

VAKIFBANK GLOBAL ECONOMY WEEKLY

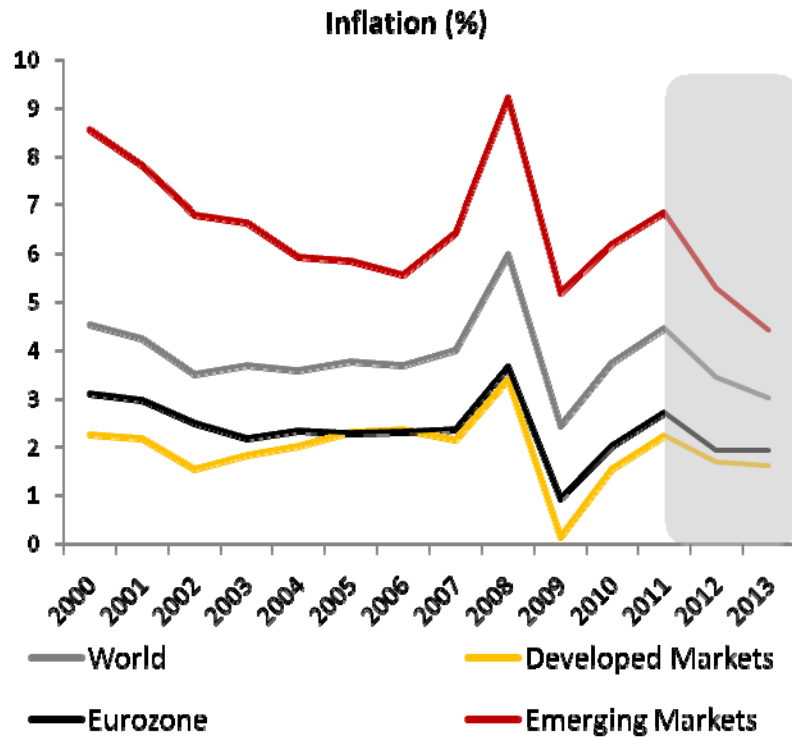
**In many emerging economies,
inflationary pressure is rising...**



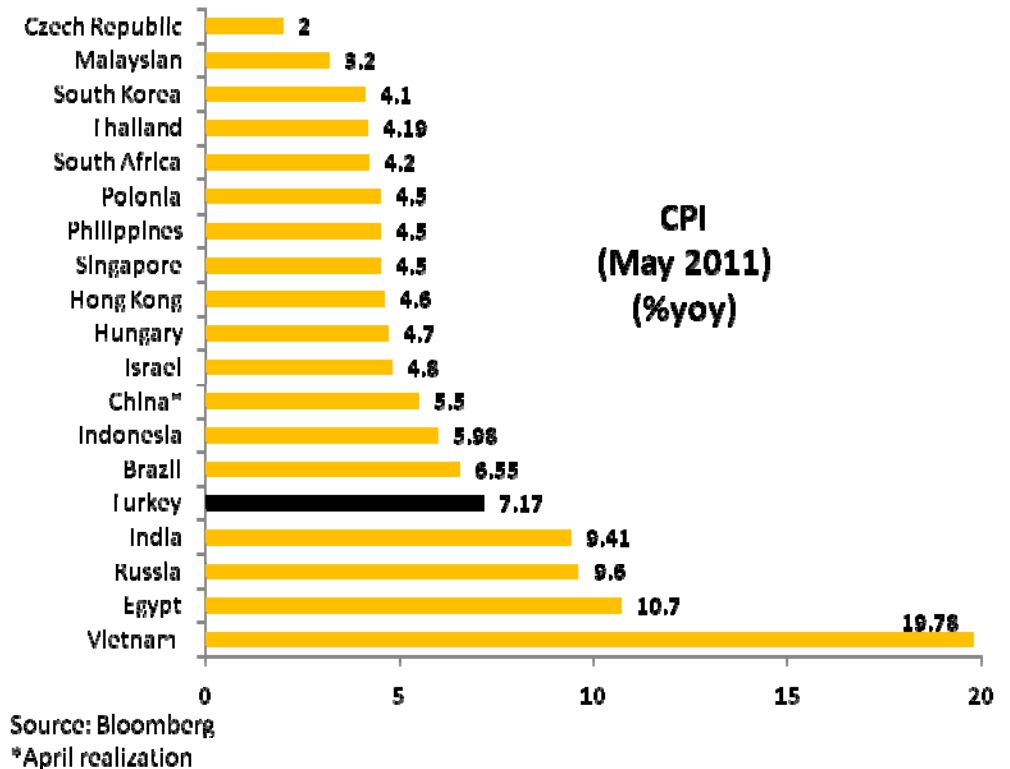
T. Vakıflar Bankası T.A.O



The inflation risk in Emerging Markets (EM) is rising...




Source: IMF



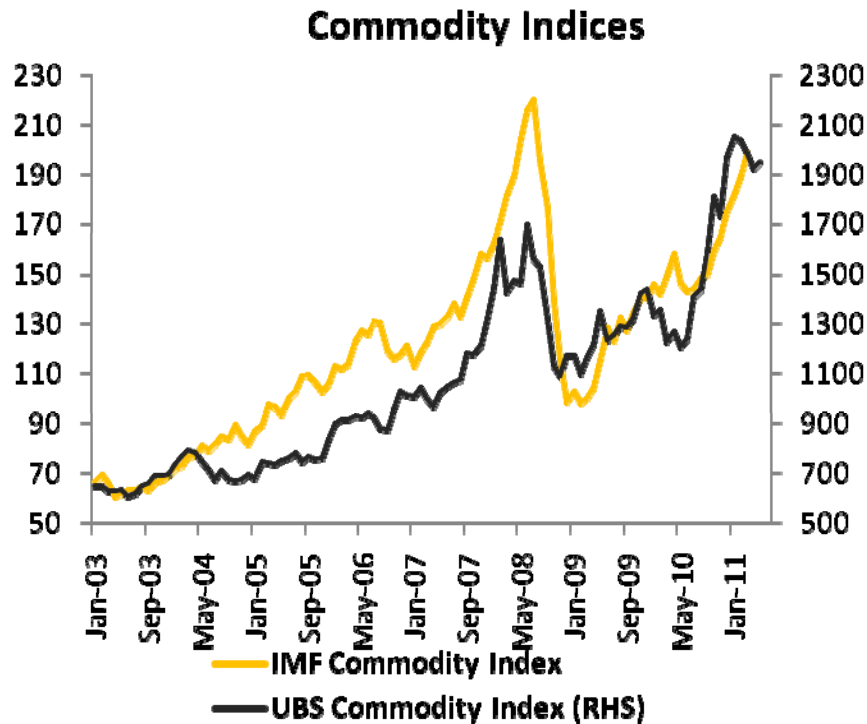
- EM countries which have more dynamic growth performance than Developed Markets (DM) after the crisis, have recently witnessed high inflation rates. As shown in above graph, inflation risks on EM are stronger than DM.
- When we look at each EM inflation rate individually, in May 2011, Vietnam has the highest inflation rate among the countries in the graph. China's inflation rate has increased by 5.5% yoy in April 2011 which is the biggest level in the last 33 months. China's recent high inflation rate is mainly driven by high food prices.

The reasons behind the rise in inflationary pressure in EM;

 *The upward trend in commodity prices...*

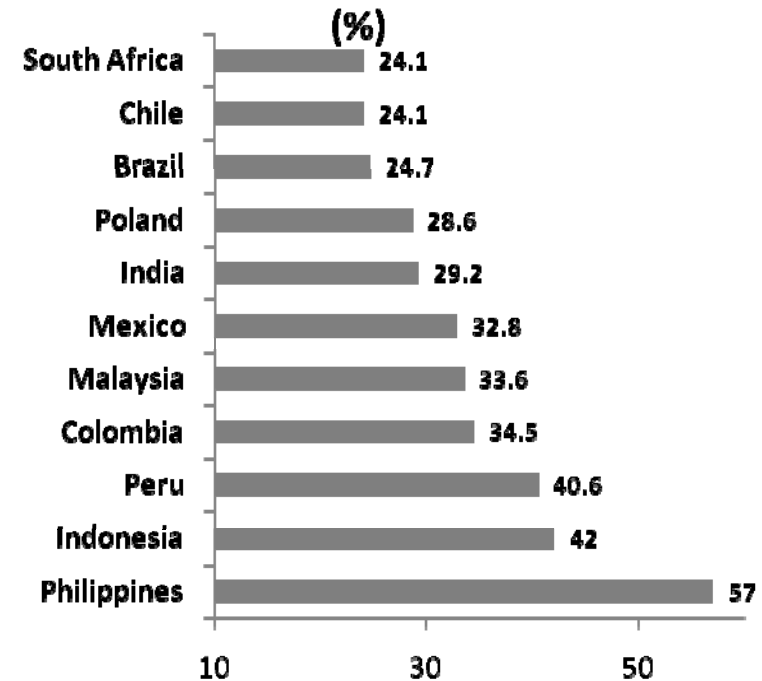
 *The strong recovery in domestic demand in EM...*

Commodity prices are the main driver of the rise in inflation...



Source: IMF, Bloomberg

Share of Food and Fuel in CPI Basket

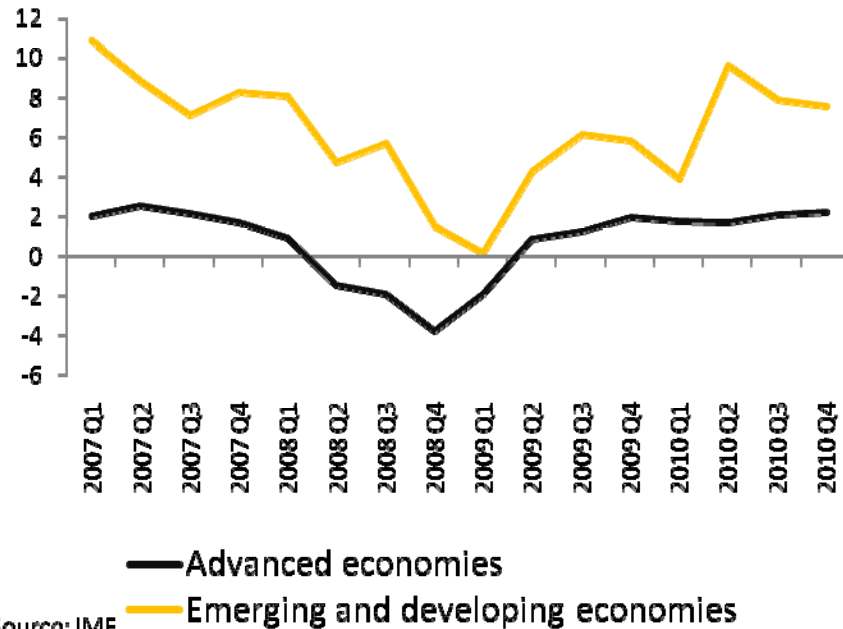


Source: IMF

- ✔ With the recovery after the crisis, commodity prices have started to increase, especially increase in commodity prices has accelerated since May 2010. Therefore the effects of high commodity prices on inflation became important.
- ✔ The share of food and fuel in CPI basket is high with an average of 33.7% among the countries in the graph above.
- ✔ The high share of food and fuel in CPI baskets in EM countries means that their economies are particularly sensitive to food and fuel price shocks.
- ✔ Therefore, high fuel and food prices may affect inflation in EM more than expected.
- ✔ However, thanks to the good weather conditions in the coming months, food prices movement may reverse and food prices may be a source of decrease in inflation.

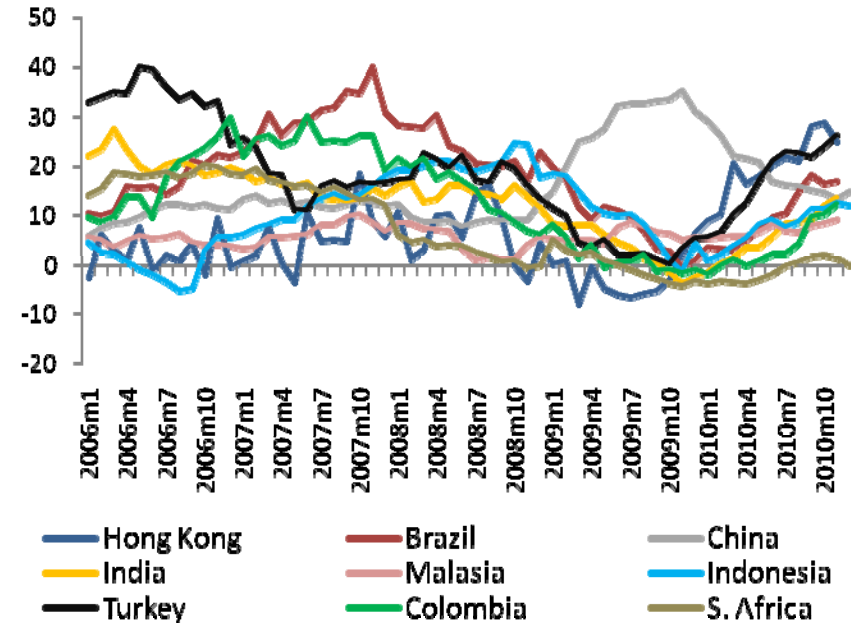
In many EM economies, inflationary pressures are rising due to strong recovery in their domestic demand...

Real Consumption (q-q,%)





Source: IMF

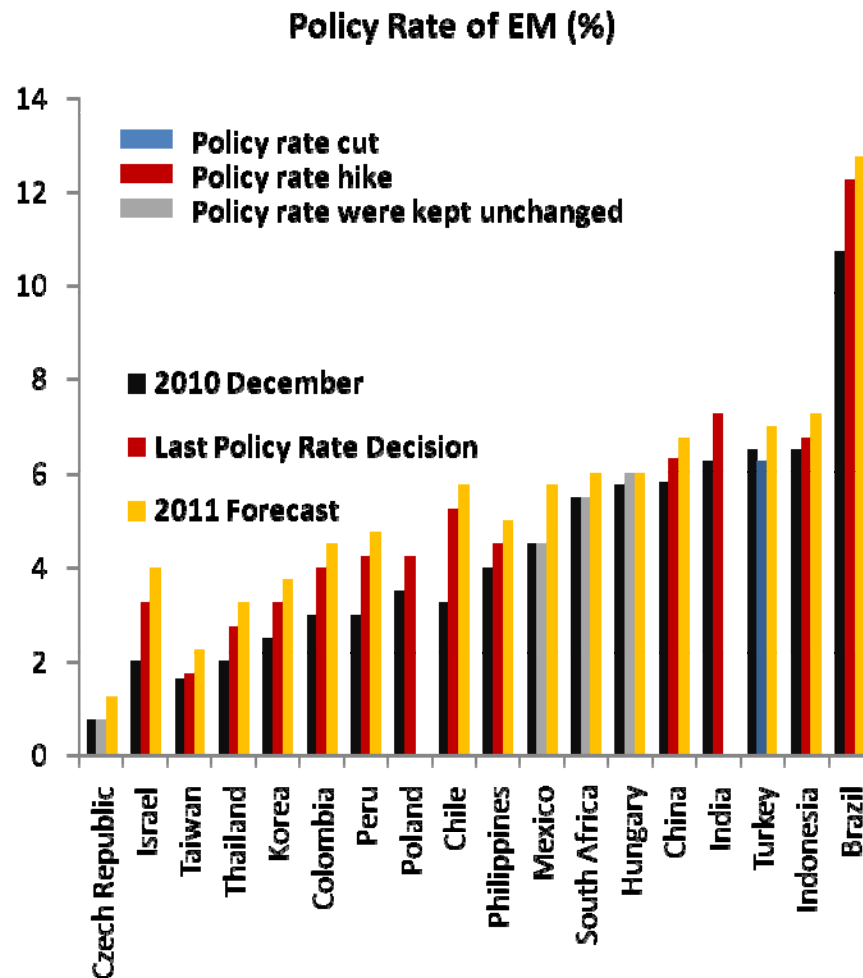
Real Credit Growth (y-y,%)



Source: IMF

-  The recovery in EM economies is stronger than the DM economies. Consumption level in EM economies is higher than DM economies and this triggers the inflationary pressure in these countries.
-  Moreover, private sector credit growth is reaching high levels again in many EM economies. This increase in credit growth points to the strong demand and inflationary pressures are broadening due to this strong recovery in their domestic demand.

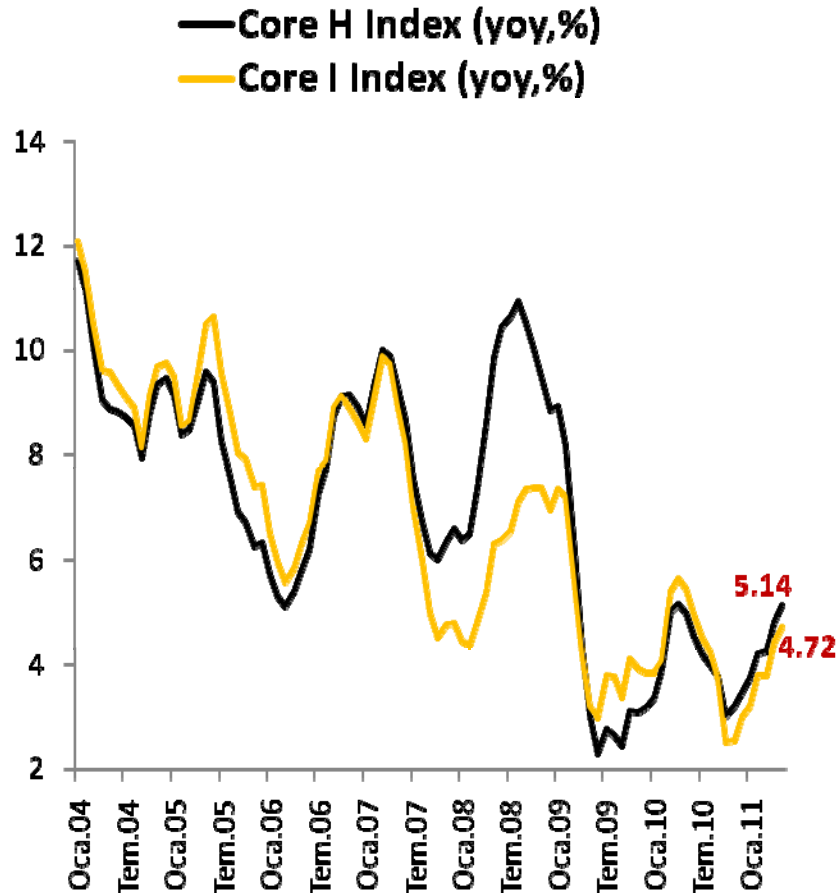
World Bank says EM Economies Must Speed Up Rate Increases...



Source: Bloomberg

- With the increasing inflationary risks, most EM countries have started to hike their policy rate earlier than DM countries. For instance, Chile and Brazil have increased policy rate 200bp and 150bp respectively since the beginning of 2011. Despite these countries, some EM countries like Turkey, Czech Republic kept their policy rate unchanged.
- World Bank determined that Asian and Latin American countries may face with high inflation, however they continue to keep policy rate unchanged and they have to tighten monetary policy more quickly to curb inflation pressures.
- Continuity of increase in commodity prices may force central banks to hike their policy rate. In addition, declaration of OPEC leaving oil production on hold supports the expectation of high commodity prices.
- Therefore, EM countries may increase their policy rate quickly due to the high inflation pressure in the second half of the 2011.

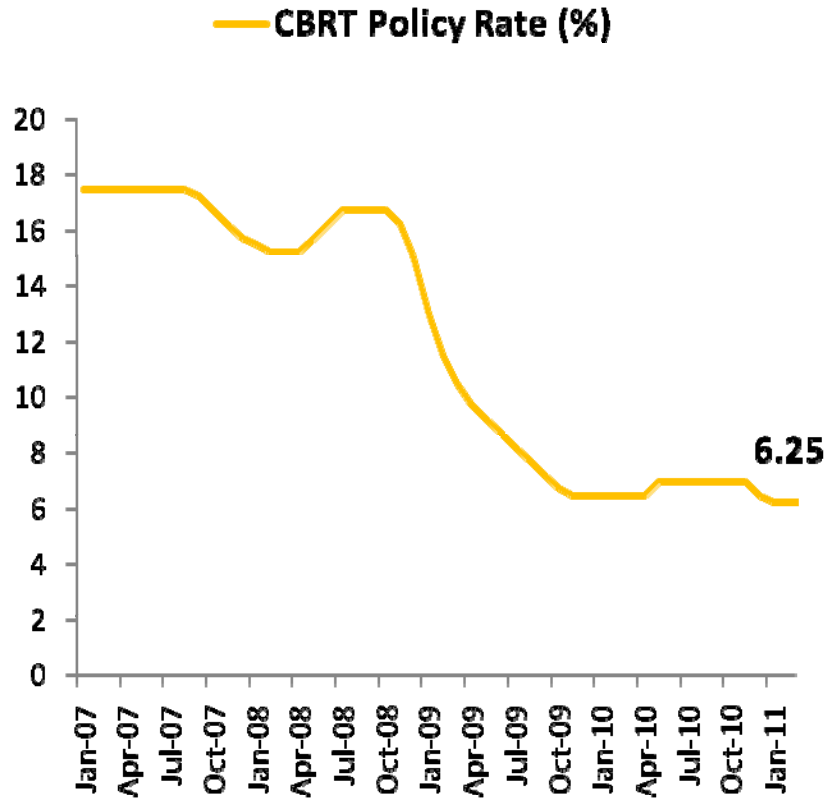
In Turkey, similar to many EM countries, inflation is rising...



Source: Turkstat

- Core CPI (I index) excluding food and energy increased 1.89% mom and 4.72% yoy in May.
- Moreover, headline CPI rose by 2.42% mom in May and the sharp monthly acceleration took annual headline inflation up from 4.3% to 7.2%.
- Thus, it can be said that similar to many EM inflationary pressures are accelerating in Turkey.

We expect that CBRT will increase the policy rate to 7% at the end of 2011...



Source : CBRT

- Although CPI increased sharply in May, the increase in inflation rate may slow down in the forthcoming months with downward correction in commodity prices and more stable USD/TRY rate.
- After the May inflation reading, our year-end inflation forecast is still 7.15%.
- May inflation is likely to make it more difficult for the CBRT to continue its recent monetary policy. Latest inflation releases show that CBRT would start rate hikes in August or September with 25 basis points. With continuing rate hikes we expect that CBRT will increase the policy rate to 7% at the end of 2011...

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