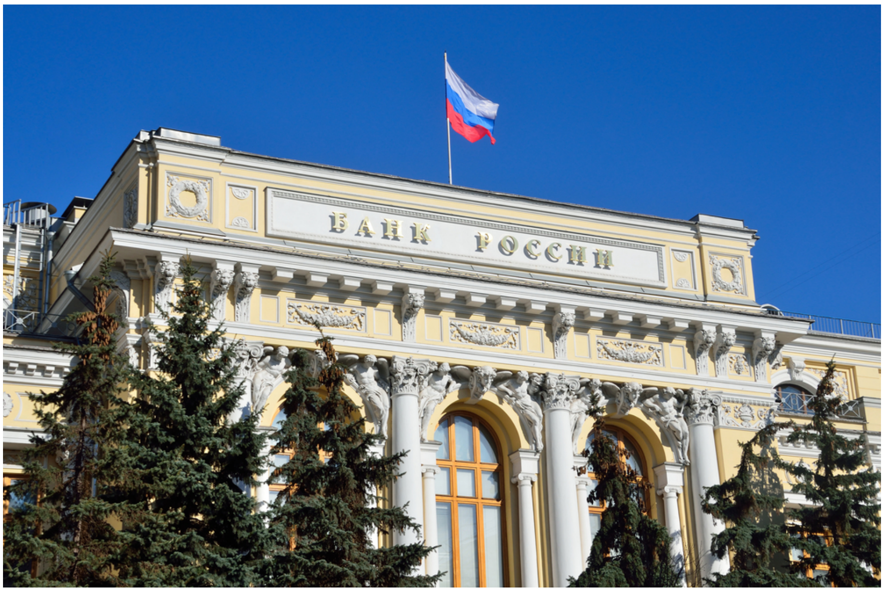
Bank of Russia capitulates to weaker inflation

Following an unusually dovish statements by the central bank governor, we cut our year-end key rate target from 6.75% to 6.5%, suggesting two 25 basis point cuts - in October and December. The 2020 rate should also move to the lower bound of the 6.0-7.0% equilibrium rate range



Central Bank of Russia, Moscow

Today, Central Bank of Russia Governor Elvira Nabiullina made dovish statements. She indicated that:

- The CBR will lower its year-end 2019 CPI forecast (currently at 4.0-4.5%) at the 25 October meeting as CPI keeps underperforming expectations as pro-inflationary risks fail to materialise. This makes perfect sense, given that as of 7 October CPI growth is already 3.9% year-on-year and is going to decelerate further, but any change in official forecasts are not customary for a non-core meeting, which suggests urgency.
- The CBR will consider a faster pace of key rate cuts vs the one kept in mind originally. To remind, the tone of the previous statements suggested the CBR still saw scope for a further reduction in the key rate (currently at 7.0%), but was not going to keep cutting at every meeting, as was the case in the previous 3 times.

Earlier we acknowledged the decline in inflationary risks, however, given that the primary drivers of this slowdown was related to seasonally tight budget execution and favourable conditions on the global grain/food market, both of which are both beyond the control of the monetary authorities, we expected the CBR to adopt a more cautious approach to monetary policy easing. Today's statements suggests a higher level of CBR confidence in the lack of mid-term pro-inflationary factors. As a result, we now see two consecutive 25 bp cuts in October and December this year to 6.5%.

Given the lack of CPI stabilisation in October we see a higher likelihood of inflation underperforming our 3.7% forecast for year-end 2019, which would also mean that it should drop below 3% YoY in 1Q20 on base effects, and a return to 4.0% by the end 2020 may be a challenge. This suggests that next year the key rate may approach the lower bound of the neutral rate range of 6.0-7.0%. At the same time, we do not expect any revision of the 4.0% CPI target or of the neutral range band anytime soon - for the sake of continuity and credibility of the current inflation targeting regime.

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