

Economic Watch

# Turkey: Inflation in line with expectations

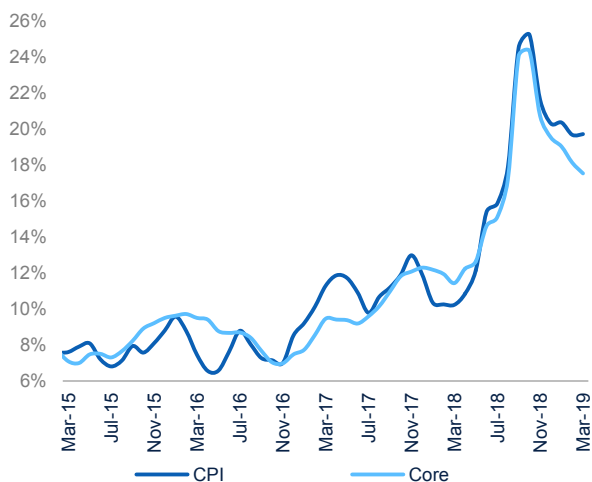
Seda Guler Mert / Adem Ileri / Serkan Kocabas / Alvaro Ortiz

Consumer prices increased by 1.03% in March, resulting in 19.7% in yearly terms. The results have been in line with both market and our expectations. While higher oil prices and food inflation maintained the upward pressure, core inflation continued to diminish on lower exchange rate pass through on negative output gap. Thus, annual core C inflation declined from 18.1% to 17.5%, which was realized lower than our expectation. Domestic producer inflation marginally increased to an annual rate of 29.6%. While part of the recent volatility in the exchange rate is already in March data, it is still early to analyze the effects of increasing volatility in the pricing behavior of economic agents. Hence, we maintain our forecast that consumer inflation will remain between 19-20% till June, when favorable base effects will start to weigh obviously and end the year at 14.5%.

## Annual inflation remained steady on the back of high food inflation

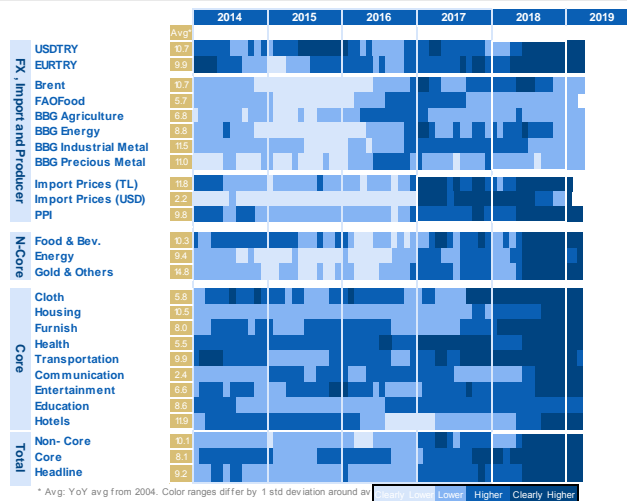
Monthly inflation stemmed mainly from higher food inflation than its seasonal average, energy and services inflation, while core prices play as the downside factors. Due to supply side pressures and distortion in the market mechanism, food prices increased by 2.6% mom (1.3% on average in the last 10 years mostly on top of un-processed food prices, leading the annual figure to stay at near 31%. Besides, still high services prices at 15.2% in annual terms implied the high inertia on backward indexation and cost-push factors. Energy inflation provided an increasing track with an annual figure rising to 16.4% from 14.6%, due to higher oil prices and depreciation in the currency. On the other hand, except education, health and services prices, there was a broad-based recovery in core prices which led annual core inflation to retreat to 17.5% from 18.1% due to diminishing pass-thru on lower demand. Despite the limited but continuing recovery in core inflation, the trend (permanent factor which eliminates seasonal and cyclical factors still hovers near 14% (Chart 5. All in all, still alive cost-push factors, high inertia and recent exchange rate volatility put upside pressures on inflation, while the likely poorer demand on tighter financial conditions, extended tax incentives and diminishing exchange rate pass-thru could be the buffers.

Chart 1 Core Inflation and CPI (YoY)



Source: BBVA Research Turkey & Turkstat

Chart 2 Inflation Heat Map



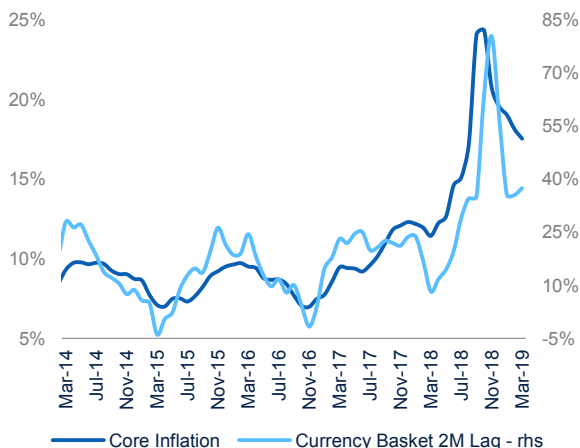
Source: BBVA Research Turkey & Turkstat

## We maintain our inflation forecast but keep an eye on FX volatility

We maintain our expectation that the consumer inflation will remain between 19-20% till June and end the year at 14.5% on favorable base effects, a negative output gap and diminishing exchange pass-thru. There are some upside risks on inflation, particularly those coming from recently increasing exchange rate volatility. We expect the CBRT to maintain a prudent stance and react to any abnormal pricing behavior.

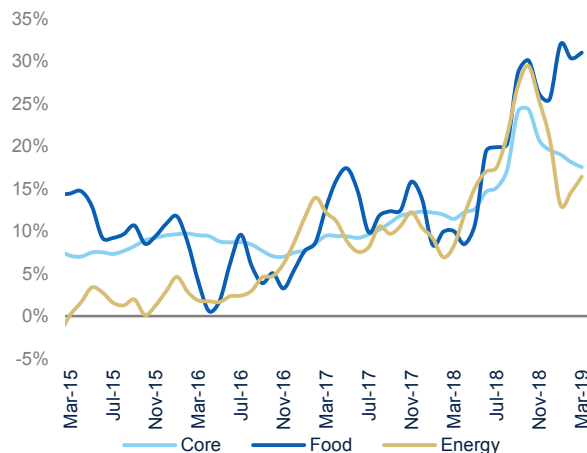
## Creating Opportunities

Chart 3 Core Inflation and Currency Basket, 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 Inflation expectations, YoY



Source: BBVA Research Turkey, Turkstat

Chart 7 CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>1.0%</b>	<b>19.7%</b>
Food & Non-alcoholic beverages	2.4%	29.8%
Beverage & Tobacco	0.0%	2.7%
Clothing & Textile	0.5%	11.0%
Housing	0.3%	16.4%
Household Equipment	0.3%	27.0%
Health	3.5%	19.7%
Transportation	0.7%	15.2%
Communication	-0.3%	10.5%
Recreation & Culture	0.2%	20.1%
Education	1.5%	12.2%
Restaurants & Hotels	0.7%	19.6%
Misc. Goods & Services	0.6%	27.9%

Source: BBVA Research Turkey & Turkstat

Chart 8 Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>1.6%</b>	<b>29.6%</b>
Mining & Quarrying	0.9%	23.4%
Manufacturing	1.6%	28.2%
Food Products	0.9%	24.2%
Textiles	1.2%	29.9%
Wearing Apparel	-1.3%	20.6%
Coke & Petroleum Products	7.7%	43.7%
Chemicals	1.2%	37.3%
Other Non-Metallic Mineral	0.9%	25.2%
Basic Metals	3.3%	25.6%
Metal Products	2.2%	30.7%
Electrical Equipment	2.0%	35.5%
Electricity, Gas, Steam	2.0%	51.6%

Source: BBVA Research Turkey & Turkstat

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