

Russian inflation slumps on base effect

Russian CPI dropped sharply in January, and combined with a recovery in the market mood increases the likelihood of a key rate cut on 7 February (still not our base case). Meanwhile, as the CPI slowdown is mostly technical, and global agriculture prices are rising, the Bank of Russia is likely to maintain a cautious stance in the medium term



Source: Shutterstock

2.4%

Russian CPI in January 2020, YoY

down from 3.0% YoY in December 2019

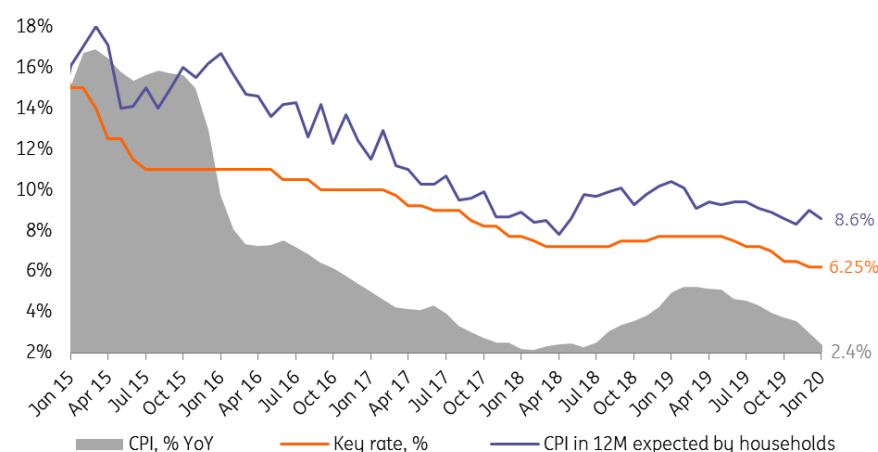
CPI down sharply on base effect

The Russian state statistics service (Rosstat) released January CPI data, which is the last datapoint ahead of the central bank meeting scheduled for 7 February. According to the release, inflation slowed sharply from 3.0% year on year as of December 2019 to 2.4% YoY in January 2020, which

is slightly below the 2.5% YoY consensus and in line with our expectations. This, combined with some relief on the Coronavirus and trade tensions newsflow may strengthen the market expectations of a key rate cut from from the current 6.25% level this Friday. While we acknowledge that the likelihood of the said scenario has increased, and the decision will indeed be a close call, there are several arguments in favour of a cautious approach, which may be reflected in no cut and/or conservative guidance, suggesting limited scope for further cuts.

1. The January slowdown (which will likely continue further in February-March) is a result of the high base effect. To remind, as a result of the VAT rate hike which came into effect on 1 January 2019, Russian CPI growth accelerated by 0.7 percentage points in January 2019 (vs December 2018) and then by another 0.3 pp by the end of March 2019, after which deceleration took place. The 0.6 pp actual slowdown in January 2020 and likely further 0.2-0.3 pp slowdown in February-March (to 2.2-2.3% YoY) seem like a mirror image.

Figure 1: Russian CPI slows sharply in January 2020 on high base effect



Source: State Statistics Service, Bank of Russia, ING

Inflationary risks from food segment rising

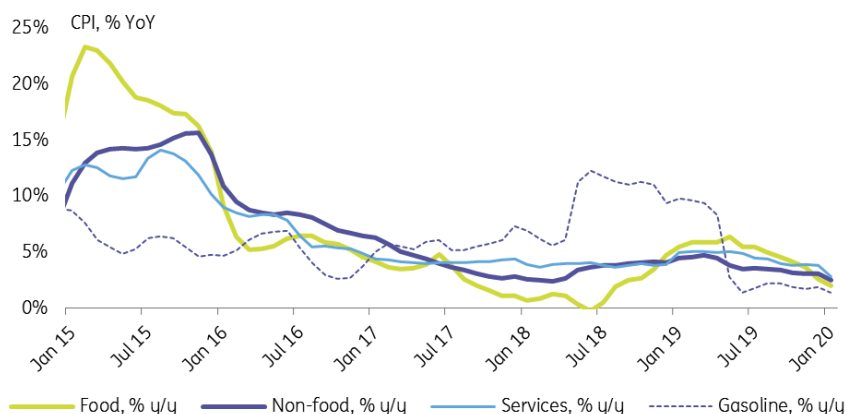
2. Looking at the January CPI composition, it appears that while deceleration in the price growth for services is more or less reflected in the base effect, non-food CPI disinflation was deeper than suggested by the base effect (probably a reflection of the strong ruble in 2019 and so far fixed gasoline prices, as the demand side was not as weak as earlier believed), the food CPI slowdown was a bit too shallow - by 0.6 pp vs a base effect of 0.8 pp, possibly masking increased upward pressure from the food prices, which will become more pronounced after March 2020 (see Figure 2)

3. One possible explanation for higher food price pressure may be coming from global food prices, with wheat prices after showing a flat to negative performance in 9M19, started to show acceleration in 4Q19, reaching 5% YoY in January in RUB terms and 7% YoY in USD terms (see Figure 3). According to Bloomberg consensus forecasts, global wheat prices are expected to accelerate further to 15% YoY in 1Q20. To remind, historically, each 10 pp of wheat price growth corresponds to 1.0 pp of Russian food CPI acceleration and 0.4 pp increase in the total Russian CPI.

4. Preliminary February data suggests acceleration in the weekly CPI in most of the food items,

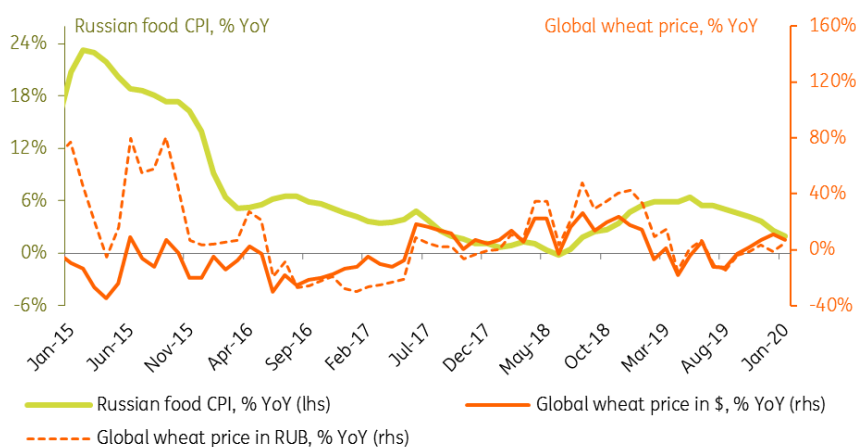
including milk, dairy, grains, meat, fruits and vegetables. In most cases, this acceleration is stronger than suggested by seasonality: for example, in the same period of last year (which was, to remind, affected by the VAT rate hike), there was no acceleration in the weekly price growth in dairy, sugar, processed meat, and some fruit and vegetables.

Figure 2: Slowdown in food CPI is a bit too shallow for the base effect standing behind it



Source: State Statistics Service, ING

Figure 3: Global agriculture prices resumed growth



Source: State Statistics Service, Bloomberg, ING

Factors beyond current CPI trends are calling for caution too

The grounds for our contrarian view on the conservative key rate decision or/and guidance lie beyond current CPI trends, which suggest growing risks from the volatile food component that may become more pronounced after the base effect-affected 1Q20. To remind, other arguments include [lack of strong desinflationary pressure from demand](#), [lack of clarity on the scale of upcoming fiscal easing](#), [risks of RUB weakening due to balance of payments fundamentals \(regardless of the Coronavirus woes\)](#), and [the possible need to re-assertain central bank's priorities in the face of more pro-growth fiscal policy](#).

In fact, some of those arguments may have been strengthened this week, as a senior government official 1) [indicated](#) that fiscal stimulus will be big enough to assure a 1.0-1.7 pp bump to the Russian GDP growth in 2020-21, and 2) called for a new mechanism of coordination between Bank of Russia and the Cabinet to assure economic growth without damaging macroeconomic stability. We don't find the content of this message to be fundamentally flawed (in fact, better alignment of economic and budget forecasts could be beneficial) , however its timing - on the eve of the key rate decision - may add an extra angle of interpretation to Bank of Russia's actions in the near term.

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