Russia key rate on hold for foreseeable future

The CBR kept the 4.25% key rate and signalled this level is here to stay. The certainty of CPI falling to 3.5-4.0% in 2021 from 4.5-5.0% currently, is now lower, which means any cut before the CPI reverses (after 1Q) is unlikely, and just one 25bp cut is possible at most. A hike in 2021 is also not a base case given weak GDP and a still relatively high real rate

Russian Central Bank Governor Elvira Nabiullina attends a press conference, Moscow, Russia

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4.25% Russian key rate

on hold

As expected

Key rate hold in line with expectations, dovish stance loses ground

The decision to keep the key rate on hold at 4.25% came in line with expectations, the primary reason being the acceleration of CPI to 4.6% year-on-year currently vs. the initial CBR forecast of 3.9-4.2% YoY for this year-end, which it had to raise to 4.6-4.9%.

The commentary has become less dovish, which suggests that the CBR has doubts about the further downside potential for the key rate in the medium term:

- Quoting the CBR directly: "the Bank of Russia will assess... the existence of a potential for additional key rate reduction".
- The CPI forecast of 3.5-4.0% for 2021 has been retained, but the level of certainty is visibly lower, as "Disinflationary risks do not prevail in 2021 as much as before, considering the strengthening of short-term proinflationary factors and risks of their influence being more prolonged'.
- In addition to the widely anticipated explanation of the current CPI acceleration of higher grain prices and recent depreciation of the rouble, the CBR added lower labour supply in some sectors, suggesting a narrowing output gap without a significant recovery in demand.
- We see additional pro-inflationary factors such as a deteriorating foreign policy context (given the new US accusations of malicious practices and lack of progress in official investigation of the Navalny poisoning) and the possibility of a softer than expected fiscal policy stance at the regional level given the need to maintain social support, as hinted by the president at yesterday's annual press conference.

While the press conference by the CBR Governor Elvira Nabiullina to be held today may shed more light on the CBR stance, some preliminary takeaways are as follows:

- The possibility of a key rate cut from current levels has become more remote.
- If it happens, it is unlikely to take place before the reversal of the CPI trend, i.e. after 1Q21. This makes April's meeting the earliest possible date for such a decision. The downside for the key rate is also unlikely to be large. We now see 25bp as the biggest possible cut for next year.
- Meanwhile, a hike next year is also not the base case given the weak GDP growth expectations and still high level of Russia's real rates (based on expected CPI) relative to peers. According to our calculations, Russia's level of 0.5-1.0% is slightly above the mid-range of peers, which varies from -2.6% in Hungary to +2.9% in Kazakhstan. This is a comfortable level for the balance of payments (given the recent improvement in the capital account) and banking sector (given the continued funding inflows amid households' persistent propensity to save).

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