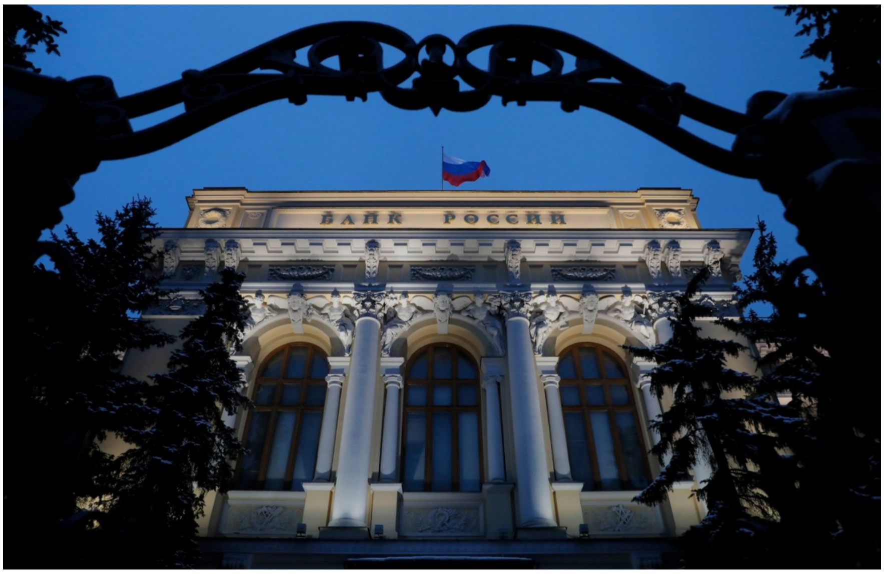
Russia: Key rate to stay on hold, signal to remain dovish

The Bank of Russia will keep the key rate at 4.25% given the recent pick up in CPI, but the medium-term signal will remain dovish. The softening in demand suggested by the budget fulfillment and industrial output for September is guiding towards a below-target CPI in 2021 and leaving room for a key rate cut to 3.5-4.0% next year

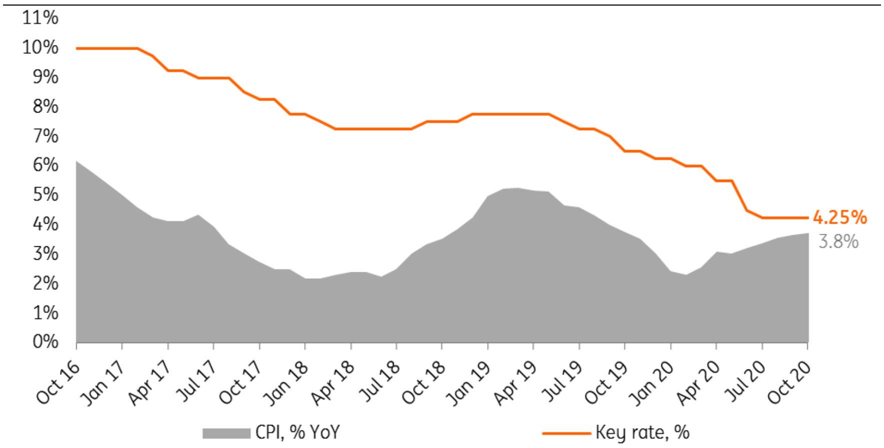


The Central Bank of Russia headquarters in Moscow

- Following the September key rate decision to stay on hold, Russia's CPI continued to accelerate and is likely to reach 3.8-3.9% year-on-year in October (Figure 1) amid weakness in the rouble and growth in global grain prices. Current trends suggest that full-year CPI may hit the middle of the 3.7-4.2% target range, which is a deterioration from previous expectations.
- Russia's real key rate, based on 12-month CPI expectations has gone down slightly towards the middle of Russia's emerging market/commodity peer range (Figure 2). In nominal terms, the key rate cut cycle seems to have halted (Figure 3) among Russia's peers amid a resurgence of inflationary risks.
- Another reason for the 'wait and see' approach in Russia is the political uncertainty around US elections and the consequences for Russia's risk-perception which, based on the recent RUB performance (Figure 4), stabilised at an elevated level in October,

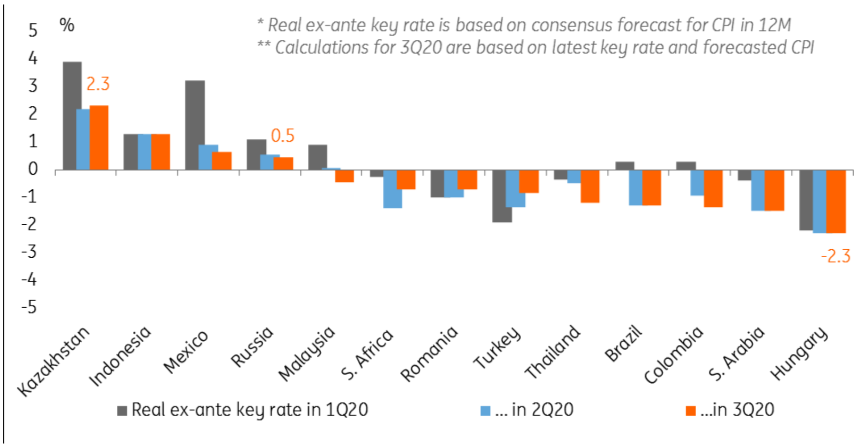
pricing in a tightening in the sanctions environment.
- Another pivotal uncertainty, which is unlikely to be resolved until November, is the Russian budget discussion. The Ministry of Finance is calling for consolidation but broader support for that call remains unclear at this point.
- At the same time, we continue to see arguments in favour of dovish guidance, which would mean 25-75 basis points of downside to the key rate in the medium-term, depending on global and local market conditions. These arguments include softening local activity amid global recovery woes and a moderation in local fiscal support in September (Fig 5). In addition, the balance of payments is promising better fundamental support to RUB in 4Q20 amid a recent improvement in the corporate capital flow structure. Should these arguments materialise, CPI will be back on track to undershoot the CBR's 4.0% CPI target in 2021.

Figure 1: Russian CPI keeps crawling up due to RUB weakness and higher grain prices



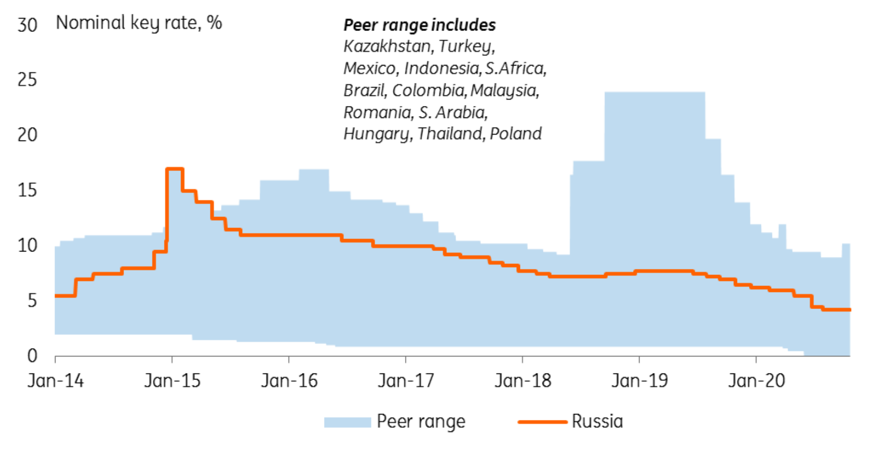
Source: Bank of Russia, Rosstat, ING

Figure 2: Russia real key rate (based on expected CPI) still slightly elevated, but peers' trend no longer down



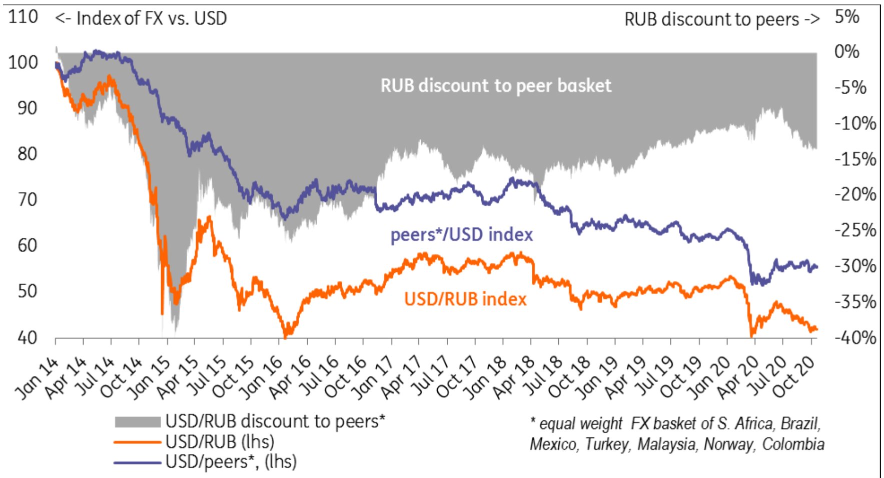
Source: Bloomberg, ING

Figure 3: Russia's peers put nominal key rate cut cycle on hold since summer



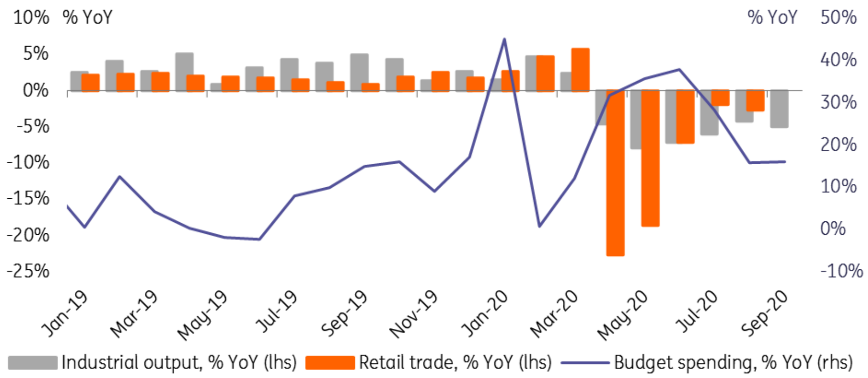
Source: Bloomberg, ING

Figure 4: Russian FX market has stabilised relative to other EMs in October, having priced in higher foreign policy risk earlier



Source: Bloomberg, ING

Figure 5: Recovery in Russian economic activity stalled in September on renewed global fears and moderation of fiscal support



Source: Rosstat, Finance Ministry, ING

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