Russia: Inflation makes it easier to cut rates faster

A new low in headline and core consumer price inflation raises the probability of a bigger move in interest rates at the forthcoming central bank meeting this Friday

Source: Shutterstock

2.2% YoY

CPI inflation

vs consensus 2.3%

Inflation at new record low in January

Headline CPI inflation fell to a new record low in January of 2.2%YoY, which was in line with our forecast but slightly below the consensus estimate of 2.3%. Core CPI was also better than expected at 1.9% vs the ING and consensus forecast of 2.0% and 2.1%, respectively. The lower print was mostly driven by slowing food (0.7%YoY vs 1.1%) and services inflation (3.9% vs 4.4%) with a modest decline in non-food price growth (2.6% vs 2.7%).

In the food segment, slower price growth was a function of relatively small gains in fruits and vegetables (4%MoM resulting in a -0.1%YoY annual print), and muted core food prices of only 0.2%YoY vs 0.3% in Dec-17. Non-food inflation, excluding gasoline and tobacco, drifted lower from 1.8% to 1.7%. In services, 4.3%YoY growth in utility prices came along with a 1.9% growth in services excluding utilities and transportation. However, eight out of 10 major non-regulated services saw monthly price growth accelerate, though this was offset by 0.4-0.8% price declines in health resorts & tourism services, likely due to strength in the ruble.

Plenty of room for sharp CBR policy easing

The data was fully in line with our expectations of muted price pressures. Together with anecdotal reports of low risk from the producer side, we think that the CBR's decision at the forthcoming Friday meeting will come down to just two options: to cut by 25bp or 50bp.

Our base-case remains a 25bp cut given that (i) inflation could have marked a trough and (ii) the pick-up in monthly price growth for non-regulated services and some durables may keep the CBR from surprising the market with a bigger cut for the second time in a row. However, our subjective probability is now 55%-vs-45% for the 25bp-vs-50bp option.

Our adjusted profile assumes the key rate at 7% by Jun-18, 6.50% by Dec-18 and 5.75% by the end of 2019, slowly bringing the real policy rate to 2-2.5% under our sub-4% inflation forecast.