

Turkey: Inflation surprised on the downside

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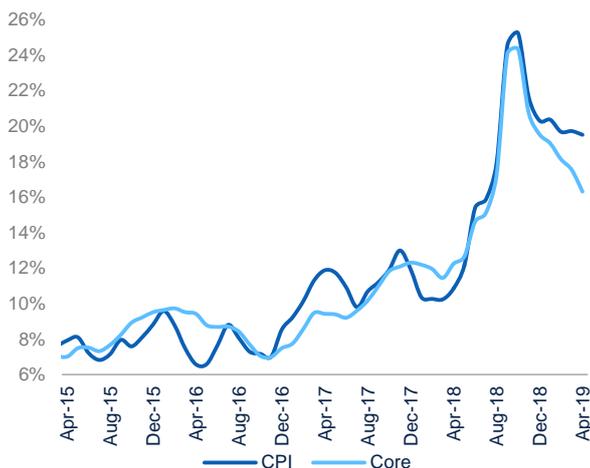
3 May 2019

Consumer prices increased by 1.69% in April, even lower than the minimum estimate shared in the consensus (2.3% market median, 2.2% BBVA Research). Thus, in contrast to the expectations, annual consumer inflation fell to 19.5% from 19.7% in March. Our discrepancy basically stemmed from the rapid decline in core inflation to 16.3% from 17.5%, which was led by the seasonally much lower clothing prices inflation. Food prices maintained the high momentum, while the partial hike in tobacco prices so far in April provided only a lower push. Domestic producer inflation marginally increased to an annual rate of 30.1%, keeping the cost-push factors alive over the consumer prices. The recent depreciation pressures over the currency with a higher volatility is a risk factor for an additional deterioration in the pricing behavior, which could disrupt the improving trend in core prices in the coming months. Yet, the favorable base effects till November and lagged effects of negative output gap will help headline inflation to start to decline fast in June with levels reaching near 11% in October. We expect inflation to realize 15.5% by end 2019 as the last two months of the year will provide a reversal due to the tax incentives of last year.

Sizable correction in core prices in April

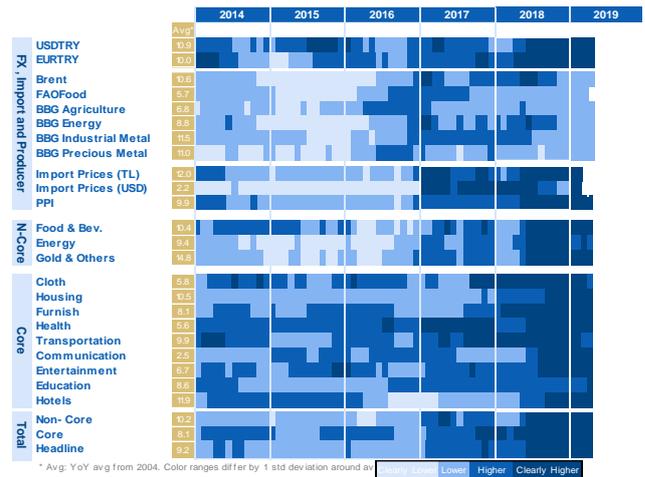
Food inflation again contributed on the upside, while core and energy prices play as the downside factors in April. Despite its seasonally favorable conditions, food prices increased by 1.4% (almost 0% on average in the last 10 years) on cost-push pressures and supply side distortions, leading the annual figure to realize 33%, the highest level in the 2003=100 series. On the other hand, energy inflation helped the headline with an annual figure decreasing to 14.4% from 16.4% thanks to the positive base effects. Also, the improvement in core inflation accelerated as the annual figure fell to 16.3% from 17.5% in March. In addition to easing exchange rate pass-thru and negative output gap, extraordinarily seasonally low rise in clothing prices (5% mom vs. 12% on average in the last 10 years) mainly led to the decline in annual core inflation, while services and some items also sensitive to demand factors such as furniture maintained the worrisome outlook. Services prices remaining near 15% in the last 7 months implies the stickiness on backward indexation and cost-push factors. Looking ahead, the recent exchange rate volatility and still alive cost-push factors could disrupt the improving trend in core prices in May; though the favorable base effects will start to weigh more to help the inflation to come down till November.

Chart 1 Core Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Inflation Heat Map

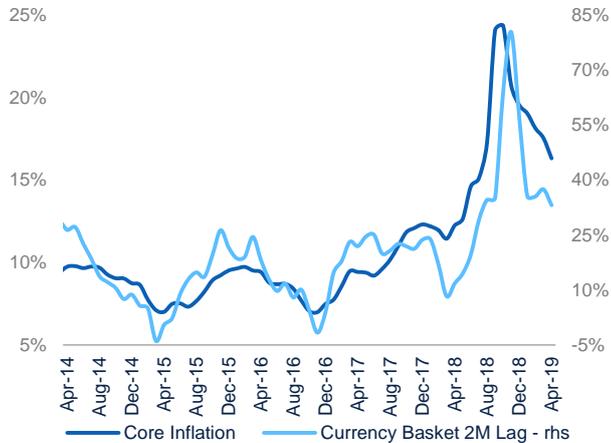


Source: BBVA Research Turkey & Turkstat

We maintain our year-end inflation expectation at 15.5%

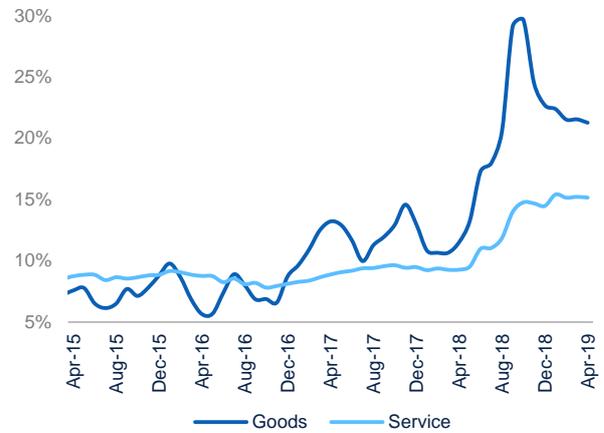
Despite the recent currency depreciation, thanks to the base effects consumer inflation will likely fall rapidly after June, but reverse in the last 2 months of the year and end 2019 at 15.5%. We expect the Central Bank (CBRT) to wait for a promising improvement in trend inflation to start a gradual easing cycle (probably in October) but react to any abnormal pricing behavior if needed.

Chart 3 Core Inflation and Currency Basket, YoY



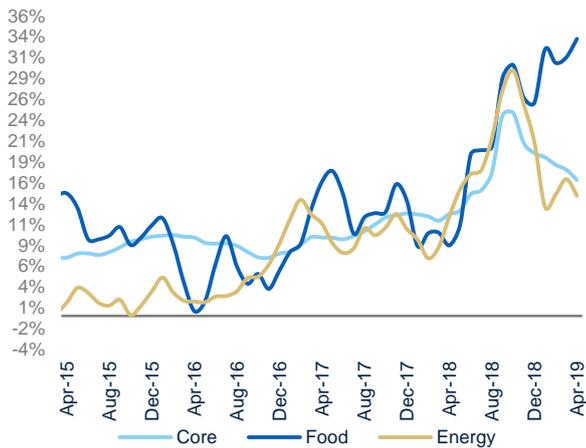
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 Goods and Service Inflation, YoY



Source: CBRT & Turkstat

Chart 5 CPI Components (YoY)



Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 6 Inflation expectations, YoY



Source: BBVA Research Turkey, Turkstat

Chart 7 CPI in Subcomponents

	MoM	YoY
Total	1.7%	19.5%
Food & Non-alcoholic beverages	1.4%	31.9%
Beverage & Tobacco	6.8%	9.7%
Clothing & Textile	5.4%	5.9%
Housing	0.4%	15.3%
Household Equipment	2.6%	27.6%
Health	0.5%	19.7%
Transportation	1.2%	12.6%
Communication	-0.3%	10.2%
Recreation & Culture	1.0%	19.3%
Education	1.3%	12.8%
Restaurants & Hotels	1.1%	19.6%
Misc. Goods & Services	1.9%	27.5%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
Total	3.0%	30.1%
Mining & Quarrying	3.4%	25.4%
Manufacturing	2.9%	28.3%
Food Products	4.1%	25.9%
Textiles	3.0%	31.1%
Wearing Apparel	0.9%	18.7%
Coke & Petroleum Products	7.4%	39.8%
Chemicals	3.5%	38.6%
Other Non-Metallic Mineral	0.7%	22.9%
Basic Metals	4.7%	26.6%
Metal Products	2.4%	30.5%
Electrical Equipment	0.9%	34.6%
Electricity, Gas, Steam	5.0%	57.9%

Source: BBVA Research Turkey & Turkstat

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