24 October 2016

Flash Comment

CBR rate decision preview: consistent hawkishness

- **We expect the CBR to hold the key rate unchanged on 28 October.**
- **Quickly appreciating RUB may soften CBR's tone.**
- **We expect the CBR to start cutting rates in Q2 17.**

Assessment and outlook

This Friday (28 October 2016) at 12:30 CET, Russia's central bank (the CBR) is due to announce its monetary policy decision. We expect the CBR to keep the key rate unchanged, as does consensus overwhelmingly, and it is also evident in market pricing.

Despite continuing disinflation (CPI fell 6.5pp YTD to 6.4% y/y in September), lowered inflation expectations and stabilised RUB, the CBR looks likely to stay hawkish over 2016. Contrary to the market pricing and economists' expectations, the CBR in its statement during the most recent meeting on 16 September (when the rate was lowered by 50bp) noticeably emphasised that 'the current key rate needs to be maintained till end-2016 with a possibility to cut it in Q1-Q2 17', which we see as the cornerstone of the CBR's message on Russia's short- and medium-term monetary policy.

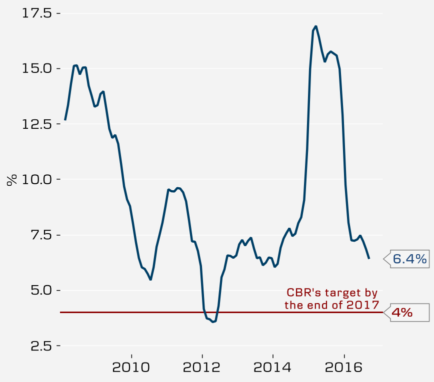
The external conditions have continued to improve since summer 2016 – global volatilities have fallen while markets have repriced the probability of a Fed rate hike for the meeting on 14 December 2016 to over 67% from 50% four months ago. We see this also as a factor fuelling CBR's cautiousness over 2016. However, too strong a RUB could add softness to the CBR's tone this Friday.

While internal economic turmoil in Russia is slowing down, improving news on the demand side and real wage growth are disappointing for monetary doves, as they are a clear sign for the CBR to prolong its hawkish stance to stay consistent in achieving the 4% inflation target by end 2017. Thus, a rate cut seen through market pricing has moved further into 2017, which we consider to be too hawkish and expect the CBR to deliver its next rate cut in Q2 17, which poses downside risks for our 2017 GDP projection of 1.2% y/y.

We do not expect a strong reaction in RUB after the meeting if no surprise is delivered and CBR's consistency holds. As during the last 30 days Brent moved into the USD45-54/bl range, the RUB spot has continued to gain, becoming a top-2 performer among 24 EM currencies, as global EM positivism is supporting Russian assets, FX redemptions by the corporate sector remain low and the share of energy revenues in Russia's budget is shrinking. However, an extreme divergence in the oil price on strengthening RUB could worsen the budget deficit, which we expect to end up at around 3% in 2016.

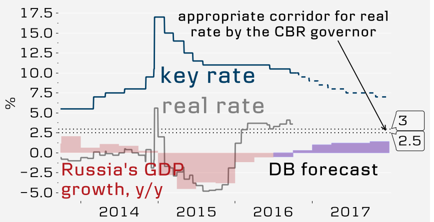
Whether the Fed turns out to be more dovish in 2017 than the markets are pricing right now and global risk sentiment improves, further fuelling the RUB rally, we still see the key rate falling to 7.0% by the end of 2017.

Disinflation goes on...



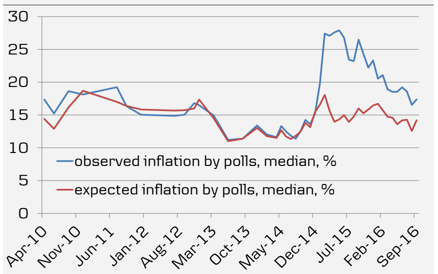
Source: Macrobond Financial, Danske Bank Markets

...while real rate escape from the appropriate corridor is set to curb inflation risks



Source: Macrobond Financial, Danske Bank Markets

Inflation expectations stay low



Source: CBR, Danske Bank Markets

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This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The author of the research report is Vladimir Miklashevsky, Senior Analyst.

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Expected updates

None.

Date of first publication

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