Russian CPI: Reversal incoming

The recent USD/RUB depreciation may put additional upward pressure on the CPI, which even before the recent oil price shock was showing subtle hints of reversal from disinflation. Our 3.7% expectation for year-end 2020 may go up by 0.5-0.8 percentage points, which however is not enough to call for emergency key rate hikes

Crowds at the Moremoll shopping centre in Sochi, Russia

2.3%

Higher than expected

CPI growth in February (year-on-year)

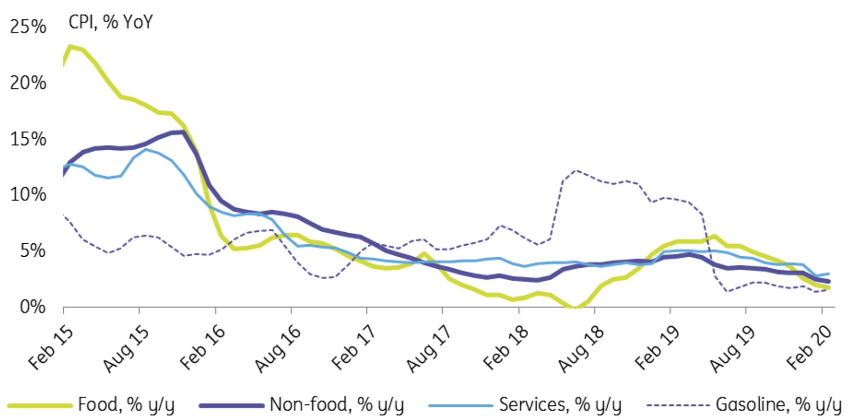
down from 2.4% YoY in February

CPI trend was about to reverse even before OPEC+ collapse

Russian CPI growth decelerated from 2.4% year-on-year in January to 2.3% YoY in February, in line with our expectations, but 0.1 percentage point (ppt) higher than the consensus. This is the first case of monthly CPI outperforming market expectations since December 2018, when inflation was accelerating ahead of the VAT hike. Subtle upward price pressure has been seen in the services and food product segments so far, but may soon be joined by the non-food products as well.

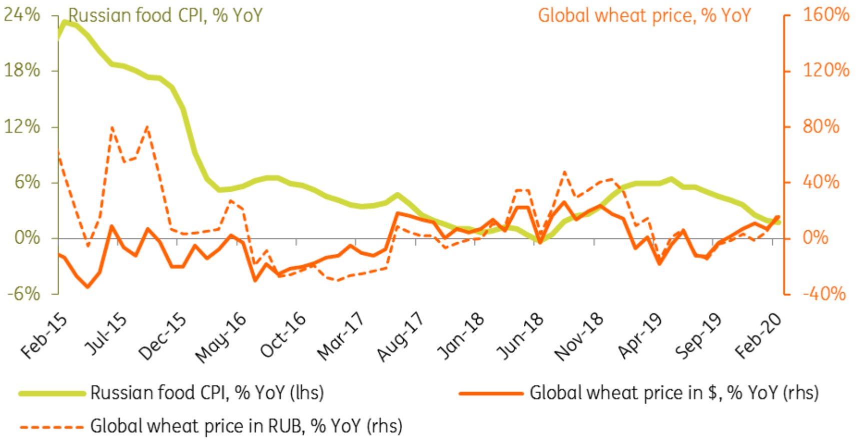
- The most obvious area of upward price pressure is in services (27% of consumer basket), which accelerated from 2.8% YoY in January to 3.0% YoY in February (see Figure 1) due to increased public transportation tariffs and mobile network charges. We note that foreign tourism price growth did not accelerate, as the 7% USD/RUB depreciation in the first two months of the year has not yet translated into final prices and might have been constrained by the apparent drop in demand for foreign travel. Prices for medical services also did not accelerate, however this will be a sector to watch given the spread of the coronavirus outside China.
- Price growth in the food segment (38% of consumer basket) continued to decelerate - from 2.0% YoY in January to 1.8% YoY in February - however this slowdown is not as deep as suggested by the higher base effect (c.0.4 ppt) caused by the upward price pressure seen in February 2019 after the VAT hike. The subtle increase in the upward price pressure may be caused by a recovery in global agro prices, to which Russia is sensitive. Global wheat prices posted 16% YoY price growth in USD terms (18% YoY up in RUB terms) in February after a more or less flat 2019 performance (see Figure 2). Historically, each 10 ppt of global wheat price growth in RUB terms translated into 1 ppt of Russian food price inflation, eventually adding 0.4 ppt to the overall CPI growth.
- Non-food products (35% of consumer basket) continued to show a disinflationary trend, with price growth decelerating from 2.5% YoY in January to 2.3% YoY in February in all key components except a minor 0.2 ppt pick-up in gasoline price growth to 1.6% YoY in February. Going forward, the key sectors to watch will be import-dependent household appliances, consumer electronics, pharmaceuticals and clothing, which are the main conduits of the FX pass-through effect on the consumer side. Meanwhile, the recent acceleration of public spending to 53% YoY in January suggests that budget policy is unlikely to be as strong a disinflationary factor as it used to be last year.

Figure 1: Services CPI increased, higher pressure in food CPI masked by base effect for now



Source: State Statistics Service, Bank of Russia, ING

Figure 2: Global agriculture prices see recovery in 2020 after flat 2019



Source: State Statistics Service, Bloomberg, ING

USD/RUB depreciation YTD may add 0.5-0.7 ppt to year-end CPI expectations

The higher-than-expected CPI in February is only the first sign of a forthcoming reversal, which we expect to take place in March-April for the following reasons:

- High base effect of 1Q19 (related to VAT hike) is about to expire after March
- Budget policy will no longer be as disinflationary as in the previous five years, evident following the recent government reshuffle
- RUB performance year-to-date (c.15% depreciation to USD) including the recent response to the oil shock has negated the 12% appreciation seen over 2019, suggesting no further disinflationary support from FX.

As a result, our call for a recovery in CPI growth from the current levels to 3.7% no longer appears pessimistic from a cost inflation perspective. Given the apparent decline in sensitivity of Russia's CPI to RUB depreciation from 10% to 3-5%, the 15% YTD USD/RUB depreciation creates potential 0.5-0.8 ppt upside to CPI expectations.

Meanwhile, as we pointed out earlier, the scale of those additional CPI risks is not large enough to call for emergency key rate hikes (unlike the cases of 2014 and 2018). We reiterate that with the moderate inflationary impact of the recent depreciation, downward global rate cycle, and the high level of the Russian real rate, a halt in the Central Bank of Russia's key rate cutting cycle (instead of previous expectations of two 25 basis point cuts in March and April) would appear an appropriate reaction.

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