

Russian key rate: up and up

Russia's central bank, the CBR, delivered on the 50 bp rise the market has been expected. But, surprisingly, it also made the commentary more hawkish, citing the necessity to keep going due to higher inflationary risks. Based on the wording, the range of the most likely key rate ceiling for this year has shifted from 5.5-6.0% to 6.0-6.5%



Elvira Nabiullina, Head of the Central Bank of Russia

5.50%

Russian key rate

a 50 bp hike

As expected

More hikes to come

The increase in Russia's key rate from 5.00% to 5.50% was in line with the market consensus and our [expectations](#). But the [commentary](#) brought a hawkish surprise. In fact, we can't recall when the CBR has previously been so definitive in guiding for further increases in the key rate.

- The CBR indicated "the necessity of further increases in the key rate at upcoming meetings"

due to a material increase in the inflationary risks compared to the previous meetings.

- Current CPI, which accelerated from 5.5% YoY in April to 6.0% YoY in May and 6.15% YoY in the first week of June, is seen as only partially driven by temporary external factors, but mostly is, according to the monetary authorities, the result of fast narrowing of the output gap.
- While previously the CBR expected the current CPI spike to be temporary and gave guidance for CPI to return to the 4.0% target by the middle of 2022, now its expectations shifted to 2H22.
- Economic activity is also seen exceeding the CBR's expectations (full-year GDP growth expectations are at 3.0-4.0%) following a better than expected [April result](#).
- The balance of inflationary risks has continued to tilt towards higher inflation, supported by elevated inflationary expectations by households and corporates.
- Potential disinflationary factors should be assigned with low weight, as the reopening of borders, which could potentially bring some relief to local inflationary pressure, seems to be postponed till later.

The upcoming CBR governor's [press conference](#) may bring further detail, but the written statement so far gives little room for guesswork in terms of further key rate prospects. We believe the **next meeting**, which will be accompanied by an update of 3-year macro forecasts:

- **will bring another 25-50 bp hike,**
- **further upward revision of the 2021 CPI forecast (currently at 4.7-5.2%),**
- **and of the expected key rate path.**

We believe the range of the most likely key rate ceiling for this year has shifted from 5.5-6.0% to 6.0-6.5%. The lower end of this range could be found satisfactory in case there are no further negative surprises on the CPI front. That could be helped by continued ruble strength and some cooling in the economic activity amid the new wave of Covid infections, which seems to be now catching up with Russia.

We also note, that even if the nominal CBR key rate exceeds the 5-6% range, it will not automatically mean that the monetary policy stance will turn restrictive. First, this range is not applicable for the short-term considerations. Second, it only makes sense in a stable 4.0% CPI environment. Third, the neutral real key rate of 1-2% should be calculated based on expected CPI, and assuming longer term CPI expectations shift from current 4.0% to 4.5-5.0% (in line with our long-term view), a 6.0-6.5% key rate would still mean a neutral monetary policy stance.

Nevertheless, **in the near term, the hawkish signal by the CBR should be taken positively by the FX market, creating a scope for improvement in our USDRUB73-75 expectations for 2H21.**

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