

Inflation Pulse

Türkiye | Higher trend inflation due to core prices

Adem İleri / Gül Yücel
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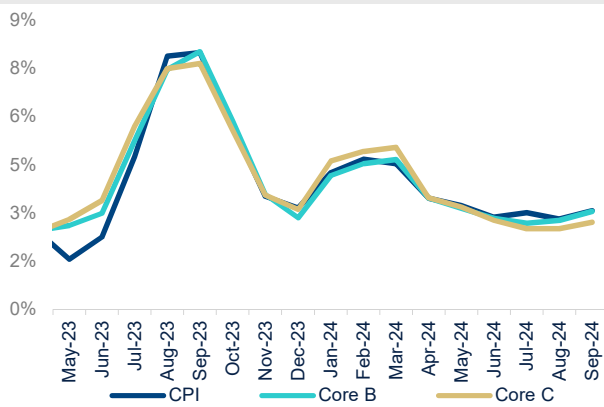
Consumer prices rose by %2.97 m/m in September, higher than our expectation (2.5%) and consensus (2.2%). Annual consumer inflation came down below 50% (49.37% vs. 51.97% prev.) on the back of base effects and steadily depreciating currency. Yet, underlying consumer inflation trend worsened further due to the deteriorating core inflation led by the elevated services inflation and accelerating goods inflation. Despite the ongoing moderation in domestic demand and relatively muted cost push factors, high inflation expectations, strong inertia, worsened pricing behavior, and uncertainties on wage hikes, administered prices and tax adjustments at the beginning of 2025 maintain upside risks on inflation outlook. We expect year-end inflation to slow-down to 43%, which could create a limited room for the CBRT to start a cautious easing cycle. Given the challenges on inflation outlook on top of delayed support from fiscal policy, we expect the first rate cut in December with 250 bps, followed by gradual cuts and maintenance of credit growth caps for a while in order to contain any inflationary impact.

Core inflation boosted by both higher services and goods prices

According to our calculations, underlying consumer inflation trend (3-month moving average of seasonally adjusted inflation) worsened to 3.1% from 2.8% previously, led by the acceleration in core prices driven by strong services inflation and the pick-up in goods prices. TURKSTAT yesterday announced that seasonal adjusted series on inflation will be released one day after the release of the original series and the CBRT will publish its price developments report following the release of the official adjusted series.

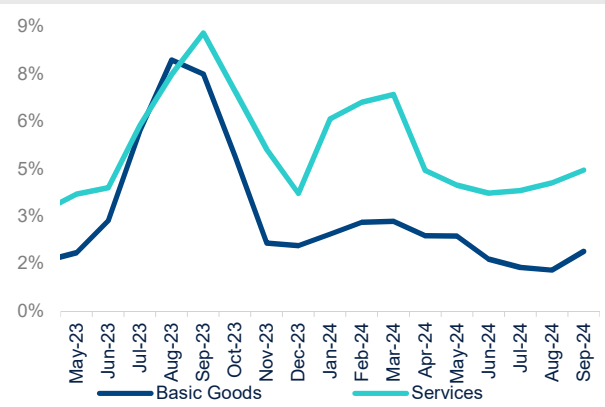
Services inflation geared up to 4.5% m/m on a seasonally adjusted basis, driven by strong backward indexation. Rent inflation remained elevated at 7.6% m/m (7.4% m/m prev.) pointing to the continuing impact of the removal of 25% rent hike ceiling in July. The upward adjustment in school tuition fees resulted in 14.2% m/m of education inflation which contributed to the services inflation. The transportation prices remained elevated despite some slowdown compared to August (6.9% m/m vs. 9.2% m/m prev.) due to the ongoing effect of price adjustments in subway, intercity train lines, taxi cab fares and other related transportation medium prices. Overall, the 3-month average trend in services inflation worsened to 4.5% (4.1% prev.).

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)



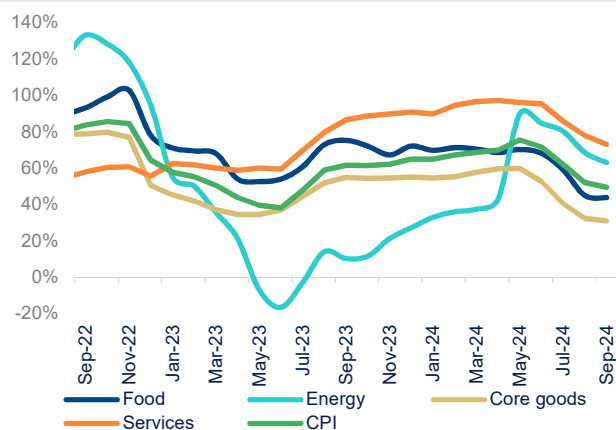
Source: Garanti BBVA Research, TURKSTAT

Basic goods price inflation also accelerated in September (2.1% m/m vs. 1.2% m/m prev.), driven by strengthening durable goods prices (signaling exchange rate pass-through from August) and clothing inflation (3.6% m/m vs. 0.3% m/m) contrary to our expectation of relatively more limited increase. As a result, the seasonal adjusted trend inflation in basic goods deteriorated to 1.9% (1.3% prev.) despite the ongoing moderation in domestic demand. Overall, the uptick in both services and goods prices led to the worsening in core trend inflation. The 3-month trend core C inflation picked up to 2.7% (2.5% m/m), while core B index reached 3.0% (2.8% m/m), according to our calculations.

Meanwhile, food inflation increased to 2.5% m/m (-1.1% m/m prev.) due to the reversal of the seasonal effects and second round effects. Fresh fruit and vegetable prices increased by 3.2% (-10.0% m/m prev.) and unprocessed food inflation reached 3.5% m/m (-4.9% m/m prev.) on the back of strengthening fish and dairy product prices. On the contrary, the processed food inflation decelerated to 1.6% m/m (vs. 2.4% m/m prev.).

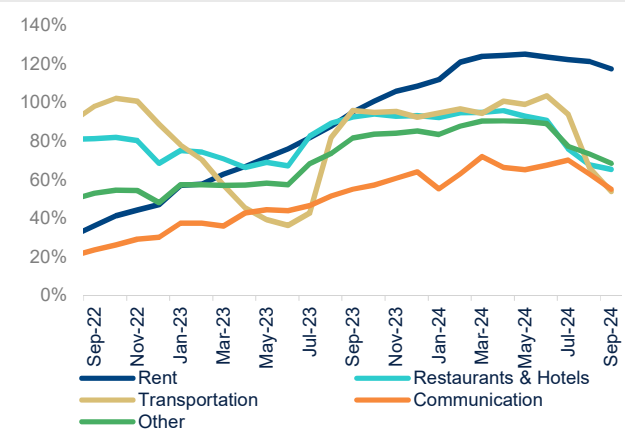
Regarding cost push factors, monthly producer price inflation eased further to 1.37% in September, resulting in an annual inflation of 33.1%. Weaker energy and commodity prices coupled with relatively stable currency maintained the cost pressures on consumer prices at moderate levels.

Figure 3. CONSUMER INFLATION INDICATORS (YoY)



Source: Garanti BBVA Research, TURKSTAT

Figure 4. SERVICES INFLATION (YoY)



Source: Garanti BBVA Research, TURKSTAT

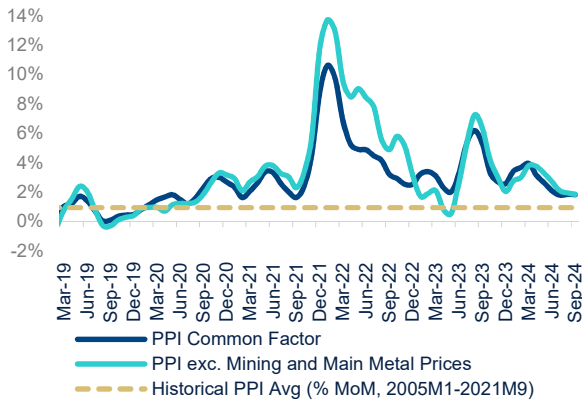
Worsening trend and high inflation expectations require the CBRT to stay cautious

Despite the moderation in domestic demand and weaker cost push factors, recent hikes in administered prices, backward indexation particularly in services, and second round effects caused a deterioration in inflation trend in September. The average monthly inflation trend reached 3% in 3Q24, exceeding the CBRT's expectation of 2.5%. Additionally, the recent increase in 3-month average of five different inflation trend indicators, which are also closely monitored by the CBRT, indicate that the current inflation trend is not in line with the CBRT's expectations. Furthermore, inflation expectations, another important indicator for the CBRT to reassess the monetary stance, remain elevated despite a slight improvement in September and continue to pose a clear risk to the CBRT's inflation targets. A recent study done by Koç University reveal that certain items such as food and transportation hold a significant weight in households' inflation expectations, highlighting still unanchored expectations as a major concern.

Meanwhile, our BVAR analysis shows that the pass-through from short-term inflation expectations to current inflation could be quite significant. The deterioration in services inflation also suggests that the inertia remains strong. High inflation expectations and strong inertia might keep negatively affecting pricing behavior. We expect inflation to average around 2% in 4Q24 on the back of continuing real appreciation, expected deceleration in secondary effects and the ongoing cooling demand factors. However, uncertainties about wage hikes, administered prices and tax

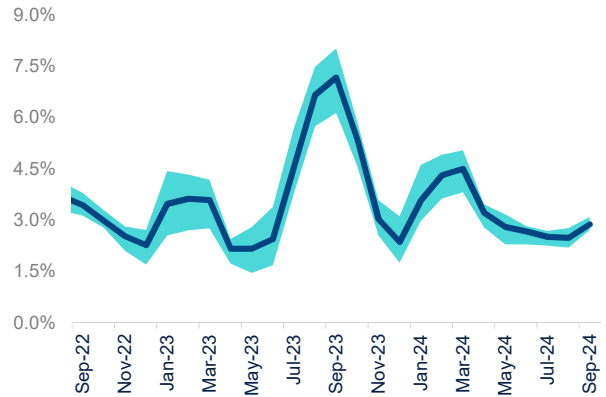
adjustments at the beginning of 2025 pose risks to the inflation trend in 1H25. Our study finds that, even in the case of taking historical average, the pass-through from wages, administered prices and taxes on fuel prices display significant secondary effects, which could pose a substantial risk going forward.

Figure 5. **PPI TREND INDICATORS*** (% MoM, 3 month moving average)



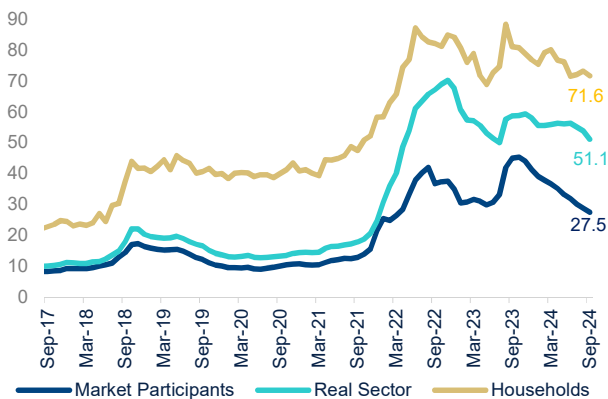
Source: Garanti BBVA Research, TURKSTAT

Figure 6. **INFLATION TREND INDICATORS*** (seasonal adj., monthly, 3-month average)



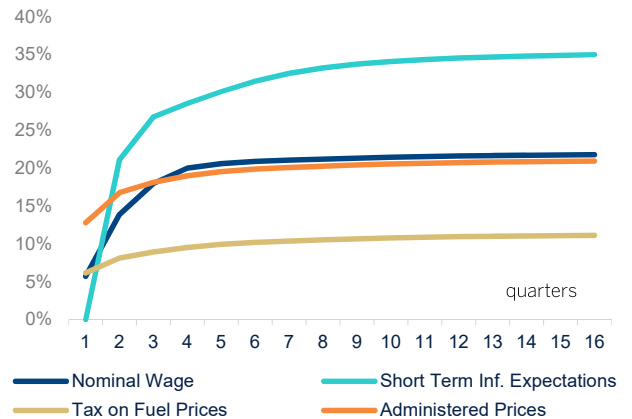
Source: Garanti BBVA Research, TURKSTAT, *Satrim, Median Inflation, Dynamic Factor, Core-B and Core-C

Figure 7. **CBRT SECTORAL INFLATION EXPECTATIONS** (% , 12 month ahead, annual)



Source: Garanti BBVA Research, CBRT

Figure 8. **CUMULATIVE PASS THRU FROM SHOCKS TO CORE-D INFLATION** (%)



Source: Garanti BBVA Research, TURKSTAT, Bayesian VAR for Core-D Inflation

The CBRT eased its tone in its September MPC meeting decision. Therefore, we understand the CBRT seemed to feel more comfortable about the risks on inflation outlook and began to change its communication for a gradual easing cycle. We expect monthly inflation trend to come down slightly below 2% in 4Q24 and reach annually 43% at the end of 2024. Although the easing inflation trend in the next months may create room for the CBRT to consider a rate cut, the aforementioned risks suggest that the bank should remain highly cautious. As a result, we had shifted our first rate cut expectation from November to December, with a 250 bps cut while anticipating further gradual cuts in the first half of the next year depending on the inflation developments. Additionally, given the high likelihood that inflation trend may remain above 2% in 1Q25 due to wage and price adjustments, maintaining monthly credit growth caps, particularly on consumer loans, could be helpful in restraining demand.

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