

# Inflation: Core inflation implies risks on the upside

Seda Guler / Asuman Kemiksiz / Gizem Onen

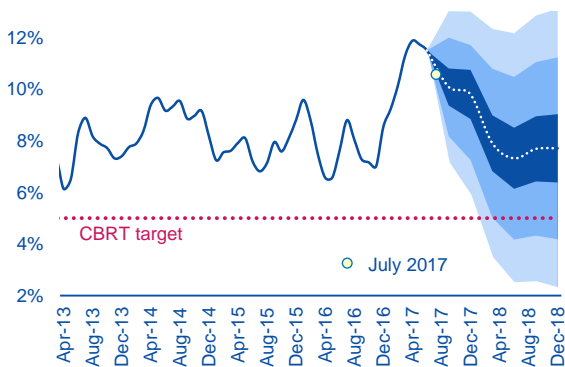
3 August 2017

Consumer prices rose by 0.15% in July, incrementally lower than the market consensus and our call (0.2%). Annual headline inflation fell to 9.8% from 10.9% thanks to food inflation and favorable base impact on tobacco prices as the Government preferred not to implement this year's price hike via PPI adjustment. Inflation outlook proved to be worsened as core inflation jumped to 9.6% from 9.2% in June, spreading over the subitems in general, reflecting the exchange rate pass-through mainly on the recent appreciation of Euro, second round price effects and spill-overs from the narrowing output gap. Elsewhere, domestic producer prices (PPI) inflation picked up to 15.5% from 14.9%, implying the ongoing upward pressure from cost push factors on consumer prices. Looking ahead, we expect the headline inflation to breach 10% in August and stay at 10-11% levels till December before it would sizably fall towards 9% at the end of the year.

## Core inflation outlook needs to be monitored

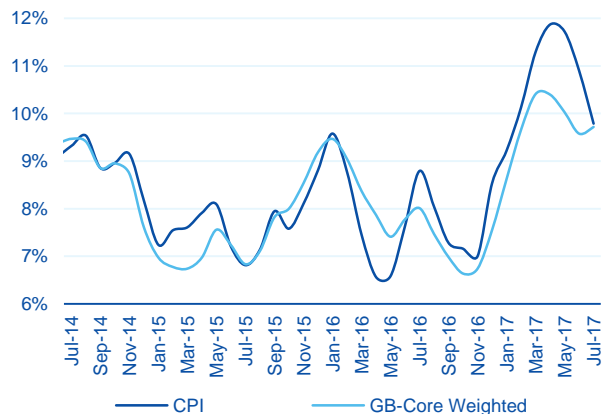
Food inflation continued to be the main factor, contributing to the decline in the headline in July. Contrary to its seasonal average (0.1%), monthly food inflation came in at -0.9%, which slowed its annual inflation down to 9.9% from 14.6%. The high base of last year was also effective on this remarkable downtrend. The other item that helped the headline was the Government's decision not to hike tobacco prices as a result of the automatic adjustment on cost push factors. On the core inflation front, exchange rate pass-through remains well alive, mostly implying the effects of the recent appreciation in Euro this time. Second round price effects continued to be observed especially on services prices due to both high levels of food inflation and cost push factors. Improving domestic demand and recovering tourism sector also implied some pressure through clothing, furniture, recreation, hotels and restaurant groups. Besides, energy inflation also picked up in July on fuel prices, contributing to the headline on the upside.

**Figure 1** Inflation Forecasts (Quarterly Avg, YoY)



Source: Garanti Research & Turkstat

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

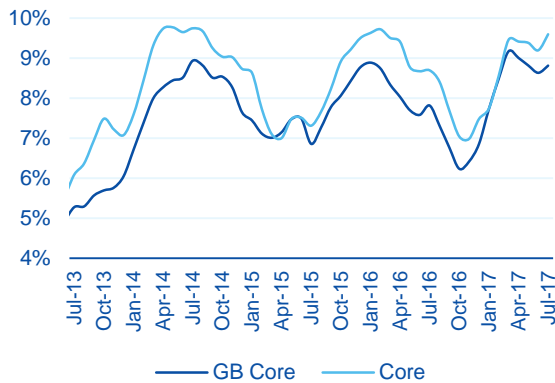


Source: Garanti Research Inflation Model & Turkstat

## Headline will be at double digits until December's fall, core inflation outlook may be a risk factor

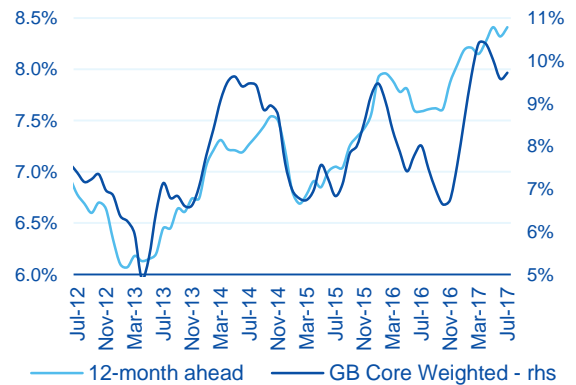
The likely additional upward pressure in September-October mainly due to this year's methodological change assigning fixed weights, high level of services inflation and second round price effects will keep the core inflation close to 10% this year before it would start to fall mainly in 1Q18. We maintain our year-end headline inflation estimate at 9%, with possible upside risks from core inflation outlook, which would require the CBRT to stay tight, in our view.

**Figure 1 Core Inflation (YoY)**



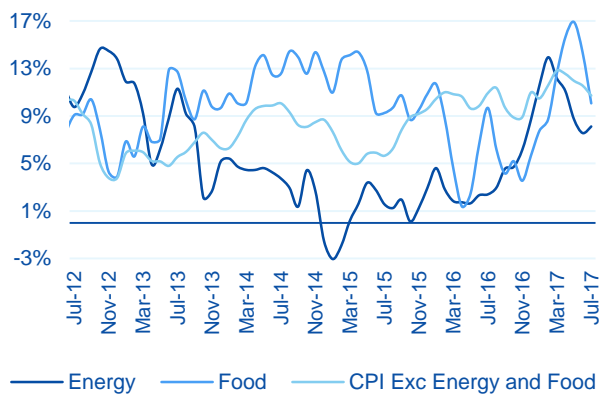
Source: Garanti Research Inflation Model & Turkstat

**Figure 2 Inflation Exp. and GB-Core (YoY)**



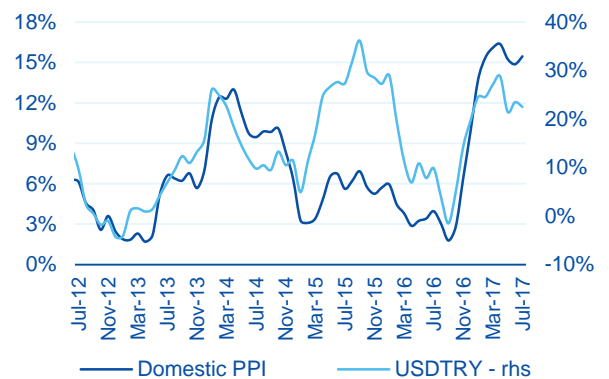
Source: Garanti Research Inflation Model & Turkstat

**Figure 1 Food and Energy Inflation (YoY)**



Source: Garanti Research & Turkstat

**Figure 2 Domestic PPI and USDTRY (YoY)**



Source: Garanti Research, CBT & Turkstat

**Figure 1 CPI in Subcomponents**

CPI	MoM	YoY
<b>Total</b>	<b>0.1%</b>	<b>9.8%</b>
Food	-0.7%	10.1%
Beverage & Tobacco	0.4%	14.1%
Clothing & Textile	-3.5%	3.9%
Housing	0.4%	7.5%
Household Equipment	0.6%	7.2%
Health	0.3%	11.9%
Transportation	1.1%	15.2%
Communication	0.1%	1.8%
Recr. & Culture	1.4%	11.2%
Education	1.0%	10.1%
Rest. & Hotels	1.8%	10.8%
Misc. Goods & Services	0.2%	10.6%

Source: Garanti Research & Turkstat

**Figure 2 Domestic PPI in Subcomponents**

Domestic PPI	MoM	YoY
<b>Total</b>	<b>0.7%</b>	<b>15.5%</b>
<b>Mining &amp; Quarrying</b>	<b>0.2%</b>	<b>8.7%</b>
<b>Manufacturing</b>	<b>0.9%</b>	<b>17.4%</b>
Food Products	0.3%	10.1%
Textiles	1.0%	22.2%
Wearing Apparel	0.7%	9.9%
Coke & Petroleum Products	2.3%	33.4%
Chemicals	1.0%	21.7%
Other Non-Metallic Mineral	0.9%	7.8%
Basic Metals	1.6%	36.8%
Metal Products	1.7%	18.4%
Electrical Equipment	0.9%	16.9%
<b>Electricity, Gas, Steam</b>	<b>-1.6%</b>	<b>-3.5%</b>

Source: Garanti Research Inflation Model & Turkstat

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