

Economic Watch

# Turkey: May CPI confirms upside risks on inflation

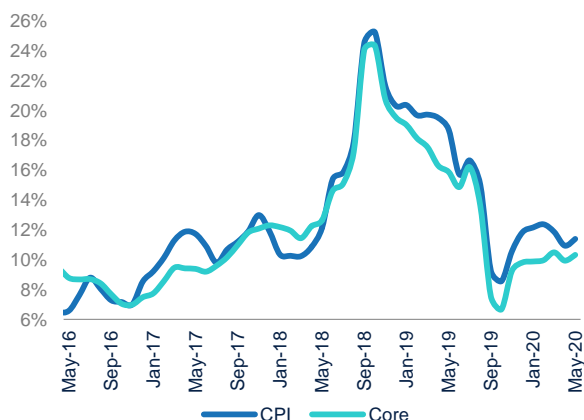
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Consumer prices increased by 1.36% in May, sizably higher than both the consensus and our expectation (0.8% vs. 0.6%). Therefore, in contrast to deceleration expectations, annual inflation accelerated to 11.39% from 10.94% in April. The upside surprise stemmed mainly from the core prices, where after the more recent depreciation in currency the firms seem to adjust their prices on the upside to absorb the poor demand. Besides, seasonally higher unprocessed food inflation continue to push the headline on the upside, which still reflect both the increasing demand and some difficulties in supply during the extended curfews. On the other hand, as energy prices started to correct faster than expectations during May, it also weigh on the headline. Also, the recent price hike in low-price cigarettes add to the upside risks. All in all, despite a deeper negative output gap, given the above-mentioned factors and today's data, we need to revise our current year-end inflation forecast (7.5%) by near 1pp. With this, depending on the food inflation and the level of exchange rate, headline inflation could stay close to 12% in June before converging to 9% towards the end of 3Q and ending the year at near 8.5%.

## Still unsupportive food and sticky core prices led by the Covid-19 pressures

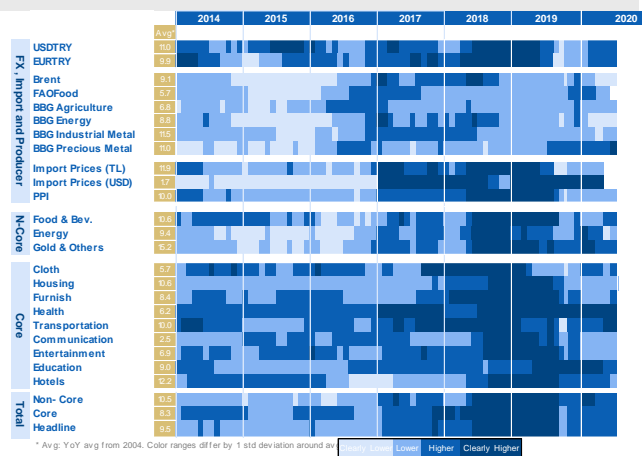
The surprising inflation figure stemmed from both food and core prices. Food prices continued to suppress its seasonal average in the last three months as it increased by 0.16% mom, on the back of mainly unprocessed food inflation (-0.3% mom vs -3.5% sea. avg.). Therefore, annual food inflation increased to 12.6% from 10.9% in April. The recent positive support from energy prices has partially reversed following the recent correction in oil prices as it jumped by 2.1% mom, resulting in an annual figure rising to 5.2% from 3.3%. Despite the weak demand, core prices increased by 1.7% mom, higher than expectations, which confirms the upside price adjustments of certain sectors to absorb the low capacity led by the measures taken to cope with Covid-19. Hence, annual core inflation rose to 10.3% from 9.9% in April. Also, the trend in inflation remains stable as it is still hovering near 11% (Chart-5) and showing a loss of pace in the recovery pattern. On the other hand, inflation inertia has eased slightly despite the huge setback in both internal and external demand as annual services inflation decreased to 11.3% from 11.8%. Besides, domestic producer prices, which increased by 1.5% mom, confirm the relatively low but still alive cost push factors on top of the correction in commodity prices, disruptions in production and the recent tax adjustments. Looking ahead, the negative output gap and energy prices could remain the supportive factors but the high inertia, potential price adjustments to cope with the impact of the outbreak pose some upside risks on inflation outlook.

Chart 1. Core Inflation and CPI (YoY)



Source: BBVA Research Turkey, Turkstat

Chart 2. Inflation Heat Map

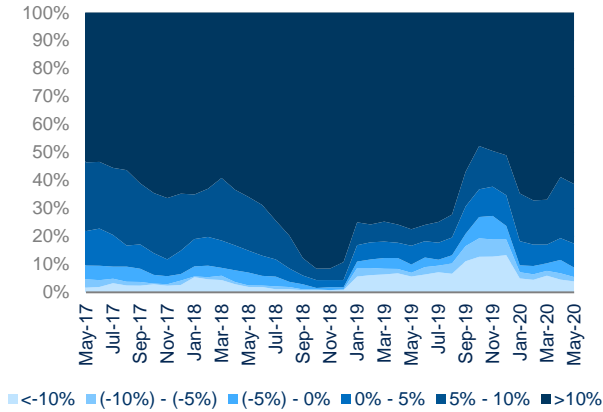


Source: BBVA Research Turkey & Turkstat

## Renewed core inflation outlook will decelerate the expected disinflation

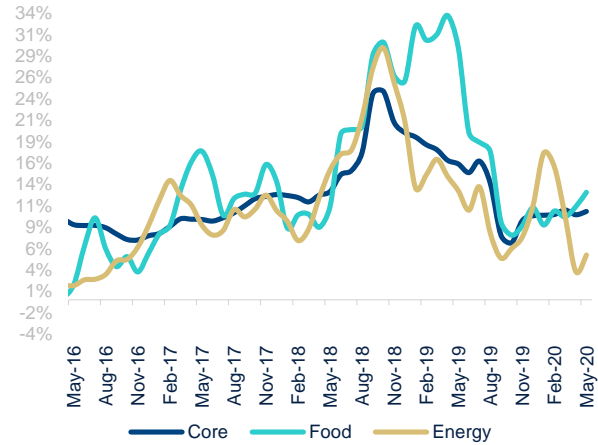
Still relatively low energy prices and a deeper negative output gap will help to satisfy a disinflation cycle this year. Though, faster than expected correction of the oil prices during May, the rigidity of the core prices as today's figures confirm, the recent tax hikes and the pressures on food prices will decelerate the initially expected path. So, we need to revise our current year-end inflation forecast (7.5%) by near 1pp, which would lead the continuation of the measured rate cuts of the CBRT to be less likely.

Chart 3. Inflation Diffusion Map, YoY



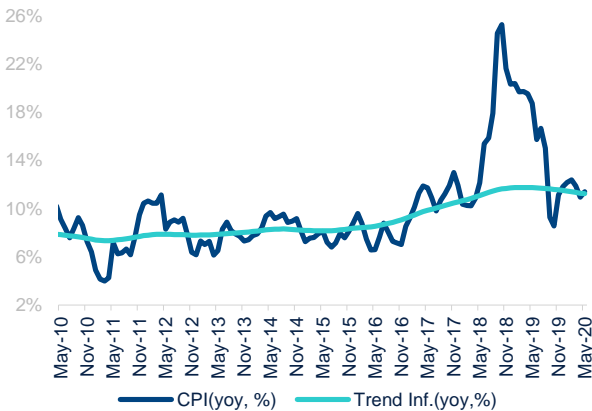
Source: BBVA Research Turkey, Turkstat,

Chart 4. CPI Components, YoY



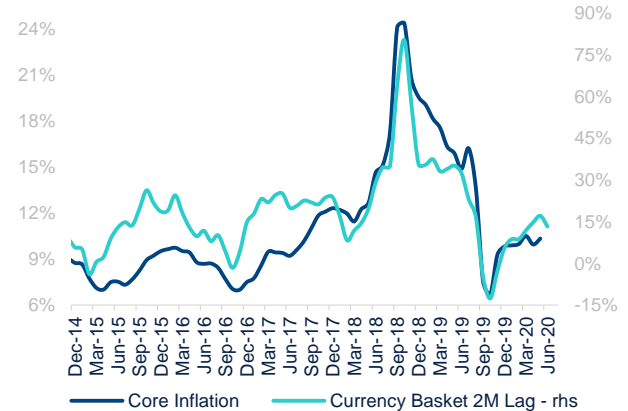
Source: BBVA-Research Turkey, Turkstat,

Chart 5. CPI and Trend Inflation, YoY



Source: BBVA Research Turkey UCSVO-MA Model, Turkstat

Chart 6. Core Inflation vs Currency Basket, YoY



Source: BBVA Research Turkey, Turkstat

Chart 7. CPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>1.4%</b>	<b>11.4%</b>
Food & Non-alcoholic beverages	0.2%	12.9%
Beverage & Tobacco	0.7%	21.4%
Clothing & Textile	6.9%	7.7%
Housing	0.3%	14.4%
Household Equipment	1.1%	9.0%
Health	0.2%	13.1%
Transportation	3.3%	6.7%
Communication	1.5%	3.0%
Recreation & Culture	0.7%	3.7%
Education	0.3%	11.2%
Restaurants & Hotels	0.2%	10.9%
Misc. Goods & Services	1.9%	20.9%

Source: BBVA Research Turkey & Turkstat

Chart 8. Domestic PPI in Subcomponents

	MoM	YoY
<b>Total</b>	<b>1.5%</b>	<b>5.5%</b>
Mining & Quarrying	-1.7%	3.6%
Manufacturing	1.6%	5.0%
Food Products	1.8%	10.2%
Textiles	2.1%	8.6%
Wearing Apparel	1.1%	4.0%
Coke & Petroleum Products	4.9%	-51.3%
Chemicals	0.3%	2.3%
Other Non-Metallic Mineral	0.4%	3.1%
Basic Metals	1.3%	1.3%
Metal Products	0.5%	10.0%
Electrical Equipment	2.1%	7.7%
Electricity, Gas, Steam	2.5%	14.5%

Source: BBVA Research Turkey & Turkstat

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