Turkey: inflation increases further in July, though at a slower pace

July inflation reflects significant price adjustments in heavy-weight products like medicine, cigarettes and bread. Currency weakness, meanwhile, impacted prices of imported products although gasoline prices fell

While inflation continued to trend higher in July, the pace of price increases decelerated due to the lowest monthly reading so far this year. Annual inflation was 79.6% last month, compared with 78.6% in June while inflation came in at 2.37% month-on-month, below the market consensus of 2.9% (and our call of 2.3%).

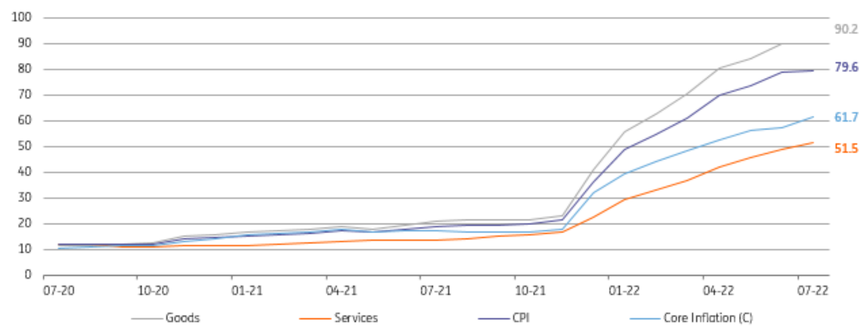
Key factors behind the ongoing rise in inflation remain the pass-through from currency weakness amid a more accommodative monetary stance as well as worsening inflation expectations and external factors, which have weighed on import prices. The outlook once again confirms the need for a correction in the path of monetary policy, in our view.

Regarding the core indicators, both B and C indices continued to rise, increasing by 68.5% and 61.7% year-on-year, respectively, their highest levels as we continue to witness a broad-based deterioration in price dynamics. However, on a positive note, the underlying trend for core C (as measured by 3-month moving average, annualised percentage change, based on the seasonally-adjusted series) has been gradually improving in recent months, though it is still very high. The underlying headline CPI trend showed a stronger decline in July, though whether this performance will be sustained has yet to be seen.

On the PPI front, the trend remains strong with a 5.2% MoM increase, pulling annual inflation up to 144.6%. Utilities and food products were responsible for the large increase in the monthly PPI and the risks are on the upside in the near term given ongoing supply-side challenges and currency-related uncertainties.

Annual Inflation (%)

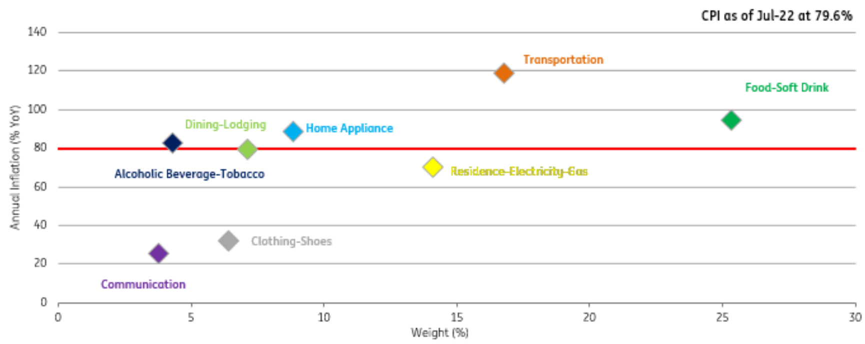
(Core = CPI excluding energy, food & drinks, alcoholic beverages, tobacco, gold)



Source: TurkStat, ING

Looking at the breakdown of the main expenditure groups, food turned out to be the biggest contributor, adding 83bp to the headline rate. However, this result was better than expected thanks to the relatively slower pace of price increases in processed foods, excluding bread and cereals (given that bread prices went up by nearly a third last month). Rapid rent increases impacted the housing group and hence the headline rate rose by 29bp. Price hikes in cigarettes added 30bp to monthly inflation, and household equipment raised the headline rate by 34bp as currency developments led to price adjustments in white goods. On the flip side, the transportation group was supportive for the monthly reading, subtracting 16bp, given the decline in oil prices last month. As a result, goods inflation hit 90.2% while annual inflation in services is at the highest in the current 2003=100 series, at 51.5%.

Annual inflation in Expenditure Groups



Source: TurkStat, ING

Going forward, we expect inflation to peak in the 85-90% range in October, before a decline to around 70% at year-end. But the risks lie to the upside given the deterioration in pricing behaviour, the impact of exchange rate developments and higher trend inflation. Currency moves will remain key for the inflation outlook.

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