Services remain a key risk to disinflation in Turkey

Base effects have contributed to a decline in Turkish headline inflation, despite a significantly higher-than-expected result. Given the persistent momentum in services inflation, the underlying trend has remained elevated

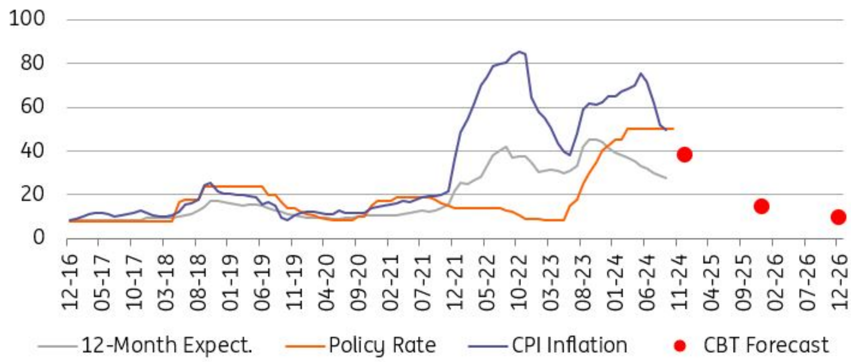
Cost-push pressures are moderating in Turkey, but pricing behaviour and inertia in services have remained key risk factors

Following the release of Istanbul's figure, which was quite high at around 4%, TurkStat's September inflation stood at 3% – a turnout markedly higher than the market consensus and our call of 2.2%. However, the annual figure has maintained its declining trend and fell to 49.4% from 52% a month ago, given the continued favourable base effect (4.75% in September 2023), while the pace of decline lost momentum with no respite in services inflation. Cumulative inflation in the first nine months of this year reached 35.9% vs the Central Bank of Turkey's 38% forecast for the whole year (with a forecast range of 34%-42%).

PPI stood at 1.4% month-on-month, showing a drop to 33.1% year-on-year vs a month ago. The data implies a continuing moderation in cost pressures with supportive currency developments (USD/TRY up by 16% on a year-to-date basis). Global commodity prices – particularly oil prices given the current geopolitical backdrop – will likely remain the key determinant of the PPI trend moving forward.

Core inflation (CPI-C) came in at 3.6% MoM, moving down to 49.1% on an annual basis, supported by the relatively slow-moving FX basket and supportive base from last year. While cost-push pressures are moderating (as evidenced by the PPI data), pricing behaviour and inertia in services have remained key risk factors, adversely affecting disinflation.

Inflation outlook (%)



Source: TurkStat, CBT, ING

When it comes to the underlying trend, TurkStat will begin releasing seasonally adjusted headline CPI and core indicators the working day after the release of the inflation data. According to our calculations, the September headline figure (on a seasonally adjusted basis) should have recorded a slight sequential decline, while the third quarter average should come in above 3% compared to the CBT's guidance of a decline to around 2.5%. The elevated underlying trend is attributable to services, which have not shown any meaningful signs of improvement yet despite a recent gradual moderation in goods group pricing pressures.

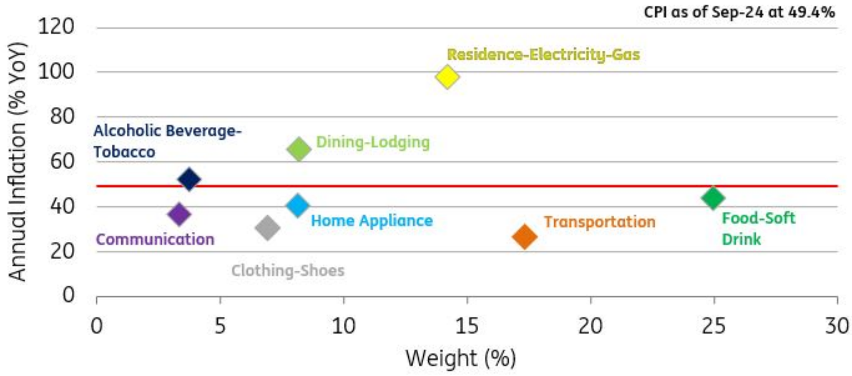
In the breakdown:

- The housing group turned out to be the major contributor to the headline rate with 0.63ppt, given rent increases exceeding 7% in the last three months with the removal of the cap (at 25% annually).
- This was followed by the food group, with a 0.59ppt impact. Compared to the same month of last year, however, processed food inflation recorded a lower increase (1.6% vs 4.1% last year) and limited the rise in the headline rate, while unprocessed food prices showed an acceleration (3.5% vs 2.4% last year). Accordingly, monthly food inflation at 2.5% was one of the key factors contributing to the decline in annual headline inflation in September.
- Transportation was the third contributor, pushing the headline rate up by 0.40ppt and reflecting the impact of transportation services and automobile prices despite the price decline in oil products.
- Annual inflation in education, on the other hand, stood at 93.6% with more than a 14% monthly increase.

As a result, goods inflation moved down to 40.3% YoY, while core goods inflation – a better indicator of the trend – inched down to 28.3% YoY. This was most likely due not only to base effects but also exchange rate-related factors. Services (which are less sensitive to currency movements but more impacted by domestic demand) and minimum wage increases fell to 72.9%

YoY.

Annual inflation in expenditure groups



Source: TurkStat, ING

Overall, despite continuing improvements in annual inflation (mainly due to base effects), Turkey's underlying trend remained elevated in September on the back of services. We think the downtrend should continue – and that the lagged effects of monetary tightening on credit and domestic demand, as well as the continued real appreciation of the Turkish lira, are likely the key factors that will keep the underlying inflation trend on a downward path for the remainder of this year. However, the September data implies that 2024's turnout will still likely come in above the CBT's forecast range. Meanwhile, the odds of a rate cut in November have declined and we may only see a change here if October's inflation data brings a significant positive surprise.

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