

# Inflation: Moderation also backed by core prices

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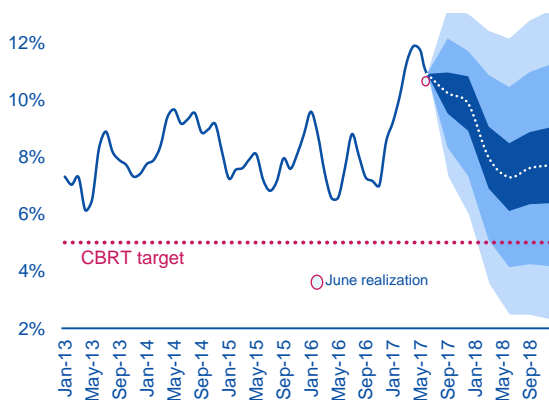
3 July 2017

Consumer prices declined by 0.27% in June in contrast to the market call of a slight rise by 0.1%. Our expectation was also a fall (-0.1%) but the data proved to be more positive thanks to the improvement in core inflation backed by the fall in auto prices. Annual consumer inflation fell to 10.9% from 11.7% in May on top of favorable base impact on food inflation, slight withdrawal in core prices and plummeting energy prices. As the base impact on food inflation will also be supportive in July, the headline is now more likely to fall below 10%. However, the reversal of base effects on food starting from August, the likely upward movement in core inflation in September-October mainly due to the methodological change assigning fixed weights to clothing and footwear group and the high level of services inflation on cost-push factors and second round effects will keep the headline at double digits towards the end of the year. We maintain our year-end inflation estimate at 9%, supported by both the stable Lira and the Government's decision not to hike taxes on tobacco in 2017.

## Rigidity in some services prices should be noteworthy

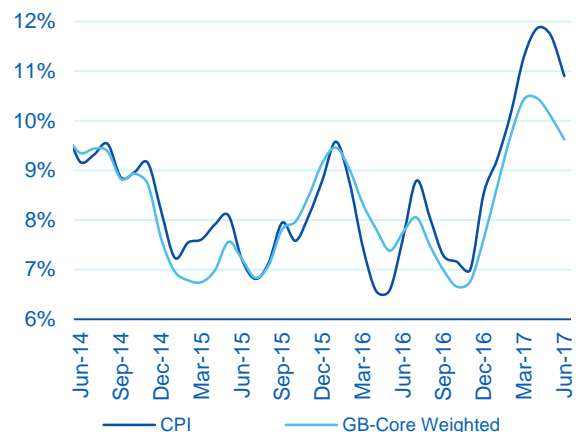
Food inflation was the main item that dragged the headline the most in June. Totally in line with our expectations, due to the sharp fall in vegetable prices, monthly food inflation came in at -1.2%, which slowed its annual inflation down to 14.6% from 79-month-high 17.4%. Exchange rate pass-through was lower than we initially expected, which was almost completely backed by the purchase of vehicles. Although this helped core inflation decline to 9.2% yoy from 9.4% previous month, the rise in services inflation in its 2<sup>nd</sup> consecutive month is noteworthy as it reflects both the cost-push factors on the high level of producer prices inflation (14.9%, yoy) and second round effects from the increasing food inflation and recovering tourism sector. Considering the non-core items, energy prices annual inflation slowed down for its 4<sup>th</sup> consecutive month to 7.6%, which was also the other positive factor for the headline.

**Figure 1** Inflation Forecasts (Quarterly Avg, YoY)



Source: Garanti Research & Turkstat

**Figure 2** CPI & BBVA-Garanti Core Inflation (YoY)

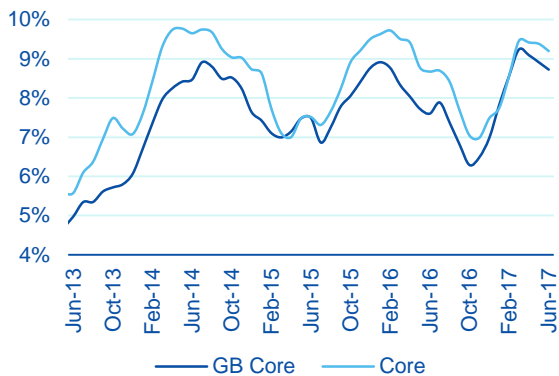


Source: Garanti Research Inflation Model & Turkstat

## The fall will persist in July, but the headline will remain at double digits until December's fall

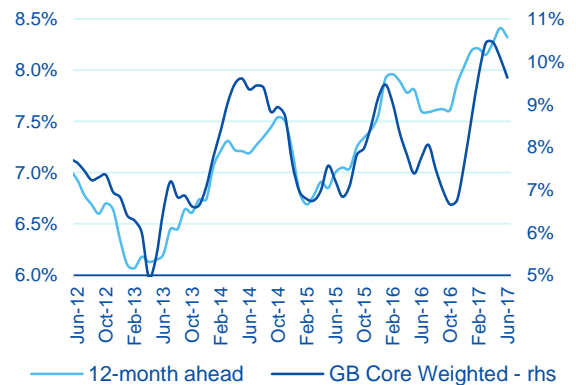
As almost the entire improvement in core inflation was due to the fall in auto prices in June and services prices continued to rise on second round effects, core inflation will stay high in the coming months. After still falling in July, the headline will likely remain at double digits until November, requiring the CBRT to stay tight, and will sharply fall to 9% in December with the help of Government's decision not to hike taxes on tobacco in 2017.

**Figure 1 Core Inflation (YoY)**



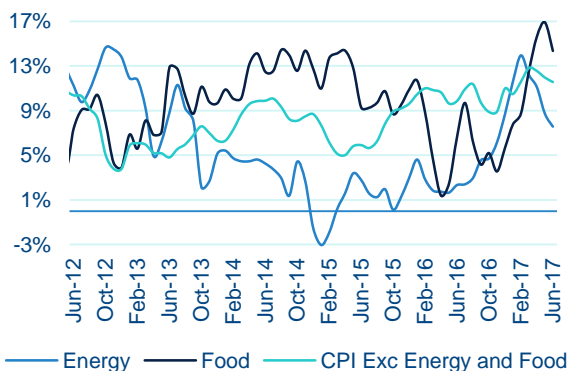
Source: Garanti Research Inflation Model & Turkstat

**Figure 2 Inflation Exp. and GB-Core (YoY)**



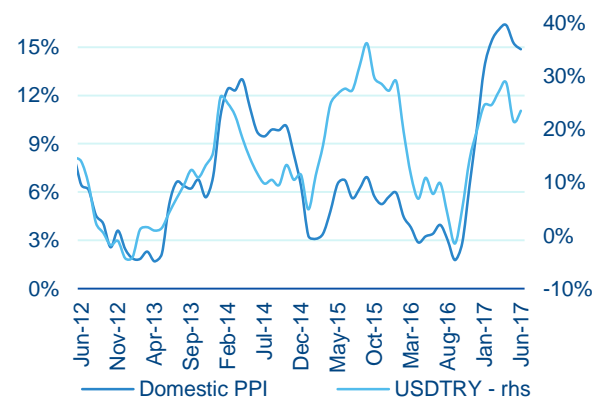
Source: Garanti Research Inflation Model & Turkstat

**Figure 1 Food and Energy Inflation (YoY)**



Source: Garanti Research & Turkstat

**Figure 2 Domestic PPI and USDTRY (YoY)**



Source: Garanti Research, CBT & Turkstat

**Figure 1 CPI in Subcomponents**

CPI	MoM	YoY
<b>Total</b>	<b>-0.3%</b>	<b>10.9%</b>
Food	-1.1%	14.3%
Beverage & Tobacco	0.0%	21.7%
Clothing & Textile	-1.2%	3.2%
Housing	0.3%	7.4%
Household Equipment	0.5%	6.8%
Health	0.2%	12.7%
Transportation	-0.8%	14.1%
Communication	-0.4%	3.1%
Recr. & Culture	-0.1%	10.9%
Education	1.0%	9.6%
Rest. & Hotels	1.0%	10.3%
Misc. Goods & Services	0.5%	11.8%

Source: Garanti Research & Turkstat

**Figure 2 Domestic PPI in Subcomponents**

Domestic PPI	MoM	YoY
<b>Total</b>	<b>0.1%</b>	<b>14.9%</b>
<b>Mining &amp; Quarrying</b>	<b>-1.3%</b>	<b>9.7%</b>
<b>Manufacturing</b>	<b>0.1%</b>	<b>16.5%</b>
Food Products	0.5%	9.7%
Textiles	0.8%	22.1%
Wearing Apparel	-0.6%	9.0%
Coke & Petroleum Products	-4.1%	26.9%
Chemicals	-0.5%	20.4%
Other Non-Metallic Mineral	0.0%	7.0%
Basic Metals	-0.4%	34.2%
Metal Products	-0.4%	17.0%
Electrical Equipment	0.7%	16.1%
<b>Electricity, Gas, Steam</b>	<b>0.9%</b>	<b>-1.5%</b>

Source: Garanti Research Inflation Model & Turkstat

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