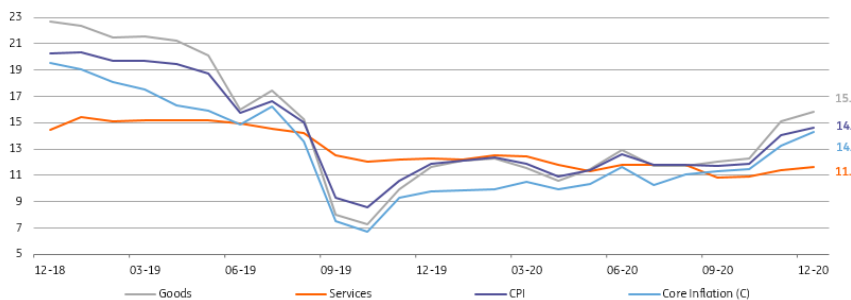


Turkey: Inflation moves up further in December

Annual inflation maintained its uptrend in December on the back of continuing pressure on food and transportation prices. The Central Bank of Turkey will likely maintain its current cautious stance and be ready to move if it sees a further substantial deterioration in the outlook



Evolution of Annual Inflation (%)



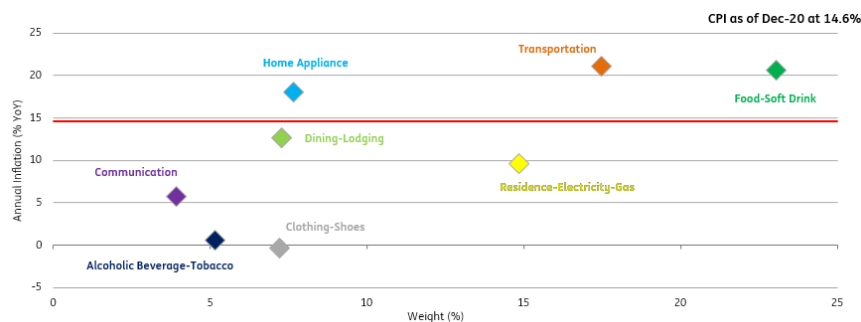
Source: TurkStat, ING

December CPI inflation stood at 1.25%, higher than the market consensus at 0.9% (and our call at 0.8%), pulling the annual figure up to 14.6% from 14.0% a month ago. Core inflation also maintained its upward move, reaching 14.3% - the highest ever December reading in the current inflation series. The data shows still high pricing pressures, with the impact of exchange rate developments complicating already challenging inflation dynamics.

In the breakdown, we see 1) a further increase in goods inflation to 15.9% from 15.1% a month ago attributable to food, energy, durables and some core goods, despite relatively benign clothing and alcoholic beverages & tobacco prices 2) elevated services inflation driven by telecommunication and other services as well as rent.

With a 2.36% monthly change, the Domestic Producer Price Index (D-PPI) has returned to mid-2019 levels following a rapid uptrend in recent months, which started with a 5.5% increase in May last year. This is attributable not only to the impact of exchange rate volatility last year but also to an unfavourable base. Producer price-driven cost pressures on the inflation outlook clearly became more evident in the second half of 2020.

Annual inflation in Expenditure Groups



Source: TurkStat, ING

Regarding the main expenditure groups, as was the case in November, food and transportation turned out to be the biggest contributors to the headline rate, at 60bp and 43bp, respectively. For food, however, annual inflation dropped slightly, given the large base from 2019, but at 20.6% it remained elevated. For transportation, higher motor vehicle and fuel prices pulled annual transportation inflation to 21.1% in December, the highest level since the Aug-18 shock. Among other sectors, the monthly contribution from household equipment of 27bp - due to price adjustments, especially on durables - was another driver of higher than expected December inflation, followed by housing with a 9bp contribution. On the flip side, clothing reflected seasonality and dragged the headline rate down by 20bp, while the annual rate of price change in this group turned negative for the first time since 2009.

The diffusion index (the ratio of the number of items with increasing prices minus the number of items with decreasing prices to the total number of items in the CPI basket) changed direction in December from the peak realised since the Aug-18 shock, though it was still high, showing the extent of pricing pressures.

Overall, annual inflation recorded another higher than expected change in December on the back of food and transportation prices. This reflected continuing cost-push factors, still

strong domestic demand and elevated services inflation being highly sticky at current levels. Inflation will likely peak in April while the exchange rate outlook, tax adjustments and expectations will remain key drivers for inflation. Given this backdrop, the CBT will likely maintain its current cautious stance and be ready to move if it sees a further substantial deterioration in the outlook.

Author

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

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