Turkey: Headline CPI surprises to the upside in August

With continuing pressure on food prices, CPI inflation reached its highest level since Apr-19 despite tax adjustments introduced by the Government last month. The CBT noted growing divergence between headline and non-food inflation.

Shoppers in Istanbul

19.3%

CPI in August (year-on-year)

Consensus at 18.7%

Higher than expected

The August monthly CPI change at 1.12% pulled annual inflation up to 19.25% (vs market consensus and our call at 18.7%), exceeding the policy rate. Diverging from the headline, both B and C core inflation indices recorded drops on an annual basis. This was more pronounced in the latter - standing at 16.8%, down from 17.2% a month ago.

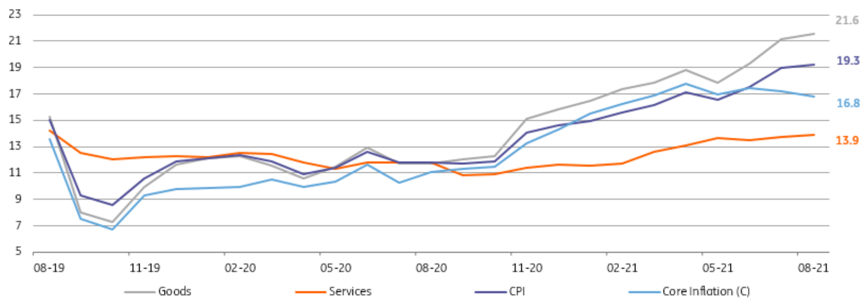
The underlying trend on a seasonally adjusted basis (3m-ma, annualized) rose slightly for the core C (at 14.7%). This highlights the extent of ongoing inflationary pressures, though also reflecting some improvement relative to the levels realized before May. The trend for services (14.4%) on the other hand has remained elevated, on the back of deteriorating pricing behavior and backward indexation.

In the CPI breakdown, we see (1) goods inflation inching up to 21.6%, attributable mainly to food, despite some moderation in core goods thanks to durable goods (excluding gold) recording a decline with recent currency strength, and (2) services inflation at 13.9% moving up further - driven by catering services, telecommunication services and rent.

The Domestic Producer Price Index (D-PPI) stood at 45.5% with another significant monthly increase of 2.8% in August. The difference between CPI and PPI expanded further to 26.3ppt, an all-time high, reflecting the elevated level of cost-push pressures driven by rising commodity prices, cumulative exchange rate effects and supply constraints in some sectors.

Annual Inflation (%)

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

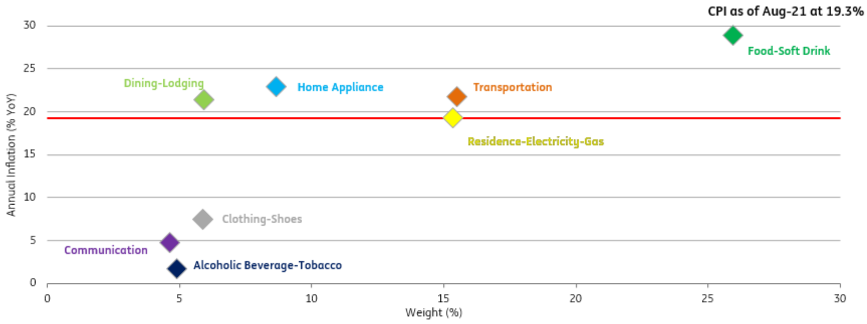


Source: TurkStat, ING

By main expenditure group, food prices recording their biggest August increase in the 2003=100 inflation series turned out to be the major driver of the higher-than-expected headline figure, with an 84bp contribution. The surprise in the food group stemmed from both unprocessed foods (with large hikes in fresh fruits and vegetables) and processed foods further weighed on already high annual inflation, now standing at 29% (vs the CBT's 15% call for end-2021 in the latest inflation report). The strong uptrend in this group in recent months is attributable to higher global food prices, adverse weather conditions and accumulated exchange rate developments.

Housing (rent hikes), catering (price adjustments following unwinding pandemic control measures and reflecting higher food prices) and household equipment (likely due to reopening and supply constraints) were the other contributors to the headline. On the flip side, clothing (seasonality) and transportation (tax cuts on automobiles) dragged.

Annual inflation in Expenditure Groups



Source: TurkStat, ING

Overall, and with continuing pressure on food prices, CPI inflation reached its highest level since Apr-19 despite tax adjustments introduced by the Government last month while the underlying trend has not signalled a meaningful weakening yet. Going forward, the possibility of administrative price adjustments, likely further pressure on food prices with the severe drought, still buoyant demand conditions, deteriorating pricing behavior and worsening expectations will remain as key risk factors despite strong favorable base effects over the remainder of the year. In the last investor meeting, the CBT pointed out the growing divergence between headline and non-food inflation, with higher food prices, and did not seem overly concerned about the non-food outlook. The current level of real rates and the path forward will likely remain as the key focus for the markets. We still expect the CBT to deliver 100bp in cuts, with 50bp moves in the last two months of the year.

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