

# Inflation: Outlook worsens on core dynamics

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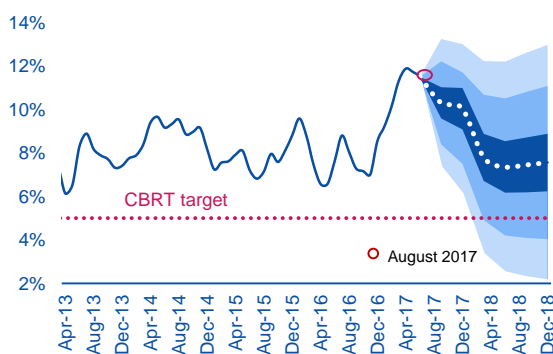
5 September 2017

In August, consumer prices rose by 0.52%, remarkably higher than the consensus (0.1%) and even our estimate (0.3%). Annual consumer inflation jumped up to double digits (10.7% from 9.8% in July) as expected but now posing extra upward risk for the year-end figure. The negative surprise is coming from the core inflation as it increased to 10.2% (vs. our expectation of 9.9%) while food inflation proved to be lower than its seasonal average. Exchange rate pass-through mostly on the recent appreciation of Euro, second round price effects on especially services prices and spill-overs from the narrowing output gap continued to be the factors behind. Elsewhere, domestic producer prices (PPI) inflation picked up to 16.3% from 15.5%, implying ongoing upward pressure from cost push factors on consumer prices. Looking ahead, we expect core inflation to ease below 10% only starting from December and the headline to touch 11% in September and stay close to those levels till December before it would sizably fall to 9-9.5% at the end of the year.

## New round of pass-through on core prices

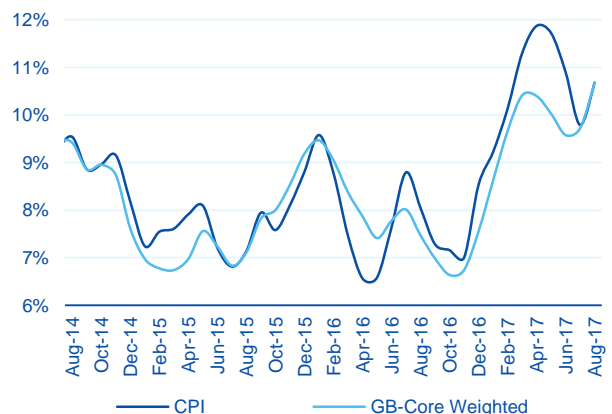
As we highlighted in our previous publications, core inflation outlook continued to deteriorate in August (1.0pp jump only in 2 months). Recent appreciation of Euro prevents the likely relief from the slowing yearly depreciation of TL against US dollar. Clothing, furniture and automobile prices reflect this pass-through, as only these could mostly explain the hike in core inflation. Second round price effects on services prices on top of cost push factors also imply upward pressure together with narrowing output gap. Apart from these, as the methodological change of this year will give extra push on the core in the two months ahead, we expect the core to stay close to 10.5% in the next 3 months and then ease marginally below 10% in December. Food inflation will also be the other increasing factor as annual food inflation rose to 11.8% in August from 9.9% and the base effects will be on the pushing side till December. Besides, energy inflation also picked up on fuel prices, contributing to the annual headline by 0.3pp on the upside.

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



Source: Garanti Research & Turkstat

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

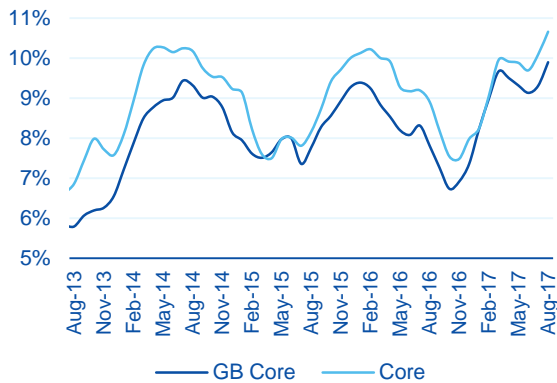


Source: Garanti Research Inflation Model & Turkstat

## Upside risks for the year-end and implying more inertia for the next year

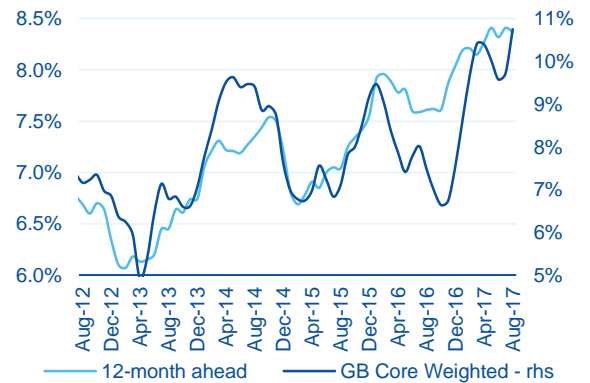
This year's methodological change assigning fixed weights and second round price effects on cost push factors will keep core inflation close to 10.5% till December before easing only marginally below 10% in December and converging to 8-8.5% towards the end of 1Q18. We maintain our year-end headline inflation estimate at 9%, with clearly upside risks from core inflation outlook, which would require the CBRT to stay tight a little longer, in our view.

**Figure 1** BBVA-GB and CBRT Core Inflation (YoY)



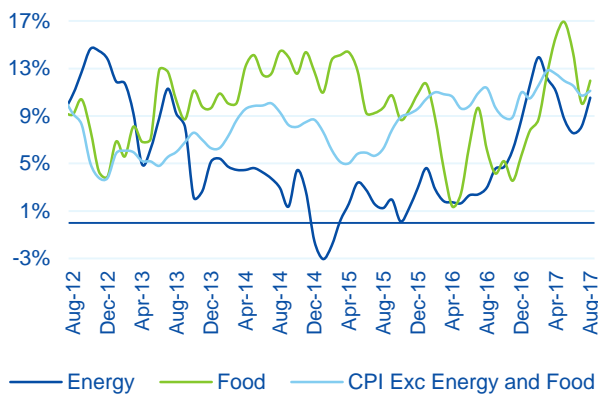
Source: Garanti Research Inflation Model & Turkstat

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



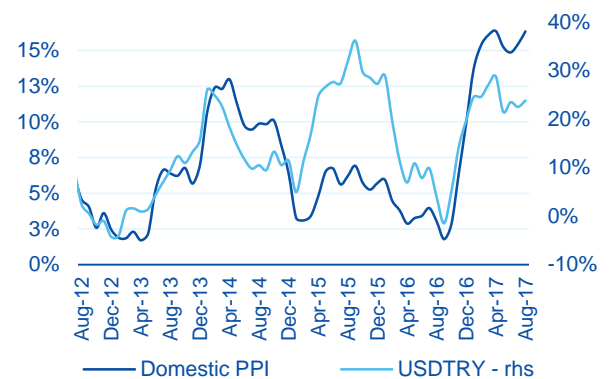
Source: Garanti Research Inflation Model & Turkstat

**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>0.5%</b>	<b>10.7%</b>
Food		-0.2%	12.0%
Beverage & Tobacco		0.0%	10.4%
Clothing & Textile		-3.1%	5.7%
Housing		0.7%	7.8%
Household Equipment		1.7%	8.7%
Health		0.2%	11.7%
Transportation		2.1%	17.4%
Communication		0.1%	1.8%
Recr. & Culture		0.3%	11.2%
Education		2.8%	10.3%
Rest. & Hotels		1.0%	11.1%
Misc. Goods & Services		0.7%	10.9%

Source: Garanti Research & Turkstat

**Figure 2** Domestic PPI in Subcomponents

	Domestic PPI	MoM	YoY
<b>Total</b>		<b>0.8%</b>	<b>16.3%</b>
Mining & Quarrying		0.9%	11.4%
Manufacturing		0.9%	17.9%
Food Products		-0.2%	9.9%
Textiles		-0.2%	19.8%
Wearing Apparel		0.1%	7.4%
Coke & Petroleum Produ		5.3%	43.5%
Chemicals		-0.1%	21.2%
Other Non-Metallic Mine		0.2%	8.1%
Basic Metals		4.0%	42.5%
Metal Products		0.9%	18.8%
Electrical Equipment		1.3%	18.1%
Electricity, Gas, Steam		0.8%	0.1%

Source: Garanti Research Inflation Model & Turkstat

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