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INFLATION EXPECTATIONS
AND CONSUMER
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INFLATION EXPECTATIONS AND CONSUMER SENTIMENT

Households' inflation expectations rose to 10.2% in December from 9.8% in November. They were primarily fuelled by the VAT rate increase from 2019. Unanchored inflation expectations – as suggested in part by growth not only in short-term but also long-term inflation expectations – are set to bring about secondary effects on inflation. According to Bank of Russia estimates, a forward-looking response of monetary policy will contain secondary effects and bring inflation down to the near 4% target as early as 2020 H1, after it temporarily accelerates in 2019.

In December 2018, households' inflation expectations for the 12 months ahead¹ increased by 0.4 pp to 10.2% (Chart 12²).

The VAT rise expectedly started to affect households' expectations by the year-end. In December, 6% of respondents (2% in November) cited this factor among the reasons for future price growth ('The VAT rate will rise from 1 January', explained the respondents). Another 5% of respondents noted that mass media released news about price growth more often in the run-up to the VAT rate hike ('The media reported that all prices will go up', 'Newspapers wrote that prices would rise').

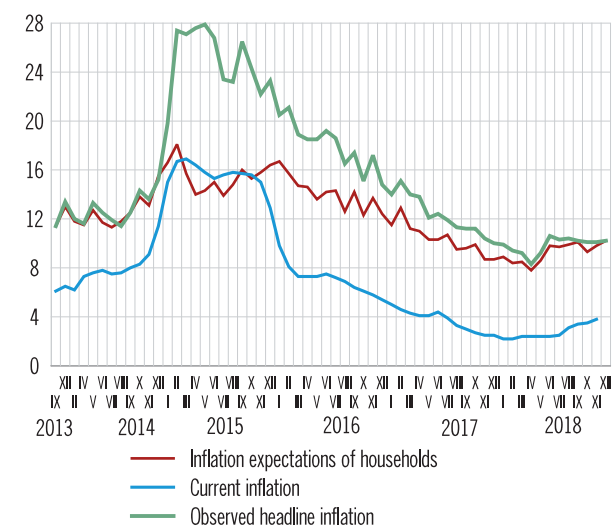
Short-term inflation expectations of respondents were affected by seasonality: 12% of respondents expected price growth in the run-up to New Year and an increase in administered tariffs starting from 1 January ('Prices are always higher before holidays', 'New Year holidays increase demand').

In December, respondents cited petrol as the product the price of which increased most rapidly as frequently as in the October-November period (33% vs 31-32%); this reflects the rise in fuel prices registered earlier in the year. Petrol holds the second position among goods and services the increase in prices of which is mentioned most frequently. Meat and poultry come first with 42% of respondents noting the rise in prices in this category (40%

a month earlier). Also, respondents mentioned growth in prices of dairy products, eggs, fruit and vegetables more often.

Inflation respondents observed in December equalled inflation expectations for the first time since early 2015 (10.2%). In the past four years, respondents estimated future inflation to be lower than current inflation, that is, they expected consumer price growth to slow down. Currently, respondents do not expect inflation to go down any longer. This is also confirmed by replies to the question about the changes in prices expected within the next 12 months. In December, 28% of respondents (the highest share since 2015) believed that prices would rise faster than at the present time.

Inflation expectations remained elevated in December



Sources: Public Opinion Foundation, inFOM, Bank of Russia calculations.

¹ inFOM median estimate.

² Here and elsewhere, references are made to charts in the Summary Report on Survey 12 (December 2018).

Answers to the question whether inflation reaches 4% in 2018 and over a three-year horizon testify to inflation expectations remaining elevated. Thus, the share of respondents who believe that inflation will be higher than 4% in 2018 rose to 59% vs 53% seen in November. The share of those, who expect inflation to exceed 4% over a three-year horizon, increased to 53% vs 50% a month earlier.

The Bank of Russia's estimates of inflation expectations based on the inFOM survey and the current pace of inflation³ rose in December to total 5.2-5.6% in 2018.

Households' expectations of a rise in inflation are overall feasible: the Bank of Russia's forecast suggests that inflation is poised to go up in early 2019, primarily on the back of the VAT hike. As a result, it may

reach 5.5% early in the year. In 2019 H2, the consumer price growth rate will start to slow to return to 4% in 2020 H1. Given the VAT hike, inflation expectations are likely to rise further in the next few months. The fact that not only short-term but also long-term expectations are rising confirms that they are unanchored and secondary effects may emerge.

The Bank of Russia raised the key rate in December to, among other things, cap inflation expectations and the related secondary effects. Inflation expectations remain unanchored, and this is one of key factors of uncertainty over 2019 H1 inflation. The forward-looking response of monetary policy will bring inflation down to the near 4% target after its temporary rise.

An inFOM survey failed to register any considerable changes in respondents' consumer sentiment in December. Financial standing estimates and expectations deteriorated somewhat compared with the previous month.

³ When calculating this indicator, the Bank of Russia takes into account qualitative responses ('inflation will rise / fall') rather than quantitative ones, and compares them with current inflation.

Cut-off date – 20 December 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.