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CONSUMER PRICE DYNAMICS

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Consumer price dynamics: facts, assessments and comments (July 2018)

Current developments will help bring inflation back to the 4% target. In July 2018, annual inflation rose to 2.5% vs 2.3% in June in line with the Bank of Russia's forecast.[1] This is primarily caused by the normalisation of food price dynamics. Annual inflation is forecast to rise further in August (to 2.8–3.0%). Estimates suggest that inflation will reach 3.5–4% by the end of the year. The Bank of Russia predicts that annual inflation will temporarily overshoot 4% in 2019 because of the increase in value added tax (VAT) from January 2019. The annual consumer price growth rate is expected to return to 4% in early 2020.

Consumer price dynamics (%)

	Jul-16	Jul-17	May-18	Jun-18	Jul-18
Inflation					
– month on corresponding month of previous year	7.2	3.9	2.4	2.3	2.5
– month on month/seasonally adjusted	0.5/0.5	0.1/0.0	0.4/0.4	0.5/0.5	0.3/0.2
Price growth on corresponding month of previous year					
– food products	6.5	3.8	0.4	-0.2	0.5
– non-food goods	8.4	3.7	3.4	3.7	3.8
– services	6.5	4.1	4	4.1	3.8
Price growth on corresponding month/seasonally adjusted					
– food products	0.0/0.5	-1.0/-0.4	-0.1/-0.1	0.4/0.5	-0.3 / 0.3
including: fruit and vegetables	-4.2 / 0.3	-8.3 / -3.9	-1.3 / -3.5	0.6 / 0.1	-5.1 / -0.5
– non-food goods	0.4 / 0.5	0.1 / 0.2	0.9 / 0.9	0.4 / 0.5	0.1 / 0.2
including: non-food goods excluding petrol	0.3 / 0.4	0.1 / 0.2	0.3 / 0.3	0.2 / 0.3	0.2 / 0.3
– services	1.7 / 0.3	1.6 / 0.2	0.3 / 0.3	0.7 / 0.4	1.3 / -0.1
Core inflation, month on corresponding month of previous year	7.4	3.3	2	2.3	2.4
Annual inflation, 12-month average	10.7	5.1	2.8	2.6	2.5

Sources: Rosstat, Bank of Russia calculations.

Current developments will help bring inflation back to the 4% target. Annual inflation rose to reach 2.5% in July 2018 vs 2.3% in June and 2.4% in the spring months. The rise in annual inflation was largely associated with normalisation of food price dynamics which was driven by several factors.

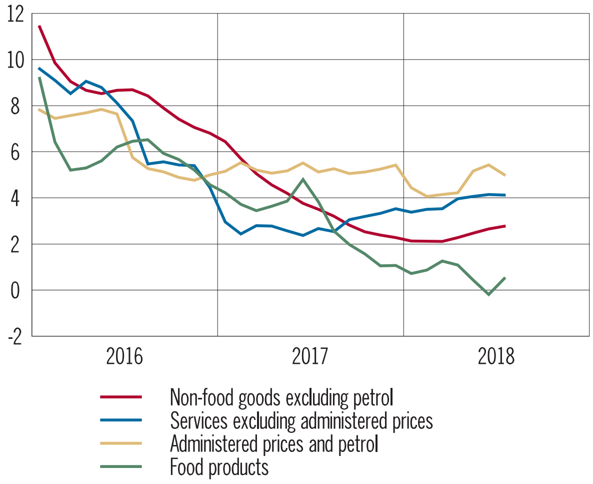
First, **last year's low base effect translated into the growth rate of fruit and vegetable prices.** In June 2017, fruit and vegetable prices rose much faster as the arrival of new harvest was delayed. This surge gave way to a considerable drop in vegetable prices in July 2017. In July 2018, price dynamics were moderate and consistent with seasonality. As a result, annual price drop rates in this product category slowed from 9.8% in June to 6.7% in July. August 2018 is expected to see a steadier arrival of new vegetable crops to the market than last August. This will result in even slower decline in prices of these products in annual terms.

Second, **other food prices were affected by changes in the supply and demand ratio,** which were primarily registered in the livestock market including the market of meat and meat products and that of milk and dairy products. Whereas these markets enjoyed quite high output

[1] *Press release on the key rate of 27 July 2018; 'Consumer Price Dynamics: Facts, Assessments and Comments (May-June 2018)'.*

Petrol price growth rates adjusted in July

Per cent change, year-on-year

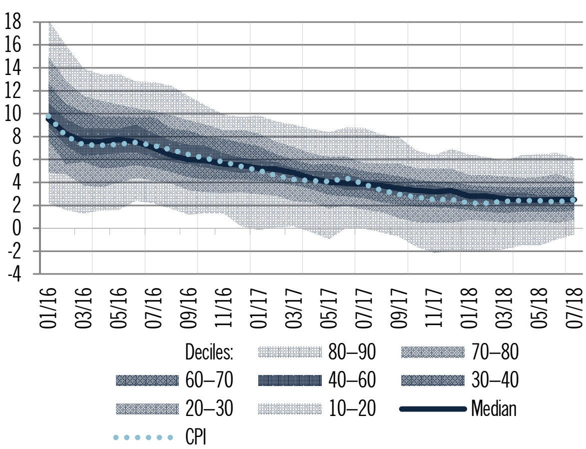


Sources: Rosstat, Bank of Russia calculations.

last year, the current season saw a considerable drop, given the demand movements. As a result, monthly price growth rates were higher than in previous periods. This translated into annual price growth rates – prices of foods other than fruit and vegetables – rising by 1.4% in July vs 1.1% in June. The rebalancing of supply and demand will be completed in food markets in the months to come, bringing annual inflation back to 4%.

Having said that, **certain food markets are influenced by local factors** which may temporarily exert an upward pressure on prices. In particular, several outbreaks of infectious diseases in livestock decreased the supply of pork and poultry, affecting consumer prices. Furthermore, faster growth in fish and seafood prices (to 4.6% YoY in July) is associated with the ruble's weakening in spring. As foreign sales proved somewhat more profitable for producers, prices in the domestic market rose.

Most dense price growth concentration shifted towards 2.9-3.0%



Sources: Rosstat, Bank of Russia calculations.

Drought in several regions will not have an excessive proinflationary effect on cereal prices. On the one hand, this is associated with the expected crops totalling close to a five-year average; on the other hand, heavy stocks of cereals from bumper-crop past years will curb the possible increase in food prices even amid a more modest harvest in 2018. Also, global markets, where stock prices of wheat and other crops have risen recently, are expected to bring only modest price pressure.

Overall, **annual food price growth rates are holding low** (0.5% in July). Low price growth rates in this group determined the overall low annual inflation in July (2.5%). Annual inflation is already close to 4% in the other two components of the consumer basket – non-food goods and services.

Annual non-food inflation remained stable in July 2018 (at 3.8% vs 3.7% in June). Having grown at an increased rate in previous months, **petrol prices dropped by 0.2% in July compared with the June readings,** whereas their annual growth rates slowed from 12.3% to 11.8%. This was expectedly brought by the decreased excise taxes, higher volumes of exchange sales and major oil companies' compliance with the agreement reached with the Government. These dynamics of petrol prices, which are a sensitive issue for households, will help further stabilise inflation expectations.[2]

Prices of some non-food goods were expectedly affected by the ruble's weakening in April. In particular, growth rates remained elevated in prices of certain non-food goods with a high share of import costs (household chemicals, electronics and medical goods). That said, the overall impact of foreign exchange rate on inflation remains moderate.

Annual inflation in the services sector slowed in July to 3.8% vs 4.1% in June. **Housing and utility rates, traditionally revised every July, rose less than last year:** utility rates increased by 4% and housing rates added 1.3% in line with the forecast. Housing rates may rise in the months to come as the indexation timeframes for some housing services are not determined.

[2] *See 'Inflation Expectations and Household Consumer Sentiment', No. 7, July 2018.*

Annual growth in services prices (bar utility rates) also slowed down (by 0.1 pp to 3.8%). The main contribution came from the adjustment of tourist services price growth in the follow-up to the World Cup. Hotel rates dropped in July by 4.1%, pointing to a faded temporary tailwind of the World Cup. Its effect on inflation expectedly failed to exceed 0.1 pp.

The after-World-Cup service price adjustment is also registered in passenger transport fares. Thereby, growth in airline fares declined after a one-off hike last month compared both with June 2018 and last July. At the same time, fare dynamics (especially bus fares) are still being affected by the earlier rise in fuel prices. The effect of the latter factor is expected to hold in the near future given that transport companies are gradually revising the cost of their services.

A wide range of price indicators support the inflation return to 4% by year-end. Inflation indicators which describe its most stable components have been steady and tended to rise in recent months. In July, core inflation stood at 2.4% (vs 2.3% in June and 2% in May). The median price growth held at 2.5% in July (the fourth straight month). The most dense price growth concentration (distribution mode) shifted towards 2.9-3.0% (vs 2.5% in June).

Preliminary estimates suggest that **consumer prices are poised to grow by 2.8-3.0% in August.** By the end of the year, inflation is expected to range between 3.5% and 4%. The Bank of Russia forecasts that **annual inflation may temporarily overshoot 4% in 2019** because of the planned tax measures. Though VAT will be raised from January 2019, its effect on prices may be seen as early as 2018. This is suggested, among other things, by the Bank of Russia-conducted company surveys. Some respondents intend to raise prices of their products throughout this year. This is overall in line with the developments in other countries which have already increased VAT.

The Bank of Russia will monitor inflation expectations and their effect on prices as part of its monetary policy.

Cut-off date – 8 August 2018.
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.*