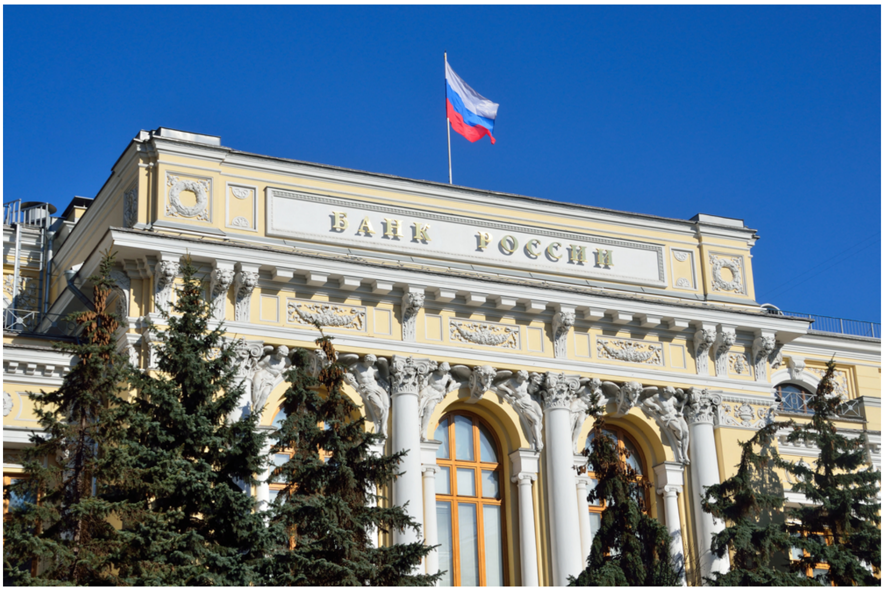
Russia key rate cut to 4.25%, another 25bp cut likely before year-end

The 25bp cut today is in line with our forecast, but is disappointing to the market. We see another 25bp cut as likely this year, though not necessarily for the next meeting. The cut in the 2021 CPI forecast from 4.0% to 3.5-4.0% is modest, lowers the likelihood of key rate below 4.0% in 2021, though it's still possible if the disinflationary trend strengthens



Central Bank of Russia, Moscow

4.25%

Russia key rate

down from 4.50%

As expected

CBR reiterates moderately dovish stance

The Bank of Russia delivered a 25 basis point cut today – from 4.50% to 4.25%. This is in line with our forecast, but less aggressive than the -50bp consensus.

Earlier we indicated that at today's meeting the CBR will be deciding between a 25bp cut accompanied by a dovish signal and a 50bp cut accompanied by a neutral signal. It appears that arguments in favour of the first option prevailed. Those include the recent cooling of EM risk sentiment, combined with higher foreign policy tensions around Russia, and uncertainties regarding the size of the local state debt supply, which have arrested the recovery of the Russian FX and bond market in June-July. Basically, the decision to narrow the step of the cut from -100bp in June may reflect the CBR's expectations of market volatility in the coming weeks and/or willingness to signal that the rate cut cycle is nearing its end.

Still, the near-term signal appears dovish, as the accompanying commentary reiterates the previous wording: "the Bank of Russia will consider the necessity of further key rate reduction at its upcoming meetings", which we interpret as that another 25bp cut is highly likely to take place by the year end, though it is not guaranteed that it will take place at the very next meeting on 18 September. The dovish signal is reinforced by the cut in the 2020 CPI forecast from 3.8-4.8% to 3.7-4.2%, 2021 CPI forecast from 4.0% sharp to the 3.5-4.0% range, reiterated concern that 2021 inflation may undershoot 4% next year, and that households are showing a higher preference to savings given the economic uncertainties. Having somewhat improved the 2020 GDP forecast from -4.0-6.0% to -4.5-5.5%, the CBR significantly worsened the expected household consumption from -1.6-3.6% to -6.2-7.2%.

Meanwhile, the longer-term signal is now less certain. While previously we were confident in the key rate entering the 3.5-4.0% range in 2021, the very modest cut in the 2021 CPI outlook to 3.5-4.0% combined with the CBR's allergy to negative real rates suggest that the likelihood of our initial scenario does not appear high at the moment. This means that a further decline in the CPI expectations would be required in order for the key rate to break the 4.0% threshold. The weakness in the consumer demand amid possible fiscal consolidation in 2021 speak in favour of a further decline in the CPI trend toward our 3.3% forecast for year-end 2021. However, potential upward price pressure from ruble volatility, cost inflation in the grains and gasoline segments still pose pro-inflationary risks.

At the moment, Russia's real key rate (based on mid-2021 CPI, expected by the market) is 1.2%, still tilted towards the upper segment of the peer range which we see between Kazakhstan's +2.0% and Hungary's -2.3%. This suggests that a scope for further cuts in the "risk-free" (from the portfolio flows perspective) rate cut remains.

We are looking forward to the governor's press-conference to shed more light on the CBR view, including on the assesment of the neutral key rate (at least the lower bound of the current 6-7% range is likely to be lowered), which will be a proxy for the key rate forecast beyond 2021.

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