

Turkey: Inflation path deteriorates further

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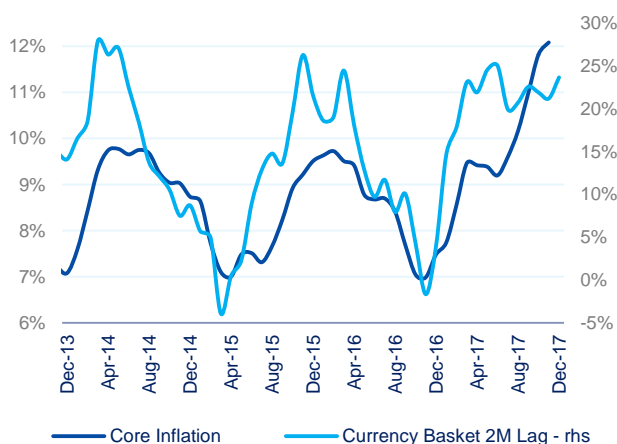
4 December 2017

Consumer prices increased by 1.49% (mom) in November, higher than median market expectation (1.2%) but fully in line with BBVA-GB forecast (1.5%). Annual consumer inflation hit 13% mostly due to the sizable pick-up in food inflation and also the jump in both energy and core prices. Annual core inflation rose to 12.1% from previous 11.8%, reflecting the exchange rate pass-through (particularly euro), second round price effects and excess demand. Today's release poses risks on the headline inflation to end the year near 11.5% (vs. our official forecast of 10%) despite the favorable base effects on food prices expected for December. Both recent depreciation of Turkish lira and upward trend in energy prices create upside risks on our current 2018 inflation forecast (7.8%) by near 1pp. Also, recent events and rigidity in core prices signal that the range of the CBRT's expected medium term disinflation path may not to be materialized, thus, monetary policy should be adjusted accordingly.

Exchange rate pass-thru and cost-push factors result in further rigidity

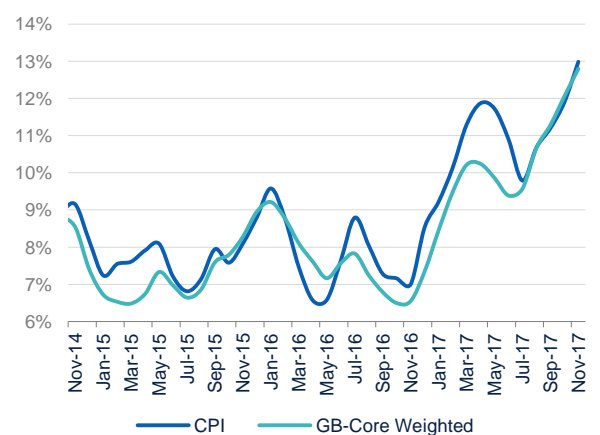
The main reason on November's jump was the food inflation, whose yearly figure rose to 15.8% from 12.5%. Bad weather conditions and transition towards greenhouse production could be the factors behind. On the other hand, core inflation (12.1% YoY) continued to be under pressure as demand conditions remain strong. In details, both the depreciation of TL (especially against euro) led automobile and furniture prices to increase and cost-push factors remained to be the impulsive force as domestic producer prices annual inflation rose to 17.3% and its yearly average reached 15.4%. We expect the core to end the year above 12% and fall slightly below 11% at best by end 1Q18. Energy inflation, can also imply upward risks over both the depreciation of TL and higher oil prices as its annual figure already reached 12.2% in November.

Figure 1 Core Inflation and Currency basket



Source: Garanti Research & Turkstat

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

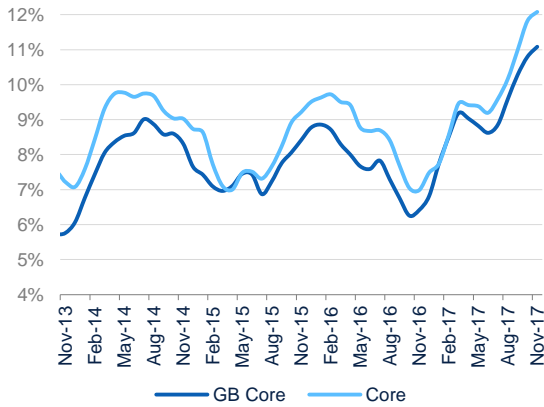


Source: Garanti Research Inflation Model & Turkstat

Deteriorated path for inflation requires the CBRT to tighten monetary policy further

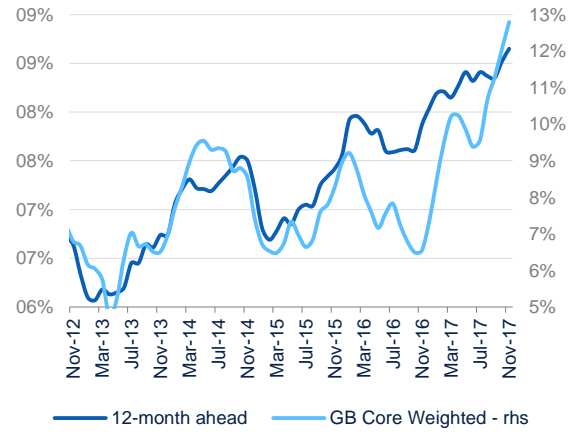
The recent depreciation of the exchange rate, higher energy prices in international markets and strong internal demand conditions (which keep core inflation high) pose serious risks for the CBRT medium term disinflation range not to be fulfilled. We believe that monetary policy should be adjusted accordingly in order to revert the inflation path to the original expected range of the CBRT and also contain further exchange rate pressures.

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



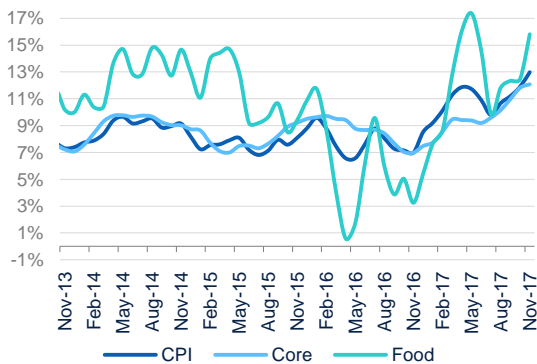
Source: Garanti Research Inflation Model & Turkstat

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



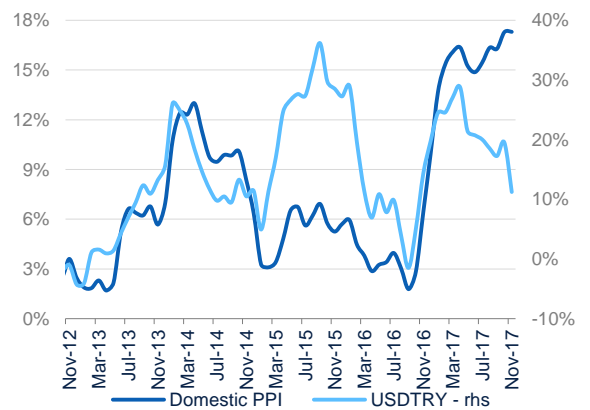
Source: Garanti Research Inflation Model & Turkstat

Figure 1 Food and Energy Inflation (YoY)



Source: Garanti Research & Turkstat

Figure 2 Domestic PPI and USDTRY (YoY)



Source: Garanti Research, CBRT & Turkstat

Figure 1 CPI in Subcomponents

CPI	MoM	YoY
Total	1.5%	13.0%
Food	2.1%	15.8%
Beverage & Tobacco	0.0%	10.4%
Clothing & Textile	3.8%	11.3%
Housing	1.2%	9.8%
Household Equipment	0.9%	12.8%
Health	0.2%	12.4%
Transportation	2.0%	18.6%
Communication	0.2%	1.4%
Recr. & Culture	0.2%	9.9%
Education	0.1%	10.5%
Rest. & Hotels	0.5%	11.4%
Misc. Goods & Services	1.8%	13.4%

Source: Garanti Research & Turkstat

Figure 2 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	2.0%	17.3%
Mining & Quarrying	2.7%	13.7%
Manufacturing	2.4%	18.9%
Food Products	0.1%	6.6%
Textiles	2.5%	21.5%
Wearing Apparel	0.2%	9.4%
Coke & Petroleum Products	11.7%	53.9%
Chemicals	3.7%	23.3%
Other Non-Metallic Mineral	1.4%	11.2%
Basic Metals	4.7%	42.9%
Metal Products	4.1%	21.7%
Electrical Equipment	3.6%	20.1%
Electricity, Gas, Steam	-3.7%	0.1%

Source: Garanti Research Inflation Model & Turkstat

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