

Economic Watch

# Turkey: Consumer inflation surprised on the upside

Adem Ileri / Seda Guler Mert / Yesim Ugurlu Solaz

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Consumer prices increased by 1.68% in January, again surprising on the upside (1% BBVA Research, 1.4% Consensus). Annual inflation accelerated to 14.97%, up from 14.6% in December. As we expected, food prices inflation proved to be seasonally low; though, higher than expected increases in core and administrative prices concluded an upward deviation from our forecast. Continuing exchange rate pass thru, cost-push factors becoming clearer on services prices, and somewhat weakening but still strong domestic demand were the main reasons behind the worsening inflation outlook. Domestic producer price inflation, being realized as 2.66%, resulted in an annual inflation of 26.16% and confirmed the strengthening cost factors and increasing uncertainties in the following period. When adjusted from seasonal and cyclical factors, the trend consumer inflation level getting near 14% will require the maintenance of the decisive tight monetary stance for a long period of time as the Central Bank (CBRT) already highlighted. We expect consumer inflation to rise further in the coming months and reach near 16% in April 2021 before a gradual disinflation path thereafter. We expect consumer inflation to end 2021 at 10.5%.

## The upward revision of weight in food and high services inflation were critical

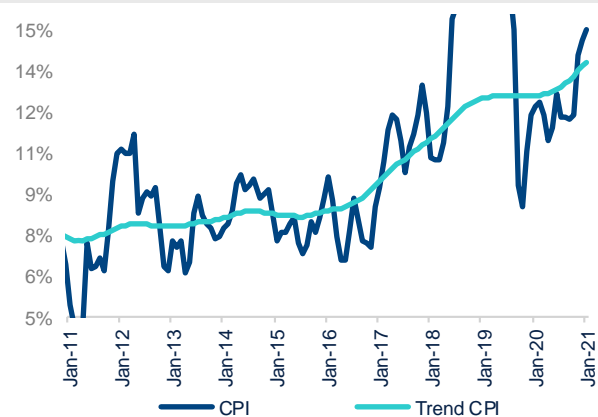
Although food inflation materialized lower than its seasonal average as we expected, the upward revision of food weight in the basket (25.94% in 2021 vs 22.77% in 2020, especially due to processed food) led the food prices to add 0.6pp to the headline. Yet, helped by positive base effects, annual food inflation still decelerated to 18.4% from 21.2%. On the energy side, the adjustment in administrative prices (water +7%, electricity +6%, natural gas 1%) and the recent rapid increase in oil prices resulted in 3.2% monthly rise of energy prices, which implied an annual inflation up to 7.9% from 5.6% in December. On the core inflation front, a lower negative level than its seasonal average (-4% realized vs. -7%) in clothing (in contrast to previous months' downward surprises), sticky services prices increasing in all sub-indices and still strong domestic demand weighed on the upside. Annual services inflation realized as 11.5%, showing the impact of the high wage increases and supply side problems on pandemic. Solid domestic demand despite the monetary tightening led certain core prices to increase fast (furniture, 6% mom; household equipment, 1.7% mom). Therefore, core prices increased by 1.1% and annual core inflation jumped to 15.5% from 14.3% in December. According to our calculations, inflation has an accelerating trend since the start of 2020 (1pp worsening during 2020) and reached as high as 13.8% in January (Chart 2). Despite the expected gains from the recent currency appreciation and decelerating domestic demand, strengthening cost push factors, high inertia and stickiness on expectations will still weigh as uncertainties on the inflation outlook as seen in our trend CPI calculations.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. CPI and Trend Inflation, YoY

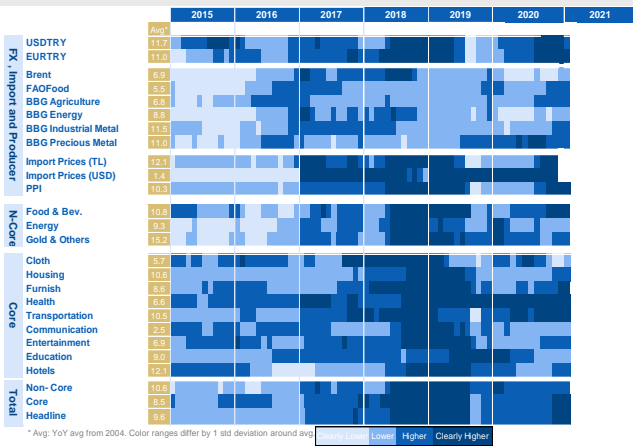


Source: BBVA Research Turkey UCSV-MA Model & Turkstat

## Still worsening trend inflation requires the maintenance of decisive tight stance

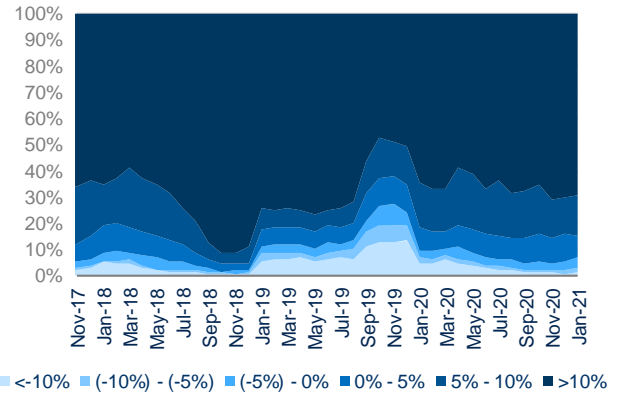
Assuming only a slight nominal depreciation of the currency this year, we expect consumer inflation to decline to 10.5% at the end of the year, especially helped by sizable positive base effects in 4Q21. Given its updated projections, today's data should not be an upside surprise for the CBRT, so we maintain our view that the CBRT will stay on hold till 4Q21. But if any clear upside surprise on inflation happen, additional tightening should not be ruled out, as it was already forward-guided by the CBRT.

Chart 3. **Consumer Inflation Heat Map**



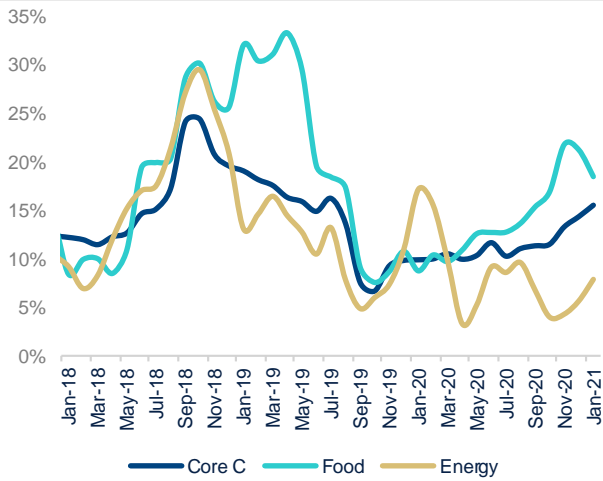
Source: BBVA Research Turkey, Turkstat,

Chart 4. **Consumer Inflation Diffusion Map, YoY**



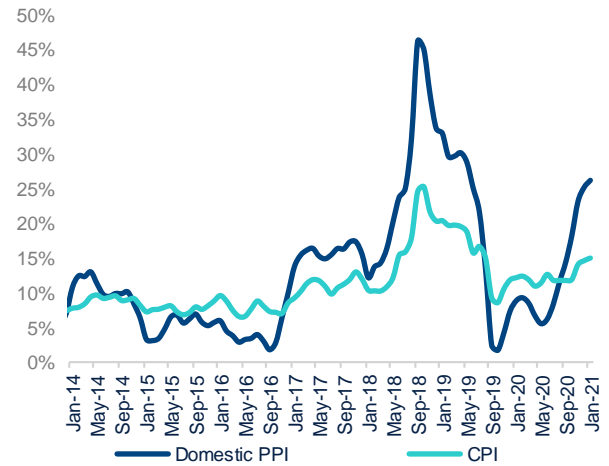
Source: BBVA-Research Turkey, Turkstat,

Chart 5. **CPI Components, YoY**



Source: BBVA Research Turkey, Turkstat

Chart 6. **CPI vs PPI, YoY**



Source: BBVA Research Turkey, Turkstat

Chart 7. **CPI in Subcomponents**

	MoM	YoY
<b>Total</b>	<b>1.68%</b>	<b>14.97%</b>
Food & Non-alcoholic beverages	2.5%	18.1%
Beverage & Tobacco	0.7%	1.4%
Clothing & Textile	-4.4%	2.1%
Housing	3.0%	11.6%
Household Equipment	2.9%	23.2%
Health	4.3%	17.0%
Transportation	1.1%	21.4%
Communication	0.3%	6.3%
Recreation & Culture	1.2%	9.7%
Education	0.0%	6.1%
Restaurants & Hotels	1.6%	12.9%
Misc. Goods & Services	1.9%	24.5%

Source: BBVA Research Turkey & Turkstat

Chart 8. **Domestic PPI in Subcomponents**

	MoM	YoY
<b>Total</b>	<b>2.66%</b>	<b>26.16%</b>
Mining & Quarrying	2.5%	19.2%
Manufacturing	2.7%	28.4%
Food Products	3.7%	26.6%
Textiles	0.8%	24.1%
Wearing Apparel	1.0%	8.4%
Coke & Petroleum Products	4.1%	3.4%
Chemicals	1.0%	26.7%
Other Non-Metallic Mineral	4.8%	20.7%
Basic Metals	3.0%	56.9%
Metal Products	0.0%	30.5%
Electrical Equipment	2.3%	29.5%
Electricity, Gas, Steam	0.7%	0.0%

Source: BBVA Research Turkey & Turkstat

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### ENQUIRIES TO:

BBVA Research: Azul Street, 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).  
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25  
bbvaresearch@bbva.com www.bbvaresearch.com

