## Inflation & Wage Inertia

November inflation of 2.24% vs Bloomberg consensus of 1.92% bringing YOY inflation from 47.8% in October to 47.1% in November. The Cribstone full year 2024 inflation forecast of 45.3% (now 45.5%) assumed 2.1% in Nov. While not a big miss, November inflation is typically a close to average month, and is usually less than half the October figure (October 2024 was 2.88%). Why did we not finally get a sub 2% print as consensus hoped? The resilience of November inflation, despite high rates and the economic slowdown, is likely a consequence of the 15-20% wage hikes many workers got in July despite the frozen minimum wage. The government's failure to use targeted fiscal measures to tackle that July "windfall" among the better paid has arguably been the reason that we've seen higher than expected prints consistently in recent months. Regretfully, every higher than hoped for inflation print exacerbates the pain, for exporters in particular, from Turkey's real currency appreciation.

## Should the Central Bank cut in December…probably not

On the simplest metric of a headline 50% policy rate vs trailing inflation of 47.1%, the Central Bank should probably not cut in December. In the past Turkish Central banks tended to cut at the first market opportunity, irrespective of inflation dynamics. This Central Bank team has spent much effort building up their credibility as serious data-dependent inflation fighters. It would be somewhat strange to cut with November (and previous months) coming in higher than expected, and with trailing 12-month CPI still so close to the policy rate. This however is not to say they can't justify a cut if they want to, as YOY inflation is set to fall sharply in the coming months. Even today the underlying run rate of inflation is closer to 30% than 40%, implying real rates are now extremely high.

When looking at median monthly inflation prints from 2005-2020, November inflation is traditionally just a touch below the average monthly inflation rate throughout the year. On the view that inflation and wage inertia mean there is some lag in the data, simply annualizing the November inflation print should give us a conservative view of the coming 12 month inflation trend. When we annualize the 2.24% November 2024 print, we get an annual rate of inflation of 30%. That is still well off the Central Bank's 2025 target of 21%, but it is nonetheless proof that current policy is now very restrictive. Still, as successive CPI prints have been higher than expected, and as the pending decision on the minimum wage and national wages are extremely important to the 2025 inflation outlook, the value of waiting a month to cement credibility would seem to outweigh the gains of cutting in December.

## December inflation likely a good headline, much less important than January

December is traditionally one of the least inflationary months of the year, meaning the market should finally get a sub-2% print. Importantly we should see a meaningful fall in YOY CPI (from 47.1% to 45.5% or lower) as we are cycling against a 2.93% inflation rate in December of 2023. It is important to note that December 2023 reflected a 34% rise in virtually all wages in July of 2023, a very tight labour market, and expectations that wage hikes in January 2024 would be generous (at 49%...they were). By contrast mid-year wage hikes in July 2024 were not universal and those that did get raises typically saw 15-20% vs

34% in July 2023 rise. Additionally the rampant stimulus has given way to a slowing economy. There is now a lot of constructive debate around wage policy and even Erdogan, who likely blames inflation for the AKP's dismal local election performance in 2024, is saying minimum wages should only rise in line with 2025 targets rather than 2024 inflation. As consumers are hearing that January wage hikes may be stingy, December spending and pricing behaviour is likely to be subdued.

However, as December is one of the lowest inflation months of the year, seasonality argues that to achieve a low 20s full year CPI run rate, December inflation needs to be much closer to 1% than 2%. That is possible, but unlikely. However, January could provide some interesting evidence of a step change in pricing behaviour.

## January Wage Policy and CPI print are crucial:

January is always one of the highest inflation months historically, a trend which has been exacerbated by populism in recent years as start of year wage increases have led to a high degree of automatic CPI pass through that has driven big upticks in January inflation prints. In January 2022, minimum wages, which drive most wages, went up 50% and January CPI was 11.07%. In January 2023 minimum wages went up 55% and January CPI was 6.65%. In January 2024 minimum wages went up 49% and CPI came in at 6.7%. In recent years, every barber and salon operator knew about the January wage windfall of their clients, and they adjusted prices accordingly. This year however, they will know their clients higher wages did not keep pace with inflation and that their clients are struggling. The days of automatic wage pass through to service prices look over.

## Unlike July, minimum wages more likely to drive economy wide wages in January:

While Erdogan took the politically costly decision to not raise the minimum wage in July 2024, the strength of the wage stimulus up to that point meant the economy was so strong that most firms felt a need (or an ability) to raise wages 15-20%. The Cribstone view is the government's unwillingness to tax part of this windfall has driven the subsequent higher than expected inflation prints. However, for the pending January wage increases, the Cribstone view is that the government will raise the minimum wage well below the trailing 45% inflation rate. With a slowing economy and high wage bills hitting exporters in particular, the likelihood is the minimum wage will go up no more than 25-30%, with no more than 25-35% raises economy wide. With wage hikes 10-20 percentage points below 2024 inflation, the automatic inflation pass-through we've seen during years of wage driven inflation will likely give way to more prudence and even shock from consumers. While in the past wage hikes created a temporary sense of windfall that immediately drove prices higher, with 25-35% hikes vs 45% headline inflation, consumers' sustained loss of purchasing power will become obvious to them. Assuming the wage discipline materializes, expect pricing behaviour to change meaningfully from January 2025.

## The government should be ready if corporate wage policy proves too generous

What if too many companies give wage increases that are inconsistent with inflation targets and more consistent with trailing 45% inflation? Ideally the government should pre-empt this risk today, by introducing taxes at the corporate level that dis-incentivize too much real wage inflation. However if they wait and economy wide wage hikes prove inflationary as

they did in July 2024, the government should be ready to capture some of this "windfall" directly through income taxes on those who benefit the most. This targeting of fiscal policy to align with dis-inflation objectives will not just be bond-market friendly, it will also be politically palatable as it will spread the pain of anti-inflation policies beyond minimum wage impacted workers. Rather than wait for the result, the Central Bank should today be interviewing every large company CFO about their wage inflation assumptions for their 2025 budgets. If it looks like wage inertia will remain a problem, the government and Central Bank should be more proactive in talk and action now.

## Rate Cuts inevitable in Q1

With a 50% policy rate and trailing YOY inflation in January likely to be least 800bp (and probably more than 900bp) below this, it seems almost impossible that we will not get a first rate cut by February 2025 at the very latest (base case January). By Q2, headline inflation should fall below 35%. Assuming a first cut of 250bp no later than February, it is highly likely we will then see a minimum of 1000bp of cuts over a four-month period as YOY inflation falls below 35% by Q2. As inflation then should fall into the 20s, expect further but less consistent rate cuts thereafter.

## Real currency appreciation continues through Q1 but could end in Q2

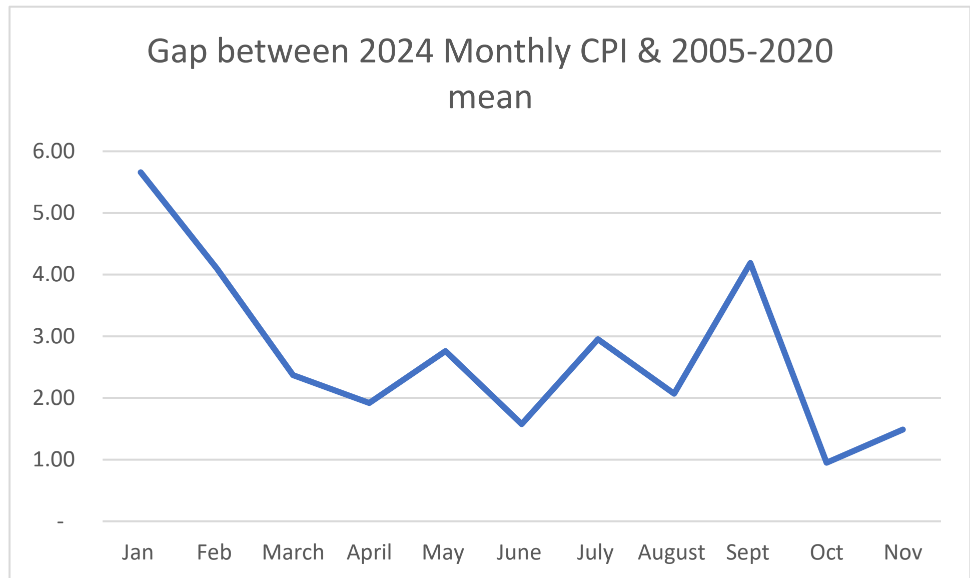
The Central Bank continues to argue that real currency appreciation will help support lower inflation. While this is likely through Q1, if it becomes clear that inflation expectations are anchored by domestic wage and demand trends, the Central Bank may be willing to tolerate some real currency weakness in Q2 of 2025 without risking a change in inflation expectations. However do not expect this to be telegraphed and instead look for rare days with currency weakness that allows for some erosion of currency appreciation without creating market expectations that currency weakness will be sustained. While it may disturb the carry trade, as inflation and rates fall and the current account deficit disappears as a concern, expect more and more willingness to lock into longer duration that will look through bouts of Central Bank supported, rather than market driven, currency weakness.

## Strong fixed income trade, less strong equity backdrop but inflows likely as rates fall

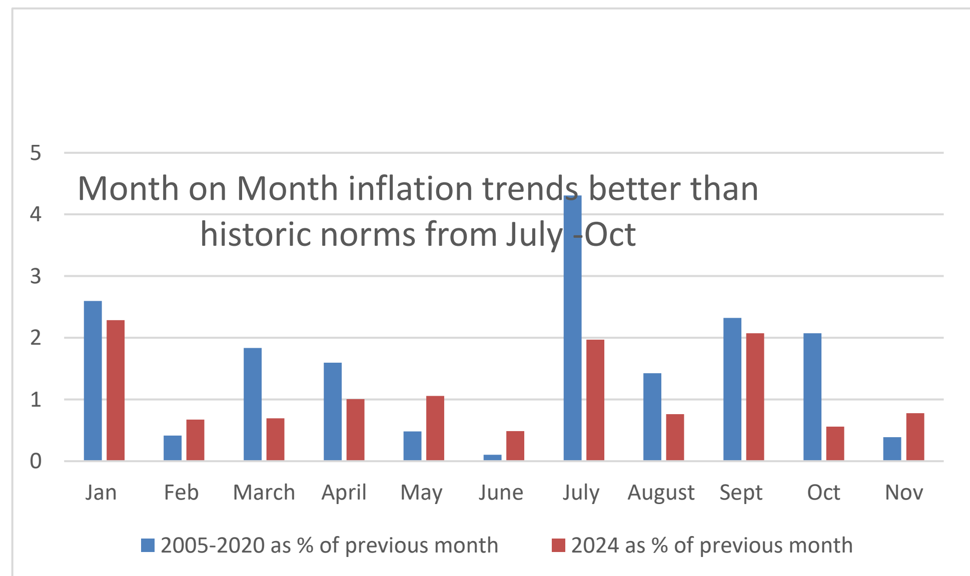
Purchasing power challenges as wage growth falls well short of trailing inflation are likely to be felt economy wide. At the same time exporters, like all economic actors, will likely face a one off 25-30% rise in wage bills in January. Accordingly expect 2025 will start with disappointing employment trends. This supports falling inflation and the rate-cut driven fixed income trade. However it will create a tough macro backdrop where GDP forecasts are likely to fall and unemployment will persistently rise. From an equity investor perspective, Turkey is facing a unique situation where few stocks will be resilient to the downturn. While the country is again "investable" the likelihood is neither traditionally defensive exporters or domestic focused players will be untouched by the macro challenges. As long absent GEM investors reengage as rates fall and currency risk looks minimal, they are likely to concentrate around the few large and liquid names that have either secular growth potential or some combination of pricing power or margin resilience.

## Supporting Inflation Charts & Forecasts

*While not as good as October, November inflation was still lower relative to 2005-2020 means than any other month in 2024.*




*January inflation from 2005-2020 was typically well over 2X December inflation. Unless the December print falls comfortably below 1.5% (which itself would be very positive), it is likely the January premium to the December print will be below historic norms.*

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