

Economic Watch

# Turkey: Inflation surprised on the downside

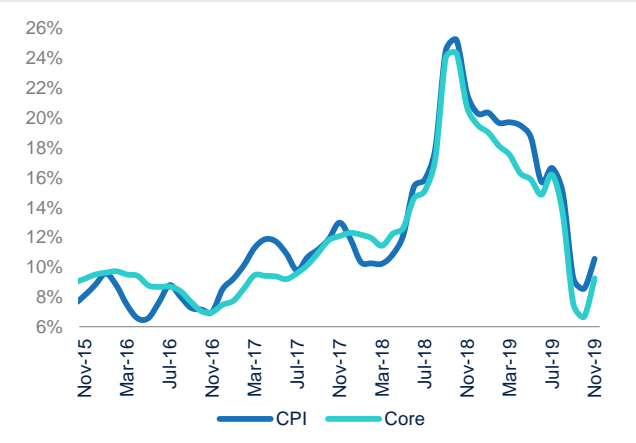
Adem Ileri / Alvaro Ortiz  
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Consumer prices increased by 0.38% mom in November, way lower than market consensus and ours (0.75%, Bloomberg vs 0.77%, BBVA). Annual inflation increased to 10.56% from 8.55% in October due to the unfavorable base effect stemmed from tax incentives applied to durable goods last year. Annual core inflation also pick up to 9.25% from 6.7% in October. Inflation outlook has been supported by low food prices on better than seasonal climate condition, weak demand pressures, lower pass-thru and the ease in cost push factors. We expect that annual inflation will increase close to 11.8% at the end of 2019 with downside risks taking into account the less volatility in currency and favorable weather conditions for food prices. We think that annual consumer inflation will fluctuate between 11%-12% in the first half of 2020 assuming no further shock. While the disinflation path has been remarkable, the pick-up in inflation, the high inertia, the still high and unanchored inflation expectations and the recent acceleration in the economic recovery demands prudence in the policy mix.

## Better food prices and weak push-pull factors but unfavorable base effect

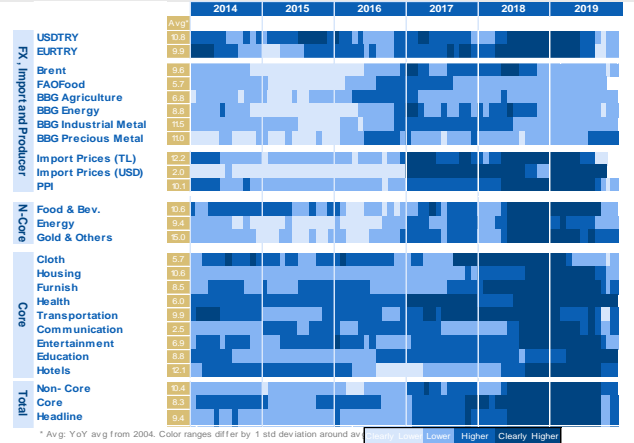
Food prices increased slightly by 0.2% mom in November, lower than the seasonal average on the back of the decline in unprocessed food prices though the processed food prices rose by 1% mom. Annual food inflation materialized as 8.7%, could remain below CBRT expectation of 10% for the end of 2019. Energy inflation increased by 0.5% mom but annual figure rose to 7.3% on unfavorable base effect. Core inflation also continued to support disinflation path as it picked up only by 0.5% mom thanks to still weak demand pressures, the ease in cost push factors, low seasonal effect and diminishing pass-thru. Clothing inflation materialized as 2.5% mom, lower than seasonal average while the basic goods prices also slightly increased by 0.8% mom. Hence, annual core inflation has upsurged to 9.25% in November mainly on base effect. The cost push factors remained weak as domestic producer prices decreased by 0.8% mom, leading annual figure to be as 4.3%. On the other hand, some negative factors could put gloomy picture on inflation outlook. First of all, according to our calculation, the trend inflation does not include seasonal and cyclical factors still remain close 12% (Chart 5). Secondly, inertia is alive as services prices continued to increase around 12% yoy. Finally, inflation expectations in medium term are unanchored despite the better than expected disinflation path as one year and two year ahead inflation expectations are 10.5% and 9.2%, respectively and way above than CBRT inflation forecasts of 8.2% for 2020 and 5.4% for 2021 according to October Inflation Report.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

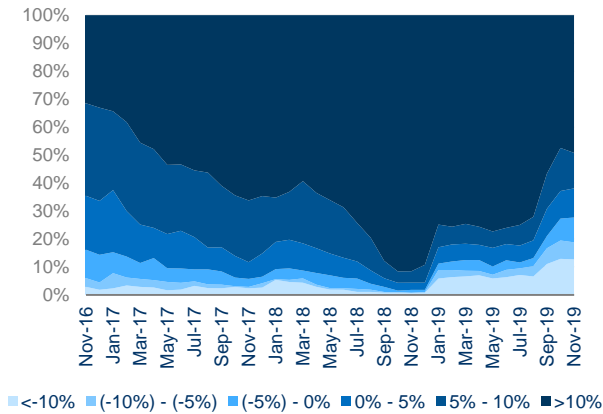


Source: BBVA Research Turkey & Turkstat

## Uncertainties over medium term inflation outlook require some prudence

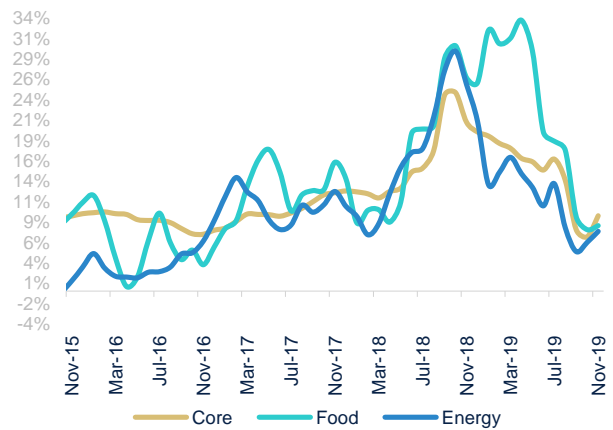
Geopolitical, global and local factors continued to pose some upside risks on inflation outlook of CBRT on top of unanchored medium run inflation expectation and high inertia. The monetary policy should maintain reasonable real interest rate in order to buffer some risks and face the incoming acceleration on the economic recovery .

Chart 3. Inflation Diffusion Map, YoY



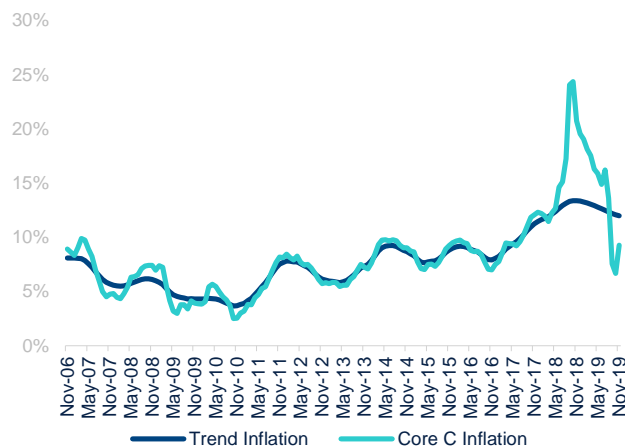
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



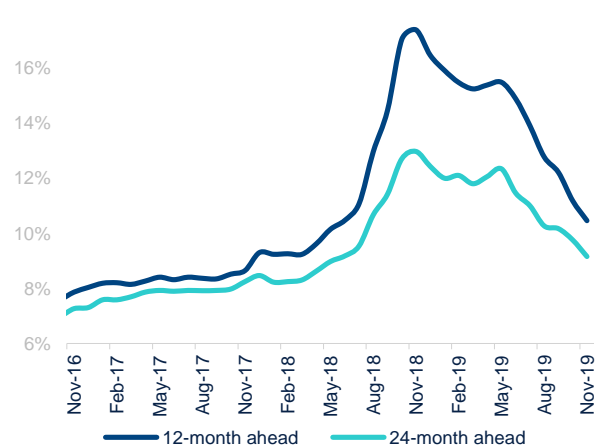
Source: BBVA-Research Turkey, Turkstat,

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>0.4%</b>	<b>10.6%</b>
Food & Non-alcoholic beverages	0.2%	8.9%
Beverage & Tobacco	0.0%	43.4%
Clothing & Textile	2.7%	2.2%
Housing	0.4%	9.6%
Household Equipment	0.6%	9.8%
Health	0.2%	13.9%
Transportation	0.3%	8.7%
Communication	0.4%	2.8%
Recreation & Culture	0.1%	6.9%
Education	0.1%	14.4%
Restaurants & Hotels	-0.2%	13.1%
Misc. Goods & Services	-0.4%	14.0%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>-0.1%</b>	<b>4.3%</b>
Mining & Quarrying	-0.1%	9.9%
Manufacturing	0.0%	4.4%
Food Products	1.5%	11.2%
Textiles	-0.5%	3.4%
Wearing Apparel	-0.2%	-2.2%
Coke & Petroleum Products	-0.6%	-6.9%
Chemicals	-1.4%	-0.1%
Other Non-Metallic Mineral	0.3%	8.3%
Basic Metals	-1.8%	-9.0%
Metal Products	-0.6%	3.1%
Electrical Equipment	0.4%	8.1%
Electricity, Gas, Steam	-0.5%	3.8%

Source: BBVA Research Turkey & Turkstat

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