

Türkiye | May inflation eases though underlying pressures persist

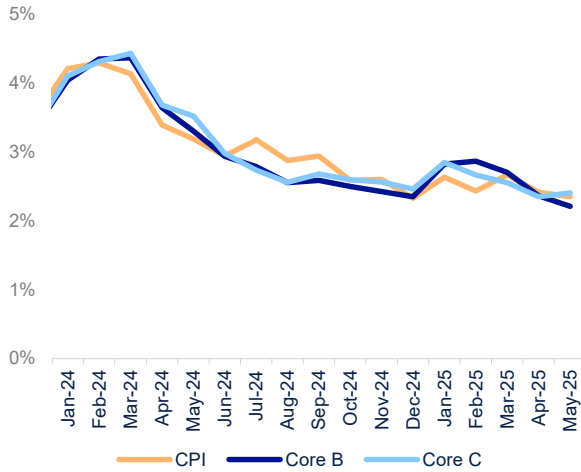
Berfin Kardaslar / Gül Yücel

- Consumer inflation rose by 1.53% m/m, lower than both our expectation (1.8%) and the market consensus (2.0%), driving annual inflation down to 35.4%.
- According to our calculations, seasonally adjusted (s.a.) monthly inflation improved considerably to 1.96% (down from 2.6% in March), led by mainly the slowdown in core goods inflation on weakening exchange rate pass-thru and domestic demand. As a result, 3-month average trend slightly improved to 2.35% in May (vs. 2.5% previously).
- Services inflation decelerated as well, but to a lower extent, with a 3-month trend level of 2.8% while it is staying closer to 2% in the case of basic goods.
- We remain prudent by maintaining our year-end inflation forecast of 31%, nonetheless, monetary policy becoming more restrictive, low trend of energy prices, and a better-than-expected inflation trend in recent months have increased the downside risks on our forecast.

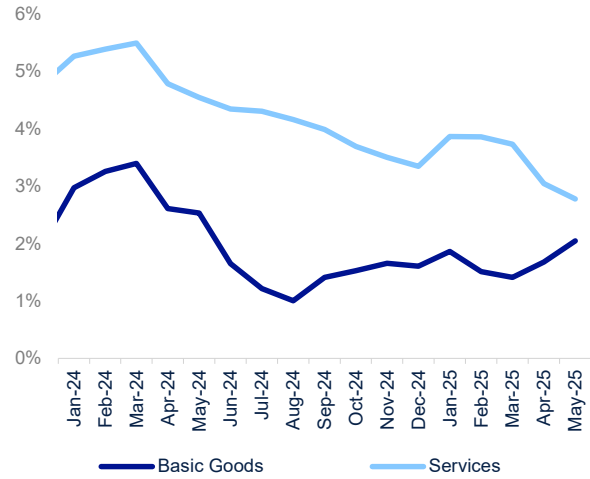
May CPI Surprised to the Downside, Underlying Trend Yet to Return the Pre-Shock Levels

Consumer prices rose by 1.53% m/m in May (vs. 3.00% m/m in April), surprising to the downside relative to the consensus (2.10% m/m) and our expectation (1.85% m/m), resulting in a decline in annual inflation to 35.41% from the previous 37.86%. Our seasonally adjusted CPI calculations indicate an improvement to 1.96% m/m from 2.58% m/m in April, driven by mainly core goods and energy, due to a decreasing response to the currency depreciation shock in mid-March—which had translated into April inflation—and dying out carry-over effects of the electricity price hike in April for the latter.

Compared to March figures, the contribution of durable goods (0.41pp) has not returned to the pre-shock levels observed in March (0.25pp), revealing that lagged effects are still present in the data. However, contributions to other components of basic goods have generally stabilized, and the decline in services inflation, particularly from restaurants and hotels prices, shows that the Central Bank (CBRT)—acting proactively—has managed expectations well in the face of the currency shock, amid already weakened demand due to lower purchasing power and tight financial conditions. Consequently, the 3-month headline inflation trend fell to 2.35% m/m from 2.41% m/m in April, where the deterioration in the basic goods inflation trend was offset by the improvement in the services inflation trend, according to our calculations.

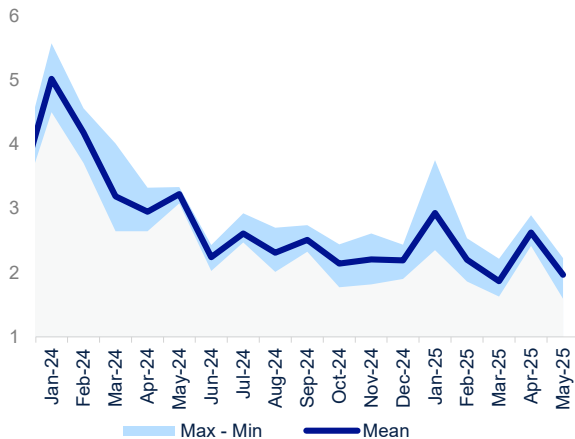
Figure 1. Consumer Inflation Indicators
 (seasonal adj., monthly, 3-month average)


Source: Garanti BBVA Research, TURKSTAT

Figure 2. Core C Inflation Indicators
 (seasonal adj., monthly, 3-month average)


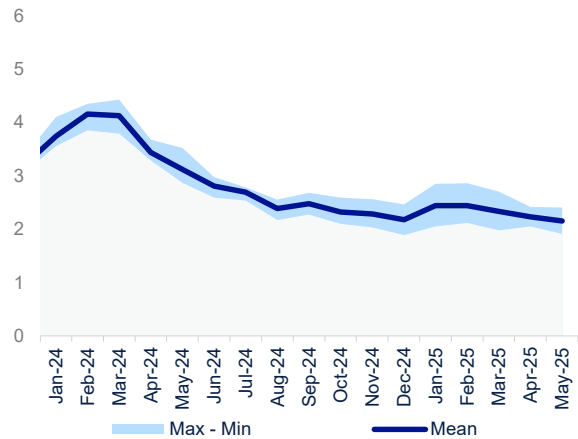
Source: Garanti BBVA Research, TURKSTAT

According to our calculations, seasonally adjusted underlying trend indicators followed by the CBRT improved in May, and their monthly average decreased to 1.96% m/m from the previous 2.62% m/m. However, this figure is still higher than the March level of 1.87% m/m. As a result, the 3-month trend of the underlying inflation slightly eased to 2.15% m/m from 2.23% m/m in April, also helped by the elimination of the high February reading—which had contained some influence from price hikes at the beginning of the year—from the average calculation.

Figure 3. Consumer Inflation Indicators*
 (seasonal adj., monthly)


Source: Garanti BBVA Research, TURKSTAT

* Mean represents the average of different trend indicators including seasonally adjusted B, C, SATRIM, Median, inflation excluding volatile items and dynamic factor. The highlighted area shows the maximum and minimum range.

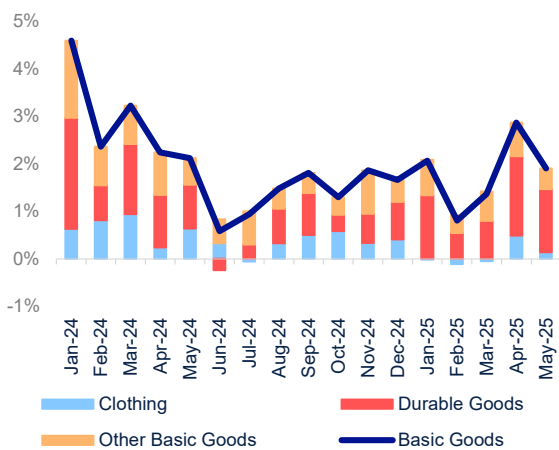
Figure 4. Consumer Inflation Indicators*
 (seasonal adj., monthly, 3-month average)


Source: Garanti BBVA Research, TURKSTAT

Among the components of the underlying trend indicators, Core C (up to 2.22% from 2.09% in March) was the highest, while the SATRIM (down to 1.59% m/m from 1.73% m/m in March) was the lowest. The median inflation reached 1.96% m/m (from 1.74% m/m in March and 2.65% m/m in April). Another indicator excluding extreme values, V_1, rose to 1.72% m/m from 1.63% m/m in March (2.54% m/m in April), showing that even when items highly sensitive to currency depreciation and other factors are excluded, recent developments have stagnated the improvement in the underlying trends. In parallel, the dynamic factor model inflation figure remained closer to the March level of 2.21% m/m in May (vs. 2.52% m/m in April). Overall, despite the recent shock interrupting the progress in the underlying trends, tighter financial conditions, stronger monetary transmission mechanism with also proactive measures by the CBRT have prevented an amplifying exchange rate pass-through.

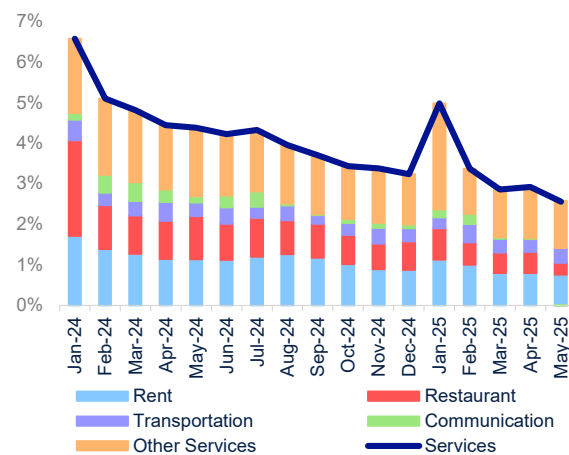
Core C inflation improved to 2.22% m/m in May from 2.89% m/m previously, standing higher than the pre-shock level of 2.09% m/m. Ongoing pass-through effects on items sensitive to the euro prevented further improvement in durable goods (2.73% m/m, down from 3.43% m/m in April). Amid weakened demand and carry-over effects, clothing inflation remained modest, posting 0.62% m/m inflation (2.26% m/m in April vs. -0.26% m/m in March), and other basic goods inflation even improved compared to the March level, posting 1.49% m/m inflation in May (2.38% m/m in April vs. 2.09% m/m in March). Services inflation decelerated to 2.56%, posting the lowest level since late 2021, on lower restaurants and hotels inflation (1.13% m/m in May vs. 2.03% m/m in April). Although still sticky, due to backward indexation on decreased annual inflation figures, rent inflation fell to 3.98% m/m in May from 4.18% m/m in April. Other services (2.99% m/m vs. 3.28% m/m in April) and communication services inflation (-0.14% m/m vs. 0.38% m/m in April) improved in May -the former still weighing on overall services inflation- while transportation services inflation deteriorated (3.74% m/m vs. 3.21% m/m in April). On top of fading pass-through effects, tighter financial conditions, weakened domestic demand, and improving expectations will likely contain Core C inflation in the next months.

Figure 5. Contributions to Basic Goods Inflation (seasonal adj., monthly, pp)



Source: Garanti BBVA Research, TURKSTAT

Figure 6. Contributions to Services Inflation (seasonal adj., monthly, pp)



Source: Garanti BBVA Research, TURKSTAT

On food inflation, seasonally adjusted data slightly deteriorated on the back of unprocessed food inflation (1.61% m/m in May vs. 0.54% m/m in April), while the improvement in processed food inflation prevented a further deterioration in May (1.39% m/m vs. 2.04% m/m in April). Accordingly, overall food and non-alcoholic beverages inflation rose to 1.50% m/m in May from 1.34% m/m in April, bringing its annual inflation down to 32.87% from 36.09% previously, on carry-over effects from last year. As for energy, monthly inflation decelerated to 2.15% in May from 4.32% in April, with dying out effects from the electricity price hike at the start of April. Supported by favorable oil prices, energy inflation remained contained. Barring a potential natural gas price hike during the summer, energy prices are expected to remain supportive going forward.

On the other hand, domestic producer price inflation decelerated only slightly to 2.48% m/m in May from 2.76% previously, posting a higher figure than our expectations and resulting in a deterioration in the annual figure to 23.13% m/m from 22.50% m/m in April.

Disinflation prospects overshadowed by persistent risks

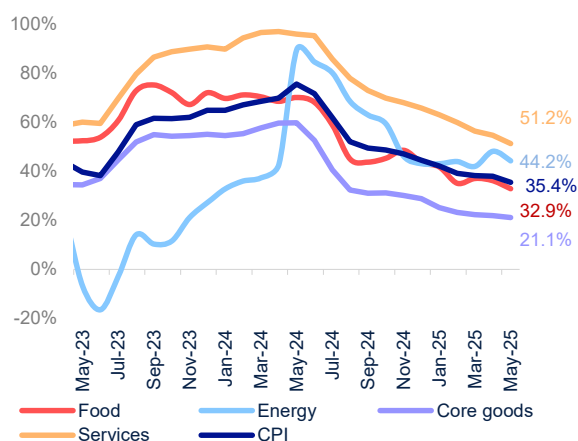
Both downside and upside risks are at play, imposing uncertainties on the near-term inflation outlook. Tight financial conditions, cautious monetary stance, weakening domestic demand and supportive energy prices could help the disinflation process in the short term. On the other hand, several risk factors likely pose upward inflationary pressure. One particular risk factor at the forefront is the distorted pricing behavior due to unanchored inflation expectations. According to the CBRT surveys on inflation expectations demonstrated very limited improvement in May in the expectations of market participants and real sector with their 12-month ahead inflation expectations at 25.1% and 41.0% respectively. Meanwhile, households' expectations for 12-month ahead inflation expectations continued to deteriorate with 59.86%, further enlarging the difference between their expectations and that of market participants to 34.8pp. Secondly, the recent agricultural frost has exerted supply shock especially in the fresh fruits, evident by the 24.4% annual decline projected by Turkstat for fruits. This could feed into the pressure over the food inflation. Third, growing downside risks on the near term growth outlook may result in a fiscal stance not being able to be tightened as targeted. 1Q25 GDP data confirmed the slowdown in economic activity, while leading indicators signal the continuation of worsening, affecting the employment outlook. Headline unemployment rate jumped to 8.6% in April from 8.0%, while underutilization rate, broad-based definition of unemployment rate, increased to an all-time high of 32.2%. Furthermore, uncertainties about the postponed administrative prices hikes persist. Finally, despite some slowdown, ongoing inertia in the services prices especially on rent and other services prices continue to pose upward pressure on the inflation outlook.

Overall, assuming no additional minimum wage hike for 2H25, 25% natural gas price hike for households later in the year, supportive energy prices and GDP growth of 3.5% for 2025, we evaluate the balance of risks on our year-end inflation forecast of 31% becomes slightly tilted to

the downside. Nonetheless, we keep our prudence and plan to revise our projections, depending on the near term overall stance of the policy mix.

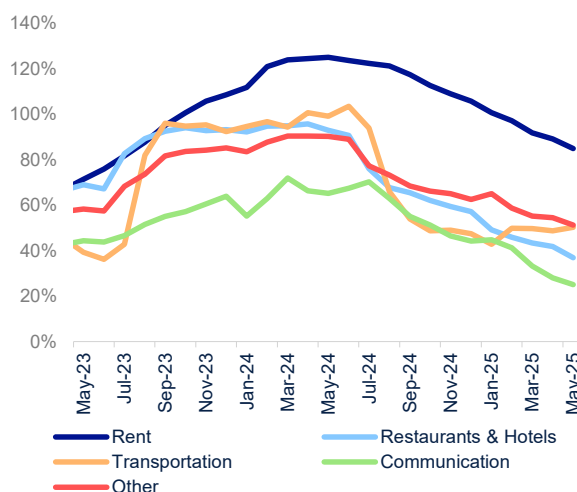
On the monetary stance, we evaluate a significant opportunity window has opened for the CBRT: Much faster decline in the underlying inflation trend, stronger accumulation of reserves - especially with the tourism season gaining momentum, and a gradual build-up of policy credibility, which can help anchor expectations if they continue to act with caution. Their recent efforts to sterilize excess Turkish lira liquidity confirm such prudence. We expect the easing cycle to start with a normalization in funding towards policy rate (46%) at some point in June together with some easing in macro-pru selectively, and to continue later with carefully calibrated cuts in the policy rate as of July.

Figure 8. Consumer Inflation Subcomponents (YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 9. Services Inflation (YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 10. CPI Subcomponents

	MoM	YoY
Total	1.53%	35.41%
Food & Non-alcoholic beverages	-0.7%	32.9%
Beverage & Tobacco	0.1%	27.9%
Clothing & Textile	7.0%	14.1%
Housing	3.0%	67.4%
Household Equipment	1.2%	29.7%
Health	0.5%	40.1%
Transportation	2.7%	24.6%
Communication	-0.7%	19.2%
Recreation & Culture	1.9%	26.0%
Education	1.2%	71.7%
Restaurants & Hotels	1.8%	36.9%
Misc. Goods & Services	1.6%	36.0%

Source: Garanti BBVA Research, TURKSTAT

Figure 11. PPI Subcomponents

	MoM	YoY
Total	2.48%	22.50%
Mining & Quarrying	1.2%	29.6%
Manufacturing	1.7%	22.7%
Food Products	1.7%	27.1%
Textiles	1.6%	16.6%
Wearing Apparel	1.6%	31.3%
Coke & Petroleum Products	-0.1%	-4.1%
Chemicals	1.2%	22.2%
Other Non-Metallic Mineral	1.4%	20.8%
Basic Metals	2.3%	9.2%
Metal Products	2.0%	21.4%
Electrical Equipment	2.2%	22.3%
Electricity, Gas, Steam	12.4%	14.4%

Source: Garanti BBVA Research, TURKSTAT

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