

Further Rise in Inflation as Expected

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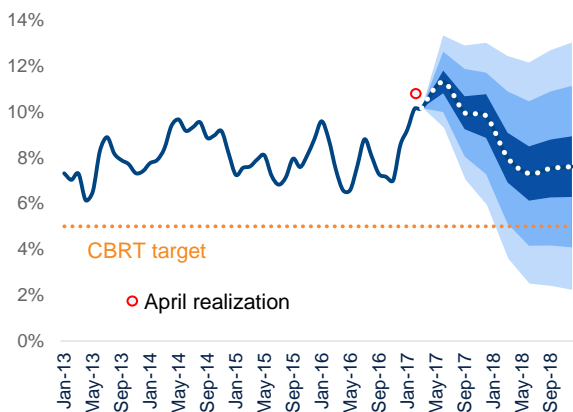
3 May 2017

Consumer prices rose by 1.31% in line with the market consensus, but lower than our expectations (1.6%) in April. Thus, annual inflation rose further to 11.9% from 11.3%. The reason behind this month's increase was almost entirely due to the surge in food prices. Core inflation remained surprisingly stable thanks to lower than expected clothing inflation, despite the ongoing exchange rate pass-through on other core items. Elsewhere, annual domestic producer prices inflation increased to 16.4% (from 16.1%), still signalling further cost push factors on inflation. Bearing in mind the likely upwards correction in clothing inflation and the ongoing but losing pace pass-through, we forecast the headline to remain stable in May. We will need to wait for June-July period for a temporary relief in annual headline inflation, as base effects on food reverse. We estimate that inflation will fall into single digits in the last two months and end the year at 9% thanks to fading pass-through and base effects on both food and administrative prices inflation.

Once more food inflation takes the stage

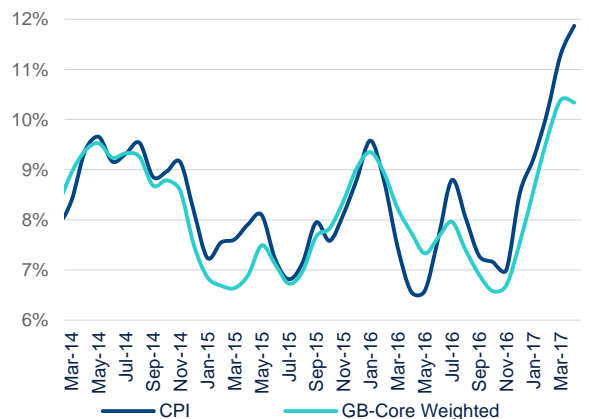
The reason behind the rise in annual inflation was the food inflation which soared to 16.1% from 12.8% in annual terms due to unfavorable base impacts and a higher realization compared to its seasonal average. The possible causes are the continuing exchange rate pass-through on processed food and supply side problems on unprocessed food. Annual core inflation stayed muted at 9.5% in April as clothing prices rose by only 9% compared to its 10-year average of 12% bringing a 0.4pp decline in the annual core inflation. The fact that other core prices still show signals of exchange rate pass-through may imply that we haven't reached the peak in core inflation yet. Energy inflation, on the other hand, continued to help as annual energy inflation fell to 11.1% from 12.2%.

Figure 1 Inflation Forecasts (Quarterly Avg, YoY)



Source: Garanti Research & Turkstat

Figure 2 CPI & BBVA-Garanti Core Inflation (YoY)

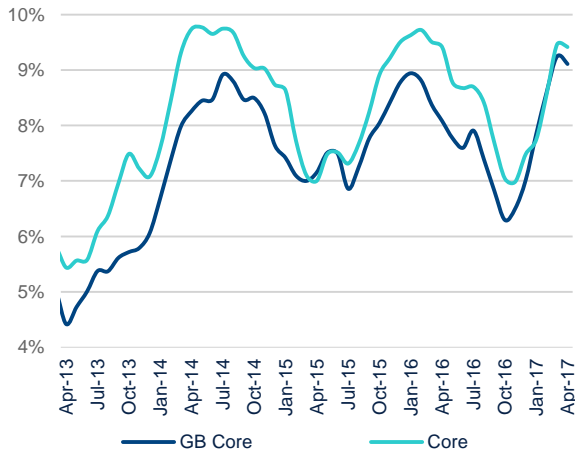


Source: Garanti Research Inflation Model & Turkstat

Inflation outlook implies two-digits until the last quarter of the year

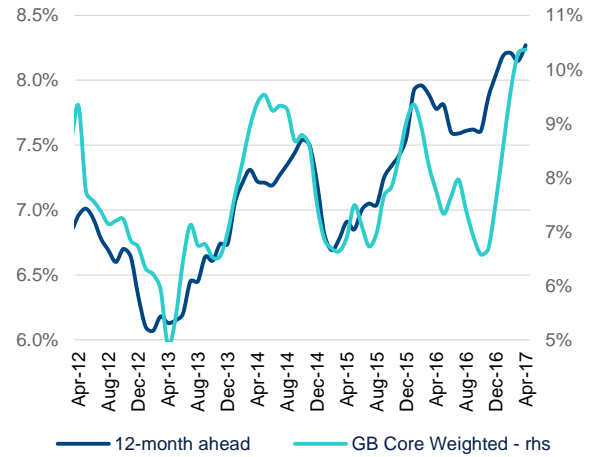
According to our estimates, inflation will remain close to the current levels in May before a temporary decline in June-July period. As credit growth has recovered rapidly thanks to the Government's fiscal stimulus, improving demand pull factors and ongoing second round impacts of cost push factors are likely to keep the headline at 10% levels until the last quarter of the year. We forecast the year-end inflation at 9% and deem the balance of risks as neutral.

Figure 3 Core Inflation (YoY)



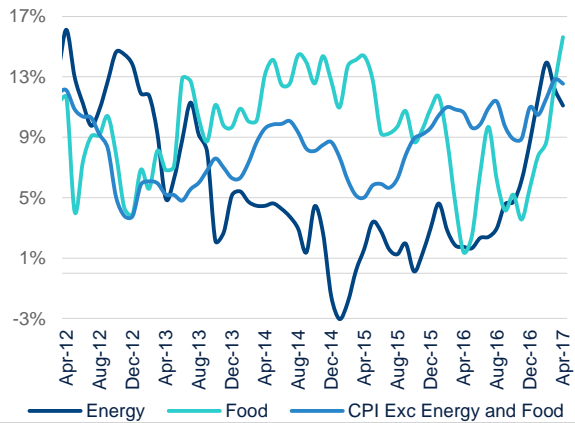
Source: Garanti Research Inflation Model & Turkstat

Figure 4 Inflation Exp. and GB-Core (YoY)



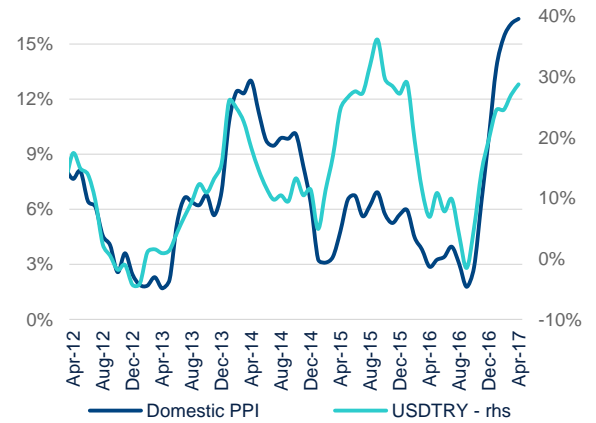
Source: Garanti Research Inflation Model & Turkstat

Figure 5 Food and Energy Inflation (YoY)



Source: Garanti Research & Turkstat

Figure 6 Domestic PPI and USDTRY (YoY)



Source: Garanti Research, CBT & Turkstat

Table 1 CPI in Subcomponents

CPI	MoM	YoY
Total	1.3%	11.9%
Food	1.2%	15.6%
Beverage & Tobacco	0.0%	21.7%
Clothing & Textile	9.1%	5.2%
Housing	0.2%	7.5%
Household Equipment	0.9%	5.6%
Health	0.5%	13.3%
Transportation	0.8%	17.9%
Communication	0.0%	4.1%
Recr. & Culture	0.7%	9.2%
Education	0.7%	9.6%
Rest. & Hotels	1.0%	9.3%
Misc. Goods & Services	1.3%	13.7%

Source: Garanti Research & Turkstat

Table 2 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	0.8%	16.4%
Mining & Quarrying	-0.8%	17.3%
Manufacturing	0.8%	18.3%
Food Products	0.8%	9.3%
Textiles	0.4%	21.7%
Wearing Apparel	1.1%	8.0%
Coke & Petroleum Products	0.4%	70.1%
Chemicals	1.0%	23.3%
Other Non-Metallic Mineral	1.0%	7.1%
Basic Metals	0.8%	42.7%
Metal Products	1.1%	18.5%
Electrical Equipment	0.7%	15.8%
Electricity, Gas, Steam	1.0%	-5.1%

Source: Garanti Research Inflation Model & Turkstat

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