

Turkey: Temporary rise in annual inflation

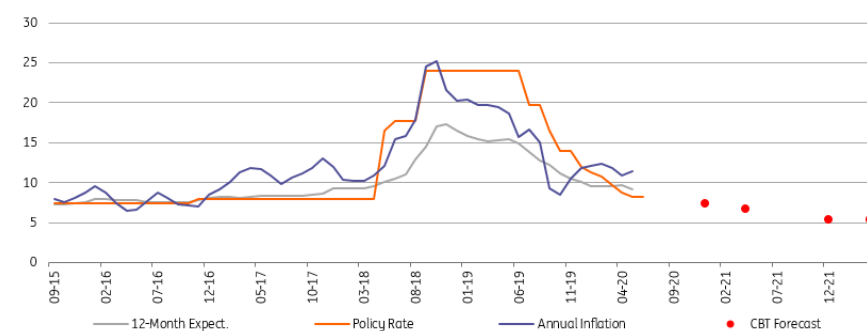
Annual inflation rose in May due to a reversal in oil prices and elevated food inflation, but this will likely be temporary as softer domestic demand supports disinflation



Source: Flickr

Monthly inflation was higher than expected in May at 1.4% vs the consensus at 1.0% (aligned with our call), pulling the annual figure up to 11.4% from 10.9% a month ago. Annual core inflation also changed direction, moving into double digits, at 10.3%. Still, the monthly figure was broadly in line with the long-term average in May, which suggests we're not seeing a strong revival of pricing pressures due to weak demand.

Inflation Outlook (%)



Source: CBT, ING

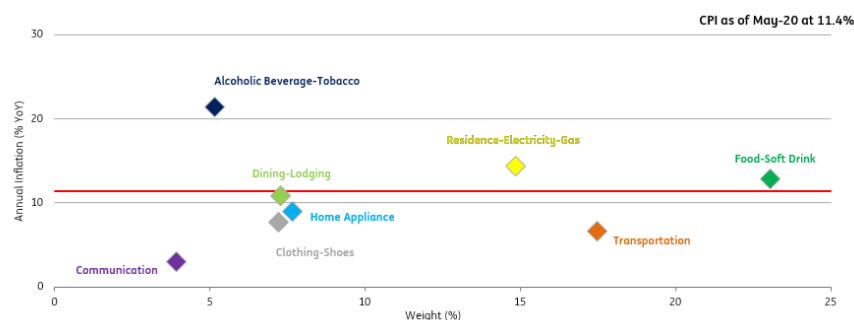
In the breakdown, we see 1) an increase in annual goods inflation to 11.4% driven by energy due to the partial reversal in oil prices last month. Food prices also rose in part because of the base effect from fresh fruit and vegetables while core goods such as clothing and durables went up as well 2) services inflation, on the other hand, fell to 11.3% driven by rents, which should be positive for the outlook.

The Domestic Producer Price Index (D-PPI) fell to 5.5% from 6.7% a month ago. The data, which also reflects a supportive base effect, implies lower producer price-driven cost effects.

Regarding the main expenditure groups, all contributed positively to the monthly reading:

- As expected, transportation pulled the headline up by 48 basis points thanks to a recovery in energy prices. Weakness in the Turkish lira also led to price increases in automobiles, however annual inflation is low, at 6.7%.
- Another key contributor was the clothing group, with a 43bp impact due to seasonal effects, though the monthly price change was relatively low in comparison to earlier years.
- In the volatile food group, lower than expected seasonal declines in fresh fruit and vegetables as well as elevated processed food prices drove annual food inflation to 12.9% in May from 11.3% in April.
- Among the remaining groups, contributions to the headline rate floated in a 1 to 11bp range, while home appliances and miscellaneous goods had a relatively higher impact.

Annual inflation in Expenditure Groups



Source: TurkStat, ING

While May's annual inflation rose, this will likely be temporary as softer domestic demand conditions support disinflation. Exchange rate developments will remain one of the major determinants of the inflation outlook, though FX pass-through should be relatively limited during the slowdown and relative strength in the TRY recently is a positive. Turkey's central bank has already cut its policy rate significantly- extending its easing cycle since mid-2019- pulling it markedly below the annual inflation rate. But given the bank's inflation estimate of 7.4% and its focus on the ex-ante real rate (by relying on its own forecast) to guide its policy decisions, an easing bias will likely remain in place in the near term.

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