Russian CPI may underperform CBR forecast in 2019

Russian CPI decelerated to a below-consensus 4.7% YoY in June. Given the favourable harvest situation and stronger FX, CPI could decelerate to 4.0% YoY at year-end 2019, which is below the Bank of Russia's (CBR) current forecast range of 4.2-4.7%. Lower near-term CPI risks strengthen our case for at least two 25 bp rate cuts - in July and September

Source: Shutterstock

4.7% YoY

June CPI growth

down from 5.1% YoY in May

Lower than expected

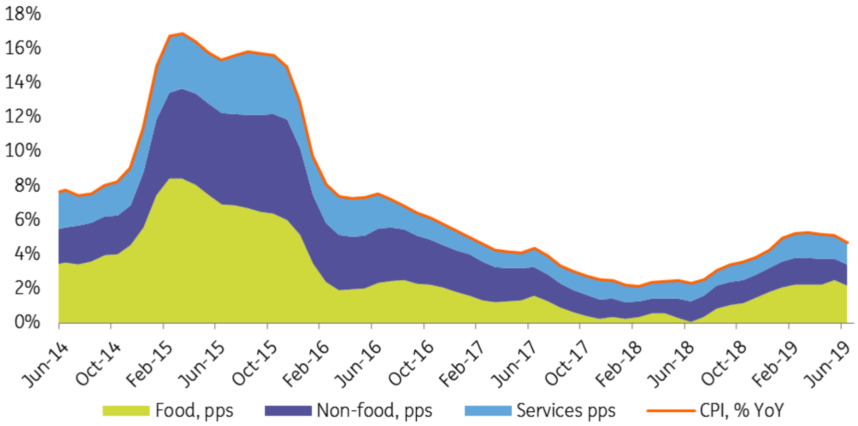
CPI decelerated to 4.7% YoY in June, mainly thanks to monthly food deflation, strong RUB

The noticeable slowdown in CPI from 5.1% year on year in May to 4.7% YoY in June came as a positive surprise to the market, which expected to see it slightly higher at 4.8% YoY. While the Ministry of Economic Development declared it to be the result of weak aggregate demand in the economy, we attribute it mostly to the supply side.

Monthly food price deflation explains 75% of the June slowdown in the overall CPI

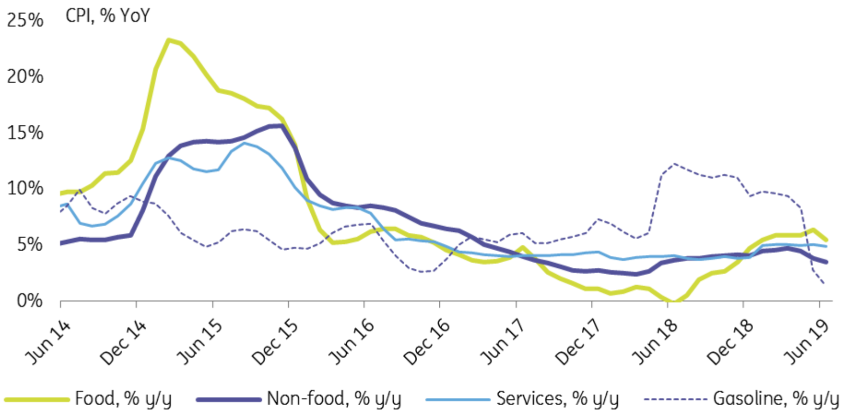
- Food (38% of the total CPI basket) accounted for 0.3 out of 0.4 percentage point (pp) of the slowdown in June vs. May. Thanks to the favourable weather/harvest situation Russia saw a month on month food deflation in June, earlier than usual (July-August). In terms of YoY growth rate, food CPI growth seems to have peaked in May at 6.4% YoY and decelerated to 5.5% YoY in June.
- Non-food products and services (62% of the total CPI basket) accounted for the remaining 0.1 pp of the YoY deceleration. We attribute the slowdown mainly to the favourable FX trend (RUB appreciated to USD by 10% in 1H19) and the local gasoline price freeze. In terms of YoY growth rate, non-food CPI growth decelerated from 3.8% YoY in May to 3.5% YoY in June (including gasoline from 2.8% YoY to 1.4% YoY), while services CPI slowed from 5.1% YoY to 4.9% YoY.

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



Source: State Statistics Service, Bank of Russia, ING

Russian CPI growth by components (% YoY)



Source: State Statistics Service, ING

Russian CPI to decelerate to 4.0% YoY by year-end 2019

We believe favourable weather/harvest will continue to have a positive effect on the local food and overall CPI trend. Historically, Russian food CPI growth had a 10% sensitivity to the ruble-denominated global grain price growth (which combines the effects of global grain price and RUB exchange price moves). In other words, acceleration/deceleration of the global RUB grain prices by 10 pp translates into 1 pp acceleration/deceleration of the Russian food CPI (see the chart below).

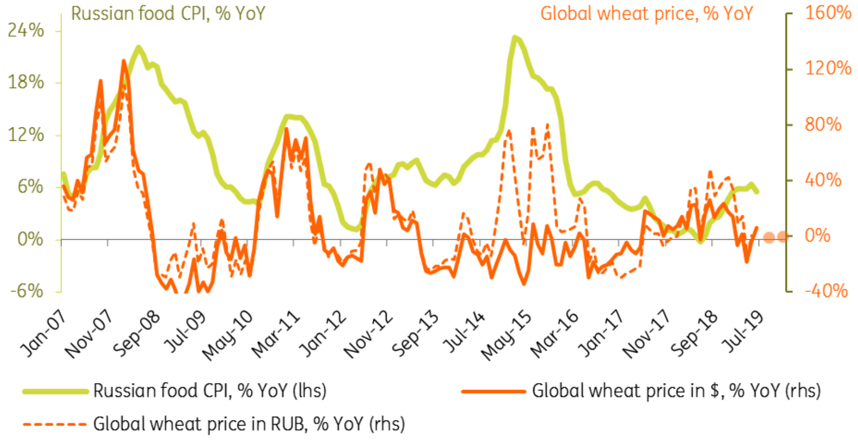
We note, that throughout 1H19 the global wheat price (in RUB terms) growth has decelerated from 40% YoY to zero, while local food price growth remained stable at around 5-6% YoY. Bloomberg's global agro forecasts and our recent RUB exchange rate forecast update [https://think.ing.com/articles/after-the-rally-domestic-factors-to-now-play-a-greater-role-in-rub-pricing/] suggest that the zero grain price growth is likely to stay at least until the year-end. This means, that all else being equal, the local food CPI growth has the potential for around a 4 pp deceleration, which translates into around 1.6 pp downside to the overall CPI growth rate.

The recent deceleration in the global grain prices and RUB appreciation areate a potential for the Russian CPI to decelerate by up to 1.6 pp from here

As the slowdown in food prices does not necessarily have to take place immediately, and given the risks of some pro-inflationary factors, such as expected acceleration of the budget spending in 2H19 and possible release of the local gasoline prices, we - cautiously - set our year-end CPI forecast to 4.0%. We also note, that due to the high base effect the CPI is very likely to drop even further - to 3.0% YoY in 1Q20 - however that move should be considered temporary.

https://think.ing.com/articles/after-the-rally-domestic-factors-to-now-play-a-greater-role-in-rub-pricing/

Global wheat price growth and Russian food CPI, % YoY



Source: State Statistics Service, Bloomberg, ING

Decline in the near-term CPI risks favour a set of key rate cuts

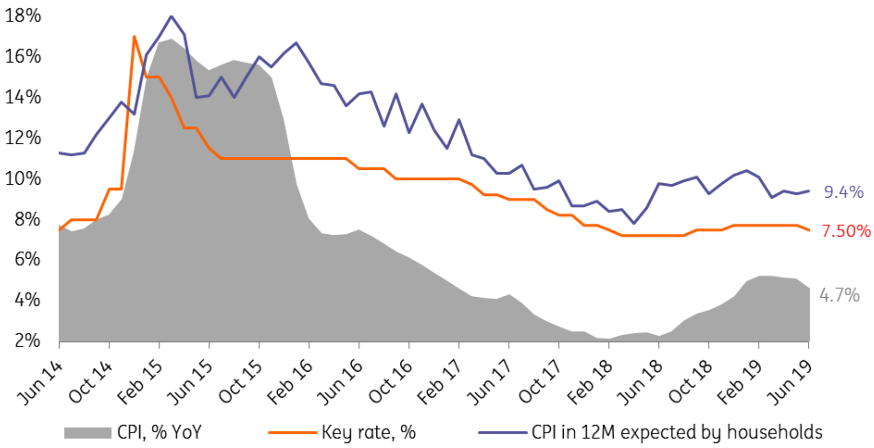
We believe the decline in the near-term CPI risks reinforces the case for at least a 50 basis point cut in the near future - most likely it will be two 25 bp cuts, on 26 July and 6 September. However, this was already our base case scenario since the 14 June CBR meeting. The global risk-on that followed and the below-expected CPI has just increased the likelihood of that scenario. Now, given that our year-end CPI forecast of 4.0% is below the recently updated CBR forecast range of 4.2-4.7%, another 25 bp cut - possibly in December - is not out of the question. That leaves the year-end 2019 key rate target at 6.75-7.00%.

Still, there are a number of considerations that may (and should) prompt the CBR to be cautious about reacting to the CPI surprises aggressively. First, the primary reason for the CPI slowdown and the improvement of our inflation view (global food prices) is non-monetary in nature and historically quite volatile. Second, there is still a great deal of uncertainty regarding the local gasoline price growth. Thirdly, the local inflationary expectations remain elevated and unanchored, as reiterated recently by the CBR Governor Elvira Nabiullina. Indeed, as can be seen from the chart below, the deceleration in the local CPI was accompanied by some deterioration of the forward-looking estimates by households. Finally, the uncertainties regarding the budget policy (i.e. the recent idea to invest part of the fiscal savings locally) limit the scope for the long-term cut in the key rate.

Given the abovementioned limitations, we still see the terminal key rate level in the mid- to upper border of the indicative 6-7% range.

https://think.ing.com/articles/russia-weak-activity-is-starting-to-affect-budget-policy/

Russian CPI, inflationary expectations, and key rate



Source: State Statistics Service, Bank of Russia, ING

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