

Economic Watch

# Turkey: Inflation declines again in December

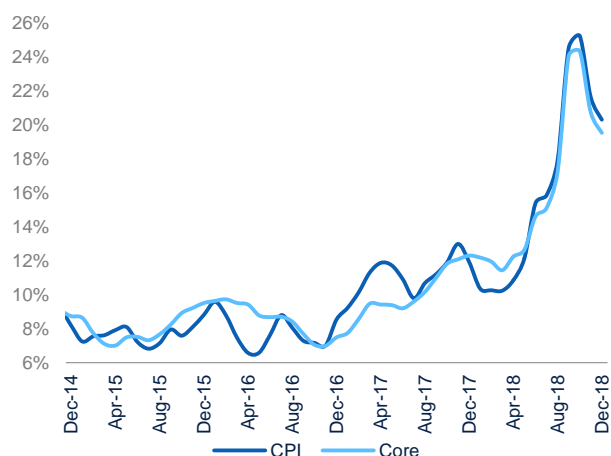
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz

Consumer prices fell by -0.4% in December, slightly lower than Reuters consensus and BBVA Research estimates (-0.23% vs. -0.15%). Thus, annual consumer inflation further eased to 20.3% from 21.6% in November. The deviation in our estimate mostly stems from the lower-than-expected food inflation and the impact of the poor demand weighing more on the core prices. Annual core inflation retreated to 19.5% from 20.7%, also supported by the additional appreciation in the currency and the continuation of tax reductions. Besides, domestic producer prices preserved its correction by declining 2.2% and bringing the annual figure to 33.6%, down from 38.5%. Looking ahead, the maintenance of tax incentives till the end of March, reductions in utility prices and relatively weaker oil prices will likely lead consumer inflation to increase less slightly than expected, only by around 1-2pp in 1Q. The extension of the tax incentives will also change the forecasted path for inflation, bringing this year's peak to April. Higher-than-expected minimum wage hike and the increasing volatility in the currency could be the upside risks on inflation.

## Continued correction mainly led by core and energy prices

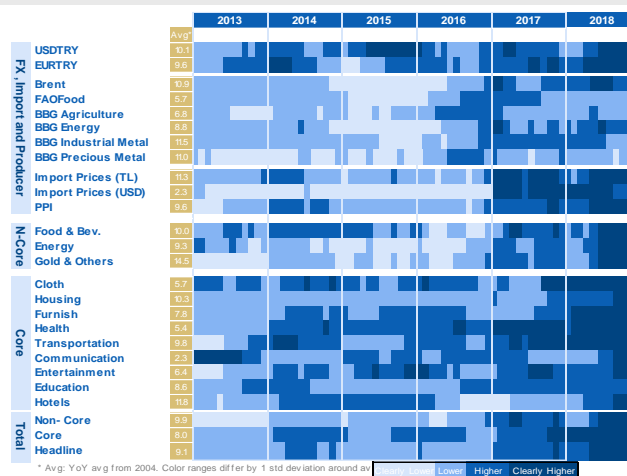
The main contributor to the decline in the headline CPI was the core prices, especially led by the fall in automobile and clothing prices. Although the cyclical factors such as currency appreciation, maintenance of tax reductions and price discount campaigns, and weak demand seemed to help core prices, negative seasonal component was the other factor on the continued correction in core inflation (Chart 5). Hence, to see a permanent correction in core inflation, the high inertia needs to be tackled by further gains in currency volatility and inflation expectations. Energy inflation also helped the headline, with an annual figure down to 20.8% from 25.3%, thanks to lower oil prices and gains in the currency. On the other hand, food inflation remained to be high at 26% despite a lower monthly realization than its seasonal average (1.2% vs. 1.6%). Looking ahead, higher-than-expected minimum wage hike could bring an additional 1pp upward risk on our baseline scenario, though the price reductions in utility prices for houses (0.4pp) and natural gas discounts for SMEs (0.5pp) could eliminate that impact. All in all, the extension of the tax incentives till the end of March will change the forecasted path for inflation, making it harder for additional price adjustments during a period when the negative output gap will weigh more. We estimate the transitory increase in the headline to be lower at 1-2pp in 1Q, still keeping the likelihood to have this year's peak in April.

Chart 1 Core Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Inflation Heat Map

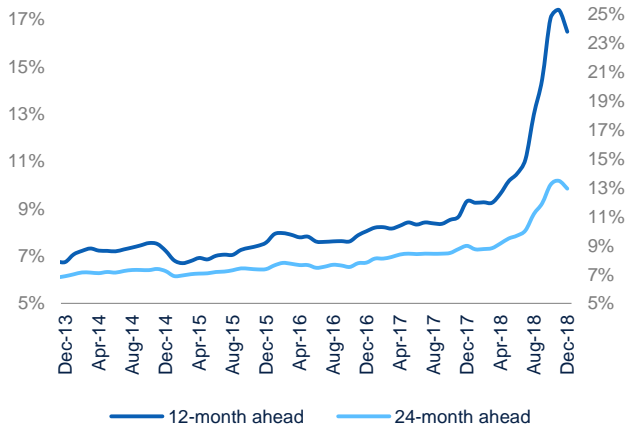


Source: BBVA Research Turkey & Turkstat

## The CBRT should still wait for permanent improvement in inflation outlook

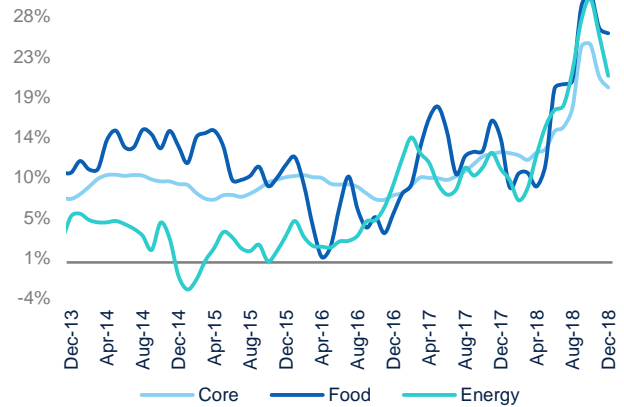
Considering the recent price regulations, risks are balanced on our year-end inflation expectation of 16%. Though, the path for output gap, oil prices and currency volatility will be the determinant factors on inflation. We maintain our view that the Central Bank should wait for at least June, when the recovery in the headline becomes promising, to start a gradual easing cycle. If the conditions turn to be unresponsive, the first rate cut could even be delayed.

Chart 3 Inflation expectations, YoY



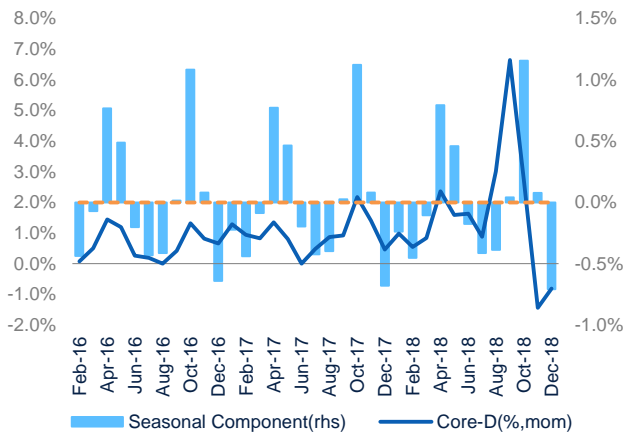
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 CPI Components (YoY)



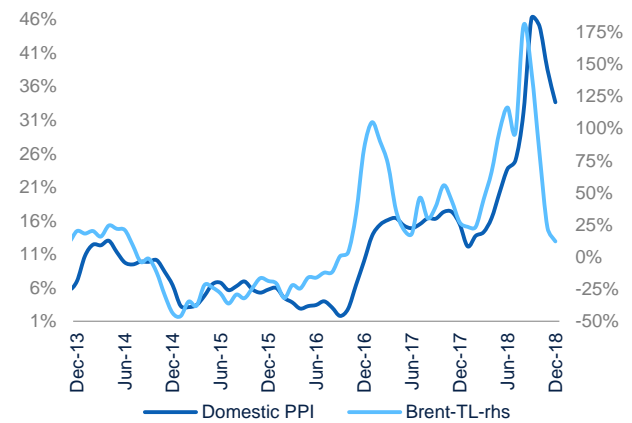
Source: CBRT & Turkstat

Chart 5 Core D Inflation and Its Seasonal Component



Source: BBVA Research Turkey & Turkstat. \* Core-D inflation: 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
<b>Total</b>	<b>-0.4%</b>	<b>20.3%</b>
Food & Non-alcoholic beverages	1.1%	25.1%
Beverage & Tobacco	0.2%	2.4%
Clothing & Textile	-4.1%	14.8%
Housing	-0.1%	23.7%
Household Equipment	0.1%	31.4%
Health	0.6%	16.7%
Transportation	-2.6%	16.0%
Communication	-0.1%	9.6%
Recr. & Culture	-0.2%	20.9%
Education	0.0%	10.2%
Rest. & Hotels	0.3%	19.8%
Misc. Goods & Services	0.8%	28.8%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>-2.2%</b>	<b>33.6%</b>
Mining & Quarrying	-2.5%	24.3%
Manufacturing	-1.6%	31.1%
Food Products	-0.6%	25.5%
Textiles	-1.8%	32.3%
Wearing Apparel	-0.5%	26.1%
Coke & Petroleum Products	-13.1%	36.6%
Chemicals	-0.9%	44.6%
Other Non-Metallic Mineral	-0.4%	28.5%
Basic Metals	-5.1%	32.6%
Metal Products	-0.7%	35.5%
Electrical Equipment	-1.6%	31.3%
Electricity, Gas, Steam	-8.5%	75.0%

Source: BBVA Research Turkey & Turkstat

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