

Inflation: Another surprise from core inflation

Seda Guler / Gizem Onen / Asuman Kemiksiz

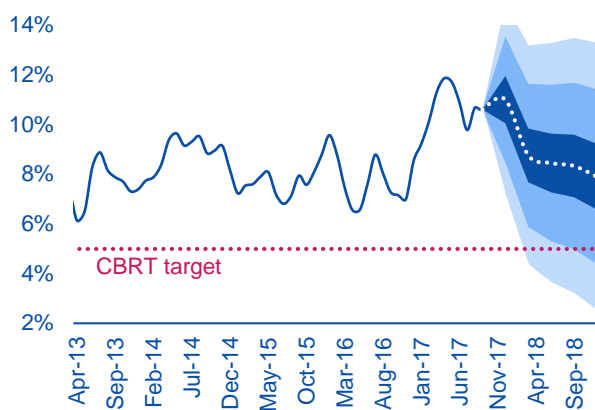
3 October 2017

Consumer prices increased by 0.65% (mom) in September, in line with consensus but slightly lower than ours (0.8%). Annual consumer inflation, hence, rose to 11.2% from August's 10.7%. Core inflation was the negative surprise, reaching 11% higher than both our and market's expectation of 10.6%. Negative food inflation in contrast to its seasonal average avoided the headline to climb up further although its yearly figure still rose on top of base impact. This year's methodological change assigning fixed weights and second round price effects on cost push factors created a sharper pressure on core prices together with the recent appreciation of Euro and spillovers from narrowing output gap. Besides, domestic producer prices (D-PPI) continues its high path, maintaining the annual figure at 16.3%. We expect the headline to converge to 11.5% in October and even higher in November before it falls towards 10% at the end of 2017 with favorable base effects.

Core inflation surprised stemming mainly from clothing

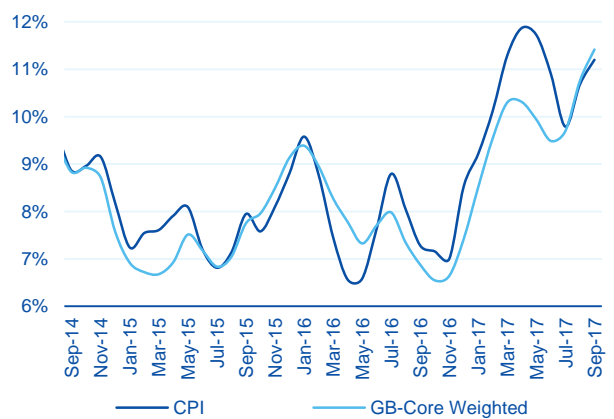
The main reason on the deterioration in inflation outlook was the core inflation in September as the annual figure jumped up by 80bps to %11. Clothing group was the leading factor behind the higher than expected core inflation as its annual inflation surged to %10.4 from 5.7%, contributing 30bps to the headline on its own. Besides, the worsening across the other core items in general continued to reflect second round price effects on cost push factors and upward pressures from narrowing output gap. We expect the core to stay at 11-11.5% in the next 2 months and then start to ease only marginally in December. Food inflation which picked the annual headline figure only limitedly in September will be the other pushing factor till December as the base effects will be on the increasing side. Energy inflation only helped the headline in September, contributing to the annual headline inflation by 0.1pp on the downside.

Figure 1 Inflation Forecasts (Quarterly Avg, YoY)



Source: Garanti Research & Turkstat

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

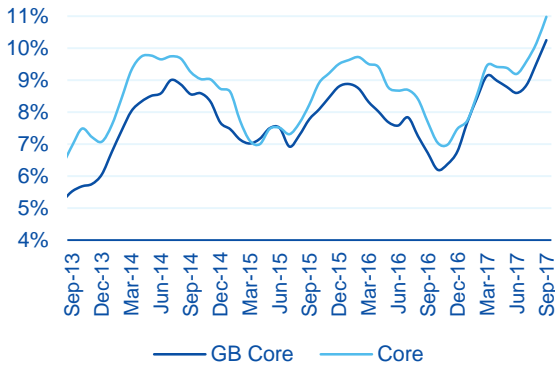


Source: Garanti Research Inflation Model & Turkstat

Worsening core dynamics imply more inertia for the next year

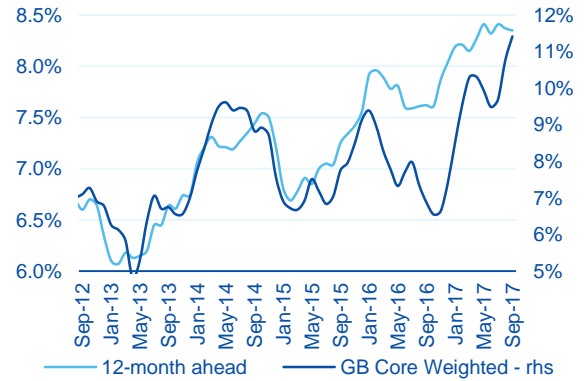
Core inflation may further increase after today's data of the highest realization since February 2004 before starting to ease only marginally in December. Second round price effects on cost push factors and the high momentum in economic activity may keep core inflation close to 9.5% at the end of 1Q18, which would require the CBRT to stay tight for longer. We are in the process of updating our 2017 year-end estimate of 9% by around 1pp and evaluate the risks on our 2018 year-end estimate of around 8% as balanced, considering the Government's efforts on food inflation and tax measures not to create extra inflationary pressures next year.

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



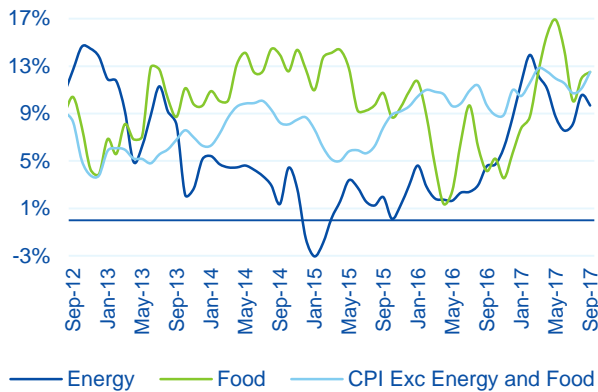
Source: Garanti Research Inflation Model & Turkstat

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



Source: Garanti Research Inflation Model & Turkstat

Figure 1 Food and Energy Inflation (YoY)



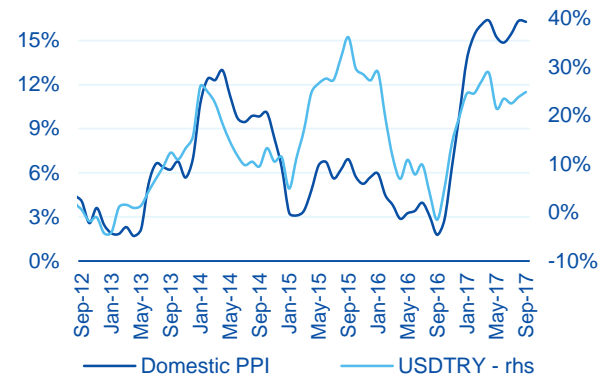
Source: Garanti Research & Turkstat

Figure 1 CPI in Subcomponents

CPI	MoM	YoY
Total	0.7%	11.2%
Food	-0.2%	12.5%
Beverage & Tobacco	0.0%	10.4%
Clothing & Textile	0.8%	10.4%
Housing	0.8%	8.1%
Household Equipment	0.4%	9.1%
Health	0.4%	11.9%
Transportation	1.6%	16.1%
Communication	0.3%	1.8%
Recr. & Culture	0.2%	11.8%
Education	2.1%	10.4%
Rest. & Hotels	1.0%	11.5%
Misc. Goods & Services	1.3%	12.1%

Source: Garanti Research & Turkstat

Figure 2 Domestic PPI and USDTRY (YoY)



Source: Garanti Research, CBT & Turkstat

Figure 2 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	0.2%	16.3%
Mining & Quarrying	0.7%	11.9%
Manufacturing	0.3%	18.0%
Food Products	-1.8%	7.5%
Textiles	0.1%	19.8%
Wearing Apparel	1.1%	7.8%
Coke & Petroleum Produ	3.9%	41.8%
Chemicals	0.5%	21.7%
Other Non-Metallic Mine	0.5%	8.8%
Basic Metals	3.1%	48.4%
Metal Products	0.3%	19.1%
Electrical Equipment	1.1%	19.4%
Electricity, Gas, Steam	-1.6%	-1.7%

Source: Garanti Research Inflation Model & Turkstat

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.