Turkey: Inflation closed 2017 with a downward move

Consumer prices surprised once again to the upside though yearly inflation fell to 11.9% in December, from 13.0% a month ago. Core inflation maintained its uptrend, reflecting exchange rate developments

Source: Shutterstock

11.9%

2017 inflation

(YoY)

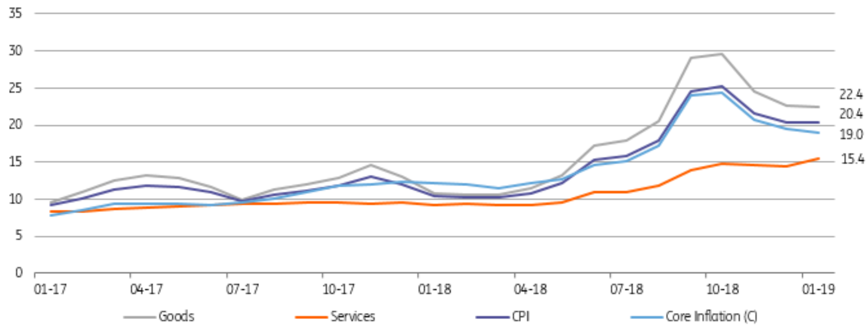
Worse than expected

Supportive base effects contribute to decline in annual inflation

Consumer prices increased by 0.69% in December, above median market expectations and our call at 0.5%. Annual inflation changed direction and closed 2017 at 11.92%, on supportive base effects and down from 12.98% a month ago (its highest since the inception of the 2003=100 series). An improvement in goods inflation contributed the most to the monthly reading, mainly driven by easing base effects on transportation prices and food inflation. Services inflation, on the other hand, remained broadly unchanged, though a small decline in rents is noteworthy.

The Domestic Producer Price Index (D-PPI), on the other hand, rose by 1.37%. Annual inflation fell to 15.47% from 17.30% (its highest level since Jul-08) the previous month. Notwithstanding the base-effect-driven disinflation, widespread pricing pressures in all PPI groups (with the exception of minor declines at metal ores and wearing apparel) driven by continuing TRY weakness show that producer-driven cost factors remained significant.

Evolution of Annual Inflation (%)

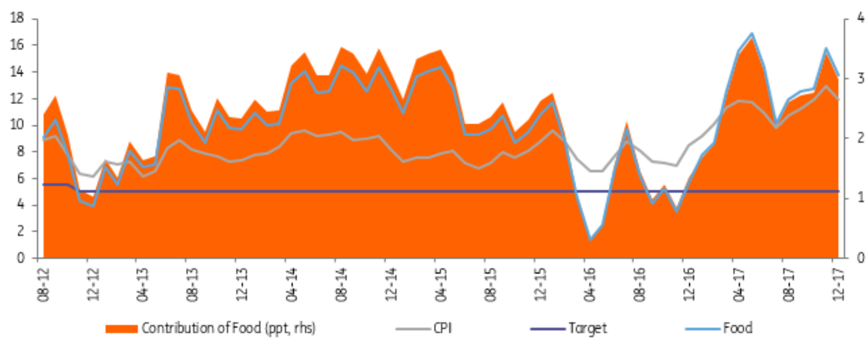


Source: TurkStat, ING Bank

Food again the major driver, along with transportation

In the CPI breakdown, the increase in share of items in the CPI basket that saw price declines in December - from 17.9% to 30.2% - is noteworthy. Among the positive drivers of the monthly reading, the food group stood out as the major contributor at 34bp, though annual inflation in this group fell from 15.78% to 13.79% on favourable base effects. The transportation group followed, at plus 28bp and reflecting exchange rate developments. Annual inflation in this group turned out to be 18.2% in 2017, the highest of all groups. Other factors contributing to higher inflation include utilities (+12bp), home appliances (+9bp), and catering (4bp) - refleccting a combination of direct and indirect effects from exchange rate developments, seasonality, inflation indexation and elevated food prices. On the flipside, clothing reduced the headline by 18bp, showing the impact of seasonality. With the exception of communication and alcoholic beverages & tobacco, annual inflation in all groups remained elevated at close to or above the 10% threshold.

Food vs CPI (%)



Source: TurkStat, ING Bank

Core inflation at a new peak

Regarding core inflation, the "C" indicator in the set (C = CPI excluding all food & beverages, energy, alcoholic drinks & tobacco, gold) recorded a 0.55% change in December, pulling annual inflation further up to 12.30%, a new peak in the current inflation series. The data show continuation of the impact from currency effects and from strong economic activity, with no clear sign of any downtrend in core inflation yet. Given the continuing impact of recent TRY weakness and ongoing deterioration in expectations and pricing behaviour, core inflation is likely to remain in double digits.

> Overall, the December data show a fall in headline inflation, as expected. In the coming months easing base effects will continue to contribute to a recovery in the inflation outlook. However the fall will likely be shorter and shallower than previously envisaged, while concerns about the sustainability of disinflation will remain. In the latest MPC, the CBT hiked the late liquidity window (LLW) rate by 50bp (market expectations: 75-100bp hike) - this lower than expected move is attributable to improving risk appetite towards EMs and consequent recovery in TRY vs USD. So, the CBT's rates policy is driven not only by the changes in inflation outlook but also by concerns about the exchange rate. Given this backdrop and this CBT's continuing tightening bias, any decision in the January meeting will be dependent on market conditions.

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