

Economic Watch

# Turkey: Inflation materialized as expected

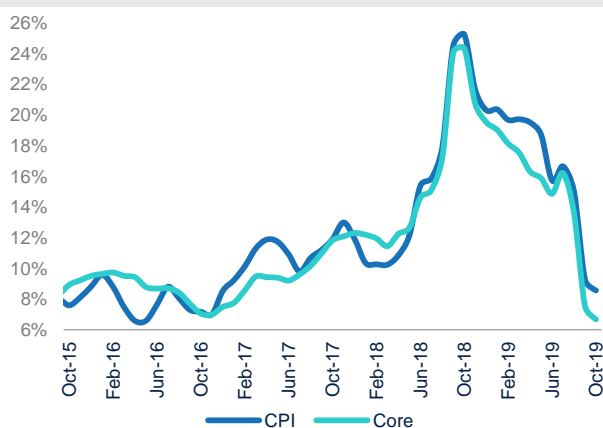
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Consumer prices increased by 2.0% mom in October, in line with median market expectation but slightly higher than ours (2.0%, Bloomberg vs 1.8%, BBVA). Annual inflation decreased further to 8.55% from 9.3% in September on the back of strong favorable base effect despite the impact of price hikes in electricity and fuel. Annual core inflation also fell to 6.67% from 7.54% in September thanks to lower pass thru on weak activity and base effect. Though the positive disinflation momentum, diminishing pass thru and weak demand pressures will support inflation outlook, we expect that annual inflation will increase close to 11.8% at the end of the year on unfavorable base effect. According to our calculation assuming no additional shock, we think that inflation could experience the lowest figure in terms of near future expectation as annual consumer inflation will fluctuate around 12% in the first half of 2020. High inflation expectation, strong trend inflation and uncertainties on geopolitical and global factors should rule out complacency on policy front.

## Further deceleration in inflation on favorable base effect

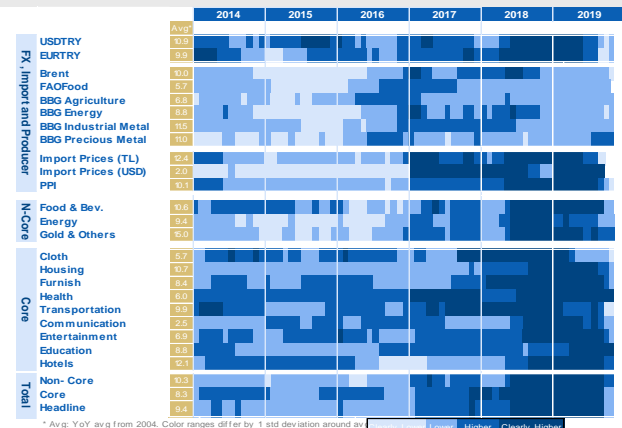
Food prices, which displayed the negative inflation in the last five months, increased by 1.75% mom in October but still lower than the seasonal average thanks to the low processed food inflation(0.7% mom). Annual food inflation decreased further to 7.5% from 9.1% on favorable base effect. On the other hand, energy inflation increased by 4.8% mom on the price hikes in fuel and electricity, led annual figure to rise from 4.9% in September to 6%. Core inflation increased by 1.8% mom due to seasonal effects like clothing prices(11.7% mom) but diminishing pass-thru and still low demand pressure( negative output gap) continued to support disinflation path as seasonal adjusted monthly core figure signaled the weak inflation dynamics. Annual core inflation retreated to 6.67% from 7.54% in October. The observation is also supported by diffusion indices(Chart 3), indicating the rising share of goods having negative inflation. Inflation inertia is still alive but at least weakening on the back of the ease in inflation dynamics and retreated inflation expectation as the annual services inflation fell further to 12.0%. Cost push factor continued to ease on lower oil prices and base effect as annual domestic PPI retreated further to 1.7% from 2.45% in September. Despite the recovery in core inflation, the trend factor which eliminates seasonal and cyclical factors still hovers near 12% (Chart 5). Looking ahead, we expect year end annual inflation to materialize as 11.8% and could remain around 12% in the first half of 2020 in the absence of no further shock.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

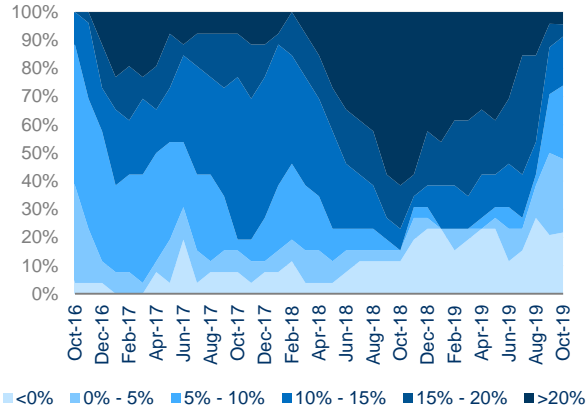


Source: BBVA Research Turkey & Turkstat

## Risks on inflation outlook required CBRT to remain prudent

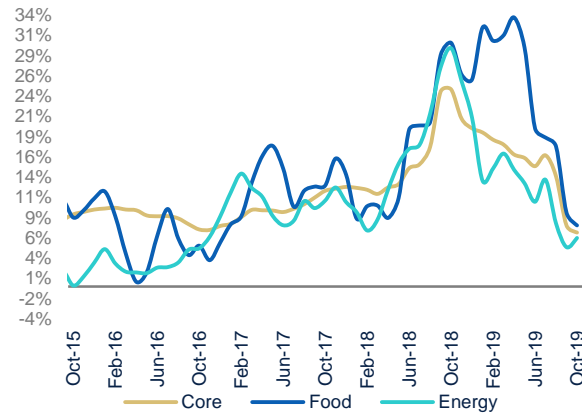
Unanchored medium run inflation expectation, high trend inflation and still alive inertia put uncertainty on near future inflation outlook. Taking into account geopolitical and global uncertainties, we believe that CBRT should remain on prudent side as maintaining a reasonable real interest rate.

Chart 3. Inflation Diffusion Map, YoY



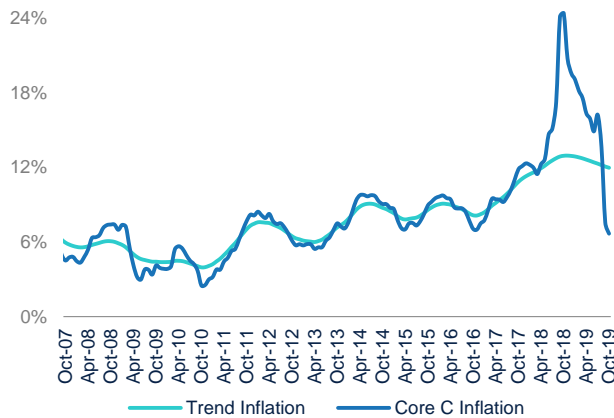
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



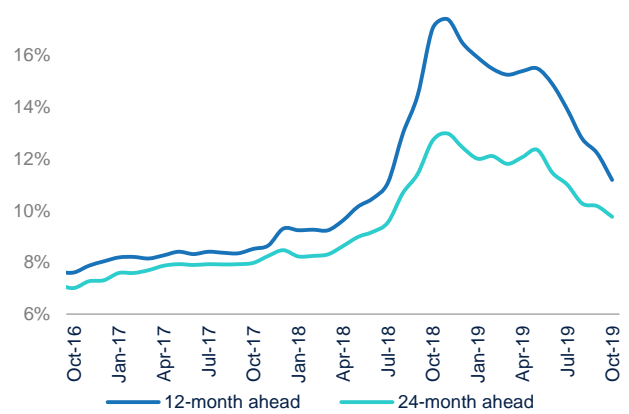
Source: BBVA-Research Turkey, Turkstat,

Chart 5. Core C Inflation vs. Trend



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
<b>Total</b>	<b>2.0%</b>	<b>8.6%</b>
Food & Non-alcoholic beverages	1.7%	7.8%
Beverage & Tobacco	0.0%	43.6%
Clothing & Textile	11.7%	1.9%
Housing	3.5%	9.7%
Household Equipment	1.0%	6.1%
Health	0.4%	14.2%
Transportation	1.2%	1.4%
Communication	1.4%	1.7%
Recreation & Culture	-0.6%	4.6%
Education	0.2%	14.2%
Restaurants & Hotels	0.5%	13.7%
Misc. Goods & Services	0.2%	13.4%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.2%</b>	<b>1.7%</b>
Mining & Quarrying	1.3%	8.0%
Manufacturing	0.0%	1.3%
Food Products	-0.2%	7.9%
Textiles	0.3%	-0.3%
Wearing Apparel	1.5%	-1.3%
Coke & Petroleum Products	1.3%	-20.9%
Chemicals	0.4%	-3.2%
Other Non-Metallic Mineral	0.3%	8.7%
Basic Metals	-2.2%	-14.9%
Metal Products	0.2%	0.2%
Electrical Equipment	0.2%	5.0%
Electricity, Gas, Steam	1.3%	6.8%

Source: BBVA Research Turkey & Turkstat

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