The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Why Russians and the World Dislike the Ruble

By Martin Gilman

November 20, 2012

Russians have long had an ambivalent relationship with the ruble. Even now, Russian companies and individuals by and large seem to prefer to save in dollars or euros, carry out large financial operations offshore and minimize their exposure to ruble assets when they can.

This seems odd. Generally in the modern world, most people have sufficient confidence in their own currencies to keep most of their assets denominated in them. It is sometimes called a home-currency bias. For example, Japanese residents hold yen despite low interest rates. Usually, it is only when significant risks are perceived that people flock to monetary hedges such as gold. The phenomenon was also evident in the case of Greece, when the collapse in domestic bank deposits signaled a fear that people's euros would soon become drachmas.

Although a casual bystander in the center of a large Russian city may be led to believe there are banks on every block, only a handful of the country's 892 banks affiliated with the state deposit insurance agency actively engage in commercial, much less retail, operations. According to a Credit Suisse survey last year, only 24 percent of Russian households even have a bank account, compared with 37 percent in Indonesia and 80 percent in China.

Russia is not only underbanked. It is also undermonetized, at least as far as the ruble is concerned. Residents of other countries who perhaps feel more secure using their domestic currency usually save it as well as spend it. The demand for money, meaning holdings of bank notes and bank deposits in domestic currency as a percentage of gross domestic product, is a key measure of financial deepening in a country. The World Bank data for 2011 reveal that average money demand is about 80 to 90 percent of GDP. In Russia, the figure for ruble holdings is only half that, putting the country in the good company of Belarus, Kazakhstan, and Kosovo.

There has been no better indicator of Russia's progress in becoming a normal, stable market economy than demand for the ruble, which is affected by a range of factors, including income levels, interest rates, inflation and uncertainty about the future. It encapsulates the degree of confidence in the central bank's ability to control inflation and the government's ability to avoid debt financing, as well as the durability of the political regime.

Since Russia has the highest per-capita GDP of all the emerging and developing countries in the Group of 20, it is not as if Russians are using barter. The data would underscore, however, that they minimize the use of rubles. This implies that the economy is still, even now, "dollarized" more than it should be. After all, other countries have also suffered historic financial shocks, yet money demand has recovered. Neighboring examples include Poland, Bulgaria and the Czech Republic.

It could be that the collective memory in Russia is unusually wary of the money issued by its own sovereign. This may be understandable in view of history. After all, in 1947, the Soviet authorities implemented a confiscatory redenomination of the currency whereby old rubles were worth only one-tenth of their face value. In 1961, a new round of redenomination of the ruble was essentially a repeat of the 1947 reform.

Then, recently enough to still have traumatic effects on much of population, in January 1991, in an attempt to stamp out a thriving black market, the government under former Soviet leader Mikhail Gorbachev withdrew all 50- and 100-ruble notes from circulation and limited exchange of large bank notes to one month's standard salary. This infamous currency reform amounted to a confiscation of about one-third of the money held by households and companies. It not only severely disrupted the economy but also may have contributed to Gorbachev's downfall.

Since the early 1990s, foreign currency — mainly the U.S. dollar — has generally served the standard functions of money in Russia. That is, foreign currency has been used in Russia as a unit of account, as savings and as a means of payment. So much so that when the government under President Boris Yeltsin prematurely banned the use of dollars on Jan. 1, 1994, there was almost another crisis.

But it was quickly clarified that Russians could continue to hold dollars, including in bank accounts. Although foreign currency is no longer considered legal tender in Russia, the U.S.

dollar and, increasingly, the euro are still reportedly used as a de facto means of payment — mainly in large purchases such as real estate.

In retrospect, it seems almost serendipitous that the ruble conversion of Jan. 1, 1998, worked without a banking panic. Three zeroes were knocked off the old ruble, which continued circulating for several months, showing that the Central Bank had learned from the earlier fiascoes. The timing nevertheless was awkward. The effects of the Asian debt crisis were hitting Russia, making the job of defending the redefined ruble all the harder, as the subsequent months demonstrated.

Russia is hardly alone in terms of a troubled legacy with its own money. There are countries, notably in sub-Saharan Africa and the Caucasus, where money demand is much lower than in Russia. The good news is that ruble demand is rising. In 1999, holdings of rubles were only about 10 percent of GDP. Putting things in perspective, Russia is on the gently upward slope of ruble monetization.

Perhaps in an attempt to dispel the demons of the past and facilitate the process of making the ruble more credible, Russia made its currency fully convertible in 2006. In fact, Russia is almost alone among the major emerging and developing countries in embracing completely free capital flows.

So in contrast with the policies of China, Brazil and India, Russians and foreigners alike can freely hold and trade rubles and foreign currencies both in Russia and abroad. In so doing, the country has made itself more vulnerable to speculative capital flows, as demonstrated during the global financial meltdown in late 2008. The upside is that with no exchange controls, the country is obliged to pursue prudent macroeconomic policies.

It takes time to build credibility once it has been lost. Russia is at least moving in the right direction.

Martin Gilman, a former senior representative of the International Monetary Fund in Russia, is a professor at the Higher School of Economics.

Related articles:

- Banking on the Russia Risk You Know
- Rosneft Getting Bank Commitments
- Central Bank Keeps Rates Unchanged