are not regulated either by the CB or by the FSFR (Federal Financial Markets Service), and considering the openness of trans-boundary

operations, the capacities of regulatory arbitration are increased many times over.

However, I must say that the need to reduce the capacities of regulatory arbitration is but one of the reasons for adopting the decision on a mega-regulator. The main reason was the desire to strengthen the Federal Financial Markets Service -- both financially, and in terms of staffing and methodology -- so as to elevate regulation and oversight in the non-banking segment of the financial market to a new level.

(Correspondent) From your standpoint, does the problem of risk migration between financial and banking components of holdings already exist in Russia?

(Nabiullina) Such a problem exists, as does the problem of being "too big to fail." The sense of comprehensive oversight is associated not only with the migration of risks from one sector to another, but also with a high level of concentration within certain segments of the market. We have both banks and insurance companies that hold a significant part of the market, and they are too big to fail, because they may drag down the entire market with them. The CB began developing macro-prudential oversight under the leadership of Sergey Ignatyev, and now this is one of the priority directions. We must perform oversight not only of each bank and insurance company individually, but we must also monitor the accumulation of risks in the financial system as a whole.

(Correspondent) Such work requires rather serious investments into the CB's analytical services. And you prepared for such investments, and primarily for investments into staffing?

(Nabiullina) Of course, this is necessary. Key decisions must always be backed up by analytical work and expert appraisal. Aside from that, this helps to oppose lobbying, whose manifestations are difficult to trace. Research work in the CB is fairly well established. And the development of analytical competencies takes on particular significance in making the changeover to targeting inflation, which in and of itself means the adoption of decisions specifically on the basis of analysis and prediction of the behavior of macroeconomic parameters -- inflation, economic growth in the sectors, unemployment, and load on production capacities.

(Correspondent) There are two conceptual approaches to reform of specific CB oversight: Consolidation in the form of retaining the MGTU (Moscow Main Territorial Administration), creation of OPERU-2 (Operations Department), and decentralization with transfer of part of the oversight prerogatives to the CB's territorial administrations. Which arguments will you operate with in choosing one approach or another?

(Nabiullina) That is not the easiest question. Today, approaches to oversight in general are seriously changing. This is already not simply oversight of adherence to formal indicators. It is a changeover to Basel-2 and Basel-3, the introduction of risk management, and quality control of work at the level of the banks themselves. In addition to this, the set of information technologies that allow us to implement more effective long-distance oversight is expanding. The third important factor is the appearance of the category of systematically significant financial organizations -- moreover, not only in the banking sphere, but also in the insurance and financial sectors. Finally, there are new approaches and methodologies in oversight which provide for motivated judgment.

These factors will influence the organization of oversight itself, its structure. I think that a number of the powers and authorities which are exercised at the level of the regions and territorial institutions may also be exercised at the level of the central apparatus. Such a redistribution of functions is possible. It is already ongoing within the scope of the CB. The number of territorial institutions is decreasing, and this is a correct tendency.

Is a changeover to OPERU-2 possible? We must carefully analyze the pluses and minuses of this. Already today, the CB is organizing oversight of second-tier banks. This is around 200 major banks. But the creation of a special subsection within the central apparatus -- that is the question that we are specifically discussing now, and will come to a final decision in the nearest time.

(Correspondent) The CB as an institution is not only independence of status, but also an entire culture, based to a significant degree on operational autonomy. Do you intend to preserve the autonomy of the CB in the broad sense, or to more greatly integrate the regulator into the agencies of authority?

(Nabiullina) The CB must remain independent in implementing monetary-credit policy. I cannot imagine targeting inflation outside the scope of an independent CB. Therefore, if we understand autonomy as

independence in making decisions on monetary-credit policy within the scope of the mandate given to us by the legislation, then, without a doubt, we must retain this independence. Secondly, we must make the CB's activity and its methods of regulation more transparent. It is important to retain and strengthen trust in the CB. This is required in order to implement an effective monetary-credit policy, which is built on trust in the actions of the CB, on intelligibility of the process of making decisions, and on their substantiation. If the decisions of the CB are intelligible, opinions to the effect that the CB is a "black box," a "state within a state" will disappear.

At the same time, we are expecting that the National Banking Council will even more actively assist in the resolution of this problem.

(Correspondent) Do you expect a change in the CB's mandate at the suggestion of the Ministry of Economics, a legislative imputation for the CB to create conditions for economic growth?

(Nabiullina) The CB, in essence, is already participating in creating conditions for economic growth -- through reduction of inflation and development of the banking sector. But, as soon as we change over to the language of specific measures and instruments that the Central Bank may activate, we must avoid mutually exclusive and contradictory actions. Otherwise, not one of the stated goals will be achieved. Inflation and economic growth are two targets, two tasks, which may contradict each other at certain time intervals. And it is hard to influence two tendencies of different directionality with one set of instruments. Subordination of tasks cannot be avoided in this situation. And while for the government the overriding task is economic growth, for the Central Bank it is reducing inflation and achieving financial stability.

But in those cases when the tasks do not contradict each other -- that is, in cases when it is necessary to implement a countercyclical policy, we will implement it.

(Correspondent) Do you believe that inflation targeting must in any case remain within the goals of activity of the CB?

(Nabiullina) I believe that the goal of reducing inflation must remain. For our country -- certainly, because we still have a high level of inflation. I repeat: The level of inflation is very high. We talk a lot about economic growth, about how good it would be to obligate the CB to be responsible for economic growth, and we forget that macroeconomic stability is one of the factors of economic growth, while low inflation is one of the main factors in the investment type of growth. Low inflation in and of itself is insufficient for there to be investments. But with high inflation, and especially with volatile inflation, we certainly will not see an investment boom. It will be impossible to expect financial recoverability of projects and to attract long-term financing.

(Correspondent) What do you think about the second component of the Economic Ministry's proposals -- weakening the real exchange rate of the ruble in order to stimulate economic growth?

(Nabiullina) With an artificially cheap ruble, growth in a number of export-oriented sectors is temporarily possible. Moreover, these would be sectors for whose products there is no significant decline in demand on world markets.

(Correspondent) Should this possibility be realized?

(Nabiullina) Usually, countries that want to maintain the export orientation of certain sectors of the economy weaken their exchange rate. Look at where, on what markets, we are present, and to what degree we would be able to increase export in these sectors if we weaken the ruble. Why, this can easily be calculated! I think that the calculation will show that, even in these sectors, we would not achieve a great rate of growth. And in other sectors, we would get problems: Import of investment equipment would become more expensive and prices would grow, since consumer prices are to a significant degree determined by import prices. Before even proposing such things, we must consider the consequences.

I believe that we should not try to artificially influence the exchange rate. This is dangerous under conditions of the unstable world situation: Any abrupt changes there, and we would get all the problems here. Problems associated with an abrupt change in the exchange rate, or with expenditures for artificially maintaining it. In any case, the potential shocks are huge. We cannot do this.

(Correspondent) For you, as an economist, is the idea of manipulating the exchange rate for the purpose of spurring growth generally unacceptable?

(Nabiullina) Absolutely. Short-term actions cannot solve long-term problems, the reasons for which are entirely different and also long-term. We need to act on the reasons, and not on their effects.

(Correspondent) May the ruble -- which today is sooner in a regimen of flotation rather than in a managed regimen-- be considered artificially overestimated in a certain sense?

(Nabiullina) It is not artificially overestimated. There are certain elements which influence its overestimation in a very small volume. Among others, this is the effective mechanism of purchasing currency for reserve funds, which Finance Minister Anton Siluanov spoke of. If the purchase becomes an operation on the open market, and not an operation within the CB balance, it may lead to a certain change in the ruble exchange rate. But the effect from the fact that today currency is not being purchased on the market is slight, if not a pittance.

(Correspondent) That is, we may summarize: There are countries for which is interesting and important to participate in competitive devaluation, but Russia is not one of them?

(Nabiullina) This is not a solution for Russia. And we should not forget: Countries that hold down growth of the national currency by methods of currency policy usually limit the movement of capital. You cannot have one without the other.

(Correspondent) Indicative rates -- from your standpoint, is this an unnecessary measure, or dangerous in some way?

(Nabiullina) It is unnecessary. And I do not understand whom this indication is for. If it is for a bank, which must be guided by this rate in issuing loans to certain borrowers, then this is a step backwards. A bank must introduce risk analysis. That is, it must create a rather complex model, which allows it to appraise each borrower and to build its loan products based on this. Standardized loan products, where interest rates are the same for a broad range of borrowers, are mainly consumer oriented, while the proposal calls for using indicative rates on the commercial loan market, where rates are individual. If we want to give an indication to audit agencies or to the Federal Antimonopoly Service, as had been proposed, we will get only a negative effect: Any sanction against a bank that issues a loan above the indicative rate would lead to the fact that this credit product would generally not be issued. Banks will not reduce rates to the indicative rate. They will simply stop lending. When we begin to hold down prices on any product -- be this bread, gasoline or loans -- a shortage of this product arises. If we want to develop lending, then we must do exactly the opposite: Not increase administrative pressure, but develop competition.

(Correspondent) What seems rational to you in the proposals on stimulating economic growth that are being discussed?

(Nabiullina) All of the questions associated with the investment climate. We must really move ahead in implementation of those "road maps" of the investment climate which were coordinated with business. They must simply be implemented. And we are greatly falling behind in this. Work is needed on improving the quality of corporate management of public companies. For example, one of the standard explanations for increasing credit rates on the part of banks is the lack of transparency of the borrower, the increasing privacy.

This concerns not only major companies. Take small and medium-scale business: It is feeling bad not only because financing rates are high, because high administrative expenditures have been placed on it, because it bears the burden of corruption and a heavy fiscal load has been placed on it. Under this pressure, it is going into the shadows and becoming non-transparent. And then, how can a bank lend to it?

Therefore, increased transparency not only of public companies, but of companies in general, is a very correct direction. We met with representatives of small and medium-sized business and banks in order to see what the regulator can do to develop lending to small and medium-scale business. There are some very sensible ideas, which could have been implemented. Part of the companies of small and medium-scale business are ready to disclose information about themselves in an increased volume, to give information about themselves to the credit history bureaus, which in this case would work not only with individuals, but also with legal entities. There is also a possibility of establishing cooperation of banks and the Pension Fund, to disclose information on payments to the fund to banks. In this case, banks are prepared to reduce the interest rates by half a percentage point or a percentage point. It seems to me

there is something to work on here.

This is the general approach: To reduce bank risk appraisals by market methods.

(Correspondent) One other proposal for stimulating growth was to invest the funds of the National Welfare Fund (NWF), pension savings and other quasi-state funds into the economy. What is your attitude toward this idea? Obviously, this would influence the monetary-credit policy of the CB, among other things.

(Nabiullina) I have a positive view of this initiative. When I was minister of economics, I also proposed that a certain share of the NWF funds go to Russian assets. But! It is important that the money from the NWF, and especially from the Pension Fund, go by different procedures and to different projects than direct investment from the budget provides. Private investors, who must assume risks and estimate the return on capital and the economic recoverability of projects, must necessarily participate in projects that are financed in this way. The NWF may only co-invest in such projects, and investments must be made in products with an understood return and an understood yield. These are long-term investments. That is something that the market cannot allow itself today, but nevertheless these are specifically investments, and not something else. They are not subsidies, and not handing out money for free.

(Correspondent) In essence, this position is similar to the position of Finance Minister Anton Siluanov.

(Nabiullina) Yes, in general, our positions are close on such questions. And this is understandable: In practice, what we have is not a shortage of money, but of well-structured projects in which to invest the money. After all, permission has already been given to invest up to R100 billion from the NWF into such projects. But there are no projects that have been worked out! That is the problem.

(Correspondent) The Finance Ministry is currently developing the principles of compulsory oversight of pension funds. Will this oversight also be consolidated under the auspices of the CB?

(Nabiullina) Yes. We are actively cooperating with the Finance Ministry on this question. Insurance organizations, the NPF (National Pension Fund), PIFs (mutual funds) -- all of them, in essence, are financial market institutions.

(Correspondent) The relations of the CB and the Finance Ministry were largely built on partnership in placement of money from sovereign funds and on coordinating operations on the OFZ (federal loan bond) market and the state debt market in general. As of August of 2013, this model will change. What else will change in the mutual relations with this financial department?

(Nabiullina) There are many more lines of cooperation between the CB and the Finance Ministry, not to mention the fact that the CB is not a subject of legislative initiative and therefore passes its proposals for amending the laws through the Finance Ministry.

For example, we have some very serious legislative work ahead of us on strengthening regulation and oversight of the insurance market. For now, we have a very weak base of regulation and oversight, and therefore the trust in this system is not great. And as a result, this sector of the market is rather paltry. As for management of the money of the Reserve Fund and the NWF -- there was an idea to create the Russian Financial Agency, but it encountered largely justified objections of experts, lawyers and deputies. The decision was adopted to seek alternative approaches, and the Finance Ministry presented the idea of expanding the powers and authorities of the CB and allowing it the opportunity to invest reserve funds into a broader set of instruments.

As for ruble funds and investments into Russian investment projects, this, of course, is not the "business" of the CB. The CB cannot assess the risks of investment projects. This is absolutely not our history, and we should not have to deal with this. But if we speak of managing investment abroad, the CB rather conservatively invests all of the funds of the Reserve Fund and the NWF, even though these funds have a different purpose. In the Reserve Fund, we need high-liquidity investments. Investment of the foreign part of the NWF may be performed according to the rules of more long-term investment, which is more greatly aimed toward yield.

(Correspondent) That is, in essence, the three parts of the Russian Federation's international reserves will be invested according to different rules?

(Nabiullina) First and foremost, it is possible to separate the principles of investing funds in accordance

with the ratio of Reserve Fund and NWF funds in the reserves.

(Correspondent) For quite a while now, Sergey Ignatyev has been talking about the problem of dubious operations in the banking sector. Evidently, the problem remains. What do you intend to do about it?

(Nabiullina) This is the bane of our economy. Part of the banking system really is living on dubious operations, and this is very bad. If only because this is an attack on the principle of fair competition. It turns out that part of the agents of economic activity within the country may not pay taxes, launder unlawfully gained and corrupt funds, and pass all this through the banking system.

There are various approaches to organization of work. We may try to monitor all of the chains and all of the legal entities and to look into their organizers. After that, there are police-criminal measures and decisions by the regulator -- that is, everything that is provided by law. This is work that we will do in any case, but we must understand: This is the most labor-intensive, the most expensive route. For example, the struggle against one-day companies presupposes a tightening of the rules for creating companies -- and it is the honest agents, among others, who will be forced to pay for this. I am already not speaking of the fact that this is post factum work. That is, after the money has already been stolen or withdrawn.

After all, we must change over to prevention of such incidents. I definitely support the proposals on amending the legislation in this sphere. For example, the right of banks to independently suspend operations on accounts in case of operations that the bank deems to be dubious, the right not to open an account for a client who has not passed the bank's verification procedures, the bank's obligation to verify clients -- all this must now be secured in a methodological and organizational manner.

(Correspondent) The effectiveness of such work will surely give rise to dissatisfaction. Are you ready for political pressure on the CB in this sphere?

(Nabiullina) In principle, I have noticed that in the CB -- and this is entirely explicable -- there is a trauma associated with the murder of Central Bank Deputy Chairman Andrey Kozlov. Perhaps the regulator is now really working in an overly cautious manner in this field. Perhaps even a bit more cautiously than the acuteness of the situation demands. In any case, I am prepared to do what must be done. But this is an institutional problem. Simply to write letters to the law enforcement agencies so that they catch the criminals -- that is necessary, but in a certain sense useless, at least in the systematic plane. If we see a chain of organizers or a scheme, the CB may perhaps be the initiator of persecution, working with the law enforcement agencies. In any case, I have an inner readiness to do this.

But here is what must solve the essence of the problem. Step by step, we must make rules that will increase transaction expenses for such activity. Step by step. This is a priority.

(Correspondent) May we speak of the evolution of your views on the economy in recent years?

(Nabiullina) I have been asking myself that question. Yes, evidently so. I now devote more attention to what is called the euphemism of "emacroeconomic stability," as well as economic fairness, equality of approach in regulation, stable and equal conditions of development for all economies.

(Correspondent) While the number of proponents of growth stimulation is increasing?

(Nabiullina) Of course, the attack on the principles of macro-stability has intensified with the change of CB leadership. When a person with my background finds oneself at the head of the Bank of Russia, a person who has always supported economic growth, investments, and state investments, of course there is a natural desire to determine whether it is possible to advance the principles.

On the other hand, this is an absolute mainstream -- an attack on the central banks, the demand for central banks to assume part of the problems which the government had not solved before. This is happening throughout the world. Non-standard methods of action by central banks are being examined and employed in this sphere. One thing is important: No one has yet appraised the long-term effect of these measures. Today, we are seeing only the short-term effects. Moreover, they are not the most positive from the standpoint of economic growth. Therefore, it is not surprising that the attack on the central banks is being seen specifically now, when it is becoming clear that not everything is all that simple with stimulation. On the other hand, all this motivates me to more actively tell about why we need to implement the policy which I intend to implement.