Creating Opportunities

BBVA Research

Economic Watch

Turkey: Annual consumer inflation reached 15.6%

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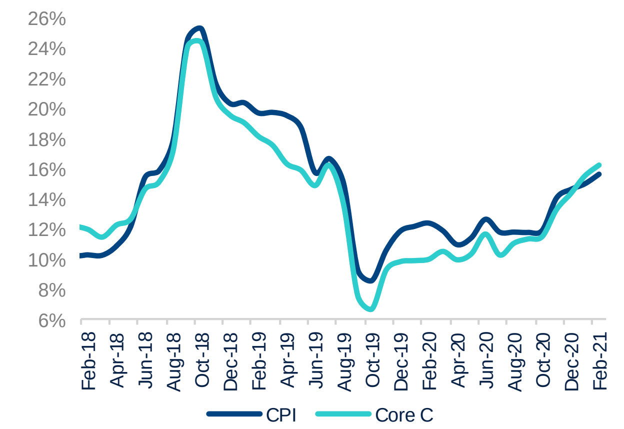
Consumer prices increased by 0.91% in February in line with our call (0.9%) but higher than the Consensus (0.7%), bringing the annual inflation up to 15.6% from 15% in January. Although exchange rate pass thru has eased, cost-push factors becoming clearer on services prices, somewhat weakening but still strong domestic demand and certain sub-factors affected by the suspended demand led by the evolution of the pandemic (such as clothing prices) remain the main reasons behind the worsening inflation outlook. In this respect, core prices annual inflation jumped up to 16.2%, the highest level since April 2019. Also, domestic producer price inflation, being realized as 1.2%, resulted in an annual inflation of 27.1% and confirmed increasing uncertainties in the following period, considering the strengthening commodity prices and potential rises in unit costs in the re-opening of the economy. The peak CPI level that we initially expected to observe in April at 16% could be realized as 17-17.5%, given the current upward pressures; which would mean the upper bound of the Central Bank's current inflation projection at that time and highlight the need for additional tightening by either actions or strengthening forward guidance.

Unfavorable food and commodity prices but diminishing exchange rate impact

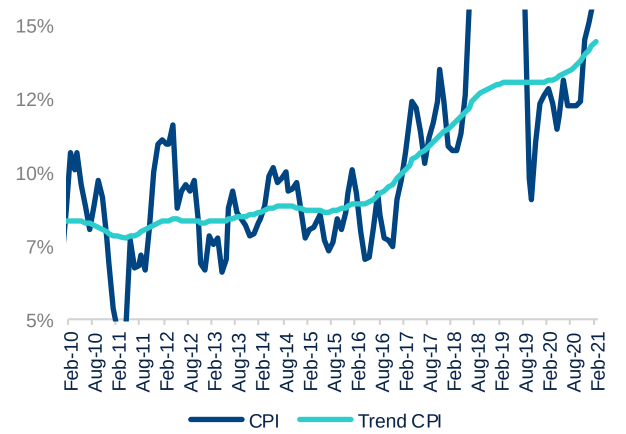
Food inflation materialized as 2.5% mom, supported by both unprocessed (2.9%) and processed food (2.3%) prices, resulting in annual food inflation of 18.7%. Despite a weak rise in energy prices (0.3% mom) thanks to the Government ceiling in fuel prices, yet annual energy inflation increased to 8.8% on base effects. On the other hand, the stabilization in currency and some moderation in domestic demand led core prices to rise by only 0.44% mom despite the lower contraction in clothing prices than its seasonal average (-0.9% vs. -5.5% mom) and sticky services prices. Yet, annual core inflation still jumped to 16.2% from 15.5% in January on base effects. High inertia persisted as annual services inflation further rose to 11.74% on the back of high wage increases and negative effects of the pandemic. On top of that, cost push factors got stronger as domestic producer prices increased by 1.2% mom, resulting in annual figure of 27.1% up from 26.2%. Looking ahead, the expected tight stance of the monetary policy and the deceleration in domestic demand could accelerate the disinflation process as the currency impact on inflation (according to our calculations, which is close 4pp on core D inflation, Chart 5) could diminish further with stabilization in currency. However, the increasing commodity prices could be one of the negative factors on inflation outlook as the oil price impact on inflation turned to positive as of February according to our estimation (Chart 6). Last but not least, trend inflation excluding seasonal and cyclical factors continued to increase and reached 14% in our calculations (Chart 2), confirming a gloomy picture on the expected disinflation path. All in all, the CBRT should remain tight for a long period and should react in advance if the current upside risks will threaten the year-end target of the CBRT (9.4%).

Chart 1. **Core Inflation and CPI (YoY)**



Source: Garanti BBVA Research, Turkstat

Chart 2. **CPI and Trend Inflation, YoY**

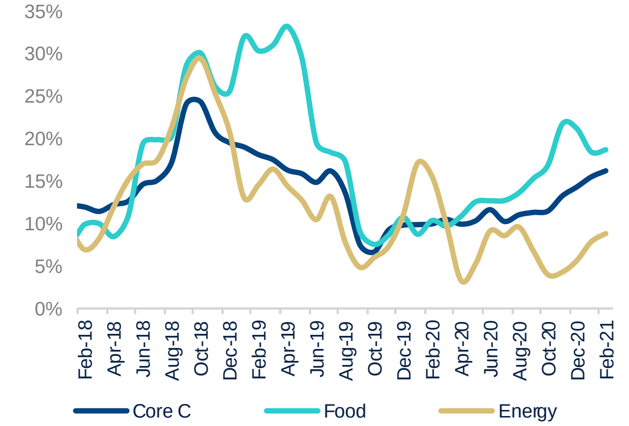


Source: Garanti BBVA Research, UCSV-MA Model & Turkstat

Increasing inflation risks might require the CBRT to react

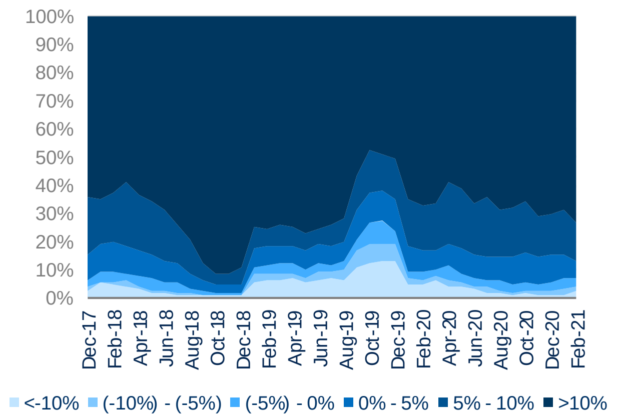
Although we expect some ease from currency pass-thru, stronger commodity prices and potential rises in unit costs after the re-opening of the economy raise uncertainties over the inflation outlook. If not compensated by exchange rate effects, we calculate 1.5pp upside risk on our current CPI forecast (10.5% year-end), led by the recent pressures from oil prices. So, also considering the need for restoring credibility, the CBRT might need to act by either additional tightening or staying tight for longer.

Chart 3. **CPI Components, YoY**



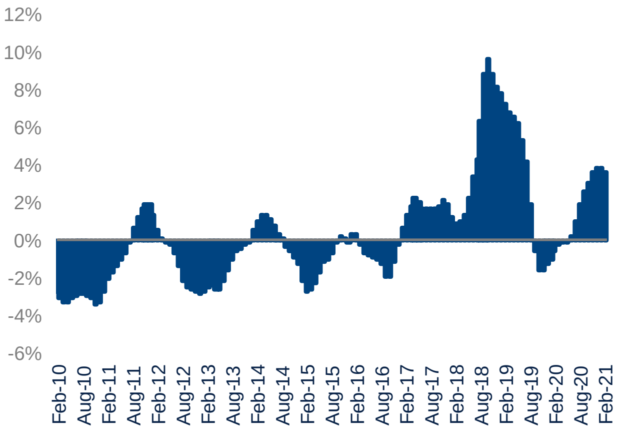
Source: Garanti BBVA Research, Turkstat,

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



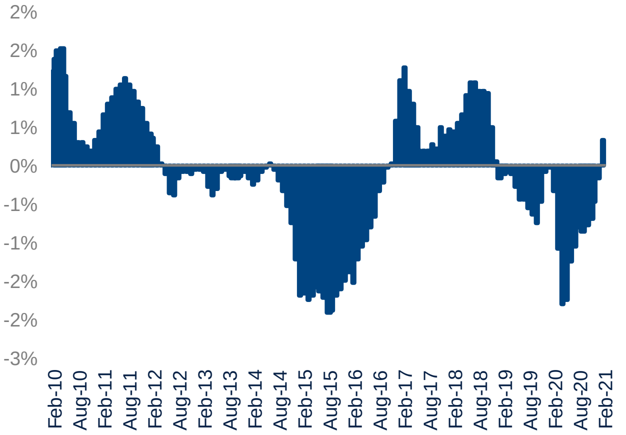
Source: Garanti BBVA Research, Turkstat,

Chart 5. **Contribution of Currency Basket on Core-D Inflation, annual pp**



Source: Garanti BBVA Research, Turkstat

Chart 6. **Contribution of Oil Prices on Core-D Inflation, annual pp**



Source: Garanti BBVA Research, Turkstat

Chart 7. **CPI in Subcomponents**

	MoM	YoY
Total	**0.91%**	**15.61%**
Food & Non-alcoholic beverages	2.6%	18.4%
Beverage & Tobacco	0.1%	2.9%
Clothing & Textile	-0.9%	6.3%
Housing	0.6%	11.7%
Household Equipment	0.3%	23.7%
Health	3.0%	18.1%
Transportation	0.5%	22.5%
Communication	0.6%	7.2%
Recreation & Culture	-1.0%	8.7%
Education	0.9%	6.1%
Restaurants & Hotels	1.3%	13.4%
Misc. Goods & Services	-2.3%	20.6%

Source: Garanti BBVA Research, Turkstat

Chart 8. **Domestic PPI in Subcomponents**

	MoM	YoY
Total	**1.22%**	**27.09%**
Mining & Quarrying	-0.1%	17.3%
Manufacturing	1.6%	29.6%
Food Products	2.8%	28.6%
Textiles	1.5%	24.4%
Wearing Apparel	-0.6%	6.8%
Coke & Petroleum Products	5.5%	19.8%
Chemicals	0.9%	26.9%
Other Non-Metallic Mineral	2.6%	23.6%
Basic Metals	-0.5%	52.6%
Metal Products	-2.3%	25.6%
Electrical Equipment	0.5%	29.1%
Electricity, Gas, Steam	-1.7%	0.7%

Source: Garanti BBVA Research, Turkstat

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