22.10.2020

Olga Nikolaeva
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Senior Fixed Income Analyst
Olga.Nikolaeva@iticapital.com

Bank of Russia: stable and unchanged

On Friday, September 23, the Bank of Russia will hold a planned policy meeting. Just like the last time, we expect that the regulator will not change the current parameters of monetary policy and will keep the key rate at 4.25%. Since this view is shared by most analysts, the market reaction is expected to be neutral. In the week preceding the current week of “silence”, the Bank of Russia representatives didn't make any specific statements on further monetary policy, thus indicating the regulator's unwillingness to take active action now. Meanwhile, we expect the press release to reflect a dovish tone yet another time. The key factors affecting the Central Bank's decision have hardly changed since the last meeting. We still assume that the final stage of the current monetary stimulus cycle is still ahead and will take place in 1Q21, when the key rate may drop to 3.75% (provided that there are no destabilising factors). We do not expect a transition to neutral monetary policy until early 2022.

REASONS FOR KEEPING THE RATE UNCHANGED:

- The weakening of the rouble in recent months combined with higher inflationary expectations (the median estimate of expected inflation in October was the highest in six months) have triggered some acceleration of inflation. According to weekly statistics, since the end of September, prices have been rising by 0.1% for two consecutive weeks after seven consecutive weeks of zero growth or deflation. Annual CPI was 3.82% as of 12 October, the Federal State Statistics Service said. At the same time, we are not yet inclined to overestimate inflation risks. Constraints such as lower incomes and demand from individuals continue to suppress inflation. Moreover, the recent anti-epidemic restrictions will also have a negative impact on consumer behaviour.
- Russia still faces increased volatility due to high uncertainty on external markets. In the run-up to the US presidential elections, investors become increasingly nervous, which is reflected in their reluctance to increase risk positions in financial markets. The second wave of the Covid-19 actively spreading around the world also influences domestic climate. Moreover, sanctions against Russia are still on the agenda. The national currency trades at a significant "geopolitical premium", so it is undesirable that it is exposed to further pressure from monetary policy.
- Rouble-denominated retail deposit rates have been falling, which could trigger further outflow of passive funds from banks. According to the Central Bank, in the first decade of October, the maximum deposits rate fell to 4.326%, almost reaching the key rate level.
- The next key rate cut is unlikely to result in lower borrowing costs for the Ministry of Finance. Current OFZ rates have untied from the current monetary parameters. Higher yields result from both the primary market supply surge and a premium for geopolitical risks.

Our view on the prospects of the OFZ market.

We do not expect any tangible market reaction to the regulator's decision to keep the rate unchanged, as it has long been reflected in consensus. Bond prices may slide if the bank's statement lacks dovish words, indicating a possible end to the monetary stimulus cycle. We assume this is an unlikely scenario.

We note the gap between short OFZ rates (up to three years) and current policy parameters, leading to a positive premium above the key rate. As market conditions stabilise (one of the most important dates will be the US election), we believe it will be reasonable to open positions in this segment, waiting for the premium to fade. This strategy will also limit potential market risks in the event of an adverse development.

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CONTACT LIST

Trading

Mikhail Durov | Fixed Income Trader | Mikhail.Durov@iticapital.com

Sales

Aleksandr Panfilov | Head of Fixed Income Sales | Aleksandr.Panfilov@iticapital.com

Research

Iskander Lutsko | Head of Research, Chief Investment Strategist | Iskander.Lutsko@iticapital.com

Olga Nikolaeva | Senior Fixed Income Research Analyst | Olga.Nikolaeva@iticapital.com

Stanislav Yudin | Senior analyst, Equity Research | Stanislav.Yudin@iticapital.com

Irina Fomkina | Research Analyst | Irina.Fomkina@iticapital.com

Kirill Sosov | Research Analyst | Kirill.Sosov@iticapital.com

Oleg Makarov | Chief Editor | Oleg.Makarov@iticapital.ru

CONTACT DETAILS:
ITI Capital Limited
Level 33 Tower 42,
25 Old Broad Street,
London EC2N 1HQ,
United Kingdom

PHONE:
+44 (0) 20 3889 8333
+44 (0) 20 3889 8331

WEB:
iticapital.com