Published in “Voprosi Economiki”, №12, 2009.

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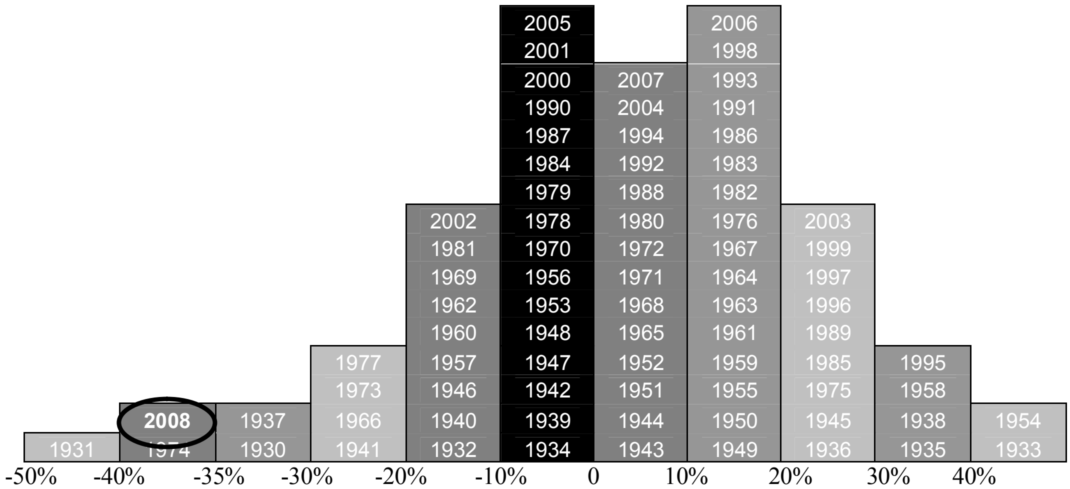
GLOBAL FINANCIAL CRISIS: A YEAR LATER*

*The article reflects the personal opinion of the author

September of 2009 has commemorated a year’s anniversary since bankruptcy of Lehman Brothers was announced. Amid the growing imbalances and distortions that accumulated in the global economy, this event triggered the beginning of large-scale systemic market corrections, fundamental changes in regulation approaches, and caused a revision of the principles of modern market architecture and the market ideology itself.

The decline of the US stock market was one of the greatest in the entire history of observations (Fig. 1).

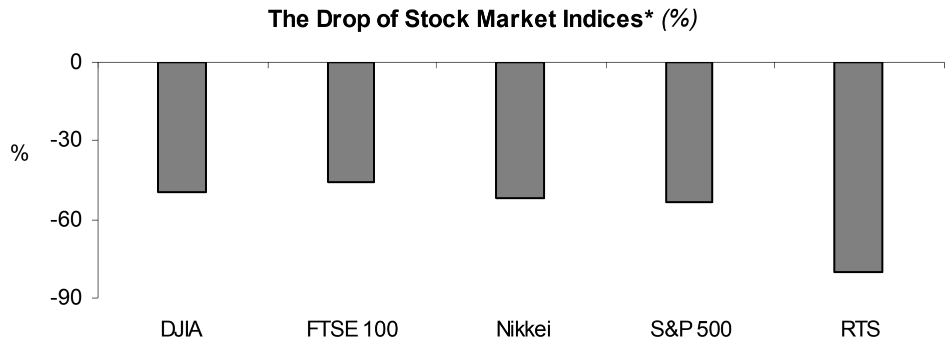
Dow Jones Trends in 1930-2008 *



* Rate of increase; in real terms of chained 2000 dollars.
Source: calc. based on NYSE data.

Fig. 1

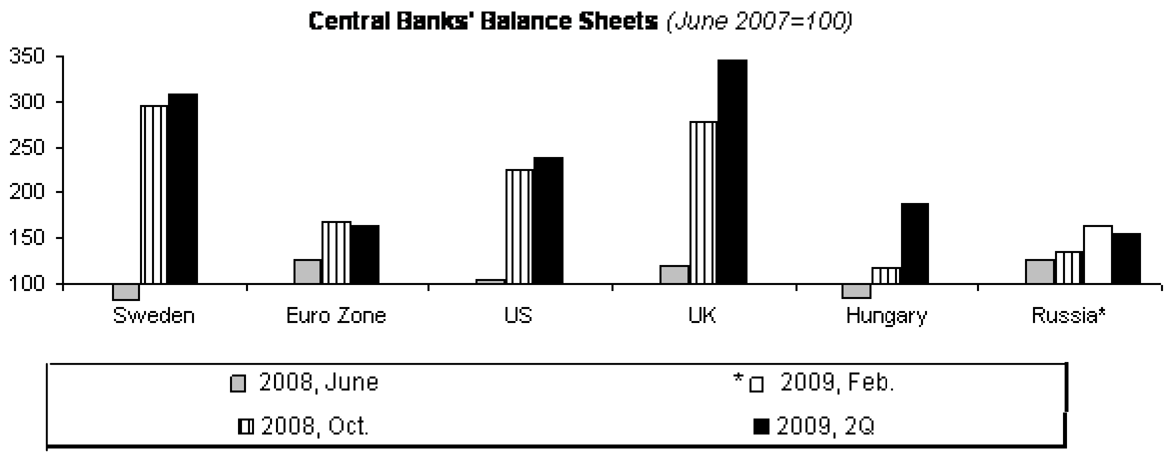
Other markets generally behaved in a similar manner. In the case of Russian stocks, whose fall was deeper than in many other countries, the situation only highlighted those sore spots of our economy and stock market which were repeatedly described in this magazine and which are associated with our market being greatly dependent on both foreign investors and international financing sources as a whole, the predominance of speculative investors over strategic ones, a poor market diversification, the insufficiency of measures to control cash flows, etc.[1] (Fig. 2).



* from their peaks in H1 2008 to their minimum in Q1 2009.
Source: calc. based on data from finance.yahoo.com.

Fig. 2

The magnitude of the problems made regulators in most countries take urgent measures of unprecedented scale. This involved a wide use of monetary instruments to stabilize economies, with a substantial increase in the balances of central banks in leading nations (Fig. 3).

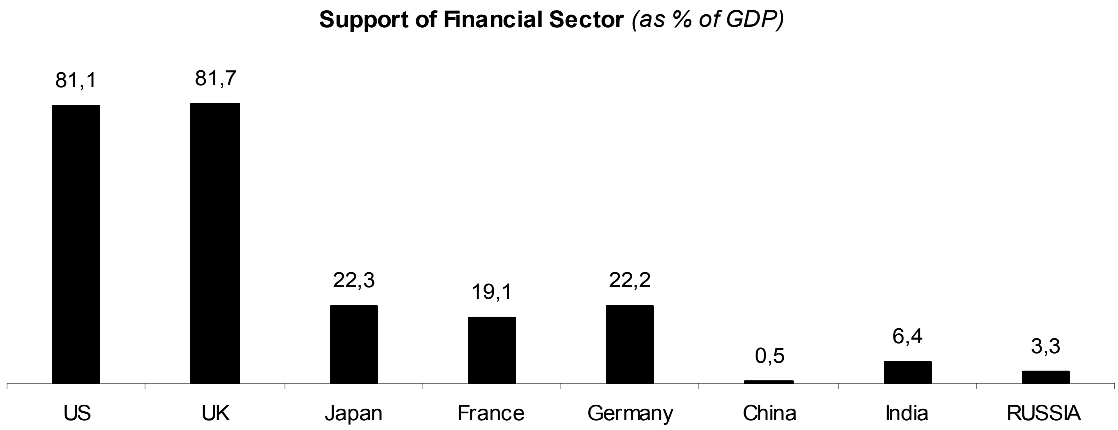


Source: IMF, WEO, Oct 2009; calc. based on CBR data.

Fig. 3

While the main center of risks during the Great Depression in the USA was in the household sector (with accompanying "bank runs," large-scale withdrawals of deposits, and a stupor in the financial system), this time it was the financial sector that became the primary source of risks and of a potential panic. After the drop in prices in the real estate market and the aggravation of problems related to "sub-prime" credits, financial companies and banks started to close positions on each other and refuse to renew credits. This strengthened the "demultiplying effect," leading to a shrinkage in financial resources (deleveraging) and increased the nonpayment and bankruptcy risks. In this situation, the continuity of operations of financial sector became the main task (Fig. 4).

[1] See: *M. Ershov*. How to Assure Stable Development in Unstable Financial Environment? // Voprosy Ekonomiki [Economic Issues]. 2007. No. 12.

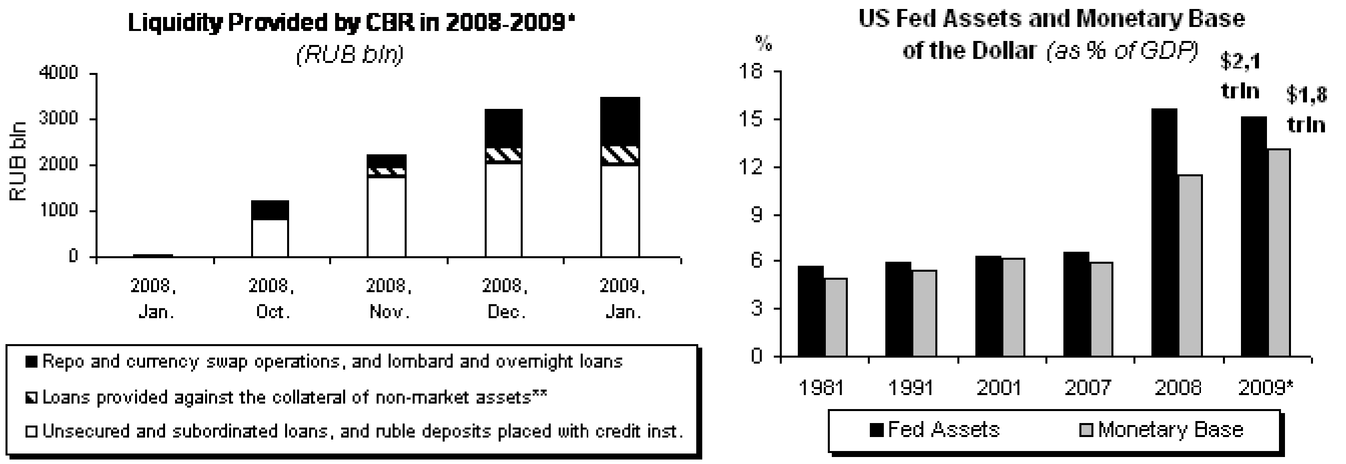


Source: UNCTAD, Trade and Development Report, 2009; IMF; calc. based on premier.gov.ru, Rosstat data.

Fig. 4

Some New Approaches

The degree of risks was so considerable that several leading countries had to change substantially the framework and structure of their monetary approaches (Fig. 5). During the early phases, they used both - interest rate reductions and additional liquidity injections into economies through all channels of monetary mechanisms. The scale of measures became much larger than in the past years.



* excl. subordinated loans to Sberbank of Russia.
** incl. promissory notes and claims under credit agreements.
Source: Bank of Russia.

* as of early Oct.2009.
Source: US Fed; calc. based on US Fed and Bureau of Economic Analysis data.

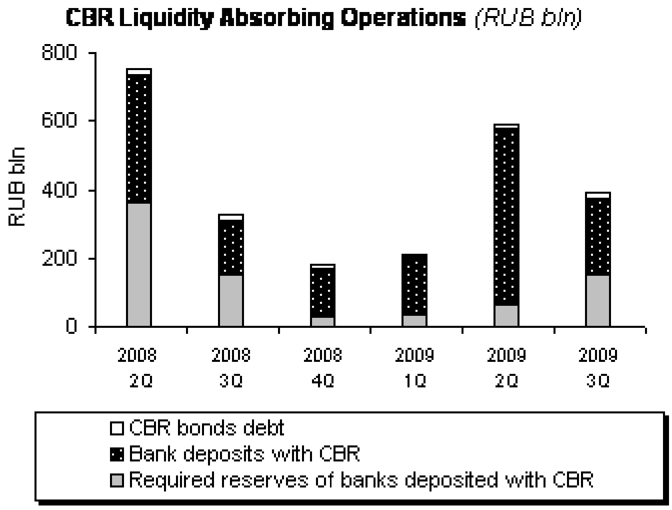
Fig. 5

During the later phase of the crisis management process, when interest rates in leading economies (primarily in the USA) reached low levels, regulators started to pursue, as their main method, the "quantitative easing" policy, which actually meant injecting an economy with financial resources.

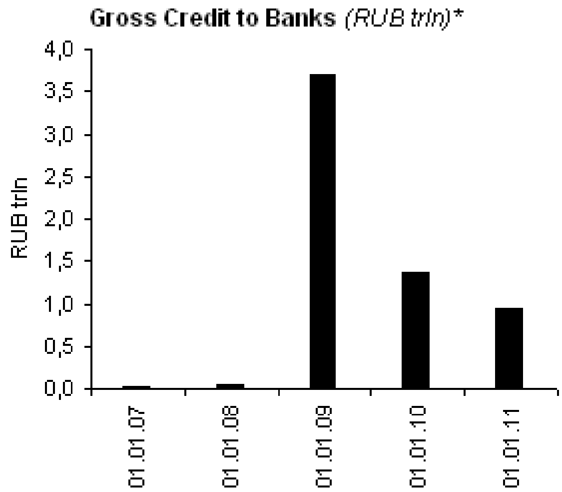
In this connection, there have already been instances where, in a situation which is equivalent to "liquidity trap" (with low levels of interest rates) further increases in liquidity have led to negative interest rates. This was the case in Sweden, for example, where central bank set negative interest rates on the deposits placed by commercial banks with the central bank.

Meanwhile, as a deep phase of the crisis was over, many banks tried to decrease their dependence on regulators' assistance (particularly since such assistance is often associated with a relative loss of economic autonomy implying transfer of banks' shares as collateral to regulators). In addition to economic considerations, this was one of the causes why Russian banks did not show big interest to the regulators' initiative to increase banks' capitalization through an exchange of bank preferred shares for federal loan bonds (OFZ). On the whole, many programs in different countries (TARP and others) are being gradually scaled down. According to data from the Bank of Russia (CBR), debts which were created by use of unsecured credits equaled about Rub 1.9 trln in February 2009 and went down to about Rub 0.44 trln by September.[2] The share of CBR's funds in the banks' liabilities also decreased substantially (Fig. 6).

[2] See: Speech by Chairman of the Bank of Russia S. M. Ignatyev at the October 16, 2009 Session of the State Duma // Dengi and Kredit [Money and Credit]. 2009. No. 10. P. 3.

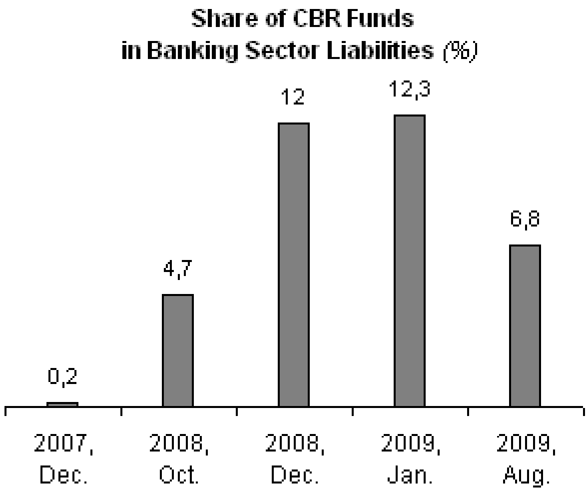


Source: Bank of Russia.



* 01.01.10 - est. of CBR, 01.01.11- projections of CBR according to the basic (second) variant of monetary program of 2009.

Source: Guidelines for the Single State Monetary Policy / Bank of Russia (for relevant periods).

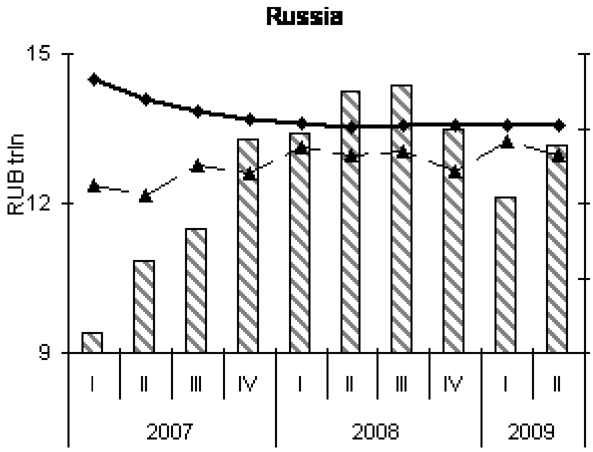


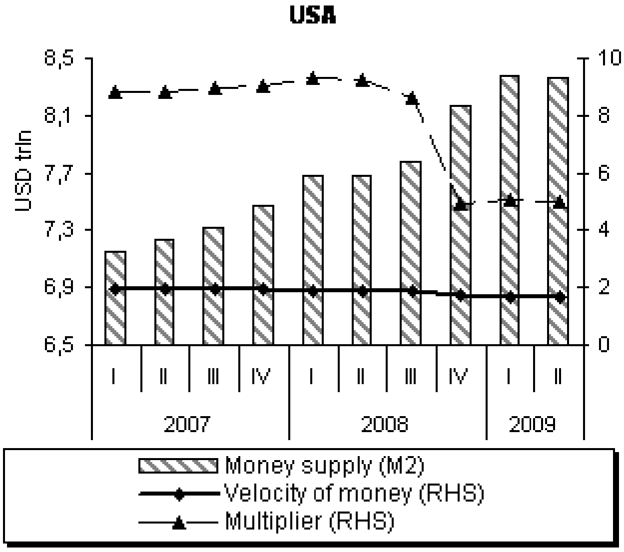
Source: Bank of Russia.

Fig. 6

This, in combination with using various sterilization mechanisms, finally resulted in a noticeable decrease in money supply in the Russian economy. For information, in the USA the increase in liquidity had a more systemic character and money supply was steadily increasing (Fig. 7). The multiplier became lower as well, which reflects the general slowdown of financial processes (lending, investing) as well as certain increase in cash (which is often the case for periods of financial uncertainty).

Money Supply, Velocity of Money and Multiplier





Source: Bank of Russia; calc. based on CBR data.

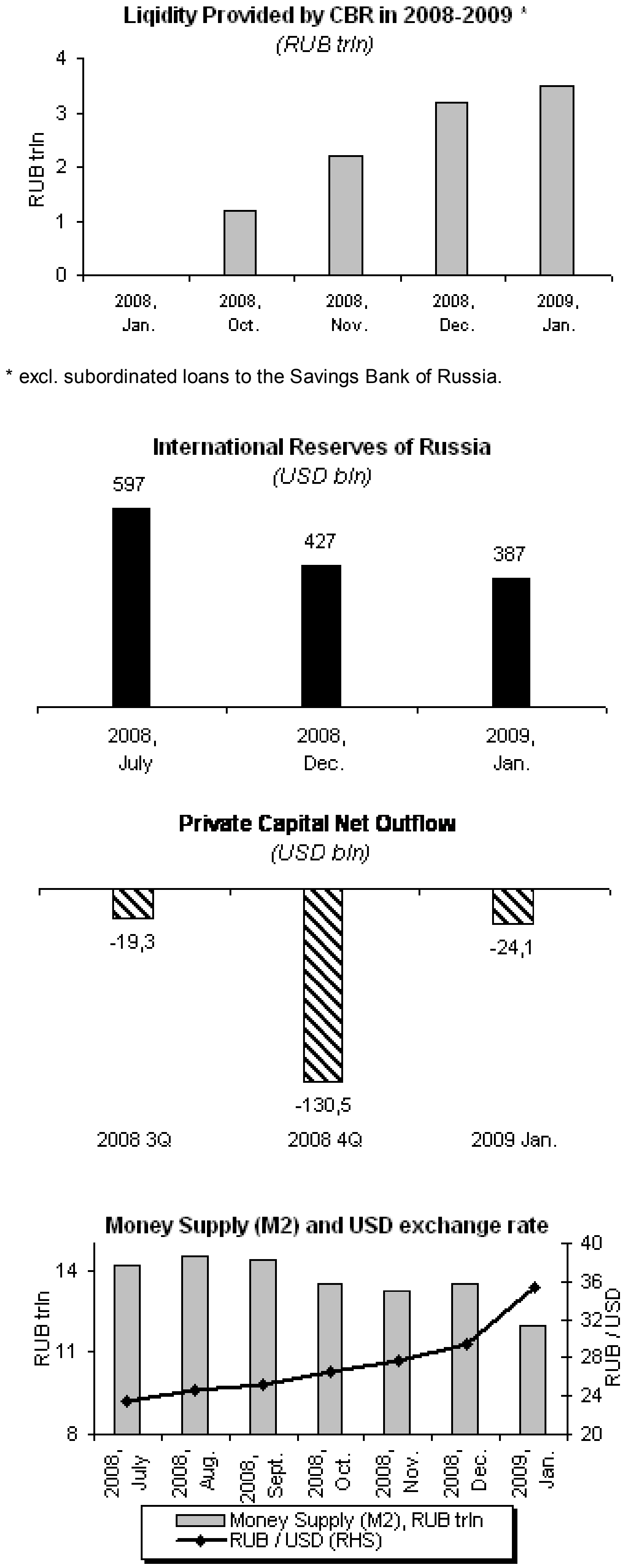
Source: US Fed; calc. based on US Fed and BEA data.

Fig. *7*

Some new dimensions of the monetary policy emerge as well. The purpose-oriented provision of funds to specific companies and banks, which was happening on a large scale during the crisis, in essence presents elements of industrial policy. In this connection, the monetary policy pursued under the antirecessionary measures in developed economies made it perfectly possible to talk about the formation of a sort of "**monetary industrial**" policy, which means implementing monetary approaches with industrial priorities (its sectorial and corporate elements).

The crisis developments raise another important question as to how to monetize the economy and inject financial resources when the economy is open and capital flows are liberalized? The Russian trends for increasing liquidity in late 2008 – early 2009 were accompanied by reduction in international reserves, increased capital outflows, which resulted in the devaluation of the ruble and, eventually, caused a decrease in money supply (Fig. 8).

Injection of Liquidity when Economy is Open



Source: Bank of Russia.

Fig. 8

In a more broad context, many countries face the problem of controlling directions of cash flow (in both – domestically and internationally).

In this regard, international discussions raise as to how to observe national priorities when using taxpayers' money. "Financial institutions have been increasingly asked to serve for the domestic 'interests' and sort of 'financial nationalism' seems to have emerged," said the Governor of the Bank of Japan at the FRS conference in August 2009.[3] Even such countries as Switzerland which represent "financial neutrality" approaches began to use measures to encourage their own banks to finance their domestic projects more than international ones.

Despite the fact that many economies differ quite significantly, the problems they face are often similar. For example, some of them faced the phenomenon of segmentation of financial flows when these flows were restrained by narrow bounds. The transmission mechanism providing the efficient and even flow of funds stopped working. It is well known that, amid the crisis, the inter-bank market (in UK, US, Russia, etc.) did not function and, to put it

[3] See: *Shirakawa M.* International Policy Response to Financial Crises. Remarks at the Symposium Sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming. Aug. 22, 2009. P. 5.

back on track, the support of central banks was needed.

It was often the case that financial resources themselves did not reach the real economy, and even if they did so they could be used by recipients for other than initially claimed purposes (for instance, to buy foreign currency), not for production ones.

Let us remind that at their earlier stages the Russian and Soviet economies were faced with segmentation of financial flows, which resulted from either regulation (including separation of non-cash and cash operations with restrictions for transfers from one form into the other, as was the case, for instance, in the Soviet Union) or the market environment. The latter occurred in the pre-crisis period of the second half of the 1990s, when, with a low monetization of the economy, available monetary resources went not into the real sector but into the market of state treasury federal bonds (GKO), which made the problem of money transmission and crossflow of funds even worse. In addition to traditional monetary elements money stock at this time encompassed money surrogates, barter trade, non-payments, which offset liquidity shortage and made up for the actual narrowing of money supply.

Under such conditions, it is necessary to continue with the efforts toward creating efficient mechanisms for ensuring the desired flow of funds. In this connection, it would be necessary to use both - "purpose-oriented" forms of refinancing (secured by the bills and notes of companies having a certain rating) and other instruments, for example, regional securities, which will promote sectorial or territorial crossflow of funds. It would be practicable to provide additional resources with a subsequent purpose-oriented 'strings-attached' approaches determining the purpose of using funds.

About Protectionism

Financial difficulties make the use of protectionist measures more possible. The international rules of the game require world participants to give their assurances that protectionism is unacceptable. However on the country level the approaches may be different. Speaking about international regulation, US Treasury Secretary T. Geithner said that regulation is a sovereign prerogative: "We are not going to give anyone else the responsibility for deciding what balance between stability and efficiency is right for our markets."[4] As the declaration of the G-20 Pittsburgh Summit which emphasized the importance to fight protectionism was released, the United States took measures to restrict its auto tire trade with China, which may cause retaliatory steps and lead to a new round of trade conflicts. A. Greenspan's rightly emphasized, that "you

[4] Financial Times, March 30, 2009.

cannot have free global trade with highly restrictive, regulated domestic markets."[5] Given the intensifying regulation and growing instability, the issue of direct or indirect forms of protectionism will constantly be in the focus of attention of regulators.

The G-20 declaration addresses the issue of fighting protectionism, with the special emphasis on the financial protectionism as inadmissible particularly when it comes to measures restricting global capital flows, primarily to developing countries.

Obviously, issued funds will seek spheres of application under the new conditions, and for their holders it is evidently desirable that the possibility of using funds should not be limited. It is clear that under such conditions one may also expect both an influx of funds to the stock market, with its subsequent growth (which may be not a long-lasting one and be coupled with a high degree of volatility) as well as an influx of longer-term investment resources.

On the other hand, it is important for potential recipients to evaluate incoming resources with greater consideration. One should not base his judgments on such principles as "any resources are good" and "the more - the better" but should have a clear picture of the origin of funds, their possible use, the period of their stay in the country, the repatriation procedures[6].

In leading countries, these issues are under close control. Let us remind about the Committee on Foreign Investment in the United States, established in 2007 to control inflows of foreign investments to the United States. In addition to four economic ministers (Treasury, Commerce, Energy, Labor) the Committee also includes the Secretary of Defense, the Secretary of the Department of Homeland Security, the Attorney General of the US, the Director of National Intelligence, and the Secretary of State. Such approaches show that in the environment of new risks this problem acquires a geo-economic and strategic importance.

The US support provided to its financial sector may push the problems beyond its bounds and transform into the difficulties for the economy at large. Besides domestic US problems may give rise to foreign exchange problems which are systemic in nature causing international ramifications.

It is yet difficult to talk about the full picture and in-depth links of the current processes, but anyway this problem requires careful monitoring.

Cross-country coordination is extremely important to enhance the final effect of joint anti-crisis measures. Unilateral steps that may be taken by some countries (particularly those countries whose currencies are freely convertible) may put this efficiency of such coordination in jeopardy.

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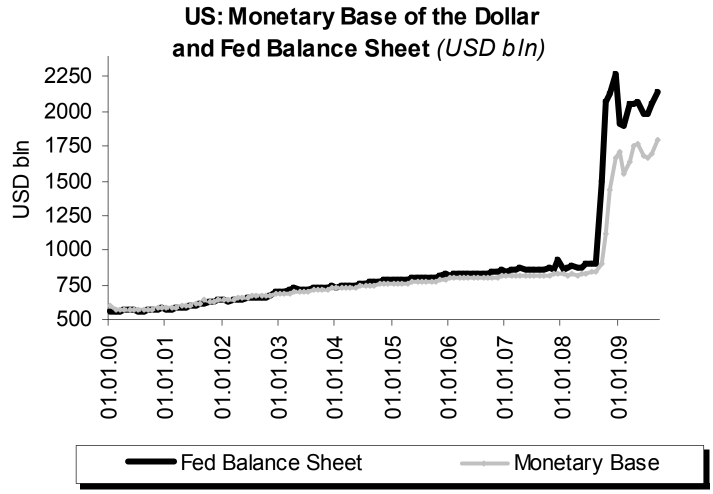
[5] BBC, September 8, 2009.

[6] For example, China amid the crises extended up to 5 years the period upon which expiration foreign investors may sell shares in Chinese banks.

Probable Consequences of FRS Decision

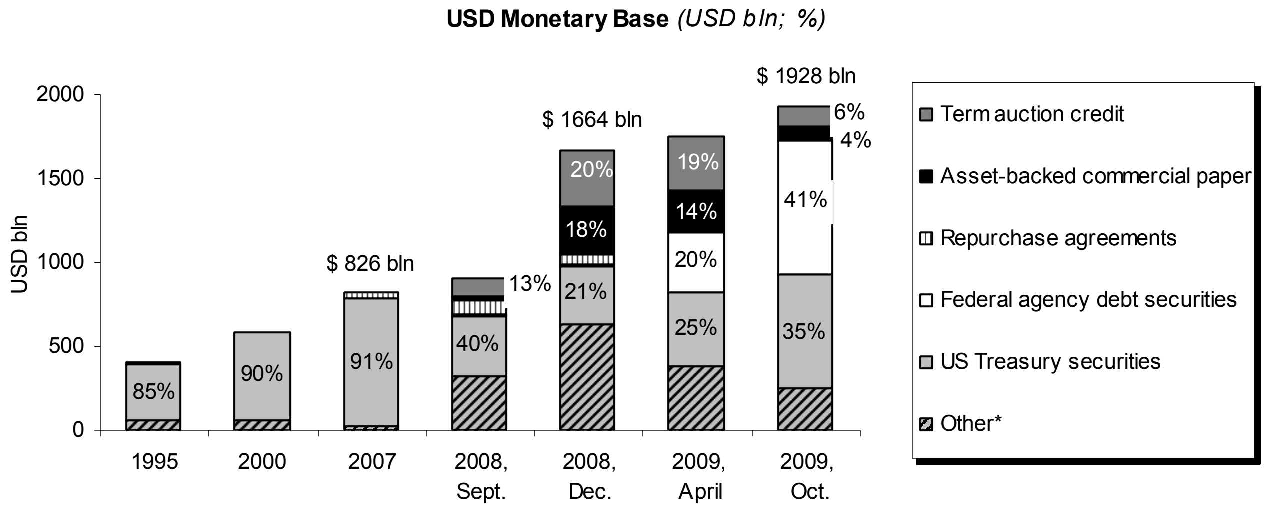
As early as March 2009, FRS made a decision of large-scale purchase of securities from the market. This provides for an almost 50% increase in the FRS balance (Fig. 9) up to more than 3 trillion USD. These plans immediately caused a substantial drop of the USD exchange rate against the Euro and some other currencies and an increase in prices of gold, silver, and oil.



Source: US Fed.

Fig. 9

It is provided that, in addition to purchases of mortgage-backed securities, the FRS also plans to purchase treasury bonds to increase its balance sheet. The latter instrument has been constantly used by FRS for many years to form the monetary base of the dollar, which was the centerpiece of their balance sheet and the entire money supply (Fig. 10).

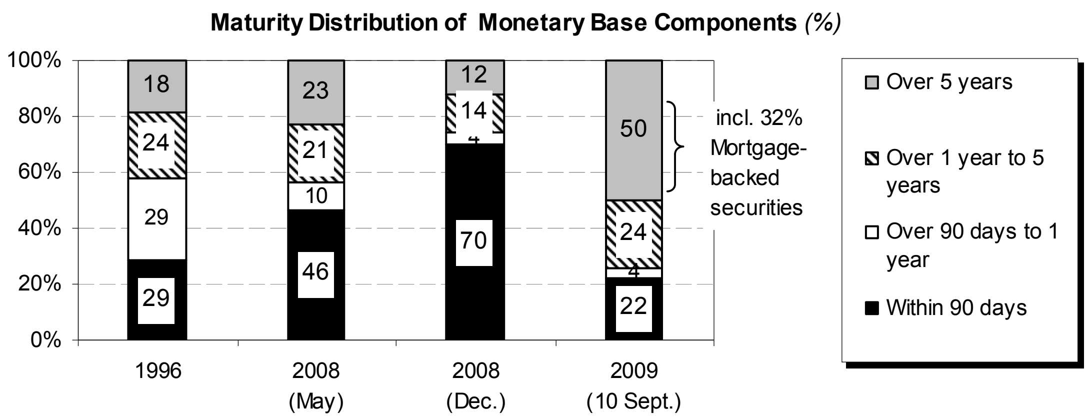


* Incl.: other loans, gold stock, central bank liquidity swaps etc.
Source: US Fed, calc. based on US Fed data.

Fig. 10

The latest recessionary developments, however, forced FRS to substantially increase the monetary base itself (actually 2-fold by now) as well as to radically change the structure of its components. The manageability of money flows and the predictability of their changes under the new conditions become lower. Moreover, the increase in monetary base and, as a consequence, in money supply should be associated with a corresponding increase in GDP, which now, naturally, is not happening.

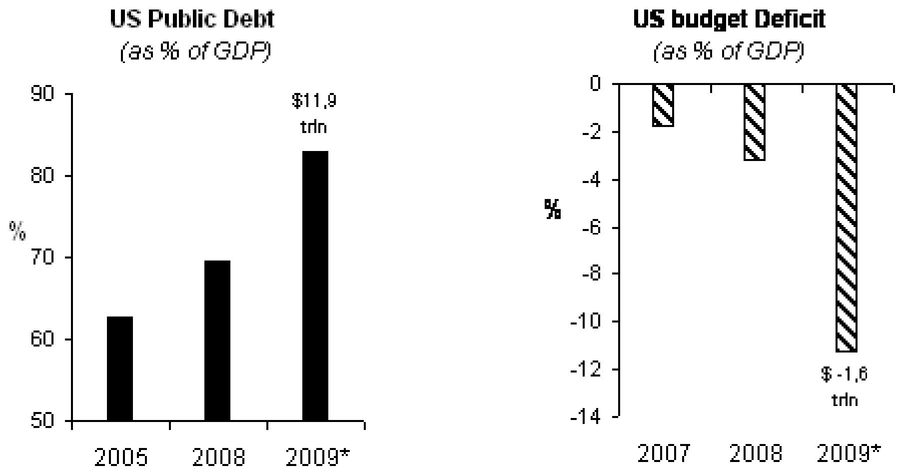
The term structure of monetary base components also requires some attention. During a long period the creation of dollars was based on the FRS purchase of the long-term instruments (which accounted for at least 40% of the entire monetary base). This made it possible to form a more stable long-term basis of financial resources in the economy. During the acute phase of the crises, the short-term instruments came to the forefront (this was caused by the need to provide emergency funds to the market). By mid-2009, however, the component of long-term resources regained importance (instruments whose term exceeded 1 year accounted for more than 70% of the entire portfolio). Let us point out, however, that the greater share of long-term securities can be explained by the purchase of mortgage securities to support this market segment. Therefore, although on the whole (with an adjustment for mortgage instruments) the share of long-term securities returned to the regular levels of the mid-1990s–2000s, the FRS balance appears to be less stable than before (Fig. 11).



Source: calc. based on US Fed data.

Fig. 11

Given that the US budget deficit and public debt have sharply increased (Fig. 12) the anti-crisis measures in total may give rise to the formation of other risks and lead to other crises.



* as of end of Oct 2009. * est. of CBO (Aug. 2009).

Source: US Treasury, Congressional Budget Office.

Fig. 12

About New Views on FRS and Its Future Role

The emergency of the situation and the imbalances accumulated in the US economy made its regulators to announce, in June 2009, a financial regulatory reform. At first US President B. Obama and then US Treasury Secretary T. Geithner presented a detailed program (yet to be adopted) of new approaches. The program provides for substantial changes in the "weight categories" of the regulators, where the Department of the Treasury, not FRS, will often have the dominant role. This immediately gave rise to talks about the decrease in the prior longstanding independence of FRS pointing that these measures may in some cases transform it into a functional unit of the Treasury. Specifically, it is provided as follows:

- to create the Financial Services Oversight Council (chaired by Treasury and including the heads of the principal federal financial regulators as members);

- to create the National Bank Supervisor (as a single agency with separate status in Treasury), which will be responsible for federally chartered depository institutions. [mimeo: Let us point out that these functions should have rather been the prerogative of FRS, and therefore these innovations may be regarded as a transfer of the center of balance in regulation toward the Treasury];

- new authority for the FRS to supervise not only banks, but also all firms that may pose a threat to financial stability. [mimeo: One should suppose that such extensive functions may substantially complicate FRS's work, making it in fact responsible for financial failures of the entire corporate sector];

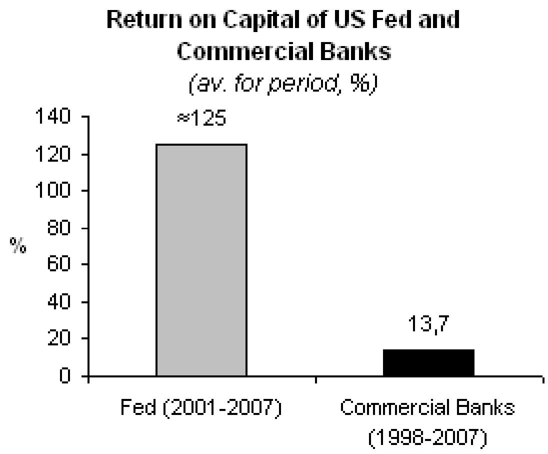
- limitation of FRS's capacity in the matters of providing of emergency loans and receiving prior written approval for these actions from the Secretary of the Treasury.

FRS comprises 12 Federal Reserve Banks (FRBs), whose degree of independence, at least de jure, may be regarded as quite high. Each of the FRB's shareholders bear responsibility under the individual obligations of the relevant bank (but not of other federal banks)[7]. In this connection, one can, for example, recall such precedents where the Federal Reserve Bank of Chicago refused to conduct operations aimed at supporting the Federal Reserve Bank of New York in the pre-war period[8].

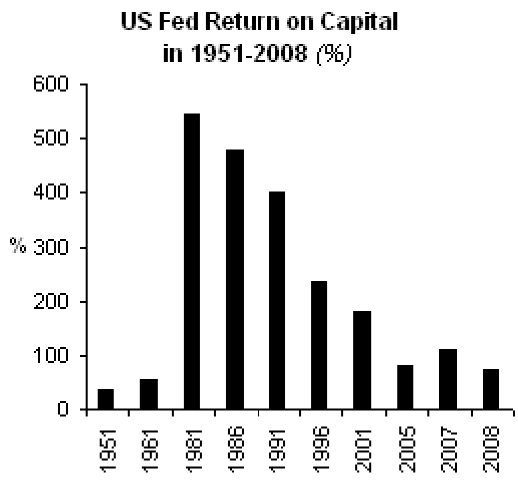
Therefore, the consolidated balance sheet of FRS may be regarded as such with certain reservations. Although the shareholders of the regional commercial banks may be the same entities that are the shareholders of their mother banks at the same time thus making such collisions unlikely in modern times. Nevertheless, these circumstances should be taken into consideration while assessing risks of the balance sheet of FRS.

Finally, more and more often questions are raised about the necessity for differentiating between the independence of the monetary policy, on the one hand, and the independence of FRS itself, on the other. Particularly since the shareholders of regional FRBs are commercial banks that are having quite concrete commercial interests and interests of their shareholders.

Recently, there has been more attention paid to the efficiency of FRS activities (Fig. 13; Fig. 14 – for information).



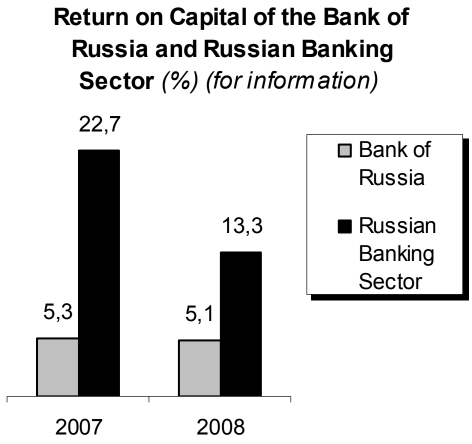
Source: IMF; calc. based on IMF data.



Source: IMF.

Fig. 13

[7] Federal Reserve Act (December 23, 1913). Sec. 2, partly incorporated in 12 USC 222 and 223. As amend by act of July 7, 1958 (72 Stat. 350); March 18, 1959 (73 Stat. 12); 12 USC 502.
[8] See: *Meltzer, Allan H.* A History of the Federal Reserve, Volume 1*:* 1913-1951. University of Chicago Press, 2003.



Source: Bank of Russia; calc. based on CBR data.

Fig. 14

Moreover, at present the US Congress is considering a bill providing for conducting an audit of FRS. The crisis urged the lawmakers toward the necessity for obtaining as complete information about the activities of FRS as possible. Until now, no audits have been conducted of such important spheres of its activities as monetary operations, including credits through the discount window (facilitating direct lending to participants of the financial market); open market operations; operations with foreign governments and foreign central banks.

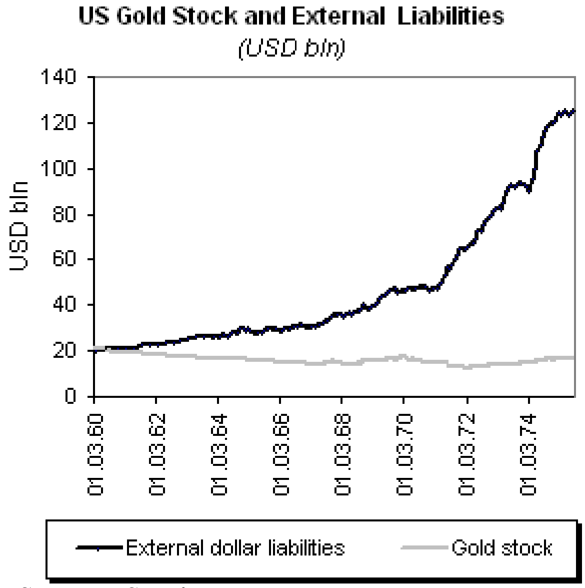
Therefore, one cannot rule out that the current recessionary situation may serve as an impulse for serious systemic changes in the formation of fundamental bases that determine the degree of participation of the economic power centers in the functioning of the modern financial system[9]. Such "interdepartmental optimization" and the associated redistribution of spheres of influence on the regulatory and corporate levels may lead to the formation of a different geoeconomic and geopolitical configuration of modern processes and mechanisms.

About New Dollar Risks

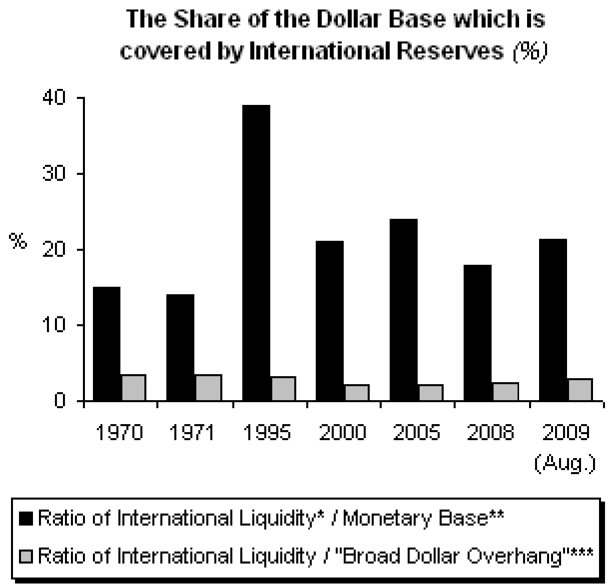
On the whole, the currency market gave a nervous respond to the made decisions about dollar creation by FRS, thinking that the dollar would suffer significant losses. According to international experts, "in the grand sweep of history we are witnessing the end of 'Rome' on the Potomac." "This is a historic moment the start of debasement of the world's reserve currency." [10]

The dollar may enter the same risk zone as it did before the collapse of the Bretton Woods System in the earlier 1970s, when it lost the required gold backing (Fig. 15).

[9] Some attempts to partially transfer the center of power from FRS toward the Department of the Treasury (in such most important matters as the issuance of national currency) were last made during the J. Kennedy administration.
[10] Bloomberg. March 23, 2009.



Source: US Fed.



* Incl. foreign currency reserves, reserve position in IMF, SDR, gold stock. Gold value is calculated based on market value.

** Incl. currency in circulation (excluding currency in the depositaries of the money authorities), reserve funds of commercial banks with US Feds.

*** Incl. monetary base, debt of monetary authorities minus Treasury securities at US Fed balance sheet.

Source: calc. based on US Fed data.

Fig. 15

With such dollar creation in place the amount of international reserves that support (back) it become profoundly meaningful particularly taking into consideration the internal debt factor. The market calmness will be higher if such support is high as well. The dollar exchange rate has been continuously declining in recent time (Fig. 16).

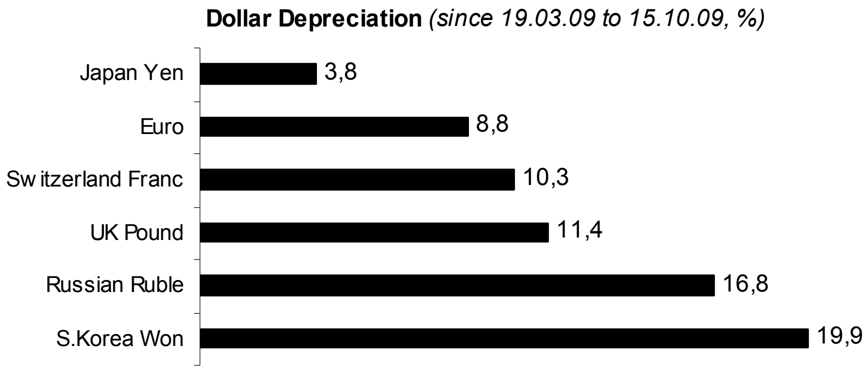


Fig. 16

That is why the markets were so alarmed with the announced decisions by FRS, which gave rise to bringing up the issue of new reserve currencies again.

It is obvious that the process of an adequate substitution of the dollar with other currencies cannot be fast. It is also clear that it will run into a powerful opposition on the geopolitical and geoeconomic levels (with all its relevance, this issue was not even included in the agenda the G-20

London Summit). However, the objective need for this is becoming more and more obvious. In early April, China announced that it would provide more than CNY600 billion (almost USD100 billion) to such countries as Argentina, Indonesia, Malaysia, Belarus, and South Korea for settlements for Chinese exports to these countries. In addition, China sees necessary to decrease the reliance on the dollar and turn RMB into a regional reserve currency. Russia also made repeated statements expressing similar interests. In this magazine, we have already discussed possible approaches toward solving this issue[11].

About Some Forecasts

Speaking of systemic threats, which have long started to form steadily, we pointed out in 2000 that "the global currency system is facing a real prospect of a large-scale currency crisis. The possibility of mitigating its risks and preventing its destructive consequences for the global economy as a whole would depend on how adequate and coordinated would be the measures taken by leading nations."[12] We also emphasized that, "prospects of the USD and, as a consequence, the global currency system as a whole appear to be quite problematic."[13] Experts and practitioners have started pointing out these risks more and more frequently. For example, P. Volcker (former Chairman of FRS) wrote in 2003 that "there is a 75% chance of a currency crisis in the USA within 5 years."[14]

On a more applicational level, many attempts to assess developments in the financial markets were unsuccessful. Speaking at the Congress hearings on the financial crisis, A. Greenspan said that many things had to be viewed differently and revalued due to the crises. Moreover, he mentioned (as a sort of self-excuse) in this connection that powerful models had been created to predict the occurrence of such events and that some of their authors even received Nobel Prizes. However, those models failed to predict such turn of events. "The whole intellectual edifice … collapsed … because the data inputted into the risk management models generally covered only the past two decades, a period of euphoria."[15]

In this regard we shall ask: Are the models that do not serve the purposes they were created for needed? And one more question: What is then the quality of the top awards given in the economy?

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[11] See: *M. Ershov.* On Pivotal Economic Problems // Voprosy Ekonomiki [Economic Issues]. 2004. No. 12.

[12] See: *M. Ershov.* Monetary and Financial Mechanisms in Modern World (recessionary experience of the late 1990s). M.: Ekonomika [Economy], 2000. P. 45.

[13] See: *M. Ershov.* Monetary and Financial Mechanisms in Modern World (recessionary experience of the late 1990s). M.: Ekonomika [Economy], 2000. P. 40.

[14] See: The Economist. 2004. November, 13th. P. 88.

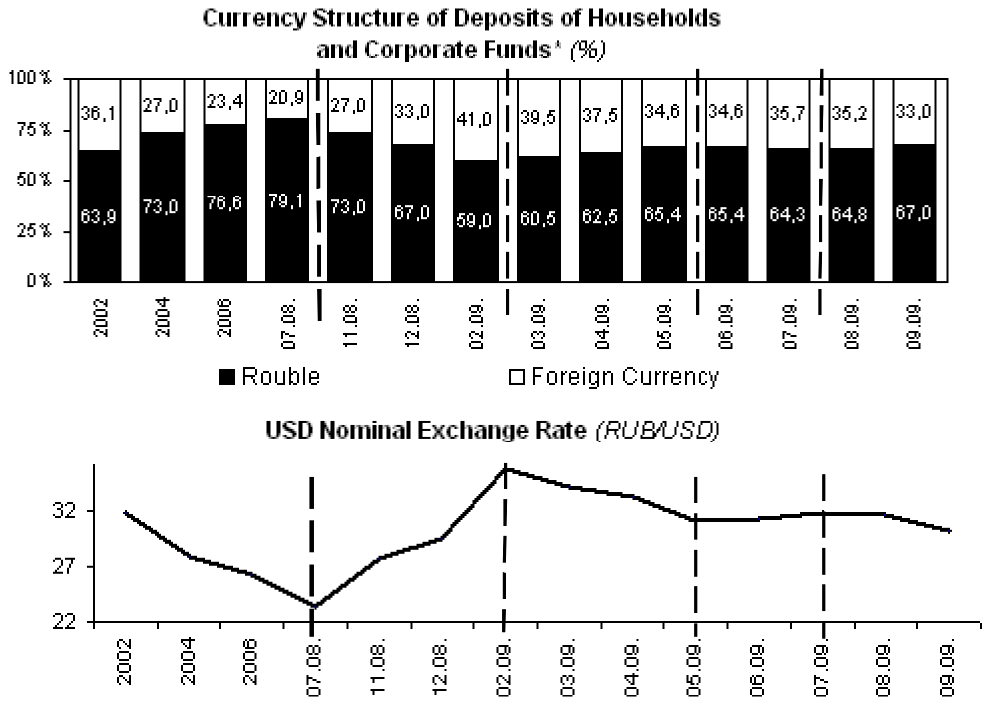
[15] See: *A. Greenspan.* Statement during Committee Hearings on the Financial Crisis and the Role of Federal Regulators, US House of Representatives. Oct. 23, 2008.

Some Risks of the Russian Financial System

The mechanisms that form internal sources of financing play an important role of anti-recessionary stabilizers in the crisis environment. Such mechanisms should help make development of domestic economic processes less dependent on the global market environment. An important role should also be played by a policy for enhancing attractiveness of the ruble and making its role in savings and investments more significant.

Let us note in this regard that the ruble devaluation conducted in late 2008–early 2009 had a considerable effect on the currency structure of business and household deposits, and substantially lowered attractiveness of the ruble. Several months of ruble devaluation have undone all the progress of the growth of ruble which it has been continuously showing several years in a row (Fig. 17).

It is also interesting to note how closely the changes of exchange rates and changes of "currency preferences" are related (ruble deposits grew with the ruble's appreciation and vice versa), which should be taken into consideration in the foreign exchange policy.

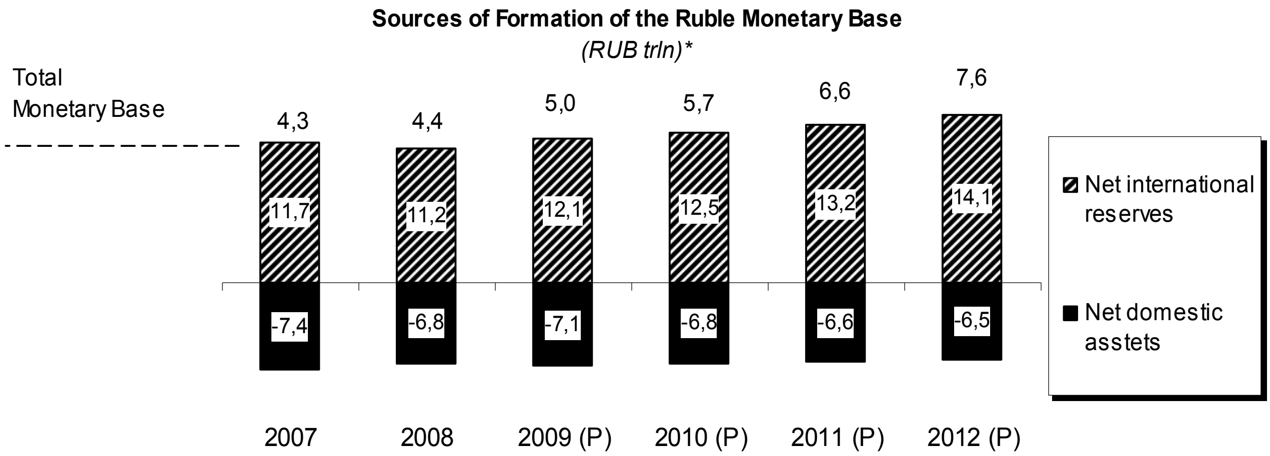


* *Corporate funds incl. money on deposits, settlement accounts and other accounts.*
Source: Bank of Russia; calculations based on CBR data.

Fig. 17

Mechanisms for forming money supply may serve as another important element of development of the financial system. A year ago "The Guidelines for the Single State Monetary Policy in 2009 and for 2010 and 2011" for the first time in many years began to put emphasis on domestic channels as the main source of money supply creation. Net domestic assets were to grow while external factor had to decrease. The regulators planned to use these new approaches in order to “use more effectively the interest rate instruments of monetary regulation and make the interest rate channel of the monetary policy transmission mechanism work” [16] and “the scaling down of the Bank of Russia presence on the domestic forex market will help make the exchange rate policy more flexible and implement a gradual transition to the free floating exchange rate regime”[17].

However, the monetary program for 2010 was based on the assumption of growing net international reserves as the main source of growth of the monetary base (Fig. 18). This basically meant a departure from the approaches, announced by the Central Bank a year ago, when CBR under the crisis pressure switched to using domestic sources of monetization as the main ones. Now (again, like during preceding years) external sources will serve as the main ones in the formation of monetary base.



* 2009 - est. of CBR; 2010-2012 -projections of CBR according to the basic (second) variant of monetary program of 2009.
Source: according to Guidelines for the Single State Monetary Policy in 2009 and for 2010 and 2011; Guidelines for the Single State Monetary Policy in 2010 and for 2011 and 2012/ Bank of Russia.

Fig. 18

No one can say however that the priorities which were laid down in 2008 document became unimportant. What then are the ways to meet the systemic structural challenges that Russian economy has to undergo? We should mention that the external source of monetization increases external risks of drawing of resources (or impossibility of such attraction, as was the case during the crisis). In addition, the mentioned approaches promote conservation of the export and raw material orientation of the Russian economy, a departure from which is set as an important systemic objective. Since an exporter of raw materials, by selling currency earnings and receiving additional rubles thus basically forms a demand for the other economic sectors which increasingly start to serve the interests of raw material sectors. As a result oil and gas positions in exports and GDP

[16] See: Guidelines for the Single State Monetary Policy in 2009 and for 2010 and 2011 / Bank of Russia. P. 27.
[17] See: ibid.

grow (which we observed for many years). In this connection, financial flows into non-export sectors decrease, transmission mechanisms cannot ensure efficient crossflows of resources, while interest rates cannot adequately reflect the price of funding for the economy[18].

Growth of international reserves apparently increases the degree of strength for the economy (it was shown in the recessionary period). However, it does not mean that one should switch to the "currency board" mechanism (at least in essence), where the entire liquidity forms only on the basis of foreign exchange inflows, while the central bank basically refrains from its main function of a primary source of financial resources, which are equally accessible to the export and non-export sectors. Export earnings and foreign loans will come into the economy anyway. But their role in the formation of monetary base, however, should be balanced by domestic resources, with the domestic demand of economic particularly of non-export sectors playing a large role. Without the development of such domestic sectors, one can hardly count on a real diversification of the economy and its departure from its raw material orientation.

Raw material supplies are surely necessary for the global economy. And since there are no efficient alternatives, Russia has to serve as such supplier.

But should this function suffice and will it enable Russia to ensure its long-term systemic role in the world? And what should the Russian economy do when its non-renewable reserves shrink?

Although the Monetary Program for 2010–2012 provides for a certain maintenance of gross credits (with a continual decrease in their volume) to banks, it is planned that the greatest reduction will be made in "net credit to general government," which would mean an additional withdrawal of funds from the economy and will, as before, necessitate attraction of funds from external sources, with all ensuing risks (Table).

Table

Indicators of the Monetary Program for 2009–2011 *(at end of period, RUB trln)**

	2009	2010	2011
Monetary base (narrow definition)	5.0	5.7	6.6
Net international reserves	12.1	12.5	13.2
Net domestic assets	-7.1	-6.8	-6.6
including net credit to general government	-4.9	-3.1	-2.3
net credit to banks	0.2	-1.1	-1.4

** 2009 - est. of CBR; 2010-2011 - projections of CBR according to the basic (second) variant of monetary program of 2009.
Source: Guidelines for the Single State Monetary Policy in 2010 and for 2011 and 2012/ Bank of Russia.

[18] These and other shortcomings of similar approaches were repeatedly pointed out before. See, for example, *M. Ershov.* Economic Growth: New Problems and New Risks // Voprosy Ekonomiki [Economic Issues]. 2006. No. 12.

With balance of payment surplus in place (which is quite probable with relatively high oil prices), external monetization (with all its importance) should not be the only channel of money resources in the economy. If the objectives to improve the structure of the economy and to lower external risks remain acute, then it is necessary to carefully assess the possibility of a mixed approach, when the mechanisms of providing funds to the domestic sectors (while keeping optimal level of exchange rate) come to the forefront[19].

* * * * *

It is important that the use of anti-crisis measures be along the lines of longer term "systemic" approaches that Russian economy faces. Regulators and market participants should have a clear picture (as far as such certainty is possible in the current highly dynamic environment at all) of what the post-crisis economy should look like, what specific steps should be made to overcome the crisis, and how serious new risks may be[20].

Positive as it may seem (worldwide and in Russia) the trends of late 2009 should be assessed bearing in mind that the prime causes that triggered-off the current crisis (accumulated volume of debts, mortgage market environment, low savings, etc.) have not vanished. The growth which is underway in the stock market may only be a temporary correction, which may be followed by a second and even deeper market failure (which was sometimes the case in the past). The additional global liquidity will seek spheres of application, simultaneously intensifying cross-border capital flows and the associated risks (excessive mobility of resources, influence of "hot money," etc.). Potentially, the USD risks are quite high and may become a substantial factor for global destabilization. The growing prices of gold and other metals reflect uncertainty of investors and their attempts to find safe spheres of placing their resources. The regionalization of the markets,

[19] Using this approach, currency earnings, for example, can be purchased by the regulator not in full, but remain in the currency market (which will promote appreciation of the ruble, on the one hand, and an incomplete formation of monetary base resulting from purchase of the currency, on the other hand). To neutralize these consequence, a smaller (than planned) monetization can be compensated with the replenishment of resources through domestic channels, for which purpose combined use of refinancing, gross credits to banks, budgetary channels etc. can be applied.
The additional liquidity entered through the indicated channels may promote a more even distribution of resources among the export and non-export sectors. It may also bring about the adjustment of exchange rate (as some of this liquidity may return to the currency market and cause depreciating tendencies).
It is also possible to use the currency instruments of the Ministry of Finance or the Central Bank (with a sufficient rate of return) to accumulate some part of currency earnings. In this connection, one should assess the practical side of ensuing direct sale of this currency from the Ministry of Finance (if purchases were made using its instruments of the Ministry of Finance) to the Central Bank at the market rate as of the date of the operation (which, firstly, would replenish the ruble liquidity to the market and, secondly, would not have a direct impact on the exchange rate).

[20] We have earlier discussed possible measures in the magazine. See: *M. Ershov.* The 2008 Crisis: "A Moment of Truth" for the Global Economy and New Opportunities for Russia // Voprosy Ekonomiki [Economic Issues]. 2008. No. 12; *M. Ershov.* How to Assure Stable Development in Unstable Financial Environment? // Voprosy Ekonomiki [Economic Issues]. 2007. No. 12.

protectionism, and insufficient coordination of approaches – all these risks became more intense in the recessionary environment.

Finally, the systemic approaches also imply that if structural imbalances persist in economies (particularly in the Russian economy), they would hamper economic development and would not make it possible to create required stabilizers, which are needed in case of a new turbulence.

National regulators, national businesses, and the world at large still have a lot to do.