

# Turkey: June inflation reaches a worrying 15.4%

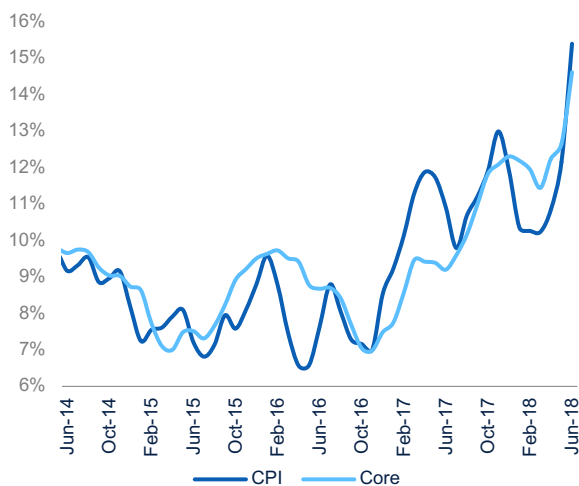
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz

Consumer prices increased 2.61% (mom) in June, remarkably higher than expectations (BBVA Research 1.8% vs. Consensus 1.4%). Thus, annual consumer inflation hit 15.4%, the highest level since December 2003, up from 12.2% in May. The upside surprise stemmed from the exceptional food inflation mainly due to weather conditions and the rapid acceleration in core prices. Annual core inflation jumped to 14.6% by 2pp in only one month. On the other hand, annual domestic producer price inflation skyrocketed to a new peak of 24%, keeping the cost push factors on the upside. Looking ahead, depending on the level of correction in food inflation and the likely removal of the adjustment in fuel prices, the peak in the headline could still be in July. Assuming no additional negative currency shock, we estimate the year-end inflation to be around 13.5%. The inflation problem should be the top priority by the incoming administration.

## Continued deterioration in pricing behavior strengthens inflation inertia

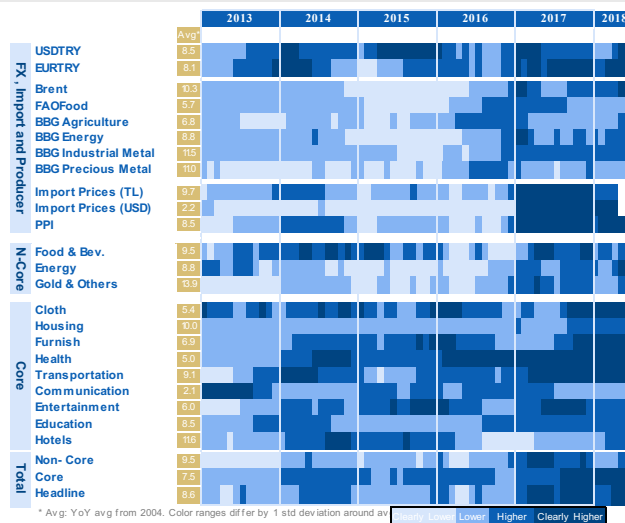
The high deviation in the headline was due to the surprising food inflation and the broad-based acceleration in core inflation. First, food prices increased by 6% mom, mainly pushed by vegetables despite the negative seasonal pattern (-2% mom). Secondly, ongoing exchange rate pass-thru, which was more apparent in furniture, transportation and communication, led core inflation to jump to 14.6% yoy from 12.6% in May. Besides, the spike in annual services inflation to 11% (the highest since Sep08) from 9.5% is also noteworthy as it signals the level of deterioration in pricing behavior. According to our analysis, cumulative pass-thru impact on consumer inflation is currently 4.3pp and we expect it to reach around 5pp in September. Annual headline inflation adjusted from exchange rate pass-thru is now close to 11%, compared to the levels fluctuating around 6% in 2011-2016. Hence, continued deterioration in pricing behavior seems to strengthen inertia via second round price effects, cost push factors and expectations in the last couple of years. This unhealthy trend implies consistent fiscal and monetary policies should be the top priority of the new economy team to fight against inflation. Last but not the least, recent increase in oil prices will keep the upward pressures as now the annual energy inflation hit 17% in June.

Chart 1 Core Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Core Inflation Heat Map

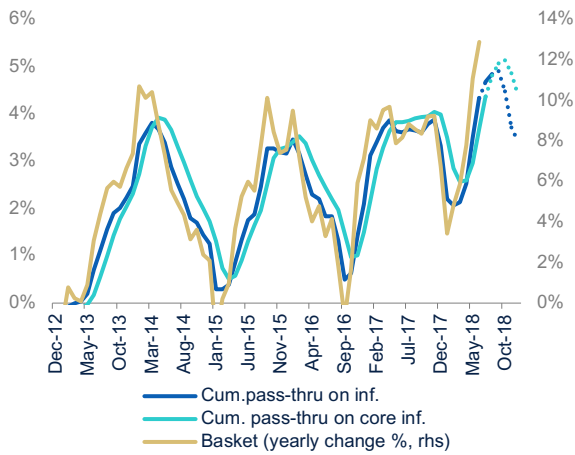


Source: BBVA Research Turkey & Turkstat

## The anti-inflation fight needs to be the top priority of the economic strategy

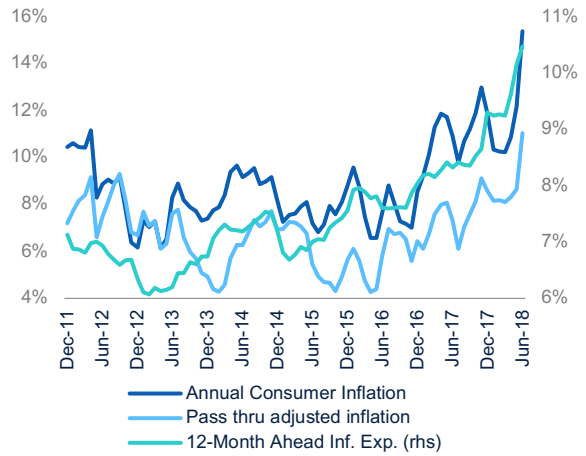
Given the surprising June data, the likely high deviation in future inflation expectations has to be tackled by tighter monetary policy of at least 50bps in its next meeting on the 24<sup>th</sup> of July. However, we reiterate that the anti-inflation strategy should be comprehensive (including all policies and accepting lower but healthier economic growth) and elevated to the top of the agenda of the incoming new administration.

Chart 3 Pass-thru on CPI and Core CPI



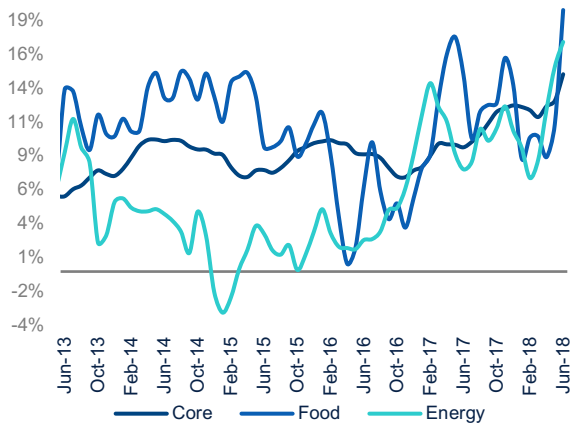
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 Pass-thru adj. Inflation vs Inflation Expectations



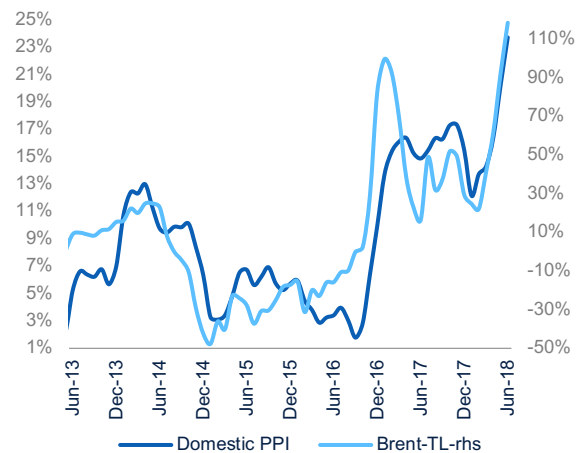
Source: CBRT & Turkstat

Chart 5 CPI Components (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 6 Domestic PPI and Oil Prices in TL (YoY)



Source: BBVA Research Turkey, CBT & Turkstat

Chart 7 CPI in Subcomponents

CPI	MoM	YoY
<b>Total</b>	<b>2.6%</b>	<b>15.4%</b>
Food	6.0%	18.9%
Beverage & Tobacco	0.0%	1.1%
Clothing & Textile	-1.1%	11.3%
Housing	1.0%	12.0%
Household Equipment	2.2%	18.9%
Health	0.8%	10.8%
Transportation	2.7%	24.3%
Communication	4.8%	4.9%
Recr. & Culture	2.2%	9.4%
Education	0.9%	10.8%
Rest. & Hotels	1.7%	13.3%
Misc. Goods & Services	1.8%	16.8%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
<b>Total</b>	<b>3.8%</b>	<b>23.7%</b>
Mining & Quarrying	2.6%	24.1%
Manufacturing	3.4%	24.1%
Food Products	2.4%	11.5%
Textiles	4.4%	21.7%
Wearing Apparel	2.6%	13.1%
Coke & Petroleum Products	12.2%	87.8%
Chemicals	4.1%	29.1%
Other Non-Metallic Mineral	2.8%	20.3%
Basic Metals	4.7%	48.3%
Metal Products	4.5%	29.7%
Electrical Equipment	2.6%	24.8%
Electricity, Gas, Steam	9.3%	19.9%

Source: BBVA Research Turkey & Turkstat

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