Inflation Pulse

Türkiye | Challenging outlook on inflation trend

Adem İleri / Gül Yücel

3 June 2024

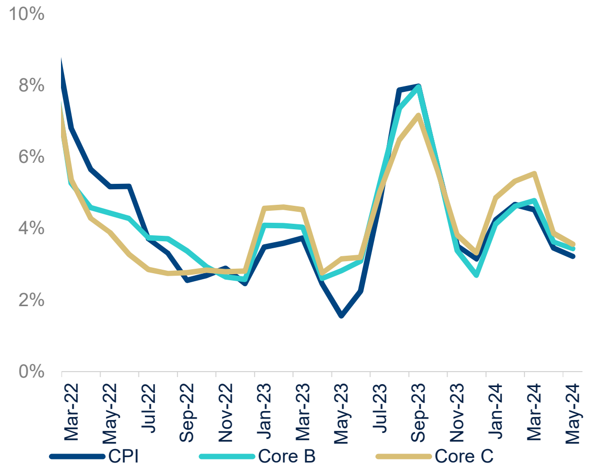
Consumer prices rose by 3.37% m/m in May, higher than our expectations (3.0%) and consensus (3.1%), which led the annual inflation to rise to 75.45%. The easing in core prices trend was very limited due to stickiness in services prices and basic goods prices on top of the continuation of solid demand, second round effects, high inflation expectations and strong inertia. On the other hand, producer prices inflation slowed down in the presence of lower energy prices and most recent favorable currency outlook. We expect annual consumer inflation to decelerate faster starting from June on favorable base effects and to decline to 43% by end 2024. Given the unanchored medium run inflation expectations, we think the Central Bank (CBRT) should remain tight for longer. If the fiscal consolidation starts to materialize on top of new additional demand restrictive macro-prudential policies, the CBRT could start an easing cycle very gradually in 4Q24.

Despite stable currency, strong inertia and steady basic prices maintain challenges

Consumer prices inflation materialized as 3.65% m/m on a seasonally adjusted basis due to the high course of core inflation. Yet, if we exclude 0.45 percentage point impact stemming from the finalization of natural gas subsidy up to 25 m^3, the monthly inflation trend rose even slightly (3.2% vs 3% m/m in April, if seasonally adjusted). Solid services inflation on top of second round effects and backward indexation, and steady basic prices on the back of solid demand prevent a faster improvement in core inflation. Despite the stable exchange rate levels, core C prices inflation (excluding food, alcohol & tobacco, energy and gold) gained pace with %3.8 m/m in May (3.5% m/m if seasonally adjusted) and led its 3-month average trend to retreat only to 3.6% m/m from 3.9% in April based on our calculation (Figure 1).

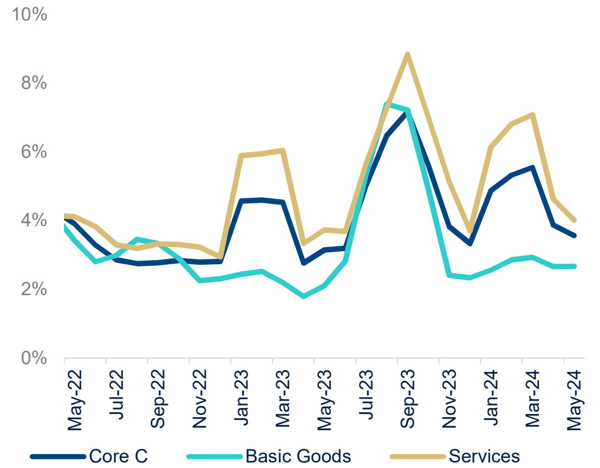
Led by strong inertia, services prices inflation materialized at 4.0% m/m (3.8% m/m seasonal adjusted), resulting in an annual inflation of 95.9%. In particular, rent (5.5% m/m vs. 4.6% prev.) and restaurant & hotel prices (5.5% m/m vs. 4.7% prev.) accelerated, though the transportation services inflation came down slightly with -0.1% m/m. Furthermore, ongoing solid demand and high inflation expectations keep upside risks on goods prices since basic goods prices inflation rose to 3.5% m/m (2.6% m/m if seasonally adjusted). Automobile (3.1% m/m) and clothing prices (9.6%) were the leading factors, while furniture and household equipment prices (1.9 m/m), which are sensitive to the currency, remained supportive of disinflation. To sum up, 3-month average trend in goods inflation remain steady at 2.7% while services inflation decelerated only to 4% from 4.6% in April (Figure-2).

Figure 1. **CONSUMER INFLATION INDICATORS** (seasonal adj., monthly, 3-month average)



Source: Garanti BBVA Research, TURKSTAT

Figure 2. **CONSUMER INFLATION INDICATORS** (seasonal adj., monthly, 3-month average)

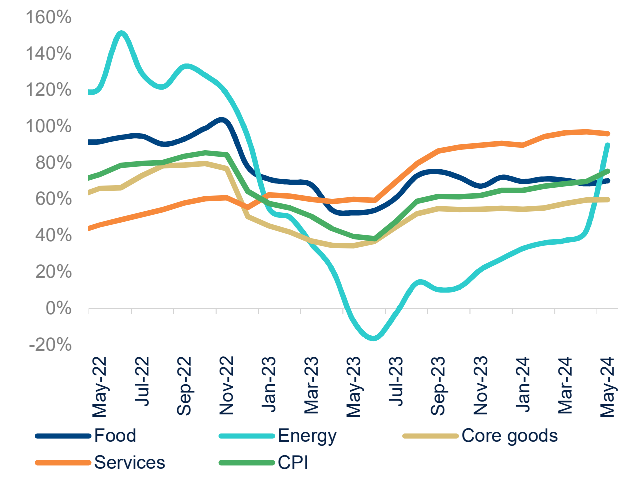


Source: Garanti BBVA Research, TURKSTAT

Food prices inflation (1.5% m/m vs. 2.9% in April) turned out to be higher than our expectations (0.5% m/m). Despite the considerable deceleration in unprocessed food prices (1.2% m/m vs. 5.8% prev.), processed food prices geared up (3.8% m/m vs. 1.8%), especially stemming from recent adjustment in bread and dairy products' prices. On the other hand, fresh fruit and vegetable prices fell by 3.2% m/m on seasonal factors, moderating the overall food inflation. Regarding energy inflation, despite the recent decline in oil prices and stable currency, energy prices increased by 4.9% m/m on the back of the finalization of the zero price implementation for gas usage below 25 m^3. Gas prices adjustment has around 3.5 percentage point upward impact on annual consumer inflation.

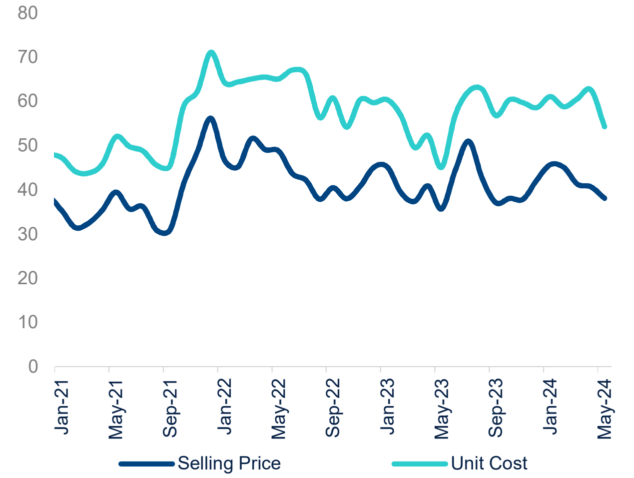
Lastly, cost push factors moderated further in the presence of real currency appreciation and the recent retreat in oil prices as the monthly producer prices inflation declined to 2.0% m/m (3.6% m/m prev.). Still, the annual producer inflation slightly picked up to 57.68% y/y (55.66% y/y prev.) on base effects. According to the business tendency survey in May, firms' expectation for the unit cost in the next three months has improved, signalling further improvement in cost push factors in the near future.

Figure 3. **CONSUMER INFLATION INDICATORS** (YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 4. **UNIT COST AND SELLING PRICE EXPECTATIONS FOR 3-MONTH AHEAD** (Balance)*

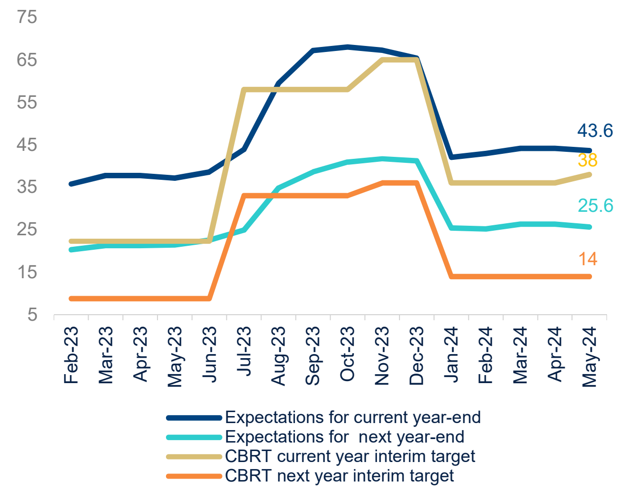


Source: CBRT Business Tendency Survey
*The balance is defined as the difference between the share of firms expecting price increase and the share of firms expecting price decrease.

High inflation expectations require prudent stance to stay for longer

The improvement in inflation expectations has been limited so far based on different indicators due to gradual monetary policy adjustment, still pending fiscal consolidation and high inflation realizations. According to the CBRT market participants survey in May, professional forecasters' year end inflation expectations for 2024 and 2025 decreased only to 43.6% and 25.6%, respectively, staying well above the CBRT's interim targets of 38% and 14% (Figure 5). Also, 2-year and 5-year CPI indexed bonds display high inflation expectations in both medium and long-run despite the most recent limited improvement for the medium run (Figure 6). High inflation expectations on top of retailers' spending availability could pose upside risks on inflation outlook. According to our Bayesian VAR Analysis for Core-D Inflation, we calculate a significant pass through from inflation expectation shocks to current inflation considering 70% confidence band, reaching as high as 40% in two year-horizon (Figure 7).

Figure 5. **CBRT MARKET PARTICIPANTS SURVEY INFLATION EXPECTATIONS** (%)

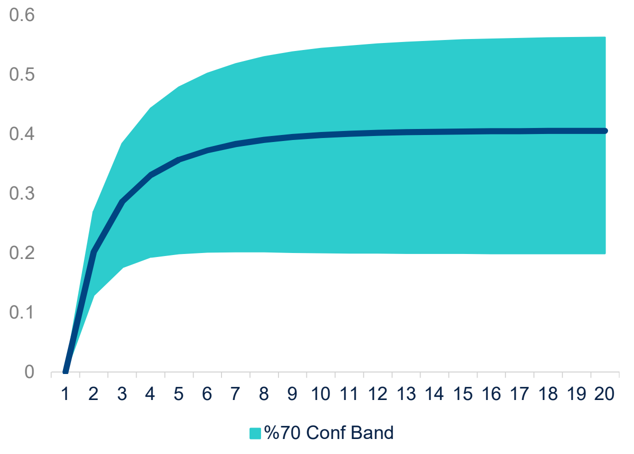


Source: Garanti BBVA Research, CBRT

Figure 6. **MARKET INFLATION EXPECTATIONS ON CPI LINKERS** (%)

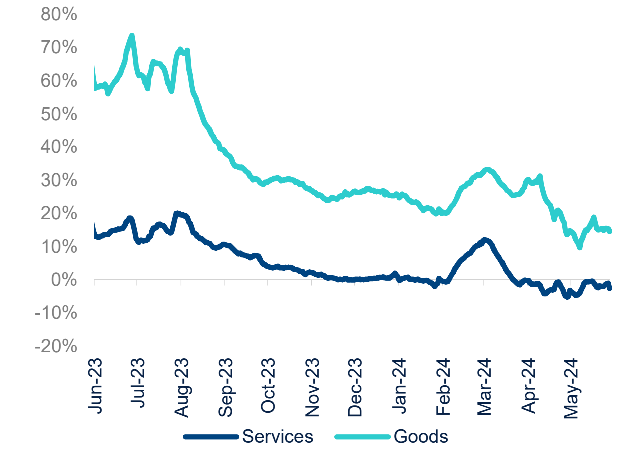
Source: Garanti BBVA Research, Bloomberg

Figure 7. **CUMULATIVE PASS-THROUGH TO CORE-D FROM 1% ST INF EXP SHOCK** (Quarterly, percentage point)



Source: Garanti BBVA Research, Bloomberg, TURKSTAT

Figure 8. **GARANTI BBVA BIG DATA CONSUMPTION INDICATORS** (28-day sum, real YoY)



Source: Garanti BBVA Research, TURKSTAT

Our big data consumption indicator signals that despite some normalization private consumption remains strong especially on goods (Figure-8). Strong inertia, elevated inflation expectations and still strong domestic demand increase the challenges on the disinflation path. All in all, we expect annual consumer inflation to decelerate faster starting from June on favourable base effects and to decline 43% by the end of 2024 under the assumption of no additional minimum wage adjustment, gradual energy price hikes for households, $84 average Brent oil prices per barrel and the year-end US Dollar/TL currency of 38.

Considering the lagged impact of the monetary policy measures and expected fiscal consolidation, domestic demand have not decelerated as expected so far. Hence, we maintain our view that additional demand restrictive measures especially on retailers' spending availability could be complementary to start anchoring inflation expectations towards the targeted levels. Besides, keeping financial conditions tight for longer will be needed to start a sustained path to unwind current regulations. We maintain our view that inflation is likely to get closer to the upper bound of the CBRT forecasted range (42%) and this will provide a limited room to start easing with very gradual steps in 4Q24. Yet, the lagged effects of most recently announced fiscal measures and lacking macro-prudential policies on consumption might delay the easing cycle.

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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