

Economic Watch

Turkey: Annual CPI realized at 10.9% in April

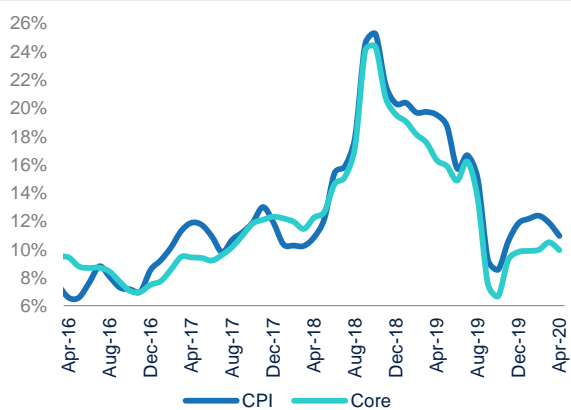
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04 May 2020

Consumer prices increased by 0.85% in April, higher than both the consensus and our expectation (0.6%). Though, annual inflation continued to decelerate to 10.94% from 11.86% in March on top of favorable base effects led by energy prices. The deviation of our forecast stemmed mainly from the seasonally higher unprocessed food inflation which could likely be pushed by both the recent increasing demand and some difficulties in supply during the extended weekend curfews. Core inflation, on the other hand, starts to reflect the impact of the poor demand (even in services) despite the more recent depreciation in currency. Besides, the suppressed energy prices continue to weigh on the downside as expected. As April inflation figures confirm, the gains from lower commodity prices and a deeper negative output gap now offset the potential impact of the tighter financial conditions led by a weaker currency and accelerate the disinflation cycle. Looking ahead, depending on the food inflation and the level of exchange rate, headline inflation could come down below 10% in May and end 2Q with a high single digit level before experiencing a much more rapid disinflation in 3Q. We expect consumer inflation to be 7.5% at the end of 2020.

Unfavorable food prices compensated by low energy prices and core inflation

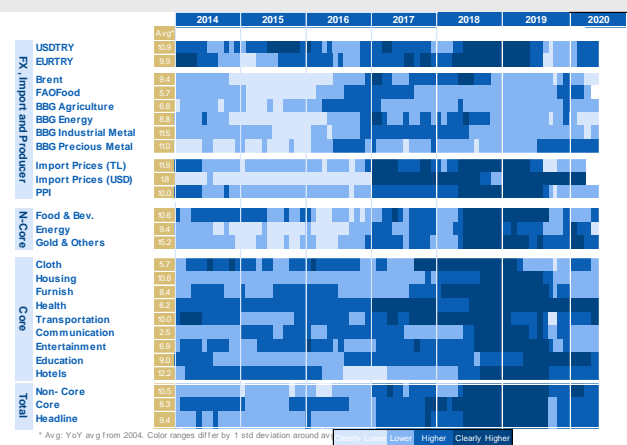
Food prices, which surprised us on the upside, increased by 2.5% mom mainly on the back of unprocessed food inflation (3.6%). The good news is that the rise in fresh fruits and vegetables' prices came from only a couple of items which have high weights in the basket, while the rest of the unprocessed food was the unsupportive. Therefore, annual food inflation increased to 10.9% from 9.7% in March. However, energy and core prices cushioned the negative impact of food prices on the headline. Energy prices decreased by 5% mom led by the historically low oil prices, resulted in a sharp decline in annual energy inflation to 3.3% from 9.8%. Core prices increased only by 1% mom, causing annual core inflation to decelerate further to 9.9%, backed by poor demand and lower seasonal effects in the new methodology by offsetting the impact of the recent depreciation in the exchange rate. Besides, inflation inertia has also eased as annual services prices retreated to 11.8% despite the rise in the real unit labor cost. With this, trend headline inflation continued to recover to 9.7%, the lowest level since January 2018 (Chart-5). However, cost push factors give some early upward signals as domestic producer prices increased by 1.3% mom, continuing to surprise us on the upside (Chart-6) in the last few months despite the sharp fall in commodity prices. Though, the expected deceleration in aggregate demand and supportive energy prices could dominate the impact of pass-thru and second round effects and trigger a more rapid disinflation. The Central Bank (CBRT) also revised its year end inflation projection downward to 7.4% from 8.2% by acknowledging the support of the deeper negative output gap and lower oil prices in line with our forecast.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

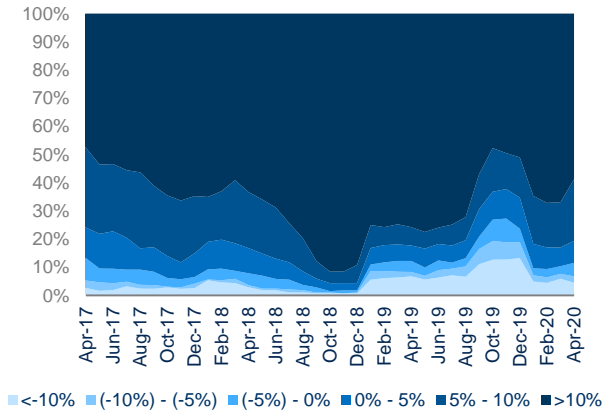


Source: BBVA Research Turkey & Turkstat

Record low energy prices and deeper negative output gap accelerate disinflation

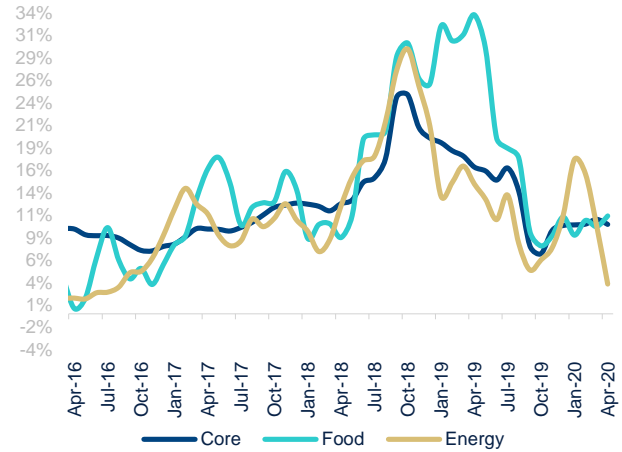
Suppressed energy prices and a deeper negative output gap will dominate the potentially higher exchange rate pass-thru due to the increased volatility over the uncertainties resulting from the outbreak. Assuming a partial normalization in both activity and market conditions in the second half of the year, we expect inflation to realize 7.5% at the end of 2020, which would still imply the continuation of the measured rate cuts of the CBRT in the next few meetings.

Chart 3. Inflation Diffusion Map, YoY



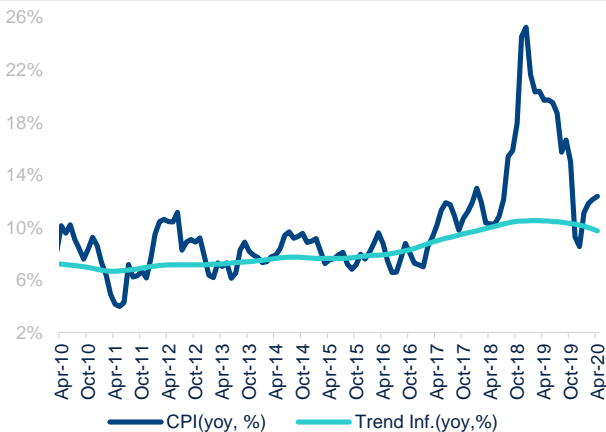
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



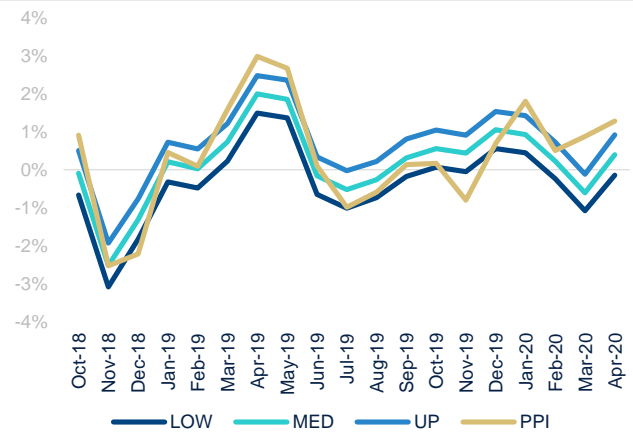
Source: BBVA-Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, YoY



Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 6. PPI Inflation Forecast vs Realization (MoM)



Source: BBVA Research Turkey, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
Total	0.9%	10.9%
Food & Non-alcoholic beverages	2.5%	11.3%
Beverage & Tobacco	0.0%	31.3%
Clothing & Textile	4.1%	4.9%
Housing	-0.3%	14.5%
Household Equipment	1.1%	6.1%
Health	0.5%	12.9%
Transportation	-1.8%	5.5%
Communication	-1.2%	1.6%
Recreation & Culture	-0.7%	4.9%
Education	0.3%	12.3%
Restaurants & Hotels	0.1%	12.5%
Misc. Goods & Services	4.7%	20.3%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
Total	1.3%	6.7%
Mining & Quarrying	0.2%	7.4%
Manufacturing	1.4%	6.3%
Food Products	1.3%	12.9%
Textiles	3.7%	10.4%
Wearing Apparel	0.7%	2.3%
Coke & Petroleum Products	-28.5%	-50.5%
Chemicals	2.4%	4.7%
Other Non-Metallic Mineral	0.0%	4.8%
Basic Metals	3.9%	3.7%
Metal Products	4.3%	12.1%
Electrical Equipment	1.9%	7.8%
Electricity, Gas, Steam	0.3%	12.9%

Source: BBVA Research Turkey & Turkstat

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