

Economic Watch

# Turkey: Inflation eased on core prices

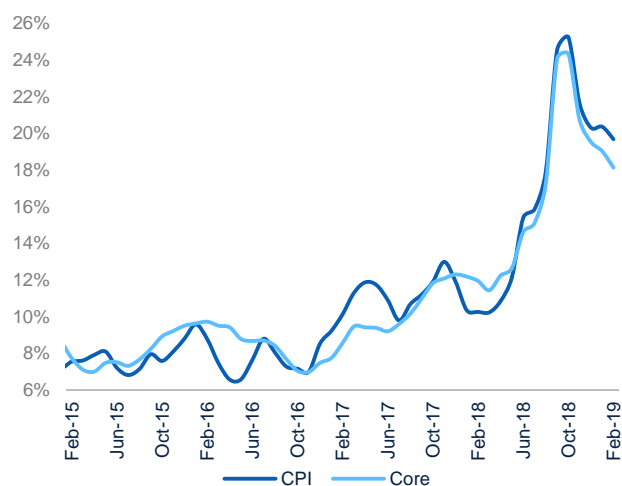
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz

Consumer prices rose by 0.16% in February lower than the consensus but higher than our estimate (0.4% vs. -0.3%). Thus, annual consumer inflation slowed down to 19.7% from 20.4% in January. Our deviation was basically from food prices, which continued to maintain upward pressure on inflation with an annual figure at 30% despite the recent discounts led by the Government's subsidized food stalls. On the other hand, in line with our expectations, annual core inflation further retreated to 18.1% from 19.0% on top of poor demand and easing exchange rate pass-through. Domestic producer prices inflation also declined to 29.6% from 32.9%, remaining high but implying some relief for cost-push factors. Looking ahead, in absence of a correction from the end of tax incentives after March, we expect consumer inflation to stay between 19-20% till June, when favorable base effects will start to weigh and reach as low as 10.5% in October with a reversal afterwards by ending the year at 14.5%.

## Food inflation maintains upward pressure over inflation

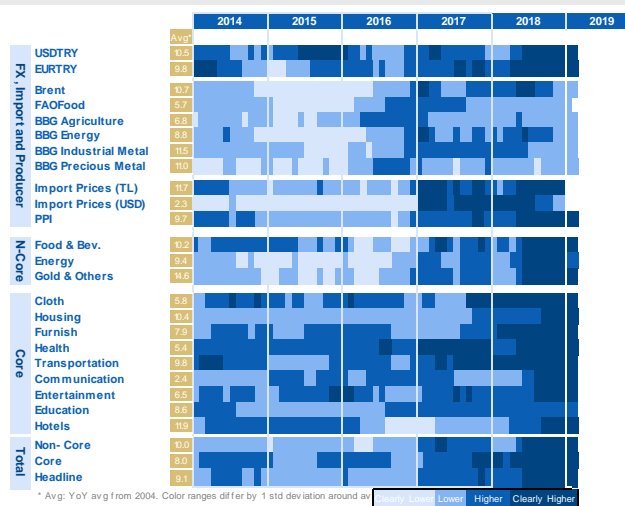
The main surprise for February inflation was from the food prices as the indirect impact of the Government's subsidized food stalls was inadequate to produce the expected decline in food inflation. The monthly food inflation was realized close to its seasonal average, keeping the annual figure at 30.3%, only down from 32% in January. Annual inflation of fresh vegetables and fruits remained at near 60%, while the total unprocessed food inflation eased only to 39%. On the other hand, core prices were the main items on the decline in inflation, with its annual inflation down to 18.1% from 19%. Especially led by the goods prices sensitive to demand and exchange rate movements, core inflation maintained its downward pattern on the gains in currency, lower demand and diminishing exchange rate pass-thru. Though, services prices remain sticky with an annual figure at 15.1%, only down from 15.4% in January, showing the easing but still high cost-push factors on the back of high inertia, minimum wage hike beyond expectations and tighter financial conditions. All in all, the trend (permanent) factor that eliminates the temporary effects in core inflation starts to show some stabilization but still hovers near 14.5%, which makes it harder for the Central Bank (CBRT) to introduce any premature rate cut before observing a persuasive improvement in this component (Chart 5). In sum, cost-push factors and high food inflation remain to be the main upside risks on inflation, while widening negative output gap and stabilized currency provide 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

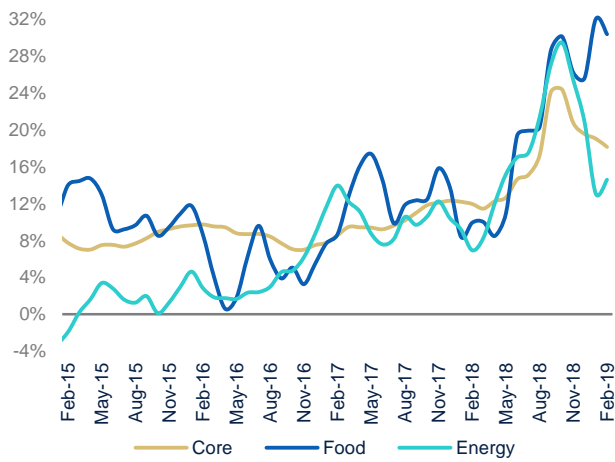
## The CBRT will wait for signals on a persuasive improvement in inflation

We expect the inflation stay near 20% till June and end the year at 14.5% on favorable base effects, deeper negative output gap and stabilized currency. Despite some stabilization, still high levels of trend inflation and sticky inflation expectations should still be the main concern for the CBRT. We maintain our view that the CBRT should wait for at least June to start a gradual easing cycle.

## Creating Opportunities

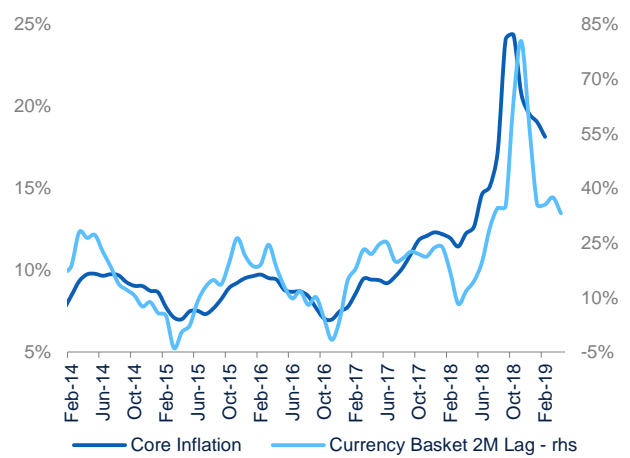
Turkey Economic Watch – 4 March 2019

Chart 3 CPI Components, YoY



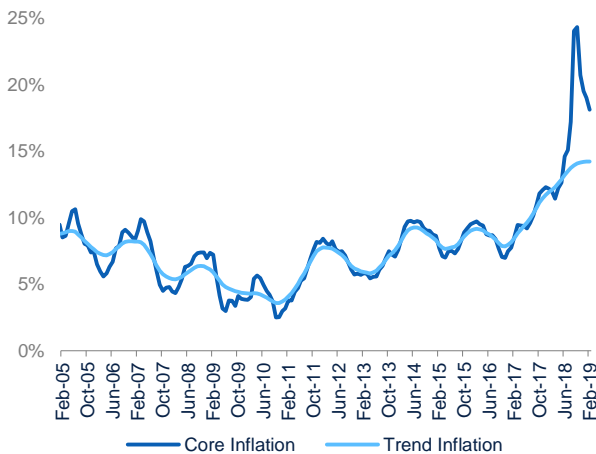
Source: BBVA Research Turkey Inflation Model & Turkstat

Chart 4 Core Inflation and Currency Basket, YoY



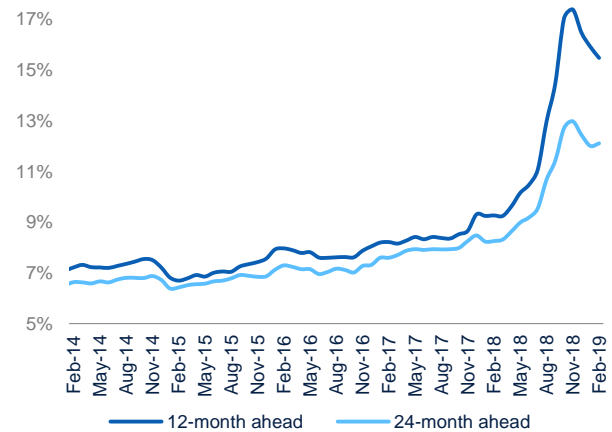
Source: CBRT & Turkstat

Chart 5 Core C Inflation vs. Trend



Source: BBVA Research Turkey UCSV-MA Model, Turkstat

Chart 6 Inflation Expectations, YoY



Source: BBVA Research Turkey, Turkstat

Chart 7 CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.2%</b>	<b>19.7%</b>
Food & Non-alcoholic beverages	0.9%	29.3%
Beverage & Tobacco	0.1%	2.7%
Clothing & Textile	-4.8%	11.6%
Housing	0.0%	16.6%
Household Equipment	0.1%	27.6%
Health	2.5%	17.9%
Transportation	0.7%	15.2%
Communication	-0.3%	10.9%
Recreation & Culture	-0.4%	20.4%
Education	1.6%	11.6%
Restaurants & Hotels	0.9%	19.8%
Misc. Goods & Services	-0.4%	28.1%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.1%</b>	<b>29.6%</b>
Mining & Quarrying	1.9%	22.6%
Manufacturing	0.6%	28.5%
Food Products	1.4%	25.8%
Textiles	-0.7%	29.9%
Wearing Apparel	-1.2%	22.7%
Coke & Petroleum Products	4.8%	36.3%
Chemicals	-0.8%	38.4%
Other Non-Metallic Mineral	1.0%	25.7%
Basic Metals	0.1%	26.1%
Metal Products	0.3%	30.1%
Electrical Equipment	1.1%	35.1%
Electricity, Gas, Steam	-7.4%	47.4%

Source: BBVA Research Turkey & Turkstat

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**This report has been produced by:**

Chief Economist  
Álvaro Ortiz  
alvaro.ortiz@bbva.com

Adem İleri  
ademil@bbva.com

Serkan Kocabas  
serkankoc@bbva.com

Ali Batuhan Barlas  
albari@bbva.com

Yigit Engin  
yigite@bbva.com

Deniz Ergun  
denizer@bbva.com

Pelin Ayranci  
Pelin.ayranci@bbva.com

Seda Guler Mert  
sedagul@bbva.com

**ENQUIRIES TO:**

BBVA Research: Calle Azul, 4 Edificio La Vela, Floors 4 & 5 28050 Madrid, Spain  
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 25  
bbvaresearch@bbva.com www.bbvaresearch.com

