

# VAKIFBANK TURKISH ECONOMY WEEKLY

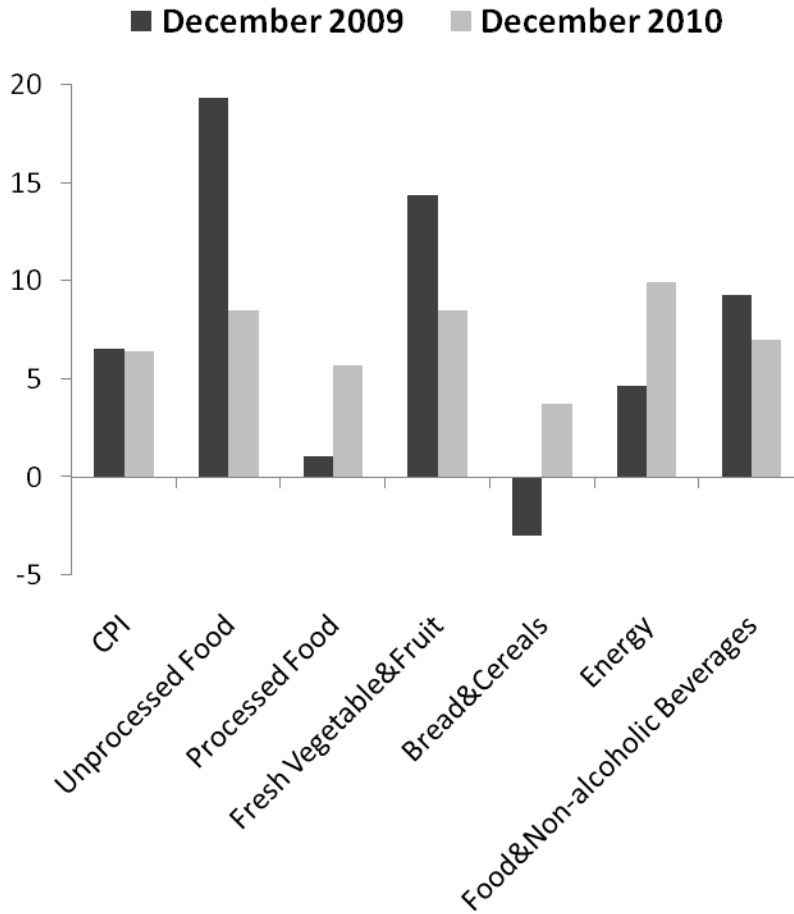
**Ease off in Inflation supports  
monetary policy**



**T. Vakıflar Bankası T.A.O**



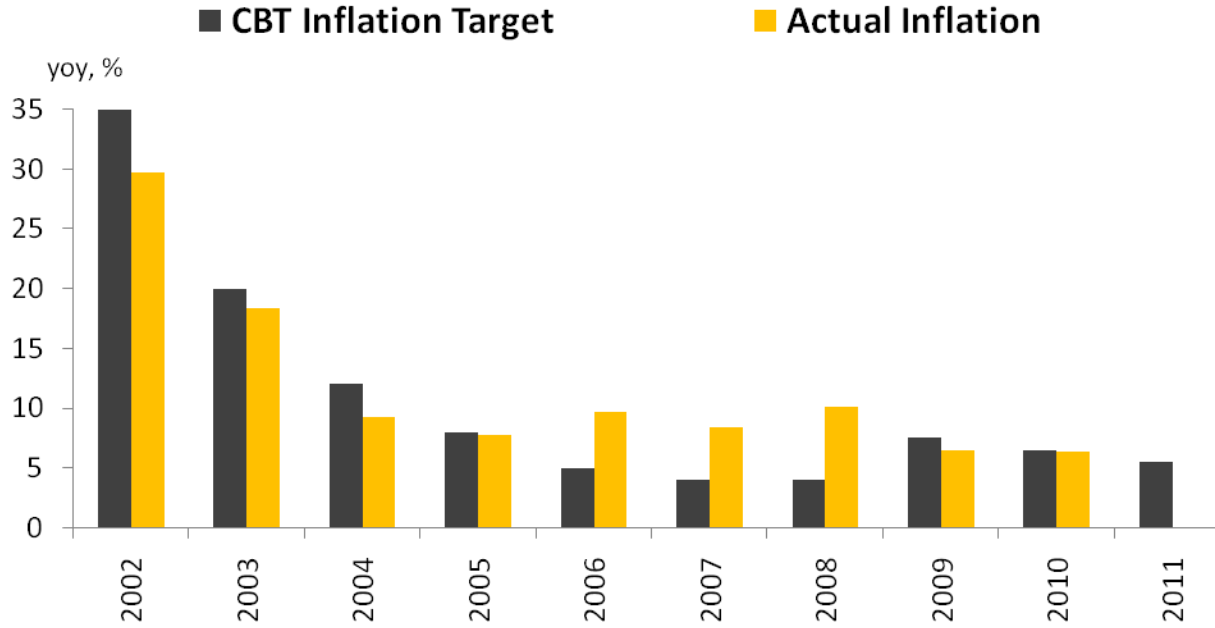
# CPI have seen its lowest level with 6.4% since 1968...



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

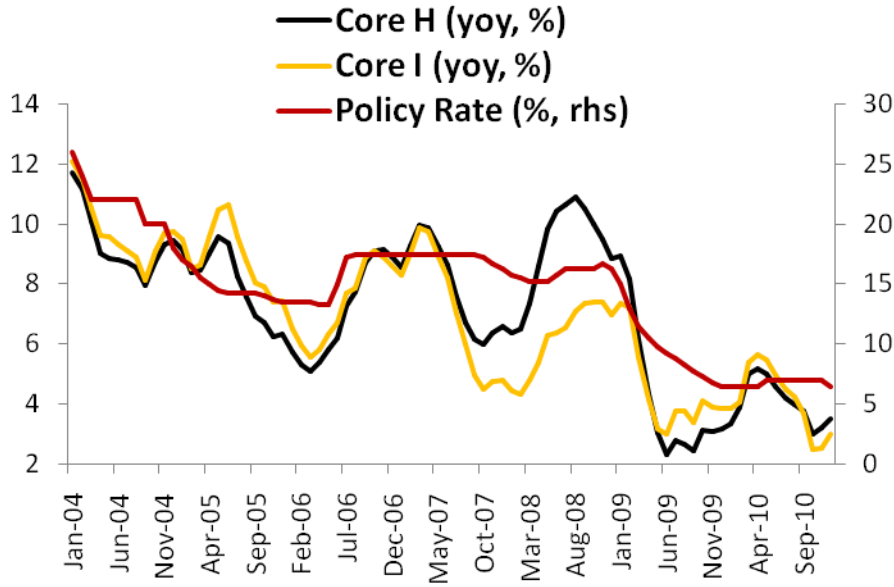
# CBT reached its 2010 year-end inflation target...



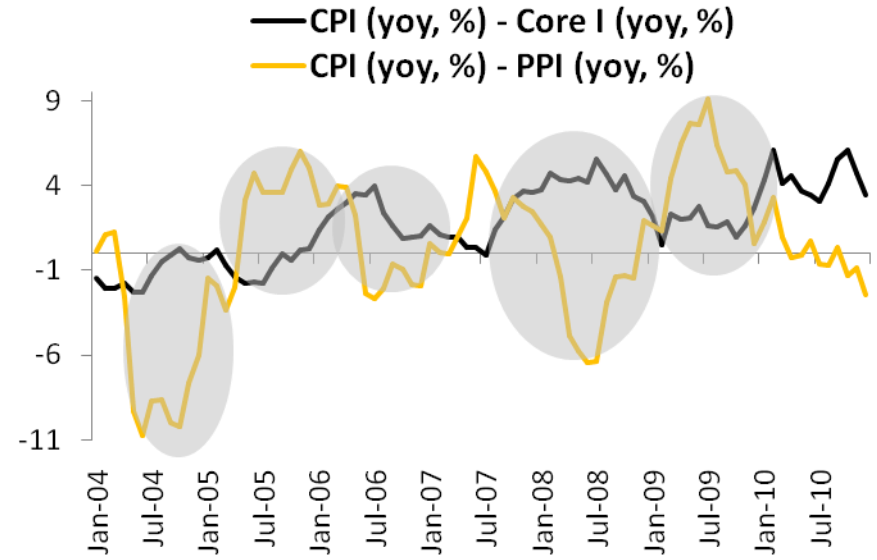
Source: CBT

- 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...



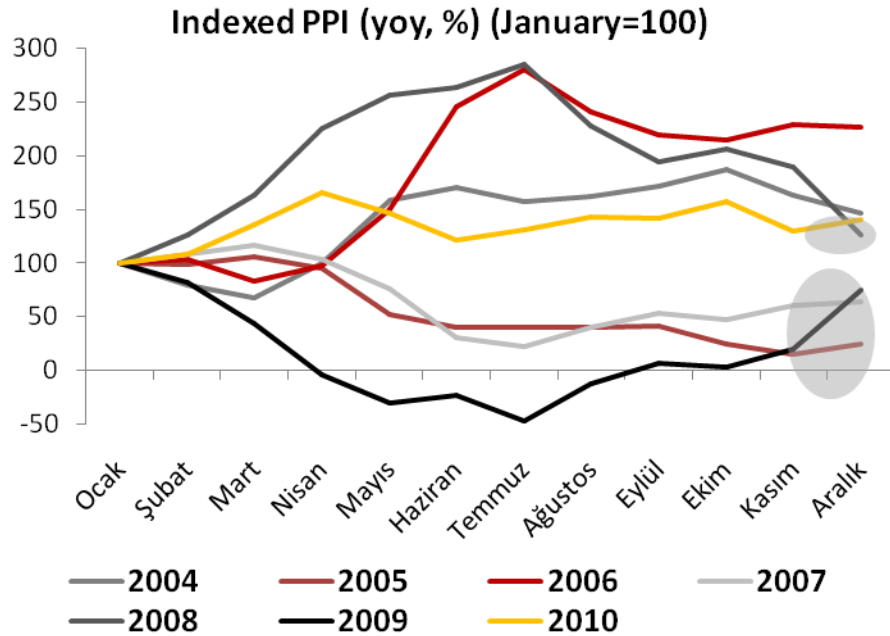
Source: Turkstat



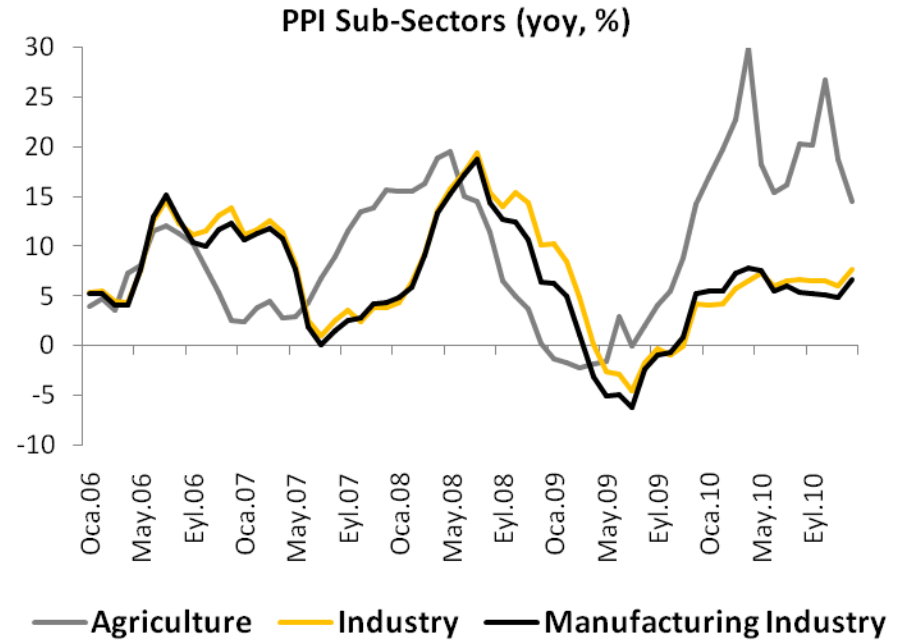
Source: Turkstat, Vakifbank

- 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



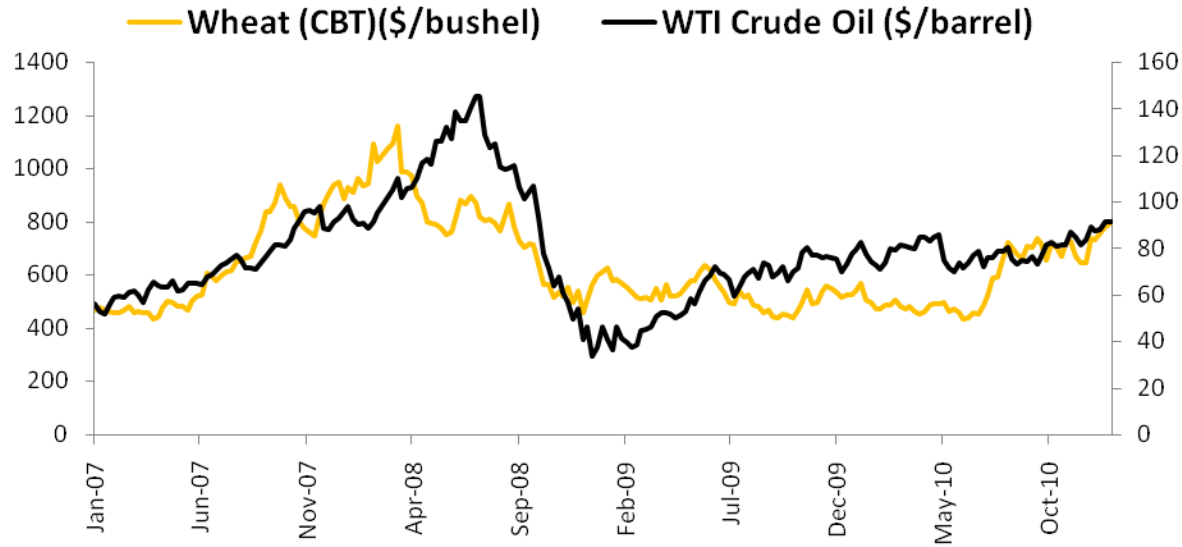
Source: Turkstat

- 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 Erođlu

Senior Economist

+ 90 312 455 8480

Cem.eroglu@vakifbank.com.tr

Nazan Kılıç

Economist

+ 90 312 455 8489

Nazan.kilic@vakifbank.com.tr

Naime Dođan

Researcher

+ 90 312 455 8486

Naime.dogan@vakifbank.com.tr

Senem Güder

Researcher

+ 90 312 455 8476

Senem.guder@vakifbank.com.tr

T. Vakıflar Bankası T.A.O

Ataturk Bulvari No: 207

Kavaklıdere 06683 Ankara, Turkey

[www.vakifbank.com.tr](http://www.vakifbank.com.tr)

Vakıfbank Economic Research

ekonomik.arastirmalar@vakifbank.com.tr

---

The information in this report has been obtained by Türkiye Vakıflar Bankası T.A.O. from sources believed to be reliable. However, Türkiye Vakıflar Bankası T.A.O. cannot guarantee the accuracy, adequacy, or completeness of such information, and cannot be responsible for the results of investment decisions made on account of this report. This document is not a solicitation to buy or sell any of the securities mentioned. All opinions and estimates included in this report constitute our judgment as of this date and are subject to change without notice. This report is to be distributed to professional emerging markets investors only.

---