

Economic Watch

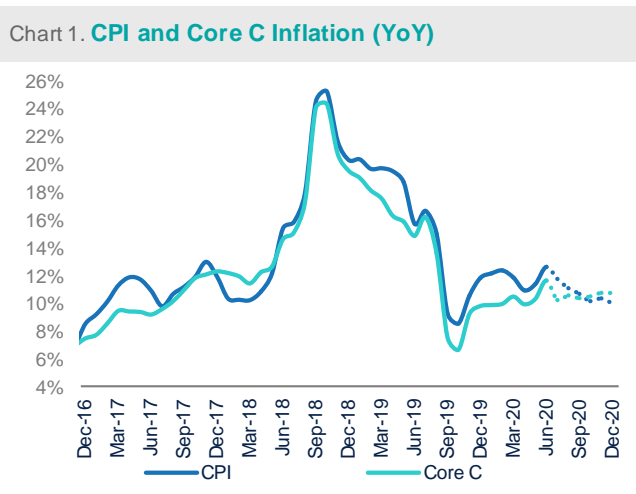
# Turkey: Consumer inflation decelerates to 11.76%

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04 August 2020

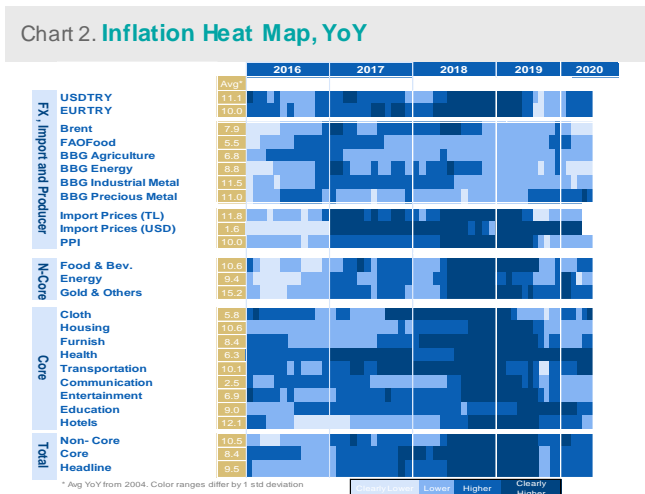
Consumer prices increased by 0.58% in July, this time surprising on the downside (1% BBVA Research vs. 0.8% Consensus). Led by the positive base effects, annual inflation decelerated to 11.76% from 12.62% in June. Our main deviation stemmed from a much more rapid seasonal decline in food prices and tobacco prices staying constant despite the recent tax hike. On the other hand, core prices moved in line with our expectations, showing a deceleration to 10.25% in annual terms, after the huge price adjustments in the previous two months due to the increase in unit costs on the back of low capacity in certain sectors (especially in services) and the recent credit expansion especially in the consumer segment. Though, sub-items sensitive to demand and exchange rate pass-thru, and second-round price effects still keep the inflationary pressures alive. Therefore, backed by the base effects, we expect the headline inflation to show a declining pattern from now onwards but with a decelerated disinflation path due to both supply side effects and demand pull factors despite the negative output gap (although with the elimination of deepening pressures) and relatively low oil prices. Hence, also depending on the food inflation and the level of exchange rate, headline inflation could stay close to 11% in August before converging to 10% at the end of the year.

## Upward pressures on core prices decelerate but remain alive

The downside surprise stemmed from the food prices, which fell by 1.3% compared to our 0.5% decline estimate, leading the annual figure to remain stable at 12.7%. Besides, tobacco prices stayed constant, while we were expecting an increase (near 4%) parallel to the tax hike introduced by the Government at the start of July. On the other hand, upside price adjustments especially in services sectors started to slow-down but certain sub-items (furniture, white goods, mobile phones, automobiles etc.) sensitive to both demand factors and exchange rate pass-thru keep the upward pressures on core prices alive. Also, second round price effects like rent prices start to kick-in, which have the potential to make core inflation further sticky. Though, helped by the base effects, annual basic goods inflation fell to 8.6% from 11.4%, while services inflation remained at 11.8%. Therefore, core C inflation decelerated to 10.25% from 11.64% in June. Energy inflation also slowed-down to 8.6% in annual terms, again helped by the favorable base effects (last year we had electricity price hike). Domestic producer prices, which increased by 1% mom, confirm the relatively subdued but still alive cost push factors on the correction in commodity prices, disruptions in production and the recent tax adjustments. Looking ahead, 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. So, we expect the annual core prices to stay between 10.5-11% in the very short term.



Source: BBVA Research Turkey, Turkstat

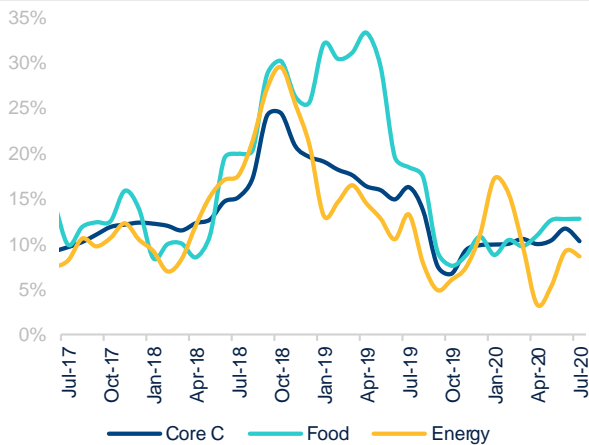


Source: BBVA Research Turkey & Turkstat

## Inflation will decline from now onwards but will show a slower disinflation path

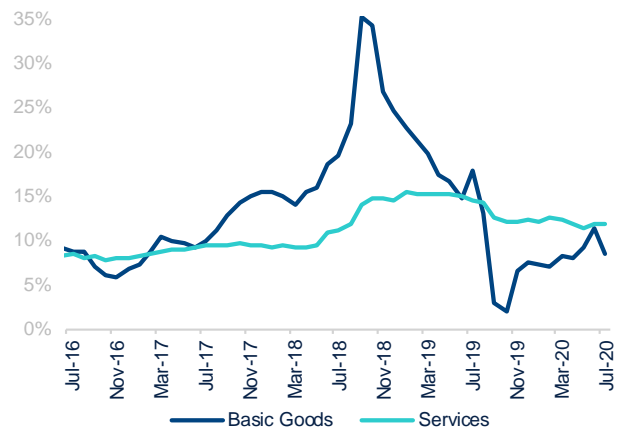
Still relatively low energy prices and negative output gap will help to satisfy a disinflation path in the rest of the year. Though, rigid core prices led by the supply side effects of the pandemic and the potential fast recovery in domestic demand will decelerate the initially expected path. Recent currency depreciation could also weigh on the upside in the short term (Chart 5). So, we now expect consumer inflation to stay at two-digits and to be realized at 10% at the end of the year.

Chart 3. **CPI Components, YoY**



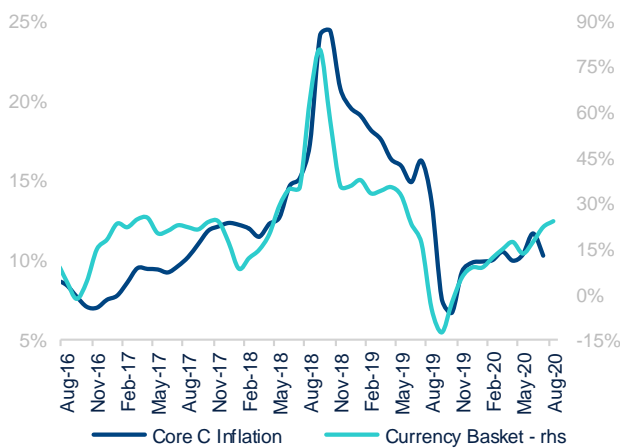
Source: BBVA Research Turkey, Turkstat,

Chart 4. **Basic Goods & Services Inflation, YoY**



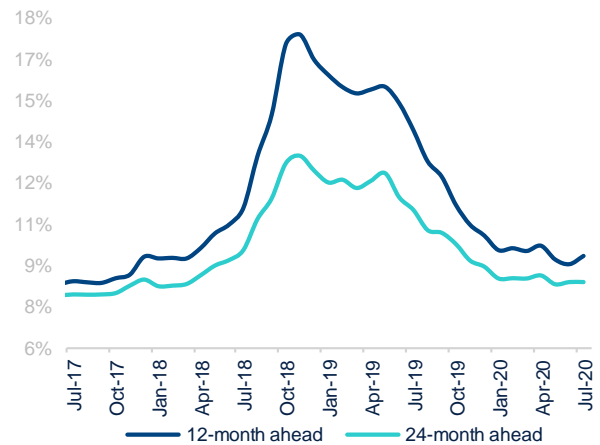
Source: BBVA-Research Turkey, Turkstat,

Chart 5. **Core Inflation vs Currency Basket, 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
<b>Total</b>	<b>0.58%</b>	<b>11.76%</b>
Food & Non-alcoholic beverages	-1.3%	12.7%
Beverage & Tobacco	0.2%	21.8%
Clothing & Textile	-3.5%	10.3%
Housing	0.9%	12.5%
Household Equipment	2.4%	7.8%
Health	0.8%	14.2%
Transportation	2.4%	8.8%
Communication	1.8%	5.8%
Recreation & Culture	1.3%	6.0%
Education	1.7%	12.6%
Restaurants & Hotels	1.2%	10.9%
Misc. Goods & Services	2.4%	21.9%

Source: BBVA Research Turkey & Turkstat

Chart 8. **Domestic PPI in Subcomponents**

	MoM	YoY
<b>Total</b>	<b>1.02%</b>	<b>8.33%</b>
Mining & Quarrying	4.1%	8.9%
Manufacturing	1.0%	7.9%
Food Products	-0.4%	8.7%
Textiles	0.7%	10.2%
Wearing Apparel	-0.2%	3.3%
Coke & Petroleum Products	11.7%	-19.9%
Chemicals	1.1%	5.5%
Other Non-Metallic Mineral	1.0%	4.6%
Basic Metals	0.9%	7.5%
Metal Products	0.5%	13.3%
Electrical Equipment	2.2%	12.5%
Electricity, Gas, Steam	-0.4%	12.7%

Source: BBVA Research Turkey & Turkstat

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