Russia keeps rates on hold, prioritises support to markets and banks

The Bank of Russia satisfied market expectations by keeping the 6.00% key rate on hold. Our key takeaway from the decision and commentary is that the policy rate has been de-prioritised in favour of other supportive measures to financial markets and banks. For now, we expect the key rate to remain unchanged in 2020

Russian Central Bank Head, Elvira Nabiullina

6.0%

As expected

Russian key rate

unchanged

Key takeaways

We are not surprised by the Central Bank of Russia's decision to keep the key rate on hold and prioritise other measures, including FX interventions and a large-scale list of
actions to support individuals, SMEs, the mortgage market, banks, other financials, and large

companies in response to the coronavirus outbreak and consequent deterioration in the economic growth trend, and financial market volatility.

We have the following takeaways from the decision and commentary:

- CBR local market pressure has come from external pressures (oil price drop plus global risk-off) and is not a Russia-specific story. This needs to be addressed as it was in 2014. This is in line with our take that Russia's capital account is not a big concern at this point. While the daily data shows portfolio outflows of around $1 billion from the local state bond market (OFZ) over the last week, local companies, banks, and households are not showing signs of increased capital outflow.
- The current rouble depreciation (23% year-to-date) and consumer spending splurge, seen from the news headlines and partially from the February retail trade acceleration to 4.7% year-on-year (much of it may reflect the leap year effect), will give only a short-term boost to CPI. Later on, this will be drowned out by the drop in demand. According to the CBR, CPI will peak in 2Q21, modestly exceeding the 4.0% target, but it will be back to target by year-end 2021. The CBR expects the economic growth trend to deteriorate in the coming quarters, and sees GDP growth as just marginally positive in 2020. We agree and are cutting our GDP growth expectations from 1.5% to 0.5%, with the risk of further downgrades.
- The CBR governor prioritised financial stability in her commentary. She highlighted a long list of measures aimed at lowering financial and administrative pressure on the population, businesses, and banks. These include but are not limited to, easing servicing conditions for loans to individuals infected with the coronavirus, easing in terms of financing to SMEs, lower loan quality requirements for some mortgage segments, easing in macroprudential, administrative, and regulatory requirements for banks and easing in some corporate governance procedures for large corporates.
- Earlier this week, the CBR announced FX sales (in addition to those mandated by the fiscal rule) when Urals is below $25/bbl, which we believe to be aimed at lowering RUB volatility (confirmed today by the CBR Governor Elvira Nabiullina) and to re-align USD/RUB with peers. So far, USD/RUB remains a year-to-date underperformer to the Mexican and Colombian peso, Brazil's real and South Africa's rand despite the rouble's stronger macro fundamentals - possibly reflecting fears of additional sanction pressure from the US in response to low oil prices (which are hurting the US shale oil industry).

Our forecasts

Overall, we see the key rate remaining at 6.0% for a long period of time, possibly until the end of 2020, amid an acceleration in CPI from the current 2.3% YoY to 4.2% by year-end, and possibly higher, which would mean a gradual reduction in the real key rate and suggest an easing in monetary policy. Meanwhile, we reiterate the reduced importance of the key rate at this time, and expect markets to refocus on fundamentals and key rate expectations at a later date. For now, the prospect of Russia exiting the emergency financial measures regime is clouded by the continued spread of the coronavirus in a number of countries, including Russia, the rapid deterioration in the economic growth forecasts, persistent foreign policy uncertainties and high volatility on the commodity and financial markets.

Our forecasts assume:

- A gradual oil price recovery in the second half of this year

- A return of USD/RUB to the 70-75 range
- An acceleration of CPI to 4.2-4.5% over 12 months
- An unchanged key rate of 6.0%
- A deceleration of GDP growth to 0.5% YoY in 2020
- And a budget deficit of 1.5% of GDP.

But these all remain subject to risks from both sides.

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