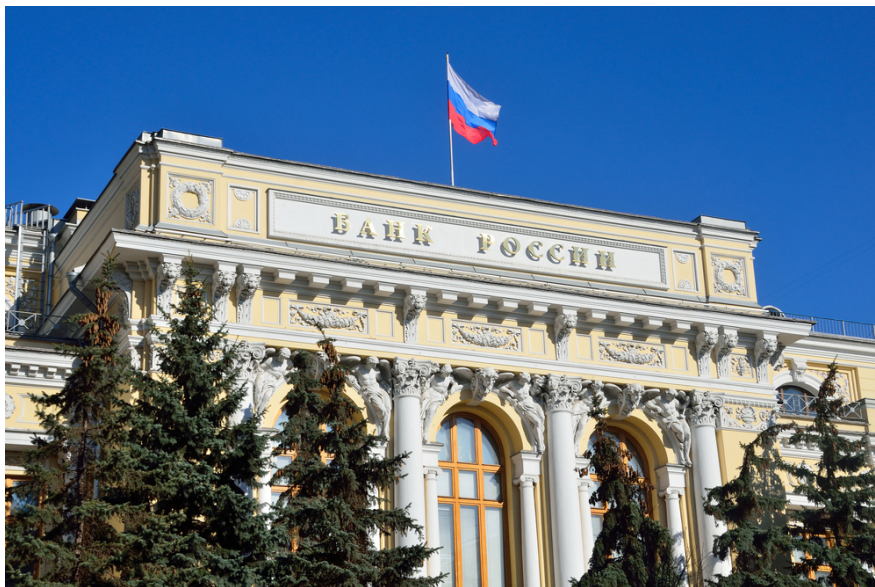


Bank of Russia: Still dovish but more nuanced

The central bank has subtly shifted its rhetoric from 'easing at all costs' back to a more balanced guidance. For now, it should discourage expectations of key rate cuts that are 1) ahead of schedule, 2) exceed 100 bp per cut, and 3) exceed 150 bp in total from the current level of 5.50%. A more aggressive scenario is possible if CPI continues to underperform



Central Bank of Russia,
Moscow

CBR warns the markets against getting overexcited

In our view, today's communication from the Russian central bank, mainly comprising Governor Nabiullina's bi-weekly press briefing, was aimed at cooling down the growing market expectations that the key rate, currently at 5.50%, could be cut ahead of schedule (before 19 June) and/or by more than 100 bp, and that the terminal key rate may be lower than 4.0% (CBR's official CPI target). To remind, those expectations, which have been propelled by the CBR's previous communication, deteriorating activity outlook, and underperformance of Russian CPI in the last week, have contributed to the very strong performance on the Russian bond market, with average 10-year OFZ yields dropping below 5.5% in the recent days, which is not just 300 bp lower than the 18 March peak, but also is around 50 bp below the early March lows.

We highlight several points of caution in today's announcements:

- While acknowledging CPI staying below the expected trajectory (CPI stabilising around 3.0-3.1% YoY recently) on recovery in RUB exchange rate and exhaustion of panic buying, the CBR downplayed its importance by questioning its sustainability after the Covid-19 lockdown is lifted, by mentioning elevated inflationary expectations by households, and by expressing confidence in acceleration of CPI in 2H20 on the base effect.
- The CBR has reiterated its earlier signal that they see scope for further reduction in the key rate. In terms of the possible step, the governor reiterated that a 100 bp rate cut is still on the table (similar to the case of the previous meeting, when the board eventually decided on a 50 bp cut), but the likelihood of this particular decision is less than 100%.
- The CBR governor has also indicated that at the moment they do not consider the market and economic conditions to be extraordinary enough to warrant an ahead of schedule key rate cut.
- Speaking on likelihood of real key rate turning negative (based on expected CPI), the governor indicated low likelihood of such scenario, having reiterated CBR's commitment to the 4.0% CPI target. To remind, according to the CBR's [base case scenario](#), Russian CPI should stay at 4.0% from 2021 on.

In addition to the statements by the governor, the CBR also announced the appointment of Kirill Tremasov, an analyst with a track record of accurate predictions on the monetary policy, and former deputy minister of economic development, as head of the monetary policy department, and the promotion of his predecessor Alexey Zabotkin to the newly created position of the deputy chairman, responsible for the monetary policy (previously the head of the monetary policy department was reporting directly to the governor). While the market may perceive the new appointments as a strengthening of the 'doves' in the CBR team, it remains to be seen whether it will materially change the decision-making process within the CBR board of directors, as the minutes from the board meetings are not in public domain.

Terminal key rate at 4.0-4.5% for now, continued CPI underperformance required in order for it to go lower

Today's communication by the Bank of Russia tells us that the 19 June decision is likely to be between a 50 bp and 100 bp cut, with the latter option becoming increasingly likely amid lower-than-expected CPI growth seen in May. Room for further reduction appears limited at this point, as the CBR is unwilling to go negative on the real rates. Meanwhile, the CPI trajectory, which will become more indicative in summer along with lifting in the quarantine measures, will be crucial in determining the eventual rate floor. For now we tend to agree with the CBR expectations of CPI returning to 4% (we base this on expected cost inflation in the food segment and assumptions of further fiscal expansion), however the downside risks to this forecast cannot be ignored.

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