

Türkiye: Downside surprise in March CPI

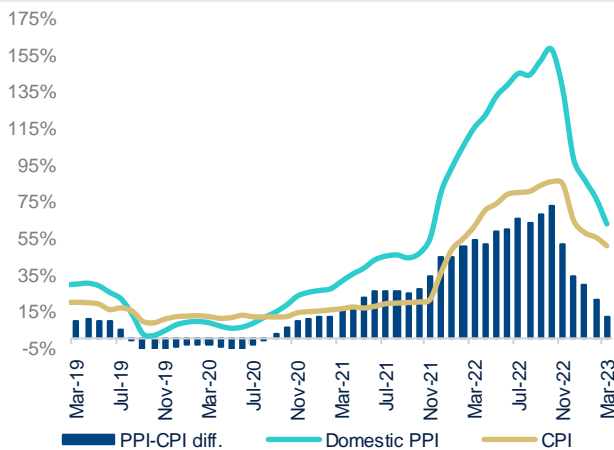
Adem Ileri / Tugce Tatoglu / Gul Yucel
03.04.2023

Consumer prices rose by 2.3% in March, lower than both our expectations (2.5%) and market consensus (2.8%) while annual inflation neared 50.5%. The main deviation in our forecast was mainly due to clothing and footwear, which surprisingly continued to decline in March in contrary to its long term seasonal average. Meanwhile, domestic producer prices continued to lose pace by growing only 0.4% m/m, which led annual PPI to decline to 62.5% from 76.6% on weaker energy prices and favorable base effects. The recent price reductions in electricity to all economic agents and in natural gas for industry might have a total negative impact of 1.4pp on CPI. However, the latest decision of OPEC+ to further cut production, the potential minimum wage hike in July, ongoing high inertia and robust demand will weigh upward on consumer inflation. All in all, we maintain our year end inflation forecast of 45% but acknowledge risks on the upside.

Limited relief from food prices while services inflation won't budge

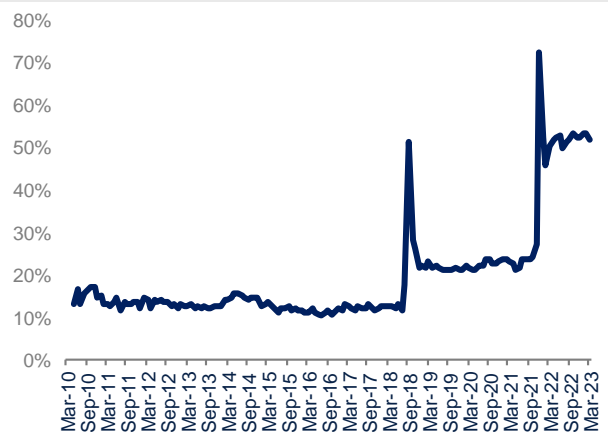
Core prices (C index) inflation continued to rise by 2.15% m/m (2.13% m/m prev.), where basic good prices remained unchanged with 1.2% m/m and pressure from services persisted. Surprisingly, contraction in clothing and footwear prices deepened further in March to 2.0% m/m (-1.9% prev.), well below its seasonal average in the current 2003 series (+0.4% for March). Services inflation remained unchanged with 3.1% m/m preserving its strong trend and signaling strong inertia, supported by accelerating rent prices (4.9% m/m vs. 2.7% prev.) despite broad-based slowdown in all other services sectors including restaurants, accommodation and logistics. With these realizations, annual services inflation geared down to 59.9% from 61.6% in the previous month.

Figure 1. CPI vs Domestic PPI, YoY



Source: Garanti BBVA Research, Turkstat

Figure 2. Exchange Rate Pass-thru on Core D, recursive



Source: Garanti BBVA Research, Turkstat

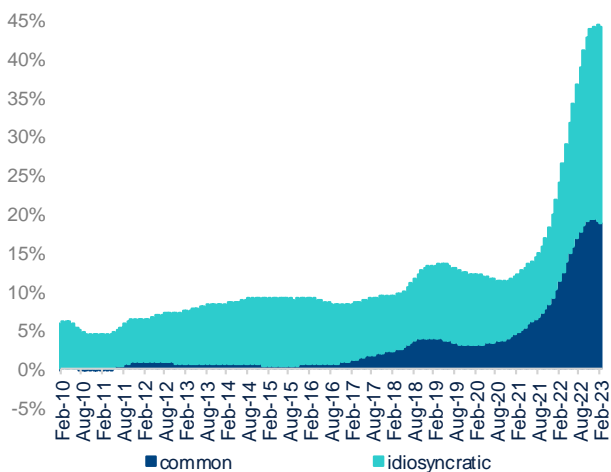
Increase in energy prices was limited with 0.4% m/m, slightly coming down from 0.6% the month before due to lower fuel prices, which resulted in an abrupt decline in annual energy inflation (35.7% y/y from 50.0% prev.). The Government's decision to reduce electricity prices in April (15%, including all agents) will have -0.55pp direct impact on consumer prices and the total negative impact might reach 1.1pp, including indirect effects from producer prices. Cost push factors decelerated further as domestic producer prices increased only by 0.4% m/m mainly on energy prices, which resulted in an annual inflation of 62.5% (76.6% y/y prev.). Therefore, the gap between annual CPI and domestic PPI continued to narrow and reached 11.9pp, the lowest since Feb21. Looking ahead, potentially higher global oil prices following the OPEC's recent decision to cut production could bring additional upside risks on cost push factors, whereas 20% cut on gas prices for industry in the domestic market could help ease some pressures.

On the food inflation side, prices geared down to 3.9% m/m (7.6% m/m prev.) which resulted in an annual figure slightly coming down to 67.1% (68.6% prev.). The slow-down in food prices stemmed from the 2.7% m/m contraction in fresh fruit and vegetable prices on top of the high base of the previous month, when they had posted 18% m/m inflation. Processed food inflation also decelerated to 2.3% m/m (4.6% m/m prev.), while other unprocessed food inflation fastened to 11.3% m/m (6.8% m/m prev.) on the back of yet another hike in meat prices, counter-balancing the impact of declining fresh fruit and vegetable prices.

Decomposition of trend inflation shows reinforced impact from common shocks

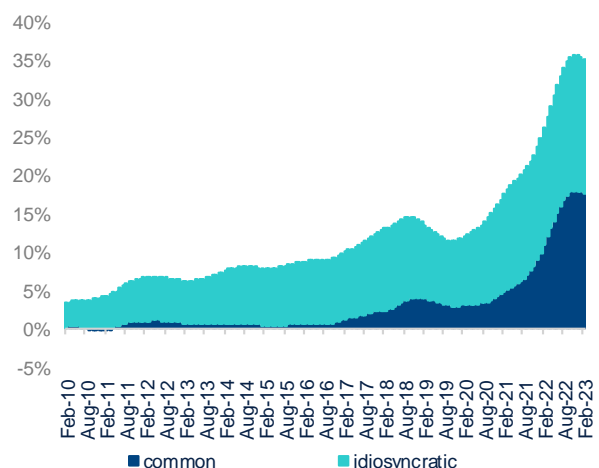
Following the studies of Stock and Watson (2016, 2020)^{1,2}, drivers of inflation could be decomposed to trend, temporary and seasonal factors. Trend factor composed of common part generally results from changes in macroeconomic environment and idiosyncratic reasons, which are specific to sector dynamics. We analyze four main aggregated sub-indices, including food, basic goods, services and energy to obtain common and idiosyncratic factors in trend inflation. According to our results, although idiosyncratic factors conclude a much higher trend inflation, the common part has remarkably elevated in recent years on the back of the deterioration in macroeconomic variables, particularly inflation expectations on top of loose economic policies and ongoing currency shocks. Our results also signal that acquiring more orthodox policies on both fiscal and monetary front would not be enough to attain low two digit inflation level easily in the medium run. Some structural measures especially in food prices also should accompany normalization efforts in the economic policies, which will finally help well-anchor inflation expectations.

Figure 3. **Services Trend Inflation, YoY**



Source: Garanti BBVA Research, Turkstat, *Confidence bands are 50%, 65% and 80%.

Figure 4. **Basic Goods Trend Inflation, YoY**



Source: Garanti BBVA Research

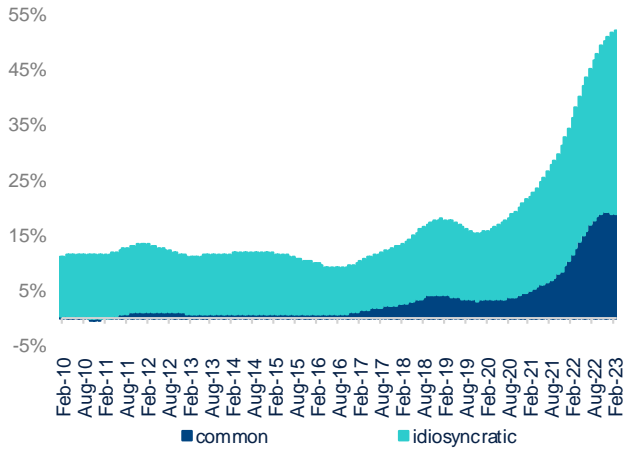
Inflation could remain high throughout 2023

Despite our expectation of a gradual policy normalization after the elections scheduled in May, continuation of high inflation trend, still strong cost push factors and uncertainties on food inflation due to the supply disruptions in the quakes region and the risk of a drought keep upside risks on inflation outlook. We expect consumer inflation to get closer to 45% in May just before the elections. The inflation outlook thereafter will depend on the design of the economic policies and the exchange rate. We expect year-end inflation to be 45%, assuming a stabilization of the currency after the initial adjustment to close the current inflation gap. Though, risks remain tilted to the upside.

¹ Stock, J. H., & Watson, M. W. (2016). Core inflation and trend inflation. *Review of Economics and Statistics*, 98(4), 770-784.

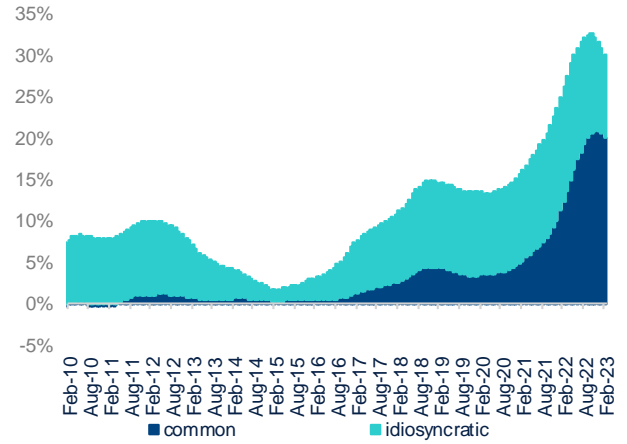
² Stock, J. H., & Watson, M. W. (2020). Trend, seasonal, and sectorial inflation in the Euro Area. *Serie Banca Central, análisis y políticas económicas*, no. 27.

Figure 5. **Food Trend Inflation, YoY**



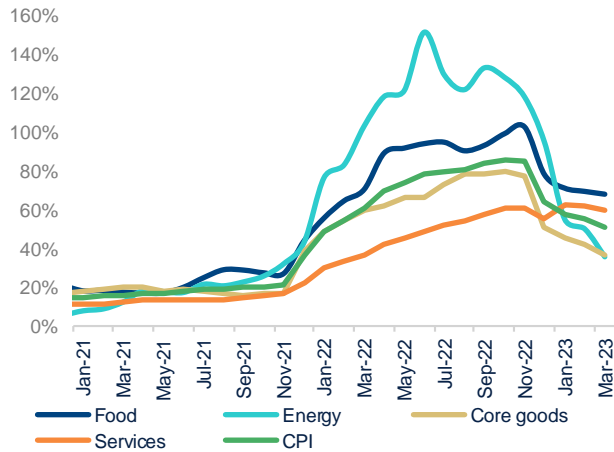
Source: Garanti BBVA Research, TURKSTAT

Figure 6. **Energy Trend Inflation, YoY**



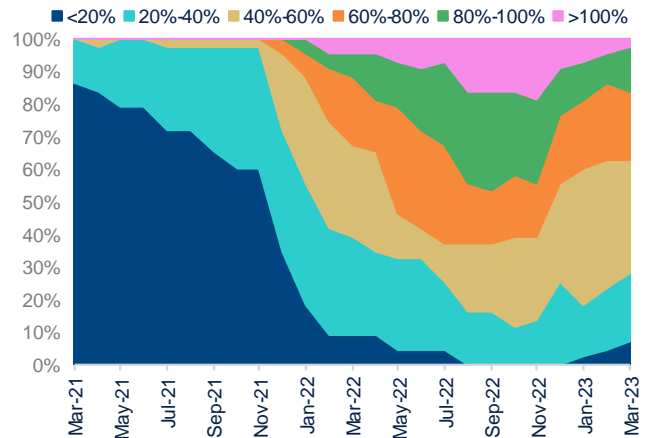
Source: Garanti BBVA Research, TURKSTAT

Figure 7. **CPI Main Subcomponents, YoY**



Source: Garanti BBVA Research, TURKSTAT

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



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI Subcomponents**

	MoM	YoY
Total	2.29%	50.51%
Food & Non-alcoholic beverages	3.8%	67.9%
Beverage & Tobacco	0.1%	43.7%
Clothing & Textile	-1.9%	17.3%
Housing	2.0%	56.1%
Household Equipment	2.7%	53.3%
Health	2.0%	64.7%
Transportation	0.6%	28.7%
Communication	0.6%	32.4%
Recreation & Culture	2.9%	47.4%
Education	6.3%	43.8%
Restaurants & Hotels	3.8%	70.7%
Misc. Goods & Services	2.7%	47.2%

Source: Garanti BBVA Research, Turkstat

Figure 10. **Domestic PPI Subcomponents**

	MoM	YoY
Total	0.44%	62.45%
Mining & Quarrying	1.5%	80.4%
Manufacturing	2.0%	55.2%
Food Products	4.6%	88.4%
Textiles	1.4%	39.4%
Wearing Apparel	1.3%	55.1%
Coke & Petroleum Products	-4.7%	2.0%
Chemicals	0.4%	46.9%
Other Non-Metallic Mineral	2.0%	103.9%
Basic Metals	1.1%	19.0%
Metal Products	1.7%	43.3%
Electrical Equipment	1.2%	53.2%
Electricity, Gas, Steam	-13.3%	95.5%

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

