

Turkey: High core prices pose additional risks

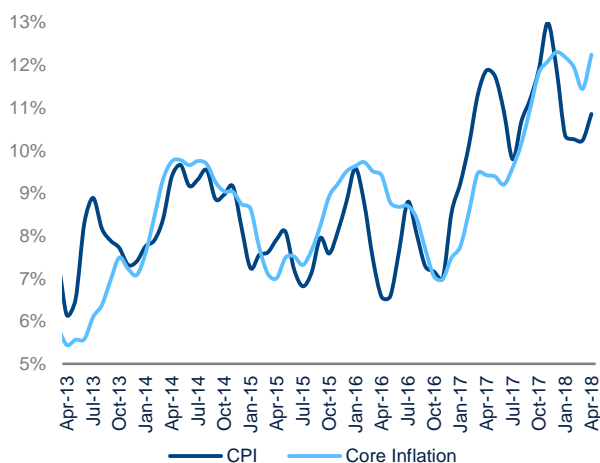
Adem Ileri / Alvaro Ortiz/ Seda Guler Mert / Serkan Kocabas

Consumer prices increased 1.87% (mom) in April, even higher than our above consensus estimate (BBVA Research 1.7% vs. Consensus 1.5%). Annual consumer inflation jumped to 10.85% from 10.23% with a more rapid pick-up in core prices than our expectation. The recent exchange rate pass-thru reinforces the already elevated inflation problem that needs a tighter and more comprehensive policy reaction. High inertia (backward and forward looking), still positive output gap and supply side shocks are now pushing inflation to the edge of limits. Beyond this, worsening core inflation (which will continue its increasing trend in the next months, leading the headline to breach 12% during summer) and producer prices complete a non-promising outlook for inflation. We maintain our year-end inflation estimate at 10.5% and believe that a more coordinated policy mix (Monetary & Fiscal), a necessary condition to bring inflation back to a sustainable path, is urgent to tackle two-digits inflation problem.

A broad based problem

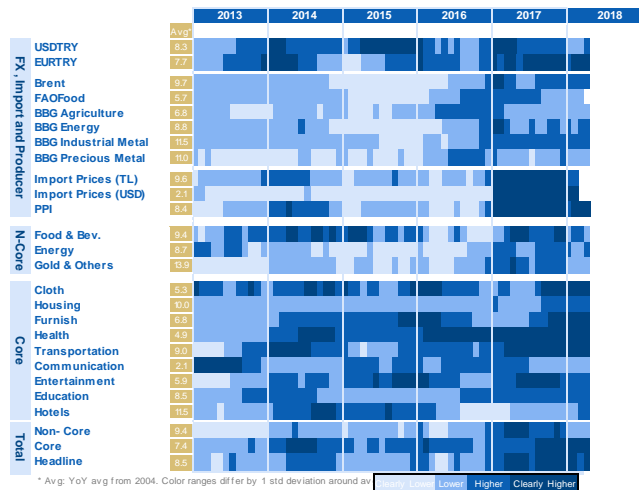
Annual consumer inflation increased on exchange rate pass thru, higher energy prices (including the price hike in electricity) and cost push factors from rising producer prices. Beyond this, accelerating core inflation signals a more complex problem including second round effects of currency depreciation (automobile and furniture prices, increased by 4.6% and 4.2% mom) and higher import prices, which now implies more rapid price adjustments than expected. Still solid domestic demand is also strengthening the pass-thru and cumulating second round price effects (services inflation remains above 9%). Thus, annual core inflation picked up from 11.4% to 12.2% in April, which reflects both backward and forward looking inertia. We expect core inflation to rise in the short term before falling below 11% in the last months of the year at best on favorable base effects and expected cool-down in activity. Recent shocks also keep the pressures upward on producer prices as its annual inflation reached 16.4%, up from 14.3%. Oil price, exchange rate depreciation and loose policies pose upside risks to our year end forecast.

Chart 1 Core Inflation and CPI



Source: BBVA Research Turkey & Turkstat

Chart 2 Core Inflation Heat Map

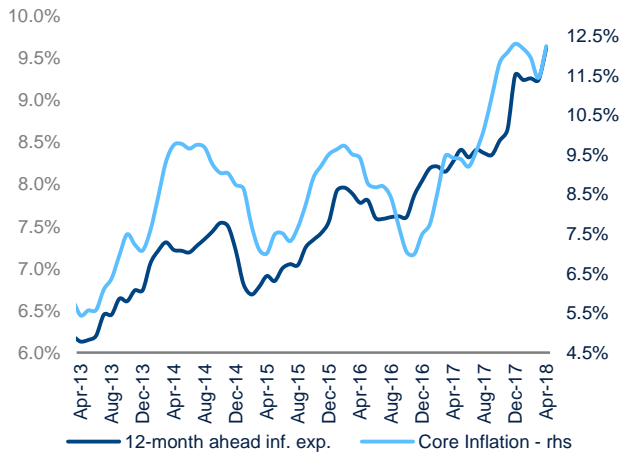


Source: BBVA Research Turkey & Turkstat

A more comprehensive fight against inflation is urgently needed

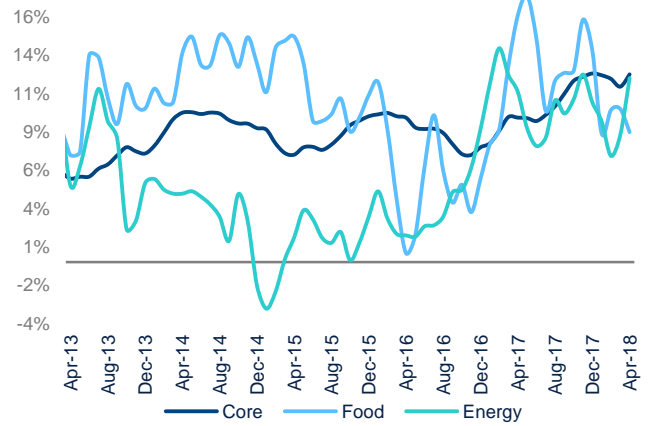
Ongoing high levels of inflation should call for an urgent and comprehensive strategy against inflation. Policies need to be tightened accordingly to solve two-digits inflation problem and this should be at the top of the agenda. We maintain our year-end inflation estimate at 10.5%, though exchange rate volatility and loose policies could pose upside risks.

Chart 3 Inflation Expectations & CBRT Core Inflation (YoY)



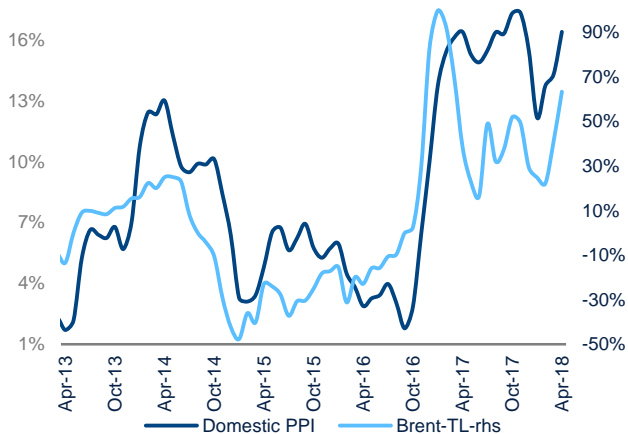
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 CPI Components (YoY)



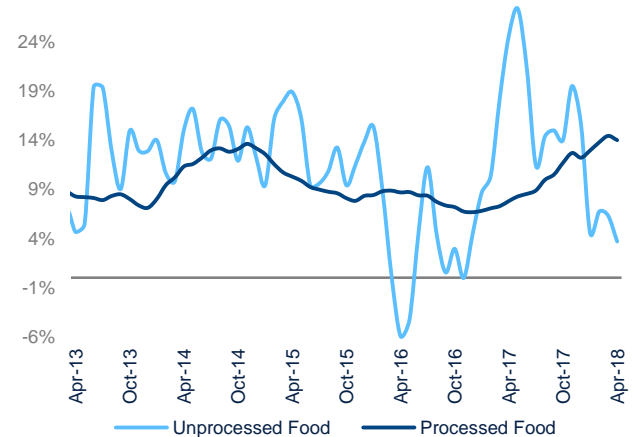
Source: CBRT & Turkstat

Chart 5 Domestic PPI and Oil Prices in TL (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 6 Processed & Unprocessed Food (YoY)



Source: BBVA Research Turkey, CBT & Turkstat

Chart 7 CPI in Subcomponents

CPI	MoM	YoY
Total	1.9%	10.8%
Food	-0.2%	8.8%
Beverage & Tobacco	0.0%	0.9%
Clothing & Textile	10.4%	12.0%
Housing	1.3%	10.6%
Household Equipment	2.1%	16.8%
Health	0.5%	10.0%
Transportation	3.5%	16.4%
Communication	0.0%	-0.1%
Recr. & Culture	1.7%	8.2%
Education	0.7%	10.9%
Rest. & Hotels	1.2%	11.9%
Misc. Goods & Services	2.3%	12.0%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	2.6%	16.4%
Mining & Quarrying	1.8%	15.9%
Manufacturing	2.8%	17.0%
Food Products	2.7%	8.5%
Textiles	2.1%	14.1%
Wearing Apparel	2.4%	5.7%
Coke & Petroleum Products	10.4%	41.4%
Chemicals	2.5%	17.7%
Other Non-Metallic Mineral	2.6%	16.5%
Basic Metals	3.9%	33.1%
Metal Products	2.6%	19.5%
Electrical Equipment	1.6%	17.2%
Electricity, Gas, Steam	0.8%	8.9%

Source: BBVA Research Turkey & Turkstat

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BBVA Research Turkey Unit

Chief Economist for Turkey, China and Big Data Unit

Álvaro Ortiz

alvaro.ortiz@bbva.com

Adem Ileri
ademil@bbva.com

Ali Batuhan Barlas
albari@bbva.com

Deniz Ergun
denizer@bbva.com

Seda Guler Mert
sedagul@bbva.com

Serkan Kocabas
serkankoc@bbva.com

Yigit Engin
yigite@bbva.com

BBVA Research

Chief Economist BBVA Group

Jorge Sicilia Serrano

Macroeconomic Analysis

Rafael Doménech

r.domenech@bbva.com

Digital Economy

Alejandro Neut

robertoalejandro.neut@bbva.com

Global Macroeconomic Scenarios

Miguel Jiménez

mjimenezg@bbva.com

Global Financial Markets

Sonsoles Castillo

s.castillo@bbva.com

Long-Term Global Modelling and Analysis

Julián Cubero

juan.cubero@bbva.com

Innovation and Processes

Oscar de las Peñas

oscar.delaspenas@bbva.com

Financial Systems and Regulation

Santiago Fernández de Lis

sfernandezdelis@bbva.com

Digital Regulation and Trends

Álvaro Martín

alvaro.martin@bbva.com

Regulation

Ana Rubio

arubiog@bbva.com

Financial Systems

Olga Cerqueira

olga.gouveia@bbva.com

Spain and Portugal

Miguel Cardoso

miguel.cardoso@bbva.com

United States

Nathaniel Karp

nathaniel.Karp@bbva.com

Mexico

Carlos Serrano

carlos.serranoh@bbva.com

Middle East, Asia and Big Data

Álvaro Ortiz

alvaro.ortiz@bbva.com

Turkey

Álvaro Ortiz

alvaro.ortiz@bbva.com

Asia

Le Xia

le.xia@bbva.com

South America

Juan Manuel Ruiz

juan.ruiz@bbva.com

Argentina

Gloria Sorensen

gsorensen@bbva.com

Chile

Jorge Selaive

jselaive@bbva.com

Colombia

Juana Téllez

juana.tellez@bbva.com

Peru

Hugo Perea

hperea@bbva.com

Venezuela

Julio Pineda

juliocesar.pineda@bbva.com

CONTACT DETAILS:

BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain). Tel.: +34 91 374 60 00 and +34 91 537 70 00 / Fax: +34 91 374 30 25 - bbvaresearch@bbva.com www.bbvaresearch.com