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## Strategy and Tactics of Monetary Policy in Conditions of the Global Economic Crisis

*The article analyzes changes in monetary policy goals and instruments during the global economic crisis in industrial countries and Russia. The authors emphasize the need for an active exchange rate policy in Russia, and for the development of interest rate instruments via the implementation of exchange restrictions to prevent crisis contagion in the future.*

### **Financial globalization and the global economic crisis**

The globalization processes that are developing in the international economy and are most drastically manifested in the financial sphere are having a significant impact on the development of national economies and the conduct of economic policy. Qualitative changes in the external environment also influence monetary policy. This was manifested especially dramatically during the

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global financial and economic crisis of 2008–9, which created new problems for national monetary policy. Among the prerequisites for development of the crisis that are related to globalization and have directly influenced monetary policy, we can single out the following.

The growing role of financial markets and cross-border capital flows, and expansion of the set of available financial instruments. A fairly extensive literature is devoted to these trends. However, in the domestic literature considerably less attention has been given to the influence of these changes on monetary policy. In connection with this, we point out two circumstances that we think are important. First, monetary policy affects the financial system primarily through the banking sector, while the process of globalization increases the significance of securities markets as a mechanism for redistributing financial resources in the economy. Second, monetary policy practically did not take into account the increase in leverage in financial markets prior to the crisis. In the foreign literature, discussion of the advisability of monetary policy measures that influence financial markets in conditions of globalization began quite a while ago, but this problem has not been unequivocally solved. Proponents of intervention by central banks in the functioning of financial markets usually argue that in the current conditions large-scale price fluctuations in these markets have a substantial impact on the economy as a whole, and smoothing them out can have a positive macroeconomic effect. At the same time, opponents of intervention usually emphasize that it is natural for the prices of assets to change, and this is associated with a change in the market's assessment of risk, and they point out how hard it is to set a target for parameter as volatile as the price of a financial asset. It should be noted that the current economic crisis has revealed serious problems in risk assessment by financial markets.

In theory, one advantage of globalization is the possibility of noninflationary growth of aggregate demand. This is because the process of globalization per se has a powerful effect on inflation, tending to lower it.<sup>1</sup> However, explosive growth of asset prices and formation of financial bubbles are side effects of such a buildup of aggregate demand. As a result, this creates secondary inflationary effects. For instance, income growth for a significant number of households in poor countries was one factor leading to an increase in food prices in international markets in the second half of 2007. In turn, because of the high portion of food products in the consumer basket in developing countries, this led to increased inflation.

Even though theory says that it is not possible to combine a fixed exchange rate with an independent monetary policy, in practice many developing countries maintained regulation of the behavior of their exchange rate in one form or another. At the end of April 2008, eighty-one countries used some form of

pegging their exchange rate (not counting currency management and official dollarization regimes), forty-four countries had a managed float, and only forty countries (mainly developed ones as well as the most developed among developing countries) allowed their national currency to float freely.<sup>2</sup> In this case, continued regulation of the exchange rate by developing countries that play a large role in international trade (China, Persian Gulf countries, Russia) had important consequences from the standpoint of supporting the international currency system, in which the U.S. dollar functions as an international reserve currency.

To a considerable extent, the current global economic crisis was due to peculiarities of how financial markets operate, which were pointed out by John Maynard Keynes in his time.

The English economist wrote about the behavior of investors in the securities market

Most of these persons [speculators and professional investors—authors] are, in fact, largely concerned, not with making superior forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it “for keeps,” but with what the market will value it at, under the influence of mass psychology, three months or a year hence.<sup>3</sup>

In the current financial system, financial markets, which are supposed to promote the dissemination of information in the economy, themselves introduce distortions in this information. This is largely because of asymmetry in the distribution of information between market participants and the use of complex financial products that do not permit a full assessment of their inherent risk levels.

Moreover, the rapid growth of financial markets has enlarged the role of financial intermediaries in securities markets in comparison with traditional commercial banks. This trend is clearly illustrated by the more rapid increase in the assets of these intermediaries. While the ratio of assets held by U.S. commercial banks to aggregate household assets in 2008 was still approximately at the 1980 level, the ratio of brokers’ and dealers’ assets to the same base increased by a factor of almost eleven during this period, growing especially rapidly in the first decade of 2000.<sup>4</sup>

As we know, the crisis originated in the financial system of developed countries, primarily in the United States, and then spread to Western Europe, where financial institutions are closely linked with the American financial market. The first global manifestation of the crisis was shocks in national interbank markets worldwide (including Russia) in August 2007. These shocks

took various forms: higher volatility of overnight rates and short-term interest rates, a sharp increase in interbank rates for a longer term (three-month rates), a decline in trading volumes, signs of rationing, and a higher price variance in the interbank market.<sup>5</sup>

Complex financial instruments—derivatives and “derivatives of derivatives”—largely served as the link through which the crisis was transmitted. While they were supposed to effectively redistribute risk in the financial system, they actually created additional system-wide risks. Complications in the financial system observed during the past decade provided an opportunity to use so-called regulatory arbitrage within a single jurisdiction, considering that various segments of the financial market were generally regulated with different stringency and frequently by different regulatory institutions. The result was distinctive gray zones in the financial market within the national economy, where regulation was weak or completely lacking.

In addition, the prevalence of financial globalization processes, which enabled financial institutions to expand their presence in various countries, led to “interjurisdictional regulatory arbitrage,” which was involved in selecting a place to conduct particular operations where they were not as heavily regulated. As a result, risks were spread beyond the bounds of national jurisdiction.

The main channels through which the crisis moved from developed to developing countries were capital outflow to developed countries (because of the need to cover positions on the balance sheets of financial institutions from these countries) and a drop in these countries’ demand for products produced in developing countries (because of the overall decline in domestic demand).

### **New challenges for monetary policy in developed economies**

The crisis showed that the monetary system and financial markets are highly interdependent. In addition to its direct impact on the banking system, in countries where financial markets play a significant role in the financial system the crisis spread to the banking system through individual segments of the financial market (mainly those related to mortgage securities, and later through the stock market). The overall result of these processes was a “credit crunch” in the banking system. Central banks tried to increase banking system liquidity, inter alia by helping individual banks that were too big to fail, but until the summer of 2008 they were constrained, to some extent, by an elevated inflationary background (because of the growth of energy and food prices in the international market, which had somewhat increased global inflation in 2007).

We can distinguish several basic directions taken by the central banks of developed countries in response to the crisis, placing them approximately in chronological order.

In the first stage of the crisis, central banks used the standard tools of monetary policy (open market operations and changes in the basic interest rate), in an attempt to increase the money supply. The result of this policy was that the central banks of several countries (the United States, Japan, Switzerland, and Great Britain) lowered their interest rates to zero by the end of 2008 or the first half of 2009. This significantly constrained their ability to conduct standard monetary policy.

Difficulties in conducting standard monetary policy were seen first in Anglo-Saxon countries (primarily the United States), where a financial system based on financial markets has traditionally been dominant. To preserve the stability of the financial system and its functions of moving funds between various groups of economic agents, the central banks in these countries set the additional task of supporting individual segments of financial markets that play an important role in transmitting signals from monetary policy to the economy and are too big to fail. Examples include the introduction of a series of new monetary policy tools by the U.S. Federal Reserve System<sup>6</sup> and the Bank of England's program to purchase assets.<sup>7</sup> These tools in the United States and Great Britain were directly intended to support individual segments of the securities market.

Changes were made in the set of monetary policy tools in other countries, primarily to help increase the money supply in the economy in response to the actions of central banks. For example, after October 2008, the European Central Bank (ECB), which had conducted its own refinancing operations in auctions with floating interest rates, began to use auctions with fixed rates. This gave banks in the euro zone unlimited access to liquidity with a one-week to six-month term at the central bank's basic rate.<sup>8</sup>

In addition, almost all of the central banks in developed countries expanded the number of securities that could be taken as collateral for conducting open-market operations and, in some cases, the range of the central banks' counterparties in these operations. The latter change was particularly true of Anglo-Saxon financial systems, where not only banks but also the main participants in the securities market were given access to liquidity.

The terms of the central bank's provision of funds to commercial banks were lengthened. While operations to provide liquidity had previously been mostly for a relatively short term (up to one month), because of the crisis, central banks began to introduce mechanisms designed for longer-term lending (up to one year).

It should be noted that central banks in developed countries took a number of coordinated actions in response to the global crisis.

First, on October 8, 2008, six of the world's leading central banks followed a coordinated rate reduction. Considering the role of interest rate policy in

regulating exchange rates, among other things, this action demonstrates the desire of central banks in developed countries not to use competing devaluation of their currencies to support their economies.

Second, a number of central banks opened currency swap lines for central banks that were experiencing a need for additional financing in the respective currency. Swap agreements between the Federal Reserve and a number of central banks are particularly noteworthy.<sup>9</sup> Other currency swap agreements also appeared between central banks, such as the one between the Swedish Riksbank and Iceland, Latvia, and Estonia,<sup>10</sup> as well as the People's Bank of China's agreements with Belarus, Argentina, and a number of Southeast Asian countries, which caused a political stir.

The question of helping financial institutions that are too big to fail during the crisis needs to be examined separately. In this case, considerations of moral risk took a backseat, since not helping individual financial institutions might lead to serious macroeconomic or even global consequences (as the experience of Lehman Brothers showed). During the crisis, traditional arguments in favor of supporting individual key banks (those that are "too big to fail") in the national banking system were supplemented with new ones: "too global to fail" and "too interconnected to fail," which undoubtedly reflected qualitative changes that had occurred in the international financial system. As a consequence, a number of large banks were nationalized. For the most part, this nationalization took the form of the government taking an equity position in a particular bank in order to support it financially.<sup>11</sup> However, in almost all cases it was announced that this measure would be temporary.

In spite of the numerous measures intended to increase the money supply and help individual financial institutions that are too big to fail, the anticrisis monetary policy in the leading developed countries could not prevent a decline in aggregate demand and a drop in production. This was graphically demonstrated by the behavior of gross domestic product and industrial production at the end of 2008 and beginning of 2009.

The key problem is that difficulties have occurred in the functioning of the traditional transmission mechanisms of monetary policy. Because of disruptions in financial market operations, an important link in the transmission of signals through the interest rate mechanism has stopping working. Moreover, in conditions of a loss of confidence and increased risk assessment, banks put additional restrictions on lending, which weakened the effect of the credit channel. Researchers at the Bank for International Settlements even distinguished a special "risk-taking channel" of monetary policy that operates in the new conditions.<sup>12</sup>

Thus, on the one hand, the monetary policy of developed countries was aimed at increasing aggregate demand, while at the same time, less attention was

given to the problem of possible acceleration of inflation, and the likelihood of deflation raised much greater fears. On the other hand, monetary authorities tried to overcome bottlenecks that appeared in the financial system as a result of the crisis (individual segments of the financial market that are important from the standpoint of the monetary policy transmission mechanism and the functioning of the financial system as a whole ceased to operate), using new monetary policy tools.

### **Anticrisis monetary policy in Russia**

A specific model combining monetary and fiscal policy was established in Russia in the precrisis period (first decade of 2000). Monetary policy (by means of currency interventions) actually had the purpose of targeting the nominal exchange rate, while fiscal policy had the purpose of targeting the money supply (using the Stabilization Fund). As a result, the authorities managed to target both the nominal and real exchange rate relatively successfully.<sup>13</sup>

As a result of this policy, international reserves began to grow. The monetary authorities adhered to conservative methods of managing these reserves and did not use them to modernize the economy, although numerous such proposals were made, including one by one of the authors of this article.<sup>14</sup>

The first shocks in the international financial market in August 2007 led to changes in Russia's monetary policy model. Because of shocks in the interbank markets of developed countries, Russian banks also experienced a shortage of liquidity. To resolve this problem, the Central Bank of the Russian Federation [Central Bank] eased its monetary policy.<sup>15</sup> The basic monetary policy tools (other than currency interventions) that had been used up until then for sterilization purposes, along with fiscal policy, were reoriented to providing liquidity. Here we should note the renewal, beginning in August 2007, of direct repo auctions, a temporary reduction in the mandatory reserve standard, and a number of other measures. However, by the end of 2007 there were signs that inflation was accelerating, due to an increase in international food prices.

Responding to increased inflation, the Central Bank began to tighten its monetary policy at the beginning of 2008. The mandatory reserve standards were raised, and a gradual increase in the refinancing rate began. However, at the same time, currency reserves continue to build up, contributing to an increase in the money supply.

The full-scale spread of crisis phenomena to the Russian economy began in July–August 2008, through the same channels by which they spread from developed to developing economies (outflow of foreign capital and a drop in exports). Following the decline in exports, industrial production fell, and firms in the fuel and energy complex curtailed their investment programs. As

a consequence, manufacturing output began to decrease even faster than that of the extractive industry.

The banking system ran into serious problems in conditions of a sharp drop in the securities market,<sup>16</sup> a practically complete shutdown of the interbank market, and a loss of depositors' confidence in it. In September–October 2008, deposits by individuals fell 7.4 percent.<sup>17</sup>

All of this forced a change in the monetary policy model. The reaction to the full-scale financial and economic crisis developed in two basic directions.

First, the policy of helping the banking system was continued. This was the same policy that had been conducted in the first wave of the crisis, only on a larger scale and using more tools (see Figures 1 and 2).

Beginning in August–September 2008, the Central Bank sharply increased its provision of funds to commercial banks through traditional channels. In this case, the main mechanism for lending to banks was repo operations, and this help peaked at the end of 2008 and beginning of 2009.

The conditions for providing liquidity for individual instruments also changed. They were analogous to the changes that took place in developed countries and were aimed at expanding the range of financial institutions that have access to the Central Bank's resources, expanding the range of securities that can be taken by the Central Bank as collateral for loans, and extending the terms for which resources are provided.

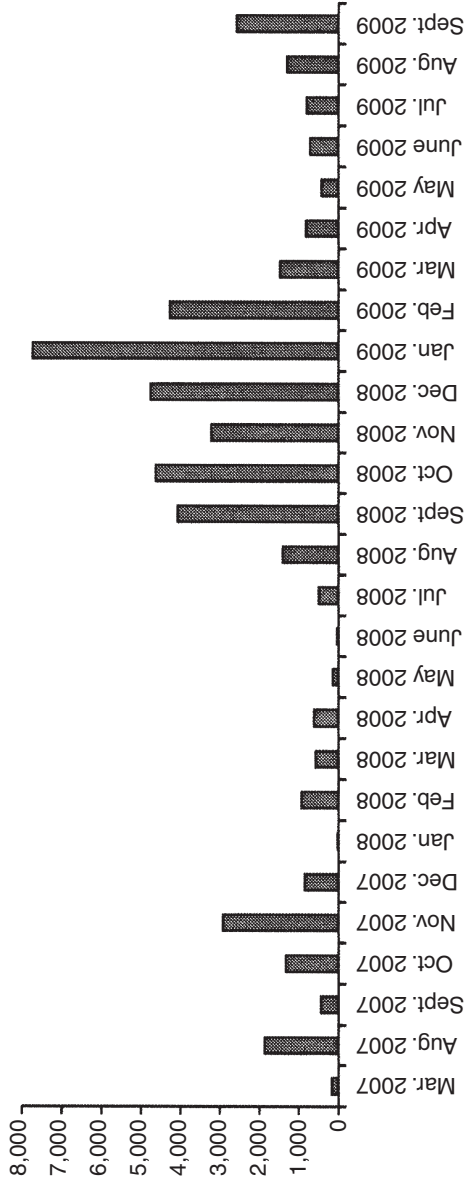
New monetary policy tools were introduced, primarily unsecured loans (see Figure 3). The Central Bank began to provide loans secured by "nonmarket" assets (pledged bills, loan assets).<sup>18</sup>

During the acute phase of the crisis, other economic policy tools were also used to regulate the monetary sphere in order to provide additional help to the banking system: placement of temporarily idle federal budget funds in bank deposits, loans from Vneshekonombank to service companies' foreign loans (taken out prior to September 25, 2008), and subsidized loans to banks whose owners increased their capital during the crisis.

The second direction of monetary policy in Russia during the acute phase of the crisis was regulation of exchange rate movement. While the first direction was in the mainstream of developed countries' anticrisis monetary policy, the second was more typical of developing market economies. This was associated with the effort to support the foreign and domestic competitiveness of Russian producers, the high level of foreign borrowing, and the presence of substantial assets denominated in foreign currency circulating in the national economy. These factors affected the desired level of the exchange rate in different directions. Two opposite trends were encountered during the crisis: on the one hand, the effort to keep the national currency from precipitous depreciation and concomitant uncontrolled inflationary processes and capital

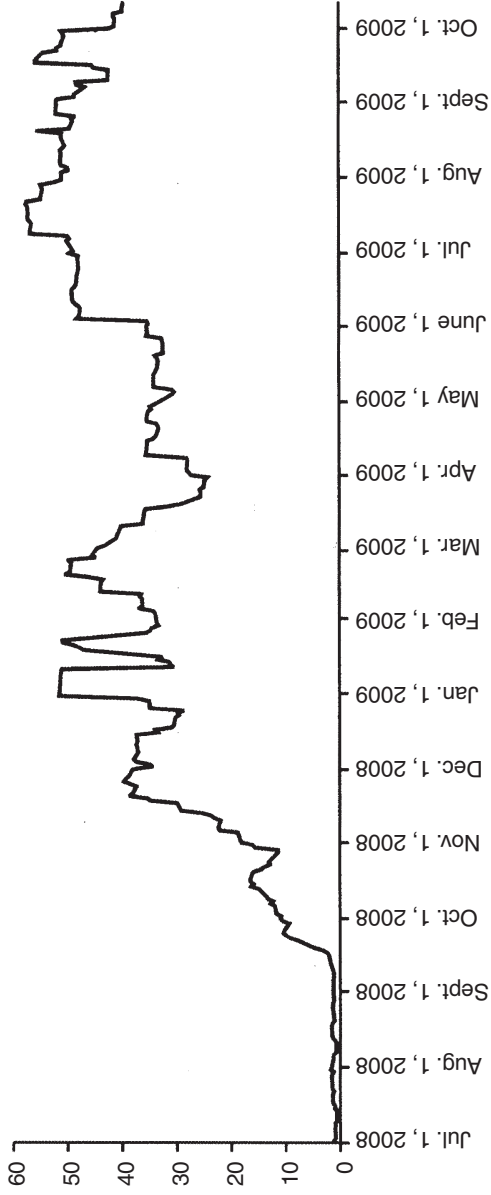


Figure 1. Direct Repo Operations by the Central Bank of (billion rubles)



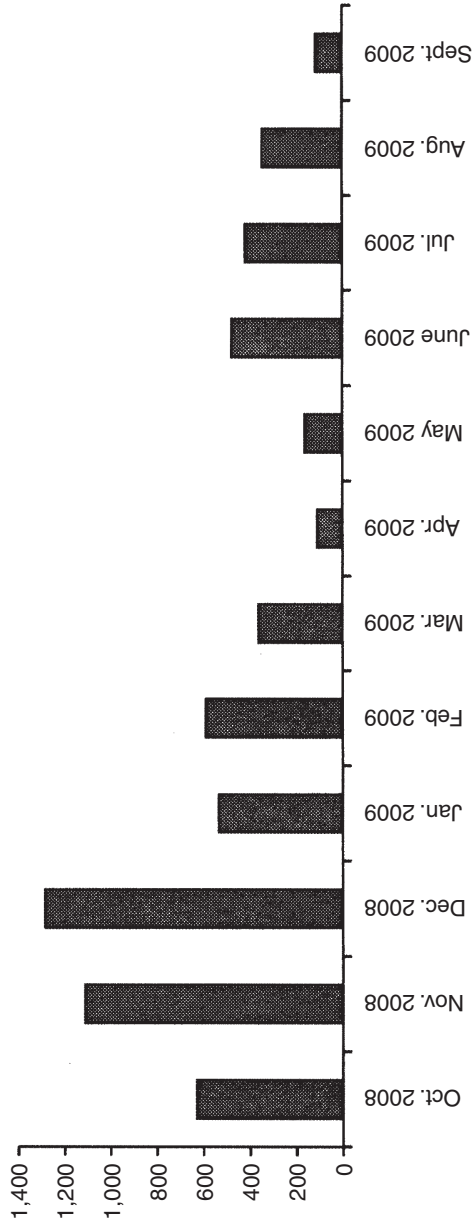
Source: Data from the Central Bank of the Russian Federation ([www.cbr.ru/hd\\_base/repo.asp](http://www.cbr.ru/hd_base/repo.asp)).

Figure 2. Commercial Bank Debt on Collateral Loans from the Central Bank



Source: Data from the Central Bank of the Russian Federation ([www.cbr.ru/hd\\_base/DV.asp?TP=2/](http://www.cbr.ru/hd_base/DV.asp?TP=2/)).

Figure 3. Unsecured Loans to Lending Institutions (billion rubles)



Source: Data from the Central Bank of the Russian Federation ([www.cbr.ru/hd\\_base/UnSecLoans.asp](http://www.cbr.ru/hd_base/UnSecLoans.asp)).

outflow, and on the other hand, to support the competitiveness of the national economy through a controlled reduction in the exchange rate.

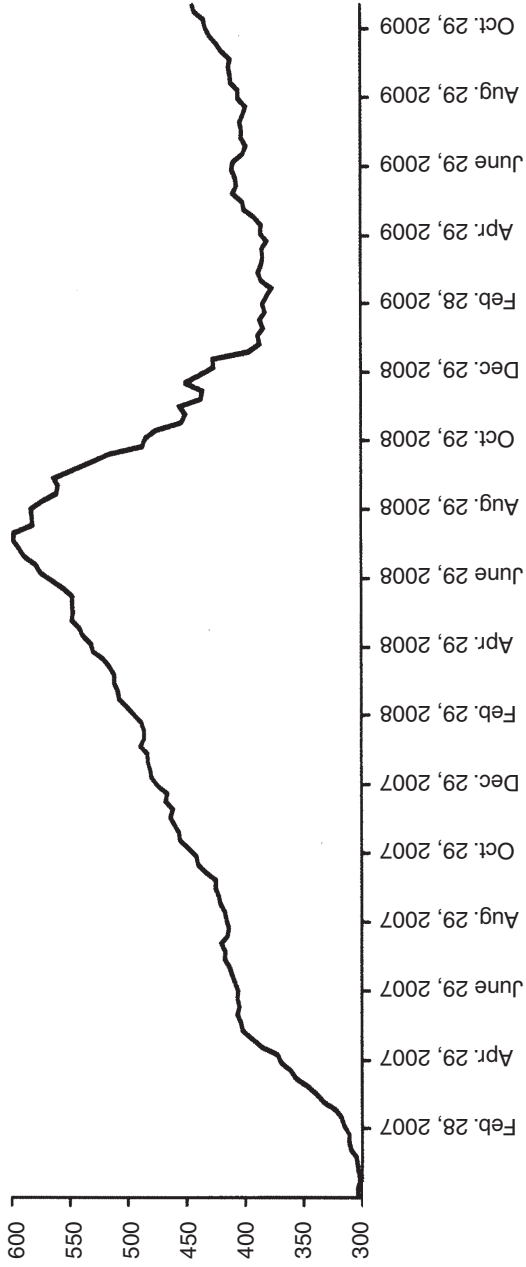
At the beginning of the crisis, Russia's monetary authorities conducted a policy aimed at restraining depreciation of the Russian ruble in relation to the U.S. dollar and the two-currency basket. This is very clearly illustrated by the trend of the Russian Federation's international reserves (Figure 4). One of the main reasons for this policy was the substantial amount of foreign debt of the corporate and banking sectors in Russia in the precrisis period (on October 1, 2008, the foreign debt of these two sectors was already approaching \$500 billion). From the standpoint of the need to prevent sudden growth of the foreign debt burden (as a result of drastic ruble depreciation) such a policy can be considered fully justified.<sup>19</sup>

The controlled lowering of the exchange rate occurred in several stages: until November 2008, the Central Bank supported the ruble exchange rate in relation to the two-currency basket (at the time, in conditions of movement of the exchange rates of international currencies, this meant that the ruble/dollar exchange rate fell); in November–December 2008, the target figures for the ruble exchange rate in relation to the two-currency basket were lowered; and by the second half of January 2009, the decline of the exchange rate became more like a collapse, with respect to a number of parameters. According to Central Bank data, its sale of foreign currency peaked in December 2008 (net sales of U.S. dollars amounted to about \$57.4 billion).<sup>20</sup>

It should be noted that, during the period of a precipitous drop in the ruble exchange rate, in January 2009 the Central Bank rather unexpectedly announced limits of the currency corridor, while before that it had practiced implicit targeting of the exchange rate.<sup>21</sup> It is obvious that the switch to a particular form of explicit targeting of the exchange rate during the crisis period threatens to undermine confidence in the monetary authorities and the national currency if the target is not met.

The pressure in the currency market in the fall and winter of 2008 was due to the effect of negative external factors (the drop in oil prices, outflow of foreign capital) as well as the low level of confidence of economic agents within the country and significant expectations that the national currency would depreciate. As a result, funds intended for the banking system wound up in the currency market and left the country. The net removal of capital by the private sector from August through December 2008 was more than \$168 billion, and another \$35 billion left the country through this channel in the first quarter of 2009.<sup>22</sup> The growth of negative expectations for the national economy put additional pressure on the exchange rate, creating a spiral of lending by the Central Bank to the banking system—removal of funds from the country—reduction of currency reserves.

Figure 4. The Russian Federation's International Reserves in 2007–2009 (billion dollars)



Source: Data from the Central Bank of the Russian Federation ([www.cbr.ru/statistics/?Prtd=svs/](http://www.cbr.ru/statistics/?Prtd=svs/)).

In our opinion, it was the desire to restrain the outflow of capital from the country and support the exchange rate that dictated the Central Bank's policy of raising interest rates at the height of the crisis: the refinancing rate was increased from 11 percent in July 2008 to 13 percent in December 2008.

The overall result of the two directions of monetary policy in the acute phase of the crisis was a reduction of the money supply,<sup>23</sup> which indicates that the predominant direction was aimed at regulating the exchange rate. Thus, the objective of monetary policy to support aggregate demand was not accomplished.

There was an alternative to this policy, which could have been used to avoid such a significant waste of currency reserves and keep interest rates at a high level: the introduction of currency restrictions, which was initially rejected by the country's authorities. Use of this measure would have made it possible to save currency reserves. The costs of not using this measure can be calculated. The reduction in international reserves during the period when the exchange rate was supported was about \$220 billion. With an oil price of \$40 per barrel in the fall of 2008, this is equivalent to about 800 million tons of oil, which is what the country produces in approximately a year and a half.

After the stage of ruble depreciation ended, the monetary policy model in Russia changed once again. Since the spring of 2009, the Central Bank has been gradually building up currency reserves and reducing the amount of support for the banking system.<sup>24</sup> At the same time, it has begun a cycle of lowering the refinancing rate (from the end of April through the end of November 2009, the rate was lowered 3.5 percentage points). The overall effect of monetary policy during this period did involve some growth of the money supply (by 15.7 percent from February 1 through November 1, 2009);<sup>25</sup> however, it is still too soon to definitively assess its results.<sup>26</sup> During this period there was one important qualitative change: the Central Bank considerably diminished its impact on the movement of the ruble exchange rate.

The main result of the anticrisis monetary policy was that it kept the banking system as a whole afloat. However, the policy did not manage to prevent a considerable drop in production, which continued at least until October 2009. In this, the results of monetary policy in Russia are qualitatively no different from those in developed countries; however, we should keep in mind that the decline of basic macroeconomic indicators was significantly deeper in our country.

### **Monetary policy strategy in the postcrisis period**

Speaking of the prospects of monetary policy, it is necessary to concentrate on two basic questions: how can such deep financial and economic crises be

prevented in the future, and what should the exit policy be in conditions when substantial sums have been provided to the banking system and interest rates in developed countries are practically at zero?

The answer to the first question goes beyond the bounds of monetary policy proper. In large part, it depends on what model for development of the financial system the developed countries choose. If this model stays the same, then there is a significant probability that financial crises will also occur in the future, due to the above-mentioned systemic shortcomings of this model. The proposals of leading international forums and organizations (the G-20, International Monetary Fund, etc.) mainly amount to strengthening the regulation of individual segments of the financial market, coordinating the actions of regulatory agencies in developed countries, making financial transactions more transparent, and implementing other measures of a more palliative nature.<sup>27</sup>

In our opinion, the economic ills that were discovered in the course of the crisis require more serious treatment. To all appearances, a change to stricter regulation of the whole financial system is needed, possibly with a return to separation of financial institutions according to the nature of their operations (e.g., separation of commercial and investment banks), with various regulation models. The ultimate objective of such solutions should be to return to national economies at least some of the funds that are circulating within the financial system, which are largely of a virtual nature.

Considering the highly interdependent nature of national financial markets and the high volatility of foreign portfolio capital, it makes sense to return to a discussion of measures to limit the mobility of this capital on a worldwide scale. In particular, we can talk about introducing a so-called Tobin tax, which has been the subject of a long-running academic debate. However, it has been introduced in only a few countries in practice, mostly in the crisis and post-crisis periods. We should immediately make the reservation that measures to restrict the cross-border movement of capital on a worldwide scale should not affect foreign direct investment.

The problem of the prospects of the international currency system requires separate analysis. During the crisis, proposals appeared in the expert environment about implementing extreme scenarios, for example, returning to commodity money or money tied to some commodity standard.<sup>28</sup> A system based on commodity money would be too inelastic in comparison with the system of credit money, which economic history has already clearly demonstrated. In the case of commodity-backed money, it would be based on an asset for which the prices are extremely volatile (this is true of almost all basic commodities). Such a monetary system would thus be susceptible to overly strong shocks with changes in the supply and demand of the basic asset.

Table 1

**Breakdown of Currency Reserves of World Countries by Key Currencies (%)**

	2002	2003	2004	2005	2006	2007	2008	Q2 2009
Dollar	67.1	65.9	65.9	66.9	65.5	64.1	64.1	62.8
Euro	23.8	25.2	24.8	24.0	25.1	26.3	26.5	27.5
Pound sterling	2.8	2.8	3.4	3.6	4.4	4.7	4.1	4.3
Japanese yen	4.4	3.9	3.8	3.6	3.1	2.9	3.1	3.1
Swiss franc	0.4	0.2	0.2	0.1	0.2	0.2	0.1	0.1

*Source:* Calculated on the basis of data from the International Monetary Fund ([www.imf.org/external/np/sta/cofer/eng/index.htm](http://www.imf.org/external/np/sta/cofer/eng/index.htm)).

The next, somewhat more realistic, alternative that has been proposed by some countries and economists at present is to move toward a system with regional reserve currencies. However, the creation of a regional reserve currency requires serious political decisions and a high level of economic integration in the region, which cannot be achieved instantaneously. With the exception of the euro, a regional currency that has already been created, no possibility of creating other such currencies is seen in the medium term.

Thus, the question of the future of the international currency system actually boils down to a question of competition between the dollar and the euro (and, possibly, a number of other national currencies) for the status of an international reserve currency. If we trace the changes of various currencies' share in the currency reserves of the world's countries<sup>29</sup> (see Table 1), we can see a clear trend toward a certain decline in the U.S. dollar's share in international currency reserves and growth of the euro's share since it was first put into circulation (2002). However, there has not been any fundamental shift in the breakdown of currency reserves: as before, more than 60 percent of international currency reserves are dollar-denominated. And the dollar and euro together consistently account for more than 90 percent of international currency reserves, which indicates that they have almost a monopoly position as reserve currencies. Thus, it can be said that in the near future the dollar will keep its status as the international reserve currency, while in the medium term the only competition it will have will be from the unified European currency, which can currently be considered more a regional reserve currency.

An alternative to this scenario should be noted. Developing countries account for a significant portion of world currency reserves, and they regulate



the exchange rates of their own currencies. If such regulation is abandoned, these countries will need significantly smaller currency reserves (or at least they will not build them up as rapidly as in the precrisis period), that is, switching to free-floating currencies could significantly shake the dollar's position as the international reserve currency. It should be noted, however, that this will hardly have a significant effect on its widespread use in the international currency market, where dollar transactions account for 86.3 percent of the volume.<sup>30</sup> But in the current situation it seems unlikely that developing countries, which play a key role in international trade, will switch to floating exchange rates, since they actively use regulation of their exchange rates to influence foreign trade activity.

As for developed countries, one of the most urgent subjects for them in the analysis of monetary policy at present is the exit strategy from the anti-crisis model. The problem is that it will be necessary to abandon the current, extremely easy regime, which may have an unfavorable impact on aggregate demand. Ending the stimulus policy too soon or too abruptly might interrupt the economy's postcrisis recovery, while a delay in tightening the policy might entail inflationary consequences and/or inflation of the next financial bubble, threatening the next crisis.

Another question regarding the exit strategy is how willing the central banks of developed countries will be to keep in their arsenal the changes in monetary policy tools that they made during the crisis. If only superficial changes in the regulation of national financial systems and the international one are made after the crisis, it is highly likely that such tools will be needed again in the future. However, we must remember that in the conditions of the current crisis the effectiveness of these tools was quite limited.

The impact of the current economic crisis on the prospects of monetary policy in Russia can be seen from two perspectives: the goals and the tools of this policy. In regard to the goals, discussion of the question of switching to an inflation targeting regime has once again become timely, since such a goal was set in the Basic Directions of Unified Government Monetary Policy in 2010 and the Period of 2011 and 2012, at the end of the time period covered by this document.<sup>31</sup> Both Russian and foreign researchers have written more than once of the lack of basic prerequisites for switching to inflation targeting in Russia.<sup>32</sup> Therefore, we will touch upon the question of switching to a free-floating ruble regime as one of the conditions for introducing inflation targeting.

In conditions when the behavior of the exchange rate depends mostly on one factor—oil prices in the international market—such a change of regime would obviously mean that the exchange rate would be more volatile and less predictable. In such a situation, free floating of the currency would not

smooth out external shocks but exacerbate them, impeding diversification of the national economy when oil prices rise and intensifying the negative consequences for the economy when they fall. Thus, the change to a free float would have to be correlated with diversification of the national economy and the structure of exports. Therefore, at least in the medium term, regulation of the exchange rate will play an important role from the standpoint of its impact on the national economy. Taking into account the above-mentioned development trends in the international currency system and the distinctive characteristics of pricing in the commodity market, the primary focus of attention should be the ruble/dollar exchange rate.

Another fundamental question in the case of inflation targeting is the choice of target values. Trying to reduce inflation in a relatively short time (a few years) to levels close to those in developed countries may require an unduly tight policy and lead to losses in terms of output. In the conditions of a postcrisis recovery, which will most likely be fairly sensitive to fluctuations of aggregate demand and be characterized by some acceleration of price dynamics as it picks up steam, the introduction of inflation targeting may lead to more significant losses in terms of output than in “normal” economic conditions.

As for monetary policy tools, judging from the actions and statements of the monetary authorities, it is planned to move the main emphasis from currency interventions to interest rate policy tools. This would be a step in the direction of changing to the monetary regulation model typical of developed countries. But its practical implementation would require overcoming a number of serious obstacles. As the experience of the current crisis has shown, changes in the refinancing rate are not fully transformed into corresponding changes in interest rates on loans. And we still have to point out the role of the crisis (particularly its acute phase) in development of the tools for providing banking system liquidity and increasing the role of interest rate policy in comparison with the precrisis period. However, the channel for transmitting signals from monetary policy through the interest rate has not yet been adequately developed. Its development requires measures to make the financial markets operate more efficiently and improve the system for refinancing commercial banks in Russia. So far, the Central Bank has developed mechanisms for providing liquidity to the banking sector on an ad hoc basis, and the crisis could serve as a good stimulus for shaping them into a permanent system.

In the context of possible development of crisis phenomena, in the future it would be extremely important to return to introducing currency restrictions at the first signs of external destabilization of the economic system. To do this, it is necessary to add an appropriate article on anticrisis measures to the law “On Currency Regulation.” To prevent possible new fluctuations in the

currency market, in the near future it would be advisable to restrict, at least temporarily, the removal of capital from the country, make 100 percent sale of foreign-currency export earnings mandatory, limit the amount of banks' open currency positions, and so on. In addition, a number of currency restrictions could be used to reduce the risks of crisis phenomena in the future. (For example, by applying appropriate tools, it might have been possible to avoid the rapid buildup of foreign debt in the corporate and banking sectors before the current crisis.)

The current global economic crisis has raised new challenges for monetary policy, to which developed and developing countries have responded by significantly easing their policy and improving its tools. For developed countries, it is becoming especially important to correlate monetary policy with new trends in financial system functioning, given that the system itself needs fundamental reforms. For Russia, it is more urgent to create transmission mechanisms for monetary policy (that would help to improve the efficiency of its impact on the economy and foster development of the financial system), taking into account the risks that the current global economic crisis has revealed, which have affected our country to a lesser extent. The creation of such mechanisms would move the center of gravity in monetary policy tools from currency interventions to use of the interest rate, without forcing a formal switch to inflation targeting. To reduce the negative impact of external shocks, in the near future it is advisable to return to the practice of using individual currency restrictions.

## Notes

1. For more details, see M. Golovnin, "Finansovaia globalizatsiia i ogranicheniia natsional'noi denezhno-kreditnoi politiki," *Voprosy ekonomiki*, 2007, no. 7, pp. 24–27.

2. International Monetary Fund, "De Facto Classification of Exchange Rate Regimes and Monetary Policy Frameworks," 2008; available at [www.imf.org/external/np/mfd/er/2008/eng/0408.htm](http://www.imf.org/external/np/mfd/er/2008/eng/0408.htm).

3. Dzh.M. Keins [J.M. Keynes], "Obshchaia teoriia zaniatosti, protsenta i deneg" [The General Theory of Employment, Interest and Money], in *Antologiiia ekonomicheskoi mysli* (Moscow: Ekonov, 1993), vol. 2, p. 256.

4. T. Adrian and H.S. Shin, "Financial Intermediaries, Financial Stability and Monetary Policy," paper presented at the Federal Reserve Bank of Kansas City Symposium at Jackson Hole, August 21–23, 2008, pp. 7–8.

5. C. Borio and W. Nelson, "Monetary Operations and the Financial Turmoil," *BIS Quarterly Review*, March 2008, p. 38.

6. See [www.federalreserve.gov/monetarypolicy/default.htm](http://www.federalreserve.gov/monetarypolicy/default.htm) (Policy Tools).

7. Bank of England, "Inflation Report," May 2009, p. 16.

8. J.-C. Trichet, "What Lessons Can Be Learned from the Economic and Financial Crisis?" *BIS Review*, 2009, no. 31, pp. 2–3.

9. In December 2007, similar agreements were entered into with the ECB and the Swiss National Bank. The limits set in these agreements were later increased, and the range of participants was expanded to include the central banks of other developed countries.

10. S. Ingres, "The Monetary Policy Landscape in a Financial Crisis," *BIS Review*, 2009, no. 41, p. 6.

11. V.A. Mau even uses the term "socialist" in relation to measures to socialize risks and nationalize banks in developed countries (see V. Mau, "Drama 2008 goda: ot ekonomicheskogo chuda k ekonomicheskomu krizisu," *Voprosy ekonomiki*, 2009, no. 2, p. 15).

12. C. Borio and N. Zhu, "Capital Regulation, Risk-Taking and Monetary Policy: A Missing Link in the Transmission Mechanism?" *BIS Working Papers*, 2008, no. 268.

13. For more details about this model, see A.D. Nekipelov, "Riski denezhno-kreditnoi politiki i sovremennye finansovye krizisy," *Ekonomika Ukrainy*, 2009, no. 2.

14. See, for example, A.D. Nekipelov, "Stabilizatsiia ili sterilizatsiia?" *Nezavisimaia gazeta*, November 24, 2006.

15. We will specify that what we are talking about here is monetary policy measures unrelated to interventions in the currency market. Steady growth of currency reserves contributing to an increase in the money supply occurred almost up to August 2008.

16. For more about the effect of trends in the securities market on development of the crisis in Russia, see B. Zamaraev, A. Kiiutsevskaiia, A. Nazarova, and R. Sukhanov, "Ekonomicheskie itogi 2008 goda: konets 'tuchnykh' let," *Voprosy Ekonomiki*, 2009, no. 3, pp. 6–13.

17. Calculated on the basis of data from the Bank of Russia's Survey of the Banking System ([www.cbr.ru/statistics/print.aspx?file=credit\\_statistics/survey\\_bs\\_08.htm&pid=dkfs&sid=MN\\_14522/](http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/survey_bs_08.htm&pid=dkfs&sid=MN_14522/)).

18. "Sostoianie denezhnoi sfery i realizatsiia denezhno-kreditnoi politiki v 2008 godu," *Vestnik Banka Rossii*, 2009, no. 19. S.V. Aleksashenko comes to the same conclusion, but on the basis of analysis of the short-term currency position of Russian banks. See S. Aleksashenko, "Obval' noe padenie zakonchilos', krizis prodolzhaetsia," *Voprosy ekonomiki*, 2009, no. 5, p. 12 [translated as "The Collapse Is Over, the Crisis Continues," in *Problems of Economic Transition*, vol. 52, no. 4 (August 2009), pp. 3–24]. V.A. Mau holds a different opinion (see Mau, "Drama 2008 goda," p. 18).

20. See [www.cbr.ru/hd\\_base?VALINT.asp](http://www.cbr.ru/hd_base?VALINT.asp).

21. In a press release of January 22, 2009, the Central Bank announced that, beginning January 23, 2009, the upper limit of the technical corridor (for the two-currency basket) would be set at the level of 41 rubles (see [www.cbr.ru/press/Archive\\_get\\_blob.asp?doc\\_id=090122\\_1811281.htm](http://www.cbr.ru/press/Archive_get_blob.asp?doc_id=090122_1811281.htm)).

22. See [www.cbr.ru/statistics/credit\\_statistics/print.asp?file=capital.htm](http://www.cbr.ru/statistics/credit_statistics/print.asp?file=capital.htm).

23. From September 1, 2008, through February 1, 2009, the M2 money supply, in the national definition, decreased by more than 17 percent.

24. In a report by the Development Center Institute of the State University–Higher School of Economics, these two directions are interlinked: in the authors' opinion, ruble appreciation was associated with tightened monetary policy and the associated need for banks to sell foreign currency assets (see "Rossiiskaia ekonomika na fone mirovogo krizisa: tekushchie tendentsii i perspektivy razvitiia," *Voprosy ekonomiki*, 2009, no. 9, p. 74). However, as follows from the data that we have cited, the monetary policy from the spring through the fall of 2009 can hardly be called unequivocally tight.

25. See [www.cbr.ru/statistics/credit\\_statistics/MS.asp?Year=2009/](http://www.cbr.ru/statistics/credit_statistics/MS.asp?Year=2009/).

26. For instance, during this period, after a certain break in the second quarter of 2009, a net capital outflow from the country through the private sector was seen throughout the third quarter of 2009. According to Central Bank estimates, it amounted to \$31.5 billion (see [www.cbr.ru/statistics/credit\\_statistics/print.asp?file=capital.htm](http://www.cbr.ru/statistics/credit_statistics/print.asp?file=capital.htm)).

27. See, in particular, G. Fetisov, “O merakh po preodeleniiu mirovogo krizisa i formirovaniu ustoichivoi finansovo-ekonomicheskoi sistemy (predlozheniia dlia ‘Gruppy dvadtsati’ po finansovym rynkam i mirovoi ekonomike),” *Voprosy ekonomiki*, 2009, no. 4 [translated as “Measures to Overcome the Global Crisis and Establish a Stable Financial and Economic System (Proposals for the G-20 on Financial Markets and the International Economy),” in *Problems of Economic Transition*, vol. 52, no. 5 (September 2009), pp. 20–34]; Iu. Danilov, V. Sednev, and E. Shipova, “Finansovaia arkhitektura postkrizisnogo mira: effektivnost’ i/ili spravedlivost’,” *Voprosy ekonomiki*, 2009, no. 11.

28. A detailed list of various alternatives for reform of the international currency system proposed by experts in crisis conditions can be found in Danilov, Sednev, and Shipova, “Finansovaia arkhitektura postkrizisnogo mira,” p. 14.

29. Counting currency reserves the currency of which can be determined.

30. Data for 2007. The figure was calculated on the basis of a total of 200 percent, since each currency transaction includes two currencies. See “Triennial Central Bank Survey. Foreign Exchange and Derivatives Market Activity in 2007,” BIS, December 2007, p. 11.

31. See [www.cbr.ru/today/publications\\_reports/on\\_2010\(2011–2012\).pdf](http://www.cbr.ru/today/publications_reports/on_2010(2011–2012).pdf).

32. See, for example, V. Burlachkov and S. Andriushin, “Denezhno-kreditnaia politika i global’nyi finansovyi krizis: voprosy metodologii i uroki dlia Rossii,” *Voprosy ekonomiki*, 2008, no. 11, p. 45; “Russian Federation,” in *OECD Economic Surveys. 2009*, pp. 84–85. However, in this case, the Organization for Economic Cooperation and Development experts think that a gradual transition to inflation targeting is needed.

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