VAKIFBANK TURKISH ECONOMY WEEKLY

Ease off in Inflation supports monetary policy

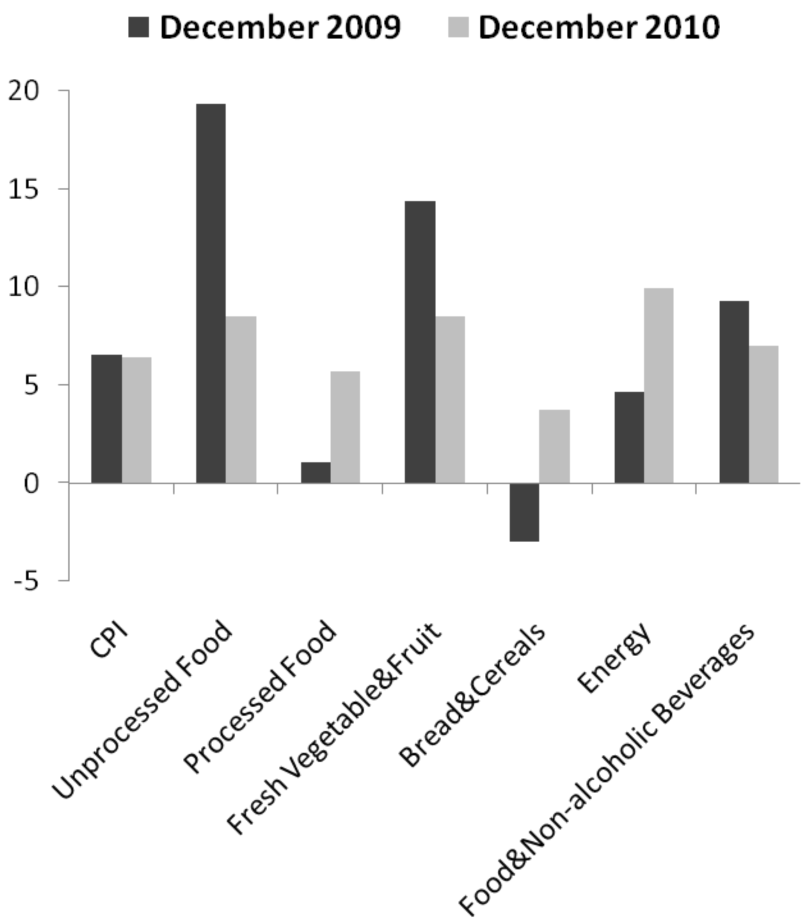
T. Vakıflar Bankası T.A.O

10 January 2011

No: 10

Vakıfbank Economic Research

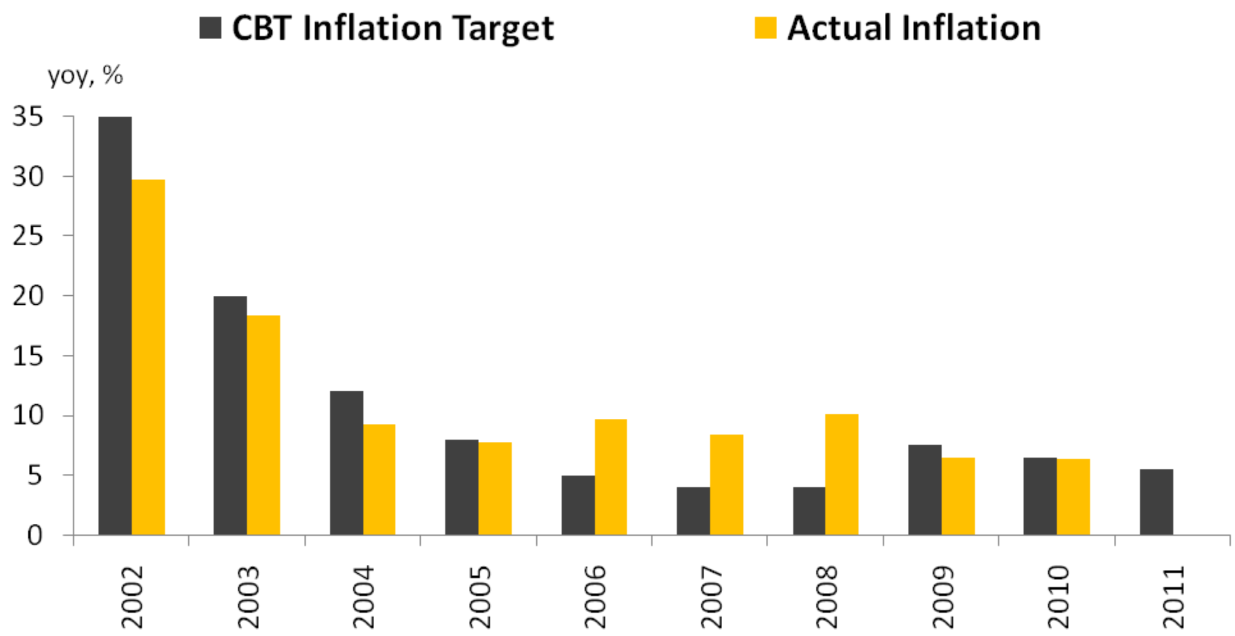
CPI have seen its lowest level with 6.4% since 1968...



Source:CBRT

- *Headline CPI decreased 0.31% mom in December mainly due to the sharp downward adjustment in food prices and favourable base effects. And, yearly CPI fell to 6.4% from 7.3%.*
- *2.66% fall in food and beverages group has the major negative contribution to CPI with 0.73 points.*
- *Startup of the seasonal discounts caused a 1.77% fall in clothing and shoes group, pulling headline CPI 0.13 points down.*
- *The highest monthly increase (2.65%) came in communication prices.*
- *Transportation prices increased 1.07% with the effect of energy price increases, but the price cuts in automotive sector limited the increase in this group.*
- *House prices increased 1.17% mom above its general trend because of the recent increases in housing credits*

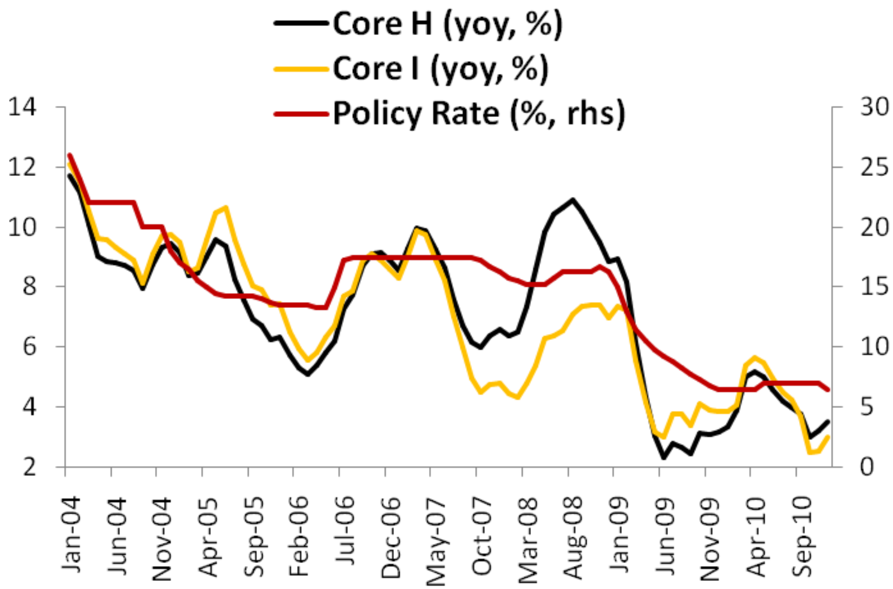
CBT reached its 2010 year-end inflation target...



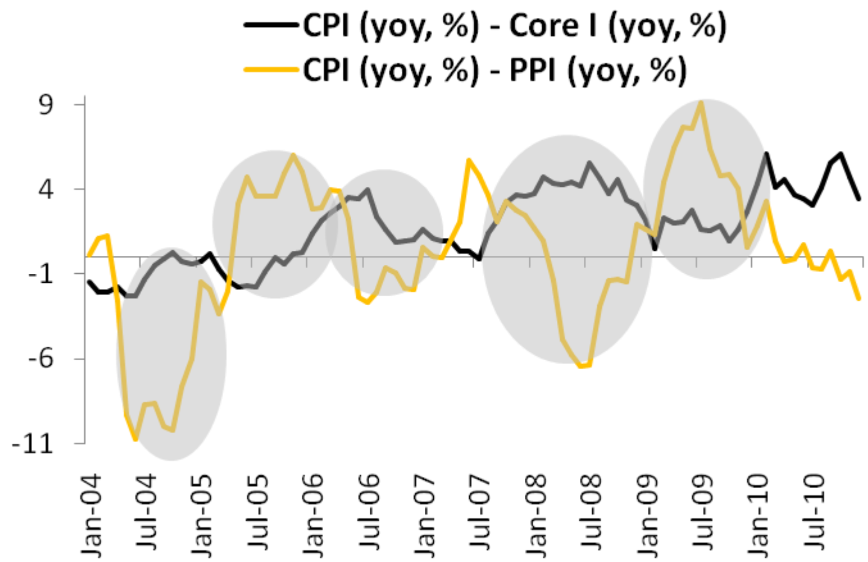
Source: CBT

- *With the headline CPI increasing 6.4% yoy in December, CBT hit its 2010 year-end target of 6.5%.*
- *Main reason of the favourable year-end inflation data is the fact that Turkish economy has not reached the pre-crisis growth performance yet.*
- *Low inflation is comforting for CBT in its financial stability efforts.*
- *CBT’s credibility should accrue with December inflation data.*

Core inflation leads headline inflation…



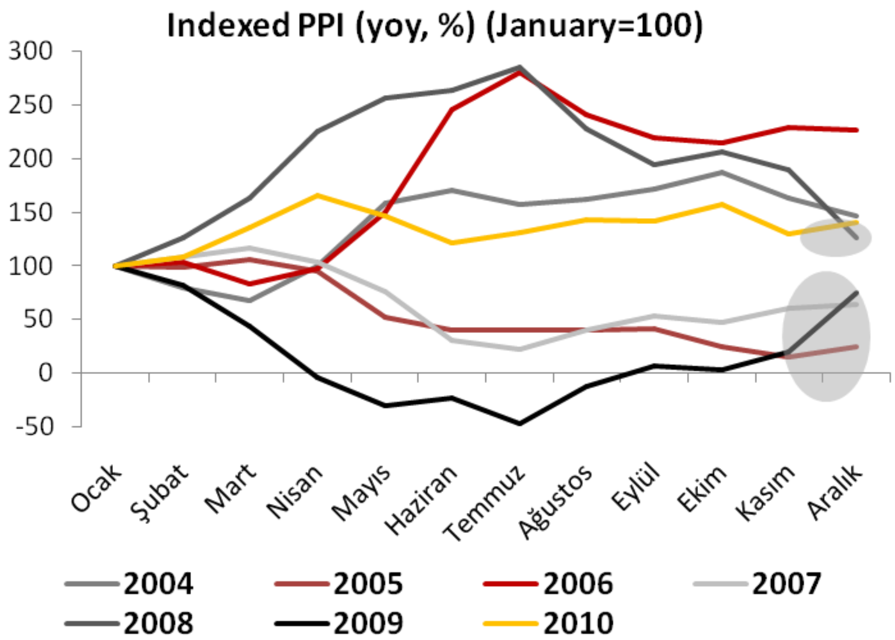
Source: Turkstat



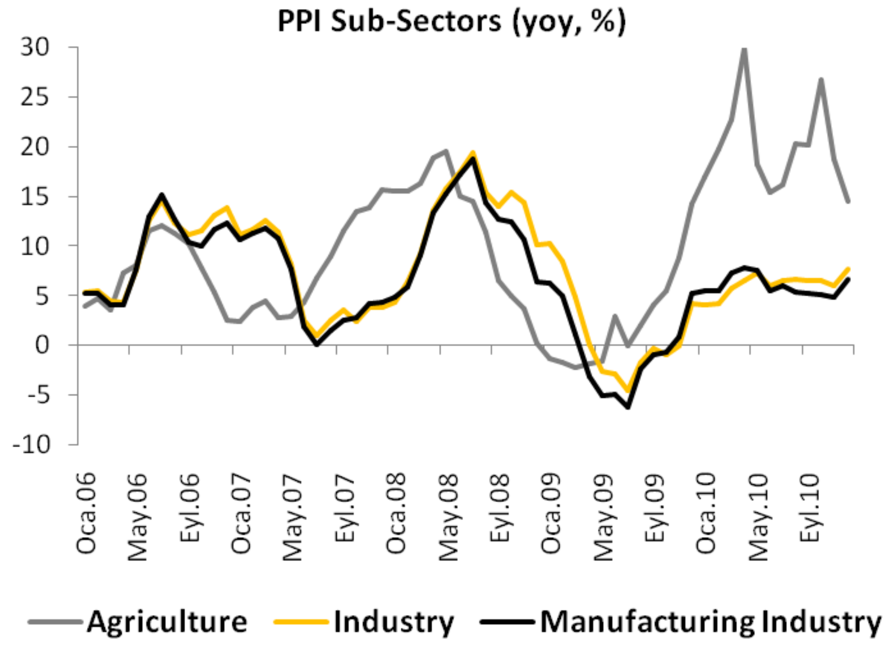
Source: Turkstat, Vakıfbank

- *Because core inflation leads headline inflation, upward movement in core inflation may be expected to create an upward pressure on headline inflation.*
- *Despite the volatility in headline inflation in 2010, CBT didn't change the policy rate concentrating on the core inflation rather than the headline.*
- *Spread between headline and core inflation narrowed in Q4 2010. Also we see that CPI – Core I Index spread and CPI – PPI spread intersect in April or May in the previous years except crisis years. This analysis indicates that CPI may decrease in Q1 2011.*

December PPI increased by 1.31% with the effect of rising oil prices…



Source: Turkstat, Vakıfbank



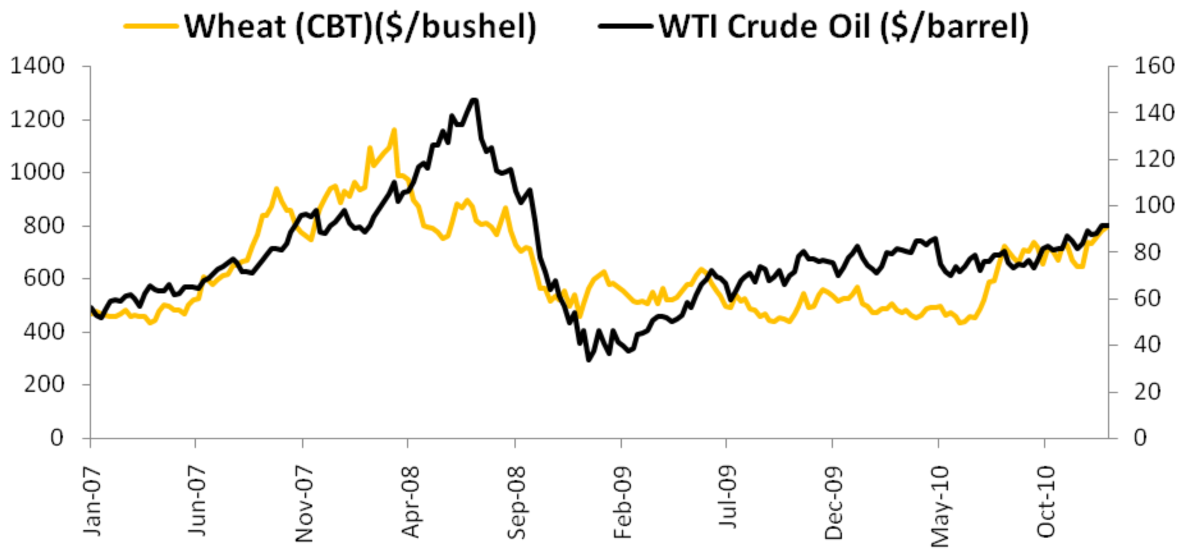
Source: Turkstat

- *In contrast to the decline in consumer prices on a monthly basis, Producer Price Index (PPI) increased by 1.31% by the impact of rising oil prices.*
- *Manufacturing industry in PPI sub-sectors increased by 6.6% yoy. Basic metal industry had the highest rate of price increase (25.68%, yoy) among manufacturing industry with.*
- *Agricultural sector has experienced a relatively limited increase (14.52%) yoy, but on a monthly basis it decreased by 1.76%. This shows that agriculture prices limited the increase in PPI in December 2010.*

Short term inflation outlook seems positive...

- *December inflation figures support our view that CPI will continue its downfall in Q1 2011.*
- *CPI might perform its strongest yearly decline in January mainly due to the seasonal discounts in clothing.*
- *Positive impact of continuing meat exports and seasonal increase in livestock population are expected to limit food price increases.*
- *The contribution of transportation prices to core inflation is expected to continue as a result of new year price increases in automotive sector, price adjustments in public transportation and fuel price increases.*
- *Downward trend in inflation might continue in the first half of 2011 owing largely to base effects provided that global inflationary pressures are subdued.*
- *Despite the upward risks on the downward trend of inflation, the Q1 2011 inflation outlook is rather precise.*
- *However, the price pressures seen in PPI, brings out the likelihood of the decline in CPI to be short lived.*

Unexpected commodity price increases might increase inflationary pressures...



Source: Bloomberg

- *Commodity prices may rise because of the demand increase induced by the potentially strong performance of EMs in 2011.*
- *An unexpectedly positive outlook in the US and other developed countries is another risk on commodity prices induced inflation.*
- *Energy and wheat prices are not expected to test the record high levels in 2008 for now. But the increase seen since Q3 2010 is widely expected to continue.*
- *The probable upward trend of commodity prices might create cost inflation which subsequently increase headline inflation.*

CBT may deliver a 50 bps rate cut in January...

- *The deceleration of inflation in December should provide an important opportunity for CBT to take a quick and effective step under its new and unconventional policy frame.*
- *CBT may find it necessary to enhance the effects of its recent monetary policy decisions, since a one time rate cut may be inadequate to reach its goals.*
- *The recent depreciation of TL might be considered as a plus for decreasing C/A deficit. But if the confidence in CBT's new policy stance increases too much, short term capital flows may continue in a record low global interest rates environment.*
- *This probability might limit the upward movement in USD/TL and cause C/A deficit to further increase. As a result of this, it might be too difficult to avoid overheating.*
- *Current outlook of food supply and an unexpected decline in food stocks may cause inflationary pressures.*
- *Such a jump in food prices besides a cost inflation increase may force CBT to start rate hikes in July 2011.*

Serkan Özcan
Chief Economist
+ 90 312 455 7087
Serkan.ozcan@vakifbank.com.tr

Cem Eroğlu
Senior Economist
+ 90 312 455 8480
Cem.eroglu@vakifbank.com.tr

Nazan Kılıç
Economist
+ 90 312 455 8489
Nazan.kilic@vakifbank.com.tr

Naime Doğan
Reseacher
+ 90 312 455 8486
Naime.dogan@vakifbank.com.tr

Senem Güder
Reseacher
+ 90 312 455 8476
Senem.guder@vakifbank.com.tr

T. Vakiflar Bankasi T.A.O
Ataturk Bulvari No: 207
Kavaklidere 06683 Ankara, Turkey
www.vakifbank.com.tr

Vakifbank Economic Research
ekonomik.arastirmalar@vakifbank.com.tr