Russia

RUB under pressure

CBR's rate cut lifts oil price risk

- **The RUB has fallen 7% against the basket since its peak in June 2009, a drop that was much influenced by the oil price correction. However, we now see further risk to the currency stemming from the central bank's attempts to revive bank credit expansion by lowering key interest rates. Seeing the risk of a further 200-400bp rate cut, we do not rule out the rouble dropping to RUB41/basket, the upper boundary of its current trading range.**

On Friday 10 July the CBR delivered its fourth 50bp rate cut since April 2009. Apart from recent evidence of dropping inflation and increased FX market stability, the CBR was motivated by the need to revive bank lending activity. The sector's lack of credit is now widely considered as the key impediment to Russian economic recovery.

We see the risk of a further 200-400bp cut in rates this year, as bank credit growth considerations may become prioritised in the CBR's calculations. The decline in the CBR's key rates needs to be large enough at least partly to balance the remaining hurdles to credit expansion, including the lack of stable and long-term funding for banks, as well as the still uncertain dynamics of the quality of banks' assets.

Such a fall in rates is likely to trigger a further drop in the RUB, with the currency potentially testing the upper bound of its trading range versus the basket: RUB41/basket. The resulting weakening could become a stimulus to the real economy, and, more importantly from the government's point of view, it could support the profits of Russia's main taxpayers.

We do not think that by easing rates, the CBR will risk increasing inflationary pressures. This is because Russia's economy continues to operate at 15-20% lower capacity utilisation (IET surveys) compared with before the crisis, which makes it able to absorb any additional demand without increasing prices.

The implied NDF yields on the RUB are among the highest in the emerging markets. This reflects both remaining expectation of RUB weakening, and the relatively high local costs of borrowing. We expect the fall in local interest rates and resulting RUB decline is the most likely way for NDF yields on RUB to fall from current highs.

Current oil price dynamics pose additional risks to the RUB. Last week, oil prices plunged below the technically important EMA-200 level of US$63/bbl, indicating a potential further drop to US$47-54/bbl. If this happens, the RUB looks destined to weaken as well, given its greatly strengthened correlation with oil prices over the past two quarters.

FX forecasts

	1M	3M	6M	12M
USD/RUB	33.4	34.7	35.8	42.1
EUR/RUB	45.8	46.9	46.6	53.4
Basket	39.0	40.2	40.7	47.2

Source ING

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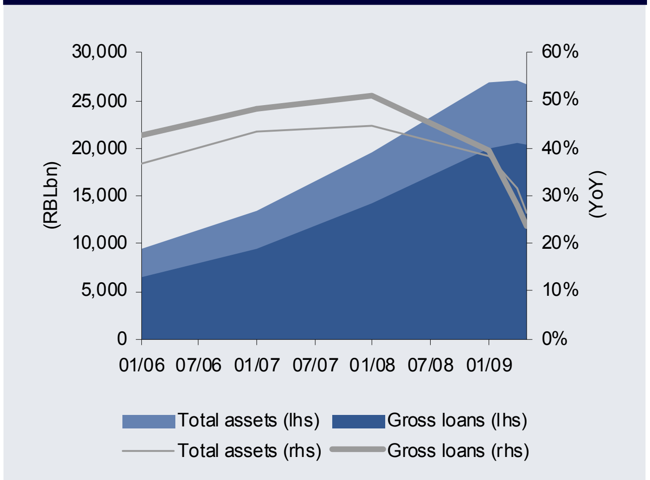
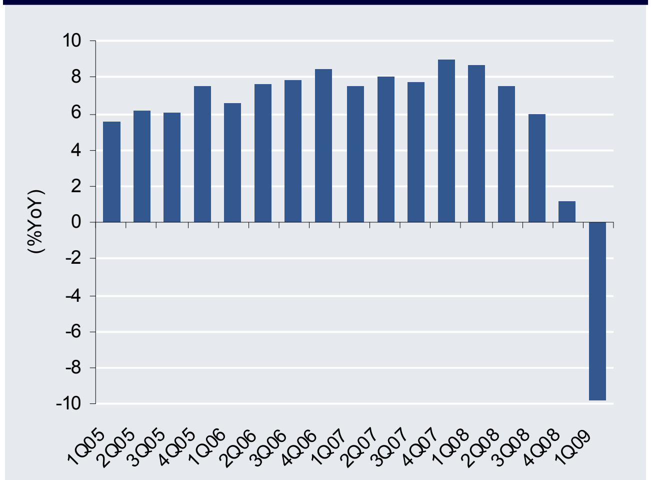
Fig 1 Bank lending dynamics



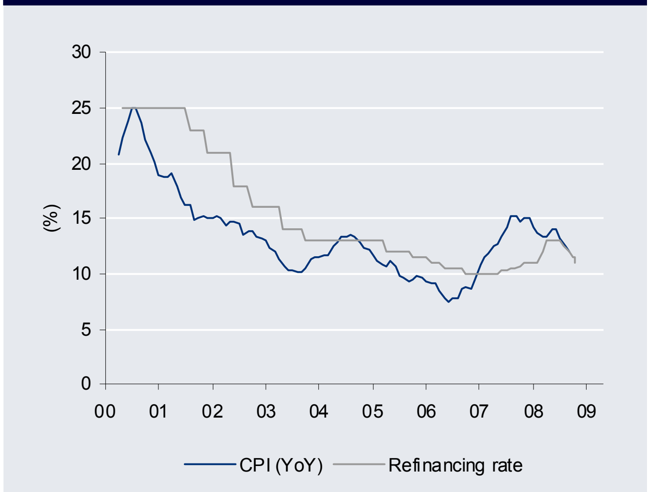
Source: CBR

Fig 2 GDP growth



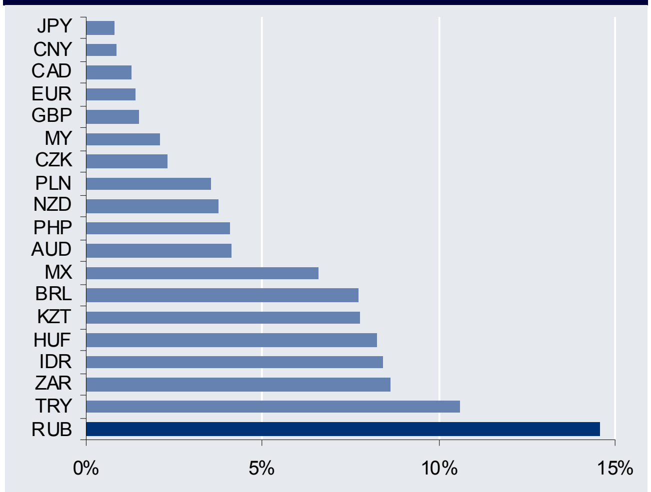
Source: CBR, Russian State Statistic Service

Fig 3 CPI and refinancing rate



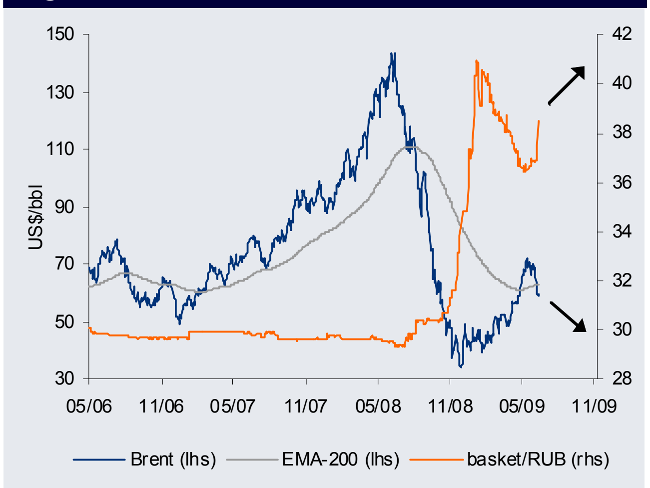
Source: CBR

Fig 4 One-year NDF implied yield



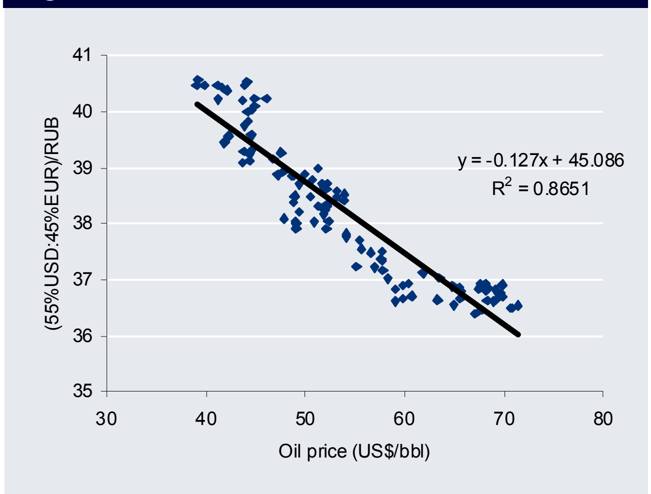
Source: Bloomberg

Fig 5 Basket vs Brent



Source: Reuters

Fig 6 Brent vs basket/RUB since Feb 2009



Source: Reuters, ING Research

Disclosures Appendix

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