

Türkiye: August CPI surprised to the downside

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Consumer prices rose by 1.46% in August, once again below both market consensus and our expectation (2%), which led to an annual inflation of 80.2%. The downside surprise stemmed from a larger decline in energy prices and weaker food inflation. Therefore, core CPI inflation was in line with our expectation (3.10% vs 3.15%, respectively). The surprise in energy prices also led to a smaller increase (2.4% mom) in domestic producer prices compared to previous months and resulted in an annual inflation of 143.7%. Looking ahead, stronger aggregate demand than supply, high cost push factors, recent utility price hikes and significantly deteriorated inflation expectations will lead to further acceleration in CPI despite recent easing in global commodity prices. Thus, we expect year-end consumer inflation at 70%, being supported by favorable base effects and assuming no further shocks to the exchange rate.

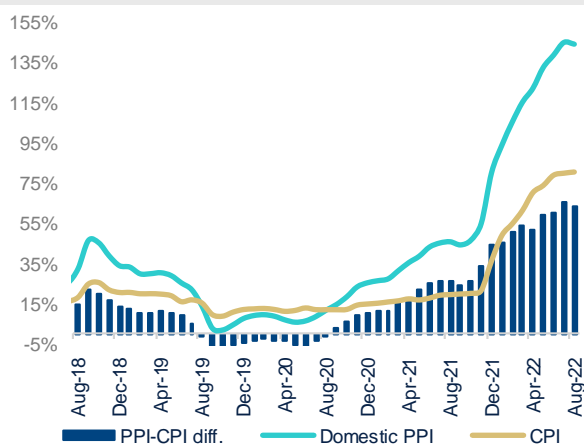
Weak CPI and PPI reading on higher than expected fall in energy prices

Food prices continued to rise in August by 0.5% mom, leading to an annual figure of 89.3% down from 94.5%. Although processed food prices (3.4% mom) kept climbing due to the increase in cost push factors, unprocessed food prices retreated on a monthly basis. This reflected a fall in fresh fruits and vegetables (-6.3% mom) on the back of seasonal factors; other unprocessed food prices rose very slightly (0.1% mom). Meanwhile, energy prices decreased by 2.7% mom on the back of downward adjustments in fuel prices. As a result, although annual energy inflation edged down to 121.7% from 129.3% in July, it still remained historically high. The drop in energy prices prevented a further deterioration in headline inflation.

The increase in core prices (3.1% mom), which was in line with our expectations, led to an annual inflation of 66.1% up from 61.7% in July, driven by stronger cost push factors, robust domestic demand and ongoing currency depreciation. Basic goods prices increased by the same magnitude, boosted by durable and semi-durable goods - like clothing- contrary to its seasonality. Inflation inertia remained robust given the 3.2% increase in services prices. Consequently, the 12-month change reached a new record of 54.3%.

As was the case with CPI, the drop in energy prices helped domestic producer prices to slowdown to 2.4% mom from 5.2% in July. However, the 12-month change remained high at 143.7%, signaling persistent strong cost push factors. In fact, non-energy domestic producer prices jumped more than 3% mom. Moreover, recent price hikes in utility prices -natural gas and electricity- for both households (20% each) and industries (50%), will have a direct impact of 0.8pp on CPI in September. Combined with indirect effects, the impact could be around 2.8pp, or even higher considering the deterioration in inflation expectations and a higher pass thru.

Figure 1. CPI vs Domestic PPI, YoY



Source: Garanti BBVA Research, Turkstat

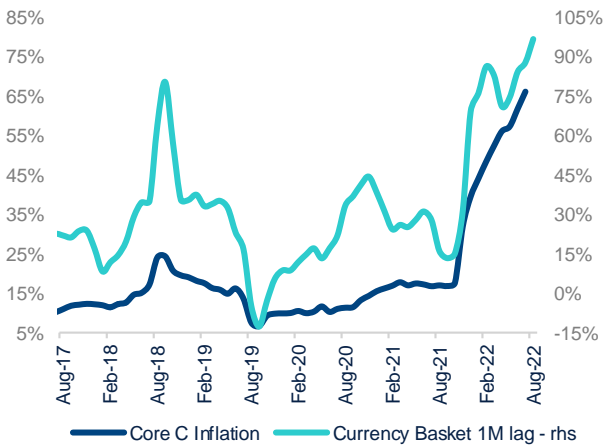
Figure 2. Trend CPI vs CPI, YoY



Source: Garanti BBVA Research, Turkstat

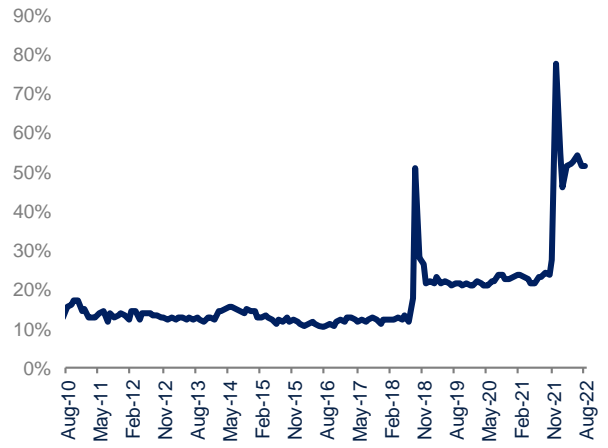
Not surprisingly, inflation expectations continue to deteriorate significantly with levels of 42% for one-year and 24.4% for two-years ahead. The recent policy rate cut aimed at supporting the growth momentum creates more pressures on already worsened inflation expectations. According to our calculations (Figure 2), trend CPI inflation (adjusted for seasonal and idiosyncratic factors) reached almost 20%, while the exchange rate pass thru remains at elevated levels (Figure 4). Even after adjusting for outliers, the pass-thru ratio stands at 26% (if not adjusted, it is as high as 51%), significantly above the historical average before 2018's currency shock.

Figure 3. Core Inflation vs Currency Basket, YoY



Source: Garanti BBVA Research, Turkstat

Figure 4 Exchange Rate Pass-thru on Core D, recursive



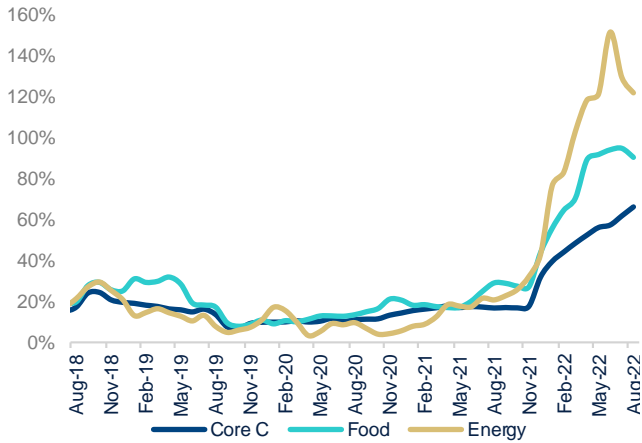
Source: Garanti BBVA Research

Inflation will remain high without any nominal anchor

According to Government's revised Medium Term Program for 2023-2025, annual consumer inflation is expected to reach 65% by year-end 2022 and decline very fast to 24.9% by year-end 2023. The expected disinflation process appears optimistic given the 5% GDP growth target for both years, which is well above potential (our calculation is currently near 3.5%).

We envisage that without any clear coordination on both fiscal and monetary policies to fight against inflation, the time inconsistency problem would eventually lead to higher inflation figures than the official targets as we had repeatedly witnessed in the recent years. High inertia, particularly on backward indexation (such as wages and rents), worsened inflation expectations, loose economic policies, and swelling intervention and regulatory barriers will continue to keep upside risks on the inflation outlook. Moreover, ongoing high external financing needs and strong dollarization fuel depreciation pressures, which result in higher production costs. Therefore, we forecast consumer inflation to be 70% at the end of this year and 33% at the end of 2023, with risks skewed to the upside.

Figure 5. **CPI Main Subcomponents, YoY**



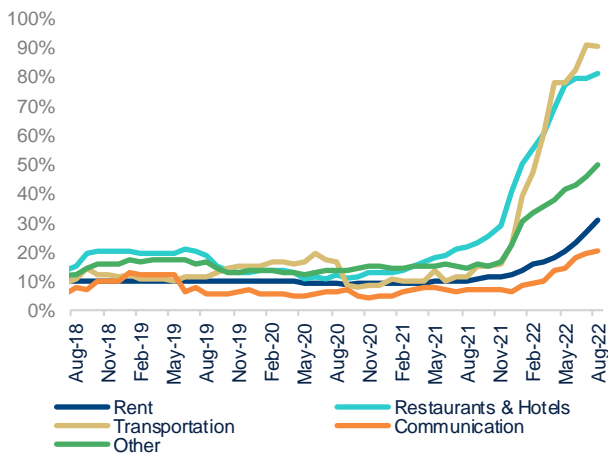
Source: Garanti BBVA Research, TURKSTAT

Figure 6. **Basic Goods and Services Inflation, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 7. **Services Inflation, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 8. **Survey Based Inflation Expectations, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI in Subcomponents**

	MoM	YoY
Total	1.46%	80.21%
Food & Non-alcoholic beverages	0.9%	90.3%
Beverage & Tobacco	0.1%	82.5%
Clothing & Textile	1.3%	38.0%
Housing	2.1%	71.8%
Household Equipment	3.4%	92.0%
Health	7.0%	58.4%
Transportation	-1.8%	116.9%
Communication	1.9%	27.1%
Recreation & Culture	3.3%	58.7%
Education	6.6%	34.3%
Restaurants & Hotels	3.3%	80.9%
Misc. Goods & Services	3.9%	71.2%

Source: Garanti BBVA Research, Turkstat

Figure 10. **Domestic PPI in Subcomponents**

	MoM	YoY
Total	2.41%	143.75%
Mining & Quarrying	4.1%	153.3%
Manufacturing	2.9%	125.4%
Food Products	3.1%	141.5%
Textiles	4.6%	132.1%
Wearing Apparel	2.2%	56.1%
Coke & Petroleum Products	-5.8%	233.9%
Chemicals	4.4%	138.6%
Other Non-Metallic Mineral	5.5%	198.5%
Basic Metals	1.1%	93.7%
Metal Products	2.8%	121.1%
Electrical Equipment	3.7%	99.7%
Electricity, Gas, Steam	-1.1%	348.4%

Source: Garanti BBVA Research, Turkstat

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