Turkey sees bigger-than-expected drop in inflation

Annual inflation continued its downward trend in December, as expected. Depending on the stability of the currency, the downtrend could continue until May mainly due to strong base effects

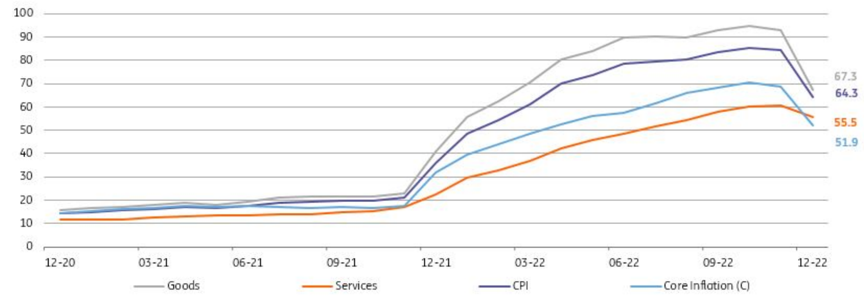
Inflation in Turkey may fall further in the near term

With inflation at 1.18% month-on-month, annual inflation turned out to be 64.3% in 2022 on the back of large favourable base effects, after a change in direction in November. The annual figure showed a more pronounced decline than the market consensus had envisaged given more benign monthly figures in transportation and food groups than expected. We will likely see a further fall in the near term with the presence of large base effects, if stability in the lira continues.

According to the data release, core "C" inflation, which strips out food, energy and some other goods, went down sharply to 51.9% YoY at the end of last year, while the underlying trend (as measured by the three-month moving average, annualised percentage change, based on the seasonally adjusted series) continued to improve, along with headline and goods inflation. However, the inertia is quite strong in services inflation and the recovery in the underlying trend is still small.

Annual inflation (%)

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

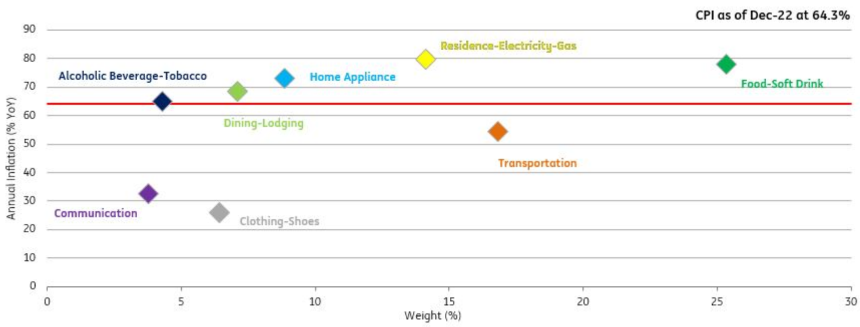


Source: TurkStat, ING

PPI inflation recorded another sharp drop to 97.7% YoY, the first double-digit turnout since January 2022. While base effects have been the main determinant, we also see support from a price drop in utilities, leading to the first negative monthly reading in more than three years. This hints at some easing in cost-push pressures lately.

In the breakdown of the main expenditure groups, monthly inflation in the heavy-weight food group came in below the long-term average, at 1.4% MoM, thanks to price declines in fresh fruit and vegetables. Accordingly, the fall in group annual inflation was more pronounced than envisaged earlier, coming in at 77.9% YoY vs 102.5% YoY a month ago, also thanks to the impact of large base effects. Transportation also surprised, with annual inflation recording a drop to 54.4% YoY from 107% YoY in November, reflecting the effects of a strong base as well as the moderation in global energy prices and recent currency stability. Among other groups, housing and household equipment lifted the headline rate by more than 40bp in December. This was due to continuing rent increases and water fee adjustments for the former and price hikes in furniture and white goods for the latter. As a result, goods inflation moderated to 67.3% YoY, while annual inflation in services stood at 55.5% YoY with relatively less improvement compared to other groups, from the peak of the current inflation series in November.

Annual inflation in expenditure groups



Source: TurkStat, ING

Given deeply negative real interest rates, further disinflation could be quite challenging, while risks to the outlook this year are on the upside given the significant deterioration in pricing behaviour, higher trend inflation and the still-elevated level of cost-push pressures. In this environment, the Central Bank of Turkey is expected to keep interest rates low while focusing on selective credit policy and pursuing a 'liraisation' strategy. The announcement on the last day of 2022, i) widening the scope of the securities maintenance regulation to factoring companies ii) extension of this regulation for banks to end-2023 iii) expansion of the scope of assets and liabilities of banks subject to the securities maintenance practice, shows that the current macro-prudential framework will be key for the macro and financial outlook in the near term.

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