Russia: CPI pressure mounting

CPI accelerated to 3.1% year on year in April and is likely to continue in the coming months, mainly due to the pressures in the food segment and despite disinflationary services. Nevertheless, this is unlikely to prevent Bank of Russia from making at least one 50 bp cut, especially if the fiscal stance remains conservative

A man making a choice in a Russian supermarket

3.1% YoY

Russian CPI growth in April

up from 2.5% YoY in March

As expected

Russian CPI accelerates due to food and durable goods, while services disinflate

Russian CPI growth picked up from 2.5% YoY in March to 3.1% YoY in April, in line with consensus and slightly underperforming our 3.2% expectations. We expect inflation to continue accelerating at least till the end of June, likely exceeding 4% by mid year.

- Food segment (38% of the consumer basket) has been the primary driver of acceleration, picking up by 1.3 percentage points to 3.5% YoY in April. Looking into the composition, higher inflationary pressure is seen in the majority of food items, which suggests that it is driven by the demand side (stockpiling of products with distant expiration date) but also by the cost input side. As we mentioned earlier, grain prices, which have a significant pass-through into the entire food basket, have picked up materially. Global wheat prices, after being flat YoY until February, are now up 25% YoY in USD terms and 45-50% YoY in ruble terms. Given the long-established sensitivity (each 10 pp of wheat price growth in RUB terms translates into 1 pp of food inflation in Russia), Russian food CPI can pick up by another 2.5-3.5 pp from the current level, translating into 1.0-1.4 pp upside to the overall CPI in the coming months.
- Non-food products (35% of the consumer basket) CPI picked up by 0.3 pp to 2.8% YoY in April. Unlike the food segment, non-food products are showing an uneven performance, with consumer electronics, household chemicals, and pharmaceuticals showing higher inflation (due to a higher share of imports and higher demand on those products), while other durables, such as clothes and gasoline, posting no acceleration. We believe the 16% USDRUB depreciation YTD combined with hightened demand for some of the non-food products suggest that the scope for further acceleration in the non-food CPI is not yet exhausted.
- Services (27% of the consumer basket) CPI decelerated by 0.1 pp to 2.9% YoY on an obvious lack of demand and the lack of opportunity to provide them. The most notable and also unsurprising in the current conditions is the lack of any pick-up in the prices for foreign tourism. Going forward, we expect services to show a mixed performance, as the disinflationary effect of weaker demand will be contrasted by FX-driven inflationary pressure in foreign tourism along with a gradual removal of travel restrictions.

Monetary easing likely to continue anyway

We do not see accelerating CPI as an obstacle to further cuts in the key rate from the current level of 5.5%, and see at least one 50 bp cut in the near term, at the June policy meeting, for the following reasons:

- Acceleration of CPI appears temporary, as the exhaustion the effects of agro inflation and RUB depreciation, combined with mounting disinflationary pressure of demand, should bring Russian CPI back on the downward path in 2H20, provided no new shocks take place.
- The deteriorating outlook on economic activity amid the continuing Covid-19 lockdown and so far modest fiscal support of under 3% of GDP is calling for de-prioritization of the near-term CPI trend in Bank of Russia's decision making. Despite some relief in the quarantine measures after 11 May, it appears that most of the major cities, consumer and transportation business will remain on lockdown at least until the end of May. That makes our 2.5% GDP drop forecast for 2020 highly optimistic at this point.
- Based on the comparison of real rates among Russia's direct EM peers, we see a 50 bp cut as non-damaging to Russian assets from the real rate perspective. In addition, Bank of Russia's sizable FX sales of US$6.8 bn in March-April suggest a priority of direct support measures to the financial markets as opposed to interest rate tools.

At the same time, scope for further easing remains debatable and will largely depend on the actual scope of fiscal stimulus in Russia and its effect on overall ecnomic and consumer activity and the long-term CPI trend.

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