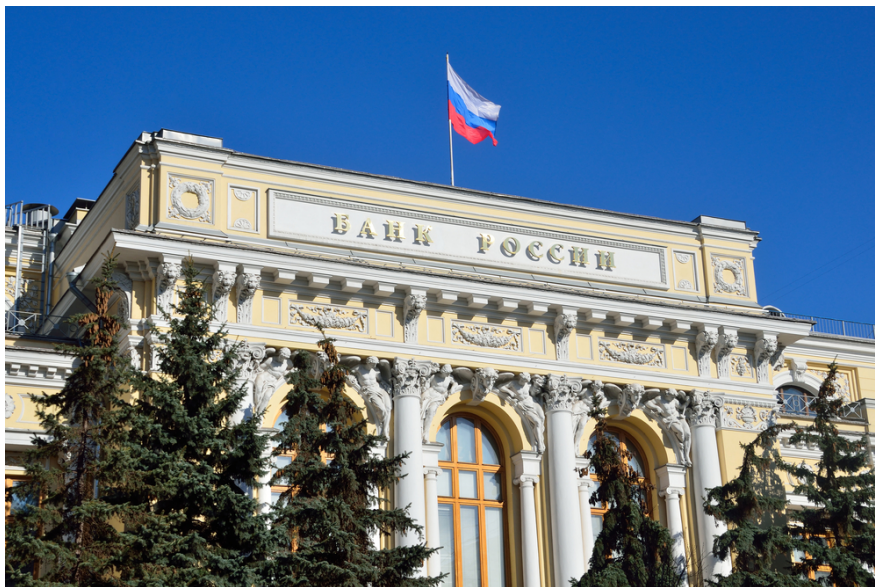


Bank of Russia guides for first rate cut as soon as 2-3Q

The CBR kept its key rate at 7.75% and provided dovish mid-term guidance, as we had expected. While originally, we cautiously expected a first 25 bp cut to follow in 4Q, now, with a gasoline price freeze secured, a September cut feels more appropriate. A more aggressive trajectory would require a continued rally in financial markets, which is not secured



Central Bank of Russia,
Moscow

7.75%

As expected

CBR key rate

unchanged vs. 22 March

The decision to keep the key rate unchanged and to acknowledge the improvement in the near-term balance of risks was widely expected thanks to a strong performance in oil, OFZ bonds and the rouble, which contributed to lower-than-expected CPI of 5.3% year-on-year in March and a

slowdown to 5.1% year-on-year as of 22 April. However, the CBR's indication that a first cut may take place at early as the second to third quarter may reflect an attempt to adjust market expectations, which have so far been more conservative.

Our explanation for the CBR's increased confidence in the favourable CPI trend going forward is the very recent indication from the government that the local gasoline price freeze, effective since last year until 1 July this year, might be extended further. While there is no official confirmation about an extension, the discussion of returning RUB200 billion of oil taxes back to oil companies this year and the possibility of increasing the sum to RUB400 billion is an indirect hint at the social priorities of the budget policy at the moment.

We think the news on gasoline prices is a good reason to improve our CPI and key rate outlook for this year. While previously we expected CPI to accelerate to 5.5% YoY by mid-year and retreat to 5.0% YoY by year-end, we no longer expect an acceleration from the current level and see CPI at 4.6% YoY as of YE19, assuming an extension of the gasoline price freeze for the entire year and persistently weak consumer demand (showcased by 1Q19). This would allow the CBR to make to 25 basis point rate cuts in September and December, assuming no tightening in international sanctions.

As for the prospects of an even earlier cut - at the next meeting on 14 June - we consider this as a possible scenario, which would require the continued strong performance of OFZ and the rouble. Given the unfavourable balance of payments seasonality for RUB in 2-3Q, volatility of emerging market risk appetite (as confirmed by this week's performance) and the persistent foreign policy uncertainties related to Venezuela and Ukraine, such a scenario should be treated as an optimistic case. We continue to expect RUB's return to RUB65-67 range in 2Q19, limiting the pace of the CPI slowdown going forward.

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