

Local Markets |

# EM Looking Glass

## RUB's new appreciation bias – forecast update



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Several positive developments to Russia's internal and external backdrop in late December through early January have resulted in notable changes to RUB's trading patterns. To our minds, these developments imply greater scope for RUB appreciation in 2020-2021, with a potential tilt towards USD-RUB at 61.5 in 1H20 and only gradual RUB depreciation through the end of the two-year horizon:

■ **Geopolitical risks failed to materialize in 2019.** This paved the way for a gradual de-escalation of conflict with Ukraine and the signing of a new medium-term gas transfer contract.

Against this backdrop, the RUB likely lost a substantial part of the geopolitical premium. 5y USD CDS for Russia descended below 60bp recently, well below the 1-year moving average at 96bp. The decline in the sovereign risk premium may encourage foreign investors to strengthen positioning in local assets: foreign holdings in OFZ bonds increased by \$3.9bn in 4Q19 (share registered at 31.5%) according to preliminary estimates.

■ **Global sentiment improved following announcement of a phase-one agreement between the US and China,** which later progressed to a deal. The positive conclusion of this chapter in trade tensions helped to spur favourable sentiment across EM FX and to tame concerns about the potential impact of a trade spat on global growth and structural oil demand.

Combined with the recent OPEC+ decision to expand production cuts, the current oil market price structure may provide additional contributions to the Russian current account surplus by c. \$23bn (to \$76.6bn in 2020) versus the baseline projection of SG Commodity team. The impact of these increased contributions will be especially strong in the peak heating season in 1Q20. Hence, trading flows may aid USD-RUB in hovering around the 61.5 territory.

■ **Importantly, the domestic backdrop is also supportive of RUB.** Despite a potential softening of the budget stance by the new Russian Government, domestic inflation may continue to undershoot the inflation target through 1H20. This may provide additional room for further monetary policy easing by the CBR during 1H20 (SGe: -50bp to 5.75%). Finally, the MinFin's budget rule might be slightly relaxed starting in 2H20 in order to secure domestic investments from the liquidity part of the National Wealth Fund.

### Key forecasts for Russia (end-of-period figures)

	Current	1Q20	2Q20	3Q20	4Q20	2020	2021
USD/RUB	61.7	61.5	62.5	63.7	64.8	64.8	66.5
USD/RUB (old forecast)		63.0	64.0	64.5	66.5	66.5	66.5
CPI growth, %	2.8	2.4	2.9	3.0	3.4	3.4	4.5
Key rate, %	6.25	6.00	5.75	5.75	5.75	5.75	6.25

Source: SG Cross Asset Research/EM

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