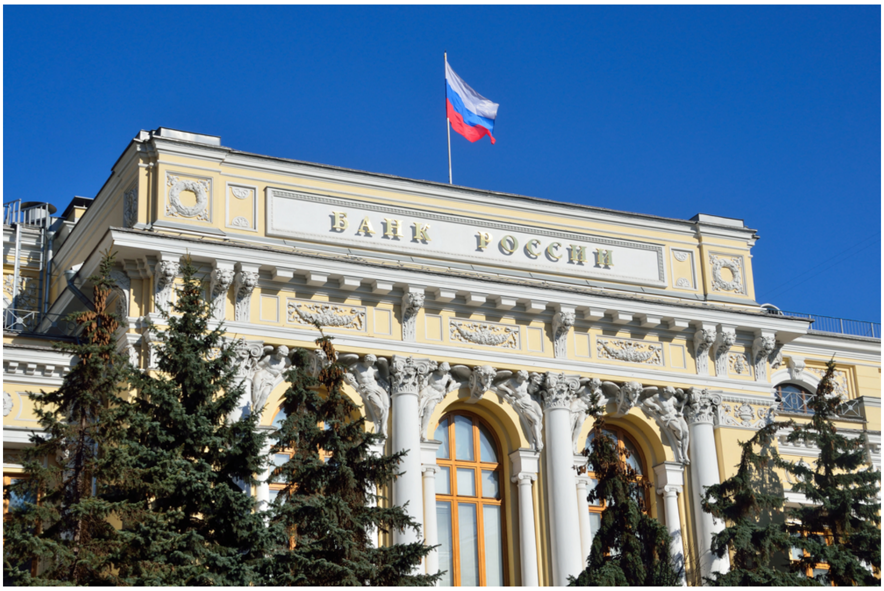
Bank of Russia: Rate cut inevitable

The Bank of Russia has guided for a cut in its 6.0% key rate, with a magnitude likely exceeding the standard 25 basis points. This is a reaction to more stable financial markets, a darkening outlook for local activity and so far, modest fiscal stimulus. Based on cross-country experience, we estimate the near-term downside to the key rate at 50-100bp



Central Bank of Russia, Moscow

5.50%

Our CBR key rate expectation for 24 April

down from previous 6.0%

Russian central bank makes another dovish shift

The CBR made a dovish shift in its communication on 17 April, the last day before the self-imposed media blackout period ahead of the 24 April meeting, strongly suggesting that a cut is not only the primary option but that it may exceed the standard 25bp. This comes despite the acknowledgment of accelerating CPI (from 2.3% year-on-year in February to 2.9% YoY currently) and deteriorating inflationary expectations amid panic buying of some consumer products, growing global agro prices and the recent USD/RUB depreciation. We believe this shift was triggered by a combination of factors, including:

- **Stabilisation in global markets** in recent weeks, which helped to assure a 2% recovery in USD/RUB and an almost 140bp drop in local 10-year state bond (OFZ) yields in the last 30 days. Stabilisation on the local FX market has also been assured by the CBR's FX sales amounting to $175-200 million per day, reflecting both the fiscal rule (as the actual Urals price is below the $42.4/bbl cutoff level) and extra sales, related to the handover of a 50% equity stake in Sberbank, Russia's largest lender, from CBR to Minfin. The deal was valued at $26-28 billion, and the FX sales are likely to continue going forward, helping to smooth out rouble volatility.
- **Experience of other emerging market central banks** which according to the IIF, cut policy rates by 25-300bp in March-April, with the Russian central bank standing out as the only monetary authority which had refrained from a cut in the last two months.
- **Deterioration of Russian GDP growth expectations.** Russia has been in a Covid-19-related quarantine since the end of March, and the lockdown will be in place at least until the end of April. Assuming this one month of quarantine, Russian GDP could drop by 2.5% this year, but if the lockdown is extended into May, which given the progression of Covid-19 is becoming increasing likely - then our outlook could be downgraded by another 2.5 percentage points to a total of 5%. Put simply, based on preliminary activity estimates, each month of quarantine may cost 20-30% of monthly GDP.
- **Very modest fiscal support** in the face of Covid-19 challenges. So far, the announced fiscal stimulus is 2.8% of GDP, out of which up to 1ppt represents the redistribution of previously announced spending plans and up to 0.5ppt is in state guarantees. The support is also quite targeted, focusing mainly on low income households, the unemployed, those on sick leave, and SMEs. Assuming some recovery in oil prices in 2H20, and the 1.5% GDP proceeds from the Sberbank sale are returned from the CBR to the government, the Russian budget will be in a 3.5% of GDP deficit this year, which appears controllable given Russia's 10%+ GDP liquid fiscal savings and small public debt of below 15% of GDP. It appears that the stringent fiscal approach allows, and in a way may be pushing the CBR to step up from the monetary side.

Near-term downside for the key rate is 50-100bp, based on cross-country real rates

The scope of a potential cut remains highly uncertain, with market expectations ranging from 25 to 100bp at this point. We believe the best way of looking at the potential room for a key rate cut is by looking at real rates from a cross-country perspective.

- Based on expected Russian CPI in 12 months, which is 4-5%, according to the Bloomberg consensus range, the real key rate in Russia is currently at 1-2%.
- Based on the cross-country 12 month CPI expectations, the real rates in Russia's direct EM/commodity peers are ranging from c.-0.5% in Saudi Arabia and South Africa to c.0.5% in Brazil and Colombia, and to c.+1.0% in Malaysia and Indonesia). There are indeed more extreme cases such as Turkey (c.-2%) and Mexico (c.+3%), however we treat these as more country-specific.

Given this comparison and the CBR's historic preference to remain in the upper half of the real rate range, we estimate the near-term downside to the nominal key rate at 50-100bp. We believe that the near-term risks to the rouble and recent retail deposit outflows amounting to 0.6% of

GDP from Russian banks suggest that the CBR will still opt against moves that would be seen as too aggressive. Our base case scenario for 24 April is for a 50bp cut to 5.5%.

Real key rate by country

	Russia	S. Arabia	Mexico	S. Africa	Malaysia	Indonesia	Thailand	Turkey	Brazil	Colombia
Current key rate (%)	6.00	1.00	6.50	4.25	2.50	4.50	0.75	9.75	3.75	3.75
Latest CPI reading (% YoY)	2.5	1.2	3.3	4.6	1.0	3.0	-0.5	11.9	3.3	3.9
CPI BBG consensus for 1Q21 (% YoY)	4.9	1.4	3.3	4.5	1.6	3.2	1.1	11.6	3.5	3.5
Expected change in CPI in 12M, pp	2.4	0.2	0.0	-0.1	0.6	0.2	1.6	-0.3	0.2	-0.4
Real key rate, % ex-ante (based on CPI expected at 1Q21)	1.1	-0.4	3.2	-0.3	0.9	1.3	-0.4	-1.9	0.3	0.3

Source: Bloomberg, ING

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