

VAKIFBANK TURKISH ECONOMY WEEKLY

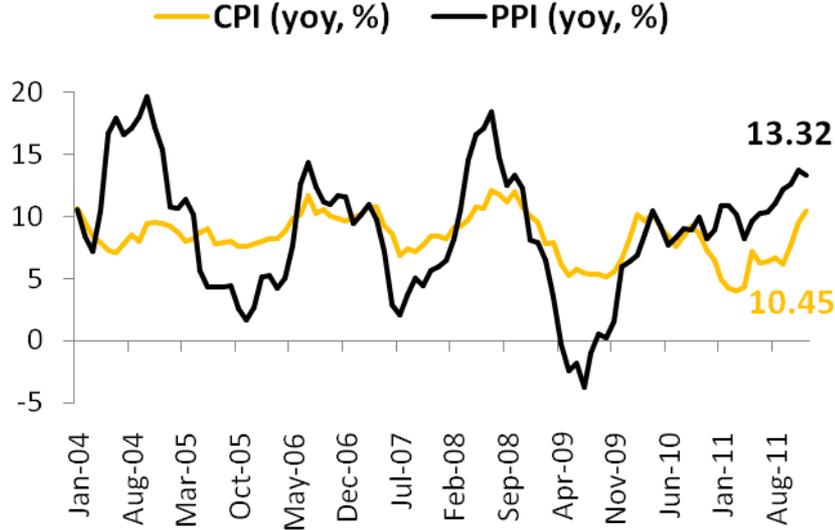
Double Digit Inflation After Twenty Months



T. Vakıflar Bankası T.A.O



In 2011 inflation moved in a wide range...

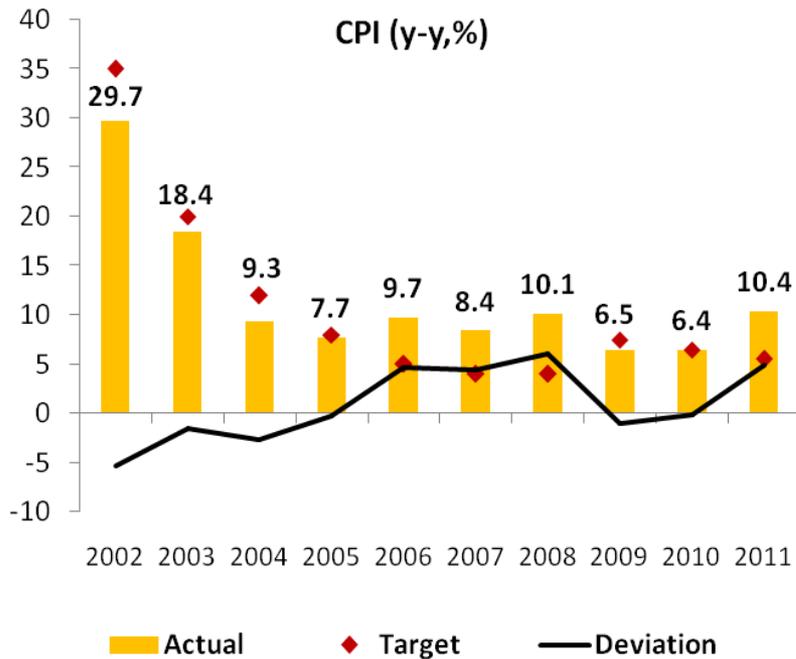


Source: Turkstat

- 📌 CPI rose by 0.58% mom and 10.45% yoy in December 2011.
- 📌 After falling to 3.98% level in Q1 2011, yearly CPI it increased to 10.45% by year end.
- 📌 Thus, in the beginning of 2011 CPI inflation decreased to the lowest level of the last 41 years. And, by the end of 2011 it reached to the highest level since November 2008.

- 📌 Positive base effect from last year has played an important role on the sharp fall of CPI in Q2 2011.
- 📌 With the easing of positive base effect, CPI has been volatile in Q2 2011. Since July 2011 inflationary pressures has increased due to ongoing depreciation of TL.
- 📌 PPI, following an upward trend in 2011 rose by 1% mom and 13.3% yoy in December 2011.
- 📌 Agricultural prices and oil prices were effective on the upward trend of PPI.
- 📌 This upward trend in PPI might have negative repercussions on consumer prices in the coming period.

The year-end figure of 10.45% overshoots CBRT's 2011 inflation target of 5.5%...



Source: CBRT

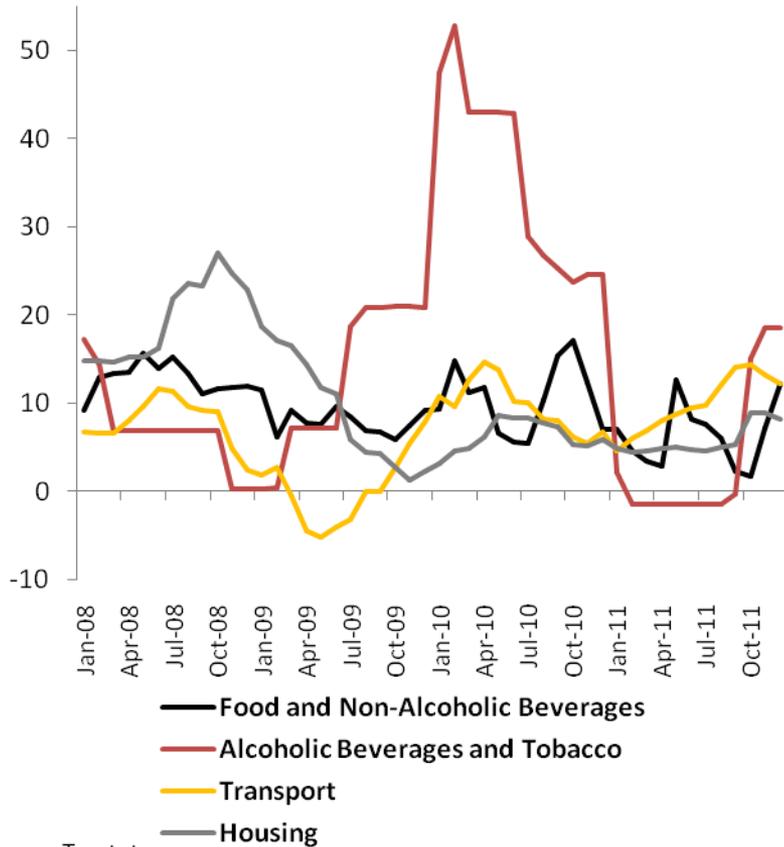
-  Inflationary developments especially in Q4 2011 were the main reason behind the overshooting of the year-end target.
-  Comparison of actual and target inflation rates with previous years provides a better understanding for the inflation dynamics of Turkey.
-  During the implicit inflation targeting period, CBRT had achieved the target for corresponding year. However, during full-fledged inflation targeting period inflation was below target 2 times in 6 years mainly due to the global conditions.
-  Between 2009 and 2010 which are the years that inflation target had been achieved, 2010 has an importance in terms of its dynamics.

 In 2010, Turkish economy grew by 9% indicating very strong growth performance. Despite high inflationary pressures driven by strong domestic demand, achievement of the target indicates that inflation developments were well-managed in 2010.

 Following the achievement of target in 2010, historically low levels of inflation seen in Q1 2011 reduced the need to focus on price stability and CBRT took financial stability to the forefront during this period. However inflation developments has changed especially in H2 of 2011 and change in prices of items beyond the control of CBRT played an essential role in overshooting of the inflation target.

High food prices is the main determinant of inflation...

Inflation Rates (yoy%)

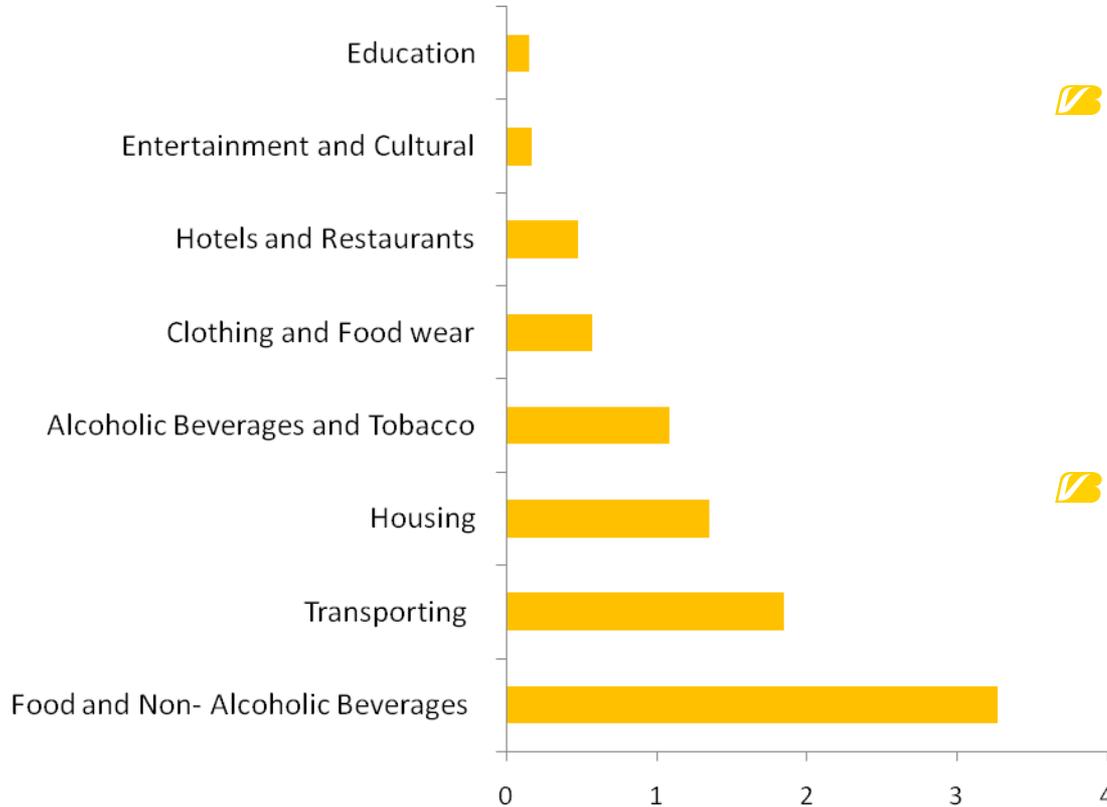


Source: Turstat

- Food inflation which was 17% in October 2010 followed a fluctuating movement during 2011.
- In May, unprocessed food prices increased to the highest level of 2011 because of the bad weather conditions. UN food prices was also high in the same period.
- Food prices decreased to 1.75% in October after May because of the normal weather conditions. But it increased harshly again in Q4 and it contributed inflation rate 3.27 points which was the highest contribution among other expenditure groups.
- Increasing food prices in Q4 2011 showed that the value-added tax reduction on meat prices to prevent the increase in food prices didn't affect the consumer prices.

CBRT has carried out a tightening monetary policy to control inflation estimates...

Contributions of Expenditures to CPI (point)

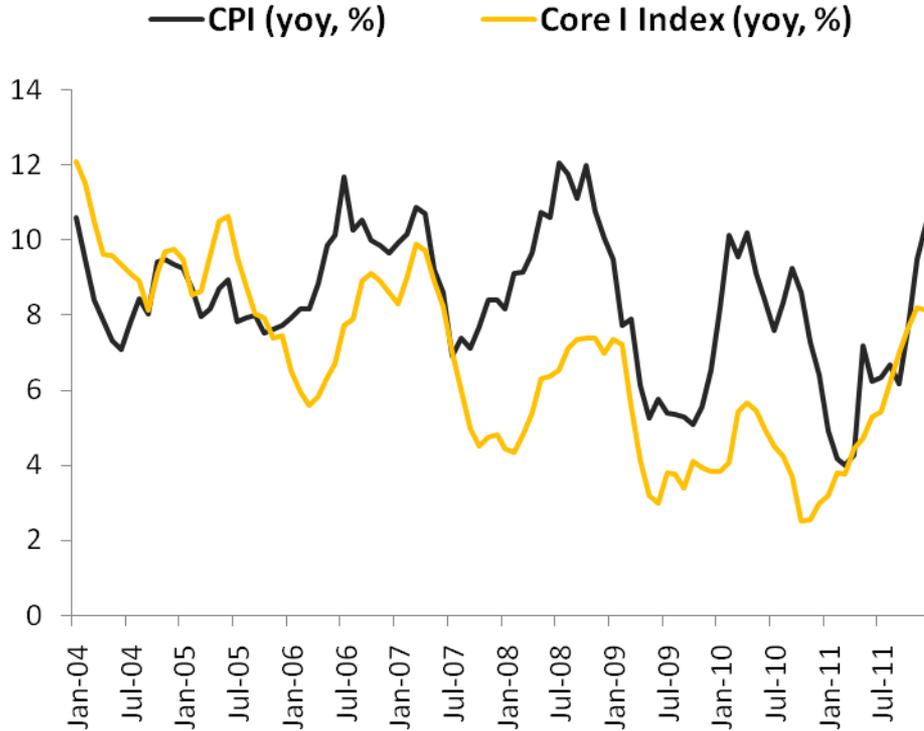


Transportation is another expenditure group which has high contribution to CPI after food prices. Yearly price increases in transportation group reached 14.3% in October 2011 and fell to 12.2% by year-end.

Housing prices, alcoholic beverages and tobacco prices had also high contribution to CPI.

Source: Turstat

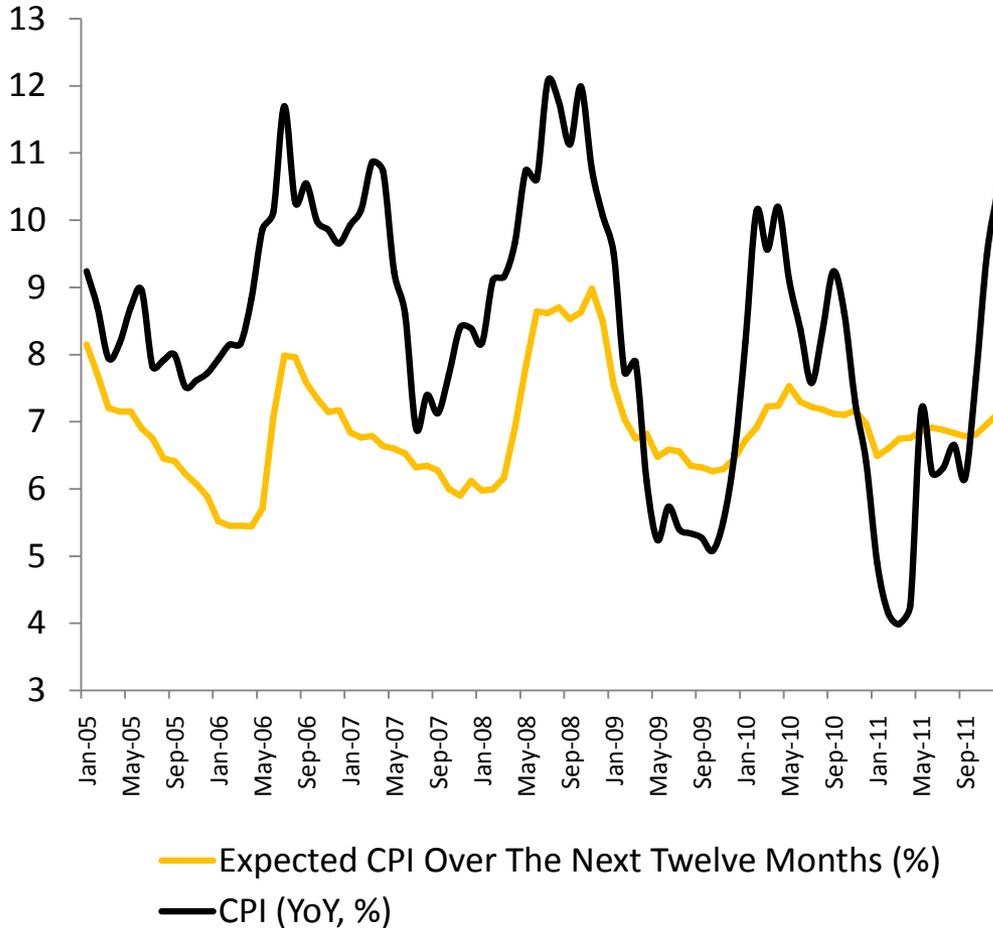
Upward trend of core Inflation paused by the end of 2011...



Source: CBRT

-  I index, which is followed closely by CBRT as the widest core inflation indicator increased 8.12% on a yearly basis in December 2011 after a yearly 8.18% rise in November.
-  This is the first decline in core inflation since November 2010.
-  And, it might be interpreted as an early signal of a probable downfall in headline inflation.

Inflation and Expectations



Source: CBRT

- ▣ CBRT has been carrying out a tightening monetary policy to control inflation estimates. CBRT announced that in the first months of 2012 increasing exchange rate would continue to effect consumer prices but throughout the year it would lose its affect gradually and CPI would converge to the 2012 target of 5%.
- ▣ It is often highlighted by the Central Bank within the framework of inflation targeting that, managing inflation expectations has become more important during the period of rising inflation.
- ▣ The fact that inflation expectations are closely monitored by Central Bank in the scope of inflation targeting objective, supports the current tightening monetary policy stance.
- ▣ Downward trend in inflation which might start in the first or second quarter of 2012, would provide a more comfortable environment in terms of monetary policy.

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