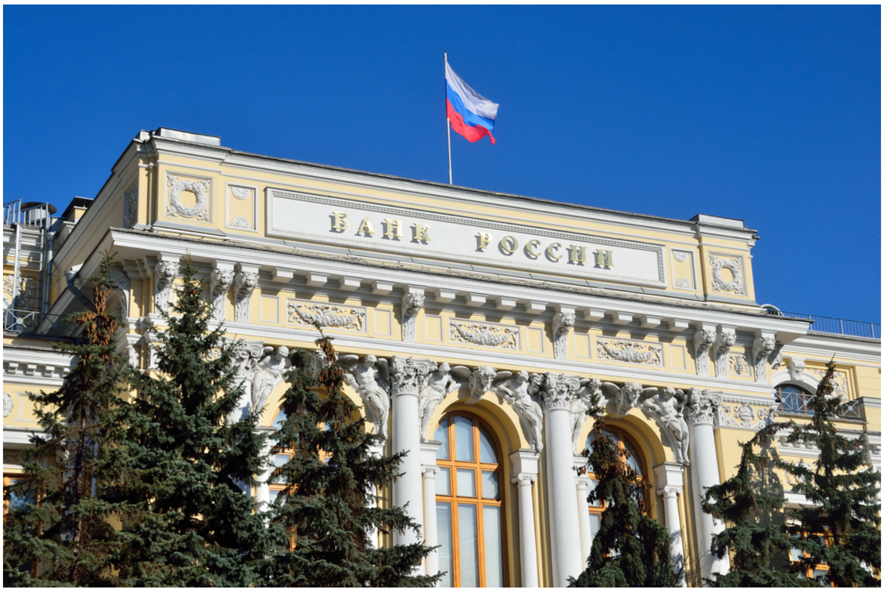
Russia's central bank to cut and hold

We expect the Bank of Russia to lower the key rate by 25 basis points to 7.0% this Friday as inflation has underperformed. The mid-term outlook may become more cautious to account for higher global uncertainty. After this week's cut, we expect the rate to remain unchanged, at least until the core 13 December meeting



Central Bank of Russia, Moscow

This Friday, the Bank of Russia holds its core monetary policy meeting, accompanied by the governor's press conference and a macro forecast update. We agree with the consensus that a 25bp cut to 7.0% is the most likely action, mainly thanks to the favourable CPI trend observed recently.

- CPI growth is likely to decelerate from 4.6% year-on-year in July to 4.4-4.5% YoY in August (to be confirmed on 5 September). This follows three deflationary weeks last month on the back of a strong local fruit and vegetable harvest and deepening drop in global wheat prices from -12% YoY in July to -13% YoY in August (in USD).
- Inflation expected by households in 12 months improved from 9.4% YoY in July to a six month low of 9.1% YoY, and the metric of corporate inflation expectations also improved, suggesting little contagion from the spike in global nervousness.
- The rouble depreciated by 4.7% against the US dollar in August but failed to approach this year's lows of RUB68-70, reducing the risk of a deterioration in inflation expectations in the

near-term.
- The lower-than-expected indicators of household and corporate activity for July may support the case for a key rate cut, even if real sector trends are driven more by the budget policy.
- CBR representatives did not feel the need to adjust market expectations about the cut ahead of the 'silent week'.

We also do not exclude that the CBR will improve its year-end CPI outlook from the current 4.2-4.7% range towards our 4.0% forecast. We remain comfortable with our forecast because even if the August number underperforms our 4.5% YoY expectation, this could be due to a temporary shift in agri seasonality this year.

https://think.ing.com/articles/key-events-in-emea-and-latam-next-week-290819/

https://think.ing.com/snaps/russia-july-activity-disappoints/

We believe the key focus on Friday will be on the commentary, as the central bank will have to balance low near-term risks to local CPI with increased external risks. We do not exclude a more cautious tone to the communique to account for:

- the higher risk of global market volatility, as the uncertainty related to US-China trade tensions, Brexit, and EU slowdown remain in place;
- declining room for further rate cuts after the key rate touches 7.0%, which is the upper boundary of the indicated equilibrium range of 6.0-7.0%;
- persistent local uncertainty related to the prospect of investing a portion of state savings (National Wealth Fund) locally after reaching 7% of GDP.

If our expectations regarding the commentary are borne out, it would suggest that the CBR is likely to pause after the September cut, at least until the next core meeting on 13 December, to reassess the balance of risks to the long-term 4% inflation target.

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