

Russia Economic Review

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The CBR kept its policy rate unchanged at 10.5%, but may return to rate cuts in the autumn as the disinflationary trend accelerates. The services PMI came out at 55, suggesting that the economy is gaining momentum.

- The CBR maintained its key interest rate at 10.5%, but with relative stability on global markets and a sustained disinflationary trend, there is a chance of rate cut in September.
- The negative weekly inflation reading on 1 August was the first since September 2011, suggesting that disinflationary trend accelerates.
- July's services PMI came out at 55pts after being above 50pts for six consecutive months suggesting that the Russian economy is gaining momentum.

Russia's central bank maintained its current interest rate at 10.5%

On 29 July Russia's central bank (CBR) decided to keep its key interest rate (one-week repo rate) of 10.5% unchanged and this decision was in line with the Bloomberg consensus forecast. While the CBR forecasts that economic growth will probably return positive later this year on a quarterly basis and to positive, albeit moderate, annual growth from next year and the disinflationary trend strengthens, the latest downward move in oil prices has weighed on the rouble and, unsurprisingly, on the CBR's decisions too, making them rather opportunistic.

Nonetheless, the proactive stance of BoE to mitigate the post-Brexit shock and the relatively calm, compared to last year's volatility caused by worries about the Chinese economy, the market reaction give some relief to emerging markets, Russia included, and we expect the CBR to put rate cuts back on the table in the autumn, should the status quo on global markets be sustained. Indeed, the CBR expects inflation in July 2017 to be 5%Y/Y and to reach the inflation target of 4%Y/Y at the end of that year.

Disinflationary trend pace upbeats expectations

The July inflation rate came out at 7.2%Y/Y, down by 0.3ppt compared to the previous month and 0.2ppt below the Bloomberg consensus forecast. On a monthly basis the inflation rate was 0.5%M/M a touch above the monthly inflation in June of 0.4%M/M. Core inflation of 7.4%Y/Y also follows the pattern, down by 0.1ppt on the previous month. Monthly core inflation in July was 0.3%M/M (0.4%M/M in June). Food prices rose in July by 6.5%Y/Y (0.0%M/M), food prices without fruit and vegetables by 6.7%Y/Y (0.5%M/M), non-food up by 8.4%Y/Y (0.4%M/M) and services up by 6.5%Y/Y (1.7%M/M).

And while the summer is traditionally a "season of low inflation" thanks to lower prices of fruit and vegetables, the negative weekly inflation of 0.1% in 1 August came as a surprise, because even on a weekly basis negative inflation is very rare in Russia – the last time negative growth of prices was registered for two weeks in August and one week in September in 2011. While a good harvest is definitely playing a role in a faster than expected disinflationary pace in July-August the deflationary effect from continuing sluggish domestic demand also can't be dismissed.

We see a possibility that negative monthly inflation rate can be reported in August, should the above trends persist. And if this is the case, the possibility that the CBR will decide to cut interest rates at its next regular board meeting on monetary policy scheduled on 16 September, is fairly high.

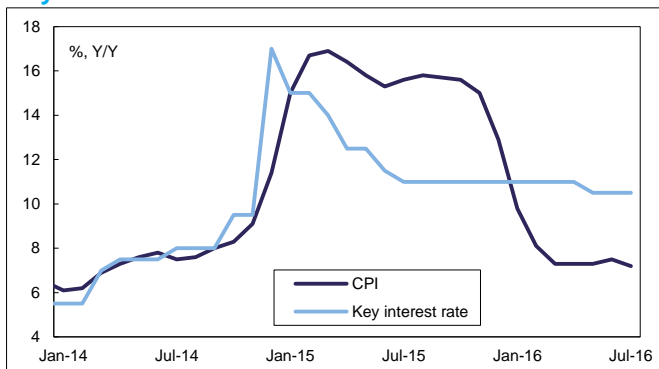
July's services PMI came out at 55.0 - the highest level since February 2013

While July's manufacturing PMI of 49.5 was softer than expected - 1.5pts below the Bloomberg consensus forecast and down 2.0pts compared to the previous month, as new orders were a bit weaker and output grew only marginally, the services PMI, which came out at 55.0 (being in expansion territory above 50pts for six consecutive months) suggests that the Russian economy is gaining momentum.

In the service sector the new orders sub-index grew at the fastest pace in three and half years and employment also increased for first time in almost 2.5 years, suggesting that the upside trend will probably continue. Thanks to the higher services PMI, the composite index in July has been maintained at 53.5 – the same level as a month ago.

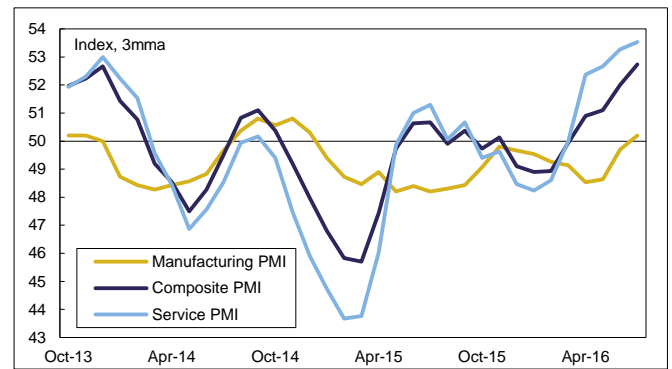


Key interest rate and CPI



Source: Russia's Central Bank and Daiwa Capital Markets Europe Ltd.

PMIs



Source: Markit and Daiwa Capital Markets Europe Ltd.

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