

Russian CPI structure supports central bank's hawkish bias

The rise in headline inflation to 6.7% YoY in August is within the forecast range, but the pick-up in both food and non-food inflation, as well as the spike of core inflation to 7.1% YoY are clearly negative, meaning that full-year CPI may exceed 6% this year. A 50 bp key rate hike is now just as likely as 25 bp this Friday, and the signal is likely to remain hawkish



Building materials warehouse in St. Petersburg, Russia

6.68

Russian inflation for August, % YoY

up from 6.46% YoY in July

Higher than expected

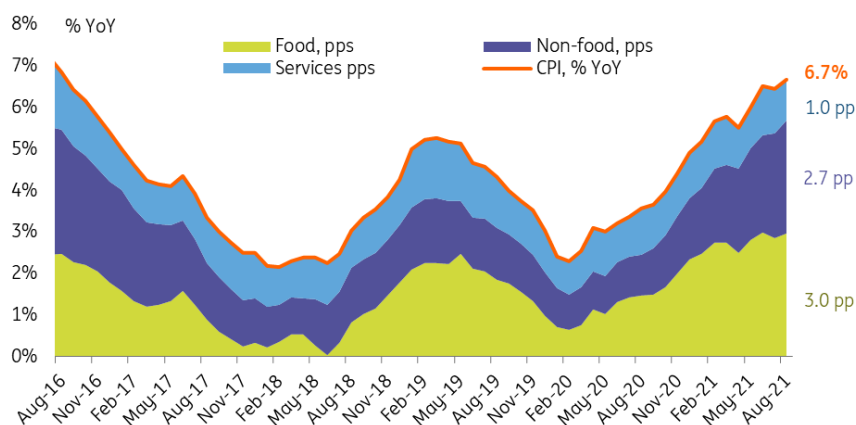
Local CPI remains elevated despite moderation in economic activity

In August, Russian CPI increased 0.16% month-on-month, lifting inflation from 6.5% year-on-year in July to 6.7% YoY.

This is only marginally higher than our expectations of 6.6% and within the consensus range of 6.6-6.8%. However, core CPI spiked unexpectedly by 0.3 percentage points to 7.1% YoY, and the structure of CPI growth continued to deteriorate, which is a cause for concern.

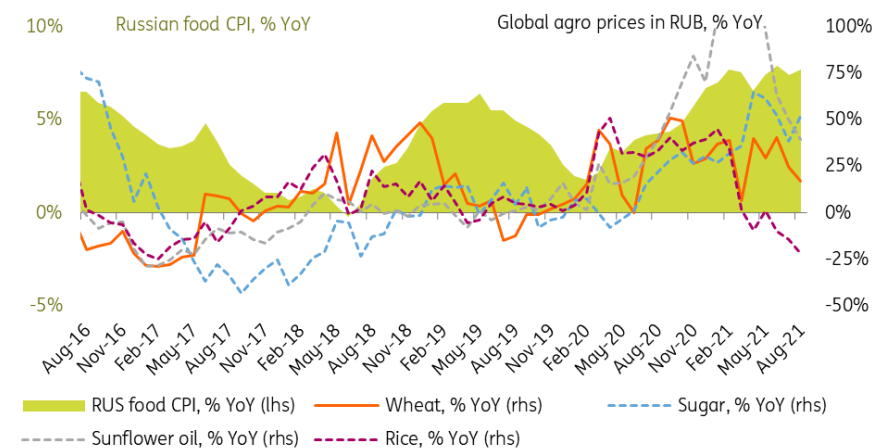
- Both food and non-food CPI growth accelerated in August (Figure 1), increasing their contributions to overall inflation despite the higher base effect of the previous year. The scope of seasonal monthly deflation in fruits and vegetables in the food segment was not enough to offset the growing price pressure in other items. More importantly, in the non-food segment, we were negatively surprised by the spike in gasoline price growth and the continued increase in most construction materials, consumer appliances, and pharmaceuticals. A pick-up in services inflation was avoided mainly thanks to a higher base effect, while risks related to travel, healthcare and renovation pressed on.
- Looking into the next couple of months, the promising developments in moderation of global food price growth for most items (Figure 2), rouble stability, and the moderation in the housing market boom may help contain local inflation. At the same time, the risks of a further rise in local CPI is still high due to the end of the electoral cycle with the mid-September Parliamentary elections, the expected 0.2-0.3 pp inflationary effect of the one-off social payments of August-September, and the global context of global cost input inflation.
- CPI for the first week of September totalled 0.07% week-on-week, suggesting no relief so far. In the last 15 years, there were only three cases when September's monthly price growth was lower than August's - in 2006 and crisis years 2009 and 2020. Assuming a return to regular seasonality, CPI can jump to 7.1% YoY in September.

Figure 1: Inflation pressure increased in August in food and non-food segments



Source: Bank of Russia, Rosstat, ING

Figure 2: Global agriculture price growth moderates, except sugar



2021 CPI forecast raised to 6.0-6.5%, CBR stance to remain hawkish

The structure of August CPI combined with near-term risks suggests that our 5.7% CPI target for the year-end is too optimistic and is shifting into the 6.0-6.5% territory.

In terms of implications for monetary policy, a cautious 25 bp hike in the key rate this Friday is still likely, as the CPI trend remains in line with the central bank scenario, the inflationary expectations of the population and households are elevated but moderating. However, a 50 bp hike is becoming just as likely.

More importantly, given the persistent inflationary risks for the medium term, it now appears likely that the central bank will keep its hawkish stance, meaning a shift in the expected key rate ceiling from 6.5-7.0% to the 7.0-7.5% range.

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