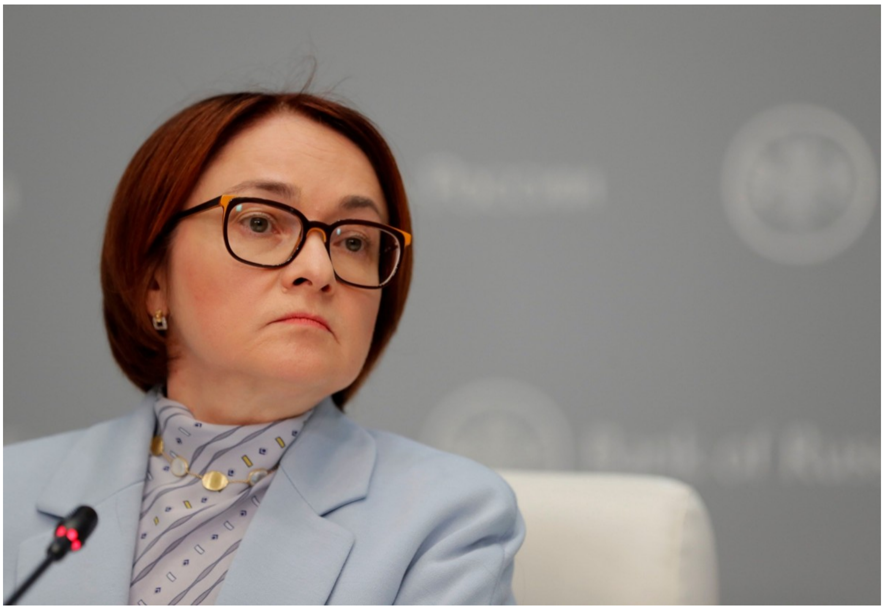
# Russia cuts key rate to 6.5% and maintains its dovish guidance

Russia's central bank cuts its key rate by a further 50 basis points. The move reflects a material improvement in near-term inflationary expectations, as the YE19 CPI target was lowered by 0.8pp and YE20 by 0.3pp. We see scope for further cuts to 6% and maybe even lower, though an immediate followup in December is not guaranteed



Elvira Nabiullina is the Bank of Russia's Governor

**6.50%**

Russia key rate

A 50bp cut

Lower than expected

## CBR makes a decisive 50bp cut to signal improvement in inflationary expectations

The Bank of Russia (CBR) has cut its key rate by 50bp to 6.5%, on the dovish side of analyst consensus but in line with more aggressive market expectations. Those emerged last week after the CBR governor Elvira Nabiullina indicated that the monetary authorities might take more decisive steps.

In our view, the CBR has increased the step from 25 to 50 bp today to highlight a material improvement in its near to medium-term inflationary expectations. Looking at the commentary, we see the CBR has:

- dropped the 'heightened inflationary expectations' phrase from the headline statement. Later, the text mentioned a disinflationary shift in the balance of near-term risks,
- lowered the YE2019 CPI forecast by 0.8pps from 4.0-4.5% to 3.2-3.7%,
- lowered the YE2020 CPI forecast by c.0.3pps from 4.0% to 3.5-4.0%,
- mentioned the increased role of weak demand on the CPI slowdown, which is helped by tighter-than-expected budget spending.

We welcome the adjustment of the CBR's CPI expectations to reality and acknowledge that our own YE19 and YE20 CPI forecasts of 3.7% YoY and 4.0% YoY respectively seem conservative. We believe there are two key internal reasons why the CBR is now more confident in the favourable CPI trend:

1. The government is struggling with allocating planned CAPEX spending; overall spending growth is 6% YoY as of 9M19 vs. 9% YoY according to the annual plan; As of 9M19, National Projects account for only 53% of the annual plan; local investments of the National Wealth Fund will be limited to 0.2-0.4% GDP in 2020; the ability to fulfil public spending plans next year are uncertain,
2. Households are showing more signs of returning back to savings mode, with retail trade decelerating over four consecutive months amid a gradual acceleration of retail deposit growth.

https://think.ing.com/articles/russia-september-activity-interesting-but-uninspiring/

## Key rate has at least 50bp downside from here, though December cut is not guaranteed

The tone of the CBR commentary does little to suggest we are at the end of the easing cycle, and we continue to see scope for more reductions, at least until the lower bound of the indicated neutral key rate range of 6.0-7.0% in 1H20. At the same time, there is no guarantee that the next cut will take place in December. The near-term guidance is as follows: "If the situation develops in line with the baseline forecast, the Bank of Russia will consider the necessity of further key rate reduction at one of the upcoming Board of Directors' meetings".

This is exactly in line with the wording accompanying the September decision, which prompted expectations of an unchanged key rate in October (those were later adjusted materially by verbal interventions from the CBR management).

> *There is still no urgency to cut the key rate*

We also believe there is still no urgency to cut the key rate. Obstacles to GDP growth are related more to the budget and structural policy, and it would be more beneficial for the bond market to start the new year with an expected net OFZ placement of RUB 1.7 tr, with a higher rather than lower scope for key rate cuts.

In order to proceed with the key rate cuts in the near term, a number of conditions need to be met:

- The global market mood remains calm; the Fed confirms its dovish stance; the ruble remains stable.
- Russian CPI continues to decelerate from 3.7-3.8% YoY in October towards 3% YoY in December, as budget spending fails to accelerate materially; inflationary expectations continue to improve.
- Some hints of a potential downward revision to the neutral key rate estimates and/or long-term inflation targets need to appear.

## Author

**Dmitry Dolgin**
Chief Economist, CIS
dmitry.dolgin@ing.de

### Disclaimer