

Turkey: Inflation fell on base effects as expected

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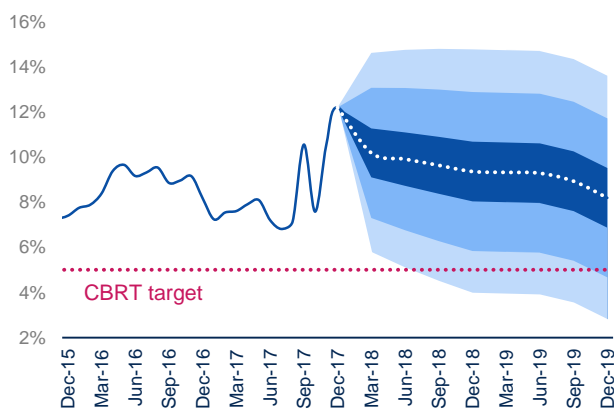
5 February 2018

Consumer prices increased by 1.02% (mom) in January, higher than our forecast (0.75%) but lower than the market call (1.3%). The reason behind our deviation was fresh food and vegetable prices that we observed almost no monthly change. Annual consumer inflation fell to 10.35% from 11.92% thanks to favorable base effects mostly on food. Core prices prove to be sticky as annual core inflation only limitedly declined to 12.18% from 12.30% as exchange rate pass-thru and solid domestic demand continue to kick-in. Looking ahead, lagged effects of currency depreciation, robust economic activity and cost-push factors will likely keep core inflation high, possibly above 11% in the first half of the year and at two-digits until the last quarter of the year. We expect the headline to ease towards slightly below 10% by the end of 1Q but then show some volatility during summer months before falling to around 9% on base effects at the end of the year.

Stickiness on core inflation outlook

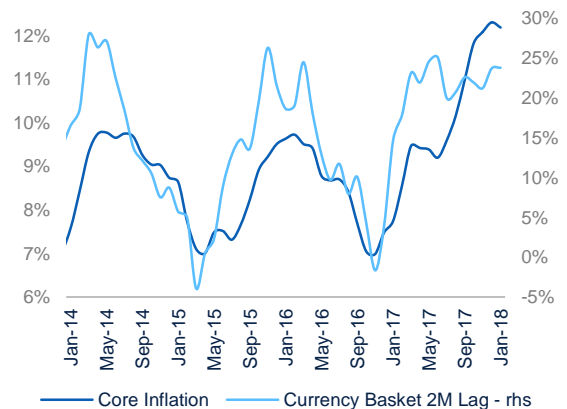
Thanks to base effects mostly on food, annual headline inflation fell by 1.6 pp to %10.35 in January from 11.92% in December, 2017. Food prices lifted up by 1.7% (mom) in Jan18, far below its seasonal average (3.3% in the last 10 years) and the previous year's realization (6.8%), resulting in a decline of 1.2pp on the annual headline. Following the food, energy prices also implied a fall by 0.2pp on lower increases in fuel prices compared to last year. Besides, the exclusion of a similar tax hike on tobacco in this period and the base impact on gold prices helped a total of 0.2pp decline. On the other hand, core inflation slightly receded to %12.2 in January from 12.3% the month before. Ongoing solid domestic demand and lagged effects of exchange rate depreciation limit a sizable recovery in core inflation. Similarly, despite the easing domestic producer prices inflation to 12.1% from 15.5%, cost-push factors from still high levels keep upward pressures alive on consumer inflation.

Figure 1 BBVA-GB Inflation Expectations (3M, YoY)



Source: Garanti Research & Turkstat

Figure 2 Core Inflation and Currency basket

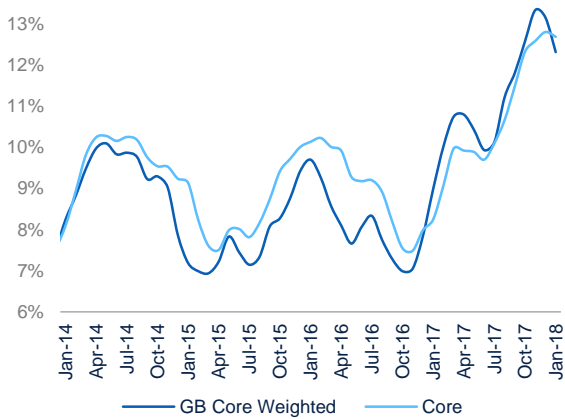


Source: Garanti Research Inflation Model & Turkstat

Despite the easing on base effects, still high inflation levels will require the CBRT to stay tight

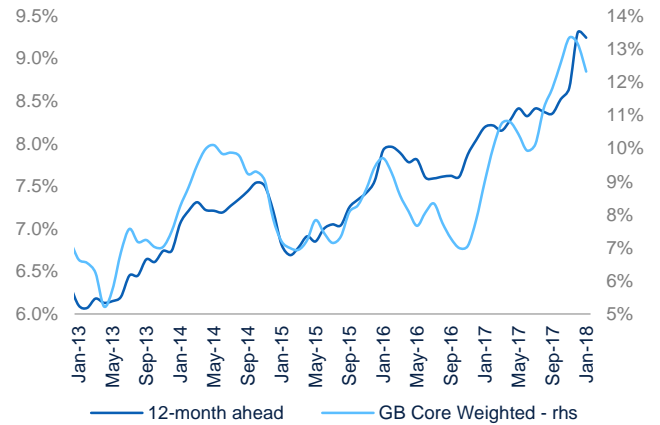
Base effects will likely help until June; though the Central Bank (CBRT) will maintain the tight stance until inflation outlook proves to contain inflation expectations, independent of base effects and temporary factors. Lagged effects of exchange rate depreciation, rises in wages above inflation, increasing energy prices, cost-push factors from high producer prices inflation, sticky inflation expectations and strong economic activity will likely keep the risks on inflation on the upside, requiring the Central Bank (CBRT) to stay tight throughout the year.

Figure 3 BBVA-GB and CBRT Core Inflation (YoY)



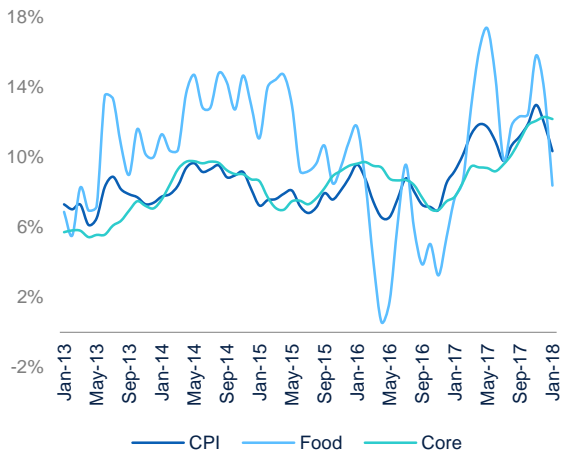
Source: Garanti Research Inflation Model & Turkstat

Figure 4 Inflation Exp. and GB-Core Inflation (YoY)



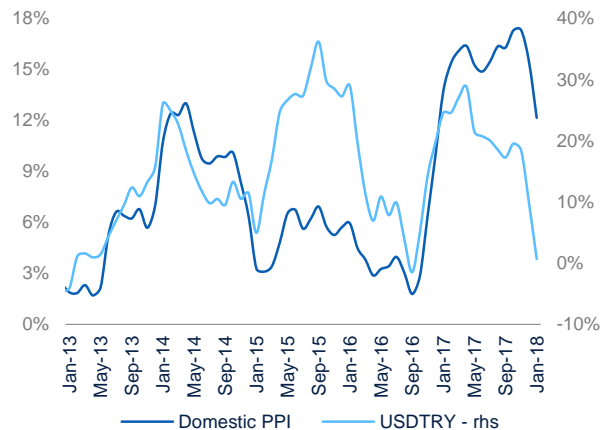
Source: Garanti Research Inflation Model & Turkstat

Figure 5 CPI and Components (YoY)



Source: Garanti Research & Turkstat

Figure 6 Domestic PPI and USDTRY (YoY)



Source: Garanti Research, CBT & Turkstat

Figure 7 CPI in Subcomponents

CPI	MoM	YoY
Total	1.0%	10.3%
Food	1.7%	8.8%
Beverage & Tobacco	0.4%	0.9%
Clothing & Textile	-6.0%	12.6%
Housing	2.3%	10.2%
Household Equipment	2.4%	13.5%
Health	2.4%	9.5%
Transportation	1.3%	16.0%
Communication	-1.0%	0.3%
Recr. & Culture	1.3%	7.2%
Education	0.2%	10.7%
Rest. & Hotels	1.0%	11.4%
Misc. Goods & Services	3.0%	11.4%

Source: Garanti Research & Turkstat

Figure 8 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	1.0%	12.1%
Mining & Quarrying	4.4%	13.7%
Manufacturing	1.6%	14.1%
Food Products	0.8%	3.8%
Textiles	0.9%	13.7%
Wearing Apparel	-0.9%	5.1%
Coke & Petroleum Products	3.0%	21.9%
Chemicals	1.9%	17.4%
Other Non-Metallic Mineral	3.6%	14.8%
Basic Metals	1.3%	27.9%
Metal Products	2.7%	16.5%
Electrical Equipment	0.6%	14.4%
Electricity, Gas, Steam	-8.9%	-12.1%

Source: Garanti Research Inflation Model & Turkstat

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