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Monetary policy rules for Russia ☆

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The paper reviews the recent conduct of monetary policy and the central bank's rule-based behavior in Russia. Using different policy rules, we test whether the Bank of Russia reacts to changes in inflation, the output gap and the exchange rate in a consistent and predictable manner. Our results indicate that, during the period from 1993 to 2004, the Bank of Russia used monetary aggregates as the main policy instrument. Some estimations provide evidence that the Bank of Russia was more concerned with reducing inflation before 1995, while the priorities shifted towards exchange rate stabilization after 1995. *Journal of Comparative Economics* 33 (3) (2005) 484–499. CREES, University of Toronto; Kiel University and Kiel Institute for World Economics (IfW); European Commission and Kiel Institute for World Economics (IfW).

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1. Introduction

Motivated by the seminal papers of [McCallum \(1988\)](#) and [Taylor \(1993\)](#), much research on the evaluation of monetary policy rules has been undertaken in the last ten years. Many studies investigate the behavior of the monetary authorities in developed economies, using either a simple McCallum–Taylor rule or some straightforward variation, e.g., including lags of the short-term interest rate or output deviations. For developed countries, such rules explain the behavior of central banks rather well and stabilize deviations, either from a target level of inflation or in the output gap, using an interest-rate instrument.

Such simple rules have other advantages; they are relatively easy to implement and they are easily understood by economic agents. One advantage of rules is that they do not require a fully specified underlying model of the economy.¹ For example, the estimation of the McCallum rule does not entail the modeling of the aggregate demand or the aggregate supply of money, as [McCallum \(2000\)](#) demonstrates.

However, for developing and emerging-market countries, the ability of such rules to describe policy behavior is not clear-cut. Given the specific features of emerging-market economies, the adequate policy instrument might not be the short-term interest rate or the monetary base but rather the exchange rate.² Including the exchange rate in the central bank's reaction function does not contradict its objectives, if exchange rate stabilization is a precondition for both output stabilization and reducing inflation to a targeted level, as [Taylor \(2000\)](#) discusses. Studies investigating monetary policy rules in emerging-market economies find that central banks follow some rule-based monetary policy and that an open-economy version of the Taylor rule describes much of the variation in short-term interest rates ([Calderon and Schmidt-Hebbel, 2003](#); [Minella et al., 2003](#); [Mohanty and Klau, 2003](#); [Taylor, 2001](#) and [Torres Garcia, 2003](#)).

Nonetheless, in transition economies, financial markets are even less developed so that the implementation of rule-based monetary policy may face institutional difficulties. Because of greater model specification problems and difficulties in collecting reliable data, little research has been done on monetary policy rules in these economies. This study examines the conduct of monetary policy in Russia from 1993 to 2004. The empirical estimation of alternative rules for monetary policy allows us to test the hypothesis that, in financially less developed economies, monetary targeting rules can provide an effective description of the behavior of the monetary authorities and of their stated objectives in Russia.

The rest of this paper is organized as follows. Section 2 describes the evolution of monetary policy instruments and the monetary regime followed by the Russian central bank in chronological order. Section 3 specifies the different empirical models used in evaluating monetary policy rules, while Section 4 presents the results of our empirical estimations. Finally, Section 5 draws some policy implications from the Russian case.

¹ However, welfare-based comparisons of the optimality of alternative rules are not possible.

² [Detken and Gaspar \(2003\)](#) show that a monetary authority for which price deviations matter will also pay attention to exchange rate developments, even if it does not targeting the latter formally. Therefore, exchange-rate targeting may be observationally equivalent to inflation targeting.

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