Creating Opportunities

Inflation Pulse

Türkiye | Still strong inflation trend keeps risks alive

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3 May 2024

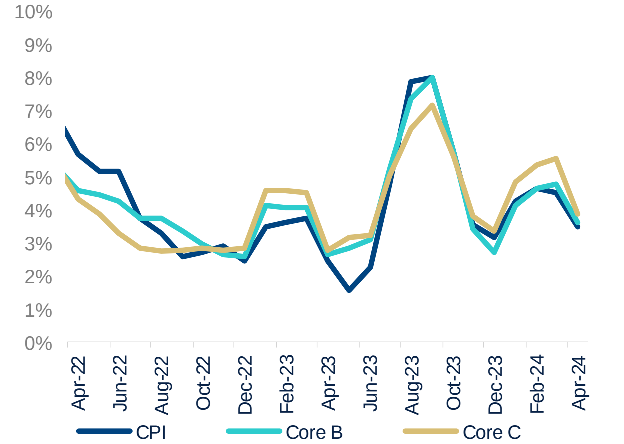
Consumer prices rose by 3.18% in April, parallel to our expectation of 3.1% and slightly lower than the market consensus of 3.4%, which led to an annual consumer inflation of 69.8%. Core inflation trend has eased thanks to basic goods inflation, whereas high services inflation pointed out a strong inertia. Despite the most recent slow-down in domestic demand and relatively stable currency, elevated inflation expectations, high exchange rate pass-through, continuing cost pressures and geopolitical risks maintain upside risks on the inflation outlook. Assuming no additional minimum wage increase, gradual hikes in households' energy prices, a tight fiscal policy excluding earthquake expenditures and a restrictive monetary stance for longer, we maintain our 45% year-end inflation forecast for the time being, with a bias tilted to the slightly downside.

Despite some easing in goods prices, strong inertia remains as the main challenge

Core C prices (excluding food, alcohol & tobacco, energy and gold) rose by 3.6% m/m in April (vs. 3.5% m/m prev.) mainly due to still strong services inflation, leading annual core C inflation to accelerate slightly to 75.8% from 75.2%. Yet, on seasonal adjusted series according to our calculations, a limited slow-down took place (3.3% m/m vs. 3.9% m/m prev.) and its 3-month average trend decelerated to 3.9% from almost 5.5% in March (Figure 1), which was also triggered by the removal of the strong January data (around 8%).

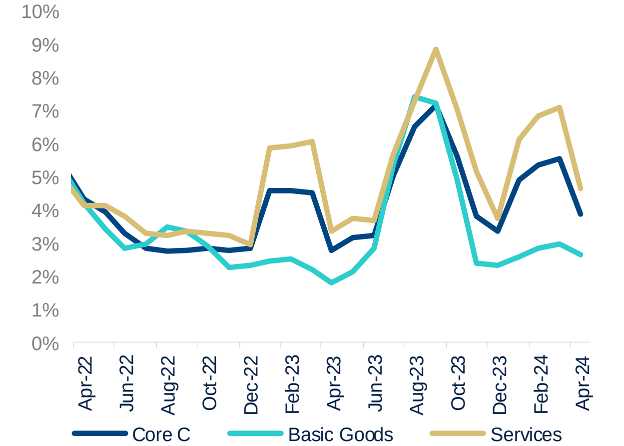
In sub-details, monthly services prices inflation remained unchanged with 4.2% compared to the previous month and annual services inflation gained limited pace to 97% from 96.5% the month before. On seasonal adjusted series, monthly services inflation stayed almost the same (4.1%) due to the continuation of strong inertia and its 3-month trend decelerated to 4.6% mostly on the carry-over impact (Figure 2). The main drivers of the strong services prices were the acceleration in restaurant & hotel (4.7% m/m) and transportation services prices (6.4% m/m), which could have been affected by second round price effects and the long Eid al-Fitr holiday in April. The distortions in pricing behaviour due to unanchored inflation expectations and very slow deceleration in consumption up to April (wage hikes and huge availability of credit card spending) have kept services prices resilient, resulting in a strong inflation inertia. Yet, some progress has also started to be seen with the elimination of some transitory factors, particularly the ease in rental prices inflation (4.6% in Apr vs. 8.3% in 1Q24).

Figure 1. **CONSUMER INFLATION INDICATORS (seasonal adj., monthly, 3-month average)**



Source: Garanti BBVA Research, TURKSTAT

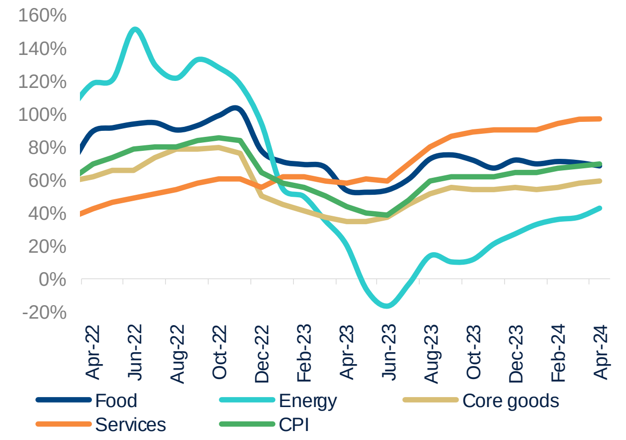
Figure 2. **CONSUMER INFLATION INDICATORS (seasonal adj., monthly, 3-month average)**



Source: Garanti BBVA Research, TURKSTAT

On the goods side, some slow-down in domestic demand more clearly seen in April (Figure 4) and limited currency depreciation seem to support basic goods inflation. Basic good prices rose by 3% (2.9% m/m prev.), mainly led by clothing and footwear prices (4.6% m/m) due to both seasonal factors and Eid al-Fitr. With this realization, 3-month average trend in goods inflation improved limitedly to 2.7% (vs. 2.9% in March). Even though the monthly currency depreciation was very gradual, unanchored pricing behaviour and cost push factors on commodity prices still maintained high inflation readings on the exchange rate sensitive items, such as furniture (6.6% m/m), household appliances (2.9%) and personal care (3.1%). All in all, consumer inflation trend has started to improve compared to previous months by decelerating to 3.5% on a 3-month average basis (vs. the CBRT's target of 1.5% in 4Q24), led by the gains in basic goods and food prices to some extent.

Figure 3. **CONSUMER INFLATION INDICATORS** (YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 4. **GARANTI BBVA BIG DATA CONSUMPTION INDICATORS** (28-day sum, real YoY)

Source: Garanti BBVA Research

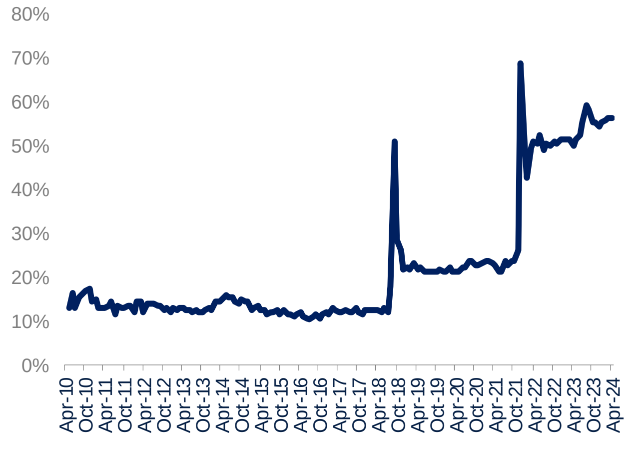
Food prices increased by 2.9% m/m (vs. 3.5% m/m in March) on the back of some deceleration in unprocessed food (3.8% m/m) and a limited increase in processed food prices (1.8% m/m). As a result, annual food inflation slowed down to 68.4% from 70.5% the month before (Figure 3). The slight increase in fresh fruit and vegetable prices (0.7% m/m) on seasonal factors helped a more moderate increase in unprocessed food prices. Yet, other unprocessed food inflation (5.8% m/m) still remained high due to additional strong price increases in both red meat and poultry prices. Energy prices remained flat following the 1.4% increase of the previous month, but annual energy prices accelerated to 42.8% from 37.3%, led by the low base effects. Last but not the least, the deteriorating impact of cost push factors on the inflation outlook continued as confirmed by the 3.6% monthly acceleration in domestic producer prices (3.3% m/m prev.), as well as the 55.7% annual producer inflation (51.5% y/y prev.).

The coordinated policy mix will be crucial to contain high inflation expectations

Strong inertia, high exchange rate pass through, elevated inflation expectations and geopolitical risks keep risks on inflation outlook on the upside. Despite the surprising rate hike of the CBRT in March, inflation expectations in April remained unchanged for the year-end of 2024 and 2025 with 44.2% and 26.3%, respectively, well above the CBRT's interim targets of 36% and 14% (Figure 6). Also, heightened geopolitical tension in the Middle East poses upward pressure on commodity prices and their volatility. The probability of a rapid convergence in inflation expectations to the CBRT targets would be low, considering that the current inflation trend (3 month average adjusted CPI) is around 3.5%, given the strong inertia. Therefore, it is important that the CBRT maintains a cautious stance against the risks on inflation. The second inflation report of the year will be published on May 9th where we do not expect a significant revision in the CBRT's inflation forecasts but their communication will be key for the near term inflation expectations.

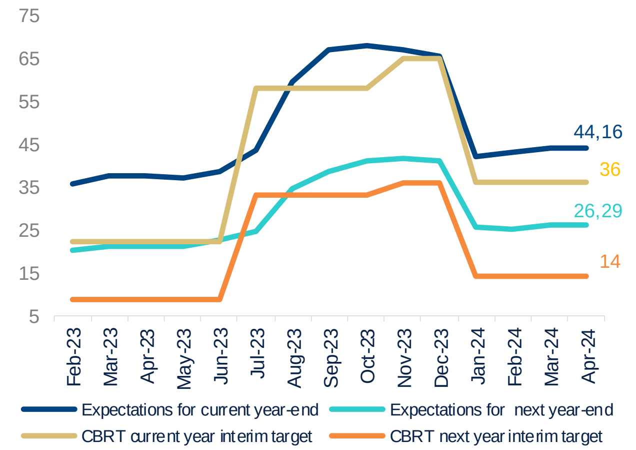
On the other hand, some positive signals have recently started to contain upside risks on inflation. First, our big data indicators show a loss of momentum in both goods and services consumption in April. Yet, it might still be early to call it as a fast normalization due to the calendar day effects of the long holiday. This trend may be sustained if the restrictive lending rates continue to limit private consumption as seen in the 4-week average credit growth rates (Figure 7). Financial conditions continue to remain tight, especially after the recent upsurge in loan rates. However, the real return of the stock market, the real currency appreciation and the decrease in risk premium seem to have prevented further tightening (Figure 8). In this regard, wealth effects and repercussions from the previous financial repression period might still support domestic demand, weakening the monetary transmission mechanism. On the positive side, the dollarization tendency, which had strengthened prior to the local election in March, has started to reverse in April. The de-dollarization among residents may accelerate in the near term, which could help the stabilization of the currency, together with the increasing foreign capital inflow and a promising tourism season.

Figure 5. **EXCHANGE PASS-THROUGH ON CORE D INFLATION** (Recursive Method)



Source: Garanti BBVA Research, TURKSTAT

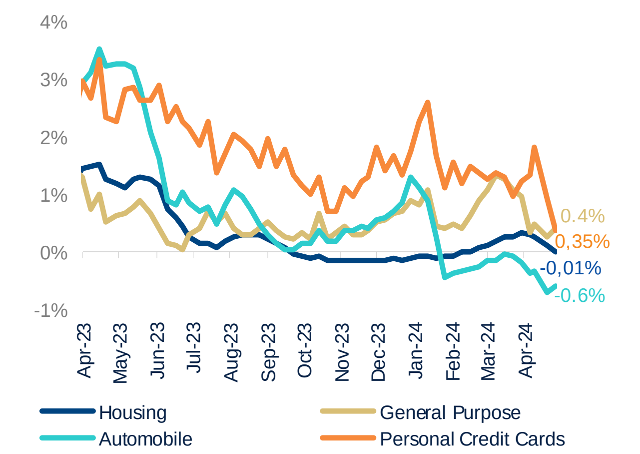
Figure 6. **CBRT Market Participants Survey Inflation Expectations (%)**



Source: Garanti BBVA Research, CBRT

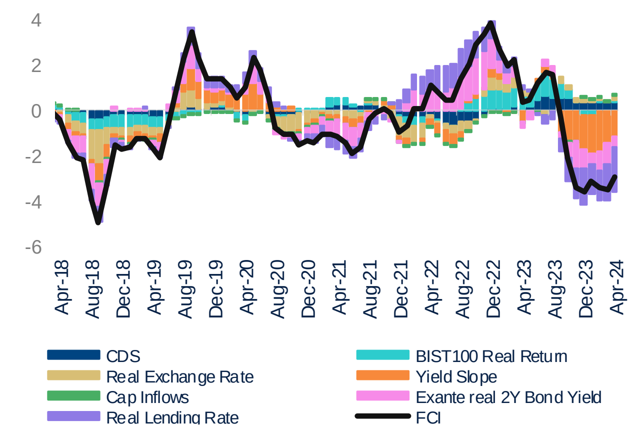
We expect annual consumer inflation to reach around 75% in May due to the elimination of the natural gas subsidies (close +2pp impact) before starting to decrease in the second half of the year on both base effects and deceleration in its trend. Assuming no additional minimum wage increase, gradual hikes in households' energy prices, a tight fiscal policy excluding earthquake expenditures and a restrictive monetary stance for longer, we maintain our 45% year-end inflation forecast for the time being. However, we also assess downward risk on our forecast has increased. Although it is too early to talk about on the easing cycle, it would be more crucial that the CBRT eases or removes current regulations to support the monetary transmission mechanism before cutting rates. If the year-end inflation falls below 42%, the upper bound of the CBRT's target, the CBRT could start an easing cycle very gradually in 4Q24 since inflation expectations for 2025 are well above the CBRT's point target of 14%.

Figure 7. **CONSUMER CREDIT GROWTH** (4-week avg.)



Source: Garanti BBVA Research, CBRT

Figure 8. **GARANTI BBVA FINANCIAL CONDITIONS INDEX** (standardized, + easing, - tightening)



Source: Garanti BBVA Research, CBRT, Bloomberg

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