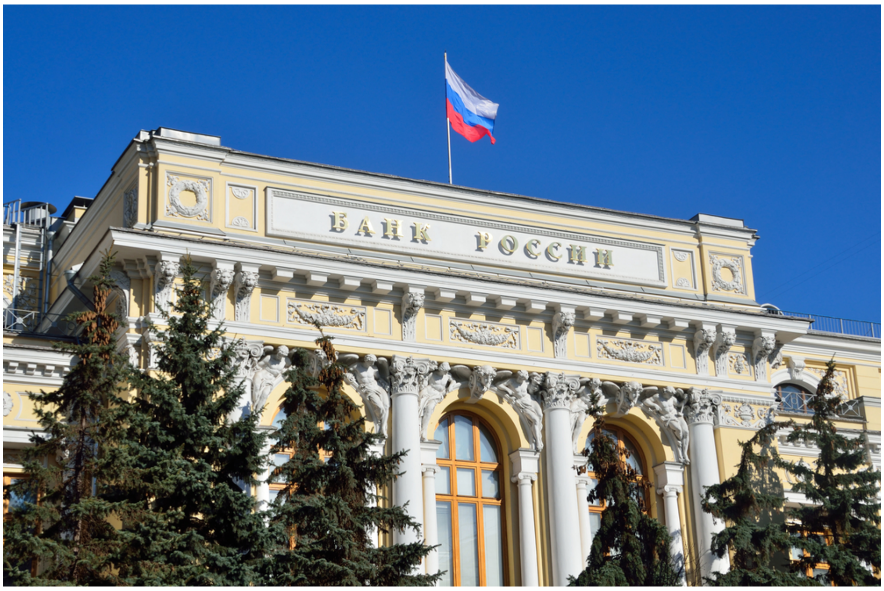
Russia key rate: easing cycle continues

Bank of Russia cut the key rate by 25 bp to 7.25% and guided for further cuts, in line with expectations. We see a similar rate cut on 6 September as highly likely provided the global mood does not deteriorate but do not see the terminal rate below 6.5% at mid-2020



Central Bank of Russia, Moscow

7.25%

Russia key rate

a 25 bp cut

As expected

July cut expected, another 1-2 cuts to follow in 2019

Bank of Russia (CBR) cut the key rate by 25 basis points to 7.25% today, in line with our expectations. Initially a contrarian view, over the course of the last 6 weeks it has become a nearly perfect consensus among analysts (39 out of 40 economists polled by Bloomberg expected this action), as the global markets responded very positively to the dovish shift in the signals coming from the global central banks, and local CPI growth decelerated from 5.1% YoY in May to 4.7% in June and kept decelerating in July, according to the preliminary weekly data. Some market participants have been aggressively expecting a 50 bp cut, however, such a move would be highly unlikely at a non-core meeting, which is not accompanied by a change in the macro forecasts.

The forward-looking guidance remained dovish, also in line with expectations.

- CBR has acknowledged the improvement in the global market conditions, limiting the risks of portfolio outflows from Emerging Markets
- CBR is guiding for a further slowdown in local CPI - to around 4% by the beginning of 2020 (we expect 4.0% by year-end 2019 and temporarily to 3.0% in 1Q20 on the base effect, with a subsequent return to 4%)
- CBR has mentioned weak local demand as a strong disinflationary factor, in addition to the non-demand related factors such as ruble strength and a good harvest.

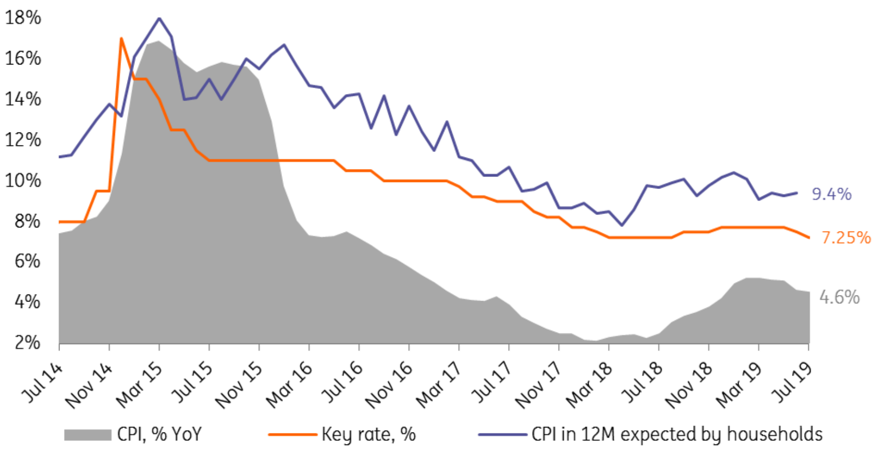
The focus on the weakness in the local demand is a bit of a surprise to us, as we consider the current slowdown in CPI mainly as a consequence of favourable external conditions (see our recent report on inflation "Russian CPI may underperform CBR forecast in 2019"). Also, the stress on the well below expected economic growth rate in the CBR communique may be misinterpreted by the market that the CBR is trying to boost economic growth with monetary tools. Our interpretation is that the mentioning of the weak internal demand is a way for the CBR to acknowledge the growth concerns recently expressed by the government.

We see a scope for at least one more 25 bp cut

In any case, as the local CPI, regardless of the reasons, seems to be on track to hit the lower bound of CBR forecast of 4.2-4.7% at year-end 2019, or even undershoot it, we see a scope for at least one more 25 bp cut on 6 September and potentially another one on 13 December, both meetings are core (accompanied by a press conference and a macro forecast update), provided the global environment remains benign.

https://think.ing.com/articles/key-events-in-emea-and-latam-next-week-180719/

Russian CPI, inflationary expectations, and key rate



Source: State Statistics Service, Bank of Russia, ING

Terminal rate (expected at mid 2020) unlikely to be under 6.5%

In terms of longer-term forecasts, we also stick to our view, that the terminal key rate should stay in the mid to upper range of the target nominal guidance range of 6.0-7.0% for the following reasons:

- The current CPI slowdown is a result of favourable external conditions, including the global EM rally and stabilization of the global agro prices after the 2018 spike - both can prove volatile.
- There is no need to support local activity with an aggressive monetary easing, as the former is more responsive to the budget spending, which is set to accelerate materially in 2H19, as the National Projects (mainly infrastructure construction) should gain traction. The debate on potential easing in the budget policy (through investing part of the state savings into local projects) is ongoing.
- The ability of the government to address the structural constraints to GDP growth so far also remains unclear due to the lack of track record.
- CBR maintains that the inflationary expectations of the households remain elevated and unanchored.

https://think.ing.com/snaps/russian-cpi-may-underperform-cbr-forecast-in-2019/

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