

Turkish inflation surges in August

Annual inflation recorded another strong rise in August due to large increases in transportation and food prices



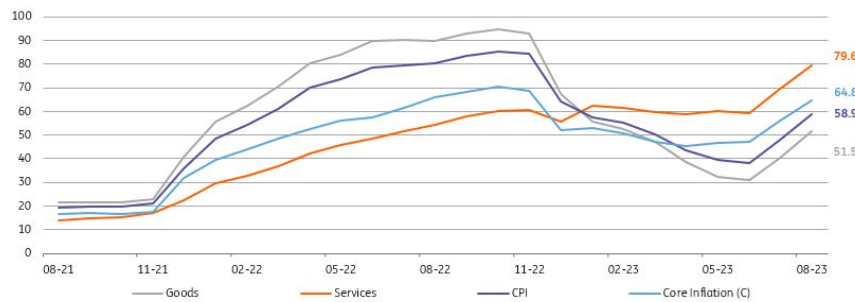
Turkish inflation came in at 9.1% month-on-month in August, higher than the consensus (7.0% MoM) and the highest August figure in the current inflation series. The jump in inflation was driven by both food and non-food prices, despite a supportive base as the average August inflation rate in the 2003-based index is 0.5%. Accordingly, annual inflation accelerated further to 58.9% last month versus the 58% forecast from the Central Bank of Turkey (CBT).

Core inflation (CPI-C) came in at 8.9% MoM, rising to 64.8% on an annual basis, attributable to exchange rate developments, administered price hikes and a rise in commodity prices. Durable goods prices rose by 7.8% MoM, while core goods inflation increased to 52.0% YoY. The underlying trend (as measured by the 3-month moving average, annualised percentage change, based on seasonally adjusted series) for all inflation indicators that markedly increased in July accelerated further in August.

After a sharp increase in June and July, PPI has remained on a rapid upswing with a monthly reading of 5.9%, reflecting a significant jump in the Turkish lira equivalent of import prices due to commodity and exchange rate increases. The data imply that cost pressures have gained strength again.

Inflation outlook (%)

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

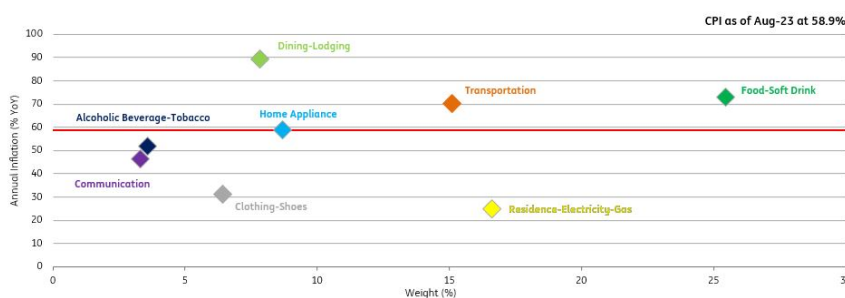


Source: TurkStat, ING

Looking at the breakdown, all of the main expenditure groups positively impacted the headline figure. Among them, transportation turned out to be the major contributor at 2.78ppt, due to higher fuel prices, adjustments in transportation services and a weaker Turkish lira. This was followed by food at 2.3ppt as both processed and unprocessed food products witnessed significant price increases. Annual inflation in this group came close to 73% versus the CBT's assumption in the inflation report of 61.5%.

Among other non-food groups, substantial increases were recorded in household equipment, clothing, health, restaurants and hotels, and entertainment and cultural activities. As a result, goods inflation jumped to 51.5% YoY, while annual inflation in services, which is significantly influenced by domestic demand and minimum wage hikes, reached 79.6% YoY, a new peak in the current inflation series with big annual increases in rents, restaurants and hotels, transport and other services.

Annual inflation in expenditure groups



Source: TurkStat, ING

Overall, given the deterioration in pricing behaviour, currency weakness despite some recovery in late August, widespread increase in wages and tax adjustments, and a markedly negative real policy rate, inflation will likely remain under pressure in the near term, as we have already seen a significant jump in the last two months.

In this environment, the CBT has taken steps towards normalisation in interest rates and the exchange rate policy. The latest rate hike in August was significant and likely raised

expectations for the final level in the current cycle. This move and its likely impact on deposit and loan rates, along with other macro-prudential decisions, will be important towards tightening financial conditions and controlling domestic demand.

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