

PASS-THROUGH EFFECT: RISE IN PRICES IN Q3 WILL SLOW DOWN¹

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The analysis of consumer prices dynamics and the forecast based on the model of exchange rate pass-through effect indicates that in the Q3 2016, one should not expect significant inflation growth. The forecast of price dynamics in consumer segments is quite heterogeneous: the prices of non-food products will grow more (4.9% relative to December 2015) than the prices of food products (3.4% relative to December 2015), while in the latter group, the biggest growth will be observed in products with a significant share of imports among them (fish and seafood, sugar, sunflower oil). If expectations concerning the increase in prices are met and the dynamics of inflation projected for Q3 2016 continues until the end of the year, the level of inflation can stay at 6.5–7% per annum.

One of the significant effects of changes in the terms of trade that occurred in late 2014 and continued in 2015, which was accompanied by ruble depreciation, was a significant rise in prices observed in all major sectors of the Russian economy².

Much of this rise can be explained³ by the so-called exchange rate pass-through effect resulting from the law of one price – the equality of prices of tradable goods in different countries adjusted for transportation and transaction costs.

Generally, changes in the exchange rate influence prices through three channels: (1) change in final consumer prices of imported goods, (2) increase in the cost of imported production factors, (3) “reverse” pass-through effect of exchange rate changes due to short-term changes in the competitiveness of domestic tradable goods that can be exported and the growth in demand for them on the part of domestic and foreign consumers⁴.

Ultimately, these factors lead to an increase in consumer prices following depreciation of the national currency. The effect from the exchange rate changes appears with some lag, fading over time. This thesis may be illustrated by the graph demonstrating the changes in the consumer price index and the price indices for food and non-food products (*Fig. 1*).

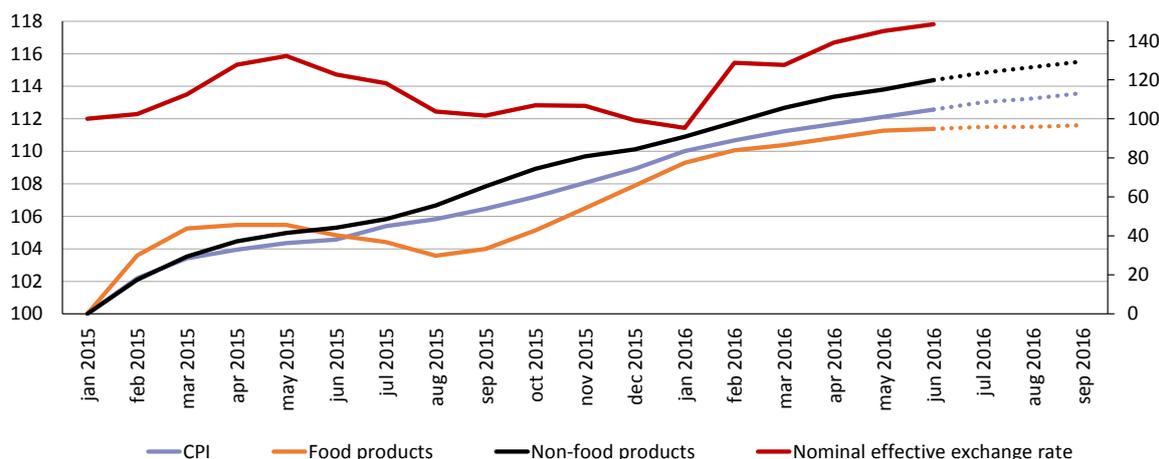
As can be seen from the graph, the greatest effect from the ruble depreciation in the end of 2014 was observed in Q1 2015. Then, consumer price infla-

1 This paper was originally published in *Online Monitoring of Russia's Economic Outlook* No.12(30).

2 See Idrisov G., Kaukin A., Ponomarev Y. Pass-through effect: Rise in prices in the production sector will continue // Real-time monitoring of the economic situation in Russia. Trends and challenges of social and economic development, No.4 (March) 2015.

3 Ponomarev Y., Trunin P., Ulyukayev A. Exchange rate pass-through in Russia // *Voprosy Ekonomiki*, No.3. 2014.

4 For example, ruble depreciation in the case of domestic products which can be supplied to the domestic market as well as for export will lead to “raising” of domestic prices of these products to the level of world prices expressed in roubles due to increased demand for them on the part of domestic and foreign consumers; this will provide equal profitability of supplies to the domestic and foreign markets.



NB: The dotted line denotes the forecast of indices for 2016.

Sources: Rosstat, author's calculations.

Fig. 1. The dynamics of the rouble nominal effective exchange rate (right axis), indices of consumer prices in 2015, and forecast for Q3 2016, calculated on the basis of the exchange rate pass-through effect (January 2015 = 100)

tion decreased, which was due to the relative stabilization of the exchange rate in Q2. Slowdown in growth rates in the non-food sector was much less significant than that in the food sector.

The new round of decline in oil prices and the corresponding rouble depreciation in autumn 2015 led to an acceleration of growth of consumer prices, but the subsequent recovery in oil spot prices since the beginning of 2016 led to moderate rouble strengthening¹. Due to the asymmetry of the pass-through effect², this rouble appreciation will put downward pressure on inflation, but not as significant in absolute terms as in case of inflation acceleration due to weakening rouble. At the same time, the consumer inflation forecast suggests that in the short term (Q3 2016), significant acceleration of rise in prices should not be expected.

According to the forecast (Table 1), the consumer price index will rise by 4.3% by September 2016 in relation to December 2015; the rise will be somewhat more substantial in some commodity groups. Among the leaders, there are: sugar – its price will grow by 11.6%, fish and seafood – by 9.3%, sunflower oil – by 7.4%. These commodity groups belong to those most dependent on supplies of imported products.

If expectations concerning the prices increase are met and the dynamics of inflation projected for Q3 2016 continues until the end of the year, the level of inflation can stay at 6.5–7% per annum. It should be clarified, however, that the forecast is highly reliable only for the next few months, because at the longer time interval, effects of future changes in the exchange rate will play a significant role.

1 Brent crude oil price rose from \$29 per barrel in mid-January 2016 to more than \$50 per barrel in end-June 2016. Strengthening of the nominal effective exchange rate January to June 2016 was 55.7%. Rouble nominal effective exchange rate strengthening in January–June 2016 was 55.7%.

2 Oppositely directed changes (strengthening and weakening) of exchange rate have a different impact, in absolute value, on domestic prices in the Russian economy. For details, see: Ponomarev Y., Trunin P., Ulyukayev A. Exchange rate pass-through in Russia // Voprosy Ekonomiki, No.3. 2014.

Table 1

**ACTUAL CHANGES AND FORECAST OF INCREASE IN CONSUMER PRICES
IN Q1–3 2016, % OF THE PRECEDING MONTH**

	Apr	May	Jun	Jul	Aug	Sep
CPI	100.4	100.4	100.4	100.4	100.2	100.3
Food products	100.4	100.4	100.1	100.1	100.0	100.1
Non-food products	100.6	100.4	100.5	100.4	100.3	100.3
Alcoholic beverages	100.8	100.4	100.6	100.5	100.6	100.5
Grain and legumes	102.1	102.9	101.9	101.6	102.0	102.3
Pasta	100.8	100.2	100.5	100.6	100.5	100.9
Sunflower oil, kg	101.0	100.6	100.0	100.2	101.1	101.7
Butter, kg	100.7	100.3	100.2	100.3	100.4	100.6
Milk and dairy products	100.6	100.2	100.1	100.0	100.1	100.2
Meat and poultry	99.7	100.0	99.8	99.9	100.0	100.1
Fruit and vegetable products, including potatoes	99.9	100.6	98.9	98.4	95.0	100.1
Fish and seafood	101.0	101.1	100.7	100.5	100.9	101.1
Sugar, kg	98.0	98.5	102.4	102.5	103.4	101.6
Eggs	97.1	91.7	92.0	94.4	97.3	99.8

NB: Italics denotes the forecast of indices for 2016, calculated on the basis of the exchange rate pass-through effect.

Sources: Rosstat, author's calculations. ●