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INDEPENDENT NEWS FROM RUSSIA

Russia Cuts Interest Rates to New Record Low

Central Bank fears inflation could stay low into 2021 and signals more cuts are on the horizon.

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The Central Bank has cut interest rates to a record low, as the economy enters stormy waters. **Evgeny Razumny / Vedomosti / TASS**

Russia's Central Bank has cut its key interest rate to 4.25% in its latest move to help get the Russian economy firing after the coronavirus pandemic.

The latest cut — from 4.5% — sets a new record low for Russia's interest rates, and is the third consecutive downwards move from the Central Bank since it started cutting rates in mid-April in response to the economic impact of the pandemic.

Markets expected a cut, though analysts were split between whether the Central Bank would cut by 25 or 50 basis points. The bank stuck to the more cautious approach, but in a statement signalled more rate cuts were likely to come, possibly at its next meeting in September. Most forecasts predict the bank will take rates down to 4% by the end of the year.

Inflation is currently running at 3.2% — well below the Central Bank's target rate of 4%. While cuts are unlikely to help restore inflation toward the bank's target this year, VTB Capital analyst Alexander Isakov said in a research note before the decision was published that further downwards moves signal the bank is also worried inflation could undershoot in 2021 amid a weak economic recovery.

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"The recovery of the global and Russian economies will be gradual despite the fact that the easing of restrictions revives economic activity," the Central Bank said in a statement. "In these circumstances, there is a risk that in 2021 inflation might deviate downwards from the 4% target."

The bank also updated its macroeconomic forecasts. It expects Russia's GDP to decline by 4.5-5.5% in 2020, followed by an expansion of 3.5-4.5% next year.

Governor Elvira Nabiullina also cut her assessment of the so-called neutral rate — an interest rate which does not have any impact on inflation. Speaking at a press conference in Moscow, Nabiullina said the bank now assesses the neutral rate to be between 5-6% in nominal terms, a revision of the previous 6-7% assessment. The shift is a strong signal that the bank expects interest rates to stay at a lower level than previously assessed, as Russia and the global economy emerge from the crisis.

She also spoke out against the idea of Russia investing in a Mexico-style financial hedge against another oil price crash, an idea currently being discussed inside the Russian government.

She said it would be too expensive and pointed to Russia's existing protection against oil price fluctuations in the form of the fiscal rule — a mechanism that uses profits from sales of oil when prices are high to build up foreign currency reserves, which are then drawn down when oil prices are low, thus helping to neutralize sharp volatility in the value of the ruble and knock-on effects throughout the Russian economy.