



Bank of Russia: CBR has reached the bottom of the current easing cycle?!

OUR VIEW:

Bank of Russia's left the key rate unchanged at the last monetary policy meeting of the year, as expected. The key rate was left flat at 4.25% for the third time in a row and down by 200 bps from the beginning of the year. The decision was in line with the market consensus. The biggest surprise for the market was the degree of hawkishness in rhetoric of Russia's banking regulator.

Elvira Nabiullina, the governor of CBR, said that there might not be any room for further rate cuts in the future (while the previous statements suggested there was a room for maneuver), as there are signs suggesting that proinflationary trends may become longer-lasting than originally expected. The 2020 inflation forecast was raised yet another time, from 3.9-4.2% to 4.6-4.9%. However, the regulator didn't provide its estimates for 2021.

KEY MARKET INDICATORS - FORECAST

Indicator	Current level	1Q21	2Q21	3Q21	4Q21
MICEX, pt	3 240	3 050	3 355	3 650	3 700
S&P 500, pt	3 700	3 750	3 900	4 150	4 200
Brent, \$/bbl	50.6	47	58	65	61
USDRUB	74.8	75	71	68	70
Bank of Russia's key rate, %	4.25	4.25	4	4	4

Source: ITI Capital estimates

Thus, ***if the situation continues to deviate from the baseline scenario, we may assume that the CBR has reached the bottom of the current easing cycle.*** If inflation slows down, there is still a chance that the central bank would decide to cut the rate to 4% in mid-spring next year, which will mark the end of the easing cycle.

Based on CBR latest rhetoric and our assumptions, we believe OFZ price rally is now a thing of the past. We do not expect any significant changes in yields at the middle and the far end of the sovereign curve in the coming months. Therefore, the 10Y benchmark rate will continue to hover around in the range of YTM 5.8-6% per annum. Even if non-residents' demand for the rouble-denominated government bonds remains in place (inflow of foreign investment reached ₺102.2 bln in November, the highest since February 2020), it will provide insufficient support to the bonds. The Finance Ministry is set get back to the primary market in January to launch the ambitious ₺3.7 trln (gross) borrowing plan for 2021 as quickly as possible. The ministry expects to ramp up domestic borrowing by offering fixed-coupon securities,

which will add pressure on yields. In turn, the duration of stimulus policy will depend on the key macroeconomic indicators. The CBR now assumes that the transition to a neutral rate (5-6%) will not start until 2022.

MARKET REACTION

The OFZ market has been flat most of the time recently, with yield fluctuating within a 2-3 bps range in the absence of any drivers. Renewed purchases by foreign investors have slowed the sovereign bonds' decline, as local players cut their positions. However, accelerating CPI growth led non-residents to turn their attention to local equities. The MICEX renewed its all-time high in the beginning of December, reaching 3,318 pt. After Nabiullina's speech, the far end of the OFZ curve came under additional pressure. Long bonds prices declined by up to 0.4%. The rouble was weakening since morning, although we believe the decline was primarily driven by tougher pro-sanctions rhetoric.

THE BRIEFING HIGHLIGHTS:

- Since the previous Bank of Russia meeting at the end of October, the ratio of proinflationary and disinflationary factors and risks has clearly shifted towards inflationary ones. At the same time, the view of the economic situation has not changed significantly. There are risks that proinflationary trends may become longer-lasting than originally expected.
- The current annual inflation rate is way higher than the Central Bank's October estimate (3.9-4.2%). Price growth has accelerated due to situation in individual food markets and global inflationary processes. Food products' prices increase due to rising costs (supply disruptions, labour shortages). Non-food prices are primarily driven by exchange rate movements. As a result, the central bank has raised its 2020 forecast yet another time, to 4.6-4.9%.
- The CBR considers it is too early to adjust its medium-term inflation forecast since it is necessary to also analyse the effect of competing factors on price movements. The CBR will carry out an additional analysis to assess whether there are grounds for adjusting its forecast in February, for the core meeting on the key rate.
- The bank's preliminary estimates show that annual inflation will approximate 5% in Q121 and then fall to the 4% target by mid-year. Given the accommodative monetary policy pursued, inflation is expected to equal 3.5-4% by the end of 2021.
- Further monetary policy and potential for further key rate cuts will depend on actual and expected inflation relative to the target, the economy situation and geopolitical risks. The Central Bank still sees room for cutting the key rate, yet there is less ground for the move. The likelihood of further easing turned out to be lower than it had been expected previously.
- It is possible that the view of the key rate trajectory in 2021 will change due to rising proinflationary risks, but the adjustments will be made as more macroeconomic data becomes available. The publication of the trajectory graph (dot plot) is scheduled for the first half of 2021.
- The Bank of Russia has begun publishing a "beige book", will post a report on the state of the regional economy on its website eight times a year, before policy

meetings and the “week of silence”.

- The bank's easy monetary policy has helped to limit the downturn. The central bank has revised the GDP estimate upwards in 2020. Even given the pause in economic recovery in 4Q20 due to reimposed restrictions, the GDP is expected to decline by about 4%.
- The state's participation in the banking sector will shrink. The CBR is committed to divesting from the banks' equity.

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