

Flash Comment

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Russia: Devaluation process initiated

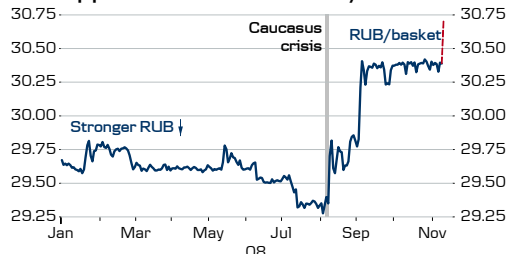
This morning the rouble weakened has more than 1% vs. its dual currency basket (45% EUR and 55% USD), as the Russian central bank (CBR) refrained from intervening at the RUB/basket 30.40 level where the rouble had been trading since the beginning of September. The market pushed RUB/basket to 30.79, before it settled around 30.70-71 – or roughly a 1% weaker RUB.

The 'devaluation' came earlier than we had anticipated, as we expected that the CBR would defend the rouble at RUB/basket 30.40 for the rest of the year, and then allow a 6% weakening of the rouble vs. the basket to RUB/basket 32.2 in 2009, and a further 6% in 2010 to RUB/basket 34.1. Clearly the risk of an even larger depreciation has now risen significantly. The move today follows comments from the CBR yesterday when Chairman Sergei Ignatyev said he would not rule out more flexibility in the rouble exchange rate and that some rouble weakening was possible. Last week an adviser to President Medvedev, Mr Dvorkovich, suggested that he could see a weaker currency going forward if the C/A balance moved markedly into negative territory.

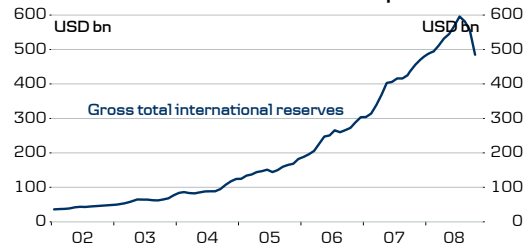
Market reaction: Equities were 7% down in early trading and trading on MICEX was suspended for an hour. After re-opening, equities are dropping further. Rates are being pushed significantly higher and basis swap spreads are widening. There is also a spill-over onto other currencies in CEE this morning.

Outlook: We expect market participants to increase bets on a weaker rouble, and this could add to the pressure on the Russian currency. Overall, we are looking for further weakness in the rouble. The CBR will try to control this process and gradually move its support level for the RUB/basket. The ultimate question is just what it will do if the market decides to exit rouble positions at an even faster pace than has been witnessed recently (FX reserves fell by USD 77bn in October). Market participants are certainly becoming more nervous as expectations rise for more RUB weakness to come. The CBR will have to tread very carefully going forward if it is to avoid creating panic in the market.

New support level around RUB/basket 30.70



FX reserves have been under pressure



Source: EcoWin, Reuters

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