

## Russia's central bank to wait and see till December

Bank of Russia is likely to keep rates on hold as inflation is in line with the year-end target, the economy isn't overheated, and the FX/FI markets have calmed down in the last six weeks. The December decision is still uncertain as the outcome will depend on volatile factors such as oil price, global emerging market flows, and foreign policy



Source: shutterstock

**7.5%** ING key rate expectations

Unchanged from September and in line with consensus

### Key rate likely to be kept on hold for now

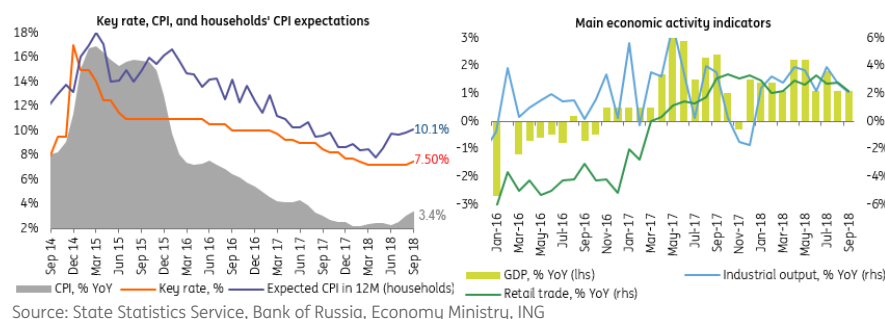
We agree with the consensus view that the central bank of Russia has no urgency in changing the

7.5% key rate at the next meeting as current trends aren't in breach of the guidelines the monetary authorities provided after hiking rates in September.

- CPI growth has accelerated from 3.1% year on year in August to 3.4% YoY in September and may reach 3.6% YoY in October - predominantly as a result of the base effect in the food segment. However, the 3.8-4.2% YoY range targeted for the end of 2018 still appears realistic even if monthly inflation keeps increasing from 0.2% MoM in September to 0.4% MoM in October and 0.5-0.6% MoM in the following months.
- Households' expectations of CPI for the next 12 months have deteriorated slightly by 0.2 percentage points in September, but remain around the 10% level seen since June. The households' CPI expectations, as well as the perception of the current price growth, have historically been significantly more pessimistic relative to the official ex-post CPI metrics.
- Economic growth, according to preliminary government estimates, has slowed down from 1.9% YoY in 2Q18 to 1.3% YoY in 3Q18 amid some cooling in the consumer confidence. The resulting 1.6% YoY GDP growth in 9M18 is in line with the central bank's estimate of the potential growth rate of 1.5-2.0% and suggests there is no immediate risk of overheating.
- Since mid-September, when the central bank decided to raise rates and suspend the \$5-6 billion monthly FX purchases for the Finance Ministry, the ruble has appreciated 4% to the USD, while the yield curve on the benchmark 2-10Y OFZ narrowed by 20-40 bps - suggesting calmer market conditions.

### Russia: Weaker consumer activity - a challenge to budget conservatism?

## Russian key rate, inflation, economic activity indicators



## Look out for local gasoline prices, global EM risk appetite, Russia-specific foreign policy issues

For now, we expect the key rate to remain unchanged until the end of 2019, but this view relies on Russia's ability to keep inflation within 6.0% YoY during 1H19 and 5.5% YoY by the end of 2019 - which the central bank has indicated as the upper forecast range. This forecast incorporates the effect of the upcoming VAT hike from 18 to 20% and the pass-through effect of the recent ruble depreciation.

We see three major risk factors, that may negatively affect inflationary expectations forcing the central bank to raise rates in the medium-term:

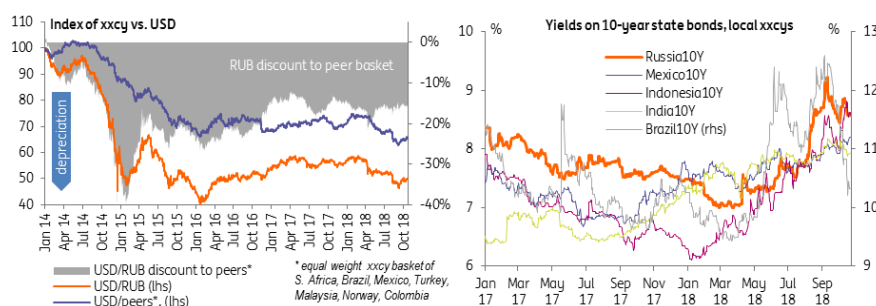
1. Persistently high or growing oil prices combined with local tax manoeuvring in the oil downstream and further hikes in excise could put additional upward pressure on the local

gasoline prices. The local PPI, which is oil price-driven, has recently slowed down but at 11.1% YoY is still significantly above the CPI rate. The recent weekly CPI data shows consumer prices for gasoline have resumed weekly growth in October.

2. While we are expecting the ruble to return to the 60-65/USD range by the end of the year, this view is partially dependent on global emerging market flows, which are subjects to multiple risks, including Fed tightening, US-China tensions, etc. The CBR decision to put the FX interventions on hold might have absorbed some Russia-specific pressure on the ruble, but it hasn't made it immune to global trends. According to our estimates, two percentage points out of 4% the ruble's appreciation to USD since mid-September was attributable to USD's weakness against Russia's FX peers. The same principle applies to the benchmark rates on the local FI market: the recent decline in emerging market yields may still look like a correction relative to the upward move seen since spring 2018.
3. The likelihood of sanctions against new state debt has increased over the last couple of months. However, it remains unclear how much of it is already in the prices on the FX and FI markets. Non-residents have withdrawn some RUB 550 billion from the OFZ market since April, reducing their peak holdings by 25%, but the increase in yields and FX depreciation was in line with that of peers. This suggests that in case of sanctions against the new state debt acceleration in net capital outflow is still possible. According to our estimates, each \$5 billion outflow lowers RUB fair value by RUB1/USD, but the initial market reaction may be stronger. Each 10% RUB depreciation adds 0.5-1.0 pp to the CPI trend on the six months horizon.

### Russia: Net capital outflow a key uncertainty

## Russian FX and FI trends vs. peers



Source: Bloomberg, ING

## Author

**Dmitry Dolgin**

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto: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 [www.ing.com](http://www.ing.com).