

# Turkey: Slightly higher than expected inflation

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Consumer prices increased by 0.73% (mom) in February, higher than both our and market expectation (0.6% and 0.5%, respectively). Base effects were supportive again, but this time the overall impact helped annual consumer inflation to fall to only 10.26% from 10.35%. The limiting factor on the decline was food inflation but the ongoing pass-thru on core prices also supported the stickiness as annual core inflation moderated to only 11.9% (40bps decline in two months). Looking ahead, although the likelihood of one-digit realization in March is now lower, the headline may oscillate between 9.5-10% till June and deteriorate further during summer months above 10% before falling to around 9% on base effects at the end of the year.

## Recovery in core inflation was moderate

The expected decline on base effects was contained by food prices, which lifted up by 2.24% mom higher than its seasonal average (1.3% in the last 7 years). Thus, annual food inflation increased to 9.9% from 8.4% in January. On the other hand, the recovery in core inflation stayed moderate, as it retreated to %11.9 from 12.2% the month before since exchange rate pass-through on clothing, furniture, household equipment, transportation and health is still high and containing the favorable base impact. Ongoing solid domestic demand, lagged effects of exchange rate depreciation and second round price effects on especially services prices limit a sizable recovery in core inflation. Core inflation may stay above to 11% in the first half of the year, before falling below 10% in the last quarter, given our current exchange rate expectations. Energy inflation was also supportive on the decline of the headline in February, as its annual inflation fell to 6.9% from 9.2%. However, the pick-up in domestic producer prices inflation to 13.7% from 12.1% on increasing costs of the electricity producers will keep upward pressures on consumer inflation.

Figure 1 Core Inflation Heat Map (YoY)

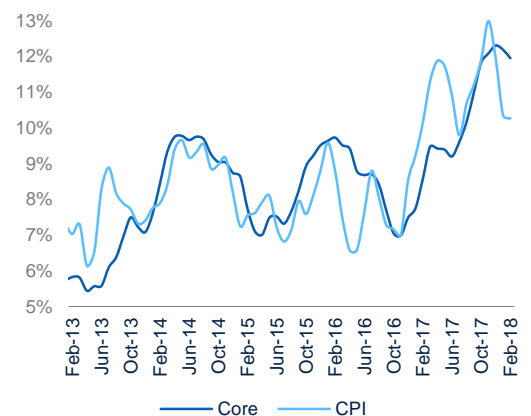
	Avg*	2017					2018		
		Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Clothing&Footwear	5.2	3.9	5.7	10.4	11.4	11.3	11.5	12.6	11.8
Housing	10.0	9.7	9.7	10.1	10.5	10.7	10.5	10.7	11.8
Furnish.&Household Equip.	6.6	7.2	8.7	9.1	11.7	12.9	12.7	13.5	15.7
Health	4.8	11.9	11.7	11.9	12.2	12.4	11.9	9.5	9.9
Transportation	8.8	15.7	16.1	16.1	17.9	18.6	20.2	20.4	17.7
Communication	2.1	1.8	1.8	1.8	1.8	1.4	1.4	0.3	-0.1
Recreation&Culture	6.6	11.2	11.2	11.9	11.0	9.9	8.4	7.2	8.2
Education	8.4	10.1	10.3	10.4	10.5	10.5	10.5	10.7	10.9
Hotels&Restaurants	6.6	7.2	11.1	11.5	11.5	11.4	11.5	11.4	11.5
Others	7.6	10.1	10.2	10.6	10.1	10.5	10.2	11.1	10.8
Core (C Index)	7.3	9.6	10.2	11.0	11.8	12.1	12.3	12.2	11.9
Non-Core	9.8	10.0	11.4	11.5	12.0	14.2	11.4	7.9	8.0

\* Avg: YoY avg from 2004. Color ranges differ by 1 std deviation around avg.

Clearly Lower    Lower    Higher    Clearly Higher

Source: Garanti Research & Turkstat

Figure 2 Core Inflation and CPI

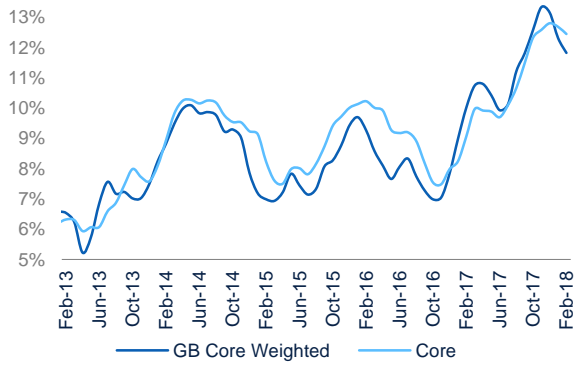


Source: Garanti Research & Turkstat

## Core inflation outlook remains worrying, which will require the CBRT to stay tight

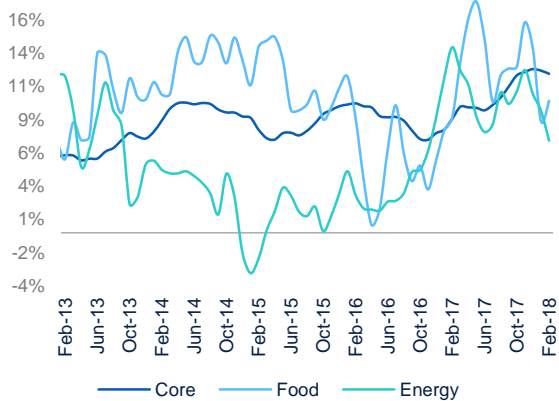
February inflation release was not positive, though we maintain our year-end estimate at 9% on better than expected exchange rate levels against US dollar so far, which may serve as a compensating factor against the additional pass-thru from euro sensitive items in the basket and likely higher demand on top of recent policy stimulus measures. In our view, the Central Bank (CBRT) should maintain the tight stance until inflation outlook proves to contain inflation expectations.

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



Source: Garanti Research Inflation Model & Turkstat

**Figure 5** CPI Components (YoY)



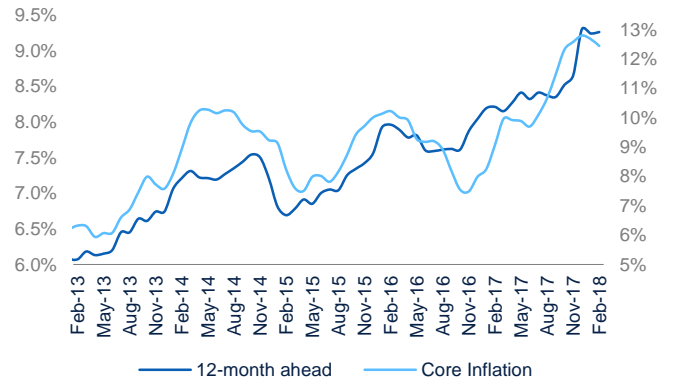
Source: Garanti Research & Turkstat

**Figure 7** CPI in Subcomponents

CPI	MoM	YoY
<b>Total</b>	<b>0.7%</b>	<b>10.3%</b>
Food	2.2%	10.3%
Beverage & Tobacco	0.0%	0.9%
Clothing & Textile	-4.1%	11.8%
Housing	0.5%	9.5%
Household Equipment	1.2%	15.7%
Health	2.6%	9.9%
Transportation	0.3%	13.2%
Communication	0.2%	-0.1%
Recr. & Culture	1.9%	8.2%
Education	0.2%	10.9%
Rest. & Hotels	1.0%	11.5%
Misc. Goods & Services	0.8%	10.8%

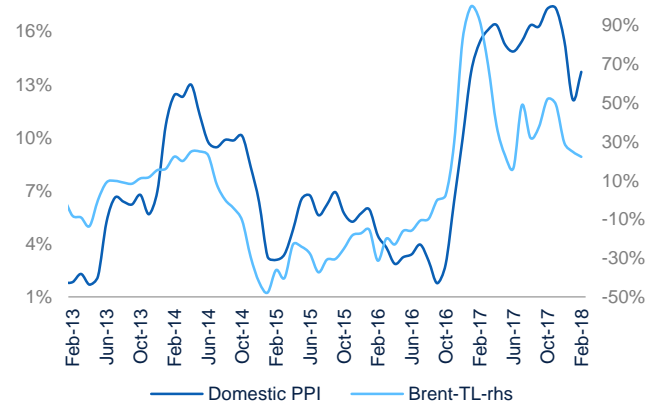
Source: Garanti Research & Turkstat

**Figure 4** Inflation Exp. and CBRT Core Inflation (YoY)



Source: CBRT & Turkstat

**Figure 6** Domestic PPI and Oil Prices in TL (YoY)



Source: Garanti Research, CBT & Turkstat

**Figure 8** Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
<b>Total</b>	<b>2.7%</b>	<b>13.7%</b>
Mining & Quarrying	1.8%	13.1%
Manufacturing	1.5%	14.3%
Food Products	1.7%	4.6%
Textiles	1.5%	13.8%
Wearing Apparel	0.5%	5.0%
Coke & Petroleum Products	-1.1%	20.3%
Chemicals	1.5%	15.5%
Other Non-Metallic Mineral	1.6%	14.9%
Basic Metals	1.5%	28.6%
Metal Products	1.4%	16.8%
Electrical Equipment	1.1%	15.2%
Electricity, Gas, Steam	21.1%	7.1%

Source: Garanti Research Inflation Model & Turkstat

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