Investment Research — General Market Conditions

24 July 2017

Flash Comment

CBR rate decision preview: we pencil in a cautious cut

- **We expect Russia's central bank, the CBR, to cut the key rate by 25bp to 8.75% on 28 July, as calculated trend inflation has slowed further. Equally, we cannot rule out that the CBR may keep rates unchanged given rising external risks and food inflation.**
- **High real rates are set to prevail throughout 2017, supporting the RUB and oil decoupling.**
- **We still expect the CBR to follow its monetary easing path, hitting 8.00% by end-2017 and 7.00% by late-2018.**

Assessment and outlook

This Friday at 12:30 CET, the CBR is due to announce its monetary policy decision. On the back of Bloomberg's most recent poll, we have moved into the minority group and expect the CBR to cut the key rate by 25bp to 8.75%, while consensus has tilted towards 'unchanged'. However, we expect the statement to express a more cautious tone. Markets are pricing in a full cut for the September meeting.

We see the following **reasons supporting our call for a cautious 25bp cut**:

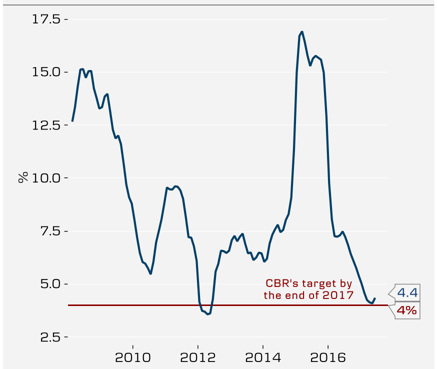
- While inflation diverged from the CBR's 4.0% y/y target, climbing to 4.4% y/y in June, the CBR considers the acceleration to be temporary and sees CPI hitting its target by end-2017.
- While monitoring inflation expectations remains crucial to the CBR's decision making, the situation in June was more or less unchanged versus May. Poll inflation expectations remained unchanged, while there was a marginal rise in observed inflation.
- The CBR has plenty of room for cautious cuts as the real rate remains far above the acceptable corridor of 2.50-2.75%. At the same time, moderate cuts are favourable for narrowing the RUB's divergence from oil price fluctuations.

These factors are in favour of keeping rates unchanged:

- Headline inflation diverged from the CBR's 4.0% y/y target, climbing to 4.4% y/y in June and missing economists' estimates due to the increase in fruit and vegetable prices. We have witnessed the CBR being overcautious in the past, and this stance cannot be ruled out completely before the target is anchored.
- Medium-term external environment prospects for the RUB and inflation outlook have worsened as Russia is preparing for the prospect of fresh anti-Russia sanctions by the EU and the US in coming weeks. The Brent price continues to fluctuate below USD50/bl, which could hit inflation expectations.
- News on worsening harvests could hit inflation expectations looking into autumn 2017.

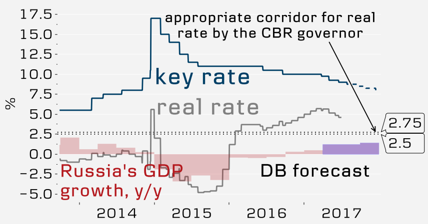
We expect the real rate to hover around 3.0% in 2017, still attracting carry traders. Given current pricing by markets, a 25bp cut would result in a temporary RUB weakening, which would result from a confirmation of the CBR prioritising monetary easing further.

Inflation has not been anchored to the target – yet



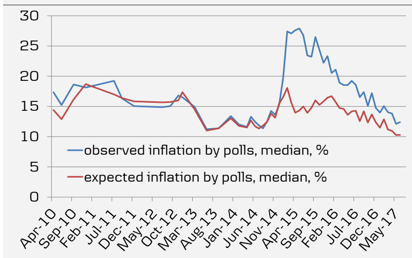
Source: Macrobond Financial, Danske Bank Markets

The real rate remains high, keeping RUB bulls in



Source: Macrobond Financial, Danske Bank Markets

Decline in inflation expectations stopped in June 2017



Source: CBR, Danske Bank Markets

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None.

Date of first publication

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