

**Macro: Inflation falling, underlying trend improving, yet no room for complacency**

Consumer inflation was 1.5% mom and 35.4% yoy, well below market expectations (monthly  $\approx 2.1\%$  mom; annual  $\approx 36.2\%$  yoy) and closer to our forecast (1.8%). Thus, annual inflation continued to decline by 2.5 pp mom.

Monthly inflation trend declined compared to the previous month. Using the direct approach, we calculate the seasonally adjusted (s.a.) monthly CPI inflation at 1.7% (previously 2.7%). This is the lowest level since the general elections in May 2023. The monthly increase in core goods and services (s.a.) was 2.1%. The improvement in services signals a cooling in aggregate demand and labor market. The median and trimmed-mean inflation rates of the distribution-based trend indicators are 2.0% and 1.9% mom (previously 2.5% and 2.4%). Thus, inflation returned to the levels before the electricity price adjustment in April. It is also positive that the IQR (interquartile range) bandwidth, one of the distributional indicators that we consider important for pricing behavior, reached the October 2021 level in April-May.

Weaker aggregate demand outlook due to the tightening in financial conditions and global developments and the mild course of commodity prices are likely to continue to weaken the inflation trend. With a strong policy coordination and a patient and prudent monetary policy stance, it is possible to break the underlying trend hovering around 2% in the second half of the year.

Although the gradual increase in reserves and the improving inflation outlook keep the possibility of a rate cut alive at the June MPC meeting, we expect the CBRT to adopt a prudent approach due to the vulnerabilities related to the risks that have emerged since March. Our base case scenario is that the weighted average funding rate (WAFR) will be lowered to 46% in June and the policy rate will be cut in July.

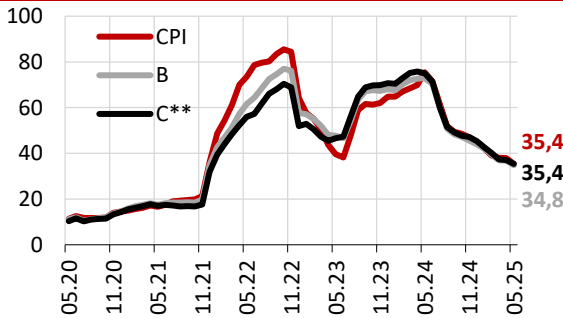
We maintain our year-end inflation forecast at 30.0% against a backdrop of (i) growth limited to 3.0% for the full year as demand conditions weaken from the second quarter onwards; (ii) USD exchange rate of 43.0 at year-end; (iii) a 25% increase in household natural gas prices before fall; and (iv) Brent oil prices averaging around \$65 for the rest of the year. However, we note that the risks around the forecast is predominantly on the downside. In addition to how the monetary stance will be shaped, we prefer to monitor for a while the extent of the slowdown in demand and its impact on pricing power, and in particular upside risks on food prices due to the agricultural frost and drought. We believe that we are more likely to revise our forecast downwards in the upcoming period.

**Consumer Price Index (CPI)**

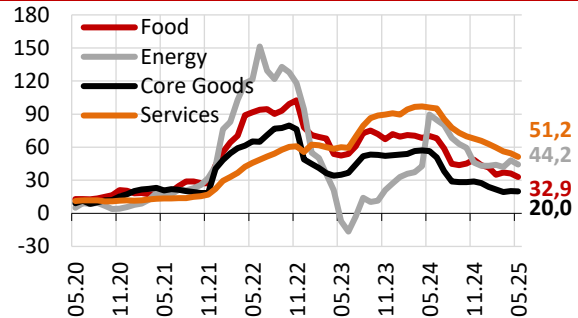
Monthly inflation was 1.53%, closer to our forecast (1.8% mom; 35.8% yoy) and well below market expectations ( $\approx 2.1\%$  mom;  $\approx 36.2\%$  yoy). The realization is in line with the CBRT's forecast path in the last Inflation Report. Thus, annual inflation fell by 2.5 pp to 35.4%. According to our own calculations, the seasonally adjusted (s.a.) monthly CPI inflation came in at 1.7%, improving by around 1 point compared to last month.

**Annual inflation in core indicators also declined significantly.** Annual inflation in the B index fell by 2 points to 34.8%, while annual inflation in the C index fell by 1.75 points to 35.4% (Chart 1, Table 3).

**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

**In May, annual inflation decreased across all groups, while the fall in core goods remained relatively limited** (Chart 2, Table 1). The details are as follows:

- **Food:** The slowdown in food inflation, which started after Ramadan, continued in May. **Food prices** fell by 0.7% mom as unprocessed food prices fell by 3% mom due to the seasonal decline in both fresh **fruits and vegetables** and other **unprocessed food** prices. **Processed food inflation** also slowed down in May. Thus, annual food inflation decreased by 3.2 points to 32.9% and remained below the annual headline inflation (Table 1).

**Adjusted for seasonal effects, monthly food inflation decelerated from 2.4% in April to 1.6% in May.** This slowdown was led by bread and cereals and other unprocessed food groups. In the **fresh fruits and vegetables** group, prices (s.a.) rose by 4.8%, limiting the decline. Price developments in the **fruit group** continued to be unfavorable compared to vegetables. We think that the recent agricultural frost will have a negative impact on fruit inflation in the upcoming period. The improvement in **other unprocessed food** group was mainly driven by the decline in egg prices, which had been on a strong upward trend due to the recent increase in export opportunities. Egg prices fell by 18.8% mom (s.a. 10.1%), contributing -0.14 pp to the monthly inflation. However, annual egg inflation remained high at 80.2%.

- **Energy:** Prices in the energy group increased by 2.2% mom thanks to the carry-over impact of the April electricity tariff hike (2.4%) and the strong increase in municipal water prices (7.1%), while annual energy inflation fell by 3.9 pp to 44.2%.

**Fuel prices** decreased by 0.4% mom due to the mild course of Brent oil prices. **Bottled gas** prices retreated slightly, while **solid fuel** prices increased by 0.28%.

Although we maintain our expectation for an increase in the **natural gas** tariff in the upcoming period, the timing of the increase remains uncertain. Based on the Energy Minister's statement, the price adjustment is likely to take place in July or August.

- **Core goods:** Monthly core goods inflation was 3.3% (2.1% s.a.) in May due to the continued pass-through of the rise in the basket exchange rate to durable goods, particularly automobiles, and the strong seasonal price increase in the clothing group (7.1%). Thus, annual inflation in this group edged down by 0.3 points to 20% (Chart 2, Table 2).

**Clothing and footwear** inflation continues to diverge significantly from our field observations and alternative measures. Clothing prices rose by 7.1% mom due to seasonal effects and by 0.6% in s.a. terms (Jan-March av.: -0.13%). Annual clothing inflation fell by 2.8 pp to 13.4%, while ICC's price index stands at 45.5%.

**Durable goods (excluding gold) prices** rose by 2.7% mom (2.5% s.a.) due to the lagged effects of the exchange rate hike. This was led by the 4.9% (s.a. 3.3%) rise in **automobile prices**. Apart from this, monthly inflation was 2.0% (s.a. 2.4%) in **electrical and non-electrical household appliances** and 0.75% (s.a. 2.1%) in **furniture**.

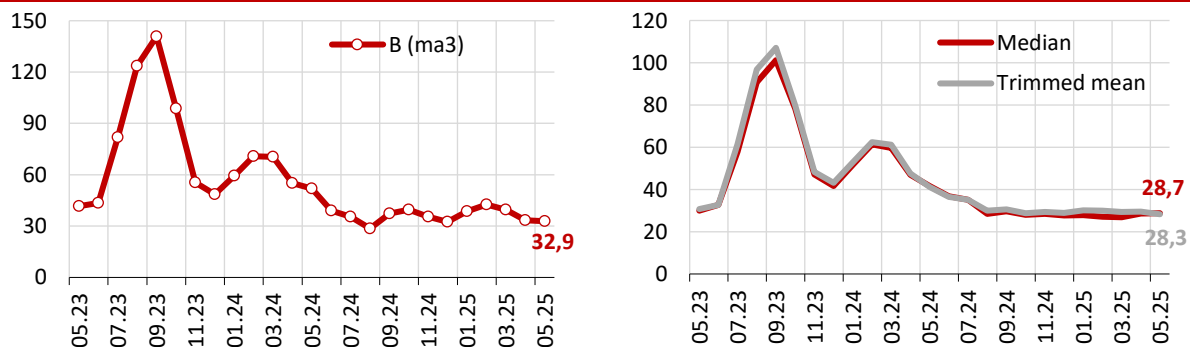
- **Services:** The underlying trend of services inflation improved in May. Prices of services rose by 1.9% mom, while we calculate that the "s.a." monthly increase fell below 3%. Annual services inflation decreased by 1.7 points to 54.6%. Although the services group continued to narrow the gap, it continues to be the main group with the highest annual increase (Chart 2).

The improvement in monthly **rent** inflation, which paused last month, continued in May. Monthly rent inflation fell from 4.9% to 4.0%, supported by the gradual decline in the benchmark rate of increase. Despite falling by 4.3 percentage points, the group's annual inflation remained significantly higher than that of other services subcategories and the CPI, at 84.9%.

Monthly inflation in the **restaurants-hotels** group was 1.8%, while we calculate that prices (s.a.) remained almost flat. Annual inflation in this group was 36.9%, the lowest level since November 2021 (28.9%).

Monthly inflation in **transport** services was 0.99%, slightly accelerating in "s.a." terms compared to April. Monthly inflation in **communication services** turned negative (-0.14%) for the first time since April 2021.

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



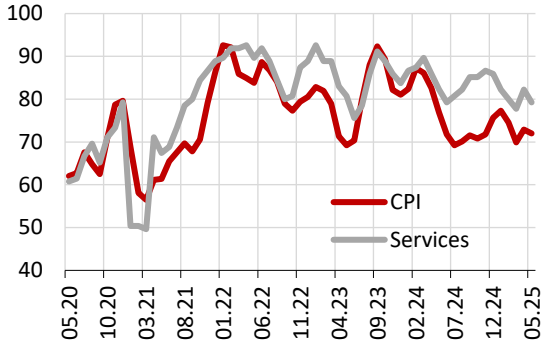
\* In calculating trimmed mean indicator, 15% of the monthly inflation distribution has been deducted from both ends.

Source: Turkstat, Akbank

**The monthly inflation trend has declined compared to last month.** According to our calculations, the monthly CPI (s.a.) inflation rate was 1.7%, which is a significant improvement on last month's rate of 2.7%. This was primarily due to the disappearance of the direct impact of the electricity price hike and

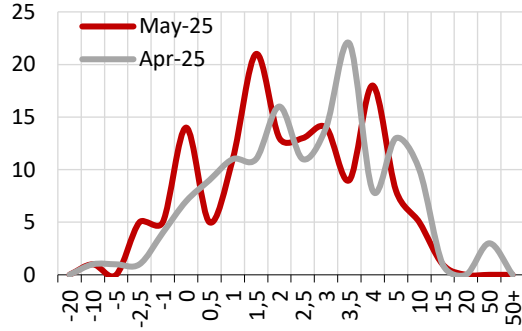
the stabilization of food prices. The median and trimmed-mean monthly inflation rates, which are distribution-based trend indicators, were back to their levels before the electricity price hike in April (Chart 3): 2.0% and 1.9% mom (previously 2.5% and 2.4%). However, the level of the diffusion index and the distribution of monthly inflation in CPI subcategories suggest that risks to pricing behavior persist.

**Chart 4. Diffusion Index (seas. adj., increase-decrease, %)**



Source: Turkstat, Akbank

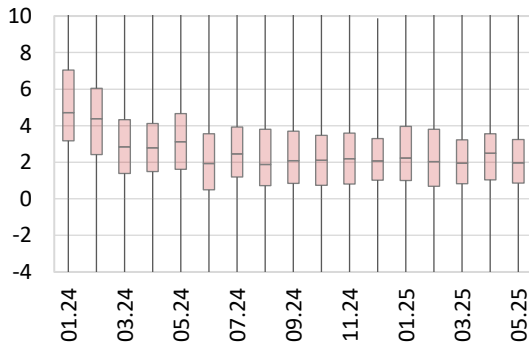
**Chart 5. CPI Subgroups Monthly Inflation Histogram (seas. adj.)**



Source: Turkstat, Akbank

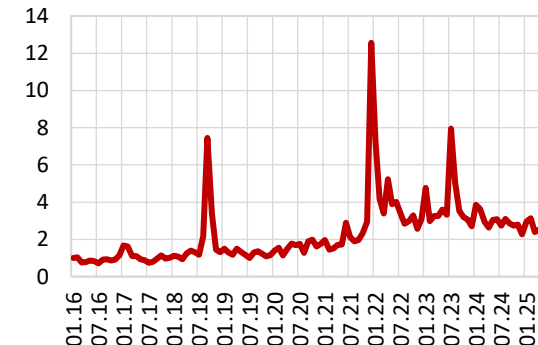
**The distribution of inflation by subcategories provides important information for assessing underlying trends and pricing behavior.** Chart 6 shows how the “s.a.” monthly inflation distribution of CPI subcategories has changed since the beginning of 2024. The vertical lines show the minimum and maximum values for the respective month; the red boxes show the values in the first and third percentiles of the distribution (interquartile range-IQR); and the horizontal lines inside the red boxes show the median inflation rates. It is also positive that the IQR bandwidth, one of the distribution indicators that we consider important for pricing behavior, reached October 2021 in April-May.

**Chart 6. Monthly Inflation Distribution (%)**



Source: TURKSTAT, Akbank

**Chart 7. Interquartile Range (IQR, %)**



Source: TURKSTAT, Akbank

Weaker aggregate demand outlook due to the tightening in financial conditions and global developments and the mild course of commodity prices are likely to continue to weaken the inflation trend. With a strong policy coordination and a patient and prudent monetary policy stance, it is possible to break the underlying trend hovering around 2% in the second half of the year.

We maintain our year-end inflation forecast at 30.0% against a backdrop of (i) growth limited to 3.0% for the full year as demand conditions weakened from the second quarter onwards; (ii) USD exchange rate of 43.0 at year-end; (iii) a 25% increase in household natural gas prices ahead of the fall; and (iv) Brent oil prices averaging around \$65 for the rest of the year. However, we note that the risks around the forecast is predominantly on the downside. In addition to how the monetary stance will be shaped, we prefer to monitor for a while the extent of the slowdown in demand and its impact on pricing

power, and in particular especially upside risks on food prices due to the agricultural frost and drought. We believe that we are more likely to revise our forecast downwards in the upcoming period.

**Table 1. Consumer Price Index (Raw data)**

	Monthly % Change			Annual % Change		
	Mar.25	Apr.25	May.25	Mar.25	Apr.25	May.25
<b>CPI</b>	<b>3,37</b>	<b>3,00</b>	<b>1,53</b>	<b>75,45</b>	<b>37,86</b>	<b>35,41</b>
Food and Non-Alcoholic Beverages	1,69	2,01	-0,71	70,14	36,09	32,87
Alcoholic Beverages and Tobacco	4,74	-0,06	0,06	86,48	33,85	27,87
Clothing and Footwear	9,60	6,50	6,97	50,85	16,92	14,12
Housing, Water, Electricity, Gas and Other Fuels	7,08	4,66	2,99	93,21	74,07	67,43
Furnishings, household equipment, maintenance of the house	1,87	2,64	1,21	69,34	30,54	29,69
Health	1,81	1,02	0,47	77,67	41,99	40,12
Transport	1,16	3,80	2,66	79,10	22,76	24,59
Communication	1,01	0,94	-0,71	54,31	21,31	19,25
Recreation and Culture	1,75	1,37	1,94	63,99	25,81	26,04
Education	5,63	2,28	1,19	104,80	79,20	71,67
Restaurants and Hotels	5,52	3,59	1,83	92,94	41,87	36,91
Miscellaneous Goods and Services	1,62	2,65	1,59	65,90	36,03	35,98

Source: TURKSTAT

**Table 2. Core Indicators (Raw Data)**

	Monthly % Change			Annual % Change		
	May.24	Apr.25	May.25	May.24	Apr.25	May.25
<b>CPI</b>	<b>3,37</b>	<b>3,00</b>	<b>1,53</b>	<b>75,45</b>	<b>37,86</b>	<b>35,41</b>
<b>Goods</b>	<b>3,08</b>	<b>2,99</b>	<b>1,43</b>	<b>67,58</b>	<b>30,79</b>	<b>28,70</b>
Energy	4,91	4,32	2,15	89,68	48,11	44,21
Food and Non-alcoholic Beverages	1,69	2,01	-0,71	70,14	36,09	32,87
Unprocessed Food	-0,45	1,98	-3,01	76,53	37,06	33,53
Fresh Fruits and Vegetables	-3,17	-1,49	-4,67	81,32	59,00	56,53
Other Unprocessed Food	1,15	4,69	-1,79	74,58	24,13	20,51
Processed Food	3,80	2,04	1,39	64,50	35,35	32,21
Bread and Cereals	4,06	2,61	1,17	65,86	44,90	40,87
Other Processed Food	3,68	1,74	1,51	63,84	30,88	28,14
Goods excl. Energy and Food	3,56	3,36	2,90	59,72	21,86	21,08
Core Goods	3,48	3,74	3,26	56,51	20,28	20,02
Clothing and Footwear	9,69	6,57	7,09	49,90	16,14	13,38
Durable Goods (excl. Gold)	1,89	3,43	2,73	57,43	19,28	20,26
Other Core Goods	1,90	2,38	1,49	59,56	25,50	24,99
<b>Services</b>	<b>4,03</b>	<b>3,00</b>	<b>1,74</b>	<b>95,93</b>	<b>54,60</b>	<b>51,19</b>
Rent	5,46	3,20	3,10	125,14	89,19	84,94
Restaurant-Hotels	5,52	3,59	1,83	92,94	41,87	36,91
Transportation Services	-0,11	5,75	0,99	99,10	48,66	50,29
Telecommunication Services	2,27	0,38	-0,14	65,17	28,02	25,01
Other Services	3,60	2,27	1,39	90,28	54,49	51,18
<b>CPI</b>	<b>3,37</b>	<b>3,00</b>	<b>1,53</b>	<b>75,45</b>	<b>37,86</b>	<b>35,41</b>
A (CPI excl. seasonal products)	3,29	3,04	1,53	76,92	38,39	36,04
B (CPI excl. unpro. food.. energy.. alc. bev.. tob.. gold)	3,77	3,10	2,25	72,99	36,81	34,81
C (CPI excl. energy. food. alc. bev.. tob.. and gold)	3,76	3,34	2,43	74,98	37,12	35,37
D (CPI excl. unproc. food.. alc. bev. and tobacco)	3,88	3,27	2,24	74,89	38,18	35,99
E (CPI excl. alcoholic beverages and tobacco)	3,32	3,11	1,58	75,05	38,01	35,69
F (CPI excluding administered prices)	2,89	2,96	1,49	74,81	34,74	32,90

Source: TURKSTAT

**Domestic Producer Price Index (D-PPI)**

While the monthly D-PPI inflation was 2.48%, annual producer inflation increased by 0.8 points to 23.1% (Table 3). While the 8.0% increase in energy prices limited the slowdown in monthly PPI inflation, monthly inflation in all main groups except energy prices decelerated more markedly compared to April. We expect the deceleration in exchange rate appreciation and the mild course of international commodity prices to limit the monthly increase in producer prices.

**Table 3. Domestic Producer Price Index**

	Monthly % Change			Annual % Change		
	May.24	Apr.25	May.25	May.24	Apr.25	May.25
<b>Domestic PPI</b>	<b>1,96</b>	<b>2,76</b>	<b>2,48</b>	<b>57,68</b>	<b>22,50</b>	<b>23,13</b>
Intermediate Goods	1,44	3,08	1,92	55,48	19,93	20,50
Durable Consumption Goods	2,00	2,73	0,05	64,91	31,74	29,22
Non-durable Consumption Goods	2,43	2,78	1,70	66,12	28,41	27,48
Energy	3,32	0,61	7,98	43,74	12,00	17,05
Capital Goods	1,34	3,69	2,38	63,51	25,20	26,48

Source: TURKSTAT

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