

## Inflation

### Annual CPI remained above 20% in January

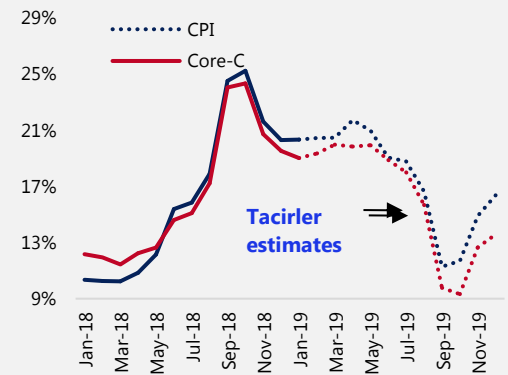
**January CPI increased by 1.06% m/m in line with the consensus estimate at 1%, yet slightly higher compared to our house forecast at 0.8%.** As a result, the annual inflation remained almost unchanged at 20.35% compared to 2018YE level. The market reaction to the inflation figures was muted.

**The main component that drives the volatility in the January inflation was the food prices, especially the unprocessed food segment.** Both Istanbul and Ankara food prices have already depicted unsupportive landscape for headline inflation in January. The bad weather conditions have led a significantly higher fresh vegetables and fruit prices, which posted a monthly increase of 29.7% in January. The processed food prices, on the other hand, followed a tamer pattern with 0.88% monthly increase. As a result, the food prices rose by a significant 6.43% in January adding 1.5pp to the headline. Note that TURKSTAT also held an annual basket weight change, while the weight of the food in basket has edged up to 23.29% from previous 23.03%. (please see the table at page 2) The annual price change in food prices as of January is high at 31%. According to the CBT's very latest assumption, food price change assumptions for 2019 and 2020 remained constant at 13% and 10% respectively. We expect the food inflation to ease towards 17% in 2019 down from 20.3% in 2018. We believe most of the improvement would stem from the processed food side, which will be under pressure of weaker domestic demand. However, strong tourism sector will continue to weigh on the food inflation, which poses an upward risk on our estimate.

#### In respect to the underlying inflation;

- **The core good prices declined by 1.87% in January**, while in annual terms, the rise eased to 22.75% from previous month's 24.67%. The clothing sector prices continued to make positive surprises, which decreased by 8.13% m/m sharper compared to its historical trend. In addition, the durable good prices recorded another monthly decline (0.22%) which stands fourth month in a row. Key determinants of core goods prices are the course of TL and economic activity. These two components ignited a sharp increase in core goods prices starting from the beginning of 2017. However, the weak economic activity in 1H19 and rather stable TL will stage material improvement from very high levels in 2018.
- **The service prices posted a significant rise at 2.09% pushing the annual change to 15.4% from its previous 14.46%.** Pricing behavior and inertia are very critical for the course of the services sector inflation. The FX pass-through has a limited direct impact on the services side, given that services lack the pressure from international competitiveness and thus is rather closed in nature. Inertia finds its way by backward indexation, given that the services sector is labor-intensive and the wage contracts are critical on general pricing levels. The pricing behavior has deteriorated notably which can be detected by the course of the services sector prices.

Annual CPI & CPI-C



Source: TURKSTAT, Tacirler Investment

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- **As a result, the core inflation, CPI-C, stayed muted with only 0.04% monthly rise, which carried the annual inflation to 19.02% from previous month's 19.53%.**

**TURKSTAT started to release two additional core indicators;** (i) CPI excluding alcoholic beverages and tobacco (CPI-E) , ii) CBT excluding administered and directed prices (CPI-F). Both indicators rose by 1.08% m/m and 1.66% m/m respectively in January. We believe that these indicators would gain more importance in the coming period given that we believe a tobacco price increase might take place after the tax adjustment in January. Yet it is still unknown to what extent the adjustment would be reflected into end-prices. (Our house estimate incorporates tobacco price hikes to fully reflect tax adjustments in 2Q19).

**All in all, we believe that the course of inflation in 1Q19 will be key for the investors whether the underlying inflation trend is improving.** The sharp deceleration in economic activity has already shown itself on demand inflation, while moderate energy prices are also restraining inflationary pressures. Nonetheless, we believe the tax adjustments in 1H will retain the annual inflation at rather high levels, while inflation will dwindle during the remainder of the year.

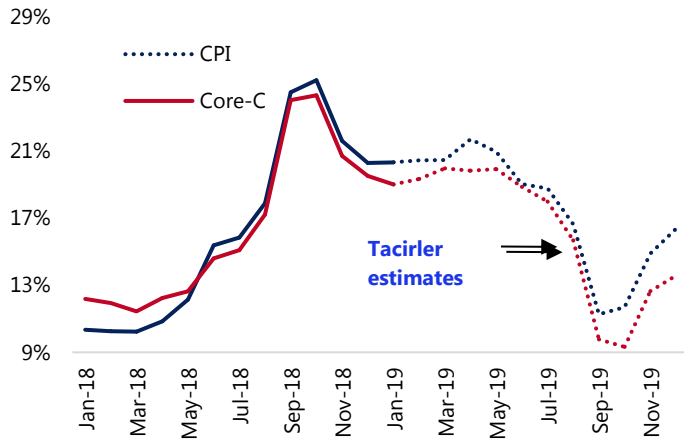
**We believe that strong inflationary pressures will likely moderate in 2H19, leading to some rate cuts by the CBT.** Our 2019YE CPI estimate stands at 16.3%. Under these circumstances, we believe that the most appropriate start of timing for the monetary easing cycle would be as of June and expect CBT to reduce the one-week repo rate (policy rate) by 500bps to 19% this year. Moreover, we believe that the current monetary stance supports the carry advantage of TRY significantly both in ex-ante and ex-post terms.

### CPI – subcomponent's weights

	New basket weights	Previous year's basket weights
Food and non-alcoholic beverages	23.3%	23.0%
Alcoholic beverages and tobacco	4.2%	5.1%
Clothing	7.2%	7.2%
Housing	15.2%	14.9%
Houseware	8.3%	7.7%
Health	2.6%	2.6%
Transportation	16.8%	17.5%
Communication	3.7%	3.9%
Recreation and culture	3.3%	3.4%
Education	2.4%	2.7%
Hotels and restaurants	7.9%	7.3%
Miscellaneous goods & services	5.2%	4.8%

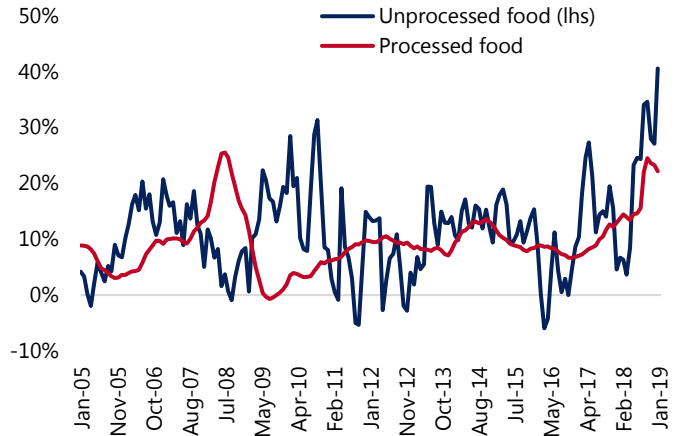
Source: TURKSTAT, Tacirler Investment

**Annual CPI & CPI-C**



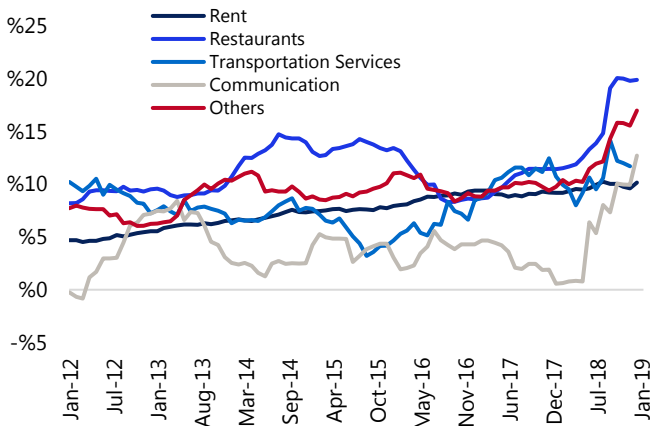
Source: TURKSTAT, Tacirler Investment

**Food – Unprocessed & Processed (y/y)**



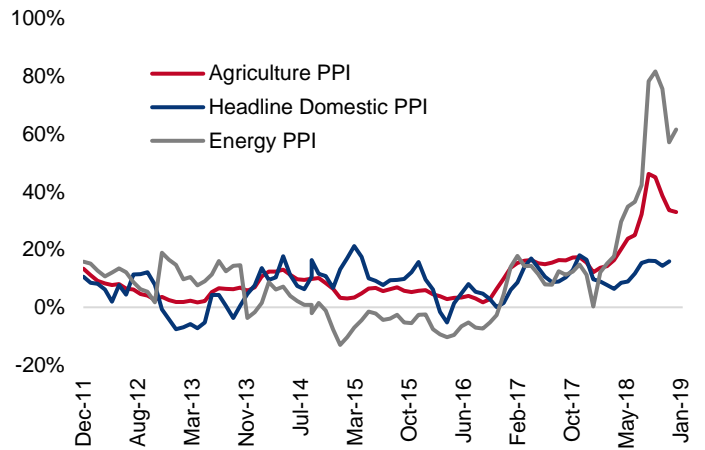
Source: TURKSTAT, Tacirler Investment

**Services Prices (y/y)**



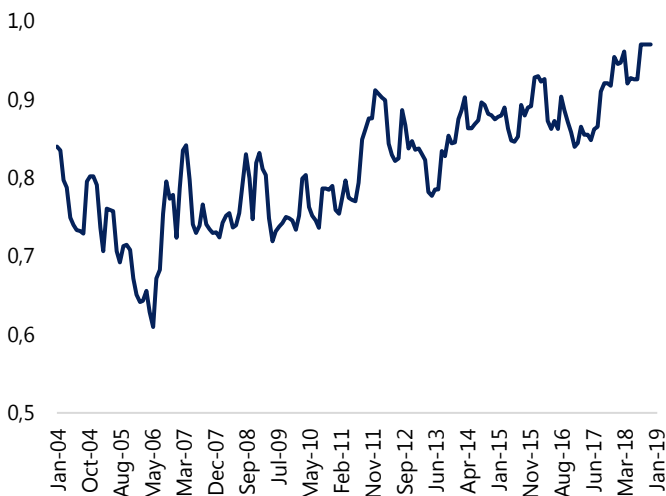
Source: TURKSTAT, Tacirler Investment

**Cost-based inflation aggregates (y/y)**



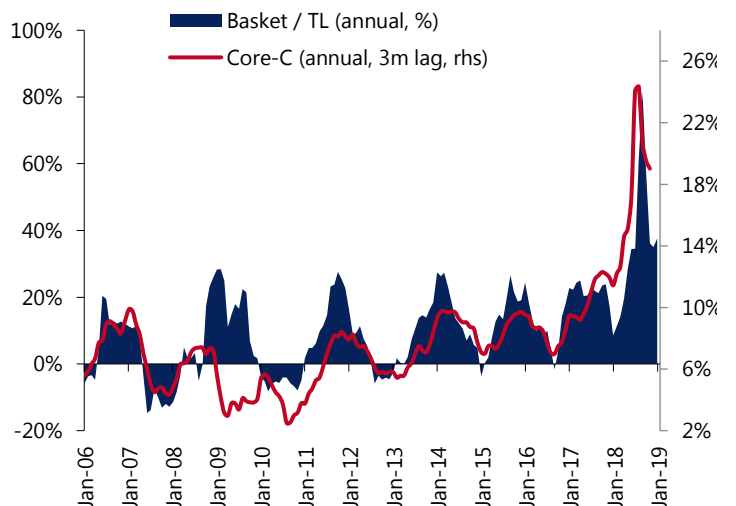
Source: TURKSTAT, Tacirler Investment

**Inflation diffusion index**



Source: TURKSTAT, Tacirler Investment

**FX pass-through on prices**



Source: TURKSTAT,CBT, Tacirler Investment

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