

Economic Watch

Turkey: Inflation again surprised on the downside

Adem Ileri / Alvaro Ortiz

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Consumer prices increased by 0.99% mom in September lower than the median consensus (1.38%, Bloomberg and BBVA Research). Hence, annual inflation decreased to one digit level of 9.3% from 15% in August, the lowest level since January 2017 on the back of strong favorable base effect, ongoing normalization in food prices and easing in core prices. Besides, despite the price hike in transportation services and the increase in clothing prices, diminishing pass thru on the stabilization in currency volatility and the decline in cost push factors on top of base effect led annual core inflation to fell to 7.6% from 13.6% in August. Though the expected impact of electricity price hike on inflation (0.45pp direct impact), current low inflation dynamics and expected base effect could highly likely led annual inflation to decline below 9% in October. The positive disinflation momentum, weak pass-thru and still low demand pressures could compensate somewhat the expected unfavorable base effect from November onwards. Therefore, we expect annual inflation to get closer to 12.5% at the end of the year. While the rapid disinflation provide some comfort for rate cuts, the still two digit inflation expectations and uncertainties stemmed from global and local factors require the Central Bank a more gradual adjustment .

Negative food inflation and high base effect led one digit level inflation

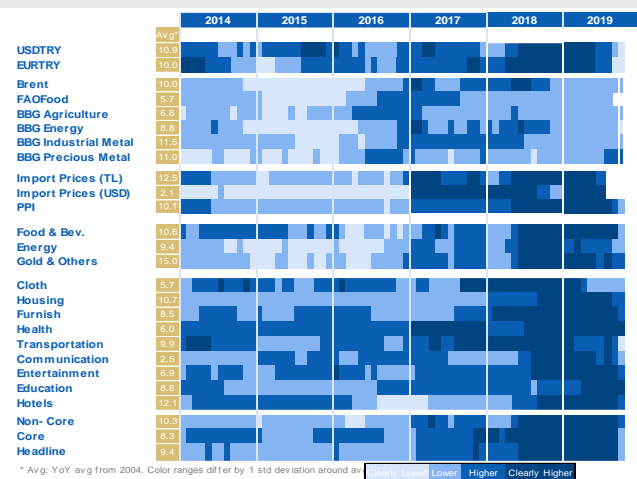
Monthly contraction in food prices has continued as the negative unprocessed food inflation (-2% mom) and lower processed food inflation (0.6% mom) on stable currency led 0.6% mom decline. Annual food inflation retreated further to 9.1% from 17.2%. Annual energy inflation has eased to 4.9% from 7.8% in August thanks to the base effect despite the monthly increase of 3.2% mainly stemmed from the price hike in natural gas and fuel prices. On the other hand, core inflation increased by only 1.13% mom despite the 2.1% mom increase in clothing prices contrary to seasonally negative inflation expectation and price hikes in transportation services. Hence, annual core inflation decreased sharply to 7.5% from 13.6% in August on substantial base effect. Additionally, high inertia is still alive but at least moderating on the back of the ease in inflation dynamics and retreated inflation expectation as the annual services inflation fell to 12.5% from 14.2%. Relatively low oil prices, stabilization in currency and base effect caused the further ease in cost-push factors as annual domestic PPI retreated sharply to 2.45% from 13.45% in August. Looking ahead, the favorable base effect and disinflation momentum will provide annual inflation to decline below 9% in October. Unfavorable base effect beginning from November would result in inflation to increase through the end of the year but still weak demand pressure and low inflation dynamics could compensate somewhat.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

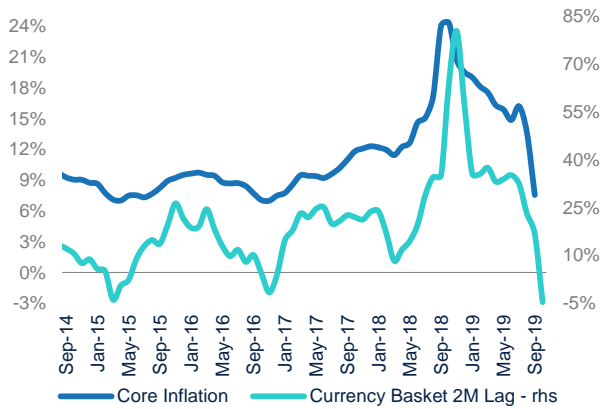


Source: BBVA Research Turkey & Turkstat

Inflation outlook creates room for maneuver on policy rate to CBRT

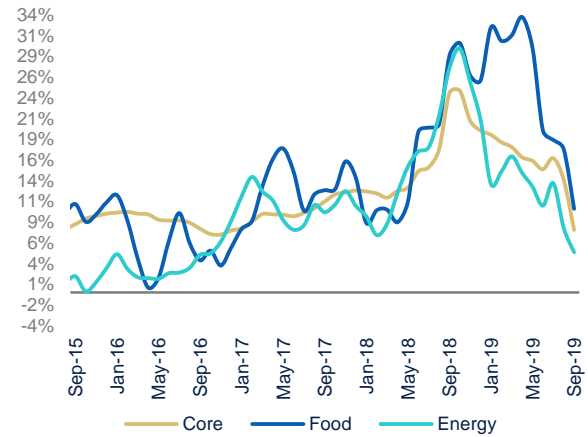
Inflation could decrease further in October on base effect and materialize closer to 12.5% at the end of year. However, the CBRT should monitor cautiously through fine tuning given that base effect on inflation will revert at the end of the year and the situation from global markets remains uncertain.

Chart 3. Core Inflation and Currency Baskets, YoY



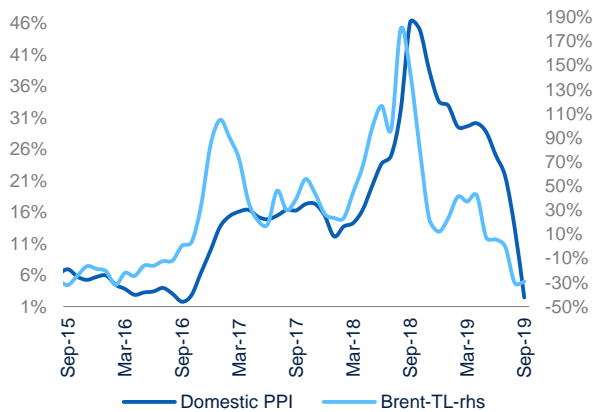
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



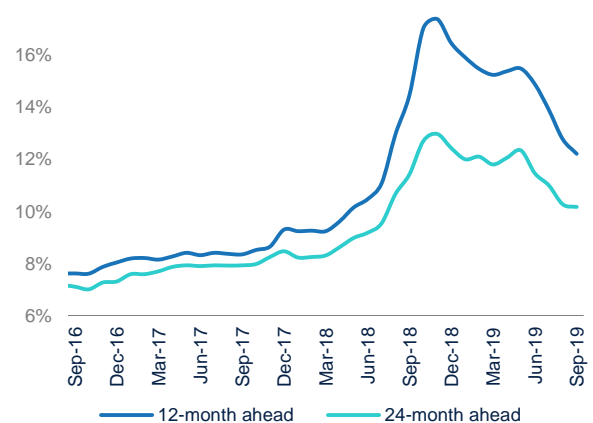
Source: BBVA-Research Turkey, Turkstat,

Chart 5. Domestic PPI and Oil Prices in TL YoY



Source: BBVA Research Turkey, Turkstat

Chart 6. Inflation expectations, YoY



Source: BBVA Research Turkey, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
Total	1.0%	9.3%
Food & Non-alcoholic beverages	-0.6%	9.5%
Beverage & Tobacco	1.8%	43.9%
Clothing & Textile	2.1%	2.8%
Housing	2.2%	10.3%
Household Equipment	0.8%	8.7%
Health	0.5%	15.4%
Transportation	1.6%	-0.7%
Communication	-0.1%	2.4%
Recreation & Culture	-0.5%	7.4%
Education	0.8%	14.0%
Restaurants & Hotels	1.5%	14.9%
Misc. Goods & Services	2.1%	15.0%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
Total	0.1%	2.4%
Mining & Quarrying	-0.9%	7.8%
Manufacturing	-0.1%	1.4%
Food Products	-1.4%	9.1%
Textiles	-0.1%	-1.3%
Wearing Apparel	1.5%	0.3%
Coke & Petroleum Products	4.1%	-23.4%
Chemicals	0.4%	-4.0%
Other Non-Metallic Mineral	0.9%	11.3%
Basic Metals	-1.3%	-16.5%
Metal Products	-0.1%	-1.3%
Electrical Equipment	0.4%	3.7%
Electricity, Gas, Steam	3.0%	14.5%

Source: BBVA Research Turkey & Turkstat

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ENQUIRIES TO:

BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com

