

Inflation: Further Worsening over Core Prices

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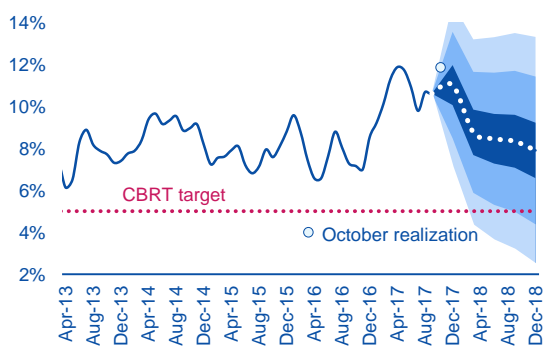
3 November 2017

Consumer prices increased by 2.08% (mom) in October, higher than the consensus (1.7%) and our forecast (1.9%). Annual consumer inflation jumped up to 11.9% from 11.2% on still worsening core inflation and the renewed pick-up in energy prices. Annual core inflation rose to 11.8% by 0.8pp in line with our expectation, but food inflation has beaten our estimate on higher processed food prices. The end of tax incentives on durables, exchange rate pass-through (particularly euro), methodological change, cost push factors and high momentum in economic activity were the reasons behind the worsening in core prices. We expect the headline to breach 12% in November before falling below 11% at the end of this year with favorable base effects. Recent depreciation pressures on lira and upward trend in commodity prices pose upside risks on our already high 10% inflation forecast for end-2017 and 2018 inflation expectations. We maintain our view of a tight monetary policy for longer period (when inflation starts a disinflationary path as of December) but also think that further measures could be needed to contain inflation pressures if those upside risks persist.

Core inflation outlook pose upside risks

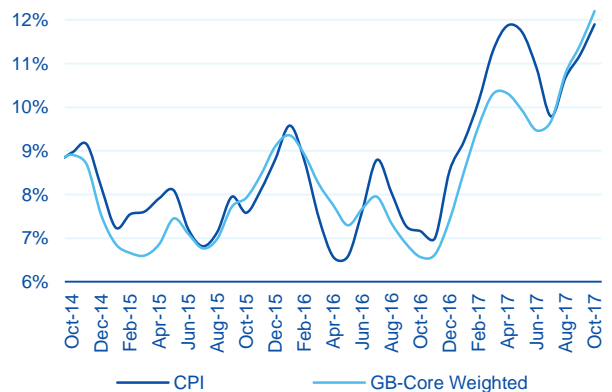
The main reason on the deterioration in inflation outlook continued to be the core inflation in October. Furniture prices were the leading factor as tax incentives came to an end as of September, while automobile prices followed it on the recent appreciation of Euro. Clothing group also pushed on the upside, reflecting this year's methodological change assigning fixed weights. Apart from these, services prices remained sticky on second round price effects over cost push factors and upward pressures from the narrowing output gap. We expect the core to end the year close to 12% and fall towards 10% by end 1Q18. Food inflation which picked the annual headline figure only limitedly in October will help the headline fall in December thanks to the base effects. Energy inflation, however, can imply upward risks over both the depreciation of TL and higher oil prices as its annual figure already reached 10.6% in October.

Figure 1 Inflation Forecasts (Quarterly Avg, YoY)



Source: Garanti Research & Turkstat

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

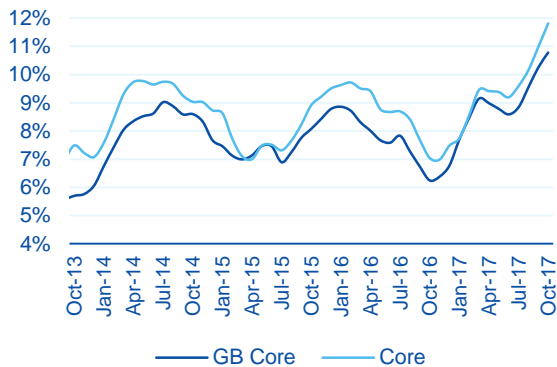


Source: Garanti Research Inflation Model & Turkstat

Worsened outlook may require even more tighter stance from the CBRT

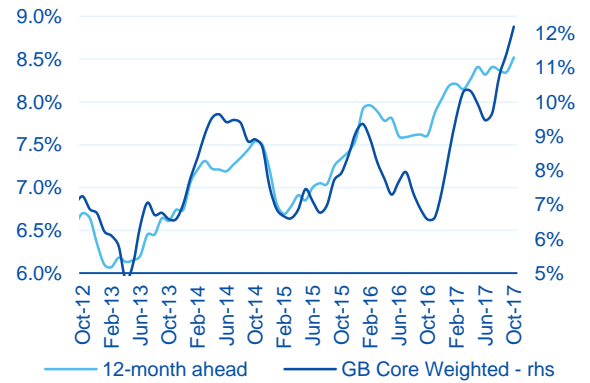
Core inflation may further increase after today's data before starting to ease in December as strong domestic demand thanks to the Credit Guarantee Fund (CGF) and exchange rate pass-through continue to kick in. Core inflation will remain near 10% at the end of 1Q18 which will require the CBRT to remain alert and further tightening cannot be ruled out if this situation persists. We maintain our 2018 year-end estimate of 7.8%, bearing in mind that tight monetary policy for longer period and structural measures to contain food inflation could provide support in the medium term.

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



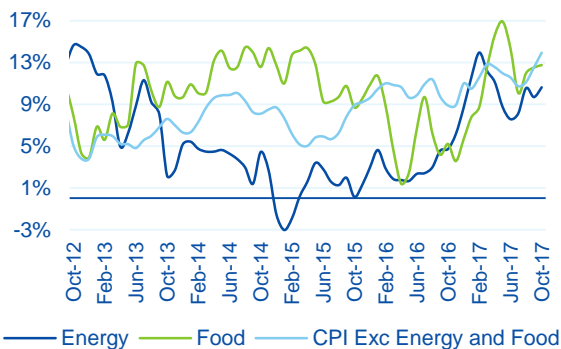
Source: Garanti Research Inflation Model & Turkstat

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



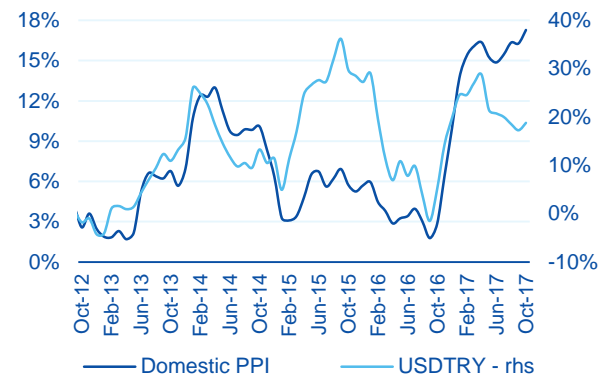
Source: Garanti Research Inflation Model & Turkstat

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
Total	2.1%	11.9%
Food	2.0%	12.7%
Beverage & Tobacco	0.0%	10.4%
Clothing & Textile	11.5%	11.4%
Housing	0.9%	9.4%
Household Equipment	3.0%	11.6%
Health	0.5%	12.2%
Transportation	2.6%	16.8%
Communication	0.0%	1.8%
Recr. & Culture	-1.7%	11.0%
Education	0.4%	10.5%
Rest. & Hotels	0.7%	11.5%
Misc. Goods & Services	0.9%	12.6%

Source: Garanti Research & Turkstat

Figure 2 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	1.7%	17.3%
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	2.2%	20.2%
Electrical Equipment	1.1%	19.4%
Electricity, Gas, Steam	-1.6%	-1.7%

Source: Garanti Research Inflation Model & Turkstat

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