Turkey sees an improvement in the underlying services inflation trend

While annual inflation in Turkey dropped further last month, the underlying trend remained elevated, albeit recording a drop in comparison to September thanks to a moderation in services inflation

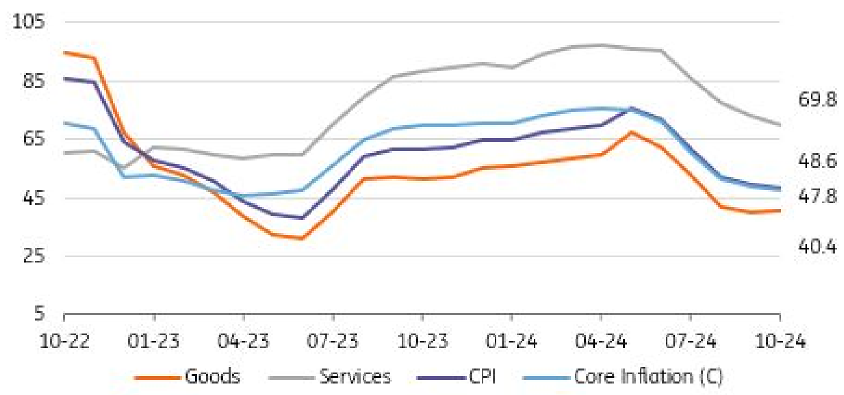
Despite the continued fall in annual inflation, the underlying trend remained elevated in October

Turkish inflation was 2.9% in October, higher than the market consensus of 2.5%. The annual figure, however, has maintained its declining trend and fell to 48.6% from 49.4% a month ago, given that favourable base effects (as it was 3.43% in October 2023) were more apparent in the second half of this year. Cumulative inflation in the first 10 months of the year reached 39.8%, exceeding the Central Bank of Turkey's 38% forecast for the year (with a forecast range of 34-42%).

PPI stood at 1.3% month-on-month, reflecting a decrease to 32.2% year-on-year compared to the previous month. The data implies further moderation in cost pressures with supportive currency developments (USD/TRY up by slightly higher than 16% on a year-to-date basis). Global commodity prices, and particularly oil prices, in the current geopolitical backdrop will likely remain the key determinant of the PPI trend ahead.

Core inflation (CPI-C) came in at 2.8% MoM, moving down to 47.8% on an annual basis, supported by the relatively slow-moving FX basket and supportive base from the last year. While cost-push pressures are moderating as evidenced by the PPI data, pricing behaviour and inertia in services have remained key risk factors, for the pace of the current disinflation process.

Inflation outlook (%)



Source: TurkStat, ING

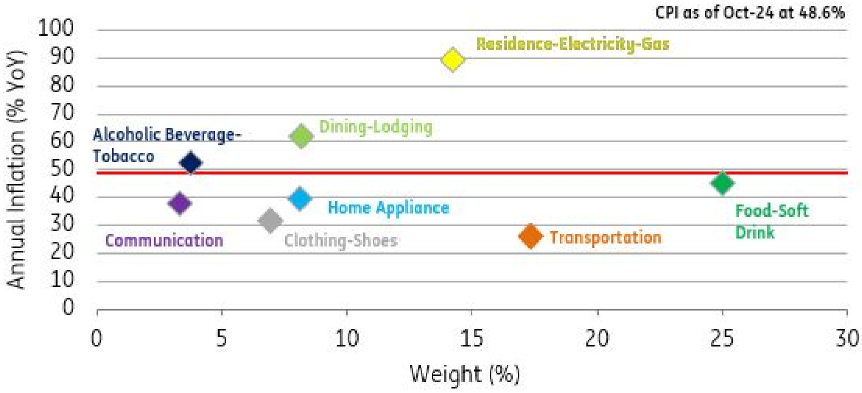
Regarding the underlying trend, the Turkish Statistical Institute will release seasonally adjusted headline CPI and core indicators tomorrow. According to our calculations, the October headline figure, on a seasonally adjusted basis, recorded a sequential decline, thanks to a marked slowdown in the services inflation underlying trend. However, the CBT expects a drop in seasonally adjusted monthly inflation to below 1.5% in the last quarter of this year, and to attain this level the monthly outcome should be less than 1% in November and December from above the 2.5% level in October.

The details of the breakdown include:

- The food group was a major contributor to the headline with 1.03ppt. Compared to the same month of last year, unprocessed food inflation recorded a higher increase (6.8% vs 4.1% last year) and led to an upward move in food inflation, while processed food prices showed a deceleration (2.2% vs 2.5% last year). Accordingly, monthly food inflation at 4.3% was one of the factors that contributed to a higher-than-expected increase in October.
- This was followed by clothing with a 0.85ppt impact given the highest October reading in the current inflation series, more than the usual seasonality.
- Housing, pulling the headline up by 0.48ppt, was the third contributor, reflecting the impact of rents.

As a result, goods inflation inched up to 40.4% YoY, while core goods inflation, a better indicator of the trend, stood at 28.5% YoY. Services, which is less sensitive to currency movements but more impacted by domestic demand and minimum wage increases, is now below 70% YoY, down from 72.9% a month ago thanks to price drops in transportation services.

Annual inflation in expenditure groups



Source: TurkStat, ING

Overall, despite the continued fall in annual inflation mainly due to base effects, the underlying trend remained elevated in October, albeit recording a drop in comparison to September thanks to a moderation in the services inflation trend.

The CBT seems to have slowed down the depreciation of the TRY recently. It has done this not by selling FX to the market, but by slowing down the pace of FX purchases.

Given this backdrop, in addition to the lagged effects of the monetary tightening on credit and domestic demand, the downtrend in annual inflation will likely continue and the underlying inflation trend will remain on a downward path for the remainder of this year. Accordingly, we think a measured cut in December is still on the table, despite a higher-than-expected October reading, while the last inflation report of this year (to be released on 8 November) is likely to provide more clarity on the CBT behaviour going forward.

Author

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

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