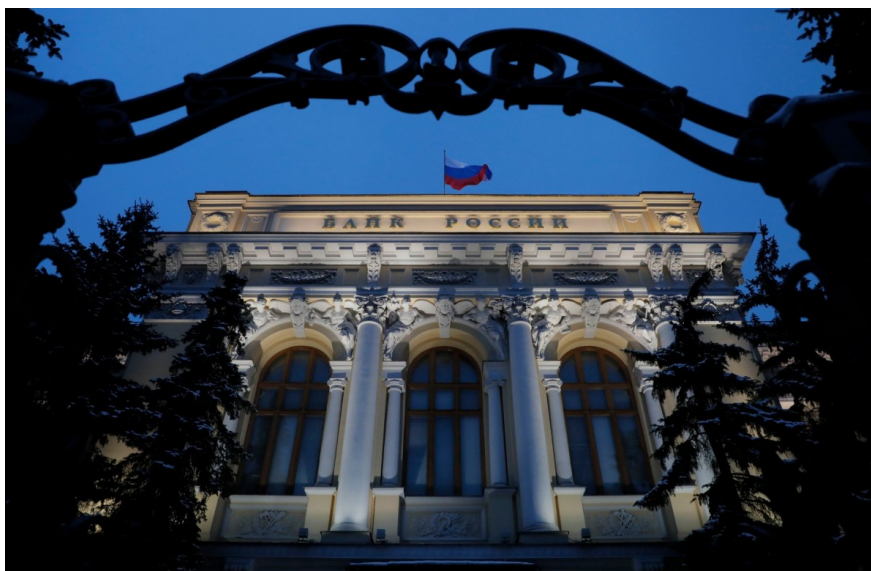


Russia: Key rate to stay on hold, signal to remain dovish

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



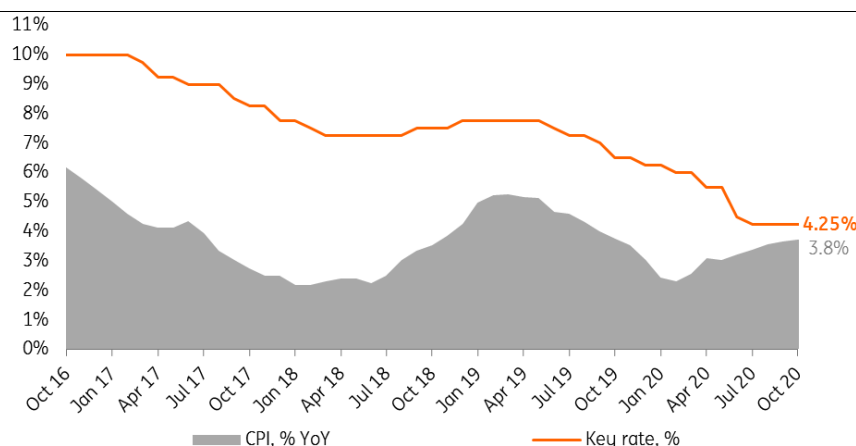
The Central Bank of Russia headquarters in Moscow

- 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.

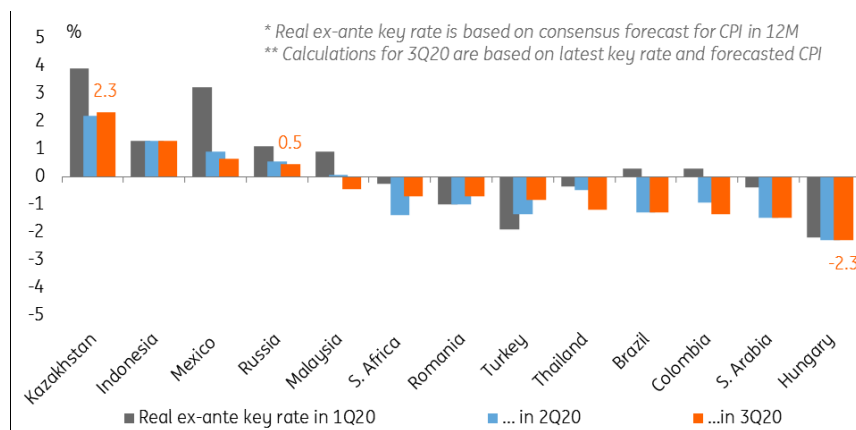
- Another pivotal uncertainty, which is unlikely to be resolved until November, is the Russian budget discussion. The Ministry of Finance is calling for [consolidation](#) but broader support for that call remains unclear at this point.
- At the same time, we continue to see arguments in favour of dovish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



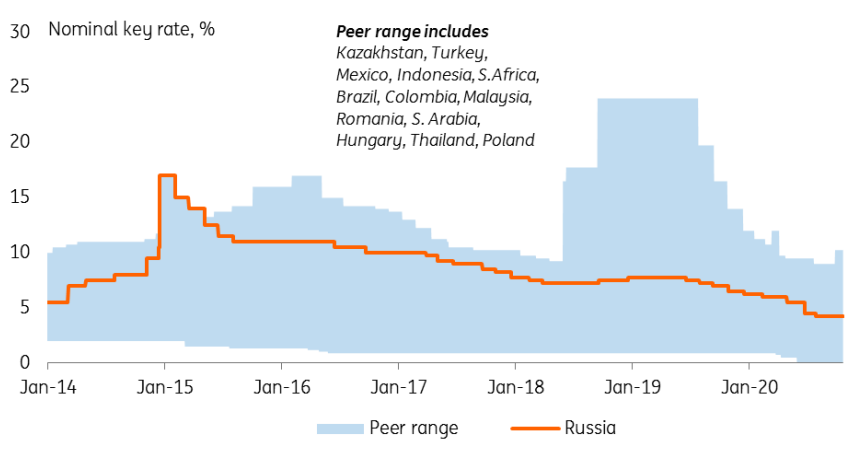
Source: Bank of Russia, Rosstat, ING

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



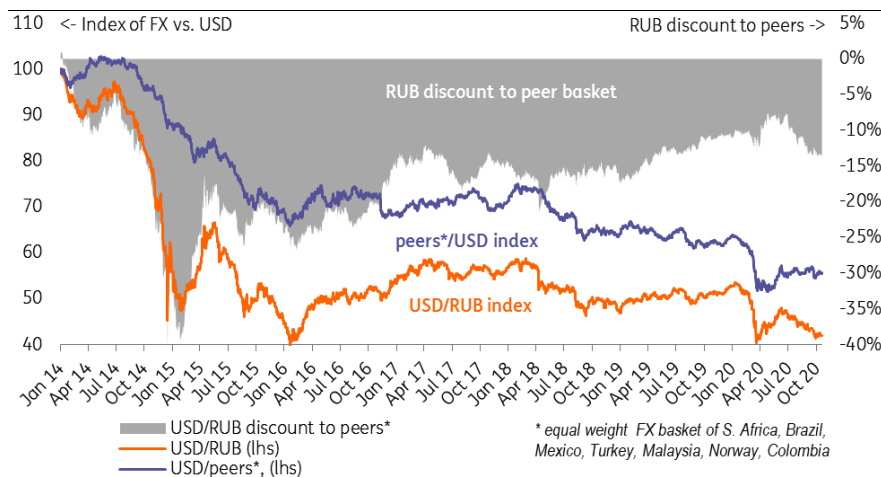
Source: Bloomberg, ING

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



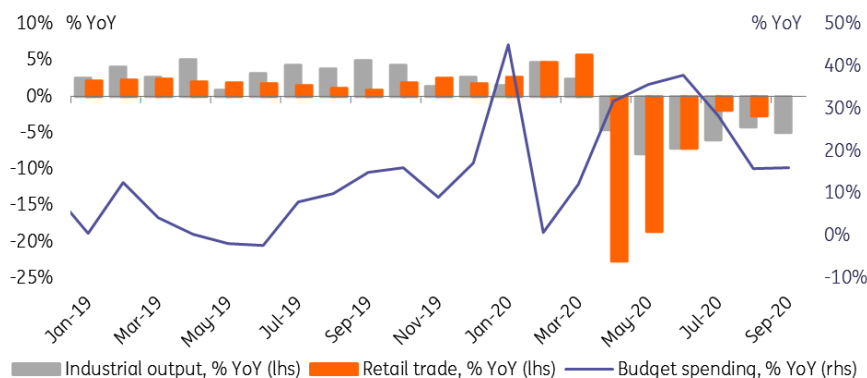
Source: Bloomberg, ING

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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