

Economic Watch

# Turkey: Inflation ended 2019 at 11.8%

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Consumer prices increased by 0.74% in December, beating the consensus and our estimate of 0.4%; which led the annual CPI to end 2019 at 11.84% up from 10.56% in November. As anticipated, unfavorable base effects in the last two months of the year pioneered the rise in the annual figure, apart from the higher seasonal factors. Higher than expected food inflation, basically based on the processed food, and our discrepancy for the core inflation both seem to give the first signs of a more rapid pass-through over the prices, given the recent recovery in domestic demand. Still negative output gap, more stabilized currency, ease in cost push factors and more favorable administrative prices continue to be the supporting factors for disinflation. Though, sticky services inflation on wage indexation and inertia, still high and unanchored inflation expectations and increasingly less competitive currency over the front-loaded monetary policy loosening remain to be the challenging factors. Looking ahead, in absence of shocks, headline inflation could stay between 11-12% in 1Q20 before experiencing levels close to 10.5% in 2Q20 and finally one digit levels in the second half of the year. We expect consumer inflation to be 8.5% at the end of 2020.

## Unfavorable base effect led by the increase in food prices in December

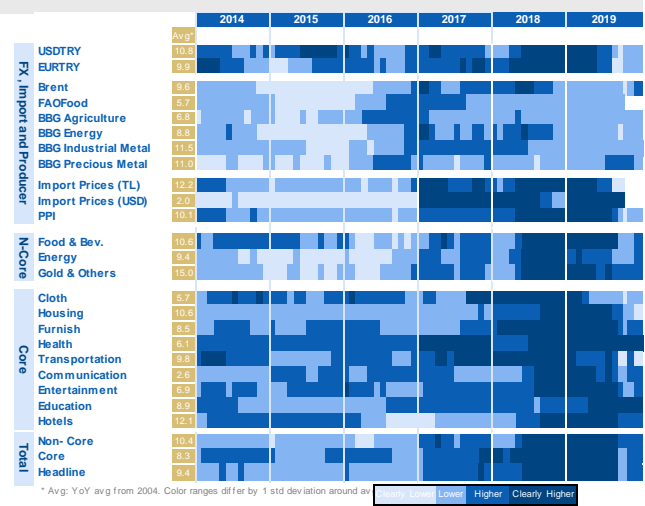
The positive support from food prices since May 2019 halted as food inflation materialized as 3.1% mom in December on the back of both unprocessed (4% mom) and processed food prices (2.1% mom). Thus, annual food inflation rose to 10.8% from 8.7% in November. Energy prices increased slightly (0.2% mom) but its annual figure accelerated to 11% on unfavorable base effects. Core inflation increased by only 0.1% mom thanks to the seasonal effect as the basic goods decreased by 0.2%, mainly on the fall in clothing prices (2% mom). However, seasonal adjusted core inflation signaled that the pick-up in demand starts to kick in and annual core inflation increased to 9.8%, also fueled by unfavorable base effects. Cost push factors remain relatively weak as domestic producer prices increased by 0.7% mom, leading the annual figure to reach 7.4%. However, other sticky factors still require to stay on prudent side. First, inflation expectations are still unanchored with one-year ahead inflation expectation close to 10% and two-year ahead expectation at 9%, which are above the current CBRT inflation forecasts of 8.2% for 2020 and 5.4% for 2021. Second, trend core inflation (Chart 5) is still hovering around 12%. Finally, inertia stays challenging as services inflation remains near 12% (could be further fueled by 15% minimum wage hike). Despite the recent tax incentives in furniture and no price hike in alcoholic beverages and tobacco in the first half of 2020, we still expect inflation to fluctuate near 11% in the first half of 2020 depending on seasonal factors and the expected recovery in economic activity (output gap).

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

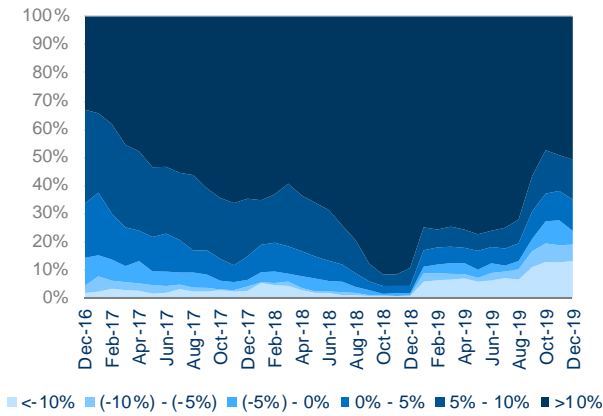


Source: BBVA Research Turkey & Turkstat

## Still challenging factors on inflation requires the CBRT to stay prudent

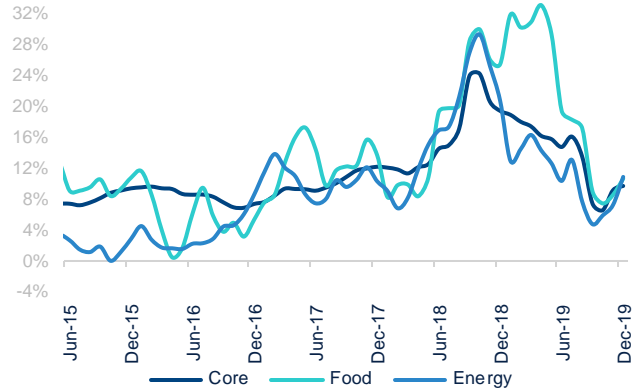
In addition to the increasingly high volatile conditions both locally and globally, stickiness on inertia and inflation expectations and recent slow but promising recovery in domestic demand prove to be the main challenges to bring inflation permanently to one-digit levels. In our view, the Central Bank (CBRT) should decelerate rate cuts in order to maintain a reasonable real interest rate to ensure prudence.

Chart 3. Inflation Diffusion Map, YoY



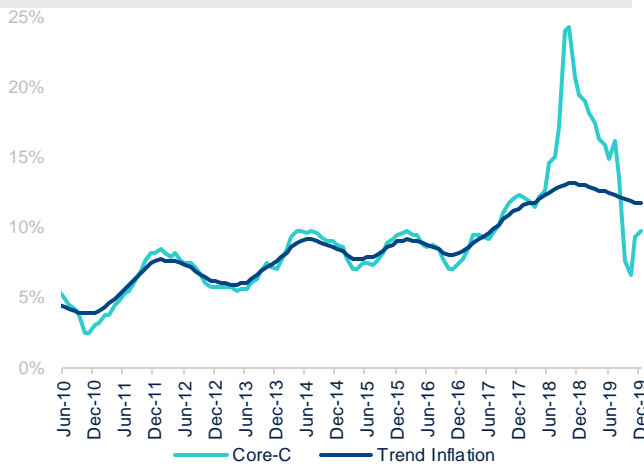
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



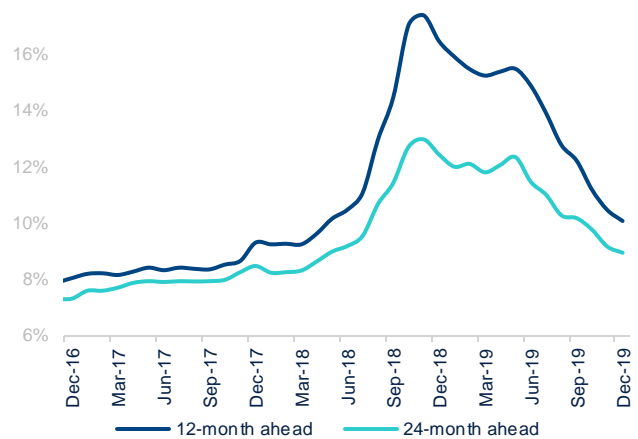
Source: BBVA-Research Turkey, Turkstat,

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>0.7%</b>	<b>11.8%</b>
Food & Non-alcoholic beverages	2.9%	10.9%
Beverage & Tobacco	0.0%	43.1%
Clothing & Textile	-1.9%	4.5%
Housing	0.2%	9.9%
Household Equipment	0.1%	9.8%
Health	0.4%	13.6%
Transportation	0.6%	12.2%
Communication	0.3%	3.2%
Recreation & Culture	-0.1%	7.0%
Education	0.1%	14.5%
Restaurants & Hotels	0.4%	13.2%
Misc. Goods & Services	0.4%	13.6%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.7%</b>	<b>7.4%</b>
Mining & Quarrying	0.5%	13.3%
Manufacturing	0.8%	7.0%
Food Products	1.8%	13.9%
Textiles	0.4%	5.8%
Wearing Apparel	-0.2%	-1.9%
Coke & Petroleum Products	2.0%	9.3%
Chemicals	0.2%	1.0%
Other Non-Metallic Mineral	0.3%	9.1%
Basic Metals	1.5%	-2.8%
Metal Products	0.7%	4.5%
Electrical Equipment	0.3%	10.2%
Electricity, Gas, Steam	-0.9%	12.4%

Source: BBVA Research Turkey & Turkstat

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