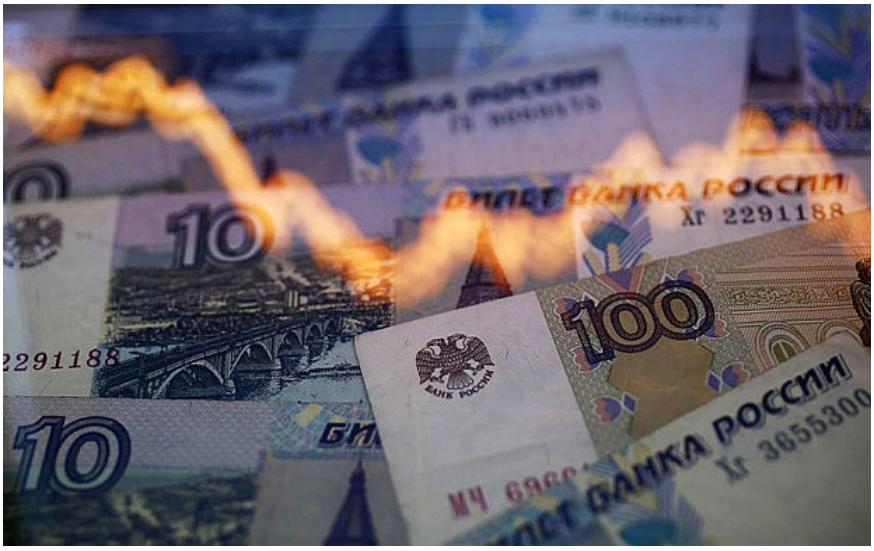
Russia hikes interest rates to 17pc to stop rouble collapse

Russia's central bank makes shock move just days after raising rates to 10.5pc, after rouble crashes 13pc against the dollar



The rouble smashed through resistance to an all-time low of 65.5 to the dollar Photo: Reuters

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Russia's central bank has hiked the country's benchmark interest rate to 17pc, just days after raising it to 10.5pc, in a bid to stop a full-blown currency crisis.

The shock move - Bank of Russia's sixth increase this year - takes rates to heights not seen since the country's default in 1998, and "is aimed at limiting substantially increased rouble depreciation risks and inflation risks".

It also increased the maximum volume of foreign currency it provides to Russian banks via its foreign-exchange repurchase agreement auctions for 28 days to $5bn (£3.2bn) from $1.5bn.

"This should make it more difficult to short [the rouble]," said Jorge Mariscal, chief investment officer at UBS Wealth Management. "It shows they are really concerned about the speed of the decline in the rouble.”

The rouble jumped against the dollar after the rate hike was announced, just hours the Russian currency crashed 13pc to an all-time low of 65.5 to the dollar.

The Russian currency has lost half its value since President Vladimir Putin first sent forces into Ukraine, setting off a chain of events that the Kremlin can no longer control.

“This is being driven by pure fear. We have crossed a line and the crisis is now self-feeding,” Chris Weafer, from Macro Advisory in Moscow, said before the rate rise. “The central bank must intervene immediately with a great deal of money to overwhelm the sense of panic.”

The central bank said capital flight will reach $130bn this year. In a drastic change in outlook, it warned that the economy may contract by 4.7pc in 2015 if oil settles near $60 a barrel. Morgan Stanley said the economy will shrink at a rate of 6pc if crude drops to $50.

The sell-off is spreading far beyond Russia and risks turning into a broader market emerging rout, made worse by fears of a dollar surge as the US Federal Reserve prepares for the first rate rise in seven years. The MSCI index of emerging market stocks has dropped to a 10-month low, led by a 2.4pc slide in the Brazilian Bovespa. Dubai’s DFM index crashed over the weekend and is now down 26pc in nine days.

Russia burned through $80bn of foreign reserves earlier this year defending the rouble but is now holding on jealously to the $416bn that remains.

The currency's collapse will feed into double-digit inflation in short order. “This is extreme central banking, and the question is, what are they trying to achieve?” said Tim Ash, from Standard Bank.

“Moves like this create systemic risks, the risk of panic among the general population, and surely risks major deposit flight. It makes you think whether they forgot to read the manual which came with the bazooka. But this is a really high-risk strategy from the central bank."

The Institute of International Finance says Russia's reserves are not as large as they appear, given the levels of external debt and a chronic capital deficit of 2pc to 3pc of GDP a year. It says the danger line is around $330bn, suggesting that the central bank cannot safely bleed its funds for long to stem the outflow.

Mr Putin has so far defended the central bank against accusations from populists in the Duma that it has betrayed Russia by letting the rouble crash, and is run by “liberal feminists” in thrall to the International Monetary Fund.

He has promised "harsh" measures against traders betting against the rouble, warning that “we know who these speculators are” and how to deal with them. Yet the Kremlin appears out of its depth and is struggling to keep up with events.

The crumbling rouble has effectively doubled the real burden of nearly $700bn in external debt, mostly owed by banks and companies, and mostly in dollars. They cannot roll over the loans because the global capital markets are shut for Russian companies.

These firms must repay $125bn by the end of next year. Several have already requested help from the state to meet their dollar obligations. Mr Weafer said others have built up a stash of dollars in reserves and should be able to weather the crisis.

Credit default swaps (CDS) measuring bond risk in Russia soared 67 points to 556 on Monday, pricing in a 28pc chance of a sovereign default within five years. Ukraine's CDS spiked 389 points to 2414. The country seems headed for near certain debt restructuring, with serious implications for Russian and Austrian banks.

“The Russian balance sheet is one of the strongest in the emerging markets," said Mr Weafer. "There is no danger of default whatsoever. The weaker rouble is actually protecting the budget and is preventing the collapse of the economy.”

Neil Shearing, from Capital Economics, said there is growing pressure for more drastic action. "Hardliners inside the Kremlin are most likely to be making the case for capital controls. But we suspect that stringent forms of capital controls are likely to remain a measure of very last resort," he said.

These sorts of controls are porous and would have limited impact. "They would eliminate any remaining credibility that Russia has," he said.

The Republicans in the US Congress are pushing for further sanctions against Russia but these are becoming increasingly redundant at this stage as oil prices bring the economy to its knees.

President Barack Obama said it would foolish to break ranks with Europe by going too far.

“The notion that we can simply ratchet up sanctions further and further, and then, ultimately, Putin changes his mind I think is a miscalculation," Mr Obama said.

"What will ultimately lead to Russia making a strategic decision is if they recognize that Europe is standing with us and will be in it for the long haul and we are patient. And if they see that there aren’t any cracks in the coalition, then over time, you could see them saying that the costs to their economy outweigh whatever strategic benefits that they get.

"Putin does not have good cards, and he has not played them as well as the Western press seems to give him credit for. Putin will succeed if he creates a rift in the Trans-Atlantic relationship, if we see Europe divided from the United States. That would be a strategic victory for him and I intend on preventing that."

How we moderate