Turkey: CPI reached above 61% in March

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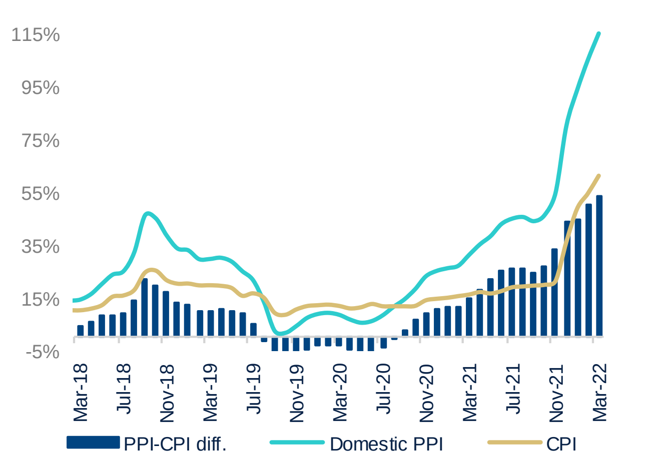
Consumer prices increased by 5.5% in March, parallel to expectations (BBVA Research 6%, Consensus 5.8%) and resulted in an annual inflation of 61.1%, up from 54.4% in the previous month. Food prices remained seasonally high but materialized lower than our expectations, whereas core inflation surprised on the upside with a broad-based worsening especially in services prices. Meanwhile, domestic producer prices jumped 9.2% m/m and 115% y/y due to higher commodity prices and lagged effects of energy price hikes. Looking ahead, we expect consumer inflation to hover near 70% in 2Q and 3Q and decline to 50% at the end of the year due to base effects. The uncertainty on commodity prices and spill-over effects from the Russia-Ukraine conflict keep risks on inflation on the upside.

Stronger pass-thru and cost effects on inflation

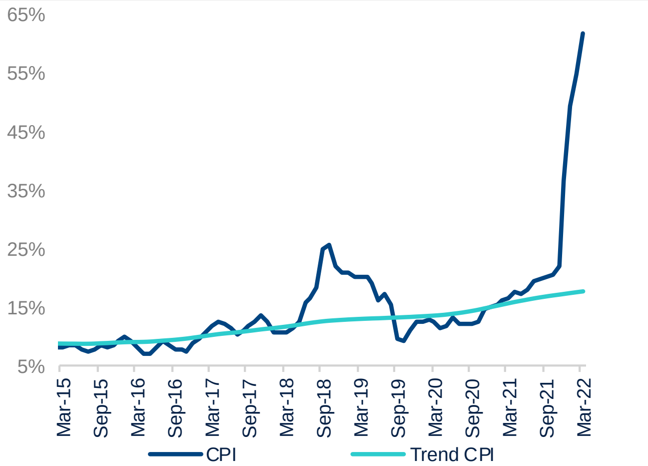
Food prices continued to rise (4.8% m/m), leading the annual figure to reach a new record level of 71.6% in series starting from 2003. The recent price hikes in administrative prices (sugar, milk, meat, etc.) and continuing pressures from commodities will keep the upward bias on food inflation. Similarly, energy prices kept accelerating (11% m/m and 102% y/y) following Russia's invasion of Ukraine. Core prices also gained momentum with 4.6% m/m increase, fueled by renewed depreciation pressures on the exchange rate (as seen in automobile, furniture, telephone, personal care and recreation prices) and strengthening cost-push factors. Services prices climbed up further by 4.2% m/m and 36.7% y/y led by transportation and restaurant & hotel prices, reflecting the effects of both high commodity prices and the sharp minimum wage hike at the start of the year. Therefore, annual core C inflation accelerated to 48.3%. In addition, cost push factors continued to deepen as domestic producer prices (PPI) rose by 9.2% m/m and reached a new record level of 115% on a y/y basis. Ultra-dovish monetary policy together with loose fiscal and credit policies resulted in further worsening of inflation expectations, which reached a high of 26.4% and 17% for 12-month and 24-month ahead, respectively. All in all, continuing exchange rate pass through and inertia, fueled by accelerating cost push factors, and worsening inflation expectations keep upside risks to the inflation outlook. According to our calculations, if seasonal, cyclical and other idiosyncratic factors are excluded, trend CPI has increased above 17%, which will be extremely difficult to lower as long as inflation expectations are unanchored even if some cyclical or seasonal improvements take place (Figure 2).

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



Source: Garanti BBVA Research, Turkstat

Figure 2. **CPI vs Trend CPI, YoY**

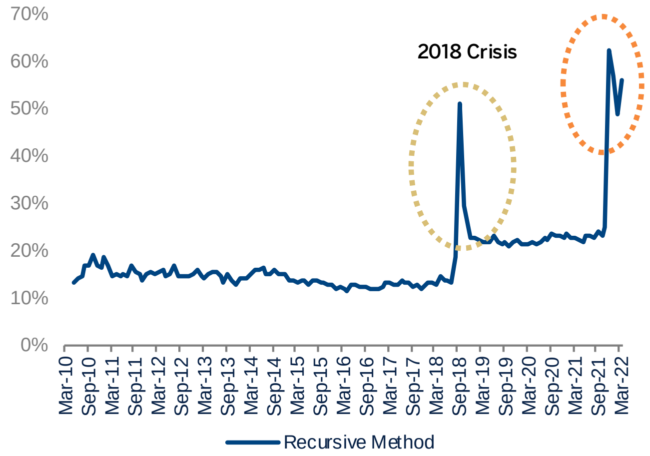


Source: Garanti BBVA Research, Turkstat

Exchange rate pass-through gains momentum

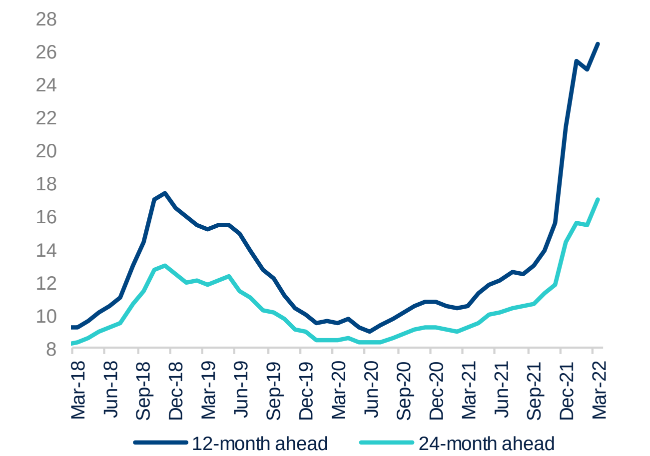
Despite the strategy of eliminating exchange rate effects on inflation by means of stabilizing the currency, we calculate slightly increasing exchange rate pass-through in March (Figure 3). This is basically linked to significantly worsening inflation expectations in the absence of a clear monetary policy reaction aimed at tighter financial conditions. Instead, declining credit interest rates sizably below inflation levels imply an opposite monetary transmission mechanism and reinforce the loose stance.

Figure 3. **Exchange Rate Pass-thru on Core D**



Source: Garanti BBVA Research, Turkstat, recursive method

Figure 4. **Inflation Expectations, annual %**

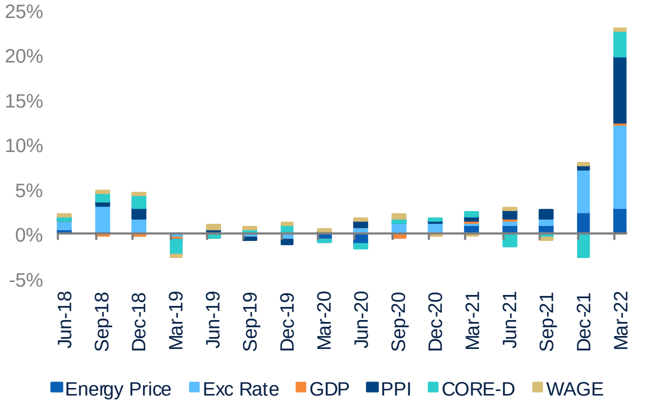


Source: Garanti BBVA Research, Turkstat

Wage and second round effects feed in stickiness

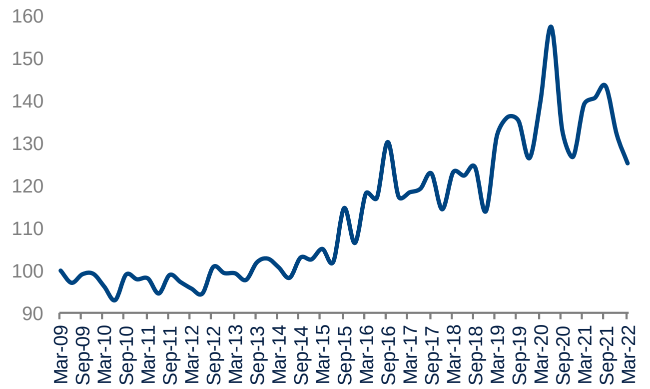
An historical decomposition on inflation (figure 5), highlights an increasing contribution from wages and inertia. This confirms the uptick seen in services prices, which will increase the stickiness of inflation, on top of additional pressures from forward looking expectations as explained above. Therefore, even though wages are targeted to be adjusted by inflation, especially for minimum wage earners, these self-fulfilling price pressures eliminate and even reduce any real wage gains, thereby reducing the overall welfare of all workers.

Figure 5. **Historical Decomposition on Core D, quarterly**



Source: Garanti BBVA Research, Turkstat

Figure 6. **Gross Wages, deflated by CPI, 2009=100**

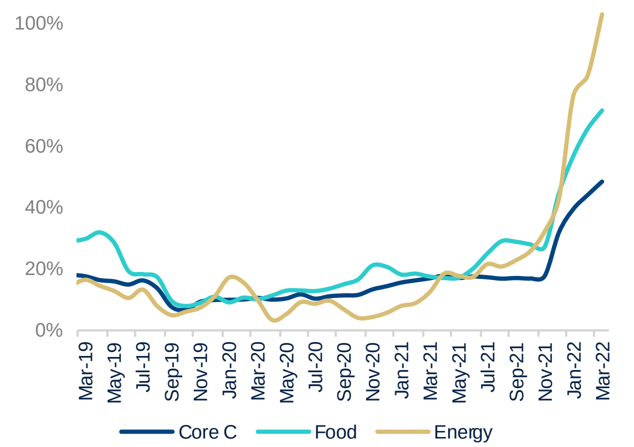


Source: Garanti BBVA Research, Turkstat, 1Q22 level is forecasted

Mounting upside risks to inflation

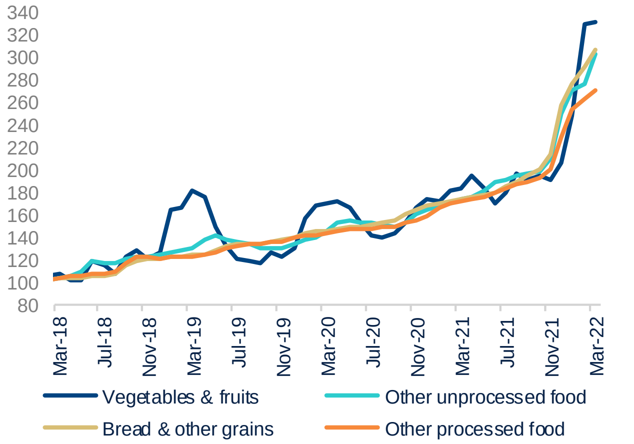
We expect consumer inflation to hover near 70% in 2Q22 and 3Q22, before slowing down to 50% in December on the back of base effects. Risks remain clearly to the upside given mounting upward pressures from both back-ward and forward looking indexation. Since foreign yields are also rising and global inflation will be higher, keeping current loose domestic policies will make price stability more challenging. Recent developments on both inflation expectations and second round effects confirm a non-trivial risk of an inflation spiral, which would exert pressure on the currency and bring forward the monetary policy reversal.

Figure 7. **CPI Components, YoY**



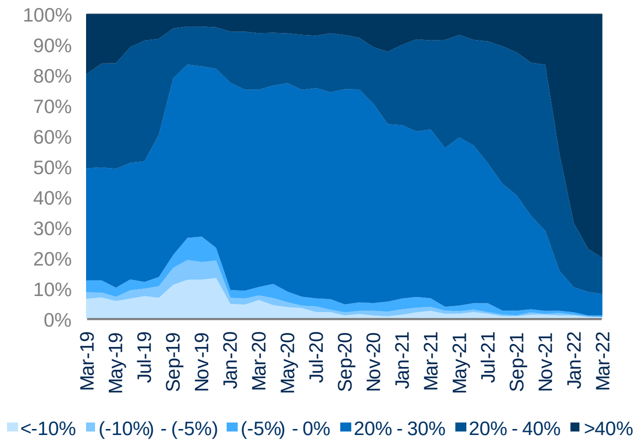
Source: Garanti BBVA Research, TURKSTAT

Figure 8. **Food Prices, January 2018 = 100**



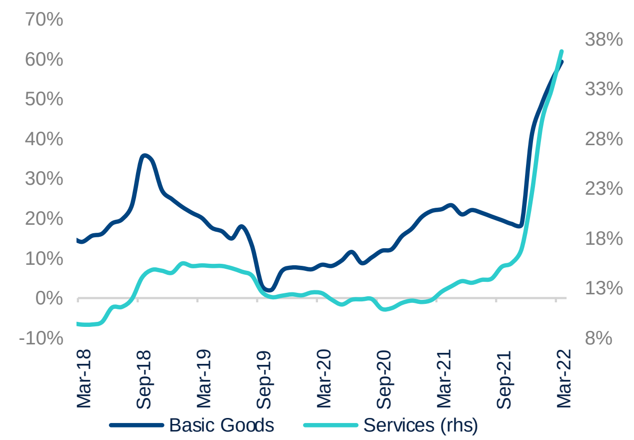
Source: Garanti BBVA Research, TURKSTAT

Figure 9. **Consumer Inflation Diffusion Map, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 10. **Basic Goods and Services Inflation, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 11. **CPI in Subcomponents**

	MoM	YoY
Total	**5.46%**	**61.14%**
Food & Non-alcoholic beverages	4.7%	70.3%
Beverage & Tobacco	3.9%	51.4%
Clothing & Textile	1.8%	27.0%
Housing	1.8%	51.4%
Household Equipment	3.2%	69.3%
Health	5.3%	34.9%
Transportation	13.3%	99.1%
Communication	3.6%	15.1%
Recreation & Culture	2.8%	40.9%
Education	6.6%	26.7%
Restaurants & Hotels	6.0%	60.4%
Misc. Goods & Services	4.9%	60.2%

Source: Garanti BBVA Research, Turkstat

Figure 12. **Domestic PPI in Subcomponents**

	MoM	YoY
Total	**9.19%**	**114.97%**
Mining & Quarrying	9.1%	110.4%
Manufacturing	8.9%	106.6%
Food Products	10.5%	92.4%
Textiles	7.0%	112.6%
Wearing Apparel	4.7%	38.8%
Coke & Petroleum Products	36.0%	256.4%
Chemicals	4.8%	118.3%
Other Non-Metallic Mineral	14.4%	132.8%
Basic Metals	1.1%	151.1%
Metal Products	11.0%	104.2%
Electrical Equipment	4.5%	101.9%
Electricity, Gas, Steam	11.9%	228.9%

Source: Garanti BBVA Research, Turkstat

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