

## Turkey: Inflation downtrend reverses, but not for long

At 1.36%, CPI inflation in July temporarily boosted the annual figure to 16.65% from 15.72% in June, which was the lowest level in a year. This was due to upside effects from indirect tax and administrative price adjustments



Shoppers in Istanbul

**1.36%** July inflation (MoM)

Lower than expected

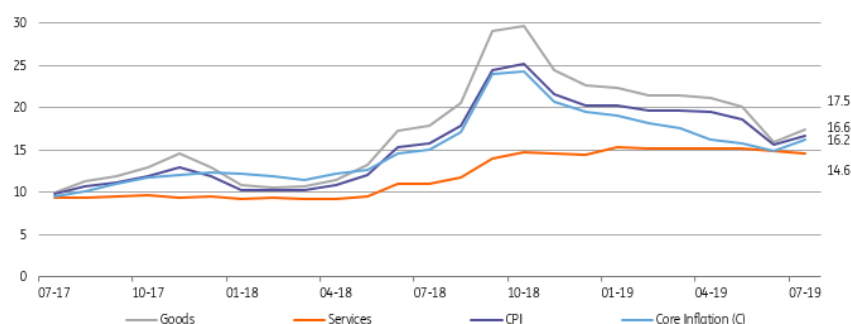
At 1.36%, month-on-month inflation in July came in below the consensus (and our call) at 1.6%, but this still took the annual figure up to 16.65% from 15.7% a month ago and brought a temporary halt to the downward trend, which has prevailed since late-2018.

Annual goods inflation increased to 17.5%, thanks to higher energy and core goods prices,

although there was a further improvement in pricing pressures in the food group. We also saw a slight decline in annual services inflation, to 14.6%, although this remains elevated around recent highs, reflecting inertia in this group.

## Evolution of Annual Inflation (%)

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



Source: TurkStat, ING

Annual core inflation stood at 16.2% last month, up from the lowest level since Jun-18, given administrative price adjustments in several product groups. We expect core inflation to revert to its previous improving trend in the period ahead.

The Domestic Producer Price Index (D-PPI), on the other hand, stood at -1%, with annual inflation maintaining its downtrend and falling to 21.6% from 21.7% a month ago. This implies further moderation in producer price-driven cost pressures on the back of falling commodity prices and continuing strength in the currency.

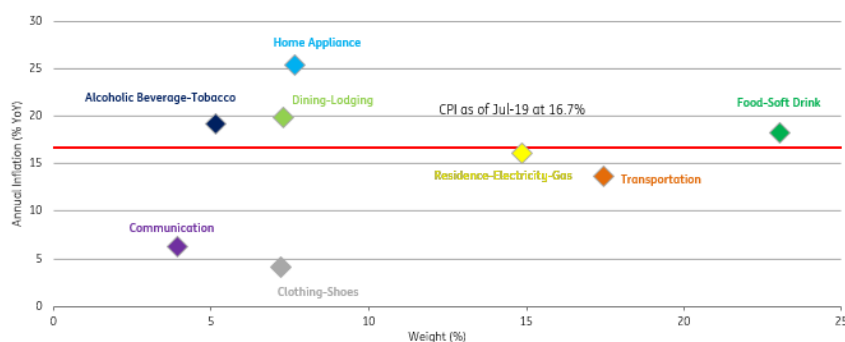
In the breakdown:

1. Transportation turned out to be the major contributor to the headline, adding 75 basis points, despite lower energy prices and a strong Turkish lira. This was due to the reversal in tax advantages granted by the government in 4Q18 and later extended in early 2019.
2. Utilities pulled inflation up by 44bp in July, reflecting the impact of administrative price increases, especially in natural gas.
3. Home appliances were another driver, adding 34bp, on the back of indirect tax adjustments.

On the flip side,

1. Food inflation dragged the headline down by 27bp thanks to a sharp drop in fresh fruit and vegetable prices. These items have been volatile, with annual inflation plunging from more than 70% to less than 5% in the last three months due to large base effects. However, processed food inflation has gone in a different direction, limiting the supportive impact of unprocessed food.
2. Clothing reduced the headline by 27bp due to seasonal factors.

## Contributions to annual inflation



Source: TurkStat, ING

Overall, following the stronger than expected downturn in inflation in June, July data showed a temporary reversal due to electricity price hikes and other administrative price adjustments, as well as the removal of tax incentives on automobiles and some durable consumer goods. However, inflation will drop very rapidly in September and reverse thereafter because of large base effects. Given this backdrop, we expect two more rate cuts in September and October and see the policy rate at 17.50% by the end of this year. However, risks are to the downside, given the central bank's signal in its inflation report meeting that there could be noteworthy room to manoeuvre in the period ahead.

### Author

**Muhammet Mercan**

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

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