

# Flash Comment

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Lars T. Rasmussen, Analyst, +45 4512 8534 (direct), +45 2055 2798 (mobile), [laras@danskebank.dk](mailto:laras@danskebank.dk)

## Russia: Gradual rouble devaluation is wrong strategy

The Russian central bank (CBR) this morning widened the rouble trading band by another 30 kopecks. Market participants immediately drove the rouble to the (new) weak end of the trading band, with the RUB/basket going from 30.70 to 31.00 – a roughly 1% weaker RUB – before closing a little stronger (RUB/basket 30.87). The CBR last widened the trading band two weeks ago – see *Flash Comment - Russia: Devaluation process initiated*, 11 November 2008 – and today's move implies that the Russian authorities realise the need for a weaker rouble given that Ural oil prices are moving below USD 45 a barrel.

That said, we expect renewed pressure on the central bank to defend the rouble in the coming days. The latest data highlight the challenges that the Russian authorities face.

Monetary contraction has been substantial, with **FX reserves continuing to drop** (see chart below). In the week ending Friday 14 November, FX reserves dropped by USD 21.9bn to USD 453.5bn. Hence the CBR has now spent USD 144.5 of its FX reserves since the beginning of August to prop up the rouble. Further, the head of the deposit insurance agency this morning indicated that **banks had lost 5-7% of deposits in October**. A weakening of the balance of payments position and a further and sustained run on deposits would escalate the crisis currently faced by the Russian authorities. The current crisis to a large extent reflects a loss of confidence by market participants (local and international) in the Russian authorities and in how they communicate the future path for monetary policy. Basically, most watchers fear a very sharp devaluation or even worse – implementation of capital controls.

Going forward, the CBR faces a major challenge in trying to weaken the rouble – to reflect lower oil prices and the expected C/A deficit as of Q4 08 – while also trying to curb a mass flight of deposits. It seems the CBR has chosen to weaken the rouble gradually. However, the danger inherent in such a move is that while it allows for a weaker rouble over time, the CBR may still have to put all its FX reserves into play to prevent the rouble dropping too fast. The end result could well be the CBR ending up with a weaker rouble while at the same time having used all its FX reserves. Given this, **the risk of a large one-off devaluation of the rouble has certainly increased in recent weeks, as the current path of gradual “devaluation” is probably not sustainable, in our view**. With oil prices around current levels, we would expect a C/A deficit of 4-5% of GDP in 2009, while the public budget deficit could be 3-4% of GDP in 2009.

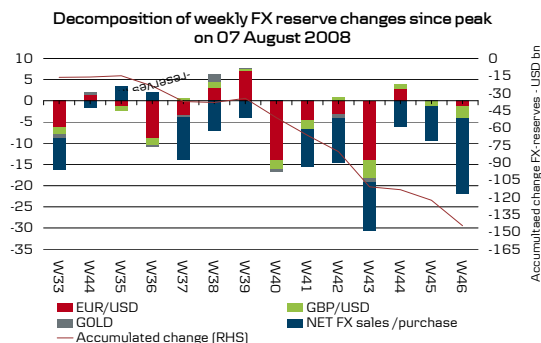
*See charts overleaf*

## New support level around RUB/basket 31.00



Source: EcoWin, Reuters

## FX reserves plunge



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