Türkiye: Weaker inflation realization in April

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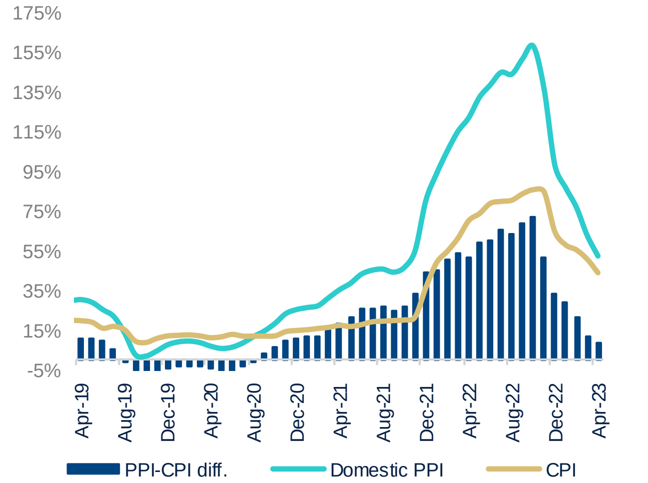
Consumer prices rose by 2.4% m/m in April, lower than both our expectation (2.6%) and consensus (2.7%) and its annual inflation came down to 43.7% from 50.5% on favorable base effects. The main deviation in our forecast was mainly due to clothing and footwear prices, which continued to be confusing in terms of both long-term seasonal averages and other institutions' calculations. Weaker than expected clothing and other basic goods prices prevented further deterioration in core inflation, while services prices signaled additional inertia. Meanwhile, domestic producer prices inflation remained muted (0.8% m/m) mainly led by the recent contraction in energy prices, which resulted in an annual level of 52.1%. We expect year-end consumer inflation to be 45%, assuming a manageable depreciation of the currency after the elections. We acknowledge risks on the upside due to a potential wage adjustment in July on populist policies, challenging food inflation on supply disruptions led by quakes and a possible drought season and ongoing high inertia.

Energy and clothing prices prevented further deterioration in consumer inflation

Despite the seasonal impact and strong domestic demand, core prices (C index) increased lower than expected by 3.2% m/m due to weaker clothing prices inflation (3.8% m/m vs. 6.9% on average in the last 5 years) and muted realization in other basic goods (1.1% m/m). Consequently, annual core prices inflation slowed down to 45.5% from 47.4%. Quite noteworthy, clothing inflation remained to be much lower than other institutions' calculations, which were closely related historically such as Istanbul Chamber of Commerce (ICC) and Northern Cyprus Statistical Institution. On the other hand, the deterioration in services prices was broad-based with a monthly figure of 3.9%, despite the limited slowdown in its annual figure of 58.6% (59.9% prev.). As a result, the details of the cumulative inflation in the first four months of the year showed how the inflation outlook has worsened further with a level of 24.5% in services and 11.9% in goods in contrast with the level of 15.5% in the headline.

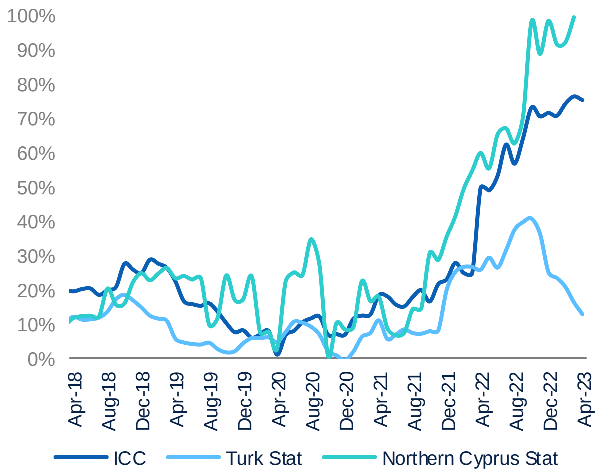
Energy prices contracted in monthly terms (-3.9% m/m) for the first time in the last four months on the back of the recent price reductions in electricity for all economic agents (15%) and the ease in fuel prices (particularly LPG). Therefore, annual energy prices sharply came down to 21.2% from 35.7%, the lowest level since September 2021.

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



Source: Garanti BBVA Research, Turkstat

Figure 2. **Clothing Prices Inflation, YoY**



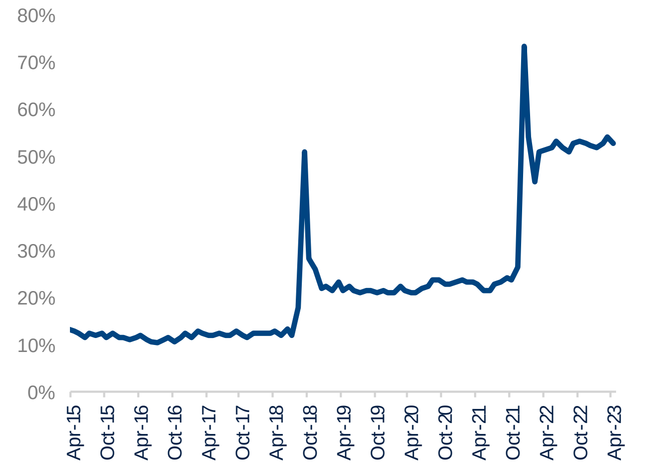
Source: Garanti BBVA Research, Turkstat

The deterioration in food prices was maintained by 4.1% m/m increase in April mainly due to the unprocessed food and fresh fruit and vegetables prices, which resulted in an annual figure of 53.1% down from 67.1%. Fresh fruit and vegetables prices increased by 3.3% m/m despite the historical average of -2.5% m/m. Also, other unprocessed food prices rose by 10% m/m led by continuing price hikes in red meat, possibly including Ramadan impact.

Domestic producer prices increased by only 0.8% m/m, which led its annual figure to decline further to 52.1% from 62.5%. However, the main reason of a weaker realization stemmed from 17% m/m fall in electricity, gas and steam prices thanks to the latest decision to cut electricity prices by 15% and natural gas prices by 20% for industrial users on top of the lower global commodity prices, whereas the manufacturing prices rose by 2.5% m/m.

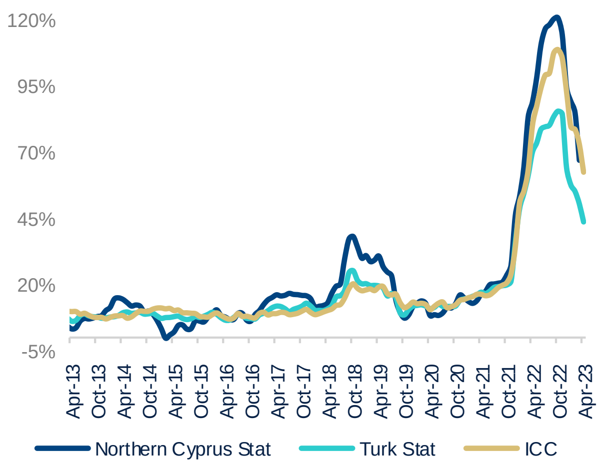
Looking ahead, as we have previously discussed in our decomposition analysis of trend inflation, the impact of the common shocks due to the macroeconomic imbalances in the recent years has recently became more prominent, which results in the continuation of deteriorating inflation expectations on top of populist policies and currency shocks. Market participants in the Central Bank (CBRT) survey expect year-end annual inflation to be 37.7% and 17.5% in a two-years horizon. In its latest World Economic Outlook projections, on the other hand, IMF forecasts Türkiye's consumer inflation to decline to only 20% in the coming 5 years, confirming our analysis where we had highlighted that reducing inflation beyond 20% levels will be challenging and require structural changes, accordingly. All in all, unanchored inflation expectations, strong inflation inertia and continuing cost pressures (with an exchange rate pass-thru of near 50% in our calculations), which might be strengthened further by a high potential wage adjustment in July, keep upside risks on the inflation outlook.

Figure 3. **Exchange Rate Pass-thru on Core D, recursive**



Source: Garanti BBVA Research, Turkstat

Figure 4. **Consumer Prices, YoY**

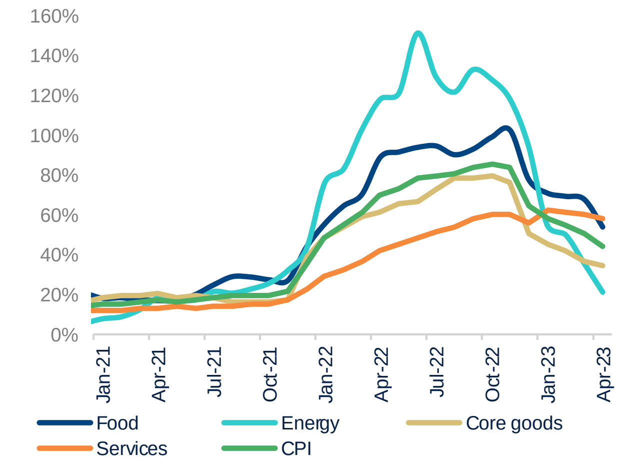


Source: Garanti BBVA Research

Inflation outlook will be challenging for the new management

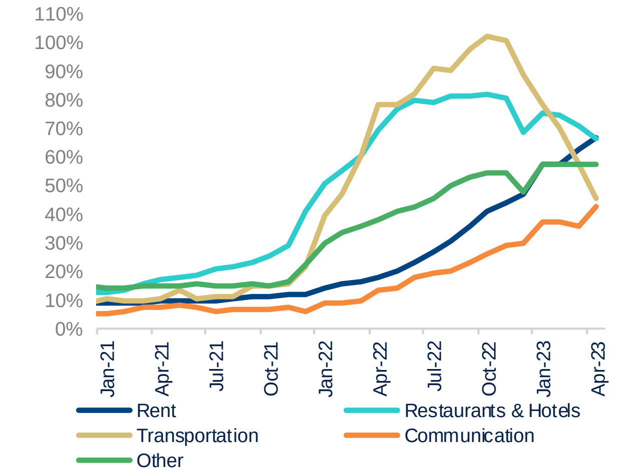
Despite the recent slow-down on favorable base effects, still high course of inflation underlines the necessity for accordance between fiscal and monetary policy to contain inflationary pressures. However, the continuation of populist policies which have also been outlined for the upcoming period in the recent election campaigns might bring further adversities in the fight against inflation. Consequently, the inflation outlook will depend on the design of the economic policies and the level of the exchange rate after the elections. We expect year-end inflation to be 45%, assuming a stabilization in the currency after its initial adjustment to close the current inflation gap. Though, risks remain tilted to the upside.

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



Source: Garanti BBVA Research, TURKSTAT

Figure 6. **Services Inflation Subcomponents, YoY**

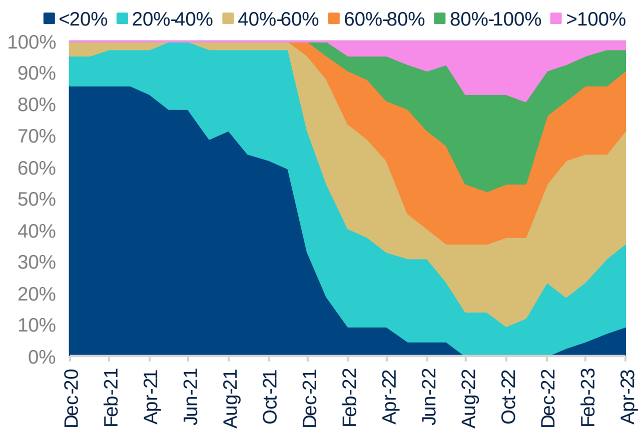


Source: TURKSTAT

Figure 7. **CBRT Survey Inflation Expectations, YoY**

Source: Garanti BBVA Research, TURKSTAT

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



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI Subcomponents**

	MoM	YoY
Total	**2.39%**	**43.68%**
Food & Non-alcoholic beverages	3.9%	53.9%
Beverage & Tobacco	0.0%	38.2%
Clothing & Textile	3.8%	13.8%
Housing	-1.5%	43.2%
Household Equipment	1.5%	48.4%
Health	2.5%	66.6%
Transportation	2.5%	25.6%
Communication	5.9%	36.4%
Recreation & Culture	2.5%	46.4%
Education	3.1%	44.1%
Restaurants & Hotels	4.2%	66.4%
Misc. Goods & Services	1.4%	48.0%

Source: Garanti BBVA Research, Turkstat

Figure 10. **Domestic PPI Subcomponents**

	MoM	YoY
Total	**0.81%**	**52.11%**
Mining & Quarrying	2.4%	63.9%
Manufacturing	2.5%	48.2%
Food Products	4.1%	72.2%
Textiles	4.0%	38.6%
Wearing Apparel	0.5%	50.7%
Coke & Petroleum Products	0.3%	-1.0%
Chemicals	0.8%	39.1%
Other Non-Metallic Mineral	1.3%	80.1%
Basic Metals	1.1%	14.2%
Metal Products	3.4%	41.4%
Electrical Equipment	2.6%	52.9%
Electricity, Gas, Steam	-17.0%	50.3%

Source: Garanti BBVA Research, Turkstat

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