Inflation Pulse

Türkiye | 2023 year-end CPI parallel to CBRT target

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Consumer prices rose by 2.93% in December close to our expectation (3.3%) and market consensus (3.0%) and its annual inflation accelerated to 64.77% from 61.98% the month before, beating the Central Bank's revised interim target of 65%. The main deviation in our forecast was due to core inflation being slightly weaker than expected. Monthly services inflation trend continued to decelerate, whereas basic goods prices gained momentum due to inadequate slow-down in consumption so far to correct the distortions in pricing behavior ahead of the January 2024 price and wage hikes. We expect consumer inflation to slow down to 45% at the end of 2024 with a strengthening bias to the downside, led by the recent decline in monthly inflation trend and enhanced likelihood of keeping a stable currency thanks to tightening monetary stance.

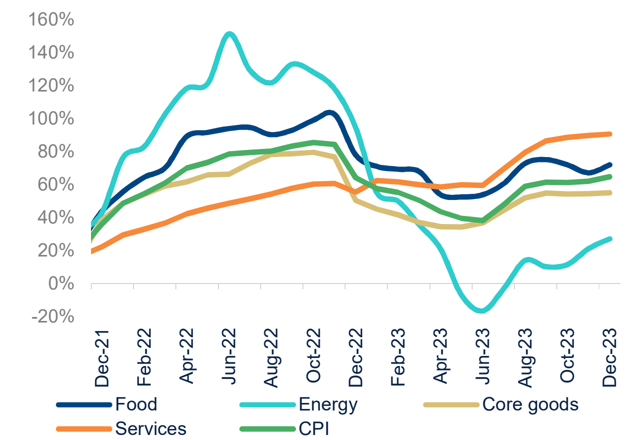
The trend in core prices turned upward, food prices put further pressure

After the downward trend on a monthly basis recorded in the last five months, core prices (C index) rose by 2.3% m/m in December, leading its annual inflation to gear up to 70.6% from 69.9%. Monthly services inflation continued to decelerate (2.4% m/m); whereas basic goods prices gained momentum (2.2% m/m), led by the acceleration in durable goods prices (2.8% m/m) and other core goods prices (3.8% m/m). In services prices sub-details, rental prices maintained a strong pace with 4.5% m/m increase (7.2% on average in 2H23), while the rise in restaurant & hotel prices stayed relatively weaker (2.8% m/m). Therefore, annual services prices inflation further climbed up to 90.7%, while basic goods prices annual inflation stood at 52.8%.

If adjusted by seasonal factors, we calculate the monthly core trend inflation at nearly 4%, confirming the recent boost from the goods component; where the main driver remains to be the sticky services prices. Expected price hikes following the strong wage adjustments and administrative price hikes at the start of the year may have contributed to the acceleration in goods prices since domestic demand has not adequately slowed down yet to correct the distortions in pricing behavior. Instead, we observe somewhat a stabilization at solid levels in our Big Data Goods Consumption Indicator in December, highlighting the need of additional tightening in financial conditions. Otherwise, reduction in the underlying trend of inflation cannot be sustained since inflation expectations might remain far from anchored toward the Central Bank's interim inflation targets (36% by 2024 end and 14% by 2025 end).

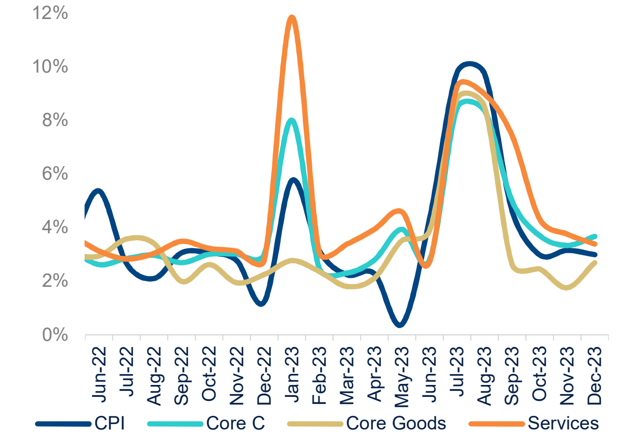
Our calculations show a monthly CPI trend of around 3% in December, which will likely increase in the first months of 2024 given the start of the year wage and price hikes and add challenges to maintain a disinflation trend under the lagging clearer deceleration in consumption, which is also pushed by the targeted real appreciation of the currency.

Figure 1. **CONSUMER INFLATION SUB-COMPONENTS (YoY)**



Source: Garanti BBVA Research, TURKSTAT

Figure 2. **CONSUMER INFLATION INDICATORS (sa, monthly changes)**



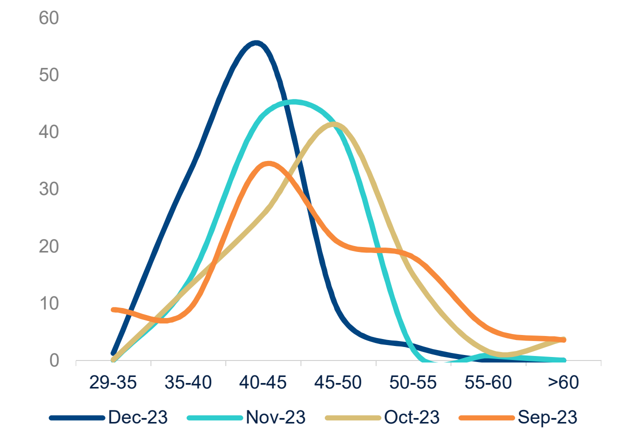
Source: Garanti BBVA Research, TURKSTAT

Food prices drastically picked up with 5.0% m/m (3% on average in the last 3 months) mainly due to the significant acceleration in unprocessed food prices (7.2% m/m) on seasonal factors. Fresh fruit and vegetable prices gained momentum by 11.4% m/m, driven by a 17.8% monthly acceleration in vegetable prices (vs. -0.6 m/m fruit prices), while the increase in other unprocessed food prices remained relatively limited with 5.0% m/m. Processed food prices inflation slowed down to 2.8% m/m (vs. 3.8% on average in the last 3 months) as a result of the managed depreciation of the currency. All in all, given the base effects due to much weaker food inflation realization in the previous year, annual food inflation accelerated to 72.2% from 67.3%.

Energy prices slowed down to 2.7% m/m (10.0% m/m in Nov) due to the recent decline in global energy prices and the weakening impact of households' natural gas usage above $25m^3$ included in the calculations of CPI compared to November. Meanwhile, domestic producer prices remained relatively muted (1.1% m/m) and its annual inflation slightly increased to 44.2% y/y (42.2% prev.). Upward adjustment in wages and expected price hikes in natural gas and electricity for industrial users will likely keep cost push factors on consumer inflation in the coming months.

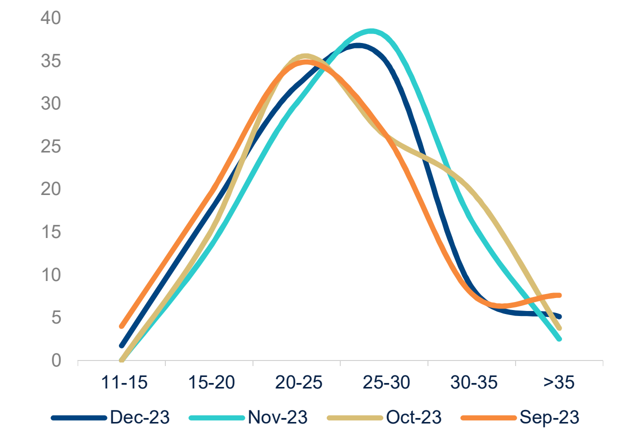
According to the Market Participants Survey of the CBRT for December, 12-month and 24-month ahead inflation expectations moved downward to 41.2% and 24.8%, from 43.9% and 25.1%, respectively. The range of the 12-month ahead inflation expectations also narrowed down, as its probability distribution shows that the variation among expectations is decreasing led by the enhanced forward guidance of the monetary policy. Though, the range of the 24-month ahead expectations remain divergent and the probability assigned to reach the CBRT's target in 2025 is almost negligible. The managed depreciation of the currency helps goods trend inflation decelerate but services inflation trend remains relatively higher, both reinforcing inflation inertia and containing improvement in inflation expectations. This is why more restrictive stance is needed and it should be maintained as long as needed to ensure sustained price stability.

Figure 3. **CBRT MARKET PARTICIPANTS SURVEY INFLATION EXPECTATIONS** (12M ahead, probability distribution)



Source: Garanti BBVA Research, CBRT

Figure 4. **CBRT MARKET PARTICIPANTS SURVEY INFLATION EXPECTATIONS** (24M ahead, probability distribution)



Source: Garanti BBVA Research, CBRT

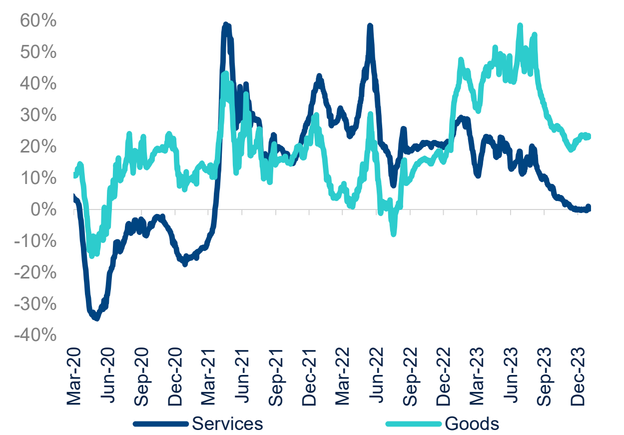
Price adjustments contribute to inflationary pressures

The CBRT reduced the pace of monetary tightening in December with 250 bps hike and raised the policy rate to 42.5%. The CBRT acknowledges that the level of tightening is close to the level required to establish the expected disinflation, hence the tightening cycle may end with a final rate hike of 250 bps raising the policy rate to 45%. As noted in the Monetary Policy Document for 2024, the CBRT will also continue quantitative tightening in order to help sterilize the excess TL liquidity in the market and strengthen the transmission mechanism.

We run different simulations to understand how fast the disinflation trend can be maintained in 2024. Given the recent decline in inflation trend and enhanced likelihood of keeping a stable currency led by accelerating non-residents' portfolio inflow (even before the local election in March 2024) and improving inflation expectations, we realize that 2024 year-end inflation can get closer to 40% compared to our current 45% forecast, assuming an overall 50% hike in wages and energy price hikes for households in 2Q24 and 4Q24. However, still solid goods consumption, improving but ongoing distortions in pricing behavior, potentially high inertia due to tendency toward backward indexation and sticky services inflation on top of wage hikes will likely keep inflationary pressure. As a result, for the time being we stick to our 2024 year-end expectation of 45% but acknowledge slight downside risk on our forecast.

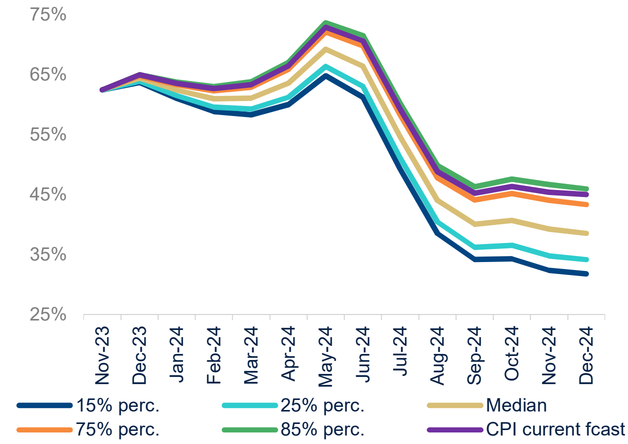
If our CPI simulation result materializes, it might open room for the CBRT, even in ex-post terms, to start cutting rates in 3Q24 from the reached 45% policy rate in January, which might also be supported by the expected easing cycle from the global central banks. However, it will be very premature and risky to make it sooner with bold steps since reducing inflation further beyond 20% at the end of 2025 will be more challenging given underlying high inflation trend. Therefore, we maintain our call of keeping 45% policy rate throughout the year but if inflation trend starts to decline much faster in 2H24, we also envisage the CBRT might start the easing cycle with limited steps toward the end of the year. After observing the impact of January price hikes and wage adjustments, and overall fiscal stance as we get closer to the election, we will revise our inflation projections and accordingly our expectations for the monetary policy.

Figure 5. **GARANTI BBVA BIG DATA CONSUMPTION INDICATORS** (28-day sum, real, YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 6. **GARANTI BBVA CPI SIMULATIONS** (YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 7. **CPI SUBCOMPONENTS**

	MoM	YoY
Total	**2.93%**	**64.77%**
Food & Non-alcoholic beverages	4.8%	72.0%
Beverage & Tobacco	0.0%	71.3%
Clothing & Textile	-1.3%	40.7%
Housing	5.0%	40.4%
Household Equipment	3.6%	58.5%
Health	4.4%	79.6%
Transportation	-0.1%	77.1%
Communication	3.1%	51.0%
Recreation & Culture	5.3%	61.3%
Education	0.5%	82.1%
Restaurants & Hotels	2.8%	93.2%
Misc. Goods & Services	1.9%	59.0%

Source: Garanti BBVA Research, TURKSTAT

Figure 8. **DOMESTIC PPI SUBCOMPONENTS**

	MoM	YoY
Total	**1.14%**	**44.22%**
Mining & Quarrying	2.0%	65.6%
Manufacturing	2.0%	53.7%
Food Products	2.6%	63.7%
Textiles	1.6%	46.6%
Wearing Apparel	4.3%	55.7%
Coke & Petroleum Products	-3.6%	43.8%
Chemicals	1.2%	43.1%
Other Non-Metallic Mineral	0.8%	49.7%
Basic Metals	3.2%	43.3%
Metal Products	3.1%	61.8%
Electrical Equipment	2.6%	63.0%
Electricity, Gas, Steam	-11.4%	-29.7%

Source: Garanti BBVA Research, TURKSTAT

DISCLAIMER

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