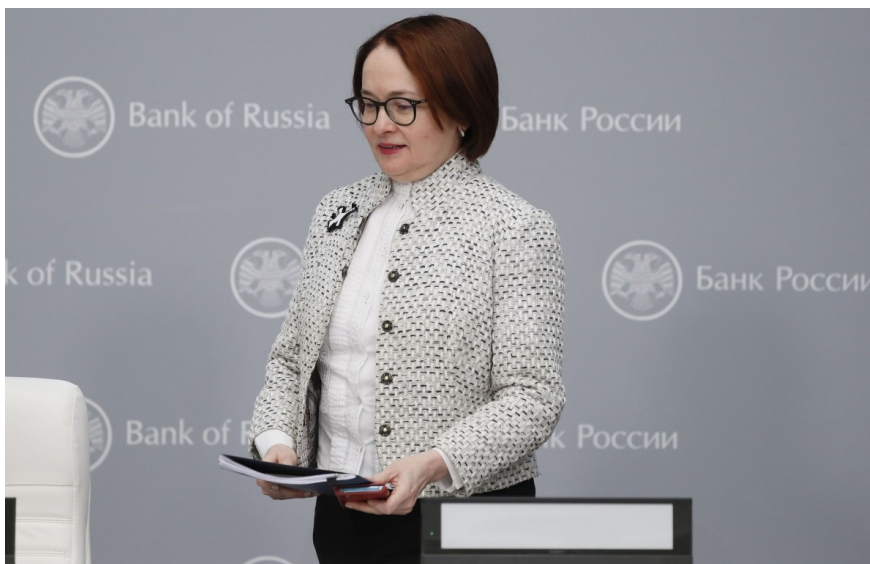


Russia aggressively hikes rates but the ceiling is in sight

A 100 basis point hike to 6.5% was slightly more aggressive than we expected and inflation is to blame. The Central Bank of Russia now doubts that CPI will return to 4% in 2022. The commentary suggests that further upside is limited, and we reiterate our expectations of a ceiling at 6.5 to 7.0%, with a 25 bp hike likely to follow in September



The Head of the Russian Central Bank, Elvira Nabiulina

6.50%

Russian key rate

a 100 basis point hike

Higher than expected

Hawkish bias confirmed

Russia's central bank has confirmed its hawkish bias. The key rate is up 100 basis points to 6.5%, which is in line with analyst consensus and slightly more aggressive than [our 75 bp call](#).

The [commentary](#) suggests that inflationary concerns are to blame, forcing the more aggressive

stance.

- The CBR has highlighted the continued growth in households' inflationary expectations and expressed doubts in the CPI's ability to return to the targeted 4.0% in 2H22, which is a deterioration compared to the previous decision.
- According to the CBR's updated medium-term [macro forecast](#), the year-end CPI forecast for 2021 was increased from 4.7-5.2% to 5.7-6.2% (challenging our 5.7% view) and for 2022 it went up from 4.0-4.2% to 4.0-4.5%.
- Based on the CBR's updated key rate projections, the average key rate until the year-end is likely to stay between 6.5-7.1% (up from 4.8-5.4%), while expectations for 2022 increased from 5.3-6.3% to 6.0-7.0%.

Overall, the tone of the commentary remains hawkish, but became somewhat softer, reflecting a **smaller upside of the key rate from the current level**.

- The near-term guidance softened from "necessity of further increases in the key rate" to "will consider the necessity of further key rate increase at its upcoming meetings".
- In describing the balance of risks the pro-inflationary tilt remained, but became nuanced, as the CBR admitted that the risks from the food segment are somewhat lower, in line with our expectations.
- We also note that the upgrade in the 2021 GDP growth forecast from 3.0-4.0% to 4.0-4.5% is driven primarily by the upgrade in the external demand expectations rather than local momentum, suggesting lower inflationary risks coming from the demand side.

Upside to the key rate appears limited, unless new negative surprises follow

Based on the written commentary and ahead of the governor's press conference we believe that at least a 25 bp hike is more or less guaranteed for the second half of this year and, given the expected CPI profile, it is likely to come sooner rather than later - i.e. in September, as afterwards CPI inflation should stabilise and start to decelerate, everything being equal.

Further hikes are less certain at this point, suggesting that our view on the key rate ceiling in the 6.5-7.0% range still stands. We reiterate our take, that factors limiting the upside to inflation and the key rate should gain importance, as monetary supply growth has been decelerating since September last year. That should translate into monetary inflation with a 12-month lag, global food CPI should also stabilise, and the local growth story is facing obstacles in the form of higher pandemic risks.

Following today's hike, the real key rate, based on 12M expected CPI, is north of 2%, keeping Russia in the top 3 among its peers (after Turkey and Kazakhstan), which should be positive for portfolio inflows into Russian assets. This does not suggest immunity to external risk-off, but should assure more or less defensive market performance relative to peers. A real rate in excess of 2%, i.e. north of the neutral range, should also allow the CBR to refrain from a material increase in the key rate even in case of further moderate deterioration in inflationary expectations.

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