

# Turkey: Core inflation came down to 16.8%

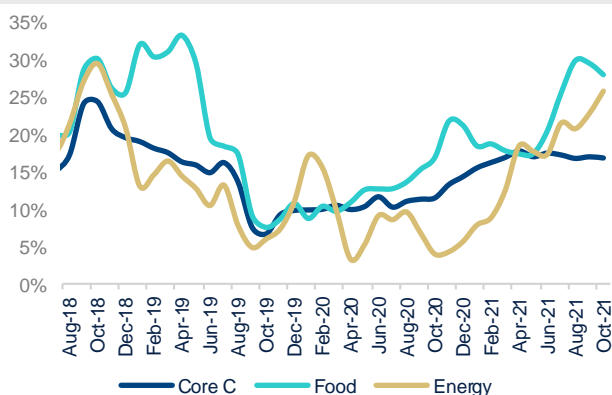
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3 November 2021

Consumer prices increased by 2.39% in October surprisingly lower than expectations (market 2.8%, ours 3.4%), resulting in an annual inflation of 19.89% up from 19.58% the month before. Our main deviation was due to both food and core prices inflation, which reflected weaker than expected pass-thru from cost factors despite the continuing domestic demand basically on consumption. Domestic producer prices rose by 5.2% and 46.3% in annual terms, which will likely accelerate further due to strong energy prices and recent depreciation of the currency. Looking ahead, still high food inflation, deepening cost-push factors, and potentially ongoing energy price hikes following the pressures from global prices maintain risks on the upside for inflation outlook. Besides, domestic demand remains strong and inflation expectations keep deteriorating. We expect consumer inflation to be realized as 19.5% at the end of the year, with risks clearly on the upside, which will further challenge the recent slower but continuing easing bias of the CBRT.

## Weak core inflation despite the strengthening cost push factors

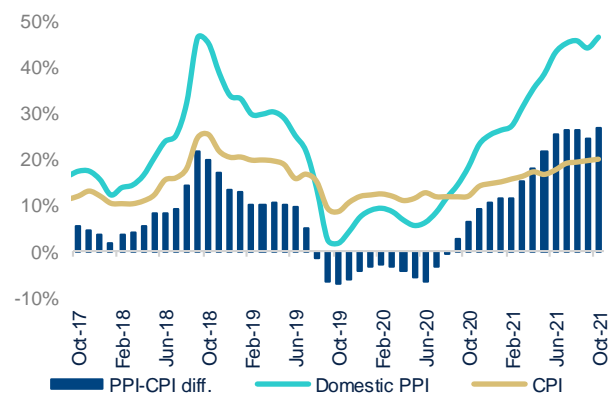
Food inflation surprisingly remained moderate with 1.9% on the back of record low fresh fruit and vegetable prices (2% mom) compared to over 8% mom seasonal average, while processed food inflation rose by 2.1% mom. Thus, annual food inflation declined to 27.9% in October from the previous 29.5%. Meanwhile, energy prices accelerated with 4.6% mom increase led by higher commodity prices, recent currency depreciation and price hikes, and resulted in an annual inflation of 25.8% where we would expect further deterioration. In contrast to increased push factors, still robust demand and faster currency depreciation, core prices inflation surprised on the downside with the lower than expected goods prices (such as clothing (7.6% mom vs its seasonal 10% avg.), vehicle purchases (0.2% mom) and personal care products (0.7%)). Services prices inflation was also weak compared to previous months (1% mom) but annual services inflation remained high with 15.4%, which underlines the strengthening inertia impact. As a result, annual core inflation declined to 16.82% in October which was 16.98% the previous month. On the other hand, cost push factors continued to accelerate as producer prices increased by 5.2% mom carrying the annual figure to 46.3% led by higher energy prices and fast currency depreciation. We expect PPI to remain elevated given natural gas price hikes for the industry and expected further deterioration in the energy prices in the near future. Inflation expectations keep worsening as 12-month CPI and 24-month ahead expectations reached 13.9% and 11.3% respectively, which will likely lead to high wage hikes with inertia reinforcing itself. All in all, considering global supply side restrictions, lagged impact of currency depreciation and strengthening cost push factors accompanied with still robust demand, risks remain clearly on the upside for inflation outlook.

Figure 1. CPI Components, YoY



Source: Garanti BBVA Research, Turkstat

Figure 2. CPI vs Domestic PPI, YoY

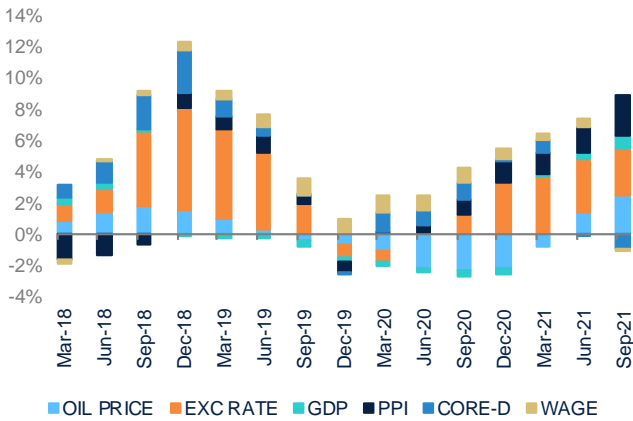


Source: Garanti BBVA Research, Turkstat

## Cost factors will play-in, worsening the inflation outlook even further

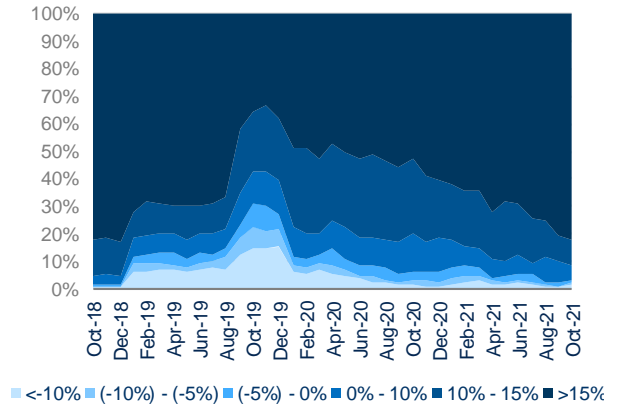
Given the recent depreciation and increased volatility, inflation will likely surprise on the upside, which will be very challenging given the easing bias of the CBRT and other likely loose policies in a period of potentially tighter financial conditions in global markets. We expect consumer inflation to reach 19.5% at the end of the year, which will be followed by higher levels in early 2022 before declining to 18% at the end of 2022.

Figure 3. Contributions to Core-DInflation, YoY



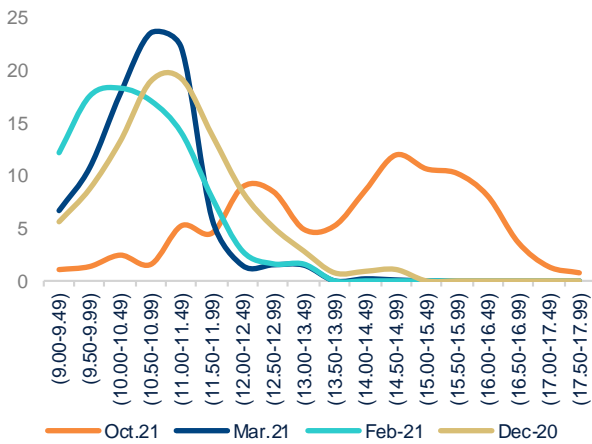
Source: Garanti BBVA Research BVAR Inflation Model, Turkstat

Figure 4. Consumer Inflation Diffusion Map, YoY



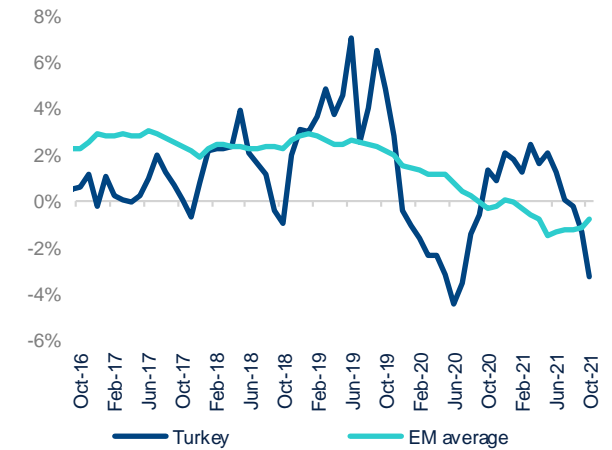
Source: Garanti BBVA Research, Turkstat

Figure 5. Probability Distribution of 12-month ahead CPI Expectations (%)



Source: Garanti BBVA Research, Turkstat

Figure 6. Ex Post Real Policy Interest Rate



Source: Garanti BBVA Research, Turkstat, Bloomberg, \*EM corresponds to Brazil, India, Mexico, Indonesia, South Africa, Russia and Colombia

Figure 7. CPI in Subcomponents

|                                | MoM          | YoY           |
|--------------------------------|--------------|---------------|
| <b>Total</b>                   | <b>2.39%</b> | <b>19.89%</b> |
| Food & Non-alcoholic beverages | 1.9%         | 27.4%         |
| Beverage & Tobacco             | 6.0%         | 7.9%          |
| Clothing & Textile             | 7.6%         | 8.1%          |
| Housing                        | 2.3%         | 21.3%         |
| Household Equipment            | 2.3%         | 23.0%         |
| Health                         | 0.6%         | 17.2%         |
| Transportation                 | 2.4%         | 20.7%         |
| Communication                  | 0.5%         | 5.3%          |
| Recreation & Culture           | 0.5%         | 13.1%         |
| Education                      | 0.2%         | 16.7%         |
| Restaurants & Hotels           | 2.3%         | 25.2%         |
| Misc. Goods & Services         | 1.7%         | 13.6%         |

Source: Garanti BBVA Research, Turkstat

Figure 8. Domestic PPI in Subcomponents

|                            | MoM          | YoY           |
|----------------------------|--------------|---------------|
| <b>Total</b>               | <b>5.24%</b> | <b>46.31%</b> |
| Mining & Quarrying         | 4.5%         | 32.2%         |
| Manufacturing              | 5.4%         | 45.9%         |
| Food Products              | 3.3%         | 38.0%         |
| Textiles                   | 6.5%         | 38.1%         |
| Wearing Apparel            | 1.6%         | 10.3%         |
| Coke & Petroleum Products  | 20.9%        | 130.6%        |
| Chemicals                  | 8.0%         | 52.2%         |
| Other Non-Metallic Mineral | 3.9%         | 45.4%         |
| Basic Metals               | 1.1%         | 91.2%         |
| Metal Products             | 5.8%         | 34.1%         |
| Electrical Equipment       | 4.1%         | 40.6%         |
| Electricity, Gas, Steam    | 4.6%         | 53.4%         |

Source: Garanti BBVA Research, Turkstat

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