

Inflation Pulse

Türkiye | Significant worsening in inflation trend

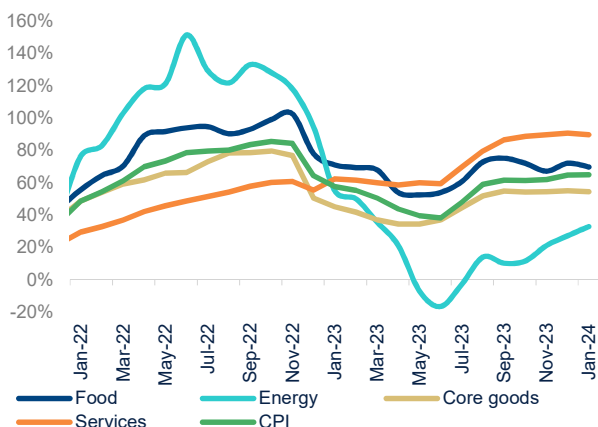
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5 February 2024

Consumer prices rose by 6.70% in January, higher than our expectation (5.7%) but parallel to the consensus (6.6%) and annual consumer inflation accelerated slightly to 64.86% from 64.77% the month before. Our main deviation stemmed from higher than expected realization in core prices led by the services across-the-board. The deterioration in services inflation trend was more pronounced due to the strong wage adjustments, while the trend in basic goods prices still accelerated on distortions in pricing behavior despite the gradual depreciation of the currency. The current stabilized level in overall financial conditions, inadequate slow-down in consumption so far, acceleration in fiscal impulse, and still elevated inflation expectations keep challenges on the targeted disinflation path. We eliminate our previous downward bias and now expect consumer inflation to slow down to 45% by end 2024. The change of the CBRT Governor hints an increasing likelihood of a tighter stance. If so, we will revise our interest rate and inflation projections, accordingly.

The declining trend in core prices reversed in January

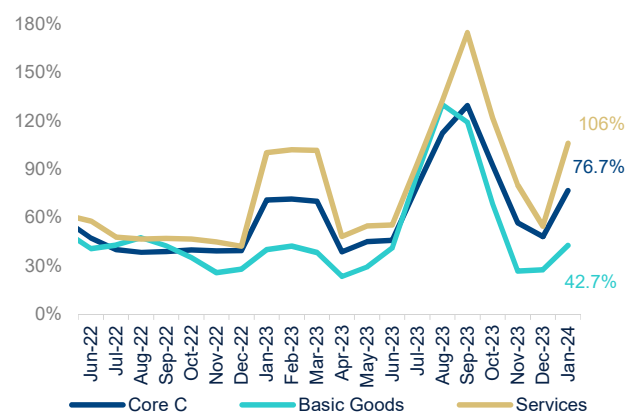
Following the gradual slow-down in monthly inflation trend in 2H23, core prices (C index) rose by 7.6% m/m and 8.3% m/m if adjusted from seasonality (vs 3.3 m/m prev.), according to our calculations. Annual core inflation remained almost stable at 70.5%. In sub-details, services prices inflation proved to be much stronger with 12.1% m/m (11.5% if seas adjusted), driven by a broad-based acceleration except for telecommunication services. The increase in rent prices reached its historical peak with 11.5% m/m (vs. 6.3% on average in 2023). Furthermore, the significant monthly acceleration in restaurant & hotel prices (12.2% m/m) confirmed the strengthening of second round effects arising mainly from the higher-than-expected wage adjustments (49% hike in minimum wage compared to July upgrade and 99% on annual basis). Hence, annual services prices inflation slightly slowed down to 89.7% y/y from 90.7% y/y the month before due to a similar strong base of last year. On the other hand, the acceleration in basic goods prices remained relatively weaker with 3.6% m/m (5.1% if seasonally adjusted). The price increases in furnishing and household equipment were more evident with 7.3% m/m while auto prices increased by 2.8% m/m, which led to durable goods prices (excluding gold) gearing up to 4.8% m/m. Despite the gradual depreciation of the currency, the trend in basic goods prices still accelerated on unanchored inflation expectations and distortions in the pricing behavior, requiring tighter financial conditions to achieve the targeted decline in monthly inflation trend.

Figure 1. CONSUMER INFLATION SUBCOMPONENTS (YoY change)



Source: Garanti BBVA Research, TURKSTAT

Figure 2. CONSUMER INFLATION INDICATORS (seas. adj., 3-month avg. annualized changes)



Source: Garanti BBVA Research, TURKSTAT

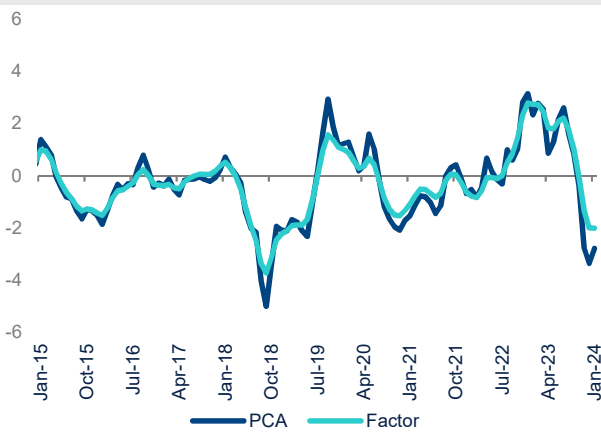
Food prices increased by 5.3% m/m (vs. January average of 6.5% in the last five years), led by the relatively limited increase in processed food prices (3.6% m/m); while unprocessed food prices rose by 7% m/m on top of the increases

in fresh fruit and vegetable prices (7.6% m/m) and other unprocessed food prices (6.6% m/m). All in all, given the strong base effects from the last year, annual food inflation lost pace with 69.6% (vs. 72.2% previously).

Energy prices rose by 6.1% m/m mainly due to the recent hikes in gasoline prices driven by the automated special consumption tax adjustment, while the impact from the natural gas consumption continued to weaken with 8.9% m/m (vs. 24.9% m/m prev.). So, annual energy inflation accelerated to 32.9% y/y. Meanwhile, domestic producer prices increased by 4.1% m/m mainly due to the upward adjustment in wages, while its annual inflation remained unchanged compared to the previous month with 44.2% y/y.

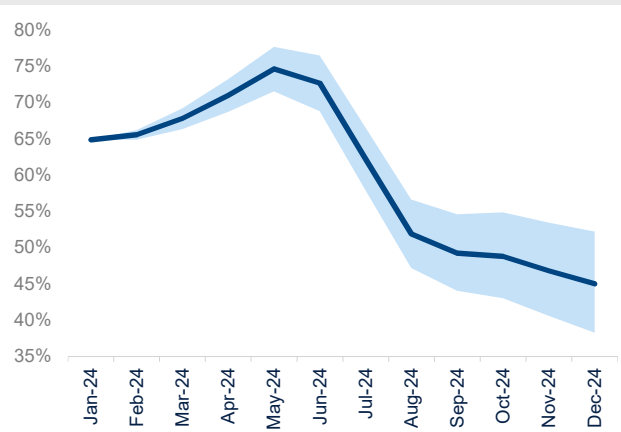
Moreover, the regular revision of the CPI basket weights showed the highest decline in the housing category with 2.4pp, triggered by the 1.8pp decline in electricity and 0.3pp decline in natural gas due to the continuation of high price subsidies for households. We expect significant price hikes on electricity and gas used in houses after the local election in March, which will finally reduce those subsidies and therefore the fiscal burden, while adding new challenges on inflation outlook with the renewed dynamic effects going forward.

Figure 3. **GARANTI BBVA FINANCIAL CONDITIONS INDEX¹** (standardized, + easing, - tightening)



Source: Garanti BBVA Research, TURKSTAT

Figure 4. **GARANTI BBVA CPI FORECASTS (y/y with %70 confidence band)**



Source: Garanti BBVA Research, TURKSTAT

First inflation report of the year will give clue on the future monetary stance

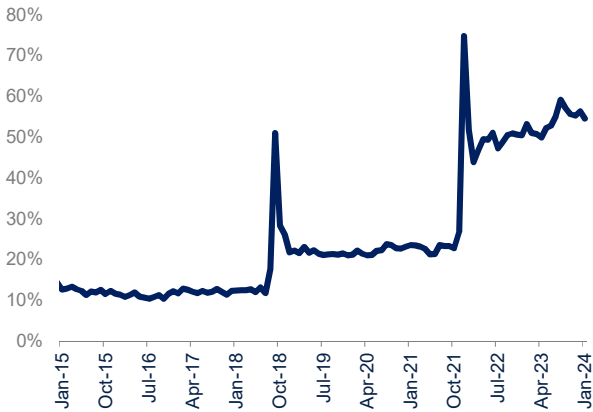
The CBRT increased the policy rate by 250 bps to 45% in January and emphasized that the current tightening level is sufficient to ensure the disinflation path. As signaled by our financial conditions index, its current level signals somewhat an easing in overall conditions most recently (conditions are tighter but it is still far from the level observed during 2018) which maintains upside risks on inflation outlook, given still solid domestic demand growing above the supply. Second, strong services prices keep inertia high, led by a wage-price spiral. Third, the latest data shows a robust exchange rate pass-through to inflation at a level around 55%. Last not but least, inflation expectations are far above the CBRT's interim inflation targets of 36% for 2024 and 14% for 2025. For example, according to the CBRT's survey of market participants, inflation expectation for the end of 2024 was 42.3%; while 24 month ahead expectation was materialized as 24%, with a negligible distribution to achieve the CBRT's target.

Based on our simulation under the assumptions of a gradual currency depreciation (42 USDTRY by end 2024), household energy price hikes after the local election, recent wage adjustments and realized January inflation, we forecast consumer inflation to come down to 45% at the end of 2024. Contrary to our previous downside bias, we now evaluate that the risks are more balanced. To sum up, in order to be consistent and reinforce credibility, the CBRT will likely revise its inflation forecasts slightly to the upside in the next inflation report to be published on February 8 and strengthen the hawkish stance with the likelihood getting higher for a future limited hike and other restrictive monetary tools. If not, it will be more challenging to defend the current interim targets and anchor inflation

¹ Based on the study done by Bahçeşehir University Financial Research and Implementation Center(BFRC), we calculate the financial conditions index. The following variables are included; CDS, ex-ante 2 year yield(real), real exchange rate, real stock price, portföli inflows, yield curve slope(10y-2y), real loans rate.

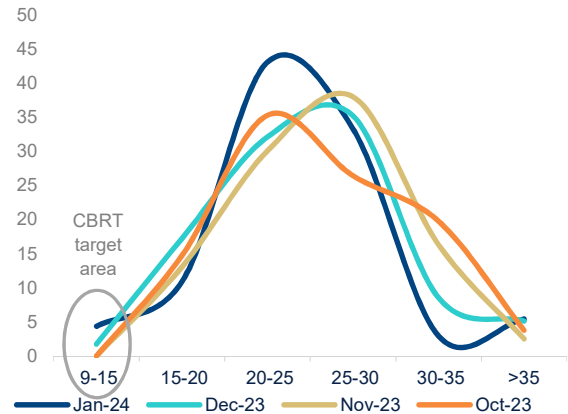
expectations under stricter risks on the inflation outlook. The change of the CBRT Governor hints an increasing likelihood of a tighter stance. If so, we will revise our interest rate and inflation projections, accordingly.

Figure 5. **EXCHANGE PASS-THROUGH ON CORE D INFLATION** (recursive method)



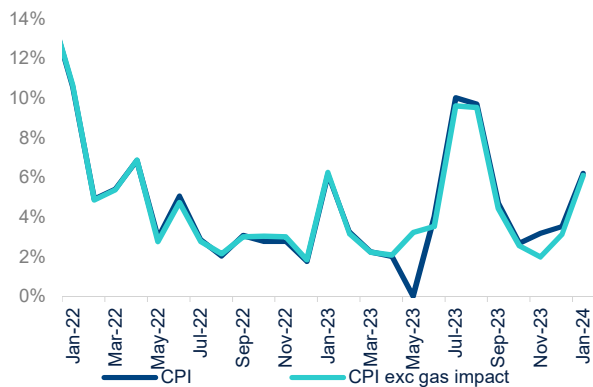
Source: Garanti BBVA Research, CBRT

Figure 6. **CBRT MARKET PARTICIPANTS SURVEY INFLATION EXPECTATIONS** (24M ahead, probability distribution)



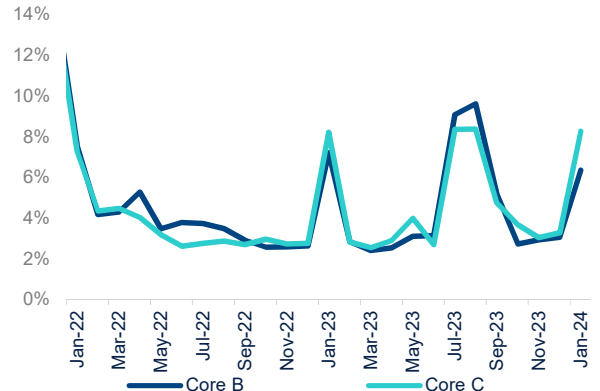
Source: Garanti BBVA Research, CBRT

Figure 7. **INFLATION INDICATORS** (seasonal adjusted, monthly changes)



Source: Garanti BBVA Research, TURKSTAT

Figure 8. **CORE INFLATION INDICATORS** (seasonal adjusted, monthly changes)



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI SUBCOMPONENTS**

	MoM	YoY
Total	6.70%	64.86%
Food & Non-alcoholic beverages	5.2%	69.7%
Beverage & Tobacco	4.9%	61.6%
Clothing & Textile	-1.6%	40.6%
Housing	7.4%	46.0%
Household Equipment	7.3%	61.1%
Health	17.7%	78.6%
Transportation	6.5%	77.5%
Communication	3.0%	46.4%
Recreation & Culture	9.1%	61.8%
Education	3.2%	79.8%
Restaurants & Hotels	12.2%	92.3%
Misc. Goods & Services	10.3%	58.9%

Source: Garanti BBVA Research, TURKSTAT

Figure 10. **DOMESTIC PPI SUBCOMPONENTS**

	MoM	YoY
Total	4.14%	44.20%
Mining & Quarrying	5.7%	65.0%
Manufacturing	5.2%	53.8%
Food Products	4.9%	59.1%
Textiles	3.7%	49.2%
Wearing Apparel	5.8%	58.5%
Coke & Petroleum Products	2.8%	42.6%
Chemicals	5.3%	47.5%
Other Non-Metallic Mineral	3.2%	42.6%
Basic Metals	5.4%	47.9%
Metal Products	7.1%	68.5%
Electrical Equipment	5.4%	63.8%
Electricity, Gas, Steam	-6.3%	-32.0%

Source: Garanti BBVA Research, TURKSTAT

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