

Economic Watch

# Turkey: Still worrisome inflation outlook

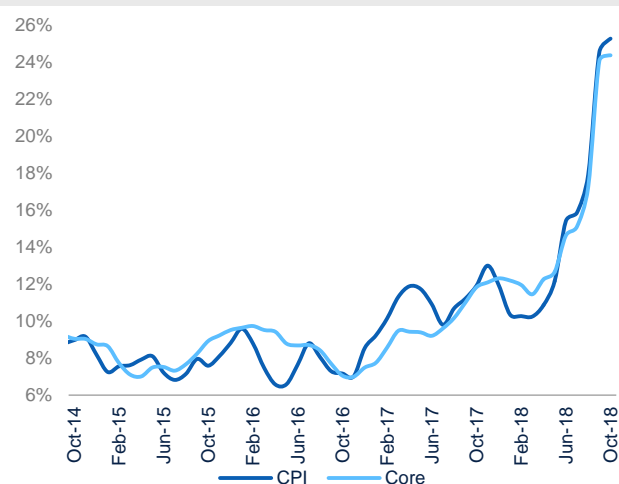
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz

Consumer prices increased by 2.67% in October (slightly higher than market & BBVA Research expectations of 2.5%). Annual consumer inflation maintained its upward trend by reaching 25.2%, up from 24.5% in September. Given the increasing uncertainty on the recent voluntary price discount campaigns, October CPI implies only a limited impact of the campaigns and lower exchange rate pass-through thanks to the stabilization of the currency since September. Producer prices (PPI), on the other hand, surprised on the downside with only 0.9% mom rise, leading the annual figure to slightly recede to 45% from 46.2%. We expect consumer inflation to come down to 23.5% at the end of 2018 on recent tax cuts on automobile and durable goods and lagged effects of current price discount campaigns. Upward pressures after December could arise as the campaign and tax effects might revert.

## Exchange rate pass-thru and second round price effects continue to weigh

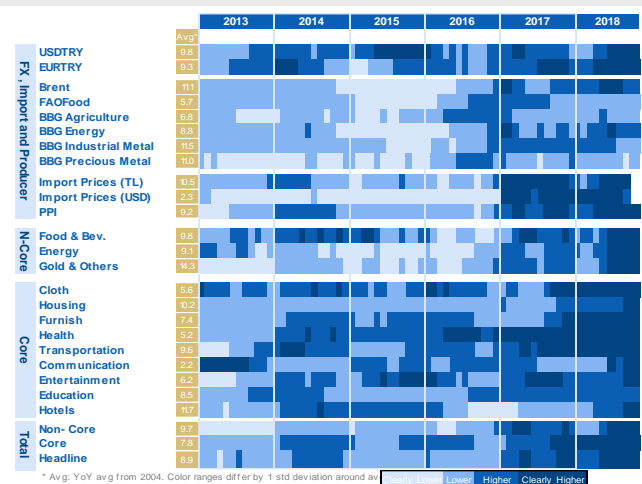
Food prices rose by 3.2% mom, higher than the last 5 years' average of 2.3%. Hence, annual food inflation climbed up to 30.1%, which was also fueled by the processed food inflation (24.5% yoy). Despite the easing in automobile prices (-3% mom) due to the change in Special Consumption Tax base prices, annual core inflation also accelerated to 24.3% from 24%, implying the continuation of exchange rate pass-thru and worsening pricing behavior across-the-board. The entertainment, clothing, restaurants and furniture group took the lead in the deterioration of core inflation. According to our calculations, we expect the exchange rate pass-thru (Chart 5) to ease on the recent stabilization of the currency and the rapidly widening negative output gap in the coming months. Additionally, recent tax cuts on automobile, furniture and white goods to be effective as of November could also drag down near 1pp from the headline figure, which could also be accelerated by the current voluntary price discount campaigns. However, continuing cost push factors despite the temporary relief in October PPI figure (the extraordinarily high September PPI could have included a front-loaded price adjustment) and the likely reversal of the campaigns and unfavorable base effects at the start of next year will likely show additional worsening of consumer inflation towards near 27% in 1Q19 after ending 2018 at 23.5%.

Chart 1 Core Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Inflation Heat Map



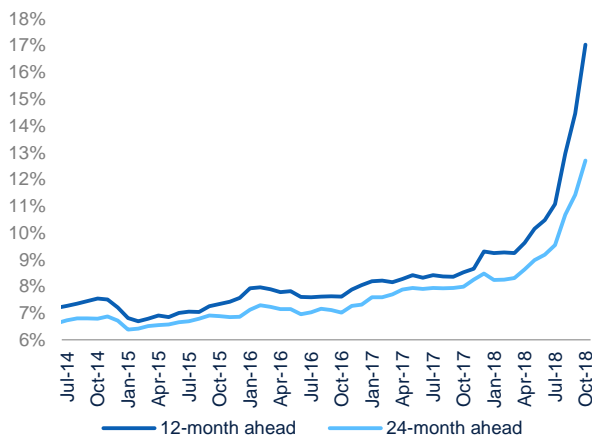
Source: BBVA Research Turkey & Turkstat

## Policy makers should maintain the focus on anti-inflation policies

October inflation realization seems to be in line with the Central Bank's recently updated inflation projections. The Central Bank will remain vigilant and evaluate the effects of its sharp monetary policy tightening in terms of lower currency volatility and level of output gap. Still, policymakers should maintain the focus on anti-inflation policies as inflation remains high and could transitorily revert in 1Q19 once the discount campaigns and tax reductions are finalized.

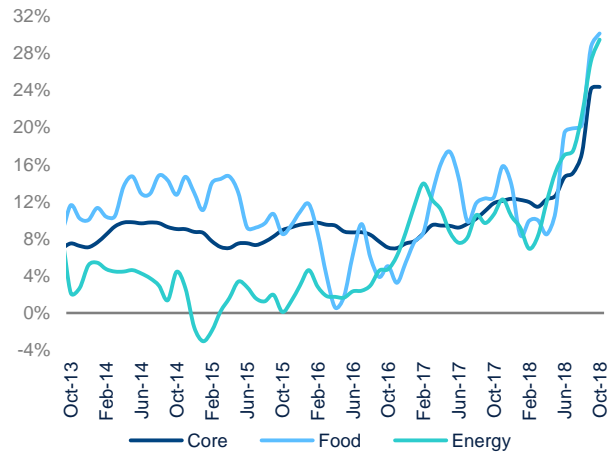
## Creating Opportunities

Chart 3 Inflation expectations, YoY



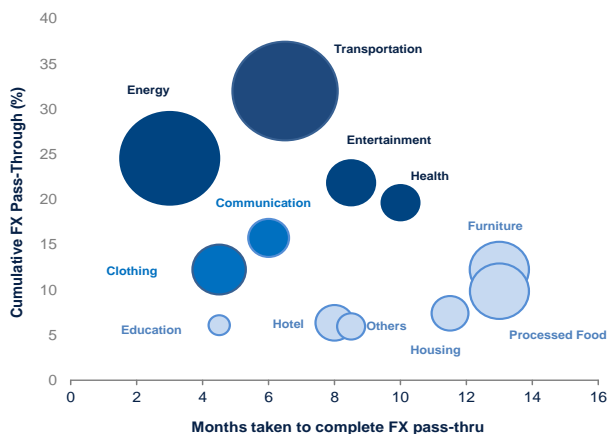
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 CPI Components (YoY)



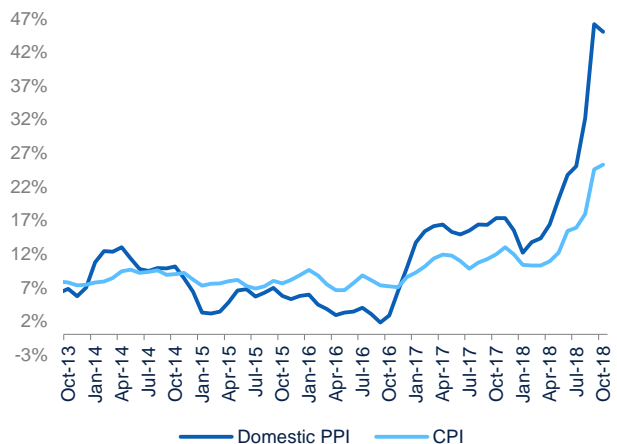
Source: CBRT & Turkstat

Chart 5 Exchange Rate Pass Thru in Core D Inflation\*



Source: BBVA Research Turkey (TVAR Model) & Turkstat, \*Bubble size corresponds to the contribution to CPI

Chart 6 Domestic PPI and CPI (YoY)



Source: BBVA Research Turkey, CBT & Turkstat

Chart 7 CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>2.7%</b>	<b>25.2%</b>
Food & Non-alcoholic beverages	3.2%	29.3%
Beverage & Tobacco	0.2%	2.1%
Clothing & Textile	12.7%	18.5%
Housing	4.1%	25.7%
Household Equipment	3.4%	37.9%
Health	1.5%	15.8%
Transportation	-0.8%	32.0%
Communication	2.1%	10.5%
Recr. & Culture	2.1%	24.0%
Education	0.0%	10.3%
Rest. & Hotels	1.5%	20.1%
Misc. Goods & Services	1.6%	31.5%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.9%</b>	<b>45.0%</b>
Mining & Quarrying	1.1%	35.9%
Manufacturing	0.2%	42.6%
Food Products	0.9%	29.4%
Textiles	-0.6%	45.7%
Wearing Apparel	3.1%	25.7%
Coke & Petroleum Products	-1.9%	110.4%
Chemicals	-0.5%	60.1%
Other Non-Metallic Mineral	2.7%	31.7%
Basic Metals	-4.1%	64.3%
Metal Products	-1.2%	48.4%
Electrical Equipment	-1.0%	45.2%
Electricity, Gas, Steam	8.6%	82.9%

Source: BBVA Research Turkey & Turkstat

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