

Russia: Inflation takes a pause in May

Russian CPI slowed to 3.0% year on year in May, but may crawl back to 4.0% in the summer as lockdown constraints are eased.

Nevertheless, the 5.5% key rate has scope for reduction. Given the recent central bank guidance, a total of 150 basis points in rate cuts is quite plausible, including 50-100bp on 19 June



A man making a choice in a Russian supermarket

3.0

May CPI growth, % YoY

down from 3.1% YoY in April

As expected

CPI down 0.1 pp in May - a temporary rollback?

Russian CPI slowed from .1% YoY in April to 3.0% YoY in May, in line with market consensus and our expectations. We take this move as not very indicative and expect some recovery in price growth as the gradual easing in the Covid-19 related restrictions will restore supply and demand for

consumer goods and services. We have the following observations from the May CPI statistics:

- Food (37% of the consumer basket) price growth decelerated from 3.5% YoY in April to 3.3% YoY in May, being the key driver of the slowdown in the overall CPI. This slowdown in the food segment took place partially due to the high base effect of May 2019 (around 0.5 percentage points). We also note that the price performance within the food segment last month was highly uneven by item: bread, meat, dairy, and vegetables saw disinflation, whereas grains, eggs, and alcohol saw faster price growth. This can be explained by conflicting effects of supply-side cost inflation and the drop in demand. Meanwhile, the continued global grain price growth (May wheat price was up 4% YoY in USD terms and 11% in RUB terms) is likely to keep upward pressure on cost inputs in Russia, while the recent studies of local consumer sentiment suggest that recovery in demand for food is a matter of several weeks to several months.
- Non-food products (35% of the basket) showed stable 2.8% YoY price growth, despite the low base effect (around 0.7 pp), with little divergence by item. It appears that inflation in this segment is significantly constrained by the recovery in the ruble exchange rate after the March shock, and by the drop in consumer demand. According to various studies of consumer sentiment, it will take several months before consumer demand for most non-food items will start to recover, however some categories, such as clothes and cosmetics may recover early into the relaxation of quarantine measures, which are taking place in June.
- Services price growth accelerated modestly from 2.9% YoY to 3.0% YoY, reflecting higher CPI in transport and communication services. Foreign tourism also saw limited price growth due to the weaker ruble YTD, however with a lack of actual supply of those services it remains unclear how indicative this item is. According to the consumer sentiment studies, Russian households cut their travel spending by 40-50%, and do not see any material recovery at least until the end of this year. This on one hand confirms our expectations of foreign travel expenditures being down around US\$20-25bn from their normal US\$45-50bn annual level. At the same time, it cannot be excluded that in the mid-to-higher income segment foreign travel expenditures could be substituted with local goods and services, somewhat softening the blow for the local consumption.

Overall, we expect some recovery in CPI growth to 4% YoY during the summer amid relaxation in the Covid-19 related restrictions and statistical base effects.

Scope for further cuts in the key rate remains significant

The expectations of higher CPI are in no way an obstacle to further cuts in the key rate, currently at 5.50%.

In her bi-weekly press-briefing on 5 June, Central Bank of Russia governor Elvira Nabiullina largely reiterated her dovish but nuanced signals we discussed [earlier](#). On the dovish side, she mentioned the decline in near-term inflationary risks compared to the assessment made at the time of the previous key rate decision – thanks to the stronger ruble and weaker demand. However, she limited the dovishness by highlighting that 1) the May CPI trend is in line with the 4.0% seasonally adjusted annual growth rate, and the current numbers can be noisy because of the lockdown; 2) high frequency data suggests consumption strength is actively recovering; 3) a 100bp cut remains on the agenda for the 19 June meeting as one of the possible options, and answering the question on whether a

cut of over 100bp is possible for this month's meeting (as was the case for the previous meeting, when the CBR opted for 50bp), she highlighted that the CBR prefers to act gradually in order to avoid shocks for banks' funding.

Based on the CPI trend and CBR statements, we reiterate our view that the key rate has a downside of up to 150bp from the current 5.5% level (the lower limit being the real key rate of zero under the assumption of 4% CPI in the long-term), with the most likely decision range for the 19 June meeting being between 50-100bp. Meanwhile, if the summer months reveal continued CPI underperformance relative to the CBR's target, we do not exclude that the medium-term key rate floor can temporarily fall below 4.0%.

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