Rouble floating will spur German sympathy vote

Another country goes for exchange rate depreciation

by David Marsh

Tue 11 Nov 2014

Russia's decision to let the rouble float on Monday, although generally expected, marks another step towards exchange rate depreciation by many of the world's major monetary powers. The move will have a particular effect in Europe, where Germany will see it as another sign of how US-led sanctions risk isolating Russia and turning it towards inward-facing economic policies detrimental to the wider European economy.

This seems likely to add further to pressure for a weaker euro against the dollar, a course apparently favoured by the European Central Bank, as hawkish and dovish policy-makers on the 24-strong governing council play out an uneasy truce.

Mario Draghi, the ECB president, last week added to expectations of a weaker currency by backing fresh monetary easing in coming months, even though the likelihood of full-scale quantitative easing through ECB purchases of government bonds still seems unlikely, unless the European economic position weakens drastically further and inflation falls towards zero. 'Should it become necessary to further address risks of too prolonged a period of low inflation, the governing council is unanimous in its commitment to using additional unconventional instruments within its mandate,' he said on 6 November.

Draghi's diplomatic efforts to paper over cracks in the council, and his indications that the ECB's balance sheet could rise, under certain circumstances, by €1tn, should be enough to maintain a cease-fire at least until February-March next year. Up to that time no new ECB action is expected.

Not just German central bankers, but representatives from several other countries in the euro area, are making a concerted effort to convince the market that liquidity-boosting measures already under way or announced could have a sizeable effect on the ECB's balance sheet. They caution against expectations that central bank moves to purchase government bonds that had a sizeable effect on the US economy earlier after the Lehman Brothers collapse could have a similar impact in Europe. This is in view of differences in economic structures, and much lower interest rates in Europe than in the US when the Fed's QE was first implemented.

The spectre of a floating rouble, even though its economic impact in Germany will be limited, should bolster the German sympathy vote for Russia over sanctions, amid signs that public and industry support for Chancellor Angela Merkel's pro-US commitment over Russia and Ukraine has been ebbing.

The rouble fell sharply last week when the Bank of Russia announced it was ending its policy of potentially unlimited intervention, but it rallied on Monday after the central bank said it was removing the dual-currency trading band and ending routine foreign exchange intervention. President Vladimir Putin hailed the decision, which effectively brings forward a fully flexible exchange rate regime earlier conceived for end-year, saying that allowing the rouble to find its own level would reduce harmful speculation.