CBR MEETING REVIEW: NOT THE TIME TO ACT

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Pavel Biryukov
Economist
+7 (495) 287 61 00 (ext. 2 37 46)
Pavel.Biryukov@gazprombank.ru

At its scheduled meeting today, the CBR kept the key rate unchanged at its current level of 7.5% for the fourth straight time. As before, the decision stemmed from a continued equilibrium between inflationary and disinflationary factors, albeit this time the CBR emphasized the effects of external demand on inflation and gave restrained comments regarding the improvement of inflation expectations.

The key message in the press release remained unchanged: the CBR will consider a key rate hike in case of deterioration of inflationary risks. The regulator noted that inflation may temporarily dip below 4% in 2Q23.

The CBR has kept the key rate unchanged at its current level of 7.5% for the fourth straight time, in line with both our expectations and the market consensus. During the press conference, the regulator admitted to the two options considered at the meeting: keeping the rate unchanged (CBR consensus) or hiking it (with no indication by how much).

As was the case before, the CBR's decision was based on a continued equilibrium between inflationary and disinflationary factors. On the positive side, there were the current macroeconomic statistics, pointing to a noticeable improvement of household inflation expectations, restrained growth of demand during the holiday period, unusual spring deflation in vegetable prices and a recovery in external supply. The negative set of arguments was shaped up by mounting inflationary risks amid concern over sustainability of external demand for key export goods, high growth rates of budget expenditures and overheating in the labor market, which has restrained the potential for supply recovery in the economy (for details, see our *"CBR meeting preview: Any frost in March?*" of March 13).

The new features in the CBR rhetoric are the mention of influence the external demand has on inflation and the prudent comment regarding the improvement of inflation expectations. This time, the CBR focused on the effect that a contraction of external demand may have on Russian exports. Potential ruble depreciation amid falling export revenues reflect upon inflationary pressure. That said, ruble's weakening over the past two months has not yet taken its toll on consumer prices. In these conditions, the CBR is treating the noticeable improvement of household inflation expectations in March with caution. Should further FX dynamic lead to an increase in consumer prices, household inflation expectations may deteriorate quickly, as it was the case in February. This view is entirely in line with our own one outlined in our *"CPI monitor: Romantic mood manages to leave its mark*" of March 16.

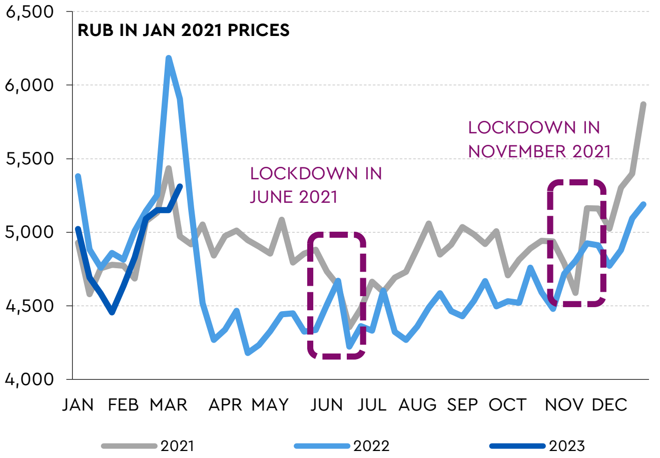
The CBR also kept unchanged its neutral estimate of monetary conditions. Despite a slight deceleration at the beginning of the year, lending activity remained high thanks to the corporate sector. The CBR also noted the contribution of budget expenditures into growth of balances on current accounts within the banking system. Going forward, an increase in the risk premium incorporated in bond yields and loan interest rates may result in additional monetary tightening, which will restrain lending activity.

The key message in the press release remained unchanged: the CBR will consider a key rate hike in case of deterioration of inflationary risks. At the same time, the CBR again stressed the importance of budget discipline: should the budget deficit expand, a tighter monetary policy may be required to keep inflation within the CBR forecast range in 2023 (5-7%) and 2024 (4%) (more details about budget revenues are available in our report of March 7 entitled *"Budget monitor: On path toward normalization"*).

The Central Bank pointed out that inflation will temporarily fall below 4% in 2Q22. Anticipating potential questions, the CBR noted that annualized inflation in the coming months will fall below 4%. However, the impression of normalization will be misleading due to a high base effect of 2Q22.

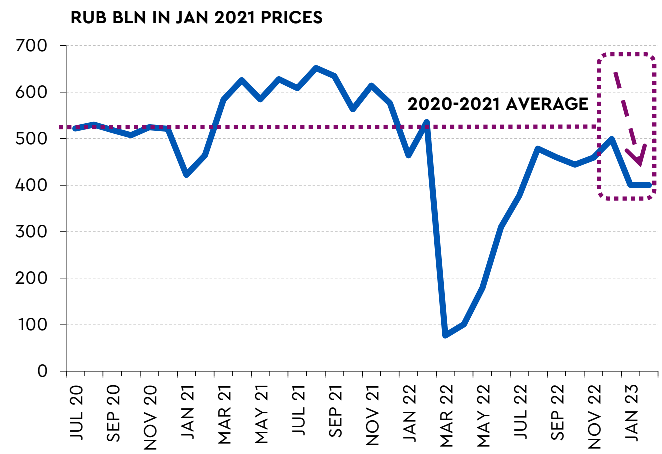
We maintain our year-end outlook for the key rate, expecting its dynamic to depend on the demand trajectory. As we noted in our report of December 6 entitled *"Russia economy 2023: Demand is everything"*, two different trajectories of demand are possible in 2023: the maintenance of currently restrained consumption or its rapid recovery. In the base case, restrained demand will allow the CBR to start reducing the rate by end 2023 and lower it to 7.25%. Alternatively, a rate hike will keep inflation within the CBR forecast range, while by end 2023 the rate would be cut to 8.5%. At the same time, acceleration of demand might be triggered not only by consumer sentiment, but also by budgetary policy and the ruble dynamic.

Chart 1. Consumption has accelerated ahead of the March 8 holiday, albeit with a lag



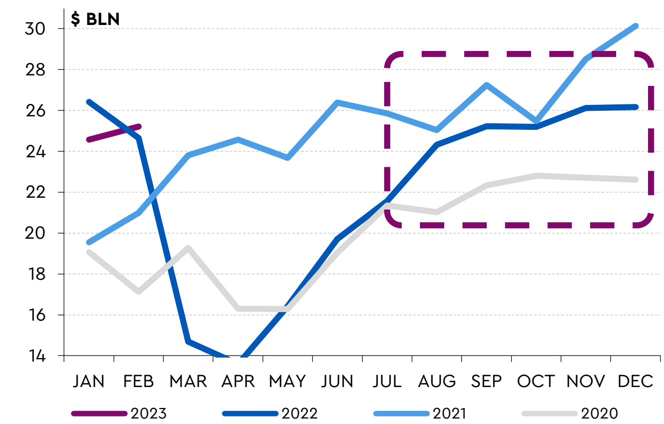
Source: Romir,

Chart 2. Unsecured lending (another proxy of consumer activity) declined again in 2M23



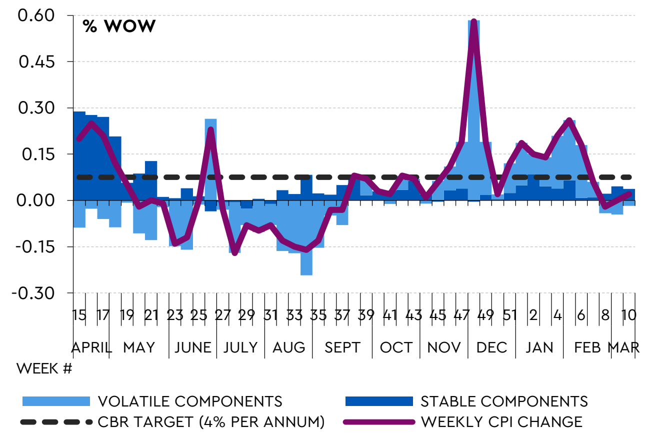
Source: FrankMedia,Gazprombank estimates

Chart 3. Since August, imports have reached the 2021 level



Source: national statistics and customs agencies, Gazprombank estimates

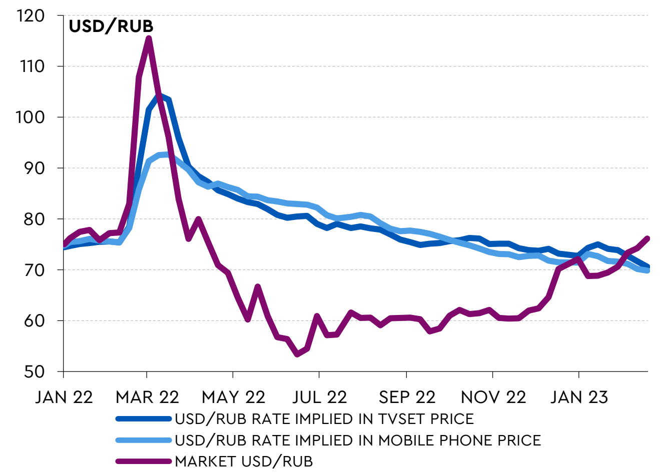
Chart 4. Spring deflation may be caused by volatile CPI components, while stable ones have remained low since May 2022



Note. The group of volatile CPI components includes prices for fruits and vegetables, meat, automobiles, imported electronic goods, passenger transportation fares and utility tariffs.

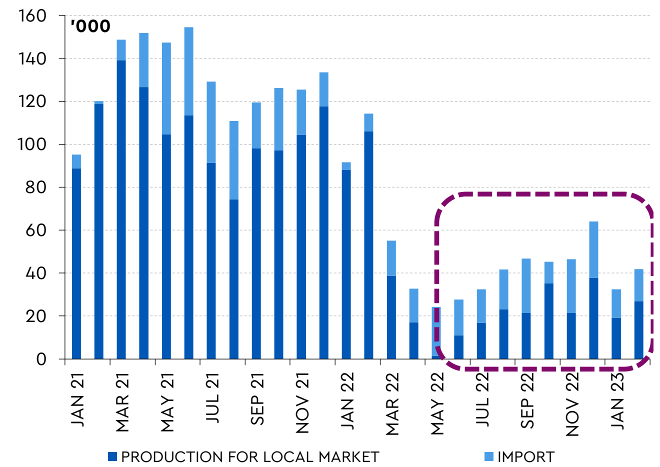
Source: State Statistics Service, Gazprombank estimates

Chart 5. Ruble weakening may again boost prices for imported electronics



Source: MOEX, State Statistics Service, Gazprombank estimates

Chart 6. Passenger car production resumed last summer



Source: AEB, State Statistics Service, Gazprombank estimates

HQ: 16/1 Nametkina St., Moscow 117420, Russia. **Office:** 7 Koroviy val St.

Research Department

+7 (495) 983 18 00

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