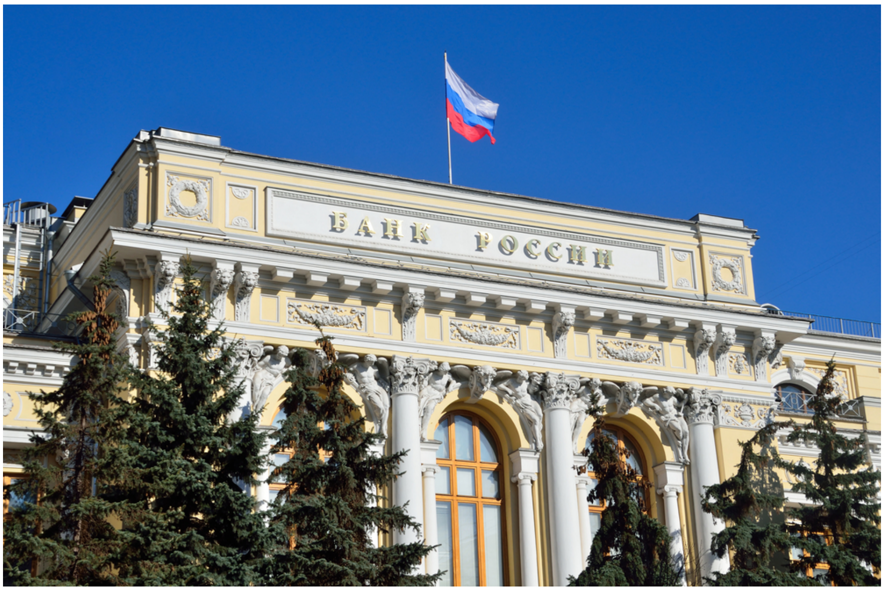
Bank of Russia is signaling a front-loaded tightening

Higher than expected CPI of 5.8% YoY as of 9 March and recent CBR rhetoric are making a March 25bp hike from the current 4.25% a 50/50 chance, while another two hikes in April in July are guaranteed. But a 5-6% key rate in 2021 would require a strong GDP recovery, which so far is not our base case. In any case, the hawkish CBR stance should be supportive for FX



Central Bank of Russia, Moscow

Last week, we raised our year-end CPI forecast from 3.7% to 4.2%. Assuming RUB stability and normalisation of agricultural prices, CPI should slow from its 1Q21 peak of 5.7%, staying above 5.0% till October, but dropping rapidly in 4Q21 and 1Q22 (to below 4.0%) thanks to the high base effect. The increase in expected CPI made **two 25bp key rate hikes to the level of 4.75% by the year-end our base case**. The initial assumption for hikes was for the core meetings in April and July, followed by a pause related to expected softening in the CPI trend in 2H21. Meanwhile, the global reflation and potential easing on the local fiscal stance pose upward risks to this forecast.

Moreover, the recent pick-up in CPI to 5.8% YoY as of 9 March combined with further tightening in the Central Bank of Russia rhetoric, including official statements by the deputy governor Zabotkin, then governor Nabiullina, and finally a media leak during a blackout period on CBR discussing more than a 1 percentage point hike throughout 2021, suggests a willingness to communicate front-loading of the expected tightening. **This means that there is a 50/50 chance of a first 25bp hike from the current 4.25% level as early as this Friday**, with the total magnitude of hikes potentially exceeding the base-case 50bp in 2021.

Meanwhile, a return to a 5-6% key rate in 2021 requires a combination of persistently high CPI (also supported externally) and confidence in the local economic recovery, as the CBR's base case is a 3-4% GDP growth rate this year. The latter is questionable, in our view, and given the case of premature rate hikes in 2018, which subsequently had to be reversed, there is still a chance that the announced discussion will eventually be softened.

The hawkish CBR bias should add to the stability of the ruble as the upcoming CBR rate hikes will protect the RUB real rate and underscore the RUB's carry potential. As a high yielder, RUB should also reap some benefits from the tentative signs of a less erratic behaviour in core yields. A high oil price is a positive and reinforces Russia macro stability, but in terms of the impact on the currency it will be offset by the MinFin FX purchases. Sectoral sanctions are still not our base case. USD/RUB to converge to 72.00 in 2Q and we see any spikes in USD/RUB above 74.00 as an opportunity to go short.

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