Inflation Pulse

# Türkiye | Upsurge in services CPI keeps trend high

Tugce Tatoglu / Gul Yucel
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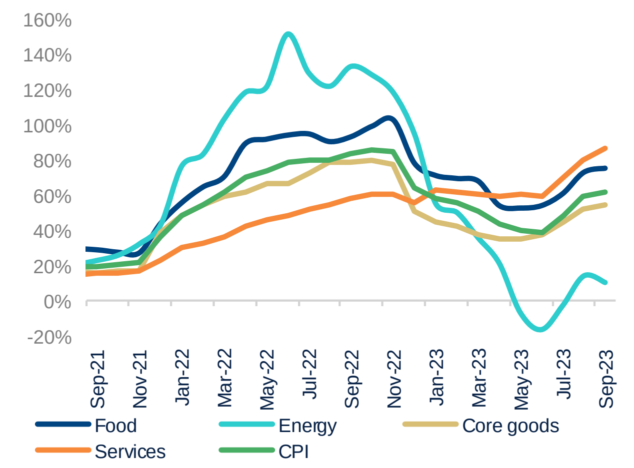
**Consumer prices rose by 4.75% m/m in September, close to our expectation and market consensus (both at 4.8%), which led to an annual inflation accelerating to 61.5% from 58.9% previously. Lagged effects of currency depreciation, wage adjustments and tax hikes together with the recent increase in energy prices exacerbated cost factors thereby resulting in a much higher core inflation of 68.9% y/y mainly boosted by services prices. Despite ongoing rate hikes of the Central Bank (CBRT), the gradual approach so far has not been enough yet to curb consumption in order to start a correction on import demand, which keeps demand pull factors on inflation and has the potential to be reinforced in the face of loose fiscal stance in the very short term. Additionally, backward indexation and unanchored inflation expectations will add challenges to reduce the pace of the inflation. Assuming a delayed adjustment in the currency after the election next year in March and a soft landing pattern in growth outlook, we expect consumer inflation to get closer to 70% by end 2023 and reach 50% at the end of 2024, if the expected economic stabilization will finally occur with a clearly tighter stance in economic policies in post-election period.**

## Services prices show further stickiness led by cost push factors

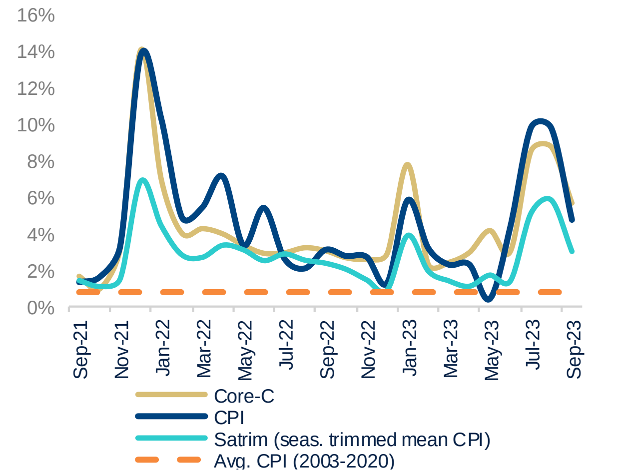
Despite the average of 9.2% m/m in the last 2 months, core prices (C index) inflation maintained its strong upward trend increasing by 5.3% m/m (vs. 4.9% ours and 4.7% consensus). Thus, annual core prices inflation geared up to 69% from 65% in August, closer to its record level in the current series seen in October 2022 (70.4% y/y). In quarterly trends, seasonal adjusted (s.a.) core (C index) prices also increased by 21% q/q in 3Q (vs. +9.4% q/q in 2Q), mainly due to the acceleration in both basic goods (19.8% q/q) and services prices (23.8% q/q), stemming from the sharp currency depreciation with a faster and larger exchange rate pass through, high wage adjustments (34% hike in minimum wage in July) and tax hikes mainly on indirect taxes, continuing solid domestic demand and strong second round price effects. Although basic goods prices slowed down significantly in September (2.6% m/m vs. 8.6% prev.), the 7.9% monthly increase in service prices remained remarkable. Despite the broad-based deterioration in services prices, the acceleration in rental prices (9.5% m/m) and the sharp increase in transportation services prices with 15.2% m/m on top of high realizations in previous months pioneered among the others. All in all, ongoing strong trend in services prices continued to signal strengthening inflation inertia and recorded the new record high rate of 86.5% in its annual inflation (Figure 1). Last but not least, the trend of headline inflation points out to a slow-down after the recent outliers, but its monthly trend remains close to 5%, keeping the challenges ahead (Figure 2).

Figure 1. CONSUMER INFLATION SUBCOMPONENTS (YoY)




Source: Garanti BBVA Research, TURKSTAT

Figure 2. CONSUMER INFLATION INDICATORS (sa, monthly Changes)

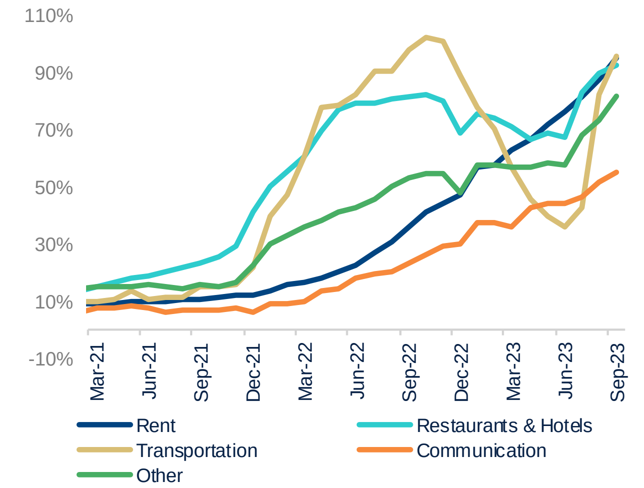



Source: Garanti BBVA Research, TURKSTAT

Thanks to the decelerating lagged impact of currency depreciation and favorable seasonal factors, the increase in food prices geared down compared to previous months rising by 3.2% m/m, but remained well above the its seasonal average of 1.1% in the last 7 years. Despite the monthly deceleration in food inflation, annual food inflation continued to climb up to 75.7% from the previous 73.6% in August. In the sub-items, processed food prices increased by 4.1% m/m mainly due to the price hikes in dairy products stemming from the delayed impact of the 35% hike in raw milk prices in August. Also, other unprocessed food prices rose by 3.7% m/m driven by the increase in fresh milk (7.7% m/m), red meat (6.7% in lamb) and egg prices (9.5% m/m). Thanks to the positive seasonal factors, vegetable prices contracted by 1.2% m/m, while fruit prices continued to increase by 4.2% m/m, causing fresh fruit and vegetables to remain almost flat (0.2% m/m). Though, negative seasonal effects, strengthening cost-push factors and deterioration of inflation expectations are likely to put upward pressure on food prices for the coming period.

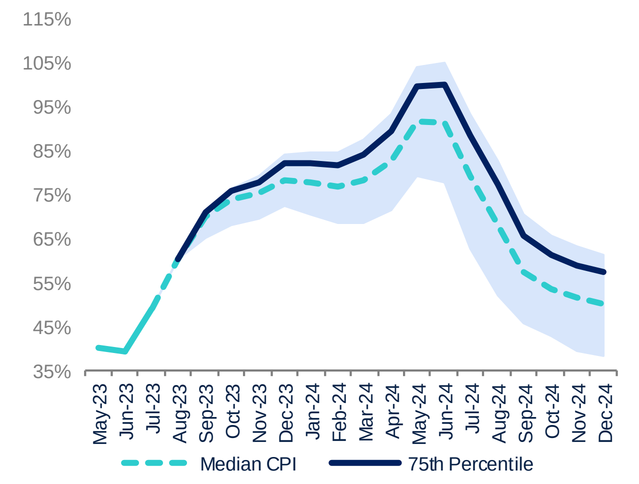
After the significant increase of 14.2% in August, energy prices showed a moderate increase of 3.8% m/m as a result of the relatively limited increase in fuel prices. Thanks to the base effects, annual energy inflation decelerated to 10.2% from 14% in August. On the other hand, state-run Petroleum Pipeline Corporation (BOTAŞ) announced a 20% hike in the prices of natural gas and electricity for industrial users as of October, therefore putting further pressure on domestic producer prices in the coming months, which slowed down limitedly to 3.4% m/m in September (vs. 6.9% m/m avg. in the last three months). The indirect impact of the latest utility price hikes on consumer prices will be limited with near 1pp; however, we expect the delayed utility price hikes for households will be finally implemented in the coming period, which will reinforce inflationary pressure.

Figure 3. **SERVICES INFLATION SUBCOMPONENTS (YoY)**




Source: Garanti BBVA Research, TURKSTAT

Figure 4. **GARANTI BBVA CPI SIMULATIONS (YoY)**




Source: Garanti BBVA Research, TURKSTAT

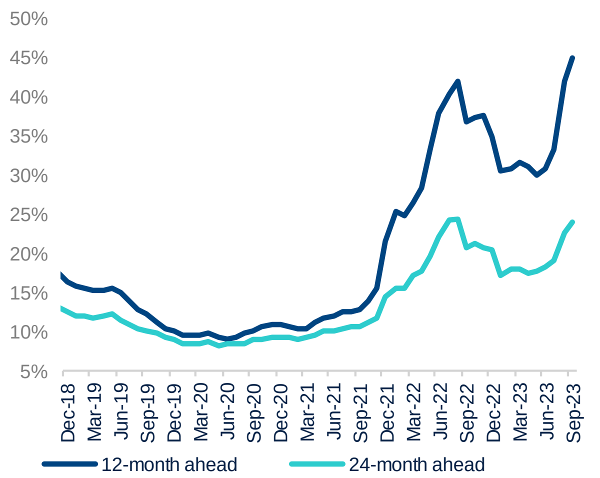
## Disinflation is harder to achieve amid mounting cost pressures

The CBRT hiked the policy rate by 500 bps to 30% in September after the positively surprising rate hike of 750 bps in August and much weaker hikes of 650 bps and 250 bps in the previous two meetings. It also evaluated the recent upward pressure on inflation due to tax regulations and cost pressures stemming from wages and currency depreciation will decline and the year-end inflation will get closer to the upper bound of the forecast range (most likely referring to 65% year end inflation projection in the Medium Term Program, MTP). The CBRT signals further tightening to achieve their projected disinflation pattern in 2024 but the gradual approach so far has not been enough yet to curb consumption, which keeps demand pull factors on inflation. Meanwhile, the MTP released at the beginning of September signals increasing non-interest expenditures next year apart from the earthquake spending mainly on personnel expenditures and current transfers. Given this short term loose bias and the government's assumptions of 44% and 54% currency depreciation on average for 2023 and 2024, our simulations show that reducing consumer inflation beyond 40% by end next year will finally require much tighter stance in economic policies (Figure 4).

## Policy preferences will be the key determinant of the inflation trend

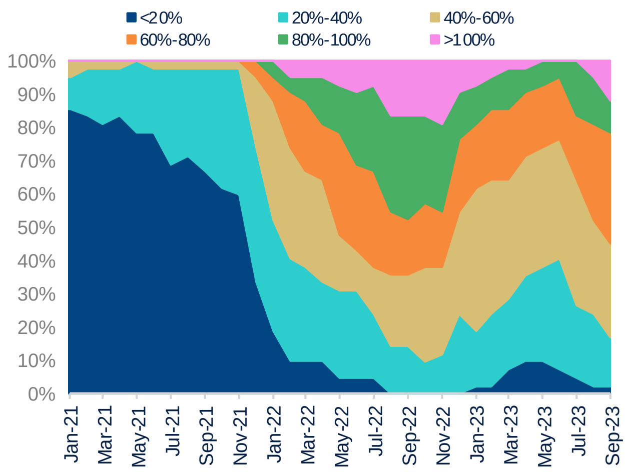
We expect the continuation of strong monthly inflation trend hovering around 4% until economic policies become clearly demand restrictive. We forecast the consumer inflation getting closer to 70% by end 2023 and moving upward to around 85% till May on base effects and wage adjustments at the start 2024, before coming down to 50% by the end of 2024 if the expected economic stabilization will occur and the pace of inflation decelerates. In the MTP, there is no clear fiscal saving planned till 2025. Therefore, it will be very hard to achieve a clear disinflation path under continuing high fiscal spending together with still high current account deficit. This is why a harsher tighter stance in economic policies will be finally required to be seen in order to help finance the twin deficit and stabilize the economy.

Figure 5. **CBRT SURVEY INFLATION EXPECTATIONS (YOY)**




Source: Garanti BBVA Research, TURKSTAT

Figure 6. **CPI DIFFUSION ANALYSIS (YOY)**




Source: Garanti BBVA Research, TURKSTAT

Figure 7. **CPI SUBCOMPONENTS**

| | MoM | YoY |
|---|---|---|
| **Total** | **4.75%** | **61.53%** |
| Food & Non-alcoholic beverages | 3.3% | 75.1% |
| Beverage & Tobacco | 10.0% | 67.2% |
| Clothing & Textile | 2.6% | 32.5% |
| Housing | 5.8% | 20.2% |
| Household Equipment | 5.2% | 63.8% |
| Health | 3.4% | 79.8% |
| Transportation | 4.4% | 76.1% |
| Communication | 3.6% | 46.6% |
| Recreation & Culture | 4.7% | 55.4% |
| Education | 30.3% | 81.0% |
| Restaurants & Hotels | 4.1% | 92.5% |
| Misc. Goods & Services | 3.9% | 59.4% |

Source: Garanti BBVA Research, TURKSTAT

Figure 8. **DOMESTIC PPI SUBCOMPONENTS**

| | MoM | YoY |
|---|---|---|
| **Total** | **3.40%** | **47.44%** |
| Mining & Quarrying | 6.0% | 69.4% |
| Manufacturing | 3.1% | 55.0% |
| Food Products | 4.9% | 65.3% |
| Textiles | 1.2% | 41.8% |
| Wearing Apparel | 4.9% | 52.3% |
| Coke & Petroleum Products | 6.0% | 45.6% |
| Chemicals | 2.3% | 41.3% |
| Other Non-Metallic Mineral | 4.4% | 58.9% |
| Basic Metals | 1.1% | 34.9% |
| Metal Products | 0.9% | 59.3% |
| Electrical Equipment | 1.6% | 66.8% |
| Electricity, Gas, Steam | 5.5% | -17.1% |

Source: Garanti BBVA Research, TURKSTAT

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ENQUIRIES TO:
Garanti BANKASI A.Ş. Nispetiye Mah. Aytar Cad. No:2 34340 Levent Beşiktaş İstanbul.
Tel.: +90 212 318 18 18 (ext 1064)
www.bbvaresearch.com