Russia: Celebrating success with a bigger cut

The Central Bank of Russia decided to go against consensus and cut its policy rate by 50bp to 7.75%. The extended OPEC+ deal and record-low inflation made the move possible leaving room for further policy easing in 1H18

Source: Shutterstock

7.75% CBR policy rate

Consensus 8%

It is all about OPEC+ deal and lower inflation risks in 2018

It is not uncommon for the Central Bank of Russia (CBR) to surprise the consensus when it is especially strong (8% this time with no other views), and today's decision to slash the policy rate by 50bp vs the expected 25bp to 7.75% will add to the track-record.

The CBR said the extended OPEC+ deal would reduce inflation risks in 2018, which together with the already record-low inflation of 2.5% (vs the target 4%) allowed it to do the more significant cut. However, it still retained a bit of caution saying that mid-term upside inflation risks outweigh those of inflation sustainably undershooting the target.

The CBR reiterated it would continue slowly moving from a current moderately-tight to neutral policy, but also said that there is room for some further policy easing in 1H18.

Higher GDP forecast for 2018, same mid-term inflation risks

Given the OPEC+ deal and its support for oil prices, the CBR said it kept its 2017 GDP growth forecast of 1.7-2.2% intact but upgraded its view on 2018 economic growth. The CBR will factor in US$55/bbl oil price assumption vs US$44/bbl in the base-case, which will likely see GDP growth near 2017 levels (1.7-2.2%). Overall, the CBR sticks to the narrative of the economy growing with a potential 1.5-2% a year without structural reforms. This, together with moderately-tight policy, shouldn't create excessive inflation risks.

As for those inflation risks, the CBR noted that global energy and food price dynamics create two-way risks for inflation during the next 12 months. As for the mid-term risks, the CBR stuck to a list of a tight labour market, changes in consumer behaviour and inflation expectations.

What was new is the wording about potential risks from fiscal and tariffs decisions in 2019-2022 - the reference which we haven't seen for quite some time. Post-election uncertainty about the President's priorities could be an explanation.

Finally, the CBR mentioned external factors which should include the risk of US sanctions against sovereign debt, even though it doesn't look like the base-case scenario both for the CBR and the market.

The bigger the move, the shorter the talk

During the press conference, the Governor Elvira Nabiullina reiterated that the bigger move stays within the possible range of 0-50bp rate cuts, and the decision reflected the new assessment of the 2018 outlook not affecting the overall view on the future policy trajectory. The CBR believes its communication policy works well trying to balance the level of openness vs fears of market misinterpreting excessive communication.

The CBR doesn't factor in the tail-risk of sovereign sanctions but reiterated that it has all options to address this or any other external risks without changing the policy rate. The governor did say direct OFZ purchases by the CBR, in the case of sanctions, is in the list of potential policy measures, but the CBR still not sure it would be necessary used/needed.

Overall, the press conference lasted less than previous ones and was concluded with the unanswered question about governor's view on the 8-year sentence for the former Economy Minister, Alexey Ulyukaev.

What does it mean for 2018?

Before the meeting, we expected to see the policy rate at 7% in 2018 and 6% in 2019. We still think there is a downside potential of 75-100bp for the key rate in 2018 sticking to the 6% call in 2019. With policy normalisation likely taking 1-2 years and the fiscal rule expectedly arresting RUB volatility we reiterate our call that the CBR policy outlook is not a risk for the RUB.

And, the clear retention of the easing bias going forward works perfectly well for our positive view of a further reduction of OFZ yields over the course of 2018.