

## Russian CPI exceeds expectations in 2020 despite weakness in demand

Russian inflation shot up at the end of 2020, exceeding expectations. The good news is that for the most part it is global agriculture inflation, RUB depreciation, and low base effect, all of which should end soon. But the bad news is that inflationary expectations are shooting up, and the demand-driven disinflation seems nowhere to be found



# 4.9%

December CPI, % YoY

up from 4.4% YoY in November

Higher than expected

### Expected trend, unexpected levels

The pick-up in CPI from 4.4% year-on-year in November to 4.9% YoY in December (Figure 1) is not

really news, but rather confirmation of the preliminary estimates available on 31 December last year. Still, the number is worth mentioning, as it exceeds the initial consensus by 0.2 percentage points and is at the upper bound of Bank of Russia's forecast range of 4.6-4.9% YoY made [public](#) on 18 December.

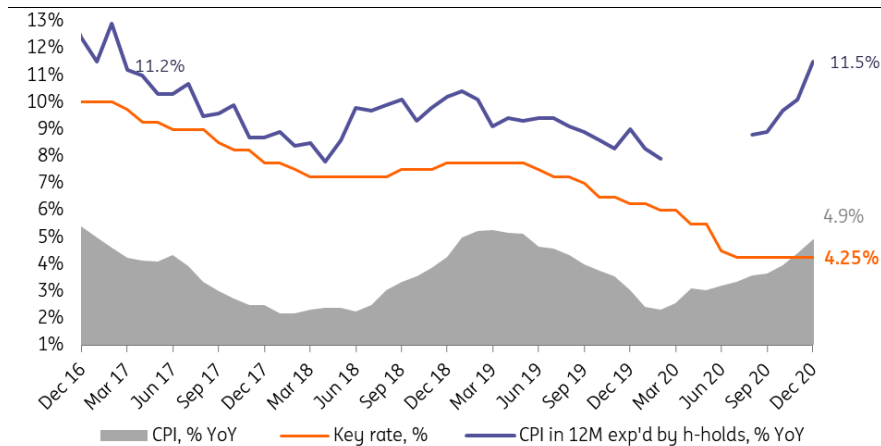
The good news is that the trend itself was not unexpected: CPI has been on the upward path since the February 2020 low point of 2.3% YoY, driven by the following:

- **USDRUB depreciation** by 15% in March, and, after some rebound in 2Q20, by another 8% over 3Q20. Normally, the pass-through effect is 0.3-0.5 extra CPI growth per each 10% depreciation, with the effect lasting for up to two quarters, meaning that the inflationary effect of RUB depreciation should be minimized after 1Q21.
- **Global agriculture inflation**, with global wheat price growth peaking at around 25% YoY in USD terms in August-September (Figure 3), and by around 50% YoY in RUB terms (Figure 2). Historically, each 10% of global wheat price growth translates into 1ppt of Russian food price growth, fully explaining the spike in local food price growth from the February low of 1.8% YoY to 6.7% YoY by the end of last year. Again, the good news is that global food prices seem to have slowed in 4Q20, and the global outlook for 2021 is currently benign.
- **Low statistical base** effect of 2H19, during which the local CPI decelerated from 4.7% YoY to 3.0% YoY owing to a combination of the abnormally tight approach to budget spending and a number of one-off cost-input restraints. This effect will continue into 1Q21 (in 1Q20, CPI slowed down by 0.7ppt), suggesting that the local CPI peak is yet to be reached in the coming months before stabilizing.

The bad news is that the scale of the inflation pick-up keeps exceeding expectations, about which we have the following observations and conclusions:

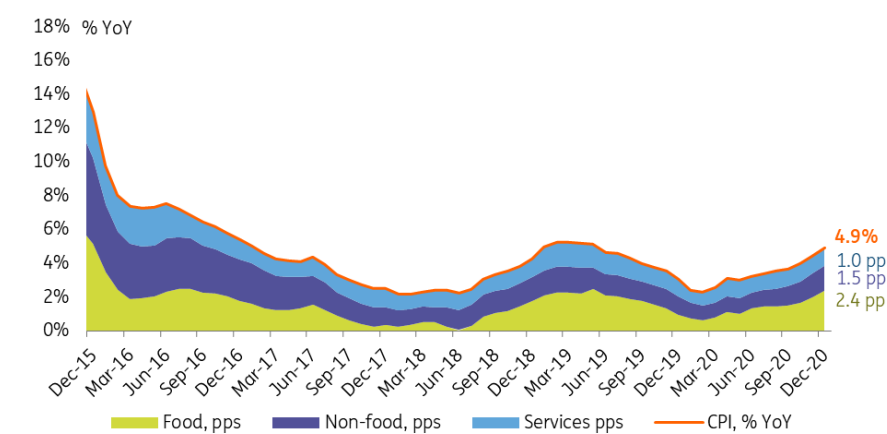
- Higher-than-expected CPI means a **lack of disinflationary effect of weak demand**. While indeed food inflation is the primary contributor to the overall CPI pick-up (the former accounts for 1.4ppt out of the total 1.9ppt increase of the latter throughout 2020), non-food products inflation also picked up – from 3.1% YoY to 4.8% YoY – and contributed to a 0.4ppt pick-up in CPI (Figure 2). Looking deeper at the composition of the non-food CPI evolution, all items except apparel showed acceleration in price growth throughout 2020, be they dependent on imports (such as consumer electronics) or not (construction materials, gasoline). The services sector did show a 1.1ppt YoY disinflation throughout 2020 but that did not affect the overall picture due to its relatively low weight of 28%. The lack of disinflation in products despite the 4.1% YoY retail sales drop in 11M20 suggests low sensitivity to the weakness in consumer demand. Meanwhile, it is not guaranteed that the upcoming recovery in consumption amid a c.4% increase of state pensions in February, state sector salaries in October, and possible additional social support ahead of the September Parliamentary elections will not be pro-inflationary.
- The pick-up in CPI seems to be **affecting inflationary expectations** of households, which have also been on the rise at the end of the year (Figure 1), with producers' price expectations also elevated. The unanchored nature of the local inflationary expectations amid nearly-missed official CPI forecasts are likely to be a **cause of concern for the Bank of Russia**, requiring a more cautious approach to inflation targeting in the coming months.

**Figure 1: CPI jumped to 4.9% YoY in December, pushing up expectations**



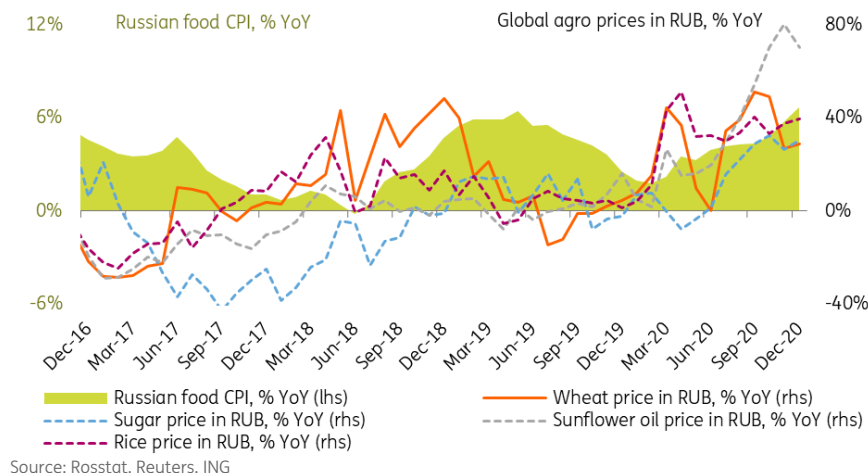
Source: Bank of Russia, Rosstat, ING

**Figure 2: Food remains the key driver of the pick-up**

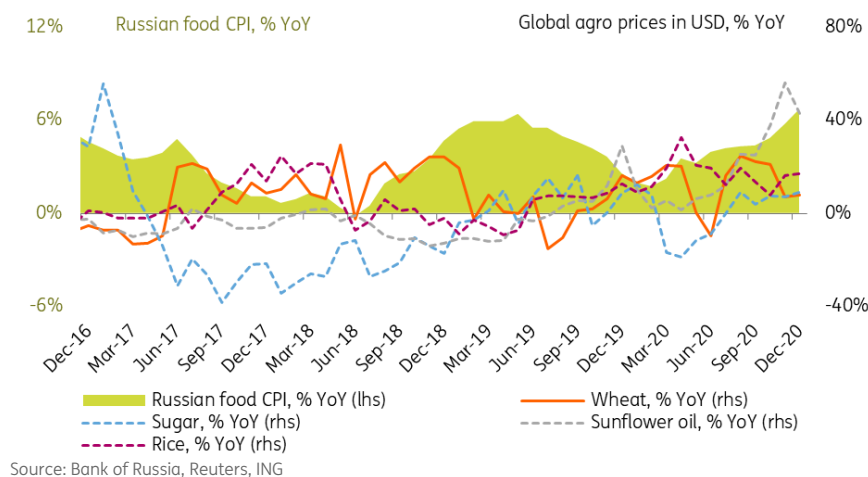


Source: Bank of Russia, Rosstat, ING

**Figure 3: Spike in Russian food CPI stems from global agriculture inflation and RUB depreciation...**



**Figure 4: ...both of which seem to be over now**



### Year-end forecasts of 3.5% CPI and 4.0% key rate challenged

The recent CPI performance challenges our view that 2021 CPI will peak within 5.0% YoY in 1Q21 and decelerate to 3.5% YoY by the year-end. While we stand by the expected trajectory, the lack of disinflation from the demand side may push the targeted levels by up to 0.5ppt. Concerns regarding the vulnerability of CPI and inflationary expectations suggests that our expectations of one last cut in the key rate (currently 4.25%) in April is also becoming optimistic.

## Author

**Dmitry Dolgin**

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto: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>.