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Snap

## Bank of Russia to keep the key rate on hold... for now

We expect the Bank of Russia (CBR) to keep the key rate at 7.75% on 8 February, mainly thanks to the CPI trend staying within the forecast range, yet uncertainties regarding further steps should put the CBR commentary in focus

**5.0% YoY** January CPI  
up from 4.3% YoY in 2018

Lower than expected

### We expect the CBR to keep the key rate at 7.75% at the upcoming meeting

We see several reasons why the Russian Central Bank should keep the key rate on hold on 8 February:

1. Acceleration of CPI to 5.0% YoY as of January comes in at the lower range of expectations and reflects the effect of the VAT hike effective 1 January 2019, probably softened by the weakening in the consumption trend. The CPI figure is thus far well below the 6% threshold the CBR had outlined for 1H19 when incorporating the tax hike effects in its macro assumptions. Based on the flash weekly data, inflation may have stabilized in the first half-week of February.
2. Although the 2.3% GDP growth in 4Q18 exceeded market expectations of the 1.5-2.0% potential growth rate estimated by the CBR, this positive result should be seen as a one-off. As we mentioned earlier, the growth is not broad-based, seems localized in the oil&gas sector, and still implies a slowdown in consumption from 3.0% in 2017 to 1.9% in 2018 and investments from 5.5% to 2.3%.
3. Since the previous CBR meeting the market mood improved globally, as the softening in Fed rhetoric has resulted in appreciation of the ruble and its peers by 3-6% to USD, yields on local state bonds retreated by around 50 basis points, and the majority of EM central banks have kept their rates on hold.
4. In the near term, the balance of payments does not seem to require additional protection through higher rates, as the 1Q19 current account of US\$9-10 billion per month is large enough to cover:
  - FX interventions, which even with the announced catch up on the 2018 backlog, are staying within US\$4 billion per month in January and February;
  - foreign debt redemptions, which we expect to stay within US\$1 billion per month in 1Q19 (vs. scheduled gross redemption of US\$3-4 billion per month); and
  - net portfolio outflows from state bonds, which were as little as US\$0.1 billion in November and December 2018 and may have stopped completely in 1Q19.

## CBR commentary may hint at the more important 22 March meeting

At the same time, we believe the CBR commentary to the decision should draw the market attention, as the core 22 March meeting (unlike this Friday's meeting it will be accompanied by macro forecasts revision and the press-conference by the governor), is so far clouded by a number of uncertainties:

1. It would be premature to assume that the acceleration of the CPI is over, as the pass-through of VAT may still take 3 to 6 months, and so far it's not clear whether the risk of CPI hitting the CBR's 6% threshold has completely abated
2. It remains unclear whether the inflationary expectations are anchored enough, and the CBR earlier indicated the increasing inflationary expectations by households and corporates as one of the primary reasons for the pre-emptive hike in December. According to the most recent polls, the households' forward-looking 12M CPI expectations increased in January for the fourth month in a row to a level of 10.4%, hitting a 1.5 year high. More importantly, the share of companies expecting acceleration in CPI in the next 3 months has surged to almost 19%, which is a 4-year high
3. Medium-term risks to the Russian financial markets remain, as
  - the global expectations of a flat Fed rate may prove too optimistic given the strong labour market data in the US, and the concerns regarding China may reappear
  - the foreign policy risks for Russia have not evaporated, given the situation around Venezuela and the investigation of alleged Russian interference into the US elections
  - the seasonality of the balance of payments suggest a contraction of current account surplus to US\$3-5 billion per month in 2Q-3Q19, which is barely enough to cover FX interventions and foreign debt redemptions, making RUB more vulnerable to external negativity

If the CBR commentary to the 8 February decision is focused on the above-mentioned risks, we would see it as a sign that a hike on 22 March is likely.

Dmitry Dolgin

Chief Economist, Russia

+7 495 771 79 94

[Dmitry.Dolgin@ingbank.com](mailto:Dmitry.Dolgin@ingbank.com)

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