

Economic Watch

# Turkey: Inflation stays at 20.35% as expected

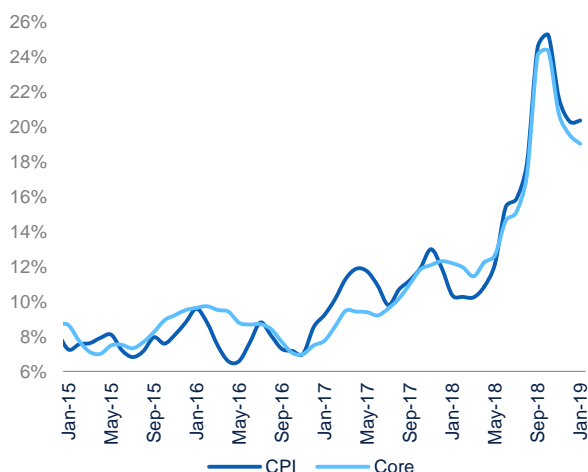
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz

Consumer prices rose by 1.06% in January parallel to expectations (1%, Consensus & BBVA Research), leading the annual inflation to stay at 20.35%. As expected, the sizable acceleration in food inflation was compensated by the utility price reductions and the easing in core prices on the back of the stabilization in currency and poor demand. Annual core C inflation retreated to 19.0% from 19.5% on the support from goods prices, while the services inflation jumped carrying risks from high inertia on backward indexation. Looking ahead, in contrast to the Central Bank’s updated projections pointing more or less a steady level in 1H19, we still expect a transitory increase in the headline in 1Q19 at around 1pp and a further slight pick-up in April when the tax incentives are dropped. Higher-than-expected minimum wage rise, the potential price hike in cigarettes and seasonally higher food prices still play an important role, keeping the likelihood to have the headline above 20% till 2H19. We maintain our year-end inflation estimate at 16%.

## Inflation surged on the back of food and services prices

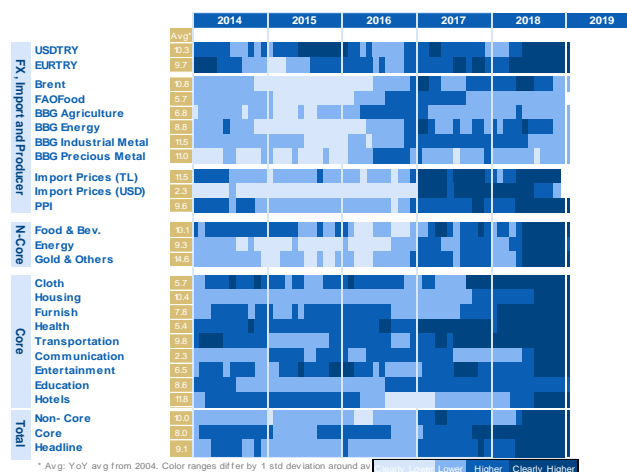
Monthly inflation mainly stemmed from sizably higher food inflation than its seasonal average and services prices, while energy and core prices were the downside factors. Due to bad weather conditions, food prices increased by 6.9% mom, leading the annual figure to rise to 31% from 25% in December. Besides, 2.1% mom pick-up in services prices probably caused by backward indexation on top of the high year-end inflation realization was the other main factor on inflation. However, especially led by clothing and furniture prices, core inflation still remained almost steady on monthly basis due to stabilization in currency, lower demand and diminishing exchange rate pass-thru. Despite the recent recovery in core inflation, the trend (permanent) factor, eliminating temporary effects still has an increasing pattern and hovers near 15% due to the deterioration in pricing behavior since 3Q16 (Chart 5). Energy inflation also helped the headline, with an annual figure down to 13.1% from 20.8%, thanks to the recent utility price reductions, lower oil prices and gains in the currency. Though, in contrast to our negative monthly expectation, domestic producer prices rose by 0.45% and stayed near 33% in annual terms, still reflecting the high cost-push factors. On the other hand, the revised weights in inflation basket show important changes among the sub-items (+1.1pp core C, +0.3pp food & beverages, -0.5pp energy and -0.9pp tobacco in Chart6) and could alter the magnitude from expected price changes. All in all, cost-push factors and high food inflation remain to be the main upside risks on inflation, while widening output gap and stabilized currency being the buffers.

Chart 1 Core-C Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Inflation Heat Map

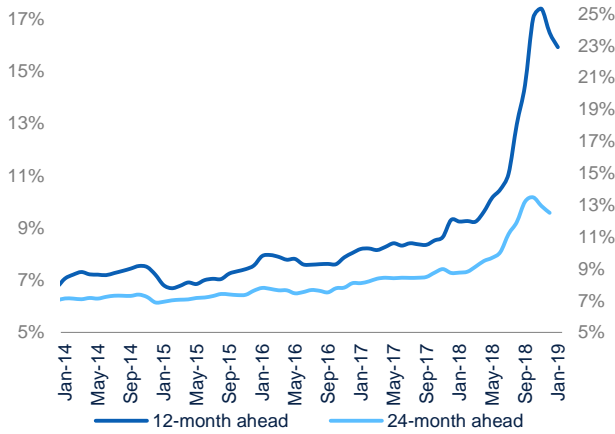


Source: BBVA Research Turkey & Turkstat

## The Central Bank will remain tight in the short term

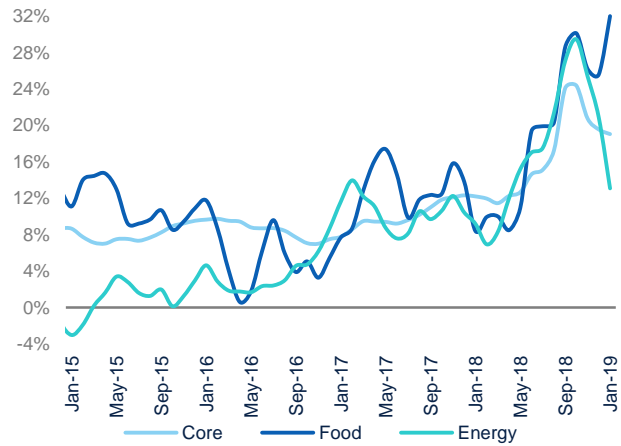
Despite the recent recovery in core prices on cyclical and irregular factors, its trend still shows an increasing track. We expect the headline inflation stay above 20% till 2H19 and end the year at 16% on favorable base effects, deeper negative output gap and stabilized currency. We still maintain our view that the Central Bank should wait for at least June, when the trend inflation gains some stabilization, to start a gradual easing cycle.

Chart 3 Inflation expectations, YoY



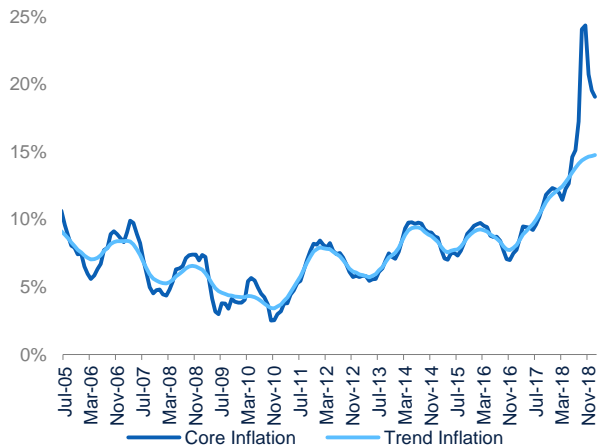
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 CPI Components (YoY)



Source: CBRT & Turkstat

Chart 5 Core C Inflation vs. Trend



Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 6 Changes in Weights in the CPI Basket

Main Indices in CPI Basket	2019	Chg. From 2018 (pp)
Food & Non-alcoholic beverages	23.3%	0.3
Beverage & Tobacco	4.2%	-0.9
Clothing & Textile	7.2%	0.0
Housing	15.2%	0.3
Household Equipment	8.3%	0.7
Health	2.6%	-0.1
Transportation	16.8%	-0.7
Communication	3.7%	-0.2
Recreation & Culture	3.3%	-0.1
Education	2.4%	-0.3
Restaurants & Hotels	7.9%	0.6
Misc. Goods & Services	5.2%	0.4

Source: BBVA Research Turkey, Turkstat

Chart 7 CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>1.1%</b>	<b>20.4%</b>
Food & Non-alcoholic beverages	6.4%	31.0%
Beverage & Tobacco	0.6%	2.6%
Clothing & Textile	-8.0%	12.5%
Housing	-3.1%	17.2%
Household Equipment	0.7%	29.1%
Health	3.6%	18.0%
Transportation	0.2%	14.7%
Communication	0.7%	11.5%
Recr. & Culture	3.2%	23.1%
Education	0.1%	10.0%
Rest. & Hotels	1.1%	19.9%
Misc. Goods & Services	3.6%	29.6%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.5%</b>	<b>32.9%</b>
Mining & Quarrying	2.8%	22.5%
Manufacturing	0.5%	29.6%
Food Products	1.3%	26.2%
Textiles	1.3%	32.8%
Wearing Apparel	-1.8%	24.9%
Coke & Petroleum Products	-3.0%	28.6%
Chemicals	-0.3%	41.6%
Other Non-Metallic Mineral	1.9%	26.5%
Basic Metals	-2.3%	27.8%
Metal Products	-0.3%	31.5%
Electrical Equipment	3.6%	35.1%
Electricity, Gas, Steam	0.4%	92.8%

Source: BBVA Research Turkey & Turkstat

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