

Economic Watch

Turkey: Headline CPI stays at 11.77% in August

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Consumer prices increased by 0.86% mom in August, slightly below both the consensus and our expectation (0.95% mom), leading the annual inflation to stay almost stable at 11.77%. Our main deviation stemmed mainly from the food prices, which we expected to be a mild positive figure compared to its lower seasonal average. On the other hand, core prices moved in line with our expectations, showing an acceleration to 11.03% from 10.25% in annual terms, reflecting a gradual exchange rate pass-thru and the impact of the demand pull factors in some sub-items (including services despite the recent tax incentives). Also, cost push factors continue to weigh on the upside due to both the increase in unit costs on the back of low capacity in certain sectors (especially in services) and the recent financial tightening. The negative output gap (although with the elimination of deepening pressures) and relatively stable low oil prices will partially absorb the recent upside pressures. However, depending on the volatility in currency and the evolution in food prices, we expect the headline inflation to be 11% at the end of the year. Inflation could stay at double digits during the next year, realizing 10% by end 2021.

Supply side effects and demand pull factors push the core prices upward

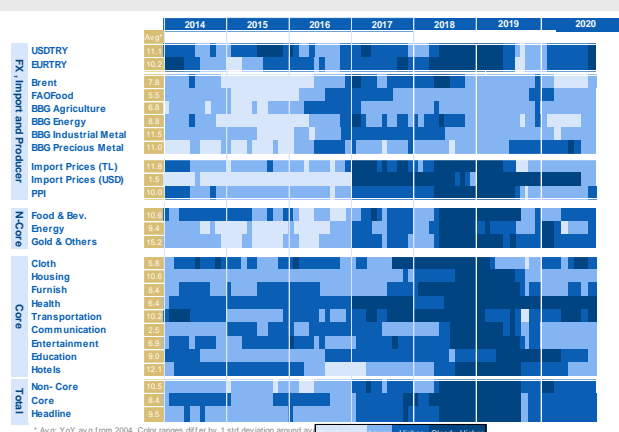
The slight downside deviation stemmed from the food prices, which fell by 0.13% mom compared to our mild 0.2% mom increase estimate, but which still resulted in an annual food inflation rising to 13.6% on base effects. On the other hand, certain sub-items (furniture, white goods, mobile phones, automobiles etc.) sensitive to both demand factors and exchange rate pass-thru kept the upward pressures on core prices alive but showed only a gradual pass-thru from the recent depreciation, which could be continuing in the coming months. Also, cost push factors (further fueled by the recent increase in unit costs -especially in services- and tighter financial conditions) and second round price effects (like rent, restaurant and hotel prices) maintain the potential for further stickiness. As it can be seen in trend inflation (Chart 5), its level has been staying almost stable at near 12% since the latest currency shock in 3Q18. Therefore, core C inflation accelerating to 11% in August could stay above 11% for a longer period. Energy inflation also temporarily increased to 9.6% in annual terms, which will be reversed by the favorable base effects (natural gas and electricity price hikes of last year) in the next two months. Domestic producer prices, which increased by 2.3% mom, confirmed the still alive cost push factors on the tighter financial conditions, the disruptions in production and the recent tax adjustments. Looking ahead, negative output gap and energy prices could remain the supportive factors but high inertia, currency depreciation, fast recovery in demand factors and volatile food prices prove to be the upside risks.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

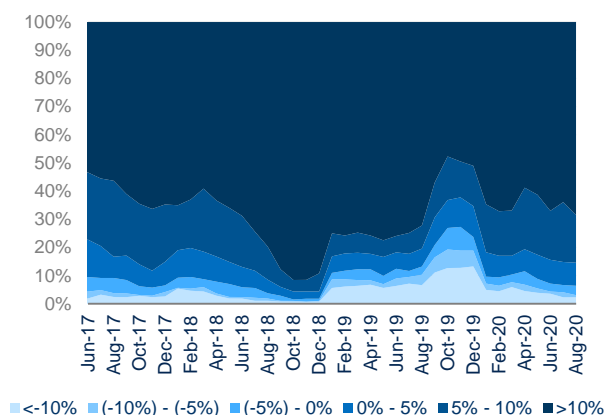


Source: BBVA Research Turkey & Turkstat

Worsened core inflation outlook will weigh on the upside

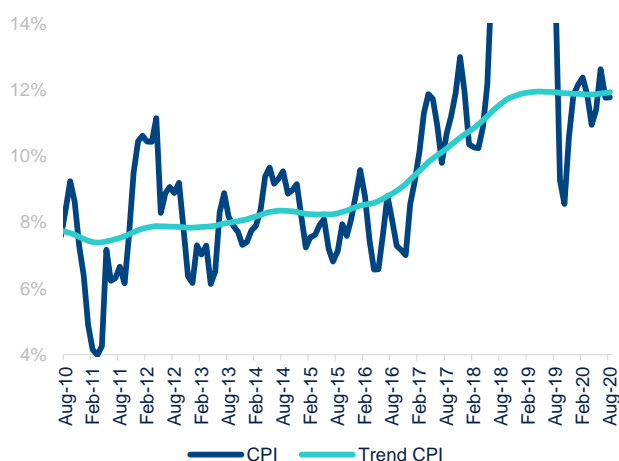
Rigidity in core prices led by the supply side effects of the pandemic, continuing exchange rate pass-thru, fast recovery in domestic demand and high inertia on top of the stickiness in trend inflation maintain the upside risks on inflation. In contrast, still negative output gap, relatively stable low oil prices and some tax incentives partially absorb the upside pressures. All in all, we expect the headline inflation to converge towards 11% at the end of the year, which would require additional tightening from the Central Bank. Inflation could stay at double digits during the next year, realizing 10% by end 2021.

Chart 3. Inflation Diffusion Map, YoY



Source: BBVA Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, YoY



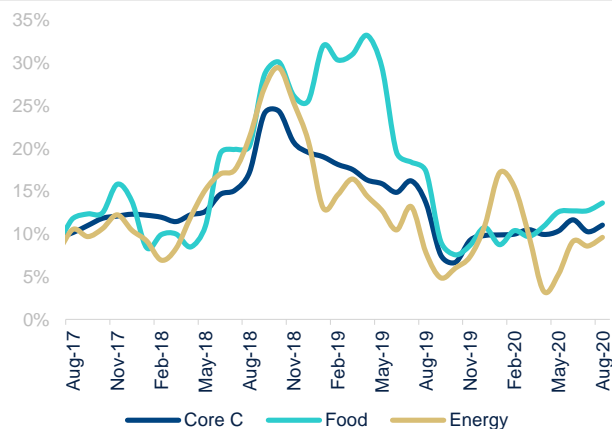
Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
Total	0.86%	11.77%
Food & Non-alcoholic beverages	-0.1%	13.5%
Beverage & Tobacco	0.2%	2.4%
Clothing & Textile	-2.1%	9.2%
Housing	1.0%	11.3%
Household Equipment	1.2%	8.9%
Health	0.9%	14.7%
Transportation	1.6%	12.7%
Communication	0.5%	6.4%
Recreation & Culture	1.1%	6.6%
Education	0.5%	8.5%
Restaurants & Hotels	1.6%	11.8%
Misc. Goods & Services	5.1%	27.0%

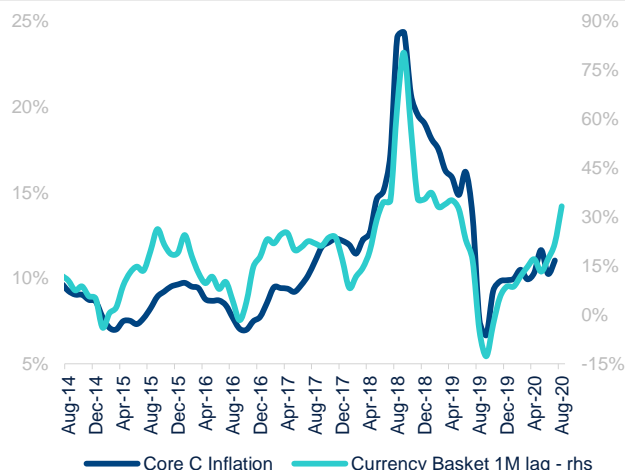
Source: BBVA Research Turkey & Turkstat

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
Total	2.35%	11.53%
Mining & Quarrying	4.7%	13.3%
Manufacturing	3.0%	12.3%
Food Products	0.9%	11.3%
Textiles	2.6%	14.3%
Wearing Apparel	0.8%	4.4%
Coke & Petroleum Products	6.4%	-7.6%
Chemicals	3.1%	10.9%
Other Non-Metallic Mineral	1.4%	5.9%
Basic Metals	7.1%	17.5%
Metal Products	4.3%	19.1%
Electrical Equipment	3.7%	16.8%
Electricity, Gas, Steam	-7.3%	0.1%

Source: BBVA Research Turkey & Turkstat

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