

Russia reiterates commitment to inflation targeting despite shocks

Bank of Russia kept the key rate at 20%, citing inflationary risks and pointing at the budget as the tool to support economic growth. Combined with the president's support to Ms. Nabiullina's reappointment as CBR governor and his warning against direct price controls or monetary emission, Russia's commitment to inflation targeting seems to be intact



Governor of the Bank of Russia, Elvira Nabiullina

20.0

Russian key rate, %

unchanged since 28 February

As expected

Bank of Russia keeps the rate at 20%, not looking to actively support demand

Bank of Russia held its first regular monetary policy meeting since the military conflict in Ukraine. The board [decided](#) to keep the key rate unchanged at 20%. This level was reached after an [emergency 10.5 percentage point hike](#) that took place on 28 February in response to the new economic reality.

Today's decision to keep the key rate at 20% is unsurprising and in line with our expectations, as the emergency hike two weeks ago was pre-emptive enough. A further increase in the key rate now would have signalled additional nervousness to the market, while a cut would contradict the logic of inflation targeting. The structure of the CBR commentary, suggests that the commitment to inflation targeting so far remains in place.

The content of the communiqué points at the dominance of CBR's concerns over controlling inflation, rather than with supporting economic growth:

- the expected GDP drop “will be mainly driven by supply-side factors, thereby producing a limited disinflationary effect”. This suggests that the CBR sees little point in addressing the deteriorating economic conditions with monetary easing.
- “Pro-inflationary risks have considerably increased and are now prevailing over the entire forecast horizon”. This statement speaks for itself and suggests little relief in CPI pressure in the foreseeable future.
- 4% CPI target has been reiterated, but the expected return to that level shifted from 2023 to 2024
- “Economic activity and inflation dynamics will be largely impacted by fiscal policy decisions”. This means that CBR expects fiscal easing to be the main tool of economic support in the coming months.

While the central bank's statement lacks any detailed quantitative assessment of the economic situation in Russia, we believe the text generally implies CBR's agreement with the [consensus](#) forecast of analysts polled by the CBR on 10 March. The results of the poll suggest 2022 CPI of 20%, unchanged key rate till the year-end, 8% GDP drop amid 10% drop in real wages, followed by an L-shaped recovery, USDRUB of around 110 with further depreciation. Those forecasts are close to our [expectations](#).

Earlier today President Putin proposed to re-appoint Elvira Nabiullina for another 5-year term as governor, while earlier this week he indicated that he is against manual price controls and monetary emission. We take it as a sign of support to the course of actions taken by the central bank so far.

During her short [press-conference](#), Governor Nabiullina indicated that the elevated key rate is a temporary anti-crisis measure, and it will be cut in the future. At the same time she also stressed the need to assure the return of inflation back to the 4% target in 2024. We take it as an indication, that the CBR will be ready to start the cut cycle after some signs of sustainable deceleration in the CPI. Currently, we expect such signs to appear not earlier than by the end of 2022.

In other news, Bank of Russia announced the reopening of the local exchange trading of local

currency public debt (OFZ) and indicated a readiness to intervene with direct purchases. According to the latest available data from MOEX, the OFZ market size is RUB15.6tr, out of which RUB2.7tr are held by offshore non-residents (selling of these instruments is frozen), RUB0.9tr held by foreign-owned banks operating in Russia, while the remainder is with the residents, mainly large banks and investment funds. Our general understanding for now, that it is not CBR's intention to conduct a quantitative easing with large monetary emission, but rather to prevent volatility of the market.

Key watch factors going forward

According to our expectations, CP is likely to reach 16% YoY in March, 20-25% YoY during the year and 20% by the year-end. Unless CPI exceeds the 20-25% range, the key rate is likely to remain unchanged in the foreseeable future. Factors preventing a cut include elevated local demand: March retail trade is likely to spike 25-30% YoY (extra RUB1.0-1.5tr of domestic demand) in response to a weaker ruble and expected shortages of imported goods. Factors limiting the scope for higher key rate include the enforced capital controls, already tight monetary conditions and expected deceleration of lending later into the year, as well as deterioration of the GDP drop expectations.

The important factors to watch on the Russian economy (in addition to geopolitics and monetary policy) going forward include the current account, capital outflows and potential repatriation, as well as fiscal policy.

- On the **current account** side, despite the wide range of international sanctions, Russia's critical commodity exports are largely intact so far. The current account surplus may reach \$200-300 bn in 2022 on a drop of imports and outward dividends, depending on commodity prices and export volumes. Each \$1/bbl of oil price equals \$3.0-3.5bn of annual exports, assuming no material drop in the physical volumes. Addressing the issue of blocked CBR reserves, all Russian exporters are now obliged to sell 80% of their export revenues, de facto replacing CBR interventions. According to our estimates, this translates into \$50-75bn of monthly FX sales.
- Addressing the pressure on the **capital account**, Russia enforced capital controls, banning offshore non-residents from selling Russian assets, preventing corporate residents from providing new debt and deposits with non-residents (while allowing to service existing liabilities in FX to companies from friendly countries and in rubles from countries that joined sanctions), significantly narrowing possibilities for individuals to make outward international transfers and setting absolute limit on carry-on FX cash at \$10,000 per person and setting the same limit for cashing out of local banks. A large portion of the net capital outflow expected for 2022, will represent accelerated foreign debt redemption, as was the case in 2014-16. Accumulation of foreign assets given external sanctions and local capital controls would be problematic. Overall, Russia's gross foreign assets (net of CBR) are \$1.0tr, while gross foreign liabilities are \$1.2tr. We would expect an unwinding of both sides to some extent. Potential inward investments from friendly countries will be a watch factor, but the scope and timing of such inflows are unclear at this point.
- The prospects of **repatriation of the Russian capital**, pushed by the Russian government and international sanctions, is also in focus. According to CBR, Russia's outward FDI to Cyprus and tax havens as of mid-2021 were \$210bn, while inward FDI from those jurisdictions are \$240bn. Other net FDI investors into Russia include Benelux and the rest of EU at around \$30bn each.

- On the **budget side**, the fiscal rule was suspended, which means a halt of debt placement (Russia has RUB4.5tr excess treasury cash to cover current spending), targeted tax breaks and inspection holidays for businesses, use of oil revenues to finance current expenditures (each \$1/bbl of oil price brings in c.\$2.0bn of annual oil revenues). Urals (\$80/bbl) is trading with a \$20/bbl discount to Brent (\$100/bbl). At \$80-100/bbl and USDRUB100 the Russian budget oil revenues may exceed initial plans by RUB6-11 trillion this year (assuming no material decline in volumes), which will be used to finance the tax cut and higher spending. So far, the Russian government announced RUB1tr support to the economy, President Putin pledged indexation of income to 40 million pensioners and 20 million state sector employees. Extra social spending of RUB450bn has already been announced. According to our estimates, each 1 percentage point of indexation of pensions, other social payments and state sector salaries means around RUB300bn of budget spending. Also, the National Wealth Fund will be used to purchase corporate debt and equity from residents. According to our estimates, NWF has access to up to \$85bn equivalent of its savings in CNY and gold.

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