BBVA Research

Creating Opportunities

Türkiye: Headline inflation reached 85.5%

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Consumer price inflation accelerated further by 3.54% in October, parallel to market expectations but below our estimate (4.5%), which led to an annual inflation of 85.5%. The upside surprise was due to core inflation (3.2% mom vs. exp. 4.6%). Food prices continued to gain momentum, especially due to sharp increases in fresh fruits and vegetables. Meanwhile, cost push factors grew more prominent thereby widening the gap between CPI and domestic PPI at 72.2pp. The weaker realizations in the last few months increase the probability that annual inflation will be in the range of 65% to 70% at the end of 2022, signaling a slight downside risk to our forecast of 70%. Looking ahead, we expect consumer inflation to slow down around 55% on average in 1Q23, on positive base effects. However, inflation could remain high throughout 2023 on worsening inflation expectations, high global inflation, strong inertia and the loose economic policies.

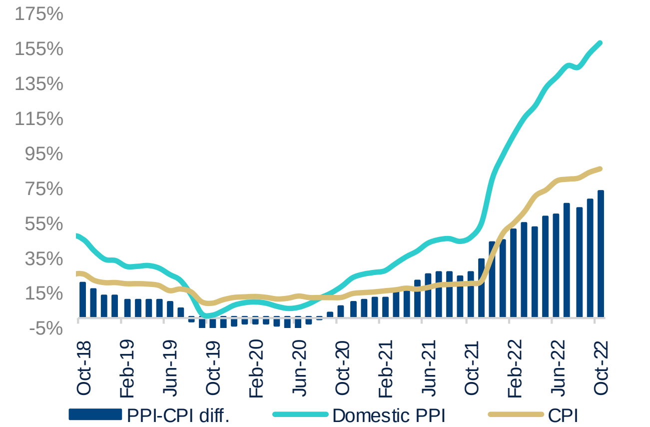
High food prices and further acceleration in cost push factors

Increase in food price inflation recorded the new highest level in the last 6 months (5.3% m/m), which was in line with our expectations (5% m/m), resulting in an annual figure of 98.7%, up from 92.4% in September. Both seasonally sharp increases in fresh fruit and vegetable prices (14.3% m/m) and the rise in processed food (3.3% m/m) and other unprocessed food prices (3.9% m/m), led by recent price hikes of dairy products, were the main reasons for the sharp increase in food inflation. Energy prices slowed down to 2.4% m/m from 7.4% m/m in September, on the back of some easing in commodity prices, leading to an annual inflation of 128.1% in October, vs 133% in September.

Cost push factors accelerated further as domestic PPI jumped to 7.8% m/m from 4.8% m/m in September, leading annual producer price inflation to reach a new record level of 157.7% (Figure 1). Weaker adjustment in consumer prices despite the cost factors resulted in the gap between CPI and domestic PPI to continue to widen further (Figure 1). In addition, the difference between official figures and the Istanbul retailer prices inflation (ICC, Istanbul Chamber of Commerce) remained at a high level of 23.3pp in annual terms (Figure 3).

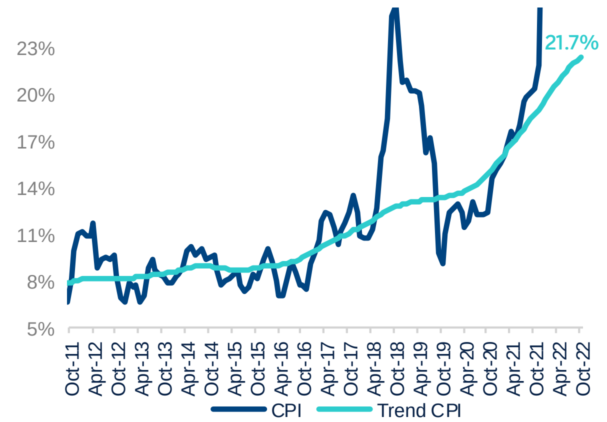
Despite stronger cost push factors, gradual currency depreciation and strong aggregate demand, core prices increased less than expected (3.2 m/m vs. exp. 4.6%). Nonetheless, annual core inflation edged up to 70.5% from 68.1% in September. Basic goods prices geared up to 3.7% m/m on the back of an acceleration in clothing prices with 8.4% m/m (1.4% m/m prev.) mainly due to seasonal effects. Nonetheless, the subdued increase in other durable goods' prices (especially auto prices, 1.4% m/m) prevented further deterioration in core prices. Similarly, services inflation slowed down slightly in monthly terms (2.6% m/m) on the back of a weaker increase in restaurant and transportation prices (2.6% m/m and 2% m/m, respectively) while rent prices rose by 4.9% m/m. However, annual services inflation recorded an all-time high level with 60.2% y/y, signaling further strengthening of inflation inertia.

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



Source: Garanti BBVA Research, Turkstat

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



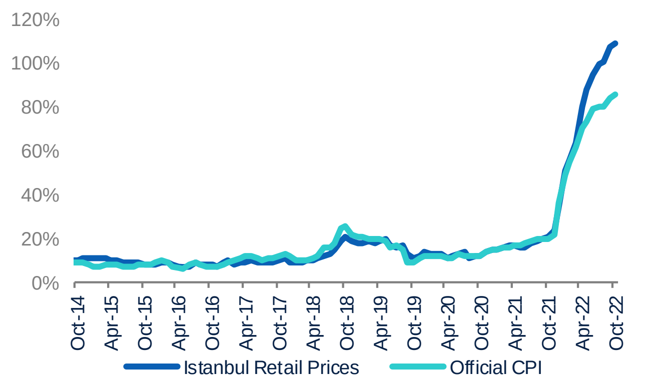
Source: Garanti BBVA Research, Turkstat

Despite CBRT's upward revision to its inflation forecast, the outlook remains optimistic

According to the Central Bank's (CBRT) medium term forecasts of inflation, released in the fourth Inflation Report of 2022, annual inflation will gradually decline in to 65.2% in 2022, 22.3% in 2023 and 8.8% by year-end 2024. CBRT justifies the disinflation path with the decline in external demand and international commodity prices, along with a negative output gap and weak food inflation. In addition, that the expectations for the exchange rate implicitly assume a relatively more stable trend for 2023.

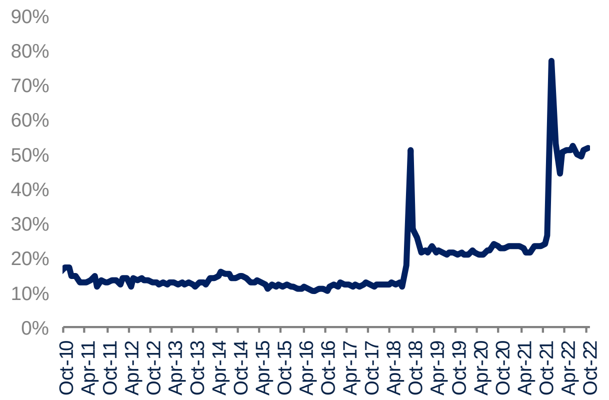
CBRT stated that instead of fighting against high demand via increasing the policy rate, they preferred the policy rate cut as a right choice to support the supply side, while inflation expectations remained high. However, according to econometric analysis, CBRT's projection of a negative output gap in 2023 is not consistent with the extreme high negative real interest rate. In addition, the deterioration in inflation expectations and the absence of a nominal anchor could lead trend inflation to increase further (Figure 2) rather than ease down. Moreover, weaker global demand and tighter external financial conditions, together with loose economic policies could swell the pressures on the exchange rate, which would result in further price pressures. Furthermore, the expected high adjustment in wages could increase the risk of a wage inflation spiral in 2023. Finally, the high cost push factors, deteriorated inflation expectations and high inertia (backward indexation) would create more challenges for the inflation path in 2023.

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**

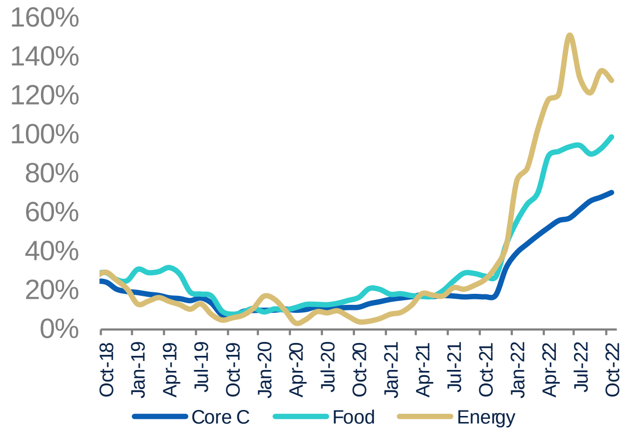


Source: Garanti BBVA Research

Inflation could be high in the medium run in the absence of nominal anchor

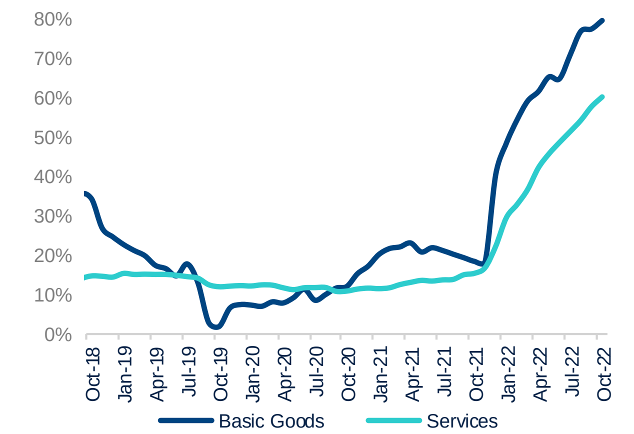
The CBRT maintains an optimistic outlook on inflation, with a strong disinflation trend in 2023 and 2024. However, there might not be a large room for optimism given the high priority on growth, which would keep the output gap positive at least until the elections. Moreover, expected minimum wage increases at the beginning of 2023, are likely to contribute to second round effects. Likewise, the ongoing loose monetary policy is likely to continue excerting pressures on the exchange rate. Hence, we expect that in the absence of negative shocks, favorable base effect would enable annual inflation to decrease around 70% at the end of 2022 and 55% on average in 1Q23. However, it will be challenging to decrease inflation afterwards without a clear policy commitment to fight against inflation. Hence, we expect inflation to remain between 45% and 50% before declining to 45% at the end of 2023.

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



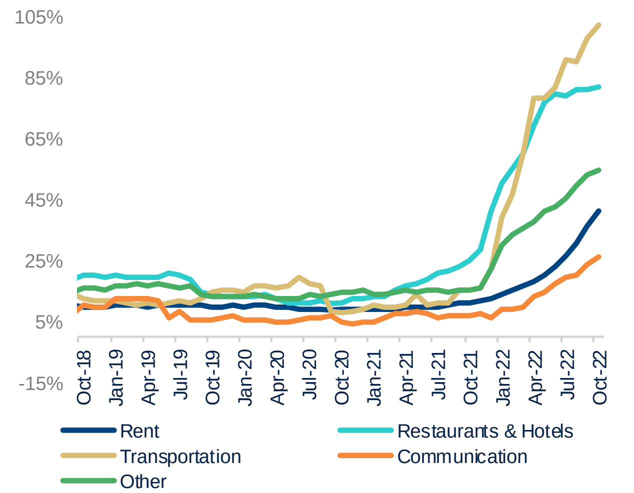
Source: Garanti BBVA Research, TURKSTAT

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



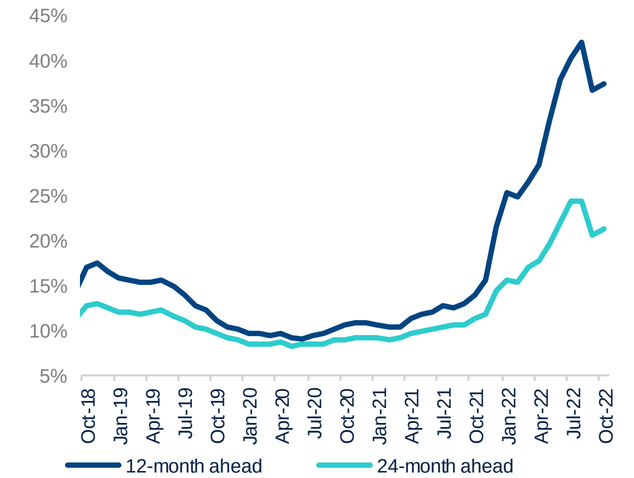
Source: Garanti BBVA Research, TURKSTAT

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 Subcomponents**

	MoM	YoY
Total	**3.54%**	**85.51%**
Food & Non-alcoholic beverages	5.1%	99.0%
Beverage & Tobacco	3.3%	77.9%
Clothing & Textile	8.3%	41.3%
Housing	2.6%	85.2%
Household Equipment	4.4%	93.6%
Health	1.8%	62.7%
Transportation	2.2%	117.1%
Communication	2.6%	33.5%
Recreation & Culture	1.3%	61.5%
Education	0.4%	36.9%
Restaurants & Hotels	2.6%	81.9%
Misc. Goods & Services	2.5%	75.3%

Source: Garanti BBVA Research, Turkstat

Figure 10. **Domestic PPI Subcomponents**

	MoM	YoY
Total	**7.83%**	**157.69%**
Mining & Quarrying	3.5%	162.1%
Manufacturing	3.2%	123.0%
Food Products	4.6%	150.0%
Textiles	1.6%	124.4%
Wearing Apparel	6.5%	80.7%
Coke & Petroleum Products	6.3%	176.0%
Chemicals	1.1%	125.6%
Other Non-Metallic Mineral	6.3%	214.1%
Basic Metals	1.1%	83.4%
Metal Products	1.8%	113.0%
Electrical Equipment	-13.6%	69.9%
Electricity, Gas, Steam	32.6%	554.6%

Source: Garanti BBVA Research, Turkstat

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