Russia Central Bank cuts key rate by 25bp

We stay confident with our call of at least a 6.50% key rate by the end of 2018 and 5.75% in 2019. The CBR may cut again in April and June but there might be some pauses in 2H18

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7.25%

CBR key rate

vs 7.50% before

As expected

The 25bp rate cut was widely expected

The Central Bank of Russia's decision to cut its policy rate by 25bp from 7.50% to 7.25% has been a base case not just for ING but also for the wider market.From the summary comment and wider details of the CBR's logic, we think the following is important to highlight:

- The "lower for longer inflation" (2.2% now) argument widened the CPI forecast in 2018 from "near 4%" to "3-4%" which, in turn, allowed it to make forward guidance more certain and to flag that the shift to neutral policy WILL be completed in 2018; before it was said it COULD be completed. It has reaffirmed a thesis that some previous "temporary" factors seem to have turned into "permanent/structural" disinflationary forces. Inflation is though seen to be approaching the 4% target in 2019.

- The GDP growth assessment hasn't changed much, and lower rates will be supportive of domestic demand. Mid-term GDP growth is seen near the potential of 1.5-2% despite some upgrade to the base-case oil price. This is due to the fiscal rule limiting oil price impact on RUB, CPI and overall economic activity.
- Mid-term inflation risks haven't changed except those related to the labour market and wages, which is due to the surge in real wage growth in 2M18 (10.5% in 2M18). Potential inflationary effects remain uncertain (they will depend on the pass-through of higher wages to consumption), so the CBR will continue monitoring these developments closely to assess potential risks. The CBR will also keep an eye on external risks related to markets volatility and global trade (eg. "trade wars").

Rate cuts in 2Q18 may continue, but pauses are likely in 2H18

Overall, we've got the same dovish bias from the CBR, but with a higher certainty that policy normalisation will happen in 2018. We stick to our call of at least a 6.50% rate in 2018 and 5.75% in 2019. The outcome of the next two meetings looks supportive for another 25bp cut at each, but the CBR still has some flexibility to distribute the planned rate cuts within the year as needed depending on the consumption/inflation pattern. Therefore, we look for the Bank to pause during some meetings in the second half of the year.

The policy signal supports the fundamental appeal of OFZs (especially long-end), but their ultimate risk/return profile stands more dependent (vs 2016-17) on external market developments. As for the RUB, we can only repeat our previous arguments: with the targeted neutral real policy rate of 2-3% the CBR policy easing poses no major risks to the RUB. The fiscal rule will further arrest its volatility, but some intra-year seasonality in the current account can make it more sensitive to capital flows over 2Q-3Q18.