

Economic Watch

Turkey: February CPI surprised on the downside

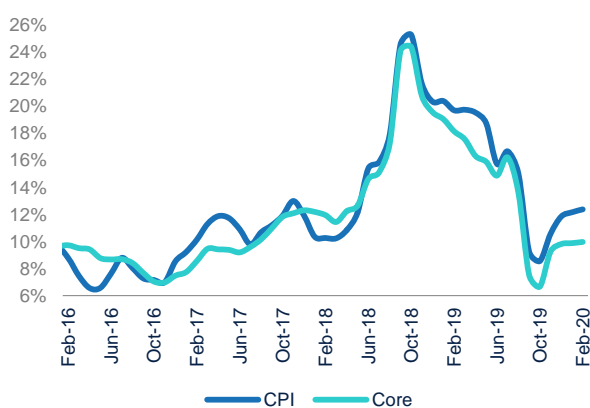
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Consumer prices increased by 0.35% in February, lower than both the consensus (0.69%, Bloomberg) and our expectation (0.85%). Though, the annual figure still rose to 12.37% from 12.15% in January on top of base effects. Better than expected realization mainly stemmed from the core prices, which surprised us on the downside despite the first signals of the pass-through from domestic demand we had seen in the previous two months. Depending on the persistency of the recent volatility in the exchange rate, still negative output gap and suppressed energy prices could still be supportive for the inflation outlook. Also, in absence of shocks, base effects will be favorable from now onwards. On the other hand, stickiness in services inflation, inertia on indexation, some worsening in inflation expectations, refreshing cost push factors on tighter financial conditions, and less competitive currency over the narrowing real interest gap remain to be the challenging factors. Looking ahead, we expect the headline inflation to start to improve slightly in March before experiencing levels at 10.5-11% in 2Q20 and finally one digit levels in the second half of the year. We expect consumer inflation to be 8.5% at the end of 2020 under the assumptions of a neutral real exchange rate and a food inflation at historically seasonal averages.

The ease in core and energy inflation compensated the pick-up in food inflation

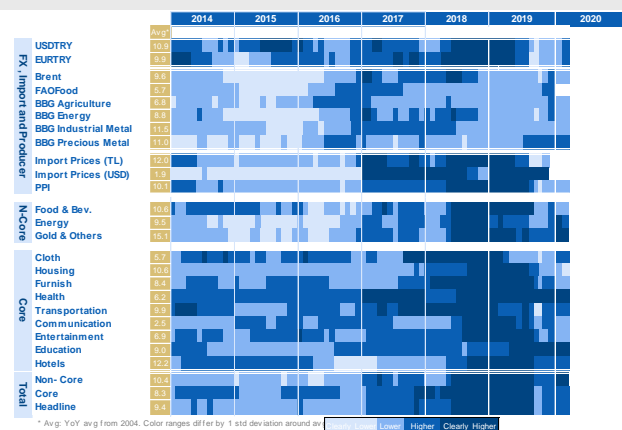
Monthly food inflation realized at 2.5% in February, which was supported by both unprocessed (3.8% mom) and processed food prices (0.9% mom) and remained above its seasonal averages. Therefore, annual food inflation accelerated to 10.4% from 8.7% in January. On the other hand, energy prices declined by 0.6% mom on the back of lower oil prices, leading its annual figure to retreat from 17.1% to 15.5%. Secondly, core prices, which materialized far from our expectations, contradicted the previous two months realizations which were signaling the pass-through from domestic demand which had started to kick in gradually. Core prices declined by 0.2%, supported by a widespread ease in basic goods (-1.4% mom) especially coming from the seasonal factors in clothing prices (-4.9% mom). Though, as we expect output gap to recover further in the coming period, this month's downward bias could be temporary and demand factors which are also accompanied by the current volatility in exchange rate could weigh more, depending on the reactions from macro policies. On the other hand, despite the decline in oil prices, domestic producer prices increased by 0.48%, leading its annual figure to rise to 9.3% from 8.8% in January and somewhat refreshed cost-push factors. Inertia also remained well alive as annual services inflation materialized as 12.5%, remaining above 12% in the last 6 months. On top of that, according to our calculations, trend inflation continued to hover around 11.5%, confirming the high inertia observed in services prices and inflation expectations (Chart 5).

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

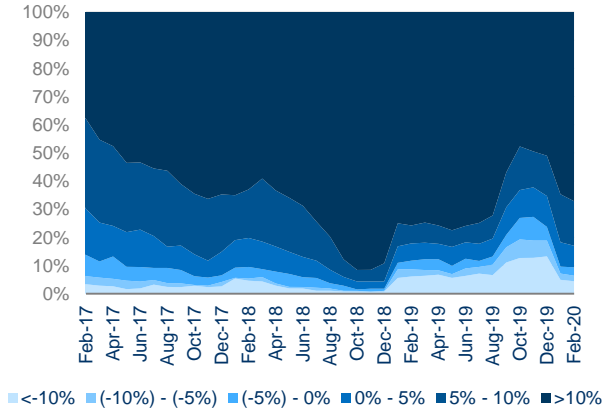


Source: BBVA Research Turkey & Turkstat

Currently increased volatility requires prudent policies

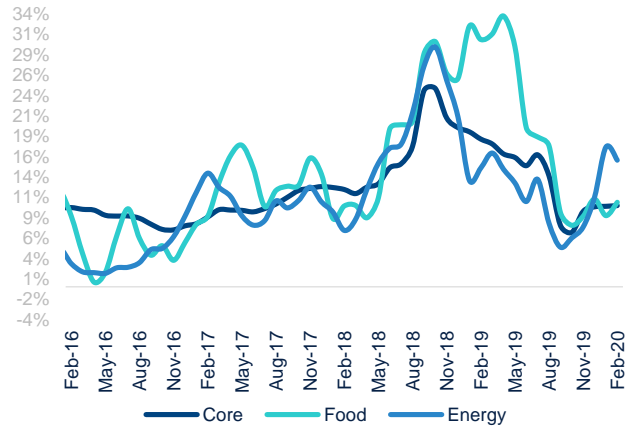
Recent high volatility fueled by both local and external factors, uncertainties on the implications from the outbreak, stickiness on inertia and inflation expectations and current supportive credit impulses remain to be the main challenges over the pricing behavior. Depreciation pressures over the currency which are now accompanied by the recovery in domestic demand should be managed by prudent policies not to trigger new imbalances. We maintain our year-end inflation forecast at 8.5% for 2020.

Chart 3. Inflation Diffusion Map, YoY



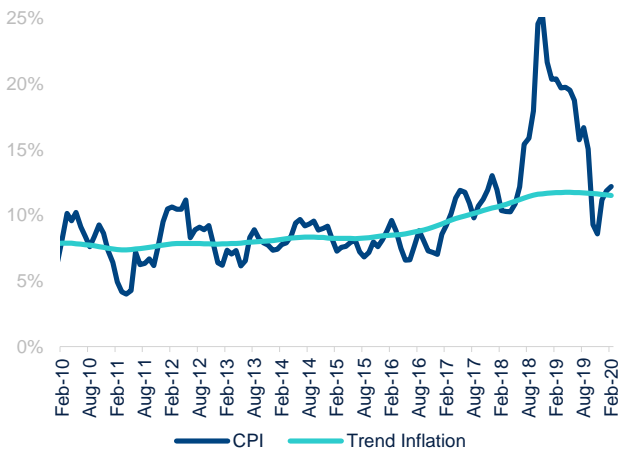
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



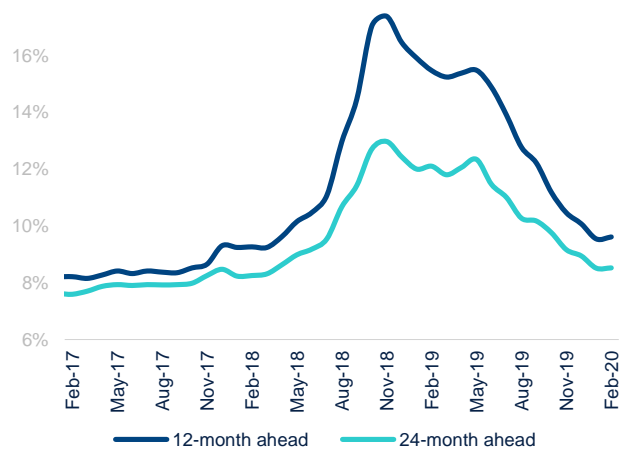
Source: BBVA-Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, 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	0.4%	12.4%
Food & Non-alcoholic beverages	2.3%	10.6%
Beverage & Tobacco	-1.3%	40.1%
Clothing & Textile	-4.8%	6.0%
Housing	0.5%	15.3%
Household Equipment	-0.1%	7.4%
Health	2.0%	13.6%
Transportation	-0.4%	11.7%
Communication	-0.2%	2.3%
Recreation & Culture	0.0%	6.0%
Education	0.9%	14.2%
Restaurants & Hotels	0.8%	13.5%
Misc. Goods & Services	0.9%	16.4%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
Total	0.5%	9.3%
Mining & Quarrying	1.4%	12.3%
Manufacturing	0.7%	8.5%
Food Products	1.2%	14.8%
Textiles	1.3%	8.4%
Wearing Apparel	0.9%	1.5%
Coke & Petroleum Products	-9.0%	3.2%
Chemicals	0.6%	4.2%
Other Non-Metallic Mineral	0.2%	6.5%
Basic Metals	2.3%	4.4%
Metal Products	1.5%	12.5%
Electrical Equipment	0.9%	8.0%
Electricity, Gas, Steam	-2.4%	19.2%

Source: BBVA Research Turkey & Turkstat

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