

Ukraine Watch: Inflation returns to single-digit territory in August

Inflation returned to single-digit in August slowing to 8.6%. Main factor was a sharp decline in vegetable prices, which came to a 20-year record monthly deflation for August (-1.4%). Disinflation will add to the arguments for continuing the monetary easing cycle this Thursday.

Inflation in August returns to single-digit territory earlier than expected **1**

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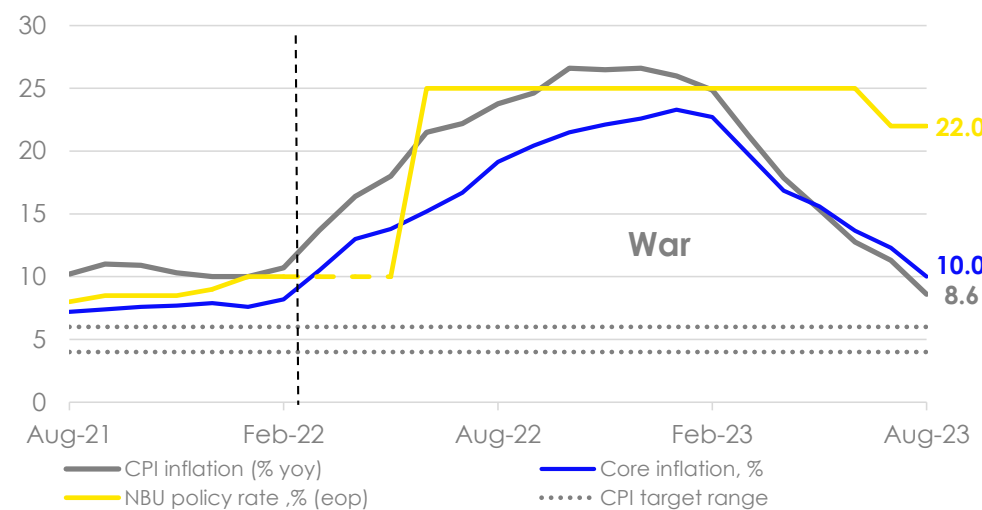
Analyst **7**



Inflation in August returns to single-digit territory earlier than expected

Even though **deflation in August** usually represents a seasonal pattern (i.e. it was recorded seven times over the last ten years), it **was rather unexpected in terms of both numbers** (i.e. -1.4% mom is the second-largest figure over August historically) **and time** (i.e. during the active warfare). We think **a very strong decline in vegetable prices** by 38% mom **was the main factor** behind this dynamic. Definitely, good harvest volumes and increasing harvesting yields (due to favourable weather conditions) contributed to this phenomenon. It is also worth noting the positive impact of the liberation of the right bank of Dnipro in the Kherson region (which reduced risks for adjacent agricultural regions) and the partial relocation of production facilities after the war started.

Chart 1 - Inflation and NBU policy rate



Source: NBU, RBI/Raiffeisen Research

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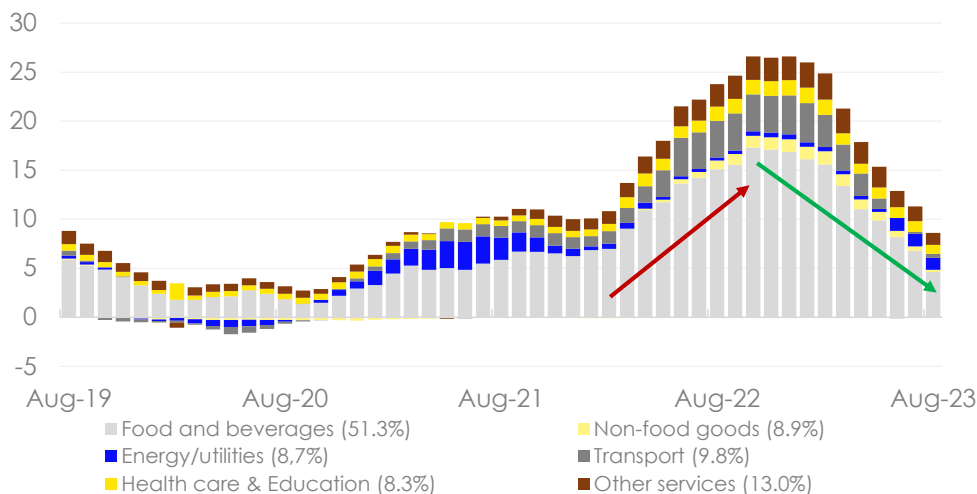
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The total monthly drop in **food prices** reached 3.9% in August, while they increased by 8.4% in annual terms, which is **close to the annual inflation rate** in August. Indeed, annual CPI returned to the single-digit area for the first time in the last two years and recorded its lowest level since May 2021. **Core CPI was recorded at 0% mom** for the second month running, **while it dropped rather visibly in yoy terms** (from 12.3% to 10.0% then) due to improving comparison base effect. It is worth noting that rising global oil prices and the return of pre-war fuel taxes preserved core CPI behind its headline reading for the fourth month in a row. Definitely, **the return to pre-war fuel taxation** did its job by raising fuel prices by 7.4% mom. But this was **the only solid pro-inflationary factor** in August, thus offsetting the trend in vegetable prices just partially. However, both these trends are not sustainable. Hence, they can be changed rather quickly in the coming months due to **two factors**: 1) the seasonal hike in fruit and vegetable prices closer to year-end and 2) the hike in fuel prices is almost exhausted, so their **impact will not be as strong in the coming months**.

According to our estimates, **the return of CPI to the single-digit area should have happened somewhat later**, i.e. closer to the end of the year. However, **we keep our annual inflation forecast** for 2023 at 9.3% yoy **unchanged** so far, even though the probability of its improvement is growing. Indeed, the main disinflation factors are almost exhausted this year, while pro-inflationary factors (like imported inflation in case NBU decides to correct the exchange rate upwards) remain moderately high.

The latest news on the inflation front provides **additional support** to our view on **the NBU key rate cut** by 200 bp to 20% this Thursday, but we do not think this may be an argument for a more aggressive key policy rate cut then. In particular, the dynamic of core inflation (10.0% in August) is in line with the NBU forecast (9.5% in 3Q23), which should provide concerns to NBU on a more aggressive key rate cut this week.

Chart 2 - Contribution to CPI (pp)



Source: Ukrstat, RBI/Raiffeisen Research

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