Creating Opportunities

Türkiye: Annual CPI ended 2022 below 65%

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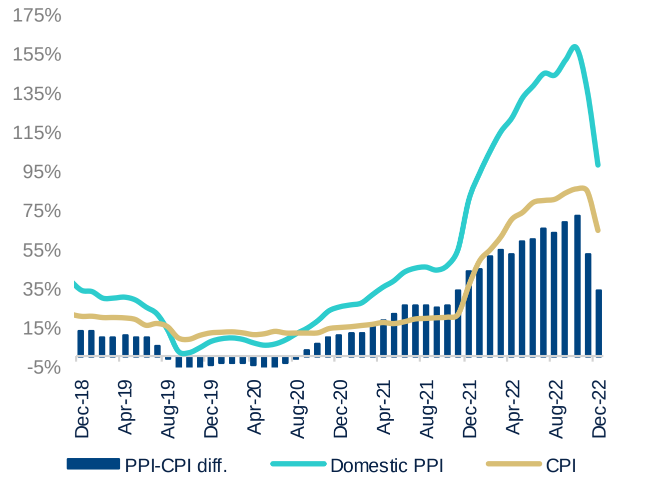
Consumer prices increased by 1.2% in December, slightly lower than our expectation (1.5%) but with a large deviation from the consensus (2.3%). As a result, annual consumer inflation fell sharply on base effects to 64.3% from the previous 84.4%, leading to a full year average of 72.3%. Meanwhile, domestic producer prices declined by 0.2% m/m and annual PPI slowed-down to 97.7% from 136%. Weaker energy prices and almost stable currency help to absorb upward pressure from strong demand, weakening but continuing cost push factors, second round effects and inertia. Government's efforts to maintain a manageable currency depreciation and decelerating global commodity prices will keep favorable base effects on annual CPI in the next months. However, as we have previously underlined, increasing populism in terms of expansionary policies and wage adjustments will further boost consumption and therefore the deceleration in inflation might be much lower. We expect annual CPI to come down to 50-55% in 1Q23 and decline further to 40-45% just before the elections. Inflation outlook in the second half of the year will depend on the adjustment in economic policies and therefore the exchange rate. We forecast year-end inflation to be 42%.

Base effects result in a significant fall in annual inflation levels

Food prices rose by 2% m/m, leading to an annual figure of 76.8% down from 102% the month before. Following the much higher realizations in the previous months, food prices finally showed some correction, particularly in fresh fruit and vegetable prices (-3.3% m/m). Other unprocessed food prices maintained an upward trend (4% m/m) on the back of mainly red meat, whereas processed food prices slowed down (2.2% m/m) after the significant increase in milk prices in November. On the other hand, energy prices declined by 2.1% m/m, led by the decrease in fuel prices, recording the lowest annual level in the last 10 months (94.4% y/y). Accordingly, domestic producer prices fell for the first time since November 2019 (-0.2% m/m) and annual PPI fell sharply to 97.7% y/y. Although the gap between annual CPI and domestic PPI narrowed down to 33.5pp, still high PPI figures will maintain cost push factors.

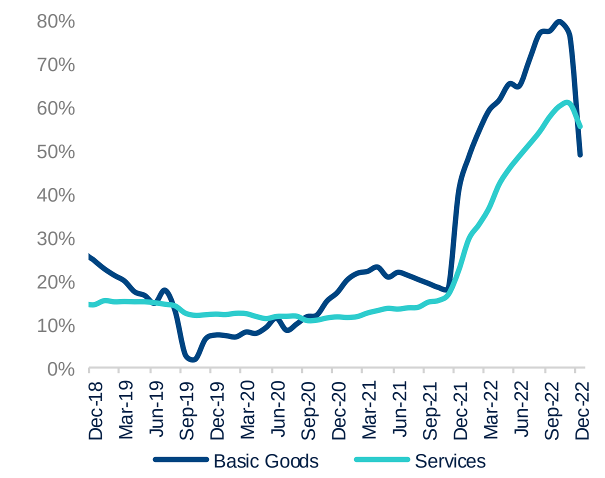
On core inflation front (1.9% m/m), decelerating commodity prices and almost stable currency continued to help, whose annual inflation slowed down to 51.9% from 68.9% in November. The seasonal contraction in clothing and footwear prices (-1.5% m/m) and the decline in automobile prices due to the changes in special consumption tax bases led to weaker basic goods prices (1.9% m/m) despite the upward pressure from durable goods prices steming from the appreciation of Euro against the US dollar. Meanwhile, services inflation remained sticky at 1.9% m/m on top of rent and restaurant prices (3.1% m/m and 2.6% m/m, respectively). Consequently, basic goods annual inflation slowed down to 49% (vs. 76% in November), whereas services inflation decelerated only limitedly to 55% down from 61%, which will keep inertia effects high in the coming period.

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



Source: Garanti BBVA Research, Turkstat

Figure 2. **Basic Goods and Services Inflation, YoY**



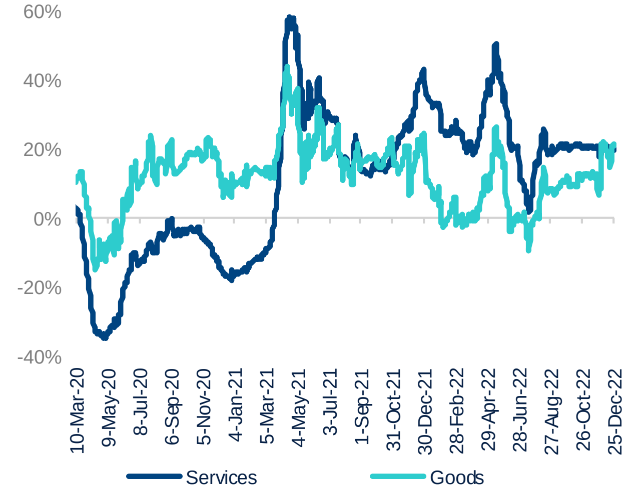
Source: Garanti BBVA Research, Turkstat

Strong consumption will reinforce inflationary pressures

As seen in our latest nowcasts and Big Data consumption indicators, aggregate demand driven mainly by private consumption, remains stronger than supply, thereby contributing to inflationary pressures. Expansionary policies, significant wage adjustments and early retirement bonuses will boost consumption further ahead of the elections. Early retirement benefit for more than 2 million citizens will account for TL 250bn for the budget in 2023 and increase further in the following years with additional retirees. Minimum wage is also increased by 55% to around TL 8,500 (USD 455), whereas salaries for public officers and pensions were raised by 25% for 2023. The Government will help private sector by means of Credit Guarantee Fund (CGF) loans (TL 200bn worth of Treasury guarantee) in order to raise enough funding for the payments. The Government will also generate funding from the CBRT's and banks' higher exposure to sovereign bonds, which will eventually free up an abundance of TL liquidity in the first months of the year. Moreover, the Government has reduced natural gas prices by 12% for houses in Istanbul and electricity prices by near 15% for industry in the overall country. Last but not least, the Government has raised income tax brackets for 2023, referring to lower taxes for low income groups but higher payments for high income generators. All in all, companies will benefit from demand pull factors to easily surpass their continuing costs, consequently reducing the impact from favorable base effects on annual consumer inflation.

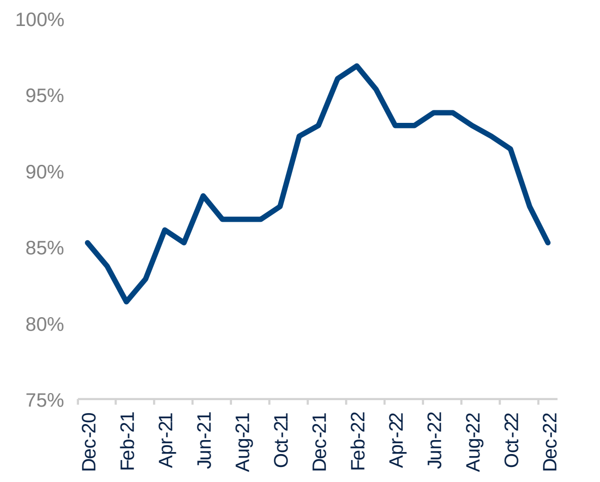
Meanwhile, price hikes were also announced across various sub-components including transportation, pharmaceuticals, meat products and lump sum tax, which might add 1-1.5pp to inflation in January. The expected increase in alcohol & tobacco and bread could also accelerate inflation by an additional 1.5-2pp. Furthermore, we calculate 15% pass-thru from wages to core D inflation, which will reinforce stickiness over services prices in the short term. On the other hand, the reductions in administrative energy prices so far might ease the upward pressure to only a limited extent (0.5pp so far), including indirect effects from producer prices.

Figure 3. **Garanti BBVA Big Data Consumption Indicators (28-day sum YoY, real, adjusted by CPI)**



Source: Garanti BBVA Research, Turkstat

Figure 4. **CPI Components with MoM Positive Change (% share in total, 3m average)**



Source: Garanti BBVA Research

In Monetary Policy and Liraization Strategy for 2023, there were not any explicit remarks regarding the fight against inflation, which shows CBRT's inclination towards macroprudential policy measures, involving raising TL weight in both assets and liabilities of the banking system. We expect the maintanence of the current policy framework at least until the elections, where negative real interest rates will continue to keep upside risks on inflation outlook. We expect consumer inflation to come down to 50-55% in 1Q23 and decline further to 40-45% just before the elections. Inflation outlook in the second half of the year will depend on the adjustment in economic policies and therefore the exchange rate. We forecast year-end inflation to be 42%.

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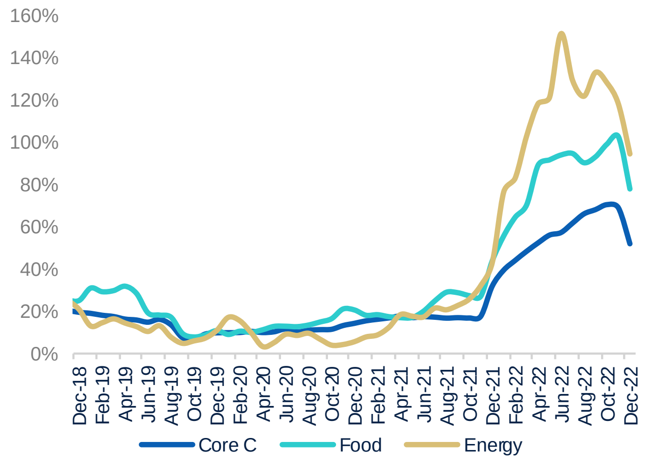
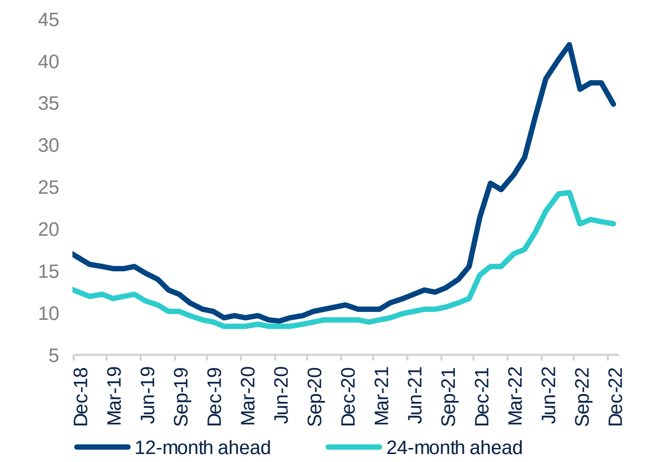
Figure 5. **CPI Main Subcomponents, YoY**



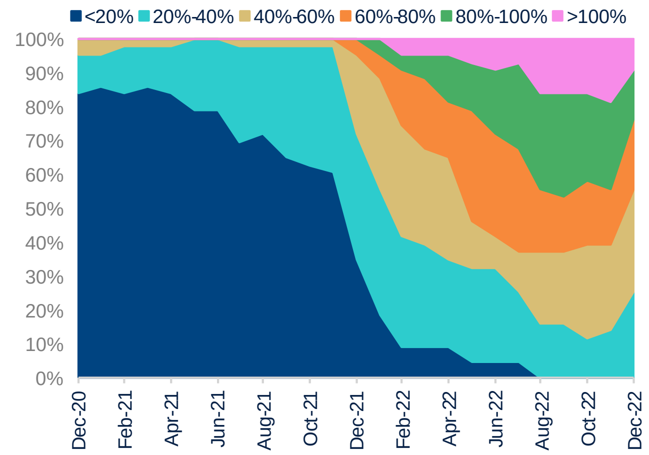
Source: Garanti BBVA Research, TURKSTAT

Figure 6. **Survey Based Inflation Expectations, YoY**



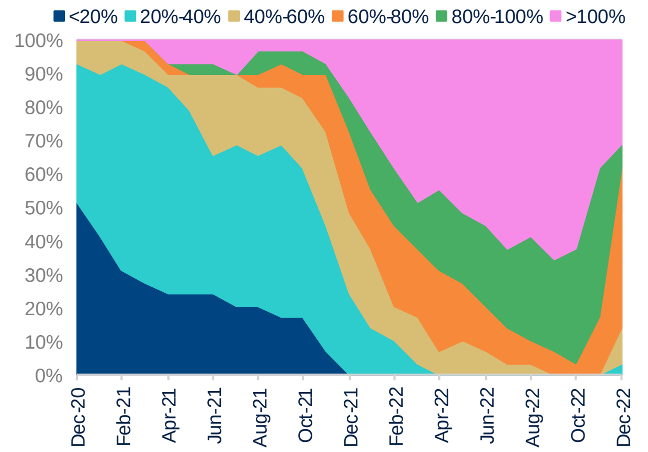
Source: Garanti BBVA Research, TURKSTAT

Figure 7. **CPI Diffusion Analysis, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 8. **PPI Diffusion Analysis, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI Subcomponents**

	MoM	YoY
Total	**1.18%**	**64.27%**
Food & Non-alcoholic beverages	1.9%	77.9%
Beverage & Tobacco	0.1%	65.1%
Clothing & Textile	-1.3%	25.9%
Housing	2.8%	79.8%
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	**-0.24%**	**97.72%**
Mining & Quarrying	1.9%	122.9%
Manufacturing	2.3%	78.7%
Food Products	3.3%	105.3%
Textiles	0.8%	60.8%
Wearing Apparel	1.7%	68.8%
Coke & Petroleum Products	-12.5%	78.7%
Chemicals	2.0%	67.4%
Other Non-Metallic Mineral	2.6%	173.2%
Basic Metals	1.1%	33.1%
Metal Products	1.3%	68.0%
Electrical Equipment	-13.6%	39.9%
Electricity, Gas, Steam	-11.8%	285.0%

Source: Garanti BBVA Research, Turkstat

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