

Macro: Underlying inflation remains sticky

In March, consumer prices rose by 3.16% and annual inflation increased from 67.1% to 68.5%, which is quite close to the upper limit of CBRT's forecast band. Although inflation trend is still high in seasonally adjusted (s.a.) terms, the impact of the wage adjustments at the beginning of the year is abating. Risks to inflation expectations and pricing behaviour remain intact. The distribution of monthly inflation of CPI 5-digit sub-indices indicate that pricing behaviour has not yet improved significantly.

The difference between underlying trend of goods and services inflation is noteworthy. While goods inflation improved relatively with the controlled nominal depreciation (s.a. 2.8%, annualized 40%), services inflation remains sticky (s.a. 5.4%, annualized 88%). This points out that the disinflation strategy based on real appreciation should be supported by a macro policy stance that will sufficiently curb domestic demand. Indeed, the deep negative output gap forecast in the Inflation Report imply a significant weakening in economic activity (2024 growth: ≈2%). Considering that high-frequency data signals an annual growth exceeding 5.0% in the first quarter, we believe that fiscal policy should focus on controlling domestic demand in a way to enhance the effectiveness of the current monetary stance. In this regard, public expenditure and tax policies as well as the incomes policy for the second half of the year will be of critical importance. On the other hand, administered prices are a significant source of uncertainty for the inflation path. The timing and the size of energy price adjustments will play a crucial role in managing expectations and the distribution of the burden on macro policies.

Despite the earlier and stronger policy rate hike in March than we had previously anticipated, we revised our year-end inflation forecast slightly downwards to 43.5% due to the upward revision in our oil price assumption. This forecast is based on the assumptions that (i) there will be no further monetary policy tightening beyond the room provided by the interest rate corridor, (ii) the primary budget deficit will be around 2% of GDP, (iii) the Turkish lira will appreciate slightly in real terms, (iv) Brent oil price will hover around \$85 on average, (v) the projected increase in household electricity and natural gas prices will be distributed over time, (vi) there will be no further minimum wage adjustment by mid-year, and (vii) growth will slow down more moderately throughout the year compared to the Inflation Report projections. A tighter macro policy stance compared to these assumptions is the main downside risk to our forecast. We see the upside risks regarding the incomes policy alleviated compared to the previous month. Risks to the fiscal stance and administered prices remain significant.

Consumer Price Index (CPI)

Monthly inflation in March was 3.16%, in line with our forecast (Akbank: 3.1%), below market forecasts (Foreks: 3.60%, AA Finans: 3.67%, Bloomberg HT: 3.50%) and above the inflation implied by the CBRT Inflation Report forecast path (2.7%). Thus, annual inflation increased by 1.4 points to 68.5%, close to the upper band of CBRT's forecast path (≈69%).

Underlying inflation is sticky. Seasonally adjusted (s.a.) monthly CPI inflation was 3.3% (down from 4.1%) in March, corresponding to an annualised inflation rate of approximately 47%. On the other hand, the difference between underlying trend of goods and services inflation is noteworthy. While goods inflation improved relatively with the controlled nominal depreciation (s.a. 2.8%, annualized 40%), services inflation remains sticky (s.a. 5.4%, annualized 88%).

The annual rate of increase in core inflation indicators continued to rise. Annual inflation in the B index rose by 1.6 points to 71.9%, while annual inflation in the C index rose by 2.3 points to 75.2% (Chart 1, Table 2).

Chart 1. CPI and Core CPI (annual% change)

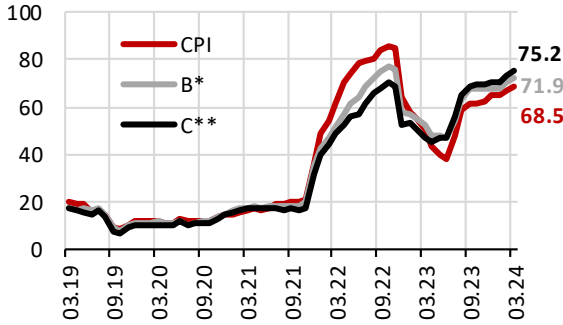
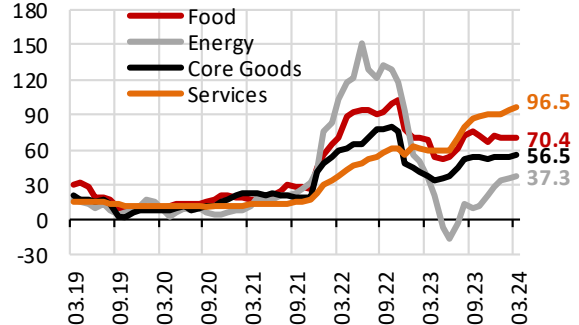


Chart 2. CPI Sub-Indices (annual% change)



* CPI excluding unprocessed food, energy, alcoholic beverages and tobacco products, and gold

** CPI excluding energy, food and non-alcoholic beverages, alcoholic beverages and tobacco products, and gold

Source: Turkstat

Annual inflation increased in all main groups other than food compared to February (Chart 2, Table 1). The decline in food annual inflation was limited. Details are as follows:

- **Food:** The monthly inflation of **food and non-alcoholic beverages group** decelerated, but remained above CPI in both raw (3.4%) and seasonally adjusted terms (3.5%) (Table 1). Therefore, food price increases continue to be one of the factors pushing inflation upwards. Meanwhile, annual inflation in the processed food group edged down (by 0.7 points) to 70.4% (Tables 1 and 2).

Unprocessed food prices were the main driver of food inflation in March: The monthly price increase was 5.6% (s.a. 4.6%), while annual inflation decreased by 0.3 pp to 84.1%. Meat prices, in particular, continue to have a very negative impact on food inflation. Monthly meat inflation was 14.0% (s.a. 6.75%), while annual meat inflation decreased to 98.5% thanks to the base effect. However, annual inflation in lamb meat, is at very high levels with 145.6% and still on the rise. In fresh fruits and vegetables, the outlook was more favourable compared to last month. While the monthly increase decreased to 2.0% (s.a.) led by vegetable prices, the group's annual inflation rose by 5.9 points to 82.7%.

The monthly price increase in **the processed food group** was 1.4%, the lowest in the last 10 months, while the group's annual inflation fell by 1.5 points to 59.0%. Monthly inflation in **the bread and cereals group** was 0.95% (Table 2). Deferred price adjustments may lead to a rebound in bread prices in the upcoming period. Prices of milk and dairy products, which increased sharply last month due to the hike in raw milk prices, recorded a limited change as the pass-through was largely completed. Thus, the monthly price change in other processed food prices decelerated significantly by 1.6% compared to February (8.0%).

In the first quarter, food prices rose by a cumulative 17.7% (s.a. 13.4%), following a more unfavourable course than non-food items. This suggests that CBRT's food annual inflation assumption (34.6%) remains optimistic and food prices continue to pose a significant upside risk to the inflation forecast.

- **Energy:** Monthly inflation in energy group remained below last month's figures with 1.4%, while annual energy inflation increased by 1.3 points to 37.3%. While **fuel prices** increased by 1.7% in March, the most significant increase was in bottled gas prices by 7.1%. **Electricity** prices remained

unchanged in March, while **solid fuel** and **municipal water** prices increased by 0.9% and 1.5%, respectively. In April, we are likely to see the reflections of the recent increases in oil prices. The energy price adjustments that we expect in the following period will be a factor that will significantly increase the group inflation.

- **Core goods:** Monthly group inflation was 2.9% (s.a. 3.3%), maintaining its recent steady uptrend. Annual group inflation increased by 2.5 points to 56.5%. **Clothing prices** rose by 2.6% mom, while the seasonally adjusted monthly increase accelerated slightly to 3.6%. Although the group's annual inflation increased by 6.7 pp to 49.1%, it remained below the CPI. The rate of increase is well below the cost increases in the sector and the ICC annual clothing inflation (109.0%).

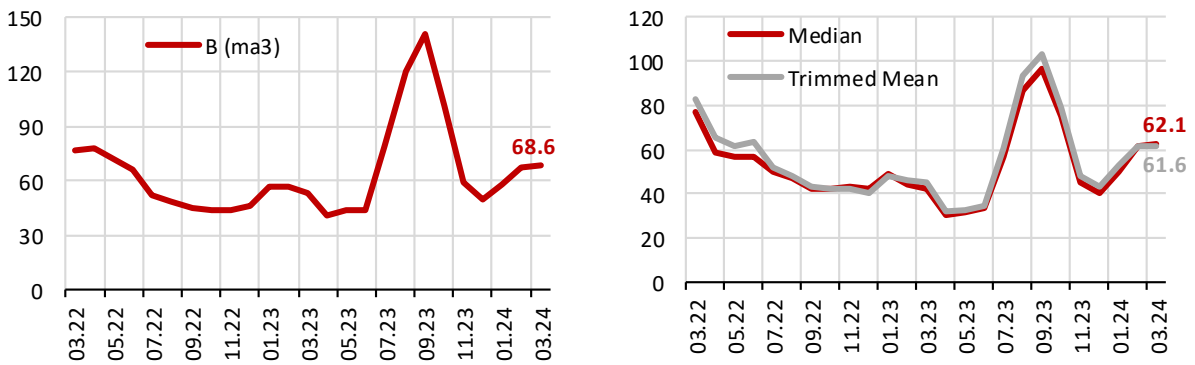
The monthly increase in **durable goods (excluding gold)** accelerated to 3.0% (s.a. 3.1%), while the price increase was widespread. Furniture and household appliances rose by 5.1% (s.a. 4.7%) and 2.6% (s.a. 4.2%), respectively, while the increase in motor vehicle prices was 2.5% (s.a. 3.2%). The monthly price increase in **other core goods, which excludes clothing and durable goods** (excluding gold), was parallel to February (2.7%).

- **Services:** Stickiness in services inflation continued. **Prices of services** increased by 4.2% mom (s.a. 5.4%), while annual services inflation rose by 2.1 points to 96.5%. Services continue to be the main group with the highest annual inflation (Chart 2).

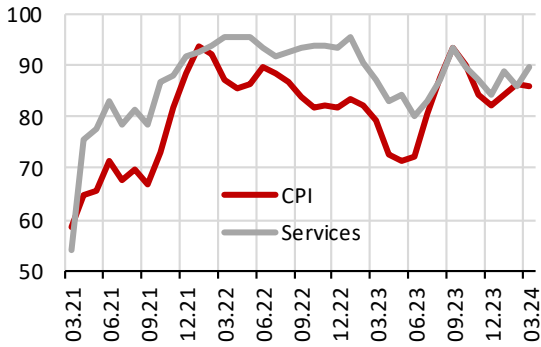
Monthly rent inflation remained high at 6.3% (s.a. 7.1%). Annual inflation in this group increased by 3.0 points to 124.0%. The impact of food prices on **the restaurants-hotels group** was still evident. The group's seasonally adjusted monthly inflation was 4.8%, quite similar to February and pointing to a strong inflation trend. Prices in **transport services** decreased by 0.2% due to seasonal effects. In seasonally adjusted terms, there was an increase of 3.0%. Prices of **communication services** continued to rise strongly by 6.6% in March. We think that the update in mobile communication fee ceiling prices will cause further increases in the group prices in the upcoming period. Among other services, education inflation (monthly raw data: 13.1%, s.a. 9.2%) was noteworthy due to the 21% increase in primary and secondary education fees.

Underlying trend indicators calculated based on three-month averages hover above the year-end target. In addition to the Core-B trend, median and trimmed inflation indicators exceeded 60% (Chart 3). **Risks to inflation expectations and pricing behaviour remain significant.** Diffusion indices still hover at very high levels (Chart 4). The distribution of monthly inflation of CPI 5-digit sub-indices indicate that pricing behaviour has not yet improved significantly (Chart 5).

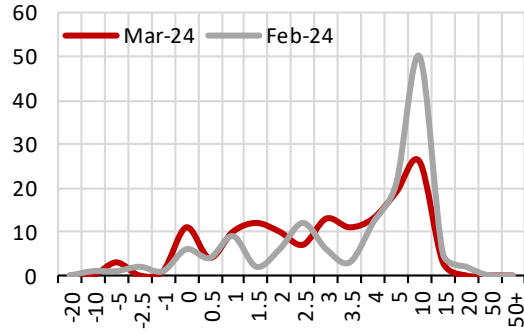
Chart 3. Underlying Inflation* (seas. adj. m-o-m, 3-month moving average, annualized)



* In calculating trimmed mean indicator, 15% of the monthly inflation distribution has been deducted from both ends.
Source: Turkstat, Akbank

Chart 6. Diffusion Index (seas. adj., increase-decrease, %)

Source: Turkstat, Akbank

Chart 7. CPI Subgroups Monthly Inflation Histogram (seas. adj)

Source: Turkstat, Akbank

Inflation Forecasts

Annual inflation was 68.5% in March, quite close to the upper band of the CBRT's forecast (69%). The difference between underlying trend of goods and services inflation points out that the disinflation strategy based on real appreciation should be supported by a macro policy stance that will sufficiently curb domestic demand. Indeed, the deep negative output gap forecast in the Inflation Report imply a significant weakening in economic activity (2024 growth: $\approx 2\%$) ([Macro: Inflation forecasts were maintained with the change in the forward guidance on the monetary stance](#)).

Considering that high-frequency data signals an annual growth exceeding 5.0% in the first quarter, we believe that **fiscal policy should focus on controlling domestic demand in a way to enhance the effectiveness of the current monetary stance.** In this regard, public expenditure and tax policies as well as the incomes policy for the second half of the year will be of critical importance.

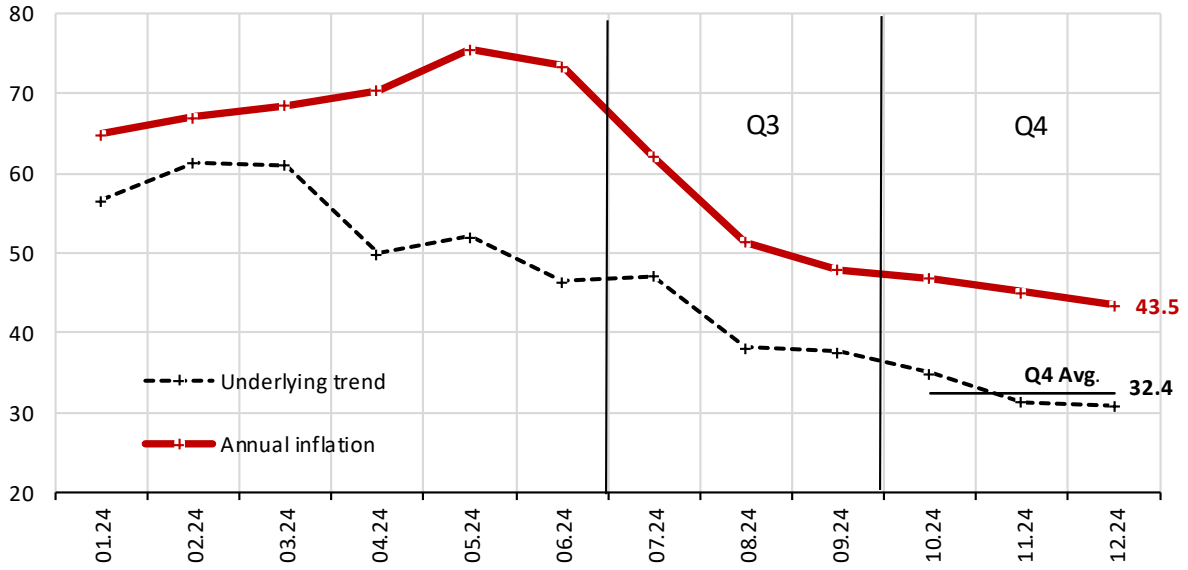
Administered prices are a significant source of uncertainty for the inflation path. The timing and the size of energy price adjustments will play a crucial role in managing expectations and the distribution of the burden on macro policies.

Despite the earlier and stronger policy rate hike in March than we had previously anticipated, **we revised our year-end inflation forecast slightly downwards to 43.5%** due to the upward revision in our oil price assumption

- **Assumptions:** Our assumptions are as follows: (i) there will be no further monetary policy tightening beyond the room provided by the interest rate corridor, (ii) the primary budget deficit will be around 2% of GDP, (iii) the Turkish lira will appreciate slightly in real terms, (iv) Brent oil price will hover around \$85 on average, (v) the projected increase in household electricity and natural gas prices will be distributed over time, (vi) there will be no further minimum wage adjustment by mid-year, and (vii) growth will slow down more moderately throughout the year compared to the Inflation Report projections.
- **Risks:** A tighter macro policy stance compared to these assumptions is the main downside risk to our forecast. We see the upside risks regarding the incomes policy alleviated compared to the previous month. Risks to the fiscal stance and administered prices remain significant.
- **Underlying trend:** Our inflation forecast implies a gradual decline in the underlying trend over the year to 30%-35% by the end of the year (Chart 6). However, factors that have significantly affected the course of inflation over the past year (natural gas price support, wage adjustments, large depreciations) make it difficult to calculate the seasonally adjusted price changes that we use to

measure the underlying trend. Therefore, we also note that it is difficult to accurately forecast the underlying trend in the upcoming period using the current seasonally adjusted methods.

Chart 6. Annual Inflation and Underlying Trend* Forecast (%)



*Note: Underlying trend shows the annualized value of the change in seasonally adjusted CPI over the last 3 months.

Table 1. Consumer Price Index (Raw data)

	Monthly % Change			Annual % Change		
	Mar.23	Feb.24	Mar.24	Mar.23	Feb.24	Mar.24
CPI	2.3	4.5	3.2	50.5	67.1	68.5
Food and Non-Alcoholic Beverages	3.8	8.3	3.4	67.9	71.1	70.4
Alcoholic Beverages and Tobacco	0.1	0.5	0.0	43.7	63.1	63.0
Clothing and Footwear	-1.9	0.2	2.6	17.3	43.4	50.1
Housing, Water, Electricity, Gas and Other Fuels	2.0	3.4	3.4	56.1	49.1	51.2
Furnishings, household equipment, maintenance of the house	2.7	3.0	3.2	53.3	62.9	63.7
Health	2.0	3.6	1.4	64.7	81.3	80.3
Transport	0.6	2.8	1.7	28.7	78.0	79.9
Communication	0.6	4.3	5.6	32.4	51.9	59.5
Recreation and Culture	2.9	3.2	3.7	47.4	65.4	66.8
Education	6.3	12.8	13.1	43.8	91.8	104.1
Restaurants and Hotels	3.8	5.4	4.0	70.7	94.8	95.0
Miscellaneous Goods and Services	2.7	3.5	3.2	47.2	61.9	62.7

Source: TURKSTAT

Table 2. Core Indicators (Raw Data)

	Monthly % Change			Annual % Change		
	Mar.23	Feb.24	Mar.24	Mar.23	Feb.24	Mar.24
CPI	2.3	4.5	3.2	50.5	67.1	68.5
Goods	2.0	4.1	2.7	47.1	57.0	58.2
Energy	0.4	3.0	1.4	35.7	36.0	37.3
Food and Non-alcoholic Beverages	3.8	8.3	3.4	67.9	71.1	70.4
Unprocessed Food	5.7	9.3	5.6	65.9	84.4	84.1
Fresh Fruits and Vegetables	-2.7	13.7	0.6	35.7	76.7	82.7
Other Unprocessed Food	11.3	6.5	8.9	86.2	89.1	85.0
Processed Food	2.3	7.3	1.4	71.7	60.4	59.0
Bread and Cereals	2.4	5.7	1.0	57.9	61.0	58.8
Other Processed Food	2.3	8.0	1.6	79.7	60.1	59.0
Goods excl. Energy and Food	1.1	1.5	2.7	37.0	55.2	57.6
Core Goods	1.2	1.6	2.9	36.6	54.0	56.5
Clothing and Footwear	-2.0	0.1	2.6	16.3	42.4	49.1
Durable Goods (excl. Gold)	1.7	1.5	3.0	40.2	59.0	61.1
Other Core Goods	2.5	2.7	2.7	44.5	55.0	55.2
Services	3.1	5.7	4.2	59.9	94.4	96.5
Rent	4.9	7.1	6.3	62.8	120.9	123.9
Restaurant-Hotels	3.8	5.4	4.0	70.7	94.8	95.0
Transportation Services	1.0	2.3	-0.2	57.1	96.7	94.4
Telecommunication Services	1.0	6.3	6.6	35.9	63.0	72.0
Other Services	2.7	6.1	4.1	57.1	87.8	90.4
CPI	2.3	4.5	3.2	50.5	67.1	68.5
A (CPI excl. seasonal products)	2.8	4.4	3.3	53.7	68.3	69.2
B (CPI excl. unproc. food., energy., alc. bev., tob., gold)	2.2	4.2	3.1	52.1	70.3	71.9
C (CPI excl. energy, food, alc. bev., tob., and gold)	2.2	3.6	3.5	47.4	72.9	75.2
D (CPI excl. unproc. food., alc. bev. and tobacco)	1.9	4.0	2.9	49.0	64.9	66.6
E (CPI excl. alcoholic beverages and tobacco)	2.4	4.7	3.3	50.8	67.2	68.7
F (CPI excluding administered prices)	2.5	5.2	3.6	48.8	72.6	74.4

Source: TURKSTAT

Domestic Producer Price Index (D-PPI)

Producer prices rose by 3.3% mom. Monthly increases in main industrial groupings excluding energy were realized in the range of 3.4%-4.3% and the month-on-month slowdown was limited (Table 3). In March, increases in both energy and non-energy commodities as well as the depreciation in the Turkish lira were influential on producer prices, while survey indicators such as BTS and PMI signalled that the effects of wage increases started to weaken.

Table 3. Domestic Producer Price Index

	Monthly % Change			Annual % Change		
	Mar.23	Feb.24	Mar.24	Mar.23	Feb.24	Mar.24
Domestic PPI	0.4	3.7	3.3	62.5	47.3	51.5
Intermediate Goods	1.9	3.9	3.5	47.0	51.5	53.8
Durable Consumption Goods	2.0	5.1	3.4	54.8	61.5	63.7
Non-durable Consumption Goods	4.2	5.4	4.3	85.2	64.3	64.4
Energy	-9.3	0.0	0.7	80.0	0.5	11.5
Capital Goods	1.3	3.2	3.4	51.9	64.7	68.1

Source: TURKSTAT

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