

Russian CPI below expected in 2019; key rate downside still limited

CPI dropped to 3.0% YoY in December, at the lower bound of Bank of Russia's forecast range, and is set to temporarily fall close to 2% in 1Q20 on a high base effect. This, however, does not guarantee a rate cut on 7 February as the CPI slowdown relies only on the food component, while inflationary expectations of households and corporates are deteriorating



Crowds at the Moremoll shopping centre in Sochi, Russia

3.0%

Inflation at year-end 2019, YoY

Down from 3.5% in November 2019 and 4.3% in December 2018

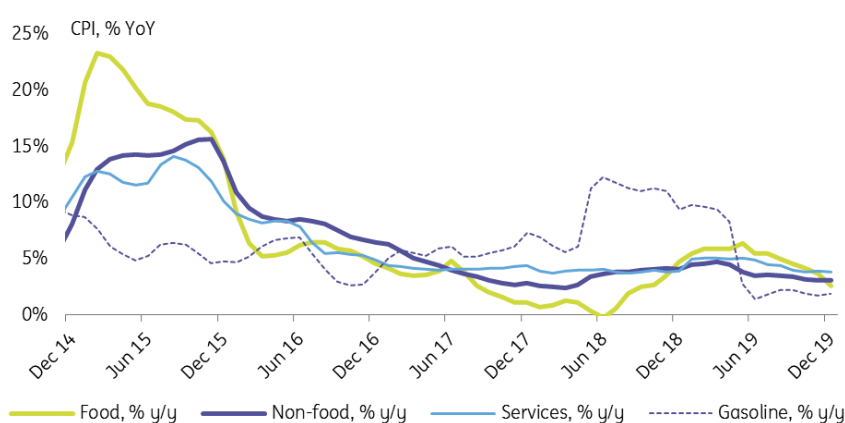
Lower than expected

CPI falls below expectations and should drop further, but don't expect the central bank to react immediately

In line with the long established pattern, Russian CPI underperformed our and the market expectations, having been confirmed at 3.0% year on year for December 2019 (initial estimate was released on 31 December), down from 3.5% YoY in November and 4.3% YoY in December 2018. The headline reading for December is close to the lower bound of the Central Bank of Russia's forecast range, which may increase market expectations of another key rate cut at the upcoming monetary policy meeting to be held on 7 February. While we agree that the likelihood of that scenario has increased, we still believe that the final decision will be a close call, and see the following arguments against a cut.

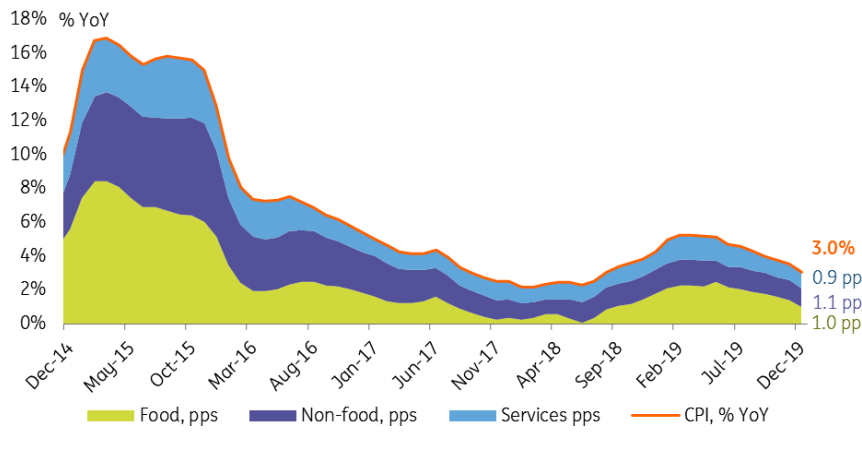
- Looking at the CPI composition, we note that food products (38% of consumer basket) is the sole disinflationary component, with food CPI slowing from 3.7% YoY in November to 2.6% YoY in December on a higher statistical base, while non-food CPI growth stayed unchanged at 3.1% YoY amid accelerating gasoline price growth, and services CPI decelerating only marginally from 3.9% YoY to 3.8% YoY (see Charts 1 and 2).
- Global grain prices, which we earlier identified as one of the primary disinflationary factors in 2019, seem to be heading north again after showing a negative to flat YoY performance in the middle of 2019. Global wheat prices in US dollar terms were up 11% YoY in December 2019 and flattish in ruble terms (see Chart 3), with roughly similar expectations for 1Q20, depending on RUB performance.
- Inflationary expectations, as reported by the Bank of Russia, deteriorated in December both for households (see Chart 4) and corporates, which may suggest some reassessment of the CPI prospects after November's Black Friday promotional discounts. In the meantime, the consumer sentiment index in December was reported at 95 points, which is 6 points higher than a year ago, while retail trade growth accelerated to 2.3% YoY in November, the highest level in 11 months, suggesting a lack of demand-driven constraints to CPI growth.

Russian CPI growth by components (% YoY)



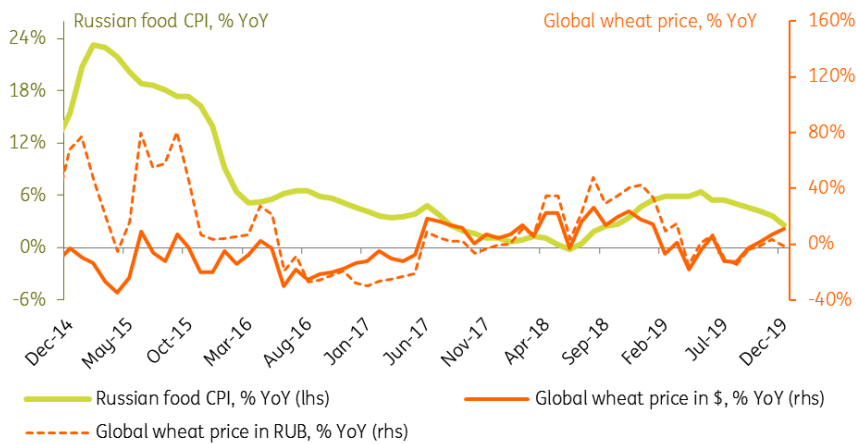
Source: State Statistics Service, Bank of Russia, ING

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



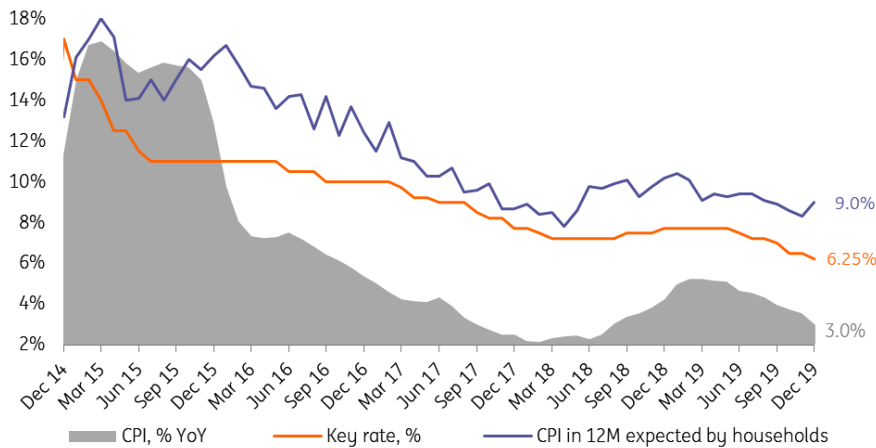
Source: State Statistics Service, Bank of Russia, ING

Global wheat price growth and Russian food CPI, % YoY



Source: State Statistics Service, Bloomberg, ING

Russian CPI, inflationary expectations and key rate



Source: State Statistics Service, Bank of Russia, ING

The over-reliance of the CPI slowdown on the food component, the recovery in global food prices and deterioration of local inflationary expectations suggests, that following the likely slowdown to around 2% YoY in 1Q20 (which will come from the high base of 1Q19, when the VAT hike took effect), CPI will start moving back towards the CBR's 4% target (and our forecast of 3.7%). As a result, we believe the Bank of Russia is more likely to deliver on the signal it gave at the December meeting, which hinted at a pause at least in February in order to better evaluate the CPI trend and suggested very limited scope for a cut in the key rate, at least in 1H20.

Our base case scenario assumes a 25 basis point cut on 20 March to the level of 6.0% with a subsequent long pause in order to determine whether inflation is headed back to the 3.5-4.0% it targets for the year-end. In the meantime, the risks to our forecasts on CPI and key rate are tilted south in case the government fails to return the budget expenditure pattern back on track following a surprising underspending in 2019 and if the ruble continues to strengthen.

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>.