

Bank of Russia cuts rates by 100bp, guides for more

The Bank of Russia aggressively cut the key rate from 5.50% to 4.50% today, and the guidance suggests that some scope for further cuts remains. Based on CBR communication and cross-country comparison, another 50 basis point cut is highly likely this year. If CPI continues to underperform the 4.0% target, the key rate may fall to 3.5-4.0% in 4Q20 or 2021



Source: shutterstock

4.50%

Russian key rate

down from 5.50%

As expected

CBR makes an aggressive cut and maintains dovish guidance

The Bank of Russia cut the key rate from 5.50% to 4.50%. This move is in line with the consensus forecast, though we were leaning towards the conservative side of the 50-100bp range, thinking that the CBR would prefer to make smaller cuts while maintaining significant room for further reductions.

The key rate guidance is slightly less aggressive than before, noting that the Bank of Russia "will consider the necessity of further key rate reduction at its upcoming meetings" after previously saying it "holds open the prospect of further key rate reduction at its upcoming meetings". In CBR language it means that the step of the next cut is highly likely to be smaller and the so is the likelihood for an immediate cut at the next meeting.

Nevertheless, the content of the communique is still dovish, as the CBR mentions that:

- short-term pro-inflationary pressure related to market volatility and panic stockpiling is over
- CPI, currently at 3.1% year-on-year, will move higher due to base effects, but will be pressured by weak demand and the recent ruble appreciation; the GDP drop in 2Q20 may be deeper than initially expected (though annual GDP guidance is unchanged at -4-6%). Importantly, the CBR dropped the previous 3.8-4.8% YoY CPI expectation mentioned at the time of the previous decision
- there are significant risks of CPI underperforming the 4.0% target in 2021 due to the above-mentioned disinflationary factors.

Following the decision, the CBR governor reiterated a cautiously dovish signal, suggesting some scope for further rate cuts (though not necessarily at the very next meeting) with the key points being:

- Today's 100bp step is extraordinary and should not be taken as a new normal;
- CPI is headed towards the lower bound of the earlier CBR forecast of 3.8-4.8% at year-end 2020
- The CBR may slightly lower its estimate of the equilibrium rate range from the previous 6-7%, however, it is unlikely that the new estimate will be lower than 5%. We remain of the view that the actual rate can go below the equilibrium range when monetary policy is accommodative (which it is now).

Cross-country comparison confirms further downside to Russian key rate

From the real rate perspective, the Bank of Russia's monetary policy approach has eased materially since the beginning of the year but based on cross-country comparison there is still around 0.5 percentage point downside to the current real rate without sacrificing Russia's relative attractiveness to portfolio investors and without the real rate turning negative (to which the CBR seems to be vocally averse).

- With CPI at mid-year 2021 expected at 3.5-4.0% by the market, the current real key rate in Russia is 0.5-1.0% (Figure 1). Given the recent CPI dynamics we do not exclude that inflationary expectations can go lower. As a reminder, at the time of the CBR's April decision, the [12-month CPI expectations](#) were close to 5.0%.
- The current real rate is lower than the 1.0-1.5% seen ahead of the CBR's April decision and

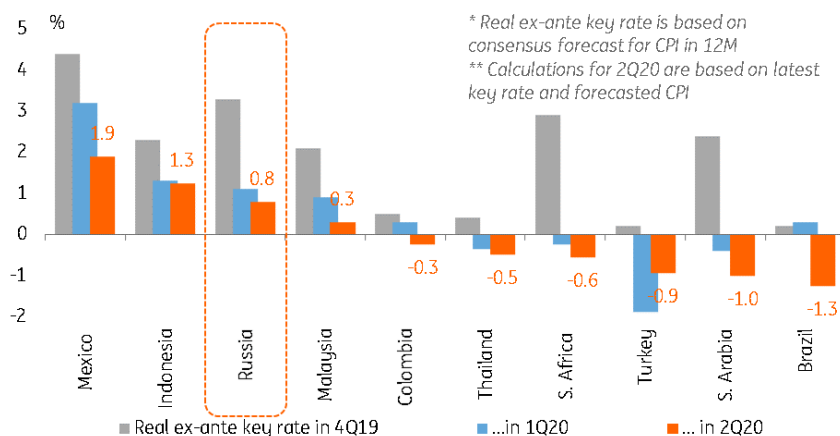
significantly lower than 3.0-3.5% at the beginning of the year. Still, with the real rate range for EM/commodity peers also down year-to-date, Russia remains in the upper half of the comparative range, which is now between Brazil's -1.3% and Mexico's +1.9% (Figure 2). For now, the downward real rate trend remains uniform among Russia's peers with Turkey being the only exception.

Figure 1: Real key rate by country

	Russia	S. Arabia	Mexico	S. Africa	Malaysia	Indonesia	Thailand	Turkey	Brazil	Colombia
Current key rate, %	4.5	10	5.5	3.8	2.0	4.3	0.5	8.3	2.3	2.8
Latest CPI reading, % YoY	3.0	13	2.8	4.1	-2.9	2.2	-3.4	11.4	19	2.9
CPI BBG consensus formid-21, % YoY	3.7	2.0	3.6	4.3	1.7	3.0	1.0	9.2	3.5	3.0
Expected change in CPI in 12M, pp	0.7	0.7	0.8	0.2	4.6	0.8	4.4	-2.2	16	0.2
Real key rate, % ex-ante (based on CPI expected at mid-21)	0.8	-10	19	-0.6	0.3	13	-0.5	-0.9	-13	-0.3

Source: Bloomberg, ING

Figure 2: Russian real rate is down but still comparatively elevated



Source: Bloomberg, ING

Adjusting the key rate outlook

Today's decision and the overall tone of the CBR communication suggests that there is further room for a cut in the key rate, supported by a weak economic performance, below target CPI, and the example of Russia's emerging market peers. While previously we saw the key rate floor at 4.0-4.5% for 2020-21, this view is too conservative. A further cut of 50bp from the current 4.5% level now seems to be the base case for 2020, but additional cuts are also possible for 4Q20 and 2021 if CPI shows signs of sustained underperformance to the targeted 4.0%.

For now, we assume 3.7% YoY CPI growth in 2021, although this forecast is highly uncertain given the still-volatile external markets, as well as the local economic performance and fiscal response. The announced fiscal stimulus for 2020 has so far been modest, at 3.5% GDP, but it may have to be increased if household income, consumption (data for April-May to be released later today), and approval ratings remain under pressure.

Author

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.