

# VAKIFBANK TURKISH ECONOMY WEEKLY

CBRT published Inflation Report-II of  
2011 ...






T. Vakıflar Bankası T.A.O

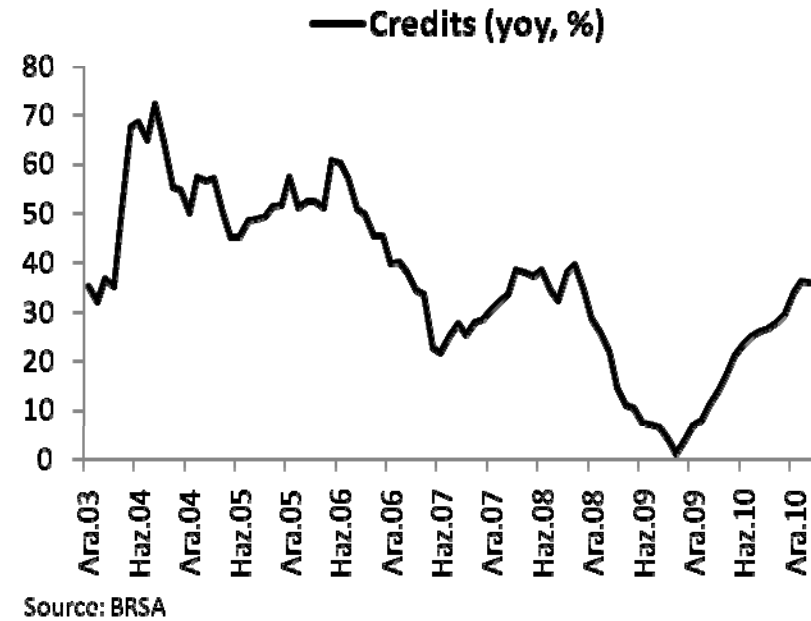
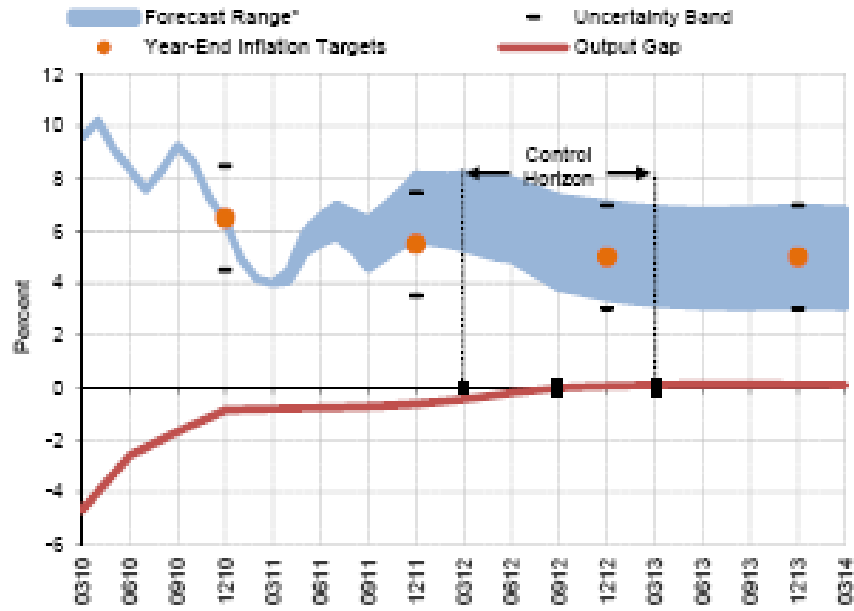


## CBRT Inflation Report-II 2011 was published...

	Inflation Report 2011-I	Inflation Report 2011-II	Revision
<b>Food Prices</b>	2011: 7.5%	2011: 7.5%	
<b>Oil Prices</b>	2011: 95\$ 2012: --\$	2011: 115\$ 2012: \$	Upward
<b>Inflation</b>	2011 range:4.5 %-7.3 % (Mid Point:5.9 %) 2012: 3.3 %-6.9 % (Mid Point:5.1 %)	2011 range: 5.6 %-8.2 % (Mid Point:6.9 %) 2012: 3.4 %-7.0 % (Mid Point:5.2 %)	Upward
<b>CBRT Policy Rate Decision</b>	<i>The expectation of a limited additional monetary tightening for the rest of the year</i>	<i>The expectations of rate hike are increased as CBRT has started to implement more cautious stance and has shifted in policy toward tightening</i>	

-  The limited upward revisions on inflation projections in the Inflation Report-II draw attention.
-  Sharp increases in oil and import prices led to about 0.5 basis points upward revision for end-2011 inflation forecast and a slight upward revision for 2012 inflation forecast.
-  Thus, 2011 year-end inflation expectation increased to 6.9 % from 5.9 %

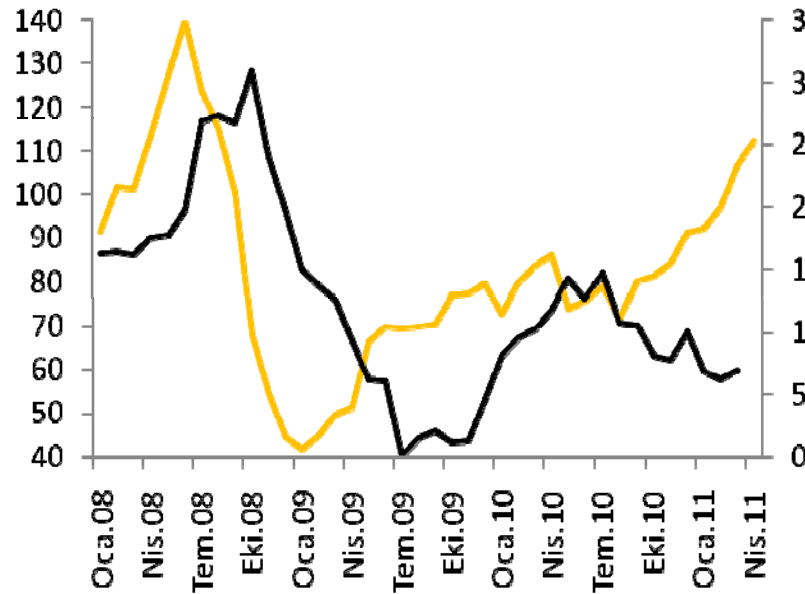
## 1) Domestic demand continues to rise...



- ✔ While domestic demand preserved strong view, foreign demand was relatively weak in the Q1 of 2011.
- ✔ As domestic demand increased more than expectations, CBRT revised its output gap expectations upwardly.
- ✔ Output gap closed up lately compared to previous period due to strong monetary tightening measures which were taken by CBRT in the Q1 2011.
- ✔ Although CBRT has increased required reserve ratios to slow down credit expansion, the acceleration of credit growth is still above the desired levels.
- ✔ However, due to the lagged effects of the ongoing monetary tightening, CBRT expected credit acceleration will slow down in the second quarter.

## 2) CBRT increased its expectations for oil and other import prices for the end of 2011...

— Oil Price — Energy Price (yoy,%) (Right Axis)



Source: CBRT, Bloomberg

Oil and other import prices are above the expectations in January Inflation Report because of supply-side developments.

Hence, CBRT revised oil and other import prices upwardly.

CBRT increased oil price expectations from \$95 to 115\$ and the yearly percentage changes of other import prices expectations from 10.9 % to 16.2 % for 2011.





These changes led to about 0.5 basis points upward revision for end-2011 inflation forecast and a slight upward revision for 2012 inflation forecast.

Before the global financial crisis, oil and other commodity prices increased sharply. While oil prices was \$30 in 2004, it increased from \$150 in June 2008.

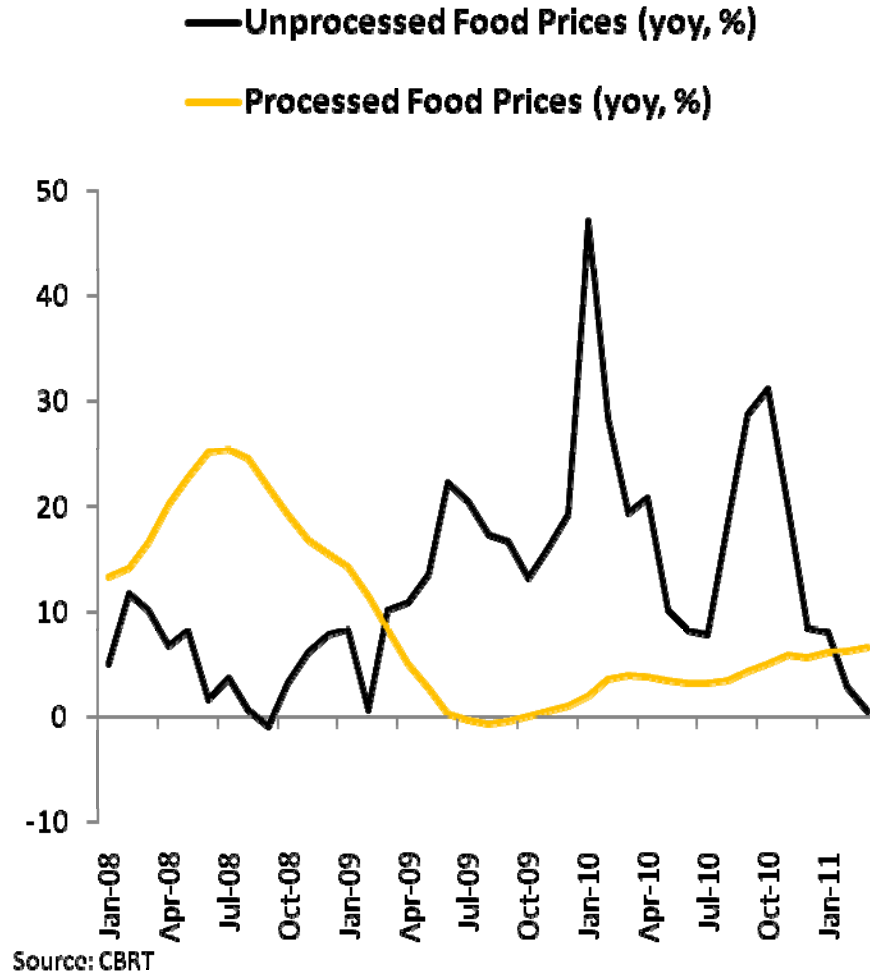
Although commodity prices increased sharply, inflation rate in Turkey decreased in the same period. The main reason of this situation is TL appreciation against dollar due to relatively high real interest rates in Turkey.

Hence, we expect that increasing oil prices and progress of USD/TRY will affect inflation rate in the forthcoming period.

### ***3) Custom duty in textile and confection increases...***

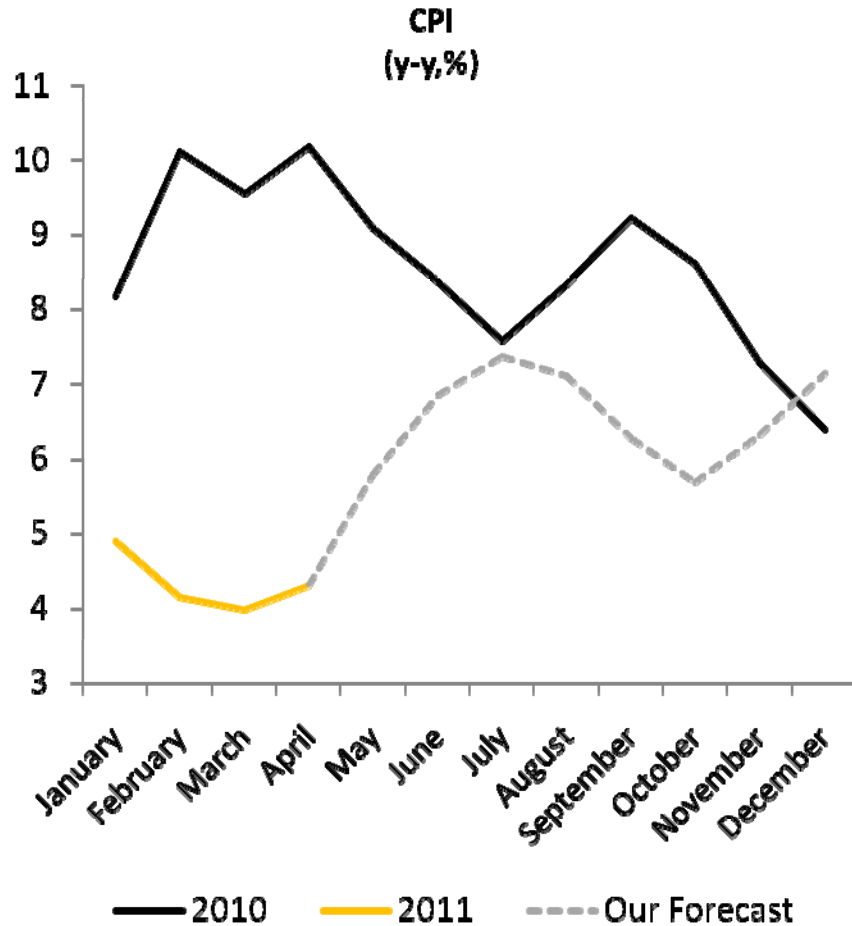
-  Increases in the custom duty of the textile and confection was one of the important factors for the upward revision of the inflation forecast.
-  According to a study on the effect of custom duty of textile on inflation, additional custom tax regulations would contribute 0.5 basis point to the inflation forecast at the end of the 2011.
-  However the report has drawn attention that there are several uncertainties about the calculations of this contribution.
-  Under the consideration of the last Inflation Report, domestic producers' company prefer, conditions of competitions and pricing treatments of domestic producers can be decisive on the ultimate effect of consumer prices.

#### 4) The food inflation expectation for the end-2011 remains unchanged at 7.5%...



- Annual growth of the food prices decreased to 3.47% and food prices have moved under the expectations of CBRT.
- Downward movement of the food price was driven by the correction of the unprocessed food prices. Especially decrease in fruit and vegetable prices led to a decrease in unprocessed food prices. In addition, decrease in meat prices has continued due to measures taken by the government for the meat import
- The extreme volatility in unprocessed food prices and the rapid increases in agricultural commodity prices necessitate a cautious approach in terms of food inflation projections. Accordingly, the food inflation expectation for end-2011 remains unchanged at 7.5%.

The base effect and high commodity prices are likely to drive inflation higher in the near term...



Source: VakıfBank, CBRT

- ✓ In April, we expect that CPI will increase by 1.20% (market expectation: 0.75%) on a monthly basis.
- ✓ The continuation increase in the oil prices may lead to an increase in transportation prices in April.
- ✓ Due to the starting of the new season in clothing sector, clothing prices are expected to increase sharply on a monthly basis in April.
- ✓ On the other hand, the movement of the food prices which is the main determinant of the CPI in 2010, will be important in April. The increases in prices of fruits and vegetables may drive food prices upwards.
- ✓ Hence, we expect that the annual CPI will increase by 4.61% in April.
- ✓ The increases in CPI may continue in the forthcoming months. Although CPI is expected to decline in the third quarter of 2011, an upward movement can be seen again in the last quarter of 2011.

## As a result,

- ✔ CBRT pointed out that due to lagged impact of rising oil prices, inflation is expected to display an increasing trend in the near term.
- ✔ Although CBRT determined that it will not react to the first round effects of the increases in oil and other commodity prices, second round effects will be closely monitored and a deterioration in the pricing behavior will not be tolerated by CBRT.
- ✔ In the light of these developments, with the acceleration of inflationary pressures, CBRT is expected to hike policy rate in the second half of the year. We expect that CBRT may begin to hike the policy rate in July of 2011 and increase policy rate by 100 bp in total.
- ✔ As a result, in the Inflation Report-II, CBRT's revision of the inflation expectations has not been a surprise. Following the increases in commodity prices, particularly oil prices, CBRT is expected to revise its expectations. Moreover, CBRT has started to talk about upside risks on inflation since February.
- ✔ However the market is anxious about the amount of increases in inflation forecast. Under the considerations of the upward revision of inflation, it is said that CBRT takes a cautious stance on inflation.
- ✔ After the release of the last Inflation Report, we do not change our end 2011 inflation expectation of 7.15%. Our expectation is above 6.9% which is the mid point of the end 2011 expectation of CBRT.

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