Türkiye: January CPI surprised to the upside

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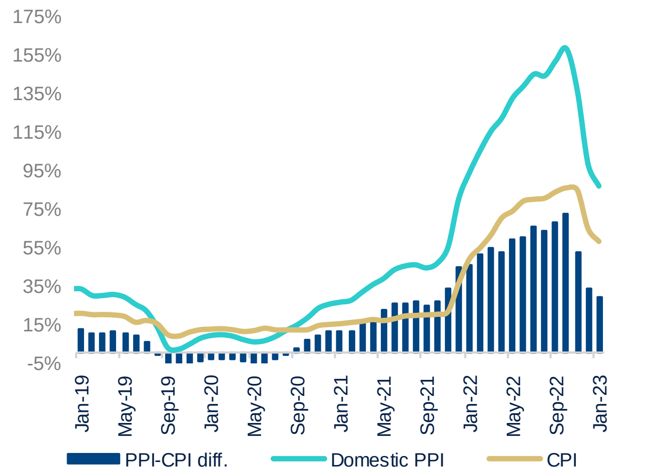
Consumer prices rose by 6.65% in January, significantly above both our expectations and market consensus (4% both). Annual CPI still came down to 57.7% from 64.3% the month before on favorable base effects. Meanwhile, domestic producer prices increased by 4.2% m/m and annual PPI slowed-down to 86.5% from 97.7%. Almost stable currency help to absorb some upward pressure from strong demand, weakening but continuing cost push factors, second round effects and inertia. However, increasing populism in terms of expansionary policies and wage adjustments further boost consumption and result in more sticky services prices. Therefore the deceleration in annual inflation prove to be much lower. We expect annual CPI to come down to 55% on average in 1Q23 and decline further to 40-45% in May just before the elections. Inflation outlook in the second half of the year will depend on the adjustment in economic policies and therefore the exchange rate. We forecast year-end inflation to be 42%.

Soaring services prices accelerated core inflation

Core inflation skyrocketed in January to 7.7% m/m (1.86% m/m prev.), recording the highest monthly increase since December 2021 (13.2% m/m). Services inflation contributed to soaring core inflation with 12.7% m/m (62.4% y/y) mainly on the back of wage adjustments following minimum wage hike in the previous month, second round effects and strong demand. As we calculate 15% pass-thru from wages to core D inflation which contributes to price stickiness in services prices, we expect services inflation to keep inflation inertia alive in the upcoming periods. Clothing and footwear continued to contract due to seasonal effects with -1.8% m/m but much better than its seasonal average while durable goods picked up with 4.9% m/m, which resulted in basic goods inflation reaching 3.2% m/m. Despite almost stable currency, robust demand and continuing cost push factors continue to keep inflationary pressures, which turn out to feed second round effects and reinforce inertia further.

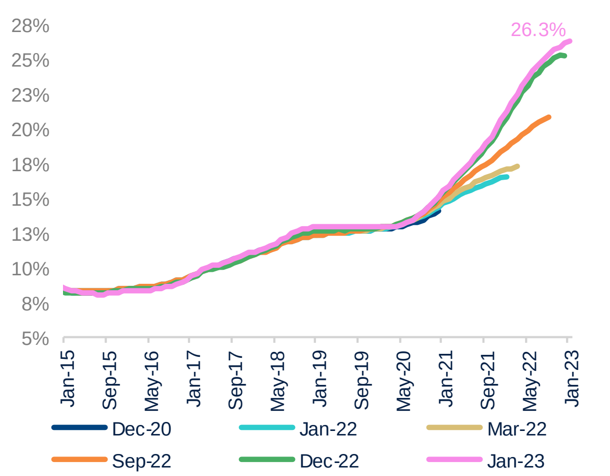
Food prices drastically picked up with 6.6 m/m (1.9% m/m prev.), while losing pace on annual basis with 71.0% y/y (77.9% y/y prev.). Fresh fruits and vegetables rebounded by increasing 6.4% m/m after 3.3% m/m decline the month before. Similarly, other unprocessed food paced up with 9.2% m/m on the back of increasing meat and dairy product prices, whereas hikes in bread prices contributed to accelerating processed food prices (11.0 m/m) inflation. Increase in energy prices was relatively limited with 1.6% m/m, which stemmed from some ease in energy prices, and accordingly annual energy inflation slowed-down to 55.0% (94.4% y/y prev.). Finally, cost push factors accelerated on monthly basis as producer prices increased by 4.2% m/m, while continuing to gear down on annual terms with 86.5%. This deceleration led the gap between annual CPI and domestic PPI to narrow further down to 28.8%.

Figure 1. **CPI vs Domestic PPI, YoY**



Source: Garanti BBVA Research, Turkstat

Figure 2. **Trend CPI, YoY**

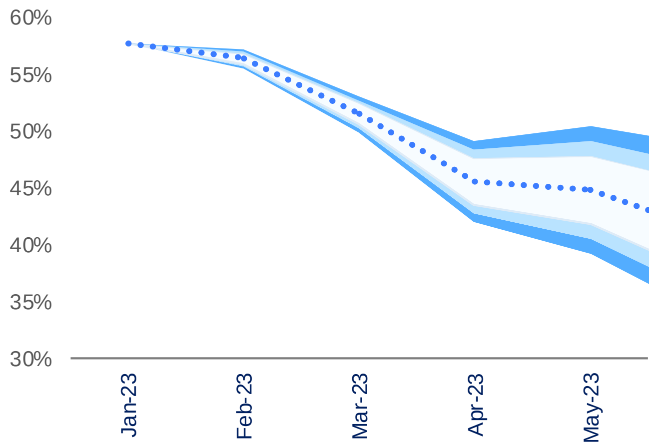


Source: Garanti BBVA Research, Turkstat

Populist policies could prevent inflation from decelerating fast before the election

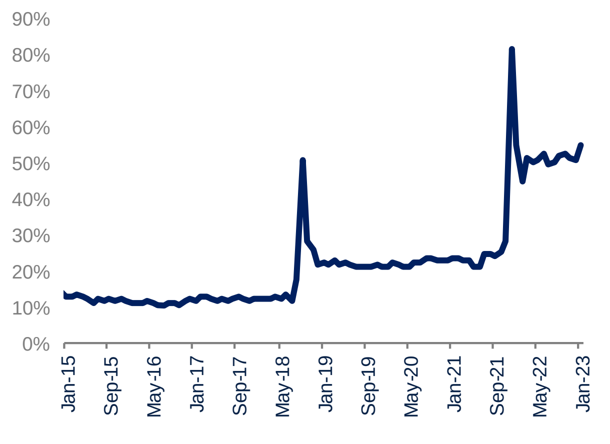
According to the latest inflation report of the Central Bank (CBRT) in January 2023, annual consumer inflation is expected to decline rapidly in the first half of the year to the range of near 30-35% by the end of June. Despite the Government's effort to keep almost a stable level in the exchange rate and accordingly reinforce favorable base effects on inflation till May, higher-than-expected January inflation, decelerating but still continuing cost push factors, expected further expansionary policies maintaining strong levels of consumption, high wage adjustments and second round price effects will likely prevent a faster decline in inflation ahead of the elections. We calculate that the deterioration in the trend inflation continues and it already reached above 26% in January (Figure 2). This worsening may continue in the coming period converging to 30% in the short term, which signals that decreasing inflation below 30% would be very challenging without a strictly clear commitment against inflation. Secondly, exchange rate pass-thru(Figure 4) remains high on the back of deterioration in expectations. Therefore, even if we assume a very gradual currency depreciation and a balanced outlook in energy prices until June, our simulations (Figure 3) show that it would be difficult for inflation to come down below 40%, which is also confirmed by our calculations for trend inflation. Even in the wider confidence interval (80% band), we forecast the lowest level of inflation to be near 40% in May. Last but not least, the high average and volatile levels of inflation lead economic agents to adjust prices more frequently, which would limit the positive impact of expected monetary policy on economic activity in the short term.

Figure 3. **CPI Forecast Path (YoY)**



Source: Garanti BBVA Research, Turkstat

Figure 4. **Exchange Rate Pass-thru on Core D, recursive**

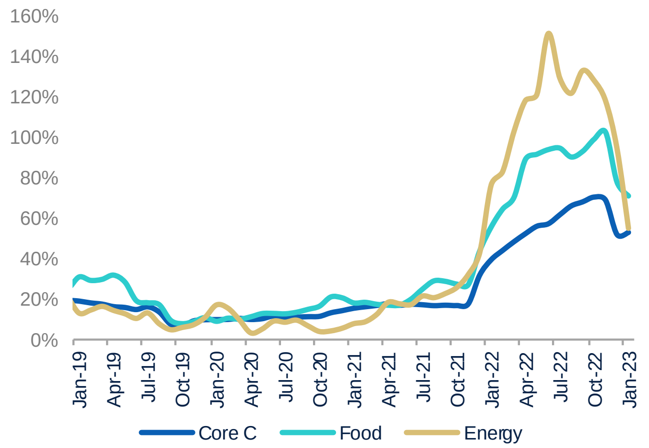


Source: Garanti BBVA Research

Inflation likely to remain high in both short and medium term

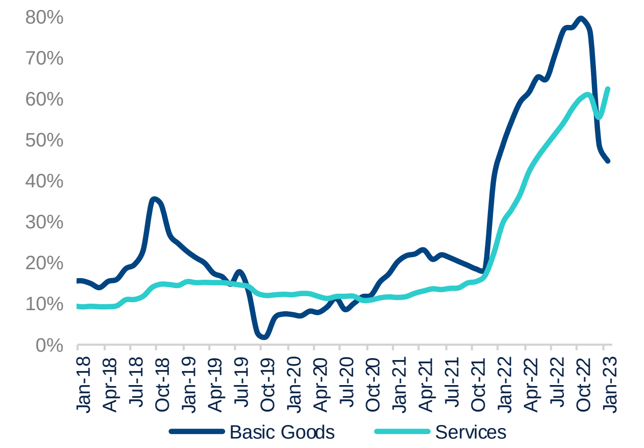
High cost pressures, continuing strong demand and loose economic policies will maintain inflationary pressures in the short term. The risk of a severe drought this year might add additional upward risk on inflation outlook. Therefore, we expect consumer inflation to remain near 55% on average in the first quarter of the year and decelerate to 40-45% in the second quarter. Assuming a gradual normalization in economic policies in the second half of the year, we expect inflation to retreat to 42% at the end of 2023. In the medium term, strong inertia on both backward pricing and deterioration in expectations may keep inflation to remain high.

Figure 5. **CPI Main Subcomponents, YoY**



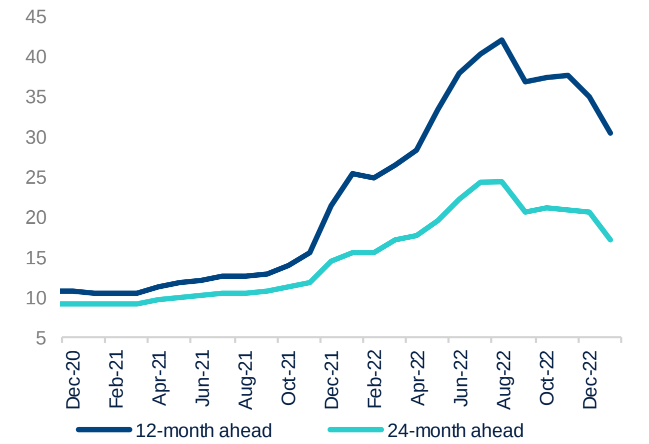
Source: Garanti BBVA Research, TURKSTAT

Figure 6. **Basic Goods and Services Inflation, YoY**



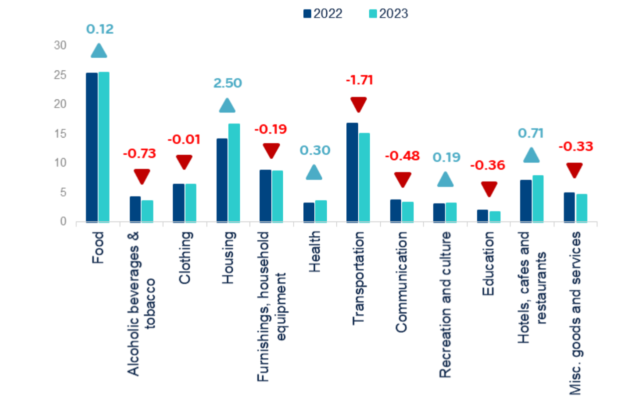
Source: Garanti BBVA Research, TURKSTAT

Figure 7. **Survey Based Inflation Expectations, YoY**



Source: Garanti BBVA Research, TURKSTAT

Figure 8. **Changes in Weights by Main Groups (pp)**



Source: Garanti BBVA Research, TURKSTAT

Figure 9. **CPI Subcomponents**

	MoM	YoY
Total	**6.65%**	**57.68%**
Food & Non-alcoholic beverages	6.6%	71.0%
Beverage & Tobacco	11.2%	50.6%
Clothing & Textile	-1.5%	24.2%
Housing	3.3%	56.2%
Household Equipment	5.6%	61.9%
Health	18.4%	77.2%
Transportation	6.3%	47.7%
Communication	6.2%	37.9%
Recreation & Culture	8.7%	49.8%
Education	4.5%	41.7%
Restaurants & Hotels	12.7%	75.1%
Misc. Goods & Services	10.3%	56.9%

Source: Garanti BBVA Research, Turkstat

Figure 10. **Domestic PPI Subcomponents**

	MoM	YoY
Total	**4.15%**	**86.46%**
Mining & Quarrying	6.1%	101.5%
Manufacturing	5.1%	70.5%
Food Products	7.9%	100.2%
Textiles	1.9%	52.2%
Wearing Apparel	3.9%	62.4%
Coke & Petroleum Products	3.7%	65.9%
Chemicals	2.1%	58.3%
Other Non-Metallic Mineral	8.3%	145.1%
Basic Metals	1.1%	29.0%
Metal Products	2.8%	61.9%
Electrical Equipment	4.9%	60.7%
Electricity, Gas, Steam	-3.1%	237.1%

Source: Garanti BBVA Research, Turkstat

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