



Bank of Russia



INFLATION EXPECTATIONS AND CONSUMER SENTIMENT

No. 5 (29) • May 2019

Information and analytical commentary

5 June 2019

Inflation expectations and consumer sentiment (May 2019)

Household inflation expectations remained virtually unchanged in May 2019. The price expectations of businesses for the months to come continued to decline, though at a slower pace. The dynamics of inflation expectations reflect the fading effect of the VAT rate hike and other temporary factors. Despite a decline, short-term expectations of economic agents remain elevated. The downward trend in long-term inflation expectations of financial market participants, which approached 4%, persisted. Analysts' predictions remained virtually unchanged and suggest that after a temporary hike in early 2019, annual inflation will resume its downward movement in the second quarter to reach 4.5-4.8% as of the year-end and stabilise near 4% in 2020 Q1. According to the Bank of Russia's forecast, annual inflation is set to return to 4% in the first half of 2020.

INFLATION EXPECTATION INDICATORS

Table 1

	Expectation horizon	May 2017	May 2018	March 2019	April 2019	May 2019
Households' inflation expectations, %						
Public Opinion Foundation (median, expected inflation)	next 12 months	10.3	8.6	9.1	9.4	9.3
Public Opinion Foundation (median, observed inflation)	past 12 months	12.1	9.2	10.0	10.5	10.4
Public Opinion Foundation (Bank of Russia calculations)	next 12 months	3.7	2.2	5.7	5.5	5.4
Professional analysts, %						
Bloomberg	2019 Q4		4.0	4.7	4.5	4.6
Interfax	December 2019		4.0	4.6	4.5	
Reuters	December 2019		3.9	4.8	4.8	
Implied inflation for OFZ-IN, %						
OFZ-IN 52001, August 2023	next 4-year average	4.4	4.2	4.9	4.6	4.3
OFZ-IN 52002, February 2028	next 9-year average		4.3	4.8	4.7	4.3
Qualitative estimates of inflation expectations						
Businesses, balance of replies	next 3 months	8.2	10.1	11.0	9.9	9.5
PMI input prices, diffusion index	current month	56.2	63.6	61.8	58.9	
PMI output prices, diffusion index	current month	53.5	53.2	55.0	54.4	

Household inflation expectations

According to an inFOM survey commissioned by the Bank of Russia, the median estimate of annual inflation observed by households in the past 12 months remained virtually unchanged (10.4% compared to 10.5% in April, Table 1, Chart 1). The median estimate of inflation expected in the next 12 months stood at 9.3% (9.4% in April, Chart 1). The median estimate of inflation expectations is somewhat below the level observed since the second half of 2018, although it is still high (higher than the level in the first half of 2018).

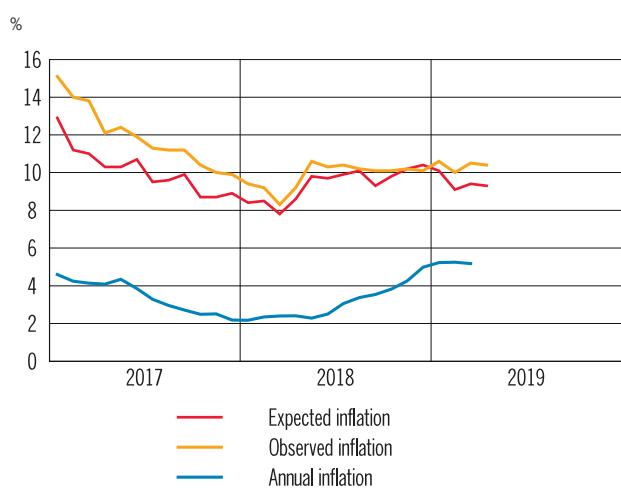
The gap between expected and observed inflation widened dramatically in recent months (to 1.1%): respondents expect it to slow down next year already.

Household inflation expectations for the next 12 months, estimated by the Bank of Russia with the use of inFOM survey data, continued the downward movement registered since February 2019. However, they remain high at the level seen in late 2016.

The share of respondents who believed that price growth over the past month was very strong continued to shrink in May (Chart 1 *inFOM Analytical Report on the Fifth Survey in 2019*, further referred to as the Report). The rise in the prices of such frequently purchased goods and services as eggs, bakery products, utility services and transport fares was less frequently perceived as considerable (Chart 3 of the Report). This is consistent with the statistics, which suggest that the month-on-month growth of these prices has slowed. Thus,

INFLATION OBSERVED AND EXPECTED BY HOUSEHOLDS (MEDIAN ESTIMATE)

Chart 1



Sources: InFOM, Rosstat.

INDEX OF CONSUMER SENTIMENT

Chart 2



Source: InFOM.

households have noticed that the temporary surge in inflation seen at the beginning of the year is currently fading.

Price expectations for the next month have also become more positive (Chart 2 of the Report). This is partially associated with seasonality: the prices of fruit and vegetables usually go down in summer.

In April and May, the share of respondents expecting inflation to be close to 4% in 2019 (Chart 8 of the Report) was significant (30–33%), the maximum since mid-2018. Nearly half of respondents believe that inflation will be ‘considerably higher than 4% a year’ in three years. Only a quarter of Russian households expect it to be ‘roughly 4% a year’ (Chart 9 of the Report). The distribution of replies to this question has not varied considerably in recent years. Therefore, household expectations continue to be high and are not anchored to Bank of Russia targets.

Household consumer sentiment

Following a drop in April, the consumer sentiment index rose in May, reaching the maximum since mid-2018 (Chart 2). Among the components of the index, respondents' estimates of the country's development prospects and of personal financial standing in the next year improved most of all (Chart 12 of the Report). Respondents became more optimistic about large purchases (Chart 18 of the Report). However, the share of those who are not ready to make such purchases is still dominant.

In May, households were asked an additional quarterly set of questions about their credit sentiment and behaviour. Survey data correlate with statistics about growth in retail lending.¹ As many as 44% of respondents have loans at the moment of survey. This share has grown steadily from 34% in the first half of 2017 (Chart 29 of the Report). The share of those who took out loans has also increased since the beginning of the year, to 9% from 2–5% in 2017–2018 (Chart 10 of the Report). Among those who currently have no loans, the share of persons who have never taken out loans is

¹ Monetary Policy Report, No. 1 (25), March 2019, p. 43.

diminishing (to 31% from 37% in February 2017, Chart 35 of the Report). Consumer loans are the most popular type (Chart 30 of the Report). The share of respondents who are generally against borrowing is simultaneously decreasing (Chart 36 of the Report).

Business price expectations

According to Markit PMI surveys,² the diffusion index of input and output prices of businesses continued to decline in April 2019 (Chart 3). This was associated with the continued weakening in the effect of the VAT rate hike on costs and prices after the January surge. Nevertheless, the index remains higher than in recent years. According to the Bank of Russia's survey of businesses,³ in May 2019, companies' price expectations for the three months ahead continued the downward trend observed since February (Chart 4). The decline was registered in all industries and regions, pointing to a fading of the effect of a general factor, i.e., the VAT hike. However, businesses' expectations for the three months ahead remain elevated.

Implied inflation for OFZ-IN

The trend towards a decline in the inflation expectations of financial market participants for the four and nine years ahead continued in May. According to Bank of Russia estimates,⁴ implied annual inflation on the said horizons stood at 4.3% (compared to 4.9–5.1% in January and 4.6–4.7% in April, Chart 5). Apart from the overall trend towards a decline in inflation expectations, the decrease in estimates may be caused by a technical factor: a three-month indexation lag. Thus, in April, indexation of the nominal value took into account increased inflation in January, whereas in May, the value of indexation went down significantly due to the slowing of monthly growth in prices in February.

² For details, refer to <https://www.markiteconomics.com/public>.

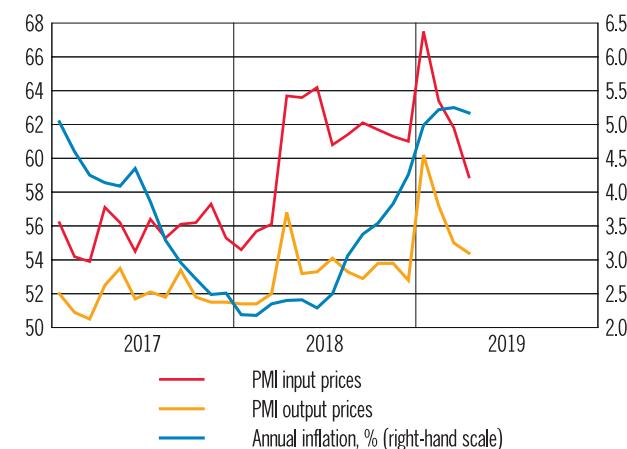
³ For survey details, refer to http://www.cbr.ru/Content/Document/File/62829/analysis_18-12.pdf.

⁴ The estimates are based on a comparison of the expected yields on inflation-indexed federal government bonds (OFZ-IN) and nominal OFZs. For details, refer to 'Deriving Expectations of Future Short-term Interest Rates from OFZ Yield' (Bank of Russia Working Paper Series, No. 11, May 2016).

CHANGES IN COMPANIES' PRICES (MARKIT PMI)

Chart 3

Diffusion index, pp

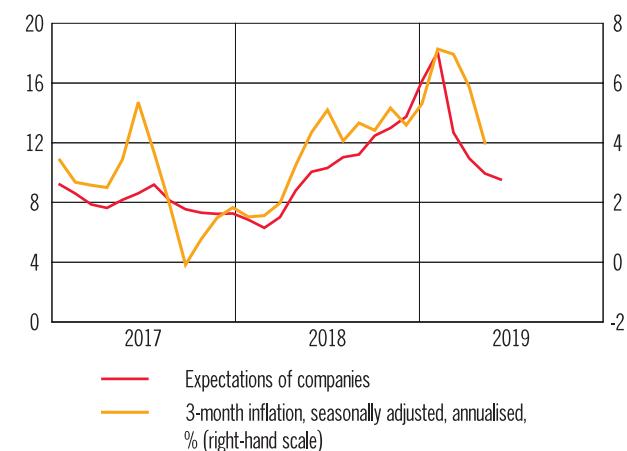


Sources: IHS Markit PMI, Rosstat.

PRICE EXPECTATIONS OF COMPANIES (BANK OF RUSSIA)

Chart 4

Balance of replies, pp

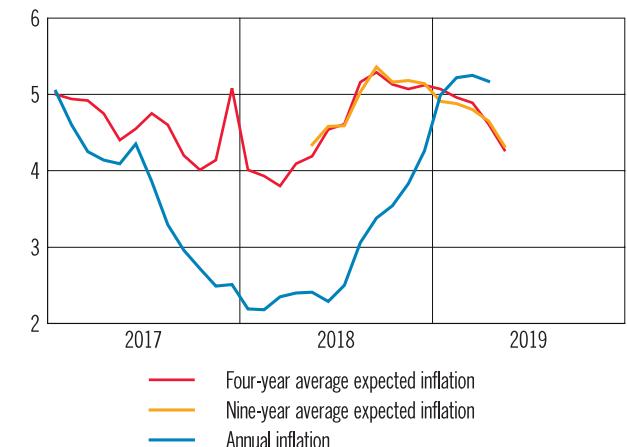


Sources: Bank of Russia, Rosstat.

IMPLIED INFLATION FOR OFZ-IN

Chart 5

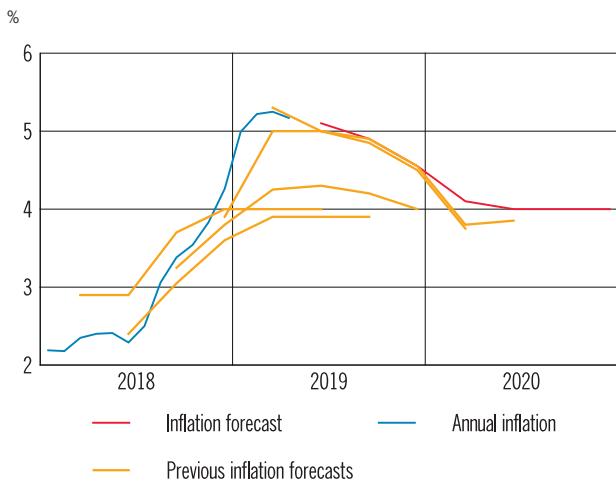
%



Sources: Bloomberg, Rosstat, Bank of Russia calculations.

BLOOMBERG ANALYST CONSENSUS FORECAST

Chart 6



Sources: Bloomberg, Rosstat.

Analysts' inflation expectations

The range of analysts' inflation forecasts for December 2019⁵ has remained almost unchanged since January, holding at 4.5–4.8% (Table 1). Analysts consider the acceleration in inflation of early 2019 to have been temporary. Their predictions suggest that annual consumer price growth rates will start to decrease from 2019 Q2 to stabilise near 4% in 2020 Q1 (Chart 6).

Bank of Russia forecast

According to the Bank of Russia's forecast, annual inflation is set to return to 4% in the first half of 2020. In its forecasts, the Bank of Russia traditionally adheres to conservative estimates of global economic and financial market development prospects. Furthermore, the Bank of Russia takes into account the risks associated with the unanchored inflation expectations of economic agents, which follow current price changes and are influenced by one-off factors, including seasonal price fluctuations.

⁵ Surveys by Interfax, Bloomberg, and Thomson Reuters.

Cut-off date – 31 May 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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