



Bank of Russia: yet another hike

OUR TAKE

The Bank of Russia raised its key rate by 50 bps to 5% at its core meeting on April 23. Therefore, the regulator swiftly returned to a neutral monetary policy (1-2% above inflation target). The decision was driven by persisting inflationary pressure and inflationary expectations growth. The bank updated its medium-term macro-forecast and raised the year-end CPI estimate by 1 pt to 4.7-5.2%. Annual inflation will return to the target in the middle of 2022 (previously it was projected to take place in the first half of 2022). Meanwhile, the regulator has somewhat eased the signal about future moves, though it remained “hawkish,” saying it “will consider the necessity of further increases in the key rate at its upcoming meetings”. The previous statement said that the bank “holds open the prospect of further increases in the key rate”.

In an important move, the bank has published the average key rate trajectory for the calendar year it had announced earlier. This step reflects material progress in improving communication with the investment community. The key rate will average at 4.8%-5.4% this year, 5.3%-6.3% in 2022 and 5-6% in 2023. In other words, the baseline scenario assumes that the key rate may either remain flat at 5%, or be raised to 6% by the end of the year. Overall, as part of the current monetary normalization cycle, the rate is unlikely to exceed 6.5%, which, incidentally, is in line with the three-year OFZ prices.

The Bank of Russia's decision met our expectations, nor was it a surprise to the market. Based on the updated information (including the trajectory of the average rate), we **believe the regulator will keep tightening monetary policy, bringing the key rate to at least 5.25-5.5% by the end of the year**. The bank is likely to hike the key rate by 25bps at the next meeting on June 11. Our base case scenario suggests that OFZ 10Y yields would reach 6.7-6.8% per annum by the end of December 2021 (now around 7% per annum).

MARKET REACTION

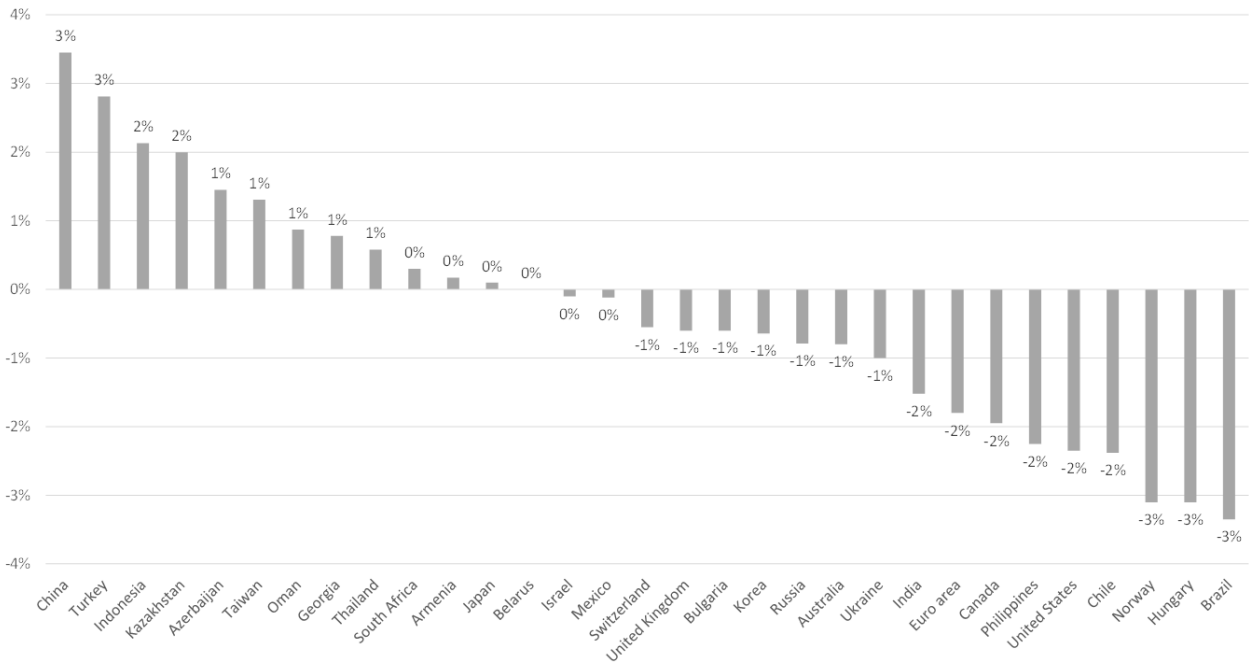
The OFZ market gained a strong positive impulse last week after the Russian troops pulled back from Crimea and the border regions of Ukraine after drills to their permanent bases. The sovereign curve dropped by 12-15 bps in the long and belly segments, as geopolitical risks eased. On Friday, April 23, in the run-up to the Bank of Russia's decision, ruble government bonds traded in a very narrow range. The first reaction of the market to the rate hike was negative, despite the fact that the short OFZ market had priced the increase in long ago. Investors were probably confused by the persisting hawkish rhetoric, as well as the publication of an average rate forecast that envisaged further massive tightening. Later, however, the market paired most of the losses and closed almost flat. It is therefore no surprise that the near-term bonds lagged a bit following the signal about further key rate hikes. The

ruble strengthened as expected.

THE BRIEFING HIGHLIGHTS:

- An outpacing recovery in demand amid constrained supply contributes to a stable inflationary climate. The inflation trajectory estimate was raised. Annual inflation is expected to remain at a plateau near 1Q21 levels (5.5% as estimated on April 19) in April-June. These developments triggered an earlier return to neutral policy than originally anticipated. At the same time, given the lag, monetary policy can still be considered “dovish” for now.
- The high end of the projected average key rate range in 2021 indicates that monetary policy may be moderately tightened by the end of the year (the key rate will reach 6%). At the same time, if we compare monetary policy with the current inflation and inflationary expectations, the policy can still be considered “dovish.” A transition to tighter policy is still unlikely.
- Since inflation is running above the 4% target, the neutral rate range could be raised in the short term. Overall, there is no reason to revise the neutral range estimates yet, but the conditions could be adjusted depending on further developments.
- At the next meeting, scheduled for June 11, the regulator is likely to consider keeping its key rate at 5% or raising it by 25 bps. However, if inflation keeps rising, another 50 bps hike is possible.
- The economy continues to recover strongly and is expected to return to pre-pandemic levels in 2H21. This growth is primarily driven by more active consumption by households. The GDP is projected to grow 3-4% this year, 2.5-3.5% in 2022, and 2-3% in 2023, according to the medium-term forecast.
- According to the Bank of Russia estimates, from April 1 to 16 non-residents sold ₺101 bln in OFZs, including ₺43 bln in the week after the latest round of sanctions. As a comparison, in March, foreign accounts balances decreased by ₺121 bln. Thus, the share of non-residents in the OFZ market as of the beginning of April dropped to 20.9% (the lowest since 2015).
- The use of \$1 trln of the liquid part of the National Wealth Fund over three years does not entail any significant inflationary risks.

GLOBAL REAL RATES



Source: ITI Capital, Bloomberg

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