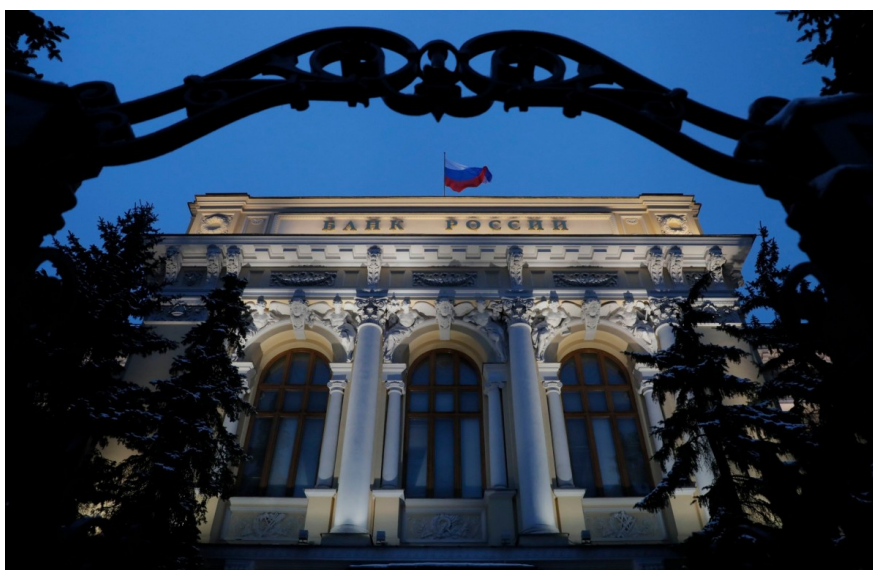


Russia: Key rate to stay on hold, signal to remain dovish

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



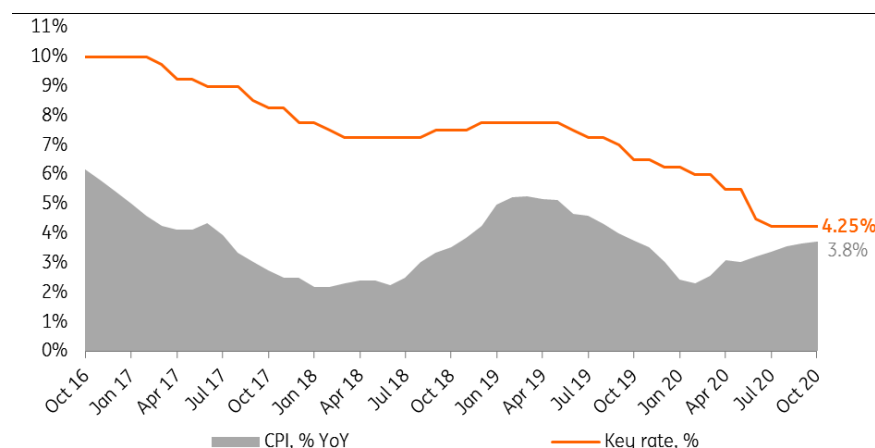
The Central Bank of Russia headquarters in Moscow

- 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.

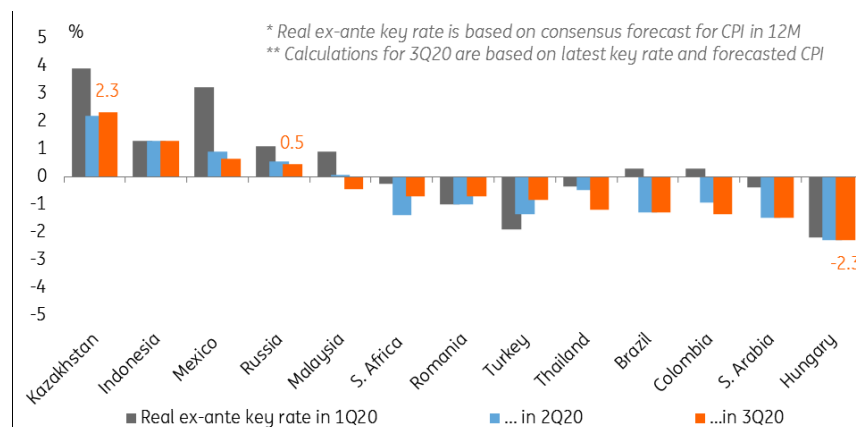
- Another pivotal uncertainty, which is unlikely to be resolved until November, is the Russian budget discussion. The Ministry of Finance is calling for [consolidation](#) but broader support for that call remains unclear at this point.
- At the same time, we continue to see arguments in favour of dovish 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



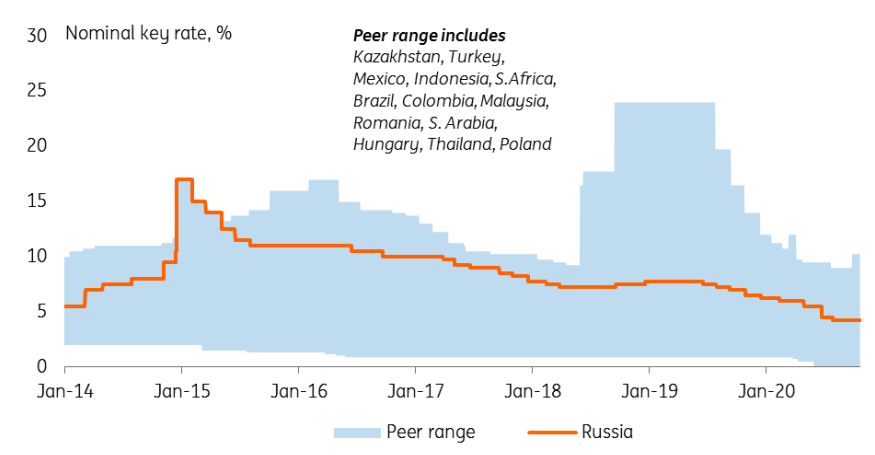
Source: Bank of Russia, Rosstat, ING

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



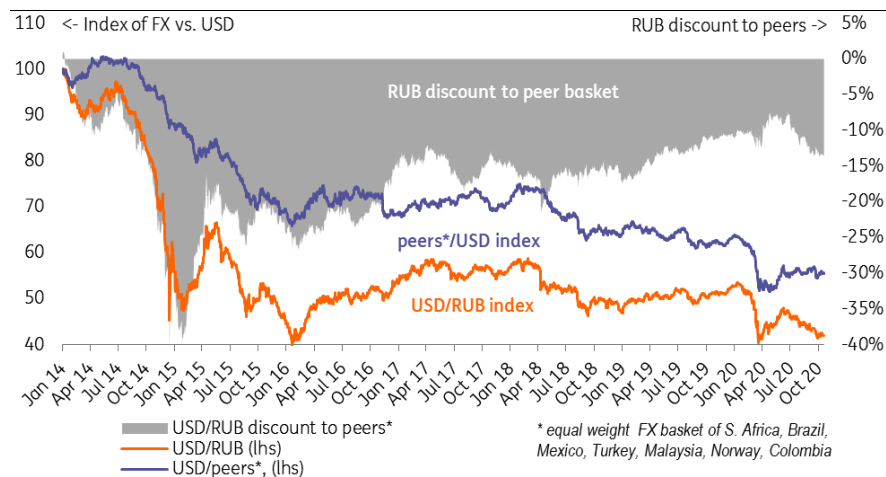
Source: Bloomberg, ING

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



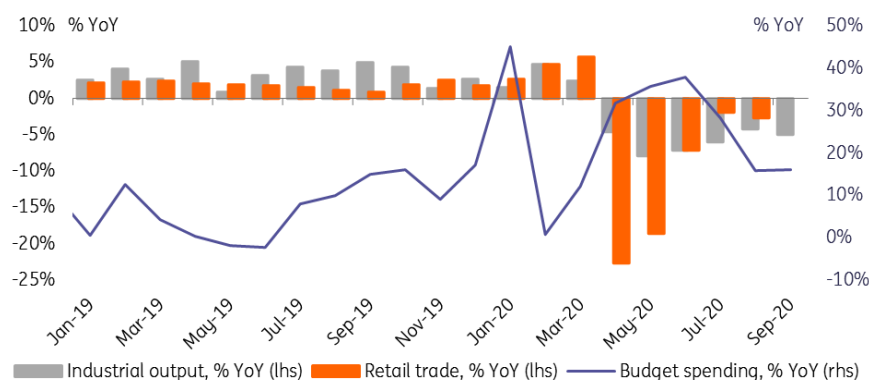
Source: Bloomberg, ING

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

Author

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.