Inside Putin’s central bank surprise

The Russian president’s unexpected compromise over a new central bank chief exposes the powerful factional pressures he faces

BY DOUGLAS BUSVINE
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“It will be a surprise – you’ll like it,” President Vladimir Putin said with a smile when asked whether he had decided who should be next head of Russia’s central bank.

The former KGB spy said nothing more to reporters but the timing of his comment on March 7, the eve of International Women’s Day, sent a coded message that was quickly deciphered.
Before the holiday weekend was out his
top economic aide, Elvira Nabiullina, had
emerged as the sole viable candidate after
months of intrigue and disinformation over
who Putin would name to the coveted post.

In an era when central bankers have
come to be seen as the high priests of glob-
al finance, creating money out of nothing,
Putin's choice of the soft-spoken former
economy minister delivered as big a sur-
prise to Kremlin watchers as did the elec-
tion of Pope Francis to the world's 1.2 bil-
lion Roman Catholics.

Nabiullina's name, derived from the
Arabic for “Prophet of Allah”, had not ap-
peared on any shortlist. It was precisely her
status as a non-candidate that defined the
49-year-old ethnic Tatar as a compromise
choice to head the Bank of Russia, say in-
siders and analysts.

She is both trusted by Putin but accept-
able to his opponents. Her selection reflects
the growing challenges that Putin, now a
year into his third presidential term, faces
in sustaining the personalised system of
rule he created after first succeeding Boris
Yeltsin in 2000.

Although the Kremlin propagates an im-
age of Putin as a master string-puller at the
peak of a unified administration, in reality he
is more like a circus master trying to control
factions that relentlessly vie for influence,

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Former first deputy chairman of the central bank

according to longtime political observers.

A slowing economy and growing mid-
dle-class discontent have deepened a rift
between Putin and his coterie of secret-
service alumni known as the siloviki, or
“men of power”, and the so-called “system
liberals” to whom he has always delegated
the fiscal and monetary management of
Russia’s $2 trillion economy.

The liberals’ standard bearer, Alexei
Kudrin, ran budget surpluses, repaid debts
and saved windfall oil revenues in a rainy-
day fund during an 11-year term as finance
minister until he was ousted in 2011.

But a rising group of Kremlin econo-
mists is determined to mobilise state re-
sources to crank up flagging economic
growth - including by slashing interest
rates, a move that would be anathema to
the inflation hawks who until now have
Russia | Inflation

Falling interest rates and inflation in the early 2000s helped Russia benefit from the global ‘great moderation’. But the economy started to overheat in 2007, with a rise in inflation turning real interest rates negative. When the crash hit in 2008, the cost of credit to business soared, sparking a deep recession.

**CORE INFLATION - CHANGE FROM PREVIOUS YEAR**

![Chart showing core inflation change from previous year]

**RCB REFINANCE RATE** vs. **AVERAGE 1-YEAR BUSINESS LOAN RATE**

![Graph comparing RCB refinance rate and average 1-year business loan rate]

Source: CBR, Reuters

been in charge of the central bank. Putin, 60, considered half a dozen other candidates before finally opting for Nabiullina, according to sources familiar with the process. In choosing a trusted confidante, he has extended his influence but stopped short of provoking an open rift with the liberals. But it was a close call.

“She is probably the most balanced person,” said Igor Yurgens, head of the Institute of Contemporary Development, a think tank with close ties to Dmitry Medvedev, the former president who is now prime minister. Nabiullina “has the closest distance to the president. She can influence him,” said Yurgens.

Supporters describe Nabiullina as a skilled economist, administrator and negotiator. They emphasise her role in drafting the market reforms of Putin’s first term that supported Russia’s return to rapid growth after the trauma of the rouble devaluation and domestic debt default of 1998.

“She’s serious and she’s smart,” said Martin Gilman, a former International Monetary Fund staffer who heads the Centre for Advanced Studies at Moscow’s Higher School of Economics.

Others are less complimentary, saying Nabiullina exerts tight control over her subordinates and focuses on managing upwards rather than outwards – weaknesses in a central bank boss who needs to be a good delegator and an adept communicator.

Where policy makers and economists agree is that Nabiullina is a compromise choice, lacking independence compared with the central bank’s current head, Sergei Ignatyev, who retires in June after 11 years in the job.

“Putin and Medvedev perceived Ignatyev as someone who can take responsibility for what he says or does. His recommendations were in a way seen as an instruction manual,” said one senior administration official who requested anonymity.

“Will Elvira have this authority? I doubt it,” the official added. “She is one of those people who would understand how things need to be done, as a professional, but realises that if the Kremlin wants something different, this is what must be done. End of story.”

Nabiullina declined to comment, but Gilman defended her independence. “Nabiullina takes the responsibility of public policy very seriously,” he said. “She is appreciated within the elite as a technocrat who does her homework and solicits views. She knows her stuff.”

**KUDRIN’S REJECTION**

Putin’s “you’ll like it” remark had a familiar ring – he used exactly the same phrase when he was prime minister in August 2011, the month before he announced he would run again for the presidency.

On Sept. 24, 2011, when Putin
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announced that he would swap jobs with Medvedev, his partner in Russia’s ruling tandem power structure, then Finance Minister Kudrin was 5,000 miles (8,000 km) away in Washington D.C. and most certainly did not like what he heard. Offbase at the autumn meetings of the International Monetary Fund and World Bank, Kudrin — said to harbour prime ministerial ambitions of his own — summoned reporters to a briefing and declared that he would not serve in a Medvedev-led government.

His remarks caused a furore. Medvedev demanded Kudrin’s head and the finance minister promptly found himself out of a job. After the ruling party won the December 2011 parliamentary election with a reduced majority, Putin offered the post of central bank chairman to Kudrin, an old ally who back in 1996 had helped Putin get his first job in the Kremlin.

Kudrin, however, showed some sympathy with demonstrators protesting over what he called “major violations” in the conduct of the elections. In private, he turned down Putin’s job offer, sources familiar with the matter say.

Throughout the selection process Kudrin played his cards close to his chest and avoided public comment on the issue. Although he did not completely break with Putin, Kudrin’s rejection of the president’s offer challenged the code of loyalty Putin relies on to control Russia’s bureaucracy.

Asked about Kudrin’s political future at a televised call-in show not long after the election, Putin’s discomfort was palpable. “Alexei Leonidovich Kudrin has not left my team. We are old comrades, he’s my friend,” he said.

Putin had miscalculated, says economist Sergei Aleksashenko, who in the 1990s served as a deputy finance minister and later as first deputy chairman of the central bank. “He (Putin) was sure that Kudrin would accept this position,” said Aleksashenko. “Kudrin rejected this proposal. It was a big surprise for Putin. Then he started to look around for who he could rely on.”

BATTLE OVER POLICY

Putin’s attention turned to Sergey Glazyev, a Soviet-educated economic prodigy and former rival. Glazyev ran against Putin for president in 2004 and, before losing heavily, accused the Russian leader of running a “corrupt and irresponsible regime”.

But in February 2012, a month before the presidential election, Glazyev had thrown his lot in with Putin, writing in a blog post that the Russian leader’s decisions were “always in the interest of the country”. Soon after taking office, Putin appointed Glazyev to a Kremlin role advising on economic integration among post-Soviet states.

Glazyev had made his name as an unorthodox economist, arguing the state should play a leading role in development and spurning the liberal consensus that has sought to bring Russia into the global financial and economic mainstream.

His views soon gained influence, inspiring increasingly strident official calls for the central bank to ease policy to bolster growth that, at 3.4 percent last year, was around half the average rate of Putin’s first two terms.

Russia’s liberal establishment recoiled at the rise of Glazyev, who is on the record accusing the West of conspiring to turn Russia into an economic colony and who once described the Russian central bank as a branch of the U.S. Federal Reserve.

“A person who argues in all seriousness that the United States and Europe are issuing money so that they can grab Russian assets on the cheap can be anyone as long as he is healthy; just not an economist,” Anatoly Chubais, the architect of Russia’s 1990s mass privatisations, wrote in January.

Glazyev was unmasked as a contender for the central bank job in February—just over a month before the deadline for Putin to make his choice—in an apparent bid by the liberal camp to undermine his candidacy.

He declined to comment to Reuters. But pro-Kremlin commentators rallied to his support, with TV pundit Mikhail Leontyev saying Glazyev was the best man for the central bank job, regardless of whether he

CONTROVERSIAL CONTENDER: Sergei Glazyev, an economist whose views prompted calls for looser central bank policy to boost growth, was considered as bank chairman but opposed by liberal factions. REUTERS/SERGEI KARPUKHIN

$500 billion

Approximate current level of Russia’s foreign currency reserves

Source: Russian central bank

OTHER PLANS: Former finance minister Alexei Kudrin rejected Vladimir Putin’s offer to nominate him as head of the central bank, but remains a powerful political influence. REUTERS/JO YONG HAK
was a candidate.

The contest for the central bank job was really a proxy battle, one senior former central banker told Reuters at the time, between the fiscal and monetary orthodoxy personified by Kudrin and the Glazyev state-led dash for growth.

“IT’s about policies, not about personalities,” he said.

NO INSIDER
The name of Alexei Ulyukayev, Ignatyev’s most senior deputy at the central bank, appeared as the most credible insider on shortlists that did the rounds in January and February. But his opposition to rate cuts counted against him.

Putin also passed over candidates from Russia’s powerful state banks that, many economists argue, bear far greater responsibility for the high cost of borrowing in Russia than the central bank itself.

His eventual choice of Nabiullina caught many by surprise. “I myself learned she was nominated from the internet,” a senior government source told Reuters. “I am not kidding. Whoever tells you he knew which candidate Putin would pick long ago is lying.”

When her nomination became public, Kudrin tweeted to wish her success.

Nabiullina will face a challenge in bringing Russia’s unruly banks to heel. The role is complicated by a plan to transform the central bank into a ‘mega-regulator’, with added responsibility for oversight of financial markets.

Even senior officials admit huge sums escape the oversight of banking regulators. In unusually forthright remarks Ignatyev, the outgoing central bank chief, said last month that nearly $50 billion was illegally siphoned abroad last year.

Much of that money, Ignatyev said, appeared to be controlled by “one well-organised group of people”. He did not name them, but Putin’s critics have interpreted the remarks to refer to the state officials who, if not involved, at least tolerate fraud and money laundering by Russian banks.

Russia | Currency
Rising oil prices helped Russia to run a fiscal surplus, pay down its debts and accumulate $600 billion in foreign reserves in the 2000s. But when Lehman Brothers collapsed in September 2008 and oil prices crashed, the central bank had to give up its defence of the rouble after spending a third of its reserves on currency intervention.

A QUESTION OF LOYALTY
Nabiullina cut an uncertain figure when Putin proposed the central bank post to her at a meeting on March 12 at his Novo-Ogaryovo residence outside Moscow. Kremlin reporters spotted her waiting, with Ignatyev, more than an hour before the two were ushered into Putin’s office.

“I would like to thank you for the confidence you have shown in proposing my candidacy. I understand how much this is a responsible, complex and professional task,” she told Putin in a meeting staged in front of journalists.

With television cameras rolling, Nabiullina then requested that, if parliament approves her candidacy, the 65-year-old Ignatyev stay on as an adviser after he retires. Putin agreed.

That may suggest Nabiullina, who
advocated pro-growth policies as economy minister but did not launch any landmark initiatives, will not stray far from the policy course demanded by Putin. But it does not mean the system liberals, many of whom sympathise with protestors’ calls to fight official corruption and boost democratic accountability, are on board for good.

It was Nabiullina’s husband, Yaroslav Kuzminov, rector of the Higher School of Economics, who in April 2011 warned of a social confrontation in five to 10 years if Russia’s leaders fail to address the concerns of the rising middle class.

It is that very proximity of potential dissent to the centre of Kremlin power that poses a threat to the fragile cohesion of the Russian elite. For now, Putin has succeeded in keeping the key liberal players inside the tent of Kremlin politics – and his nomination of Nabiullina for the central bank job is part of that strategy. But it will be a tough act to sustain as he likely eyes a fourth presidential term in 2018.

“When Putin switched jobs with Medvedev, it divided society,” said a critical Moscow-based economist. “By picking Nabiullina he has divided the country’s intellectual elite – even further than it is already divided.”

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