ROSBANK
SOCIETE GENERALE GROUP

March 18, 2020

Eco Analysis – CBR preview

Russia

Checklist

Rate decision

Unchanged at 6.00% on 20 March

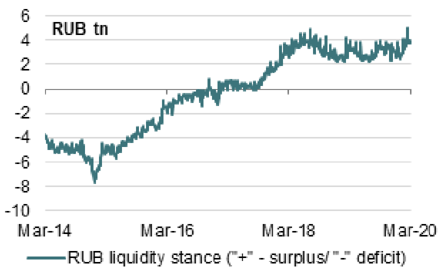
Rate guidance

While a series of recent key rate cuts was driven by decelerating inflation, and subdued price pressures may persist in 2Q20, the recent global turbulence should dominate the upcoming decision. However, a lot of measures adopted by leading central banks worldwide may provide the CBR with a strong argument to abstain from policy tightening in the short-term and to consider a downgrade of the neutral range for the key rate (6.0-7.0%) in the medium term horizon.

Economic assessment

The ruble has lost c.22% vs the USD since the middle of February which must spur an inflation rebound over the course of 2020. Because of this we upgraded our 4Q20 outlook to 3.7% yoy (+0.5pp) but do not consider tightening monetary policy conditions to be a justified measure at this stage. Local liquidity conditions remain fairly comfortable that shifts counter-crisis measures away from monetary policy.

Liquidity conditions are more resilient than in 2014



Source: Bank of Russia, Rosbank

Bank of Russia likely to keep the key rate flat on 20 March

Friday, 20 March 2020	GMT	Previous	SG Forecast	Consensus
Key rate (%)	11:30	6.00	**6.00**	6.00

The forthcoming meeting of the CBR Board of Directors on 20 March will have high importance for the local market, while under normal circumstances, it would not be that intriguing. Nonetheless, financial markets are in a fever, and commodity markets continue to slide due to the lack of coordination at OPEC+ and the plunge in demand worldwide. Moreover, the global economy is very stressed owing to the spread of the coronavirus and concerns about the timing of support from government authorities which may result not only in a technical but also fundamental recession in the US, Europe and other countries.

Domestic financial markets unintentionally drew a parallel with the crisis of 2014 and started pricing a preventive tightening of monetary policy by the CBR. Money market instruments priced up to 200-300bp hikes on the highs. Nonetheless, we keep saying that this kind of 'protection' could do more harm as the nature of the crisis has changed. The ruble's weakening would only affect inflation expectations, while inflation acceleration could be short-lived owing to structurally feeble consumer demand.

The current turbulence is different from previous crises thanks to the comfortable liquidity and overall size of countermeasures from leading central banks. First, the ECB and the Fed brought back accelerated balance sheet expansion with rates near zero or negative, which should help prevent imbalances in the distribution of FX liquidity. Second, the internal stance with ruble and FX liquidity is far from restrictive. The banking sector accumulated a liquidity surplus up to RUB2.5-3.5tn (compared with an extraordinary deficit of RUB7.5-8.0tn back in 2014) but still did not face a massive outflow of ruble deposits or a rush into FX currency. Internal funding rates both for ruble and FX liquidity are not showing stress either. Moreover, the CBR and MinFin launched a reverse selling of FX reserves in the FX market (c.$50m/d) in line with the oil budget rule. Third, a significant downgrade of global interest rates gives the CBR plenty of leeway to avoid tightening monetary policy in the short term as well as initiate a review of the neutral 6.0-7.0% range in the medium term.

Although we revised our inflation outlook upwards to 3.7% yoy (from 3.2% previously) for the end of 2020, we left average inflation at 4.3% yoy for 2021. At the same time we revised the trajectory for the key rate for 2020 and 2021 on the back of global conditions changing. Specifically, we suggest that the regulator's strategy might be to keep the key rate unchanged (at 6.00%) during times of high volatility but then relaunch an easing cycle (in a baseline scenario in 2021, but might be earlier) backed by a natural widening of interest rate parity vs global key rates. The only condition for this scenario is the ability to avoid 'extraordinary' capital outflow from local markets.

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