mni

All Signal, No Noise

MARKET ANALYSIS

Russia Central Bank Preview: September 2021

Details:

Monetary policy decision and release of Monetary Policy Report: 1130BST/1130CEST/0730ET, Friday 10th September 2021.

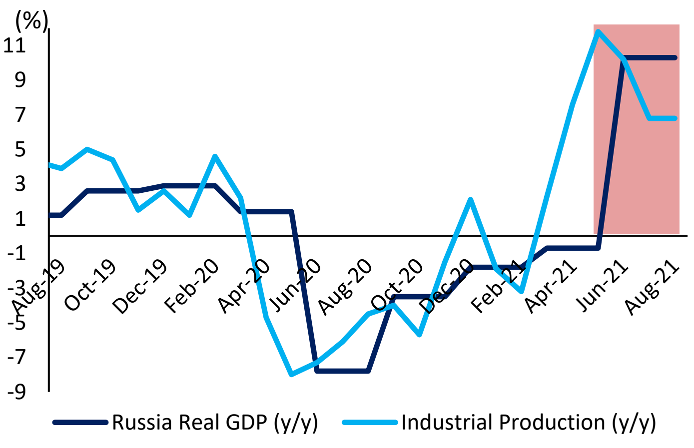
MNI Point of View

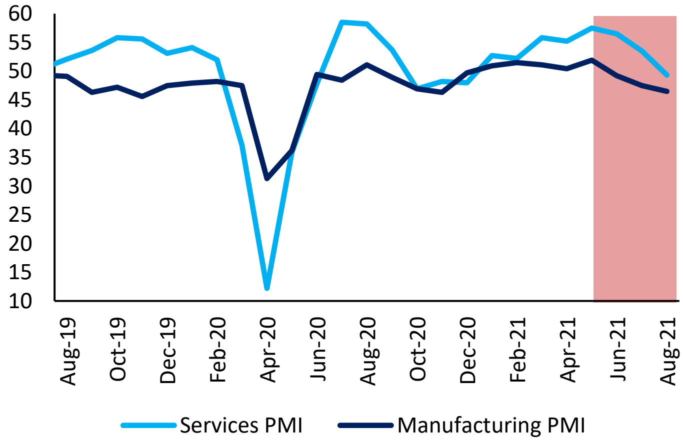
POV: CBR to Hike +50bp - The Last Dance.

The CBR is broadly expected to raise its key rate by +50bps to a terminal rate of 7.00% this week, with expectations for a September peak in CPI at 6.9% fuelling the decision for a singular larger step over two successive +25bp hikes. This should mark the end of the hiking cycle at +275bp, with base effects expected to bring a moderation of price pressures towards the 4% target into 2Q22, providing space for the CBR to initiate an easing cycle.

Headline inflation is expected to rise in August to 6.7% y/y vs 6.5% in July, with two successively higher weekly CPI prints into month-end injecting uncertainty into projections for a moderation in CPI following a September peak at 6.9% y/y. While inflation has continued to develop above the CBR's forecasts in 2021, demand-side price vectors have maintained a lower course since June - reflecting an economy no longer operating above potential.

Figure 1: High-Frequency Indicators Decelerate from June



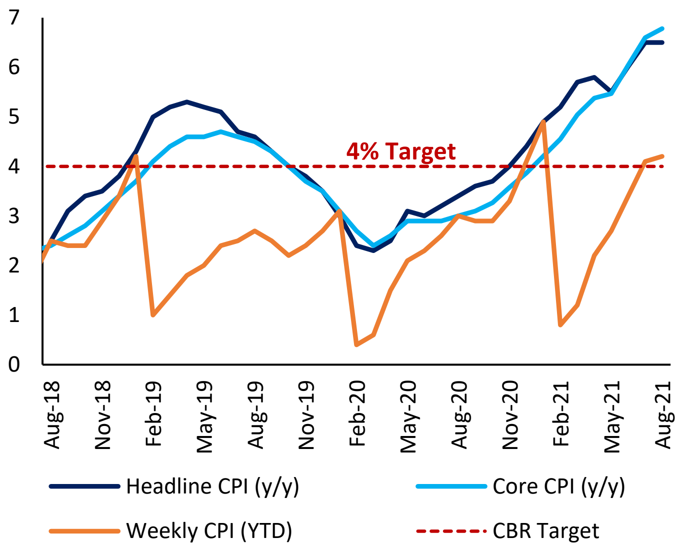


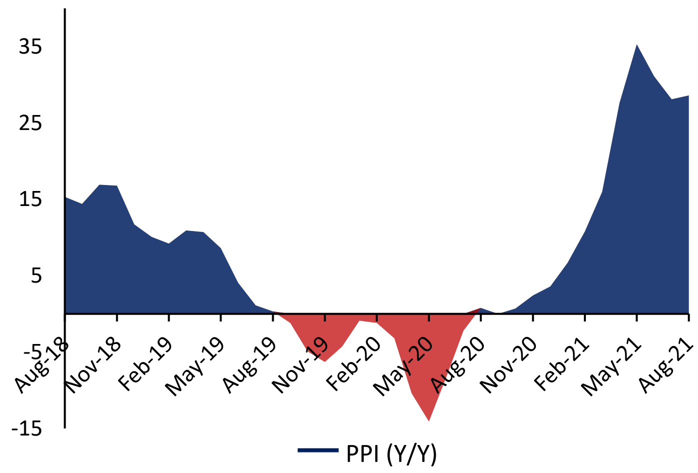
In recent months the CBR has placed outsized importance on demand-side factors in high-frequency growth data as key drivers of upside risks to the bank's pricing forecasts - which are now consolidating lower. Both Industrial production and services/manufacturing PMIs continued to slide after peaking in June with the former falling from 10.2% y/y to 6.8%, while the latter dipped to 49.5 & 46.5 respectively - solidifying the deceleration of demand pressures back in line with potential.

Conversely, although CPI continues to exhibit tentative signs of peaking, price dynamics remain well above the CBR's upper threshold of 4%. This adds weight to the case for the front-loaded +50bps step to further anchor inflation expectations which still remain at uncomfortable levels, despite having declined from 13.4%

to 12.5% in August. Similarly, PPI remains notably high at 28.1% in July, and is expected to inch slightly higher to 28.5% as supply-demand imbalances remain entrenched - breaking the trend of successively lower prints since June and adding further uncertainty. Going into year-end, CBR forecasts align with FY21 inflation closing within the 5.7-6.2% range before falling to target at 4% by mid-2022 - in line with most sell-side projections.

Figure 2: CPI Set to Peak at 6.9% in September, PPI Decline Slows in August





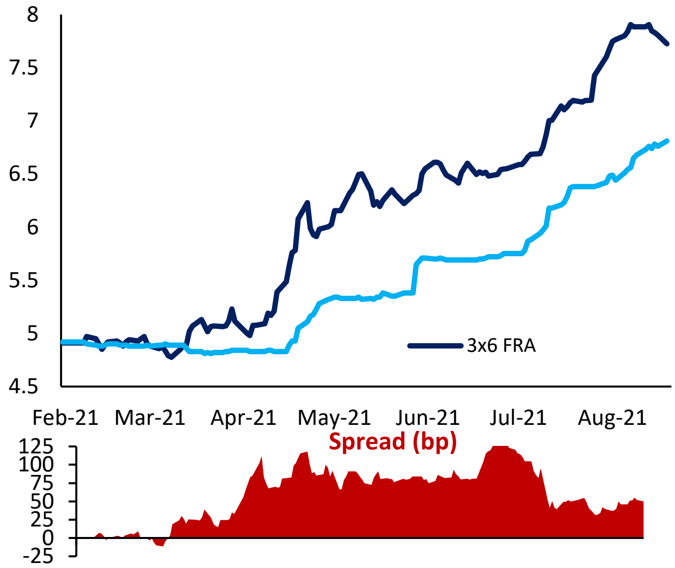
In the prior statement, the CBR softened its hawkish tone slightly in terms of forward guidance from highlighting the "necessity of further increases in the key rate at upcoming meetings" to noting that should the baseline scenario come to pass, then the Bank "will consider the necessity of further key rate increase at its upcoming meetings." Moreover, Nabiullina stressed in the presser that the CBR's forward guidance had been dialed back relative to June.

We broadly expect this marginally less hawkish sentiment to filter through into this meeting, with the CBR opting to slow the pace of hikes to +50bp, while still showing some concern about rising price pressures into September - standing ready to act if necessary. This informs our base case scenario for a near-term cap on rates into 2Q22, where the CBR will look to initiate an easing cycle, should price dynamics evolve in line with the forecast path. While some see scope for two successive +25bp hikes, we see a singular front-loaded +50bp step as more appropriate given the anticipated September peak in inflation and as an effective tool to further anchor declining inflation expectations.

Markets

Since the July meeting, USD/RUB has traded in a broad 2.75% range from 74.60-72.76 and stands -0.77% lower at the time of writing. Price action has been broadly reflective of fluctuating global risk sentiment, driven primarily by the pricing in/out of FOMC tapering and global growth concerns as markets digested relatively well-telegraphed forward guidance from various Fed speakers. Meanwhile, geopolitical risks embedded in RUB assets have subsided somewhat as bilateral ties between Washington and Moscow registered a period of relative calm as the White House grappled with the Afghan crisis.

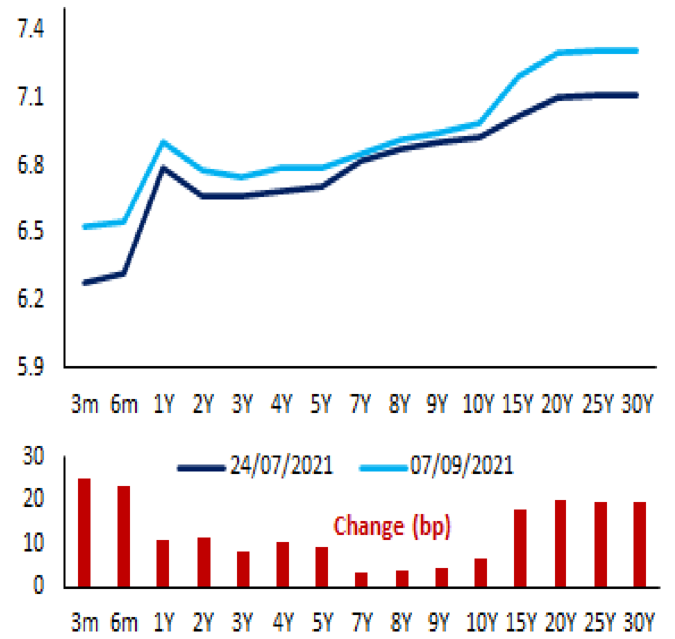
Figure 3: 3x6 FRA-Mosprime Spreads Stable Around +50bp



Going into this meeting, implied market pricing via 3x6 FRA-Mosprime spreads align with the broad market consensus for a final +50bp hike. Spreads have remained mostly stable since the prior meeting, holding within the +30-60bp range, with spot settling at +50-54bp ahead of this week's meeting.

Two weeks of successively higher weekly CPI in the lead-up to the meeting have seen spreads trading with a slight upside bias after bottoming at +30bp, but exhibiting no major concerns of an accelerated hiking trajectory over the next 3-6m period.

Figure 4: OFZ Term Structure Flattens as Markets Eye Final Hike; Outlook Becoming Constructive



Since the 23 July meeting, OFZ have also traded choppily, but weaker, in line with sustained upside pressure in weekly inflation - keeping bulls on the backfoot pending a moderation in price pressures. Nevertheless, we remain constructive in the near to medium-term on OFZs with lower implied volatility, set against a backdrop of +275bp in hikes, reduced geopolitical tensions and soon-to-be moderating inflation set to reinforce increasingly attractive vol-adjusted carry in RUB assets.

More broadly, FOMC taper fears have also proven to be overblown in terms of 2013-esque taper tantrum fears for EM, culminating in a favourable risk-on window period for high-beta risk assets to outperform. This should add weight to a constructive outlook for duration in OFZ markets, provided geopolitical risks remain muted around State Duma elections (5Y CDS at YTD lows, -10.53% since 26/07). However, the current atmosphere has no major tail risks of a material rebuild in risk premia with Russia's extensive sanctions dampening mechanisms shielding domestic assets from any major market events.

In line with our base case scenario of a +50bp hike, we may see some initial upside pressure in front end yields, which should then dissipate into September/October as hawkish expectations fade and real yields widen. With the outcome being mostly priced in, and implied volatility around the meeting moving to new lows, we should see the RUB remaining relatively well behaved following the decision - and potentially strengthening into year-end should inflation develop in line with CBR forecasts.

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	5.5	↑	5.2	↑					1.79
CPI Core YoY	% y/y	6.8	5.5	↑	4.6	↑					1.40
PPI YoY	% y/y	28.1	27.6	↑	6.7	↑					0.68
Oil Price (Brent Active)	$/bbl	72.15	67.96	↑	61.00	↑					0.78
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	46.5	51.9	↓	51.5	↓					-0.19
Markit Russia Services PMI	Index	49.3	57.5	↓	52.2	↓					-1.78
Industrial Production YoY	% y/y	6.8	7.2	↓	-2.2	↑					0.42
Trade Balance NSA	$bn	18.30	10.28	↑	10.82	↑					2.33
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	14.24	13.99	↑	13.73	↑					1.15
Citi Russia Terms of Trade	$	59.77	54.76	↑	48.74	↑					0.91
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	4.7	35.1	↓	0.5	↑					0.25
Consumer Confidence	Index	-18.0	-22.0	↑	-13.0	↓					0.19
Unemployment Rate	%	4.5	5.2	↓	5.8	↓					-1.51
Real Wages YoY	% y/y	4.9	1.8	↑	4.6	↑					0.69
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market (MOEX)	Index	4016	3722	↑	3347	↑					1.92
Russia 10-Year Yield	%	2.39	2.48	↓	3.05	↓					-0.68
Russia Yield Curve (2s-10s)	bps	170.3	146.8	↑	174.9	↓					0.12
BIS Effective Exchange Rate	Index	75.91	72.53	↑	72.33	↑					1.37

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 Deliver Final +50bp Hike, CPI to Ease in 2Q22

- At its last meeting, the Bank of Russia delivered a front-loaded 100bp hike to 6.50%, driven by the return to pre-pandemic GDP levels and prevalence of further upside risks to inflation, mainly due to fast demand growth and still high inflationary expectations.
- Furthermore, the CBR increased its end-year inflation forecast by 1pp to 5.7-6.2% y/y and growth to 4.0-4.5% y/y, noting that it “will consider the necessity of further policy rate increase at its upcoming meetings”.
- Yet, according to the estimates of the Ministry of Economy, inflation accelerated to 6.79% y/y by 30 August (vs. 6.5% y/y in July), suggesting inflation has not peaked yet. As such, we now expect CBR to hike by 50bp (from 25bp) to 7.0% in September and remain on hold through Q1 22.
- Based on the CBR’s expectations of a major downward trend in inflation next year and our projection of inflation to ease towards 4.7% y/y in Q2 22, we expect the CBR to deliver 50bp cuts in total to 6.50% in Q2 22.

Citi: CBR Set to Hike +50bp, With More Balance Assessment of CPI

- Citi assigns a 50% probability of a 50bp hike to 7.00% and issue a more balanced assessment of underlying inflation risks and 40% chance of for a smaller 25bpt rate increase, underpinned by a moderately hawkish accompanying statement.
- Such a distribution of possible monetary policy behavior would also be fully consistent with Citi’s Taylor model forecasts and would correspond to the still challenging inflation background, characterized by still rising prices and very elevated inflation expectations.
- The underlying inflation picture warrants more rate hikes by the CBR. Price pressures continue to be evident as the economy already returned to its pre-crisis level in 2Q21 and our estimates suggest that the output gap is also close to being fully eliminated.

- These demand-side considerations are matched by supply-side constraints, particularly among non-food goods, providing a fertile ground for inflation. Preliminary data suggests that Aug inflation will inch up to 6.7%YoY from its 6.5%YoY read in Jul, thus remaining at uncomfortable levels for the CBR relative to the CPI target of 4.0%. In addition, inflation expectations remain very elevated at 12.5% in Aug, even if slightly lower than their Jul peak of 13.4%.
- Even if the current evolution of price growth appears to remain along CBR's projected trajectory, which sees end-year inflation in the range of 5.7-6.2%, the risks are that by Dec the CPI will be closer to the upper boundary of that range. Hence, we think it's slightly likelier for the CBR to err on the side of caution and increase the REPO by 50bpts to 7.00%, although this would be accompanied, in our view, by a much more balanced assessment of future underlying inflation risks.
- The larger 50bpt rate hike would be consistent with our own Taylor rule forecast. The model forecasts that the REPO goes to 7.00% already in Sep and stays there for about six months, before starting to fall gradually in 2Q22 to finish the year at 6.00%.
- Beyond this particular rate decision, the next important question for monetary policy would be when to start cutting rates. Gradually moderating economic growth and favorable base argue that inflation will start losing steam towards the end of this year.
- This process should intensify into 2022 and our Taylor rule shows that rates should start falling in 2Q22 to end the year at 6.00%. This projected trajectory for the REPO should be modified, however, if the central bank decides to lower the inflation target next year.
- Citi argues that, should the CPI target be lowered to 3.0% from mid-2022, the baseline scenario of seeing lower rates over the course of 2022 would no longer be attainable as a more ambitious policy objective should require a more hawkish monetary policy.

GS: CBR to Deliver Final +50bp Hike, CPI to Fall to 3% by Mid-2022

- After the 100bp hike at its last meeting, GS sees the CBR delivering one final +50bp, from +6.5% to +7.0%, in line with the Bloomberg consensus of 7.0%
- The CBR's own guidance on rates for this year, which was confirmed by Deputy Governor Zabotkin this week, is consistent with rates rising by up to 50bp before year-end. With inflation continuing to rise more than the Bank or GS expected, GS believes the CBR will opt for 50bp rather than 25bp.
- While the pace of economic activity has slowed, the dynamics are consistent with the Bank's and GS' forecasts. In any case, GS believes the main driver of the hiking cycle is elevated inflation expectations, and although they fell slightly from 13.4% in July to 12.5% in August they remain very elevated.
- In the prior statement, the hawkishness of forward guidance was toned down relative to the June meeting. The Board moved from stating that the current situation "creates the necessity of further increases in the key rate at upcoming meetings" to saying that if the situation develops in line with its baseline scenario, then the Bank "will consider the necessity of further key rate increase at its upcoming meetings". Indeed, during the press conference Governor Nabuillina clearly stated that the CBR's forward guidance had been softened.
- July was also a core meeting, therefore the CBR also published its medium-term forecasts. As expected, GDP for 2021 was revised from +3.0-4.0%yoy to +4.0%-4.5%yoy, mostly due to the July OPEC+ decision to expand production. In the press conference, the Governor said that, according to the CBR's estimates, the new oil deal will add +0.1% to GDP in 2021 and +0.2/+0.3% in 2022.
- For 2021, household consumption was revised from +9.2-10.2%yoy to 10.1-11.2%yoy. GS is currently forecasting +9.8%yoy for 2021 and expect flat sequential growth in 2021H2. Therefore, GS interprets this forecast as having domestic demand growth below or at potential in the second half of the year. According to this new CBR forecast, GS does not see inflationary growth coming from an economy operating above potential.
- Going forward, GS believes the CBR will stay on hold for the remainder of the year, as the front-loaded hiking cycle will affect CPI and inflation expectations over the coming months. Its view of the long term remains unchanged - expecting inflation to fall back to 3% by mid-2022. 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.

JPM: CBR to Hike +50bp, But Leave the Door Open to Further Hikes

- JPM continues to expect the CBR to hike 50bp at next week's meeting and think that one bigger step (50bp) is more likely than a combination of two timid (25bp) steps—board's recent track record points to their preference for bold action, with a bias to front-load any possible future hikes.
- JPM continues to see 7.0%pa as the peak of the cycle, but suspect that CBR's post-meeting communications will leave the door open for potential further tightening in case inflation picture takes a turn to the worse.

Morgan Stanley: CBR to Hike +50bp, CPI to Peak at 6.9% In September

- The CBR meeting on September 10 will be an interesting one and will likely mark the end of the tightening cycle in Russia. Expectations are for a hike but the debate is on whether the central bank will deliver a 25bp or a 50 bp increase in the key rate.
- Inflation in Russia has been on an accelerating path since the spring months, generally surprising to the upside except for the last month. Nevertheless, our economist expects the August print, released on September 8 ahead of the CBR meeting, to accelerate to 6.7 % and eventually reach and peak at 6.9 % in September.
- Despite comments by the CBR that the price index has stabilised and is expected to start decelerating in 4 Q 2 1, the central bank is likely to deliver one final 50 bp hike. Almost half of forecasters expect a smaller hike, to 6.75%, at the point of writing.
- Inflation expectation indices such as the household survey by the CBR did decelerate in the past month and data from Markit have also shown a fall in input and output prices for a few months now.

SocGen: CBR to Hike +50bp, Paving the Way for Easing in 2H22

- A series of two weekly inflation prints in late August has muddied the waters ahead of the CBR meeting on 10 September. The prints showed a pick-up in inflation that exceeds the usual seasonal pattern and should push the adjusted monthly gain back up to 0.45-0.55% (or 5.5-6.8% annualised).
- This shift is likely to trigger another rate increase by the CBR, but how large will the hike be? Technically, following a series of seasonally adjusted monthly gains, headline CPI nosedived in July to 0.33% mom sa (SG estimate), which in annualised terms is in line with the 4.0% target. This first glimpse of success, following a series of persistently high 0.55-0.75% mom sa prints in April-June, appeared to confirm the efficiency of the front-loaded hikes delivered by the CBR in recent months (+50bp in June and +100bp in July).
- Given its end-of-year CPI projection of 5.7-6.2% yoy (SGe: 5.5% yoy) and sustainable convergence to the 4.0% target during 2022, the inflection point looks likely quite soon.
- Household inflation expectations also edged down in August, though there are still substantial discrepancies between the clusters with savings and those without. Finally, recent PMI surveys point to contractionary sentiment in the next few months, that could hamper cost-push drivers of inflation and enhance transmission of tighter monetary and macroprudential conditions over the rest of the year.
- On the other side, two strategic areas of control have emerged in recent months. First, the labour market demonstrated quite a brisk pace of recovery with the unemployment rate falling to 4.5% sa in July and a return in the number of employed to pre-pandemic levels. This does not appear to be a structural trend yet, however, as only a few industries (related to IT and e-commerce) pushed the real wage growth to 4.9% yoy in July.
- Regardless of the source of inflation expectations (either a reason or a consequence of wage growth), the CBR should closely monitor secondary effects on price growth. Secondly, the government has decided to distribute c.RUB0.9tn of additional social benefits in 3Q21.
- Those payments will not breach current fiscal rules, as they will be funded by additional non-oil income (so implied fiscal tightening will be avoided). While the payments will be one-off, they may cause some oscillation in consumer prices unless a large portion of these allowances are put into long-term savings.
- Moreover, the parameters of the 2022-24 fiscal strategy are unknown, so some easing on that side could cause additional preventive tightening by the regulator. Summing up, we would prefer the CBR to take a pause to assess the progress of the implemented measures.
- Nonetheless, we do see various risks and, given the CBR's tendency to overreact, these could be enough to lead it to raise the key rate to 7.0% by year-end. So, another front-loaded hike of 50bp could fend off concerns for at least of couple quarters and pave the way for policy easing in 2022.