

Türkiye: Uncertainty on inflation figures

Adem Ileri / Tugce Tatoglu / Gul Yucel
3 October 2022

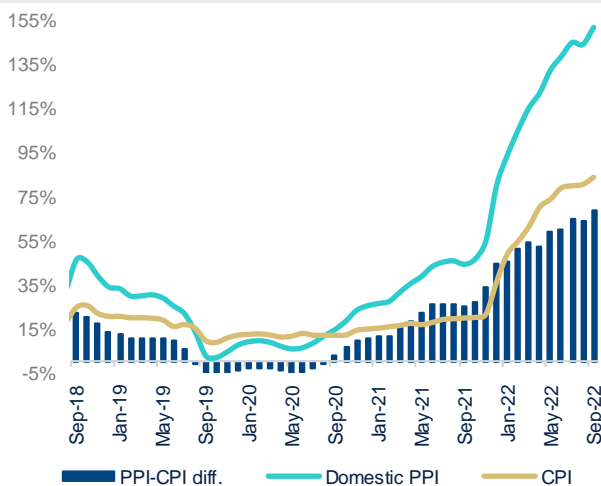
Consumer prices rose by 3.08% in September, below both market consensus (3.15%) and our expectation (3.7%), which led to an annual inflation of 83.5%. The downside surprise on our forecast stemmed from both lower than expected food and core inflation realizations. Although services prices signaled inertia, good prices excluding energy and food were relatively weaker. Therefore, core prices rose slower than expected (2.7% mom realized vs 4.2%). Nevertheless, cost push factors continued to gain momentum as domestic producer prices increased by 4.8% mom and 151.5% yoy. Ongoing high costs, still robust aggregate demand (positive output gap), second round effects and deteriorated inflation expectations will keep an increasing trend in CPI. Yet, if pressures on the exchange rate can be contained through a “managed” depreciation, base effects would still help to start a disinflation path, where we expect 70% for the end of this year. Lower than expected realizations since May generate downside risk to our forecasts in the very short term.

Weaker than expected non-energy and non-food good prices

Cost push factors accelerated further as domestic producer price inflation jumped to 4.8% mom from 2.4% in August. Consequently, annual producer price inflation reached a record high level of 151.5% (Figure 1). Despite stronger costs, depreciation in the exchange rate and still strong demand, core prices inflation slightly decelerated (2.7% mom) mainly due to a limited increase in good prices (1.4% mom) excluding food and energy. Particularly, basic goods prices slowed down to 1.7% mom on the back of deceleration in durable goods (1.0% mom) such as auto and furniture prices (0.8% and -0.2% mom, respectively) and other basic goods (3.0% mom). On the other hand, services inflation remained strong with 3.9% mom, showing clear signs of inflation inertia, while recording all-time high annual inflation with 57.8%. All in all, annual core C inflation still rose to 68.1% up from 66.1% in August.

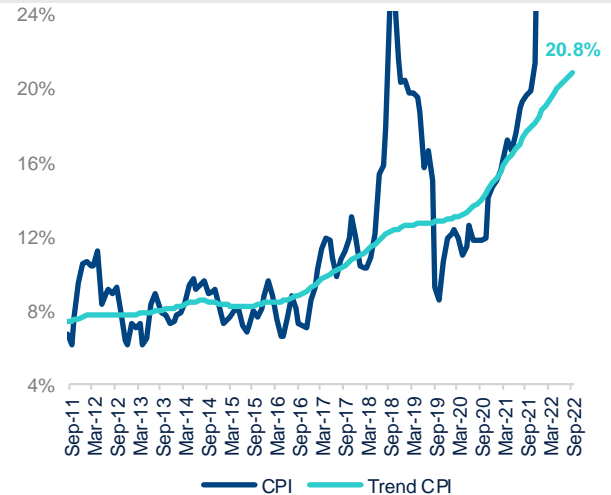
On non-core details, food price inflation stayed strong by 2% mom, leading to an annual figure of 93% up from 90.3% the month before. Processed food prices (2.7% mom) slowed-down limitedly on the back of a slight ease in commodity prices, while unprocessed food prices (1.1% mom) were pushed up by both fruits and vegetables, and other fresh food. Meanwhile, energy prices climbed up by 7.4% mom on the back of the latest price hikes for both households (20%) and industry (50%) in electricity and natural gas by the authorities and 40% increase in water prices in Istanbul despite the continued decline in fuel prices. As a result, annual energy inflation reached up to 133.0% from 121.7% in August, the highest level in the past 3 months.

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



Source: Garanti BBVA Research, Turkstat

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

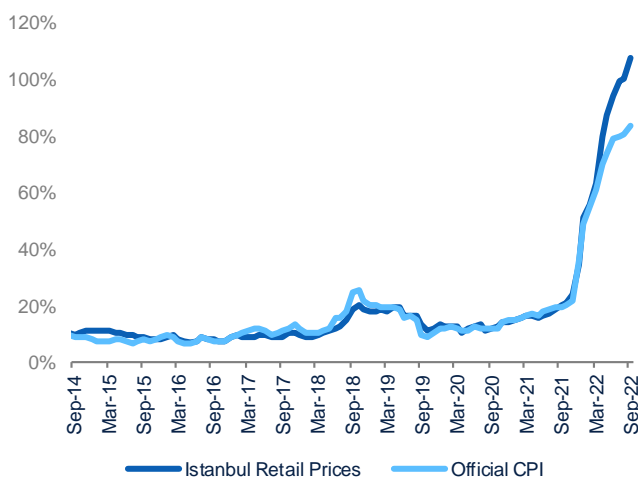


Source: Garanti BBVA Research, Turkstat

The deteriorated inflation expectations and the absence of nominal anchor continue to lead inflation trend to worsen further since permanent inflation has breached 20%, according to our calculations (Figure 2). The official data for inflation continues to keep a downside divergence from our forecasts and overall consensus in recent months. Also, the deviation of official figures from regional indexes and other independent researchers since May reinforces uncertainty in terms of pricing mechanism, affects through both backward and forward indexation and feeds into additional persistence. For example, the gap between official figures and Istanbul retailer prices inflation (ICC, Istanbul Chamber of Commerce) reached a new record high level of 24pp in annual terms (Figure 3).

Depending on the worsening expectations and the tendency of indexation explained above, exchange rate pass-thru continues to be high (slightly above 50%) despite the efforts to maintain a “managed” currency depreciation (Figure 4). This continues to keep the pressure high on the exchange rate, which turns out to be a vicious cycle and adds on inflation further, reinforcing the impact through stronger interconnectedness as we highlighted in [our previous research](#).

Figure 3. **Official CPI vs ICC Istanbul Retail Prices (YoY, %)**



Source: Garanti BBVA Research, Turkstat

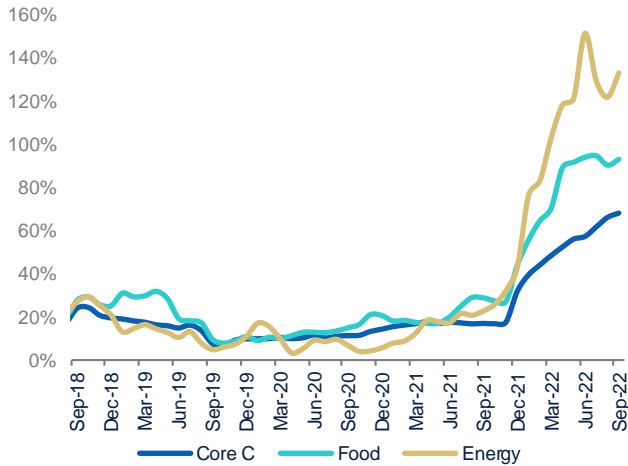
Figure 4. **Exchange Rate Pass-thru on Core D, recursive**



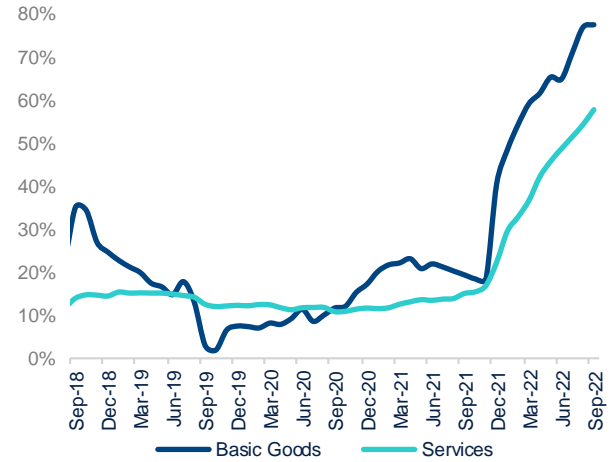
Source: Garanti BBVA Research

Growing uncertainty on inflation

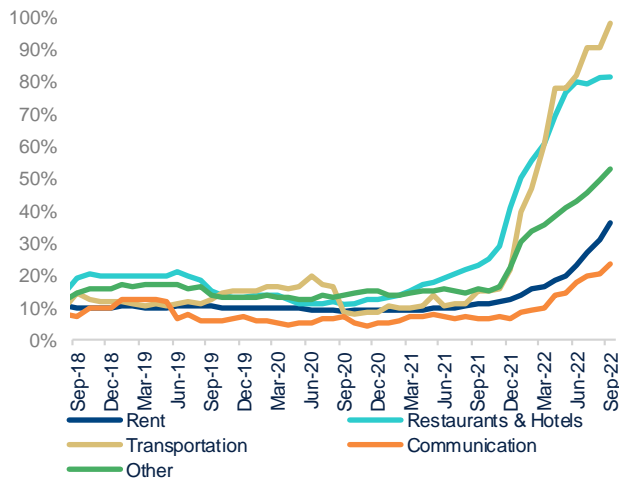
The Central Bank (CBRT) decreased the policy rate by 200bps in the last two MPC meetings and reduced it to 12% despite the upsurge in inflation. President Erdoğan has recently said that he hopes the CBRT will deliver another cut to its policy rate next month and bring it down to single digits by year-end. The government’s bias toward growth would keep a positive output gap till the elections, which could reduce the expected gain from base effects next year even under a “managed” currency depreciation. Nonetheless, the continuation of high external financing gap in the short term and deteriorated expectations on top of relatively much higher dollarization ratio in the economy will keep the pressure high on the exchange rate. This requires an adequate CBRT reserves recycling and questioning the sustainability and merits of the Government’s “model”, considering that high inflation has a disproportionate negative effect on lower income households. All in all, high inertia -particularly on backward indexation (such as wages and rents)-, worsened inflation expectations, loose economic policies, upside risks on currency and regulatory barriers will continue to keep upside risks on the inflation outlook. Therefore, we forecast consumer inflation to be near 70% at the end of this year and 45% at the end of 2023, with high uncertainty around these forecasts.

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


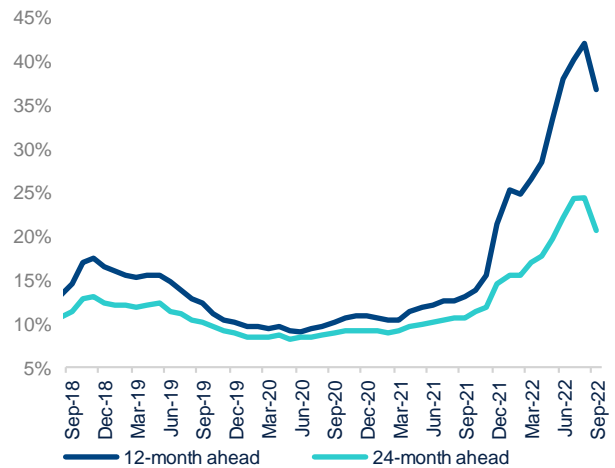
Source: Garanti BBVA Research, TURKSTAT

 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	3.08%	83.45%
Food & Non-alcoholic beverages	2.0%	93.0%
Beverage & Tobacco	0.0%	82.5%
Clothing & Textile	1.5%	40.3%
Housing	10.0%	84.7%
Household Equipment	2.1%	89.7%
Health	2.1%	60.8%
Transportation	0.9%	117.7%
Communication	3.4%	30.8%
Recreation & Culture	2.1%	60.3%
Education	7.0%	36.7%
Restaurants & Hotels	2.4%	81.3%
Misc. Goods & Services	3.2%	74.1%

Source: Garanti BBVA Research, Turkstat

 Figure 10. **Domestic PPI in Subcomponents**

	MoM	YoY
Total	4.78%	151.50%
Mining & Quarrying	4.1%	164.6%
Manufacturing	2.6%	127.7%
Food Products	3.5%	147.0%
Textiles	2.8%	135.3%
Wearing Apparel	12.0%	72.4%
Coke & Petroleum Products	-2.8%	213.9%
Chemicals	3.1%	141.0%
Other Non-Metallic Mineral	4.9%	207.1%
Basic Metals	1.1%	92.8%
Metal Products	2.0%	121.3%
Electrical Equipment	3.5%	104.7%
Electricity, Gas, Steam	16.8%	416.6%

Source: Garanti BBVA Research, Turkstat

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website www.bbvarsearch.com.

ENQUIRIES TO:

Garanti BANKASI A.Ş. Nispetiye Mah. Aytar Cad. No:2 34340 Levent Beşiktaş İstanbul.

Tel.: +90 212 318 18 18 (ext 1064)

bbvarsearch@bbva.com www.bbvarsearch.com

