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Inflation expectations and consumer sentiment

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Inflation expectations of households

In September 2017, households' inflation expectations for one year ahead alongside inflation observed over the last 12 months changed little if at all compared to August and held at their all-time lows. That said, qualitative estimates of observed and expected inflation continued to improve. Responses to the questions about prices of tracer commodities showed that households still perceived inflation to be higher than the actual one. The Bank of Russia's monetary policy stance remains moderately tight, keeping inflation close to 4% and bringing about a further drop in inflation expectations.

In September 2017, **inFOM's direct estimate of household inflation expectations for the next 12 months** (median value), based on the responses to the question about the inflation rate, **hardly changed and held at its all-time low** (9.6% after 9.5% in August) (Figure 8[1]). At the same time, **inflation expectation estimates made by the Bank of Russia** on the basis of replies to qualitative questions about next year price growth (inFOM survey) continue to decline (2.8%[2] in September against 3.2% in August). This was largely caused by a growing proportion of responses that prices will increase slower than before and will remain unchanged next year (Figure 5).

This difference in the dynamics of qualitative and quantitative estimates of inflation expectations may be associated with households' perception of current inflation. Albeit a growing proportion of respondents mention a considerable inflation reduction (Figure 4) and its further slowdown (Figure 5), they still hesitate to believe that inflation is really close to 4% and reduce their numerical estimates, because inflation was relatively high as far back as last year. The proportion of those who believe that inflation will stand at 4% in late 2017 increased slightly; however, most respondents are still hesitant (Figure 10). These factors create **risks of persistently high inflation expectations in future** and the Bank of Russia will need time to fuel households' confidence and bring inflation expectations down.

The direct estimate (median value) of observed inflation (Figure 8) stayed close to its all-time low (11.2% in September against 11.3% in August). However, quantitative estimates of both past month (Figure 1) and past year (Figure 4) price growth improved.

As price movements were favourable and no particular commodity group or services posted any upticks, there was a decline in the proportion of respondents speaking about strong price growth (Figure 3). Considerable growth in utility rates and prices of fruit, vegetables, petrol, sugar, salt, bread, eggs, cereals and pasta was mentioned less frequently.

[1] Here and elsewhere, references are made to figures in the short report on survey 9 (September 2017).

[2] The difference in inFOM's and the Bank of Russia's estimates comes as a result of the methodology applied. InFOM's direct estimate is derived from respondents' answers to the question on the expected range of inflation (interval estimate). In calculating its probabilistic estimate, the Bank of Russia uses responses about changes in inflation rather than responses with specific price growth rates, considering that respondents may have difficulty choosing a numerical interval. These responses are then mapped over current inflation estimates to derive a probabilistic estimate. For details, refer to the 'Monetary Policy / Inflation and Inflation Expectations' section of the Bank of Russia website.

In September, respondents were first asked to estimate changes in the pace of growth in prices of three groups of tracer commodities over the past year (fruit and vegetables, tea and coffee, sugar) (Figure 6) and expectations of future dynamics of these prices (Figure 7). The replies showed that **most respondents believed that prices grew at the same pace as before and expected this growth to continue in future.** The proportion of those who believe that sugar prices decreased in the past year was lower than those claiming their persistent growth. However, Rosstat data suggest that sugar prices have been falling almost uninterruptedly for the past 12 months: in August 2017, the prices were 16.5% lower than a year earlier.

In their responses about the fruit and vegetables product group, respondents stick to the opinion that prices for these goods grew as before and will grow further. Significantly, the June surge in inflation largely associated with growing prices of fruit and vegetables was followed by its reduction in July and August along with a drop in fruit and vegetable prices.

The emerging nature of inflation expectations points to persistent pro-inflationary risks. However, inflation anchored close to 4%, **with monetary conditions remaining moderately tight, is set to foster a further reduction in inflation expectations.**

Consumer sentiment of households

In September 2017, estimated changes in financial standing over the year continued to improve, while changes expected in September remained stable. On the back of rising estimates of financial standing, people more frequently refer to the present time as favourable for large purchases. The consumer sentiment index rose in September. These trends are natural amid economic improvements and bear no inflation risks.

In September 2017, **estimated changes in the financial standing over the past year continued to improve** (Figure 18). In late 2016, the proportion of respondents who mentioned better financial standing increased somewhat, this year this proportion remains almost unchanged (11%). The option suggesting the unchanged financial standing remains the most widely chosen (57%). That said, the proportion of those who believe that their financial standing has deteriorated over the past year has been shrinking consistently since early 2016. Expectations of changes in financial standing next year have been stable enough since early 2017 (Figure 19). In particular, in the period between June and September the proportion of those expecting their financial standing to remain unchanged stood at 44%, while the share of those who expected their welfare to improve in August and September was 20% (in July – 17%). These expectations are more optimistic that those registered in 2016.

Respondents' attitude to large purchases continued to improve (Figure 22). The balance of replies continued to grow hitting new highs since early 2015: one in four respondents believes that this period of time is favourable for such purchases as furniture, household appliances and electronics. This improvement is in line with the observed revival in consumer demand (in August 2017, retail trade turnover grew by 1.9% against the reading registered in August 2016).

The outcomes of the September survey that describe households' savings sentiment proved to be inconsistent. This year has registered a slight increase in the proportion of respondents who believe that this period of time is favourable for savings (Figure 25). However, in September the proportion of respondents who said their families lacked savings increased slightly month-on-month (Figure 28) and the share of those who failed to save grew (Figure 27). These dynamics are in line with households' emerging[1] propensity to make purchases. The propensity to consume is also reflected in **the higher proportion of respondents who had loans** (Figure 39). POS loans make the largest share of loans (Figure 40). An important indicator of growing sense of security is the readiness to borrow on mortgage. These loans support retail lending considerably[2] (the proportion of respondents increased from 5% in August to 7% in September). Given the rising income, growing loans bear no risk of inflation acceleration.

[1] *See Monetary Policy Report No. 3, September 2017. The Savings and Consumption Household Behaviour Models box.*

[2] *See Monetary Policy Report No. 3, September 2017. The Internal Financial Conditions section.*

Overall respondents' positive replies about their financial standing, openness to large purchases and the country's development prospects pushed up the consumer sentiment index considerably (Figure 15). However, respondents are more likely to believe in growing production and income than improvements in employment and corruption countering (Figure 17).