

Economic Watch

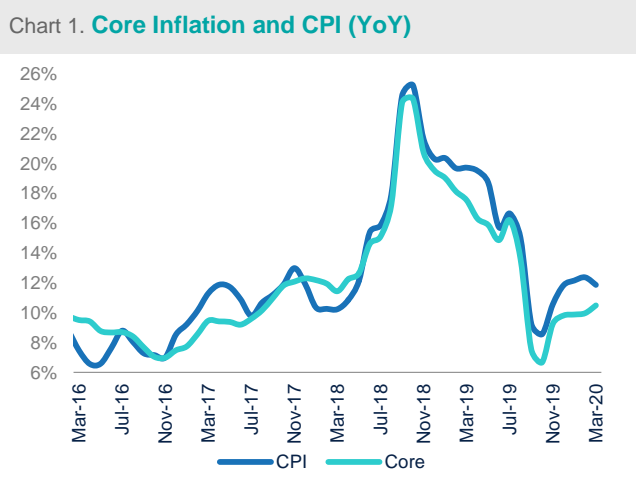
# Turkey: Annual CPI comes down to 11.9% in March

Adem Ileri / Seda Guler Mert / Alvaro Ortiz  
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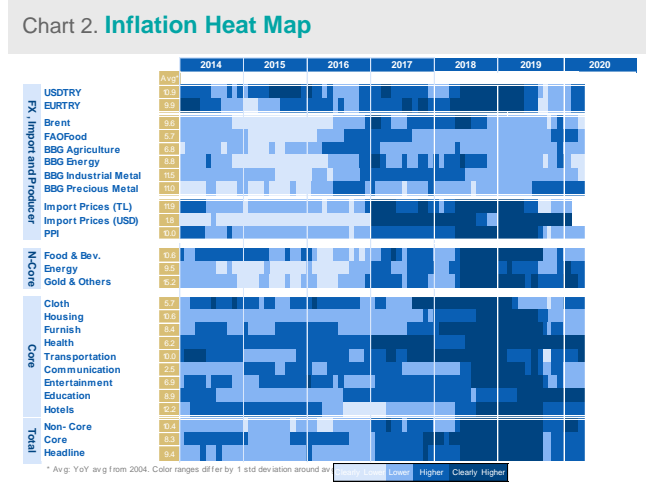
Consumer prices increased by 0.57% in March, higher than both the consensus (0.5%) and our expectation (0.23%). Though, annual inflation declined to 11.86% from 12.37% in February, led by favorable base effects. The deviation of our forecast mainly stemmed from the food prices, which surprised us on the upside with seasonally higher unprocessed food inflation. Core inflation also carries a stronger than expected exchange rate pass-thru and reflects some resistance to lower demand, which could be mostly felt starting from April. The suppressed energy prices weigh on the downside for inflation as expected. Also, depending on the current depreciation pressures over the currency, base effects will remain favorable till August. Despite the stickiness in services inflation, inertia on indexation, tighter financial conditions, and potentially a weaker currency, the gains from lower commodity prices and a deeper negative output gap will weigh more and accelerate the disinflation cycle. Looking ahead, we expect the headline inflation to experience one digit levels as early as May and end the year at near 7.5%.

## Supportive energy prices but unfavorable food prices and pass thru on core

Food inflation increased by 2% mom in March, mainly pushed by unprocessed food inflation (3.1% mom), while processed food inflation materialized as 0.8% mom close to its seasonal average. However, annual food inflation decreased to 9.7% from 10.4% in February on favorable base effects. Energy prices continued to support the disinflation path on the back of lower oil prices as annual energy inflation retreated from 15.5% to 9.8% in March. Global uncertainties triggered by the Cvirus shock lead exchange rate to fluctuate, passing thru the core prices. Core prices increased by 0.77% mom, leading annual inflation to increase from 10% in February to 10.5%. Based on our monthly core inflation model, the realizations in core inflation were close to the lower bound forecasts from August until November when the demand started to kick in (Chart 6) thereafter. Hence, the expected decline in both external and internal demand based on the current shock, the exchange rate pass-thru could be compensated by a deeper negative output gap and second round effects of lower oil prices. On the other hand, services prices remain sticky around 12% and domestic producer prices carry the upward risks in terms of cost push factors by increasing 0.87% mom despite the sharp decline in energy prices in the last two months. On top of these, according to our calculations, though the trend inflation declined slightly, it still continued to hover around 11%, confirming this realization (Chart 5). Nonetheless, we expect inflation to decelerate based on the assumptions of a deeper negative output gap, supportive energy prices and some stabilization in currency after the containment of the Cvirus.



Source: BBVA Research Turkey, Turkstat

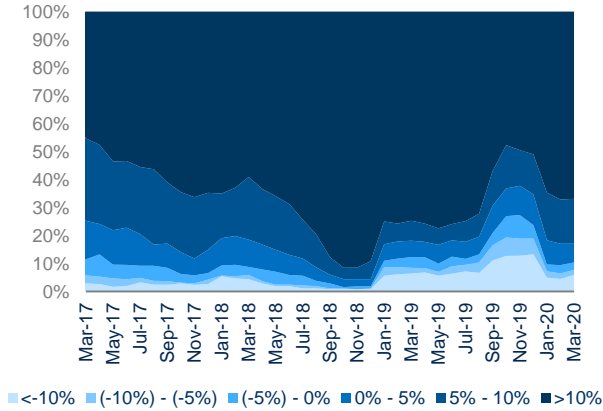


Source: BBVA Research Turkey & Turkstat

## Record low energy prices accelerate disinflation

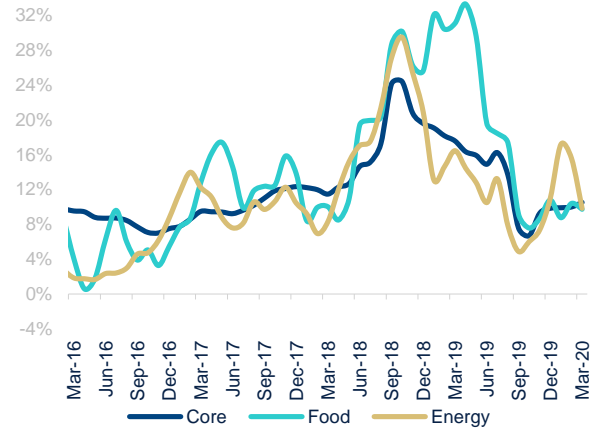
Suppressed energy prices and a deeper negative output gap will dominate the potentially higher exchange rate pass-thru due to the increased volatility over the uncertainties resulting from the Cvirus outbreak. Led by the revision in Brent oil prices (down to near 40\$ from 61\$ on average per barrel) and the GDP growth of this year (down to around 2% from 4% initially), we reduce our year-end inflation forecast by 1pp to 7.5% for the end of 2020. This widens the room for the Central Bank (CBRT) to react more aggressively as we more recently experience from the current measures especially in terms of liquidity injections.

Chart 3. Inflation Diffusion Map, YoY



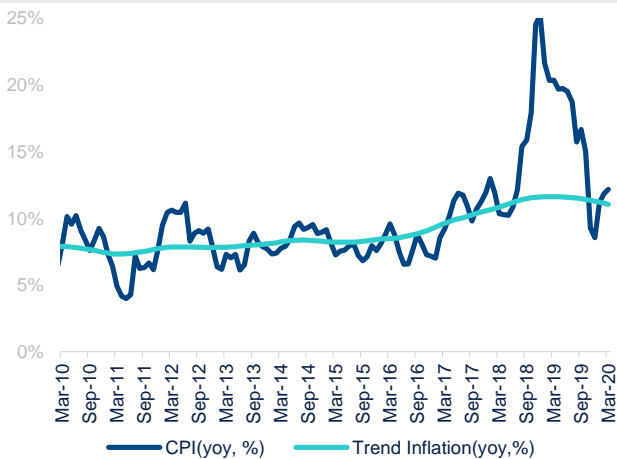
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



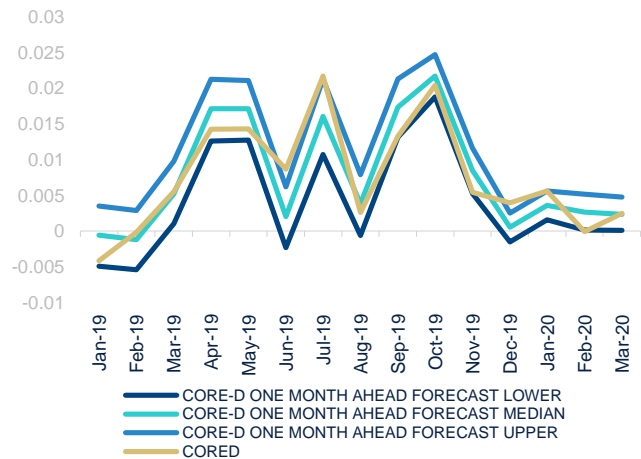
Source: BBVA-Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, YoY



Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 6. Core-D Inflation Forecast vs Realization (MoM)



Source: BBVA Research Turkey BVAR Inflation Model, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.6%</b>	<b>11.9%</b>
Food & Non-alcoholic beverages	2.0%	10.1%
Beverage & Tobacco	0.0%	40.2%
Clothing & Textile	0.6%	6.2%
Housing	0.3%	15.3%
Household Equipment	0.6%	7.7%
Health	2.8%	12.8%
Transportation	-1.9%	8.8%
Communication	0.0%	2.5%
Recreation & Culture	0.9%	6.7%
Education	0.7%	13.4%
Restaurants & Hotels	0.9%	13.7%
Misc. Goods & Services	1.2%	17.2%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>0.9%</b>	<b>8.5%</b>
Mining & Quarrying	-0.3%	10.9%
Manufacturing	0.9%	7.8%
Food Products	2.0%	16.0%
Textiles	2.3%	9.7%
Wearing Apparel	-0.4%	2.5%
Coke & Petroleum Products	-22.5%	-25.7%
Chemicals	2.8%	5.8%
Other Non-Metallic Mineral	-0.1%	5.5%
Basic Metals	3.4%	4.6%
Metal Products	1.8%	11.3%
Electrical Equipment	0.8%	6.7%
Electricity, Gas, Steam	1.0%	18.1%

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

