

Economic Watch

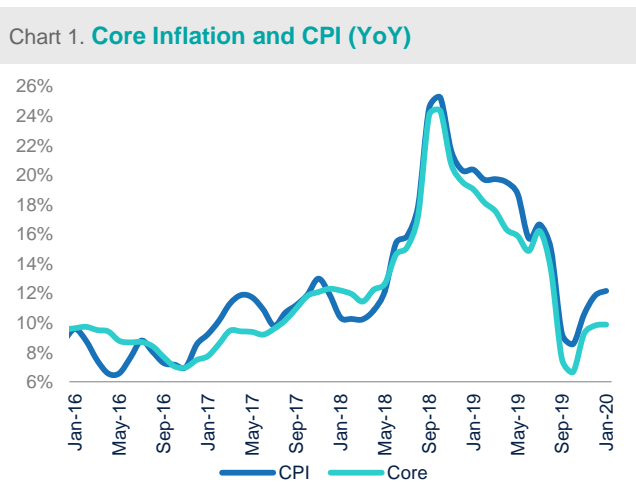
Turkey: CPI started the year at 12.15%

Adem Ileri / Seda Guler Mert / Alvaro Ortiz
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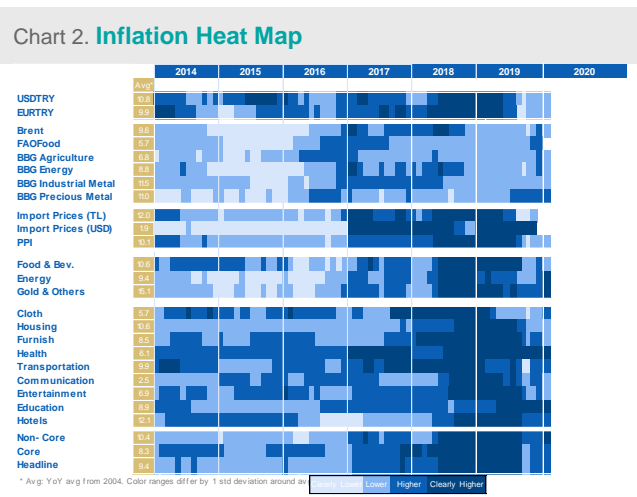
Consumer prices increased by 1.35% (1.0% Consensus vs. 1.5% BBVA Research) in January, leading the annual figure to rise to 12.15% up from 11.84% in December. Our divergence basically stemmed from food inflation, which remained seasonally high compared to the recent years but lower than what we have expected. Though, the headline accelerated as we forecasted, which was pushed mainly by the unfavorable base effects on energy prices. Also, core inflation continued to preserve the signals of the recent recovery in domestic demand, but still to a lower extent which was helped by the still negative output gap. Apart from this, more stabilized currency, current suppressive cost push factors and more favorable administrative prices continue to be the supporting factors for disinflation. Though, sticky services inflation, inertia on indexation, still unanchored inflation expectations and less competitive currency over the narrowing real interest gap remain to be the challenging factors. Looking ahead, in absence of shocks, headline inflation could hover near 12% in 1Q20 before experiencing levels 10.5-11% 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 under the assumptions of a neutral real exchange rate and a food inflation at historically seasonal averages.

Annual inflation pushed by the unfavorable base effects on energy prices

Food inflation which remained seasonally high (4.9% realization vs. 4.7% on average in the last 5 years) was the main reason on the divergence of both our estimates and the consensus. Though, as food inflation was exceptionally high (6.9%) in January last year, annual food inflation still declined on base effects to 8.7% from 10.8%. On the other hand, core prices continued to preserve the signals of the slow but ongoing recovery in domestic demand as annual core inflation slightly picked up to 9.9% despite the tax reduction in furniture prices (-0.4pp impact on Core C). Most importantly, recent wide-spread acceleration in core prices (Chart 3) and sticky services component (remains annually near 12%, Chart 5) could be the much more worrisome point. So, the main reason behind the acceleration in the annual headline inflation was the energy prices as the last year's price cuts on water and electricity provided a lower base for this year (Chart 4). On the positive side, first, cost push factors remain relatively weak as domestic producer prices increased by 1.8% mom, leading the annual figure to reach 8.8%. Second, the currency still stays resilient despite the narrowing real interest gap. Third, negative output gap still prevents jumps for inflationary motives. Lastly, favorable administrative prices in terms of tax cuts and no price hike in alcoholic beverages and tobacco in the first half of 2020 (with a 1.8pp higher weight in the 2020 basket) will be supportive. All in all, we still expect inflation to fluctuate near 12% in 1Q20 and 10.5-11% in 2Q20 depending on seasonal factors and the expected recovery in economic activity.



Source: BBVA Research Turkey, Turkstat

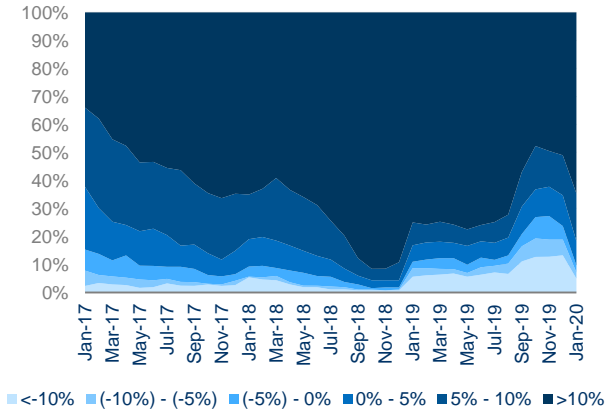


Source: BBVA Research Turkey & Turkstat

The expected pick-up in inflation in 1Q will require the CBRT to become prudent

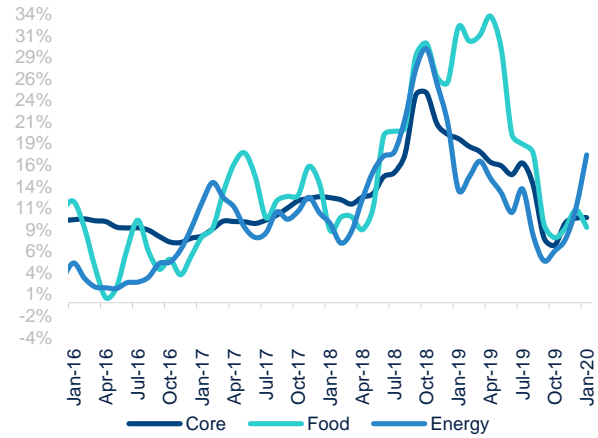
Volatile market sentiment led by both local and external factors, stickiness on inertia and inflation expectations and rapid recovery in domestic demand prove to be the main challenges over pricing behavior. In absence of shocks, we still expect inflation to experience one-digit levels in the second half of the year, which should be accompanied by prudent monetary and fiscal policies.

Chart 3. Inflation Diffusion Map, YoY



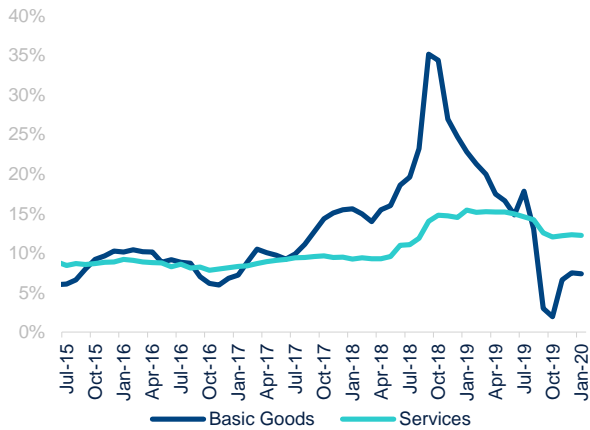
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



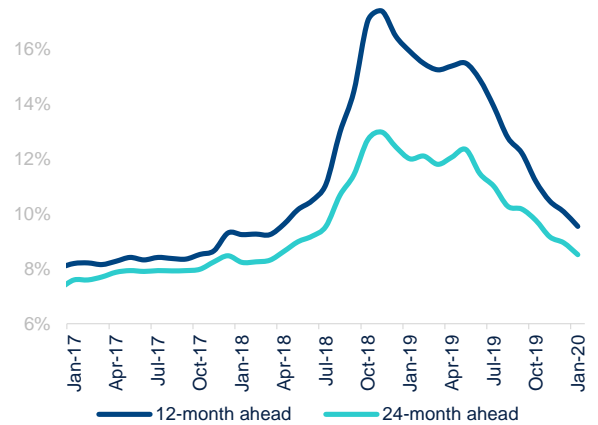
Source: BBVA-Research Turkey, Turkstat,

Chart 5. Basic Goods and Services Prices, YoY



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
Total	1.4%	12.2%
Food & Non-alcoholic beverages	4.7%	9.0%
Beverage & Tobacco	0.0%	42.2%
Clothing & Textile	-6.7%	6.0%
Housing	1.2%	14.8%
Household Equipment	-1.4%	7.5%
Health	4.0%	14.1%
Transportation	0.9%	13.0%
Communication	-0.2%	2.1%
Recreation & Culture	1.9%	5.7%
Education	0.6%	15.1%
Restaurants & Hotels	1.4%	13.5%
Misc. Goods & Services	4.9%	15.0%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
Total	1.8%	8.8%
Mining & Quarrying	2.3%	12.8%
Manufacturing	1.8%	8.4%
Food Products	2.3%	15.1%
Textiles	1.7%	6.2%
Wearing Apparel	-0.7%	-0.7%
Coke & Petroleum Products	5.5%	18.9%
Chemicals	1.4%	2.7%
Other Non-Metallic Mineral	0.3%	7.3%
Basic Metals	2.6%	2.2%
Metal Products	3.7%	12.0%
Electrical Equipment	1.7%	8.2%
Electricity, Gas, Steam	1.0%	13.1%

Source: BBVA Research Turkey & Turkstat

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ENQUIRIES TO:

BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com

