

In January, consumer prices again surprised on the upside with an annual inflation level accelerating to 15%, up from 14.6% in December. Continuing exchange rate pass thru, cost-push factors becoming clearer on services prices, and somewhat weakening but still strong domestic demand were the main reasons behind the worsening inflation outlook. Domestic producer price inflation, being realized as 26%, confirmed the strengthening cost factors and increasing uncertainties in the following period considering the recent upticks in the global commodity prices. Given these pressures and other seasonal factors, we expect consumer inflation to rise further in the coming months and reach a peak near 16% in April before a gradual disinflation path thereafter.

As usual in each year, the inflation basket and the corresponding weights in the basket have been updated. The changes in the consumption patterns during last year were reflected to the new basket, in which we now have a higher weight of food and other certain items sensitive to both demand and exchange rate pass-thru. As expected, others such as food and accommodation services gained a lower weight. Therefore, the sizable upward revision of food weight near 3pp might result in additional volatility in an environment of increased uncertainties on top of the risk of drought and commodity prices.

Assuming only a slight nominal depreciation of the currency this year, we expect consumer inflation to decline to 10.5% at the end of the year, especially helped by the sizable base effects in the fourth quarter. Given its updated projections, January inflation data should not be an upside surprise for the Central Bank, so we maintain our view that the Central Bank will stay on hold till the last quarter of the year. But if any clear upside surprise on inflation happens, additional tightening should not be ruled out, as it was already forward-guided by the Central Bank. In its recent communications, the Bank reinforced the hawkish stance by sticking to its previous year-end inflation projection of 9.4%. The Bank also clarified its forward guidance by giving the commitment of an implied real interest rate in both ex post and ex ante terms that would guarantee a strong disinflationary pattern towards the 5% target in the medium term.