



Bank of Russia

No. 3

MARCH 2019

INFLATION EXPECTATIONS AND CONSUMER SENTIMENT

Information and analytical commentary

Moscow
2019

Inflation expectations and consumer sentiment (March 2019)

In March 2019, inflation expectations in the economy continued to decline after an increase in December 2018 and January 2019, which was largely associated with the VAT hike. Inflation expected by households on a one-year horizon dropped. For a second month in a row, businesses' price expectations for the three months ahead are on the downward track after a 12-month growth period. Despite the decline, inflation expectations remain elevated and non-anchored. According to analysts, the inflation hike observed in early 2019 is temporary; its fall to roughly 4% is forecast as early as the first quarter of 2020. According to the Bank of Russia's forecast, annual inflation is set to peak to its local high in March-April 2019 to then drift down to the Bank of Russia's near 4% target.

INFLATION EXPECTATION INDICATORS

Table 1

	Expectation horizon	March 2017	March 2018	January 2019	February 2019	March 2019
Households' inflation expectations, %						
Public Opinion Foundation (median, expected inflation)	next 12 months	11.2	8.5	10.4	10.1	9.1
Public Opinion Foundation (median, observed inflation)	past 12 months	14.0	9.2	10.1	10.6	10.0
Public Opinion Foundation (Bank of Russia calculations)	next 12 months	4.0	2.2	6.2	5.9	5.7
Professional analysts, %						
Bloomberg	2019 Q4			4.7	4.6	
Interfax	December 2019		3.8	4.8	4.7	
Reuters	December 2019			4.8	4.8	
Implied inflation for OFZ-IN, %						
OFZ-IN 52001, August 2023	next 4-year average	4.9	3.8	5.1	5.0	4.9
OFZ-IN 52002, February 2028	next 9-year average			4.9	4.9	4.9
Qualitative estimates of inflation expectations						
Businesses, balance of responses	next 3 months	7.8	6.9	18.9	13.1	12.1
PMI input prices, diffusion index	next month	53.9	56.1	67.5	63.4	
PMI selling prices, diffusion index	next month	50.5	52.0	60.2	57.2	

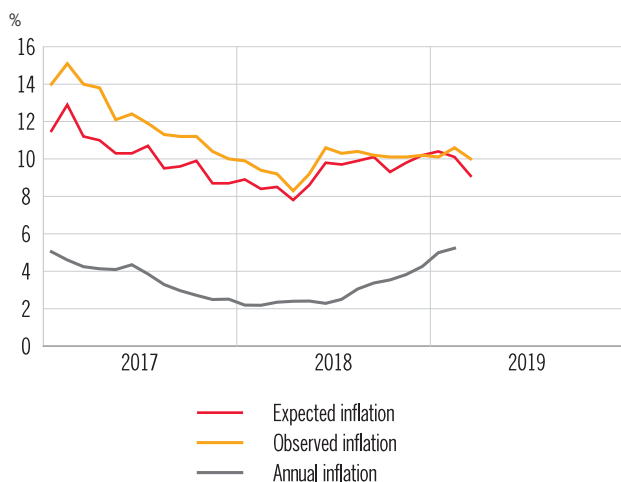
The inflation expectations of economic agents adjusted downward in February and March after growing in December 2018 - January 2019, largely on the back of the VAT rate hike (Table 1). Longer-term inflation expectations remained stable. Households' consumer sentiment improved somewhat. The reduced price expectations of businesses in February-March mean that the inflation surge triggered by the VAT hike is mostly complete. Going forwards, businesses only expect a smooth price adjustment to the new VAT rate. Analysts' 2019 forecast remained virtually unchanged; similar to Bank of Russia forecasts, they assume that inflation will slow down in the second half of 2019 with subsequent stabilisation close to 4% in 2020.

Inflation expectations of households

According to the Bank of Russia-commissioned inFOM survey, in March 2019, the median estimate of annual inflation expected by households in the next 12 months dropped by 1.0 pp to 9.1% (Table 1, Chart 1). Responses to the question about inflation dynamics in the coming month and over a one-year horizon (Charts 2 and 5 of *the inFOM Analytical Report on the Third Survey in 2019*, further referred to as the Report) also point to reduced inflation expectations. Respondents tend to mention less often the VAT rise and growth in petrol prices as factors of future inflation; this may in part reflect the observed moderate consumer price movements (Table 2).

INFLATION OBSERVED AND EXPECTED
BY HOUSEHOLDS (MEDIAN ESTIMATE)

Chart 1



Sources: InFOM, Rosstat.

FACTORS BEHIND HOUSEHOLD INFLATION
EXPECTATIONS
(as % of respondents)

Table 2

	October 2018	January 2019	February 2019	March 2019
Current change in petrol prices	43	50	53	47
Ruble exchange rate fluctuations	33	37	38	36
Current change in food prices	30	33	35	33
Wage and pension indexation	28	31	37	32

Source: InFOM.

That said, estimates for observed inflation are shaped by accelerating annual inflation and moderate monthly price growth¹. According to respondents, there was a considerable price growth in January, which was followed by a moderate growth (Chart 1 of the Report), however, respondents see inflation as continuing to accelerate y.o.y (Chart 4 of the Report). In addition, in March respondents began to mention less often the high price growth of the majority of most popular food products (Chart 3 of the Report). The overall median estimate of observed monthly inflation dropped somewhat, however, remaining in the range which had been its typical since June 2018 (Chart 1).

Utility services continued to be most frequently mentioned among consumer items that had demonstrated the most sizeable price increase in the past month (Chart 3 of the Report). 44% of respondents spoke about their appreciation (25% in December 2018). Apparently, this is associated with the indexation of utility rates starting 1 January in connection with the VAT hike and a tangible increase in household waste disposal prices. At the same time, growth in the responses about utility services slowed down (to 2 pp vs 9 pp in February) pointing to an abatement in households' concerns around the one-time character of indexation.

Overall, households tend to view inflation acceleration as temporary. Inflation expectations over a three-year horizon produced a weak response to the dynamics of actual inflation (Chart 9 of the Report). In March, the share of respondents who thought that inflation would be close to 4% in three years remained relatively low, despite showing consistent growth. This points to the fact that inflation expectations remain elevated and non-anchored.

Consumer sentiment of households

Similar to inflation expectations, indicators of consumer optimism continued to improve for a second month in a row. As in February, estimated changes in financial standing

¹ Consumer Price Dynamics, informational and analytical commentary, No. 2 (38), February 2019.

improved (Chart 16 of the Report). Continued growth was registered in the optimism about the expected improvement of living standards and employment rates (Chart 15 of the Report). All this led to a consistent increase in the consumer sentiment index in March 2019 (Chart 13 of the Report).

Nevertheless, despite a certain increase, the assessment of how favourable this time period is for large purchases holds at a lower level than a year earlier (Chart 19 of the Report). Similarly, the low level of consumer activity is evidenced by the balance of responses about the best way to spend spare money: expensive purchases are mentioned by far less often than a year earlier (Chart 22 of the Report).

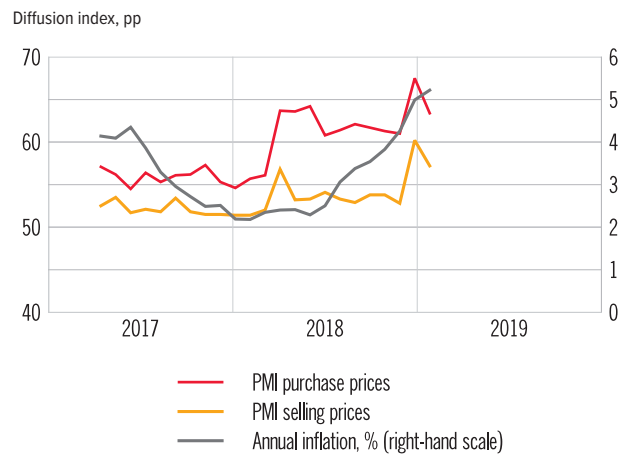
Price expectations of businesses

Markit PMI surveys² suggest that in February 2019 businesses reduced their expectations regarding an increase in both input and output prices in the month to come (Chart 2). Thus, the January surge in price expectations was one-off and was largely conditioned on the VAT rate hike. Additionally, respondents to the survey mentioned high prices of raw materials and fuel, as well as rising wages among the key cost growth factors.

According to the Bank of Russia's survey of businesses³, companies' price expectations for three months ahead dropped, as in February, after the growth observed since February 2018 (Chart 3). The decline was rather homogeneous by sector and region. This fact indicates that the pass-through of the VAT hike to prices has largely faded away. The drop in expectations was most noticeable in the wholesale and retail trade after their considerable growth in the second half of 2018. Expectations in services and construction dropped the least. Despite the decline, businesses' expectations remain elevated and non-anchored.

PRICE EXPECTATIONS OF BUSINESSES
(MARKIT PMI)

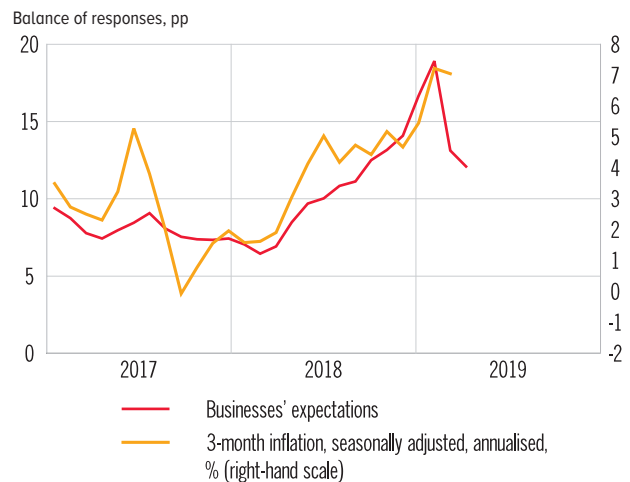
Chart 2



Sources: IHS Markit PMI, Rosstat.

PRICE EXPECTATIONS OF BUSINESSES
(BANK OF RUSSIA)

Chart 3



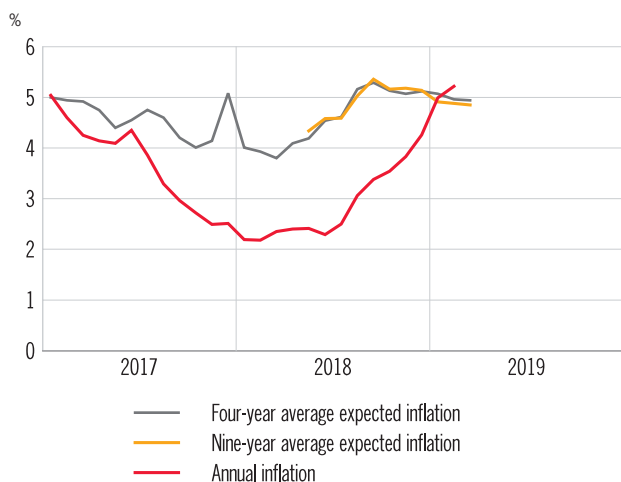
Sources: Bank of Russia, Rosstat.

² See <https://www.markiteconomics.com/public>.

³ For survey details, refer to https://www.cbr.ru/Content/Document/File/62_829/analysis_18-12.pdf.

IMPLIED INFLATION
FOR OFZ-IN

Chart 4



Sources: Bloomberg, Rosstat, Bank of Russia calculations.

Implied inflation for OFZ-IN

According to Bank of Russia estimates⁴ based on the comparison of the expected yield on inflation-indexed OFZ (OFZ-IN) and nominal OFZ, in March 2019 inflation expectations (for four and nine years ahead) were virtually unchanged, remaining elevated relative to the Bank of Russia's inflation target (Chart 4). This points to the fact that market participants still consider long-term proinflationary risks to be sufficiently high.

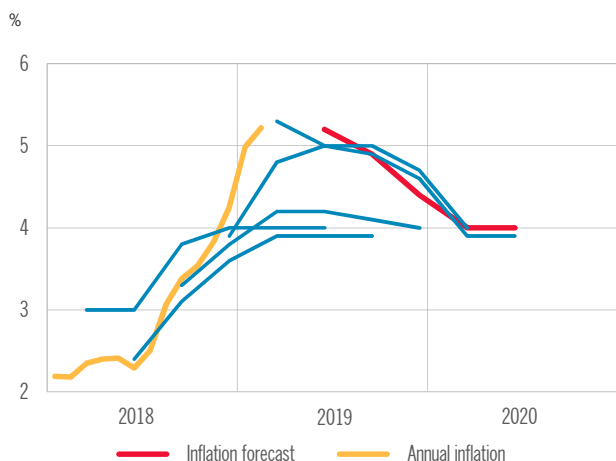
Analysts' inflation expectations

The 2019 year-end inflation range forecast made by experts⁵ in February 2019 remained virtually unchanged at 4.6-4.8% compared to the previous month (Table 1). That said, both analysts and the Bank of Russia believe that inflation acceleration in 2019 is temporary in nature. Their forecasts suggest that annual inflation is set to begin to decline from 2019 Q2 to return to the near 4% level in 2020 Q1 (Chart 5).

According to the Bank of Russia's forecast, annual inflation is set to peak to its local high in March-April 2019 to then drift down to 4% in the first half of 2020, when the pass-through of the VAT hike will be exhausted.

ANALYSTS' FORECAST THROUGHOUT
MID-2020

Chart 5



Sources: Bloomberg, Rosstat.

⁴ See 'Deriving Expectations of Future Short-term Interest Rates from OFZ Yield' (Bank of Russia Working Paper Series, No. 11, May 2016).

⁵ Surveys by Interfax, Bloomberg, and Thomson Reuters.

Cut-off date – 21.03.2019.

A soft copy of the information and analytical commentary is available 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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