

Russia: Broad-based CPI slowdown

Russian CPI showed a broad-based slowdown to 4.0% year-on-year, challenging year-end targets and fuelling expectations of a key rate cut at the 25 October meeting. The likelihood of that decision has indeed increased, but it is still not our base case, as the near-term CPI trend is only one of many factors the central bank will consider



Source: Shutterstock

4.0% YoY

Lower than expected

Russian CPI growth,
September (YoY)

Down from 4.3% YoY in August

September CPI slowdown stronger and more broad-based than we expected

Russian CPI slowed from 4.3% YoY in August to 4.0% YoY in September, which was in line with the consensus forecast and slightly below our more conservative expectations. The key observation is

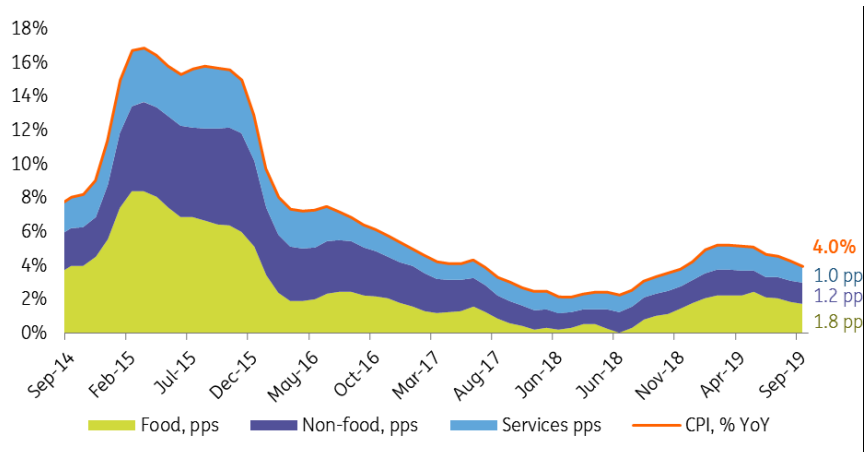
that unlike the August slowdown, which was similar in scale but driven mostly by the volatile fruit and vegetable segment, the September deceleration was broad-based:

- Food CPI (c.38% of the CPI basket) growth slowed from 5.0% YoY to 4.6% YoY despite the acceleration of fruit and vegetable price growth from 1.3% YoY to 1.8% YoY
- Non-food CPI (c.35% of the basket) growth slid from 3.5% YoY to 3.4% YoY amid a stable 2.2% YoY growth of local gasoline prices
- Services CPI growth slowed from 4.0% YoY to 4.0% YoY.

As a result, while in the previous 3-4 months only the food segment contributed to the CPI slowdown, the September deceleration was equally distributed among the three key segments. A detailed breakdown of the CPI performance suggests that Russian inflation was pushed down by global agricultural prices, which continued to decline in annual terms, and by a strong ruble performance, which helped to bring down prices for consumer electronics and foreign travel expenses. Unlike some market participants and members of the government, we do not tend to overemphasise the role of demand constraints to CPI, as the latest Rosstat statistics indicate a recovery in local consumption and investment trends in 2Q19, while the latest confidence polls showed a marked increase in consumer confidence to 93 points in September from 90 in August and 86 at the beginning of 2019.

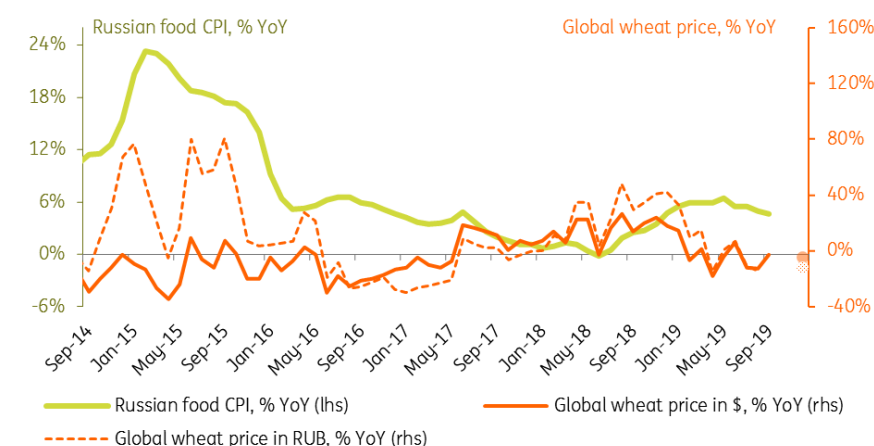
Given the weaker-than-expected CPI performance so far and some decline in global wheat price expectations from flat YoY to -5% YoY by the year-end, we lower our year-end inflation forecast for Russia from 4.0% YoY to 3.7% YoY, significantly below the Bank of Russia's year-end target of 4.0-4.5% forecast range.

Russian CPI growth by components (contribution to total, in pps)



Source: State Statistics Service, Bank of Russia, ING

Global wheat price growth and Russian food CPI, % YoY



The case for another key rate cut on 25 October is strengthening, but the CBR may still decide to wait

Lower-than-expected CPI comes as one of several arguments that may weigh on the Central Bank of Russia key rate decision at the 25 October meeting.

After the 25 basis point cut to 7.00% in September:

- inflationary expectations by Russian households and corporates have improved
- downward pressure on global key rates has intensified
- the ruble exchange rate has recovered its August losses.

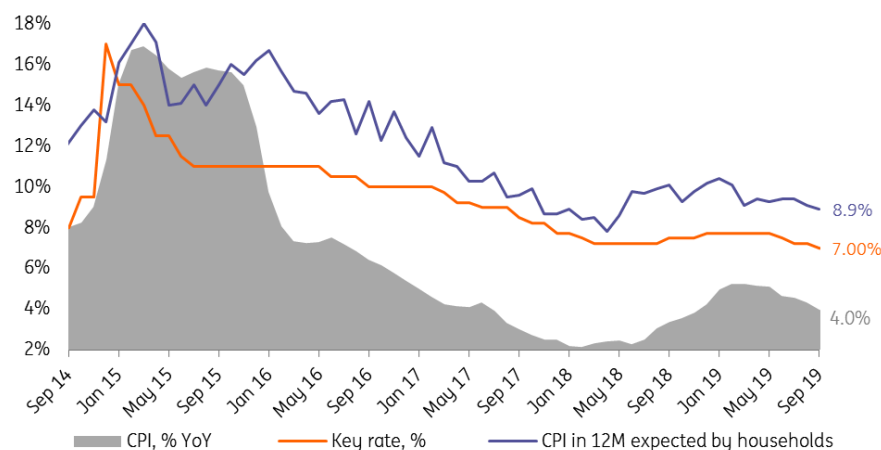
As a result, it is no surprise that the market has taken the recent comment by the deputy head of CBR Kseniya Yudaeva on the 'room for further cuts' as a hint of a fourth consecutive cut at the upcoming meeting.

We agree that the key rate of 7.0% has room for further cuts (we see the terminal rate at 6.5% next year), and expect the CBR to seriously consider such a move in three weeks, but expect uncertainty on this matter to persist until the last day and see several reasons why the pace of the cut cycle could be slower than the doves believe:

- Financial markets are still facing risks of increased volatility on trade tensions (10/11 October US-China talks may disappoint), global growth concerns, persisting foreign policy risks for Russia
- As the key rate has entered the neutral 6-7% range, the CBR actions should now be dictated more by the longer-term CPI trend, which is still facing risks related to upcoming acceleration in the budget spending growth from 5-6% YoY in 9M19 to 18% YoY in 4Q19, and the potential additional budget policy easing in 2020 through local investments of the National Wealth Fund, with the sum still under discussion (the initial RUB200-400bn indicative range may still be revised upwards)
- The improvement in the local demand indicators mentioned above lower the urgency to ease the monetary policy in Russia, especially given that the Russia tight control over the non-monetary CPI factors has yet to be established

- Though not necessarily the first and most important argument in favour of delayed cuts, it is worth keeping in mind that in the face of a sizeable net placement of RUB1.7tr worth of local state bonds (OFZ) planned for the next year, it would be better to start 2020 with more room for a key rate cut, rather than less room. This year's placement plan is already close to fulfillment.

Russian CPI, inflationary expectations, and key rate



Source: State Statistics Service, Bank of Russia, ING

Based on the September CPI performance we improve our year-end outlook from 4.0% to 3.7% and acknowledge the higher likelihood of a key rate cut at the upcoming 25 October meeting, which however is still not our base case. We believe it would be better for the Bank of Russia to start next year with a bigger scope for cuts, given the uncertainties related to the external environment, local budget spending and the sizable OFZ placement programme.

Author

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose

possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.