

# Russian Central Bank cuts key rate to 7.5%

The Central Bank of Russia cut its policy rate by 25bp to 7.50%. But sent a very strong dovish signal on policy that will turn neutral faster than expected



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**7.50%** CBR key rate

As expected

## No surprises here

By cutting its key rate by 25bp, the Central Bank of Russia (CBR) decided to take a balanced decision between the "on-hold" and "a 50bp cut" option, which was highlighted in January. One of the primary reasons was the explicit reference to increased global markets volatility.

The rest of the message, however, turned much more dovish with the CBR allowing a shift to the neutral policy stance (e.g. real policy rate at 2-3%) already in 2018. Due to the sharp undershoot in

inflation vs the target (2.2% vs 4%) and improving inflation expectations, risks of CPI overshooting the target of 4% in 2018 have diminished. It stated that not only temporary but also permanent factors keep inflation in check. This reduces short-term inflation risks, shifting the balance of risks somewhat towards risks to economic growth.

However, the CBR also said that its view on mid-term inflation risks and their list (tight labour market, changes in consumer behaviour to lower savings, inflation expectations sensitivity, fiscal and tariffs decisions, external factors) hadn't changed significantly, remaining fully in line with our expectations.

## More room for faster policy easing

The new forward guidance in the statements sends a powerful and clear message: there will be bigger and faster rate cuts over 2018 than the market expects. Bear in mind, Bloomberg consensus was 6.75% and 6.25% for 2018 and 2019 respectively. This is despite retaining the "mantra" about mid-term inflation risks, which has probably prevented the market from turning excessively aggressive in rate cut expectations.

It's worth mentioning the CBR said, risks to economic growth for the first time over a long period, which is clearly related to the 4Q17 GDP growth weakness and some related uncertainty about growth strength in 2018. Elections are ahead of us, and President Putin comments in January on possible rate cuts could have likely been heard in the CBR too. But it's unlikely, they placed any pressure and were instead taken as a fair point about the existence of fundamental conditions for policy easing.

Before the decision, we already adjusted our forecasts to have the key rate at 6.50% in December 2018 and further down to 5.75% by December 2019 to have the real policy rate within a 2-2.5% range vs our inflation projections. Although it doesn't contradict our updated guidance, the key is where between 2% and 3% in terms of the real rate the CBR would see the policy neutral.

For now, we keep our view unchanged, but there is some downside risk to our projections for 2018.

The RUB is still reacting positively to the dovish policy signal which could be related to the fact that even at normality, the real policy rate will be kept at 2-3%, which under the fiscal rule-driven decline in volatility should keep the rouble OK from the carry perspective. And OFZs remain appealing after the forward guidance.