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A worrying trend

Success in fighting inflation, which is especially impressive in view of the serious devaluation of the Russian rouble against the majority of leading world currencies, has recently been more frequently described as one of the Russian authorities' most significant economic and financial achievements. For many years running, devaluation and price rises have been going in tandem in Russia and other post-Soviet countries, reflecting the high level of dependence on imports, and citizens' and businesses' distrust in national currencies. To a great extent, the latter problem has been overcome lately, which is undoubtedly the great achievement of the Russian Central Bank and government, but, in my opinion, we may face another problem.

Aiming once again to "kill" high inflation, which has been considered the scourge of the Russian economy, the government made significant progress. The rate of price growth has declined from 11.36% in 2014 and 12.91% in 2015 to a predicted 5.6–5.8% this year, and the authorities are talking about some 4-plus percent for the next year. Formally, it looks like a success – one of the few goals the authorities have achieved in the field of economics. But there are some questions.

According to its parameters, the Russian economy is different from the economies of developed countries. The risks are a lot higher, businesses seek faster capital turnover, the share of household income in GDP is significantly lower, the role of "natural monopolies" is much more important, and the bank rates are historically much higher. For almost 15 years the Russian economy has got used to relying on a constant flow of oil dollars, operating in a climate of fairly high inflation (in 2001–2015 it was 10.9% on average, according to the Russian Federal State Statistics Service). It is also remarkable that in the period of lower growth in 2011–2015, inflation (8.6%) was lower than average, and significantly lower than in the "triumphant decade" of 1999–2008 (15.9%). I note that during Putin's first two terms, and in the period between the crises of 2008–2009 and 2014, the national currency rate remained stable.

What does this mean? Primarily, that the Russian economy develops better with moderate growth of prices (in our case it is 8–10%) than when it is harshly suppressed. There are several reasons. First of all, the growth of prices is affected by the growth of tariffs, and this is unlikely to stop (even in 2016 the tariffs for gas were increased by 8.5%, and for electricity by 7.5%). Consequently, low inflation affects the profits of processing plants, which discourages entrepreneurs and impedes the development of the economy. Secondly, the pricing stability creates an unusual situation for Russian entrepreneurs: goods produced today are sold at the same price half a year later, subsequently lowering profit expectations and motivation for investment. Thirdly, the Russian economy is significantly dependent on imports, almost half of which are machinery and production equipment. When the growth of prices is lagging behind the growth of dollar and euro rates, purchasing equipment and technologies becomes increasingly unprofitable, whereas there is often no domestic equivalent on the Russian market. Fourthly, low inflation convinces customers of the possibility to postpone their purchases and increase savings (primarily in dollars, by the way, because currency rates grow faster than inflation). Savings increase banks' available cash assets (the positive balance on Central Bank correspondent accounts grew by almost 60% in the last year: from 1.38 trillion roubles on October 14, 2015 to 2.17 trillion roubles on October 12, 2016), but credit volumes stayed on the same level. Finally, the Russian Central Bank's base rate, which remains high (and is acknowledged as an instrument to hamper inflation) determines high credit costs and, in the end, paralyses the banking system.

In other words, this might mean that the cost of victory over inflation would be the destruction of the domestic economy, which, due to its structure and competition models, is not adapted for survival in such conditions. The economic branches that will certainly profit from the new reality are the telecommunications sector, Internet service providers and other high technology sectors, in which deflation (i.e. reduction of prices for their services) has long been the norm, but all the rest will end up in quite a difficult situation. What is more, the labour market has long been anticipating cyclical wage growth, which would put serious pressure on businesses in the current circumstances; in case of 8–9% inflation it would be counterbalanced by the growth of prices, and real income would at least remain at the previous level (the economy would be unable to withstand their significant growth at the moment).

In my opinion, Russia's experience from the first half of the 2000s shows that relatively high inflation has not obstructed economic growth. In Turkey, for example, between 2001 and 2014, the rate of economic growth was 5.7% on average, while average inflation was 14% per year. During the so-called "Glorious Thirty" (*Les Trente Glorieuses*) in France, the inflation rate was 4.6% on average for over a decade, and in Germany – 3.9%; while the GDP growth reached 5.1% and 6% correspondingly over the same time period, with unemployment rates under 1.6% in France and 1% in Germany. In August 2016, the inflation rates in those countries were 0.38% and 0.36%, while the economic growth in the second quarter was 1.3% and 1.7%, and unemployment – 10.5% and 6.1%.

At the moment, economic growth is more important for Russia than inflation, and the Russian Central Bank's task should be to ensure predictable inflation rather than just keeping it at a low level (even a relatively high but stable level inflation rate would allow rational and effective economic decisions to be made).

The Russian monetary authorities have no other option in the current situation than to permit higher inflation – by decreasing the base rate, increasing the money stock, making verbal interventions focusing on changing priorities. It is not about supporting Sergey Glazyev's and the Party of Growth's concepts, which lobby "controlled" monetary emissions which would benefit individual large enterprises. What we need today is to "squeeze" into the real sector funds that have already been accumulated in private accounts, accounts of enterprises and banks, as well as private savings outside of the banking system. The price growth expectations can activate demand (this is what was actually happening in Autumn 2014, for example), accelerate capital turnover and simultaneously convince businesses that they can receive "inflation bonuses" on top of their "usual" profits, which is especially valuable given the comparative stability of the currency market.

To go even further, I cannot see anything catastrophic in the monetary stimulation of demand, which is currently not considered a suitable measure precisely due to fears that it would boost inflation. If the state would be more confident in "injecting" money into the economy via consumers (developing systems that encourage larger purchases [cars or property], raising the lowest pensions and benefits, introducing some sort of food coupons, etc.), it might facilitate the growth of the general level of prices, but the social and economic effects from such programmes would most certainly be positive.

We are observing the Russian economy now adjusting to survive without oil and gas stimulation. The transition from the previous model to the new one has in itself an extremely negative impact on economic growth. Simultaneous attempts to alter the familiar environment in which Russian citizens and Russian businesses have been operating for decades could be too risky. And the tendency for "irreversibly" lowering inflation today seems worrying, rather than optimistic.

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