 Political Instability and the August 1998 Ruble Crisis

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Abstract

The main objective of this study is to highlight the importance of political instability, defined as frequent changes in and of government, in undermining the Russian exchange rate based stabilization program of the 1990s. The empirical evidence supports the significance of political instability along with economic fundamentals in determining Russian real effective exchange rate and exchange market pressure, used as a proxy to the crisis.

- JEL classification: F31, C13
- Keywords: Currency crises, Economic fundamentals, Political instability

I. Introduction

In its early years of transition and after experiencing a mini currency crisis,1 Russia in consultation with the International Monetary Fund implemented an exchange rate based stabilisation programme in 1995 with the objective of achieving single-digit inflation, financial stability, and growth. From June 1995 to redenomination of ruble in January 1998,2 the management of exchange rate within

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a band and tighter monetary stance resulted in low prices. A combination of low inflation, high interest rates, and rising and relatively stable oil price until mid 1997 strengthened the demand for ruble (Figure 1). These developments signalled stability of the economy and opened the way for ‘euphoric’ capital inflows during

1In October 1994, ruble depreciated by nearly 20 percent.

2In the redenomination, three zeros were slashed from the ruble.