Turkey: Continuing broad-based deterioration in price dynamics

Following a slightly better-than-expected February inflation print, cumulative inflation in the first two months of the year reached 10%, showing the continuation of a broad-based deterioration in price dynamics despite currency stability in recent months

Turkish consumer prices rose 3.15% in February, the second-highest February reading since 2000

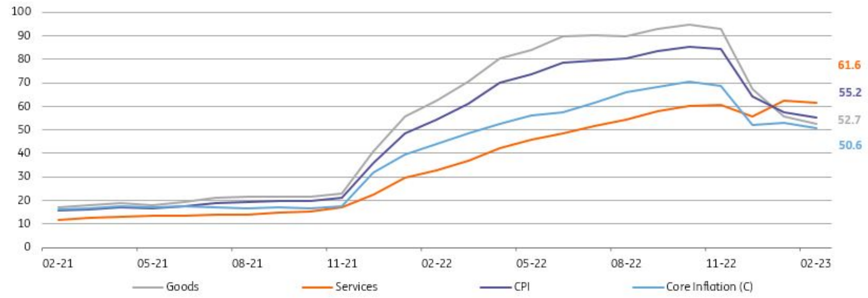
After a surge in inflation in January (to 6.65%), Turkish consumer prices rose 3.15% in February (vs the market consensus of 3.4%), the second-highest February reading since 2000. Accordingly, cumulative inflation in the first two months reached almost 10%, while the Central Bank of Turkey's (CBT's) forecast in the January inflation report for the whole year was 22.3%. However, the annual figure maintained a downtrend to 55.2% from 57.7% a month ago attributable to large base effects. Therefore, while the latest figures show a continuation of the broad-based deterioration in price dynamics despite currency stability in recent months, increases across all groups were lower than last year which contributed to the drop in the headline reading. We will likely see further falls in the near term with the presence of large base effects if stability in the Lira continues.

The underlying trend (as measured by the 3-month moving average, annualised percentage change, based on seasonally adjusted series) for goods inflation remained broadly unchanged in comparison to the previous month. However, the services group which has strong inertia has remained elevated with a strong contribution to the deterioration in underlying trends of core and headline in February.

PPI inflation recorded another sharp drop to 76.6% year-on-year, the lowest reading since November 2021, implying that there are still high, but improving, cost-push pressures in comparison to previous months. While the monthly reading was 1.56% with support from a price drop in utilities, the base effects have been the main determinant of the decline in annual inflation.

Annual inflation (%)

Core = CPI excluding energy, food & drinks, alcoholic beverages, tobacco, gold

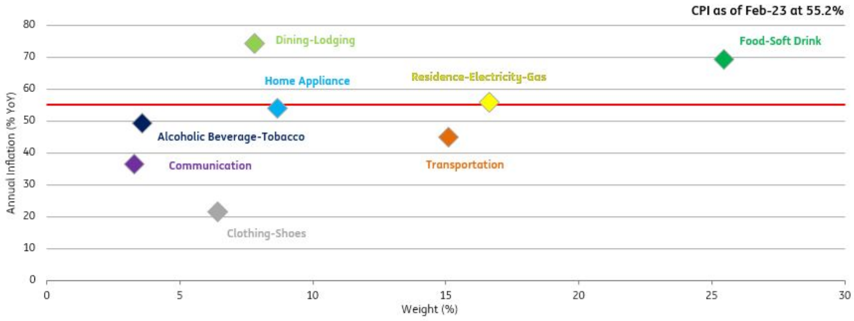


Source: TurkStat, ING

In the breakdown of the main expenditure groups, annual inflation in the food group declined due to unprocessed food prices. However, the monthly figure more than tripled the long-term February average, pulling the headline up by 1.87ppt. We see food prices continuing to impact catering prices, making it a strong contributor with 0.34ppt. With a 0.39ppt impact on the monthly headline, transportation was among the major contributors given price adjustments in transportation services, and automobile prices. However, the annual change in this group further declined to 44.9% from triple digits in November, showing the extent of base effects.

With the exception of clothing and shoes and alcoholic beverages and tobacco which all recorded a price decline, all other groups showed strong increases, confirming challenges to disinflation despite the CBT's relatively optimistic forecast for this year. As a result, goods inflation moderated to 52.7% YoY, while annual inflation in services recorded a 61.6% YoY change that is slightly below the peak of the current inflation series driven in particular by rent, catering and transportation services.

Annual inflation in expenditure groups



Source: TurkStat, ING

Overall, annual inflation maintained a downtrend in February as widely expected, and is likely to decline further until May mainly due to strong base effects, though currency stability will remain key for the outlook. However, given deeply negative real interest rates, further disinflation will be quite challenging, while risks to the outlook this year are on the upside given the significant deterioration in pricing behaviour, higher trend inflation and a still-elevated level of cost-push pressures.

In the February Monetary Policy Committee, the CBT hinted that interest rate cuts will not continue as a series, while we can expect further macro-prudential measures to maintain favourable financial conditions with the objective of minimising the effects of the recent earthquakes. Following the earthquakes, the policy mix will likely be even more supportive with larger fiscal stimulus, i.e. a net increase in the budget deficit, and looser monetary policy. This, in return, should be inflationary. In this environment, the CBT is likely to maintain its control over locals' FX flows to maintain low rates.

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