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INFLATION EXPECTATIONS AND CONSUMER SENTIMENT

Information and analytical commentary

Moscow
2019

Inflation expectations and consumer sentiment (January 2019)

In December 2018 – January 2019, inflation expectations of households and businesses rose smoothly. Expectations were mainly driven by accelerating growth of food prices in late 2018. The VAT rate hike, effective from 1 January 2019, continued to exert pressure on short-term inflation expectations of businesses. Analysts' inflation expectations for 2019 changed immaterially, as they had factored in the VAT hike in their previous forecasts. That said, analysts believe that inflation will speed up in 2019 only temporarily and annual inflation will return to the near 4% level as soon as 2020 Q1. The Bank of Russia's forecast suggests that inflation will temporarily peak in the first half of 2019. Quarterly year-on-year consumer price growth is set to decelerate to 4% as early as the second half of 2019. At the end of 2019, inflation will come in at 5.0–5.5%.

Inflation expectation indicators

Table 1

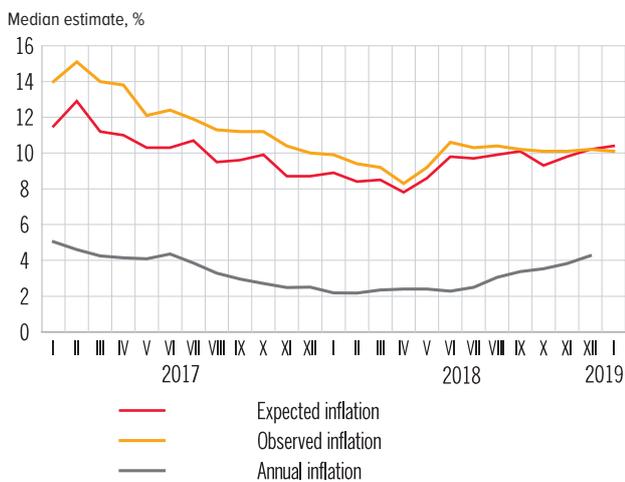
	Expectation horizon	January 2017	January 2018	November 2018	December 2018	January 2019
Households' inflation expectations, %						
Public Opinion Foundation (median, expected inflation)	next 12 months	11.5	8.9	9.8	10.2	10.4
Public Opinion Foundation (median, observed inflation)	past 12 months	14.0	9.9	10.1	10.2	10.1
Public Opinion Foundation (Monetary Policy Department calculations)	next 12 months	4.6	2.1	4.4	5.4	6.7
Professional analysts, %						
Bloomberg	2019			4,6	4,5	4,6
Interfax	2019		3,6	4,4	4,7	
Reuters	2019			4,7	5,0	
Financial markets, %						
OFZ-IN	next 4 years	5.0	4.0	5.1	5.1	5.1
OFZ-IN	next 9 years			5.2	5.1	4.9
Qualitative estimates of inflation expectations						
Businesses, balance of replies	next 3 months	9.4	7.0	14.1	16.7	18.9
PMI purchase price, diffusion index	next month	56.2	54.6	61.7	61.3	61.0
PMI selling price, diffusion index	next month	52.0	51.4	53.8	53.8	52.8

In December 2018 – January 2019, inflation expectations of households and businesses rose smoothly. Expectations were mainly driven by accelerating growth of food prices in late 2018. The VAT rate hike, effective from 1 January 2019, continued to exert pressure on short-term inflation expectations of businesses. Analysts' inflation expectations for 2019 changed immaterially, as they had factored in the VAT hike in their previous forecasts. That said, analysts believe that inflation will speed up in 2019 only temporarily and annual inflation will return to the near 4% level as soon as 2020 Q1. The Bank of Russia's forecast suggests that inflation will temporarily peak in the first half of 2019. Quarterly year-on-year consumer price growth is set to decelerate to 4% as early as

the second half of 2019. At the end of 2019, inflation will come in at 5.0-5.5%.

In December 2018 – January 2019, most inflation expectation estimates from different sources rose (Table 1). The rise in expectations, largely adaptive in nature, was influenced by accelerating price growth in December 2018; in particular, this is true for food prices. Inflation expectations have remained elevated since mid-2018, when a number of factors pushed them upwards. These include the ruble's depreciation on the back of, among other things, rising sanctions pressure, abrupt petrol price hikes in May and June, underpinned by high oil prices, and the VAT rate increase from 1 January 2019. The dramatic acceleration of actual inflation on the back of the VAT hike will determine inflation expectations in the months to come.

Median estimate of inflation expectations continued to rise *Chart 1*



Sources: InFOM, Rosstat.

Signs of future price growth (as % of total respondents)

Table 2

	October 2018	January 2019
Current change in petrol prices	43	50
Ruble exchange rate fluctuations	33	37
Current change in food prices	30	33
Wage and pension indexation	28	31

Households' inflation expectations

In January 2019, households' inflation expectations for the next 12 months¹ continued to rise (by 0.2 pp against the December readings, to 10.4%).

Answers to the question about inflation expectation drivers suggest that the rise in actual inflation served as the main trigger. Households' inflation expectations are sensitive to price hikes of regularly purchased goods accounting for a sizeable share of the household budget (e.g., food and petrol) (Table 2). In December 2018, Rosstat data registered accelerated growth in prices of vegetables, meat and dairy products, and chicken eggs,² which make up a considerable share of the food basket (Chart 3 of the Summary Report on Survey 1 (January 2019); further referred to as the Report). The VAT rate hike was also cited among the triggers of the rise in inflation expectations.

¹ inFOM median estimate.

² Price Dynamics: Facts, Assessments and Comments, information and analytical commentary, No. 12 (36), December 2018.

The median estimate of observed inflation remained virtually unchanged in January 2019 (Chart 6 of the Report). That said, expected inflation exceeded observed inflation for the first time since January 2015 (Chart 1).

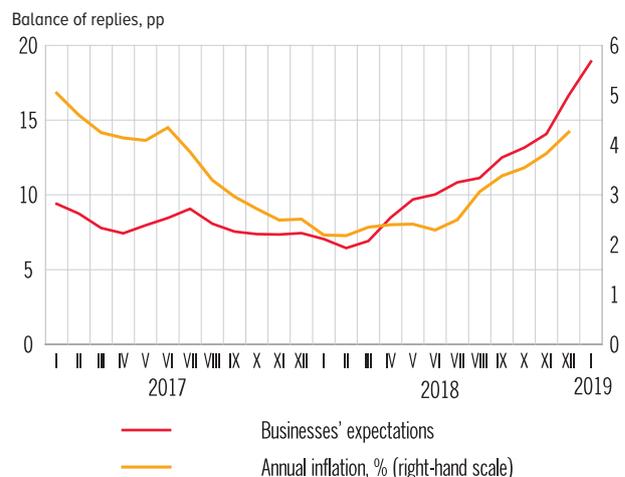
Consumer sentiment of households

According to inFOM surveys, in January 2019, as inflation expectations were on the rise, respondents were more pessimistic about their future financial standing (Chart 15 of the Report).

Business inflation expectations

A survey of businesses³ conducted by the Bank of Russia in mid-January 2019 pointed to a persisting trend towards a rise in inflation expectations for three months ahead (Chart 2). They were at the highest point since March 2015. The most noticeable increase in expectations is registered in wholesale and retail trade, mainly as a result of the VAT rise and ruble exchange rate developments. In manufacturing, higher price growth expectations were chiefly specific to consumer product manufacturers. For instance, price expectations rose dramatically in production of vehicles, computers, food, textiles, and clothes. A considerable surge in inflation

Business inflation expectations (Bank of Russia estimate) sped up growth *Chart 2*

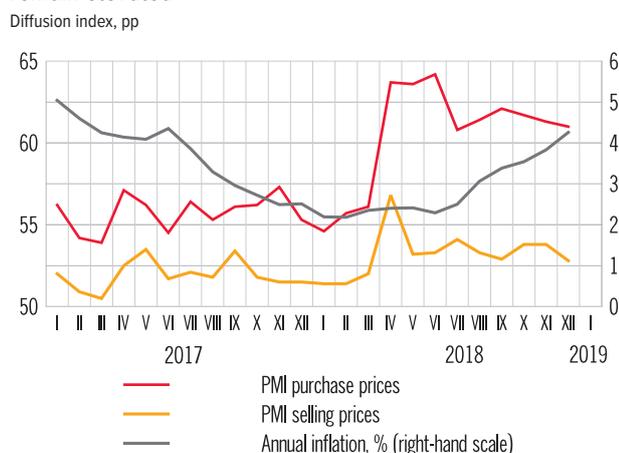


Sources: Bank of Russia, Rosstat.

³ For survey details refer to http://cbr.ru/DKP/surveys/infl_exp/enterprises/. The aggregate index – balance of replies – is a difference in the share of replies of the respondents who expect that prices will increase and that prices will decrease.

Business inflation expectations
(Markit PMI estimate)
remain elevated

Chart 3



Sources: IHS Markit PMI, Rosstat.

expectations was registered in agriculture, as producer prices increased on the back of, among other things, rising global grain prices. According to Rosstat, annual growth of producer prices in the sector continued to accelerate in December 2018 to 12.9% (in November, 10.1%). At the same time, mining and quarrying companies lowered price growth expectations in the context of sliding oil prices.

The IHS Markit PMI survey⁴ held in December 2018 among manufacturing companies pointed to elevated expectations of output price growth in the month ahead after the surge in April 2018 (Chart 3). Respondents to the survey attributed its slight decline last month to commodity price movements and tighter competition.

Inflation expectations of financial markets

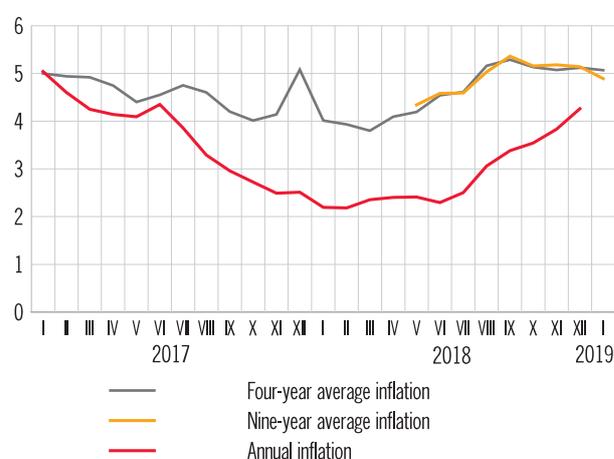
According to the Bank of Russia estimates⁵ based on the comparison of the expected yield on inflation-indexed federal government bonds (OFZ-in) and nominal federal government bonds, in January 2019, inflation expectations (for four and nine years ahead) remained elevated after increasing in June-August 2018 on the back of the decision to rise the VAT rate (Chart 4). At the same time, compared to the previous

⁴ For details, refer to <https://www.markiteconomics.com/public>.

⁵ For details, see 'Deriving Expectations of Future Short-term Interest Rates from OFZ Yield' (Bank of Russia Working Paper Series), No. 11, May 2016.

Inflation expectations
(financial market data)
hold high (%)

Chart 4



Sources: Bloomberg, Rosstat, Bank of Russia calculations.

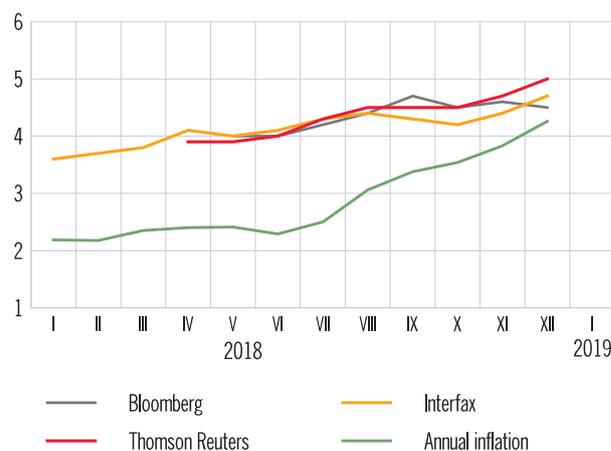
month, expected inflation declined somewhat in January 2019.

Analysts' inflation expectations

Forecasts⁶ experts made in late December 2018 regarding end-2019 inflation continued to increase, moving closer to the Bank of Russia forecast (Chart 5). They fall within the 4.5-5.0% range (compared with 4.4-4.7% in November and 4.2-4.5% in October). The forecast updates in November and December 2018 may be associated with the revision of fallouts from the VAT hike on inflation and the weakening of the ruble in 2018. That said, analysts believe that

Analysts' inflation expectations for 2019 are
approaching the Bank of Russia forecast (%)

Chart 5



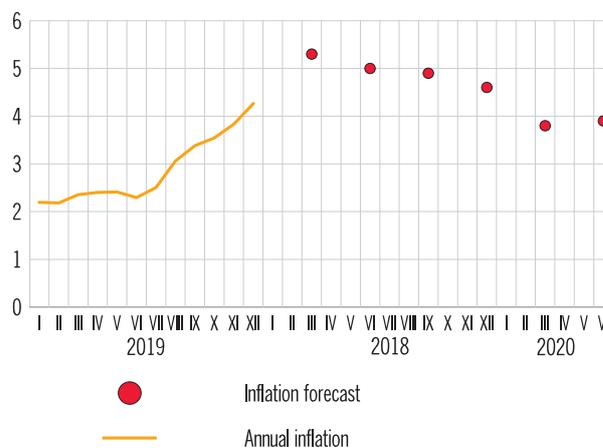
Sources: Interfax, Bloomberg, Thomson Reuters, Rosstat.

⁶ Surveys by Interfax, Bloomberg, and Thomson Reuters.

inflation will speed up in 2019 only temporarily and annual inflation will return to the near 4% level as early as 2020 Q1 (Chart 6).

The Bank of Russia forecasts similar inflation dynamics. The VAT hike and the weakening of the ruble in 2018 are expected to temporarily accelerate annual inflation, which will peak in the first six months of 2019 and run at 5.0-5.5% by the end of 2019. Quarterly year-on-year consumer price growth is set to decelerate to 4% as early as the second half of 2019. Annual inflation will return to 4% in the first half of 2020 when the effects of the ruble weakening and the VAT rise peter out.

Analysts expect inflation to return to the near 4% level in early 2020 (%) Chart 6



Sources: InFOM, Rosstat.

Cut-off date – 30 January 2019.

A soft copy of the information and analytical material is published on the Bank of Russia website (<http://www.cbr.ru/DKP/>).

Please send your comments and suggestions to svc_analysis@cbr.ru.

This commentary is prepared by the Monetary Policy Department.

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