

Economic Watch

Turkey: October CPI came close to expectations

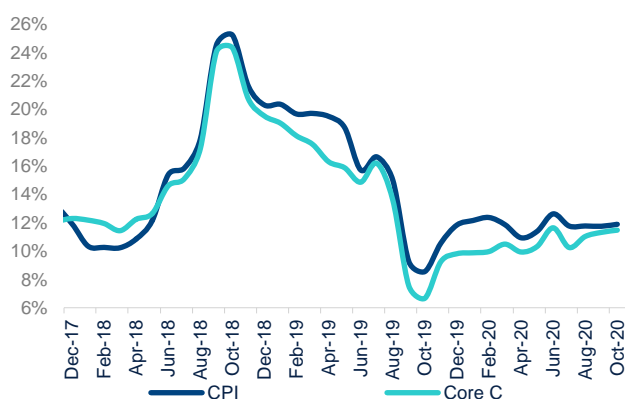
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Consumer prices increased by 2.13% mom in October parallel to the expectations (2.1% BBVA Research, 2.15% Consensus), leading the annual inflation to slightly increase to 11.89%. Core inflation again surprised on the downside led by the seasonally low clothing prices and the potential downward impact of the recent tax cuts in certain services prices. Though, there still occurred an acceleration in core inflation to 11.5% from 11.3% in annual terms, but to a lower extent, showing only a gradual exchange rate pass-thru on negative output gap and spare capacity in some services activities. However, cost push factors continued to weigh on the upside as domestic producer prices rose by 3.6% in monthly terms and resulted in an annual inflation of 18.2%, led by the recent financial tightening on top of the rapid currency depreciation. Considering a very gradual pass-thru impact so far, risks are tilted on upside for the inflation outlook, while expected slow-down in activity and relatively low oil prices might partially absorb the upward pressures. Hence, we expect consumer inflation to end the year near 13% and evaluate the risks on the upside for our current year-end 2021 inflation forecast of 10%, given the ongoing high currency volatility.

Still gradual pass-thru on inflation but cost push factors put worrisome signal

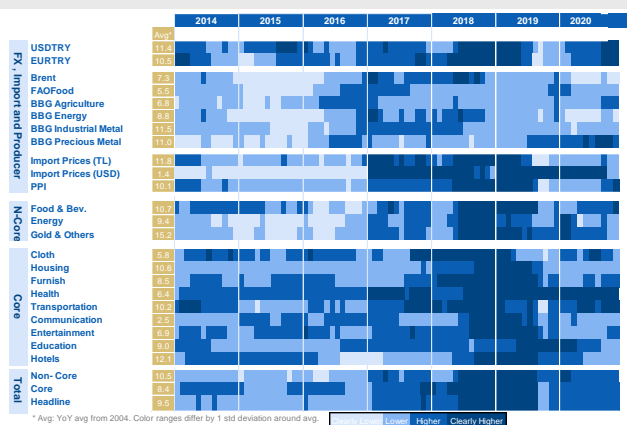
Food prices increased by 3.1% mom on the back of both unprocessed (4% mom) and processed food prices (2.1% mom on exchange rate depreciation and hike in bread prices), leading the annual food inflation to reach 17.2%. Energy prices also rose by 2.1% mom, but annual energy inflation remained weak at 4% on favorable base effects. On the core prices side, certain sub-items sensitive to both demand and exchange rate (furniture, automobiles and white goods) kept upside pressure on prices whereas clothing prices (6.9% mom) provided some cushion compared to its higher seasonal average (10% mom). Despite the sharp depreciation in currency, core prices increased by 1.9% mom, still displaying a gradual exchange rate pass-thru on negative output gap, which could accelerate in the coming months. Also, services prices remained weak, stemming from spare capacity, weakening demand and tax incentives as annual services inflation only slightly rose to 10.9% from 10.8%. However, cost push factors could underpin the upside pressures on consumer inflation in the coming months as domestic producer prices (3.6% mom) jumped up by 18.2% in annual terms, accelerating from 14.3% on top of unfavorable base effects. Looking ahead, recent sharp currency depreciation, still strong domestic demand, deterioration in inflation expectations and increasing supply-side factors put clear upside risks on inflation outlook which was also confirmed by the Central Bank since it revised its inflation forecasts sharply to 12.1% for 2020 (+3.2pp) and 9.4% for 2021 (+3.2pp).

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

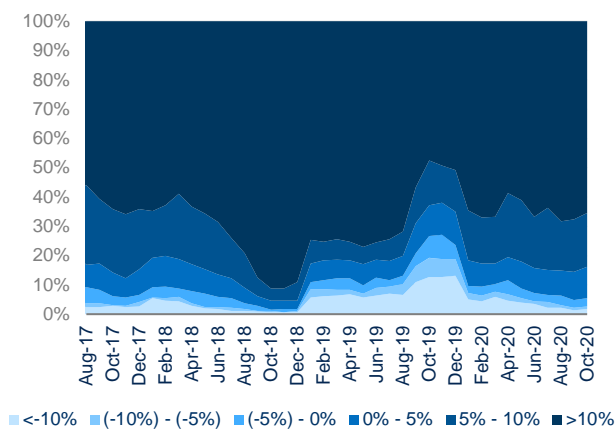


Source: BBVA Research Turkey & Turkstat

Inflation outlook maintains risks on the upside

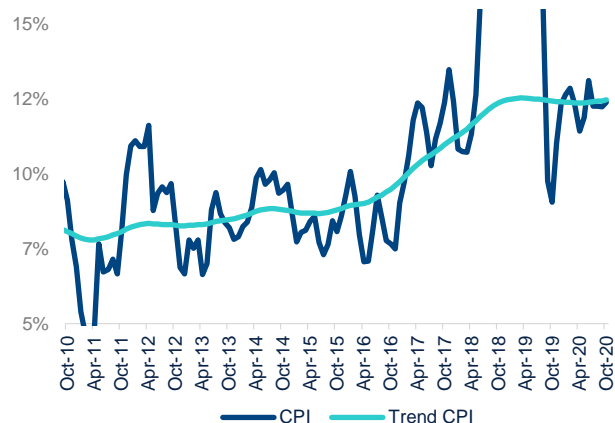
Only a gradual exchange rate pass-thru so far, still strong domestic demand, increasing cost-push factors and high inertia on top of the stickiness in trend inflation maintain the upside risks on inflation. In contrast, expected slow-down in activity, recent sharp deceleration in credits, relatively stable oil prices and some tax incentives would partially absorb the upside pressures. All in all, we expect the headline inflation to get close to 13% at the end of the year, which would require the Central Bank to take clearer bold steps to tighten the monetary policy further.

Chart 3. Inflation Diffusion Map, YoY



Source: BBVA Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, YoY



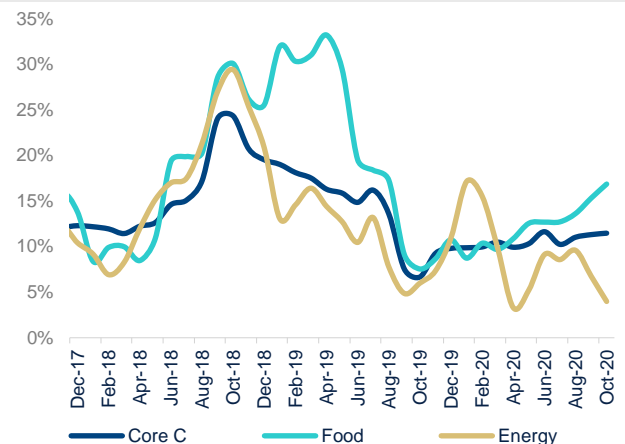
Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
Total	2.13%	11.89%
Food & Non-alcoholic beverages	3.0%	16.5%
Beverage & Tobacco	0.0%	0.7%
Clothing & Textile	6.8%	2.2%
Housing	2.0%	8.4%
Household Equipment	2.5%	13.0%
Health	0.9%	15.6%
Transportation	2.0%	13.9%
Communication	0.2%	5.5%
Recreation & Culture	-0.1%	8.7%
Education	0.0%	7.4%
Restaurants & Hotels	0.7%	11.2%
Misc. Goods & Services	2.0%	27.4%

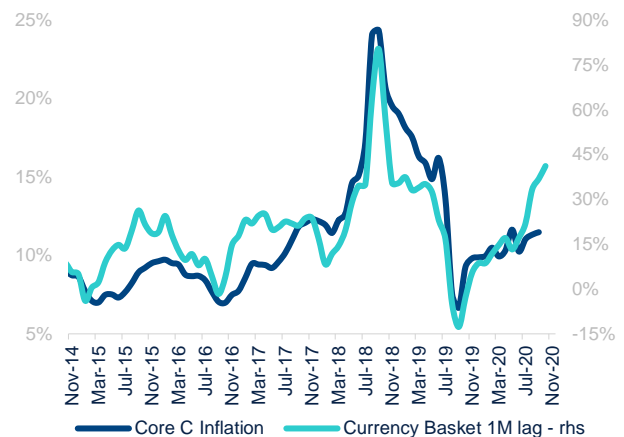
Source: BBVA Research Turkey & Turkstat

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	3.55%	18.20%
Mining & Quarrying	1.4%	17.0%
Manufacturing	3.7%	19.8%
Food Products	3.3%	19.1%
Textiles	3.5%	21.3%
Wearing Apparel	1.1%	4.9%
Coke & Petroleum Products	5.9%	-8.8%
Chemicals	4.2%	18.8%
Other Non-Metallic Mineral	2.2%	9.0%
Basic Metals	5.8%	36.1%
Metal Products	4.1%	26.5%
Electrical Equipment	3.1%	22.7%
Electricity, Gas, Steam	2.4%	-1.6%

Source: BBVA Research Turkey & Turkstat

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