

# Flash Comment

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## Russia: Bad news on inflation

September inflation numbers were published today by the Russian Federal Service of State Statistics (RFSS). Consumer prices (CPI) rose 0.8% m/m (non seasonally adjusted) – significantly above our and consensus expectations of 0.4% m/m.

Year-to-date inflation is now 7.5% in the first nine months of the year, compared to 7.2% y/y in the same period in 2006. The risk to inflation in 2007 is that it will now exceed the 9.0% y/y that was seen in 2006.

Breaking up the data shows that food prices rose no less than 1.0% m/m – not a big surprise given the latest rise in international grain and sugar prices. The non-food component rose 0.8% m/m, while services added 0.4% m/m. FRSS said that core inflation rose no less than 1.6% m/m.

Today's numbers are really bad news for the Russian authorities, who have made it a high priority to bring down inflation to no more than 8.0% y/y in 2007. Now it looks like price growth will be higher than last year. How can we expect the authorities to react to these numbers?

The authorities have lately shown their willingness to carry out protectionist policies – tariffs and exports duties on sugar and grain – to keep local food supply as high as possible in order to reduce pressure. This is in our view not the way to reduce the overall inflationary pressures in the economy.

The monetary authorities should rather be more focused on tightening the monetary conditions in order to reduce the overall inflationary pressures in the Russian economy. On this issue the authorities have received a “helping” hand from the global credit crunch, which has made local Russian banks tighten up their lending policies to private households. This will have the effect of reducing growth and thus the inflationary pressure, but is it enough?

We would certainly urge the central bank (CBR) to tighten even further – and as it looks right now the best way to do this would be to allow the rouble to strengthen against the dual currency basket. We are however not sure that CBR will allow much more appreciation in the rouble this year – no more than 0.25%. We maintain our 12 months forecast on 1.5%-2% appreciation in the rouble.

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