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Türkiye | Hope Heats Up as Inflation Cools Down

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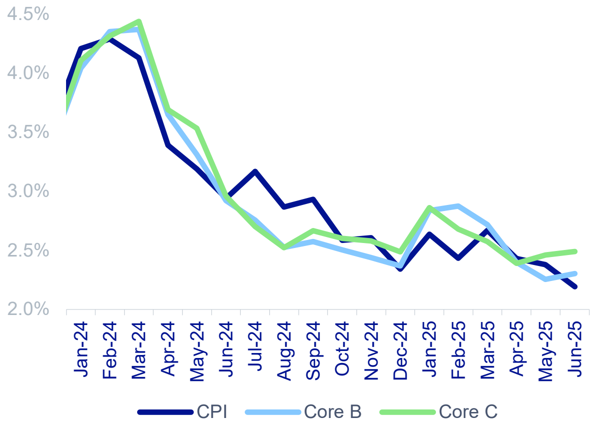
- Consumer prices rose by 1.37% m/m, lower than both our expectation and the consensus (1.5%), driving annual inflation down to 35.05%.
- According to our calculations, seasonally adjusted (s.a.) monthly consumer inflation decelerated only marginally to 1.96% (vs. 2.01% in May) due to the deterioration in services inflation, despite the slow-down in basic goods inflation on weakening domestic demand and managed currency. However, 3-month average trend improved further to 2.2% in June (vs. 2.4% previously).
- Services inflation (s.a) rose to 3.1% m/m in June (vs 2.7% previously) on a broad-based deterioration except for transportation, whereas basic goods inflation retreated to 1.4% m/m (vs. 1.9% m/m in May) due to a clearer deceleration in durable goods inflation.
- Monthly inflation in July could upsurge to a range of 2-2.5% due one-off effects such as the 24.6% hike in natural gas prices for households and other potential upward adjustments in administered prices. Nevertheless, most recent better than expected inflation realizations and ongoing tight monetary policy have increased the likelihood of a year-end consumer inflation below 30%, to which we will revise once we see how the July administered price hikes are finalized in the next days.
- As a result, we now evaluate a larger room of rate cuts for the Central Bank (CBRT). However, uncertainties about the scale of fiscal consolidation, food prices due to the impact from frost, strong inflation inertia, and high inflation expectations require the CBRT to remain prudent.

Disinflation Driven by Durable Goods Amid Services Pressure

Consumer prices rose by 1.37% m/m in June (vs. 1.53% in May), marking a downside surprise for the third consecutive month relative to both consensus and our expectations (1.5% m/m for June). This resulted in a decline in annual inflation to 35.05% from 35.41%. Our seasonally adjusted calculations indicate a relatively flat trajectory, with headline CPI at 1.96% m/m, slightly down from 2.01% in May. A broad-based deterioration in services inflation masked improvements in goods inflation, which were confined to durable goods amid weakened demand and waning effects of the exchange rate pass-through from March.

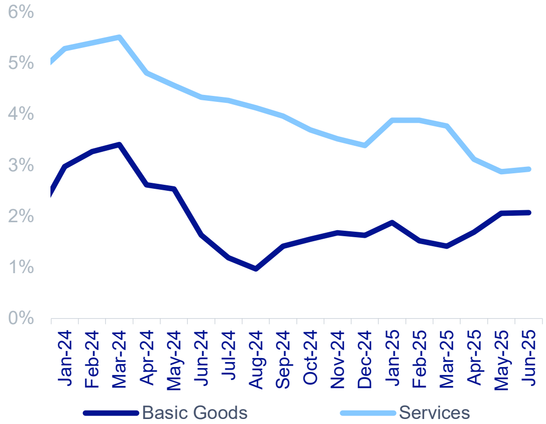
The 3-month headline inflation trend fell to 2.19% from 2.38% in May, due to the exclusion of the high March print on non-core items. In contrast, the 3-month trends for core B and core C inflation remained relatively stable at approximately 2.3% and 2.5%, respectively.

Figure 1. Consumer Inflation Indicators
(seasonal adj., monthly, 3-month average)



Source: Garanti BBVA Research, TURKSTAT

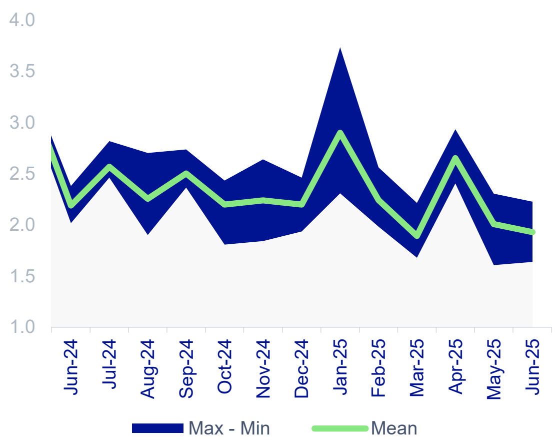
Figure 2. Core C Inflation Indicators
(seasonal adj., monthly, 3-month average)



Source: Garanti BBVA Research, TURKSTAT

According to our calculations, seasonally adjusted underlying trend indicators monitored by the CBRT continued to improve in June, falling to 1.9% m/m from 2.0% m/m in May -converging towards the pre-shock March level. As a result, the 3-month trend of the underlying inflation remained stable at 2.2% m/m in June. Among the underlying trend indicators, core C posted the highest reading (2.2%, down from 2.3% in May), as it includes certain high-weight services outliers such as rent and education (pre-primary, primary, secondary). The lowest was V_1, an indicator excluding extreme values, which improved to 1.6% m/m from 1.8%. Median inflation declined to 1.8% m/m from 2.0% in May (vs. 1.7% in March). However, the range between the second and third quartiles of the 143-item basket widened, and inflation edged up in both quartiles in June compared to May, signaling caution regarding the inflation outlook. Similarly, the dynamic factor model remained at 2.2% m/m, suggesting persistent structural pressures preventing a faster disinflation.

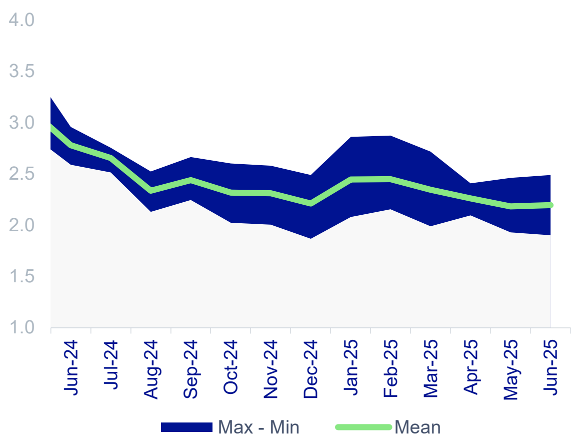
Figure 3. Consumer Inflation Indicators*
(seasonal adj., monthly)



Source: Garanti BBVA Research, TURKSTAT

* Mean represents the average of different trend indicators including seasonally adjusted B, C, SATRIM, Median, inflation excluding volatile items and dynamic factor. The highlighted area shows the maximum and minimum range.

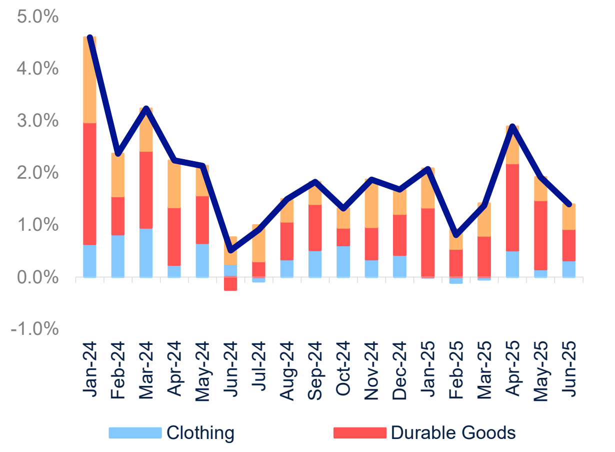
Figure 4. Consumer Inflation Indicators*
(seasonal adj., monthly, 3-month average)



Source: Garanti BBVA Research, TURKSTAT

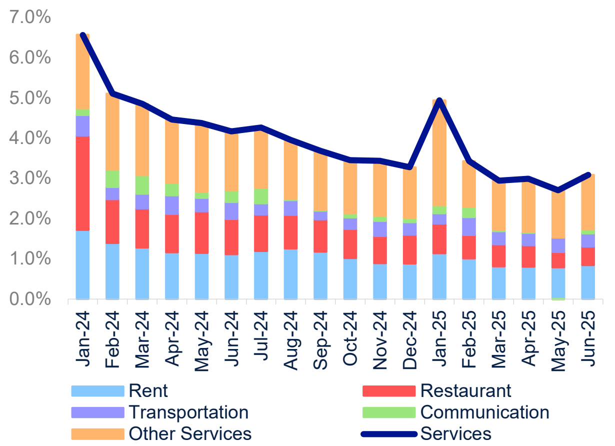
Seasonal adjusted core C inflation improved to 2.23% m/m in June, down from 2.31% in May, yet still above the pre-shock level of 2.14% in March. The improvement was driven solely by durable goods (down to 1.2% m/m from 2.7%), while other basic goods showed signs of deterioration. Clothing inflation rose to 1.5% (from 0.7%), and other basic goods rose to 1.6% (from 1.5%). It seems tight financial conditions and weaker purchasing power appear to compress profit margins on durables, which are more sensitive to demand conditions (compared to basic needs). Overall, basic goods inflation declined to 1.4% from 1.9%. In adjusted terms, services inflation deteriorated to 3.1% from 2.7%, reflecting broad-based increases: rent (up to 4.4% from 4.1%), restaurant & services (1.8% from 1.5%), communication (1.5% from -0.1%), and other services (3.5% from 3.1%). Only transportation services inflation improved, falling to 3.3% from 3.6%.

Figure 5. Contributions to Basic Goods Inflation (seasonal adj., monthly, pp)



Source: Garanti BBVA Research, TURKSTAT

Figure 6. Contributions to Services Inflation (seasonal adj., monthly, pp)



Source: Garanti BBVA Research, TURKSTAT

In adjusted terms, food inflation remained supportive due to a deceleration in processed food inflation (down 1.0% from 1.4%), while unprocessed food inflation accelerated (up 2.0% from 1.6%). Although fresh food inflation decelerated in June (to 3.1% from 4.5%), the effects of the agricultural frost have yet to materialize. Unlike fresh foods, other unprocessed food might have experienced a higher price increase due to expected weak supply from today. Accordingly, food and non-alcoholic beverages inflation remained relatively stable at 1.5% m/m, bringing annual inflation down to 30.3% from 32.9%. Given the uncertainty in timing, food inflation remains a risk to the inflation outlook.

Energy inflation almost remained stable at 2.3% m/m (vs. 2.1% in May), driven by fuel prices amid geopolitical tensions and a 5.0% increase in water prices. The natural gas price hike of 24.6% at the start of July is expected to add a direct impact of approximately 0.5pp to July inflation CPI. Considering a potential increase in the special consumption tax on fuel prices, energy inflation is expected to rise further in July. On the producer side, domestic PPI came at 2.5% m/m in June, bringing its annual inflation to 24.5%, up from 23.1%. With the natural gas price increase for industry (7.9% in July) and potential fuel price hikes, cost-push pressures are intensifying. However, subdued domestic demand may limit pass-through to consumer prices.

Better inflation outlook but no room for complacency

Over the past three months, inflation realizations have surprised to the downside, with seasonally adjusted monthly inflation stabilizing at around 2%. The consumer inflation diffusion index (Figure 10), based on seasonally adjusted subcomponents, shows that in recent months the share of items increasing by 4% or more on a monthly basis has declined, while the share of items rising between 0% and 2% has increased, proving the improvement in the inflation distribution. While July inflation reading might increase slightly due to one-off effects, there might not be a deterioration in the underlying trend, thanks to the CBRT's tight monetary stance and expected weak demand conditions. In fact, the output gap appears to have deepened further into negative territory in 2Q25, reinforcing the disinflation narrative.

However, several persistent risks warrant a cautious approach. First, services inflation remains elevated at around 3% (seasonally adjusted), suggesting persistent inflation inertia. We may continue to see lagged effects on services inflation driven by backward-looking pricing behavior in the coming months. Second, inflation expectations, which significantly influence price-setting behavior, remain elevated despite some improvement. According to the market participants survey made by the CBRT, 12- and 24-month inflation expectations materialized at 24.56% and 17.35%, respectively, with only a modest improvement in June. Real sector expectations fell only marginally to 39.8% from 41%, and households' expectations, down by around 6.9pp, still remain high at 53%. These figures continue to stay above the CBRT forecast range (19-29% for 2025 end) and could undermine the effectiveness of disinflation efforts.

There are also sector-specific uncertainties. While food prices have recently supported lower headline inflation readings, the potential impact from agricultural frost has not yet been fully reflected, maintaining uncertainty. Meanwhile, energy prices -although having fallen back following a ceasefire in Iran war- remain vulnerable to geopolitical tensions, given the uncertainty around the durability of the truce. Last but not the least, adding to the complexity, fiscal policy remains an unknown. With downside risks to growth outlook rising, the extent to which fiscal policy will support the disinflation process is unclear.

In summary, recent developments have improved optimism about the inflation outlook, but risks leave little room for complacency. Assuming monetary policy remains tight, oil prices hover around $65, year-end USD/TRY at 45, GDP growth to remain in a range of 3-3.5% and a limited impact of frost on food prices, we see a high probability that year-end inflation will fall below 30%. This improved backdrop gives the CBRT more room to start monetary easing. However, we believe a cautious approach is warranted. The CBRT confirmed this clearly in its June MPC decision, keeping rates unchanged despite market expectations for a cut on the upper band of interest rate corridor. For July, market expectations for rate cut vary widely -between 250 and 350 basis points. Our baseline forecast is a 300 bps cut, though we do not rule out the downside risk. Although we see growing downside risks to our year-end policy rate forecast of 36%, the final level will likely depend on the degree of the fiscal discipline.

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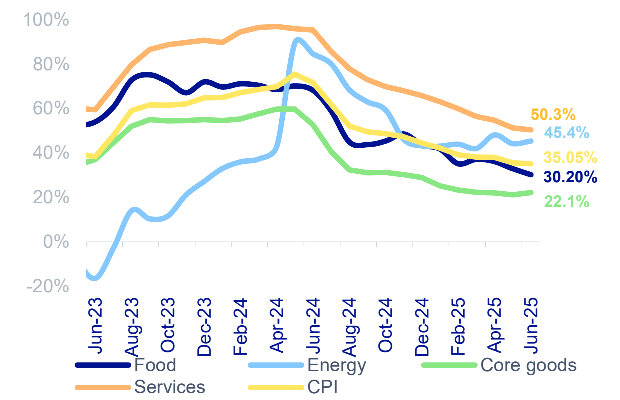
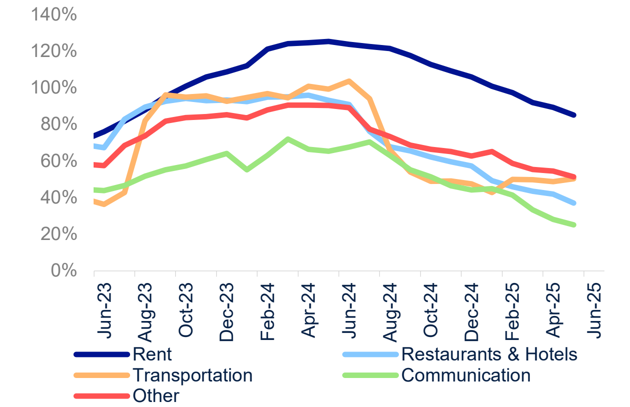
Figure 8. Consumer Inflation Subcomponents (YoY)



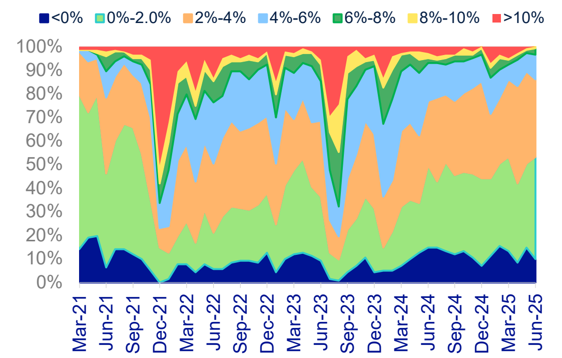
Source: Garanti BBVA Research, TURKSTAT

Figure 9. Services Inflation (YoY)



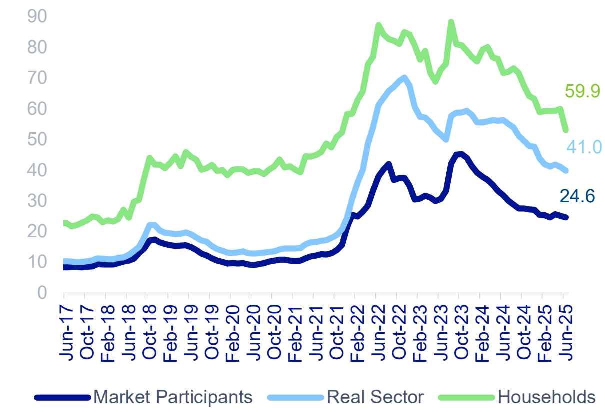
Source: Garanti BBVA Research, TURKSTAT

Figure 10. CPI Diffusion Index



Source: Garanti BBVA Research, TURKSTAT

Figure 11. Inflation Expectations (12 Month Ahead, %)



Source: Garanti BBVA Research, TURKSTAT

Figure 12. CPI Subcomponents

	MoM	YoY
Total	**1.37%**	**35.05%**
Food & Non-alcoholic beverages	-0.3%	30.2%
Beverage & Tobacco	0.1%	28.0%
Clothing & Textile	-0.3%	14.5%
Housing	2.6%	65.5%
Household Equipment	2.0%	30.2%
Health	0.7%	38.7%
Transportation	2.4%	27.7%
Communication	1.8%	18.4%
Recreation & Culture	1.4%	27.5%
Education	4.5%	73.3%
Restaurants & Hotels	2.1%	35.6%
Misc. Goods & Services	1.7%	36.2%

Source: Garanti BBVA Research, TURKSTAT

Figure 13. PPI Subcomponents

	MoM	YoY
Total	**2.46%**	**24.45%**
Mining & Quarrying	0.7%	25.7%
Manufacturing	1.8%	23.8%
Food Products	0.8%	25.0%
Textiles	1.5%	18.6%
Wearing Apparel	1.8%	28.2%
Coke & Petroleum Products	8.1%	10.0%
Chemicals	2.0%	23.0%
Other Non-Metallic Mineral	2.1%	18.8%
Basic Metals	1.8%	16.1%
Metal Products	1.9%	23.5%
Electrical Equipment	2.9%	23.9%
Electricity, Gas, Steam	9.9%	28.3%

Source: Garanti BBVA Research, TURKSTAT

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