



Macro Scope

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Weekly Economic and Strategic Review

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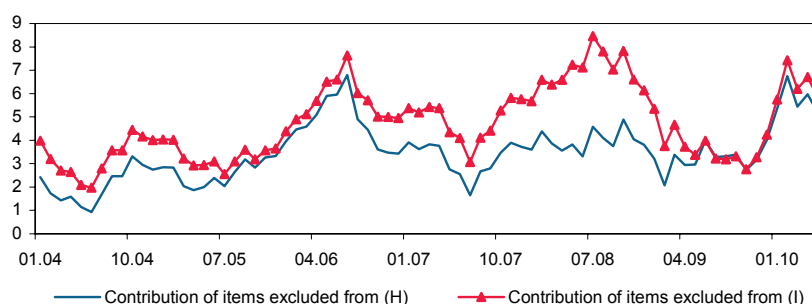
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Easy Come Easy Go...

A memo released following the June meeting of the Central Bank's Monetary Policy Committee (MPC) highlighted that falling non-processed food prices and slackening commodity prices brought a more positive outlook for inflation than that anticipated in the April inflation report, which in turn had a positive impact on inflation expectations. This came as little surprise, however, given that it had been argued in the previously released summary of the MPC's May meeting that the actual inflation rate would be closer to the 6.5 percent target than the year-end estimate of 8.4 percent for 2010. As a matter of fact, with the contraction of annual CPI to 9.1 percent at the end of May, the year-end expectation for annual CPI dropped back to 8 percent from 8.6 percent but the 12 and 24-month inflation expectations remain above the path in line with the inflation rate targets for 2011 and 2012, at 7.35 and 6.86 percent, respectively. As is known, the rise in headline inflation seen in the previous months stemmed from external factors (tax hike, higher food and energy prices) and the increase in the core inflation rate was limited. In our MacroScope of April 5, 2010 we analyzed the effects of sub-items such as food, energy, gold, and tobacco on the annual inflation rate. The average annual contributions from 2004 through 2009 stood at 3.3 and 4.6 percentage points, respectively, for the above-mentioned items excluded from the H and I indexes. At the end of February, the annual contributions were near historic highs at 6.7 and 7.4 percentage points, respectively. But if the external factors swing the other way like CBT said, it might be assumed that the contributions of items excluded from core inflation to the annual CPI will over time converge toward the worst average, or at best return to their historical lows of 1 and 2 percentage points, respectively. If the contribution to the annual CPI of items excluded from the core inflation is likely to converge toward the average over time, annual growth in the H and I indexes is estimated to be 3.2 and 1.9 percentage points, respectively, consistent with this year's 6.5 percent CPI target. If the contribution converges towards the lowest end, it will

The Contribution of the Items excluded from H and I to Annual CPI



Items excluded from H Index: Energy, Unprocessed Food, Alcoholic Beverages and Tobacco and Gold.
Items excluded from I Index: Energy, Food, Alcoholic Beverages and Tobacco and Gold

stand at 5.5 and 4.5 percentage points, respectively. **Annual increase for H and I core price indicators at the end of May – 5 and 5.5 percent respectively – makes it clear that CPI will only approach this year's target if the most optimistic scenario for external factors come to pass.** Obviously, reaching the 5.5 percent inflation rate target for 2011 and a 5 percent medium-term inflation rate target would require a lower core inflation rate. The low seasonally adjusted monthly increases of the last two months, which are an indicator for the core inflation trend, as well as the contraction in annualized increases back to around 2 percent are encouraging. **That being said, the historical course of the core inflation trend leads us to believe that it would not be easy to remain below 4 percent permanently.**

Keeping these basic findings in mind, we used the data on Turkey from the **Harmonized Index of Consumer Prices (HICP) released by Eurostat** to analyze the effects of external factors more thoroughly since the Turkstat does not publish detailed data on the weights of the items and groups that go into the inflation basket. It will be recalled that the Turkstat created a new CPI index in 2005 based on consumption patterns and weights obtained from the Household Budget Survey conducted in 2003, and adopted a system whereby it would update the weights of items in line with the results of annual surveys – similarly to the HICP methodology used by Eurostat. The latter's website can be used to monitor data on the weights and price changes of many items and main groups such as goods and services that are not published by TSI. **This key information helps us better distinguish between temporary and permanent price increases.** Let's give an example. Eurostat data shows that the weight of meat prices in the CPI is 4.9 percent, and that the annual price increase for meat reached 40.6 percent at the end of April – thus contributing 2 percentage points to the rise in the annual CPI. But when meat price increases converge over time towards the average of previous years (the average for the 2005 to 2009 period is 9 percent), 1.6 percentage points of this contribution effectively disappears. Likewise, the annual rise in prices of non-processed food items jumped up to 30 percent at the end of February but dropped back to 12.4 percent at the end of May. Here too the influence of meat prices is dominant – as evidenced by the low annual price increases in the fruit and vegetable groups. **The best assumption the CBRT can make for the hard-to-predict and volatile food prices is that in the short term these prices may hit extremes at both ends, but will eventually converge towards the average increase in general price levels.**

Highest Contribution to CPI				Food Prices (% annual change)				
	Weight	05.2005		Weights	2008	2009	05.2010	
CPI	100.0	9.1%		Food and non-alcoholic beverages	27.6	11.9%	9.3%	6.7%
Meat	4.9	33.4%	1.6	Food	25.8	12.1%	9.5%	6.8%
Fuels and lubricants for transport equipment	3.8	22.5%	0.9	Bread and cereals	5.9	23.7%	-1.9%	-1.6%
Motor cars	5.3	15.5%	0.8	Meat	4.9	14.7%	34.5%	33.4%
Restaurants, cafés and the like	5.1	10.7%	0.5	Fish and seafood	0.4	7.3%	16.3%	0.1%
Gas	2.9	15.7%	0.5	Milk, cheese and eggs	3.4	7.0%	6.2%	10.3%
Milk, cheese and eggs	3.4	10.3%	0.4	Oils and fats	1.5	19.9%	-8.6%	-4.7%
Electricity	3.2	11.0%	0.4	Fruit	2.5	-5.0%	11.4%	1.0%
Water supply	2.5	12.7%	0.3	Vegetables	4.6	6.0%	12.8%	-0.6%
Furniture and furnishings	1.7	15.5%	0.3	Sugar, jam, honey, chocolate and confectionery	2.1	14.1%	4.1%	4.2%
Passenger transport by road	3.4	7.5%	0.3	Food products n.e.c.	0.4	11.8%	5.1%	2.6%
Garments	5.2	4.9%	0.3	Non-alcoholic beverages	1.8	9.3%	5.6%	3.9%
Jewellery, clocks and watches (mainly gold)	0.8	29.0%	0.2	Coffee, tea and cocoa	0.8	13.3%	5.9%	5.7%
				Mineral waters, soft drinks, fruit and vegetable juices	1.1	5.9%	5.2%	2.5%

Source: EUROSTAT

Source: EUROSTAT

Eurostat data also enables monitoring the finer details of the goods and services group. The Turkstat does not release such data differentiations and the CBRT mentions these differentiations only as levels in memos it publishes after inflation data. The shares of the goods and services groups in the CPI are 73 percent and 27 percent, respectively. As would be expected, the 10.2 percent price increase in the goods group, which includes all external factors, is above

that of the services group. As for price increases in the services group, which are key components of core inflation, with the exception of transportation and food services these increases are benign. **Given that these categories will also be affected – with some time lag – by food and fuel prices which have embarked on a downward path, it seems normal that the CBRT is in a hopeful, expectant mood concerning developments in the core inflation rate.** The Central Bank suggests that core inflation will remain below the year-end target and in line with medium-term targets. But apart from the CPI target of 6.5 percent that the Bank has shared with the public, no other target for core inflation is known to have been set. **Our inference from these analyses is that what is meant is not the level at which core inflation stands currently but the level indicated by its trend.**

To sum up, the inflation outlook recovered slightly following the opposite movement observed in factors beyond the control of monetary policy after the rise in the inflation that was caused by these same factors. The possible scenario of a major deviation from the CBRT's year-end target is off the agenda for now. But even the most optimistic scenario for external factors does not foresee easily reaching the targets set for this year and beyond without any downward ruptures in the basic inflation trend. For this reason, sticky inflation expectations can be considered a safety margin against uncertainties and fluctuations of external factors.

Goods and Service Prices (% annual change)

	Weights	2008	2009	05.2010
Goods (overall index excluding services)	73.1	10.0%	7.0%	10.2%
Non-energy industrial goods	28.7	4.6%	4.5%	6.3%
<i>Non-energy industrial goods, durables only</i>	10.8	6.2%	3.5%	12.1%
<i>Non-energy industrial goods, non-durables only</i>	8.2	7.4%	5.7%	2.0%
<i>Non-energy industrial goods, semi-durables only</i>	9.7	0.7%	4.4%	4.4%
Energy	11.5	23.5%	2.8%	14.6%
Food and non-alcoholic beverages	27.6	11.9%	9.3%	6.7%
<i>Seasonal food</i>	7.5	2.1%	12.5%	0.1%
Alcoholic beverages, tobacco and narcotics	5.3	0.3%	20.9%	43.0%
Services (overall index excluding goods)	26.9	10.2%	5.2%	6.1%
Services related to communication	4.9	5.7%	3.3%	0.5%
Services related to housing	5.7	12.0%	5.4%	4.7%
Services - miscellaneous	4.6	4.9%	6.0%	6.3%
Services related to recreation, including repairs and personal care	7.1	12.2%	7.3%	10.2%
<i>Services related to rec. and pers. care, excl. package holidays</i>	6.4	12.2%	7.3%	10.5%
<i>Services related to package holidays and accomodation</i>	0.7	12.1%	6.4%	7.1%
Services related to transport	4.5	14.4%	2.9%	7.2%

Source: EUROSTAT

Economic and Political Agenda

▪ This week at home, foreign trade and first quarter GDP figures will be critical. On Thursday CNBC-e consumer confidence index, TEA's preliminary exports and ICC price data are going to be eyed carefully. At abroad, in the US core PCE, manufacturing ISM, non-farm payrolls and in Euro zone manufacturing PMI will be the most important data for the investors. Besides, US Case Shiller index, consumer confidence index, ADP employment report and pending home sales will be closely watched.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Imports & Exports, May	US\$ mn	June 30 th , 7:00 GMT	14.5 & 9.1
High	GDP, Q1	% q/q	June 30 th , 7:00 GMT	11.0 (11.5)
Medium	CBNC-e Cons. Confi. Index, June	-	July 1 st , 5:00 GMT	-
Medium	TEA's Preliminary Exports, June	US\$ mn	July 1 st , 7:00 GMT	9.0
High	ICC Price Index, June	% m/m	July 1 st , 9:00 GMT	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	U.S.	Core PCE May	% m/m	June 28 th , 12:30 GMT	0.1
Medium	U.S.	C. Shiller Hous. Price Ind., Apr.	% m/m	June 29 th , 13:00 GMT	0.0
Medium	U.S.	Cons. Conf. Index, June	-	June 29 th , 14:00 GMT	62.9
Medium	U.S.	ADP Employment, June	K	June 30 th , 12:15 GMT	59.0
Medium	U.S.	Chicago PMI, June	-	June 30 th , 13:45 GMT	59.5
High	Eurozone	Manufacturing PMI, June	-	July 1 st , 7:58 GMT	55.6
High	U.S.	Manufacturing ISM, June	-	July 1 st , 14:00 GMT	59.0
Medium	U.S.	Pending Home Sales, May	% m/m	July 1 st , 14:00 GMT	-10.0
Medium	U.S.	Non-farm payrolls, June	K	July 2 nd , 12:30 GMT	-70.0
Medium	U.S.	Factory Orders, May	% m/m	July 2 nd , 14:00 GMT	-0.1

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	954.0	1,087.6	1,196.9	1,310.1
GDP (US\$ - bn) (*)	616.6	710.9	776.0	834.6
GDP Growth (y/y % chg) (*)	-4.7	6.0	4.0	4.0
PPI (y/y % chg)	5.9	5.0	5.0	5.0
CPI (y/y % chg)	6.5	8.0	6.0	5.5
Trade Balance (US\$ - bn)	-38.6	-61.0	-69.8	-70.4
Exports (FOB, excl. luggage trade)	102.2	103.8	122.9	142.7
Imports (CIF, incl. gold)	140.8	164.9	192.7	213.0
Current Account Balance (US\$ - bn)	-13.8	-34.1	-39.4	-36.9
Current Account Balance / GDP (%)	-2.2	-4.8	-5.1	-4.4

(*) 2010 values are our forecasts

Financial Indicators Forecasts

	June 25 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5708	1.5800	1.5500	1.5500	1.5500	1.5500	1.5600
EUR/TRY	1.9307	1.9300	1.9400	1.9700	2.0000	1.9700	2.1100
FX Basket	3.5015	3.5100	3.4900	3.5200	3.5300	3.5200	3.6700
EUR/US\$	1.2291	1.2200	1.2500	1.2700	1.3100	1.2700	1.3500
Policy Rate	7.00%	7.00%	7.00%	8.00%	9.50%	8.00%	9.50%
Benchmark Bond	8.70%	8.80%	9.30%	10.00%	11.00%	10.00%	11.00%

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