

Economic Watch

Turkey: Upside surprise from core prices

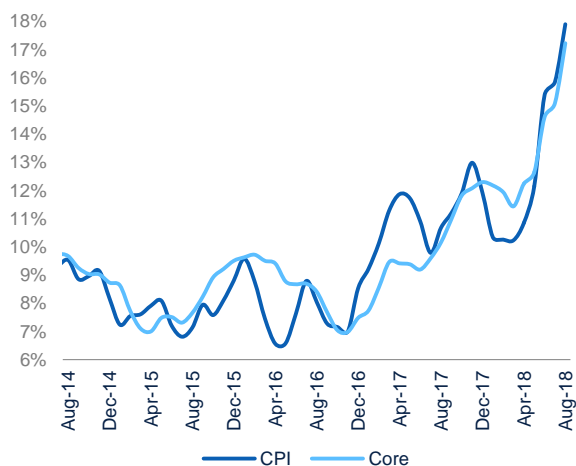
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz

Consumer prices increased 2.3% (mom) in August slightly higher than our estimate and market consensus (2.0% vs. 2.2%), leading the annual figure to rise to 17.90% from 15.85% in July. The upside surprise came from the rapid worsening in core prices, while food inflation partially eliminated the overall deterioration. Annual core inflation accelerated to 17.2% in August from 15.1% on top of strengthening exchange rate pass-thru and climbing cost-push factors. Domestic producer prices (PPI) also surprised on the upside by hitting 32.1% in annual terms, which will keep cost pressures over consumer prices in the short term. Given the recent worsening outlook and price hikes on utility prices on both consumers and industry, we forecast the year-end inflation to reach around 21.5%, with sizable increases in September and October.

Rapid price adjustment in core prices

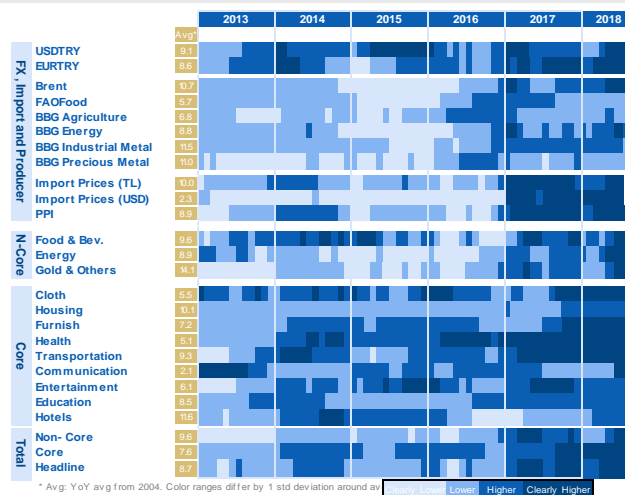
High CPI realization in August was due to the accelerated exchange rate pass-thru after sharp currency depreciation and the jump in energy inflation (up to 21.3% from 17.5% in July) on recent hikes on both consumer and producer utilization prices and the elimination of tax adjustment in fuel prices. Despite the favorable figure close to its seasonal average on top of weak unprocessed food inflation (-1.9% mom), food prices remained at elevated levels (20.3% yoy), backed by the processed food inflation (2.1% mom) as a result of the partial increase in bread prices and ongoing pass-thru impact. Also, core inflation surprised on the upside, signaling much more rapid price adjustment than envisaged after the recent currency shock as the deterioration in core prices remained to be broad-based, led by transportation, furniture, clothing and housing. According to our analysis, cumulative pass-thru impact on CPI (6pp up from 4pp in July) will continue to increase towards the end of the year under the assumption of no additional currency shock. The hikes on utility prices in September will bring 0.4pp direct impact on consumer prices, while the indirect impact from producer prices will likely make the total effect near 1pp at the end of the year. Hence, the surge in annual PPI to 32% from 25% will maintain cost push factors upward on CPI in the coming periods as it will keep rising on lagged effects of currency depreciation and recent hikes in utility prices.

Chart 1 Core Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Core Inflation Heat Map



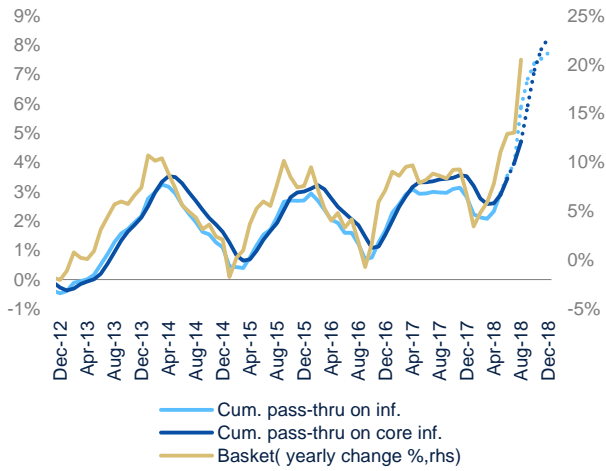
Source: BBVA Research Turkey & Turkstat

Forward guidance of the CBRT may signal a bold reaction in next meeting

Given the negative currency shock and latest utility price hikes, we estimate the inflation to rapidly surpass 20% in September and end the year at near 21.5%, eliminating favorable base effects. The sizable worsening in price adjustment behavior and inflation expectations will require the CBRT to take necessary actions, which has also been announced after today's inflation release stating that monetary stance will be adjusted in September meeting.

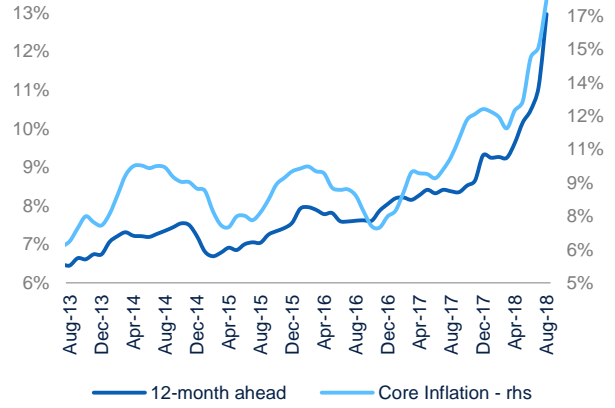
Creating Opportunities

Chart 3 12 month Pass-thru on CPI and Core CPI



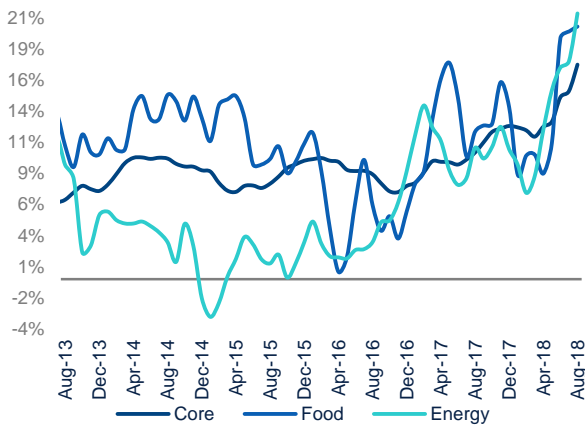
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 Core Inflation vs Inflation Expectations (YoY)



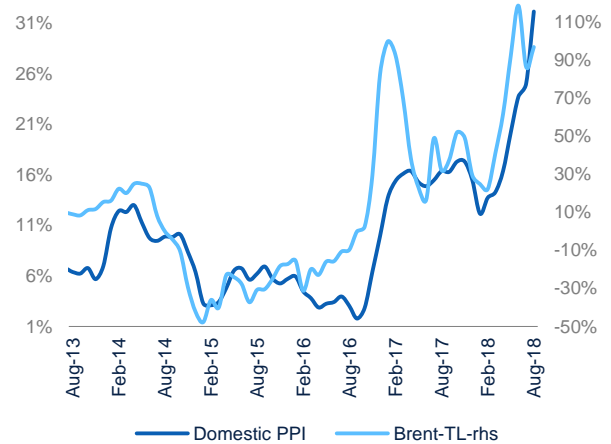
Source: CBRT & Turkstat

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
Total	2.3%	17.9%
Food	0.1%	19.7%
Beverage & Tobacco	0.4%	1.8%
Clothing & Textile	-1.6%	13.6%
Housing	3.9%	16.3%
Household Equipment	4.6%	23.8%
Health	0.9%	12.6%
Transportation	4.5%	27.1%
Communication	2.6%	7.3%
Recr. & Culture	2.6%	12.2%
Education	0.8%	8.7%
Rest. & Hotels	1.9%	14.8%
Misc. Goods & Services	5.9%	23.2%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

Domestic PPI	MoM	YoY
Total	6.6%	32.1%
Mining & Quarrying	5.7%	30.8%
Manufacturing	7.3%	33.3%
Food Products	2.9%	16.1%
Textiles	9.6%	34.8%
Wearing Apparel	5.8%	21.1%
Coke & Petroleum Products	25.1%	120.1%
Chemicals	10.7%	46.6%
Other Non-Metallic Mineral	3.5%	24.4%
Basic Metals	12.1%	61.7%
Metal Products	9.5%	40.6%
Electrical Equipment	8.3%	33.7%
Electricity, Gas, Steam	-1.2%	20.7%

Source: BBVA Research Turkey & Turkstat

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