

Economic Watch

# Turkey: June CPI reinforces a worsening outlook

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Consumer prices increased by 1.13% in June, remaining significantly above both the consensus and our expectation (0.6% vs. 0.45%). Thus, also led by the negative base effects, annual inflation accelerated to 12.62% from 11.39% in May. The upside surprise stemmed from the core prices whose annual inflation rose to 11.64% in contrast to our deceleration expectation led by the current weak demand. The increase in unit costs due to low capacity in certain sectors and the recent credit expansion especially in the consumer segment seem to weigh more, worsening the inflation outlook across-the-board. Besides, as energy prices started to correct faster than expectations since May, it continued to push the headline on the upside. Food inflation, this time, helped the overall inflation by staying stable in annual terms. All in all, despite the negative output gap (though with the elimination of deepening pressures), the above-mentioned factors and today's data create upside risks on our current year-end inflation forecast (8.5%). With this, also depending on the food inflation and the level of exchange rate, headline inflation could stay close to 12% in July before converging to 10% towards the end of 3Q and ending the year at near two-digits.

## Supply side effects push the core prices on the upside

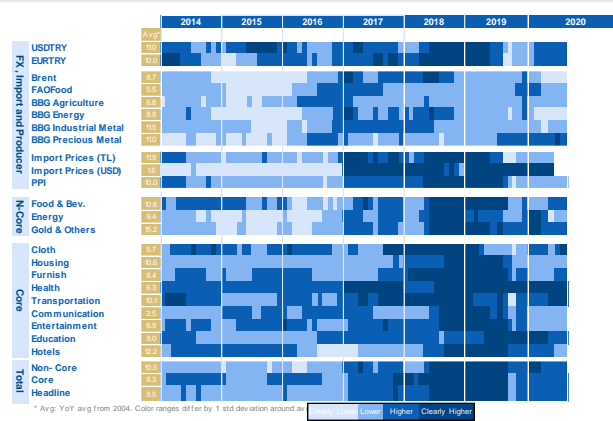
The second consecutive surprising upside deviation stemmed from the core prices, which increased by 1.9% compared to our only 0.4% estimate, leading the annual figure to jump up to 11.6% from 10.3% in May. Despite the favorable seasonal factors and still weak demand, supply side effects due to the low capacity in certain sectors seem to bring upside price adjustments across-the-board, but especially in the sub-segments sensitive to the exchange rate pass-thru. The highest contribution came from the transportation group, which was followed by the clothing prices (which rose in monthly terms despite the negative seasonality). Services prices also increased with an annual figure rising to 11.8%, led by all the sub-indices, except for the rent prices. Besides, the recent correction in oil prices also weighed on the headline in June, where annual energy inflation accelerated to 9.1% from 5.2%, which we expect to stabilize from now onwards assuming the oil prices to stay at the current levels. On the other hand, food inflation came below its seasonal average with -1.7% mom, which still keep its annual figure steady at 12.7% as a result of the unfavorable base effects. Domestic producer prices, which increased by 0.7% mom, confirm the relatively low but still alive cost push factors on the correction in commodity prices, disruptions in production and the recent tax adjustments. Looking ahead, the negative output gap and energy prices could remain the supportive factors but the high inertia, potential fast recovery in demand factors, volatile food prices and the exchange rate prove to be the upside risks.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

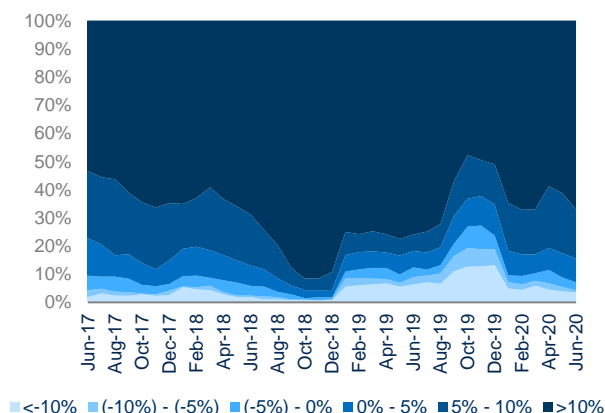


Source: BBVA Research Turkey & Turkstat

## Worsened core inflation outlook will decelerate the expected disinflation path

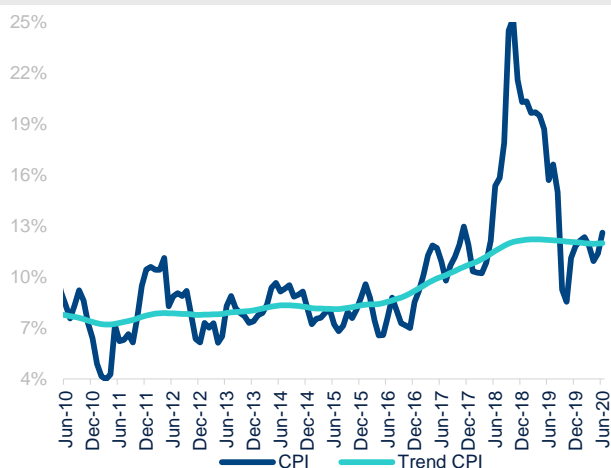
Still relatively low energy prices and negative output gap will help to satisfy a disinflation path this year. Though, faster than expected correction of the oil prices since May, the rigidity of the core prices due to the increased unit costs led by the supply side effects of the pandemic and the potential fast recovery in domestic demand will decelerate the initially expected path. So, risks on our current year-end inflation forecast (8.5%) are clearly on the upside, which would more likely keep the Central Bank to stay on hold until being sure about the inflation dynamics during 3Q.

Chart 3. Inflation Diffusion Map, YoY



Source: BBVA Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, YoY



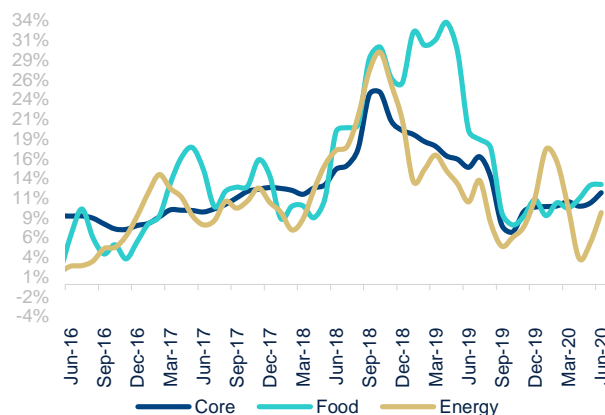
Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>1.1%</b>	<b>12.6%</b>
Food & Non-alcoholic beverages	-1.6%	12.9%
Beverage & Tobacco	0.9%	22.4%
Clothing & Textile	1.2%	10.7%
Housing	0.7%	15.0%
Household Equipment	1.3%	9.7%
Health	1.0%	13.5%
Transportation	4.5%	11.0%
Communication	2.2%	4.8%
Recreation & Culture	2.5%	6.3%
Education	1.9%	11.7%
Restaurants & Hotels	2.8%	11.1%
Misc. Goods & Services	1.0%	19.8%

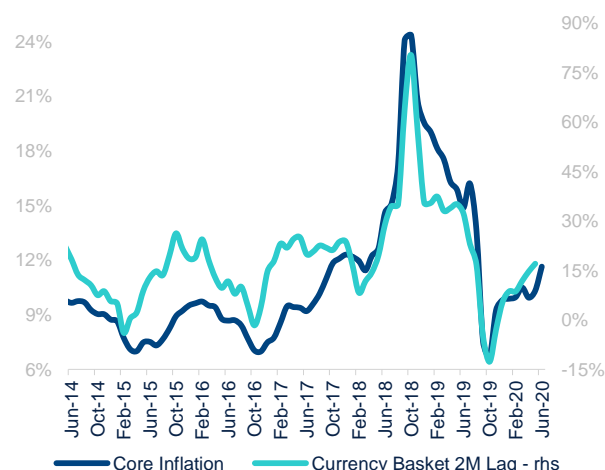
Source: BBVA Research Turkey &amp; Turkstat

Chart 4. CPI Components, YoY



Source: BBVA-Research Turkey, Turkstat,

Chart 6. Core Inflation vs Currency Basket, YoY



Source: BBVA Research Turkey, Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.7%</b>	<b>6.2%</b>
Mining & Quarrying	1.0%	4.2%
Manufacturing	0.5%	6.0%
Food Products	-0.1%	8.2%
Textiles	-1.0%	8.3%
Wearing Apparel	-0.6%	3.1%
Coke & Petroleum Products	29.9%	-28.2%
Chemicals	-0.9%	2.8%
Other Non-Metallic Mineral	0.8%	3.6%
Basic Metals	-1.0%	3.1%
Metal Products	0.5%	12.3%
Electrical Equipment	1.1%	9.1%
Electricity, Gas, Steam	3.0%	9.4%

Source: BBVA Research Turkey &amp; Turkstat

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