Turkish inflation maintains its rapid uptrend

Inflation came closer to the 50% threshold on an annual basis given the impact of recent exchange rate developments, worsening inflation expectations and large administrative price adjustments implemented in January

Shoppers in Istanbul just after Christmas

11.1%

January CPI, MoM%

(48.7% YoY)

Higher than expected

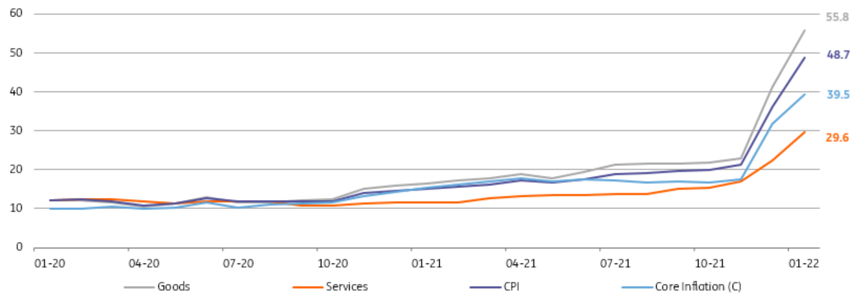
Standing at 11.1% MoM, the January inflation numbers came in considerably higher than the consensus forecast (9.8% MoM) and our projection (8.5% MoM). Accordingly, annual inflation is keeping up its rapid uptrend and moved to 48.7% YoY, the highest in the last two decades, from 36.1% a month ago. Inflation in the last three months, on the other hand, stood at 30.6%. This shows the impact of worsening inflation expectations and significant currency weakness in the aftermath of monetary easing delivered by the Central Bank of Turkey, while large administrative price hikes in January were a key determinant of the monthly figure. Following these developments, trend inflation that was at high single digits in the past is now estimated to be around 18%, pointing out a need for a more restrictive policy stance.

A close look at the data shows that core inflation indicators, both B (excluding unprocessed food, energy, alcoholic beverages, tobacco and gold) and C (excluding energy, food and non-alcoholic beverages, alcoholic beverages, tobacco and gold) indices moved up further to 42.7% YoY and 39.5% YoY, respectively with the underlying trend for both indicators showing a marked deterioration.

The January Domestic Producer Price Index (D-PPI) is just short of triple-digit territory at 93.5% YoY, reflecting record high cost-push pressures given the impact of recent wage adjustments, large FX volatility in recent months, higher commodity prices and likely supply challenges in the current environment.

Evolution of annual inflation (%)

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



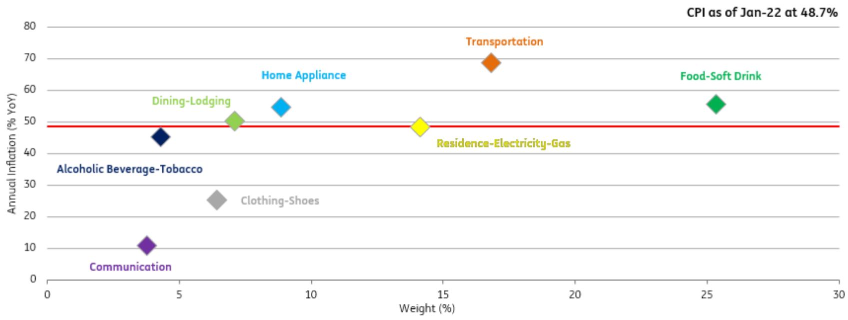
Source: TurkStat, ING

In the breakdown of the CPI, we see:

1. **Goods inflation:** It moved up to 55.8% given the continuing impact of currency weakness, higher oil prices and price adjustments by the government, taking a toll on energy, alcoholic beverages and tobacco as well as durable goods. Food, on the other hand, recorded a sharp increase driven by not only a jump in unprocessed food and particularly fresh fruits and vegetables but also continuing pressures on processed food. Clothing remained mute with a slight decline in prices though the monthly change was still high in comparison to what seasonal behaviour in the past implied
2. **Services inflation:** This acceleration to 29.6%, reflecting FX pass-through and deteriorating pricing behaviour, despite a relatively slow pace in rent and telecommunication services, though both have gained momentum lately. Accordingly, in the main expenditure groups, we saw price increases across the board last month with the exception of clothing while food, transportation and utilities turned out to be the biggest contributors to the monthly inflation figure.

Finally, the TurkStat made usual revisions to the CPI basket by cutting the weights of utilities, communication, food, and alcoholic beverages & tobacco and adding to transportation, clothing, catering and household equipment. After the changes, the weight of the food group still remains the highest at 25.32%, followed by transportation at 16.8% and housing at 14.12%.

Annual Inflation in expenditure groups



Source: CBT, ING

Overall, the January data showed the continuing impact of FX volatility, while a broad-based deterioration in pricing behaviour, high trend inflation, the possibility of further administrative price adjustments and increase in FX pass-through point to further challenges in inflation dynamics in the period ahead. We see, in line with the consensus, that inflation will likely peak in the second quarter and hover around the peak in the following months before showing some moderation into year-end 2022 with the support of large base effects. However, risks are tilted to the upside given a less restrictive policy stance and the uncertain exchange rate outlook. So, the inflation outlook and recent decline in CBT reserves will not leave any room for further policy easing in the near term, in our view.

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