

Turkey: Upside surprise in June CPI

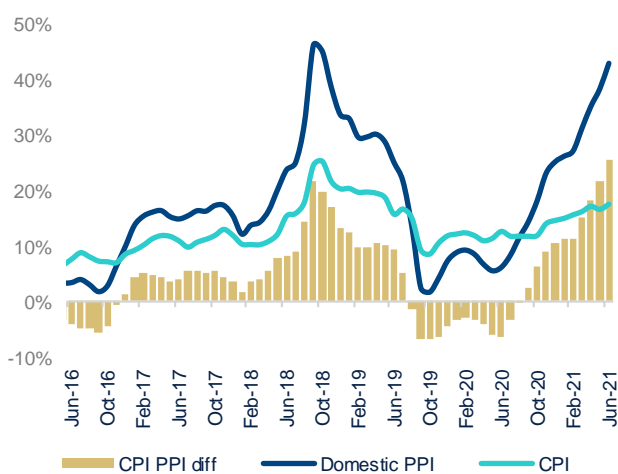
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Consumer prices increased by 1.94% in June, remarkably higher than expectations (BBVA Research, Consensus 1.4%), which resulted in an annual inflation of 17.53% (up from 16.59% the month before). The main deviation in our forecast stemmed from a seasonally high food inflation but stronger than expected core prices in certain items also pushed up the headline further. June CPI figure reflected the adjustments after the reopening in the economy in a period of deepening cost-push factors as domestic producer price inflation once again surprised on the upside with 4% mom increase implying an annual inflation of 42.9%. Since deceleration in domestic demand is still very limited and inflation expectations remain deteriorating led by the increasing uncertainty in domestic policies and other supply-side problems, risks remain tilted to the upside. Utility price hikes as of July will also add near 1pp on the headline including the indirect effects. Even in a gradual currency depreciation pattern, we expect consumer inflation to hover around 18.5% till November and end the year at near 16% with the help of positive base effects on food inflation in the last two months of the year.

Strong price adjustments after the reopening and deepening cost push factors

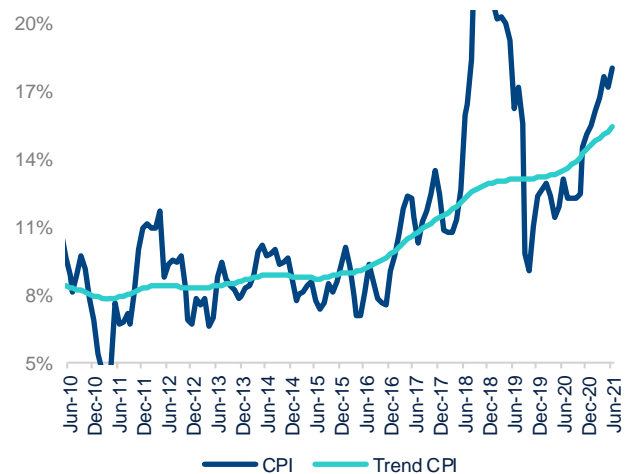
Food inflation surprised on the upside with 0.8% mom despite its seasonal average at near -1%, which mainly stemmed from other unprocessed (3.5% mom) and processed food prices (2% mom) and resulted in an annual inflation of 20.4%. Energy prices increased by 2.2% mom on the lagged effect of May tax hikes on fuel. Though, favorable base effects still led annual energy inflation to decline slightly to 17.3% from 17.7% in May. On the other hand, core inflation reflected the continuing exchange rate pass-thru impact and strengthening supply-side factors after the reopening in the economy with 2.5% mom on the back of basic goods (3.1% mom) and services prices inflation (1.9% mom). Stronger price increases were observed in both demand and exchange rate sensitive items such as furniture, white goods, automobiles, clothing, entertainment and restaurant & hotel prices. Hence, annual core inflation increased up to 17.5% with upward pressures across-the-board. Cost push factors deepened further as domestic producer prices rose by 4% mom, surprising on the upside for the forth consequent month with an annual figure of 43% and implying a record level of difference between consumer and producer prices (Figure 1). Also, high inertia persists as annual services inflation remains at 13.5% with relatively higher price increases in certain groups. Last but not least, led by the recent hike in electricity and gas prices (near 0.7% direct impact), we expect July CPI to materialize near 18.5% and remain close to this level till November figure.

Figure 1. **CPI vs Domestic PPI, YoY**



Source: Garanti BBVA Research, Turkstat

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

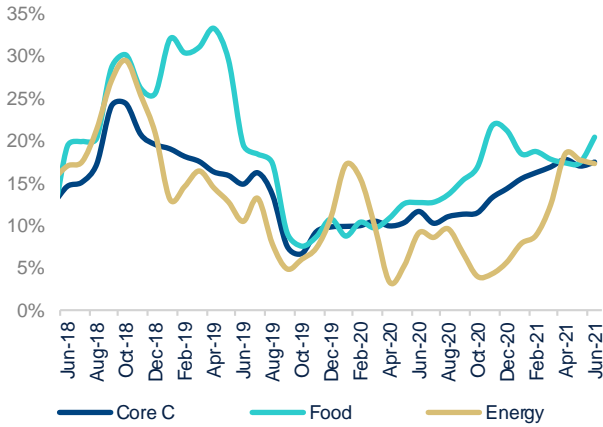


Source: Garanti BBVA Research, Turkstat

Uncertainty on inflation outlook increased further

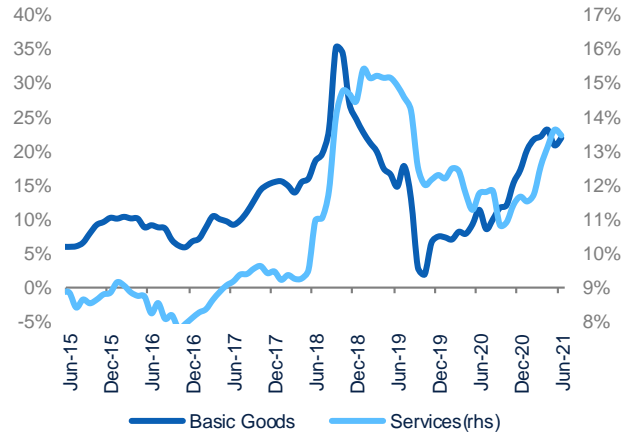
Higher commodity prices, deepening cost push factors, ongoing exchange rate pass thru and still growing domestic demand keep the risks on the upside for the inflation outlook. We revise our year-end inflation forecast to 16% and expect the CBRT to start an easing cycle in October but in a much more gradual manner.

Figure 3. **CPI Components, YoY**



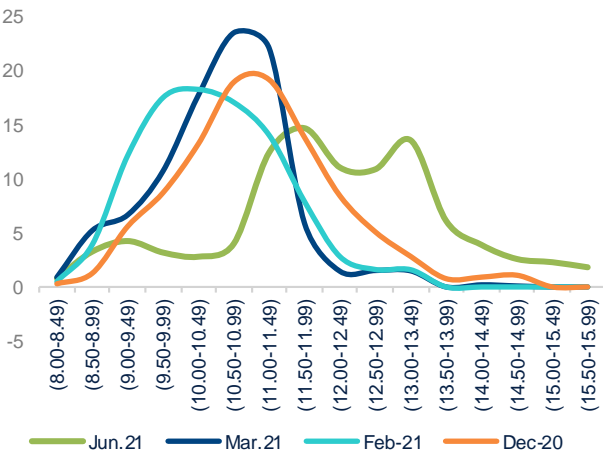
Source: Garanti BBVA Research, Turkstat

Figure 4. **CPI Components, YoY**



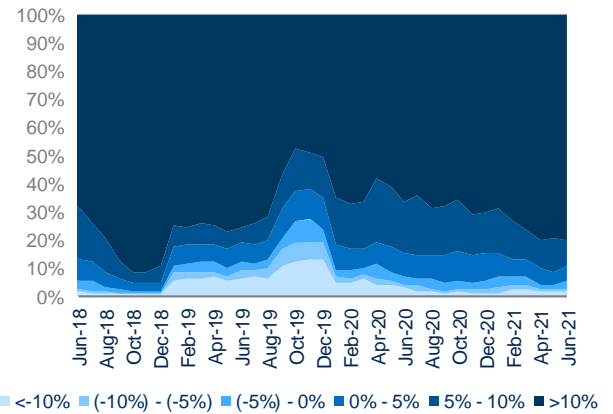
Source: Garanti BBVA Research, Turkstat, Bloomberg

Figure 5. **Probability Distribution of 12-month ahead CPI Expectations**



Source: Garanti BBVA Research, Turkstat

Figure 6. **Consumer Inflation Diffusion Map, YoY**



Source: Garanti BBVA Research, Turkstat

Figure 7. **CPI in Subcomponents**

	MoM	YoY
Total	1.94%	17.53%
Food & Non-alcoholic beverages	0.9%	20.0%
Beverage & Tobacco	0.0%	2.0%
Clothing & Textile	2.4%	7.1%
Housing	1.2%	14.6%
Household Equipment	4.5%	25.7%
Health	0.8%	19.1%
Transportation	2.8%	26.3%
Communication	0.4%	6.1%
Recreation & Culture	4.5%	12.2%
Education	2.2%	10.9%
Restaurants & Hotels	3.8%	18.9%
Misc. Goods & Services	2.7%	19.9%

Source: Garanti BBVA Research, Turkstat

Figure 8. **Domestic PPI in Subcomponents**

	MoM	YoY
Total	4.01%	42.89%
Mining & Quarrying	2.9%	35.3%
Manufacturing	3.8%	45.9%
Food Products	3.8%	35.1%
Textiles	2.3%	37.9%
Wearing Apparel	1.1%	10.4%
Coke & Petroleum Products	8.8%	123.8%
Chemicals	3.3%	50.1%
Other Non-Metallic Mineral	3.0%	37.1%
Basic Metals	1.1%	100.0%
Metal Products	2.9%	39.0%
Electrical Equipment	4.2%	41.0%
Electricity, Gas, Steam	7.5%	11.2%

Source: Garanti BBVA Research, Turkstat

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