

VAKIFBANK TURKISH ECONOMY WEEKLY

**Headline CPI rose by 2.42% mom
in May...**



T. Vakıflar Bankası T.A.O



Headline CPI rose by 2.42% mom in May higher than market consensus (1.02%) and our forecast (1.0%)...

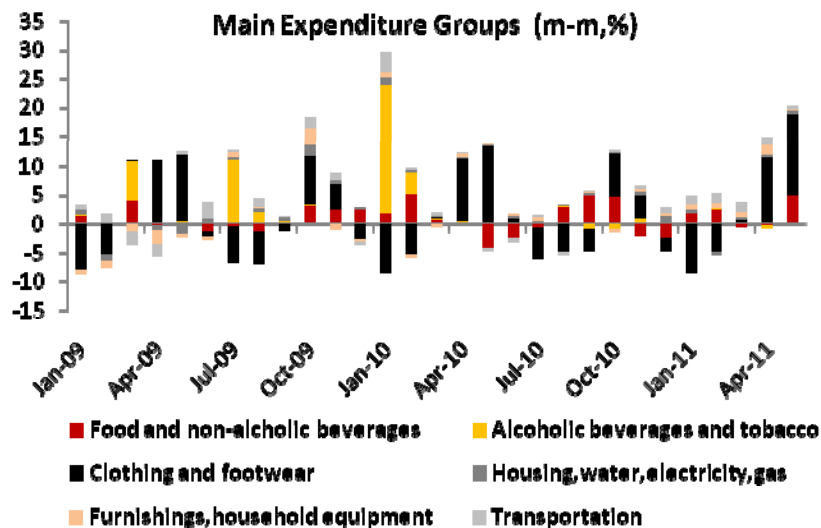
- ✔ The sharp monthly acceleration took annual headline inflation up from 4.3% to 7.2%.
- ✔ The unexpected increase in food prices (4.71% mom), was the main driver of the unexpected rise in inflation.
- ✔ Sharp rise in fresh fruit prices driven by seasonal variations was the main reason behind the huge inflation in food prices.
- ✔ On the other hand, the downward correction in fruit prices in June may lead to see a decline in inflation in June.

	CPI	PPI
(2003=100)	May.11	May.11
Compared to the previous month	2.42	0.15
Compared to December of the previous year	4.93	6.20
Compared to the same month of the previous year	7.17	9.63
Compared to the twelve months moving averages basis	6.64	9.21

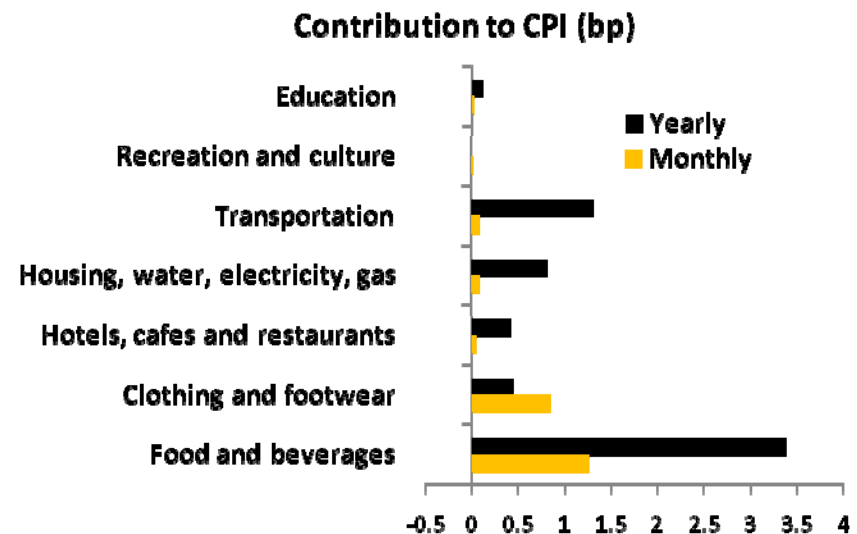
Source: TurkStat

Food inflation increased to 12.6% yoy in May from 2.8% yoy in April...

- ✔ CPI has been unexpectedly high in May because of the strict increase in food prices. This is also the proof of the strong contribution of food prices on CPI.
- ✔ Food prices increased by 4.71% on a monthly basis and it contributed to monthly CPI by 1.26bps which increased by 2.42% on a monthly basis. Thus, food prices increased by 12.61% on a yearly basis.
- ✔ Due to seasonality, clothing and footwear which is among the major expenditure groups experienced the most severe increase with 11.68% in May. Contribution of this group to CPI was 0.84 bps.
- ✔ Besides the increase in food prices and clothing and foot wear, other subgroups of CPI was positive in May. For instance, the increase in transportation (0.63 mom) was exhibited a parallel view according to our expectations.

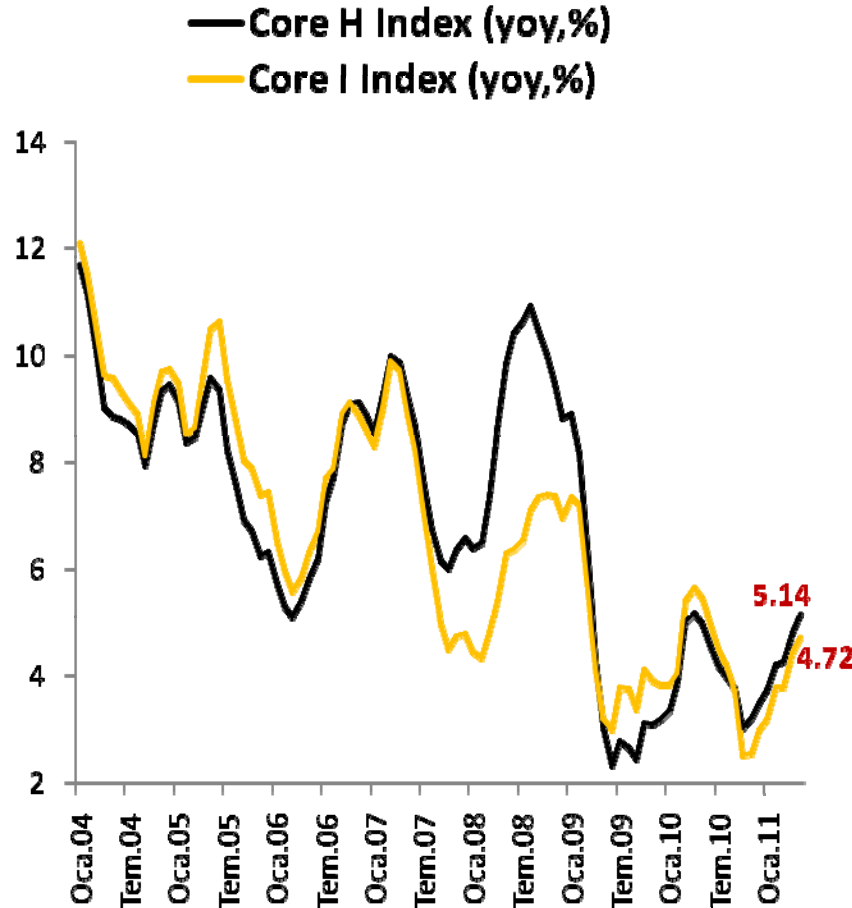


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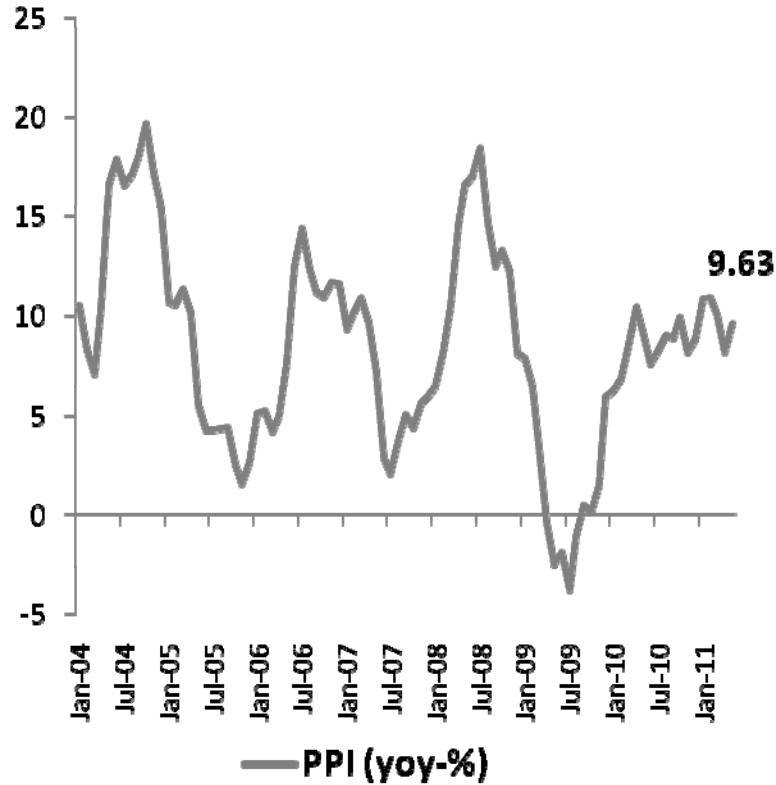
Core CPI was under headline CPI in May...



Source: Turkstat

- Core CPI (I index) excluding food and energy increased 1.89% mom and 4.72% yoy in May. The other core CPI (I Index) excluding unprocessed food products, energy, alcoholic beverages, tobacco products and gold increased by 1.55% mom and 4.77%yoy in May.
- Core CPI monthly increase had been 1.77% in April. On the other hand, H index increased the highest level in its' history with 5.14% after 4.81% in April.
- Thus, core CPI declined under headline CPI in May. Moreover, the spread between them widened again.
- Increase in core CPI was caused by seasonal rise in cloth prices.
- Moreover, movements in core CPI which was in the increasing trend since October 2010 will be important in the coming period.

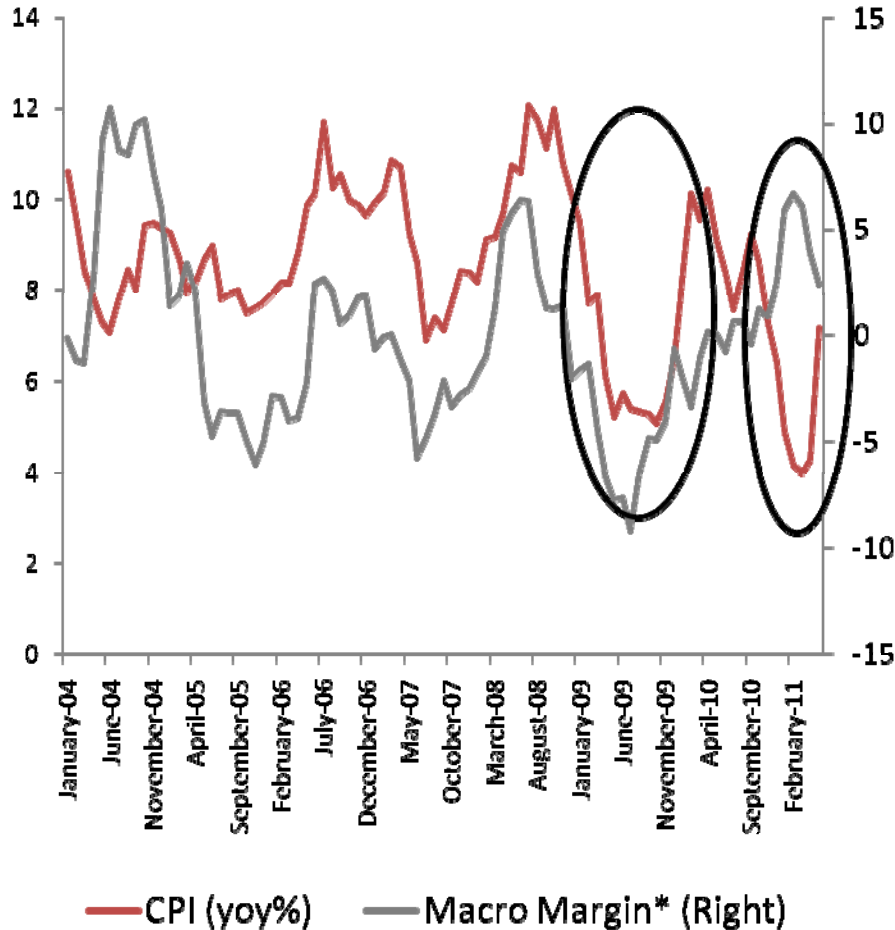
On a monthly basis, PPI increased by 0.15% in May...



Sources: CBRT

- ✓ Monthly PPI increase fell to 0.15% in May due to the decrease in agriculture sector prices.
- ✓ Agriculture sector prices decrease by 1.93% on monthly basis, but the industry sector prices increased by 0.63% due to rising commodity prices and exchange rate movements.
- ✓ Moreover, the annual PPI inflation increase to 9.63% in May. With this increase, the gap between CPI and PPI become narrower in May.

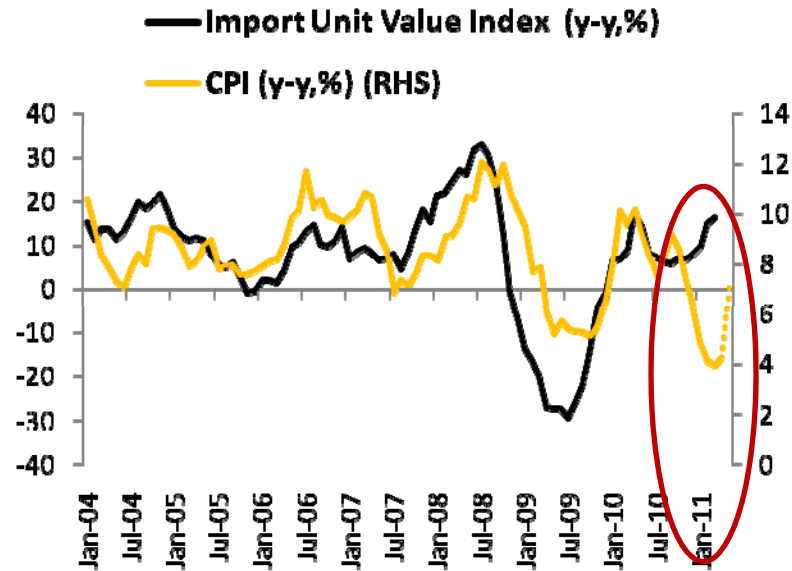
The gap between macro margin and CPI is closed in May...



*Macro Margin: spread between CPI-PPI

- ✓ When we consider the previous movements of macro margin, it draws attention that the upward movements of macro margin leads a lagged upward movement on CPI.
- ✓ We can see in the graph that the increase in macro margin has recently affected the movements of CPI. Thus, the last downward movement in macro margin results in this rise in CPI.
- ✓ According to previous movements in macro margin, it draws attention that the spread between CPI and macro margin was closed now as we expect.

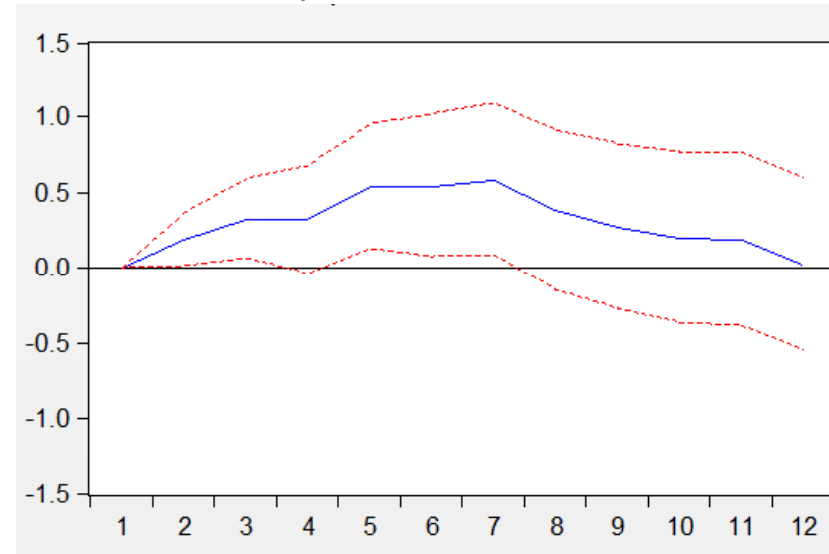
There is strong correlation between import unit value index and CPI ...



Source: CBRT

When the relationship between annual rate of import unit value index and the annual rate of CPI is analyzed, it is generally observed that the changes in import unit value index have reflected on CPI after 3-4 months. The reflection of these increases in import unit value index to CPI have held over in the 1st quarter of 2011 mainly due to positive base effect. Although the difference between import unit value index and CPI have widened till May, the difference has begun to diminish after May CPI .

CPI Impulse Response Function to the Shock in Import Unit Value Index



CPI's impulse response towards the shocks in import unit value index is analyzed above. It is observed that, CPI has given 0.5 response to 1 standard deviation shock seen in import unit value index and CPI responses this shock after 1 month. The correlation between these two variables is strong with 70 per cent.

To sum up...

- ✔ Despite unexpected increase in May CPI, the rate of increase in CPI 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%.
- ✔ The unexpected increase in food prices was the main driver of the unexpected rise in May inflation. However, the rise in food prices may slow down in the forthcoming months.
- ✔ 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 October with 25 basis points rate hike. With continuing rate hikes the policy rate is expected to reach 7% at the end of 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

Seda Meyveci

Economist

+ 90 312 455 8485

seda.meyveci@vakifbank.com.tr

Halide Pelin Kaptan

Researcher

+ 90 312 455 8483

halidepelin.kaptan@vakifbank.com.tr

Naime Dođan

Researcher

+ 90 312 455 8486

naime.dogan@vakifbank.com.tr

T. Vakıflar Bankası T.A.O

Ataturk Bulvari No: 207

Kavaklıdere 06683 Ankara, Turkey

www.vakifbank.com.tr

Vakıfbank Economic Research

ekonomik.arastirmalar@vakifbank.com.tr

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