Inflation Pulse

Türkiye | Low inflation realization on zero gas prices

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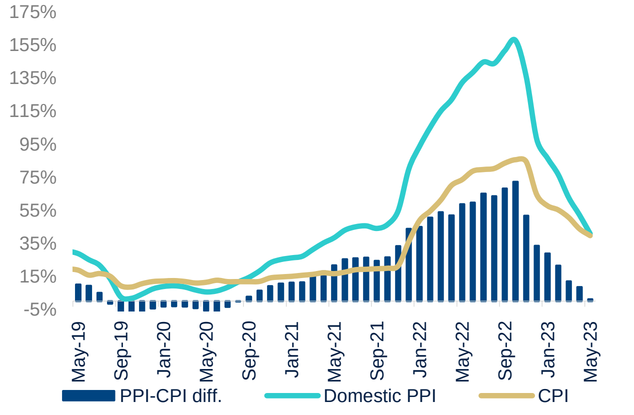
Consumer prices rose by 0.04% in May, slightly lower than both our expectations and market consensus (0.2% both). Therefore, annual inflation significantly came down to 39.6% from 43.7% the month before, driven by the Turkstat's "zero price" method applied for natural gas prices in May. On the other hand, stronger than expected core C inflation (4.3% m/m) signaled high inflation dynamics on the back of both basic goods and services prices. Even assuming a gradual depreciation in the currency, taking into account potential strong wage adjustments in July on election promises, still robust domestic demand, high inertia, cost push factors, challenging food inflation on supply disruptions and second round effects, we expect 2023 year-end inflation to get closer to 50%. Thereafter, the magnitude and the duration of the expected tight stance of the new economy management in monetary and fiscal policies will be decisive on the inflation outlook in 2024.

Stronger than expected core prices prevent further improvement in inflation

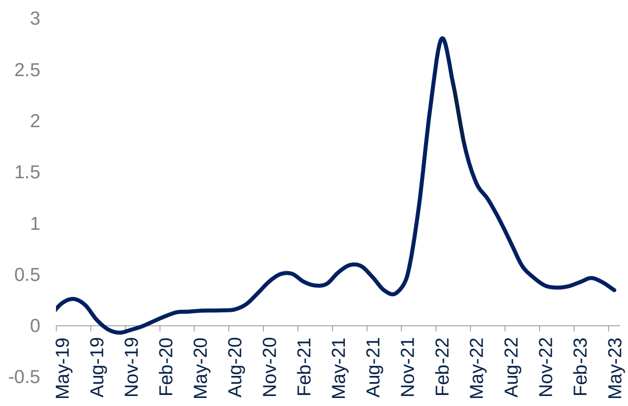
Core prices (C index) inflation remained stronger than both market consensus and our forecast (2.8% and 2.7% m/m, respectively), climbing up to 4.3% m/m in May from 3.2% in April. Consequently, annual core prices inflation geared up to 46.6% from 45.5%. Basic good prices and services inflation increased by 3.9% m/m and 4.6% m/m, respectively, contributing to the acceleration of monthly core inflation. Expected but delayed upward adjustment in clothing and footwear prices, which have been well below its seasonal average in recent months, finally took place in May. The sharp increase in seasonal adjusted (s.a.) clothing and footwear prices (7.1% m/m) and the high increase in auto prices (s.a., 6.2% m/m) were the main drivers of the acceleration in basic good prices. Also, the acceleration in services prices was mainly due to the strong realizations in restaurants and hotels (7.1% m/m vs. 4.2% m/m prev.), rent prices (5.1% m/m vs. 4.4 m/m prev.) and other services (3.7% m/m vs. 2.7% m/m prev.).

Figure 1. **CPI VS DOMESTIC PPI** (YOY)



Source: Garanti BBVA Research, TURKSTAT

Figure 2. **ANNUALIZED MANUFACTURING PPI TREND** (THREE MONTH MOVING AVERAGE,%)



Source: Garanti BBVA Research, TURKSTAT

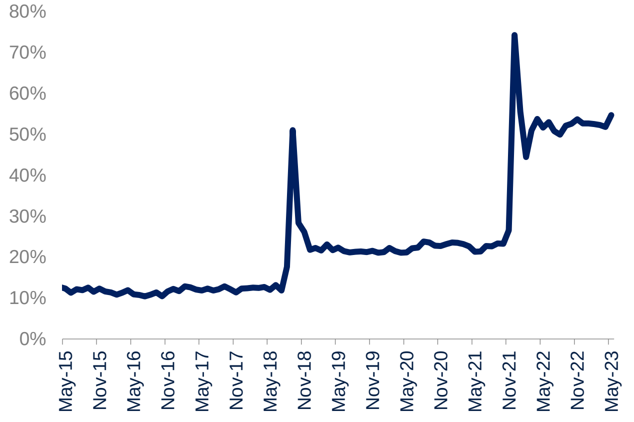
Increase in food prices remained limited with 0.7% m/m, coming down from 4.1% in April mainly due to the contraction in fresh fruit and vegetable prices (-5.0% m/m) and weak processed food prices (1.1% m/m) while other unprocessed food prices continued to remain high with 3.2% m/m. So, annual food inflation slightly lost pace with 52.1% y/y (53.1 y/y prev.) on favorable base effects. Equalizing natural gas prices to 0 in the CPI calculations of Turkstat led energy prices to contract on both a monthly and annual basis (-21.0 m/m and -7.0% y/y, respectively).

Finally, domestic producer prices decelerated by 0.65% m/m, mainly on the back of the decline in electricity, gas and steam prices (-7.4% m/m), led annual figure to decline to 40.8% y/y from 52.1% y/y previously. Therefore, the gap between annual CPI and domestic PPI reached the lowest level since September 2020 with 1.2pp. However, if we check the annualized trend in 3 months moving average of manufacturing producer prices, it decreased just slightly to 35% in May 2023 from 37.2% in December 2022, signaling cost push factors are still alive despite the stable currency and the ease in energy prices.

Gas prices may help in short run but trend inflation pose more challenges ahead

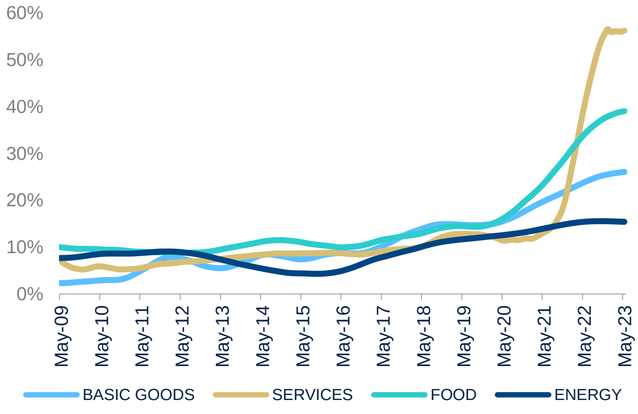
The natural gas bill was written off in May and the initial 25m^3 of monthly consumption was announced to be written off during one year as part of the election promises. Accordingly, Turkstat announced the price of natural gas being used by households would be equalized to 0 for May consumer inflation, and it would be covering only the unit price of the consumption over 25m^3 per month until May 2024. Leaving out the impact of the natural gas price, we calculate that the monthly inflation would be around 2.9% which would correspond to 43.5% annual inflation. Considering the natural gas consumption patterns of the households, it is highly likely that natural gas price would remain equal to 0 until the start of November. Thereafter, colder weather conditions might incur positive gas price (higher than 0) as the natural gas consumption of an average household may exceed 25m^3. Accordingly, the delayed impact will be added to the inflation but the yearly average inflation will come down in 2023.

Figure 3. **EXCHANGE PASS-THROUGH ON CORE D INFLATION** (RECURSIVE METHOD)



Source: Garanti BBVA Research, TURKSTAT

Figure 4. **TREND INFLATION IN SUB-COMPONENTS** (YOY)



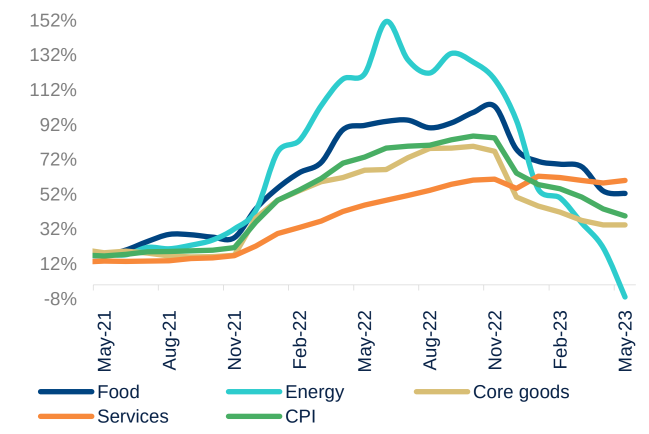
Source: UCSV-MA Model, Garanti BBVA Research, TURKSTAT

Trend inflation in subcomponents remaining steady at high levels exhibited that services and food prices would require more effort to curb down inflation in the near future, while only the energy inflation help trend outlook to some extent. On top of that, according to our calculations, exchange pass-through to core inflation also remains strong. Despite the slowdown thanks to adjustments in energy bill, inflationary pressures will continue to keep the momentum strong in the upcoming months. Higher than expected trend in core C inflation driven by high course of services prices might strengthen in the upcoming months with the additional upward impact from recently announced price hikes in tobacco, cars and some other products. Potential high adjustments in public servants' wages and minimum wages based on election promises could exacerbate cost push factors.

The degree of the will to fight against inflation would be decisive on outlook

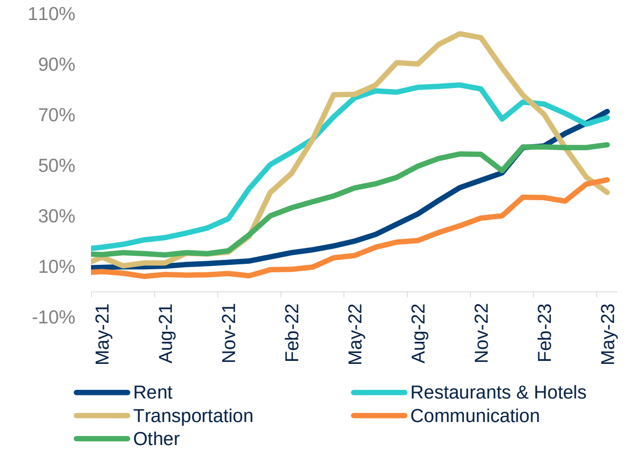
Although inflation is gearing down with the help of favorable base effects and energy price adjustments, high inertia, robust inflation trend, high food prices and deteriorated inflation expectations pose upside risk on inflation outlook. As our previous analyses have indicated, bringing annual inflation down below 20% will require structural changes in economic policies. Assuming the currency to stabilize at levels which will close the inflation differential we have been experiencing since late 2021, we expect the year-end inflation to get closer to 50% in 2023. The new economy administration emphasizes that the fight against inflation will be their priority. On the other hand, as a political choice, a sharp adjustment in economic activity might not be allowed before the local election in March 2024. Therefore, we may not see a rapid improvement in inflation outlook in the short term while the disinflation pattern will be shaped by the stance of the economic policies in 2024.

Figure 5. **CPI MAIN SUBCOMPONENTS** (YOY)



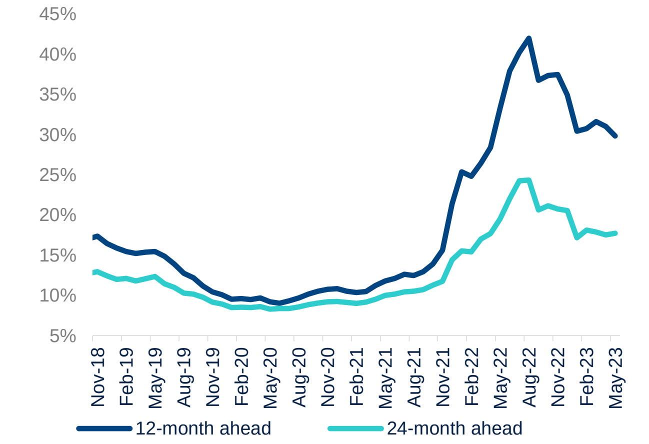
Source: Garanti BBVA Research, TURKSTAT

Figure 6. **SERVICES INFLATION SUBCOMPONENTS** (YOY)



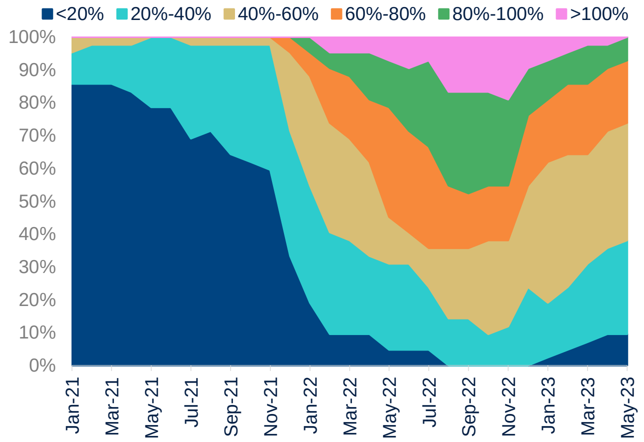
Source: TURKSTAT

Figure 7. **CBRT SURVEY INFLATION EXPECTATIONS** (YOY)



Source: Garanti BBVA Research, TURKSTAT

Figure 8. **CPI DIFFUSION ANALYSIS** (YOY)



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI SUBCOMPONENTS**

	MoM	YoY
Total	**0.04%**	**39.59%**
Food & Non-alcoholic beverages	0.7%	52.5%
Beverage & Tobacco	0.3%	30.1%
Clothing & Textile	9.9%	19.5%
Housing	-13.8%	20.7%
Household Equipment	1.0%	45.1%
Health	1.8%	66.9%
Transportation	1.9%	23.7%
Communication	1.7%	36.7%
Recreation & Culture	3.6%	42.9%
Education	5.1%	50.9%
Restaurants & Hotels	7.1%	69.0%
Misc. Goods & Services	1.8%	46.1%

Source: Garanti BBVA Research, Turkstat

Figure 10. **DOMESTIC PPI SUBCOMPONENTS**

	MoM	YoY
Total	**0.65%**	**40.76%**
Mining & Quarrying	1.7%	56.8%
Manufacturing	1.3%	42.3%
Food Products	3.2%	64.5%
Textiles	0.7%	33.2%
Wearing Apparel	2.2%	50.5%
Coke & Petroleum Products	-8.6%	-15.4%
Chemicals	1.4%	33.3%
Other Non-Metallic Mineral	0.7%	67.1%
Basic Metals	1.1%	10.4%
Metal Products	6.6%	44.3%
Electrical Equipment	2.2%	53.1%
Electricity, Gas, Steam	-7.4%	0.5%

Source: Garanti BBVA Research, Turkstat

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