

VAKIFBANK WEEKLY ECONOMIC REPORT

Global Inflation: 2011 Outlook and Implications for 2012

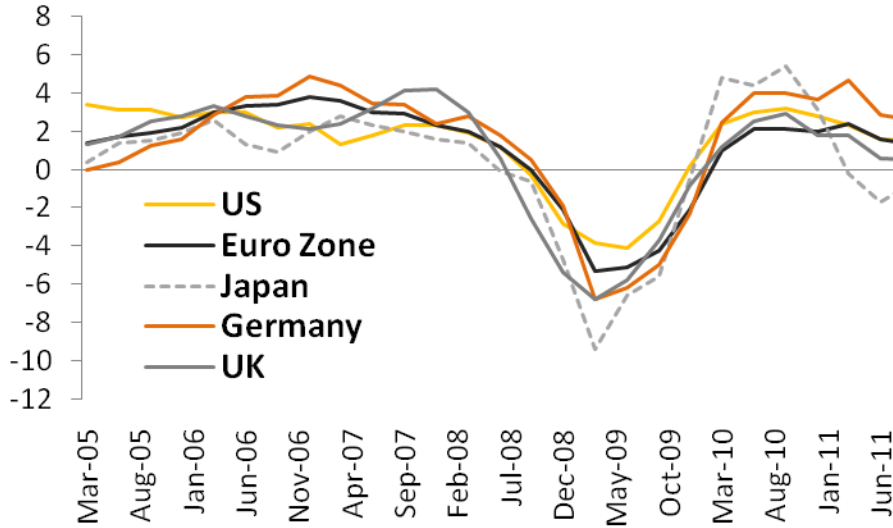


T. Vakıflar Bankası T.A.O



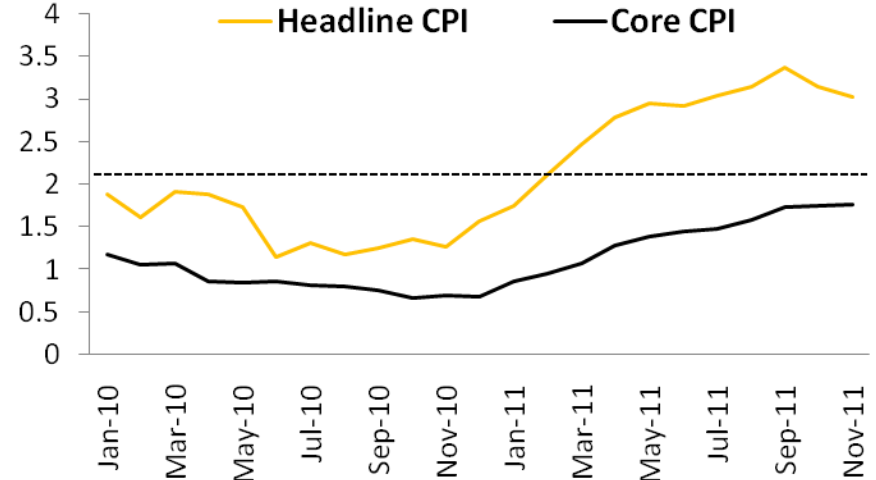
Lower inflation was the outcome of lower growth performances in developed countries in 2011...

Developed Country Growth Rates (yoy, %)



Source: Bloomberg

Developed Countries' Inflation (yy, %)



Source: Bloomberg, IMF, VakifBank

*Weighted average of USA, Eurozone, UK, Japan CPI indices is used.

- Due to high fiscal deficits and public debt vulnerabilities domestic demand couldn't preserve its resurgence in developed countries in 2011. This prevented a contraction in unemployment and kept inflationary pressures lower.
- The yearly inflation rates derived from the CPI index which was composed of the weighted average of CPI indices of USA, Eurozone, UK and Japan, indicate that the expected rise in inflation due to basis effect, didn't occur in 2011.
- Core inflation in developed countries also didn't signal a strong domestic demand.

Eurozone risks and US outlook is important for global inflation...

Forecasts*	2010		2011		2012	
	USA	Euro zone	USA	Euro zone	USA	Euro zone
Real GDP (yoy, %)	2.9	1.9	1.8	1.6	2.1	-0.2
CPI (yoy, %)	1.63	1.58	3.2	2.7	2.1	1.9
Unemployment (%)	9.6	10.12	9	10.1	8.7	10.5
Source: Bloomberg *FED forecasts for US, ECB forecasts for EZ.						

📌 Eurozone risks are highly important for 2012 inflation in developed countries.

📌 Eurozone GDP is expected to decrease slightly due to contractionary fiscal measures in 2012. Accordingly, the slowdown in domestic demand is expected to prevent inflationary pressures.

📌 A potential contagion of the current Eurozone uncertainties in global financial markets might cause a slowdown in world economy through a global financial meltdown. This probability implies lower inflation for 2012.

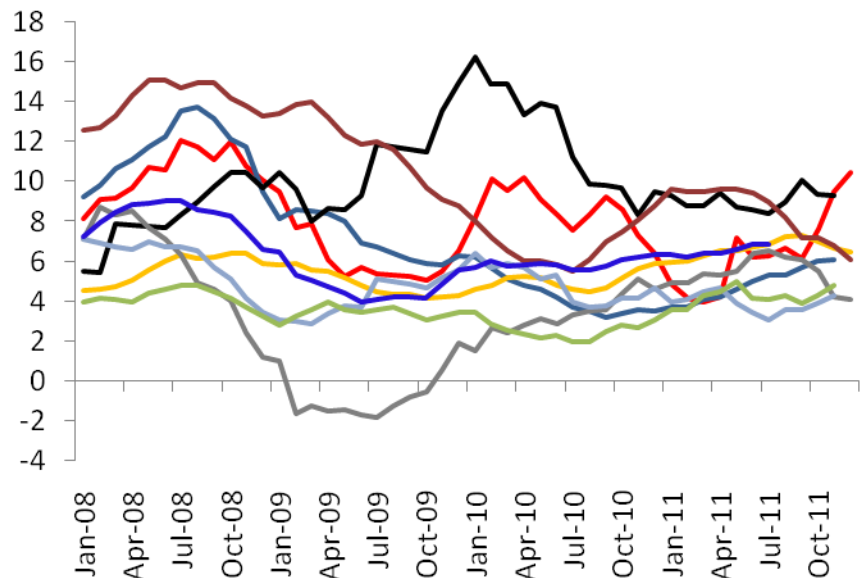
📌 If the optimism in recent US economic data continues in the coming months, global risk perception might ameliorate having a positive impact on global economy and increase inflationary pressures.

📌 Demand side inflationary pressures are expected to be lower in 2012.

📌 On the other hand the way for supply side inflation seem to be open, due to upward pressures in oil and food prices.

In 2011 inflation moved upwards in emerging markets...

Emerging Markets Inflation Rates (yoy, %)

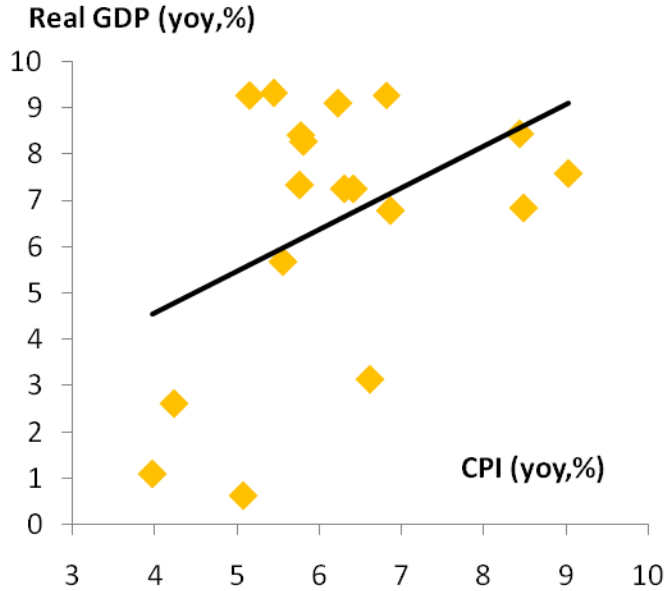


- Turkey
- India
- Hungary
- South Africa
- Russia
- Poland
- Brazil
- China
- Emerging Markets

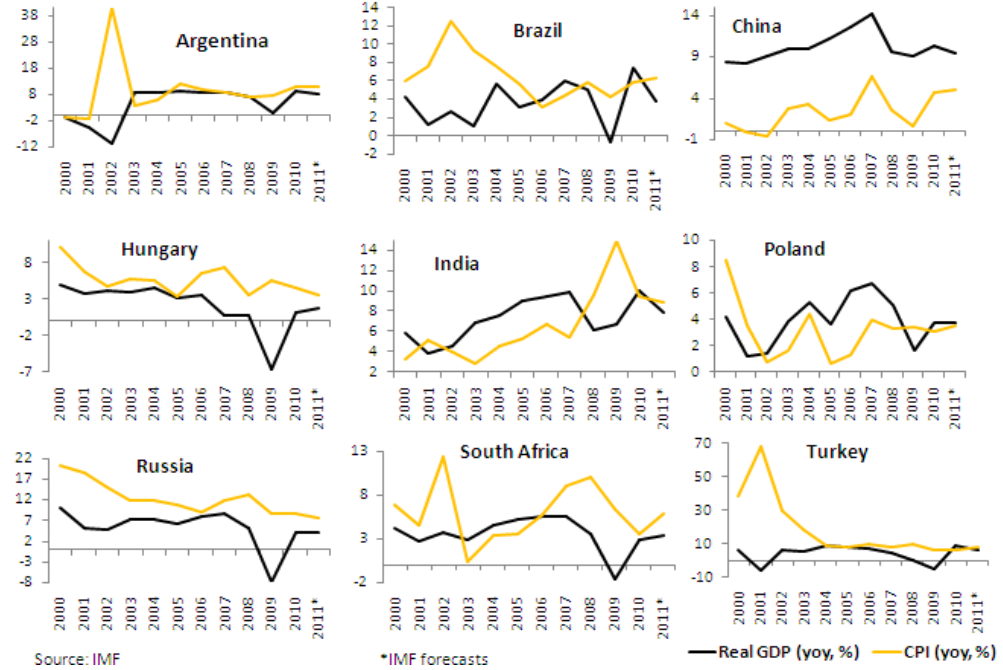
Source: Bloomberg, IMF




- Although CPI in emerging markets (EM) has increased since June 2009, it is still under the pre-crisis levels.
- Inflation had a volatile movement throughout 2011 in EMs.
- While in the first half of 2011 inflation moved upwards in China, Brazil, Russia and Poland, it moved downwards in Turkey and India. However, in the second half this situation changed. Moreover, in South Africa, inflation moved upwardly throughout the year.
- In 2011, exchange rate developments and positive domestic demand besides the economic recovery in emerging markets were behind the upward movements in inflation.

There is a positive relationship between inflation and growth...

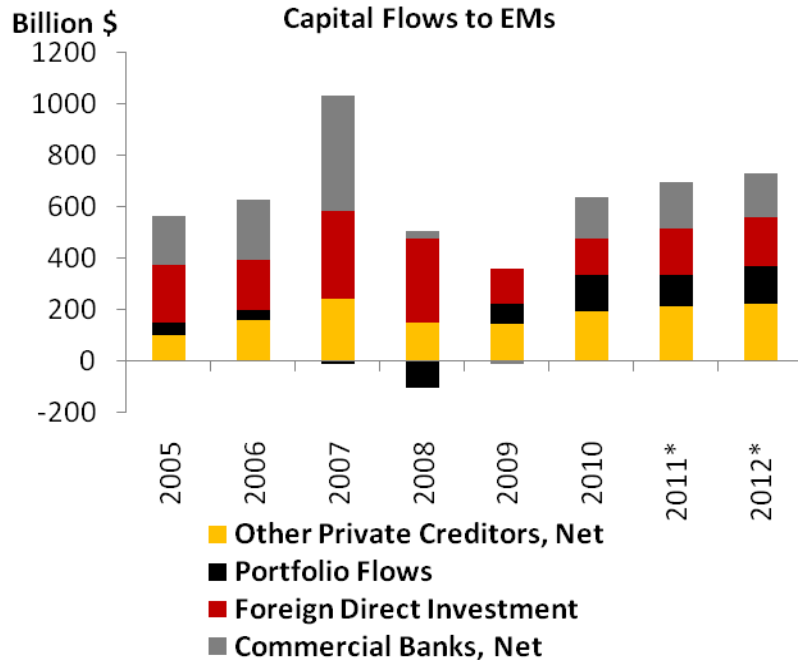


Source: IMF

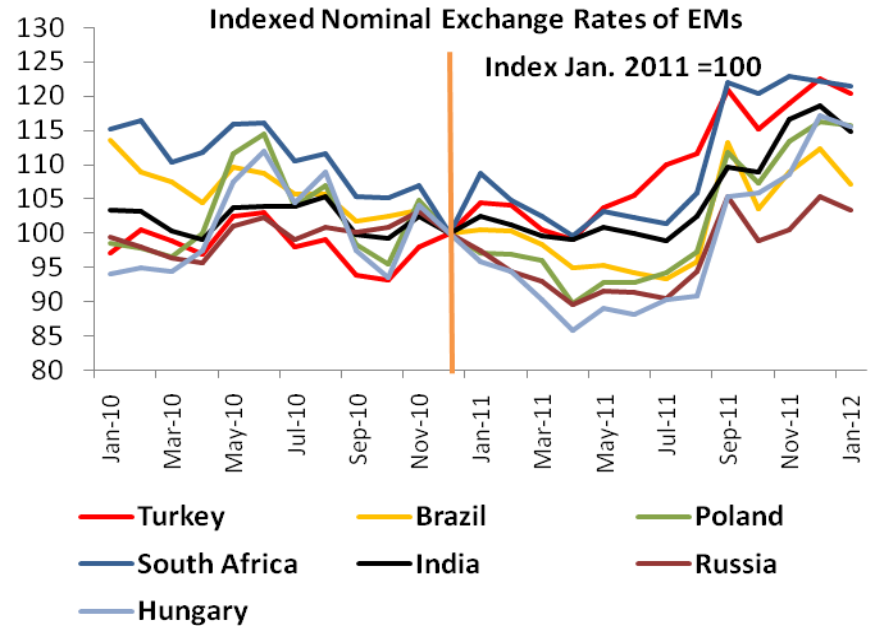


-  In the periods when the relatively high growth rates showing the strong demand were experienced, inflation rates were high generally. However, in the crisis periods with the slowing growth rates depending on the decreasing demand, inflation rates decreased.
-  Under the assumption of that growth rates in 2012 will be lower than 2011 with the effect of the risks originated from developed countries, decrease in demand driven inflationary pressures is seen to be possible.
-  However, there are some periods when inflation did not decrease as expected despite the slowing growth rates. Hence, it is required to investigate other factors affecting inflation.

The upward movements of exchange rates pose a risk for inflation in 2012...



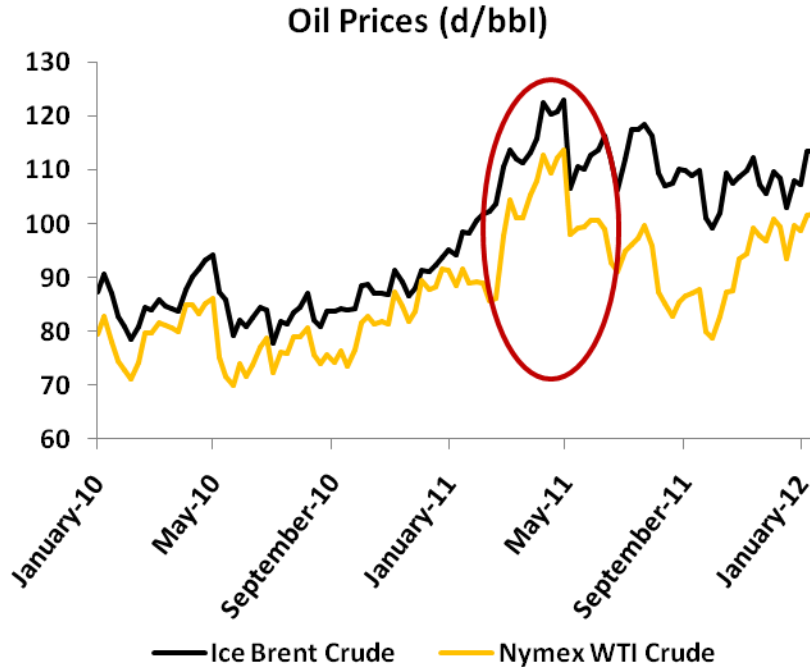
Source: IIF



Source: Reuters

- Especially in the second half of 2011, exchange rates of EMs have moved upward. During this period, the acceleration of capital outflows in the EMs has led to pressures on exchange rates. Hence, EM currencies has depreciated against the US dollar by an average of 20.6% since July.
- The upward movements of exchange rate pose a risk for EM inflation. For EMs including Turkey, exchange rate pass-through has been one of the important factors of overshooting of the year-end inflation target.
- According to the IIF estimates, capital inflows to EMs are likely to increase slightly in 2012. However, in the first half of 2012 we may still see the second round effects of exchange rate movements on inflation. It is possible that pressures of exchange rates on inflation slow down in the second half of 2012.

In 2011 oil prices moved in a wide band...

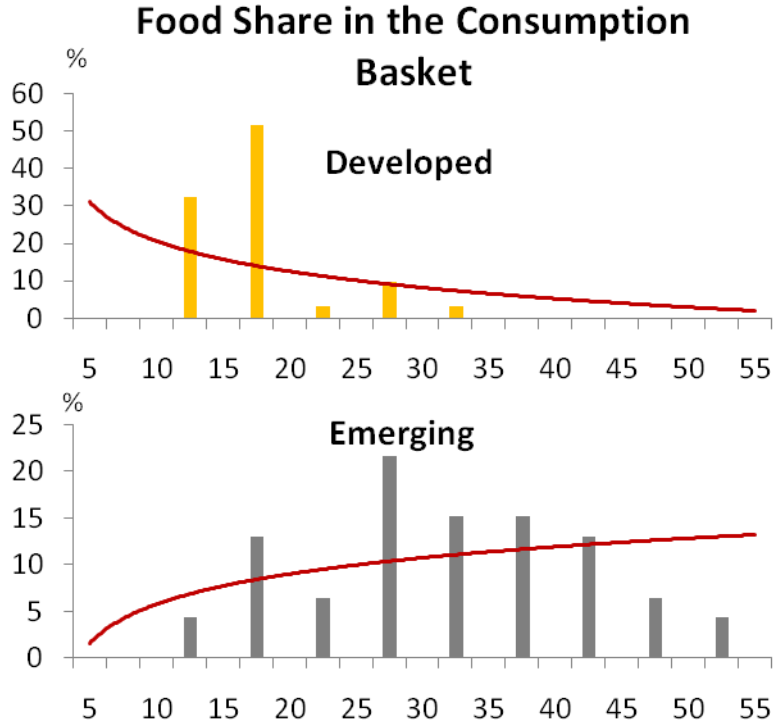


Source :Bloomberg

- Considering the trend of oil prices in 2011, Arab Spring events were determinant on price increases especially in April and May 2011.
- The effects of oil price hikes has played an important role on the rise of Turkey's CPI in these months.
- When we look at the recent period of world agenda, possible tensions between Iran and U.S. and the role of Organization of Petroleum Exporting Countries (OPEC) draws attention.
- Thus, possible fluctuations in oil prices and the effects of these fluctuations on inflation will hold an important place in our agenda in this year.

- In recent weeks, nuclear arming of the Iran, U.S. imposed sanctions against Iran and the probability of closing up of Hormuz strait increased the volatility in oil prices. Also OPEC's announcement of daily 30 million barrel oil production limit might cause an upward movement in oil prices.
- At the same time due to the increasing public spending in some Arab countries such as Saudi Arabia who was forced to increase social spending to prevent social unrest, oil prices are not expected to have a downward trend in 2012.
- In terms of growth, The expected rise in oil demand of China in the coming periods might induce an upward trend in oil too.
- As a result of the increase in oil prices and supply shocks, price hikes in sectors such as transportation and plastic that use oil as a main input might be inevitable. Consequently rising prices can create a high pressure on inflation in oil importing countries and this may lead to an increase in global inflation.

Food prices has more influence on EM countries than DM countries...

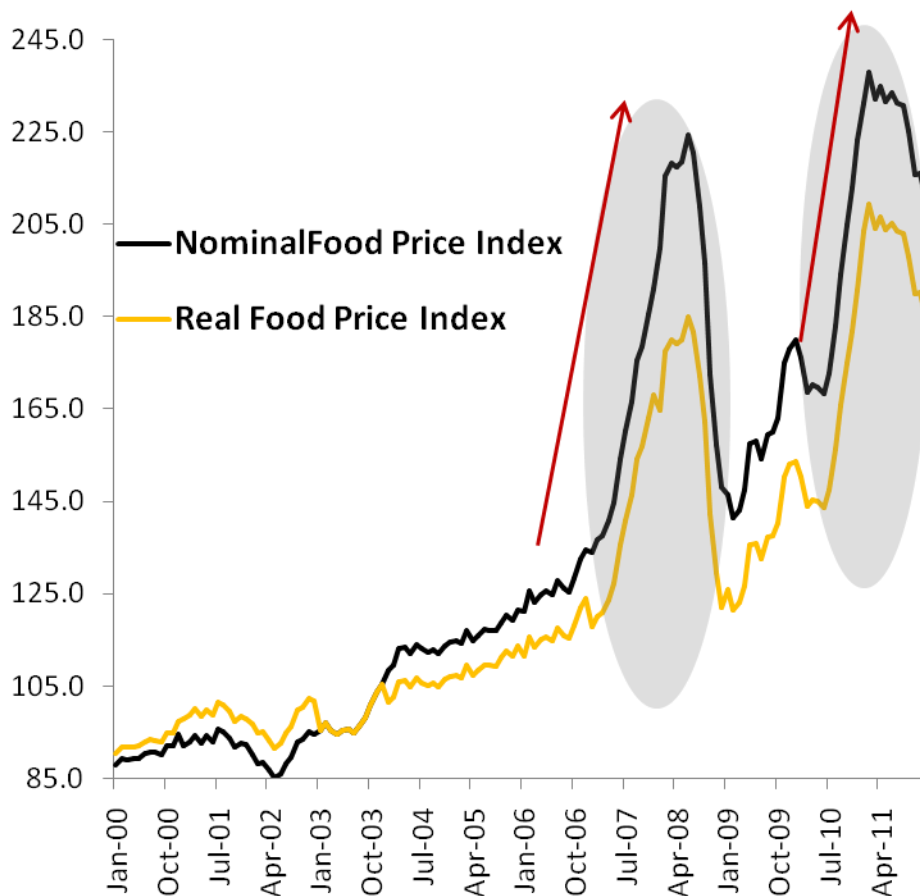


Source: IMF

- Emerging economies tend to have a much higher share of food in their consumption baskets. The median CPI weight in 60% of developed economies (DM) is 17%, whereas this weight for 20% of emerging economies is 31% and also in some of emerging countries it reaches to 55%.
- This shows that food price increases have more influence on EM economies than DM economies. For example, the high food prices in 2008 crisis period have contributed EM inflation by 2 points compared to 0.5 points contribution to DM inflation.

- International institutions' food aids to the countries fighting poverty and difficult ecological conditions such as South Africa, create a positive effect to the poor countries in the short term. But they affect domestic dynamics of remitter countries in the long term and lead to inflationary pressures.
- However, the long term revenue assurance is not provided because of the frequent economic crisis in today's world and this situation limits the 'FAO food security arguments'.

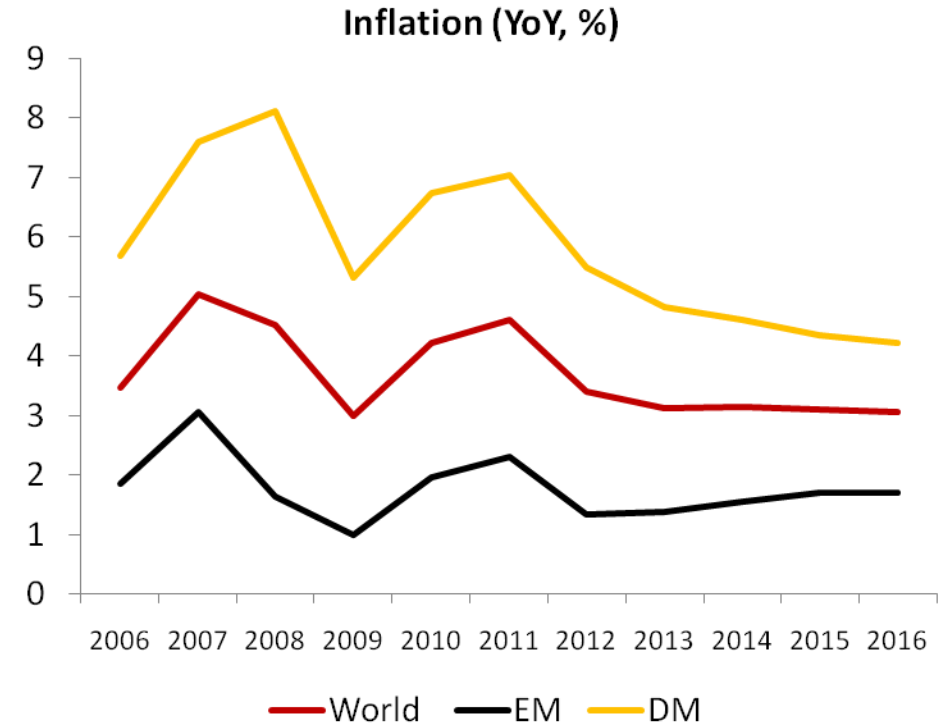
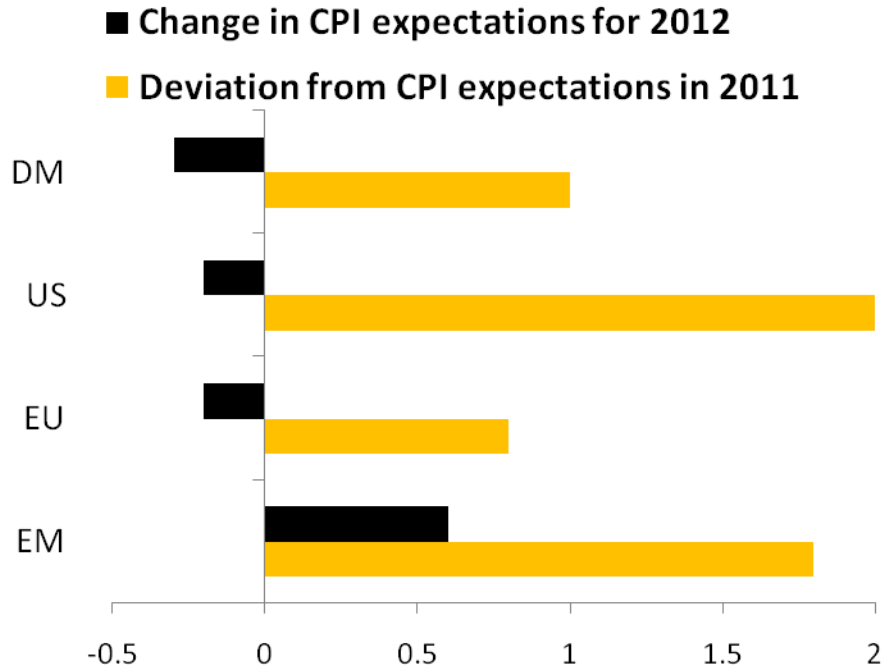
FAO Food Price Indices



Source: FAO

- High food prices in 2008 crisis period began cooling down with the slowing effects of crisis, however, they started to increase again since June 2010 and reached to highest levels in history in February 2011.
- After its highest level, food price index has started fluctuating because of the political concerns in Middle East and South Africa but with the decreasing effects of these concerns price index has started to move downwardly.
- The food price index has completed 2011 with a sharp fall which aroused from the decrease in sugar, cereals and oil prices.

Global inflation will probably stay low...



- Global annual inflation accelerated during 2011. At the end of the 2010 IMF had expected CPI to be 1.3% for DM, 3% for US and 1.5% for EU. In 2011, inflation was over 2 points in the US and 0.8 points in the EU.
- Headline inflation is expected to moderate in 2012 because of lower growth performances and weaker commodity price pass-through.
- The European debt crisis will play a crucial role on inflation in 2012. But, new quantitative easing measures against the current problems may lead to increase in expectations of inflation.

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