

Turkey: Central bank is likely to remain on hold in May given still high inflation risks

The April inflation confirm the still challenging inflation dynamics with demand conditions, elevated services inflation, recent uptrend in commodity prices, TRY weakness and supply constraints during the pandemic

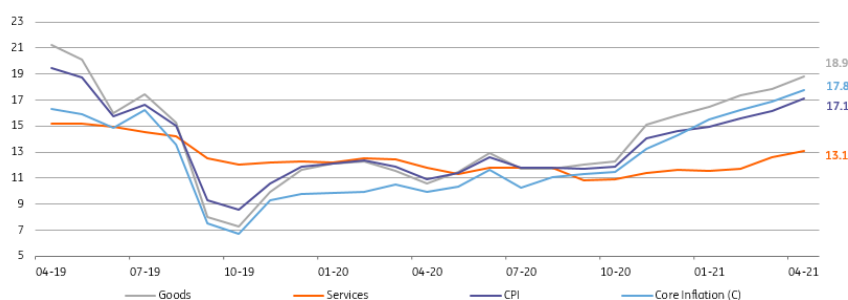


In line with our expectations and with market consensus, April inflation stood at 1.68%, pulling annual CPI inflation further up to 17.1% from 16.2% a month ago due to a weaker base. While core inflation remain elevated at about 17.8% year-on-year, it has shown some improvement on a seasonally adjusted basis (3m-ma, annualised) from its peak in January.

In the breakdown, we see 1) goods inflation at 18.9%, the highest since mid-2019, up from 17.8% a month ago attributable to energy, clothing and core goods along with the base effects from the last year and 2) services inflation at 13.1% inching up further driven by rent as well as catering and transportation services. Price pressures has remained high in services as indicated by the seasonally adjusted data (3m-ma, annualised), keeping the uptrend since September.

Evolution of Annual Inflation (%)

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



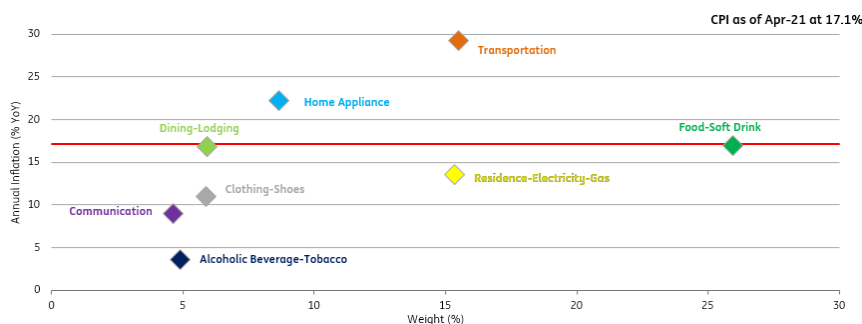
Source: TurkStat, ING

The Domestic Producer Price Index (D-PPI) exceeded 35% with another above 4% month-on-month increase in April, keeping the sharp uptrend in the last one year on the back of the impact of exchange rate developments but also rising commodity prices and strong base effects. The outlook indicates significant producer-price-driven cost pressures on the inflation outlook.

Regarding the main expenditure groups:

- Food has remained the biggest contributor to the headline with 57 basis points, attributable to the unprocessed foods given the monthly reading in fresh fruits and vegetables turned out to be the highest April figure in the current inflation series. However, annual inflation in food group showed a decline to 17% from 17.4% (vs the Central Bank of Turkey's 13% call for end-2021, revised upwards in the latest inflation report release).
- The second highest contributor was clothing with 41bp on the back of seasonality, followed by a 25bp impact from transportation. Annual inflation in the latter reached 29% showing the impact of currency weakness in automobile prices, despite the cap on gasoline prices given that the government has recently decided to absorb some of the price shock from the oil price spike via automatic tax adjustment.
- Among others, the monthly contribution from housing by 15bp due to rent and natural gas was another driver of May inflation, followed by restaurants-hotels with an 8bp contribution attributable to catering services, and the increases in food prices.

Annual inflation in Expenditure Groups



Source: TurkStat, ING

Overall, the latest data confirm the still challenging inflation dynamics with demand conditions, elevated services inflation, recent uptrend in commodity prices, TRY weakness and supply constraints during the pandemic. April inflation is likely a cyclical peak though near-term risks remain elevated given exchange rate developments, continuing supply constraints in some sectors and deterioration in inflation expectations weighing on the pricing behavior. Changes to the latest April Monetary Policy Committee statement including elimination of additional tightening bias and removal of tighter for longer commitment signal a dovish shift, though the Governor's latest remarks underlined a need for tight policies. Challenging inflation dynamics, fragile capital flows and exchange rate outlook is likely to keep the CBT cautious ahead in its policy actions. Given this backdrop, we expect the bank to remain on hold in the May MPC on Thursday and the first cut is likely to come in late 3Q.

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