Russia Central Bank Preview: July 2021

Details:

Monetary policy decision and release of Monetary Policy Report: 1130BST/1130CEST/0730ET, Friday 23rd July 2021.

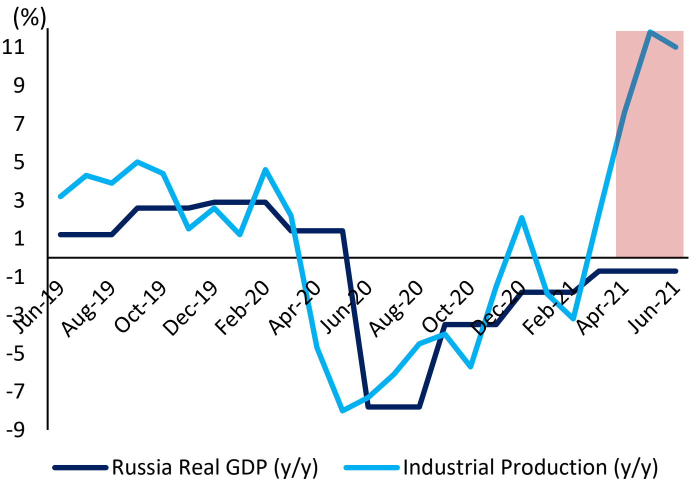
MNI Point of View

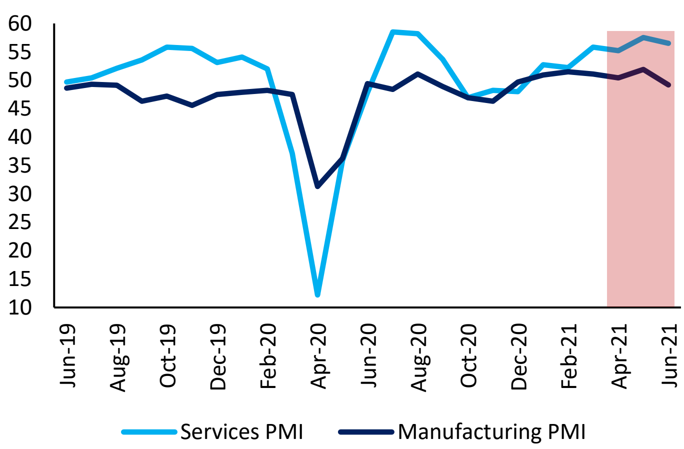
POV: CBR to Hike +75bp, Material Risks to "One-Off" +100bp Hike

Despite the broad uncertainty surrounding this meeting, as reflected in the +50-100bps range of expectations, we see the CBR delivering a +75bps hike with risks to +100bps as sharply overshooting CPI continues to drive policy rates beyond the 5-6% neutral range in the near-term. Elevated uncertainty in the pricing outlook may see the CBR seek to retain the optionality of a further +25-50bps in the pipeline for September, should prices fail to moderate on favourable base effects.

Since the April meeting, the CBR has placed outsized value on bubbling demand-side factors as a core driver of upside risks to the bank's pricing forecasts, which have been largely underestimated by the sell-side. High frequency growth data softened slightly on the margins in June, but remained firm after a substantial uptick in March-May period. Both industrial production and manufacturing/services PMIs registered notable rises in May to 11.8% y/y (vs 7.6% prior), 51.9 (vs 50.4 prior) & 57.5 (vs 55.2 prior), but eased slightly in June - easing some demand-side pressures and tempering the need for a substantially larger hawkish response from the CBR (+100bps).

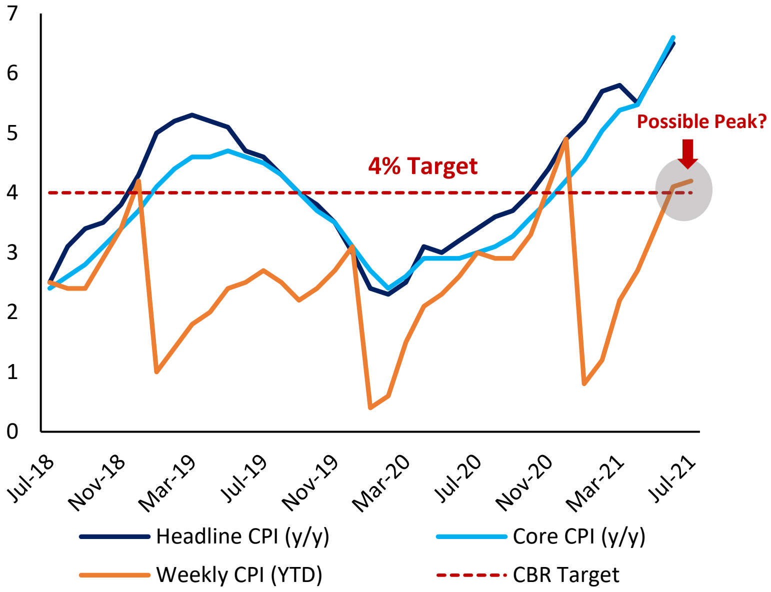
Figure 1: High-Frequency Indicators Decelerate in June

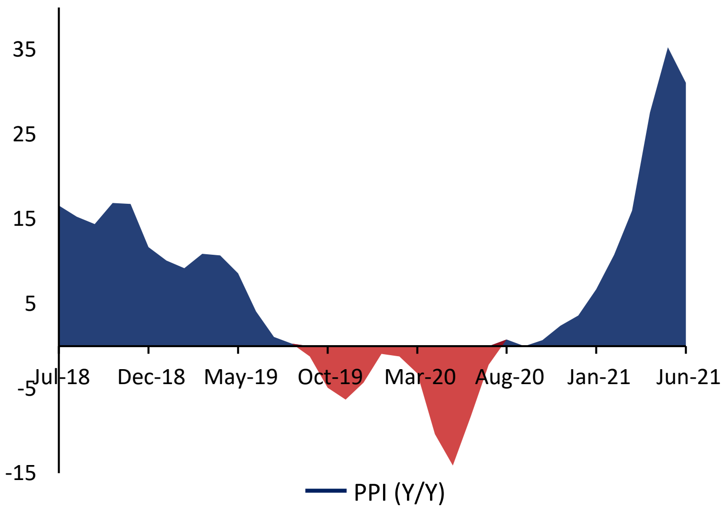




These firmer demand-side factors were broadly reflected in the June inflation numbers with headline CPI surprising to the upside at 6.5% y/y vs 6.4% exp, alongside higher core CPI at 6.6% y/y vs 6.3% exp. PPI fell slightly to 31.1% y/y from May readings at 35.5%, but still printed above expectations of 29.3% y/y. Although weekly CPI has shown tentative signs of moderation in the past two weeks, headline CPI is expected to reach 6.7% y/y in July before declining towards 5-5.5% into year-end on more favourable base effects.

Figure 2: Weekly CPI Decelerates Slightly in July, PPI Slips from May Highs >35%





Signs of deceleration in the last two weeks of weekly CPI data may be a tentative indication of a peak in price pressures in July - September, paving the way for a more material softening as base effects kick in. However, the CBR will not wish to continue chasing data and rather act decisively to anchor runaway expectations through a larger hike than the prior two (+50bps) which have done little to temper pressure on CPI. Additionally, with the RUB having depreciated >3% vs the USD since the prior meeting, higher FX passthrough to inflation will undoubtedly be factored into the CBR's reaction function.

In the prior statement, the CBR delivered a slight hawkish tilt in phrasing - stressing that "the balance of risks had shifted *significantly* towards pro-inflationary ones" with prices continuing to "develop above the Bank's forecasts." Inflationary pressures resulting from surplus demand vs output expansion capacity, expectations near 4-year highs and price growth in global commodity markets were highlighted as core drivers and an increasing cause for concern within the MPC. Nabiullina also noted that deviations from the CPI target may be more prolonged, with CPI only expected to return to target (4.0%) in 2H22. In recent weeks, senior MPC members also argued that the near-term neutral rate should be "materially higher" than 5-6%, adding weight to both hawkish assumptions for this meeting and prior guidance towards short-term overshooting of the range to counter unanchored price pressures.

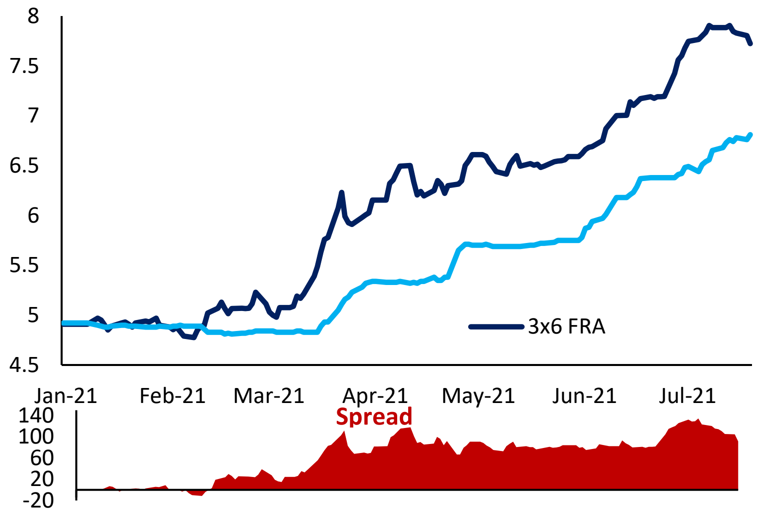
These communications, coupled with firmer demand-driven high-frequency and inflation data, underpin our base case for a +75bps rate hike at this week's meeting. However, with base effects expected to kick in in September, the prospect of a "one-off" 100bps hike remains almost equally as appealing as a means of shocking the market into paring back lofty expectations, but by the same token, could also spark concerns of unpredictability. Nevertheless, we see elevated uncertainty in the pricing outlook, alongside tentative signs of moderation in high-frequency metrics and weekly CPI, moving the CBR to take an orderly step higher whilst retaining optionality for a final hike in September. In terms of guidance, Nabiullina will likely also be careful to retain the prior meeting's relatively hawkish tone - alluding to data-dependent future developments until the deceleration in pro-inflationary factors becomes more deeply established.

Markets

Since the June meeting, USD/RUB has depreciated ~3.2% vs the USD with concerns regarding the US inflation trajectory denting investor appetite for risky assets across the EM space. Domestically, clashes with the US over cyber-security and minimal progress on addressing bilateral frictions at the Geneva summit weighed on RUB sentiment.

1m Implied vols have come off their June lows that tested key lateral support at 10.00, but remain mostly subdued and 5.36 points lower YTD. 1m vols made a near-term peak at 12.735 on 8 July, but have moderated since - broadly in line with implied market pricing mechanisms.

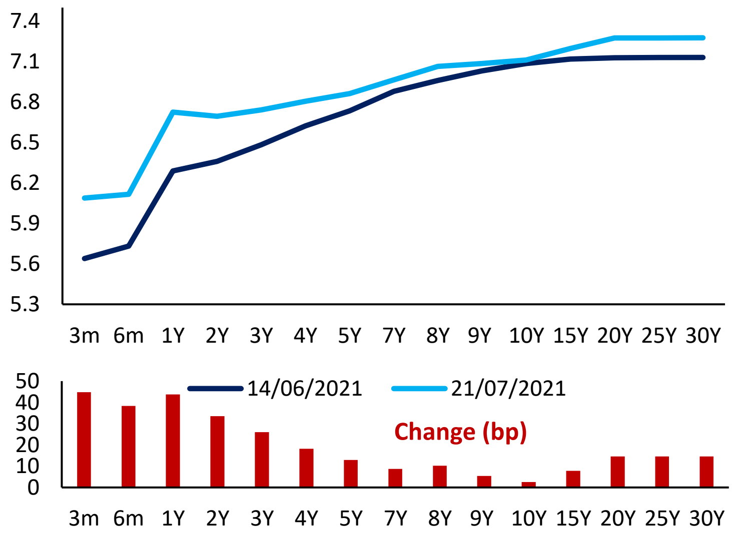
Figure 3: 3x6 FRA – Mosprime Spreads Narrow -47.5bp as Weekly CPI Falls in July



Going into this meeting, implied market pricing via 3x6 FRA-Mosprime spreads stands at +93.5bp, down from a peak of +140bps on 8 July. This paring of hawkish expectations aligns with our base case for a +75bps hike, with risks to +100bps and optionality for +25-50bps in the pipeline for September.

Additionally, price action mirrors signs of tentative peaking in weekly CPI figures, which could precipitate an eventual easing of the CBR's hawkish trajectory.

Figure 4: Term structure Bear Flattens as Hawkish Bets Gain Momentum



Since the prior meeting, Russia's OFZ term structure has continued to bear flatten broadly in line with expectations for tighter policy as CPI continues to overshoot CBR forecasts.

In line with our base case scenario, selling pressure may continue to keep front-end yields elevated, should the CBR retain its hawkish guidance and allude to the possibility of further hikes in the pipeline for September. Delivering above the base case at +100bps would likely result in an accentuated move higher.

Overall, given the relatively high USD/RUB spot price, we should see a modest firming in the RUB into and following the meeting, should the CBR deliver +75 or +100bps. With the market consensus tilted slightly towards +75bps, the outcome will be mostly priced in and depend more on Nabiullina's post-decision guidance for directionality. An anti-consensus hike of +50bps, as some are calling for (notably GS), would most likely draw concern in markets of the CBR not doing enough to stabilise rising CPI and result in a some near-term RUB weakness, provided guidance is not hawkish enough to offset market concerns.

Russia Central Bank Watch

MNI CBR Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI YoY	% y/y	6.5	5.8	↑	4.9	↑					1.99
CPI Core YoY	% y/y	6.6	5.4	↑	4.2	↑					1.55
PPI YoY	% y/y	31.1	16.0	↑	3.6	↑					1.11
Oil Price (Brent Active)	$/bbl	71.45	61.49	↑	51.20	↑					1.52
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Markit Russia Manuf PMI	Index	49.2	51.1	↓	49.7	↓					0.35
Markit Russia Services PMI	Index	56.5	55.8	↑	48.0	↑					0.89
Industrial Production YoY	% y/y	11.8	-3.2	↑	-1.5	↑					1.77
Trade Balance NSA	$bn	10.21	9.09	↑	7.39	↑					0.62
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Money Supply Narrow Def	% y/y	14.05	13.77	↑	13.83	↑					1.20
Citi Russia Terms of Trade	$	59.44	47.83	↑	37.14	↑					1.38
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales Real YoY	% y/y	27.2	-1.2	↑	-2.4	↑					2.31
Consumer Confidence	Index	-18.0	-22.0	↑	-13.0	↓					0.19
Unemployment Rate	%	4.9	5.7	↓	6.1	↓					-1.63
Real Wages YoY	% y/y	7.8	0.1	↑	0.5	↑					2.06
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market (MOEX)	Index	3722	3542	↑	3289	↑					2.26
Russia 10-Year Yield	%	2.39	2.48	↓	3.05	↓					-0.68
Russia Yield Curve (2s-10s)	bps	155.8	120.9	↑	178.0	↓					0.06
BIS Effective Exchange Rate	Index	74.15	72.71	↑	71.12	↑					1.32

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

SELL SIDE VIEW

Barclays: CBR to Hike +50bp, But Risks Skewed to +75-100bp

- Following a 0.5pp rise in CPI to 6.5% y/y in June and Governor Nabiullina's hawkish comments in the post-pandemic statement after the 50bp hike decision in June (ie, saying that the MPC discussed 50bp and 100bp hike options), expectations for the next meeting on 23 July have turned more hawkish.
- Accordingly, the Bloomberg consensus expectation has increased to 75bp from a 50bp hike previously. We maintain our expectation of a 50bp hike for three reasons.
- First, the recent elevation in inflation was primarily driven by a few individual items. On the food front, the fruit & vegetables segment contributed c.0.14pp to the 0.5pp rise in headline CPI in June.
- Similarly, tourism prices were the main drivers of higher services CPI. Food CPI is likely to stabilise in the period ahead with the help of reversal/stabilisation in global agriculture prices.
- Based on weekly CPI figures in the first two weeks of July, we estimate another 0.2pp rise in CPI to 6.7% y/y and inflation to remain stable at about 6.5% y/ in the next few months before ending the year at 5.9% y/y, and falling further towards the target in 2022.
- Second, changing the pace of hikes at this stage would increase uncertainty, which is not something the CBR would want to do. Third, although the growth outlook looks robust at this juncture, rising COVID-19 case rates increase downside risks for the growth outlook for the rest of the year.
- The bottom line is that, while we maintain our expectations for a 50bp hike next week, we agree that the risks are skewed to the upside (ie, for a 75bp or 100bp hike)

BofA: CBR to Hike +100bp in a "One and Done" Move Before Base Effects Kick In

- CBR to deliver a large 100bp "one and done" rate hike this week. The likely inflation slowdown in 3Q21 should help stop the tightening cycle at 6.5% and may launch a discussion about the timing and scale of a future easing cycle.

- CPI rose by a stronger-than-expected 0.69% mom in June, pushing annual inflation to a five-year high of 6.5%. Core CPI picked up to an even higher 6.55% yoy on the back of a broad-based acceleration across nearly all CPI segments.
- CBR chair and several other senior CBR officials, have pointed out that the near-term neutral nominal policy range should be "materially higher" than 5-6%, given high current inflation as well as elevated near-term inflationary expectations among businesses and the population.
- The actual scale of the rate hike this week may not reach 100bp. We admit that the CBR may take a more cautious approach to deliver a 50-75bp hike, leaving some place for more tightening later in the year.
- Moreover, we also note tentative signs of an inflation slowdown in mid-July, which could be interpreted as a reason for a less aggressive hike this week. However, even in this case, we think the hike will most likely be the last in the current tightening cycle.
- We still think inflation might have already reached its peak in June/early July and may start to slow in yoy terms by the time of the next policy meeting in September.
- In fact, weekly CPI for the second week of July has given the first indication that inflation may have started to slow. Weekly CPI growth has actually slowed to below last year's levels, which suggests that annual inflation might have declined yoy for the first time since April/early May.
- Such a slowdown was mainly due to higher seasonal deflation in the fruit and vegetable basket, where prices dropped 1.3% wow, as well as in hospitality as tariffs for hotel stays dropped by 0.25-3.3% wow.
- This suggests that this slowdown may intensify in the coming weeks/months, given the likely arrival of the new harvest as well as the continued normalization of international travel.
- The expected peak in inflation in coming weeks (or maybe even in late June) as well as tentative start of a new disinflation trend could bring a change in the CBR policy guidance from aggressively hawkish to a more neutral one.
- Given that the CBR may need full July or even early August data to call inflation peak, we think the Bank will refrain from a full reversal of near-term policy stance from hawkish to dovish.
- However, we may expect a discussion of the expected timing of inflation peak as well as the potential end of the overall tightening cycle. Such signals of the potential end of the tightening cycle could launch a market discussion on the timing and scale of the eventual easing cycle.
- This week, the CBR is expected to update its macro and key rate forecasts as well as publish its quarterly monetary policy report. All of this could be used to update the near-term policy view and to give a signal on the potential timing of the eventual easing cycle.
- In particular, the CBR's current forecast is most consistent with 5.75% as the terminal policy rate in the current tightening cycle and signals 25bp in rate cuts in 2023. The likely new July forecast will clearly be revised upwards to reflect the July hike and stronger-than-expected 2Q21 inflation.
- However, such a higher policy rate in 3Q21 may also bring forward the eventual policy easing from 2023 to 2022. Thus, we note that our expected 6.5%, the key rate in July already, will enter a "tight" policy range in a "steady-state" 4% inflation scenario.
- Such a level may be justified in 2021 given elevated near- term inflation, but will likely be deemed as overly tight in 2022, after all the effects of 2020 shocks are fully priced.
- We think that at least 50bp in cuts are feasible in 2022, but we will await the CBR's signal on such easing, before calling actual cuts next year.

Goldman Sachs: CBR to Hike +50bp, Uncertainty in CPI to Keep the CBR from Calling a Peak

- CBR to increase its key policy rate by 50bp, slightly below the median Bloomberg consensus of 6.25% (which has 7 in favour of a 50bp hike, 6 in favour of a 75bp hike and 4 in favour of a 100bp hike).
- We acknowledge that there are good reasons for a larger hike but, having moved in 50bp increments till now, we think the CBR will refrain from changing the size of the move at this stage, so as not to add to the uncertainty on rates.
- There is no clarity yet on where the inflation rate and inflation expectations will peak, and hence it is hard for the CBR to adjust in one step and call for an end to the cycle.
- The July meeting will be a core meeting and the medium-term forecasts will be revised. We expect upside revisions to both average and end-year inflation, and also a more hawkish average rate interval for 2021 and 2022.

- Furthermore, there could be an increase to the growth forecast for 2021, given that the CBR has stated that it sees growth as closer to +4.0%yoy in 2021 (current forecast: +3.0%-4.0%yoy) and given the recent increase of the EconMin's forecast from +3.3%yoy to +3.8%yoy.
- The Governor disclosed in a Bloomberg interview last week that hikes of 25, 50, 75 and 100 basis points will be discussed at the upcoming meeting, similar to the previous meeting.
- The Bank has also guided that, given current inflation, rates could rise above the long-term neutral range of 5-6% and could reach "moderately tight" levels. We expect rates to rise by another 100bp between now and September to +6.5%, with another 50bp hike in September.
- However, with inflation still surprising to the upside, the risk to our forecast remains to the upside. In fact, recent data have in our view raised the probability of a larger hike in the July meeting.
- Indeed, headline inflation increased by a further 0.5pp in June, from +6.0%yoy to +6.5%yoy, and inflation increased from +6.0%yoy to +6.6%yoy. The increase was mostly due to transport services and tourism rather than being widespread.
- Furthermore, activity data in May pointed to continued growth, which set household demand around 2% above pre-COVID levels (January 2020) between April and May. However, the Governor said that the Bank is putting some weight on being predictable; therefore, we believe that 50bp will be its preference.
- Also, in its assessment of the June inflation print, the Bank acknowledged that inflation momentum is still high but was showing signs of softening, and that it was expecting inflation to start falling in the autumn.
- Looking forward, given the higher starting level and momentum, our model now suggests that inflation will remain around +6.5%yoy until September and will only fall to +5.6%yoy by year-end.
- However, we still think that the inflation shock will prove temporary and that inflation will return to 3.0% next year, a similar level to that prior to the Covid shock, assuming the Ruble performs in line with the forward.
- We think this will ultimately trigger a cutting cycle back to +4.5%, the mid-point of the CBR's estimate of neutral, if inflation is at +3.0%yoy. However, the timing of this is more uncertain post the CBR's announcement that it will review the inflation target this year.

JP Morgan: CBR to Hike +100bp, +50bp More in September

- We expect the CBR to hike 100bp to 6.5%, with post-decision communications leaving the door open for potential further hikes (we expect 50bp more in September).
- Inflation momentum remained strong through June, while growth has not suffered too much in the third wave of the pandemic.
- Inflation expectations of households and businesses have remained very high. And CBR rhetoric has remained hawkish recently, stressing that much of the inflation uptick reflects demand-pull and expectations components by now, and appears less transitory.
- Risks to our rate call are skewed to the downside—the CBR may consider a smaller hike of 50bp or 75bp, but given that market pricing has shifted toward 100bp, while the CBR's preference is to frontload the tightening cycle and, if anything, to surprise on the hawkish side, we think 100bp is more probable.

SocGen: CBR to Hike +75bp, Bank Unlikely to Shift to Extra-Hawkish Mode in July

- The regulator is likely to consider a range of hike options from 25bp to 100bp, with the upper bound of the range affected by the persistence of inflation and inflation expectations.
- To recap, the CBR has raised the key rate by 125bp year to date (to 5.5%) and may raise it to 6.5% in just one meeting. After looking through the incoming pieces of data posted since the last meeting in June, we are doubtful about an abrupt switch into an extra hawkish mode and expect +75bp as the baseline scenario.
- The spike in annual inflation to 6.5% yoy in June was likely the main trigger of the recent wave of hawkish signals and divided projections from banking experts (consensus is divided between +50bp/+75bp and +100bp, but will be finalised on Monday morning).
- Before this spike, the profile of the CPI time series pointed to high risk of the annual inflation flirting with the range of 6.4% yoy to 6.8% yoy during summer months because of base effects.
- Elevated inflation expectations also caused the CBR to take an ultra-conservative position in the debate about permanent or transition inflation, which is opposite to leading central banks.

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- As a consequence, the CBR is ready to act with preventive measures and may prefer to choose from a wide range. We have been standing on 50bp options recently because of the argument: the gap of the CPI mom saar versus the 4.0% CPI target did not change that much from the previous month.
- So far, the gap in May and the key rate hike in June by 50bp were a relevant benchmark of policy response function.
- The only argument that made us revise our projection to +75bp was related to some hawkish talks about the short-term neutral rate – one of the group of experts within the CBR recommended current inflation (above 6.0%) as a relevant basis for calculating the nominal neutral rate (with a 1-2% real rate margin) versus the current 5-6% range based on 4.0% target inflation.
- We consider this recommendation exaggerated and even consider reconstruction of the pre-pandemic neutral key rate range (6-7%) premature. So far, a hike to 6.5% or higher by the end of the year might be misleading for the medium-term monetary stance.
- We have also revised our year-end inflation expectation to 5.5% (from 5.0% yoy) based on the risk of protracted price inertia in select food and non-food goods.
- However, we still see a quick reversal of inflation below the 4.0% target by the middle of 2022. As a consequence, some dovishness might be put back on the table, especially if domestic momentum dissipates quickly in 2H21 pulled back by cumulative monetary tightening and a redistribution of spare funds to savings or prepayment of credit

TD Securities: CBR to Hike +75bp, Higher CPI & Weaker RUB to Boost Hawkishness

- At the June meeting the CBR sounded decisively more hawkish:"Increased inflationary pressure in the context of the completing economic recovery can lead to a more substantial and prolonged deviation of inflation upward from the target. This creates the necessity of further increases in the key rate at the upcoming meetings".
- Over the past few weeks, three developments in particular strengthened our conviction for a 75bps hike at the upcoming central bank meeting.
- Hawkish Governor: Governor Elvira Nabiullina, in a June 28 interview, hinted that the hike could be a big one as she stated that the CBR will consider raising rates by between 25-100bps at the July meeting. She also stressed that monetary policy is the main tool to curb inflation.
- July CPI surprise: July CPI surprised to the upside and came out at 6.5% y/y (consensus at 6.4%). The upside surprise in core inflation was even more pronounced at 6.6% y/y (vs the consensus at 6.3% y/y).
- Weaker RUB: Recent EMFX risk-off and escalation of diplomatic tension with the US over the ransomware attacks have pushed USDRUB around 3% higher since the June CBR meeting. Furthermore, RUB weakness will spill over, to some extent, into CPI.
- Against this backdrop, we expect the CBR to hike 75bps and to leave the door open for more tightening.

Unicredit: CBR to Hike +75bp, Bold Decision Needed to Counter Rising CPI

- After inflation accelerated rapidly in June and in the first weeks of July (to 6.5-6.6% yoy), the market expects a bold decision.
- Recent weekly consumer price index (CPI) readings have been higher than expected, except for last week's data, which showed that momentum remains strong.
- Sectoral data also suggest that recovery to the pre-pandemic levels is generally complete, while credit activity is still high (although companies and individuals seem to be trying to utilize last opportunities to take advantage of low interest rates).
- On the other hand, inflation is mostly driven by temporary factors. The seasonality could lead to slower price increases in the coming weeks, and the economic recovery could slow.
- Hence, Russia's financial authorities should treat current price growth as temporary. We think that the CBR could deliver a 75bp rate increase, thus somewhat frontloading planned hikes for this year.
- However, while the neutral range (5-6%) will be exceeded in July, Russia's monetary authorities might not finish tightening, and another 25bp rate hike could be delivered later.
- Alternatively, the CBR could go directly for a 100bp hike next week. Accompanying comments are important to show whether the central bank sees scope for more hikes after Friday's anticipated move.