Central Bank of Russia cuts rates

The central bank has cautiously cut rates by 50bp. But the bigger story for investors is the potential for more cuts in 2018

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CBR rate cut

In the policy statement, the Central Bank of Russia said mid-term upside inflation risks to the 4% target still outweigh the downside risks, requiring a moderately-tight policy. Yet, it commented it deems it possible to cut the key rate over the next two-quarters.

-50bp

CBR's key rate cut

Fully in line with ING view

As expected

Upgraded growth view and shrinking mid-term risks

The strong 2Q17 GDP growth of 2.5% forced the CBR to upgrade its 2017 growth view to 1.7-2.2% while sticking to 1.5-2% as the most probable range for coming years without structural reforms. The list of mid-term risks shrunk from five (oil prices, tight labour market, higher/lower consumption/savings, fragile inflation expectations and non-oil tax manoeuvre) to four with the last one dropped as it looks off the table for, at least, 2018.

Monetary Policy Report and press conference highlights

The CBR Governor's press-conference, the Monetary Policy Report and the draft of the Monetary Policy Guidelines for 2018-20 didn't provide any game-changers. But some key highlights include:

- Any steps from pauses to 50bp cuts are possible going forward, but the policy easing will remain slow and gradual;
- The CBR sticks to 6.5 - 7% nominal rate as the terminal rate, which may be hit in 2019;
- Lower impact on inflation expectations from volatile CPI components (e.g. food prices) would allow the CBR to cut rates quicker;
- CBR looks "through" the recent CPI undershoot of the target, as volatile food prices mostly drive it;
- There is no quantification for CPI deviations from the target, providing the CBR with extra flexibility, yet the CPI deviation should be significant and sustainable over time, and it should materially affect inflation expectations to trigger a policy response;
- Inflation expectations unlikely to fall to 4%, but their sustainable decline and falling volatility is key;
- Downside inflation risks are food prices and higher oil prices;
- Wages drives consumption, not loans, the expected public wages hike in 4Q17-1Q18 and the hike in the minimum wage won't pose high risks and may add 0.1-0.3ppt to CPI;
- CBR expects CPI within 3.5-3.8% in 2017;
- CBR expects oil at US$50/bbl in 2017, down to US$40/bbl in real terms in 2018 if there is no extension to the OPEC+ deal;
- RUB still seen relatively stable going forward as the BoP is balanced, and looking only at the current account balance is useless for predicting RUB;
- Geopolitics is seen having a lower impact both on global and Russian markets, so the CBR is more comfortable now.

All in all, the CBR prefers a cautious (not hawkish) bias, and the story is about a link between CPI and inflation expectations under the uninterrupted view on mid-term inflation risks.

Given expectations have been adaptive, the longer CPI undershoots the target, the lower expectations will be and the easier it will be for CBR to cut rates further. The focus now shifts to keeping inflation near the 4% target and, preferably, slightly below rather than above it, so this requires a consistent policy approach.

Our view

We see CPI at 3.3 - 3.4% in 2017 vs the CBR range of 3.5-3.8%, so there is room to cut by 25bp once or twice to 8.00-8.25%. A bigger story for investors is the potential for rate cuts in 2018, which we see near 150bp from here. We expect CPI growth below 4% until 3Q18, averaging not more than 4% in 2018 and 3.5% in 2019. So, we retain our forecast of a 7% key rate by end-2018.

That said, the CBR decisions in 2018 will be fully data-dependent, providing it with some flexibility in policymaking. The policy looks mostly neutral for RUB and still moderately supportive for the OFZ market into 4Q17-2018.