Economic Watch

# Turkey: Inflation surprised on the downside

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Consumer prices fell by 1.44% in November, remarkably lower than the consensus and BBVA Research estimates (-0.3% vs. 0.1%). Annual consumer inflation showed a rapid correction, by declining to 21.6% from 25.2% in October. The appreciation of Turkish lira near 20% in the last 2 months, tax reductions in certain items (near 1pp impact), the retreatment in oil prices and negative food inflation compared to its higher seasonal average all helped the headline to come down fast. Domestic producer prices also showed a sizable correction by declining 2.5% and bringing the annual figure to 38.5%, down from 45%. Looking ahead, the continuation of discount campaigns and tax incentives till the end of the year could lead consumer inflation to fall further to near 21% in December. Though, likely reversal of the discount campaigns and tax incentives and unfavorable base effects at the start of next year could bring a transitory increase in the headline; but given the recent supportive external financial conditions, risks are cumulating on the downside.

Correction led by currency appreciation, tax incentives and easing oil prices

The main contributor to the decline in the headline CPI was the core prices as annual core inflation fell to 20.7% from 24.3% in October. In addition to the tax reductions in automobiles, furniture and white goods, the additional discount campaigns seem to increase the expected total impact on top of negative demand conditions (compared to the previous incentive cycle in February 2017). The broad-based recovery in other items was also supportive, especially in those carrying exchange rate pass-thru and being sensitive to demand. Food inflation also contributed to the overall improvement, by declining 0.8% mom compared to its seasonal average of 0.6% rise in November. Thus, annual food inflation retreated to 26% from 30%, mainly on top of the falling unprocessed food inflation. The retreatment in energy prices and domestic producer prices inflation show that the cost push factors could ease from now onwards, which will start to help consumer inflation gradually. Looking ahead, also helped by the recent supportive risk-on mood in financial markets and the ease in oil prices, we think the expected transitory increase in CPI will be limited at 2-3pp by 1Q19 before stabilizing close to these levels until June and declining faster afterwards on top of sizable base effects and lagged impact of the widening negative output gap.

Chart 1 Core Inflation and CPI (YoY)
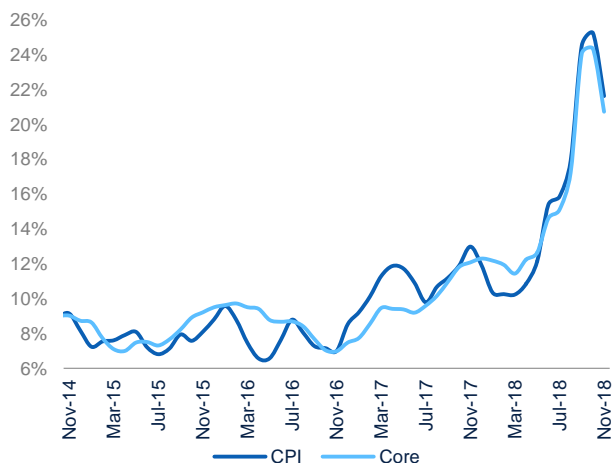
Source: BBVA Research Turkey & Turkstat

Chart 2 Inflation Heat Map
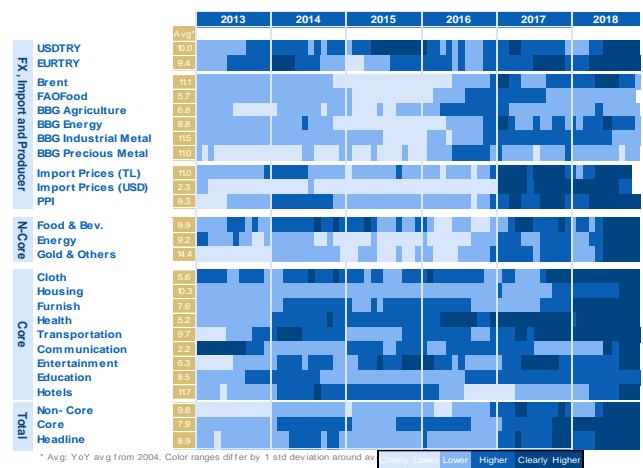
Source: BBVA Research Turkey & Turkstat

## Inflation will likely materialize below CBRT projections in the short term

November inflation also seems to surprise the Central Bank (CBRT) on the downside, given the positive external financial conditions than they initially forecasted. Though, still the uncertainties over the likely reversal of the price campaigns and other adjustments at the start of next year should keep the CBRT vigilant and avoid from an immediate easing cycle before realizing a permanent improvement in inflation and medium term expectations.
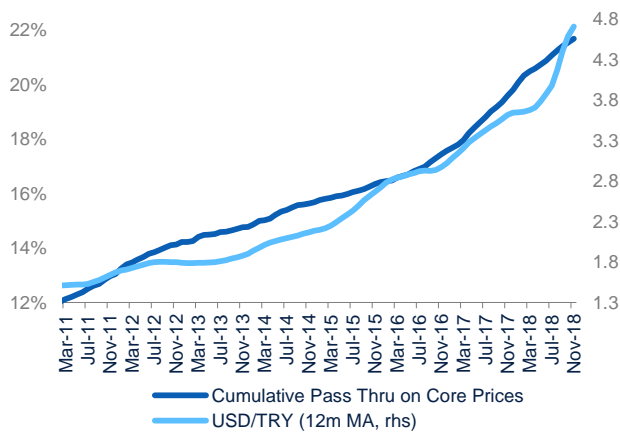
Chart 3 Inflation expectations, YoY
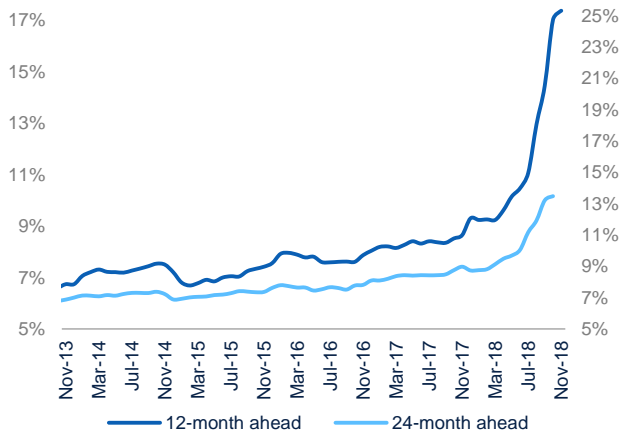
Source: BBVA Research Turkey Inflation Model & Turkstat
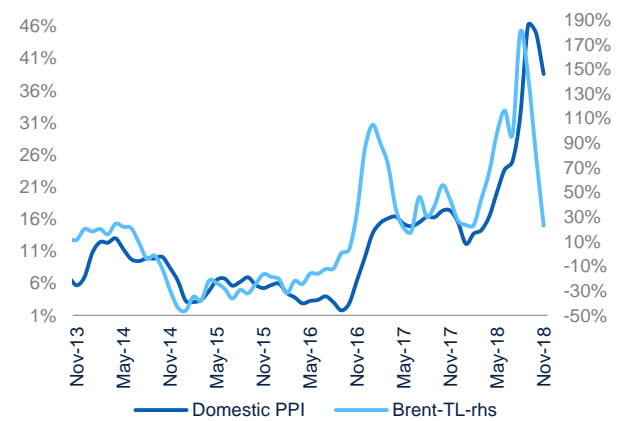
Chart 4 CPI Components (YoY)
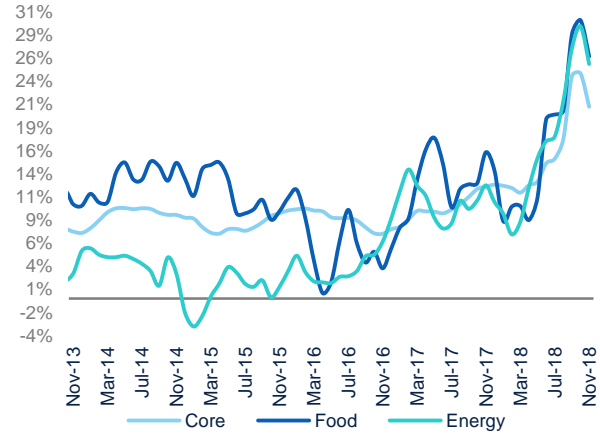
Source: CBRT & Turkstat

Chart 5 Exchange Rate Pass Thru in Core D Inflation*

Source: BBVA Research Turkey (TVAR Model) & Turkstat. *Core Prices refer to Core-D (CPI excluding unprocessed food, alcohol and tobacco)

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

Source: BBVA Research Turkey, CBT & Turkstat

Chart 7 CPI in Subcomponents

	MoM	YoY
Total	**-1.4%**	**21.6%**
Food & Non-alcoholic beverages	-0.7%	25.7%
Beverage & Tobacco	0.2%	2.2%
Clothing & Textile	2.4%	16.9%
Housing	0.5%	24.8%
Household Equipment	-2.9%	32.7%
Health	0.6%	16.3%
Transportation	-6.5%	21.0%
Communication	-0.6%	9.6%
Recr. & Culture	-2.1%	21.2%
Education	0.0%	10.2%
Rest. & Hotels	0.4%	20.0%
Misc. Goods & Services	-1.0%	27.9%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
Total	**-2.5%**	**38.5%**
Mining & Quarrying	-1.8%	29.9%
Manufacturing	-3.1%	35.0%
Food Products	-1.5%	27.3%
Textiles	-4.2%	36.3%
Wearing Apparel	0.7%	26.3%
Coke & Petroleum Products	-15.5%	59.2%
Chemicals	-4.4%	47.5%
Other Non-Metallic Mineral	0.7%	30.8%
Basic Metals	-8.1%	44.3%
Metal Products	-3.4%	37.7%
Electrical Equipment	-2.4%	36.8%
Electricity, Gas, Steam	2.3%	94.4%

Source: BBVA Research Turkey & Turkstat

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